



**TÜRKİYE CUMHURİYET
MERKEZ BANKASI**

Monetary and Exchange Rate Policy for 2015

**Erdem BAŞÇI
Governor**

**10 December 2014
Ankara**

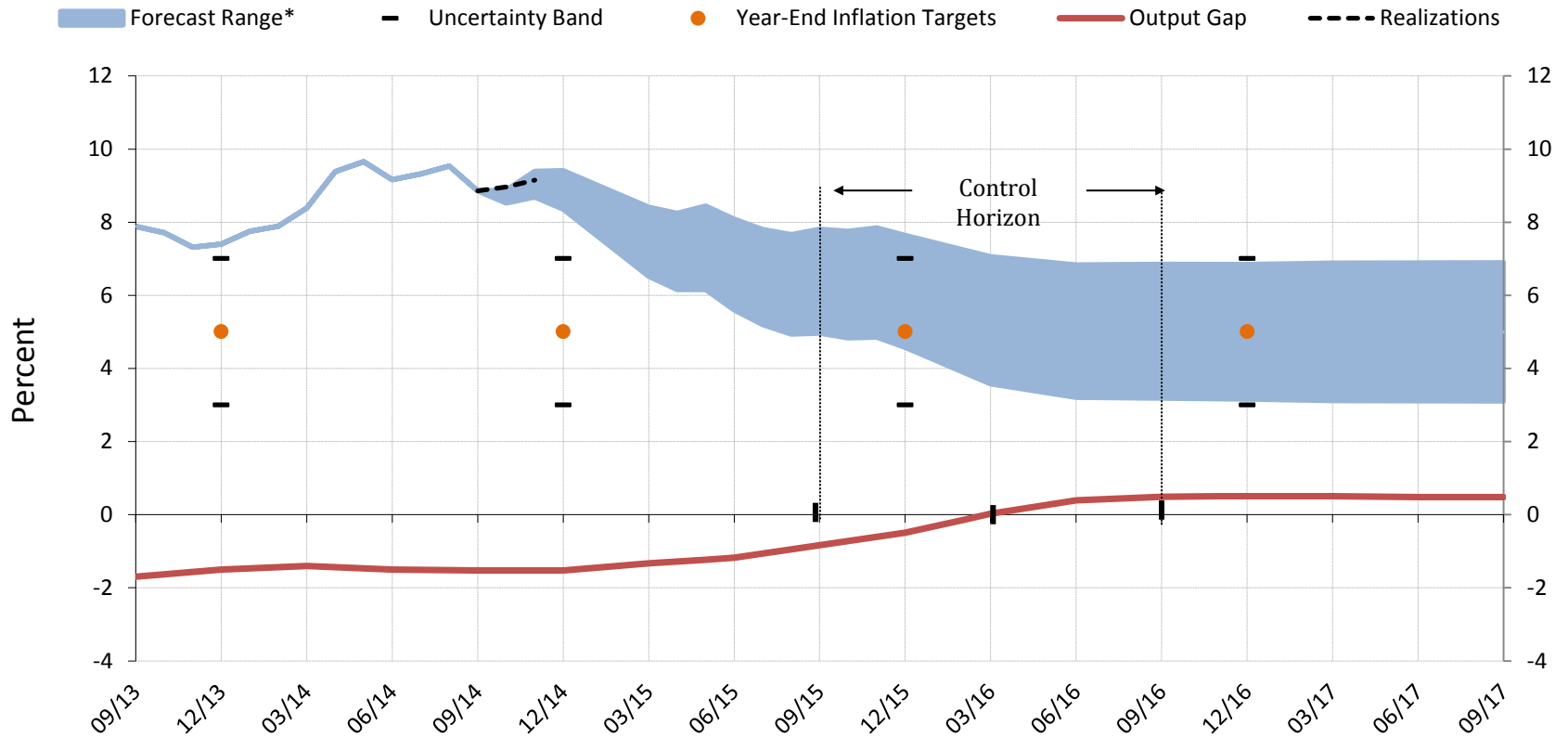
Main Objective: Price Stability

- As agreed with the Government, the year-end inflation target for 2017 was set at 5 percent.

PRICE STABILITY

Inflation is expected to gradually decline in 2015.

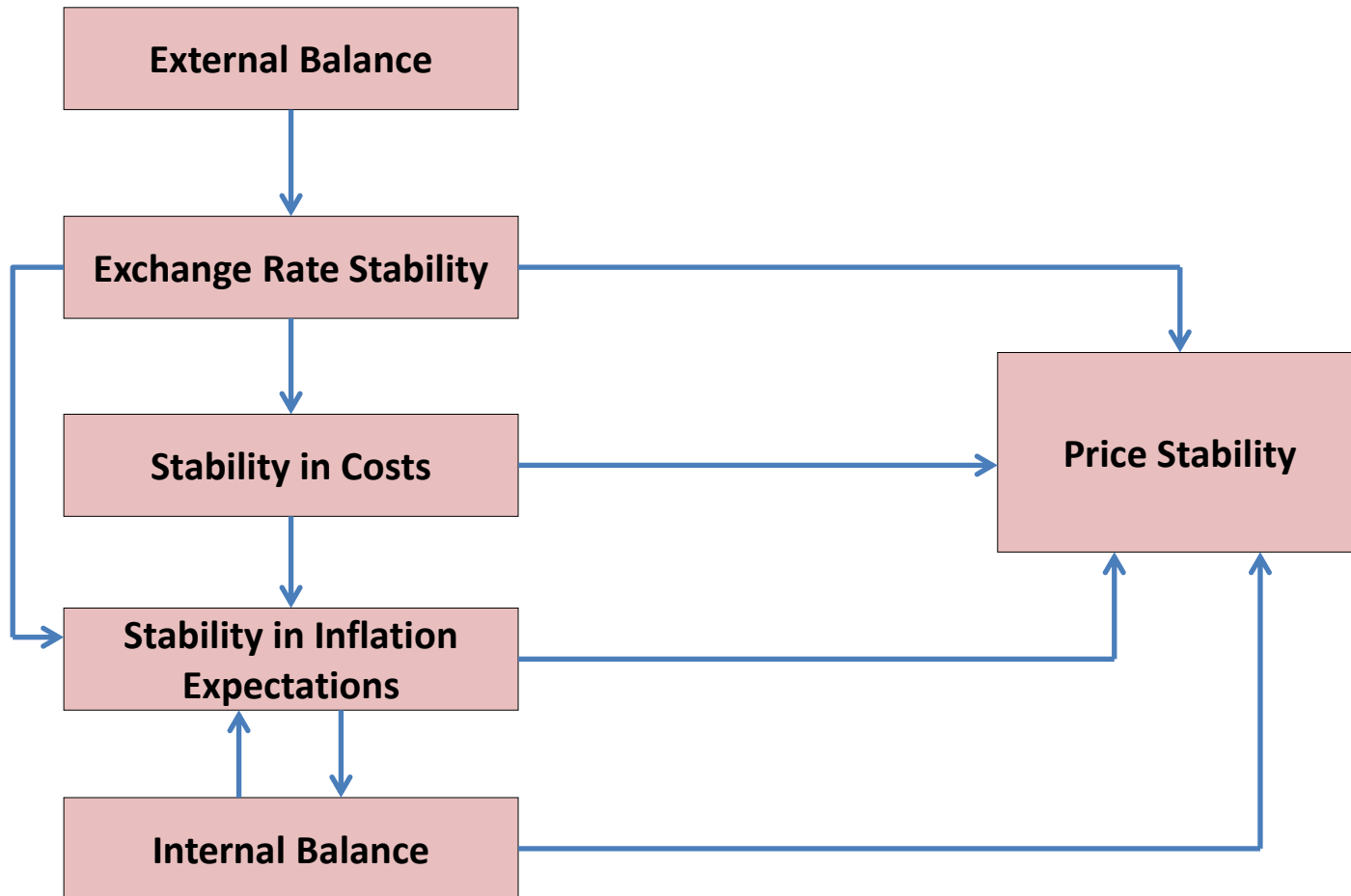
Inflation Report Forecasts (Percent)



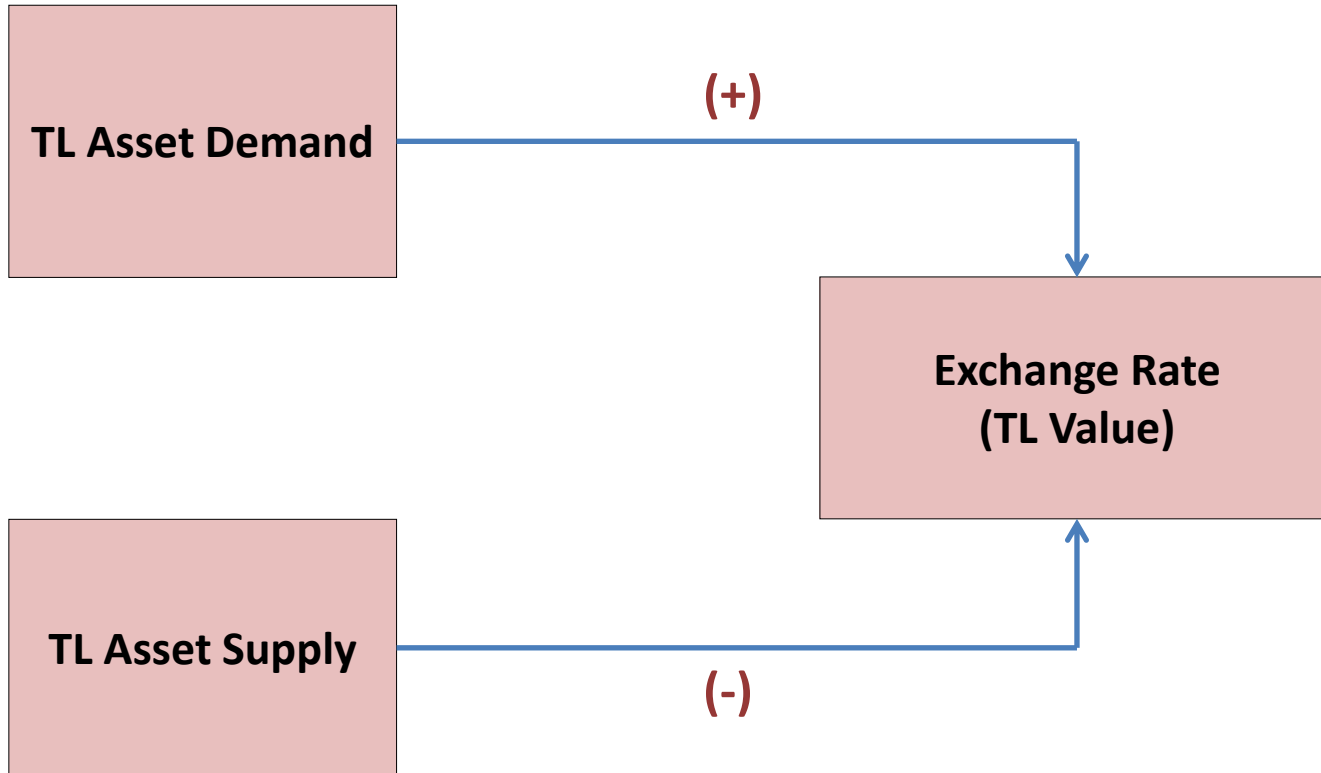
* Shaded region indicates 70 percent confidence interval for the forecast.

Last observation: November 2014.

Price Stability

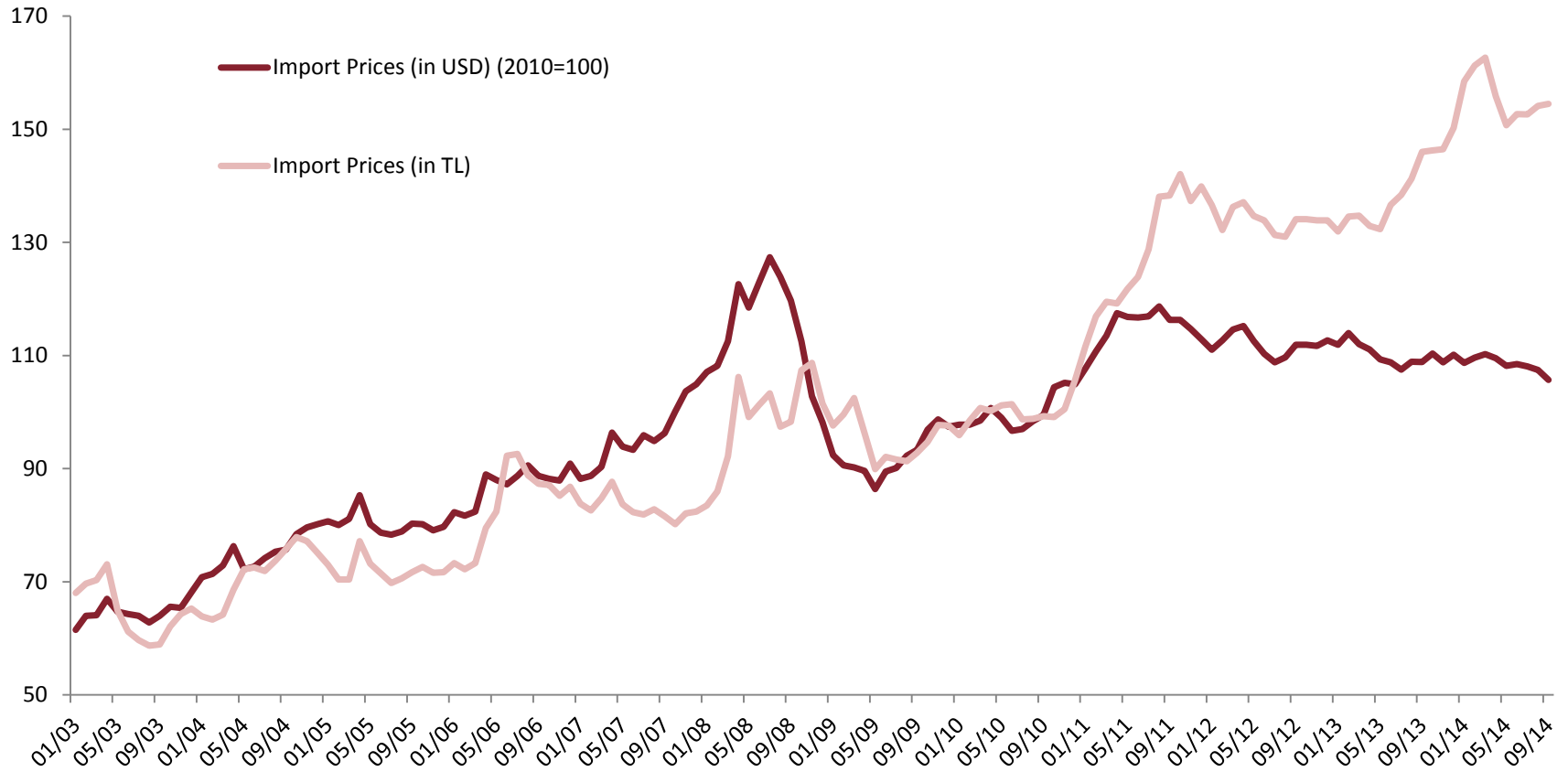


Exchange Rate Equilibrium



Exchange rate pass-through has been the main driver of inflation in the past year.

