



MACRO ECONOMIC OUTLOOK ON TURKEY

EULER HERMES TURKEY
RISK UNDERWRITING DEPT.
ISTANBUL / January 2020

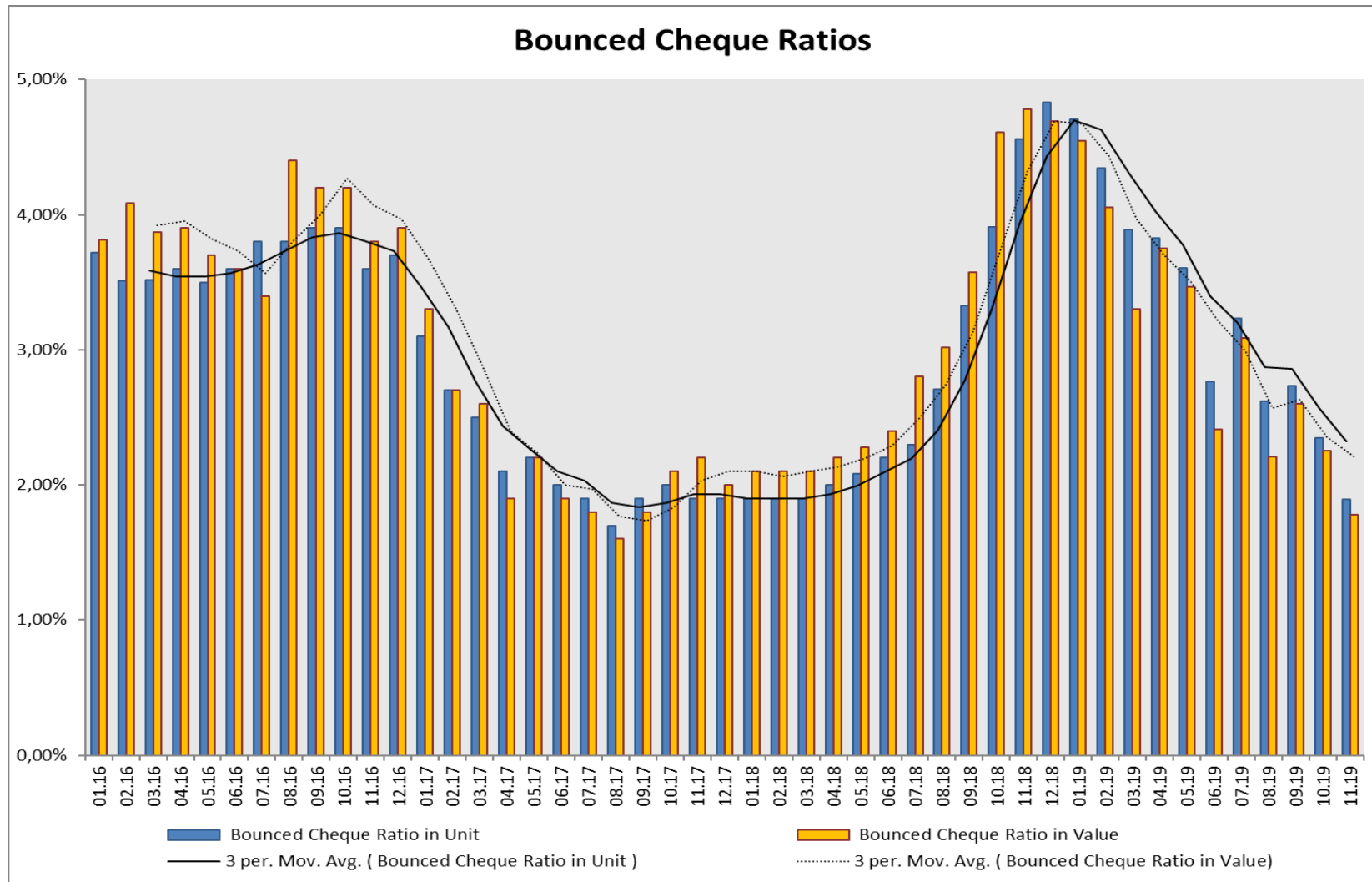
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FINANCIAL MARKET INDICATORS

- Bounced Cheques
- Concordato Cases
- Banking Sector NPL Evolution
- Loan & Deposit Spreads
- Commercial & Consumer Loans Growth



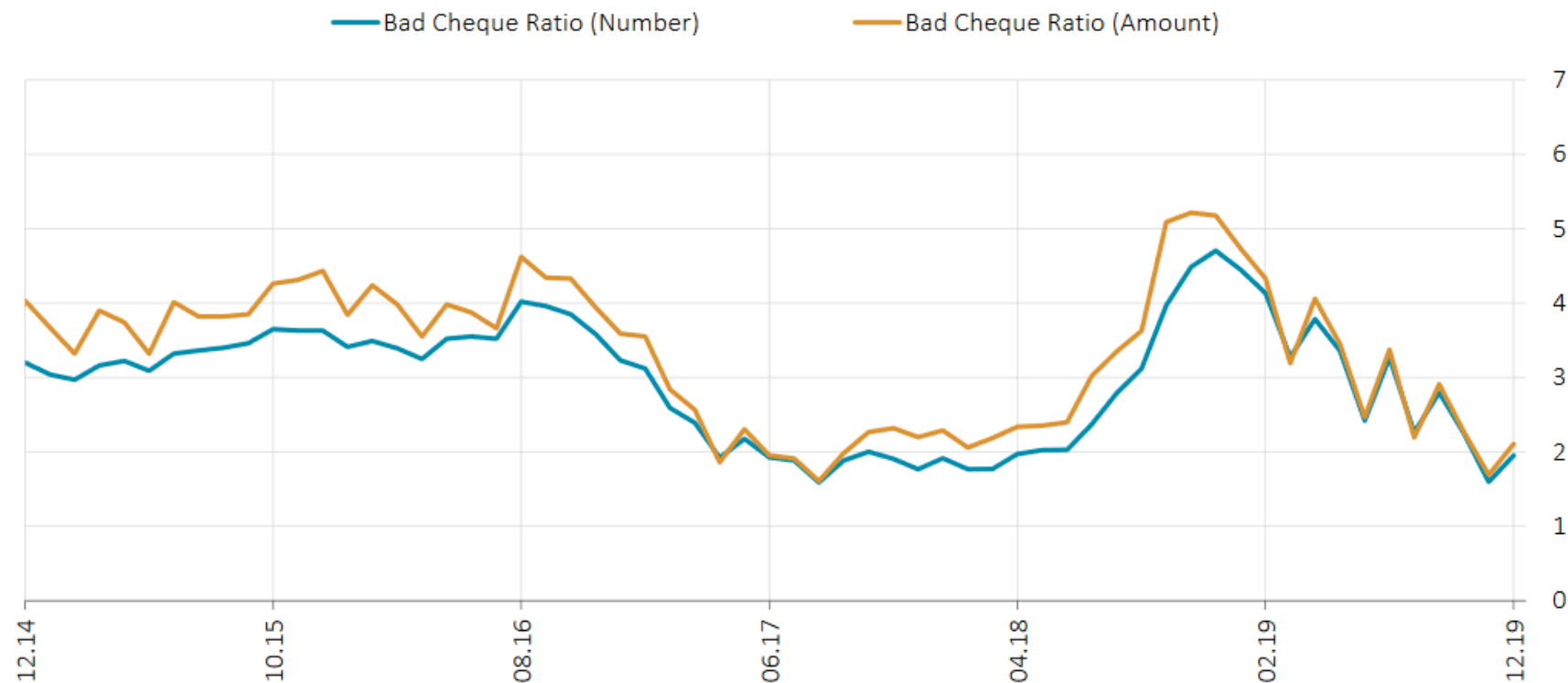
BOUNCED CHEQUES EVOLUTION



- We see a gradual decline in bounced cheques after December 2018. November 2019 ratios indicate a very positive payment pattern with 1.9% in number and 1.8% in amount.
- Banks are slightly supportive for commercial credit growth while they are keen on restructuring problem loans in stage 2 status. This softens the impact of low liquidity in the market and lower the insolvency and bounced cheque ratios. As we have been expecting, bounced cheque ratios gradually declined after peak level of December 2018 level (4.8% in number).

