DenizBank Economic Update

November 2018

- Economy
- Financial Markets
- Banking Sector

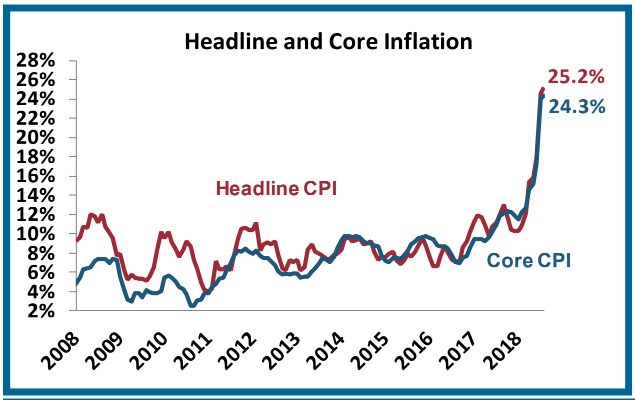
Economic Research and Strategy
Saruhan Özel, Ph.D.
Ezgi Gülbaş
Deniz Bayram

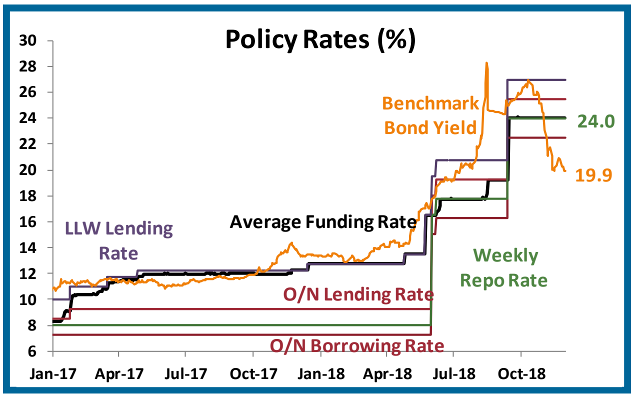
DenizBank Economic Research – (90) 212 348 20 00 or ekonomikarastirmalar@denizbank.com

DenizBank Economic Update

Economy (I)

Inflation





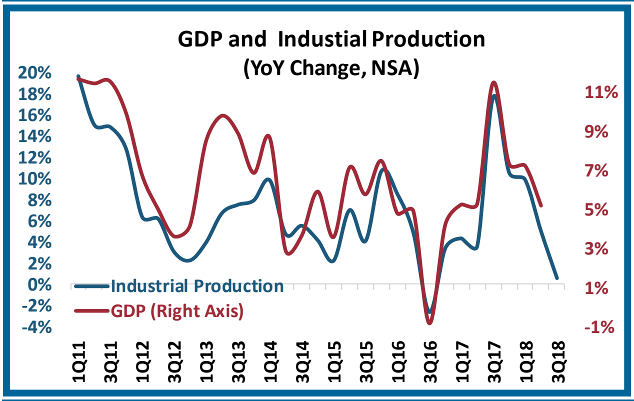
Inflation climbs to 25.2% as the deterioration in pricing dynamics continue...

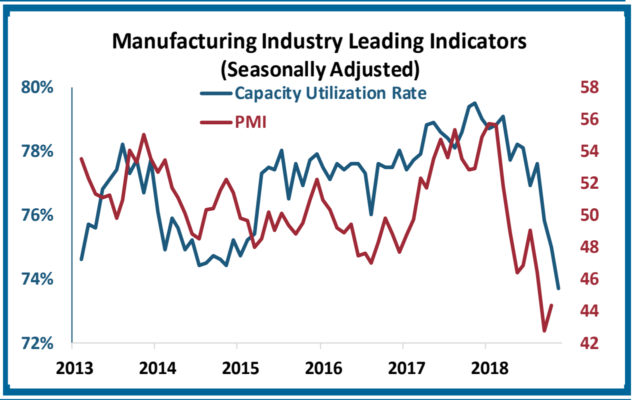
● Consumer prices rose by 2.7% MoM in October. While highest contribution to monthly inflation came from seasonal price increases in clothing (12.7% MoM) and rising food prices (3.2% MoM), price hikes in exchange rate sensitive core goods such as transportation and household equipment) were still significant.

