

CENTRAL BANK OF THE REPUBLIC OF TURKEY

Presentation before the Council of Ministers

Erdem BAŐCI
Governor

April 2011

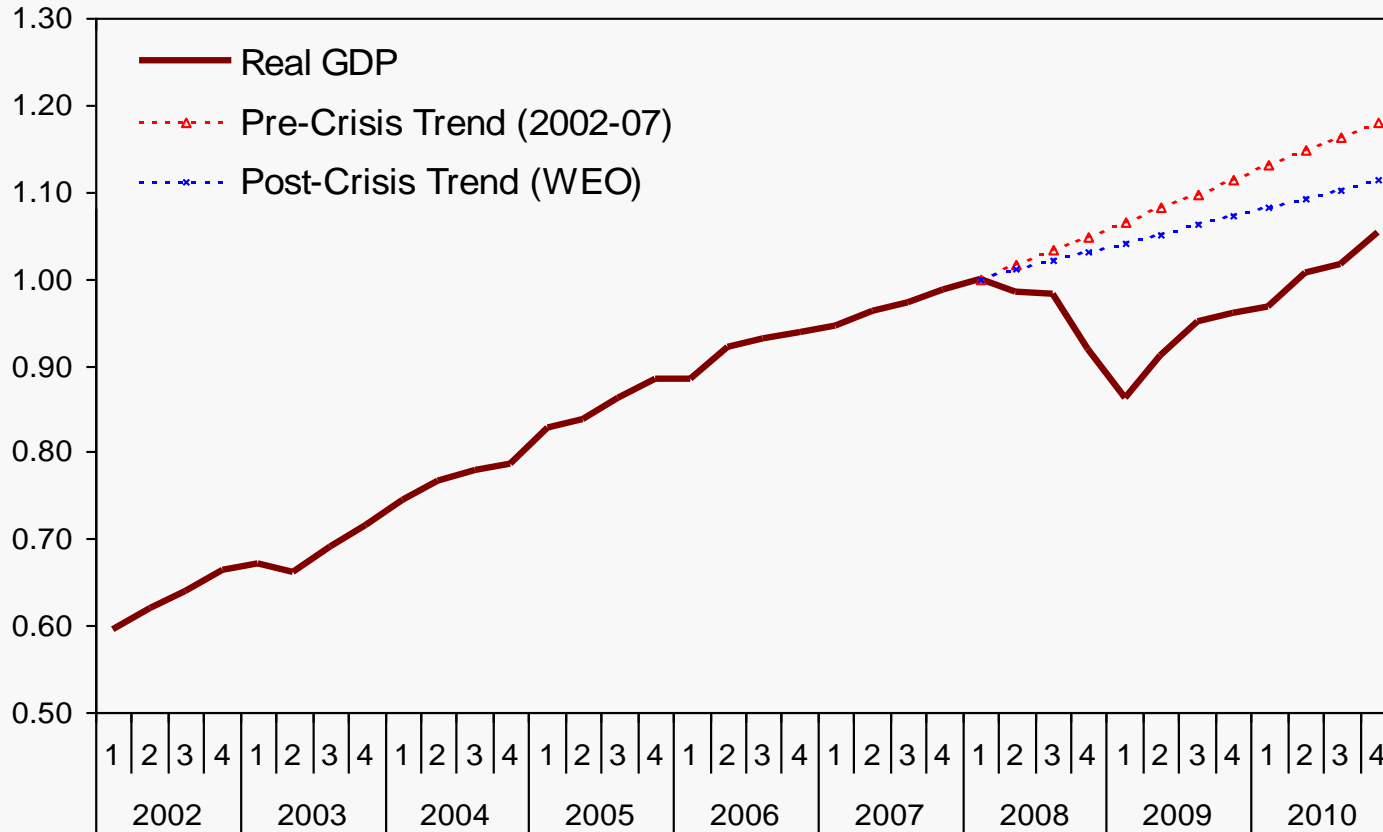
Presentation Outline

- I. Recovery After the Global Financial Crisis**
- II. Monetary Policy in the Aftermath of the Crisis**
- III. Policy Outcomes**
- IV. Global Risks**

I. Recovery After the Global Financial Crisis

Potential Growth and Output Gap: Turkey

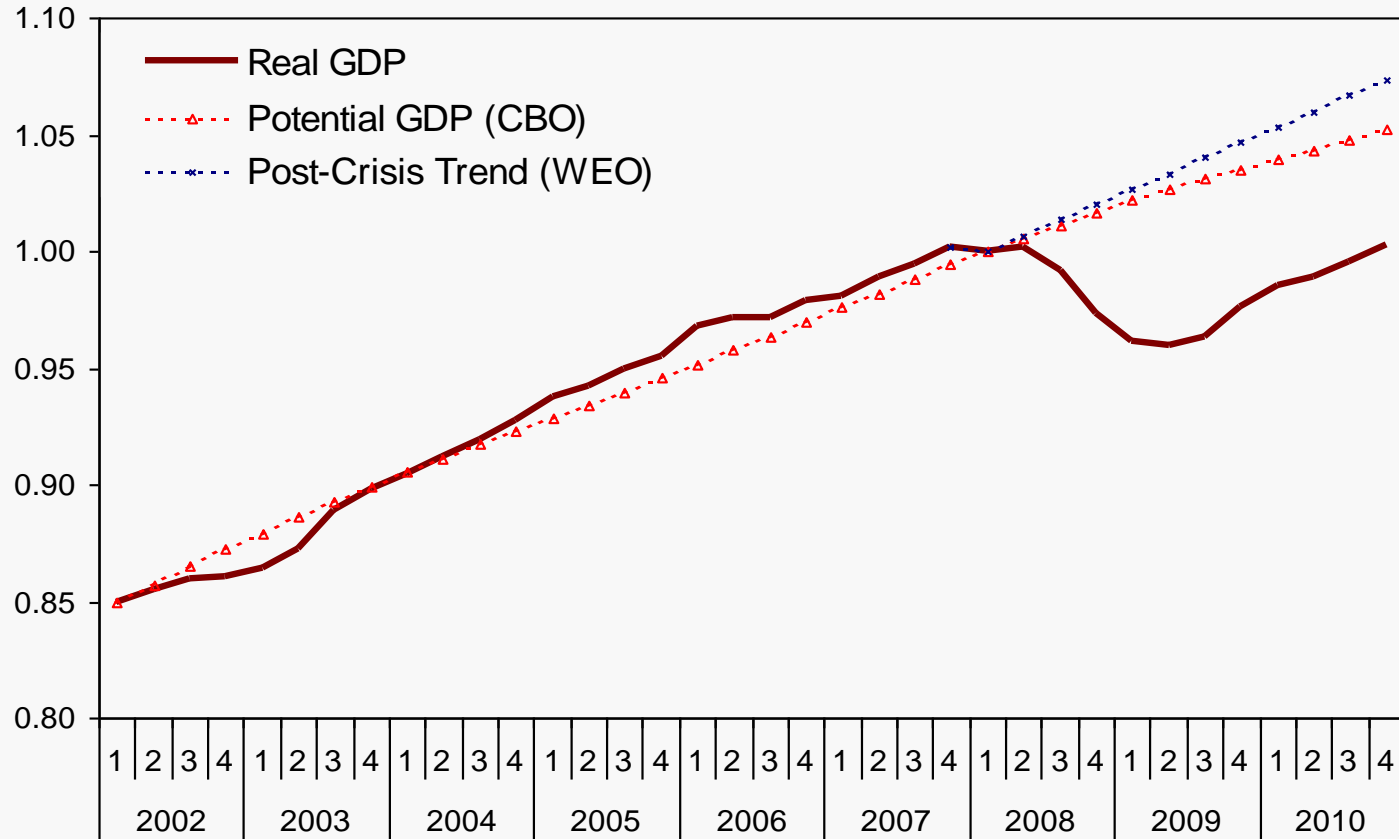
Potential Growth and Output Gap in Turkey
(natural logarithm, seasonally adjusted, 2008 Q1=1)



Source: IMF-WEO, TURKSTAT, CBRT

Potential Growth and Output Gap: USA

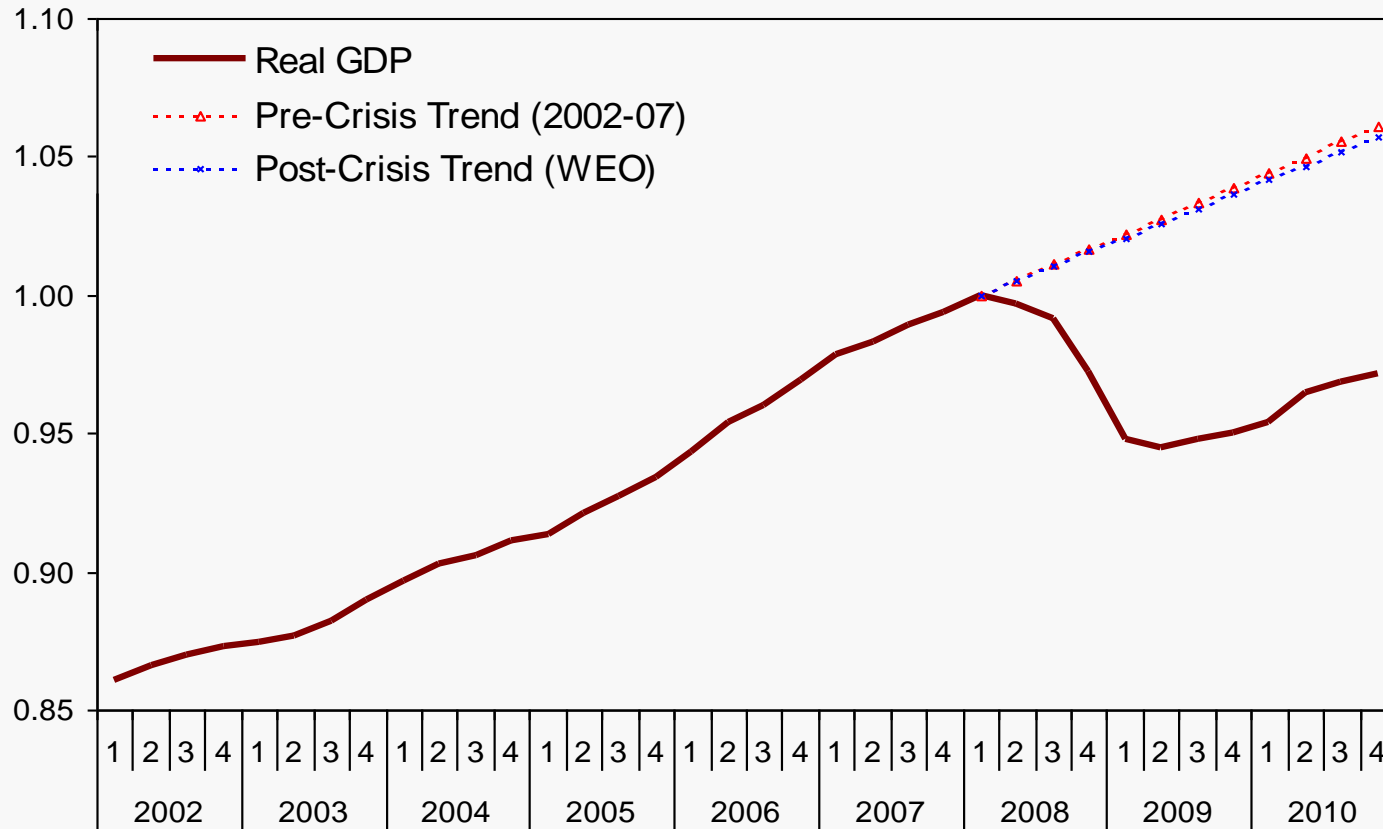
Potential Growth and Output Gap in the USA
(natural logarithm, seasonally adjusted, 2008 Q1=1)



