

## 2. International Economic Developments

In the first quarter of 2015, global economic activity remained weak, and year-end global growth forecasts have contracted since the publication of the previous Inflation Report. The sluggish growth performance of emerging economies was sustained in this period, while economic activity followed a relatively positive course in advanced economies. The languishing growth performance in emerging economies is shaped by the slowdown in the Chinese economy, the persistent weak readings in commodity prices, tight external financing conditions and geopolitical factors. The relatively positive outlook in advanced economies, on the other hand, is driven by loose financial conditions, low oil prices and an improving labor market. Risks to global growth pertaining to the upcoming period are still downward. The recently elevated volatility in financial markets may be a substantial risk factor on growth performances of both advanced and emerging economies.

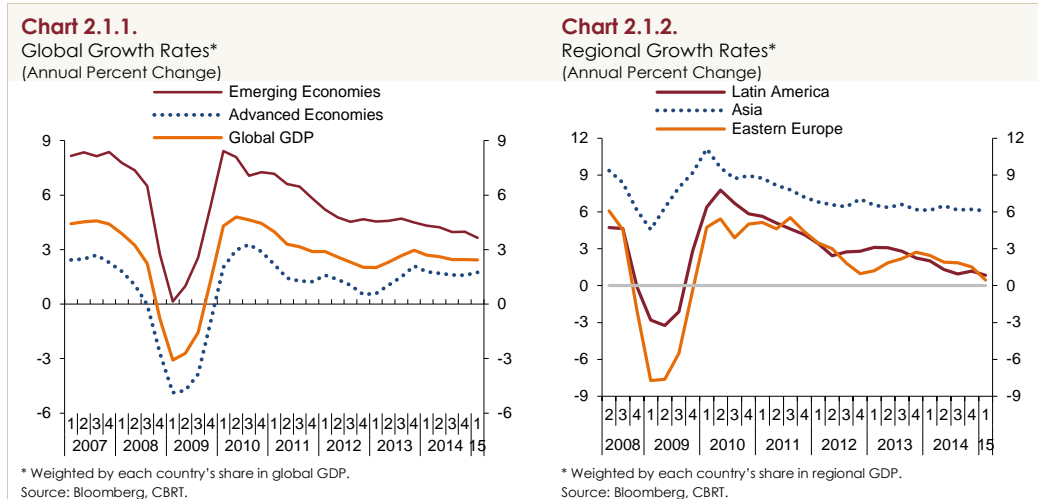
Owing to the absence of an evident rebound in global economic activity, industrial and precious metal prices recorded a decline in the second quarter. This was mainly fueled by the slowdown in the Chinese economy. Oil prices in the same period posted an increase in line with the expected fall in aggregate supply. Due to weather conditions, agricultural prices also increased and stood out as a factor leading to an increase in the headline commodity price index. In contrast to the rise in the headline commodity price index, inflation rates in advanced economies remained almost unchanged in the second quarter, while inflation in emerging economies stopped accelerating due to sluggish domestic demand.

Monetary policy remained loose in the second quarter in line with the non-inflationary levels of the output gap on a global scale. The uncertainty regarding the timing and pace of the Fed's policy rate hike remains as the main determinant of the financial market dynamics. In this context, the Fed's announcements that it will not implement policy rate increases in the very short term directed the risk appetite to a favorable course in the start of the previous quarter. On the other hand, financial markets saw increased volatility and deteriorated risk appetite due to the recent consternation in Greece, and the Euro area in turn. Meanwhile, the settlement of the Greek debt issue created a positive effect on financial markets. Parallel to the increased volatility in financial markets, capital flows in emerging economies followed a fluctuating course in the second quarter and stock markets saw considerable outflows in June and in the second half of July. In addition to these developments, the lingering weak economic activity in emerging economies is considered to be the primary downside risk to capital flows towards emerging economies.

