

DenizBank Economic Update

October 2014

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

Economic Research and Strategy

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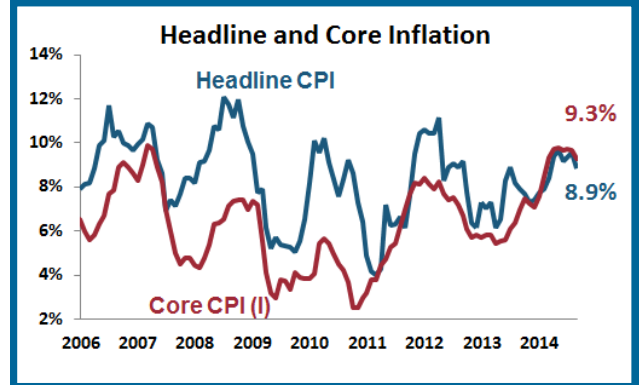
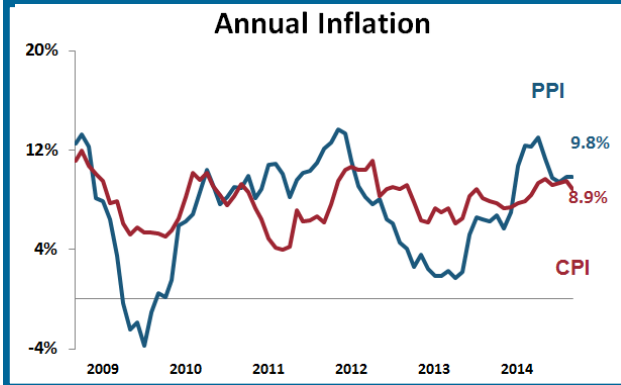
DenizBank 

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DenizBank Economic Update

Economy (I)

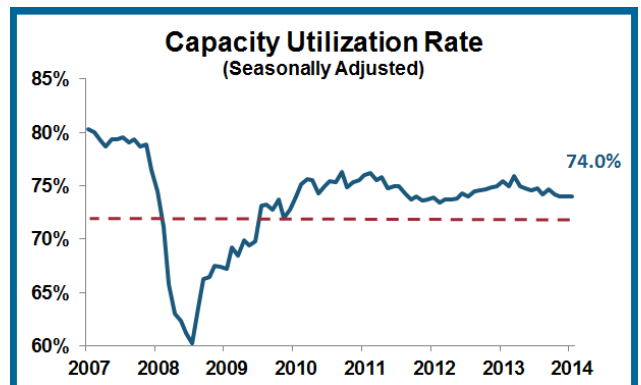
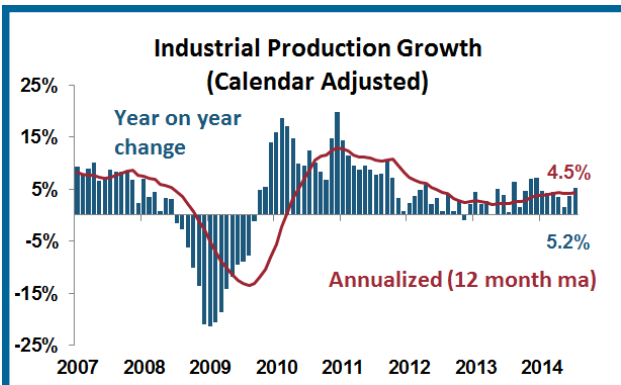
Inflation



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

- Inflation came slightly better than expectations at 0.14% in September driven by the decline in clothing and alcoholic beverage groups' prices. As a result, annual inflation eased from 9.5% to 8.9%, lowest level since March. However, it is still substantially higher than the Central Bank's (CB) 5% ($\pm 2\%$) inflation target.
- All core inflation indicators showed an improvement in September and annual Core I indicator went down to 9.3% from 9.7%, an important indicator showing that inflationary pressures started to ease...
- We expect to see the impact of fading FX pass through and favorable base effects on inflation next year. Taking into account the effect of recent electricity and natural gas price hikes, we revised our year end expectations to 9.2%. However, sharp decline in oil prices poses downside risks to our forecast.
- Similarly, the CB revised up its forecasts to 8.9% and 6.1% for 2014 and 2015 respectively from 7.6% and 5.0% in its 4th inflation report...The CB's revised forecasts are roughly in line with market expectations.

