

VAKIFBANK TURKISH ECONOMY WEEKLY

CBRT Keeps Rates on Hold...

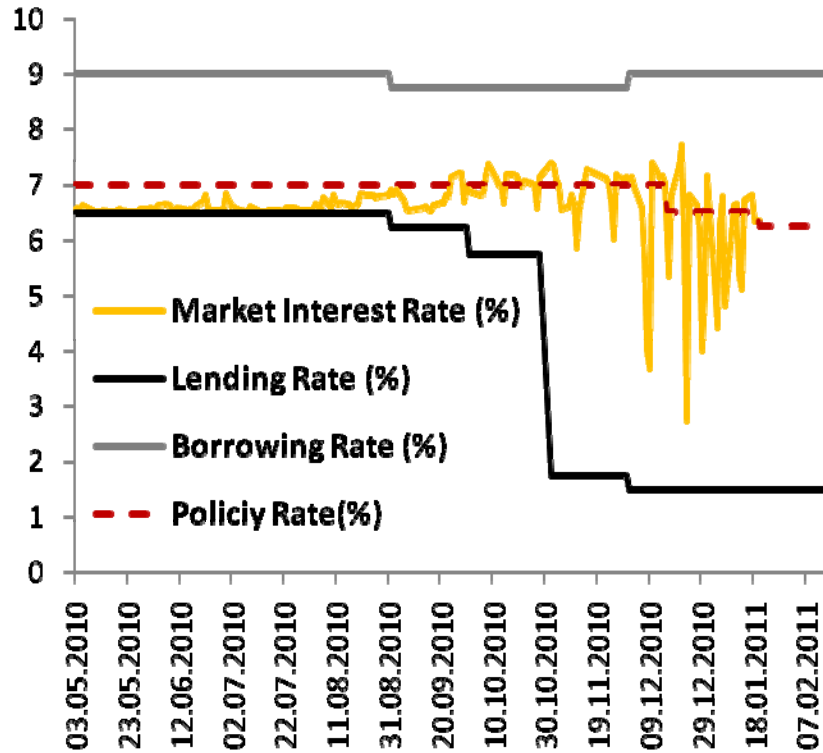


T. Vakıflar Bankası T.A.O



CBRT kept its policy rate at 6.25% in line with the market expectations...

Corridor System and O/N Interest Rate (%)



Source: CBRT, Reuters

✓ Last week at Monetary Policy Committee (MPC) meeting, CBRT kept its policy rate unchanged at 6.25% in line with the expectations and did not change the lending and borrowing rates.

✓ Overnight Interest Rates;

✓ Borrowing rate at 1.50%

✓ Lending rate at 9%

✓ The interest rate on borrowing facilities provided for primary dealers via repo transactions at 8%

✓ Late Liquidity Window Interest Rates (between 4:00 p.m.–5:00 p.m.);

✓ Borrowing rate at 0%,

✓ Lending rate at 12%.

CBRT emphasized the upside risks on prices due to the high energy and other commodity prices...

