

CENTRAL BANK OF THE REPUBLIC OF TURKEY

Presentation at the Kahramanmaraş Chamber of Commerce
and Industry

Durmuş YILMAZ
Governor

20 September 2010

Presentation Outline

- I. Global Economic Developments**
- II. Latest Developments in the Turkish Economy**
- III. Inflation Outlook**
- IV. Monetary Policy**
- V. Financial Stability**

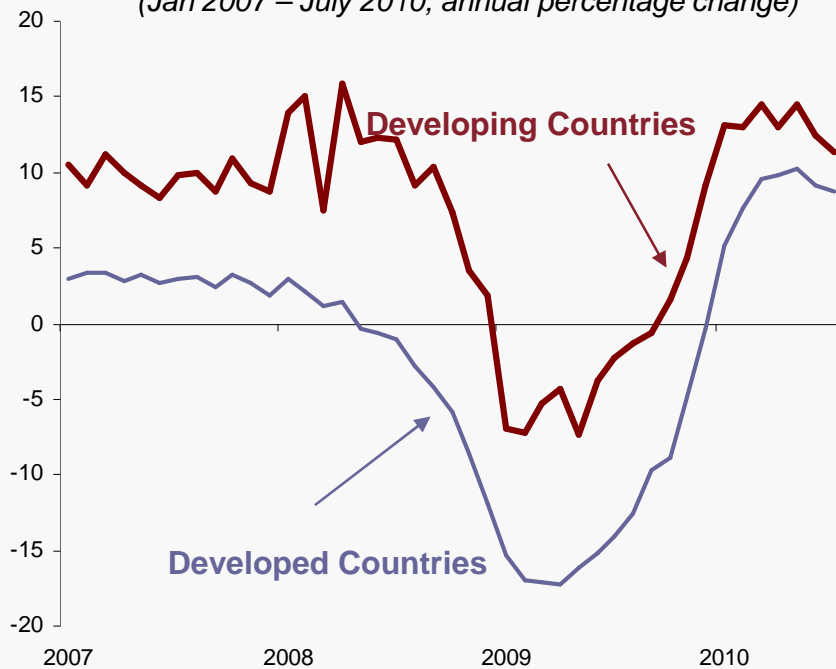
I. Global Economic Developments

Leaving the Global Crisis Behind

The rebound in the global economy, which became pronounced in the second half of 2009, continued through the first half of 2010. However, recently there have been signals of a recurrent global slowdown.

Industrial Production in Developed and Developing Countries

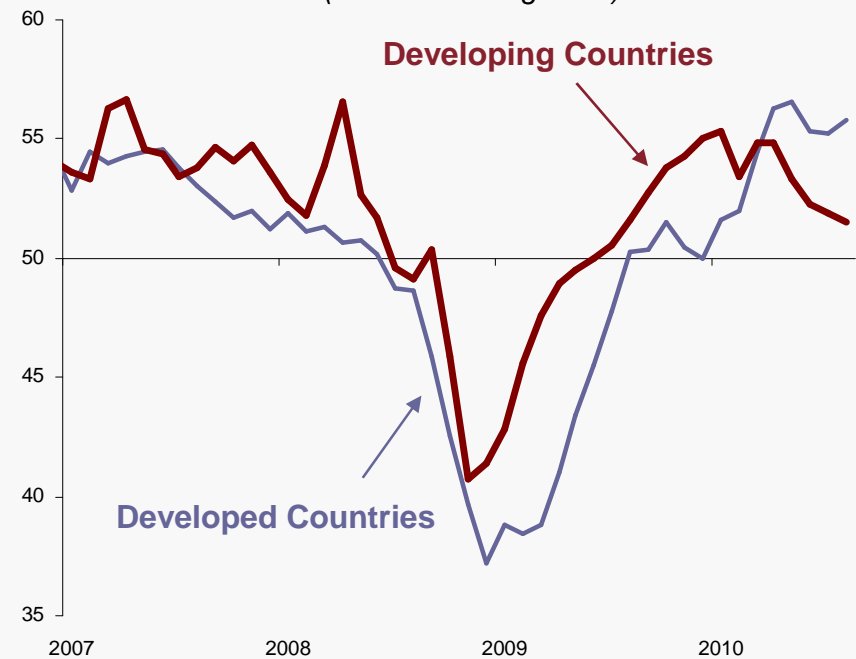
(Jan 2007 – July 2010, annual percentage change)



Source: Bloomberg, CBT

Purchasing Managers' Index (PMI) in Developed and Developing Countries

(Jan 2007 – Aug 2010)

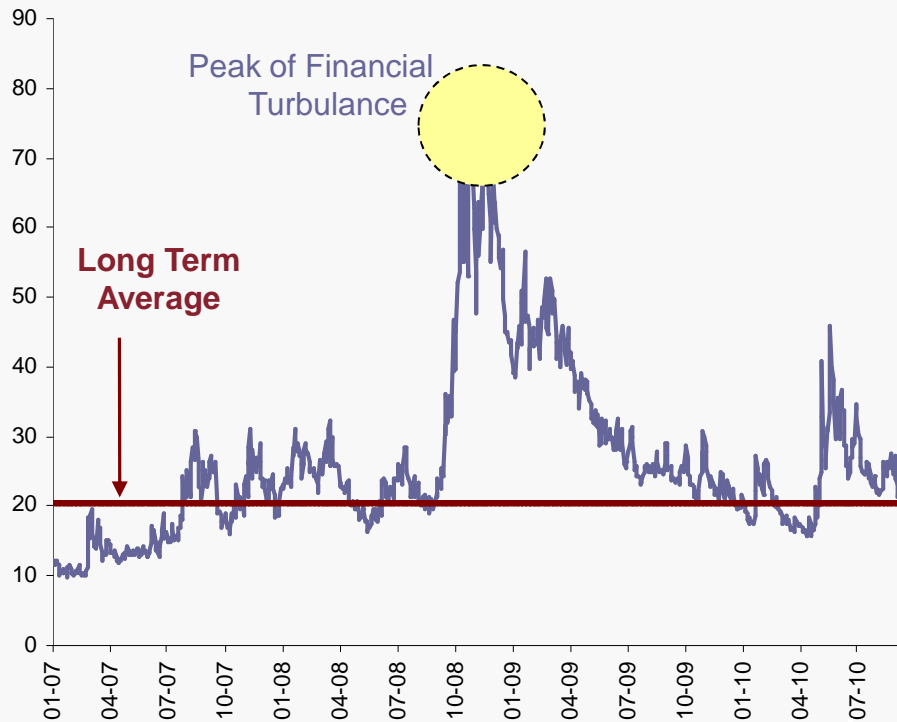


Source: Bloomberg, CBT

Leaving the Global Crisis Behind

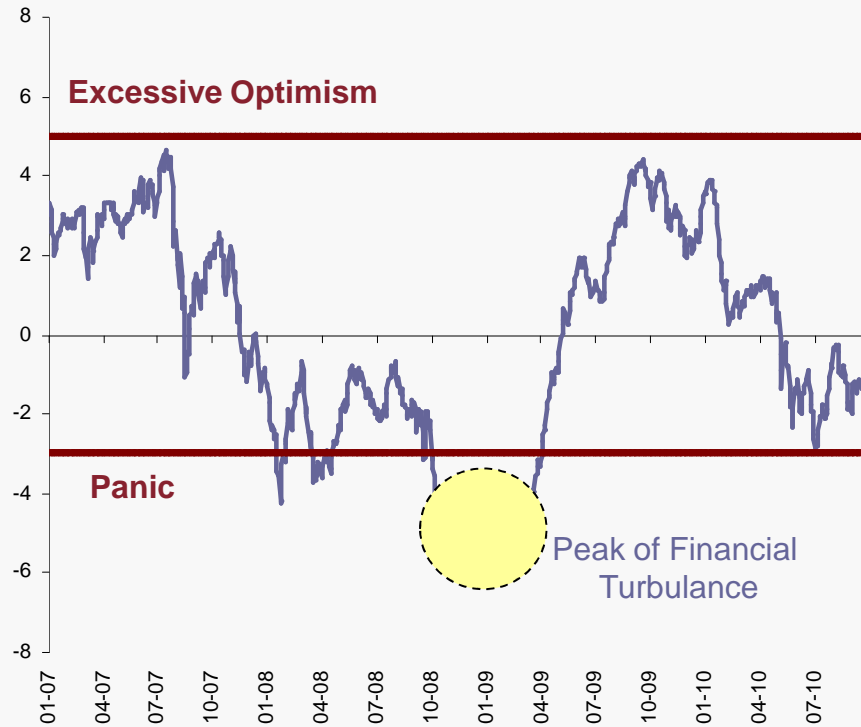
Risk indicators, which deteriorated in the second quarter due to global risk factors that grew more apparent, recovered slightly thanks to the better-than-expected economic data in developed countries.

Volatility Index
(Jan 2007 – Sep 2010)



Source: Bloomberg, CBT

Global Risk Appetite Index
(Jan 2007 – Sep 2010)

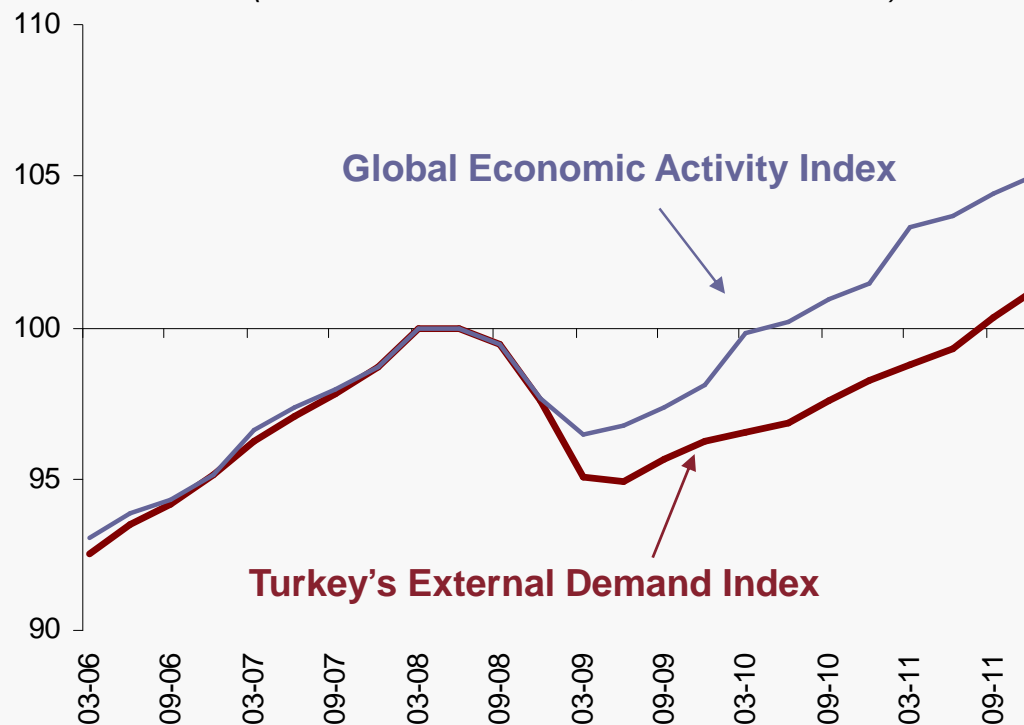


Source: Credit Suisse, CBT

External Demand Developments

Since the eruption of the global financial crisis, the low level of growth expectations for the European Union, which is Turkey's largest exports market, has weakened external demand.

Global Economic Activity and Turkey's External Demand Index*
(March 2006 – Dec 2011, June 2008=100)



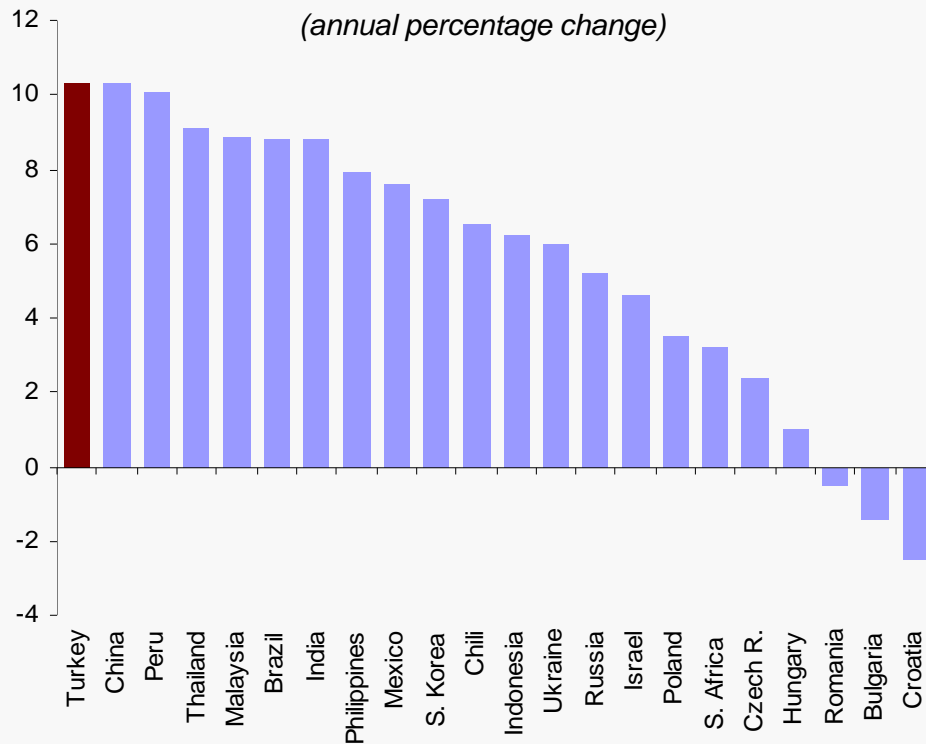
* The shares of countries within the exports of Turkey and weighted GDP data are employed for the calculation of the external demand index of Turkey.

Source: Bloomberg, Consensus Forecasts, IMF WEO, TurkStat, CBT

Decoupling Signals in Global Economy ?

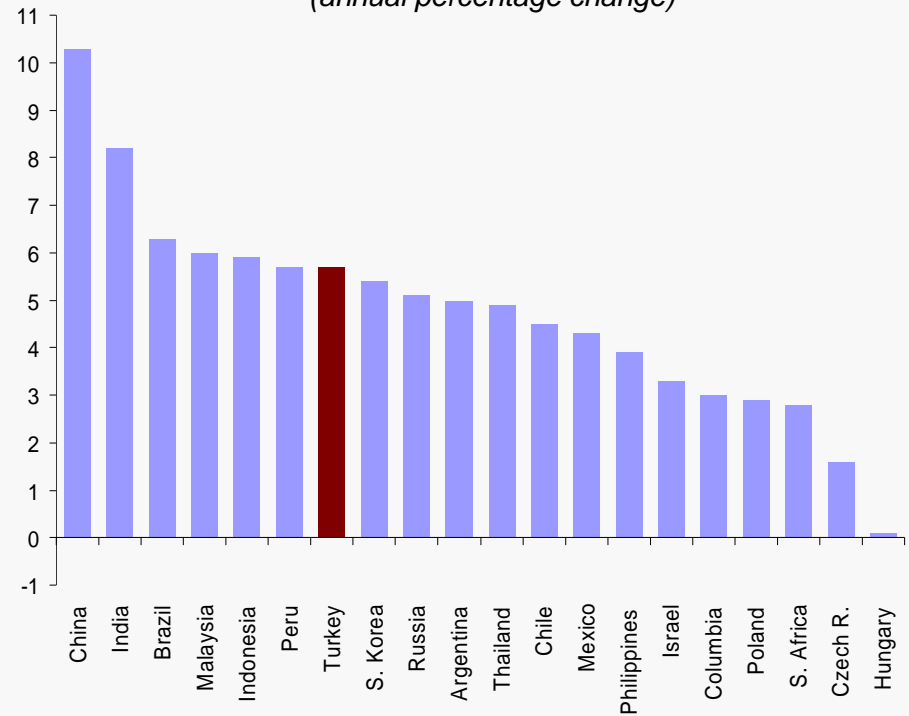
While economic activity in many developing countries including Turkey has displayed a significant rebound, growth data in developed countries and Eastern Europe remain subdued.

Growth Rates in 2010 Q2
(annual percentage change)



Source: Bloomberg, CBT

Growth Prospects for 2010
(annual percentage change)



Source: Consensus Forecasts, CBT

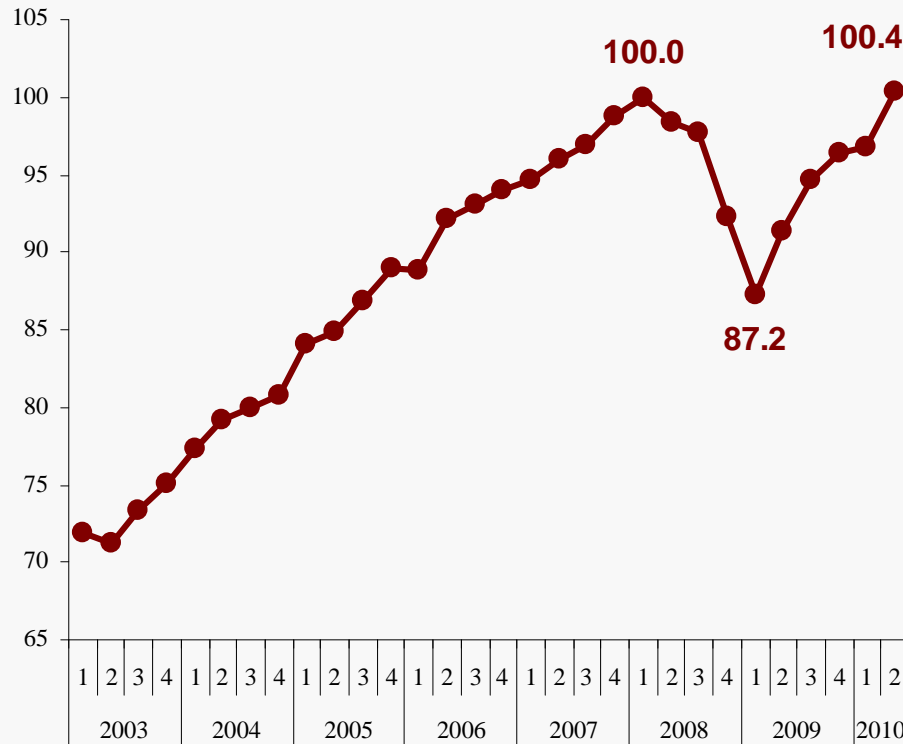
II. Latest Developments in the Turkish Economy

Gross National Product

The latest data indicate that recovery in economic activity continues. Turkey's GDP resumed its pre-crisis level in the second quarter of the year.