Source: CBO, IMF-WEO, CBRT

Potential Growth and Output Gap: EU

Potential Growth and Output Gap in the European Union
(natural logarithm, seasonally adjusted, 2008 Q1=1)

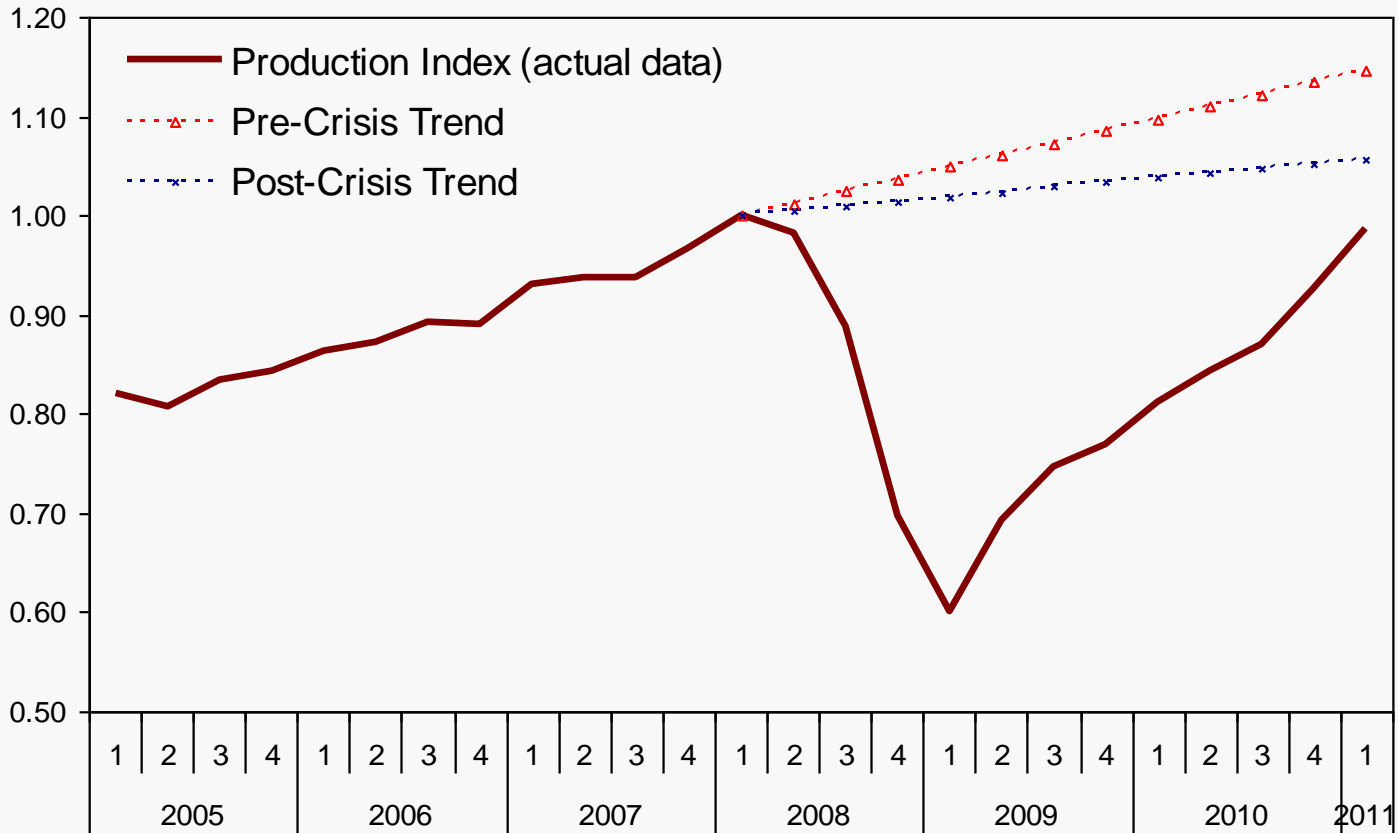


Source: Eurostat, IMF-WEO, CBRT

Export-Oriented Manufacturing: Turkey

Output Gap and Potential Growth

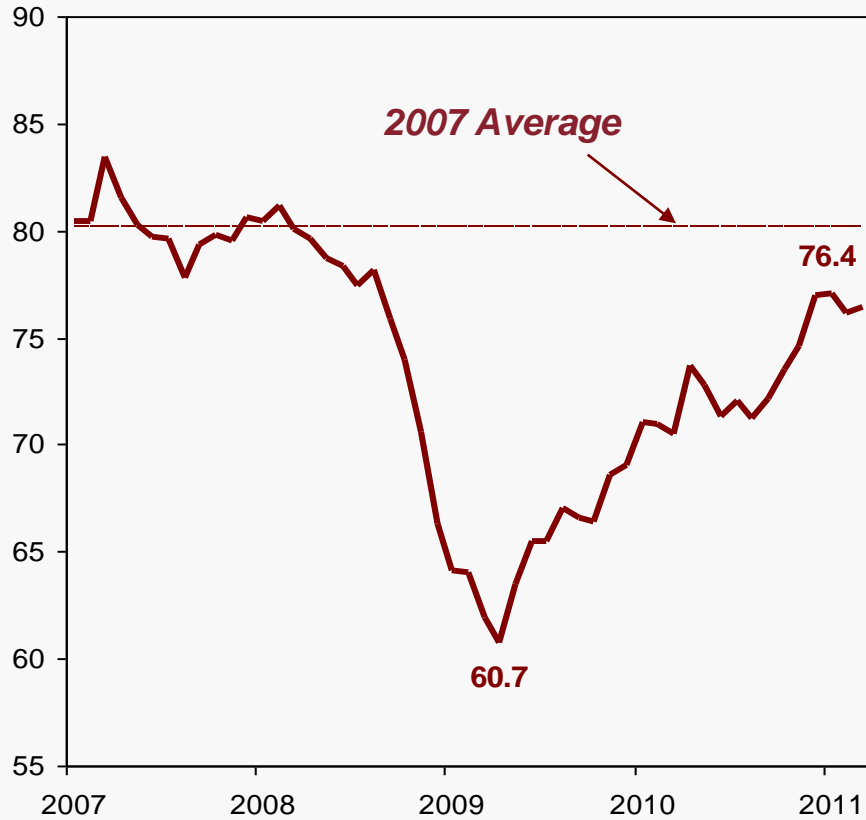
(Export-oriented manufacturing sectors, natural logarithm, 2008 Q1=1)



Source: TURKSTAT, CBRT

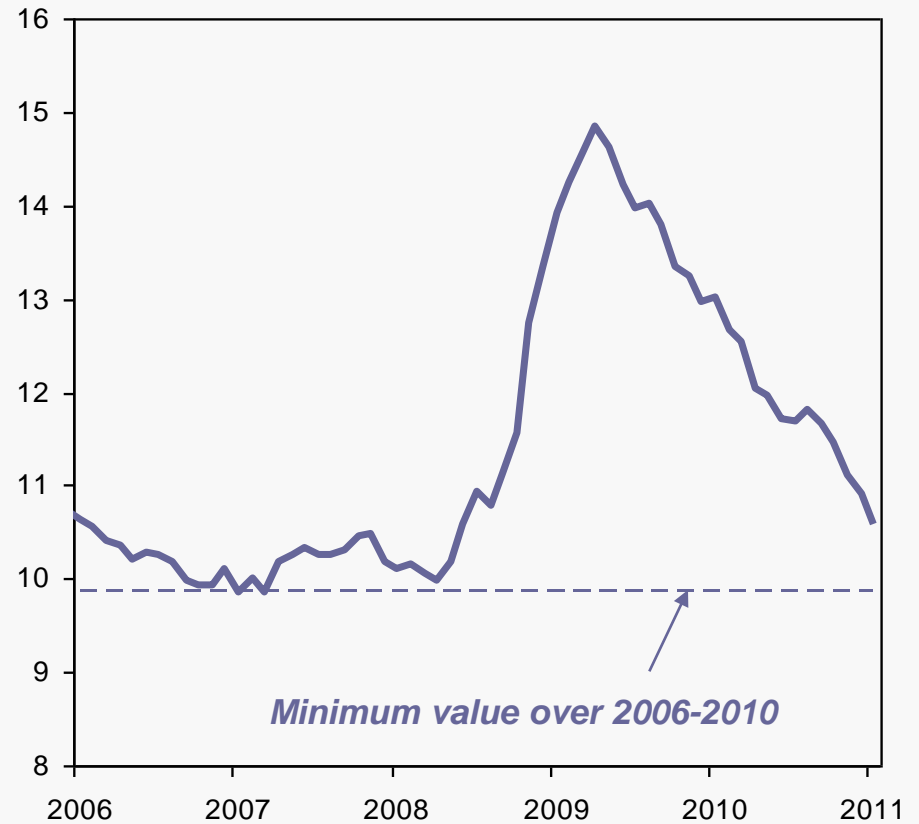
Capacity Utilization and Unemployment Gap: Turkey

Capacity Utilization Rate* (percent)



*Seasonally adjusted
Source: TURKSTAT, CBRT

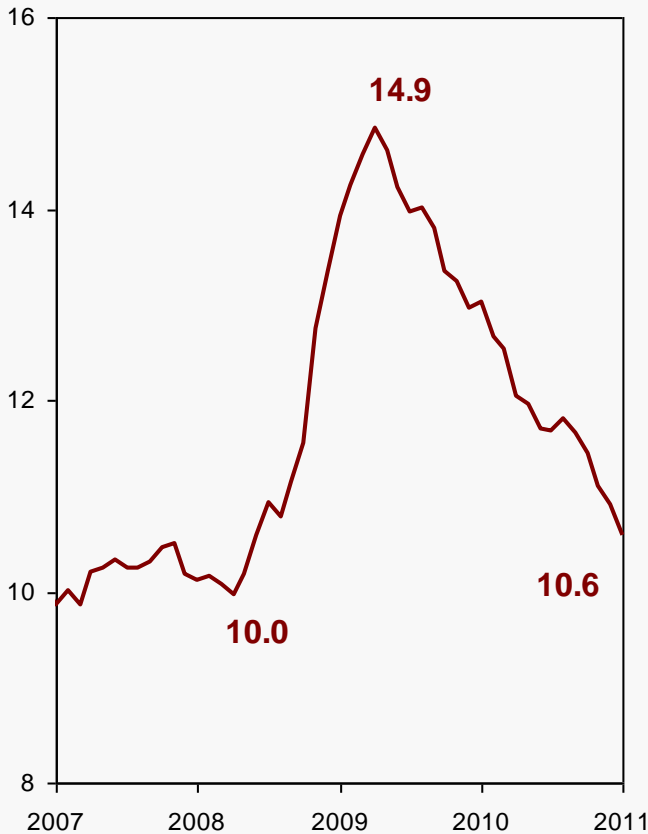
Unemployment Rate* (percent)



*Seasonally adjusted
Source: TURKSTAT, CBRT

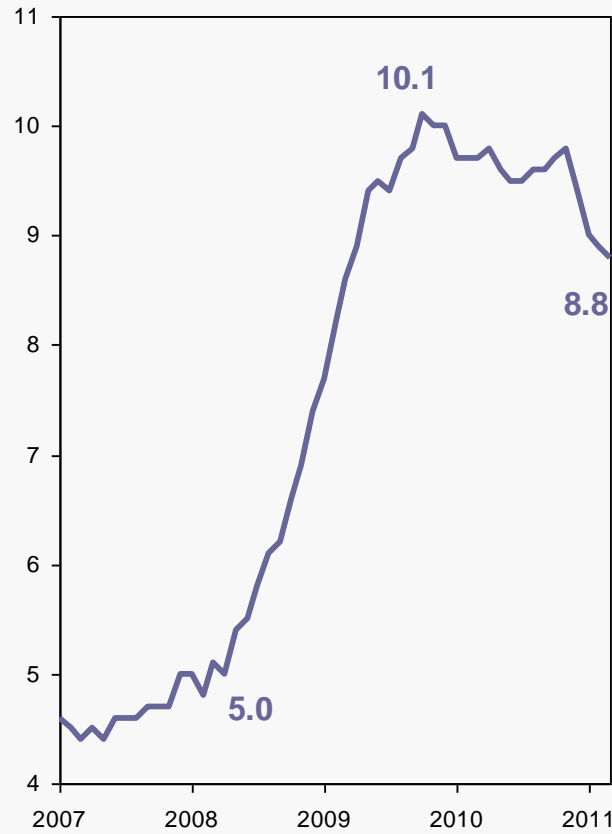
Unemployment Rates

Unemployment Rates in Turkey*
(percent)