Growth



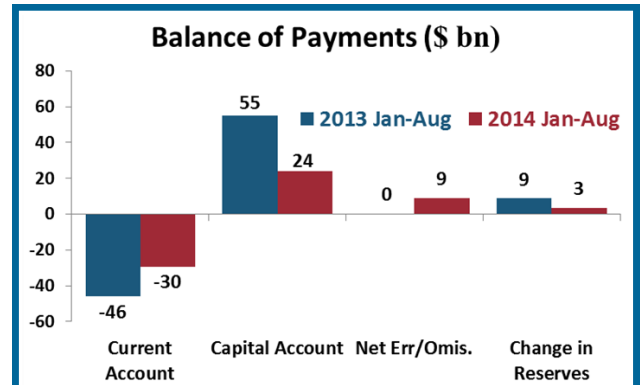
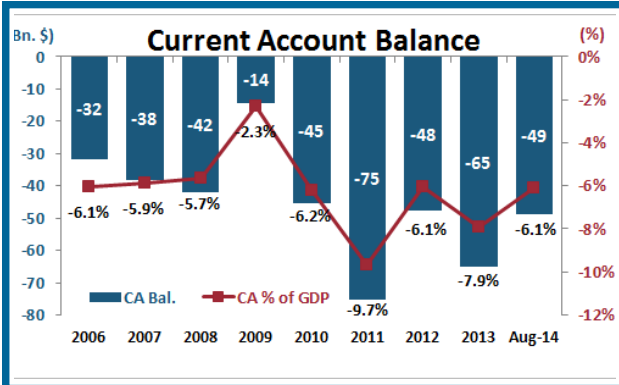
Manufacturing activity remains subdued

- The calendar adjusted industrial production index (IP) increased YoY by 5.2% in August slightly below the market consensus of 5.7%. Seasonally adjusted IP index posted 1.4% compared to the previous month, partially due to high base effect (1.9% increase in previous month).
- Annualized increase in manufacturing activity stays at 4.5% in August. Leading indicators such as PMI manufacturing index stays at 50.4 in September, slightly above critical level of 50 and capacity utilization is constant at 74%. This indicates the growth rate of economic activity will be close to the previous quarter.
- We expect slowdown in manufacturing activity to be more visible in the coming term with the weakness in external demand conditions. We expect 2014 GDP growth to be at 3.0%, compared to 4.0% in the previous year.
- In most recent Medium Term Plan (MTP), the authorities revised down their 2014 GDP growth forecast to 3.3% from 4.0%...

DenizBank Economic Update

Economy (II)

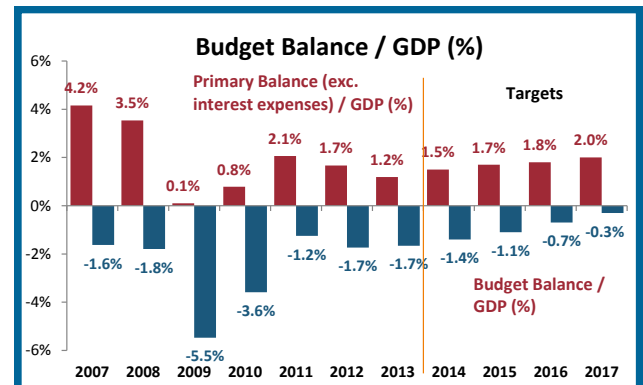
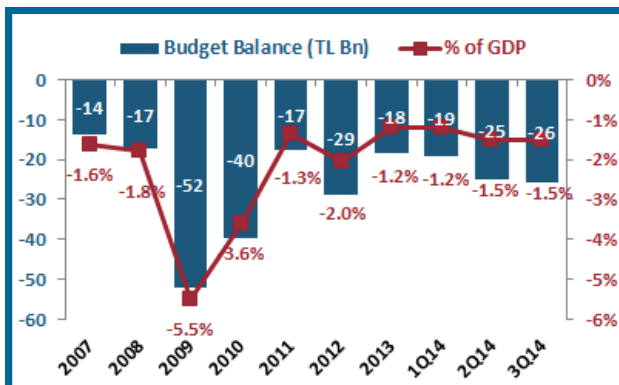
External Sector



Current account continues narrowing in August.

