

## Global Economy

- ◆ IMF published its World Economic Outlook Report in January. IMF revised up developed countries' growth estimates for 2017 and 2018 compared to its October estimates while leaving its global growth forecasts unchanged.
- ◆ Fed kept interest rates unchanged at the meeting ended on February 1. The statement cited that job gains remained solid, inflation continued to rise and sentiment towards the economy has improved. However, the Fed gave no hint on the timing of next interest rate hike.
- ◆ The US President Trump started to carry out his pledges regarding the protective trade policies in his first week in office which, in turn, has unsettled financial markets. While the new US administration started to implement a protectionist trade policy, the uncertainty surrounding the new government's pro-growth economic policy including tax cuts still prevails.
- ◆ The UK's exit plan from the EU has been high on the agenda in recent period. After the remarks of British Prime Minister May on January 17, uncertainty over the Brexit process has eased to some extent and thus pound has appreciated against the US dollar.
- ◆ ECB held its monetary policy steady at its meeting on January 19. Draghi, President of the ECB, stressed that risks continued to relate to developments in the global economy in his post-meeting press conference.
- ◆ Chinese economy grew by 6.8% in the last quarter of 2016, exceeding the expectations.

## Turkish Economy

- ◆ Fitch lowered Turkey's credit rating to BB+ on January 27, 2017. Thus, none of the three major rating agencies assign investment grade to Turkey.
- ◆ The number of unemployed persons in Turkey surged to 3.6 million in October period, rising by 500 thousand on an annual basis. Unemployment rate picked up by 1.3 pp to 11.8% in this period. The seasonally adjusted figures also pointed to deterioration in labor market indicators.
- ◆ Calendar adjusted industrial production posted an annual rise of 2.7% in November. After posting limited increase in October, industrial production fell short of expectations in November indicating that economic activity, which shrank in the third quarter, recovered slightly in the last quarter.
- ◆ Exports rose by 9% yoy in December following 9.5% annual increase in November with the aid of the depreciation in TRY. Thus, the contraction in exports stood at 0.9% in 2016. Imports decreased by 4.2% in overall 2016 due to the downward trend, especially in the first half of the year. Foreign trade deficit narrowed to 56 billion USD in 2016, dropping by 11.7%.
- ◆ In January-November period, the current account deficit expanded by 5% yoy and became 26.5 billion USD. According to 12-month cumulative figures, the deficit rose to 33.7 billion USD, climbing to one-year high.
- ◆ Owing to the surge in expenditures in 2016, budget deficit grew by 24.4% yoy and amounted to 29.3 billion TRY. Nevertheless, fiscal discipline was maintained as budget deficit came in 430 million TRY less than the year-end target.
- ◆ As CPI registered the highest monthly increase rate in the last 63 months, annual CPI inflation reached 9.22% in January.

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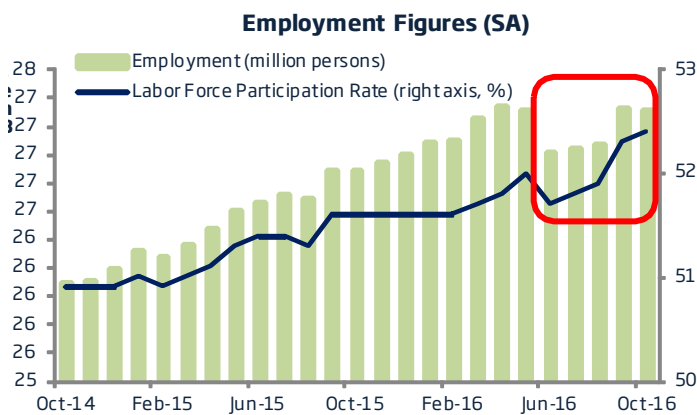
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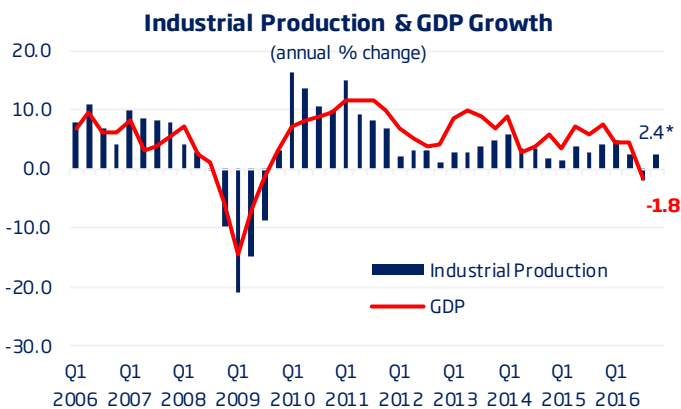
### Unemployment rate rose to 11.8%.

The number of unemployed persons in Turkey surged to 3.6 million in the October period, rising by 500 thousand on an annual basis. Unemployment rate picked up by 1.3 pp to 11.8% in this period. The seasonally adjusted figures also pointed to deterioration in labor market indicators. As the number of employed persons fell by 23 thousand from a month earlier according to these figures, the unemployment rate reached the highest rate of last 6.5 years with 11.7%. This development was driven by the decline in the number of unemployed persons in construction and agriculture sectors as well as the surge in labor force participation rate which became 52.4%.



### Industrial production rose by 2.7% in November.

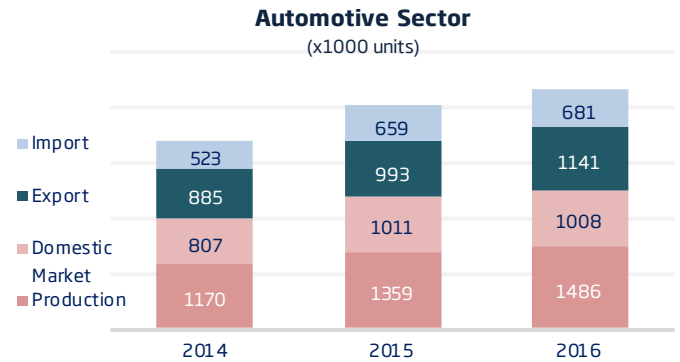
Calendar adjusted industrial production posted an annual rise of 2.7% in November. The recovery in motor vehicles, electronic and optical products and pharmaceuticals industry made 2.1 pp contribution to the growth in industrial production. On the other hand, the contraction in base metal industry and wearing apparel industry constrained the rise in industrial production. After posting a limited increase in October, industrial production fell short of expectations in November indicating that economic activity, which shrank in the third quarter, recovered slightly in the last quarter.



(\*). 2.4% change in industrial production belongs to October-November period.

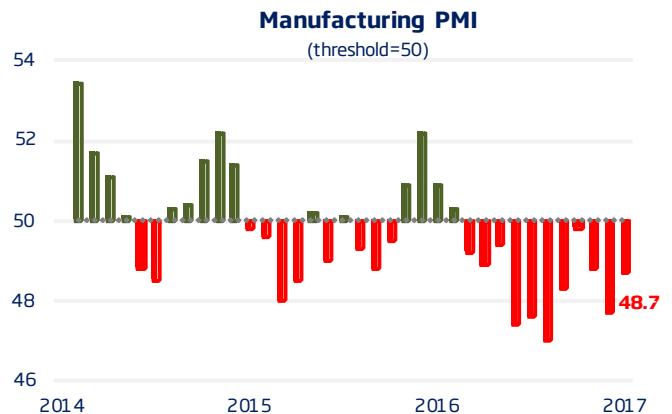
### Automotive industry...

Total sales in automotive sector dropped slightly and amounted to 1 million units in 2016 when domestic demand was stagnant. While total production surged by 9% in this period, the 15% annual rise in exports was worth noting. Indeed, exports became 24.3 billion USD in 2016 rising by 12%. Yet, this reading was below the historic high of 24.7 billion USD registered in 2008.



### Manufacturing PMI remained below the threshold for 11 consecutive months.

Despite the upturn in the Purchasing Managers' Index (PMI) in January, the index remained below the threshold with a level of 48.7. This suggested that activity in manufacturing sector contracted for the 11<sup>th</sup> month in a row in January. Among sub-indices, assessments on output and new orders were below the threshold level whereas it was noteworthy that new export orders displayed a favorable outlook by growing for 4 times in 6 months.



Consumer confidence index rose by 5.6% mom in January, however, the fall in all seasonally adjusted sectoral confidence indices indicated a sluggish outlook in economic activity.

Source: Datastream, Turkstat, CBRT, Markit,

### Exports recovered in the last two months of 2016.

The volume of exports rose by 9% yoy in December following 9.5% annual increase in November with the aid of the depreciation in TRY. Thus, the contraction in total exports in 2016 stood at 0.9%. The volume of imports has increased in the last quarter of the year due to the recovery in energy and commodity prices. On the other hand, imports decreased by 4.2% in overall 2016 on the back of the downward trend, especially in the first half of the year. As imports fell more than exports, foreign trade deficit narrowed to 56 billion USD in 2016, dropping by 11.7%.

### Germany ranked first in total exports.

Germany continued to be the biggest export market of Turkey in 2016. In this period, the decline in exports to Iraq, which ranked third in total exports, persisted despite losing pace. It was noteworthy that exports to the EU countries gained momentum in 2016.

