

# DenizBank Economic Update

September 2019

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

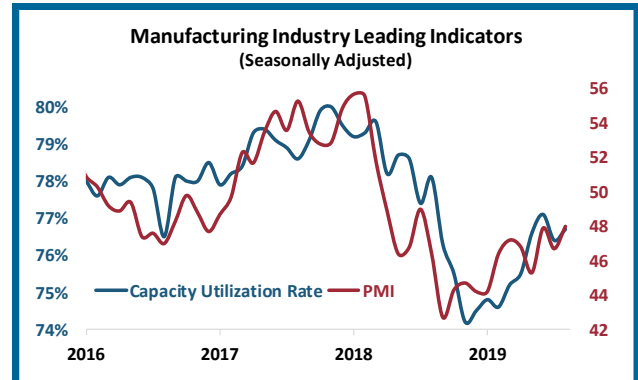
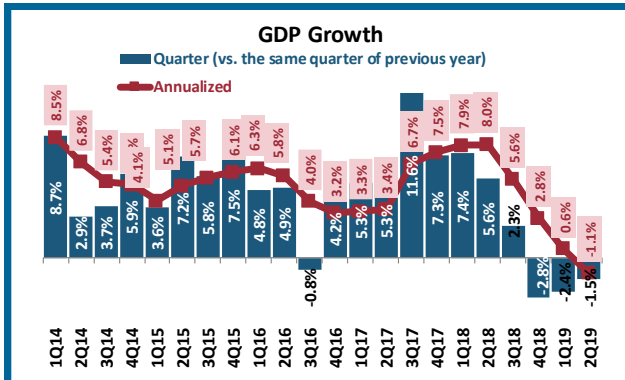


DenizBank Economic Research and Strategy

# DenizBank Economic Update

## Economy (I)

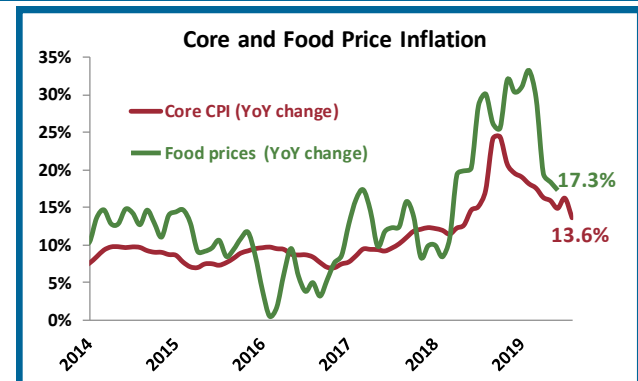
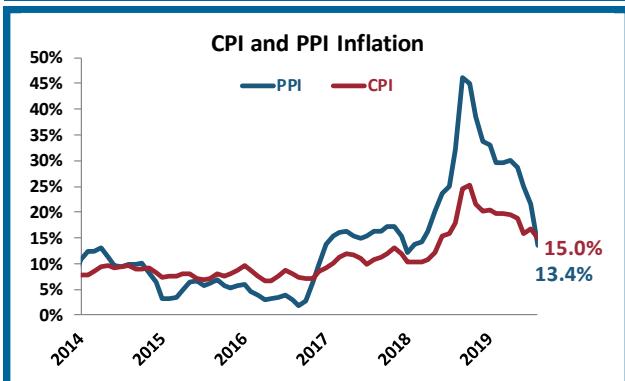
### Growth



### Turkey has recovered from last year's recession, but economy remains stagnant

- In 2Q19 Turkish economy contracted by 1.5% compared to a year ago, less severely than 1Q19 (-2.4%) and outperforming market expectations. On calendar and seasonally adjusted basis, economy grew by 1.2% compared to the previous quarter, avoiding the risks of falling into a second recession.
- While private consumption improves gradually, exports continued to be the main driver of growth. On the other hand, investment spending weakened further in 2Q19, dropping sharply by 23% YoY, which may be the main drag on growth in next quarters. Sectoral breakdown suggest that industrial production continued to decline at a slower pace and services sector contributed positively to annual growth in 2Q19.
- Preliminary data such as PMI (13-months high in August), capacity utilization rate and imports point to further recovery in economic activity in 3Q19. However, weak credit growth and worsening global outlook suggests that the rebound will be slow. Overall, we expect annual growth to turn positive in 2H19 on the back of low base effect and full-year growth rate to be 1%, significantly below its potential. As economy remains stagnant, weak labor market conditions prevail.

