TÜRKİYE CUMHURİYET MERKEZ BANKASI

Bulletin

Issue: 23 / June 2012

Prime Minister Recep Tayyip Erdoğan   Governor Dr. Erdem Başçı

TURKISH LIRA SIGN REVEALED

Central Bank of the Republic of Turkey unveiled a currency sign for Turkish lira on 1 March 2012

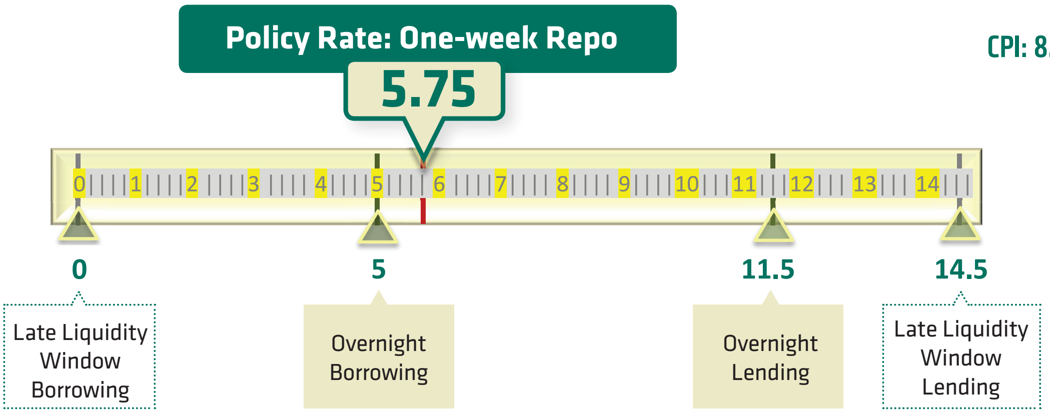
On the back of the economic stability program pursued after the 2001 crisis in Turkey, the Turkish economy has continued to expand.

In 2005, the Government of Turkey took the step of stripping six zeros from the currency and Turkey emerged relatively unscathed from the financial crisis.

In order to capitalize on the Turkish lira's growing recognition and prestige in international markets, a sign has been determined for the Turkish currency. The sign was endorsed following a country-wide contest.

The Turkish lira sign is shaped like an anchor conveying the idea that the currency is a safe haven, while the upward facing lines represent its rising prestige.

CBRT Interest Rates % (As of 29 May 2012)



CBRT Foreign Exchange Reserves: 78.23 billion USD (As of 1 June 2012)

CPI: 8.28 (Annual May 2012)

CONSUMER LOAN MARGINS AND CREDIT SUPPLY

While most central banks have been acquiring instrumental independence in implementing monetary policy, there has been a tendency towards assigning the duty of supervising banks to authorities other than central banks. This, however, has not diminished the importance attached by central banks to assessing financial stability.

In order to evaluate financial and monetary conditions, central banks use several parameters. Consumer loan margins are among the most important of such parameters that the CBRT uses to gather more information about credit supply conditions.

Basically, three parameters are used to calculate consumer loan margins; loan rates (including non-interest fees and commissions), the cost of funding and credit risk premium. The consumer loan margin is calculated by subtracting the cost of funding and risk premium from loan rates.

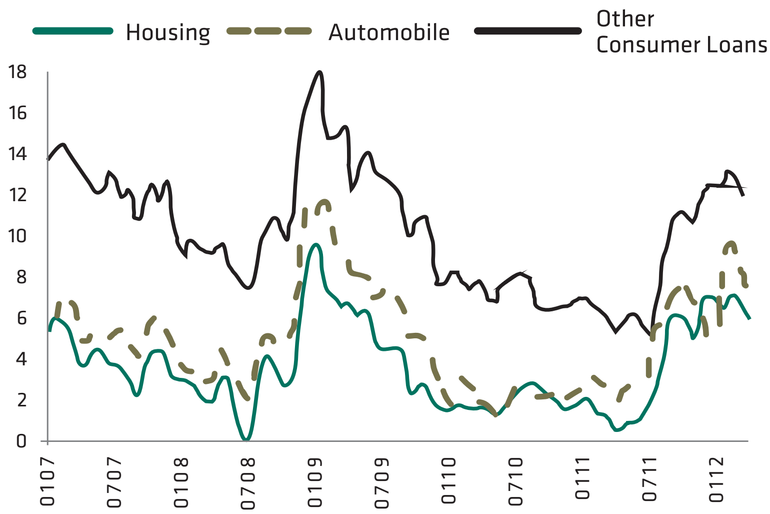
Consumer Loan Margins = Loan Rates – (Cost of Funding + Risk Premium)