● October imprint took annual inflation to 25.2% from 24.5%, its highest level since 2003. Upward trend in core inflation (24.3%) and price hikes spreading across all categories indicate significant deterioration in pricing behavior. Moreover annual PPI inflation remained elevated at 45%, suggesting cost-push pressures will persist. As lagged impact of FX depreciation continue, we expect headline inflation to remain above 20% in 1H19, before high base effect kicks in. Our 2018 and 2019 year-end inflation expectations are at 25% and 16%, respectively.

● Following the 625 bps hike in in September meeting, Central Bank (CB) kept the policy rate constant at 24% in October. Yet CB keeps the hawkish tone and the tightening bias, reiterating that the tight monetary stance will be maintained until gloomy inflation outlook displays significant improvement. Recent appreciation of 9% in TL since the last meeting and contraction in economic activity provides a case for CB against further rate hikes. However, given the elevated levels of inflation expectations, we expect CB to avoid any premature rate cuts and keep the policy rate at least at current levels until the end of 1H19.

Growth





Slowdown in economic activity deepens in 4Q18...

●Following the strong economic growth (6.2% YoY) in first half of 2018, leading indicators demonstrate a significant downturn in economic activity starting from 3Q18. Industrial production (IP) was up 0.5% in 3Q18 compared to 7.3% in 1H18, signalling economic activity remained roughly flat in 3Q18.

●Moreover, preliminary indicators suggest contraction in economic activity in 4Q18. Manufacturing PMI decreased to 44.3 in October from 46 in 3Q18 and capacity utilization decreased to %73.7 in November from 77%, indicating IP growth turned to negative territory in 4Q18. Moreover, consumption good imports decreased by 40% in October and auto (-68%) and white goods sales (-29%) nosedived, reflecting the sharp contraction in domestic demand. This is also evident in 1% nominal decrease in consumption tax revenues.

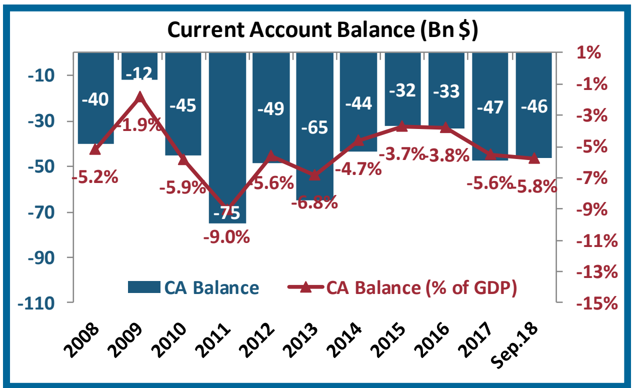
● As contraction in bank loans accelerated (-10.1%, see page 5), we expect a more severe slowdown in economic activity in 4Q18. As growth turns to negative in 4Q18, we expect 2018 full-year growth rate to decrease to 1-1.5%.

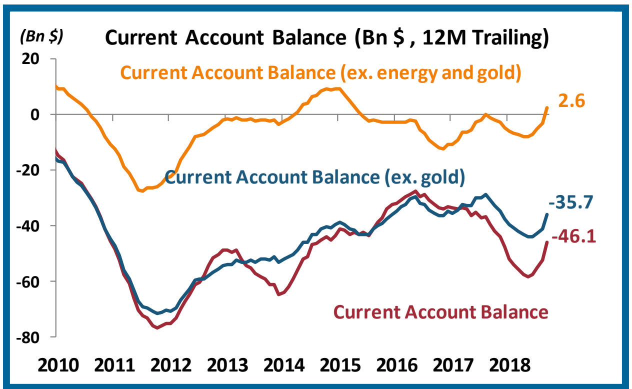
November 2018

DenizBank Economic Update

Economy (II)

External Sector





Improvement in external balances gains momentum...

