Durmuş Yilmaz: Recent economic and financial developments in Turkey

Opening speech by Mr Durmuş Yilmaz, Governor of the Central Bank of the Republic of Turkey, at the 78th Ordinary Meeting of the General Assembly, Ankara, 20 April 2010.

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I. Introduction

1. Esteemed Shareholders, Distinguished Guests and Members of the Press, Welcome to the 78th Ordinary Meeting of the General Assembly of the Central Bank of the Republic of Turkey.

2. I would like to start my speech with a brief evaluation of the global financial crisis that deepened to spread over the whole world in the final quarter of 2008 and took its toll throughout 2009. Later on, I will summarize the key macroeconomic developments that took place in Turkey in 2009. Finally, I will share my evaluations pertaining to inflation developments and monetary policy implementations.

II. Global economic developments

Distinguished Guests,

3. The effects of the financial crisis, which first started in advanced countries and deepened mainly due to the bankruptcy of some major financial firms in the USA in September 2008, continued to dominate financial markets throughout 2009. Accordingly, growth rates slumped globally but particularly in advanced countries. Owing to extensive liquidity operations led by central banks and large-scale government interventions, the effects of the crisis started to subside as of the second half of 2009 and the global economy exhibited signs of a slow and gradual recovery.

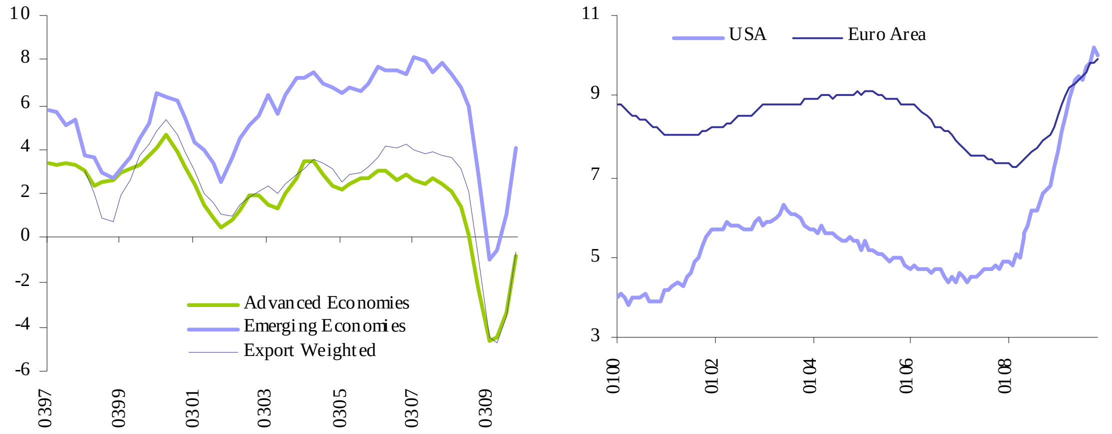
4. The recovery in global economic activity that started on the back of the historically large fiscal stimulus packages launched by advanced economies contributed to the improvement of global risk perceptions and normalization of financial markets. Readings on economic activity and global financial system in the first quarter of 2010 point out that the recovery is ongoing. However, soaring budget deficits – especially in advanced economies – reach levels of concern, problems across credit markets linger, and unemployment rates continue to remain elevated, all suggesting that it would take a long time for the global economic problems to be resolved permanently. Moreover, ongoing uncertainties regarding the exit strategies from unconventional monetary and fiscal measures continue to pose risks on the sustainability of the recovery.

5. It is observed that advanced and emerging market economies started to recover as of the second quarter of 2009, mainly on the back of expansionary monetary and fiscal policies implemented worldwide and on inventory accumulation mostly in advanced economies. Despite positive signs of recovery in the global economy, high unemployment rates in advanced countries, primarily in the USA and Euro Area, still persist. With global economic growth mainly based on expansionary monetary and fiscal policies temporary in nature and the fact that unemployment rates remain currently high and oil prices re-started rallying, the global economic recovery will likely to be slow and protracted.

Growth Rates and Unemployment Rates in Advanced and Emerging Economies

Growth Rates
(Annual Percentage Change)

Advanced Economies Unemployment Rates
(Percent)



Source: Bloomberg, CBRT.

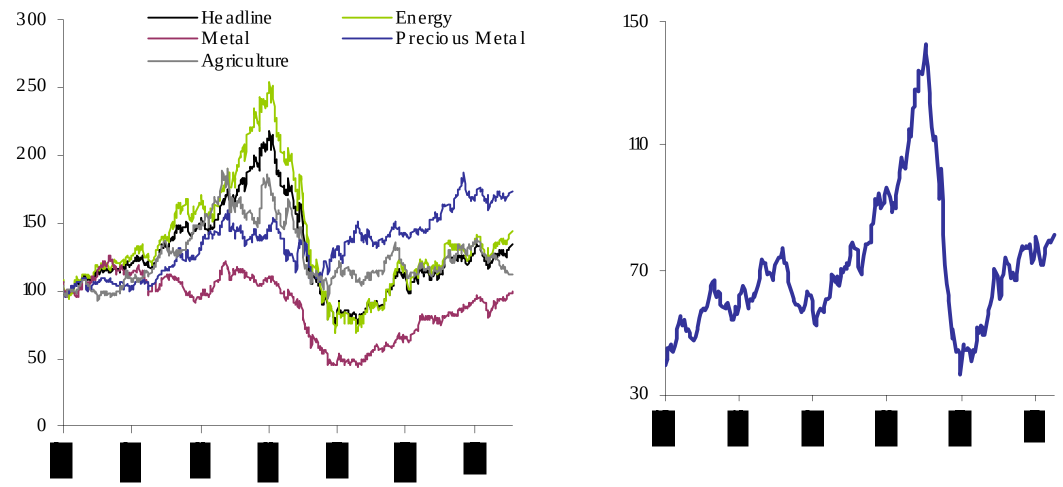
Source: Bloomberg, CBRT.

6. Commodity prices, which fell drastically in the last quarter of 2008 due to the significant contraction in global economic activity, hovered at low levels in early 2009. However, commodity prices began trending upward as of the second half of the year mainly on the back of the growing optimism about the global economic recovery and the boosting demand stimulated by the fiscal incentives implemented in China. The liquidity glut that was particularly fuelled by stimulus packages implemented in advanced countries, and the accelerating global economic activity resulted in an increase in oil and commodity prices, which further continued into the first quarter of 2010 as well.

