2. International Economic Developments

The stronger pace of the global economic activity in the last quarter of 2013 is expected to continue in 2014. Global growth was mostly driven by advanced economies in the last quarter. Nevertheless, economic activity hovered below the pre-crisis levels and commodity prices followed a weak course, resulting in inflation rates in advanced economies to continue lagging behind the target. Alleviated tightening in fiscal policies and the currently growth-boosting monetary policies stand out as the factors promoting growth in advanced economies in the upcoming period. In this context, the US is believed to be the driving force of growth in advanced economies. However, the recovery remained limited in emerging economies as capital inflows continued to slow down in the first quarter of the year. In order to avert inflation and financial stability from the possible adverse effects of external financing risks and depreciation of exchange rates that may stem from aggravated capital outflows, emerging economies have started to slightly tighten their monetary policies. In the upcoming period, exports may contribute positively to growth in emerging economies amid the favorable course of economic activity in advanced economies, while tightened monetary policy may restrict domestic demand.

The course of the US monetary policy has grown more important than ever since the Fed's taper signal in May 2013. As uncertainties on the ending of asset purchases have largely faded, the current main risk factor regarding the global monetary policy is the timing and the amount of the Fed's first policy rate hike. Currently, the Fed's taper of asset purchases, which started effectively in January, and the divergence of growth in favor of advanced economies, will keep the downside risks brisk on capital flows towards emerging economies in the upcoming period. Expectations for an immediate policy rate hike by the Fed may also deepen capital outflows, thereby deteriorating financial stability in these economies. Accordingly, emerging market policy rates, which registered a higher-than-expected rise in the first quarter as a caution against the adverse effects of capital outflows, may continue to trend upward for the rest of the year as well.

2.1. Global Growth

In the last quarter of 2013, global economic activity gained further pace on an annual basis, amid the favorable growth performance of advanced economies (Charts 2.1.1 and 2.1.2). In this period, besides the positive growth outlook in the US, UK and Japan, the Euro Area's exit from the recession also contributed favorably to global growth. Having remained flat in the last quarter, the pace of growth in emerging economies caused no distortion to global growth (Chart 2.1.2).

Chart 2.1.1.
Global Growth Rates*
(Annual Percent Change)

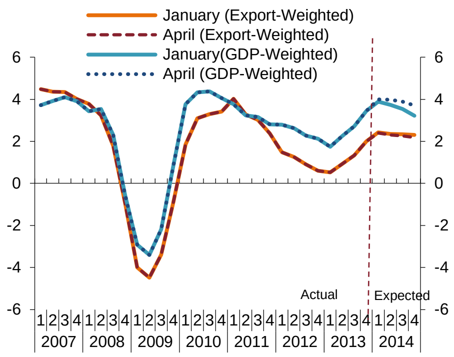
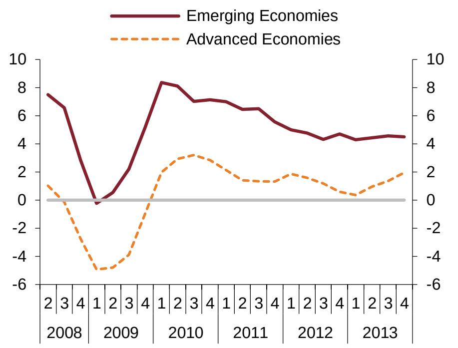


Chart 2.1.2.
Global Growth Rates*
(Annual Percent Change)



* Weighted by each country's share in Turkish exports and by each country's share in global GDP for export-weighted growth and GDP-weighted growth, respectively.
Source: Bloomberg, CBRT.

The global economic activity is expected to maintain its positive course in the first quarter of 2014 amid the favorable pace of growth in advanced economies. In fact, first-quarter readings on the global manufacturing industry confirm this projection (Chart 2.1.3). Similarly, data on the manufacturing industry PMI of the Euro Area and the US point that the favorable growth performances in these economies will contribute positively to global growth in the first quarter of the year (Chart 2.1.4). However, the relatively positive course of growth in advanced economies notwithstanding, unemployment levels are far above the pre-crisis levels, particularly in the Euro Area, and this poses a downside risk to the pace of global growth. In addition, the persisting downtrend in capital flows towards emerging economies should be evaluated as another factor imposing a downside risk to global growth by deteriorating the economic activity in these countries.

