Bank Audi

TURKEY ECONOMIC REPORT

NOVEMBER 2024

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POLICY TURNAROUND REDUCING ECONOMIC IMBALANCES AND REVIVING CONFIDENCE

Shift in economic policies tightening overall policy stance

A decisive shift in economic policies over the past year has tightened Turkey's overall policy stance. The Central Bank of the Republic of Turkey (CBRT) has brought the ex ante real policy rate into positive territory while reducing regulatory complexity. Tax and expenditure measures underpin efforts to restore fiscal prudence and the commitment to stronger incomes policies has strengthened credibility. The policy turnaround has reduced economic imbalances and revived confidence as stated by the IMF. Headline inflation has fallen as tighter financial conditions are weighing on domestic demand. Market sentiment has sharply improved, with domestic and foreign investors shifting into lira-denominated assets while lower commodity prices, buoyant exports, and reduced gold imports have strengthened the current account, supporting a large improvement in both the gross and net reserves position.

Turkey's BoP standing improving albeit remaining in deficit

During the first nine months of 2024, Turkey's balance of payments (BoP) standing has improved vis-à-vis figures from the same period of 2023 albeit remaining in a deficit. This comes primarily amid a tightening deficit in the Balance of Goods during the period. Looking at Turkey's Current Account, a deficit of US$ 5.3 billion is recorded for the first nine months (9M) of 2024. This figure denotes a significant tightening of 85.3% year-on-year in Current Account deficit against the same period of the year prior.

Widening fiscal deficit this year on earthquake relief spending and large minimum wage hike

Turkey's central government budget deficit widened significantly in US$ terms in 2024, the latter considered the main year for earthquake reconstruction. This came along efforts to increase the efficiency and fairness of the tax system, broaden the tax base, and reduce tax evasion and informality. That being said, the central government budget deficit (on a cash basis) more than tripled over the first nine months of 2024, reaching circa TL 1,479 billion (US$ 45.9 billion), compared to a deficit of TL 461 billion (US$ 21.3 billion) during the same period of 2023.

Disinflation stays on track after a return to Orthodox monetary policy

The policy turnaround in Turkey with a decisive monetary policy tightening since May 2023 presidential elections, supported disinflation efforts, while concomitantly strengthening gross foreign exchange reserves, and allowing a further correction in currency overvaluation. Nine large interest rate hikes were delivered since June 2023 amid a commitment to bringing down the underlying trend of monthly inflation through moderation in domestic demand, real appreciation in Turkish lira, and improvement in inflation expectations. This took the benchmark one-week Repo Rate from 8.50% at end-May 2023 to an unprecedented high level of 50.0% in March 2024, and remained constant since then.

Better than expected banking industry trends in 2024

The Turkish banking sector recorded better than expected trends in 2024. Total deposit growth was circa 33% yoy, as per the latest weekly data for Aug 2024, with TL deposit growth of circa 43% year-on-year. Foreign currency (FC) deposits grew circa 20% year-on-year. The overall banking sector TL loan-to-deposit ratio is down circa 5 percentage points since Dec-2023 end, and has declined circa 9 percentage points yoy to 84%, while the FC loan-to-deposit ratio has increased circa 18 pp yoy to 81%. Total loan growth was circa 38% yoy, as per the latest weekly data for Aug 2024. TL loan growth came in at circa 29% yoy, while FC loan growth came in at circa 55% year-on-year. According to the latest CBRT data, marginal TL lending rates for commercial and consumer local currency loans stood at circa 60.3% and 74.1%, respectively, in August, while the weighted average cost of TL deposits stood at circa 55.3%.

IMF sees growth slowing down in 2024 and 2025 and recovering in the medium term

After a strong first quarter this year, growth has weakened and is expected to fall to 3% in 2024 and 2.7% in 2025, recovering toward 4% in the medium term. A deceleration of private consumption, which currently makes up just under 60% of GDP, will play the central role in cooling down the Turkish economy. Real GDP growth will ease going forward as tighter credit conditions and lower labor demand pass through into softer demand, only partly offset by stronger exports of goods and services. A gradual recovery is expected to take hold from 2026. Risks around the baseline are significant and tilted to the downside. They include stronger-than-expected wage and price inertia, a reversal of capital flows, higher global energy prices, and escalating geopolitical tensions at large.

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A decisive shift in economic policies over the past year has tightened Turkey's overall policy stance. The Central Bank of the Republic of Turkey (CBRT) has brought the ex ante real policy rate into positive territory while reducing regulatory complexity. Tax and expenditure measures underpin efforts to restore fiscal prudence and the commitment to stronger incomes policies has strengthened credibility.

The policy turnaround has reduced economic imbalances and revived confidence as stated by the IMF in its just released Article IV report. Headline inflation has fallen as tighter financial conditions are weighing on domestic demand. Market sentiment has sharply improved, with domestic and foreign investors shifting into lira-denominated assets while lower commodity prices, buoyant exports, and reduced gold imports have strengthened the current account, supporting a large improvement in both the gross and net reserves position. The financial and corporate sectors appear to have weathered the policy tightening and financial liberalization so far. Credit default swaps (CDS) spreads are now at about half their mid-2023 levels.

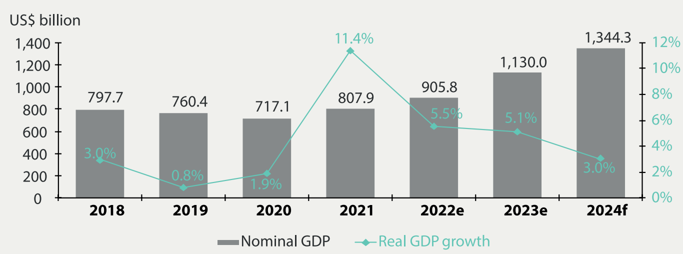
In fact, the Central Bank of the Republic of Turkey's (CBRT's) tight monetary stance has enabled Turkish authorities to stabilize the lira, bring down inflation, rebuild reserves, and de-dollarize the financial system. Turkey's savings gap with the rest of the world has narrowed, which is visible in the approximately 4% of GDP decline in the current account deficit since 2022.

Within this context, S&P has raised its long-term rating on Turkey to 'BB-' from 'B+' and affirmed the 'B' short-term rating, as well as raised the national scale ratings to 'trAA+/trA-1+' from 'trAA-/trA-1+'. The outlook is stable to reflect balanced risks over the next 12 months to authorities' ambitious plans to bring down still elevated inflation, manage workers' wage expectations, and rebalance the Turkish economy. Likewise, Fitch Ratings has upgraded Turkiye's Long-Term Foreign-Currency Issuer Default Rating (IDR) to 'BB-' from 'B+'. Last but not least, Moody's Ratings (Moody's) has upgraded Government of Turkey's long-term foreign- and domestic-currency issuer and foreign-currency senior unsecured ratings to B1 from B3, while the outlook remains positive.

At the financial sector level, improved external financing conditions have lead to an increase in external borrowing by companies and banks. At the same time, domestic credit growth is not keeping up with inflation, and private investment remains stagnant, although there has been a rise in foreign currency borrowing by Turkish companies from domestic banks, reflecting the large gap between local currency and foreign currency interest rates.

