Macroeconomic Outlook and Monetary Policy in Turkey

3 September 2020 | İstanbul
Outline

I. Macroeconomic Outlook

II. Monetary Policy and Financial Conditions

III. Overview
I. Macroeconomic Outlook
Economic Activity and External Balance
Economic activity contracted sharply in the second quarter due to the pandemic.

**Gross Domestic Product** (Seasonally and Calendar Adjusted, Chain-Linked Volume Index, 2009=100)

Source: TURKSTAT

Last Observation: 2020 Q2
Turkey outperformed many G20 countries in 2020 Q2.

2020 Q2 GDP Growth Rates (% YoY, Seasonally Adjusted)

Source: Bloomberg, IMF, OECD

* Not seasonally adjusted.
While the weakening in economic activity became more pronounced in April...

**Industrial Production Index (Annual % Change)**

Source: TURKSTAT  
Last Observation: June 2020

**Industrial Production Index (Annual % Change)**

Source: TURKSTAT  
Last Observation: June 2020
...economic recovery has started as of May following gradual steps towards normalization.

(*) The index is constructed in a way that the mean and standard deviation of the index are 0 and 1, respectively. Index value shows the distance (high/low) from the mean in terms of the standard deviation.
Soft indicators signal a promising recovery in the manufacturing sector.

PMI Indices (Seasonally Adjusted Level)

Source: IHS Markit
Last Observation: August 2020

PUMAX* Industry and PUMAX Services (Seasonally Adjusted, 2-Month Moving Average)

Source: MÜSİAD
Last Observation: August 2020

(*) PUMAX: MÜSİAD Purchasing Manager Index
The improvement in confidence and activity is relatively strong compared to both developed and developing economies.

Manufacturing Sector Confidence Index in Europe (Deviation from the Average, Seasonally Adjusted)*

Manufacturing PMI (Seasonally Adjusted)

*Range shows the maximum and minimum values for the European countries. Average is calculated over January 2007-July 2020.
**Selected developing countries are Brazil, China, India, Indonesia, Mexico and Russian Federation.
Health care system in Turkey proved its capability to overcome difficulties stemming from rising COVID-19 cases.
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Case Fatality Rates of G-20 Countries (%)

Recovered / Total Cases of G-20 Countries (%)

Number of ICU Beds of G-20 Countries* (per 100,000 Population)

*Capacity of intensive care unit (ICU) beds can play a crucial role in tackling the pandemic. This gains importance in terms of the rapidness and efficiency of the response to the critical cases, contributing to the fight against the epidemic more effectively and much lower number of casualties. Data for each country represents the latest value available.
Unemployment rates increased during the pandemic.

Unemployment Rates (Seasonally Adjusted, %)

Unemployment Rate
Non-Farm Unemployment Rate

Source: TURKSTAT

(*) Covers the April-May-June period.
While global economic outlook restrains external demand...

Eurozone PMI (Level)

Source: IHS Markit

Last Observation: August 2020
...improved competitiveness continues to support external balance.

Real Effective Exchange Rate (CPI-Based, 2003=100)

Source: CBRT

Last Observation: July 2020
Exports display a stronger rebound than previously envisaged.

**Exports (Billion USD, Seasonally Adjusted)**

**Imports (Billion USD, Seasonally Adjusted)**

Source: CBRT, TEA

Last Observation: August 2020
The recovery in exports of goods with the ongoing normalization and low levels of commodity prices will support the current account balance.

**Current Account Balance (12-Month Cumulative, % of GDP)**

The chart depicts the current account balance over the years from 2010 to 2020, showing the percentage of GDP. The recovery in exports is evident with the ongoing normalization and low levels of commodity prices, indicating a positive impact on the current account balance.

Source: CBRT

Last Observation: 2020 Q2
Trade deficit has started to narrow down as import-coverage by exports returned to pre-pandemic levels after April.

Exports-to-Imports Ratio* (Excluding Gold %)

Source: TURKSTAT, CBRT, Ministry of Trade

Last Observation: August 2020

* GTS data
Deleveraging in the corporate sector continues.

External Debt Rollover (3-Month Moving Average, %)

Source: CBRT

(*) Non-banking sector data is as of June 2020.
The CBRT reserves cover total short-term FX financial debt repayments.

