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# Monthly Economic Review
April 2017

## Global Economy

- Central banks' meetings in developed countries were high on agenda of the global economy during March.
- Fed increased the policy rate by 25 basis points to 0.75-1.0% at its meeting ended on March 15. Fed members kept their forecasts for the pace of rate hikes as they anticipated 2 more hikes in the rest of 2017 and 3 hikes in 2018. This development fueled the optimism that interest rate hikes would be at a gradual pace.
- Recently, inflation and economic activity in the Euro Area have posted a better than expected figures. The annual increase in inflation in the region was 2% in February. However, the current election process in major European economies caused political risks to elevate.
- ECB kept its policy rate and asset purchase program on hold as expected, at the meeting on March 9. Draghi, the President of the ECB, pointed out that the ECB had removed a reference from its statement that it would act by using all the instruments available within its mandate, noting that there is no longer that sense of urgency in taking further actions.
- Prime Minister of the UK, Theresa May, formally started the process of leaving the European Union on March 29.
- Core consumer prices in Japan increased in the first two months of the year. On the other hand, annual rise in CPI remained well below the Central Bank's target.
- As the Fed signaled that the rate hikes will not be faster than anticipated, the USD depreciated which in turn led gold prices to surge.

## Turkish Economy

- On March 17, Moody's cut Turkey's rating outlook from 'stable' to 'negative'. Moody's, on the other hand, has kept Turkey's credit rating unchanged at "Ba1".
- In the last quarter of 2016, Turkish economy expanded by 3.5%, well above expectations. For the full of 2016, the economy posted an annual growth rate of 2.9%.
- In 2016, the labor market recorded its weakest performance since 2008. According to labor statistics for the December period, unemployment rate rose by 1.9 points yoy to 12.7%, the highest level in almost 7 years.
- Calendar adjusted industrial production continued to expand at a modest pace in the first month of 2017. The index increased by 2.6% from a year earlier.
- In February, exports decreased by 1.9% yoy. Imports, on the other hand, rose by 1.6% in the same period. Thus, foreign trade deficit widened by 15% yoy in February. Low basis effect stemming from commodity prices has been felt on foreign trade figures.
- The current account deficit widened by 561 million USD yoy and was 2.8 billion USD in January. Surge in foreign trade deficit along with the fall in tourism revenues were the main drivers behind this development. 12-month cumulative deficit rose to 33.2 billion USD.
- The central government budget posted a deficit of 6.8 billion TRY in February. While total budget revenues increased only by 4.9% yoy as tax revenues rose marginally in February, total expenditures expanded by 27% yoy due to the rapid increase in current transfers. These developments caused budget outlook to deteriorate.
- Having exceeded market forecast since December 2016, annual rise in CPI became 11.29% in March.

## Contents



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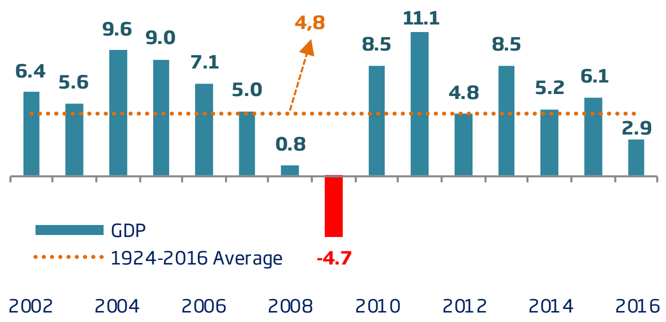
### Turkish economy grew by 2.9% in 2016.

In the last quarter of 2016, Turkish economy expanded by 3.5%, well above expectations. The second and third quarter growth rates, previously announced as 4.5% and -1.8%, were revised to 5.3% and -1.3%, respectively. For the full of 2016, the economy posted an annual growth rate of 2.9%. Although the growth rate was better than expected pace, it came in below its long-term average.

**Annual GDP Growth**

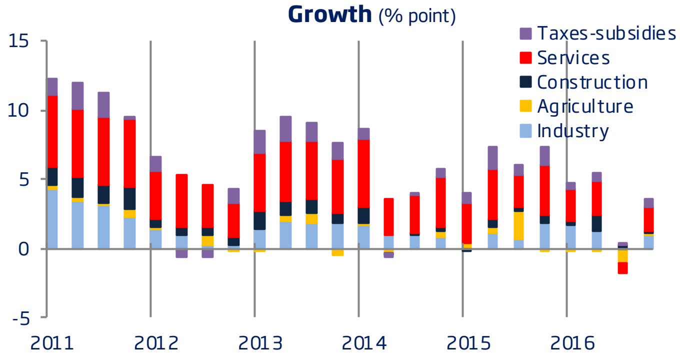
(chain linked volume index 2009=100, %)




### Consumption spending increased rapidly in the last quarter.

Consumption spending accelerated in the last quarter of 2016. Private consumption expenditures made the highest contribution to the GDP growth by 3.4 points in this period while public consumption contributed only marginally. On the other hand, a large-scale revision of public consumption expenditures in the third quarter was noteworthy. The contribution of this item to the growth, which was previously announced as 2.8 points, has fallen to 0.7 point. Considering the upward revision to total investment expenditures in the third quarter, it is thought that some items classified as consumption expenditures of the public sector may be reclassified as investment spending. In the last quarter, while investment spending kept its moderate performance, net exports continued to drag GDP down.

**Production Approach - Contributions to GDP Growth** (% point)




For 2016 as a whole, consumption expenditures were the main driver of the economic growth. Public and private consumption expenditures displayed a relatively balanced outlook in this period. On the other hand, investments were remarkably weak compared to the past years as Turkey experienced economic and political uncertainties in 2016. Except for a few months of the year, net exports lowered the growth throughout the year in the face of the slowdown in exports and the rise in imports.

### Recovery in industry and agriculture sectors...

According to production approach of GDP (chain linked volume index 2009=100), industrial sector expanded by 5% annually, contributing 1 point to the growth in the last quarter of 2016. The recovery in manufacturing industry played a big part in this development. Having contracted in the first three quarters of 2016, agriculture sector recovered in the fourth quarter and played an important role in better than expected GDP growth. Construction sector

**Expenditure Approach - Contributions to GDP Growth (chain linked volume index 2009=100)** **(% points)**

| | 2014 | | | | | 2015 | | | | | 2016 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Annual | Q1 | Q2 | Q3 | Q4 | Annual | Q1 | Q2 | Q3 | Q4 | Annual |
| **Consumption** | **2.8** | **1.2** | **1.4** | **3.8** | **2.3** | **3.1** | **5.2** | **2.3** | **5.0** | **3.9** | **1.9** | **4.4** | **-0.3** | **3.6** | **2.4** |
| Private | 1.8 | 1.3 | 1.3 | 3.0 | 1.9 | 3.9 | 4.2 | 2.2 | 3.3 | 3.4 | 0.6 | 2.5 | -1.0 | 3.4 | 1.4 |
| Public | 1.0 | -0.1 | 0.1 | 0.8 | 0.4 | -0.7 | 1.0 | 0.1 | 1.7 | 0.5 | 1.3 | 1.9 | 0.7 | 0.1 | 1.0 |
| **Investment** | **3.7** | **0.4** | **0.4** | **1.7** | **1.5** | **1.0** | **3.9** | **2.5** | **3.1** | **2.7** | **1.9** | **1.2** | **0.1** | **0.6** | **0.9** |
| **Change in Stock** | **-0.6** | **-1.5** | **-0.2** | **0.3** | **-0.5** | **-0.2** | **-2.4** | **0.1** | **-1.8** | **-1.1** | **1.0** | **1.9** | **1.5** | **-0.4** | **1.0** |
| **Net Export** | **2.8** | **2.8** | **2.1** | **0.2** | **1.9** | **-0.4** | **0.4** | **0.9** | **1.0** | **0.5** | **-0.4** | **-2.2** | **-2.5** | **-0.2** | **-1.3** |
| Exports | 2.9 | 1.5 | 1.9 | 1.1 | 1.8 | 0.6 | 1.0 | 1.1 | 1.1 | 0.9 | 0.3 | -0.4 | -2.1 | 0.5 | -0.5 |
| Imports | -0.1 | 1.3 | 0.2 | -0.9 | 0.1 | -1.0 | -0.6 | -0.1 | -0.1 | -0.4 | -0.7 | -1.8 | -0.5 | -0.7 | -0.9 |
| **GDP** | **8.7** | **2.9** | **3.7** | **5.9** | **5.2** | **3.5** | **7.2** | **5.9** | **7.4** | **6.1** | **4.5** | **5.3** | **-1.3** | **3.5** | **2.9** |

Numbers may not add to total due to rounding.

Source: Datastream, Turkstat

grew by 3.7% yoy in the last quarter and added 0.3 point to the growth. The services sector[1], which surged by 3% yoy in the fourth quarter, contributed 1.6 points to the growth. Recovery in information and communication as well as finance and insurance activities were decisive in the upsurge of the services sector. In addition, 0.6 point contribution of the net subsidies (taxes-subsidies) to the growth in the last quarter was worth mentioning.

In 2016 as a whole, owing to the problems related to foreign trade channel and high base effect, agriculture sector contracted by 4.1%, dragging the growth down by 0.3 point. Industrial sector contributed 0.9 point to the annual growth in this period. The construction sector, which recorded an expansion even in the third quarter whereas the economy contracted, added 0.5 point to 2016 growth, surging by 7.2% yoy. In addition to financial services, real estate, professional support, education, human health and social work activities exhibited a positive outlook in 2016. Accordingly, services sector made the highest contribution to the growth by 1.3 points.

## Expectations

Despite the stronger-than-expected pickup in growth, Turkish economy had the weakest growth performance in 2016 since the global crisis. National income per capita, which exceeded 12 thousand USD in both 2013 and 2014, fell to 10.8 thousand USD in 2016 also due to the depreciation in Turkish Lira. In spite of the slowdown in economic activity in 2016, there has been no improvement in the current account deficit/GDP ratio owing to the drop in tourism revenues. The budget deficit/GDP ratio rose slightly on the ground of the steps taken by the public sector to support the economic activity. In this period, the EU defined public debt stock surged by 14% yoy and thus the debt stock/GDP ratio reached 28.3%. Although recent data indicated a limited deterioration in these figures, Turkish economy maintained its strong position in terms of budget and public debt outlook compared with peer countries.

We think that Turkish economy will exhibit more favorable performance in 2017 compared to the previous year on the back of the easing macroprudential measures and steps taken by government to stimulate economic activity. However, we anticipate that the ongoing uncertainties surrounding the global economic outlook and geopolitical risks will put downward pressure on the growth. In this framework, we estimate that the growth rate will be around 3-3.5%, remaining below its long-term average.

