2. International Economic Developments

The global economic slowdown that started in the first quarter of 2014 continued in the remainder of the year. Although this slowdown, which dominated the whole year, was driven by both advanced and emerging economies, the divergences of growth performances persisted across countries. Among advanced economies, the US economy continued to grow robustly whereas the EU remained weak in spite of a slight recovery in the final quarter. The ongoing recession in Japan put further downward pressure on global growth. On the emerging economies front, the slowdown persisted across key economies in the fourth quarter, with Russia nearing the zero mark for annual growth and most Eastern European economies tackling a sluggish economic activity amid weak EU demand and developments in Russia. Leading indicators for the first quarter of 2015 signal a very limited improvement for global economic activity.

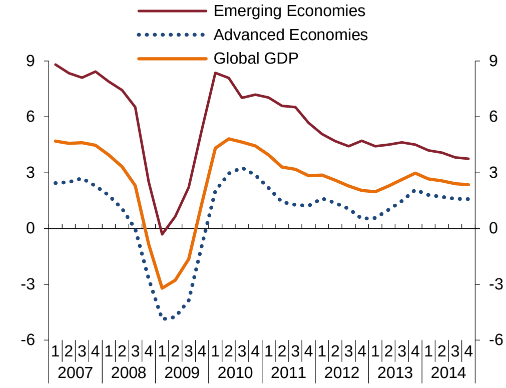
Having fallen since mid-2014, commodity prices dropped further in the first quarter of 2015, by 5 percent quarter-on-quarter. This decline was largely attributed to tumbling oil prices driven by record-high supplies, and partly to lower agricultural prices amid an inventory and production rise. Thus, inflation rates remained low across major advanced economies and those with weak economic activity faced deflation. Among emerging economies, falling commodity prices exerted a downward pressure on inflation but the depreciation of local currencies placed a strong upward pressure, driving the emerging market inflation rate higher.

In view of low inflation rates and weak economic activity, the majority of advanced economies still faces historically low interest rates and continues to use unconventional monetary policy tools to maintain a loose monetary policy. However, diverging growth performances lead to different monetary policy outlooks in the forthcoming period. In this sense, the Fed has already started to normalize its policy by signaling its willingness to start rate hikes soon, while the ECB has employed more aggressive monetary easing. Further, many European countries with strong economic ties with the EU lowered their policy rates. Yet, due to the Fed's possible rate hike, the central banks of some emerging economies that witnessed capital outflows –mostly from stock markets– and currency depreciations raised their policy rates in the first quarter. In addition to this divergence in global monetary policies, the slowing economic activity across emerging economies adds to the downside risks for volatile capital flows.

2.1. Global Growth

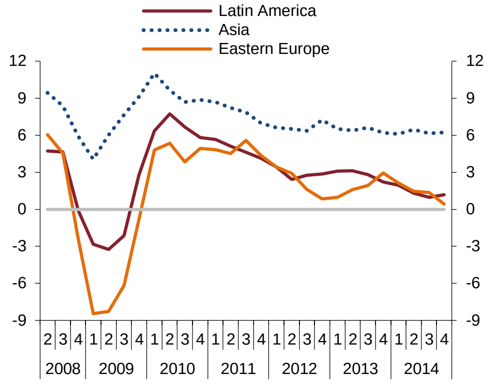
The slowdown in global economic growth in the first nine months of 2014 continued through the fourth quarter (Chart 2.1.1). On the advanced economies side, despite the pick-up in the US and Euro Area growth, Japan's ongoing recession has been a key driver of global economic slowdown in the final quarter of 2014. Across emerging economies, the worst quarter-on-quarter growth performance was seen in the Eastern Europe, largely due to the accelerating slowdown in the Russian economy. In this period, the growth in Asia and Latin America followed a more favorable track compared to the previous quarter, yet Brazil's contracting economy caused Latin American growth to remain sluggish (Chart 2.1.2).

Chart 2.1.1.
Global Growth Rates*
(Annual Percent Change)



* Weighted by each country's share in global GDP.
Source: Bloomberg, CBRT.

