



**TÜRKİYE CUMHURİYET
MERKEZ BANKASI**

The IMF - World Bank Annual Meetings

**Erdem Başçı
Governor**

October 2013

Overview

- Inflation is expected to fall further despite a temporary rise in core indicators due to the recent depreciation.
- The monetary policy reaction has been front-loaded and stronger than the rise in inflation expectations.
- Tighter liquidity policy coupled with macroprudential measures lead to a tightening in monetary and financial conditions, which will contain excessive growth in consumer loans.
- Leading indicators point to a moderate but more balanced economic growth in the second half of 2013.
- Growth will remain robust in the medium term thanks to strong capital formation, job creation, and labor force participation.

Contents

I. Inflation

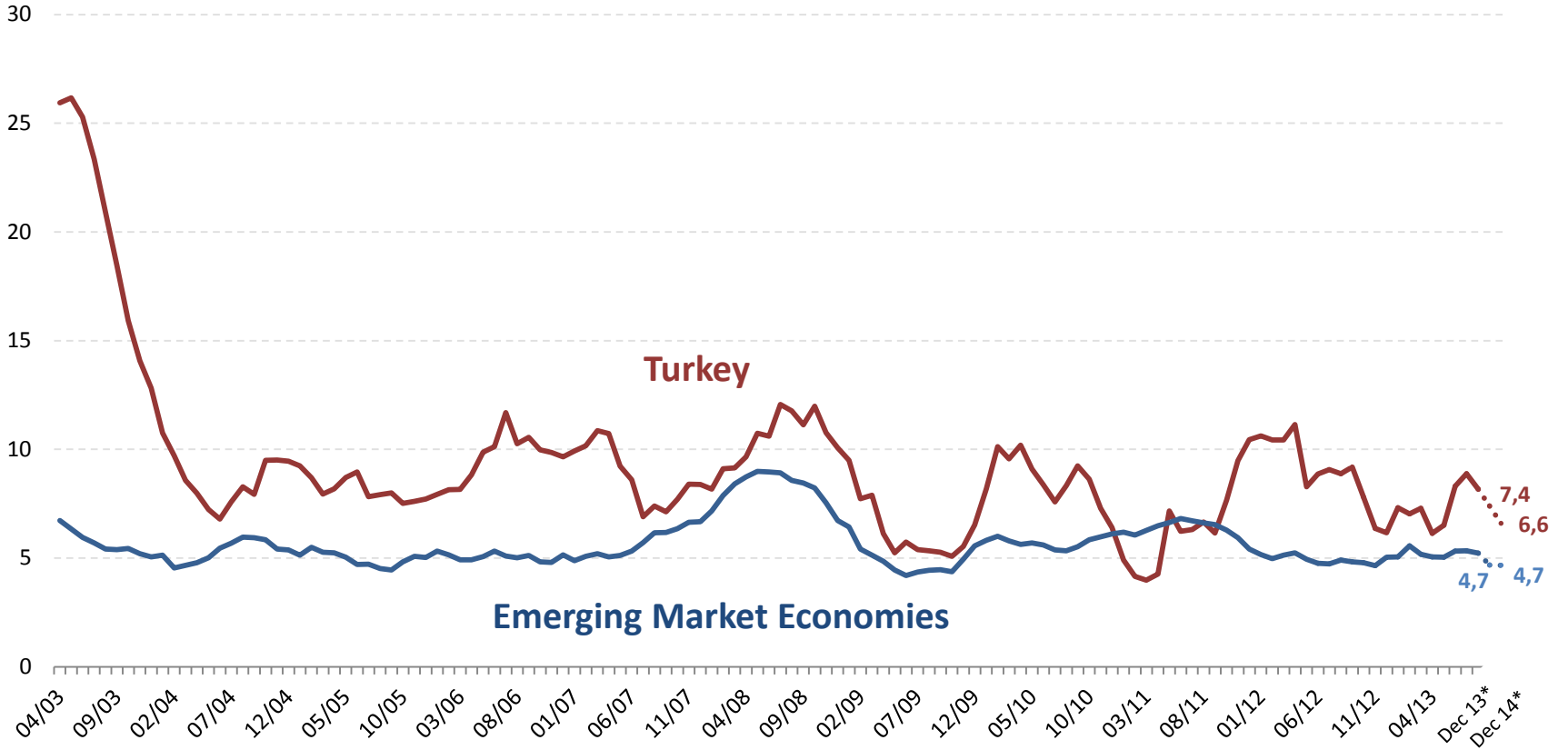
II. External Balance

III. Growth

INFLATION

Inflation...

Inflation in Turkey vs. Emerging Market Economies (Percent, Weighted Average)

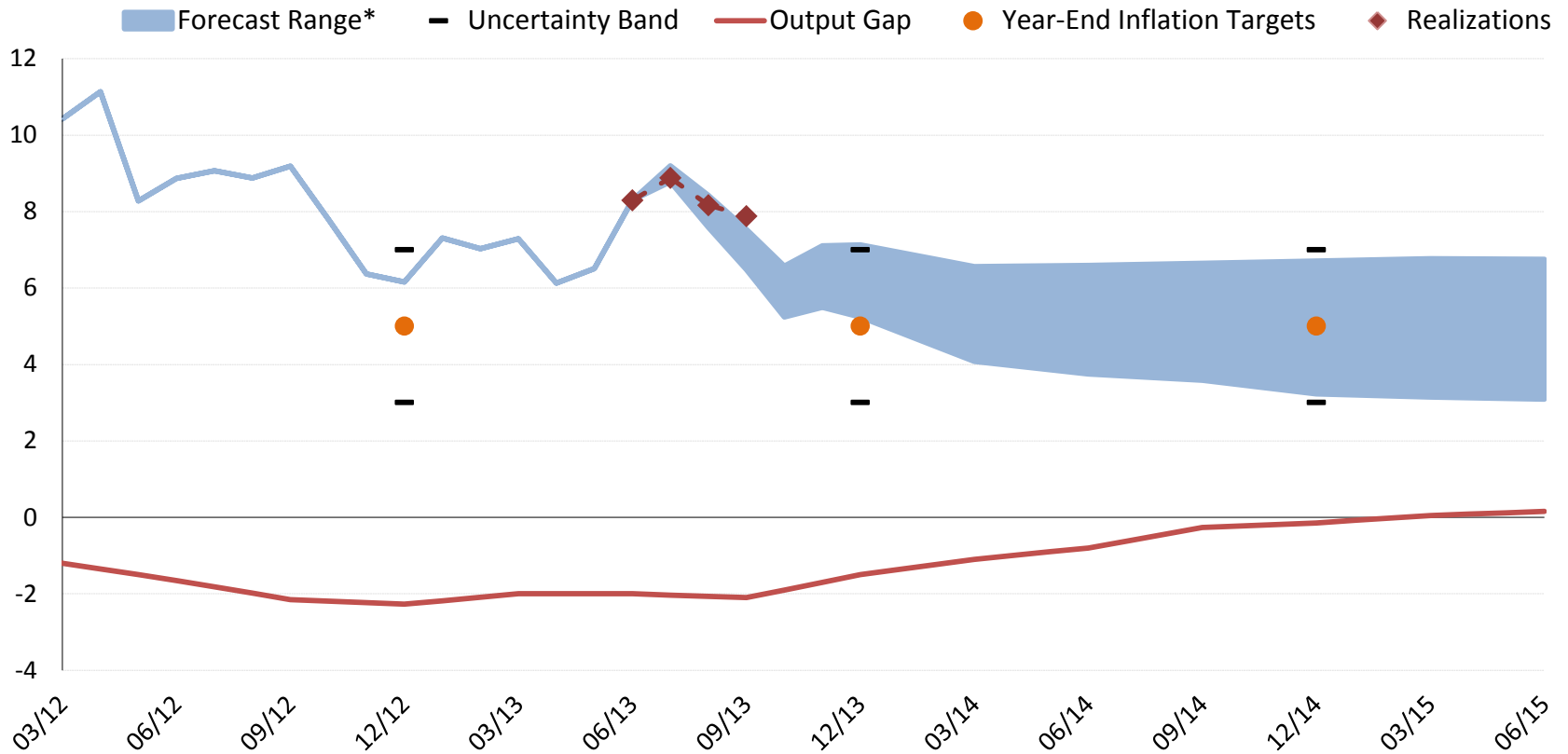


Source: Bloomberg, CBRT.

Emerging Market Economies: Brazil, Mexico, Czech Rep., Hungary, Poland, S. Africa, China, India, Russia, Turkey, Indonesia, Argentina, Thailand, Malaysia, Colombia, Romania, Ukraine, Vietnam, Chile, Peru, Egypt, Morocco, Lebanon, S. Arabia . *Forecasts for end-2013 and end-2014 are taken from "Consensus Forecasts".

... is expected to fall further,

Inflation Forecasts and Realizations (Percent)

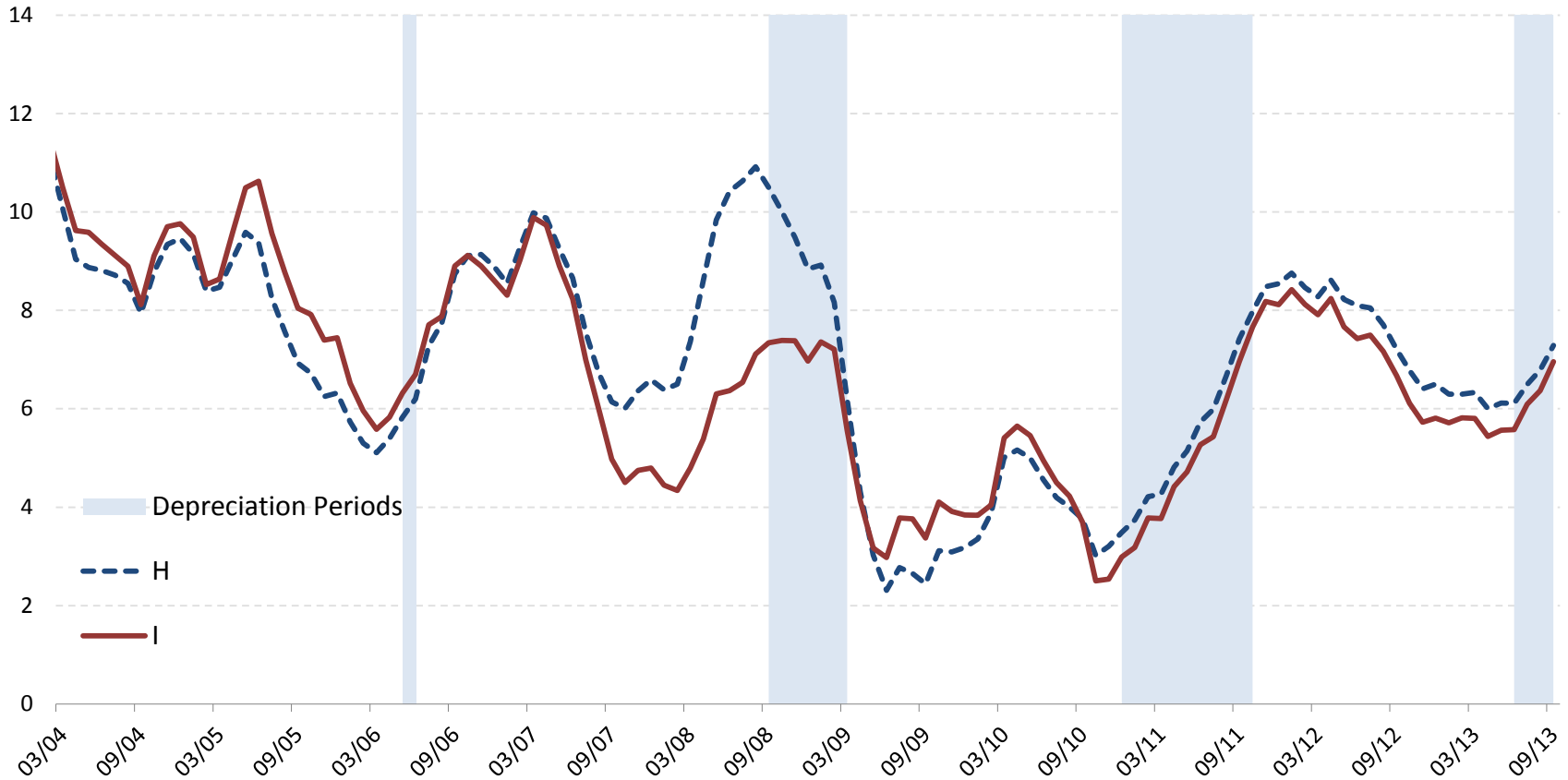


Source: CBRT.

*Shaded region indicates the 70 percent confidence interval for the forecast.

... despite a temporary rise in core indicators,

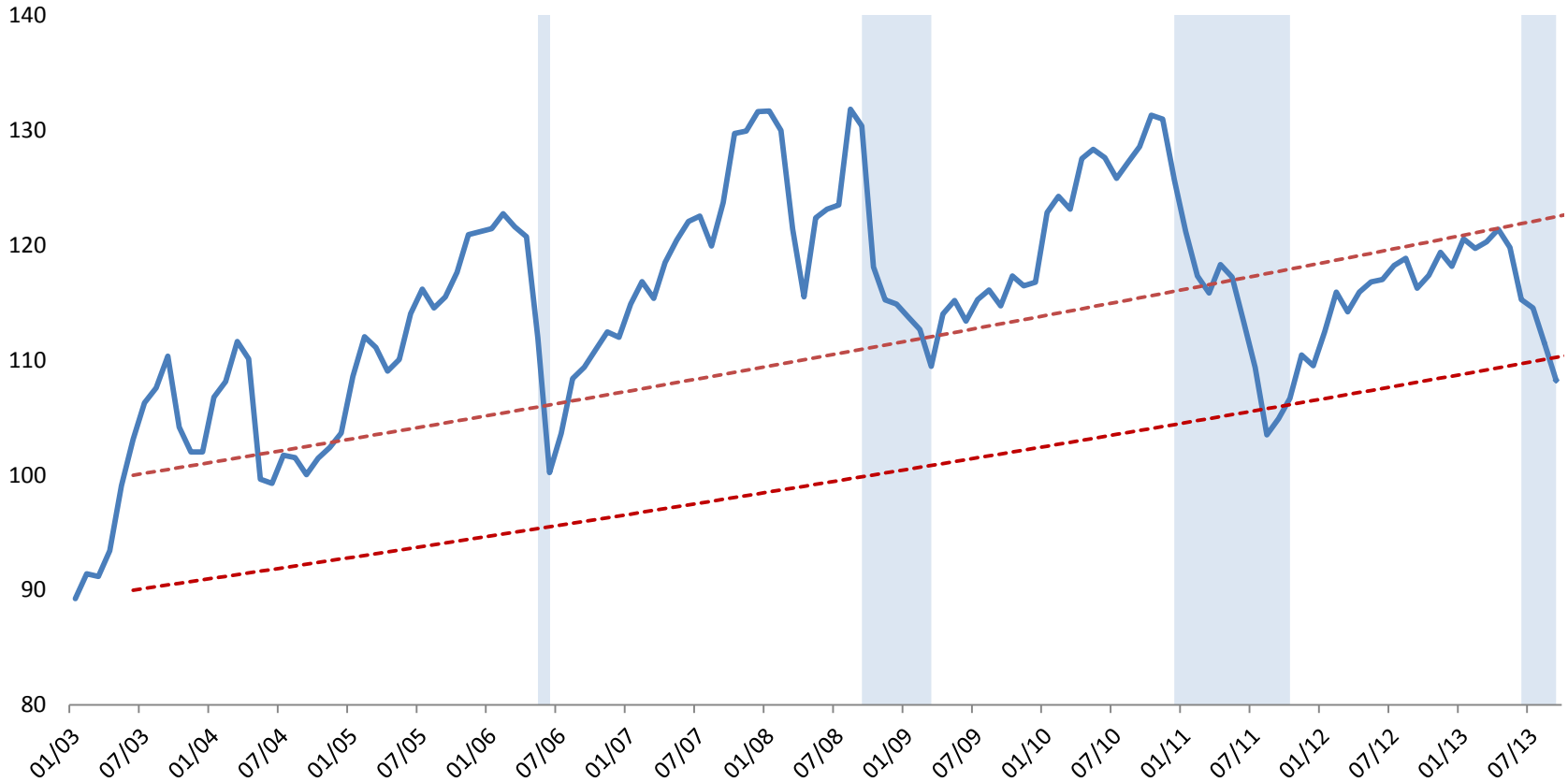
Core Indicators (Annual Change, Percent)



Source: Turkstat, CBRT.

... due to the recent depreciation.