### Inflation



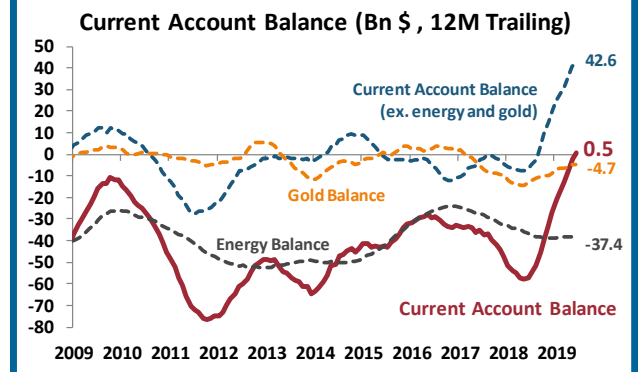
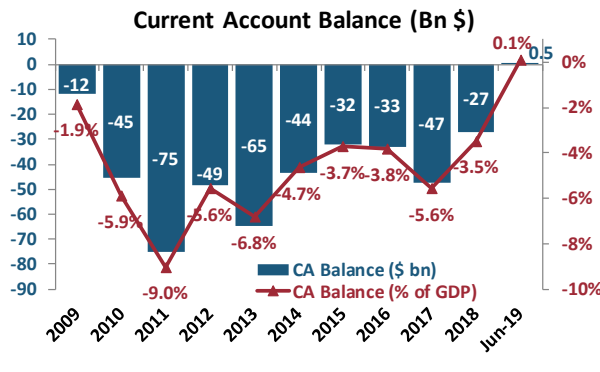
### Inflation retreats to 15-months low supporting Central Bank's pending rate cuts

- Monthly inflation (0.86%) was lower than expectations for the fifth consecutive month in August, bringing annual inflation down to 15% from 16.6% a month ago, lowest in 15-months. While administrative and tax-related price hikes in gas and tobacco were the main drivers of inflation, decline in core inflation (13.6%), was more significant, as core goods inflation was subdued by weak domestic demand.
- Price pressures have weakened significantly in the last few months due to muted domestic demand, normalization in food prices, subdued volatility in TL and decline in commodity prices, while administrative price hikes (termination of tax cuts in durable goods, rise in gas, electricity, and tobacco prices) were the main contributor to inflation in last two months. More importantly, cost-push pressures weakened significantly, as evident in the PPI inflation (13.5%) which fell below headline figure for the first time since 2016.
- As favorable base effect becomes more pronounced, we expect inflation to fall to single digits (9-10%) in September and November, before finishing the year at 12.5%. Improved price dynamics, subsiding inflation expectations and the support from global low interest rate environment provide room for Central Bank (CBRT) to continue its large rate cuts, as long as political risks are avoided and global conditions continue to be supportive. Following the initial 425 bps cut in July, we expect CBRT to deliver further cuts around 400 bps till the end of the year, bringing policy rate below 16%.

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## Economy (II)

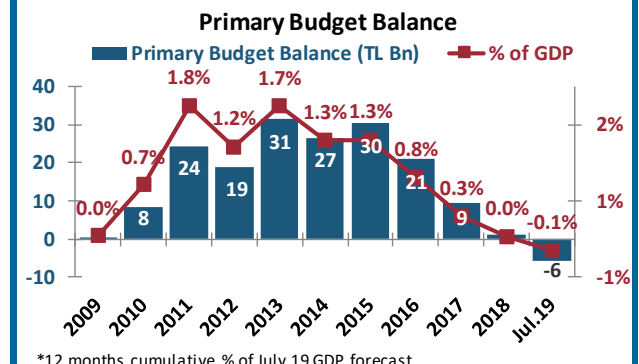
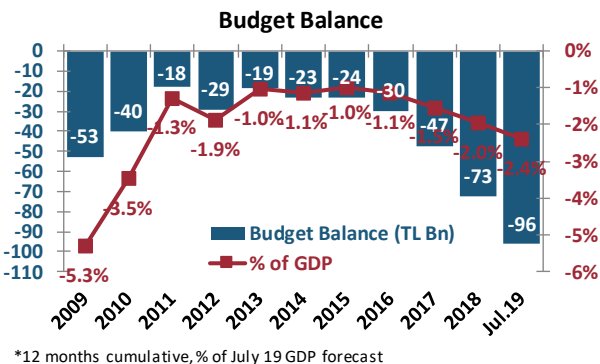
### External Sector