In the computation of consumer loan margins, the effects of regulations and cost stemming from the economic climate are excluded. Therefore margins are deemed to be an important indicator of credit supply. For instance, when there is an increase in margins, this means that the banks transform the additional cost brought about by the changing economic climate to consumers by tightening short-run credit supply conditions.

However, in order to assess changes in margins, operational costs and competitiveness should also be taken into account. An increase in the cost of banking operations or a reduction in competition within the banking system encourages banks to increase their margins. In such cases, margins may be a misleading factor. On the other hand, in the short run the cost of banking conditions and the competitive element tend to remain unchanged. In this sense, margins are considered a better indicator of credit supply conditions for short periods.

Source Inflation Report 2012-II (Box 5.2)

Consumer Loan Margins
(Percent, 4-Week Average)



Source CBRT.

The Course of Consumer Margins in Turkey

In an economy, turning points of the consumer loan margins should be analyzed in conjunction with the events shaping the economic climate of the country (See chart). In Turkey, it can be observed that margins jumped sharply after the 2008 global crisis mainly owing to banks' tightening supply conditions. Moreover, the decline in margins following the easing of the adverse effects of the crisis on the Turkish economy is an indicator of the imminent role of credit supply conditions in the increase of credit growth. Another turning point corresponding to the third and fourth quarters of year 2011, when margins were increasing, is a reflection of the banks' tightening supply conditions.

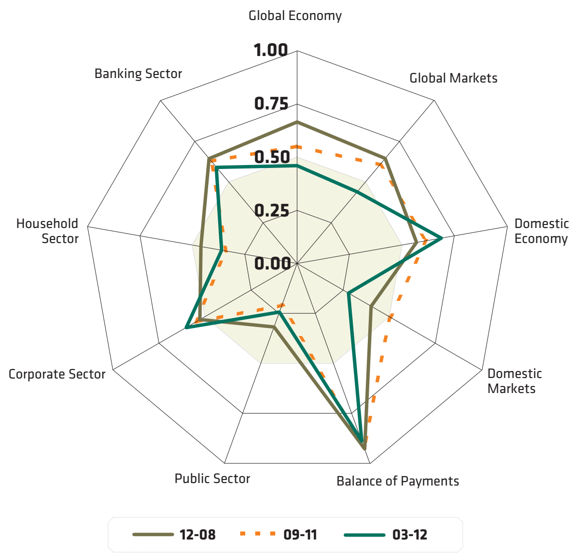
FINANCIAL STABILITY REPORT

In order to contain macro-financial risks driven by global imbalances, the CBRT enhanced the inflation targeting regime and designed a new monetary policy strategy: The CBRT now takes macro-financial stability into account as much as economic conditions permit while preserving the primary objective of maintaining price stability.

On 31 May 2012 the CBRT published the 14th volume of the Financial Stability Report, which serves the purpose of revealing the CBRT's macro perspective on financial markets and evaluates recent developments and risks regarding financial stability. A few highlights from the latest issue of the Financial Stability Report are listed below:

- Banking sector indicators reveal that the robust structure of the sector is sustained. The surging tendency in credits, albeit containing seasonal effects, is within plausible limits.
- Open FX positions of the corporate sector continue to be a significant risk factor. In fact, it has been observed that the ratio of debt to equity has surged and the rise in profits has been limited due to increased provisions on exchange rate movements. On the other hand, the surge in corporate sector debt experienced in 2010-2011 has come to a halt, and the share of foreign borrowing in 2012 has remained stable.
- The rate of increase in household liabilities has been slower since the second half of 2011 and there has been a setback in nonperforming loans and unemployment rates. While the lack of interest and exchange rate risks in household liabilities is considered a positive factor, there has been a decline in saving rates despite income increases.
- The banking sector still has a sound capital structure. Although a limited decline in the capital adequacy ratio is foreseen with the launch of Basel II in July 2012, it is expected to remain within the legal (8 percent) and target (12 percent) ratios. Consequently, it is presumed that no complications will emerge in achieving harmonization with Basel III implementations.
- With the growth of sector profitability in the first quarter of 2012, capital structure of the banks gained strength.
- Notwithstanding the sound structure of the Turkish banking sector, the use of macro prudential measures has been necessary to ensure minimum impact from the developments in the global financial markets. In this framework, the required reserve ratios have been employed effectively to reduce macroeconomic and financial risks and to safeguard financial stability since 2010. The differentiation of required reserve ratios according to the maturity structure of deposits has helped reduce the asset-liability maturity mismatch of banks. Besides, ratios for short-term maturities have been raised by taking into account the increasing tendency of credits. After the second half of 2011, however, required reserve ratios have been reduced due to the slowing down of the global economy and developments in domestic demand.
- To strengthen the build-up of the CBRT's gold reserves and to provide the banking system with more flexibility in liquidity management, the CBRT enabled the facility that allows banks to hold a part of their reserve requirements for Turkish lira deposits in gold as well as FX, and for FX deposits in gold.
- In the light of experiences gained from the financial crisis, international principles regarding the infrastructure of financial markets have been redefined. The CBRT, via its membership of the Committee on Payment and Settlement Systems, is actively involved in efforts to re-determine the principles, while at the same time continues its practices to update domestic regulations.

Financial Stability Map



Source: CBRT.

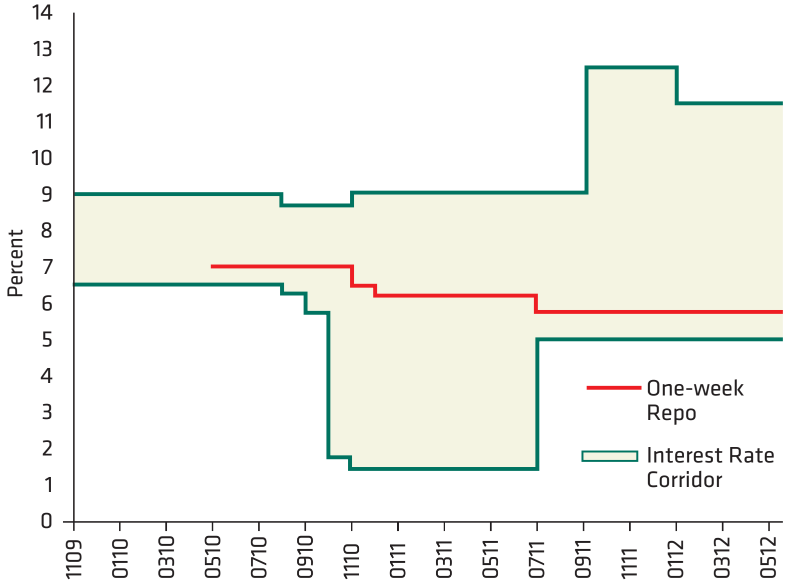
The closer to the center, the more stable the sector is. Analysis allows time series comparisons within each sector. Among sectors, the comparison can be made in terms of the directional change in position with respect to the center.

For the set of variables and methodology used in the financial stability map, see the CBRT Financial Stability Report, Volume 13, Special Topic IV. 10.

Against heightening macro financial risks in the first half of 2011, CBRT aimed to gradually steer the economy towards a more balanced growth composition. Accordingly, measures to slow down loan growth were adopted. Moreover, policies were implemented against the excessive deviation of exchange rates from economic fundamentals in either direction. Since October 2011 monetary policy has focused on maintaining price stability.

