TÜRKİYE CUMHURİYET
MERKEZ BANKASI

ECONOMIC OUTLOOK and MONETARY POLICY

January 3, 2012

Ankara

Outline

I. Recovery After 2008

II. Global Monetary Expansion

III. Implications on Emerging Markets

IV. Reflections on Turkish Economy

V. Price and Financial Stability in Turkey

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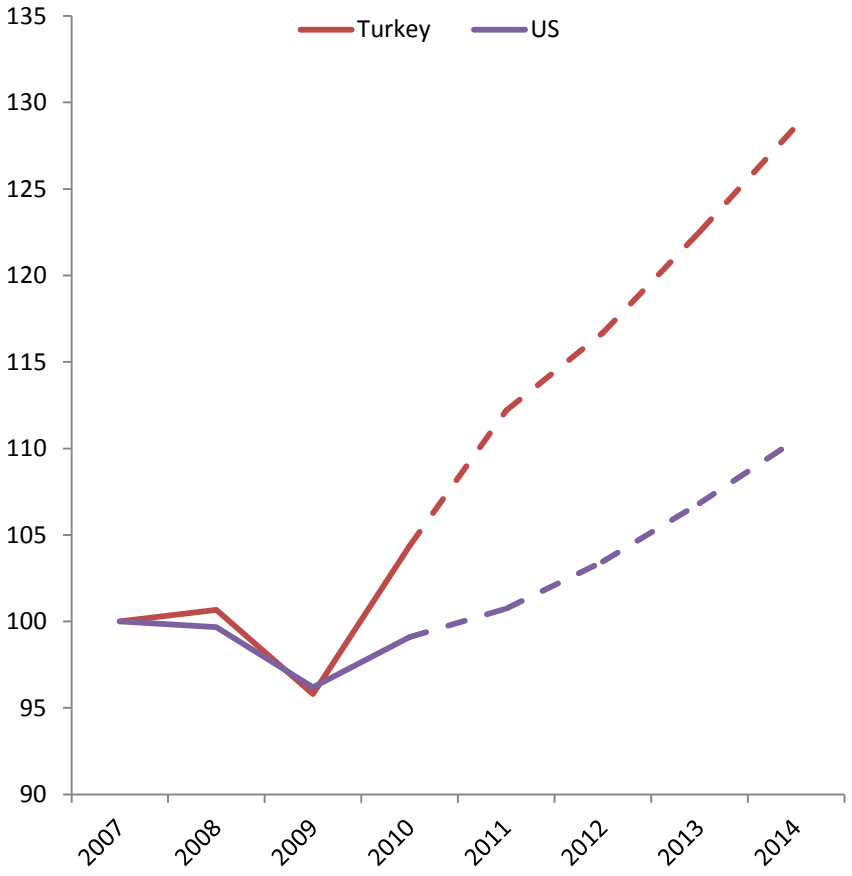
Turkey and US

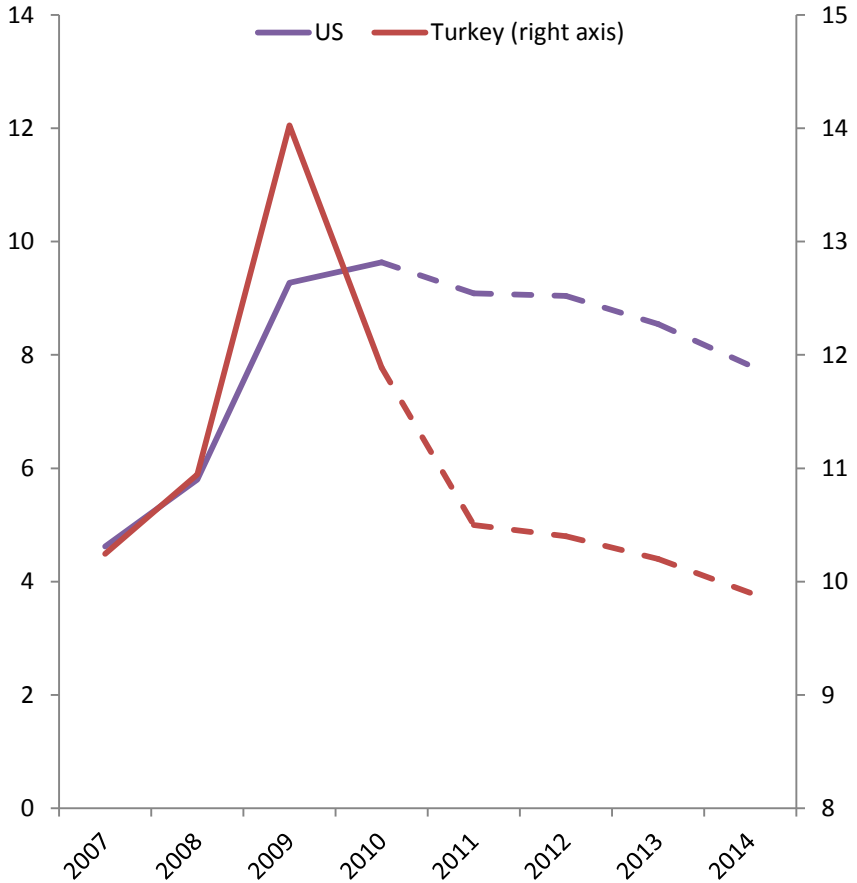
GDP
(Real, 2007=100)



Source: IMF WEO, CBRT.

*Medium Term Program projections used for Turkey, other country projections are based on IMF data.

Unemployment
(Percent)

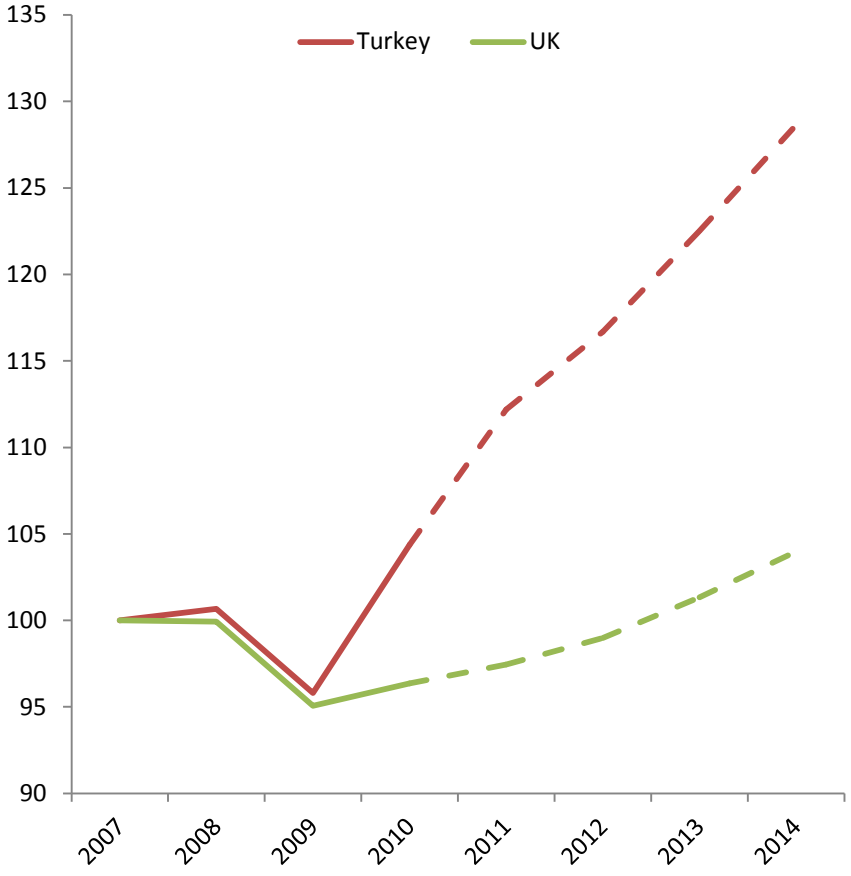


Source: IMF WEO, CBRT.

*Medium Term Program projections used for Turkey, other country projections are based on IMF data.

Turkey and UK

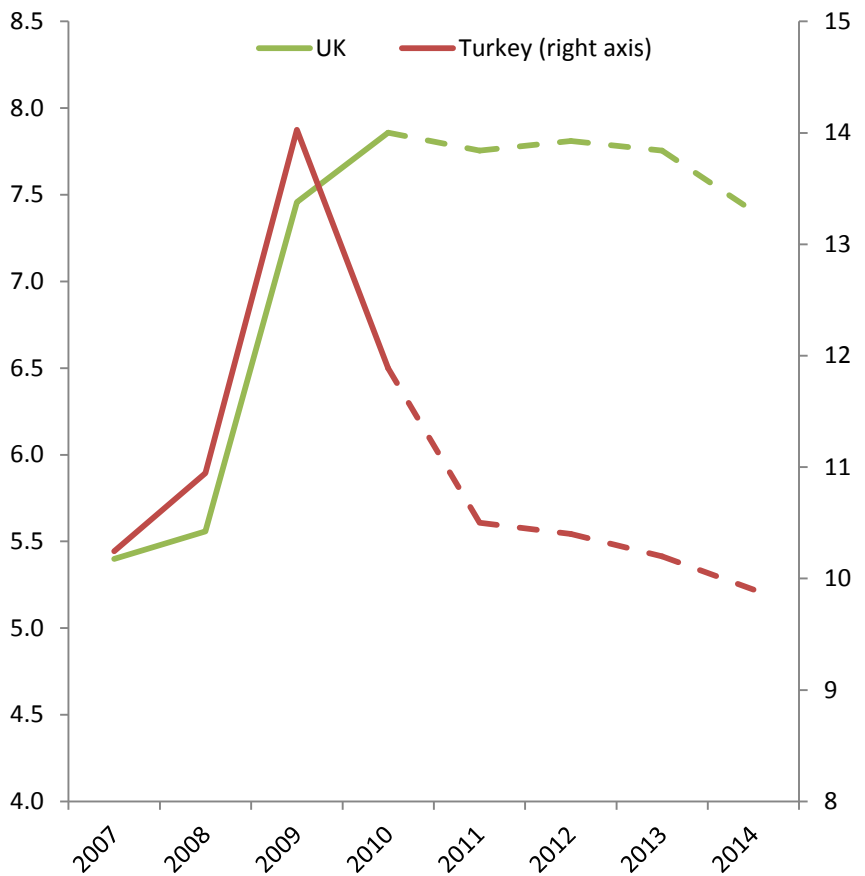
GDP
(Real, 2007=100)



Source: IMF WEO, CBRT.

*Medium Term Program projections used for Turkey, other country projections are based on IMF data.

Unemployment
(Percent)



Source: IMF WEO, CBRT.

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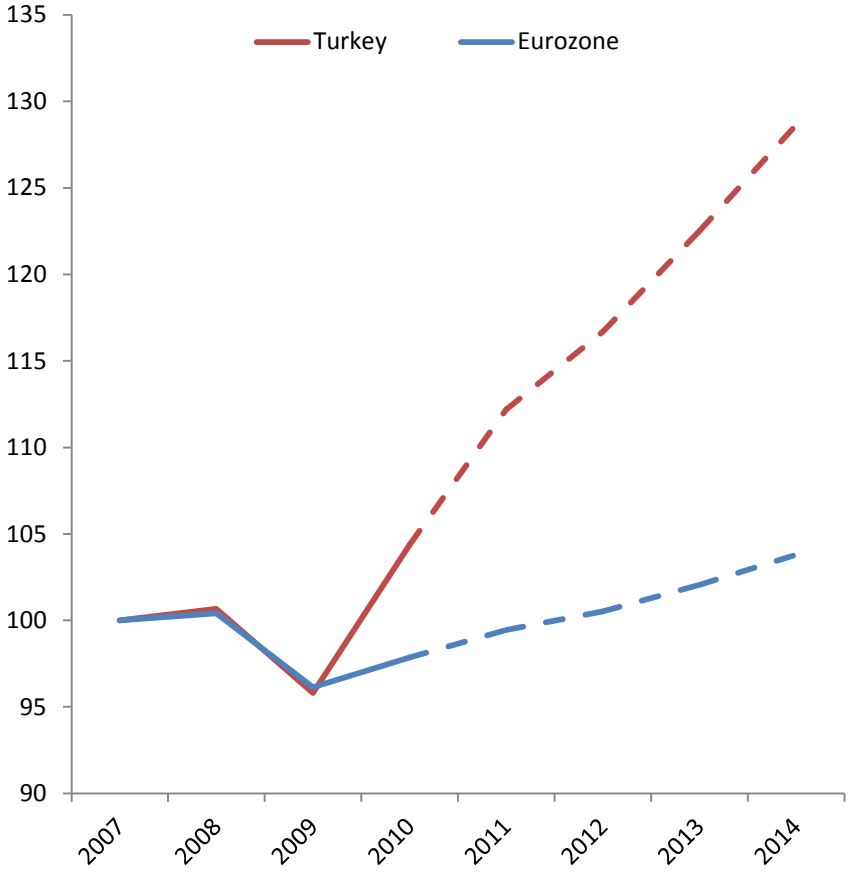
Turkey and Eurozone

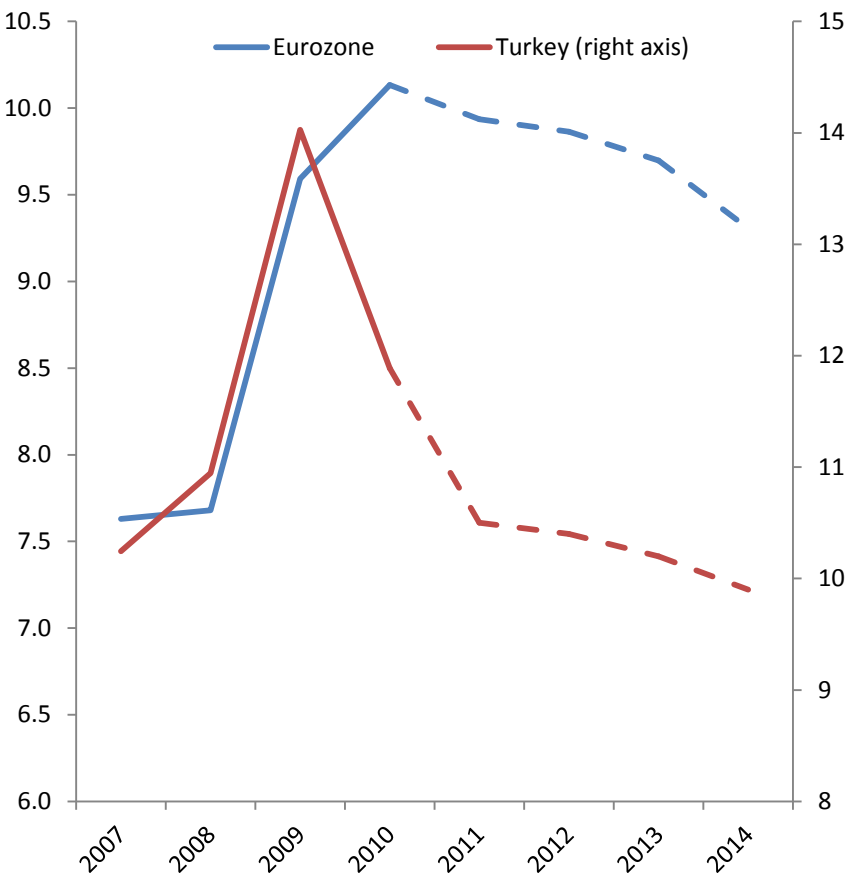
GDP
(Real, 2007=100)



Source: IMF WEO, CBRT.

*Medium Term Program projections used for Turkey, other country projections are based on IMF data.

Unemployment
(Percent)

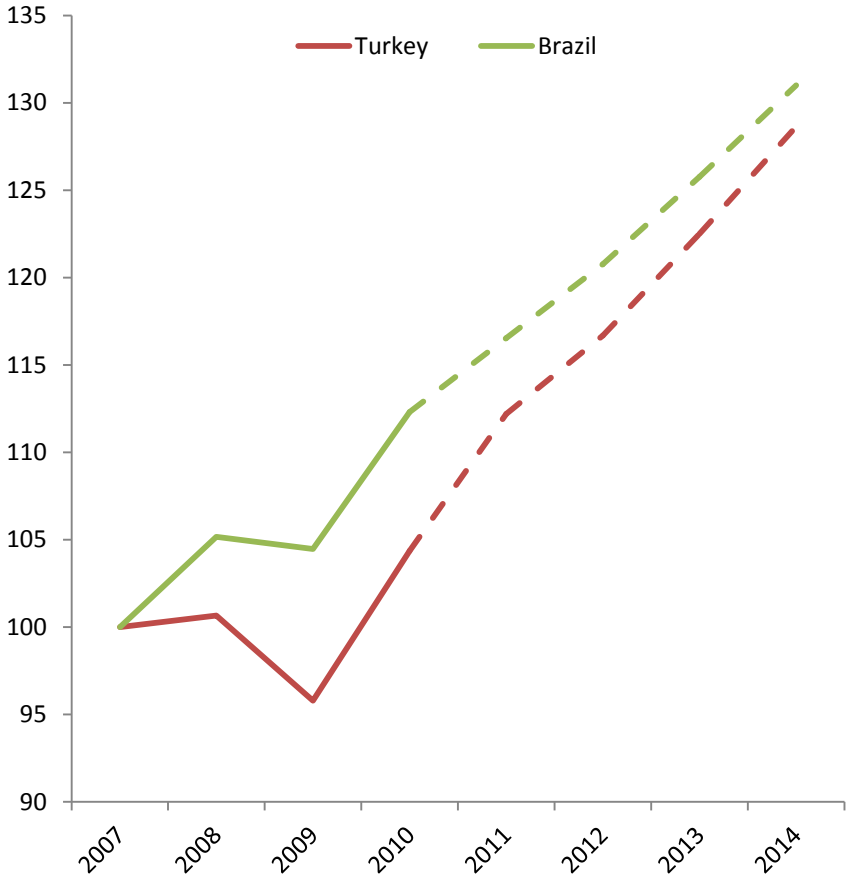


Source: IMF WEO, CBRT.

*Medium Term Program projections used for Turkey, other country projections are based on IMF data.

Turkey and Brazil

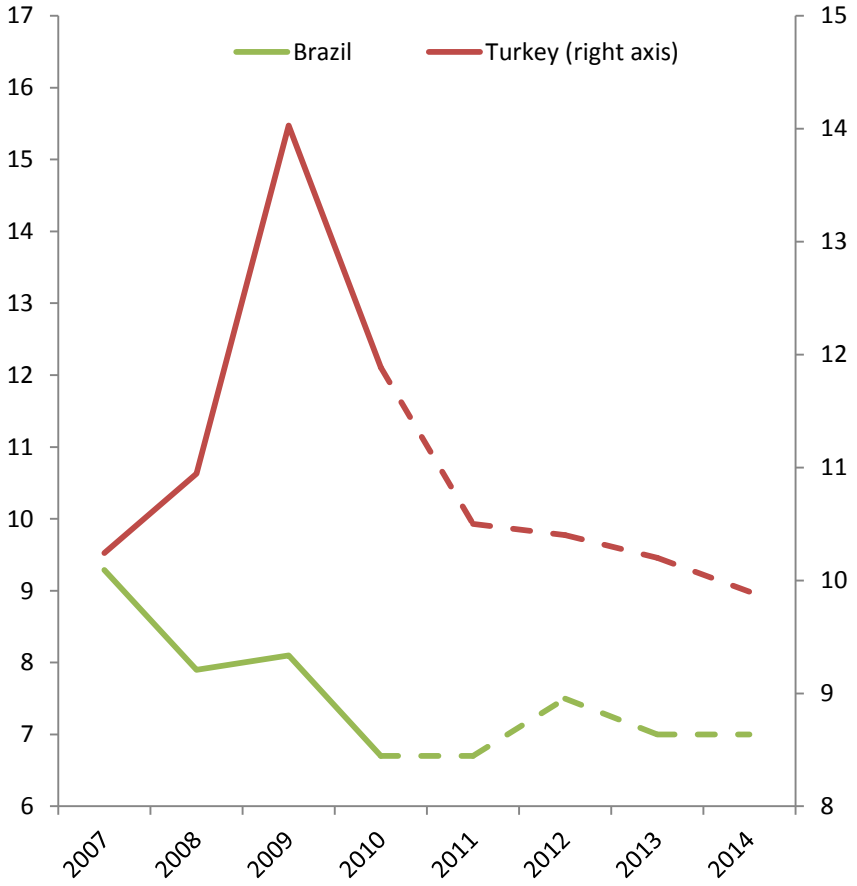
GDP
(Real, 2007=100)



Source: IMF WEO, CBRT.

*Medium Term Program projections used for Turkey, other country projections are based on IMF data.

Unemployment
(Percent)

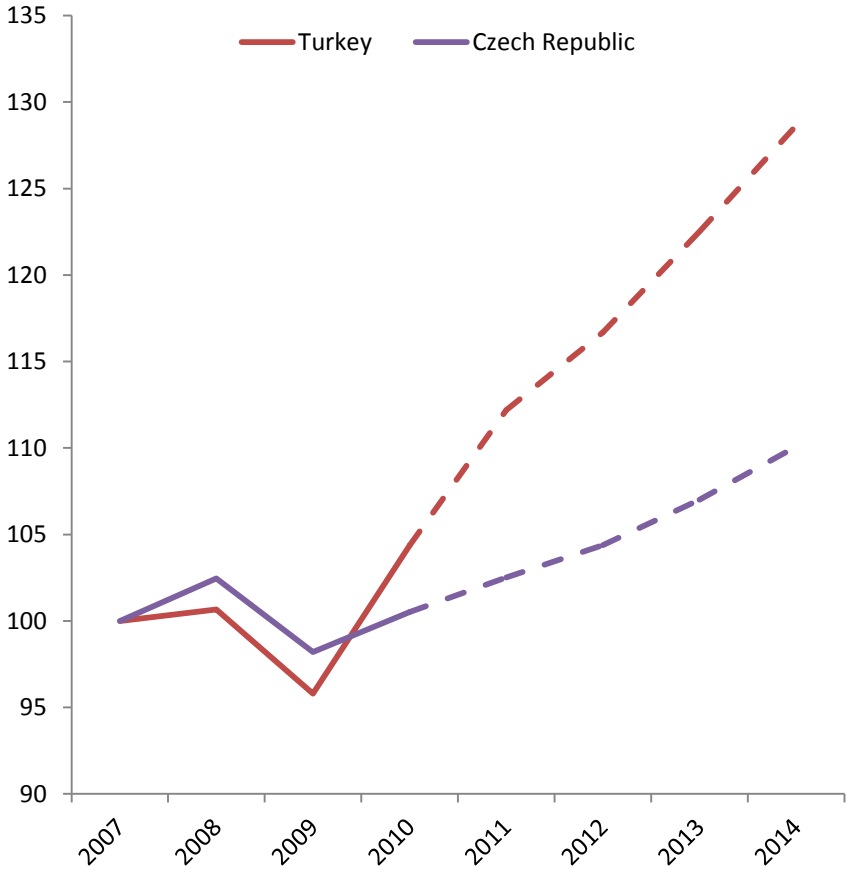


Source: IMF WEO, CBRT.

*Medium Term Program projections used for Turkey, other country projections are based on IMF data.

Turkey and Czech Republic

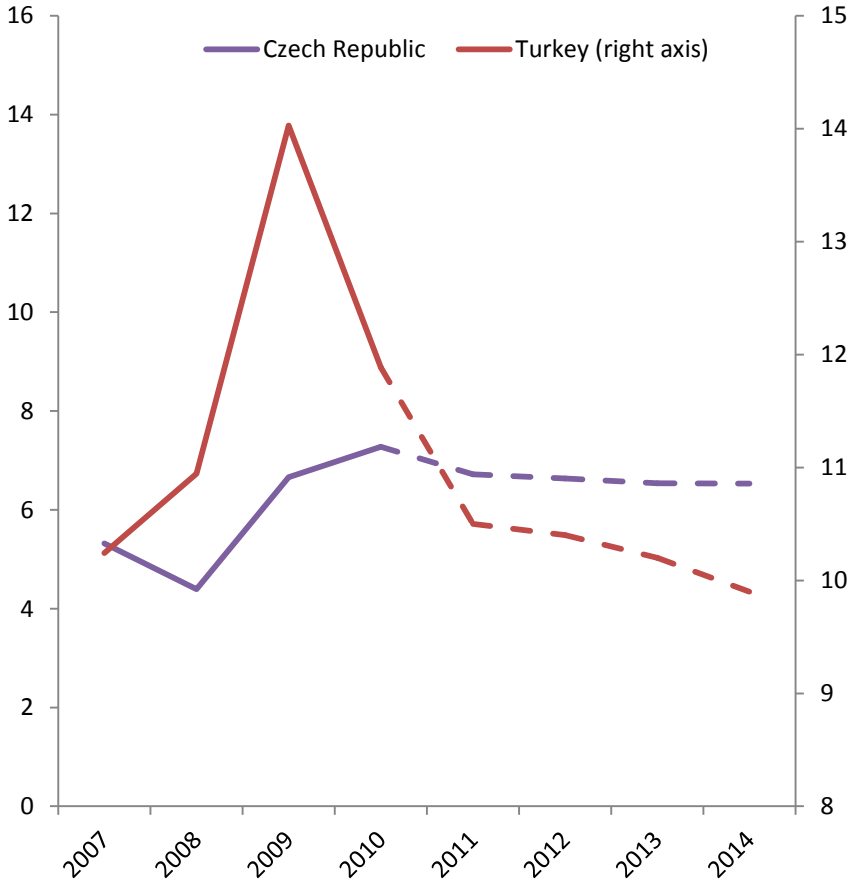
GDP
(Real, 2007=100)



Source: IMF WEO, CBRT.

