TURKEY ECONOMIC REPORT

AMID A SOMEWHAT RESILIENT DOMESTIC DEMAND AND A WEAKENED FOREIGN DEMAND

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- A retreat in economic growth amid weakened foreign demand

  Throughout the year 2016, the Turkish economy went under some pressures, mainly in its real sector. Increased political uncertainty, a fall in tourism, weak business confidence and adverse domestic and external shocks are taking their toll on Turkey's economy, where growth is expected to fall to 2.9% this year as per the IMF, against 4% in 2015. In brief, what is impacted in Turkey is foreign demand in its different components of FDI, portfolio inflows and touristic receipts, but domestic demand that accounts for 80% of total demand is almost unaffected by this year's events.

- Current account deficit benefitting from low oil prices effect, though partially offset by weak tourism season

  Having narrowed sharply since 2013, Turkey's current account deficit has slightly widened in the third quarter of 2016, as geopolitical conflict, rising incidence of terrorist attacks within Turkish borders, and failed coup attempt have weighed on the external sector, dampening the gradual improving trend in external imbalances over the previous couple of years. Having said that, the weakened Turkish lira could limit this expansion by boosting export competitiveness and curbing import demand. Within this environment, it is worth mentioning that the balance of payments close the first nine months' period with a surplus of US$ 5.6 billion, against a deficit of US$ 3.8 billion in the similar 2015 period.

- First increase in policy rates in three years amid extended falls in Turkish lira

  Turkey's monetary conditions were marked in 2016 by sharp losses in the value of the Turkish lira, a first-time increase in policy rates in nearly three years and a sustained high consumer price inflation standing well above the official medium-term target of 5%, along with plans to achieve a single rate monetary policy. The Turkish lira has depreciated by 17.2% over the first eleven months of 2016, moving from TL/US$ 2.92 at end-2015 to TL/US$ 3.42 at end-November 2016, amid domestic political concerns, sovereign rating cuts by international rating agencies, and fueled expectations of an interest rate hike by the US Federal Reserve in December 2016 following US Presidential elections.

- Resilient banking activity amid adequate overall financial standing

  The Turkish banking sector pulled out a satisfactory activity growth during the first nine months of this year despite a tough operating environment marked by local currency depreciation and political uncertainties especially following the failed coup attempt during the summer period. Measured by total assets of banks operating in the country, sector activity grew by 7.5% in local currency terms (+4.1% in US dollar terms) in the first nine months of 2016. A 54.1% growth in banks' net profits was reported over the covered period (+39% in US dollar terms). Consequently, return ratios ameliorated, with the annualized return on average assets ratio at 1.6% in the first nine months of 2016 and the annualized return on average equity ratio reaching around 14% over the same period.

- Small equity price gains along with extended declines in bond prices

  Turkish equities managed to post small gains over the year 2016 despite heightened domestic and geopolitical concerns and the increased market volatility following the US Presidential elections, mainly supported by favorable market valuations. However, Turkish bonds continued to register price drops, mainly suppressed by credit rating cuts and following US Treasuries move, along with continuous expansions in Turkey's CDS spreads. The BIST 100 closed at 73,995.2 at end-November 2016, up by 3.2% since year-end 2015. In parallel, the five-year CDS spreads moved from 274 basis points at end-2015 to 290 basis points at end-November 2016, following an expansion of 89 basis points in 2015.

- Economic outlook still driven by intrinsic strengths

  Finally, while there are undoubtedly some adverse developments at the economic level, we believe there is no major deterioration in fundamentals post coup for a number of intrinsic considerations. These considerations do not mean that recent developments do not entail risk factors, namely rating downgrades, deterioration in capital inflows and further tourism sector suffering but financial and macro implications are mostly manageable. In sum, the Turkish economy had strong fundamentals pre-coup which would not be shaken drastically in its aftermath.

The Turkey Economic Report can be accessed via internet at the following web address: http://www.bankaudigroup.com

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Throughout the year 2016, the Turkish economy went under considerable pressures in its real sector, while its financial sector proved to be somehow resilient. Increased political uncertainty, a fall in tourism, weak business confidence and adverse domestic and external shocks are taking their toll on Turkey's economy, where growth is expected to fall to 2.9% this year as per the IMF, against 4% in 2015.

Regarding tourism, the number of tourists fell by 31% over the first ten-month period. The country's total revenue from tourism was US$ 17 billion over the first nine months of the year, US$ 8 billion less compared to the same period last year when it was US$ 25 billion. Turkey suffered from a significant decline in hotel occupancy rates with a 21% decline in the first seven months of 2016 compared to the same period of 2015, and had the lowest hotel occupancy rate across Europe with 49%. In parallel, net FDI fell by 60% over the first nine months of 2016 relative to the 2015 same period.

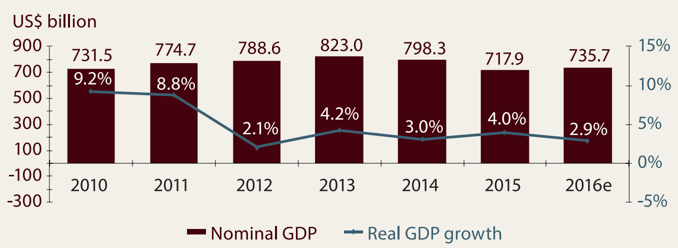
In brief, what is impacted in Turkey is foreign demand in its different components of FDI, portolio inflows and touristic receipts, but domestic demand that accounts for 80% of total demand is almost unaffected by this year's events. As a matter of fact, at the level of domestic demand, a hike in minimum wages, the positive terms-of-trade from low oil prices, and demand from 2 million-plus refugees living in Turkey, have all contributed to sound consumption growth.

Within this environment, the government announced its 2017-2019 Medium-Term Program, which prioritizes political and economic stability. Real GDP growth is forecasted at 3.2% for 2016, 4.4% for 2017 and 5% for 2018 and 2019. As per the program, the government expects inflation to decline from 7.5% at the end of 2016 to 6.5% at the end of 2017 and 5% in 2018 and 2019.

At the external sector level, the year 2016 is reporting a sustained current account deficit ratio of 4.5% of GDP, benefitting recently from the decline in oil prices in addition to exchange rate depreciation fostering improved competitiveness in foreign trade. The ratio of exports to imports reported a high of 78% in the first nine months of 2016. In parallel, despite the expansion in fiscal deficit this year, the latter still represents a mere 1.9% of GDP, bringing down the public debt ratio to a low of 31.7% of GDP.