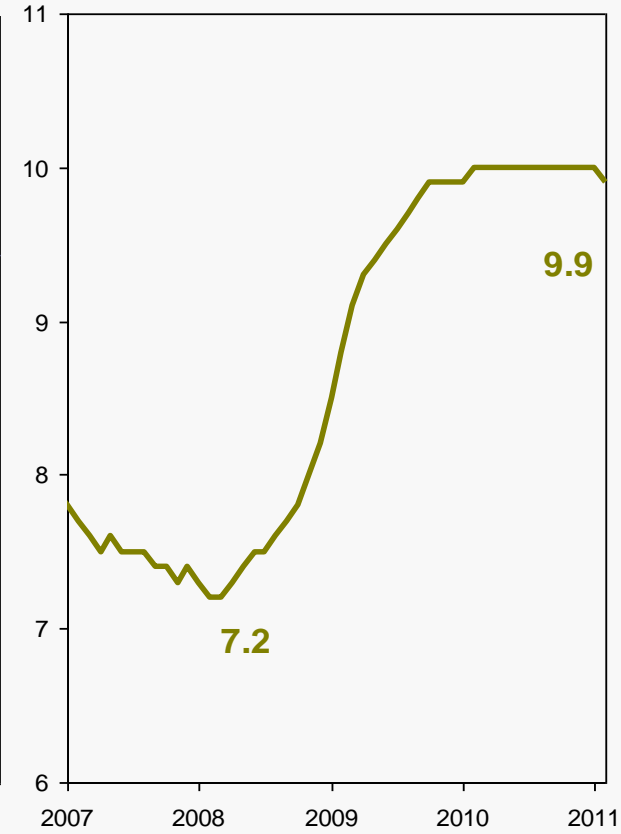
*Seasonally adjusted
Source: TURKSTAT, CBRT

Unemployment Rates in the USA*
(percent)



*Seasonally adjusted
Source: BLS, CBRT

Unemployment Rates in Euro Area*
(percent)

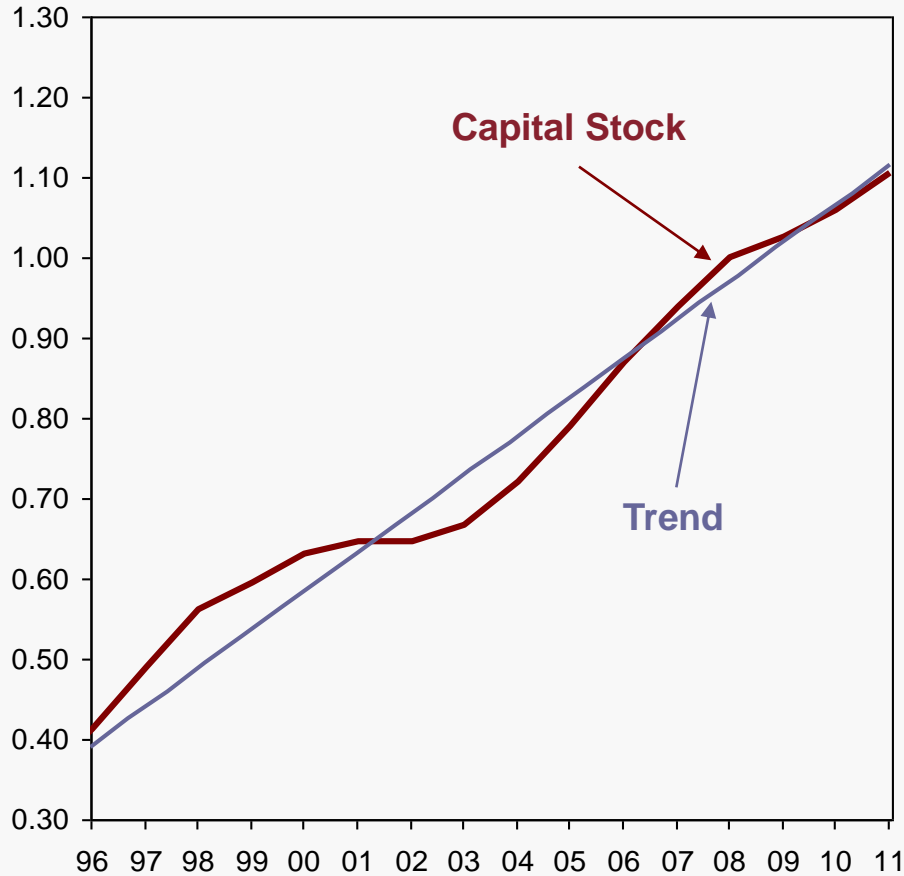


*Seasonally adjusted
Source: Eurostat, CBRT

Potential Production: Capital and Labor

Capital Stock

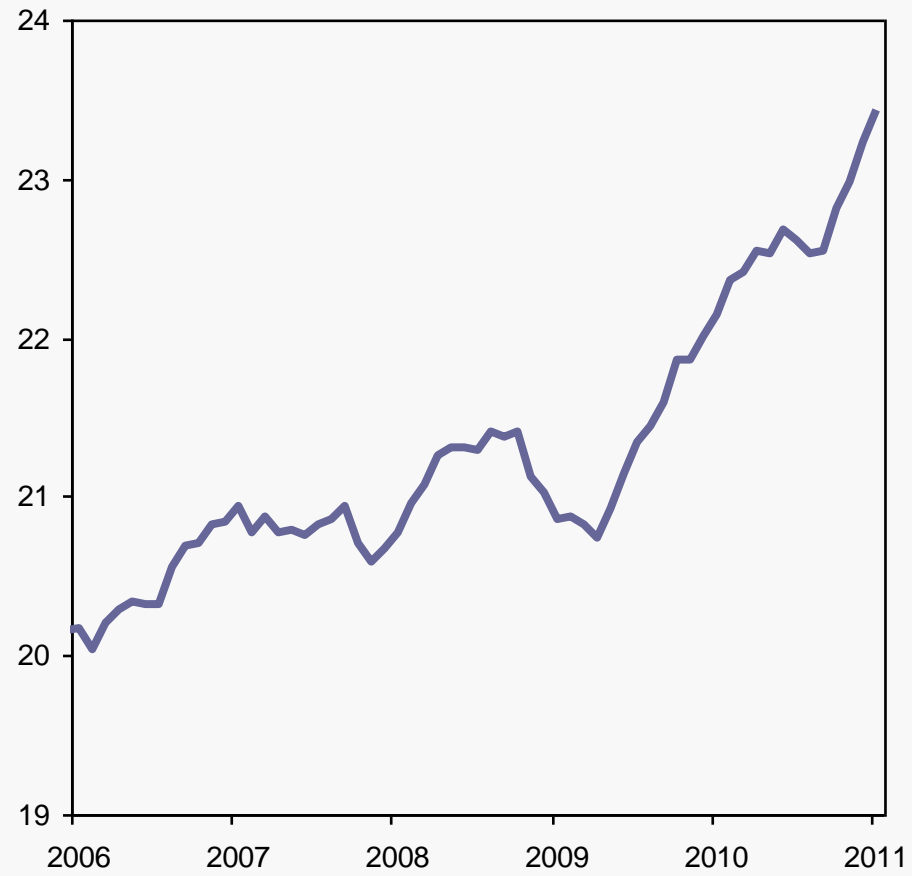
(constant prices, natural logarithm, 2008=1)



Source: TURKSTAT, CBRT

Total Employment*

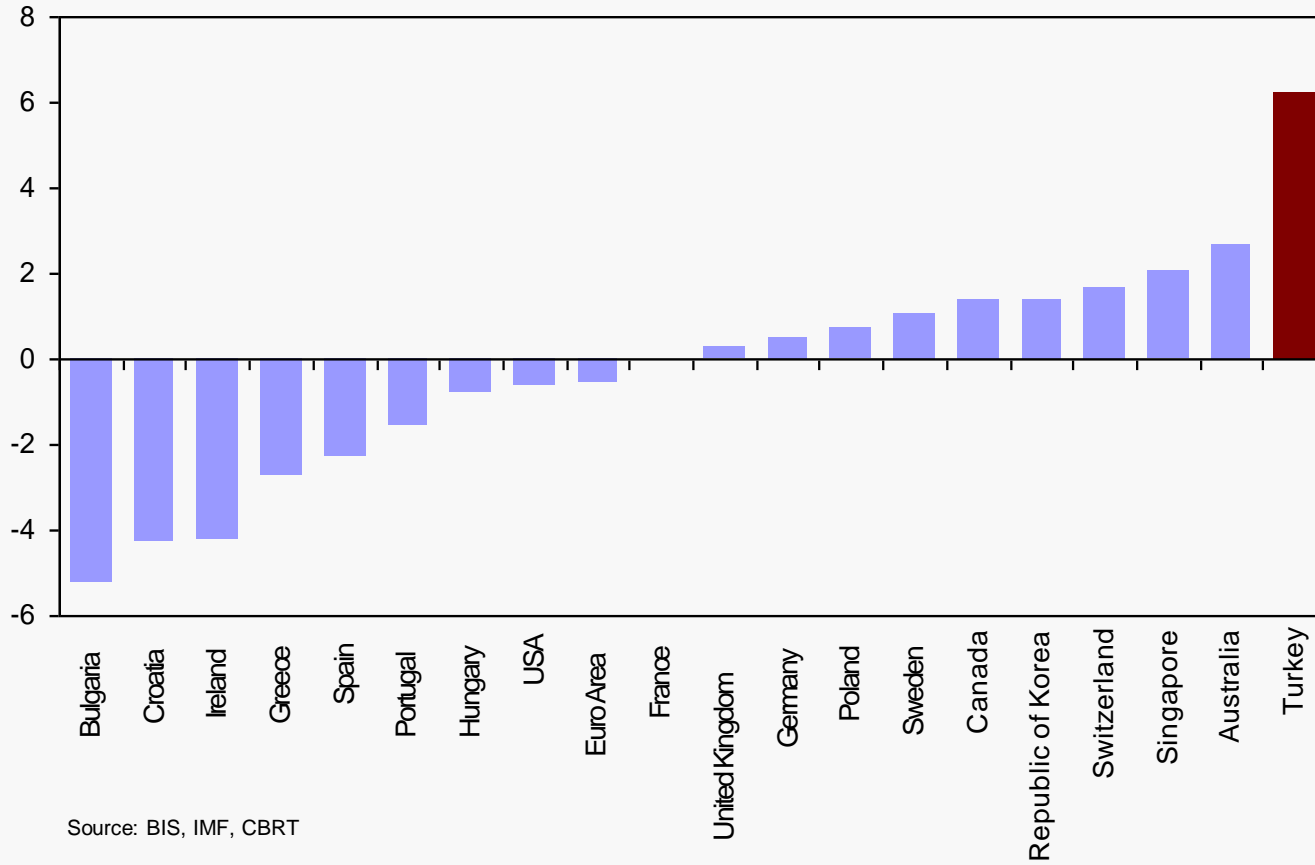
(million people)