*Medium Term Program projections used for Turkey, other country projections are based on IMF data.

Unemployment
(Percent)

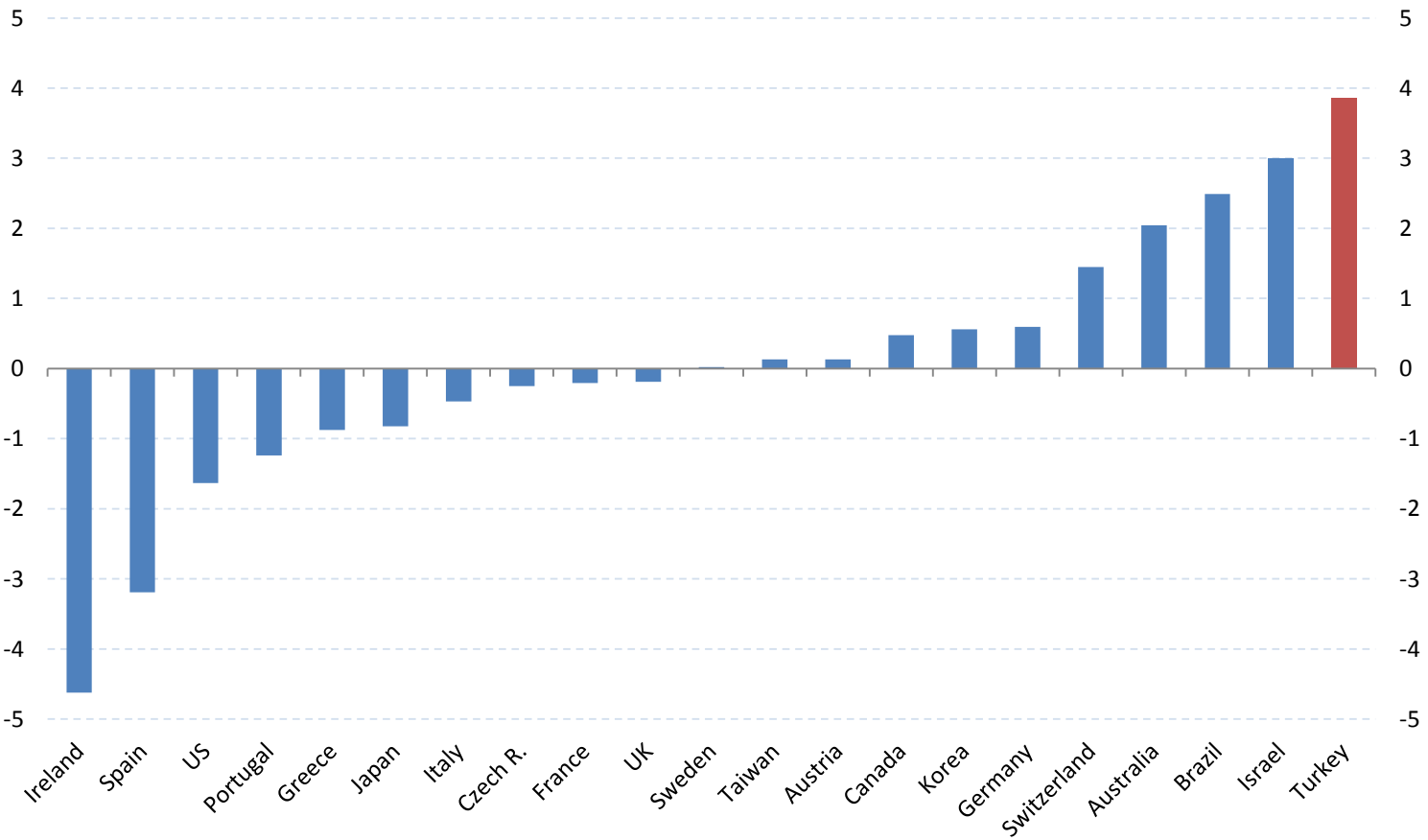


Source: IMF WEO, CBRT.

*Medium Term Program projections used for Turkey, other country projections are based on IMF data.

Employment

Average Annual Employment Growth*
(Percent, 2007-2010)

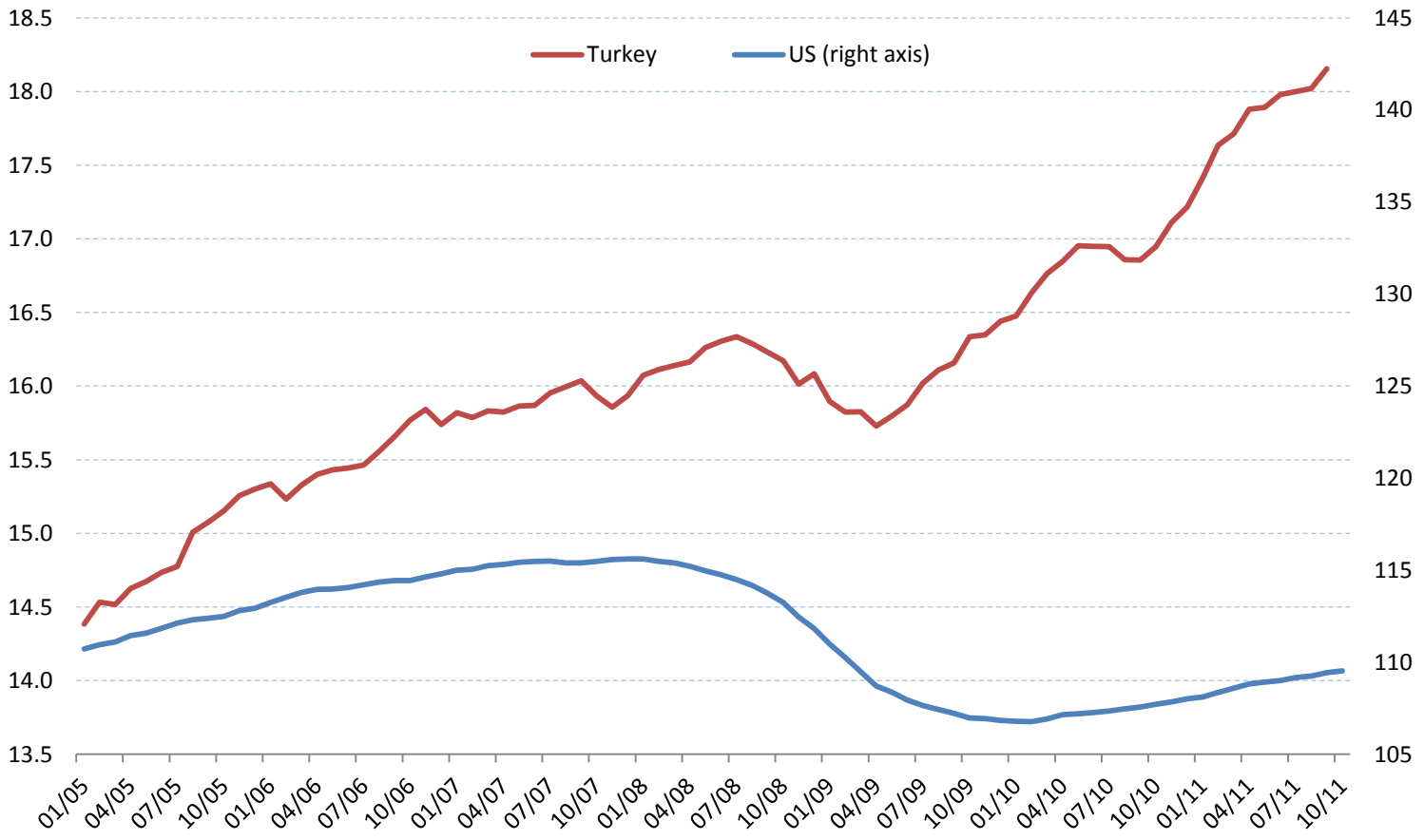


Source: IMF WEO, ILO, TURKSTAT, CBRT.

*Difference of natural logs

Employment: Turkey and US

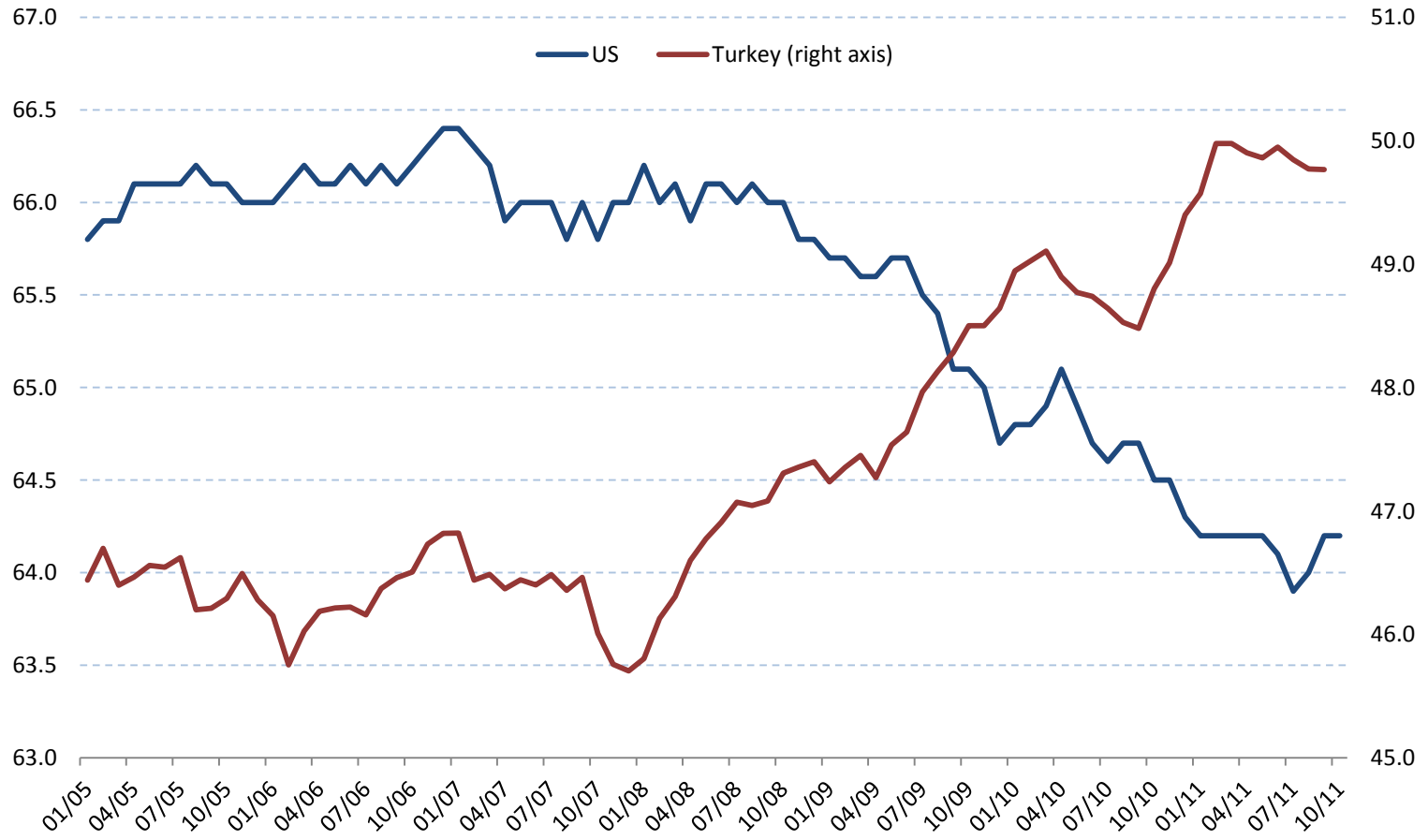
Total Employment
(Seasonally Adjusted, Non-Agricultural, Million People)



Source: TurkStat, ADM, CBRT.

Labor Market Participation: Turkey and US

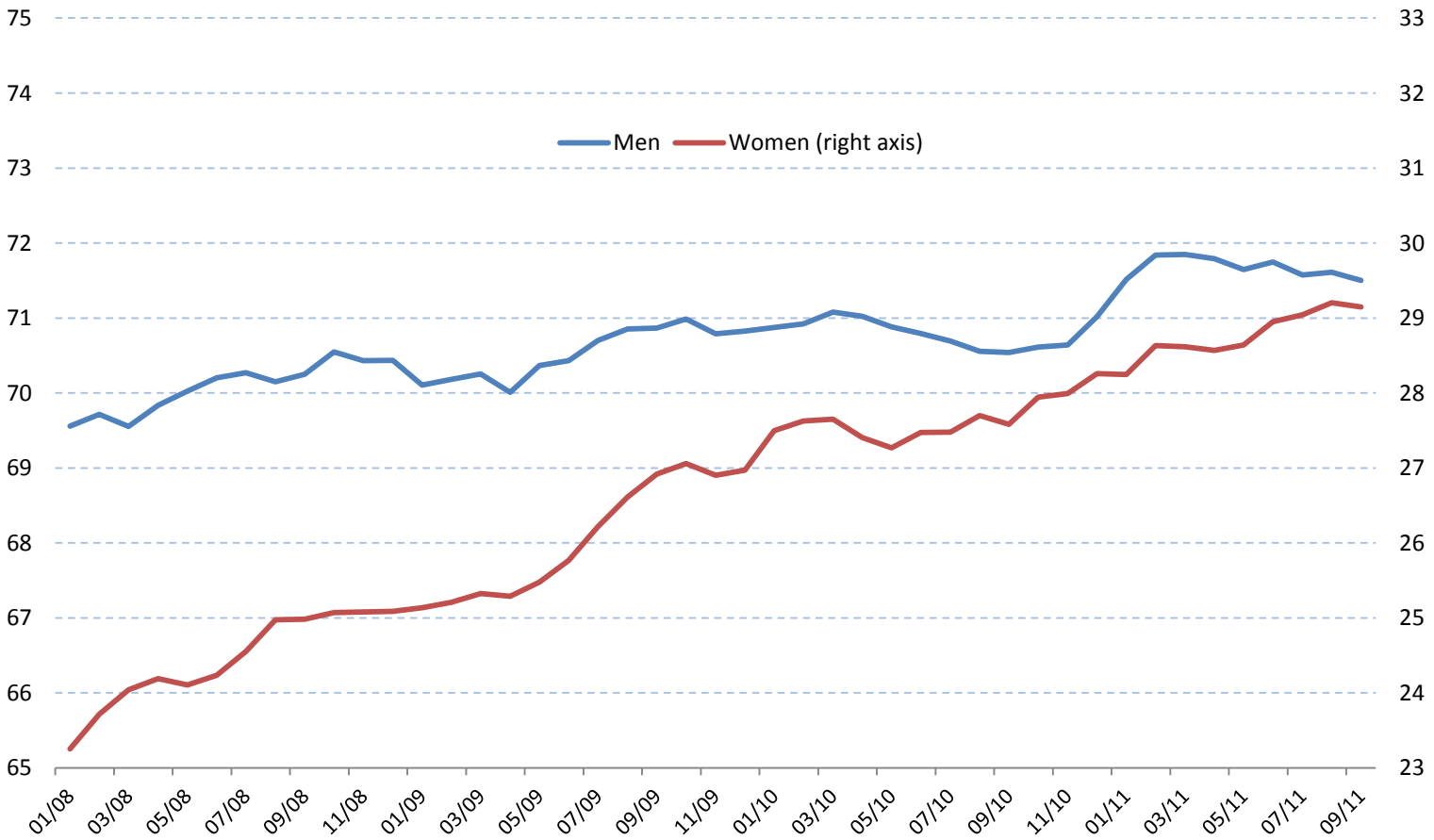
Labor Participation Rate
(Seasonally Adjusted, Percent)



Source: TURKSTAT, BLS, CBRT.

Labor Market Participation By Gender

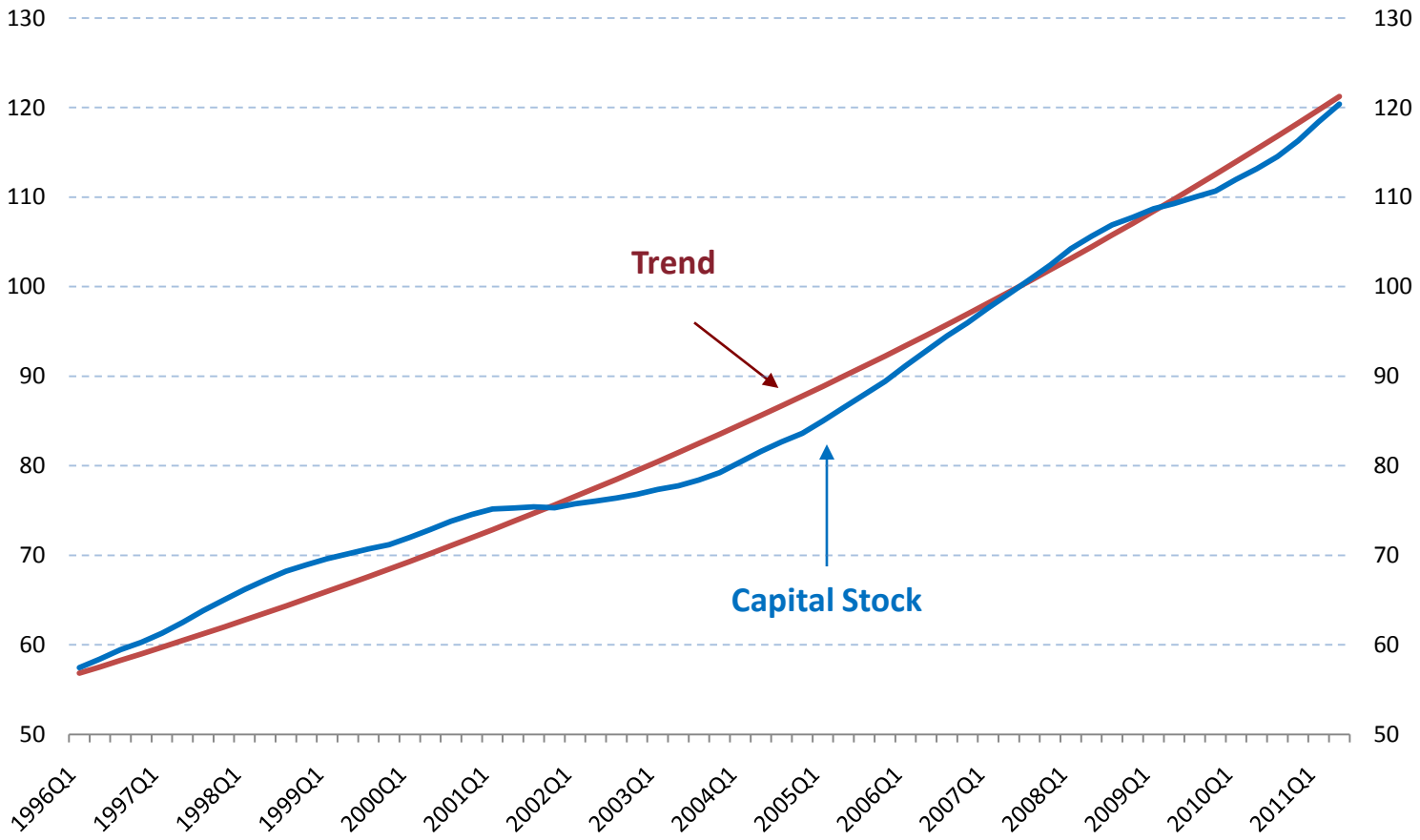
Male and Female Participation Rates in Turkey
(Seasonally Adjusted, Percent)



Source: TurkStat, CBRT.

Capital

Capital Stock
(constant prices, 2008=100)



Source: TURKSTAT, CBRT.

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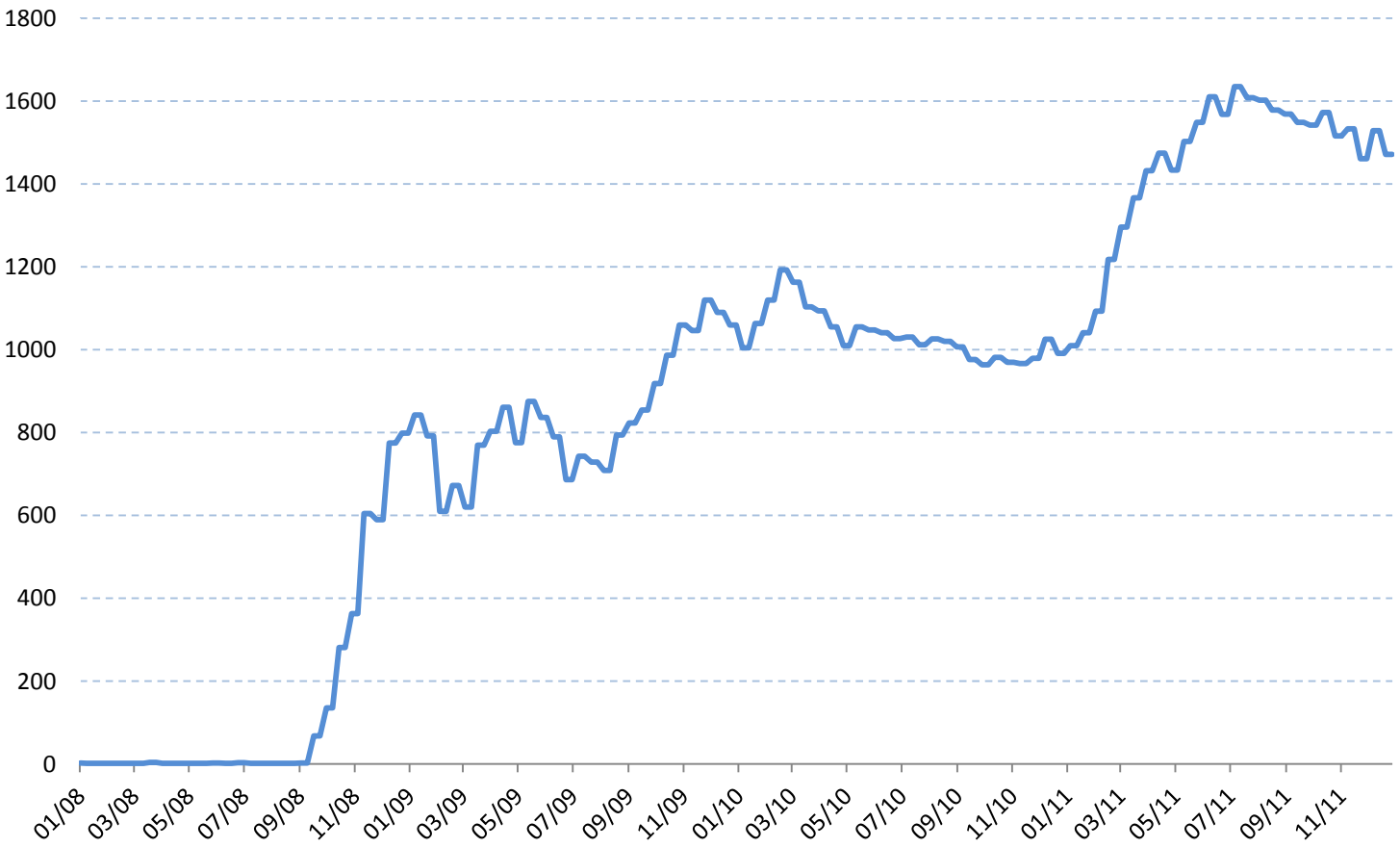
Monetary Expansion (US)

Excess Reserves (FED)

(Billion USD)

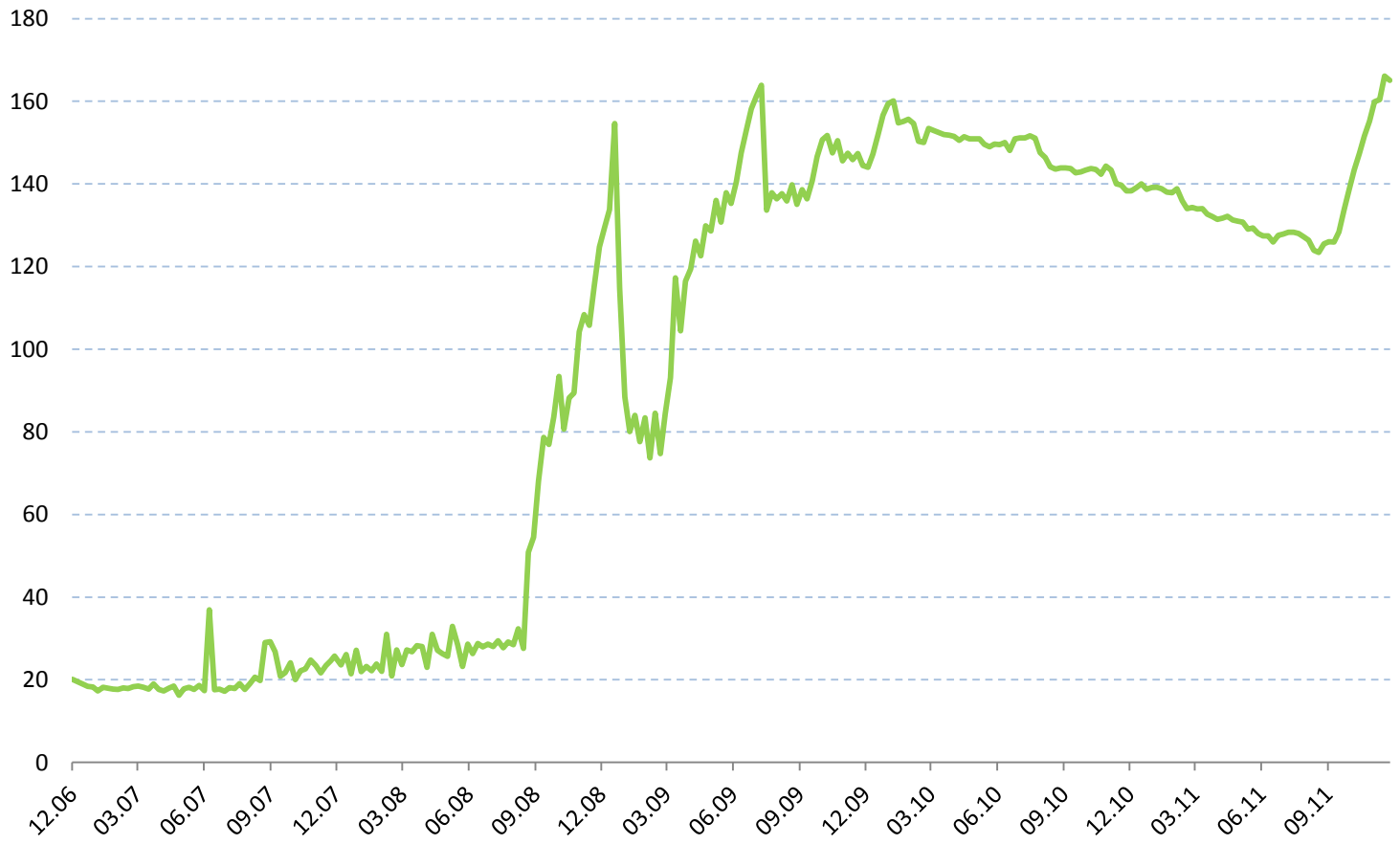


Source: FED, CBRT.

