

DenizBank Economic Update

August 2014

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

Economic Research and Strategy

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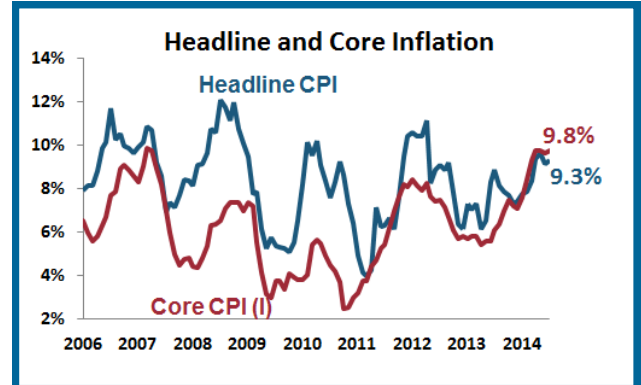
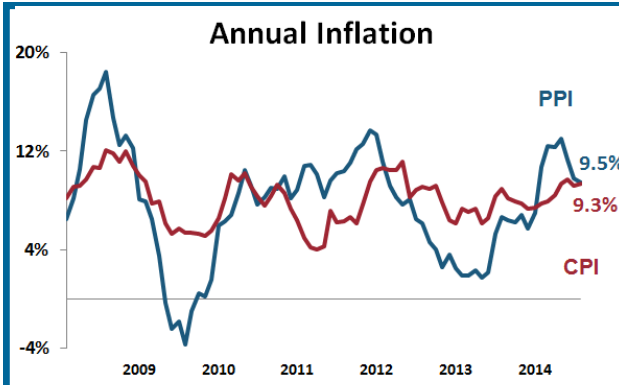
Ali Can Duran



DenizBank Economic Update

Economy (I)

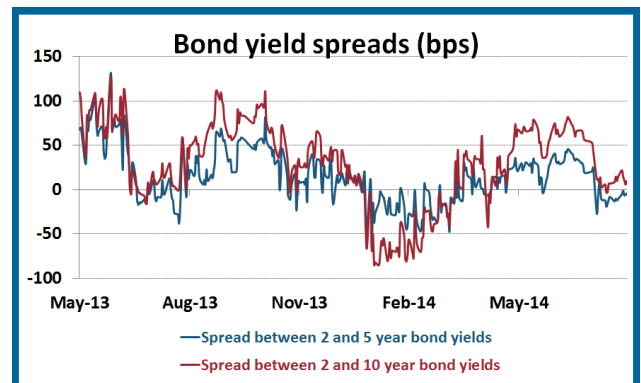
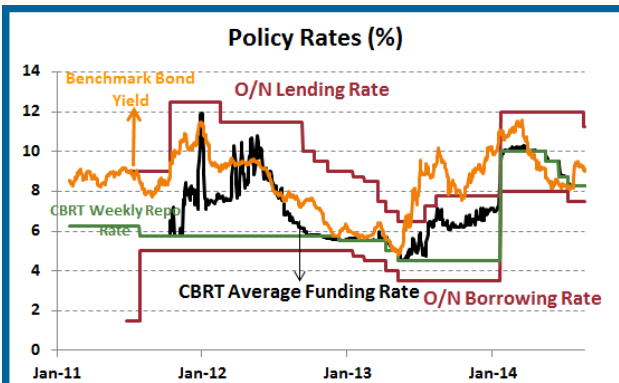
Inflation



Annual inflation surprised on the upside in July, price pressures was broad-based...

- Inflation came above expectations at 0.4% in July driven not only by food prices but also generalized across all categories with the exception of seasonal decrease in clothing prices. As a result, annual inflation stayed above 9%, markedly higher than the Central Bank's (CB) 5% ($\pm 2\%$) inflation target.
- Although decelerating momentum of PPI signal that inflationary pressures will relatively decrease in coming months, high food inflation due to drought and geopolitical tensions pose risk on the inflation outlook.
- We expect a gradual deceleration in the remaining months of the year on the back of stable currency, subdued domestic demand and favorable base effects. Our year end expectations stays at 8.8%.
- The CB has recently started to emphasize upward pressures in inflation outlook, emanating mainly from higher food prices. The trend in food inflation (currently 12.6%), it seems, will have a pivotal effect in terms future trajectory.

