Handan Saygın
Here we are again with the honour to present another set of above consensus and strong results.

With a 27% annual increase, our six months earnings exceeded TL 3.9 billion, suggesting an ROAA of 2.1 and an ROAE of 18.1%, despite a low leverage of only 7.7 times book. Our strong net income generation capability could more than offset the negative currency impact on capital year-to-date. Post a record high dividend distribution, we again ended the first half with well above the required level, capital adequacy ratio of 16.2%. On the liquidity front, our regulatory ratio also remains well above the minimum required level.

What lies beneath this performance can be summarized under four main headlines:

1. Outstanding NIM management, which contributes 4.1% to ROAA and 34.5% to ROAE
2. Strong fee generation, again, a high and sustainable contribution to both ROAA and ROAE
3. Contained OPEX growth
4. Prudent provisioning

Now, we could book another core NIM expansion of 18 basis points in the second quarter, increasing loan yields due to timely and proactive loan repricing, coupled with funding cost optimization yielded a 4.7 core margin in the second quarter. However, the significant rate hike in second quarter of 500 basis points will inevitably impact 3Q margins, core NIM negatively. On the other hand, our CPI linkers will serve their hedging purpose and mitigate this pressure. It is now expected that October-to-October CPI reading will be around 14%. Adjusting that for the full year, CPI valuation we will be using will be 19.2% in the third quarter. This will highly likely be sufficient to fully offset the expected margin suppression.

Moving onto the next page, the balance sheet growth. As you can see here, the total loans amounted to TL 253 billion. We have a very well balanced loan book, roughly one-third in foreign currency business, one-third in Turkish lira business loans, and one-third in consumer and credit cards. We registered a Turkish lending growth of 9% year-to-date, 5% coming in the second quarter. Our foreign currency loan book continued shrinking another 5% year-to-date. As you may recall, we have been deliberately shrinking our foreign currency loan growth over the last four years.

We were able to book healthy market share gains in the quarter and also year-to-date, especially in the high yielding categories. In general purpose lending, we booked 10% growth year-to-date, in credit cards 6% growth year-to-date, a big portion coming in the second quarter. On the consumer mortgage front, we did originate loans, but we also had some maturing portion, so the growth was muted. We, of course, kept our rational pricing stance, so the year-to-date growth in consumer loans, including credit cards, came in about 6%.

Higher growth came in from the Turkish lira business banking loans. Just in the last quarter, we booked 7% growth there alone, bringing the year-to-date Turkish lira business banking

lending growth to 12%. There is Credit Guarantee Fund contribution to the year-to-date growth, about 4% contribution comes from the Credit Guarantee Fund. We have been assigned TL 6.2 billion limit from the Credit Guarantee Fund in the first half.

Fuat Erbil
And maybe just a little reminder, Handan, on our solo balance sheet loan book, foreign currency part is only 32%, since we do have the Romania and Netherlands, those euro countries is making that 36%.

Handan Saygın
36% for the foreign currency business banking loans. The bank-only figure is one-third.

Looking at the funding side, we had a very well diversified funding portfolio, deposits making up majority of the funding. The Turkish lira deposits growth year-to-date matched the Turkish lira lending growth, and foreign currency deposit growth was lower than the foreign currency lending shrinkage, so we were able to improve our loan-to-deposit ratio year-to-date by more than 300 basis points.

More importantly, we see that our demand deposits share in total deposits increased significantly. We had 29% of our total deposits was in demand deposits. This figure in bank-only basis is 27% and when compared to the sector, it is 22%. Also, the fact that majority of the TL deposits, 77%, coming from SME and retail deposits also make it sticky as well as relatively low cost.

During the quarter, we utilized almost as much of swap funding as we did in the first quarter. The cost has come up a little bit, but overall, more or less, the swap utilization continued and we continued to deliver successful dual currency balance sheet management. Also, in the second quarter, we were able to rollover our syndication loans by 100% at a cost of LIBOR +1.30 and EURIBOR +1.20, and also in June 2018, we also did first ever gender bond issuance with six years maturity for a very small amount, at the moment, but this the first ever gender bond.

Fuat Erbil
Maybe highlighting, again, what Handan said, demand deposit portion 29% is the highest ever that I can recall in our history, and imagine this 29%, which is the highest, in an environment that we have seen in terms of rates, the highest ever for some time, so we will be enjoying in terms of NIM perspective, very positively, of this high percentage of demand for this going forward.

