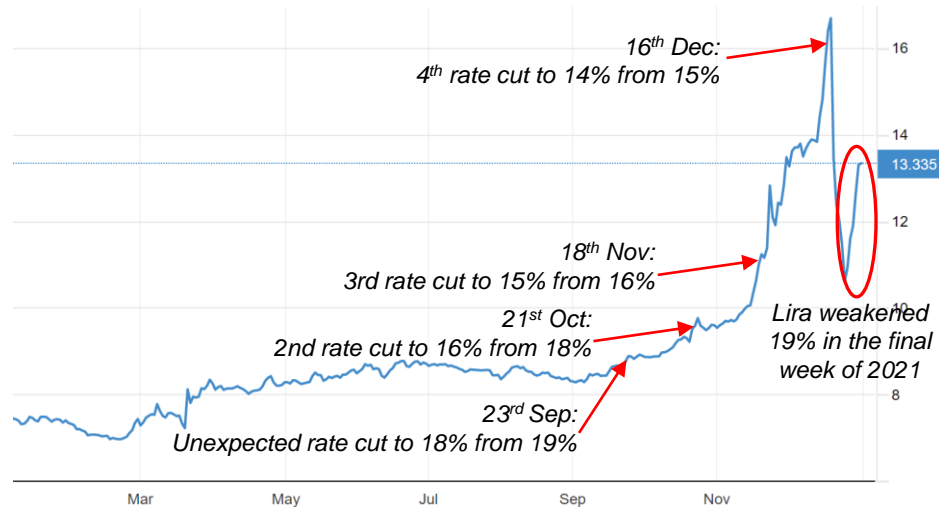




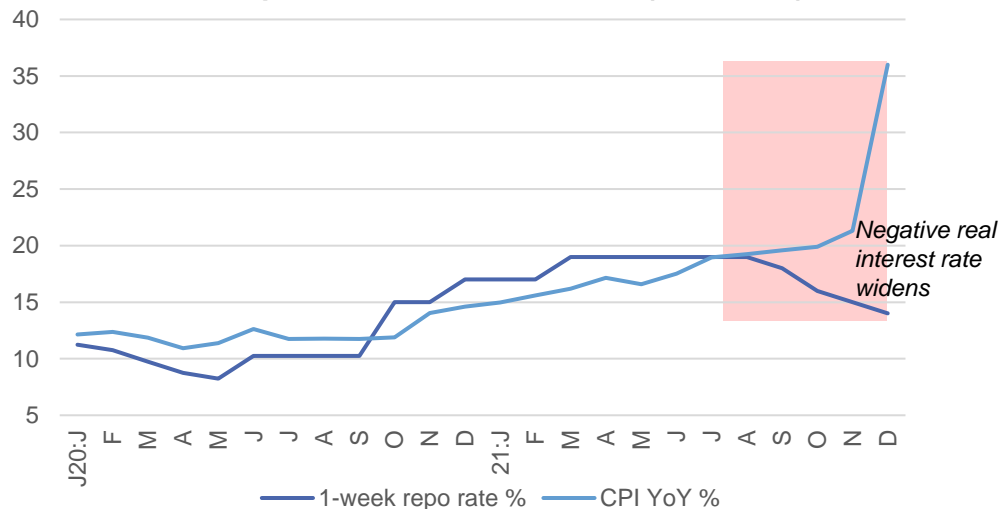
## Turkish Lira Outlook: “Not Out of the Woods Just Yet”

# Lira at the worst annual performance since 1994, Turkey's real yield is at its lowest level in at least 10 years

USDTRY trends (2021)



1-Week Repo Rate vs. Inflation trends (2020-2021)



