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THE ENVIRONMENT WE OPERATE IN

2018 MACROECONOMIC OVERVIEW AND 2019 OUTLOOK

A YEAR OF MARKEDLY INCREASED VOLATILITIES

Despite performing better than its trend in recent years, global economic activity lost pace as compared to 2017, and acquired an outlook of decreased synchronization among geographies in 2018. Increased protectionist measures in trade, coupled with the financial stress inflicting some developing economies already began affecting the world growth negatively. Increased volatility in commercial activity and deteriorated confidence indicators confirm that the global outlook is worsening. According to our projections, global growth can come to 3.7% in 2018, similar to its 2017 value, before slowing down to 3.5% in 2019.

Although the anticipated direct impact (trade channel) of the recently introduced protectionist measures is relatively restricted, indirect impact can be higher through confidence and financial channel particularly for China and developing countries. While this situation that pervaded the whole 2018 gave the US a year of positive decoupling owing to her strong performance backed by fiscal policy incentives, the instability that began in the Eurozone, gradual slowdown of China, and the correction in some developing economies such as Brazil, Turkey and Argentina have been the key factors to give a push to the volatility in financial markets.

While China's strategies aimed at alleviating the effects of trade protectionism without further deepening the financial vulnerabilities (by way of successfully managing the level of Yuan and the debt-reduction process in the private sector) are expected to prop growth above 6% in 2019, overall concerns about global growth is likely to be the main agenda topic of 2019. In fact, the postponement of monetary tightening steps by global central banks could prove to be somewhat supportive for global financing conditions. This could result in relatively more positive portfolio inflows, primarily to developing economies.

With respect to the monetary policy strategies in developed markets, we predict that the normalization process will continue with differentiated steps. We are anticipating the US Federal Reserve (the Fed) to continue rate hikes and to increase the benchmark interest rate to the 2.75-3% interval through two additional rate increases in June and December. We are forecasting that the European Central Bank (ECB) will shift the first repo rate hike timing previously anticipated as December 2019 to June 2020.

As a result, while global outlook has some downside risks, we predict that it could adopt a momentum dominated by trade wars and the Fed's exit strategy (the renewed sell-off pressures in developing economies can act as a potential leverage). The main risks, particularly in the US, could include a faster-than-anticipated tightening by the Fed and a drastic economic slowdown (although low, the likelihood of an economic recession in 2020 is increasing). As the protectionist measures in China bear potential risks that will hinder the debt-reduction process of the private sector.In Europe, uncertainties increase in connection with Brexit, while deceleration in growth reached worrisome levels.

REBALANCING IN THE TURKISH ECONOMY

2018 was anticipated to be a year of rebalancing for the Turkish economy after its strong performance in 2017 that experienced a growth rate of higher than 7%. However, this impact has been somewhat faster and harder than expected. Lagging impact on inflation and current account balance put extra pressure on Turkey's risk premium during the sell-off in developing countries' assets that commenced in March. Moreover, the decision to move presidential and general elections forward

to June 2018 from the scheduled November 2019, and the Constitutional change increased the negative impact on Turkish financial assets. Lastly, geopolitical developments and the conflict with the US led to a free fall in the Turkish currency (TL) on August 10th, resulting in a pronounced deterioration of Turkey's risk premium. The new economy administration immediately responded to these developments with several steps in the right direction. The Central Bank of the Republic of Turkey (CBRT) surprised the market on the upside with 625 bps increase in its policy rate in September (cumulative increase in interest rates in 2018: 1125 bps) and the Government introduced the New Economic Program (NEP) including a strict financial consolidation plan. In the aftermath of these events, the atmosphere dominating the markets was reversed to a positive one upon renewal of syndicated loans by major banks with a rollover ratio of above 100% and the easing of the tension with the US. In addition, Turkey was temporarily exempted from the US sanctions against Iran in relation to importing Iranian oil, which relieved the markets greatly.

