

VAKIFBANK TURKISH ECONOMY WEEKLY

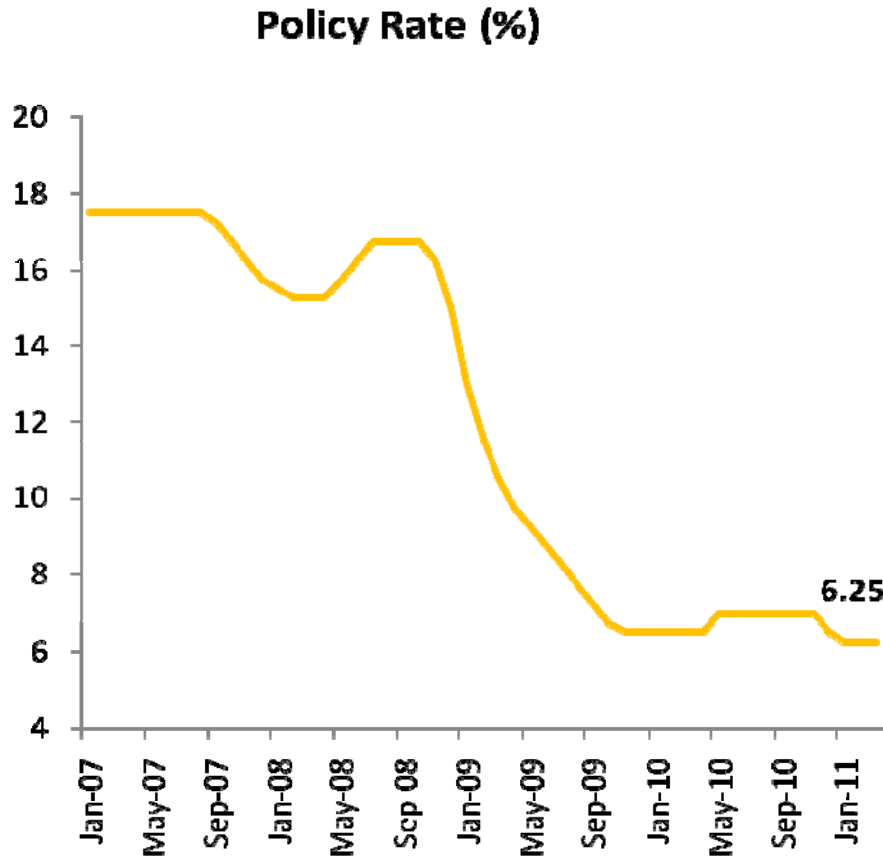
Policy Surprise ... Again



T. Vakıflar Bankası T.A.O



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



Source: CBRT

- ✓ CBRT cut the policy rate by 50 bps in December 2010 and by 25 bps in January 2011.
- ✓ However, at the same time CBRT increased the required reserve ratios (RRR) since September 2010. Especially, in December 2010 the TL RRR were differentiated according to the maturity structure of deposits.
- ✓ In the last meeting, Monetary Policy Committee (MPC) kept the policy rate constant, emphasising the increase in inflationary pressures due to the recent rise in commodity prices.
- ✓ However, CBRT surprised the market by increasing the RRR sharply.

CBRT increased the RRR unexpectedly...

- With the sharp increase in the RRR, CBRT aimed to restrict the effects of the increasing oil and other commodity prices on inflation in addition to enhancing the financial stability.
- Based on current data, CBRT planned to withdraw approximately TRY 19.1 billion from the market.
- CBRT withdrew approximately TRY 21.6 billion and \$1.7 billion from the market since September 2010.
- Planned withdrawal with the last hike in RRR will reach the total TL liquidity withdrawal since September. This indicates that the latest RRR increase is considerably sharp.

TL Required Reserve Ratios (%)		
	Previous Level	23.03.2011
Demand deposits, notice deposits and private current accounts	12	15
Deposits/participation accounts up to 1-month maturity	10	15
Deposits/participation accounts and special fund pools up to 3-month maturity	9	13
Deposits/participation accounts and special fund pools up to 6-month maturity	7	9
Deposits/participation accounts and special fund pools up to 1-year maturity	6	6
Deposits/participation accounts and special fund pools with 1-year and longer maturity and cumulative deposits/participation accounts	5	5
Liabilities other than deposits/participation funds	9	13

Source: CBRT

Developments in Loans and Growth of Loans in 2011...

