



# Monthly Economic Review November 2014



## Global Economy

- ◆ In the latest issue of "World Economic Outlook" report published on October 7, International Monetary Fund (IMF) pointed out that global economic recovery had been weak and uneven. IMF stated that the evolution of the global economy has become more differentiated among countries.
- ◆ The US economy grew at an annual rate of 3.5% in the third quarter, beating the expectations. Thus, the US economy posted the fastest six-month economic growth in over a decade.
- ◆ At its two-day meeting held on October 28-29, the US Federal Reserve (Fed) decided to end its third round of quantitative easing, which was announced on 13 September 2012.
- ◆ The latest figures about the Euro Area pointed out that the region's economy continued to remain under pressure. In the Euro area, annual inflation rose from a five-year low level and was realized as 0.4% in October.
- ◆ ECB announced that 1.7 billion Euros of covered-bond purchases were settled during the first week of the asset purchase program.
- ◆ Central Bank of Japan (BoJ) announced that annual asset-purchasing program will be expanded to 80 trillion Yen (726 billion USD) from 70 trillion Yen.
- ◆ Oil prices have followed a downward trend owing to the expected weak oil demand as a result of the downward revisions to the global growth forecasts.

## Turkish Economy

- ◆ The calendar adjusted industrial production index increased by 5.2% yoy in August, above the market expectations. Industrial production gained momentum in the third quarter of the year.
- ◆ In September, exports increased by 4.6% yoy while imports declined by 0.2% yoy. For the first nine months of 2014, exports increased by 5.5% and imports decreased by 4.2% compared to the same period of 2013.
- ◆ Current account posted a deficit of 2.8 billion USD in August, below the market expectations. In the first eight months of the year, the deficit narrowed by 35.4% yoy. This development mainly stemmed from the narrowing foreign trade deficit thanks to the increasing exports and declining imports and partly from the rise in services revenues.
- ◆ Central government budget expenditures increased by 13.5% in September compared to the same period of the previous year. Budget revenues, on the other hand, increased by 0.7% in the same period. Thus, the budget deficit increased from 4.7 billion TRY in September 2013 to 9.2 billion TRY in September 2014 and reached the highest monthly level of 2014.
- ◆ Annual CPI inflation was realized as 8.96% in October. The annual D-PPI inflation, which was hovering close to 10% since June, increased to 10.10%, rising again at double-digit levels.
- ◆ CBRT announced on October 21 that it would start remunerate the Turkish lira component of required reserves of financial institutions in order to spur balanced growth and domestic savings. At its Monetary Policy Meeting on October 23, CBRT kept the one-week repo rate (the policy rate) unchanged at 8.25%.

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## Industrial production increased by 5.2% yoy in August.

Industrial production gained momentum in the third quarter of the year. The calendar adjusted industrial production index increased by 5.2% yoy in August, above the market expectations. The increase in index was 3.6% yoy in July. Analyzing industrial production data by subgroups, it was seen that the upturn in economic activity was spread out across almost all sectors. Having exhibited a weak performance recently, capital goods had a fast recovery in August rising by 12.8% yoy.

According to Markit, manufacturing PMI increased by 1.1 points on a monthly basis and was realized as 51.5 in October, the highest level registered in seven months. This momentum gain mostly stemmed from the rise in output and new orders items recorded during the said period. Hence, the index continued to stay above the threshold level of 50, which signals an expansion, for the third consecutive month.

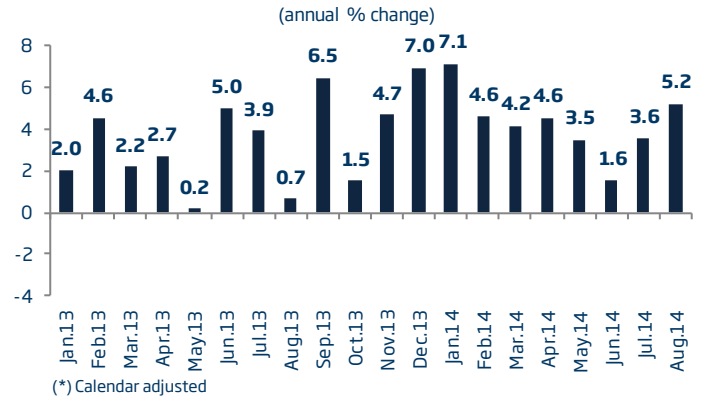
## The contraction in automotive market decelerated.

Automotive market had been suppressed especially in the first half of the year. Yet, the contraction in the market decelerated in September. According to data released by Automotive Distributor's Association, automotive sales, which had decreased by 20.8% yoy in the first eight months of the year, decreased by 1.3% mom in September. Having been supported by exports, automotive production increased. During the first nine months of the year, on the other hand, automotive production declined by 0.5% yoy and became 836.000. During the same period, it was noticeable that automotive exports posted an annual increase of 5.7%.

## Unemployment rate continued to rise.

Recently, the unemployment rate has been on an upward trend. According to the Household Labor Force Survey, unemployment rate increased by 1.2 points yoy and was realized as 9.8% in July. In the same period, seasonally adjusted unemployment rate rose by 0.4 point mom and became 10.4% which was the highest level registered in the last 4 years.

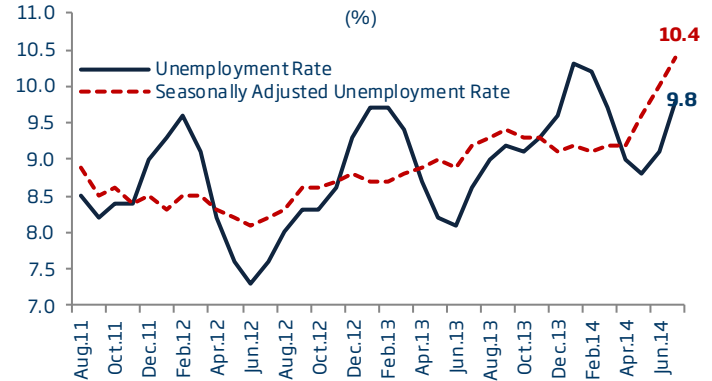
Industrial Production Index\*



## Automotive Market

(thousands)	September		January-September	
	2013	2014 Change %	2013	2014 Change %
Sales	71	70 -1.3	614	500 -18.5
Production	112	116 4.3	840	836 -0.5
Export	77	83 8.4	618	653 5.7
Import	48	43 -12.0	424	332 -21.8

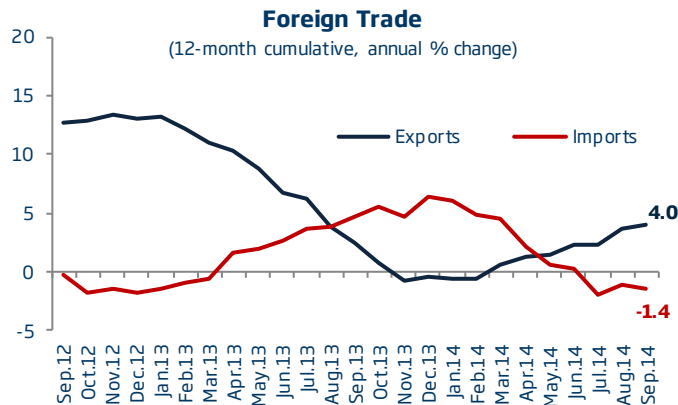
Unemployment Rate



Source: Turkstat, CBRT, Automotive Distributor's Association

## In September, exports increased by 4.6% while imports declined by 0.2%.

In September, exports increased by 4.6% yoy while imports declined by 0.2% yoy. For the first nine months of 2014, exports increased by 5.5% and imports decreased by 4.2% compared to the same period of 2013. Thus, the foreign trade deficit narrowed by 18.8% in the first nine months and the import coverage ratio increased from 59.9% to 66%.



### Automotive sector ranked first in exports.

The automotive sector ranked first in exports in the first nine months of the year with an export volume of 13.6 billion USD. This sector was followed by machineries while knitted goods ranked third.

### Imports of precious metals decreased from 12.9 billion USD to 4.9 billion USD.

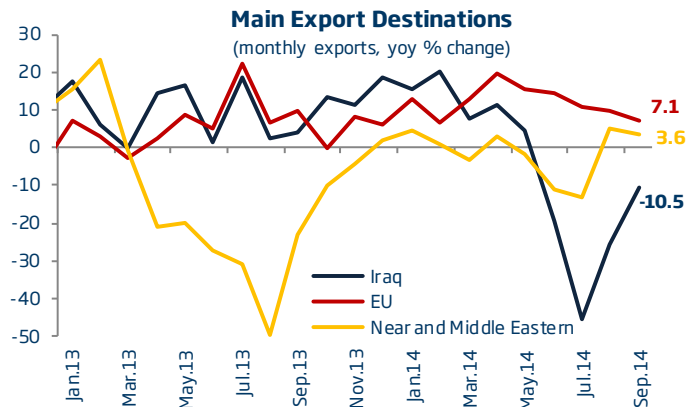
Imports of mineral fuels and oils reached 41.7 billion USD in the first nine months of 2014. Although they continued to rank first in total imports as in previous years, imports of mineral fuels and oils remained almost unchanged in the first nine months compared to the same period of previous year due to the slowdown in domestic demand throughout 2014 and the recent decline in oil prices. Machinery imports ranked second in total import. Imports of precious metals, which ranked fourth in total imports in the first nine months of the previous year with 12.9 billion USD import volume due to the high amount of gold imports, were only 4.9 billion USD in the same period of 2014. In fact, 8 billion USD of the total 14.2 billion USD decline in the foreign trade deficit in the first nine months of 2014 stemmed from these developments in the said chapter.