Import Price Indices (2010=100)

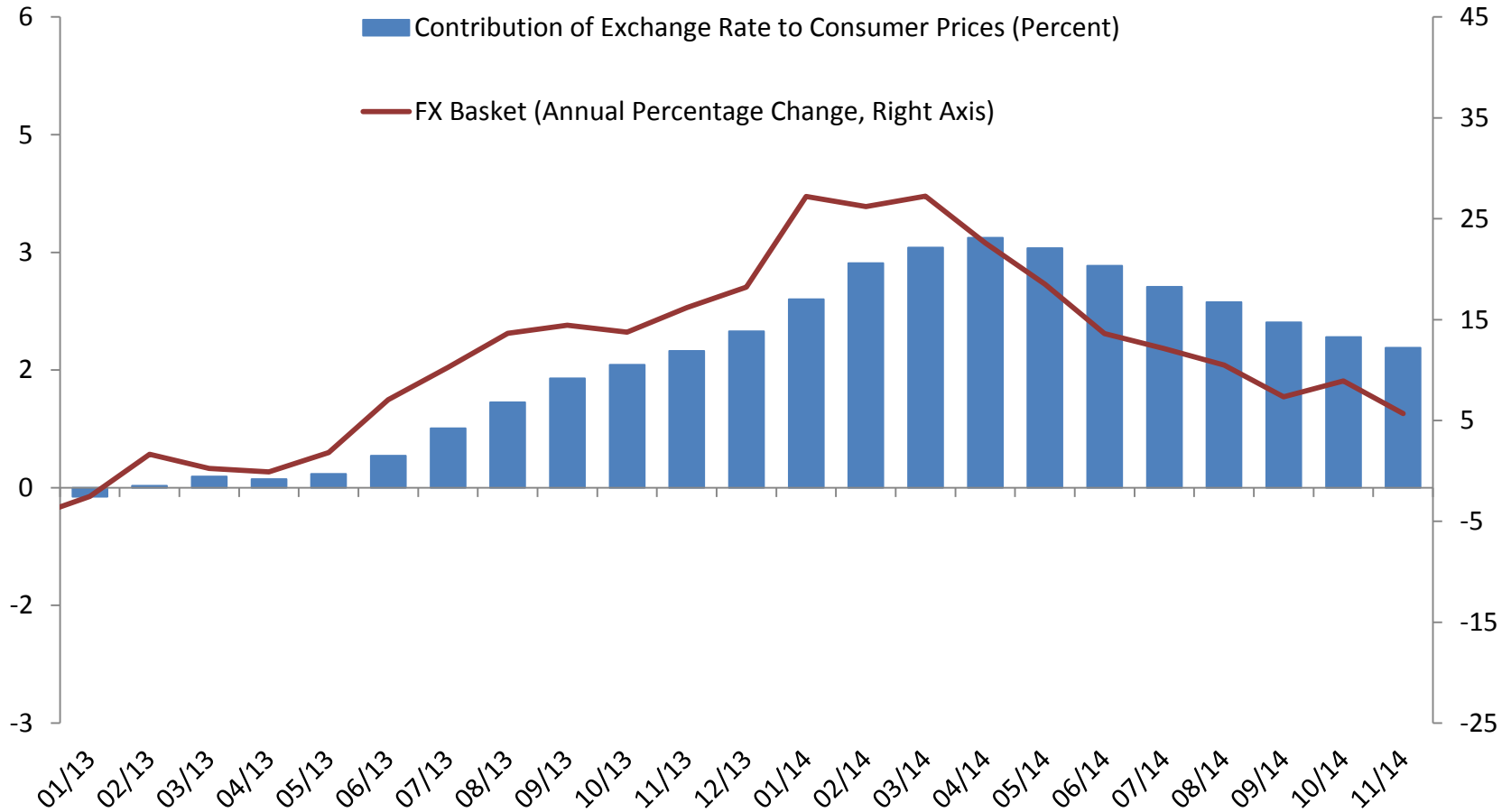


Source: TURKSTAT

Last observation: October 2014.

The adverse impact of cumulative exchange rate developments on annual inflation is gradually tapering off.

Contribution of Exchange Rate to Consumer Prices



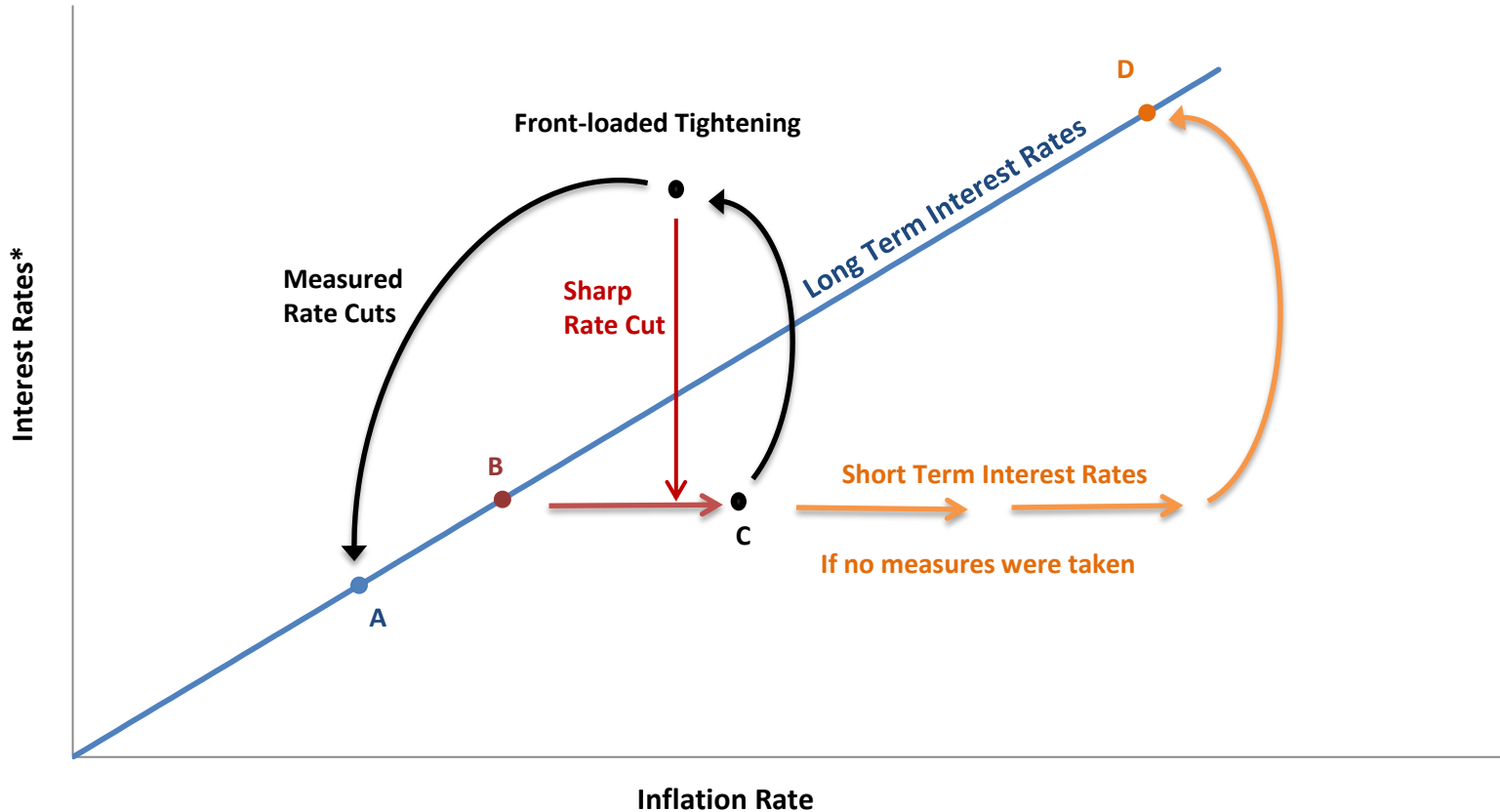
Source: CBRT.

Last observation: November 2014.

Monetary Policy Stance

- “[...] tight monetary policy stance will be maintained, by keeping a flat yield curve, until there is a significant improvement in the inflation outlook.”

Tight monetary policy stance reduces long-term interest rates by lowering expected inflation.



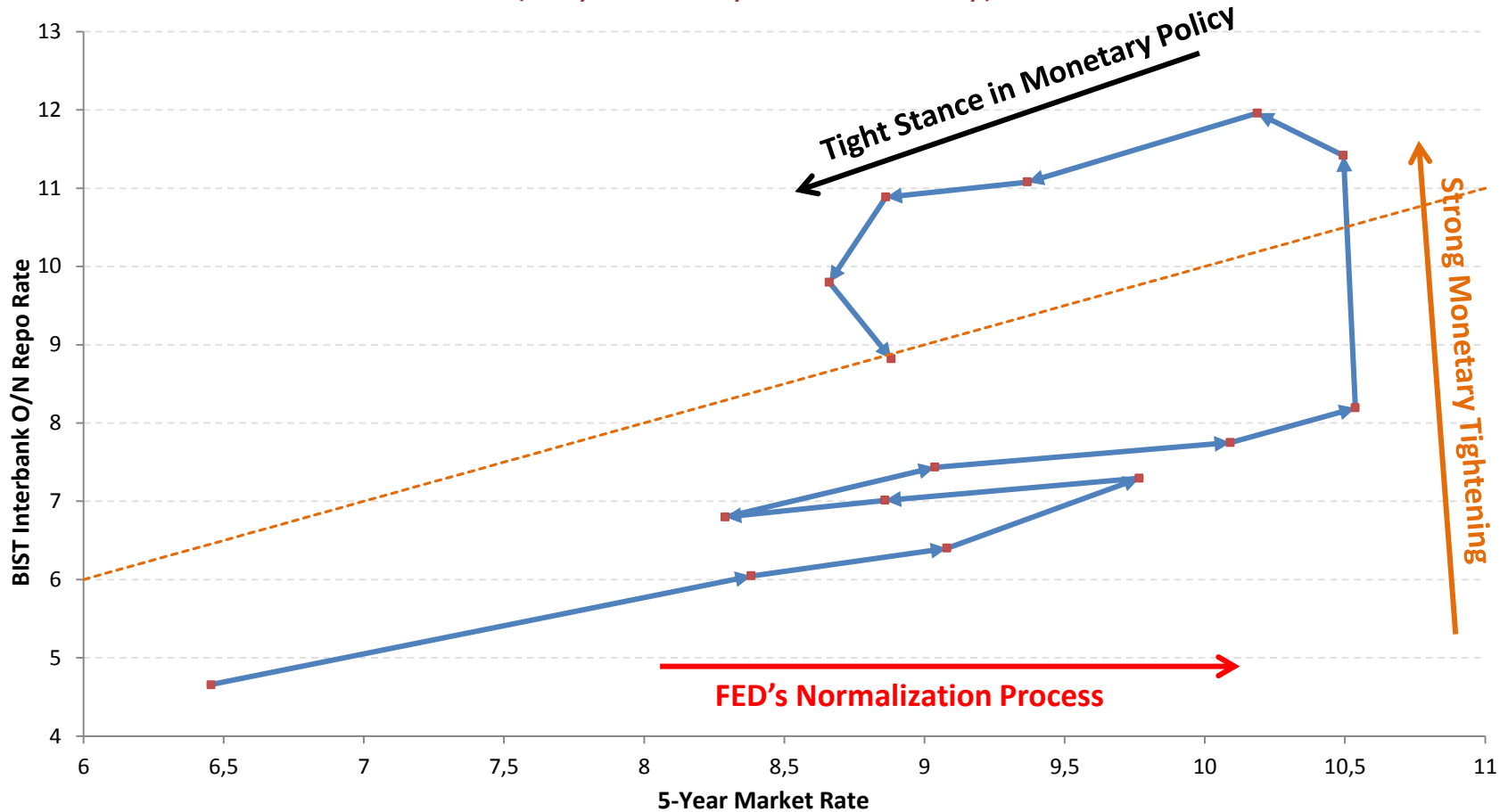
A: Inflation Target, B: Pre-shock Case, C: Inflation Shock
D: In Case of Delayed and Weak Policy Response.

*It represents long-term interest rates for Fisher curve, short-term interest rates for dynamic curves.
Maturity premium and risk premium are assumed to be zero.

Source: Stephen Williamson Blog, CBRT.

Tight monetary policy stance reduces long-term interest rates by lowering expected inflation.

BİST Interbank O/N Repo Rate ve 5-Year Market Rate (May 2013-July 2014, Monthly)

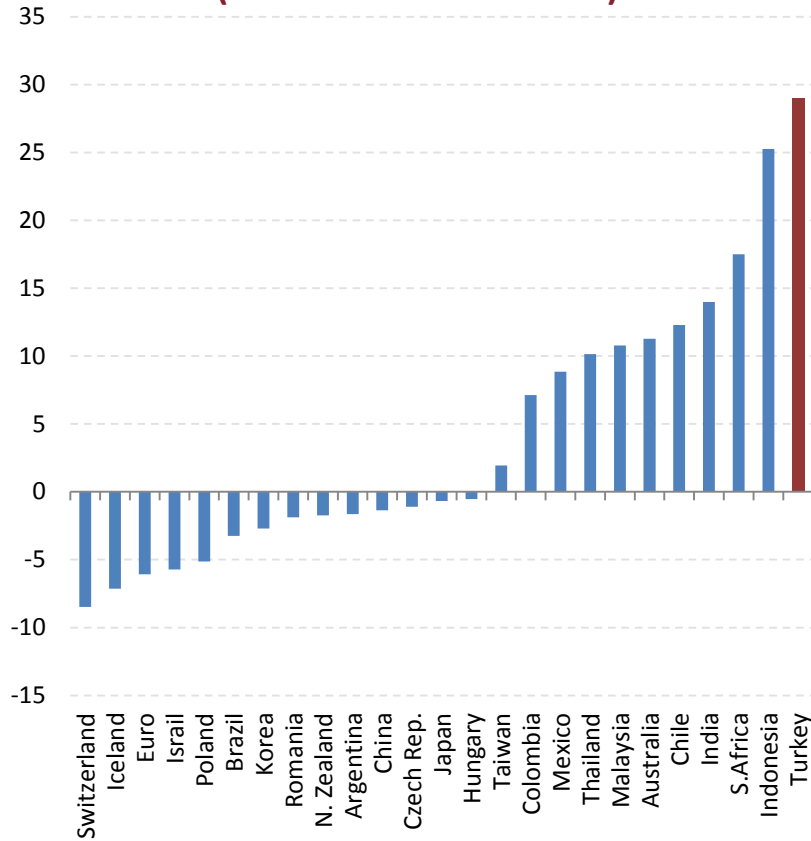


Source: Bloomberg, BİST.

