

DenizBank Economic Update

January 2015

- **Economy**
- **Financial Markets**
- **Banking Sector**

Economic Research and Strategy

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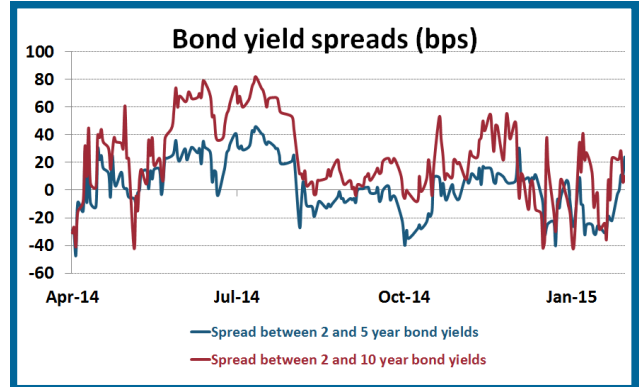
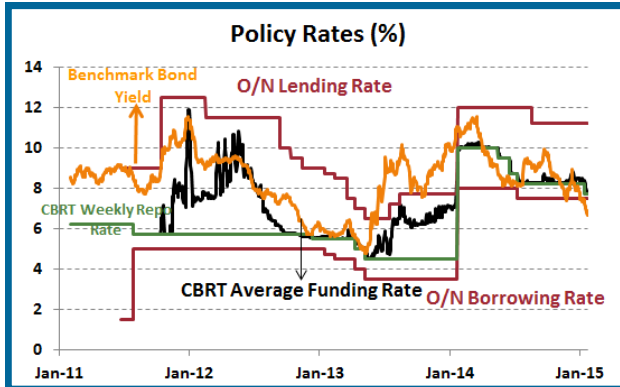
DenizBank 



DenizBank Economic Update

Economy (I)

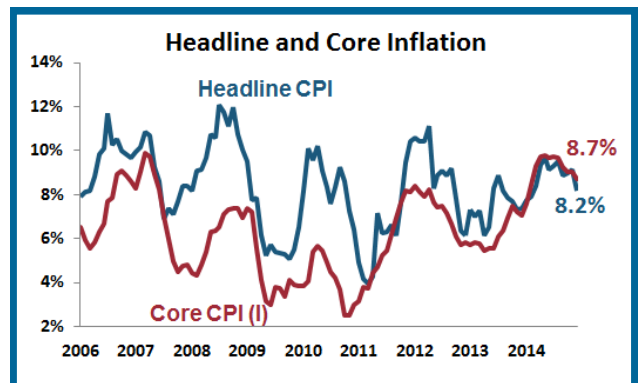
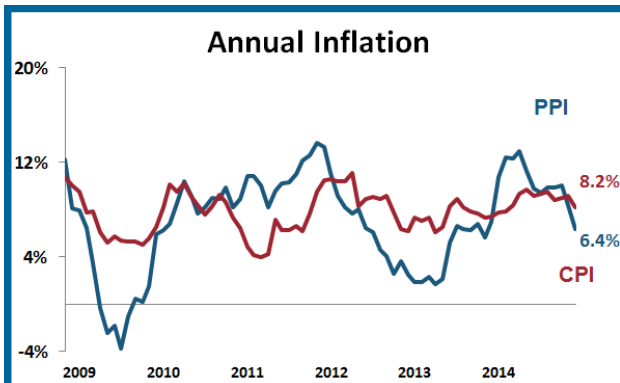
Policy Rates



Central Bank (CB) cut policy rate by 50 bps and further cuts are on the way...

- The CB cut one-week repo rate (policy rate) by 50bps to 8.25%, keeping O/N borrowing and lending rates unchanged at 7.50% and 11.25%, respectively.
- Despite the rate cut decision, the CB continued to highlight that the monetary policy should remain tight until the inflation outlook improves significantly and the yield curve should be flat. In the statement, CB sounded more confident about the disinflation process and now expects that the inflation will decline to target (5.0%) by mid-2015.
- The CB Governor stated that should the January inflation signal sharp deceleration in annual CPI print, they will consider to cut rates in extraordinary meeting as of January 4th.
- We think benign inflation outlook in 1H15 will provide room for further easing. Depending on the global market conditions, we think that the CB could lower the policy rate and also lower band of the corridor by the same amount at cautious steps in the coming term. However, taking into account the recent volatility in global markets, the CB would choose to remain on halt this month despite the possibility of sharp fall in annual inflation.