BOUNCED CHEQUES EVOLUTION-LONGER HORIZON

(%)



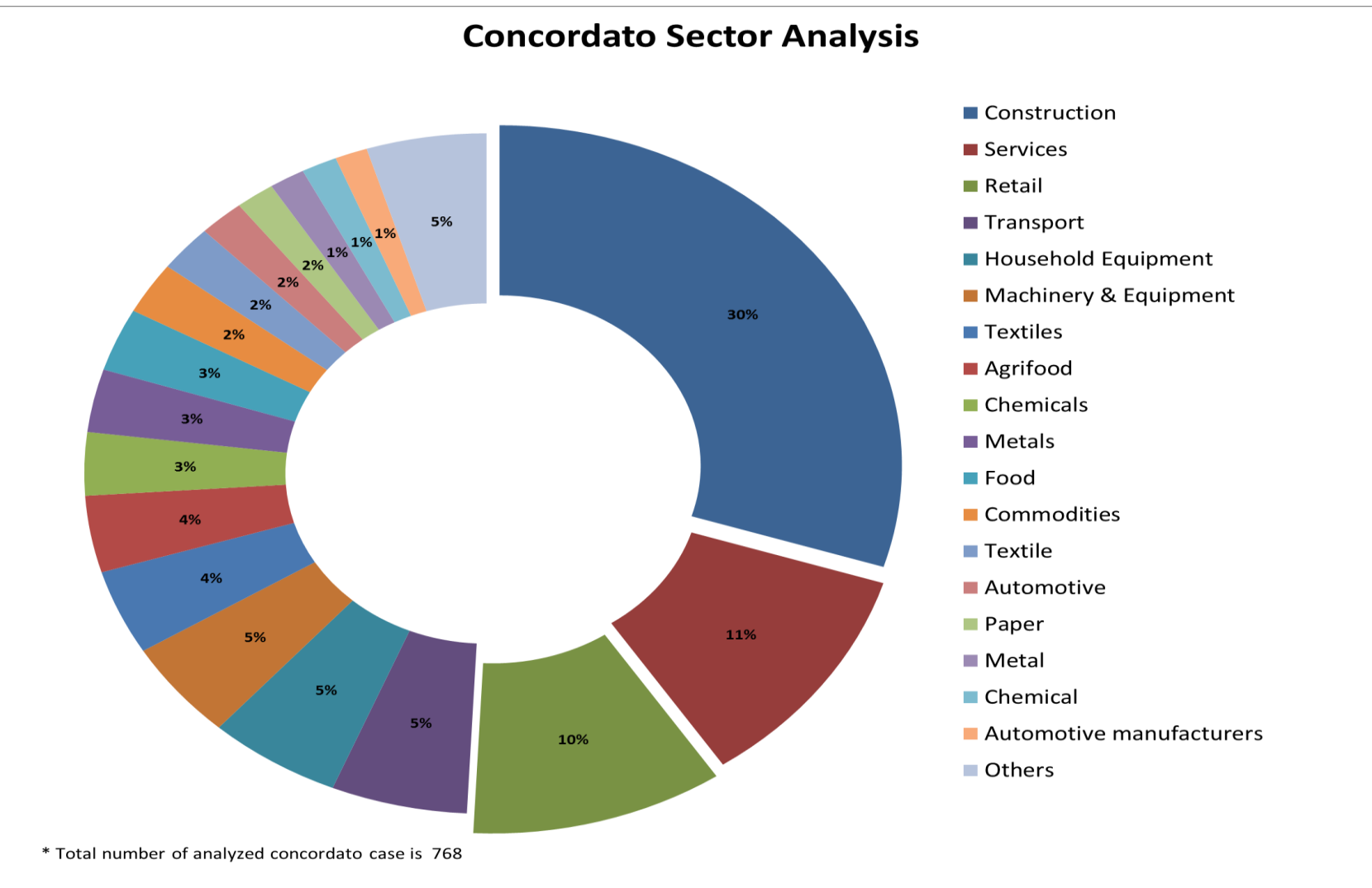
Source: CBRT.

Last Observation: December 2019

- ❑ Despite the rapid increase of bounced cheques in last year, the positive trend after December 2018 now resulted in ratios equal to 2017 levels where liquidity was abundant due to KGF (Kredi Garanti Fonu – Credit Guarantee Fund) backed loan growth.
- ❑ We had positive outlook for bounced cheques for 2019 which is now reflected to graph. Restructurings for bulk loans and healthy credit growth should follow in order to speak about mid-term positive trend.

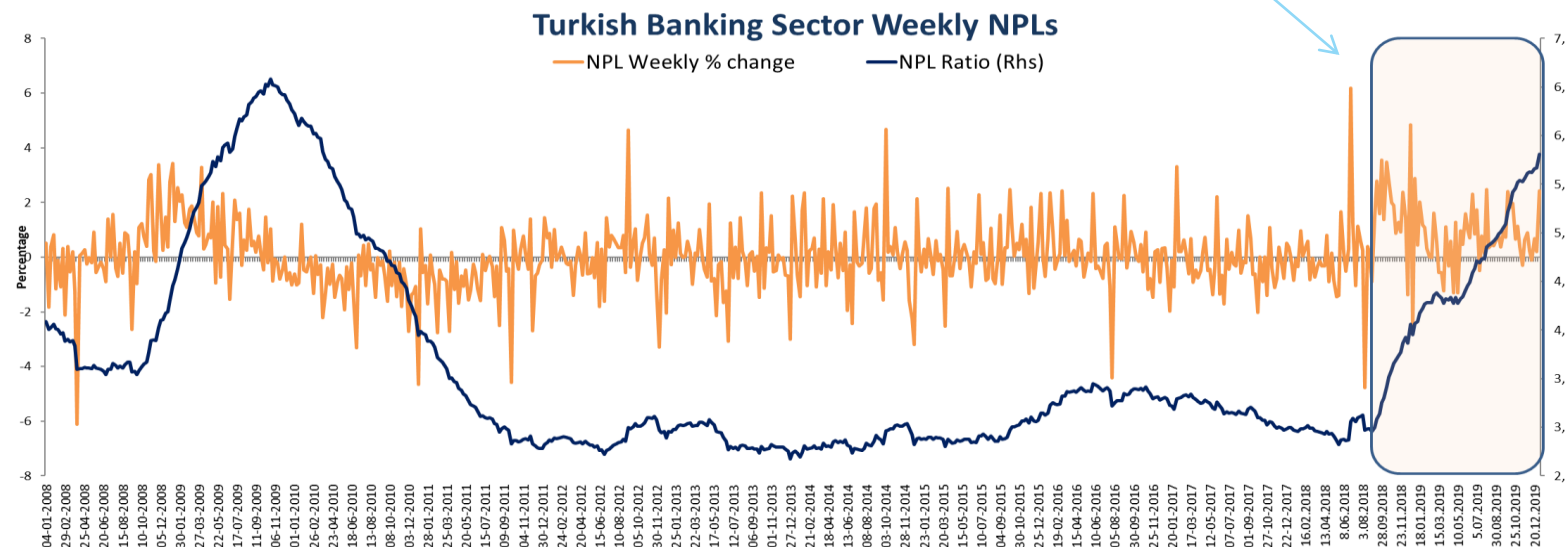
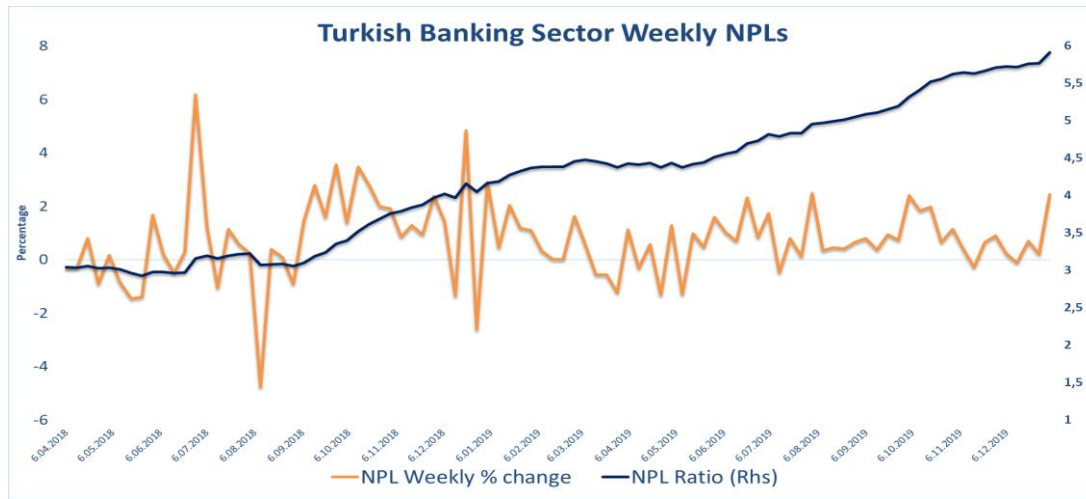
CONCORDATO SECTORAL ANALYSIS

- Construction was the leading sector in Concordato cases in 2018 while services, retail and transport are following it. Concordato cases are now rare due to legislative changes put into force in 2019.



