



Monthly Economic Review October 2014



Global Economy

- ◆ OECD stated that the global economy continued to expand at a moderate and uneven pace in its interim economic assessment report published in September. OECD revised GDP growth figures of the United States and Eurozone downwards while that of China was kept unchanged.
- ◆ In the United States, second quarter GDP growth was revised up to 4.6% from 4.2%, the highest level since the last quarter of 2011. Recent data releases also indicated a positive outlook in the economic activity.
- ◆ The Federal Open Market Committee (FOMC) decided to reduce monthly asset purchase program by 10 billion USD to 15 billion USD in line with the expectations at its meeting held on September 16-17. The Federal Reserve Chair Janet Yellen reiterated that interest rate hike decision would depend on the course of economic data. However, it was noteworthy that Fed officials' policy interest rate expectations for both 2015 and 2016 increased.
- ◆ European Central Bank (ECB) kept policy rates unchanged at its meeting held on October 2nd. It was announced that the asset purchases would start in the last quarter of 2014 and last at least 2 years.
- ◆ On September 18th, the ECB lent 82.6 billion Euro under its first targeted longer-term refinancing operation (TLTRO) which was announced in June. The overall allotment was below the expectations of 150 billion Euros.
- ◆ In China, the impacts of the measures taken by the government to support economy appeared to be limited amid the prevailing concerns over housing sector.

Turkish Economy

- ◆ Turkish economy grew by 2.1% yoy in the second quarter of 2014, missing estimates. On the other hand, Turkstat revised first quarter GDP growth upwards from 4.3% to 4.7%. The annual GDP growth in the first half of 2014 was realized as 3.3%.
- ◆ The calendar adjusted industrial production index increased by 3.6% yoy in July, parallel to the market expectations.
- ◆ In August exports increased by 2.9% yoy. In this period, imports also rose by 7% yoy after contracting in the last six consecutive months and thus the foreign trade deficit came in above the market expectations and was realized as 8 billion USD.
- ◆ Current account deficit was realized as 2.6 billion USD in July, parallel to expectations. It was 6.3 billion USD in the same period of 2013. In the first seven months of the year, the deficit narrowed by 38.3% yoy.
- ◆ The Ministry of Finance announced both July and August budget data due to the fiscal holiday. After having registered a deficit of 5.3 billion TRY in July, the budget posted 5.9 billion TRY surplus in August, pointing out a favorable outlook. The primary surplus, on the other hand, reached 30.1 billion TRY in January-August period, staying higher than the year-end target of 18.7 billion TRY.
- ◆ Annual CPI inflation, which hovered above 9% since April, decreased to 8.86% in October.
- ◆ At its meeting on September 25th, the CBRT decided to hold the interest rates unchanged.

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GDP growth missed the estimates in the second quarter.

Turkish economy grew by 2.1% yoy in the second quarter of 2014, missing estimates. According to Reuters' Survey, the markets expected 2.65% yoy GDP growth. On the other hand, Turkstat revised first quarter GDP growth upwards from 4.3% to 4.7% and the 2013 year-end GDP growth from 4% to 4.1%. The annual GDP growth in the first half of 2014 was realized as 3.3%.

The calendar adjusted GDP grew by 2.4% yoy in the second quarter. The calendar and seasonal adjusted GDP, on the other hand, decreased by 0.5% qoq, the first quarterly contraction since the first half of 2012.

The deceleration in domestic consumption expenditures continued in the second quarter.

The impacts of the measures taken by the BRSA (Banking Regulation and Supervision Agency) in order to limit the growth in consumer loans and CBRT's rate hike at the end of January on private consumption expenditures became more evident in the second quarter. The private consumption expenditures, which have the highest share in GDP with 64.6%, made only 0.3 point contribution to growth. Their contribution to first quarter growth was 2.2 points. The public sector consumption expenditures, which increased rapidly ahead of the local elections, decelerated in the second quarter on annual basis. Thus, the contribution of public expenditures to GDP growth decreased from 0.9 point to 0.3 point.

Steep decline in investment expenditures

Total investment expenditures decreased by 3.5% yoy in the second quarter. This was the sharpest decline registered since the second quarter of 2012. Analyzing the breakdown of investment expenditures, public sector investment expenditures decreased by 0.9% yoy and

GDP (1998 Prices)

Period	Calendar Adjusted GDP* (%)	Seasonally and Calendar Adjusted GDP** (%)
2011 Q1	12.6	2.5
2011 Q2	9.3	0.6
2011 Q3	8.7	1.2
2011 Q4	5.2	0.8
2012 Q1	2.5	-0.2
2012 Q2	3.1	1.1
2012 Q3	1.7	0.2
2012 Q4	1.3	0.3
2013 Q1	3.6	1.9
2013 Q2	4.2	1.7
2013 Q3	4.0	0.3
2013 Q4	4.6	0.9
2014 Q1	4.7	1.8
2014 Q2	2.4	-0.5

*Change compared to the same period of previous year

**Quarter over quarter change

private sector investment expenditures decreased by 4.1% yoy in the second quarter. It was noteworthy that the decline mainly stemmed from the 7.6% yoy contraction in private sector's machinery and equipment expenditures. On the other hand, compared to the same quarter of the previous year, both the public sector and the private sector increased their construction investments in the second quarter.

Net exports made the highest contribution to growth.

As opposed to the limited increase in consumption expenditures (0.4% yoy) and the decline in investments expenditures, the net exports' contribution to GDP growth was realized as 2.9 points in the second quarter, up from 2.6 points in the first quarter. According to the GDP figures, exports increased by 5.5% yoy while imports declined by 4.6% yoy due to the downward pressure on domestic demand in the second quarter.

Expenditure Approach - Contribution to GDP (1998 Prices) (% points)

	2012		2013			2014			1 st Half
	Annual	Q1	Q2	Q3	Q3	Annual	Q1	Q2	
Consumption	0.3	3.0	4.5	3.9	5.0	4.1	3.2	0.5	1.8
Private	-0.3	2.2	3.6	3.7	4.0	3.4	2.2	0.3	1.2
Public	0.6	0.8	0.8	0.2	0.9	0.7	0.9	0.3	0.6
Investment	-0.7	0.1	0.9	1.2	1.8	1.0	0.0	-0.9	-0.5
Private	-1.1	-1.3	-0.2	0.5	1.2	0.1	-0.3	-0.9	-0.6
Public	0.4	1.4	1.1	0.7	0.7	0.9	0.3	0.0	0.1
Change in Stock	-1.5	1.4	2.9	1.2	0.9	1.6	-1.1	-0.4	-0.7
Net Exports	4.0	-1.4	-3.6	-2.0	-3.2	-2.6	2.6	2.9	2.7
Exports	3.9	0.8	0.0	-0.6	-0.3	-0.1	2.8	1.5	2.1
Imports	0.1	-2.2	-3.6	-1.4	-2.9	-2.5	-0.2	1.4	0.6
GDP	2.1	3.1	4.6	4.2	4.5	4.1	4.7	2.1	3.3

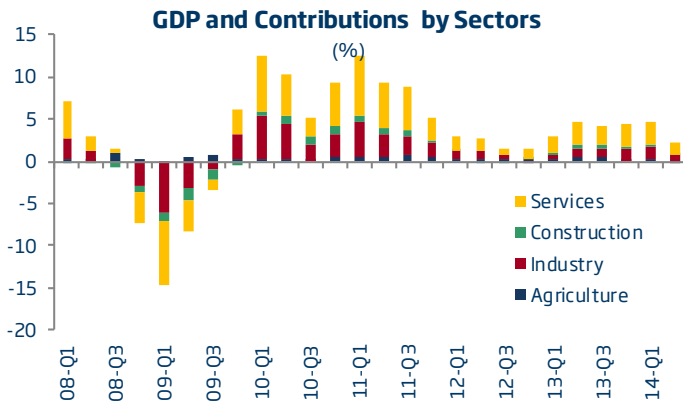
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Source: Calculated from Turkstat figures.

Source: Turkstat

Drought is adversely affecting the agriculture sector.

According to the production approach, the services sector, which has the biggest share in GDP, also made the highest contribution to second quarter growth by 1.4 points. During the same period, industrial sector made 0.7 point and construction made 0.2 point contribution to growth. On the other hand, agriculture sector lowered the growth by 0.1 point due to the drought.



We estimate that the 2014 year-end growth might surpass 3%.

The loss of momentum in domestic demand became evident in the second quarter while net exports continued to make significant contribution to growth.

In the second half of the year, we think that domestic demand might enliven thanks to the CBRT's rate cuts and the diminishing political uncertainties. Despite this expected revival in domestic demand, the foreign demand conditions will be less favorable in the remaining part of the year due to the loss of momentum in Turkey's largest export market, the EU, and the ongoing conflicts in Turkey's second biggest export market, Iraq. Thus, the contribution of net exports to growth might not be as strong as it was in the first half. On the other hand, one opportunity for Turkey to increase exports is Russia's embargo on several food imports from US, EU, Canada, Norway and Australia. Russian importers will look for alternative countries and Turkish exporters might benefit from this. In addition, European Central Bank's recent rate cuts and its decision to start a new asset purchase program in October are considered as a positive development in terms of global liquidity conditions and in turn will also help to revive the demand in Euro Area. In this context, we estimate that Turkey's GDP growth, which was 3.3% yoy in the first half of 2014, will be above 3% at the end of 2014.

Industrial production rose by 3.6% yoy in July.

The calendar adjusted industrial production index increased by 3.6% yoy in July, parallel to the market expectations. Seasonally and calendar adjusted industrial production index also recorded a monthly increase of 1.8%. Among the main industry groups, the highest seasonally and calendar adjusted increase was registered in capital goods production while intermediate goods production recorded a limited decrease.

According to Markit, manufacturing PMI increased by 0.1 point on a monthly basis and was realized as 50.4 in September. Having remaining above the 50 threshold, the index indicated a moderate expansion in manufacturing activities.