Handan Saygın
Moving onto the fee performance, our stellar growth continued that we booked in the first quarter, again, more than 30% net fees and commissions growth in the first half was registered thanks to our diversified fee sources. The story is the same, so main contributors

continued to be payment systems, cash and non-cash loans, money transfers, insurance, and of course the growth in digital channels contributing hefty to our fee growth.

Moving onto the operating expenses, we stay committed to improve efficiency, and as you can see here, our operating expense growth is quite differentiated versus what is in the sector, so we could book an operating expense growth in the year that is five percentage points below inflation, and this 10% is actually a little, I would say, inflated, because of the currency as 15% of the OPEX base is foreign currency linked. Even though you see 10%, it doesn't fully impact the bottom line, as we minimized the impact of the foreign currency through hedging activities. We continued to deliver a very acceptable, very low cost/income ratio. This ratio includes the provisions in it, so it is 44.9% on a consolidated basis, and bank-only, it was 41.8%.

Our OPEX in average assets on a consolidated basis is 2.3% and our fees to OPEX coverage has been 59% on a consolidated basis, and 66% on a bank-only basis, so we continue to move in the right direction, as we increase efficiency, the ROE delivery will remain high.

Fuat Erbil
Go left and up.

Handan Saygın
Left and up, yes.

Now, moving onto the asset quality, let me first talk about our prudently defined IFRS 9 criteria and how it is reflected on staging. I would like to start with explaining our Stage 2 loans, as that is the area everybody is most curious about. Its relatively high share in performing loans has been attracting a lot of attention.

So let me first clarify the fact that Stage 2 share of 17% within the performing loans figure that we have actually is not comparable to any bank, now, mainly due to the criteria difference in the quantitative assessment, meaning the significant increase in credit risk definition, and the approach difference for qualitative assessment, as it was the case in the past when we were classifying our Group 2 loans.

As you all have been following Turkey, macro parameter-wise, significant changes occurred in the second quarter, interest rates went up, currency depreciated significantly by 16%, inflation readings reached unexpectedly high levels, and unemployment ticked upwards. So taking into account the new macro conditions, IFRS 9 model yielded increasing Stage 2. Now, this explains a portion of the increase in Stage 2 in the second quarter, and a greater portion of the increase is attributable to currency impact, as 72% of the qualitatively assessed portion of Stage 2, namely the watch list, restructured and past-due files is foreign currency denominated.

Now, giving more colour on the Stage 2 portfolio on page 11, 43% of our Stage 2 is SICR, meaning it is the quantitatively assessed portion, or in other words, the outcome of the

prudently and internally defined IFRS 9 parameters. All of this portfolio is less than 30 days past due, and 85% is not delinquent at all, meaning they have not missed a payment. For that reason, the provision coverage we allocate for this portion is only 3%, as you can see on the bottom left hand side. The rest of Stage 2 is actually very similar to what we used to have in the past as Group 2. It has been our common practice before the IFRS 9 world that files are moved to watch list proactively, due to our advanced risk assessments, rather than on a reactive manner. On top, whenever we restructure or refinance a loan, we keep in Stage 2 for a minimum of two years, if not for lifetime. Provision coverage in this category per individual assessment is also higher at an average 16%. Again, you can see on the left hand side.

Now, looking more closely to the qualitatively assessed portion, 57%, one-third remains to energy, which I will get into detail on the next slide, one-third is Otas and the other famous restructured conglomerate loan. In the last one-third, consumer, real estate, and tourism sector loans explain most of it.

Now, for consumer loans, even though we had the highest market share in consumer lending, including credit cards or even excluding credit cards, we have the market share, the Stage 2 portion is minimal. It is only 3% of the book. This is a direct reflection of our strict underwriting criteria and advanced collection system.

Tourism, as you may recall, we deeply troubled a couple of years ago. Our exposure to this sector has been quite limited, and about 15% of that has ended up as Stage 2 and mostly restructured. We foresee increasing potential of recovery, tailored to the recovery in the sector. You may have noticed, actually, so far that net tourism revenues increased 37% on average in the first half of this year compared to last year, and so the outlook seems promising.

Now, as for the real estate, let's move onto page 12. Real estate exposure as you can see in the sectoral breakdown of the portfolio constitutes only 2.6%.