### Exports to European Union increased by 7.1% in September.

Although the recovery in the European Union economies is

weaker than expected and the demand conditions in the region is poor, Turkey's exports to the European Union increased by 7.1% yoy in September. The increase in the first nine months was 12.1% yoy. Thus, the share of European Union in Turkey's total exports increased from 41.1% in the first nine months of 2013 to 43.7% in the same period of 2014. On the other hand, exports to Iraq decreased by 10.5% yoy in September due to the ongoing problems in that country. However, it was noteworthy that the rate of decline in exports to Iraq slowed down considering that exports were down by 45.5% yoy in July and 25.9% yoy in August.

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, Turkey's exports to Russia declined by 11.5% yoy and 14.3% yoy in August and September, respectively and showed that the expected positive impact on exports have not materialized yet.



### Expectations

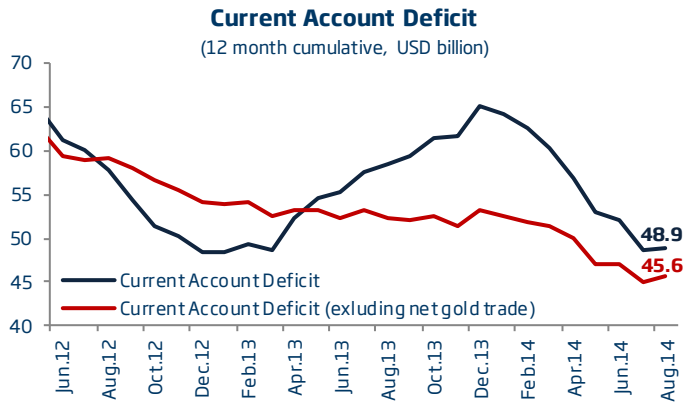
The foreign trade figures point out that the export momentum was broadly kept despite the ongoing problems in Turkey's main export destinations. Imports might start to accelerate in the coming months in parallel with the expected enlivening in domestic demand as a result of the CBRT's interest rate cuts in previous months. On the other hand, there was a notable decline in oil prices recently. The annual average price of Brent crude, which was 109 USD/barrel in 2013, decreased to 107 USD/barrel on average in the first nine months of 2014 and it decreased to as low as 85 USD/barrel as of October 31, 2014 as a result of the rising concerns over global economic growth. Should the oil prices kept their current levels in the coming period, foreign trade deficit might stay around its current level despite the expected increase in domestic demand.

Foreign Trade Balance	(USD billion)					
	September		Change (%)	January-September		Change (%)
	2013	2014		2013	2014	
Exports	13.1	13.7	4.6	112.4	118.5	5.5
Imports	20.6	20.6	-0.2	187.6	179.7	-4.2
<b>Foreign Trade Balance</b>	<b>-7.6</b>	<b>-6.9</b>	<b>-8.4</b>	<b>-75.3</b>	<b>-61.1</b>	<b>-18.8</b>
Import Coverage Ratio (%)	63.3	66.4	-	59.9	66.0	-

Source: Turkstat

## Current account deficit came in below market expectations at 2.8 billion USD in August.

Current account posted a deficit of 2.8 billion USD in August, below market expectations of 3.2 billion USD. In the first eight months of the year, the deficit narrowed by 35.4% yoy to 29.6 billion USD. This development mainly stemmed from the narrowing foreign trade deficit thanks to the increasing exports and declining imports and partly from the rise in services revenues. In fact, exports increased by 6.1% while imports decreased by 4.5% and services revenues rose by 8.8% during this period. The 12-month cumulative current account deficit, which was realized as 48.5 billion USD in July and recorded the lowest level since January 2013, followed a flat course with 48.9 billion USD in August.



## Negative impact of net gold trade on current account deficit has been disappearing.

The negative impact of net gold trade on current account deficit continued to disappear in August. Gold trade deficit, which was 8.9 billion USD during the first eight month of 2013, dropped to 357 million USD in the same period of this year.

Tourism revenues monitored under services balance item contributed to the narrowing of current account deficit. Indeed, tourism revenues rose by 5.3% yoy in the first eight months of the year.

## Net foreign direct investments towards Turkey maintained their positive trend.

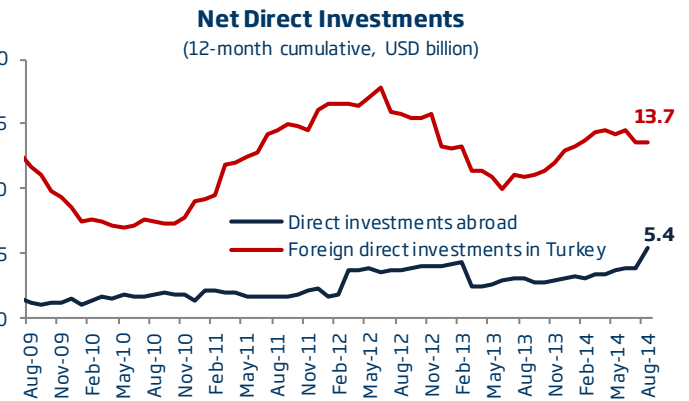
Foreign direct investment inflows to Turkey increased by 9.8% yoy and reached 8.6 billion USD in the first eight months of the year. Real estate investments, which have 34% share in total foreign direct investment inflows, rose by 65% in the same period. Analyzing non-residents' direct investments by subsectors, it is seen that 35% of inflows were directed to manufacturing sector while 16% of them were directed to banking sector. On the other hand, residents' direct investments abroad exhibited a rapid

increase in the first eight months of the year and reached 4 billion USD. This development, which adversely affected current account balance, was mainly due to the rise in investments in extraction of crude petroleum and gas sector in August.

12-month cumulative figures also revealed that the upward trend in net foreign direct investments in Turkey maintained, increasing by 24.7% yoy in August.

## Net capital outflow from portfolio investments...

Having sustained a strong outlook since April 2014, portfolio investments account registered a net outflow by 1.7 billion USD in August. A significant part of this amount (1.6 billion USD) was stemmed from the net sales in debt securities. During the same period, equity securities also registered a net capital outflow of 189 million USD. In the first eight months of the year, on the other hand, equity and debt securities attracted 1.9 billion USD and 10.9 billion USD net inflows, respectively. During the same period, banking sector borrowed net 6.6 billion USD from international markets via bond issues.



## Banking sector was net credit borrower in August.

In August, banking and non-bank sectors borrowed 309 million USD and 252 million USD, respectively. Non-bank sectors were net borrower with 2 billion USD in long-term loans while they were net credit re-payer in short-term loans. In the first eight month of the year, banking and non-bank sectors were net credit borrowers with 4.7 billion USD and 4 billion USD, respectively. During the same period, banks' and non-bank sectors' long-term debt roll-over ratios followed a flat course and were realized as 175% and 125%, respectively.

## Net errors and omissions account recorded 9.1 billion USD inflows in the first eight months of the year.

Net errors and omissions account posted an increase of 817 million USD in August. Hence, capital inflows recorded under

this item reached 9.1 billion USD in the first eight months of the year and 11.8 billion USD during the last 12 months. Accordingly, this account played a noteworthy role in the financing of the current account deficit.

## Expectations...

In line with the expected deceleration in exports as a result of the stagnation in the EU economies observed in recent period, the narrowing of the current account deficit might lose some momentum in the coming months. Also, developments in Iraq are continued to be monitored closely due to their further impacts on Turkey's exports outlook. On the other hand, the continuation of declining trend in oil prices might affect current account deficit positively in the longer run. Regarding the financing of the current account deficit, some fluctuations have been observed depending on the course of expectations about the monetary policies of major central banks, especially that of the Fed. Capital

inflows to emerging markets will be shaped by the expectations regarding the Fed's anticipated rate hikes in 2015 and the European Central Bank's expansionary monetary policy aiming to support economic activity in the region.

<b>Current Account Balance</b>	<b>(USD million)</b>				
	<b>August 2014</b>	<b>January-August 2013 2014</b>		<b>% Change</b>	<b>12 Month Cumulative</b>
<b>Current Account Balance</b>	<b>-2,768</b>	<b>-45,785</b>	<b>-29,586</b>	<b>-35.4</b>	<b>-48,869</b>
Foreign Trade Balance	-6,479	-54,677	-40,819	-25.3	-66,165
Services Balance	4,230	14,829	16,529	11.5	24,832
Tourism Revenues (net)	3,687	14,790	15,580	5.3	23,970
Income Balance	-609	-6,652	-5,816	-12.6	-8,522
Current Transfers	90	715	520	-27.3	986
<b>Capital and Financial Accounts</b>	<b>1,951</b>	<b>45,578</b>	<b>20,480</b>	<b>-55.1</b>	<b>37,114</b>
Direct Investments (net)	-991	6,121	4,590	-25.0	8,242
Portfolio Investments (net)	-1,739	16,857	12,067	-28.4	18,901
Assets	57	2,436	-717	-	-552
Liabilities	-1,796	14,421	12,784	-11.4	19,453
Equity Securities	-189	-1,059	1,930	-	3,830
Debt Securities	-1,607	15,480	10,854	-29.9	15,623
Other Investments (net)	6,572	31,402	7,227	-77.0	14,577
Assets	5,157	2,491	-104	-	-203
Currency and Deposits	3,873	3,232	830	-74.3	2,168
Liabilities	1,415	28,911	7,331	-74.6	14,780
Trade Credits	194	4,752	-732	-	119
Loans	469	12,415	7,873	-36.6	17,001
Banking Sector	309	12,799	4,731	-63.0	13,550
Non-bank Sectors	252	-2	3,954	-	4,751
Deposits	716	11,301	-209	-	-2,877
Foreign Banks	1,011	9,854	-211	-	-2,839
Foreign Exchange	1,386	9,955	-765	-	-4,346
Turkish Lira	-375	-101	554	-	1,507
Non-residents	239	2,628	1,647	-37.3	2,426
Reserve Assets (net)	-1,885	-8,722	-3,354	-61.5	-4,543
<b>Net Errors and Omissions</b>	<b>817</b>	<b>207</b>	<b>9,106</b>	<b>4,299.0</b>	<b>11,755</b>

Source: CBRT

## The central government budget gave 11.9 billion TRY deficit during January-September.

According to the Ministry of Finance's announcements, central government budget expenditures increased by 13.5% in September compared to the same period of the previous year. Budget revenues, on the other hand, increased by 0.7% in the same period. Thus, the budget deficit increased from 4.7 billion TRY in September 2013 to 9.2 billion TRY in September 2014 and reached the highest monthly level of 2014.