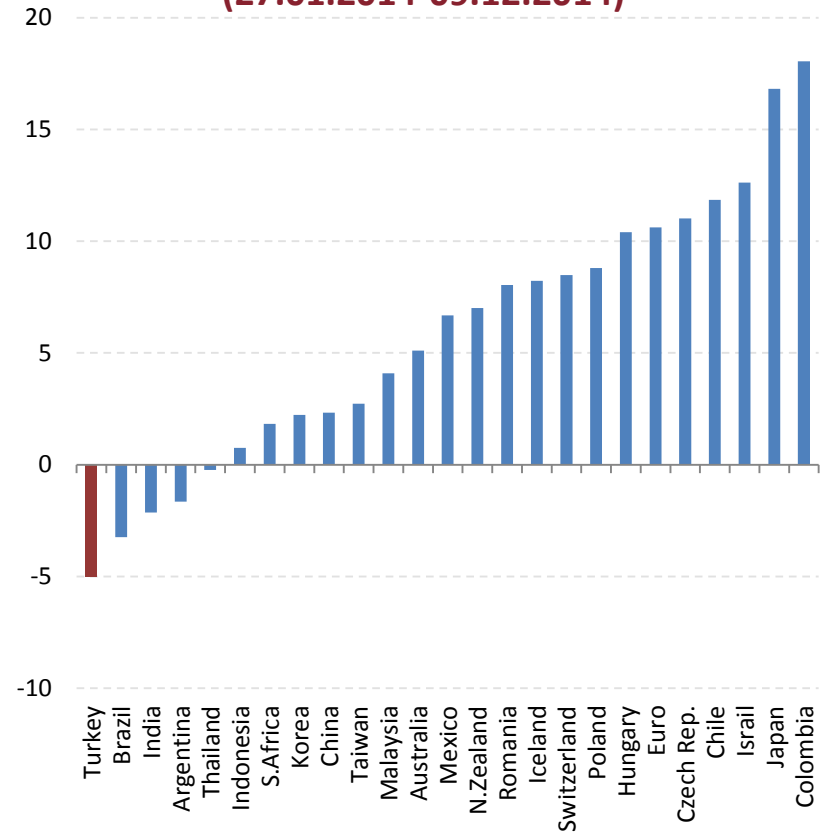
Monetary policy tightening prevented the excessive depreciation of Turkish Lira.

Change in Exchange Rates Against USD

Before Tight Stance of Monetary Policy
(22.05.2013-27.01.2014)



After Tight Stance of Monetary Policy
(27.01.2014-09.12.2014)

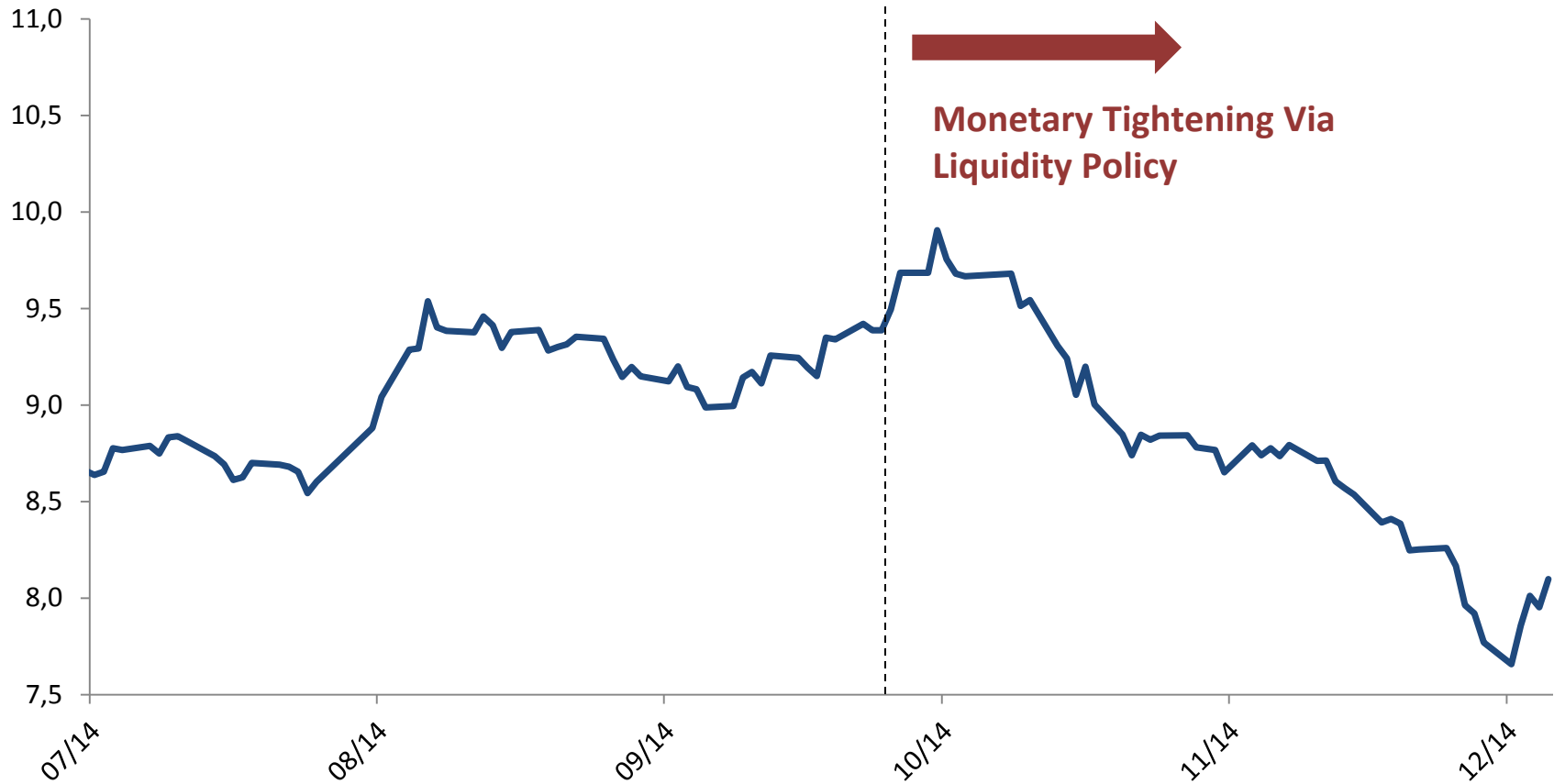


Source: Bloomberg.

Source: Bloomberg.

Tightening in liquidity policy has lowered the long-term interest rates.

5-Year Bond Rate
(Percent)

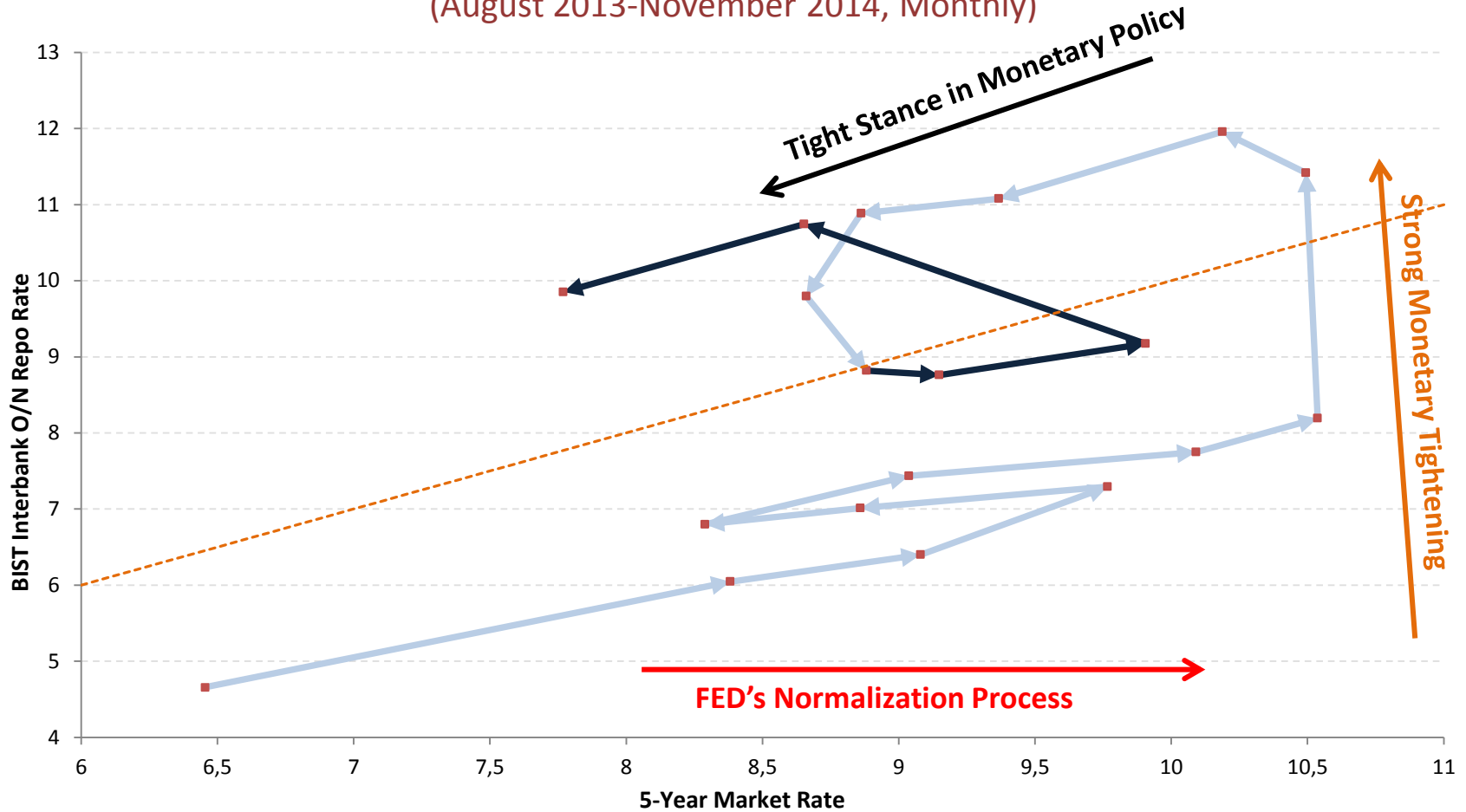


Source: Bloomberg.

Last observation: December 05, 2014.

Tight monetary policy stance reduces long-term interest rates by lowering expected inflation.

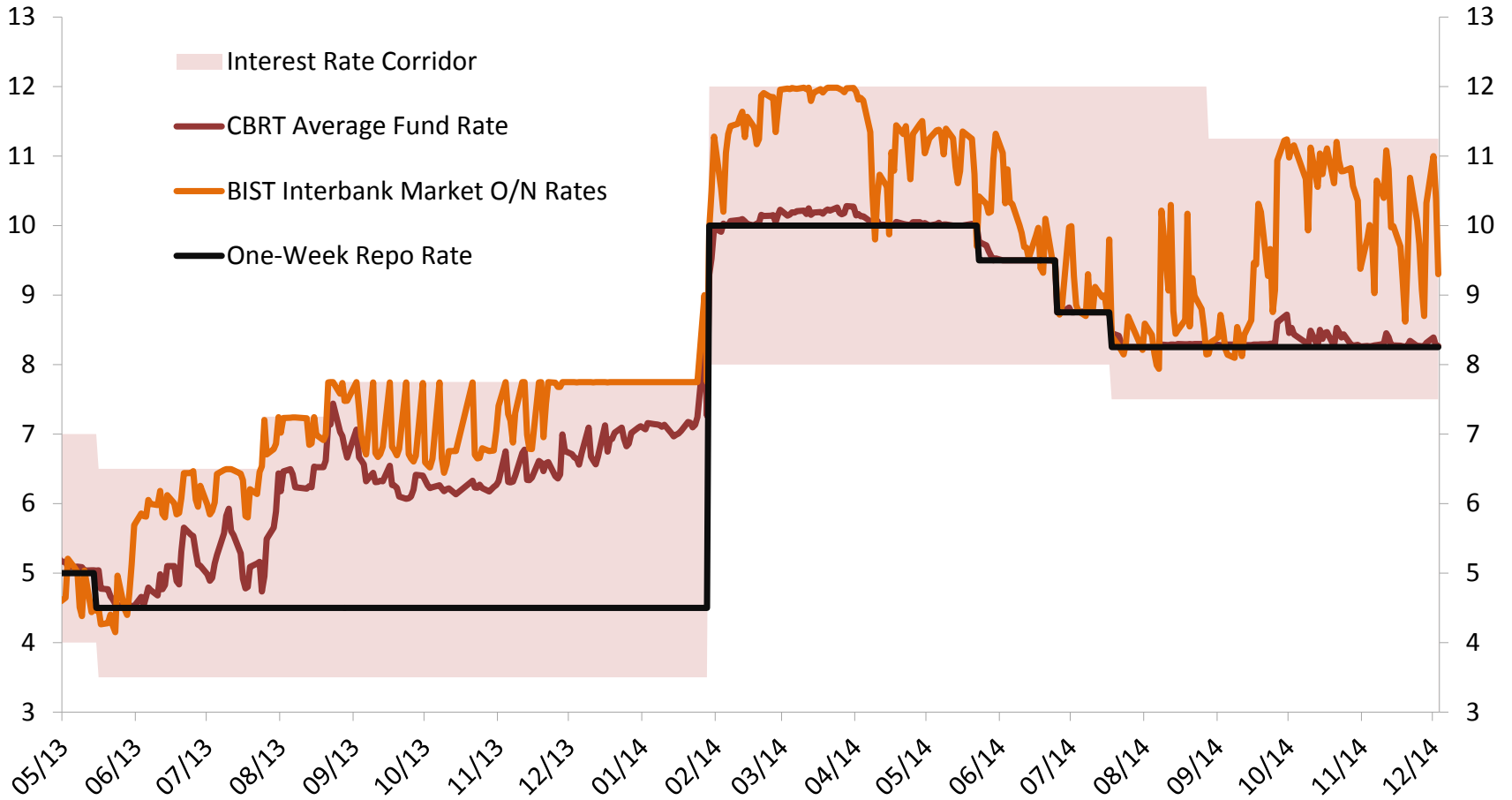
BIST Interbank O/N Repo Rate ve 5-Year Market Rate (August 2013-November 2014, Monthly)



Source: Bloomberg, BIST.

Last observation: November 2014.