Chart 2.1.2.
Regional Growth Rates*
(Annual Percent Change)

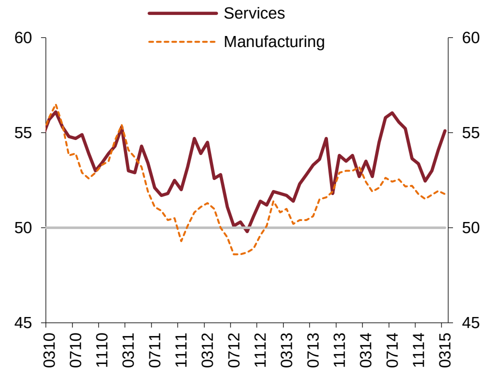


* Weighted by each country's share in regional GDP.
Source: Bloomberg, CBRT.

Global PMI data for the first quarter of 2015 remained unchanged from the previous quarter (Chart 2.1.3). The Euro Area manufacturing PMI recorded a notable increase in this period, which creates an expectation that the favorable Euro Area growth will continue more vigorously in the first quarter of 2015. The ongoing fall in unemployment during the first two months of the year and the positive outlook suggested by the PMI for employment and new orders add to this expectation. The first-quarter uptrend notwithstanding, the US manufacturing PMI was quite close to the quarter-ago average on a quarterly basis, suggesting that the first-quarter US growth is likely to be comparable to the fourth quarter. The Japanese manufacturing PMI, on the other hand, shows that the recession continued into the first quarter (Chart 2.1.4). On the emerging economies front, the manufacturing PMIs, particularly those of China and Russia, declined considerably in the first quarter. Thus, economic growth is expected to slow further in emerging economies over the first quarter of 2015.

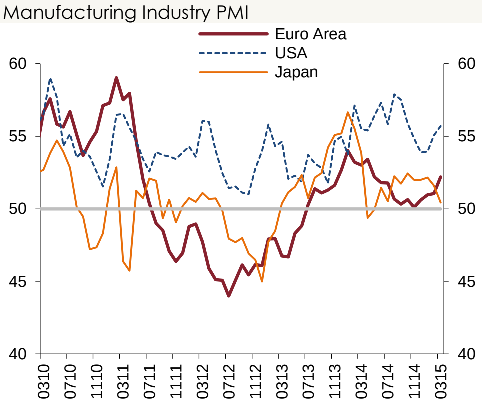
In sum, the global economic slowdown will probably persist in the first quarter of 2015 largely due to the decelerating growth in emerging economies and the pace of global growth may dip even below the previous quarter. Japan stands out as the leading country among advanced economies to pull global growth down in this period, while China, Brazil and Russia on the emerging economies front are also expected to decelerate global growth.

Chart 2.1.3.
Markit Global PMI



Source: Markit.

Chart 2.1.4.
Manufacturing Industry PMI



The end-2015 global growth forecasts were revised down by 0.3 points from the previous reporting period in April's Consensus Forecasts. Across advanced economies, growth forecasts were revised upward for the UK, and especially for the Euro Area, and downwards for the US and Japan. On the emerging economies side, compared to the previous report projections, growth forecasts for end-2015 were revised upward for Asia-Pacific and downward for Eastern Europe, albeit slightly, and Latin America, more notably (Table 2.1.1). In comparison with the January Inflation Report, growth forecasts for end-2016 were revised slightly upward for advanced economies, while the most significant change across emerging economies was the downward revision for Latin America. Accordingly, the export-weighted global production index, updated in line with April forecasts, points to a slower annual global growth than stated in the January Inflation Report (Chart 2.1.5). Thus, Turkey's weak external demand outlook is likely to continue into 2015.

Table 2.1.1.

Growth Forecasts for end-2015 and end-2016 (Annual Percent Change)

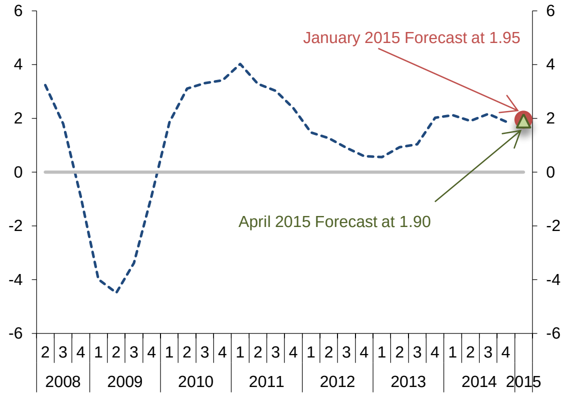
	January		April	
	2015	2016	2015	2016
World	3.0	3.2	2.7	3.2
Advanced Economies				
USA	3.2	2.8	2.9	2.8
Euro Area	1.1	1.6	1.5	1.8
Germany	1.4	1.8	1.9	2.0
France	0.9	1.3	1.1	1.6
Italy	0.4	1.0	0.6	1.2
Spain	2.0	2.1	2.5	2.4
Greece	1.8	2.3	0.7	2.0
Japan	1.2	1.5	1.0	1.7
UK	2.6	2.4	2.6	2.5
Emerging Economies				
Asia-Pacific	6.0	6.0	6.1	6.1
China	7.0	6.9	6.9	6.8
India	6.3	6.7	7.7	8.0
Latin America	1.3	2.7	0.5	2.1
Brazil	0.4	1.9	-1.1	1.2
Eastern Europe	-0.2	2.1	-0.4	2.0
Russia	-4.1	0.3	-4.0	0.2