#### Top Export Destinations (billion USD)

	2015		2016		Change (%)
	Value	Share %	Value	Share %	
Germany	13.4	9.3	14.0	9.8	4.4
UK	10.6	7.3	11.7	8.2	10.7
Iraq	8.5	5.9	7.6	5.4	-10.6
Italy	6.9	4.8	7.6	5.3	10.1
USA	6.4	4.4	6.6	4.6	3.6
France	5.8	4.1	6.0	4.2	3.1
UAE	4.7	3.3	5.4	3.8	15.5
Spain	4.7	3.3	5.0	3.5	5.3
Iran	3.7	2.5	5.0	3.5	35.6
Netherlands	3.2	2.2	3.6	2.5	13.8
Other	75.9	52.8	70.1	49.1	-7.7
<b>Total</b>	<b>144</b>	<b>100</b>	<b>143</b>	<b>100</b>	<b>-0.9</b>

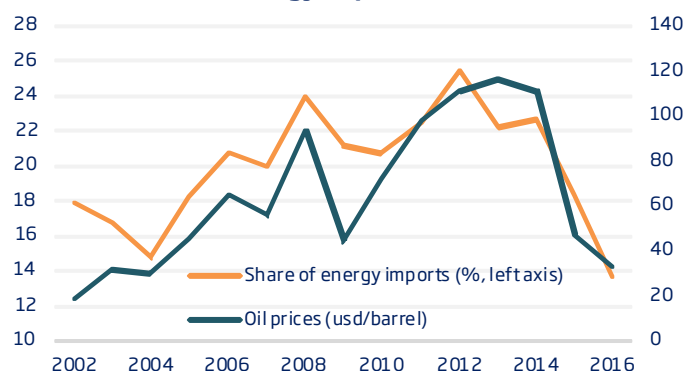
Automotive sector became the largest export sector in 2016. In this period, automotive exports rose to historic levels with 1.1 million units. While this item was followed by

machinery industry, precious and semi-precious stones ranked third in total exports thanks to the rise in gold exports as it was the case in the previous years.

### Decline in imports mainly stemmed from energy and iron/steel.

Imports of mineral fuels and oils, which have been Turkey's biggest import item owing to high energy deficit, dropped to 27 billion USD in 2016, falling by 28.2%. Energy imports, which accounts for nearly one-fourth of total imports when oil prices were above 100 USD/barrel, consisted 13.7% of imports in 2016. The decline in imports of iron/steel and aluminum also contributed significantly to the decline in total imports. On the other hand, gold imports which have nearly doubled in this period has limited the fall in imports.

#### Share of Energy Imports and Oil Prices



### Expectations...

In line with the recovery in oil prices since the last quarter of 2016, we expect the positive impact of low energy prices on imports to diminish in the coming period. In addition, we think that recent steps to boost domestic demand may also have an upward impact on imports. In this framework, we anticipate that the upward pressure on the foreign trade deficit may increase in 2017.

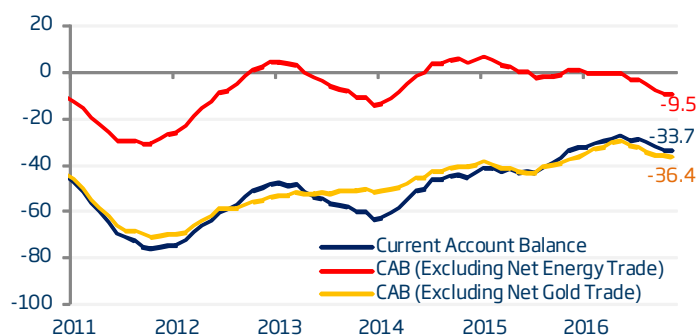
	Foreign Trade Balance (USD billion)					
	December		Change (%)	Jan.-Dec.		Change (%)
	2015	2016		2015	2016	
Exports	11.8	12.8	9.0	143.8	142.6	-0.9
Imports	18.0	18.4	2.3	207.2	198.6	-4.2
<b>Foreign Trade Balance</b>	<b>-6.2</b>	<b>-5.6</b>	<b>-10.3</b>	<b>-63.4</b>	<b>-56.0</b>	<b>-11.7</b>
Import Coverage Ratio (%)	65.3	69.6	-	69.4	71.8	-

### Current account deficit came in below expectations.

Having remained broadly flat in November, current account deficit was 2.3 billion USD, below market expectations.

In the first eleven months of the year, on the other hand, the current account deficit expanded by 5% yoy to 26.5 billion USD. According to 12-month cumulative figures, the deficit rose to 33.7 billion USD, climbing to one-year high. Worth mentioning that, excluding net energy trade, the current account balance which gave a surplus of 1 billion USD at the end of 2015, posted a deficit of 9.5 billion USD in November. Hence, this reading was the highest level since February 2014.

**Current Account Balance**  
(12-month cumulative, USD billion)



### Contraction in foreign trade deficit...

According to the balance-of-payments data, 6.4% annual contraction in foreign trade deficit thanks mainly to the upsurge in exports, positively affected the current account figures in November. The increase in gold exports amounting to 524 million USD played a big part in this development. Indeed, the current account deficit widened by 14.4% yoy in November when net gold trade is excluded.

Having remained low throughout 2016, tourism revenues displayed their weakest November performance in nine years with a reading of 1.3 billion USD. In addition to tourism revenues, other services items such as transportation declined and thus services balance narrowed by 292 million

USD yoy. As a result, deterioration in the services balance offset positive impact of improving foreign trade on the current account deficit.

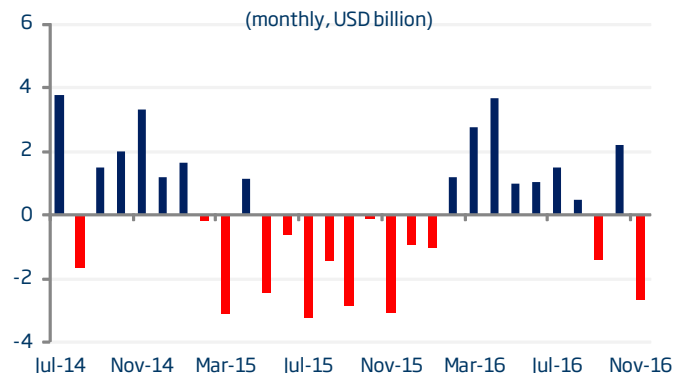
### 6.1 billion USD capital inflows in foreign direct investments...

In November, foreign direct investments recorded a net capital inflow of 444 million USD. Having decelerated since August, foreign direct investments dropped by 42.6% yoy to 6.1 billion USD in the January-November period.

### Volatile capital flows under portfolio investments...

Portfolio investments remained on a volatile trajectory in 2016. In November, portfolio investments recorded the highest capital outflow in 2016 with an amount of 2.7 billion USD.

**Portfolio Flows**  
(monthly, USD billion)



Analyzing the sub-items, non-residents made sales of 504 million USD in equity transactions and 1.8 billion USD in government domestic debt securities transactions. Regarding the bond issues in international capital markets, banking sector made a net repayment of 513 million USD, while other sectors borrowed net 500 million USD.

### Other investments...

Other investments recorded a net inflow of 1 billion USD in November. Surge in nonresident banks' deposits held within domestic banks was the main driver behind this development. Regarding the loans raised from

### Breakdown of Net Capital Inflows

### (12-month cumulative, USD million)

			Breakdown of Net Capital Inflows (%)	
	Dec. 2015	Nov. 2016	Dec. 2015	Nov. 2016
<b>Current Account Balance</b>	<b>-32,278</b>	<b>-33,651</b>	-	-
<b>Total Net Foreign Capital Inflows</b>	<b>20,447</b>	<b>34,783</b>	<b>100.0</b>	<b>100.0</b>
-Direct Investments	11,972	7,479	58.6	21.5
-Portfolio Investments	-15,719	7,311	-	-
-Other Investments	14,893	12,687	72.8	36.5
-Net Errors and Omissions	9,322	7,298	45.6	21.0
-Other	-21	8	-0.1	0.0
<b>Reserves<sup>(1)</sup></b>	<b>11,831</b>	<b>-1,132</b>	-	-

Note: The numbers may not add up to total due to rounding.

(1) (-) sign indicates an increase in reserves while (+) sign indicates a decrease.

Source: Datastream, CBRT

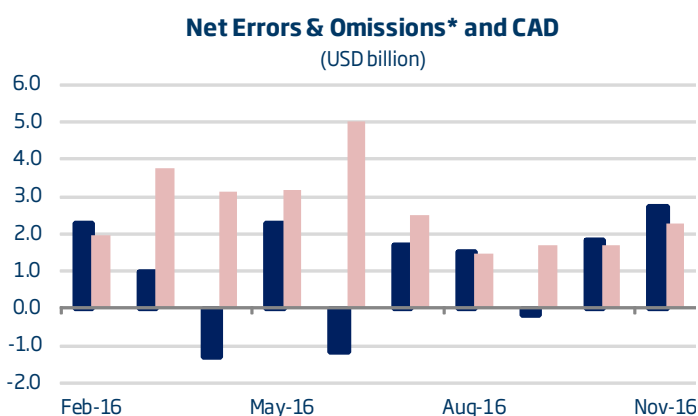
abroad, banks and non-banks sectors borrowed a net amount of 125 million and 669 million USD, respectively in this period. Besides, downward trend in long-term debt rollover ratios persisted in November. This ratio for the banking sector was 111% while that for the non-banking sectors became 158%, according to the 12-month cumulative figures.

### Net errors and omissions...

Net errors and omissions registered an inflow of 2.7 billion USD in November. It was noteworthy that this amount exceeded monthly current account deficit. Having declined by 788 million USD, reserves also made contribution to the financing of the current account deficit in the same period.

### Expectations...

Provisional figures of exports in December posting almost 10% increase indicate that favorable impact of the foreign trade on current account might persist. On the contrary, we think that the deterioration in the services balance arising from weak performance of tourism revenues, may limit this impact to some extent. Against this backdrop, we anticipate that the current account deficit has been realized as 4.5 billion USD in December and bringing the year-end deficit to 33 billion USD.