Trade Sector	# of Concordato Cases
Construction	229
Services	83
Retail	78
Transport	42
Household Equipment	41
Machinery & Equipment	36
Textiles	31
Agrifood	28
Chemicals	23
Metals	23
Food	23
Commodities	19
Textile	17
Automotive	14
Paper	12
Metal	11
Chemical	11
Automotive manufacturers	10
Others	37
Total	768

TURKISH BANKING SECTOR NPL EVOLUTION

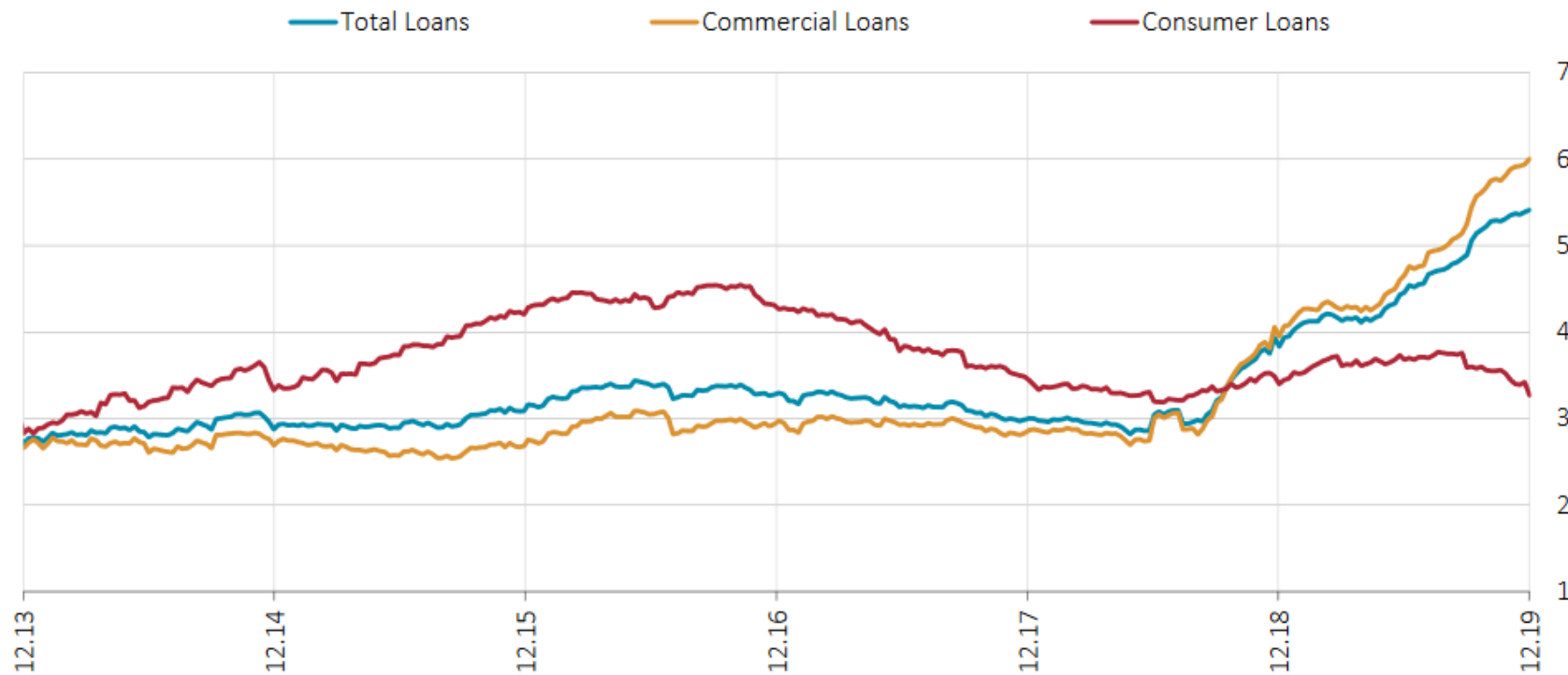


Weekly Banking Sector NPL jumped to 5.91% as of 3rd of January update. BRSA's internal stress test of last year had forecasted 6% for 2019YE while some foreign investment banks projected 8-10% until 2020 end.

Factoring monthly NPL data also indicates a rapid increase after March 2018 (4.57%) while November NPL ratio is 9.8% which is relatively stable for last 7 months after hitting highs at April 2019 with 10.3%.

TURKISH BANKING SECTOR NPL PER CREDIT TYPE

(%)



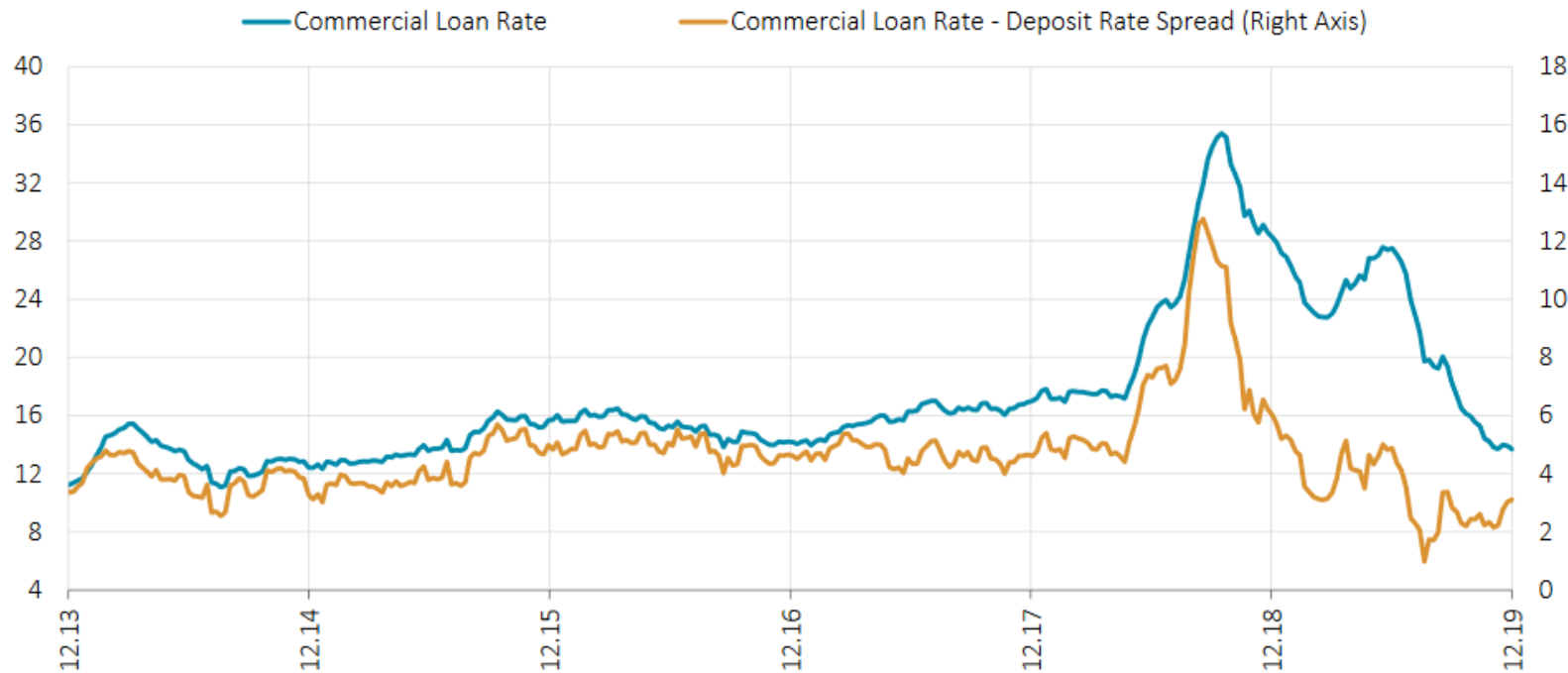
Source: CBRT

Last Observation: December 27, 2019

- ❑ Commercial Loan and Total Loan NPLs rapidly increased and they both exceeded Consumer Loan NPL ratio which now decreases as a result of rapid increase in consumer loan growth (see «consumer loans growth» slide).
- ❑ Household indebtedness is not a problem yet but commercial indebtedness and high interest rates leading to more insolvencies might probably result in more unemployment and more household problems - > Vicious Circle

TL COMMERCIAL LOAN RATE – DEPOSIT RATE SPREAD

(Flow, 4-Week Average, %)