As a result, although normalization began replacing the recent financial shocks since September, the lagging impact upon the real economy began to become evident as of the last quarter of 2018. Given these conditions, we are anticipating the Turkish economy to attain around 3.0% growth for the full year, after growing 6.2% in the first half of the year and registering a relatively very weak performance in the second half. This year, we are anticipating growth to slow down to 1%. On the inflation part, we have observed a rapid increase due to the sharp currency depreciation, and the significantly deteriorated pricing behavior. After making its peak of recent years at 25% in October, consumer inflation declined quickly thanks to lower oil prices, appreciation inthe currency , poor demand, discount campaigns and tax cuts, and closed 2018 at 20.3%. In 2019, we are expecting year-end inflation to go down to 16% with the support of base effects that will become evident in the second half of the year, in the absence of a further negative shock. In this respect, we foresee that the CBRT will maintain its current stance in the first half of the year, and might initiate limited rate reductions as of June. The developments on the part of fiscal policy will also take place among the key topics of 2019. Since realizations close to the targets set down in the New Economic Program (NEP) will satisfy anticipations, they will support the gains on the exchange rate. We think that 2019 will be a year of rebalancing for the Turkish economy and also a year of corrections in terms of financial variables.

On the external balance front, shrinking domestic demand caused a rapid reduction of current account deficit in 2018. After producing a monthly surplus for the fourth month in November, the 12-month deficit went down to USD 27.6 billion (3.5% of GDP) by year end (year-end 2017: 5.6% of GDP with USD 47.3 billion). The slowing economy, still-ongoing supportive tourism revenues, and the recently low oil prices have been the key drivers behind the decline in the current account deficit. On the financing side, while CBRT reserves and net errors and omissions made up the main items, there were outflows from the portfolio and net other investments. We estimate the 12-month current account deficit to be around USD 16 billion (2.2% of GDP) at year-end 2019.

Budget realizations proved to be in line with the Government's targets by end 2018. While budget expenditures remained strong due to high personnel expenses and goods & services purchases, budget revenues continued to be supportive thanks to one-off revenues such as zoning reform, tax amnesty and military service by payment. Hence, the central government budget produced a deficit of TL 72.6 billion (1.9% of GDP) in 2018, while primary balance generated a surplus of TL 1.3 billion (0% of GDP). In the period ahead, the extension of tax incentives, the weak performance expected in tax revenues as a result of the slowdown in economy and previously unbudgeted employer subsidies may affect the budget performance negatively. On the other hand, the zoning reform extended until July 2019 and a higher-than-expected profit transfer from the CBRT could act as a buffer against the deterioration in the budget. At the bottom line, we are projecting a budget deficit to GDP ratio of 2.2% in 2018, somewhat above the New Economic Program (NEP) forecast of 1.8%.

OPPORTUNITIES AND CHALLENGES OF THE TURKISH ECONOMY

Serving as a bridge between Asia and Europe, Turkey's economy had a year of rebalancing in 2018. With a GDP of USD 713 billion, Turkey is the 17th largest economy in the world[1]. After the global financial crisis in 2008-2009, the Turkish economy managed to grow by more than 6%, a rate that is well above the rates of EU and other developing countries excluding China and proves the

[1] IMF's World Economic Outlook Report dated October 2018. Ranking as of YE 2017

dynamic nature of the Turkish economy. In this respect, although we forecast 2018 and 2019 as a period of rebalancing , we are still projecting our potential growth rate close to 5%.

Fiscal discipline, sound monetary policy, a strong and well-supervised financial system and a reform agenda continue to be the main pillars of Turkey's economic program. Turkey's central government is expected to produce a budget deficit to GDP ratio of 1.9% in 2018. The general government debt stock ratio has been meeting the EU Maastricht Criteria of 60% since 2004.

Another important factor that supports the growth profile is the demographics of Turkey. Turkey has a sizable, young and growing population. With around 80 million people, Turkey has one of the highest populations in Europe and the CEEMEA countries. 55% of the Turkish population is under 35 years old and the labor force is constantly evolving towards a more qualified level with increasing participation of women. In 2030, the population is expected to reach 88 million, compared to a negative growth in Europe and the CEEMEA region.

One of the main challenges Turkey faces is the high dependence of the production on intermediate goods imports, which, being in the lower part of the global supply chain, results in both higher trade and current account deficit as the Turkish economy grows. Hence, it is vital for Turkey to attract capital inflows in order to finance the deficit. This fact has been recently posing challenges as central banks of the advanced economies, especially the Fed, continue to withdraw from the accommodative monetary policies. The likelihood that the monetary policy normalization could be gradual in advanced economies may alleviate the pressure on emerging markets by giving more room to implement necessary reforms as capital inflows would remain moderate despite the likely increase in the cost of financing. To this aim, the economy management in Turkey has already begun implementing some structural reforms such as increasing savings tendencies and lowering intermediate goods imports by replacing them with domestic production.