**Basic Macroeconomic Indicators**

| | 2014 | 2015 | 2016 |
|---|---|---|---|
| GDP Growth (%) | 5.2 | 6.1 | 2.9 |
| GDP (billion TRY) | 2,044 | 2,338 | 2,591 |
| GDP (billion USD) | 935 | 861 | 857 |
| Per Capita GDP (USD) | 12,112 | 11,014 | 10,807 |
| Current Account Deficit/GDP (%) | 4.7 | 3.7 | 3.8 |
| Budget Deficit/GDP (%) | -1.1 | -1.0 | -1.1 |
| EU Defined Debt Stock/GDP (%) | 28.6 | 27.5 | 28.3 |
| Investments/GDP (%) | 28.9 | 29.7 | 29.8 |
| Banking Sector Assets/GDP (%) | 97.5 | 100.9 | 105.4 |
| Loan Volume/GDP (%) | 60.7 | 63.5 | 66.9 |
| Deposit Volume/GDP (%) | 51.5 | 53.3 | 56.1 |

(1) Services sector constitutes of the information and communication, financial and insurance activities, real estate activities, professional, administrative and support service activities, public administration, education, human health and social work activities and other service activities

Source: Datastream, Turkstat

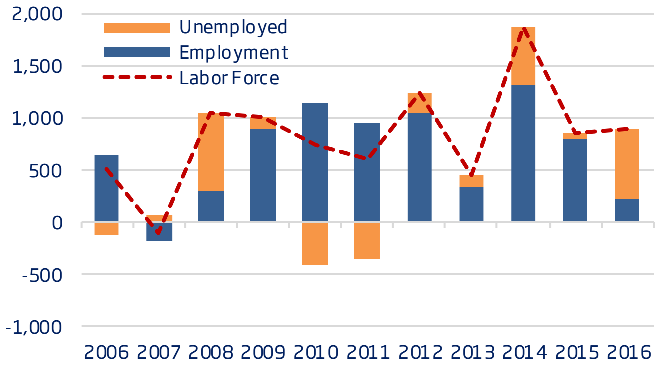
## Unemployment rate became 12.7% in December 2016.

In 2016, labor market recorded its weakest performance since 2008. According to the labor statistics for the December period, the unemployment rate rose by 1.9 points yoy to 12.7%, the highest level in almost 7 years. Total employment increased by only 221 thousand persons on annual basis whereas labor force surged by 888 thousand persons. In this period, the number of unemployed people rose by 668 thousand and became 3.9 million. It was noteworthy that youth unemployment rate increased by 4.8 points 2016 from a year earlier and reached 24% in December.

According to the annual labor force statistics, the unemployment rate was realized as 10.9% in 2016.

**Change in Labor Force, Employment and Unemployed**

(annual, thousand persons)




## The rise in industrial production continued.

Calendar adjusted industrial production continued to expand at a modest pace in the first month of 2017. The index increased by 2.6% compared to the same month of the previous year. The strong performance of motor vehicles production prevailed in the first month of the year. Food production also made a significant contribution to the industrial production growth. Motor vehicles and food production added 1.9 and 1.1 percentage points to the manufacturing industry. Most of the sub-sectors' contribution to the production remained relatively flat. On the other hand, the declines in the wearing apparels and textile sectors were remarkable.

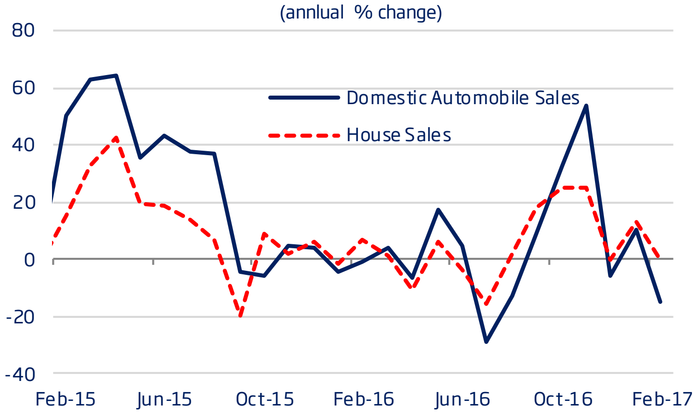
## Housing and automotive sectors…

Housing sales in Turkey fell by 0.2% in February compared to the same period of the previous year. In this period, sales financed by credit, described as mortgaged sales, picked up by 27% yoy while other sales dropped by 11.9% yoy. In January-February period, housing sales showed a moderate outlook due to the regulations on housing loans. Total housing sales expanded by 5.7% yoy in the first two months. Mortgaged sales surged by 30.9% yoy in this period.

Domestic automobile demand performed weakly during the first two months of 2017. Besides, positive outlook of automotive export was a bigger determinant of automotive production.

**Domestic Automobile and House Sales**

(annlual % change)




## Manufacturing PMI was above the threshold for the first time in 13 months.

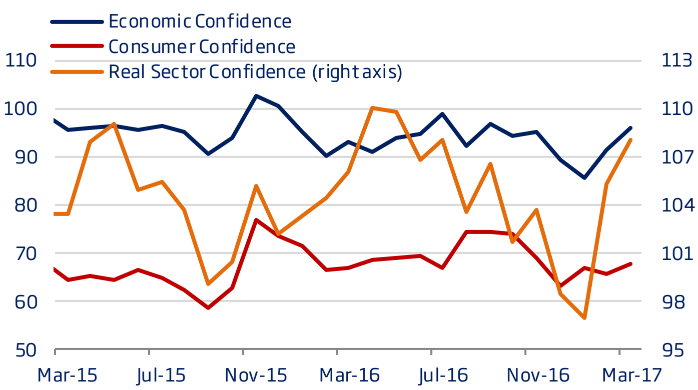
Manufacturing PMI rose to 52.3 in March, indicating that conditions in the sector improved for the first time after 13 months. All sub items of the index, especially output, showed a positive outlook. The rapid increase in the index confirmed the view that economic activity accelerated in the first quarter of 2017.

## Recovery in confidence indices…

Confidence indices recovered in March. Real sector confidence index reached 108.1 due to the improvement in expectations for employment and production volume for next 3 months.

Consumer confidence index rose by 3.2% yoy in March. This development was led by the steps taken to support economic activity. Indeed, assessments regarding the convenience of current period for buying durable consumption goods improved thanks to SCT reduction. Also, expectations that consumer prices would decline in response to the tight liquidity policy of the CBRT have strengthened.

**Confidence Indicators**

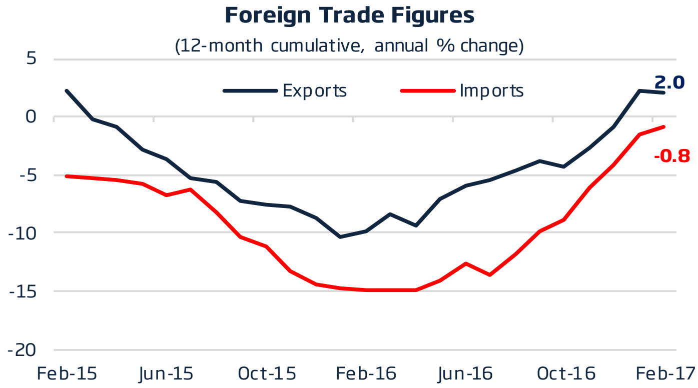



Source: Datastream, Turkstat, CBRT, Markit,

### Foreign trade deficit kept widening.

In February, exports decreased by 1.9% compared to the same month of the previous year. Imports, on the other hand, increased by 1.6% in the same period. Thus, foreign trade deficit widened by 15% in February compared to the same month of 2016.

Analysis of 12-month cumulative figures indicated that export volume lost momentum in February after posting a rise in January. The contraction in import volume also continued to lose pace.

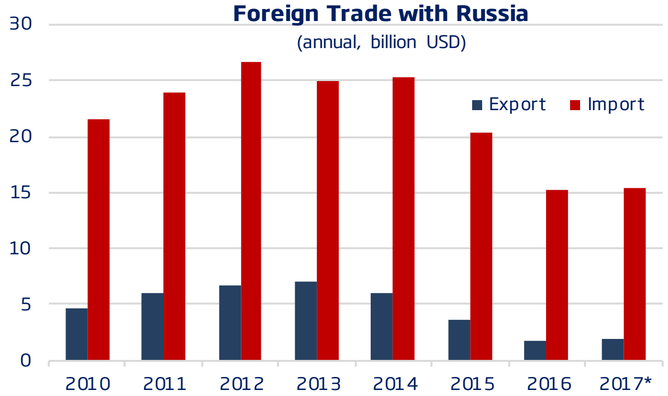



### Widespread export declines across sectors...

Upward trend in export volume across the sectors seen in January has reversed in February. Only 3 of the top 10 sectors were able to increase their exports on an annual basis. Manufacture of motor vehicles kept its first place among sectors as its exports surged by 13% in February from a year earlier. Due to the rise in commodity prices, iron-steel and mineral fuels were the two sectors that recorded increases in their export volumes. Exports of precious metals and stones, being 1.7 billion USD in February 2016, posted an annual decline of 44.5% in the same period of 2017. Therefore, the sector has fallen to third rank.

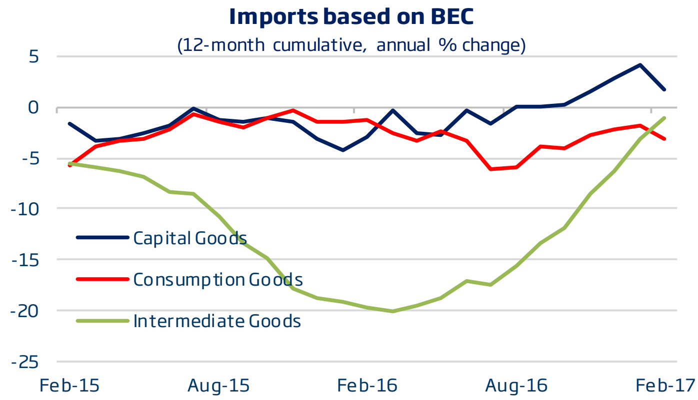
Analyzing the country groups, it is seen that exports to the Middle Eastern countries kept increasing in February. It is noteworthy that exports to the United Arab Emirates (UAE) in February have almost tripled compared to the same month of the previous year. Thus, UAE became the second largest export market after Germany in February. However, exports to the EU countries contracted by 3.2%. The 33.4% drop in exports to the UK has stood out.

As Russia has been high on agenda with the trade restrictions on Turkish goods, exports to Russia continued to perform weakly in February compared to the previous years. We anticipate that the current level of exports is likely to be sustained if no improvement is seen in the upcoming period.




