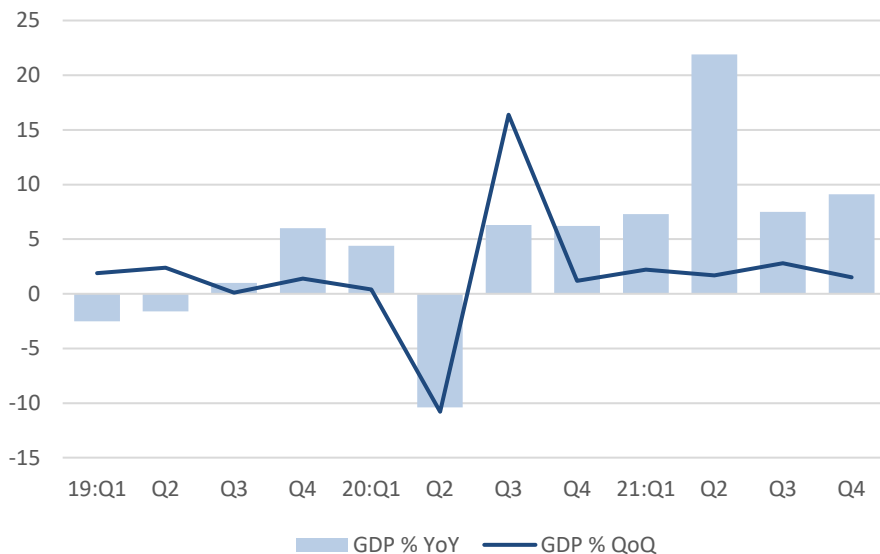




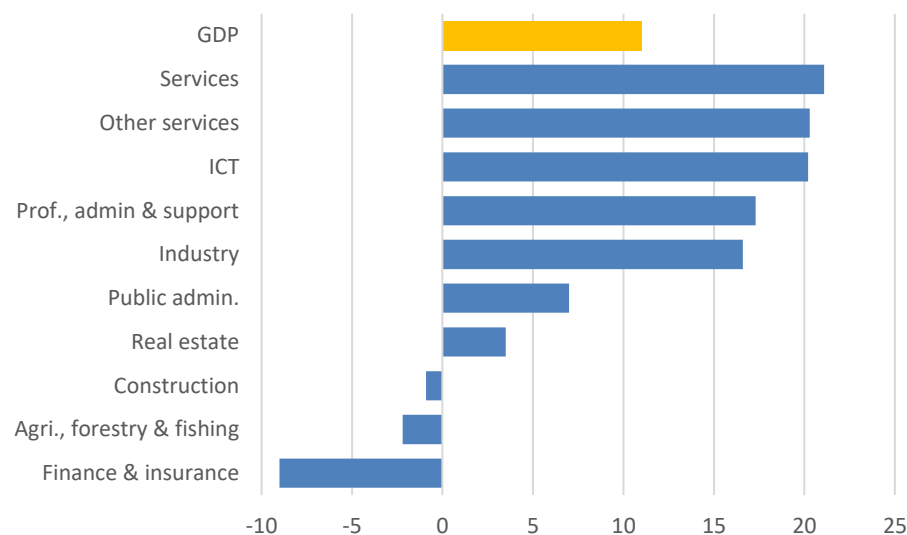
## Turkey's Economic Updates

# Turkey's GDP growth bounced back 11% in 2021, but is expected to slow sharply in 2022 on high inflation and geopolitics

Turkey's GDP Growth, 2019-2021, %



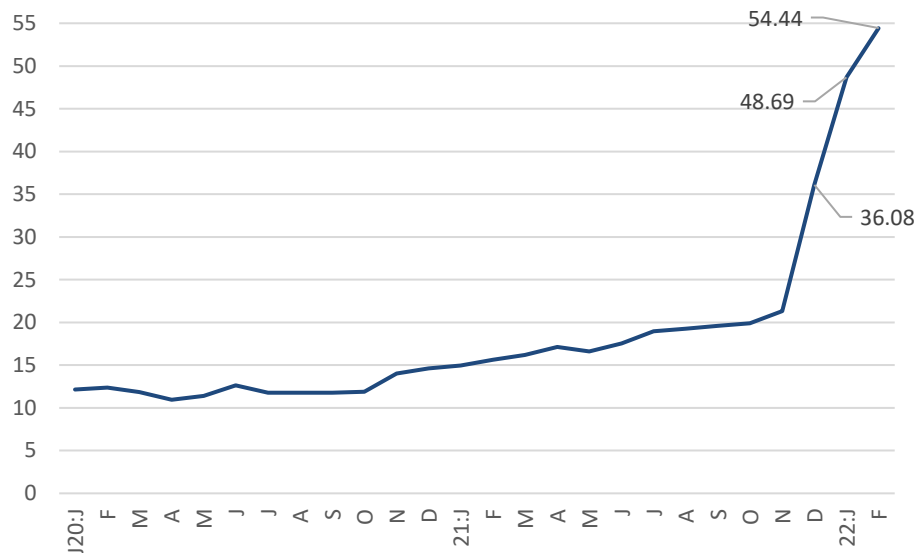
Turkey's GDP Growth by Sectors, 2021, % YoY



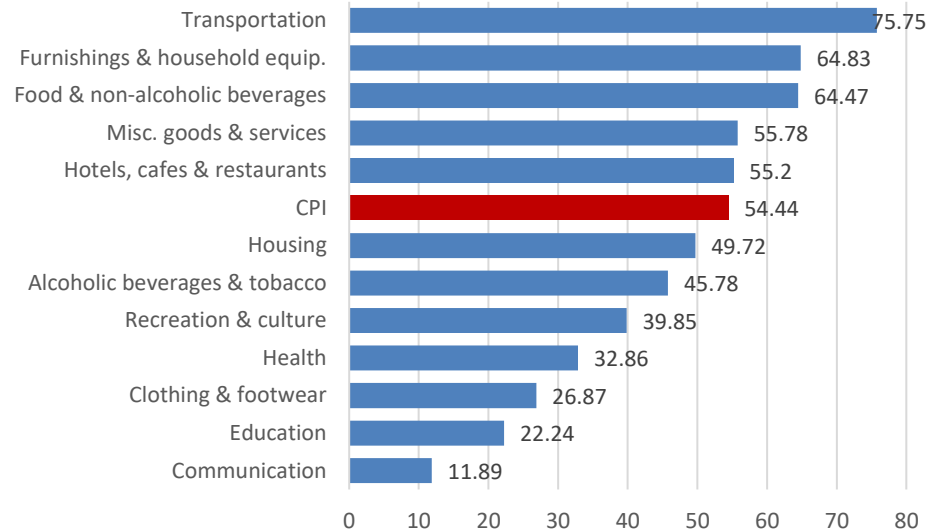
- ✓ **Turkey's economy bounced back from the pandemic to grow at 11% YoY in 2021** (2019: 0.9%, 2020: 1.8%), the highest in a decade. Consumer consumption, at 55.1% of GDP, increased by 15.1% YoY during the year. This was followed by gross fixed capital formation at 6.4% YoY (28% of GDP), and government spending of 2.1% YoY (13.1% of GDP).
- ✓ On economic sectors, positive growth was registered in the services 21.1%, industry 16.6%, ICT 21.1%, real estate 3.5%. In contrast, sectors which registered negative growth were **agriculture, forestry & fishing at -2.2%, finance & insurance at -9% and construction at -0.9%**.
- ✓ **The current geopolitics will contribute to keep inflation elevated for a longer period and threaten to hit tourism revenues** (vital to reducing gap on current account deficit). Leading indicators showed that while the industry sector holds up, retail sales have declined. **Turkey's GDP is expected to contract by 2.5%-3.0% in 1Q22, with full year growth expected to slow sharply to 3.5%.**

