TURKEY ECONOMIC REPORT

AN IMPROVING POST-ELECTIONS MACRO OUTLOOK WHILE FUNDAMENTAL CHALLENGES REMAIN

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- Mixed overall economic performance in 2015

  Despite a relative slowdown in the overall economy, the latter is still expected to grow by 3.0% in 2015, according to the latest estimates recently released by the IMF. The first half growth results surprised on the upside but the second half results are expected to be more subdued. Contrary to 2014 when net exports contributed positively to growth and domestic demand was weak, the growth drivers reversed this year driven by domestic demand growth while net exports were negative. The rebound in private investment was notable, with a considerable pre-election government spending, while consumption picked up more than expected in response to monetary policy.

- Contracting budget deficit along with declining debt-to-GDP ratio

  Turkey's fiscal deficit contracted over the first ten months of 2015 and the primary balance remained in surplus, spotting light on favorable debt dynamics. Central government revenues grew by 14.5% while expenditures went up by 11.5% in the first ten months of 2015. The IMF forecasts a general government deficit of 0.8% of GDP in 2015. The ratio of the gross debt to GDP continued to follow a downward trajectory and is expected to reach 32.1% at end-2015, the lowest in 15 years.

- Monetary policy kept tight despite measured rate cuts

  Turkey's monetary policy has been kept tight in 2015 despite "measured" rate cuts delivered by the Central Bank of the Republic of Turkey earlier this year. This came within the context of a persistently high inflation, staying well above the Central Bank's target of 5%, amidst a sharp fall in the Turkish Lira that has offset the disinflationary effect of plunging oil prices. Inflation slowed over the year 2015, yet remained quite high. The Consumer Price Index rose by 7.5% on average during the first ten months of 2015 after averaging 8.9% in 2014. This came within the context of plunging oil prices that have affected inflation favorably, while the cumulative depreciation of the Turkish Lira has pushed the annual core goods inflation upwards and caused the core inflation trend to deteriorate slightly.

- Healthy banking activity growth in local currency terms turning negative in US$ terms

  The Turkish banking sector has seen a healthy activity growth so far this year in local currency terms, in line with the moderate economic activity growth, but the sharp Turkish Lira depreciation over the course of 2015 is likely to start pressuring banks' loan portfolios and exacerbate their funding position's sensitivity to global credit market conditions. Measured by total assets of banks operating in Turkey, the sector's activity grew by a notable 17.7% in local currency terms in the first ten months of 2015, which yet translated into a negative growth when expressed in US dollar (-5.6%) due to the local currency depreciation. This marks an acceleration relatively to the already healthy 10.6% rise registered in local currency terms in the corresponding period of 2014. While financial soundness indicators remain favorable, the sharp Lira depreciation exerts pressure on funding and asset quality.

- Price falls across capital markets amidst geopolitical and domestic concerns

  The Turkish capital markets witnessed downward price movements over 2015, along with a significant expansion in the cost of insuring debt amidst heated geopolitical tensions, domestic political uncertainties and security drifts, and rising bets over US Fed interest rate hike. The BIST 100, which represents the 100 largest companies by market capitalization, dropped by 11.5% over the first eleven months of 2015. The cost of insuring debt in Turkey expanded considerably since year-end 2014, with the five-year CDS spreads moving from 184 basis points at end-2014 to 258 basis points currently.

- Short term macro outlook improved but fundamental challenges remain

  The most important recent political development with economic implications is the finalization of parliamentary elections, where the AKP took an absolute majority to form alone a government. The elections results were initially positively perceived by the markets. As a new government was swiftly formed after the elections in November, the negative divergence in investors' perception should be reversed to reflect the real value of Turkish financial assets. Beyond the short term however, forthcoming economic policy and the pace of reform implementation to combat the weaker growth environment amidst volatile capital flows, in addition to the ability to preserve the strength and independence of key institutions against the backdrop of a possible push towards more political centralization, would determine the fundamental outlook of the Turkish sovereign, banks and corporates at large.

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

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Overall economic performance in Turkey has been mixed in 2015. The first half growth results surprised on the upside but the second half results are expected to be more subdued. Contrary to 2014 when net exports contributed positively to growth and domestic demand was weak, the growth drivers reversed this year driven by domestic demand growth while net exports were negative. The rebound in private investment was notable, with a considerable pre-election government spending, while consumption picked up more than expected in response to monetary policy.

Having said that, despite a relative slowdown in the overall economy, the latter is still expected to grow by 3.0% in 2015, according to the latest estimates recently released by the IMF. Such a performance is realized within the context of net economic benefits generated by the decrease in oil prices leading to lower external deficits and improved economic efficiency, against the backdrop of sustained volatility in the exchange rate and reference rates resulting from the impact of the US Federal Reserve policies on the emerging markets at large. In parallel, consumer price inflation has remained stubbornly high, well above the official 5% medium-term target, as a weaker lira has, for the most part, offset the disinflationary effects of plunging global oil prices. The 12-month headline inflation accelerated to 8% in September 2015.

At the foreign sector level, Turkey's current account deficit, the soft spot of the Turkish economy, continued to decline towards sustainable levels thanks to the plunge in oil prices and underlying benign trend in current account balance. The IMF forecasts a current account deficit of 4.5% of GDP in 2015 against 5.8% in 2014. On the contrary, inflationary dynamics have not improved much due to the sharp depreciation in the Turkish Lira in 2015.

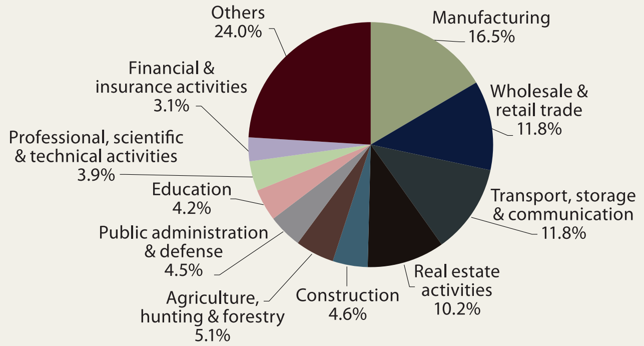
At the public finance level, Turkey is still witnessing an ongoing fiscal discipline. The overall government balance sheet remains strong and the commitment to fiscal discipline appears to benefit from considerable consensus across the political spectrum. Turkey continues to have a strong fiscal framework, including a track record of primary fiscal surpluses and low government debt levels that allow for flexible policy responses. The IMF forecasts a general government deficit of 0.8% of GDP in 2015, close to its previous year's level. Government debt to GDP continues falling and is set to hit 32.1% at end-2015, its lowest level in more than two decades.