Fuat Erbil
Maybe before starting this slide, can we get the previous slide? The 43% of that 41 billion Turkish lira, which is 17% of our loan book, is coming from the model. And as you have stated, 85% of this not delinquent at all, even one day. Main portion is coming from Turkish lira, and the coverage is only 3%. This means the model comes up with IFRS 9 to our world, and making a big difference for our Stage 2 loans is a result of a quantitative model.

So this model is a new model. Like every model, we are working to calibrate the model in a positive way, so that will be on-going study to come up with more precise numbers, so that has already started, so calibration of this portion will be done going forward. I think this is going to be important for everybody.

Handan Saygın

Continuing with the real estate on page 12, as you can see, it is only 2.6% of our loan book, and this exposure includes both commercial and residential real estate, where we have a very selective approach. Now, our ticket size in residential real estate is very small and so the concentration. For the ones that are in Stage 2, which is 26% of the real estate exposure, we have a relatively high 19% coverage.

Now, on the energy exposure front, which makes up 12.2% of our loans – by the way, these are the unconsolidated gross loan breakdown – electricity generation projects have the highest share of 66%. And looking at the characteristics of our generation exposure, it is a well-diversified and proactively managed portfolio I can say. We have heavily concentrated on the renewables, which we expect to have no problems because of the feed-in tariffs, and we have stayed away from CCGTs, namely the natural gas-fired power plants, especially from the low efficient ones, which we anticipated to have problems due to merchant risk and high competition in the market.

Moreover, we have been taking measures to decrease our merchant exposure since 2015. As a result of this, 70% of our electricity generation portfolio currently consists of renewables, and projects with contracted revenues. These are all in the safe zone. The projects having difficulties are mostly positioned in the remaining 30%, whereby vast majority of that group has already been classified under Stage 2. And we do not expect major shifts from performing loans to other stages for energy files going forward.

Remaining 34% of our total energy exposure is composed of electricity and gas distribution, which is utilities, and oil and gas companies, including refineries, which don't exhibit any major sectoral problems.

Fuat Erbil
So out of this 12.2%, only generation related part is 66%, including all types of generation, including gas, thermic, hydro, all renewables.

Handan Saygın
Correct and 70% of the 66% is in the safe zone. As to the current difficulties experienced by the energy sector, are not a surprise for Garanti, having an experienced team focused on energy sector and anticipating the approaching excess supply way before the others in the market, we have been foreseeing these rainy days and shaped our energy loan portfolio accordingly.

Please recall the electricity markets report we had published on our IR website back in 2015.

Our current projections indicate that we have already seen the worst in energy sector, and we think that the difficulties currently experienced by the energy sector will fade away over time. Recovery will start with the expected increase in oil prices and slowdown in supply growth.

Fuat Erbil
I think, again, I will repeat what you said, but to summarize two very popular among investors universe sector, which is one is real estate, the other one is the energy that we wanted to give some further detailed share, as always, our full transparency approach. Real estate, as you can see is very limited portion of our loan book, and as you can see the staging breakdown, which we don't see any real concern related with this sector. For the energy, I think this is important, only two-thirds of the total energy loans is generation related, and I want to repeat what you said, we are not expecting a major shift from our performing loans in our energy files to other stages going forward. Because what happened with the energy, it has been happening for the last three years already, it is not a new thing.

Handan Saygın
Let's move onto the NPLs on page 30. Now, recall that we guided you about the normalisation expectations in NPL inflows and asset quality trend this year versus last year exceptionally low base. We did start seeing the kick in normalization a bit earlier due to significant changes in the macro scenario. Especially in the second quarter, a few commercial files that we have been following in Stage 2 for a long time with comfortable coverage has been moved to Stage 3. This move, as you have noticed, has also reduced our Stage 3 coverage to 63%, again, on the bottom left hand side (the coverage) if you look, from 68% in the first quarter, and increased the business banking NPLs from 2.1% to 2.8%.

Credit Guarantee Fund NPLs are also followed under business banking NPLs and continue to be quite healthy with a growth NPL ratio of only 80 basis points. Total NPL ratio on a consolidated basis ended the quarter with 3.4% and 3% on a bank-only basis.

Now, there are a couple of things here I would like to bring to your attention. First, we have not gone ahead with our planned NPL sale due to unattractive market conditions. And second, the IFRS 9 implementation, with that implementation, we started accounting for the foreign currency denominated NPLs in their original currency, so with currency going up, it also had 16 basis points impact on the consolidated NPL.