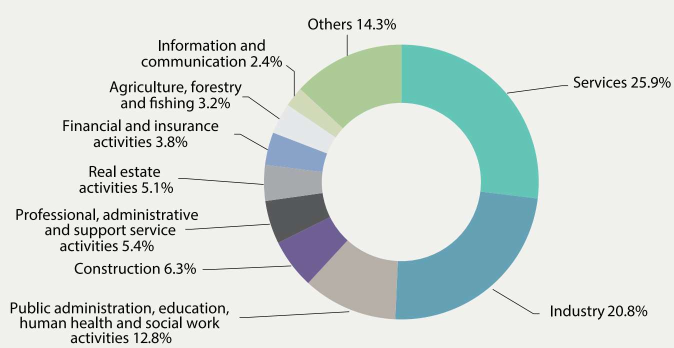
Despite major tightening since mid-2023, fiscal policy this year is projected to be stimulative. In the first half of 2023, a large increase in the wage bill, pensions, and subsidies raised spending by over 3 percent of GDP. In mid-year, VAT rates, special consumption taxes on petroleum and motor vehicles, and CIT rates were increased, adding around 2¼ percent of GDP to fiscal revenue (on an annualized basis). Together with earthquake recovery spending of 1% of GDP, this implied an annual cash stimulus of around 0.7% of GDP. In 2024, the authorities tightened other current and non-earthquake capital expenditure; in

GROSS DOMESTIC PRODUCT PERFORMANCE



Sources: IMF, Bank Audi's Group Research Department

BREAKDOWN OF GDP BY SECTOR (H1 2024)



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

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August introduced minimum corporate taxation; and in July began to reduce energy subsidies—together amounting to net savings of around 0.5% of GDP. However, with a wage bill of 7.2% of GDP—a 10–year high—and continued earthquake spending, fiscal policies will remain stimulative as per IMF.

At the capital markets level, the stock market witnessed a flourishing performance this year, with a 19% year-to-date rise in the BIST 100 price index, raising market capitalization from US$ 341 billion at end-2023 to US$ 358 billion at end-October 2024, and leading to a 4-year high for the Price to Earnings ratio at 9.63 by end-October. The rise in prices was accompanied by active trading volumes. The latter reported 1,509 billion shares in the first ten months of 2023, (approaching the 1,745 billion shares in full-year 2023 and 1,644 billion shares in full-year 2022) and exceeding the total of 2021 (1,203 billion shares). Likewise, the fixed income market witnessed improved risk perception, with the CDS spread, declining from 510 basis points at end-2022 to 283 basis points at end-2023 and to 268 basis points at end-October 2024.

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, financial and monetary conditions looking ahead.

1. ECONOMIC CONDITIONS

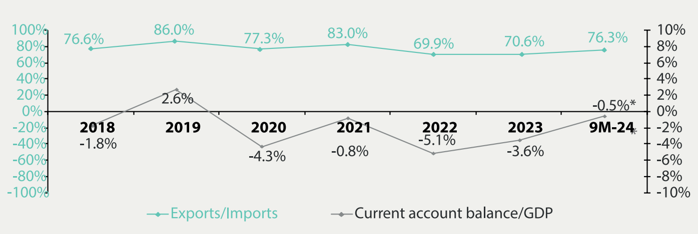
1.1. REAL SECTOR

1.1.1. Agriculture

Primary sector continues its growth driven by favorable weather conditions

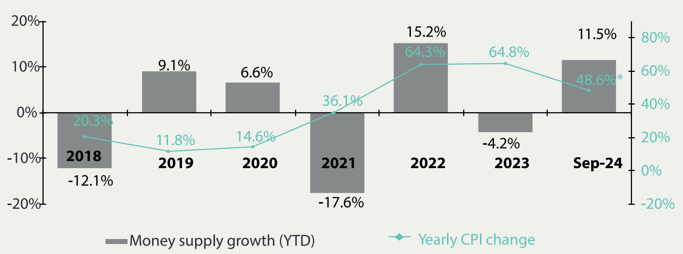
Despite Turkey's February 2023 earthquake and drought conditions over 2022-2023, which have caused disruptions in agricultural activities and supply chains, including crop planting and production, the agricultural sector managed to report a real growth of 0.2% in 2023, against a higher growth of 1.3% in real terms in 2022. In parallel, the share of the sector in the country's GDP stood at 6.2% in 2023, compared to 6.5% in 2022.

FOREIGN SECTOR INDICATORS



Sources: Central Bank of Turkey, Turkstat, IMF, Bank Audi's Group Research Department
*Nine-month figures annualized as a percentage of GDP

MONEY SUPPLY GROWTH AND INFLATION



* As at end-October

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

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At the level of crop production, the latter continued its upward trajectory in 2023, expanding 6.4% year-on-year in 2023.

In details, total cereals and other crops increased by 10.5% year-on-year in 2023 to stand at 78,995 thousand tons, according to TurkStat. A closer look at sub-categories shows that the largest expansion in 2023 was in sugar beets production (23.7%), followed by cereals (9.1%), potatoes and dried legumineus (7.7%) and tobacco (4.0%). In contrast, raw materials used in textiles reported a drop of 23.6%, followed by oil seed (-12.8%) and plants for perfumery and pharmacy (-2.2%).

Al the level of total fruits, nuts and spices crops reported an annual rise of 2.1% in 2023. In parallel, for vegetables and other crops, production went up by 0.6% in 2023 when compared to the previous year, as per TurkStat.

All in all, the production displayed a steady growth in 2023. However, the ongoing depreciation of the Turkish lira against the US dollar is exerting upward pressure on overall farm production costs in the country. This, combined with the country's reliance on imported feed, which makes up roughly 80% of total farm expenditures and challenges in forage production, could complicate the business environment of the agricultural sector.

Further expansion in production is expected in 2024, mainly driven by favorable weather conditions and higher yields. Moreover, the government's payment supports for fertilizers and fuel, and initiatives from non-governmental organizations would assist in the recovery and stability of grain planting and harvesting in 2024, as per Fitch Solutions.

Within this context, the latest figures released by TurkStat showed that Turkey's agriculture sector saw a 4.2% real growth in the first half of 2024, against a contraction of 1.5% in real terms in the first half of 2023. In parallel, the share of the sector in the country's GDP stood at 3.2% in the first half of 2024, compared to 3.5% in the first half of 2023.

That being said, the Ministry of Agriculture and Forestry unveiled that fruits, beverage and spices crops are estimated to grow by 3.5%, when compared with the previous year, along with vegetables production that are forecasted to rise by 6.0%, while production quantities of cereals and other crops are expected to decrease by 5.2% in 2024.

CROP PRODUCTION IN 2023 (CEREALS, VEGETABLES AND FRUITS)

000s tons	Volume	Share		Volume	Share		Volume	Share
Cereals	**42,199**	**53%**	**Vegetables**	**25,189**	**79%**	**Fruits**	**19,342**	**71%**
o.w. Wheat	22,000	28%	o.w. Tomatoes	13,300	42%	o.w. Citrus fruits	7,878	29%
o.w. Barley	9,000	11%	o.w. Watermelon	3,148	10%	o.w. Pome fruits	5,329	19%
o.w. Maize	9,200	12%	o.w. Cucumber	1,872	6%	o.w. Stone fruits	3,165	12%
Sugar beets	**23,500**	**30%**	o.w. Melon	1,403	4%	o.w. Bananas, Kiwis, Avocado, Figs	1,415	5%
Potatoes, dried legumineus	**7,011**	**9%**	o.w. Pepper (green)	939	3%	o.w. Other fruits	1,555	6%
Oil seeds	**2,704**	**3%**	**Bulb and root vegetables**	**4,079**	**13%**	**Grapes**	**3,400**	**12%**
Dry pulses	**1,309**	**2%**	o.w. Dry onion	2,600	8%	**Olive production**	**1,520**	**6%**
Raw materials used in textiles	**2,100**	**3%**	o.w. Carrots	778	2%	**Tea production**	**1,360**	**5%**
Plants for perfumery, pharmacy	**86**	**0%**	**Other vegetables**	**2,519**	**8%**	**Nuts**	**1,427**	**5%**
Tobacco	**86**	**0%**	o.w. Leafy or edible stem vegetables	2,080	7%	**Spices crops**	**342**	**1%**
Total Cereals and other crops*	**78,995**	**100%**	**Total Vegetables & other crops**	**31,788**	**100%**	**Total Fruits, nuts & spices crops**	**27,391**	**100%**

**Excluding fodder crops*

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

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1.1.2. Industry

Turkey's industrial sector amid contractionary mode on the back of economic and monetary challenges

Turkey's industrial sector, which accounts for around one-fifth of GDP, entered into a contractionary mode in 2024, amidst a further weakening in the Turkish lira and lingering economic challenges.