### Current account balance posts annual surplus for the first time since 2002

- Turkey's external balance has improved dramatically in first half of 2019 with significant drop in imports due to weakening domestic demand, stable increase in exports and strong tourism inflows. In line with re-balancing in the economy, imports were down by 20% to \$197 bn annually in June 2019 from \$247 bn a year ago while exports are up by 5% to \$171 bn from \$163 bn. Rising tourism revenues (\$31 bn annually) as number of tourists reach all time high, together with transportation income balance out remaining external trade deficit. As a result, annual current account balance (CAD), which gave \$57 bn (6.5% of GDP) deficit a year ago, turned to surplus (\$0.5 bn, 0.1% of GDP) for the first time since 2002. Excluding energy and gold, current account surplus yielded a record-high surplus of \$43 bn (5.9% of GDP).
- On the financial account side, banks' debt repayments (\$20 bn annually, 12-month cumulative debt rollover: 65%) and deposit outflows were compensated by FDI inflows (\$9 bn), reserve drawdowns (\$4 bn) and net errors/omissions (\$9 bn). Portfolio investments continued to decline (-\$1.4 bn annually).
- In July and August, annual trade deficit decreased further by \$3bn, suggesting current account surplus may have expanded above 2002 levels combined with surging tourism revenues. As economic activity picks up gradually in rest of the year, we expect current account turn back to deficit yet remain low around 1-1.5% of the GDP in 2019.

### Public Sector



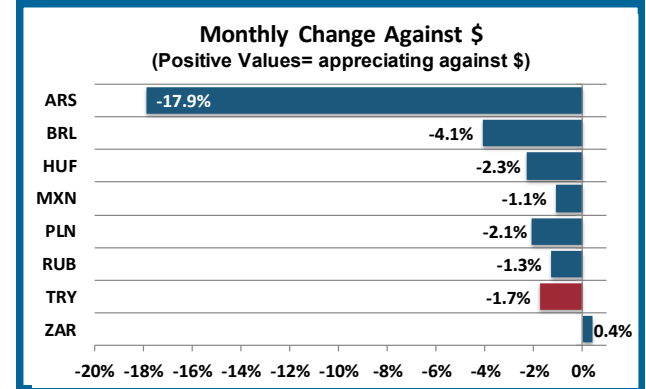
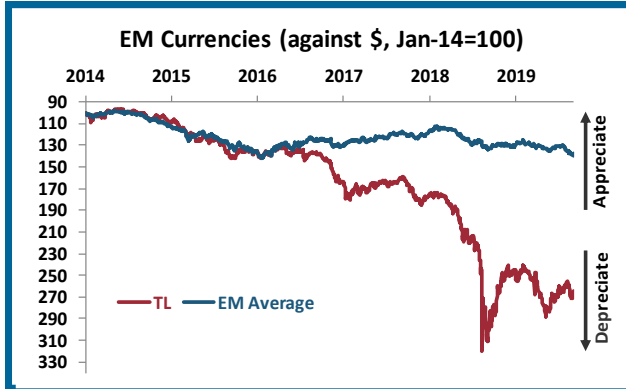
### Budget deficit is rising with very limited pressure on public debt and market liquidity

- As authorities eased the fiscal policy to support economic growth, Turkey's budget deficit increased by 53% in the first seven months of the year, bringing 12 months trailing figure to TL96 bn (2.4% of GDP), above the 2019 target of 1.8% (2018: 2.0%). The exemplary primary balance, also turned to a small deficit of TL 6 bn (0.1% of GDP).
- Besides countercyclical spending and higher interest expenses, significant slowdown in tax revenues in the stagnant economy (indirect tax revenues were down 10% YoY) deteriorated the budget balance. However, weakening tax income was partly compensated by non-tax income which has doubled throughout last year, keeping the budget deficit below international criteria of 3%.
- Going forward, we expect annual budget deficit to remain below 3% with restrained spending and pending revenue support from CBRT, as pledged by Ministry of Treasury and Finance. Moreover, gross government debt, with moderate increase, remains low at c.34%, keeping the sovereign risk low.