Regarding the cumulative figures for the first 9 months, the budget expenditures increased by 10.5% yoy while budget revenues increased by 8.1% yoy. Hence, the budget deficit increased from 4.5 billion TRY in the first 9 months of 2013 to 11.9 billion TRY in the same period of 2014.

### Interest expenditures decreased.

It was noteworthy that the interest expenditures decreased by 12.7% yoy in the first 9 months. On the other hand, non-interest expenditures rose faster than inflation in the corresponding period. In fact, in the first 9 months, compensation of public sector employees, capital expenditures, goods and services purchases increased by 15%, 21.1% and 13.7% yoy, respectively. The rise in total non-interest expenditures was realized as 14.5% yoy.

### Weak tax collection in the first 9 months

Tax revenues were negatively affected by the slowdown in economic growth in 2014. In fact, after having increased by 19% yoy in the first 9 months of 2013, tax collection rose by only 7.7% during the same period of this year. Due to the rise in interest rates and measures taken in order to curb consumption, domestic demand slowed down. Accordingly, the Domestic Value Added Tax (VAT) collection increased by only 1% yoy, Special Consumption Tax collection increased by 4.4% yoy and VAT on Imports increased by 3.1% yoy in the first 9 months. Despite this weak outlook in indirect taxes, Income Tax and Corporate Tax collections were up by 16.3% yoy and 14.4% yoy, respectively, limiting the slowdown in total tax revenues.

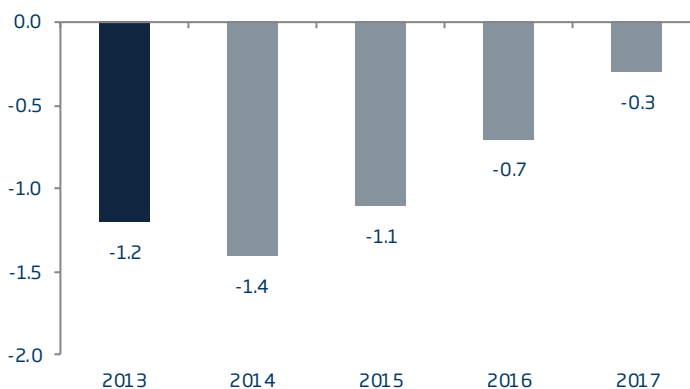
The non-tax revenues increased by 10.2% in the first 9 months.

## Medium Term Program and expectations

The government announced the Medium Term Program (MTP) in October. The program includes the Government's 2014 forecast for several macroeconomic variables and fiscal policy indicators. It also provides the Government's targets set for the 2015-2017 period. According to the MTP, the share of public expenditures and revenues in GDP will continue to shrink so that public sector's weight in economic activity will decline gradually in the coming period. The central government budget deficit to GDP ratio, which was set as 1.9% in the previous MTP, is forecasted to realize as 1.4%. The primary surplus to GDP ratio, which was set as 1.1% in the previous MTP, is anticipated to be 1.5%. The central government budget deficit to GDP ratio is targeted to decrease to 1.1% in 2015 and decrease further to 0.3% at the end of the Program period. In other words, central government budget will be almost "balanced" at the end of 2017. The EU defined general government debt stock to GDP ratio, which was 36.2% in 2013, is also forecasted to decline to 33.1% at the end of 2014 and is targeted to further decrease to 28.5% at the end of the Program.

The expected improvement in nominal debt stock to GDP ratio indicates that the public sector will borrow less in the Program period. Moreover, taking into account that the 2014 budget deficit to GDP ratio will be lower than previously targeted despite the local elections and Presidential election that were held in 2014, the upcoming general election in 2015 is not likely to cause a notable loosening in the fiscal policy.

Central Government Budget Balance (% GDP)



Source: Medium Term Program (2015-2017)

## Central Government Budget

	September		%	January-September		%	2014 Budget		MTP	Real./
	2013	2014		Change	2013		2014	Change		
<b>Expenditures</b>	<b>34.8</b>	<b>39.6</b>	<b>13.5</b>	<b>294.5</b>	<b>325.4</b>	<b>10.5</b>	<b>436.4</b>	<b>448.4</b>	<b>72.6</b>	
Interest Expenditures	6.1	4.6	-24.0	43.8	38.3	-12.7	52.0	50.2	76.2	
Non-interest Expenditures	28.7	34.9	21.5	250.7	287.2	14.5	384.4	398.2	72.1	
<b>Revenues</b>	<b>30.1</b>	<b>30.3</b>	<b>0.7</b>	<b>290.0</b>	<b>313.5</b>	<b>8.1</b>	<b>403.2</b>	<b>424.0</b>	<b>73.9</b>	
Tax Revenues	24.2	26.2	8.3	240.3	258.7	7.7	348.4	351.6	73.6	
Other Revenues	5.9	4.1	-30.5	49.8	54.9	10.2	54.8	72.4	75.8	
<b>Budget Balance</b>	<b>-4.7</b>	<b>-9.2</b>	<b>95.0</b>	<b>-4.5</b>	<b>-11.9</b>	<b>165.5</b>	<b>-33.3</b>	<b>-24.4</b>	<b>48.9</b>	
<b>Primary Balance</b>	<b>1.4</b>	<b>-4.6</b>	<b>-</b>	<b>39.3</b>	<b>26.3</b>	<b>-33.1</b>	<b>18.7</b>	<b>25.8</b>	<b>102.1</b>	

Numbers may not add up to total due to rounding

Source: Finance Ministry

## CPI inflation came in above the expectations in October.

In October, CPI and Domestic PPI (D-PPI) increased by 1.90% and 0.92% mom, respectively. According to the Reuters' survey, CPI was expected to increase by 1.84% mom in October. According to the CBRT's survey, markets' monthly CPI expectation was 1.38%.

### Annual CPI inflation was realized as 8.96%.

Annual CPI inflation was realized as 8.96% in October. The annual D-PPI inflation, which was hovering close to 10% since June, increased to 10.10%, rising again at double-digit levels.

### A significant increase in food prices...

Analysis of the main expenditure groups in October showed that seasonal price increases in clothing and footwear group were influential in the higher than expected monthly CPI inflation. Indeed, 9.95% mom increase in clothing and footwear prices made the highest contribution to the monthly inflation by 70 basis points. The food prices, which followed an upward course during 2014, increased by 2.65% mom and made 63 basis points contribution to the monthly CPI inflation. Annual inflation in food prices was 12.56% as of October. In addition, owing to the increases in administered prices such as natural gas and electricity prices, the price hikes in housing group contributed the monthly inflation by 47 basis points in October.

Accordingly, total contribution of price increases in clothing and footwear, food and housing groups to the monthly inflation reached 1.8 points. On the other hand, the price changes in other groups came in at low levels and were not influential on the course of the inflation in October.

### Weak course in the core inflation indicators...

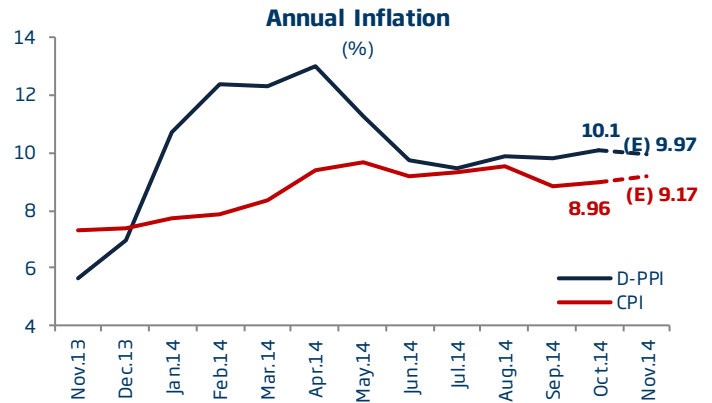
In October, seasonal factors were influential on the increase in CPI inflation. In fact, monthly increase in CPI declines to 0.84% when seasonal products are excluded. Annual increases in CBRT's favorite core indices denominated by H and I, representing the main trend of inflation, were realized as 9.83% and 9.04%, respectively, continuing their downward trend in October.

### The annual D-PPI inflation was 10.1% in October.

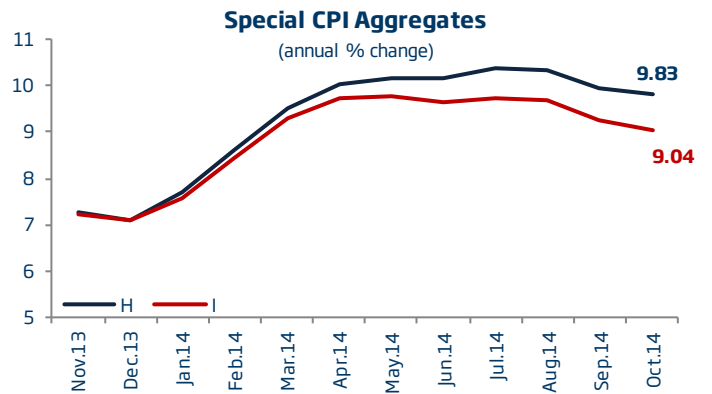
Annual increase in D-PPI which followed a high course throughout the year, displayed a similar outlook in October. Price increases in electricity and gas production and distribution made the highest contribution to the monthly D-PPI inflation by 60 basis points. On the other hand, the price developments in other groups had limited impact on the course of the inflation in October.