Monetary Expansion (UK)

Excess Reserves* (BoE)

(Billion Pound)



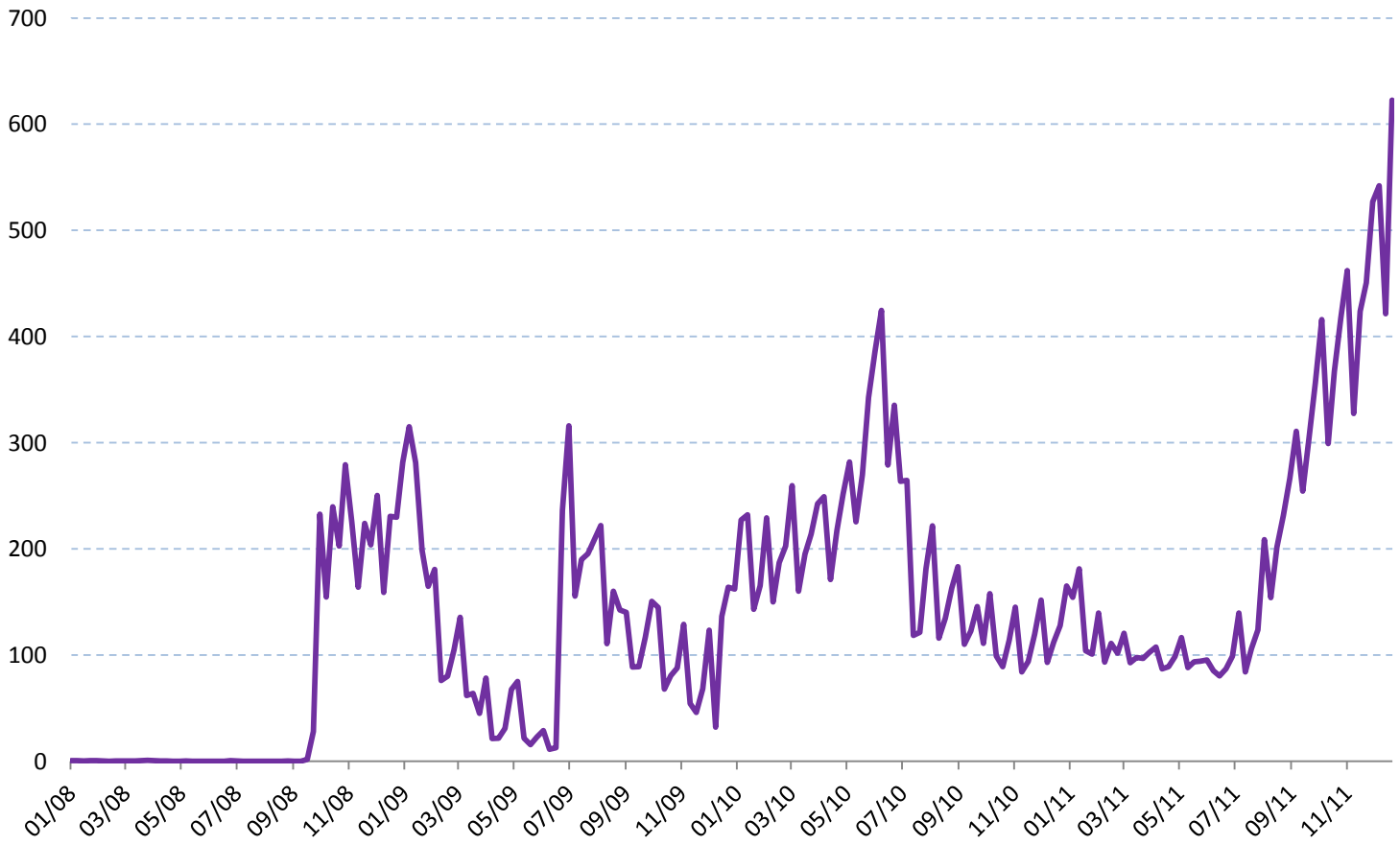
Source: BoE, CBRT.

*Excess Reserve= Banking sector free deposits + Short term open market operations

Monetary Expansion (Eurozone)

Excess Reserves* (ECB)

(Billion Euro)

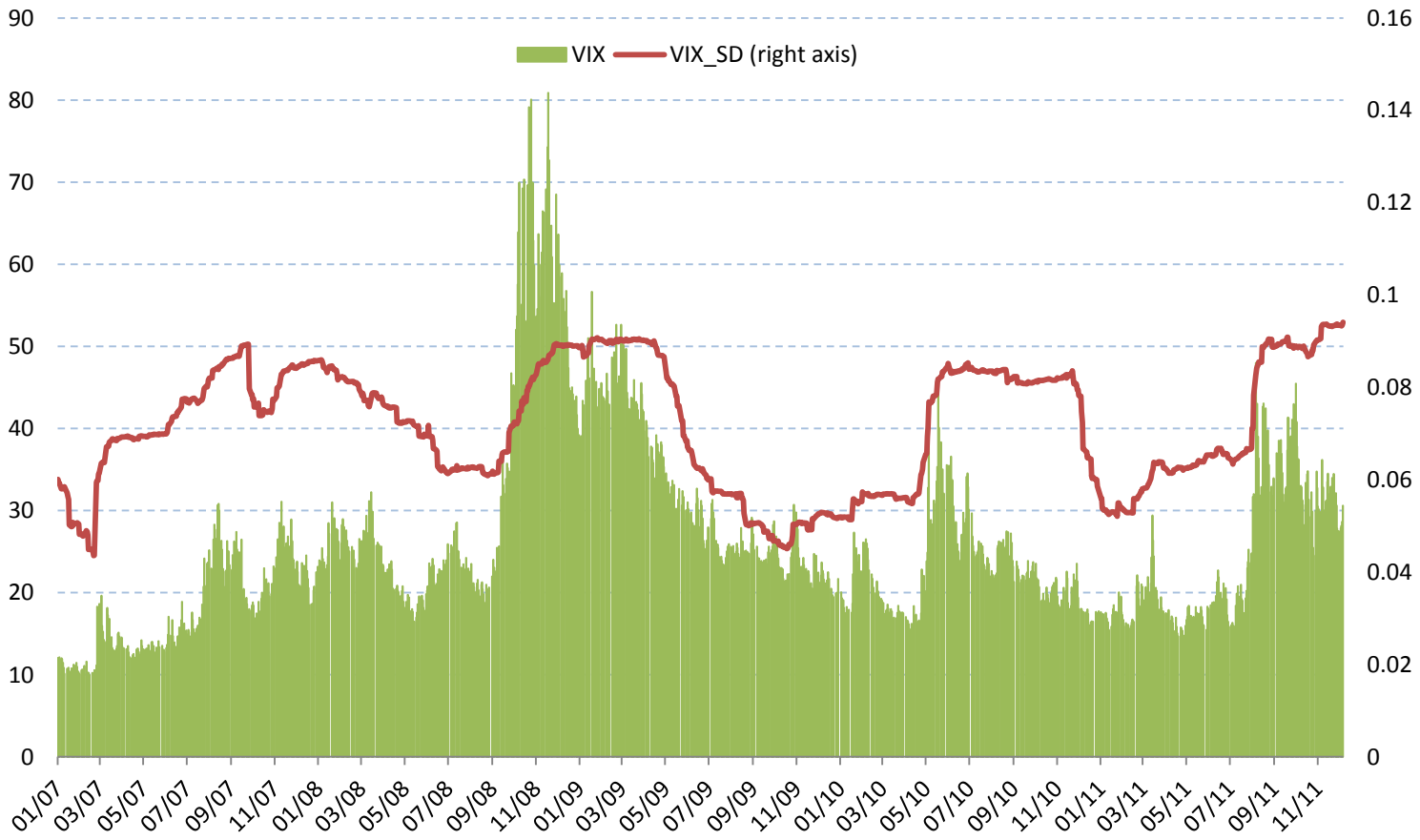


Source: ECB, CBRT.

*Excess Reserves=ECB Balance Sheet Deposit Facility + Fixed Term Deposits

Volatility of Volatility

Market Volatility Index*



* VIX_SD is the standard deviation of daily percentage changes in the VIX index for the last 150 days.

Source: CBRT, Bloomberg.

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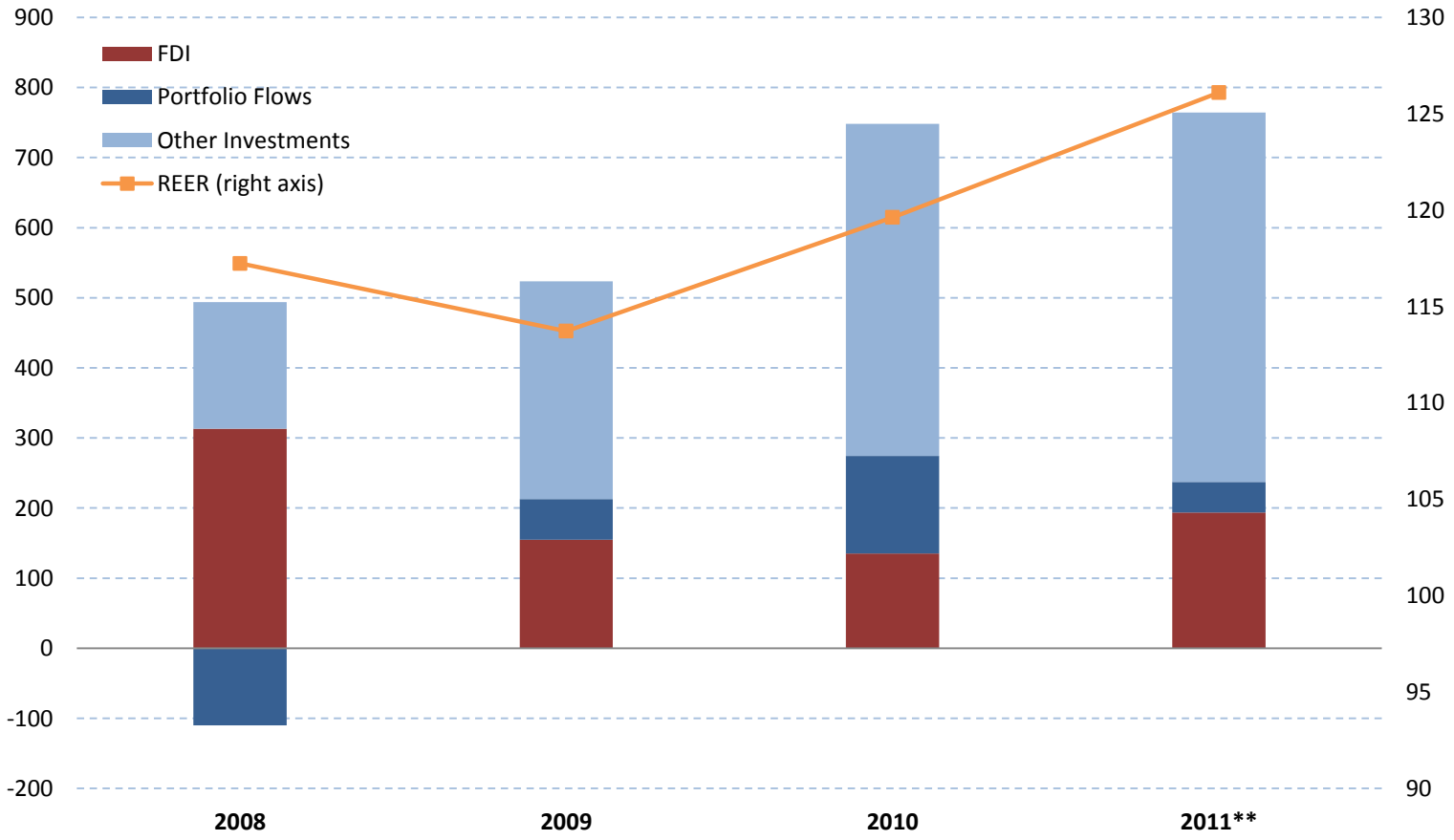
Global monetary expansion…

Capital Flows to EMs and Real Effective Exchange Rate*
(Billion USD, Index 2005=100)



* EMs cover 30 countries from Asia/Pacific, Europe, Latin America and MENA regions.

**2011 data is IIF forecast.

Source: IIF, CBRT.

...led to appreciation pressures on currencies...

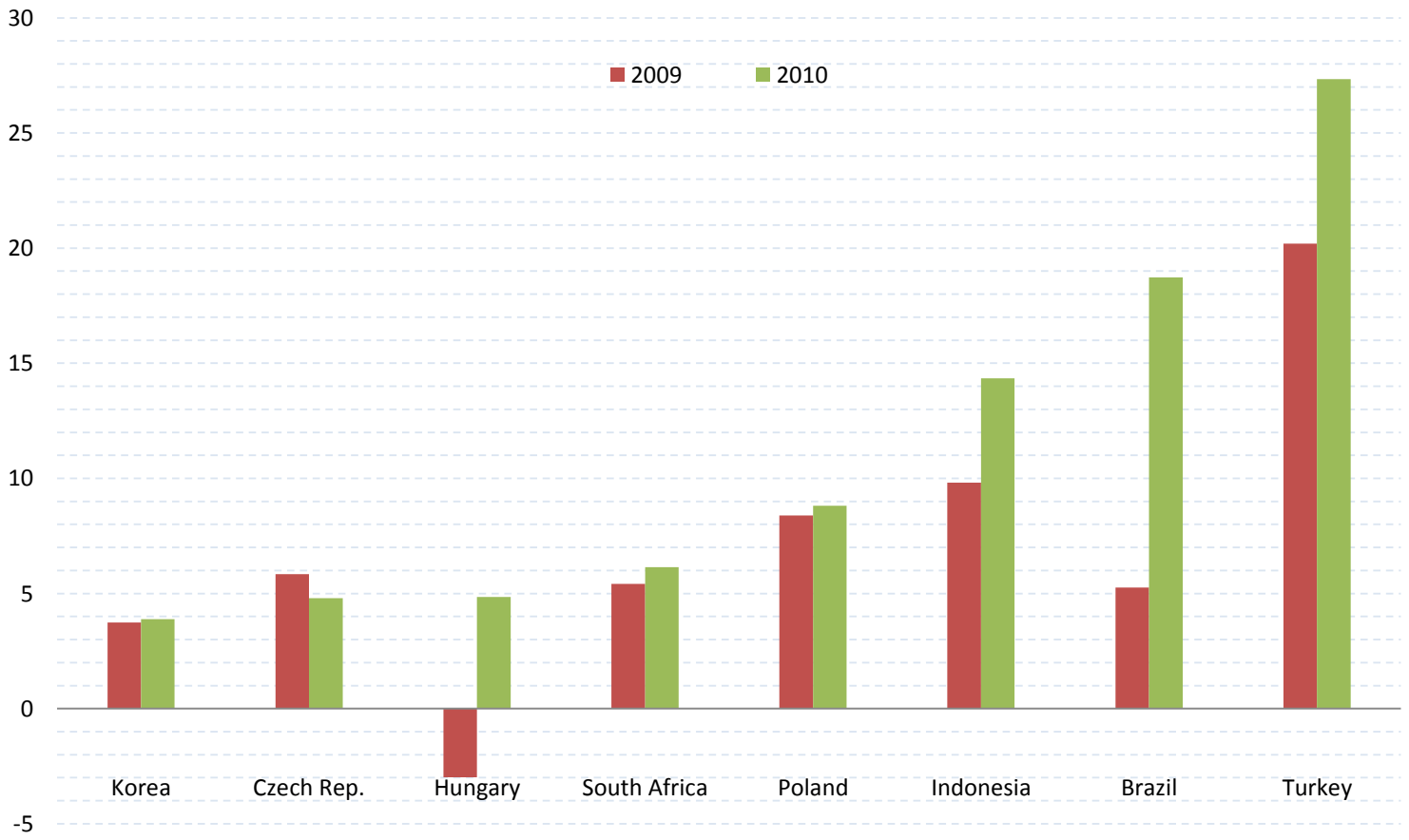
Average of EM currencies against USD*
(4 Jan 2010=1)

Source: Bloomberg, CBRT.

*Average of emerging market currencies, including Brazil, Chile, Czech Republic, Hungary, Mexico, Poland, South Africa, Indonesia, South Korea and Colombia.

...and rapid credit growth in EMs.

Net Domestic Credit Growth*
(Percent)



*Net domestic credit is the sum of net credit to the nonfinancial public sector, credit to the private sector and other accounts.

Source: World Bank.

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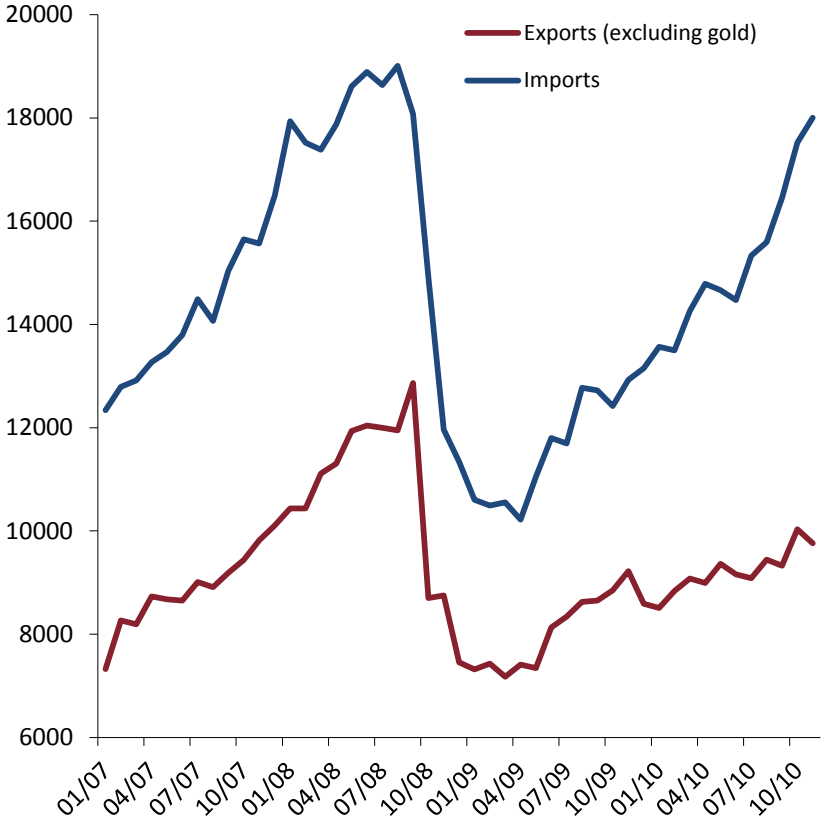
Need for Rebalancing

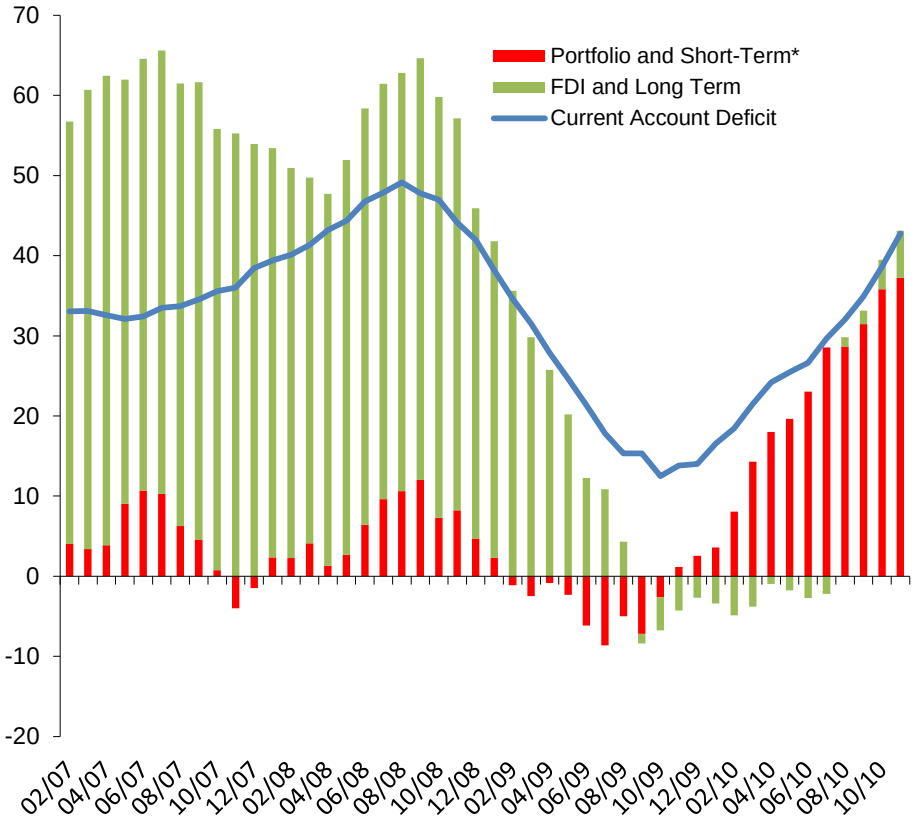
Global monetary expansion combined with a strong recovery led to an imbalance between external and domestic demand growth rates.

Monthly Imports and Exports (Seasonally Adjusted, Million USD)



Source: TurkStat, CBRT.