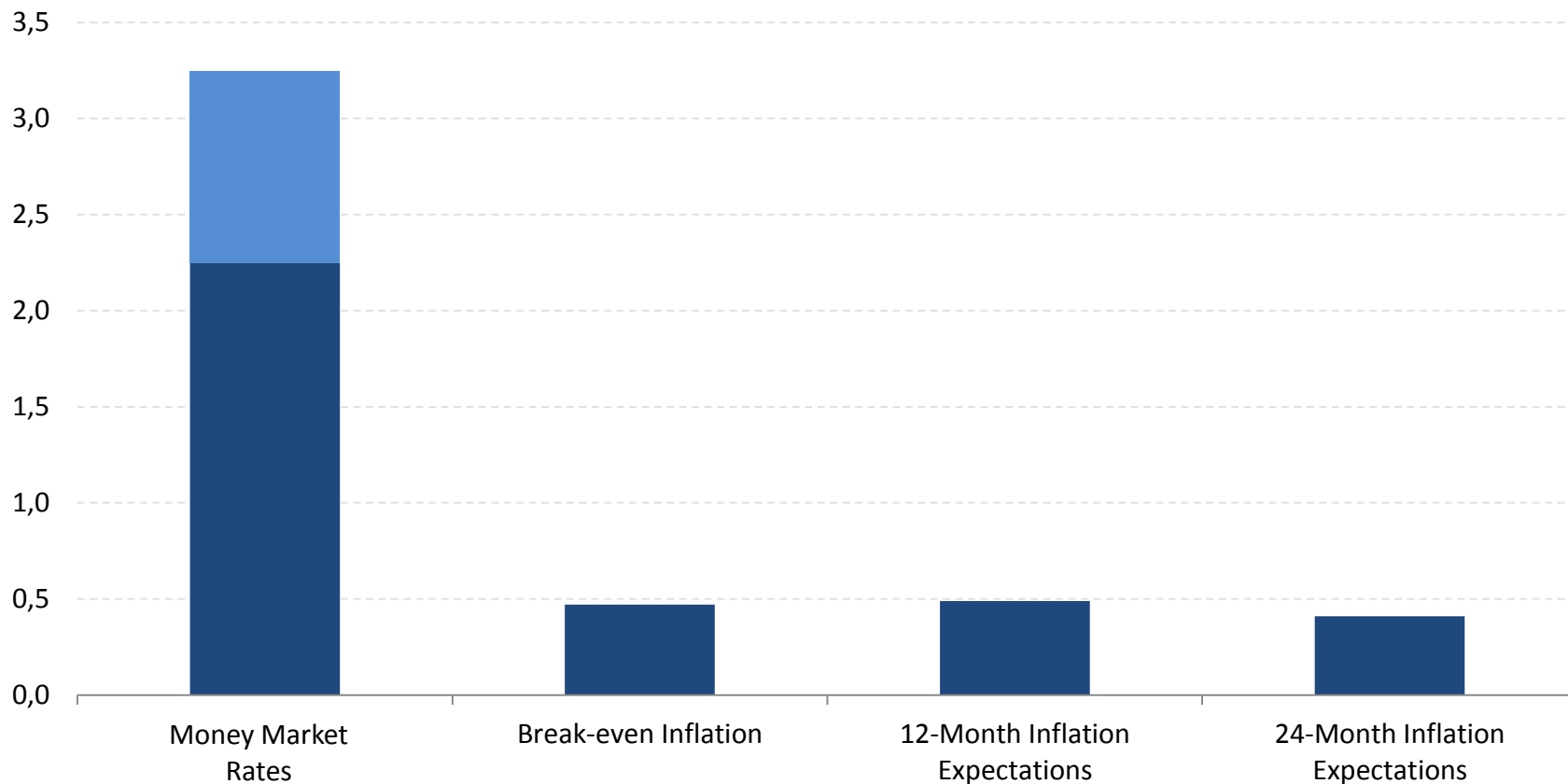
CPI Based Real Effective Exchange Rate (Base Year: 2003)



Source: CBRT.

The monetary policy reaction has been front-loaded...

Change in Key Variables (Percent, from May 22 to October 9)

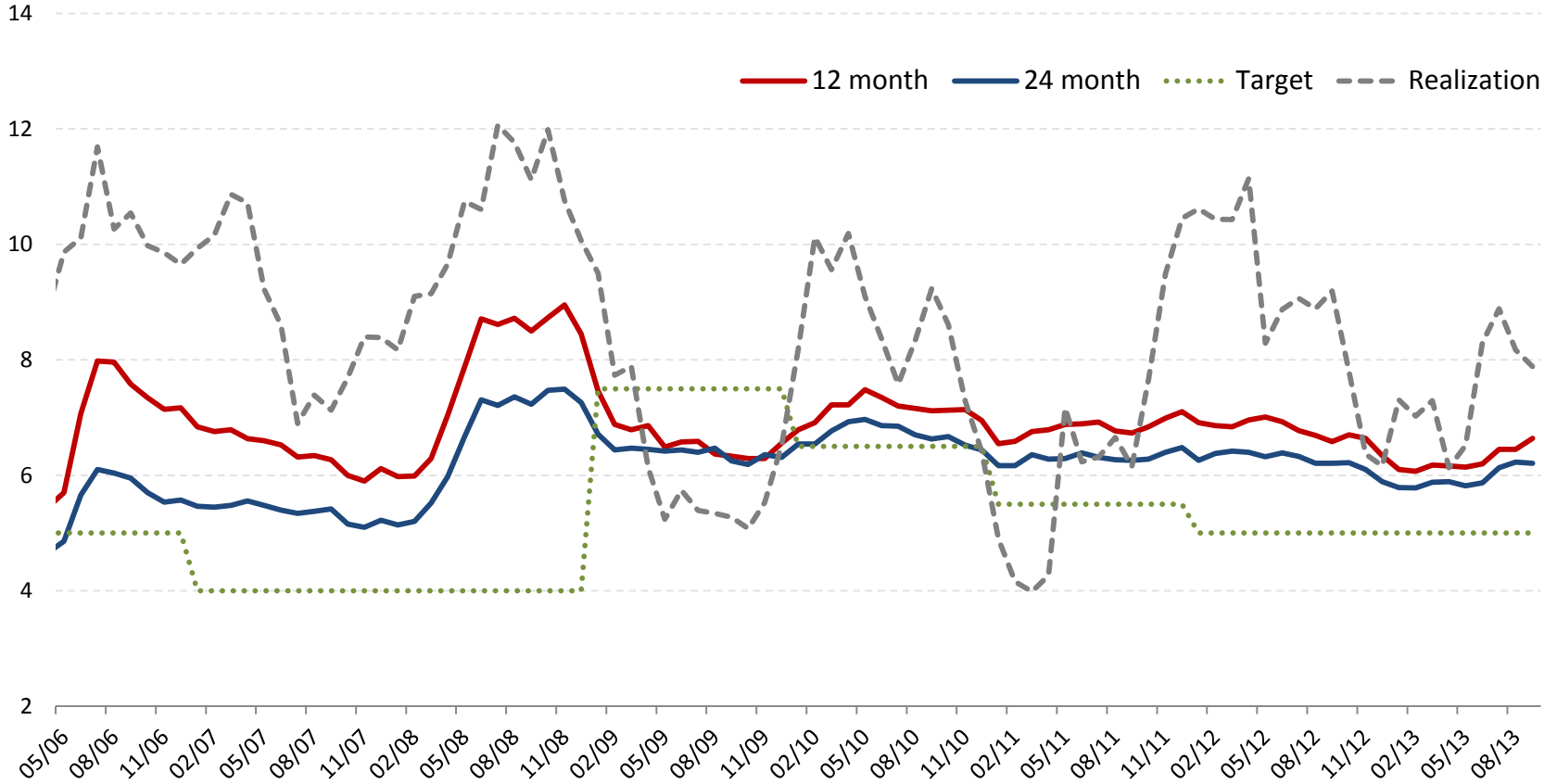


Source: CBRT.

*Light blue area corresponds to the margin for additional tightening.

... and stronger than the rise in inflation expectations.

Medium Term Inflation Expectations* (Percent)

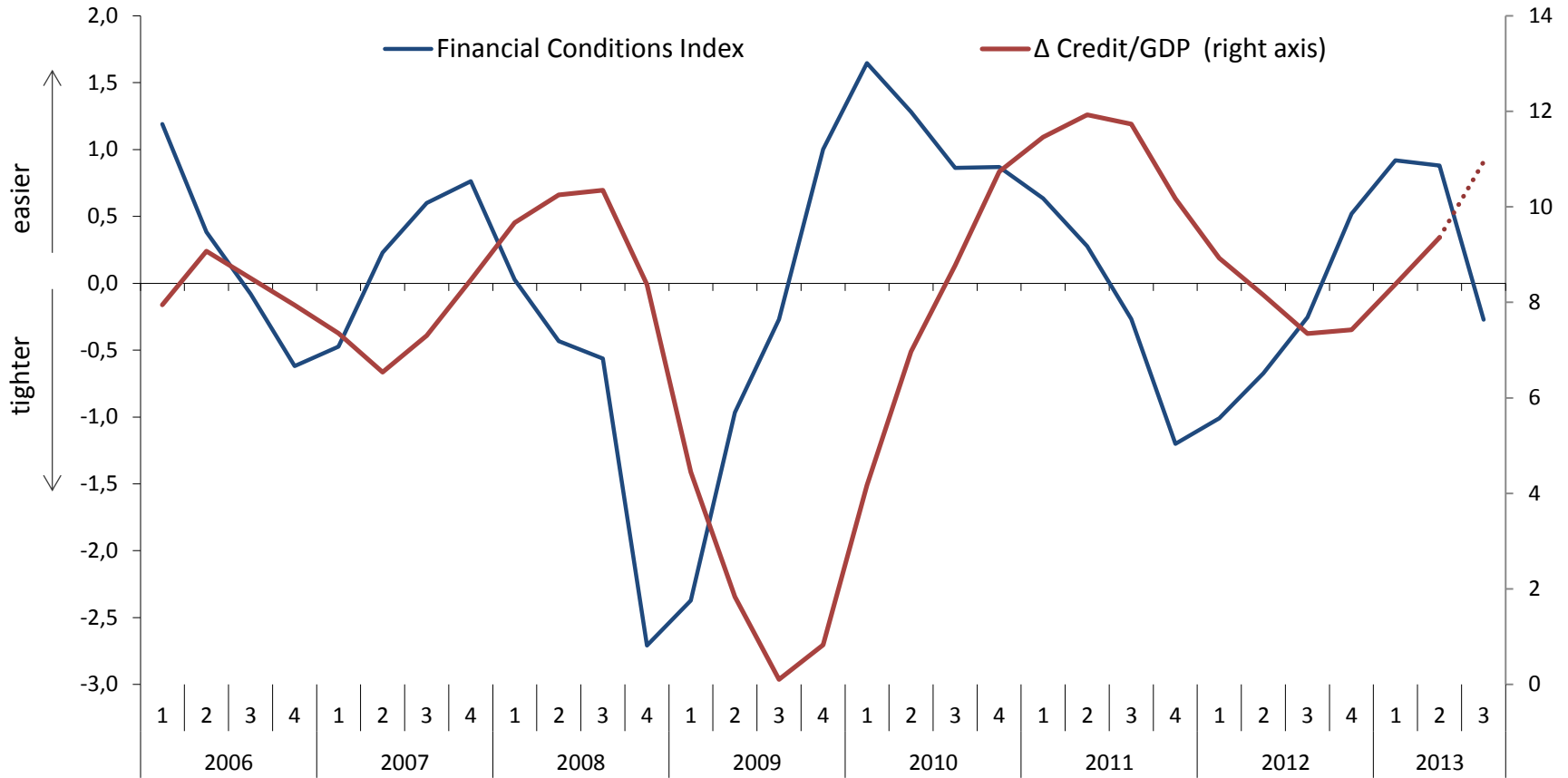


Source: Turkstat, CBRT.

*CBRT Survey of Expectations.

Financial conditions have tightened...

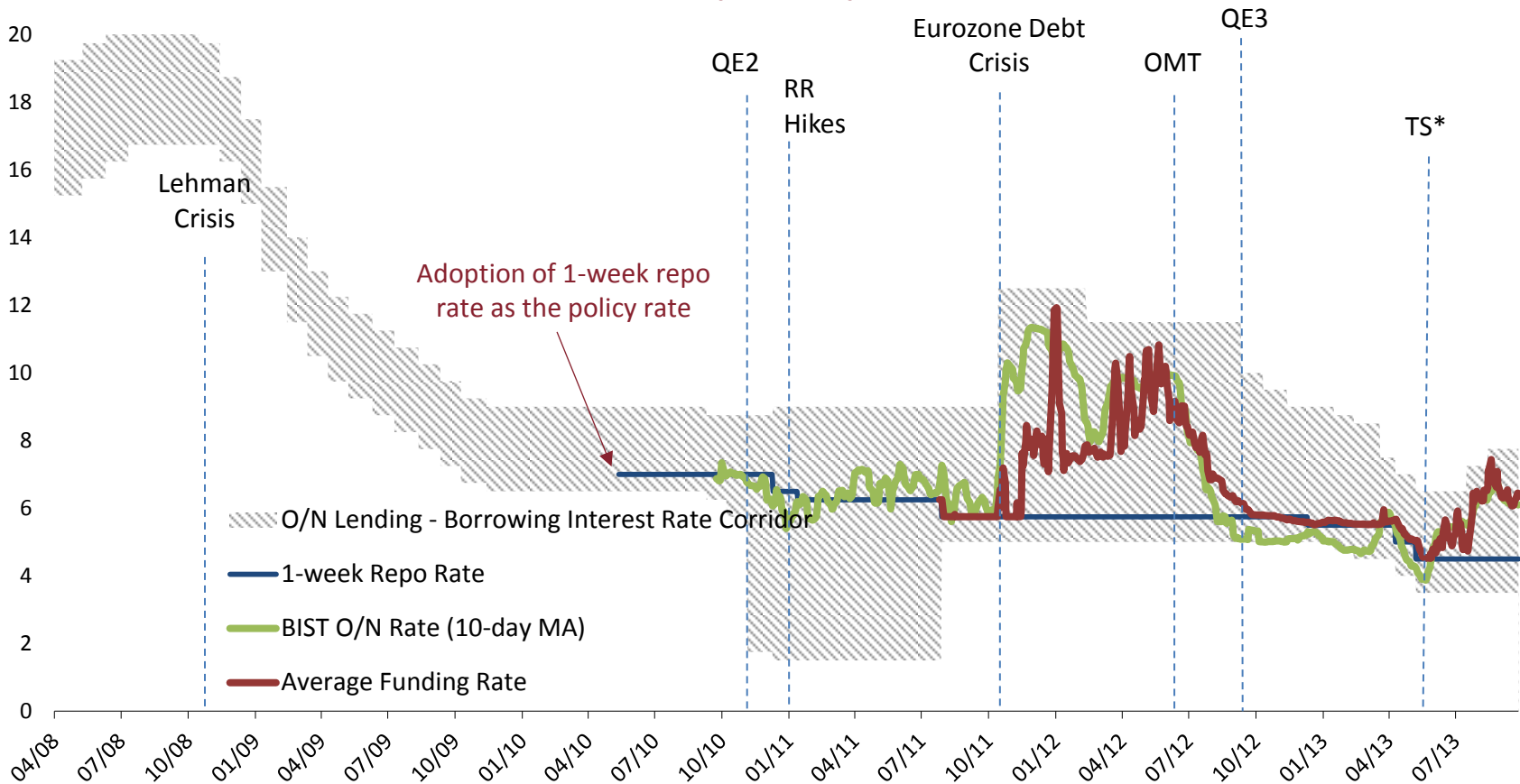
Financial Conditions Index and Change in Credit (Ratio to GDP, Percent)



Source: CBRT.

... due to a tighter liquidity policy,

Interest Rate Corridor and Average Funding Rate (Percent)

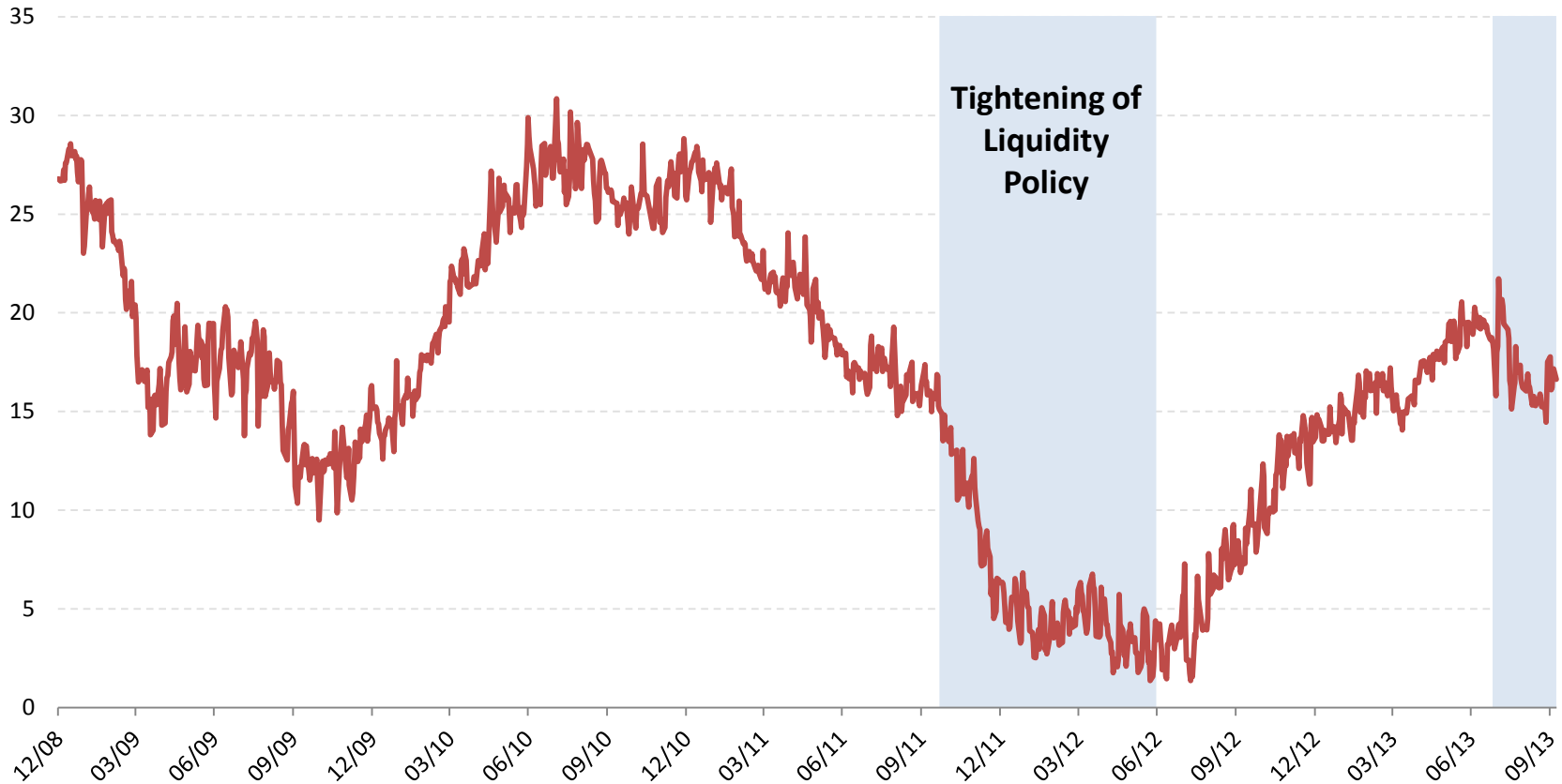


Source: BIST, CBRT.