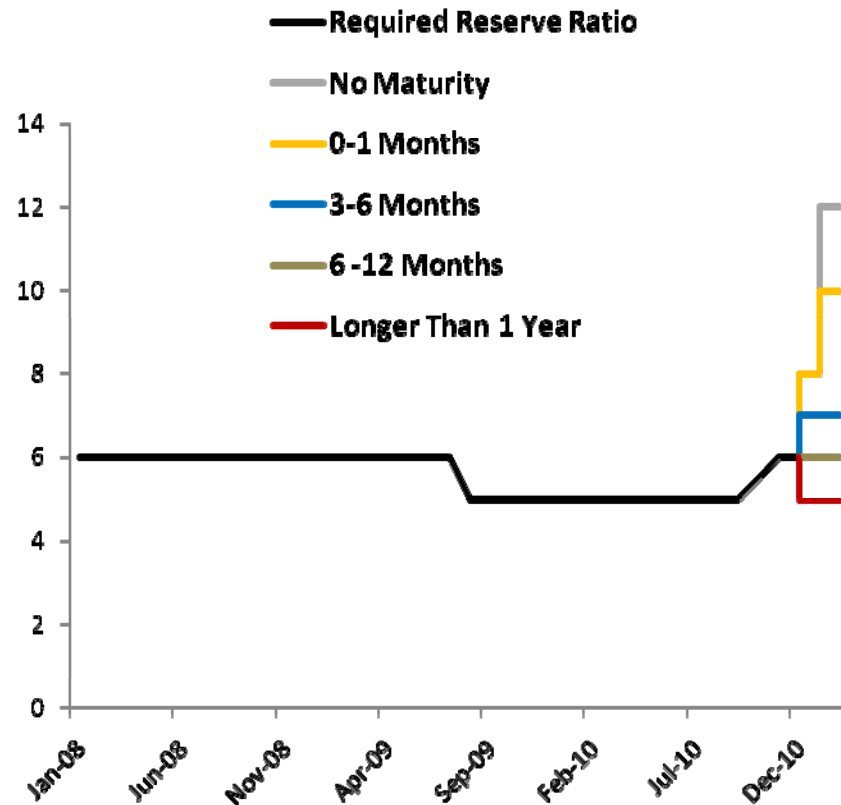


CBRT's February statement appears to be more cautious compared with the previous one. In particular;

- ✔ Recent macro economic datas have been consistent with the outlook presented in the January Inflation Report.
- ✔ Thanks to increasing domestic demand, economic activity continues to recover.
- ✔ Although external demand has started to recover, it is still relatively weak.
- ✔ Employment conditions continue to improve, but unemployment rate remains at high levels.
- ✔ Annual inflation will occur at the level close to the January Inflation Report forecast.
- ✔ The measures which have been taken by CBRT since November, limit import demand and this reduce macro-financial risks by leading to a more balanced growth.
- ✔ The monetary tightening will limit demand related pressures on inflation.
- ✔ Rising energy and other commodity prices are supply related risks on inflation outlook.

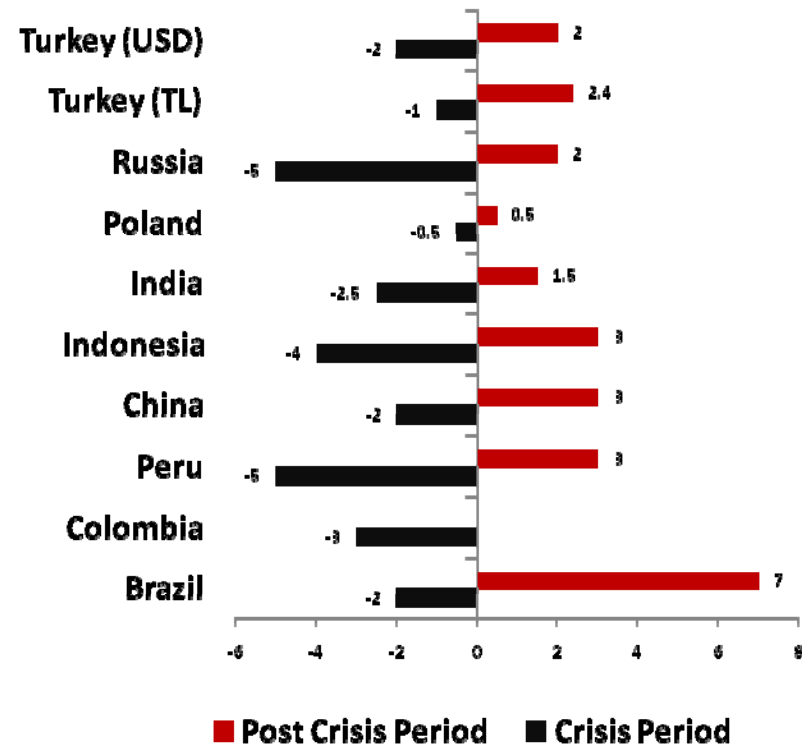
The CBRT left the RRRs unchanged...

