

CENTRAL BANK OF THE REPUBLIC OF TURKEY

Durmuş YILMAZ

Governor

April, 2010

Outline

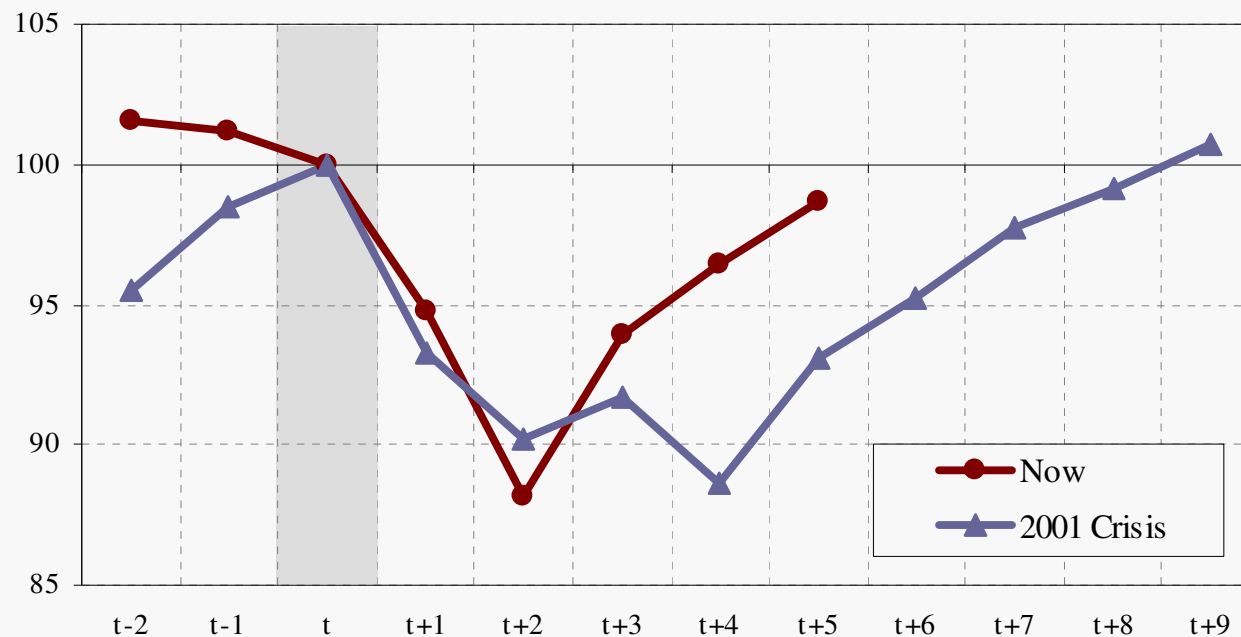
- I. Comparative Analysis of 2001 and 2009 Crises**
- II. Financial Developments**
- III. Macroeconomic Developments**
- IV. Monetary Policy Stance**
- V. Balance of Payments**
- VI. Financial Stability**
- VII. Public Finance**
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I. Comparison of the 2001 and 2009 Crises

A Tale of Two Crises

The extent of the damage was the same, but the speed of the recovery differed: During both crises, the Turkish economy contracted about 10 percent within the first 2 months. In 2001 economic activity returned to its pre-crisis level in 9 quarters. As for the 2009 crisis, a relatively faster recovery has been experienced so far.

*Seasonally Adjusted Real GDP During 2001 and 2009 Crises**



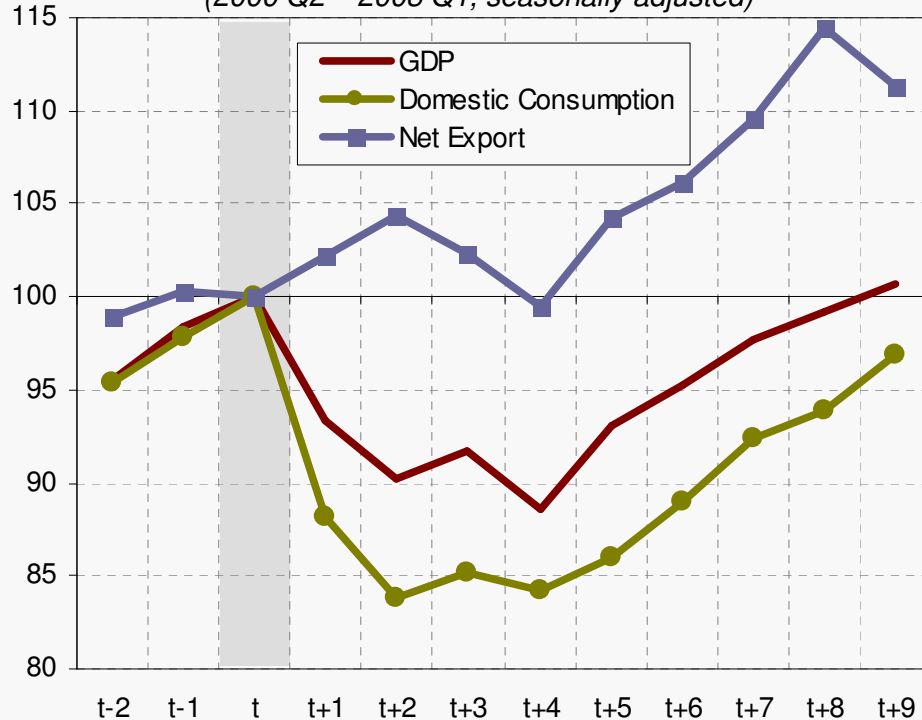
*Start of the recession: 2001 Q1 for the 2001 crisis; 2008 Q3 for the 2009 crisis.

Source: TURKSTAT, CBT

A Tale of Two Crises

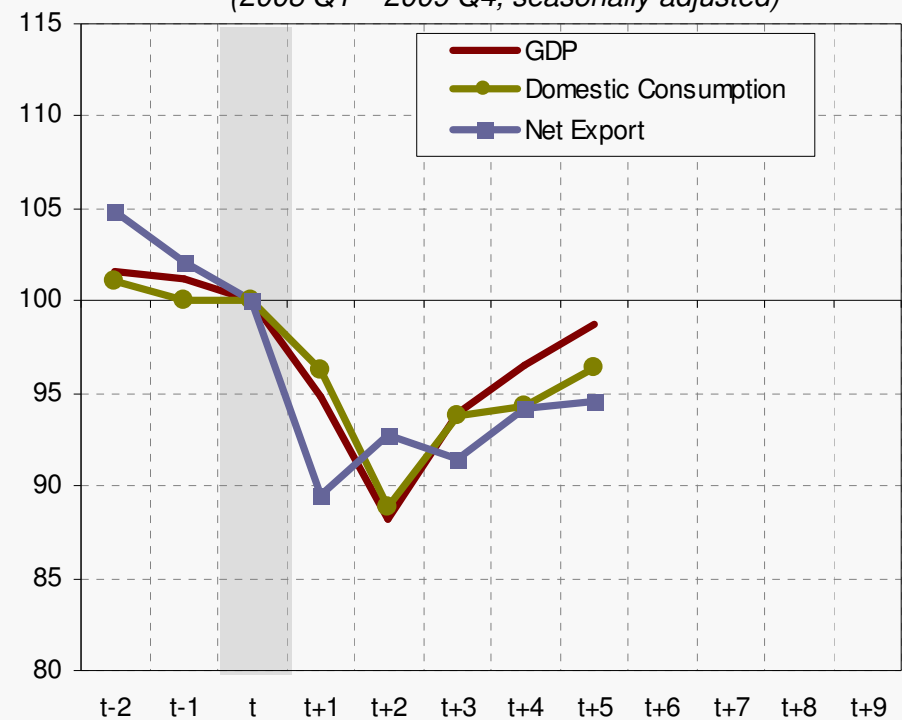
The decomposition of the recovery was also different: External demand provided significant support in the aftermath of the 2001 crisis. In the domestic front, the contraction was milder in 2009 thanks to structural reforms, fiscal discipline and strong financial system.

Turkish Economy During the 2001 Crisis*
(2000 Q2 – 2003 Q1, seasonally adjusted)



*Start of the recession: 2001 Q1 for the 2001 crisis; 2008 Q3 for the 2009 crisis.
Source: TURKSTAT, CBT

Turkish Economy During the 2009 Crisis*
(2008 Q1 – 2009 Q4, seasonally adjusted)

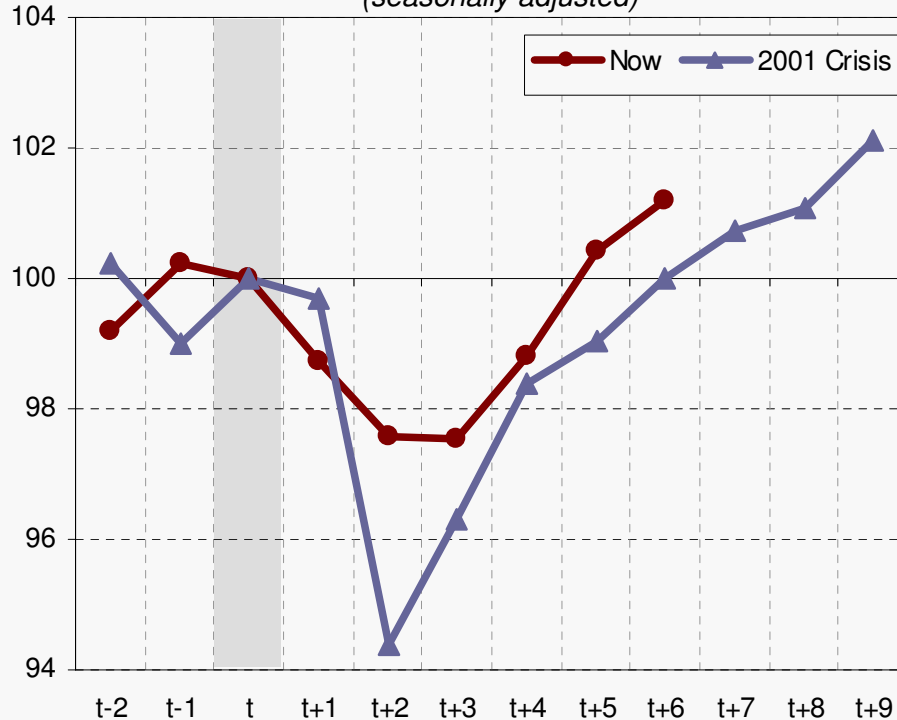


*Start of the recession: 2001 Q1 for the 2001 crisis; 2008 Q3 for the 2009 crisis.
Source: TURKSTAT, CBT

A Tale of Two Crises

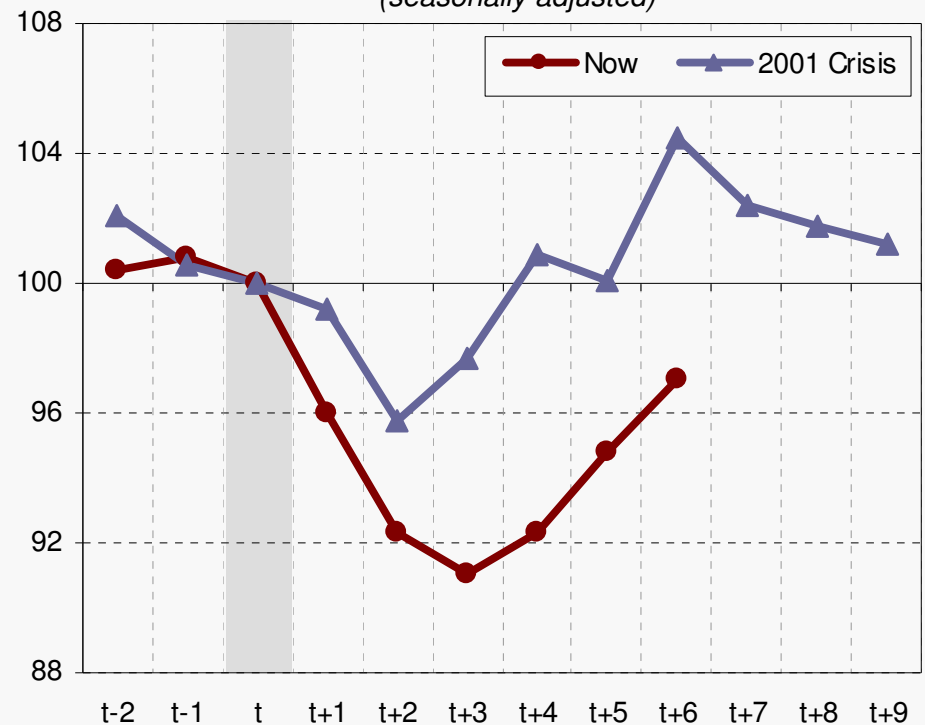
Two-speed recovery has affected the labor market as well: Industrial employment has plunged much deeper compared to the 2001 crisis. However, the resilience of the services sector restricted the damage in the labor market.

Non-Farm Employment* During Recessions
(seasonally adjusted)



*Start of the recession: 2001 Q1 for the 2001 crisis; 2008 Q3 for the 2009 crisis. 2010Q1 covers only Jan 2010.
Source: TURKSTAT, CBT

Industrial Employment* During Recessions
(seasonally adjusted)



*Start of the recession: 2001 Q1 for the 2001 crisis; 2008 Q3 for the 2009 crisis. 2010Q1 covers only Jan 2010.
Source: TURKSTAT, CBT

II. Financial Developments

Turkey's Bond Spreads Have Narrowed

Turkey's risk indicators have continued to outperform those of other emerging market economies.

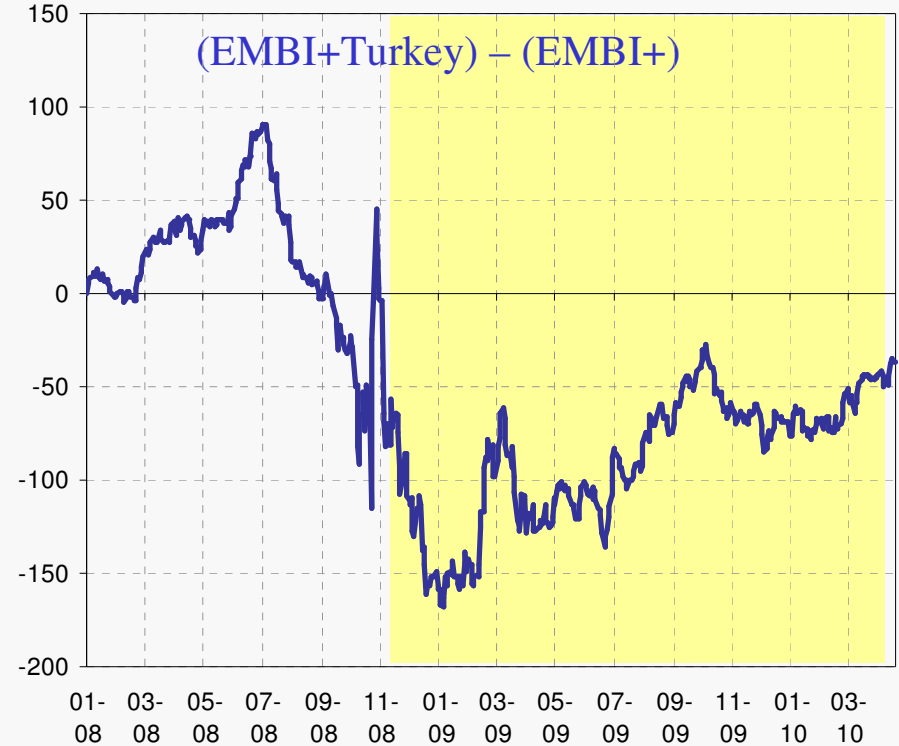
EMBI Spreads

(Jan 2008 - Apr 2010, basis points)



Difference Between EMBI and EMBI+Turkey

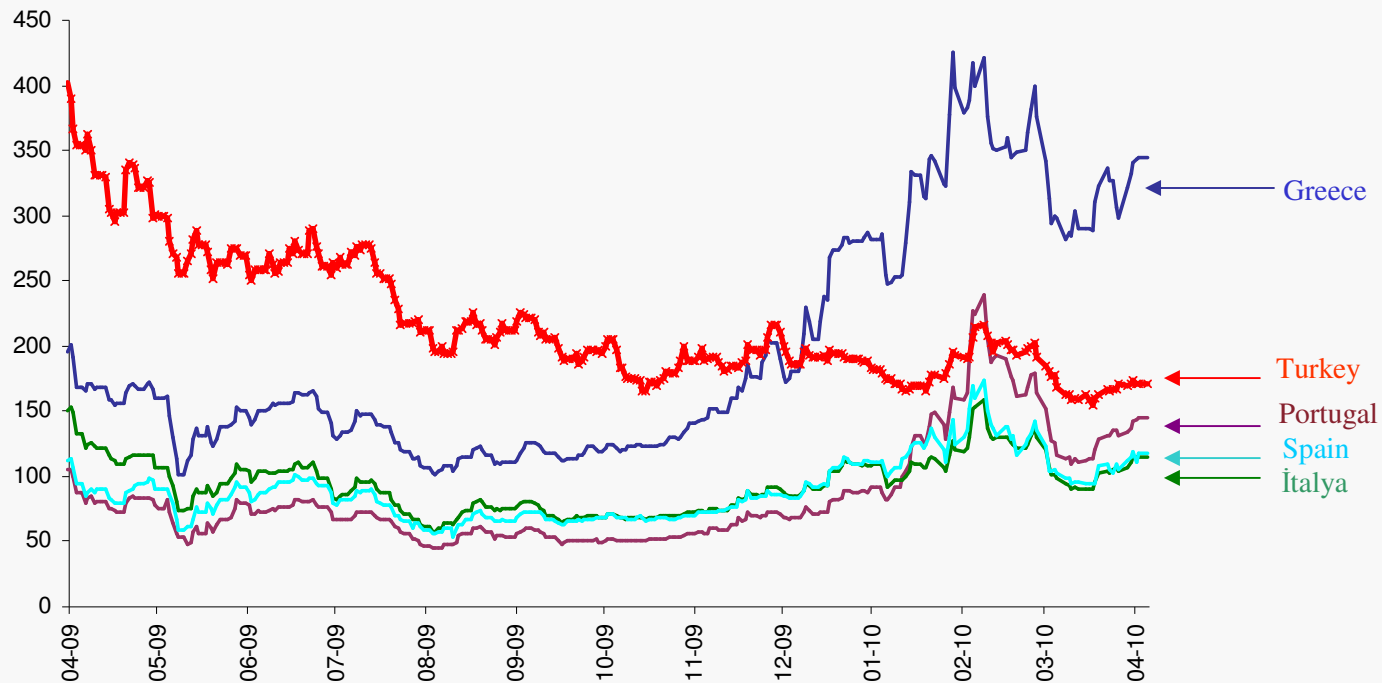
(Jan 2008 - Apr 2010, basis points)



Turkey's Sovereign Risk Premium Has Declined

The risk premia of countries with high level of debt have risen significantly in recent months. Turkey's risk premium, however, has sustained its stable course thanks to her solid financial system and low level of indebtedness.

CDS Premia of Selected Countries
(Apr 2009 – Apr 2010, Oct 2009 = 100)

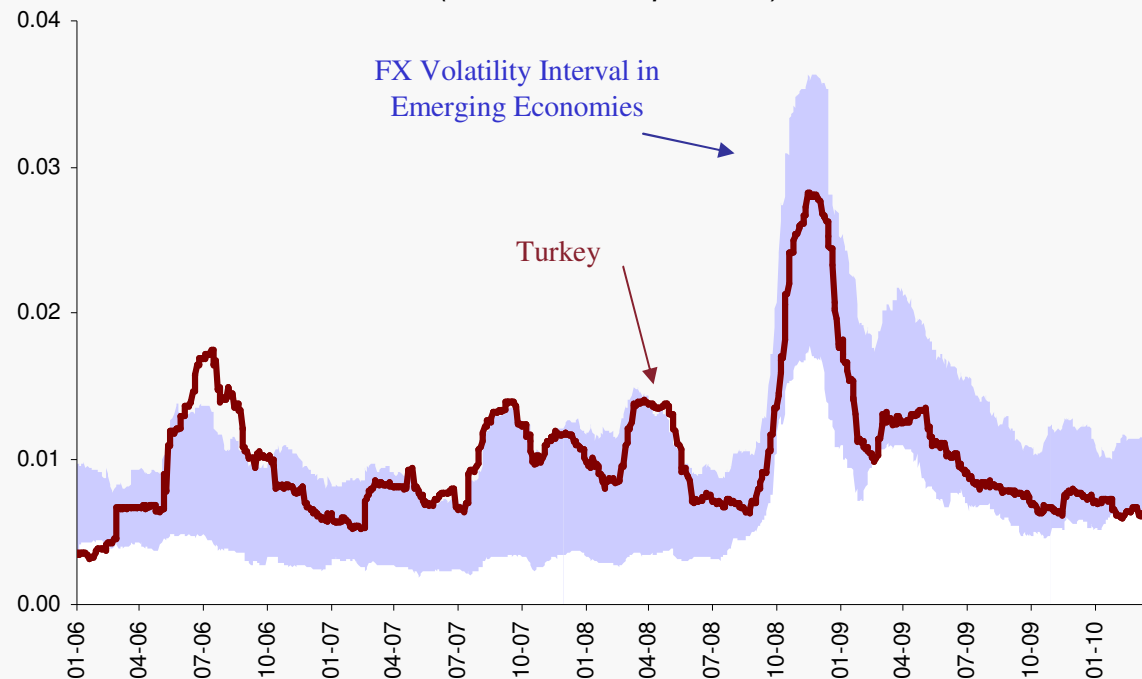


Source: Bloomberg, CBT

Turkish Lira Has Remained Fairly Stable

The relatively stable course of the Turkish lira, which used to be one of the currencies with historically high volatility and high vulnerability to the global risk appetite, has continued in the first half of 2010.

FX Volatility of Selected Countries*
(Jan 2006 – Apr 2010)



*50 days of standard deviation; Brazil, Chile, Czech R., Hungary, Mexico, New Zealand, Poland, S.Africa, S.Korea
(highest and lowest values)

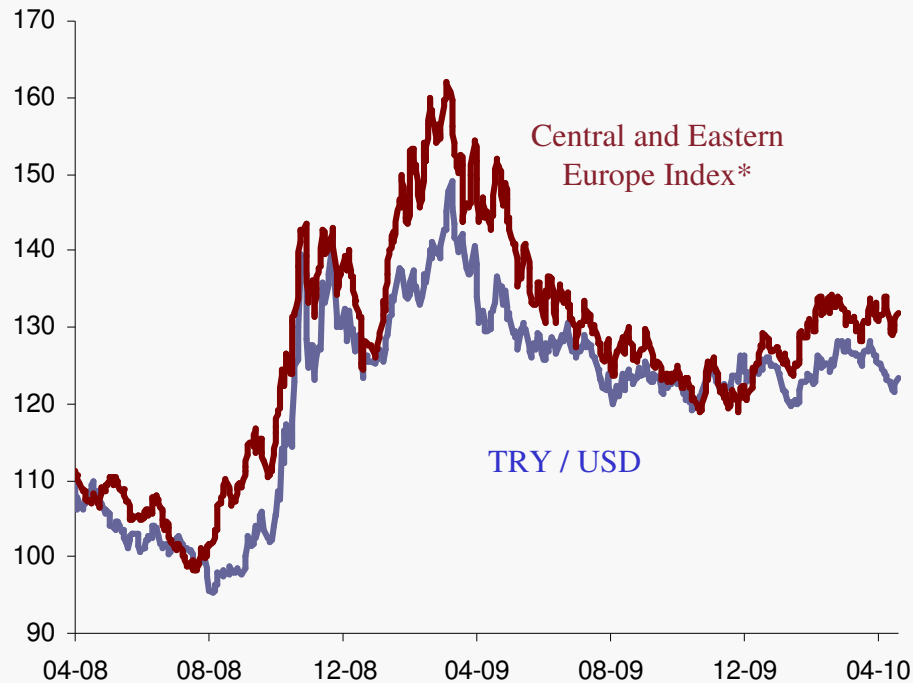
Source: Bloomberg, CBT

No Significant Appreciation in Turkish Lira

Compared to the currencies of other emerging economies, no significant change is observed in the value of the Turkish lira.

