DenizBank Economic Update

September 2014

- Economy
- Financial Markets
- Banking Sector

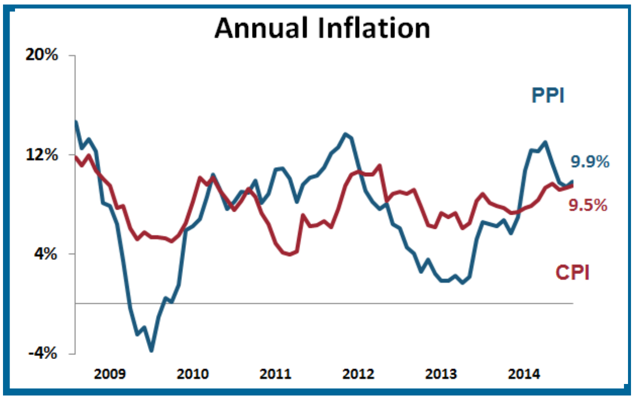
Economic Research and Strategy
Saruhan Özel, Ph.D.
Ercan Ergüzel
Ezgi Gülbaş
Ali Can Duran

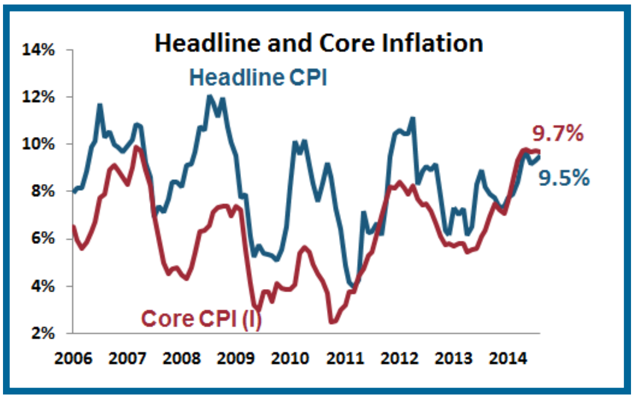
DenizBank Economic Research – (90) 212 272 99 65 or ekonomikarastirmavestrateji@denizbank.com

DenizBank Economic Update

Economy (I)

Inflation





Annual inflation remains well above Central Bank's expectation...

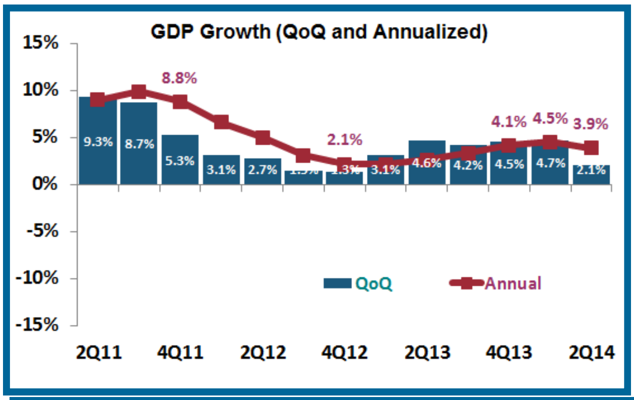
● Inflation came slightly worse than expectations at 0.09% in August driven by the increase in food prices. As a result, annual inflation increased to 9.5% due the base effect, substantially higher than the Central Bank's (CB) 5% (±2%) inflation target.

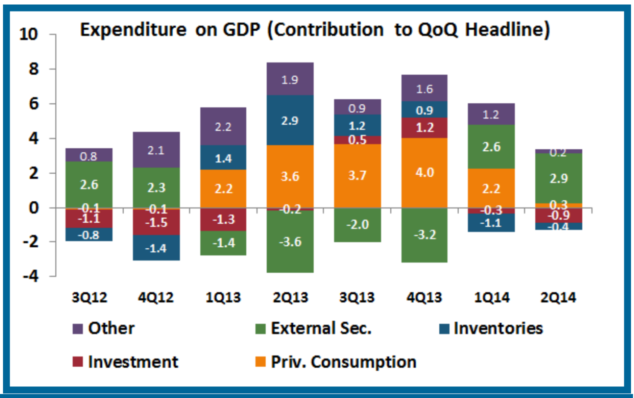
● Decelerating momentum of PPI halted, indicating cost-side inflationary pressures in coming months. In addition, annual food inflation, which rose to 14.8%, due to drought and geopolitical tensions remains to be a risk factor on the inflation outlook.