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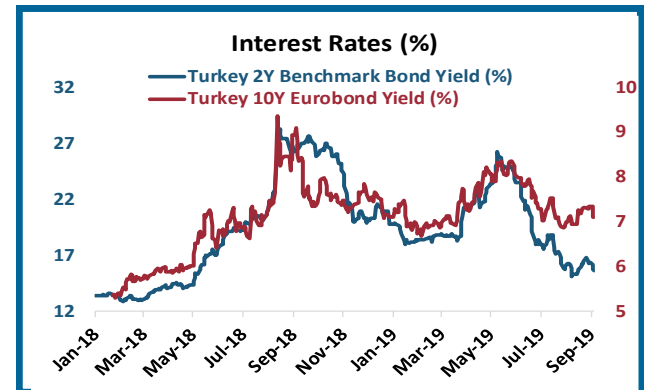
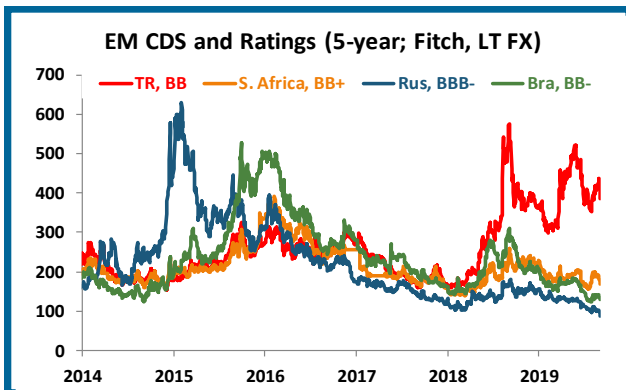
## Financial Markets

### Currency Market



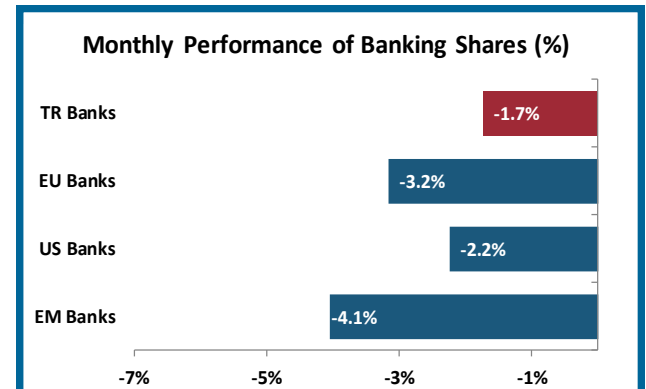
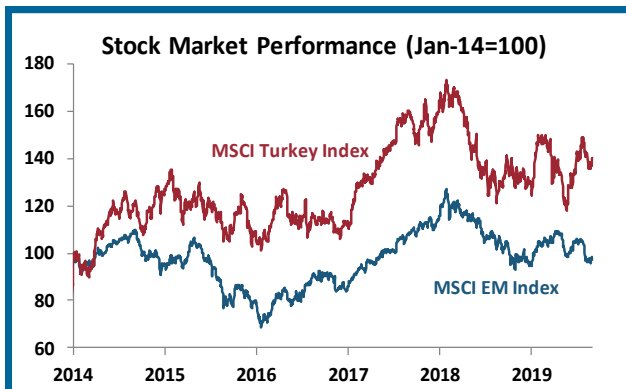
Turkish Lira depreciated by 1.5% since the beginning of August, bringing year-to-date losses to 7%.

### Debt Market



Turkey's CDS rose to 440 bps in August, before recovering below 390 bps in early September. 2-year TL benchmark bond yield decreased by almost 1000 bps since May down to 15.2%, lowest in 15 months.

### Stock Market

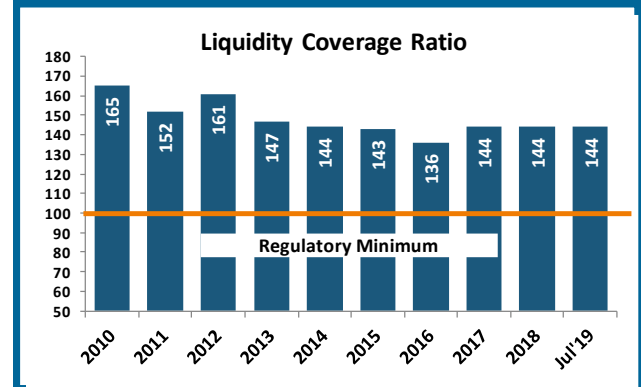
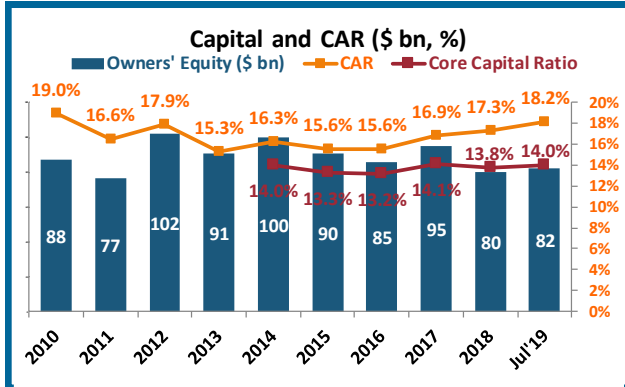