Exchange Rates

(Apr 2008 – Apr 2010, Jan 2008=100)

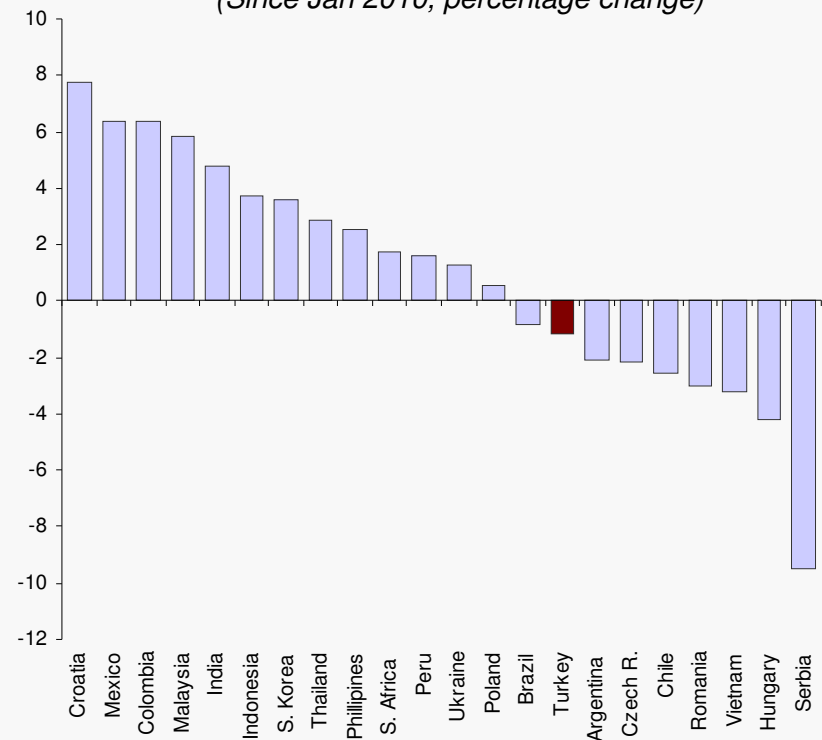


* Equally-weighted average of the domestic currencies of the Czech Republic, Croatia, Hungary, Lithuania, Poland, Romania, Slovak Republic and Ukraine.

Source: Bloomberg, CBT

Change in Local Currencies Against US Dollar

(Since Jan 2010, percentage change)



Source: Bloomberg, CBT

Real Interest Rates Remain Subdued

Real market rates in Turkey have remained low and stable --- despite the moderate recovery in the economic activity, thanks to counter-cyclical monetary policy of the CBT and lower risk premium.

Real Interest Rate of 2-Year Domestic Bonds*
(Jan 2008- Mar 2010, percent)



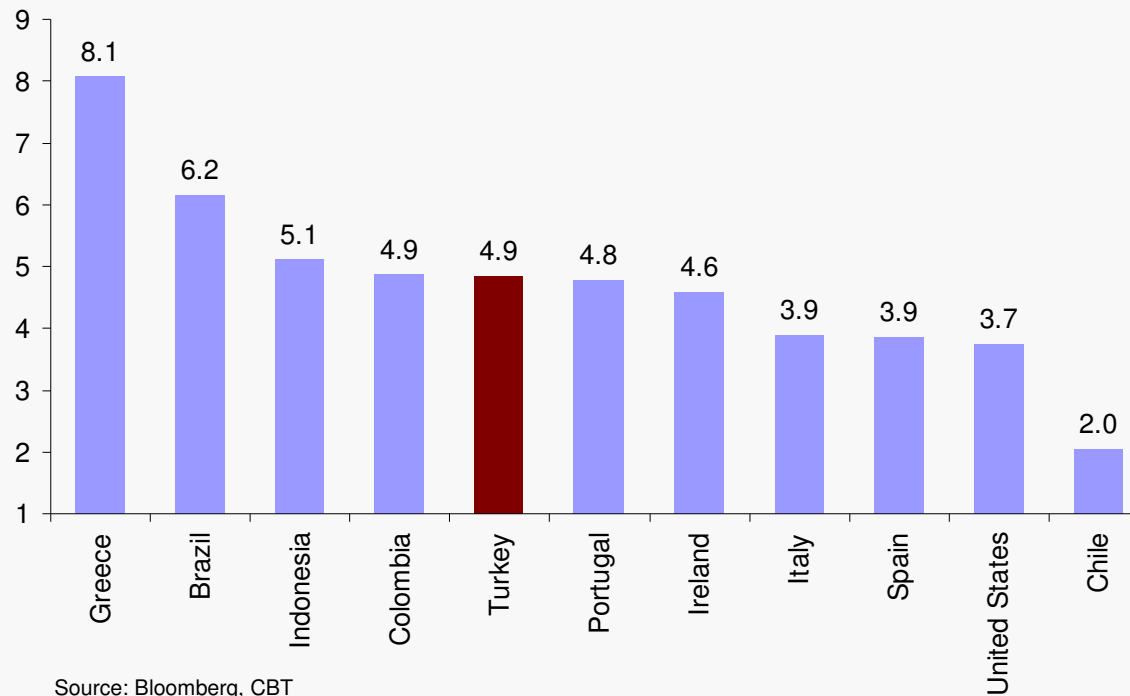
* 2 year nominal interest rate is derived from yield curve. Based on 24 month forward inflation expectations.

Source: CBT

Long Term Rates Also Contained

Yield on 10-Year Turkish Government Bonds denominated in USD has also stayed in par with investment grade economies, reflecting the confidence in the Turkish economy.

Yields on 10-Year Government Bonds denominated in USD
(April 2010, percent)



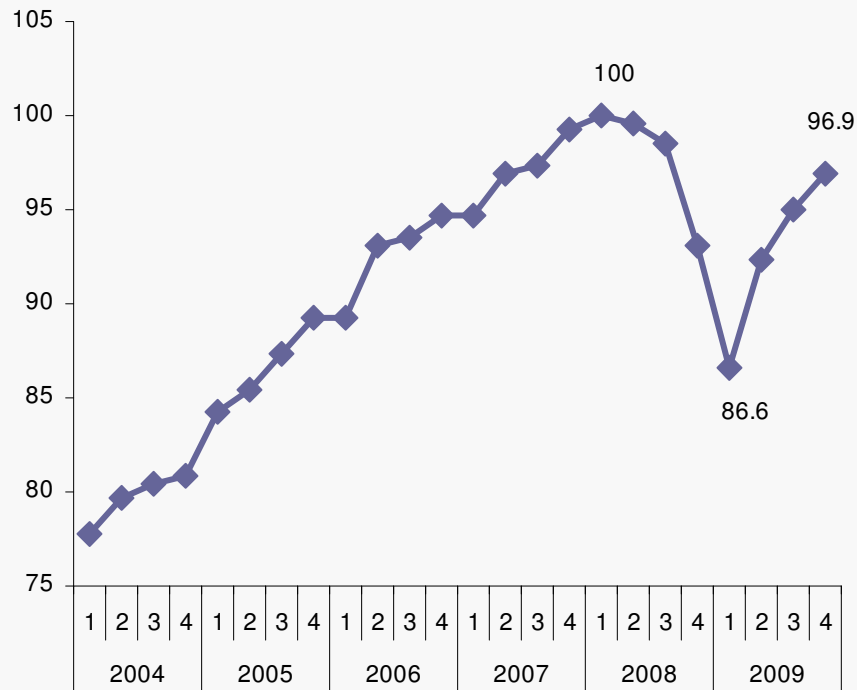
III. Macroeconomic Indicators

Economic Growth is Positive Since 09Q1

Recent data suggest that the moderate recovery in economic activity continues.

GDP

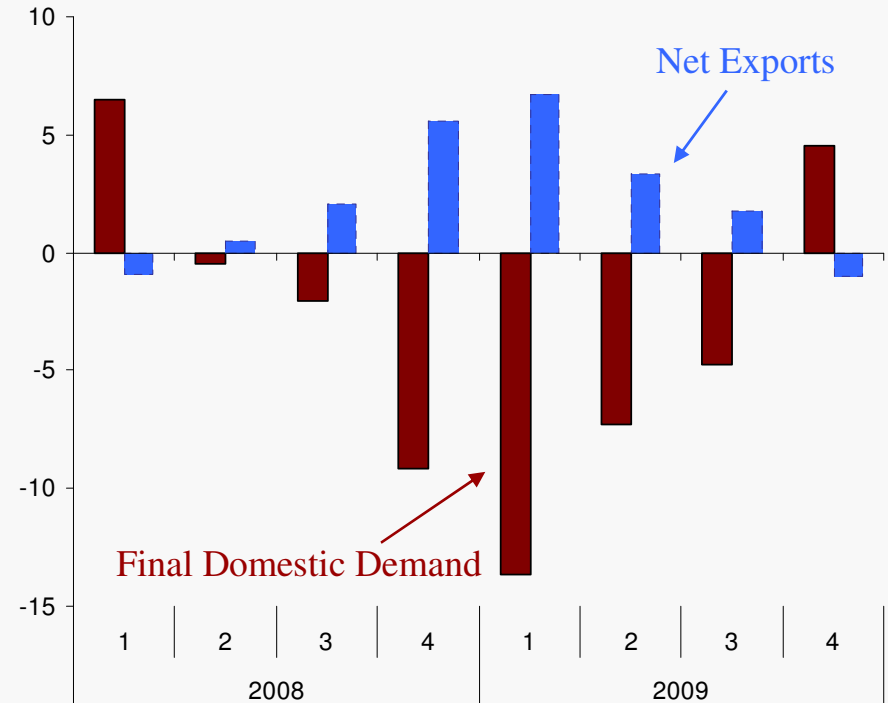
(Real, seasonally adjusted, 2004 Q1 – 2009 Q4, 2008 Q1=100)



Source: TURKSTAT, CBT

Composition of Growth

(2008 Q1 – 2009 Q4, annual percentage contribution)

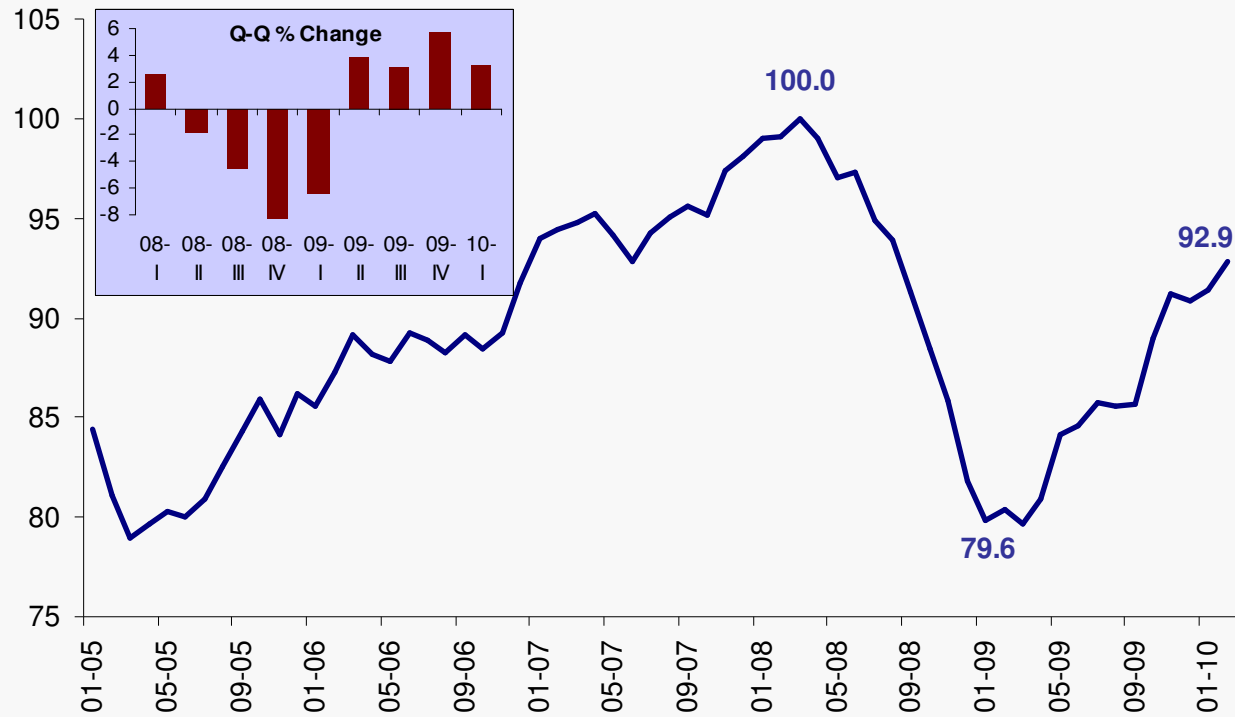


Source: TURKSTAT, CBT

Production is Back to Pre-Lehman Level

Industrial production has displayed a gradual increase since the second quarter of 2009.

Seasonally Adjusted Industrial Production Index
(Jan 2005 – Feb 2010, Mar 2008=100)

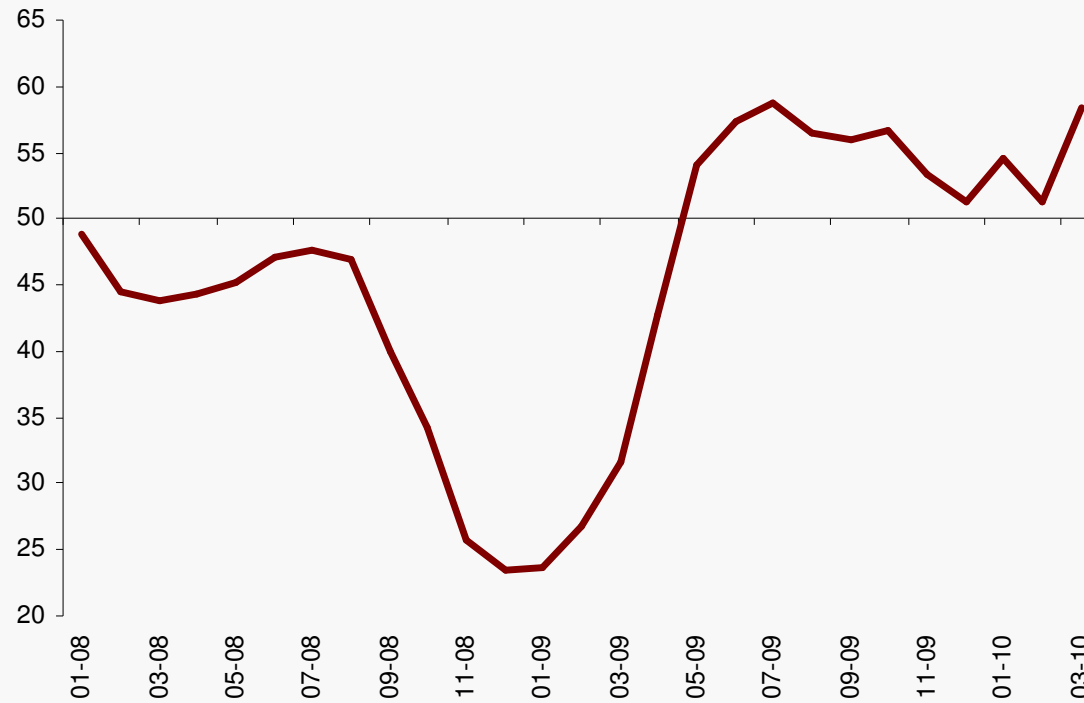


Source: TURKSTAT, CBT

New Orders are Rising

PMI new orders index has remained above 50 for the last 9 months.

PMI New Orders Index
(Jan 2008 – Mar 2010)

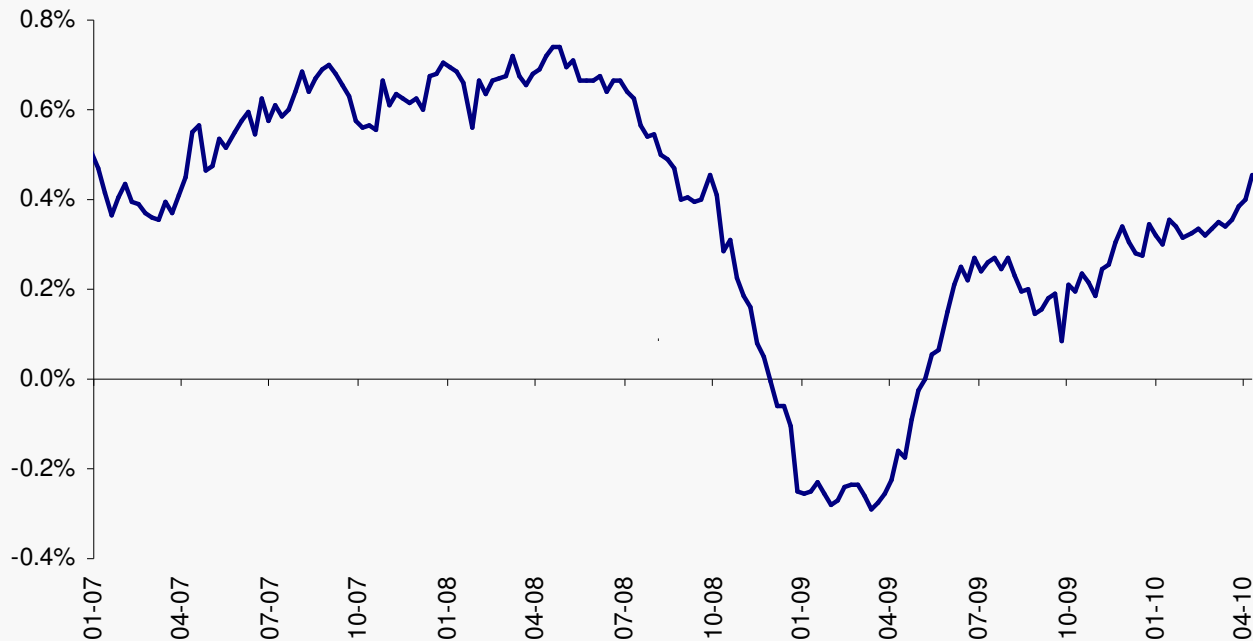


Source: Markit, CBT

Credit Channels Have Opened Up

With the support of the CBT's counter-cyclical monetary policy measures and improvements in global risk perceptions, credit growth has picked up, with marked rise in commercial loans.

Weekly Change in Total Credit Volume*
(Jan 2007 – Apr 2010, 13-week moving average, percent)



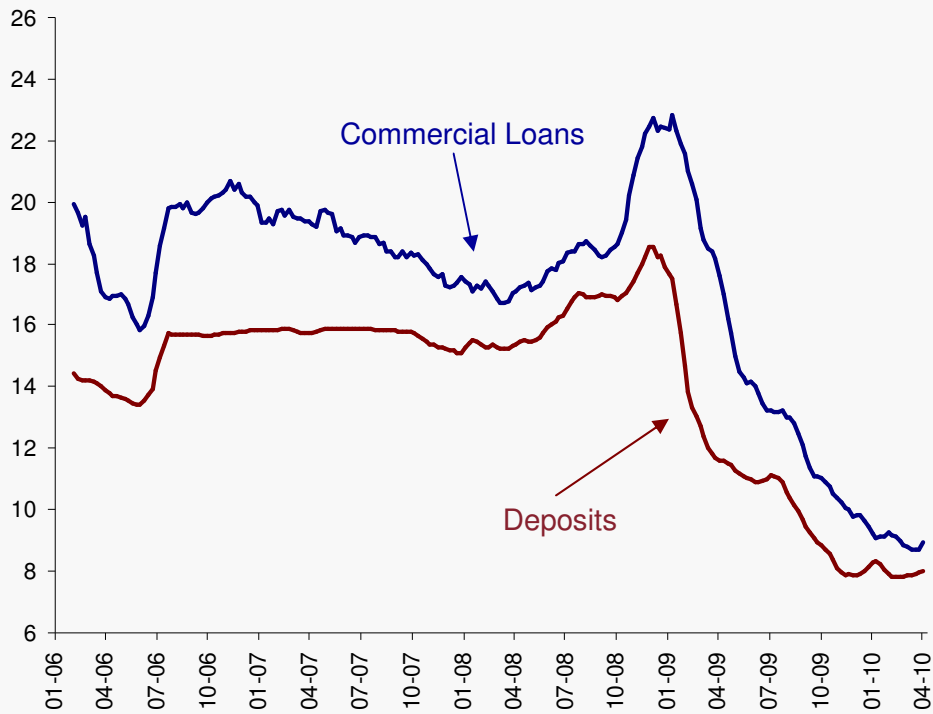
* Total credits extended by deposit, development, investment and participation banks along with consumer financing firms; exchange rate adjusted
Source: BRSA, CBT

Credit Conditions are Supportive

Monetary measures put into effect by the CBT has contributed to the easing of exceptional tightening in financial conditions. Credit spreads have narrowed considerably since the last quarter of 2009.

