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Global Economy

Fed raised its policy rate by 25 basis points at the last meeting of the year. FOMC members who kept their expectation of three rate hikes in 2018, revised their growth and inflation projections.

The tax reform scheme has been enacted in the US. One of the main changes under the new law was the reduction of corporate tax rate from 35% to 21%. However, the possible effects of tax cuts on economic activity and monetary policy remain unclear.

The US economy's growth rate for the Q3 was lowered from 3.3% to 3.2% under the final revision. While the economic activity in the US continued its strong performance in the last quarter, the inflation figures remained relatively weak during this period.

At its meeting on December 14, ECB kept its monetary policy unchanged and confirmed its view that the economic recovery would continue by raising its GDP growth forecasts for 2017 and 2018.

The latest PMI figures in Euro Area supported positive views on economic recovery by reaching their highest levels in last 7 years.

First phase of Brexit negotiations between United Kingdom and EU was completed.

BoE, which raised its policy rate in November, made no change in December. Accomplishment of Brexit's first phase eased the worries of BoE about the possible effects of Brexit.

BoJ kept its current monetary policy unchanged at the last meeting of the year. It is stated after the meeting that inflation developments will be monitored closely.

Turkish Economy

Turkish economy expanded by 11.1% yoy in the third quarter of the year, according to the chain volume index. This higher-than-expected figure marked the strongest growth seen in the last 6 years.

Recovery in employment figures continued in September period. Calendar adjusted unemployment rate decreased by 0.1 point to 10.7% in September compared to previous term.

Annual expansion of calendar adjusted industrial production in October by 7.3% pointed out that industrial production kept its strong performance in the first month of the last quarter.

Foreign trade deficit continued to widen in November. In this month, export volume increased by 11.2% yoy and import volume picked up by 21.3%. Thus, foreign trade deficit widened by 52.4% yoy and became 6.3 billion USD in November.

In the first 10 months of the year, current account deficit expanded by 33.7% yoy to 35.3 billion USD. 12-month cumulative current account deficit reached its highest level since July 2015 with 41.9 billion USD in October.

In the first 11 months of the year, budget expenditures and revenues increased by 17.7% and 13% yoy, respectively. In this period, budget deficit became 26.5 billion TRY, posting a sharp increase.

In December, CPI increased by 0.69% on a monthly basis, slightly above the market expectations. Annual CPI increase became 11.92% in 2017.

CBRT raised Late Liquidity Window facility rate by 50 basis points to 12.75% in its meeting held in December 14.

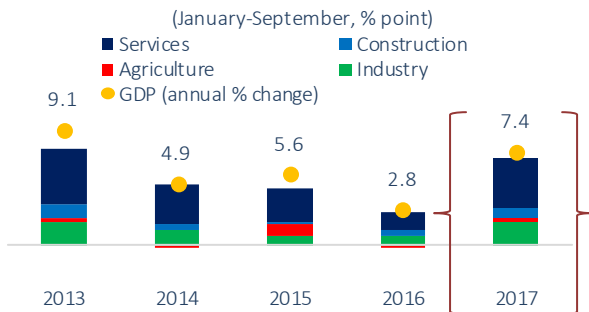
Turkish economy grew by 11.1% in the third quarter.

Turkish economy expanded by 11.1% yoy in the third quarter of the year, according to the chain volume index. This higher-than-expected figure marked the strongest growth seen in the last 6 years.

According to GDP data by expenditure approach, private consumption expenditures contributed to the growth by 7 points in the third quarter. The 31% increase in consumption expenditures for durable goods stood out during this period. This rise was largely due to the low base effect and demand being brought forward before the withdrawal of tax incentives which were effective until the end of the Q3. On the other hand, public consumption expenditures made a limited contribution to growth during this period.

GDP data by production approach suggested that services and manufacturing sectors provided a significant boost to growth. Along with the sustained recovery in tourism sector, services sector added 5.7 points to growth in this period. Industrial sector made its highest contribution of the last 6 years by 2.6 points. According to 9-month cumulative figures, services and industrial sectors made a 5.9 points contribution to annual GDP growth of 7.4%. During this period, construction and agriculture sectors added 0.8 point and 0.2 point to growth, respectively.

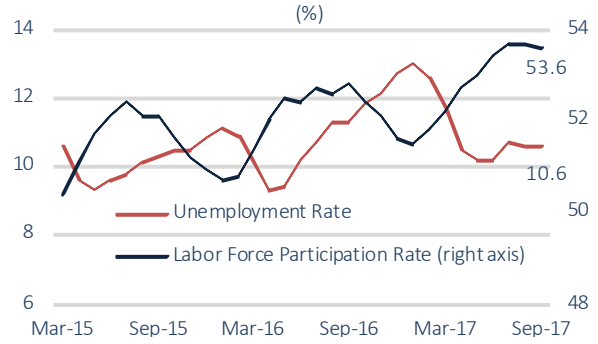
Production Approach - Contributions to GDP Growth



Employment indicators...

In September period, unemployment rate decreased by 0.7 points compared to the same period of the previous year and was realized as 10.6%. Labor force participation rate increased to 53.6%. In this period, the number of employed persons increased by 1.233 million, whereas the number of unemployed persons decreased by 104 thousand. Particularly, the contribution of services sector rose in this period while the contribution of the industrial sector decreased. Analyzing the seasonally adjusted figures, the unemployment rate declined by 0.1 points to 10.7%. The number of employed persons increased by 137 thousand mom and the employment rate was recorded as 47.4% during this period.

Labor Market



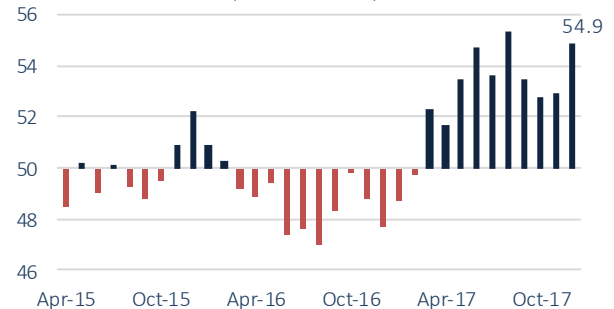
Industrial production rose by 7.3% yoy in October.