Source: Consensus Forecasts.

Chart 2.1.5.

Export-Weighted Global Production Index*

(Annual Percent Change)



* Weighted by each country's share in Turkey's exports.

Source: Bloomberg, CBRT.

2.2. Commodity Prices and Global Inflation

The headline commodity price index posted a quarter-on-quarter decline by 5.1 percent in the first quarter of 2015. In this period, the price index for precious metals was the only one rising, by 0.7 percent, while price indices for all other commodities fell due to excess supply and weak demand. Prices of energy and industrial metals decreased by 4.1 and 5 percent, respectively, whereas the agricultural price index plunged by 9 percent because of high supply and production (Chart 2.2.1).

Chart 2.2.1.
S&P Goldman Sachs Commodity Prices
(January 2010=100)

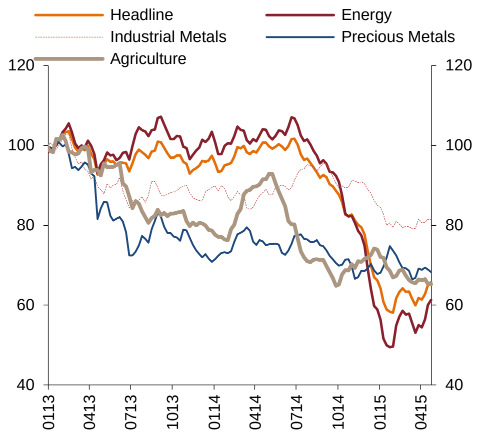
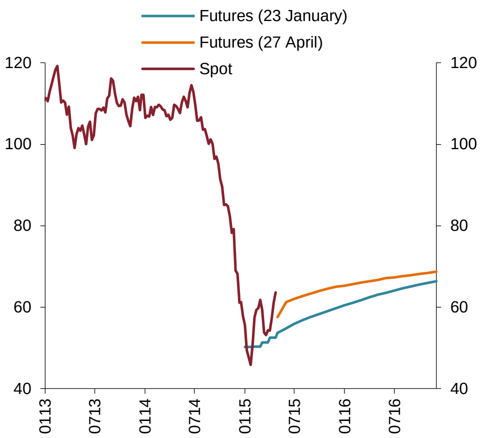


Chart 2.2.2.
Crude Oil (Brent) Prices*
(USD/bbl)

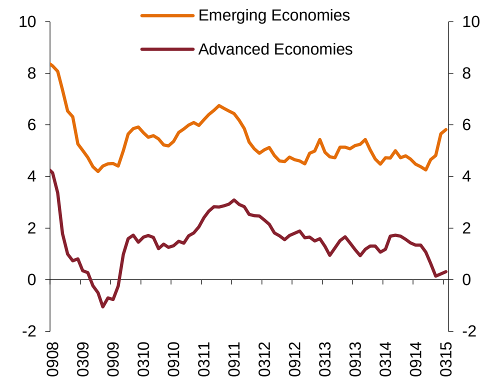


* 27 April 27 and 23 January denote the arithmetical average of the prices quoted at futures contracts during 1-27 April and 1-23 January, respectively.
Source: Bloomberg.

Oil prices have been fluctuating since the crude oil price slump in the fourth quarter of 2014. The ample supply hinted by the surprise jump in US crude oil inventories weighs on prices whereas geopolitical risks pose an upside risk to them. As of the first half of April, oil prices were slightly higher than in the previous reporting period, but amid the narrowing spread between futures and spot prices, the December 2015 contracts for crude oil, which were traded at 64.5 USD at end-January, changed barely in April (Chart 2.2.2). In addition, the Iran framework deal strengthened expectations of an oil supply glut in the second half of 2015. This might compensate for the anticipated correction in the US shale oil output, hinting at a longer-than-expected supply-driven downward pressure on oil prices.