**Short Term External FX Financial Debt** *(Remaining Maturity, Billion USD)*

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount (Billion USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>CENTRAL BANK</td>
<td>19.6</td>
</tr>
<tr>
<td>GENERAL GOVERNMENT</td>
<td>5.7</td>
</tr>
<tr>
<td>BANKS</td>
<td>42.7</td>
</tr>
<tr>
<td>CREDITS</td>
<td>32.3</td>
</tr>
<tr>
<td>BANKS ACCOUNTS</td>
<td>10.4</td>
</tr>
<tr>
<td>OTHER SECTORS</td>
<td>19.7</td>
</tr>
<tr>
<td>OTHER CREDITS</td>
<td>19.7</td>
</tr>
<tr>
<td>PUBLIC</td>
<td>1.3</td>
</tr>
<tr>
<td>PRIVATE</td>
<td>18.4</td>
</tr>
<tr>
<td>TOTAL</td>
<td>87.7</td>
</tr>
</tbody>
</table>

Source: CBRT (Short Term External Debt Statistics)  
Last Observation: June 2020  

**CBRT Reserves** *(Billion USD)*

- **Gold**: 43.3  
- **FX Reserves**: 45.4

Source: CBRT  
Last Observation: August 21, 2020

(*) Short Term FX External Debt table is derived from Short Term External Debt Statistics, Table 5 (Short-Term External Debt Stock on a Remaining Maturity Basis). It excludes FX deposits of non-resident real and legal persons (excluding banks), FX deposits in resident banks, TRY deposits and trade credits of the corporate sector.
Banks maintain ample FX liquidity buffers to cover short-term external debt.

Banks’ Short Term FX External Debt and FX Liquid Assets* (Billion USD)

- **Eurobond**: 13
- **Cash**: 7
- **Foreign free**: 10
- **ROM**: 3
- **FX Reserve Requirement**: 48
- **Debt due in 1-year**: 42.7

Source: CBRT

(*) Banks’ short term external debt data is as of June 2020. Eurobond, cash, foreign free, FX Reserve Requirement and ROM data is as of August 21. Gold Reserve Requirement is included in FX Reserve Requirement figure.
Inflation
Inflation displayed a downward trend following the monetary tightening.

CPI and Core Inflation Indicator (B)* (Annual % Change)

(*) CPI excluding unprocessed food, energy, alcoholic beverages, tobacco, and gold.
Pandemic-related rise in unit costs and accumulated exchange rate effects led to some increase in the trends of core inflation indicators.

**Core Price Indexes B and C** (Seasonally Adjusted, Annualized, 3-Month Average % Change)

- **B**
- **B (Adjusted for Tax Effect)**
- **C (Adjusted for Tax Effect)**

**Subgroups of B Index** (Seasonally Adjusted, Annualized, 3-Month Average % Change)

- **Core Goods (Adjusted for Tax Effect)**
- **Services**
- **Processed Food**

Source: CBRT, TURKSTAT

Last Observation: August 2020
Inflation is expected to decline over the medium-term.

July Inflation Report Forecasts for Inflation and Output Gap*

(*) Shaded area denotes the 70 percent confidence interval for the forecast.
Inflation expectations for the medium-term increased slightly.

Inflation Expectations (%)

Source: CBRT
Last Observation: August 2020

Distribution of Inflation Expectations (12-Months)

Source: CBRT
Last Observation: August 2020
Inflation Compensation (5-Day Moving Average, %)

Market-based measures of inflation expectations have increased recently.

Source: Bloomberg
Last Observation: September 1, 2020
II. Monetary Policy and Financial Conditions
CBRT took several tightening steps through liquidity measures in August.

- Targeted additional liquidity facilities started to be gradually phased down.
- Liquidity limits offered to Primary Dealers in the framework of OMOs first reduced to half of their limits, and later reduced to zero.
- CBRT started conducting repo auctions via the traditional auction method.
- Banks’ borrowing limits at the CBRT for O/N transactions reduced to half of their limits.
- TL and FX reserve requirement ratios raised for banks fulfilling real credit growth conditions.
In August, the CBRT kept the policy rate unchanged while taking a series of liquidity measures.
Yield curve shifted up at all maturities.