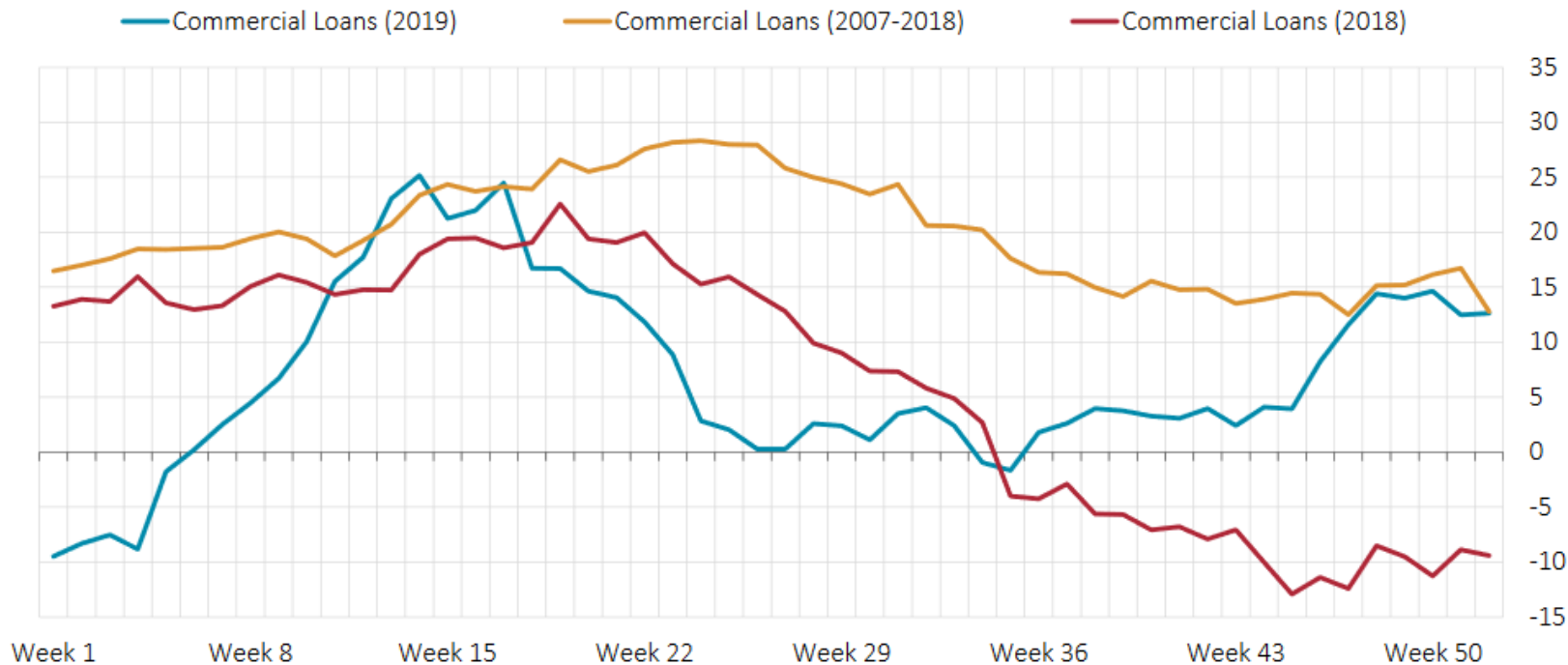
Source: CBRT

Last Observation: December 27, 2019

- During 2018, official interest rate was increased 1200 pts by CBRT. This triggered the loan and deposit rates up to 36% and loan-deposit spread to 13% in August with rising uncertainty and funding costs. The trend turned downwards after decreased volatility in USDTRY and financial markets and after re-run of local elections in Istanbul and relative easing of tension with USA after Ankara summit due to Peace Spring Operation in Northern Syria. Rapid resolution of recent escalated tension between US-Iran avoided another volatility attack.
- Cost of financing has increased vs last year and this diminished the net profit margins and available cash flow for the leveraged firms. However, decreasing inflation rate followed by CBRT's policy rate cuts and decreased volatility in Turkish Lira provided a positive period which might lead to economic turnaround.

COMMERCIAL LOANS GROWTH

(Adjusted for Exchange Rate, 13-Week Average Annualized Growth**, %)



Source: CBRT

Last Observation: December 27, 2019

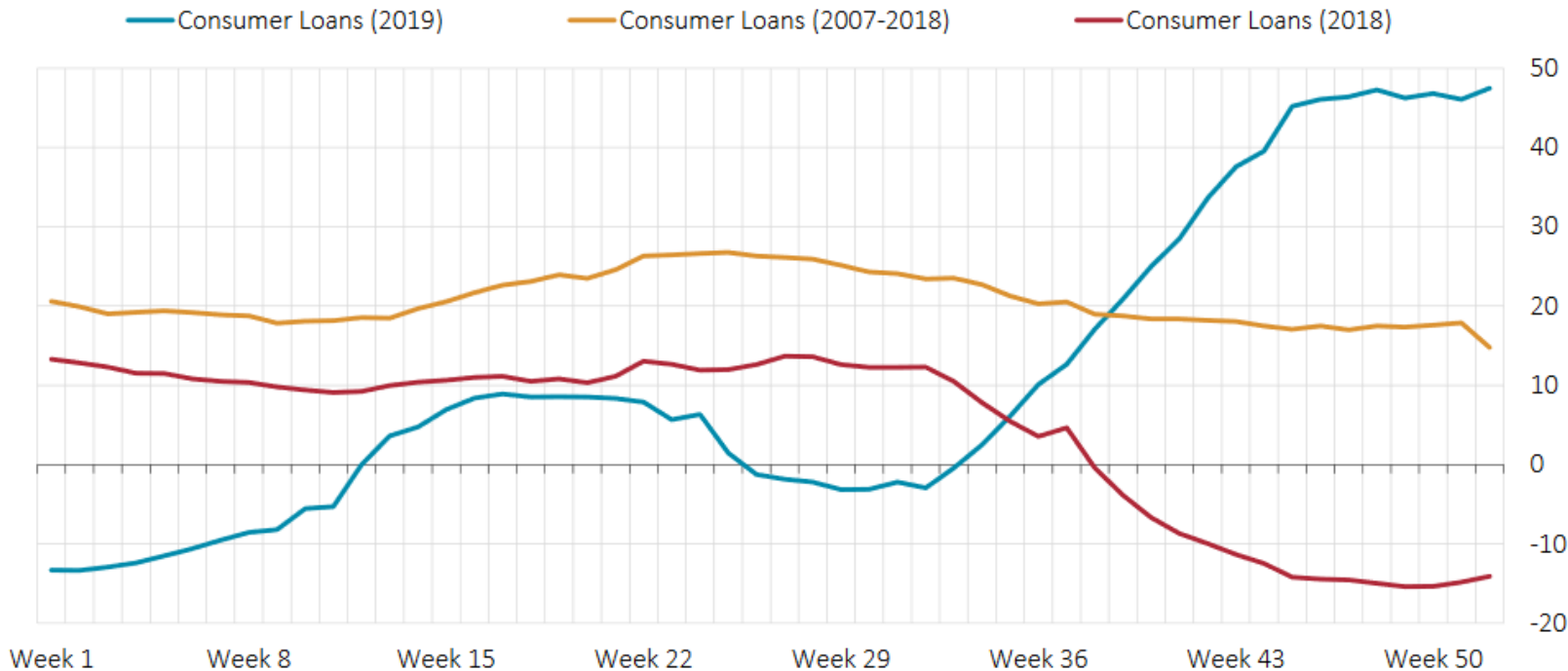
*Total banking sector (including participation banks) NPLs excluded.

**The annual growth rate of credit stock is calculated as the 52nd power of 13-week moving average of weekly growth rate.

- ❑ Credit growth rate compatible with Turkey's economic fundamentals is around 15%. It has converged below 0% in 2nd half of 2018 but turned back above it in 2019 especially with momentum gained by support of State owned banks.
- ❑ GDP and Credit growth has high correlation in Turkey and with this credit crunch, GDP is likely to grow only slightly in 2019 (+0.1% forecast by EH) while 2020 will be the year of recovery (EH Forecast: +2.3%).
- ❑ Commercial loan growth rate (currency adjusted and 13-week average annualized) has now gained pace and been moving above 10% as of December.

CONSUMER LOANS GROWTH

(13-Week Average Annualized Growth**, %)



Source: CBRT

Last Observation: December 27, 2019

*Total banking sector (including participation banks) NPLs excluded.

**The annual growth rate of credit stock is calculated as the 52nd power of 13-week moving average of weekly growth rate.

- ❑ Consumer spending growth decreased to 1.1% in 2018 from 6.1% of 2017 due to sharp decrease in TRY's value and high inflation.
- ❑ EH Forecast for 2019 Consumer Spending Growth is -1.0% while 2020 is +2.8%. We see a sharp increase in consumer loans after August owing to declining inflation and CBRT rate cuts.
- ❑ Also state banks play a very significant role in this credit boom as they subsidizing mortgage and consumer loans to revive the suffering revenue generation of construction and automotive companies.