MSCI Turkey index was up 7% since the beginning of the year, overperforming EM peers (MSCI EM index was up 1%)

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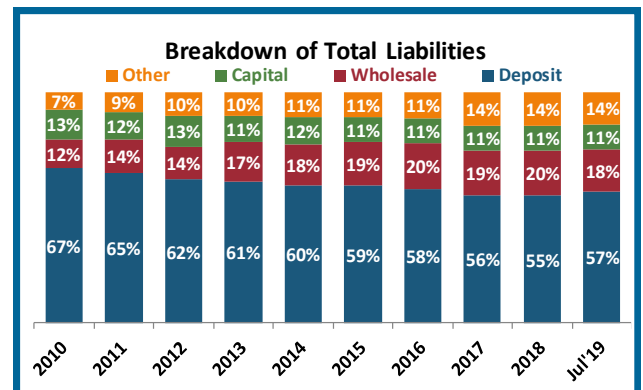
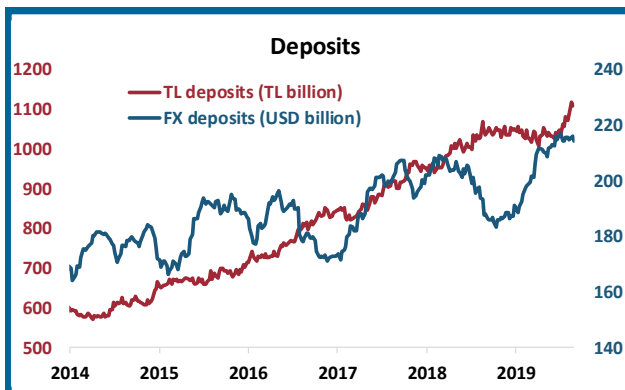
## Banking Sector (I)

### Capital



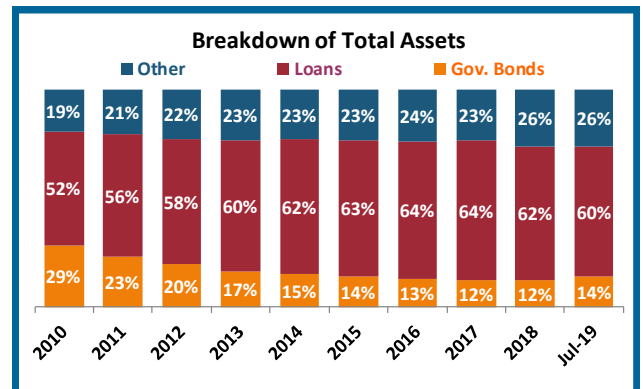
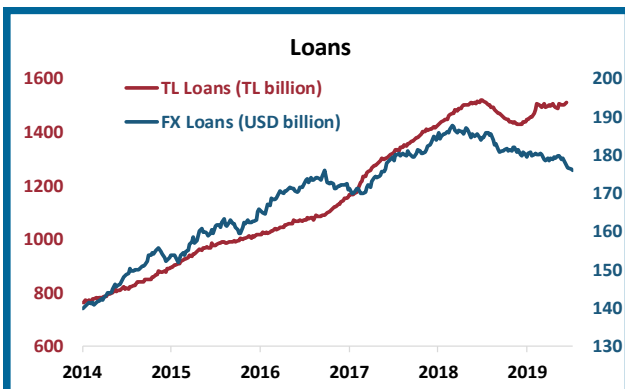
Turkish banking sector has a strong capital base. Capital adequacy ratio rose to 18.2% in July 2019.

### Funding



FX deposits went up by 13.5% since the beginning of 2019 while TL deposits increased only by 6.3%.

