The Morning Briefing

Turkey – April 8, 2021

EXECUTIVE SUMMARY

-The CBRT's on-balance sheet net foreign exchange position is calculated as -$1.1B at the end of March, and its net foreign exchange position including swap is calculated as -$61.3B.

-As per the data announced by BRSA; in the week ended by April 2, the volume of FX deposits fell to $244B, dropped by $2.5B.Thus, the total decrease in FX deposits reached $11.6B in the two-week period when exchange rates jumped with the dismissal of the CBRT Governor

-The debt rollover ratio declined to 95.3% in the January-March period of 2021 and to 133.5% in the last 12 months, maintaining its recent downward trend.

- Strategy to decrease the share of FX in domestic borrowing by increasing the share of gold.

- Treasury cash balance posted a surplus of TRY41B in March, showing significant improvement due to CBRT profit transfer, tax restructuring and tax shifting.

- In Turkey the domestic and international line passenger traffic stood at 4.5M and 2.4M people, down by 4.4% and 2.8% annually.

- Country's calendar adjusted industrial production index is expected to up by 9.2%, ranging between 5.7% and 12.4%.

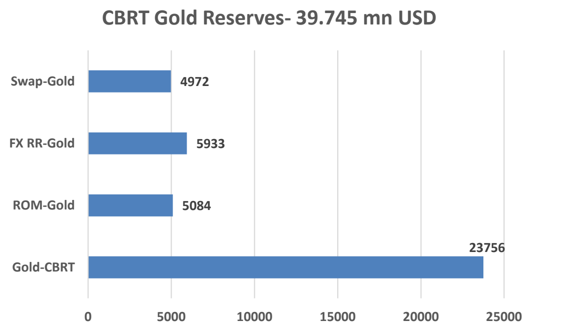
On-balance sheet net FX position at -$1.1B, net FX position including swap at -$61.3B

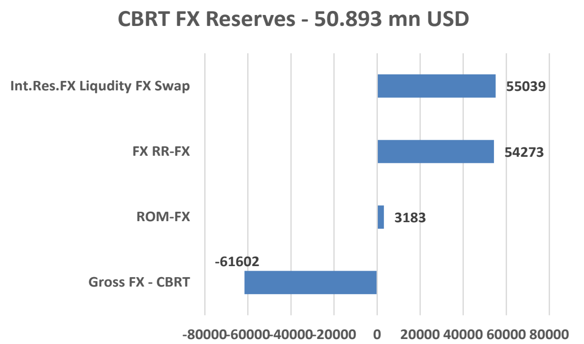
As it does every month, we will check out the endstate of the CBRT's reserve indicators such as total reserves, net international reserves (NIR) and net foreign exchange position. We will also look at the latest developments in the net foreign exchange position, excluding the swap, which has turned negative for a while.We will also touch on the latest developments in the CBRT-owned gold and FX reserves.

First of all, in the last balance sheet of the CBRT dated March 26, the total foreign exchange reserves and IMF-defined net international reserves stood at $90.6B and $12.8B. In other words, we calculate that gross reserves and net reserves declined by $2.6B and $0.9B year-to-date. In the relevant period, the net foreign exchange position decreased by $4.8B to $1.3B year-to-date. The difference between net international reserves (NIR) and net foreign exchange position is due to the fact that public deposits are accepted as domestic liabilities in the NIR account, not as external liabilities.

When the distribution of the CBRT's gold and gross foreign exchange reserves is analyzed as of March 19-April 2, gold reserves held under the reserve options mechanism remained at $5.1B, while gross foreign exchange reserves fell to $3.2B. In addition, gold held under the FX reserve requirement ratio dropped to $5.9B, while FX fell to $54.3B.