- Current account deficit came at \$2.8 bn in August, below the consensus expectation of \$3.1 bn. 12 month cumulative current account deficit narrowed down from \$65 bn (7.9% of GDP) in 2013 to \$48.9 bn (6.1% of GDP).
- Despite the risks in export markets on the back of geopolitical risks, we expect current account deficit to be at 5.8% of GDP at the year-end. As it the case in inflation, further decline in oil prices poses downside risks to our forecast.
- On the financing side, despite lower capital inflow, it is strongly positive at \$24 bn at first 8 months of the year. In addition to that, the inflows from the net errors/omissions played a pivotal role in financing of the CA as the details are given in the graph above.

Public Sector



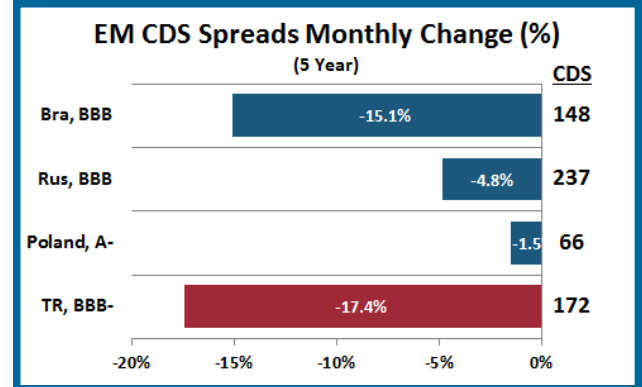
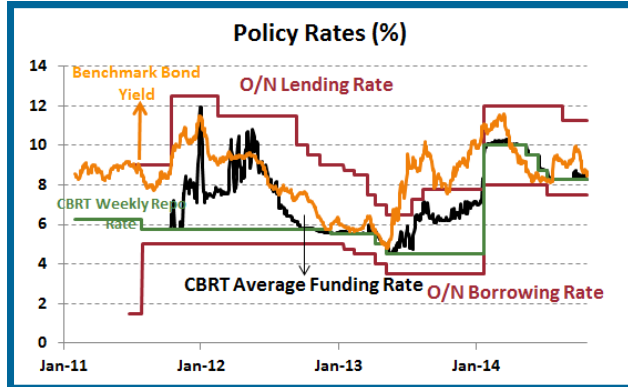
Budget discipline maintained, year-end targets is likely to be achieved.

- The central government budget posted deficit of TL11.9 bn in January-September period of 2014, while primary surplus reached to TL26.3 bn. Both YTD budget deficit and primary surplus figures are worse than the previous year due to the moderate growth in tax revenues, but compatible with year-end targets.
- YTD increase in non-tax revenues was strong (up YoY by 10%) 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.
- New Medium Term Plan (MTP) for the years 2015-17 set more challenging budget targets for 2014 and the following years, such that Budget Deficit / Gdp target for 2015 was reduced to 1.4% from 1.6% in the previous year's MTP.

DenizBank Economic Update

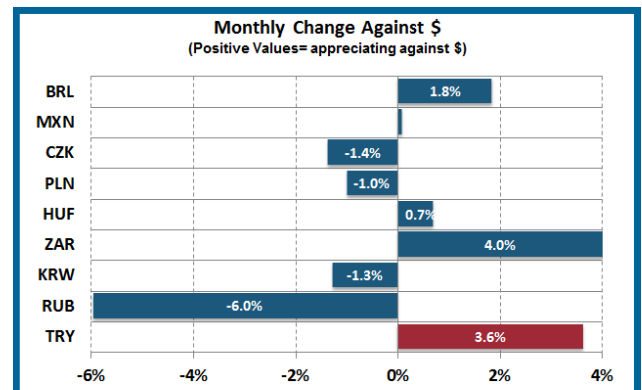
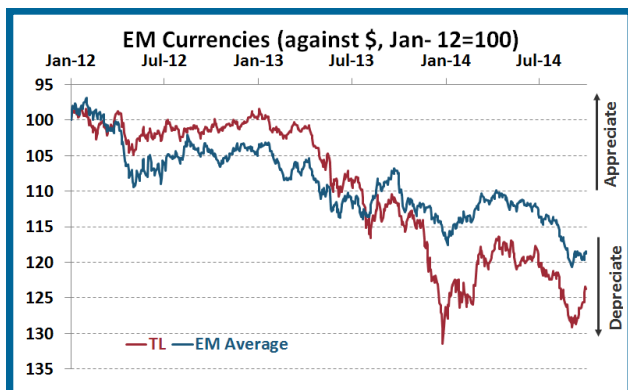
Financial Markets