In October, calendar adjusted industrial production expanded by 7.3% yoy. Manufacturing industry (7.7% yoy) and electricity, gas, steam and air conditioning production and distribution sector (7.3% yoy) were the main industry groups which made the highest contribution to industrial production. Analyzing the sub-sectors of the manufacturing industry, it is seen that the growth was widespread throughout the sectors. The production of food and motor vehicles made the highest contribution to manufacturing industry during this period. Rise in the production of intermediate goods and capital goods also gave positive signals for investments.

Increase in manufacturing PMI...

The manufacturing PMI, which was 52.9 in November, rose to 54.9 in December, showing that the sector have continued to expand for 10 consecutive months. Employment index was at its highest level since March

Manufacturing PMI
(benchmark=50)



2011 which helped the manufacturing industry to remain strong in the last month of the year.

Capacity utilization rate...

In December, capacity utilization rate (CUR) rose by 0.9 from a year ago to 79%. Compared to November, seasonally adjusted CUR decreased by 0.5 points to 79%. In December, CUR increased rapidly to 90% in manufacturing of computers, electronics and optical products. On the other hand, it is noteworthy that CUR in

Source: Datastream, Markit, Turkstat, ODD

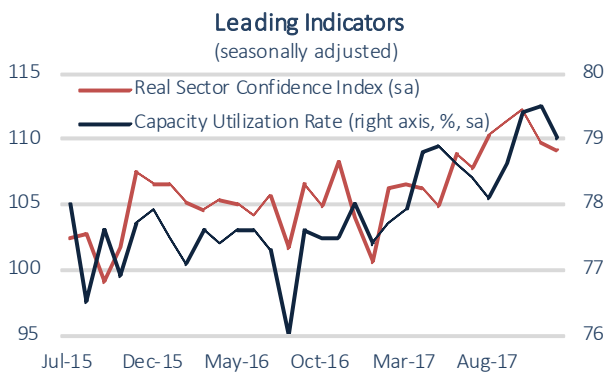
production of coke and refined petroleum products sharply declined in this period.

Decline in real sector confidence...

In December, the real sector confidence index decreased by 2.9 points to 103.3, the lowest level since January 2017. Despite the improvement in expectations of general outlook compared to the previous month, the sharp deterioration in output volume and export orders for the next three months was noteworthy. Both items fell to the lowest levels since 2013. The sectoral confidence indices announced by TURKSTAT indicated that confidence in services, retail trade and construction sectors have deteriorated. The worsening in expectations for the next three months drew the attention.

Limited deterioration in budget indicators...

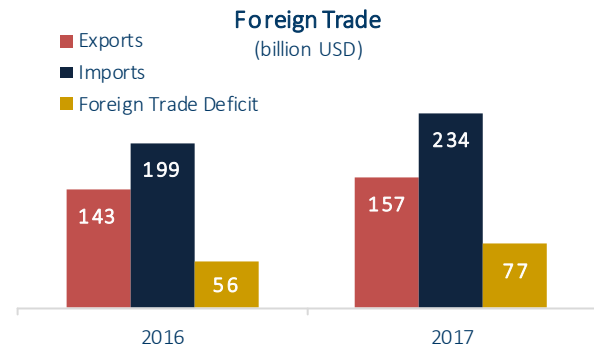
Rise in non-interest expenditures due to the steps taken to support economic activity was effective in the expansion of budget deficit throughout 2017. On the other hand, it was seen that the recovery in economic activity limited the deterioration via tax incomes. In the first eleven months of the year, budget expenditures and revenues rose by 17.7% yoy and 13.0% yoy, respectively. Thus, in this period budget deficit increased rapidly and became 26.5 billion TRY. Given that the government's budget deficit forecast for the year was 61.7 billion TRY, it is understood that the budget deficit was realized at a high level in December.



Rapid increase in foreign trade deficit...

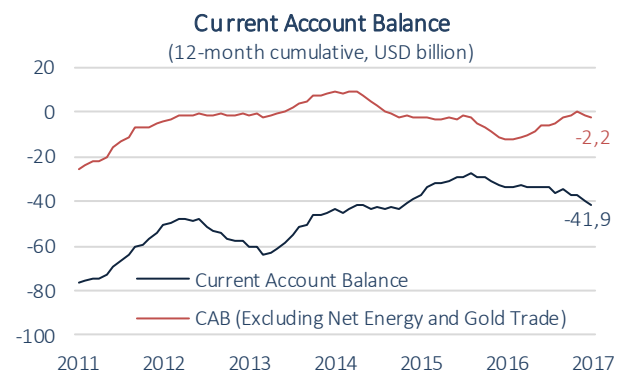
Expansion trend in foreign trade deficit prevailed in November. In this period, export volume increased by 11.2% yoy, while import volume rose by 21.3%. Thus, foreign trade deficit widened by 52.4% to 6.3 billion USD. Despite the recovery in EU economies, upsurge in oil prices and the positive outlook for domestic economic activity put upward pressure on foreign trade deficit.

According to the provisional foreign trade data released by the Ministry of Customs and Trade, the foreign trade deficit widened in December. In this period, exports and imports increased by 8.6% yoy and 27.7% yoy, respectively. In 2017, exports grew by 10.2% to 157 billion USD and imports rose by 17.9% to 234 billion USD.



Current account deficit was below expectations.

In line with the expansion in foreign trade deficit, current account deficit also deteriorated. In the first 10 months of the year, current account deficit expanded by 33.7% compared to the same period of the previous year and reached 35.3 billion USD. 12-month cumulative current account deficit reached its highest level since July 2015 with 41.9 billion USD in October. The acceleration observed in economic activity in addition to the revival in credits and the strengthening oil prices in international markets were effective in this widening. On the other hand, the continuing recovery in tourism revenues limited the expansion in the current account deficit. In the upcoming period, it is expected that the risks on the current account deficit would be mostly upward.