Commercial Loan Rates and Deposit Rates*

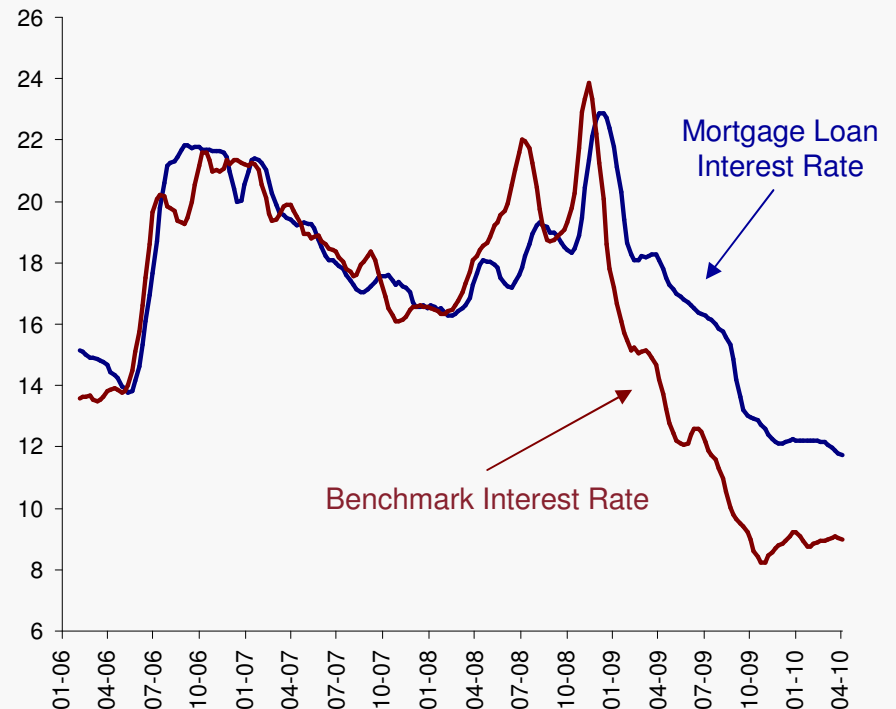
(Jan 2006 – Apr 2010, 4-week moving average, annual percentage)



* Weighted average, flow interest rates.
Source: CBT

Mortgage Rates and Benchmark Government Bond Rate*

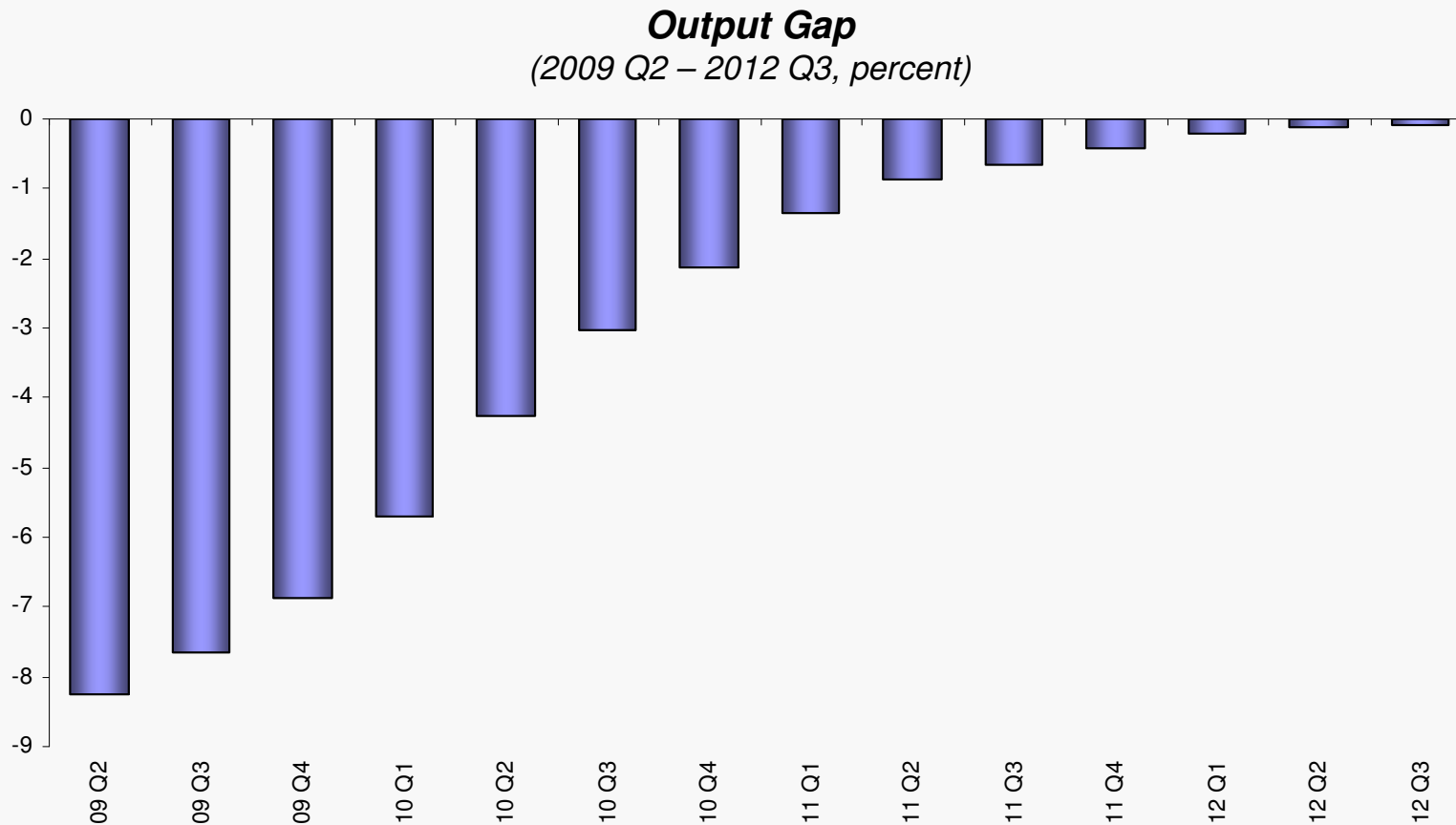
(Jan 2006 – Apr 2010, 4-week moving average, annual percentage)



* Weighted average, flow interest rates.
Source: CBT

Output Gap Has Not Closed Yet

Despite recovery in production, domestic demand, and financial system, output gap is likely to remain disinflationary for a considerable period.

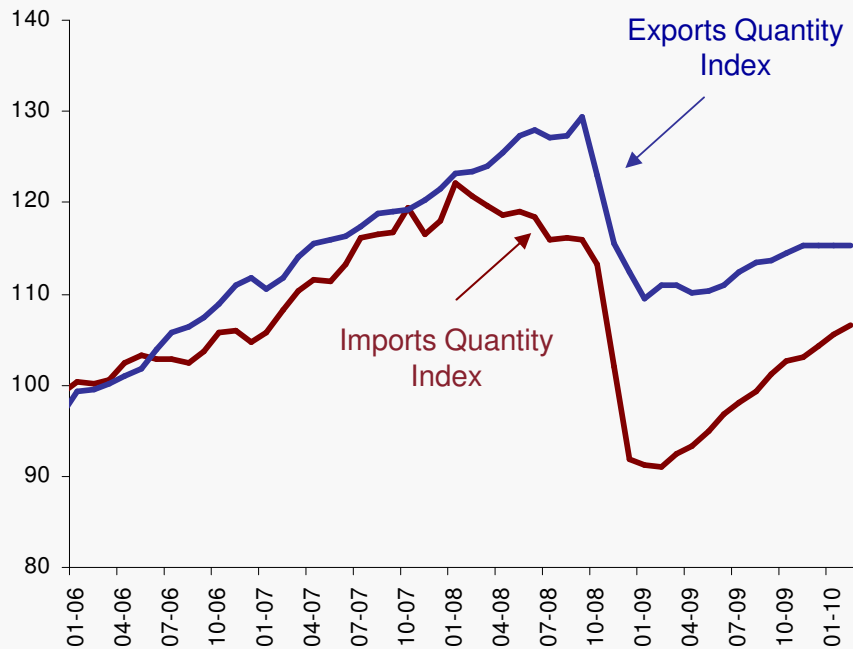


Source: CBT

Challenges Remain in Export Markets

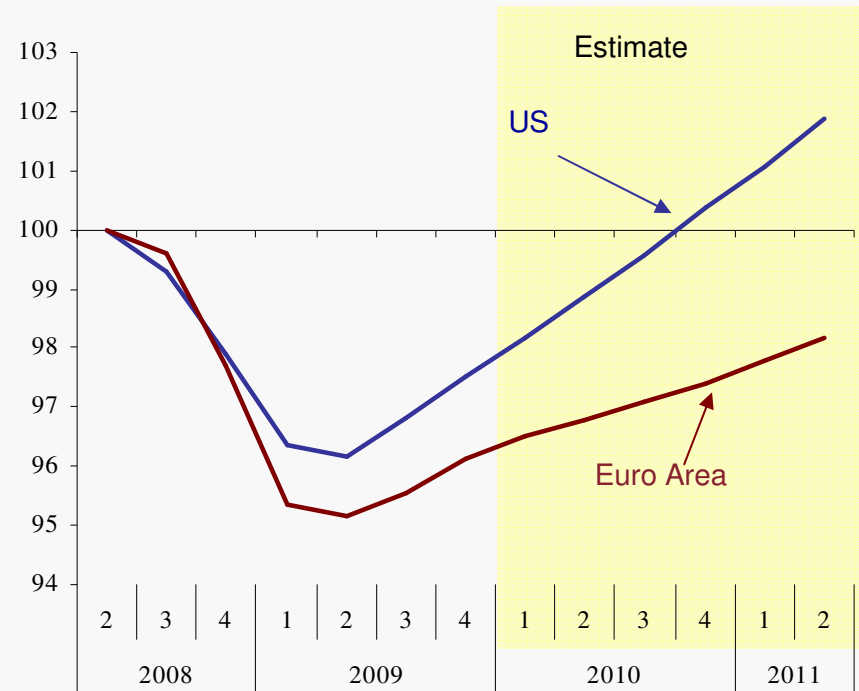
The especially weak pace of economic recovery in the Euro Area poses a downside risk on exports. The recovery in exports is expected to be gradual.

Exports and Imports Quantity Indices*
(Jan 2006 – Feb 2010, Jan 2006 = 100)



* Seasonally adjusted, 2 month moving average.
Source: TURKSTAT, CBT

Growth Estimates for the USA and Euro Area
(2008 Q2 – 2011 Q2, 2008 Q2 = 100)



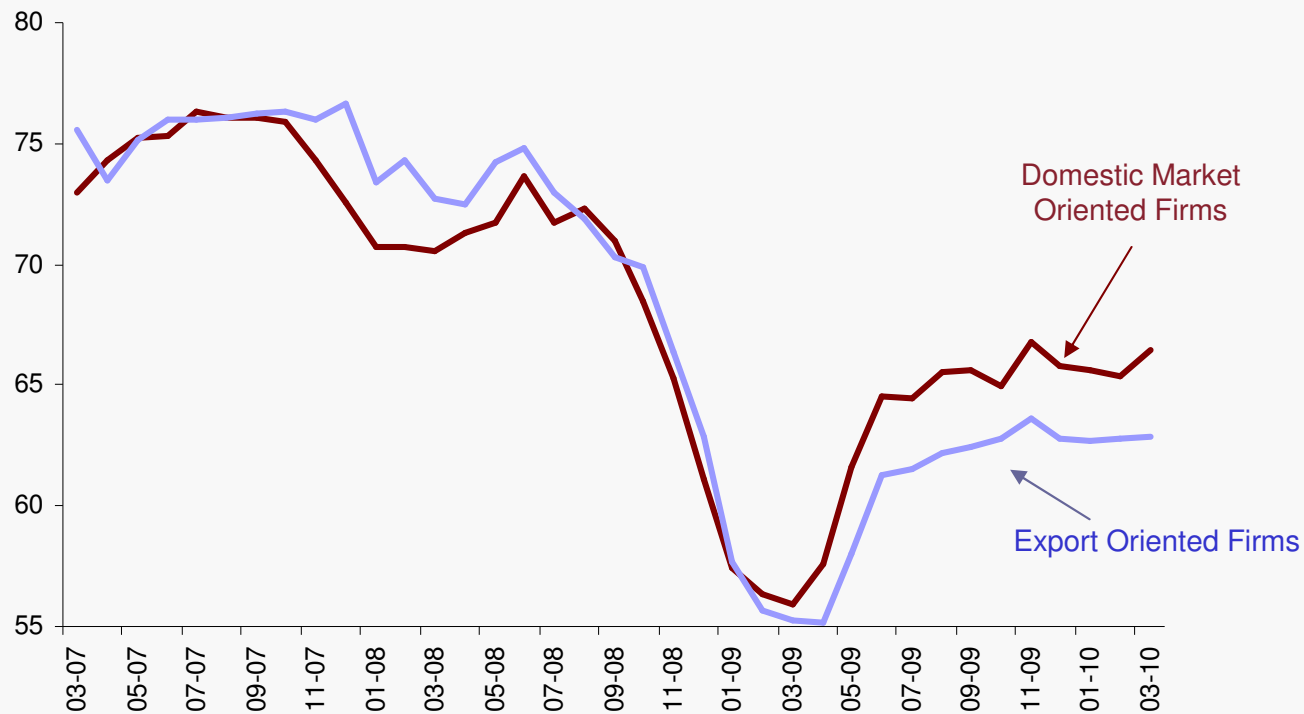
Source: Concensus Forecast

Two-Speed Recovery in Manufacturing

Capacity utilization ratio has been recovering faster among firms producing for domestic market. Still, it remains below the pre-crisis average by a wide margin in all sectors.

Seasonally Adjusted Capacity Utilization Rate

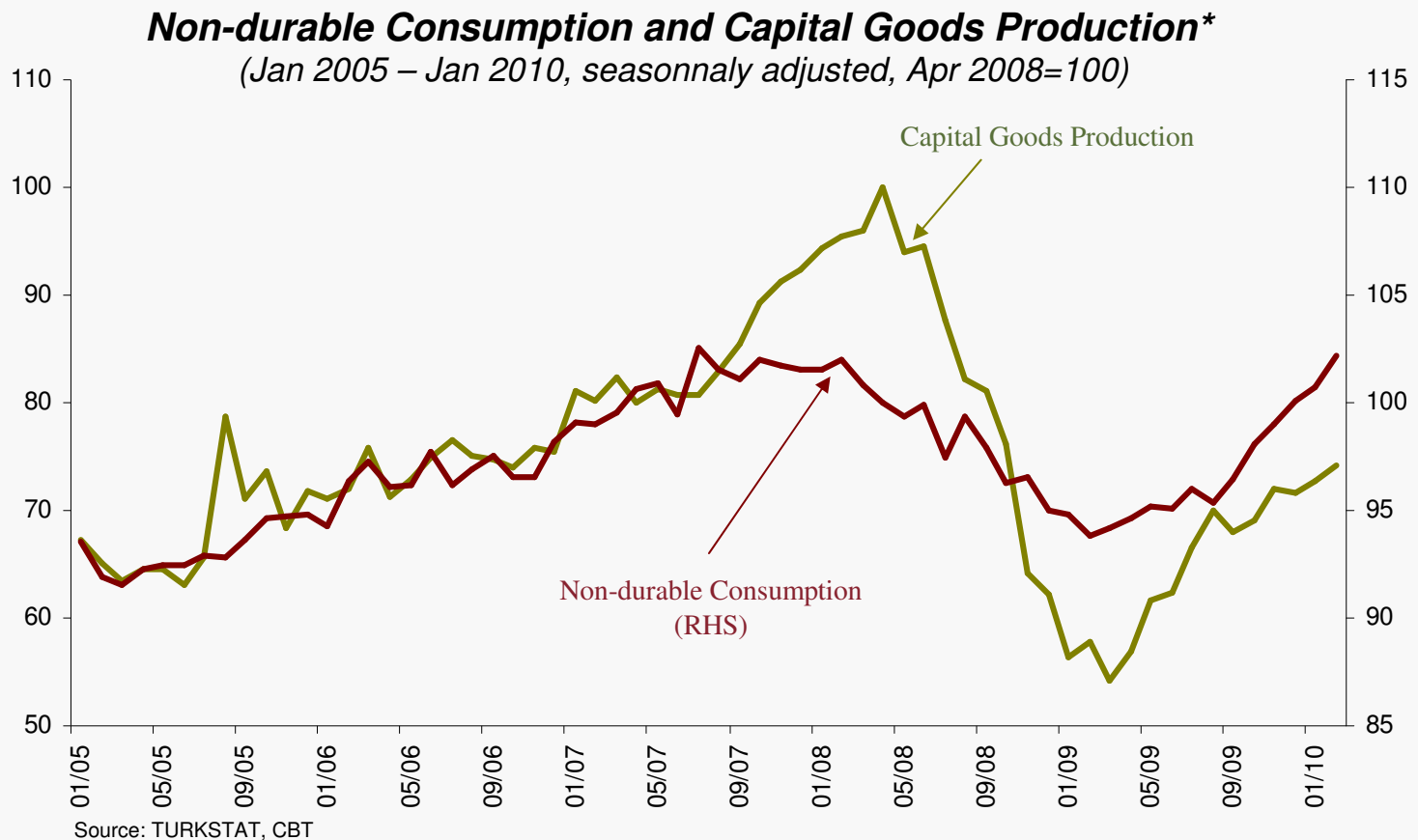
(Mar 2007 – Mar 2010, percent)



Source: CBT

Two-Speed Recovery in Manufacturing

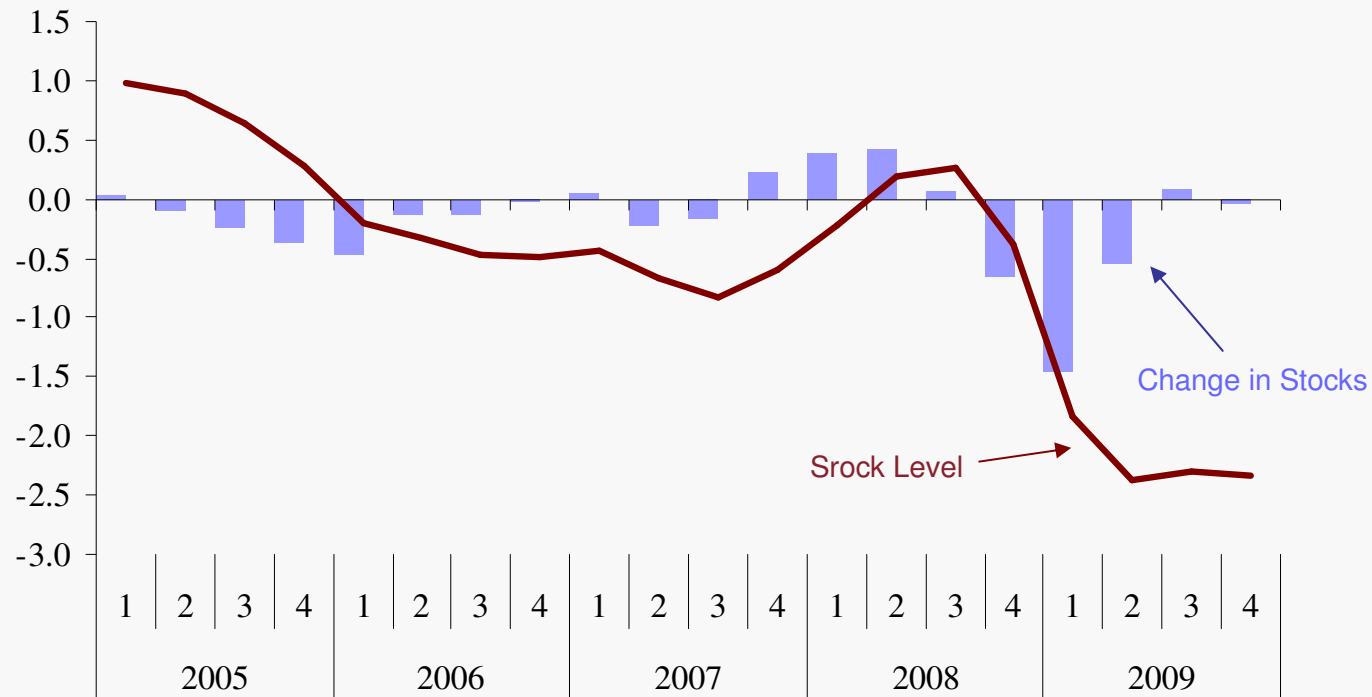
Due to excess capacity and uncertainty in aggregate demand outlook, firms are reluctant to engage in new investments. Production of capital goods (a leading indicator of investments) remains subdued.



Restocking Has Not Started Yet

For the same reason, firms are not willing to accelerate production. Appetite for stock accumulation is muted.

Change in Stocks*
(2005 Q1 – 2009 Q4, constant prices)

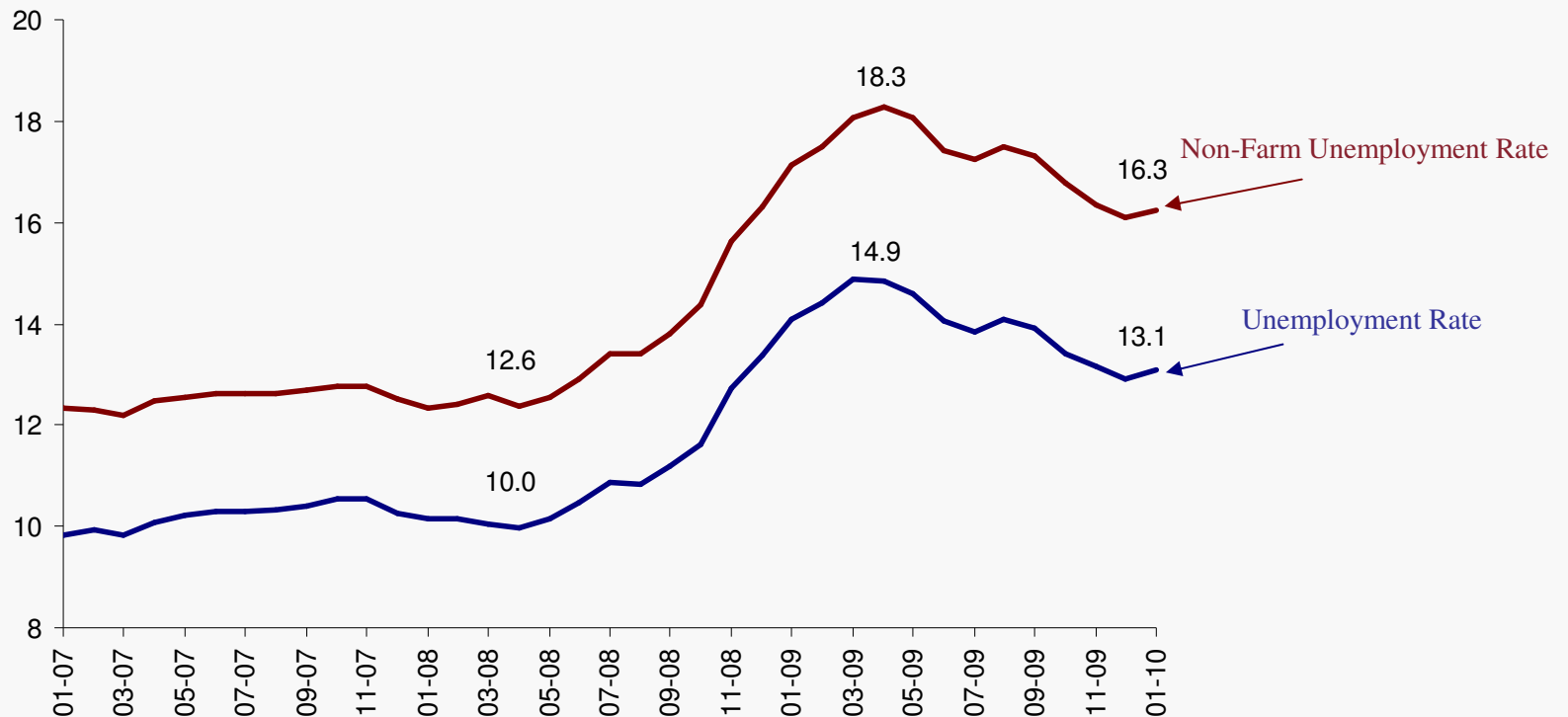


* Seasonally adjusted
Source: TURKSTAT, CBT

Ample Slack in Labor Market

Although there has been a mild improvement in labor market, unemployment rate is still considerably higher than its pre-crisis level.