### 2.1. Global Growth

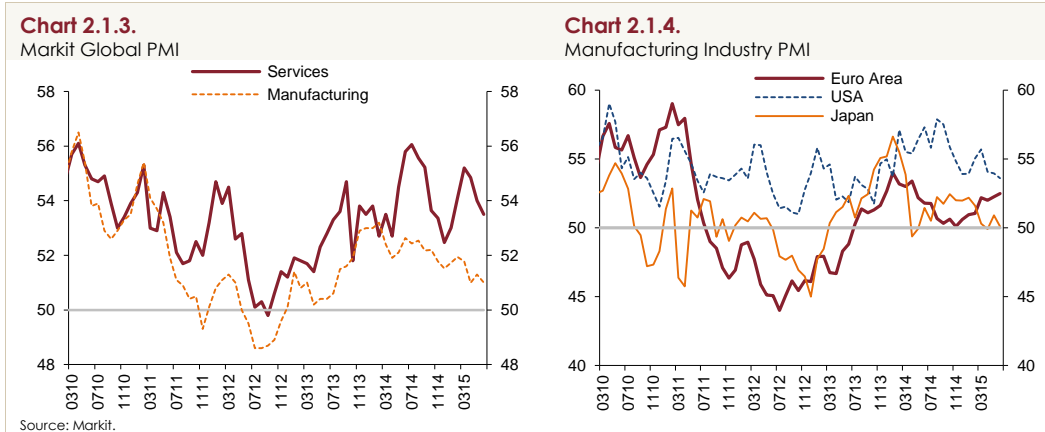
The slowdown in global economic activity, which has prevailed during 2014, continued through the first quarter of 2015 mostly due to emerging economies, and global growth lost momentum compared to the previous quarter (Chart 2.1.1). The slowdown in the Chinese economy as well as the contraction in the Russian and Brazilian economies emerged as the leading factors to decelerate the global growth rate in this period. On the emerging economies front, the growth rate hit almost zero in Eastern Europe and Latin America (Chart 2.1.2). On the advanced economies side, the ongoing recession in Japan featured as another factor to pull the global growth rate down. On the other hand, last year's favorable growth performance in the Euro area continued into the first quarter of 2015. As for

the US, the GDP posted a quarter-on-quarter decline by 0.2 percent in annualized terms, which was driven by bad weather conditions and the unfavorable net export performance due to the appreciation of the US dollar. Still, the US economy affected the global growth rate favorably by registering a 2.9 percent year-on-year growth in the first quarter of 2015 owing to the base effect.



The global PMI data of the second quarter signal a worse growth performance compared to the previous quarter (Chart 2.1.3). However, the Euro area manufacturing industry PMI continued to increase in this period (Chart 2.1.4). This suggests that the Euro area may continue to experience a positive growth performance and the growth rate may accelerate in the second quarter. Accordingly, the Greek debt problem is estimated to have a limited effect on the Euro area growth rate. In the US, the manufacturing industry PMI followed an evidently negative course in the second quarter compared to the first quarter (Chart 2.1.4). The decelerated annual growth rate of industrial production in April and May also confirms the PMI data. Nevertheless, the base effect caused by the contraction in the first quarter is expected to direct the US economy to a positive growth rate on a quarterly basis in the second quarter. The favorable outlook continued in the US labor market and the unemployment rate receded to 5.3 percent in June, supporting this expectation. The Japanese manufacturing industry PMI remained unfavorable in the second quarter, which indicates that the ongoing recession also persisted in this period (Chart 2.1.4).

The manufacturing industry PMI pertaining to emerging economies recorded a quarter-on-quarter decline in the second quarter, especially in Brazil, Mexico and China. In addition, leading indicators suggest that the recession in Russia and Brazil continued in the second quarter. Due both to the deterioration in the PMI as well as the slowdown in the annual growth rates of industrial production, external trade volume and fixed capital investments, it is estimated that the Chinese economy will continue to slow in the second quarter. Hence, emerging economies are expected to experience further deceleration in the second quarter.