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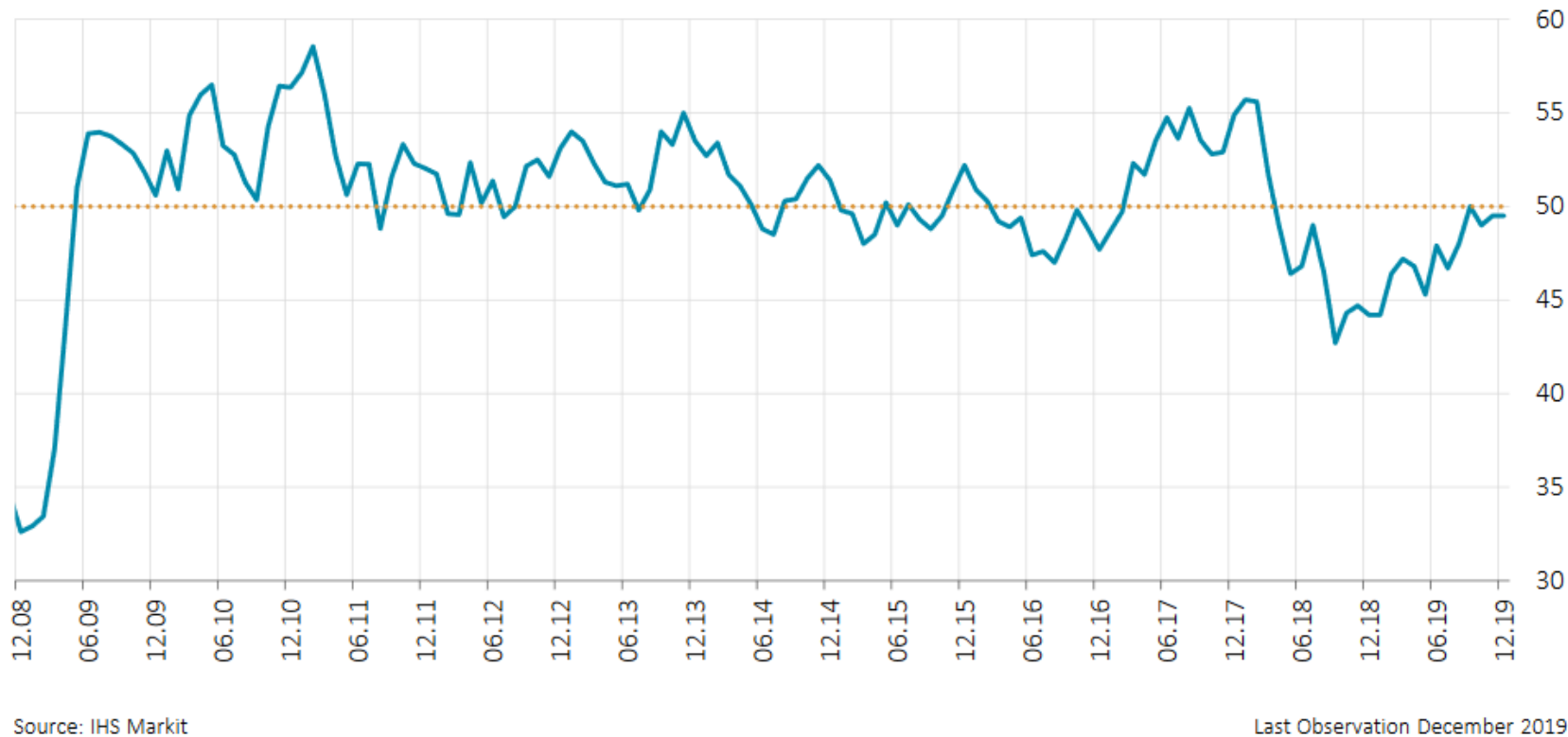
MACRO OUTLOOK

- PMI
- Real Sector Confidence Index
- Unemployment
- Current Account Balance
- Main Sources of External Finance
- USDTRY and Volatility
- USDTRY and Inflation
- Real Sector Net FX Position
- EH Economic Research – Turkey: Key Forecasts



PMI

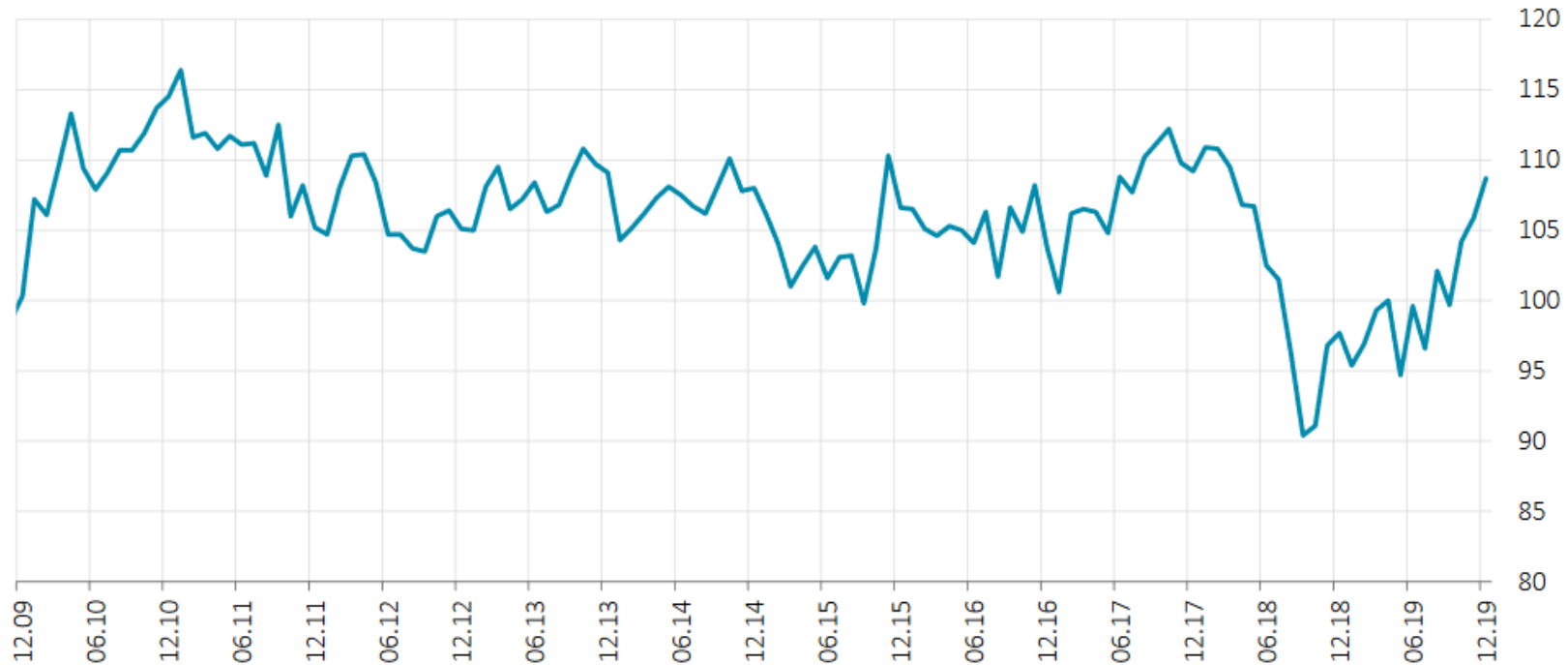
(Seasonally Adjusted)



- ❑ One of the most important indicators of economic sentiment, PMI, contracted during 2018, which gave early warning signals for a hard landing in economic growth. PMI is now 49.5 as of December 2019 and slowly recuperating since September 2018.
- ❑ Turkey's economy grew by 0.9% yoy in the Q3-2019 period after seeing 3 consecutive quarters of negative growth yoy since 2018Q4. Annualized GDP of Turkey at current prices became TRY 4.1 trillion and USD 734 billion in USD terms as of end of September 2019. Net exports made a negative contribution to GDP in Q3 by 0.2 pps while private consumption made a positive contribution by 0.9 pps.

REAL SECTOR CONFIDENCE INDEX

(Seasonally Adjusted)