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

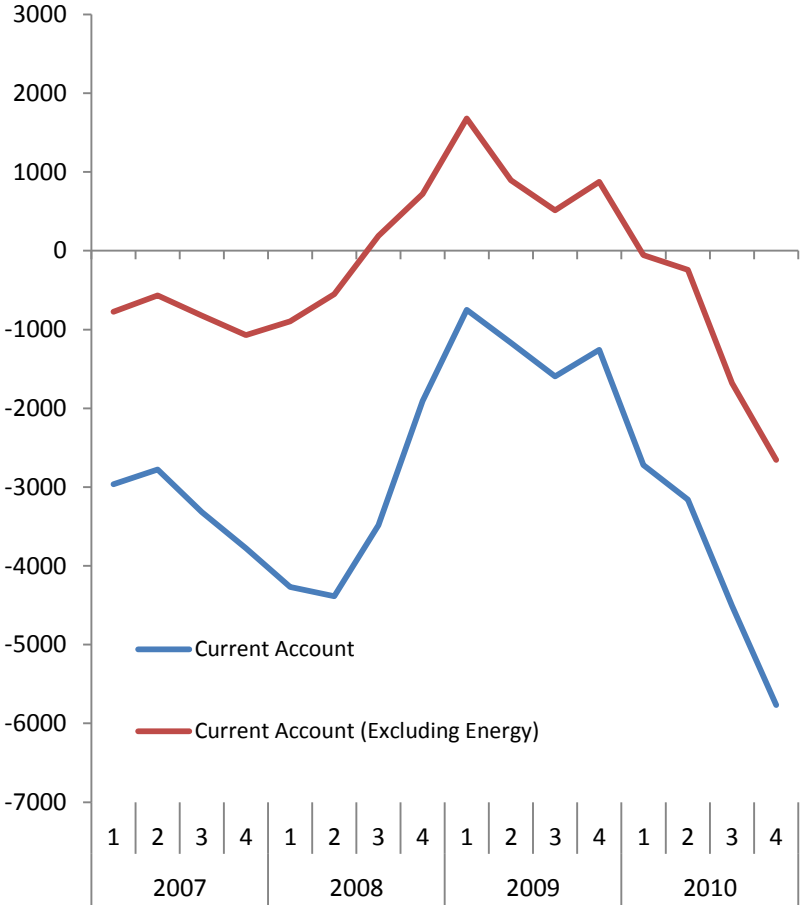


Source: CBRT.

*Short-term capital movements are sum of banking and real sectors' short term net credits and deposits in banks.

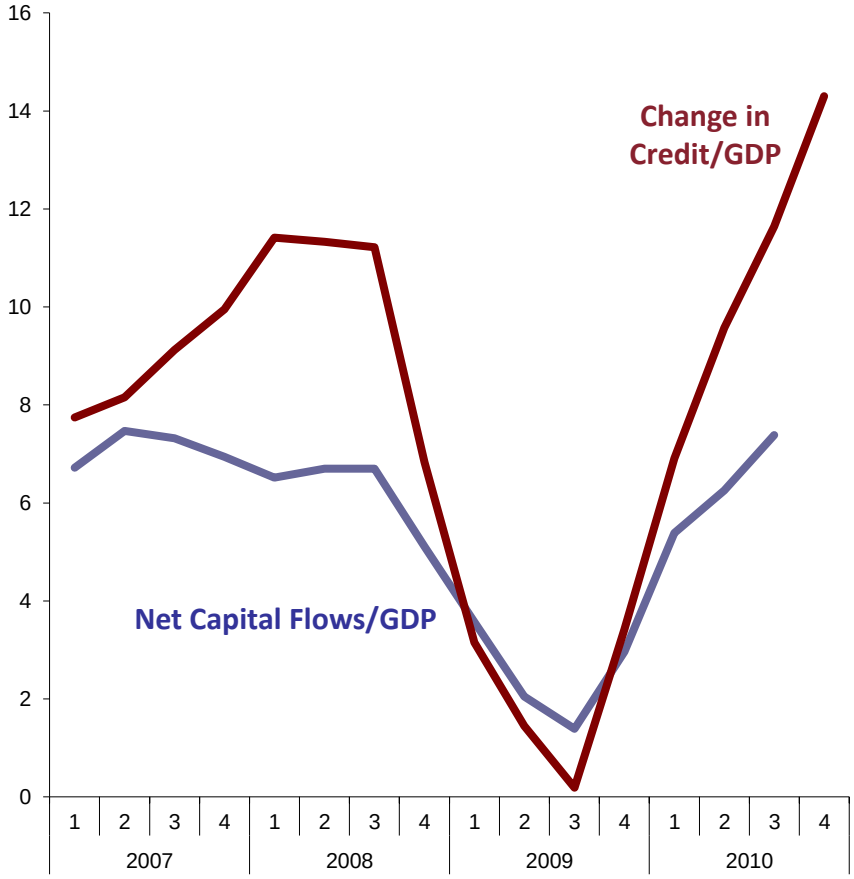
Need for Rebalancing

Current Account Balance
(Seasonally Adjusted, Monthly Average, Million USD)



Source: TURKSTAT, CBRT.
*July and August figures are realization, September and Q4 figures are forecast.

Capital Flows and Credit Growth
(percent)



Source:TurkStat, CBRT .

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Policies Against Short Term Capital Flows

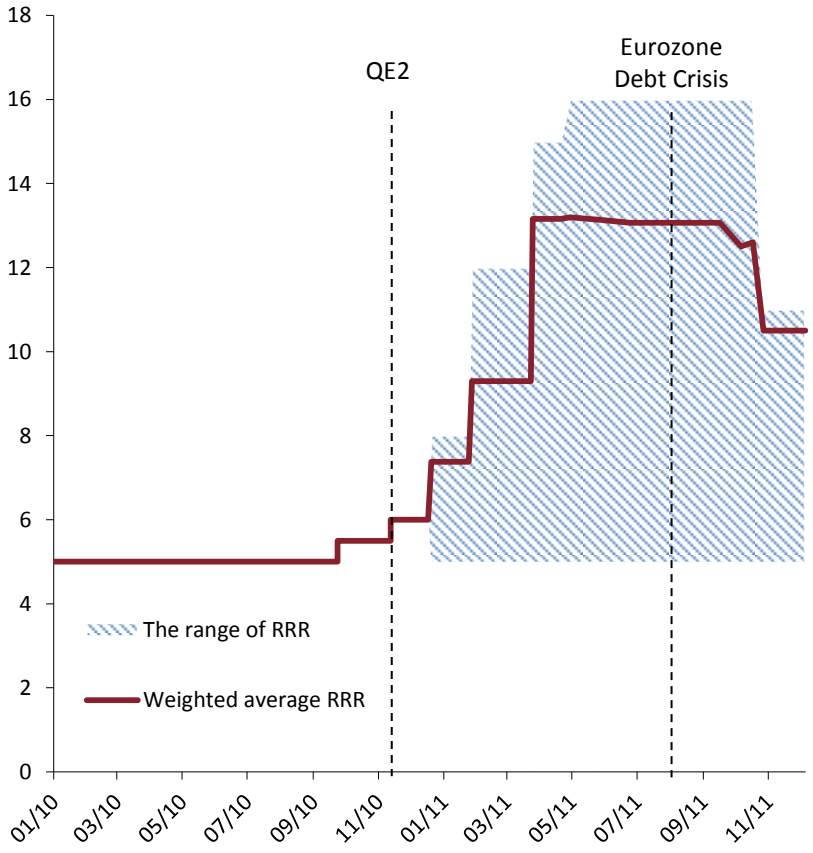
Strong Inflows	Outflows/Weak Inflows
FX Purchases	FX Sales
Decreasing the lower bound of the interest rate corridor	Increasing the upper bound of the interest rate corridor
RRR hikes	RRR cuts

Measures Against Excessive Credit Growth

	Predominant Policy
Before August 2011	Macroprudential Tightening
After October 2011	Monetary Tightening

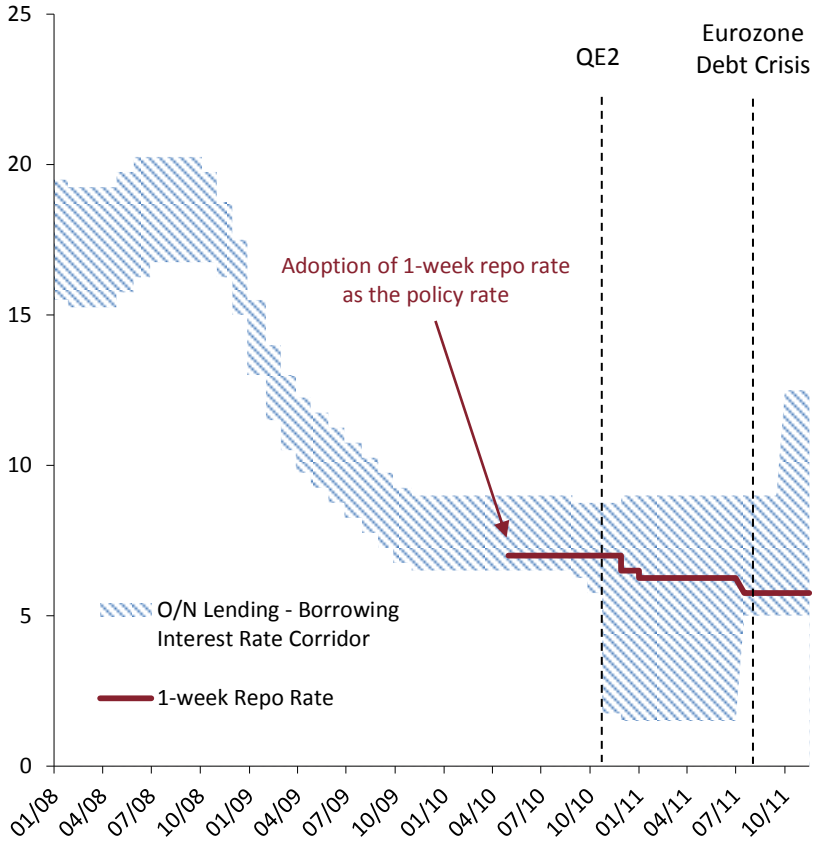
Sequencing

TL Required Reserve Ratios (RRR)
(Percent)



Source: CBRT.

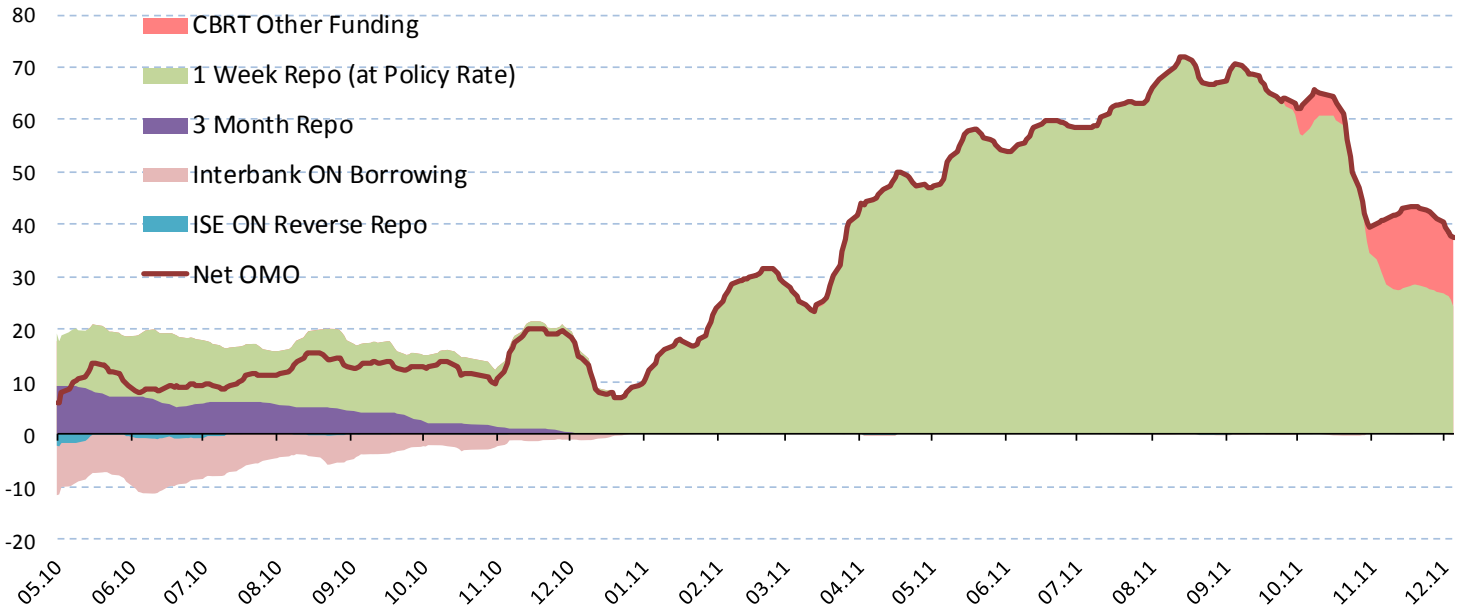
CBRT Policy Rates
(Percent)



Source: CBRT.

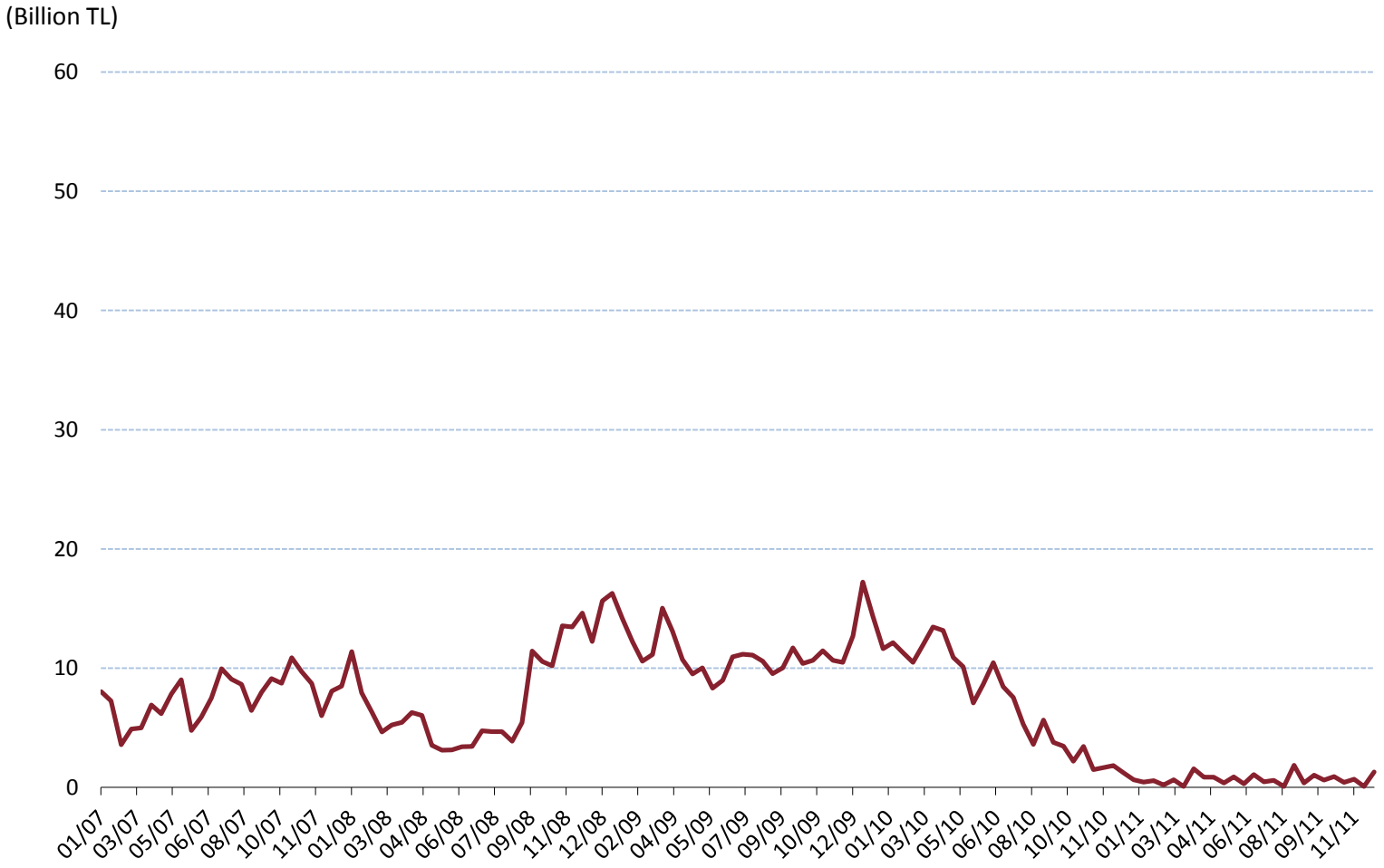
Liquidity Management

Composition of Liquidity
(Two Week Moving Averages, Billion TL)



Source: CBRT.

Excess Reserves* (CBRT)



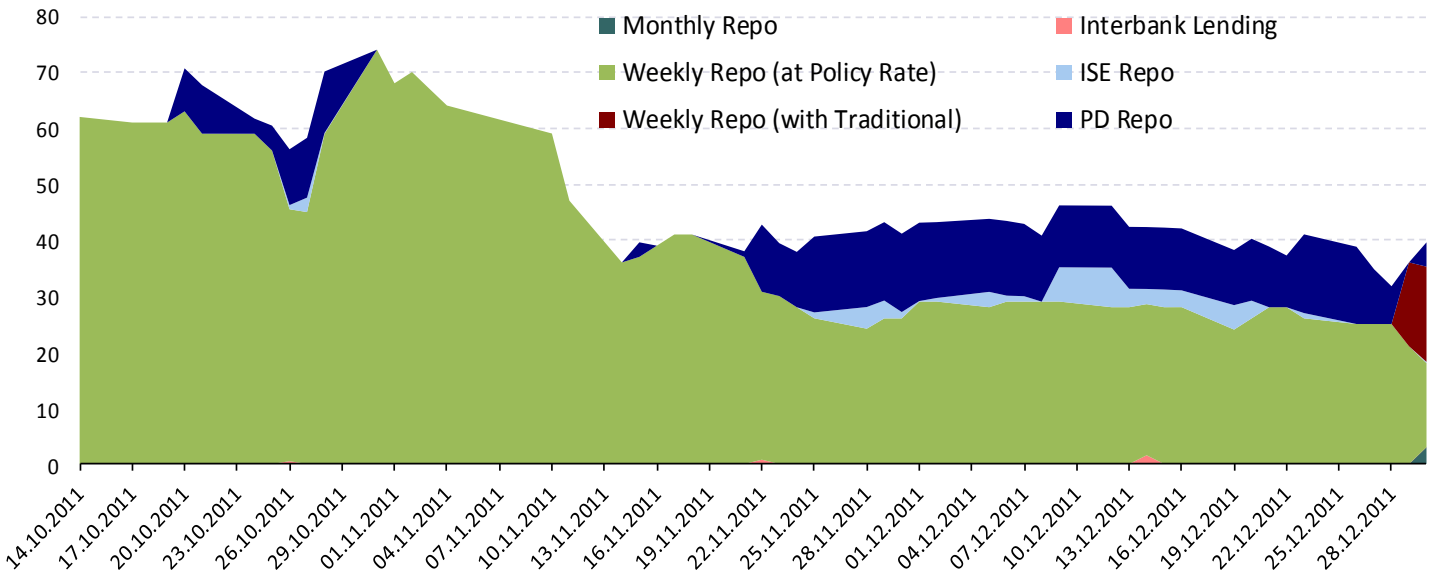
Source: CBRT.

* Excess Reserves = Sterilization through O/N Borrowing + Banking Sector Free Deposit - Banking Sector Required Reserves

CBRT Funding

(Billion TL , 14.10.2011-30.12.2011)

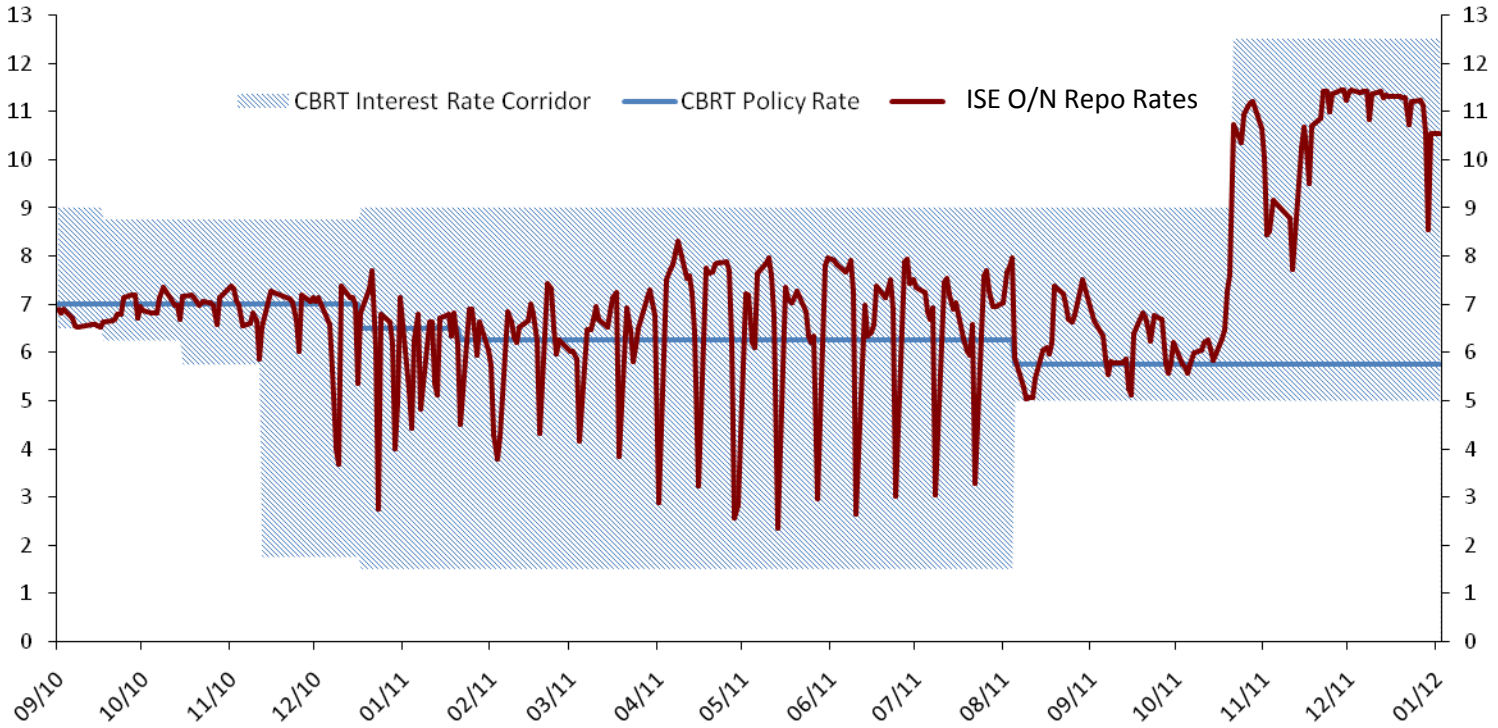
The liquidity need of the banking system was realized as 41.5 billion TL on average in December. In addition to the daily one-week repo auctions, since December 30, 2011 the CBRT started to conduct one-month repo auctions via traditional method every Friday. It is decided that in additional-monetary-tightening days, one week repo auctions are going to be conducted via traditional method.



Source: CBRT.