At the monetary level, although the Central Bank of Turkey reduced its key policy interest rate – the one-week repurchase lending rate – by a total of 175 bps in May-July 2014 to 8.25% and by 75 bps in January-February 2015, to 7.5%, monetary policy has been kept relatively tight. The yield curve is flat, with short term interest rates at a similar level to long term rates. Having said that, there are substantial risks to exchange rate forecasts, arising from the prospect of higher US interest rates and uncertainty about the outlook for global financial flows, as well as the impact on investor confidence of domestic political tension. It is worth noting that the Turkish Lira lost 13.7% of its value in real terms in 2015.

GROSS DOMESTIC PRODUCT PERFORMANCE

Sources: IMF, Bank Audi's Group Research Department

BREAKDOWN OF GDP BY SECTOR (1H 2015)

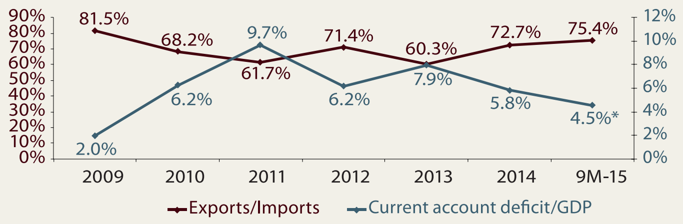


Sources: Central Bank of Turkey, Bank Audi's Group Research Department

While the country is facing tough challenges related to its domestic and external environments resulting in monetary drifts, its financial sector is continuing to grow steadily amidst favorable financial soundness indicators on the overall. The banking sector has proved resilient against the headwinds in 2015 due to heightened global and domestic risks. Loan and deposit interest rates increased markedly in 2015 as the risk premium of Turkey increased. Bank assets grew by 17.7% in TL terms in the first ten months of 2015, driven by a 17.6% growth in deposits while loans grew by 18.1% over the same period. Such growth rates yet turn negative when computed in US dollar. Relative resilience in bank spreads was observed, partly owed to the sector's ability to maintain a strong net interest margin (circa 3.5% in 2015) in spite of interest rate volatility, generating satisfactory profit metrics on the overall. Financial soundness indicators for the sector on aggregate are still reasonable in terms of profitability, asset quality, liquidity and capitalisation.

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 economy on the back of the recent parliamentary elections results and the fundamental challenges looking forward.

FOREIGN SECTOR INDICATORS



* IMF full-year forecast

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

MONEY SUPPLY GROWTH AND INFLATION

* IMF full-year forecast

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

1. ECONOMIC CONDITIONS

1.1. REAL SECTOR

1.1.1. Agricultural Sector

Mild growth in the primary sector

Agriculture in Turkey has been shaped, this year again, by unfavorable weather conditions, with moderate growth reflecting the effect of floods, frost, and snowstorms in early 2015. Indeed, the agriculture, forestry, and fishing sector, accounting for around 5% of the country's GDP, grew by 5.2% year-on-year in the first half of 2015, following a negligible growth of 0.4% in the same period of the year before.

The country's exports of agricultural products went down by 2.5% in the first ten months of 2015, reaching US$ 4.46 billion and follow a one-digit rise of 7.0% reported in the equivalent period of 2014. In parallel, imports of agricultural products went down by 14.8% in the above mentioned period of 2015, following a growth of 10.3% reported in the first ten months of 2014. The double-digit drop in agricultural imports value is probably due to the effect of the local currency depreciation, and the corollary relative rise in prices of imported agricultural products. Accordingly, the value of the latter category has reached US$ 5.94 billion by end-October 2015.

As to crop production, the overall output has registered a moderate decline in 2014, according to the latest estimates by Turkstat. In fact, crop production (cereals, vegetables and fruits) went down by a yearly 5.0% to reach 105.8 million tons. This follows a moderate growth in output production of 5.4% reported in the previous season. As to the cereals, constituting the largest share of crop production, they reversed their rising trail, going down by 7.1% after reporting a rise of 8.4% last year. On the other hand, production of vegetables remained almost constant year-on-year, while that of fruits, nuts, and spices went down by 5.4% yearly.

Turkey has announced plans to increase agricultural revenue to US$ 150 billion over a ten-year period, up from US$ 61 billion in 2014. However, looking over the medium-term, Russia will restrict imports of Turkish agricultural products as part of a package of new sanctions. It is worth noting in this regard that Turkish food supplies to Russia became more important after Moscow banned many Western food imports in 2014. For instance, Turkish vegetables alone currently account for some 20% of vegetable imports to Russia.

CROP PRODUCTION IN 2014 (CEREALS, VEGETABLES AND FRUITS)

000s tons	Volume	Share		Volume	Share		Volume	Share
Cereals	**32,714**	**55%**	**Vegetables**	**23,620**	**83%**	**Fruits**	**10,123**	**55%**
o.w. Wheat	19,000	32%	o.w. Tomatoes	11,850	42%	o.w. Citrus fruits	3,784	21%
o.w. Barley	6,300	11%	o.w. Watermelon	3,886	14%	o.w. Pome fruits	3,067	17%
o.w. Maize	5,950	10%	o.w. Cucumber	1,846	6%	o.w. Stone fruits	1,796	10%
Sugar beets	**16,573**	**28%**	o.w. Melon	1,707	6%	o.w. Other fruits	1,477	8%
Potatoes, dried legumineus	**4,166**	**7%**	o.w. Pepper (green)	907	3%	**Grapes**	**4,175**	**23%**
Oil seeds	**3,509**	**6%**	**Bulb and root vegetables**	**3,052**	**11%**	**Olive production**	**1,768**	**10%**
Dry pulses	**1,036**	**2%**	o.w. Dry onion	1,790	6%	**Tea production**	**1,260**	**7%**
Raw materials used in textiles	**846**	**1%**	o.w. Carrots	558	2%	**Nuts**	**810**	**4%**
Plants for perfumery, pharmacy	**98**	**0%**	**Other vegetables**	**1,793**	**6%**	**Spices crops**	**227**	**1%**
Tobacco	**70**	**0%**	o.w. Leafy or edible stem vegetables	1,552	5%	**Total Fruits, nuts**		
Total Cereals and other crops*	**59,012**	**100%**	**Total Vegetables and other crops**	**28,465**	**100%**	**and spices crops**	**18,364**	**100%**
* Excluding fodder crops								

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

1.1.2. Industrial Sector

Modest growth in secondary sector despite geopolitical tensions

Turkey's industrial sector witnessed modest growth so far in 2015, despite geopolitical tensions arising from the conflict in Iraq and Syria. The country's industrial sector, accounting for 21.1% of GDP, reported a real growth of 2.2% year-on-year during the first half of 2015, compared to a real growth of 4.6% recorded in the same period of last year.