Now, let's move to the P&L impact on page 14. You see on the right hand side our net cost of risk. Now, reportedly it is 177 basis points. However, since the significant portion of it, in this case it is 56 basis points, is due to currency depreciation, and is fully hedged, the portion that hits the bottom line is 121 basis points, reflecting the asset quality dynamics I have explained earlier. We now expect higher year end net cost of risk also due to additional revisions in macro parameters that might kick in, in the second half.

Now, the macro developments in the first half actually differed significantly from what we had anticipated in the beginning of the year when we presented the budgets. A 20% currency depreciation coupled with 500 basis points rate hikes urged us to revisit the operating plan guidance. Now, accordingly, we do expect some slowdown in the second half, so think that we could do 9% year-to-date in the Turkish lira lending, it seems now we will be able to deliver a little under maybe 14% Turkish lira lending growth. We do expect

shrinkage to continue, it is hard to give you a figure, but there will be shrinkage in foreign currency loans, the year-to-date figure was 5%. We do expect the year end NPL ratio to be somewhere between 4-4.5% with no assumed NPL sales. We expect the net cost of risk to be maybe hopefully below 150 basis points. This guidance excludes the currency impact, because as I explained, currency impact doesn't affect the bottom line, so I am talking excluding the currency impact.

NIM including swap costs, if you recall in the beginning of the year we were guiding, excluding the CPI impact, to be flat. Now, we expect that to be flat including the CPI, as we now expect the CPI reading to be higher versus last year's.

Fee growth, we were guiding low teens, but as you saw, the start of the year was an impressive 32%. Most likely, we will see some higher baseline effect in the second half, so it probably will bring the fee growth down to above 20% from the above 30% level.

Operating expense growth, we were saying it would be below CPI. The current CPI suggests, actually, above 10%, but we aim to keep around 10% for operating expense growth for the year.

Return on average equity, actually, taking into account all these upsides and downsides ended up that we could do even slightly better. And ROAAs are in the same territory. So even though there are some downsides, the upsides seem higher and we highly likely will end up with a better ROAE that we initially had indicated. This alone reflects the high resiliency of our business model.

Now, here I end my presentation and we can take your questions. Thank you for listening.

Question and Answer Session

We are taking the first question from Alan Webborn, Société Générale.

Alan Webborn
Could you just talk us through, again, how you feel the second half will go in terms of the net cost of risk? I know you have said, exc. the currency impact, 121 in H1, going up to 150 by year end. Could you just sort of go through the moving parts of what is getting you to that, that would be helpful. How do you feel things will move? What do you think of the impact on corporates of the higher rates that presumably are now hitting the market in the third quarter, and how you feel also you will manage the margin situation, particularly in Q3, because presumably, Q3 is going to be the tougher quarter in terms of margins? A little bit of explanation on that would be most welcome. Thank you.

Fuat Erbil
Hi Alan, thanks for your questions. In terms of cost of risk, we are guiding around 150, we do have the same approach. As always, we try to be as objective as possible, as rational as

possible and as prudent as possible. This is the figure that we came up with as we kept this approach. That is what we have seen, and it means something, actually, having from 121-150 for the whole year, it is a quite conservative jump in terms of this approach.

What will change, majority will come from, I believe, mainly macro parameter changes, so since the second half, we are expecting a slowdown, as Handan stated, unemployment, and higher impact of the high currency, high rates and so on and so forth. We might see some deterioration in terms of coming flows, that is included.

But also in terms of corporate front, we do have a book, especially in the corporate book, which is to us very well managed and very less concentrated. We do have our risk teams and finance teams going over and over again our loan book quite frequently. Based on our stress scenarios and some forecasts regarding some specific assessment of each group, each company, each file, this is the figure that we come with. I wish I could give you further details; this many bps coming from this, and this many bps… I can't, unfortunately, but this is a result of our very prudent and collaborative approach.

In terms of NIM, what we are saying, we want to keep it flat and based on our calculations, we can. The reason being the first half CPI linker contribution to our bottom line was 8.8% CPI assumption. For the second half, we are making it 14%, so this means in terms of numbers, in terms of net income contribution quarterly, while we are having roughly TL 550 million per quarter CPI contribution to our bottom line, with this assumption (new assumption) which we believe is a very likely assumption, it will be doubling, which means 1.1 billion per quarter.