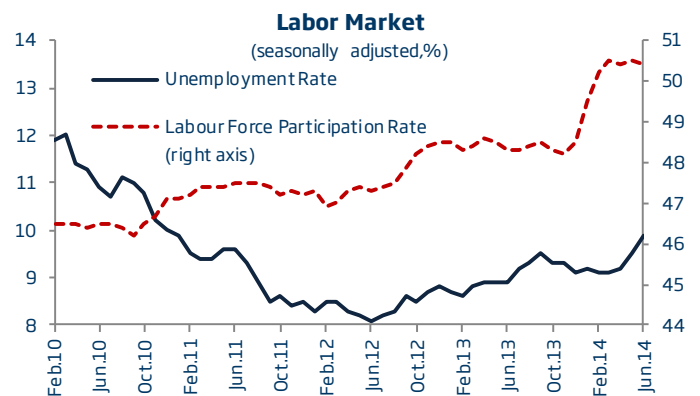
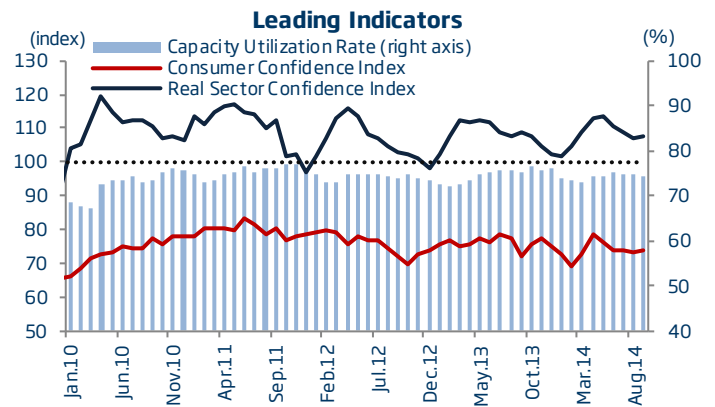
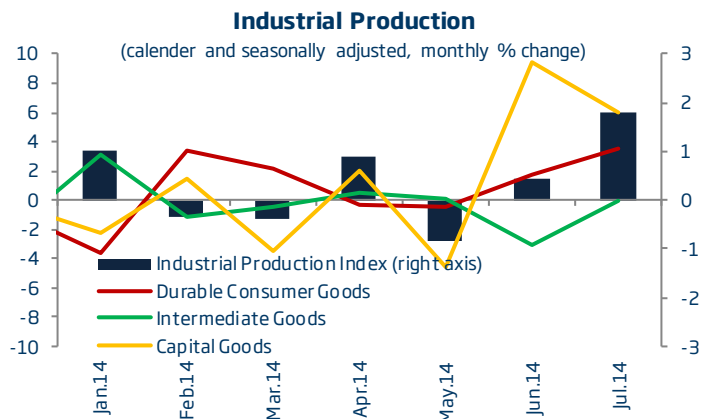
Confidence indices...

Real Sector Confidence Index decreased by 1 point to 107.6 in September, compared to the same month of previous year. The seasonally adjusted index, on the other hand, increased by 1.4 points mom. Analyzing the components of the index, it was seen that increase in index remained limited due to the deterioration in the assessments regarding general course of business, and current stock of finished goods. In September, seasonally adjusted Capacity Utilization Rate (CUR), on the other hand, remained flat compared to the previous month and was realized as 74.1%.

According to Turkstat, Consumer Confidence Index rose by 0.8 point mom to 74.0 in September. Analyzing the sub-indices, the deterioration in financial situation expectation of households was noteworthy while the biggest increase was recorded in consumers' possibility of buying a home over the next 12 months.

Unemployment rate was at 9.1%.

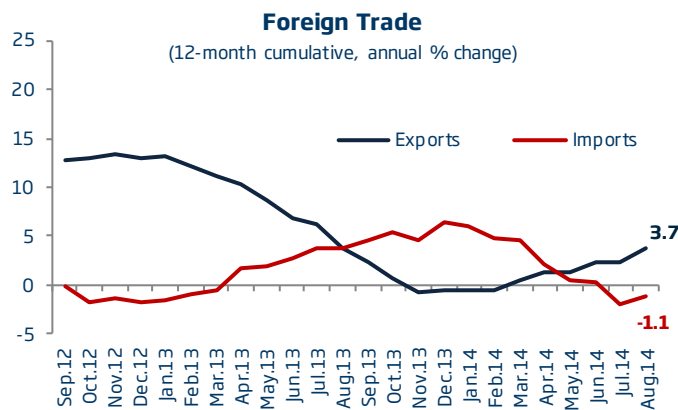
According to the Household Labor Force Survey, unemployment rate increased to 9.1% in June from 8.1% in the same month of the previous year. In the same period, non-agricultural unemployment and youth unemployment rates were realized as 11.1% and 16.7%, respectively. These figures pointed out a weak performance in labor market.



Source: Turkstat, CBRT

Foreign trade deficit came in above the expectations in August.

In August exports increased by 2.9% yoy. In this period, imports also rose by 7% yoy after contracting in the last six consecutive months and thus the foreign trade deficit came in above the market expectations and was realized as 8 billion USD. As a result, the import coverage ratio, which was 61.1% in August 2013, decreased to 58.7% in August 2014, the lowest level of this year.

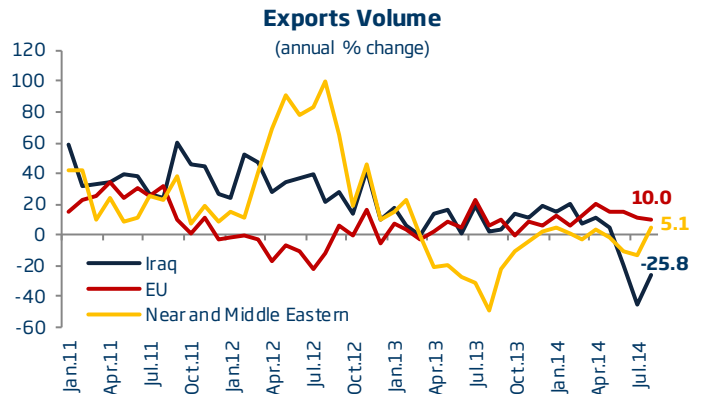


The rise in imports was widespread.

It was noteworthy that the increase in imports was widespread across the product groups. This development pointed out a slight recovery in domestic demand conditions which have followed a weak course throughout this year. Indeed, imports of motor vehicles, which declined since the beginning of the year, increased in August for the first time in 2014. In August, the annual increase in imports was also underpinned by higher number of working days compared to the previous year.

Exports to Iraq continued to decline albeit at a slower pace.

Exports to Iraq, which dropped by 19.5% yoy in June and 45.5% yoy in July, also contracted by 25.8% in August due to the ongoing conflicts in the country. This development indicated that the downward trend in exports to Iraq continued albeit at a slower pace. In August, Iraq kept its ranking as the third country in total exports with 647 billion USD. On the other hand, Russia banned imports of certain



products from the US and European Union countries in August due to the crisis in Ukraine. This raised expectations that these products would be supplied by other countries including Turkey. However, there was not a noticeable change in the course of exports to Russia in August. On the contrary, the ongoing contraction in exports to Russia since the beginning of this year was maintained.

Despite losing some of its momentum, exports to the European Union (EU) countries continued to rise on annual basis. In this context, the share of the European Union countries in total exports increased to 44.3% in August from 41.4% in the same month of the previous year. Exports to Near and Middle Eastern countries, which have followed a downward trend in recent months due to the conflicts in Iraq, recovered slightly in August thanks to notable rise in exports to Saudi Arabia and Iran. Hence, the share of Near and Middle Eastern countries in total exports, which was 21.7% in August 2013, was realized as 22.1% in the same period of this year.

Expectations

The economic activity in the EU countries, Turkey's main export destination, is expected to remain weak for a while which in turn might put downward pressure on Turkey's export performance. However, the recovery in exports to Near and Middle Eastern countries excluding Iraq was seen as a favorable outcome. On the other hand, the revival in domestic demand conditions in the coming period might widen foreign trade deficit to some extent.

Foreign Trade Balance	(USD billion)					
	August		Change (%)	January-August		Change (%)
	2013	2014		2013	2014	
Exports	11.1	11.4	2.9	99.3	104.9	5.7
Imports	18.2	19.5	7.0	167.0	159.1	-4.7
Foreign Trade Balance	-7.1	-8.0	13.5	-67.7	-54.2	-20.0
Import Coverage Ratio (%)	61.1	58.7	-	59.5	66.0	-

Source: Turkstat

12-month current account deficit came in at the lowest level since January 2011.

Current account deficit was realized as 2.6 billion USD in July, parallel to expectations. It was 6.3 billion USD in the same period of 2013. In the first seven months of the year, the deficit narrowed by 38.3% yoy. The 12-month cumulative current account deficit also declined from 52.1 billion USD in June to 48.5 billion USD in July, the lowest level since January 2011. This development stemmed mainly from the narrowing foreign trade deficit thanks to the increasing exports and partly from the positive performance of services balance.

The contraction in foreign trade deficit continued.

Having played a significant role in the narrowing trend of current account deficit, foreign trade deficit declined by 10.9% yoy in July according to 12-month cumulative figures. This decline of 8 billion USD was mostly due to the increase in exports. On the other hand, the figures recorded in the first seven months of the year revealed that the deceleration in exports continued in July. The decline in exports directed to Iraq and the loss of momentum in economic activity in the European Union countries were the main factors that weakened the export performance. During the same period, imports volume posted a limited decline and contributed to the narrowing of current account deficit. In addition to slowing domestic demand, the rapid contraction in gold imports were also influential on the narrowing of the foreign trade deficit. In fact, gold imports, which were 11.1 billion USD in the first seven months of 2013, dropped to 3.2 billion USD in the same period of this year.

The surplus in services balance increased by 10.5% yoy in the first seven months of the year and supported the improvement in current account deficit. The tourism balance, which accounted for 97% of services balance, exhibited an increase of 373 million USD during the same period.

The net inflow in portfolio investments was 3.7 billion USD in July.

Having displayed a strong outlook in June, portfolio investments account registered a net inflow of 3.7 billion USD in July. A significant part of this inflow (2.7 billion USD) was derived from the inflows directed to debt securities. Banking sector borrowed 1.7 billion USD from international capital markets via bond issues during the same period.