*Seasonally adjusted
Source: TURKSTAT, CBRT

Employment Growth

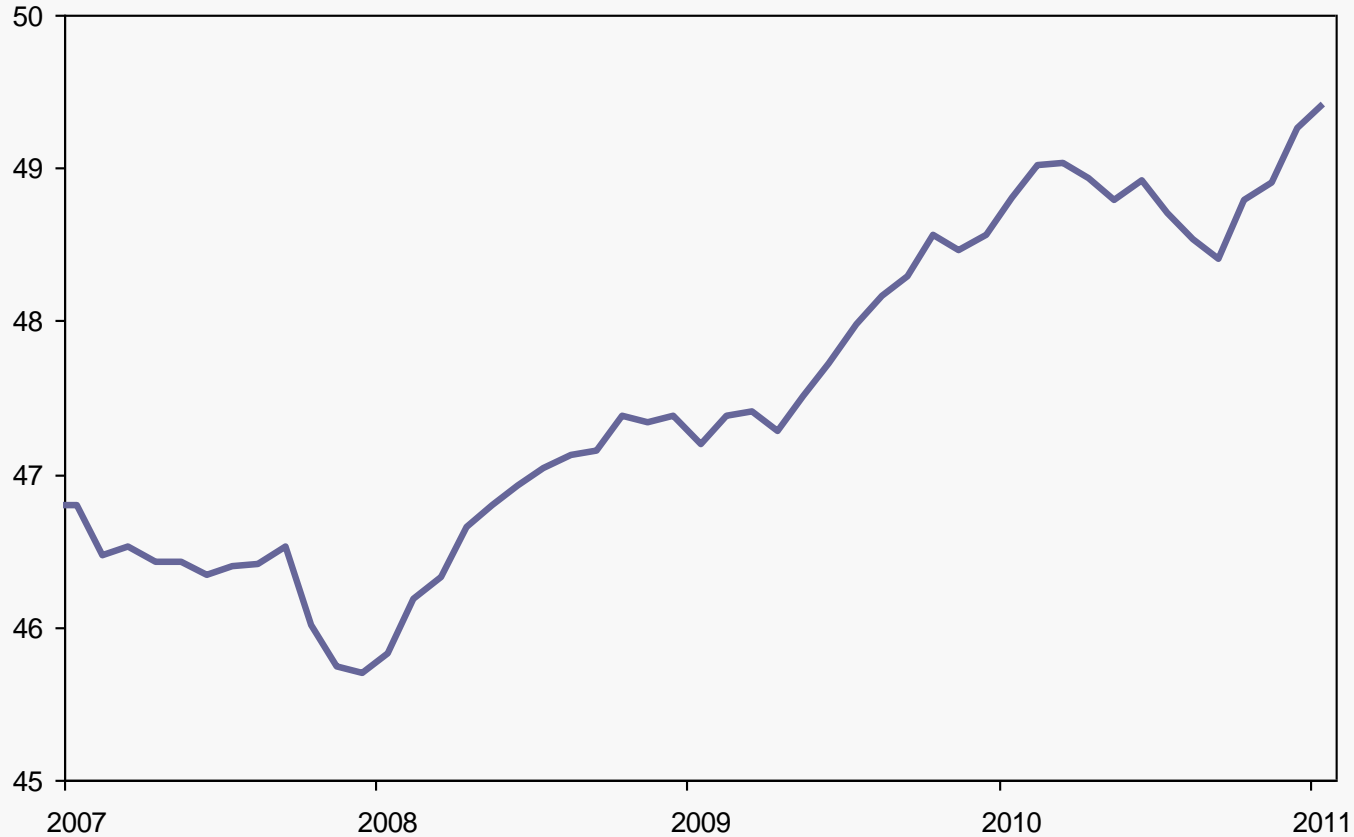
*Change in Employment in Turkey and in the World
(2010, percent)*



Source: BIS, IMF, CBRT

Labor Force Participation

Labor Force Participation Rate*
(percent)

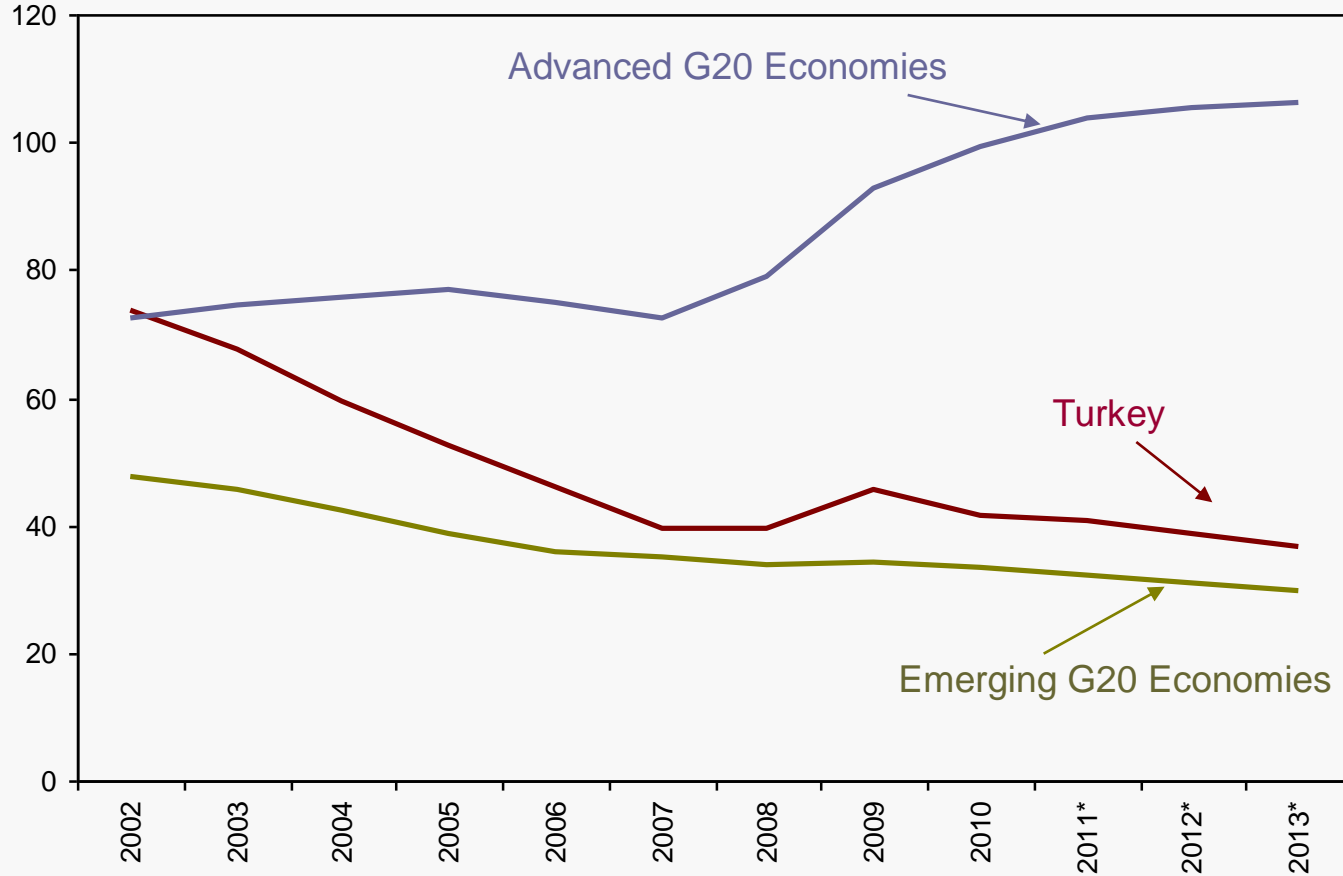


*Seasonally adjusted

Source: TURKSTAT, CBRT

Public Debt

Public Debt in Turkey and in G20 Countries
(Ratio to GDP, percent)



*Forecast

Source: IMF, Undersecretariat of Treasury, CBRT

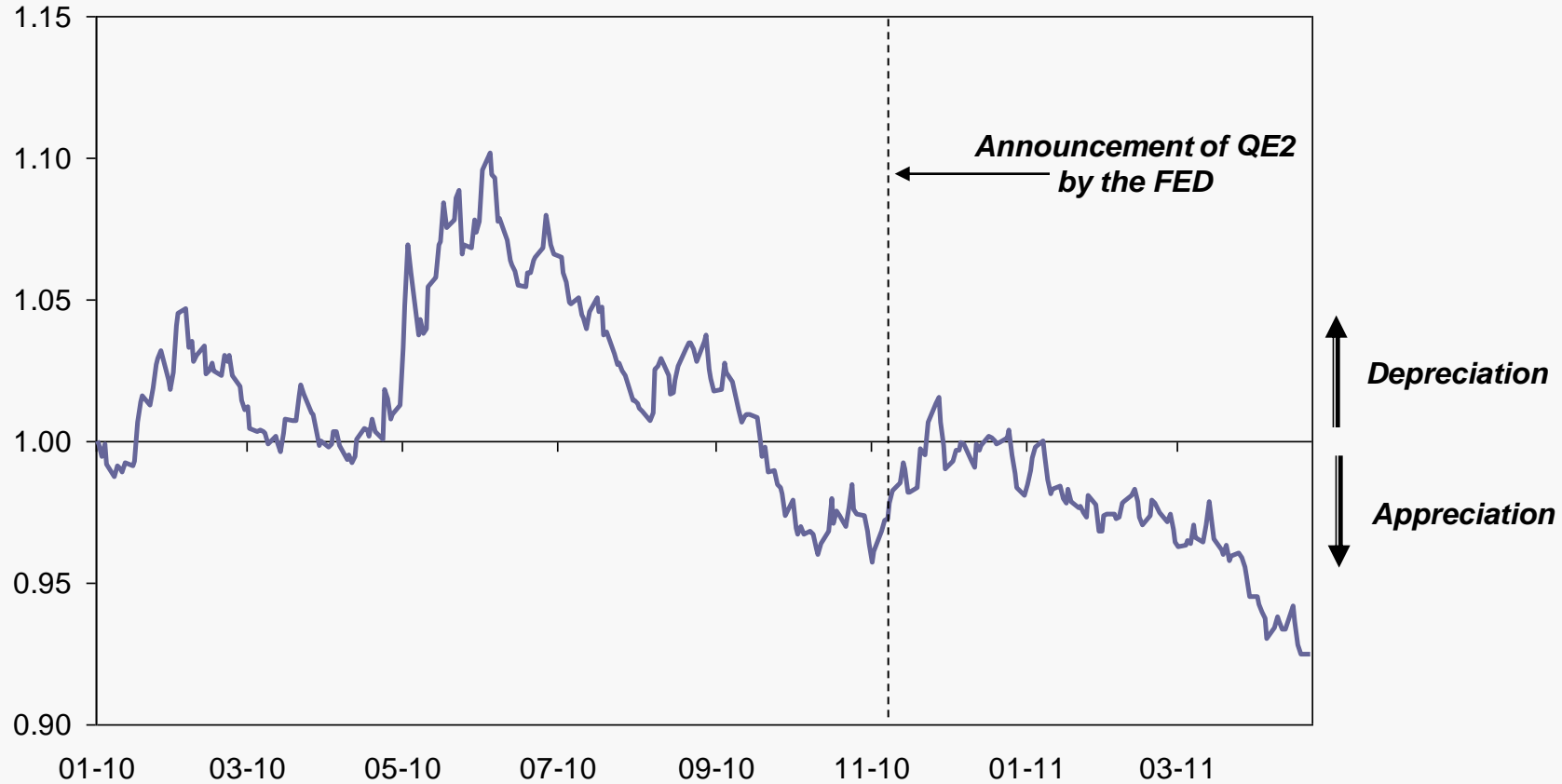
II. Monetary Policy in the Aftermath of the Crisis

Quantitative Easing vs. Quantitative Tightening

- Quantitative easing in major economies has continued in response to weakness in economic activity and heightened sovereign risks, resulting in unprecedented increases in central bank balance sheets.
- Facing a significant volume of capital inflows, some emerging economies have resorted to quantitative macroprudential tightening, even capital flow measures.
- Turkey has also initiated quantitative tightening via its exit strategy in April-November 2010 (QT1) and reserve requirement hikes after November 2010 (QT2).

