

VAKIFBANK TURKISH ECONOMY WEEKLY

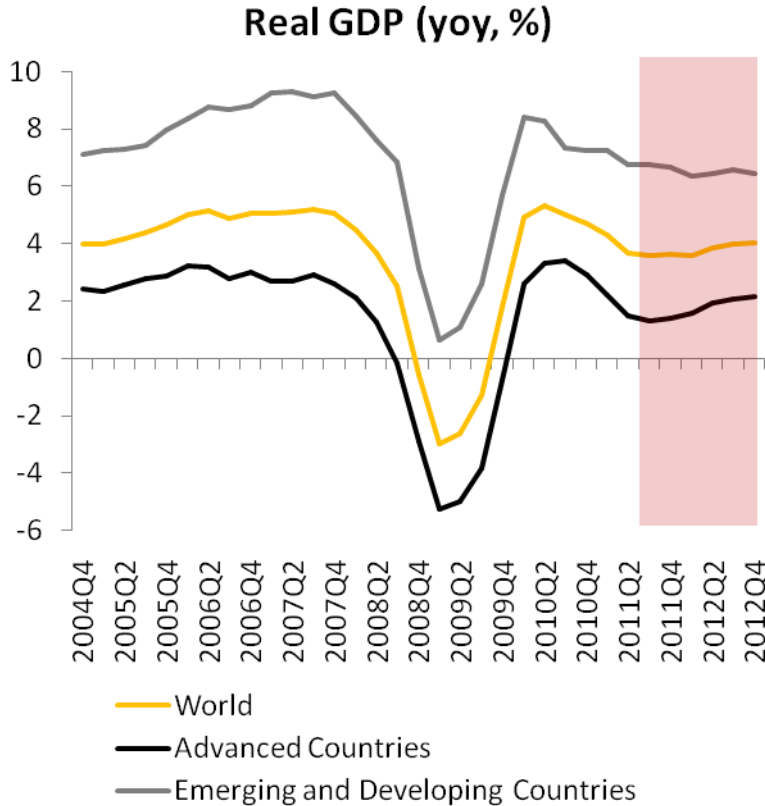
Turkish Economy 2012 Forecasts: INTEREST RATES



T. Vakıflar Bankası T.A.O



Global uncertainties seem to be the biggest challenge for interest rate markets in 2012...

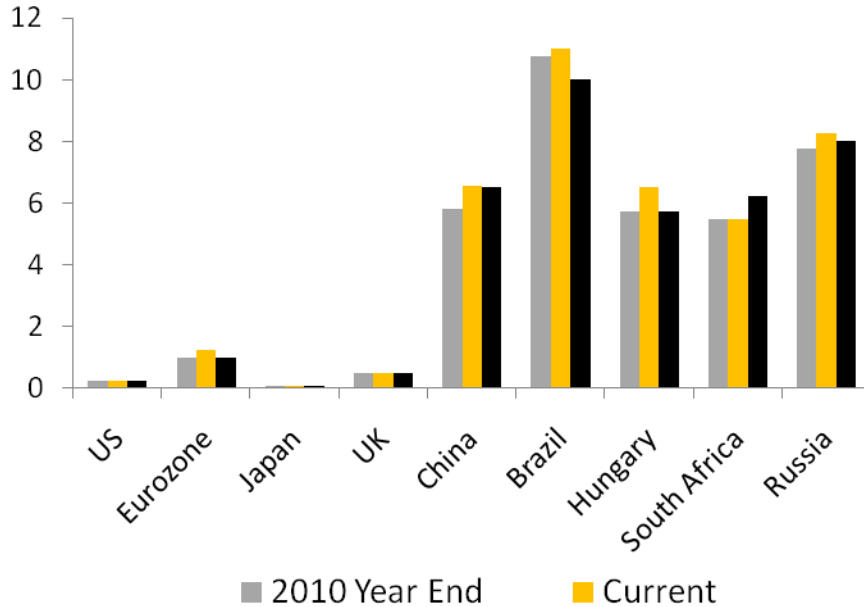


Source: IMF

- PIIGS countries in Euro Zone still have problems with public balances despite all fiscal tightening measures. Contagion risks due to these problems are still prevalent as a common solution has not been reached yet. Hence, Eurozone growth may slow down considerably in 2012.
- US has also a high public deficit problem and vulnerabilities on US growth continue. As a result, poor fiscal balances may negatively affect US growth in 2012.
- Economic weaknesses in Europe and the US have been affecting EMs by trade channel and capital flows. High dependence of EM economies to the external demand might have negative effects on EM growth performance.