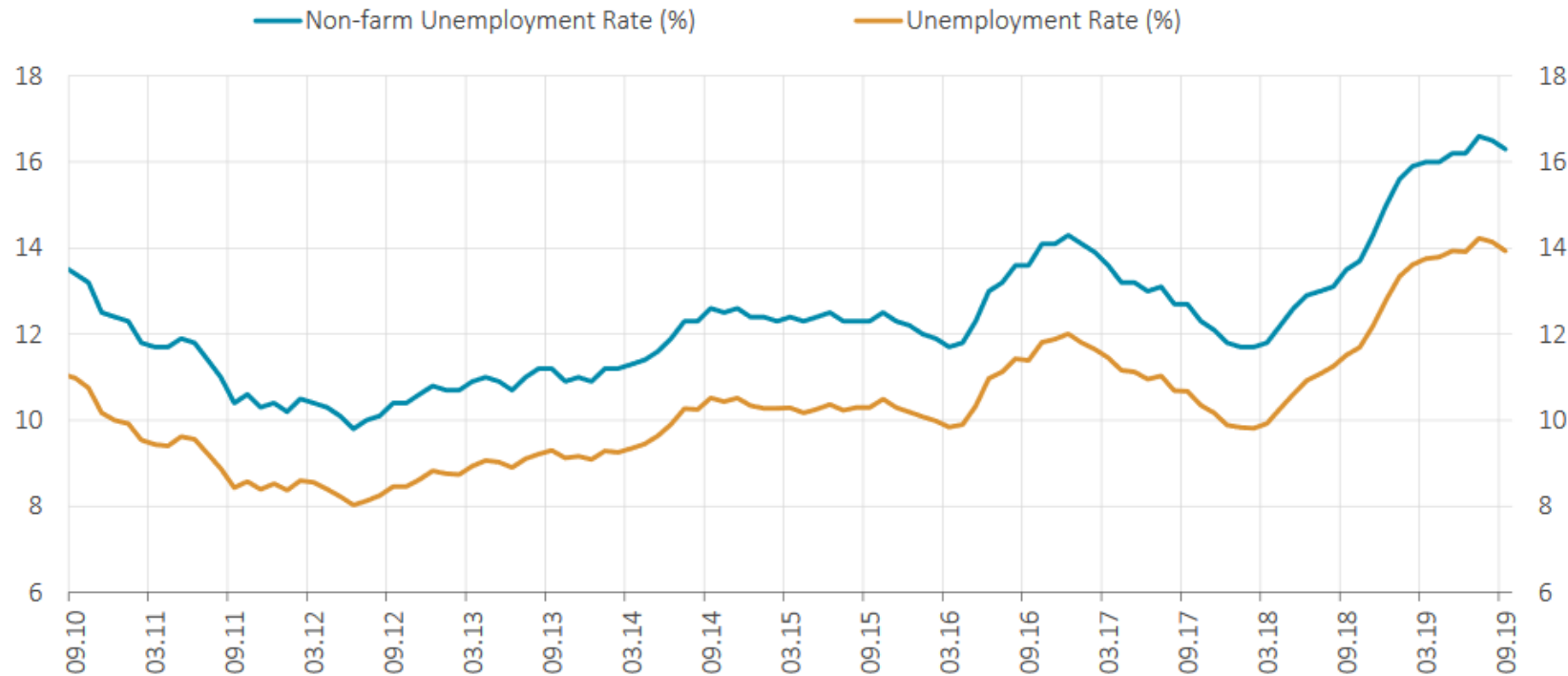
Source: CBRT

Last Observation: December 2019

- ❑ In December, seasonally adjusted real sector confidence index rose to 108.7, the highest level since March 2018.
- ❑ Consumer confidence index decreased to 58.8 in December from 60. In the same period, seasonally adjusted capacity utilization ratio of manufacturing industry climbed to the peak of more than a year with 76.9%.
- ❑ Following September, the calendar adjusted industrial production index increased also in October on an annual basis

UNEMPLOYMENT

(Seasonally Adjusted, %)



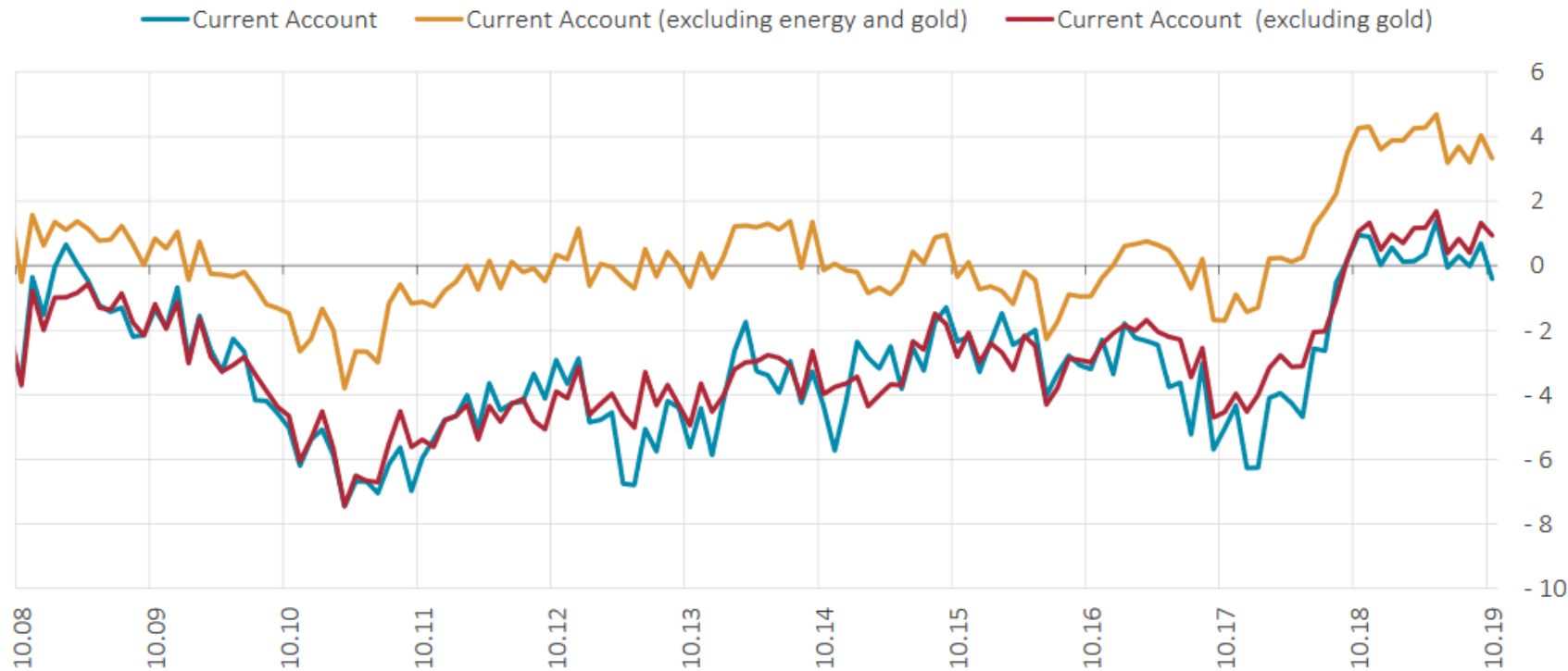
Source: CBRT, TURKSTAT

Last Observation: September 2019

- Unemployment rate in Turkey decreased to 13.4% in October 2019 from 13.8% compared to last month while it increased by 1.8% yoy basis. The number of unemployed increased by 608 thousand from a year earlier to 4.39 million while employment declined by 527 thousand to 28.34 million.
- Youth unemployment rate, measuring job-seekers between 15 and 24 years old, also rose to 25.3% by 3bps yoy.

CURRENT ACCOUNT BALANCE

(Seasonally Adjusted, Billion USD)



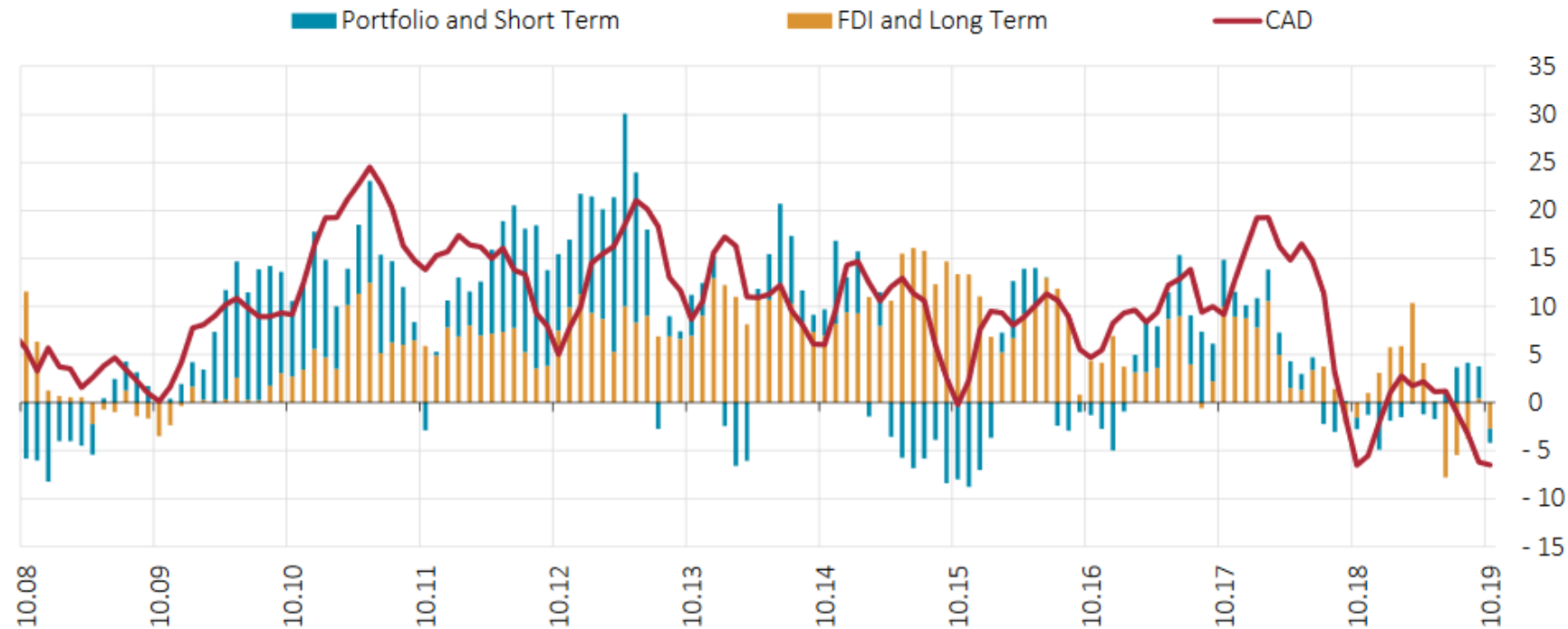
Source: CBRT

Last Observation: October 2019

- Current Account Balance turned positive due to huge drop-down in domestic demand and consequently contracting GDP. This also supported the appreciation trend of Turkish Lira in the recent period which started after the rapprochement with US after the release of the pastor. However, despite rebalancing economy and relatively high real interest rates, USDTRY still stand solid above 5.80 level due to escalated tension in the Middle-East, pending sanction implementations, increasing budget deficit, etc.
- We expect a small CAD or CAS for 2019 with contracted import vs exports swinging around current volumes.