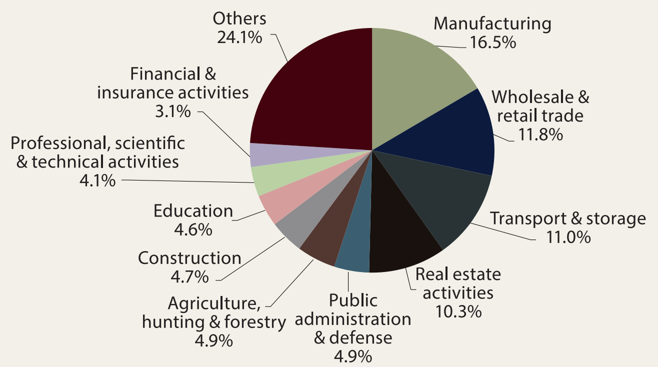
At the banking sector level, a noticeable resilience was reported this year. Total bank assets increased by 7.5% from January to September and stood at US$ 846 billion. Meanwhile, credits increased by 8.4% and reached US$ 538 billion. Also, Turkish bank profits grew by 54% in TL terms and 39% in US$ terms over the first nine months of 2016. The Turkish banking sector is fundamentally sound, with high regulatory capital ratios (16%), low NPLs (3.3%) and sizeable liquidity buffers (US$ 54 billion of FX liquid assets, the equivalent of 29% of FX deposits).

GROSS DOMESTIC PRODUCT PERFORMANCE



Sources: IMF, Bank Audi's Group Research Department

BREAKDOWN OF GDP BY SECTOR (1H 2016)



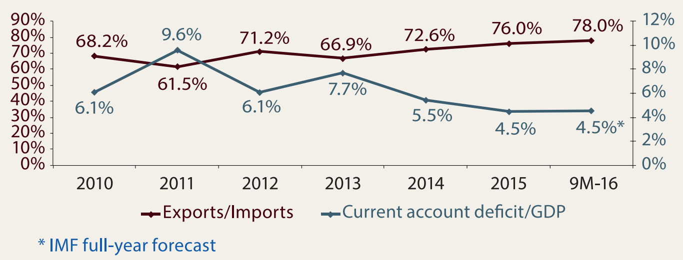
Sources: Central Bank of Turkey, Bank Audi's Group Research Department

What remains is the monetary concern, with the exchange rate depreciating by 17% this year to reach 3.42 relative to the US dollar. It is yet important to mention within this respect that Central Bank's international reserves kept a level above the US$ 100 billion threshold, recording US$ 101.6 billion, against US$ 92.9 billion at end-2015. As to reserve coverage, international reserves currently represent 17.1% of Money Supply and 6.5 months of imports, slightly lagging behind international benchmarks.

At the capital markets level, this year's developments did not entail significant pressures on stock and fixed income markets. The stock market price index rose by 3.2%, after a contraction of 16.3% in 2015, with market capitalization at US$ 168 billion, the equivalent of 23% of GDP. The stock market turnover ratio, measured by the annualized trading value to market capitalization, rose from 200.8% in 2015 to 205.2% in the first 11 months of 2016. As a reflection of market perception of country risks, the CDS spread expanded by 16 basis points year-to-date, following a widening of 85 basis points in 2015.

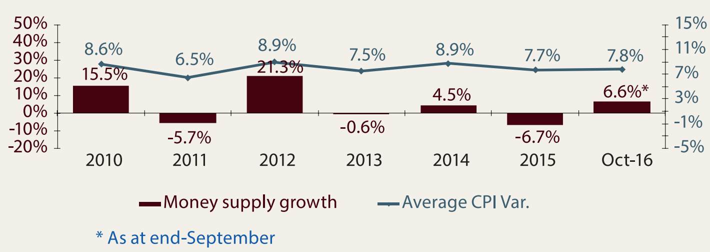
The in-depth developments in the real sector, external sector, public sector and financial sector of the economy are detailed in the forthcoming sections. The concluding remarks are left to the outlook of the Turkish economic fundamentals on the back of the recent coup attempt and the fundamental challenges looking forward.

FOREIGN SECTOR INDICATORS



Sources: Central Bank of Turkey, IMF, Bank Audi's Group Research Department

MONEY SUPPLY GROWTH AND INFLATION



Sources: Central Bank of Turkey, Bank Audi's Group Research Department

1. ECONOMIC CONDITIONS

1.1. REAL SECTOR

1.1.1. Agriculture Sector

Mild growth in the activity of the sector with negative performance of its foreign trade indicators

Turkey's primary sector which was suffering from unfavorable weather conditions in the past couple of years saw very mild growth in the first half of 2016 at a significantly slower pace than that seen in the same period a year earlier. Indeed, the agriculture, forestry and fishing sector continued to contribute by a mere 5% to the country's GDP, however, registered a real growth of 0.3% year-on-year in the aforementioned period of 2016, down from a yearly growth 5.5% in the first half of 2015.

Furthermore, the overall output of crop production in 2015 reversed the declining trend seen in the year earlier, as per the latest values by the Turkish Statistical Institute. Crop production of cereals, vegetables and fruits rose by a yearly 7.2% in 2015. This came after a yearly decline of 5.0% registered in 2014. In details, cereals, which take over the lion's share in crop production, grew by 9.9% in 2015 after a fall of 7.1% in 2014. This emphasizes a recovery in the sector following the season of drought that affected the crops in the first half of 2014. Productions of vegetables grew by 3.8% in 2015 and that of fruits, nuts and spices crops rose by an annual 4.0%.

However, it is worth mentioning that Turkey is currently facing a loss in grain production in November and December after one of its most arid seasons for agricultural production in recent years, as per the Agriculturalists Association of Turkey. Rainfall dropped in October 2016 by 58.3% compared to the yearly average and by 75.3% compared to the same month of 2015.

The country's exports of agricultural products fell by a yearly 8.1% in the first ten months of 2016, registering US$ 4.8 billion. This exceeded the decline of 2.6% reported in the year-earlier similar period. Alongside, imports of agricultural products decreased by 0.3% to stand at US$ 5.9 billion in the abovementioned period of 2016 following a decline of 14.9% in the first ten months of 2015.

Finally, the real growth in the sector, in addition to the increase in total crop production came to reverse the negative impacts of the erratic weather conditions the country suffered from in previous years. However, the decline in the levels of rainfall and other extreme weather conditions including flood, frost or snowfall keep the performance of the sector at risk.