Global liquidity conditions are expected to be loose in 2012...

Policy Interest Rates(%)



Source: Reuters, Bloomberg

* Market Forecast

- ✎ The global growth environment in the post crisis period hasn't been suitable for higher interest rates.
- ✎ Low interest rates are limiting the capability and efficiency of monetary policy in the fight against low growth performances.
- ✎ EMs have recently started rate cuts with the support of lower inflationary pressures.
- ✎ For the moment, EM central banks are able to implement conventional monetary policies.
- ✎ Stronger public balances are also increasing capabilities of EMs to limit downside growth risks.
- ✎ EM monetary policies are generally expected to be looser in 2012 for stronger growth purposes.

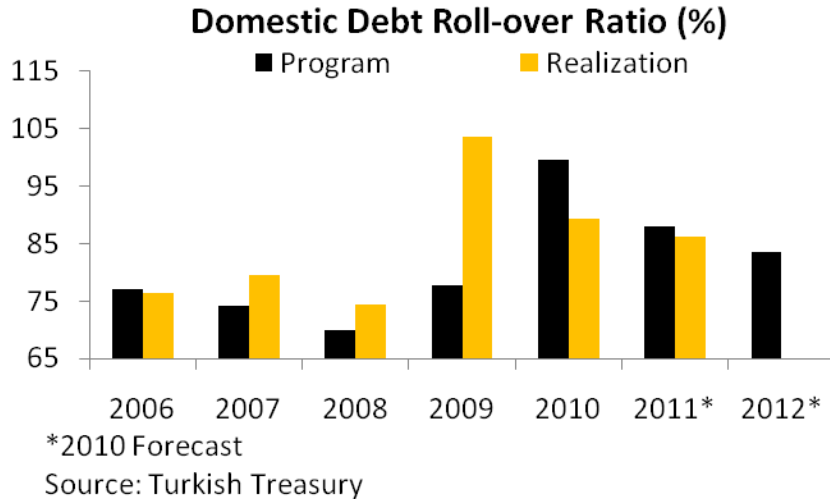
✎ ECB policy rate which is at 1.25% at the moment, provides ample space for rate cuts.





✎ FED is expected to take another step of QE having its policy rate close to zero.







✎ The swap agreement among five central banks is also a sign of the intention for lower rates in 2012.

✎ Therefore, central banks are thought to give higher importance to prevent the contagion of global risks and uncertainties.






Domestic growth expectations are implying lower interest rates in 2012...



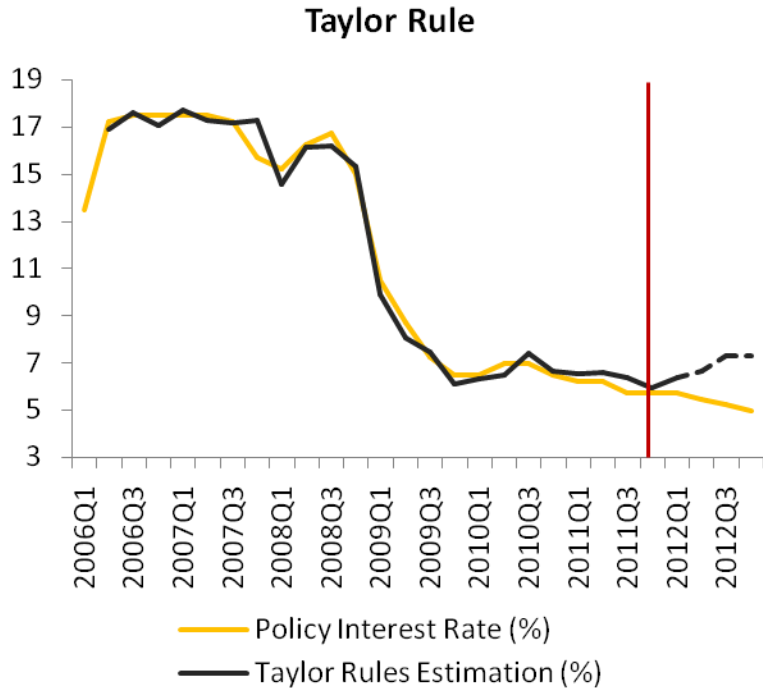
-  We're expecting the growth performance of Turkish economy to be slower in 2012.
-  We expect inflation to have a volatile path in the first half of 2012 and start losing pace by the summer months. And after the temporary increases in Q3, we expect it to fall significantly in Q4 2012 with the strong basis effect.
-  Also, we expect C/A deficit to fall to some extent in 2012.
-  Despite global risks, we expect Turkey to preserve its strong public balances in 2012.