Commodity and Crude Oil Prices

S&P Goldman Sachs Commodity
Price Indices*

Crude Oil (Brent) Prices
(US dollar/bbl)



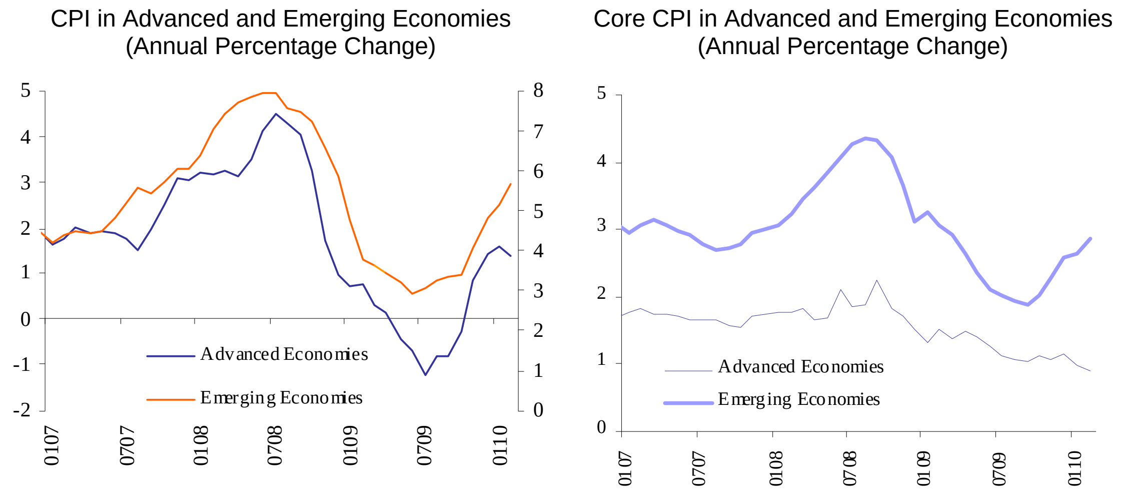
*January 2007 average is taken as 100.
Source: Goldman Sachs.

Source: Bloomberg.

7. Global inflation that had plummeted due to downward pressures arising from demand and cost conditions since the second half of 2008, maintained its course in 2009 as well, and the annual rate of change in consumer prices in advanced economies turned negative in May and June. However, it started to trend up in

August 2009, particularly due to the low base in 2008 and the surge in commodity prices. The upward trend in global inflation, being more pronounced in emerging economies, also continued into early 2010. Meanwhile, core inflation continued to decline in advanced economies, while it trended upward in emerging economies.

CPI and Core CPI in Advanced and Emerging Economies

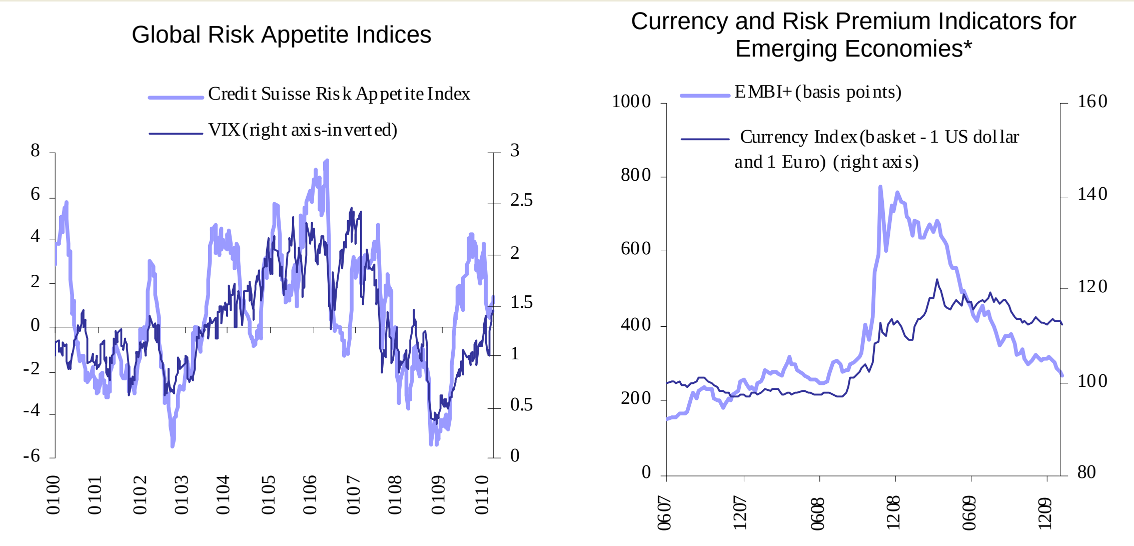


Source: Bloomberg, CBRT.

Source: Bloomberg, Datastream, CBRT.

8. In the first half of 2009, the global financial markets recovered, albeit modestly relative to the final quarter of 2008 when the impact of the crisis was felt most strongly. This recovery is mainly attributable to measures taken worldwide in order to ensure the proper functioning of financial markets, unconventional monetary and fiscal measures taken by advanced countries and the relatively promising data on global economic activity. The global risk appetite continued to improve, though slowly, as of the year-end and early 2010.

Global Risk Appetite and Risk Premium Indicators



Source: Bloomberg.

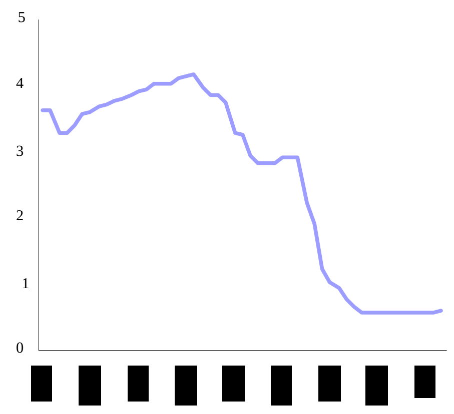
*Average of the values that emerging market currencies take against the currency basket of 1 US dollar and 1 Euro. Equals 100 on June 2007 and an upward movement denotes depreciation of emerging market currencies.
Source: Bloomberg.

9. The rate cut cycle that was initiated by the central banks of both advanced and the emerging countries at the height of the global crisis during the final quarter of 2008, continued in the first quarter of 2009, albeit with less pace. Monetary easing cycle in advanced economies, which significantly slowed down in the second quarter of 2009, ceased completely in the third quarter. Emerging market central banks, on the other hand, continued to cut policy rates at a reduced pace to contain the impact of the global crisis on economic activity.

10. As of year-end, most central banks kept policy rates at low levels and continued to implement expansionary monetary policy to stimulate economic activity by using unconventional monetary policy tools. In the first quarter of 2010, a limited number of central banks tightened their monetary policy stance by increasing policy rates, while most of them kept their rates unchanged at low levels. In the meantime, these central banks started to terminate the expansionary monetary policy implementations, which are conducted by the use of unconventional policy tools.

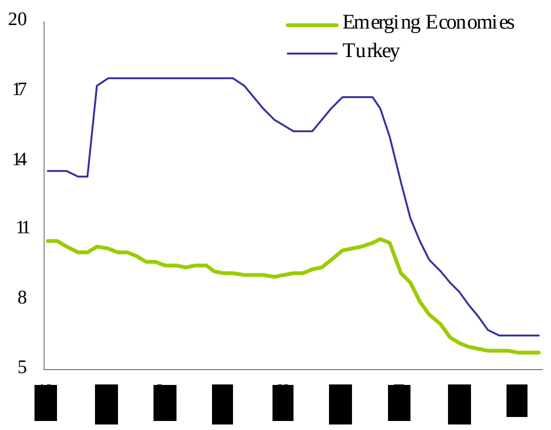
Policy Rates in Advanced and Inflation-Targeting Emerging Economies

Policy Rate in Advanced Economies



Source: Bloomberg, CBRT.

Policy Rate in Inflation-Targeting Emerging Economies



Source: Bloomberg, CBRT.