# Turkey's inflation surged to a 20-year high of 54% in February, expected to remain elevated in 2022

Turkey's Inflation, 2020-February 2022, % YoY



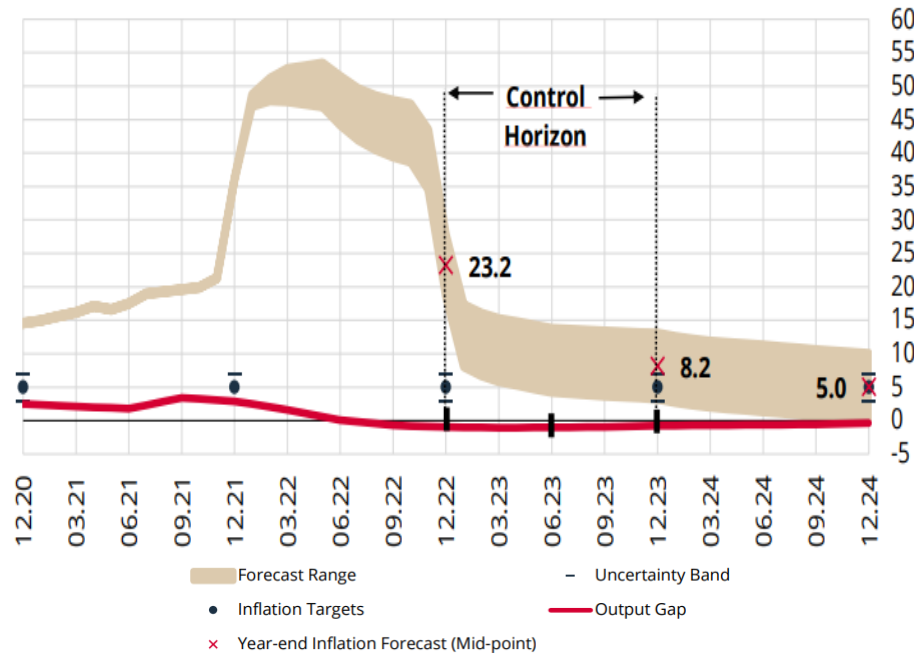
Inflation Components, February 2022, % YoY



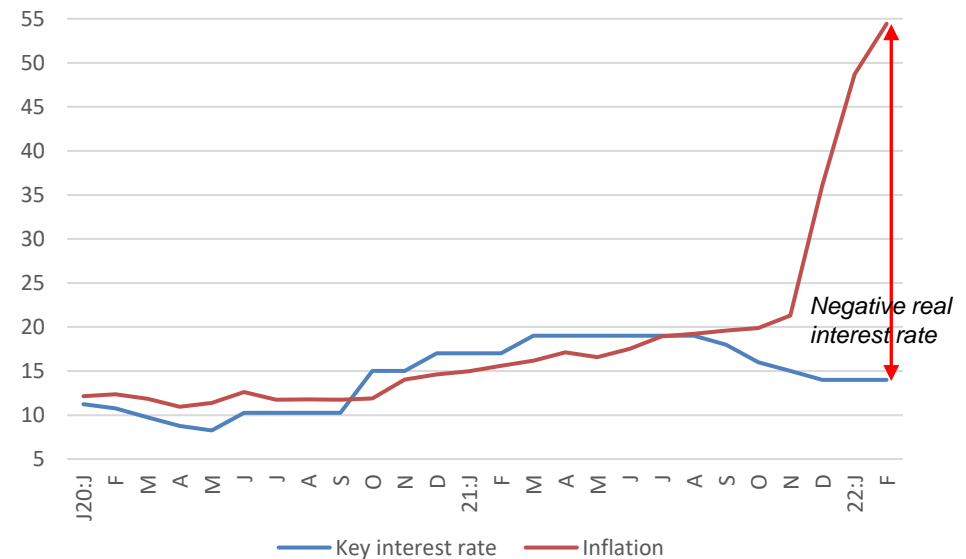
- ✓ **Turkey's inflation surged 54.44% YoY in February 2022**, the highest in 20 years as rising global food and energy prices continue to push domestic prices higher.
- ✓ The 3 main groups that registered high annual increases were transportation at 75.75% YoY, furnishings and household equipment at 64.83% YoY and food and non-alcoholic beverages at 64.47% YoY.
- ✓ Turkey lowered value added tax on food to 1% from 8% in February to fight inflation. Market expectations are that **inflation will increase further in coming months due to risks over commodity and agriculture prices, peak in May and remain elevated at 38% by end-2022.**

# Central bank projects inflation to ease in 3Q22 and beyond, key interest rate was maintained at 14%

CBRT's Inflation Forecasts, %



Inflation vs. Key Interest Rate, %

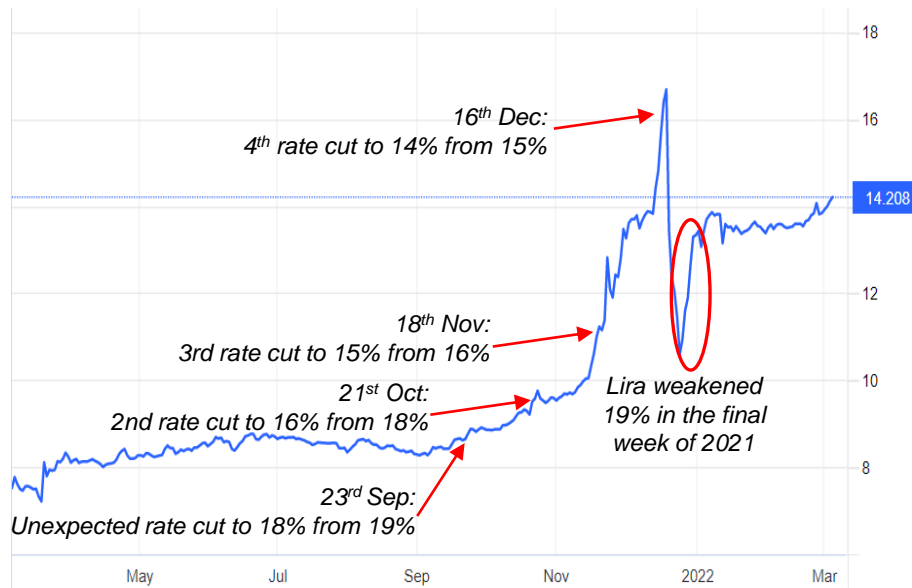


- ✓ Meanwhile, the **Central Bank of Turkey expects inflation to ease starting 3Q22** on the back of (i) measures taken for sustainable price and financial stability, and (ii) the high base effect in 2H21.
- ✓ As such, with **70% probability, the central bank expects inflation of 18.6%-27.8% (midpoint 23.2%) by end-2022**, and 3.4%-13% (midpoint 8.2%) by end-2023. **The current geopolitics and rising global prices will likely keep Turkey's inflation elevated for a longer period.**
- ✓ **Turkey's key interest rate was maintained at 14%** during February's monetary policy meeting. The central bank highlighted that Omicron and heightened geopolitics keep the downside risks to global economic activity and increases uncertainty. It added that Turkey's current high inflation was not driven by economic fundamentals but by global supply side factors.

