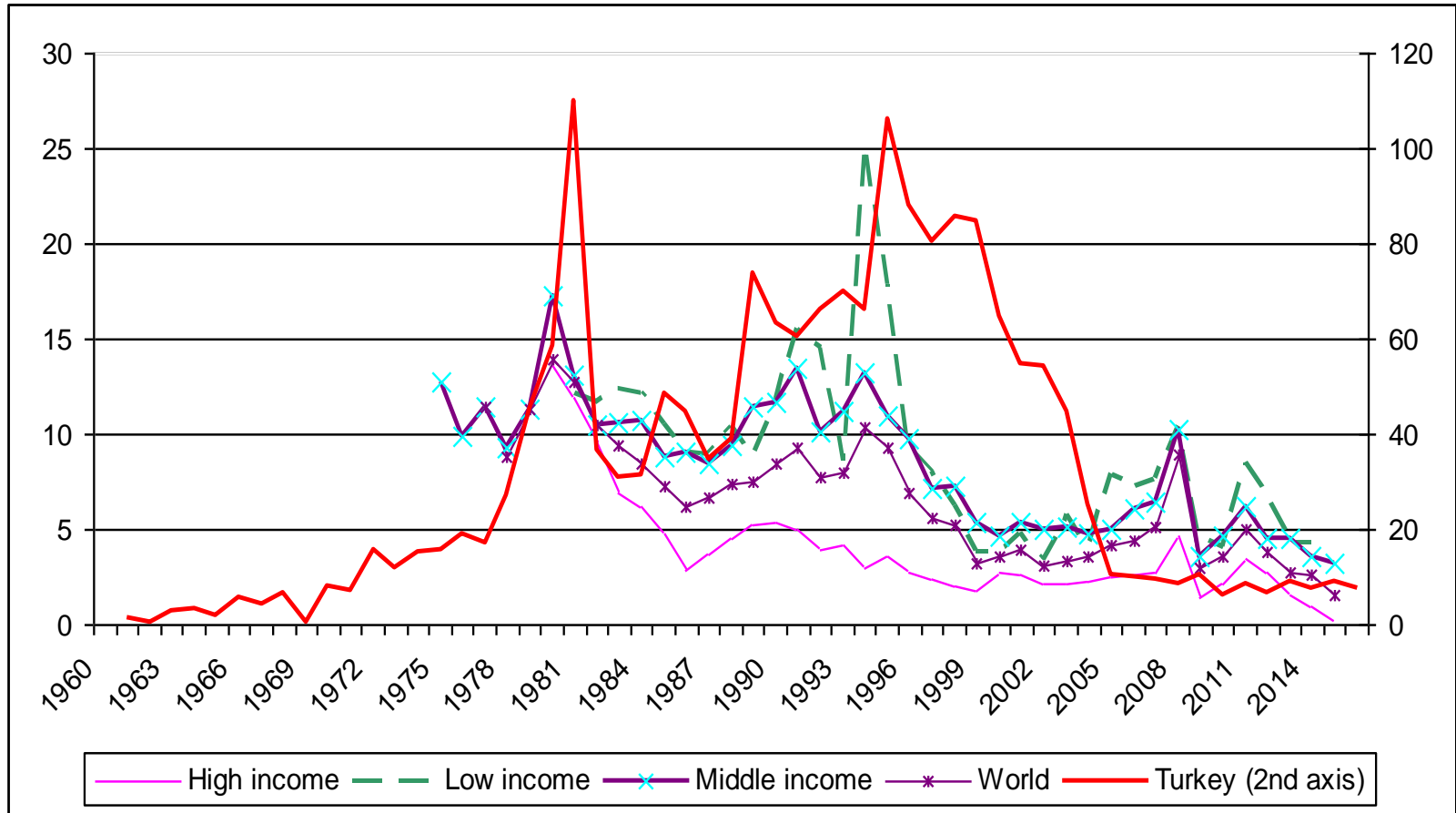


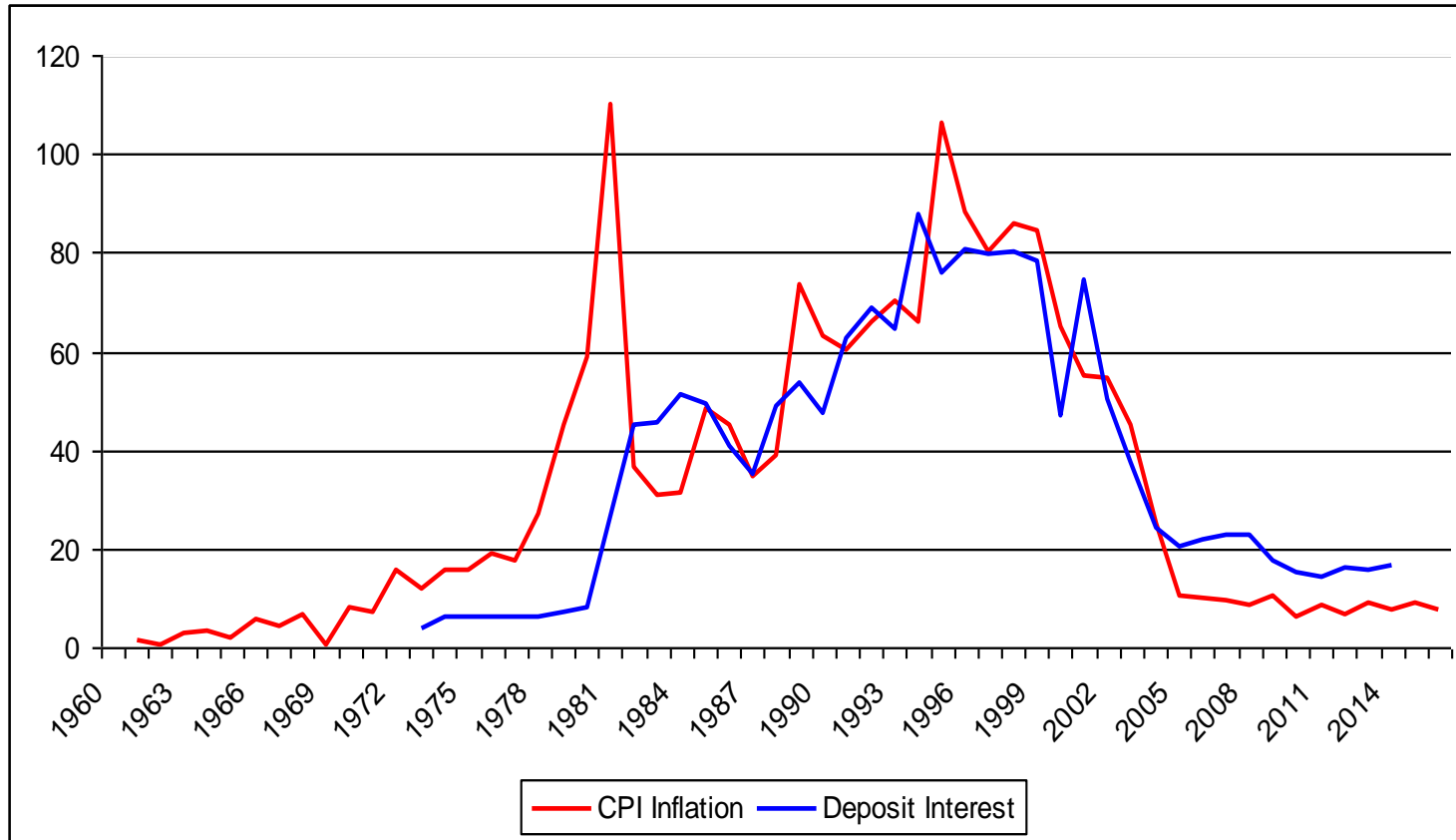
# **How Low an Interest Rate is Enough for the Turkish Economy ?**