### Balance of Payments

(USD million)

	November	Jan. - Nov.		%	12-Month
	2016	2015	2016	Change	Cumulative
<b>Current Account Balance</b>	<b>-2,268</b>	<b>-27,211</b>	<b>-28,584</b>	<b>5.0</b>	<b>-33,651</b>
Foreign Trade Balance	-2,888	-43,067	-36,674	-14.8	-41,721
Services Balance	1,002	23,550	14,868	-36.9	15,470
Travel (net)	955	20,558	13,344	-35.1	14,034
Primary Income	-476	-8,792	-8,078	-8.1	-8,924
Secondary Income	94	1,098	1,300	18.4	1,524
<b>Capital Account</b>	<b>0</b>	<b>-6</b>	<b>23</b>	<b>-</b>	<b>8</b>
<b>Financial Account</b>	<b>457</b>	<b>-15,562</b>	<b>-18,930</b>	<b>21.6</b>	<b>-26,345</b>
Direct Investments (net)	-444	-10,558	-6,065	-42.6	-7,479
Portfolio Investments (net)	2,693	14,739	-8,291	-	-7,311
Net Acquisition of Financial Assets	401	7,001	16	-99.8	-856
Net Incurrence of Liabilities	-2,292	-7,738	8,307	-	6,455
Equity Securities	-504	-1,978	705	-	288
Debt Securities	-1,788	-5,760	7,602	-	6,167
Other Investments (net)	-1,004	-14,559	-12,353	-15.2	-12,687
Currency and Deposits	-306	1,507	-1,917	-	-1,163
Net Acquisition of Financial Assets	825	14,301	2,758	-80.7	3,605
Net Incurrence of Liabilities	1,131	12,794	4,675	-63.5	4,768
Central Bank	-18	-877	-460	-47.5	-499
Banks	1,149	13,671	5,135	-62.4	5,267
Foreign Banks	1,224	9,785	4,805	-50.9	4,962
Foreign Exchange	1,160	5,127	458	-91.1	39
Turkish Lira	64	4,658	4,347	-6.7	4,923
Non-residents	-75	3,886	330	-91.5	305
Loans	-681	-14,550	-8,228	-43.5	-7,622
Net Acquisition of Financial Assets	105	525	92	-82.5	359
Net Incurrence of Liabilities	786	15,075	8,320	-44.8	7,981
Banking Sector	125	5,450	-2,210	-	-2,356
Non-bank Sectors	669	10,356	11,415	10.2	11,677
Trade Credit and Advances	-17	-1,257	-2,212	76.0	-3,903
Other Assets and Liabilities	0	-259	4	-	1
Reserve Assets (net)	-788	-5,184	7,779	-	1,132
<b>Net Errors and Omissions</b>	<b>2,725</b>	<b>11,655</b>	<b>9,631</b>	<b>-17.4</b>	<b>7,298</b>

The figures used in the table are according to the Sixth Edition of the Balance of Payments Manual. You can find the details [here](#).

Source: CBRT, Datastream

### Budget deficit became 29.3 billion TRY in 2016.

Central government budget deficit stood at 27 billion TRY in December, rising by 50% yoy mainly due to periodic increase observed in budget expenditures. During the last month of the year, budget revenues and expenditures surged by 11.9% yoy and 23.5% yoy, respectively.

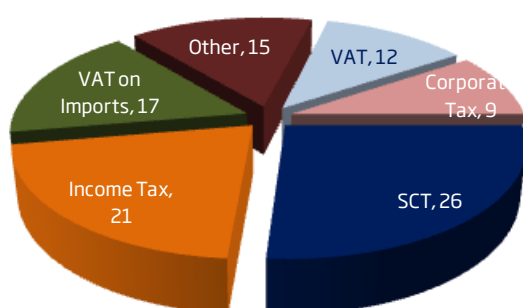
In 2016 as a whole, revenues picked up by 14.8% on an annual basis. Thus, budget revenues exceeded the targeted amount by 13.6 billion TRY. This was chiefly attributable to the funds transferred from the privatization fund amounting to 11 billion TRY. It was noteworthy that tax revenues remained below the year-end target despite obtaining 13.7 billion TRY revenues from tax amnesty. Budget expenditures came in above the year-end target, expanding by 15.3% yoy. Interest expenditures fell by 5.2% yoy in 2016 and thus the share of interest expenditures in total expenditures declined to 8.6%.

Owing to the surge in expenditures in 2016, budget deficit grew by 24.4% compared to the previous year and amounted to 29.3 billion TRY. Nevertheless, fiscal discipline was maintained as budget deficit came in 430 million TRY less than the year-end target. The primary surplus, which dropped in 2016 compared to the previous year, remained below the year-end target by 5.3 billion TRY in 2016 while exceeding the MTP target.

### Budget missed its tax revenues target.

Tax revenues increased by 12.5% yoy in 2016, slightly below the year-end target. This development stemmed from income tax revenues that fell short of target by 2.3 billion TRY in the

Composition of Tax Revenues (% ,2016)

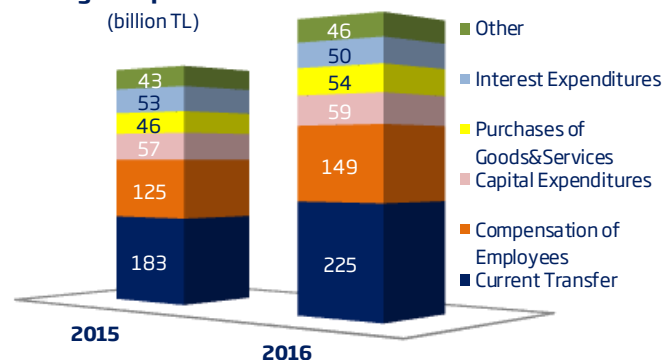


face of the weak economic activity in 2016. On the other hand, the upsurges in the revenues collected from domestic VAT, corporate tax and SCT on tobacco products considerably limited the downward impact of income tax.

### 15.3% rise in budget expenditures...

The annual increase of 23.1% in current transfers played a big role in surpassing the yearly budget expenditure target in 2016. In this period, widening of social assistance expenditures by more than 30% had an upward impact on increase of budget expenditures by 5.3 pp. It was noteworthy that the total amount of 20.4 billion TRY transferred for the social security deficit exceeded the year end target by 9.1 billion TRY. In this period, purchases of goods and services also surpassed the target. On the other hand, no use of funds from reserve appropriations and the decrease in interest expenditures affected positively budget figures in 2016.

Budget Expenditures



### Expectations...

According to the central government budget figures, fiscal discipline was maintained in 2016. Thus, we anticipate that the budget deficit to GDP ratio has been realized as 1.1% in the previous year taking in the consideration the revision of GDP calculation methodology. Under the MTP projections, the annual increases in revenues and expenditures for 2017 are expected to be 9.5% and 11%, respectively with a budget deficit target of 46.9 billion TRY. Against this backdrop, we foresee that the budget deficit to GDP ratio will be 1.6% in 2017.

### Central Government Budget

	November			January-November			2016 Budget		
	2015	2016	% Change	2015	2016	% Change	Target	MTP Target	Real/MTP Target (%)
<b>Expenditures</b>	<b>43.0</b>	<b>50.7</b>	<b>17.9</b>	<b>447.2</b>	<b>510.7</b>	<b>14.2</b>	<b>570.5</b>	<b>581.1</b>	<b>87.9</b>
Interest Expenditures	3.9	3.8	-1.0	51.3	48.4	-5.6	56.0	51.5	94.0
Non-Interest Expenditures	39.1	46.9	19.8	396.0	462.3	16.8	514.5	529.6	87.3
<b>Revenues</b>	<b>43.8</b>	<b>60.7</b>	<b>38.6</b>	<b>441.8</b>	<b>508.6</b>	<b>15.1</b>	<b>540.8</b>	<b>546.5</b>	<b>93.1</b>
Tax Revenues	39.4	54.1	37.2	372.7	419.1	12.4	459.2	450.0	93.1
Other Revenues	4.4	6.7	51.7	69.0	89.5	29.6	81.7	96.5	92.7
<b>Budget Balance</b>	<b>0.8</b>	<b>10.0</b>	<b>1,155.6</b>	<b>-5.4</b>	<b>-2.1</b>	<b>-61.0</b>	<b>-29.7</b>	<b>-34.6</b>	<b>6.1</b>
<b>Primary Balance</b>	<b>4.7</b>	<b>13.9</b>	<b>196.8</b>	<b>45.8</b>	<b>46.3</b>	<b>1.0</b>	<b>26.3</b>	<b>16.9</b>	<b>273.9</b>

Numbers may not add up to total value due to rounding.

Source: Datastream, Ministry of Finance



### CPI inflation came in well above expectations in January.

CPI increased by 2.46% mom in the first month of the year, significantly above the market expectations. According to the Reuters survey, monthly CPI inflation had been anticipated to be 1.78%. Domestic PPI (D-PPI) also surged by 3.98%, the highest monthly increase in nearly 9 years.

January (change %)	CPI		D-PPI	
	2016	2017	2016	2017
Monthly	1.82	2.46	0.55	3.98
Annual	8.53	9.22	5.94	13.69
Annual Average	7.87	7.76	5.50	4.96

### Annual CPI inflation was 9.2%.

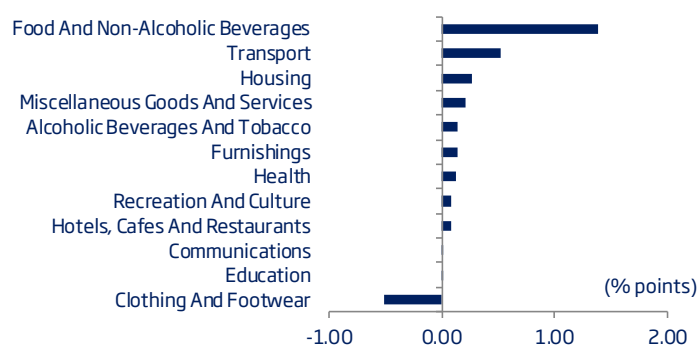
As CPI registered the highest monthly increase rate in the last 63 months, annual CPI inflation reached 9.22% in January. Besides, annual D-PPI inflation climbed to 13.69%, the highest level since August 2008.

