4. Supply and Demand Developments

The GDP data of the last quarter of 2013 suggest that economic activity remained largely consistent with the outlook presented in the January Inflation Report. Seasonally adjusted data point to an increase of 0.5 percent in the GDP on a quarterly basis. Thus, economic activity, which gained momentum in the first half of the year, continued with a rather moderate course in the second half. Having settled on a weak path in the preceding two quarters, final domestic demand recorded a faster increase in the last quarter. As for the components of the final domestic demand, the private sector demand continued with a mild course across 2013, while the public sector demand, which registered a fluctuating course, proved to be the main driver of growth in the domestic demand. Imports lagged behind exports on a quarterly basis in the last quarter and demand components, as projected, displayed a balanced outlook compared to the first half of the year.

Data pertaining to the first quarter of 2014 point to a mild increase in economic activity. On the production side, the industrial production index stood above the previous quarter's average and maintained a stable uptrend on a quarterly basis in the January-February period. On the expenditures side, the private sector demand slowed due to the consumption of durable goods and private machinery and equipment investments. On the other hand, the data on the consumption of non-durable goods and construction investments are still favorable. As for the second quarter, indicators of BTS as well as credits and imports indicate that domestic demand will remain sluggish. Accordingly, domestic demand is envisaged to follow a weak course in the first half of the year.

External demand indicators point to an uptick in the exports of goods and services, and a decrease in the imports thereof. A similar situation applies to export and import indicators excluding gold that reflects the underlying trend. Thus, it is projected that the balancing among demand components will continue in the first quarter and the current account deficit will record a slight decline on a quarterly basis.

In the first half of the year, domestic demand is envisioned to follow a sluggish course due to domestic uncertainties and tightening in financial conditions, while net exports and the public sector demand are expected to compensate for this course. In line with waning uncertainties, the private sector demand is estimated to improve in the second half. Meanwhile, it should be noted that the tightening in financial conditions owing to recent developments may impose downside risks on domestic demand. Accordingly, domestic demand conditions are expected to support the disinflation process and contribute to the recent improvement in the current account deficit.

4.1. Gross Domestic Product Developments and Domestic Demand

According to the national accounts data released by the TurkStat, the GDP posted a year-on-year increase by 4.4 percent in the last quarter of 2013. The final-quarter data led to a retrospective revision of the national accounts data by subcategories (Box 4.1). Thus, following the growth of 2.1 percent in 2012, the GDP rose by 4.0 percent in 2013. Seasonally adjusted data suggest that the economic activity continued to grow at a slower pace, while the growth of final domestic demand gained slight momentum in the last quarter (Chart 4.1.1). This acceleration was attributed to the rising public sector demand that followed a fluctuating course in 2013, while the private sector demand remained mild (Chart 4.1.2).

Chart 4.1.1.
GDP and Final Domestic Demand
(Seasonally Adjusted, Billion TL, 1998 Prices)

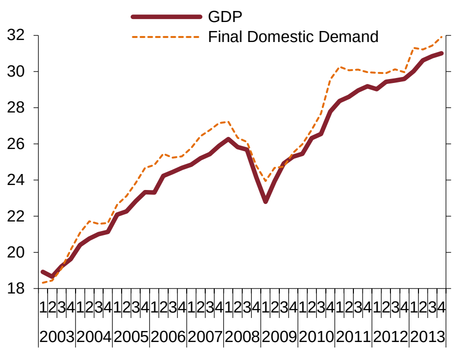
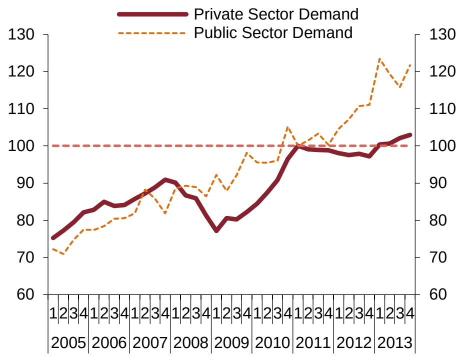


Chart 4.1.2.
Public and Private Sector Demand
(Seasonally Adjusted, 2011Q1=100)



Source: TurkStat, CBRT.

The first-quarter data indicate that private demand decelerated. In the January-February period, the production of consumption goods increased, while that of imports declined (Chart 4.1.3). The effects of tight financial conditions, depreciated Turkish lira, weakened consumer confidence and tax adjustments were mostly observed in the demand for automobiles and durable consumption goods. In fact, the analysis of consumption good imports by subcategories points to a steep fall in imports of automobiles, and a mild fall in those of durable and semi-durable goods; while imports of non-durable goods remained on the increase (Chart 4.1.4). The production of consumption goods followed a similar course in the January-February period such that the production of durable consumption goods receded on a quarterly basis in contrast to the continued increase in the production of non-durable goods. As for machinery and equipment investments, the production of investment goods excluding transport vehicles remained almost flat, while the imports thereof recorded a decline (Chart 4.1.5). On the construction front, data on investments indicate further increase in construction investments (Chart 4.1.6). In sum, demand for durable consumption goods and machinery and equipment investments decreased, while the uptrend in non-durable consumption goods and construction investments continued.

Chart 4.1.3.
Production and Import Quantity Indices of Consumption Goods
(Seasonally Adjusted, 2010=100)

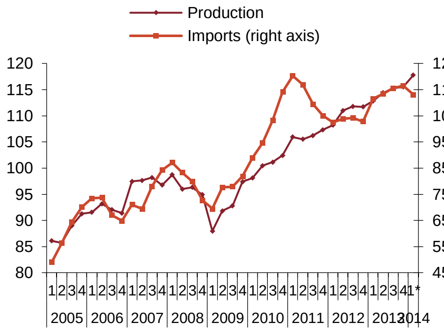
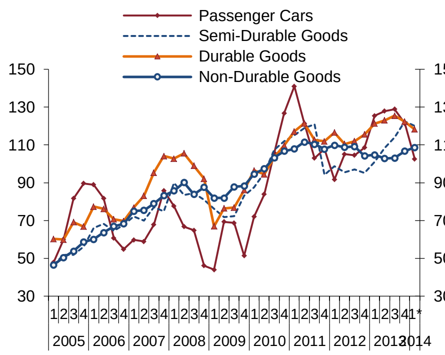


Chart 4.1.4.
Import Quantity Indices of Consumption Goods by Subcategories
(Seasonally Adjusted, 2010=100)



*As of February.
Source: TurkStat, CBRT.