CROP PRODUCTION IN 2015 (CEREALS, VEGETABLES AND FRUITS)

000s tons	Volume	Share		Volume	Share		Volume	Share
Cereals	**38,637**	**60%**	**Vegetables**	**24,589**	**83%**	**Fruits**	**11,051**	**58%**
o.w. Wheat	22,600	35%	o.w. Tomatoes	12,615	43%	o.w. Citrus fruits	3,976	21%
o.w. Barley	8,000	12%	o.w. Watermelon	3,919	13%	o.w. Pome fruits	3,163	17%
o.w. Maize	6,400	10%	o.w. Cucumber	1,856	6%	o.w. Stone fruits	2,353	12%
Sugar beets	**16,023**	**25%**	o.w. Melon	1,720	6%	o.w. Other fruits	1,559	8%
Potatoes, dried legumineus	**4,760**	**7%**	o.w. Pepper (green)	919	3%	**Grapes**	**3,650**	**19%**
Oil seeds	**3,442**	**5%**	**Bulb and root vegetables**	**3,131**	**11%**	**Olive production**	**1,700**	**9%**
Dry pulses	**1,079**	**2%**	o.w. Dry onion	1,879	6%	**Tea production**	**1,328**	**7%**
Raw materials used in textiles	**738**	**1%**	o.w. Carrots	535	2%	**Nuts**	**1,124**	**6%**
Plants for perfumery, pharmacy	**114**	**0%**	**Other vegetables**	**1,832**	**6%**	**Spices crops**	**247**	**1%**
Tobacco	**68**	**0%**	o.w. Leafy or edible stem vegetables	1,564	5%	**Total Fruits, nuts and spices crops**	**19,100**	**100%**
Total Cereals and other crops*	**64,861**	**100%**	**Total Vegetables and other crops**	**29,552**	**100%**			
* Excluding fodder crops								

Sources: Turkish Statistical Institute, Bank Audi's Group Research Department

1.1.2. Industrial Sector

Secondary sector remains on growth trend despite tough business environment

Amidst rising political tensions in the country and the further weakening of the Turkish lira, Turkey's industrial sector, which accounts for 21.2% of GDP, managed to grow during the first half of 2016. In fact, the country's industrial sector posted a real growth of 4.8% year-on-year in H1 2016, compared to a real growth rate of 2.4% recorded in the same period of 2015.

Moreover, the average Industrial Production Index, which measures the amount of output from the manufacturing, mining, electric and gas industries, expanded by 1.8% year-on-year in the first three quarters of 2016, compared to 1.7% in the corresponding period of last year, as per Turkstat.

The country's manufacturing sector, which is the most important component of the industrial sector and contributes to almost 16.5% of GDP, saw a real growth of 6.7% year-on- year during H1 2016 against 3.0% in the same period of 2015. The manufacturing average industrial production index also increased by 1.4% year-on-year in the first nine months of 2016, compared to a 2.1% rise in the corresponding period of last year. Nonetheless, the Central Bank of Turkey's seasonally adjusted manufacturing capacity utilization rate dropped to 74.9% in November 2016, from 75.1% in the same month of 2015.

Furthermore, reflecting sentiment among manufacturers, the Istanbul Chamber of Commerce Turkey PMI Manufacturing Index posted 49.8 points in October 2016, up from September's 48.3 points and rising compared to 48.9 points recorded in October 2015. It is important to mention that any figure above 50 indicates overall improvement in the sector. Thus, the November PMI figure signals a near-stabilization of business conditions in the Turkish manufacturing sector. A major risk to manufacturers in Turkey is the depreciation of the Turkish lira against the dollar, which increases the cost of dollar imports, coupled with a weakening of the Euro against the Turkish lira, which threatens Turkey export competitiveness in European markets.

Turkey's construction sector, which makes up 4.7% of GDP, grew by 6.7% year-on-year during H1 2016, compared to a contraction of 0.3% in the same period of 2015. The construction sector's growth can be attributed to a large and growing population, alongside a robust rural-urban migration backed by economic reforms.

Moving on to the electricity, gas and water supply sub-sector of industry, which constitutes 6.0% of the industrial sector's GDP, it grew by 2.3% year-on-year in the first six months of 2016, after contracting by 0.4% in the corresponding period of last year. As to the country's mining and quarrying component, making up 4.7% of the industrial sector's GDP, it expanded by 2.5% year-on-year in the first half of 2016, compared to a 7.3% contraction posted in the same period of last year.

Last but not least, despite the recent political challenges, Turkey's industrial sector expanded during the first half of 2016. The sector is anticipated to post further improvements going forward, as some of the political uncertainties have been curtailed, and the government recently took positive initiatives such as increasing incentives and subsidies, restructuring tax arrears, and easing restrictions on consumer loans.

VEHICLES PRODUCTION

(unit)	2011	2012	2013	2014	2015	10M-15	10M-16	10M/10M
Automobile	639,734	577,296	633,556	733,439	791,027	643,467	739,138	14.9%
Pick-up	479,110	426,633	410,558	357,889	468,933	378,314	380,110	0.5%
Minibus	22,475	29,335	37,751	40,744	54,209	48,895	38,270	-21.7%
Tractor	45,506	42,255	40,511	48,403	51,238	43,551	42,227	-3.0%
Truck	37,396	29,129	30,083	31,931	35,838	29,118	14,193	-51.3%
Bus	6,907	6,427	8,374	6,442	8,789	7,014	6,910	-1.5%
Midibus	3,509	4,158	5,197	5,324	7,131	5,519	2,859	-48.2%

Sources: Central Bank of Turkey, Bank Audi's Group Research Department

1.1.3. Trade and Services Sector

Trade and services sector grows despite weakness in tourism sub-sector

Turkey's trade and services sector, which makes up 59.2% of GDP, expanded during the first six months of 2016. As a matter of fact, the sector witnessed a growth of 4.3% in the first half of 2016, marginally higher than the growth rate of 4.1% in the first half of last year. In contrast, Turkey's services confidence index attained 96.8 in November 2016, down by 3.2% from 100.0 in November 2015, due to weakness in the tourism sector, as per data compiled by the Turkish Statistical Institute.

In fact, the country's wholesale and retail trade, one of the main components of the trade and services sector, which makes up 11.8% of GDP, expanded by 4.4% year-on-year in the first six months of 2016, compared to 1.8% in same period of last year. A rise in private consumption led to this expansion in wholesale and retail trade, with the former estimated to have grown by 3.8% in 2016, benefitting from the minimum wage hike, lower fuel prices and the influx of migrant workers.

With respect to Turkey's tourism sector, a significant deceleration was seen during the first ten months of 2016 due to the political and security uncertainties in the country. More specifically, the number of foreign arrivals to Turkey witnessed a decline of 31.3% year-on-year to reach 22.7 million in the aforementioned period, compared to a 1.4% decline in the number of foreign arrivals in the first ten months of 2015. The country's tourism receipts also fell by 30.4% year-on-year in the first three quarters of 2016, against a decrease of 6.5% year-on-year in the first three quarters of 2015, as per the Turkish Statistical Institute.

Turkey suffered the biggest decline in hotel occupancy rates across Europe during the first seven months of 2016 at 49.1%, posting a 21% annual decline, according to the Turkish Touristic Hotels and Investors Association. It is worth noting that hotel occupancy rates saw a dramatic decline across Turkey, with Istanbul suffering the most, while the Mediterranean resort of Antalya performed relatively better due to local tourists.