### Monthly rise in food prices became 6.4%.

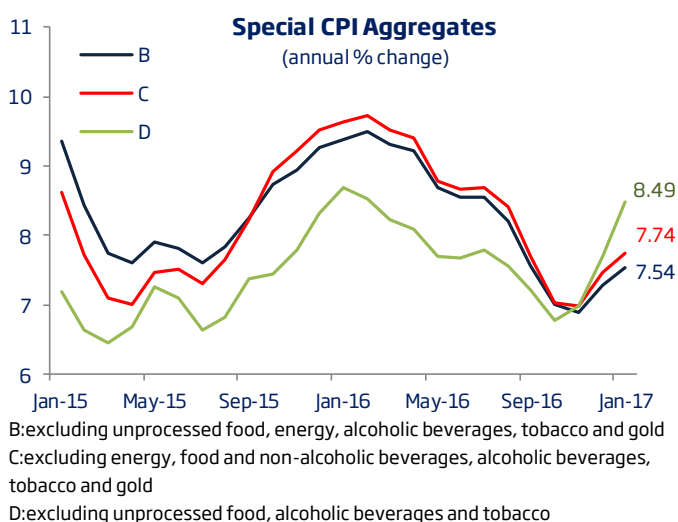
Clothing and footwear was the only group among the sub-items of CPI that recorded monthly price decline in January thanks to the seasonal discounts. Have been falling by 7% mom, this group dragged the rise in inflation down by 0.5 pp. As the weight of the food and non-alcoholic beverages in CPI basket has been decreased from 23.68% to 21.77% by Turkstat, prices in this sub-group surged by 6.4% mom and thus made a contribution of 1.4 pp to the monthly CPI inflation. Prices in transportation group, whose weight in the CPI basket was increased, pushed the inflation up by 0.5 pp, surging by 3.2% mom.

In January, monthly inflation eased to 1.97% when the seasonal products are excluded. This development stemmed mainly from the 34% monthly increase in the prices of fresh fruits and vegetables. Goods inflation was realized as 2.9% while services inflation came in at 1.5% on a monthly basis.

#### Contributions to the Monthly CPI Inflation



Besides the CBRT's favorite core indices, Turkstat has started to release new core CPI indicator. The new index D, excluding unprocessed food, alcoholic beverages and tobacco, posted a monthly rise of 1.3% while increasing by 8.5% on an annual basis. Although there has been no change in the coverage of the core CPI indicators of H and I, they started to be defined as B and C, respectively.



### Commodity prices and exchange rate developments have affected D-PPI.

Owing to the rise in oil prices and the depreciation in TRY, the acceleration in D-PPI in the last months of 2016 persisted in January as well. Increase in energy prices, which are subject to a faster exchange rate pass-through, played an important role in this development. Particularly, it was noteworthy that the crude oil and natural gas prices went up by 84.2% yoy and 29.3% mom. Thus, energy index picked up by 6.6% from a month earlier. Furthermore, basic metal prices posted a monthly rise of 7.6% in January, contributing 0.6 pp to the D-PPI. The prices of food products, which have the highest share of 18.3% in the D-PPI, pushed the inflation up by 0.4 pp, rising by 2.2%.

### Expectations

Food prices jumped in January mainly due to the weakness in Turkish lira and adverse weather conditions. Additionally, sharp increase in oil prices and recent tax adjustments, particularly in tobacco products, had a significant upward impact on inflation. We anticipate that these impacts will persist in the forthcoming months. Against this backdrop, we estimate that annual inflation will rise to double-digit level in the first quarter of this year also depending on low-base effect from the previous year. On the other hand, we believe that the upside risks to the inflation outlook may ease to some extent providing that CBRT maintains its tight liquidity stance.

Source: Datastream, Turkstat

**Global markets...**

The uncertainties regarding the economic policies to be followed by the Trump administration in the US and the unclear path of future interest rate hikes of Fed depending on new economic policies, make it difficult for the markets to set direction. In addition, developments regarding Brexit, Chinese economic performance in 2017 and uncertainty over oil market that whether supply-demand balance in the market will be restored or not, create question marks.

The US dollar has been generally under pressure at the beginning of 2017. This also stemmed from the concerns over the currency wars that has been back on the agenda as the Trump administration era has already begun.

On the domestic side, in addition to global issues, the political and geopolitical developments caused domestic markets to fluctuate. Markets came under pressure before the Fitch's downgrade decision.

**Tight monetary policy from the CBRT....**

CBRT has implemented a tight liquidity policy aiming to avoid upward movement in exchange rates. After cancelling the weekly repo auctions, CBRT has begun to fund the markets through the upper band of the interest corridor and Late Liquidity Window (LON) facility. Moreover, the Central Bank has decided to open foreign exchange deposits against Turkish lira deposits market for banks.

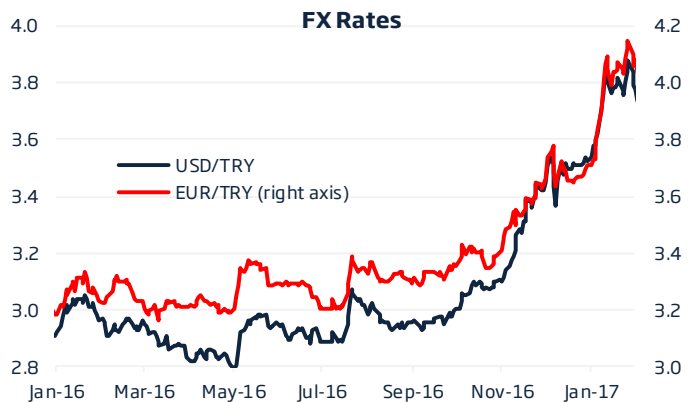
CBRT kept the policy interest rate, one week repo auction interest rate, steady at 8% at the monetary policy committee meeting held on January 24, while raising the interest rates of the upper band of the corridor and LON. CBRT raised overnight lending interest rate, upper band of the corridor, by 75 basis points to 9.25% and increased the interest rate for LON facility by 100 basis points to 11%. Thus, the weighted average cost of funding, which was 8.3% at the end of 2016, became 10.3% as of January 31, picking up by 200 basis points.

**CBRT revised its inflation forecasts upwards.**

The Central Bank, which released the first Inflation Report of 2017 on January 31, revised its inflation forecasts upwards. Accordingly, inflation forecasts for 2017 and 2018 have been raised up to 8% and 6%, respectively on the back of the upward changes on food and import price assumptions. In the report, it is predicted that domestic demand will mildly recover in 2017 so that output gap is foreseen to put downward pressure on inflation.

**Mounting pressure on TRY...**

In addition to the depreciation of emerging market currencies against the US dollar, domestic political developments and Fitch's downgrade of Turkey's rating led TRY to lose value sharply in January. In the mid-January, the USD/TRY and EUR/TRY tested the record high of 3.94 and 4.17, respectively. In the following days, steps taken by the CBRT as well as the recovery in global risk appetite have helped fall the FX rates. As of January 31, USD/TRY was realized as 3.7908 and EUR/TRY became 4.0595.

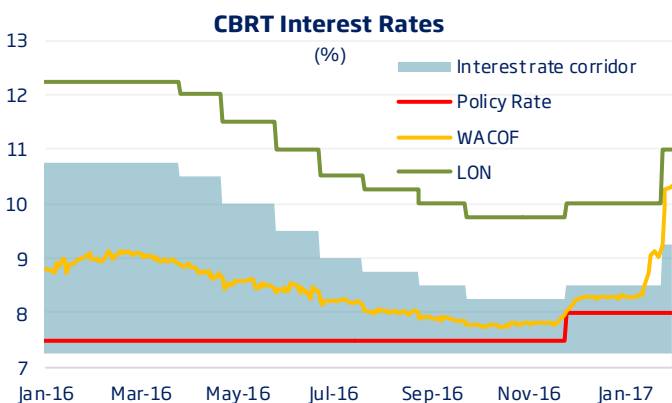


**Interest rates were hovering above 11%.**

The surge in the FX rates was also reflected in interest rates. The compound interest rate of 2-year benchmark bond, which was 10.63% at the end of 2016, rose rapidly in early January. The benchmark bond interest rate reached 11.55% on January 11, the highest level since September 2015. In the following days, the compound interest rate of the 2-year benchmark bond posted a limited decline and became 11.15% as of January 31.

**BIST-100 index...**

Although the exchange rates have risen to high levels, the stock market sustained its positive performance in the first month of 2017. It is assessed that the low level of BIST-100 index in USD terms, falling to the lowest level since 2009, played a big part in this development. The BIST-100 index increased by 10.4% compared to the end of 2016 and came in at 86.296 as of January 31.