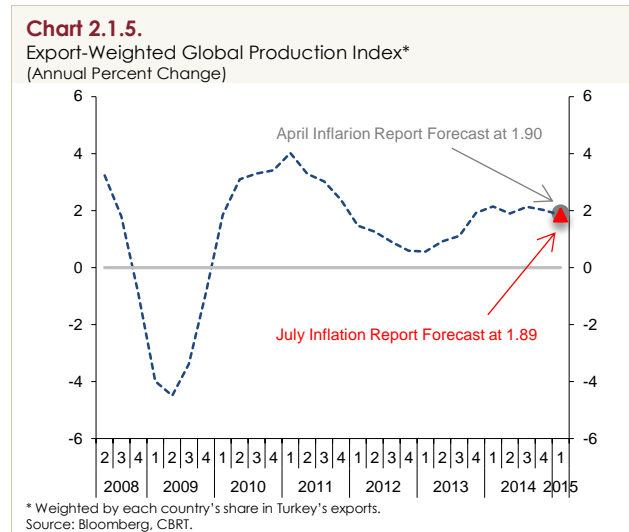


According to the July Consensus Forecasts Bulletin, year-end global growth forecasts for 2015 and 2016 were revised downwards by 0.1 points in the inter-reporting period (Table 2.1.1). On the advanced economies front, growth forecasts for the US and UK were revised downwards, while those for Japan and the Euro area were kept unchanged. On the emerging economies side, year-end growth forecasts for both 2015 and 2016 were revised downwards for the Asia-Pacific region and Latin America (Table 2.1.1). Consequently, the July Consensus Forecasts Bulletin supported the expectation that the global economic growth would continue to lose momentum in the second quarter mostly due to emerging economies, and the pace of growth will stay below the first-quarter readings. Accordingly, the growth rate of the export-weighted global production index revised by July forecasts has remained almost unchanged since the publication of the April Inflation Report (Chart 2.1.5). Thus, the unfavorable global growth performance is expected to pose further pressure on Turkey's external demand in the upcoming period.

**Table 2.1.1.**  
Growth Forecasts for end-2015 and end-2016 (Annual Percent Change)

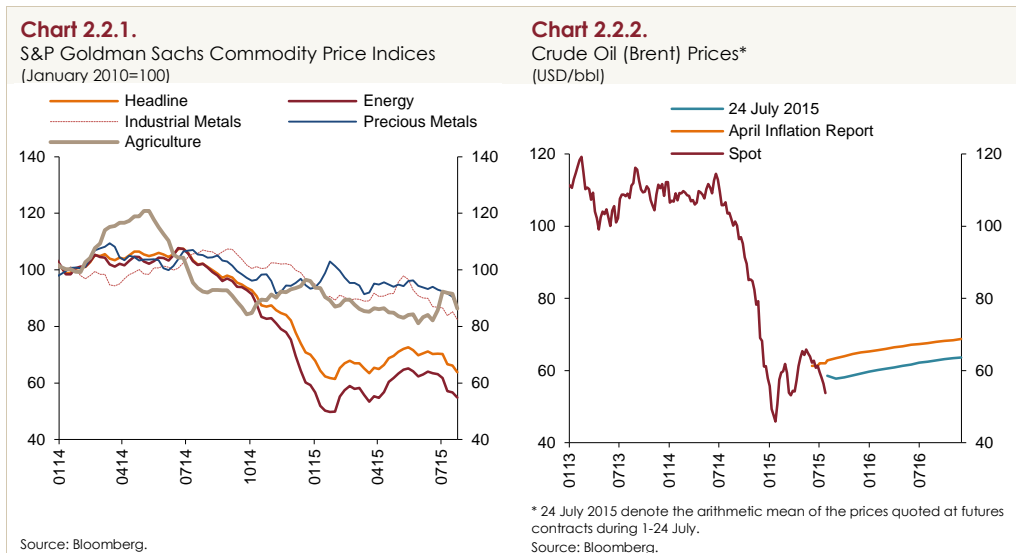
	April		July	
	2015	2016	2015	2016
World	2.7	3.2	2.6	3.1
<i>Advanced Economies</i>				
USA	2.9	2.8	2.4	2.8
Euro Area	1.5	1.8	1.5	1.8
Germany	1.9	2.0	1.9	1.9
France	1.1	1.6	1.2	1.6
Italy	0.6	1.2	0.7	1.2
Spain	2.5	2.4	3.0	2.6
Greece	0.7	2.0	-0.4	1.3
Japan	1.0	1.7	1.0	1.7
UK	2.6	2.5	2.5	2.4
<i>Emerging Economies</i>				
Asia-Pacific	6.1	6.1	5.9	6.0
China	6.9	6.8	6.8	6.7
India	7.7	8.0	7.7	8.0
Latin America	0.5	2.1	0.0	1.5
Brazil	-1.1	1.2	-1.6	0.6
Eastern Europe	-0.4	2.0	-0.2	2.0
Russia	-4.0	0.2	-3.5	0.5