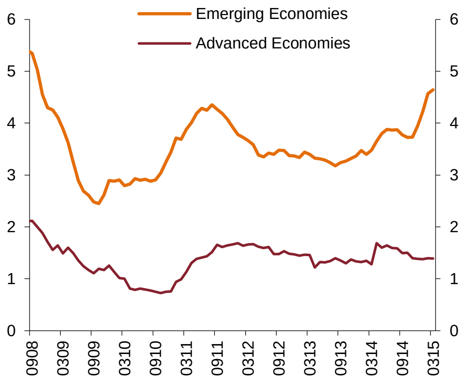
Amid falling energy prices, the consumer price inflation dropped dramatically across advanced economies in the first quarter, while core inflation remained virtually unchanged. On the other hand, emerging economies were not affected similarly by decreasing energy prices as the upward pressure generated by the depreciations of their currencies was more profound. The CPI and core inflation rates remained on the rise across emerging economies, particularly in Russia and Latin America, during the first quarter (Charts 2.2.3 and 2.2.4).

Chart 2.2.3.
CPI Inflation in Advanced and Emerging Economies
(Annual Percent Change)



Source: Bloomberg, CBRT.

Chart 2.2.4.
Core Inflation in Advanced and Emerging Economies
(Annual Percent Change)



Source: Bloomberg, DataStream, CBRT.

Global inflation forecasts for end-2015 were revised substantially downwards for advanced economies and Asia-Pacific compared to the previous reporting period. The impact of falling energy prices on inflation has largely been reflected on expectations by the massive downward revisions in the previous and current reporting periods, and thus, downside risks to inflation expectations for advanced economies have subsided. However, expectations might dip a little lower for Asia-Pacific due to low inflation rates in China and Japan. Meanwhile, end-year inflation forecasts for both 2015 and 2016 might be revised upward for Latin America and Eastern Europe (Table 2.2.1). The deteriorated expectations across commodity-exporting Latin American countries may be a result of the Chinese slowdown, yet the upcoming inflation outlook for these countries and Eastern Europe will be determined by the Fed's monetary tightening.

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

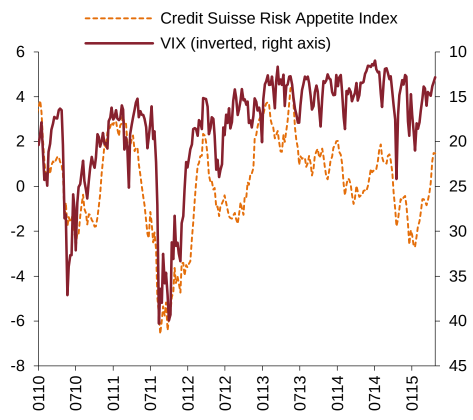
	January		April	
	2015	2016	2015	2016
World	2.6	3.1	2.5	3.0
Advanced Economies				
USA	0.7	2.2	0.1	2.2
Euro Area	0.1	1.2	0.1	1.2
Germany	0.7	1.6	0.4	1.6
France	0.3	1.2	0.1	1.1
Italy	0.2	0.7	0.1	0.8
Spain	-0.3	1	-0.5	1.2
Greece	-0.6	0.6	-1.3	0.5
Japan	0.9	1.8	0.4	1.6
UK	1.2	1.2	0.7	1.0
Emerging Economies				
Asia-Pacific	2.5	2.8	2.0	2.6
China	1.8	2.2	1.4	2.0
India	5.9	5.8	5.4	5.6
Latin America	12.3	10.6	14.6	11.9
Brazil*	6.4	5.6	7.9	5.6
Eastern Europe	7.1	5.3	8.5	5.8
Russia	10.8	6.4	13.0	7.2

* December to December.
Source: Consensus Forecasts.

2.3. Financial Conditions, Risk Indicators and Capital Flows

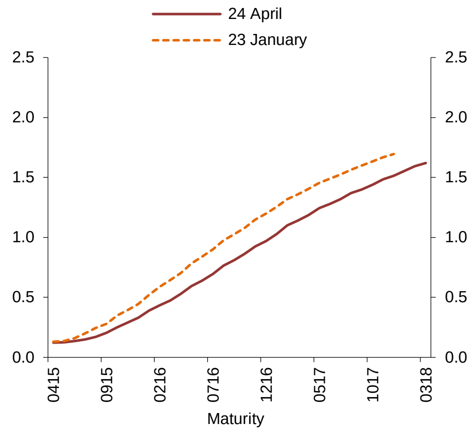
In the first quarter of the year, despite ongoing divergence in global economic activity and continued slowdown across emerging economies, the waning concerns over the Euro Area and US recovery and the delay in the Fed's expected rate hike had a positive impact on the global risk appetite (Chart 2.3.1). The fed fund futures show that the timing of the expected policy rate hike has been postponed (Chart 2.3.2).

