For better Financial Foresight

Ekinci Economics Consulting

24 Feb 2015

FLASH COMMENTARY

TURKEY - MONETARY POLICY

The Central Bank of Turkey (CBT) cut all the interest rates in its corridor band.

The upper bound of the interest rate corridor is lowered from 11.25 per cent to 10.75 per cent.

The one-week repo policy rate has been cut by 25 basis points to 7.50 per cent.

The lower bound of the interest rate corridor is lowered by 25 basis points to 7.25 per cent.

The Central Bank of Turkey did not resisted to the political pressure

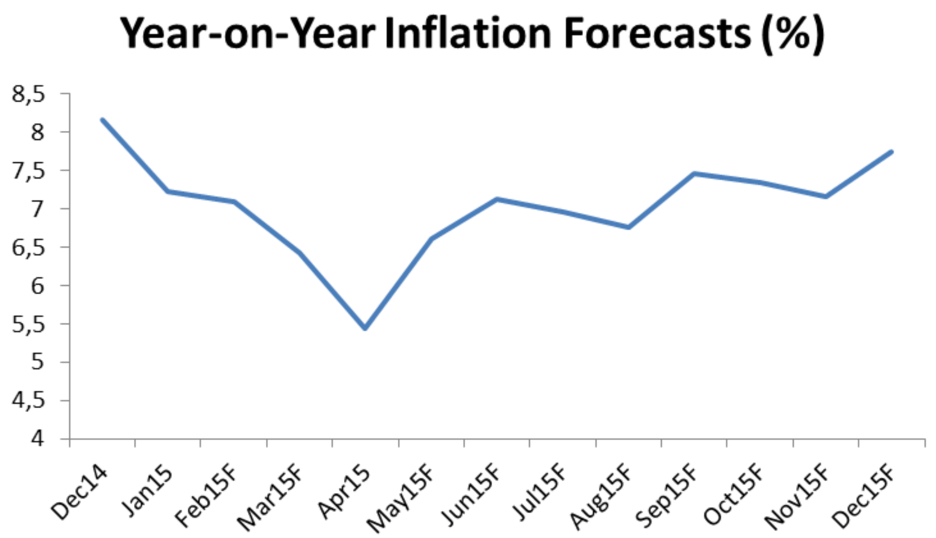
One would remember how USD/TRY parity lost 5 per cent in just 10 days between the days of January 21 and January 30. Today was the regular monetary policy meeting of the Central Bank Turkey (CBT). The previous meeting of the CBT was in January 21 and there was increasing pressures from the Turkish government towards the CBT to lower the interest rates in considerable amounts.

At that time, on January 21st, the CBT kept its cautious stance and cut only the policy rate by 50 basis points to 7.75 per cent. This was not found adequate by the government. The Governor Basci made an unfortunate comment at its Inflation Report meeting that they can reconvene on February 4th for an interim meeting to reconsider further rate cuts. The Turkish lira lost 5 per cent within this time and weakened to 2.45 from 2.32 against US Dollar. Since then the currency did not recover, it hit 2.50 against US Dollar when President Erdogan publicly criticized the CBT on February 11 for not doing its job properly.

The lira was trading around 2.47 against US Dollar today ahead of the regular CBT monetary policy meeting. Some market players were expecting no rate cut because of the weak currency. We were in expectations of 50 basis cut in the upper bound of the interest rate corridor and 25 basis points in the policy rate both because of the political pressures and the decline in the loan growth rates. The upper bound of the interest rate corridor which is the marginal funding rate directly affects the business loan rates especially the SME's. The annual growth rates in loans and the SME loans declined considerably in the last six months and for this reason we saw some room for lower upper bound of the interest rate corridor.