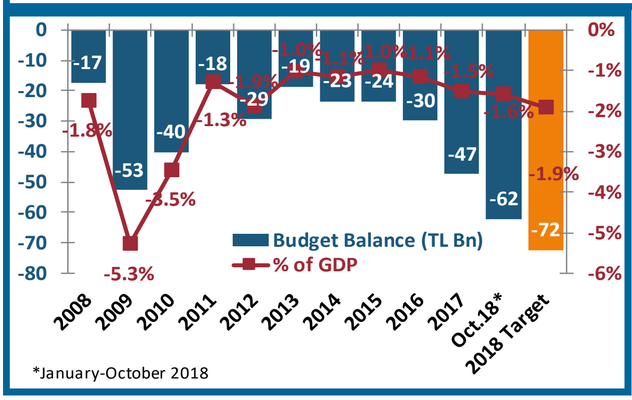
● Slowdown in economic activity led to a rapid improvement in external balances in 3Q18. In August and September, current account recorded all-time high monthly surpluses (Aug:$1.9 bn, Sep:$1.8 bn), and 12-month trailing current account deficit (CAD) decreased further to late 2017 levels of $46.1 bn (5.8% of GDP) from a peak of $58.3 bn in May.

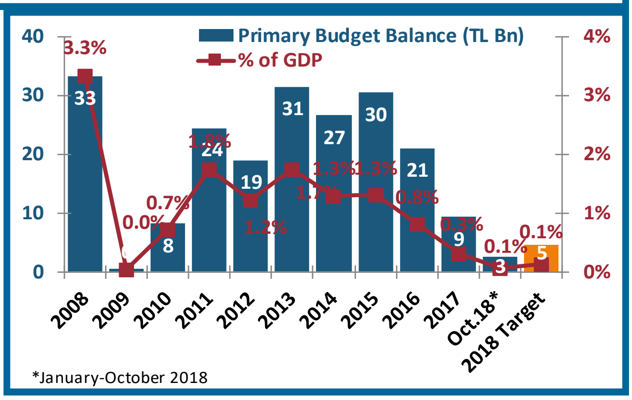
● Due to sharp slowdown in domestic demand and strong export performance, core annual CAD (exc. energy and gold) turned into a surplus ($2.6 bn) for the second time since May 2015. Net gold imports decreased significantly, although still high at $10.3 bn on 12-month basis. On the other hand, energy deficit continued to worsen ($10.4 bn annually) due to higher energy prices (Brent oil $75/bbl in Sep 18 vs. 61$/bbl in Sep 17), though at a slower pace. As oil prices retreated sharply below $60/bbl in November, prolonged deterioration in energy deficit may also come to an end in last two months of 2018.

● Quality of CAD financing worsened as reserve drawdowns ($24.6 bn annually) together with net errors and omissions ($21.2 bn) have been the main source of financing, and capital outflows continued.

● Significant decrease in trade deficit (imports down by 23%) points to another record high current account surplus in October. As contraction in domestic demand continues, we expect CAD (% of GDP) to decrease to 4.4% by the end of 2018.

Public Sector





Budget deficit continues to widen as tax revenues weaken...

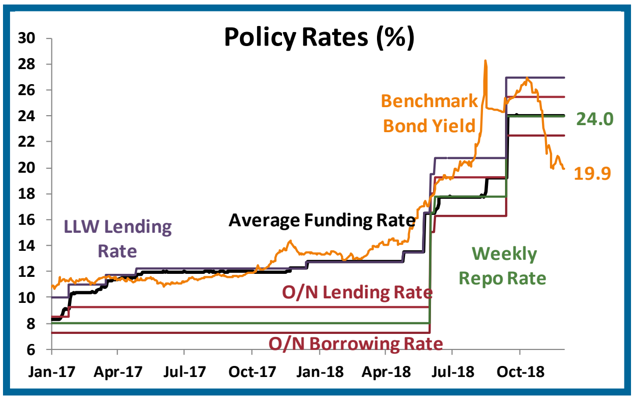
● In the first 10 months of 2018, central government budget deficit rose by 78% to TL 62 bn from TL 35 bn in the same period of 2017, bringing 12 months trailing budget deficit to TL 75 bn (1.9% of 2018). Budget expenditures increased by 23% due TL 24 bn benefit handed out to pensioners , increase in the capital spending and rising interest expenses in first ten months of 2018. On the other hand, increase in tax revenues were limited (18%). Due to weaker domestic demand and new regulation curtailing special consumption tax on oil, indirect taxes increased 12% in January-October, compared to 15% inflation in same period. Non-tax revenues (up 87%) partly compensated the slowdown in tax revenues.