### Expectations...

In November, we anticipate that the seasonal price increases in clothing and footwear prices might be influential on the course of the inflation albeit at a slower

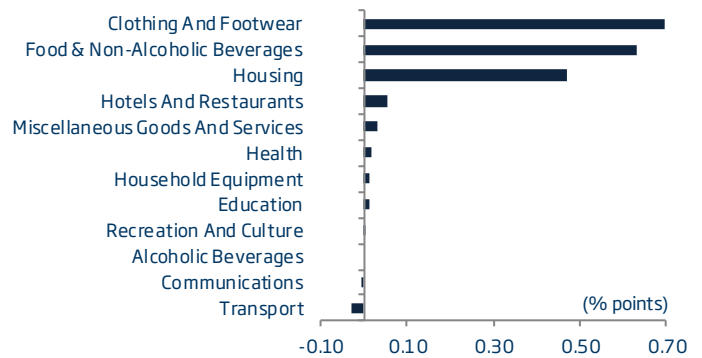


(E) Estimate



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



pace. In addition, the developments in food prices will continue to play a key role in the CPI inflation. In this context, we expect CPI and D-PPI to increase by 0.20% and 0.50% mom, respectively. We anticipate that the year-end annual CPI inflation will be around 9%.

Source: Turkstat

## CBRT kept the policy rate unchanged at its October meeting.

At its Monetary Policy Meeting on October 23, CBRT kept the one-week repo rate (the policy rate), O/N borrowing rate and O/N lending rate (marginal funding rate) unchanged at 8.25%, 7.5% and 11.25%, respectively.

Following the meeting, CBRT announced that the loan growth was at reasonable levels thanks to the tight monetary policy stance and macroprudential measures and added that exports continued to support balanced growth despite the weakening global demand. CBRT noted that the favorable impacts of monetary policy were observed in the core inflation although elevated food prices delayed the improvement in inflation. CBRT also stressed that the current levels of commodity prices, in particular declining oil prices, are expected to contribute to the decline in the inflation foreseen for the next year.

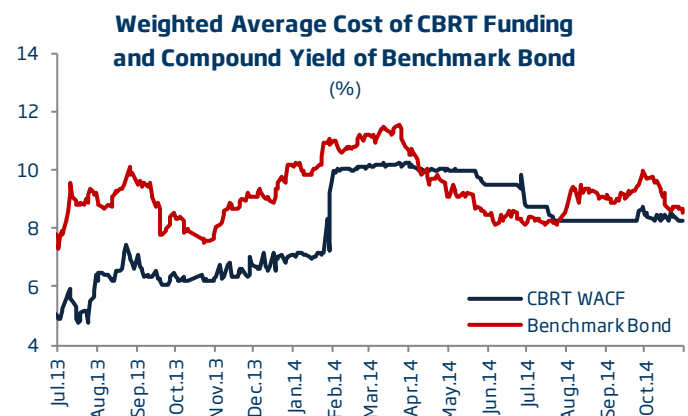
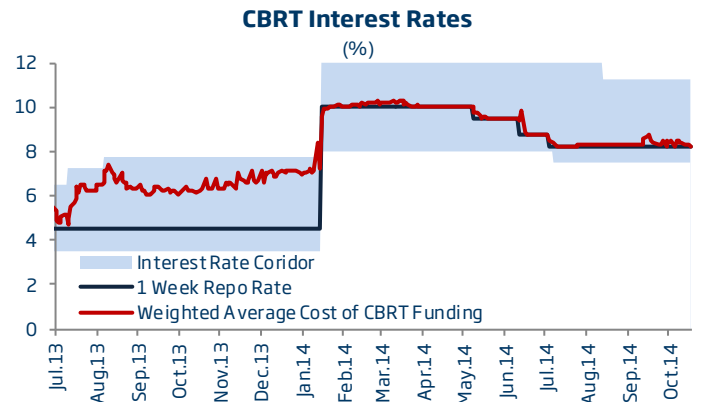
## CBRT will start to remunerate the Turkish lira component of required reserves.

After having stopped remuneration of Turkish lira required reserves in September 2010, CBRT announced on October 21, 2014, that it would start to remunerate the Turkish lira component of required reserves of financial institutions in order to spur balanced growth and domestic savings. According to the announcement, the remuneration will start in November 2014. Financial institutions whose core liability ratios (ratio of deposits and equity to loans) are higher than the sector average will be remunerated at a higher rate unless they worsen their own situation. The remuneration rate on the required reserves maintained in Turkish lira will be weighted average cost of the CBRT funding minus 500 basis points for those banks and financing companies having core liability ratios equal or above its group average. For those having core liability ratios below sector average, the remuneration will be the weighted average cost of CBRT funding minus 700 points. Considering that the weighted average cost of CBRT funding is around 8.25%, the remuneration rate will be between 1.25% and 3.25%.

## CBRT revised its inflation forecasts upwards.

CBRT published the last Inflation Report of 2014 on October 31 and revised the year-end inflation forecasts of both 2014 and 2015. Under the assumption that the tight monetary policy stance will be maintained by keeping the yield curve flat and the annual loan growth rate will near 15% by the end of 2014 and stabilize around these reasonable levels on the back of the macroprudential measures, inflation is expected to be between 8.4% and 9.4% (with a mid-point of 8.9%) at end-2014 and between 4.6% and 7.6% (with a mid-point of 6.1%) at end-2015. It is noteworthy that the CBRT's forecasts are below the

Government's forecast in the Medium Term program which was published in the beginning of October. This is mainly due to the recent decline in oil prices and the assumption that the rise in food prices will be less than expected. CBRT lowered oil price forecast of 2014 from 108 USD/barrel to 102 USD/barrel and from 106 USD/barrel to 92 USD/barrel for 2015.



Source: CBRT, Borsa Istanbul



## Risk appetite in global markets increased in October.

As a result of growing expectations of an earlier rate hike by the Fed and increasing uncertainties about the extent of the ECB's new expansionary monetary policies, risk perceptions deteriorated and global investors shifted towards safe haven instruments in October. In the following period, however, Fed officials' assessments about the current risks and increased expectations regarding gradual normalization in monetary policy enhanced the risk appetite.

## In October, Turkey decoupled positively from its counterparts.

Despite the rising concerns over global economic growth, the expectations for Turkish economy became more positive. Along with this development, risk premium of Turkish Eurobonds decoupled positively from its counterparts in October. Indeed, risk premium of Turkish Eurobonds, which was 256 basis points (bps) at the end of September, decreased to 224 bps as of October 31. During the same period, risk premium of emerging market Eurobonds dropped only by 8 bps.

## Appreciation of TRY against Dollar and Euro...

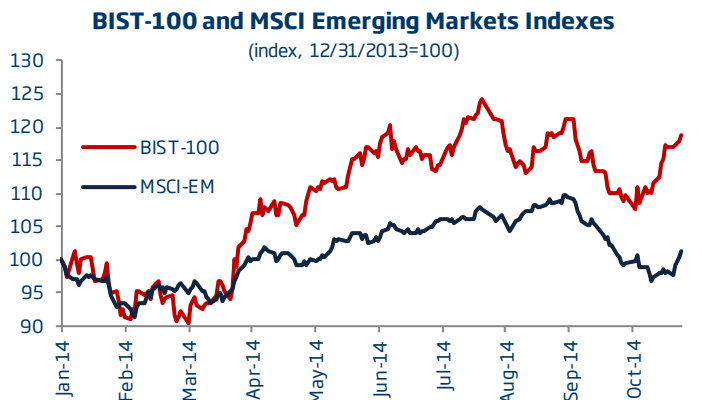
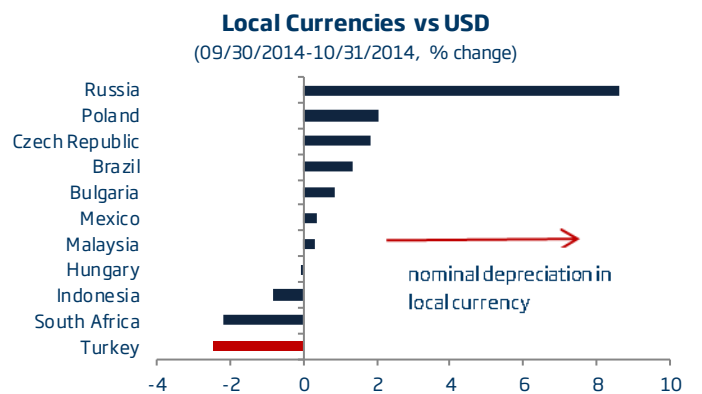
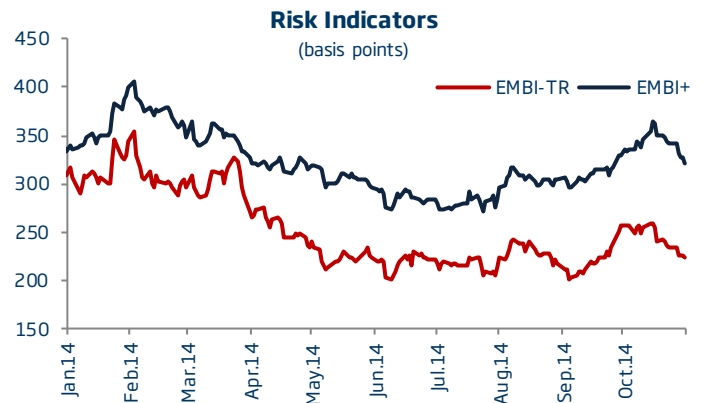
Due to the expectations about Fed's rate hike, USD/TRY had hit its highest level in the last eight months in September. In October, on the other hand, a substantial decline was registered in USD/TRY. In fact, according to the CBRT's data, as of October 31 compared to the end of September, USD/TRY and EUR/TRY dropped by 2.7% to 2.2171 and 3.5% to 2.7902, respectively.

## BIST-100 index followed an upward trend led by banking sector stocks.

BIST-100 index generally followed an upward trend in October. It was noticeable that the index performed better than other emerging markets' stock indices. Along with the favorable outlook of exchange rates, CBRT's decision to pay interest on required reserves, an implementation which had been terminated 4 years ago, also played a major role in this development. As of October 31, BIST-100 index surged by 7.5% mom on the back of gains in the banking sector and closed at 80.580 points.