### Lending



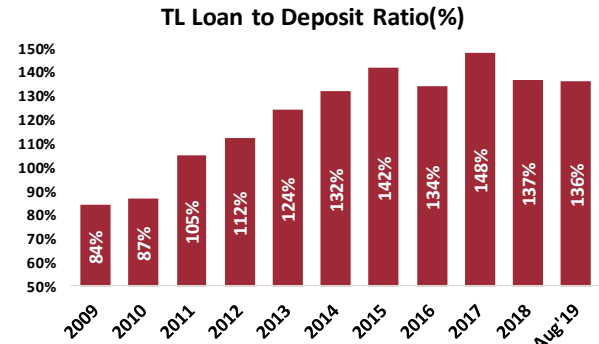
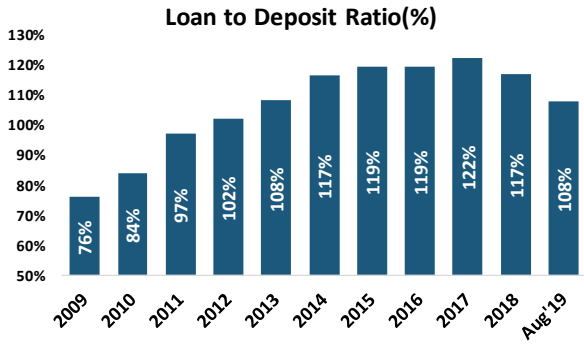
Year-to-date loan growth has been weak at 5% (1.6% net-of-currency effect).



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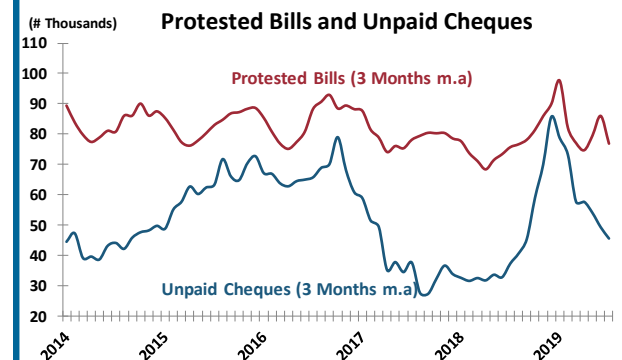
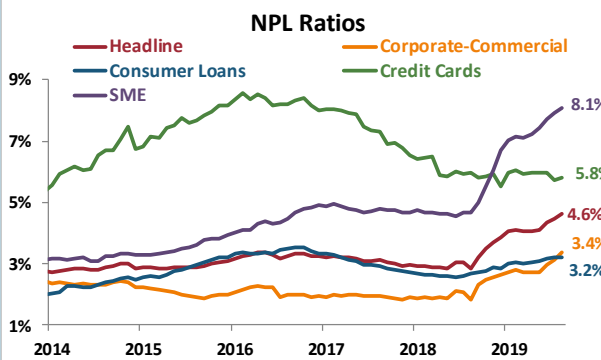
## Banking Sector (II)

### Loan to Deposit Ratios



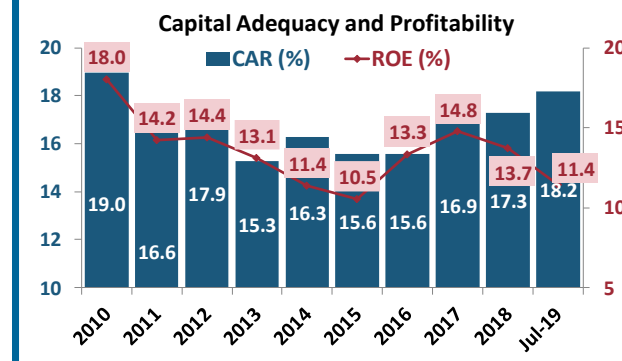
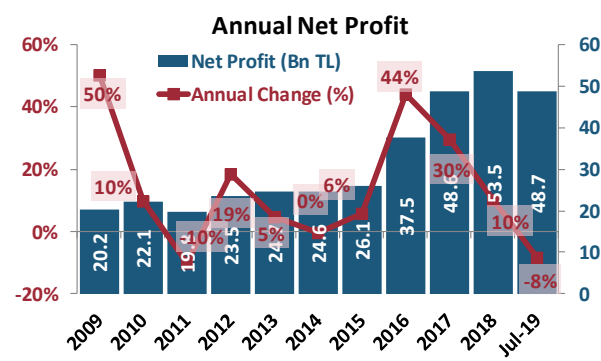
Total loan to deposit ratio (LDR) decreased to 108% while TL LDR remains high.

### Loan Quality



Headline NPL ratio for the banking sector rose to 4.6% by August 2019.

### P & L



Banking sector's annual net profit decreased by 8% YoY to TL 49 bn in July 2019. RoE of the sector decreased to 11.4%.