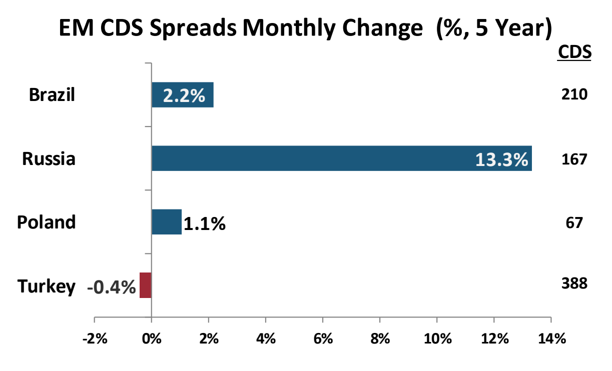
● Significant slowdown in tax revenues pose risk on government's 1.9% budget deficit and 0.1% primary surplus target in 2018, which requires slowdown in expenditure in last two months of 2018. Government commits to fiscal discipline in 2019 according to the recently announced budget plan targeting a 1.8% (%of GDP) deficit and a primary surplus of 0.8%.

DenizBank Economic Update

Financial Markets

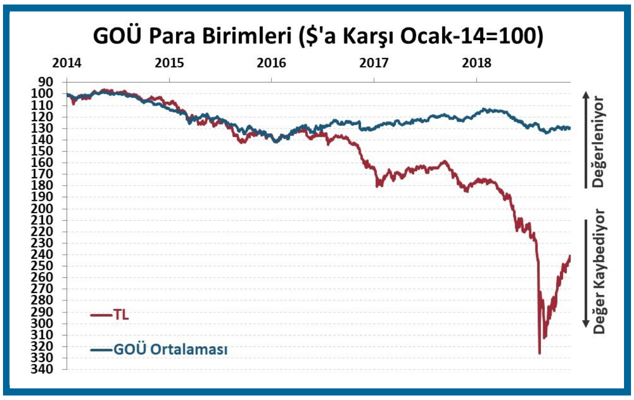
Debt Market

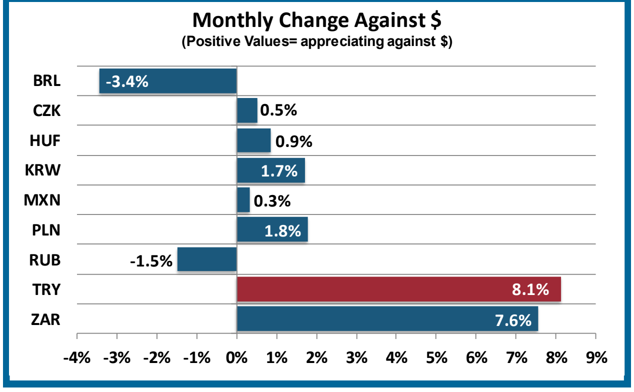




Turkey's 2-year benchmark bond yield decreased below 20% in November (-450 bps) to July 2018 level, from a peak of 28% in August (2017: 13.4%)