● We expect recently announced natural gas and electricity price hikes to limit the positive impact of subdued domestic demand and favorable base effects on inflation in the coming term. Taking into account the effect of recent electricity and natural gas price hikes, we revise our year end expectations to 9.2%.

● As upward pressures in inflation outlook is elevated and global risk taking behavior is limited, we expect CB to keep its hawkish stance and avoid further rate cuts in the coming months.

Growth





Weaker than expected growth in the 2nd quarter of 2014

● GDP growth came at 2.1% in 2Q14, worse than the market expectation of 2.7%. Annual GDP growth decelerated to 3.9% in 2Q14 from 4.5% in 1Q14. In addition, seasonally adjusted GDP contracted 0.5% compared to 1Q14.

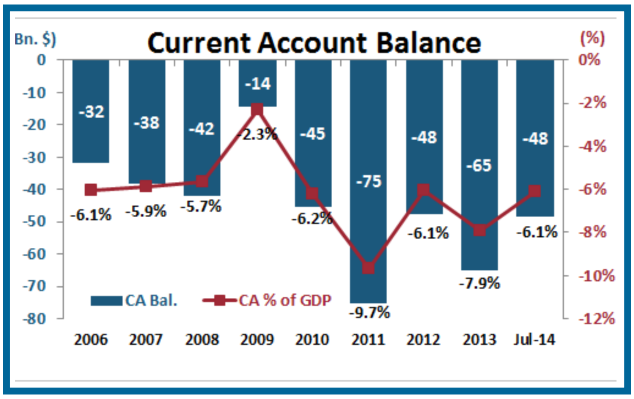
● In 1Q14, weak domestic demand was the main source of the deceleration in GDP growth, while exports contributed positively to the growth (2.9 pps). Contribution of public sector's investment and consumption to the growth declined following the local elections (0.3 pps).

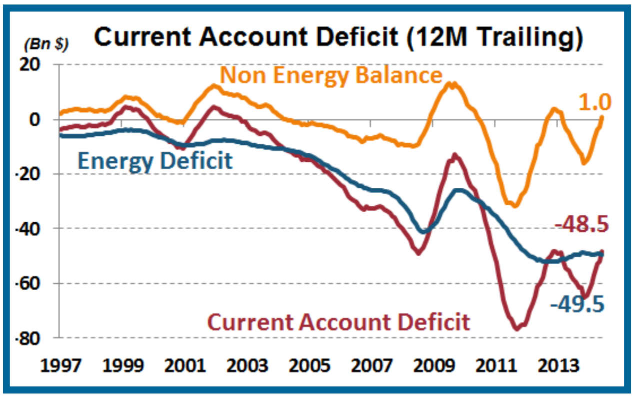
● We expect economic growth to further slow down in the second half of the year with the impact of rising interest rates, increasing geopolitical risks and decelerating retail lending on the back of tighter regulations. Our 2014 year-end GDP growth expectation stands at 3.0%.

DenizBank Economic Update

Economy (II)

External Sector





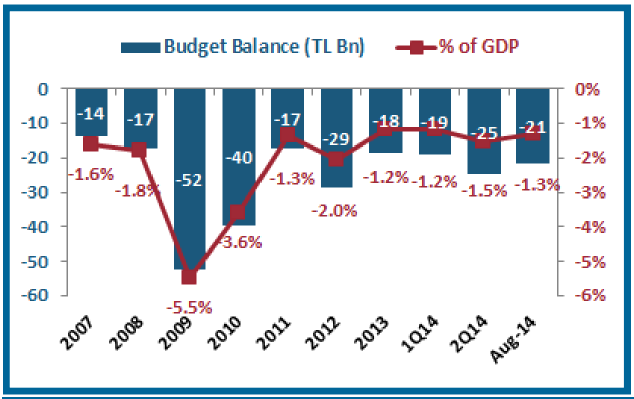
Current account continues narrowing in July.