CBRT left the RRRs unchanged to observe the impact of recent macro-prudential measures on credit growth and domestic demand. After crisis many emerging countries like Turkey have increased RRR. Especially, Brazil has hiked RRR at most to slow down capital inflows.



Source: CBRT

Reserve Requirement Rate Changes



Source: CBRT, Bloomberg

Can CBRT continue to keep rates constant?



CBRT has decided to keep the policy rates constant in line with the market expectations. The reasons behind CBRT's last policy decision and its future policies are analyzed under 3 headlines.

1- As many EM countries are expected to continue rate hikes, CBRT do not want to deepen the interest rate difference between Turkey and other EM countries.

2-CBRT keeps rates on hold in order to prevent disorderly TRY weakness.

3-Upward pressure on inflation will weaken the case for another rate cut.

1-As many EM countries are expected to continue rate hikes, CBRT do not want to deepen the interest rate difference between Turkey and other EM countries...



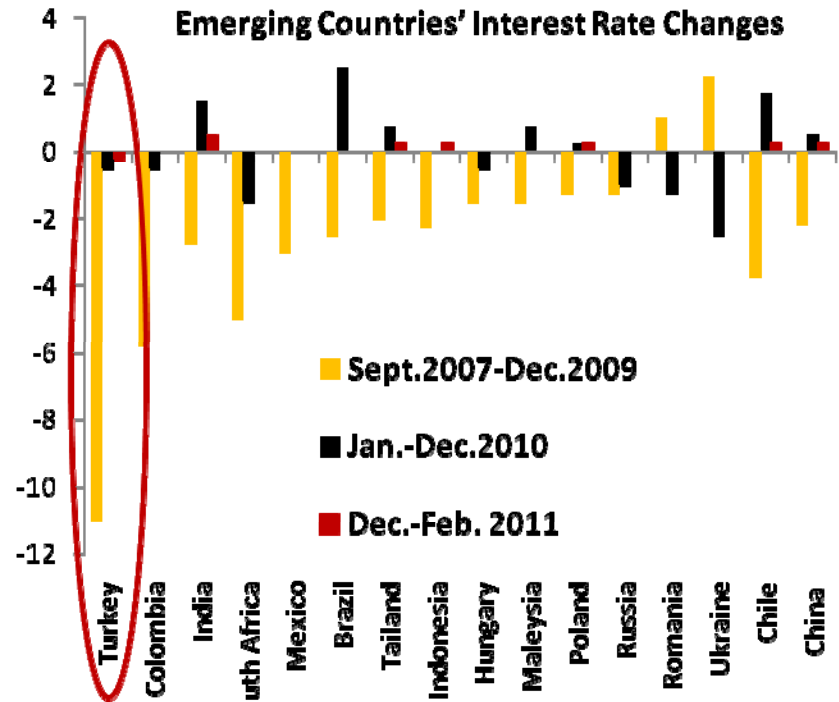
As Turkey needs high foreign capital inflows in order to finance its high current account deficit, CBRT has to consider other EM countries' rates together with inflation and growth in its monetary policy. Since high interest rates have attracted short term capital, Turkey should not want to lose its competitiveness by relatively low interest rates.

Hence;