MAIN SOURCES OF EXTERNAL FINANCE

(3-month Cumulative, Billion USD)



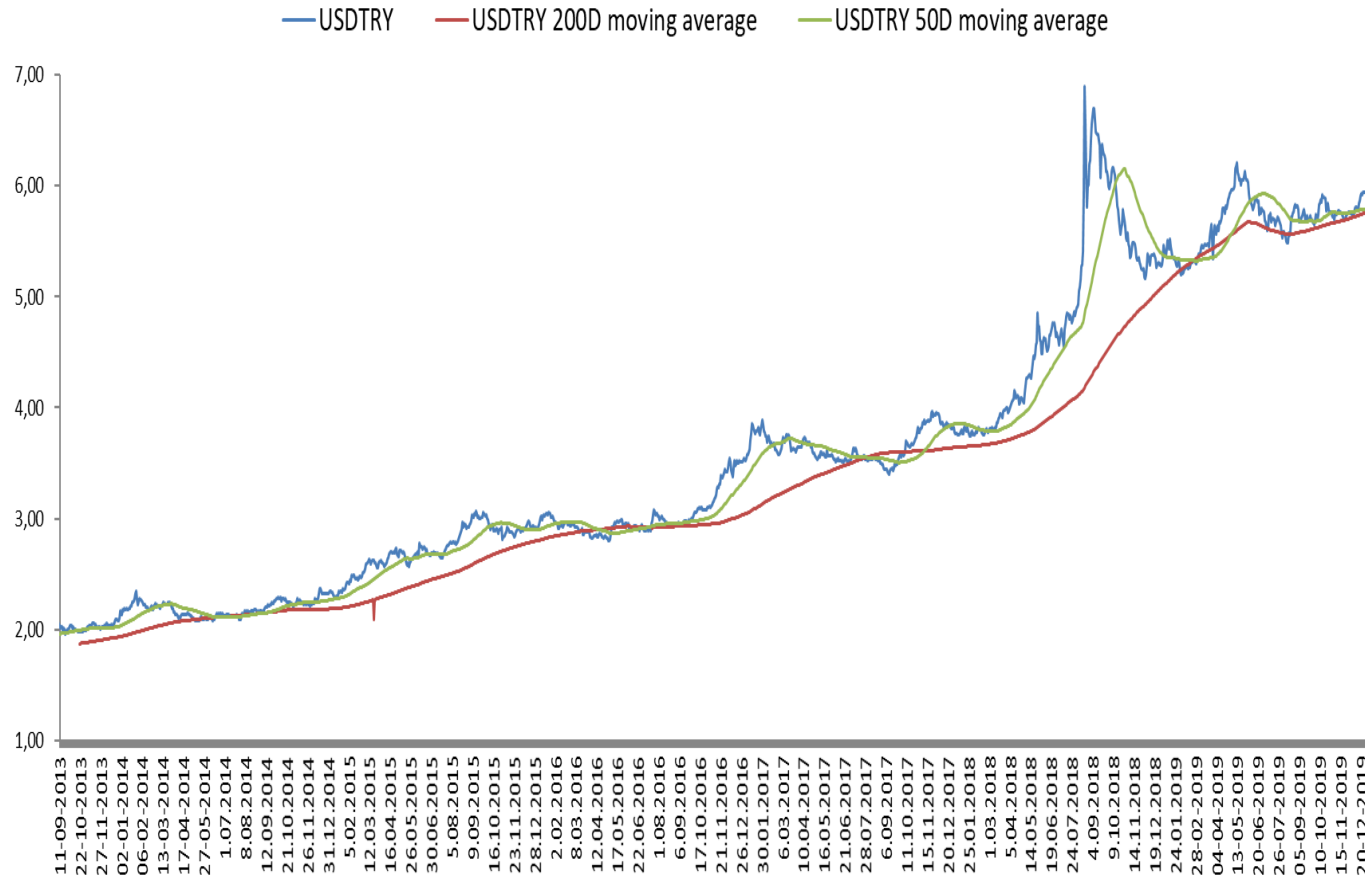
Source: CBRT

Last Observation: October 2019

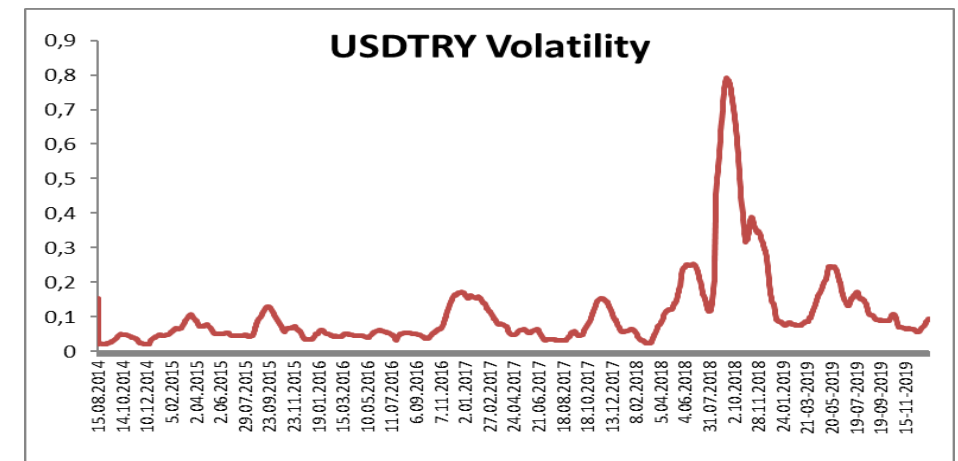
*Long term capital movements are sum of banking and real sectors' long term net credit and bonds issued by banks and the Treasury. Short term capital movements are sum of banking and real sectors' short term net credit and deposits in banks.

- Turkey's external financing need is high due to low savings, accumulated capital and demographics of the country.
- FDI net inflow was \$13 billion in 2018 (highest value in 2007 with \$22 billion). 2019 year-to-date net inflow is very limited and will be very low as compared to last year.
- Current Account Deficit (CAD) turned into Current Account Surplus in 2019 due to low import volumes.