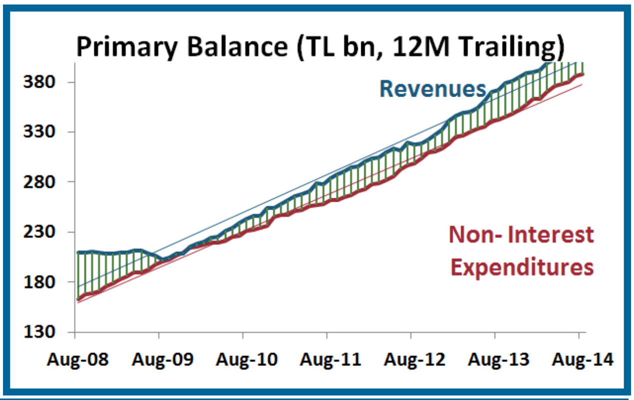
● Current account deficit came at $2.6 bn in July, below the consensus expectation of $2.8 bn. 12 month cumulative current account deficit narrowed down from $65 bn (7.9% of GDP) in 2013 to $48.5 bn (6.1% of GDP). We expect further contraction to be modest in the remainder of the year due to the elevated risks in export markets and current account deficit to be 5.8% of GDP at the year-end.

● On the financing side, short-term capital flows lost pace in July compared to the prior month. Inflows to the fixed income and stock markets were $942 bn and $661 mn, respectively.

● Banks and Turkish corporates do not have any difficulty in rolling over their long-term debt. The long-term debt rollover ratios (12M trailing) for corporates was stable at 116% while rollover ratios stayed high at 217% for banks.

Public Sector





Budget discipline maintained, year-end targets is likely to be achieved.

● The central government budget posted deficit of TL2.7 bn in January-August period of 2014, while primary surplus reached to TL30.9 bn. Both YTD budget deficit and primary surplus figures are worse than the previous year due to the moderate growth in tax revenues, but they are compatible with year-end targets.

● In Jan-Aug14 period, increase in non-tax revenues was strong (up YoY by 16%) driven by one-off privatization revenues and new items classified under other revenues. On the other hand, YTD tax revenues are relatively weak (up YoY by 8%) due to moderating domestic demand. Overall, total revenues balanced the deterioration on the expenditure side which is up YoY by 10% with rising non-interest expenditures.

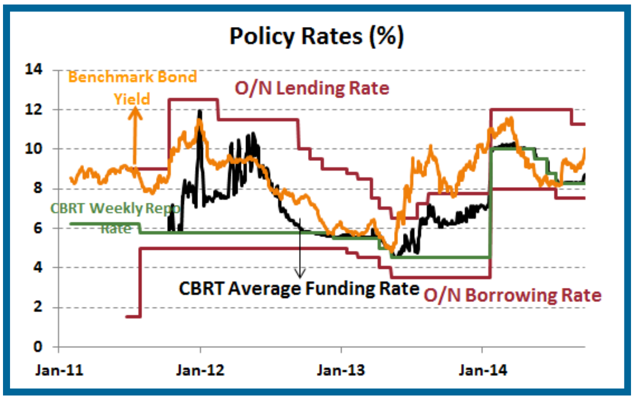
● Authorities, taking into account slower economic growth and election cycle, targeted more relaxed / realistic figures this year. We expect disciplined budget performance will continue to be a good hedge to Turkey's external deficit and rating outlook.

