

VAKIFBANK TURKISH ECONOMY WEEKLY

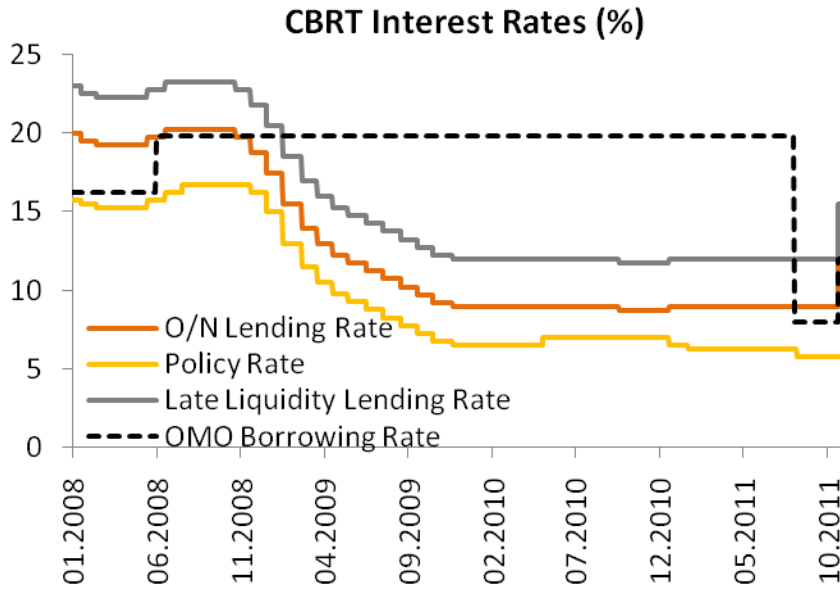
**Shooting two birds
with one stone**


VakifBank

T. Vakıflar Bankası T.A.O



CBRT has kept the policy rate at 5.75% as expected...



Source: CBRT

CBRT interest rate decisions taken in 20.10.2011		
%	Old Rates	New Rates
Policy Rate (one-week repo rate)	5.75	5.75
Overnight (O/N) Interest Rates		
CB Borrowing Rate	5	5
CB Lending Rate	9	12.5
OMO Borrowing Rate	8	12
Late Liquidity Window Interest Rates		
CB Borrowing Rate	0	0
CB Lending Rate	12	15.5
Source: CBRT		





 Monetary Policy Committee has decided to adjust interest rates as follows;

- ❖ The policy rate (one-week repo rate) has been kept at 5.75%.
- ❖ Overnight (O/N) borrowing rate has been kept at 5%
- ❖ O/N lending rate has been increased from 9% to 12.5%.
- ❖ Interest rate on borrowing facilities provided for primary dealers via repo transactions has been increased from 8% to 12%.
- ❖ Late liquidity window borrowing rate has been kept at 0% and lending rate has been increased from 12% to 15.5%

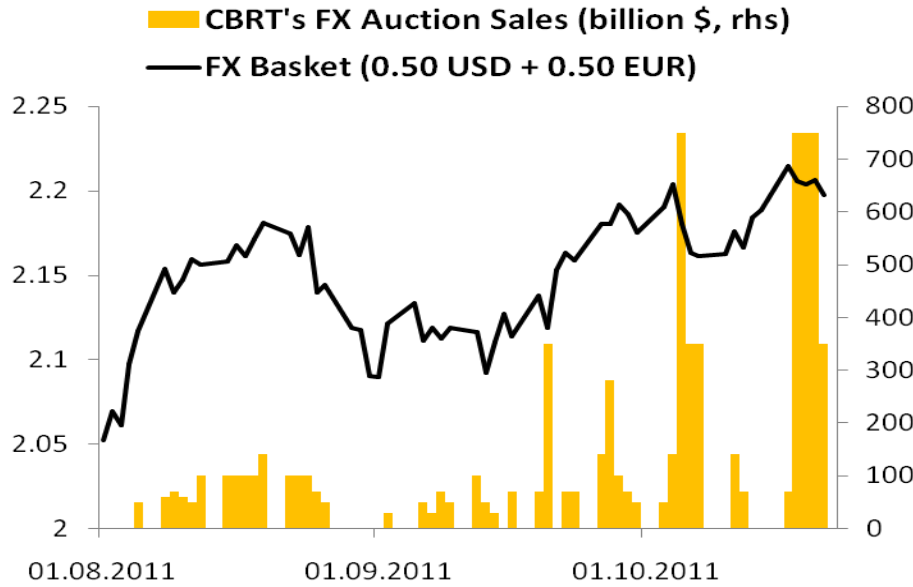
The period before CBRT's recent decisions - I

- ✍ CBRT has been following an unconventional policy path since October 2010 due to increasing financial stability risks.
- ✍ This policy was described as “unconventional” because CBRT used reserve requirement rates (RRR) instead of policy interest rate and defended financial stability without leaving aside its traditional purpose of preserving price stability.
- ✍ With the monetary policy meeting held on 4 August 2011, CBRT, changed its discourse and switched to an expansionary policy.
- ✍ This new policy of CBRT showed that it was in a challenge of defending against economic slowdown risk, increasing market volatility, and inflationary pressures on the horizon as a result of depreciation in TL.