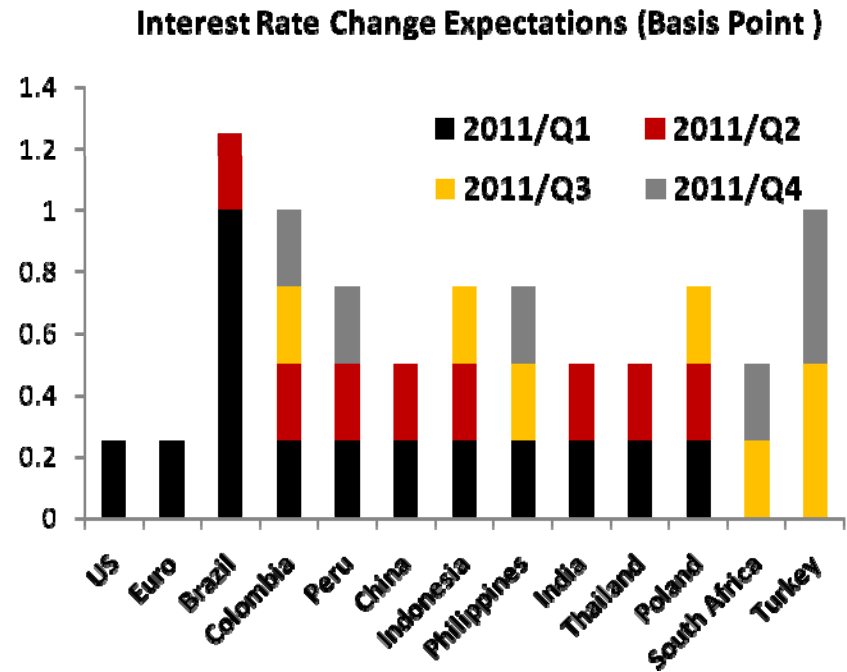
- Many EM countries are expected to continue rate hikes
- Recent politic instability in Middle Eastern countries increased risk perception towards EMs

↓

- CBRT wants to follow 'a wait and see approach' until the next meeting, concerning recent emerging countries assets sell off.