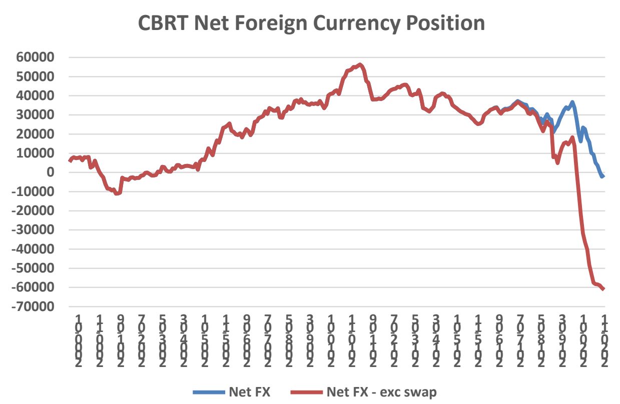
About $5B of the gold reserves of the CBRT, which stood at $39.8B as of March 26, are made up of gold swap transactions with banks. Thus, the CBRT-owned gold reserves remained unchanged at at $23.8B MoM, when all these are taken out. Of the total foreign exchange reserves of $50.9B, approximately $13.2B consists of the Treasury's FX deposits, $57.5B of the ROM and the FX reserve requirement ratio held by banks. Therefore, we can say that the CBRT's FX reserves are still at a significantly negative level. (If the Treasury's foreign currency deposit is not deducted - $61.6B)





In fact, the net FX position reflects the CBRT's FX ownership status more clearly. The FX position of the CBRT, which was stood at $36.8B at the end of 2019, fell to $3.5B in 2020 due to the sharp fall in the July-December period. This data dropped to -$1.3B at the end of March this year, the lowest level since 2002, due to the rapid decline. Yet, this data announced by the CBRT is only the on-balance sheet position. The swap transactions made by the CBRT with banks create long position of banks off-balance sheet and short foreign exchange position of the CBRT off balance sheet. Accordingly, we recalculated the net foreign exchange position, excluding the swap transactions of the CBRT.

As a result, we calculate that the swap liability rose to $60B at the end of March, while the total on-balance and off-balance sheet FX position was around -$61.3B as of March 26. At this stage, the foreign exchange position has dropped to a much weaker point than the -$11B reached in the 2001 crisis.



Decline in FX deposit volume and continuity in the outflow of foreigners from GDDS market

As per the data announced by BRSA, for the banking sector in consolidated base and daily; in the week ended by April 2, the volume of FX deposits fell to $244B, dropped by $2.5B.

Thus, the total decrease in FX deposits reached $11.6B in the two-week period when exchange rates jumped with the change of CBRT Governor.

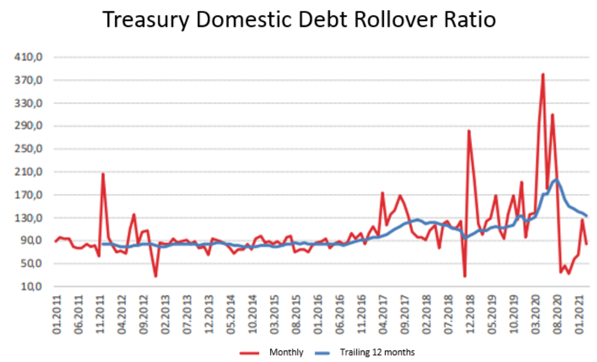
FX deposit slipped by $769M in real persons, while a decline of $1.4B was observed in legal entities.In the relevant week, parity decreased by 0.6%, ounce regressed by 0.2%.

On the other side, the TL-denominated Government Domestic Debt Securities (GDDS) portfolio held by non-residents slumped by $250M last week. Banking loan volume also surged by $24B in the same period. $10B of this was due to the increase in TL loans.

First quarter results on treasury borrowings

The Treasury re-issued 2, 5 and 10-year fixed coupon government bonds included in the March domestic borrowing program and issued floating-rate government bonds with a 7-year maturity. In addition, the Treasury has issued TLREF-indexed bond with a 5-year maturity, CPI-indexed bond with a 5-year maturity, and gold-denominated bond and lease certificate with a 3-year maturity. The Treasury borrowed a total of TRY24.5B, well below the monthly target of TRY31.2B, as the demand for tenders decreased due to the increase in interest rates.