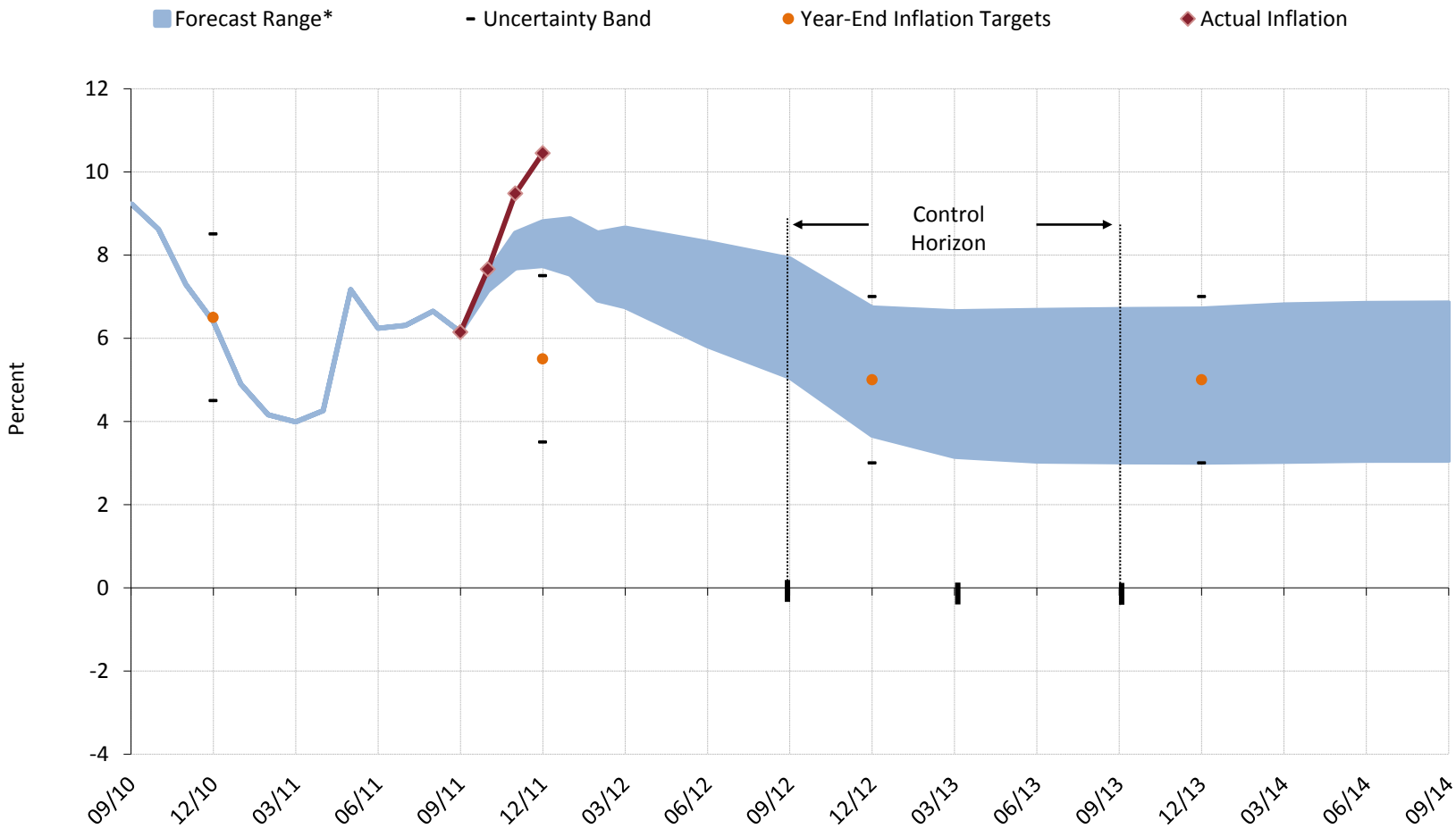
ISE O/N Repo Rates
(Percent)

O/N interest rates have continued to keep its high level in December as a result of the MPC decision to widen the interest rate corridor and to decrease funding through repo auctions.



Source: CBRT.

Inflation Developments



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

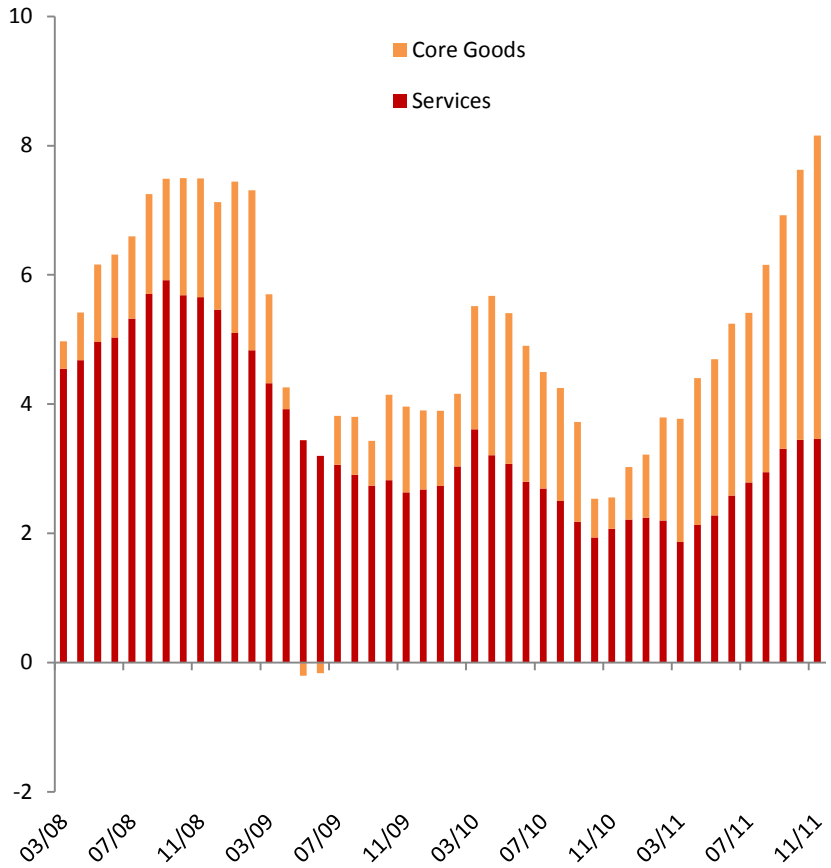
Main Drivers of Inflation so far

November Inflation	9.5
Contribution of Exchange Rate and Import Price Pass-Through	4.5
Contribution of Administered Prices	1.6

Trend Inflation

Core Inflation Indicator (I)

(Contribution of Subgroups to Annual Inflation)

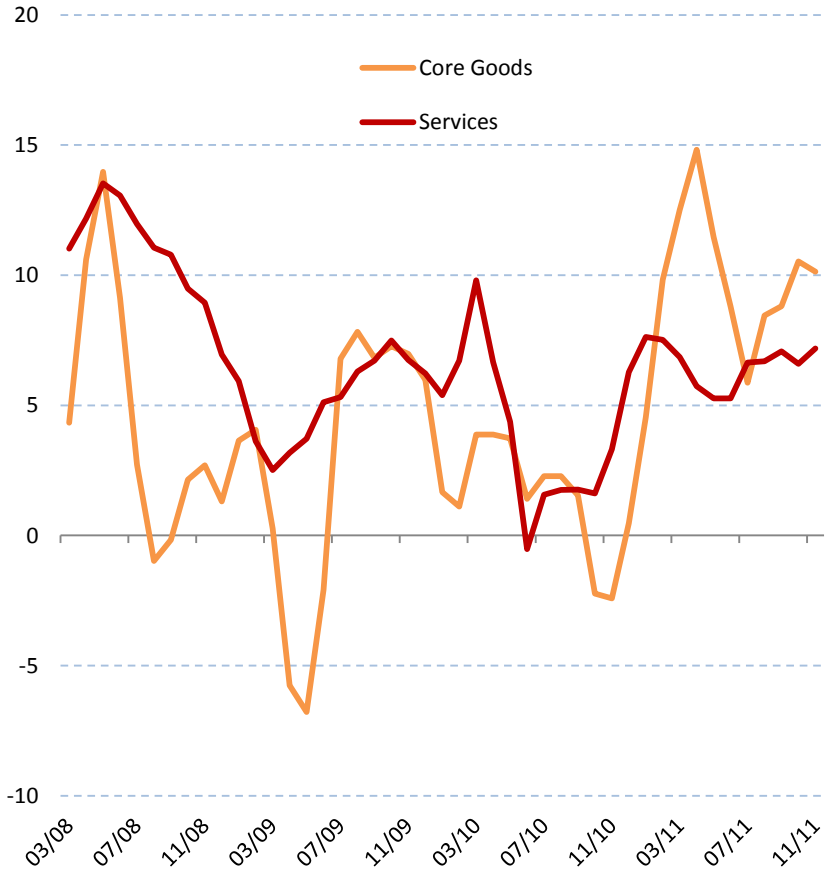


Source: TURKSTAT, CBRT.

* Core goods: Goods excluding food, energy, alcoholic beverages, tobacco and gold.

Services and Core Goods

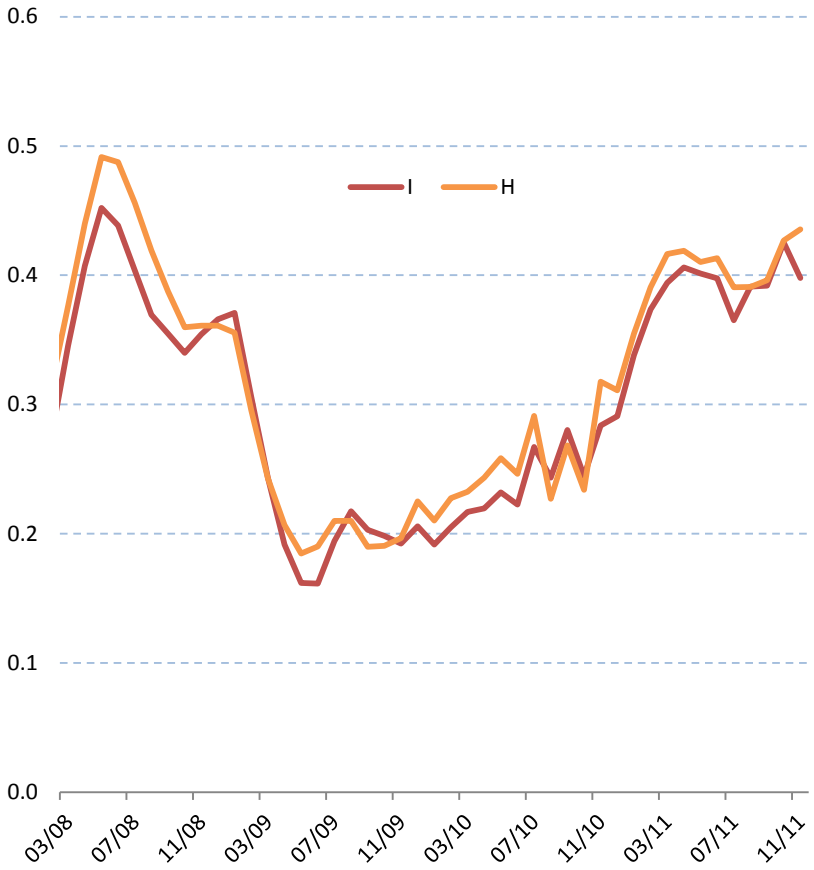
(Seas. Adjust., Annualized 3-Month Average, % Change)



Source: TURKSTAT, CBRT.

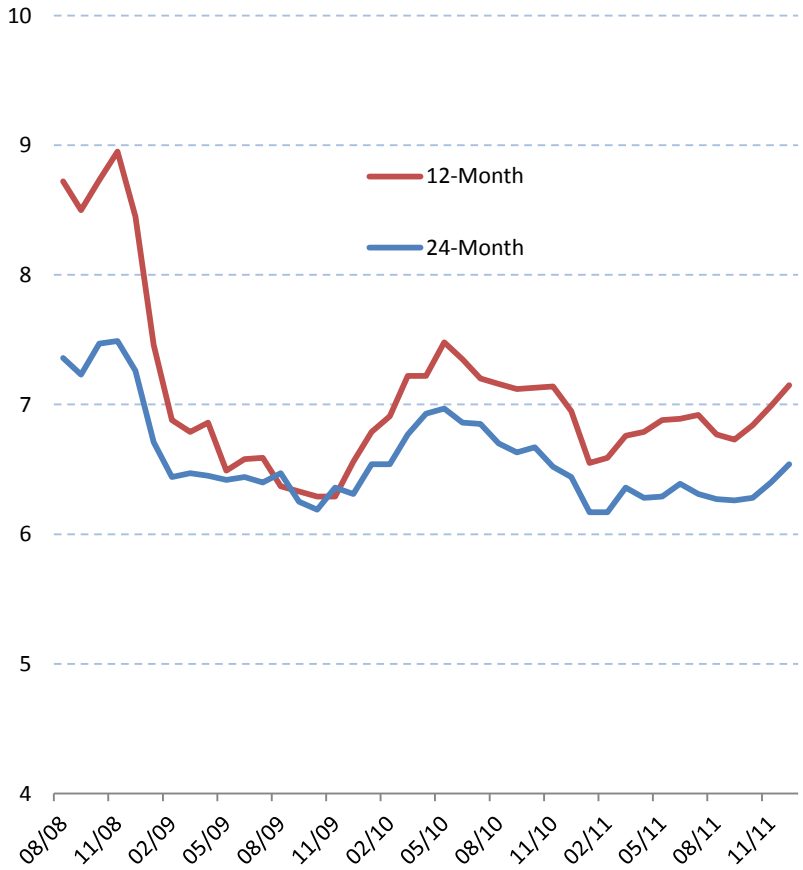
Trend Inflation

Price Diffusion Indices (H and I)
(Seasonally Adjusted, 3-Month Average)



Source: TURKSTAT, CBRT.

Inflation Expectations*

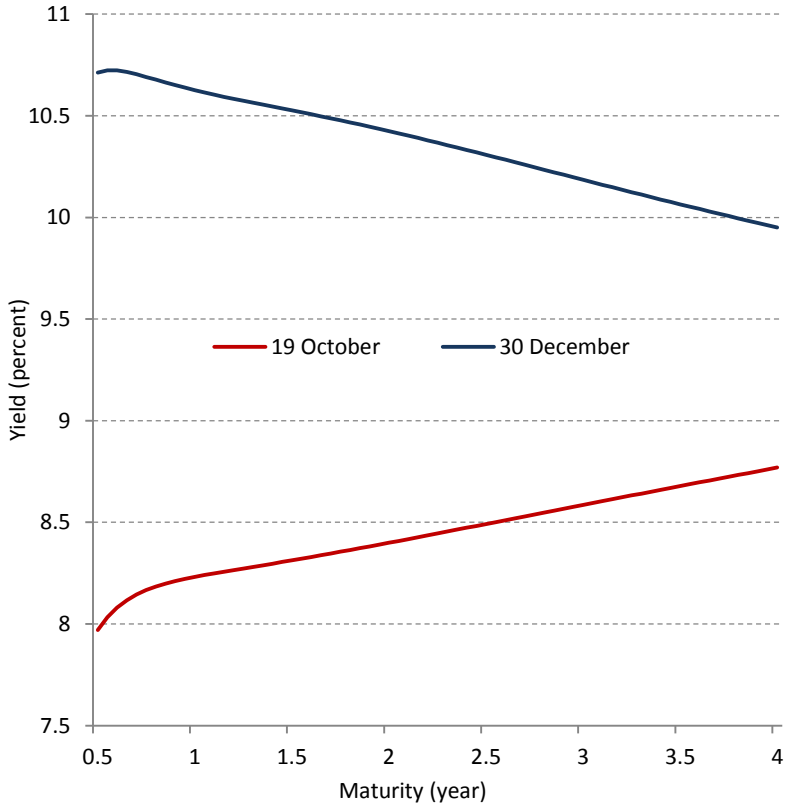


* CBRT Survey of Expectations, second survey period results.

Source: CBRT.

Monetary and Financial Conditions

Yield Curve*

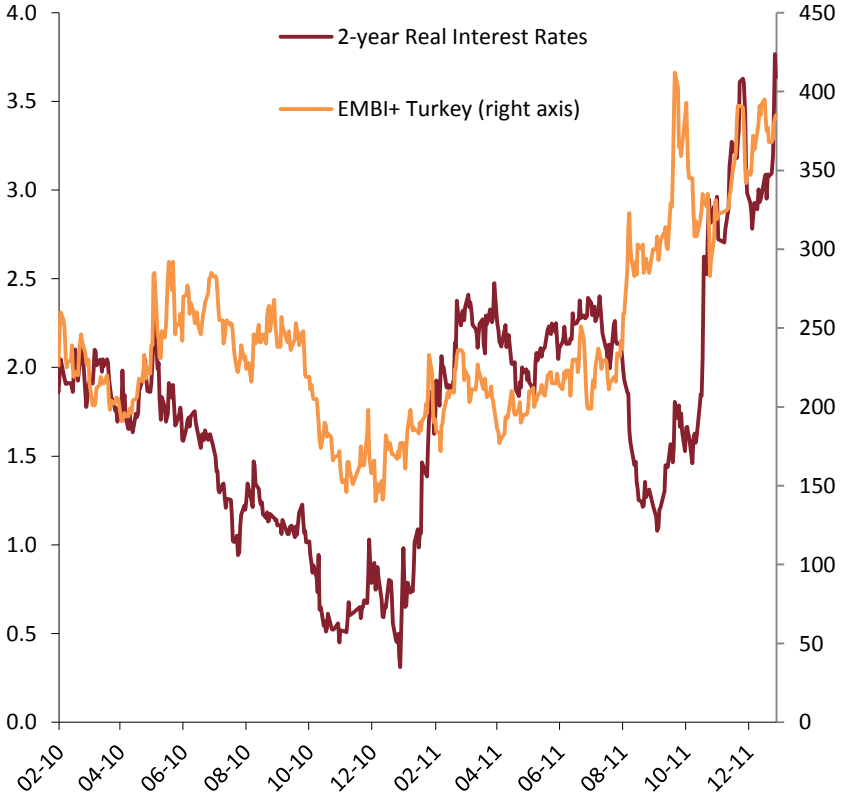


*Calculated from the compounded returns on bonds quoted in ISE Bonds and Bills Market by using ENS method.

Source: CBRT.

2-Year Real Interest Rates*

(Percent)



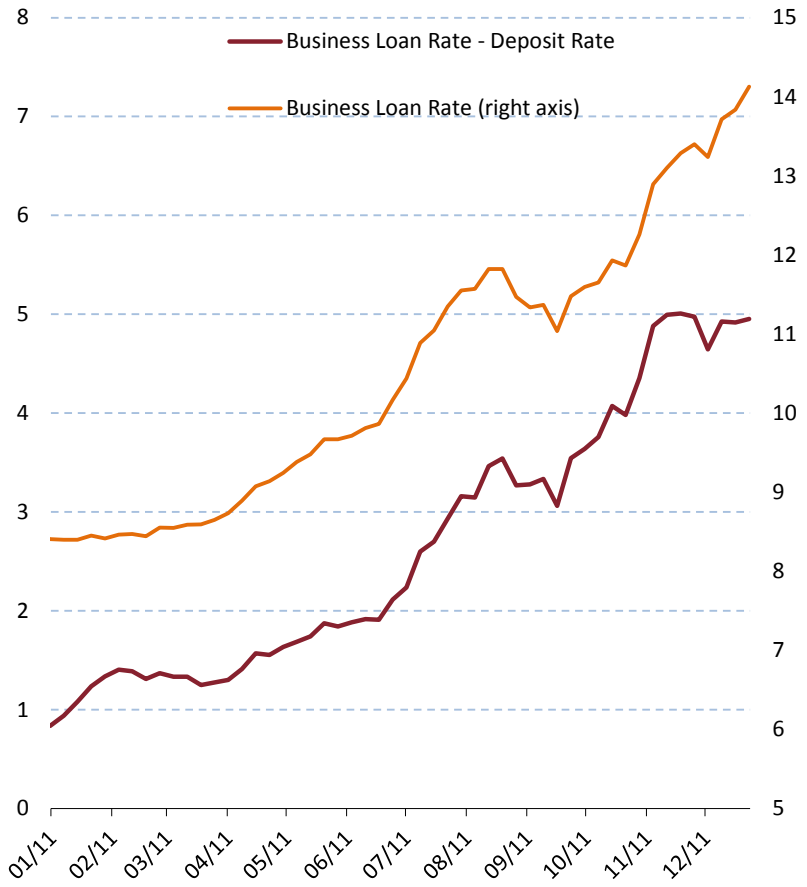
* Calculated as the 2-year discounted bond returns derived from the yield curve, minus the 2-year ahead CPI inflation rate in the CBRT's Survey of Expectations.

Source: ISE, CBRT.

Monetary and Financial Conditions

TL Business Loan Rates*

(Percent)

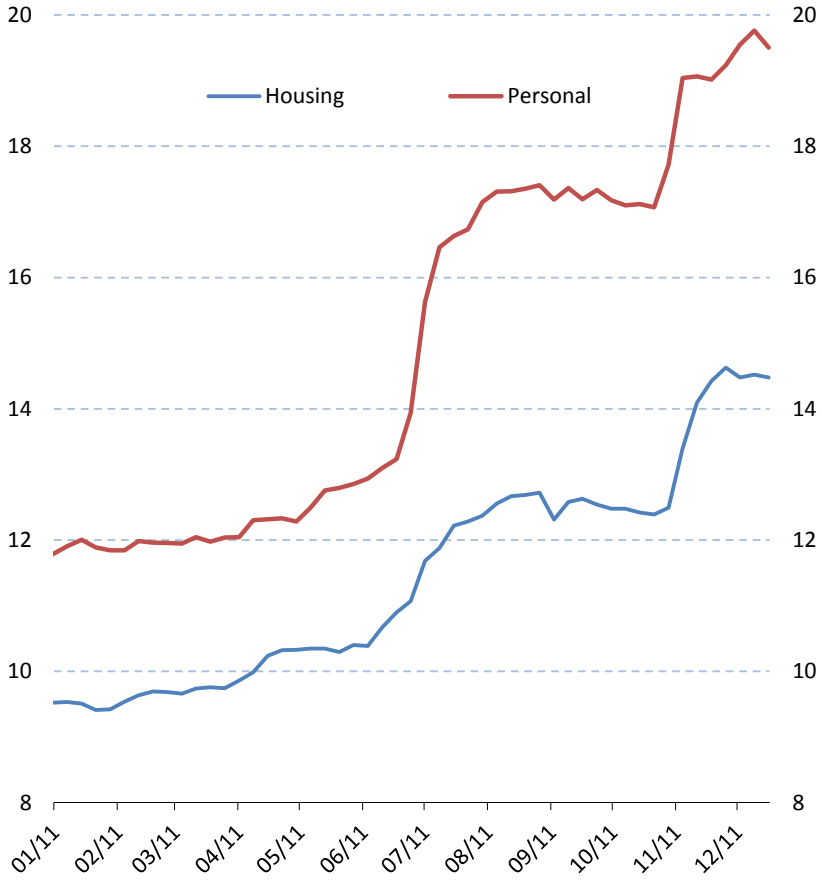


*Annual interest rates, 4-week average.

Source: CBRT.

TL Consumer Loan Rates*

(Percent)

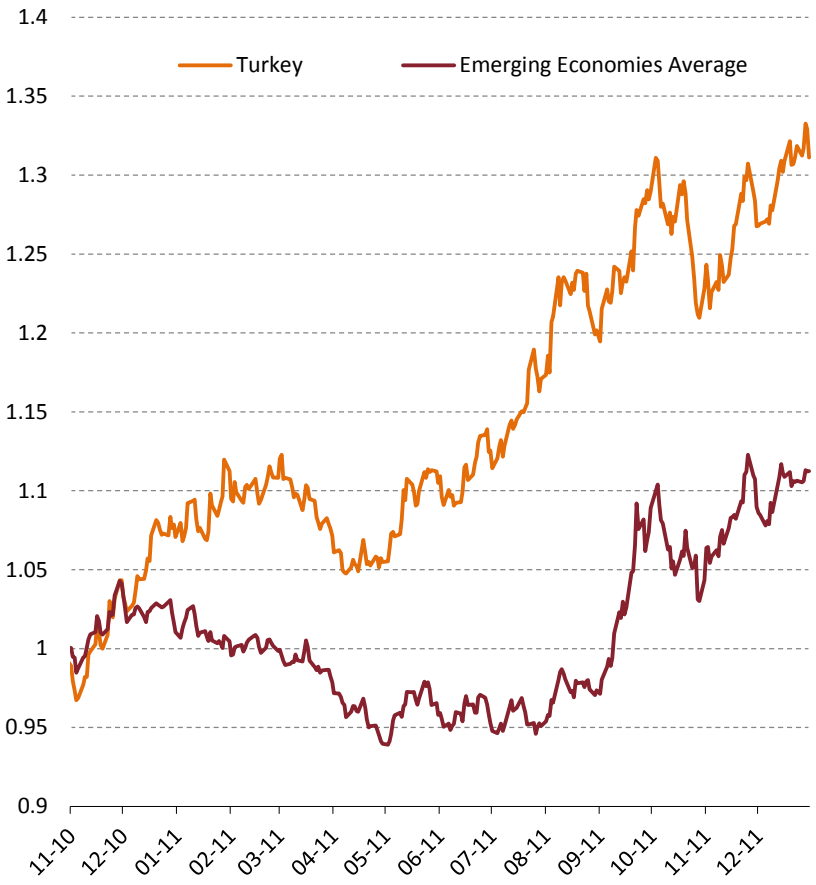


*Flow.

Source: CBRT.