### Rise in energy imports...

Energy imports rose in February after jumping in January. Import volume of mineral fuels and oils became the biggest import item, picking up by 42.8% yoy. The upsurge in imports of precious metals and stones was also a remarkable development. While imports of intermediate goods increased due to the upward movement in energy prices, imports of capital and consumption goods decreased.




### Expectations

Depreciation in TRY has limited impact on export performance of Turkey as the problems in our major export markets have prevailed. Taking the fading positive effect of commodity prices on imports into consideration, we expect that foreign trade deficit will continue to widen in the coming period. This development with the weak tourism revenues signal that current account deficit might follow an upward trend.

**Foreign Trade Balance** (USD billion)

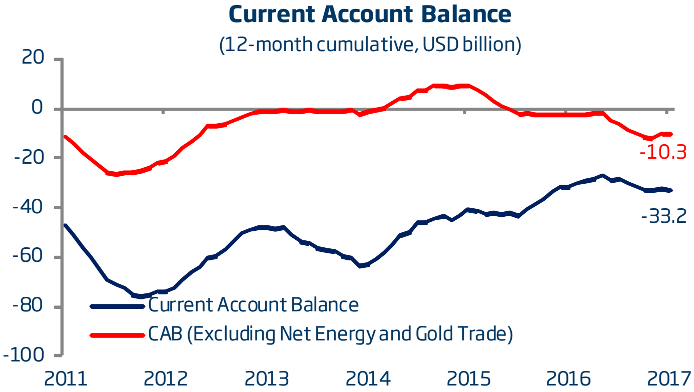
| | February | | Change | Jan.-Feb. | | Change |
|---|---|---|---|---|---|---|
| | 2016 | 2017 | (%) | 2016 | 2017 | (%) |
| Exports | 12.4 | 12.1 | -1.9 | 21.9 | 23.4 | 6.7 |
| Imports | 15.6 | 15.8 | 1.6 | 29.0 | 31.4 | 8.2 |
| **Foreign Trade Balance** | **-3.2** | **-3.7** | **15.0** | **-7.1** | **-8.0** | **12.7** |
| Import Coverage Ratio (%) | 79.4 | 76.7 | - | 75.5 | 74.5 | - |

(*) As of February 2017, 12-month cumulative.

Source: Datastream, Turkstat

### Current account deficit was in line with expectations.

The current account deficit widened by 561 million USD yoy and was realized as 2.8 billion USD in January. Surge in foreign trade deficit along with the fall in tourism revenues were the main drivers behind the expansion of CAD. According to 12-month cumulative figures, current account deficit rose by 4.1% yoy to 33.2 billion USD as of January. Excluding net energy and gold trade, on the other hand, the deficit recorded a contraction, albeit slightly.




### Foreign trade deficit has widened.

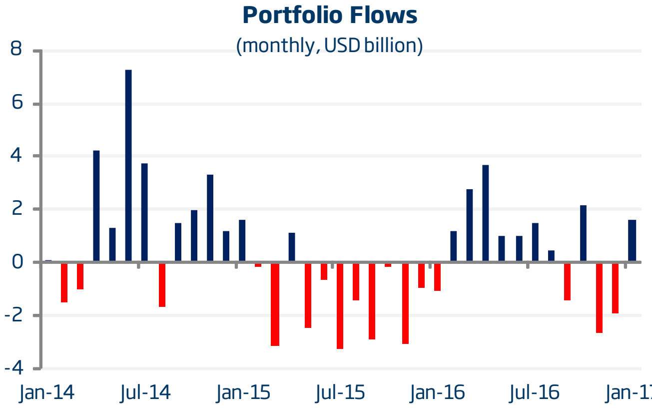
According to the balance of payments figures, despite the recovery in exports, the 2.3 billion USD annual rise in imports led the CAD to surge in January. In this period, gold import and export represented a relatively balanced outcome.

Having put upward pressure on the current account deficit throughout 2016, tourism revenues kept their weak performance in the first month of 2017 as well. Net tourism revenues fell by 17.5% from a year earlier. It was noteworthy that the number of tourists from the European countries dropped in January while the number of Russian tourists picked up significantly on the back of the normalization of the relations between Turkey and Russia. However, the total number of tourists decreased by more than 100 thousand persons on an annual basis in January, falling to 1.2 million persons.

### Capital inflows in portfolio investments...

After recording a net inflow of 6.4 billion USD in 2016, portfolio investments registered 1.6 billion USD capital inflows in January. In this period, non-residents recorded net purchases of 649 million USD in equity securities while they sold 802 million USD in government debt securities market. On the other hand, Treasury's Eurobond issues, which amounted to 2 billion USD, made a significant contribution to the financing of the CAD in January.

### Loss of momentum in FDI...




Foreign direct investment continued to decelerate in the first month of 2017 as was the case in 2016. Net direct investments halved in January compared to the same month of the previous year, amounting to 360 million USD. In this period, net real estate investments also dropped by 24.5% to 280 million USD. Azerbaijan and Netherlands had the highest shares in foreign direct investments towards Turkey that came in at 28.7% and 23.7% respectively.

### Capital outflows from other investments...

Other investments, which contributed notably to the financing of the deficit by 6.7 billion USD in 2016, recorded a net capital outflow of 534 million USD in January. In this period, capital outflows, net 2.1 billion USD, were registered under currency and deposits item. However, 1.5 billion USD was obtained from abroad via loans and trade credits.

**Breakdown of Net Capital Inflows** **(12-month cumulative, USD million)**

| | | | Breakdown of Net Capital Inflows (%) | |
|---|---|---|---|---|
| | **Dec. 2016** | **Jan. 2017** | **Dec. 2016** | **Jan. 2017** |
| **Current Account Balance** | **-32,118** | **-33,163** | **-** | **-** |
| **Total Net Foreign Capital Inflows** | **20,287** | **31,958** | **100.0** | **100.0** |
| -Direct Investments | 12,455 | 8,687 | 61.4 | 27.2 |
| -Portfolio Investments | -15,719 | 9,036 | -77.5 | 28.3 |
| -Other Investments | 13,374 | 2,595 | 65.9 | 8.1 |
| -Net Errors and Omissions | 10,198 | 11,648 | 50.3 | 36.4 |
| -Other | -21 | -8 | -0.1 | 0.0 |
| **Reserves(1)** | **11,831** | **1,205** | **58.32** | **3.77** |

Note: The numbers may not add up to total due to rounding.
(1) (-) sign indicates an increase in reserves while (+) sign indicates a decrease.

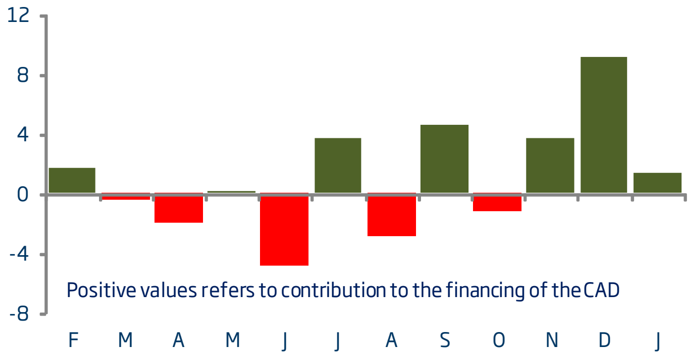
Source: Datastream, CBRT

In January, banking sector became a net borrower in short-term with 203 million USD while being a net credit payer in long-term. A similar pattern has been seen in other sectors.

According to 12-month cumulative figures, banking sector was a net credit payer in short-term with 5.9 billion USD whereas it was a net borrower in long-term with 3 billion USD. Thus, long-term debt rollover ratio of the sector remained flat at 109% in January. The ratio for the other sectors became 144% in this period.

Reserves made a significant contribution to the financing of the deficit by falling 2.1 billion USD in January while 687 million USD capital outflows were recorded under net errors and omissions item.

**CBRT Reserves and Net Errors & Omissions**
(USD billion)




### Expectations...

The declining trend in foreign trade deficit has come to an end along with the stabilization of energy prices. Although the depreciation in TL may support the export performance in the short term, geopolitical developments and the recent problems with the EU might put an upward pressure on the current account deficit via capital flows and tourism revenues. In light of these developments, we anticipate that the mild pick up in the current account deficit may continue in the forthcoming period.

**Balance of Payments** (USD million)

| | January 2016 | January 2017 | % Change | 12-Month Cumulative |
|---|---|---|---|---|
| **Current Account Balance** | **-2,201** | **-2,762** | **25.5** | **-33,163** |
| Foreign Trade Balance | -2,685 | -3,105 | 15.6 | -41,247 |
| Services Balance | 810 | 578 | -28.6 | 15,193 |
| Travel (net) | 714 | 589 | -17.5 | 13,835 |
| Primary Income | -441 | -399 | -9.5 | -8,947 |
| Secondary Income | 115 | 164 | 42.6 | 1,838 |
| **Capital Account** | **15** | **-16** | - | **-8** |
| **Financial Account** | **-3,286** | **-3,465** | **5.4** | **-21,523** |
| Direct Investments (net) | -789 | -360 | -54.4 | -8,687 |
| Portfolio Investments (net) | 1,096 | -1,584 | - | -9,036 |
| Net Acquisition of Financial Assets | 309 | 24 | -92.2 | 1,162 |
| Net Incurrence of Liabilities | -787 | 1,608 | - | 10,198 |
| Equity Securities | -261 | 649 | - | 1,733 |
| Debt Securities | -526 | 959 | - | 8,465 |
| Other Investments (net) | -3,556 | 534 | - | -2,595 |
| Currency and Deposits | -2,999 | 2,077 | - | 6,908 |
| Net Acquisition of Financial Assets | -639 | 3,341 | - | 9,404 |
| Net Incurrence of Liabilities | 2,360 | 1,264 | -46.4 | 2,496 |
| Central Bank | -18 | -8 | -55.6 | -466 |
| Banks | 2,378 | 1,272 | -46.5 | 2,962 |
| Foreign Banks | 2,440 | 1,512 | -38.0 | 3,554 |
| Foreign Exchange | 706 | 556 | -21.2 | 32 |
| Turkish Lira | 1,734 | 956 | -44.9 | 3,522 |
| Non-residents | -62 | -240 | 287.1 | -592 |
| Loans | -268 | -639 | 138.4 | -5,691 |
| Net Acquisition of Financial Assets | 390 | -57 | - | -216 |
| Net Incurrence of Liabilities | 658 | 582 | -11.6 | 5,475 |
| Banking Sector | 48 | 187 | 289.6 | -2,870 |
| Non-bank Sectors | 724 | 225 | -68.9 | 8,982 |
| Trade Credit and Advances | -391 | -901 | 130.4 | -3,815 |
| Other Assets and Liabilities | 102 | -3 | - | 3 |
| Reserve Assets (net) | -37 | -2,055 | 5,454.1 | -1,205 |
| **Net Errors and Omissions** | **-1,100** | **-687** | **-37.5** | **11,648** |

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 gave deficit in February.**

The central government budget, which gave 2.4 billion TRY surplus in February 2016, posted a deficit of 6.8 billion TRY in the same month of this year. The budget, which gave primary surplus of 6.5 billion TRY in February of last year, has recorded a deficit of 1.8 billion TRY in the same month of this year. Total budget revenues increased only by 4.9% yoy as tax revenues rose marginally in February. Total expenditures expanded by 27% yoy due to the rapid increase in current transfers. These developments caused budget outlook to deteriorate.