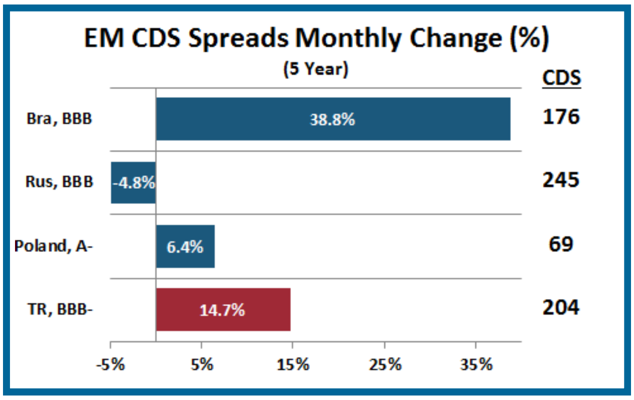
September 2014

DenizBank Economic Update

Financial Markets

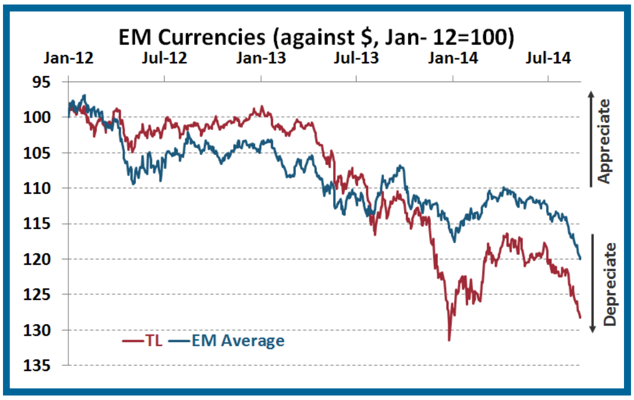
Debt Market

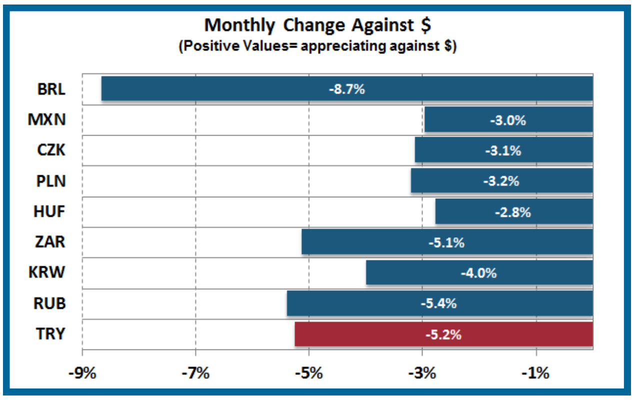




Central bank has paused on easing cycle and started to control average funding cost via covered monetary tightening thanks to the interest rate corridor. On the other hand benchmark bond yield has jumped to 10% in line with sales in other EMs.

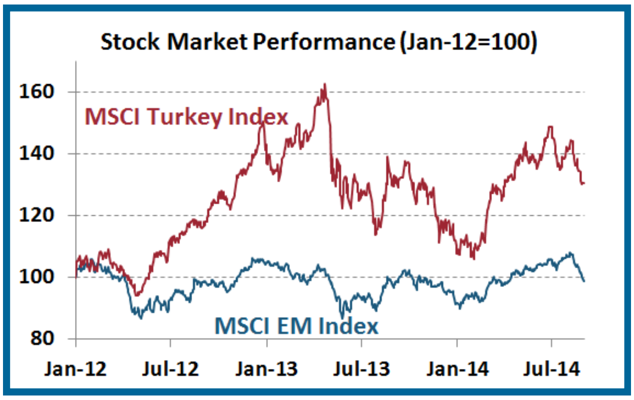
Currency Market

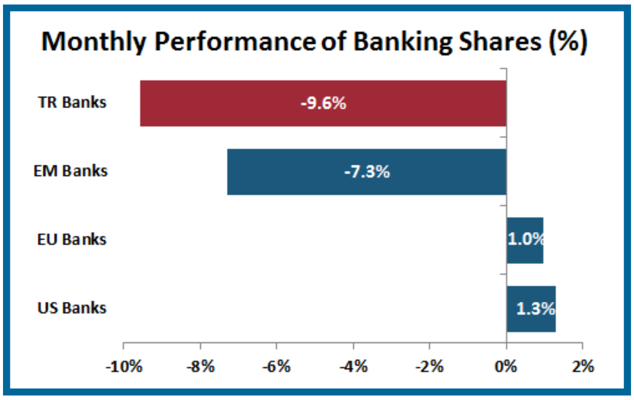




TL has depreciated more than 5%, being slightly above benchmark EM currencies average.