Chart 4.1.5.
Production and Import Quantity Indices of Capital Goods Excluding Transport Vehicles
(Seasonally Adjusted, 2010=100)

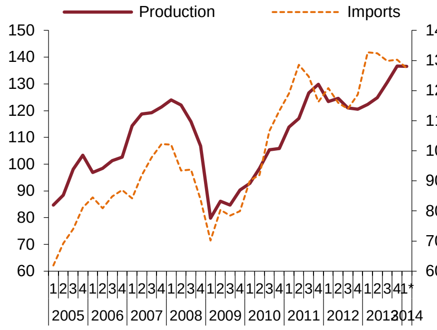
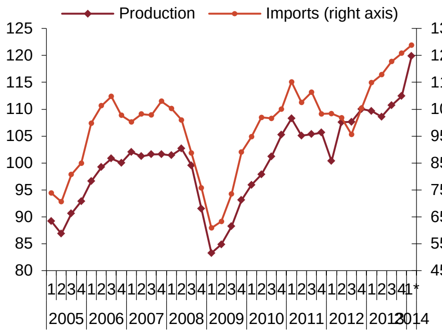


Chart 4.1.6.
Production and Import Quantity Indices of Non-Metallic Mineral Goods
(Seasonally Adjusted, 2010=100)



*As of February.
Source: TurkStat, CBRT.

BTS indicators suggest a sustained weak course in domestic demand in the second quarter. In fact, expectations of domestic market orders for the manufacturing of consumption and investment goods waned in the first quarter (Charts 4.1.7 and 4.1.8). On the other hand, the registered domestic market orders for the manufacturing of consumption goods as well as the recent recovery in the consumer confidence index suggest a possible mild rebound in the consumption demand in the upcoming period. Meanwhile, expectations of investment and employment, which reflect the relatively longer-term decisions of firms, exhibit a weak outlook (Chart 4.1.9). Accordingly, the sluggish course of investments is expected to persist for a while. However, private machinery and equipment investments, which is still 8.3 percent below the first-quarter reading in 2011, is not estimated to contract noticeably across the year, given the consumption demand outlook besides the favorable performance of exports. In sum, the lower uncertainty perception, the improved consumer confidence, the slightly appreciated Turkish lira and the recovered consumption demand are estimated to support the domestic demand for a gradual rebound starting from the second quarter (Chart 4.1.10). On the other hand, it should be noted that downside risks on domestic demand are present due to tightened financial conditions caused by recent developments.

Chart 4.1.7.
Registered Domestic Orders and Expectation of New Domestic Orders in the Manufacturing Sector of Consumption Goods*
(Seasonally Adjusted)

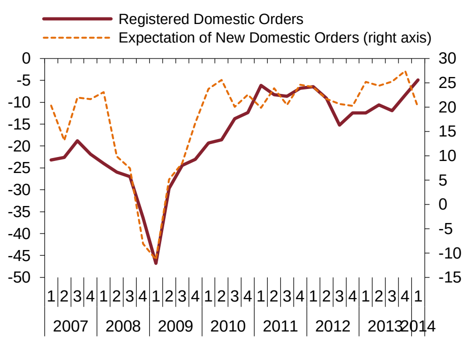
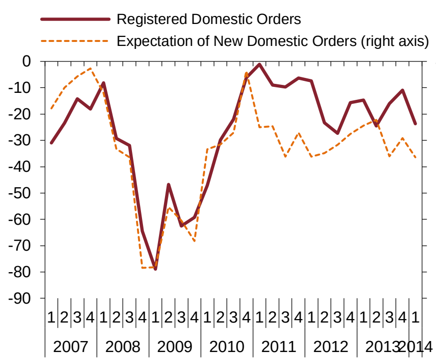
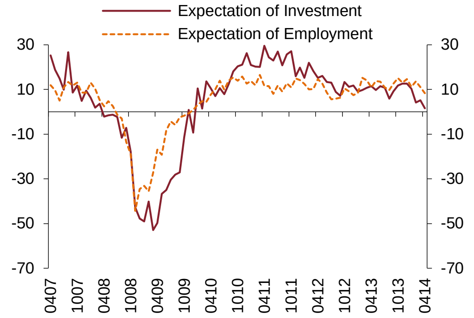


Chart 4.1.8.
Registered Domestic Orders and Expectation of New Domestic Orders in the Manufacturing Sector of Investment Goods*
(Seasonally Adjusted)



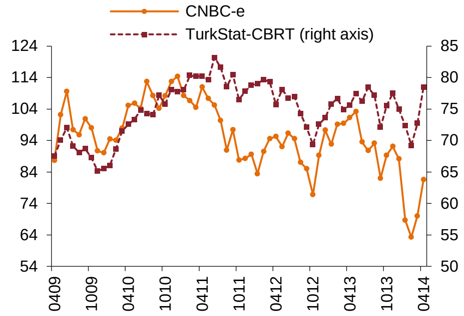
* Question 19 in BTS for registered domestic orders (below normal-above normal) and question 21 in BTS for expectation of 3-month-ahead domestic orders (increase-decrease).
Source: CBRT.

Chart 4.1.9.
BTS Expectation for Investment and Employment*
(Seasonally Adjusted)



* Question 23 in BTS asks the survey respondents the expectation of fixed investment to increase or decrease in the upcoming 12-month relative to past 12-month. Question 7 in BTS asks the survey respondents the expectation of total employment to increase or decrease in the upcoming 3-month.
Source: CBRT.