*TS: Tapering Signal
Last observation: 02.10.2013

... which will contain money growth,

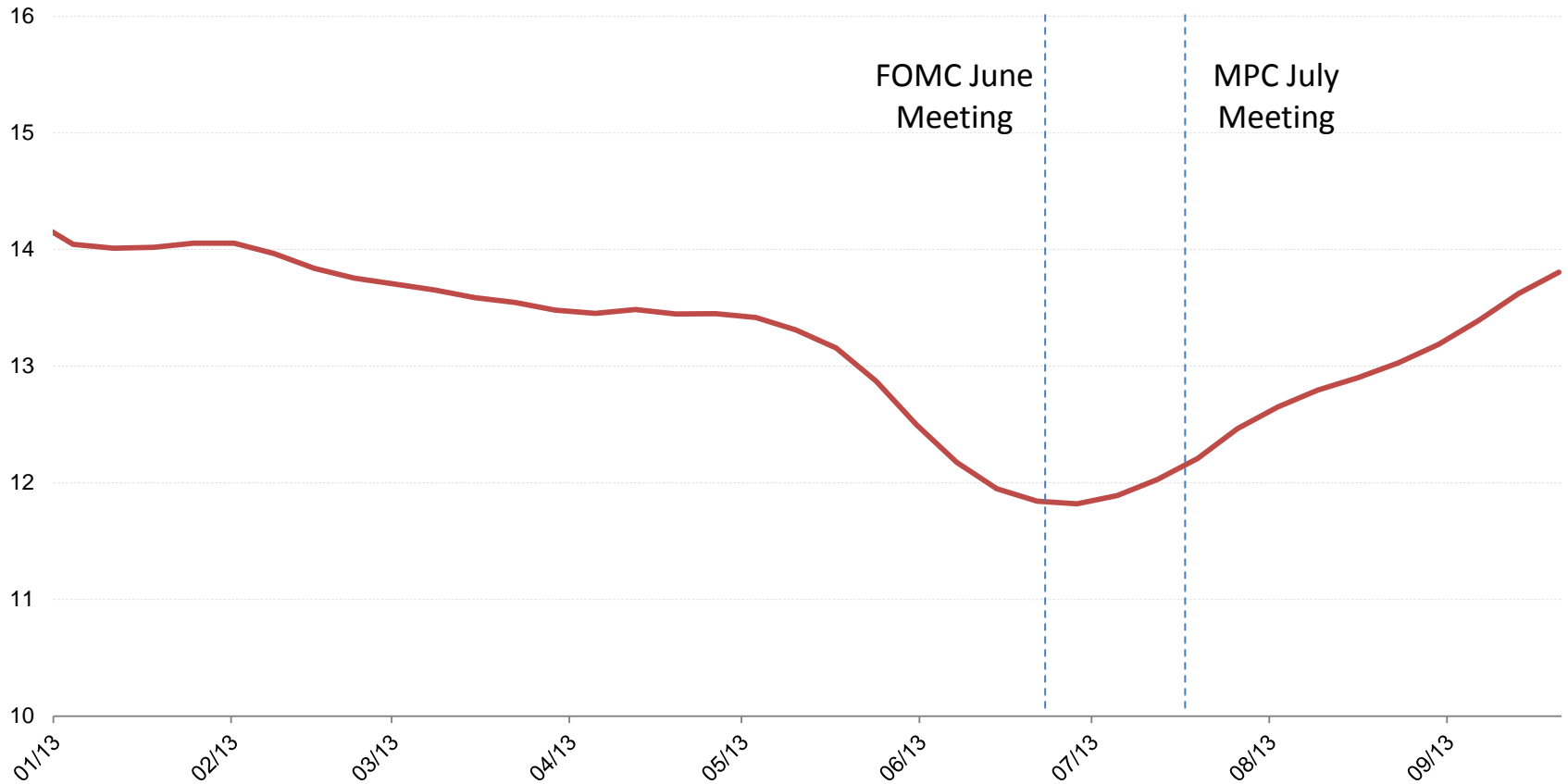
Turkish Lira Deposit Growth (Annual Change in Bank Deposits, Percent)



Source: CBRT.

... as well as excessive growth in consumer loans.

Consumer Loan Rates* (4-Weeks MA, Percent)

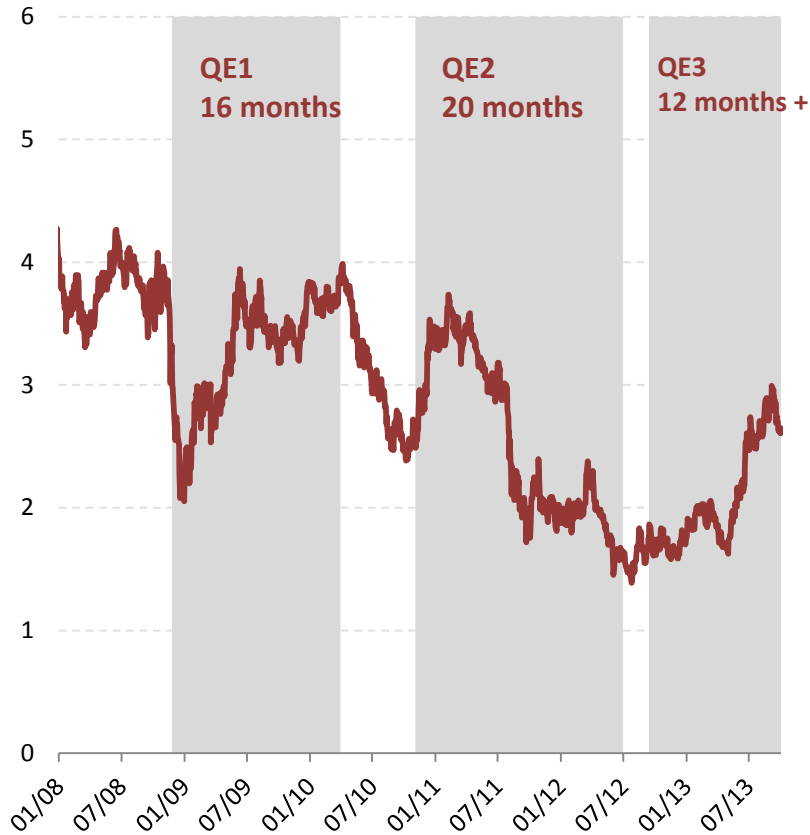


Source: CBRT.

*Excluding mortgage and auto loans.

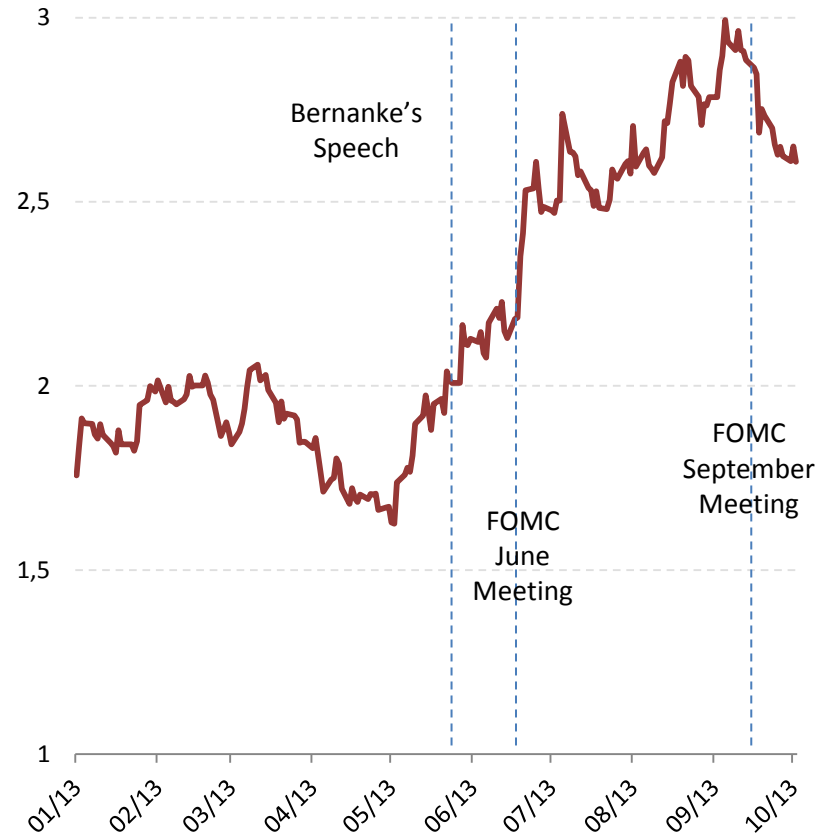
External financial conditions have also tightened...

10 Year US Govn. Bond Yields (2008-2013, Percent)



Source: Bloomberg.

Last observation: 02 October 2013

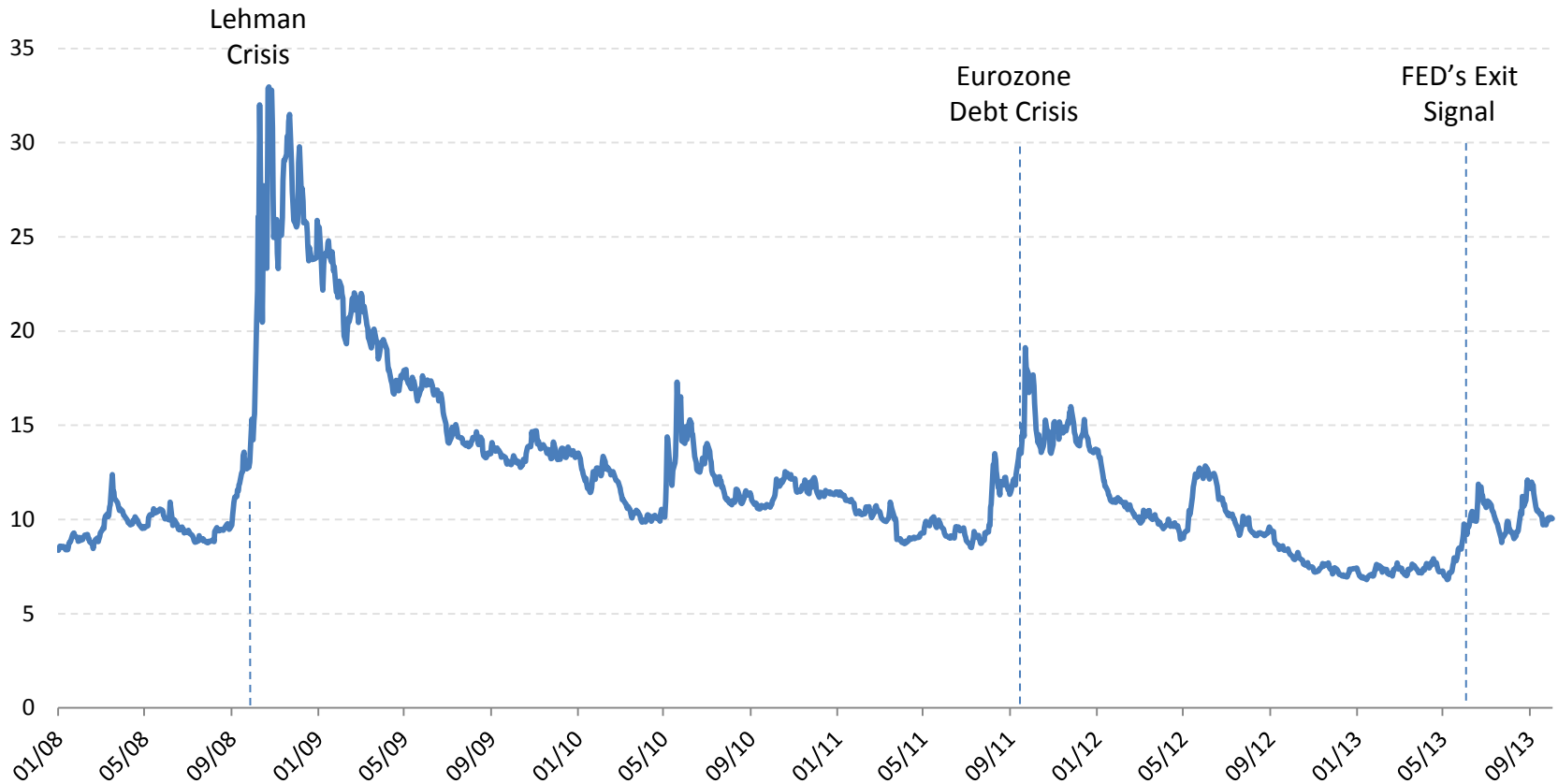


Source: Bloomberg.

Last observation: 02 October 2013

... with some impact on exchange rate volatility,

Exchange Rate Volatility Index

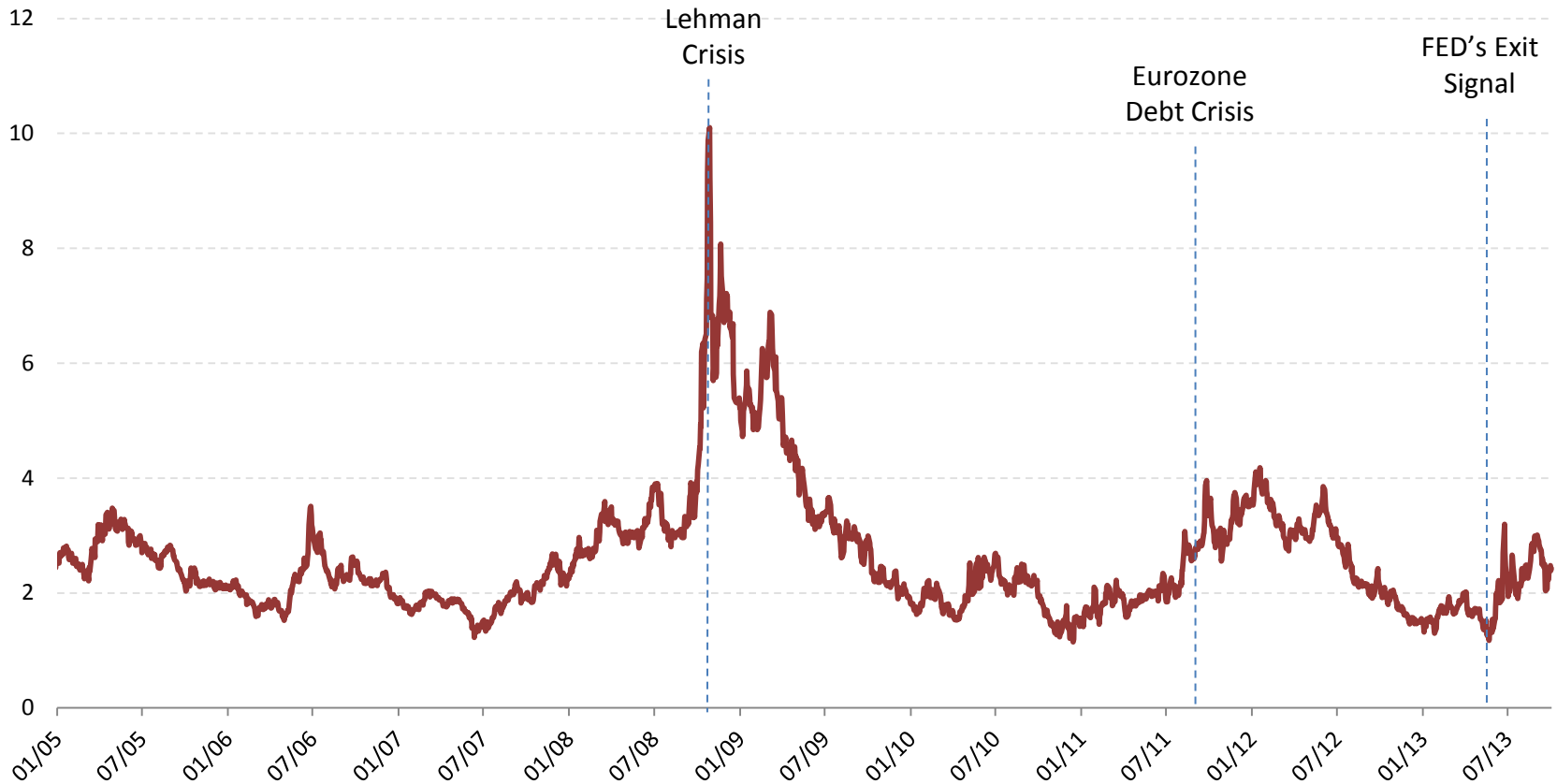


Source: Bloomberg, JPMVXYEM Index.