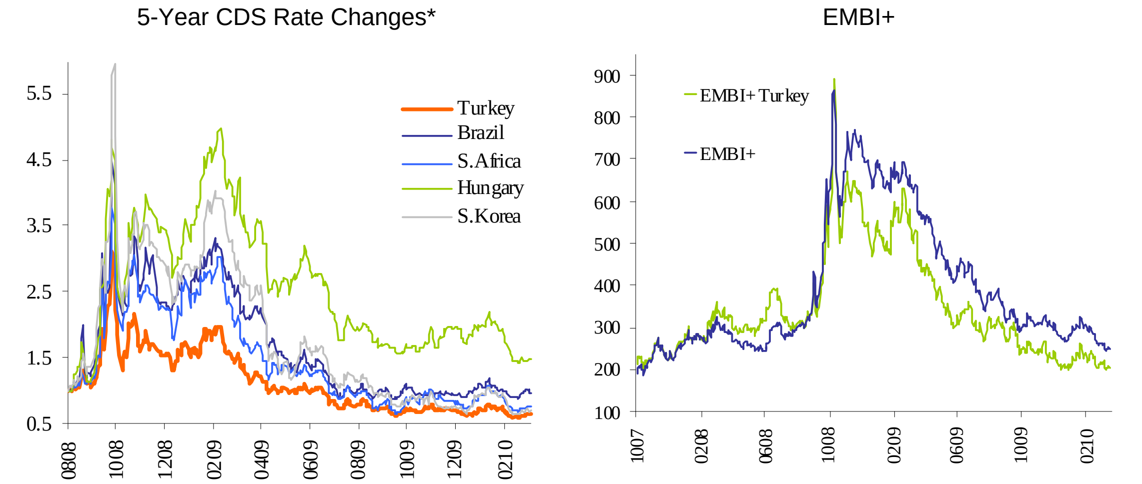
Esteemed Guests,

11. After having summarized developments in the global economy in 2009, now I would like to touch upon key macroeconomic developments in Turkey.

III. Developments in the Turkish economy

12. As I have already mentioned regarding the global economic developments, the growing perception since the last quarter of 2009 that the worst of the crisis is over and the economy has started to head towards recovery has driven the global risk appetite higher. This boosted optimism in global financial markets and provided a further positive bias towards riskier assets. Thus, emerging markets, including Turkey, have experienced capital inflows through portfolio movements, which led to an appreciation in their currencies and caused stock markets to rise.

Risk Premium Indicators



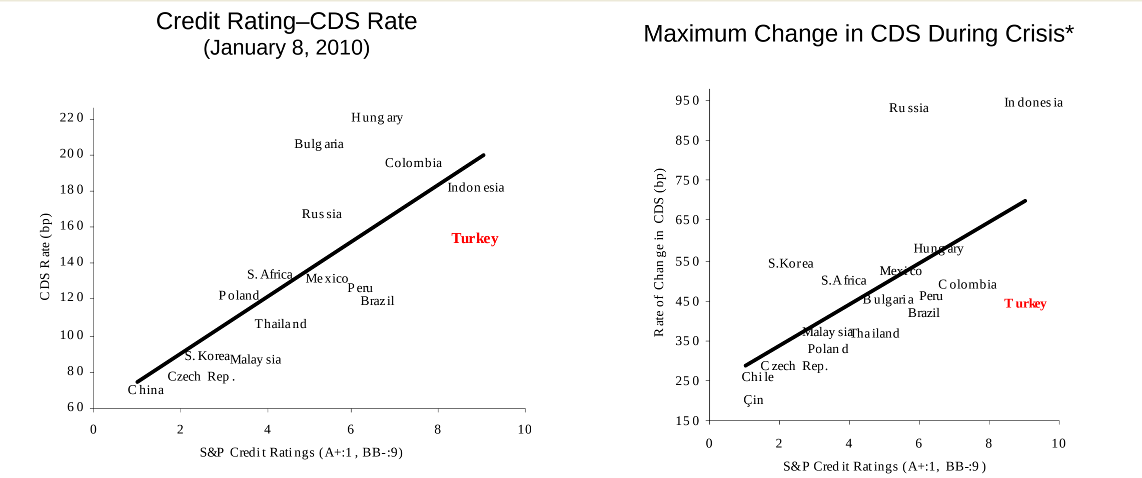
*Rate changes with base August 2008 (equals 1 on August 29, 2008).
Source: Bloomberg, CBRT.

Source: Bloomberg.

13. However, an important point that needs to be highlighted is that risk indicators for the Turkish economy have exhibited a more favorable performance compared to that of other emerging market economies especially since the height of the crisis during the final quarter of 2008. This development not only implies the soundness of the Turkish financial structure, but also indicates that our economy has gained resilience and strength against global crises compared to previous periods.

14. Turkey's CDS rating changed dramatically at the end of 2009. Medium to long-term forecasts for Turkey were revised positively, many investors increased the weight of Turkish assets in their portfolios, and more importantly, prominent credit-rating agencies upgraded Turkey's credit rating. There may be some credit upgrades in the upcoming period, in case a fiscal discipline backed by structural reforms is achieved and maintained.

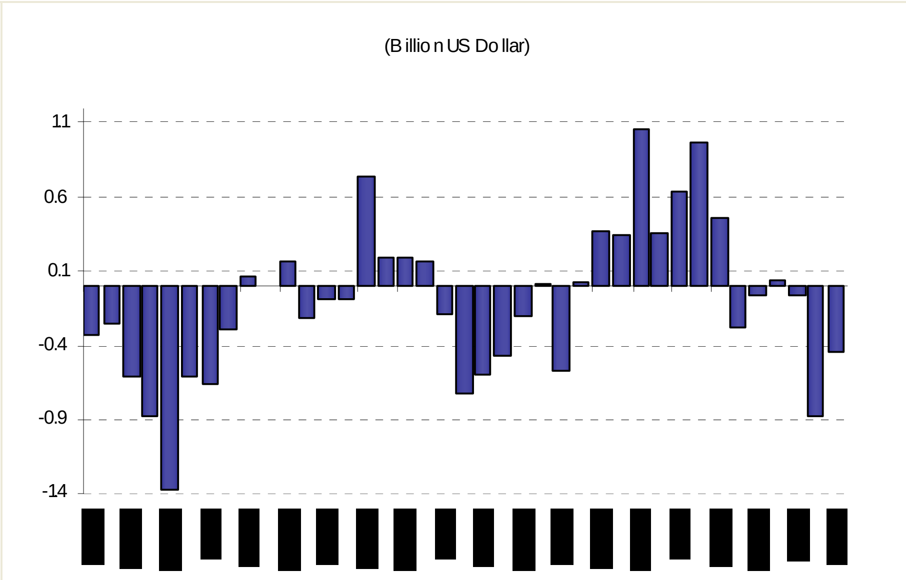
Relation Between Risk Premium and Credit Rating



*The difference between the highest CDS spreads during and before the crisis.
Source: Bloomberg, CBRT.

15. The higher performance exhibited by the Turkish economy compared to many other emerging economies during the global crisis and the recent upgrades to our credit rating are mainly attributable to the stability ensured in our financial system. Unlike its peers, Turkey did not require any cash stimulus packages for its banking system against the global financial crisis. The absence of toxic assets in banking balance sheets, strong capital adequacy ratios and considerably low levels of foreign exchange short positions have been the essentials underlying the increased strength of our financial system against the global crisis.