Turkey's Industrial Production Index (IPI), which measures the amount of output from the manufacturing, mining, electric and gas industries, reported a yearly average contraction of 0.3% during the first nine months of 2024, against an average expansion of 1.4% in the same period of 2023, as per Turkstat, as inflationary pressures caused by the depreciation of the lira, and rising raw material prices globally, have amplified manufacturers' operating costs and reduced domestic sales.

Moving on to the manufacturing sector, which contributes to almost 18.0% of nominal GDP, latest figures showed that the Purchasing Managers' Index (PMI) for manufacturing stood at 45.8 in October 2024 compared to 48.4 in October 2023, dipping deeper below the 50-point line, which separates expansion and contraction. In fact, Turkish manufacturers continue to face challenging market conditions, leading to muted demand and further slowdowns in total new orders and exports, as per the latest PMI survey data. Within this context, stocks of purchases decreased in October 2024 to the largest extent since May 2020. Employment and purchasing activity were also scaled back in response to muted new orders, although in some cases firms reported that voluntary resignations had caused a drop in staffing levels.

Looking into Turkey's construction sector, which makes up 6.3% of GDP, the sector gained more momentum over this year. Construction activity reported a yearly expansion of 8.6% in real terms in the first half of 2024, against a growth of 5.9% in the first half of 2023. In fact, the government's propensity to utilize large-scale infrastructure projects to fuel economic activity provided a degree of upside for the sector's growth trajectory, as exemplified by the Canal Istanbul project and the 2053 Transport and Logistics Master Plan, noting that elevated construction input remains a material downside risk to the market.

In sum, industrial production growth has weakened over this year amid elevated costs and unfavorable macroeconomic environment, while Turkey's favorable position as a transit country and a gateway to Europe places it in good stead for attracting foreign investment for large-scale infrastructure projects, as per Fitch Solutions.

VEHICLES PRODUCTION

(unit)	2020	2021	2022	2023	23/22	10M-23	10M-24	10M/10M
Automobile	854,913	782,212	810,889	952,666	17.5%	779,328	742,303	-4.8%
Pick-up	358,182	399,949	436,588	396,971	-9.1%	329,592	288,712	-12.4%
Minibus	51,464	46,878	46,911	50,907	8.5%	44,555	48,781	9.5%
Tractor	38,103	55,503	49,541	57,570	16.2%	48,409	39,611	-18.2%
Truck	23,126	38,465	46,575	52,320	12.3%	44,232	32,019	-27.6%
Bus	7,893	5,517	8,342	10,861	30.2%	8,651	8,125	-6.1%
Midibus	2,043	2,153	3,335	4,664	39.9%	3,982	4,031	1.2%

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

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1.1.3. Trade and Services

Turkey's tertiary sector continues to recover in 2024 though weighed down by some macro weakness

Turkey's trade and services sector continued to recover in 2024. However, some components of the tertiary sector have slowed down their growths during the year driven by the weakness in some macroeconomic indicators. These weaknesses are weighing down on local consumption and spending trends, affecting the tertiary sector as a whole.

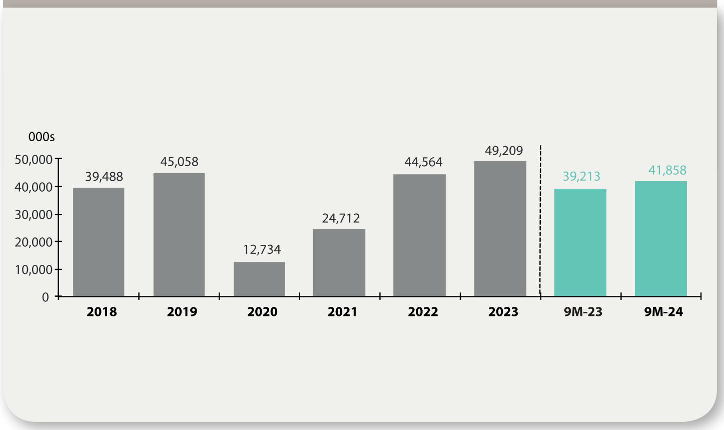
The tertiary sector had a share of 64.3% of nominal GDP in the first half of 2024. This figure denotes a 2.6 percentage point increase against the same period of 2023 showing net growth in the contribution of the sector to the economy, as per data from TURKSTAT.

Looking at Turkey's consumer outlook over the short term (2024-2025), Turkish household spending in real terms is expected to see a net slowdown in 2024 due to base effects, elevated inflation, a decline in social spending and ongoing challenges to the economy. Elevated inflation and unemployment, coupled with volatile currency exchange rates are expected to continue to mute consumer spending, with low- and middle-income households continuing to experience headwinds over 2024 and 2025. These factors have created economic pressures on both retailers and consumers. Disposable income per household in US$ is forecast to decrease by 8.4% year-on-year in 2024 to reach US$ 13,499 per household. These factors, while not majorly affecting the tertiary sector, are expected to weigh on the growth potential of some sub-sectors. However, looking ahead, between 2025 and 2028 this downwards trend is set to reverse with an average increase in disposable income of 4.7% per annum per household.

Looking at Turkey's telecommunications sector, the total number of mobile phone subscribers is expected to reach 95.0 million in 2024 showing a 3.0% increase against the year prior. A softening trend is expected over the medium term (2025-2029) at an average growth rate of 1.4% per annum. In parallel, a switch to post-paid is set to continue along with an increase in data usage and average revenue per user, as per FitchSolutions.

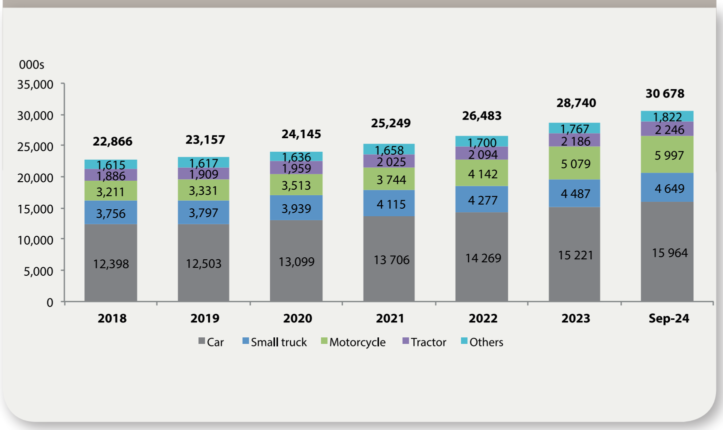
At the level of real estate, average rent per m2 per month in US$ is set to continue on a downward trend in both Ankara and Istanbul when looking at Office rental, Retail rental and Industrial rental. Additionally, Net Rental Yield rates in both cities are expected to stagnate in all the aforementioned types of rentals. Residential and non-residential building' industry value growth is expected to increase by 4.8% in 2024 following a 9.9% increase in 2023. The value of the aforementioned industry is also forecast to increase by an average of 4.4% per annum over the long term (2025-2033). Political and economic uncertainty is set to further dampen appetite for investments in commercial assets and the aftermath of the 2023 earthquake is estimated to continue affecting real estate. Additionally, real household spending in Turkiye is expected to contract in 2024, weighing on retail assets.