Seasonally Adjusted GDP

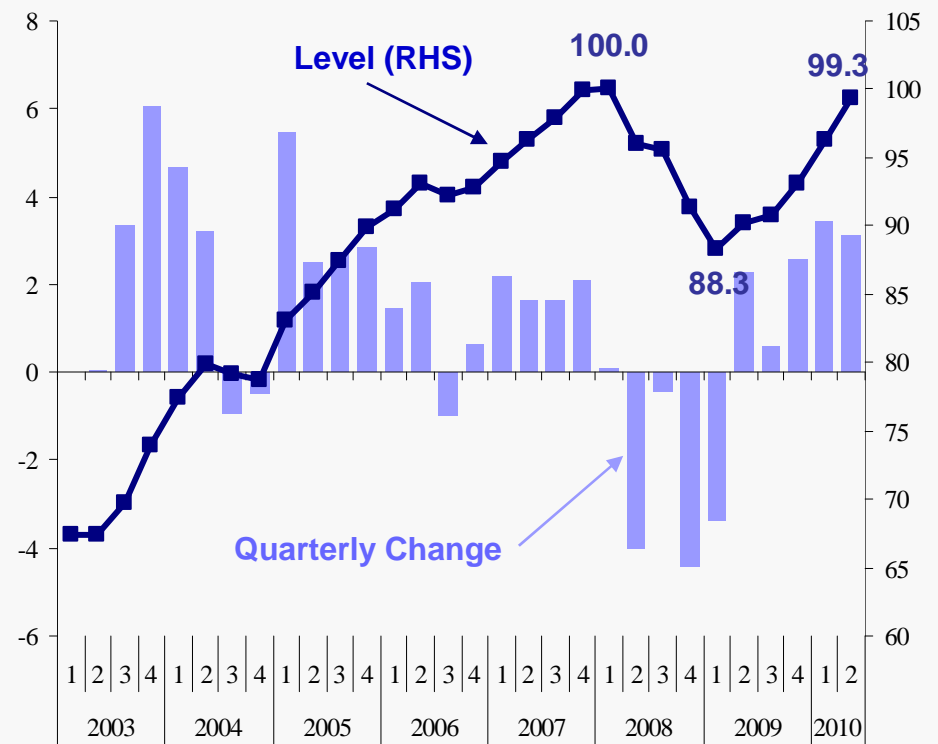
(2003Q1 – 2010Q2, constant prices, 2008Q1 = 100)



Source: TurkStat, CBT

Seasonally Adjusted Final Domestic Demand

(2003Q1 – 2010Q2, constant prices, 2008Q1=100)

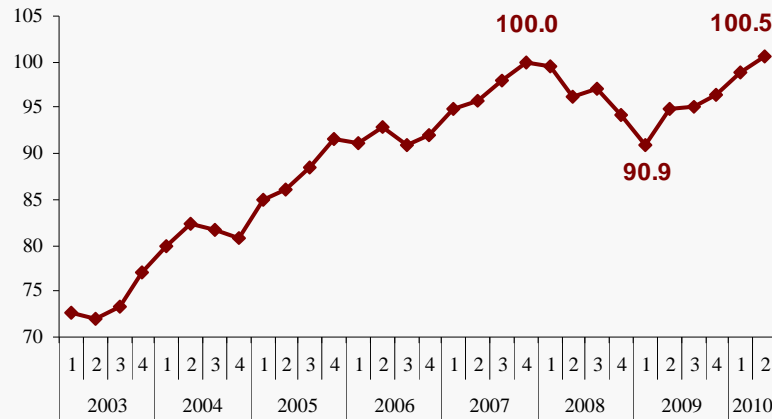


Source: TurkStat, CBT

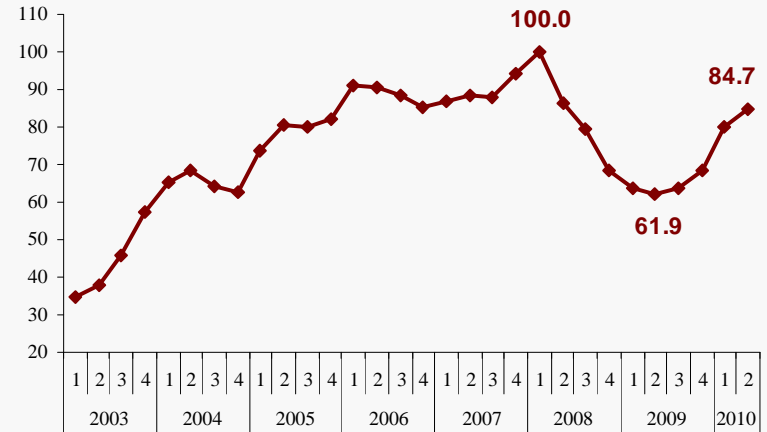
Gross National Product

Private sector consumption and investment expenditures are on a steady upward track.

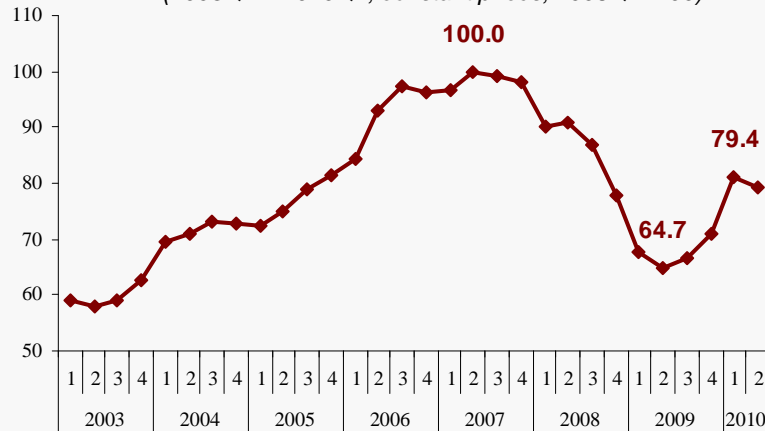
Private Consumption Expenditures*
(2003Q1 – 2010Q2, constant prices, 2008Q1=100)



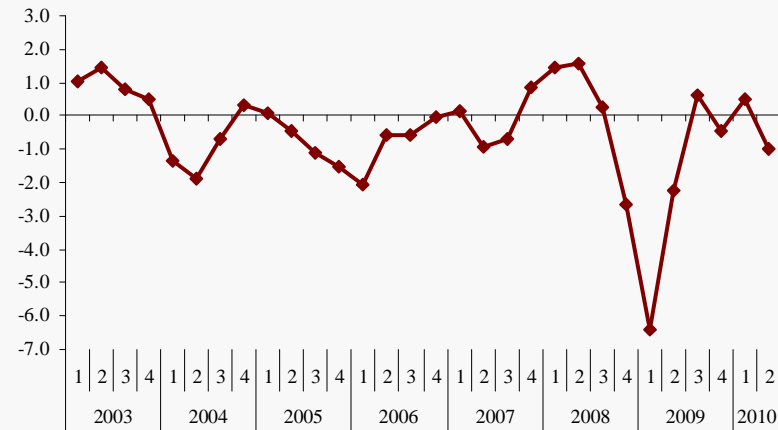
Private Sector Machinery-Equipment Investments*
(2003Q1 – 2010Q2, constant prices, 2008Q1=100)



Private Sector Construction Investments*
(2003Q1 – 2010Q2, constant prices, 2008Q1=100)



Stock Expenditures*
(2003Q1 – 2010Q2, Ratio to GDP, percent)



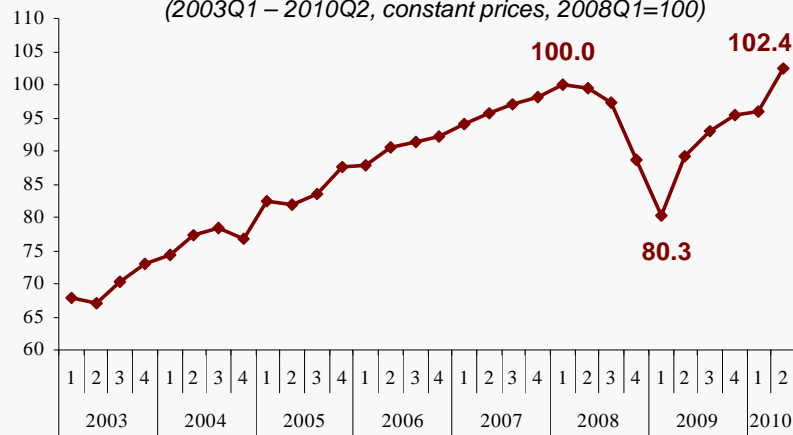
* Seasonally Adjusted
Source: TurkStat, CBT

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Source: TurkStat, CBT

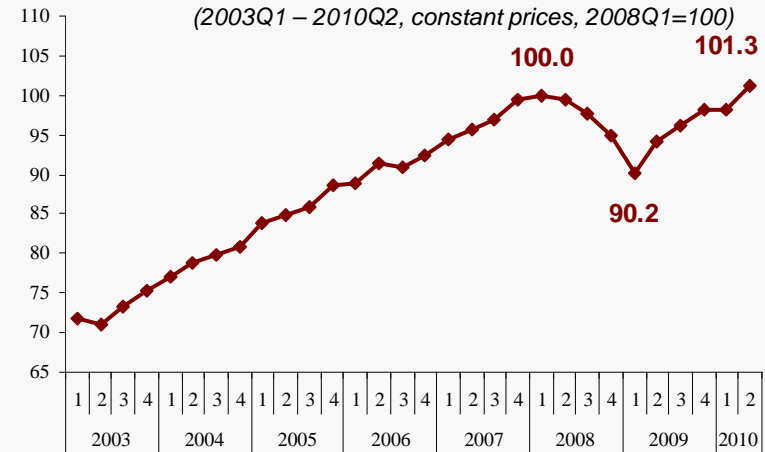
Gross National Product

While the value added of industrial and services sectors posted rapid growth following the standstill in the first quarter, the steady recovery in the value added of the construction sector has continued.

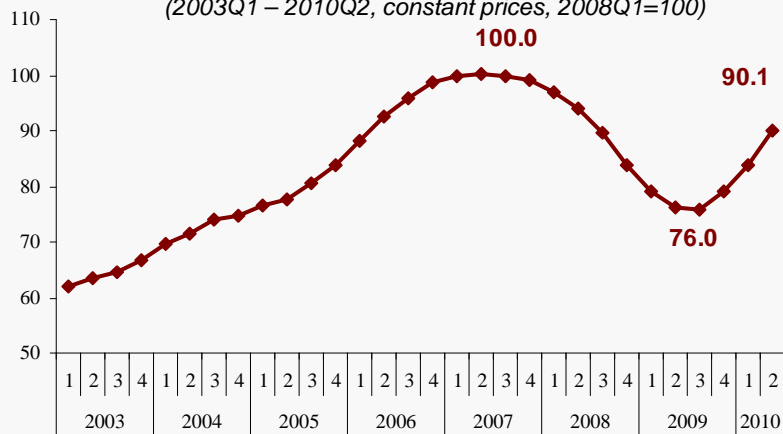
Value Added of the Industrial Sector*
(2003Q1 – 2010Q2, constant prices, 2008Q1=100)



Value Added of the Services Sector*
(2003Q1 – 2010Q2, constant prices, 2008Q1=100)



Value Added of the Construction Sector*
(2003Q1 – 2010Q2, constant prices, 2008Q1=100)



Value Added of the Agricultural Sector*
(2003Q1 – 2010Q2, constant prices, 2008Q1=100)



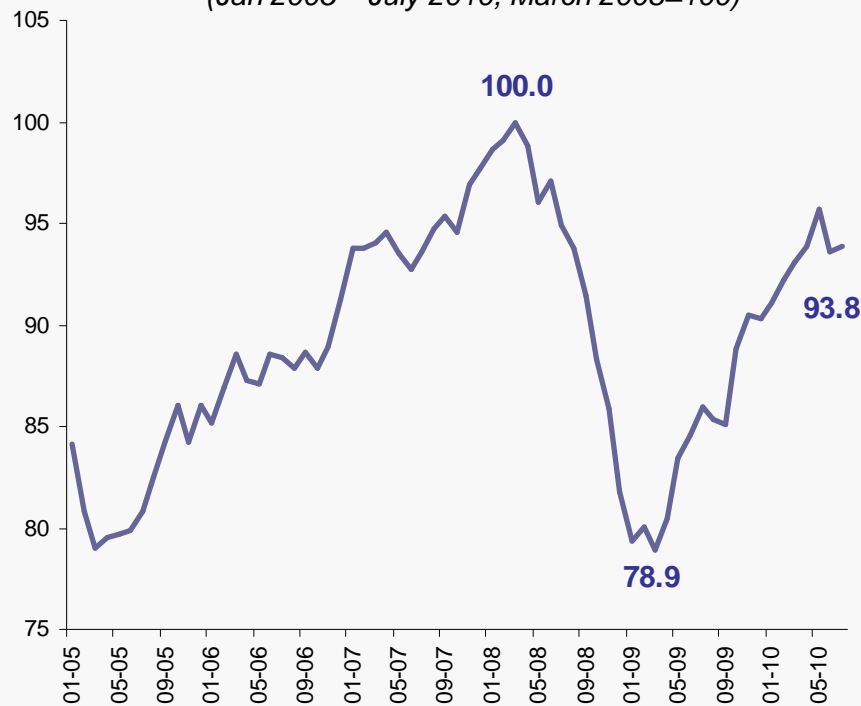
* Seasonally Adjusted
Source: TurkStat, CBT

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Source: TurkStat, CBT

Production Developments

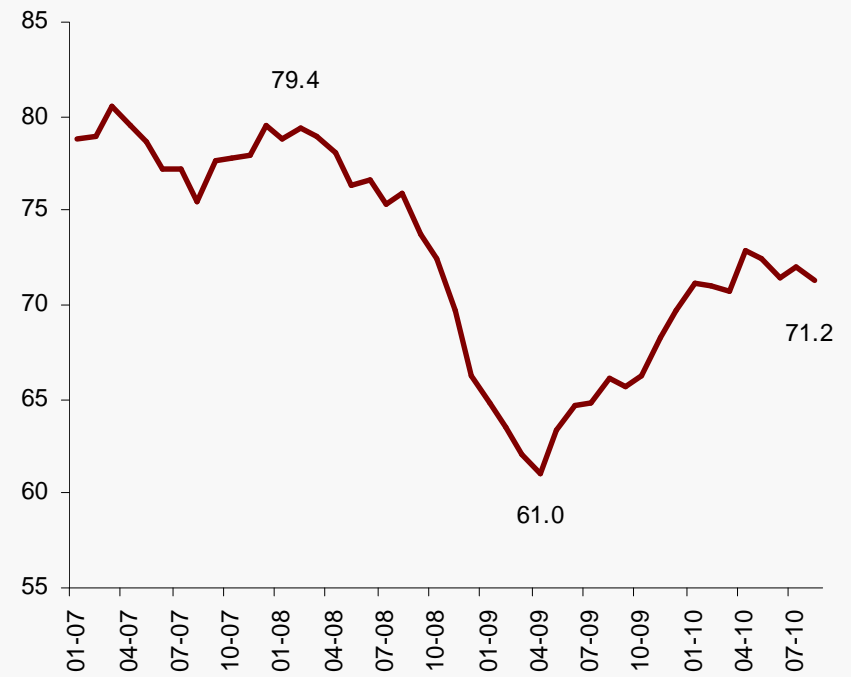
Industrial production has been rising since the second quarter of 2009. However, lingering uncertainties pertaining to external demand delay industrial production to resume pre-crisis levels.

