

DenizBank Economic Update

July 2014

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

Economic Research and Strategy

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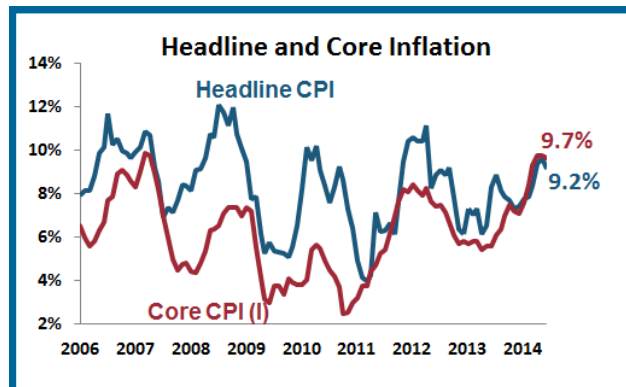
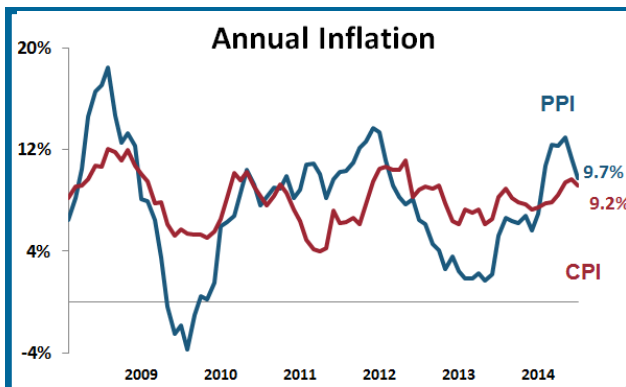
DenizBank 

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DenizBank Economic Update

Economy (I)

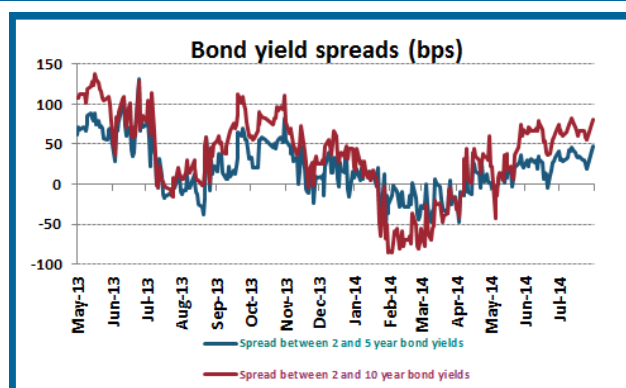
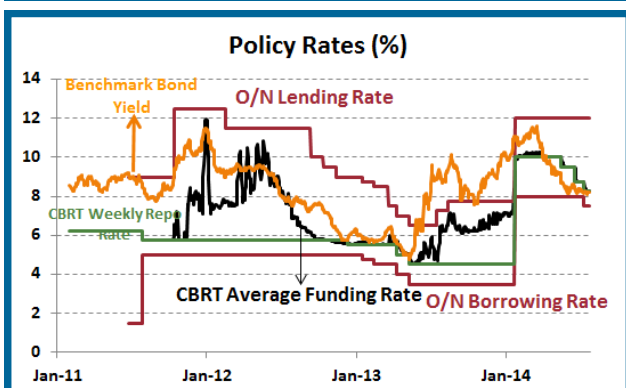
Inflation



Annual inflation declined slightly in June, yet still much higher than the targets...

- Inflation came above expectations at 0.3% driven by high food and transportation prices. After reaching its peak of 9.7% in May, annual inflation declined to 9.2% in June.
- Although decelerating momentum in core inflation and declining PPI signal that inflationary pressures will relatively decrease in coming months, high food inflation and geopolitical tensions' impact on energy prices poses risk on the inflation outlook in the longer term.
- We expect a gradual deceleration in the second half on the back of stronger/stable currency, subdued domestic demand conditions and favorable base effects. We expect inflation to come down to 8.2% at the year-end.
- Central Bank of Turkey (CB) has more optimistic inflation outlook. Based on 9% annual food inflation assumption, it kept its year end expectation at 7.6% in its latest July Inflation Report. The trend in food inflation (currently 12.5%) will have a pivotal effect in terms future trajectory.