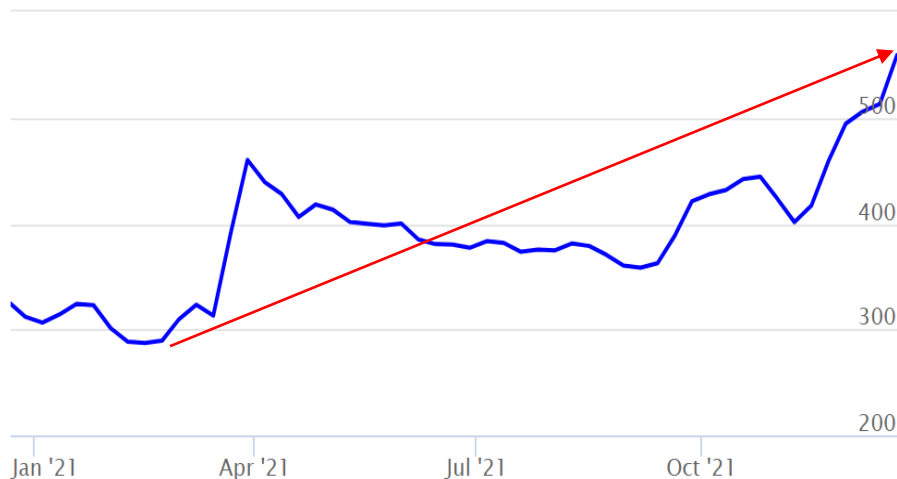
- ✓ The lira plunged more than 40% vs. USD in 2021 over fears of an inflation spiral brought on by Mr Erdogan's push for monetary easing.
- ✓ Turkish central bank cut interest rates 4 times since Sept 2021 by 500bps from 19% to 14%. The President has pledged to continue his low-rates economic policy to boost growth.
- ✓ Real interest rate fell deep into negative territory (-22%) on weakening confidence and raising demand for FX.
- ✓ The market expects inflation to reach 50% by spring 2022 unless the direction of monetary policy was reversed.
- ✓ Right after the lira touched 18.4/USD on 20<sup>th</sup> Dec, Mr Erdogan and the central bank unveiled measures to protect lira deposits against market fluctuations.
- ✓ The lira was highly volatile on 21<sup>st</sup> Dec, it fell as much as 8.6% and rose up to 18.5%, its second-largest daily move after 20<sup>th</sup> Dec intraday record swings (+25%). It closed 6% up at 12.4/USD on 21<sup>st</sup> Dec.

# Further lira depreciation could worsen Turkey's debt positions and intensify external financing pressures for corporates

USDTRY 3-Month Implied Volatility trends (2021)



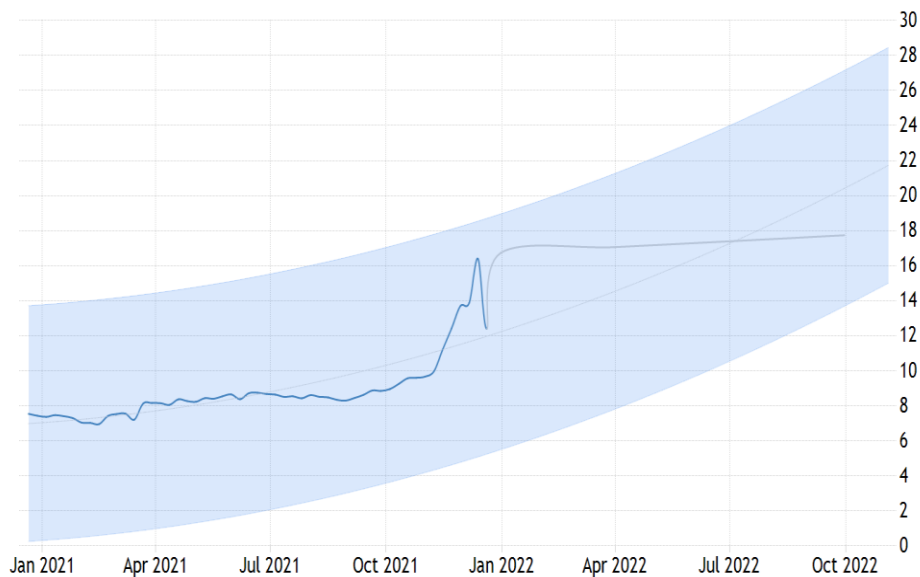
Turkey 5-Year USD CDS trends (2021)