Developments in Loans and Growth of Loans in 2011 (According to weekly releases)					
	Date	billion TL	w-w, %	By the end of 2010, %	y-y, %
	07.01.2011	531.285	-0.76	-0.76	34.19
	14.01.2011	532.651	0.26	-0.50	33.35
December regulations start to be maintained as of 18 February 2011.	21.01.2011	535.349	0.51	0.00	34.45
	28.01.2011	543.072	1.44	1.45	35.23
	04.02.2011	542.993	-0.01	1.43	34.95
	11.02.2011	546.493	0.64	2.08	35.12
January regulations start to be maintained as of 18 February 2011.	18.02.2011	550.267	0.69	2.79	35.56
	25.02.2011	556.211	1.08	3.90	34.55
	04.03.2011	558.660	0.44	4.36	35.56
	11.03.2011	560.324	0.30	4.67	35.50

Source: BRSA

RRR have been increased by 5 times since the September of 2010 and have been differentiated 3 times according to the maturity structure of deposits. Especially, with the last 3 decisions of CBRT, the increase in required reserves has become more drastic.

According to the latest releases, the growth of loans is slowing on a weekly basis while yearly credit growth is still over 35%.

Although annual growth rate of loans has been losing momentum, it remains well above the range of 20-25% that was previously stated by the CBRT.

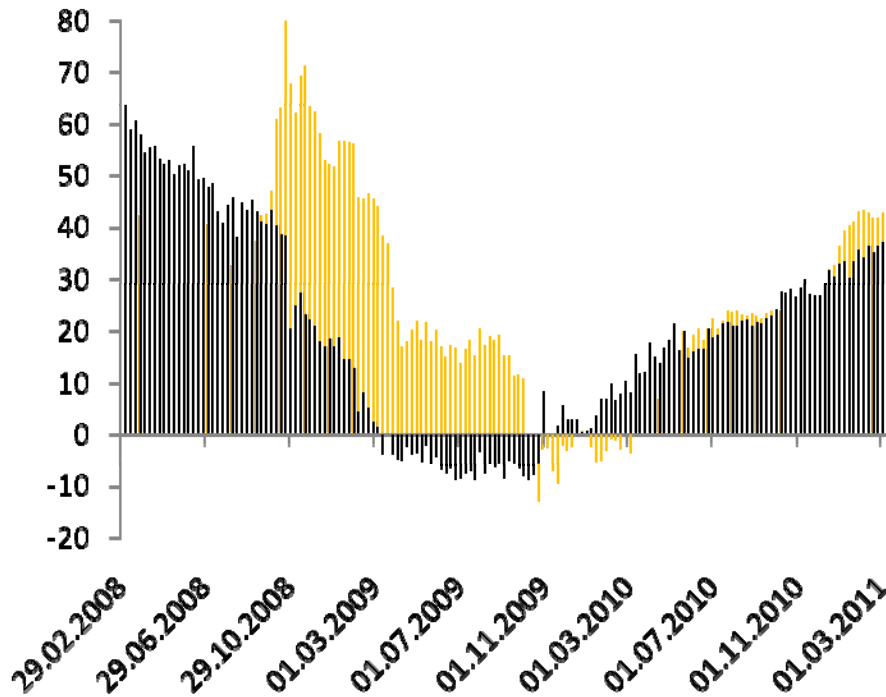
It is concluded that the banks are conservative in reflecting the effects of RRR increases to their price setting behavior.

With the rising expectations of policy rate increases, banking sector do not want to decrease the loans since they do not want to reduce the total assets.

Adjusted FX loans have increased since the beginning of 2011...

■ Total FX Loans(y-y,%)

■ Total FX Loans(Adjusted for Exchange Rate) (y-y,%)