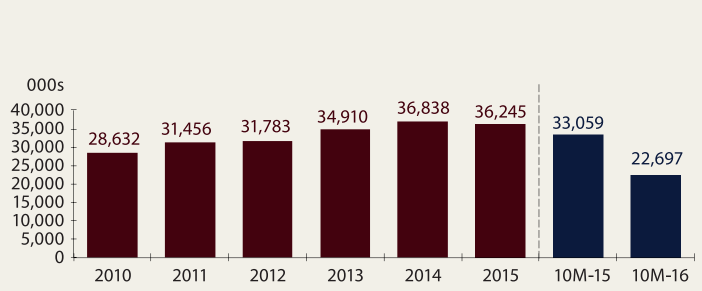
Finally, Turkey's transportation, storage, and communication sub-sectors, which contribute to 12.9% of Turkish GDP, contributed to the growth of the trade and services sector. The latter grew by 3.1% year-on-year in the first six months of 2016, against a growth rate of 2.3% in the same period of 2015.

1.2. EXTERNAL SECTOR

Steady current account deficit with lower oil prices effect being offset by weak tourism season

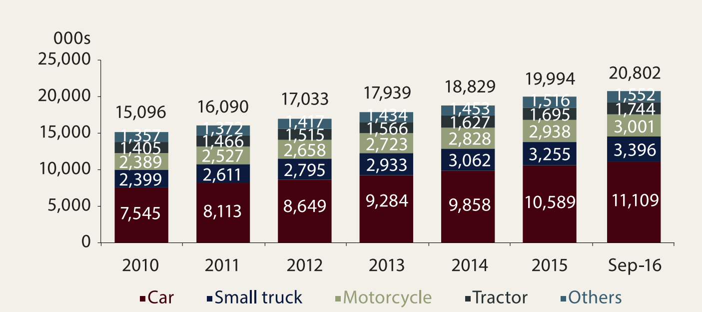
Having narrowed sharply since 2013, the current account deficit has slightly widened in the third quarter of 2016, as geopolitical conflict, rising incidence of terrorist attacks within Turkish borders, and failed coup attempt have weighed on the external sector, dampening further the gradual improving trend in

NUMBER OF FOREIGNER ARRIVALS



Sources: Ministry of Tourism and Culture, Bank Audi's Group Research Department

NUMBER OF ROAD VEHICLES



Sources: Turkish Statistical Institute, Bank Audi's Group Research Department

external imbalances over the previous couple of years, although the weak Turkish lira could limit this expansion by boosting export competitiveness and curbing import demand in the forthcoming period.

In details, Turkish exports reached US$ 109.8 billion in the first nine months of 2016, as per the latest Central Bank figures, posting a 3.2% decrease on a yearly basis, reflecting weak demand in most non-EU markets and obstacles to trade with Russia and Iraq. In parallel, exports to Turkey's main trade partner, namely the EU, have increased by 8.2% year-on-year during the first nine months of 2016. Accordingly, the share of the EU out of Turkey's total exports has rebounded to 48.5% in the first nine months of the year up from 43.6% in the equivalent period of 2015, which has softened somehow the downside resulting from troubled trade with Iraq (-18%) and volatile trade with Russia (-59%). However, the recent depreciation of the Turkish lira is expected to boost export competitiveness, along with the gradual lifting, since July, of the import restrictions imposed by Russia on Turkish goods in late 2015.

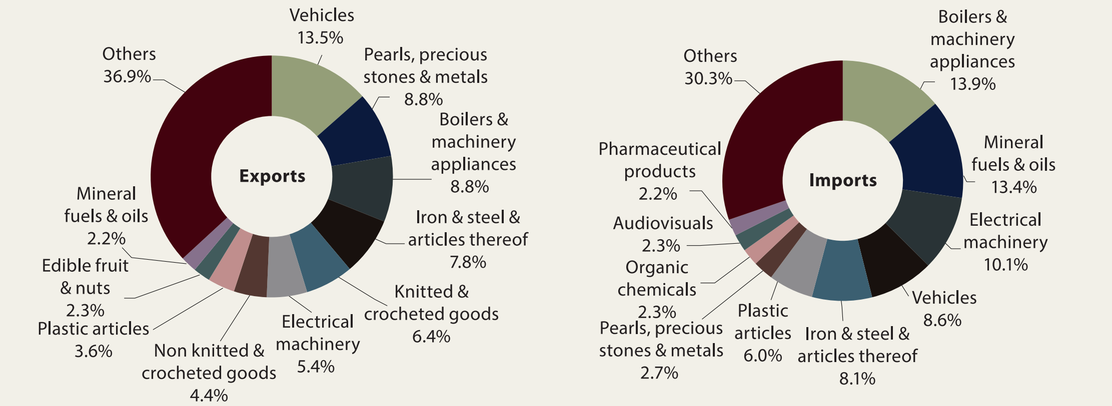
Going further into details, the breakdown of exports by category suggests that the most significant decline among the major categories was reported at the level of iron and steel with 12.6%, followed by edible fruits and nuts with 12.4%, electrical machinery and equipments with 5.9%, and plastic articles with 5.4%. In parallel, exports of vehicles reported an 11.6% growth year-on-year, followed by knitted, non-knitted and crocheted goods with a 2.3% rise over the first nine months of 2016 relative to the 2015 corresponding period, as per the Turkish Statistical Institute.

At the same time, Turkish imports reported a 6.7% year-on-year decrease during the first nine months of 2016 to US$ 140.7 billion, as the bill for mineral fuels and oils reported a 33.5% decline to reach US$ 19.5 billion due to lower global oil prices. A more detailed look at Turkey's purchases imported from the European Union, which constitute the biggest bulk of the country's imports (at 38.9%), shows a deceleration by 3.0% during the first nine months of 2016. Imports from other European countries category, which is the third most important in value, dropped by 27.7% over the same period of the year.

Accordingly, the cumulative trade deficit went down by 17.6% to reach US$ 30.9 billion over the first nine months of 2016. As such, Turkish foreign trade activity posted a net contraction in terms of volume, as the sum of exports and imports went down by 5.2% moving from US$ 264.3 billion in the first nine months of 2015 to US$ 250.5 billion in 2016. Consequently, the exports to imports coverage ratio reported a high of 78.0% in the first nine months of 2016.

In parallel, as a result of much reduced tourism revenues, the services balance which is the second most important component of the current account, has deteriorated by circa 40% during the first nine months of 2016. As such, the current account deficit deteriorated by 113% in the third quarter of the year on a year-on-year basis, compared to an improvement of 13% in the first half of the year. Accordingly, the cumulative current account deficit in the first nine months of 2016 reported a relatively steady level at US$ 24.8 billion (from US$ 24.6 billion a year earlier). Having said that, the year 2016 is expected to report a stable current account deficit ratio of 4.5% of GDP as the effect of lower energy prices has been broadly

BREAKDOWN OF EXPORTS AND IMPORTS BY MAIN COMMODITIES (9M-16)



Sources: Turkish Statistical Institute, Bank Audi's Group Research Department

offset by the weak tourism season. It is worth mentioning that the current account deficit, the main vulnerability for Turkey, has narrowed from 7.7% of GDP in 2013 to 4.5% of GDP in 2015, owing to the positive impact of lower international oil prices, net exports of gold and Turkish lira weakness.

