DenizBank Economic Update

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DenizBank Economic Update

**Economy (I)**

**Inflation**

Inflation is expected to fall sharply in the first half of 2015...

- Inflation came above consensus expectations at 1.1% in January due to the higher than expected food inflation. On the other hand, annual inflation declined from 8.2% to 7.2% with the support of high base.

- Annual core inflation, an important indicator of inflationary pressures showed modest improvement and annual core I indicator went down to 8.6% from 8.7%.

- Increase in food prices due to the harsh weather conditions and energy prices is likely to push up annual inflation temporarily in February. However, we expect headline inflation to continue to fall down in the first half of 2015 with favorable base effects and normalization in food prices. Our year-end inflation forecast for 2015 stays at 6.1%.

**Policy Rates**

Central Bank (CB) cut policy rate by 25 bps and narrows the corridor...

- The CB cut one-week repo rate (policy rate) by 25bps to 7.50% and decreased lower bound (O/N borrowing rate) of the corridor by the same amount to 7.25% in line with expectations. On the other hand, CB surprisingly cut the upper bound (O/N lending rate) of the corridor by 50 bps to 10.75%.

- Despite the rate cut decision, the CB continued to highlight that the monetary policy should remain tight until the inflation outlook improves significantly and yield curve will be kept flat.

- In the statement, CB sounded more cautious about the inflation due to the recent increase in oil prices and CB omitted the statement that the inflation will decline to target (5.0%) by mid-2015.

- Depending on the global market conditions, we think that the CB could cut the rates at a cautious steps as the benign inflation outlook in 1H15 supports further easing. However, taking into account the recent volatility in exchange rates and anticipated temporary increase in annual inflation in February, the CB would choose to remain on halt this month.
Current account deficit continued narrowing down...

- Current account deficit came at $6.8 bn in November, in line with the consensus expectation. 12 month cumulative current account deficit narrowed down from $65 bn (7.9% of GDP) in 2013 to $45.8 bn (5.8% of GDP).

- On the financing side, inflows into the bond and equity markets in 2014 was limited at US$2.6 bn and US$0.4 bn, respectively. FDI inflows was also weak at $5.5 bn. On the other hand, banks and corporates borrowed $13.5 bn from international markets. The long-term debt rollover ratios (12M trailing) for corporates was stable at 125% while rollover ratios stayed high at 191% for banks.

- Despite the risks in export markets on the back of geopolitical developments, and on the back of lower energy prices we expect current account deficit to GDP ratio to ease further to 4.7% in 2015.

Manufacturing activity remains subdued...

- The calendar adjusted industrial production index (IP) increased YoY by 2.6% in December above the market consensus of 1.9%. Seasonally adjusted IP index posted strong 1.2% MoM increase. Annualized increase in manufacturing activity declined to 3.6%.

- Leading indicators point to a slow-down in the growth rate of economic activity. Capacity utilization continued to ease to 74.1% in January. Moreover, PMI manufacturing index declined to 49.8 indicating contraction in manufacturing activity.

- We expect Turkish economy to grow by 2.8% and 3.0% in 2014 and 2015, respectively. Although being below long term average GDP growth of c. 5%, this performance may be deemed given the across the board slowdown in economic activity in many emerging countries.
Contrary to CBRT’s rate cut both on weekly repo rate and interest rate corridor, benchmark bond yield remained under pressure due to the geopolitical risks.

TRY underperformed its peers due to political risks.

As a high beta market Borsa Istanbul declined more than its peers.
Despite gloomy start to the year, banks were able to keep their CAR ratio at 16%...

Share of deposits in funding has decreased slightly to 60% in 2014.

Annualized loan growth is in line with Central Bank’s long term target of 15% in February.
Loan to deposit ratio has increased to 117% in January from 108% at the end of 2013.

Headline NPL ratio for the sector slightly came down to 2.9%. Protested bills and unpaid cheques don’t signal a deterioration on outlook for the next months.

Due to a better profitability performance (on YoY monthly basis) in the last quarter, sector’s profit remained unchanged compared to the previous year. However ROE came down to below 12%.