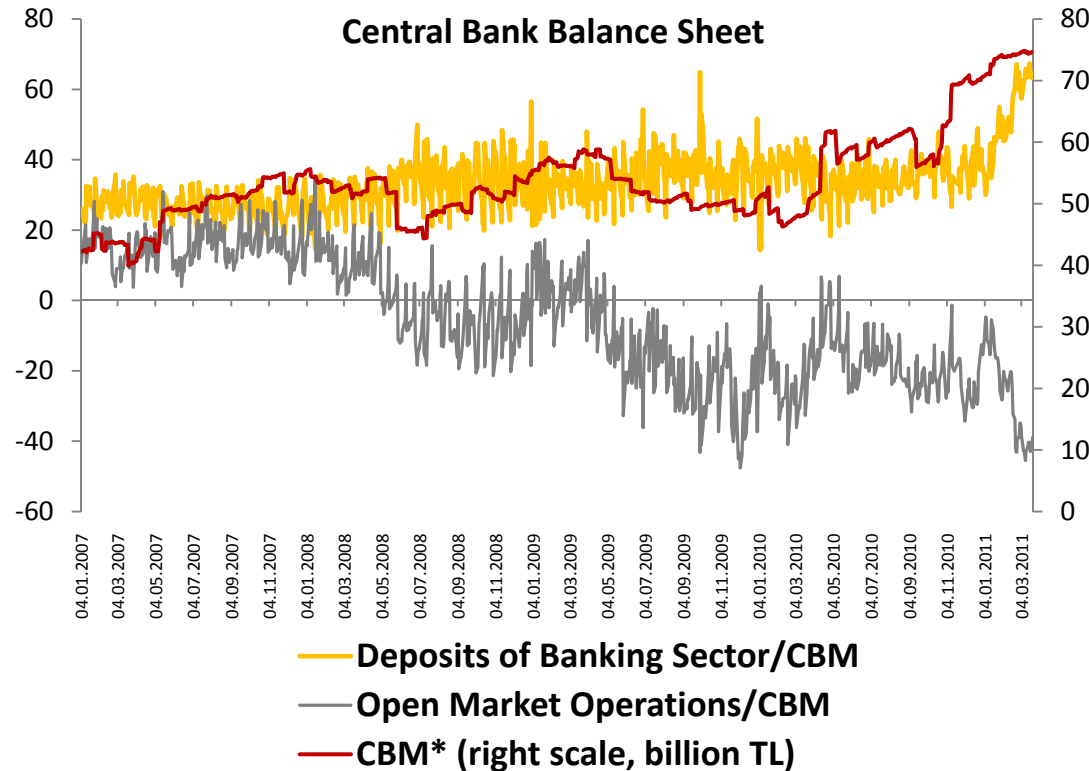
Source: BRSA

- With the sharp increase in the Turkish Lira RRR, recent developments in foreign exchange loans became more significant.
- FX loans have increased sharply on a yearly basis as seen in the graph. Due to the recent increase in exchange rate, developments in FX loans should be examined after adjusting for exchange rate effects.
- In 2011, adjusted annual growth of FX loans exceeds 35% which is the highest growth rate since October 2008.
- This indicates that the tendency of the sector to FX loans has increased since the beginning of 2011.

A number of risks seem to be important with regards to the last decision of CBRT...

- ✔ It is evident that banking sector has been the engine of growth during the crisis. And yet, the interrupted loans of banking sector may pose a risk on credits in terms of turning credit expansion to credit contraction.
- ✔ This could lead to negative results with regards to the growth performance of banking sector and accordingly Turkish economy.
- ✔ CBRT decision to increase RRR comprises all types of loans and in this respect needs to be considered as a significant issue.
- ✔ Especially in the long term, export or project loans will be effective in decreasing the current account deficit, therefore reducing this kind of loans does not seem reasonable in this environment.
- ✔ In the coming months, CBRT may differentiate the policy related to loans according to the type of loans.

CBRT's Balance Sheet shows unconventional moves in monetary policy ...