Source: Consensus Forecasts.



## 2.2. Commodity Prices and Global Inflation

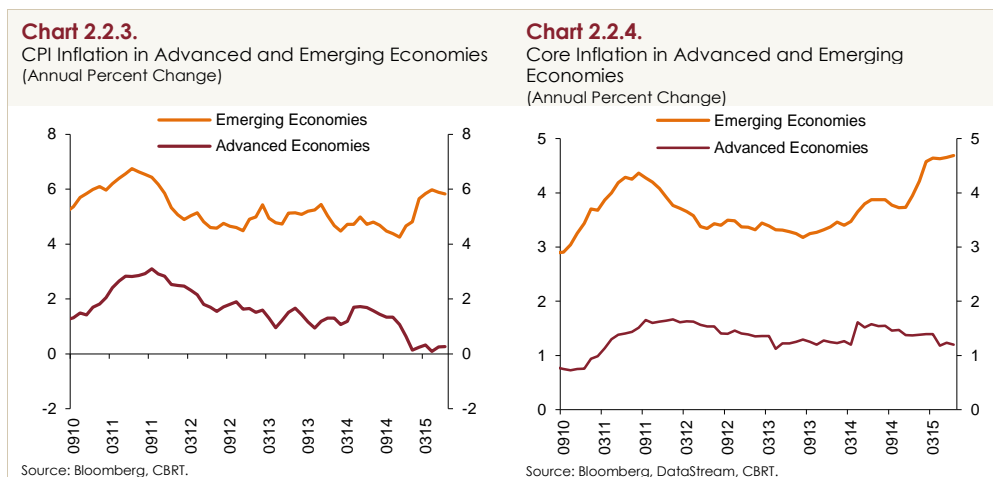
In the second quarter of 2015, the headline commodity price index posted a quarter-on-quarter increase by 11.1 percent. In this period, rising oil prices pushed the energy prices upwards by 16.5 percent. Due particularly to the weather conditions in June, the agricultural price index recorded an increase by 11.3 percent. Industrial and precious metal prices, on the other hand, fell by 4.9 and 1.5 percent, respectively, in this period owing to the slowdown in the Chinese economy (Chart 2.2.1).



Oil prices registered an increase in the second quarter in line with the expected fall in oversupply. The limited contraction in US crude oil production and the subsequent decrease in inventories fed into these expectations. However, the decision to continue with a low price policy in the June OPEC meeting in addition to the increase in active drilling rigs in the US after a long time led prices to re-settle into a downward track. Lastly, the reaching of a final deal on nuclear negotiations with Iran, which resulted in expectations that the Iranian oil will be intensively transported into international markets, strengthened the downward pressure on prices. On the back all these

developments, December 2015 contracts for Brent crude oil, which were traded at 65 USD on average in April, were traded at 59 USD on average during July (Chart 2.2.2). Recent economic developments suggest that a supply glut in the oil market will continue in the upcoming period primarily due to the negotiations with Iran and the higher-than-expected performance of the shale oil sector in the US. Considered together with the weak demand outlook, there is no notable upside risk factor on low crude oil prices except geopolitical risks.