**Bilin NEYAPTI**

# Inflation finally fell in Turkey in the 2000s:



With it, the interest rates fell as well:



Prepared for EAF-TUSIAD

# Then came the *Great Recession*...

→ Realization: “*Price stability is not enough for sustainable development*”

[ → ***Macprudential Policies:***

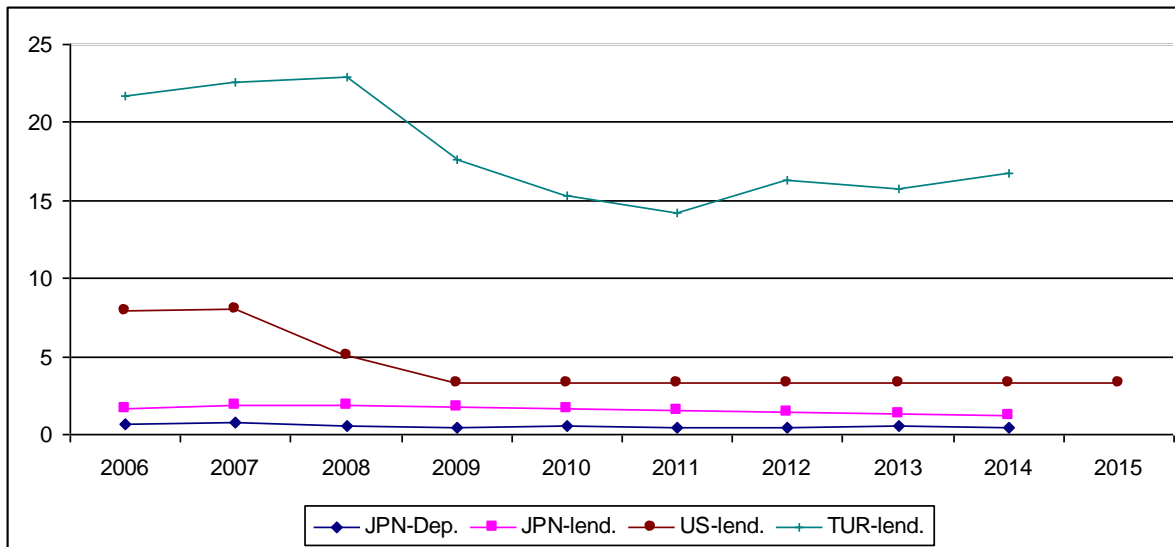
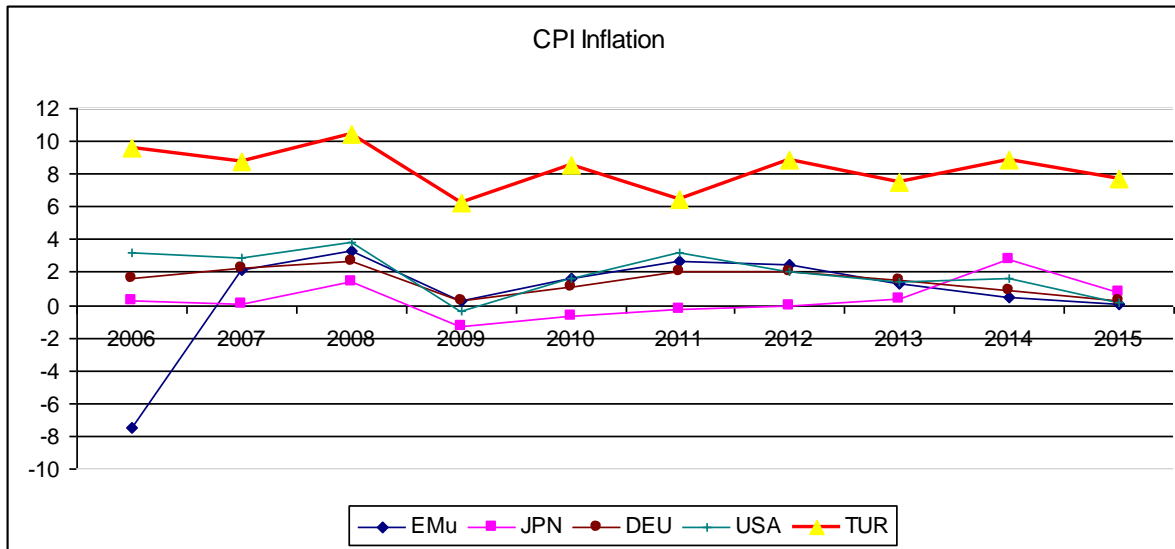
Price Stability +

Financial Stability +

Fair Income distribution ]

- Meanwhile, policymakers of the developed countries continued to explore the limits of Monetary Policy...

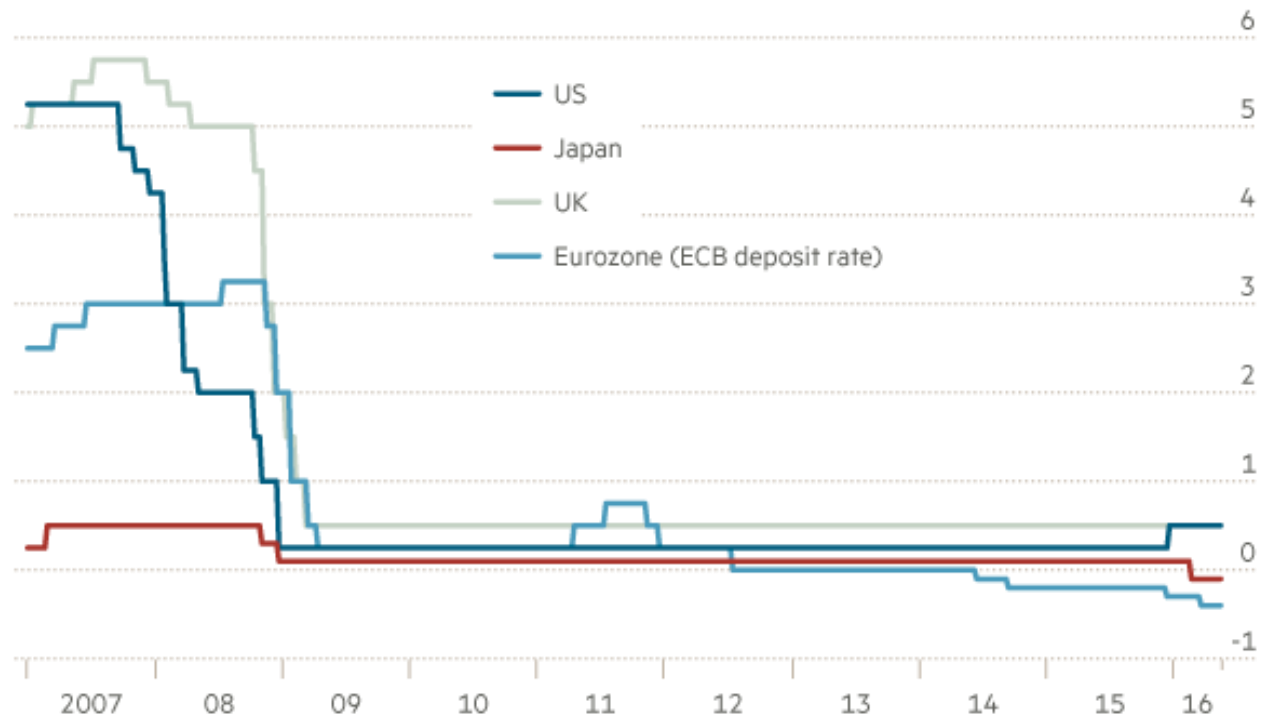
# Inflation and Interest Rates fell:



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## Central banks have cut rates ...