Seasonally Adjusted Unemployment Rates*
(Jan 2007 – Jan 2010, percent)

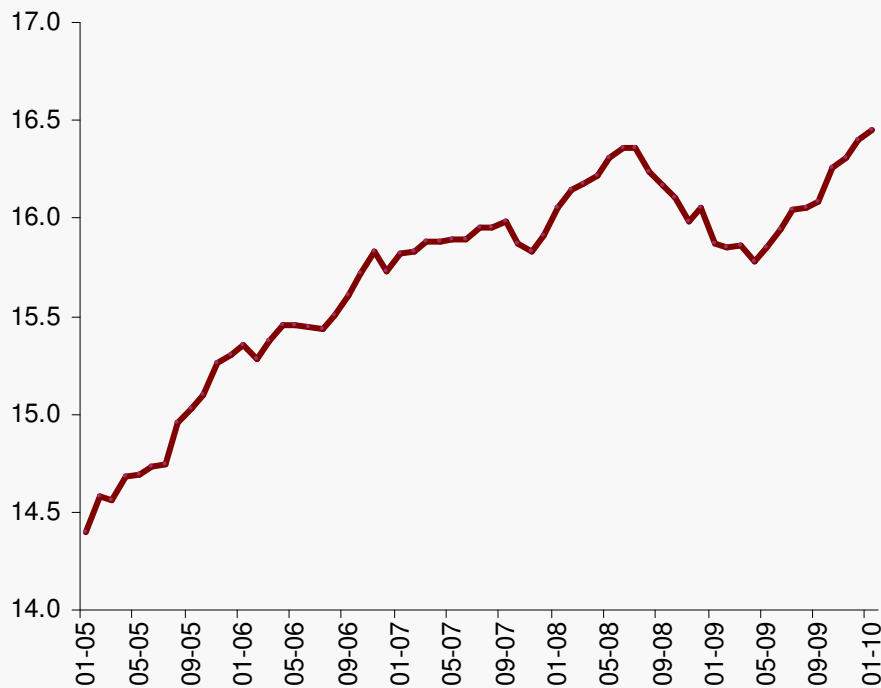


Source: TURKSTAT, CBT

Non-Farm Employment is Expanding Gradually

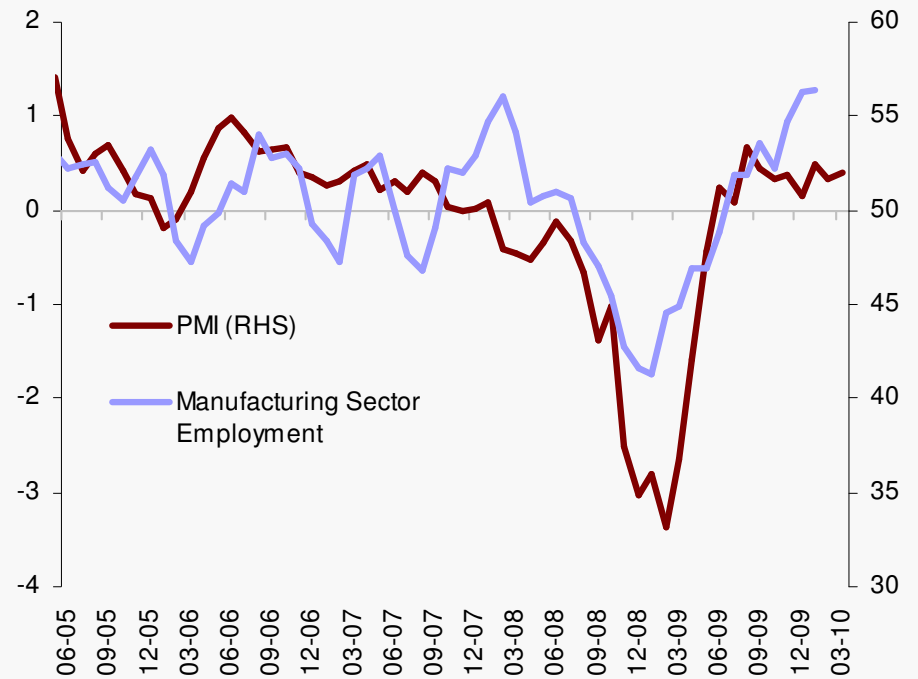
Seasonally adjusted non-farm employment has been on the rise since May 2009. A gradual recovery has been started in industrial employment.

Seasonally Adjusted Non-Farm Employment *
(Jan 2005 – Jan 2010, million)



Source: TURKSTAT, CBT

Industrial Employment (3 month moving average, monthly change, percent) **and PMI Employment Index**
(Jun 2005 - Mar 2010)

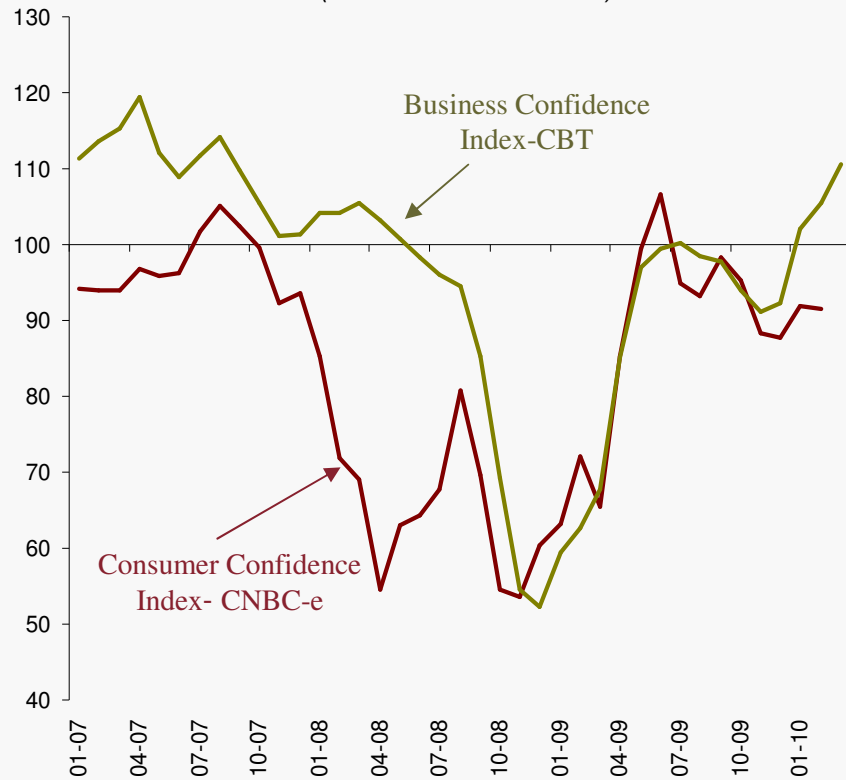


Source: Markit, TURKSTAT, CBT

Confidence Indices Provide Mixed Signals

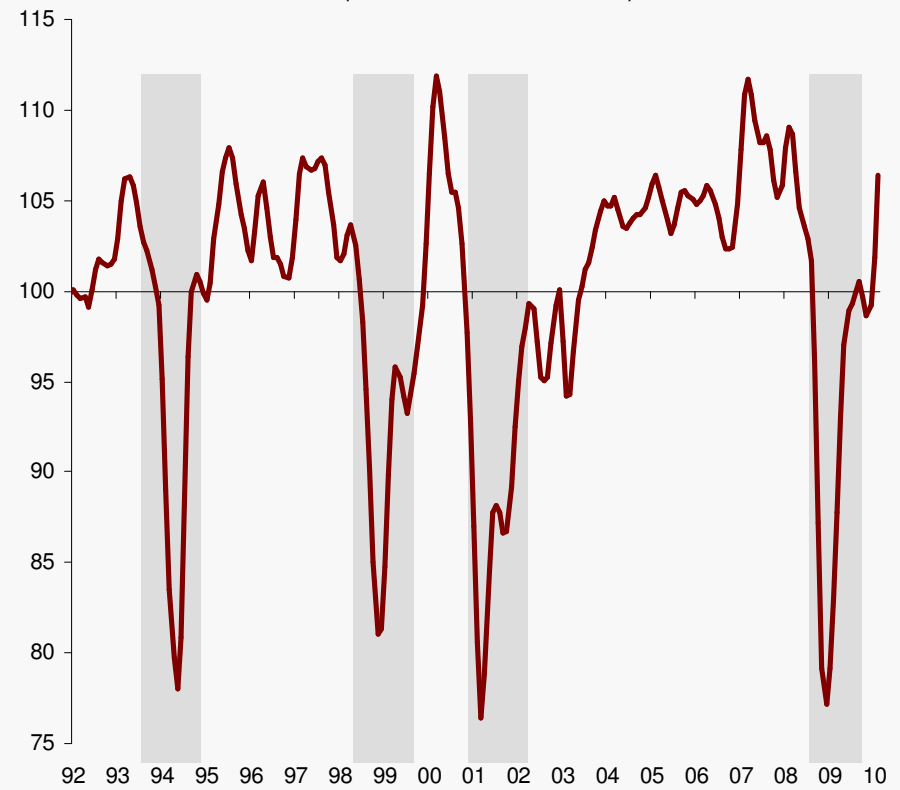
Leading indicators and business confidence have been in positive territory since the beginning of the year. Consumer confidence, on the other hand, has not recovered despite recent improvements.

Confidence Indices
(Jan 2007 – Mar 2010)



Source: CNBC-e, CBT

Leading Indicators
(Jan 1992 – Feb 2010)



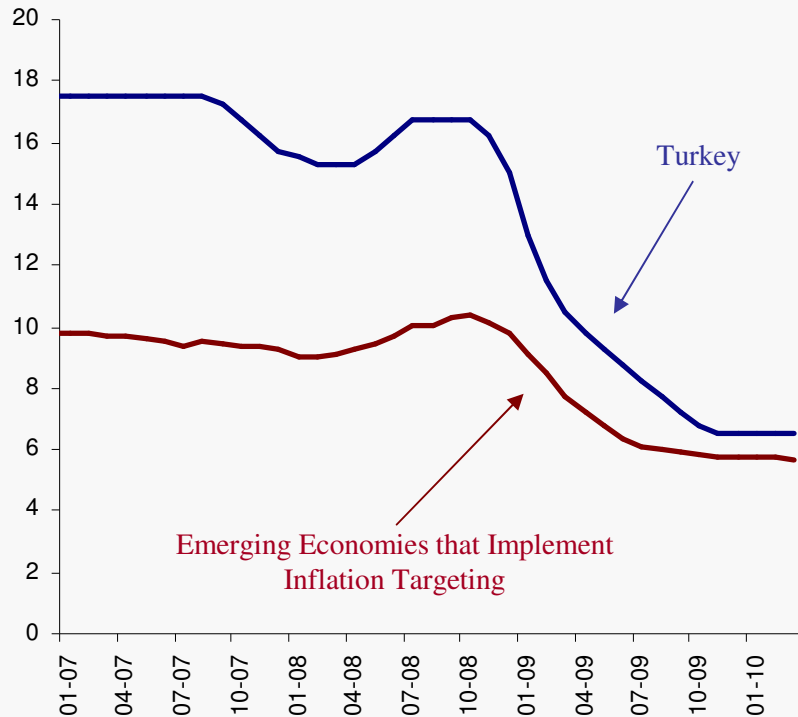
Source: CBT

IV. Monetary Policy Stance

Monetary Policy Stance

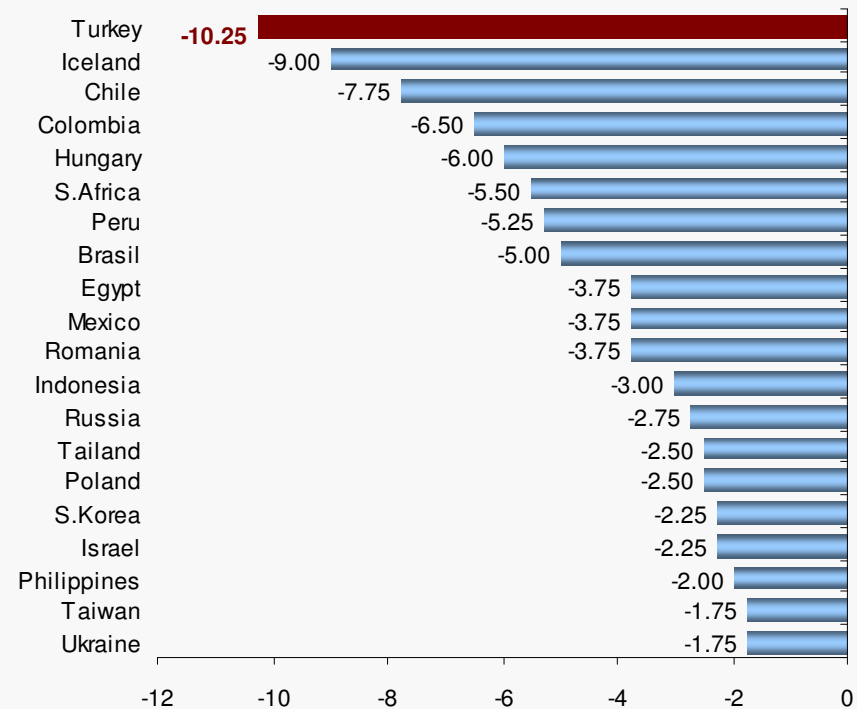
The strength of the financial system in Turkey has enabled the CBT to focus on restraining the adverse effects of the financial crisis on the Turkish economy without conflicting with the primary objective of maintaining price stability.

Policy Rates in Inflation-Targeting Emerging Economies
(Jan 2007– Mar 2010, percent)



Source: Central Banks, CBT

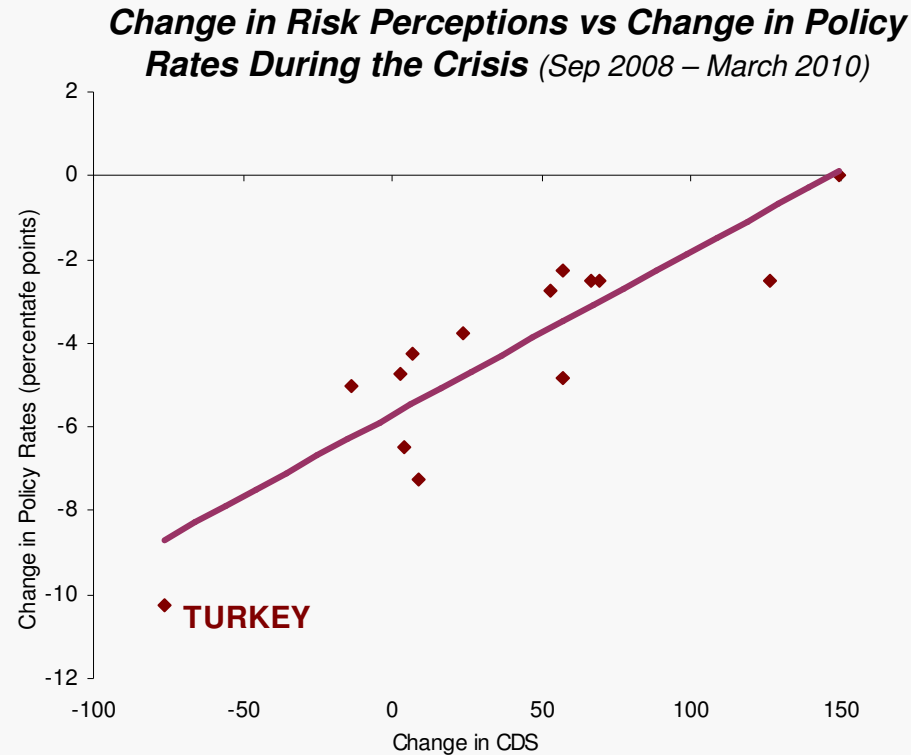
Changes in Policy Rates in Emerging Markets
(Oct 2008 – Apr 2010, percentage point)



Source: Central Banks, CBT

Monetary Policy Stance

During the Global Crisis, the degree of easing by monetary authorities among emerging economies have been largely determined by risk perceptions and currency developments. The Turkish economy has shown considerable resilience in this period --- more than implied by her credit rating.



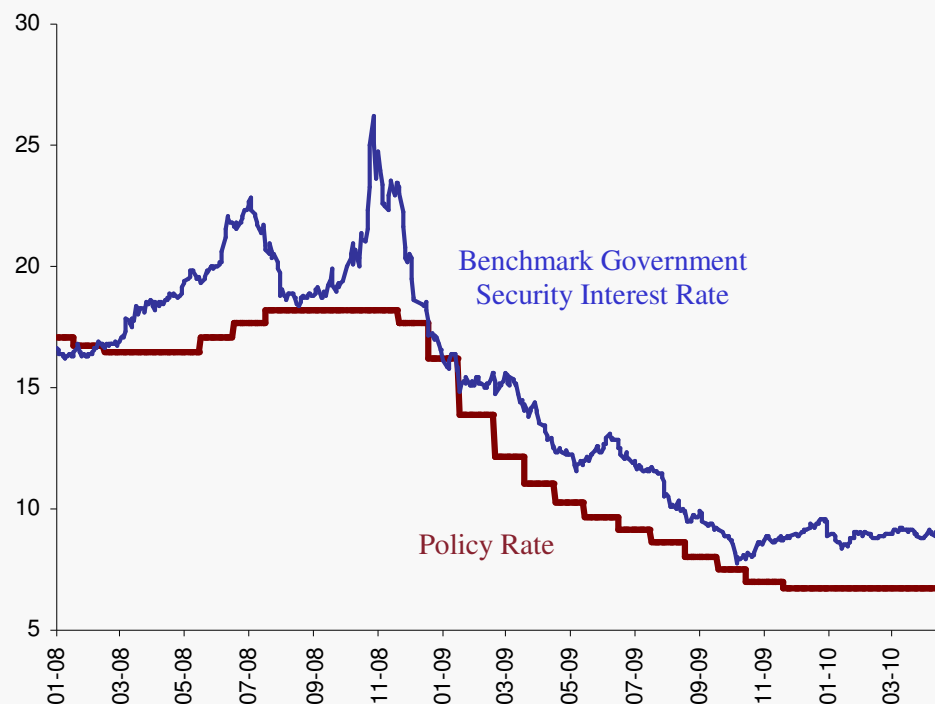
Kaynak: Bloomberg, TCMB

Monetary Policy Stance

At a time when rising levels of public debt in advanced economies are expected to put upward pressure on global interest rates, CBT's policy rates are the main determinant of market rates in Turkey indicating the improved effectiveness of monetary policy.

CBT Policy Rate and Benchmark Government Interest Rate

(Jan 2008 – Apr 2010, percent, compound)



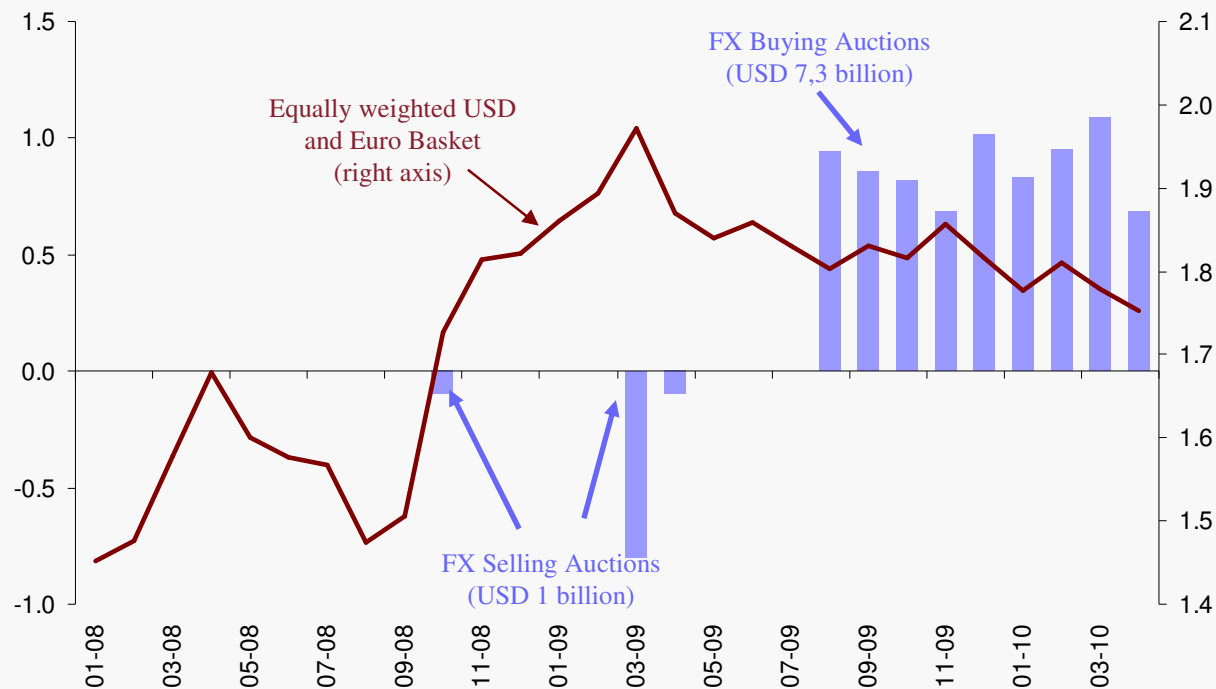
Source: Central Banks, BRSA, CBT

	Policy Rate	Decision
Nov-2008	16.25	-0.50
Dec-2008	15.00	-1.25
Jan-2009	13.00	-2.00
Feb-2009	11.50	-1.50
Mar-2009	10.50	-1.00
Apr-2009	9.75	-0.75
May-2009	9.25	-0.50
Jun-2009	8.75	-0.50
Jul-2009	8.25	-0.50
Aug-2009	7.75	-0.50
Sep-2009	7.25	-0.50
Oct-2009	6.75	-0.50
Nov-2009	6.50	-0.25
Dec-2009	6.50	0.00
Jan-2010	6.50	0.00
Feb-2010	6.50	0.00
Mar-2010	6.50	0.00
Apr-2010	6.50	0.00

Monetary Policy Stance

Since August 2009, the CBT has purchased USD 7.9 billion via foreign exchange buying auctions and injected TRY 12 billion to the market.