Appreciation Pressure

USD against EM currencies*
(4 Jan 2010=1)



* Average of emerging market currencies including Brazil, Chile, Colombia, Czech Republic, Hungary, Indonesia, Mexico, Poland, Republic of Korea and South Africa.

Source: Bloomberg, CBRT

Two Different Approaches

- **Approach 1:** Use capital flow measures to restrict inflows while tightening via interest rates (Brazil, Republic of Korea)
- **Approach 2:** Use macroprudential measures to restrict domestic credit and domestic demand while keeping the short term interest rate differentials as low as possible (Turkey)

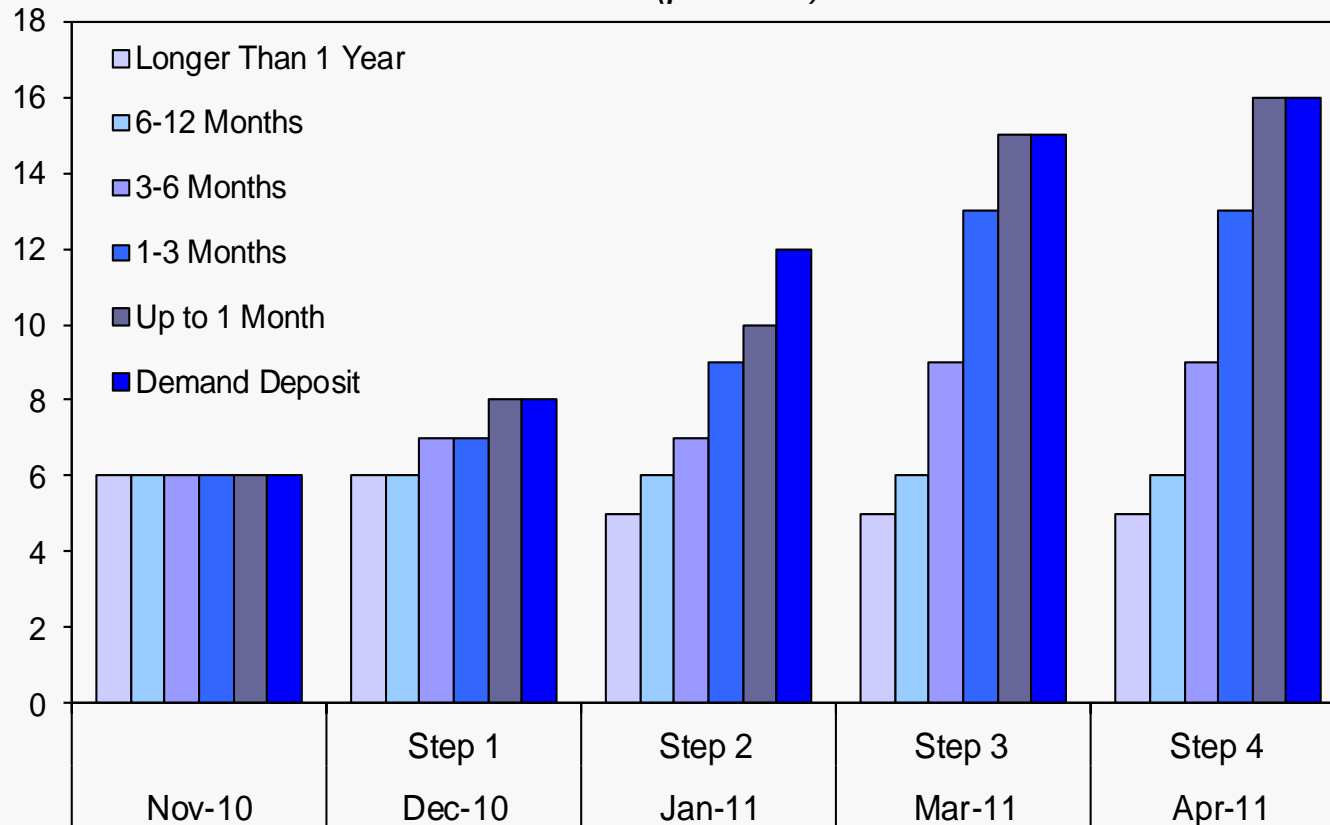
The New Policy Mix: Turkey

A lower policy rate, higher reserve requirement ratios and a wider interest rate corridor

- The framework we adopt in spirit is not significantly different from the conventional inflation targeting framework.
- The only difference is that, previously our policy instrument was the one-week repo rate, but currently our instrument is a “policy mix”
- We seek to use these instruments in the right combination in order to cope with both inflation and macro-financial risks.
- The monetary policy stance in this framework is determined not by policy rates alone, but as a combination of all the policy instruments.

Reserve Requirements as a Macroprudential Tool

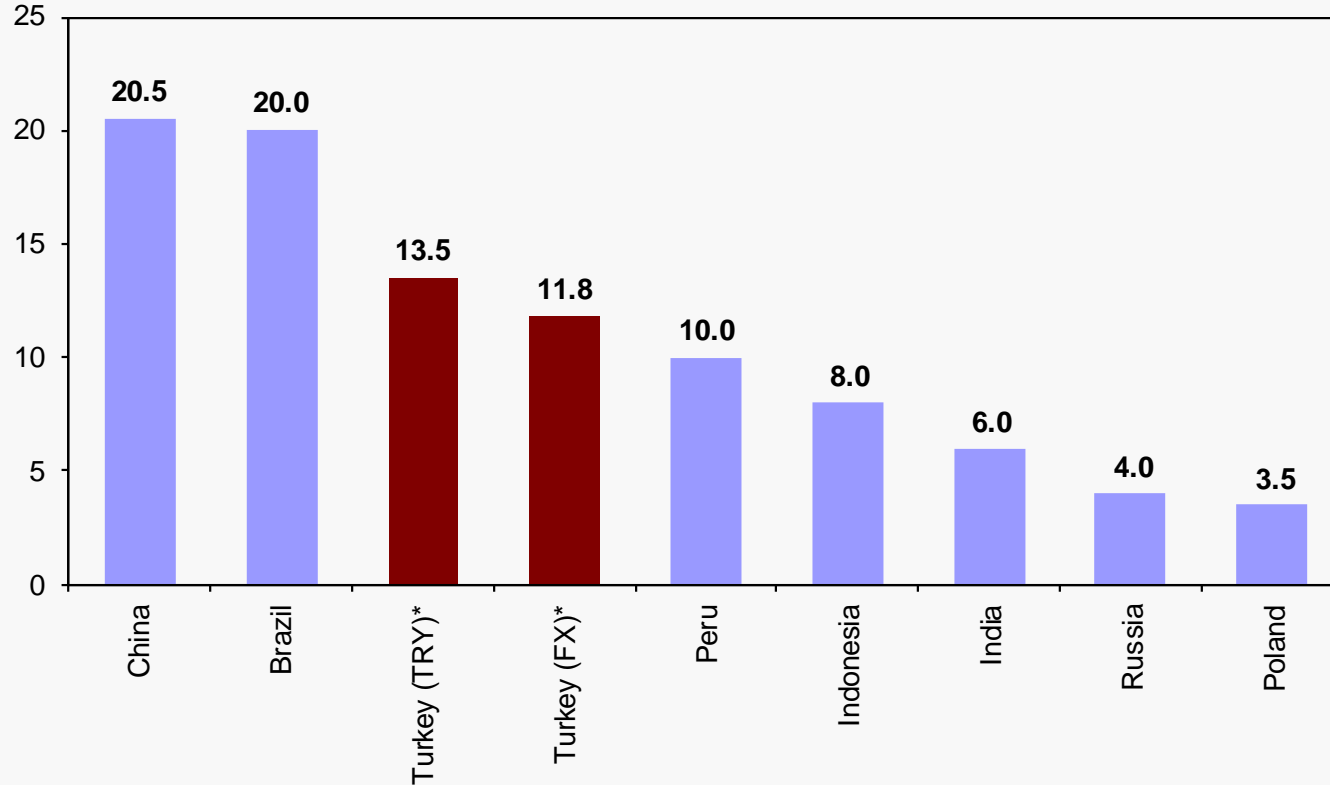
Reserve Requirement Ratios
(percent)



Source: CBRT

Reserve Requirements as a Macprudential Tool

Reserve Requirement Ratios
(percent)

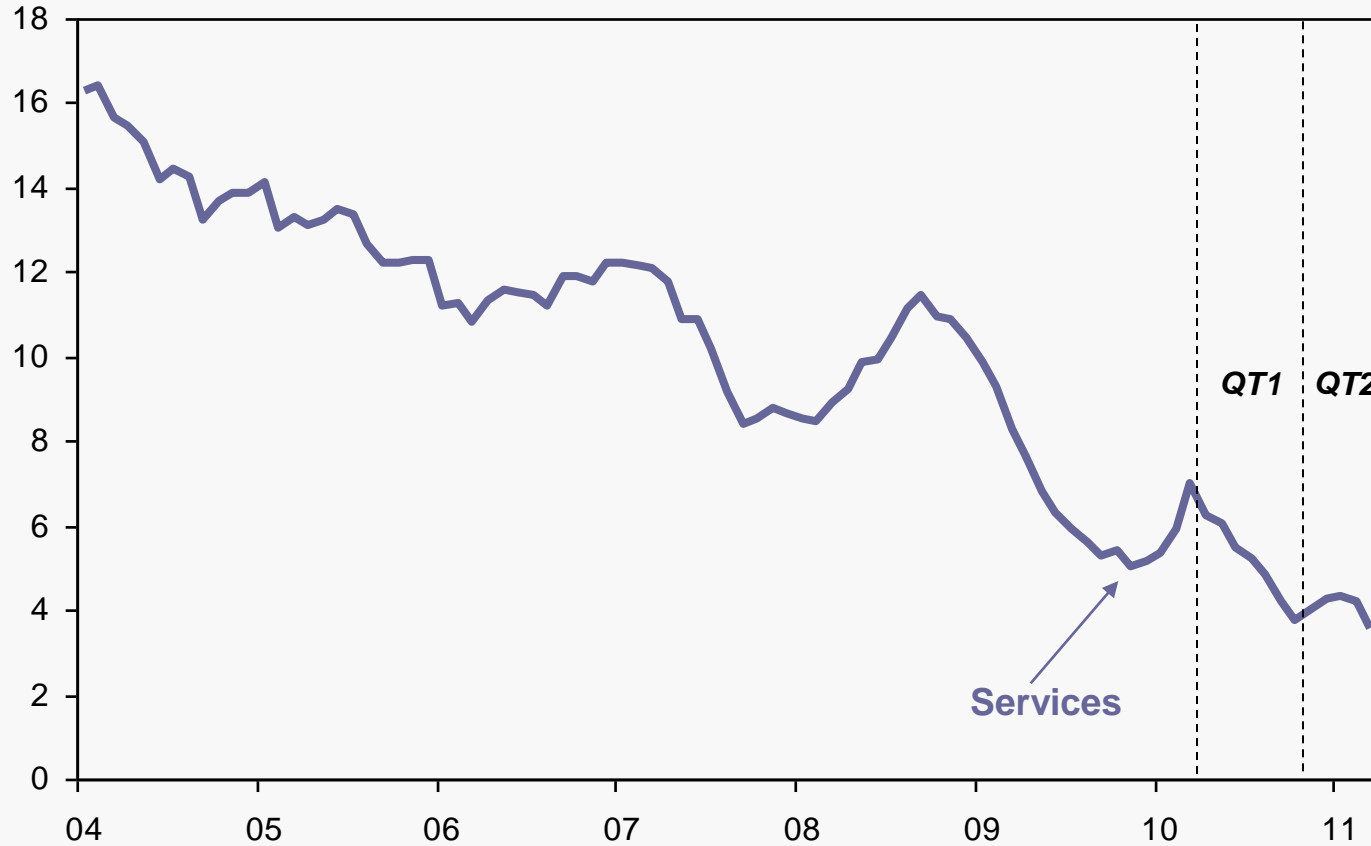


* Weighted averages

Source: Central Banks, CBRT

Disinflation via Quantitative Tightening

Services Prices
(year-on-year change, percent)