Stock Market





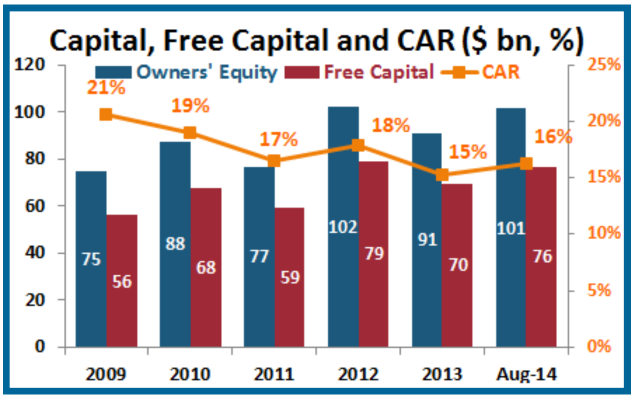
In line with risk-off mode in financial markets, stock market indices are trending down. Negative performance of Borsa Istanbul was more pronounced in September.

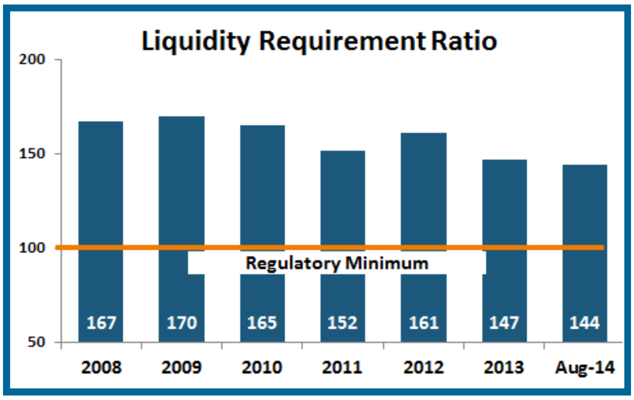
September 2014

DenizBank Economic Update

Banking Sector (I)

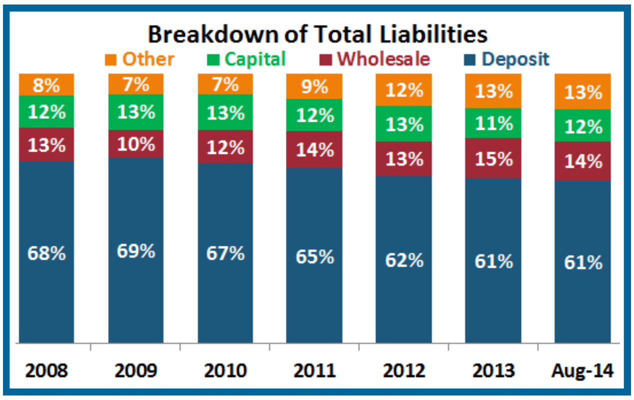
Capital

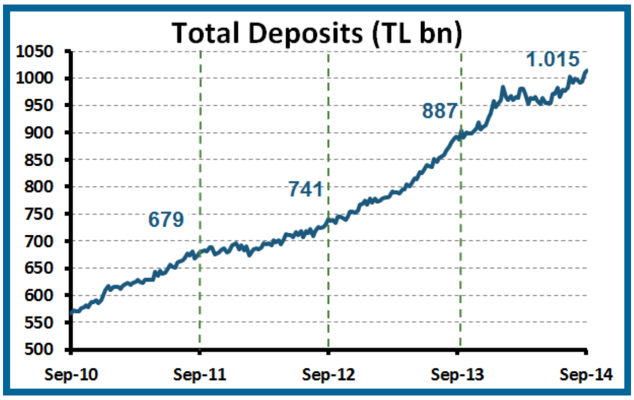




Despite declining profitability, banks are able to keep their CAR ratio at around 16%, mainly due to slower loan growth.