Chart 2.3.1.
Global Risk Appetite



Source: Bloomberg, Credit Suisse.

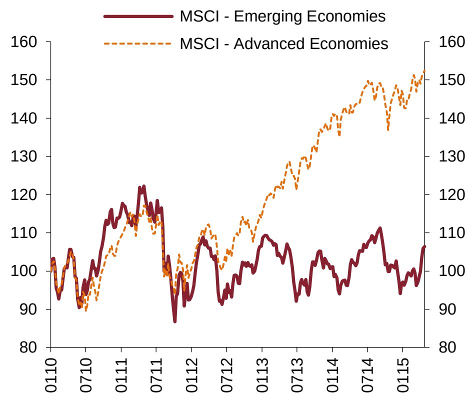
Chart 2.3.2.
Fed Funds Futures
(Percent)



Source: Bloomberg.

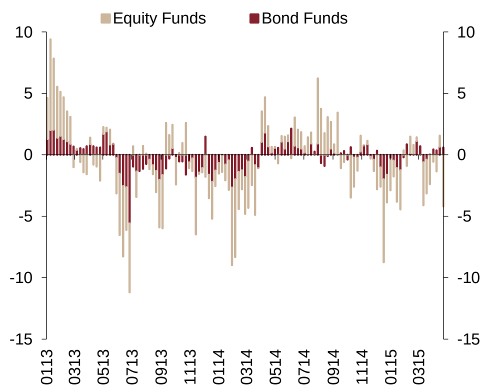
With the favorable global risk appetite, global stock markets were broadly on the rise in the first quarter. Stock markets of the emerging economies performed much better than those in advanced economies (Chart 2.3.3). Yet, among emerging economies, Latin American stock markets diverged negatively from the rest. Nevertheless, this poor performance of Latin American stock markets did not spill over into bond yields, but the favorable risk appetite brought bond yields across all emerging economies down in the first quarter (Chart 5.1.1).

Chart 2.3.3.
Global Stock Markets
(USD, 2007=100)



Source: Bloomberg.

Chart 2.3.4.
Weekly Portfolio Flows to Emerging Economies
(Billion USD)



Source: EPFR.

In the first quarter of the year, emerging economies experienced capital outflows, especially in January and March (Chart 2.3.4). Despite the favorable global risk appetite during this period, the appreciating US dollar and the deteriorated growth expectations for emerging economies were the key drivers of these outflows. The US dollar appreciation both exacerbated the debt burden of emerging economies and lessened the USD yields on local bonds, causing emerging economies to become less attractive to international investors.

Although the delay in expectations about the timing of the Fed's first policy rate hike seems to support capital inflows to emerging economies in the upcoming period, the strong US dollar, the weak emerging market growth outlook and growth performance of the Euro Area and the US add to the downside risks to these inflows over the forthcoming period. However, future FOMC decisions and global energy price developments are likely to play a major role in shaping the global risk appetite and the direction of portfolio flows.

2.4. Global Monetary Policy

With the more pronounced slowdown in both advanced and emerging economies, the global monetary policy appears to have been looser in the first quarter, except for the recovering US economy and some emerging economies facing current account problems. On the advanced economies front, this loosening was largely attributed to the ECB's quantitative easing implemented since mid-2014 amid deflationary risks and to the absence of inflationary pressures from commodity prices. Accordingly, during January-April 2015, the Sveridge Riksbank cut short-term rates by 25 basis points into a negative territory, while the Bank of Canada, the Central Bank of Korea, and the Reserve Bank of Australia lowered rates by 25 basis points each, and the Bank of Israel opted for a rate cut of 15 basis points (Chart 2.4.1).