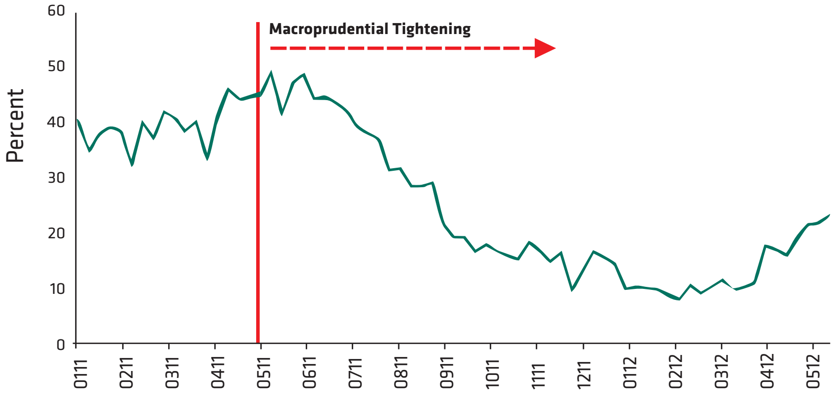
By utilizing the flexibility offered by the interest rate corridor, an additional monetary tightening has been implemented three times since October 2011 (in December 2011, March 2012 and April 2012). During episodes of additional monetary tightening, the CBRT significantly raised the average cost of its liquidity provision to the market, mostly by reducing the funding supplied through quantity auctions.

CBRT Policy Rate and the Interest Rate Corridor



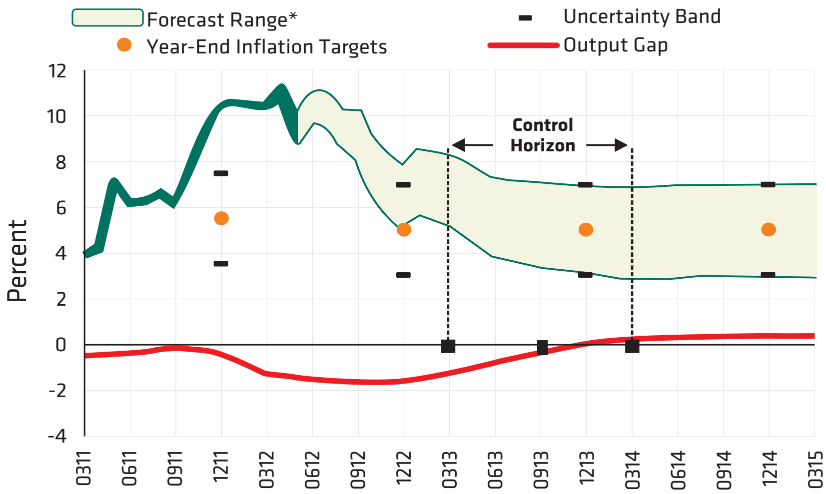
Credit Growth

(Total, 13 Weeks Moving Average, Annualized, FX Adjusted)



The FX-adjusted year-on-year growth of total credits slowed down markedly after mid-2011, with the help of measures taken by the authorities. As of May 2012, total credit growth is 21.6 percent, which is below that of 2011 and past year averages. As intended, consumer loans showed a limited increase, while corporate loans being the main driver of the total credit growth.

Inflation and Output Gap Forecasts



*Shaded region indicates the 70 percent confidence interval for the forecast.

In the first quarter of 2012, inflation remained in tandem with the April Inflation Report projections, standing at 8.28 percent at end-May. The higher-than-envisioned increases in oil prices in this period drove energy prices above projections. In the meantime, unprocessed food prices followed a more favorable course than envisaged.

Inflation is expected to be, with 70 percent probability, between 5.3 and 7.7 percent (with a mid-point of 6.5 percent) at the end of 2012, and between 3.4 and 7.0 percent (with a mid-point of 5.2 percent) at the end of 2013. Inflation is expected to stabilize around **5 percent** in the medium term.

Source: CBRT.

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