Net Foreign Exchange Position of the Banking Sector

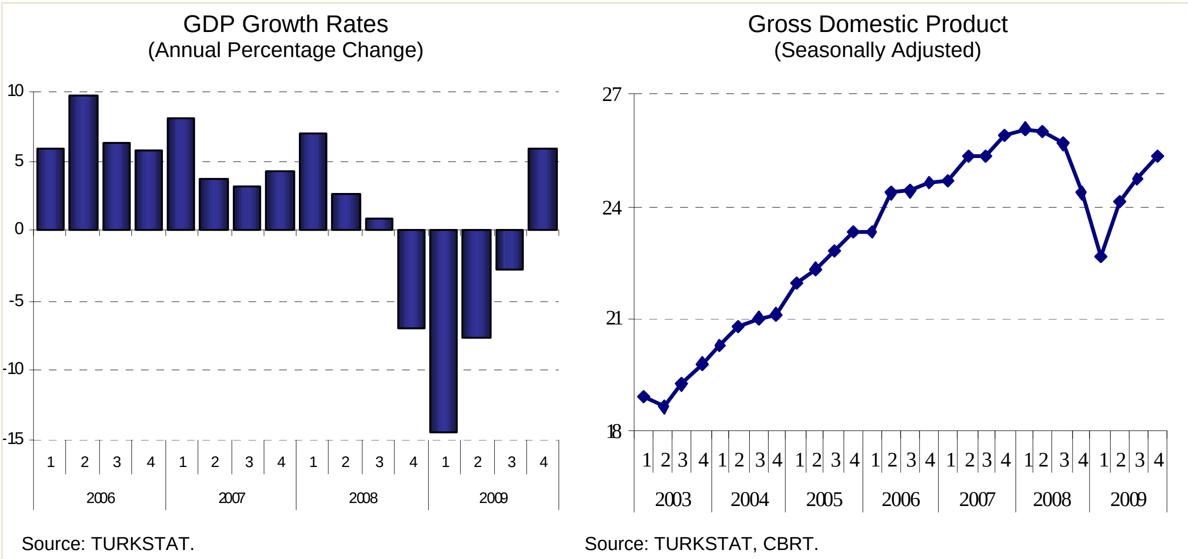


Source: BRSA.

Distinguished Guests,

16. With the problems driven by global turbulence, the domestic and foreign credit conditions in Turkey tightened and Gross Domestic Product (GDP) growth rates have slowed down significantly since the second quarter of 2008 as a result of narrowing domestic demand. Economic activity has experienced hard landings from the last quarter of 2008 to the second quarter of 2009. As the monetary and fiscal measures started to sway, the GDP, after bottoming out, started to recover rapidly as of the second quarter and contracted by 4.7 percent for the overall year. While private investment and consumption expenditures had a negative effect, government spending on consumption goods had a boosting effect on GDP growth in 2009. Meanwhile, the positive contribution of the increased net exports as a result of the reduced demand for imports partially limited the slowdown of growth in 2009.

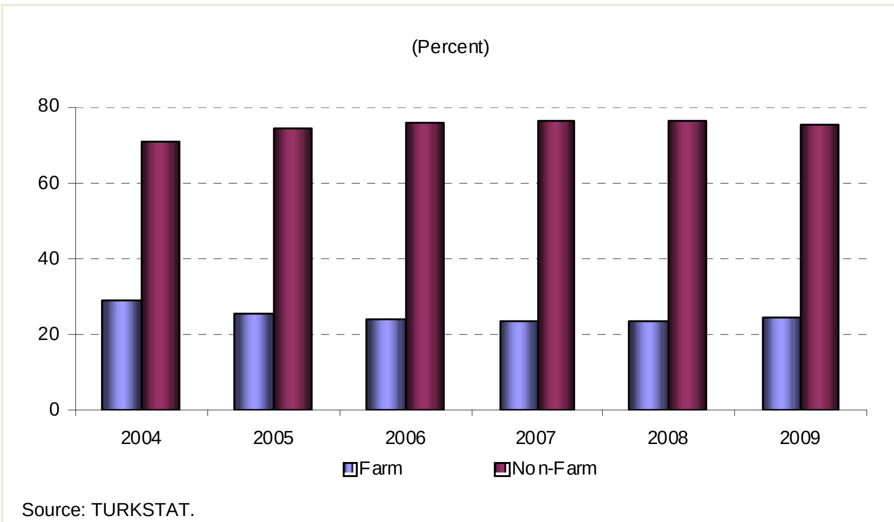
GDP Growth Rates



17. The transformation that the Turkish economy has undergone in the post-2001 period has caused major changes in the employment structure. The share of the agricultural sector in employment was 35 percent in 2002, while, this ratio fell to around 23 percent in 2007. However, with the recent economic slowdown, this trend reversed temporarily and the share of agricultural sector in employment increased to approximately 25 percent in 2009.

18. While global turmoil took a heavy toll on industrial employment, it had a scant impact on employment in construction and services sectors. In 2009, industrial employment contracted by 7 percent, whereas, employment in the construction sector and services sector increased by 0.6 percent and 1.4 percent, respectively.

Employment by Sectors

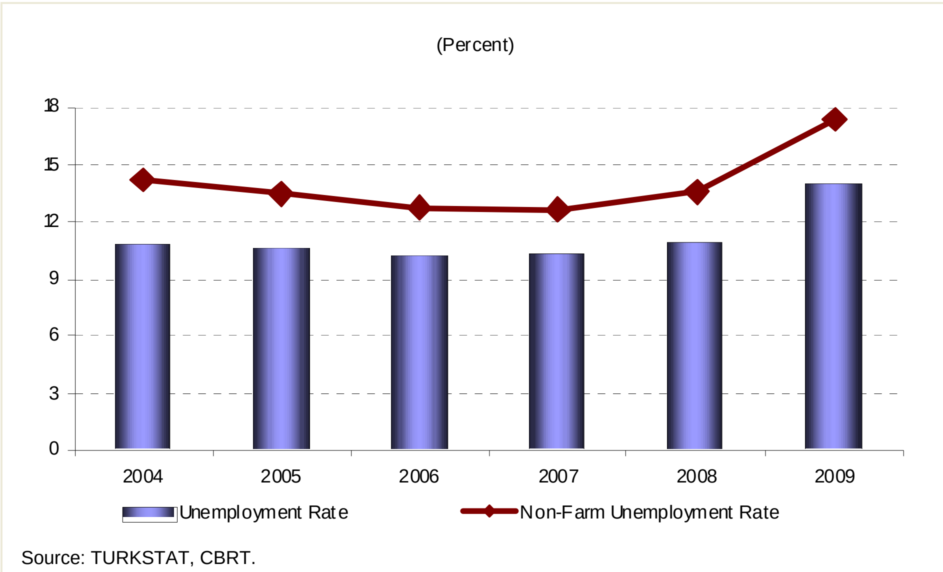


19. Demographic changes in Turkey leads to an increase in the share of the working population in the overall population and this, in turn, results in the unemployment to persist. However, the recent upsurge in the unemployment rate is mainly attributable to cyclical rather than structural factors. The economic contraction in 2009 increased the labor force participation rate while significantly curbing the pace of employment growth; hence the unemployment rate increased rapidly.

20. The labor force is comprised of 23,8 million people in 2008 and rose to 24.7 million people in 2009 by an increase of 4 percentage points, whereas, employment increased by a mere 0.4 percent, from 21.2 million to 21.3 million people. In this period, the rapid increase in labor force participation while employment remained much the same, caused the unemployment rate to climb to 14 percent in 2009 from 11 percent in 2008. Meanwhile, the non-farm unemployment rate increased from 13.6 percent to 17.4 percent.