Last but not least, the gap at the level of the current account has been once again more than offset by a surplus in the financial account during this year. The latter has tripled during the first nine months of 2016 to reach US$ 25.0 billion, driven by capital flows into Turkey and more specifically in the form of portfolio investments and other investments, while net foreign direct investments fell by 60% over the first nine months of 2016. As a result, the overall Turkish balance of payments closed the first nine months' period with a surplus of US$ 5.6 billion, against a deficit of US$ 3.8 billion registered in the similar 2015 period.

1.3. PUBLIC SECTOR

Widening budget deficit due to slow growth in main source of revenue

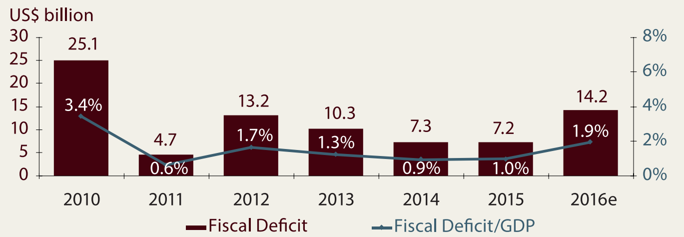
Turkey's fiscal deficit widened relatively over the first ten months of 2016, due to slower growth in tax revenues which constitute the majority of central government revenues combined with a considerable increase in expenditures. However, non-tax revenue strengthened and the primary balance remained in surplus, spotting light on favorable debt dynamics.

Central government revenues grew by 12.5% during the first ten months of 2016 to reach a total of TL 448 billion, mainly supported by a 12.6% increase in general budget revenues to TL 431 billion, a 10.3% rise in revenues from special budget institutions to TL 13 billion, and a 12.9% growth in revenues from regulatory and supervisory institutions to TL 4 billion. General budget revenues showed that tax revenues increased by 9.5% during the first ten months of 2016 to reach TL 365 billion, property income went up by 20.6% to TL 22.2 billion and capital revenues rose to reach TL 12.2 billion, while interest, shares and fines rose by 32.4% to TL 28.6 billion, and receivable collections increased to TL 868 million during the first ten months of 2016.

Expenditures went up by 13.8% during the first ten months of 2016 to reach TL 460 billion, mainly due to a 16.4% expansion in non-interest expenditures to TL 415 billion, and slightly mitigated by a 5.9% fall in interest expenditures to TL 45 billion. Non-interest expenditures showed for instance a 19.1% increase in compensation of employees during the first ten months of 2016 to TL 126 billion, an 21.2% expansion in current transfers to TL 183 billion, a 17.4% surge in goods and services purchases to TL 38 billion, a 1.4% rise in capital expenditures to TL 34.4 billion, a 25.2% drop in capital transfers to TL 5 billion, a 18.8% growth in social security contributions to TL 21 billion and a 12.4% decrease in lending to TL 9 billion. Interest expenditures showed a 7.5% decrease in domestic interest during the first ten months of 2016 to TL 33 billion, a 9.6% surge in foreign debt interest to TL 10.4 billion, and a drop in interest of discount and short term cash operation to reach TL 1.7 billion.

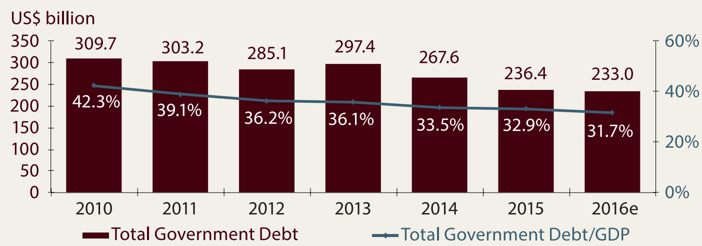
That being said, the central government deficit (on a cash basis) reached circa TL 14 billion over the first ten months of 2016 as compared to a deficit of TL 7 billion during the same period of 2015, mainly driven

FISCAL DEFICIT



Sources: IMF, Bank Audi's Group Research Department

PUBLIC INDEBTEDNESS



Sources: IMF, Bank Audi's Group Research Department by a growth in tax revenues, accounting for 81.5% of central government revenues. When excluding debt service, a primary surplus of TL 32.4 billion was recorded over the first ten months of 2016 as compared to a surplus of TL 41.2 billion over the corresponding period of 2015. According to the IMF, the General government budget deficit is projected to increase to 1.9% of GDP in full-year 2016, up from 1.1% in 2015.

In parallel, the central government debt stock reached TL 725 billion at end-October 2016 as per latest figures released by the "Prime Ministry Undersecretariat of Treasury", up from TL 678 billion in 2015, and is split into TL 465 billion in domestic debt (accounting for circa 64% of the total) and TL 260 billion in external debt (accounting for the remaining 36%). The interest composition of the total debt stock shows that the fixed rate debt captured 69.1% of the total at end-October 2016, while the floating rate debt accounted for 16.2% of the total, and the CPI indexed debt 14.7% of it. Besides, it is worth mentioning that 81.2% of domestic debt is held by residents, while 18.8% is held by non-residents. That being said, the government debt stock is estimated by the IMF to reach 31.7% of GDP in 2016, compared to 32.9% of GDP in 2015, one of the low debt ratios around the world.

1.4. FINANCIAL SECTOR

1.4.1. Monetary Situation

First increase in policy rates in three years amid extended falls in Turkish lira

Turkey's monetary conditions were marked in 2016 by sharp losses in the value of the Turkish lira, a first-time increase in policy rates in nearly three years and a sustained high consumer price inflation standing well above the official medium-term target of 5%, along with plans to achieve a single rate monetary policy.

In details, the Turkish lira has depreciated by 17.2% over the first eleven months of 2016, moving from TL/US$ 2.92 at end-2015 to TL/US$ 3.42 at end-November 2016, amid domestic political concerns, sovereign rating cuts by international rating agencies, and fueled expectations of an interest rate hike by the US Federal Reserve in December 2016 following the US Presidential elections that raised bets about a new era of US tax cuts and US government spending. Within this context, it is worth mentioning that the Turkish lira has depreciated significantly by 10.5% during the month of November 2016 amid a wide currency sell-off in emerging markets following the US Presidential elections.