The average Industrial Production Index, measuring the amount of output from the manufacturing, mining, electric and gas industries, also increased by 3.1% year-on-year in the first three quarters of 2015, compared to 2.6% in the corresponding period of 2014, as per Turkstat.

Turkey's manufacturing sector, contributing to almost 16.5% of GDP, witnessed a real growth of 3.1% year-on-year during the first half of this year, compared to a growth rate of 4.6% in the same period of last year. The manufacturing average industrial production index rose by 3.5% year-on-year in the first nine months of 2015, compared to a 1.6% rise in the corresponding period of 2014

Furthermore, sentiment among manufacturers improved according to the seasonally adjusted real sector confidence index, rising above the neutral 100 mark to 103.2 in October 2015, from 99.5 in September. This improvement came in spite of a month-on-month decline of 0.8 percentage points in the seasonally adjusted manufacturing capacity utilization rate, to 74.6% in October. Moreover, the seasonally adjusted Istanbul Chamber of Industry Turkey Manufacturing PMI, a composite indicator designed to provide a single-figure snapshot of the performance of the manufacturing industry, reached 52.4 in November 2015, up by 0.9% from 51.9 in November 2014 (a reading above 50 indicates expansion in manufacturing activity).

It is worth noting that one of the main downside risks to the Turkish manufacturing sector is the depreciation of the Euro against the Turkish lira, with the TL appreciating in real terms against the Euro by 7% in the first nine months of 2015. This would erode Turkey's export competitiveness gains from the decline in the value of the Turkish lira against the US dollar, because of the importance of Turkey's European export markets while the cost of dollar price imports rises, as per the same source.

With regards to the electricity, gas and water supply sector, which makes up 6.1% of the industrial sector's GDP, its value rose by 1.6% year-on-year in the first six months of 2015, after rising by 4.4% in the corresponding period of last year. Turkey's mining and quarrying component, accounting for 4.8% of the industrial sector's GDP, contracted by 6.4% year-on-year in the first half of 2015, compared to an 8.2% expansion posted in the same period of last year.

Turkey's construction sector, which accounted for 4.6% of GDP, marginally contracted by 0.3% year-on-year during the first half of 2015, compared to a growth of 4.5% in the same period of 2014. While the non-residential construction demand is dampened by the continued depreciation in the lira and associated macroeconomic headwinds, Turkey's residential sector is supported by the country's strong

VEHICLES PRODUCTION

(unit)	2010	2011	2012	2013	2014	10M-14	10M-15	10M/10M
Automobile	603,394	639,734	577,296	633,556	723,228	593,493	643,326	8.4%
Pick-up	442,408	479,110	426,633	410,558	345,495	280,428	378,369	34.9%
Minibus	16,978	22,475	29,335	37,751	34,176	27,471	50,806	84.9%
Tractor	30,425	45,506	42,255	40,511	49,174	40,752	43,551	6.9%
Truck	23,851	37,396	29,129	30,083	30,650	25,456	29,120	14.4%
Bus	5,268	6,907	6,427	8,374	6,446	5,327	7,014	31.7%
Midibus	2,658	3,509	4,158	5,197	5,297	4,584	5,519	20.4%

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

fundamentals: a large, young and growing population, combined with a robust rural-urban migration backed by economic reforms, which should provide long-term potential for growth.

1.1.3. Trade and Services Sector

Slight improvement in Turkish trade and services sector supported by growth in sub-sectors

The country's trade and services sector, which contributes to around 60% of Turkey's GDP, remained on a positive trend during the first six months of 2015. The sector posted an improvement of 5.2% in the first half of 2015, slightly down from a growth rate of 6.0% in the first half of 2014. Similar to last year, this improvement can be attributed to increased activity in most of the branches of Turkey's tertiary sector. Furthermore, Turkey's services confidence index reached 100.0 in November 2015, up by 2.7% from 97.3 in November 2014, as per data compiled by the Turkish Statistical Institute.

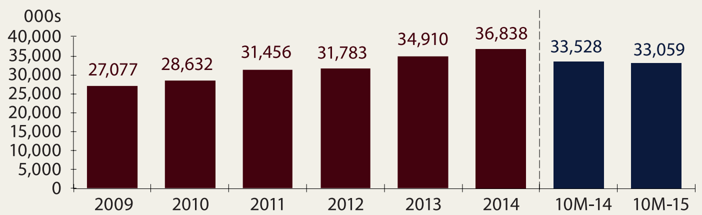
One of the main components of Turkey's trade and services sector is wholesale and retail trade, which contributes to 11.8% of GDP. The latter recorded a growth rate of 1.8% year-on-year in the first six months of 2015, compared to a growth rate of 2.2% in the first half of 2014. The latter was supported by an increase in private consumption, despite a drop in the number of tourists. In fact, the Economist Intelligence Unit estimates a moderate strengthening in private consumption, from 1.4% in 2014 to an average of 2.7% in 2015, because of the solid pace of expansion in the first half of the year.

Moving on to Turkey's tourism sector, it witnessed an overall deceleration during the first ten months of 2015. In fact, the number of foreign arrivals to Turkey saw a drop of 1.4% year-on-year to reach 33.1 million in the aforementioned period, compared to a 5.6% rise in the number of foreign arrivals in the first ten months of 2014. Moreover, the country's tourism income fell by 6.5% year-on-year in the first three quarters of 2015, against an increase of 8.5% year-on-year reported by the Turkish Statistical Institute in the first three quarters of 2014. Nonetheless, Turkey's tourism industry employment is estimated to reach more than 1.34 million in 2015, up from 1.28 million last year.

In addition, Turkey's hotel occupancy rates decreased by 12.4% year-on-year to reach 65.3% in September 2015, with the country facing the steepest drop in hotel occupancy rates across Europe, as per data compiled by Turkey's Touristic Hotels & Investors Association (TUROB). It is worth noting that the hotel occupancy rates were negatively impacted by political uncertainty in the country and spilling turmoil from the ongoing conflict in Iraq and Syria, as per TUROB.

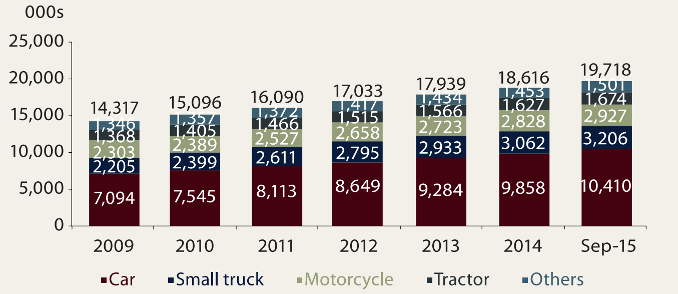
Last but not least, growth in the country's transportation, storage, and communication sub-sectors, which contribute to 11.8% of the Turkish GDP, supported growth in the trade and services sector. The latter sub-sectors expanded by 2.3% year-on-year in the first six months of 2015, against a growth rate of 3.0% in the same period of last year.