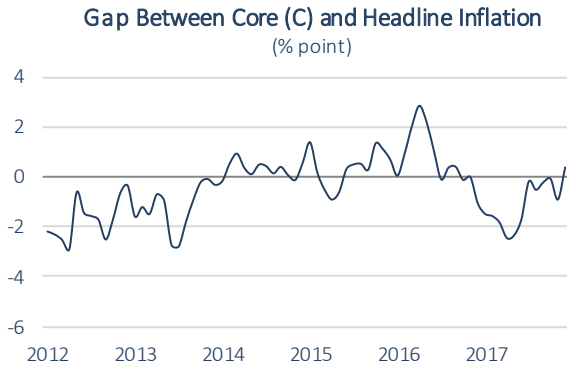
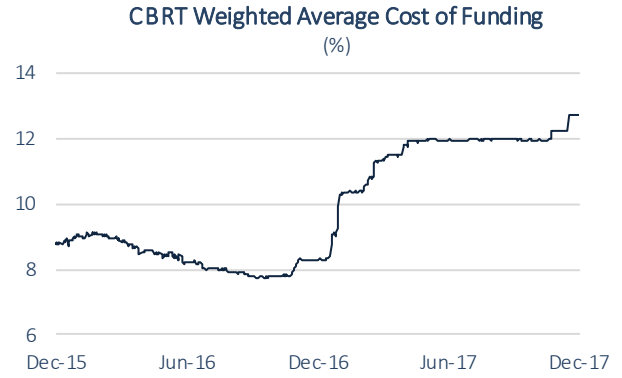
Annual inflation was 11.92% in 2017.

CPI came in above the expectations and recorded a monthly increase of 0.69% in December. Monthly increase in Domestic Producer Price Index (D-PPI) became 1.37% in December. CPI posted an annual rise of 11.92% in the last month of the year. Annual D-PPI inflation remained elevated at 15.47%. Indeed, these two figures marked the historical highs among the year-end figures in 2003 based series.

December (change %)	CPI		D-PPI	
	2016	2017	2016	2017
Monthly	1.64	0.69	2.98	1.37
Annual	8.53	11.92	9.94	15.47
Annual Average	7.78	11.14	4.30	15.82

Source: Turkstat, Datastream, CBRT, Ministry of Customs and Trade

The upward trend in B and C core inflation indicators, which are monitored closely by the CBRT, prevailed in the last month of the year. The annual rises exceeded the annual headline CPI increase for the first time since September 2016. This was noteworthy as it offers a dismal outlook for inflation expectations and realizations regarding the upcoming period. The annual increase in C index (CPI excluding energy, food, alcoholic and non-alcoholic beverages and tobacco and gold prices) was 12.30% in December, while the B index (CPI excluding unprocessed food, energy, alcoholic beverages and tobacco and gold) registered an annual rise of 12.28%.



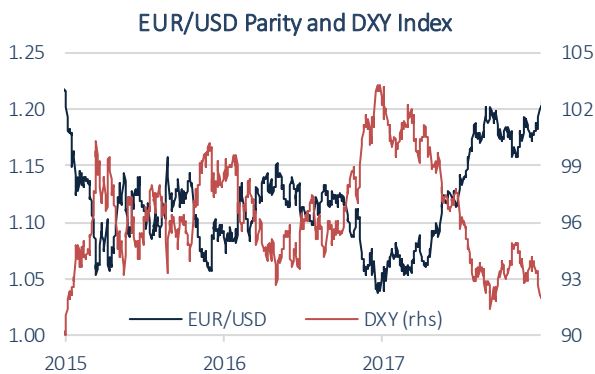
Similar to 2017, exchange rate developments as well as the trajectory of food and oil prices will lead inflation in the upcoming period. Against this backdrop, we anticipate that annual CPI inflation will decelerate somewhat in the first quarter of the year, yet it will stay at double-digit levels for the most part of 2018.

Rate hike by CBRT...

CBRT in its meeting held in December 14, raised the Late Liquidity Window (LON) interest rate by 50 basis points to 12.75%. The amount of the cut was below the market expectations. In its statement after the meeting, CBRT announced that current elevated levels of inflation and recent developments in cost factors had increased the risks on expectations and the pricing behavior, leading CBRT to tighten the monetary policy further. Moreover, while emphasizing that all available instruments will be used to ensure price stability, CBRT stated that tight monetary stance will be maintained until the inflation outlook displays a significant improvement and becomes consistent with the targets.

Surge in EUR/USD parity...

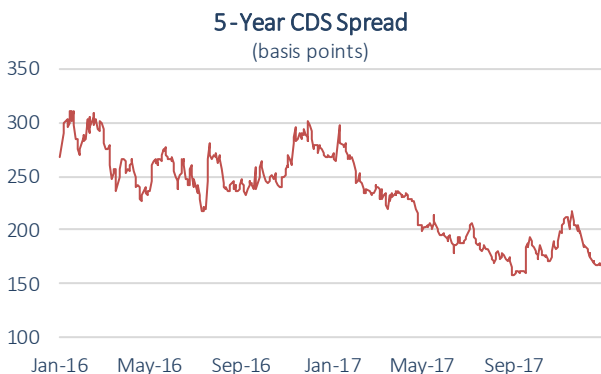
Recently, central bank decisions have been at the forefront of the global economy's agenda. While central banks generally moved in line with expectations, EUR/USD parity went up particularly in the second half of the month owing to optimistic views on the Euro Area economy. Depreciation of the dollar was another reason for the rise in EUR/USD parity. The expectations that the tax reform will provide a lesser degree of support to the economic growth than previously anticipated and the Fed will not be able to raise the policy rate as much as planned put the US dollar under pressure in the past few weeks.



The global stock indices moved upwards in the last month of the year as it was the case throughout the whole year. While US stock market indices continued to hit record highs, emerging market stock market indices also registered a rapid rise.