Debt Market



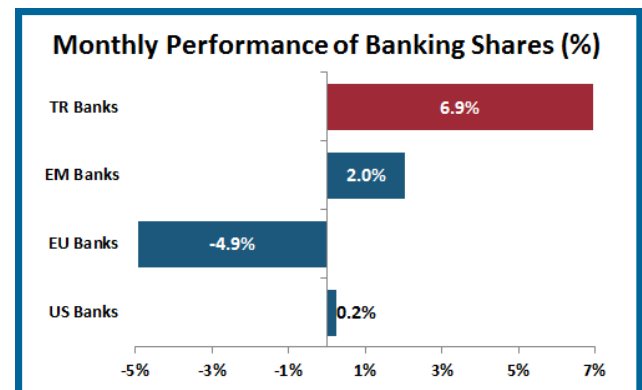
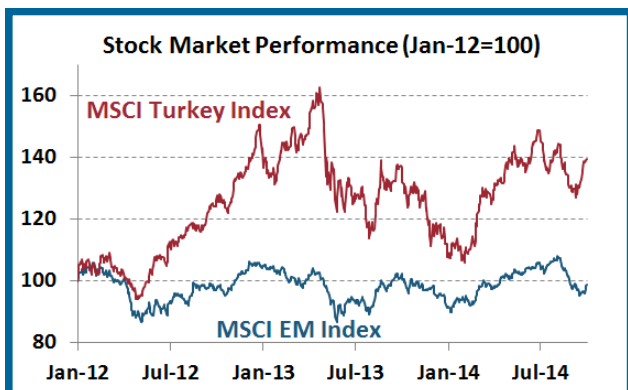
Thanks to the risk appetite after a high volatility period in EM markets, 2 year benchmark bond yield markedly came down below the 8.5%.

Currency Market



Similarly, the TL is outperforming most of its EM peers' currencies.

Stock Market

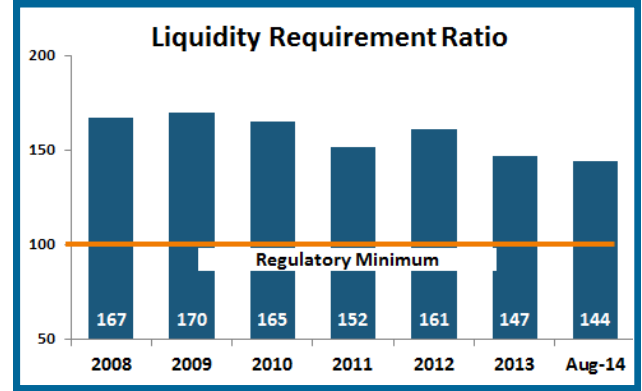
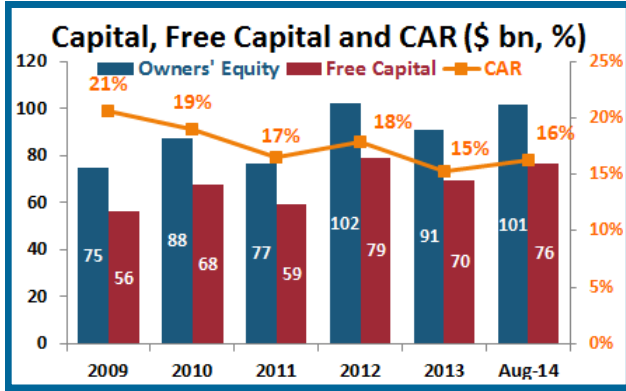


In line with risk-on mode in financial markets, stock market indices are appreciating.

