

LETTER FROM THE CEO



Dear Stakeholders,

2018 has been quite an active year for our economy and our sector. We have registered strong growth rates in the first half of the year; however, in the second half, we have witnessed the slowdown in the economy and increasing tendency toward rebalancing due to both internal and external developments. Meanwhile, in this period, risk factors such as liquidity, capital and asset quality were among the key issues under spotlight for the sector.

With respect to the sector's liquidity, we are going through a critical period in loan to deposit ratio. Deposits that outperformed the loan growth in 2018, positively affected the sector's loan to deposit ratio. Since the beginning of the year, loan to deposit ratio improved by 7bps in the sector, whereas improvement in the ratio was 14bps at Garanti. While maintaining our leadership position in consumer loans and credit cards, our deposit-driven and balanced approach continued on the funding side.

This year some concerns have also surfaced regarding the sector's international borrowings, a non-deposit funding source. Nonetheless, the sector has proven its resilience once again, and many players in the sector, including us, were able to renew their external debts with high rollover ratios. Within the framework of the borrowing program, we provided more than USD 1.3 billion in funding from overseas markets in the last quarter. This was the longest and the highest amount of borrowing of the last quarter of 2018. I would also like to underline our decreased dependency on external borrowing compared to the previous years. Turkey has completed a substantial portion of the large-scale public investments. In this context, Turkish banks have less need for long-term foreign currency funding as project finance investments cut pace versus earlier years. In this sense, I am not anticipating a negative scenario for the year ahead in raising external funds.

The effect of decelerated economic activity on asset quality became visible to a certain extent. The sector's NPL ratio went up to 4% from 3%. Increase in new NPLs largely stemmed from big-ticket corporate loans. In 2019, consumer loans will also put some pressure on asset quality due to anticipated rise in unemployment that will be driven by the cooling economy. However, household indebtedness in Turkey is quite low; actually, it is much lower than that in Eurozone and in developing countries. Therefore, we are in a position to manage these risks.

Capital was another topic that was on the agenda during the reporting period. Capital adequacy ratio of the sector sustains its controlled level as the exchange rate stabilized at a certain level. Our 2018 year-end consolidated capital adequacy ratio of 16.5%, is comfortably above the minimum required level of 12%.

Another key driver that differentiates the Turkish banking sector besides its robust financial structure is digitalization. Our digitally savvy young population enables us to offer a much more efficient and productive banking service through the digital platforms. We realize that mobile banking penetration rate in our country has reached 40%, which puts us ahead of many major European countries including France and Germany. With this awareness, as Garanti, we have been investing in digital transformation for many years. Today, our digital penetration ratio among active customers is 67%.

We have pioneered a new era with our innovative service model designed in the light of digitalization, which enables a one-stop delivery of all services to our customers in the most convenient and fastest manner. During 2018, we have completed the transformation of our entire branch network within the frame of our new service model. With this new model, we have increased the efficiency of our sales force, decreased the waiting times in branches, and improved customer experience.

Supporting responsible and sustainable development is among our strategic priorities at Garanti. We develop our products and services in this manner, and manage our customers' environmental and social risks as well. We support the participation of women in the workforce, and we are striving for the formation of an inclusive economy where all individuals have equal access to opportunities. We have taken on a pioneering

role once again in our sector in the area of sustainable finance with a green loan we have extended in July, which is the first of its kind in Turkey and fifth in the world. Taking place among the 28 banks from five continents representing consolidated total assets of USD 17 trillion, we have been invited by the United Nations Environment Programme Finance Initiative (UNEP FI) to define the new shape of banking to better align with the society's goals. The new Principles on Responsible Banking will allow every bank to credibly showcase their desire and concrete actions to contribute to our society and our planet. As Garanti, we are proud to be part of this historic movement. Being the only bank from Turkey included in a total of eight different sustainability indices including the Dow Jones Sustainability™ Emerging Markets Index, we are aspiring to act as a role model for all our stakeholders in this area.

2019 AND BEYOND...

In the year, which was characterized by highly volatile exchange rates, we were in closer and stronger coordination with the economy administration than we have ever been before. We have seen the benefits of this both for our sector and our economy. Yet, the impact of the fluctuations on the real economy will be gradual. Although the rebalancing witnessed from the second half of 2018 will continue for a while in the beginning of 2019, we are expecting recovery to start as of the second quarter. As inflation adopts a normalization trend particularly after the second half of 2019, interest rates will come down and loan growth will gain pace.

Downward trend in inflation has started. While there might be limited upside effects in the first quarter of 2019, we are expecting the decline in inflation to become visible in the second half of the year and to end the year at 16% levels with the lagging effects of the decelerated growth coupled with the appreciation of the Turkish lira.

In this period where rebalancing become evident, being in close relationship with our customers, identifying their problems in advance, and developing solutions jointly are critical both for the financial well-being of our customers, and for the management of our Bank's asset quality. Recognizing this fact, we keep standing by our retail and commercial customers by providing resources when necessary and even through restructuring if it is needed. We will continue to do so.

As Garanti Bank, we are shaping our strategy within the frame of our medium-long term investment plans, and not on short-term targets. Regardless of macroeconomic developments, we will keep pioneering the transformation in the sector with our investments targeted at our business model and customers that make up the base of our strategy. We will continue to simplify and enhance our processes and operations by evaluating them from the viewpoint of our customers.

While 2018 and 2019 are relatively tough years, we are looking at the future with confidence by taking strength from fundamentally strong banking sector, our capital generative growth strategy, advanced risk management systems and our organizational agility in capturing opportunities. Being one of Turkey's leading institutions, we act with the awareness of our responsibilities on the development of our national economy and contribution to the society. We continue to act with this awareness in our operations.

We will keep working with all our strength in order to create value for all our stakeholders who trust and support us.

Sincerely,



ALİ FUAT ERBİL
President & CEO