Monetary Policy



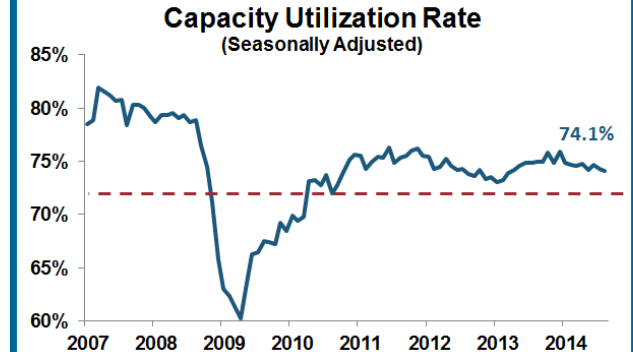
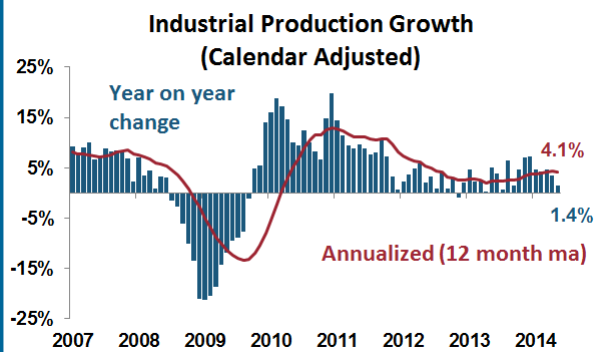
Central Bank (CB) concerned with inflationary outlook did not change policy rate...

- In its most recent MPC meeting as of 27th of August, the Central Bank of Turkey (CBRT) kept the main policy rate (i.e. one week repo rate) stable at 8.25% by stating higher than anticipated inflation.
- On the other hand, thanks mainly to normalization in global financial markets, it decreased the upper band of the interest rate, so-called O/N funding rate, by 75 bps to 11.25%, yet it has no main policy impact as it is not regularly used in current monetary policy.
- Further measured cuts in the policy rate (one week repo rate) will depend upon inflation trajectory (mainly in food items), inflation expectations and global risk mode.
- We expect to see two more 25 bps cuts until the year end, bringing down the policy rate to 7.75%.

DenizBank Economic Update

Economy (II)

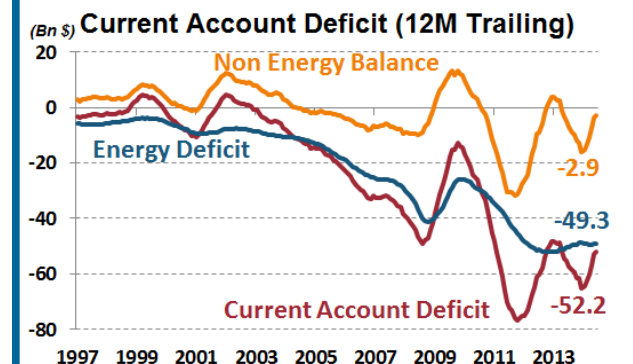
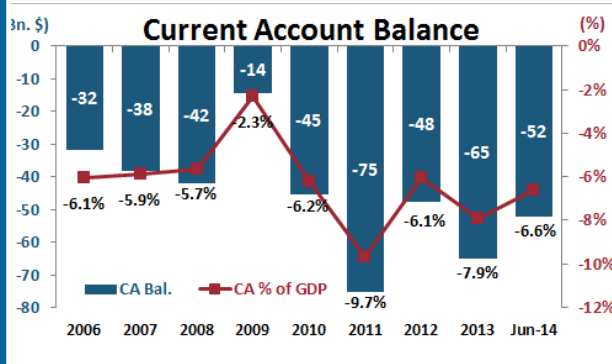
Growth



Slowdown in manufacturing activity is more visible.

- The calendar adjusted industrial production index (IP) increased YoY by 1.4% in June below the market consensus of 2.5%. Seasonally adjusted IP index was almost flat (0.1%) compared to the previous month.
- Annualized increase in manufacturing activity declined back to 4.1% in June, while slow-down in yearly IP growth rates became more visible.
- Leading indicators such as PMI manufacturing index declined further to 48.5 in July and reached its lowest level since April 2009. This indicates a slowdown in the growth rate of economic activity may be more marked in the second half of this year.
- We expect 2014 GDP growth to be at 3.0%, compared to 4.0% in the previous year.