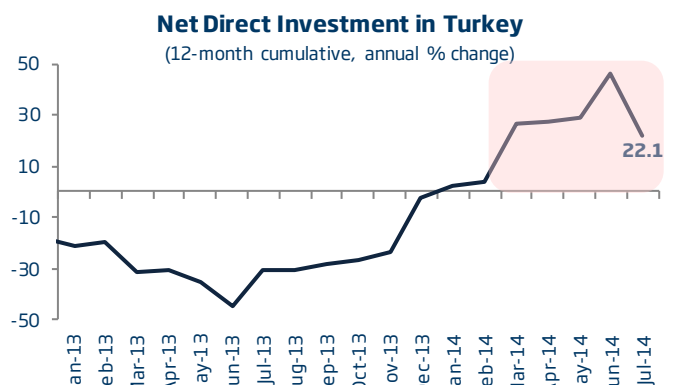
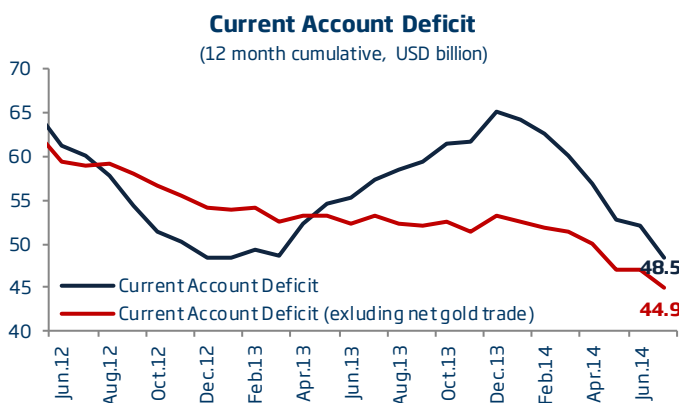
Having followed a declining trend in the first quarter of 2014 owing to capital outflows from emerging markets, portfolio investments continued to recover in July. During the first seven months of the year, equity and debt securities attracted 2.1 billion USD and 12.5 billion USD net inflows, respectively.

Net direct investments towards Turkey kept their positive trend.

Net inflow of direct investments to Turkey, which was 1.1 billion USD in June, came in 1 billion USD in July. 61% of this inflow was registered in equity capital investments account while 34% of it was composed of real estate investments account. According to 12-month cumulative figures, the upward trend in "net direct investment in Turkey" account observed since March was noteworthy. In fact, these figures revealed that net direct investments increased by 22.1% yoy in July. Analyzing figures by subsectors, manufacturing industry and banking sector were responsible for 51% of the net direct investments in Turkey in the first seven months of the year.

Banking sector was net credit re-payer in July.

Banking sector made a net repayment of 276 million USD in July. Regarding short-term loans, banking sector made 1.2 billion USD worth of net repayment. In this period, banking sector was net credit payer in short-term loans while it was net credit borrower in long-term loans. Non-bank sectors, however, utilized net 1 billion USD loans. In the first seven months of the year, net loans raised from abroad by banking



Source:CBRT

sector amounted to 4.4 billion USD while that of non-bank sectors were 3.7 billion USD. During the same period, banks' and non-bank sectors' long-term debt roll-over ratios were 177% and 125%, respectively.

Net errors and omissions account reached 8.2 billion USD in the first seven months of the year.

Net errors and omissions account posted an increase of 2 billion USD in July. Hence, capital inflow recorded under this item reached 8.2 billion USD in the first seven months of the year and 13.3 billion USD during the last 12 months. Thanks to these high levels, it played a significant role in the financing of the current account deficit.

Expectations

In parallel to the deceleration in exports owing to the increased geopolitical risks and the stagnation in the EU economies in recent months, we expect that the narrowing in the current account deficit will lose some momentum. On

the other hand, one opportunity for Turkey to increase exports is Russia's embargo on several food imports from US, EU, Canada, Norway and Australia. Russian importers will look for alternative countries and Turkish exporters might benefit from this. The continuation of declining trend in oil prices might also favorably affect current account deficit in the longer run.

Regarding the financing of the current account deficit, it is expected that a loss of momentum will occur in capital inflows to emerging markets due to the strengthening expectations of the Fed's rate hike. On the other hand, European Central Bank's expansionary monetary policies might mitigate this effect to some extent.

Current Account Balance	(USD million)				
	July 2014	January-July 2013	January-July 2014	% Change	12 Month Cumulative
Current Account Balance	-2,634	-43,348	-26,767	-38.3	-48,485
Foreign Trade Balance	-4,912	-48,941	-34,271	-30.0	-65,353
Services Balance	2,927	11,106	12,269	10.5	24,294
Tourism Revenues (net)	2,662	11,520	11,893	3.2	23,553
Income Balance	-708	-6,143	-5,206	-15.3	-8,418
Current Transfers	59	630	441	-30.0	992
Capital and Financial Accounts	641	45,656	18,542	-59.4	35,187
Direct Investments (net)	771	5,599	5,534	-1.2	9,726
Portfolio Investments (net)	3,748	14,927	13,887	-7.0	22,651
Assets	386	2,185	-693	-	-277
Liabilities	3,362	12,742	14,580	14.4	22,928
Equity Securities	661	-801	2,119	-	3,761
Debt Securities	2,701	13,543	12,461	-8.0	19,167
Other Investments (net)	-3,646	29,924	625	-97.9	9,524
Assets	-4,658	2,524	-5,287	-	-5,417
Currency and Deposits	-2,719	3,963	-3,038	-	-2,414
Liabilities	1,012	27,400	5,912	-78.4	14,941
Trade Credits	-1	6,274	-927	-	-1,598
Loans	806	10,171	7,405	-27.2	18,846
Banking Sector	-276	11,261	4,448	-60.5	14,805
Non-bank Sectors	1,001	-608	3,678	-	5,150
Deposits	152	10,608	-929	-	-2,904
Foreign Banks	-254	9,173	-1,222	-	-3,169
Foreign Exchange	78	8,488	-2,151	-	-4,265
Turkish Lira	-332	685	929	35.6	1,096
Non-residents	631	2,215	1,404	-36.6	2,596
Reserve Assets (net)	-211	-4,728	-1,469	-68.9	-6,652
Net Errors and Omissions	1,993	-2,308	8,225	-	13,298

Source: CBRT

Central government budget registered a deficit of 2.7 billion TRY in January-August period.

The Ministry of Finance announced both July and August budget data due to the fiscal holiday. 19.1% yoy increase in budget revenues recorded in August compensated their decrease of 6.4% yoy in July. On the other hand, budget expenditures registered an increase of 8.7% yoy in July while they contracted by 8.6% yoy in August. Thus, after having registered a deficit of 5.3 billion TRY in July, the budget posted 5.9 billion TRY surplus in August, pointing out a favorable outlook.

In the first eight months of 2014, budget revenues increased by 8.9% yoy and budget expenditures rose by 10.1% yoy. Thus, the budget, which gave a surplus of 231 million TRY in the first eight months of the previous year, posted a deficit of 2.7 billion TRY during the same period of 2014. The primary surplus, on the other hand, reached 30.1 billion TRY in January-August period, staying higher than the year-end target of 18.7 billion TRY.

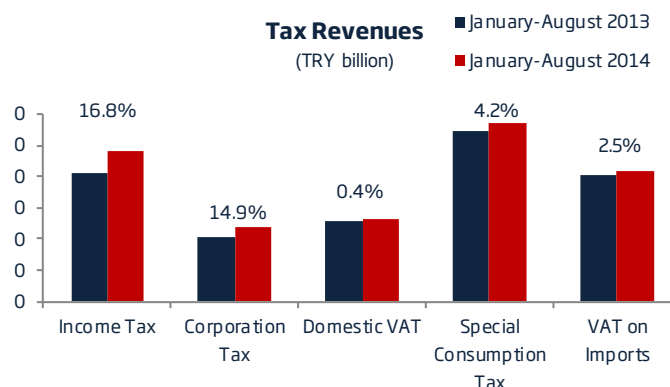
Weak performance in tax revenues...

While tax revenues recorded a limited increase of 3.8% yoy in July, the contraction in other revenues (47.1% yoy) was noteworthy. Domestic Value Added Tax (VAT) and VAT on imports limited the positive impact of the expansion in income and special consumption taxes in July. Domestic VAT maintained its downward course in August as well. On the other hand, total tax revenues registered an increase of 19.6% yoy with the help of the rise in corporation taxes (61.8% yoy).

In the first eight months of the year, central government budget realizations displayed a better outlook than the year-end targets. Indeed, in this period budget revenues reached 70.2% of their year-end target. However, it was noteworthy that in this period all taxes except banking and insurance transaction, income and corporation taxes registered a decline in real terms.

The decline in non-interest expenditures...

After having increased by 19.1% yoy in July, non-interest expenditures decelerated in August. Indeed, annual



increase in this item was realized as 6.4% in August. In July, the expansion in non-interest expenditures mainly stemmed from the increase of 26.2% yoy in current transfers. On the other hand, current transfers recorded a limited decrease of 3.9% yoy in August.

In the first eight months of 2014, non-interest expenditures increased by 13.6% yoy, while interest expenditures contracted by 10.9% yoy. It was noteworthy that the increase in both compensation of employees and current transfers constituted 77% of the rise in total expenditures. 5.1 billion TRY increase in retirement and social aid expenditure costs as well as 4.5 billion TRY rise in share from revenues were influential on this development.

Expectations

The loss of momentum in economic activity continued to affect tax revenues negatively in 2014. Regarding high sensitivity of domestic VAT and VAT on imports to course of economic activity, it is expected that tax revenues will continue to follow a relatively weak course in the forthcoming period. Considering the slowdown in domestic demand, it is anticipated that the expansion in budget expenditures in order to support economic activity might gain momentum. Nevertheless, the current central government budget figures, which were compatible with the year-end targets, are expected to keep their positive outlook in the coming period.