Chart 4.1.10.
Consumer Confidence*



*Preliminary CNBC-e data for April.
Source: CNBC-e, TurkStat, CBRT.

To sum up, economic activity registered a mild increase in the second half of 2013 following the robust course in the first half. The public sector followed a fluctuating course throughout the year, while the private sector demand remained moderate. Due to domestic developments and the movements in the exchange rates and interest rates in the first quarter, the private sector demand is expected to grow at a decelerating pace in the first half of 2014. On the other hand, parallel to the waning domestic uncertainties, the private sector demand is estimated to recover, while tight financial conditions will limit this rise. Under these circumstances, domestic demand developments are expected to partially restrain the recent cost-side pressures. Moreover, the anticipated slowdown in domestic demand is believed to support the recent improvement in the current account deficit and the balancing process.

4.2. External Demand

National accounts data of the last quarter of 2013 indicated that exports of goods and services fell by 1.5 percent, while imports thereof rose by 9.3 percent in annualized terms. Thus, the negative contribution of net exports to annual growth continued into the last quarter (Chart 4.2.1). In seasonally adjusted terms, exports recorded a more pronounced increase than imports on a quarterly basis, affecting the balancing among external demand components positively (Chart 4.2.2).

Chart 4.2.1.
Contribution of Net Exports to Annual GDP Growth
(Percentage Point)

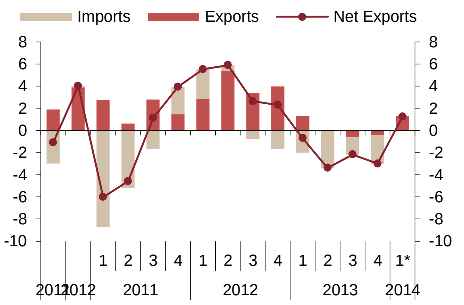
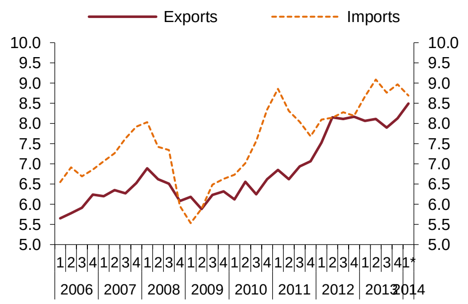


Chart 4.2.2.
Exports and Imports of Goods and Services
(Seasonally Adjusted, 1998 Prices, Billion TL)



* Estimate.
Source: TurkStat, CBRT.

Data regarding the first quarter of 2014 reveal that the export quantity index trended upwards in the January-February period. The core index excluding gold exports continued with its steady trend and posted a quarter-on-quarter increase in this period (Chart 4.2.3). Recent indicators on PMI point to a sustained recovery on a global scale. As for medium-term indicators, the export-weighted global growth continues to improve (Chart 2.1.1). In addition, exports are expected to contribute positively to growth in the upcoming period amid the depreciation of the Turkish lira.

Chart 4.2.3.
Export Quantity Indices
(Seasonally Adjusted, 2010=100)

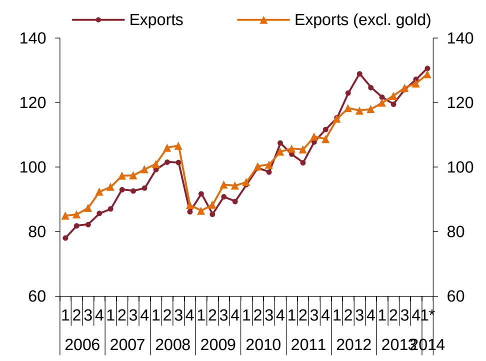
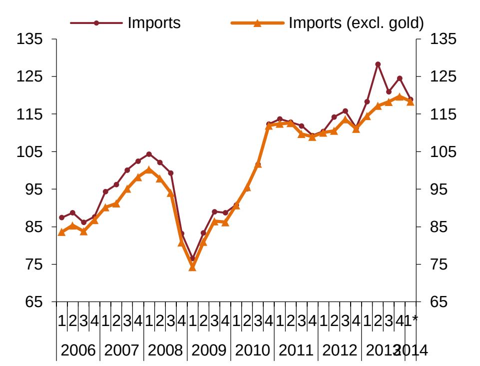


Chart 4.2.4.
Import Quantity Indices
(Seasonally Adjusted, 2010=100)



* Estimate for March.
Source: TurkStat, CBRT.

The import quantity index slumped in the January-February period; however, excluding gold, the index posted a modest fall quarter-on-quarter. Due to the recent tightening in financial conditions coupled with the measures taken, the growth rate of consumer loans lost pace. Accordingly, the current data on the domestic sales of white goods and automobiles indicated a dramatic decline. Analysis of these developments in quarterly terms leads to the anticipation that the deceleration in domestic demand will pull both total imports and imports excluding gold down in the first quarter (Chart 4.2.4). Accordingly, imports of goods and services are expected to fall in this period (Chart 4.2.2).

In the first quarter of 2014, final domestic demand is expected to lose momentum, while exports are estimated to restrain the effects of this deceleration on growth. It is projected that the re-balancing will continue further and net exports will contribute positively to growth in this period (Chart 4.2.1).

The improvement in the seasonally adjusted current account balance is expected to accelerate and the current account balance excluding energy and gold is envisaged to post surplus again in the first quarter (Chart 4.2.5). On the other hand, the recovery in the 12-month cumulative current account balance in nominal terms is anticipated to be slower and rather limited (Chart 4.2.6).