Policy rates (%)



Source: Thomson Reuters Datastream

FT

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# What links the interest and the inflation rates?

- Interest rate → Inflation rate... if ***cost-push***  
(Price Puzzle, Sims)

- Empirical Findings:

It is mainly the ***intermediate input*** and ***labor*** costs, and not the financing costs, that affect the cost-push inflation during 2006-2014 (based on 20+). (Yüncüler & Öğünç, 2015)

- Producer Cost Inflation ~>CPI inf. ; Labor cost>CPI (by %10)
  - Average financing cost: 3.6% (highest: 5.1% in Services sector.)
  - Average intermediate input cost: ~%41.5 (% 60 in manuf. & constr.)
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Or, is it: Inflation rate  $\rightarrow$  Interest rate... (*Fisher effect*)

Nominal interest rate =

real interest rate + expected inflation +  
expected depreciation

***Expected inflation*** = {economic prospects; CB  
credibility; political risks}

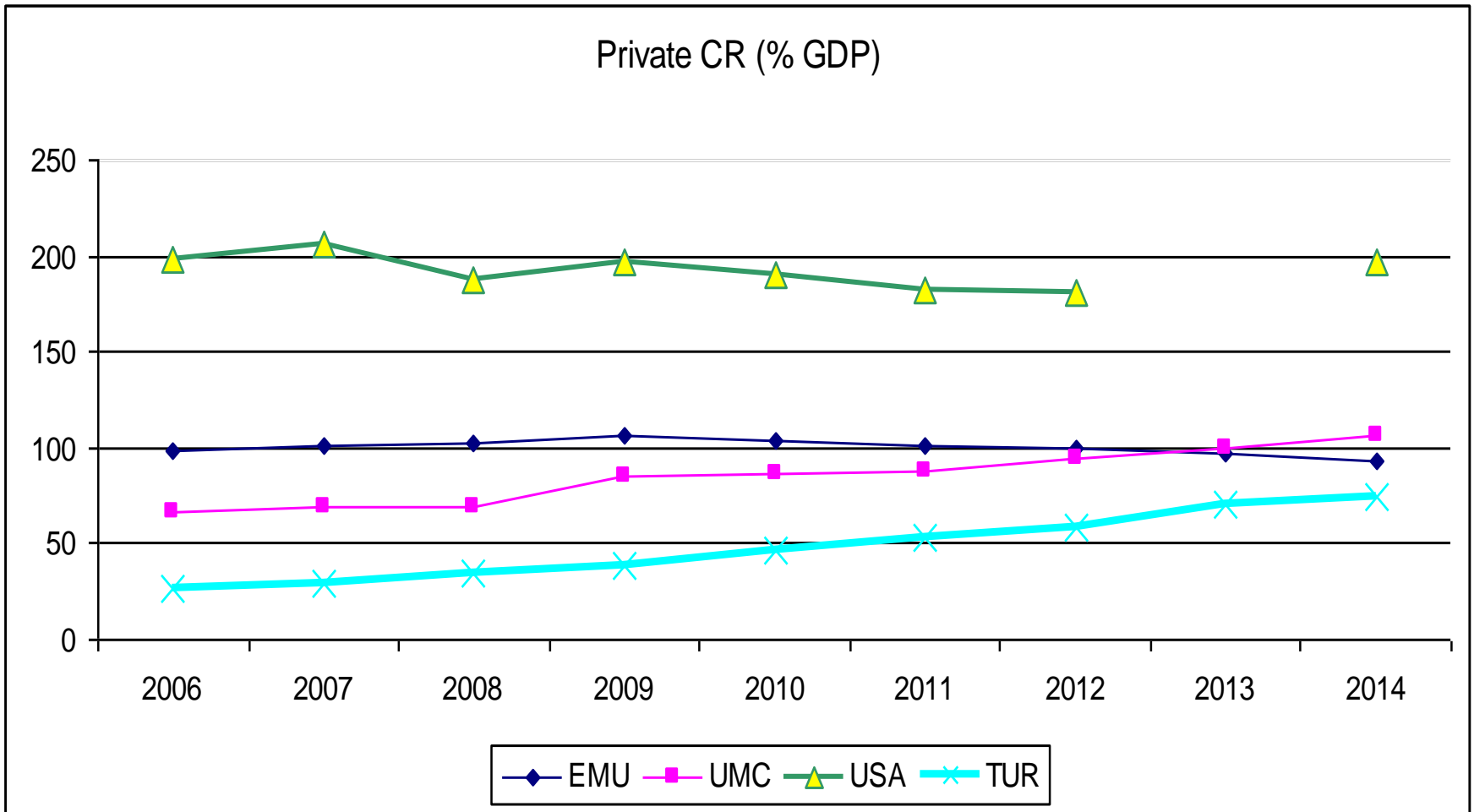
***Expected deflation*** = {US recovery; political/  
economic risks }