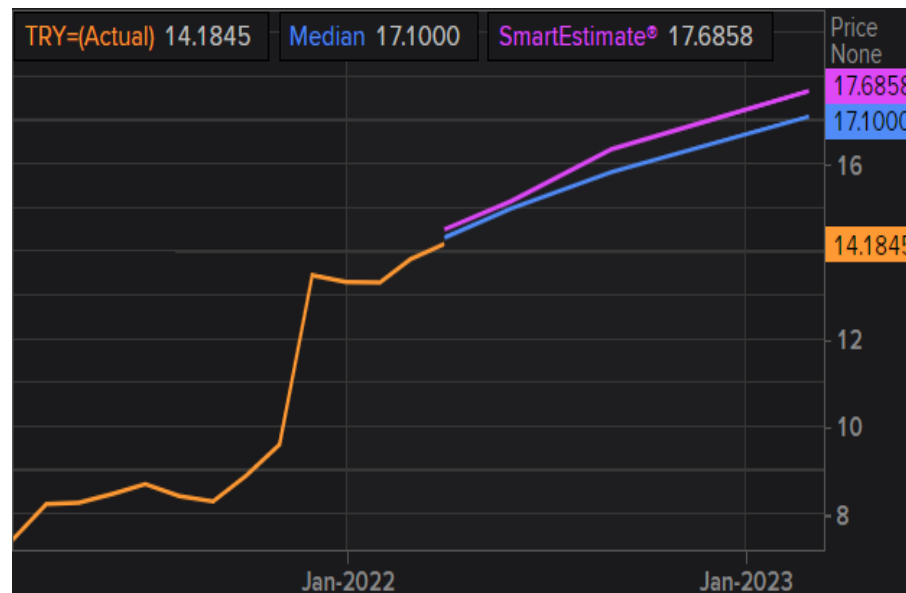


# Lira traded around 14.65 per dollar, current geopolitics threatened Turkey's macroeconomic stability

USDTRY Exchange Rate, 1-Year Trend, as at 4<sup>th</sup> March 2022



USDTRY Exchange Rate 1-Year Forecasts, as at 9<sup>th</sup> March 2022

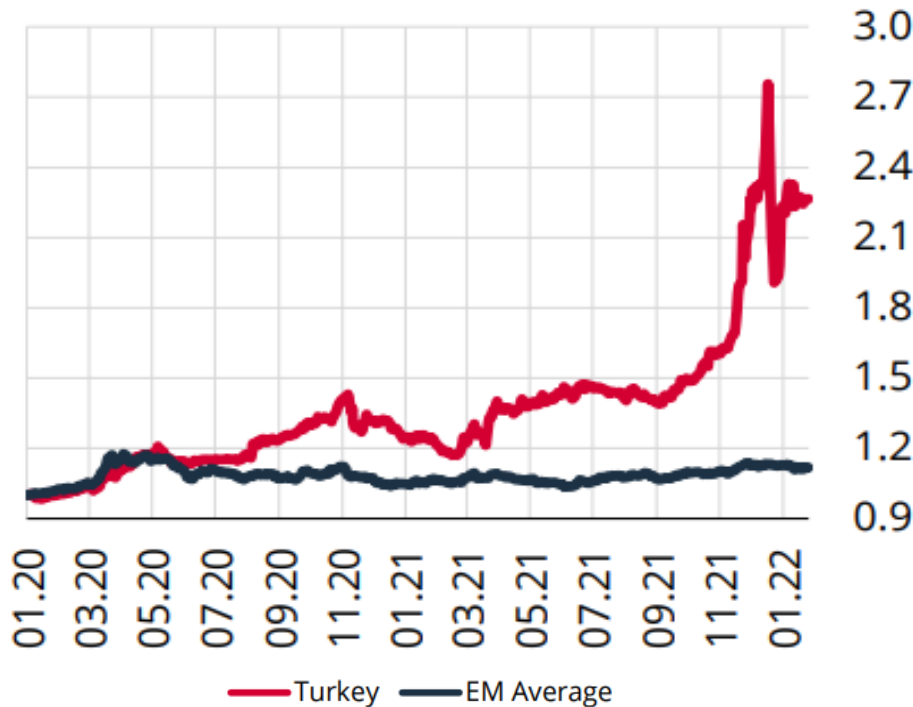


- ✓ **The lira traded around 14.65/USD on 9<sup>th</sup> March**, the lowest since December 2021 as current geopolitics threatened Turkey's already fragile macroeconomic stability. **The lira depreciated close to 90% to the dollar in the past 1 year.**
- ✓ There has been temporarily reprieve to the lira due to the (costly) government support schemes introduced since December 2021, the central bank is estimated to have sold USD20bln in reserves to support the lira in December 2021, and USD7-8bln in 2022 to-date.
- ✓ **Downward pressure on the lira is expected to continue given Turkey's unconventional monetary policy stance** (and on the back of the US interest rate hikes expectations). As at 4<sup>th</sup> March, median forecasts for **lira to reach 17.1/USD by January 2023.**

