DenizBank Economic Update

June 2014

- Economy
- Financial Markets
- Banking Sector

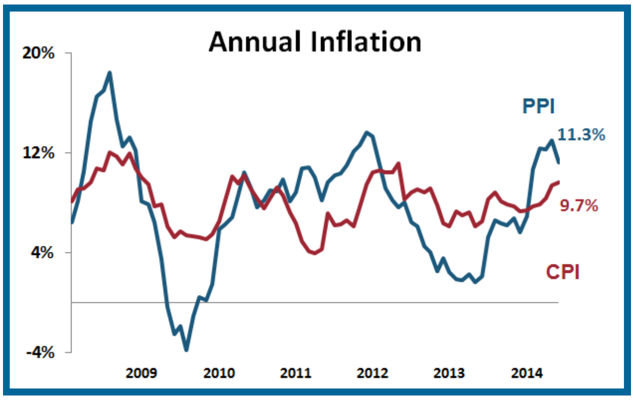
Economic Research and Strategy
Saruhan Özel, Ph.D.
Ercan Ergüzel
Ezgi Gülbaş
Ali Can Duran

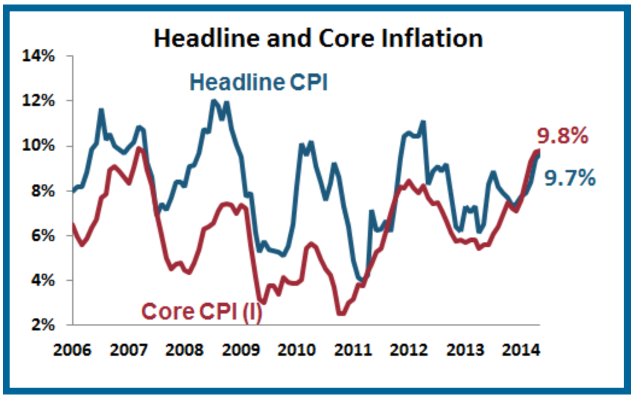
DenizBank Economic Research – (90) 212 272 99 65 or ekonomikarastirmavestrateji@denizbank.com

DenizBank Economic Update

Economy (I)

Inflation





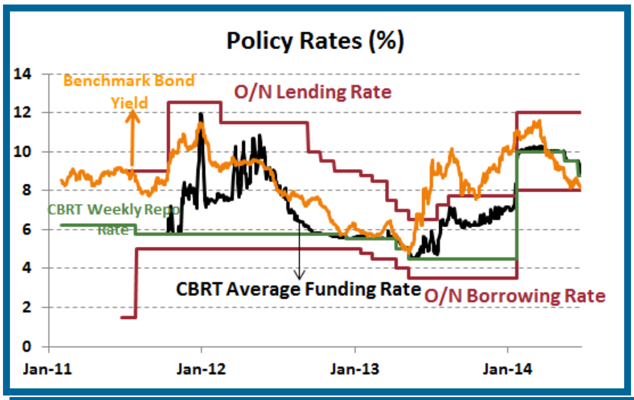
Inflation is expected to decrease after reaching its peak in May...

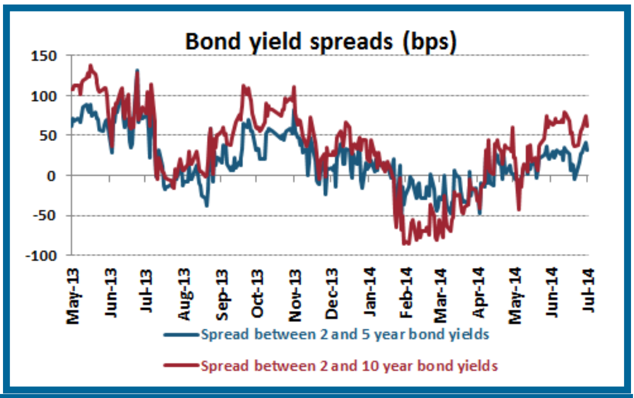
● Inflation came below expectations in May and signaled that it might have reached its peak. After 0.4% MoM increase in May, annual inflation increased to its possible peak of 9.7% from 9.4%. Correction on global food prices showed its effect on inflation in May contributing –0.3 points to headline inflation.