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

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At the level of tourism, the number of visitors arriving to Turkey has continued to recover even surpassing tourism levels noted pre-pandemic. In the first nine months of 2024, 49.2 million visitors arrived into Turkey, up from 45.2 million in the same period of 2023 recording an increase of 8.7%. The increase in the number of visitors has slowed down from levels seen in the year prior albeit surpassing pre-pandemic numbers (41.6 million visitors in the first nine months of 2019). Total arrivals into Turkey are expected to continue expanding at an average of 4.7% per annum in the medium term (2025-2028).

It is worth noting that 85.1% (41.9 million individuals) of all visitors into Turkey were foreigners in the first nine months of 2024, down by 1.6 percentage points from levels during the same period of 2023, as per data from Turkey's Ministry of Culture and Tourism (MoCT).

Tourism receipts also posted an amelioration of 6.6% in the first nine months of 2024 against the same period of 2023 to reach US$ 46.9 billion in the former. This increase follows an increase of 15.1% in the same period of 2023/2022.

It is worth mentioning that despite the Russia-Ukraine conflict, Russian tourists still represent a key source of arrivals for Turkey constituting around 13.1% of total foreign arrivals in the first nine months of 2024, as per data from Turkey's MoCT.

Looking at the hospitality subsector, the occupancy rate within Turkey's accommodation establishments reached 54.1% in the first nine months of 2024. At the level of occupancy rates in popular touristic provinces, Istanbul recorded an occupancy rate of 62.7%, Antalya an occupancy rate of 88.9% and Mugla an occupancy rate of 79.2% in September 2024.

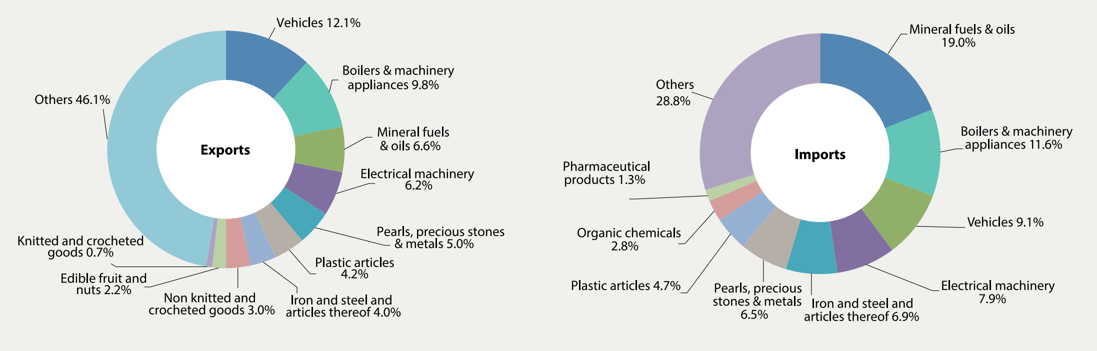
Finally, the economic confidence index in Turkey rose to 98.0 in October 2024, up from 96.5 in the same month of the year prior. At the level of the tertiary sector, the services confidence index increased by 0.6 points against levels registered in October 2023 to reach 114.2 in October 2024. Retail trade confidence decreased by 3.2 points against the same month of the year prior to reach 110.7 in October 2024. Consumer confidence and real sector confidence both recorded decreases as well in October 2024 against October 2023 of 15.9 points and 3.1 points respectively. Construction confidence decreased by 2.8 points during the period as well, as per TURKSTAT.

1.2. EXTERNAL SECTOR

Turkey's BoP standing improves albeit remaining in deficit

During the first nine months of 2024, Turkey's Balance of Payments (BoP) standing has improved vis-à-vis figures from the same period of 2023 albeit remaining in a deficit. This comes primarily amid a tightening deficit in the Balance of Goods during the period.

BREAKDOWN OF EXPORTS AND IMPORTS BY MAIN COMMODITIES (9M-24)



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

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Looking at Turkey's Current Account, a deficit of US$ 5.3 billion is recorded for the first nine months (9M) of 2024. This figure denotes a significant tightening of 85.3% year-on-year in Current Account deficit against the same period of the year prior.

In details, Turkey's Balance of Goods noted a 42.6% year-on-year improvement to reach a deficit of US$ 41.5 billion in the first nine months of 2024, up from a deficit of US$ 72.3 billion in the first nine months of 2023. Additionally, the Balance of Services also posted an improvement in its surplus between 9M 2023 and 9M 2024 by 7.0% year-on-year to reach US$ 47.7 billion. On the other hand, the deficit in Primary Income increased during the period by 30.7% year-on-year while the surplus in Secondary Income dropped by 99.6% year-on-year between 9M 2023 and 9M 2024.

In parallel, Turkey's Capital Account deficit shrunk significantly by 33.5% year-on-year to reach US$ 111 million in 9M 2024. Additionally, Turkey's Financial Account recorded a deficit of US$ 26.1 billion in 9M 2024, down from a deficit of US$ 44.6 billion in the same period of 2023. This entails a tightening of the deficit in the Financial Account by 41.5% year-on-year in the aforementioned period.

At the level of foreign trade for 9M 2024, Turkey's Balance of Trade (BoT) recorded a deficit of US$ 60.1 billion, down from a deficit of US$ 87.7 billion in the same period of 2023. This figure shows a significant tightening in the BoT's deficit by 31.5% year-on-year during the period. This improvement comes amid an increase in exports as well as a decrease in imports.

In details, Turkish exports reached US$ 192.8 billion over 9M 2024, showing a year-on-year increase of 3.2% up from US$ 186.9 billion in 9M 2023, as per the Turkish Ministry of Trade.

The breakdown of domestic exports by commodity shows that the main exports over 9M 2024 were vehicles (12.1% of total exports), boilers and machinery appliances (9.8%), mineral fuels, oils and products thereof (6.6%), electrical machinery, equipment and parts thereof (6.2%) and precious stones, metals, pearls and articles thereof (5.0%). The geographic distribution of domestic exports indicates that 7.9% of total exports went to Germany, followed by the United States of America with 6.1% United Kingdom with 5.8% of the total, Iraq with 4.9% of the total and Italy with 4.9% of total domestic exports over the same period.

In parallel, Turkish imports reported a significant decrease of 7.9% over 9M 2024 when compared to the same period of 2023, to reach US$ 252.9 billion. The breakdown of domestic imports by commodity shows that the main imports over 9M 2024 were mineral fuels and oils (19.0% of total imports), followed by boilers and machinery appliances (11.7%), vehicles (9.1%), electrical machinery (7.9%) and iron & steel (6.9%). The breakdown of imports by country of origin shows that most of the inward merchandise came from China with 13.1% of the totals, followed by Russia with 12.8%, Germany with 7.9%, Italy with 5.5% and USA with 4.9% of total imports over the same period.

The decrease in imports was mainly noted for mineral fuels and oils, fats & oils, iron & steel and precious stones. In details, imports of mineral fuels and oils decreased by 7.3% to reach US$ 48.0 billion in 9M 2024, down from US$ 51.8 billion in the same period of the year prior. The imports of iron & steel decreased by 8.9% to reach US$ 17.4 billion in 9M 2024, down from US$ 19.1 billion in the same period of the year prior. The import of precious stones noted a significant year-on-year decrease of 39.0% to reach US$ 16.3 billion in 9M 2024. Additionally, the import of fats & oils decreased by 13.0% to reach US$ 2.2 billion in 9M 2024, down from US$ 2.5 billion in the same period of the year prior.