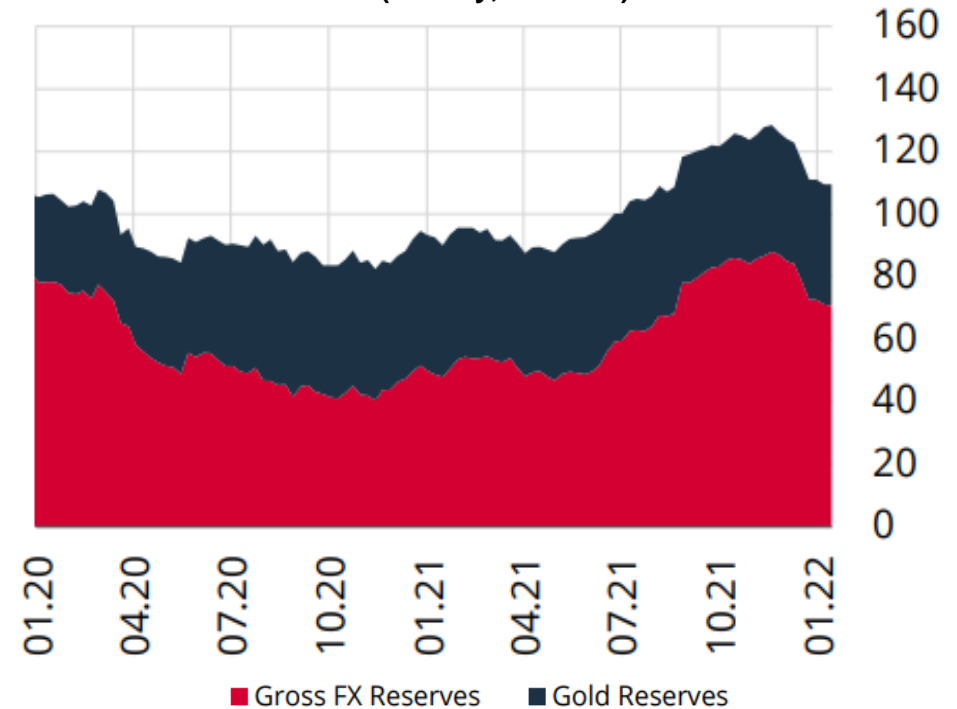


# Emerging market currencies depreciated slightly against the USD but the lira diverged negatively, Turkey's FX reserves reversed its uptrend

Lira and EM Currencies vs. USD  
(Index 31.12.2019=1)



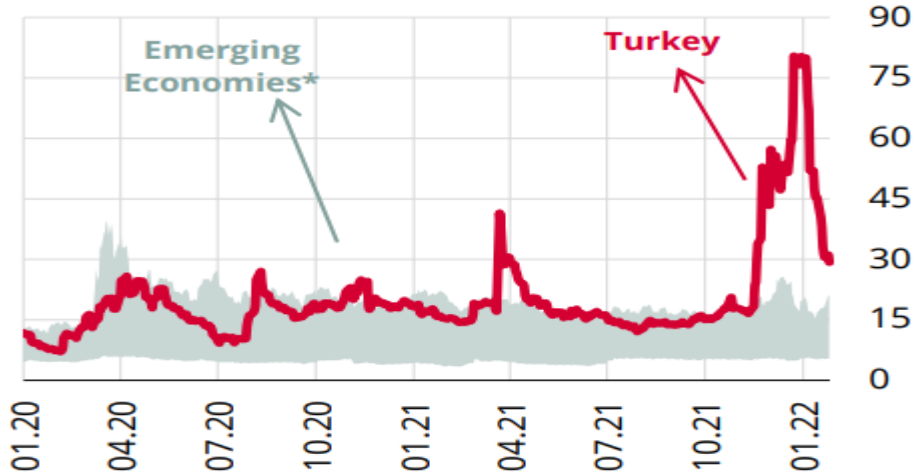
Change in CBRT's International Reserves  
(Weekly, USD bln)



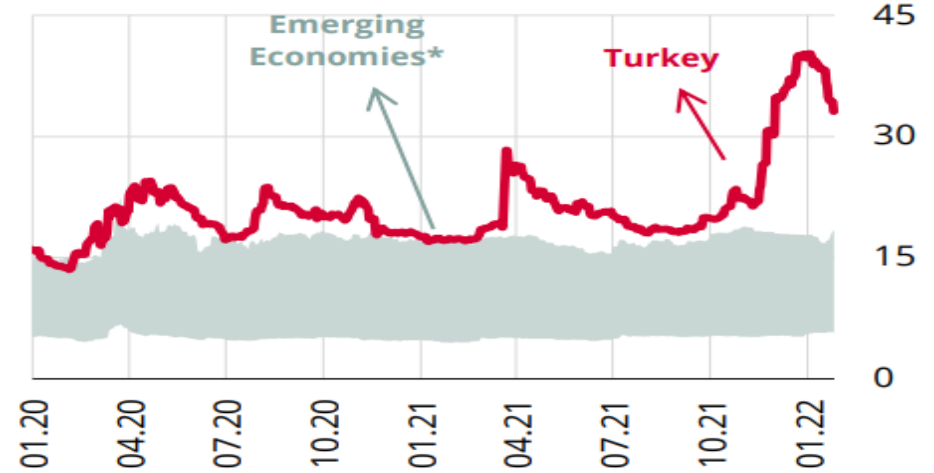
- ✓ While emerging market (EM) currencies depreciated slightly against the USD in response to the increase in the dollar index, the Turkish lira diverged negatively.
- ✓ The uptrend in the central bank's **international reserves** reversed, **declined by 1.3% on a monthly basis to USD109.7bln in January 2022. FX reserves fell by 2.4% to USD63.3bln** while gold reserves increased by 0.3% to USD38.6bln.

# Lira implied volatility is relatively high vs. EM currencies, high inflation & deterioration in inflation outlook drove up yield curves

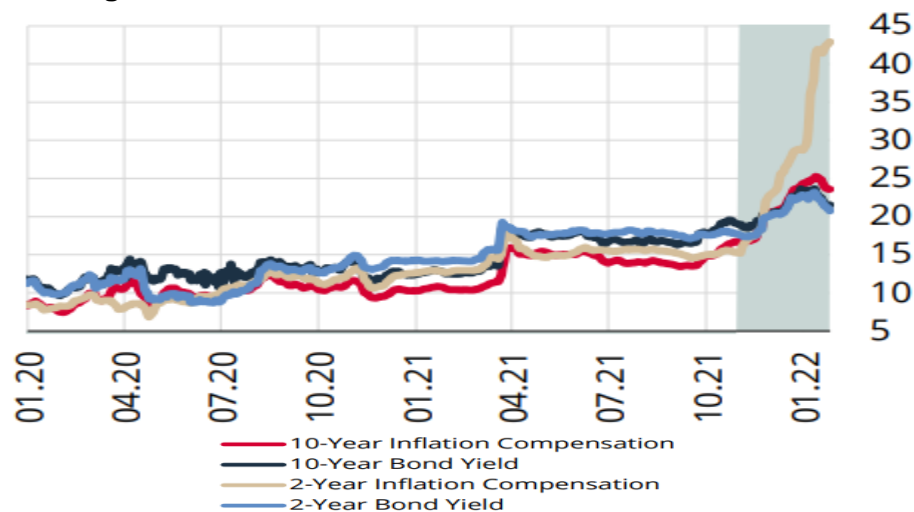
Exchange Rate Volatilities Implied by Options  
(vs. USD, 1-Month Forward, %)



Exchange Rate Volatilities Implied by Options  
(vs. USD, 12-Month Forward, %)

