DenizBank Economic Update

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Economic Research and Strategy
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March industrial production did not meet expectations...

- Industrial production index rose YoY by 2.9% in March below the market expectation of 3.6%. February data was revised up to 5.9% from 5.8%. On a monthly basis, the index dropped by 0.5%. In annualized terms, index was up by 3.9%.

- The slowdown in economic activity signaled by the industrial production is also visible in other indicators. Manufacturing PMI continued its downward trend as it retreated to 48.9 in April from 49.2 in March. A figure below 50 is regarded as economic activity is contracting. Capacity utilization rate remained flat at 75.4% in May.

- Despite a slowdown in latest data, overall economic activity has been strong in the first quarter of the year, thanks to robust domestic demand. Risks for the remainder of the year tend to be downward. Geopolitical risks and the slowdown in tourism sector should be watched closely.

Falling food prices and stable Turkish Lira brought headline inflation down in April...

- CPI in April rose MoM by 0.78%, less than the market expectation of 1.02%. Food prices fell by 1.48% on a monthly basis. Annual food inflation fell to its lowest level since 2003 with 1.38%.

- Annual inflation decreased to 6.57% from 7.46% driven by the drop in food prices and a stable Turkish Lira. Core inflation, however, continues to be sticky. Core-I index retreated slightly to 9.41% from 9.51% a month ago.

- Going forward, food prices are likely to be volatile. However, with the ban from Russia on Turkish imports, the abundance of goods in the domestic market may continue to put downward pressure on prices. Currency appreciation, on the other hand, seems to have run its course, as Turkish Lira have given away all its gains since the beginning of the year. The improvement in market's medium term expectations have come to a pause as well. With the low base effect in the remainder of the year inflation may climb back to levels higher than 7%.
Monetary Policy

Central Bank (CBT) continued the simplification process by a 50 bps cut to the upper end...

- In its monthly MPC Meeting, CBT left the policy rate (one week repo rate) unchanged at 7.5%, in line with the market expectation. O/N lending rate was cut by 0.50% to 9.50%.
- As stated earlier, CBT continues with steps towards monetary policy simplification as much as inflation and market conditions allow. Since March upper end of the corridor has been decreased by 125 bps. The decision statement of this month’s MPC meeting no longer mentions that CBT is expecting inflation to fall in coming months. Thus, a slowdown in the pace of rate cuts may be expected.
- Despite the 125 bps cut in the upper end between March and May, CBT’s average funding rate has come down to 8.4% from 8.9% during the same period. Even with headline inflation improving, the bank kept its tight monetary stance as core inflation still remains high. This, along with the pause in the improvement of 12-month and 24-month ahead inflation expectations could mean that CBT would keep average funding rate at these levels, until core inflation comes down significantly.

External Sector

Current account deficit continued to improve in 1Q16 thanks to low energy prices and a narrowing trade deficit...

- Current account deficit (CAD) in March came at $3.7 bn. 12 month cumulative CAD narrowed down to $29.5 bn (3.9% of GDP) from $30.6 bn in February.
- On the financing side, there has been an FDI inflow of $0.7 bn in March. Inflow to the bond market was $0.5bn and to the equity market was $1.0 bn. Reserve assets increased in March by $1.5bn.
- 12 month cumulative energy deficit in March shrank by 36% on an annual basis to $29.1 bn.
- For the remainder of the year, current account’s quality of financing may deteriorate, as the slowdown in tourism sector takes its toll on foreign currency entry.
**Debt Market**

Benchmark bond yield is at 9.29%.

**Currency Market**

EM currencies depreciated against US Dollar in May.

**Stock Market**

MSCI Turkey equity index' performance was worse than other EMs in May.
CAR is at 15.8% in April, compared to 15.6% as the end of 2015.

Share of deposits in funding was at 59% as of Apr 16.

Annualized loan growth is at 11.2% as of May 20th.
Loan to deposit ratio is 117% in April.

Headline NPL ratio for the sector is at 3.4%.

As of April, sector’s 12 month cumulative profit increased YoY by 14%. ROE is at 11.2%.