DenizBank Economic Update

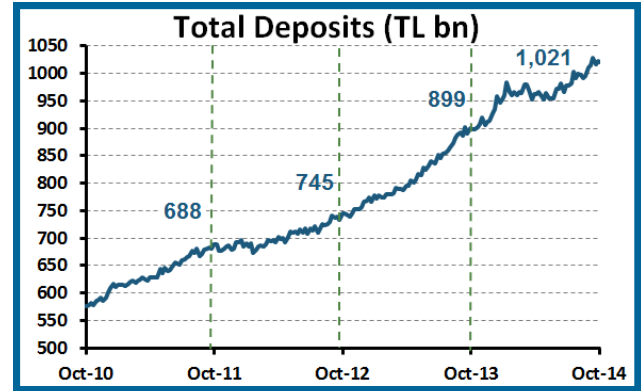
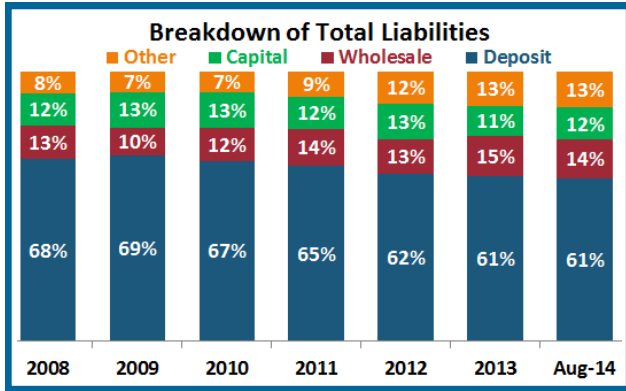
Banking Sector (I)

Capital



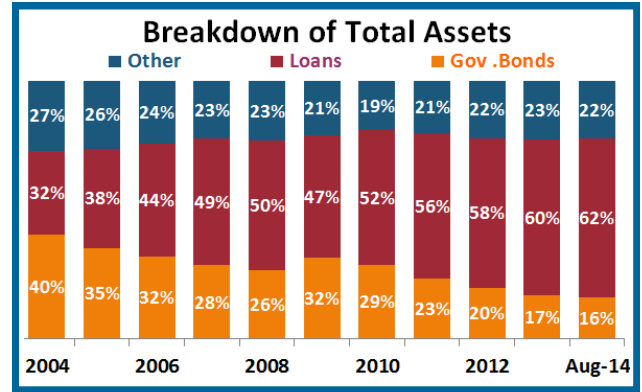
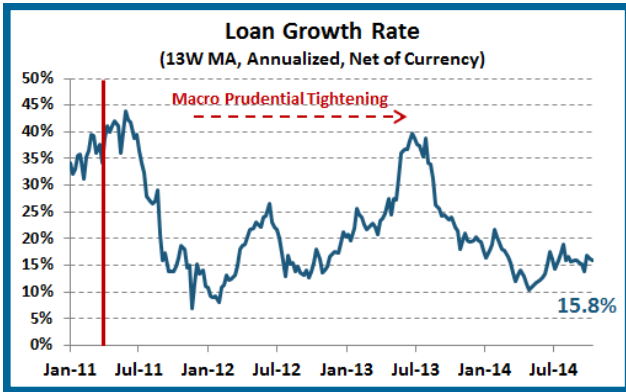
Despite declining profitability, banks are able to keep their CAR ratio at around 16%, thanks mainly due to slower loan growth.

Funding



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

Lending

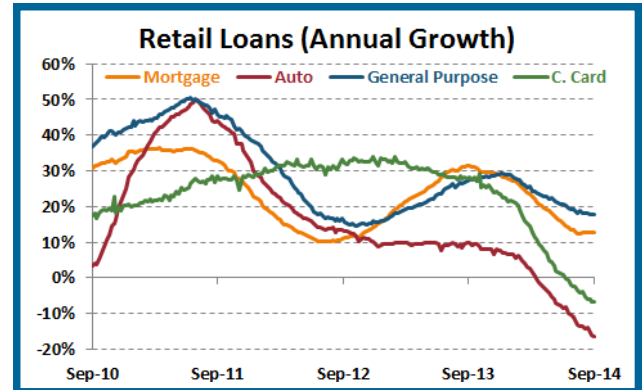
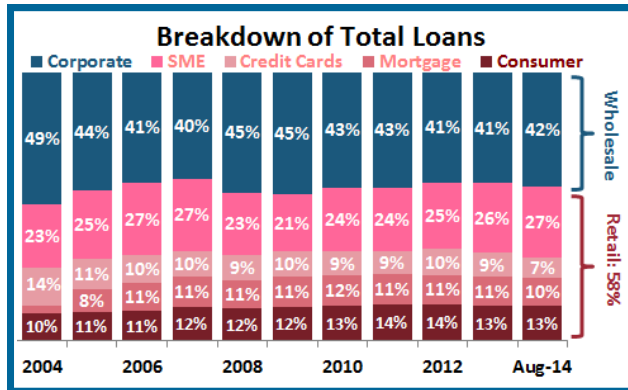