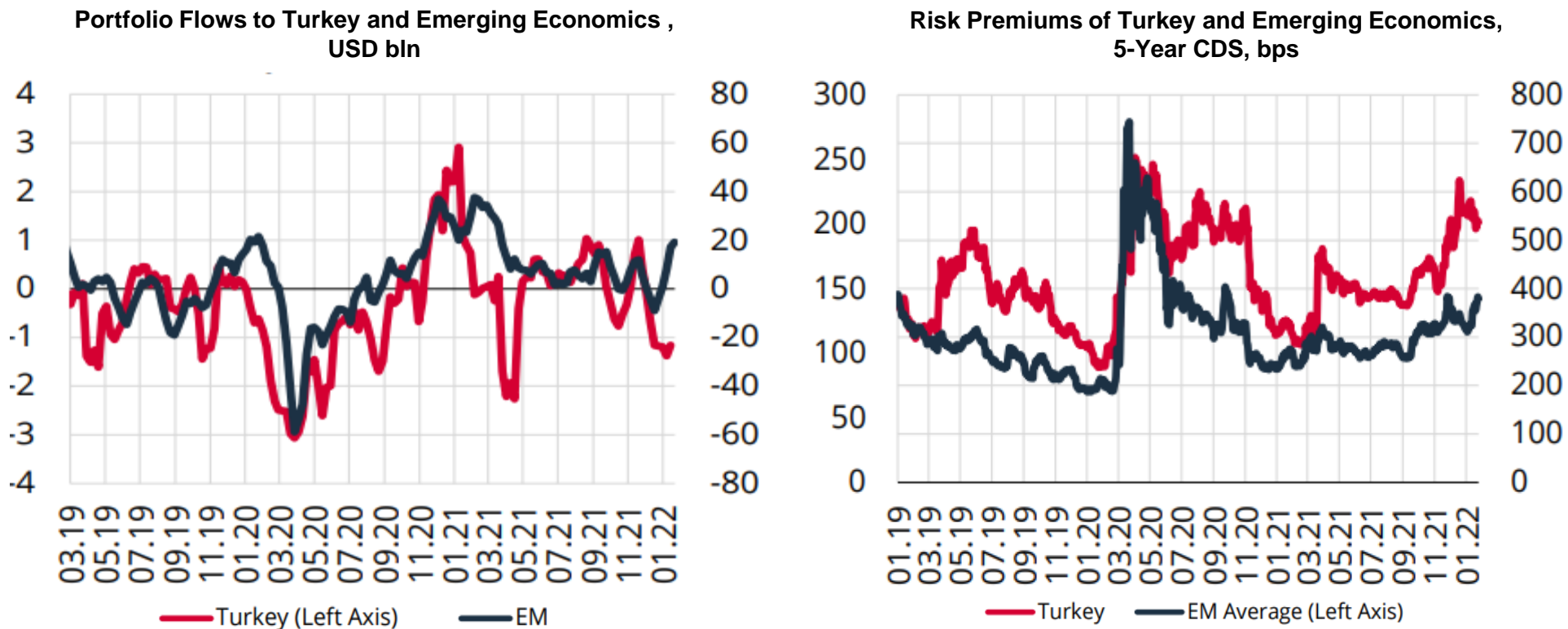


Long-Term USD Bond Yields & Inflation-Indexed Yields, %



- ✓ After rising significantly in December 2021, the **exchange rate volatility of the lira** declined in January 2022 but is still **hovering at relatively high levels compared to the implied volatilities of EM currencies**.
- ✓ Turkey's **inflation expectations and USD bond yields rose due to the increase in risk premium and the lira volatilities**.
- ✓ **Yield curves shifted upwards in all maturities**. Increase in actual inflation and deterioration in inflation outlook drove up the 2-year inflation indexed bond yield to above 40%.

# While portfolio inflows to emerging markets have continued, Turkey saw net portfolio outflows since December

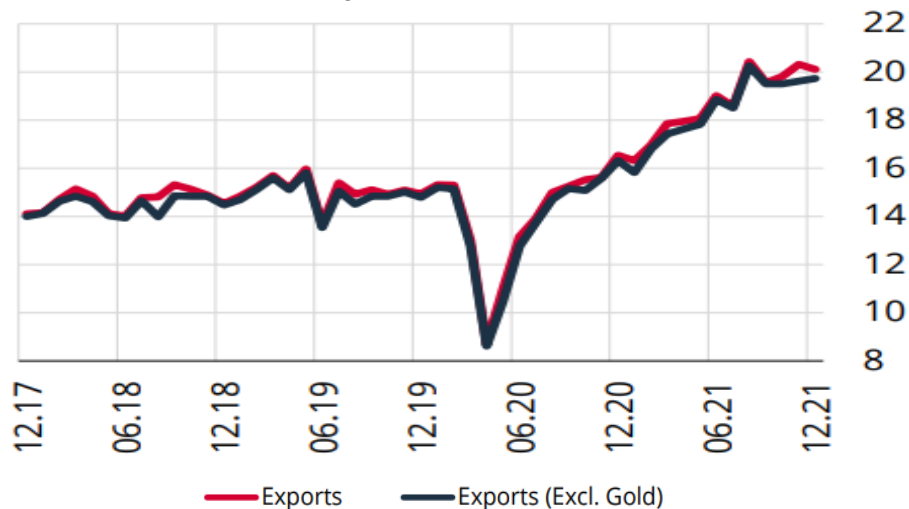


- ✓ Turkey's equity and USD debt markets registered net portfolio outflows of USD1bln and USD0.3bln respectively since December 2021 vs. continued portfolio inflows to emerging economies equity markets in general.
- ✓ During this period, EM risk premiums showed fluctuations and Turkey's risk premium diverged negatively from the overall EM risk premiums.