Whatever we got from first half in terms of net income from our CPIs, we will get at least double what we got in the first half for the second half. So this will lead us, based on our assumption, it will cover the cost of funding gap which will hit our balance sheet, mainly Q3, it will cover going forward. Our expectation, again, most likely we will be keeping our net interest margin flattish, although we do have a hit in Q3 in terms of cost of funding or core NIM, but fully compensated by the CPIs.

I hope I could answer your two questions.

Alan Webborn
In the first quarter, you gave this rather useful sort of business as usual IFRS 9 currency split. Is there any chance you could give us that and what you think is the… do you think the IFRS 9 impact is going to be bigger in the second half of the year, or do you think it is going to be smaller. Is your business as usual cost of risk, as you see it now, expected to rise from, I think, it was 115 in the second quarter if I read the presentation right. If you could carry on from what you gave us in Q1 across the year, that would be also helpful, even if it is qualitative.

Fuat Erbil

If I didn't get you wrong, you're referring on page 14 the 21 bps coming from the macro parameter used in IFRS model, so you're right, you're right. Definitely it will be higher. I don't have the exact figure, but I can say that at least 40 bps will come in the second half from this macro parameter change. It means doubling up what we had in the first quarter coming from the macro, but again, we haven't run our models yet. I think we'll be running in the month of August, so whenever we come up with the exact number, we will share with the investor community to change interim-wise.

Handan Saygın
But this is why conservative to start with, if you recall. I mean, there may be some pressures, but not of the adjustments when actually the macro is parameter driven to the net cost of risk.

Operator
Our next question comes from Ali Dhaloomal, Bank of America. Please go ahead.

Ali Dhaloomal
I have just two quick questions. I mean, the first one, can you give us your outlook in terms of capital? I mean, you had the 60 basis points erosion. I was wondering if you have any targets by year-end for CAR or for CET-1. How do you see it playing out and how you will use your balance sheet's flexibility maybe to achieve a certain target? My second question is just about asset quality. I was wondering if you could disclose if your exposure to Doğuş Holding is still in stage one or in stage two right now. Thank you.

Fuat Erbil
In terms of capital, the reason why we have come up from 16.8 to 16.2 is mainly because we paid a dividend. As you might recall, our pay-out ratio was 27.5%, so the pure reason is the dividend payment. The rest is fully compensated with our net income generation, so as you can see here from page three, what was the major impact was the currency impact, which was 107 bps, which we don't expect that much in the second half, and net income contribution will continue to contribute positively. There won't be any dividend payments, so under normal conditions you might expect with the current currency rate, level of the currency, around 16-plus percent capital adequacy ratio consolidated at the year-end. You could easily come up with a calculation if there is a further depreciation in the currency, so you can come up with that, so just a very basic calculation. Take another 140 bps of net income contribution for the second half, so that's straightforward, but very briefly, we're not expecting a decrease on our capital ratio for the year-end, and the quality, as you know, is 87% of our total capital is CET-1.

Handan Saygın
And also maybe wanting to add is like the sensitivity to currency is every 10% depreciation, 55 basis points negative on capital adequacy ratio, so we think we're all set capital

adequacy-wise. As our CEO mentioned, we are expecting to end the year above 16% capital adequacy ratio.

Fuat Erbil
For the specific file, I cannot disclose detailed information to you, but since the restructuring talks still continuing, there are two to three main banks – we're not one of them – who is making the coordination with the client, so as soon as they finish the talks and they agree on the restructuring, we may come up with the numbers, but the approach they have, other than the former restructuring, there are two buckets of the group, they divide the total loans into two buckets. One bucket is the one to be restructured and the second bucket, which is the rest, 50%, will be the dedicated – not restructured, it's because of those companies are self-sufficient in terms of financials, as well as some project finance loans. As long as we have the more concrete numbers, and if they disclose them, they will be disclosing.

Operator
Our next question comes from Ksenia Mishankina, UBP Asset Management. Please go ahead.

Ksenia Mishankina
My question is about the increase in your NPLs that you expect. Where do you think it will come from and can you please provide a bit more detail on that in relation to the increase? Thanks.

Fuat Erbil
We are not expecting any specific sector related or any specific company related. There is a normalisation in the business lending, so the main contribution will come from the business lending and there will be some, again, increases in our retail portfolio, but we're expecting some slight increases, so the 4-4.5% NPL ratio comes as a result of this.