● Correction in food prices and decrease in PPI signals inflationary pressures will relatively decrease in coming months. Yet, we expect a gradual deceleration in the second half on back of stronger currency, subdued domestic demand conditions and stable commodity & energy prices.

● Central Bank of Turkey (CB) has a similar inflation trajectory in its mind as described above and its year end expectation is at 7.6%. The trend in food inflation will also be critical given the unfavorable weather conditions both locally and regionally.

Monetary Policy





Central Bank (CB) cut policy rate further while keeping its hawkish rhetoric ...

● The CB cut one-week repo rate further (policy rate) by 75bps to 8.75%, keeping O/N borrowing and lending rates unchanged at 8% and 12%, respectively. Although it was above the market consensus of 50bps, it was still within a measured scale of 25-75bps.

● As highlighted in previous meeting, the CB reiterated that the monetary policy should remain tight until the inflation outlook improves. The CB is of the view that flat yield curve is an indicator of tight monetary policy.

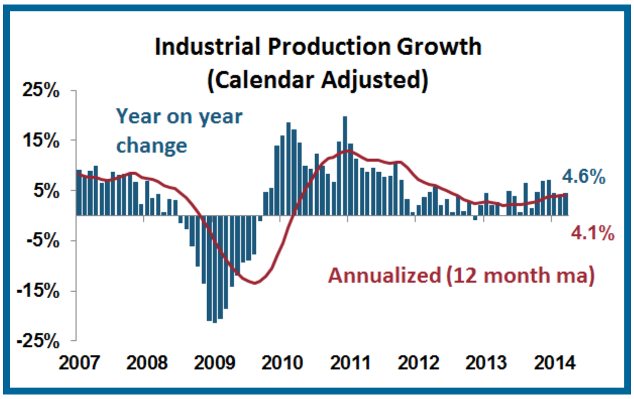
● Higher food prices in addition to pass-thru from currency depreciation had a pivotal effect in rising inflation. Yet, it is expected to decelerate markedly starting from June print, according to the CB.

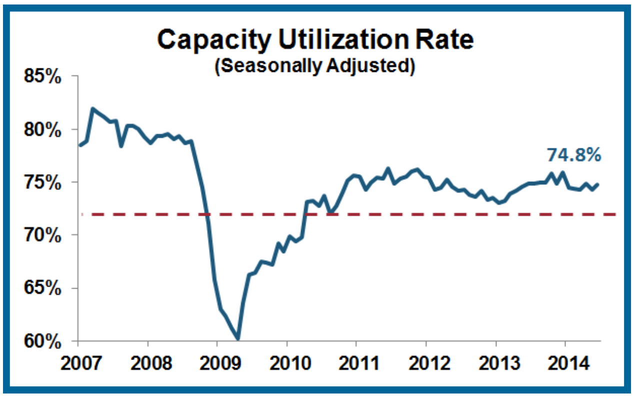
● The possibility of further easing(s) will be mostly dependent on global risk appetite. Barring any negative event, the CB may cut the policy rate by another 150 bps in total in the remainder of the year.

DenizBank Economic Update

Economy (II)

Growth





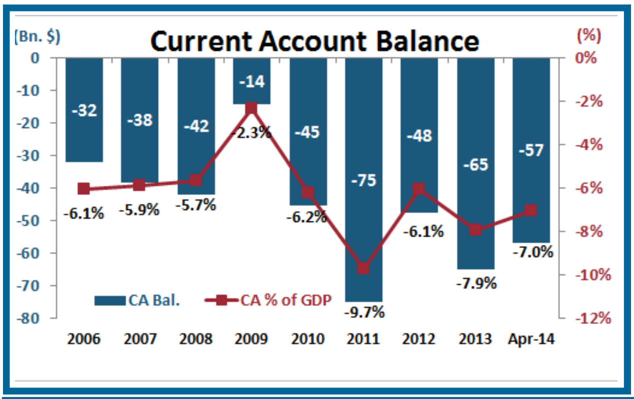
Slowdown in manufacturing activity is smoother than expected.