External Sector



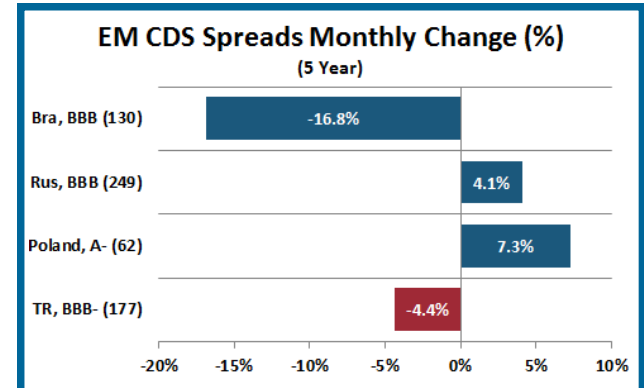
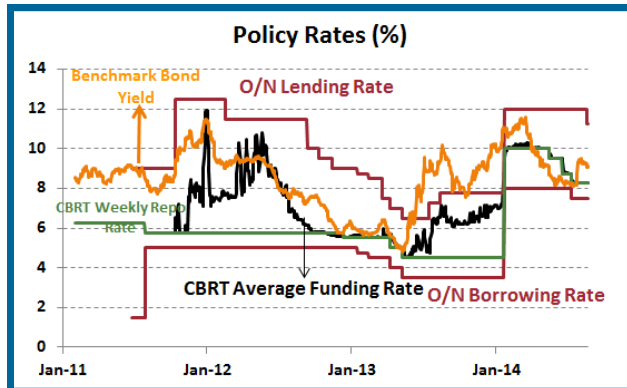
Current account continues narrowing in June.

- Current account deficit came at \$4.1 bn in June, surpassing the consensus expectation of \$3.7 bn. 12 month cumulative current account deficit narrowed down from \$65 bn (7.9% of GDP) in 2013 to \$52 bn (6.6% of GDP)
- Short-term capital flows was strong in June. While fixed income market attracted strong flow of \$3.3bn, outflow from stock market was limited to \$153 mn.
- Banks and Turkish corporates do not have any difficulty in rolling over their long-term debt. The long-term debt rollover ratios (12M trailing) rose to 117% for corporates while stayed high at 226% for banks.
- We expect current account deficit to ease further to 5.8% of GDP this year driven by the slowdown in imports with weaker domestic and recovery in exports.

DenizBank Economic Update

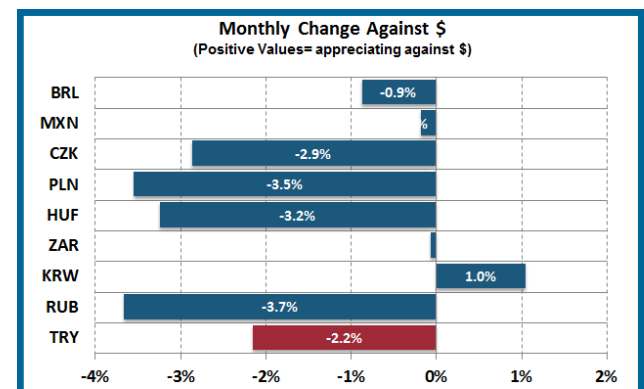
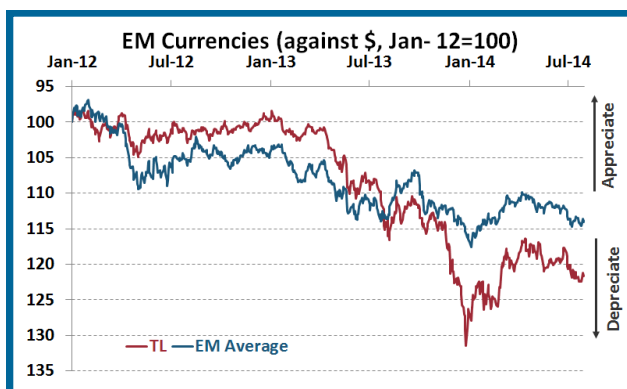
Financial Markets