Another main challenge could be the real sector's open FX position of around 25% of GDP. It exacerbates vulnerabilities of the economy to external shocks as exchange rate volatility could get higher during a turbulence in global financial markets. Meanwhile, to tackle the problem, the economy management has initiated certain measures such as non-deliverable TL forward contracts and some limitations of foreign currency loans under a risk exposure of 15 million dollars. All in all, together with the program initiated to increase savings, both external financing needs and vulnerabilities in the economy could be diminished as the Government continues to pursue indispensable structural reforms.

OPPORTUNITIES AND CHALLENGES OF THE TURKISH BANKING SECTOR

The Turkish banking sector is strictly regulated and highly monitored by two powerful agencies; Banking Regulation and Supervision Agency (BRSA) and Central Bank of the Republic of Turkey (CBRT).

According to the BRSA sector data as of December 2018, there are 50 banks operating in Turkey (29 private commercial banks, 3 state banks, 13 development and investment banks, 5 participation banks). The top seven banks, three of which are state-controlled, are holding more than 70% of the banking sector's total assets, loans and deposits in Turkey. The current fragmented structure presents future opportunities for mergers and acquisitions between the banks.

Turkey's 55% of the population is younger than 35 years old and bankable population is only 60%[2] . These are among the key indicators of the growth dynamic of the Turkish banking sector. The Turkish banking sector had a cumulative average growth rate of 20% since 2002. Despite this outstanding performance, sustainable credit growth is considered around 15%, given the population dynamics and the banking penetration levels. However, below-potential growth rates emerged as a result of the decelerated economic activity particularly in the second half of the year. This could live on in the second half of 2019, as well. In the second half of 2019, credit growth is expected to pick up with the normalization in inflation outlook leading to an easing in interest rates which will eventually support the loan demand.

Another driver behind the growth of the Turkish banking sector is the high liquidity and solid capital structure of the banks. The Turkish banking sector is in compliance with Basel III guidelines. Although capital adequacy ratios suffered a downturn due to

[2] Per World Bank's "Turkey: Financial Inclusion Conference" notes dated June 3-4, 2014.

the volatile exchange rates in the third quarter of 2018, they are still strong at 17.3% thanks to the actions taken and the recovery in exchange rates. An in-depth analysis of the capital structure of Turkish banks indicates that the banking sector's capital is mainly made up of Common Equity Tier I capital (as high as 80%), namely paid-up capital, legal reserves, profit for the period and retained earnings. It is just the opposite, however, for European and US banks.

BRSA has been monitoring the liquidity position of the banks closely. Liquidity Coverage Ratio requires banks to carry high quality liquid asset reserve sufficient to cover their net cash outflows and the ratio is well-above required levels indicating at Turkish banks' solid liquidity position.

Customer deposits constituting 50% of the total assets, serve as the main source of funding of the Turkish banking sector. However, average maturities of deposits are mostly 1 to 2 months due to the high inflation/high interest period in Turkey's past. Given this short-term nature of deposits, maturity mismatch is unavoidable for the Turkish banking sector. As it leads to faster deposits pricing versus loan pricing, net interest margin is exposed to short-term pressure when funding costs rise. However, Turkish banks also invest in CPI-linkers in order to hedge their balance sheets against increasing interest environment. Despite the pressure on the margin stemming from the rise in funding costs especially in the second half of 2018, the Turkish banking sector managed to increase its margin to 4.6% compared to 2017 on the back of the high returns on CPI-linkers. From the second half of 2019, loan to deposit spread will likely expand as a result of deposit costs in connection with the anticipated downtrend in inflation, and net interest margin will possibly improve significantly in 2020 in connection with the increasing growth rates.

The sector funds 25% of its assets from external financing resources. As Turkish banks do not fund their long-term loans such as project finance loans or mortgages with short-term deposits, they turn to long-term borrowings from international markets. While that indicates at the sector's sensitivity to external developments, the Turkish banking sector's dependence on external borrowing decreased from 2017 given the slumped demand for long-term FC loans and their redemption, and it will continue to do so.