The exchange-rate weakness quickly feeds through into inflation by raising the domestic prices of motor fuels and other goods that are imported or contain imported components. Also, the complex monetary framework, with multiple interest rates, helped a high pass-through of exchange rate depreciation into headline inflation. That being said, the Consumer Price Index rose by 7.8% on average during the first ten months of 2016 after averaging 7.7% in 2015, as per the CBRT, and is expected to average 8.4% in 2016, according to IMF estimates.

Amid this currency sell-off environment and the persistent high inflation rate, the Central Bank of the Republic of Turkey raised in November 2016 its policy rates for the first time in nearly three years, in an attempt to contain inflation and stem a currency sell-off sparked by fueled expectations of a US interest rate hike.

In details, the Central Bank of the Republic of Turkey raised the one-week repurchase rate by 50 basis points on November 25, 2016 to reach 8.00%, as compared to a rate of 7.50% in February 2015, noting that this is the first time the CBRT lifts its one-week repo rate since January 29, 2014. Also, the CBRT raised on November 25, 2016 its overnight lending rate for the first time in nearly three years, moving by 25 basis points to reach 8.50%. This followed seven consecutive rate cuts over the March-September 2016 period for a total of 250 basis points and compared to an overnight lending rate of 10.75% in February 2015.

Within this context, it is worth highlighting that the CBRT has been slashing the overnight lending rate since March 2016 as it embarked on simplifying the monetary policy framework, a process that involves the shift from the current wide "interest rate corridor" to a single interest rate policy. The aim is to ensure funding via a single rate, bringing short-term market rates closer to the CBRT funding rate.

Despite weakening Turkish lira, the CBRT's gross foreign exchange reserves managed to grow by 9.4% over the first ten months of 2016 to reach US$ 101.6 billion at end-October 2016, mainly owing to the strong net capital inflows in the early months of 2016 amid less hawkish expectations of US interest rate rises, and supported by international bond sales.

In the upcoming period, the monetary policy stance would continue to depend on the inflation outlook. The CBRT would maintain its cautious monetary policy stance by taking into account the developments regarding the pricing behavior and inflation expectations, especially that the latest exchange rate movements due to the recently heightened global uncertainty and volatility pose upside risks on the inflation outlook.

1.4.2. Banking Activity

Resilient activity amidst domestic political tensions coupled with overall adequate financial standing

The Turkish banking sector pulled out a satisfactory activity growth during the first nine months of this year despite a tough operating environment marked by local currency depreciation and political uncertainties especially following the failed coup attempt during the summer period. Measured by total assets of banks operating in the country, sector activity grew by 7.5% in local currency terms (+4.1% in US dollar terms) in the first nine months of 2016 to reach the equivalent of US$ 846.4 billion at end-September.

A look at the asset breakdown over the covered period reveals that the bulk of activity growth was by far driven by lending activity. The latter accounted for close to 71% of total activity growth in this year's first nine months. As a matter of fact, total sector loans progressed by 8.4% in local currency terms (+5.0% in US dollar terms) to reach the equivalent of US$ 538.2 billion at end-September 2016.

The surge in lending activity was primarily driven by rising exposure to construction, wholesale and retail, and utilities sectors. From a currency angle, rising lending activity was attributed to local currency lending to the extent of 60% and to foreign currencies to the extent of 40%. It is yet important to note that loan growth actually declined by 48% relative to that of 9M2015, with the coup attempt in the summer somewhat curbing banks' appetite for new loans.

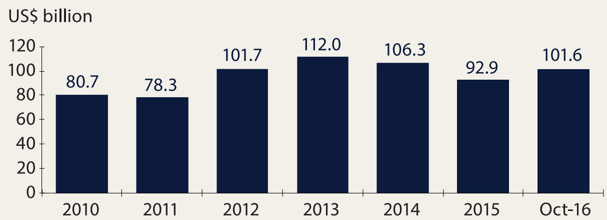
More recently, and in the aftermath of the failed coup, Turkish authorities decided to lend up to TL 17 billion (around US$ 5 billion) to small and medium-sized companies through the Credit Guarantee Fund Facility. There are measures that the authorities will take amid the recent FX fluctuation, and administrative measures include making SMEs have easier access to credit. Bank credit is also likely to receive a further boost after some large banks recently cut lending rates to consumers and small businesses for a second time in three months after the President called on lenders to ease borrowing costs to foster economic growth in the country.

MONETARY SITUATION

Flows in US$ million	2010	2011	2012	2013	2014	2015	9M-16
Net foreign assets	**-25,493**	**-2,341**	**6,649**	**-25,739**	**-16,026**	**-4,681**	**8,980**
Foreign assets	-93	7,123	28,861	11,888	-4,318	-13,448	11,536
Foreign liabilities	-25,399	-9,464	-22,211	-37,626	-11,708	8,767	-2,556
Domestic Assets	**93,155**	**-26,520**	**94,369**	**22,228**	**41,881**	**-35,585**	**27,911**
Claims on private sector	84,676	26,540	91,188	46,689	44,265	-21,705	28,597
Claims on public sector	4,304	-49,055	-563	-24,558	-3,997	-12,765	-641
Claims on non-bank financial institutions	4,175	-4,005	3,744	97	1,614	-1,115	-45
Total Money Supply	**67,662**	**-28,861**	**101,018**	**-3,533**	**25,878**	**-40,266**	**36,891**
Money Supply (M1)	15,099	-6,572	10,383	6,080	2,301	-5,155	10,950
Quasi-Money	43,183	-17,745	61,002	-4,927	11,254	-28,822	18,865
Other Items (Net)	9,380	-4,544	29,633	-4,686	12,323	-6,289	7,076

Sources: Central Bank of Turkey, Bank Audi's Group Research Department

CENTRAL BANK RESERVES



Sources: Central Bank of Turkey, Bank Audi's Group Research Department

The rise in loans extended by Turkish banks was to a large extent the result of growing liquidity in the sector. As a matter of fact, total deposits grew by 7.7% in local currency terms (+4.3% in US dollar terms) in the first nine months of 2016 to reach the equivalent of US$ 448.1 billion at end-September.

It is worth reporting that the banking sector operated quite smoothly through the coup attempt and deposit outflows at the time were minimal. It is just that deposit growth slowed down since and when compared to the first nine months of 2015, deposit growth (in local currency terms) proved 56% lower in 9M2016. Following the coup, FX deposits slightly shrank since June and local currency deposits lead total deposit growth. The bulk of deposit growth (about 92%) was attributed to resident deposits.

With external borrowing on international money markets accounting for a larger share in total banks' balance sheets than a few years ago at the detriment of total deposits amidst rather sluggish domestic savings growth, refinancing risks at maturity have risen, given that short-term borrowing makes up the bulk of external funding and remains subject to swings in investor sentiment. Such refinancing risks have come to the fore anew now that the US is on the verge of raising rates again and likely to adopt pro-growth policies under the new Administration, which is likely to warrant higher US interest rates and thus impact emerging markets at large.