## Fall in interest rates in bonds and bills market...

The interest rate of 2-year benchmark bond, which reached its highest level since April 2014 by realizing at 9.98% as of September 30, declined with the help of the improvement in risk appetite towards emerging markets observed in October. As of October 31, 2-year benchmark bond (due June 13, 2016) yield decreased by 142 bps to 8.56% compared to September 30.



Source: JP Morgan, Reuters, BIST

## Deposit volume grew by 6.8% year to date.

According to BRSA's Weekly Bulletin, as of October 24, total deposit volume recorded an increase of 6.8% ytd and was realized as 1,084 billion TRY.

Annual increase in deposit volume was recorded as 14.2% as of October 24 after having registered the lowest annual increase (12.4%) over last two years in the first week of September. In the same period, TRY deposits rose by 7.4% yoy while FX deposits in USD terms increased by 10.6% yoy.

## Annual growth in loans accelerated...

Total loan volume expanded by 12.3% ytd and reached 1,196 billion TRY as of October 24. Having declined to as low as 18.1% in September, annual growth in total loan volume was realized as 19.6% as of October 24. The annual growth in FX loans in USD terms, which followed a downward trend in recent period, fell to 11.1% as of October 24. In the same period, annual expansion was 17.2% in TRY loans. Annual increase in total exchange rate adjusted credit volume was 15.5% as of October 24.

As of October 24, consumer loans registered a limited increase of 4.7% ytd in line with the measures taken in the beginning of the year in order to slow down the growth in consumer loans. In the same period, commercial and corporate loans expanded by 15.8% ytd.

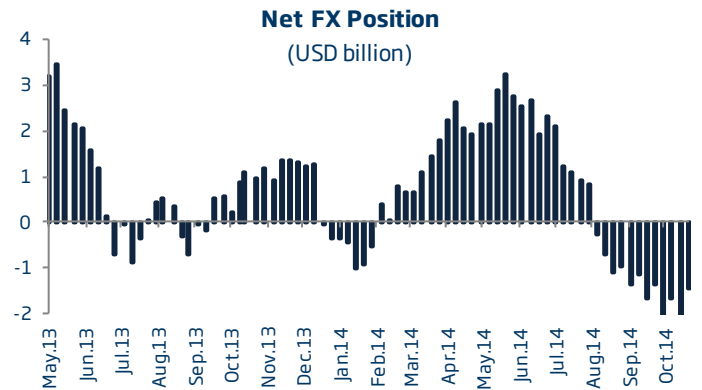
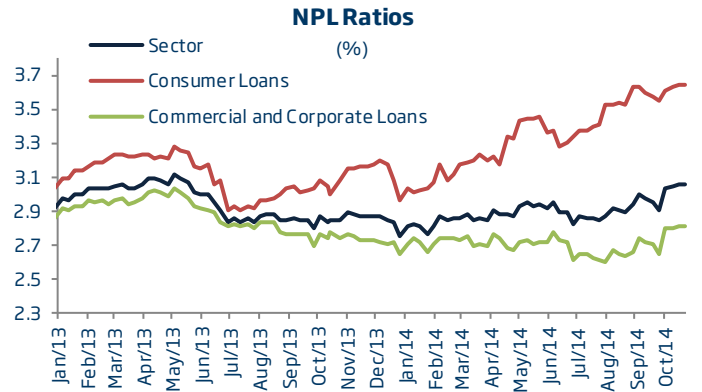
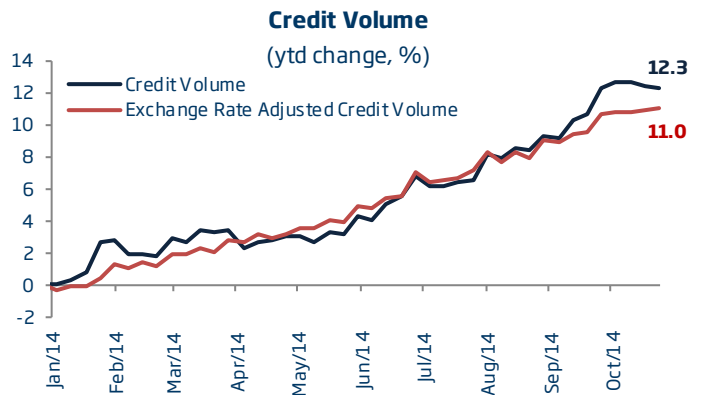
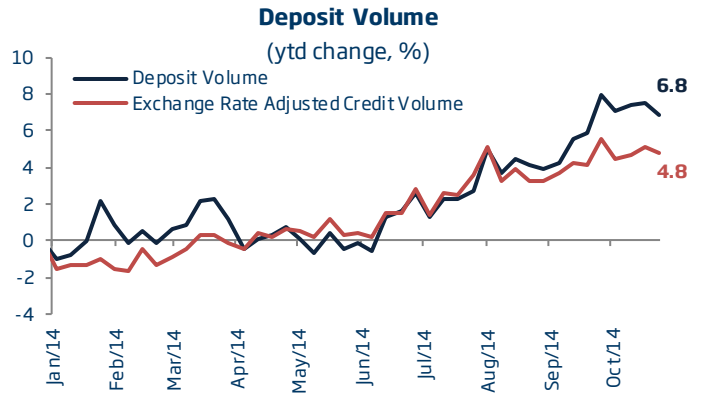
The NPL ratio in consumer loans rose by 0.7 point ytd to 3.6% as of October 24. NPL ratios in commercial loans and total loan volume were realized as 2.8% and 3.0%, respectively.

## Securities portfolio...

Securities portfolio of the banking sector grew by 2.6% ytd as of October 24. The increase in securities portfolio was limited by the decline in volume of securities held to maturity.

## Net FX position...

As of October 24, banks' on-balance sheet FX position was (-) 44,287 million USD while off-balance sheet FX position was (+) 42,815 million USD. Hence, banks' net FX position was realized as (-) 1,472 million USD. It is seen that banking sector started to carry FX short position since August, albeit at low level.



Source: BRSA Weekly Bulletin

The concerns over the global economic growth have increased recently. In fact, several institutions revised their economic growth forecasts for 2014 and 2015 downwards. As a result of this expected slowdown in global demand, oil and other commodity prices started to decline. This development weakened the growth outlook for commodity exporter emerging markets weakened. On the other hand, lower commodity prices will help energy importers like Turkey by improving their foreign trade balances.

Regarding advanced economies, the recovery in the US economy is continuing at a moderate pace while the growth prospects for the Euro Area and Japan remained weak. In the US, the recent employment and growth figures in particular were strong and the Fed ended its monthly asset purchase program at the end of October. On the other hand, ECB and BoJ have been keeping their accommodative monetary policies, which in turn, are supporting global risk appetite.

Analyzing the recent developments in Turkish economy, the rise in global risk appetite and the decline in oil prices have reflected positively on domestic markets. However, the ongoing problems in Turkey's main export markets point out that in the coming period export performance will be weaker compared to the beginning of 2014. On the other hand, the decline in oil prices will help to compensate the pressure on foreign trade deficit. We expect that the contribution of net exports to growth will decrease in the coming period while that of domestic demand will increase.

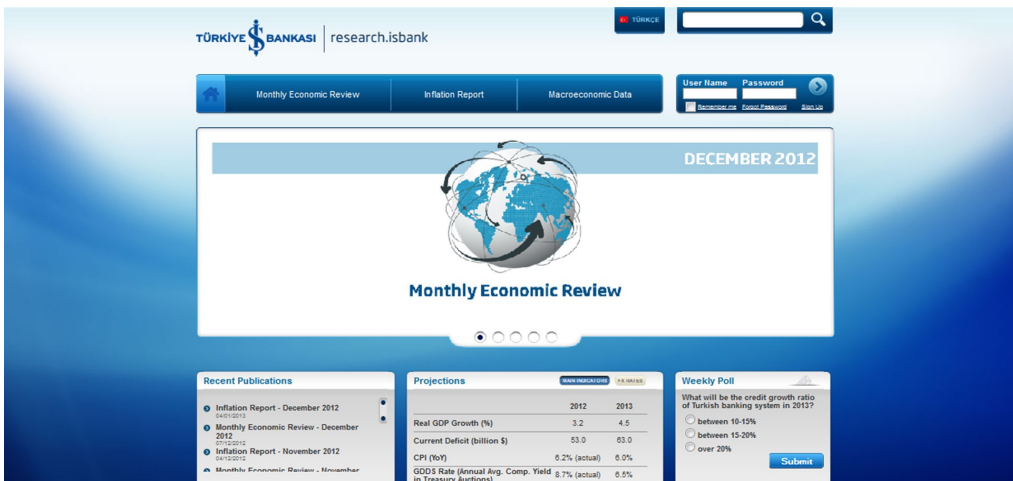
Forecasts (%)	2013 (R)	2014
Growth	4.1	3.4
CA Deficit/GDP	7.9	5.7
Inflation	7.4	9.0
GDDI Interest*	7.6	9.8