Source: TURKSTAT, CBRT

Goods Prices

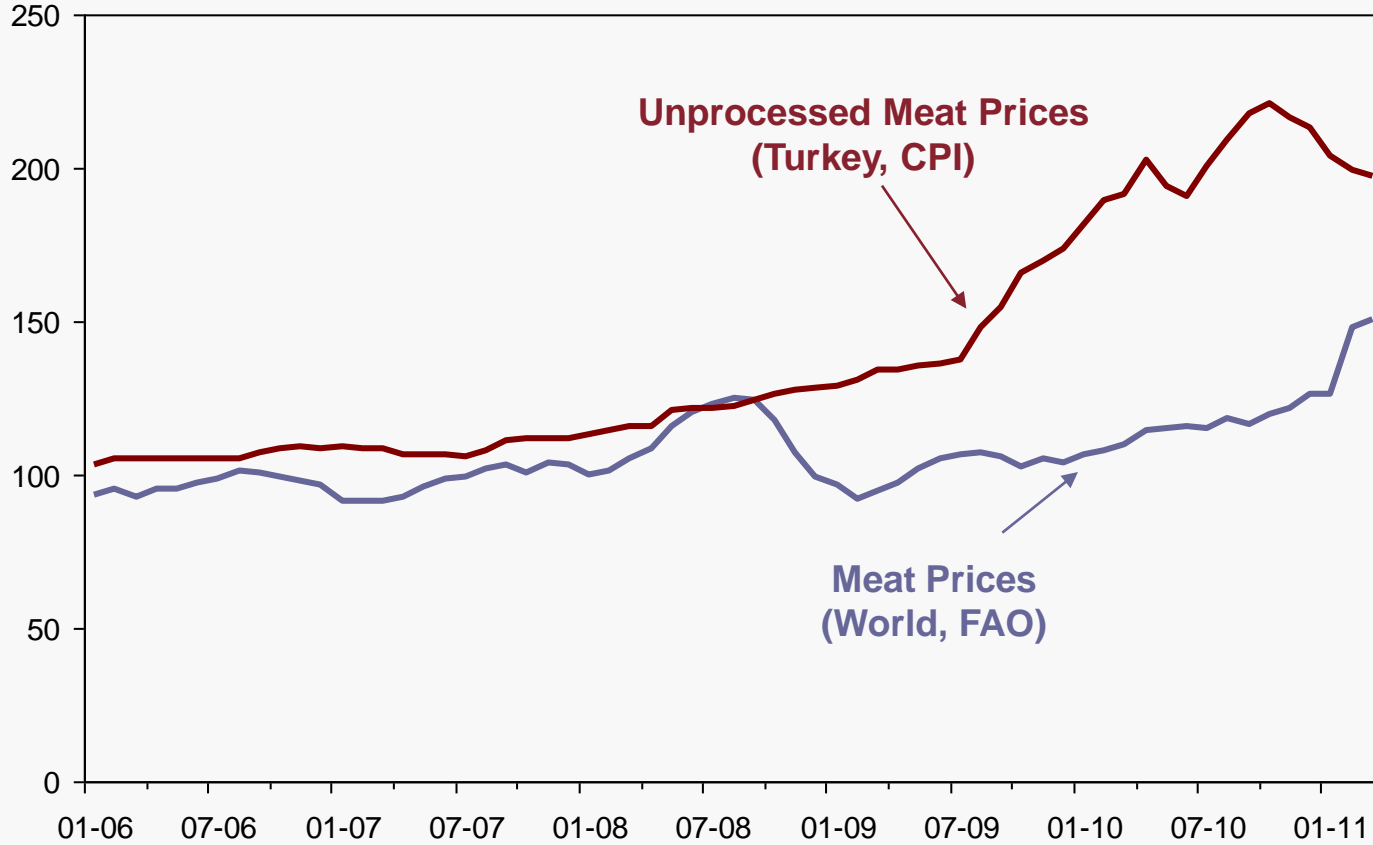
Goods and Services Prices
(year-on-year change, percent)



Source: TURKSTAT, CBRT

Food Prices

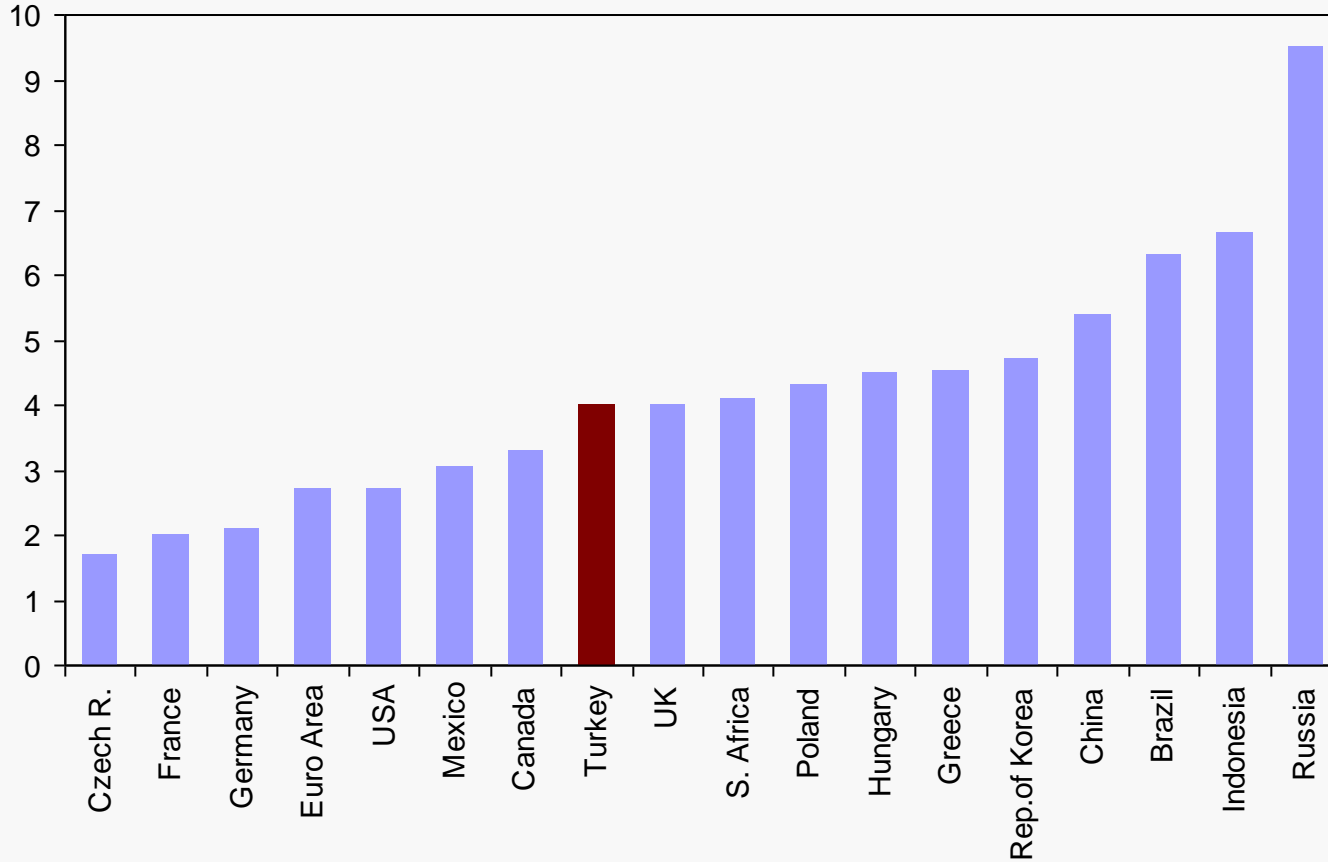
Meat Prices (2005=100)



Source: FAO, TURKSTAT, CBRT

Comparison of Inflation Rates

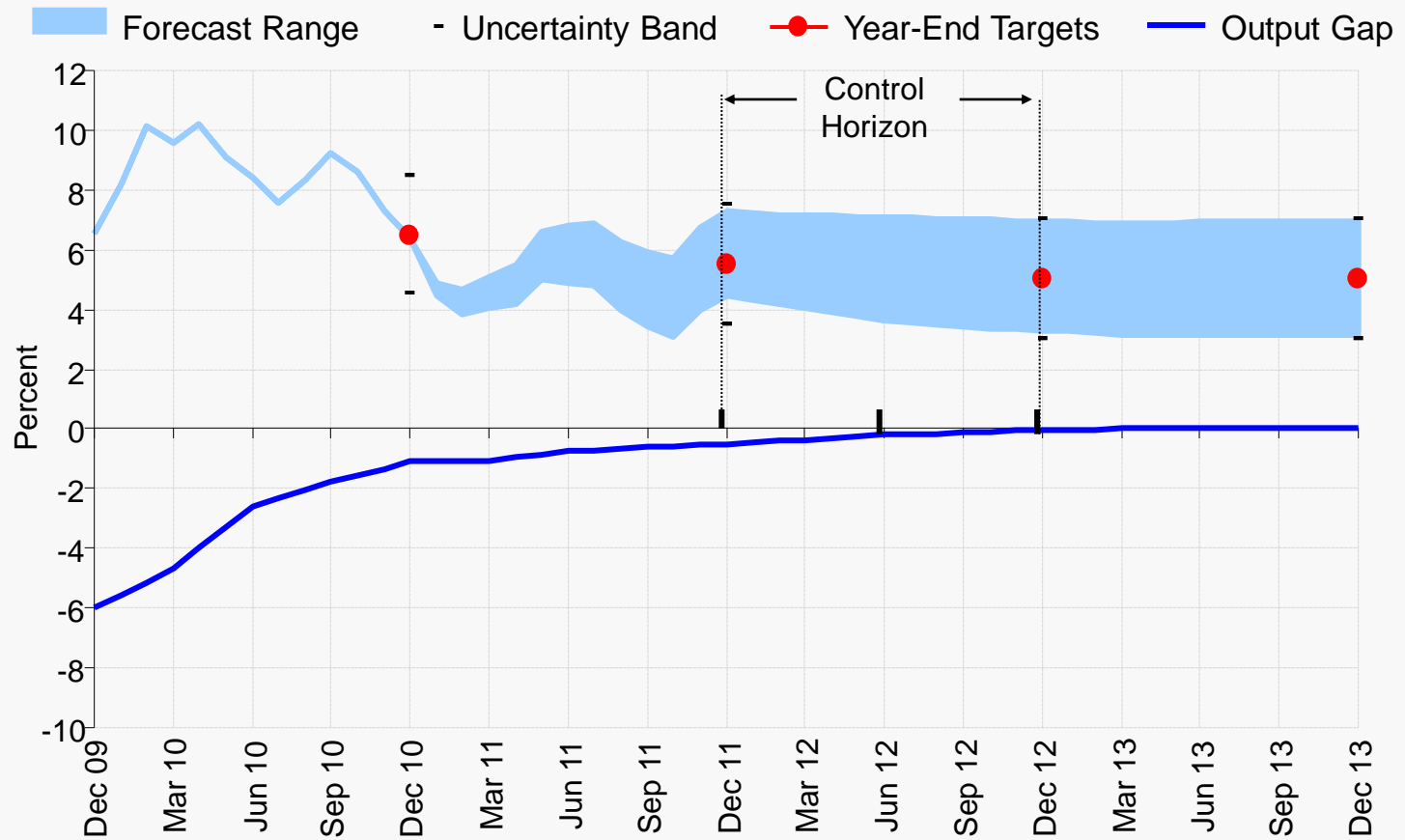
Inflation Rates in Turkey and around the Globe
(March 2011, percent)