Last observation: 02 October 2013

... and risk premium,

Difference Between Turkey-USA 10-Year Bond Rates (Percent)

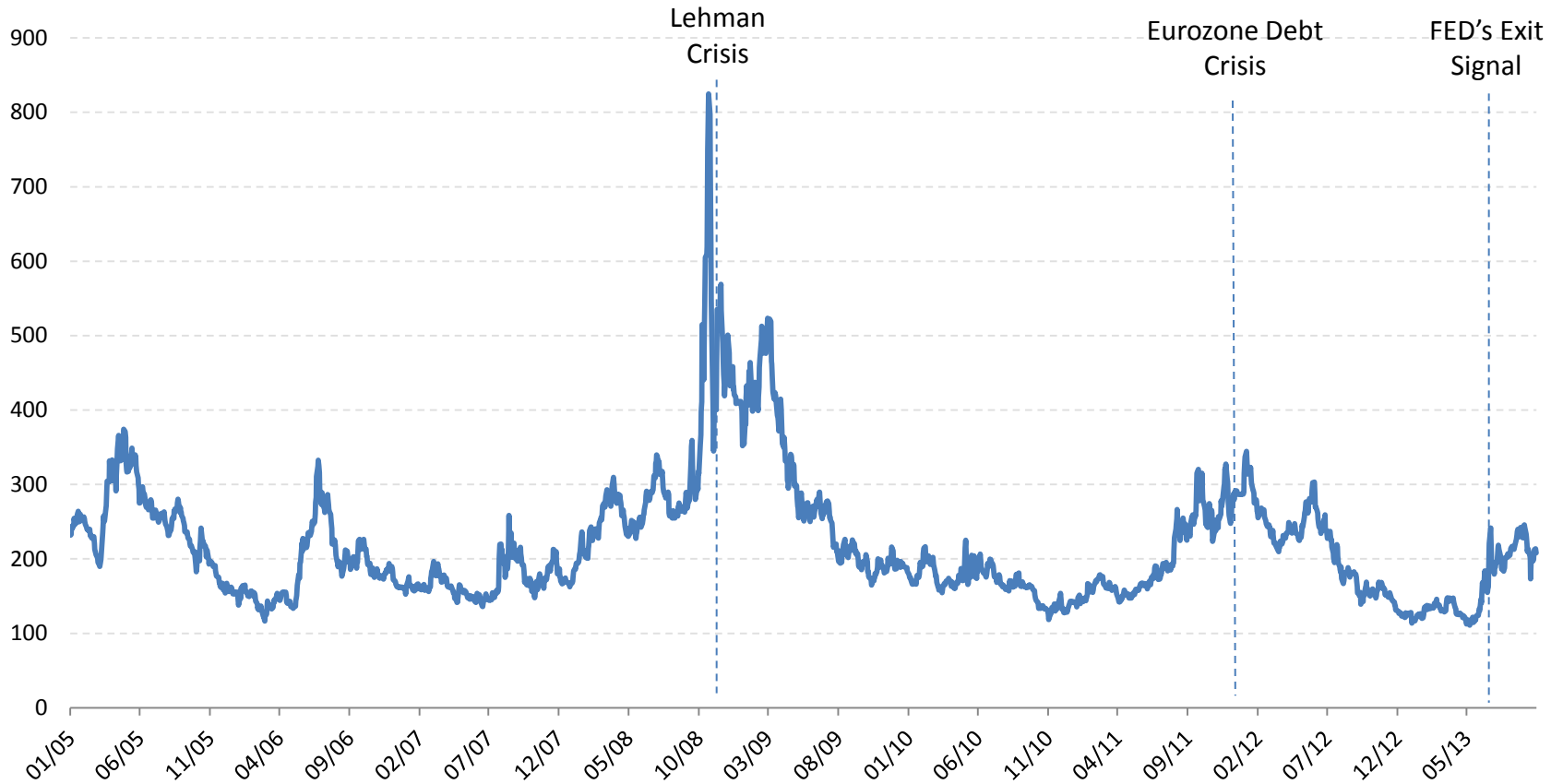


Source: Bloomberg, CBRT.

Last observation: 02 October 2013

... in emerging market economies, including Turkey.

Turkey 5-Year CDS Prices

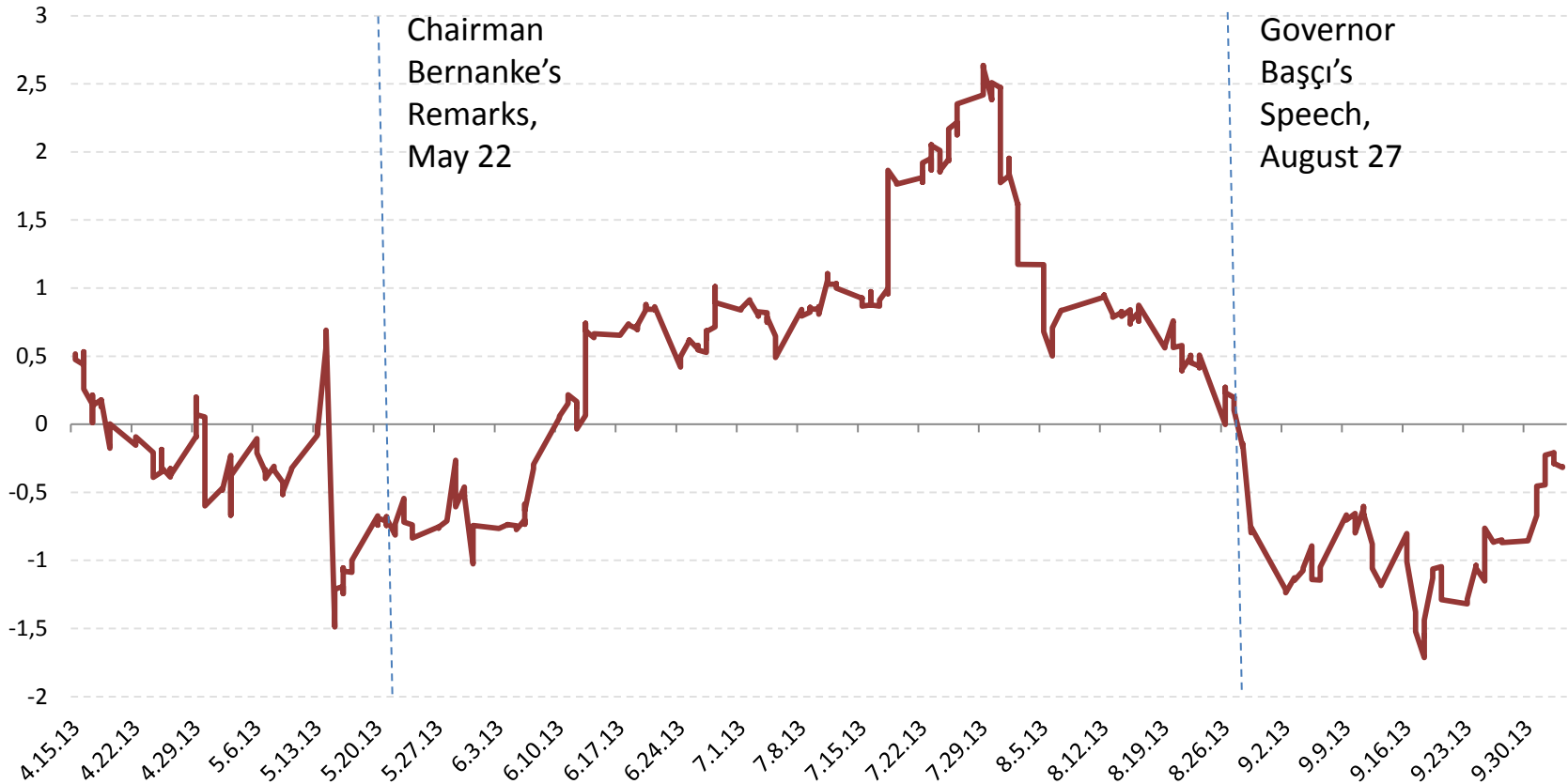


Source: Bloomberg, CBRT.

Last observation: 01 October 2013

Forward guidance in August helped reduce the systematic risk of Turkish Lira bonds.

Beta for Turkish 3-Month Bond Yields* (10-day moving window)



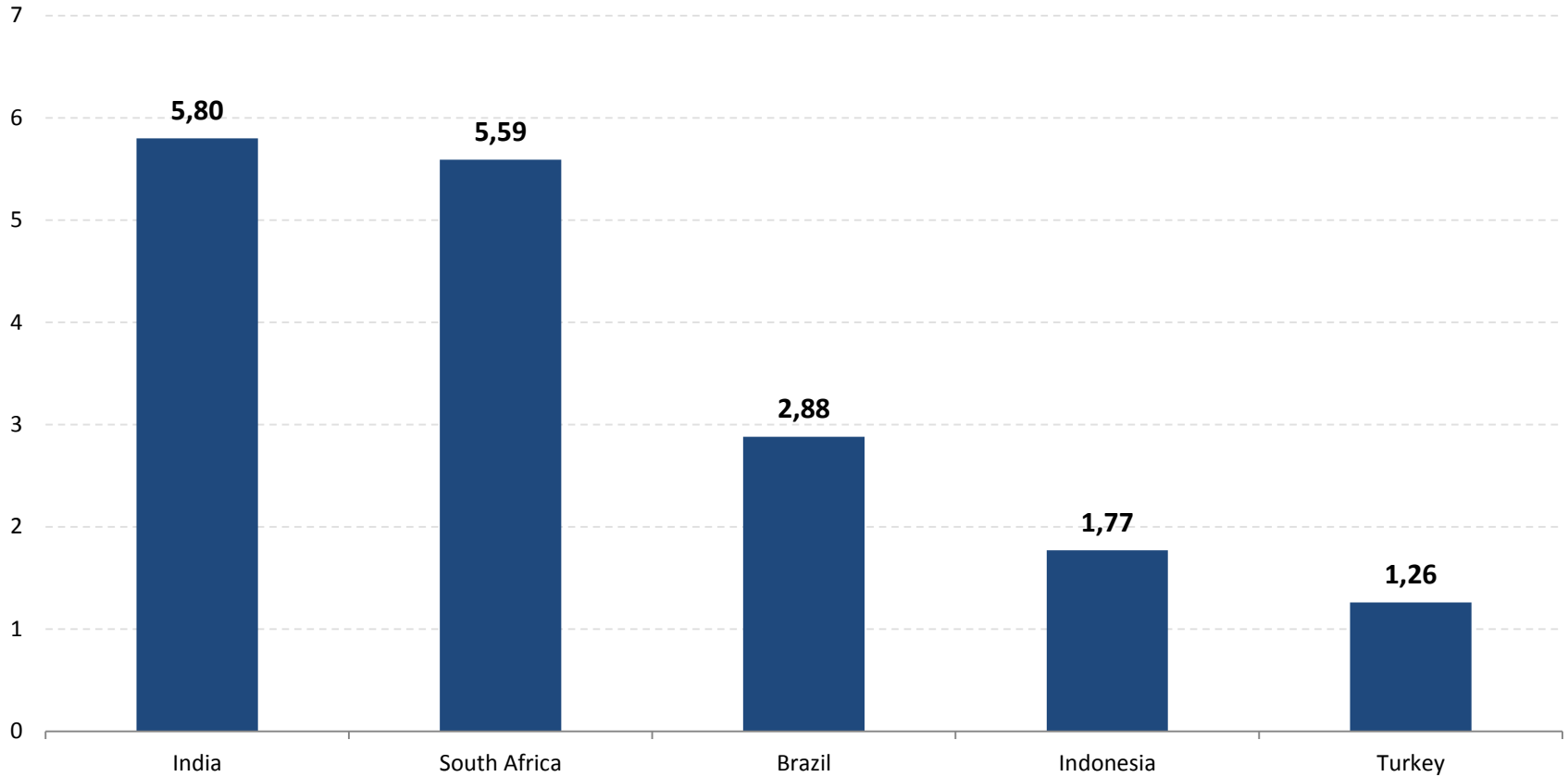
Source: Bloomberg, CBRT.

*Beta is the coefficient of the US 10Y Bond returns in the following regression; $\Delta r_{TL} = \alpha + \beta \Delta r_{us} + \epsilon$

EXTERNAL BALANCE

Turkey's external deficit is mainly due to private borrowing.

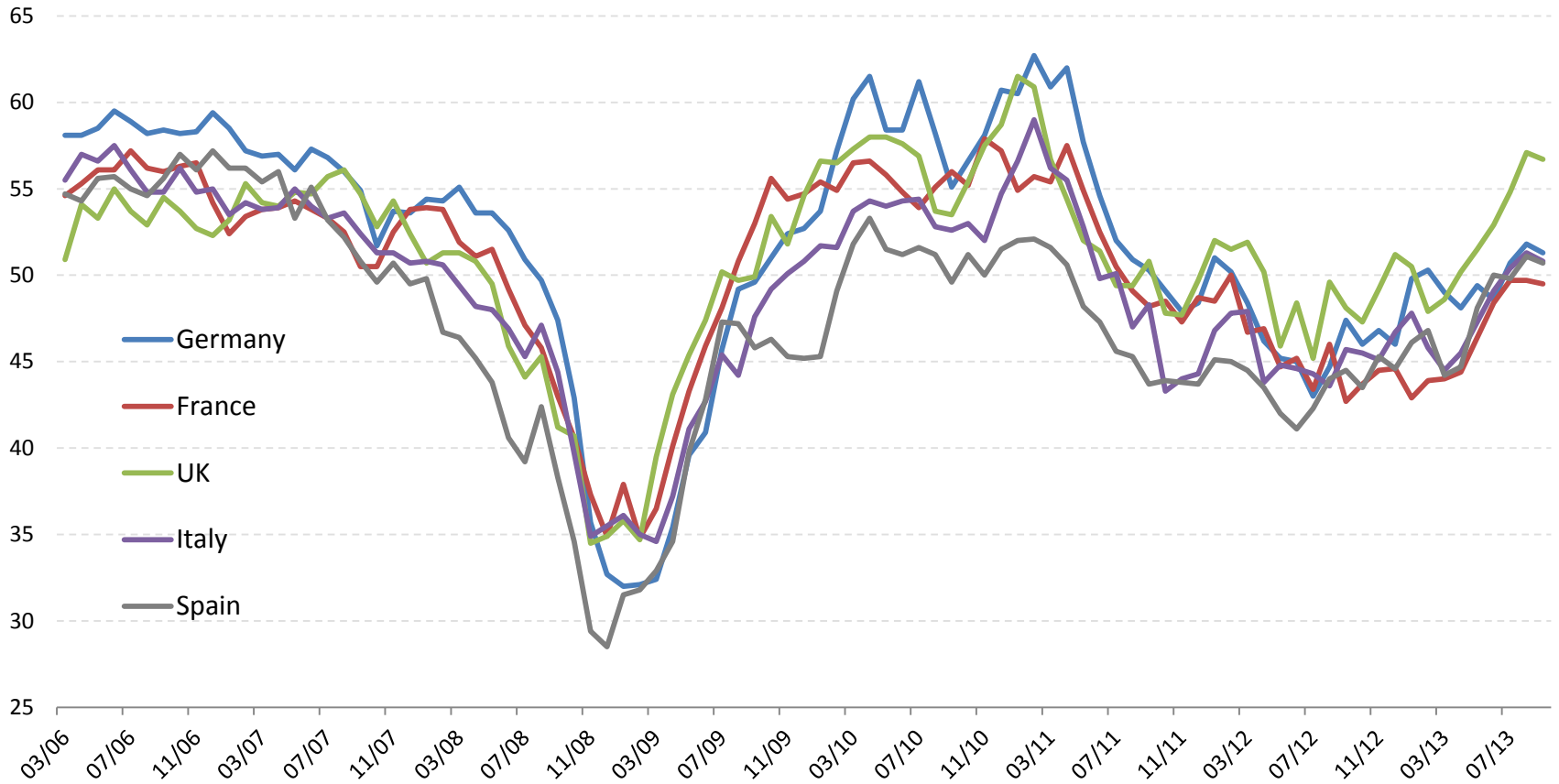
Budget Deficit
(As of June 2013, Ratio to GDP, Percent)



Source: IMF Fiscal Monitor, MTP.

Signs of recovery in Europe ...