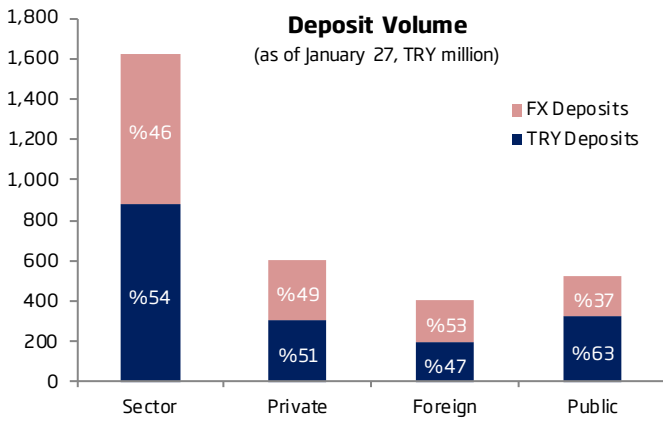


Source: CBRT, Reuters, Datastream



### Deposit volume rose by 5.3% ytd.

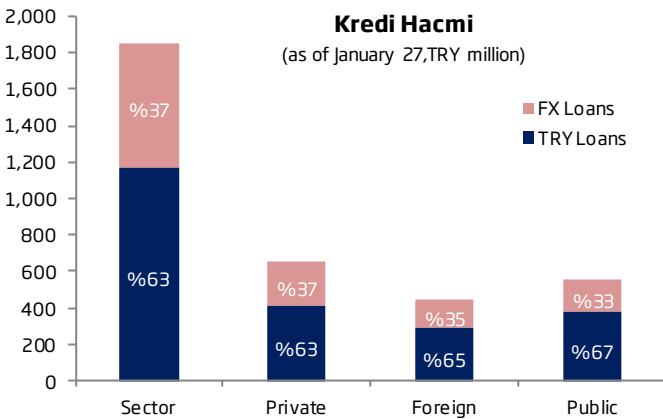
The depreciation of the TRY at the beginning of 2017 caused high nominal increases in main banking indicators. As of January 27, deposit volume expanded by 5.3% compared to the end of 2016, while the growth rate in TRY deposits was 1.1%. In the same period, FX deposits in USD terms also increased by 1.1% while FX deposits grew by 10.7% as a result of the sharp increase in exchange rates. Thus, the share of FX deposits in total deposits reached 45%.



According to exchange rate adjusted figures, as of January 27, the year-to-date expansion in deposit volume was realized as 1.1%.

### The rate of growth in loan volume became 4.7%.

As of January 27, total loan volume expanded by 4.7% compared to the end of 2016 also due to the rise in exchange rates. According to the exchange rate adjusted figures, the growth rate in loan volume was 1.4% in this period.



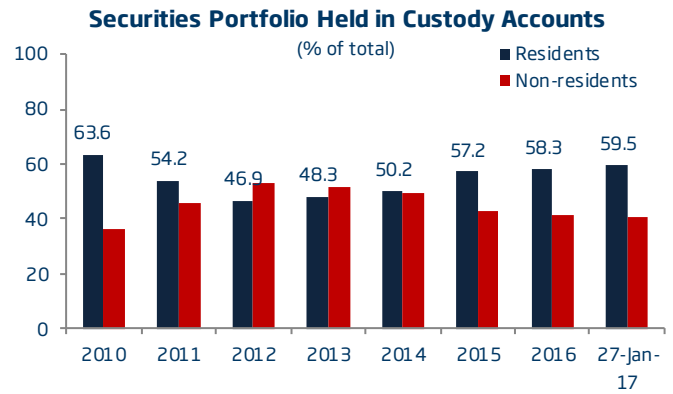
As of January 27, while consumer loans posted a limited increase by 0.4% compared to the end of 2016, the decline in vehicle loans was noteworthy. On the other hand, commercial and corporate loans expanded by 6.1% ytd owing to the depreciation of TRY. Thus, the share of the said

loans in total loans reached 77.2%.

### Securities portfolio...

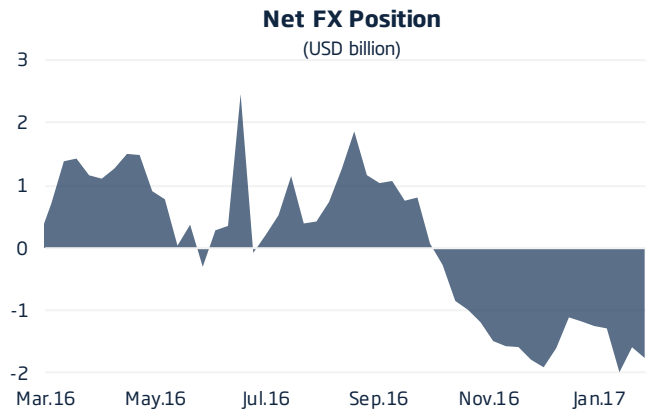
Securities portfolio of the banking sector grew by 4.1% in the first four weeks of the year. The 5.9% expansion of the securities available for sale was influential in this development.

There has been no significant change in the portfolio of securities held under custody in this period. In the first four weeks of 2017, residents' securities increased by 2.3%, while non-residents' securities portfolio decreased by 2.5%.



### Net FX position...

As of January 27, banks' on-balance sheet FX position was (-) USD 27,251 million while off-balance sheet FX position realized as (+)USD 25,489 million. Hence, banking sector's net FX position became (-)USD 1,762 million.



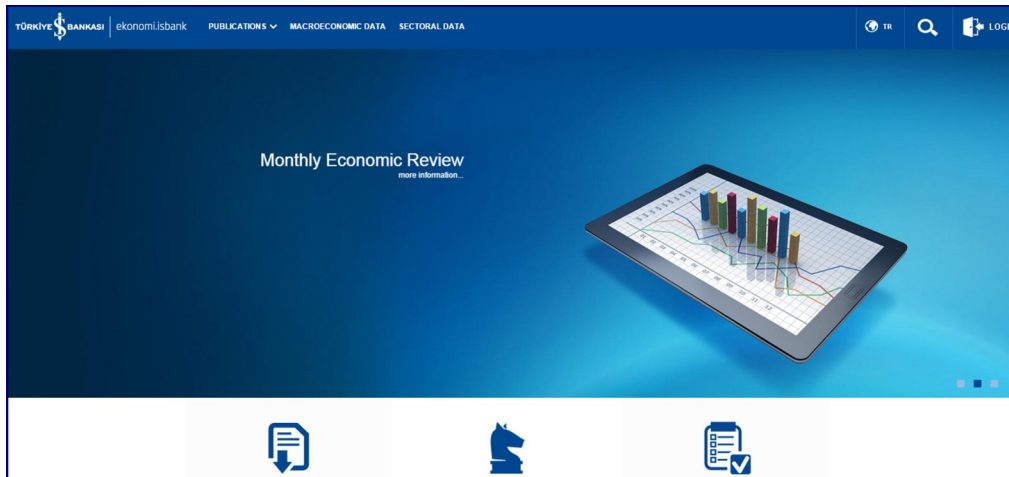
The US President Trump started to carry out his pledges regarding the protective trade policies in his first week in office which, in turn, has unsettled financial markets. While the new US administration started to implement a protectionist trade policy, the uncertainty surrounding the new government's pro-growth economic policy including tax cuts still prevails. Despite the positive economic outlook, Fed kept the monetary policy unchanged and gave no hint on timing of next rate hike at its first meeting of 2017. This indicates that the Federal Reserve wants to see more evidence of fulfilling of President Trump's campaign promises. Taking into account the current risks to global growth outlook, its future path becomes less predictable.

On the domestic side, recent measures taken by the CBRT in response to the sharp depreciation in TRY observed since last November have supported TRY. Nonetheless, we anticipate that the rise in FX rates will continue to put upward pressure on CPI in the coming months. Regarding the course of economic activity, it is seen that domestic demand has recovered gradually, however, political and geopolitical developments caused the confidence of consumer and real sector to weaken. Under the current conditions, we estimate that economic activity will be under pressure in the first half of the year, though it might perform better in the second half of the year.

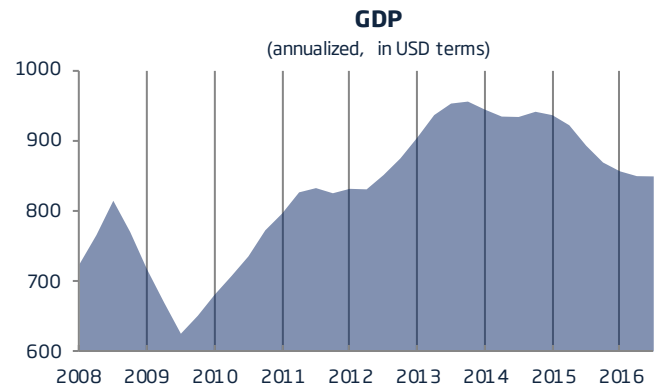
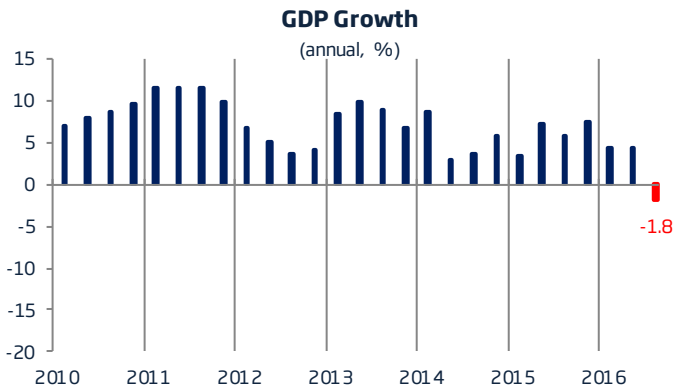
Forecasts (%)	2016	2017
Growth	2.5	3.3
CA Deficit/GDP	3.9	4.2
Inflation	8.5(R)	9.0