Inflation



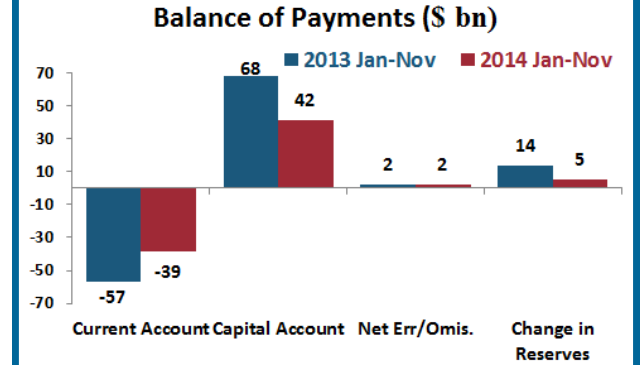
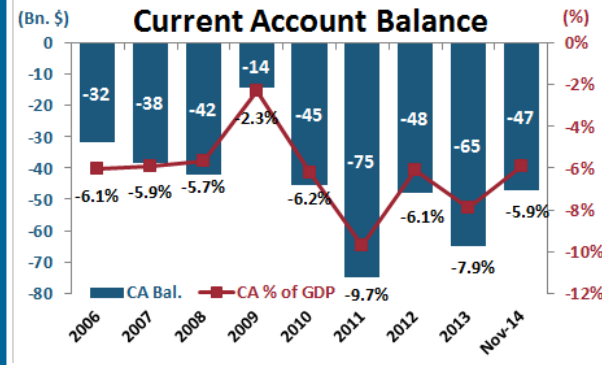
Inflation is expected to fall sharply in the first half of 2015...

- Inflation print came below consensus expectations in December and annual inflation declined from 9.2% to 8.2% with the support of softer food prices. substantially higher than the Central Bank's (CB) 5% ($\pm 2\%$) inflation target.
- Annual core inflation, an important indicator of inflationary pressures, was also weaker in December. Annual Core I indicator went down to 8.7% from 9.0%.
- We expect headline inflation fall sharply in the first half of 2015 with favorable base effects. Falling energy prices and expected fall in food prices will also support disinflationary process.
- CB's revised its year-end 2015 inflation forecast to 5.5% in the first Inflation report of the year, which is above our 2015 year-end inflation forecast of 6.1%.

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Economy (II)

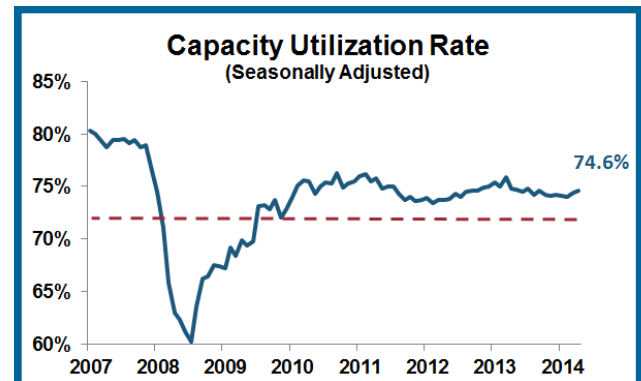
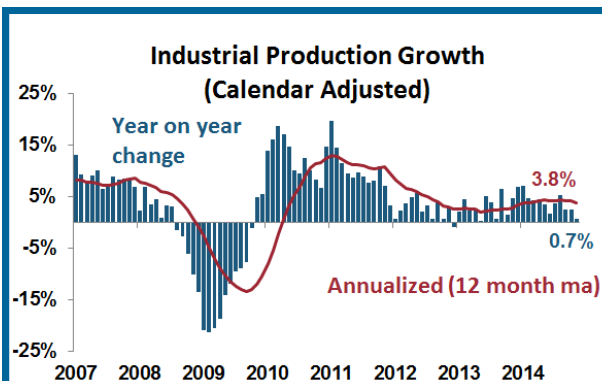
External Sector



Current account deficit continues narrowing in October.