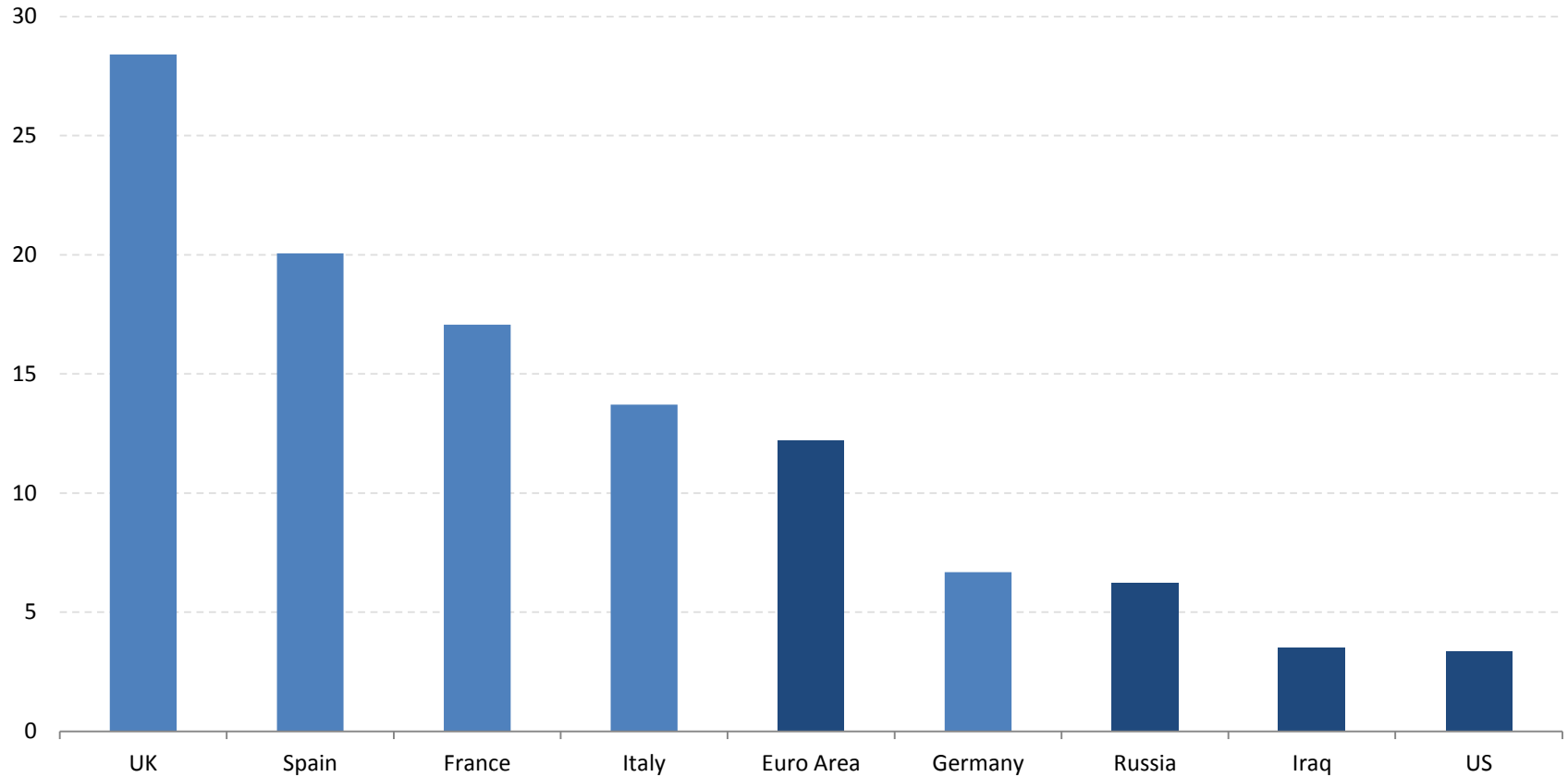
Manufacturing PMI in Europe



Source: MARKIT

... boost Turkish exports to the region,

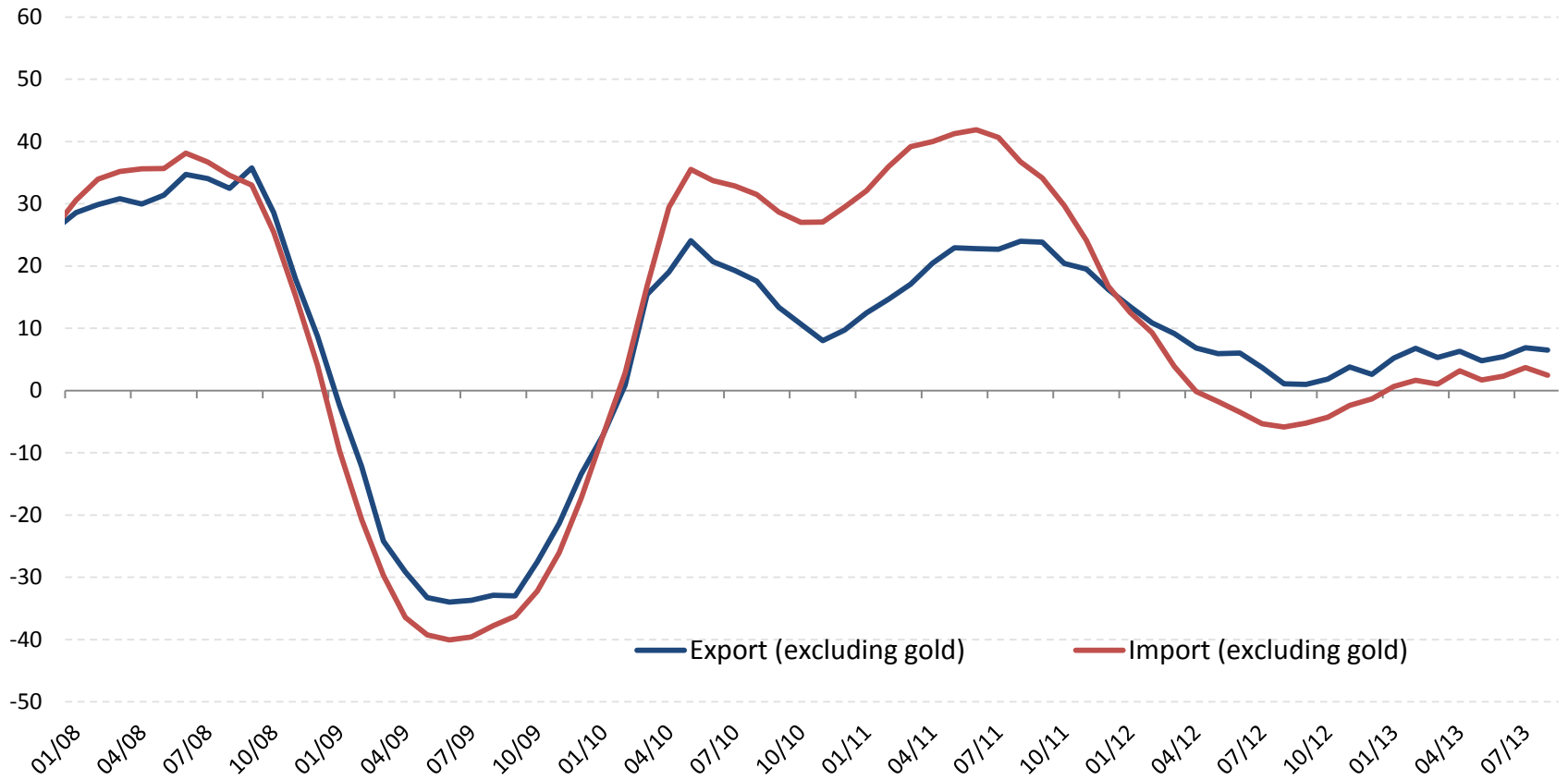
Exports to Main Trade Partners (YoY Change for September, Percent)



Source: TİM, CBRT.

... contributing to the ongoing rebalancing process.

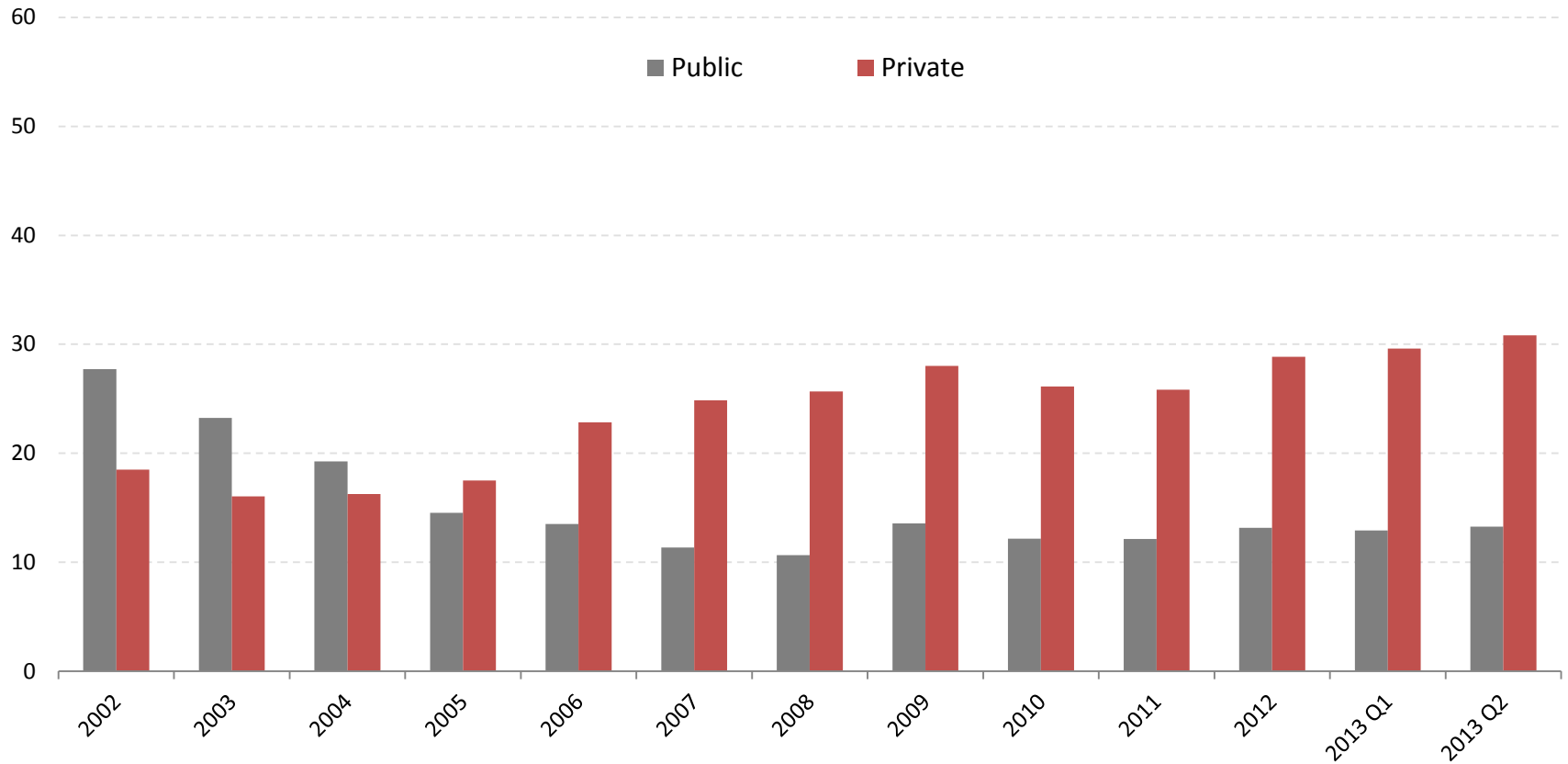
Exports and Imports (Nominal, 6-Month MA, YoY % Change)



Source: Turkstat.

Current account balances are driven by private borrowing...

Public and Private Sector External Debt (Ratio to GDP, Percent)

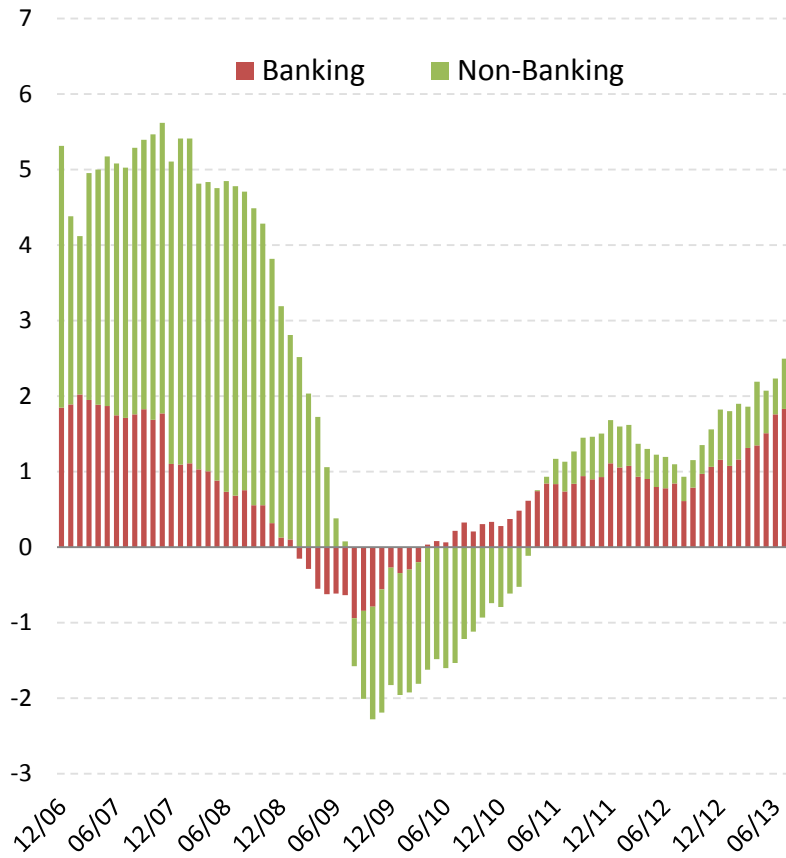


Source: CBRT.

... which is based more on bank funding,

Long-Term Borrowing

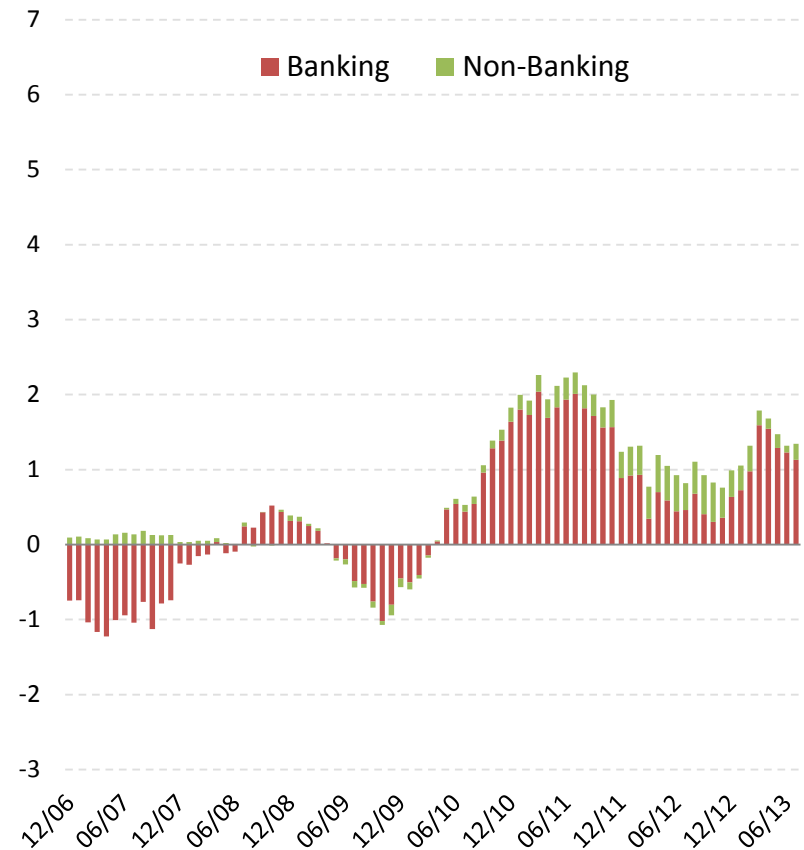
(12-Month Cumulative, Ratio to GDP, Percent)



Source: CBRT.