Chart 4.2.5.
Current Account Balance*
(Seasonally Adjusted, Billion USD)

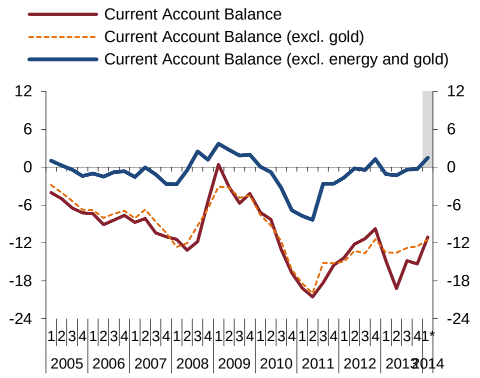
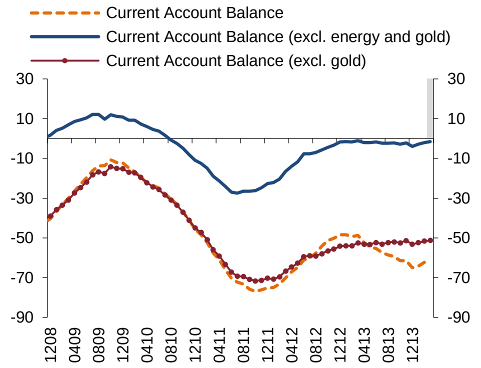


Chart 4.2.6.
Current Account Balance*
(12-Month Cumulative, Billion USD)



* Estimate for March.
Source: TurkStat, CBRT.

4.3. Labor Market

Unemployment rates have recorded an increase as of the first quarter of 2013 amid the sluggish course of non-farm employment. The third quarter was marked by the deepest slowdown in employment such that the non-farm employment decreased, while unemployment rates surged (Charts 4.3.1 and 4.3.2). In the January period covering the observations regarding the last quarter of 2013 and the first quarter of 2014, unemployment rates plummeted compared to the third quarter of 2013. The decline in unemployment rates was mainly driven by the rise in the non-farm employment (Chart 4.3.2).

Chart 4.3.1.
Unemployment Rates
(Seasonally Adjusted, Percent)

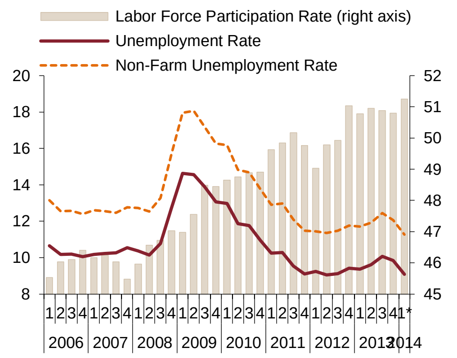
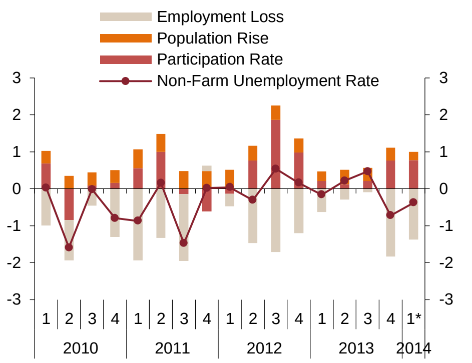


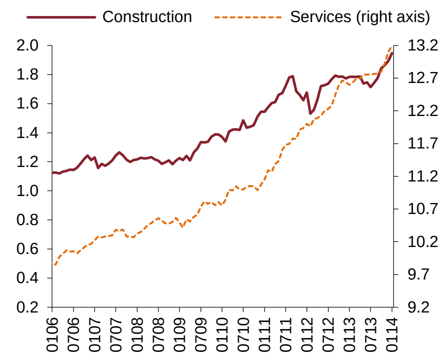
Chart 4.3.2.
Contributions to Non-Farm Unemployment
(Seasonally Adjusted, Percent)



* 2-month difference as of January.
Source: TurkStat, CBRT.

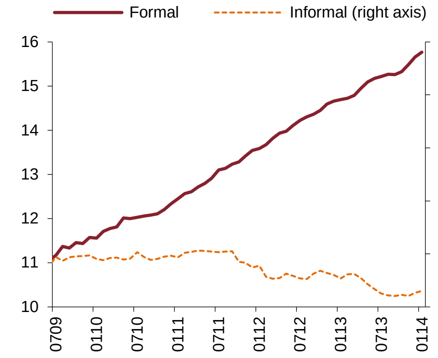
In the first quarter of 2013, non-farm employment increased owing to the contributions of the industrial and business services sectors. In the succeeding period, the slowdown in these sectors and the employment losses in the construction sector caused the employment outlook to deteriorate (Charts 4.3.3 and 4.3.5). Both in the last quarter of 2013 and in January 2014, non-farm employment recorded an increase thanks to the construction and services sectors. Employment in the construction sector increased far above the readings in early 2013, mostly amid the rise in unregistered employment. Having trended downwards in the first half of 2013, unregistered employment followed a flat course in the subsequent periods also owing to the rise in unregistered construction employment. Registered employment, which slowed down gradually in the first three quarters of 2013, displayed an upsurge in the following two quarters (Chart 4.3.4).

Chart 4.3.3.
Employment in Services and Construction Sectors
(Seasonally Adjusted, Million People)



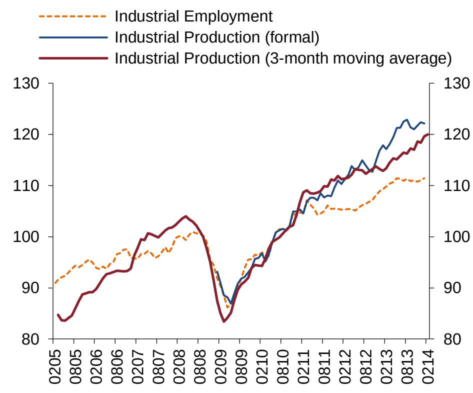
Source: TurkStat HLFS, CBRT.