Source: Bloomberg, CBRT

Price Stability

Inflation and Output Gap Forecasts



Source: CBRT

Financial Stability: Objectives

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 FX positions of public and private sectors
4. **Risk management processes and methods:** More effective management of all types of risks by all agents in the economy

Macroprudential Tools

- It does not seem to be possible to simultaneously ensure price stability and financial stability by means of policy rates alone.
- **Solution:** Using macroprudential instruments in coordination with all the relevant public authorities.
- **Macroprudential tools:**
 1. *Required reserve ratios*
 2. *Liquidity management of the Central Bank*
 3. *Capital adequacy ratios*
 4. *Liquidity adequacy ratios*
 5. *Taxes*
 6. *Primary expenditures of government*

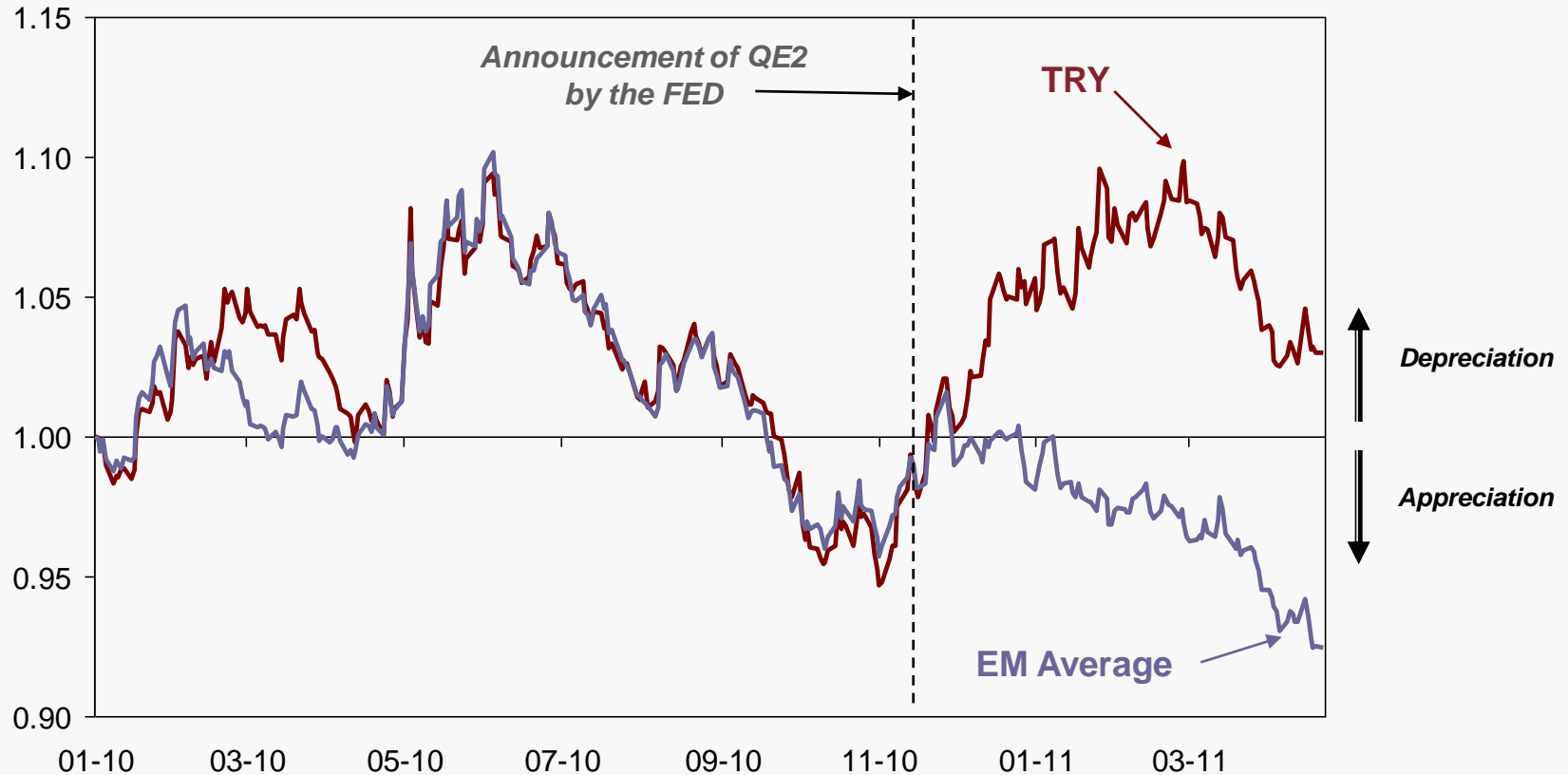
Measures Taken by Other Authorities

1. Fiscal discipline
2. Ban on FX loans to households
3. Domestic currency bond market
4. Loan/value restrictions
5. Tax hikes on certain consumer loans
6. Restrictions on credit card borrowing

III. Policy Outcomes

Effects on the Exchange Rate

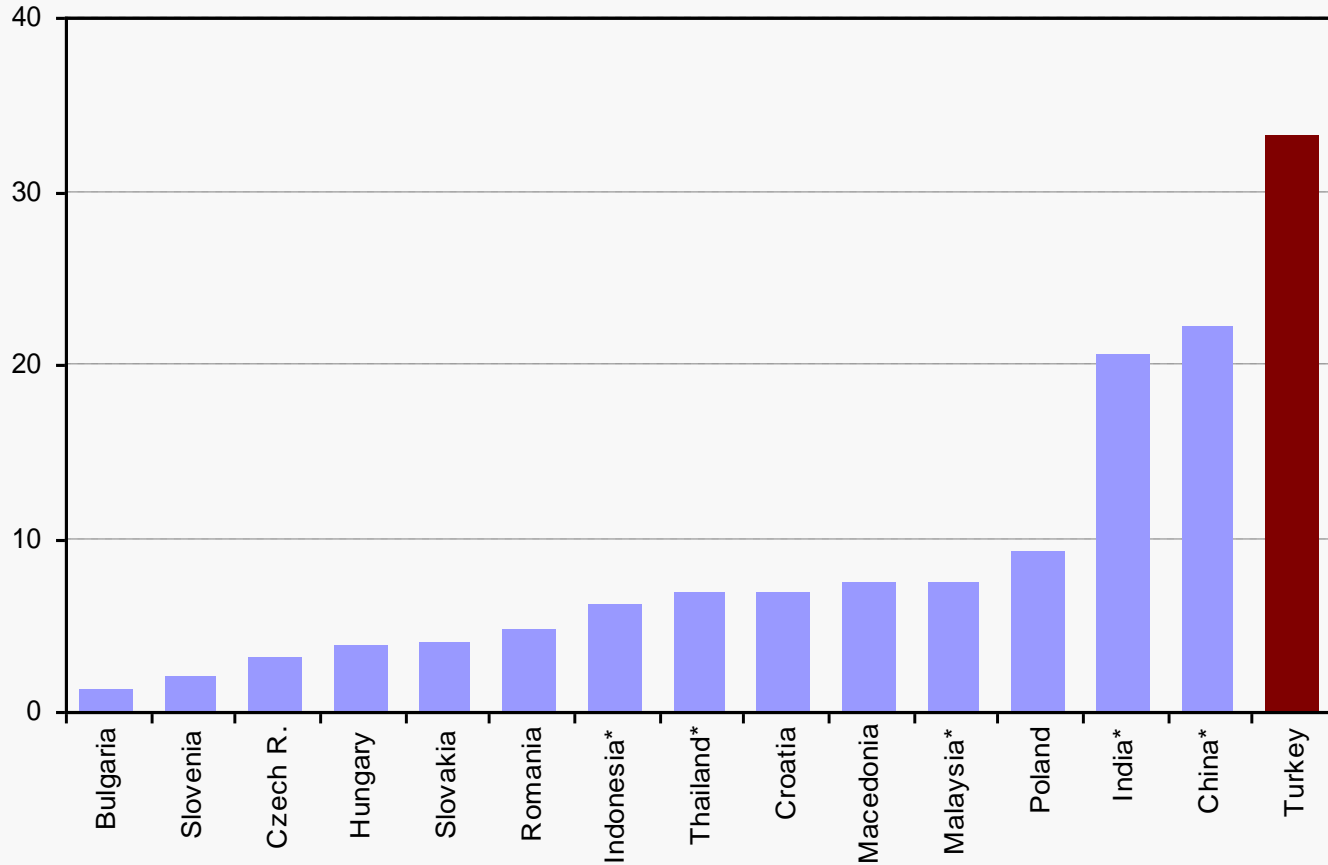
USD against EM Currencies and TRY*
(4 Jan 2010=1)



* Average of emerging market currencies including Brazil, Chile, Colombia, Czech Republic, Hungary, Indonesia, Mexico, Poland, Republic of Korea and South Africa.
Source: Bloomberg, CBRT

Rate of Increase in Bank Loans

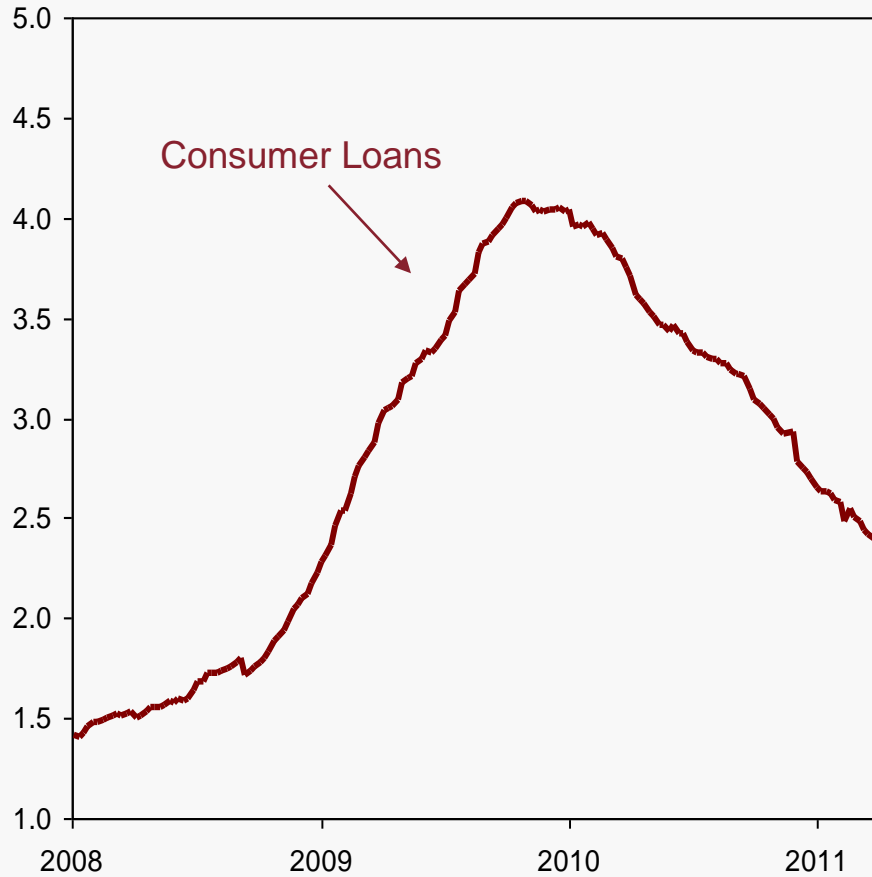
Change in Bank Loans
(year-on-year, percent, 2010)



*Annual change to June 2010
Source: BIS, IMF, CBRT

Non-Performing Loans

NPL Ratios
(percent)