- Current account deficit came at \$5.6 bn in November, slightly above the consensus expectation of \$5.4 bn. 12 month cumulative current account deficit narrowed down from \$65 bn (7.9% of GDP) in 2013 to \$47.1 bn (5.9% of GDP).
- On the financing side, there were strong inflows of \$8.7 bn in November, while the net errors and omissions were in negative territory (\$-3.5 bn).
- Despite the risks in export markets on the back of geopolitical developments, with the support of lower oil prices we expect current account deficit to GDP ratio to ease to 5.8% at the 2014 year-end and further to 4.5% in 2015. Further decline in oil prices poses downside risks to our forecast for 2015.

Growth



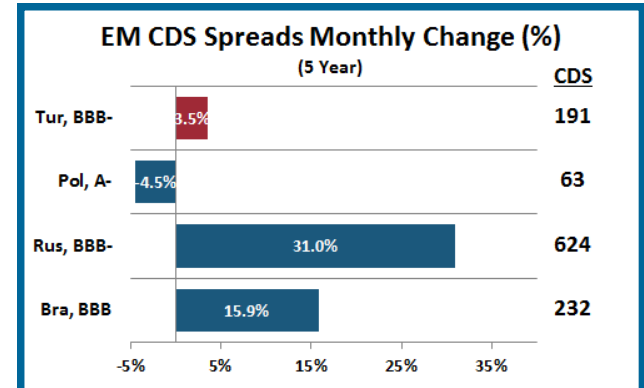
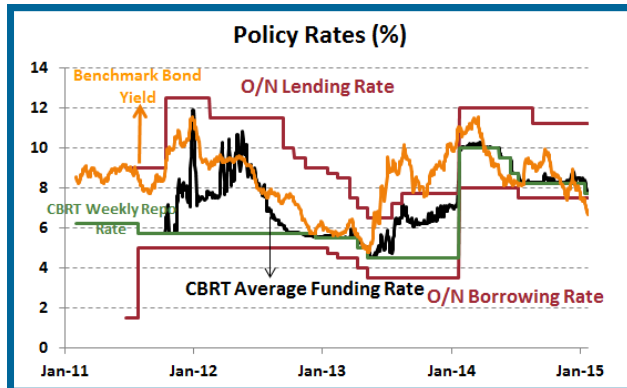
Manufacturing activity remains subdued...

- The calendar adjusted industrial production index (IP) increased YoY by 0.7% in November below the market consensus of 1.8%. Seasonally adjusted IP index posted 0.1% MoM decline following a sharp decline of 21.8% in the previous month. Annualized increase in manufacturing activity declined to 3.8%
- Leading indicators point to a moderate recovery of economic activity. Capacity utilization continued to improve third consecutive month in January to 74.6%. On the other hand, PMI manufacturing index eased from 52.2 to 51.4 in December after increasing four consecutive month in a row.
- Turkish economy is expected to grow 2.8% and 3.5% 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.

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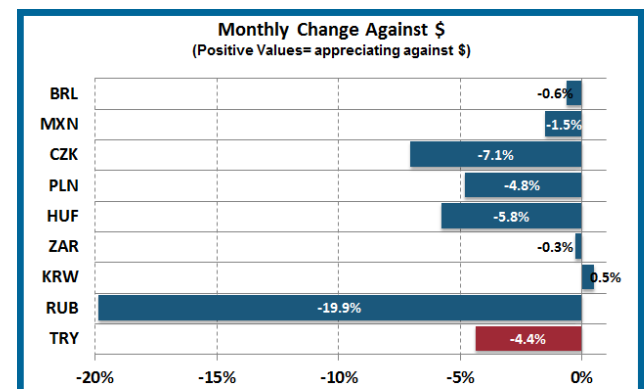
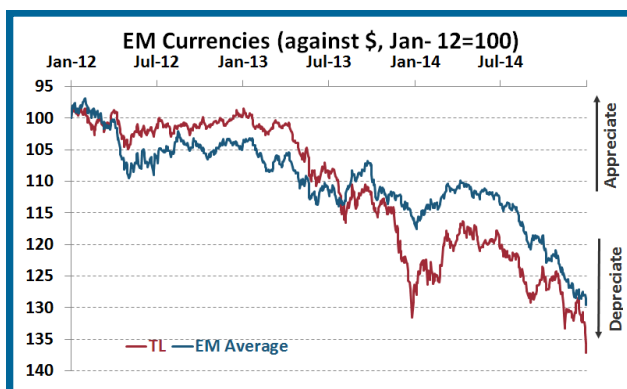
Financial Markets