21. As I mentioned in my previous presentations, creating new employment opportunities for the growing labor supply in Turkey is contingent upon carrying out cost-reducing and resilience-enhancing reforms in labor markets. These reforms, by promoting registered employment, will also help us overcome problems in our social security system.

Unemployment Rates

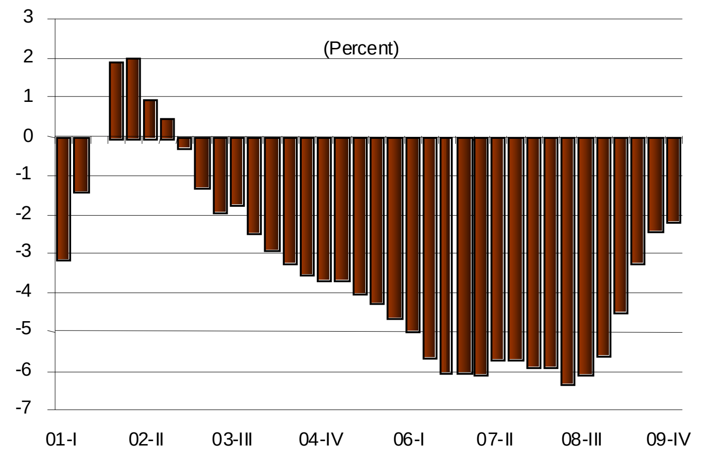


Distinguished Guests,

22. The impact of the global economic crisis on Turkey's foreign trade has been evident, and the contraction in domestic and foreign demand and the slumps in commodity prices, especially in crude oil as well as iron and steel led imports and exports to shrink rapidly as of the last quarter of 2008. Significant declines have been observed throughout the year in imports and exports, which tended to recover as of the second quarter of 2009 as signs of revival in global economic activity appeared. Total exports of goods fell by 22.1 percent to 109.7 billion USD, while total imports of goods fell by 30.7 percent year-on-year to 134.4 billion USD in 2009. Consequently, the foreign trade deficit, which was 53 billion USD in 2008, dropped to 24.7 billion USD in 2009.

23. The adverse impact of the global crisis on tourism revenues was translated as a decrease in expenditures. In 2009, tourism revenues decreased by 3.2 percent. The said decline is mainly attributable to the fall in average tourism revenues. In fact, the number of visitors increased by 3.3 percent in 2009. Due to the recovery in other services items, the slowdown in the services surplus remained limited at 5.3 percent. Hence, the current account deficit has been 13.9 billion USD in 2009, while the ratio of current account deficit to GDP fell from 5.6 percent in 2008 to 2.2 percent in 2009.

Current Account Balance/GDP*



*Annualized data.
Source: CBRT.

Distinguished Guests,

24. Uncertainties led by the global crisis adversely affected the credit market in Turkey as well. On the supply side, 2009 is evaluated as a year in which the banks were cautious in lending basically due to risk perceptions. On the demand side, the demand for investment loans has been on a decline because of the slowdown in economic activity. On the other hand, the willingness of firms to restructure their debts emerged as a significant factor that increased credit demand.

Consumer Loans and Credit Card Claims
(Real Quarterly Percentage Change, End Values)

	2008		2009			
	III	IV	I	II	III	IV
Consumer Loans	6.0	-5.0	-0.7	2.0	2.0	2.2
Housing	3.5	-4.4	-0.6	2.0	2.5	3.4
Automobile	-0.5	-11.9	-10.5	-4.9	-5.7	-7.1
Other	9.6	-4.5	0.5	2.9	2.5	2.1
Credit Cards	6.6	-0.4	-3.3	5.0	1.7	-1.9

Source: CBRT.

25. Measures taken by the Central Bank to maintain financial stability and to promote the functionality of credit markets had favorable impacts on credit markets during the crisis. Policy rate cuts and stabilizing liquidity measures were reflected on credit rates and this contributed to the easing of financial tightness. Especially as of the second half of 2009, with the decline in credit rates, the uptrend in credit volume became more pronounced.

Distinguished Guests,

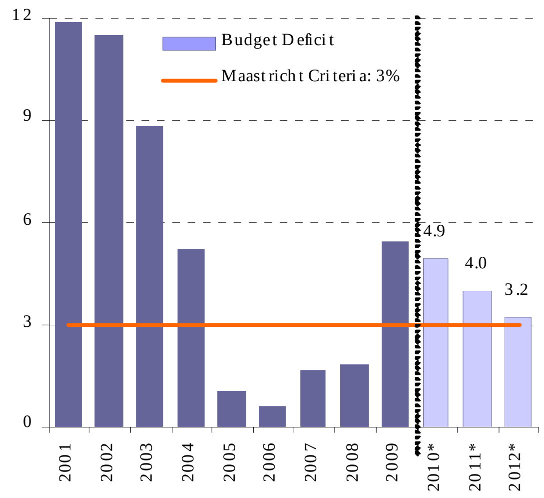
26. The comprehensive fiscal incentive policies implemented to alleviate the effects of the global economic crisis caused fiscal deficits and debts stocks to soar globally, primarily in advanced countries. Additionally, the decline in tax revenues consequent to the contraction in economic activity accelerated the increase in budget deficits.

27. In parallel with the global rise in government fiscal balances, the ratios of budget deficits and debt stocks to national income also soared in Turkey in 2009. During

this period, lower-than-targeted tax revenues due to contraction in domestic demand as well as higher-than-targeted primary expenditures mainly due to increase in current transfers to Social Security Institution due to slowdown in employment growth have been the primary causes of the surge in the budget deficit. An analysis of developments in public finance in the first quarter of 2010 reveals that the central government budget balance had an improved year-on-year performance, this being mainly attributable to the increase in tax revenues with the revival in economic activity.

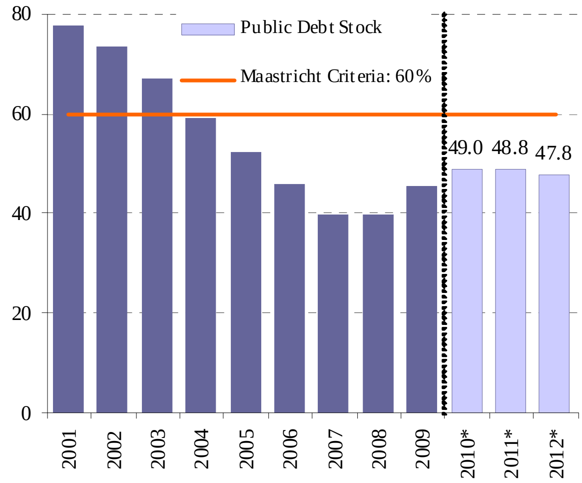
Central Government Budget Deficit and EU-Defined Public Debt Stock

Budget Deficit
(Ratio to GDP)



* Medium Term Program (2010-2012) Targets.
Source: Ministry of Finance, Medium Term Program (2010-2012).