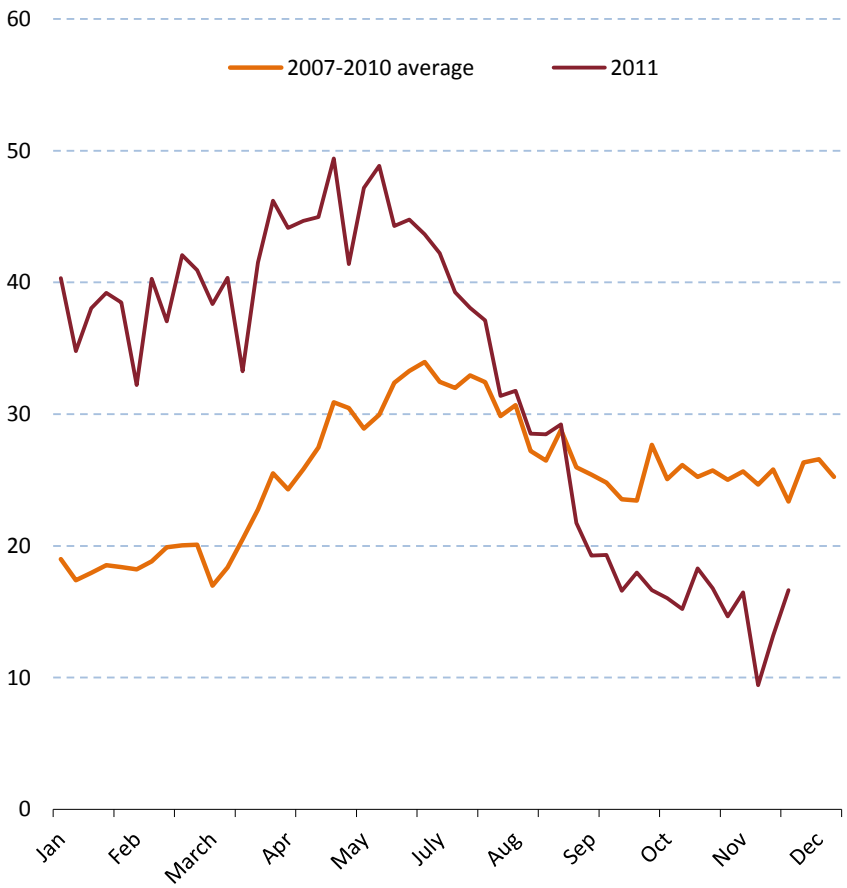
Exchange Rates and Credit Growth

TL and Emerging Market Currencies*
(October 1, 2010 = 1)



*Against USD. Average of normalized exchange rates of Brazil, Chile, Czech Republic, Hungary, Mexico, Poland, S. Africa, Indonesia, South Korea and Colombia. Increases imply depreciation of domestic currency against USD.
Source: Bloomberg, CBRT.

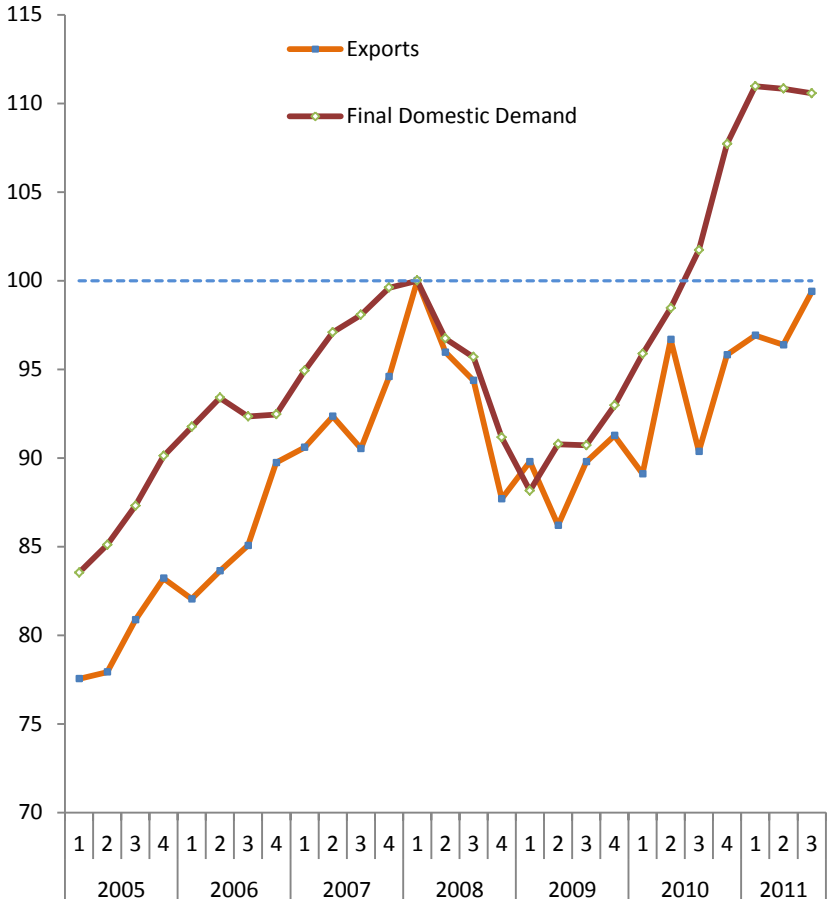
Loan Growth Rates *
(13-Week Average, Annualized, Percent)



*FX adjusted.
Source: CBRT.

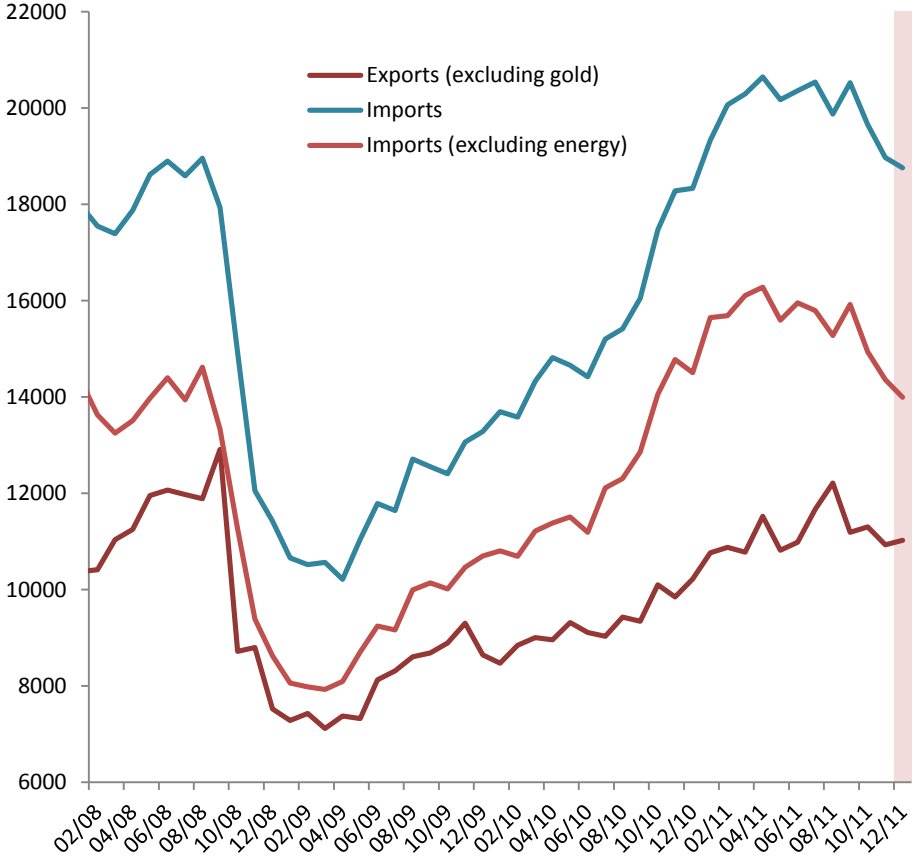
Rebalancing of the Economy

Composition of Demand
(Seasonally Adjusted, 2008Q1=100)



Source: TURKSTAT, CBRT.

Imports and Exports*
(Seasonally Adjusted, Million USD)



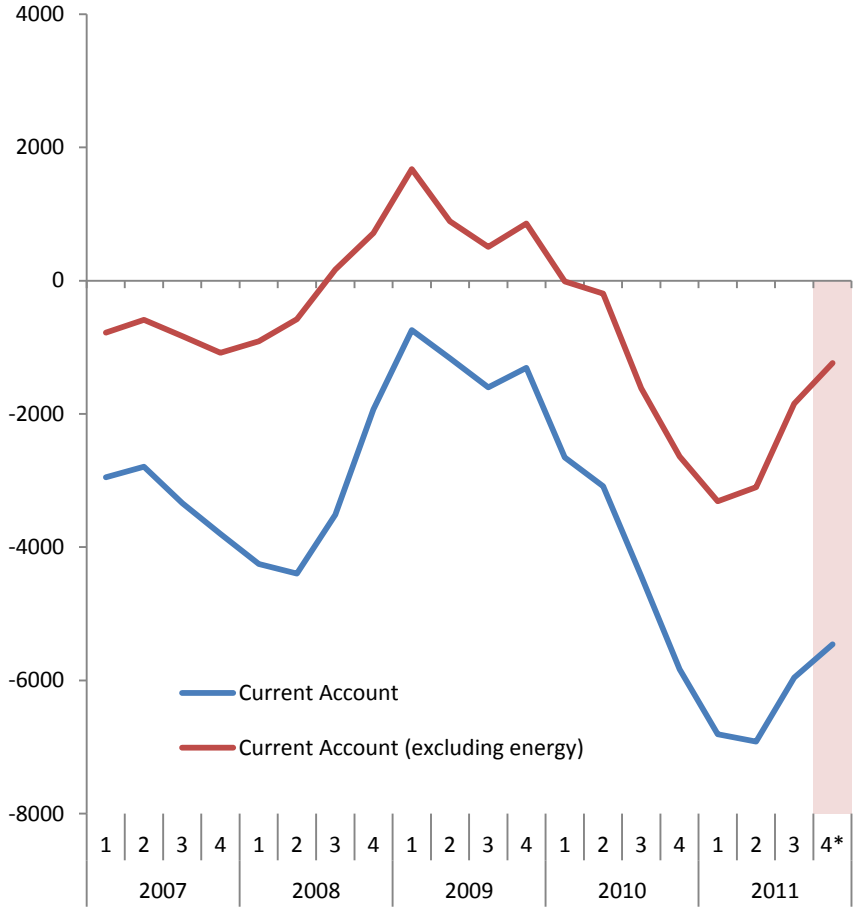
*Estimate for December.

Source: TURKSTAT, CBRT.

Rebalancing of the Economy

Current Account Balance

(Seasonally Adjusted, Monthly Average, Million USD)

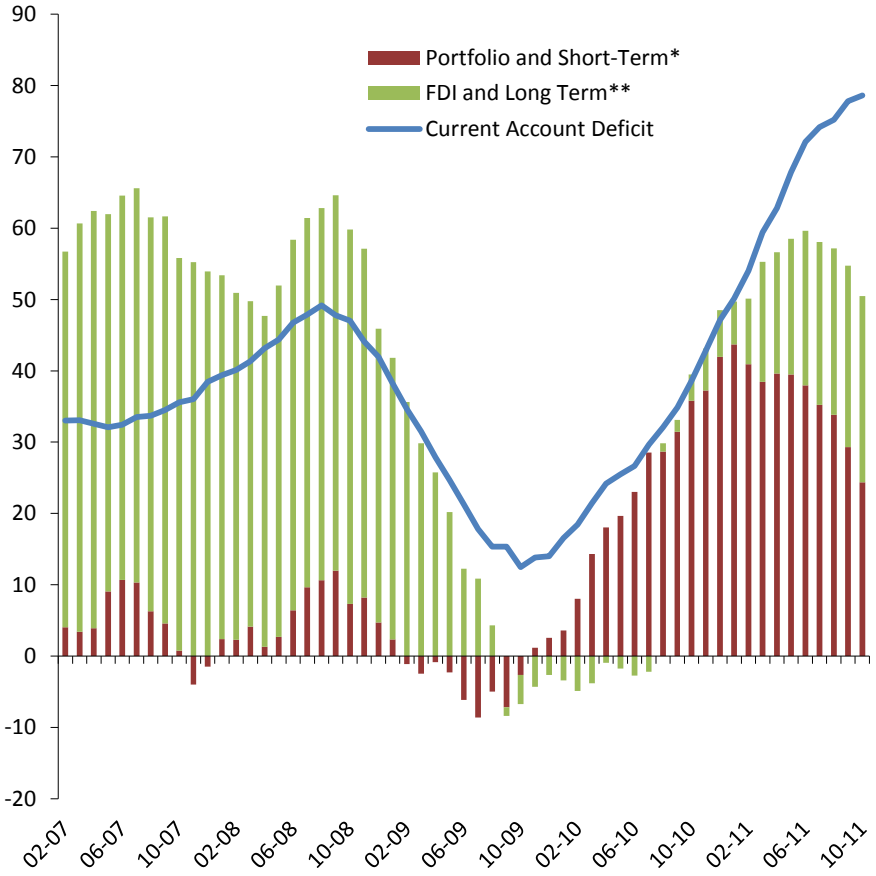


*Estimate.

Source: TURKSTAT, CBRT.

Main Sources of Current Account Deficit Finance

(12-months Cumulative, Billion USD)

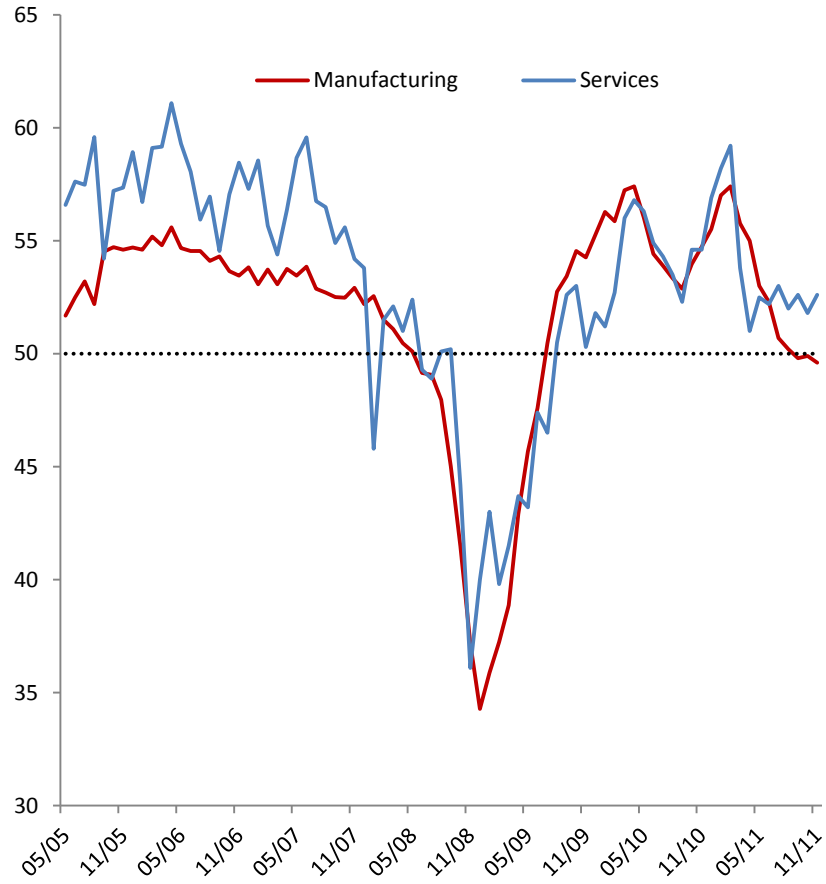


*Portfolio and Short-term capital movements are sum of equities, treasury bonds, banking and real sectors' short term net credits and deposits in banks.

** Long-term capital movements are sum of banking and real sectors' long term net credits and bonds issued by banks and the Treasury. Source: CBRT.

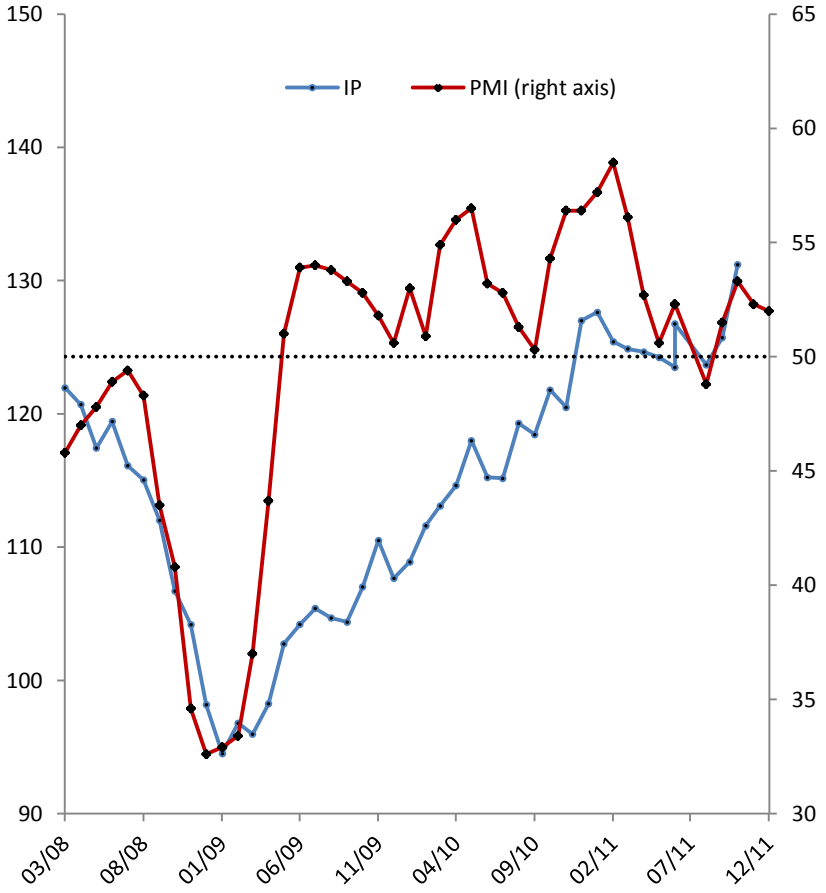
Leading Indicators

Global PMI Indices
(Seasonally Adjusted)



Source: Bloomberg.

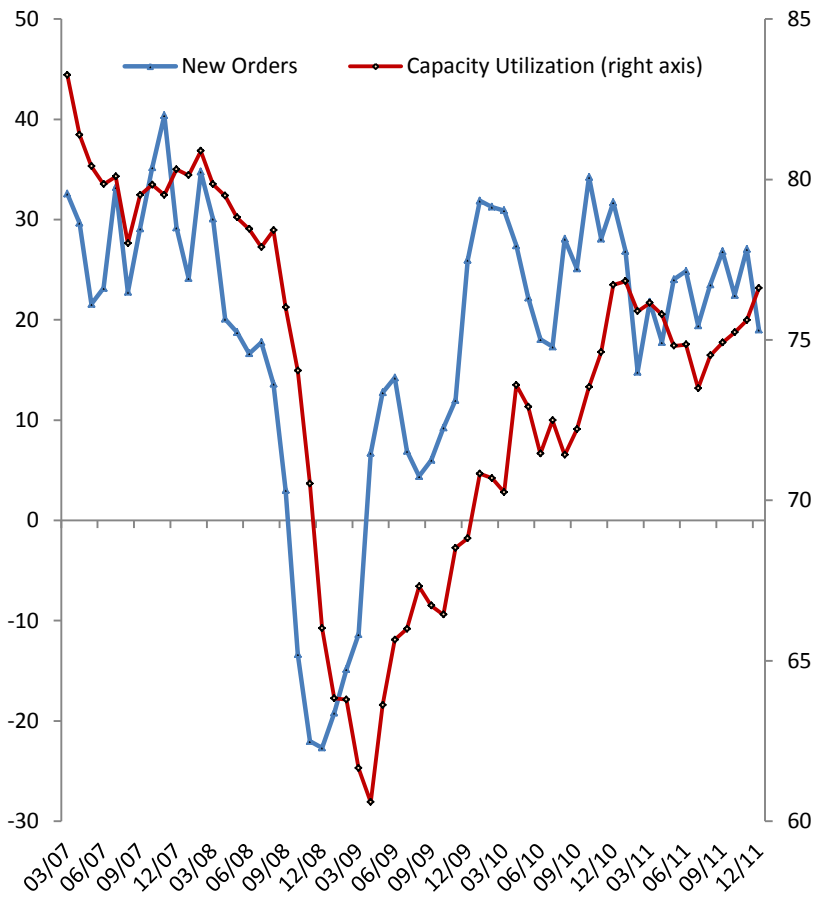
Industrial Production and PMI in Turkey
(Seasonally Adjusted)



Source: MARKIT, TURKSTAT.

Leading Indicators

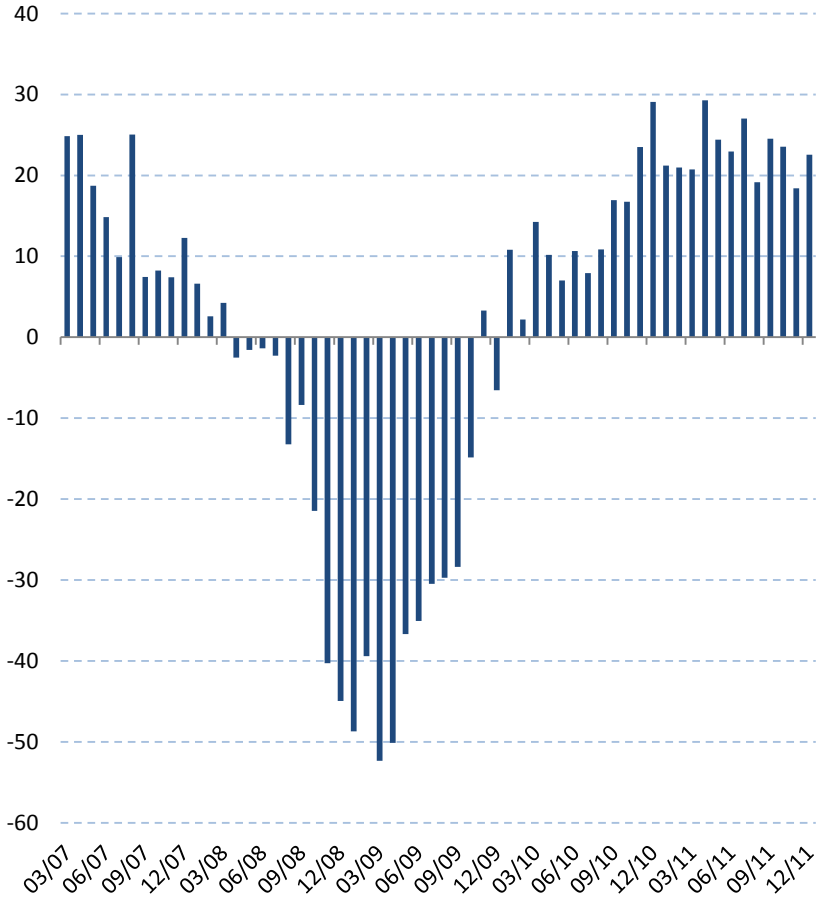
New Orders* and Capacity Utilization
(Seasonally Adjusted)



*Question number 17 from Business Tendency Survey: How do you expect your overall orders to develop over the next three months?

Source: CBRT.