CBRT maintains its tight monetary policy.



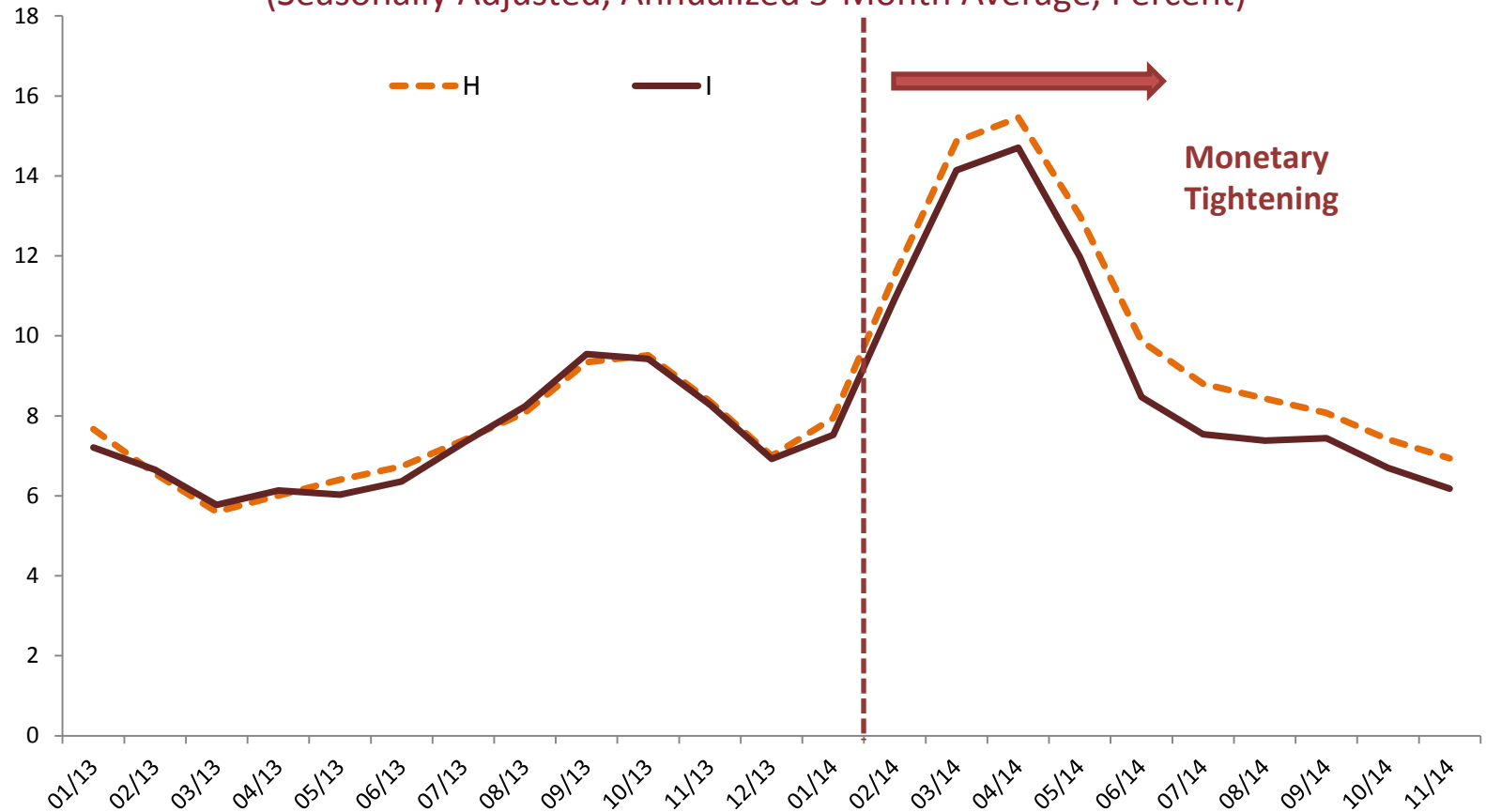
Source: CBRT.

Last observation: December 03, 2014.

The tight monetary policy stance and macroprudential measures taken at the beginning of the year had favorable impact on the core inflation trend.

Core Inflation Indicators H and I

(Seasonally Adjusted, Annualized 3-Month Average, Percent)

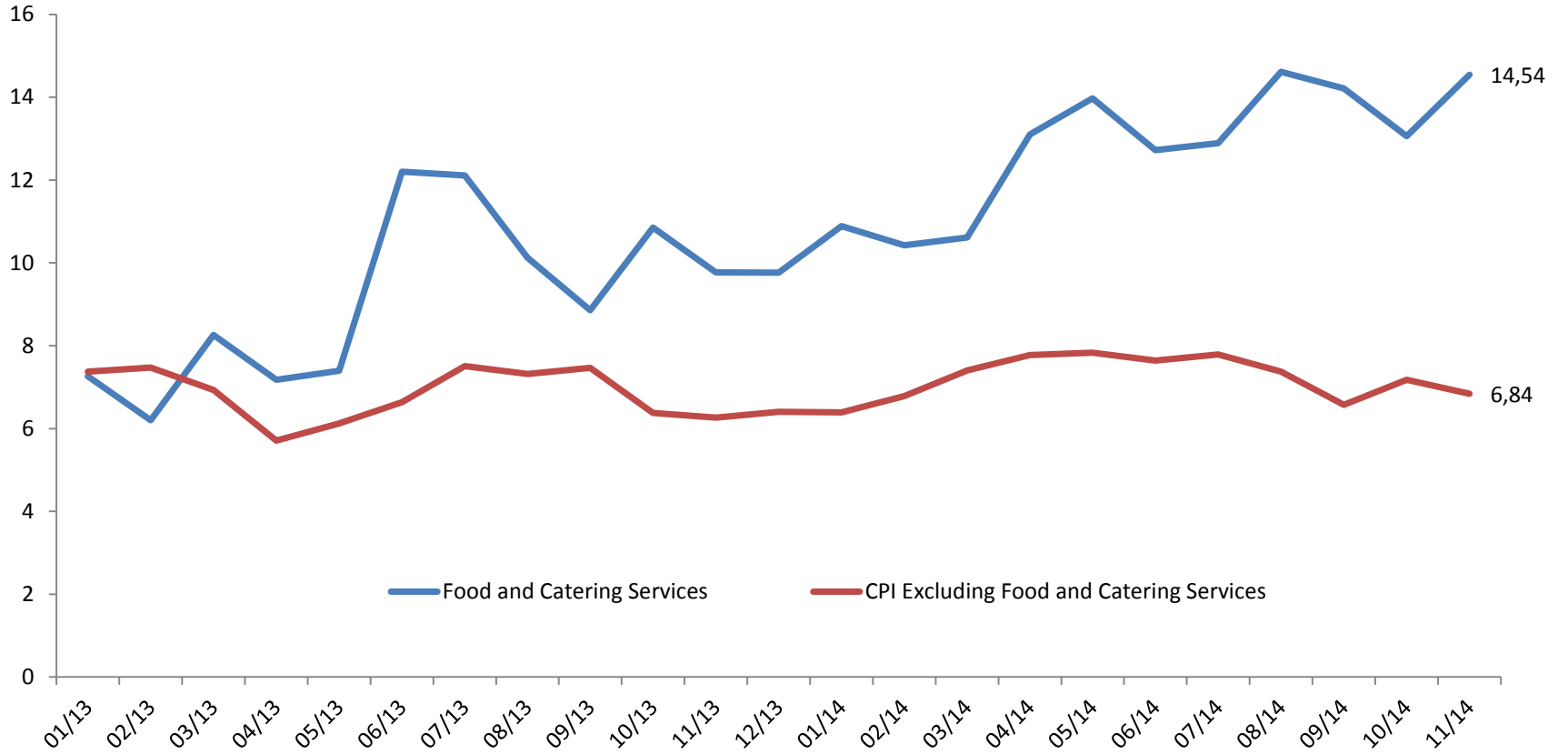


Source: TURKSTAT, CBRT.

Last observation: November 2014.

Elevated food prices delayed the improvement in the inflation outlook.

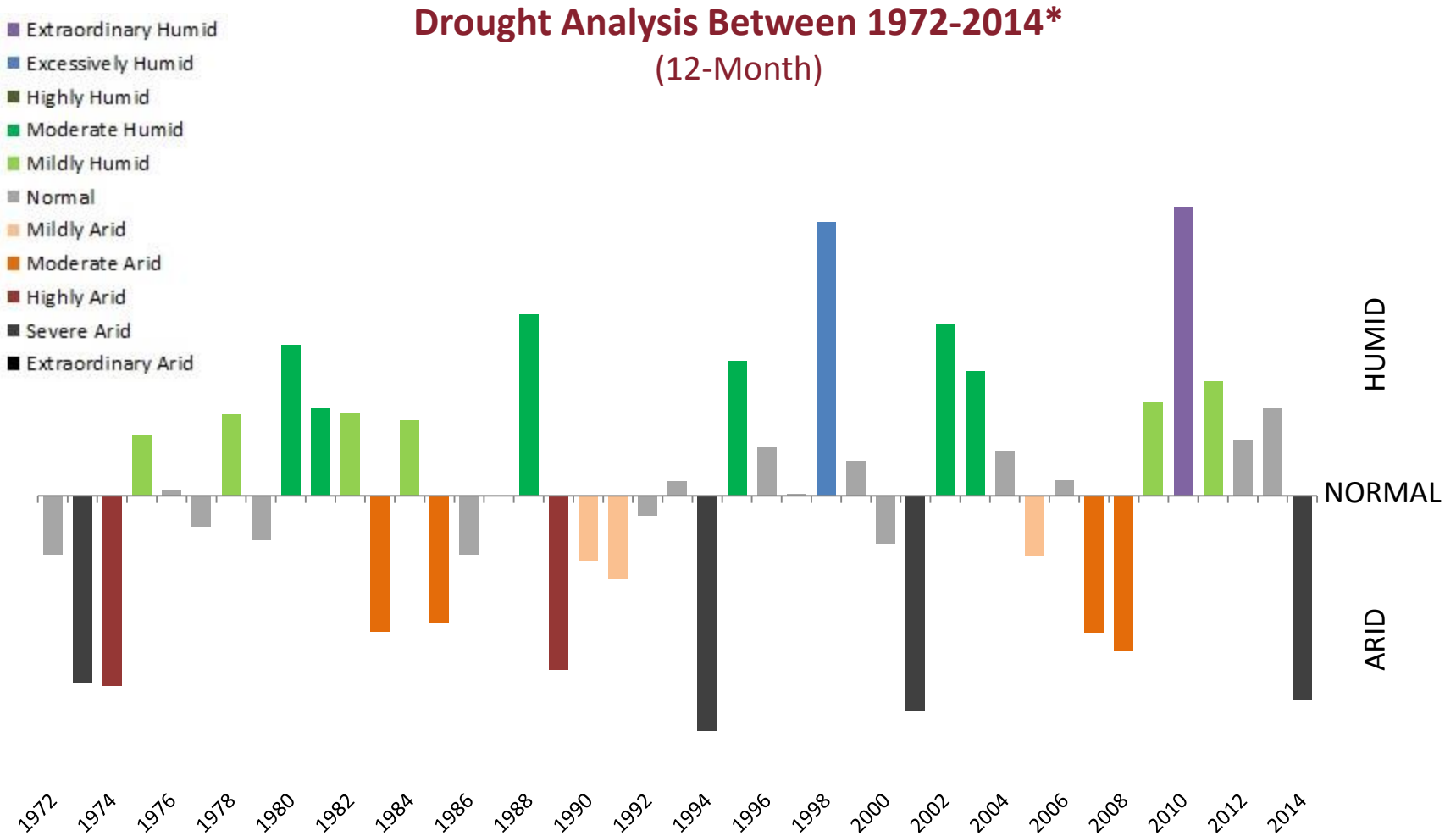
Annual Inflation (Percent)



Source: TURKSTAT, CBRT.

Last observation: November 2014.

Drought had negative effects on food prices.

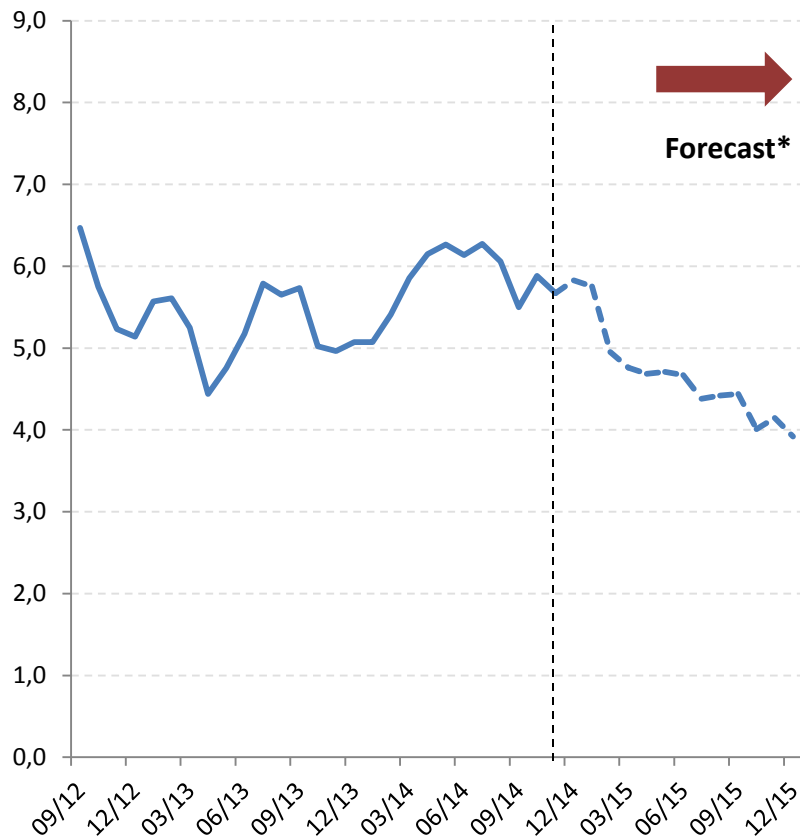


Source: Turkish State Meteorological Service

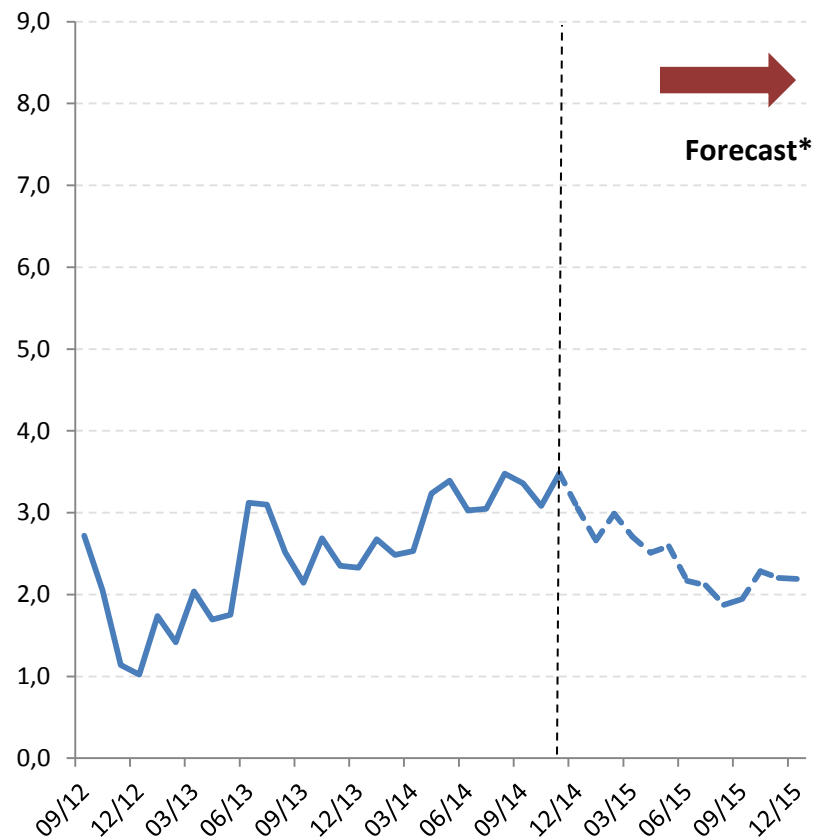
*It shows the deviation of last 12 months' cumulative precipitation from the period average as of June.