Debt Market



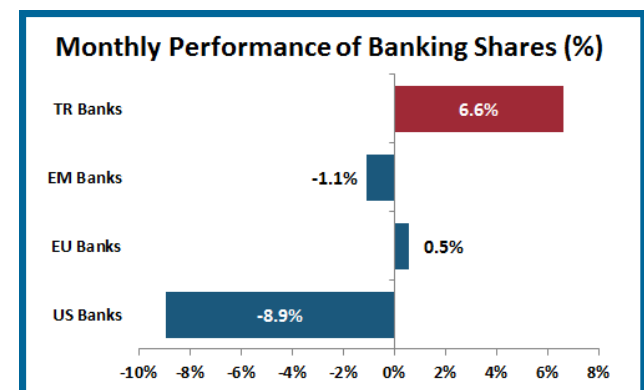
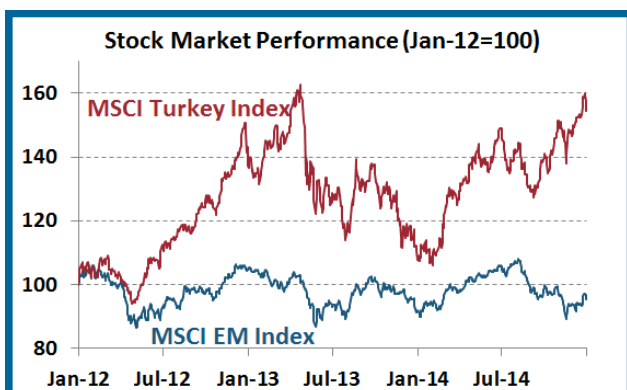
On the back of CBRT's rate cut and further rate cut expectations, and ECB's announcement of QE program, benchmark bond yield had come down to below 7%

Currency Market



While USD keeps appreciating, rate cut expectations from CBRT led TRY to underperform its peers

Stock Market

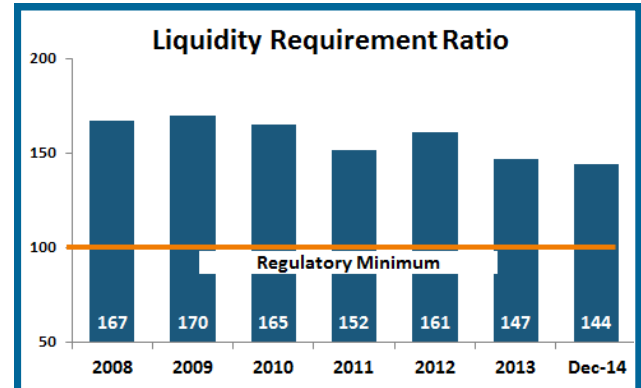
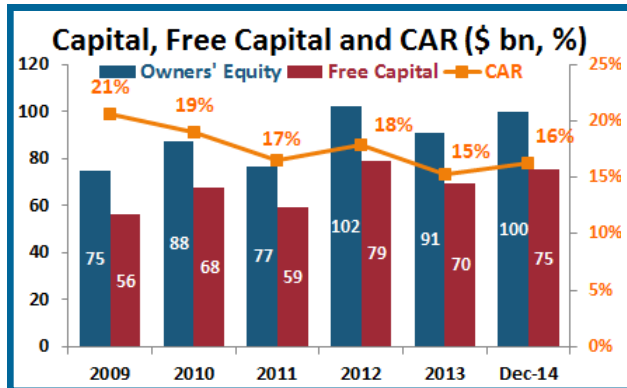


Borsa Istanbul continues to overperform EM equity index led by a better performance in banking sector equities