Short-Term Borrowing

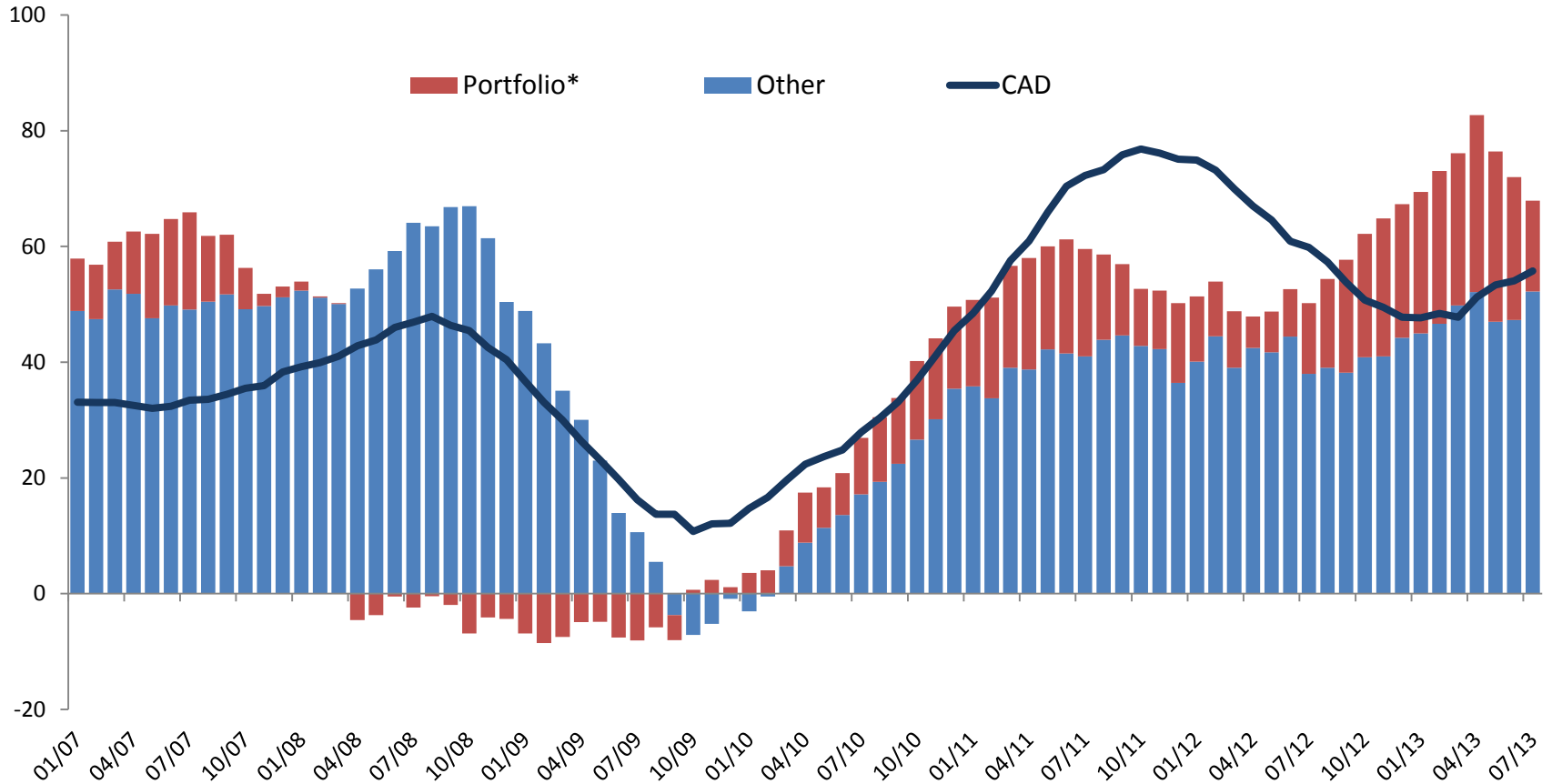
(12-Month Cumulative, Ratio to GDP, Percent)



Source: CBRT.

... and less on portfolio flows.

Main Sources of Current Account Deficit Finance (12-Month Cumulative, Billion USD)

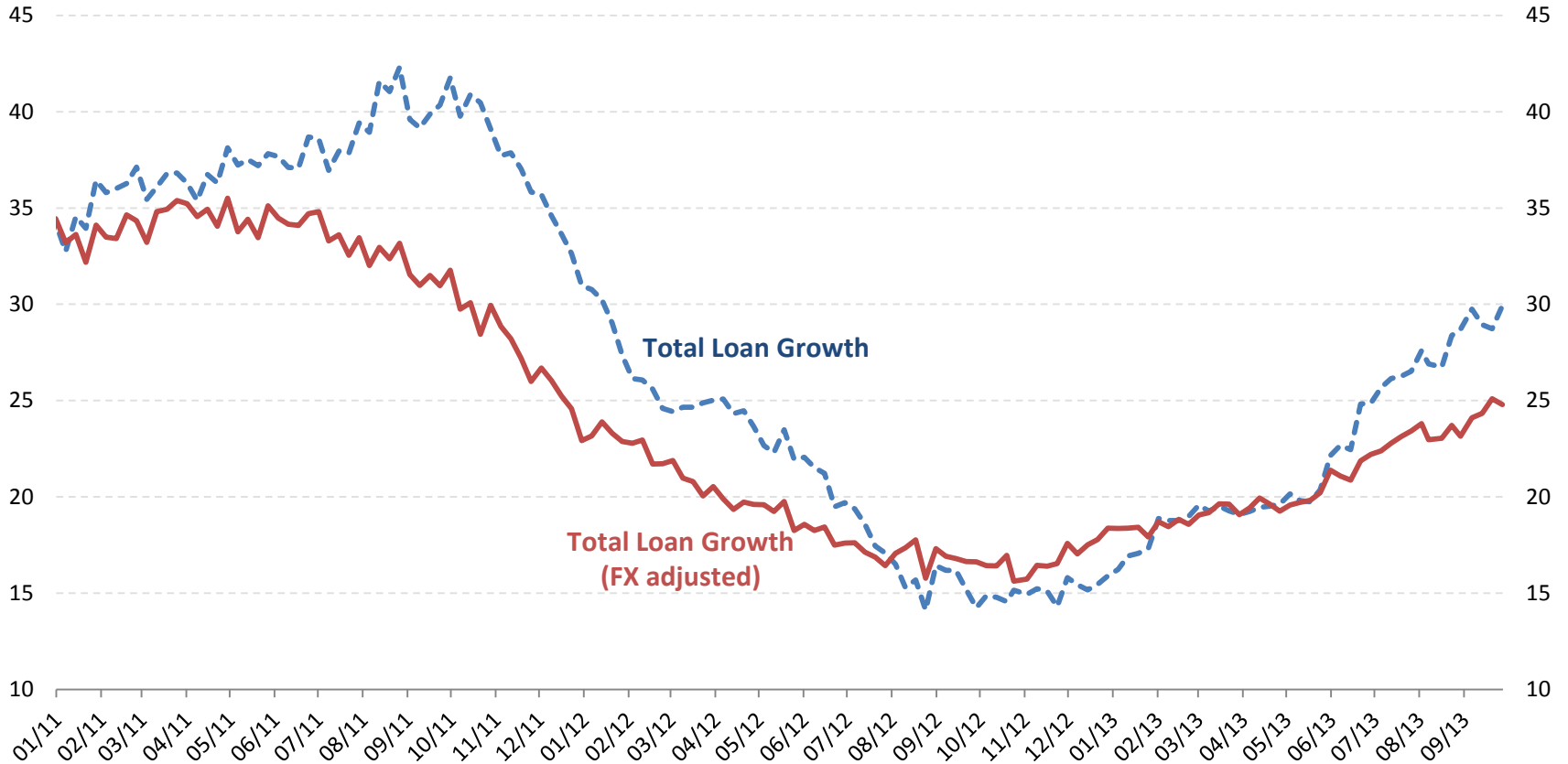


Source: CBRT.

*Portfolio includes equities and domestic government bonds.

Thereby, increasing domestic credit growth ...

Total Loan Growth Rates* (YoY Change, Percent)

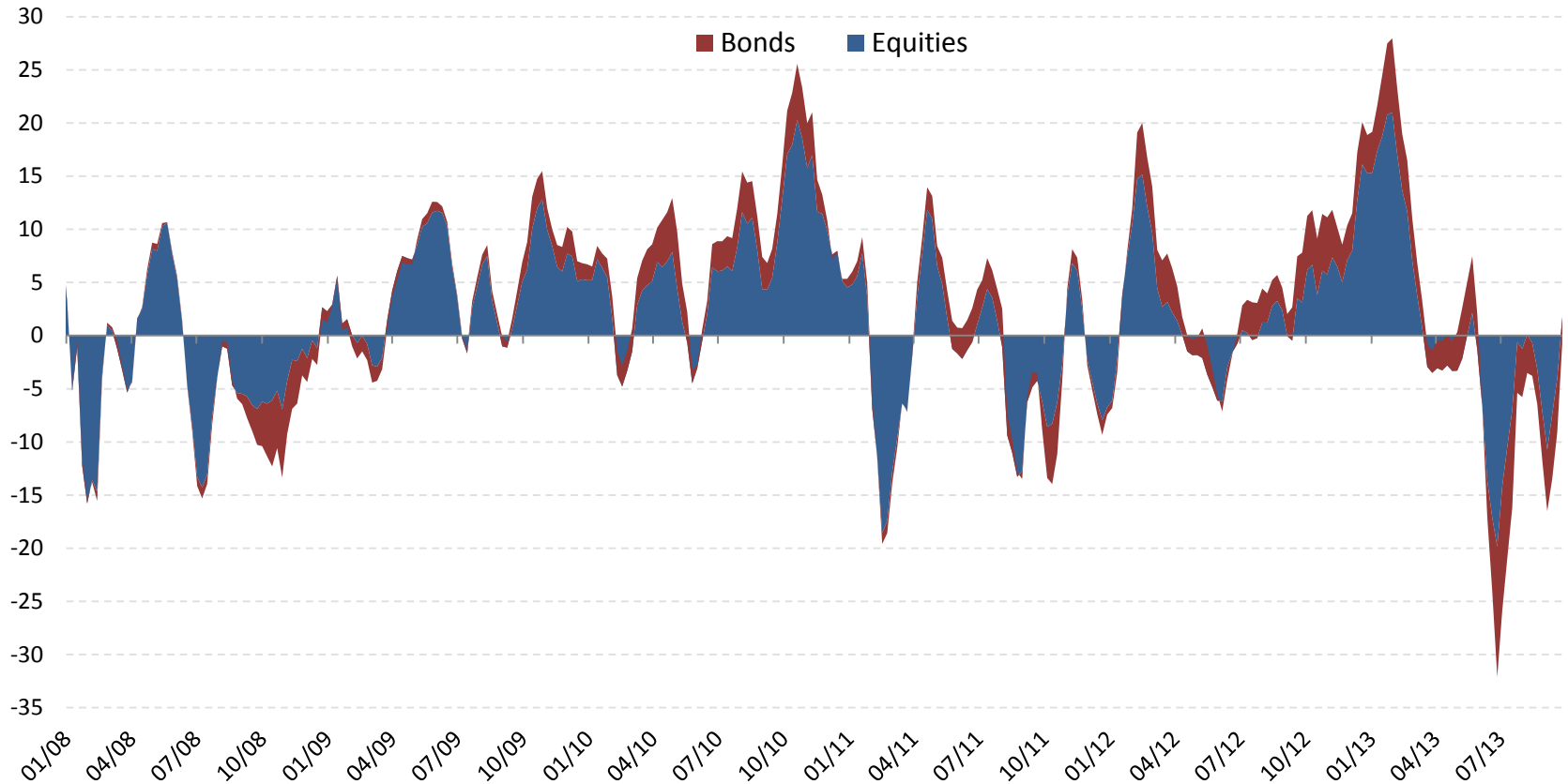


Source: BRSA.

*Total credit is inclusive of all types of banks (deposit banks, participation banks, and development/investment banks) and credit cards.

... despite volatile capital flows.

Equity and Bond Flows to Emerging Market Economies (4-Week Moving Sum, Billion USD)

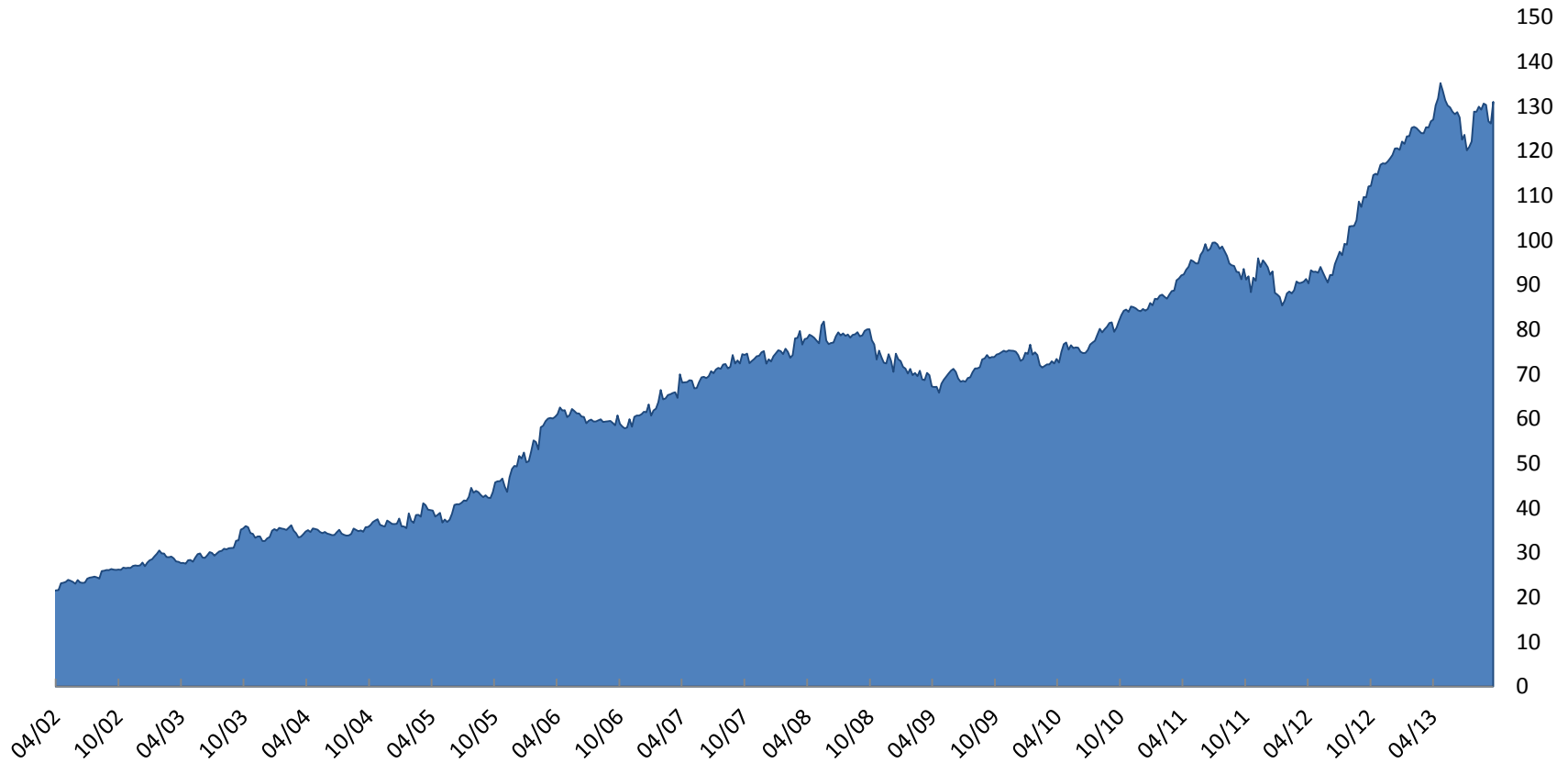


Source: Emerging Portfolio Fund Research (EPFR)

Last observation: 25 September 2013

The Central Bank continues to accumulate reserves...