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

1.2. EXTERNAL SECTOR

Decline in current account deficit coupled with lower financial account surplus

Turkey's external sector imbalances emerge again as a main vulnerability. Decreased imports have overweighed the drop in exports driving the trade account deficit downwards. However, this overall positive development at the level of the current account has been overweighed by lower surplus at the level of the financial account, turning the balance of payments into deficit.

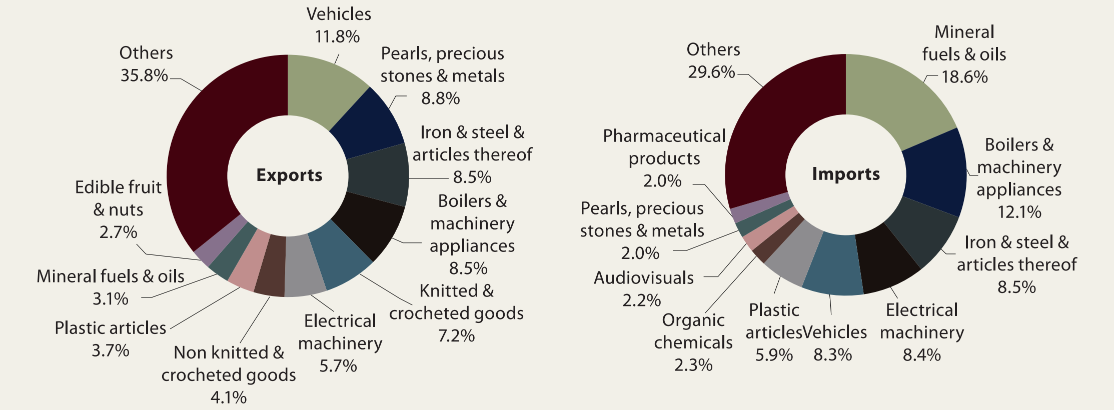
In details, Turkish exports reached US$ 113.8 billion in the first nine months of 2015, as per the latest Central Bank figures, posting a 10.5% decrease on a yearly basis. The drop in export value was 45% due to lower exports to the European Union. Indeed, exports to the latter category went down by 9.7% year-on-year during the first nine months of the year, following a rise of 12.1% registered in the same period of the year before. This is mainly due to the depreciation of the Euro against the Turkish lira, eroding Turkey's export competitiveness gains from the decline in the local currency against the US dollar.

However, the EU kept its share of Turkish exports unchanged at 44% of the total. Within this group of countries, the most significant drop was registered by Germany, whose imports of Turkish origin went down by 14.7% year-on-year. Decline in exports value was due next to lower activity with Near and Middle Eastern countries (down by 9.3% year-on-year), particularly Iraq, whose imports with Turkey went down by a significant 19.7%. Lower activity with Russia comes in next, accounting for 16.3% of the yearly variation. Indeed, exports to Russia, which were already volatile in 2014, went down drastically by 40.1% year-on-year in the first nine months of 2015. Activity with North African countries went down by 14.5% year-on-year and was responsible for 9.5% of the total decline in exports. A breakdown of exports by type shows that the overall decrease can be attributed to a drop in the main component, namely manufacturing. The latter, which makes up 94% of Turkey's exports, has posted a year-on-year decrease of 9.4% during the first nine months of 2015.

At the same time, Turkish imports reported a 12.5% year-on-year decrease during the aforesaid period of 2015 to US$ 151.0 billion. This was driven first by a 10.0% decrease in the value of imported manufactured products, followed by a 23.1% decrease in the value of mining and quarrying products, and a 35.1% decrease in the value of wholesale and retail trade products. The above factors hint to a weaker internal demand despite a modest pick-up in growth. This probably reflects the effect of the Lira depreciation on the relative prices for imported goods and the impact of higher interest rates on slow spending starting in the second half of this year and into 2016.

A detailed look at Turkey's imports show that the drop was mainly due to lower products from the European Union, which decelerated by 11.0% year-on-year during the first nine months of 2015. However, their share remained almost unchanged year-on-year at 37% of total imports, the highest among Turkey's trading partners. The drop in imports from other European countries and Near and Middle Eastern

BREAKDOWN OF EXPORTS AND IMPORTS BY MAIN COMMODITIES (10M-15)



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

countries came in next. Imports from the first category of countries went down by 19.3%, while those from the second category went down by 31.9% over the same period of the year.

As the decrease in the value of exports was so far this year coupled with a more significant drop on the side of imports, Turkey's trade deficit remained on a sliding path, reporting another double-digit improvement of 18.2%. Accordingly, the country's trade deficit reached US$ 37.2 billion in the first nine months of 2015, down from US$ 45.5 billion in the equivalent period of 2014, year during which the deficit also tightened by 20.4%. The improvement of Turkey's trade balance was a main driver behind shrinking the country's current account deficit. The latter reached US$ 25.6 billion during the first nine months of 2015, posting an 18.9% decrease relative to the equivalent period of 2014. The deficit of the current account balance is projected by the IMF to settle at 4.5% of GDP for full-year 2015, down from 5.8% last year, yet remains somehow high relative to other emerging markets.

The shrinking of the deficit registered at the level of the current account has been accompanied by a much stronger drop in the financial account surplus. The latter reached US$ 17.3 billion, decreasing by 67.4% year-on-year. The drop was driven, among other reasons, by a higher incurrence of direct investments liabilities, a lower acquisition of portfolio and other assets, as well as a higher incurrence of central bank, commercial banks, and other sectors' liabilities. Lower financial surplus actually reflect Turkeys' continued elevated geopolitical risks in an environment of risk aversion and decreased investment capital for emerging markets.

Turkey's sustained current account deficit along with a decreased financial account surplus expose the country to large external funding needs, estimated at 27% of GDP. This reality continues to put the country at increased risk of sudden and sustained halt in capital inflows and to expose its banking sector to scarcer and more expensive foreign funds in the medium term.