According to the domestic borrowing strategy announced by the Treasury, a total of TRY31.2B of domestic borrowing, TRY29.9B of which was from the market, projected in March against a redemption of TRY29B. The planned total domestic debt rollover ratio was 107%, whereas the realization stood at 85%. In 2020, the debt rollover ratio jumped to 145.3%, the highest rate seen since the 2001 crisis. The ratio declined to 95.3% in the January-March period of 2021 and to 133.5% in the last 12 months, maintaining its recent downward trend.

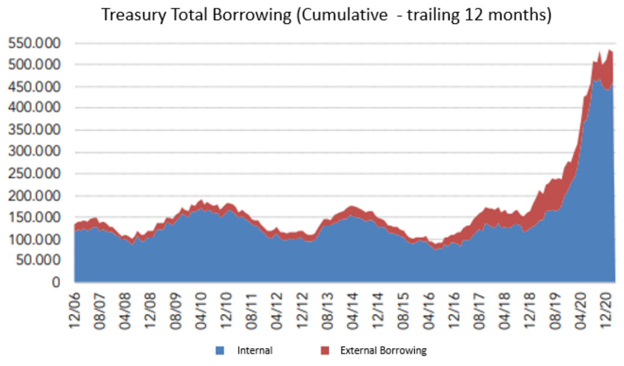


According to the domestic borrowing strategy for the April-June 2021 period announced by the Treasury, a total of TRY33B domestic borrowing, of which TRY24.9B from the market, is foreseen in April. In May, a total of TRY54B of domestic borrowing, of which TRY53.2B billion from the market, and a total of TRY43.8B of domestic borrowing, of which TRY41.8B from the market, is projected in June. In April, the borrowing target from the market decreased significantly (TRY10B) with the contribution of the CBRT profit transfer, while the public borrowing target increased by TRY5B. In addition, 3-year gold-denominated bond and lease certificate issuances were added to the borrowing program. This month, the 10-year bond issue in the previous program was also canceled.

The planned total domestic debt rollover ratio decreased to 89% compared to the previous 118.0%. In addition, the May rate fell to 101% compared to the previous one, and the June rate announced for the first time determined as 142%.

On the other side, we calculate that the Treasury's total borrowing for the last 12 months stood at TRY516B at the end of March, TRY447B of which was composed of domestic borrowing. According to the Treasury's 2021 debt repayment and financing program, the domestic debt service is TRY449B billion TL and the foreign debt service is TRY98.2B.Moreover, in the program, domestic borrowing was planned to be TRY541.6B and external borrowing to TRY77.6B. That would take the debt rollover ratio to reach 120.5%.Foreign borrowing is projected at $10B as Eurobond issuance. With loans from external financing institutions, this amount was planned to be $10.1B in total.

Considering the long-term projection of domestic debt repayments, the redemption intensity is high in all months of this year and in the first months of next year, except for August and November-December, despite the Treasury's exchange auctions in recent months. However, May and July stand out with redemptions above TRY50B. On the flip side, the total repayment projection for 2022 calculated over the borrowings realized so far has already exceeded TRY282B. According to the 2021 borrowing program, the total repayment this year was expected to reach TRY449B. The total repayment announced by the Treasury for the remaining period (April-December) this year is TRY286.5B.



On the external debt repayment side, after the March repayments of $4.5B have been overcome, there will be no backlog this year except in November and February 2021. $7B of external debt will be repaid in the remaining period this year. The total repayment projection for 2022 is $12.5B. On the external borrowing side, a total of $11.2B reached with Eurobond and lease certificate issues in 2019 and $8.8B in 2020. This year, on the other side, the year started fast with a total issuance of $3.5B in January. However, when the market conditions deteriorated, new issues could not be launched, despite the massive $4.5B redemption of Eurobond in March Considering the next three months, the foreign debt service is at $0.6B in April, $0.5B in May and $1.4B in June. In this context, we think that a new Eurobond issue will be made at the earliest opportunity as soon as market conditions improve.The Treasury's net borrowing continues to rapid climb. Treasury's General Budget financing data showed that TRY18.9B net borrowing was realized in February, which was due to TRY19.6B net domestic borrowing versus TRY0.6B net foreign debt repayment. Yet, when the foreign borrowing made in February last year did not repeat, the net borrowing for the last 12 months slumped to TRY250.5B. In March, while the total borrowing was at the level of TRY24.5B, which was entirely driven by domestic borrowing, this month, the total repayment of the principal was TRY49.5B, not net borrowing, but TRY25B net repayment.
The net borrowing limit for 2021, the difference between the general budget revenues of TRY1.82T and the expenditure appropriations of TRY1.3T will be made by the Treasury.
In other words, the ceiling was determined as TRY246B this year. Yet, the Minister of Economy and the President may increase this limit by 10% to TRY270B. 20% of the limit was exceeded in January and February.