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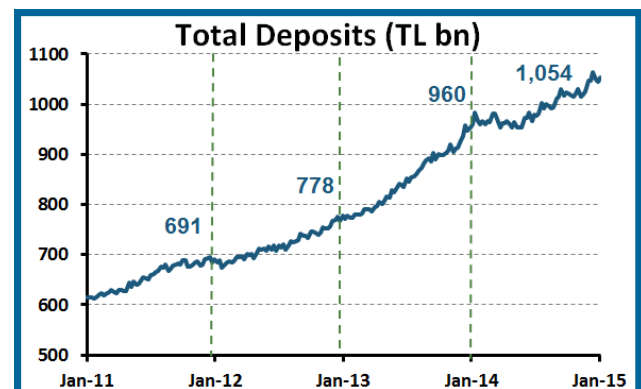
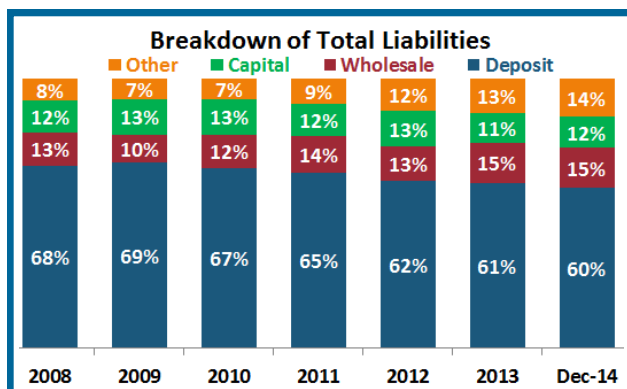
Banking Sector (I)

Capital



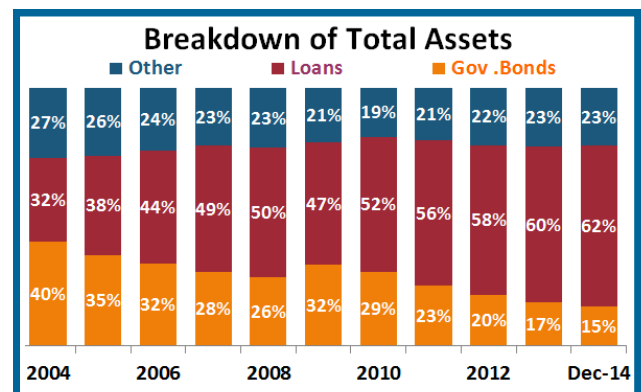
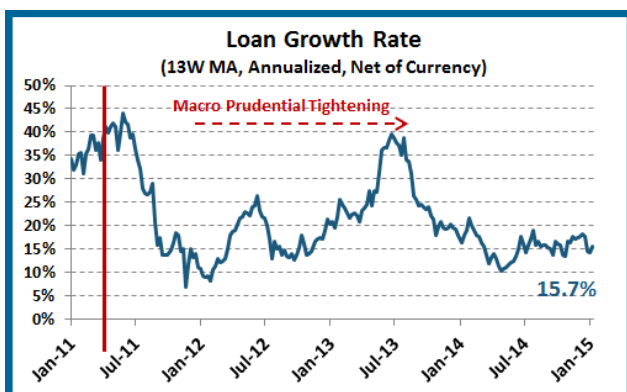
Despite declining profitability, banks still manage to keep their CAR ratio high above 16%...

Funding



Share of deposits in funding has decreased slightly to 60% in the last quarter.

Lending

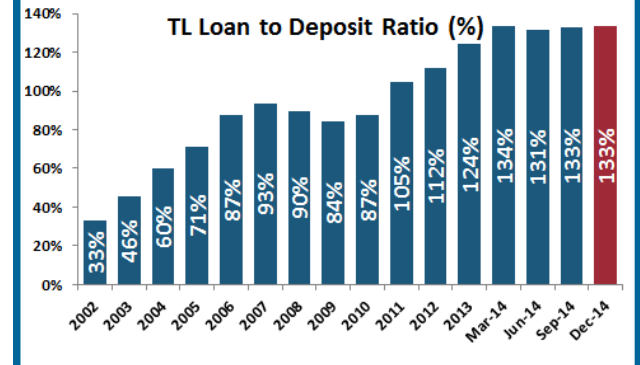
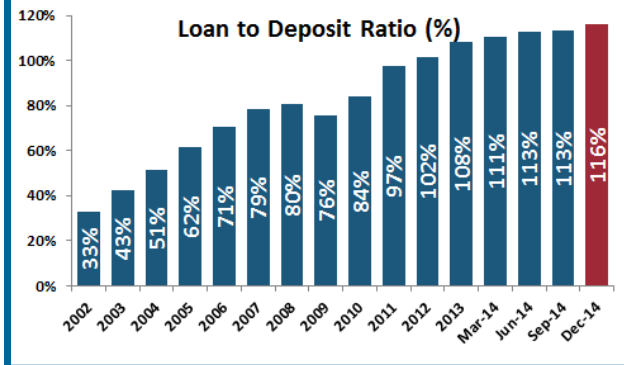


Annualized loan growth is in line with Central Bank's long term target of 15% in December.