Investment Tendency*
(Seasonally Adjusted)

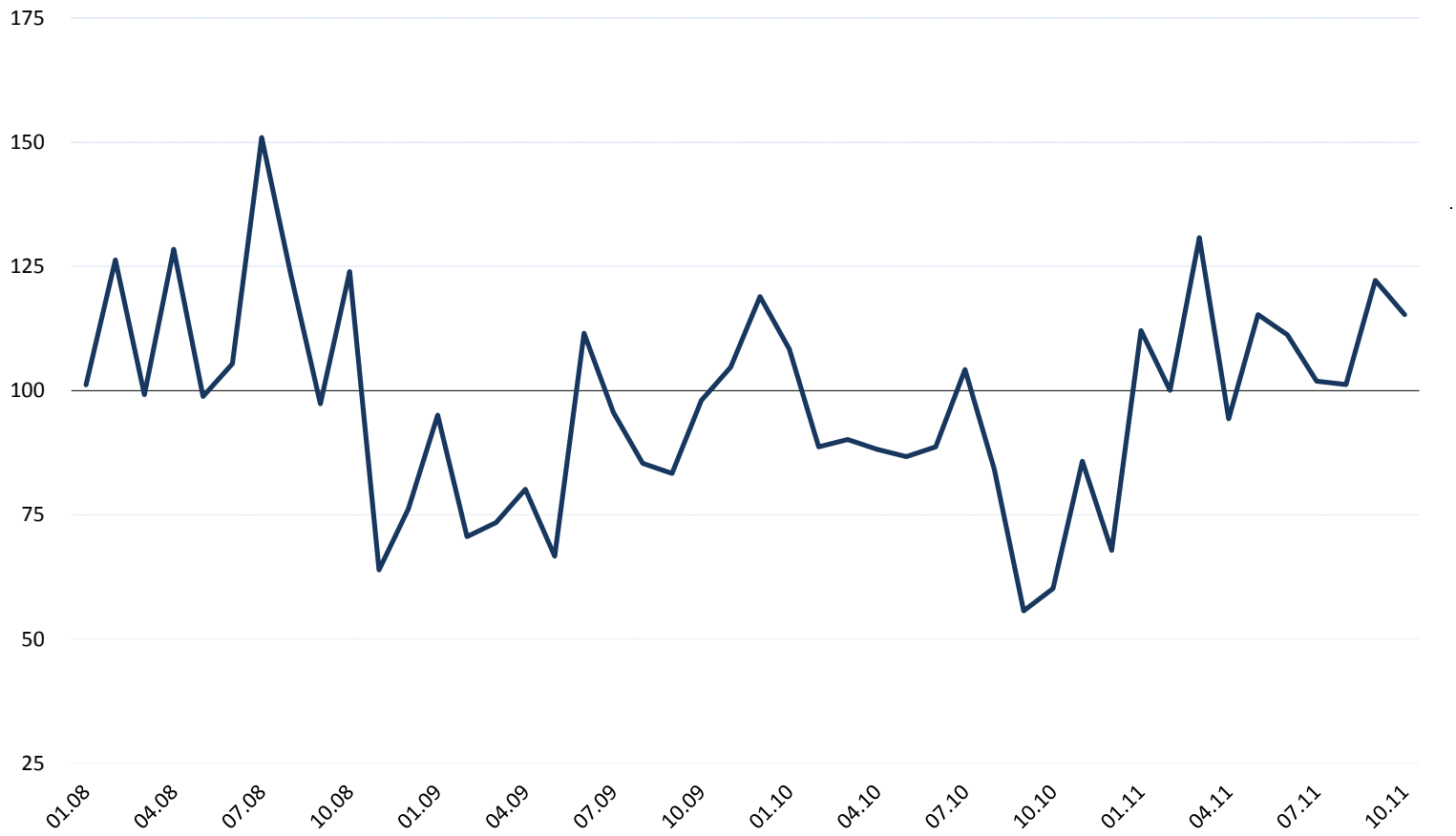


*Question number 23 from Business Tendency Survey: Compared to the last 12 months, how do you expect your fixed investment expenditure to change over the next 12 months?

Source: CBRT.

Rollover Ratio

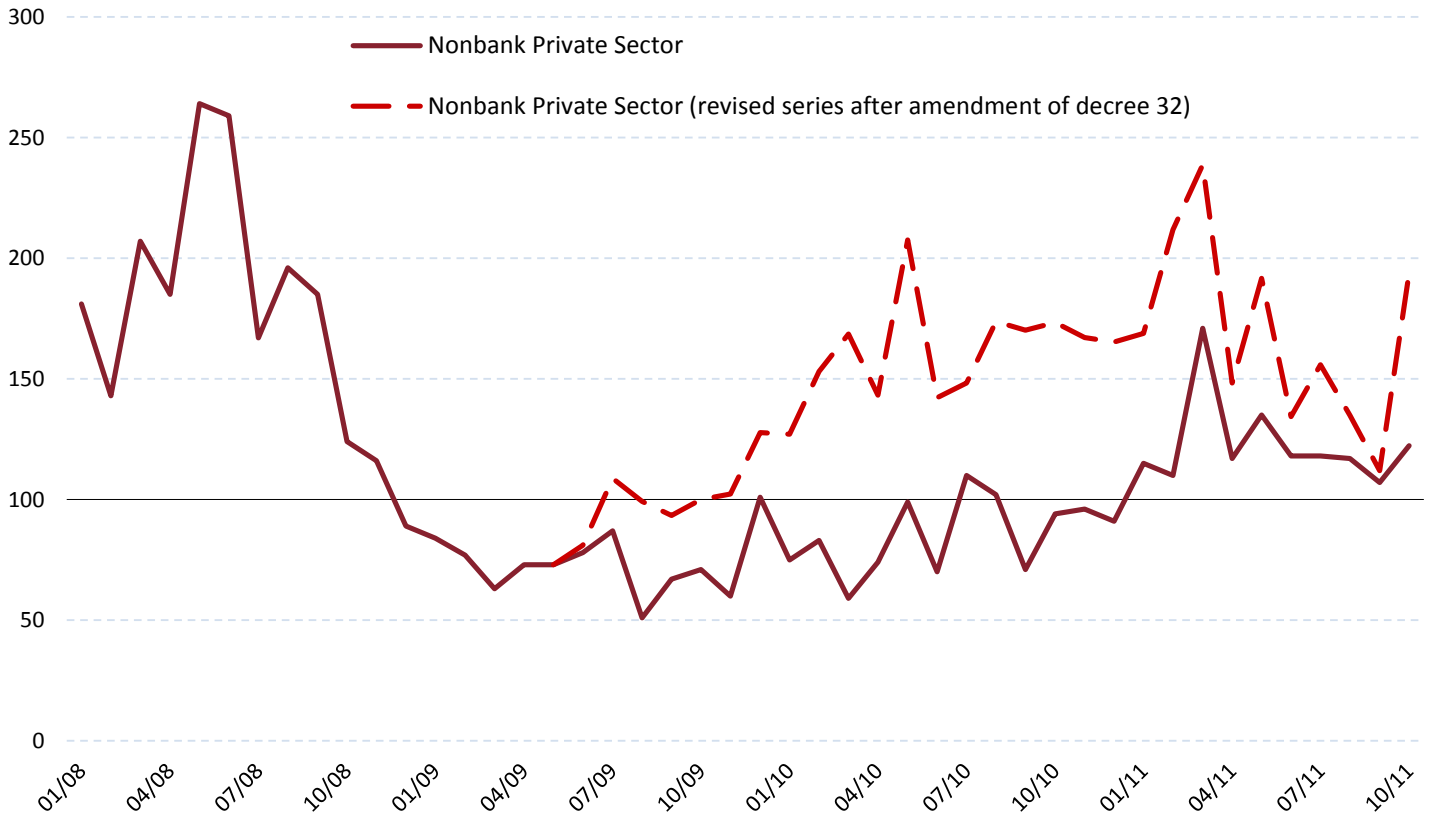
Foreign Debt Rollover Ratio of Banks
(Percent)



Source: CBRT.

Rollover Ratio

Foreign Debt Rollover Ratio of Nonbank Private Sector
(Percent)



Source: CBRT.

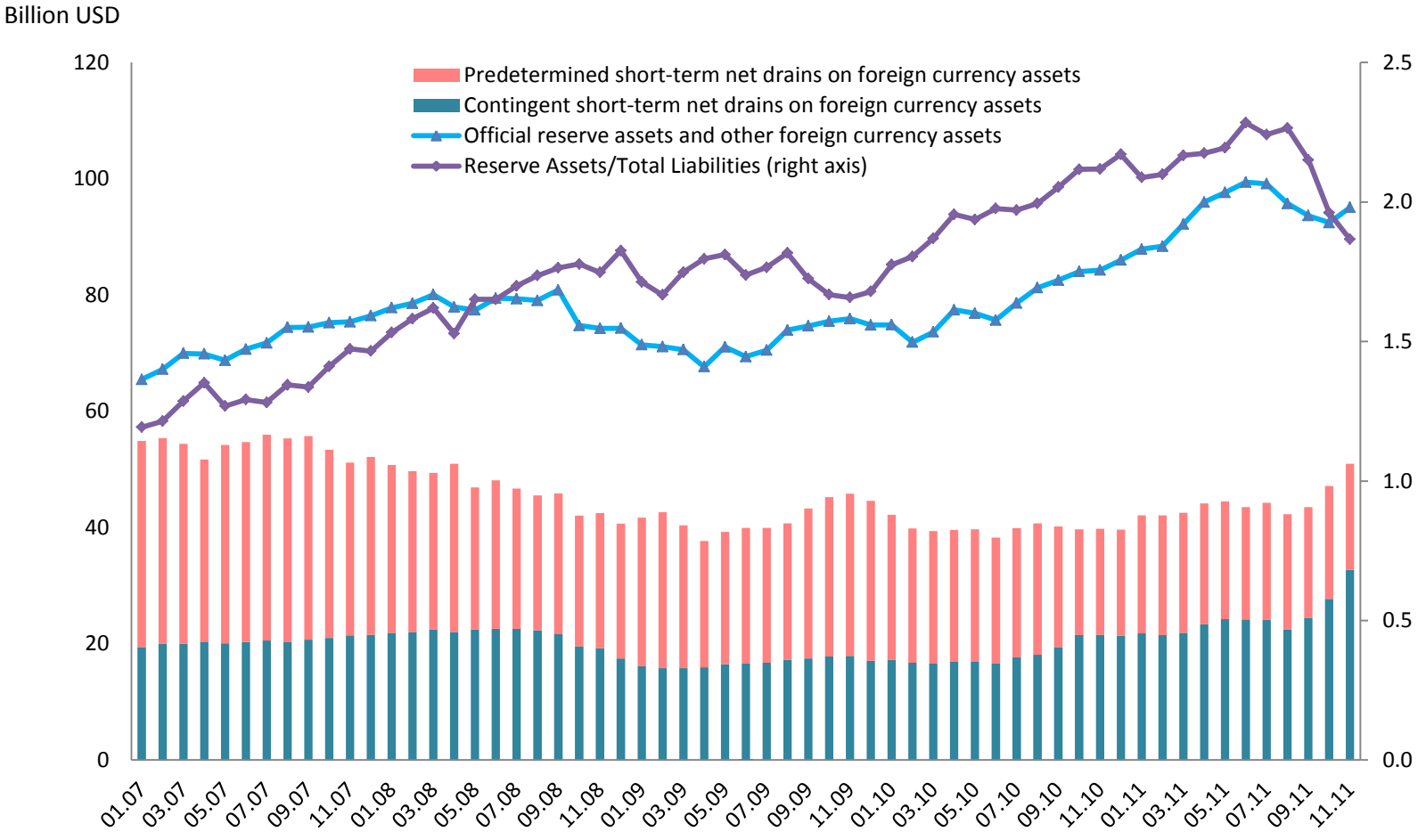
Reserves of the CBRT
(FX and Gold, Million USD)

Source: CBRT.

Latest observation: December 30, 2011.

Drains on Foreign Currency Assets

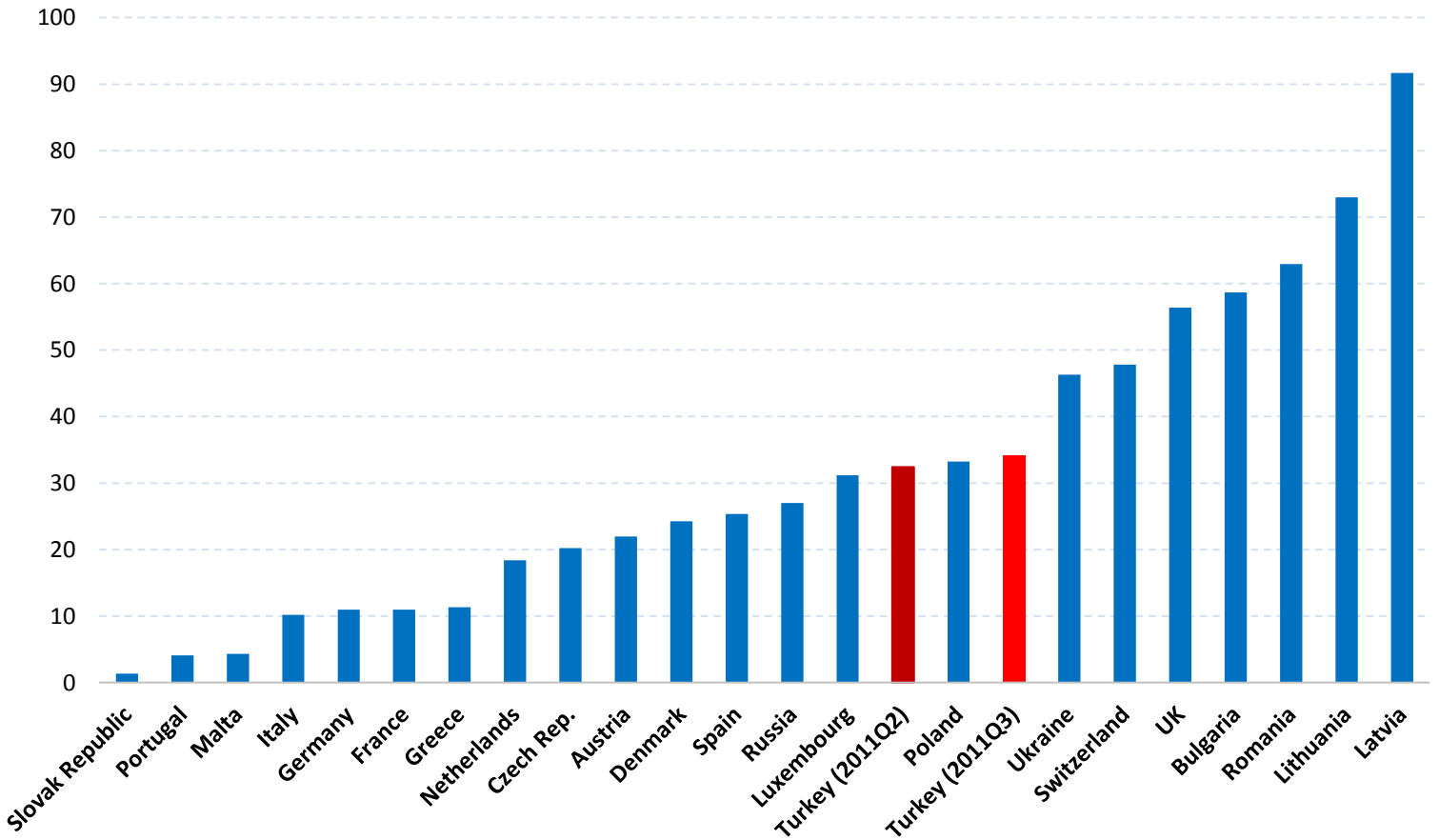
Reserve Assets and Predetermined Short-term Net Drains on Foreign Currency Assets



Source: Data can be obtained from the CBRT website. http://www.tcmb.gov.tr/odemedenge/rezerv/RT201111T.pdf

FX Loans

FX Loans to Total Loans*
(Percent, 2011Q2)



*Loans provided by the banking sector.

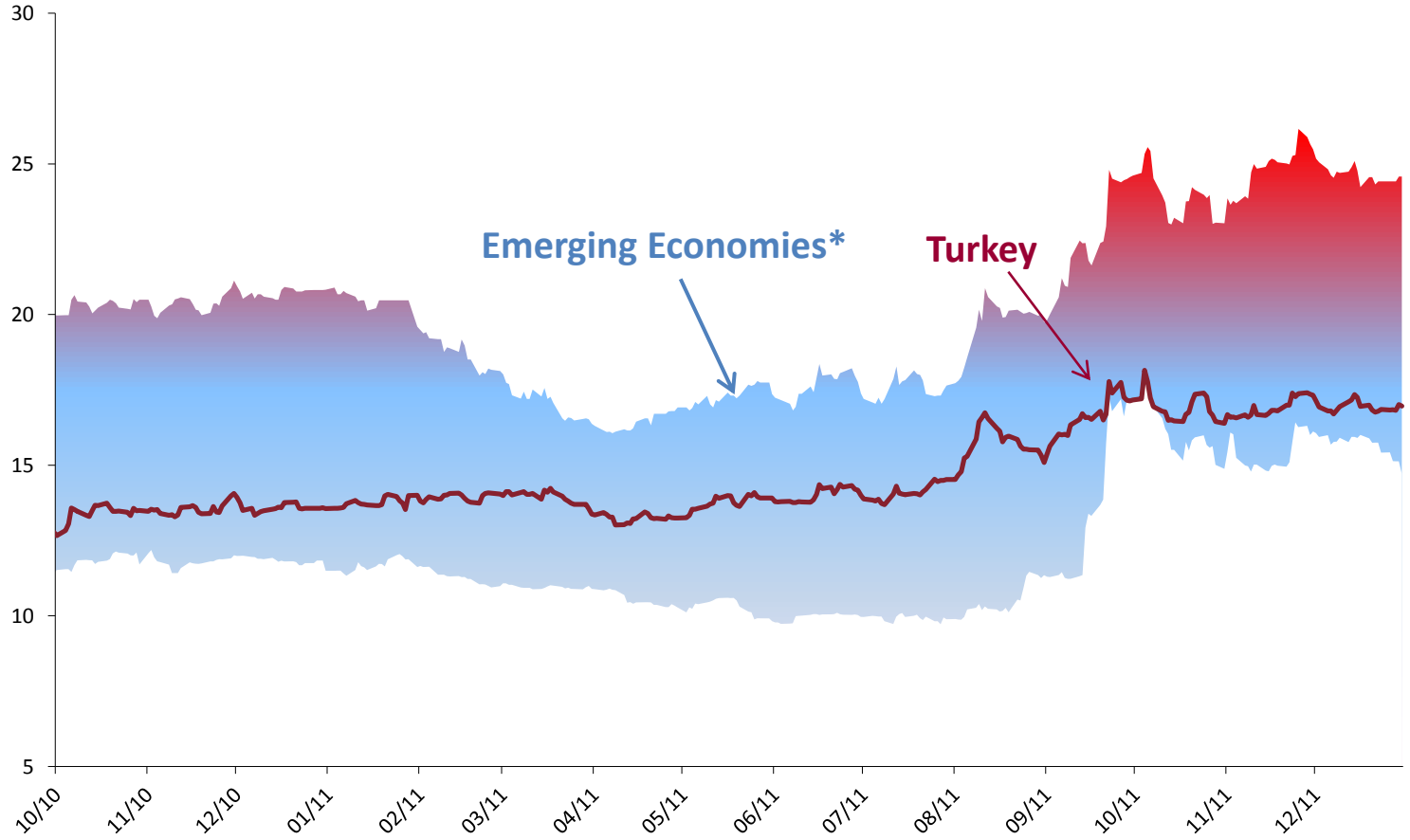
Source: CBRT, BRSA, IMF Financial Soundness Indicators.

Policy Transmission Channels

	Direct	Indirect
TL Funding	Credit Growth	Exchange Rate
FX Sales	Volatility of the Exchange Rate	Credit Growth

Implied Exchange Rate Volatility

Volatility in Emerging Market Currencies
(Percent, Implied for the next 12 months)

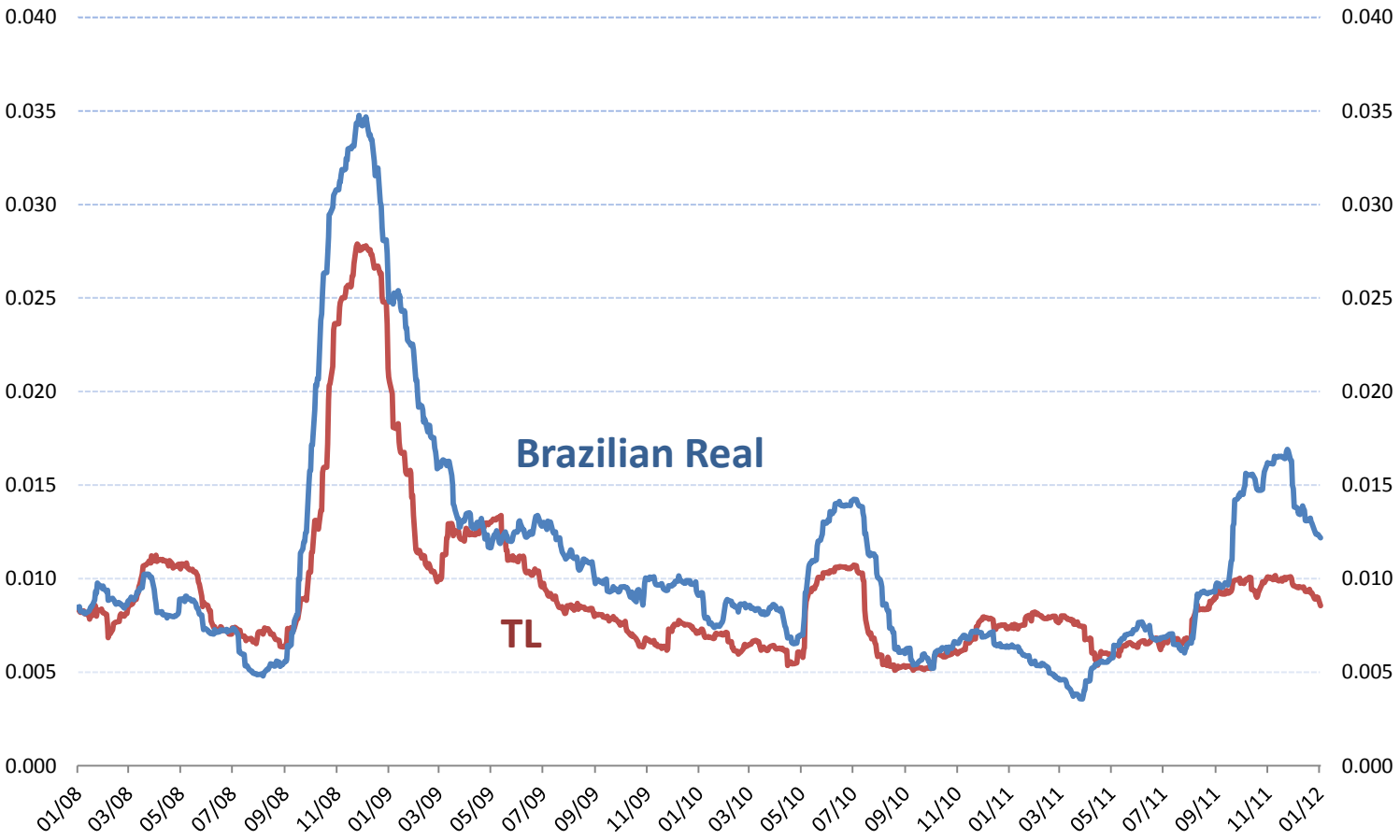


Source: Bloomberg, CBRT.

*Average of emerging market currencies, including Brazil, Chile, Czech Republic, Hungary, Mexico, Poland, South Africa, Indonesia, South Korea, Colombia and Turkey.

Exchange Rates: Daily Volatility

TL and Brazilian Real*

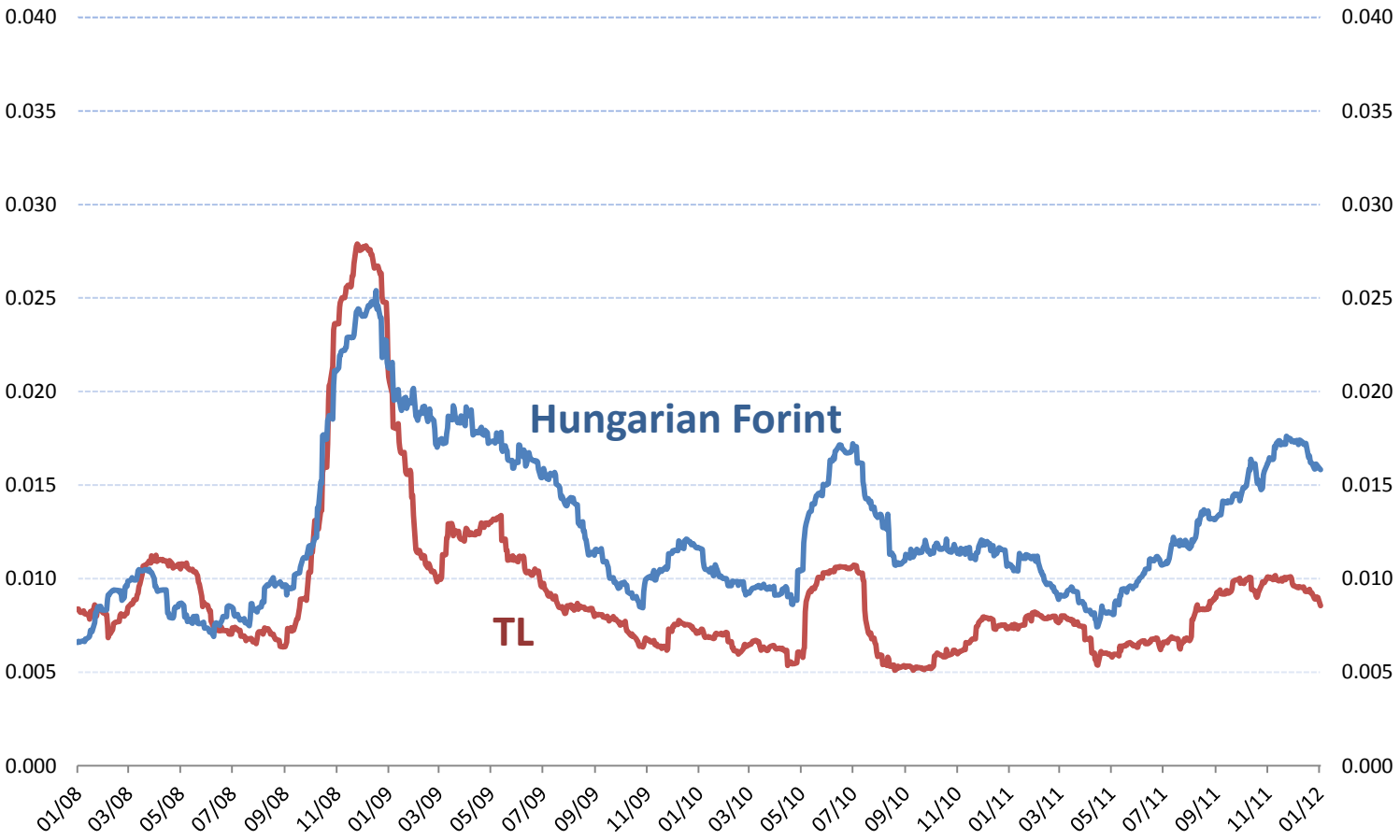


Source: CBRT, Bloomberg.