Central Government Budget

	July 2014		August 2014		January-August 2013			January-August 2014	
	Value	% Change*	Value	% Change*	Value	Value	% Change	Budget Target	Real/Target(%)
Expenditures	40.0	8.7	32.0	-8.6	259.7	285.9	10.1	436.4	65.5
Interest Expenditures	4.4	-36.1	2.8	-63.4	37.7	33.6	-10.9	52.0	64.7
Non-interest Expenditures	35.6	19.1	29.3	6.4	222.0	252.2	13.6	384.4	65.6
Revenues	34.7	-6.4	38.0	19.1	259.9	283.2	8.9	403.2	70.2
Tax Revenues	30.7	3.8	33.6	19.6	216.0	232.4	7.6	348.4	66.7
Other Revenues	4.0	-47.1	4.4	15.4	43.9	50.8	15.7	54.8	92.6
Budget Balance	-5.3	-	5.9	-	0.2	-2.7	-	-33.3	8.2
Primary Balance	-0.9	-	8.7	98.5	38.0	30.9	-18.6	18.7	165

Numbers may not add up to total due to rounding

Source: Finance Ministry

*Compared to the same month of the previous year

Source: Finance Ministry

Lower than expected CPI inflation in September

In September, CPI and Domestic PPI (D-PPI) increased by 0.14% and 0.85% mom, respectively. According to the Reuters' survey, CPI was expected to increase by 0.45% mom in September. According to the CBRT's survey, markets' monthly CPI expectation was 0.53%.

Annual CPI inflation decreased to 8.86%.

Annual CPI inflation, which hovered above 9% since April, decreased to 8.86% in October. In the same period, the annual D-PPI inflation was realized as 9.84%, approaching double-digit levels.

The rise in food price slowed down.

Analysis of the main expenditures groups in September show edthat the food prices, which increased rapidly in the first 8 months of the year as a result of the adverse weather conditions, increased moderately in September and was effective in the lower than expected monthly CPI reading. In fact, after having increased by 1.11% mom in average during the first 8 months, food prices increased by only 0.31% in September and made 0.08 contribution to the monthly CPI inflation. The decreases in clothing and footwear prices and alcoholic beverages–tobacco prices also played role in the lower than expected CPI increase. On the other hand, the price increases in the housing group, which has the second highest share in the CPI basket, have accelerated. In addition, the prices in the education group also increased notably in line with the start of the new school year.

The annual rise in core inflation indicators declined.

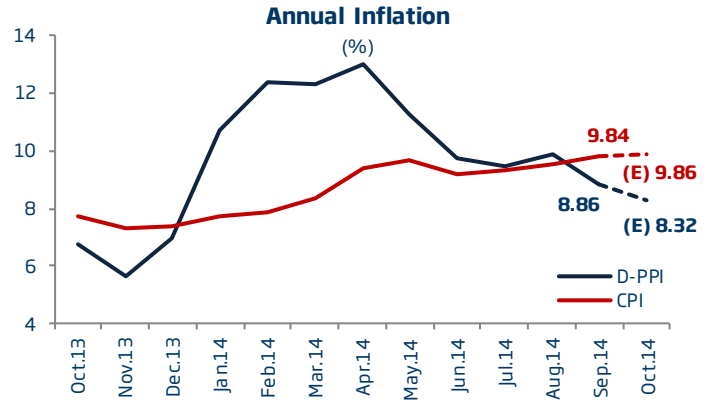
The core inflation figures, representing the main trend of inflation, also declined in parallel with the general index. In fact, the annual increases in CBRT's favorite core indices denominated by H and I were realized as 9.95% and 9.25%, respectively. These rates are the lowest increases since March 2014 for the H index, and since February 2014 for the I index.

The annual D-PPI inflation was 9.84% in September.

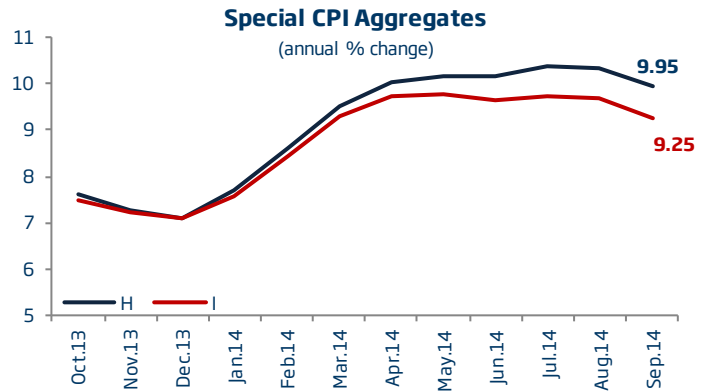
Despite the lower than expected increase in CPI in September, the increase in D-PPI kept its high level. There are 29 product groups which constitute the D-PPI index. In 20 of them, prices registered an increase in September. Despite the fact that the food prices in the CPI increased by 0.31% mom, the increase in food prices in D-PPI was realized as 2.76%. In fact, the highest contribution to monthly D-PPI increase came from food prices. This development shows that the upward pressure on CPI inflation stemming from the rise in food prices might continue in the coming period.

Expectations

In October, we expect that clothing and footwear prices would increase due to the seasonal factors. Moreover, we anticipate that the price hikes in natural gas and electricity

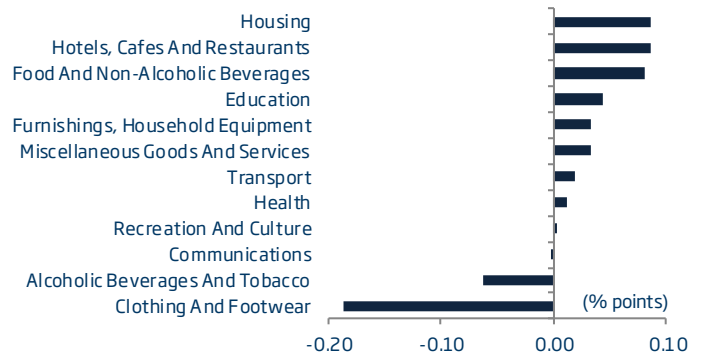


(E) Estimate



H: CPI excluding unprocessed food products, energy, alcoholic beverages, tobacco products and gold.
I: Excluding energy, food and non-alcoholic beverages, alcoholic beverages, tobacco

Contributions to the Monthly CPI by Subgroups



will contribute to monthly inflation by 30 basis points while their total contribution will reach 40 basis points until year-end. In this context, we expect CPI and D-PPI to increase by 1.30% and 0.70% mom, respectively. We anticipate that the year-end annual CPI inflation would be around 9%.

Source: Turkstat

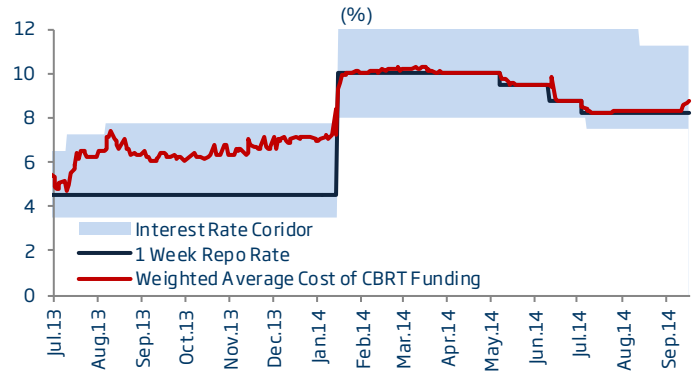
CBRT kept the policy rate unchanged at its September meeting.

At its meeting on September 25th, the CBRT kept the one-week repo rate (policy rate) at 8.25%. The lower and upper bounds of interest rate corridor were also kept unchanged at 7.5% and 11.25%, respectively. Moreover, the CBRT did not change the reserve requirement ratios and reserve option coefficients.

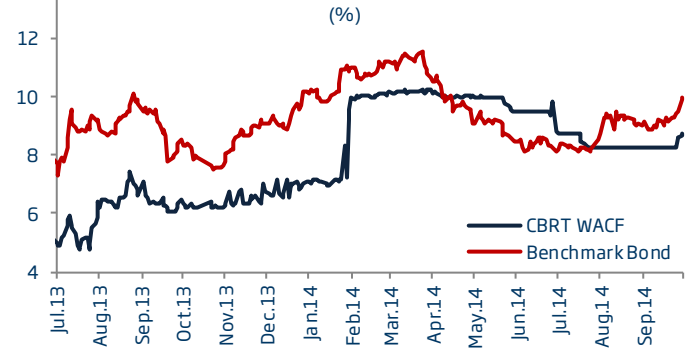
CBRT stated that loan growth continued at reasonable levels in response to the tight monetary policy stance and macroprudential measures while exports remained to support growth in spite of weakening global demand. Having cited that the macroprudential measures taken at the beginning of the year and the tight monetary policy stance started to have favorable impact on the core inflation trend, the CBRT envisaged that upward course in food prices continued to delay the improvement in the inflation outlook. The CBRT pointed out that declining commodity prices were expected to limit upside risks on inflation.

As the expectations grew that interest rate hikes by the Fed would arrive sooner and at a faster pace than anticipated, the currencies of emerging countries' faced downward pressures. Considering the uncertainties about the course of the Fed's policy and the current inflation outlook, CBRT maintained its cautious monetary policy stance. Moreover, the weighted average cost of CBRT funding rate was realized higher than the policy rate in the last days of September indicating relatively tighter liquidity conditions.

CBRT Interest Rates



Weighted Average Cost of CBRT Funding and Compound Yield of Benchmark Bond



Expectations regarding Fed's monetary policy continued to weigh on markets.

At its monetary policy meeting held on September 16-17th, Fed did not give a clear signal about the timing of an interest rate increase despite growing expectations that an interest rate hike could come sooner and faster than previously predicted. This accelerated the pace of USD's appreciation against major currencies in the second half of September. Parallel to other emerging market currencies, TRY also depreciated against the Dollar. Emerging markets equity indices, in general, followed a downward trend as well.

Risk premiums rose in September.

Due to the expectations of rate hikes by the Fed, risk premiums followed an upward trend especially in emerging markets. Risk premium of Turkish Eurobonds, which was 211 basis points (bps) at the beginning of September, rose to the highest level of four and a half month with 256 bps as of September 30. Turkey's 5-year CDS spreads, which were 175 bps as of September 1, also climbed to 205 bps as of September 30.

TRY depreciated against the Dollar and the Euro.