(R) Realization  
Year-end forecast for inflation

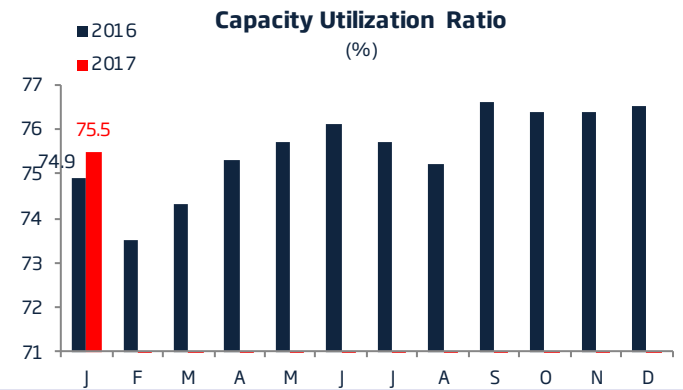
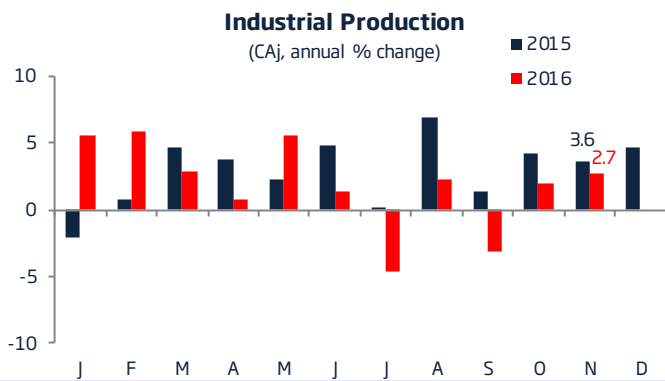
Our reports are available on our website <https://research.isbank.com.tr>



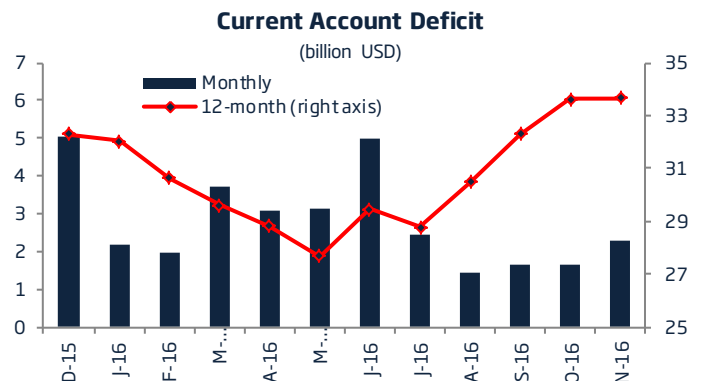
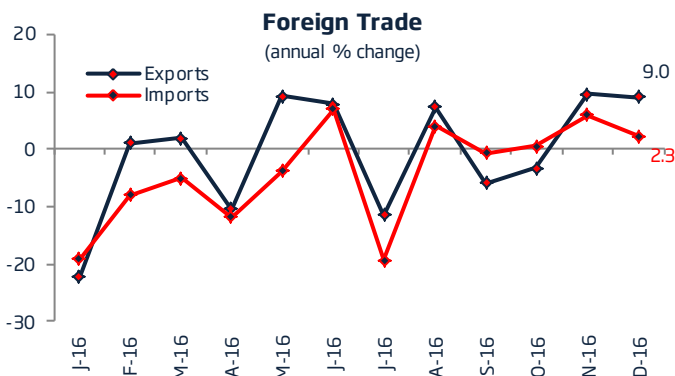
## Growth



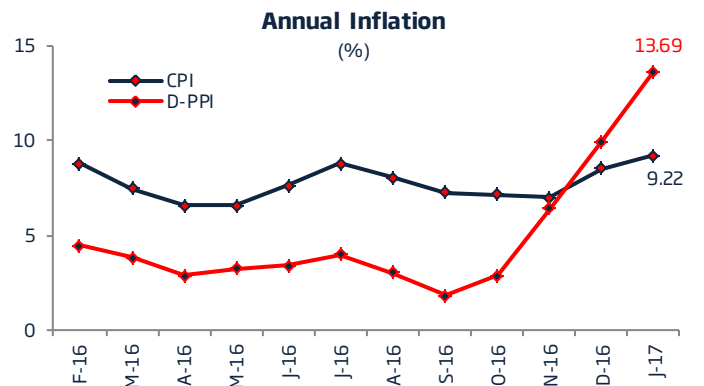
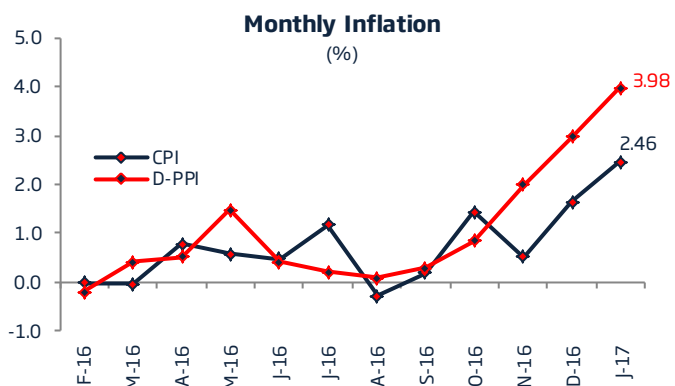
## Industrial Production and Capacity Utilization Ratio