Debt Market



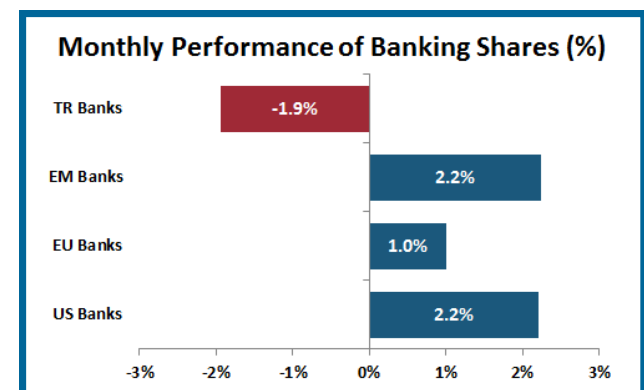
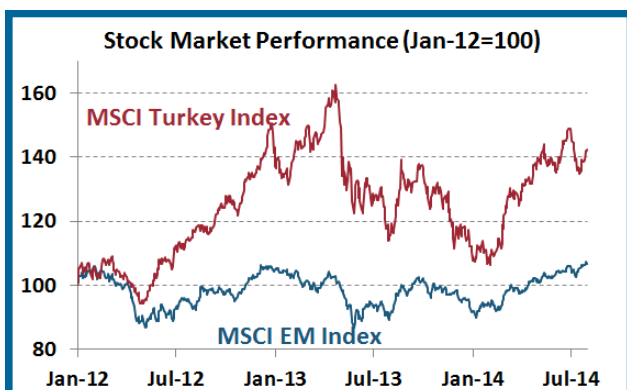
Though the CB has ended its easing cycle, the benchmark gov. bond yield (2 year) is down to 9.01% on the back of declining political uncertainty in Turkey and falling interest rates all over the world.

Currency Market



Being in line with other EM currencies, the TL was down by more than 2% against the Dollar in August. Yet, it was flat against the basket of the EUR and the USD (50% and 50%)

Stock Market

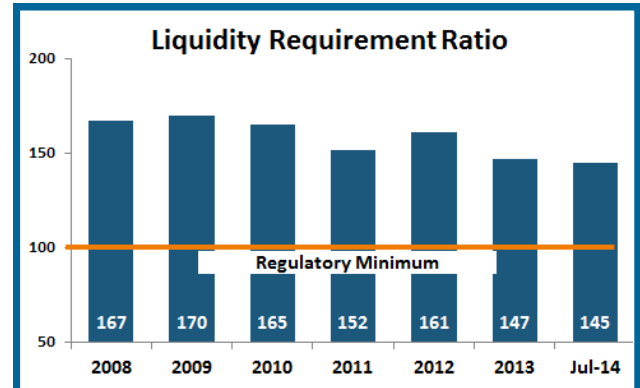
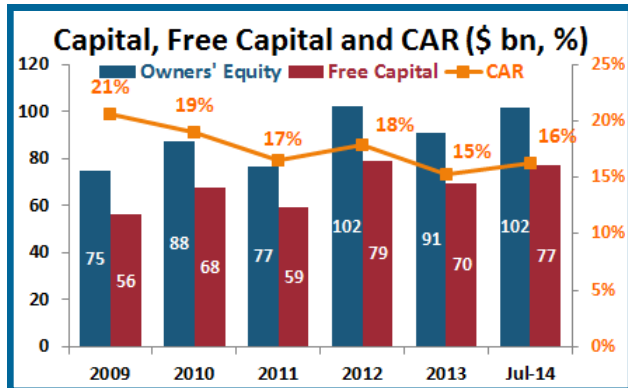


Despite a better performance after the election, BIST underperformed its EM peers.