(\*) Annual compound average interest rate in treasury auctions

(R) Realization

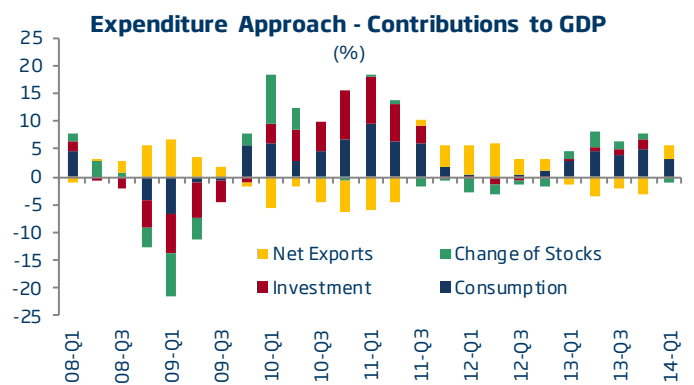
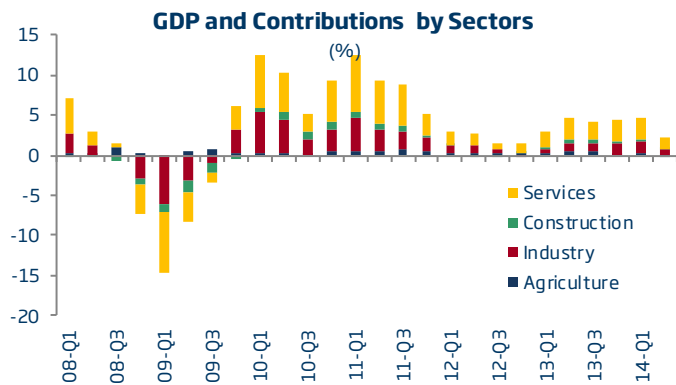
Interest and inflation are year-end forecasts

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

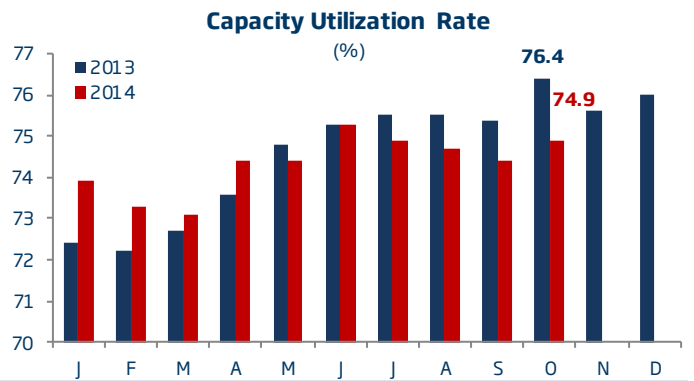
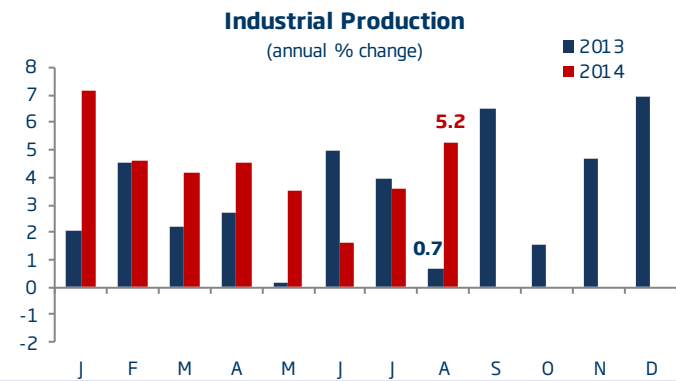


The screenshot shows the website interface for the 'Monthly Economic Review' report for December 2012. The page features a navigation menu with 'Monthly Economic Review', 'Inflation Report', and 'Macroeconomic Data'. A search bar and user login fields are visible at the top right. The main content area displays a globe graphic and the title 'Monthly Economic Review'. Below this, there are sections for 'Recent Publications', 'Projections' (comparing 2012 and 2013 data for Real GDP Growth, Current Deficit, CPI, and GDS Rate), and a 'Weekly Poll' regarding the credit growth ratio of the Turkish banking system in 2013.

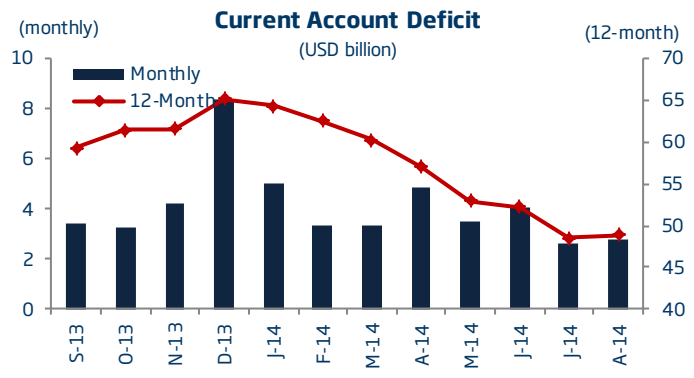
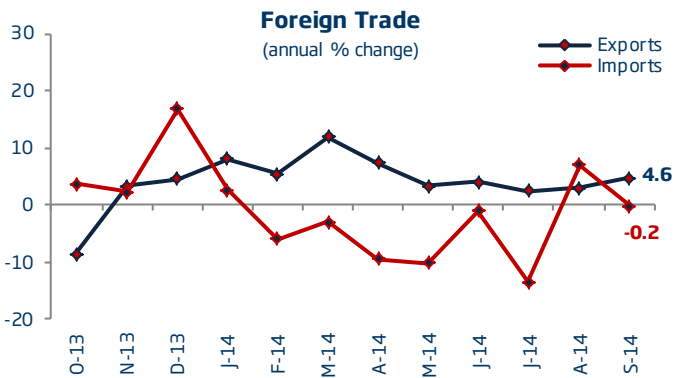
## Growth



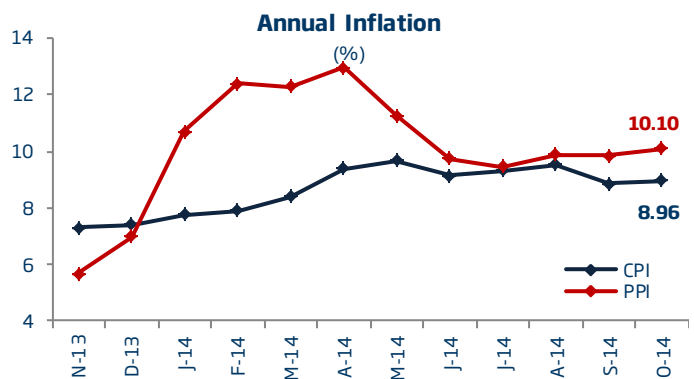
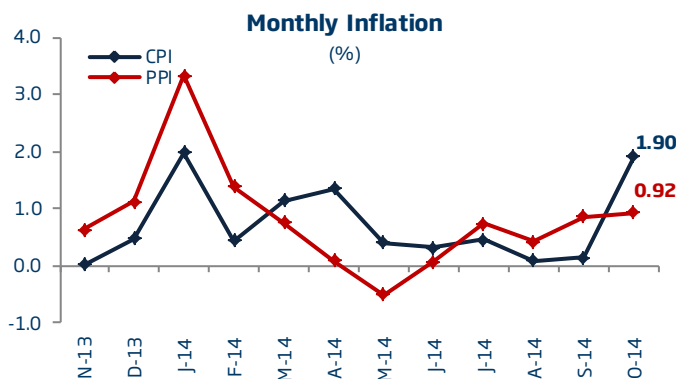
## Industrial Production