-  The average maturity of debt which was 44.1 months in 2010 has lengthened to 46.2 months in Jan-Oct 2011 period.
-  The share of the short term debt in total debt has fallen to 21% by September 2011 from 42% in 2003.
-  Turkish Treasury is expecting the roll-over ratio of its debt to fall to 86.2% in 2011 and 83.5% in 2012 from 89.3% in 2010.
-  Hence, there seems to be no problem with the borrowing capabilities of the Treasury in 2012 and the debt/GDP ratio expectation stated in Medium Term Program of the government seems to be feasible.
-  According to our econometric forecasts we are expecting the budget deficit/GDP ratio to be -1.87% in 2011 and -1.59% in 2012.
-  On the other hand, the government's expectations for the budget deficit/GDP ratio is -1.7% in 2011 and -1.5% in 2012.

The 2011 monetary policy of CBRT sheds light on the policy alternatives for 2012...

-  CBRT performed quiet unusual policies in 2011 considering global uncertainties and domestic vulnerabilities. Under current global problems and expectations of domestic macroeconomic challenges, 2012 might be a hard year for CBRT, too.
-  We expect CBRT to implement a quite complicated and difficult monetary policy in 2012.
-  Depreciation of TL has also complicated CBRT policies in 2011.
-  Although TL depreciated 22% since mid April, it has been stronger compared to other EM currencies during 2011.
-  The high correlation of global risk averseness with the value of TL, implies that TL will probably be open to negative effects of global imbalances and market volatility in 2012.

We expect CBRT to cut policy interest rate 75 bps in 2012...



Source: Bloomberg, VakıfBank

$$i = b_0 + b_1(\pi - \pi^*) + b_2(y - y^*)$$

i : Nominal interest rate

$\pi - \pi^*$: Deviation of inflation rate from target

$y - y^*$: Output Gap

- ✎ Taylor Rule estimate of the policy rate and the actual policy rate have been moving in parallel until Q1 2011.
- ✎ Since then, Taylor Rule estimates have drawn a higher trend which means that Taylor Rule is indicating sharp interest rate increases.
- ✎ On the other hand CBRT has been implementing a discretionary monetary policy in practice by using conventional and unconventional policy tools.
- ✎ In the press release of the November meeting, CBRT stated that price increases are temporary and output gap expectations indicate that recovery has become inverse since Q2 2011. These comments decrease the possibility of the application of a monetary policy based roughly on Taylor Rule.
- ✎ We expect that CBRT will keep the policy rate at 5.75% until the end of 2011 and will cut the policy rate by 75 bps in 2012.