In addition to non-food inflation, food inflation is also foreseen to fall significantly in 2015.

Contribution of Non-Food Items to CPI (Percentage Points)



Contribution of Food to CPI (Percentage Points)



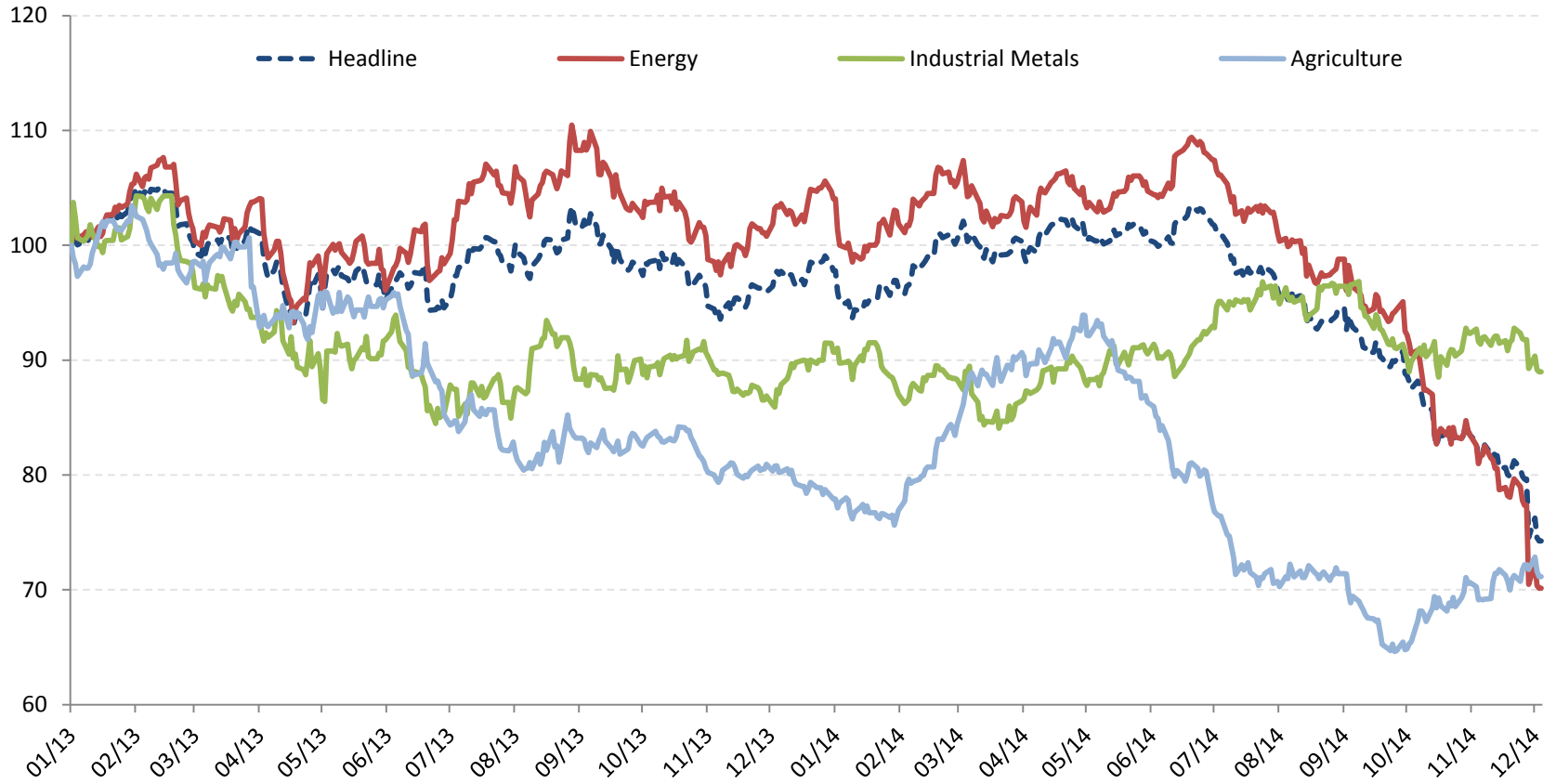
Source: TURKSTAT, CBRT.

Last observation: November 2014.

* Contributions of food and non-food items which are consistent with inflation forecasts in Inflation Report.

Falling commodity prices, oil prices in particular, are expected to support the disinflation process in the next year.

S&P GS Indices (01.01.2013=100)

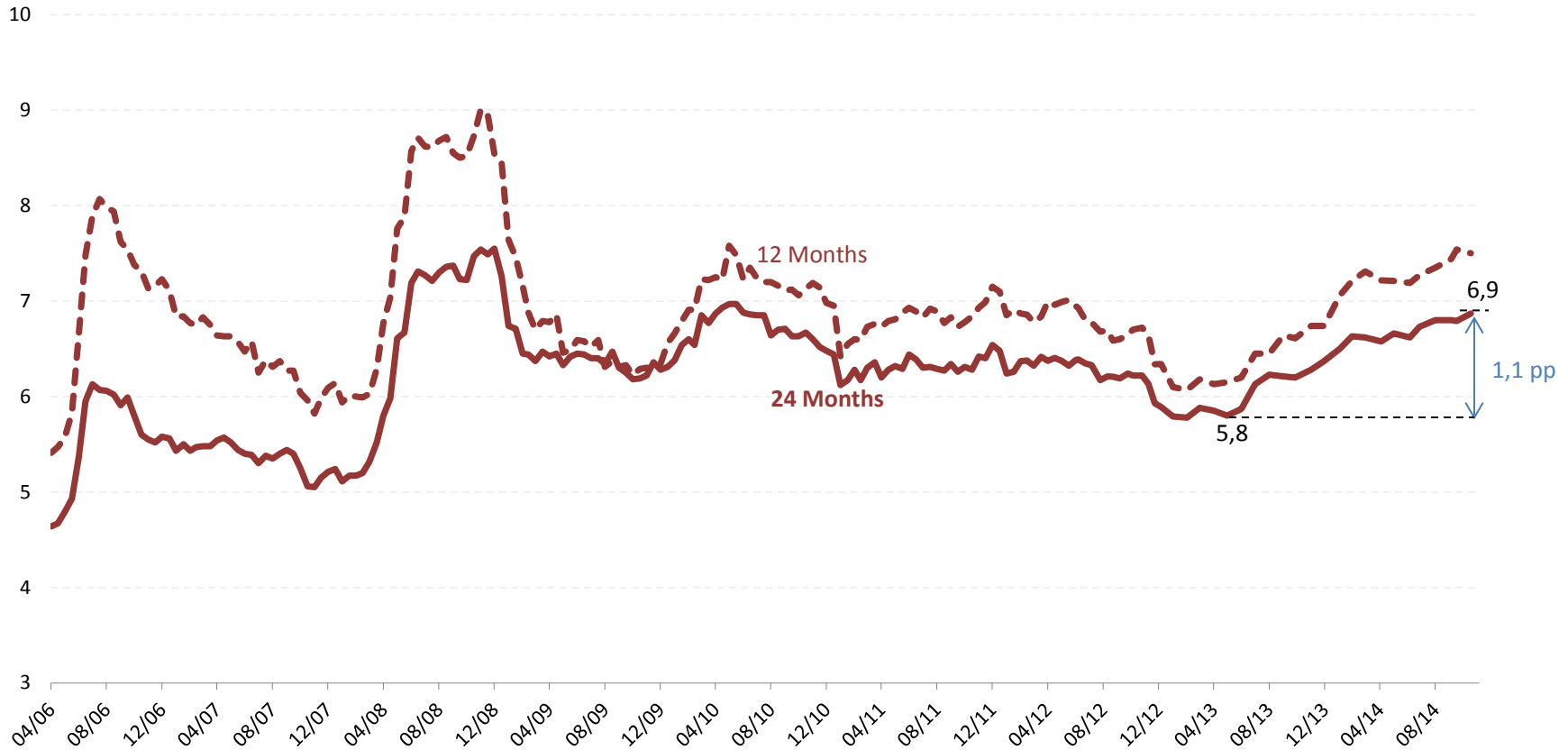


Source: Bloomberg.

Last observation: December 04, 2014.

Through the taken and planned measures, expected inflation is aimed to be contained and to improve gradually.

Inflation Expectations (Percent)



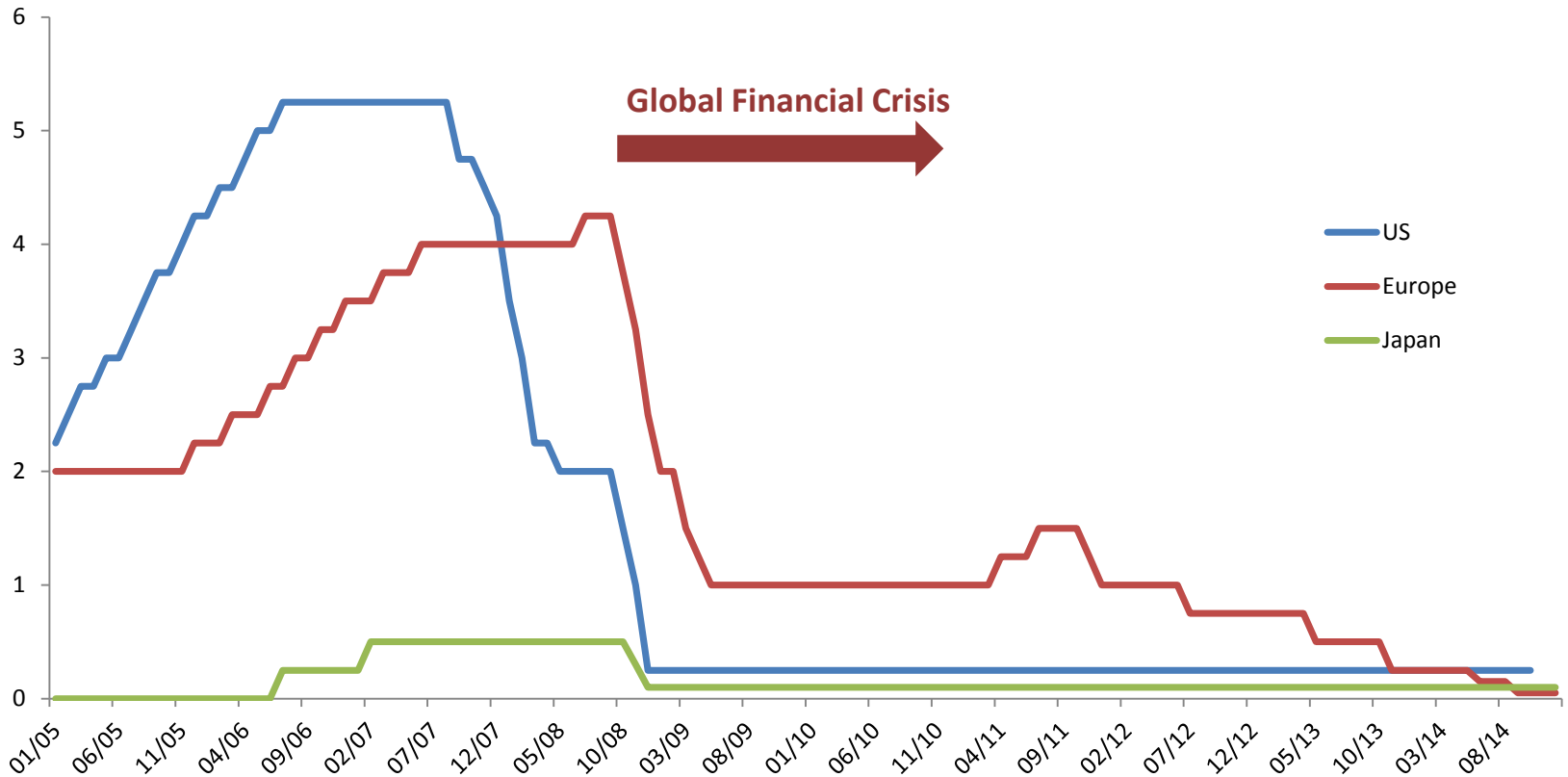
Source: CBRT.

Last observation: November 2014.

FINANCIAL STABILITY

Following the global financial crisis, central banks of advanced economies have lowered policy rates close to zero.

Monetary Policy Rates (Percent)



Source: Bloomberg.

Last Observation: December 2014 for Europe and Japan; October 2014 for US.

Long-term interest rates also fell to historically low levels.

Germany 10 Year Government Bond Rate (Percent)



Source: Bloomberg.

Last Observation: December 8, 2014

Long-term interest rates also fell to historically low levels.