Yield Curve (Government Bond, %)

Source: Bloomberg
Last Observation: September 1, 2020
Lending and deposit rates have increased after tightening steps by CBRT.

TL Loan and Deposit Rates* (%)

Source: CBRT

Last Observation: August 21, 2020

(*) TL commercial loan rate series excludes overdraft accounts, credit cards and zero-rate loans. General purpose consumer loan rate series excludes overdraft account rates.
Annual loan growth has started to flatten.

**Annual Change** (Adjusted for Exchange Rate Effect, %)

Source: CBRT

Last Observation: August 28, 2020
The recent loan growth momentum has slowed down.

**Total Loan Growth** (Adjusted for Exchange Rate Effect, Annualized 13-Week Growth, %)

Source: CBRT

Last Observation: August 28, 2020
Banking sector NPL ratios have eased on the back of regulatory forbearance measures and strong credit growth.
Banks have strong capital buffers.

Capital Adequacy Ratios (%)
Loan growth is mainly funded by deposit growth since 2018.

(*) Investment and development banks are excluded.
III. Overview
Overview

► Economic recovery, which started in May following gradual steps towards normalization, is gaining pace.

► Monetary and fiscal measures contributed to financial stability and economic recovery by supporting the potential output of the economy.

► Although tourism revenues declined due to the pandemic, easing of travel restrictions has started to contribute to a partial improvement.

► The recovery in exports of goods, relatively low levels of commodity prices and the level of the real exchange rate will support the current account balance in the upcoming periods.

► Along with the pandemic-related rise in unit costs, exchange rate and credit developments restrain the demand-side disinflationary effects, and the trends of core inflation indicators have increased.

► As the normalization process continues, supply-side factors, which have prevailed recently due to pandemic-related restrictions, will phase out.

► The gradual normalization of pandemic-specific financial measures and recent tightening steps taken in the framework of liquidity management are judged to support macrofinancial stability.

► However, depending on the course of the pandemic, uncertainties regarding domestic and external demand conditions remain significant. Accordingly, the CBRT decided to keep the policy rate unchanged in August, while continuing with liquidity measures.

► The Central Bank will continue to use all available instruments in pursuit of the price stability and financial stability objectives.
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Appendix (1): Policy Response
In addition to interest rate cuts, the CBRT has implemented a comprehensive set of measures.

1. Enhancing predictability and flexibility in Turkish lira and FX liquidity management
2. Providing targeted additional liquidity facilities to banks to secure uninterrupted credit flow to corporate sector
3. Rediscount credit regulations to support cash flow of exporting firms
4. Supporting the Government Domestic Debt Securities (GDDS) market liquidity
In addition to interest rate cuts, the CBRT has implemented a comprehensive set of measures.

**Enhancing predictability and flexibility in Turkish lira and FX liquidity management**

- As much liquidity as needed by banks will be provided through intraday and overnight standing facilities.
- In addition to one-week repo auctions, the CBRT’s main policy instrument, the Bank may inject liquidity to the market through repo auctions with maturities up to 91 days on the days needed.
- To support the Primary Dealership System, liquidity limits of Primary Dealers in the framework of Open Market Operations (OMOs) have been increased.
- Conventional (multi-price) swap auctions with maturities of one, three and six months, which are currently available against US dollars, may also be held against euros and gold.
- Swap auction limits are raised from 20% to 30% of the Foreign Exchange and Banknotes Market limits.
- Under the Turkish lira and foreign exchange operations, the asset-backed securities (ABS) and mortgage-backed securities (MBS) are also included in the collateral pool.
- The aim is to increase the liquidity of similar securities issuances, enable deepening of capital markets and diversify the liquidity facilities that banks can use.
- When accepting eligible securities as collaterals, discounts will be applied at different rates depending on credit scores given by national or international credit rating agencies, credit rating outlook, and remaining maturities.
- In addition, the share of these securities in total collaterals is limited to 10%.
In addition to interest rate cuts, the CBRT has implemented a comprehensive set of measures.

