DenizBank Economic Update

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Economic Research and Strategy
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GDP growth remained below expectations as domestic spending cut pace...

- Turkish economy grew by 3.1% in 2Q16 below the market expectation of 3.7%. Annualized growth rate was 4.3%.

- Despite a slowdown, domestic demand continued to be the main driver of growth. Household spending grew by 5.2% Q-on-Q making a 3.4 pp contribution to headline growth figure, down from 4.9 pp in Q1. Public spending increased by 15.9% and made a 1.7 pp contribution. Net exports shaved off 2.1 pp.

- Initial signs of the slowdown in domestic demand is clearly visible in second quarter GDP figures. In the second half of the year, household may slow even further, as loan growth has been subdued. 13-week, annualized, net of currency loan growth is down to 7.5% in mid-September. Measures taken to ease loan and credit card usage may offset some of the slowdown in consumption, however 2016 annual growth may decrease to around 3%.

Headline inflation dropped, as volatile food inflation made a downward move in August...

- CPI in August decreased MoM by 0.29%, contrary to the market expectation of a 0.05% increase. Food prices decreased by 1.92% bringing annual food inflation to 6.19% from 9.69% a month ago.

- Annual inflation decreased to 8.05% from 8.79% in July. Core inflation, I index, was 8.41%, at its lowest level in 2016. The improvement in pricing behavior was reflected in services inflation. Price levels in service sector items dropped, excluding education.

- The volatility in food prices continues to determine the overall inflation trend. In August, the surprise was positive, breaking the 4-month upward trend in annual inflation. The slowdown in domestic demand may create a downward pressure on the headline figure. However, because of the volatility in food prices and depreciation in Turkish Lira, the downward pressure may be limited. There may be slight fall in year end inflation to 8.5%, vs 8.8% in end of 2015.
CBT continued to narrow the interest rate corridor and average funding rate...

- In its monthly MPC Meeting, CB left the policy rate (one week repo rate) unchanged at 7.5%, O/N lending rate was cut by 0.25% to 8.25% in line with the market expectation.
- Statement released after the decision reveals the bank has assumed a rather dovish position, in light of the early indicators that signal a slowdown in economic activity in the 3rd quarter. The bank evaluates that financial conditions have been quite tight. The slowdown in domestic demand supports the gradual improvement in core inflation and a drop in headline inflation is expected due to the fall in food prices. The price hike in gas prices and other cost factors hinder further improvement in inflation.
- The bank has softened its monetary stance to cautious from tight in previous months, reflecting the positive global backdrop for EMs may continue in the short term. Average funding rate fell down to 7.86% on average in September from 7.99% a month ago. The bank may continue to decrease average funding rate, as long as global headwinds continue to favor EMs. The drop in funding rate may bring loan rates down as well, possibly enabling a pick-up in economic activity.

Compression in current account deficit is back after a one month break, but it may temporary...

- Current account deficit (CAD) in July came at $2.6bn. 12 month cumulative CAD decreased to $28.9 bn (3.9% of GDP) from $29.5bn in June.
- On the financing side, there has been an FDI inflow of $0.5bn in July. There has been an inflow of $0.6bn in portfolio flows. Outflow in the equity markets was $0.3bn. Reserve assets decreased in July by $1.7bn.
- 12 month cumulative energy deficit in July shrank by 37% on an annual basis to $25.6 bn.
- The decrease in imports allowed for an improvement in the 12 month cumulative deficit. However, as the downward trend in tourism revenues continue, annual current account deficit to GDP ratio may jump up to a level slightly over 4% towards the end of the year.
Financial Markets

**Debt Market**

Benchmark bond yield is at 8.71%.

**Currency Market**

EM currencies appreciated on average, while Turkish Lira depreciated.

**Stock Market**

EM stock markets performed positively in August.
CAR is at 15.8% in July, compared to 15.6% as the end of 2015.

Share of deposits in funding was at 60% as of Jul 16.

Annualized loan growth is at 7.5% as of September 16th.
Loan to deposit ratio is 117% in August.

Headline NPL ratio for the sector is at 3.2% as of Jul-16.

As of Jul-16, sector’s 12 month cumulative profit increased YoY by 31%. ROE is at 12.7%.