TRY depreciated significantly in September due to the expectations regarding the course of the Fed's rate hikes and USD/TRY reached eight-month high of 2.2900 on September 29th. During the same period, the rise in EUR/TRY, on the other hand, was limited thanks to the weakening trend of the Euro against the Dollar in parallel with the ECB's recent expansionary monetary policies. According to the CBRT's data, as of September 30, USD/TRY and EUR/TRY increased by 5.3% to 2.2775 and 1.3% to 2.8776, respectively.

BIST-100 index fell by 6.7% in September.

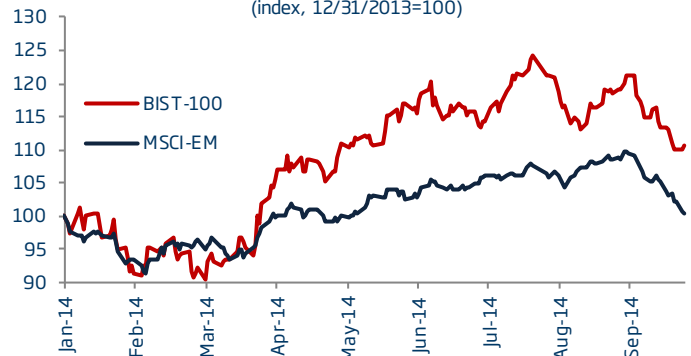
Having followed an upward trend in the second half of August, BIST-100 index dropped along with the decline in risk appetite towards emerging markets in September. As of September 30, the index fell by 6.7% on a monthly basis and closed at 74.938.

Benchmark interest rate approached to 10% level.

The decline in domestic political uncertainty in the beginning of September led to a downward trend in interest rates in bonds and bills market. On the other hand, the expectations regarding the Fed's exit strategy weighed on the markets in the following period. In fact, the interest rate of benchmark bond (due June 13, 2016) increased by 91 bps mom to 9.98% as of September 30th.

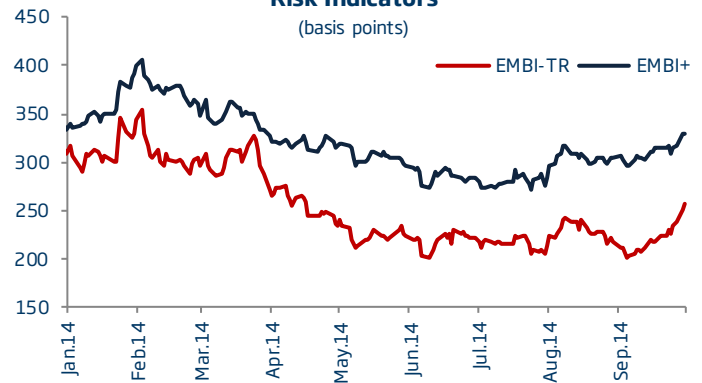
BIST-100 and MSCI Emerging Markets Indexes

(index, 12/31/2013=100)



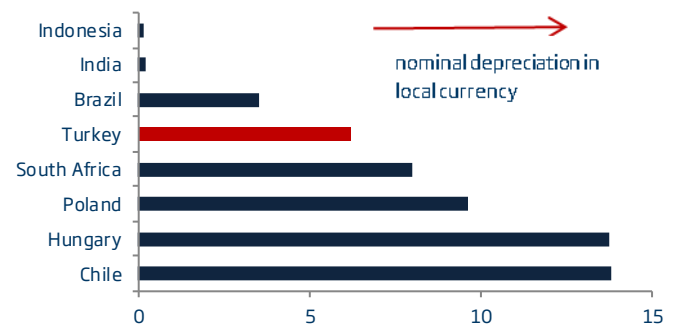
Risk Indicators

(basis points)



Local Currencies vs USD

(12/31/2013-09/30/2014, % change)



Source: JP Morgan, Reuters, BIST

Deposit volume grew by 5.9% ytd.

According to BRSA's Weekly Bulletin, as of September 19, total deposit volume recorded an increase of 5.9% ytd and was realized as 1,075 billion TRY. The annual increase in deposit volume was 14.8%. The highest annual increase in deposit volume was registered in the week of January 24 when TRY depreciated sharply against the Dollar. As of September 19, TRY deposits and FX deposits in USD terms rose by 9.2% yoy and 9.4% yoy, respectively.

Loans rose by 19.9% yoy.

Total loan volume expanded by 10.7% ytd and reached 1,179 billion TRY as of September 19. Having followed a declining trend since the beginning of 2014, annual growth rate of total loan volume decelerated to as low as 18.1% by September 5th. As of September 19, on the other hand, the annual growth in total loan volume reached 19.9% with gaining some momentum. During the same period, FX loans in USD terms and TRY loans rose by 12.9% yoy and 17% yoy, respectively.

Analyzing by credit types, it was seen that the contraction in vehicle loans continued and was realized as 16.3% on annual basis as of September 19. Personal finance loans also continued to lose momentum in the same period. Having realized as 28.7% in the last week of 2013, the annual rise in personal finance loans fell to 12.9% as of September 19. Housing loans rose by 12.7% yoy in the same period. With a 25.5% annual growth, commercial and corporate loans outperformed consumer loans.

Securities portfolio...

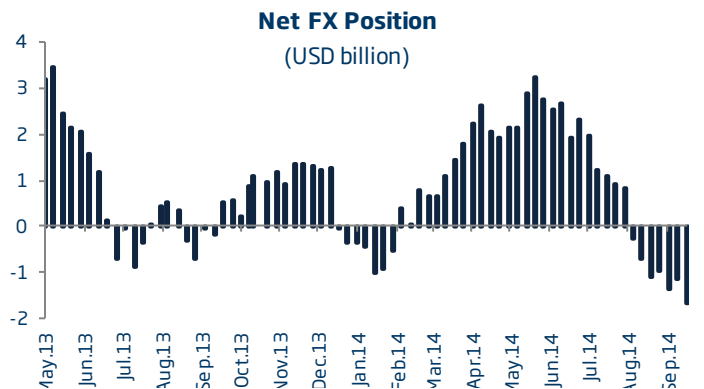
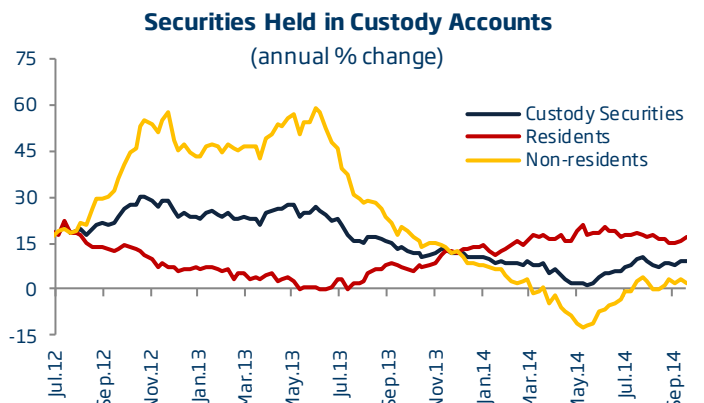
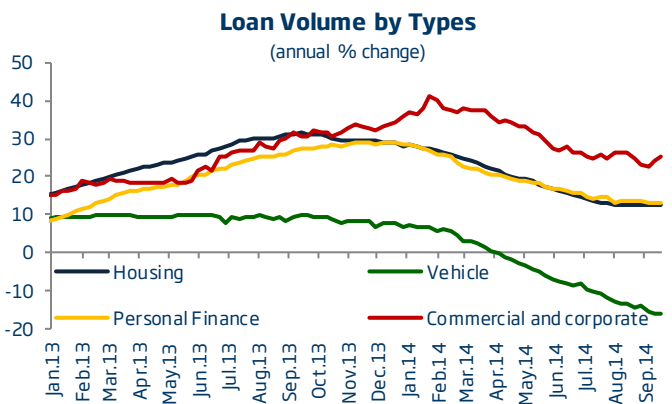
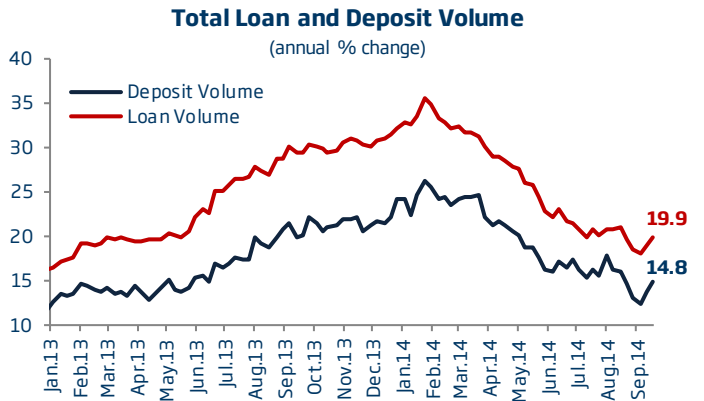
Securities portfolio of the banking sector grew by 2.4% ytd as of September 19. During this period, it was seen that the securities portfolio of private and foreign banks increased while that of public banks' decreased.

Securities held in custody accounts...

In nominal terms, securities held in custody accounts increased by 11.8 billion TRY ytd as of September 19. In this period, non-residents' portfolio increased by 2.1 billion TRY while residents' portfolio rose by 9.7 billion TRY.

Net FX position...

As of September 19, banks' on-balance sheet FX position was (-)38,016 million USD while off-balance sheet FX position was (+)36,358 million USD. Hence, banks' net FX position was realized as (-)1,658 million USD.



Source: BRSA Weekly Bulletin

There are encouraging signs that the recovery in the US economy has been continuing. Following the Fed's September meeting, assessments that the Fed might start to normalize monetary policy faster than markets' expectations have increased which in turn have resulted in a rapid appreciation of the USD against other major currencies. Regarding the Euro Area, some economies in the region fell back into stagnation. In addition, Russia's new sanctions might also create downward pressure on economic activity in the region. These developments increased the concerns that steps taken by the ECB in recent months might not be sufficient to support the region's economy. Thus, the ECB might take new steps in order to increase the effectiveness of the monetary policy. In emerging countries, on the other hand, a broad-based economic slowdown which started in 2013 has continued. The impact of slowing emerging markets growth, especially in China, has been felt on industrial commodity prices which have declined significantly.