- The maximum amount of funds that an eligible bank may receive from this new liquidity facility will be linked to the amount of credit that this bank has already provided or will provide for the corporate sector.
- Turkish lira liquidity will be provided via repo auctions with maturities up to 91 days with an interest rate 150 basis points lower than the one-week repo rate, i.e. the CBRT’s policy rate, and with quantity auction method.
- Turkish lira currency swap auctions with a maturity of 1 year based on quantity auction method will be conducted. With these swap auctions, related banks will be provided with Turkish lira liquidity against US dollars, euros and gold with an interest rate 100 basis points lower than the one-week repo rate, i.e. policy rate.
- Additionally, through swap auctions with six-month maturity, related banks will be provided with Turkish lira liquidity against US dollars, euros or gold at an interest rate 125 basis points lower than the one-week repo rate.
- Within the context of the reserve requirement practice that is based on real credit growth, the FX reserve requirement ratios are reduced by 500 basis points across all liability types and all maturity brackets for banks that meet the conditions.
- With this decision, the banks that meet real credit growth conditions will be provided with FX and gold liquidity at the amount of approximately USD 5.6 billion.
In addition to interest rate cuts, the CBRT has implemented a comprehensive set of measures.

- The maturities for repayments of rediscount credits, which will be due from 18 March 2020 to 30 June 2020, can be extended by up to 90 days.
- This can postpone the repayment of rediscount credits corresponding up to USD 7.6 billion.
- An additional 12 months export commitment fulfillment time has been offered for the rediscount credits whose export commitment has not been fulfilled yet and for the rediscount credits to be used from 18 March 2020 to 30 June 2020.
- The maximum maturities for rediscount credits have been extended to 240 days from 120 days for short-term credit utilization, and to 720 days for longer-term credit utilization.
- To facilitate goods and services exporting firms’ access to finance and support sustainability of employment, Turkish lira-denominated rediscount credits for export and foreign exchange earning services will be extended up to a total limit of TRY 60 billion.
- The interest rate for the TL denominated rediscount credits will be 150 bp lower than the one-week repo rate and the maximum commission rate of intermediary banks will be 150 bp.
In addition to interest rate cuts, the CBRT has implemented a comprehensive set of measures.

- Considering that a probable decline in the GDDS market depth and an unhealthy pricing environment may weaken the monetary transmission, CBRT decided to support the GDDS market liquidity.
- Outright purchase operations under the Open Market Operations (OMO) portfolio, which are conducted within the limits identified at the Monetary and Exchange Rate Policy for 2020 text, can be carried out in a front-loaded manner and these limits may be revised.
- Additionally, to contain the likely impacts of the GDDS sales of the Unemployment Insurance Fund on financial markets, for a temporary period, the Primary Dealer banks are allowed to sell the GDDS that they have bought from the Unemployment Insurance Fund to the CBRT or to increase at certain ratios the repo facility offered in the scope of the Primary Dealership system.
- This step is intended only for this extraordinary period shaped by the pandemic and it should not be interpreted as an unlimited asset purchase or monetary financing.
- The maximum limit for the ratio of the nominal size of the OMO portfolio to the total assets in the CBRT analytical balance sheet has been increased to 10% from 5%.
- The limits offered to PD banks for outright sales of GDDS to the CBRT will be applied independent of the repo transaction limits and that PD banks will be offered a GDDS selling limit that is equal to the repo transaction limits.
Appendix (2): Additional Slides
There was a sharp contraction in economic activity, driven by both domestic and foreign demand.
Weekly Economic Conditions Index (WECI)*

Economic recovery has started as of May following gradual steps towards normalization.

(*) The index is constructed in a way that the mean and standard deviation of the index are 0 and 1, respectively. Index value shows the distance (high/low) from the mean in terms of the standard deviation.
Soft indicators signal a promising recovery in the manufacturing sector.

**Industrial Production Index (3-Month Moving Average, Annual % Change) and PMI (Level)**

Source: IHS Markit, TURKSTAT

**Last Observation: July 2020 for PMI; June 2020 for IPI**
Exports to non-European countries have reached pre-pandemic levels.

Exports* (Billion USD, Seasonally Adjusted)

* Forecast value for August is calculated using the implied value of exports as of August 26, 2020.
Inflation is expected to decline over the medium-term.

July Inflation Report Forecasts for Core Indicator-B and Output Gap*

Source: July 2020 Inflation Report

(*) Shaded area denotes the 70 percent confidence interval for the forecast.