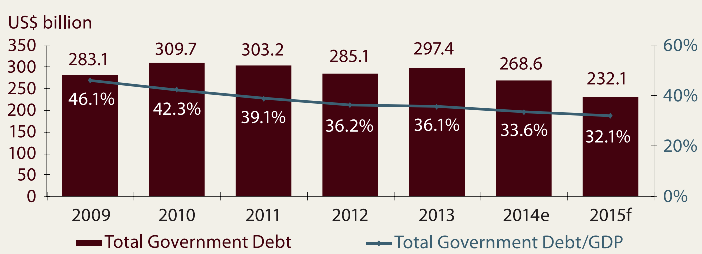
1.3. PUBLIC SECTOR

Contracting budget deficit along with declining debt-to-GDP ratio

Turkey's fiscal deficit contracted over the first ten months of 2015 and the primary balance remained in surplus, spotting light on favorable debt dynamics. The ratio of the gross debt to GDP continued to follow a downward trajectory and is expected to reach 32.1% in 2015, the lowest in 15 years.

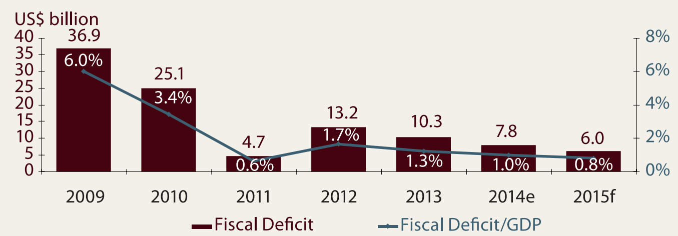
Central government revenues grew by 14.5% during the first ten months of 2015 to reach a total of TL 398 billion, mainly supported by a 14.5% increase in general budget revenues to TL 383 billion, a 12.6% rise in revenues from special budget institutions to TL 12 billion, and a 13.3% growth in revenues from regularity and supervisory institutions to TL 3 billion. General budget revenues showed that tax revenues increased by 16.3% during the first ten months of 2015 to reach TL 333.3 billion, property income went up by 27.8% to TL 18.4 billion and capital revenues rose by 6.5% to TL 7.3 billion, while interest, shares and fines fell by 8.7% to TL 21.6 billion, grants and aids and special revenues declined by a shy 0.5% to TL 1.9 billion, and receivable collections dropped by 67.7% to TL 265 million during the first ten months of 2015.

PUBLIC INDEBTEDNESS



Sources: IMF, Bank Audi's Group Research Department

FISCAL DEFICIT



Sources: IMF, Bank Audi's Group Research Department

Expenditures went up by 11.5% during the first ten months of 2015 to reach TL 404 billion, mainly due to a 12.4% expansion in non-interest expenditures to TL 357 billion, and a 4.7% rise in interest expenditures to TL 47 billion. Non-interest expenditures showed for instance a 12.6% increase in compensation of employees during the first ten months of 2015 to TL 106 billion, an 11.2% expansion in current transfers to TL 151 billion, a 15.7% surge in good and services purchases to TL 32 billion, a 9.6% rise in capital expenditures to TL 34 billion, a 38.1% jump in capital transfers to TL 7 billion, a 10.5% growth in social security contributions to TL 17 billion and a 19.5% increase in lending to TL 10 billion. Interest expenditures showed a 0.8% increase in domestic interest during the first ten months of 2015 to TL 35 billion, a 16.6% surge in foreign debt interest to TL 9.5 billion, a 15.1% growth in interest of discount and short term cash operation to TL 1.8 billion and a 41.6% jump in Certificate of rent expenditures to TL 936 million.

That being said, the central government deficit reached circa TL 6 billion over the first ten months of 2015 as compared to a deficit of TL 15 billion during the same period of 2014, mainly driven by a healthy growth in tax revenues, accounting for 84% of central government revenues. When excluding debt service, a primary surplus of TL 41.2 billion was recorded over the first ten months of 2015 as compared to a surplus of TL 30.3 billion over the corresponding period of 2014.

In parallel, the central government debt stock reached TL 678 billion at end-October 2015 as per the latest figures released by the "Prime Ministry Undersecretariat of Treasury", up from TL 612 billion in 2014, and split into TL 438 billion in domestic debt (accounting for circa 65% of the total) and TL 239 billion in external debt (accounting for the remaining 35%). The interest composition of the total debt stock shows that the fixed rate debt captured 67.4% of the total at end-October 2015, while the floating rate debt accounted for 17.9% of the total, and the CPI indexed debt represented 14.7% of it. This came along Turkey's strategy to decrease the share of debt which has interest rate refixing period of less than 12 months. Besides, it is worth mentioning that 81.7% of domestic debt is held by residents, while 18.3% is held by non-residents. That being said, the central government debt stock reached 31.6% of GDP at end-October 2015, and is expected to reach 32.1% of GDP at end-2015, as per the IMF, down from 33.6% of GDP in 2014.

Looking forward, while the reemergence of a single-party government is set to lower domestic political uncertainties, election-related spending poses some challenges to the country's fiscal performance, especially that the Justice and Development Party has promised in its electoral campaign to raise the monthly minimum wage from TL 1,000 to TL 1,300, increase the State pension and subsidize interest for SMEs, which according to the Finance Ministry, is expected to cost about TL 24 billion (or 1% of GDP) annually.

1.4. FINANCIAL SECTOR

1.4.1. Monetary Situation

Monetary policy kept tight despite measured rate cuts

Turkey's monetary policy has been kept tight in 2015 despite "measured" rate cuts delivered by the Central Bank of the Republic of Turkey earlier this year. This came within the context of a persistently high inflation, staying well above the Central Bank's target of 5%, amidst a sharp fall in the Turkish Lira that has offset the disinflationary effect of plunging oil prices.

After adopting an aggressive tight monetary policy in 2014 to defend the Turkish Lira, the Central Bank of the Republic of Turkey (CBRT) reduced interest rates at a "measured scale" early-2015, reiterating that its ongoing tight monetary policy along with prudent fiscal and macroprudential measures continue to have favorable impact on inflation, especially inflation excluding energy and food, and inflation expectations. The CBRT reduced the one-week repurchase rate twice this year- in January and February 2015- by a total of 75 bps, moving from 8.25% to 7.50%. It also trimmed the overnight borrowing rate in February 2015 by 25 bps to 7.25% and the overnight lending rate by 50 bps to 10.75%. The CBRT kept its three main interest rates unchanged since then despite repeated calls from the government to lower borrowing costs in order to boost economic growth. This came within the context of a "cautious" monetary policy adopted by the Central Bank to ensure a persistent reduction in inflation.

Inflation slowed over the year 2015, yet remained quite high and well above the Central Bank's medium-term target of 5%. The Consumer Price Index rose by 7.5% on average during the first ten months of 2015 after averaging 8.9% in 2014, and is expected to average 7.4% in 2015, according to IMF estimates. This came within the context of plunging oil prices that have affected inflation favorably, while the cumulative depreciation of the Turkish Lira has pushed the annual core goods inflation upwards and caused the core inflation trend to deteriorate slightly. In fact, the core goods inflation surged to 8.9% in October 2015, mainly due to the lagged effects of the exchange rate developments.