Chart 4.3.4.
Non-Farm Employment
(Seasonally Adjusted, Million People)



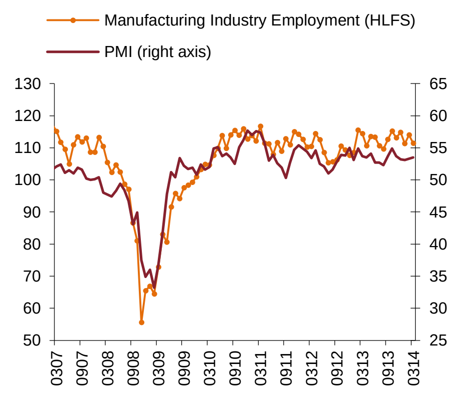
Even though industrial production continued to grow steadily since the second quarter of 2013, the industrial employment displayed a limited rise (Chart 4.3.5). Leading indicators point to a mild increase in industrial employment in the first quarter of 2014. The BTS indicator on expectation of employment, which reflects the views of private firms operating in the manufacturing industry sector, settled on a flat course in the first quarter (Chart 4.3.6). Similarly, having declined slightly in the last two quarters, the PMI indicator, which is a benchmark for the manufacturing industry employment, followed a flat course (Chart 4.3.6). In addition, production developments in the manufacturing of non-metallic mineral goods, providing the construction sector with intermediate goods, signal a recovery in construction activities in the first quarter of 2014 as well (Chart 4.1.6). Increases in construction employment in the last two quarters are consistent with this indicator. The CBRT's consumer confidence index, which reflects households' sentiments across Turkey, receded in the first quarter of 2014. Given that the unemployment rate follows the confidence index with a lag, this outlook points to a possible break in the deceleration of unemployment rate in the upcoming period.

Chart 4.3.5.
Industrial Employment and Production
(Seasonally Adjusted, 2005=100)



Source: TurkStat HLFS, CBRT.

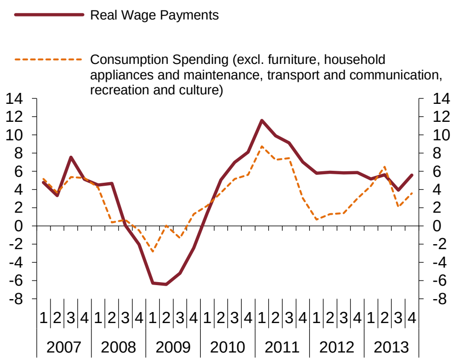
Chart 4.3.6.
Employment Expectations and PMI Employment Index
(Seasonally Adjusted)



Source: Markit, BTS.

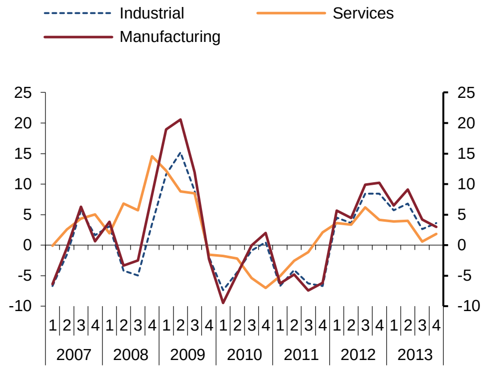
Analysis of labor market developments with regard to domestic demand suggests that, parallel to the rise in real wage payments in the last quarter of 2013, the robust course of employment points to an increased support given by total wage payments to domestic consumption spending (Chart 4.3.7). In the first half of 2013, the rise in hourly wages and the sluggish course of average productivity caused real unit wages to maintain the upward trend. Due to the deceleration of the rise in turnover and hourly wages, this trend paused in the third quarter (Chart 4.3.8). In view of the inflation projections, the minimum wage amount to apply for 2014 does not imply a decline in real wages.

Chart 4.3.7.
Household Domestic Consumption and Real Wage Payments* (Annual Percent Change)



* Calculated as the weighted average of total wages paid in industrial, construction, trade, accommodation, catering, information, communication, professional scientific and technical activities and administrative and support services activities. Deflated by CPI.
Source: TurkStat Short-Term Labor Statistics, CBRT.

Chart 4.3.8.
Real Unit Wages*
(Annual Percent Change)



* Calculated as the ratio of total wages to turnover for the services and the ratio of total wages to production and the relevant PPI for the industrial sectors.
Source: TurkStat Short-Term Labor Statistics, CBRT.

In sum, non-farm employment increased and the unemployment rate receded in the last quarter of 2013 and in January 2014. Unemployment rates declined in January amid higher employment in construction and services, while industrial employment continued to present a modest outlook. Leading indicators point to a mild increase in non-farm employment in the first quarter of 2014. However, the recent tightening in financial conditions, which may deteriorate economic activity in the upcoming period, is viewed to be a potentially restraining factor on the improvement in employment conditions.

Box 4.1 Revisions to Construction Investment Expenditures

This box presents an analysis of revisions to construction investment expenditures, which is a component of national income. Construction investment expenditures are decomposed as public and private in the GDP news bulletin and released quarterly by the TurkStat. Public construction investments pertaining to the first three quarters of the year are temporary and are measured using data from the central government, local administrations and social security institutions, which are compiled on a collection basis via surveys. Final data on public investments are calculated using the finalized accounts of these institutions and released in the last-quarter bulletin of the respective year. Thus, measurement of data in the last-quarter GDP bulletin is on an accrual basis rather than on a collection basis, which leads to quite notable revisions in previously announced data on construction investments for the first three quarters of the year.[1]

This study uses data on construction investments with base year 1998, covering the 2008Q1-2013Q4 period. The study compares 3-quarter construction investments data released in the third-quarter bulletin to the construction investments of the first three quarters released in the last-quarter bulletin, as public and private investment expenditures are not subject to any notable retrospective revision in the second and third quarters of the year. In other words, the public and private construction investment data in the third-quarter GDP bulletin are quite close to those in the first and second-quarter bulletins. Hence, the last-quarter GDP bulletin data are only compared to the third-quarter GDP bulletin data.