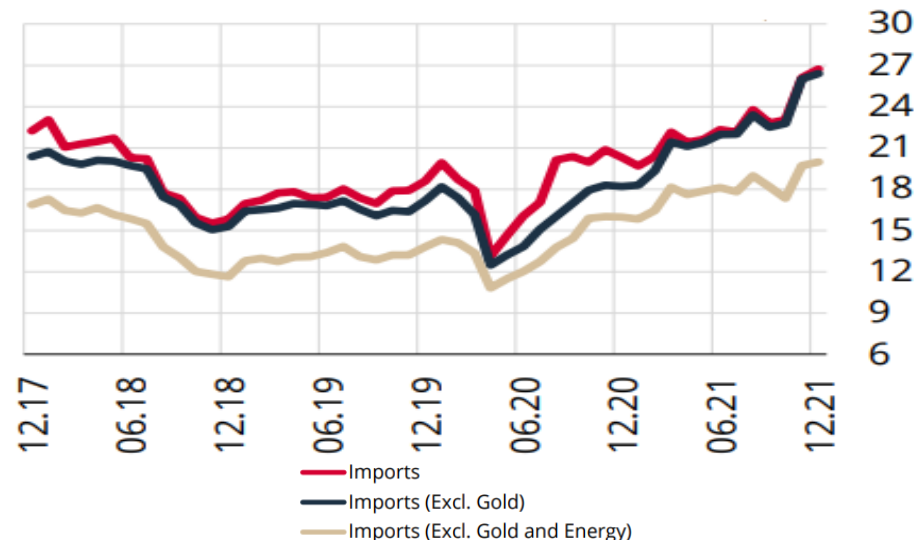


# Turkey's exports surged 33% in 2021, however the rise of energy prices drove up imports

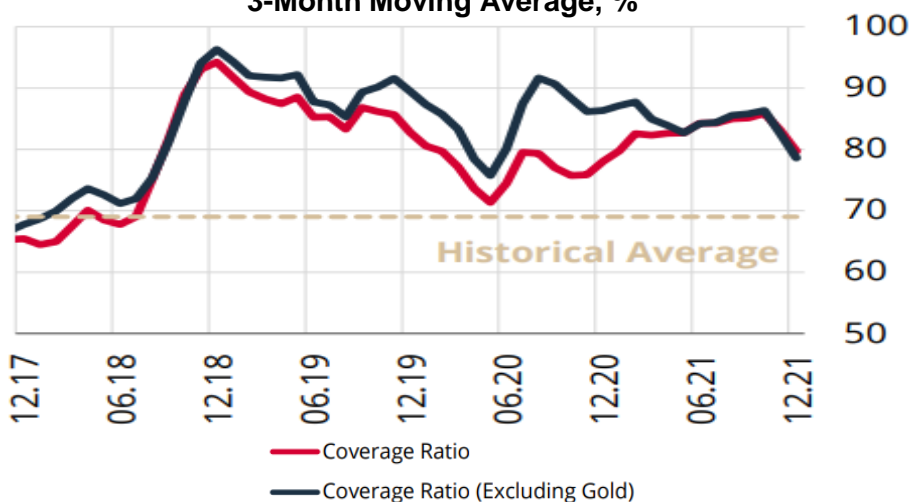
Turkey's Exports, USD bln



Turkey's Imports, USD bln



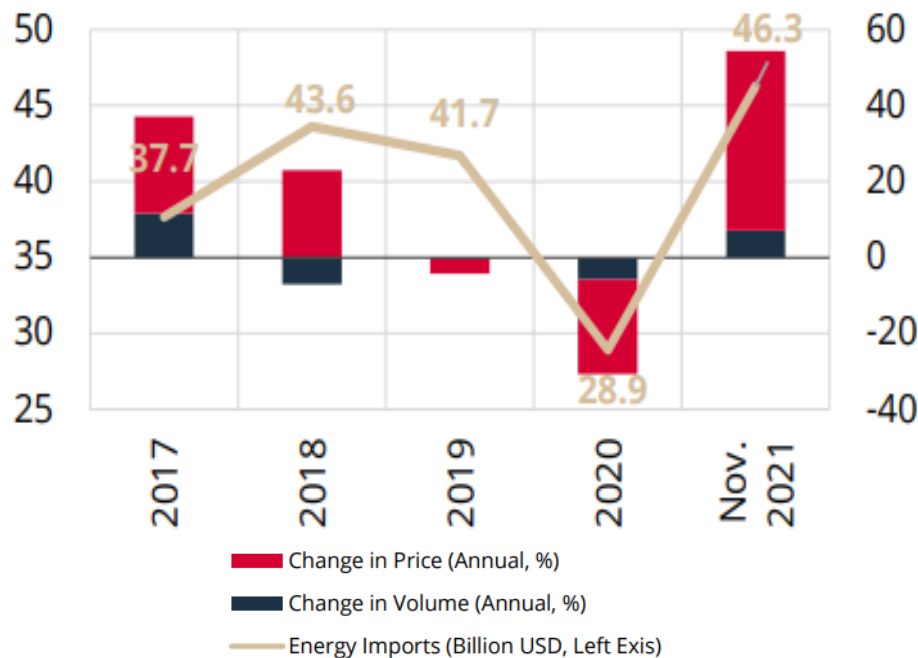
Turkey's Export-Import Coverage Ratio, 3-Month Moving Average, %



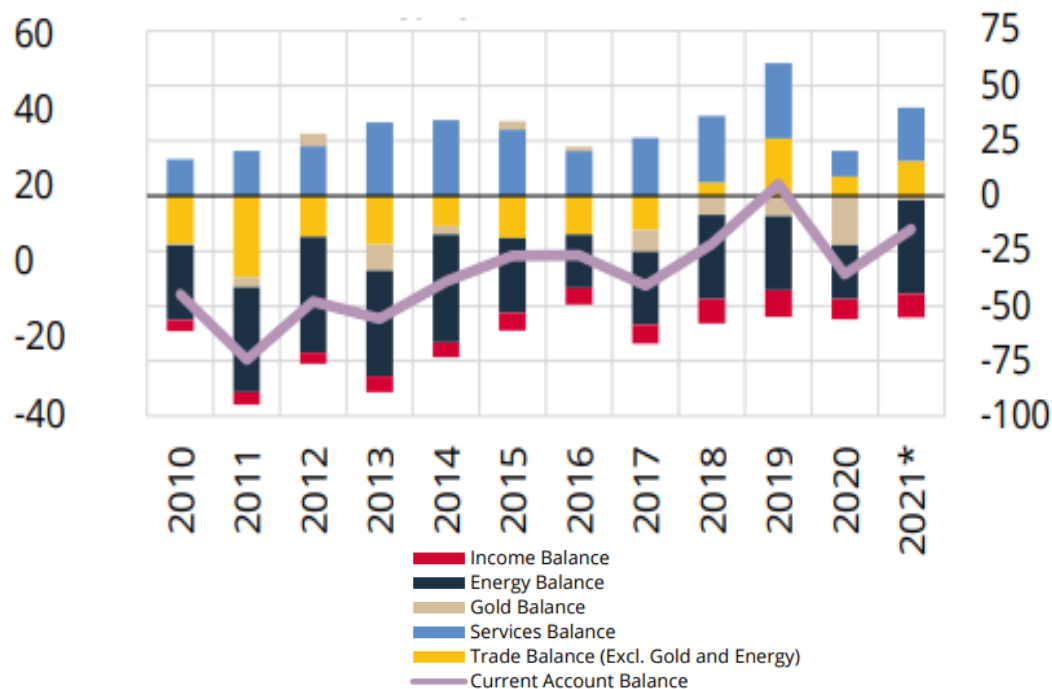
- ✓ Turkey's exports surged 33% YoY to USD225.4bln in 2021, buoyed by gold exports.
- ✓ Meanwhile, total imports amounted to USD271.4bln in 2021, driven by recovery in economic activity and rising energy prices.
- ✓ Imports of investment goods especially intermediate goods rose while imports of consumption goods fell.
- ✓ The export-import coverage ratio dropped below 80% but continued to hover above its historical average.