Resulting from the significant volatility in exchange rates from the second half of 2018, high inflation, increased interest rates, and the associated decelerated economic growth created pressure on the sector's asset quality. Having started the year with an NPL ratio of 3%, the sector ended the year with 4%. While this ratio is relatively reasonable, expected rise in the unemployment figure coupled with the decelerated growth make asset quality a critical topic also in 2019. In this sense, there could be some increase in non-performing loans in the year ahead. However, at 14%, low household indebtedness strengthens the sector's hand with respect to managing risks in the retail segment. The balanced structure of the sector's credit portfolio also offers an advantage in the sense of credit risk management. TL loans continue to constitute the majority of total loans with 60% despite the devaluated Turkish Lira, and thus, balances the default trend arising in loans from the exchange rate risk. On the other hand, FC loans are mostly big project finance loans which are granted to companies with FC revenues and relatively more eligible for restructuring. This nature of FC loans reduces the probability of loss for the sector in the long term.

In the period ahead, there are several critical factors with respect to rendering the funding and liquidity structure of the Turkish banking sector more resilient and ready for any potential development. Among these are introduction of initiatives aimed at increasing household savings in the medium term, increasing the depth of capital markets in Turkey, extending the maturities of funding resources, and steps targeted at stabilizing the shift to foreign currency.

Source: BRSA monthly data of December 2018 were used for sector data. Population data are based on TurkStat's Address-Based Population Registration System Results on 31 December 2018.

CORPORATE PROFILE

Established in 1946, Garanti Bank is *Turkey's second largest private bank* with consolidated assets of approximately *TL 400 billion* (USD 75.7 billion) as of December 31, 2018.

Garanti is an *integrated financial services group* operating in every segment of the banking sector including corporate, commercial, SME, payment systems, retail, private and investment banking together with its subsidiaries in pension and life insurance, leasing, factoring, brokerage and asset management, besides international subsidiaries in the Netherlands and Romania.

As of December 31, 2018, Garanti provides a wide range of financial services to its more than *16 million customers with over 18 thousand employees through an extensive distribution network of 926* domestic branches, 7 foreign branches in Cyprus and one in Malta, and two international representative offices* in Düsseldorf and Shanghai. Garanti offers an omni-channel convenience with seamless experience across all channels with *5,258 ATMs*, an award winning Call Center, internet, mobile and social banking platforms, all built on *cutting-edge technological infrastructure.*

Moving forward to maintain sustainable growth by creating value for all its stakeholders, Garanti builds its strategy on the principles of always approaching its customers in a *"transparent", "clear"* and *"responsible"* manner, improving customer experience continuously by offering products and services that are tailored to their needs. Its competent and dynamic human resources, uninterrupted investments in technology, innovative products and services offered with strict adherence to quality and customer satisfaction carry Garanti to a leading position in the Turkish banking sector.