With loans rising slightly faster than deposits, banks' liquidity has been under some pressure as the loan-to-deposit ratio reached a high level of 120% at end-September, which is higher than most emerging market peers. However, banks' liquidity position is on the overall satisfactory as core liquidity (which we measure as cash and required reserves and receivables from the Central Bank) represents close to 23% of total deposits and remains pretty much in line with international benchmarks.

Along the same lines, asset quality remains solid, despite having slightly deteriorated lately on account of weaker economic activity, foreign exchange rate volatility and a series of terrorist attacks that have left their imprints on bad loans notably in the tourism and energy industries. In fact, Turkish regulator statistics show that the banking sector's non-performing loans to total cash loans ratio rose from 3.09% at end-December 2015 to 3.31% at end-September 2016, though remaining much lower than emerging market and global benchmarks. In parallel, those NPLs remain adequately provisioned. The provisions for NPLs to gross NPLs ratio is in line with global averages and reached 76.4% at end-September 2016 (74.6% at end-December 2015).

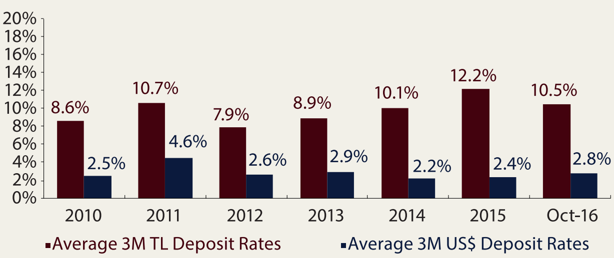
Capital adequacy of Turkish banks is comfortable as well, with the sector-wide capital adequacy ratio reaching 16.0% at end-September 2016. Core capital represents more than 86% of total capital, and the core capital ratio stood at almost 14%, shielding banks in Turkey should pressures on their capital base arise.

BANKING SECTOR INDICATORS

in US$ billion	2010	2011	2012	2013	2014	2015	Sep-16
Banking Activity							
Assets	656.5	648.1	773.4	814.4	859.8	813.4	846.4
Deposits	402.4	370.3	435.7	444.6	454.3	429.8	448.1
Credit facilities	343.1	363.5	448.4	492.4	535.5	512.3	538.2
Shareholders' equity	87.7	76.9	102.6	91.1	99.9	90.5	97.7
YTD Growth rates							
Assets	17.2%	-1.3%	19.3%	5.3%	5.6%	-5.4%	4.1%
Deposits	16.4%	-8.0%	17.7%	2.0%	2.2%	-5.4%	4.3%
Credit Facilities	30.1%	5.9%	23.4%	9.8%	8.8%	-4.3%	5.0%
Shareholders' equity	17.9%	-12.3%	33.4%	-11.2%	9.7%	-9.4%	8.0%

Sources: BRSA, Bank Audi's Group Research Department

BANKING SECTOR DEPOSIT RATES



Sources: Central Bank of Turkey, Bank Audi's Group Research Department

Last but not least, the positive quantity effect generated by growing lending activity during the year favored an 18.9% yearly surge in net interest income (in local currency terms) over the first nine months of 2016. Also, interest margins slightly improved on a yearly basis in the first nine months of 2016, with net interest income growth outpacing average asset growth. This, coupled with an 11.7% rise in non-interest income, outpaced a mild 3.0% increase in total expenses and contributed to a 54.1% growth in banks' net profits over the covered period (+39% in US dollar terms). Consequently, return ratios ameliorated, with the annualized return on average assets ratio at close to 1.6% in the first nine months of 2016 and the annualized return on average equity ratio reaching around 14% over the covered period.

1.4.3. Equity and Bond Markets

Small equity price gains along with extended declines in bond prices

Turkish equities managed to post small gains over the year 2016 despite heightened domestic and geopolitical concerns and the increased market volatility following the US Presidential elections, mainly supported by favorable market valuations. However, Turkish bonds continued to register price drops over this year, mainly suppressed by credit rating cuts and following US Treasuries move, along with continuous expansions in Turkey's five-year CDS spreads.

In details, Borsa Istanbul moved to a positive territory during the first eleven months of 2016 despite geopolitical concerns, Brexit concerns in June, the July failed coup attempt and the increased market volatility over the month of November following the US Presidential elections that fueled bets about a US interest rate hike and curbed demand for risk. The BIST 100, which represents the 100 largest companies by market capitalization, closed at 73,995.2 at end-November 2016, up by 3.2% since year-end 2015, despite sharp price falls observed in November 2016. Equity price increases were supported by relatively attractive market pricing ratios, as the Borsa traded at a P/E of 9.63x at end-November 2016, down from a P/E of 14x at end-2015.

The market capitalization dropped from US$ 190.2 billion at end-2015 to US$ 168.4 billion at end-November 2016, down by 11.4%. The total number of contracts reached 99.5 million during the first eleven months of 2016, up from 88.3 million during the corresponding period of 2015. The total trading value decreased from US$ 350.9 billion during the first eleven months of 2015 to US$ 316.7 billion during the corresponding period of 2016, moving down by 9.7%. The turnover ratio, measured by the annualized total trading value to market capitalization, reached 205.2% during the first eleven months of 2016, up from 193.0% during the corresponding period of 2015.

At the level of the bond market, Turkish bond prices continued to follow a downward trajectory over the year 2016, driven by domestic political concerns, the July coup attempt, escalated geopolitical risks, rating cuts by international rating agencies and heightened speculation over US Fed interest rate hike following the US Presidential elections. Foreign investors remained net sellers of Turkish bonds over the first eleven months of 2016, yet at a slower pace relative to the previous year. This was reflected by a US$ 4.1 billion decline in their holdings, moving from US$ 31.7 billion at end-2015 to US$ 27.6 billion at towards the end of November 2016, and compared to a larger contraction of US$ 19.9 billion over the year 2015. Within this context, the 10-year Turkish lira Benchmark bond index yield rose from 10.74% at end-2015 to 11.13% at end-November 2016. Under these circumstances, the cost of insuring debt in Turkey expanded since year-end 2015, with the five-year CDS spreads moving from 274 basis points at end-2015 to 290 basis points at end-November 2016. This followed a wider expansion of 89 basis points in 2015.

Regarding credit rating changes, Standard & Poor's lowered in July 2016 its unsolicited foreign currency long-term and short-term sovereign credit ratings on the Republic of Turkey to "BB/B" from "BB+/B", yet revised early-November 2016 its outlook on the Republic of Turkey to "stable" from "negative". The outlook revision reflects S&P's view that policymakers would continue to move toward the implementation of key economic reforms, as originally communicated more than two years ago in Turkey's Tenth Development Plan 2014-2018, and that these efforts, although subject to risks, would help underpin economic stability, despite remaining domestic and external risks.