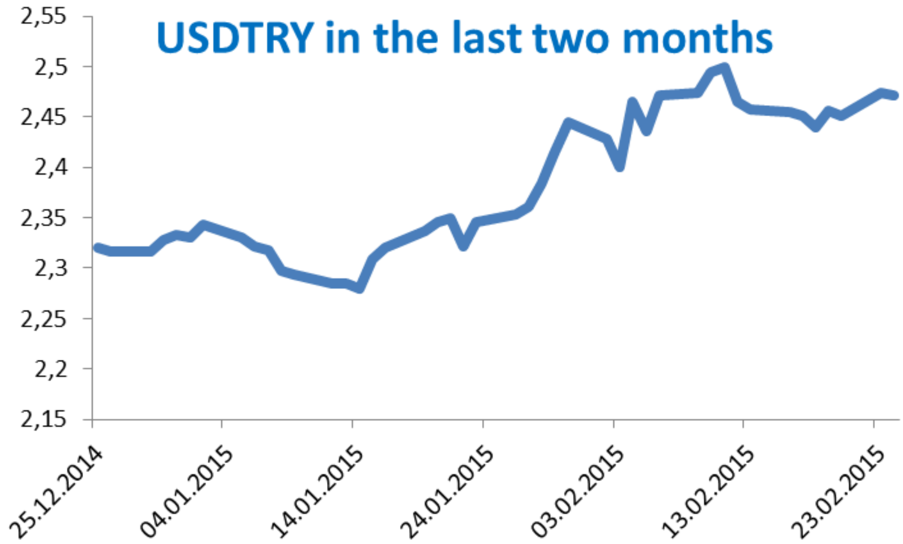
On the other side, the CBT should kept the symmetricity of the interest rate corridor, it could not just cut the policy rate to 7.50 per cent and leave it at the same level of the borrowing rate (of the lower bound of the corridor). We believe the cut in the lower bound of the corridor has been taken to make the interest rate corridor more symmetric.

The inflation data in the coming months would support the decision of the CBT, because there is very good base effect in the inflation figures in February and in March (see the graph below). The annual inflation will move around 5-6 per cent territory thanks to the favorable base effect in these months. But the real factor would reappear in June once the statements coming from the Federal Reserve harms the markets. The end-year inflation expectation of the CBT is 5.5 per cent. The bank would be obliged to hike interest rates again once Fed starts tightening and the favorable base effects for inflation disappears in the last quarter of the year.



Market reaction

The extent of the rate cuts were within the market expectations. This is why the Turkish lira did not depreciate further above 2.47. The psychological USDTRY level for the market players, 2.50, is important. USDTRY parity did not yet surpass the level of 2.50. However our calculations show that the parity will end the year around 2.60 level. The market players should be cautious for further depreciations in the days ahead.



For better Financial Foresight

Ekinci Economics Consulting

Ekinci Economics Consulting Disclosure Statement

The analysis and information presented in this report (Report) by Ekinci Economics Consulting (EEC) and the information is offered for subscriber interest only. This Report is not to be used or considered as a recommendation to buy, hold or sell any securities or other financial instruments and does not constitute an investment recommendation or investment advice.

The information contained in this Report has been compiled by EEC from various public and industry sources that we believe to be reliable; no representation or warranty, expressed or implied is made by EEC, its affiliates or any other person as to the accuracy or completeness of the information. EEC is not responsible for any errors in or omissions to such information, or for any consequences that may result from the use of such information. Such information is provided with the expectation that it will be read as part of a wider investment analysis and this Report should not be relied upon on a stand-alone basis. The opinions expressed in this Report reflect the judgment of EEC as of the date hereof and are subject to change without notice.

This Report is not an offer to sell or a solicitation of an offer to buy any securities. The offer and sale of securities are regulated generally in various jurisdictions, particularly the manner in which securities may be offered and sold to residents of a particular country or jurisdiction. To the fullest extent provided by law, neither EEC nor any of its affiliates, nor any other person accepts any liability whatsoever for any direct or consequential loss, including without limitation, lost profits arising from any use of this Report or the information contained herein.

EEC does not invest in any securities although it is possible that one or more of EEC's directors, officers, employees or consultants may at times be invested in the securities of a referenced company.