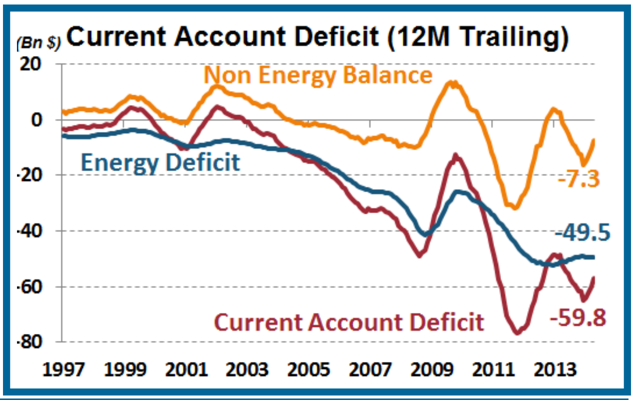
● The calendar adjusted industrial production index (IP) increased YoY by 4.6% in April above the market consensus of 4%, although there was an expectation for a slowdown in manufacturing activity. April performance of IP was on the back of better external demand.

● Annualized increase in manufacturing activity reached to 4.1% in April, indicating slowdown in the economic activity due to the increase in interest rates, regulations curbing retail lending growth, tax hikes and political uncertainty has delayed to second half.

● Although GDP growth will be moderating compared to the previous year in 2014, risks are on the upside for our forecast of 2.5%.

External Sector





Current account continues narrowing in April.

● In line with consensus expectations, current account deficit came at $4.8 bn in April stemming from stronger exports and mild domestic demand. 12 month cumulative current account deficit narrowed down from $65 bn (7.9% of GDP) to $57 bn (7.0% of GDP)

● Short-term capital flows changed its trend after signaling a $7.2 bn outflow in the first quarter. In April, stock market has received inflow of $580 mn, while fixed income market attracted $4.6 bn.

● Banks and Turkish corporates do not have any difficulty in rolling over their long-term debt. The long-term debt rollover ratios (12M trailing) was 274% for banks and 104% for corporates.

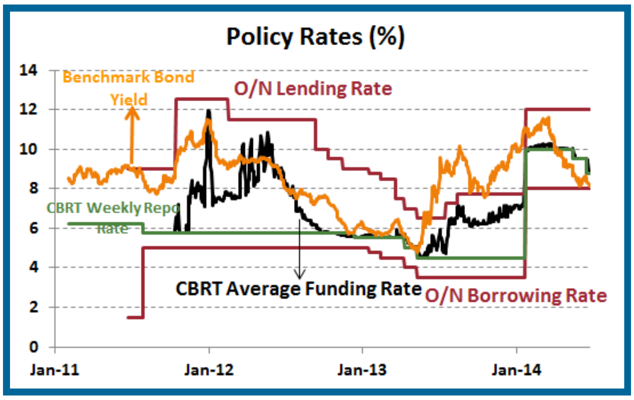
● We expect current account deficit to ease to 5.8% of GDP this year driven by the slowdown in imports with weaker domestic demand and recovery in exports thanks to recovering EU in addition to the weaker currency.