# High energy prices will continue to push up import costs and limit improvement in Turkey's current account balance

Components of Change in Turkey's Energy Imports, %



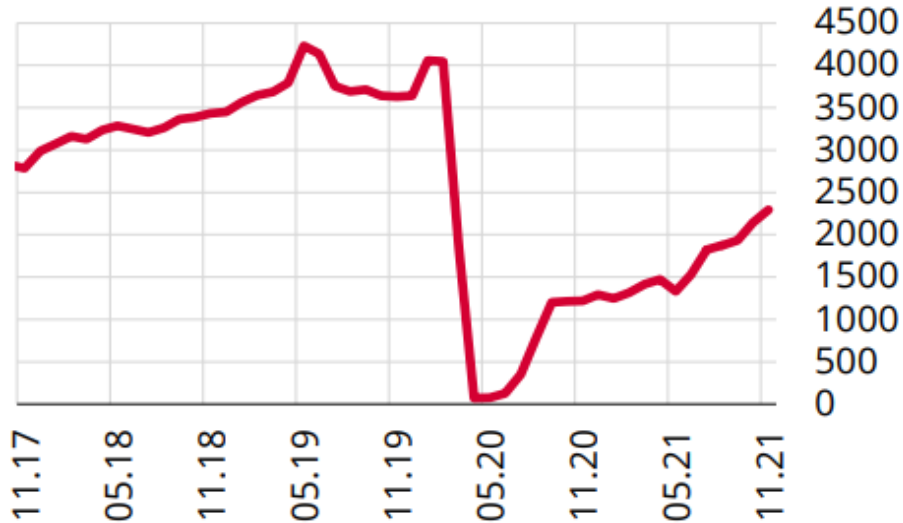
Components of Turkey's Current Account Balance, USD bln



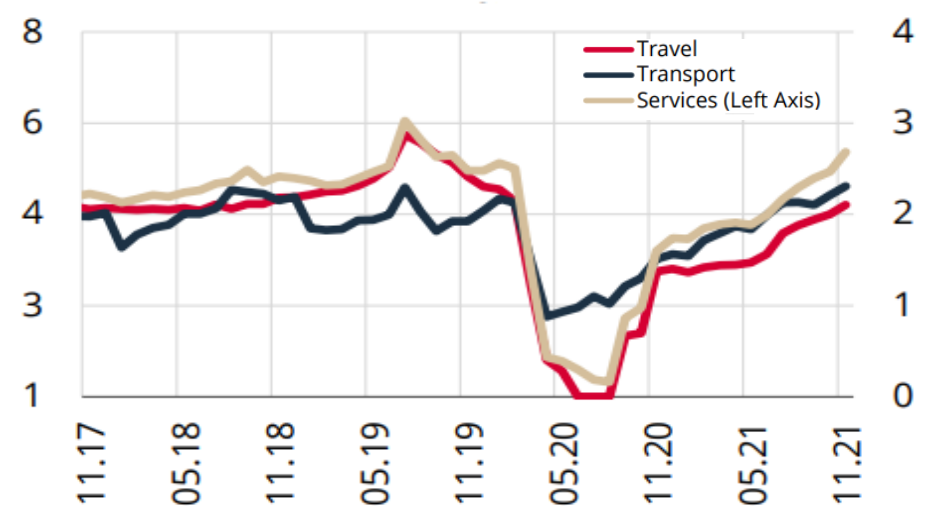
- ✓ Turkey's energy imports stood at USD46.3bln as of November 2021, an increase of 54.4% YoY. Of this increase, 47.4% were price-driven and 7% were quantity-driven.
- ✓ This reflects the significant impact of high energy prices have on Turkey's energy import costs, and its trade and current account balances. Turkey's energy-driven trade deficit was estimated to have increased to USD42.3bln in 2021.
- ✓ Turkey's energy demand is not expected to be hampered by rising prices in 1Q22 due to strong economic activity and the need for heating during winter months. High energy prices will continue to put downward pressure on the country's current account balance.

# Services revenues reached pre-pandemic levels and contributed positively to current account position, this was however offset by the rise in energy imports

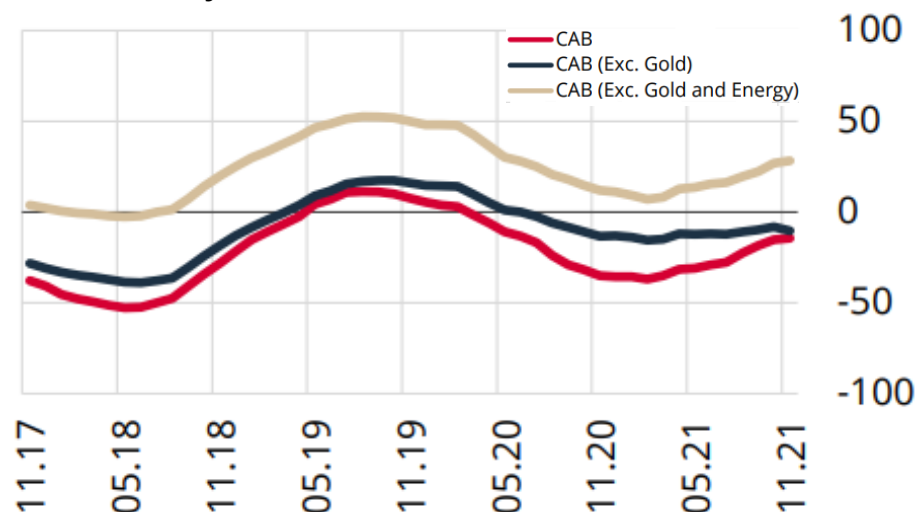
Number of Tourist in Turkey, '000 People



Turkey's Services Revenues, USD bln



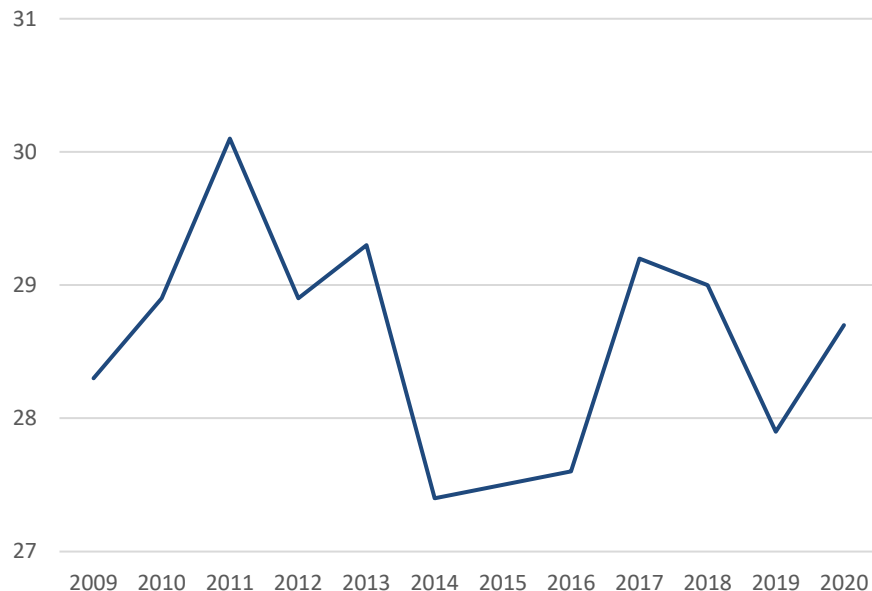
Turkey's Current Account Balance, USD bln