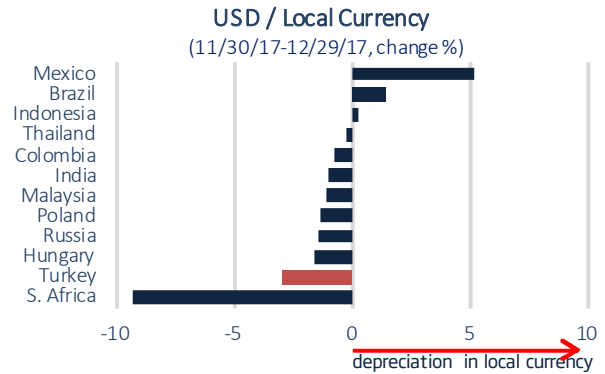
Positive mood in domestic markets...

As the visa crisis between Turkey and the US has come to an end in the last days of December, domestic markets finished the year in a positive mood. BİST-100 index outperformed other emerging stock markets, while Turkish lira gained strength against the dollar.

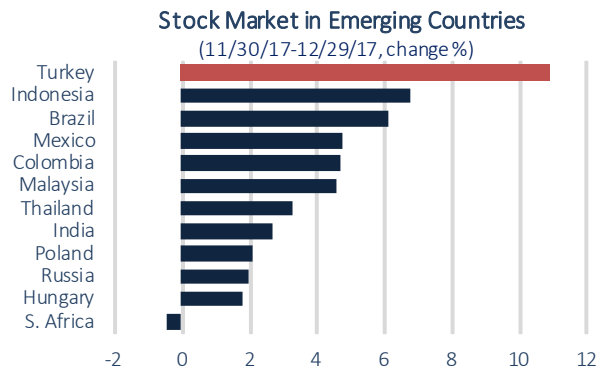


Having risen by 2.9% in November, USD/TRY declined at the same rate in December as risk perception towards Turkey has improved. Decline in EUR/TRY, however, remained comparatively limited due to the rise in EUR/

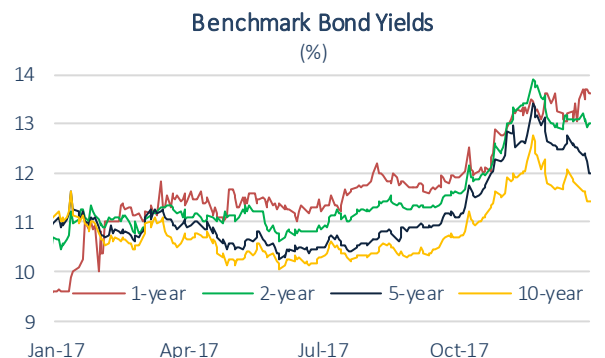
USD parity. The foreign exchange basket, which ended November at 4.28, became 4.17 as of December 29th.



BİST-100 index recorded the strongest monthly performance of the year in December. The resolution of the visa crisis with the US has also boosted the stock market index in the last few days of the month. As of December 29, BİST-100 index increased by 10.9% compared to the end of the previous month and by 47.6% compared to the end of the previous year.



Having surged rapidly in November, interest rates followed a relatively calm course in December. The compound yield of the 2-year benchmark bond, which had closed November at 13.73%, stood at 13.40% as of the end of December.

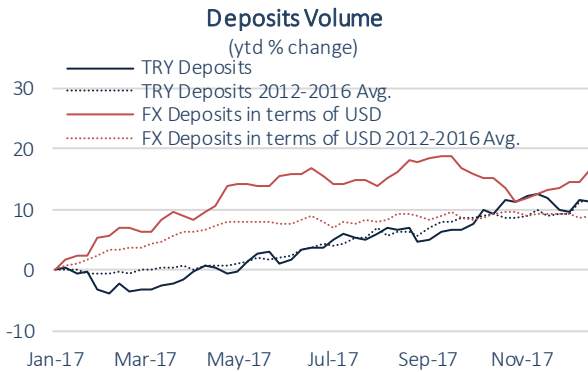


Source: CBRT, Datastream, Reuters, Borsa İstanbul

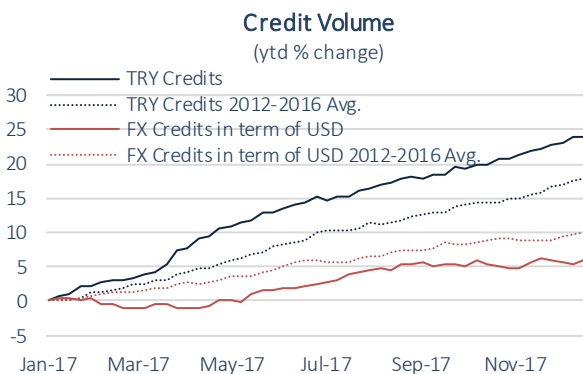
Banking Sector

Deposit volume rose by 17.9% ytd.

According to Weekly Bulletin published by BRSA, as of December 22, total deposit volume rose by 17.9% ytd to 1,817 billion TRY. FX adjusted increase in volume of total deposits declined to 13.7% in the same period. In this period, TL deposit volume performed close to the past years' average and expanded by 12.7%. The increase in FX deposit volume in USD terms, on the other hand, was above the average of past years throughout the year. As of December 22, FX deposits in USD terms increased by 15.1% ytd, while FX deposits on TL basis expanded by 24.6% in the same period.

**Rising trend in TRY loans continued...**

In 2017, FX rate fluctuations and the support of Credit Guarantee Fund (CGF) have been decisive in the course of credit volume. Demand for FX loans has been weak compared to previous years due to depreciation in TRY. On the other hand, the TRY loan volume has widened beyond the average for the period 2012-2016, with the support of credits granted under the CGF. As of December 22, FX loan volume in USD terms expanded by 5.7% compared to the end of 2016. TRY loan volume, on the other hand, increased by 23.6% in the same period. Thus, as of December 22 the expansion in total credit volume was 20.4% ytd.