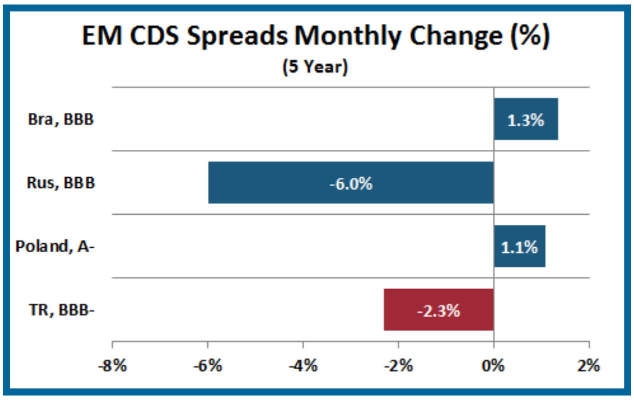
June 2014

DenizBank Economic Update

Financial Markets

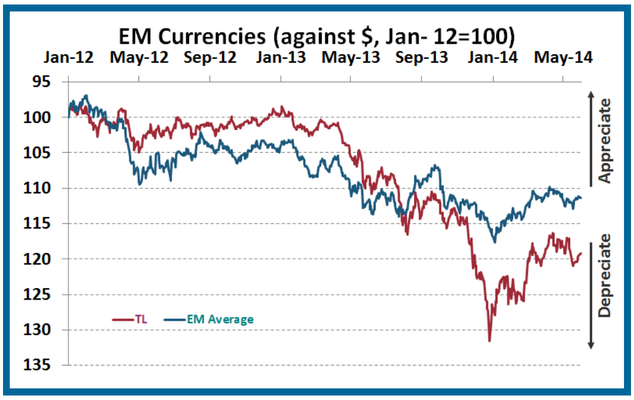
Debt Market

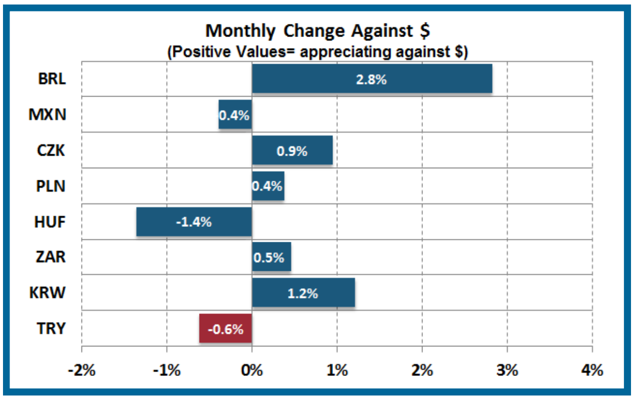




Thanks to the further rate cut expectations from the CBRT, benchmark bond yield came down to 8.15%, despite ongoing global political problems in Ukraine and in Iraq...

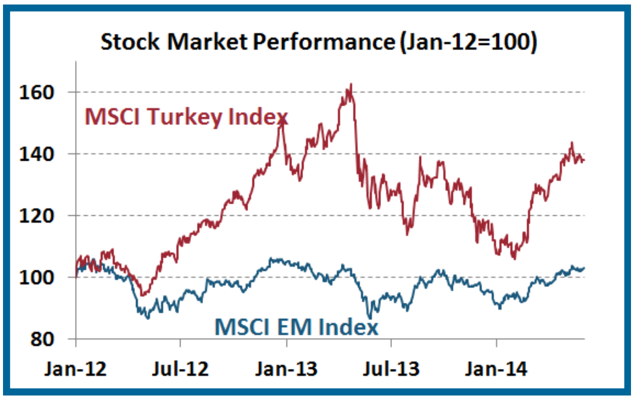
Currency Market

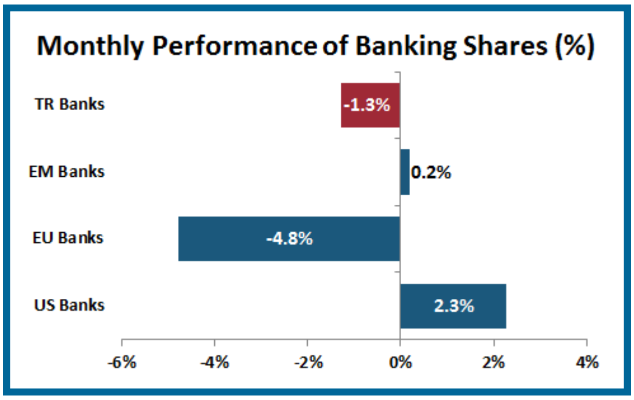




After reaching as high as 2.34 in the beginning of the year, $/TL has now stabilized at around 2.10...