USDTRY AND VOLATILITY

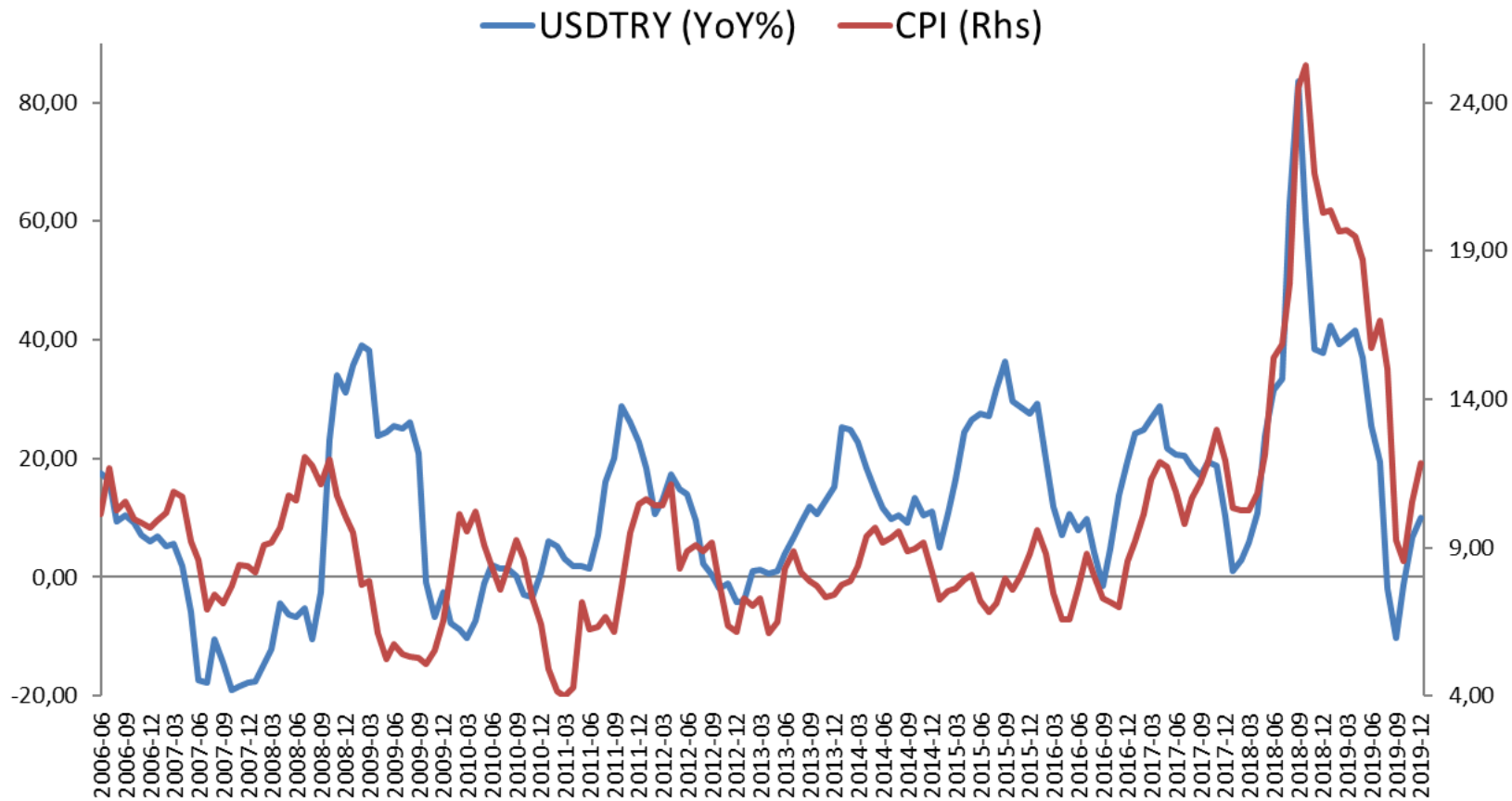


- ❑ After the panic sales/buying in August 2018, USDTRY is now moving in between 50 and 200 day moving averages. Volatility increased in last months due to Geopolitical tensions soaring again (Operation Peace Spring in N.Syria, S-400 issue with US) but now settled after TR-US meeting in Ankara and TR-Russia meeting in Sochi.
- ❑ **What can initiate another volatility attack?** a) CBRT's decision to cut interest rates even further before fx rate stabilizes and inflation decreases permanently b) Current account deficit rises again c) Sanctions and CAATSA to be implemented with harsh impact on Turkish economy. d) Escalating tension in Middle-East leading to military conflicts



Source: CBRT

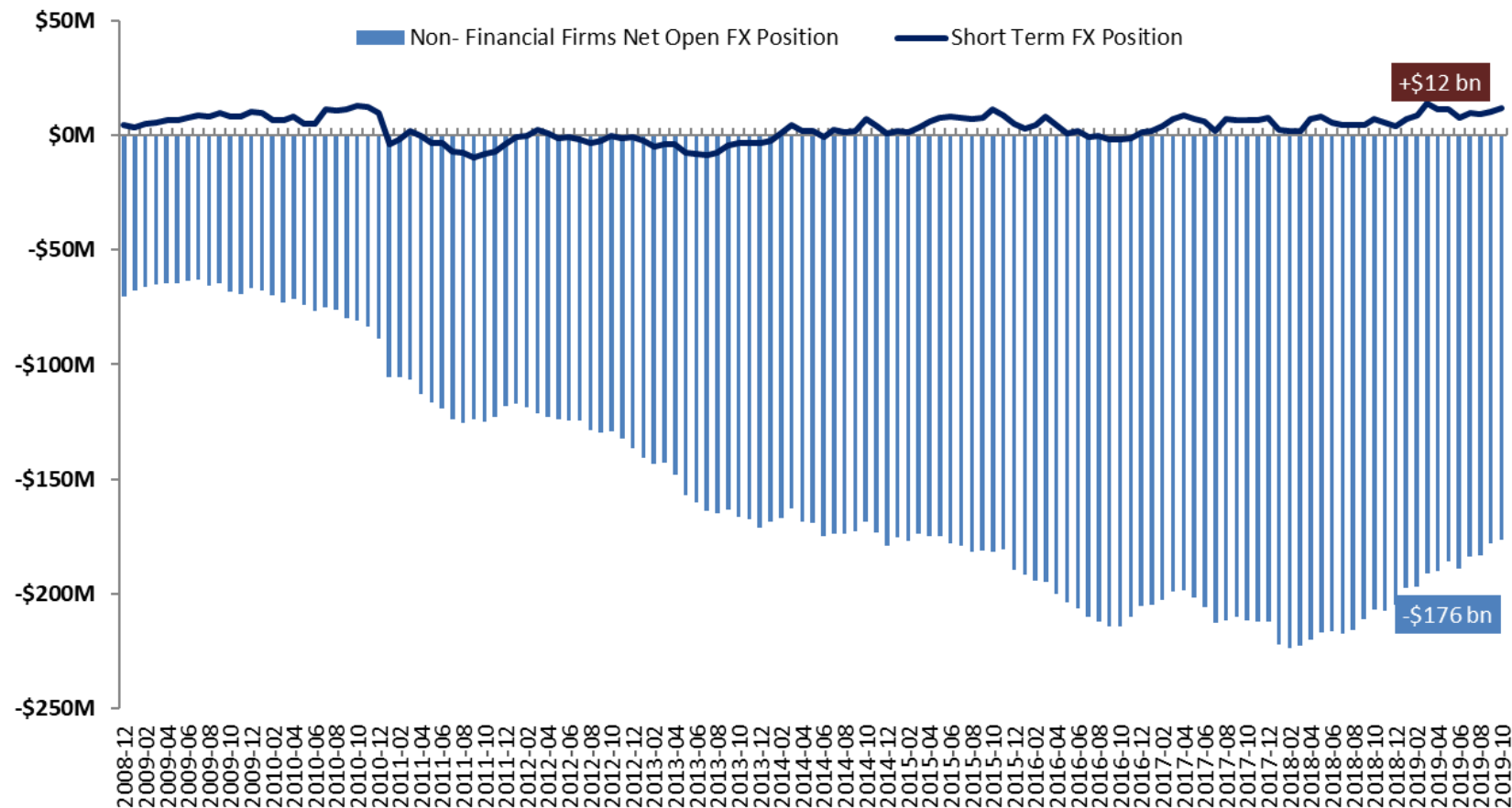
USDTRY AND INFLATION



Source: CBRT

- There is a high correlation between FX and inflation, called «FX Pass Through Effect». Together with imports in FX, domestic prices inflate. 10% of depreciation in FX results in 1.5 point additional burden on inflation rate.
- As we expected annual CPI realized at 11.84% at year-end (our expectation was 11-12%) due to stickiness in core inflation and relatively higher PPI still not being reflected to end-prices although USDTRY YoY% paced down relatively and CPI declined significantly in September (9.26%) due to base-effect while October data came even lower (8.55%).

REAL SECTOR NET FX POSITION (USD BILLION)



Source: CBRT

- Although it has a surplus in Short Term (+\$12 bn), Real Sector has huge amount of open FX position (-\$176 bn) and it creates a fragility on real sector outlook. 1% of depreciation in TRY, puts \$1.8 billion burden on real sector.
- Despite the negative outlook, corporates has been lowering their net open fx position gradually since February 2018 when the amount hit \$224 bn as highest level.

EH ECONOMIC RESEARCH–TURKEY: KEY FORECASTS

TURKEY: Key forecasts	2017	2018	2019f	2020f
GDP	7.4	2.6	0.1	2.3
Consumer Spending	6.1	1.1	-1.0	2.8
Public Spending	5.0	3.6	4.0	3.0
Investment	7.3	-1.7	-11.0	2.0
Stocks *	0.8	-2.8	-2.4	-0.5
Real Exports	12.0	7.5	6.0	3.8
Real Imports	10.3	-7.9	-12.0	3.0
Net exports *	0.1	4.7	5.5	0.2
Current account (% of GDP)	-5.5	-3.6	1.0	-2.3
External debt (% of GDP)	53.5	56.7	61.3	60.9
Inflation (eop)	11.9	20.3	12.3	11.5
Inflation (aop)	11.1	16.3	15.4	12.0
Fiscal balance (% of GDP)	-2.2	-3.0	-3.1	-2.9
Public debt (% of GDP)	28.2	30.2	32.3	32.0
TRY per USD (aop)	3.65	4.83	5.68	6.20
TRY per USD (aop, % change)	-20.8	-32.5	-17.5	-9.2

Change in % y/y, unless otherwise indicated.

* Contribution to GDP growth.

- ❑ 2019 GDP growth revised upwards to +0.1% (previous -0.2%) while 2020 forecast revised downwards to +2.3%. This is due to earlier than expected turn-around in economy in 2019Q4 but the turn-around is slow as consumer and investment spending is still negative.
- ❑ Net exports have been helping current account deficit to turn into surplus which might be around 1% of GDP at 2019 year-end.
- ❑ Inflation realized at 11.84% in 2019YE vs our 12.3% forecast. 2020 forecast is still two digits due to cost of production, expected minimum wage increase, interest rates to be stay in two digits, etc.
- ❑ USDTRY might see some volatilities but on average TRY is expected to depreciate around 8-10% in 2020.

THANK YOU

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