DenizBank Economic Update

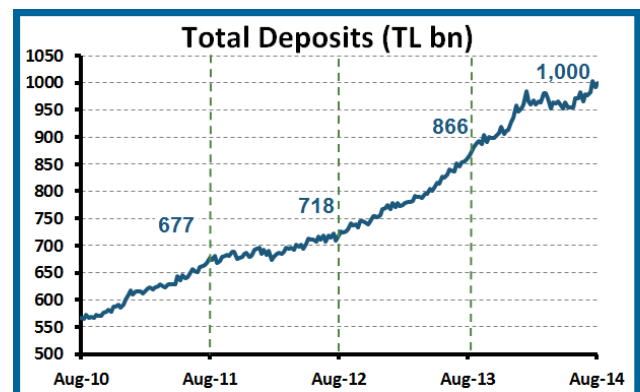
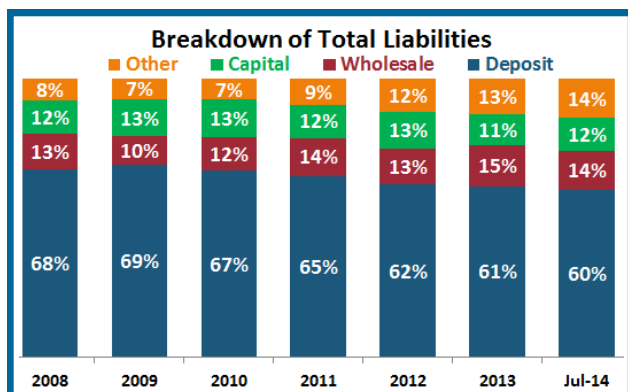
Banking Sector (I)

Capital



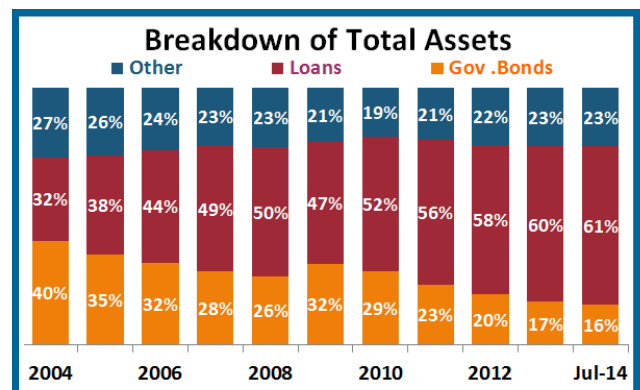
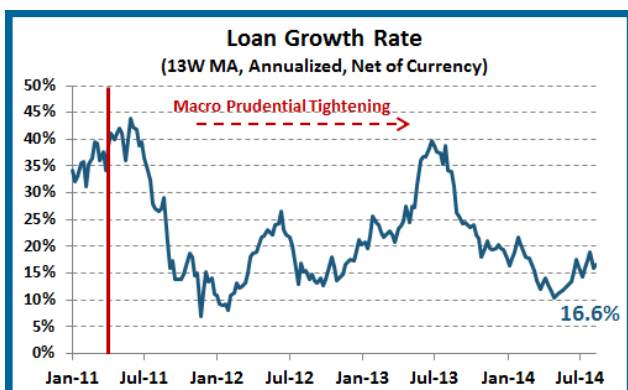
The sector's capital adequacy ratio (CAR) is well above both target of 12% and legal requirement of 8%, while liquidity indicators are well above regulatory thresholds.

Funding



Loan to deposit ratio is stable at around 113%, mainly due to slower loan growth on the back of macro-prudential measures.

Lending

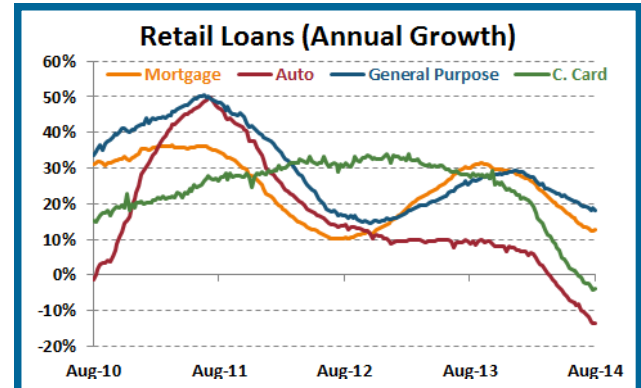
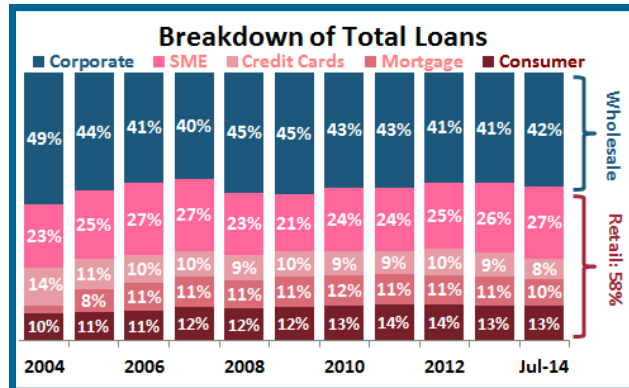


Loan growth rate increased slightly above 15% target growth rate of the CBRT, while retail loan growth rate has been hovering around 15%.