The fall in energy prices since mid-2014 was largely reflected in inflation rates of advanced economies. In the inter-reporting period, the inflation outlook in these countries did not witness a noticeable change except for the limited decline in the core inflation rates. Meanwhile, the uptrend in inflation readings of emerging economies came to a halt (Charts 2.2.3 and 2.2.4). On the other hand, inflation continued to rise in some Latin American countries like Brazil, Chile and Argentina, whereas it maintained a downward course in Russia.



Inflation expectations for end-2015 were revised slightly upwards in advanced economies compared to the previous reporting period in contrast to the slightly downward revision in the UK. Inflation expectations for end-2015 in Asia-Pacific remained almost unchanged. On the Latin American side, Brazil saw a notable upward revision while the inflation rate in Eastern Europe was revised downwards mostly due to Russia. As for end-2016, the global inflation forecast was revised slightly upwards due to Euro area (Table 2.2.1).

Oil prices and the developments in the European monetary policy had a major effect on inflation expectations in advanced economies. Accordingly, even though downside risks decreased considerably, developments in Greece have the potential to lower inflation expectations. The slowdown in the Chinese economy implies that inflation in the Asia-Pacific region may continue with a downtrend. On the other hand, amid waning capital flows resulting from deteriorated expectations, the depreciating local currencies push inflation rates upwards in commodity-exporting Latin American countries. Similarly, the normalization of the US monetary policy weighs on upside risks to inflation in Latin America and Eastern Europe.

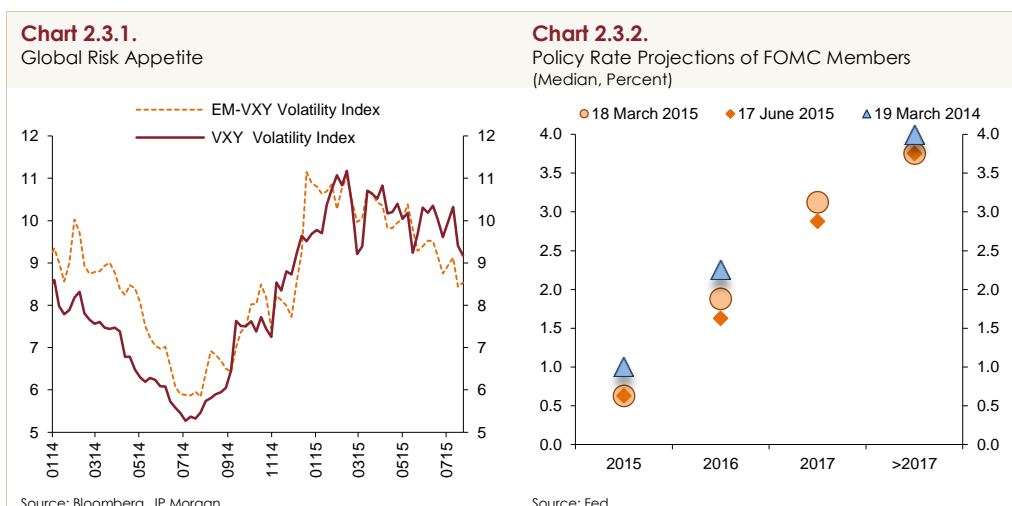
**Table 2.2.1.**  
Inflation Forecasts for end-2015 and end-2016  
(Annual Percent Change)

	April		July	
	2015	2016	2015	2016
World	2.5	3.0	2.6	3.1
<i>Advanced Economies</i>				
USA	0.1	2.2	0.2	2.2
Euro Area	0.1	1.2	0.2	1.3
Germany	0.4	1.6	0.6	1.6
France	0.1	1.1	0.3	1.2
Italy	0.1	0.8	0.2	1.1
Spain	-0.5	1.2	-0.2	1.1
Greece	-1.3	0.5	-1.3	0.3
Japan	0.4	1.6	0.2	1.6
UK	0.7	1.0	0.8	1.1
<i>Emerging Economies</i>				
Asia-Pacific	2.0	2.6	2.0	2.5
China	1.4	2.0	1.4	1.9
India	5.4	5.6	5.4	5.6
Latin America	14.6	11.9	14.5	12
Brazil*	7.9	5.6	8.4	5.5
Eastern Europe	8.5	5.8	8.0	5.6