US 10 Year Government Bond Rate (Percent)

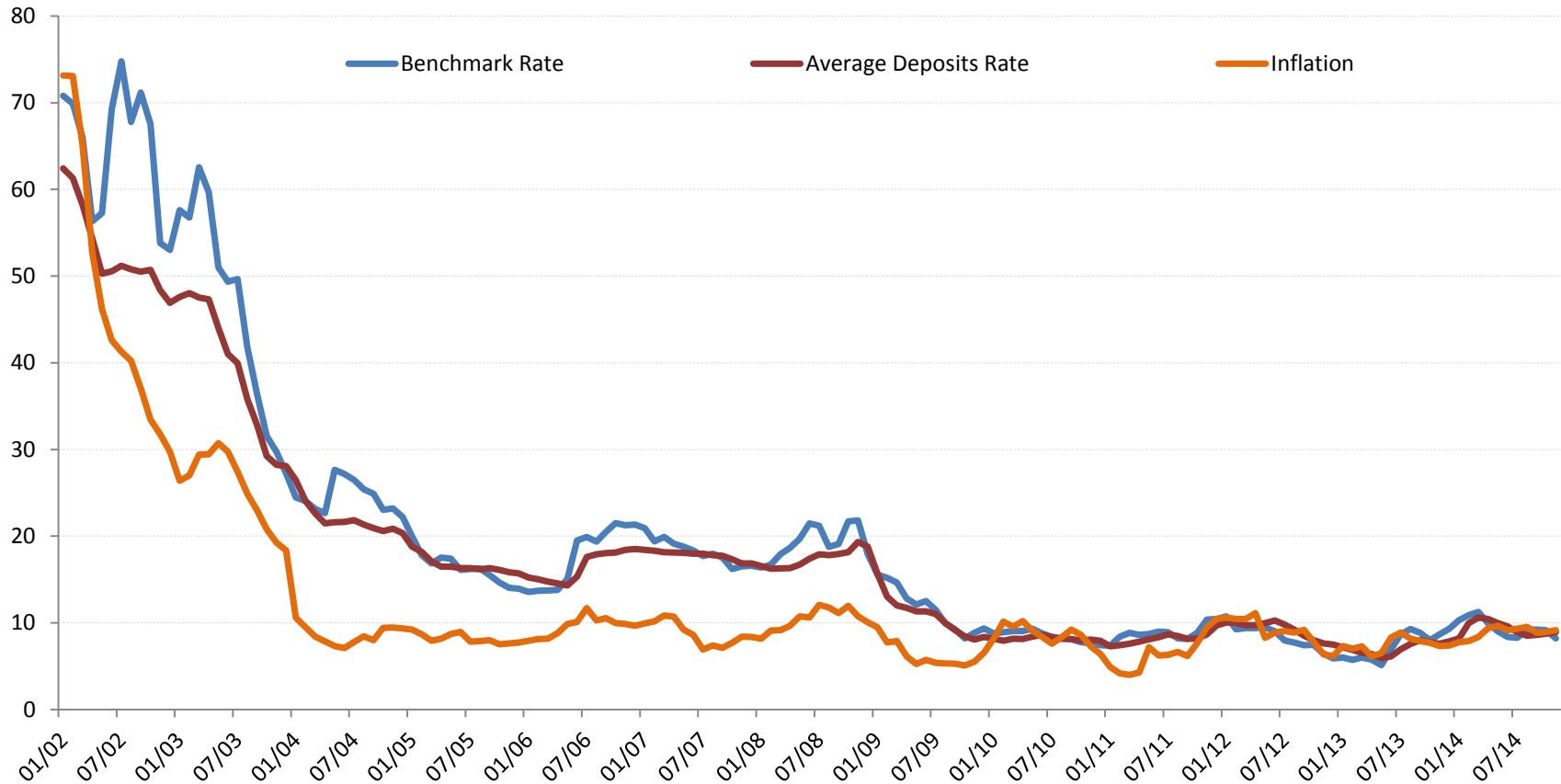


Source: Bloomberg.

Last Observation: December 8, 2014

Both nominal and real interest rates in Turkey also hover around historically low levels.

Interest Rates and Inflation (Percent)

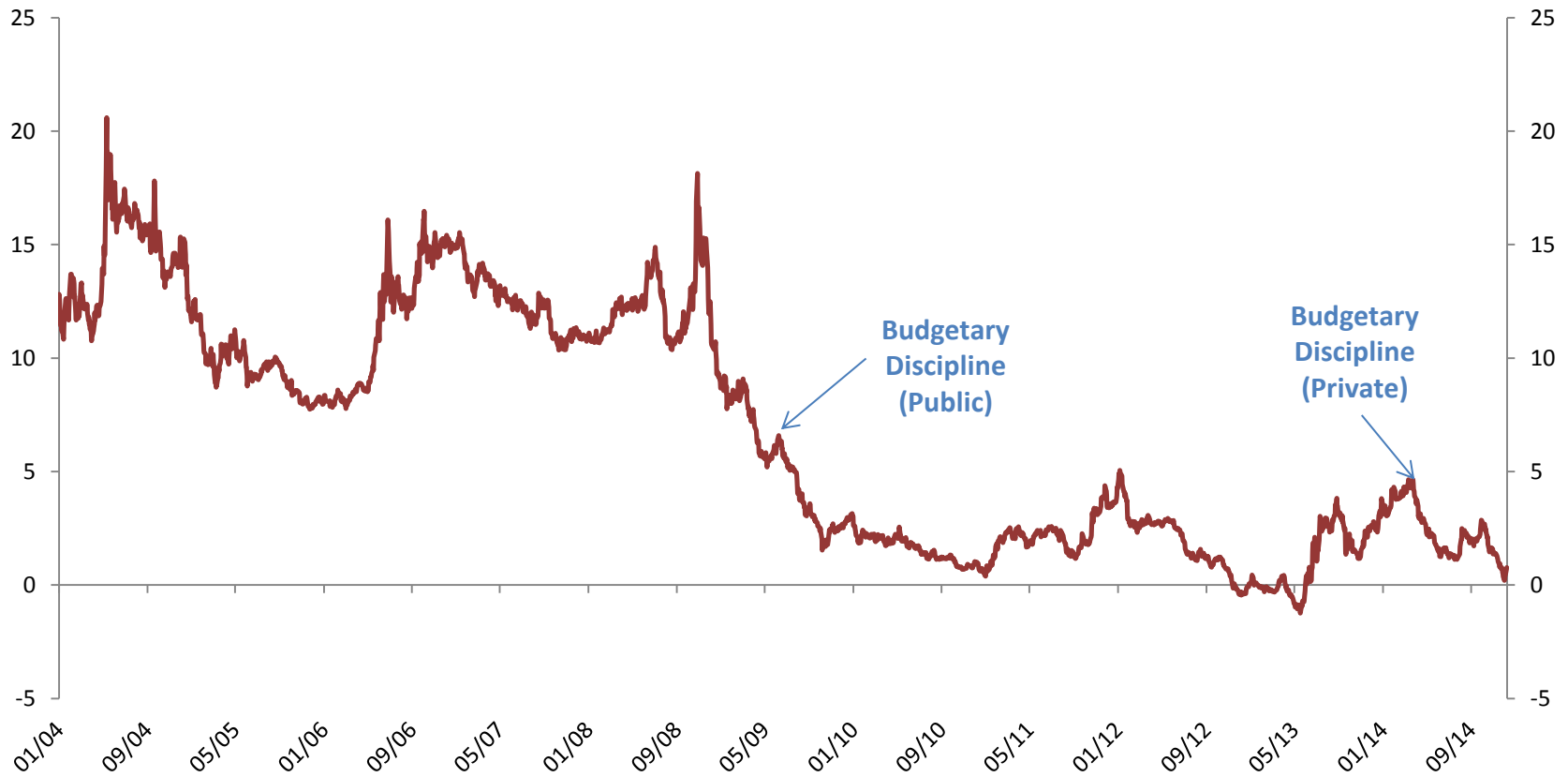


Source: Bloomberg, TURKSTAT.

Last Observation: November 2014.

Real interest rates are lower than the pre-global crisis levels thanks to the macroprudential measures.

2-Year Real Interest Rates of Turkish Treasury Securities* (Percent)

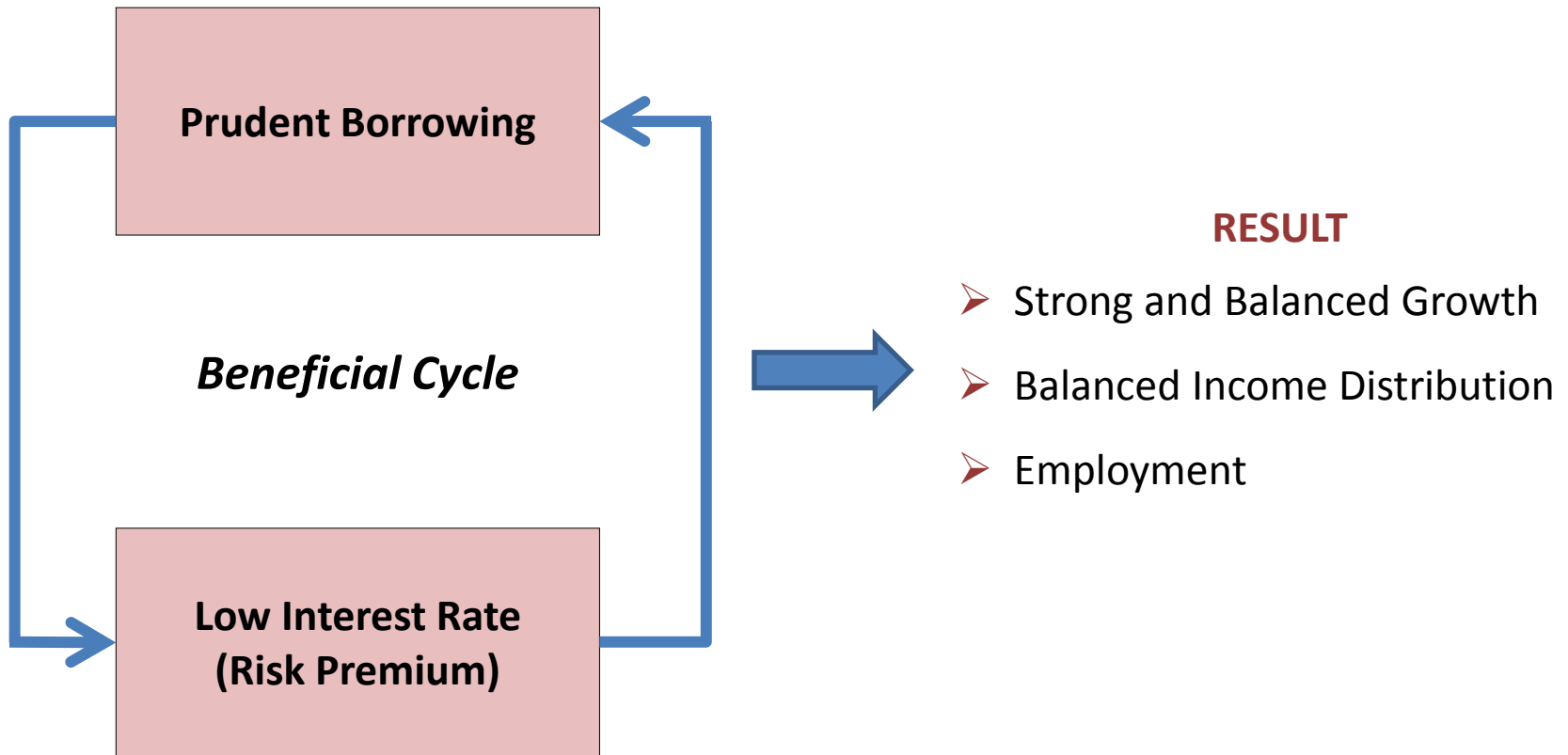


Source: CBRT, BIST.

* Calculated as the difference between 2-year benchmark rate and the inflation expectations derived from the CBRT Survey of Expectations. Inflation expectation is 12-months ahead inflation expectation before April 2006. Thereafter, inflation expectation is the compound value of 12-months ahead and 24-months ahead inflation expectations for 24 months.

Last Observation: December 8, 2014

Prudent borrowing in a low interest rate environment will be beneficial for sustainable growth, income distribution and employment.

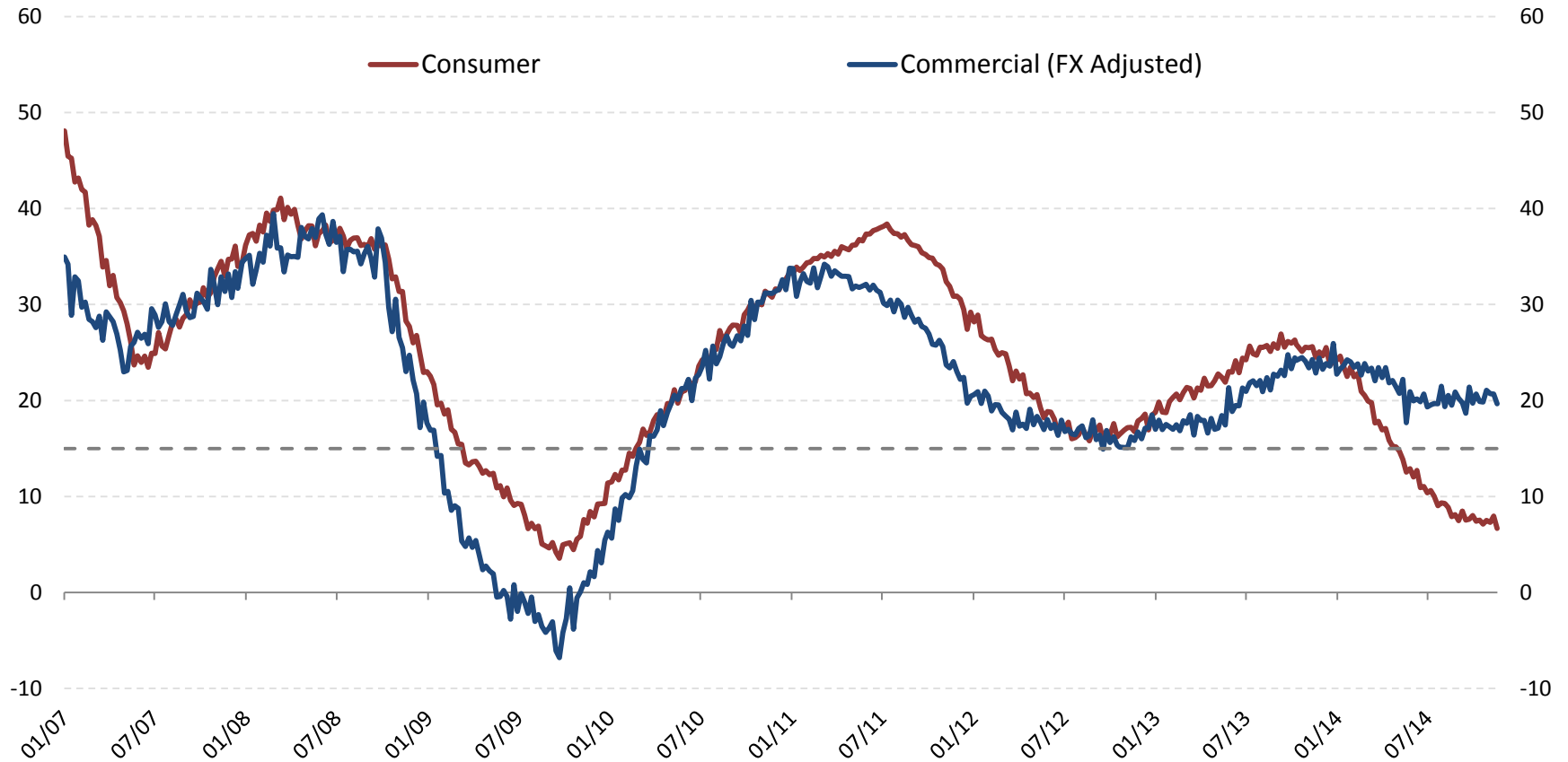


Prudent Borrowing

- Quantity: Debt Growth Rate
- Quality : Debt Compositon

Quality of credits improves through the shift of credits from financing of consumption to production.