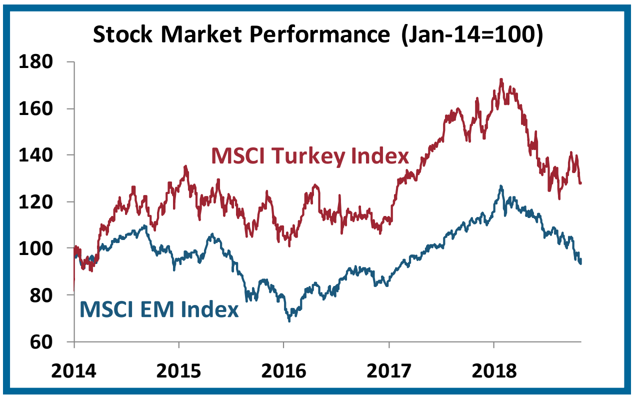
Currency Market

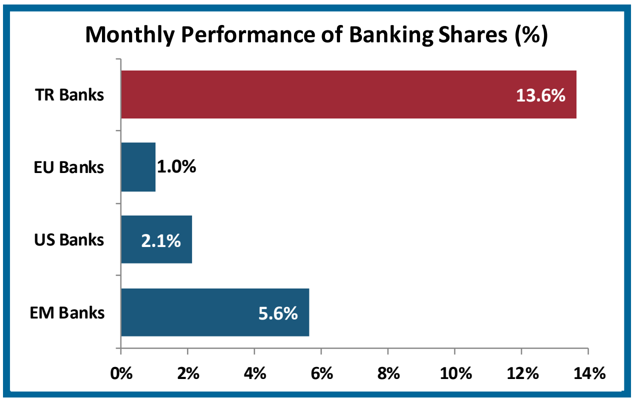




TL appreciated by 27% since the sharp drop in August (8% in November), recovering most of its losses. Yet, YtD depreciation in TL is still high at 28% while EM peers depreciated by 9% on average.

Stock Market





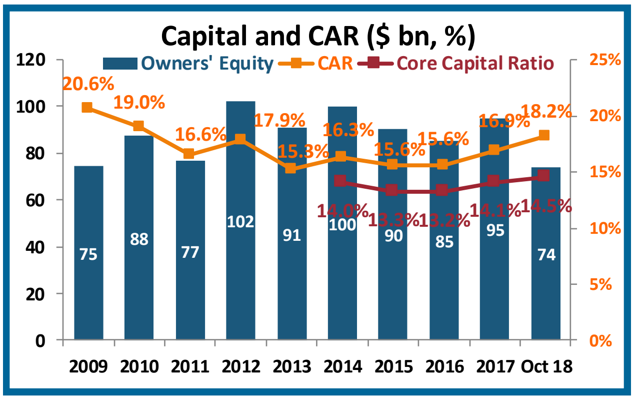
MSCI Turkey index was up MoM by 5.6% (in TL terms) in November, in line with EM peers. On YtD basis, MSCI Turkey index was down by 18%.

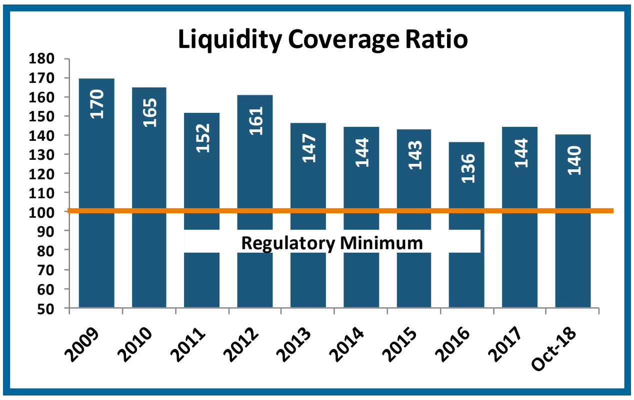
Data retrieved from Bloomberg as of 14:00 (GMT + 3), 30.11.2018

DenizBank Economic Update

Banking Sector (I)