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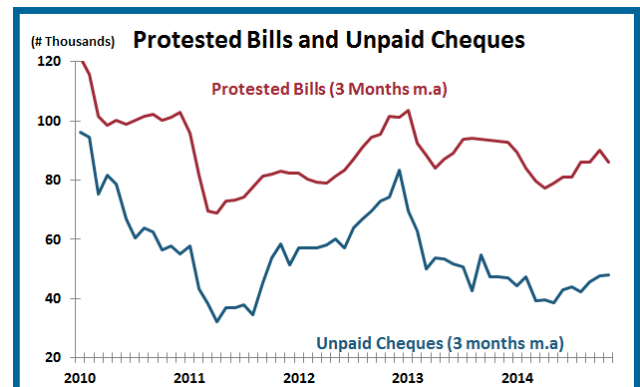
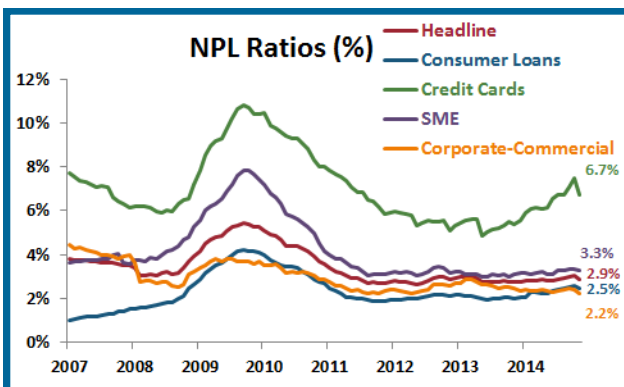
Banking Sector (II)

Loan to Deposit Ratios



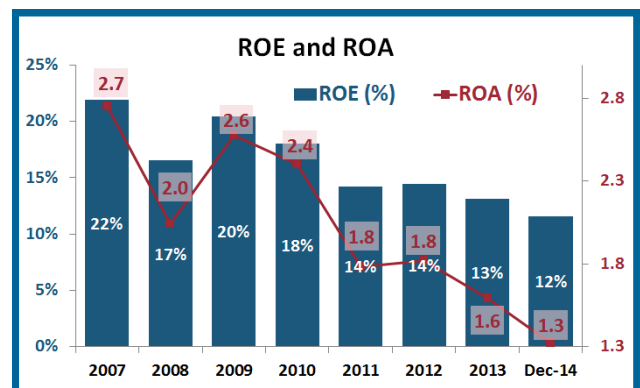
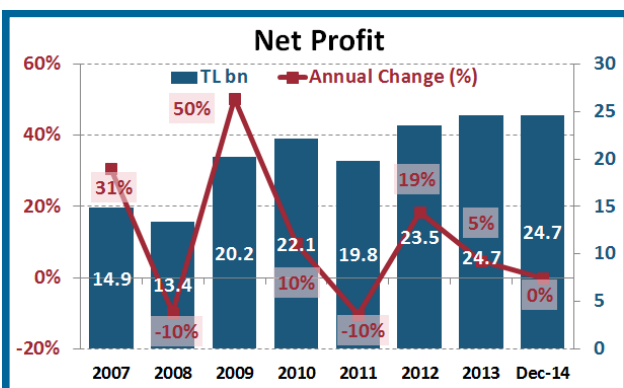
Loan to deposit ratio has increased to 116% in December from 108% at the end of 2013.

Loan Quality



Headline NPL ratio for the sector slightly came down to 2.9% due to an improvement in credit cards

P & L



Due to a better profitability performance (on YoY monthly basis) sector annual profit managed to cope its loss in the first half of the year. However ROE came down to below 12%.