Monetary Policy



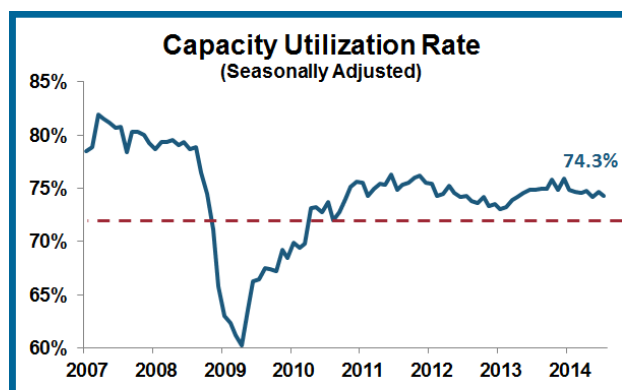
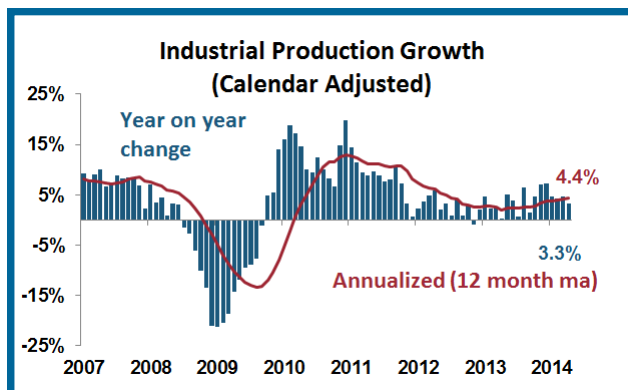
Central Bank (CB) cut policy rate further while keeping its hawkish rhetoric...

- The CB cut one-week repo (policy) and O/N borrowing rates by 50 bps to 8.25% and 7.50%, respectively; while keeping O/N lending rates unchanged at 12%.
- As highlighted in previous meeting notes, the CB reiterated that the monetary policy should remain tight until the inflation outlook improves. The CB is using flat or almost flat yield curve is an indicator of tight monetary policy.
- CB remains cautious about inflation outlook and emphasizes that high food prices limit the drop in inflation.
- The possibility of further easing(s) will be mostly dependent on global risk appetite, in our view. Barring any negative event, the CB would continue to cut the policy rate. We expect policy rate to be 7.5% by the year-end.

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Economy (II)

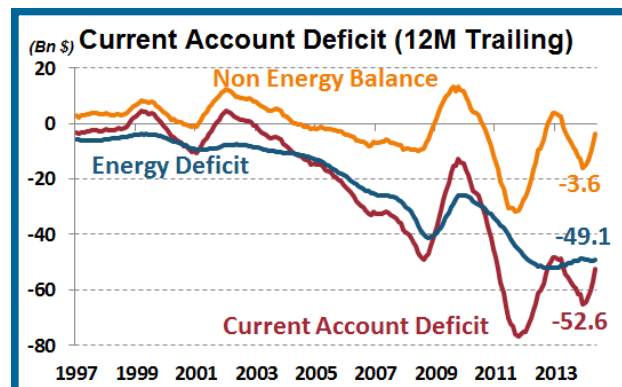
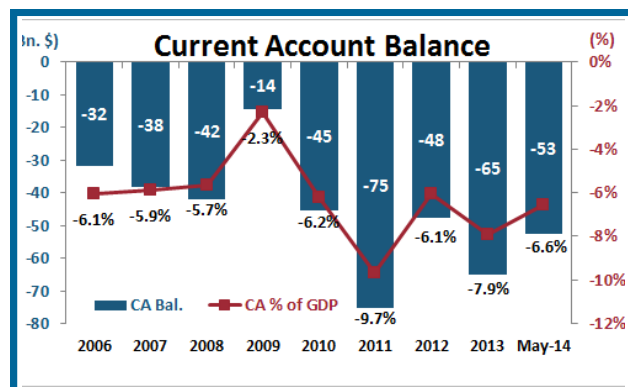
Growth



Slowdown in manufacturing activity is smoother than expected.