**Seasonally Adjusted
Industrial Production Index**
(Jan 2005 – July 2010, March 2008=100)



Source: TurkStat, CBT

**Seasonally Adjusted Capacity Utilization Rate
in Manufacturing Industry**
(Jan 2007 – Aug 2010, percent)

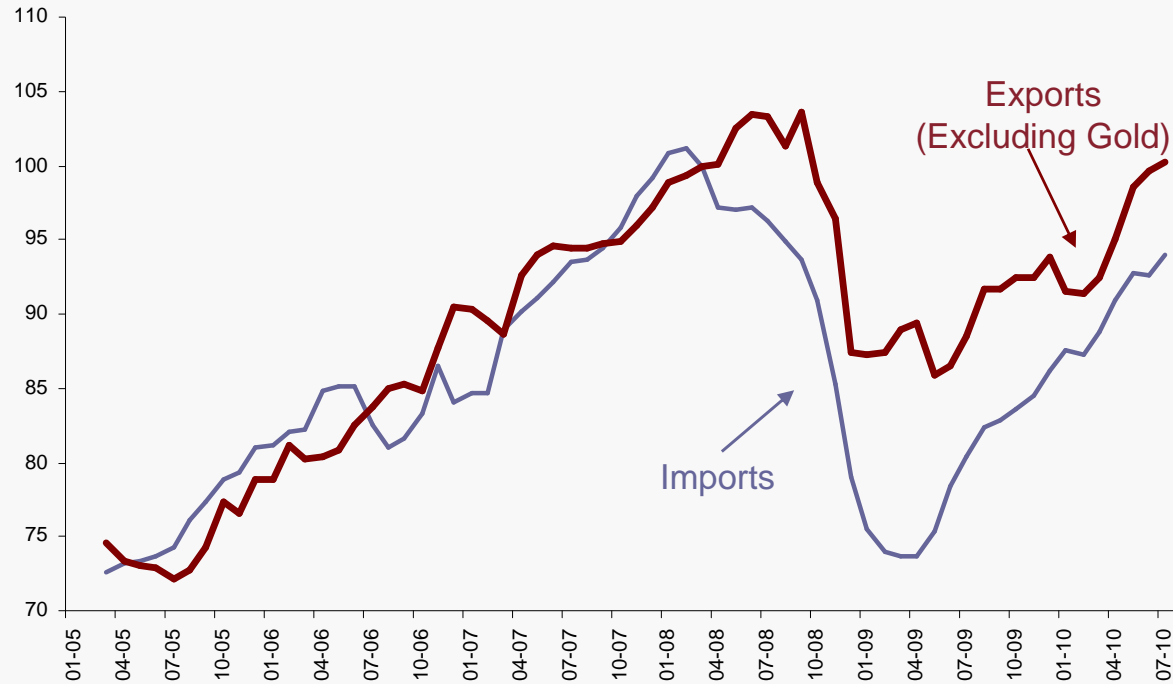


Source: CBT

Foreign Trade

The seasonally adjusted quantity indices for imports and exports maintained their gradual recovery.

Quantity Indices for Exports and Imports*
(Jan 2005 – July 2010, 2008Q1=100)

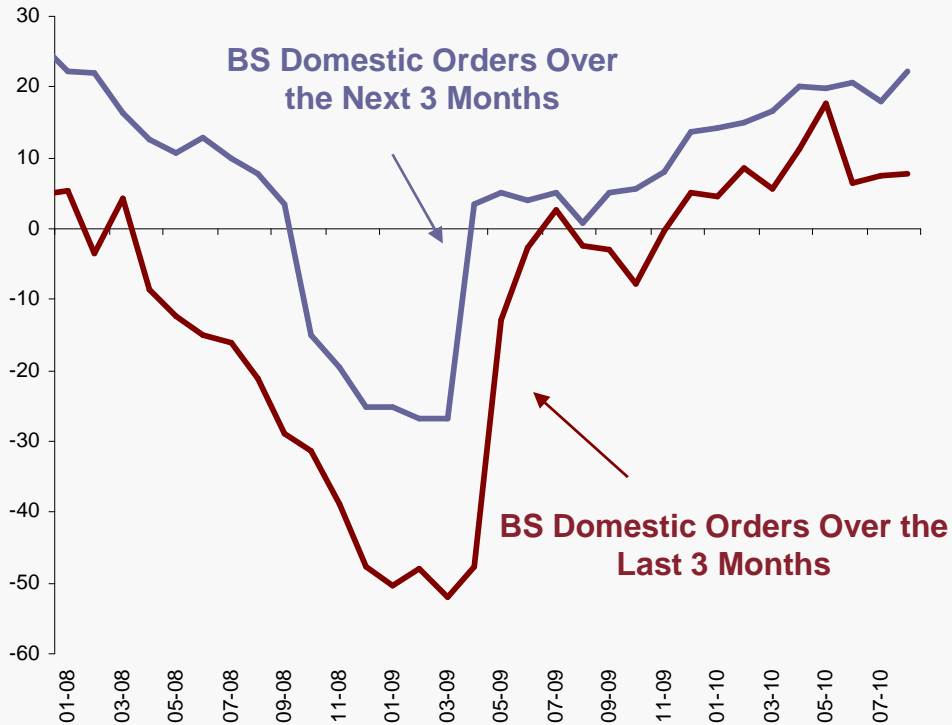


* Seasonally Adjusted, 2-month moving average
Source: TurkStat, CBT

Orders

The limited decline in order indicators, which was observed in the second quarter owing to problems in European economies, has increased the downward risks pertaining to the pace of recovery not only in external but also in domestic demand.

Domestic Orders
(Jan 2008 – Aug 2010)



* Seasonally Adjusted
Source: CBT

Orders from Foreign Markets*
(Jan 2008 – Aug 2010)

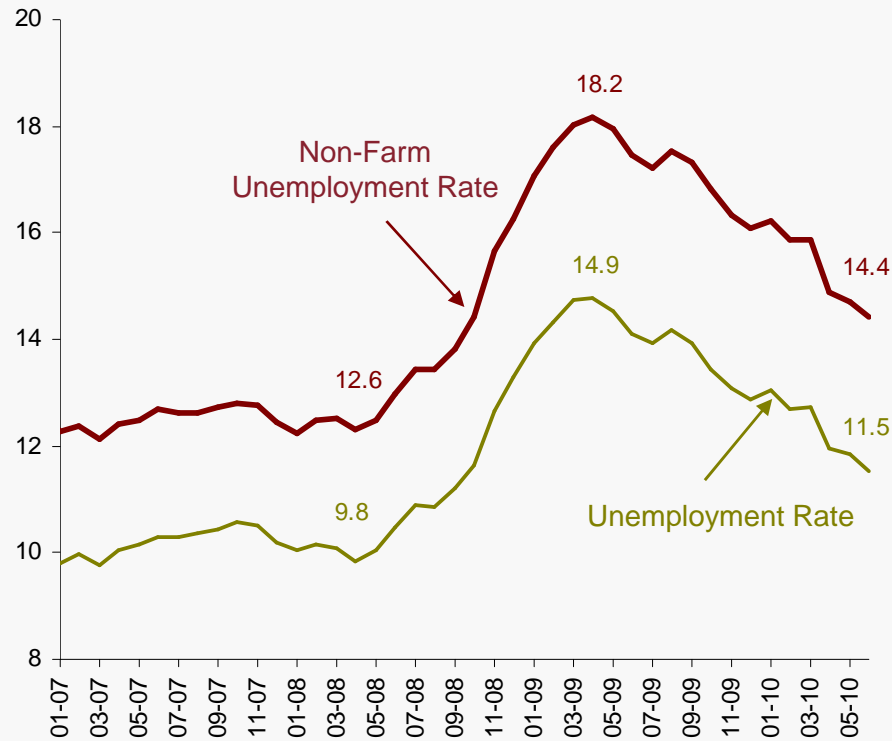


* Seasonally Adjusted
Source: CBT

Labor Market

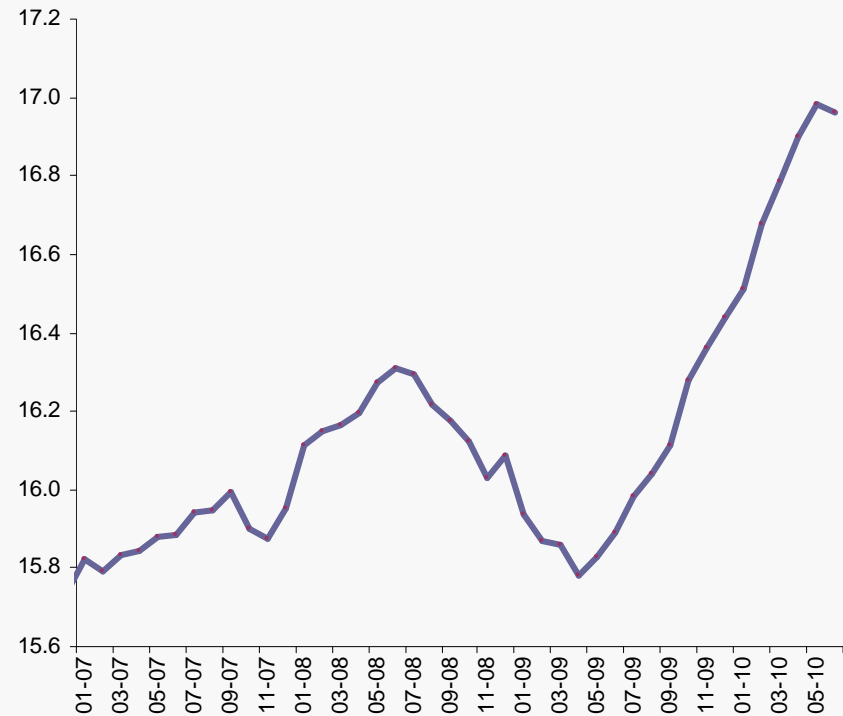
Despite continued improvement in labor conditions, unemployment rates are still high.

Unemployment Rates*
(Jan 2007 – June 2010, percent)



*Seasonally Adjusted
Source: TurkStat, CBT

Non-Farm Employment*
(Jan 2007 - June 2010, million people)



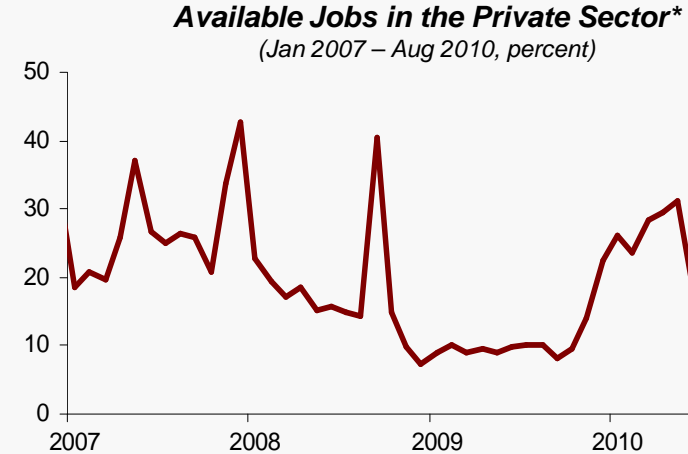
*Seasonally Adjusted
Source: TurkStat, CBT

Labor Market

Labor market indicators exhibit positive signals.



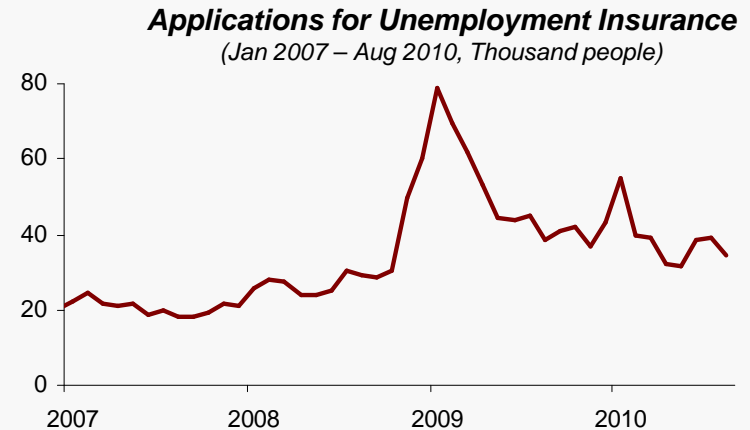
Source: TurkStat Industrial Labor Input Indicators, Markit, CBT



*The ratio of available jobs registered at the Turkish Employment Agency (ISKUR) to the number of job seekers that have applied to the agency



Source. Consumer Confidence Index, CBT

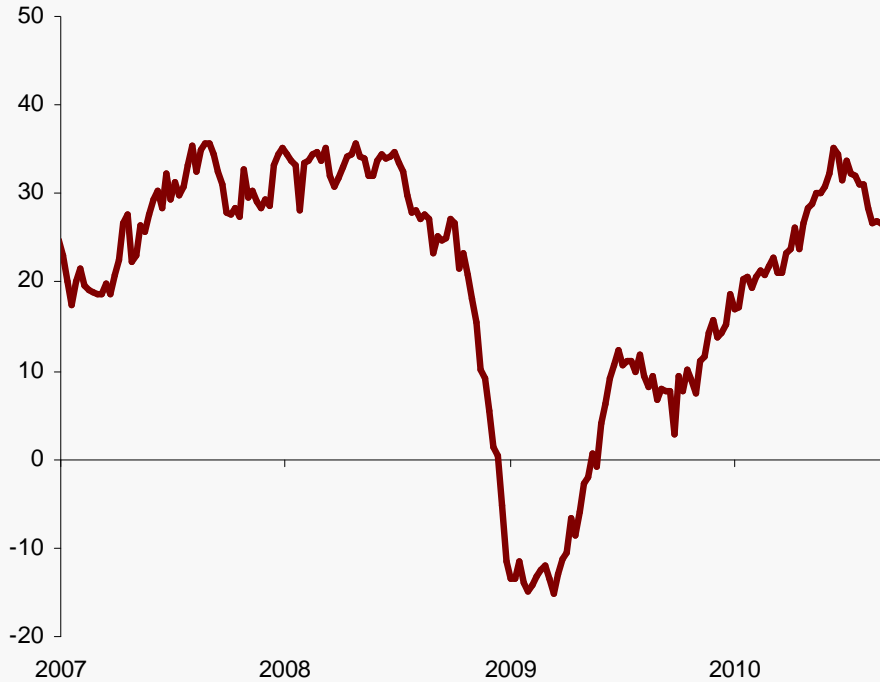


Source. CBT

Credit Developments

Bank loans, which displayed a rapid rise in the first half of 2010, are following a more stable trend in the third quarter of the year. Interest rates on loans maintain their low levels.

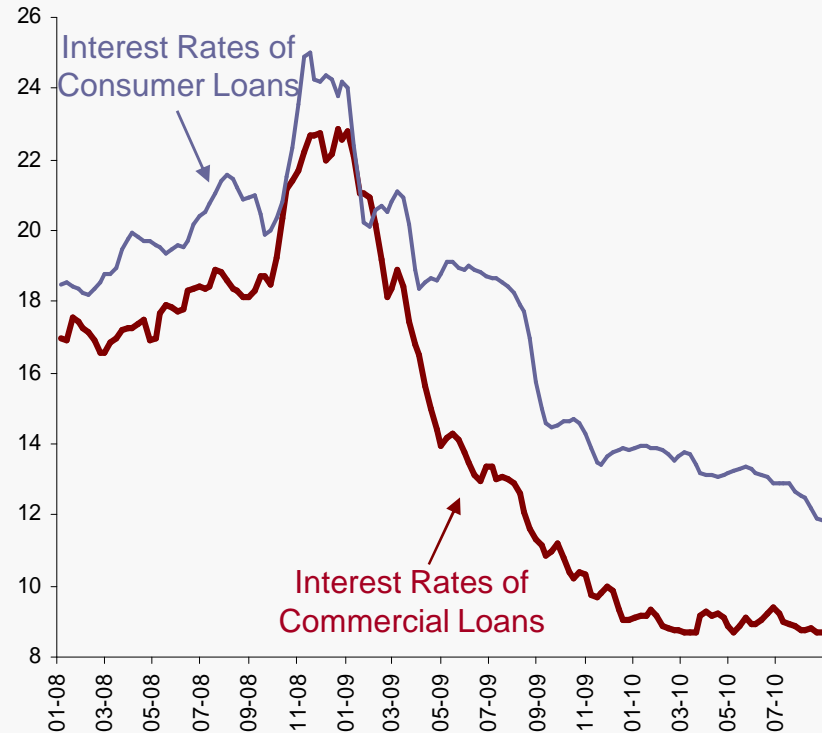
Weekly Change in Total Credit Volume*
(Jan 2007 – Sep 2010, annualized 13-week moving average)



* Total of deposit, development, investment and participation banks and consumer financing companies, adjusted for exchange rates.

Source: BRSA, CBT

Credit Interest Rates*
(Jan 2008 – Sep 2010, annual percent)



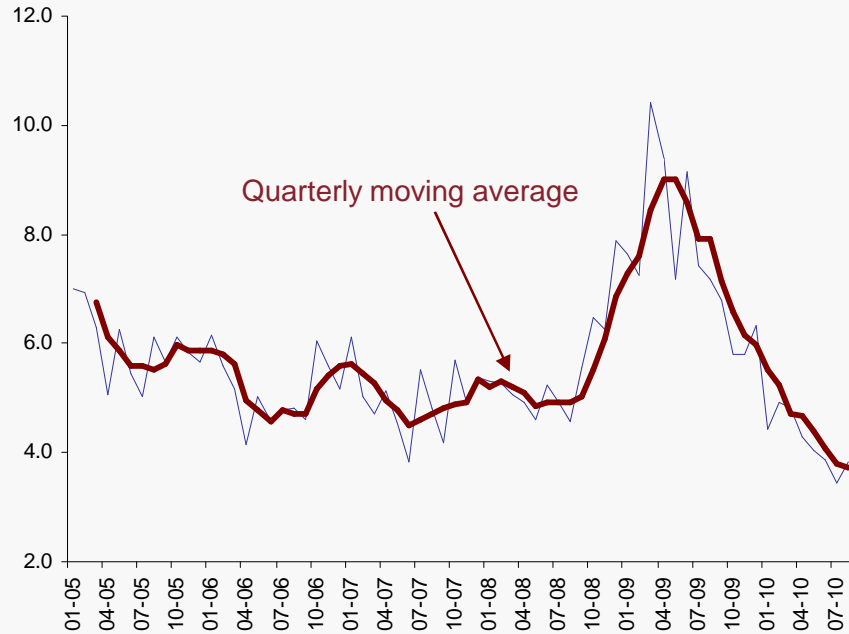
*2-week moving average

Source: BRSA, CBT

Commercial Activities

The number of bad cheques has recently displayed a remarkably decreasing trend. Furthermore, the number of newly established firms signals a rebound in economic activity.