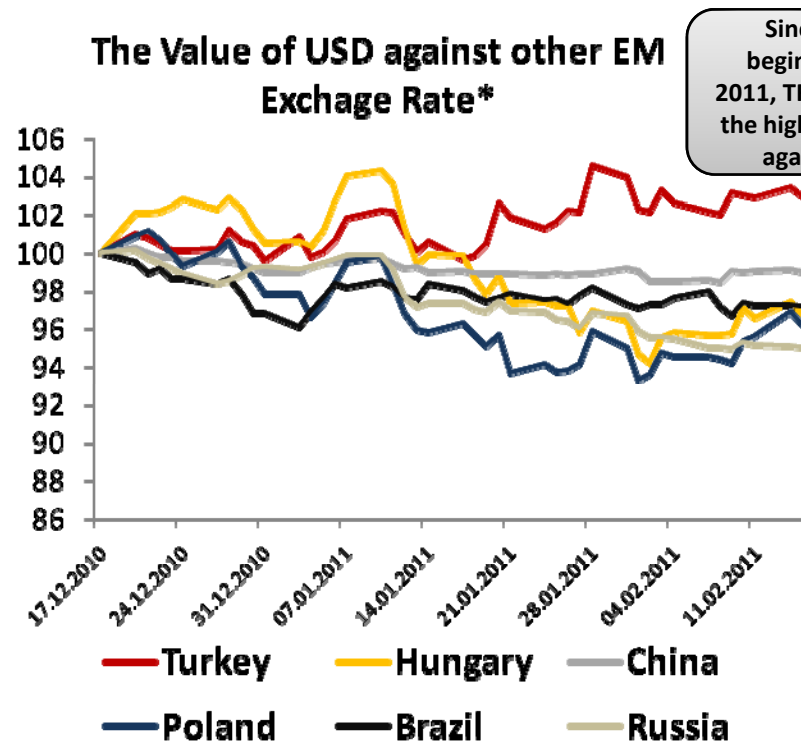


Source:Reuters



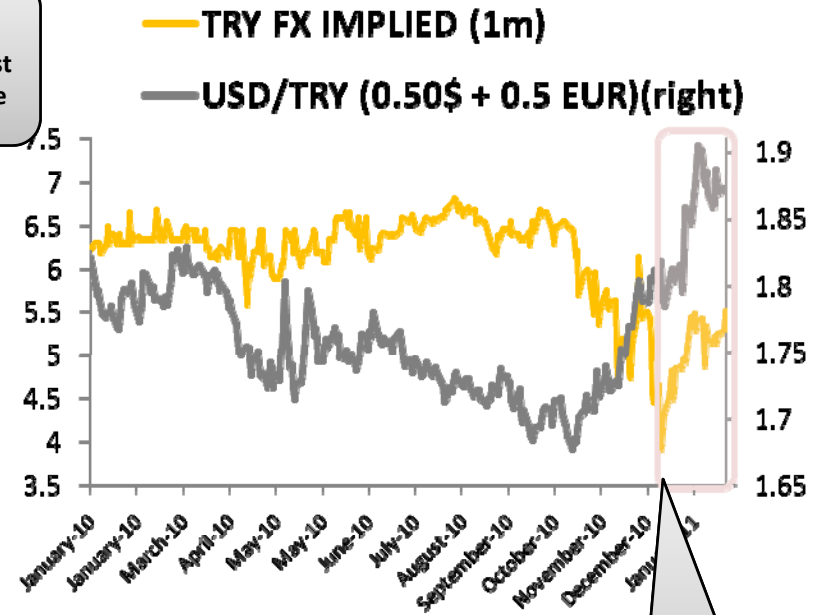
Source:Bloomberg

2- CBRT keeps rates on hold in order to prevent disorderly TRY weakness...




* Indexed by taking 17.12.2010 100

Source: Reuters



Source: Reuters

After rate cut, the volatility in USD/TRY has increased rapidly and financial market uncertainty has depressed.

 Last two rate cut decisions aim to reduce the current account deficit by making TRY weaker. After these rate cuts in December and January, USD/TRY has risen parallel to the aim of CBRT but the increasing volatility in FX market that increases the uncertainty in financial markets is remarkable at the same time. Thus, CBRT keeps rates on hold in order to prevent disorderly TRY weakness.

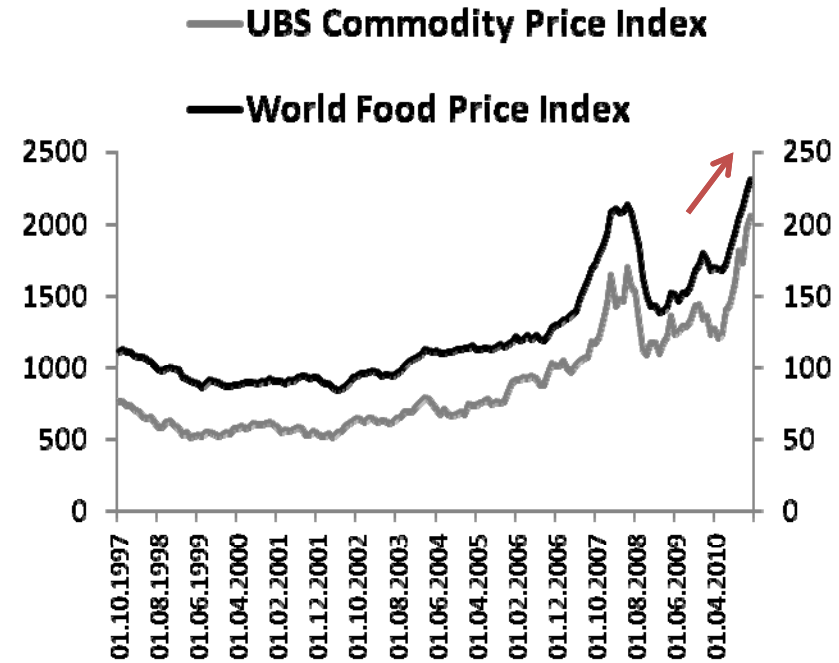
3-Upward pressure on inflation will weaken the possibility of another rate cut...

The Impact of USD/TRY and Commodity prices on CPI


$P(CPI=\uparrow \cdot)^*$	>0.5	<0.5	>0.5
USD/TRY	↑	↓	↑
Food Price	↑	↑	↓
Commodity Price	↑	↑	↓

*The conditional probability of increase in CPI given USD/TRY, food and oil price change