Chart 2.1.3.
Markit Global PMI Indices

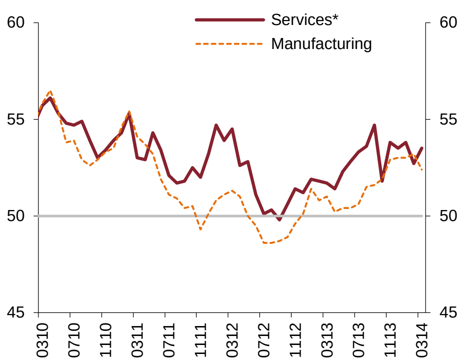
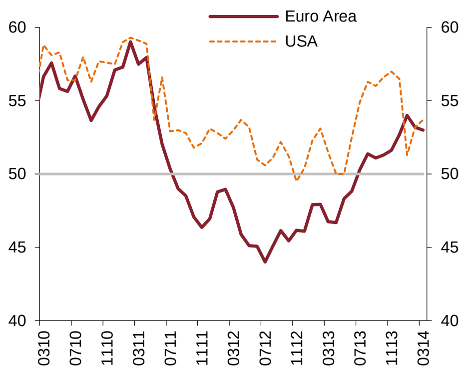


Chart 2.1.4.
Manufacturing Industry PMI Indices



* Denotes the economic activity index.
Source: Markit.

April Consensus Forecasts reveal that growth forecasts for 2014 were revised upwards for the Euro Area and the UK, and downwards for Japan by 0.3 percentage points compared to the previous reporting period. Growth forecasts for emerging economies, excluding India, were mostly revised downwards, especially for the Latin American and Eastern European countries. Growth forecasts for end-2015 were mostly revised upwards for advanced economies and downwards for emerging economies (Table 2.1.1). The World Economic Outlook forecasts by the IMF in April are largely consistent with Consensus Forecasts. Accordingly, GDP-weighted global growth forecasts for 2014 were revised upwards on account of advanced economies, while export-weighted global growth remained almost unchanged in the inter-reporting period. Despite the favorable outlook in the Euro Area, one of our major trading partners, growth forecasts for Eastern Europe were revised downwards considerably, which caused the export-weighted growth rate to remain unchanged from the previous reporting period (Chart 2.1.1).

Table 2.1.1.
Growth Forecasts for end-2014 and 2015 (Average Annual Percent Change)

	January		April	
	2014	2015	2014	2015
World	3.1	-	2.9	3.2
Advanced Economies				
USA	2.8	3.0	2.7	3.0
Euro Area	1.0	1.4	1.2	1.5
Germany	1.8	2.0	1.9	2.0
France	0.8	1.2	0.9	1.3
Italy	0.5	1.0	0.6	1.1
Spain	0.7	1.2	1.0	1.5
Greece	-0.3	1.5	0.1	1.5
Japan	1.7	1.2	1.3	1.3
UK	2.6	2.4	2.8	2.4
Emerging Economies				
Asia-Pacific	6.2	6.3	6.0	6.1
China	7.5	7.4	7.3	7.2
India	5.4	6.8	5.4	6.0
Latin America	2.8	3.1	2.3	2.9
Brazil	2.2	2.3	1.8	2.0
Eastern Europe	2.6	3.2	2.0	2.9

Source: Consensus Forecasts.

2.2. Commodity Prices and Global Inflation

In the first quarter of 2014, the headline commodity price index displayed a quarter-on-quarter increase by 1.2 percent. In this period, agricultural and precious metal prices rose by 14 and 7.1 percent, respectively, while energy prices registered a decline by 1.8 percent and industrial metal prices dropped by 5.5 percent (Chart 2.2.1).