FX Buying and Selling Auctions against TRY and FX Basket
(Jan 2008 – Apr 2010*)

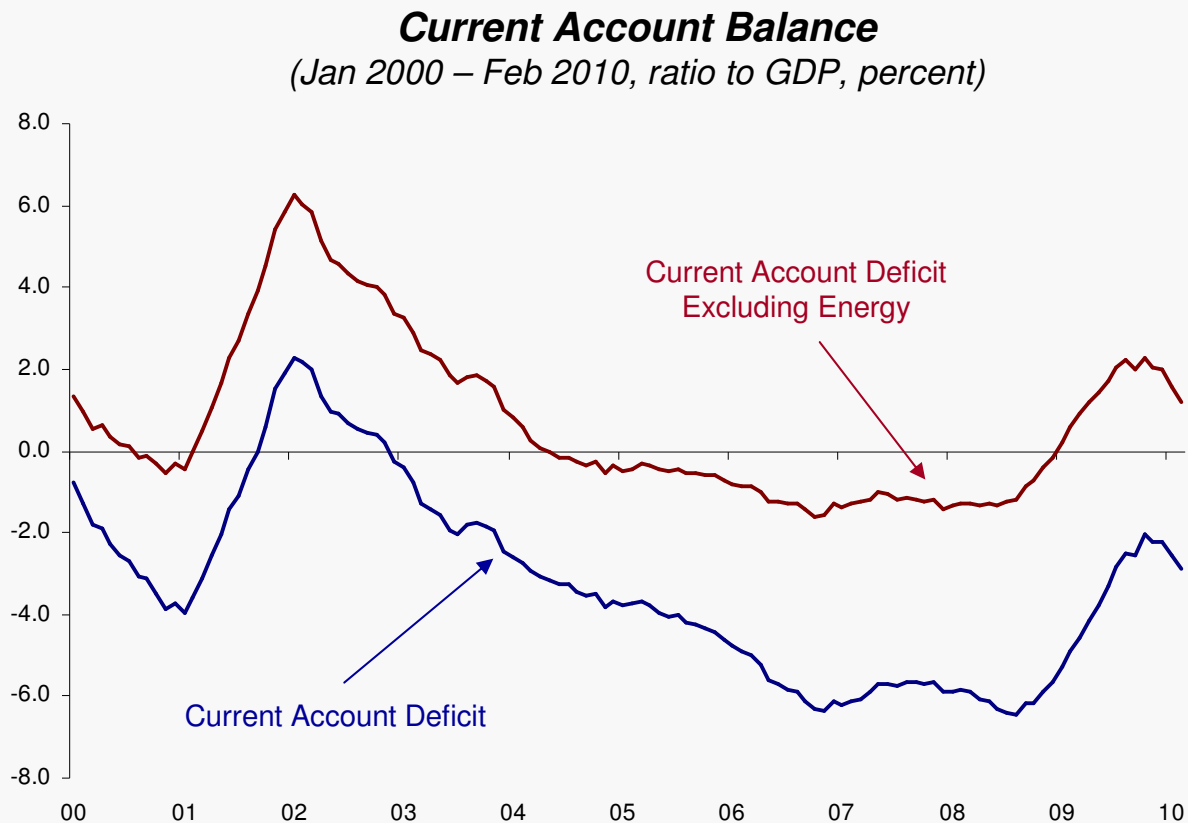


* As of 20 April, 2010
Source: CBT

V. Balance of Payments

Current Account Deficit

Current account deficit is widening gradually since October 2009 as a consequence of the economic recovery.



Source: TURKSTAT, CBT

Balance of Payments

Balance of Payments in the Last 12 Months (February 2010)

UTILIZATION	Billion USD
Current Account Balance	-18.8
Loans (Commercial loans, banking sector loans, public sector loans, other sector loans)	-14.5

REASONS FOR THE INCREASE IN NET ERRORS AND OMISSIONS

- ✓FX deposit transfers from abroad to FX accounts in Turkey due to reasons like the Repatriation Amnesty,
- ✓Conversion of FX savings in the form of banknotes to Turkish lira deposits in banks,
- ✓Losses/gains in value during the accounting of FX transactions.

SOURCE	Billion USD
Net Errors and Omissions	7.6
FDI	5.3
Portfolio Investments	14.1
(Equity)	(3.5)
(Debt Instruments)	(2.0)
(Bank Deposits)	(9.4)
Other	1.4
Reserve Assets	8.0
(Official Reserves)	(1.0)
(FX assets of banks)	(7.0)
(FX assets of other sectors)	(0.0)

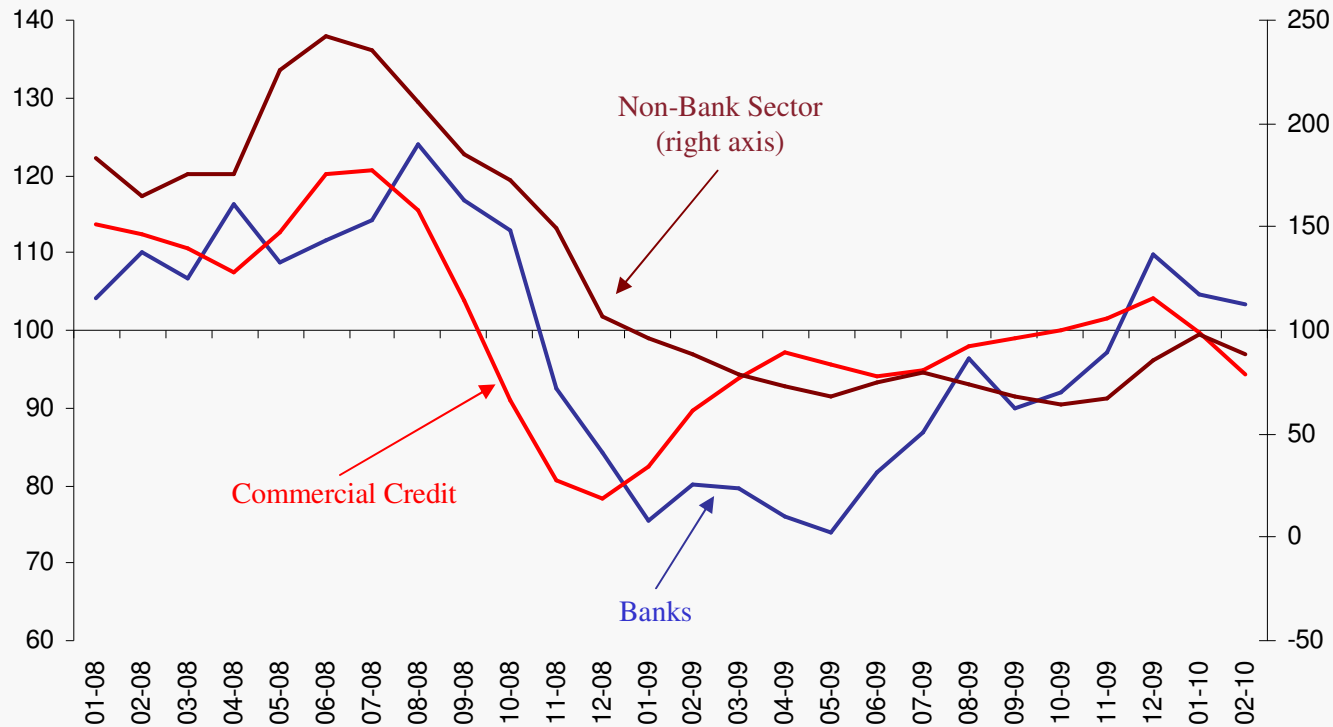
Source: TURKSTAT, CBT

Debt Rollover Ratio is Rising

The private sector debt rollover ratio is on the rise since 2009 Q1.

Private Sector Debt Rollover Ratio

(Jan 2008 – Feb 2010, Ratio of External Debt Utilization to Principal Payments, 3-month moving average, percent)

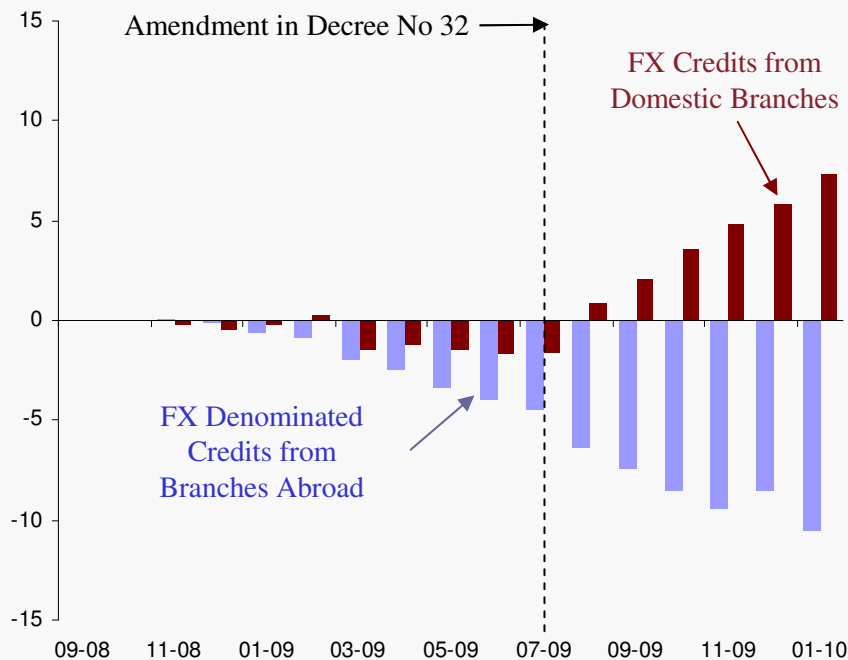


Source: TURKSTAT, CBT

Real Sector's Rollover Ratio Exceeds 100%

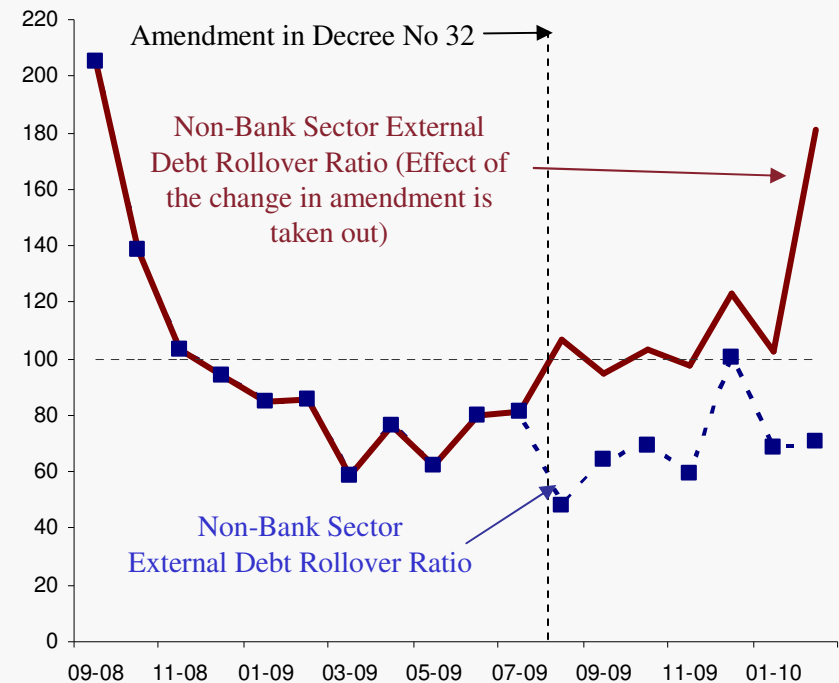
The rollover ratio of the real sector has improved considerably --- even exceeded 100%, once adjusted to reflect the impact of the recent change in banking regulations.

Domestic Banks' FX Denominated Credits
(Sep 2008 – Feb 2010, cumulative sum, billion USD)



Source: TURKSTAT, CBT

Non-Bank Sector External Debt Rollover Ratio
(Sep 2008 – Feb 2010, percent)



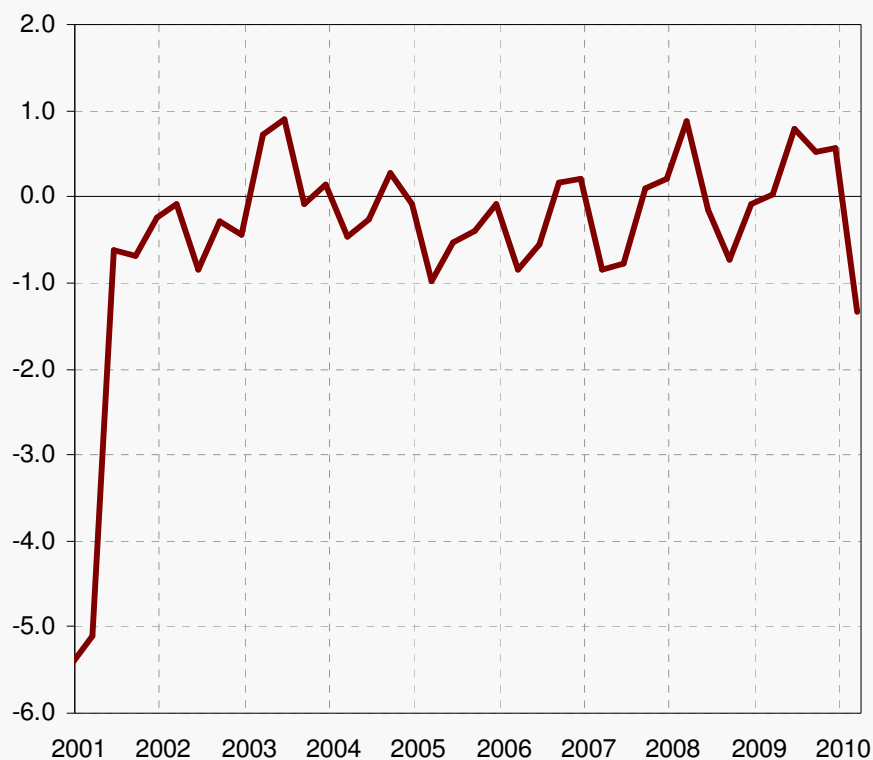
Source: TURKSTAT, CBT

VI. Financial Stability

Banking Sector is Standing Tall

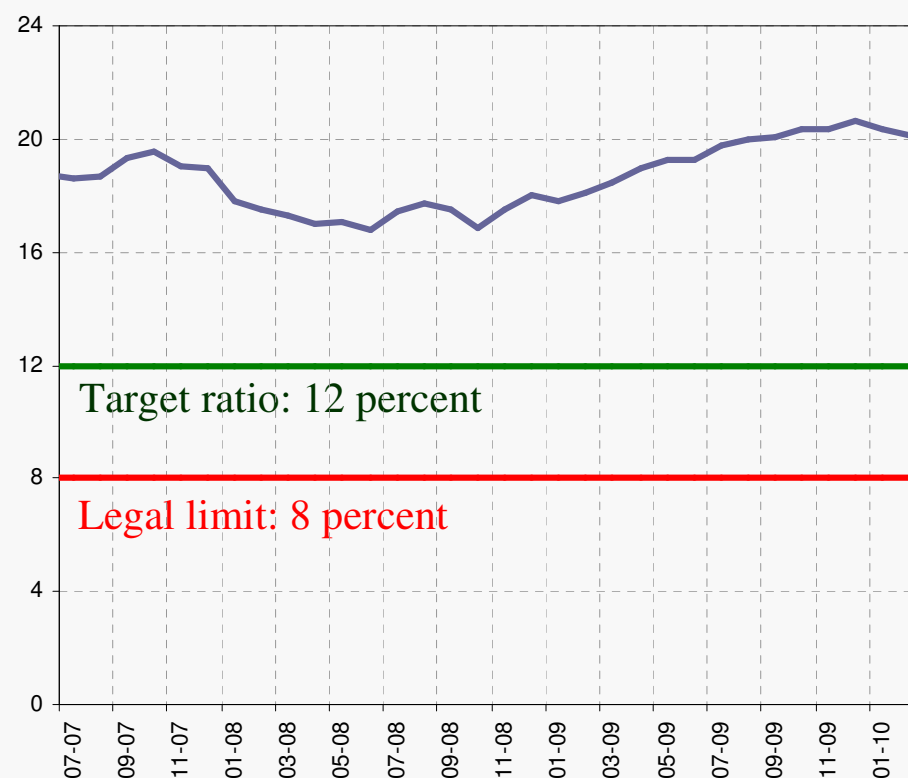
The main factor enhancing the Turkish economy's resilience against the crisis is her sound and stable structure of the banking sector.

Net FX Position of the Banking Sector
(2000 Q4 – 2010 Q1*, billion USD)



* As of February 2010
Source: BRSA, CBT

Capital Adequacy Ratio
(Jul 2007 – Feb 2010, percent)

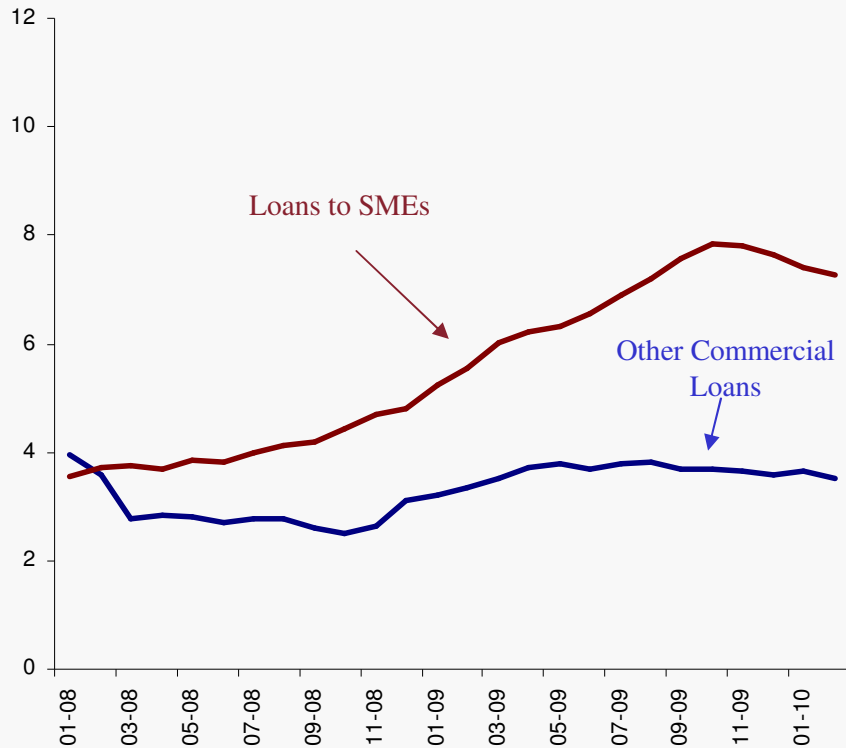


Source: BRSA, CBT

Loan Quality is Improving

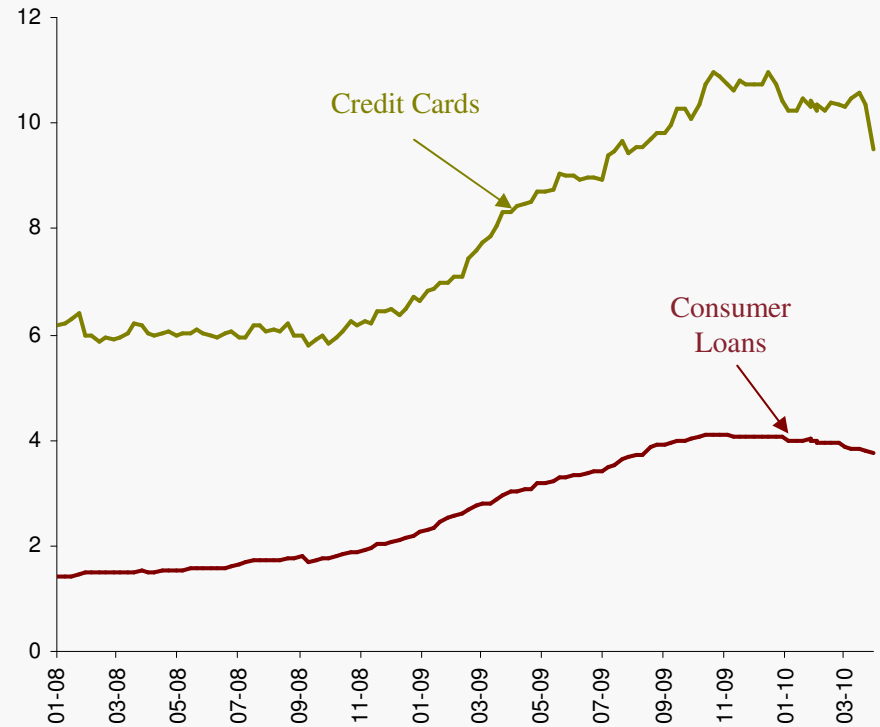
After peaking in the last quarter of 2009, NPL ratio has started to decline gradually.

Ratio of Non-Performing Loans
(Jan 2008 – Feb 2010, percent)



Source: BRSA, CBT

Ratio of Non-Performing Loans
(Jan 2008 – Apr 2010, percent)

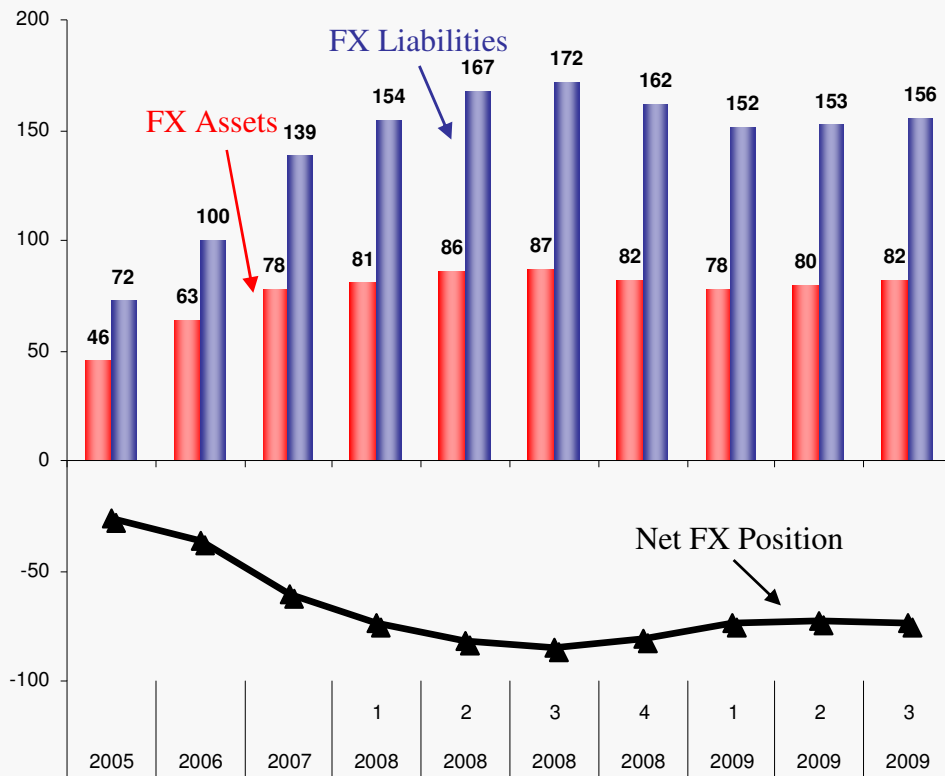


Source: BRSA, CBT

Corporate Sector Has Been Resilient to the Financial Shock

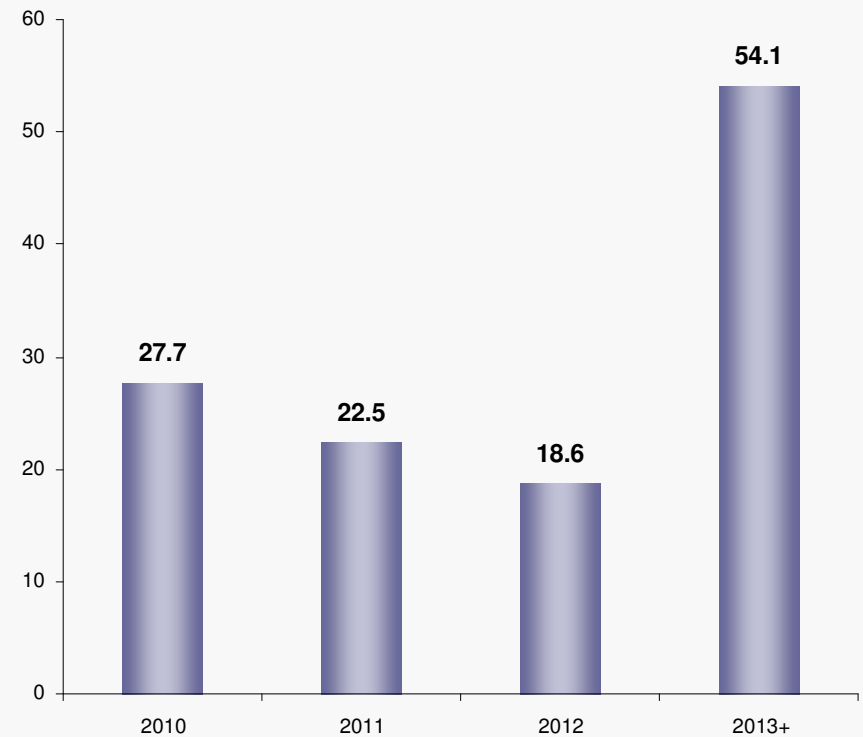
The FX position of the non-banking sector has been steady. The short-term position stands at USD 1.7 billion. Maturity of the debt is tilted towards 2013 and beyond.