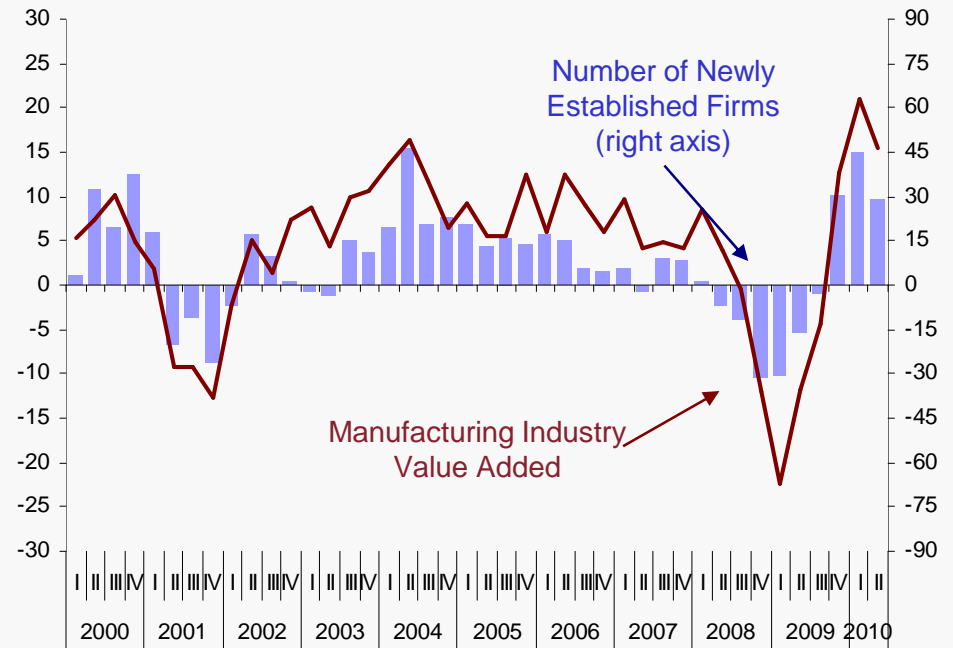
The Ratio of Bad Cheques to Total Cheques Presented to the ICH
(Jan 2005 – Aug 2010, percent)



2008	2009	2010-I	2010-II	2010-III*
5.60	7.66	4.82	3.87	3.82

*As of August 2010
Source: BTOM, CBT

Number of Newly-Established Firms and GDP Manufacturing Industry
(2000 Q1 – 2010 Q2, year-on-year percentage change)



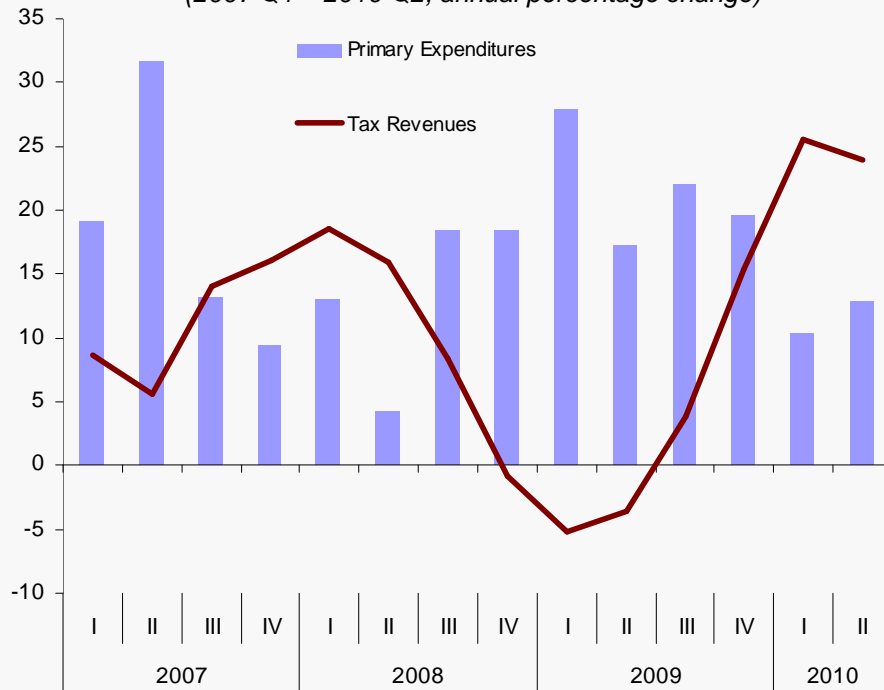
Percentage Change	09-I	09-II	09-III	09-IV	10-I	10-II
Manufacturing Industry	-22.3	-11.7	-4.5	12.8	21.0	15.4
Established Firms	-30.6	-15.8	-2.8	30.5	45.1	29.1

Source: TOBB, TurkStat, CBT

Public Finance

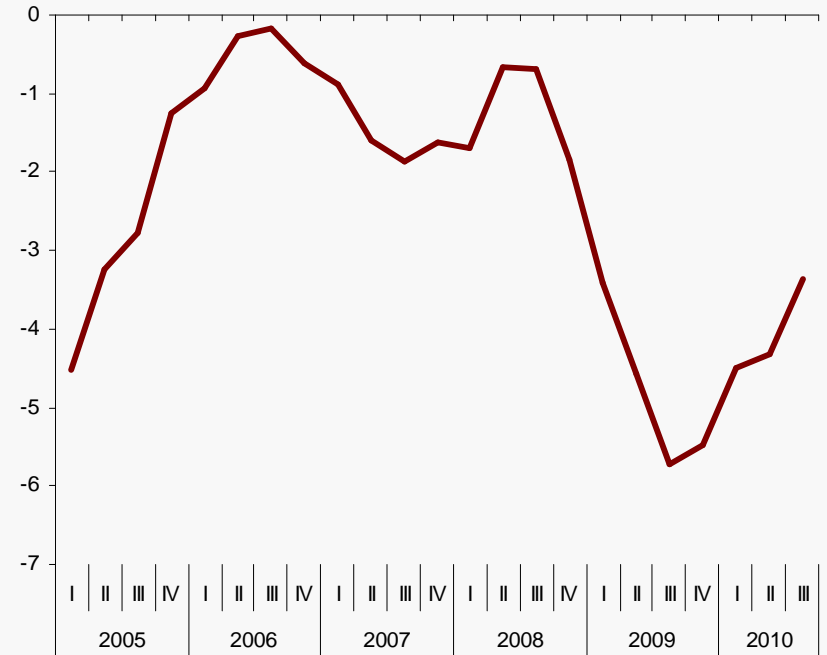
While the rise in tax revenues continue due to the rebound in economic activity, primary budget expenditures displayed a relatively limited increase. The gradual improvement in budget balances has been noticeable as of the last quarter of 2009.

Central Government Tax Revenues and Primary Expenditures
(2007 Q1 – 2010 Q2, annual percentage change)



Source: Ministry of Finance , CBT

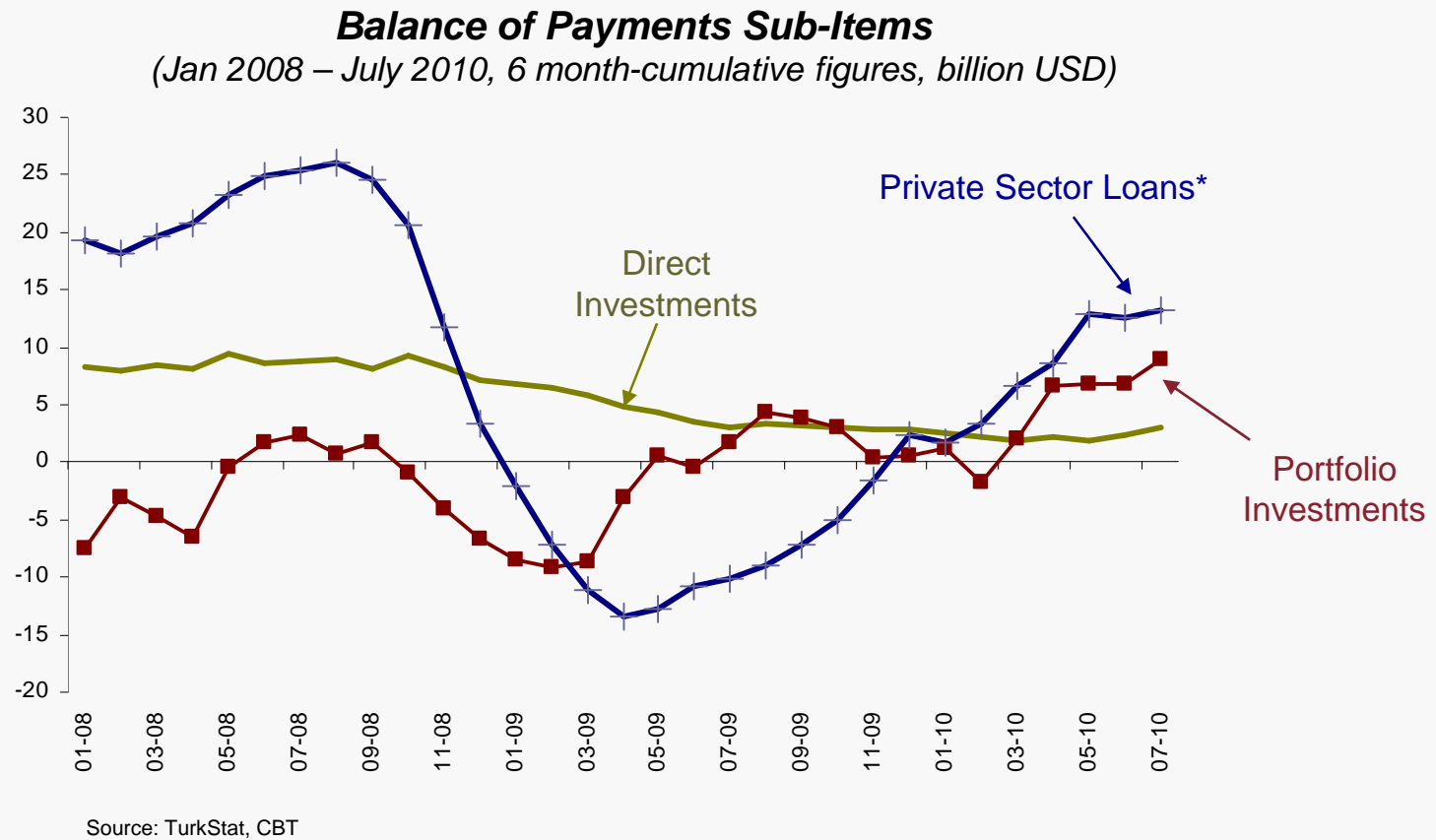
Central Government Budget Balance
(2005 Q1 – 2010 Q3, ratio to GDP, percent)



Source: Ministry of Finance , TurkStat, CBT

Balance of Payments

The weak course of economic growth in developed countries accelerates capital flow to countries with high growth potential like Turkey.

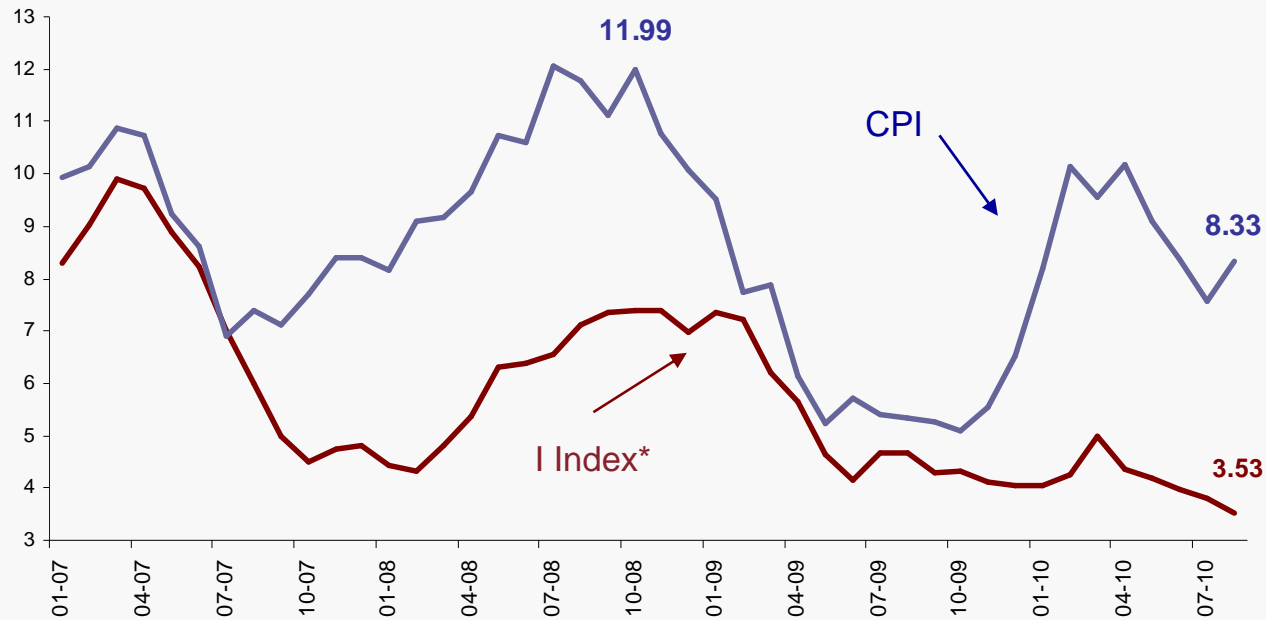


III. Inflation Outlook

Inflation Developments

Annual consumer prices inflation became 8.33 percent in August. The core inflation (I index) of 3.53 percent, adjusted for temporary tax effects, is the lowest level recorded since 2004.

Inflation Indicators
(Jan 2007 – Aug 2010, annual percentage change)

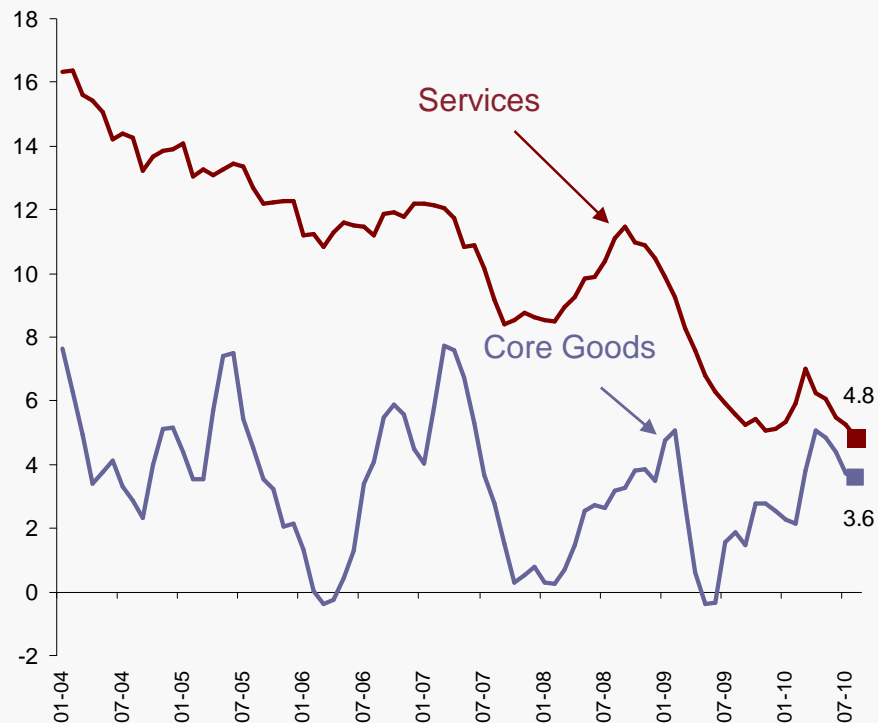


* Adjusted for temporary tax effect
Source: TurkStat, CBT

Components of Inflation

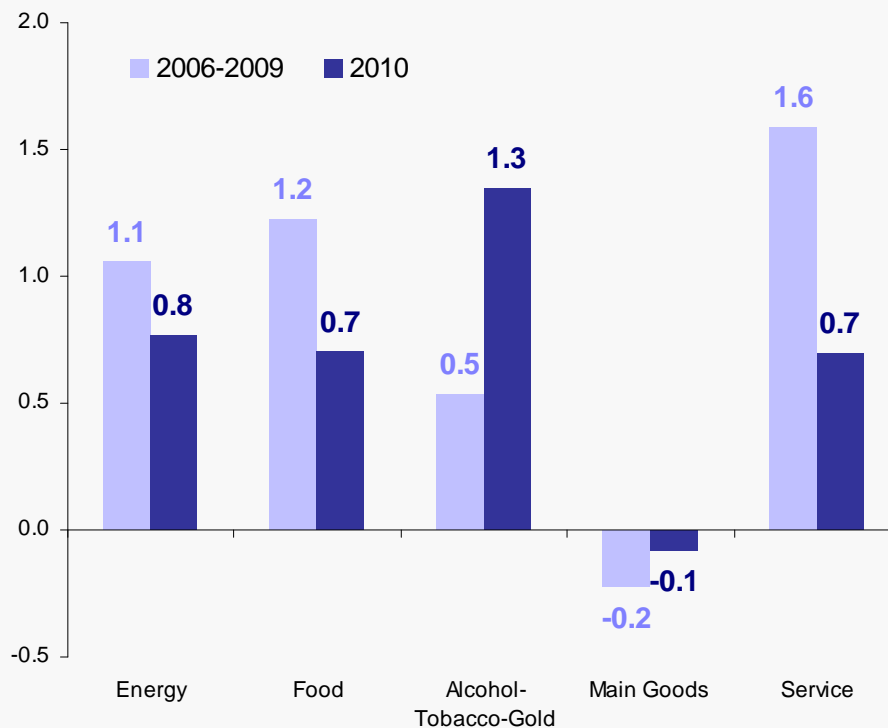
Services inflation continued its downward trend. As of August 2010, the contribution of **basic** goods and services became 0.6 points, which is far below average figures of past periods.