Chart 2.2.1.
S&P Goldman Sachs Commodity Prices
(January 2009=100)

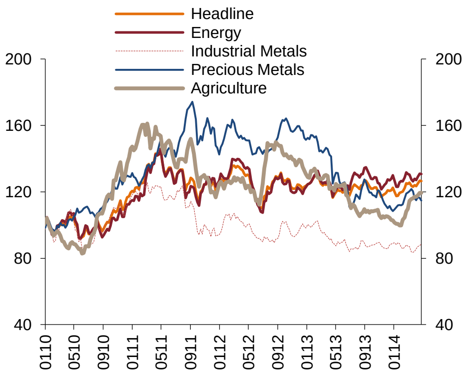
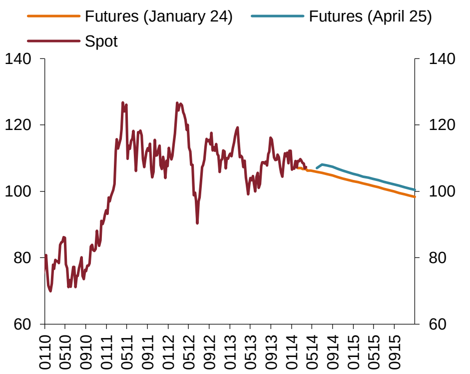


Chart 2.2.2.
Crude Oil (Brent) Prices*
(USD/bbl)



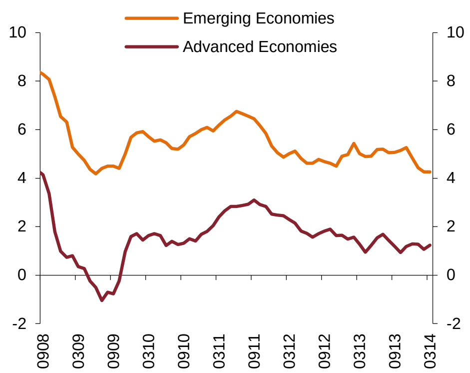
* January 24 and April 25 denote the arithmetical average of the prices quoted at futures contracts during January 1- 24 and April 1-25, 2014, respectively.
Source: Bloomberg.

Despite some recovery in global growth, the relatively weak course of growth in emerging economies continued to affect commodity prices, thereby preventing a possible demand-side pressure on oil prices. On the supply side, the US crude oil production and inventories remained high, averting an upside pressure on prices, while geopolitical risks kept concerns over the oil supply brisk. Brent crude oil prices quoted at futures contracts, which were 107 USD at the end of the first quarter, remained virtually unchanged in the inter-reporting period (Chart 2.2.2).

Upon the slowdown in economic activity in China, industrial metal prices declined in the first quarter. Meanwhile, agricultural prices, which followed a declining trend from mid-2012 to end-2013, experienced the most dramatic change in commodity prices by surging due to the weather conditions in the first quarter. Additionally, the political unrest in the Ukraine, which holds a major share in world cereal production, poses an upside pressure on agricultural prices by aggravating uncertainties on the cereal supply.

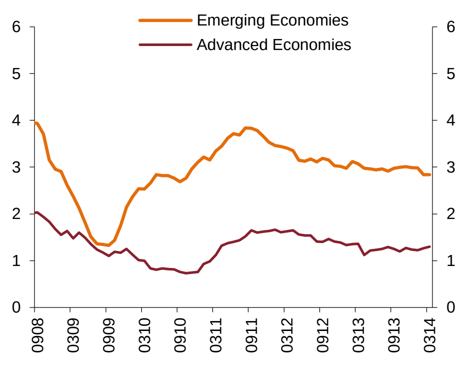
Headline and core inflation figures remained broadly unchanged in advanced economies while having fallen in emerging economies, mostly due to China and India compared to the previous reporting period (Charts 2.2.3 and 2.2.4).

Chart 2.2.3.
CPI Inflation in Advanced and Emerging Economies
(Annual, Percent)



Source: Bloomberg, CBRT.

Chart 2.2.4.
Core Inflation in Advanced and Emerging Economies
(Annual, Percent)



Source: Bloomberg, DataStream, CBRT.

On the advanced economies front, inflation forecasts for end-2014 and 2015 were revised upwards for the US and the UK, and downwards for the Euro Area and Japan (Table 2.2.1). As for emerging economies, inflation expectations were revised downwards for Asia-Pacific parallel to inflation realizations, and upwards for Latin America and Eastern Europe mostly due to the depreciation in the exchange rates. Upside risks to agricultural prices for the upcoming period pose an upward pressure on the inflation outlook of emerging economies, which have a high share of food in their consumption baskets. On the other hand, unconventional monetary policies and political risks continue to weigh on the blurred global inflation outlook.