The Turkish Lira has depreciated by 25% over the first ten months of 2015, moving from TL/US$ 2.33 at end-2014 to TL/US$ 2.92 at end-October 2015. The Turkish Lira weakening came on the back of domestic political impasse that resulted into delays in the economic policy agenda, in addition to geopolitical risks, China's currency devaluation and expectations of a tightening in US monetary policy.

On the back of weakening Turkish Lira and accelerating portfolio outflows, the CBRT's gross foreign exchange reserves pursued their downward trajectory, dropping by US$ 6.2 billion over the first ten months of 2015 to reach US$ 100.1 billion at end-October 2015, as the Central Bank sold considerable amounts of its reserves in a bid to defend the local currency.

That being said, it is worth mentioning that the CBRT released a road map in August 2015 regarding the policies to be implemented before and during the normalization of global monetary policies. Accordingly, the Central Bank announced that the width of the corridor will be narrowed and the interest rate corridor will be made more symmetric around the one-week repo interest rate, but this may be implemented only after the US Federal Reserve starts hiking interest rates. During the simplification process, adjustments will be made in the funding composition to preserve the required degree of tightness in the monetary policy. The road map also incorporated policies regarding Turkish lira liquidity, foreign exchange liquidity and financial stability to be implemented before and during the normalization.

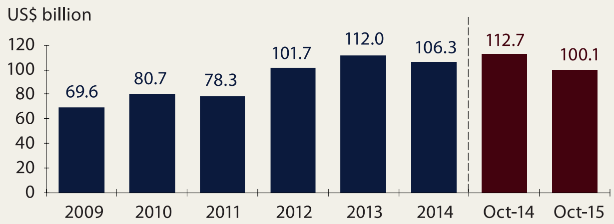
Looking forward, while considering the impact of the uncertainty in global markets on inflation expectations and taking into account the volatility in energy and unprocessed food prices, and in view of the Justice and Development Party's electoral promise to increase the net minimum wage by 30% in 2016, the CBRT is set to maintain a tight monetary policy until there is a significant improvement in the inflation outlook.

MONETARY SITUATION

Flows in US$ million	2009	2010	2011	2012	2013	2014	10M-15
Net foreign assets	**-3,073**	**-25,493**	**-2,341**	**6,649**	**-25,739**	**-16,026**	**698**
Foreign assets	-5,054	-93	7,123	28,861	11,888	-4,318	6,725
Foreign liabilities	1,980	-25,399	-9,464	-22,211	-37,626	-11,708	-6,027
Domestic Assets	**68,667**	**93,155**	**-26,520**	**94,369**	**22,228**	**41,881**	**-44,932**
Claims on private sector	29,063	84,676	26,540	91,188	46,689	44,265	-24,770
Claims on public sector	35,290	4,304	-49,055	-563	-24,558	-3,997	-17,250
Claims on non-bank financial institutions	4,315	4,175	-4,005	3,744	97	1,614	-2,912
Total Money Supply	**65,594**	**67,662**	**-28,861**	**101,018**	**-3,533**	**25,878**	**-44,234**
Money Supply (M1)	11,419	15,099	-6,572	10,383	6,080	2,301	-7,066
Quasi-Money	33,539	43,183	-17,745	61,002	-4,927	11,254	-25,341
Other Items (Net)	20,635	9,380	-4,544	29,633	-4,686	12,323	-11,827

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

1.4.2. Banking Activity

Healthy activity growth in local currency terms but sharp Lira depreciation exerting pressure on funding and asset quality

The Turkish banking sector has seen a healthy activity growth so far this year in local currency terms, in line with the moderate economic activity growth, but the sharp Turkish Lira depreciation over the course of 2015 is likely to start pressuring banks' loan portfolios and exacerbate their funding position's sensitivity to global credit market conditions. Measured by total assets of banks operating in Turkey, the sector's activity grew by a notable 17.7% in local currency terms in the first ten months of 2015, which yet translated into a negative growth when expressed in US dollar (-5.6%) by reason of the depreciation of the local currency. This actually marks an acceleration relatively to the already healthy 10.6% rise registered in local currency terms in the corresponding period of 2014.

A quick glance at banks' balance sheet breakdown shows that the bulk of this asset growth over the first ten months of 2015 comes from the expansion of banks' loan portfolios (64% of total balance sheet growth in volume), noting that the increase in required reserves (12% of total asset growth) and receivables from banks (7% of total asset growth) were also asset growth drivers over the covered period.

Focusing on the lending front, total sector loans surged by 18.1% in local currency terms (this yet translated into a 5.4% decline when expressed in US dollar terms), reflecting still strong financial intermediation activity on behalf of Turkish banks. Yet it seems that the Lira depreciation during 2015 has dented demand for credit, with lending to households and to a lesser extent corporates slowing down, and Turkish Lira loans decelerating in the second half of 2015 and even FX loans stalling throughout the year (in US dollar terms). Loans in local currency accounted for 68% of total loans at end-October 2015, and grew by 13.1% in the covered period.

Among major loan categories, working capital loans were the major contributors to the total (37% of total growth), followed by other investment loans (13% share) and consumer loans (9%), while credit cards only had a 3% contribution to lending growth so far in 2015. A sector breakdown of loans shows that the wholesale and retail trade sectors contributed the most to lending activity growth with a 21% share, followed by manufacturing with 17%, construction with 11% and electric, gas and water resources with 10% during the first ten months of 2015.

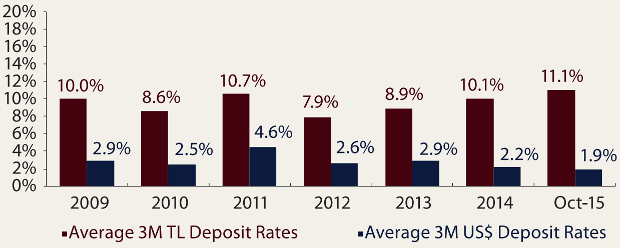
On the funding front, total deposits, a major activity driver of banking institutions accounting for 53% of total balance sheets, likewise progressed by 17.6% in the first ten months of 2015 in local currency terms (-5.8% in US dollar terms). Out of the total deposit stock at end-October 2015, 55% were accounted for by Turkish Lira funds and the remainder in foreign currencies, noting that so far this year, FX deposits grew faster than Lira funds.