On the emerging economies side, after hiking the policy rate by 750 basis points in the final quarter of 2014, the Central Bank of Russia took 300 basis points back by two rate cuts in the first quarter. Moreover, during January-April 2015, the CBRT and the National Bank of Romania cut policy rates by 75 basis points each; the National Bank of Poland lowered its policy rate by 50 basis points; the Central Reserve Bank of Peru, the Bank of Thailand and Bank Indonesia delivered a rate cut of 25 basis points each, and the Magyar Nemzeti Bank reduced its policy rate by 30 basis points. In Asia-Pacific, the People's Bank of China cut its policy rate by 25 basis points in March, whereas the Reserve Bank of India lowered its rate by a total of 50 basis points in January and March. Meanwhile, unlike all other central banks, Banco Central do Brasil hiked its policy rates twice by 50 basis points each (Chart 2.4.2).

Chart 2.4.1.
Policy Rate Changes in Advanced Economies from Jan. 2014 to Apr. 2015* (Basis Points)

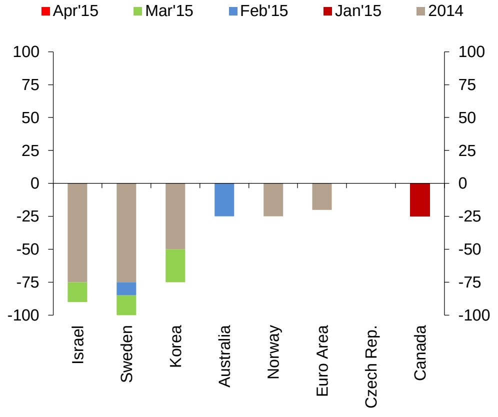
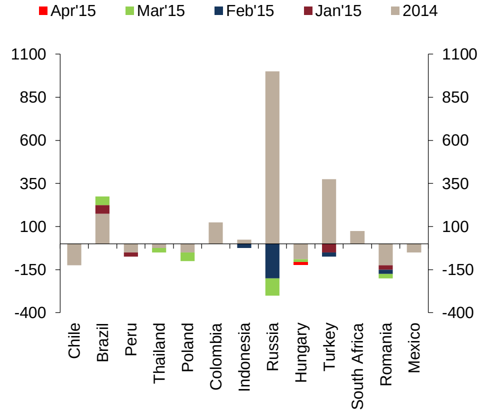


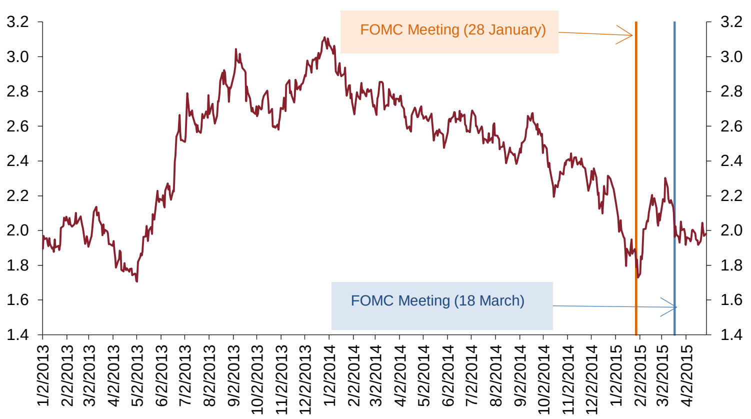
Chart 2.4.2.
Policy Rate Changes in Emerging Economies from Jan. 2014 to Apr. 2015* (Basis Points)



* As of 28 April 2015.
Source: Bloomberg, CBRT.

At its first FOMC meeting in 2015, the Fed reiterated that it would remain patient about hiking rates, which was interpreted as an almost unchanged policy stance. However, long-term interest rates soared after the meeting due to the positive data regarding economic activity. At the mid-March meeting, the Fed removed the word “patient” yet revised the end-2015 policy rate forecasts of FOMC members down and clearly stated that an April hike was unlikely. Additionally, the Fed emphasized that the rate hike would be dependent on further improvement in the labor market and on inflation moving back toward 2 percent over the medium term. Following this statement, long-term interest rates fell. Hence, having been on the rise since the first tapering hint in May 2013 until early 2014, long-term interest rates followed a downward path, despite some fluctuations, thanks to the vanished uncertainty due to the Fed’s transparent communication policy and the gradual termination of the asset purchases (Chart 2.4.3). As for the Euro Area, the ECB’s easing policies appear to have alleviated deflationary concerns and improved the growth performance as of the first quarter. The monetary policy stance in advanced economies is expected to remain nearly unchanged in the next period.

Chart 2.4.3.
Yields on 10-year US Treasury Bonds
(Percent)



Source: Bloomberg.