The second quarter GDP growth missed the expectations and the leading indicators for the third quarter implied only a moderate increase in economic activity. The current inflation outlook and the possibility of a faster than expected rate hike by the Fed leaves less room for the CBRT to maneuver. In addition, developments in Turkey's leading trading partners, the Eurozone and Iraq, will continue to be influential in the economic activity in the coming period.

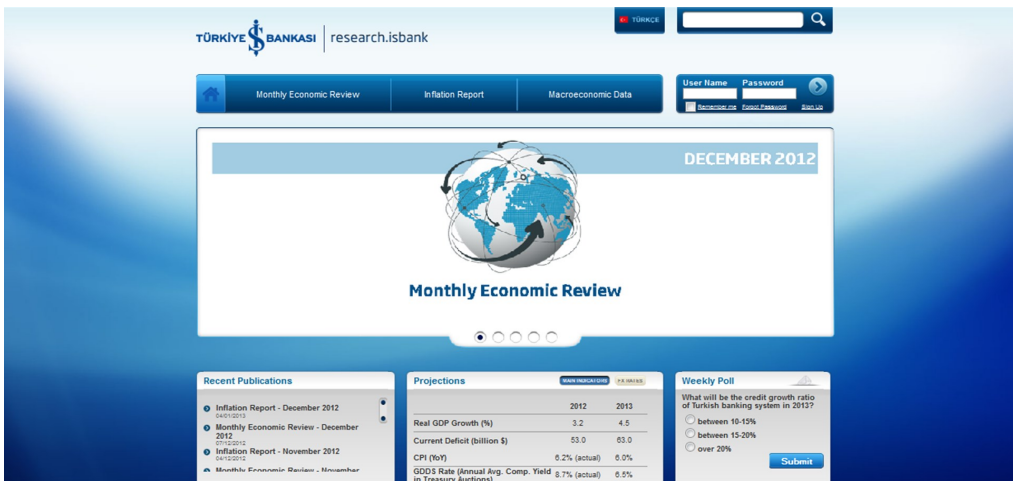
Forecasts (%)	2013 (R)	2014
Growth	4.0	3.0-3.5
CA Deficit/GDP	7.9	5.5
Inflation	7.4	9.0
GDDI Interest*	7.7	10.0

(*) Annual compound average interest rate in treasury auctions

(R) Realization

Interest and inflation are year-end forecasts

Our reports are available on our website <http://research.isbank.com.tr>



Recent Publications

- Inflation Report - December 2012 (04/01/2013)
- Monthly Economic Review - December 2012 (03/20/2013)
- Inflation Report - November 2012 (04/02/2013)
- Monthly Economic Review - November (04/02/2013)

Projections

	2012	2013
Real GDP Growth (%)	3.2	4.5
Current Deficit (billion \$)	53.0	63.0
CPI (YoY)	0.2% (actual)	0.0%
GDS Rate (Annual Avg. Comp. Yield in Treasury Auctions)	6.7% (actual)	6.5%

Weekly Poll

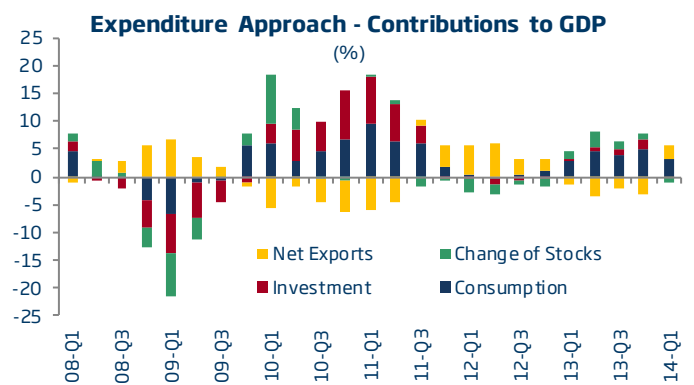
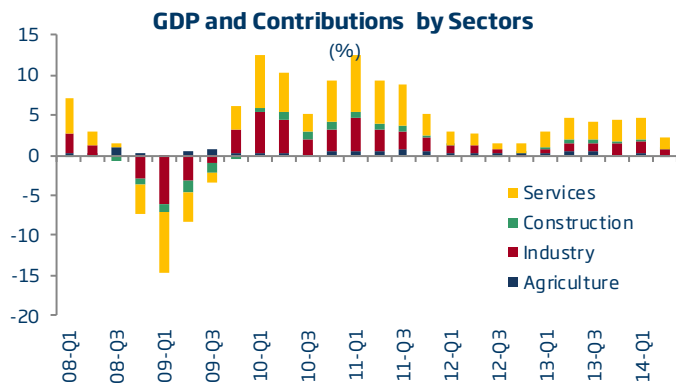
What will be the credit growth ratio of Turkish banking system in 2013?

between 10-15%

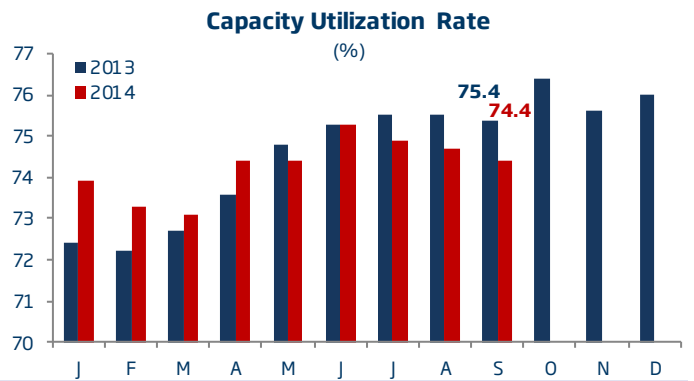
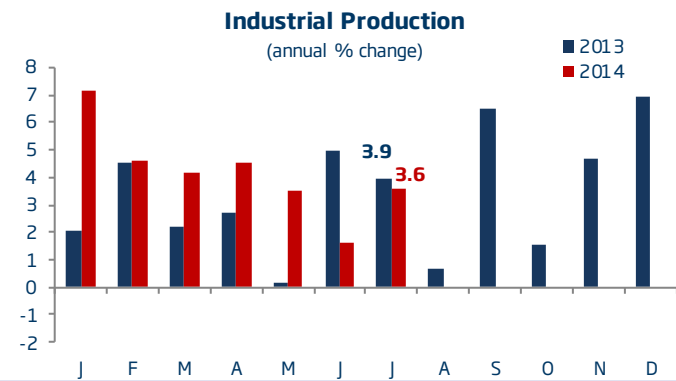
between 15-20%

over 20%

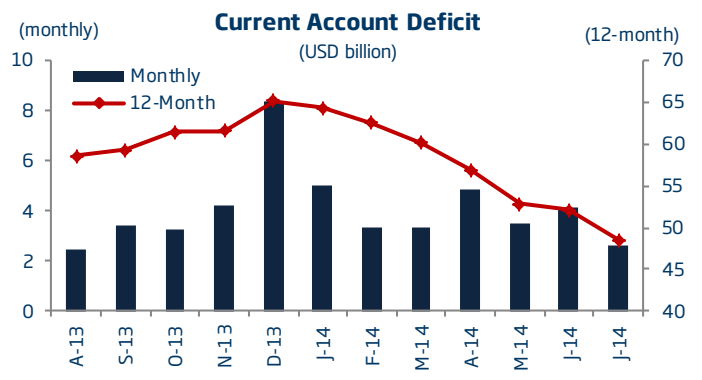
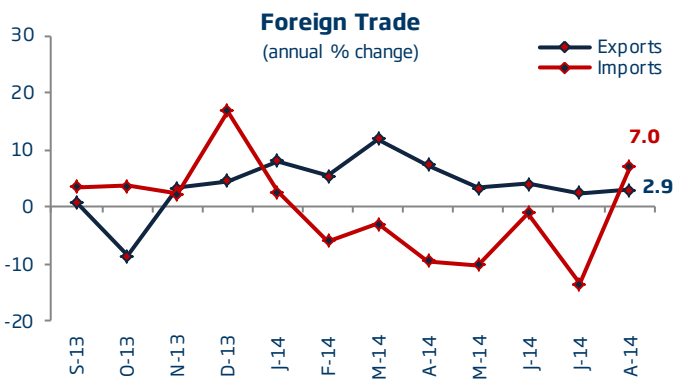
Growth



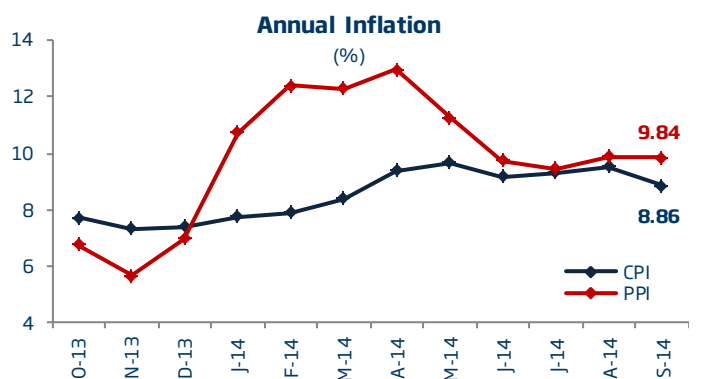
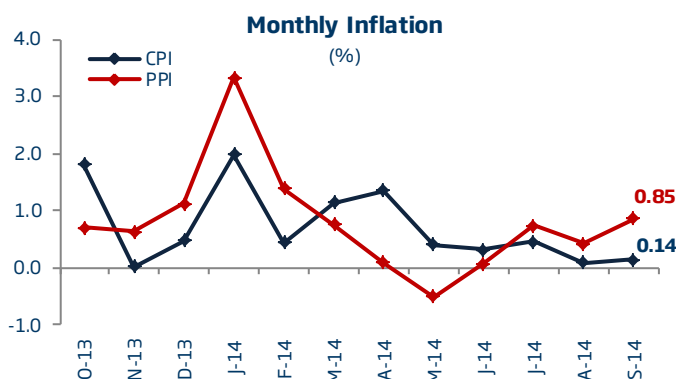
Industrial Production