## Foreign Trade and Current Account Balance



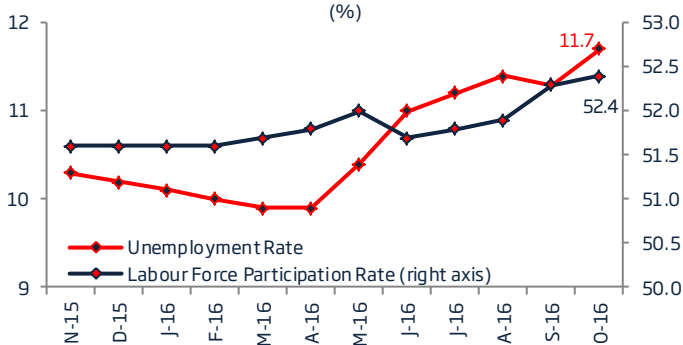
## Inflation



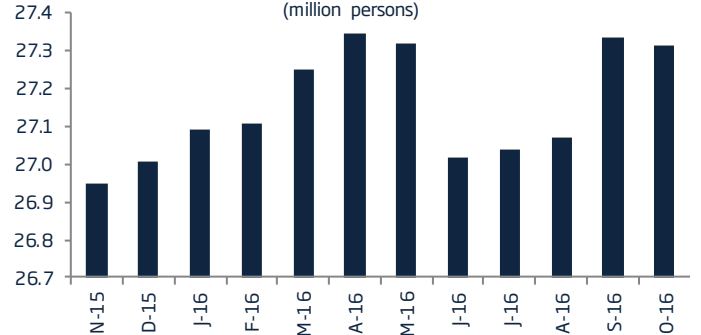
Source: CBRT, Datastream, Turkstat

## Labor Market

### Seasonally Adjusted Labour Force Indicators (%)

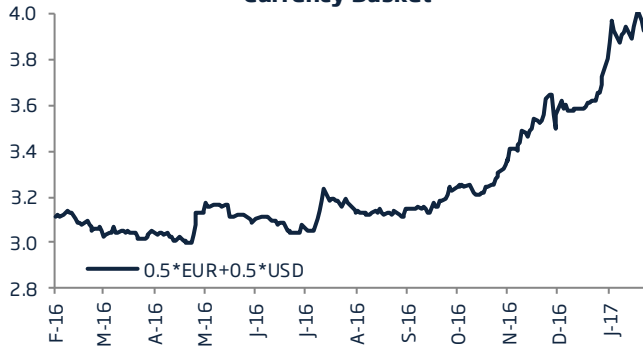


### Seasonally Adjusted Employment (million persons)

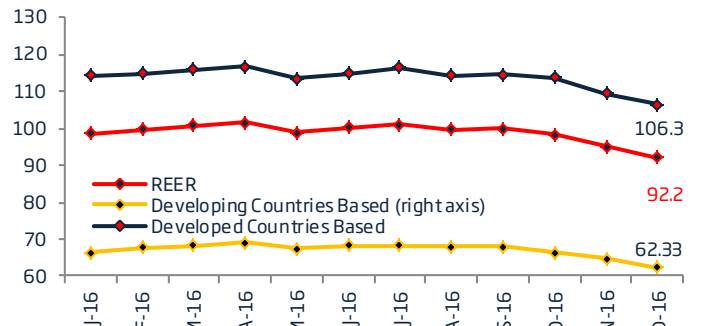


## FX Market

### Currency Basket

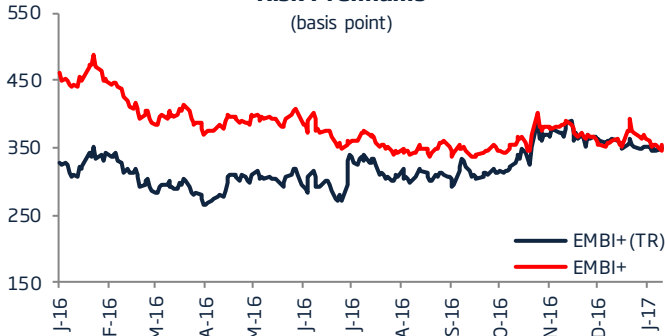


### CPI Based Real Effective Exchange Rate

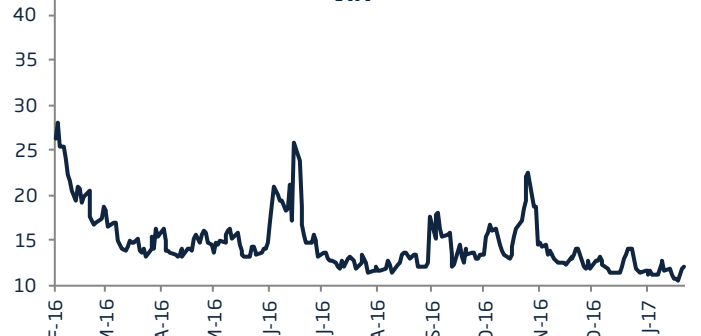


## Risk Indicators

### Risk Premiums (basis point)

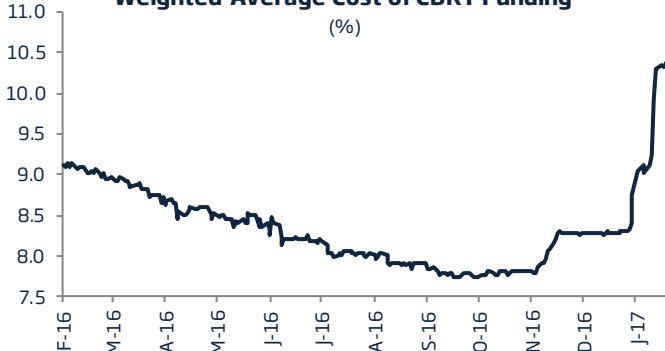


### VIX

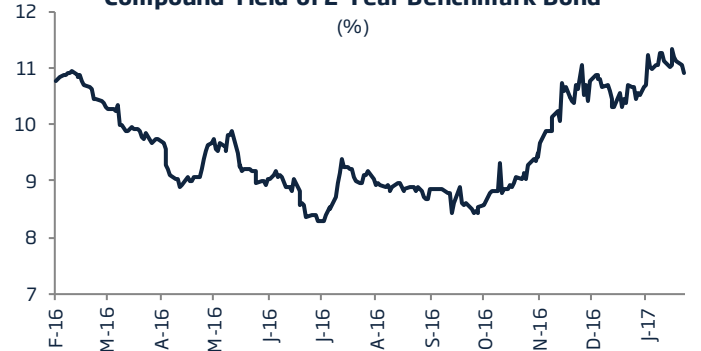


## Interest Rates

### Weighted Average Cost of CBRT Funding (%)

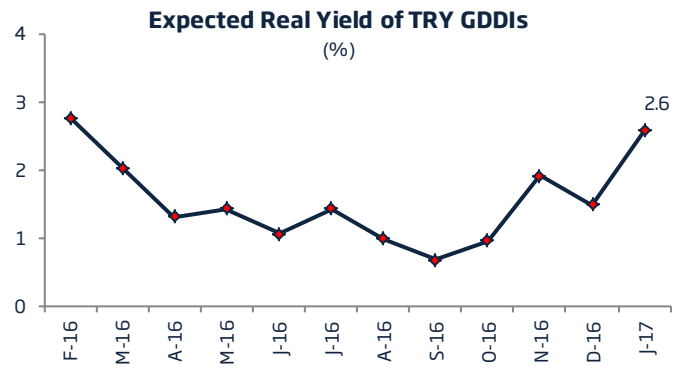
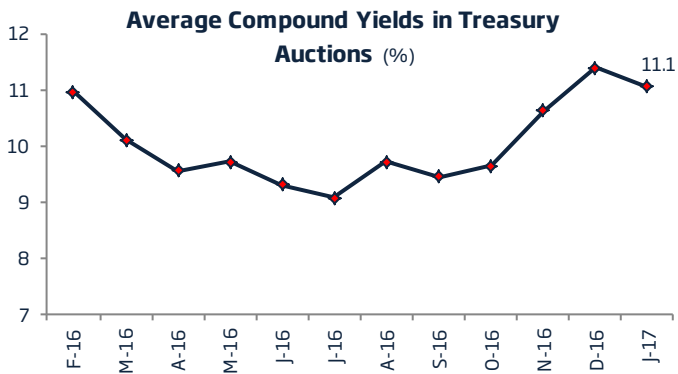


### Compound Yield of 2-Year Benchmark Bond (%)

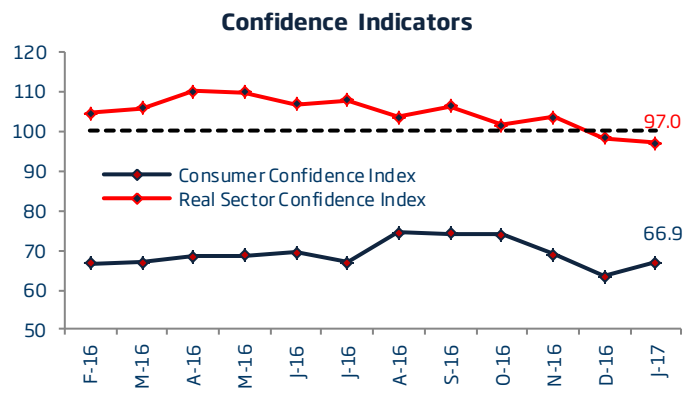
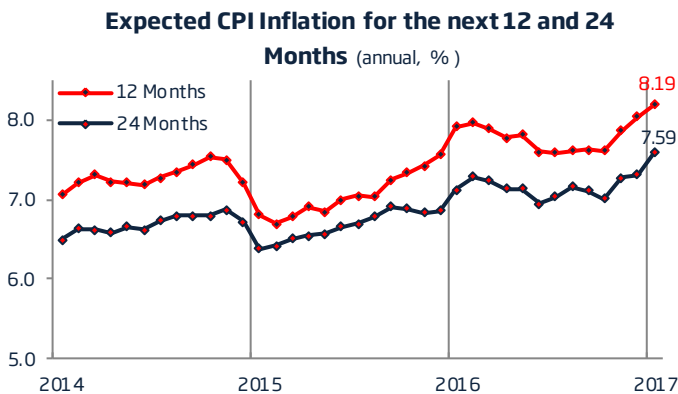
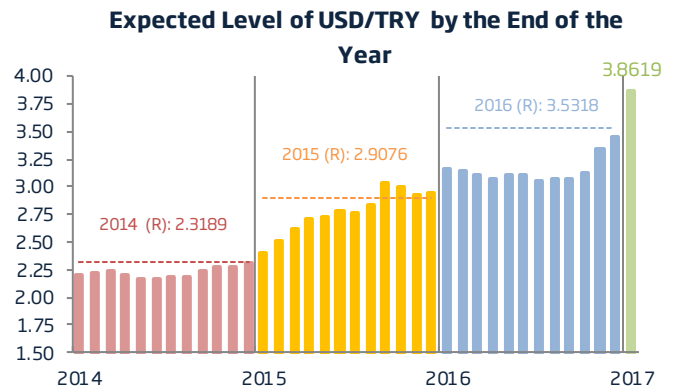
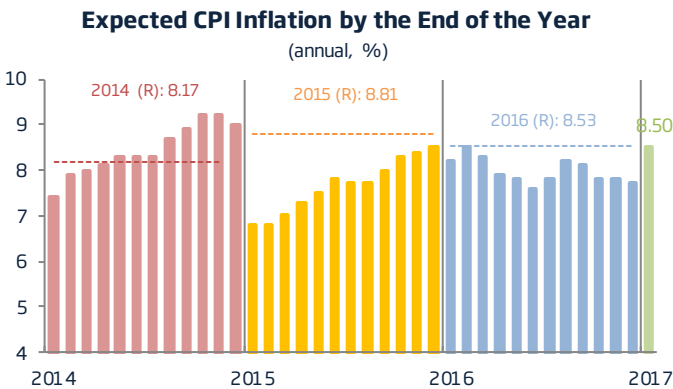
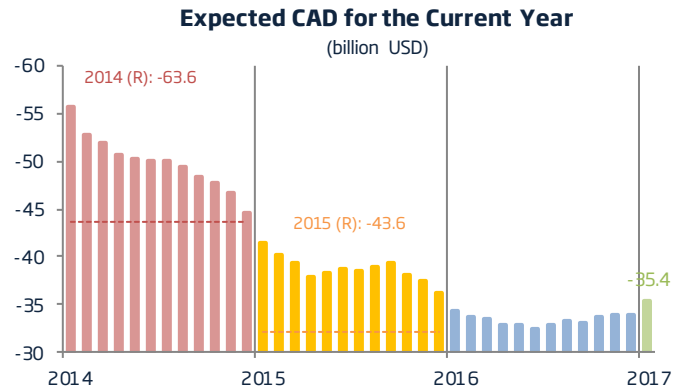
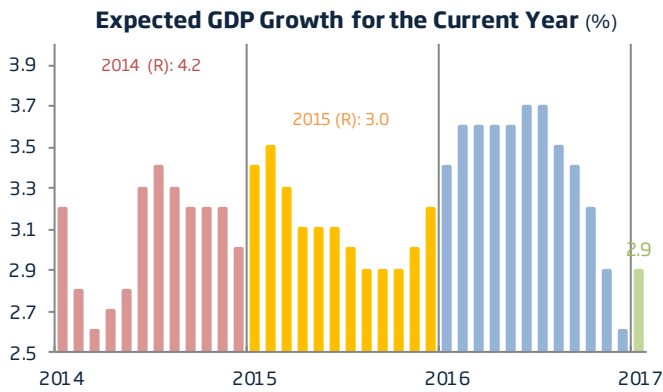


