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Yilmaz May Keep Turkey Rates at Historic Low as Growth Recedes
2010-07-12 21:01:04.0 GMT

By Steve Bryant

July 13 (Bloomberg) -- When Turkish Central Bank Governor Durmus Yilmaz drove interest rates to a historic low last November, economists said he might keep them there for half a year. Seven months later, there’s no sign he plans to budge from the current 7 percent.

All 13 economists surveyed by Bloomberg expect Yilmaz and six other policy makers to leave the one-week repo lending rate unchanged when they meet July 15 to set the benchmark. Turkey needs to keep rates “at current levels a while longer” as the global recovery wobbles, Yilmaz told a business audience in Denizli on July 8.

The worsening economic outlook in Europe, Turkey’s main export market, gives Yilmaz license to fuel demand in the 72- million-person domestic market. Mehmet Buyukeksi, head of the Turkish Exporters’ Assembly, said June 23 that sales abroad may fall significantly this month and the International Monetary Fund on July 8 reduced its forecast for growth in the 16 euro- area nations to 1.3 percent for 2011 from 1.5 percent.

“Inflation is now the least of the bank’s worries,” according to Turker Hamzaoglu, a London-based economist at Bank of America Corp.-Merrill Lynch & Co. who said in January that Yilmaz risked falling “behind the curve” by not raising rates.
“What we didn’t anticipate then was the slowdown in Europe and the euro-zone crisis. They’ve shifted the picture upside down.”

Growth, Inflation

Economic growth has slowed since Turkey emerged from recession in the second quarter of last year. It was just 0.1 percent in the first quarter. Manufacturing confidence fell for a second month in June, after rising for the previous five months.

Inflation has also slowed, with the rate dropping nearly two percentage points to 8.4 percent in the two months through June. It may finish the year “above but close” to the bank’s 6.5 percent goal, Yilmaz said July 8.

European Central Bank President Jean-Claude Trichet said July 8 he expects “price developments to remain moderate” and ECB policy makers left the key interest rate unchanged at 1 percent.

“There’s been very significant improvement in inflation,” said Yarkin Cebeci, an economist at JPMorgan Chase & Co. in Istanbul. Cebeci, who had predicted the bank would raise rates in April, says he expects the central bank to wait until the second half of next year.

The size of Turkey’s domestic market cushions it to some extent from the effects of the European debt crisis, said Neil Shearing of Capital Economics Ltd. in London. “It’s not absolutely critical for Turkey as it is for, say, the Czech Republic and Hungary,” which have much smaller populations.

Never Cheaper

Credit has never been cheaper in Turkey after the central bank lowered rates 13 times from a high of 16.75 percent in October 2008, boosting borrowing by consumers. Real interest rates are negative, with inflation at 8.4 percent in June.

Shares of Arcelik AS, the biggest maker of refrigerators and washing machines in a country where 97,000 couples married in the first quarter, have climbed almost 50 percent since the last rate reduction on Nov. 20. First-quarter profit doubled to 110 million liras ($74 million) from a year earlier. The Turkish market accounted for 48 percent of the Istanbul-based company's revenue in 2009 and Europe made up 40 percent.

The cost of five-year interest-rate swaps, contracts used to guard against fluctuations in borrowing costs, fell to the lowest in at least five years on July 8, suggesting Yilmaz may keep rates flat into 2011, when Prime Minister Recep Tayyip Erdogan campaigns for re-election.

Political Agenda

"Next year's political agenda, plus the appointment of a new central bank governor, could make it difficult to raise rates," JPMorgan's Cebeci said.

Yilmaz, 63, ends his five-year term in April. The government hasn't said whether it will award him a second mandate.

Erdogan is under pressure to reduce the unemployment rate before he attempts to win a third term in elections that must be held before July 2011. The recession left an additional 1 million people without work. Joblessness was 13.7 percent in April, more than 3 percentage points above the level in 2007, when the last election was held.

Achieving stable prices is the central bank's job, Yilmaz said in Denizli. "But it's not an end in itself. Price stability is a tool to achieve jobs for the jobless, food for the hungry and opportunities for businessmen," he said.

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--Editors: Louis Meixler, Anne Swardson

To contact the reporters on this story:
Steve Bryant in Ankara at +90-312-438-8990 or sbryant5@bloomberg.net.

To contact the editor responsible for this story:
Peter Hirschberg in Jerusalem at +972-2-640-1104 or phirschberg@bloomberg.net.