



Macro Scope

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Weekly Economic and Strategic Review

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Apparently Proactive...

While economists endured a tremendous loss of credibility in the global crisis, macroeconomic policies suffered the greatest shift in their routine paradigm. True to form, many academic studies, somewhat laden with guilt, have offered up quite a few opinions recently. The most salient of these exercises in academia was the IMF Staff Position Note, "Rethinking Macroeconomic Policy" prepared by Olivier Blanchard, the IMF Chief Economist. We realize this study only addresses general principles, but we must point out the likelihood of their notions becoming an integral part of what might be the financial architecture of economic systems of the future. However, the table below shows in essence what was discussed and what their macroeconomic policy design implies for the future.

Unfortunately, our allotted space is not ample enough to cover the entire study but at least we can elucidate our understanding of it. Briefly, the lesson to be had is that monetary policy rates are typically low in times of stability since economies lower their inflation targets, yet any convincing impact of this policy tool all but diminishes because the rates themselves are never negative, even if reduced rates proliferate in a crisis. Furthermore, a monetary policy that functions as a countercyclical policy tool is restrictive since sufficient fiscal space is not necessarily generated in times of stability. Another issue is that monetary policies frequently make faltering attempts to remedy problems such as asset bubbles and excessive risk taking. Though only broaching these issues in principle, the IMF study does propose solutions: **(1)** If inflation targets were set higher than at 2 percent, perhaps at 4 percent, in normal times, the central banks would be able to drive inflation expectations up while driving real interest rates down by stimulating present-day economic activity, which would create room for monetary policy to react to such market shocks; **(2)** when cyclical conditions permit, major fiscal adjustment is necessary and, should economic growth recover rapidly, it should be used to reduce debt-to-GDP ratios substantially, rather than to finance expenditure increases or tax cuts;

Rethinking the Macroeconomic Policy

What we thought we knew	What we have learned from the crisis
One Target: Stable Inflation	Stable inflation may be necessary but is not sufficient.
Inflation Should Be Low	Low inflation limits the scope of monetary policy in deflationary recessions.
One instrument: The Policy Rate	Financial intermediation matters.
A Limited Role for Fiscal Policy	Countercyclical fiscal policy is an important tool.
Financial Regulation: Not a Macroeconomic Policy Tool	Regulations is not macroeconomically neutral

Implications for the Design of Policy

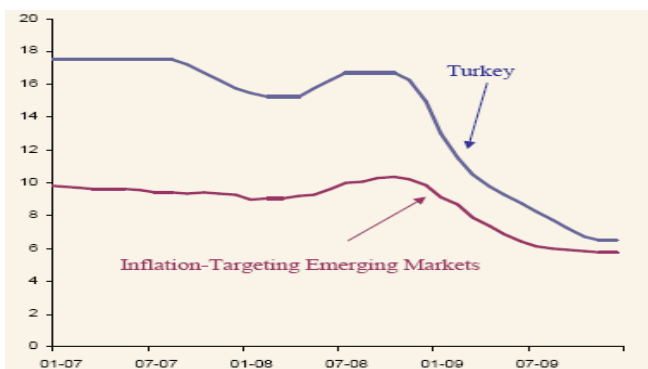
- Should the inflation targets be raised?
- Combine monetary and regulatory policy.
- Inflation targeting and foreign exchange intervention.
- Providing liquidity more broadly.
- Creating more fiscal space in good times.
- Designing better automatic fiscal stabilizers.