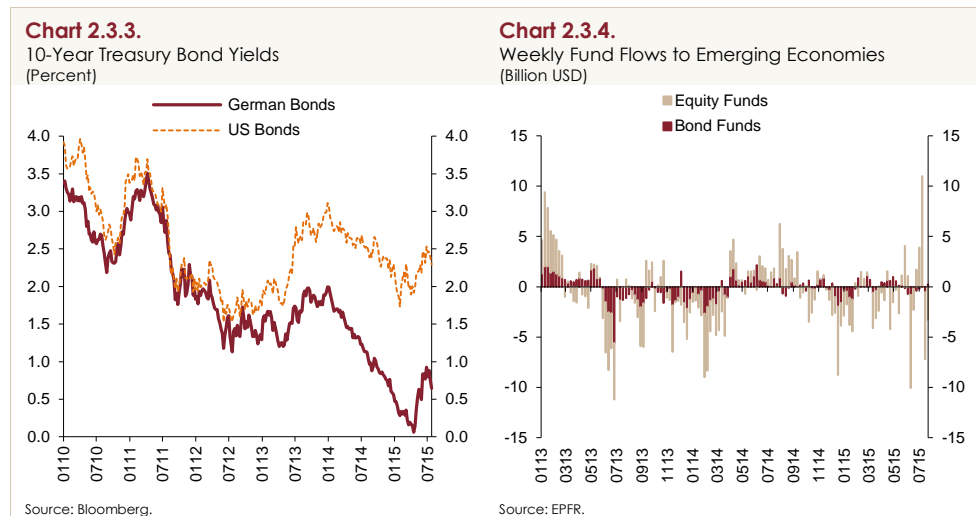
\* December to December.  
Source: Consensus Forecasts.

### 2.3. Financial Conditions, Risk Indicators and Capital Flows

The slowdown in the second quarter caused mounting concerns regarding the rebound of global economic activity. Yet, global risk appetite still assumed a favorable course in line with the signals for a gradual and slow policy rate hike by the Fed (Chart 2.3.1). This was also owed to the Fed's announcement that too much attention is attached to the timing of the first policy rate hike and conditions will evolve in the economy in a manner that will make it appropriate to raise the federal funds rate gradually over time (Chart 2.3.2). On the other hand, recent concerns over Greece and thus the Euro area are viewed to have no significant impact on the risk appetite.



Despite the expectations that policy rates of both the Fed and the central banks of leading advanced economies will stay low for a while, long-term returns trended upwards in advanced economies due to the perception that the global monetary policy will normalize, albeit at a slow pace (Chart 2.3.3). Meanwhile, amid the recent volatility in financial markets, stock markets of advanced economies started to fluctuate, and those of emerging economies saw a rapid fall. In line with these developments, risk premiums in emerging economies posted increases (Chart 5.1.1).