Table 2.2.1.
Inflation Forecasts for end-2014 and 2015 (Average Annual Percent Change)

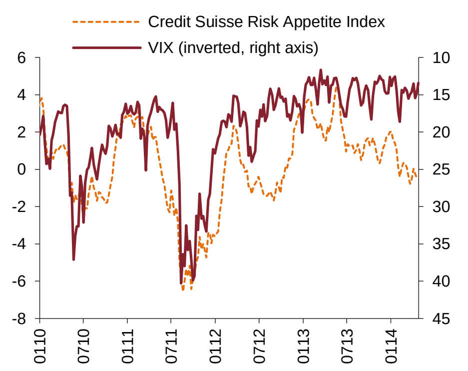
	January		April	
	2014	2015	2014	2015
World	3.0	-	3.0	3.1
Advanced Economies				
USA	1.6	1.9	1.7	1.9
Euro Area	1	1.4	0.9	1.3
Germany	1.6	2	1.4	1.8
France	1.2	1.4	1.0	1.3
Italy	1.1	1.3	0.8	1.1
Spain	0.7	1.3	0.3	1.0
Greece	-0.8	0.1	-0.9	-0.1
Japan	2.3	2.3	2.6	1.7
UK	2.3	1.6	1.9	2.1
Emerging Economies				
Asia-Pacific	3.7	3.7	3.4	3.6
China	3.1	3.3	2.6	3.0
India	8	7	7.7	7.1
Latin America	9	7.9	10.2	9
Brazil	5.9	5.6	6.3	5.8
Eastern Europe	4.7	4.8	5.1	4.8

Source: Consensus Forecasts.

2.3. Financial Conditions, Risk Indicators and Capital Flows

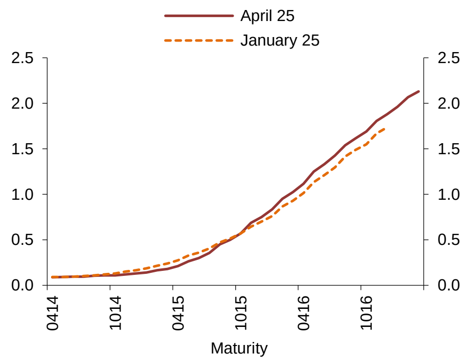
In the first quarter of 2014, the global risk appetite continued with a fluctuating course due to the persisting concerns over growth in emerging economies and the Fed's trim of asset purchases (Chart 2.3.1). Meanwhile, expectations regarding the timing of the rise in the Fed funds rate remained virtually unchanged in the inter-reporting period, whereas the amount of the expected policy rate hike displayed a marginal rise (Chart 2.3.2). This outlook was confirmed by the forecasts of the FOMC members, as the expected policy rate increased slightly for both 2015 and 2016.

Chart 2.3.1.
Global Risk Appetite



Source: Bloomberg, Credit Suisse.

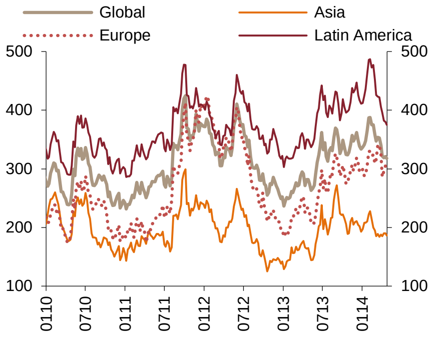
Chart 2.3.2.
Fed Funds Futures
(Percent)



Source: Bloomberg.

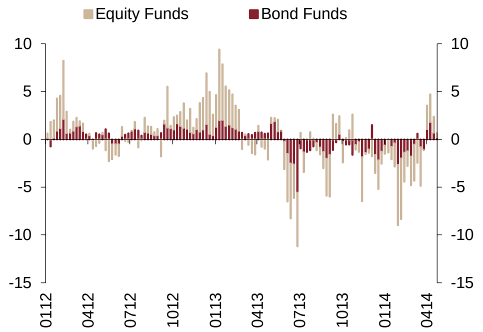
Stock markets of advanced economies continued to appreciate amid positive growth prospects for advanced economies, the US and the Euro Area in particular, and the waning of the uncertainties about the US monetary policy. Meanwhile, stock markets of emerging economies saw partial compensation of the recent depreciation. Moreover, yields on borrowing bills and bonds in emerging economies receded (Chart 2.3.3). Similarly, yields on borrowing bills and bonds of the troubled economies in the Euro Area also declined.