Public Debt Stock
(Ratio to GDP)

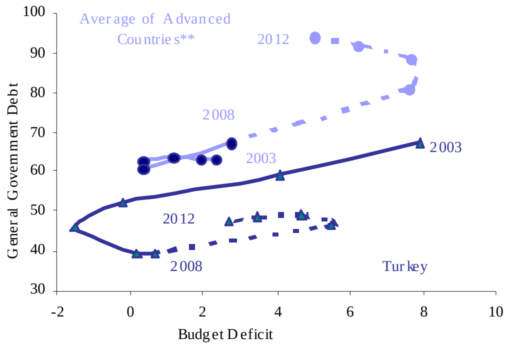


* Medium Term Program (2010-2012) Targets.
Source: Ministry of Finance, Medium Term Program (2010-2012).

28. The determined implementation of fiscal discipline in Turkey since 2002 has helped cut the ratios of government budget deficit and debt to GDP, to a level well below the average of both advanced and emerging economies. Although Turkey's budget deficit expanded at a faster pace than in many other emerging economies in 2009, according to the MTP projections, government debt stock is likely to remain below the average of other emerging economies in the upcoming years.

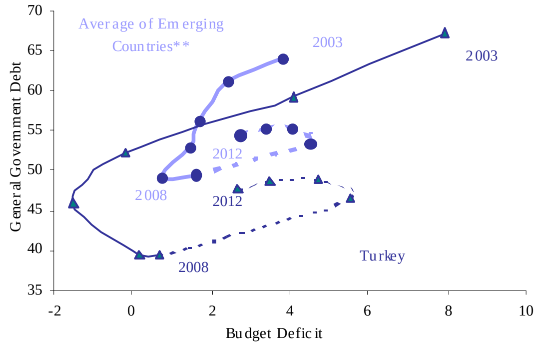
General Government Budget Deficit and Debt Ratio

Average Values in Advanced Countries and Turkey
(Percent of GDP)



*Dashed lines indicate forecasts.
**Includes USA, UK, Germany, France, Spain, Ireland, Iceland, Japan, Portugal, Israel, Greece, Italy, Austria, New Zealand and South Korea.
Source: IMF. Turkish data is taken from the Ministry of Finance, Undersecreteriat of Treasury, Medium Term Program (2010-2012) and Program for 2009.

Average Values in Emerging Countries and Turkey
(Percent of GDP)



* Dashed lines indicate forecasts.
**Includes Hungary, Mexico, Romania, Argentina, Brazil, Bulgaria, Czech Republic, India, Indonesia, Israel, Malaysia, Poland, Singapore and South Africa.
Source: IMF. Turkish data is taken from the Ministry of Finance, Undersecreteriat of Treasury, Medium Term Program (2010-2012) and Program for 2009.

29. Under current economic circumstances, in order to reinforce the optimism about sustainable macroeconomic stability in the medium term and to ensure effective expectations management, it is crucial that government budget deficit and debt should be kept under control through commitments with a strong institutional background. In this regard, attaining the targets set out in the MTP through institutional and structural improvements rather than by tax and price adjustments, is critical for further enhancing gains already achieved in terms of country risk.

Esteemed Guests,

30. In the last part of my speech, I would like to mention the monetary policy strategy that we implemented in this atmosphere of uncertainty created by the global economic crisis. I will, first of all, give an evaluation on inflation developments and monetary policy implementations within the scope of the inflation targeting regime. Then, I will briefly touch upon the exit strategy, the details of which were shared with the public last week, for gradually withdrawing measures taken during extraordinary circumstances.

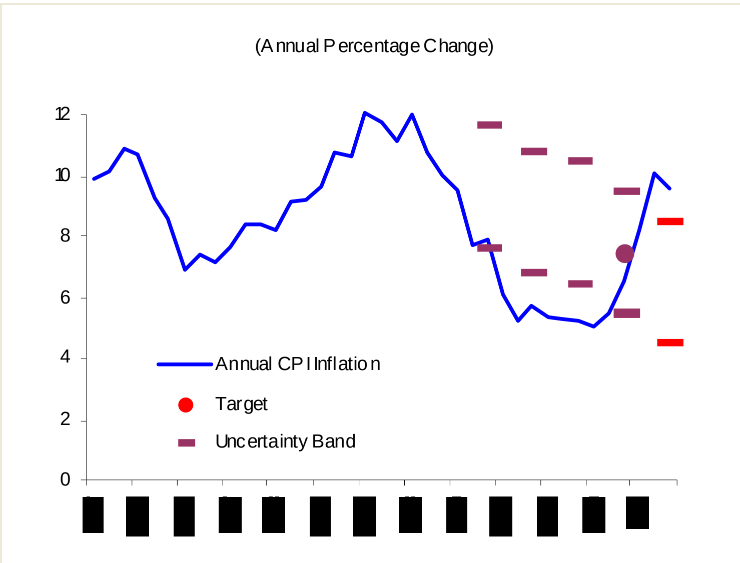
IV. Inflation developments and monetary policy implementations

31. As I have also mentioned at the beginning of my speech when evaluating the global economic developments, inflation rates saw dramatic declines on a global basis due to rapidly contracting economic activity and plunging commodity prices as of the last quarter of 2008. During this period, a similar pace was observed in Turkey regarding the inflation outlook. Despite the relatively sound structure of the Turkish financial sector, our exports being composed of mainly products sensitive to foreign conjuncture; the sensitivity of production to global credit conditions and high level of capacity at the onset of the crisis have deepened the contraction in economic activity. During this period, in addition to tightness in financial conditions, a sharp contraction in domestic demand was also experienced due to prevailing perception of uncertainty and increased precautionary savings. Furthermore, temporary tax incentives for stimulating the domestic demand led inflation to fall faster-than-

expected in the first half of 2009. Consequently, the inflation rate remained below the announced target-consistent-path, in June.

32. As I have previously mentioned, as the pace of recovery in the global economy became more pronounced, the risk appetite in global financial markets started to boost as of the second half of 2009. Accordingly, emerging markets attracted more capital through increased portfolio movements. On the Turkish economy side, this led to appreciation of the Turkish lira against major currencies, which limited the adverse effect of import price hikes on unit costs. In the third quarter of 2009, despite the upward inflationary pressure from tax adjustments to restore fiscal balance, the annual rate of change in consumer prices maintained its downward pace due to declining course of the underlying trend. By the end of the third quarter, the inflation rate continued to remain below the target-consistent-path.

Annual CPI Inflation and the Target-Consistent-Path

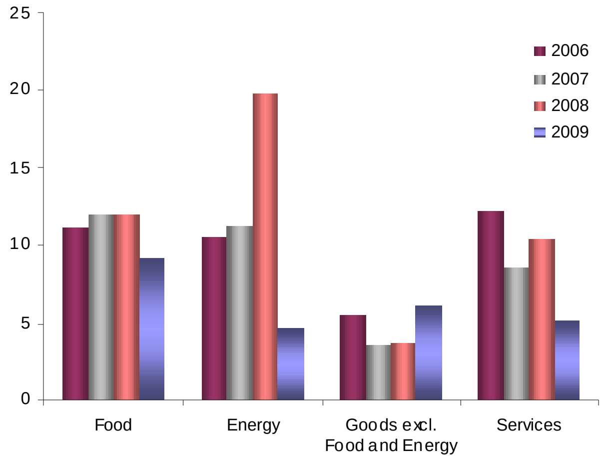


Source: TURKSTAT, CBRT.

33. In the last quarter of 2009, in line with our projections, both domestic and external demand, one of the factors that affect the underlying inflation trend, maintained their pace of moderate recovery, and resource utilization in the economy continued to remain low. Yet, inflation was up by 1 percentage point from October Inflation Report projections due to the highest increase in unprocessed food prices of the recent past. Consequently, inflation remained slightly below the target at end-2009 with 6.53 percent, yet remained within the uncertainty band.