Firms' FX Assets and Liabilities
(2005 – 2009 Q3, billion USD)



Source: CBT

Maturity Composition of Firms' Outstanding Long-Term FX Denominated Foreign Debt *
(Feb 2010, billion USD)

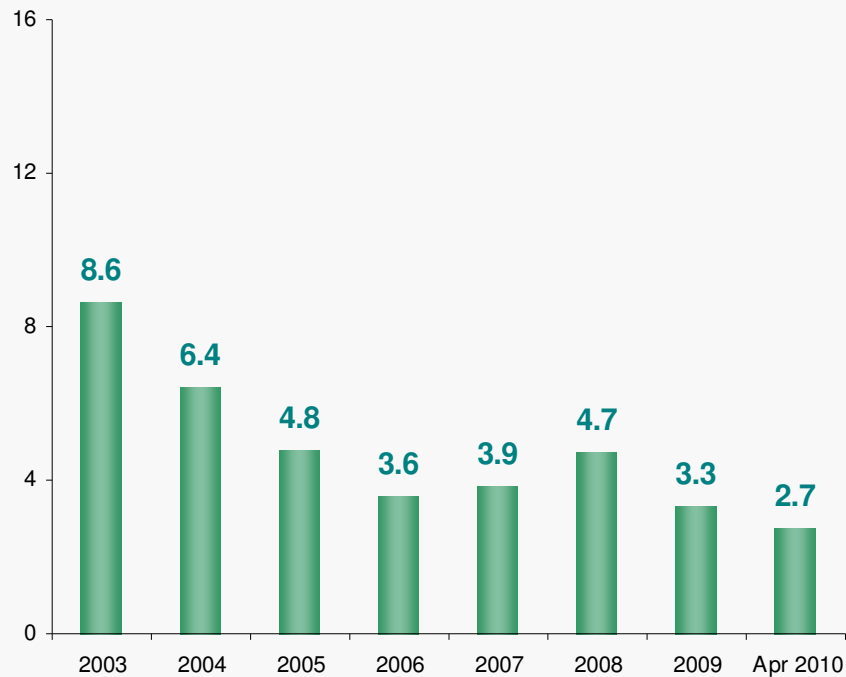


* Days to maturity
Source: CBT

Households Indebtedness Remains Subdued

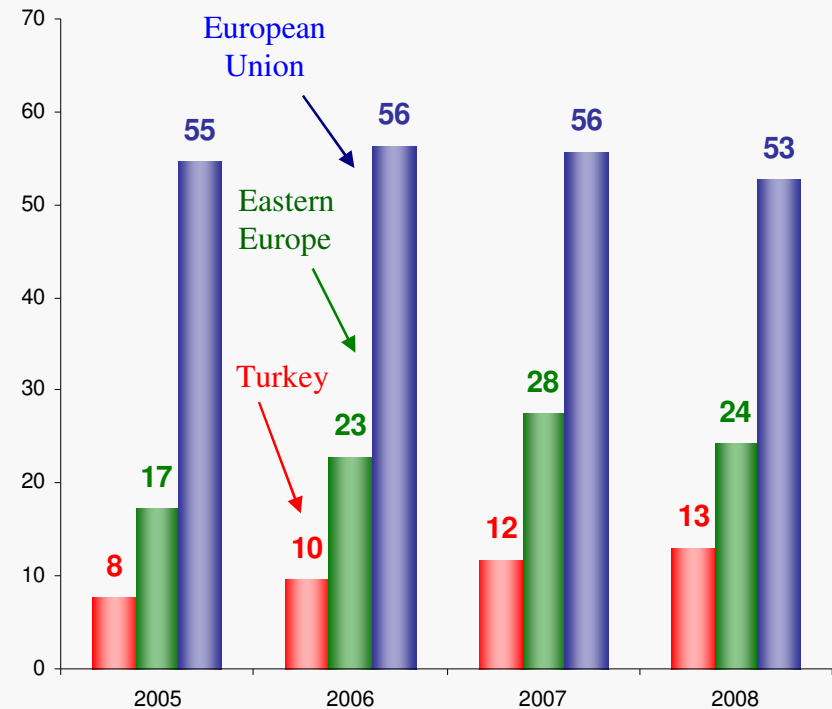
Household indebtedness is quite low compared to the EU and Eastern European countries. Household balance sheets are less exposed to exchange rate shocks.

Ratio of FX-Indexed Consumer Loans to Total Consumer Loans
(2003 – Apr 2010, percent)



Source: CBT

Ratio of Household Liabilities to GDP
(2005 – 2008, percent)

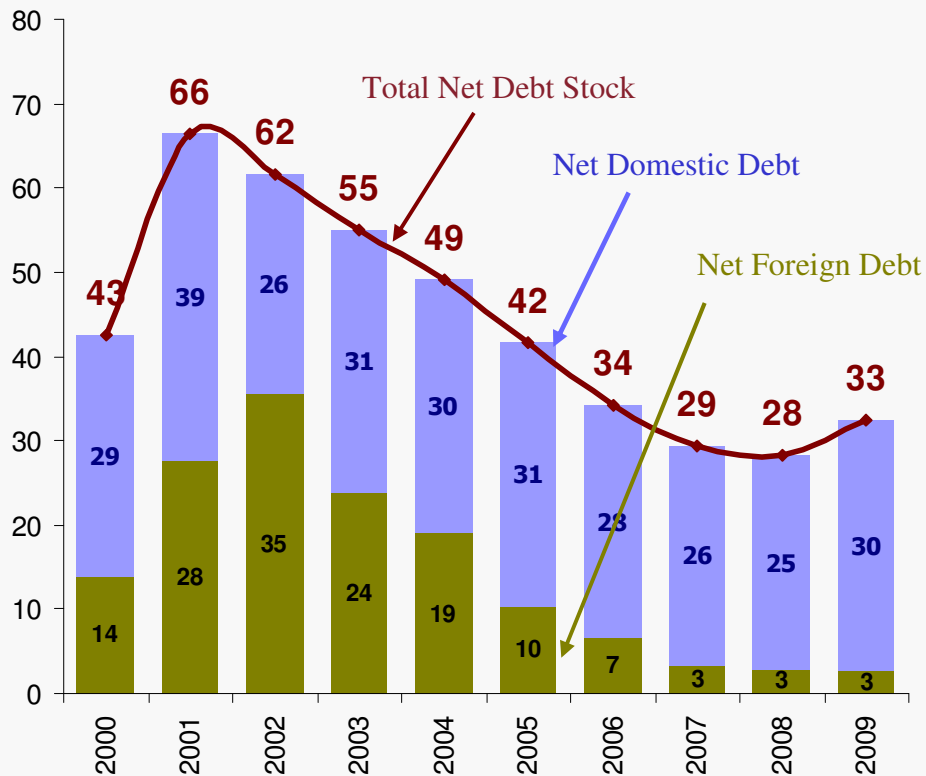


Source: European Central Bank, CBT

Fruits of Fiscal Discipline

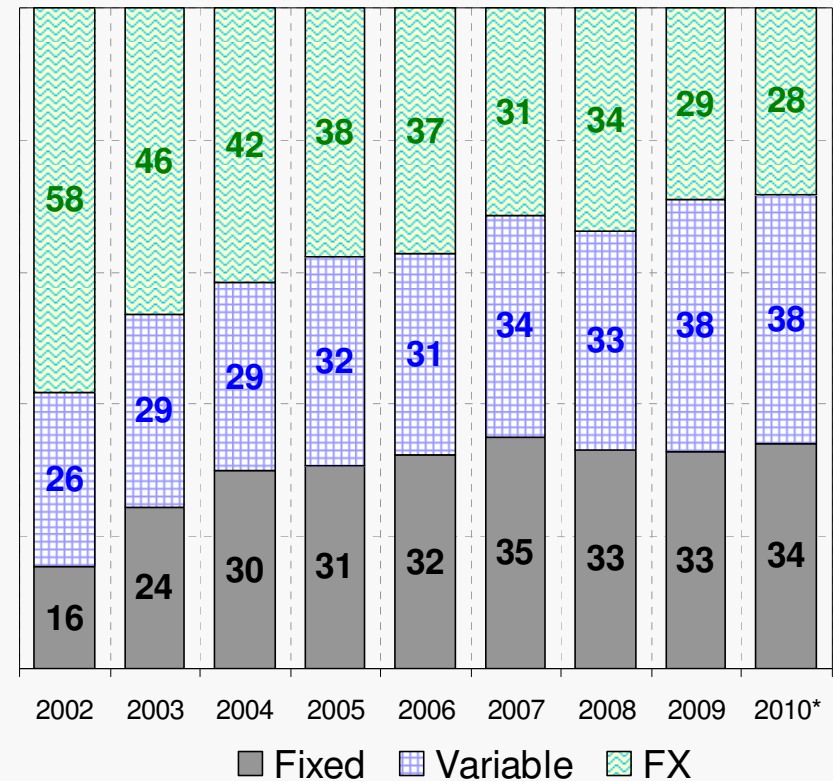
Thanks to robust fiscal policy implemented since 2001, public sector has become more resilient to external shocks.

Public Sector Net Debt Stock
(2000 – 2009, Ratio to GDP, percent)



Source: Undersecretariat of Treasury, CBT

Composition of Central Government Debt
(2002 – 2010*, percent)



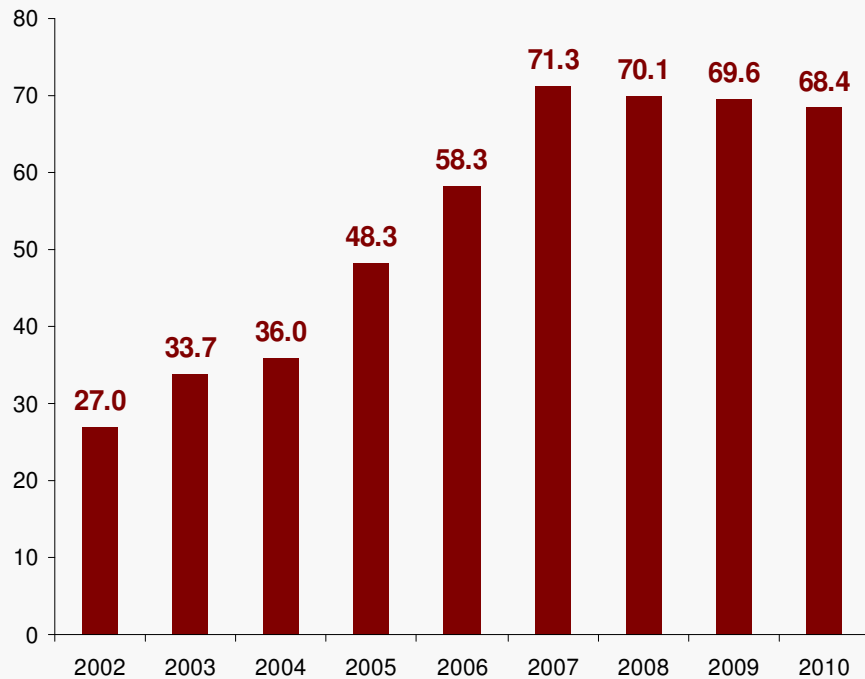
*As of February 2010.

Source: Undersecretariat of Treasury, CBT

Central Bank's FX Reserves

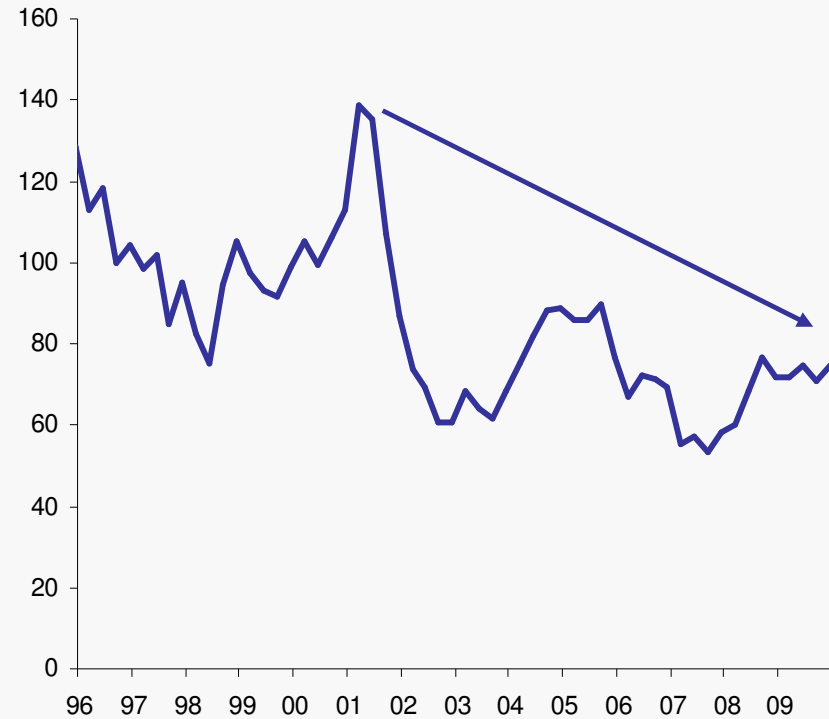
Foreign exchange reserves of the CBT is sufficient to cover the short-term foreign debt of the country.

Central Bank FX Reserves
(2002 – Apr 2010, billion USD)



Source: CBT

Ratio of Short-term Foreign Debt to Central Bank FX Reserves
(1996 – 2009 Q4, percent)



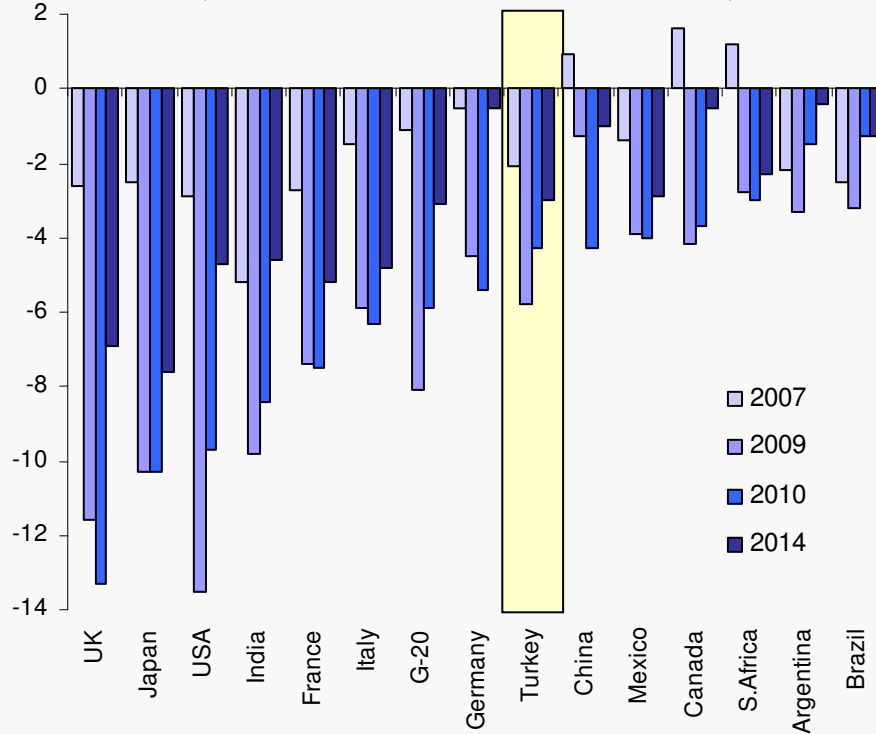
Source: Undersecretariat of Treasury, CBT

VII. Public Finance

Rising Public Deficits is a Global Concern

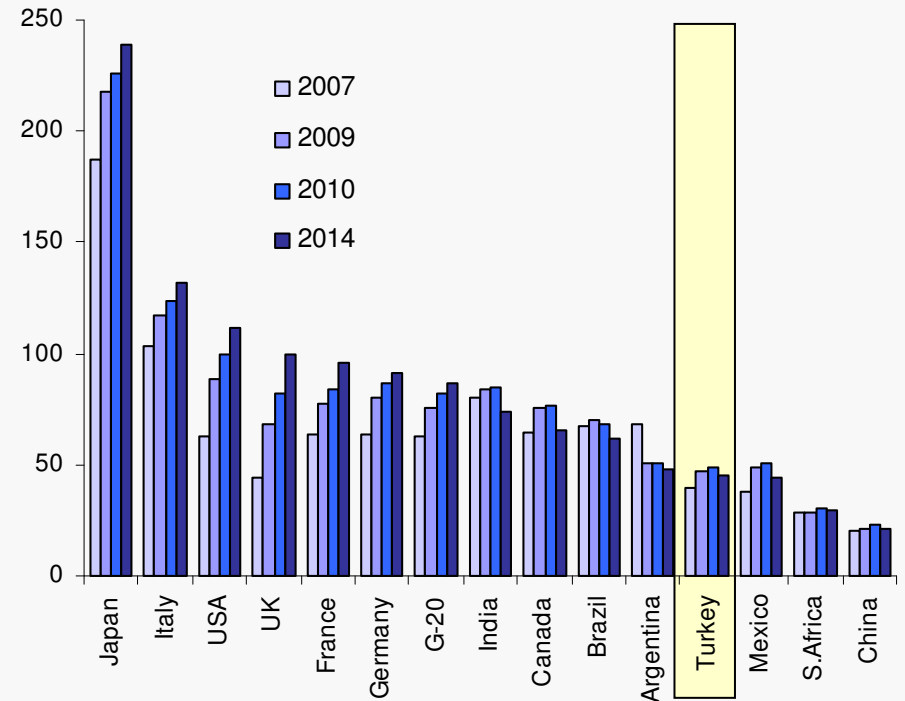
Sustainability of public debt, especially in developed economies, has continued to pose risks on private demand by triggering a deterioration in risk perceptions and raising long term interest rates.

Budget Balance in Selected Countries*
(2007, 2009*, 2010*, 2014*, ratio to GDP)



* Forecast
Source: IMF, CBT

Central Government Debt in Selected Countries*
(2007, 2009*, 2010*, 2014*, ratio to GDP)

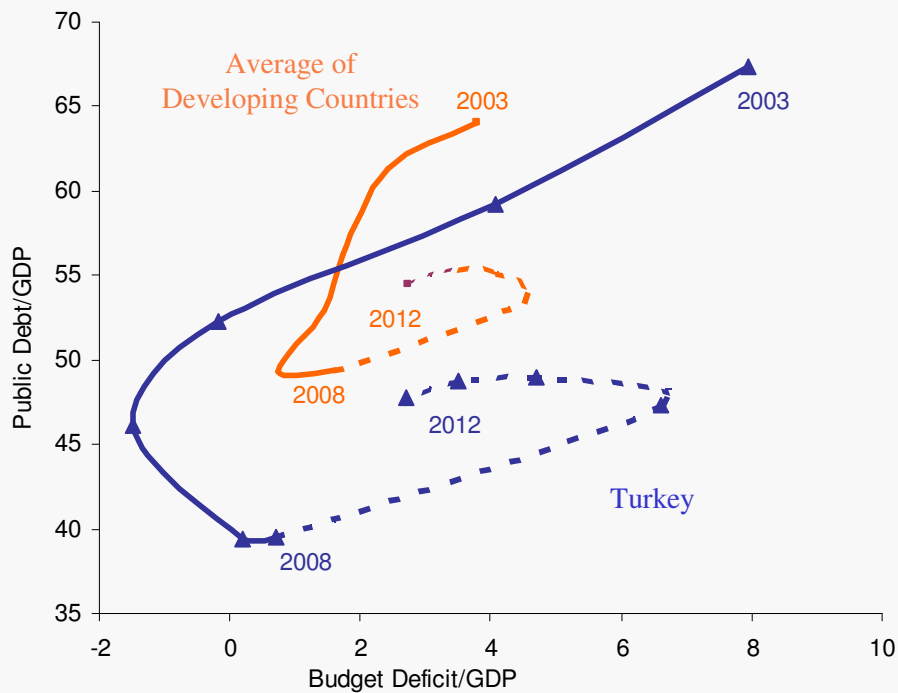


* Forecast
Source: IMF, CBT

A Comparative Look at Fiscal Balances

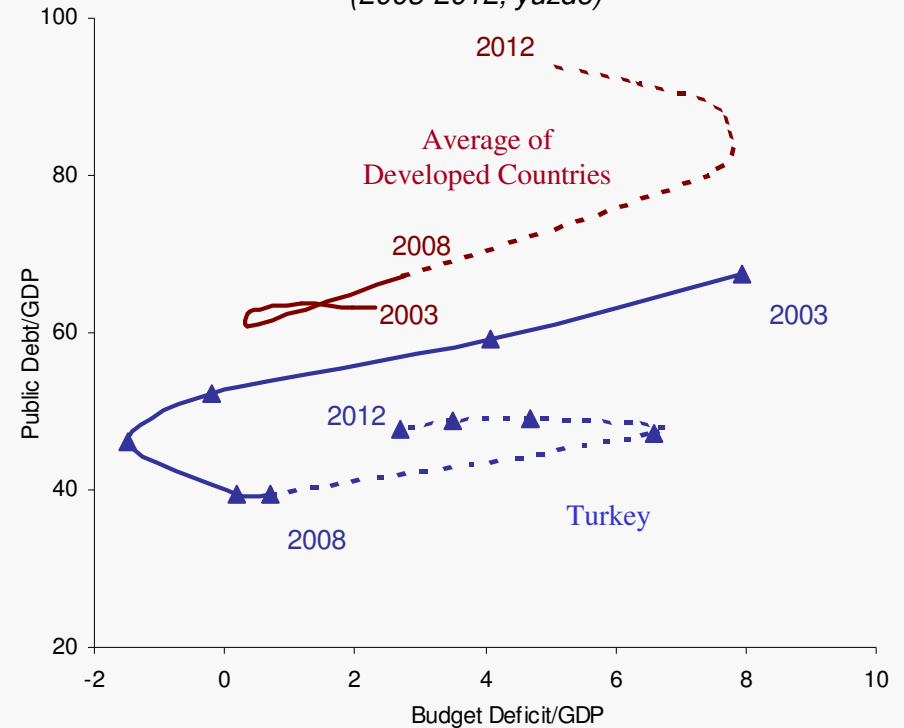
We expect to observe decoupling of economies based on their public finance performances. Turkey is likely to stand out with her low level of public debt.