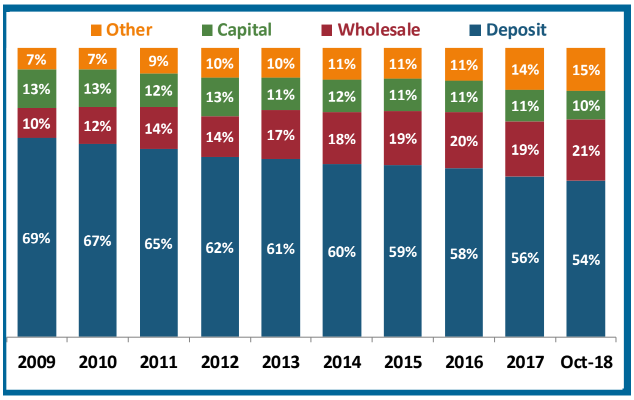
Capital

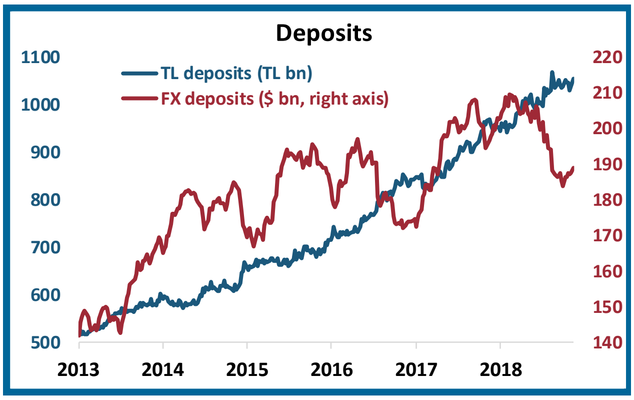




Turkish banking sector has a strong capital base. Capital Adequacy Ratio is at 18.2% as of October 2018.

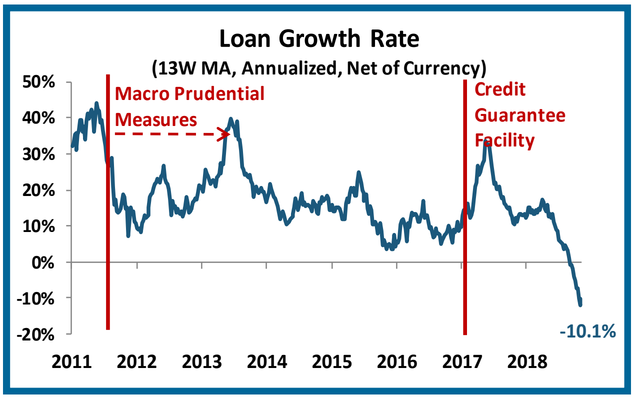
Funding

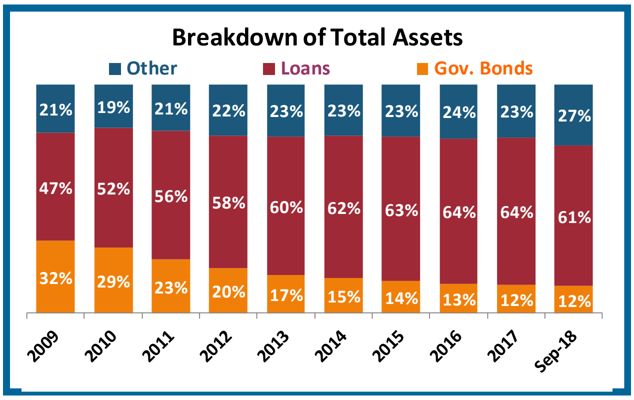




Deposits went up YoY by 19% (3.1% net-of-currency) to TL 2.1 trillion as of November 18. The share of deposits in funding is stable at 54%.

Lending





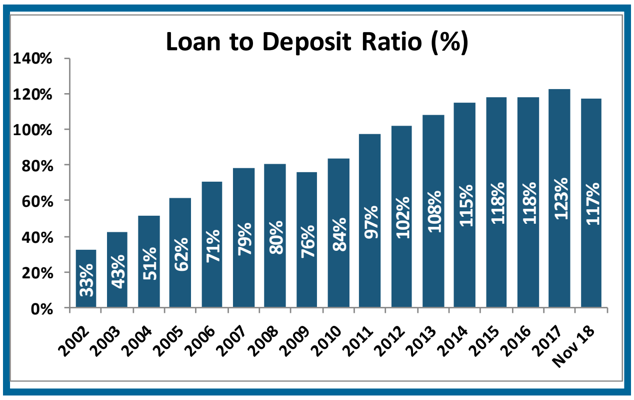
Contraction in loans (13 week average net-of-currency) accelerated to an annualized rate of 10.1% in November.