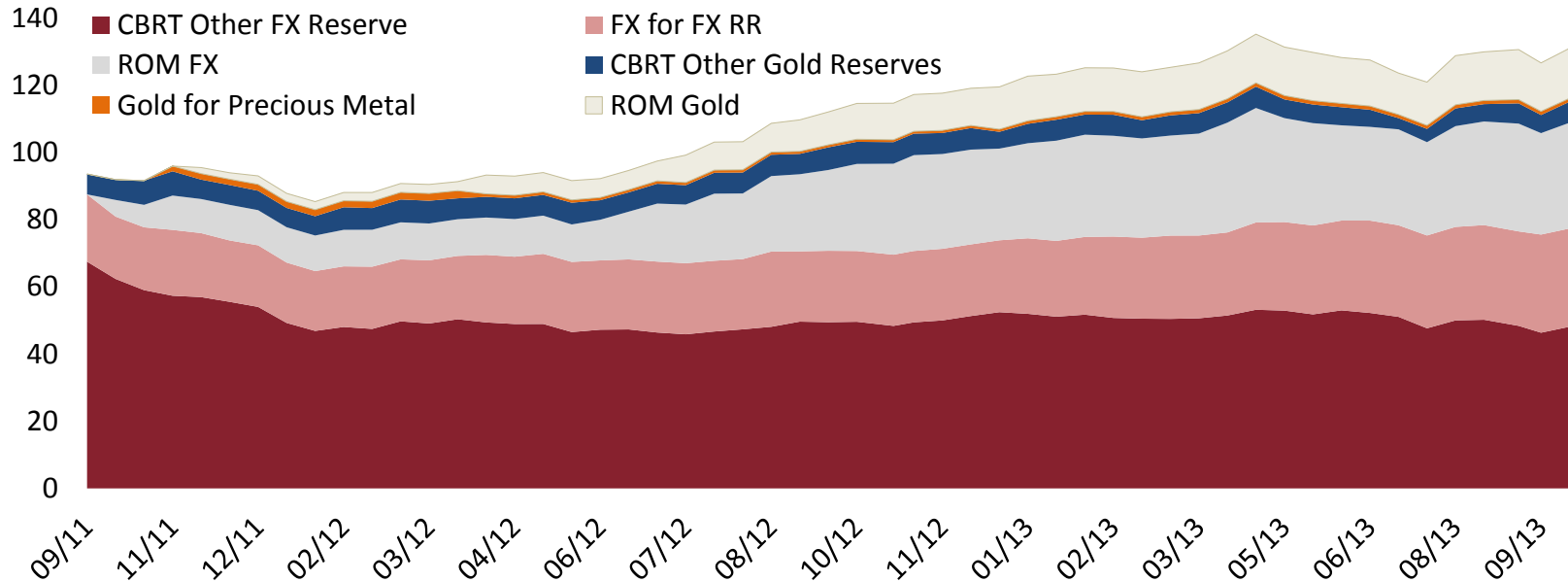
FX and Gold Reserves (Billion USD)



Source: CBRT

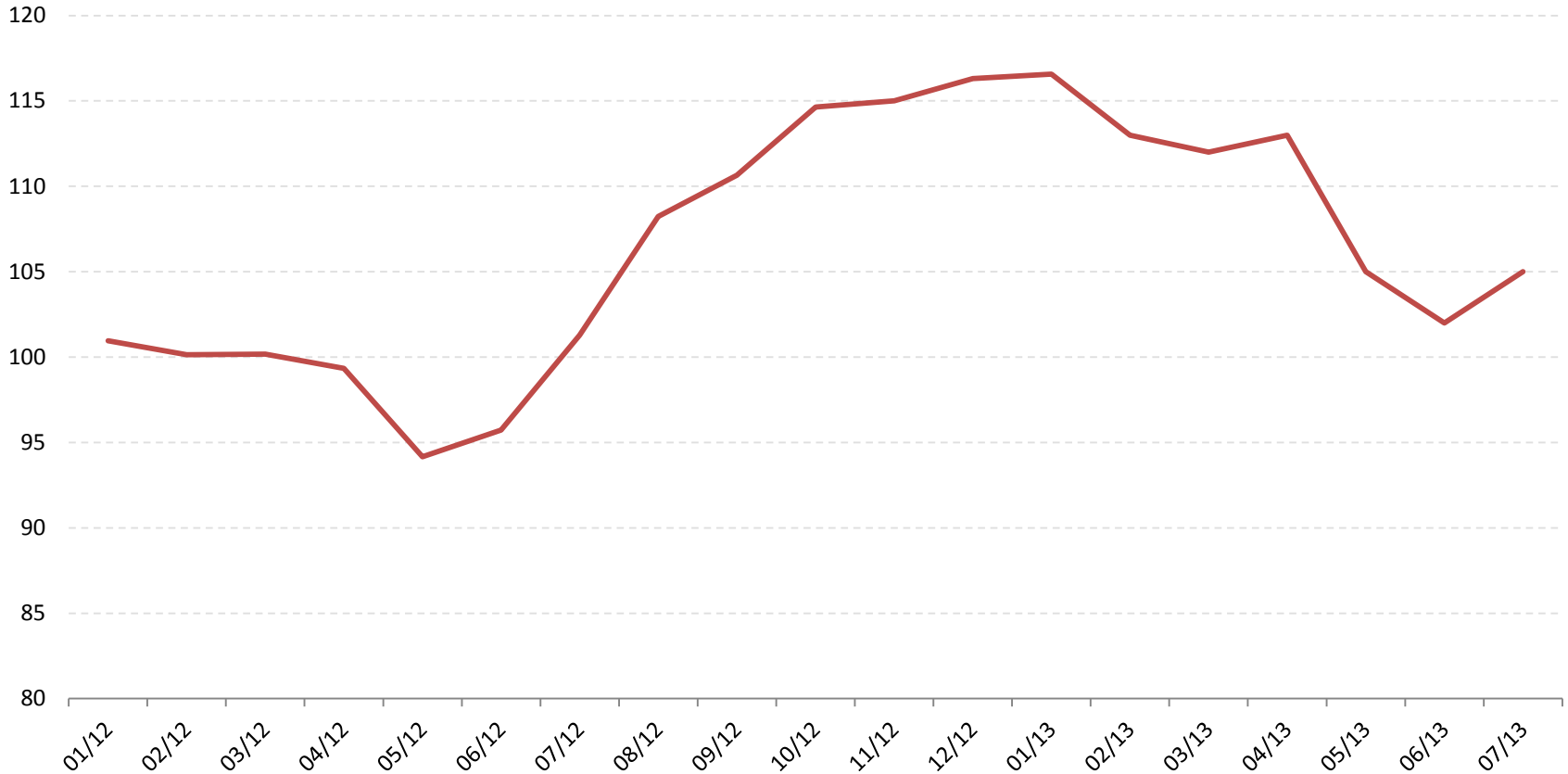
...via export credit facility and reserve requirements.

	Reserves (Billion \$)		- FX Sales (Billion \$)	+ Export Credit Facility (Billion \$)
ROM FX	31.5	June 2013	1,70	0,83
FX Required Reserves	29.3	July 2013	5,15	0,97
Total	60.7	August 2013	1,95	1,19
		September 2013	1,86	1,15



Reserves have been used during the July sell-off.

Ratio of International Reserves to Short-Term Foreign Debt*
(Greenspan-Guidotti Ratio, Percent)



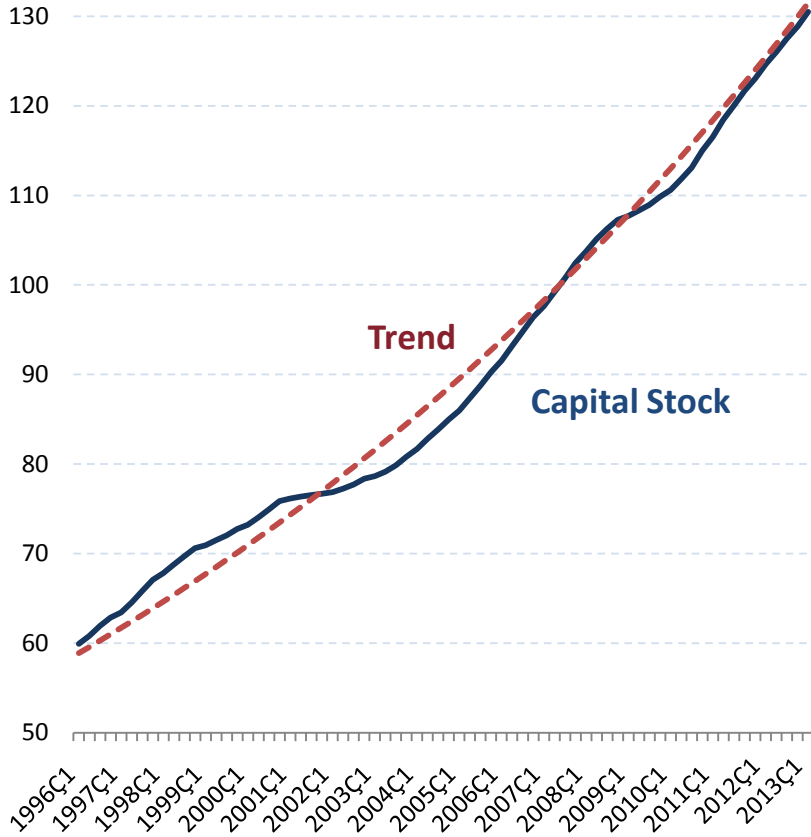
Source: CBRT

*excluding foreign branches of domestic banks.

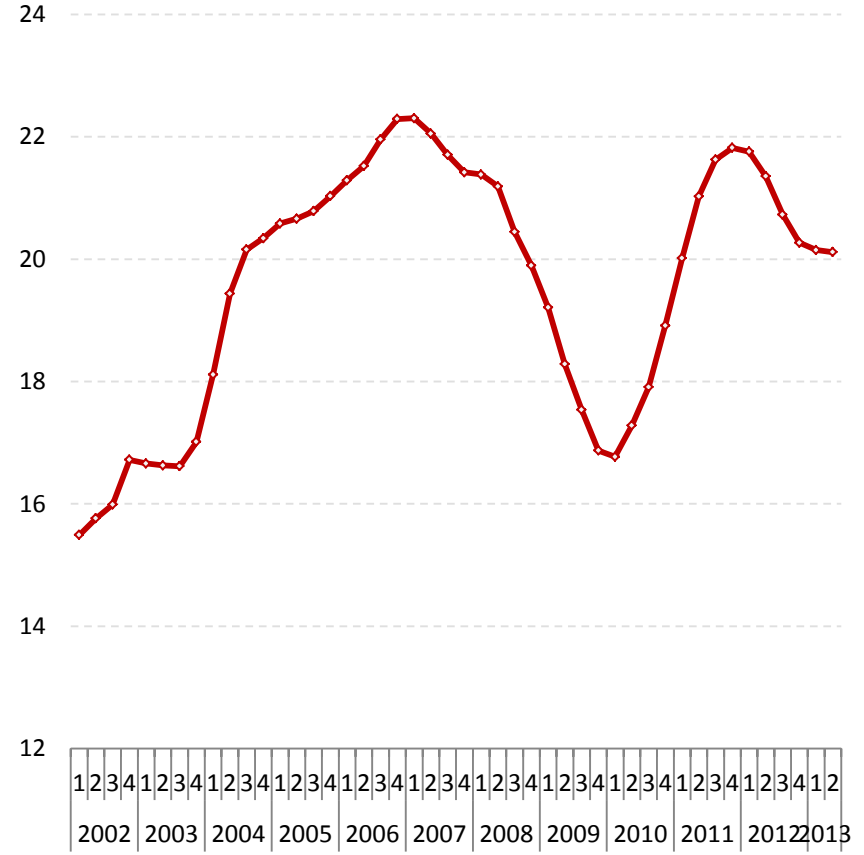
GROWTH

Growth continues thanks to strong capital formation,

Capital Stock
(Constant Prices, 2007=100)



Fixed Capital Formation*
(Percent, Ratio to GDP with current prices)



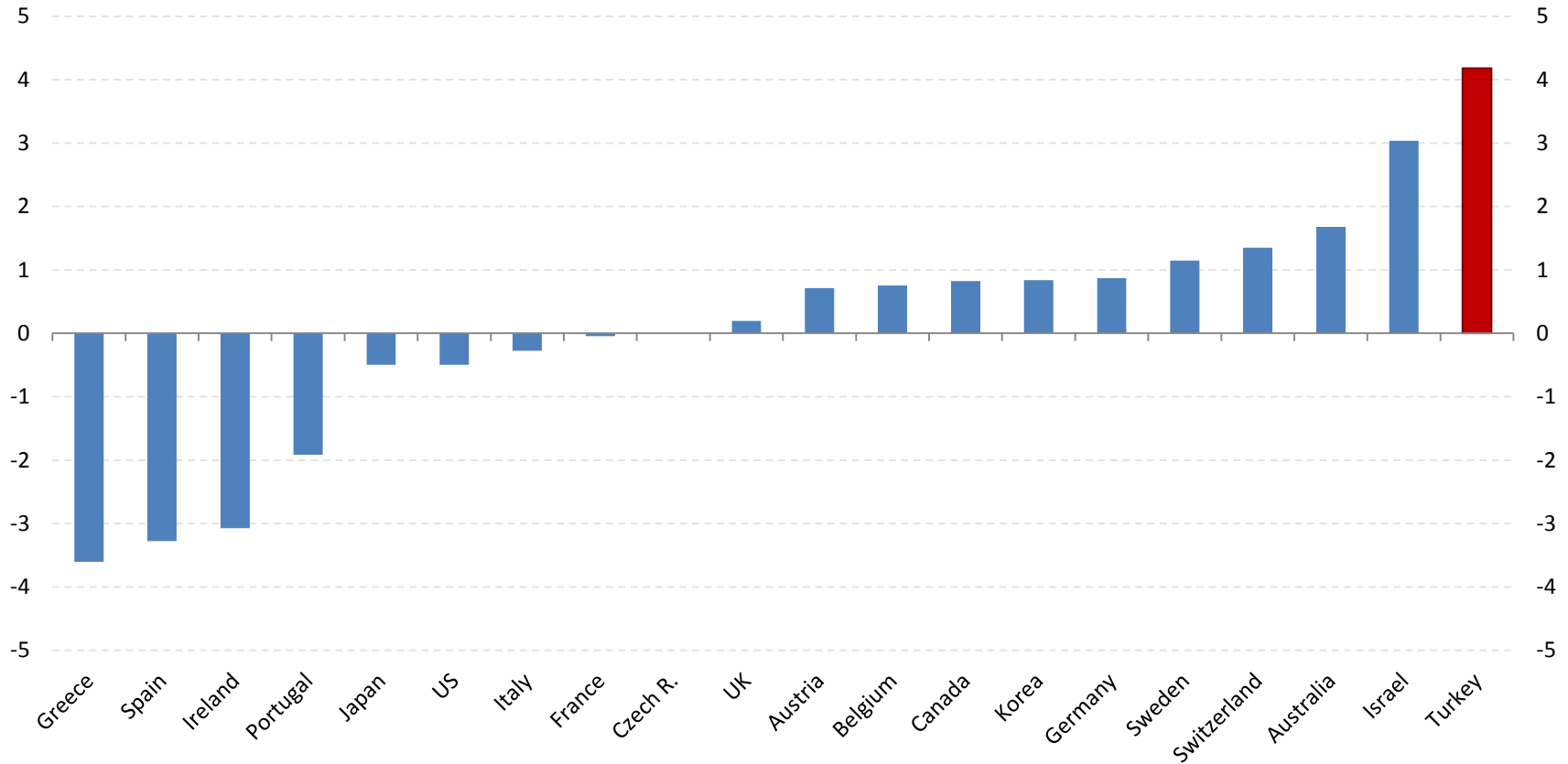
Source: TurkStat, CBRT.

Source: TurkStat, CBRT.

*Annualized.

... job creation,

Annual Average Growth of Employment* (Percent Growth, 2007-2012)

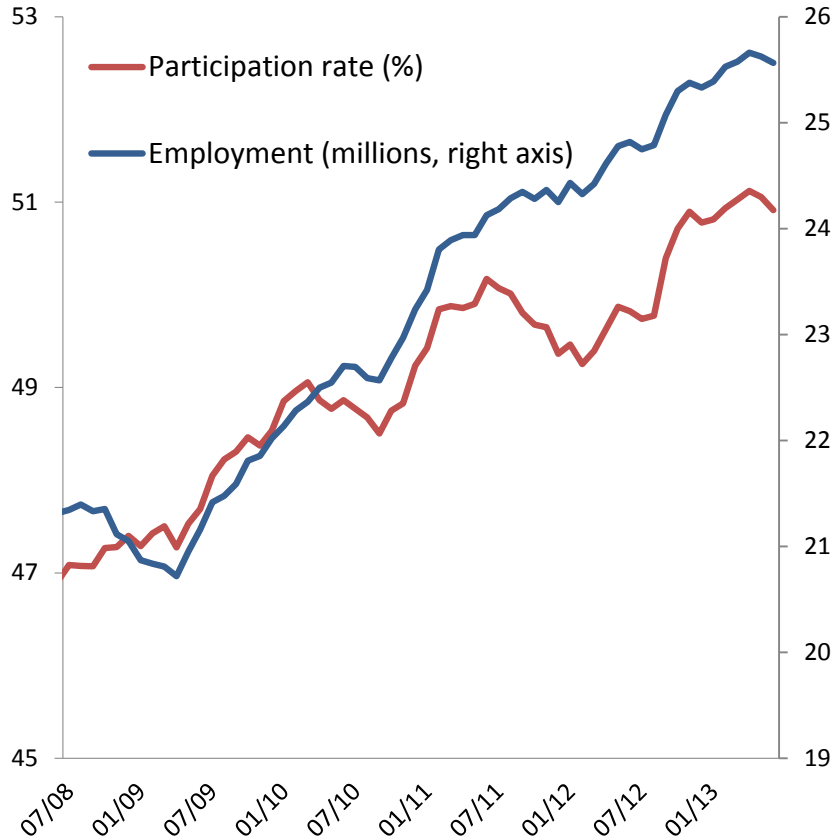


Source: IMF WEO, TURKSTAT.