Public Debt and Budget Deficit of Turkey and Other Developing Countries
(2003-2012, percent)



Undersecretary .of Treasury MTP (2010-2012) 2009 Program
Source: IMF, Ministry of Finance, CBT

Public Debt and Budget Deficit of Turkey and Developed Countries
(2003-2012, yüzde)

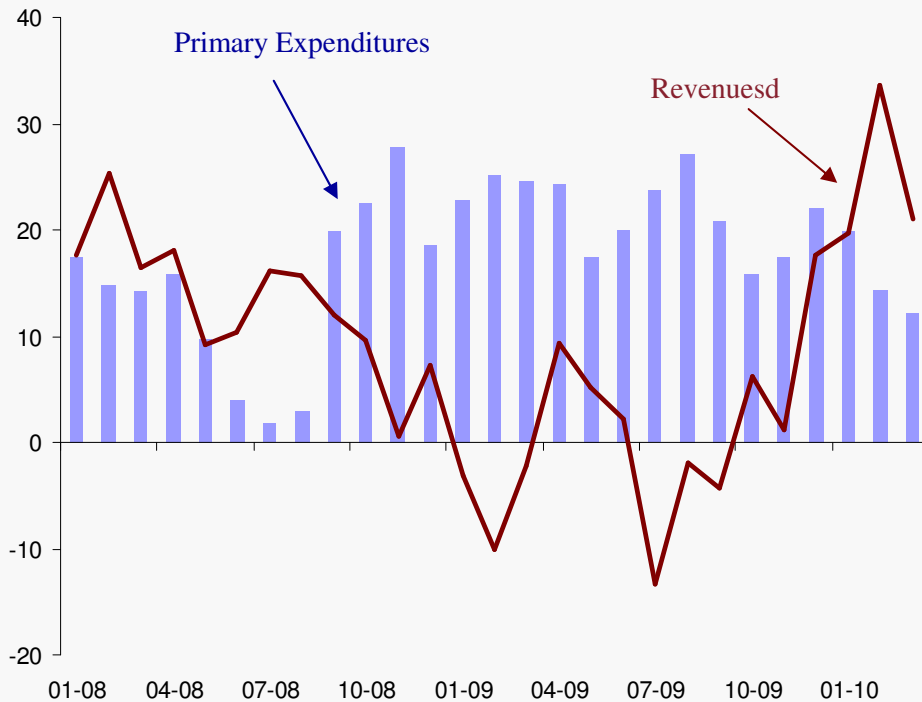


Undersecretary .of Treasury MTP (2010-2012) 2009 Program
Source: IMF, Ministry of Finance, CBT

Improvement in Fiscal Performance

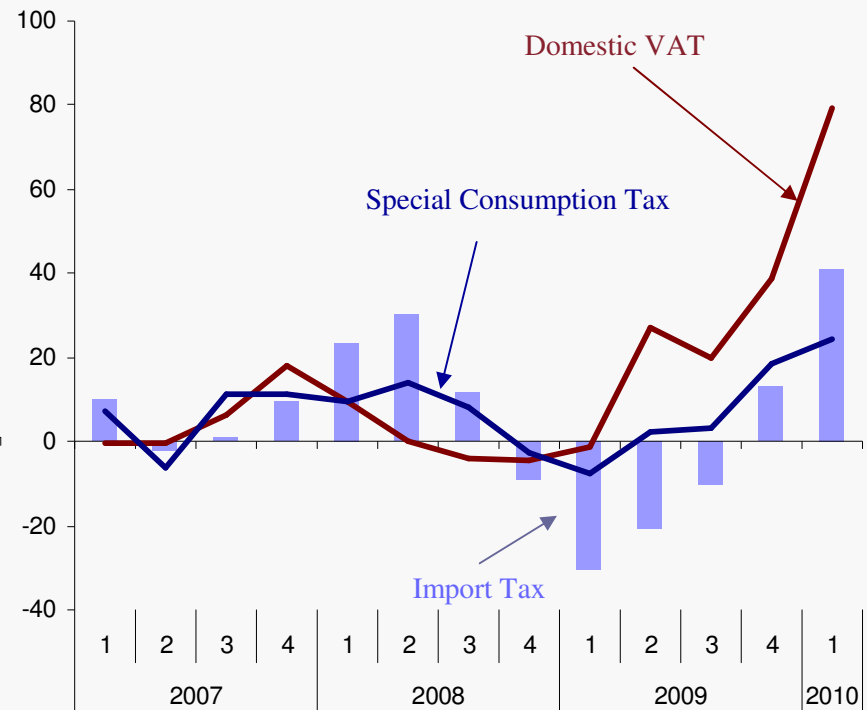
Tax revenues recovered in the last quarter of 2009 thanks to the moderate recovery in economic activity. Debt roll-over ratio is likely to stay below the Program forecasts.

Change in Government Expenditures and Revenues
(Jan 2007 – March 2010, percentage change)



Source: Ministry of Finance, CBT

Change in Indirect Tax Revenues
(2007 Q1 – 2010 Q1, real, percent)



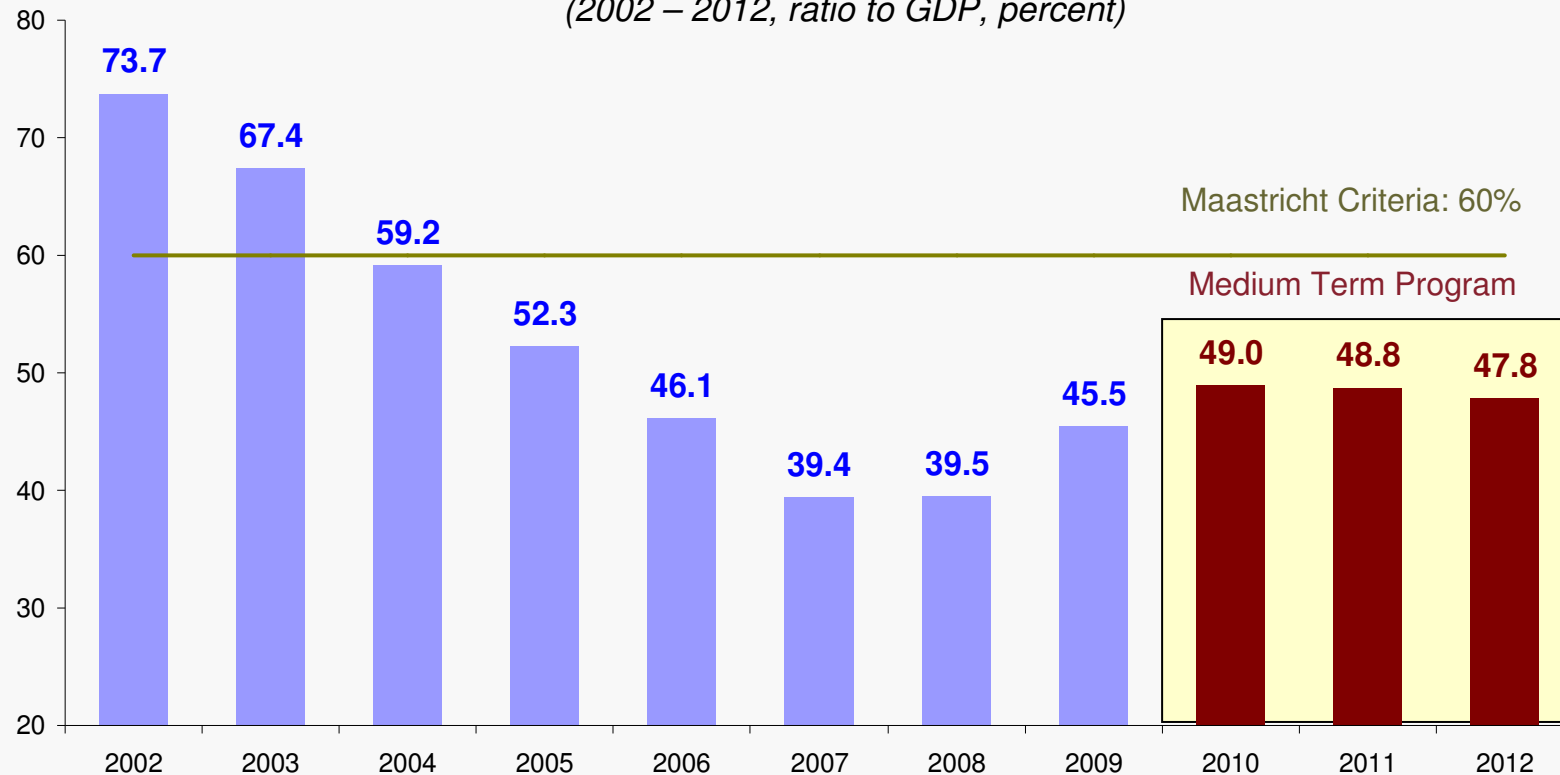
Source: Ministry of Finance, CBT

Medium Term Horizon

The Medium Term Program has been successful in reducing policy uncertainties. Adhering to the MTP would be helpful in keeping the policy rates at single digits throughout the forecast horizon.

EU-Defined Public Debt and Medium-Term Targets

(2002 – 2012, ratio to GDP, percent)



Source: Undersecretariat of Treasury, CBT

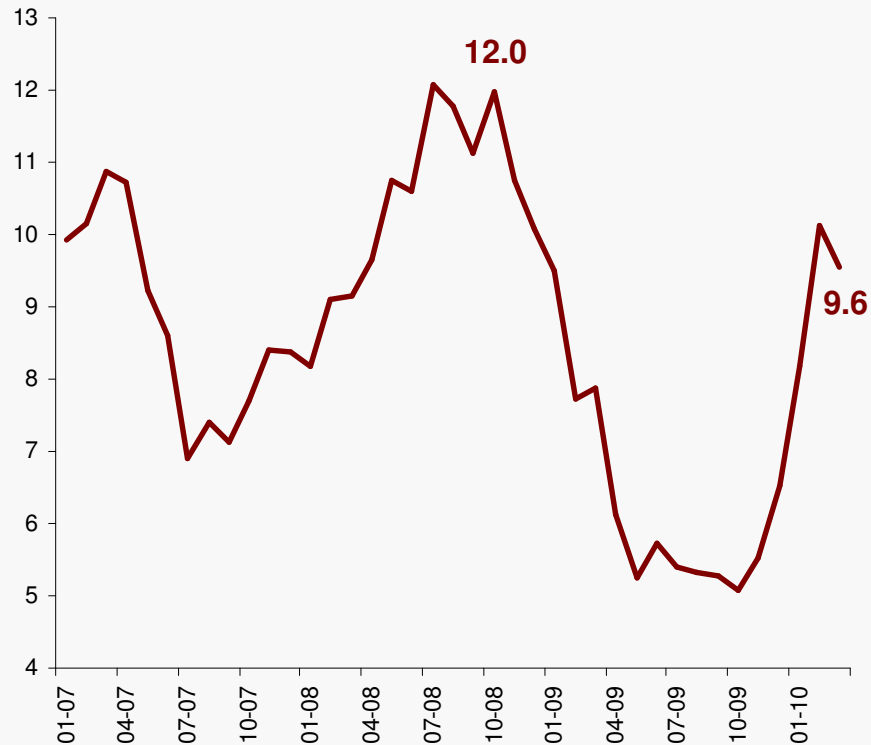
VIII. Inflation Outlook

Temporary Rise in Inflation

In March 2010, annual consumer price inflation eased to 9.56 percent.

Consumer Inflation

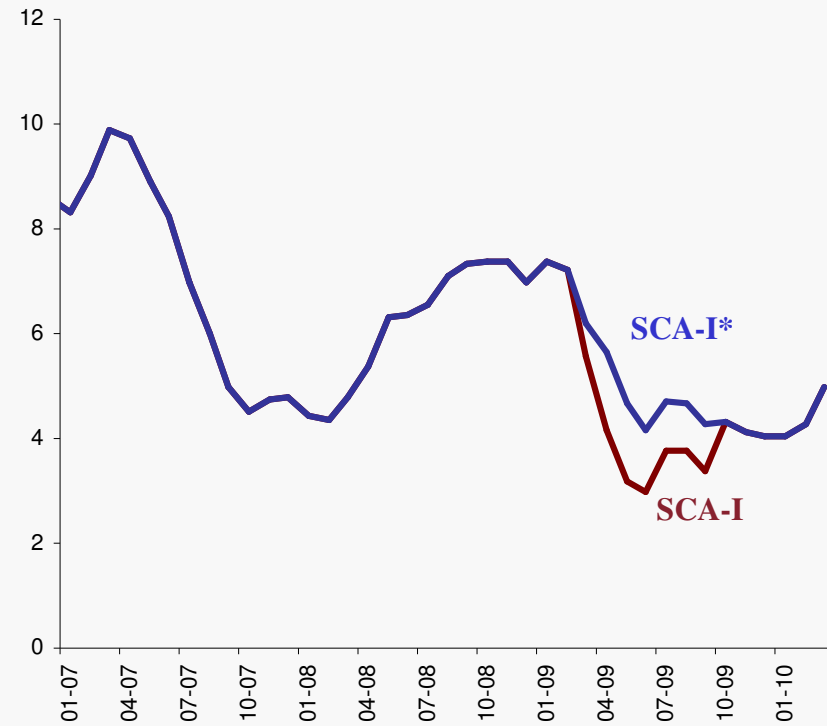
(Jan 2007 – Mar 2010, annual percentage change)



Source: TURKSTAT, CBT

SCA-I Index

(Jan 2007 – Mar 2010, annual percentage change)



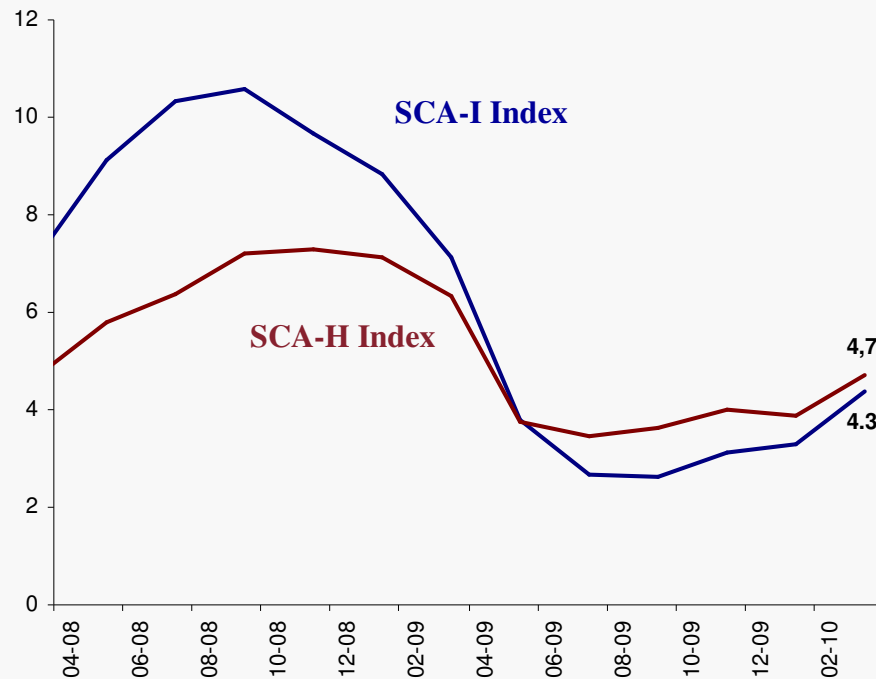
*SCA-I indicator adjusted for the change in tax rates.

Source: TURKSTAT, CBT

Core Indicators Remain Below the Inflation Target

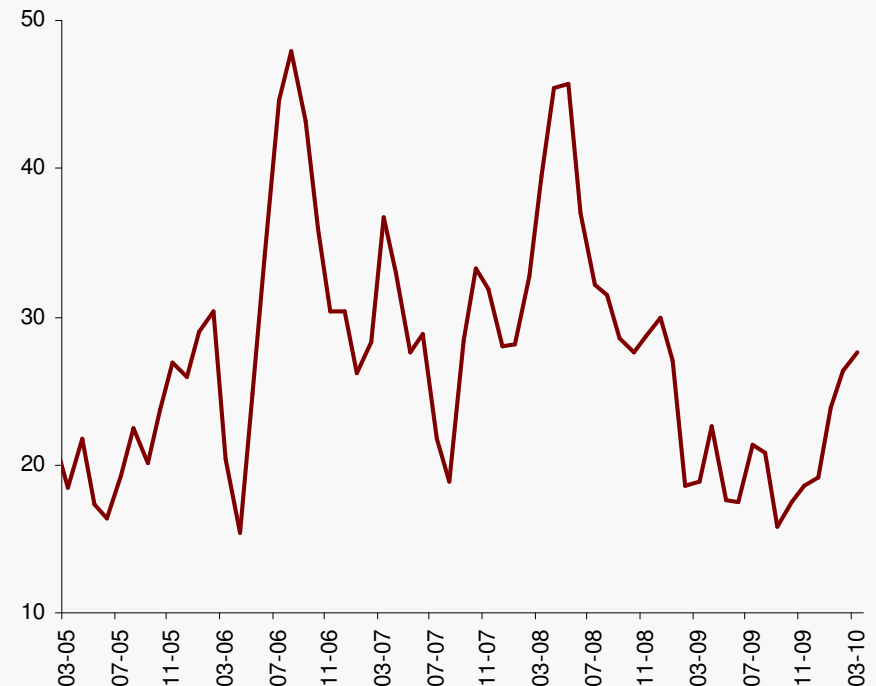
Core inflation indicators continue to remain below the target, despite slight increases due to low base effect and temporary tax cuts of the past year.

Core Inflation Indicators*
(Apr 2008– Mar 2010)



* Seasonally and tax-adjusted, 2- month averages
Source: TURKSTAT, CBT

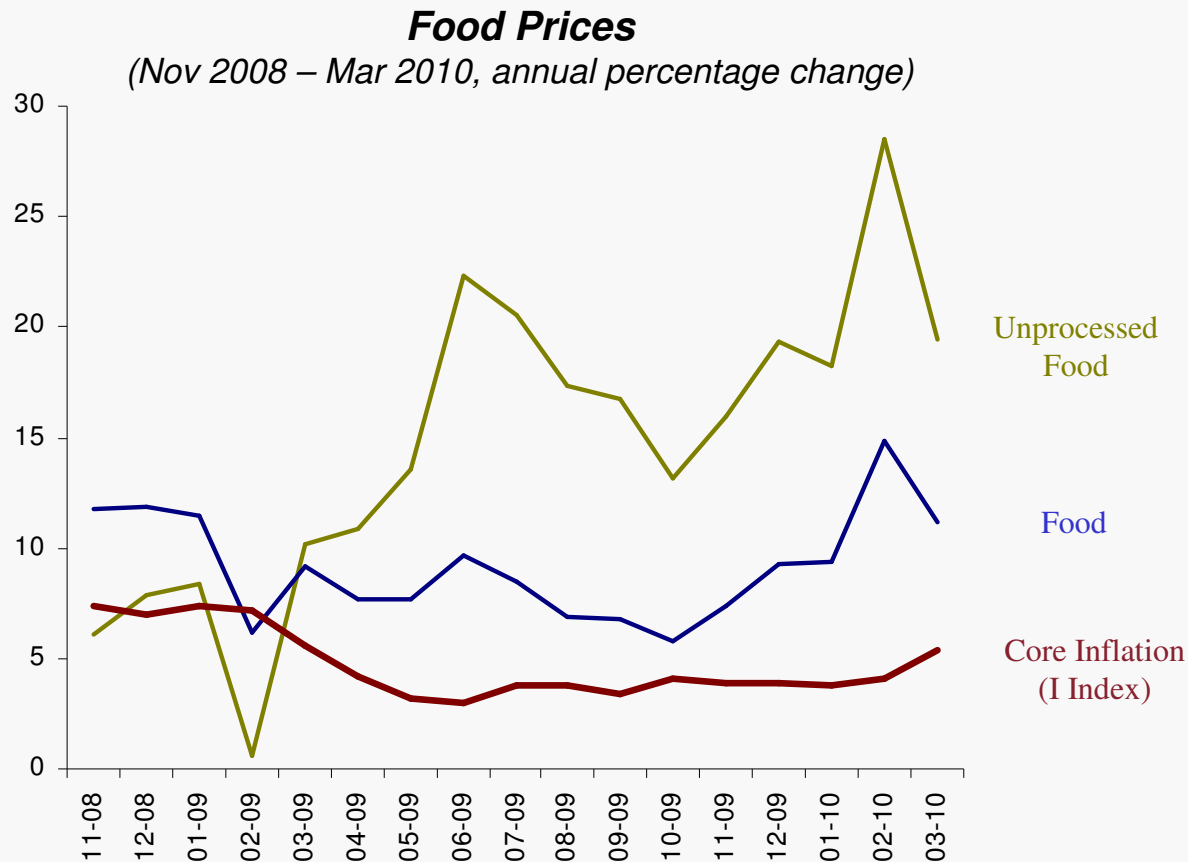
Inflation Diffusion Index*
(Mar 2005 – Mar 2010)



* Seasonally-adjusted 2- month average of the difference between the share of items with increasing prices and the share of items with falling prices in CPI
Source: TURKSTAT, CBT

Food Prices versus Core Inflation

High variability of unprocessed food prices creates significant uncertainty in inflation forecasts.