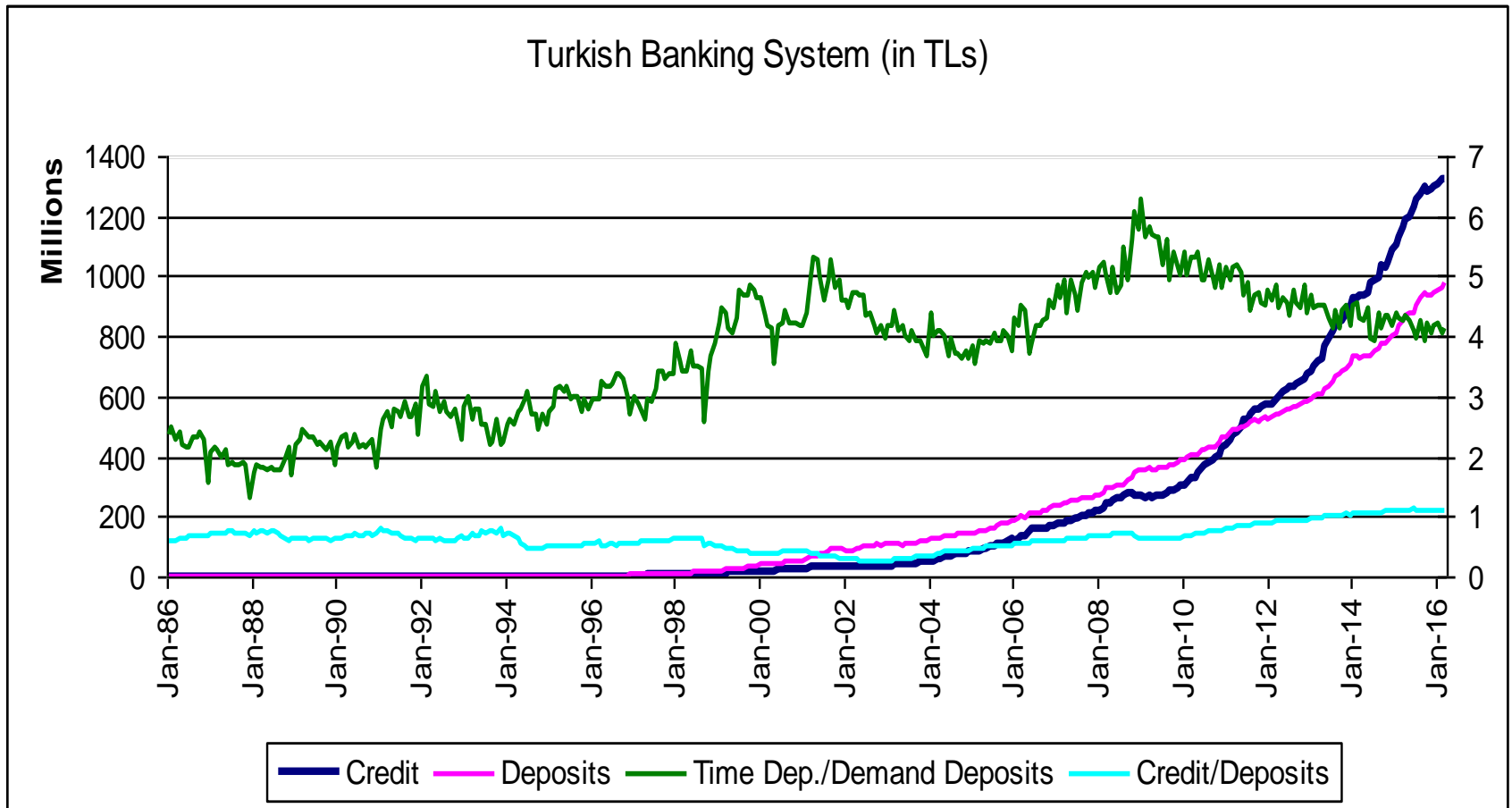
→ Why is the inflation (**& Interest**) rate still so high in Turkey?...

- Credit Crunch?
- Productivity slowdown?
- Expected inflation ?
- Exchange rate pass-through ?
- Expected depreciations ?
- Financial instability
- Economic instability?
  
- *Interest Lobby??*

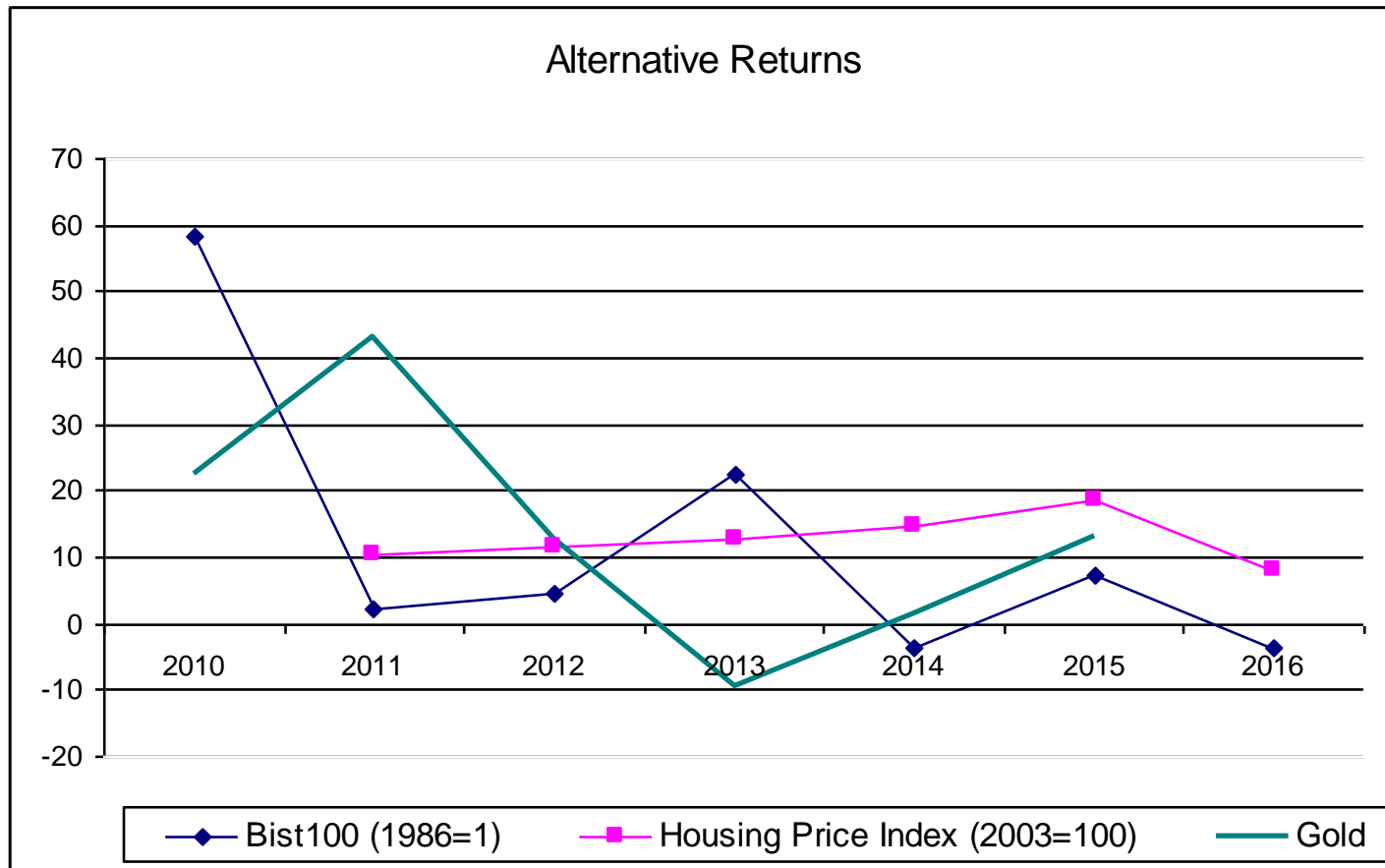
# CR crunch ?