Stock Market





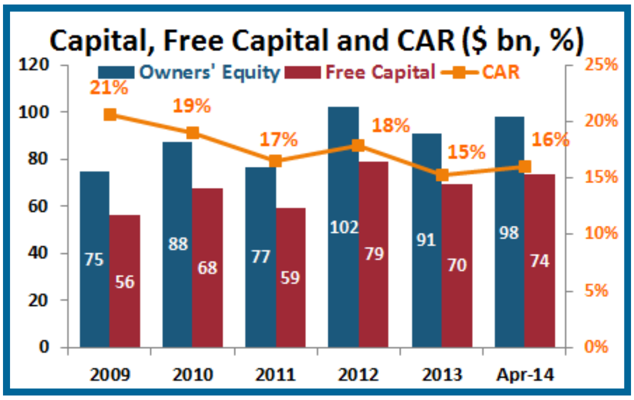
Banks underperformed EM peers in June, mainly due to the delay/cancellation of remuneration of reserve requirements held at the central banks.

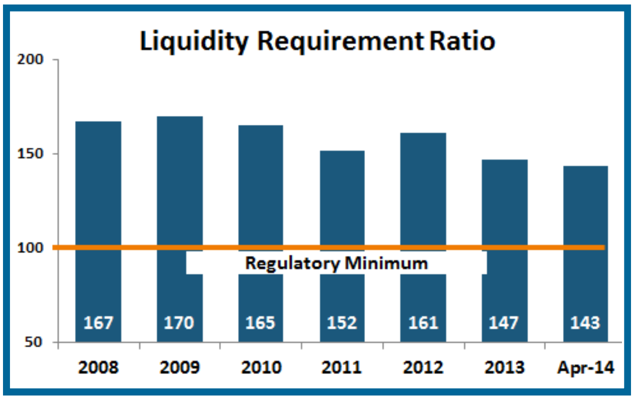
June 2014

DenizBank Economic Update

Banking Sector (I)

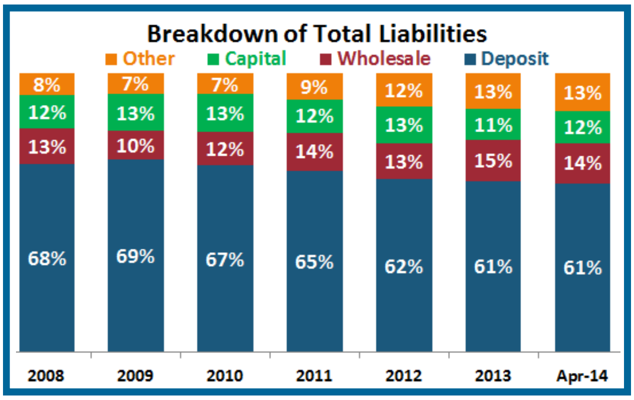
Capital

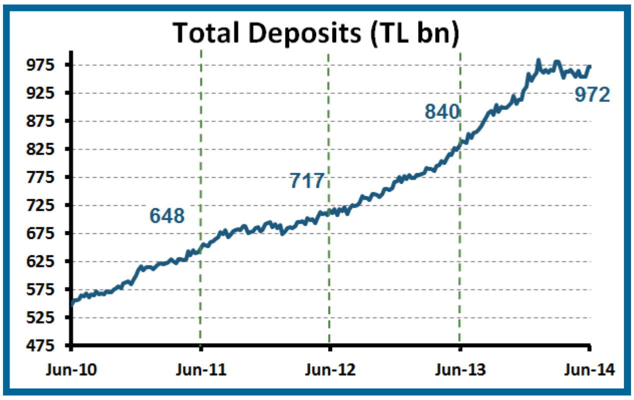




The sector's capital adequacy ratio (CAR) is well above both target of 12% and legal requirement of 8%, while liquidity indicators are well above regulatory thresholds.