Foreign Trade and Current Account Balance



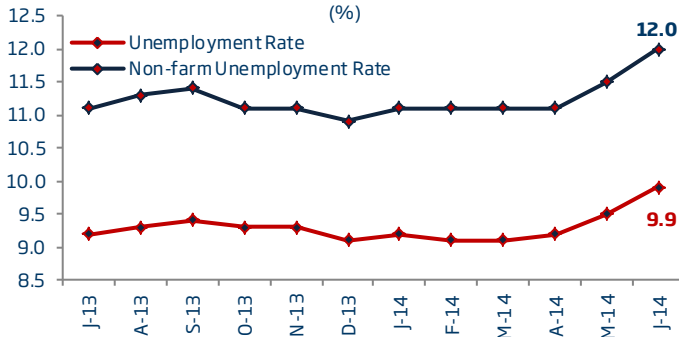
Inflation



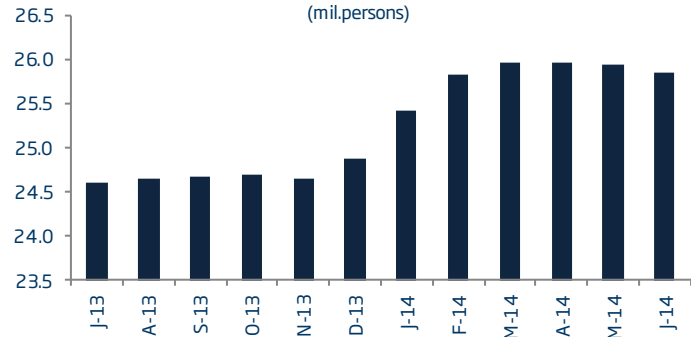
Source: Turkstat, CBRT

Labor Market

Seasonally Adjusted Unemployment Rates (%)

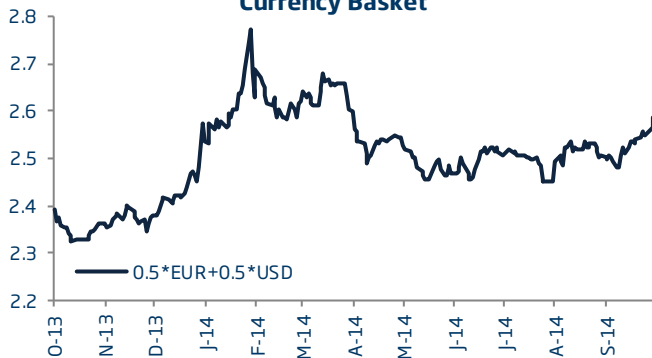


Seasonally Adjusted Employment (mil.persons)

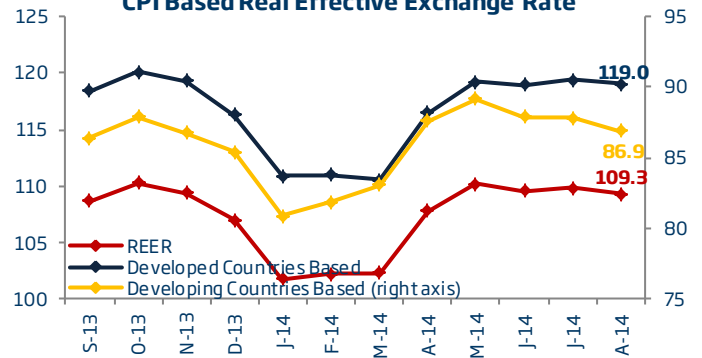


FX Market

Currency Basket

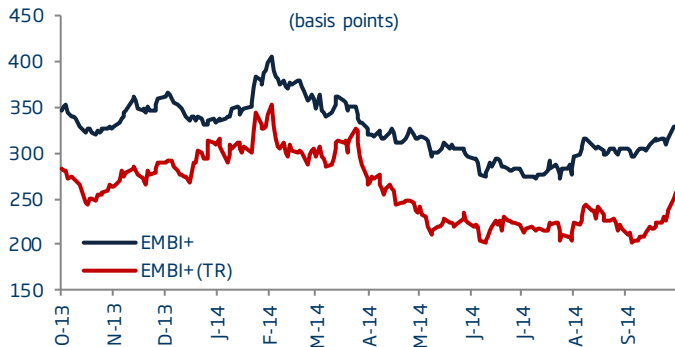


CPI Based Real Effective Exchange Rate

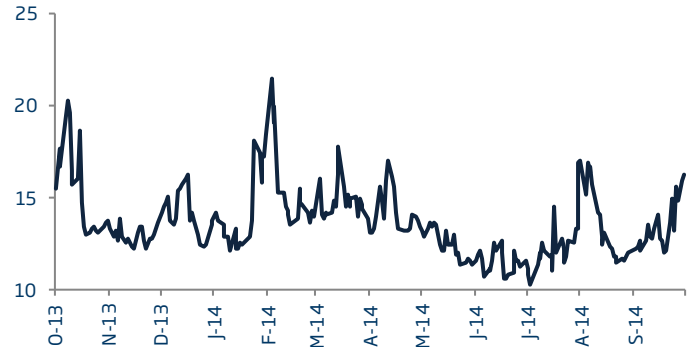


Risk Indicators

Risk Premiums (basis points)

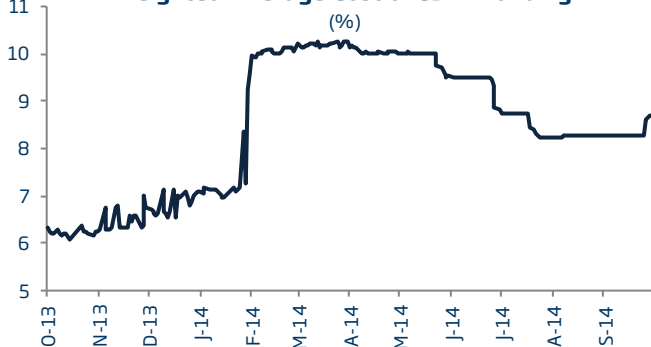


VIX



Interest Rates

Weighted Average Cost of CBRT Funding (%)

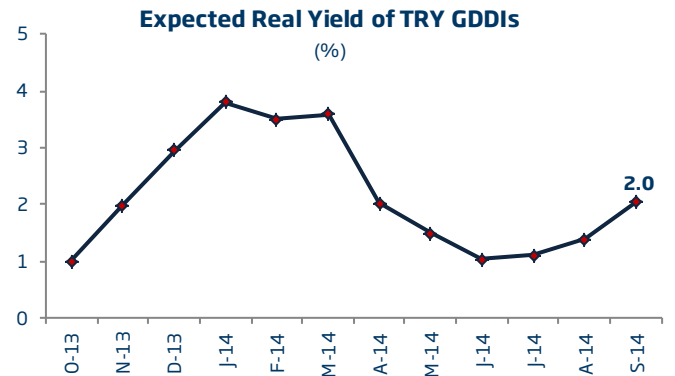
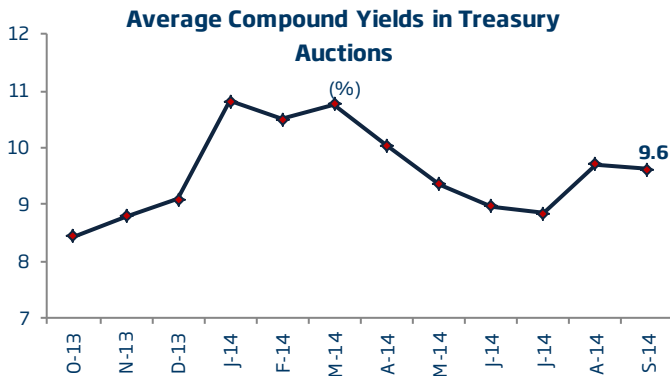


Compound Yield of Benchmark Bond (%)