Source: BIST, CBRT, Datastream, JP Morgan, Reuters, Turkstat

## Bond-Bill Market



## CBRT's Survey of Expectations and Other Leading Indicators



(R) Realization

Source: BIST, CBRT, Datastream, Economic Research Division, Treasury



# Turkish Economy at a Glance

	2011	2012	2013	2014	2015	16-Q1	16-Q2	16-Q3
<b>Growth</b>								
GDP (USD billion)	832	871	950	935	861	189.8	216.3	221.6
GDP (TRY billion)	1,395	1,570	1,810	2,045	2,338	559.3	627.5	655.4
GDP Growth Rate (%)	11.1	4.8	8.5	5.2	6.1	4.5	4.5	-1.8
<b>Inflation (%)</b>						<b>Nov-16</b>	<b>Dec-16</b>	<b>Jan-17</b>
CPI (annual)	10.45	6.16	7.40	8.17	8.81	7.00	8.53	9.22
Domestic PPI (annual)	13.33	2.45	6.97	6.36	5.71	6.41	9.94	13.69
<b>Seasonally Adjusted Labor Market Figures</b>						<b>Aug-16</b>	<b>Sep-16</b>	<b>Oct-16</b>
Unemployment Rate (%)	8.5	8.8	9.1	10.4	10.2	11.4	11.3	11.7
Labor Force Participation Rate (%)	47.2	48.5	48.5	50.9	51.6	51.9	52.3	52.4
<b>FX Rates</b>						<b>Nov-15</b>	<b>Dec-15</b>	<b>Jan-16</b>
CPI Based Real Effective Exchange Rate	102.8	110.3	100.3	105.0	97.5	98.6	97.5	98.6
USD/TRY	1.8934	1.7819	2.1323	2.3290	2.9207	2.9135	2.9207	2.9635
EUR/TRY	2.4497	2.3508	2.9370	2.8297	3.1867	3.0822	3.1867	3.2321
Currency Basket (0.5*EUR+0.5*USD)	2.1716	2.0664	2.5347	2.5794	3.0537	2.9979	3.0537	3.0978
<b>Foreign Trade Balance<sup>(1)</sup> (USD billion)</b>						<b>Oct-16</b>	<b>Nov-16</b>	<b>Dec-16</b>
Exports	134.9	152.5	151.8	157.6	143.8	140.4	141.6	142.6
Imports	240.8	236.5	251.7	242.2	207.2	197.2	198.2	198.6
<b>Foreign Trade Balance</b>	<b>-105.9</b>	<b>-84.1</b>	<b>-99.9</b>	<b>-84.6</b>	<b>-63.4</b>	<b>-56.8</b>	<b>-56.6</b>	<b>-56.0</b>
Import Coverage Ratio (%)	56.0	64.5	60.3	65.1	69.4	71.2	71.4	71.8
<b>Balance of Payments<sup>(1)</sup> (USD billion)</b>						<b>Sep-16</b>	<b>Oct-16</b>	<b>Nov-16</b>
<b>Current Account Balance</b>	<b>-74.4</b>	<b>-48.0</b>	<b>-63.6</b>	<b>-43.6</b>	<b>-32.3</b>	<b>-32.3</b>	<b>-33.6</b>	<b>-33.7</b>
<b>Capital and Financial Accounts</b>	<b>-66.1</b>	<b>-48.9</b>	<b>-62.3</b>	<b>-42.1</b>	<b>-23.0</b>	<b>-30.4</b>	<b>-28.7</b>	<b>-26.3</b>
Direct Investments (net)	-13.8	-9.2	-8.8	-5.5	-12.0	-7.2	-7.2	-7.5
Portfolio Investments (net)	-22.2	-41.0	-24.0	-20.1	15.7	-4.6	-6.9	-7.3
Other Investments (net)	-28.3	-19.6	-39.5	-16.0	-14.9	-16.2	-16.3	-12.7
Reserve Assets (net)	-1.8	20.8	9.9	-0.5	-11.8	-2.4	1.7	1.1
<b>Net Errors and Omissions</b>	<b>8.3</b>	<b>-0.9</b>	<b>1.4</b>	<b>1.6</b>	<b>9.3</b>	<b>1.9</b>	<b>4.9</b>	<b>7.3</b>
<b>Current Account Balance/GDP (%)</b>	<b>-8.9</b>	<b>-5.5</b>	<b>-6.7</b>	<b>-4.7</b>	<b>-3.7</b>	-	-	-
<b>Budget<sup>(2)(3)</sup> (TRY billion)</b>						<b>Oct-16</b>	<b>Nov-16</b>	<b>Dec-16</b>
<b>Expenditures</b>	<b>314.6</b>	<b>361.9</b>	<b>408.2</b>	<b>448.8</b>	<b>506.0</b>	<b>460.0</b>	<b>510.7</b>	<b>583.7</b>
Interest Expenditures	42.2	48.4	50.0	49.9	53.0	44.6	48.4	50.2
Non-interest Expenditures	272.4	313.5	358.2	398.8	453.0	415.4	462.3	533.4
<b>Revenues</b>	<b>296.8</b>	<b>332.5</b>	<b>389.7</b>	<b>425.4</b>	<b>483.4</b>	<b>447.9</b>	<b>508.6</b>	<b>554.4</b>
Tax Revenues	253.8	278.8	326.2	352.5	407.5	365.0	419.1	458.7
<b>Budget Balance</b>	<b>-17.8</b>	<b>-29.4</b>	<b>-18.5</b>	<b>-23.4</b>	<b>-22.6</b>	<b>-12.1</b>	<b>-2.1</b>	<b>-29.3</b>
<b>Primary Balance</b>	<b>24.4</b>	<b>19.0</b>	<b>31.4</b>	<b>26.5</b>	<b>30.4</b>	<b>32.4</b>	<b>46.3</b>	<b>21.0</b>
<b>Budget Balance/GDP (%)</b>	<b>-1.3</b>	<b>-1.9</b>	<b>-1.0</b>	<b>-1.1</b>	<b>-1.0</b>	-	-	-
<b>Central Government Debt Stock (TRY billion)</b>						<b>Sep-16</b>	<b>Oct-16</b>	<b>Dec-16</b>
Domestic Debt Stock	368.8	386.5	403.0	414.6	440.1	463.1	465.0	468.6
External Debt Stock	149.6	145.7	182.8	197.5	237.5	249.8	260.4	291.0
<b>Total Debt Stock</b>	<b>518.4</b>	<b>532.2</b>	<b>585.8</b>	<b>612.1</b>	<b>677.6</b>	<b>712.9</b>	<b>725.4</b>	<b>759.6</b>

(1) 12-month cumulative

(2) Year-to-date cumulative

(3) According to Central Government Budget

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

## BANKING SECTOR ACCORDING TO BRSA'S MONTHLY BULLETIN FIGURES

(TRY billion)	2011	2012	2013	2014	2015	Nov.16	Dec.16	Change <sup>(1)</sup>
<b>TOTAL ASSETS</b>	<b>1,217.7</b>	<b>1,370.7</b>	<b>1,732.4</b>	<b>1,994.3</b>	<b>2,357.4</b>	<b>2,702.2</b>	<b>2,730.9</b>	<b>15.8</b>
<b>Loans</b>	<b>682.9</b>	<b>794.8</b>	<b>1,047.4</b>	<b>1,240.7</b>	<b>1,485.0</b>	<b>1,704.3</b>	<b>1,734.3</b>	<b>16.8</b>
TRY Loans	484.8	588.4	752.7	881.0	1,013.4	1,114.5	1,131.4	11.6
Share (%)	71.0	74.0	71.9	71.0	68.2	65.4	65.2	-
FX Loans	198.1	206.4	294.7	359.7	471.5	589.8	602.9	27.9
Share (%)	29.0	26.0	28.1	29.0	31.8	34.6	34.8	-
Non-performing Loans	19.0	23.4	29.6	36.4	47.5	57.2	58.1	22.1
Non-performing Loan Rate (%)	2.7	2.9	2.8	2.9	3.1	3.2	3.2	-
<b>Securities</b>	<b>285.0</b>	<b>270.0</b>	<b>286.7</b>	<b>302.3</b>	<b>329.7</b>	<b>347.9</b>	<b>351.6</b>	<b>6.6</b>
<b>TOTAL LIABILITIES</b>	<b>1,217.7</b>	<b>1,370.7</b>	<b>1,732.4</b>	<b>1,994.3</b>	<b>2,357.4</b>	<b>2,702.2</b>	<b>2,730.9</b>	<b>15.8</b>
<b>Deposits</b>	<b>695.5</b>	<b>772.2</b>	<b>945.8</b>	<b>1,052.7</b>	<b>1,245.4</b>	<b>1,430.8</b>	<b>1,453.7</b>	<b>16.7</b>
TRY Deposits	460.0	520.4	594.1	661.3	715.4	843.6	845.1	18.1
Share (%)	66.1	67.4	62.8	62.8	57.4	59.0	58.1	-
FX Deposits	235.5	251.8	351.7	391.4	530.0	587.2	608.5	14.8
Share (%)	33.9	32.6	37.2	37.2	42.6	41.0	41.9	-
<b>Securities Issued</b>	<b>18.4</b>	<b>37.9</b>	<b>60.6</b>	<b>89.3</b>	<b>97.8</b>	<b>114.8</b>	<b>116.3</b>	<b>18.8</b>
<b>Payables to Banks</b>	<b>167.4</b>	<b>173.4</b>	<b>254.2</b>	<b>293.2</b>	<b>361.3</b>	<b>413.0</b>	<b>417.6</b>	<b>15.6</b>
<b>Funds from Repo Transactions</b>	<b>97.0</b>	<b>79.9</b>	<b>119.1</b>	<b>137.4</b>	<b>156.7</b>	<b>138.2</b>	<b>137.8</b>	<b>-12.0</b>
<b>SHAREHOLDERS' EQUITY</b>	<b>144.6</b>	<b>181.9</b>	<b>193.7</b>	<b>232.0</b>	<b>262.3</b>	<b>294.3</b>	<b>300.2</b>	<b>14.5</b>
Profit (Loss) of the Period	19.8	23.5	24.7	24.6	26.1	35.0	37.5	-
<b>RATIOS (%)</b>								
Loans/GDP	49.0	50.6	57.9	60.7	63.5	-	-	-
Loans/Assets	56.1	58.0	60.5	62.2	63.0	63.1	63.5	-
Securities/Assets	23.4	19.7	16.6	15.2	14.0	12.9	12.9	-
Deposits/Liabilities	57.1	56.3	54.6	52.8	52.8	53.0	53.2	-
Loans/Deposits	98.2	102.9	110.7	117.9	119.2	119.1	119.3	-
Capital Adequacy (%)	16.6	17.9	15.3	16.3	15.6	15.3	15.6	-

(1) Year-to-date % change



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