Looking forward, as Turkey's national economy starts to stabilize and as the spread between interest earnings on local currency savings versus that on foreign currency savings widens, the demand for hedging and imports should weaken. This implies the full-year current account deficit should start to stabilize further and is estimated to drop below 2% of GDP for 2024, as per S&P Global.

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1.3. PUBLIC SECTOR

Widening fiscal deficit this year on earthquake relief spending and large minimum wage hike

Turkey's central government budget deficit widened significantly in US$ terms in 2024, the latter considered the main year for earthquake reconstruction, while remaining roughly stable in GDP terms. This came along efforts to increase the efficiency and fairness of the tax system, broaden the tax base, and reduce tax evasion and informality.

On the spending side, a growth of 81.1% in central government budget expenditures was recorded over the first nine months of 2024 compared to the same period of 2023, to reach TL 7,159 billion (US$ 221.89 billion), mainly driven by large wage hikes, continued earthquake spending and various subsidies. This is mainly explained by a 79.4% expansion in primary expenditures to reach TL 6,246 billion (US$ 193.60 billion), and as interest expenditures surged by 93.7% to hit TL 911 billion (US$ 28.25 billion), noting that the latter remain very sensitive to exchange rate developments given that around two thirds of sovereign debt is FX-denominated. A breakdown of primary expenditures shows a 68.7% yearly increase in current transfers to reach TL 2,740 billion, mainly reflecting earthquake spending, while compensation of employees grew by 108.8% year-on-year to reach TL 2,007 billion. In fact, Turkey's monthly minimum wage has been lifted by 49% in January 2024 from the level determined in July 2023 and by 100% hike from January 2023. Within this context, it is worth mentioning that the current transfers and compensation of employees accounted for 78.2% of the total year-on-year rise in primary expenditures over the first nine months of 2024. On another hand, interest expenditures showed a 142.3% increase in domestic interest payments during the first nine months of 2024 to TL 632 billion, as well as a 60.5% surge in foreign debt interest to TL 165 billion.

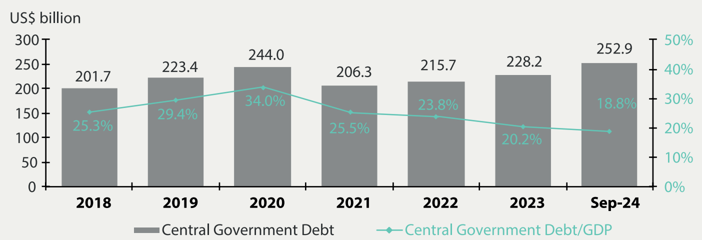
In parallel, the central government budget revenues witnessed a hike in growth of 76.9% during the first nine months of 2024 when compared to the same period of 2023 to reach a total of TL 6,085 billion (or US$ 188.60 billion), mainly driven by a 76.1% year-on-year increase in general budget revenues to TL 5,927 billion (US$ 183.7 billion), of which tax revenues rose by 72.2% to reach TL 5,134 billion (US$ 159.1 billion). It is worth noting that, the government reformed in August 2024 the tax regime in line with OECD guidelines so as to establish a minimum corporate tax rate of 10% (and 15% on global income for multinationals) regardless of tax exemptions. They also moved to narrow some exemptions on both the corporate income tax and value-added tax regimes.

SELECTED PUBLIC FINANCE INDICATORS

TL billion	2022	2023	23/22	9M-23	9M-24	9M/9M
Central government budget revenues	**2,802.4**	**5,210.5**	**85.9%**	**3,440.0**	**6,084.6**	**76.9%**
o.w. Tax revenues	2353.3	4500.9	91.3%	2982.0	5134.1	72.2%
o.w. Non-tax revenues	449.1	709.6	58.0%	457.9	950.6	107.6%
Central government budget expenditures	**2,941.4**	**6,585.5**	**123.9%**	**3,952.6**	**7,158.6**	**81.1%**
o.w. Primary expenditures	2630.5	5910.8	124.7%	3481.7	6246.0	79.4%
o.w. Interest	310.8	673.8	116.8%	470.5	911.3	93.7%
Central government budget cash balance	**-146.7**	**-633.2**	**331.6%**	**-460.5**	**-1479.3**	**221.2%**

Sources: Ministry of Finance, Bank Audi's Group Research Department

PUBLIC INDEBTEDNESS



Sources: Ministry of Finance, IMF, Bank Audi's Group Research Department

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That being said, the central government budget deficit (on a cash basis) more than tripled over the first nine months of 2024, reaching circa TL 1,479 billion (US$ 45.9 billion), compared to a deficit of TL 461 billion (US$ 21.3 billion) during the same period of 2023. This is mainly explained by the accommodative fiscal policy, even when excluding earthquake-related spending. Within this context, the IMF forecasts the fiscal deficit to reach 5.2% of GDP in 2024, roughly at its highest level since 2009, as it compared to a deficit of 5.3% of GDP in 2023.

Within the aim of curbing the budget deficit, the Finance Ministry announced in May 2024 the long-awaited "savings and efficiency package in the public sector". Accordingly, no new vehicle and building purchases/ rentals would be made for three years, and new personnel would be recruited to the public sector as much as the retired ones.

Last but not least, the central government debt stock reached TL 8,649 billion (or US$ 252.9 billion) as at end-September 2024 as per the latest figures released by the Ministry of Finance, recording an increase of 42.5% from TL 6,070 billion as at end-September 2023. This is driven by a 53.0% increase in the domestic debt over the covered period to reach TL 4,374 billion at end-September 2024 (accounting for circa 51% of the total debt stock), and a 33.2% rise in the external debt over the first nine months of 2024 to reach TL 4,275 billion at end-September (accounting for the remaining 49%). Accordingly, the general government debt is estimated at around 18.8% of GDP in 2024 compared to 20.2% of GDP in 2023. The currency composition of government debt shows that the foreign currency debt accounted for 58.9% of the total debt stock at end-September 2024, falling from 64.2% at end-2023, which shows that the authorities have reduced domestic FX borrowing in favor of TL borrowing.

In the coming period, fiscal consolidation would be supported by a decline in spending related to earthquake reconstruction, increased expenditure discipline, the gradual reduction in electricity and gas subsidies, and tax revenue measures seeking to improve collection and reduce informality. As a result, the fiscal deficit is projected by the IMF to improve to 3.6% and 3.0% of GDP in 2025 and 2026 respectively.

1.4. FINANCIAL SECTOR

1.4.1. Monetary Situation

Disinflation stays on track after a return to Orthodox monetary policy

The policy turnaround in Turkey with a decisive policy tightening since May 2023 Presidential elections, revived confidence and supported disinflation efforts, while concomitantly strengthening gross foreign exchange reserves, and allowing a further correction in currency overvaluation.