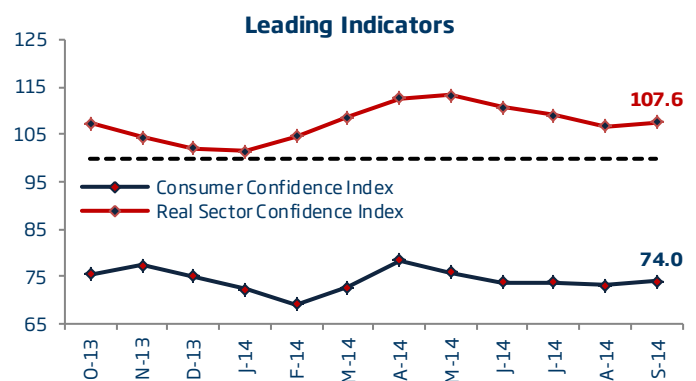
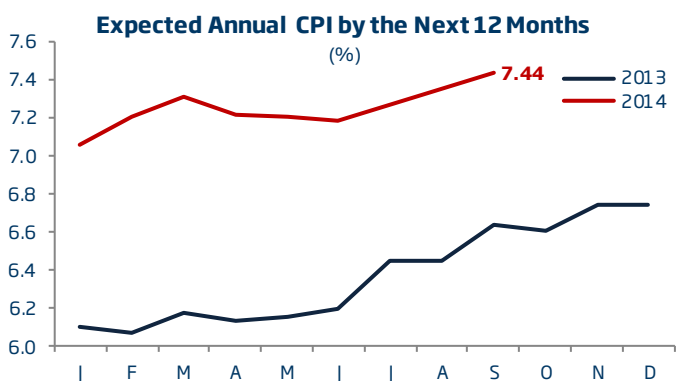
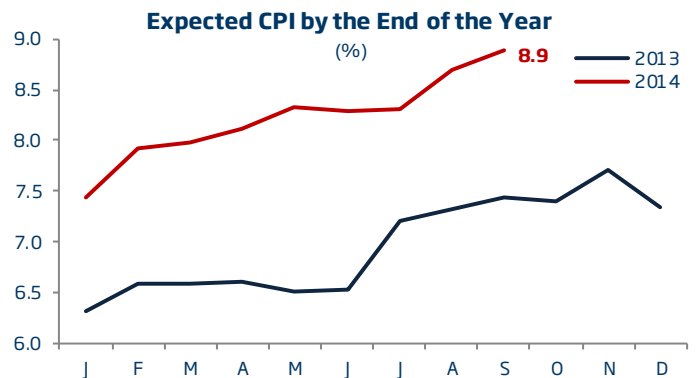
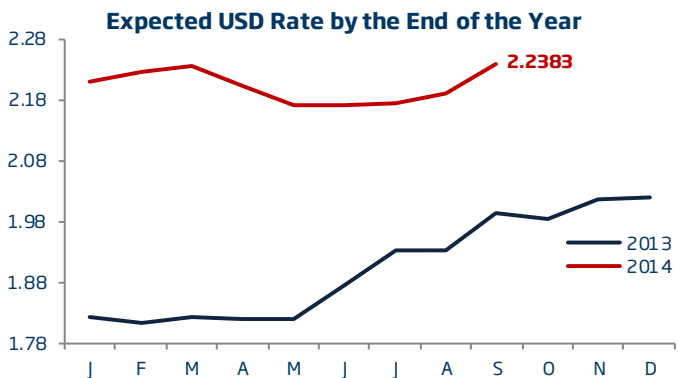
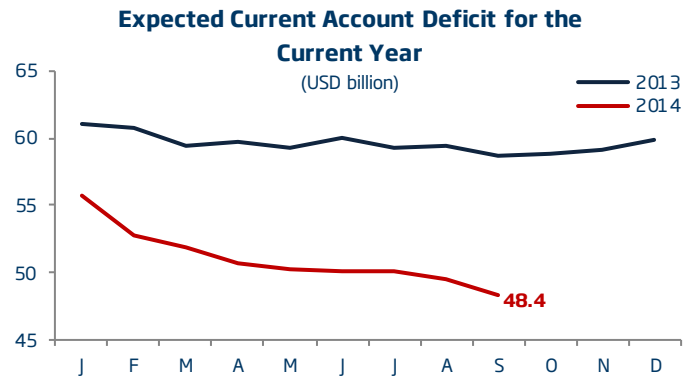
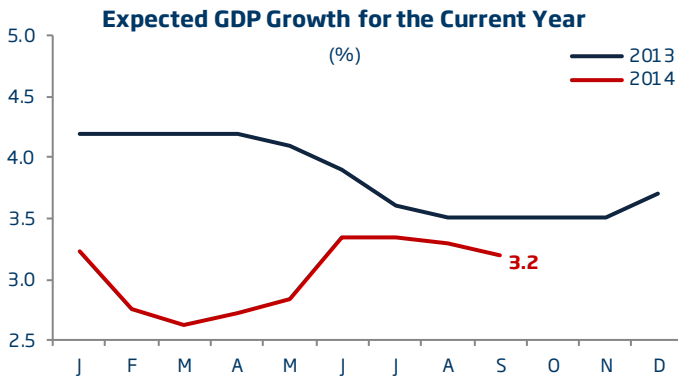


Source: Turkstat, CBRT, JP Morgan, Reuters, BIST

Bond-Bill Market



Survey of Expectations and Other Leading Indicators



Source: Treasury, BIST, CBRT, Economic Research Division

Turkish Economy at a Glance

Growth	2009	2010	2011	2012	2013	14-Q1	14-Q2	14-Q3
GDP (USD Billion)	616.7	731.6	774.0	786.3	821.9	807.5*	797.5*	
GDP Growth Rate (%)	-4.8	9.2	8.8	2.1	4.1	4.7	2.1	-
Inflation (%)						Jul-14	Aug-14	Sep-14
CPI (annual)	6.53	6.40	10.45	6.16	7.40	9.32	9.54	8.86
PPI (annual)	5.93	8.87	13.33	2.45	6.97	9.46	9.88	9.84
Seasonally Adjusted Labor Market Figures						Apr-14	May-14	Jun-14
Unemployment Rate (%)	11.9	10.0	8.5	8.8	9.1	9.2	9.5	9.9
Employment (thousand persons)	21,413	22,631	23,496	24,483	24,888	25,966	25,955	25,859
FX Rates						Jul-14	Aug-14	Sep-14
CPI Based Real Effective Exchange Rate	116.8	125.8	109.6	118.2	107.0	109.8	109.3	
USD/TRY	1.5057	1.5460	1.9065	1.7826	2.1343	2.0919	2.1619	2.2789
EUR/TRY	2.1603	2.0491	2.4592	2.3517	2.9365	2.8135	2.8528	2.8914
Currency Basket (0.5*EUR+0.5*USD)	1.8330	1.7976	2.1829	2.0672	2.5354	2.4527	2.5074	2.5852
Foreign Trade Balance⁽¹⁾ (USD billion)						Jun-14	Jul-14	Aug-14
Exports	102.1	113.9	134.9	152.5	151.8	156.8	157.1	157.4
Imports	140.9	185.5	240.8	236.5	251.7	245.6	242.5	243.8
Foreign Trade Balance	-38.8	-71.7	-105.9	-84.1	-99.9	-88.8	-85.4	-86.3
Import Coverage Ratio (%)	72.5	61.4	56.0	64.5	60.3	63.8	64.8	64.6
Current Account Balance⁽¹⁾ (USD billion)						May-14	Jun-14	Jul-14
Current Account Balance	-12.1	-45.4	-75.1	-48.5	-65.1	-52.8	-52.1	-48.5
Capital and Financial Accounts	9.0	44.5	65.9	47.4	62.3	39.6	38.7	35.2
Direct Investments (net)	7.1	7.6	13.8	9.2	9.8	10.4	10.7	9.7
Portfolio Investments (net)	0.2	16.1	22.0	40.8	23.7	8.4	15.8	22.7
Other Investments (net)	1.9	33.7	28.4	18.4	38.8	20.7	17.0	9.5
Reserve Assets (net)	-0.1	-12.8	1.8	-20.8	-9.9	0.1	-4.7	-6.7
Net Errors and Omissions	3.1	0.9	9.1	1.1	2.8	13.3	13.4	13.3
Current Account Deficit/GDP	-2.0	-6.2	-9.7	-6.2	-7.9	-	-	-
Budget⁽²⁾⁽³⁾ (TRY billion)						Jun-14	Jul-14	Aug-14
Expenditures	268.2	294.4	314.6	361.9	408.2	213.9	253.8	285.9
Interest Expenditures	53.2	48.3	42.2	48.4	50.0	26.5	30.9	33.6
Non-interest Expenditures	215.0	246.1	272.4	313.5	358.2	187.4	223.0	252.2
Revenues	215.5	254.3	296.8	332.5	389.7	210.5	245.2	283.2
Tax Revenues	172.4	210.6	253.8	278.8	326.2	168.1	198.8	232.4
Budget Balance	-52.8	-40.1	-17.8	-29.4	-18.5	-3.4	-8.7	-2.7
Primary Balance	0.4	8.2	24.4	19.0	31.4	23.1	22.2	30.9
Budget Balance/GDP	-5.5	-3.6	-1.4	-2.1	-1.2	-	-	-
Central Government Debt Stock (TRY billion)						Jun-14	Jul-14	Aug-14
Domestic Debt Stock	330.0	352.8	368.8	386.5	403.0	408.4	408.2	407.4
External Debt Stock	111.5	120.7	149.6	145.7	182.8	185.0	181.9	186.0
Total	441.5	473.6	518.4	532.2	585.8	593.4	590.2	593.4

(1) 12 month cumulative

(2) Year-to-date cumulative

(3) According to Central Government Budget

(*) Annualized

Source: Turkstat, CBRT, Treasury, Ministry of Finance, Reuters

BANKING SECTOR ACCORDING TO BRSA's MONTHLY BULLETIN FIGURES

(TRY billion)	2009	2010	2011	2012	2013	Jul-14	Aug-14	Change ⁽¹⁾
TOTAL ASSETS	834.0	1006.7	1217.7	1370.7	1732.4	1851.5	1851.9	6.9
Loans	392.6	525.9	682.9	794.8	1047.4	1137.6	1146.0	9.4
TRY Loans	288.2	383.8	484.8	588.4	752.7	823.9	823.5	9.4
Share (%)	73.4	73.0	71.0	74.0	71.9	72.4	71.9	-
FX Loans	104.4	142.1	198.1	206.4	294.7	313.7	322.5	9.4
Share (%)	26.6	27.0	29.0	26.0	28.1	27.6	28.1	-
Non-performing Loans	21.9	20.0	19.0	23.4	29.6	32.9	34.2	15.3
Non-performing Loan Rate (%)	5.3	3.7	2.7	2.9	2.8	2.8	2.9	-
Securities	262.9	287.9	285.0	270.0	286.7	288.6	291.1	1.5
TOTAL LIABILITIES	834.0	1006.7	1217.7	1370.7	1732.4	1851.5	1851.9	6.9
Deposits	514.6	617.0	695.5	772.2	945.8	1000.6	991.5	4.8
TRY Deposits	341.4	433.5	460.0	520.4	594.1	627.5	606.1	2.0
Share (%)	66.3	70.3	66.1	67.4	62.8	62.7	61.1	-
FX Deposits	173.2	183.5	235.5	251.8	351.7	373.1	385.3	9.6
Share (%)	33.7	29.7	33.9	32.6	37.2	37.3	38.9	-
Securities Issued	0.1	3.1	18.4	37.9	60.6	75.2	76.8	26.7
Payables to Banks	86.1	122.4	167.4	173.4	254.2	261.9	265.4	4.4
Funds from Repo Transactions	60.7	57.5	97.0	79.9	119.1	111.6	129.8	9.0
TOTAL SHAREHOLDERS' EQUITY	110.9	134.5	144.6	181.9	193.7	217.3	218.6	12.9
Profit (Loss) of the Period	20.2	22.1	19.8	23.5	24.7	14.5	16.7	-
RATIOS (%)								
Loans/Assets	47.1	52.2	56.1	58.0	60.5	61.4	61.9	-
Securities/Assets	31.5	28.6	23.4	19.7	16.6	15.6	15.7	-
Deposits/Liabilities	61.7	61.3	57.1	56.3	54.6	54.0	53.5	-
Deposits/Loans	131.1	117.3	101.8	97.2	90.3	88.0	86.5	-
Capital Adequacy (%)	20.6	19.0	16.6	17.9	15.3	16.3	16.3	-

(1) Year-to-date % change



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