Source: CBRT

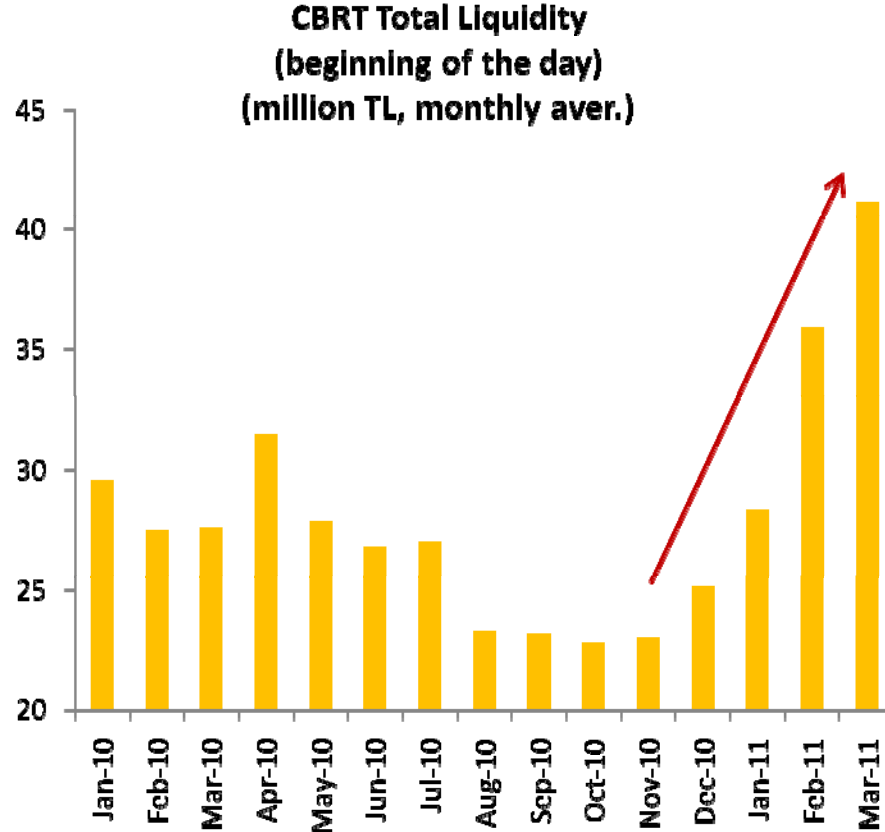
*:CBM: Central Bank Money

- While the MPC tightened monetary policy through an aggressive 400bps RRR hike on average, CBRT has provided the extra liquidity through increasing 1-week repo funding.
- The unconventional moves in monetary policy have significantly affected CBRT's balance sheet.
- Also, Open Market Operations show that there is extra liquidity in the market which helps keep liquidity conditions at comfortable levels.

Liquidity indicators...

- ✔ The expansionary monetary policy which is implemented by developed countries caused ample global liquidity. And, this led the increase in capital flows to developing countries.
- ✔ According to the last inflation report of CBRT, it is expected that higher capital flows to developing countries would carry on in the next couple of years.
- ✔ In this context, while global imbalances have showed different effects on developed and developing countries and caused divergence between these countries, CBRT has taken measures for financial stability by a mixed policy which includes short-term interest rates with liquidity method and alternative means such as high reserve requirements.
- ✔ Cutting the policy rate is a means of expansionary monetary policy. On the other hand, increasing the reserve requirements serves to the tightening purposes.
- ✔ Moreover CBRT has changed the methods of Foreign Exchange Buying Auctions both benefitting from the abundance of liquidity in global markets and in order to become more flexible through the variability of liquidity flows.

CBRT policies which are used for increasing the liquidity has started to effect the economy since Q4 2010...



Source: CBRT

- CBRT has provided liquidity to the market to prevent an upward risk on interest rates because of the negative affects which are caused by high reserve requirement policy.
- As shown in the graph, CBRT daily total liquidity data indicate that CBRT policies which are used for increasing the liquidity has started to be effective on the economy since Q4 2010.
- Increase in liquidity, especially after 2010 MPC in December when CBRT started to implement higher reserve requirements policy for the first time, has continued it's upward trend.

Serkan Özcan
Chief Economist
+ 90 312 455 7087
serkan.ozcan@vakifbank.com.tr

Cem Erođlu
Senior Economist
+ 90 312 455 8480
cem.eroglu@vakifbank.com.tr

Ümit Ünsal
Economist
+ 90 312 455 8418
umit.unsal@vakifbank.com.tr

Emine Özgü Özen
Researcher
+ 90 312 455 8487
emineozgu.ozen@vakifbank.com.tr

Naime Dođan
Researcher
+ 90 312 455 8486
naime.dogan@vakifbank.com.tr

Fatma Özlem Kanbur
Researcher
+ 90 312 455 8482
fatmaozlem.kanbur@vakifbank.com.tr

T. Vakıflar Bankası T.A.O
Atatürk Bulvarı No: 207
Kavaklıdere 06683 Ankara, Turkey
www.vakifbank.com.tr

Vakıfbank Economic Research
ekonomik.arastirmalar@vakifbank.com.tr

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