- The calendar adjusted industrial production index (IP) increased YoY by 3.3% in May below the market consensus of 4%. Seasonally adjusted IP index also 1% lower compared to the previous month.
- Although annualized increase in manufacturing activity reached to 4.4% in May, yearly IP growth rates has started to slow down in May. In addition PMI figures (48.8) for June, which reached to its lowest level since 2011 indicates a slowdown in the growth rate of economic activity in the coming months.
- Although GDP growth will be moderating compared to the previous year in 2014, based on the 1st quarter data and preliminary growth indicators in the 2nd quarter, we expect it to be 3% for the whole year.

External Sector



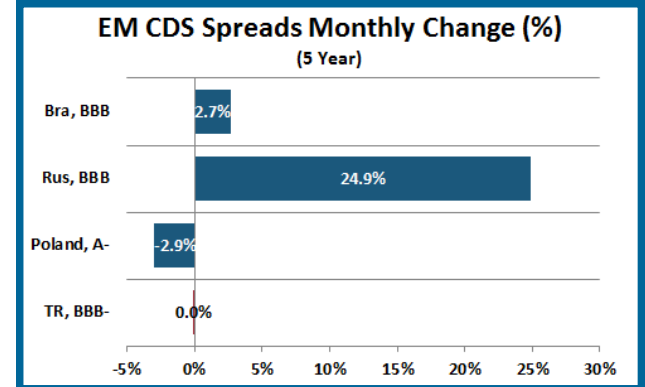
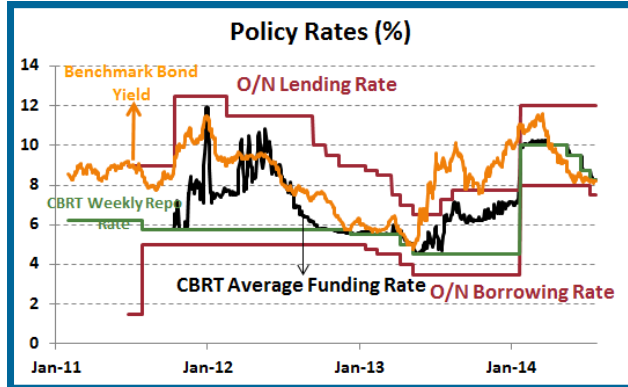
Current account continues narrowing in April.

- Current account deficit came at \$3.4 bn in May, lower than the consensus expectation of \$4.0 bn. 12 month cumulative current account deficit narrowed down from \$65 bn (7.9% of GDP) in 2013 to \$53 bn (6.6% of GDP)
- Short-term capital flows was strong in May. While inflow to stock market was \$624 mn, fixed income market attracted \$1.3bn following another strong inflow of \$4.6 bn in the previous month.
- 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 115% for corporates while stayed high at 244% 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 demand and recovery in exports thanks to recovering EU in addition to the weaker currency.

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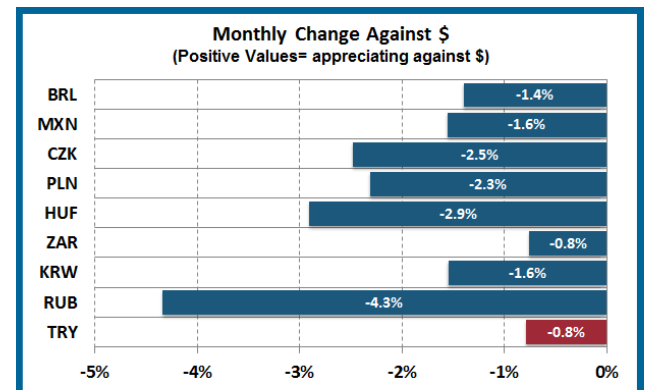
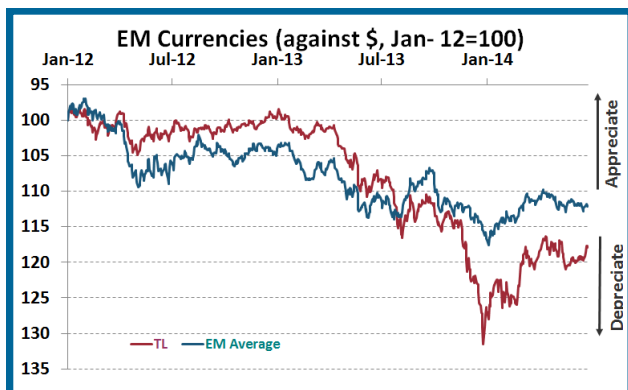
Financial Markets