Chart 2.3.3.
Regional EMBI Developments*
(5-year)



* EMBI indices denote the yield spread of the USD-denominated bills and bonds of countries over US Treasury bills and bonds.
Source: Bloomberg.

Chart 2.3.4.
Weekly Portfolio Flows to Emerging Economies
(Billion USD)



Source: EPFR.

The downtrend of the capital flows towards emerging economies continued in the first quarter. On a quarterly basis, capital outflows from emerging economies accelerated significantly in the inter-reporting period. In terms of composition, both equity and bond funds saw similar amounts of outflows in the last quarter of 2013, while capital outflows in the first quarter of 2014 were mostly driven by equity funds in emerging economies (Chart 2.3.4). On the other hand, emerging economies experienced limited capital inflows early in the second quarter. Accordingly, the future course of capital flows will remain important to the financial developments in emerging economies.

Downside risks to capital inflows towards emerging economies including the Fed's taper on asset purchases, which started effectively in January, are expected to remain brisk in the upcoming period. Despite alleviated concerns regarding the exit from the quantitative easing program amid the perception that the Fed's trim of monthly asset purchases is now routine, capital markets in emerging economies may continue to remain volatile due to persisting global uncertainties. Meanwhile, the ongoing recovery in advanced economies on one hand and the weak course of growth in emerging economies on the other may continue to deteriorate capital flows to emerging economies.

2.4. Global Monetary Policy Developments

In the first quarter of 2014, the monetary policy in advanced economies remained unchanged from the previous reporting period. Accordingly, the Fed's policy to cut asset purchases continued on a regular basis within a pre-determined schedule, while policy rates in advanced economies followed a stable course (Chart 2.4.1). Due to fluctuations in financial markets driven by capital outflows in early 2014 and the notable depreciation of emerging market currencies, the CBRT as well as the Bank of Brazil and the Reserve Bank of South Africa delivered sizeable rate hikes in the previous quarter. Owing to the political developments, the Central Bank of Russia also opted for a policy rate hike in March 2014, which caused the monetary policy in emerging economies to display a tightening stance in the first quarter of the year (Chart 2.4.2).

Chart 2.4.1.
Policy Rate Changes in Advanced Economies from Jan. 2013 to Apr. 2014* (Basis Points)

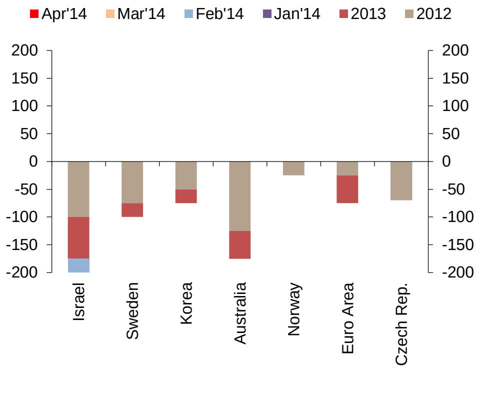
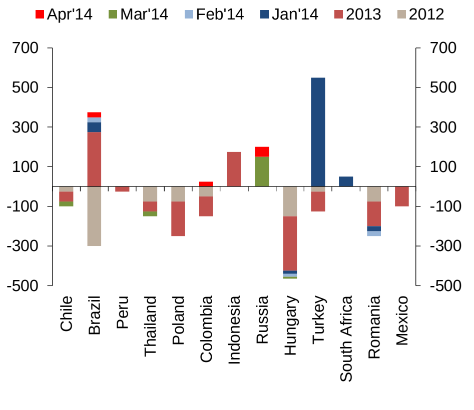


Chart 2.4.2.
Policy Rate Changes in Emerging Economies from Jan. 2013 to Apr. 2014* (Basis Points)