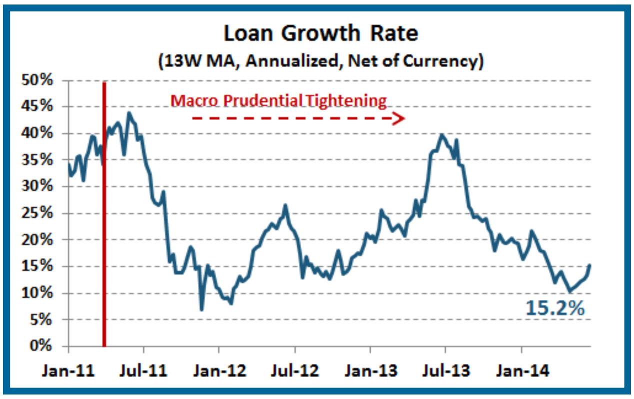
Funding

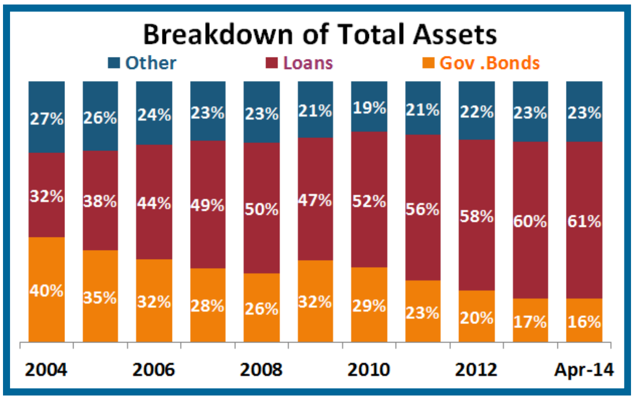




Due to the slowdown in deposit growth, loan to deposit ratio increased to 114%.

Lending





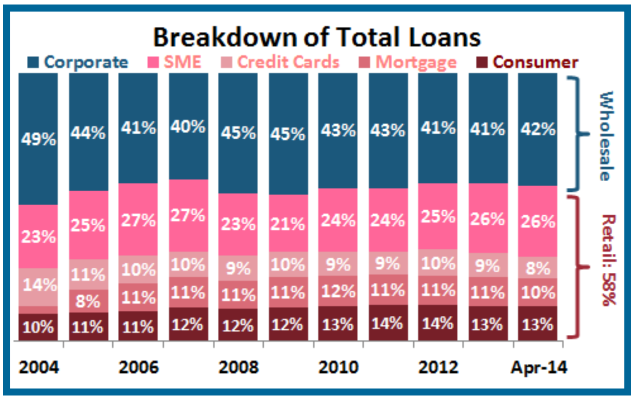
Loan growth is again back to 15%, the target growth rate of the CBRT. Yet, we expect to some slowdown in the pace pf growth in summer months due to seasonality.

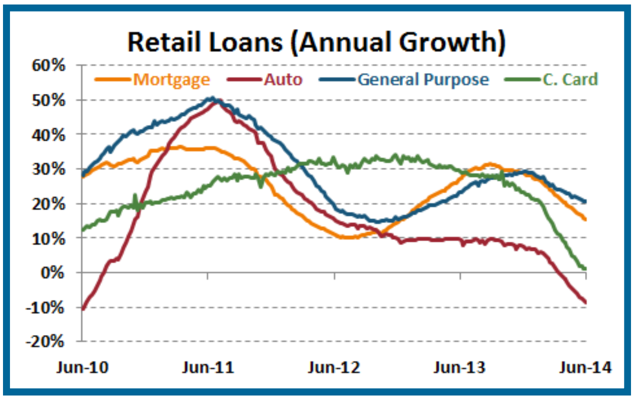
June 2014

DenizBank Economic Update

Banking Sector (II)