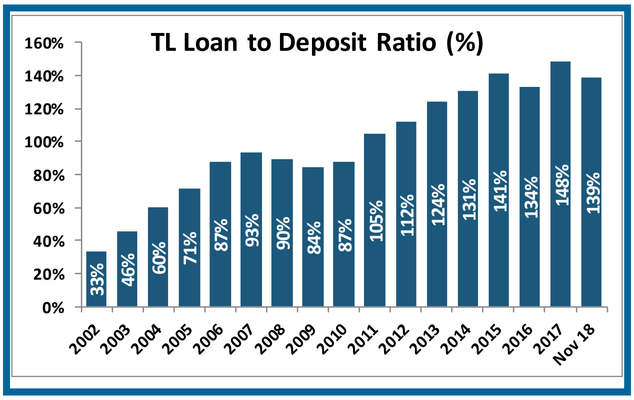
November 2018

DenizBank Economic Update

Banking Sector (II)

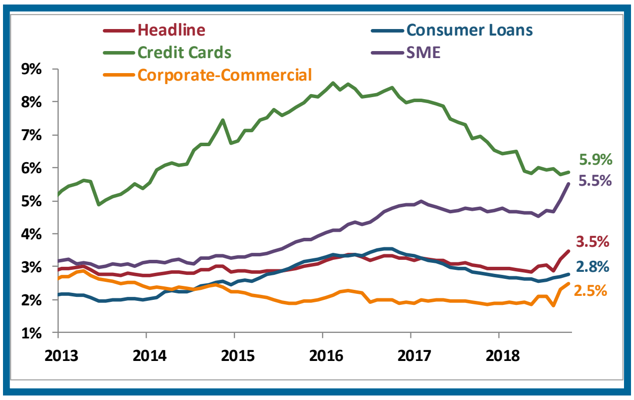
Loan to Deposit Ratios

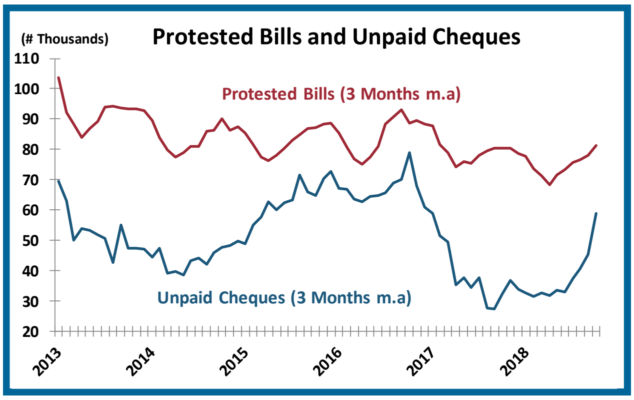




Loan to deposit ratio (LDR) and TL LDR decreased to 117% and 139%, respectively.

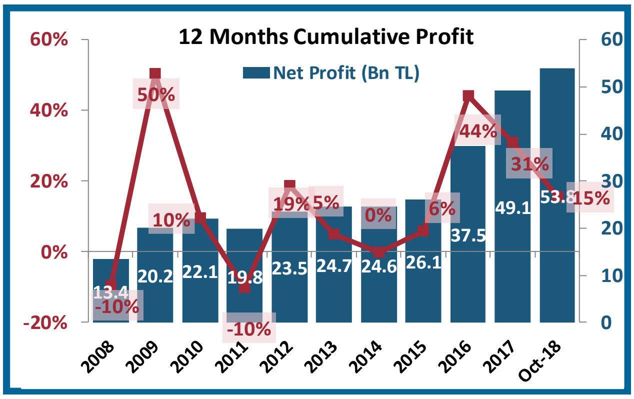
Loan Quality

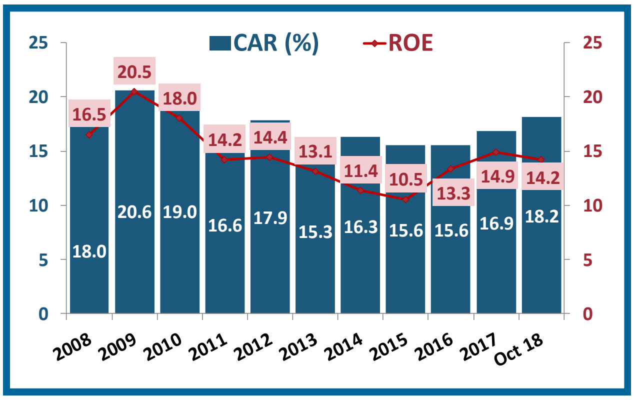




Headline NPL ratio for the banking sector rose moderately to 3.5%.

P & L





As of October 2018, 12 months cumulative profit increased YoY by 15% to TL 54 bn. RoE of the sector decreased slightly to 14.2%.