**NPL ratio is at the lowest for last 2 years.**

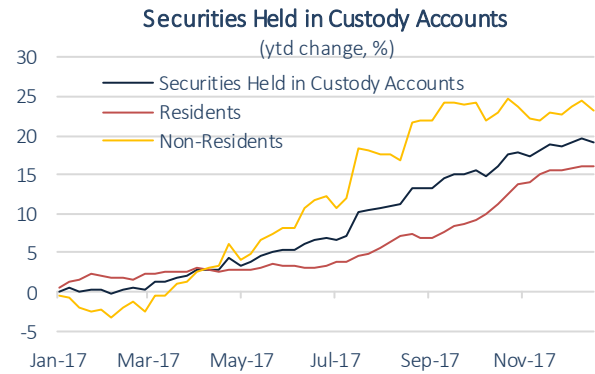
Banking sector, which continues to grow in terms of deposit and loans, maintained its healthy outlook in terms of asset quality. Rapid increase in loan volume posted in 2017 allowed NPL ratio to decline to its lowest level for more than 2 years. NPL ratio, which had

decreased by 30 basis points compared to the end of 2016, became 2.9% as of December 22. In this period, NPL ratio became 3.62% for consumer loans and 2.78% for commercial loans.

Securities portfolio...

As of December 22, securities portfolio of the banking sector grew by 14.2% compared to the year-end. While in the last years securities subject to repo transaction and available for sale were amounting the bigger part of the securities portfolio, in 2017 securities held as collateral came to the forefront. Portfolio of securities held as collateral, which was 60 billion TRY at the end of 2016, reached 182 billion TRY as of December 22.

Portfolio of securities held in custody accounts increased by 19.1% as of December 22, compared to the end of 2016. In this period the securities portfolio of non-residents posted an increase of 23.2%, while residents' securities portfolio expanded by 16.1% compared to the end of 2016.

**Net foreign currency position...**

As of December 22, banks' on-balance sheet FX position was (-) USD 46,978 million while off-balance sheet FX position was realized as (+) USD 47,519 million. Hence, banking sector's net FX position became (+) USD 541 million.

Concluding Remarks

Meetings of leading central banks and news on tax reform in the US were high on the agenda of the global economy in December.

Having raised the policy rate by 25 basis points in line with expectations, the Fed also revised upwards its growth and employment forecasts for the US economy. Despite these improved expectations, Fed members continued to project three rate hikes in 2018. This strengthened the anticipations that the Fed will preserve its cautious stance in monetary policy. On the other hand, the extent of the impact of tax reductions enacted by the Trump administration to the US economy and to the Fed's monetary policy stands out as an uncertainty.

ECB, BoE and BoJ did not change their monetary policy at their December meetings. The statement made following the meeting suggested that BoE's concerns about Brexit have diminished. On the ECB side, the Central Bank's macroeconomic projections showed that upbeat expectations regarding the economic performance of Euro Area have strengthened. BoJ, on the other hand, emphasized that inflation developments will be closely monitored and signaled that the current monetary policy will continue.

Due to the recent FX and inflation developments, CBRT raised the interest rate of LON facility by 50 basis points at the last meeting of the year. Although this decision did not meet the market expectations, FX rates barely reacted.

Turkish economy performed quite strongly in the third quarter of 2017, growing by 11.1% yoy. In addition to the significant contribution of the low base effect, private consumption and investment expenditures played a considerable role in this growth performance. Leading indicators showed that economic activity continued to be strong in the last quarter of the year, albeit losing some momentum. Against this backdrop, we estimate that Turkish economy, having expanded by 7.4% in first nine months of the year, has grown by 6.7% in 2017.

Regarding 2018 outlook, we expect that;

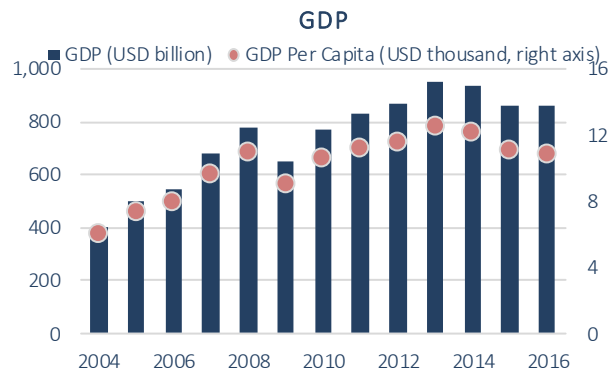
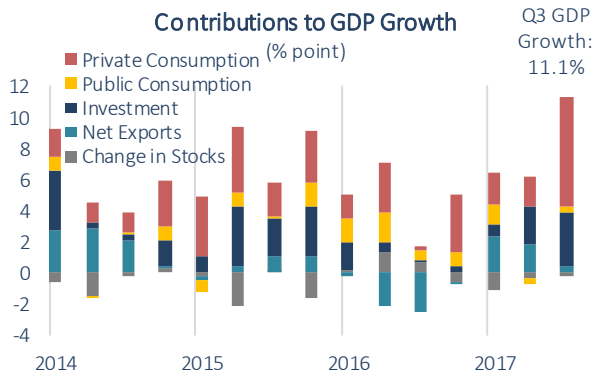
- Taking into account the limiting effect of high base, economic will slow down slightly in 2018 compared to 2017 and will converge to the long-term potential rate.
- Economic growth in 2018 will be largely driven by domestic demand,
- Relatively favorable economic outlook in our main export markets, particularly in the EU will continue to support our export performance.
- Should the upward trend in oil prices continue, upward pressure on the current account deficit would increase but recovery in tourism revenues would limit this impact.
- The annual increase in consumer prices will decline somewhat in 2018.
- Turkish lira's performance, volatility in food prices and trajectory of oil prices will continue to drive inflation.
- CBRT will keep its tight monetary policy stance depending on the inflation and inflation expectations.