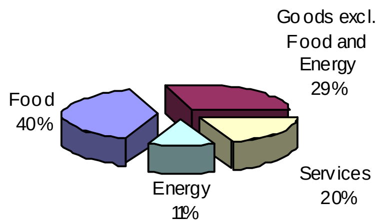
34. An analysis of inflation developments in 2009 by subcategories suggests that annual inflation slowed down in all main categories excluding food and energy for which tax adjustments were effective. Although food price inflation remained low relative to recent years, among all subcategories, the biggest contributor to overall inflation has been food prices. This is attributable to hikes in unprocessed food prices driven by supply-side shocks.

CPI by Subcategories
(Annual Percentage Change)



Source: TURKSTAT, CBRT.

Contribution to CPI Inflation in 2009
(Percentage Point)

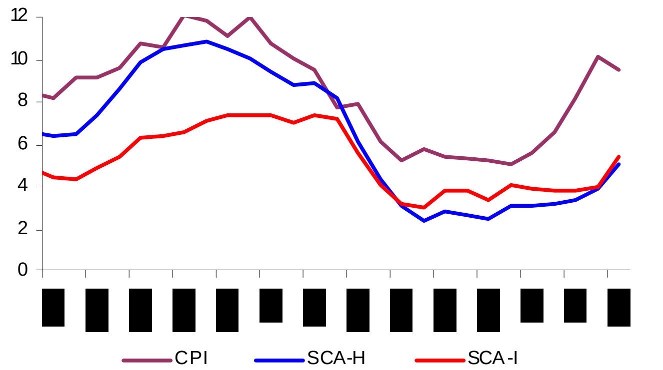


Source: TURKSTAT, CBRT.

35. Despite having followed a volatile course during periods when temporary tax adjustments were effective, core inflation, which is useful for predicting underlying inflation, had a remarkable downtrend consistent with medium-term targets throughout 2009.

Core Inflation Indicators and CPI Inflation

(Annual Percentage Change)



Source: TURKSTAT, CBRT.

36. Recent data releases indicate that the pace of recovery in economic activity continues. Domestic demand rises gradually as the lagged effects of monetary policy implementations become evident, whereas, uncertainties regarding external demand persist. Accordingly, we expect that after following a volatile course significantly above the target for some period, inflation will be back on a downtrend by the phasing out of temporary effects as of the last quarter of the year and return to target-consistent levels as of early 2011. At this point, I would like to emphasize that we closely monitor pricing behavior as inflation hovers around high levels, albeit for a temporary period. I would like to hereby remind you that we will provide public with the updated evaluations and forecasts on medium-term inflation outlook along with possible risks and policy measures, more extensively in the Inflation Report to be published on 29 April.

Distinguished Guests,

37. Throughout 2009, as the Central Bank, we focused on policies oriented towards containing the adverse effects of the crisis on the economic activity and on financial stability while also overseeing price stability. Thanks to the experience gained from domestic crises in the recent past, we were able to make prompt and effective decisions, thus we were able to do our part to minimize the adverse impacts of the global crisis. In this period, the soundness of the financial system in addition to the relatively limited deterioration in the risk premium provided monetary policy with an extra room for maneuver.

38. Accordingly, envisioning that undershooting the inflation target at year-end has been more likely, we continued the rate cut cycle that we initiated in November 2008 by pursuing a front-loaded monetary policy in early 2009. Despite signals of partial recovery in domestic economic activity as of May, we continued rate cuts until November 2009 in view of the ongoing uncertainties pertaining to the strength and sustainability of the demand recovery and also anticipating that it would take a considerable period of time before economic activity recovers and employment conditions would improve. The policy rate cuts were terminated in December 2009, due to stronger perceptions that economic activity had started to recover. Thus, the policy rates were cut by a total of 1025 basis points since November 2008.

Monetary Policy Committee's Policy Rate Decisions in 2009

Meeting Date	**Policy Rate Decision** (Percentage point)	**Policy Rate** (Percent)
January 15, 2009	-2.00	13.00
February 19, 2009	-1.50	11.50
March 19, 2009	-1.00	10.50
April 16, 2009	-0.75	9.75
May 14, 2009	-0.50	9.25
June 16, 2009	-0.50	8.75
July 16, 2009	-0.50	8.25
August 18, 2009	-0.50	7.75
September 17, 2009	-0.50	7.25
October 15, 2009	-0.50	6.75
November 19, 2009	-0.25	6.50
December 17, 2009	No Change	6.50
January 14, 2010	No Change	6.50
February 16, 2010	No Change	6.50
March 18, 2010	No Change	6.50
April 13, 2010	No Change	6.50

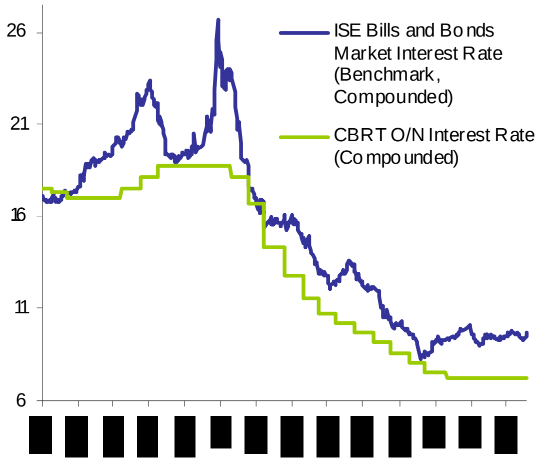
Source: CBRT.

39. Developments following the initiation of policy rate cuts have confirmed our projections on the magnitude of the crisis and its impact on economic activity and on inflation outlook, and have justified our policy decisions. This, in return, enhanced

the effectiveness of the monetary policy decisions on financial variables and expectations. Consequently, in 2009, determining role of Central Bank in shaping market interest rates has improved and hence, market interest rates came down to historic lows by following the monetary policy stance even during periods marked by high global risk perceptions. Furthermore, we observe that our policy rate cuts have also been effective on credit rates as of the second half of 2009. The downtrend in credit interest rates especially accelerated further following the issue of July Inflation Report which presented a solid perspective on medium-term policy, and on the back of the improvement in global risk perceptions, credit markets have witnessed favorable developments as of the last quarter of 2009.

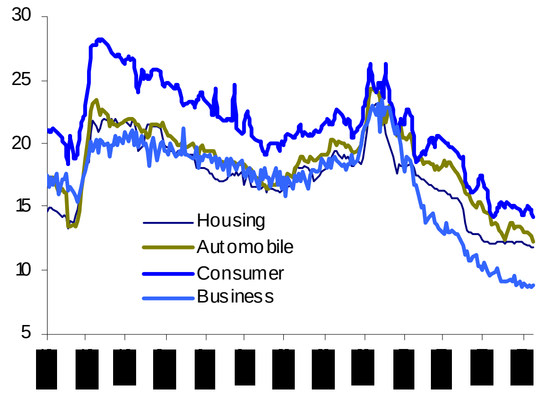
Interest Rate Developments

ISE Bills and Bonds Market and CBRT O/N Interest Rates



Source: ISE, CBRT.

Loan Rates
(Annual, Percent)



Source: CBRT.