Goods and Services Inflation
(Jan 2004 – Aug 2010, annual percentage change)



Source: TurkStat, CBT

CPI by Groups
(first 8 months' contribution, percentage points)

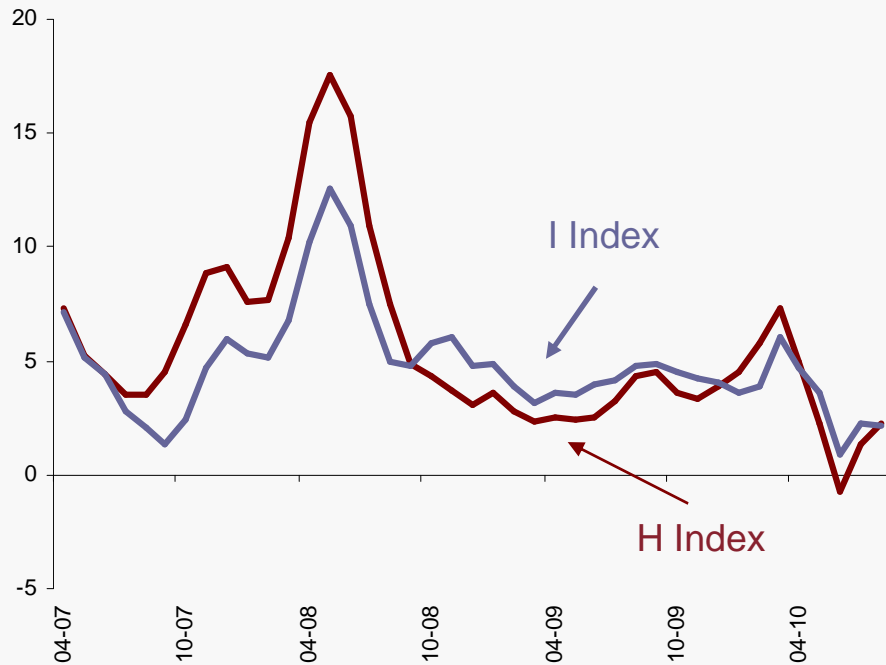


Source: TurkStat, CBT

Core Inflation

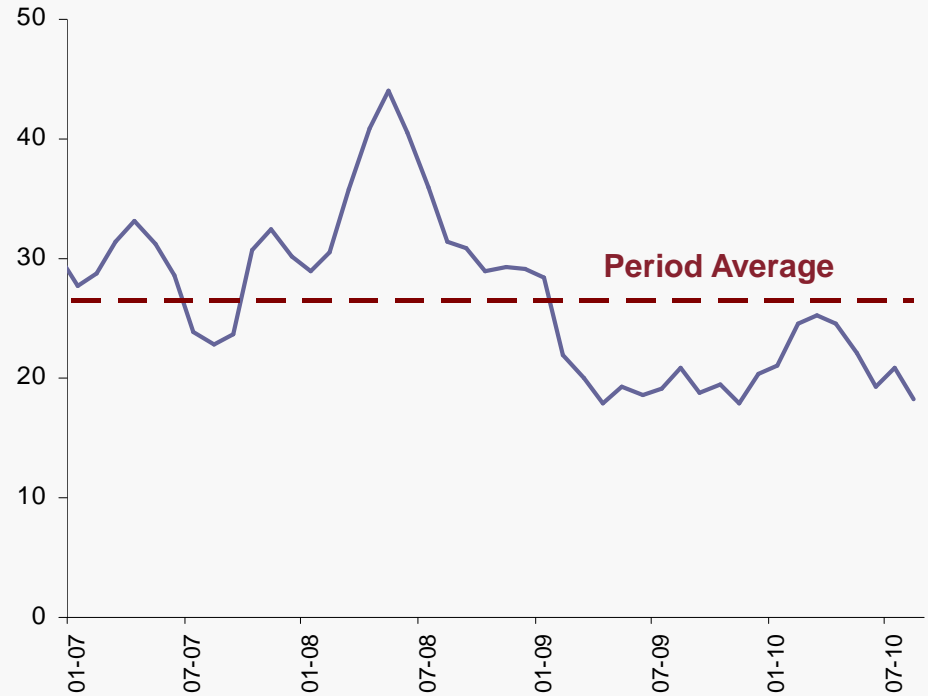
Core inflation indicators continue to follow a path consistent with medium-term targets.

Core Inflation Indicators*
(April 2007 – Aug 2010)



* Annualized quarterly averages adjusted for seasonality and tax reductions.
Source: TurkStat, CBT

Inflation Diffusion Index*
(Jan 2007 – Aug 2010)

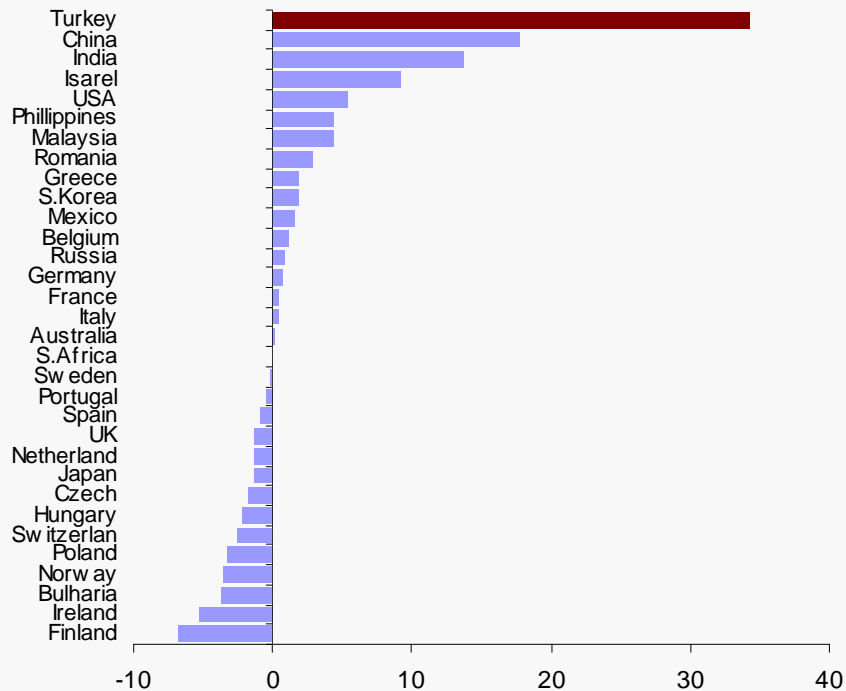


* Seasonally adjusted 3-month averages of the difference between the share of items with increasing prices and the share of items with falling prices in CPI.
Source: TurkStat, CBT.

Food Prices

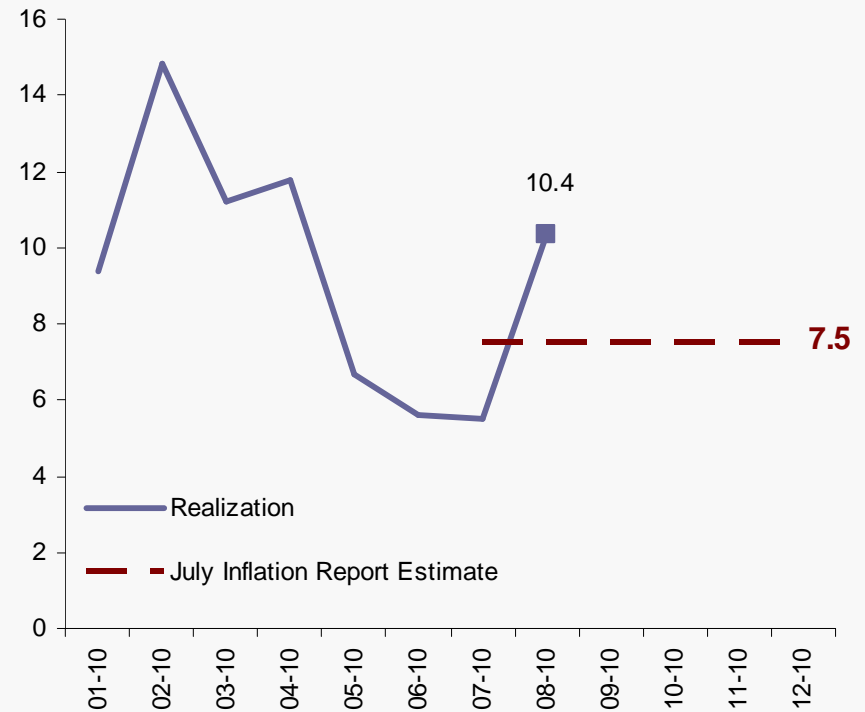
As stated in the Summary of the August Monetary Policy Committee Meeting, unprocessed food prices increased remarkably due to meat, fresh fruit and vegetables prices, and annual inflation in this group became 18.66 percent.

Meat Prices Inflation
(annual percentage change)



Source: TurkStat, CBT

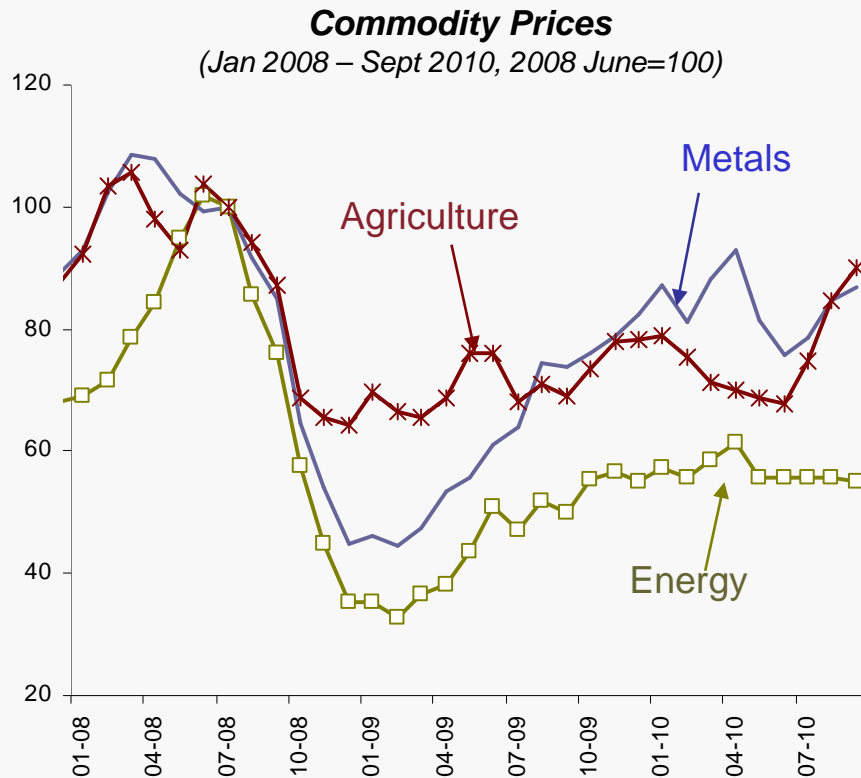
Food Prices Inflation and Assumptions
(annual percentage change)



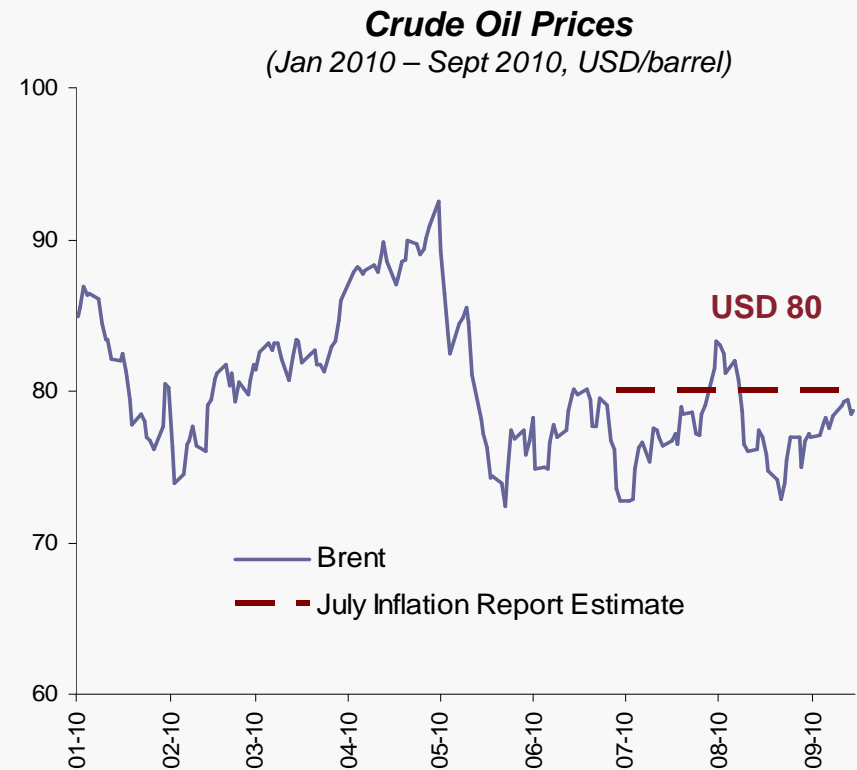
Source: TurkStat, CBT

Commodity Prices

Energy prices displayed a modest decrease in August. Oil prices follow a consistent path with our assumption in the July Inflation Report.



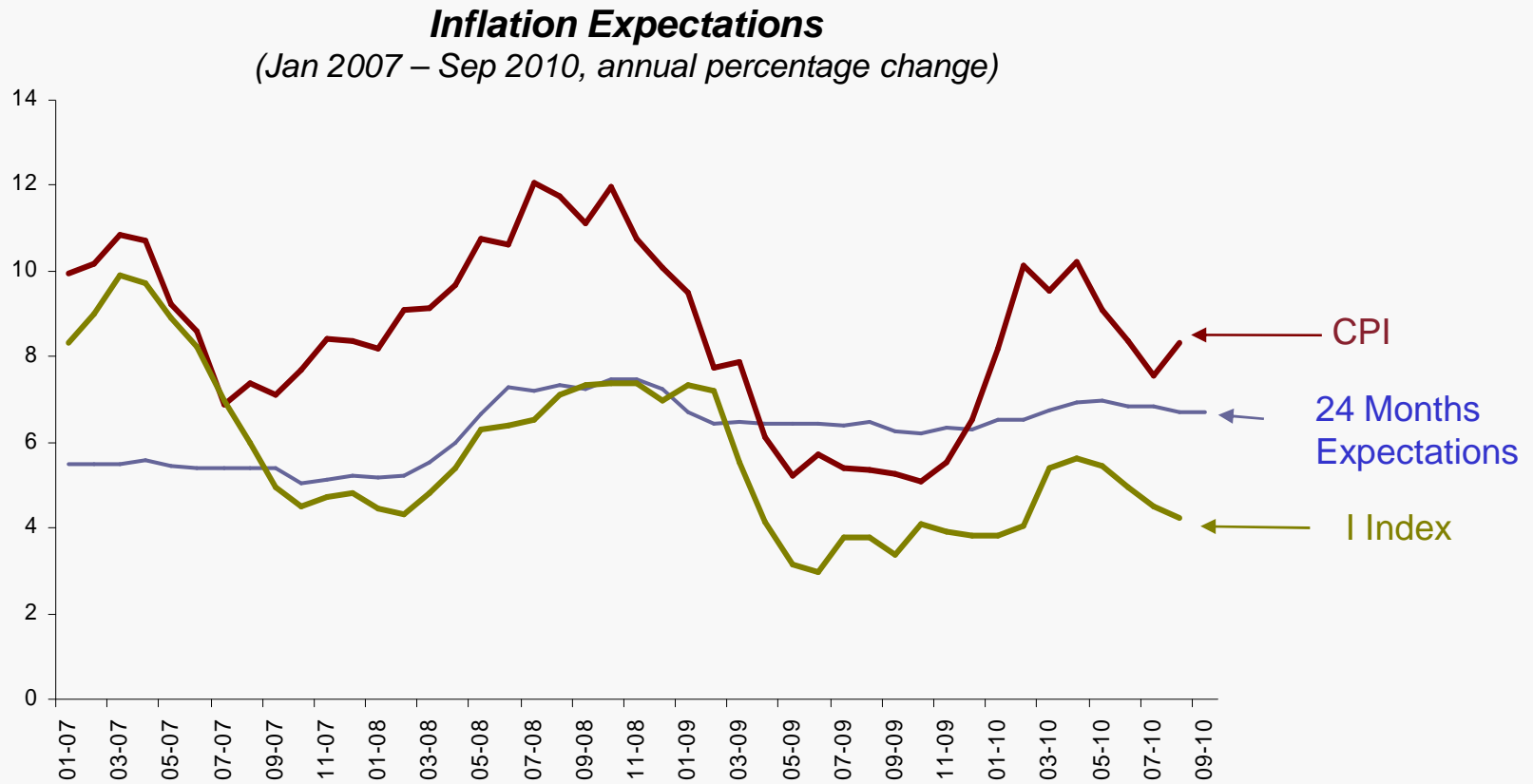
Source: GS, CBT



Source: Bloomberg, CBT

Inflation Expectations

Inflation expectations that increased in the first four months of the year due to the rise in inflation were positively influenced by the gradual removal of **adverse** temporary factors.