Also, Moody's downgraded in September 2016 the Government of Turkey's long-term issuer and senior unsecured bond ratings to "Ba1" from "Baa3" and assigned a "stable" outlook. The drivers of the downgrade are tied to the increase in the risks related to the country's sizeable external funding requirements and the weakening of previously supportive credit fundamentals, particularly growth and institutional strength. The "stable" outlook balances downside risks arising from the erosion of Turkey's economic resilience and increasing balance of payments pressures against credit-positive considerations arising from its large and flexible economy which continues to register positive growth and the government's strong fiscal track record.

As to new issues, Turkey raised US$ 4.5 billion during the first eleven months of 2016 through the issuance of a US$ 1.5 billion Eurobond maturing in 2026 at a coupon of 4.875%, a US$ 1.5 billion Eurobond maturing in 2045 at a coupon of 6.625%, and a US$ 1.5 billion Eurobond maturing in 2026 at a coupon of 4.875%. This is an addition to a US$ 1 billion 5-year Sukuk issued at 290 basis points over midswaps.

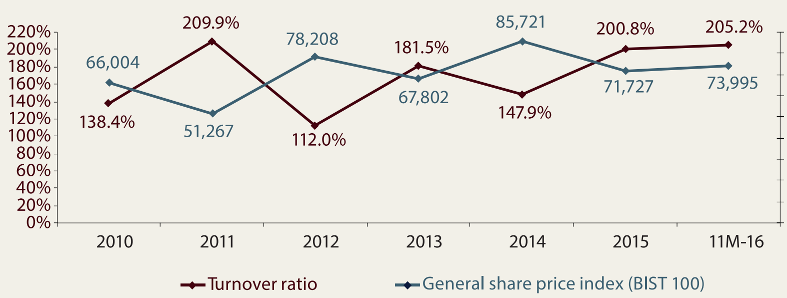
Within this context, it is worth mentioning that the Turkish government filed in November 2016 paperwork with US securities regulators to issue as much as US$ 8 billion of debt in the country, increasing the size of a shelf filing with the Securities and Exchange Commission. Turkey said it planned to use any proceeds from the future bond sale for general financing purposes, which could include the repayment of its debt.

SELECTED STOCK MARKET INDICATORS

	2010	2011	2012	2013	2014	2015	11M-16
Market capitalization (in US$ billion)	307.6	201.9	311.2	237.6	269.8	190.2	168.4
Market capitalization/GDP	42.0%	26.1%	39.5%	28.9%	33.8%	26.5%	22.9%
Trading value (in US$ billion)	425.7	423.9	348.6	431.3	399.1	381.7	316.7
Traded volume (in millions)	204,083	202,149	174,290	198,858	207,100	214,061	214,180
Number of contracts (000s)	81,457	102,855	79,808	80,298	83,640	97,300	99,462
Change in BIST 100 price index	24.9%	-22.3%	52.6%	-13.3%	26.4%	-16.3%	3.2%
Price/Earnings ratio	13.29	11.88	12.51	10.22	14.38	13.99	9.63
Dividend Yield (%)	1.79	2.57	1.73	2.27	1.54	2.84	2.42

Sources: Borsa Istanbul, Bank Audi's Group Research Department

STOCK MARKET PERFORMANCE



Sources: Borsa Istanbul, Bank Audi's Group Research Department

2. CONCLUDING REMARKS

The recent military coup attempt and its aftermath have moved Turkey's external financing vulnerabilities relatively higher on the list of investor concerns. Turkey's external imbalances are among the highest in emerging markets, with a negative Net International Investment Position (External assets minus external debt) of over 50% of GDP, and a net open FX position in the non-financial corporate sector of US$ 192 billion. Gross external debt stands today at US$ 421 billion, increasing nearly four-fold since 2001, driven by the private sector, though mostly long term (74%) with average maturity of 4 years for private debt and 9 years for public debt. Gross external financing needs are estimated at US$ 200 billion, or 28% of GDP, for the next 12 months. This does not include foreign investors' portfolios in local bonds (US$ 36 billion, 19% of the total), Turkey's sovereign bonds (US$ 40 billion, or 65% of the total), equities (US$ 42 billion, 63% of the total) and over and above US$ 45 billion of outstanding bank and corporate eurobonds, which add to the risk of flow reversal.

Within this environment, Turkey saw some adverse developments, reflected in rating downgrades, namely at the level of S&P and Moody's (to below investment grade rating), while Fitch sustains its investment grade rating. Many of the world's biggest funds require investment-grade ratings from two of the three major ratings companies - Fitch, Moody's and S&P - to consider an asset for investment.

Having said that, while there are undoubtedly some adverse developments at the economic level, we yet believe there is no major deterioratation in fundamentals post coup. As a matter of fact, there are five considerations why we believe there will be no major deterioration in macro conditions post-coup.

First, Turkey is a very agile country and well used to recover from such catastrophic events. Despite all negative developments over the past years, Turkey has decoupled positively from its EM peers in terms of macro performance, especially in terms of economic growth. It is worth mentioning that Turkey was the fourth fastest growing economy of the G20 group of nations in the first half of 2016. The survey of 41 economists based in and outside Turkey, taken by Reuters, predicted the economy would grow 3.5% this year and next. Major global institutions estimate that there will be 1% of growth foregone because of the coup attempt but given the significant growth of the first half, they maintain a sound full-year growth forecast for 2016.

Second, while foreign demand is adversely affected (tourists, portfolio inflows, FDI), domestic demand that represents 80% of GDP continues to be resilient, mainly domestic consumption, knowing that domestic consumption was still very strong in the first half of 2016 despite big terrorist events. This year, a hike in minimum wages, the positive terms-of-trade from low oil prices, and demand from 2 million-plus refugees living in Turkey, have all contributed to robust consumption growth. Despite the series of terrorist attacks, Turkey's consumer confidence index over the first six months of 2016 reported an average of 68.6, improving tangibly by 4% from the 66.0 reported over the first six months of 2015.

Third, the global financial environment has been quite supportive throughout the past year thanks to the reported delay during 2016 in US interest hike expectations, helping Turkey relatively.

Fourth, there might be some expansionary fiscal policies on behalf of the government, but this is actually affordable in a country that has 1.9% of public deficit to GDP ratio and a public debt ratio of 30% of GDP.

Fifth, the 12-month cumulative current account deficit, the main vulnerability for Turkey, fell to below US$ 30 billion, its lowest level since 2009. The current account deficit which had reached its peak in 2011 of US$ 75 billion, has witnessed a gradual improvement since then within the context of currency depreciation contracting imports and enhancing exports, in addition to the effects of low oil prices.

All these considerations do not mean that recent developments do not entail risk factors, namely rating downgrades, deterioration in capital inflows and further tourism sector suffering but financial and macro implications are mostly manageable. In sum, the Turkish economy had strong fundamentals pre-coup which would not be shaken drastically in its aftermath.

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