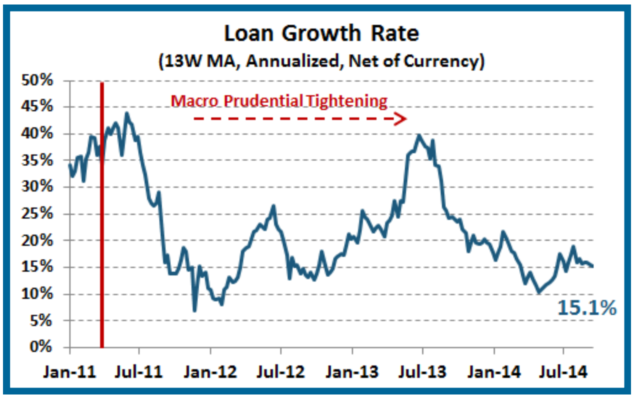
Funding

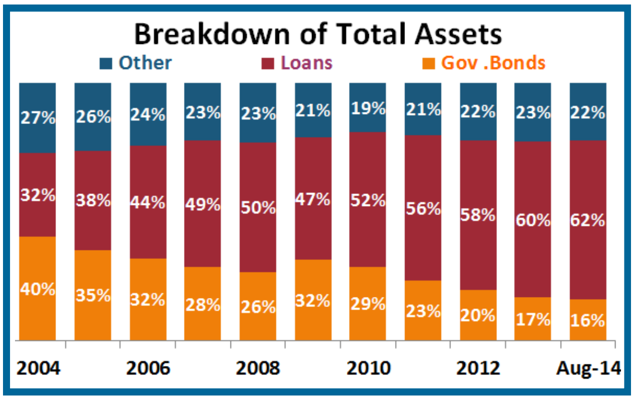




Composition of liabilities is roughly stable since year to date...

Lending



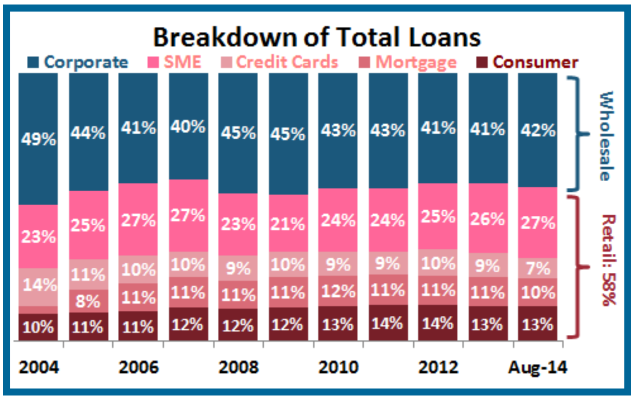


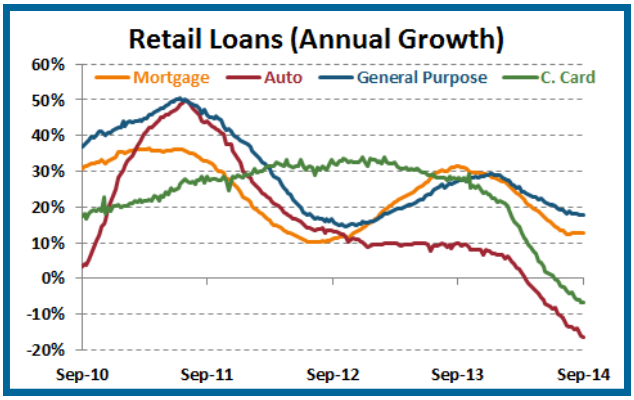
Annualized loan growth is 15%, which is in line with Central Bank's long term targets...