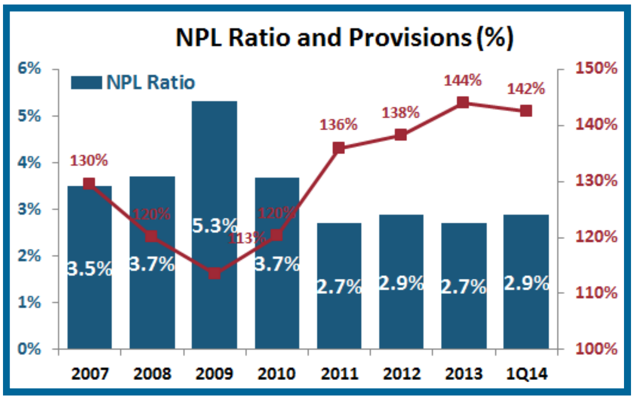
Loan Breakdown

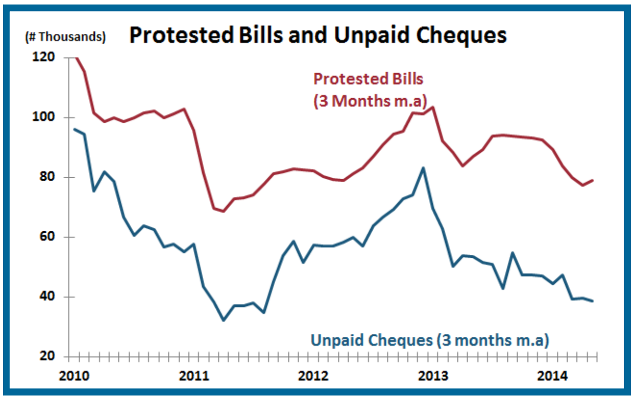




Retail loans are continuing to slow down due to measures taken by the authorities.

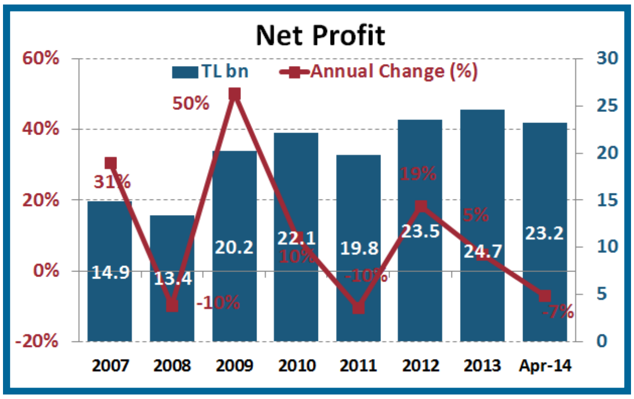
Loan Quality

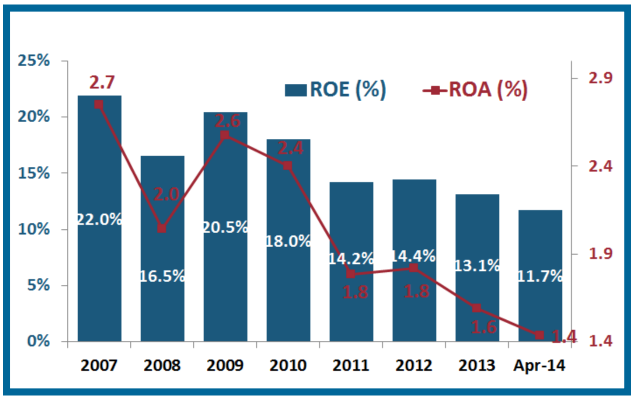




NPL ratio has been stable at 2.9%. In addition, protested bills and unpaid cheques don't signal a deterioration on outlook for the months ahead.

P & L





Profitability is falling due to decreasing margins and lower volumes. At the end of 2014, we expect to see c. 12% ROE figures compared to 13.1% of the previous year.