Source: *Rethinking Macroeconomic Policy, IMF Staff Position Note, February 12, 2010*

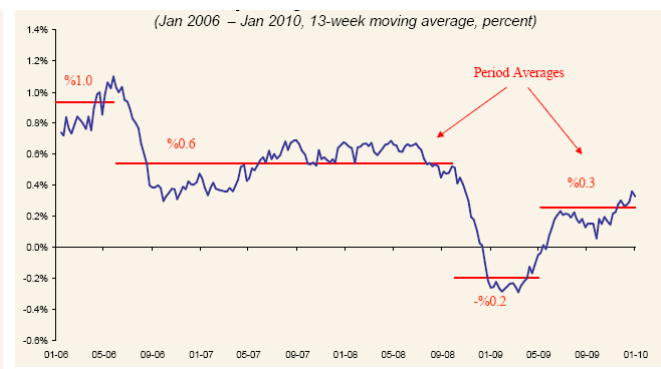
(3) Combine and find the trade-off between the monetary and regulatory tools and let the central banks do the task, instead of a separate regulatory authority. To this end, the Bank of England (BOE) has currently laid out these proposals, namely, the use of cyclical regulatory tools. For instance, if leverage appears excessive, regulatory capital ratios can be increased; if liquidity appears too low, regulatory liquidity ratios can be increased; to dampen housing prices, loan-to-value ratios can be decreased.

We contend that these proposals will stimulate outspoken debates in the days ahead. From our perspective, what strike us most is that Turkey has given us the impression that these proposals have already been implemented, apparently proactively. Turkey revised higher its inflation targets for three years in 2007 and recently raised the country's midterm inflation target to 5 percent. Moreover, during the crisis, over-the-top policy rates were quickly reduced, and, in the comfort zone of previously decreased debt to GDP ratios, primary surpluses from the pre-crisis period were allowed to quickly drain. Yet, the only difference from this model is having a separate banking regulatory authority in Turkey.

Policy Rates in Emerging Markets (Jan 2007– Dec 2009, %)



Weekly Change in Total Credit Volume (*)



(*) Total credits extended by deposit, development, investment and participation banks along with consumer financing firms; exchange rate adjusted
Source: Central Bank of Turkey

We plan to cover these proposals more thoroughly, obviously if the G20 adopts them; however, a more current topic should be reviewed at this point. Known for quite awhile, the Central Bank of Turkey announced they would continue to keep policy rates fixed until recovery reached a certain level, in effect, emulating other countries. Accordingly, current decisions on interest rates depend more on inflation rates and economic indicators, with the accurate analysis of economic trends gaining even more consequence. On the other hand, positive comments on the economy – with minor changes in the wording – have increasingly appeared in the monthly minutes of the Monetary Policy Committee. As such, former negative statements on capacity utilization and employment rates are now pronounced with watered-down phrases like “will remain low for a little while.”

Although interest rates must be kept low as these sources suggest, both the markets and the Central Bank know that interest rates will soon show an uptrend. However, when this upswing occurs and to what extent are unknown; even so, instead of being proactive, the Central Bank will base their decisions on economic indicators.

Another important unknown in this equation is whether other monetary policy tools and liquidity measures will be used to tighten financial conditions before any hike in interest rates occurs. Various commentaries have hinted that the Central Bank will rev up this process by increasing reserve requirements for the Turkish lira. We think it is helpful to remind the chronology for such measures during the crisis. First measures were focused more on supporting foreign exchange liquidity and on reducing foreign currency reserve requirements from 11 percent to 9 percent on December 5, 2008. This was necessitated by heavy capital outflows at the time. Obviously, the first set of measures to stabilise the Turkish lira, of great concern today, started with long-term (3 month) repos on June 17, 2009.

The final measure was reducing the Turkish lira reserve requirements from 6 percent to 5 percent on October 16, 2009. Naturally, reducing the policy rates started before any of these measures were taken. Accordingly, a reversal may necessitate a LIFO or FIFO-type approach – similar to the last-in first-out or first-in first-out concepts in accounting – which the Central Bank could opt for, considering the developments in banking liquidity and loan growth.

We conclude that since the global crisis tore asunder all loyalist beliefs across the board, perhaps the time has come to relook at what was factual about macroeconomic policies up to this point. While the IMF's Staff Position Note is expected to rock the boat, the study – with G20 endorsement – could perhaps complement the new global financial architecture and economic system of the future. As we see it, however, what is even more striking in this development is that Turkey appears to have somehow already implemented all these policy proposals – apparently proactively.