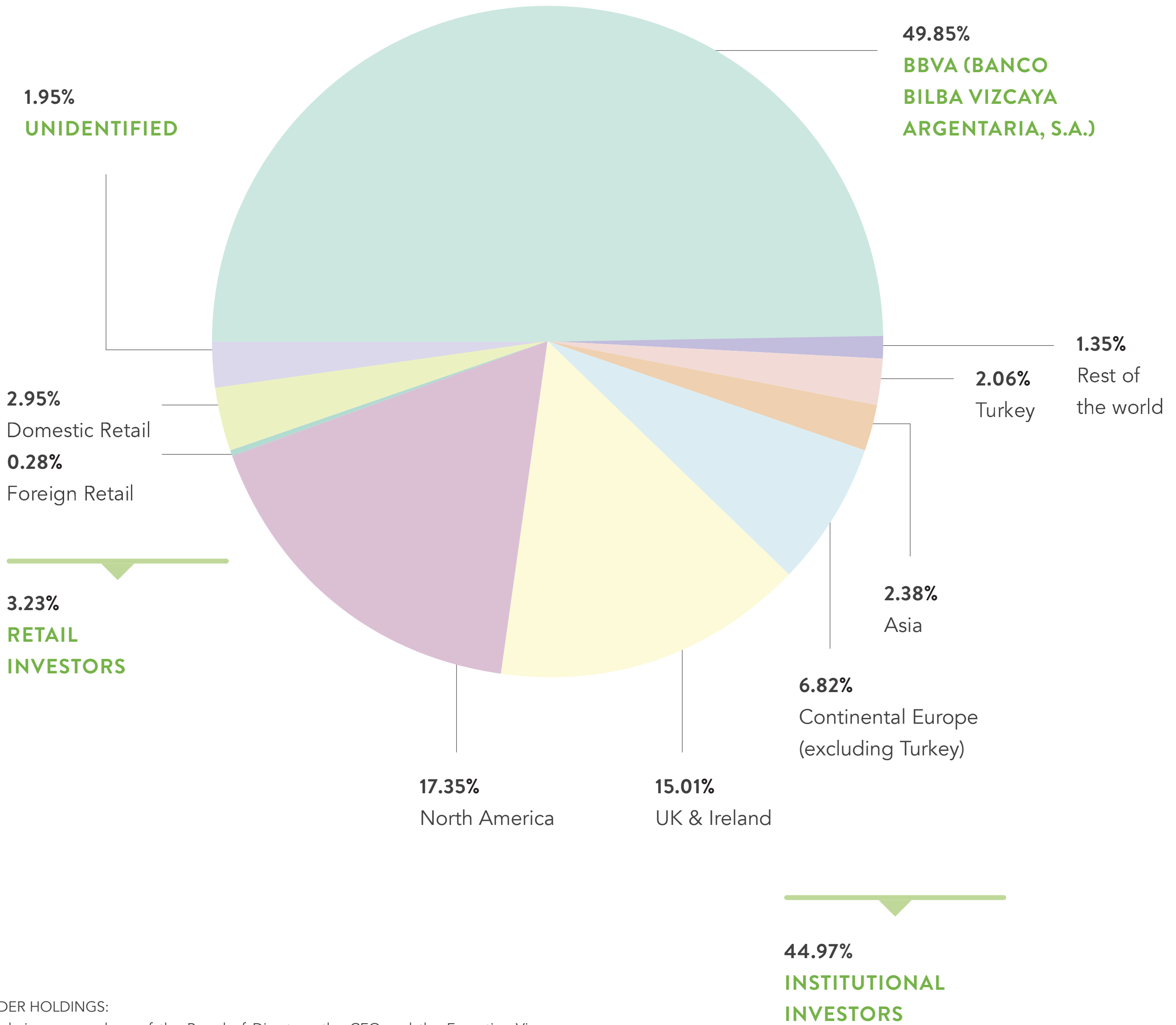
Implementing an advanced corporate governance model that promotes the Bank's core values, Garanti has Banco Bilbao Vizcaya Argentaria S.A. (BBVA) as its majority shareholder with 49.85% share. Its shares publicly traded in Turkey, and its depositary receipts in the UK and the USA, *Garanti has an actual free float of 50.07% in Borsa Istanbul as of December 31, 2018.*

Garanti's constantly improving business model is driven by its strategic priorities focused on responsible and sustainable development, customer experience, employee happiness, digitalization, optimal capital utilization and efficiency. Its custom-tailored solutions and wide product variety play a key role in reaching *TL 311.2 billion* (USD 59.0 billion) loans and non-cash loans. Garanti's capital generative, disciplined and sustainable growth strategy that strictly adheres to solid asset quality enables the Bank to move forward strongly. Its effective risk management through world-class integrated management of financial and non-financial risks and organizational agility in capturing new opportunities result in sustainable value creation for all its stakeholders.

Moreover, Garanti creates shared value and drives positive change through lending based on impact investment, as well as strategic partnerships and community programs focusing on material issues for both Garanti and its stakeholders.

* Representative office in London was closed on 31st December, 2018.

GARANTI'S OWNERSHIP STRUCTURE



INSIDER HOLDINGS:
The chairman, members of the Board of Directors, the CEO and the Executive Vice Presidents are allowed to own publicly-traded shares of Garanti Bank; their transactions in Garanti Bank shares are publicly disclosed pursuant to Capital Markets Board regulations.

Note: There is no ultimate non-corporate controlling shareholder holding more than 5% share in the shareholding structure. Institutional shareholder and foreign individual shareholder composition data based on IPREO Shareholder ID Analysis dated December 2017; the actual free float ratio and the share of local individual shareholders are all based on Central Agency Registry Agency data.