DenizBank Economic Update

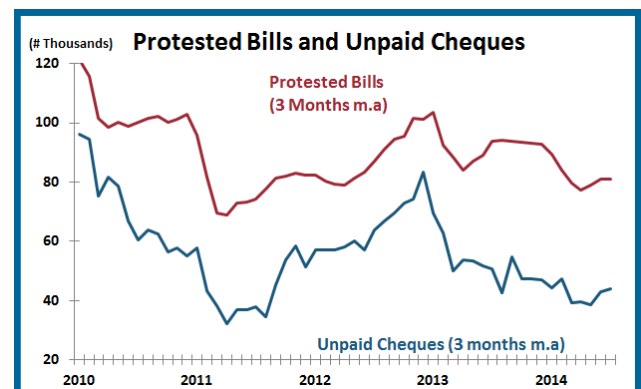
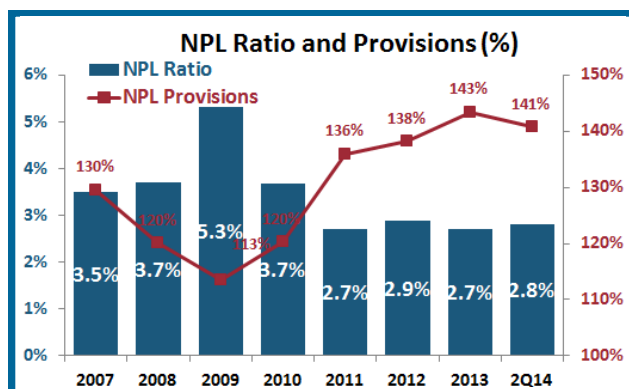
Banking Sector (II)

Loan Breakdown



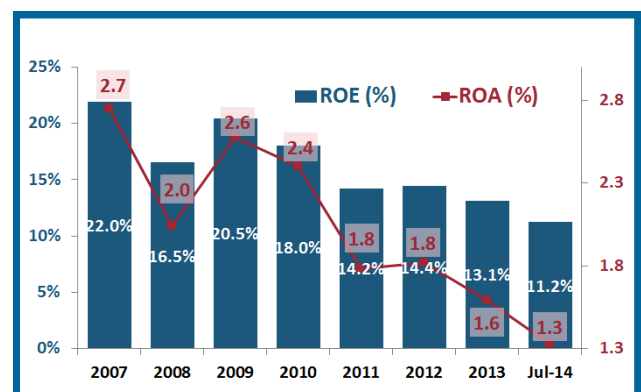
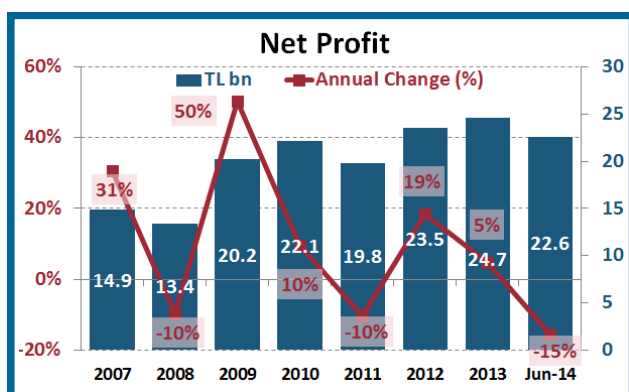
The drops in retail loan growth have recently slowed down due to lower loan interest rates.

Loan Quality



NPL ratio is stable at 2.8%. In addition, protested bills and unpaid cheques don't signal a deterioration on outlook for the months ahead.

P & L



Profitability is falling due to decreasing margins and lower volumes. At the end of 2014, we expect to see c. 12% ROE figures compared to 13.1% of the previous year.