While construction investments in the last-quarter bulletins are not subject to any noticeable retrospective revisions in total, the distinction between private and public construction investments can be apparent. In other words, total construction investments for the first three quarters are not revised significantly in the final-quarter GDP bulletins as revisions to public construction investments are offset by revisions to private construction investments. Table 1 presents the annual percentage changes in public, private and total construction investment expenditures released in the third and fourth-quarter GDP bulletins.[2] Accordingly, the annual growth rate of public construction expenditures in 2013Q1, which was announced to be 81.8 percent in the 2013Q3 bulletin, was revised as 46.2 percent in the 2013Q4 bulletin. Thus, the growth rate of public construction investment expenditures was revised downwards by 35.6 percentage points. On the other hand, the first-quarter annual growth rate of private construction investment expenditures for 2013 was revised upwards by 9.1 percentage points (from -13.9 percent to -4.8 percent) in the final-quarter bulletin (Chart 1). In terms of level, revisions to public and private construction investment expenditures are in reverse directions, which cancel each other (Chart 2). This shows that revisions are distributed evenly between public and private. Hence, evaluating construction investments on the basis of public and private distinction may not be accurate by using data released in the first three quarters of the year, while data on total construction expenditures may prove to be more reliable.

[1] For further information on construction investment expenditures, see TurkStat (2012).
[2] For further information on national income revisions, see Günay (2011).

Table 1. Annual Growth Rates of Public, Private and Total Construction in Q3 and Q4 Bulletins

Public Construction		
	2008Q3 Bulletin	2008Q4 Bulletin
2008Q1	-14.0	17.3
2008Q2	-25.2	11.3
2008Q3	22.0	1.3
2008Q4		15.1
	2009Q3 Bulletin	2009Q4 Bulletin
2009Q1	24.2	10.4
2009Q2	10.7	4.6
2009Q3	-9.2	-2.7
2009Q4		-1.0
	2010Q3 Bulletin	2010Q4 Bulletin
2010Q1	-26.5	18.8
2010Q2	18.1	19.7
2010Q3	17.9	14.3
2010Q4		15.8
	2011Q3 Bulletin	2011Q4 Bulletin
2011Q1	6.0	0.4
2011Q2	3.7	-2.0
2011Q3	9.7	3.8
2011Q4		-8.1
	2012Q3 Bulletin	2012Q4 Bulletin
2012Q1	0.4	-4.2
2012Q2	-6.3	2.3
2012Q3	6.0	-1.0
2012Q4		7.4
	2013Q3 Bulletin	2013Q4 Bulletin
2013Q1	81.8	46.2
2013Q2	37.1	25.2
2013Q3	11.5	21.2
2013Q4		29.2

Private Construction		
	2008Q3 Bulletin	2008Q4 Bulletin
2008Q1	4.8	-6.5
2008Q2	7.0	-9.0
2008Q3	-12.8	-12.5
2008Q4		-20.4
	2009Q3 Bulletin	2009Q4 Bulletin
2009Q1	-28.7	-25.2
2009Q2	-31.6	-29.1
2009Q3	-21.8	-23.3
2009Q4		-8.8
	2010Q3 Bulletin	2010Q4 Bulletin
2010Q1	19.7	4.8
2010Q2	22.9	19.9
2010Q3	26.8	25.1
2010Q4		19.1
	2011Q3 Bulletin	2011Q4 Bulletin
2011Q1	18.2	21.0
2011Q2	17.6	20.1
2011Q3	11.6	13.2
2011Q4		12.3
	2012Q3 Bulletin	2012Q4 Bulletin
2012Q1	3.0	4.0
2012Q2	1.8	-1.7
2012Q3	-3.1	-0.3
2012Q4		-0.4
	2013Q3 Bulletin	2013Q4 Bulletin
2013Q1	-13.9	-4.8
2013Q2	-3.8	0.8
2013Q3	7.5	3.5
2013Q4		-2.0

Total Construction		
	2008Q3 Bulletin	2008Q4 Bulletin
2008Q1	1.1	-2.0
2008Q2	-1.4	-3.7
2008Q3	-3.4	-8.7
2008Q4		-12.3
	2009Q3 Bulletin	2009Q4 Bulletin
2009Q1	-16.5	-17.0
2009Q2	-18.9	-19.0
2009Q3	-18.0	-17.1
2009Q4		-6.5
	2010Q3 Bulletin	2010Q4 Bulletin
2010Q1	5.6	8.6
2010Q2	21.0	19.8
2010Q3	23.7	21.0
2010Q4		18.0
	2011Q3 Bulletin	2011Q4 Bulletin
2011Q1	14.6	14.8
2011Q2	12.4	11.8
2011Q3	10.9	9.8
2011Q4		5.3
	2012Q3 Bulletin	2012Q4 Bulletin
2012Q1	2.3	1.8
2012Q2	-0.8	-0.4
2012Q3	0.0	-0.5
2012Q4		2.0
	2013Q3 Bulletin	2013Q4 Bulletin
2013Q1	10.1	8.1
2013Q2	10.0	9.1
2013Q3	8.9	9.6
2013Q4		8.0

Source: TurkStat.