Debt Market



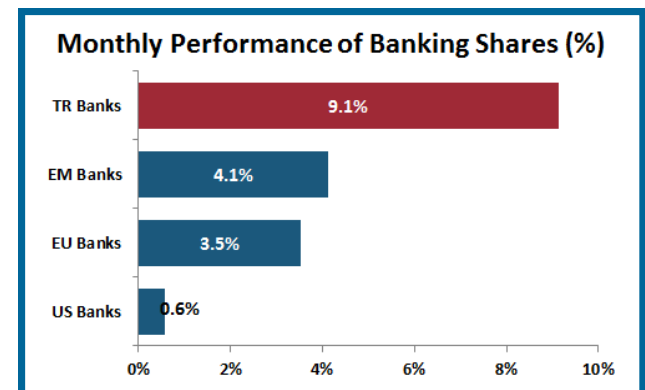
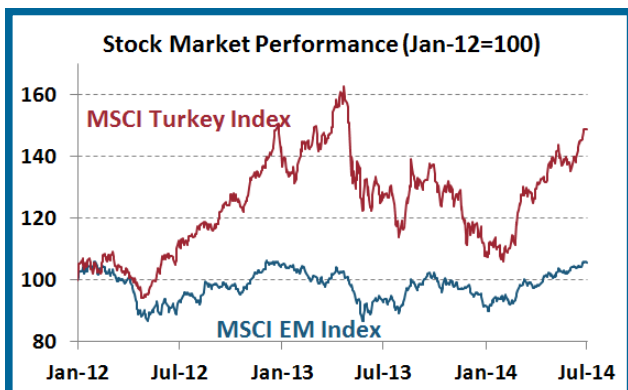
Despite the 50bps policy rate cut by the CB, benchmark bond yield increased slightly 8.19% on the back of global geopolitical problems in Ukraine and in Iraq...

Currency Market



Despite the volatility in currency markets, the TL was relatively stable thanks to the CB's flexible monetary policy.

Stock Market

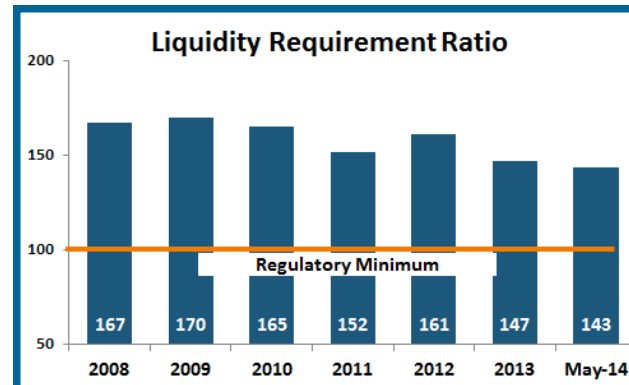
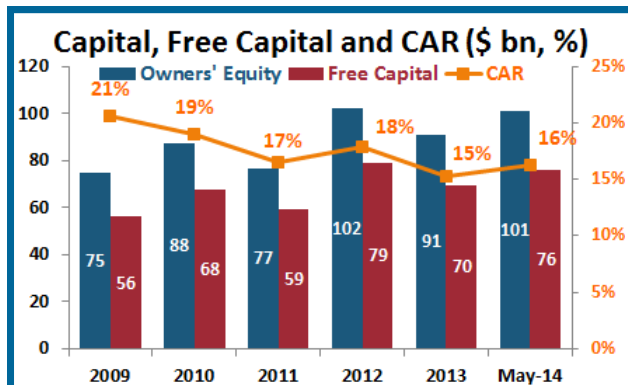


TR Banks outperformed EM peers in July, mainly due to the policy rate cut expectations in June and better second quarter earnings expectations than the first quarter.