Strategy to decrease the share of foreign currency in domestic borrowing by increasing the share of gold
The process that started with the surprise change of the CBRT Governor, will require the Ministry of Treasury and Finance to reconsider the borrowing strategies. The Treasury, which has been trying to extend the maturities of borrowing, to distribute the heavy redemption burden to other months and to reduce foreign currency-gold borrowings since November, may be forced to change its strategy.

Because, Turkey's risk premium due to high external debt has become more costly and bond yields approached 20% at all maturities.

Also, as increasing foreign demand in bonds will reverse in order to achieve the borrowing target in the auctions, it may turn to public banks again. Already, the first traces of this situation were seen in the April program announced.
Approximately TRY9.6B of the redemption burden reduced by opening change auctions in the first quarter of this year.In addition, by increasing fixed coupon long-term bond issues, the share of variable rate borrowings, whose share has increased in recent years, was tried to be reduced. On the other hand, although it is targeted even in the new package of economic reforms, this type of issuance has not yet been abandoned due to the high returns of foreign exchange-gold-denominated borrowing.

As part of the February borrowing program, total sales in Euro-denominated 3-year bond and lease certificate issues were €1.5B and gold-denominated bond and lease certificate issuances totaled $2.8B.

In March, approximately $1.2B of borrowing recorded with gold-denominated issues. Gold-denominated issues also added to the April program.In this context, it can be said that the share of domestic borrowing and foreign exchange-gold-denominated borrowing, whose share in the domestic debt stock reached a record level last year, will not decrease rapidly.

The gold-denominated debt stock of the Treasury's foreign currency denominated debt stock, calculated as TRY267.5B as of February 2021, rose to 30.1% with TRY80.4B, while its share in total domestic borrowing also rose above last year with 24% in the January-February period. In addition, the share of foreign exchange-gold denominated portion in the domestic debt stock rose to 24.7%.

On the other hand, it will be critical whether there will be a change in the active ratio regulation of the BRSA, which had a great impact on the bond market in the past, and the nominal ceiling brought by the Central Bank to the OMO portfolio size.

In case the blockage in the Treasury's domestic and foreign borrowing channels is prolonged, the Treasury's release of money to the market by not reaching its borrowing targets will indicate the incompatibility with the CBRT's tight monetary policy stance. That would also increase the upside risks on inflation.

Although the Treasury's strong cash facilities do not refer a financing risk in the short term, the possible raise in interest expenditures will increase the budget deficit. The effects of the strategies implemented so far on borrowing and debt stock can be monitored in the Public Debt Management Report, which it regularly publishes every month. The latest developments in the report, which was published at the end of March and includes February data, are summarized below;

-The average maturity of domestic borrowing stood at 34 months in 2020. At the end of February, the average maturity increased to 52.3 months (4.3 years), whereas the weighted average cost rose significantly from 10.5% to 13.8% YoY. This increase can be expected to continue due to the lengthening of the maturity and the hike in the interest rate.
-In February, the portion of the domestic borrowing with fixed rate fell to 51.5%, whereas the variable rate portion up to 48.5%.Even though the share of the CPI-indexed part in the domestic debt stock decreased slightly to 22.9%, it is still high.
-At the end of February, the issuance of foreign exchange-gold-denominated bonds and lease certificates centered. Since $4.6B borrowed from this channel, the share of foreign exchange-gold-denominated issues in the domestic debt stock up to 24.7%, while its share in the total debt stock, including the external debt stock, surged to 14.4%.
-The share of non-residents in GDDS market, which decreased to 3% at the end of September, reached 4.7% in October-February period recovering moderately from a historically low level. However, after the CBRT Governor replacement in March, this rate may decline again.