Forecasts (%)	2017	2018
Growth	6.7	4.1
Current Account Deficit/GDP	5.2	5.1
Inflation (year-end)	11.92 (R)	10.20

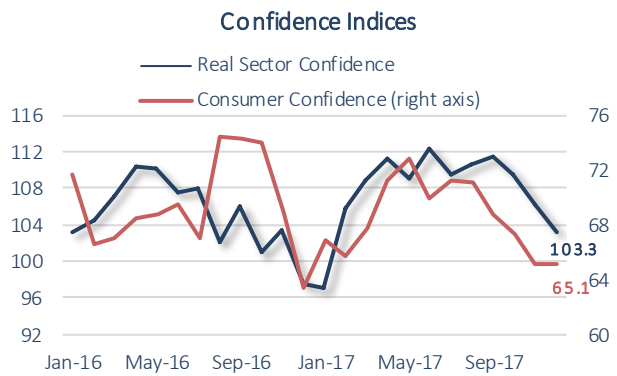
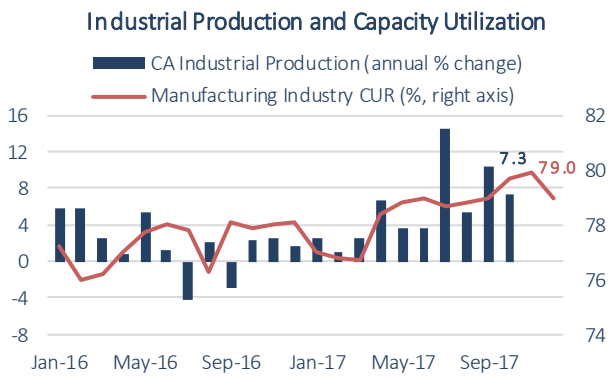
(R) Realization

Turkish Economy- Macroeconomic Indicators

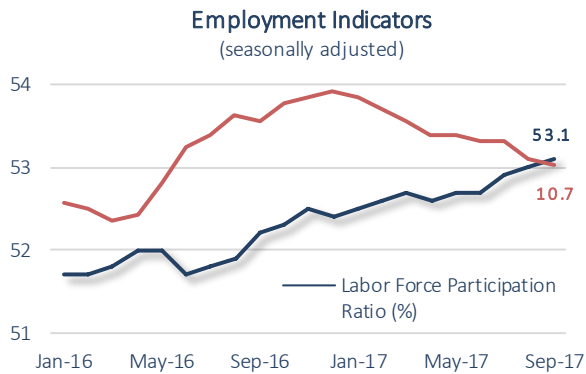
Growth



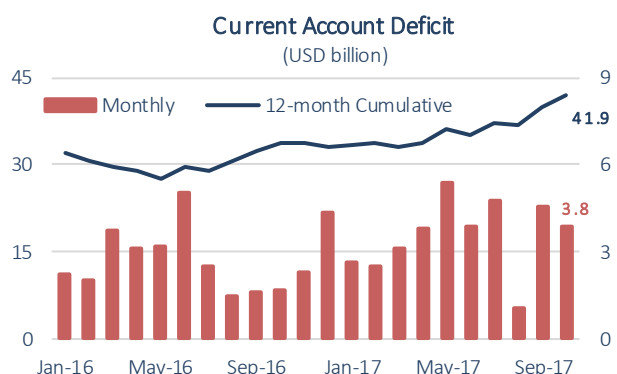
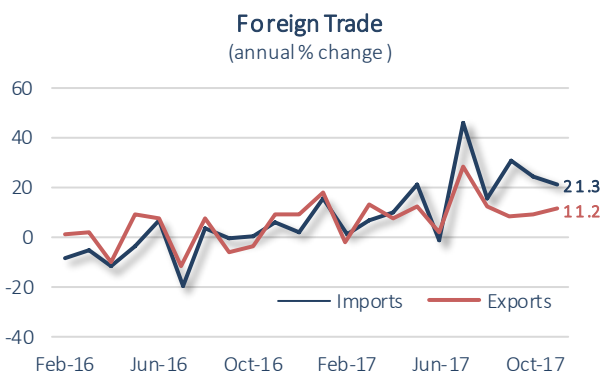
Leading Indicators



Labor Market



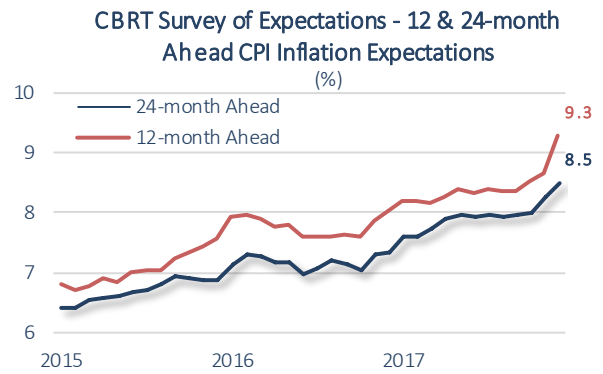
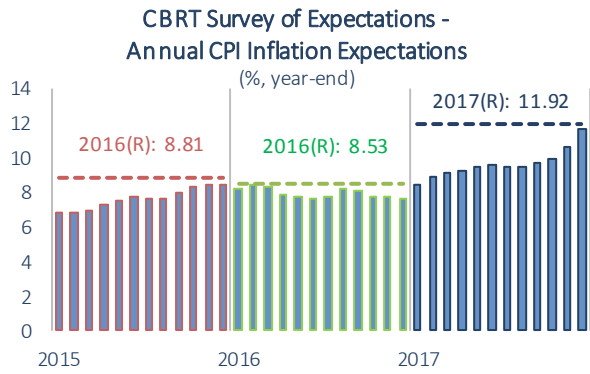
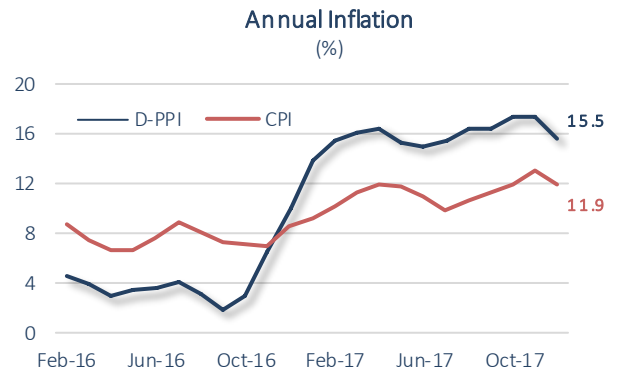
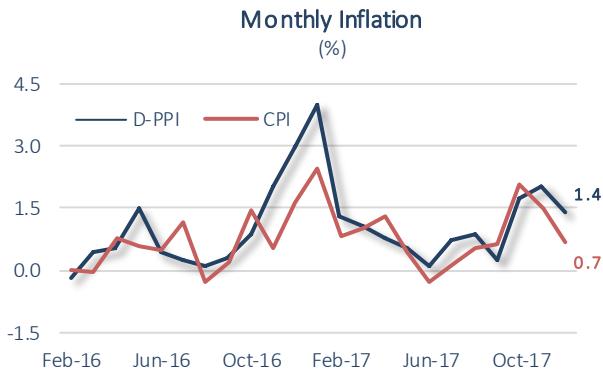
Foreign Trade and Current Account Balance