BANKING SECTOR INDICATORS

in US$ billion	2009	2010	2011	2012	2013	2014	Oct-15
Banking Activity							
Assets	560.1	656.5	648.1	773.4	814.4	859.8	811.4
Deposits	345.6	402.4	370.3	435.7	444.6	454.3	428.1
Credit facilities	263.7	343.1	363.5	448.4	492.4	535.5	506.5
Shareholders' equity	74.4	87.7	76.9	102.6	91.1	99.9	88.5
YTD Growth rates							
Assets	16.2%	17.2%	-1.3%	19.3%	5.3%	5.6%	-5.6%
Deposits	15.5%	16.4%	-8.0%	17.7%	2.0%	2.2%	-5.8%
Credit Facilities	8.9%	30.1%	5.9%	23.4%	9.8%	8.8%	-5.4%
Shareholders' equity	30.8%	17.9%	-12.3%	33.4%	-11.2%	9.7%	-11.4%

Sources: BRSA, Bank Audi's Group Research Department

BANKING SECTOR DEPOSIT RATES



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

A more detailed look at bank deposits in Turkey reveals that term deposits were the largest contributors to total deposit growth with 82% of the total, leaving 18% to demand deposits. Resident deposit growth accounted for 85% of total deposit growth, noting that resident deposits represent 93% of the total stock of deposits. The number of depositors soared by 8.2% in the first ten months of 2015, with residents representing 98% of total number growth.

But what is probably more noticeable is the decline in the share of deposits in total balance sheet of banks from above 60% a few years ago to barely more than 50% today, to the benefit of external borrowing on international money markets. As a matter of fact, the relatively sluggish domestic savings growth has prompted banks to seek funds elsewhere to finance the economy. Global markets funding, a non-negligible chunk of which is shorter term and raises refinancing risks at maturity, yet remains subject to swings in investor sentiment. This is especially true bearing in mind the upcoming US monetary policy tightening which could lead to challenging external refinancing conditions for large emerging market economies such as Turkey in the period ahead. While it is true that the recent Turkish election results might have lowered uncertainties, sizeable risk aversion towards emerging markets and rising geopolitical risks in the region lately have weighed on banks' risk profile.

This trend has also contributed to enlarging the loan-to-deposit ratio quite noticeably to reach 118.4% at end-October 2015, a high ratio relative to emerging market peers and up from levels under the 100% threshold a mere three to four years ago. Having said that, while most foreign currency funding is short-term, banks have sufficient foreign currency liquid assets to cover almost fully foreign currency wholesale liabilities maturing until the end of 2016.

Another risk to pinpoint is the banks' exposure to currency and interest rate risks, as they use foreign currency funding from international wholesale markets to finance mostly local currency lending. Here again, we note that these risks are on the overall mitigated by currency swaps, though the fact that the latter are frequently with contractual short-term maturities increases the risk of re-pricing pressure upon renewal.

On the asset quality front, non-performing loans remain low at 3.0% of total cash loans at end-October 2015 (2.9% at year-end 2014), though there are some suspicions that banks have helped out by ever-greening loans. It is true that there are concerns that the recent Lira depreciation might make it harder for borrowers to honor their foreign currency lending-related obligations given that the share of FX loans is almost a third of the total. But one must also bear in mind that FX lending to individuals and SMEs is very low, while a large portion of big companies involved generate foreign currency revenues, which dampens altogether the FX risk impact on banks' asset quality. NPLs are also adequately provisioned for, with the coverage ratio reaching around 74% at end-October 2015.

In parallel, banks have strong capital buffers to withstand a potential rise in loan losses. The sector's capital adequacy ratio reached 15.3% at end-October 2015, slightly lower than 16.3% at end-2014 but still above regulatory requirements. Also, the bulk of capitalization (85%) consists of core capital, which strengthens banks' buffers against potential capital pressures. Sector capitalization is supported by adequate internal capital generation and provisioning coverage in addition to the regulatory cap on sector dividend distribution.

Last but not least, banks' margins have come under pressure and slightly contracted since last year, and along with higher provisions have been pressuring banks' bottom lines which have only slightly inched up relative to the first ten months of 2014 (+2.2% in local currency terms). Net income growth fell short of balance sheet growth, leading to a contraction in return ratios. The annualized ROAA ratio reached 1.15% in 10M 2015 (1.33% in 2014) and the annualized ROAE ratio stood at 11.1% (12.3% in 2014).

1.4.3. Equity and Bond Markets

Price falls across capital markets amidst geopolitical and domestic concerns

The Turkish capital markets witnessed downward price movements over the year 2015, along with a significant expansion in the cost of insuring debt amidst heated geopolitical tensions, domestic political uncertainties and security drifts, and rising bets over US Fed interest rate hike.

In details, Borsa Istanbul came under downward price pressures over this year, within the context of rising domestic political uncertainties. The BIST 100, which represents the 100 largest companies by market capitalization, dropped by 11.5% over the first eleven months of 2015 to close at 75,823.31. The US dollar-denominated BIST 100 Net Total Return Index fell by 9.5% over the first eleven months of 2015 after surging by 28.7% in 2014, which spots light on the reduced attractiveness of the Turkish stocks over the current year. The Borsa traded at a P/E of 14.43x at end-October 2015, against a P/E of 14.38x at end-2014, and the market dividend yield increased from 1.54% at end-2014 to 2.59% at end-October 2015.

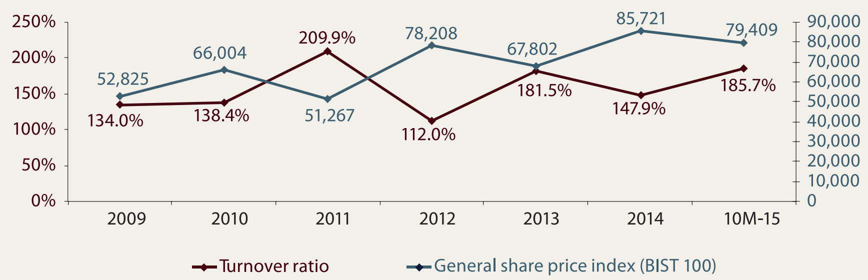
The market capitalization dropped from US$ 269.8 billion at end-2014 to US$ 205.5 billion at end-October 2015, down by 23.8%. The total number of contracts reached 79.5 million during the first ten months of 2015, up from 67.1 million during the corresponding period of 2014. The total trading value decreased from US$ 319.1 billion during the first ten months of 2014 to US$ 318.0 billion during the corresponding period of 2015, moving down by a shy 0.4%. The turnover ratio, measured by the annualized total trading

SELECTED STOCK MARKET INDICATORS

	2009	2010	2011	2012	2013	2014	10M-15
Market capitalization (in US$ billion)	236.0	307.6	201.9	311.2	237.6	269.8	205.5
Market capitalization/GDP	38.4%	42.0%	26.1%	39.5%	28.9%	33.8%	28.0%
Trading value (in US$ billion)	316.3	425.7	423.9	348.6	431.3	399.1	318.0
Number of contracts (000s)	68,700	81,457	102,855	79,808	80,298	83,640	79,501
Change in BIST 100 price index	96.6%	24.9%	-22.3%	52.6%	-13.3%	26.4%	-7.4%
Price/Earnings ratio	16.83	13.29	11.88	12.51	10.22	14.38	14.43
Dividend Yield (%)	2.37	1.79	2.57	1.73	2.27	1.54	2.59

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

STOCK MARKET PERFORMANCE



Sources: Borsa Istanbul, Bank Audi's Group Research Department value to market capitalization, reached 185.7% during the first ten months of 2015, up from 144.4% during the corresponding period of 2014, spotting light on the larger decrease in market capitalization than the trading value on the Borsa Istanbul.