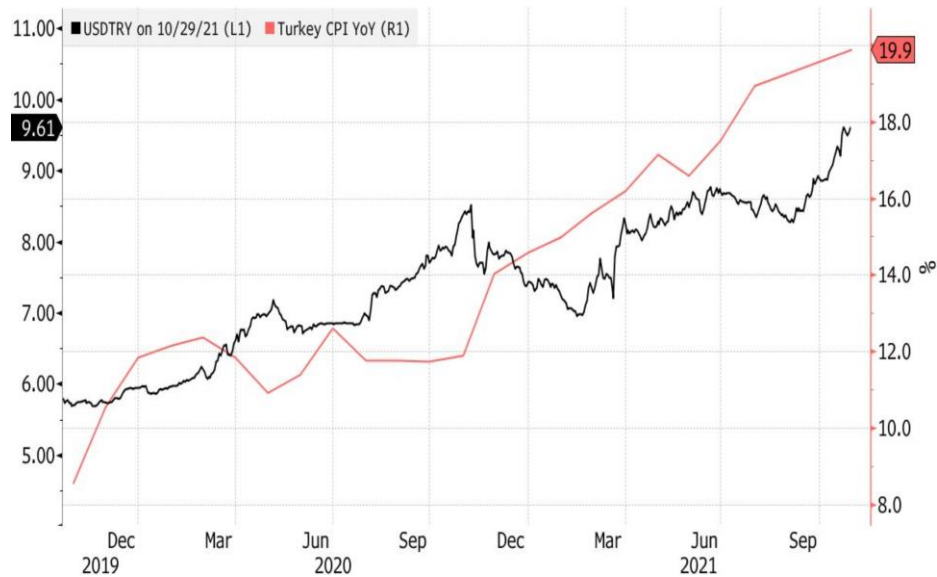
- ✓ Implied volatility on the lira jumped to 63%, the highest on record, it reflects waning investor confidence.
- ✓ Further lira depreciation could mean unlimited new debt being issued by the Treasury. The Government could turn to the central bank to monetize this, creating another inflation wave.
- ✓ Turkey's budget deficit estimated at ~3.5% of GDP for 2021, up from 1.5% in early-2021. Additional 12% lira depreciation could increase budget deficit by ~1% of GDP over a 6-month horizon (JP Morgan).
- ✓ Government debt level is estimated at 47% of GDP in 2021 (up from 40% of GDP), mostly driven by lira depreciation (Fitch).
- ✓ Turkey's 5-year USD CDS hit 622bps on 20<sup>th</sup> Dec, the highest since May 2020, reflecting the greater risk of a sovereign default.
- ✓ On 2<sup>nd</sup> Dec, Fitch Ratings downgraded Turkey's sovereign outlook to negative on premature interest rate cuts and lira slide. Fitch highlighted that lira depreciation could reignite external financing pressures.
- ✓ Turkish banks are regular FX borrowers, at USD138bln outstanding as at end-3Q21 (~22% of funding), of which USD83bln due within 12 months (Fitch estimates).