Annualized loan growth is at around 15%, which is in line with Central Bank's long term targets...

DenizBank Economic Update

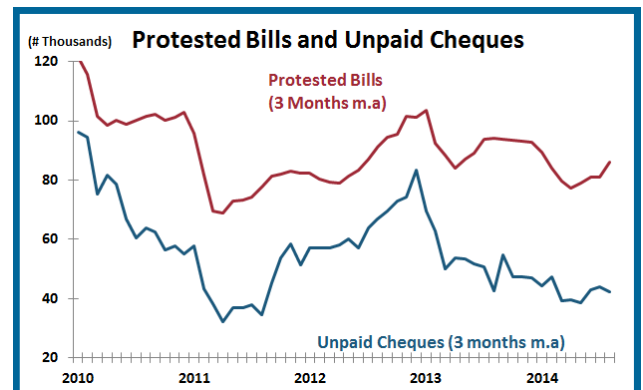
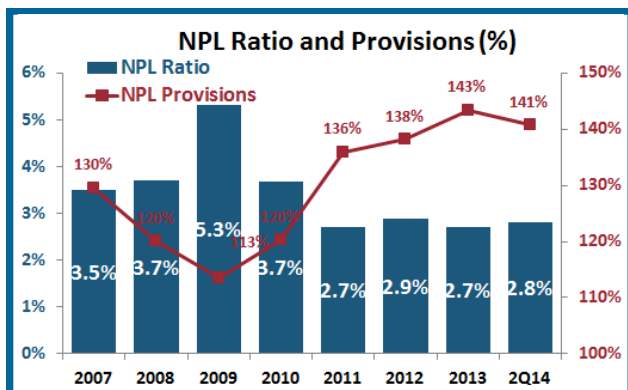
Banking Sector (II)

Loan Breakdown



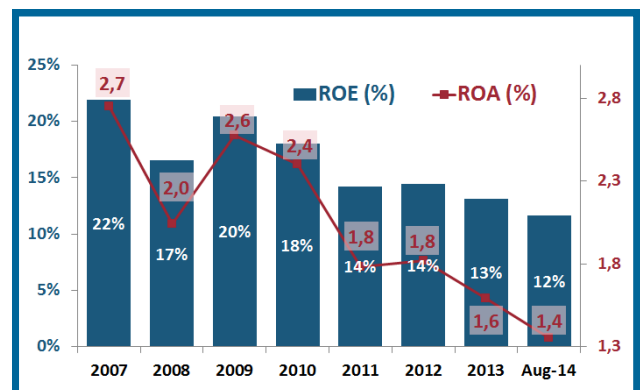
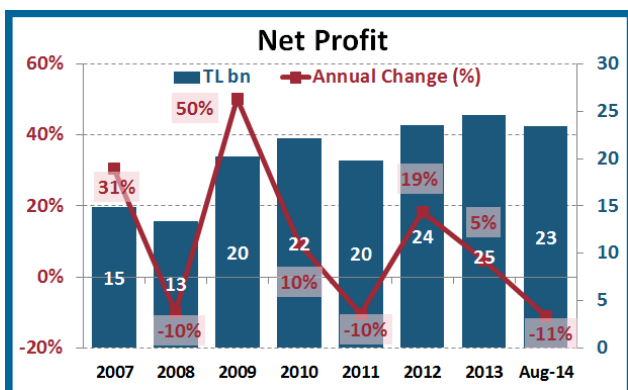
The deceleration in retail loans is more visible due to the macro-prudential measures taken by the authorities (both Central Bank and the BRSA)

Loan Quality



Stable NPL ratio at 2.8% is showing that there is no visible 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... The ROE for the year end, accordingly, is expected to ease below 12%...