Chart 1. Revisions to Annual Percentage Changes in Public, Private and Total Construction Investments between Q3 and Q4
(Percentage Points)

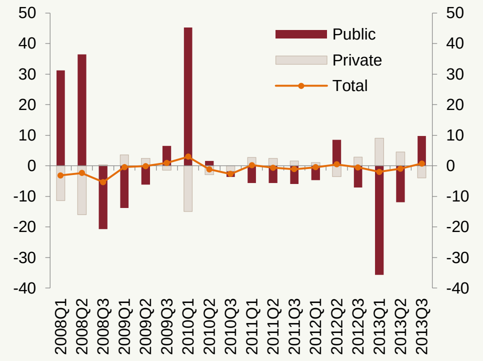
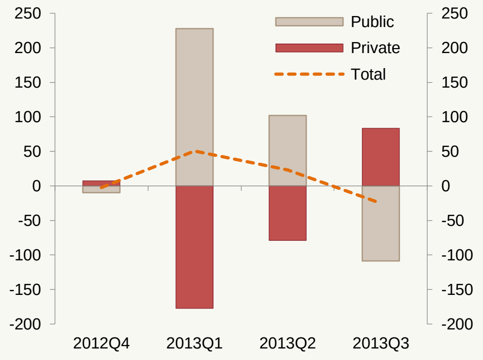


Chart 2. Revisions to Public, Private and Total Construction Investments between Q3 and Q4
(Fixed Prices, Thousand TL)



Source: TurkStat, CBRT.

Revisions significantly change the course of seasonally adjusted data as well (Charts 3 and 4). In seasonally adjusted terms, data in third-quarter bulletin of 2013 signal a sharper contraction in private construction expenditures than the quarterly contraction experienced during the global crisis. However, the revised data in the last-quarter bulletin indicate a more limited contraction in private construction expenditures in the first quarter. Meanwhile, public construction investments, which displayed a rapid rise in the first quarter, were revised downwards to exhibit a modest growth.[3]

Chart 3. Public Expenditures on Construction Investments
(Seasonally Adjusted, Fixed Prices)

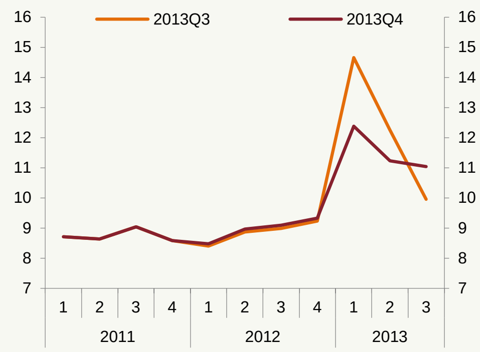
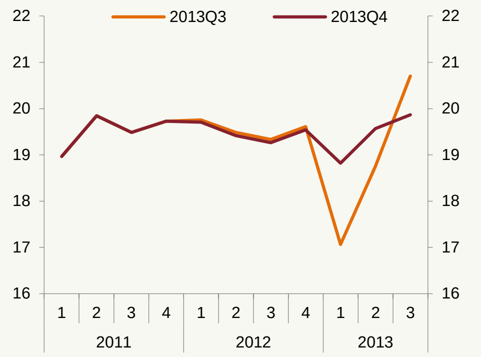


Chart 4. Private Expenditures on Construction Investments
(Seasonally Adjusted, Fixed Prices)



Source: TurkStat, CBRT.

In sum, total construction investments are not subject to a major revision in the last-quarter GDP bulletin, while public and private construction investments were revised significantly. This calls for caution in evaluating data on public and private construction investments, which are released in the first three quarters; whereas assessments using data on total construction investments are considered to be more reliable in the first three quarters.

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TurkStat, 2012, Üretim ve Harcama Yöntemiyle Gayri Safi Yurtiçi Hasıla Tahminleri, Kavram, Yöntem ve Kaynaklar (in Turkish), TurkStat Publication No. 3662.

[3] Last-quarter data on construction investments announced in 2013 are seasonally adjusted and the seasonal factors are obtained. In the next step, construction investments data released in 2013Q3 are seasonally adjusted using these factors in order to eliminate the effect of retrospective revisions that may arise from seasonal adjustment.

Box 4.2 Capital Flows Towards Turkey and Emerging Economies in 2013: Effects of the Fed's Policy Change

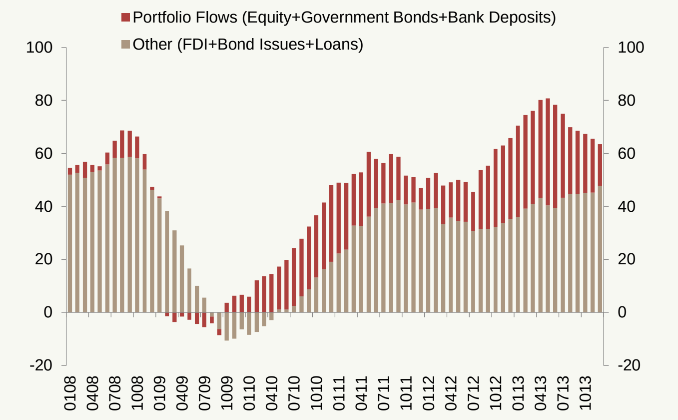
In the post-crisis period, additional monetary easing measures taken by central banks of advanced economies, particularly the Fed, invigorated the expectations that low interest rate and ample liquidity conditions would be maintained for a long time in these economies. This caused an improvement in global risk perceptions and an increased attraction of investors to risky assets with high returns. Meanwhile, given the low course of economic growth in advanced economies, the high growth performance and the relatively high interest rates in emerging economies supported this trend and accelerated portfolio flows to emerging economies, particularly Turkey. However, two major developments that adversely affect the capital flows towards emerging economies and Turkey have been experienced since the global crisis in 2008:

1) In the third quarter of 2011, increased concerns over the sustainability of public debt in the Euro Area, particularly Greece, led to marked downside risks in the global economy. Accordingly, capital flows towards emerging economies lost pace in tandem with the deterioration in the risk appetite, which adversely affected the capital flows towards Turkey as well.

2) In May 2013, the Fed announced that asset purchases, the major pillar of its quantitative easing policy, would be gradually cut and terminated in mid-2014. The associated uncertainty regarding the normalization of the Fed's monetary policy strengthened the perception that the ample liquidity conditions in global markets would end. This caused capital outflows from emerging economies, including Turkey, with high external financing needs.

Against this background, this box gives an analysis of the effects of the Fed's decisions regarding the normalization of its monetary policy and its resort to forward guidance on the capital flows to Turkey and emerging economies across 2013.