Consumer* and Commercial Loans Growth Rate (Annual Growth, Percent)



Source: CBRT.

Total Banking sector (including participation banks, excluding non-performing loans)

*Including credit cards.

Last observation: November 21, 2014.

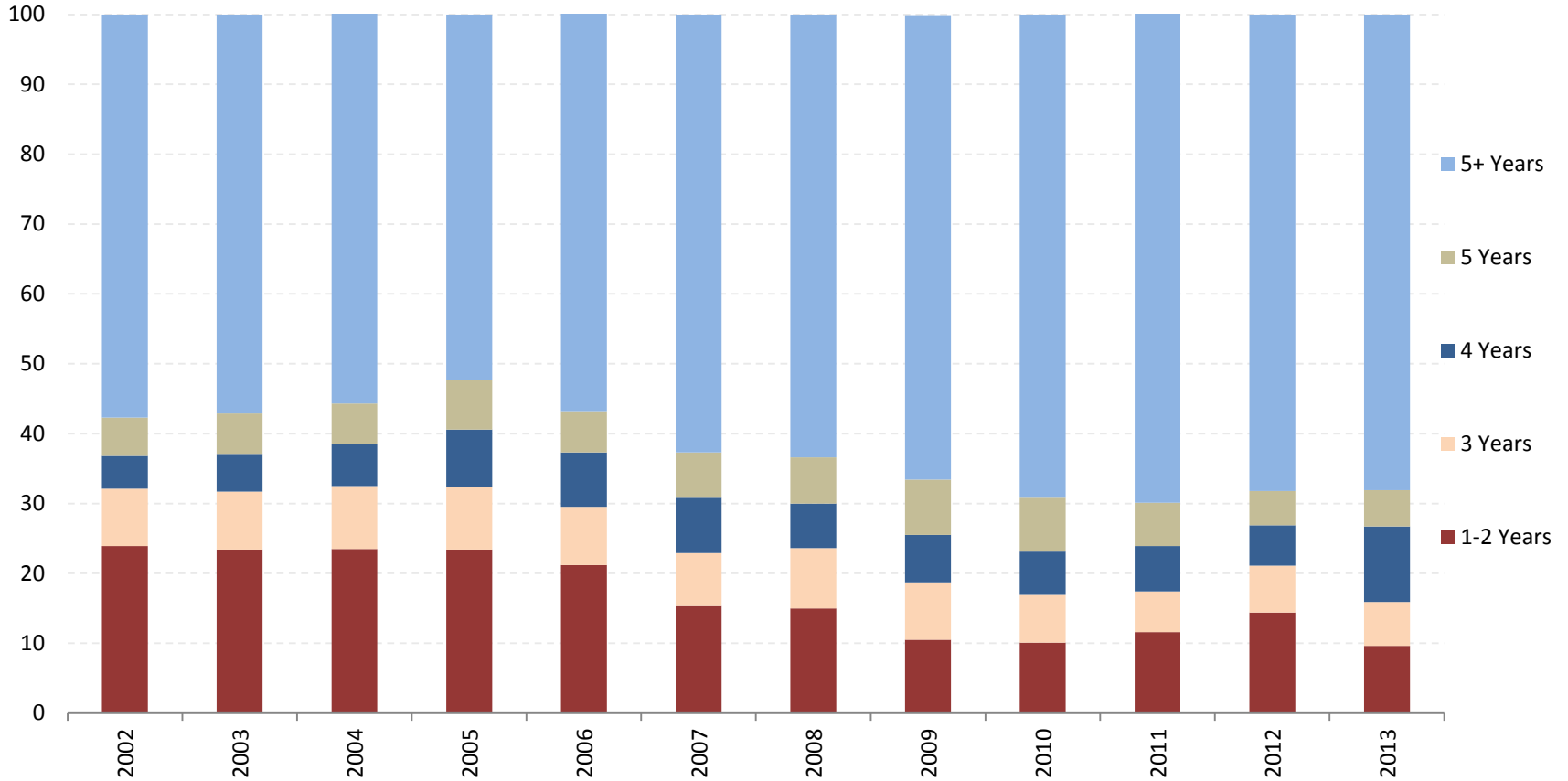
Maturity Dimension of External Borrowing

- Real Sector: Long
- Banking Sector: Extendable

Tools: Reserve Requirements

Maturity of external borrowing by the real sector is quite long.

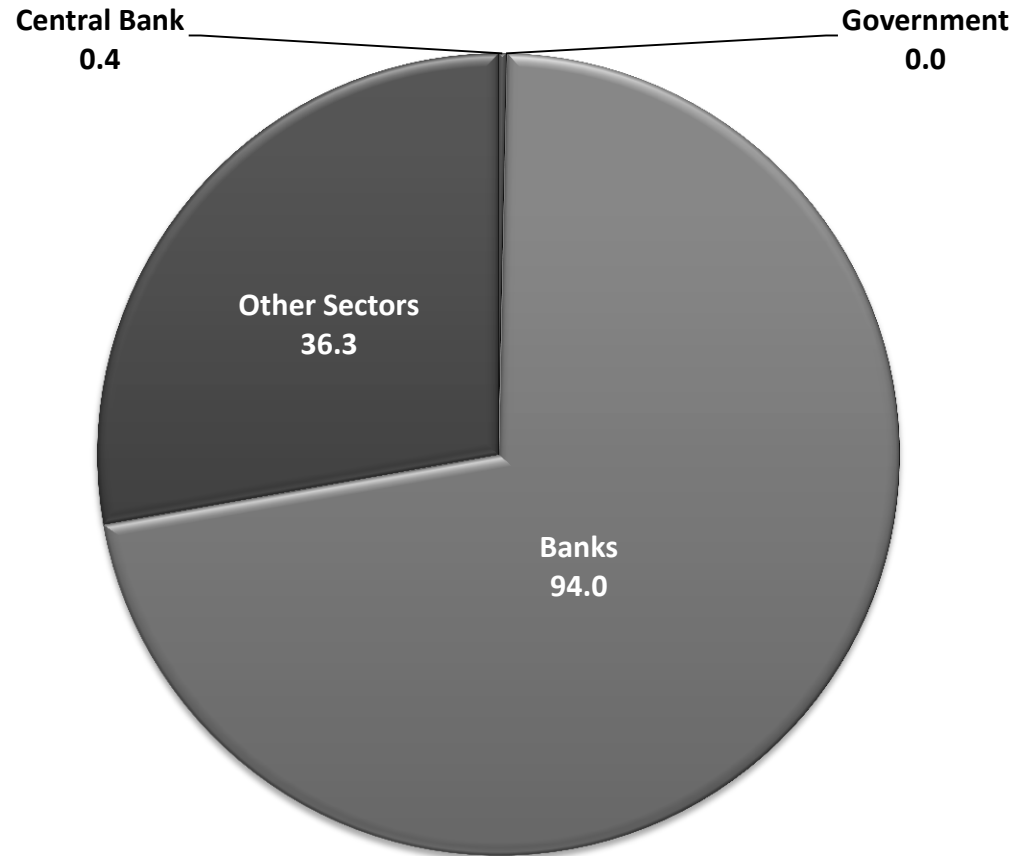
Real Sector External Debt Maturity (Percent Share)



Source: CBRT.

Extending the maturity of banks' external borrowing will contribute to sustainable growth as well.

Turkey Short Term External Debt Stock* (Billion USD)



Source: CBRT.

Last Observaton: 2014 Q3.

* Original maturity, total 130,7 billion USD.

Stability Dimension of Borrowing

- Domestic Sources: More Stable
- External Sources: More Volatile

Tools: Supporting Core Liabilities

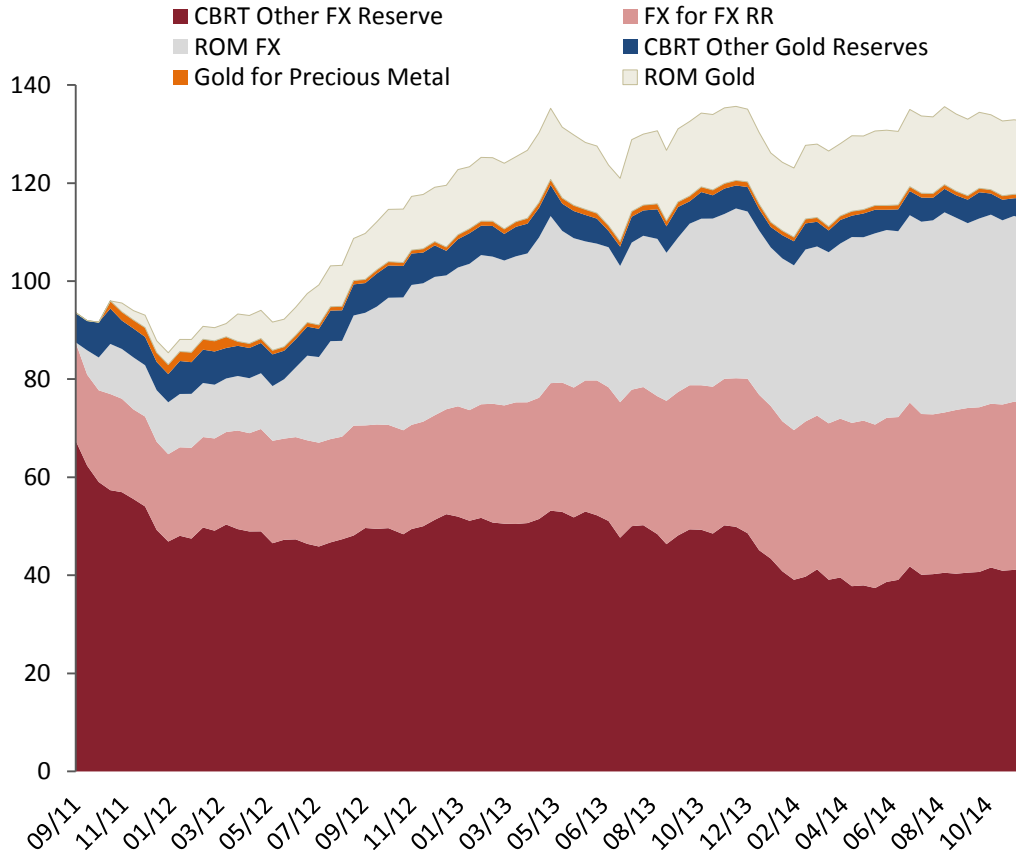
Reserve Option Mechanism

Foreign Exchange Deposit Market

Foreign Exchange Buying-Selling

Export rediscount credits provide important contribution to both foreign exchange reserves and exports.

CBRT Reserves* (Billion USD)



Source: CBRT.

Last Observation: November 21, 2014.

* Total 132,6 billion USD.

Billion USD	FX Sale (-)	Export Credit (+)
January 2014	5.8 ¹	0.57
February 2014	1.0	0.30
March 2014	1.05	0.48
April 2014	1.02	0.36
May 2014	0.50	2.06
June 2014	0.42	1.54
July 2014	0.38	1.46
August 2014	0.21	1.38
September 2014	0.31	1.42
October 2014	0.72	1.31
November 2014	0.80	0.79
December 2014 ²	0.06 ²	1.33 ⁺
TOPLAM	12,27	13

Billion USD	
ROM FX	37.2
FX Required Reserves	34.4
TOTAL	71.6

¹ Includes the direct currency intervention of January 2014.

² As of December 2014.

+Forecast.

Borrowing limits in Foreign Exchange Deposit Market have increased two-fold to 21.62 billion USD from December 10, 2014.

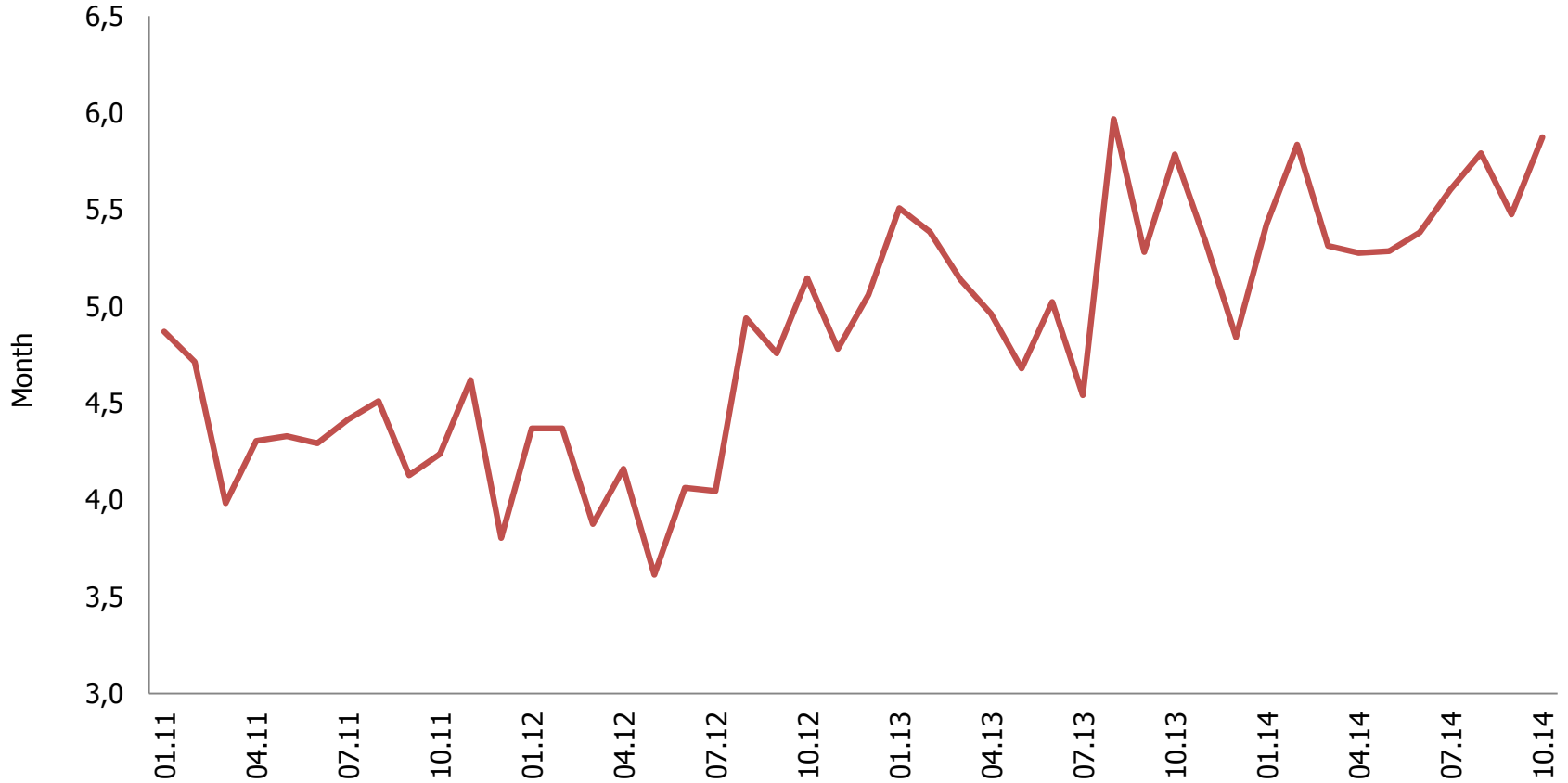
Projected Interest Rates (%):

	2015	2016	2017
USD	7.5	8.5	9
Euros	6.5	6.5	6.5

Reserve Adequacy Indicators

- Import Coverage Ratio of Reserves
- Composite Indicators
- Short-Term External Debt Coverage Ratio of Reserves

Import coverage ratio of reserves continues to improve...