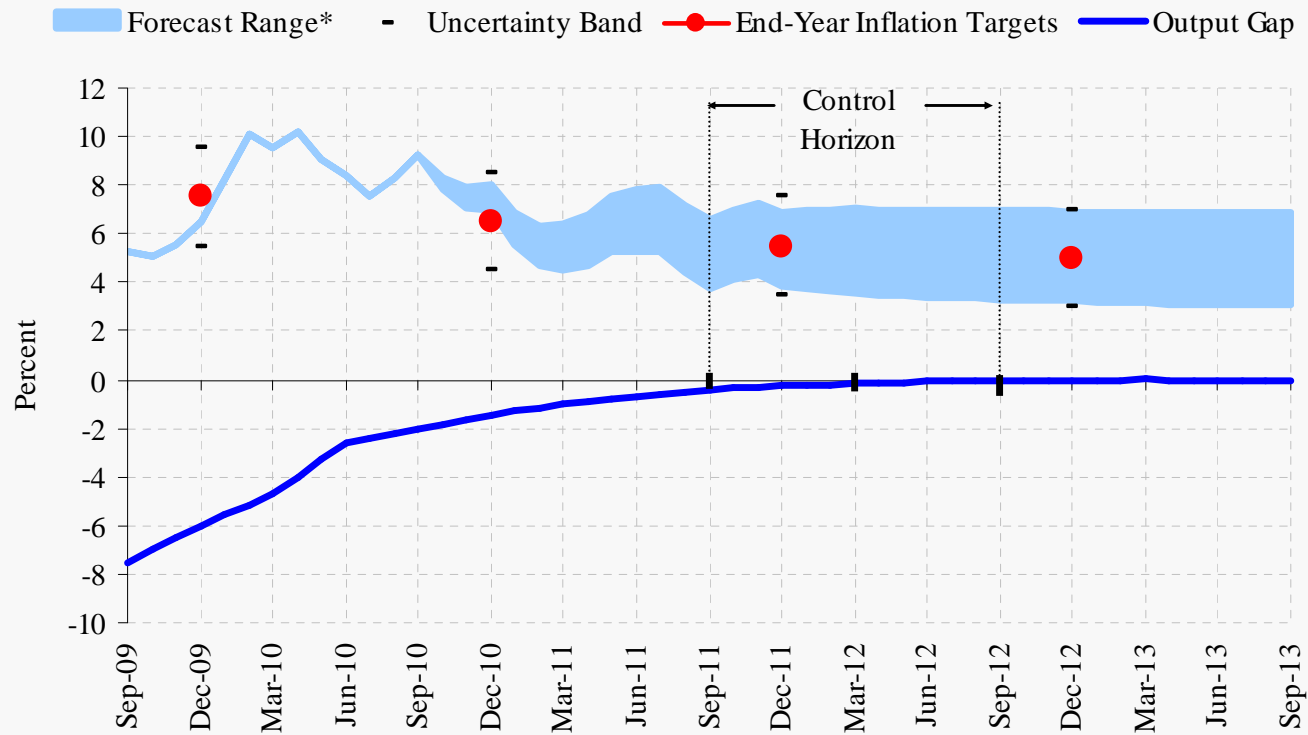


Source: TurkStat, CBT

Inflation Forecasts

Inflation is expected to re-assume a downward trend in the last quarter, after its temporary rise in the short term.

Inflation Forecasts and Realizations
(Dec 2008 – June 2013, percent)



Source: TurkStat, CBT

IV. Monetary Policy Stance

Duties of the Central Bank

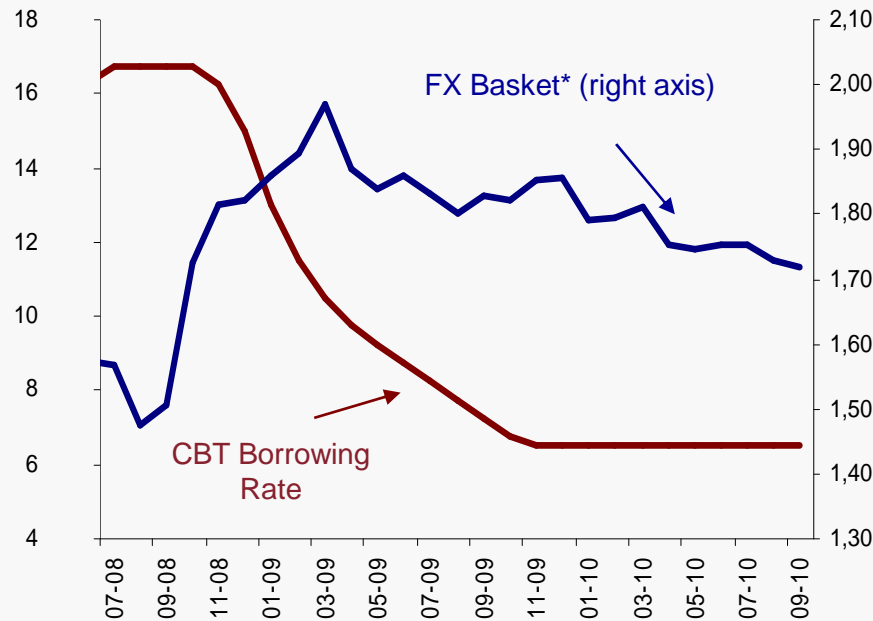
Primary objectives and duties of the Central Bank are;

- **To achieve price stability;**
- **To take measures that enhance stability of the financial system;**
- **To support the growth and employment policies of the government without **prejudice** to the objective of ensuring price stability**

Duties of the Central Bank

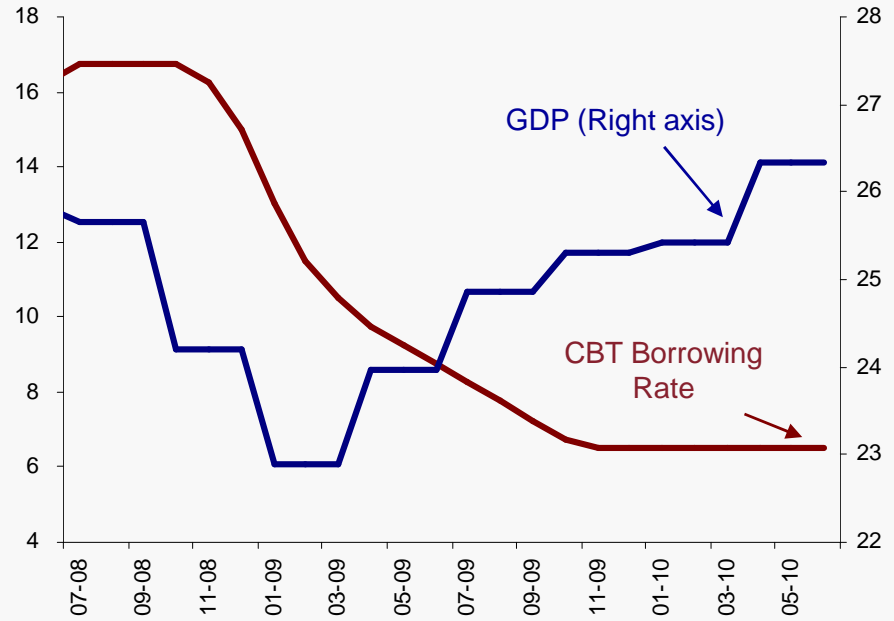
Inflation targeting entails not only price stability but also economic variables like financial stability, employment and growth. The monetary policy adopted in the post-crisis period is an example which indicates that the Central Bank also considers economic developments along with price stability.

Policy Rate (percent) and Exchange Rate
(July 2008 – Sep 2010)



*Exchange rate basket is calculated as USD 0.5 and Euro 0.5.
Source: CBT

Policy Rate (percent) and GDP
(seasonally adjusted, constant prices,
July 2008 – June 2010)

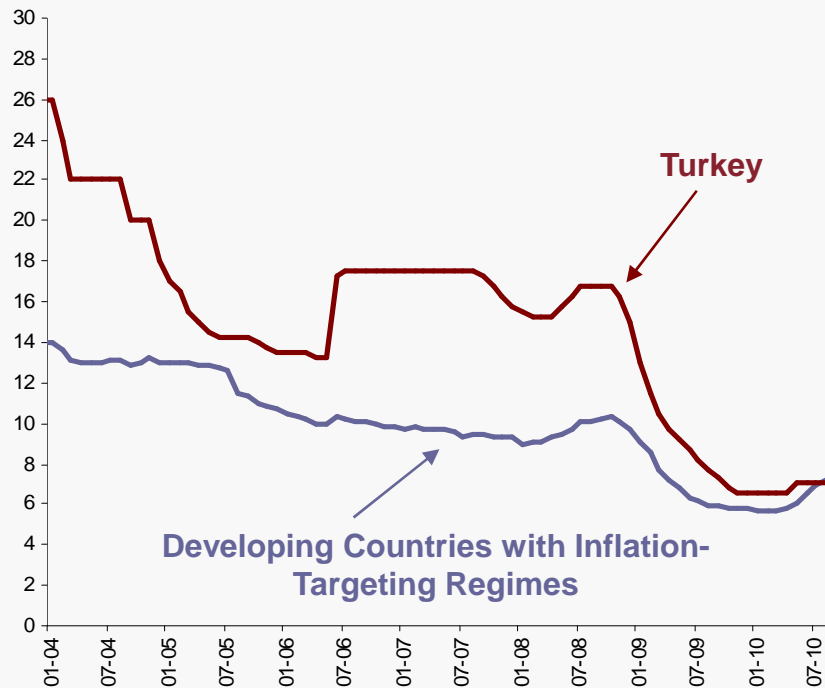


Source: TurkStat, CBT

Monetary Policy Stance

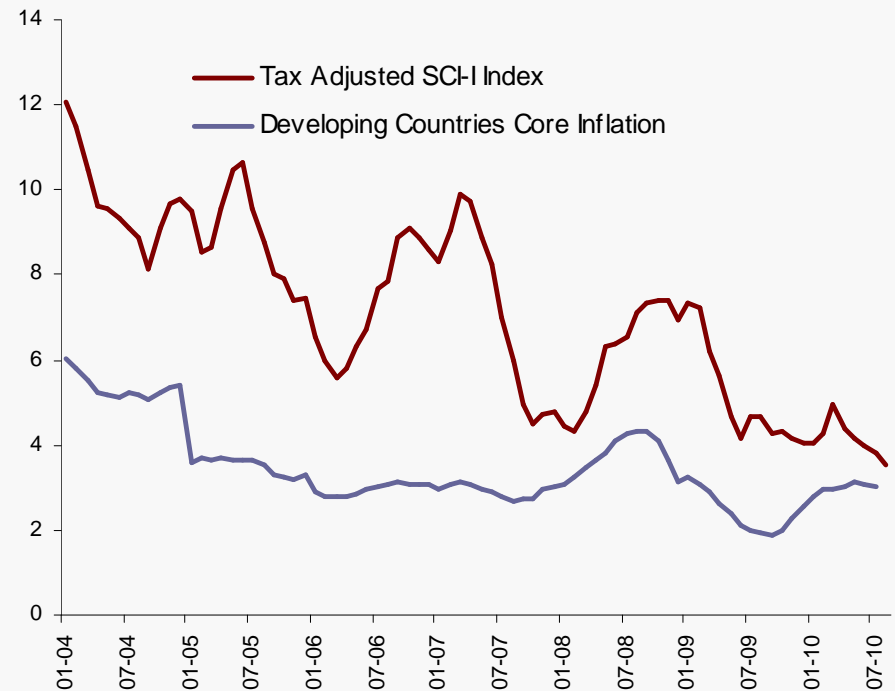
In Turkey, both the current level of policy rates and inflation realizations have converged to those of other developing countries with inflation targeting regimes. Nevertheless, there is more to be done regarding price stability.

Short Term Interest Rates in Turkey and Developing Countries with Inflation Targeting Regimes
(Jan 2004 – August 2010, percent)



Source: Central banks, CBT

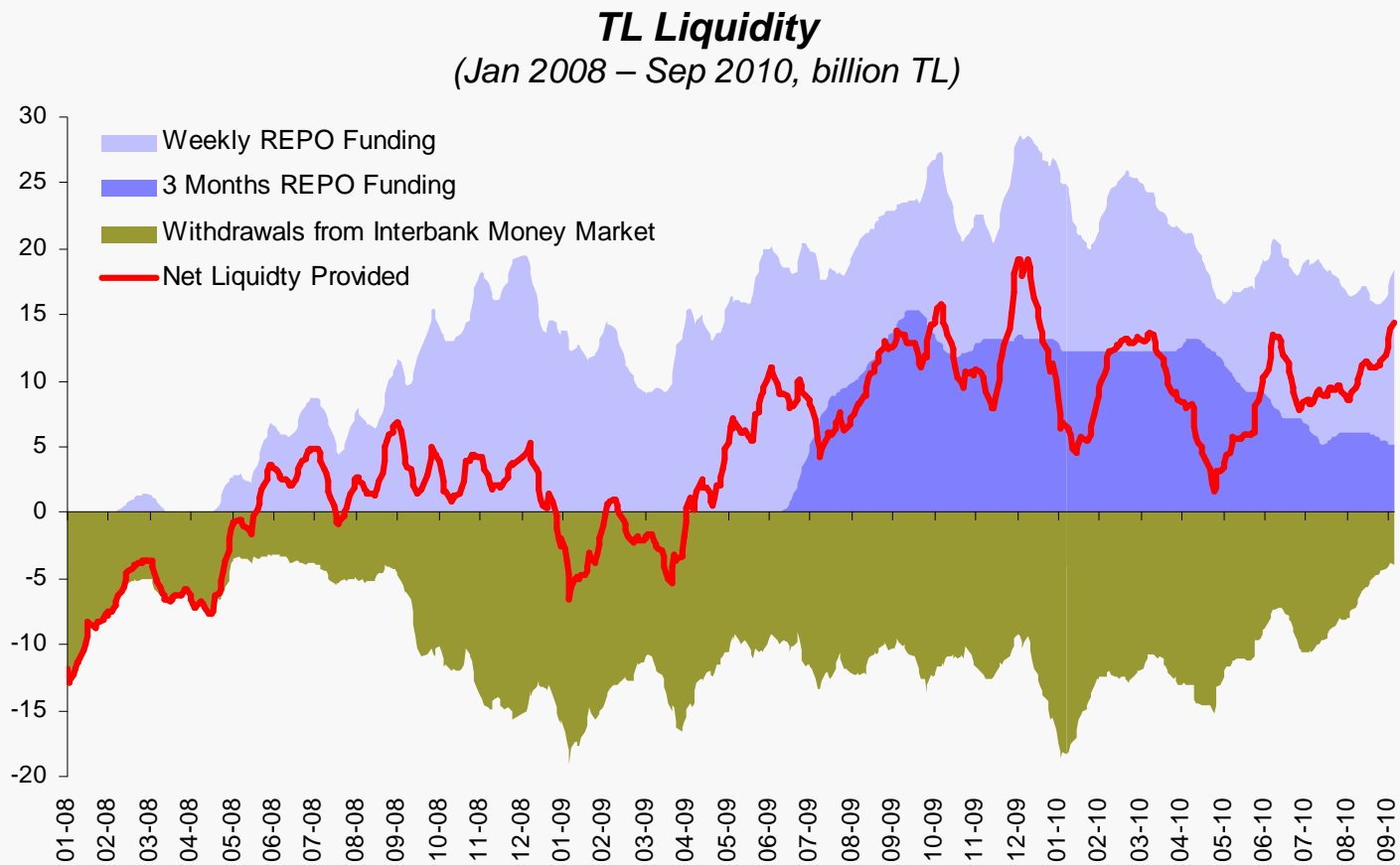
Core Inflation in Turkey and Developing Countries with Inflation Targeting Regimes
(Jan 2004 – August 2010, percent)



Source: Central banks, TurkStat, CBT

Liquidity Management

The Central Bank has provided the banking system with excess liquidity since the second quarter of 2008 and averted a possible liquidity squeeze in the markets.

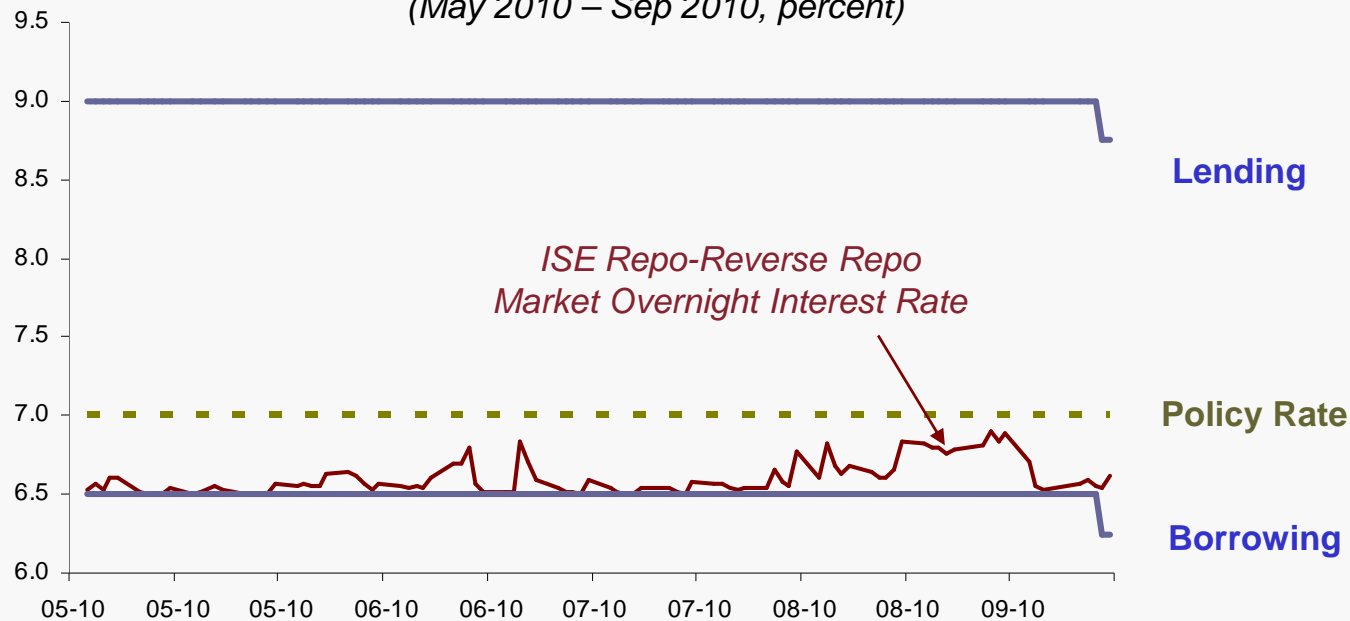


Source: CBT

Technical Rate Cut

On September 16, the Central Bank reduced borrowing and lending rates by 25 basis points. This decision does not indicate a loosening in the monetary policy stance. The policy rate was maintained at 7 percent. The decision is the second step of the technical rate adjustment mentioned in the “Monetary Policy Exit Strategy” and aims to bolster the effective functioning of money markets.