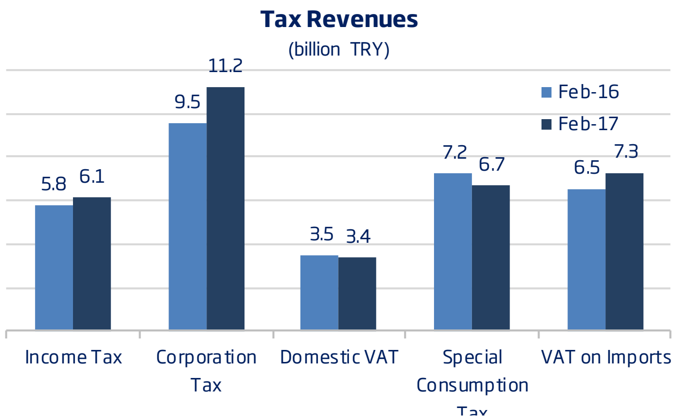
During the first two months of the year, on the other hand, the budget gave a surplus of 4.6 billion TRY albeit a smaller one than a year ago.

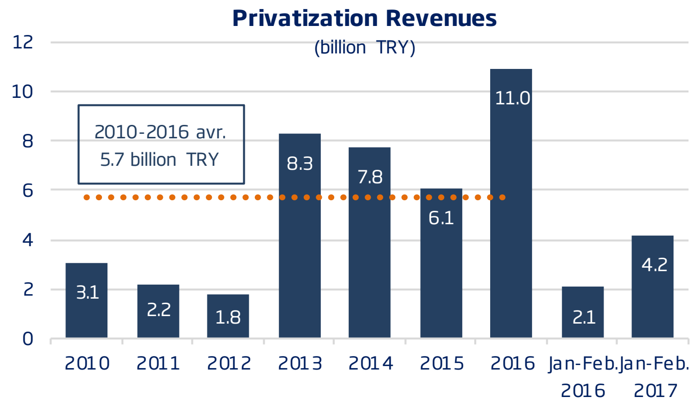
**Tax revenues rose by 4.3%**

In February, weak increase in tax revenues was attributable to the 4.3% decline in revenues collected from domestic taxes on goods and services. Especially the fall in the revenues from tobacco products, by 53.4%, was noticeably felt on tax revenues. In addition, the revenues from motor vehicles taxes dropped and thus negatively affected tax revenues.

The taxes on profits and earnings displayed a better performance with a rise of 13% in February. The increase in VAT on imports revenues also drove up tax revenues.

Despite the loss of momentum in tax revenues in February, budget revenues picked up by 15.6% yoy during January-February period. Revenues collected from the restructuring of public receivables amounted to 1.8 billion TRY in this period. Having been recorded as 4.2 billion TRY in January, the privatization revenues limited the deterioration of the budget outlook. On the other hand, as the privatization revenues are started to be transferred to the Turkiye Wealth Fund, the contribution of privatization revenues to the revenues will disappear in the coming period.




**Budget expenditures expanded by 27%.**

Transfers made to the Social Security Institution (SSI) by the Treasury in February led to a significant increase in budget expenditures. In addition to the five-point reduction made on the employer's insurance contribution, the transfers for the social security deficit finance put 7.7 billion TRY burden on the budget in February. In the same month of the previous year, the said amount was realized as 3.6 billion TRY. Moreover, interest expenditures surged by 1 billion TRY in this period.

**Expectations**

The impact of the transfer of some government stakes and privatization revenues to Turkiye Wealth Fund might felt on budget revenues in the coming period. Besides, it will be a significant factor for the budget outlook that whether the weak performance of tax revenues in February will continue or not. Taking into consideration the recent steps to support economic activity, the rising trend in budget expenditures is expected to persist in the coming period.

**Central Government Budget** (billion TRY)

| | February | | % | January February | | % | 2017 Budget | Real./ |
|---|---|---|---|---|---|---|---|---|
| | 2016 | 2017 | Change | 2016 | 2017 | Change | Target | Target (%) |
| **Expenditures** | **42.3** | **53.7** | **27.0** | **84.8** | **101.1** | **19.2** | **645.1** | **15.7** |
| Interest Expenditure | 4.1 | 5.1 | 23.3 | 9.7 | 11.7 | 19.9 | 57.5 | 20.3 |
| Non-Interest Expenditures | 38.2 | 48.7 | 27.4 | 75.1 | 89.4 | 19.1 | 587.6 | 15.2 |
| **Revenues** | **44.7** | **46.9** | **4.9** | **91.4** | **105.7** | **15.6** | **598.3** | **17.7** |
| Tax Revenues | 38.4 | 40.0 | 4.3 | 78.0 | 88.4 | 13.3 | 511.1 | 17.3 |
| Other Revenues | 6.4 | 6.9 | 8.5 | 13.4 | 17.3 | 28.8 | 87.2 | 19.8 |
| **Budget Balance** | **2.4** | **-6.8** | **-** | **6.6** | **4.6** | **-30.6** | **-46.9** | **-** |
| **Primary Balance** | **6.5** | **-1.8** | **-** | **16.4** | **16.3** | **-0.5** | **10.6** | **152.7** |

Numbers may not add up total value due to rounding.

### CPI came in above the expectations.

In March, CPI increased by 1.02% mom, beating market expectations. According to the Reuters survey, monthly CPI inflation had been anticipated to be 0.6%. Domestic PPI (D-PPI) also rose by 1.04% mom in March.

| March | CPI | | D-PPI | |
|---|---|---|---|---|
| (change %) | 2016 | 2017 | 2016 | 2017 |
| Monthly | -0.04 | 1.02 | 0.40 | 1.04 |
| Year-to-Date | 1.75 | 4.34 | 0.75 | 6.38 |
| Annual | 7.46 | 11.29 | 3.80 | 16.09 |
| Annual Average | 7.96 | 8.21 | 5.64 | 6.89 |

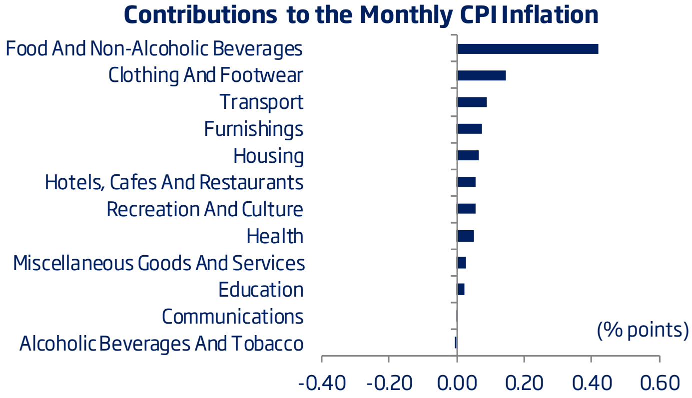
### Annual inflation hit an eight and a half year high...

Having exceeded market forecast since December 2016, annual rise in CPI became 11.29% in March. Thus, annual CPI inflation reached its highest level since October 2008, when global crisis erupted. The annual increase in the D-PPI, which hovered around 4% on average during 2016, accelerated since the end of 2016 and was 16.09% in March. Annual D-PPI inflation also picked up to a nine-year high.

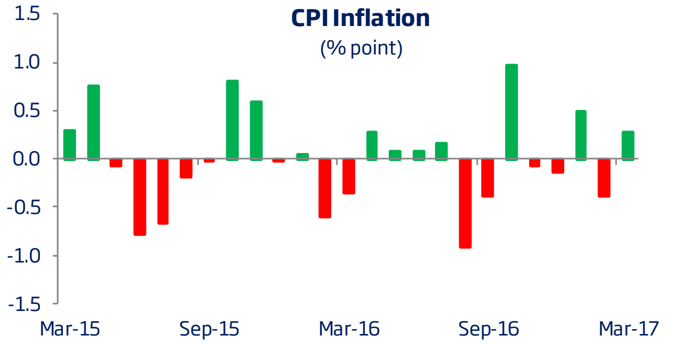
### Inflation was mainly driven by clothing and food prices.

Prices in almost all expenditure sub-groups posted monthly rises in March. Food and non-alcoholic beverages prices climbed by 1.93% mom, pushed the inflation up by 42 basis points. Clothing prices increased due to the seasonal factors and contributed 15 basis points to the inflation. Despite the decline in energy prices, transportation prices added 9 basis points to inflation owing to the escalation in transportation services prices. Increase in household equipment prices was worthy of attention despite the reduction in special consumption tax on durable household equipment. Seasonal factors had an upward impact on CPI in March. Excluding seasonal products, monthly and annual inflation fell to 0.74% and 10.79%, respectively.

**Contributions to the Monthly CPI Inflation**




**Contribution of Seasonal Factors to Monthly CPI Inflation**
(% point)

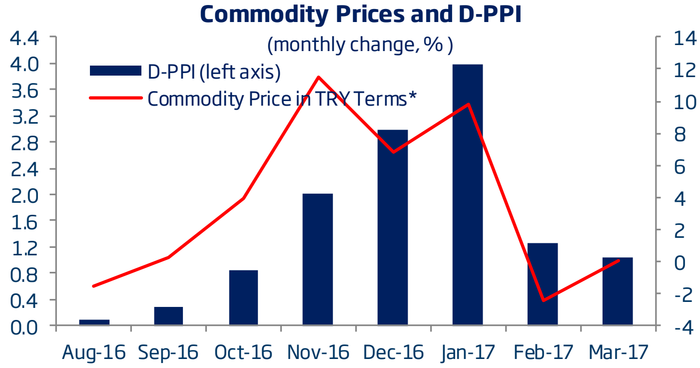



Core inflation indicators continued to deteriorate in March. Indeed, the annual rise in D index, which excludes unprocessed food, alcoholic beverages and tobacco, reached the highest levels of last 5 years with 9.75%.

### Energy prices limited the increase in D-PPI.

Commodity prices in TRY terms exhibited a flat course in March after recording 2.4% monthly decline in February. Accordingly, the increase in D-PPI was restrained to some extent in March. Contraction in the prices of coke and refine petroleum products, electricity and gas groups lowered the increase in D-PPI by 30 basis points. On the other hand, almost half of the monthly rise in the D-PPI inflation was driven by the upsurge in the prices of textile and basic metals.