# The current strength in lira is unsustainable, expected to trade at 16.00/USD by June 2022 and 17.74/USD by Dec 2022

### USDTRY trends & expectations (2021-2022)



### Inflation vs. USDTRY trends (2019-2021)

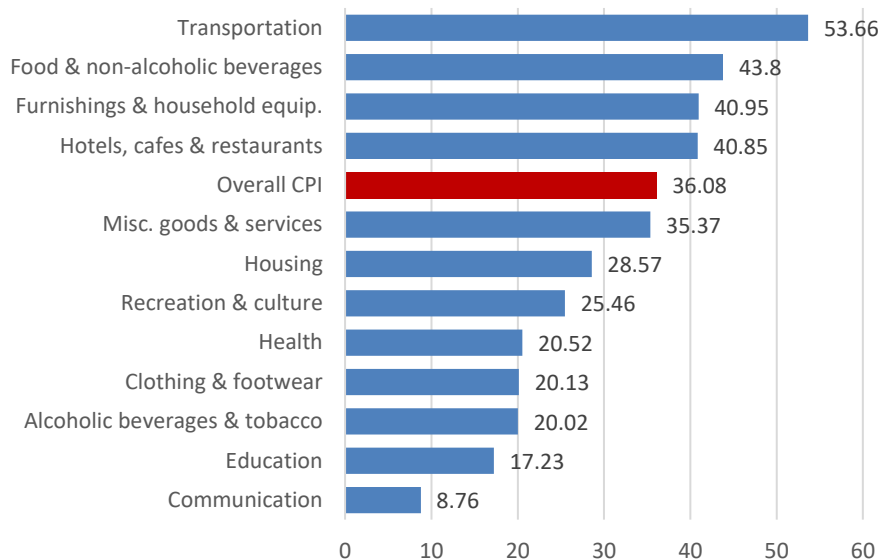


- ✓ Turkey enters into current stress period from a weak fundamental backdrop. **The ability to support the lira level is waning, FX reserve fell USD17bln as a result of recent lira intervention.** The central bank held the key rate at 14% on 20<sup>th</sup> Jan 2022.
- ✓ International banks stated they will review Turkish limits for the next debt roll over period based on the economic updates. **Some have stopped cash trading in lira and were extremely cautious about offering liquidity for forward contracts, citing market volatility and policy risks (Reuters news).**
- ✓ The market expects current lira level to be unsustainable, lira to trade weaker at **16.00/USD** by June 2022 and **17.74/USD** December 2022.