CBT and Market Interest Rates
(May 2010 – Sep 2010, percent)



Source: ISE, CBT

V. Financial Stability

Financial Stability

Factors to be considered for financial stability

1. **Debt Ratios:** *Use of more equity capital and more prudent borrowing*
2. **Debt Maturities:** *Extending maturities of domestic and foreign borrowing and deposits*
3. **FX Positions:** *Strengthening the FX positions of public and private sectors*
4. **Risk management processes and methods:** *More effective management of exchange rate risk via instruments such as the Turkish Derivatives Exchange*

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Financial Stability

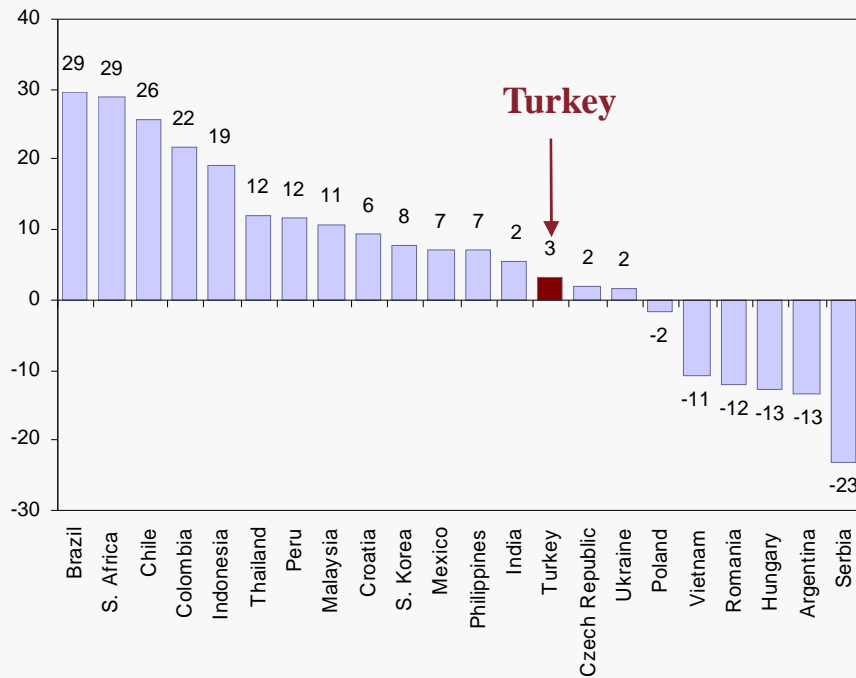
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Exchange Rate Developments

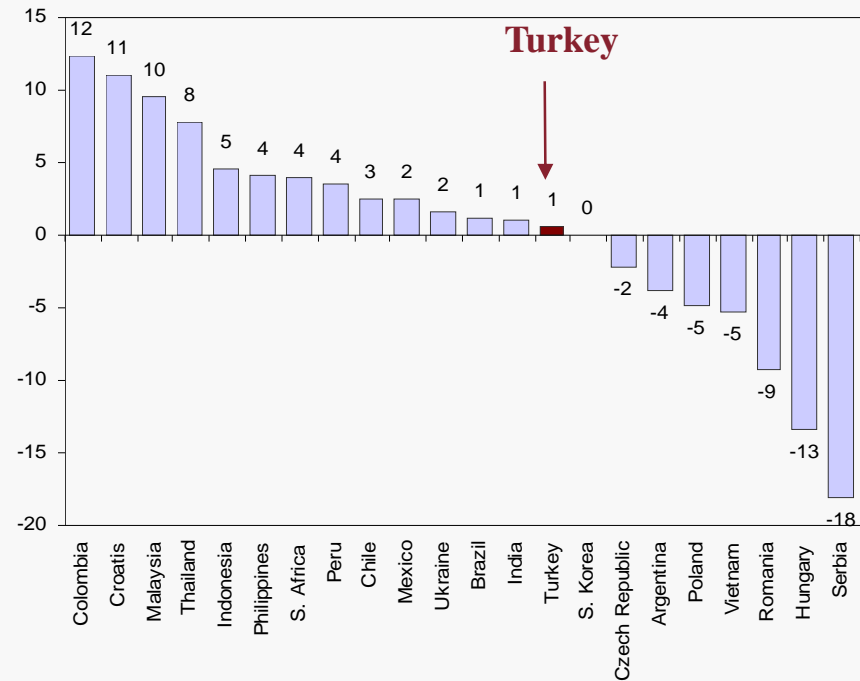
Compared to currencies of other developing countries, no significant change is observed in the value of the Turkish lira.

Change in Local Currencies Against US Dollar
(Since Jan 2009, percentage change)



Source: Bloomberg, CBT

Change in Local Currencies Against US Dollar
(Since Jan 2010, percentage change)



Source: Bloomberg, CBT

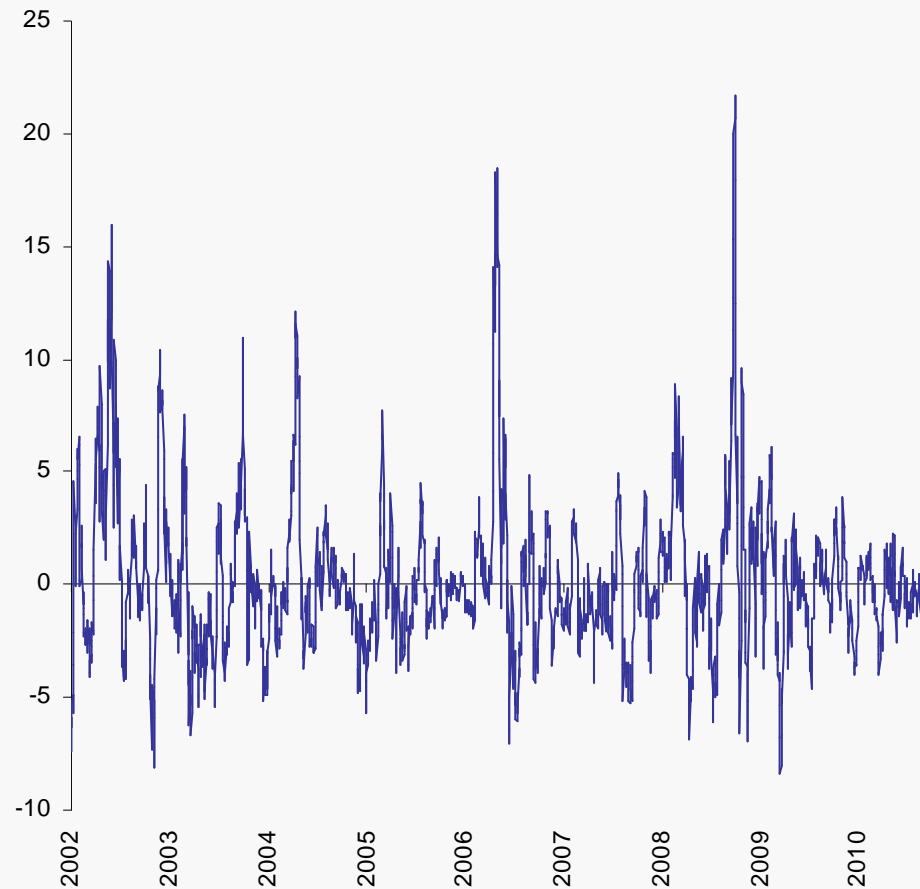
Exchange Rate Developments in Turkey

Rapid Changes in Exchange Rates
(Turkish Lira /US Dollar, 2002-2010)

Beginning date	Duration of fluctuation (day)	Value at the beginning	Peak value	change %
03-03-03	22	1.59	1.75	9.9
24-09-03	47	1.35	1.50	11.1
05-04-04	49	1.30	1.55	19.2
20-07-04	63	1.42	1.53	7.7
08-03-05	22	1.26	1.39	10.3
04-05-06	53	1.31	1.70	29.2
26-02-07	9	1.38	1.45	5.4
25-07-07	26	1.24	1.39	12.3
02-10-08	49	1.23	1.70	37.6
07-01-09	61	1.51	1.80	18.8

Source: CBT

Monthly Percentage Change in Foreign Exchange Basket
(Equally weighted Euro and US Dollar, Jan 2002- Sep 2010)



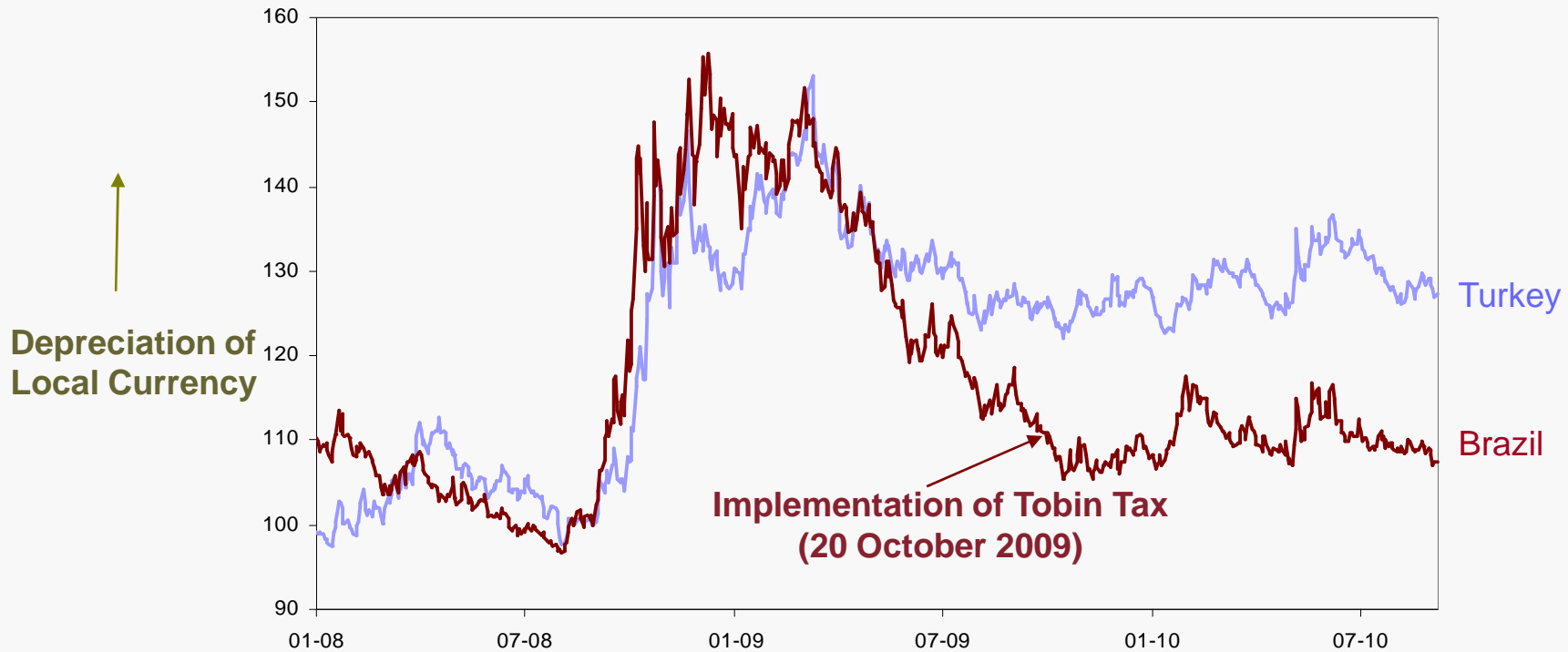
Source: CBT

Tobin Tax: The Brazilian Case

Despite the Tobin tax that has been implemented in Brazil since 20 October 2009, the Brazilian currency is more valuable than the Turkish currency (compared to the pre-crisis period).

Exchange Rate Developments in Brazil and Turkey*

(Value of the US dollar versus local currencies, Jan 2008 – Sep 2010, Aug 2008 = 100)



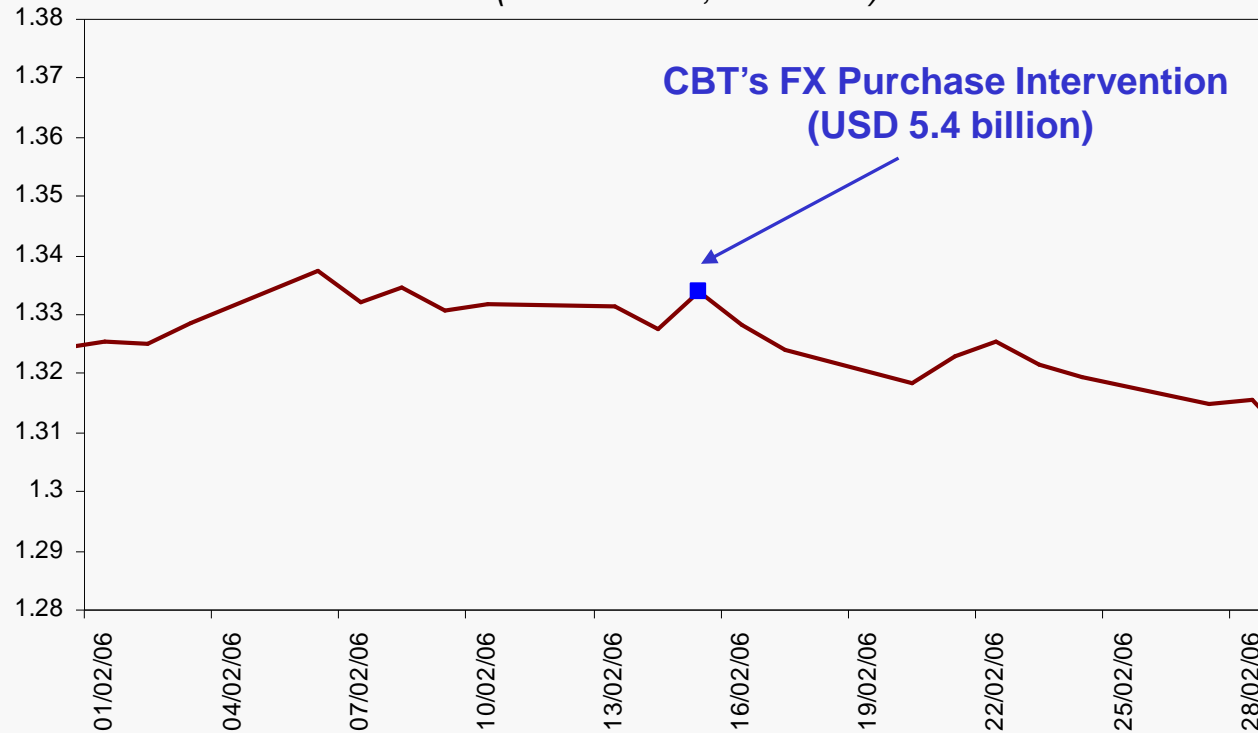
* Average Exchange Rate for August 2008 is taken as 100.
Source: Bloomberg, CBT

FX Purchase Interventions: The Turkish Case

The intensive foreign exchange interventions of the 2005-2006 period had limited impact on exchange rates.