Economic and Political Agenda

▪ This week, while the foreign trade balance on Friday will be important at home, the real sector confidence index and capacity use will be eyed as well. Glancing at external arena, there will be a busy agenda especially in the US, with housing data, durable goods orders and preliminary GDP data.

Data issuances at Home

Importance	Indicator	Unit	Date of issuance	Fortis (Consensus)
Medium	Capacity Use, Feb.	%	Feb. 22 nd , 14:30 GMT	(68.7)
High	TURKSTAT Consumer Conf., Feb.	-	Feb. 22 nd , 14:30 GMT	-
High	Imports & Exports, Jan.	US\$ bn	Feb. 26 th , 8:00 GMT	-

Data issuances Abroad

Importance	Country	Indicator	Unit	Date of Issuance	Consensus
Medium	Germany	Ifo Index, Feb.	-	Feb. 23 rd , 9:00 GMT	96.1
Medium	U.S.	Case Shiller House Price Ind., Dec.	% m/m	Feb. 23 rd , 14:00 GMT	0.0
Medium	U.S.	Consumer Confidence Index, Feb.	-	Feb. 23 rd , 15:00 GMT	56.0
High	U.S.	New Home Sales, Jan.	mn	Feb. 24 th , 15:00 GMT	0.36
High	U.S.	Durable Orders, Jan.	% m/m	Feb. 25 th , 13:30 GMT	1.5
Medium	U.S.	Core PCE, Q4.	% q/q	Feb. 26 th , 13:30 GMT	1.4
High	U.S.	GDP (prelim), 4Q	% y/y	Feb. 26 th , 13:30 GMT	5.5
Medium	U.S.	Chicago PMI Index, Feb.	-	Feb. 26 th , 14:55 GMT	60.0
Medium	U.S.	Michigan Sentiment Index, Feb.	-	Feb. 26 th , 14:55 GMT	74.3
High	U.S.	Existing Home Sales, Jan.	mn	Feb. 26 th , 15:00 GMT	5.5

Macro-Economic and Financial Forecasts

Macro Economic Outlook of 2008-2011

	2009	2010f	2011f	2012f
GDP (TRY - bn) (*)	969.4	1,090.1	1,193.8	1,297.4
GDP (US\$ - bn) (*)	626.6	721.9	761.9	816.4
GDP Growth (y/y % chg) (*)	-5.7	5.0	4.0	4.0
PPI (y/y % chg)	5.9	5.0	4.0	4.0
CPI (y/y % chg)	6.5	7.3	5.5	5.0
Trade Balance (US\$ - bn)	-38.6	-65.0	-64.4	-67.7
Exports (FOB, excl. luggage trade)	102.2	115.4	132.6	144.4
Imports (CIF, incl. gold)	140.8	179.9	197.4	212.3
Current Account Balance (US\$ - bn)	-14.2	-35.8	-33.3	-33.4
Current Account Balance / GDP (%)	-2.3	-5.0	-4.3	-4.0

(*) 2009 values are our forecasts

Financial Indicators Forecasts

	Feb. 19 th	1M	3M	6M	12M	2010	2011
US\$/TRY	1.5120	1.5300	1.5400	1.5200	1.5300	1.5200	1.5600
EUR/TRY	2.0513	2.0500	2.0900	2.0800	2.1400	2.1300	2.1800
FX Basket	3.5633	3.5800	3.6300	3.6000	3.6700	3.6500	3.7400
EUR/US\$	1.3567	1.3400	1.3600	1.3700	1.4000	1.4000	1.4000
O/N	6.50%	6.50%	6.50%	6.50%	9.00%	8.00%	10.00%
Benchmark Bond	8.90%	9.00%	10.00%	10.50%	11.20%	11.00%	12.00%

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