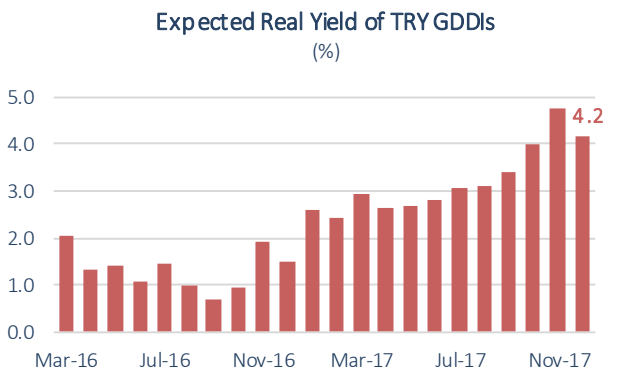
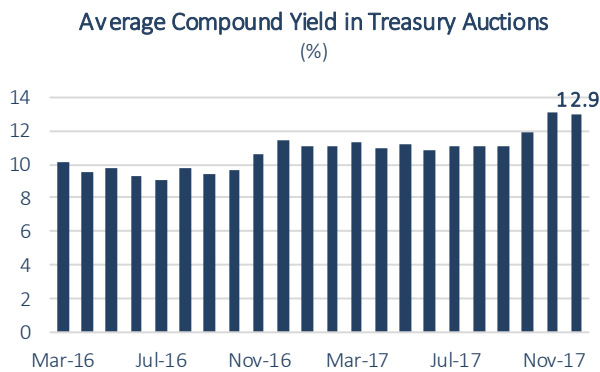
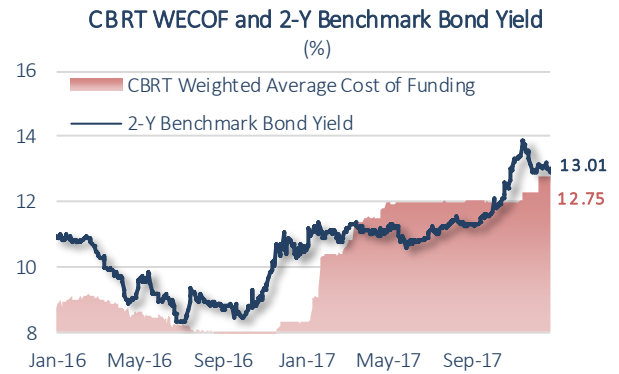
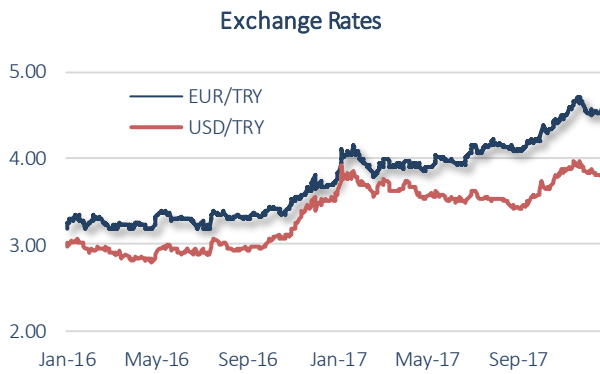
(CA) Calendar adjusted