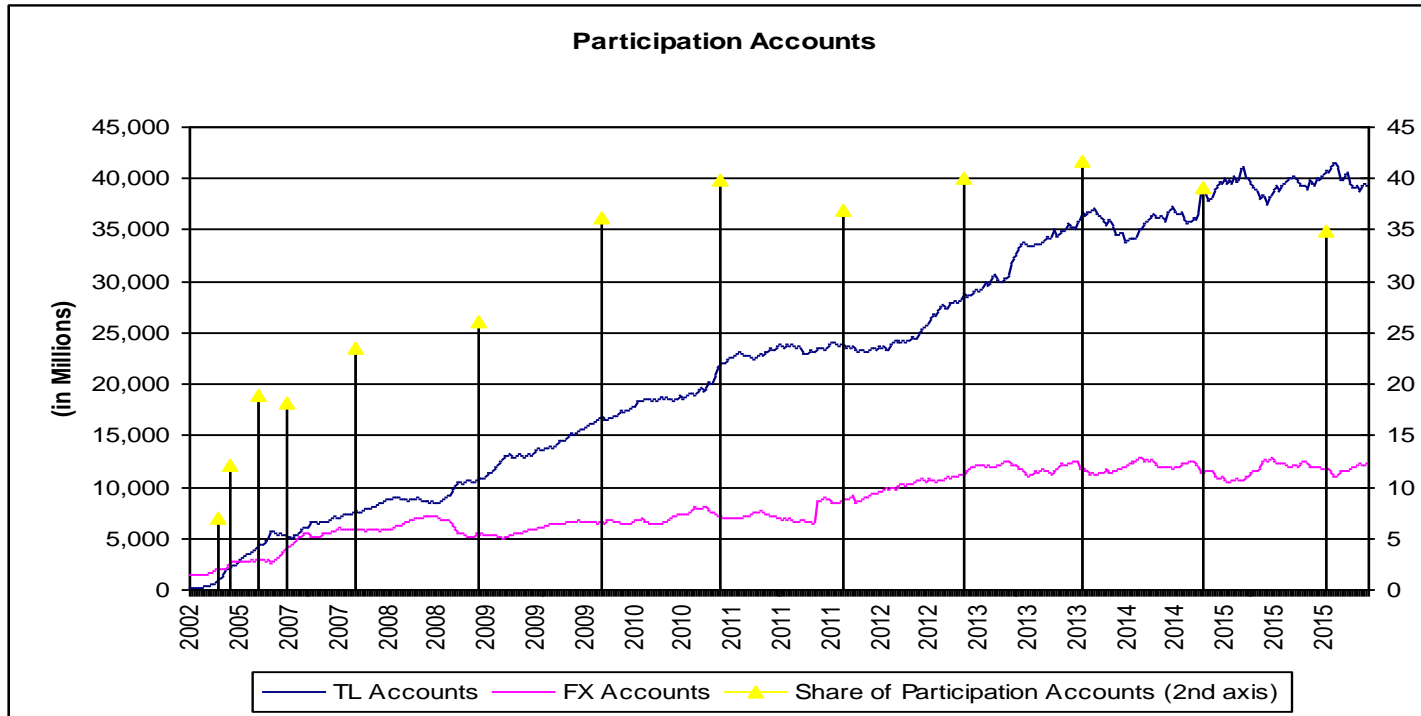
# An overlook of the Turkish Financial Sector (1) (source: CBRT):



# An overlook of the Turkish Financial Sector (2) (source: CBRT):



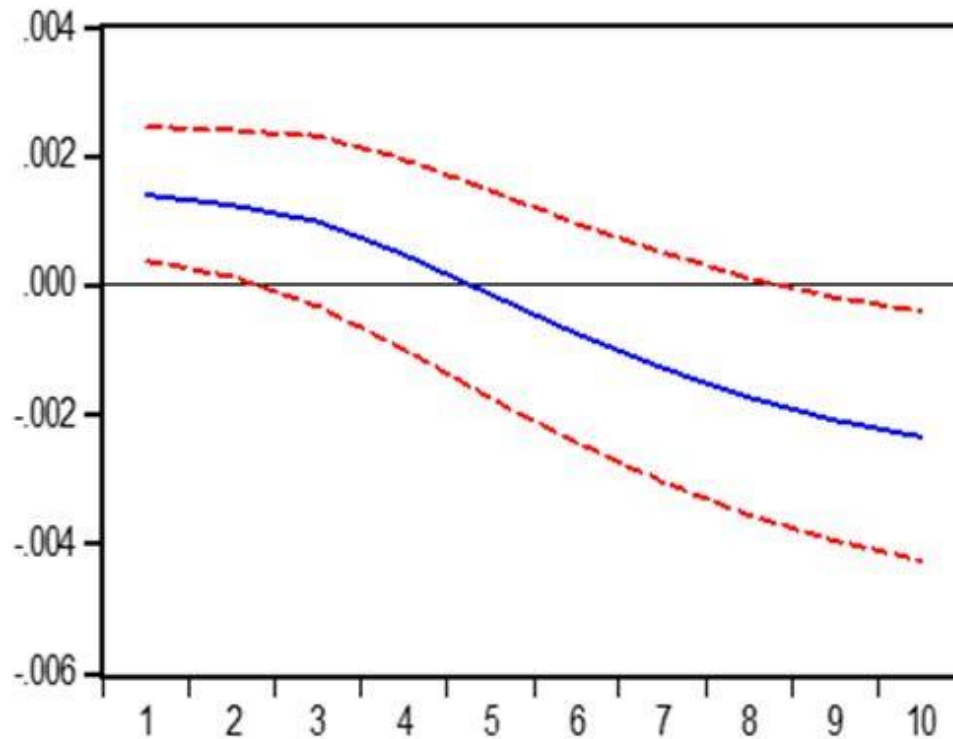
# Participation Accounts:



- Participation accounts have similar reactions to monetary policy as the commercial banks. (Demiralp & Demiralp, 2015)