Ksenia Mishankina
Sorry, my second question is have you done any, perhaps, sensitivity analysis with further Turkish lira depreciation, and how it can impact your NPLs?

Fuat Erbil
I mean, of course we're doing internally a lot of analysis and the reason why we have in the restructured and watch list portfolio, I don't remember the exact, 72% is coming from the FX portfolio, so that represents our cautious approach, but there is no direct correlation between 10% depreciation causing this much of cost of risk increases or this much NPL increases unfortunately.

Operator
Our next question comes from Simon Nellis, Citi. Please go ahead.

Simon Nellis
I was hoping you could give me just a brief overview of how much external funding you have coming and maturing in the next 12 months. When are the major rollovers, if you're seeing any issues there? Just on your swap book, can you also tell us how the market there is looking. Are you going to continue using as much swap usage? Are you seeing any reluctance of counterparties to enter into swap agreements? Thanks.

Fuat Erbil
Actually we don't have other than syndicated loans any upcoming… within the next one year, within the next 12 months, we don't have any major Eurobonds redemptions upcoming other than syndication. The syndications, as you know, we do have two tranches in dollar equivalent which $2.6-2.7 billion, half/half, one tranche is in May, the other tranche in November basically, and you know the nature of the syndication loans, which is quite different than the Eurobond or DCM market, so the syndicated loan market is more… is kind of a reciprocity basis, so with your good bank, as an example, you're a client and you're making some money, and you are Citi or Wells Fargo or as Bank of America Merrill Lynch, or Mizuho, or BTMU, or ICBC, is contributing to our syndicated loans in terms of reciprocity basis, so their nature is completely different and unlike the Eurobond markets – as an example, as of today we will like to imagine issue a Eurobond, the market conditions maybe won't let us to come up with a benchmark size, but syndication loans is since relationship driven. We always come up with very close to 100%. In the toughest days, I remember, during 2008/09, our rollover ratio was around 80%, not below 80%, so those are the two upcoming big tickets, which is totalling 2.7 billion. Other than that, we don't have any Eurobonds, as I already mentioned. We might have some small ticket bilateral loans that we had for some time in 2019, but not 2018.

Simon Nellis
Thank you and on the swap, can you give an overview of your swap strategy going forward and how you see the market there developing? Actually, who are the counterparties on the swaps generally? Is it also the City banks and the Bank of Americas of the world?

Fuat Erbil
Typical swap parties are the London names that you already mentioned some of them, so basically we do our swaps, and in the strategy, as always, we are very opportunistic. Of course, we prefer Turkish lira deposits, but if we find very attractive, the swap funding, of course we switch to the swap funding, but as you can see here in the first half, it swings around TL 22-23 billion swap book. It's not changing. We leverage with less than 12% in terms of cost of the swap book, but it is not much higher, so depending on the market

conditions, depending on the other parties' appetite, we might cut, but honestly I don't expect that appetite change in a very positive way in the short-term.

Simon Nellis
Right and maybe if I could just ask one more question, on your TL time deposit costs, where do they stand today versus the end of the second quarter and where do you think they're going to go in the next quarter or two?

Fuat Erbil
Sure. As of now we have Turkish lira time deposits only, the cost is 15.5% as of now, as of today – 15.5-15.6%. June-end it was very close to 14%. In the first quarter it was much less as you know. It is 12.5%, so it might go up with the existing rate environment to 16%, maybe a little above 16%. That's what we're expecting and we include this scenario while we're coming up with the NIM guidance to you, so that is already taken into consideration in our flat NIM guidance.

Fuat Erbil
Web Questions:

"What is the difference between real estate and the construction sector?"

Real estate sector is including residential and commercial real estate. The shopping mall is real estate or housing is real estate. Construction for those companies doing construction work like highways, infrastructure, those companies, if they are using for their own pool, holding-wise we call it construction, but if they're building an airport that's under our transport vehicles, logistics sector, or if they are building a bridge, airport, highways, so that's in the vehicles and logistics. Construction is the builders exposures of those companies.

Handan Saygın
"Could you please give some more details on funding pressure, notably for syndicated loans, rollover rate, funding cost?"

Fuat Erbil
I think we did this already.

Handan Saygın
"Could you tell us how many banks you do syndicated loans, which countries?"