**Commodity Prices and D-PPI**
(monthly change, %)




(*) Based on CRB Commodity Price Index

### Expectations...

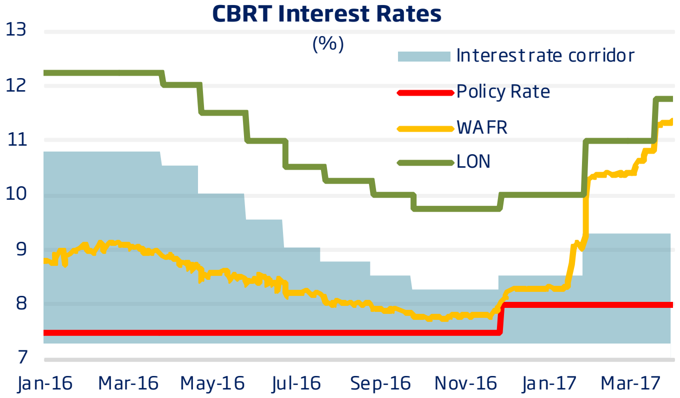
Despite temporary tax reductions, inflation remained at double-digit levels due to the lagged effects of the depreciation in the TRY. We anticipate that it will prevail in the first half of the year with the help of the partial recovery in demand conditions. If the recent TRY appreciation is permanent, a slight improvement might be recorded in inflation in the second half of the year also thanks to base effect.

Source: Datastream, Turkstat

### Further tightening from the CBRT…

The CBRT raised the late liquidity window (LON) interest rate by 75 basis points to 11.75% while keeping the other interest rates unchanged at its meeting held on March 16. CBRT stated that the monetary tightening would strengthen in order to contain the deterioration in the inflation outlook. The Central Bank also reiterated that further monetary tightening will be delivered, if needed. The weighted average cost of the CBRT funding (WAFR) has exceeded the 11.3% following the Central Bank's latest move. As a result, WAFR has increased by around 300 basis points since the end of 201.

**CBRT Interest Rates**




### Moody's cut Turkey's rating outlook to negative.

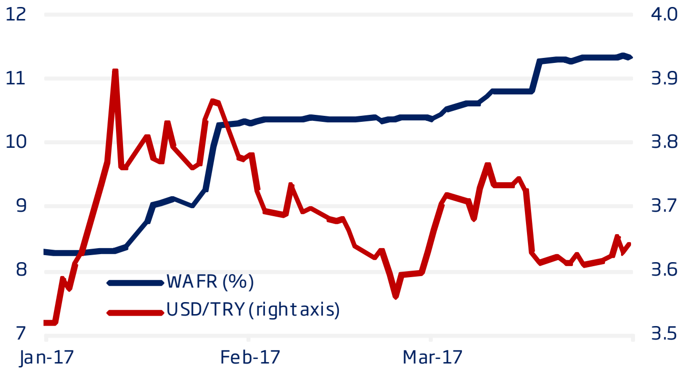
On March 17, credit rating agency Moody's lowered the outlook of Turkey's credit rating from 'stable' to 'negative', due to the weaker growth outlook, the continuing erosion of institutional strength, heightened pressures on Turkey's public and external accounts. Moody's has also affirmed the Turkey's rating at "Ba1".

Moody's stated that since the last rating action in September, domestic and external pressures on Turkey's credit profile have risen materially. This indicated that the impact of ongoing political and geopolitical tensions on domestic confidence, and the heightened external pressures that led to a steep depreciation of the TRY and high inflation would suppress growth in the near-term relative to expectations last year.

### Fluctuations in USD/TRY…

In March, meetings of the central banks of the developed countries, especially the Fed, came into focus in global markets. Along with the election agenda in the Europe, this development caused fluctuations in the markets in the first half of the month. As the Fed signaled that there would be no pick-up in the pace of monetary tightening following the Fed meeting in mid-March have created a positive

**Waighted Average Cost of the CBRT Funding and USD/TRY**




atmosphere in global markets.

USD/TRY, which remained under pressure until mid-March, followed a downward course also thanks to the further tightening of the CBRT after the Fed meeting. In addition, the withdrawal of the healthcare bill in the United States led to depreciation of the US dollar in international markets. This also had a positive impact on domestic markets as well. On the other hand, Moody's' cut of Turkey's rating outlook put upward pressure on the TRY, albeit limited. As of March 31, USD/TRY rose by 0.4% to 3.64 compared to the end of February.

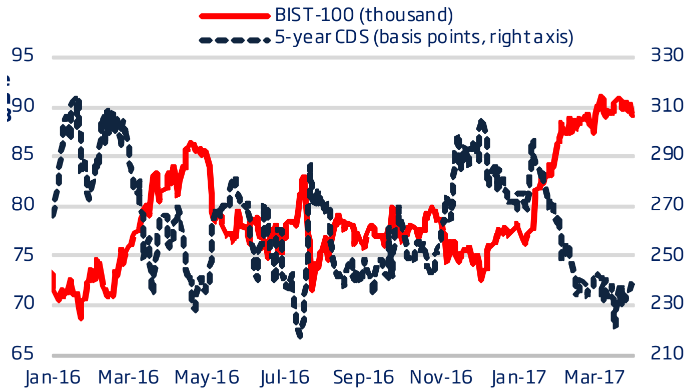
### BIST-100 index…

Despite losing pace, the favorable performance of BIST-100 index continued in March. As of March 31, the index increased by 1.7% to 88,947 compared to the end of February.

The risk premiums of emerging countries, including Turkey, fell after the Fed meeting spurred optimism. In March, Turkey's CDS risk premium came down to its lowest level since July 15.

The compound interest rate of the 2-year benchmark bond, which has ended February at 11.09%, rose to 11.30% as of March 31.

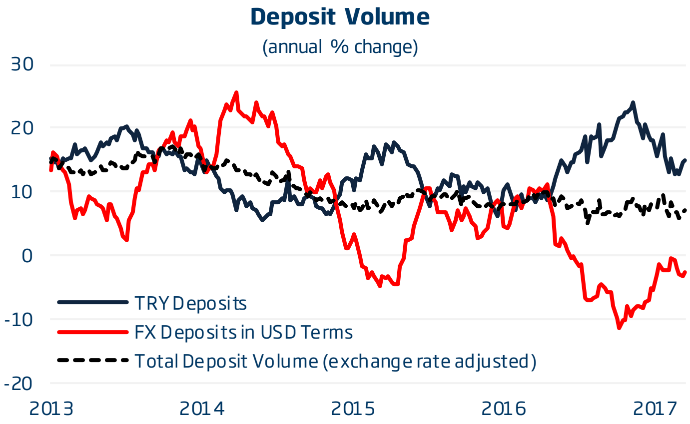
**CDS and BIST-100**




Source: CBRT, Reuters, Datastream

### Deposit volume posted an annual rise of 18.1%.

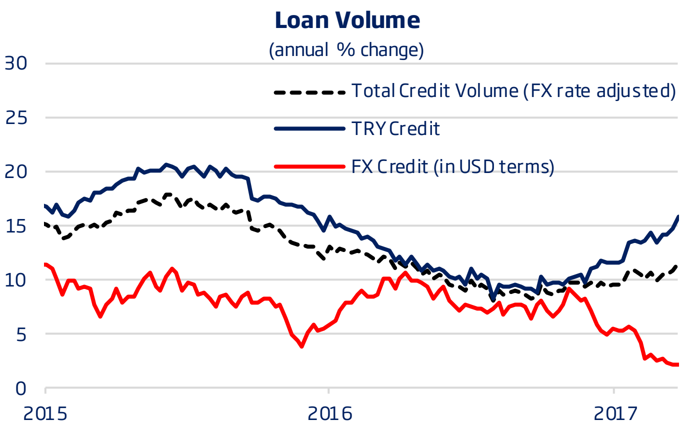
According to BRSA's Weekly Bulletin, as of March 24 deposit volume expanded by 18.1% compared to the same period of 2016 and reached 1,604 billion TRY. The growth rate in deposit volume became 7.0% in this period, according to the exchange rate adjusted figures.




TRY deposits posted an annual increase of 14.8% as of March 24. On the other hand, FX deposits in USD terms have been on a downward trend since June 2016. As of March 24, FX deposits in USD terms fell by 2.6% compared to the same period of the previous year. Due to the depreciation of TRY, FX deposit volume picked up by 22.1% in this period.

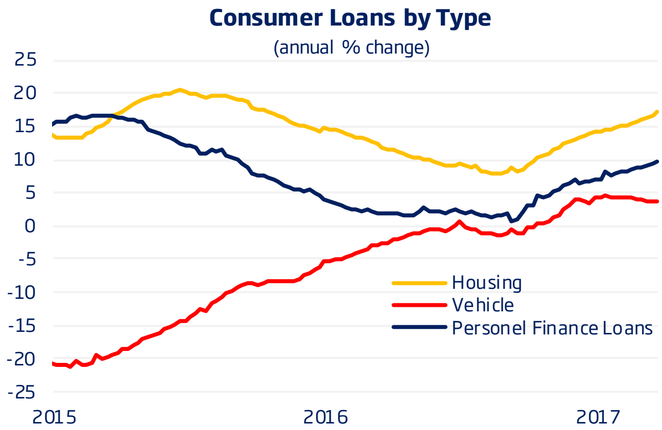
### Loan growth gained momentum.

Loan volume continued to expand thanks to the rise in the FX rates and the strong growth in TRY loan volume. As of March 24, total loan volume increased by 19.9% yoy and surged to 1,836 billion TRY. According to the exchange rate adjusted figures, credit volume grew by 11.5% in this period. TRY loan volume rose by the most since December 2015, expanding by 16.0%. FX credits in USD terms recorded an increase of 2.1% in the same period.



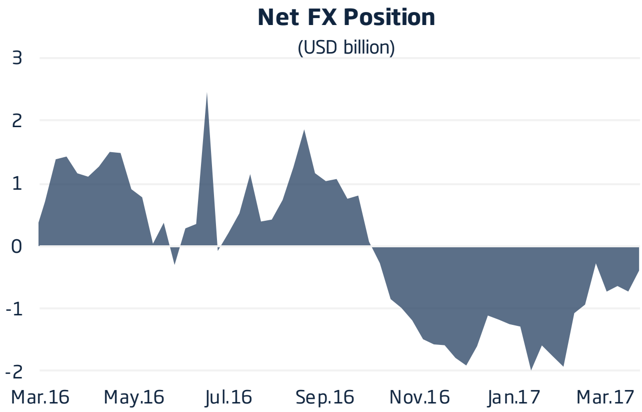

### Consumer loans...

The pace of growth in housing loans continued to accelerate. As of March 24, housing loans recorded the fastest growth rate since October 2015, surging by 17.1% yoy. Thus, the share of housing loans in total consumer loans continued to rise, reaching the highest level since May 2007 with 49.1%. Personal finance loans increased by 9.8% in the same period. Vehicle loan, on the other hand, has continued to lose momentum since January.