## Foreign Trade and Current Account Balance



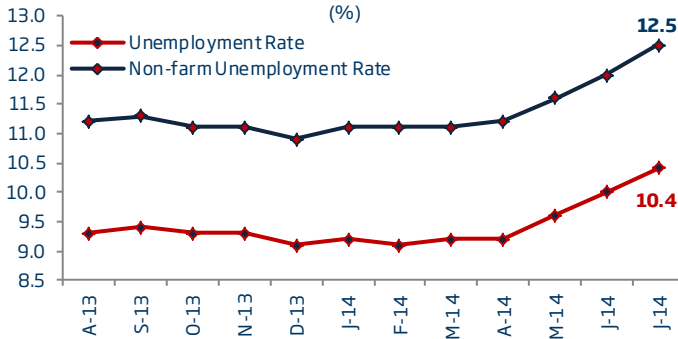
## Inflation



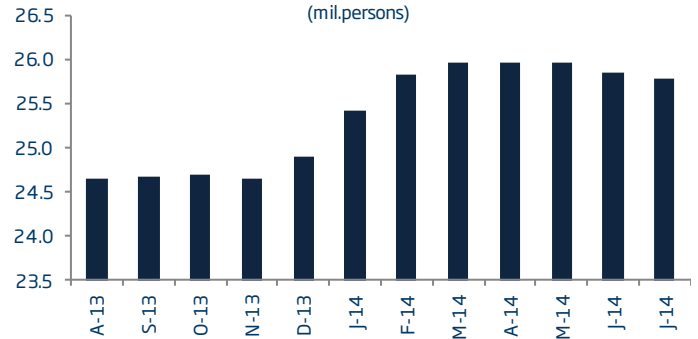
Source: Turkstat, CBRT

## Labor Market

### Seasonally Adjusted Unemployment Rates (%)

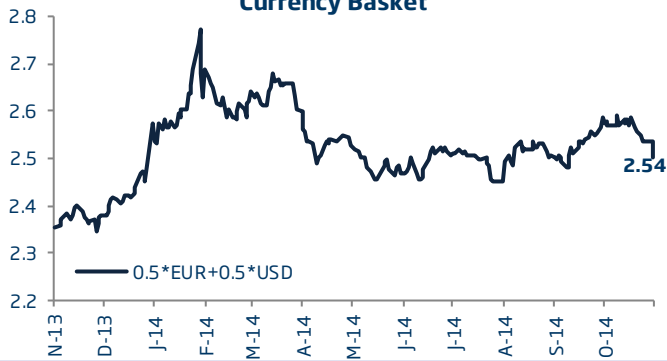


### Seasonally Adjusted Employment (mil.persons)

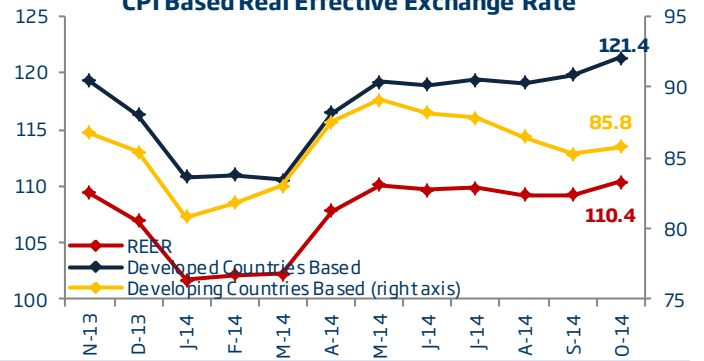


## FX Market

### Currency Basket

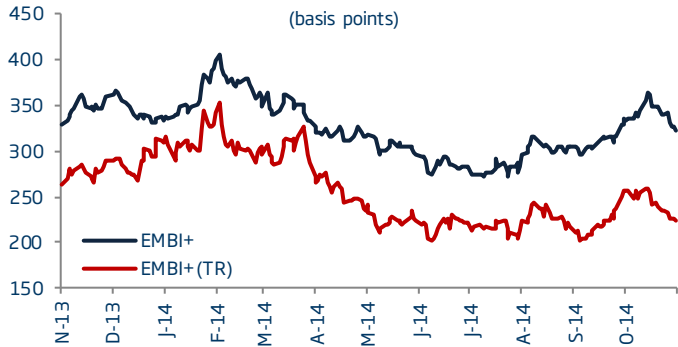


### CPI Based Real Effective Exchange Rate

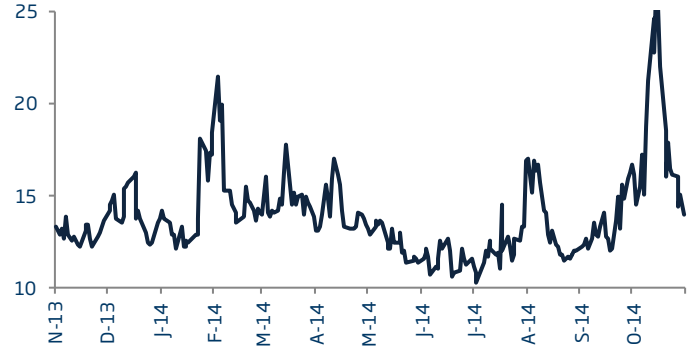


## Risk Indicators

### Risk Premiums (basis points)

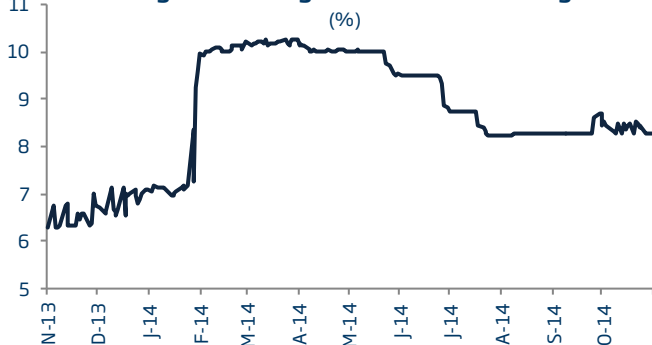


### VIX



## Interest Rates

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

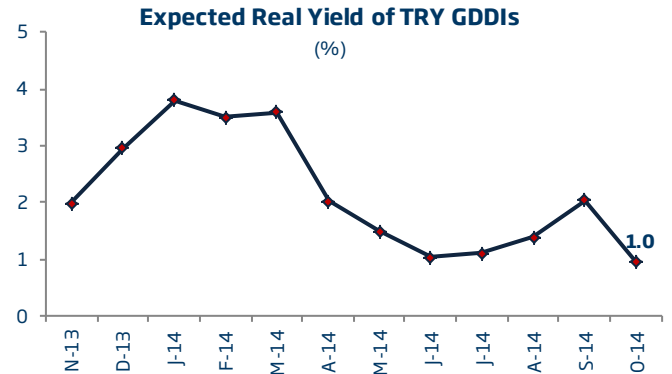
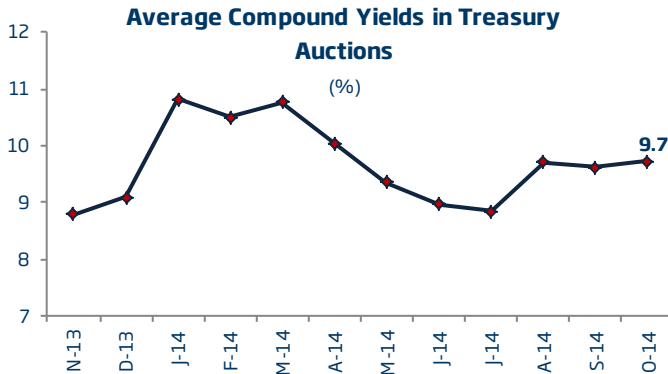


### Compound Yield of Benchmark Bond (%)

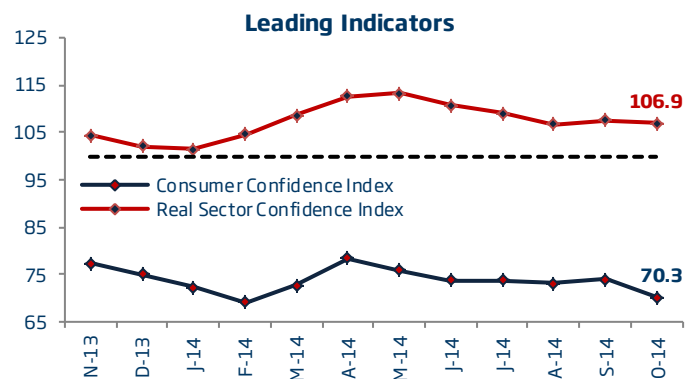
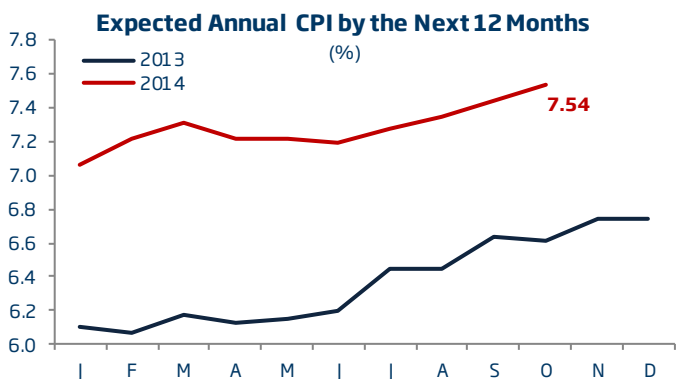
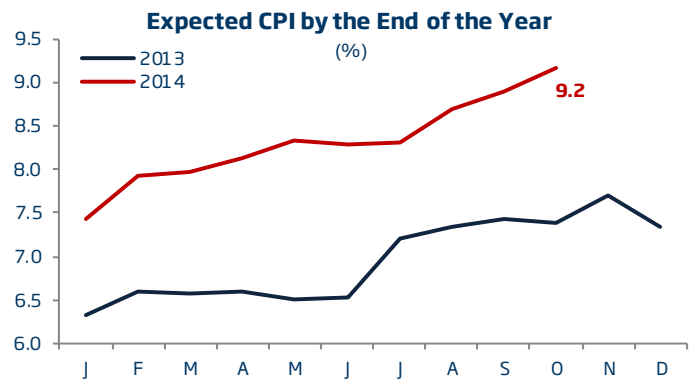
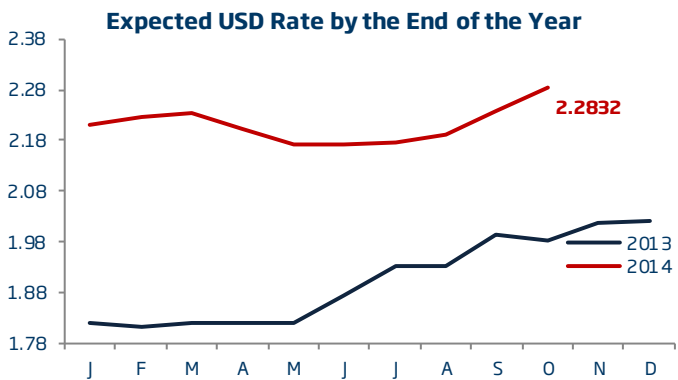
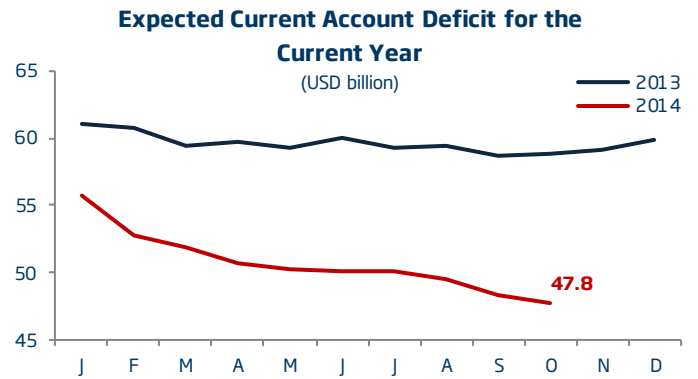
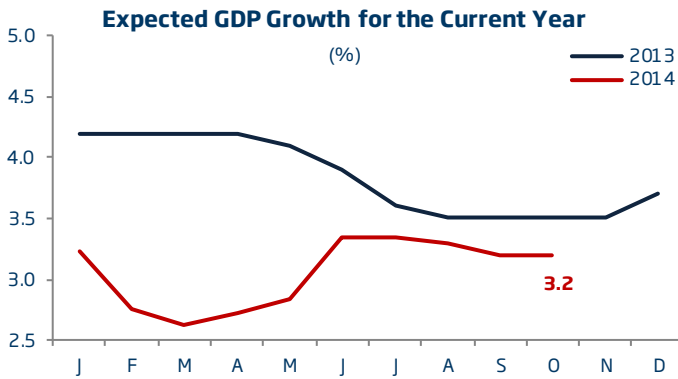