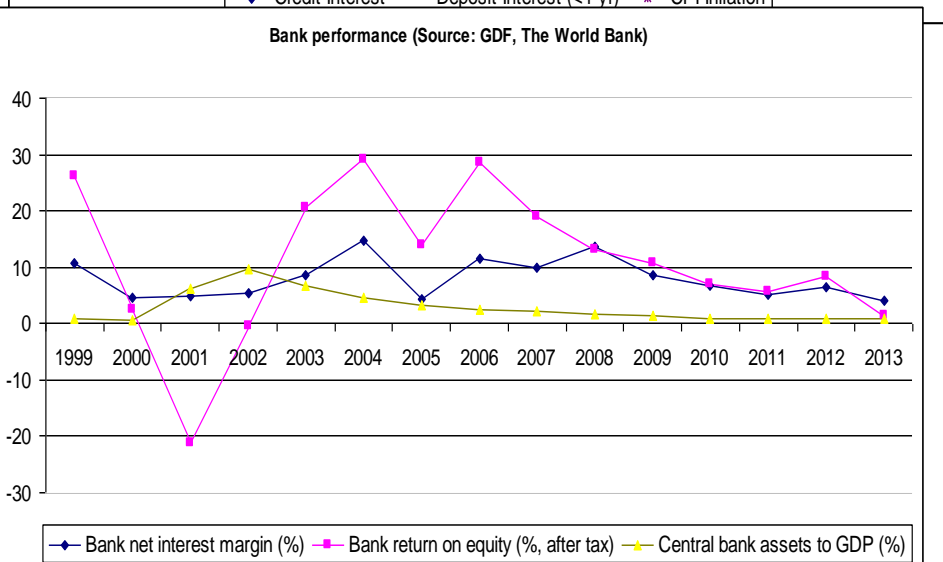
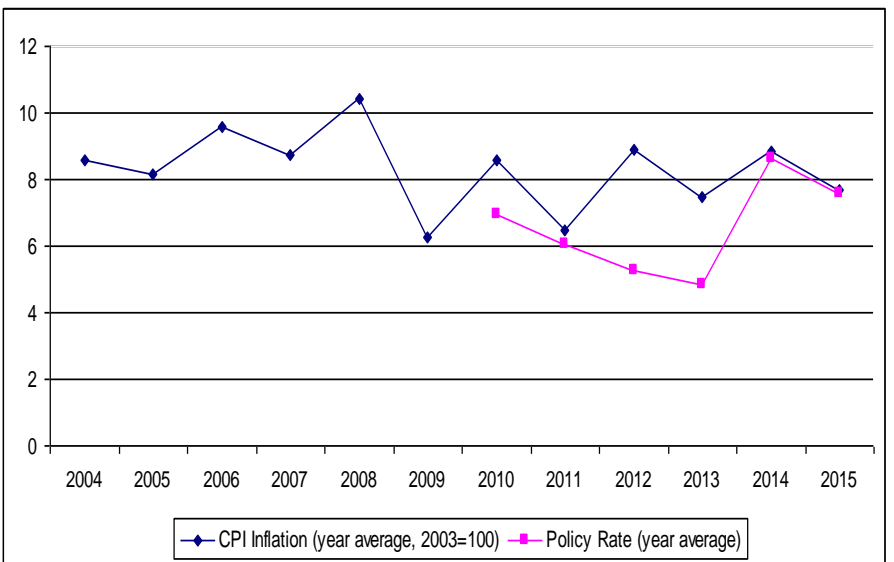
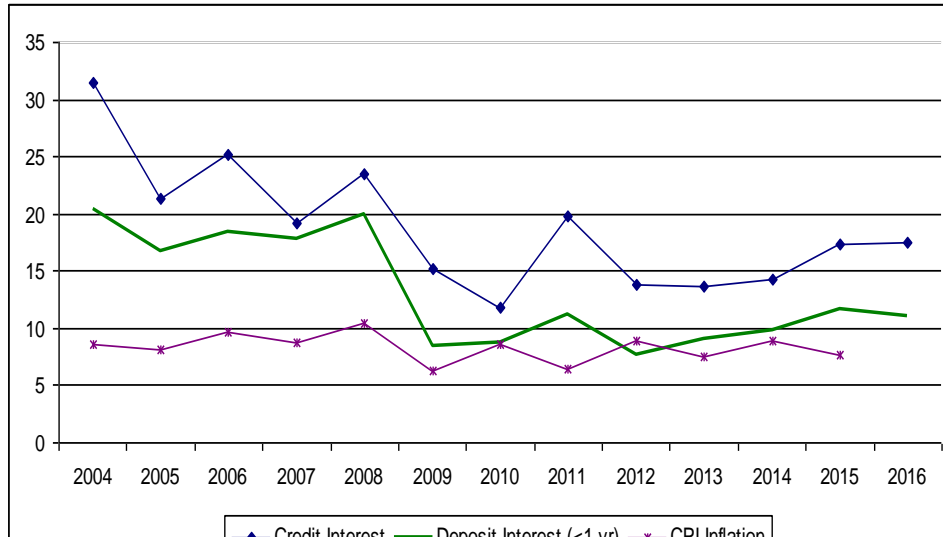
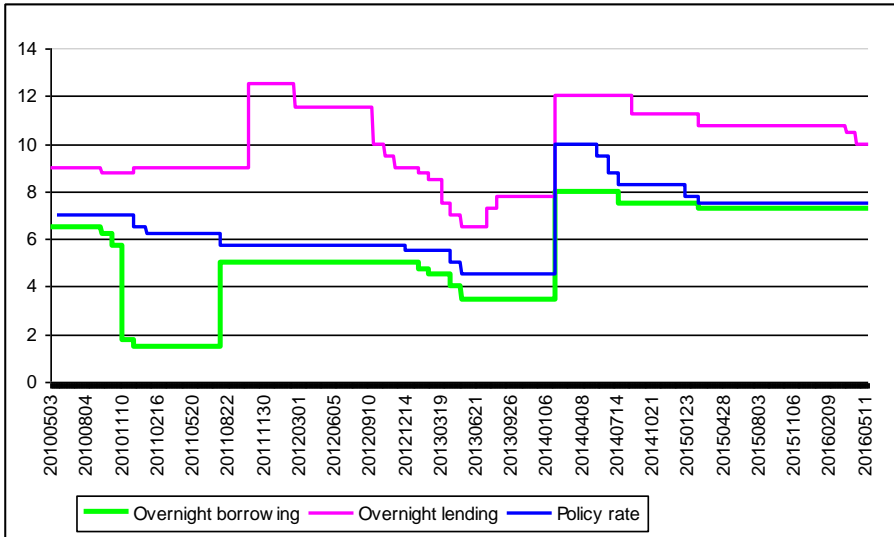
# Cost Channel in Turkey?

Response of CPI to INTEREST RATE

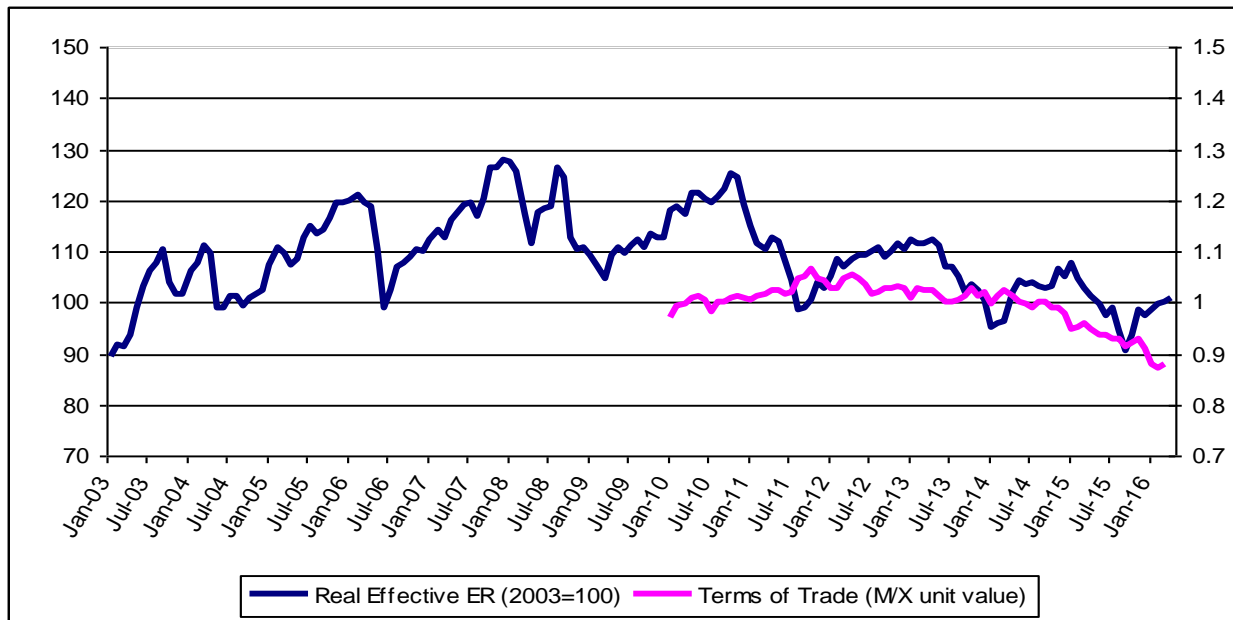
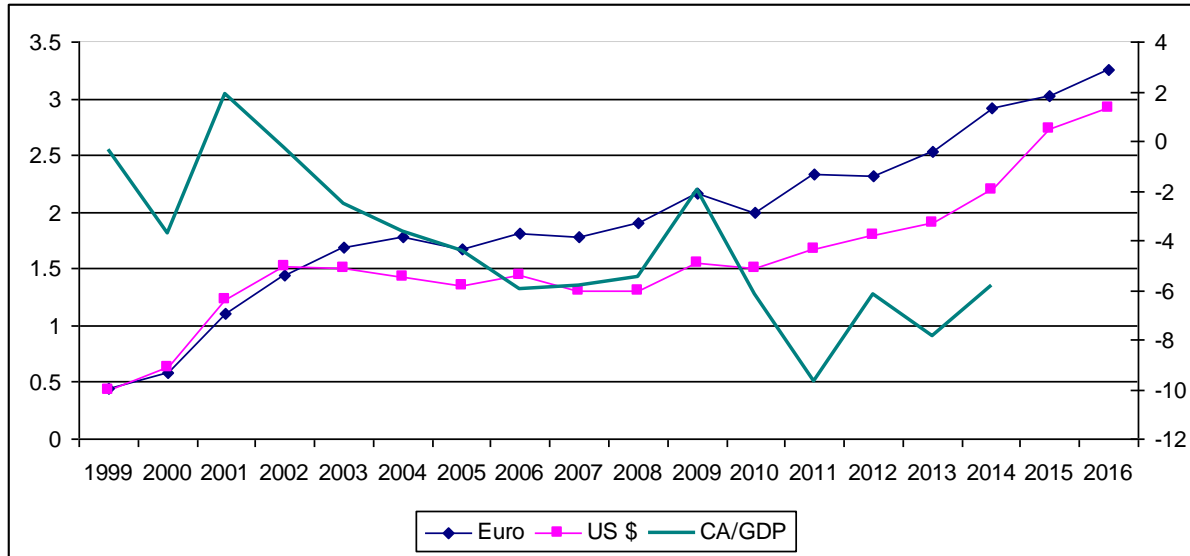