Chart 1. Capital Flows to Turkey
(12-Month Cumulative, Billion USD)



Source: CBRT.

Chart 2. Subcategories of Capital Flows Unaffected by the Fed's Decision
(12-Month Cumulative, Billion USD)

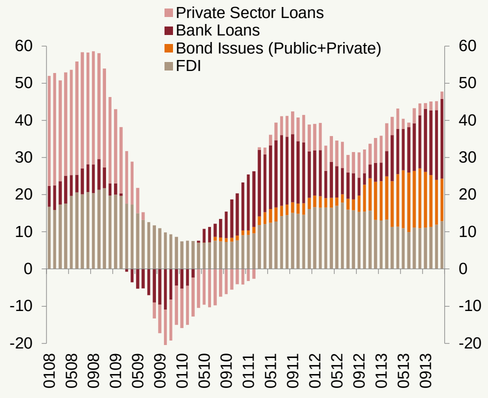
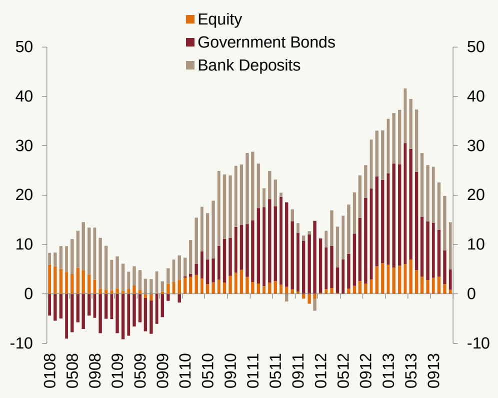


Chart 3. Subcategories of Capital Flows Affected by the Fed's Decision
(12-Month Cumulative, Billion USD)



Source: CBRT.

Chart 1 shows the subcategories of capital flows towards Turkey on an annual basis. Accordingly, three findings stand out for 2013. Firstly, capital flows displayed a steady and gradual increase until May 2013. Secondly, capital inflows started to decelerate as of May. Thirdly, this deceleration was not even across subcategories. This last finding needs further discussion. In other words, short-term financing items experienced outflows since May 2013 that have been driven by portfolio flows, which are composed of equity, government bonds and bank deposits. On the other hand, foreign direct investments, bond issues, bank loans and private sector loans, which are considered to be relatively reliable sources for the financing of the current account deficit in Turkey continued on a steady uptrend (Charts 2 and 3). Meanwhile, rollover ratios of long-term loans by banks and the private sector also increased following May. In fact, this ratio, which stood at 110 on average in the January-April period of 2013, went above 130 in the May-June period. Accordingly, even though total capital inflows lost pace due to portfolio flows after the Fed's announcement in May, financing of the current account deficit was mostly provided by long-term resources.

Meanwhile, other emerging economies also experienced portfolio outflows following the Fed's announcement in May. An analysis of 12-month cumulative portfolio flows reveals that these outflows were largely driven by equity and bonds, with more severe outflows in the latter. In this period, Turkey followed a course similar to other emerging economies with respect to outflows in equity funds, while experiencing a relatively lower outflow in bond funds.[4] Also, compared to the Euro Area crisis in 2011 when sudden capital outflows were experienced, Turkey saw a relatively limited effect on portfolio outflows (Charts 4 and 5).

[4] Some portion of the fall in portfolio investments towards emerging economies and Turkey were also driven by price changes.

Chart 4. Flows of Equity Funds
(12-Month Cumulative, Billion USD)

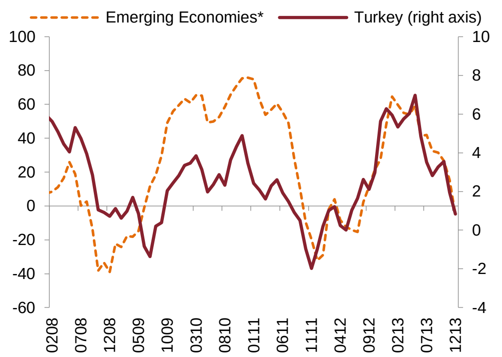
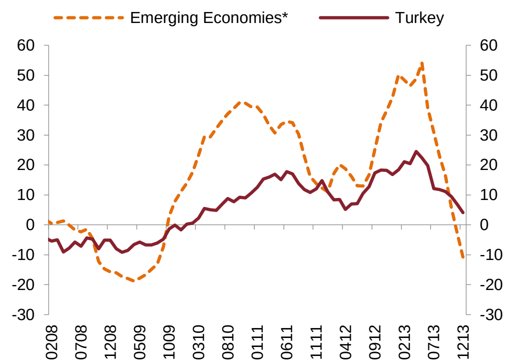


Chart 5. Flows of Bond Funds
(12-Month Cumulative, Billion USD)



* Includes 40 emerging economies with Brazil, China, Colombia, Hungary, Indonesia, Malaysia, Mexico, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand and Turkey having share above 2 percent.
Source: EPFR, CBRT.

In sum, following the Fed's announcement on its taper of asset purchases as part of a gradual exit from the quantitative easing policy, Turkey and other emerging economies experienced capital outflows in the second half of the year that were mostly driven by portfolio investments. Two major points stand out regarding capital flows towards Turkey in this period. Firstly, the deceleration in capital flows was mostly seen in short-term items like equity, bonds and deposits, while other main categories (loans, FDI, bond issues) did not experience a notable change. Secondly, equity and bond funds, which saw outflows, exhibited a less negative course compared to emerging economies. Accordingly, in terms of capital flows, Turkey did not unfavorably diverge from other emerging economies. These points indicate that capital flows towards Turkey and other emerging economies slowed mainly upon push factors (the deterioration in the global risk appetite) rather than country-specific pull factors in the second half of 2013. Hence, the Fed's decisions on normalizing its monetary policy are expected to remain as a determinant factor in the course of capital flows towards emerging economies.