Source: Turkstat, CBRT, JP Morgan, Reuters, BIST

## Bond-Bill Market



## Survey of Expectations and Other Leading Indicators



Source: Treasury, BIST, CBRT, Economic Research Division

# Turkish Economy at a Glance

<b>Growth</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>14-Q1</b>	<b>14-Q2</b>	<b>14-Q3</b>
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	-
<b>Inflation (%)</b>						<b>Aug-14</b>	<b>Sep-14</b>	<b>Oct-14</b>
CPI (annual)	6.53	6.40	10.45	6.16	7.40	9.54	8.86	8.96
PPI (annual)	5.93	8.87	13.33	2.45	6.97	9.88	9.84	10.10
<b>Seasonally Adjusted Labor Market Figures</b>						<b>May-14</b>	<b>Jun-14</b>	<b>Jul-14</b>
Unemployment Rate (%)	11.9	10.0	8.5	8.8	9.1	9.6	10.0	10.4
Employment (thousand persons)	21,413	22,631	23,496	24,483	24,888	25,961	25,863	25,791
<b>FX Rates</b>						<b>Aug-14</b>	<b>Sep-14</b>	<b>Oct-14</b>
CPI Based Real Effective Exchange Rate	116.6	125.5	109.4	117.9	106.7	109.2	109.3	110.4
USD/TRY	1.5057	1.5460	1.9065	1.7826	2.1343	2.1619	2.2789	2.2171
EUR/TRY	2.1603	2.0491	2.4592	2.3517	2.9365	2.8528	2.8914	2.7902
Currency Basket (0.5*EUR+0.5*USD)	1.8330	1.7976	2.1829	2.0672	2.5354	2.5074	2.5852	2.5037
<b>Foreign Trade Balance<sup>(1)</sup> (USD billion)</b>						<b>Jul-14</b>	<b>Aug-14</b>	<b>Sep-14</b>
Exports	102.1	113.9	134.9	152.5	151.8	157.1	157.4	158.0
Imports	140.9	185.5	240.8	236.5	251.7	242.5	243.8	243.7
<b>Foreign Trade Balance</b>	<b>-38.8</b>	<b>-71.7</b>	<b>-105.9</b>	<b>-84.1</b>	<b>-99.9</b>	<b>-85.4</b>	<b>-86.4</b>	<b>-85.7</b>
Import Coverage Ratio (%)	72.5	61.4	56.0	64.5	60.3	64.8	64.6	64.8
<b>Current Account Balance<sup>(1)</sup> (USD billion)</b>						<b>Jun-14</b>	<b>Jul-14</b>	<b>Aug-14</b>
<b>Current Account Balance</b>	<b>-12.1</b>	<b>-45.4</b>	<b>-75.1</b>	<b>-48.5</b>	<b>-65.1</b>	<b>-52.2</b>	<b>-48.5</b>	<b>-48.9</b>
<b>Capital and Financial Accounts</b>	<b>9.0</b>	<b>44.5</b>	<b>65.9</b>	<b>47.4</b>	<b>62.3</b>	<b>38.6</b>	<b>35.2</b>	<b>37.1</b>
Direct Investments (net)	7.1	7.6	13.8	9.2	9.8	10.7	9.8	8.2
Portfolio Investments (net)	0.2	16.1	22.0	40.8	23.7	15.7	22.6	18.9
Other Investments (net)	1.9	33.7	28.4	18.4	38.8	17.0	9.5	14.6
Reserve Assets (net)	-0.1	-12.8	1.8	-20.8	-9.9	-4.7	-6.7	-4.5
<b>Net Errors and Omissions</b>	<b>3.1</b>	<b>0.9</b>	<b>9.1</b>	<b>1.1</b>	<b>2.8</b>	<b>13.5</b>	<b>13.4</b>	<b>11.8</b>
<b>Current Account Deficit/GDP</b>	<b>-2.0</b>	<b>-6.2</b>	<b>-9.7</b>	<b>-6.2</b>	<b>-7.9</b>	-	-	-
<b>Budget<sup>(2)(3)</sup> (TRY billion)</b>						<b>Jul-14</b>	<b>Aug-14</b>	<b>Sep-14</b>
<b>Expenditures</b>	<b>268.2</b>	<b>294.4</b>	<b>314.6</b>	<b>361.9</b>	<b>408.2</b>	<b>253.8</b>	<b>285.9</b>	<b>325.4</b>
Interest Expenditures	53.2	48.3	42.2	48.4	50.0	30.9	33.6	38.3
Non-interest Expenditures	215.0	246.1	272.4	313.5	358.2	223.0	252.2	287.2
<b>Revenues</b>	<b>215.5</b>	<b>254.3</b>	<b>296.8</b>	<b>332.5</b>	<b>389.7</b>	<b>245.2</b>	<b>283.2</b>	<b>313.5</b>
Tax Revenues	172.4	210.6	253.8	278.8	326.2	198.8	232.4	258.7
<b>Budget Balance</b>	<b>-52.8</b>	<b>-40.1</b>	<b>-17.8</b>	<b>-29.4</b>	<b>-18.5</b>	<b>-8.7</b>	<b>-2.7</b>	<b>-11.9</b>
<b>Primary Balance</b>	<b>0.4</b>	<b>8.2</b>	<b>24.4</b>	<b>19.0</b>	<b>31.4</b>	<b>22.2</b>	<b>30.9</b>	<b>26.3</b>
<b>Budget Balance/GDP</b>	<b>-5.5</b>	<b>-3.6</b>	<b>-1.4</b>	<b>-2.1</b>	<b>-1.2</b>	-	-	-
<b>Central Government Debt Stock (TRY billion)</b>						<b>Jul-14</b>	<b>Aug-14</b>	<b>Sep-14</b>
Domestic Debt Stock	330.0	352.8	368.8	386.5	403.0	408.2	407.4	408.2
External Debt Stock	111.5	120.7	149.6	145.7	182.8	181.9	186.0	194.9
<b>Total</b>	<b>441.5</b>	<b>473.6</b>	<b>518.4</b>	<b>532.2</b>	<b>585.8</b>	<b>590.2</b>	<b>593.4</b>	<b>603.2</b>

(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	Aug-14	Sep-14	Change <sup>(1)</sup>
<b>TOTAL ASSETS</b>	<b>834.0</b>	<b>1006.7</b>	<b>1217.7</b>	<b>1370.7</b>	<b>1732.4</b>	<b>1851.9</b>	<b>1929.8</b>	<b>11.4</b>
<b>Loans</b>	<b>392.6</b>	<b>525.9</b>	<b>682.9</b>	<b>794.8</b>	<b>1047.4</b>	<b>1146.0</b>	<b>1187.3</b>	<b>13.4</b>
TRY Loans	288.2	383.8	484.8	588.4	752.7	823.5	847.9	12.6
Share (%)	73.4	73.0	71.0	74.0	71.9	71.9	71.4	-
FX Loans	104.4	142.1	198.1	206.4	294.7	322.5	339.4	15.2
Share (%)	26.6	27.0	29.0	26.0	28.1	28.1	28.6	-
Non-performing Loans	21.9	20.0	19.0	23.4	29.6	34.2	35.7	20.6
Non-performing Loan Rate (%)	5.3	3.7	2.7	2.9	2.8	2.9	2.9	-
<b>Securities</b>	<b>262.9</b>	<b>287.9</b>	<b>285.0</b>	<b>270.0</b>	<b>286.7</b>	<b>291.1</b>	<b>297.2</b>	<b>3.6</b>
<b>TOTAL LIABILITIES</b>	<b>834.0</b>	<b>1006.7</b>	<b>1217.7</b>	<b>1370.7</b>	<b>1732.4</b>	<b>1851.9</b>	<b>1929.8</b>	<b>11.4</b>
<b>Deposits</b>	<b>514.6</b>	<b>617.0</b>	<b>695.5</b>	<b>772.2</b>	<b>945.8</b>	<b>991.5</b>	<b>1020.1</b>	<b>7.9</b>
TRY Deposits	341.4	433.5	460.0	520.4	594.1	606.1	622.2	4.7
Share (%)	66.3	70.3	66.1	67.4	62.8	61.1	61.0	-
FX Deposits	173.2	183.5	235.5	251.8	351.7	385.3	397.9	13.1
Share (%)	33.7	29.7	33.9	32.6	37.2	38.9	39.0	-
<b>Securities Issued</b>	<b>0.1</b>	<b>3.1</b>	<b>18.4</b>	<b>37.9</b>	<b>60.6</b>	<b>76.8</b>	<b>82.9</b>	<b>36.9</b>
<b>Payables to Banks</b>	<b>86.1</b>	<b>122.4</b>	<b>167.4</b>	<b>173.4</b>	<b>254.2</b>	<b>265.4</b>	<b>282.6</b>	<b>11.2</b>
<b>Funds from Repo Transactions</b>	<b>60.7</b>	<b>57.5</b>	<b>97.0</b>	<b>79.9</b>	<b>119.1</b>	<b>129.8</b>	<b>133.5</b>	<b>12.1</b>
<b>TOTAL SHAREHOLDERS' EQUITY</b>	<b>110.9</b>	<b>134.5</b>	<b>144.6</b>	<b>181.9</b>	<b>193.7</b>	<b>218.6</b>	<b>219.2</b>	<b>13.2</b>
Profit (Loss) of the Period	20.2	22.1	19.8	23.5	24.7	16.7	18.8	-
<b>RATIOS (%)</b>								
Loans/Assets	47.1	52.2	56.1	58.0	60.5	61.9	61.5	-
Securities/Assets	31.5	28.6	23.4	19.7	16.6	15.7	15.4	-
Deposits/Liabilities	61.7	61.3	57.1	56.3	54.6	53.5	52.9	-
Deposits/Loans	131.1	117.3	101.8	97.2	90.3	86.5	85.9	-
Capital Adequacy (%)	20.6	19.0	16.6	17.9	15.3	16.3	15.9	-

(1) Year-to-date % change





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