- The response of CPI to an interest rate shock is first positive but then negative after six months (Demiralp & Demiralp, 2015)

# Interest lobby?



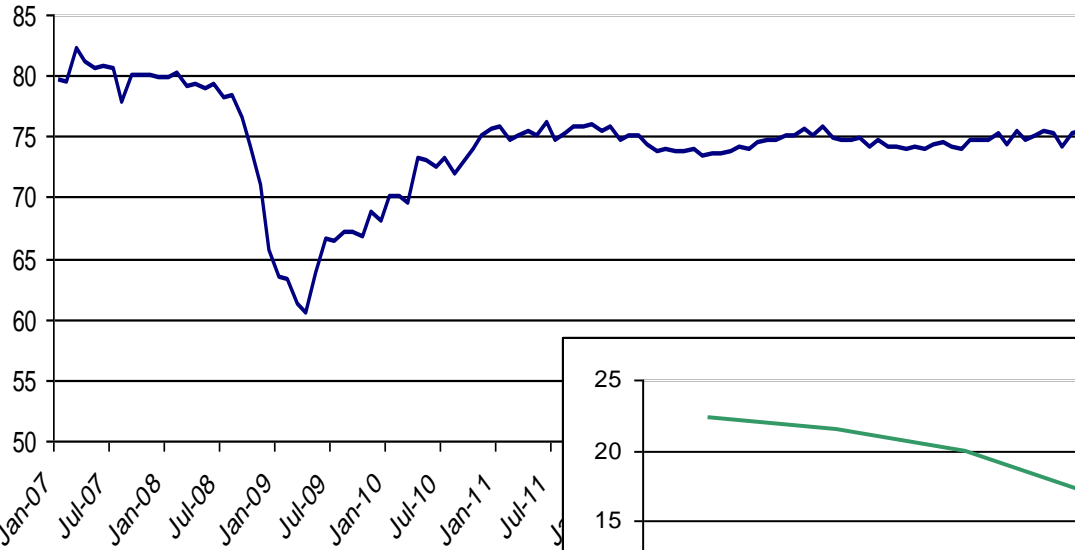
TL depreciated against \$ by 82% and against € by 124 % between 2007 and 2015:





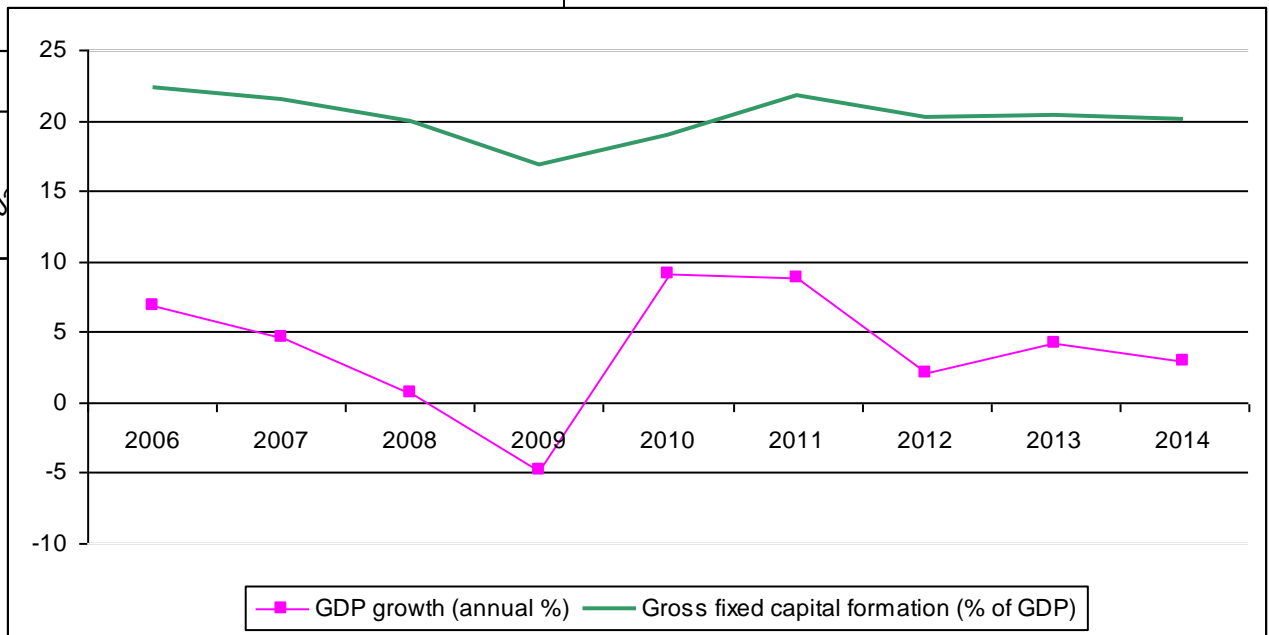
# Trends in the Real Sector: (source: CBRT):