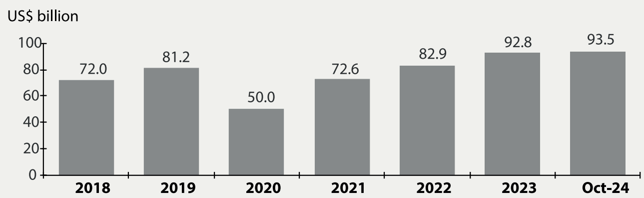
In details, the Central Bank of Turkey maintained a tight monetary policy since May 2023 Presidential elections. Nine large interest rate hikes were delivered since June 2023 until March 2024 amid a commitment to bringing

MONETARY SITUATION

Flows in US$ million	2017	2018	2019	2020	2021	2022	2023	9M-24
Net foreign assets	**-8,997**	**20,424**	**32,155**	**-20,152**	**32,772**	**10,224**	**-18,460**	**5,123**
Foreign assets	6,460	-293	13,508	-18,067	24,265	13,224	7,574	20,973
Foreign liabilities	-15,457	20,717	18,647	-2,085	8,507	-3,000	-26,034	-15,850
Domestic Assets	**56,129**	**-93,550**	**16,749**	**57,075**	**-137,711**	**64,802**	**-5,398**	**57,290**
Claims on private sector	53,758	-96,429	-1,738	32,940	-117,296	31,810	-5,108	45,238
Claims on public sector	61	5,935	17,675	23,120	-18,404	27,283	-1,442	11,573
Claims on non-bank financial institutions	2,311	-3,056	812	1,014	-2,011	5,709	1,152	479
Total Money Supply	**47,064**	**-70,853**	**46,570**	**36,923**	**-104,938**	**75,026**	**-23,859**	**62,415**
Money Supply (M1)	1,522	-23,310	11,055	-1,592	-14,172	18,651	-10,861	11,516
Quasi-Money	28,670	-42,816	39,129	33,913	-56,260	45,413	34,520	42,254
Other Items (Net)	16,872	-4,727	-3,615	4,602	-34,506	10,962	-47,517	8,644

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

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down the underlying trend of monthly inflation through moderation in domestic demand, real appreciation in Turkish lira, and improvement in inflation expectations. This took the benchmark one-week Repo Rate from 8.50% at end-May 2023 to an unprecedented high level of 50.0% in March 2024, and remained at this same level since then.

Concurrently, the CBRT moved in March 2024 to control monetary aggregates not just by increasing its policy rate, but also more directly via growth caps on loans. These caps cover most but not all bank lending, and with the lira lending rates now broadly following the policy rate, credit has fallen rapidly in real terms, likely contributing to cooling aggregate demand. Concurrently, the CBRT has strengthened policy transmission through higher reserve requirements and deposit auctions, which have helped to absorb excess liquidity.

On the back of the gradual policy adjustment, inflation slowed down, moving from 64.8% year-on-year in December 2023 to 48.6% year-on-year in October 2024. This brought the real policy rate into a positive territory at the time of writing this report. Within this context, it is worth mentioning that incomes policies have played an important role in reducing inflation in 2024, as the government has returned to annual wage adjustments for the minimum wage and refrained from excessive pension increases for retirees.

In parallel, the Turkish lira was allowed to depreciate by 16.0% over the first ten months of 2024, moving from 29.52 against the US dollar at end-December 2023 to TL/US$ 34.26 at end-October. This followed a currency collapse of 44.3% between end-May 2023 and December 2023. However, the monetary tightening has led to the lira's real appreciation, which is important for the authorities' disinflation strategy.

As to currency volatility, the Turkish Lira three-month realized or historical volatility, which reflects the actual volatility derived from a time series of currency spot prices over a specific historic time horizon, rose moderately from 13.02% at end-December 2023 to 16.68% at end-October 2024, noting that it has hit 43.10% at end-May 2023.

With the return to orthodox economic policies, market sentiment has sharply improved, with domestic and foreign investors shifting into lira-denominated assets, while lower commodity prices, buoyant exports, and reduced gold imports have strengthened the current account, supporting an improvement in net reserves position. In fact, the CBRT's gross foreign exchange reserves maintained their upward trajectory over the year 2024, moving from US$ 92.8 billion at end-December 2023 to US$ 93.5 billion at end-October 2024. This followed a large expansion of US$ 9.9 billion over the year 2023.

In the coming period, with inflationary pressures still high, and significant downside risks, the IMF calls for continued tight, data dependent monetary policy until inflation converges to target levels. The IMF sees that the Central Bank should stand ready to tighten further if needed to ensure that the path of disinflation stays on track, while highlighting that further strengthening the monetary transmission mechanism and Central Bank independence and communication would enhance policy credibility, and more contractionary fiscal policy in 2025 is expected to reduce inflation.

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1.4.2. Banking Activity

Better than expected banking industry trends in 2024

The Turkish banking sector recorded better than expected trends in 2024. Total deposit growth was circa 33% yoy, as per the latest weekly data for Aug 2024, with TL deposit growth of circa 43% year-on-year. Foreign currency (FC) deposits grew circa 20% year-on-year. The overall banking sector TL loan-to-deposit ratio is down circa 5 percentage points since Dec-2023 end, and has declined circa 9 percentage points yoy to 84%, while the FC loan-to-deposit ratio has increased circa 18 pp yoy to 81%. The total loan-to-deposit ratio is up circa 3pp yoy to 83%. Total loan growth was circa 38% yoy, as per the latest weekly data for Aug 2024. TL loan growth came in at circa 29% yoy, while FC loan growth came in at circa 55% year-on-year. According to the latest CBRT data, marginal TL lending rates for commercial and consumer local currency loans stood at circa 60.3% and 74.1%, respectively, in August, while the weighted average cost of TL deposits stood at circa 55.3%. The overall TL loan-deposit spread came in at circa 12.4% on average in Aug 2024.

The Turkish government's improvements in governance, more specifically the decisive and increasingly well-established return to orthodox monetary policy, has eased the pressure on the banks' financial performance and improved the sector's access to foreign funding. The government's efforts to unwind a foreign-exchange-protected local-currency deposit scheme have reduced its volume significantly since 2023. These actions, along with policy rate hikes, have increased banks' deposit costs beyond the policy interest rate in some cases, as banks raised local-currency deposit rates to encourage depositors to switch from foreign currency-linked deposits. Simultaneously, Moody's notes the considerable growth in credit card and SME loans in the high-interest rate environment and increased unseasoned risk, which is yet to be tested through the current economic conditions.

Moody's assessment also factors in Turkey's large and diversified economy, and young population, which support banks' resilience to shocks, alongside policy improvements. They believe post-election stability has somewhat restored investor confidence, enabling Turkish banks to raise higher volumes of foreign-currency funds in the first half of 2024.

The considerable growth in credit card and SME loans in 2023 increased unseasoned risk, which is yet to be tested through the current difficult economic slowdown. Nevertheless, high loan growth, which partly reflects low banking penetration (50.3% private-sector credit/GDP) and high inflation, has long been a feature of the Turkish banking system.