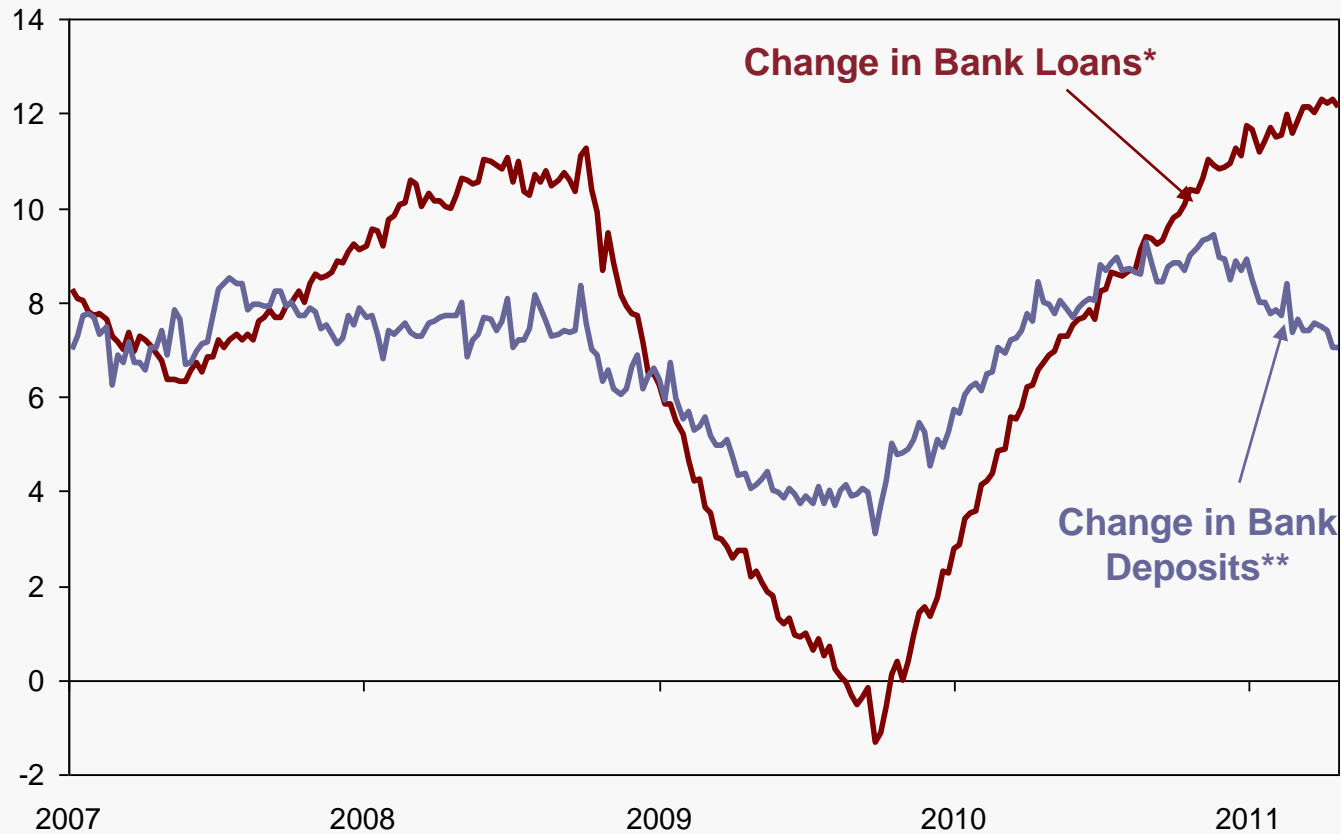
Source:CBRT



Source:CBRT

Loans and Deposit Growth

Change in Loans and Deposit-to-GDP Ratio
(year-on-year, percentage points)



* Adjusted for the exchange rate effect using a basket of 30% euro, 70% US dollar.

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Source: TURKSTAT, CBRT

Current Account Deficit

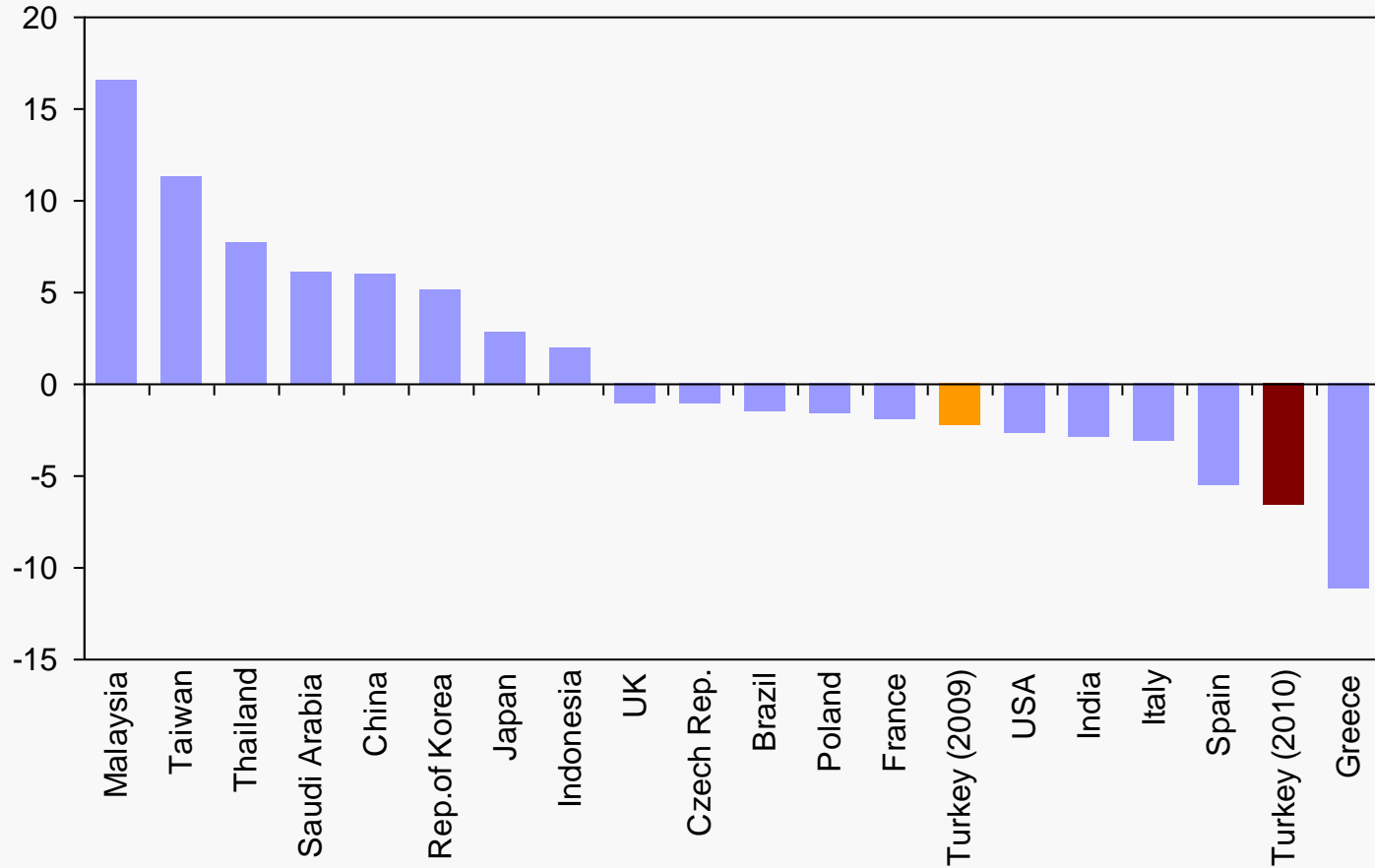
Current Account Balance
(ratio to GDP, percent)



Source: TURKSTAT, CBRT

Current Account Deficit: A Comparison

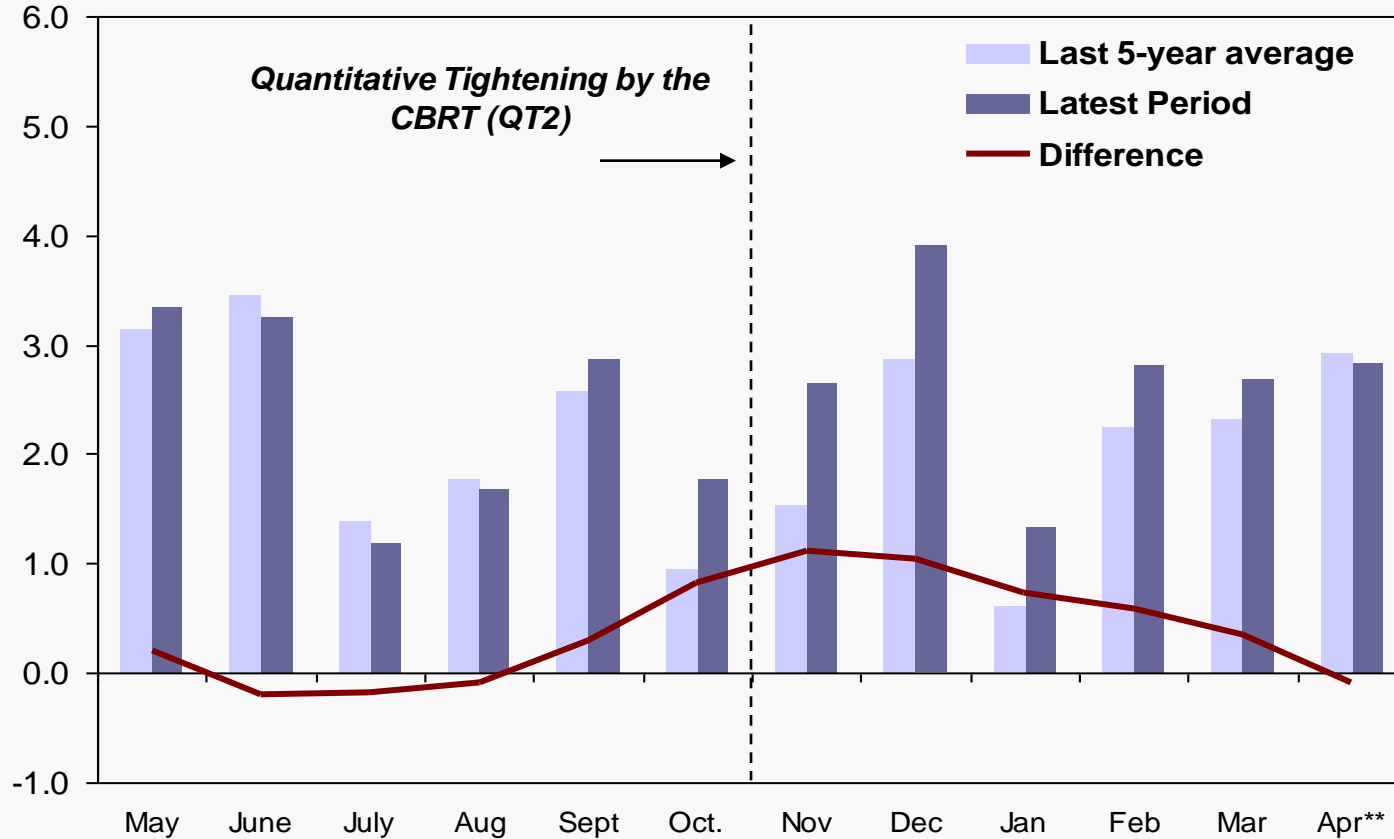
Current Account Balance
(2009, percent of GDP)



Source: IMF, CBRT

Credit Growth: Monthly Developments

Total Loans*
(monthly change, percent)



*Adjusted for the exchange rate effect using a basket of 30% euro, 70% US dollar.

** Monthly percentage change in credit volume as of 19 April of the respective year.

Source:CBRT

Outcome

1. Strong growth maintains.
2. No signs of overheating yet.
3. Oil and other commodity prices will temporarily add on inflation.
4. The excessive rate of increase in private sector's debt is contained through measures.

IV. Global Risks

Global Risks

1. **Public Debt Problem**: The USA, European Union and Japan
2. **Geopolitical Risks**: Unrest in the Middle East and North Africa

Measures Against Global Risks

1. Maintaining the fiscal discipline
2. Ensuring a more controlled and sound increase in private sector's debt
3. Speeding up of structural reforms, primarily the energy investments

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