* Volatility is the standard deviation of daily percentage changes in the last 50 days.

Exchange Rates: Daily Volatility

TL and Hungarian Forint*



Source: CBRT, Bloomberg.

* Volatility is the standard deviation of daily percentage changes in the last 50 days.

Exchange Rates: Daily Volatility

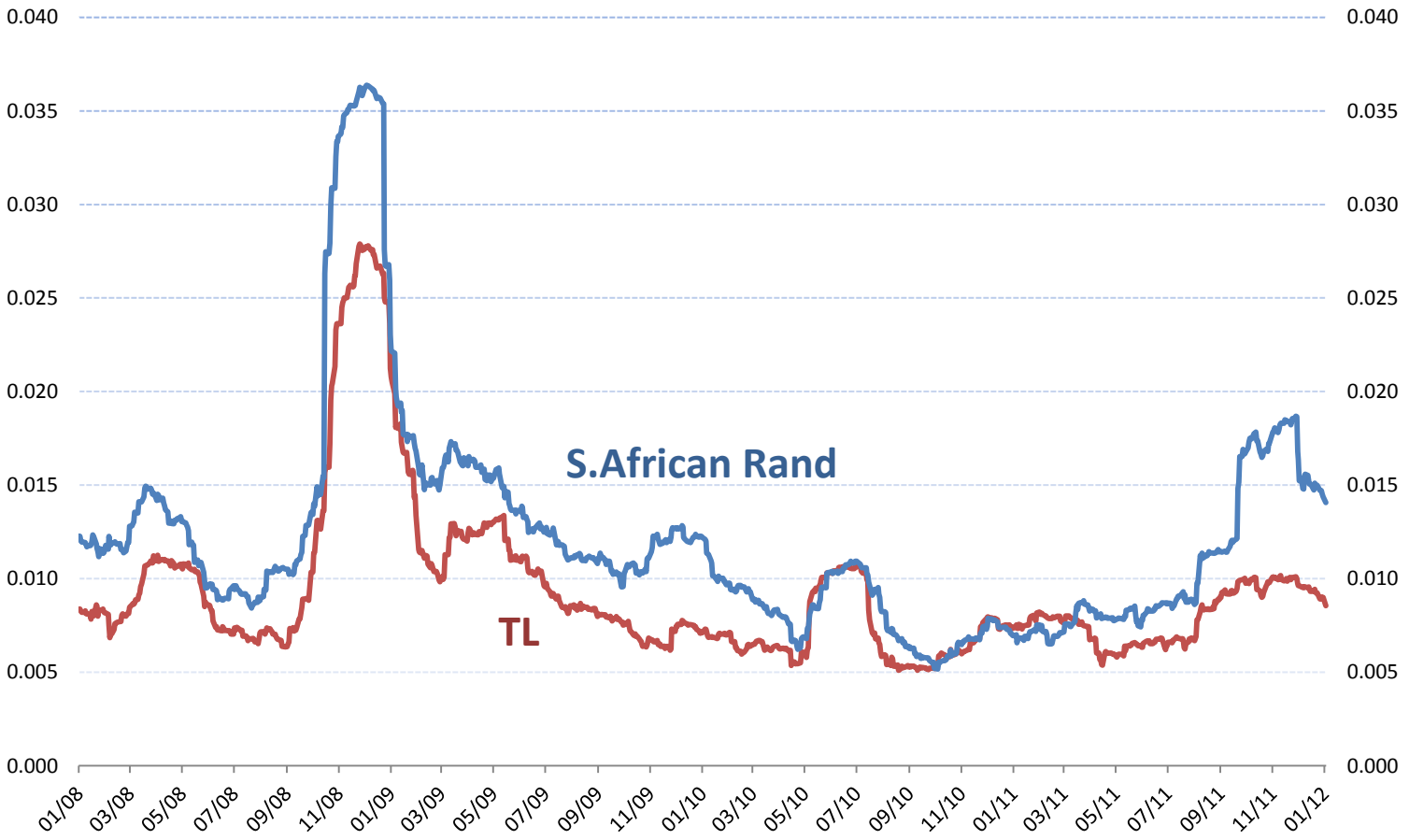
TL and Polish Zloty*

Source: CBRT, Bloomberg.

* Volatility is the standard deviation of daily percentage changes in the last 50 days.

Exchange Rates: Daily Volatility

TL and South African Rand*



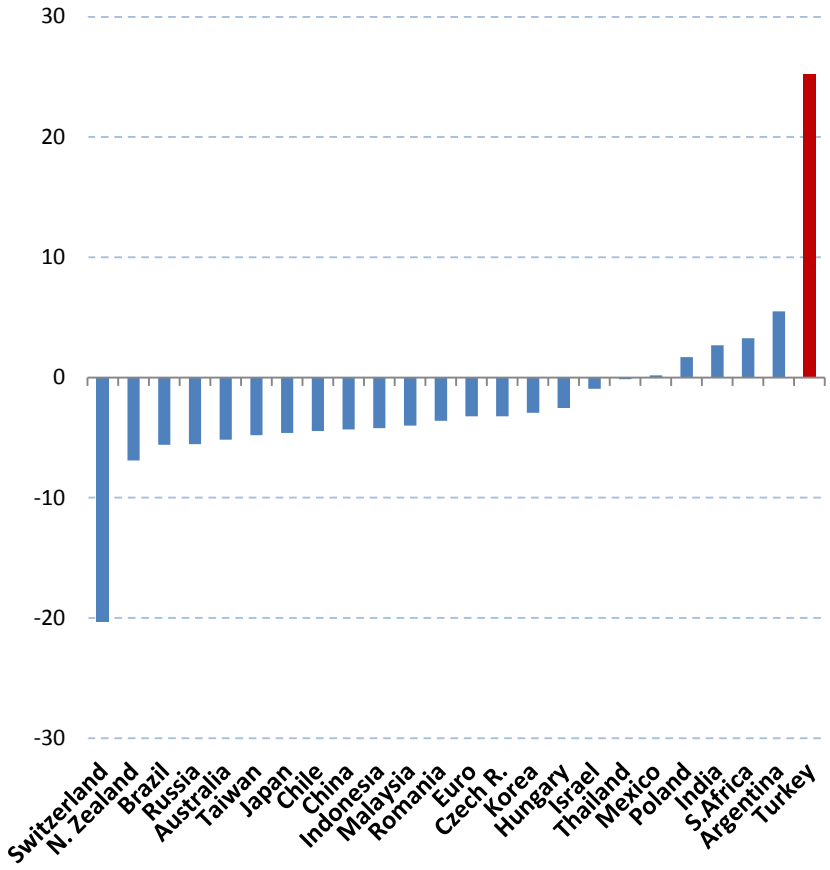
Source: CBRT, Bloomberg.

* Volatility is the standard deviation of daily percentage changes in the last 50 days.

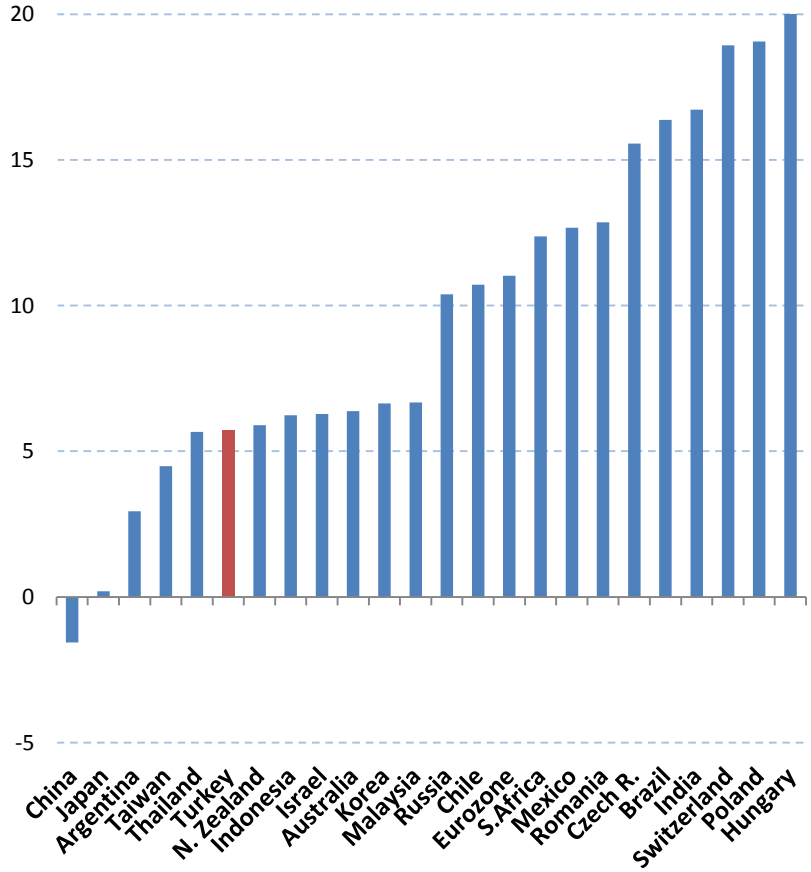
Exchange Rates

Percentage Changes in Exchange Rates

01.11.2010 – 22.08.2011



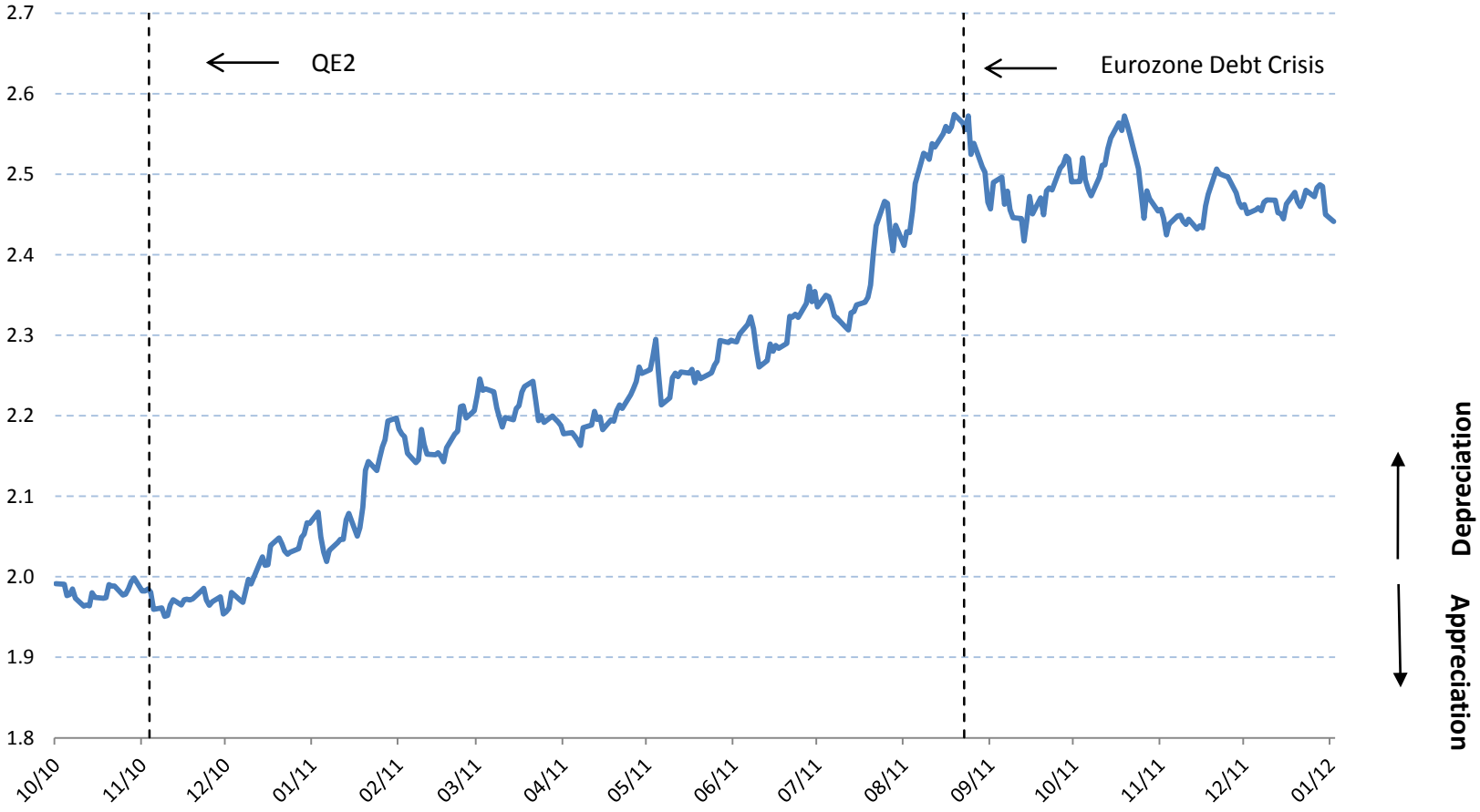
23.08.2011 – 02.01.2012



Source: Bloomberg, CBRT.
Note: Positive change means depreciation against US dollar.

TL and Euro

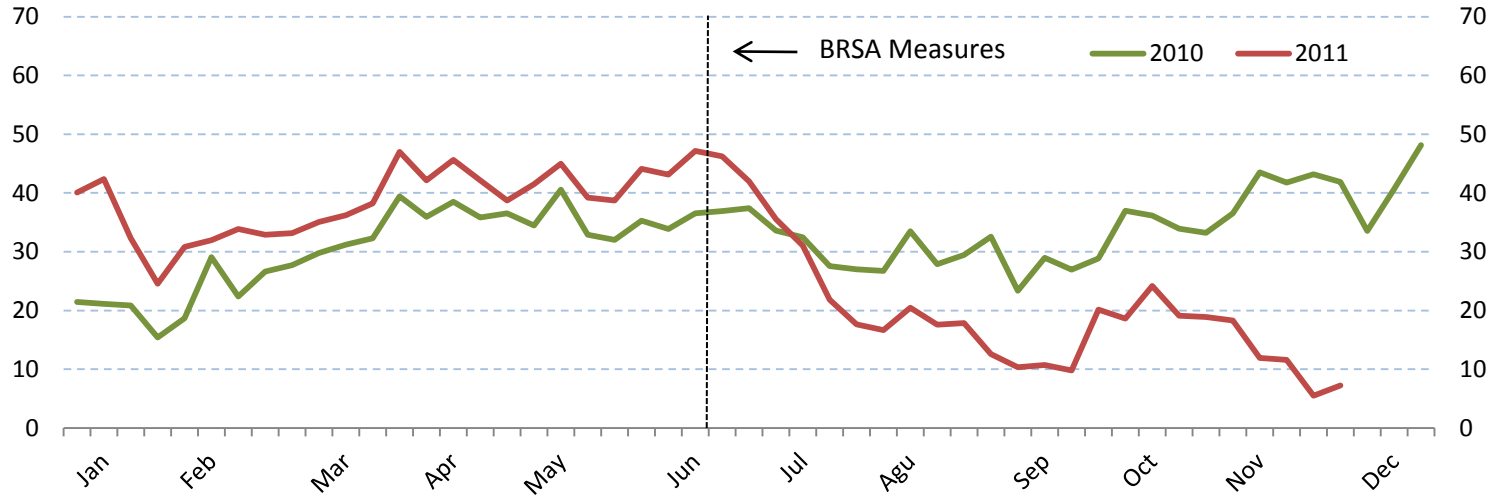
TL/Euro
(1 Oct 2010=1)



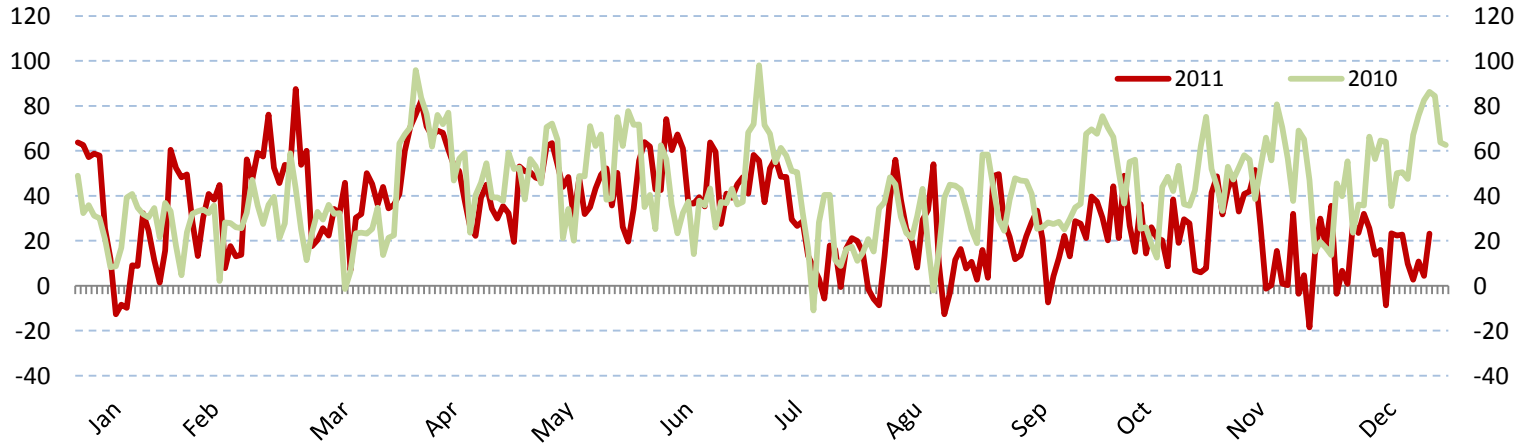
Source: CBRT, Bloomberg.

Credit Growth

Consumer Loans *(Annualized, 4 weeks moving averages, Percent)*

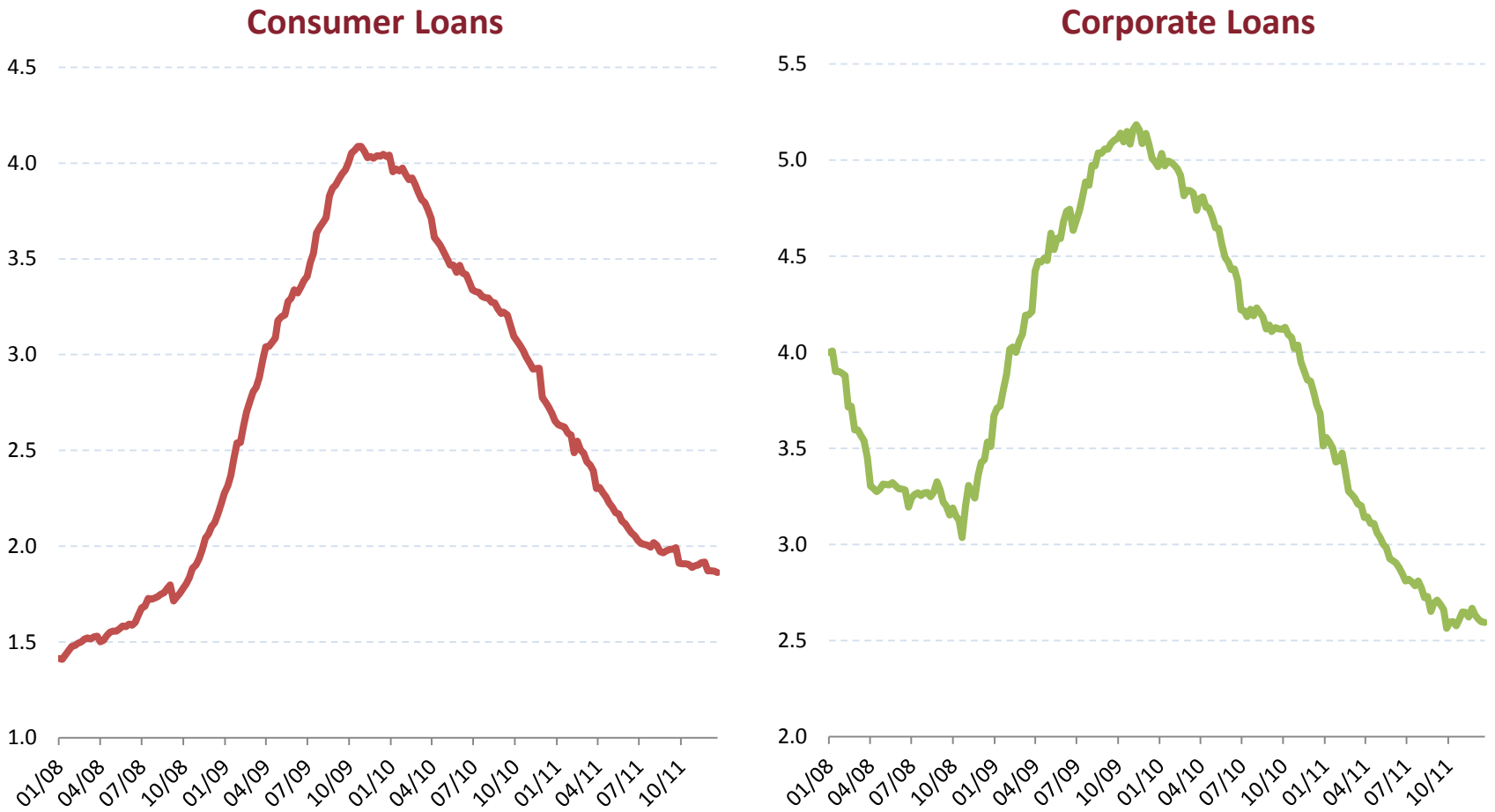


Total Loans *(Annualized, 20 days moving averages, FX adjusted, Percent)*



Non-Performing Loans

Non-Performing Loans in Turkey
(Percent)



Source: CBRT.

Latest Observations: December 23, 2011.

Summary

- Credit growth and domestic demand continues to moderate with the tightening in monetary and financial conditions.
- The improvement in the current account balance is expected to be more evident and pronounced in the following months.
- Inflation has shown a temporary rise in recent months due to exchange rate movements, hikes in administered prices, and base effects of unprocessed food prices.
- Inflation will hover above the target and start to decline from May 2012. It will converge to the target of 5 percent by the end of 2012.
- Tightened monetary and financial conditions are expected to contain the second-round effects.

Additional Monetary Tightening

- End-year inflation is materialized at 10.45 percent. In order to contain second round effects under current circumstances, it is important that disinflation starts sooner than market expectations. In this context, Central Bank of the Republic of Turkey has delivered an additional monetary tightening since December 29, 2011.
- Additional monetary tightening is mainly implemented via open market operations. Liquidity provided to the market at the policy rate is reduced temporarily below the lower bound announced for normal days.
- Unsterilized (effective) foreign exchange sales and direct interventions may also be used as a complementary instrument when necessary. The aim here is to prevent inflation expectations to be adversely affected from exchange rate movements detached from fundamentals.

Additional Monetary Tightening

- Additional monetary tightening is intended to be strong, effective and temporary. The duration of the implementation may vary depending on the speed at which main factors affecting inflation outlook turn favorable.
- Central Bank of the Republic of Turkey will continue to monitor developments regarding inflation outlook and take the necessary measures in line with the main objective of price stability.

Meetings with Bank Economists and Analysts

- Bank economists and analysts will have the opportunity to attend the Inflation Press Conferences that are held on dates and places shown below.
- Starting from February, bank economists and analysts can request additional meetings by communicating via yatirimci@tcmb.gov.tr.

Date	Location
31 January	Istanbul
26 April	Ankara
26 July	Istanbul
24 October	Ankara

TÜRKİYE CUMHURİYET
MERKEZ BANKASI

ECONOMIC OUTLOOK and MONETARY POLICY

January 3, 2012

Ankara