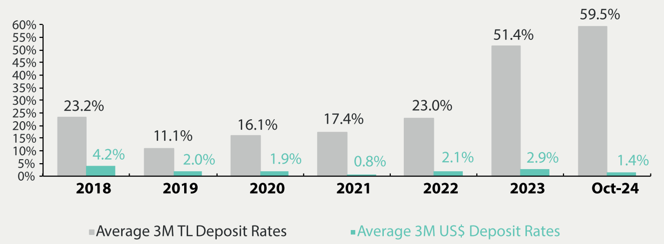
With respect to asset quality, the banking system's problem loans amounted to 1.5% of gross loans in March 2024, down from 1.6% as of year-end 2023 (December 2022: 2.4%). The improvement is stemming from the denominator effect predominantly, that is, high loan growth (101.7% since December 2022), while the stock of problem loans has started to pick up. The stock of problem loans was previously supported by

BANKING SECTOR INDICATORS

in US$ billion	2017	2018	2019	2020	2021	2022	2023	Sep-24
Banking Aggregates								
Assets	862.7	734.8	758.0	826.5	697.7	767.9	802.1	899.1
Deposits	453.4	387.1	433.6	467.8	401.6	474.4	506.1	525.9
Loans	555.8	455.1	448.4	484.1	370.9	405.8	397.7	442.3
Shareholders' equity	95.0	80.1	83.0	81.1	54.1	75.2	73.4	77.9
YTD Growth rates								
Assets	10.8%	-14.8%	3.2%	9.0%	-15.6%	10.1%	4.5%	12.1%
Deposits	9.4%	-14.6%	12.0%	7.9%	-14.1%	18.1%	6.7%	3.9%
Loans	12.4%	-18.1%	-1.5%	8.0%	-23.4%	9.4%	-2.0%	11.2%
Shareholders' equity	11.2%	-15.7%	3.6%	-2.3%	-33.3%	39.0%	-2.5%	6.2%

Sources: BDDK, Bank Audi's Group Research Department

BANKING SECTOR DEPOSIT RATES



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

strong collections performance because of high asset prices, and the recent uptick (33.5% since December 2022) is driven by the lagging effect of high inflation, combined with a sharp jump in interest rates and the economic slowdown, which weigh on borrowers' repayment capacity.

Credit risks in the construction, textile and energy sectors continue to test the creditworthiness of the existing loans that were provided to these sectors in the past three years, during the course of the unorthodox policy environment. Nevertheless, Moody's expects lower credit growth for these sectors, underpinned by the regulatory caps introduced on commercial and corporate credit growth rates by the Central Bank of the Republic of Turkey (CBRT). In addition, Turkish exports continued to aid credit conditions and robust tourism activity boosted corporate revenue, supporting banks' loan performance, while the loans provided to both the tourism and export related sectors remain exempt from the credit growth rate caps.

Moody's expects credit conditions to remain tough during the outlook period of 12-18 months because of slower economic growth and still high inflation. Monetary tightening and high policy rates will weigh on credit growth and render debt servicing more difficult. Also, government measures on fiscal tightening such as higher income taxes and value-added tax, together with high inflation and steeper borrowing costs, will worsen credit conditions for retail borrowers. Most retail loans, however, are extended to white-collar workers, which limits the correlation between retail credit conditions and economic cycles when the economy slows. This is because they expect these borrowers' incomes to grow at higher rates than minimum wage increases.

The banking system's foreign-currency funding costs moderately declined in 2023. The tier-1 banks were able to renew their syndicated market borrowings, while the rollover ratio for foreign funds (including both the syndicated loans as well as long-term market funding) was higher than 110% in the first quarter of 2024. The improved pricing conditions and strong market sentiment are also driving an increase in Additional Tier 1 (AT1) issuances by banks.

The banking system still faces some funding challenges. Firstly, the volume of foreign-currency linked deposits (KKM) still make up around 13% of the total system deposits, and the local-currency deposit costs are expected to remain high until the KKM volumes reduce to negligible levels. That being said, Moody's notes that following the reversal of the unorthodox measures, the volume KKM deposits reduced by 50% to US$ 61.6 billion in early July compared to the peak at US$ 127.6 billion in August 2023. Secondly, despite the unwinding of KKM deposits, they expect US$ deposits to increase from 43.8% of total deposits as of March 2024. Turkish depositors have historically maintained their savings predominantly in hard currencies. Thirdly, the sector's exposure to confidence-sensitive market funding, particularly funds received from foreign investors, remains significant, particularly in view of the still-fragile investor confidence. While the risk of a return to unorthodox policies is currently lower than in the past, such a policy reversal could have severely adverse implications for the foreign-currency liquidity of the banking system.

1.4.3. Equity and Bond Markets

Extended winning streak in Turkish equity and bond markets in 2024

Turkish equity and bond markets continued to benefit from improved overall investor sentiment over the year 2024 following the adoption of a tight monetary stance since May 2023 Presidential elections, which allowed the authorities to bring down inflation, rebuild reserves, and de-dollarize the financial system.

In details, Borsa Istanbul extended its winning streak over the year 2024, with the TL-denominated BIST 100 peaking at 11,172.75 on July 22, up from 7,396.34 at end-December 2023, which marked a significant expansion of 51.1% over the period, as investors cheered the prospect of a pivot toward more orthodox economic policies following May 2023 Presidential elections. Yet, Turkish stocks entered into a bear market since July 22, as still high inflation rates and prospects of delayed interest rate cuts until 2025 after the CBRT extended in October 2024 its interest rate pause for the seventh consecutive month raised concerns about domestic corporate profits, while returns from alternative and less risky investments (such as lira deposit

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accounts and money market funds) have found greater appeal among local investors. This was exacerbated by the flare up in Middle East tensions, which have reduced appeal of equities. That being said, the TL-denominated BIST 100 closed at 8,863.88 at end-October 2024, reducing gains to 18.7% over the first ten months of the year.

The total number of traded companies on the Borsa Istanbul rose from 576 companies at end-December 2023 to 611 companies at end-October 2024. On the back of new listings, and given rising equity prices, which have outpaced the 16% currency collapse over the first ten months of 2024, the market capitalization expanded by 4.9% in US dollar terms, moving from US$ 341.2 billion at end-December 2023 to US$ 357.9 billion at end-October 2024.

Concurrently, the total number of contracts reached 1,323.9 million during the first ten months of 2024, up from 1,397.5 million during the corresponding period of 2023. The total trading value reached US$ 902.5 billion during the first ten months of 2024 compared to US$ 1,186.3 billion during the first ten months of 2023, down by 23.9% year-on-year. Accordingly, the turnover ratio, measured by the annualized total trading value to market capitalization, reached 302.6% over the first ten months of 2024, down from 379.8% during the corresponding period of 2023.

At the level of the bond market, Turkish bonds continued to benefit from improved investor sentiment over the year 2024 following the return to a more conventional monetary policy, as the latter has allowed disinflation and reserve accumulation, while concomitantly strengthening the reserve composition. In fact, the net foreign asset position of the CBRT shifted to a positive territory at end-August 2024. Under these favorable conditions, all major credit ratings agencies upgraded Turkey's sovereign risk ratings over the year 2024.

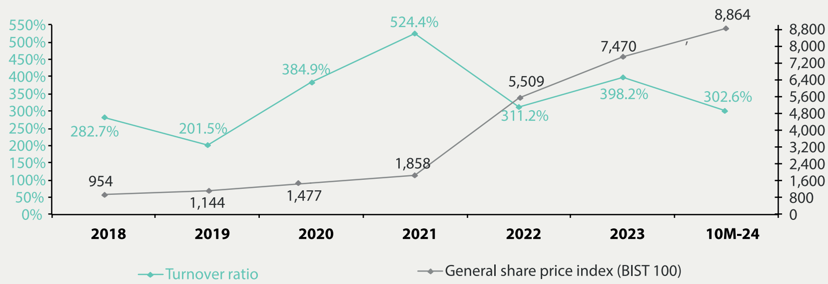
In fact, Moody's upgraded in July 2024 government of Turkey's long-term foreign and domestic currency issuer and foreign-currency senior unsecured ratings to "B1" from "B3", with a "positive" outlook, citing improvements in governance, more specifically the decisive and increasingly well-established return

SELECTED STOCK MARKET INDICATORS

	2018	2019	2020	2021	2022	2023	10M-24
Market capitalization (in US$ billion)	150.5	186.7	240.3	163.7	332.0	341.2	357.9
Market capitalization/GDP	18.9%	24.5%	33.5%	20.3%	36.7%	30.2%	26.6%
Trading value (in US$ billion)	425.5	376.1	924.7	858.7	1033.1	1358.4	902.5
Traded volume (in millions)	436,596	548,083	1,511,484	1,203,335	1,644,043	1,744,656	1,509,236
Number of contracts (000s)	230,789	264,516	670,982	691,301	975,341	1,712,072	1,323,941
Change in share BIST 100 price index	-17.3%	19.9%	29.1%	25.8%	196.6%	35.6%	18.7%
Price/Earnings ratio (times)	9.12	10.72	18.64	9.17	8.55	7.08	9.63
Dividend Yield (%)	3.28	2.35	0.83	2.39	1.30	1.36	1.83
CDS spread (bps)	362	280	304	563	510	283	268

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

STOCK MARKET PERFORMANCE



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

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to orthodox monetary policy, which is yielding first visible results in terms of reducing Turkey's major macroeconomic imbalances.