Fuat Erbil

I mean, traditionally this number is not changing significantly. 17-20 countries and around 40 banks. Those are the banks contributing to our syndicated loans. We do have starting from the East the top three names from Japan. They've always been with us. Recently, we started to see Chinese, two Chinese banks, now contributing to our syndicated loans, and the rest is coming from Europe, London, and the U.S. banks. So those names – I mean, in every country we do have a relationship. As an example in Germany, Deutsche and the Commerzbank; in France, Société Générale, BNP, are our top relations as an example; in the U.S., Wells Fargo, Citi, Bank of America Merrill Lynch, Goldman, J.P. Morgan Chase, those are the names that I can share with you.

Handan Saygın
The European banks' contribution it is more than 40%.

Handan Saygın
"There was some news yesterday on Bloomberg that the Banks Association is working on a framework agreement to determine principles for a corporate debt restructuring. What are the key areas of this discussion with regards to the framework? In other words, was the framework to increase transparency on the restructured loans and better comparability with risky Stage 2 loans among the banks?"

Fuat Erbil
I mean, currently there is no concrete decision that has been made on these two issues, as long as the Turkish Banks Association come up with, I mean they will disclose to the public.

Handan Saygın
"Can you please confirm that you still keep Yildiz and Otas in Stage 2?"

That I already answered in my presentation.

"What support from the Central Bank or State do you expect to support the banking sector or the economy in the coming 12 months?"

Fuat Erbil
I think that is irrelevant with the today's presentation.

Handan Saygın
"What is the degree of compression in core spreads do you expect in third quarter?"

Fuat Erbil
70 bps, basically that's something… 60-70 bps if there is no rate hike, with that assumption.

Handan Saygın
"Where do you see your swap costs in third quarter?"

I can answer that. It's 14% currently.

"What are the asset quality characteristics of the Credit Guaranteed Fund Portfolio, NPL ratio, coverage?"

Again, this was something I answered in my presentation.

Fuat Erbil
Which is very low.

Handan Saygın
The growth NPL is 80 basis points.

"Secondly, you talked about calibration studies in the sector. What should we expect from these changes?

Fuat Erbil
No, no, it's not sector related. It is bank related. What I tried to mention is that 43% comes from the model. We are calibrating the model, because the model is very new. We are in the process of calibration of that model, which constitutes 43% of our Stage 2 loans. Again, as long as we do have some significant changes, we will let you know the details.

Operator
Our next question comes from Gabor Kemeny, Autonomous Research. Please go ahead.

Gabor Kemeny
I just wanted to ask a couple of quick ones. One on your provisioning guidance. As I understand, you are expecting most of the increase in the second half to come from the updated macro parameters, so IFRS 9 adjustment etc, but if this is correct then why would you not expect the what you call 'business as usual' provisioning to increase when it's on an upward trend? So it was 80 basis points in the first quarter; it was above 100 basis points in the second quarter and, as I understand, you expect a slowdown in the economy in the second half.

Fuat Erbil

Gabor, I mean, don't get us wrong, that will also increase – of course, I mean the business as usual will increase that 150, as well as the macro parameters. That 100 bps will also increase.

Handan Saygın
But maybe to a lesser degree, because to start with, our 100 basis points we call it as conservative, so it will be pressured up a bit, maybe ending up in 110, 120 maybe, and then the macro parameter adjustment will come on top of it, but also keep in mind there maybe some quarterly volatility because of the macro parameter changes, but we expect to end the year 150 basis points for net cost of risk.

Fuat Erbil
I think I want to mention not directly related with your question, there is still some, I don't know, not a full understanding. For the last, I don't know how many years, more than two years for sure, we are fully hedging our FX denominated provisions, so whatever happens with the currency up or down, it is fully hedged in our trading portfolio, so I mean there is not a single penny effect on our bottom line.

Gabor Kemeny
Just another quick one on margins, so as you mentioned, three was a 500-basis-points interest rate increase, which you didn't expect, so your margin outlook actually improved, so do you have a sense what could happen if we got additional rate hikes from here? So let's say the Central Bank decided to do another 300-basis-points rate hike, how could that impact your margins? As I understand, partly you are hedged by the CPI linkers, because I just wondered how much leverage do you have to pass on higher rates to customers from here.