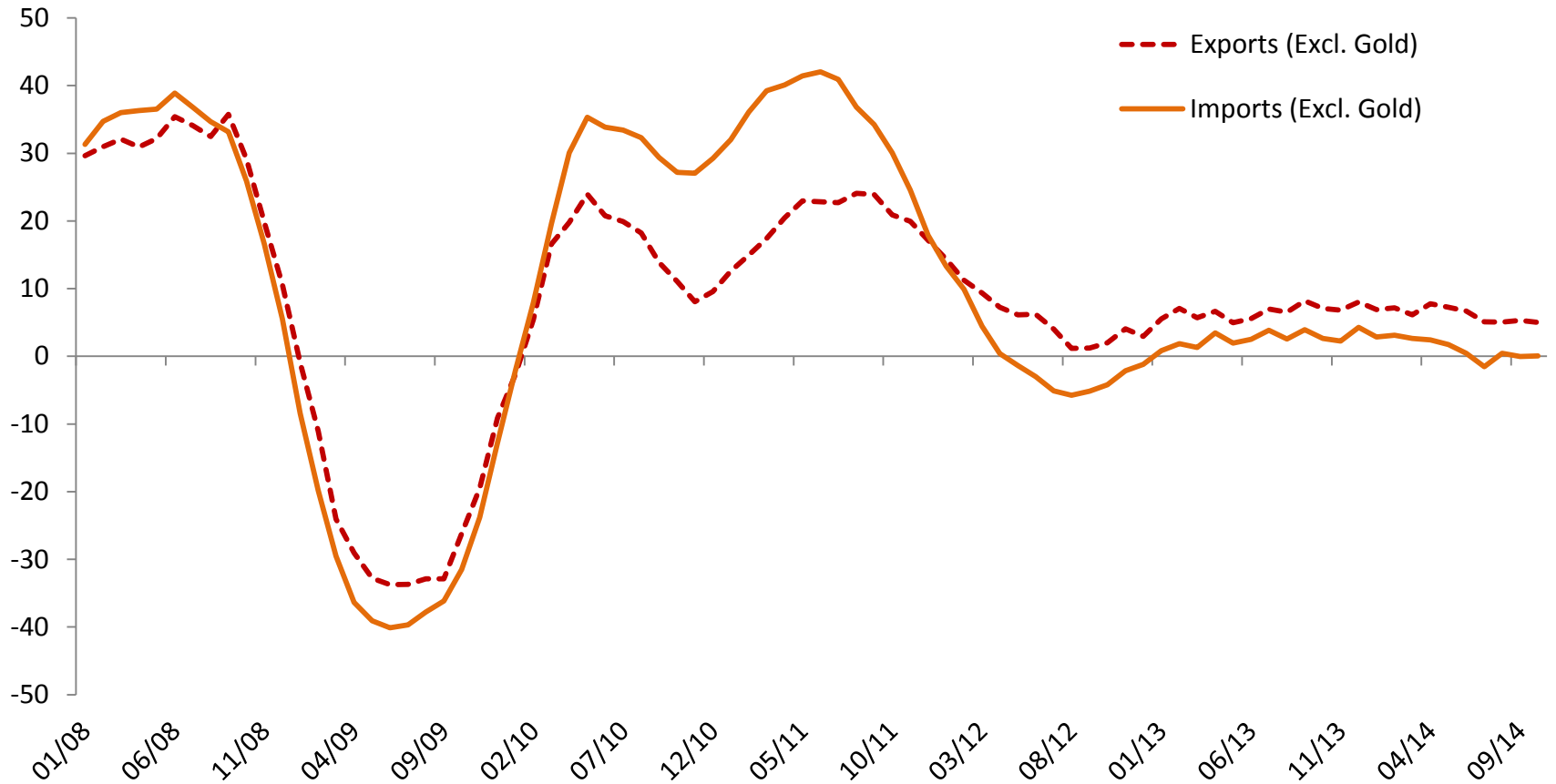


Source: CBRT.

Last Observation: October 2014.

...and this improvement is expected to continue in 2015 as well.

Exports and Imports
(Nominal, Annual Percent Change, 6-month Moving Average)

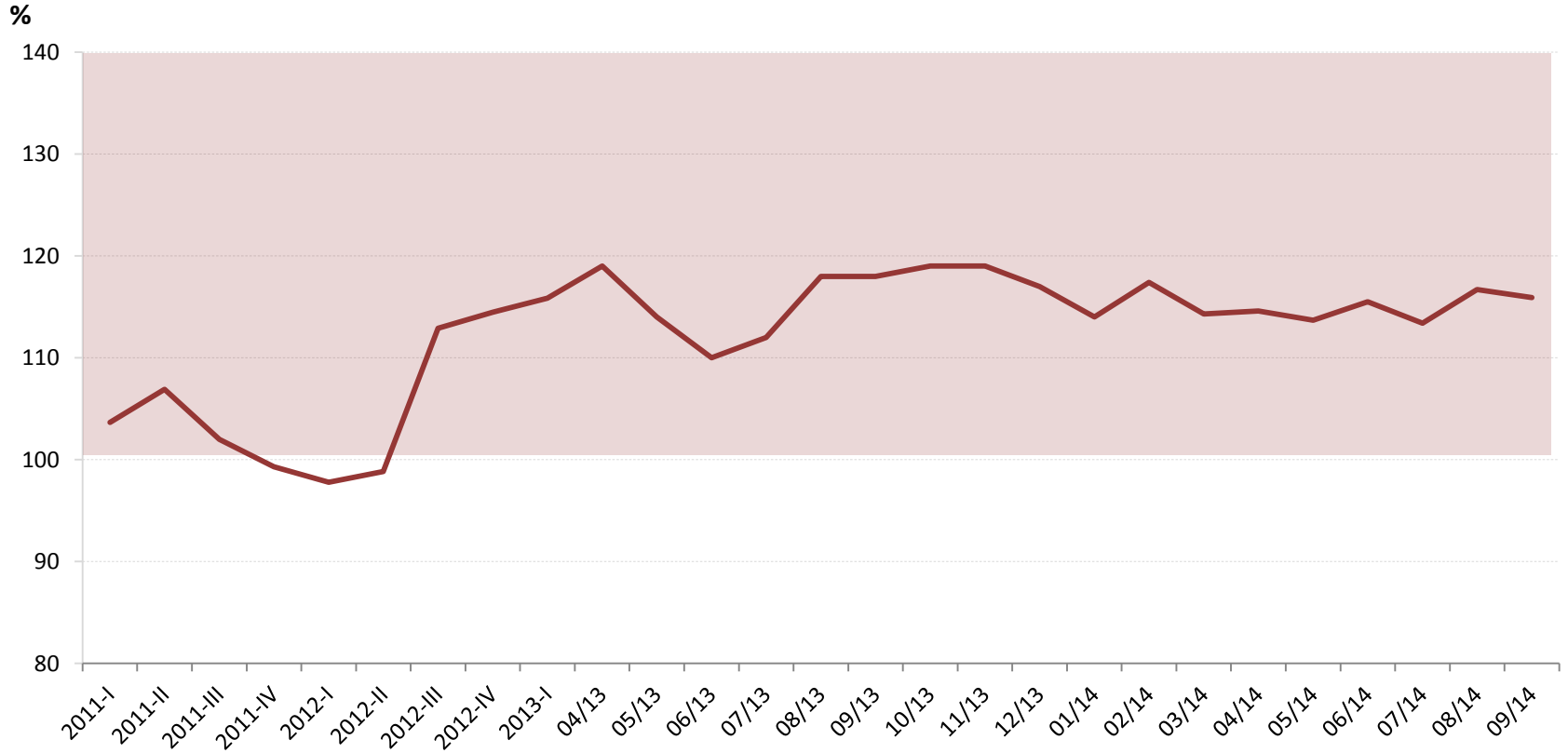


Source: CBRT.

Last Observaton: October 2014.

Reserve Adequacy: Composite Indicators

Reserve Adequacy Indicator (*)



* Reserve adequacy indicator is a new measure improved by IMF in 2011.

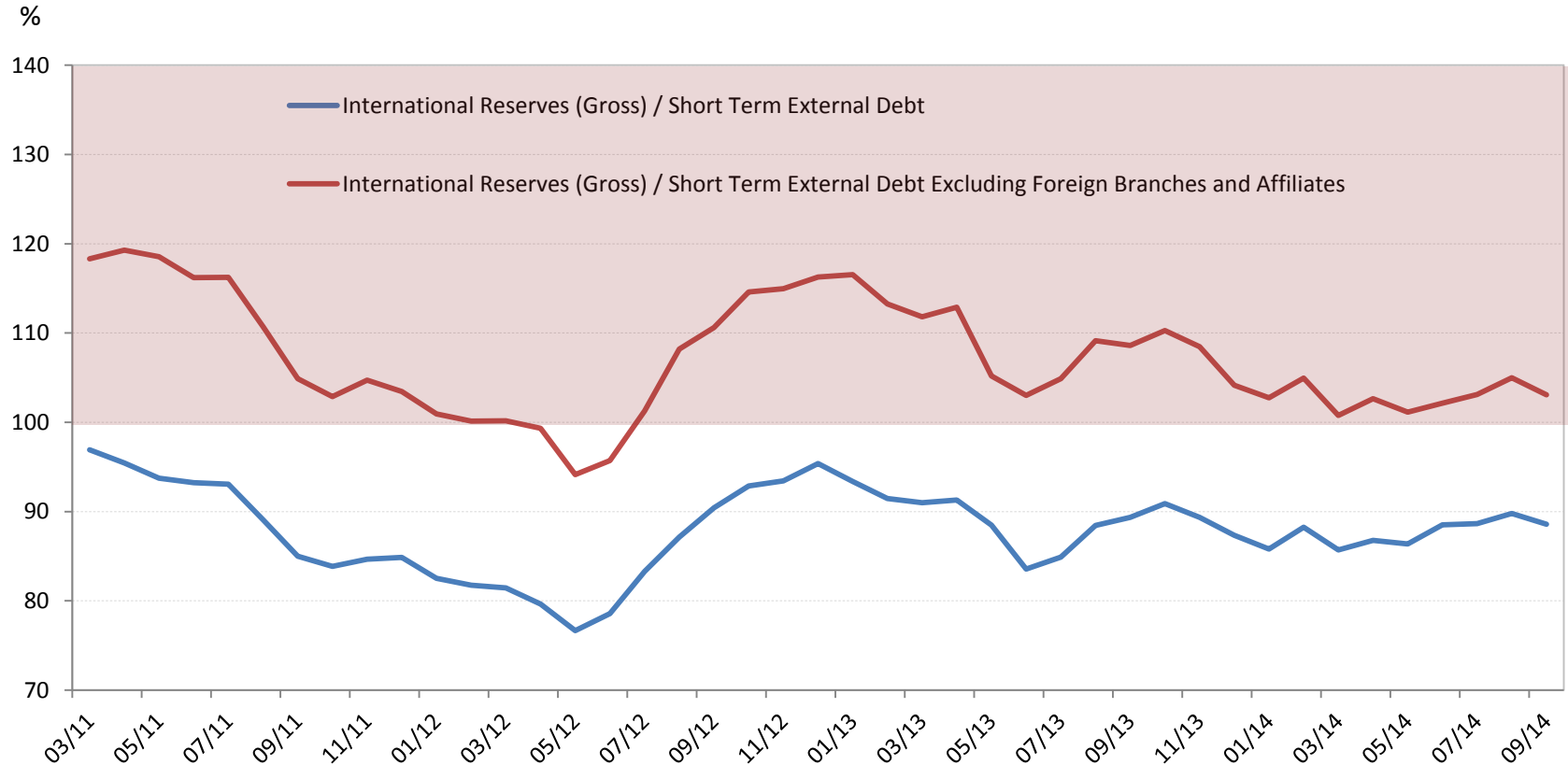
Last Observation: September 2014

For further information see Balance of Payments Report 2012-IV, Box 5, page 27.

Source: CBRT.

Short-Term External Debt Coverage Ratio of Reserves

International Reserves/Short Term External Debt In Terms of Remaining Maturity Coverage Ratio (%)



Source: CBRT.

Last Observation: September 2014.

Short-term debt coverage ratio of reserves will improve with the extension of external borrowing maturities.

- $$\text{Ratio} = \frac{\text{Foreign Exchange Reserves} \uparrow}{\text{Short Term Foreign Debt} \downarrow}$$

2015 CALENDAR

2015 Calendar

Schedule for the 2015 MPC Meetings and Reports

MPC Meetings	Summary of the MPC Meeting	Inflation Report	Financial Stability Report
20 January 2015	27 January 2015	27 January 2015	
24 February 2015	3 March 2015		
17 March 2015	24 March 2015		
22 April 2015	30 April 2015	30 April 2015	
20 May 2015	27 May 2015		29 May 2015
23 June 2015	30 June 2015		
23 July 2015	30 July 2015	30 July 2015	
18 August 2015	25 August 2015		
22 September 2015	1 October 2015		
21 October 2015	28 October 2015	28 October 2015	
24 November 2015	1 December 2015		30 November 2015
22 December 2015	29 December 2015		

Note: Monetary and Exchange Rate Policy for 2016 will be published on 9 December 2015.



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Monetary and Exchange Rate Policy in 2015

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**10 December 2014
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