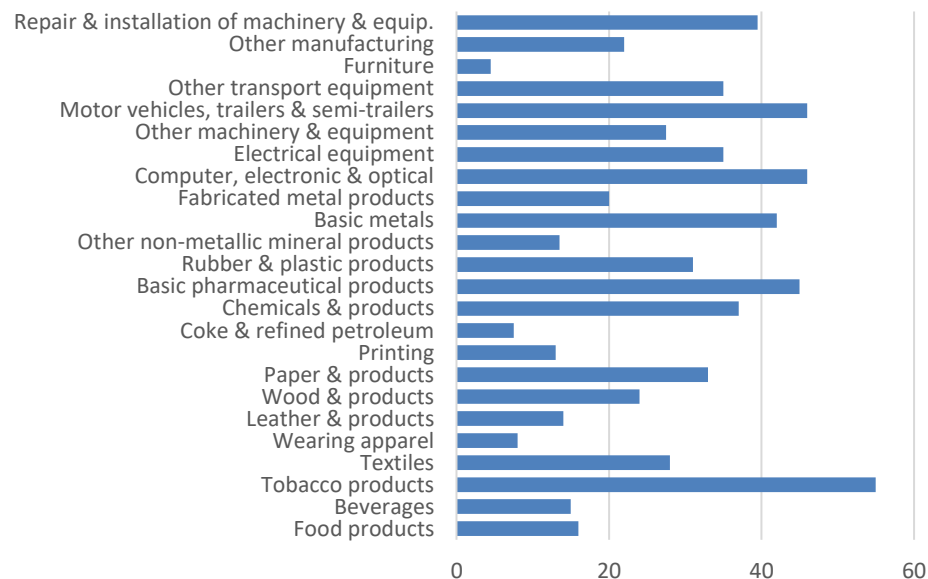
- ✓ The increase in the number of tourists in Turkey was prompted by the lifting or easing of travel restrictions to a large extent following the spread of vaccination.
- ✓ It is noted that **travel and transport revenues recovered more quickly**. Similarly, **services revenues also posted a rapid recovery and reached pre-pandemic levels**, thereby **contributed positively to the current account balance**.
- ✓ However the current account posted a deficit since November due to the **significant increase in (energy) imports given high energy prices**.

# Turkey's export-oriented manufacturing sector has high usage of imported inputs in manufacturing exports

Imported Input Share of Exporting Firms in Turkey's Manufacturing Industry, %



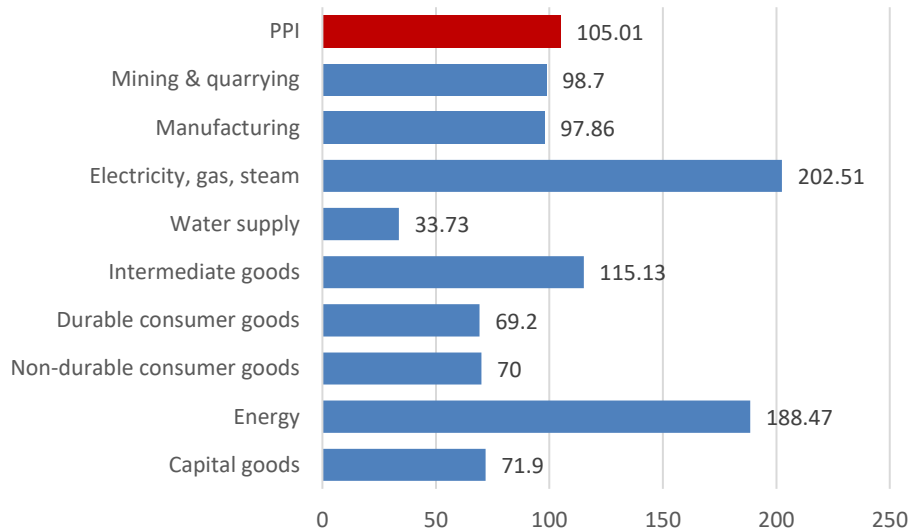
Imported Input Share by Turkey's Manufacturing Sub-Sectors, 2020, %



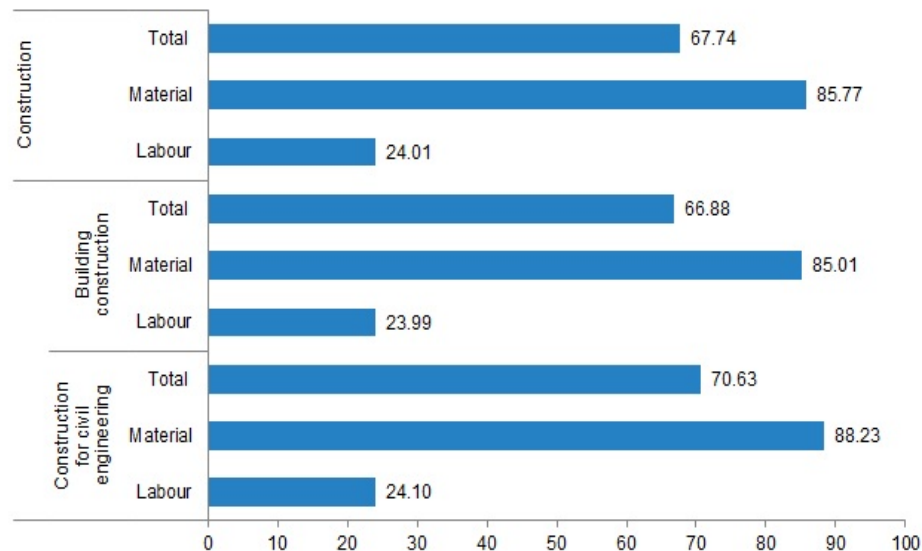
- ✓ A higher ratio of the usage of imported inputs by export-focused manufacturing sector may limit the positive effect of export competitiveness from a lira depreciation.
- ✓ The imported input share of Turkey's export-focused manufacturing sector stood at 28.63% in 2020, in line with the **historical average of 28.5% during 2009-2020**.
- ✓ A breakdown by manufacturing sub-sectors, the manufacturing of tobacco products, motor vehicles, computers, electronics & optical products, basic pharmaceutical products, and basic metals industry account for the **largest imported input share with more than 40%**.

# Producers prices are 105% higher, construction cost index surged 67.7% fueled by rising materials and labor costs

Turkey's Producer Price Index by Components, February 2022, % YoY



Turkey's Construction Cost Index (Dec 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 105.01% YoY in February 2022 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 September 2021.**
- ✓ **The Building Construction Cost Index surged 67.7% YoY in December 2021**, as material cost rose 85.8% YoY while labor cost climbed 24.0% YoY. **Expect price adjustment for constructions-in-progress or newly starting projects.**
- ✓ Uncertainties on domestic prices will prevail driven by downside risk to lira depreciation and high volatility.



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