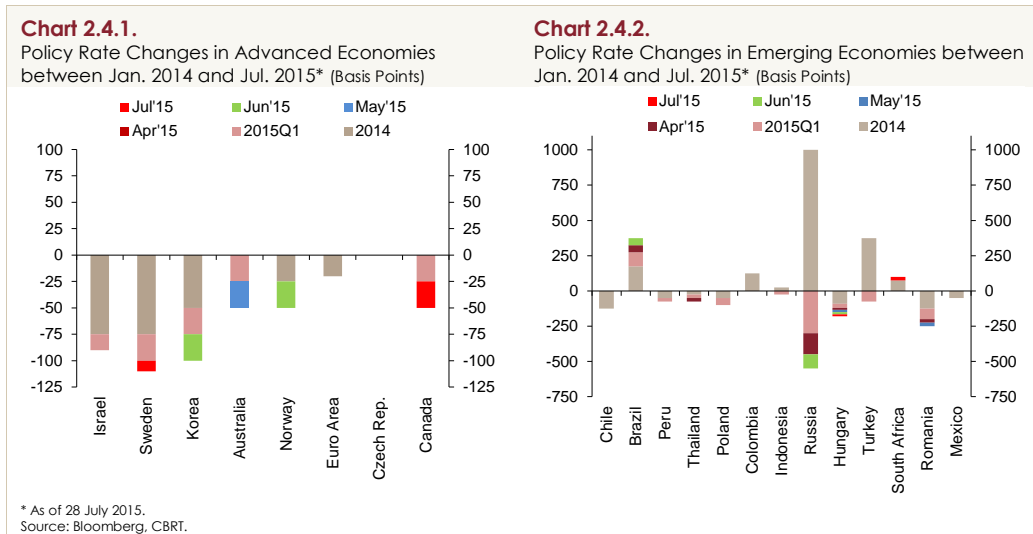


Due to the volatility in financial markets, capital flows towards emerging economies also fluctuated in the second quarter. Despite equity inflows observed in the second half of May and in early July, sizeable outflows were seen in June and in the second half of July (Chart 2.3.4). In this period, marking the end of the appreciation rally of the US dollar, fluctuations in the global risk appetite especially since mid-June, and the elevated sensitivity towards the riskiness of emerging economies were influential in capital outflows. In the upcoming period, the expectation that the Fed's policy rate hike will be slower than estimated is a factor to support capital flows towards emerging economies, while lingering concerns over Greece coupled with the weak growth prospects in emerging economies keep downside risks to capital flows brisk to these countries.

## 2.4. Global Monetary Policy

In the second quarter of 2015, the global monetary policy remained virtually unchanged compared to the first quarter, and continued to stay abated. This was owed to the ongoing weak course of global economic activity and the absence of pressure on global inflation due to the output gap. On the advanced economies front, the Bank of Korea, the Reserve Bank of Australia, the Norges Bank and the Bank of Canada opted for a policy rate cut by 25 basis points and the Sveriges Riksbank lowered the policy rate by 10 basis points between April and July (Chart 2.4.1).

On the emerging economies side, the Central Bank of Russia continued to revoke the 750-basis point hike implemented in the last quarter of 2014. Following the reduction by 300 basis points in the first quarter, the policy rate was pulled down further by 250 basis points in the April-July period. Moreover, the National Bank of Romania, the Magyar Nemzeti Bank and the Bank of Thailand opted for rate cuts by 50, 60 and 25 basis points, respectively, in the same period. The People's Bank of China and the Reserve Bank of India also implemented rate cuts by 25 basis points in response to the sluggish growth performances. On the other hand, unlike other central banks, Banco do Brasil and the South African Reserve Bank increased policy rates in this period. Accordingly, Banco do Brasil delivered increases of 50 basis points twice, while the South African Reserve Bank opted for a policy rate hike by 25 basis points (Chart 2.4.2).



The timing and the pace of the Fed's possible policy rate hike remains as the major issue that is being closely watched by the financial markets. In its announcements, the Fed emphasized that the fall in inflation reflecting earlier declines in energy prices is viewed to be temporary and the labor market is improving further, while inflation will increase towards the target of 2 percent in the medium term. In contrast to these announcements warranting a policy rate hike, the Fed also declared, especially through forward guidance statements, that the policy rate will be pulled to levels accepted as "normal" in a manner that will warrant only gradual increases in the target federal funds rate. Accordingly, members of the FOMC particularly revised their policy rate projections for end-2016 and end-2017 downwards (Chart 2.3.2). Despite eased expectations in the medium term regarding the Fed's policy stance, 10-year US Treasury bond yields have trended upwards since the previous reporting period, while German Treasury bond yields have also increased (Chart 2.3.3).