Source: Datastream, CBRT, Turkstat

Inflation



Foreign Exchange and Bond Market



Turkish Economy - Macroeconomic Indicators

Growth	2012	2013	2014	2015	2016	17-Q1	17-Q2	17-Q3
GDP (USD billion)	871	950	935	862	863	176	205	235
GDP (TRY billion)	1,810	2,045	2,339	2,609	3,040	649	736	827
GDP Growth Rate (%)	4.8	8.5	5.2	6.1	3.2	5.3	5.4	11.1
Inflation (%)						Oct-17	Nov-17	Dec-17
CPI (annual)	6.16	7.40	8.17	8.81	8.53	11.90	12.98	11.92
Domestic PPI (annual)	2.45	6.97	6.36	5.71	9.94	17.28	17.30	15.47
Seasonally Adjusted Labor Market Figures						Jul-17	Aug-17	Sep-17
Unemployment Rate (%)	8.8	9.1	10.3	10.2	11.9	11.1	10.8	10.7
Labor Force Participation Rate (%)	48.5	48.5	51.0	51.7	52.4	52.9	53.0	53.1
FX Rates						Oct-17	Nov-17	Dec-17
CPI Based Real Effective Exchange Rate	110.3	100.3	105.0	97.5	92.0	88.3	84.7	
USD/TRY	1.7847	2.1485	2.3378	2.9189	3.5176	3.7966	3.9061	3.7916
EUR/TRY	2.3530	2.9605	2.8288	3.1708	3.7102	4.4228	4.6574	4.5530
Currency Basket (0.5*EUR+0.5*USD)	2.0688	2.5545	2.5833	3.0448	3.6139	4.1097	4.2817	4.1723
Foreign Trade Balance⁽¹⁾ (USD billion)						Sep-17	Oct-17	Nov-17
Exports	152.5	151.8	157.6	143.8	142.5	153.4	154.6	156.0
Imports	236.5	251.7	242.2	207.2	198.6	221.3	225.5	229.1
Foreign Trade Balance	-84.1	-99.9	-84.6	-63.4	-56.1	-67.9	-70.9	-73.1
Import Coverage Ratio (%)	64.5	60.3	65.1	69.4	71.8	69.3	68.5	68.1
Balance of Payments⁽¹⁾ (USD billion)						Aug-17	Sep-17	Oct-17
Current Account Balance	-48.0	-63.6	-43.6	-32.1	-33.0	-36.8	-39.7	-41.9
Capital and Financial Accounts	-48.9	-62.1	-41.6	-21.9	-22.0	-32.5	-33.5	-33.5
Direct Investments (net)	-9.5	-9.3	-5.8	-12.5	-9.7	-8.7	-8.5	-8.5
Portfolio Investments (net)	-41.0	-24.0	-20.1	15.7	-6.3	-16.2	-21.2	-20.6
Other Investments (net)	-19.2	-38.8	-15.3	-13.4	-6.8	3.4	1.5	-1.1
Reserve Assets (net)	20.8	9.9	-0.5	-11.8	0.8	-11.0	-5.3	-3.2
Net Errors and Omissions	-0.9	1.6	2.0	10.2	11.0	4.2	6.2	8.4
Current Account Balance/GDP (%)	-5.5	-6.7	-4.7	-3.7	-3.8	-	-	-
Budget⁽²⁾⁽³⁾ (TRY billion)						Sep-17	Oct-17	Nov-17
Expenditures	361.9	408.2	448.8	506.3	583.7	488.2	544.4	601.1
Interest Expenditures	48.4	50.0	49.9	53.0	50.2	46.6	50.1	55.3
Non-interest Expenditures	313.5	358.2	398.8	453.3	533.4	441.6	494.3	545.8
Revenues	332.5	389.7	425.4	482.8	554.4	456.6	509.4	574.6
Tax Revenues	278.8	326.2	352.5	407.8	458.7	385.3	430.9	489.3
Budget Balance	-29.4	-18.5	-23.4	-22.6	-29.3	-31.6	-35.0	-26.5
Primary Balance	19.0	31.4	26.5	30.4	21.0	15.0	15.2	28.8
Budget Balance/GDP (%)	-1.6	-0.9	-1.0	-0.9	-1.0	-	-	-
Central Government Debt Stock (TRY billion)						Sep-17	Oct-17	Nov-17
Domestic Debt Stock	386.5	403.0	414.6	440.1	468.6	523.5	530.5	534.5
External Debt Stock	145.7	182.8	197.9	238.1	291.0	319.0	336.9	356.3
Total Debt Stock	532.2	585.8	612.5	678.2	759.6	842.5	867.4	890.8

(1) 12-month cumulative

(2) Year-to-date cumulative

(3) According to Central Government Budget

BANKING SECTOR ACCORDING TO BRSA's MONTHLY BULLETIN FIGURES

(TRY billion)	2012	2013	2014	2015	2016	Oct.17	Nov.17	Change ⁽¹⁾
TOTAL ASSETS	1,370.7	1,732.4	1,994.3	2,357.4	2,731.0	3,168.4	3,269.2	19.7
Loans	794.8	1,047.4	1,240.7	1,485.0	1,734.3	2,045.6	2,103.8	21.3
TRY Loans	588.4	752.7	881.0	1,013.4	1,131.4	1,367.9	1,396.6	23.4
Share (%)	74.0	71.9	71.0	68.2	65.2	66.9	66.4	-
FX Loans	206.4	294.7	359.7	471.5	602.9	677.6	707.1	17.3
Share (%)	26.0	28.1	29.0	31.8	34.8	33.1	33.6	-
Non-performing Loans	23.4	29.6	36.4	47.5	58.2	63.6	63.7	9.6
Non-performing Loan Rate (%)	2.9	2.8	2.9	3.1	3.2	3.0	2.9	-
Securities	270.0	286.7	302.3	329.7	351.6	386.4	393.6	12.0
TOTAL LIABILITIES	1,370.7	1,732.4	1,994.3	2,357.4	2,731.0	3,168.4	3,269.2	19.7
Deposits	772.2	945.8	1,052.7	1,245.4	1,453.6	1,686.1	1,713.4	17.9
TRY Deposits	520.4	594.1	661.3	715.4	845.1	951.0	948.5	12.2
Share (%)	67.4	62.8	62.8	57.4	58.1	56.4	55.4	-
FX Deposits	251.8	351.7	391.4	530.0	608.5	735.0	764.8	25.7
Share (%)	32.6	37.2	37.2	42.6	41.9	43.6	44.6	-
Securities Issued	37.9	60.6	89.3	97.8	116.3	146.4	147.8	27.1
Payables to Banks	173.4	254.2	293.2	361.3	417.6	461.0	479.1	14.7
Funds from Repo Transactions	79.9	119.1	137.4	156.7	137.8	98.3	98.3	-28.7
SHAREHOLDERS' EQUITY	181.9	193.7	232.0	262.3	300.3	348.9	350.9	16.9
Profit (Loss) of the Period	23.5	24.7	24.6	26.1	37.5	41.2	45.2	-
RATIOS (%)								
Loans/GDP	43.9	51.2	53.1	63.5	57.1			
Loans/Assets	58.0	60.5	62.2	63.0	63.5	64.6	64.4	-
Securities/Assets	19.7	16.6	15.2	14.0	12.9	12.2	12.0	-
Deposits/Liabilities	56.3	54.6	52.8	52.8	53.2	53.2	52.4	-
Loans/Deposits	102.9	110.7	117.9	119.2	119.3	121.3	122.8	-
Capital Adequacy (%)	17.9	15.3	16.3	15.6	15.6	16.9	16.4	-

(1) Year-to-date % change

Source: BRSA, Turkstat

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