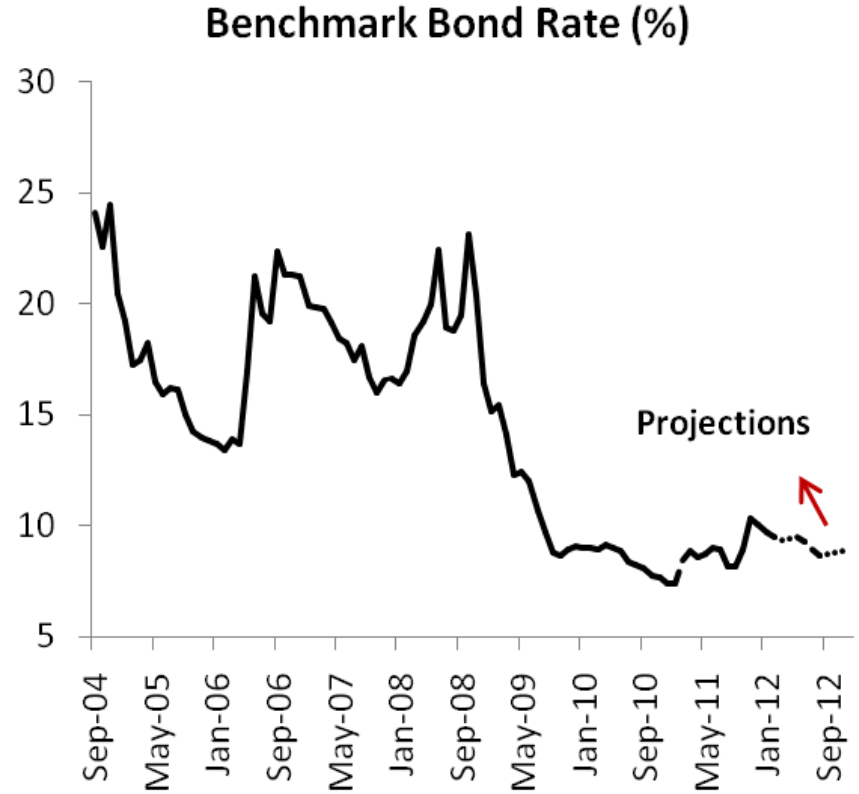
CBRT policy might differentiate depending on alternative scenarios...

- 📌 Global uncertainties and growth risks in both advanced and developing countries increase global slow down risk.
- 📌 This indicates similar risk for Turkish economy and it may also affect the monetary policy choice of CBRT.
- 📌 In the meantime, developments in financial markets will also affect the monetary policy as much as macro economic conditions.
- 📌 We expect that CBRT will support the economy using other complementary monetary policy tools besides the policy interest rate, especially if the economy slows down more than expected and the liquidity opportunities shrink considerably.
- 📌 However, according to our second scenario which includes strong growth and relatively higher inflation rate as a result of an expansion in demand, we expect that CBRT will leave the policy rate unchanged at 5.75%.



Our benchmark bond rate forecast is 8.85% for the end of 2012...

- According to the econometric model we set up to forecast the benchmark bond rate, we assume that USD/TRY will be 1.70 by the end of 2012.
- Also our policy rate assumption in this model is 5.0%.
- Our model indicates that the benchmark bond rate will be below 10% in Q1 2012.
- We expect that benchmark bond rate will follow a downward trend since the end of Q2 which is the date when the CBRT is expected to begin rate cuts.
- US 10 yr bond yield is expected to move upwardly since the second half of 2012.
- Hence, we expect that benchmark bond rate to be 8.85% by the end of 2012.



Source: Vakifbank

We analyzed our benchmark bond rate forecast under two scenarios...

1. Scenario

- Real GDP : 5.1%
- Upward movement in CPI depending on strong domestic demand

2. Scenario

- Lower growth rate
- CPI : close to 5.0%
- CBRT Policy Rate: 5.0%
- US 10 yr Bond Rate : 2%

Our Benchmark Bond Rate Forecasts(%)

Base Scenario	8.85%
1. Scenario	11.50%
2. Scenario	7.45%

Source: Vakifbank

Serkan Özcan

Chief Economist

+ 90 312 455 7087

serkan.ozcan@vakifbank.com.tr

Nazan Kılıç

Economist

+ 90 212 398 1902

nazan.kilic@vakifbank.com.tr

Emine Özgü Özen

Researcher

+ 90 212 398 1890

emineozgu.ozen@vakifbank.com.tr

Fatma Özlem Kanbur

Researcher

+ 90 212 398 1891

fatmaozlem.kanbur@vakifbank.com.tr

Naime Doğan

Researcher

+ 90 212 398 1892

naime.dogan@vakifbank.com.tr

T. Vakıflar Bankası T.A.O

www.vakifbank.com.tr

Vakıfbank Economic Research

ekonomik.arastirmalar@vakifbank.com.tr

The information in this report has been obtained by Türkiye Vakıflar Bankası T.A.O. from sources believed to be reliable. However, Türkiye Vakıflar Bankası T.A.O. cannot guarantee the accuracy, adequacy, or completeness of such information, and cannot be responsible for the results of investment decisions made on account of this report. This document is not a solicitation to buy or sell any of the securities mentioned. All opinions and estimates included in this report constitute our judgment as of this date and are subject to change without notice. This report is to be distributed to professional emerging markets investors only.