### Net FX position...

As of March 24, banks' on-balance sheet FX position was (-) USD 40,590 million while off-balance sheet FX position realized as (+)USD 40,197 million. Hence, banking sector's net FX position became (-)USD 393 million. The banking sector has carried net open FX position since October.




Source: BRSA Weekly Bulletin

# Concluding Remarks

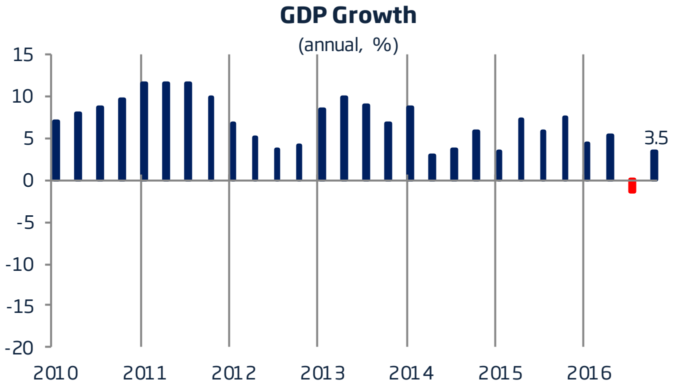
As widely expected, the Fed raised the policy rate at its meeting held in March thanks to the favorable outlook in the US economy. The announcements following the meeting showed that the pace of interest rate increases would be gradual. On the other hand, political risks continue to be a major source of uncertainty surrounding the global economy. After failing to pass healthcare bill, the policies of the Trump administration remained unclear. Besides, growing populism in Europe creates concern. The looming elections in the two biggest economies of the region, namely France and Germany, shifts focus to the political developments. In particular, the elections in France have a great importance for the future of the EU. All these developments indicate that political events will be a top item on the economic agenda throughout 2017.

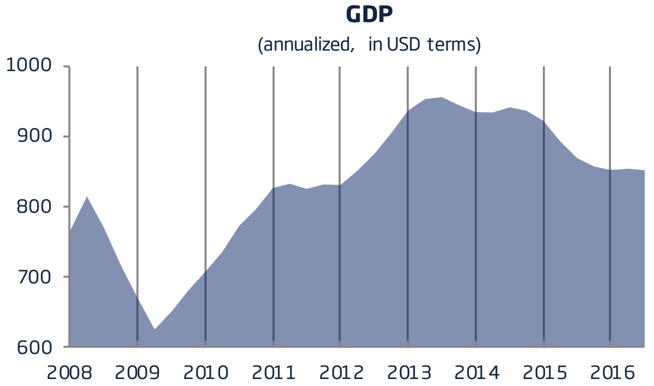
The signs of recovery in domestic economic activity have strengthened recently. We think that economic growth will show a better performance this year compared to the previous year with the help of the steps taken to increase domestic demand. However, we anticipate that the ongoing uncertainties in the global economic outlook and geopolitical developments will continue to exert downward pressure on growth.

| Forecasts (%) | 2016 [R] | 2017 |
|---|---|---|
| Growth | 2.9 | 3.3 |
| CA Deficit/GDP | 3.8 | 4.2 |
| Inflation | 8.5 | 9.0 |

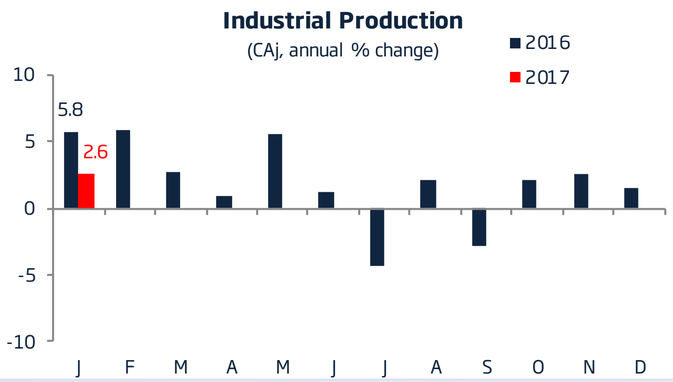
(R) Realization
Year-end forecast for inflation