DenizBank Economic Update

Banking Sector (II)

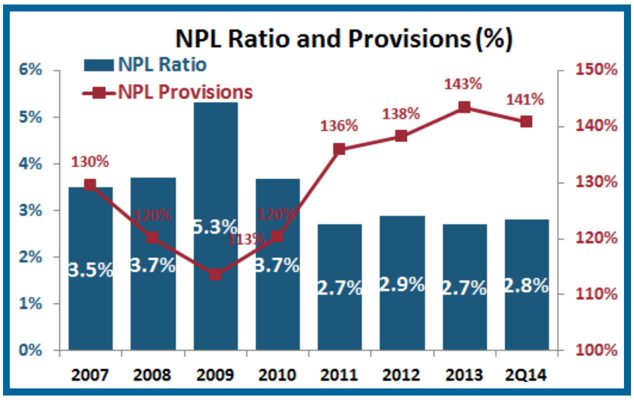
Loan Breakdown

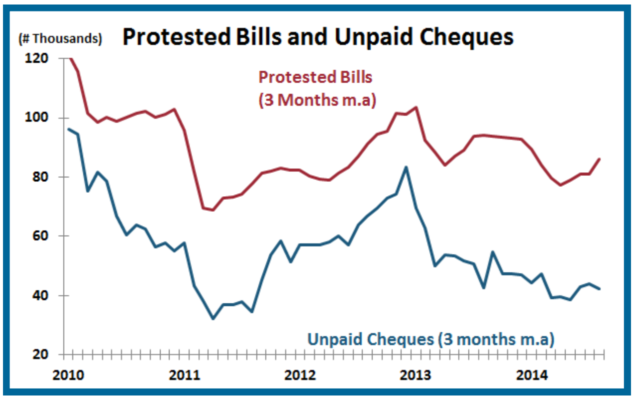




The deceleration in retail loans is more visible due to the macro-prudential measures taken by the authorities (both Central Bank and the BRSA)

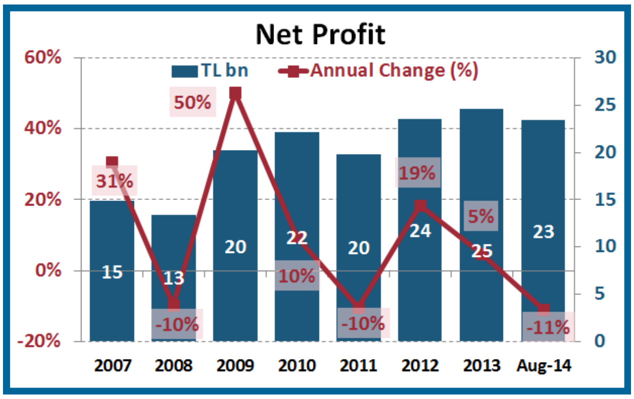
Loan Quality

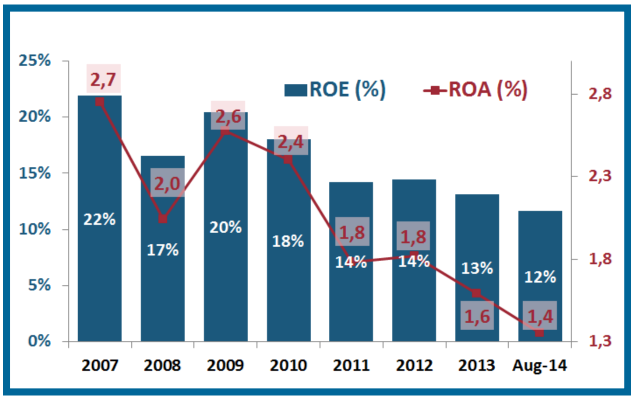




Stable NPL ratio at 2.8% is showing that there is no deterioration in the asset quality during the recent slowdown in loans…

P & L





Yet, profitability of the Sector is declining gradually mainly due to lower lending volumes and declining NIMs...