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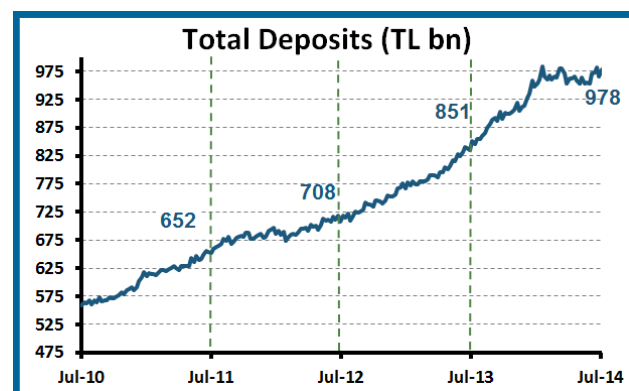
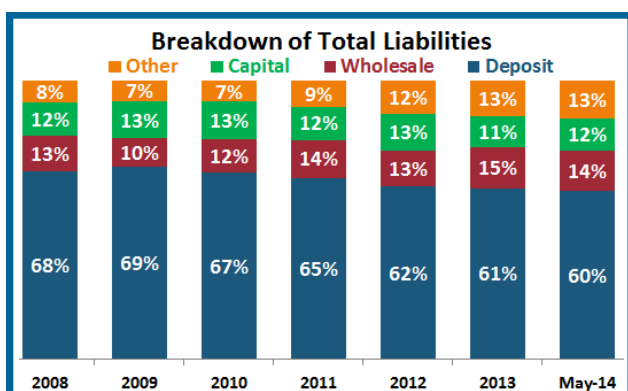
Banking Sector (I)

Capital



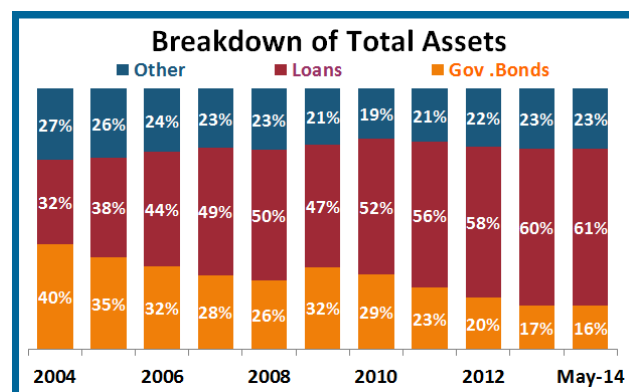
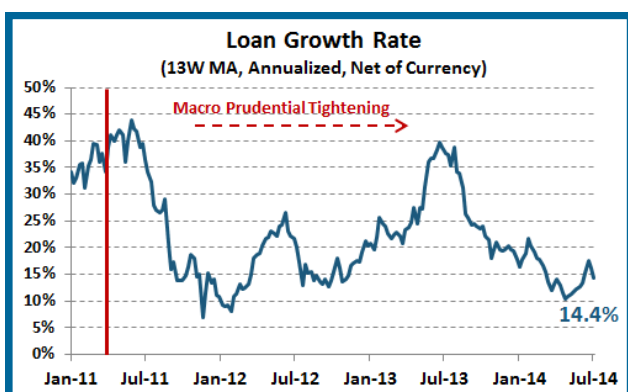
The sector's capital adequacy ratio (CAR) is well above both target of 12% and legal requirement of 8%, while liquidity indicators are well above regulatory thresholds.

Funding



Due to the slowdown in deposit growth, loan to deposit ratio increased to 113%.

Lending

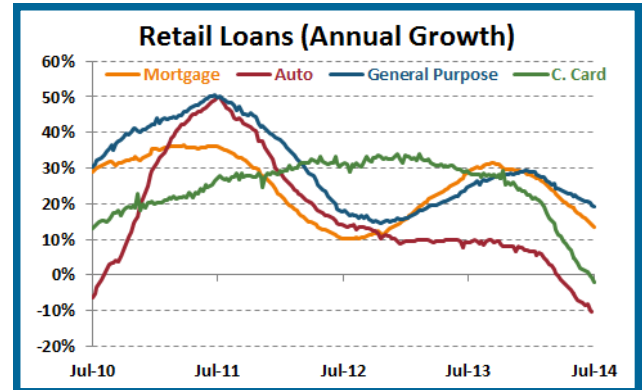
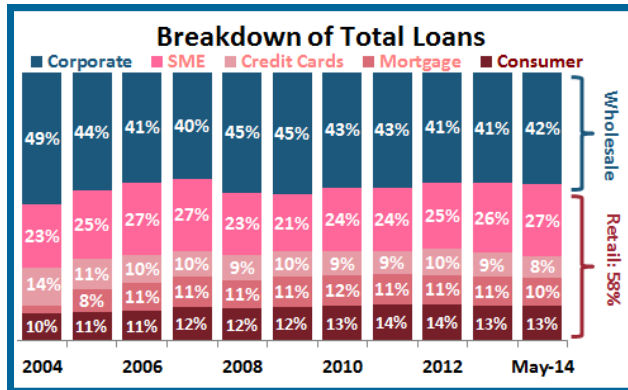