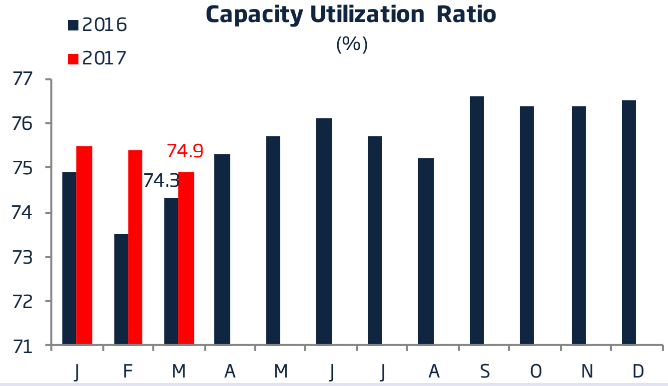
## Growth



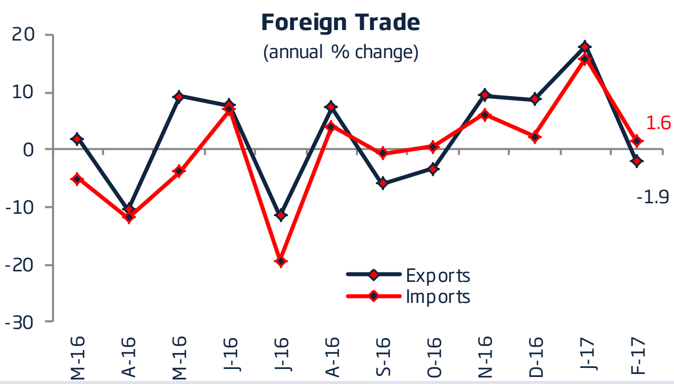



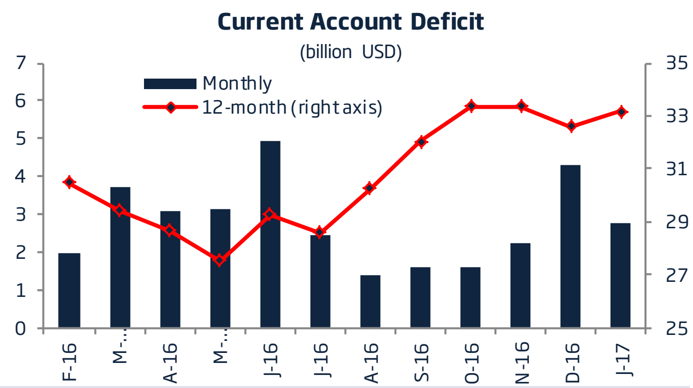

## Industrial Production and Capacity Utilization Ratio



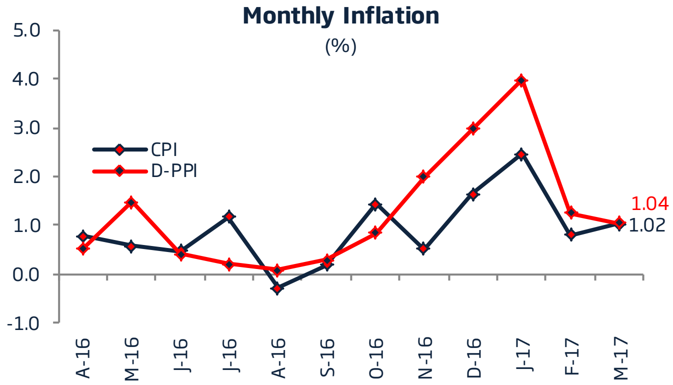



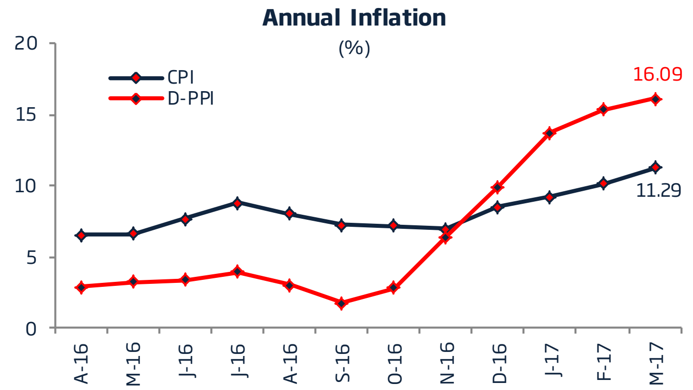

## Foreign Trade and Current Account Balance




## Inflation



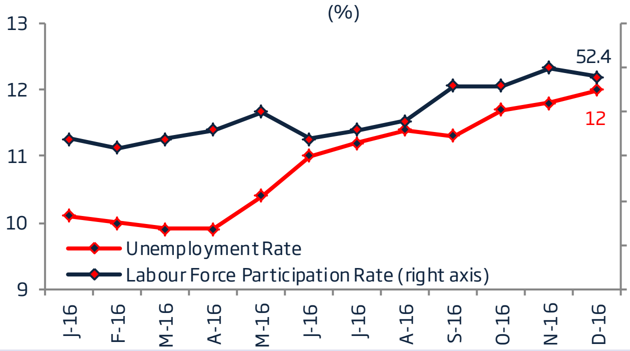




Source: CBRT, Datastream, Turkstat

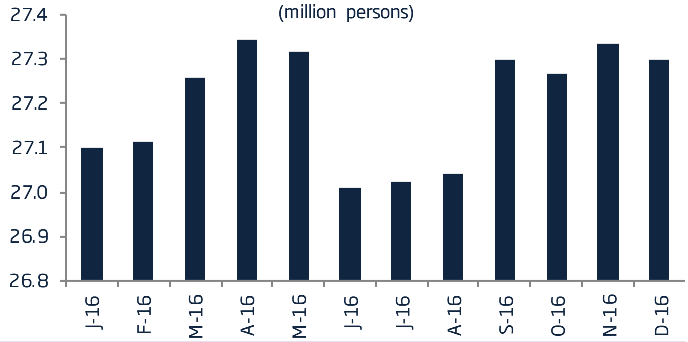
TÜRKİYE İŞ BANKASI

## Labor Market

### Seasonally Adjusted Labour Force Indicators
(%)

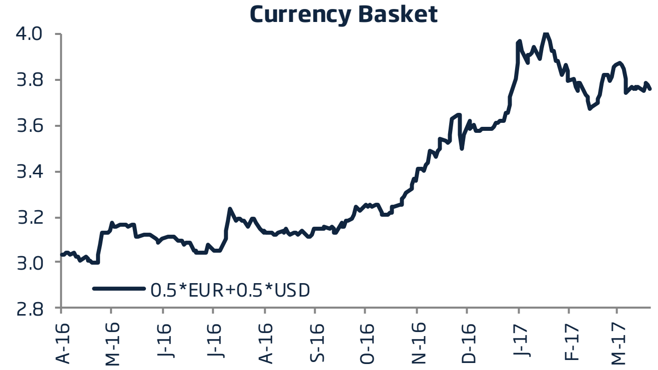



### Seasonally Adjusted Employment
(million persons)

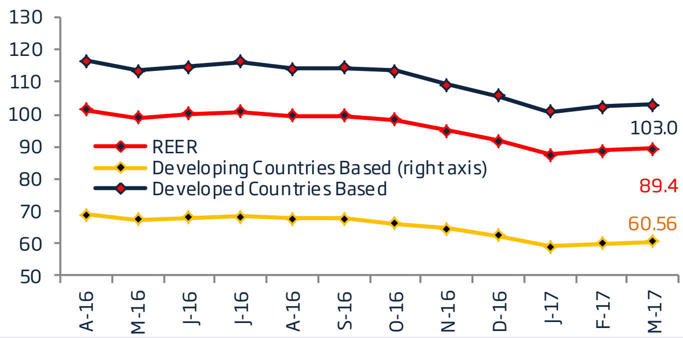


## FX Market

### Currency Basket

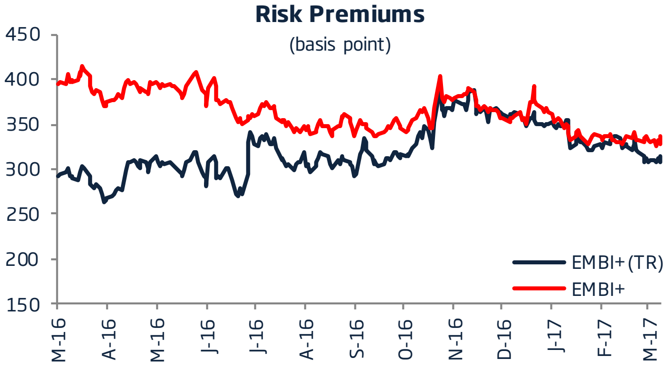



### CPI Based Real Effective Exchange Rate

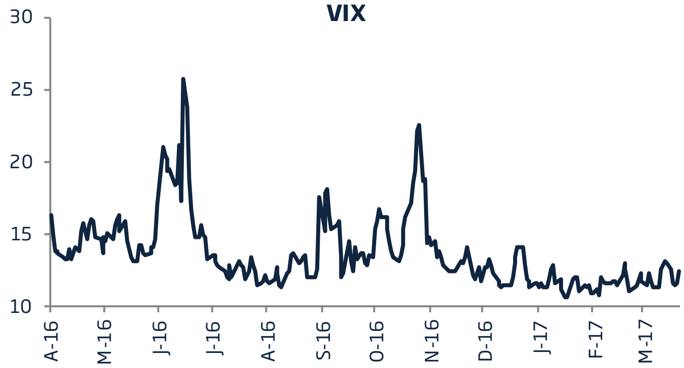



## Risk Indicators

### Risk Premiums
(basis point)

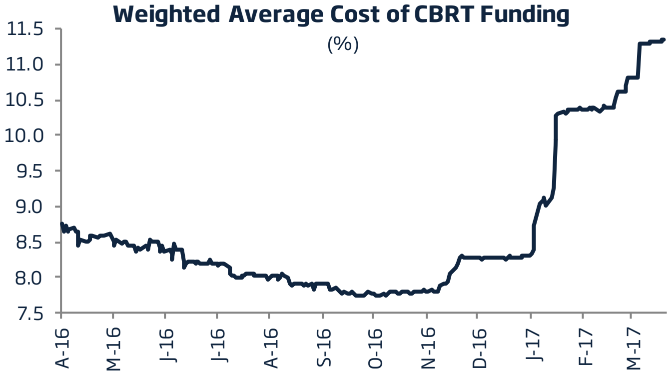



### VIX

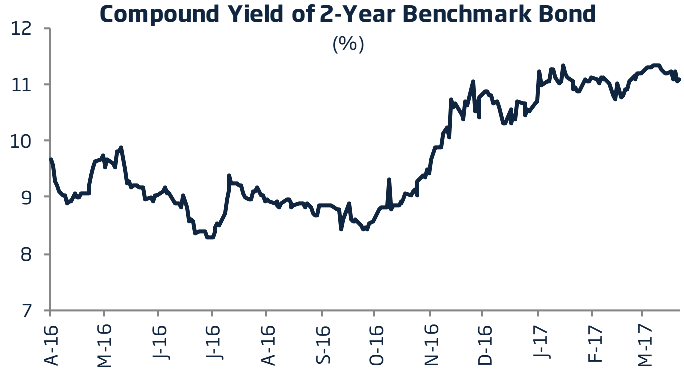


## Interest Rates

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



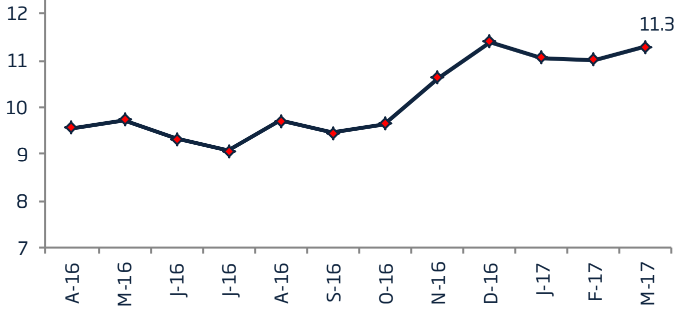
### Compound Yield of 2-Year Benchmark Bond
(%)



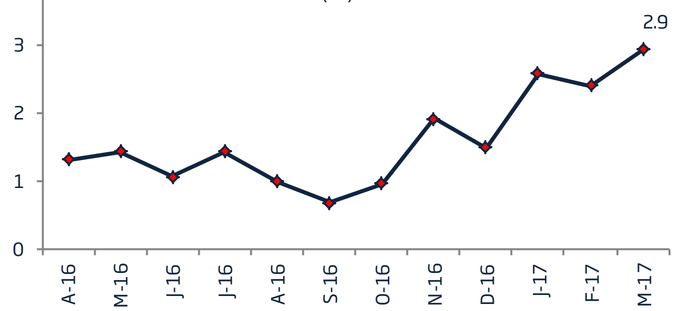
Source: BIST, CBRT, Datastream, JP Morgan, Reuters, Turkstat

## Bond-Bill Market

### Average Compound Yields in Treasury Auctions (%)

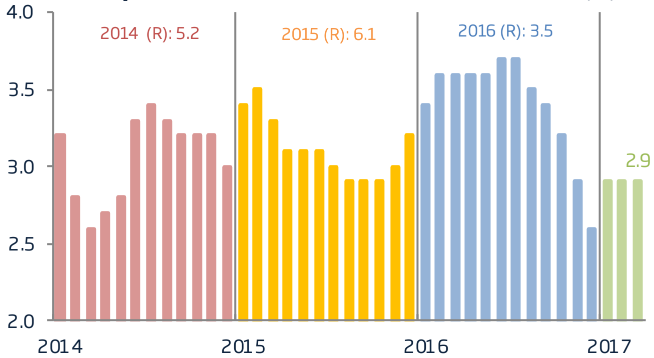



### Expected Real Yield of TRY GDDIs (%)

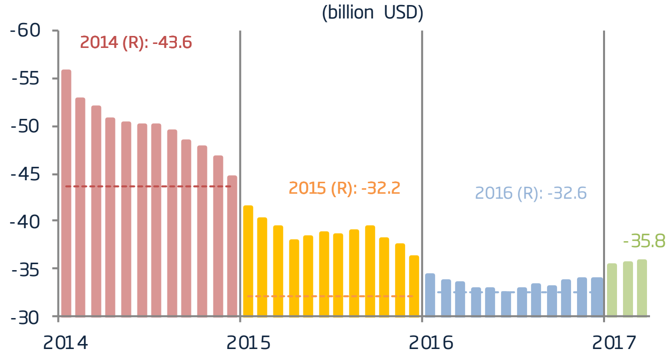



## CBRT's Survey of Expectations and Other Leading Indicators

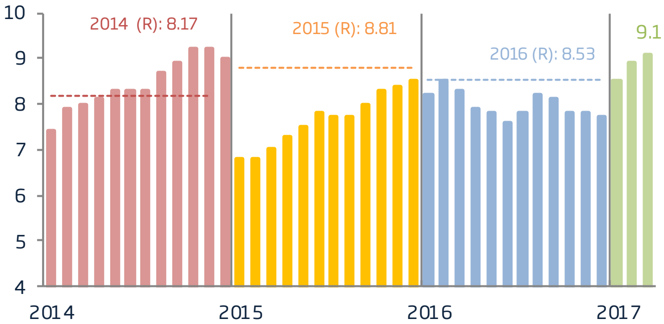
### Expected GDP Growth for the Current Year (%)