Capacity Utilization: Manufacturing Sector

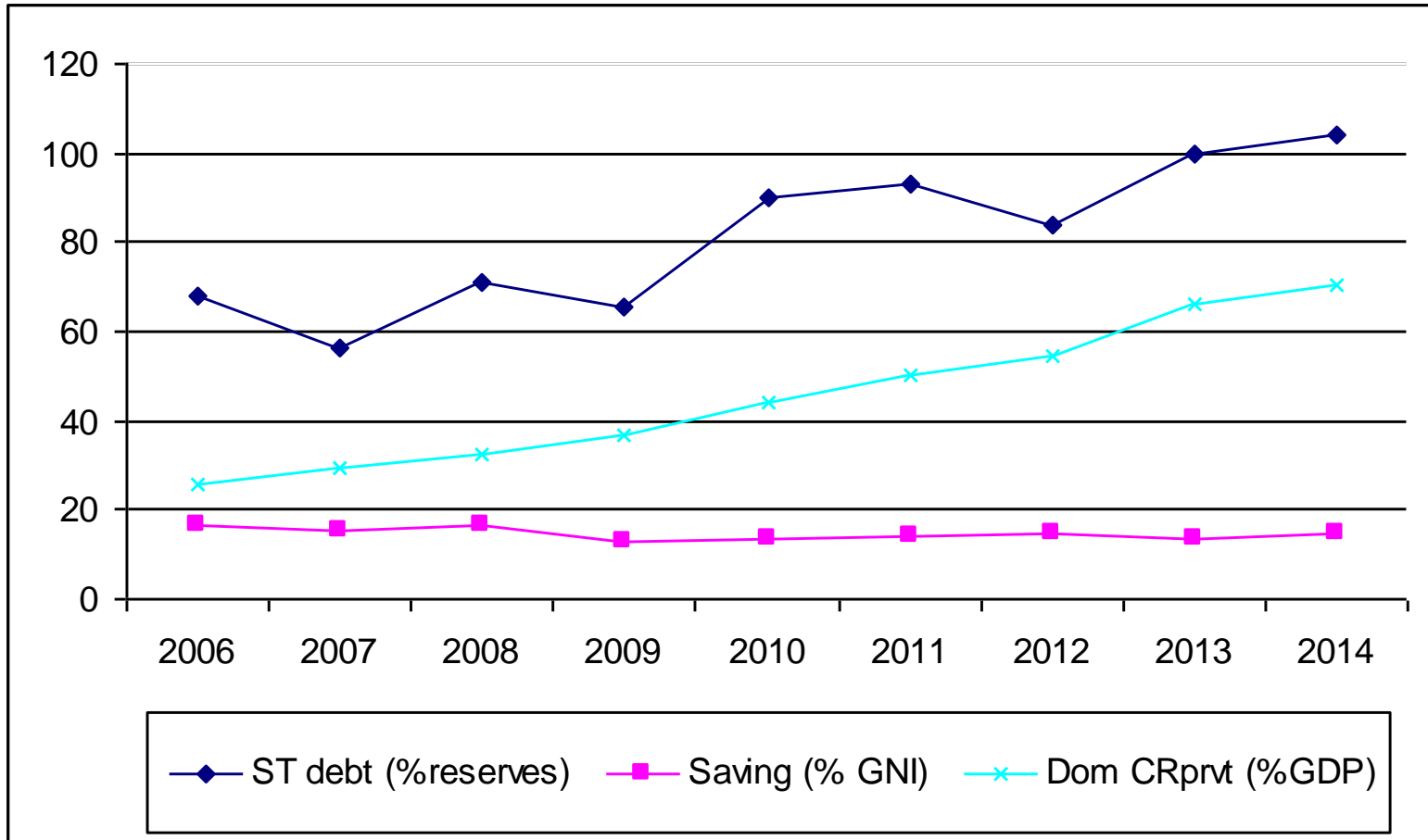


- While productivity of 20+ firms is close to that of EU, that of 20- is less than half of that of EU10. By contrast, the employment share of the latter is more than that of EU10 (Eldin Muhammed, 2014).

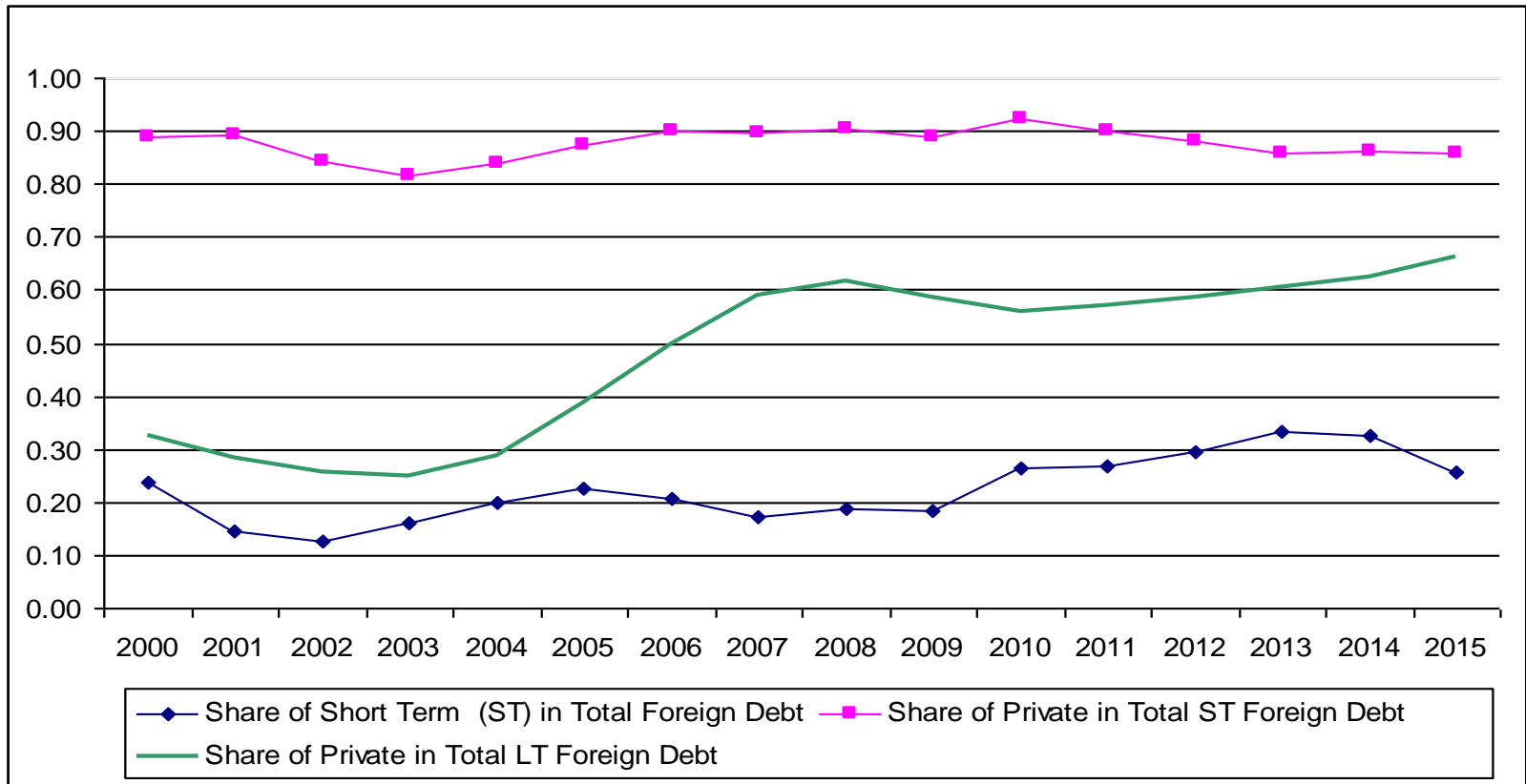
- GDP per hrs worked: 29, as % of US: 45: OECD)



# Financing Growth



# Foreign Debt composition:





# Final Remarks

- Deep recessions are often associated with corrections in income distribution, while recessions with quick fixes lead to repeated recessions with worsened income distribution (Neyapti and Aksit, 2015).

Hence, the real macroeconomic focus to break the Middle Income trap should be on (\*) :

Increasing ***education quality*** -- and thus ***income distribution*** -- is the single most important way for

- Improving ***value added*** content of exports and hence *TOT*
  - Reducing ***input dependence***
- & Improving ***savings***
- & also for **structural reforms** ..... (*vicious circle?*)