Esteemed Guests,

40. We effectively used all policy instruments to maintain financial stability during the height of the crisis. As the crisis began to deepen in October 2008, we, by establishing a strong line of communication with the public about the details and the robust structure of the liquidity management strategy, have announced liquidity facilities to be provided to the markets step-by-step, in a clear and transparent way. Subsequently, by gradually introducing the announced measures for both Turkish lira and foreign exchange markets, we considerably removed the disturbances and volatilities in the markets. In this regard, we continued to implement measures that were taken as of October 2008 – when the crisis started to deepen – for ensuring smooth operation of Turkish lira and foreign exchange markets and supporting the corporate sector, in 2009 as well. In this part of my speech, I would like to outline the measures that we have taken.

41. The monetary measures implemented for Turkish lira during the crisis can be classified into two main groups: The first pillar of monetary measures was the implementations to ease the uncertainties in money markets caused by the crisis. In this regard, as of October 2008, we started to inject liquidity excessively in order to reduce potential tension in money markets and to completely eliminate volatility in overnight interest rates. However, at this point, I would like to remind you that the excess liquidity generated as a result of the implementation which was continued throughout 2009, was sterilized by overnight operations at the end of the day.

42. The second pillar of the monetary measures was the arrangements we made to support the credit markets in view of the permanent decline in liquidity. In this regard, as a result of the increasing net liquidity shortage in the market and the possibility that this shortage may become permanent, the Central Bank started to hold 3-month repo auctions as of June in order to support the smooth operation of the credit mechanism. In October 2009, as it became evident that the liquidity shortage has been permanent, Turkish lira required reserve ratio was reduced from 6 percent to 5 percent in order to support the credit mechanism.

43. Furthermore, irrespective of these measures, we started to purchase government securities from the secondary markets at the end of 2009 on technical grounds in order to maintain operational flexibility and instrument diversity in liquidity management. Accordingly, as of April 15, we have injected 3.1 billion TL to the market against government securities with a nominal value of 3.2 billion TL through pre-scheduled auctions. I would like to underline that even though the outright purchases of government securities coincided with the crisis period, it has no direct relationship with the crisis.

44. In order to support foreign exchange liquidity and ensure smooth operation of FX markets, in February 2009, the Central Bank extended the maturity of foreign exchange deposits denominated in US dollar or Euro for banks in the FX Deposit Markets, and lending rate was reduced for transactions where the Central Bank is counterpart. Moreover, upon observing unhealthy pricing in the foreign exchange markets as a result of vanishing depth, 18 foreign exchange selling auctions were held between 10 March-2 April 2009 and 900 million USD was sold in total.

45. With the aim of supporting the corporate sector and widening the use of export discount credits, arrangements were introduced in March and April, larger number of firms was granted access to export discount credits and credit limits were raised.

Distinguished Guests,

46. Recently, one of the most debated issues with respect to monetary policy is the “exit strategies”, which entail withdrawal of measures taken during the global crisis and provide normalization of operations for monetary policies. Many central banks have been working on exit strategies for quite a long time as the adverse effects of the crisis diminish and signals of economic recovery grow stronger with the ultimate goal to prepare markets for the normalization process. Obviously, each central bank will form its own exit strategy according to country-specific conditions such as improvements in financial markets, degree of economic recovery and the severity of inflationary pressure. With its very strong and well-regulated banking system coupled with its flexible, effective and fit-for-every-condition liquidity management framework based on its past experience from several crises, Turkey was well prepared for the global crisis. These factors reduced the need for the Central Bank to take additional radical measures, and the Central Bank’s balance sheet structure did not deteriorate during the crisis. Hence, the Central Bank’s exit strategy will be simpler and easier as compared to many central banks. Yet, owing to the importance that we attach to transparency and predictability, we informed the public about the general framework of our exit strategy in our Press Release of 14 April 2010, before putting the strategy into practice.

47. Accordingly, taking account of the recent developments and the normalization in both money and credit markets; we plan to gradually withdraw some of the measures taken in the foreign exchange and Turkish lira markets during the crisis. Hence, measures taken for crisis management will be withdrawn first and the exit strategy in Turkey, like elsewhere, will be a strategy that is cautious, gradual and

safeguarding financial stability. I would like to repeat that you can find the details of our exit strategy in our press release of 14 April 2010.

Distinguished Guests,

48. In the last part of my speech, I would briefly like to mention our foreign exchange policy. As you may well know, we have been implementing floating exchange rate regime since 2001 and exchange rates are determined by supply and demand conditions in the market. However, we can directly intervene in the markets by selling or buying foreign exchange in case of any unhealthy price formation, which is driven by a vanishing market depth, is observed. Yet, I would like to remind you that we have not directly intervened in the market after our last direct selling intervention during the global financial turbulence in May-June 2006 period.

49. The second pillar of the floating exchange rate regime is the foreign exchange buying auctions held for accumulating reserves. We hold foreign exchange buying auctions in line with a pre-announced schedule in order to minimize the impact of the auctions on supply and demand conditions, and strive not to make any changes on this schedule unless extraordinary changes occur in foreign exchange liquidity. The foreign exchange buying auctions, which were suspended in October 2008 to enable banks to strengthen their foreign exchange liquidity positions amidst global crisis conditions, were resumed on August 4, 2009 on the back of the increased liquidity and stronger risk appetite and relatively stabilized foreign exchange market fuelled by favorable expectations about the global economy. Accordingly, the net amount of foreign exchange purchased in 2009 was 3.4 billion USD and the gross foreign exchange reserves reached 69.6 billion USD by the end of 2009.

Central Bank's FX Interventions and FX Auctions

(Million US dollar)

Year	FX Buying Auctions	FX Selling Auctions	FX Buying Interventions	FX Selling Interventions	Total Net FX Purchases
2003	5652	-	4229	-	9881
2004	4104	-	1283	9	5378
2005	7442	-	14565	-	22007
2006	4296	1	5441	2105	6632
2007	9906	-	-	-	9906
2008	7584	100	-	-	7484
2009	4314	900	-	-	3414
2010*	3376	-	-	-	3376

*As of 15 April 2010.
Source: CBRT.

Esteemed Guests,

50. In sum, the developments since the last quarter of 2008 demonstrated that inflation targeting is a flexible strategy that enables a timely response to economic shocks. Recent experiences have clearly confirmed that the Central Bank, when necessary, can focus on sudden slumps in growth and employment driven by external factors provided that this does not conflict with its objective of price stability. In the upcoming periods, we will continue to focus on establishing price stability permanently, acting in the light of our past experience and with the awareness of our increased credibility. I would like to hereby underline the importance of economic

units to closely monitor our future-oriented messages rather than short-term developments, for the sustainability of monetary policy gains during the crisis.

51. As of the last quarter of 2008, we focused on containing the unfavorable impact of the global crisis on the domestic economic activity without undermining the primary objective of maintaining price stability and largely did our share in this respect. A prudent monetary policy is necessary, but not sufficient by itself to maintain the resilience of the economy against global risk. Strengthening the commitment to fiscal discipline and the structural reform agenda is crucial for supporting the favorable outcomes of monetary policy decisions and maintaining low interest rates. In this respect, timely implementation of the structural reforms both entailed in the harmonization and convergence process to European Union and also in the Medium Term Program remains critically important. Therefore, I would like to end my speech by reminding that we will continue to closely monitor public finance developments while determining our medium term monetary policy strategies.

Thank you.