Loan growth went down to 14.4%, slightly below 15% target growth rate of the CBRT. We think that slowdown in the pace of loan growth is due to seasonal factors.

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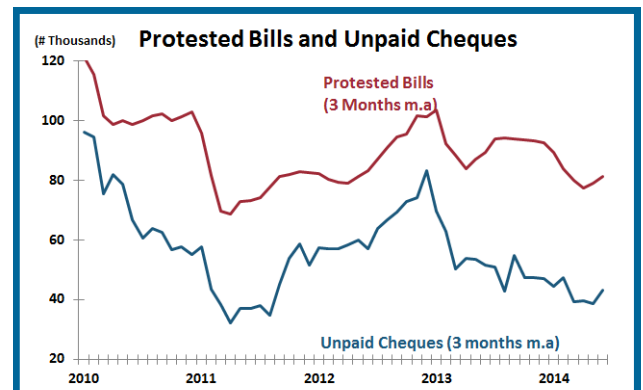
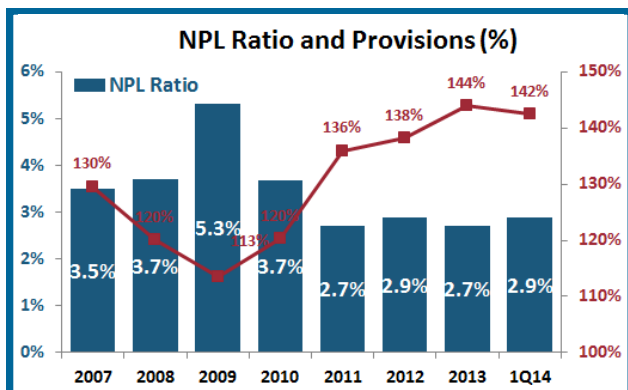
Banking Sector (II)

Loan Breakdown



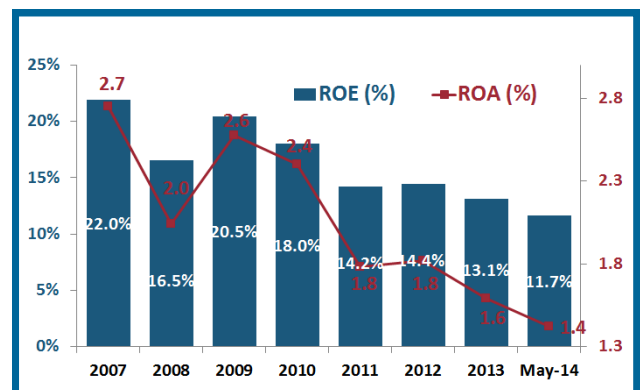
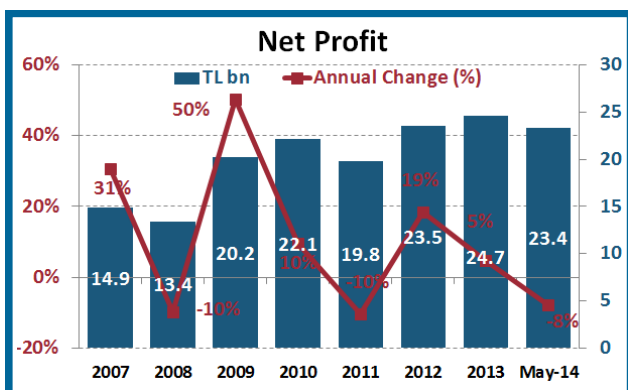
Retail loans are continuing to slow down due to measures taken by the authorities.

Loan Quality



NPL ratio has been stable at 2.9%. 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.