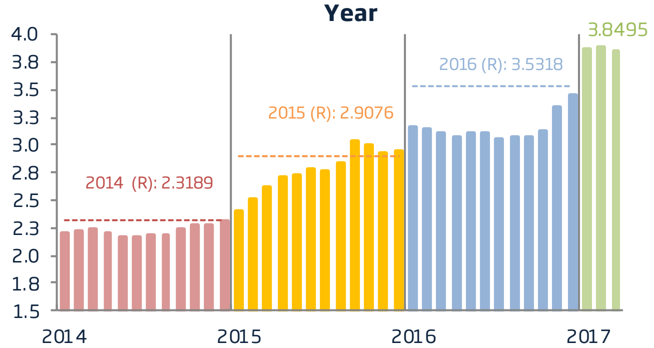

### Expected CAD for the Current Year (billion USD)



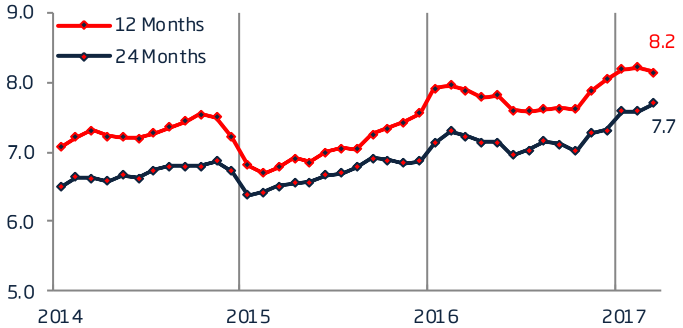

### Expected CPI Inflation by the End of the Year (annual, %)



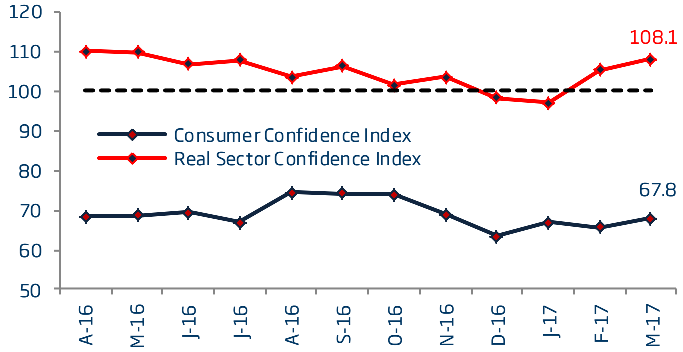

### Expected Level of USD/TRY by the End of the Year




### Expected CPI Inflation for the next 12 and 24 Months (annual, %)




### Confidence Indicators




(R) Realization

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

# Turkish Economy at a Glance

TÜRKİYE İŞ BANKASI

| **Growth** | **2012** | **2013** | **2014** | **2015** | **2016** | **17-Q1** | **17-Q2** | **17-Q3** |
|---|---|---|---|---|---|---|---|---|
| GDP (USD billion) | 871 | 950 | 935 | 861 | 857 | - | - | - |
| GDP (TRY billion) | 1,570 | 1,810 | 2,045 | 2,338 | 2,591 | - | - | - |
| GDP Growth Rate (%) | 4.8 | 8.5 | 5.2 | 6.1 | 2.9 | - | - | - |
| **Inflation (%)** | | | | | | **Jan-17** | **Feb-17** | **Mar-17** |
| CPI (annual) | 6.16 | 7.40 | 8.17 | 8.81 | 8.53 | 9.22 | 10.13 | 11.29 |
| Domestic PPI (annual) | 2.45 | 6.97 | 6.36 | 5.71 | 9.94 | 13.69 | 15.36 | 16.09 |
| **Seasonally Adjusted Labor Market Figures** | | | | | | | | |
| Unemployment Rate (%) | 8.8 | 9.1 | 10.4 | 10.2 | 12.0 | | | |
| Labor Force Participation Rate (%) | 48.5 | 48.5 | 50.9 | 51.6 | 52.4 | | | |
| **FX Rates** | | | | | | **Jan-17** | **Feb-17** | **Mar-17** |
| CPI Based Real Effective Exchange Rate | 110.3 | 100.3 | 105.0 | 97.5 | 92.0 | 87.6 | 88.9 | 89.4 |
| USD/TRY | 1.7819 | 2.1323 | 2.3290 | 2.9207 | 3.5223 | 3.7908 | 3.6110 | 3.6394 |
| EUR/TRY | 2.3508 | 2.9370 | 2.8297 | 3.1867 | 3.7132 | 4.0595 | 3.8256 | 3.8886 |
| Currency Basket (0.5*EUR+0.5*USD) | 2.0664 | 2.5347 | 2.5794 | 3.0537 | 3.6178 | 3.9252 | 3.7183 | 3.7640 |
| **Foreign Trade Balance[1] (USD billion)** | | | | | | | **Jan-17** | **Feb-17** |
| Exports | 152.5 | 151.8 | 157.6 | 143.8 | 142.5 | | 144.3 | 144.0 |
| Imports | 236.5 | 251.7 | 242.2 | 207.2 | 198.6 | | 200.8 | 201.0 |
| **Foreign Trade Balance** | **-84.1** | **-99.9** | **-84.6** | **-63.4** | **-56.1** | | **-56.5** | **-57.0** |
| Import Coverage Ratio (%) | 64.5 | 60.3 | 65.1 | 69.4 | 71.8 | | 71.9 | 71.7 |
| **Balance of Payments[1] (USD billion)** | | | | | | | | **Jan-17** |
| **Current Account Balance** | **-48.0** | **-63.6** | **-43.6** | **-32.1** | **-32.6** | | | **-33.2** |
| **Capital and Financial Accounts** | **-48.9** | **-62.1** | **-41.6** | **-21.9** | **-21.3** | | | **-21.5** |
| Direct Investments (net) | -9.5 | -9.3 | -5.8 | -12.5 | -9.1 | | | -8.7 |
| Portfolio Investments (net) | -41.0 | -24.0 | -20.1 | 15.7 | -6.4 | | | -9.0 |
| Other Investments (net) | -19.2 | -38.8 | -15.3 | -13.4 | -6.7 | | | -2.6 |
| Reserve Assets (net) | 20.8 | 9.9 | -0.5 | -11.8 | 0.8 | | | -1.2 |
| **Net Errors and Omissions** | **-0.9** | **1.6** | **2.0** | **10.2** | **11.2** | | | **11.6** |
| **Current Account Balance/GDP (%)** | **-5.5** | **-6.7** | **-4.7** | **-3.7** | **-3.8** | | | - |
| **Budget[2][3] (TRY billion)** | | | | | | | **Jan-17** | **Feb-17** |
| **Expenditures** | **361.9** | **408.2** | **448.8** | **506.0** | **583.7** | | **47.3** | **101.1** |
| Interest Expenditures | 48.4 | 50.0 | 49.9 | 53.0 | 50.2 | | 6.6 | 11.7 |
| Non-interest Expenditures | 313.5 | 358.2 | 398.8 | 453.0 | 533.4 | | 40.8 | 89.4 |
| **Revenues** | **332.5** | **389.7** | **425.4** | **483.4** | **554.4** | | **58.8** | **105.7** |
| Tax Revenues | 278.8 | 326.2 | 352.5 | 407.5 | 458.7 | | 48.4 | 88.4 |
| **Budget Balance** | **-29.4** | **-18.5** | **-23.4** | **-22.6** | **-29.3** | | **11.4** | **4.6** |
| **Primary Balance** | **19.0** | **31.4** | **26.5** | **30.4** | **21.0** | | **18.0** | **16.3** |
| **Budget Balance/GDP (%)** | **-1.9** | **-1.0** | **-1.1** | **-1.0** | **-1.1** | | - | - |
| **Central Government Debt Stock (TRY billion)** | | | | | | | **Jan-17** | **Feb-17** |
| Domestic Debt Stock | 386.5 | 403.0 | 414.6 | 440.1 | 468.6 | | 473.5 | 478.6 |
| External Debt Stock | 145.7 | 182.8 | 197.5 | 237.5 | 291.0 | | 326.7 | 304.5 |
| **Total Debt Stock** | **532.2** | **585.8** | **612.1** | **677.6** | **759.6** | | **800.2** | **783.1** |

(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) | 2012 | 2013 | 2014 | 2015 | 2016 | Jan.17 | Feb.17 | Change(1) |
|---|---|---|---|---|---|---|---|---|
| **TOTAL ASSETS** | **1,370.7** | **1,732.4** | **1,994.3** | **2,357.4** | **2,731.0** | **2,866.4** | **2,819.8** | **3.2** |
| **Loans** | **794.8** | **1,047.4** | **1,240.7** | **1,485.0** | **1,734.3** | **1,804.2** | **1,788.2** | **3.1** |
| TRY Loans | 588.4 | 752.7 | 881.0 | 1,013.4 | 1,131.4 | 1,154.0 | 1,176.0 | 3.9 |
| Share (%) | 74.0 | 71.9 | 71.0 | 68.2 | 65.2 | 64.0 | 65.8 | - |
| FX Loans | 206.4 | 294.7 | 359.7 | 471.5 | 602.9 | 650.2 | 612.2 | 1.5 |
| Share (%) | 26.0 | 28.1 | 29.0 | 31.8 | 34.8 | 36.0 | 34.2 | - |
| Non-performing Loans | 23.4 | 29.6 | 36.4 | 47.5 | 58.2 | 59.5 | 60.3 | 3.7 |
| Non-performing Loan Rate (%) | 2.9 | 2.8 | 2.9 | 3.1 | 3.2 | 3.2 | 3.3 | - |
| **Securities** | **270.0** | **286.7** | **302.3** | **329.7** | **351.6** | **364.5** | **360.2** | **2.5** |
| **TOTAL LIABILITIES** | **1,370.7** | **1,732.4** | **1,994.3** | **2,357.4** | **2,731.0** | **2,866.4** | **2,819.8** | **3.2** |
| **Deposits** | **772.2** | **945.8** | **1,052.7** | **1,245.4** | **1,453.6** | **1,499.8** | **1,484.2** | **2.1** |
| TRY Deposits | 520.4 | 594.1 | 661.3 | 715.4 | 845.1 | 833.0 | 832.3 | -1.5 |
| Share (%) | 67.4 | 62.8 | 62.8 | 57.4 | 58.1 | 55.5 | 56.1 | - |
| FX Deposits | 251.8 | 351.7 | 391.4 | 530.0 | 608.5 | 666.9 | 651.8 | 7.1 |
| Share (%) | 32.6 | 37.2 | 37.2 | 42.6 | 41.9 | 44.5 | 43.9 | - |
| **Securities Issued** | **37.9** | **60.6** | **89.3** | **97.8** | **116.3** | **122.6** | **119.0** | **2.4** |
| **Payables to Banks** | **173.4** | **254.2** | **293.2** | **361.3** | **417.6** | **448.5** | **436.9** | **4.6** |
| **Funds from Repo Transactions** | **79.9** | **119.1** | **137.4** | **156.7** | **137.8** | **98.0** | **98.3** | **-28.6** |
| **SHAREHOLDERS' EQUITY** | **181.9** | **193.7** | **232.0** | **262.3** | **300.3** | **308.4** | **315.0** | **4.9** |
| Profit (Loss) of the Period | 23.5 | 24.7 | 24.6 | 26.1 | 37.5 | 3.7 | 8.5 | - |
| **RATIOS (%)** | | | | | | | | |
| Loans/GDP | #BAŞV! | 66.7 | 68.6 | 63.5 | 66.9 | - | - | - |
| Loans/Assets | 58.0 | 60.5 | 62.2 | 63.0 | 63.5 | 62.9 | 63.4 | - |
| Securities/Assets | 19.7 | 16.6 | 15.2 | 14.0 | 12.9 | 12.7 | 12.8 | - |
| Deposits/Liabilities | 56.3 | 54.6 | 52.8 | 52.8 | 53.2 | 52.3 | 52.6 | - |
| Loans/Deposits | 102.9 | 110.7 | 117.9 | 119.2 | 119.3 | 120.3 | 120.5 | - |
| Capital Adequacy (%) | 17.9 | 15.3 | 16.3 | 14.6 | 15.6 | 15.2 | 15.9 | - |

(1) Year-to-date % change

Source: BRSA

## LEGAL NOTICE