Foreign Exchange Purchase Intervention of 15 February, 2006 and Exchange Rate Developments

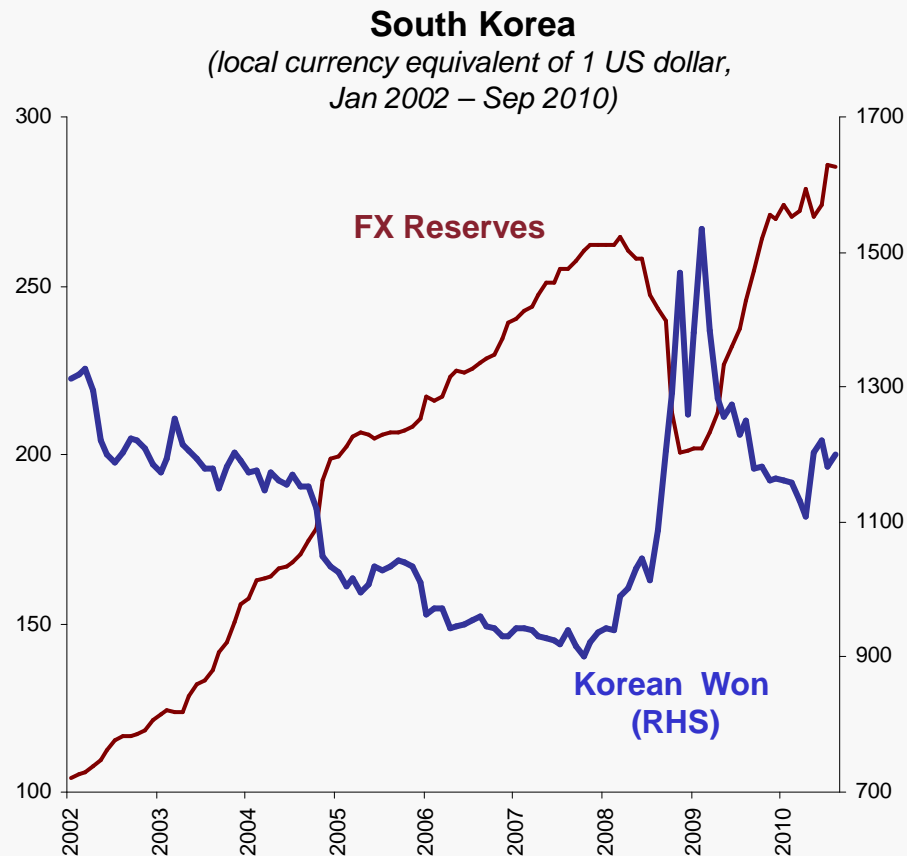
(TL/US Dollar, Feb 2006)



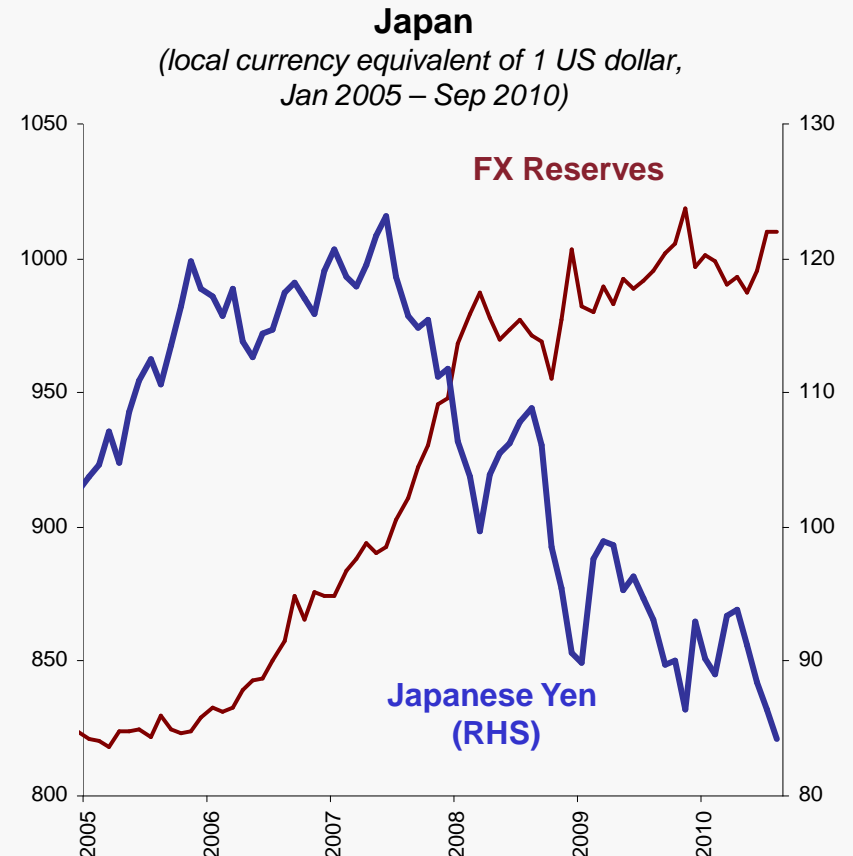
Source: CBT

FX Purchase Interventions – Country Cases

A similar situation was experienced in South Korea, Japan and Switzerland.



Source: Bloomberg, CBT

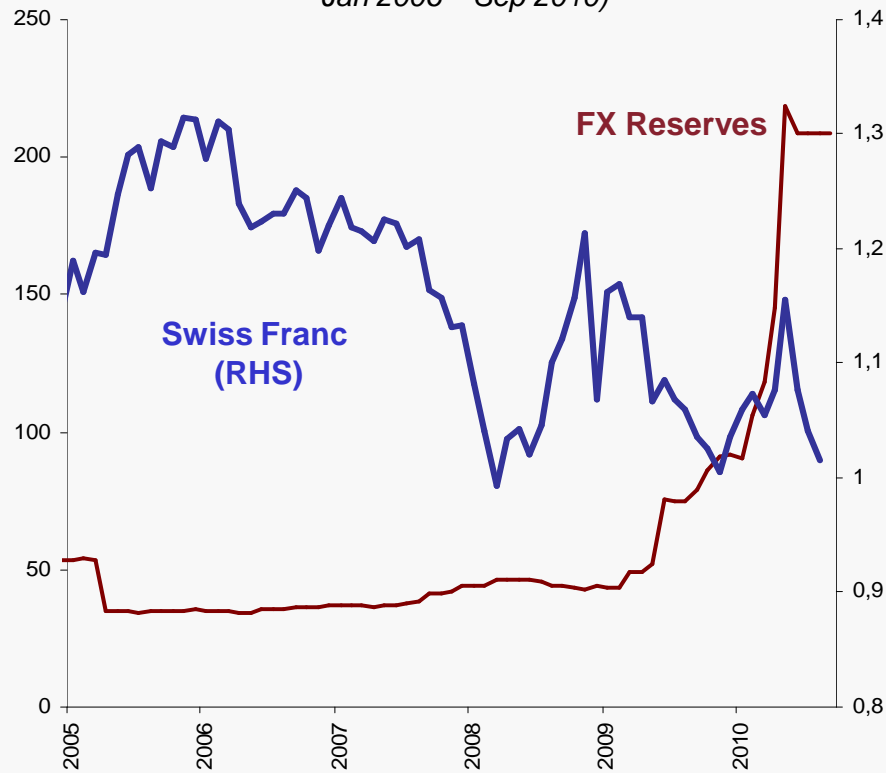


Source: Bloomberg, CBT

FX Purchase Interventions – Country Cases

Switzerland

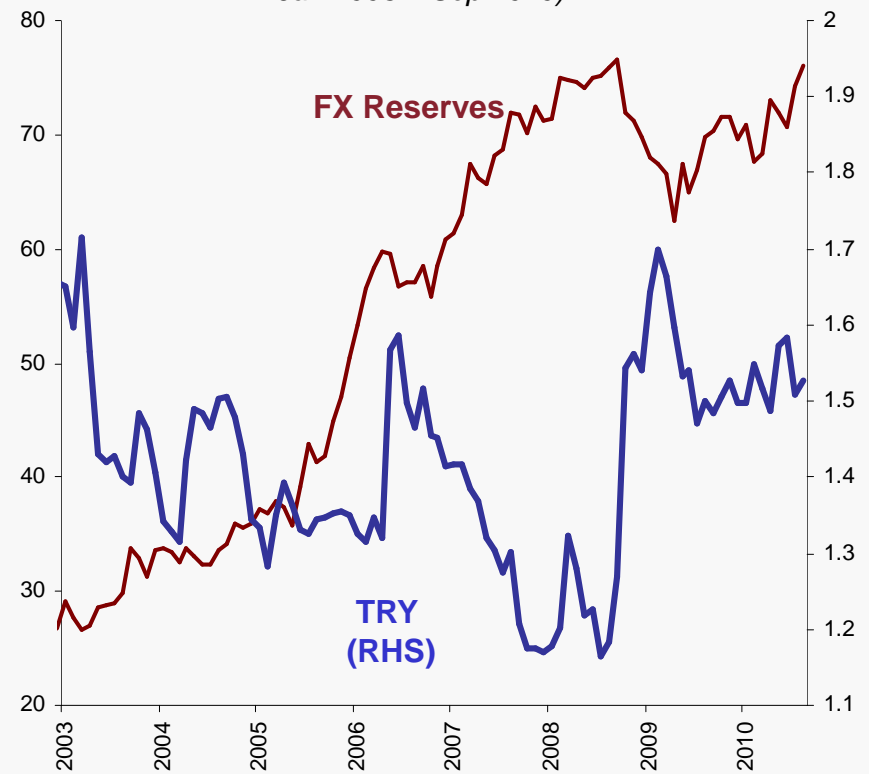
(Local currency equivalent of 1 US dollar,
Jan 2006 – Sep 2010)



Source: Bloomberg, CBT

Turkey

(Local currency equivalent of 1 US dollar,
Jan 2003 – Sep 2010)

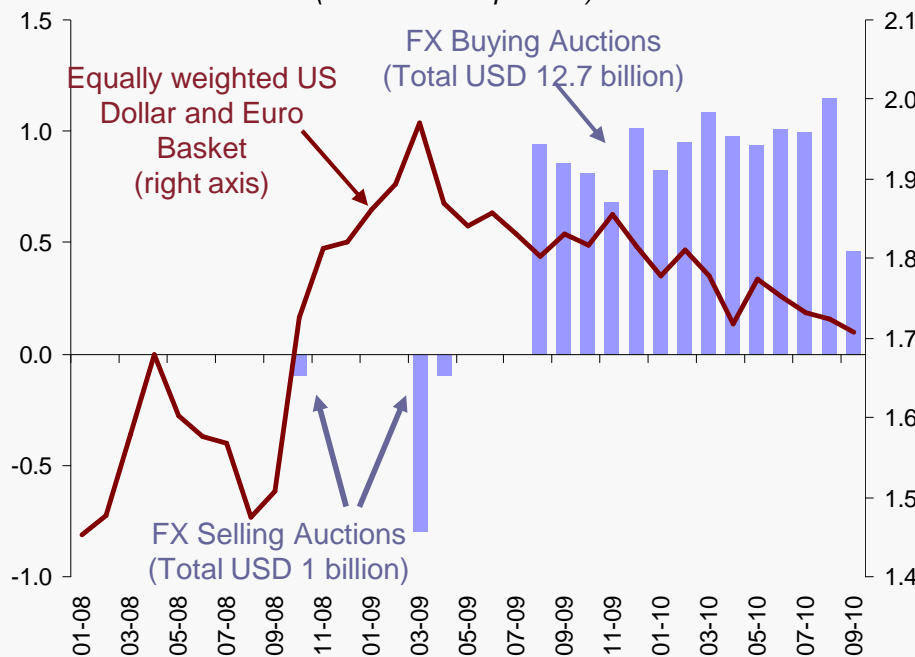


Source: Bloomberg, CBT

FX Purchase and Selling Auctions in Turkey

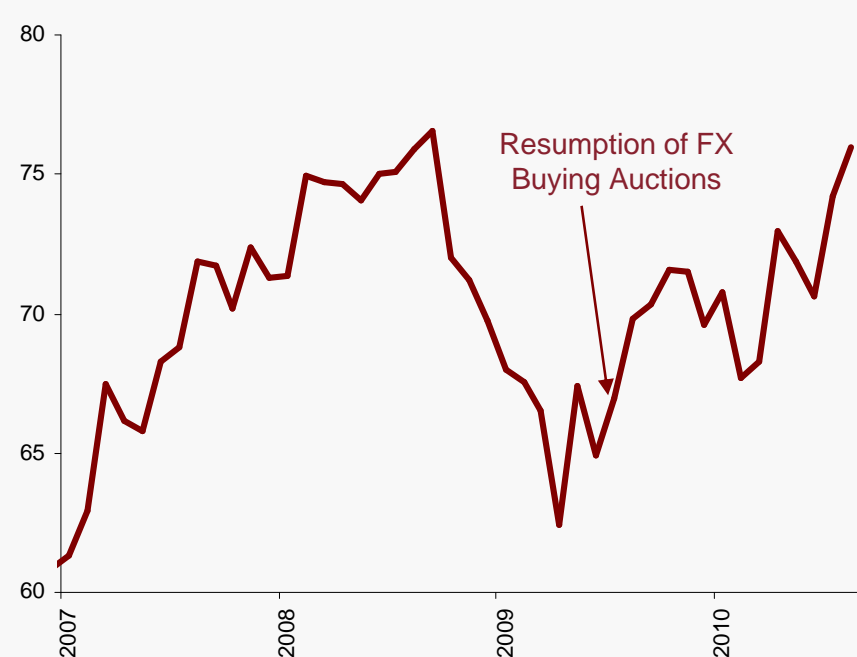
Parallel to its objective of maintaining financial stability, the CBT holds FX selling auctions in case of excessive fluctuations in exchange rates and FX buying auctions in case of foreign exchange surplus. Hence, USD 0.9 billion was sold in the March-April 2009 period and USD 12.7 billion has been purchased via auctions since August 2009.

FX Buying and Selling Auctions against TRY and FX Basket
(Jan 2008 – Sep 2010*)



*As of 15 September 2010
Source: CBT

Central Bank FX Reserves
(billion US Dollar, Jan 2003 – Sep 2010)



Source: Bloomberg, CBT

Are Interest Rates High in Turkey?

Compared to interest rates in other developing countries, the level of real interest rates in Turkey is rather low.

Inflation Rates and Policy Rates in Developing Countries
(Sep 2010, percent)

	Policy Rates	Inflation Expectations for 2010	Real Policy Rates
Thailand	1,75	3,50	-1,69
Chile	2,00	3,50	-1,45
Czech R.	0,75	1,50	-0,74
Korea	2,25	2,80	-0,54
Turkey	7,00	7,50	-0,47
Philippines	4,00	4,00	0,00
Mexico	4,50	4,30	0,19
Hungary	5,25	4,70	0,53
Malaysia	2,75	2,00	0,74
Poland	3,50	2,50	0,98
S. Africa	6,00	4,75	1,19
China	5,31	3,00	2,24
Brazil	10,25	5,10	4,90

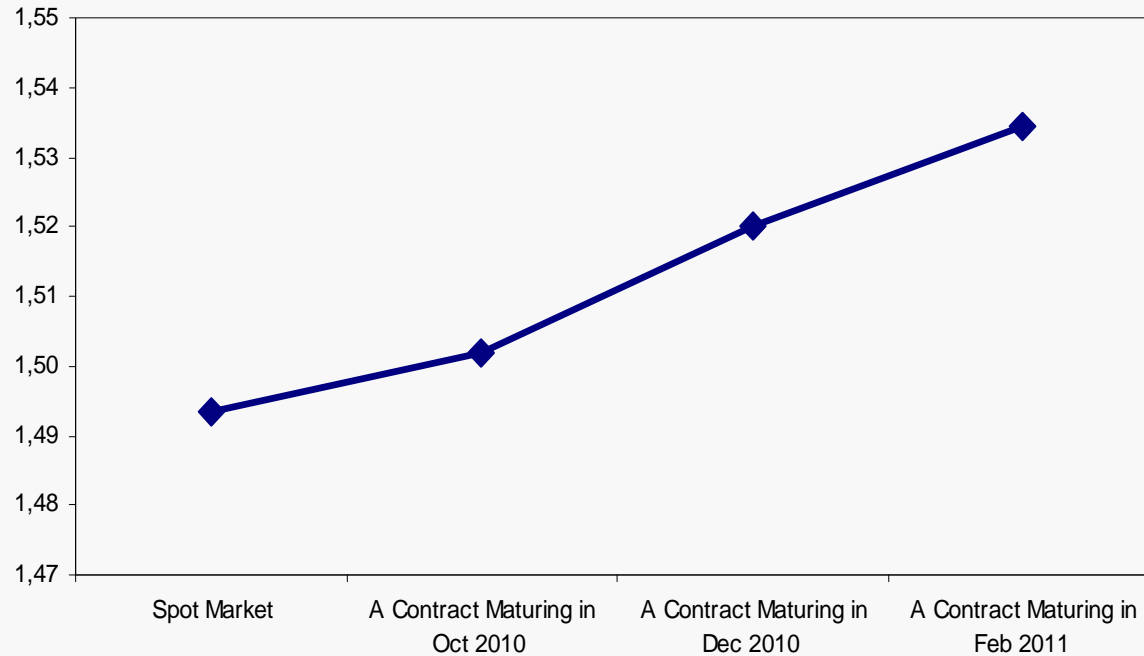
Economies with
Negative
Real Policy Rates

Source: Bloomberg, CBT

Forward Transactions to hedge against Exchange Rate Exposure

While making their investment, production and employment decisions, producers should refrain from relying on one-way assumptions about the course of exchange rates in a given country and should utilize risk management instruments. It is possible to manage foreign exchange positions and risks in a more professional way with the Turkish Derivatives Exchange (TurkDEX).

Spot and Forward Transaction Prices for Turkish lira-US dollar
(as of 15 Sep 2010)



Source: TurkDEX, CBT

Overall Assessment

- Recent data releases indicate that economic activity is on a milder path of recovery following strong growth in the second quarter.
- Uncertainties regarding external demand persist, while domestic demand displays a relatively stable outlook. Therefore, it would take a while before capacity utilization rates return to their pre-crisis levels.
- Although employment conditions continue to improve, unemployment rates remain at high levels.

Overall Assessment

- It is expected that inflation will increase temporarily in the short term before reverting to a declining path starting from the last quarter of the year.
- In the light of these developments, the Central Bank considers that it will be necessary to maintain policy rates at current levels for some time, and to keep them at low levels for a long period.
- As the second step of the technical rate adjustment mentioned in the “Monetary Policy Exit Strategy”, the Central Bank reduced borrowing and lending rates by 25 basis points on 16 September.
- This decision aims to enhance the effective functioning of money markets and does not mean a loosening of the monetary policy stance. The policy rate was kept constant at 7 percent.

CENTRAL BANK OF THE REPUBLIC OF TURKEY

Presentation at the Kahramanmaraş Chamber of Commerce
and Industry

Durmuş YILMAZ
Governor

20 September 2010