At the level of the bond market, Turkish bond prices plunged over the year 2015 amidst domestic political instability, escalated geopolitical risks, and speculation over US Fed rate hike. Foreign investors were net sellers of Turkish bonds over the first ten months of 2015, as reflected by a significant drop in their holdings from US$ 51.7 billion at end-2014 to US$ 33.9 billion at end-October 2015. Within this context, the 10-year Turkish Lira Benchmark bond index yield rose from 8.02% at end-2014 to 9.77% at end-October 2015. Under these circumstances, the cost of insuring debt in Turkey expanded considerably since year-end 2014, with the five-year CDS spreads moving from 184 basis points at end-2014 to 258 basis points currently.

Despite these negative headlines, the latest parliamentary elections showing landslide victory for Turkey's ruling Justice and Development Party are "credit positive" in the short-term, according to Moody's, because they reduce political uncertainty and thereby enhance the incoming government's ability to formulate and implement effective policies. The AKP's large majority also has the potential to improve issuing conditions, including for the three large Turkish banks (Akbank, Garanti and Vakifbank) that have set up mortgage covered bond program during 2015. As a result, there is a greater probability of them concluding their first deals and raising funds from a more traditional euro investment base, as per Moody's.

Turkey is currently rated at investment grade by Moody's ("Baa3", negative outlook) and Fitch ("BBB-", stable outlook). Standard & Poor's affirmed in November 2015 its unsolicited "BB+/B" foreign currency long-term and short-term sovereign credit ratings and "BBB-/A-3" local currency long-term and short-term sovereign credit ratings on the Republic of Turkey, with a "negative" outlook, given Turkey's flexible exchange rate and relatively well-capitalized banking system that will help absorb future external shocks.

Regarding new issues, Turkey raised US$ 3 billion during the first eleven months of 2015 through the issuance of a US$ 1.5 billion Eurobond maturing in 2043 at a coupon of 4.875% and a US$ 1.5 billion Eurobond maturing in 2026 at a coupon of 4.25%.

Looking forward, in this environment of volatile financial markets due to the uncertainties pertaining to global monetary policies and concerns about global growth, Turkey's Central Bank unveiled that it may gradually increase acceptance ratios for Eurobonds issued by the Undersecretariat of Treasury of the Republic of Turkey as collateral. This falls under the monetary policy simplification road map designed to improve the economy's resilience to global volatilities.

2. CONCLUDING REMARKS

Looking ahead, what are the drivers of the Turkish outlook in the short to middle run? Turkey's sovereign profile is supported by a diversified economy with promising growth prospects, favourable debt dynamics and fiscal performance, and improving trade linkages beyond the country's traditional European markets. It is constrained by large gross external financing needs and vulnerability to shifts in investor sentiment, low national savings rates and moderate international reserve adequacy, which limits the capacity of the economy to absorb exogenous shocks, notwithstanding a history of domestic and geopolitical turbulence that exacerbates external vulnerabilities.

The most important recent political development with economic implications is the finalization of parliamentary elections, where the AKP took an absolute majority to form alone a government. The party won 49.4% of the vote of early November, a major increase over the 40.9% it won in the previous elections. The AKP has now a comfortable majority in the Parliament, holding 316 of the 550 seats, above the 276 it needed to form government on its own. The elections results were positively perceived by the markets. The Turkish Lira per US$ exchange rate, which was quoted at a peak of 3.06 by end-September is quoted at 2.84 upon the finalization of this report but remains above the 2.33 level of end-2014. The stock market also rose by 14% since end-September, but remains 11% down year-to-date. The CDS spreads likewise dropped from 324 bps to 258 bps over the period (184 bps at end-2014). The yield on the 10-year Treasury bond declined from 11% at end-September to 9.98% today (8.0% at end-2014).

That being said, risk aversion in emerging countries' as well as in Turkish financial markets has been elevated in 2015 due to increasing geopolitical concerns and expectation of normalization in Fed monetary policy stance. Despite high volatility and weakening of Turkish Lira, the sustainable but moderate growth path Turkey has been striving to achieve is one of the most important criteria for investors in the long term. Considering the country's long-term macroeconomic fundamentals, Turkey's financial assets have remained at undervalued levels in the last couple of years as a result of the deterioration in investors' perception. In this respect, as a new government was swiftly formed after the elections in November, this negative divergence in investors' perception should be reversed to reflect the real value of Turkish financial assets.

The initial market reaction to AKP regaining single-party status was favourable, especially that it was swiftly followed by the appointment of a long awaited government. But this does not mean that such developments eliminate the obstacles to stable governance looking ahead. Investor focus will be on new economic management, given persistent concerns on Turkish policy direction. The sovereign outlook remains exposed to potential policy mistakes and a possible additional delay of normalisation in politics. Also rising tensions between Russia and Turkey could have adverse repercussions for the Turkish economy in the medium term.

External vulnerabilities remain a feature of Turkey's sovereign profile. Within the context of the expected tightening policy of the Fed soon hiking interest rates, large external financing needs leave Turkey exposed to the external environment. Indeed, Turkey's gross external financing requirements are very large and the international liquidity ratio is less than half the average of similarly rated countries. Sovereign buffers to volatility in investor sentiment have somehow diminished. In addition, uncertainties about the foreign asset position of corporates and the impact of higher financing costs increasingly represent a potential source of vulnerability.

In brief, the election results are undoubtedly favourable in the short term because they reduce political uncertainty by removing the prospect of a coalition, or even a third set of elections, thus enhancing the new government's capacity to enact and execute effective policies. Beyond the short term however, forthcoming economic policy and the pace of reform implementation to combat the weaker growth environment amidst volatile capital flows, in addition to the ability to preserve the strength and independence of key institutions against the backdrop of a possible push towards more political centralization, would determine the fundamental outlook of the Turkish sovereign, banks and corporates at large.

DISCLAIMER

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