Concomitantly, Fitch Ratings upgraded in September 2024, for the second time this year, Turkey's long-term foreign currency Issuer Default Rating to "BB-" from "B+", with a "stable" outlook, citing improved external buffers and reduced contingent FX liabilities.

Also, S&P Global Ratings raised in November 2024, for the second time this year, its unsolicited long-term sovereign credit ratings on Turkey to "BB-" from "B+", with a "stable" outlook, citing the rebalancing of Turkey's external accounts, a reduction in foreign currency deposits, and a concomitant increase in the CBRT's stock of net foreign currency reserves.

That being said, Turkish bonds extended their upward trajectory over the year 2024. A closer look at sovereigns shows that papers maturing in 2027, 2028, 2029, 2031 and 2033 registered price expansions ranging between 0.57 pt and 1.42 pt since the start of the year 2024 till mid-November. As to papers issued by financial institutions, Akbank'25 closed up by 0.95 pt over the covered period. Yapi Ve Kredi Bankasi'28 recorded price gains of 2.70 pts. Prices of Export Credit Bank of Turkey'28 expanded by 2.77 pts. QNB Finansbank'33 posted price increases of 2.22 pts since the beginning of the year 2024. As to the cost of insuring debt, Turkey's five-year CDS spread was almost halved since the start of a U-turn in Turkey's monetary policy, moving from 599 bps at end-May 2023 to 268 bps at end-October 2024 (284 bps at end-2023). This is mainly explained by improved sentiment following a pivot towards a more orthodox stance in economic policymaking.

Regarding new issues, Turkey tapped international debt markets four times over the year 2024, raising a total of US$ 8.25 billion and € 2 billion. In details, Turkey raised US$ 3.0 billion in February 2024 from the sale of 10-year bonds at a coupon of 7.625%. Also, Turkey issued in March 2024 € 2.0 billion six-year bonds at a coupon of 5.875%. In July 2024, Turkey raised US$ 1.75 billion from the sale of bonds maturing in 2032 at a coupon of 7.125%. The country returned to international bond markets in October 2024 with the sale of US$ 3.5 billion bonds maturing in 2035 at a coupon of 6.500%. Within this context, Fitch said that the recent revival in foreign currency debt issuances signals lower near-term refinancing risks as investor sentiment improves following Turkey's adoption of more conventional macroeconomic policies.

Looking forward, Fitch sees that sovereign financing, funding diversification goals, and the Islamic finance development agenda would continue to drive Turkish debt capital market issuance over the next two years.

CONCLUSION

After a strong first quarter, growth has weakened and is expected to fall to 3% in 2024 and 2.7% in 2025, recovering toward 4% in the medium term. A deceleration of private consumption, which currently makes up just under 60% of GDP, will play the central role in cooling down the Turkish economy. Real GDP growth will ease going forward as tighter credit conditions and lower labor demand pass through into softer demand, only partly offset by stronger exports of goods and services. A gradual recovery is expected to take hold from 2026.

Disinflation and improved confidence will support a narrowing of the current account deficit to about 2% of GDP and reserves to around 100% of the IMF's adequacy metric. Under the authorities' gradual policy adjustment, inflation is expected to further decline. Contractionary ex ante real policy rates, moderating wage growth, and more contractionary fiscal policy in 2025 are expected to reduce inflation to 43% this year and 24% in end-2025 as per the IMF.

Bringing down inflation further is likely to prove challenging. In December a tripartite commission that includes representatives from unions, employers, and the government is scheduled to negotiate an agreement on a national minimum wage increase to take effect in January 2025. One risk to the disinflation

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program is that the increase, which is a benchmark for wage-setting across the Turkish economy, is backward-indexed to the2024 rate of inflation of about 44% rather than to the government's year-end 2025 inflation target of 17%. Given political realities and the still tight labor market, S&P's operating assumption is that the agreement will settle on a figure somewhere between these two extremes. Anything higher than 30%, however, would, in S&P's view, almost certainly prolong an already protracted disinflation process and make single-digit inflation in 2027 a less attainable goal. Anything lower could turn already ambivalent popular support against the Stability Program.

Risks around the IMF baseline are significant and tilted to the downside. They include stronger-than-expected wage and price inertia, a reversal of capital flows, higher global energy prices, and escalating geopolitical tensions. Significant financial and external vulnerabilities remain. The authorities' gradual approach to fighting inflation prolongs the period during which risks might occur.

At the fiscal level, Fitch expects the central government deficit to decline markedly to 3.1% of GDP and further to 2.8% in 2026. Fiscal consolidation will be supported by a decline in spending related to earthquake reconstruction (planned to drop from 2.6% of GDP in 2024 to 0.9% in 2025), increased expenditure discipline, the gradual reduction in electricity and gas subsidies, and tax revenue measures seeking to improve collection and reduce informality. They project that general government debt will continue to decline to 27.3% of GDP, less than half the projected 55.2% 'BB' median, driven by still high nominal GDP growth, the real appreciation of the lira and moderate primary deficits. They forecast interest payments-to-revenue to continue to increase, reaching 9.5%in 2025, slightly below the 10.1% median.

If we were to assess the Turkish outlook looking forward, we need to look at a number of strengths but also some risk drivers. Starting with positive points, the most important are probably the large and diversified middle-income economy with favorable demographics, the moderate public debt burden; and the banking sector's good track record of managing currency volatility, the fairly diversified goods export structure, in addition to stronger structural indicators, such as GDP per capita and Human Development, relative to rating peers. To these, we can add the improved external buffers, the reduced contingent FX liabilities, the lower, but still elevated inflation, the lower current account deficits and the fiscal consolidation outlook.

Yet, a number of risk factors continue to dominate the near term outlook. Among these, we mention the unpredictable policymaking that exposes Turkey to currency stress and high inflation; the material erosion of institutional and governance strength over past several years; and the ongoing turbulent geopolitical environment and high political risk. Having said that, we expect strengths to outpace weaknesses and opportunities to exceed threats at the foreseeable horizon.

Finally, it is important to stress that the just issued IMF Article IV Consultation Mission report urged the authorities to press ahead with coordinated fiscal, monetary, and incomes policies to anchor inflationary expectations and entrench macroeconomic stability. While noting sustainable public debt levels, IMF Directors recommended a larger and more frontloaded fiscal consolidation to support disinflation efforts and further strengthen buffers. They supported strengthening tax administration, rationalizing tax expenditures, broadening the tax base, energy subsidy reform, limiting capital spending to essential projects, and enhancing risk monitoring while protecting earthquake related spending. The IMF also urged further efforts to address fiscal risks arising from contingent liabilities in state owned enterprises, public private partnerships, and pension costs. While noting the challenges, the IMF considered that phasing out backward looking indexation and shifting toward setting wages in line with inflation expectations could significantly help reduce inflation at large.

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