-The bond demand of real persons remains low with a share of 0.9%, while the share of legal persons its all time low of 12.7%. In the decrease in the share of this segment, the unemployment insurance fund, which represents the most important share among the legal entities, made a significant decrease in real terms due to the increasing expenses in the sales of the unemployment insurance fund to the CBRT during the use of short-time work allowance in April and May 2020.

- The share of mutual funds, continued to decline due to the decrease in short-term issuances and decreased to 6.4%.

-The share of the CBRT, on the other hand, rose to its highest level, reaching 7.6% in July 2020 with the unemployment insurance fund and other purchases mentioned above. However, as no purchases have been observed in recent months, this ratio dropped to 7.2%.

Significant improvement in Treasury cash budget due to the CBRT profit transfer, tax restructuring and tax shifting

Treasury Cash Balance in Turkey posted TRY53.7B primary surplus and TRY41B budget surplus in March, in line with our estimate. Although privatization revenue was not recorded in March, this year, the tax collection of TRY23B was shifted to March. In addition, the profit transfer of the CBRT stood at TRY44.3B in March. The Cash Balance recorded TRY29.5B primary surplus and TRY40.5B budget deficit last year. Accordingly, considering these unsustainable sources of finance, it can be argued that fiscal performance has improved significantly. The cash budget surplus thus reached $11.3B in the first three months of the year, while the 12-month rolling deficit significantly declined to TR144.1B (2.8% of GDP).

The annual change in revenues in March indicates a significant annual increase with 186.6% due to the tax shift and the CBRT profit transfer.Probably, this increase is influenced by the collection from new tax resturcturings.

On the flip side, the increase in primary expenditures accelerated with an annual rate of 20.8% compared to the previous months. In the cash budget balance, privatization revenues are not included in the primary balance. However, the cash balance includes privatization revenue. Another factor affecting the cash budget is the month-to-month shifts in tax collection

The collapse in the number of international passengers slowed down due to the base effect

The March passenger statistics announced by the State Airports Administration showed that the sharp contraction in the number of passengers in domestic and international flights slowed down due to the base effect. Across Turkey the domestic and international line passenger traffic stood at 4.5M and 2.4M people, down by 4.4% and 2.8% annually.It can be said that the annual shrinkage in the number of tourists will slow down significantly since March and will start to increase as of April.

Total funding continued to rise

The Central Bank’s total OMO funding rose to TRY350B, TRY75B was provided by one week repo (19%) tender. Therefore, the average funding cost closed by 19%. Meanwhile, upon CBRT’s withdrawn liquidity amount through 17.5% quotation rose to TRY5.4B, while net funding amount up to TRY346.6B.

On the other side, $805M of transactions were made in CBRT Turkish Lira Currency Swap Market one-week maturity. Thus, FX swap stock reached $31.8B.

Total transaction amount in CBRT’s Turkish Lira-Gold swap was closed with a transaction of 3417kg. The short position amounted to $5.2B. Istanbul Stock Exchange (ISE) transactions amounted to $1.8B yesterday while the swap stock declined to $4.1B, the CBRT data showed. The total short position reduced to $41.1B at the end of the day.

Industrial production growth is expected to be high also in February

Turkey's industrial production index is expected to rise by 6.9% for February, ranging between 4.2% and 13%, according to the Foreks poll of nine economists. Also country's calendar adjusted industrial production index is expected to up by 9.2%, ranging between 5.7% and 12.4%. In January, the index increased by 10.5% on an annual basis, while calendar adjusted index increased by 11.4%.The country's statistical authority is expected to announce industrial production index for February at 10.00 AM GMT+3 on April 13.

Contact information
BÜRÜMCEKÇİ RESEARCH & CONSULTANCY
www.burumcekci.com
Phone: +90 533 644 36 02
E-mail: haluk@burumcekci.com