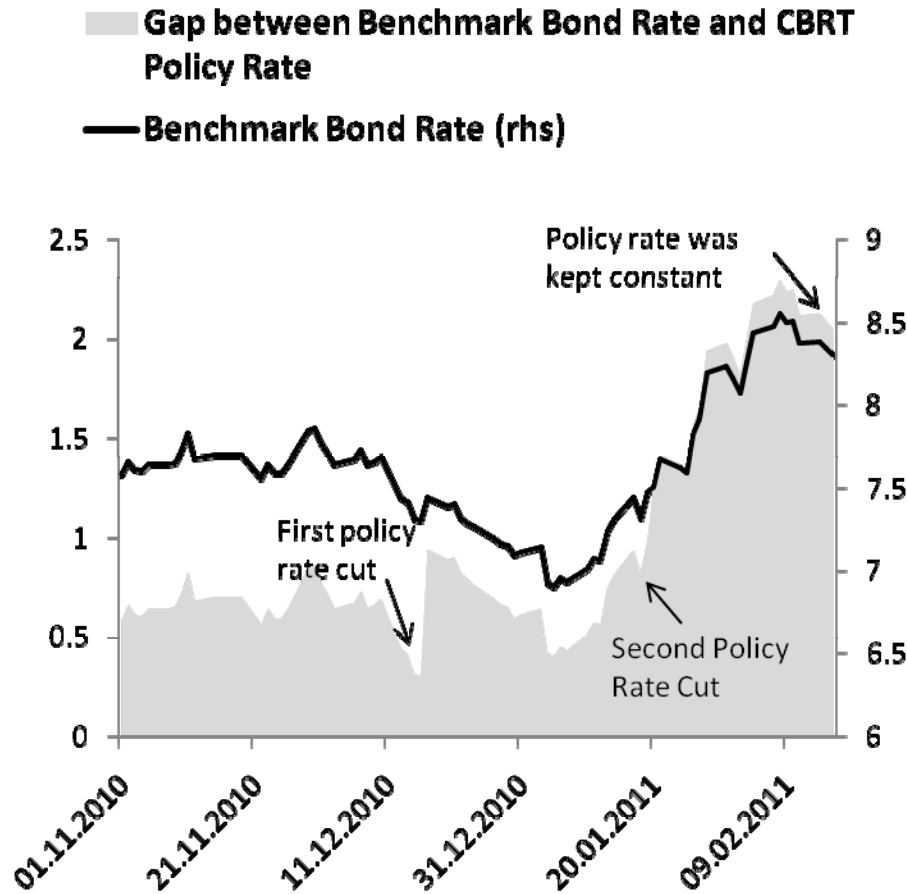
Source: Bloomberg, Vakifbank Economic Research Department



Source: Bloomberg

 The net impact of CBRT's recent policy mix of a lower policy rate coupled with higher reserve requirement will be restrictive. Thus, there will be weak demand-side pressures on inflation. However, higher oil and other commodity prices are the additional risk factors to the inflation outlook. Especially, higher oil and other commodity prices together with TRY depreciation will lead to increase the inflationary pressure in the upcoming months. Above table, the conditional probability of increase in CPI given USD/TRY, food and oil price increase is found to be high when the past movements are analyzed. Hence, this upward pressure on inflation will weaken the possibility of another rate cut.

Market perceived CBRT's policy rate decision positive...



Source: Bloomberg, CBRT

- ✓ After rate cuts in December and January, sell-off was seen in Turkey's Bond Market and benchmark bond yield has increased fastly.
- ✓ Gap between the benchmark bond rate and CBRT policy rate has increased sharply.
- ✓ After the last MPC meeting on February 15, when the Committee has decided to keep the policy rates constant, the benchmark bond rate has declined and the gap between benchmark policy rate and CBRT policy rate has reduced.
- ✓ This shows that market perceived this decision positive.
- ✓ However, the decline benchmark bond rate will not continue due to expectations about CBRT's next decision and inflationary risks.

To sum up,

- *CBRT will continue to follow “wait and see strategy” in the next months to see the impact of recent change in the policy mix.*
- *Upward pressure on inflation will weaken the possibility of another rate cut.*
- *However, RRR hikes may resume onwards depending on consumer lending, the value of TRY and the path of commodity prices.*
- *We expect CBRT to hike policy rate in the third quarter.*

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