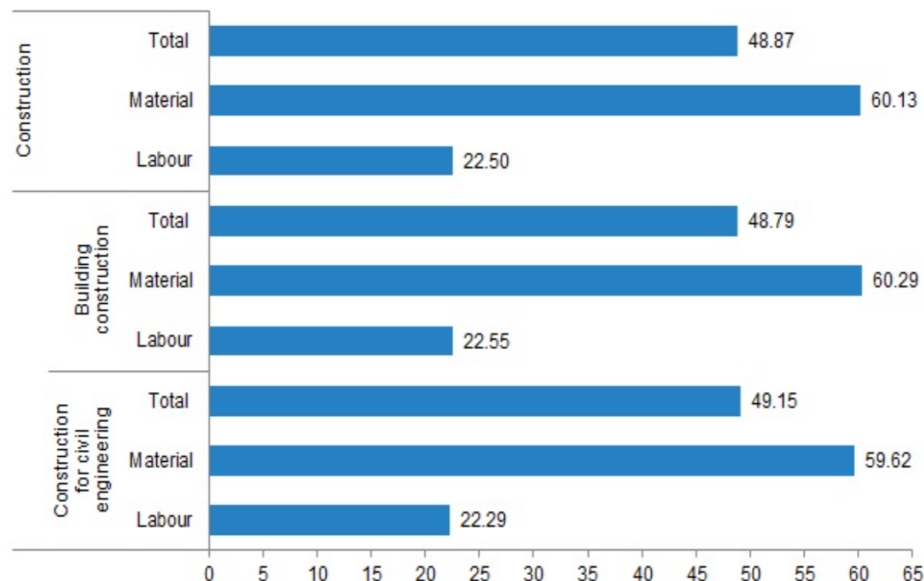


# Producers prices are 50% higher, construction cost index surged 49% fueled by rising materials and labor costs

Turkey's CPI by Components (2021), % YoY



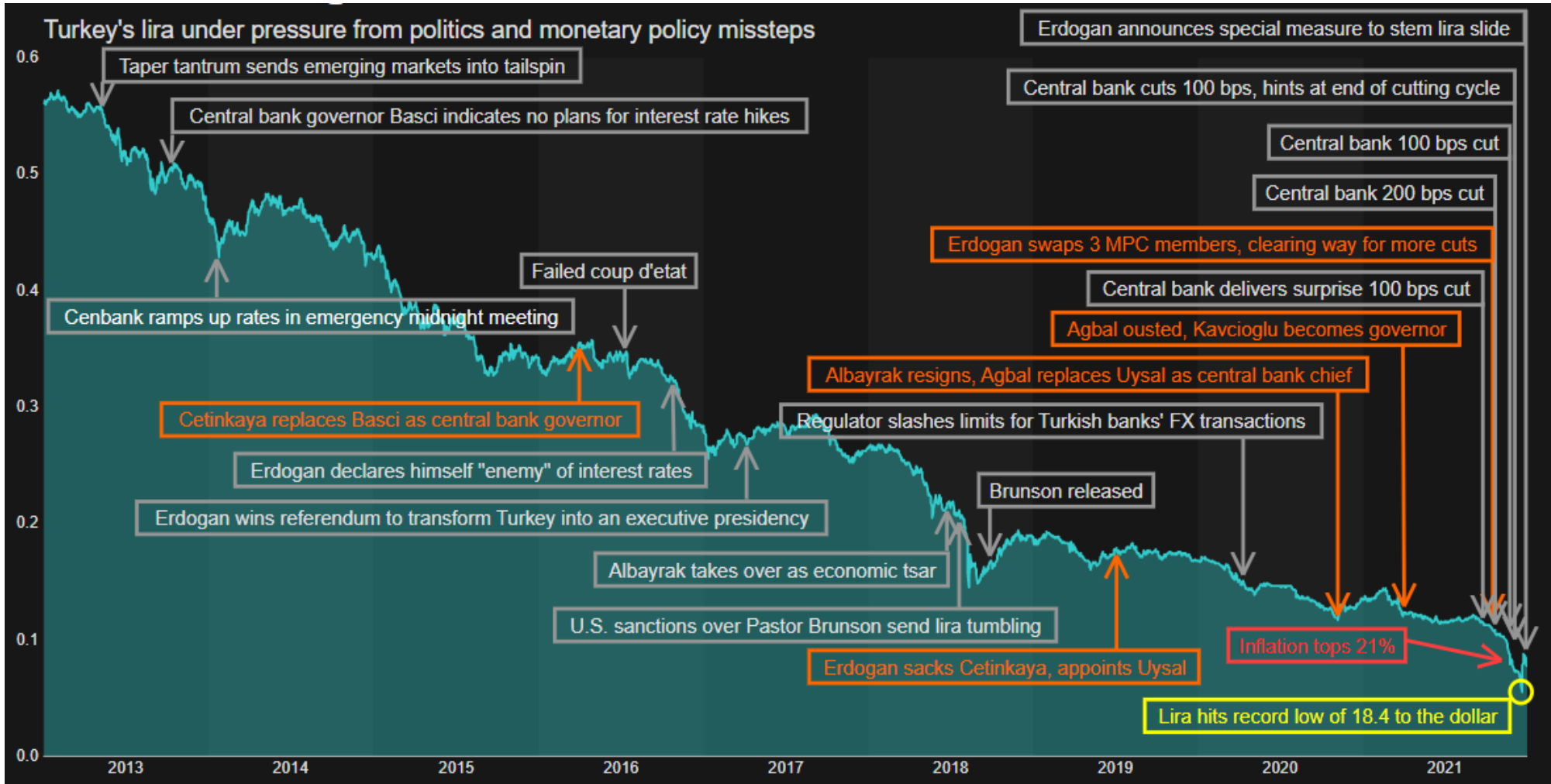
Turkey's Construction Cost Index (Nov 2021), % YoY



- ✓ **Intermediate goods account for ~75% of Turkey's total imports**, indicate widespread use of imported inputs in domestic production and for manufacturing exports. **Producers prices have risen 50% fueled by imported inflation**, likely to be passed onto consumers.
- ✓ Construction sector has been the backbone of Turkey's growth for the past 2 decades, contributes to 6% of GDP and employs ~2mln people. The sector is **hard hit by skyrocketed prices of imported raw materials and fuel due to the lira devaluation. Work has halted at numerous construction sites across Turkey since Sept 2021.**
- ✓ **The Building Construction Cost Index surged 48.8% YoY in Nov 2021**, as material cost rose 60.3% YoY while labor cost climbed 22.6% YoY. **Expect price adjustment for constructions-in-progress or newly starting projects.**
- ✓ Uncertainties on domestic prices will prevail driven by continued lira depreciation and high volatility.

# Turkish lira trends & key events (2013-2021)

TRYUSD trends (2013-2021)



# Turkey's key statistics

Key Indicator	2019A	2020A	2021		2022F		2023F	
			Prev.	Revised	Prev.	Revised	Prev.	Revised
GDP per capita, USD	9,127	8,540	8,856	8,645	9,518	7,310	10,563	8,123
Real GDP growth, %	0.9	1.8	7.9	10.5	3.5	3.6	4.5	4.5
Inflation (annual average % change)	15.5	12.3	17.3	18.3	14.6	23.7	11.8	16.8
General government balance (% of GDP)	-3.0	-3.9	-3.9	-3.4	-3.5	-3.2	-4.1	-3.4
General government debt (% of GDP)	32.6	39.5	39.2	46.9	38.4	43.1	38.3	41.2
Current account plus net FDI (% of GDP)	1.7	-4.5	-2.3	-1.5	-1.7	-1.0	-1.7	-1.3
Net external debt (% of GDP)	22.8	26.1	30.0	24.7	28.9	29.3	27.1	26.8

■ Improvement relative previous review

■ Deterioration relative previous review



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