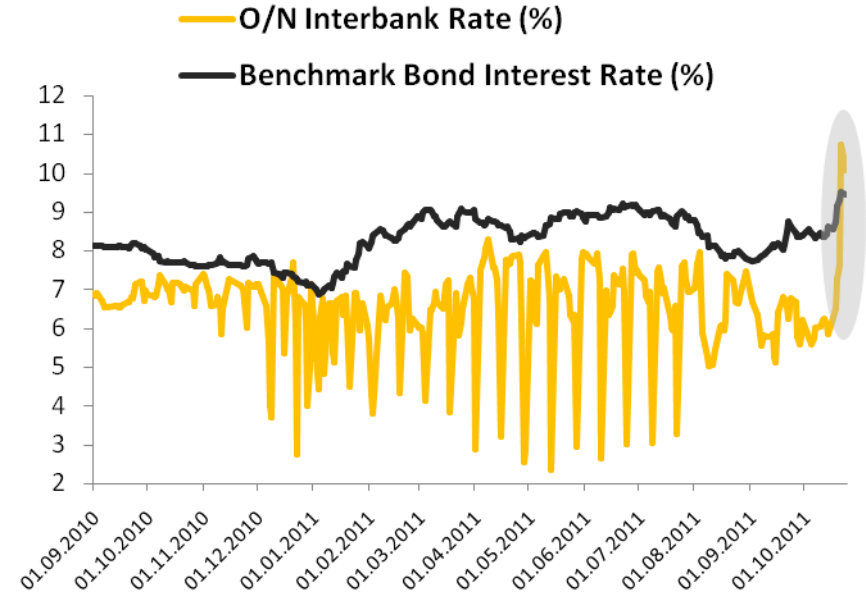
The period before CBRT's recent decisions - II

-  Before the meeting on 20 October 2011 increase in the depreciation of TL, fluctuation and upward movement in the exchange rate basket caused CBRT to increase the maximum volume of the foreign exchange selling auctions which started in the beginning of August.
-  In addition to the FX selling auctions, CBRT directly intervened to the FX market by selling \$750 million for the first time since the direct intervention in 2006 June.
-  The rise in the exchange rate was mainly parallel to the increase in global risk perceptions, and market expectation of CBRT's tighter policy stance for the coming months was effective on TL's depreciation.
-  The statement CBRT used in the press release about direct FX intervention which is: "unhealthy price formations due to a decrease in the depth of the FX market" shows that CBRT doesn't explain the recent movements in TRY only with macroeconomic developments.

Market reaction to CBRT decisions...



Source: CBRT, Bloomberg



Source: Euroline

- 📌 O/N interbank TL repo rate rose 35 bps to 10.70% right after the CBRT decision.
- 📌 2 yr benchmark bond compound yield reached its highest level in 16 months with 9.66%.
- 📌 TL appreciated slightly. USD/TL fell to 1.8150s from 1.8760 levels.
- 📌 The yield advantage of TL might be supportive for the stabilization of FX and interest rate movements.

Comments on CBRT announcement...

- ✔ CBRT's recent announcement had certain differences from its previous comments.
- ✔ CBRT used calmer expressions about growth performance unlike the previous three meeting announcements in which it had a strong emphasis on the slowdown risk.
- ✔ CBRT didn't use the "slowdown in economic activity" phrase in its last meeting announcement.
- ✔ Its calmer and confident words stating that the rise in inflation would be preliminary, turned into a determination to limit inflationary pressures.
- ✔ CBRT stated that it would not let the expected rise in inflation due to depreciation in TL besides basis effect and the recent adjustments in administered prices, disturb medium term inflationary expectations.
- ✔ CBRT also stated that the balance between domestic and foreign demand was continuing and C/A balance was improving.
- ✔ CBRT commented less on the global risk factors and made a reference to the strategy set at its 4th August meeting.
- ✔ CBRT stated that it would continue taking the necessary precautions for the stability of local markets.

CBRT decision doesn't imply a strict U-turn on its policy path...

- ✎ CBRT is obliged to fight against the slowdown in economic activity, increasing inflation and negative market conditions at the same time.
- ✎ Also the negative global economic outlook and the risks of European debt problems are still prevalent.
- ✎ Under these conditions, CBRT's manner in its latest meeting announcement can't be considered as an explicit change in its preceding discourse.
- ✎ CBRT's widening of the interest rate corridor through hiking lending rates will provide yield advantage to TL and hence, prevent its further depreciation.
- ✎ Consequently, the widening of the interest rates might provide financial stability in addition to limiting the inflationary effect of the depreciation in TL.

CBRT is inclined to use alternative policy tools for economic stability...

- ✔ Widening of the interest rate corridor might negatively effect economic activity which has already started weakening by August.
- ✔ On the other hand, CBRT's manner in its recent meeting implies that it might not be too anxious about the negative economic effects of the lending rate increases.
- ✔ Depending of a further weakening signals in global and local growth outlook CBRT may cut the TL RRRs in the coming period.
- ✔ Inflation report which will be published on 26th October will provide additional information about CBRT's opinion.
- ✔ We stick to our expectation that CBRT will hold the policy rate at 5.75% until the end of 2011.
- ✔ And, we expect further intervention from CBRT using other policy tools in the face of increasing risks.

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