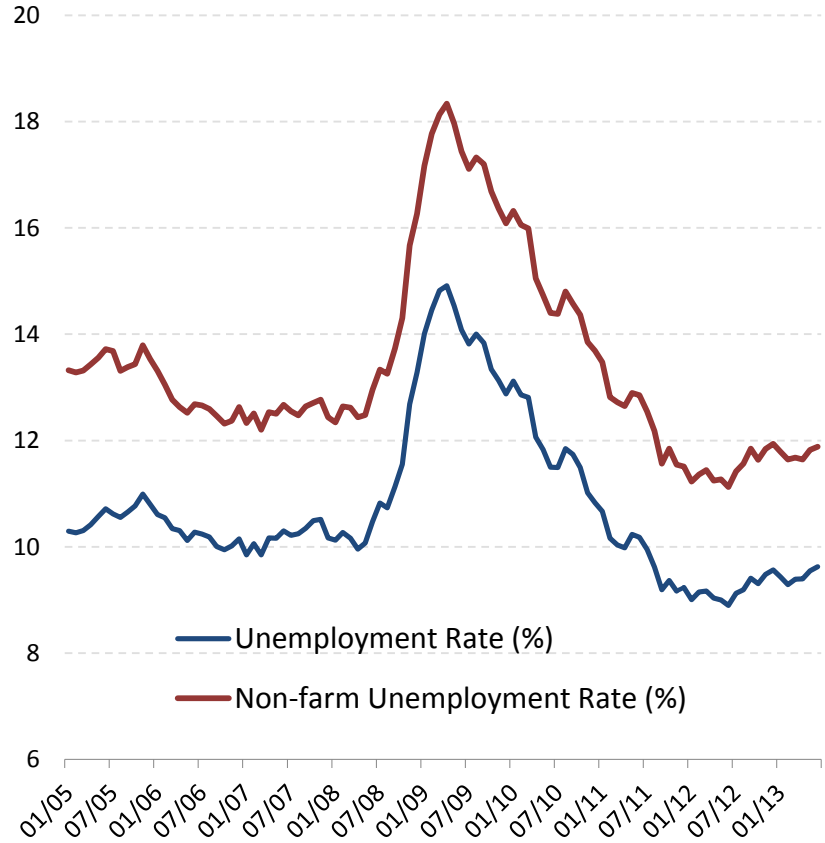
*Difference of natural logarithms

... and labor force participation.

Employment and Participation (Millions, Percent)



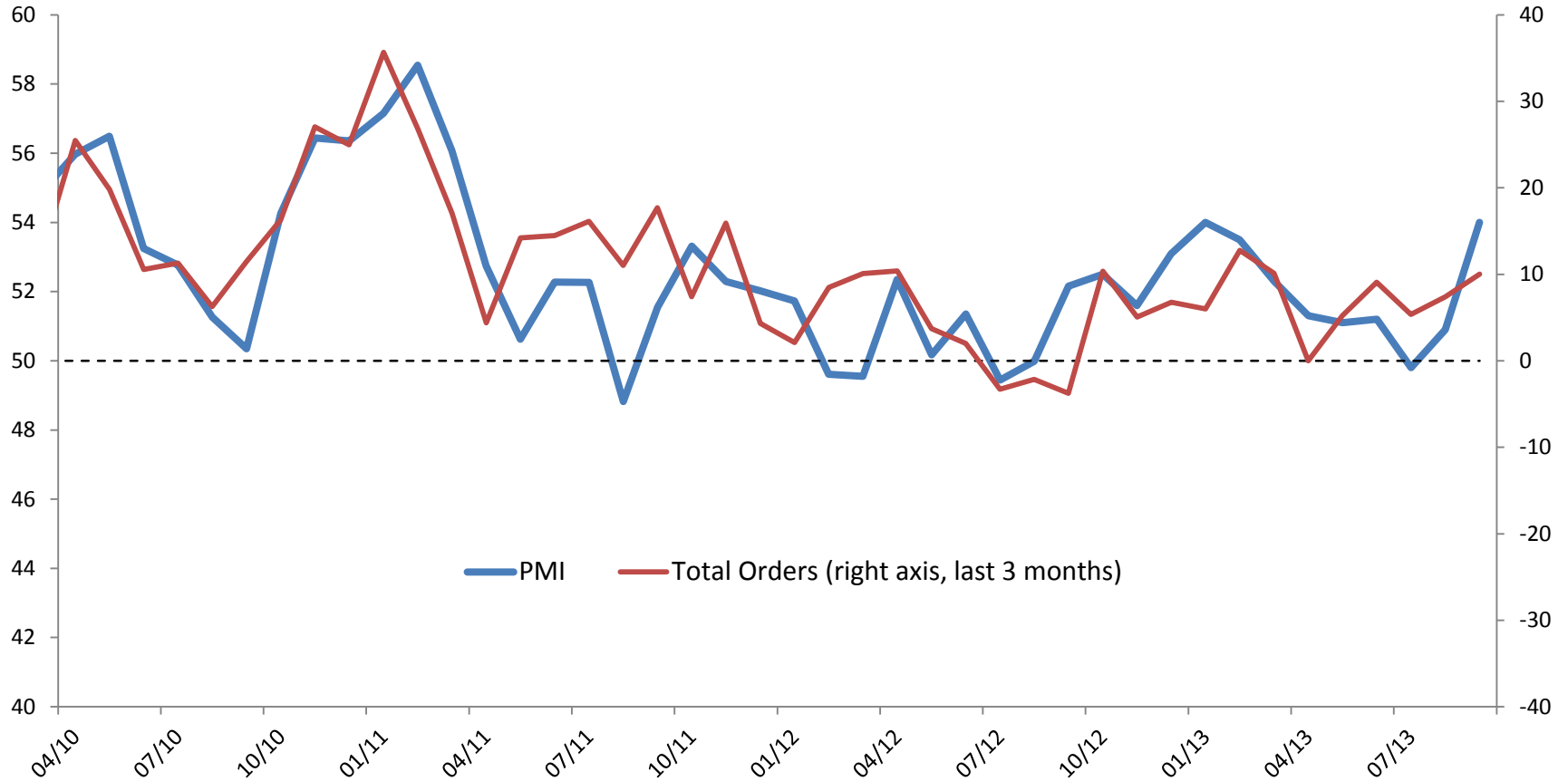
Unemployment Rate (Percent)



Source: TURKSTAT, Household Labor Force Survey, CBRT.

Leading indicators point to...

Purchasing Managers' Index (PMI) and Total Orders* (Seasonally Adjusted, Monthly)

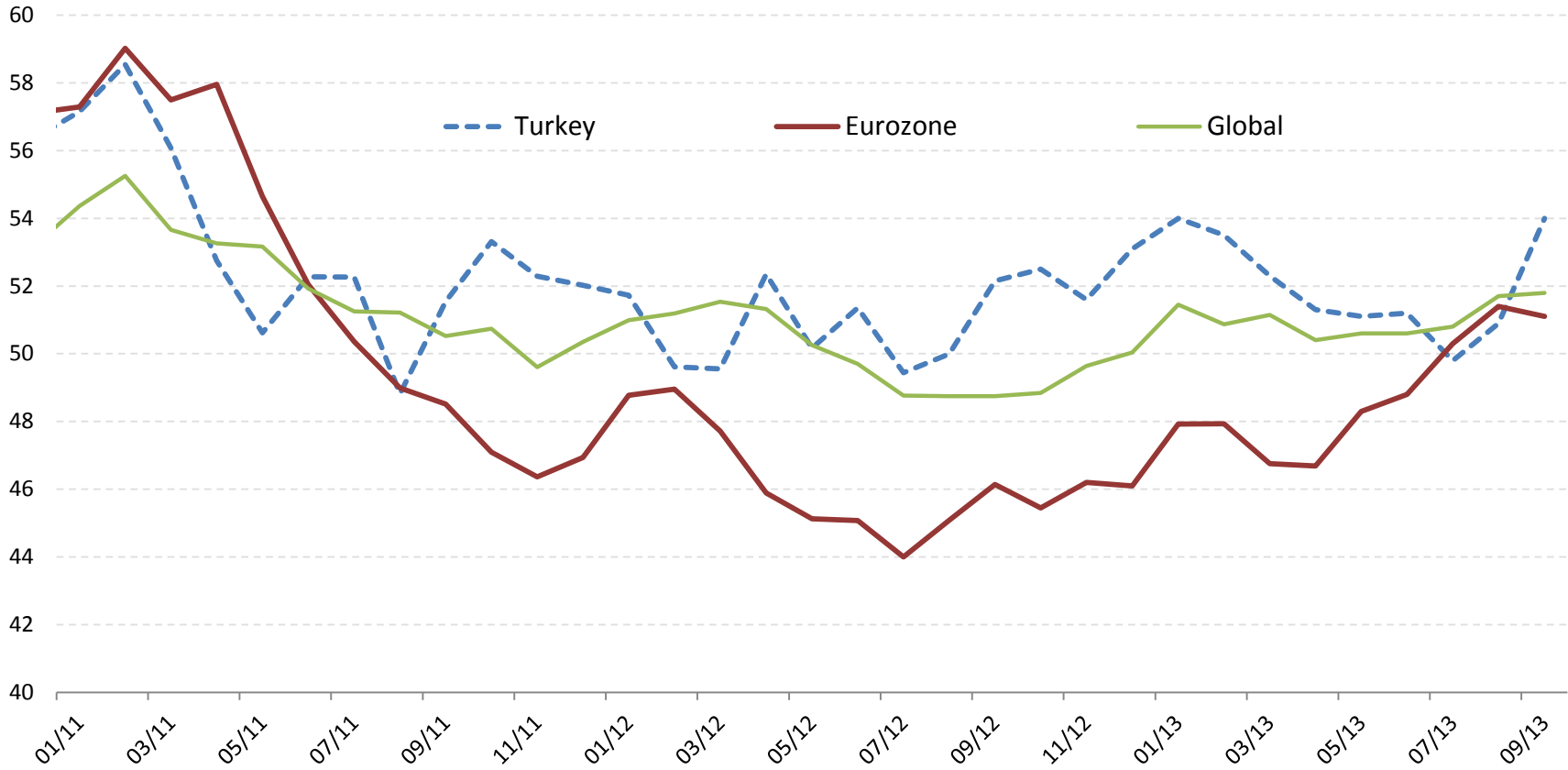


Source: TURKSTAT, MARKIT and CBRT.

*Consumer Tendency Survey, Q.11: How have your total orders developed over the past 3 months?

... continuation of a moderate,

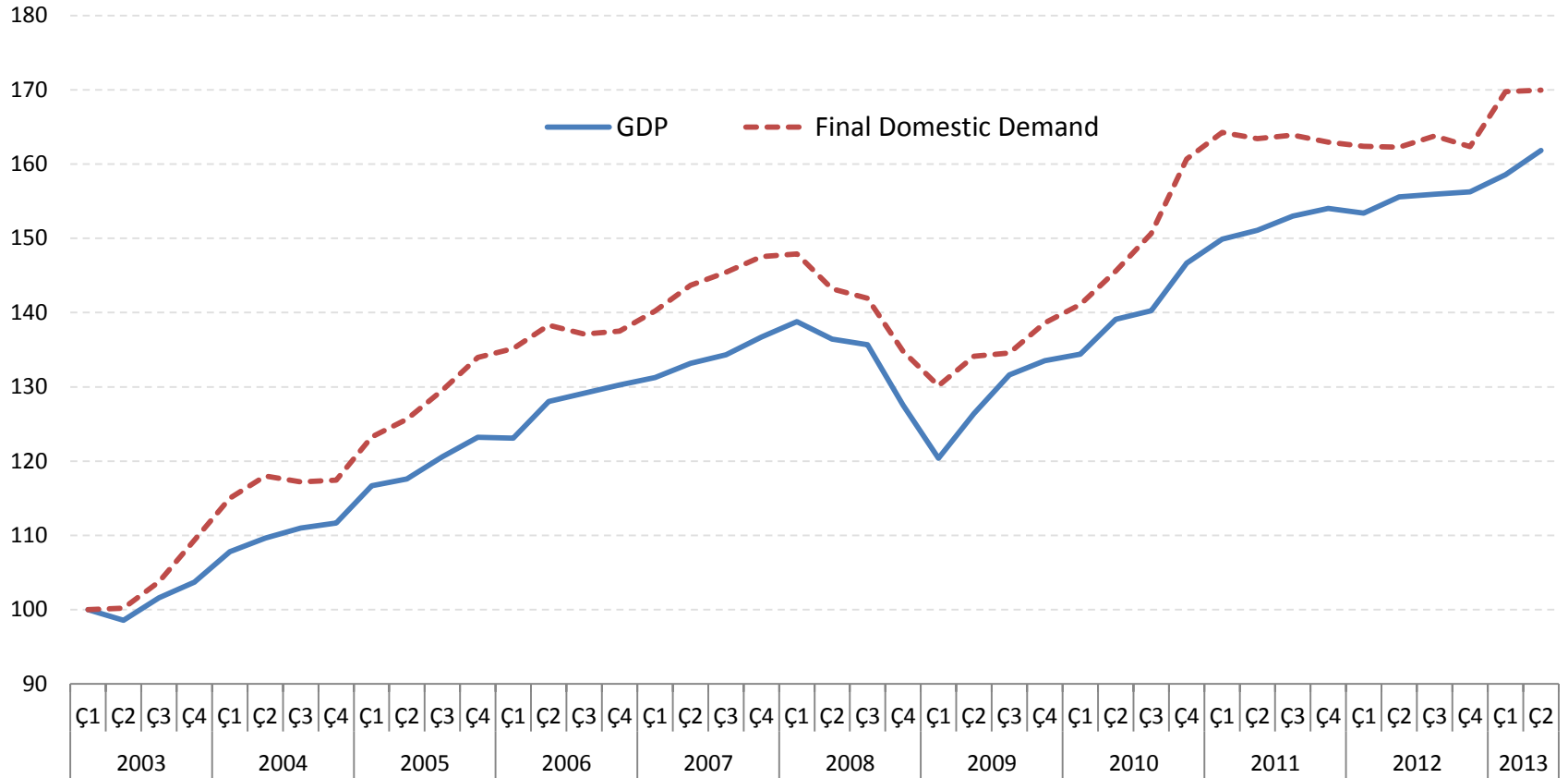
Manufacturing PMIs (Seasonally Adjusted)



Source: MARKIT.

... and a more balanced

Final Domestic Demand and GDP (Seasonally Adjusted, 2003Q1=100)

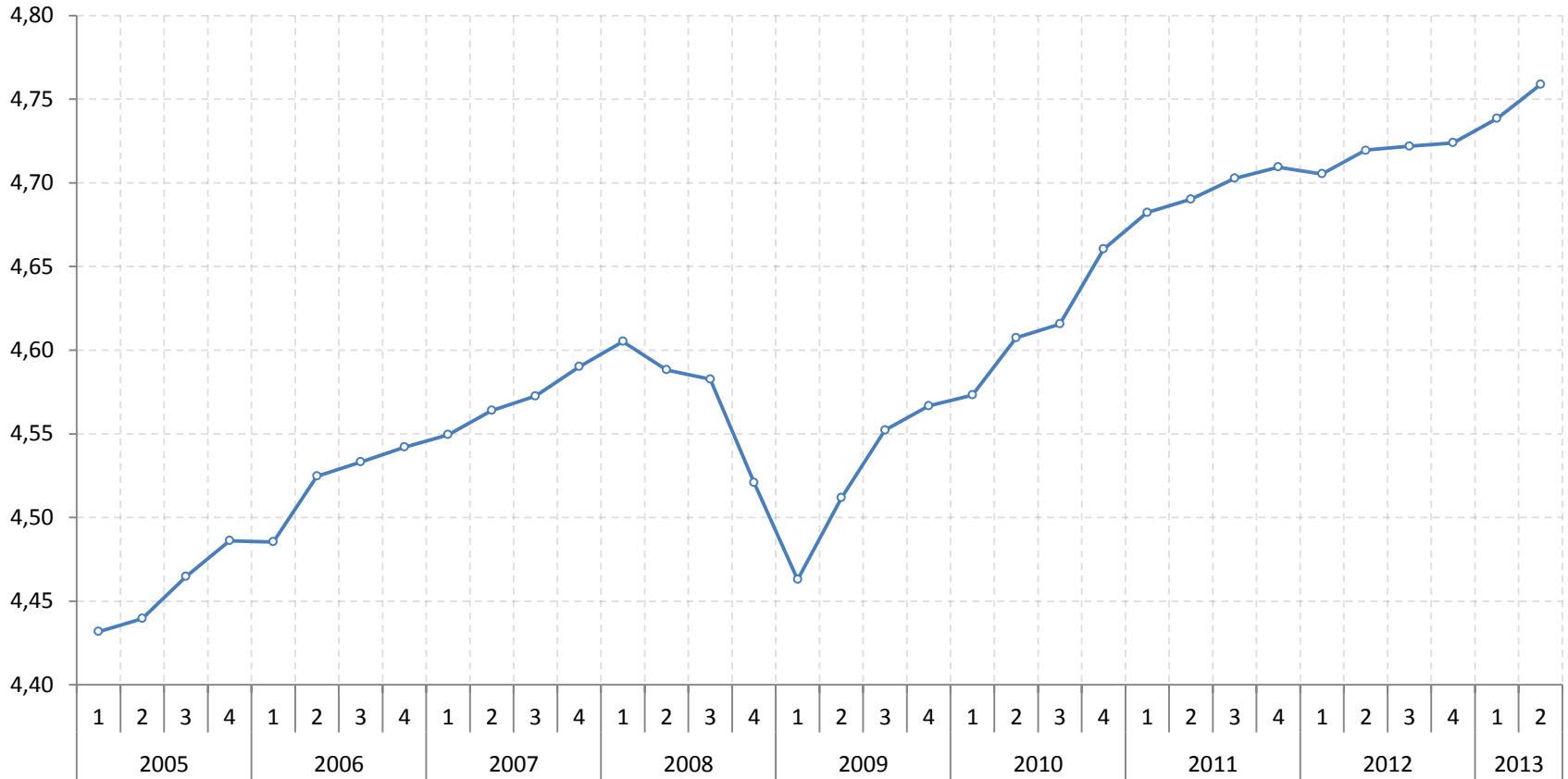


Source: TurkStat, CBRT.

... economic growth.

GDP

(Base Quarter: 2008Q1, Seasonally Adjusted, Natural Logarithms)



Source: TurkStat, CBRT.

Overview

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