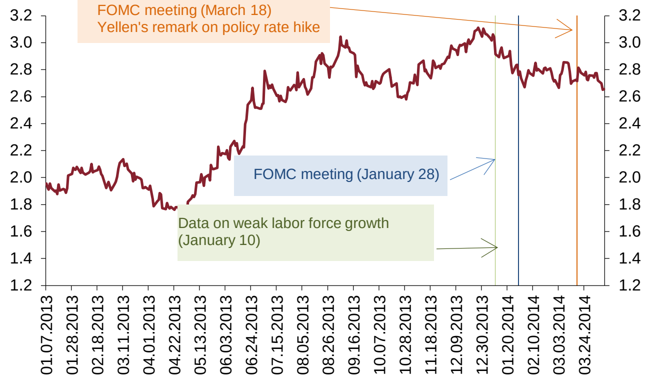


* As of April 25, 2014.
Source: Bloomberg, CBRT.

Since the Fed's signal in May 2013 to taper asset purchases, growth and employment figures in the US have been carefully monitored all over the world and each data release has been influential on the interest and exchange rates both in the US and emerging economies. Following the first reduction in December 2013, the Fed continued to cut asset purchases in the same amount (10 billion USD in every meeting). Due to waning of the uncertainty on the Fed's taper and the markets' perception that the change in the Fed's chairman would not cause a tightening in monetary policy, the US long-term rates have settled on a flat course since late January (Chart 2.4.3).

Upon alleviated uncertainty on the course of a cutback on asset purchases, the timing and the amount of the Fed's first rate hike featured as the main risk factor on the global monetary policy. In its March FOMC meeting statement, the Fed anticipated that it would be appropriate to maintain the current target range for the federal funds rate for a considerable time after the asset purchase program ends. Also, with the unemployment rate nearing 6.5 percent, the Fed has updated its forward guidance on unemployment and stated that a tightening policy would be conducted in measured steps by taking into account a wide range of information. The Bank of England also updated its forward guidance as unemployment tumbled close to 7 percent, which was set as a threshold for further policy rate rises. Meanwhile, the recovery in the Euro Area notwithstanding, the ECB is now more likely to launch a new quantitative easing program amid deflationary risks.

Chart 2.4.3.
Yields on 10-year US Treasury Bonds (Percent)



Source: Bloomberg.

Chart 2.4.4.
Expected Policy Rates in Advanced Economies (Percent)

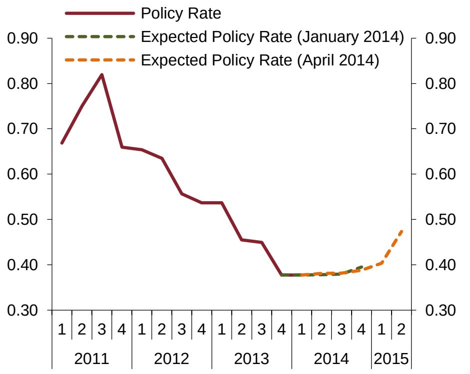
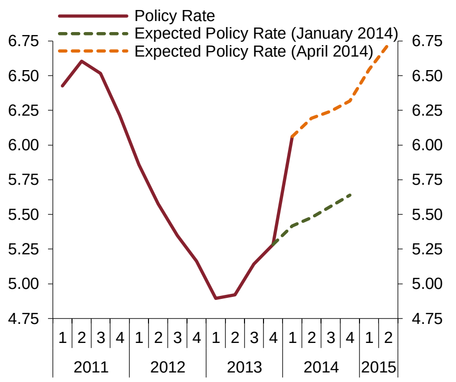


Chart 2.4.5.
Expected Policy Rates in Inflation-Targeting Emerging Economies (Percent)



Source: Bloomberg, CBRT.

In the first quarter of the year, policy rate developments in advanced economies proved consistent with the projections in the previous Inflation Report, and expected policy rates for 2014 remained stable (Chart 2.4.4). Emerging economies experienced more-than-anticipated policy rate hikes with expectations for further increases being maintained for the rest of the year (Chart 2.4.5). Policy rate expectations for both advanced and emerging economies clearly indicate an accelerated tightening in global monetary policy throughout 2015.