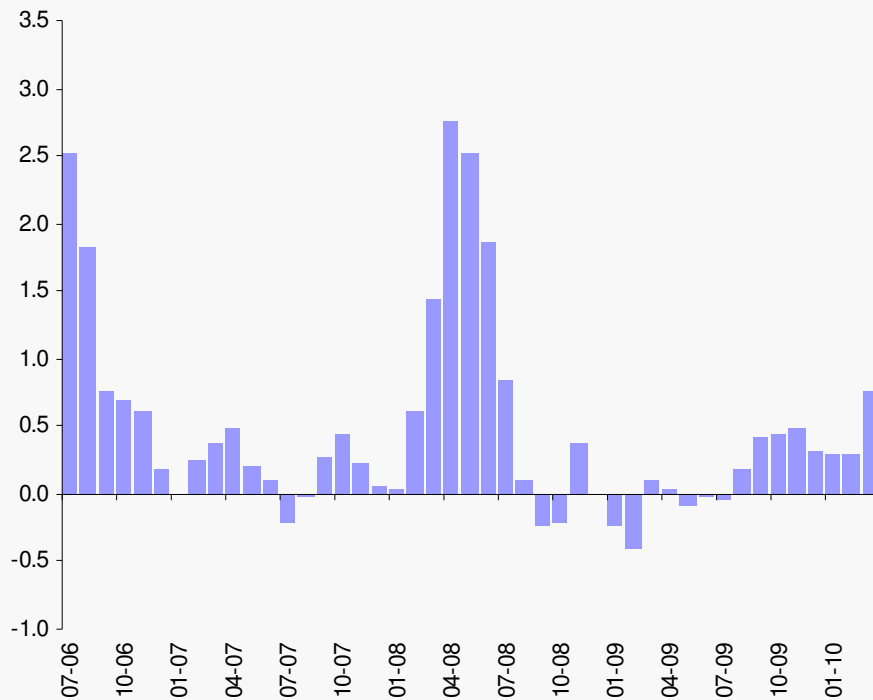


Source: TURKSTAT, CBT

No Significant Change in Input Prices

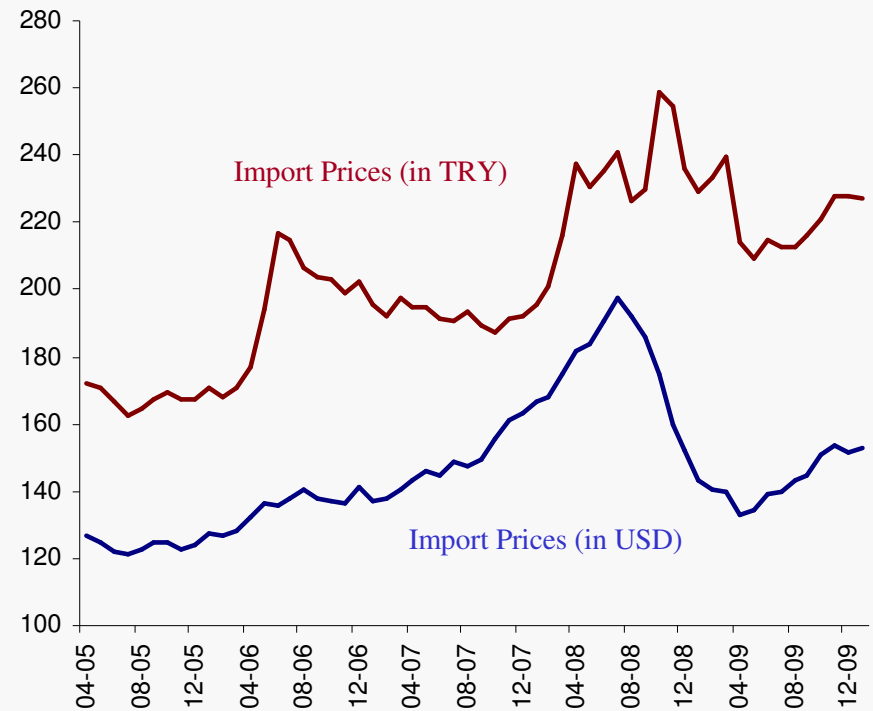
Despite recent acceleration, input prices do not exert any apparent upside pressure on consumer inflation, in part thanks to weak demand and spare capacity that limit the spillover effect of the cost-push shocks.

Manufacturing Industry Prices
(Jul 2006 – Mar 2010, annual percentage change)



Source: TURKSTAT, CBT

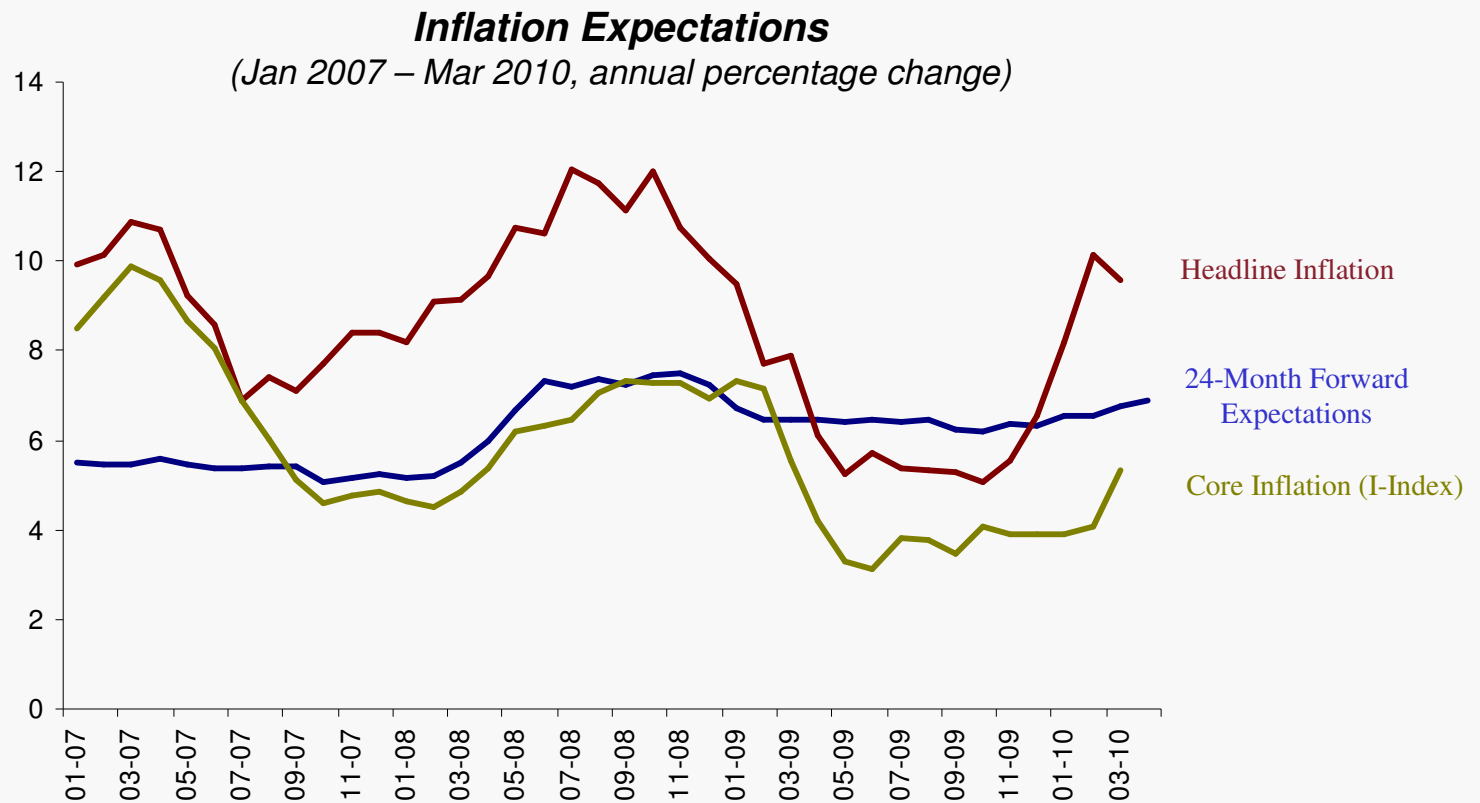
Import Unit Value Index
(Apr 2005 – Jan 2010)



Source: TURKSTAT, CBT

Inflation Expectations are Critical

Displaying a downward trend throughout 2009, inflation expectations have been affected negatively (but modestly) from the supply shocks.



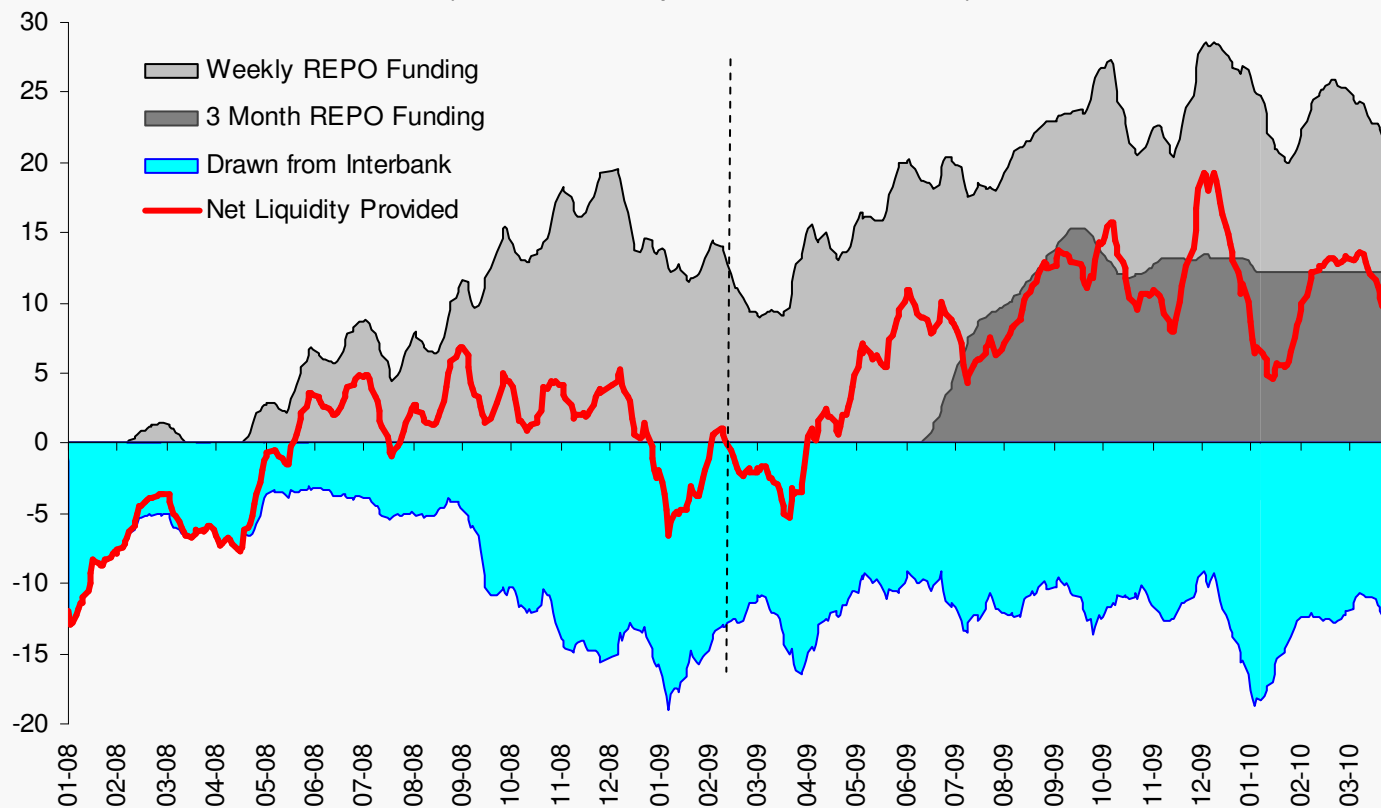
Source: TURKSTAT, CBT

IX. Exit Strategy of the Central Bank

Turkish Lira Liquidity

CBT has provided ample TRY liquidity to the banking system since 09Q2. On April 14, 2010 the CBT announced the framework of its Exit Strategy.

Market Liquidity
(Jan 2008 – Apr 2010, billion TRY)



Source: CBT

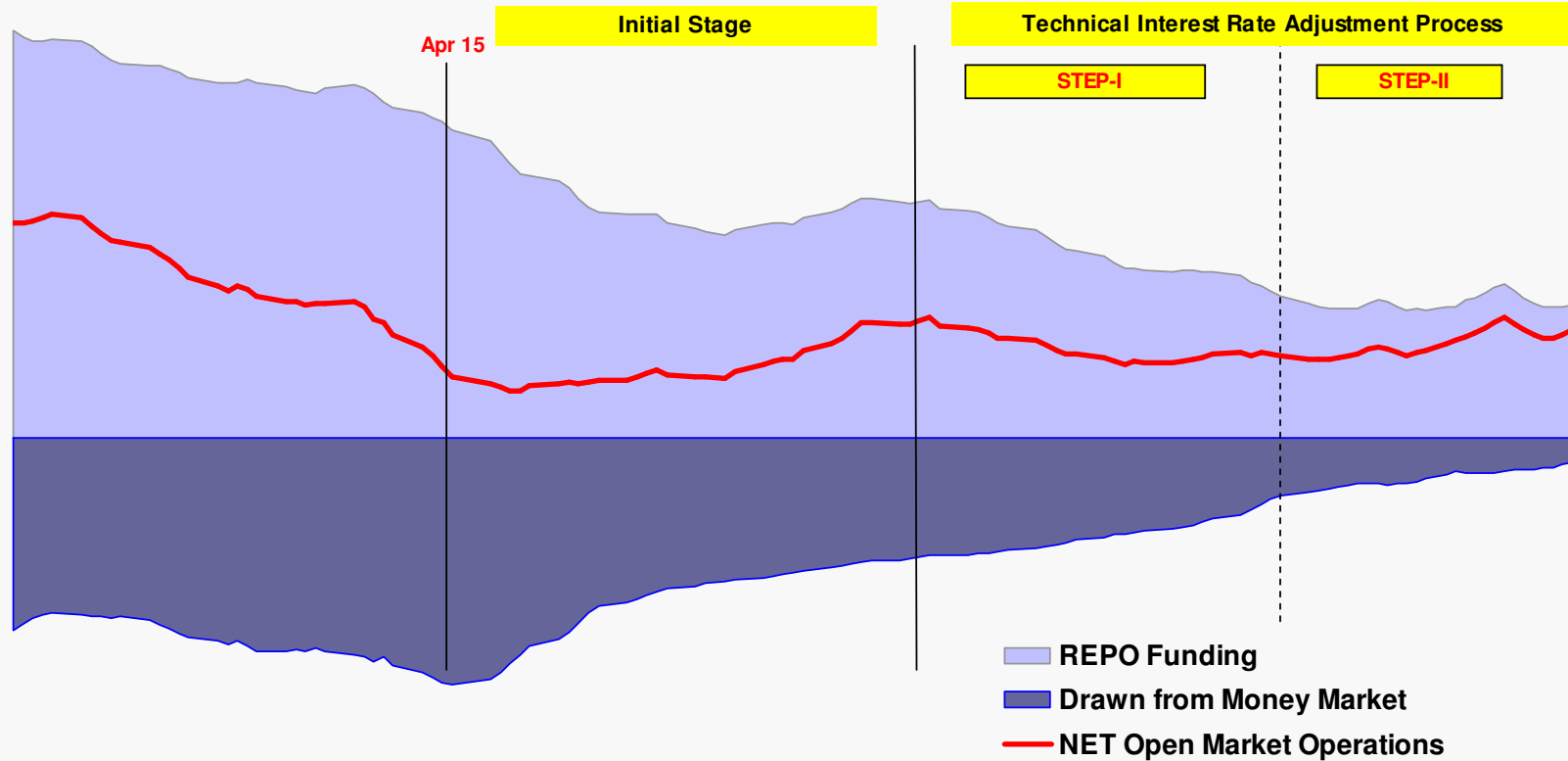
Exit Strategy – FX Liquidity

- Gradual and moderate hikes in the reserve requirement ratio on FX deposits
- Increase in the interest rate on FX liability facilities (depending on the developments in global interest rates)
- Discontinuation of the intermediary role in the FX depo market and reduction in the maturity of the FX depo facility from 3 months to one week (after assessing the impact of exit strategies of other central banks).

Exit Strategy – Turkish Lira Liquidity

We intend to gradually reduce the excess TRY funding in the money market. A slight increase in one-week repo rates may be observed.

Example: Liquidity Provided to the Banking System and Central Bank Operations During The Implementation of Exit Strategy

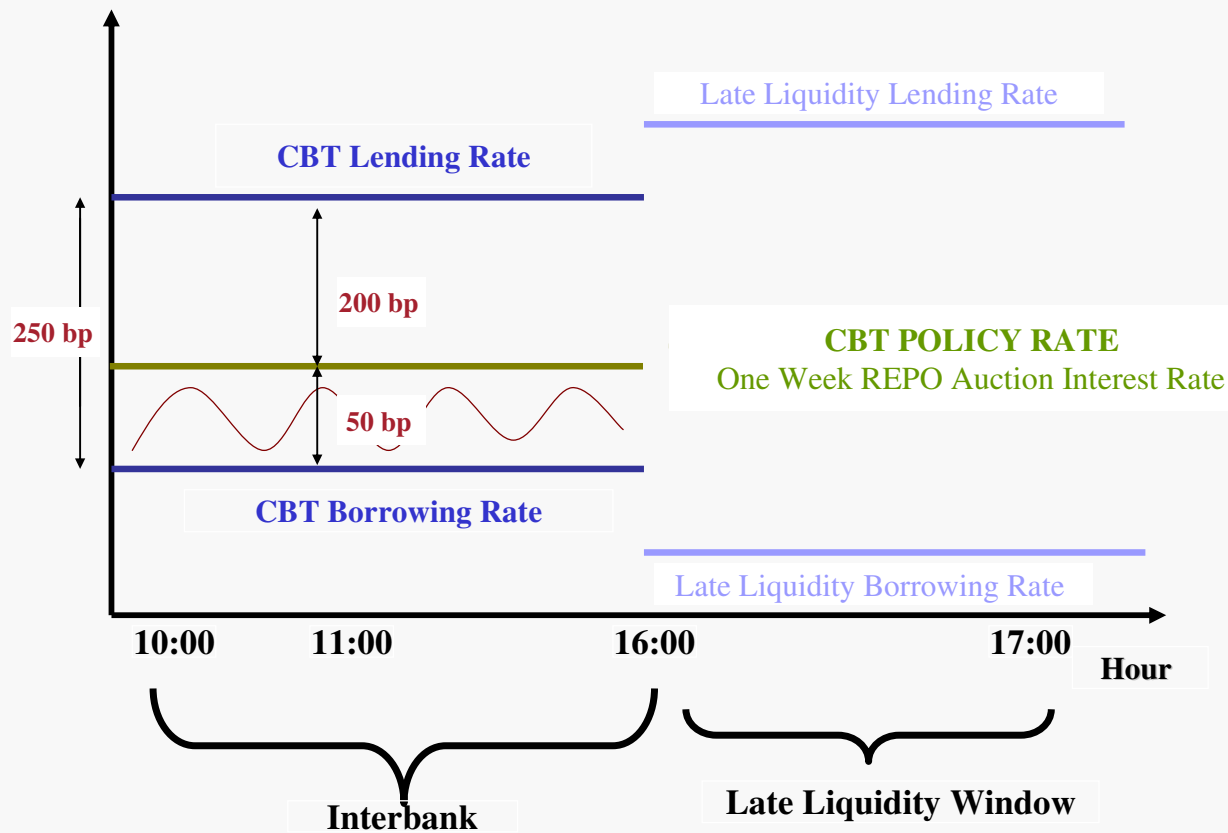


Source: CBT

Technical Interest Rate Adjustment

In the 2nd stage of our Exit Strategy, we will start using one week repo rate as our policy rate --- initially set at 50 bp above our O/N borrowing rate. O/N borrowing and lending rates will not change.

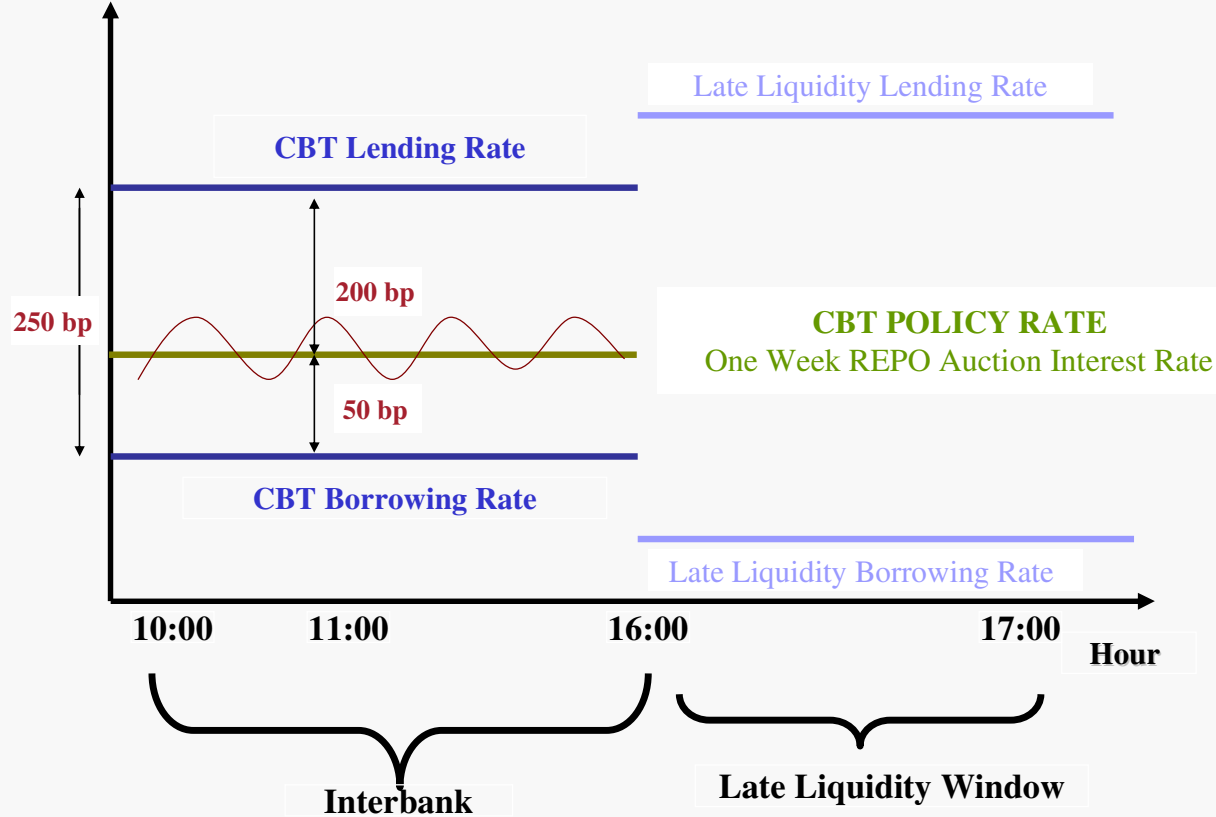
Example: Technical Interest Rate Adjustment – First Step



Technical Interest Rate Adjustment – Second Step

As the liquidity shortage increases in line with expectations, the margin between CBT borrowing and one week repo auction rates may be widened. Secondary market average overnight rate will be targeted to fluctuate around the one week repo auction rate.

Example: Technical Interest Rate Adjustment – Second Step



CENTRAL BANK OF THE REPUBLIC OF TURKEY

ECONOMIC OUTLOOK IN TURKEY

Durmuş YILMAZ

Governor

April, 2010