Fuat Erbil
Although there might be some lag, but if the Central Bank decides to hike, let's say, as you said 300 bps more, this means there will be upcoming inflation increases. As we have now, in our current case, yes, there will be a hit on our cost of funding and the core spreads, but it mainly will be hedged by the CPI assumption. So there might be some, again, slight changes gap in terms of NIM, but overall with a six-month view I am not expecting huge changes or major impacts on our NIMs.

Operator
Our next question comes from Emir Moran, ÜNLÜ & Co. Please go ahead.

Emir Moran
A brief question on my side. I know that you mentioned you paid out around 27.5% dividend from last year's earnings. Should we expect a similar dividend pay-out ratio under

the assumption that capital ratios would remain at these levels or even improve with further internal capital generation in the second half of the year? Thank you.

Fuat Erbil
The answer is very straightforward. Sure, yes, maybe more, so that's our intention. Of course it's subject to BRSA approval, but most likely our intention will keep at least that pay-out ratio at 27.5, if not more.

Emir Moran
Because current market cap corresponds to around, like, 8% yield, that's why I was curious to know. Thank you.

Operator
Our next question comes from Simon Nellis, Citi. Please go ahead.

Simon Ellis
Just quickly on fee income, can you describe exactly why it's been beating your guidance and do you expect that to be continued? I mean, I guess the economy is going to slow down a little bit and there could be… I'm just surprised at how robust it's been, if you can give us some more colour on the fee income side, thanks.

Fuat Erbil
I will leave the floor to Handan, but basically it's the outcome or result of our business model, Simon. I mean, it's coming from our very strong market share in two main areas, payment systems as well as digital, so I think Garanti is proving its service and this is the result. I mean, surprisingly it's a surprise for me too as well, so we guided you very low teens, but the pace is still the case. I mean, as of now, including the first month of third quarter, we are still keeping 30-plus pace in terms of fees and commission generation. I agree there should be a slowdown in the coming months because of the less activity in the economy, but we believe that it will be… we are very comfortable with 20%, definitely it will be well above 20% on yearly basis. So it is well diversified. Believe me, there is no one-off items in our fees and commissions. I mean, I mentioned two main areas, but there are a lot of supporting areas like insurance, like our cash management business, money transfers, project finance, and we charge SMEs and the commercial, and our share in the SMEs and the commercial is increasing recently, so we are charging more from them, and this is the outcome and we are very comfortable to guide you at least 20% fees and commission income throughout the year.

Operator
I'm going to read one of the web questions.

"Can you please comment on your Otas exposure? Did you increase provisions in the second quarter and does your new NPL guidance include the effect of Otas moving to Stage 3?"

Fuat Erbil
The answer to our investor's question is Otas is still in Stage 2, as Handan said. We provisioned 30% at the first day of the year, as you know. We are still keeping the same. The process is still continuing. We are expecting it to close very soon. We are not expecting Otas will be under Stage 3 or NPL, so since we're not expecting that, our NPL ratio does not include this Otas exposure.

Operator
Our next question comes from Charl Ayer, JP Morgan. Please go ahead.

Charl Ayer
Just a quick one, on slide three where you showed the capital bridge, I'm just wondering given that you've shown that FX loans declined by, was it 4% year-to-date, what RWA benefit from that has been?

Fuat Erbil
I mean, in constant currency, yes, but since the Turkish lira depreciated, so in Turkish lira equivalent, of course not. Overall, since even our foreign currency book is shrinking by 5% since currency depreciated more than 25% year-to-date, our RWA is in Turkish lira terms unfortunately increased, although in foreign currency dollar terms decreased.

Charl Ayer
So is it right to assume that the currency impact number of 107 that you have there is a net number, which includes the loan book shrinkage, basically?

Fuat Erbil
Of course, of course, just mainly because of that.

Charl Ayer
Okay, thank you.

Fuat Erbil
So, I mean, just for you to know, 10% appreciation or depreciation, plus or minus 53, 55 bps impact on the capital ratio – 10%, 55, thank you.

Fuat Erbil

Thank you all. I think today we were very popular. I think we have seen the highest number of attendees listening to us, so I think we are doing a good job as Garanti in this volatile and difficult environment, and we believe we will continue to deliver the same strong results going forward. We know the challenges, but we believe we can tackle with those challenges, because as I'm always saying that the machine is good, the machine is running very efficiently, so we are very confident and prudent, and transparent as always to you, so thank you for your trust and commitment, and hopefully we'll be delivering these strong results to you as the whole Garanti team. We wish you a great evening to all of you. Thank you.