



**TÜRKİYE CUMHURİYET
MERKEZ BANKASI**

Monetary Policy in the Post-Crisis Period

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**EAF Conference
October 10, 2011**

- I. Changing View of Central Banking
- II. Capital Flows to Emerging Markets
- III. Reflections on the Turkish Economy
- IV. Policy Measures and Outcomes

- More emphasis on financial stability, especially from a systemic risk and macro perspective
- Monetary policy should not ignore financial cycles and asset price booms.

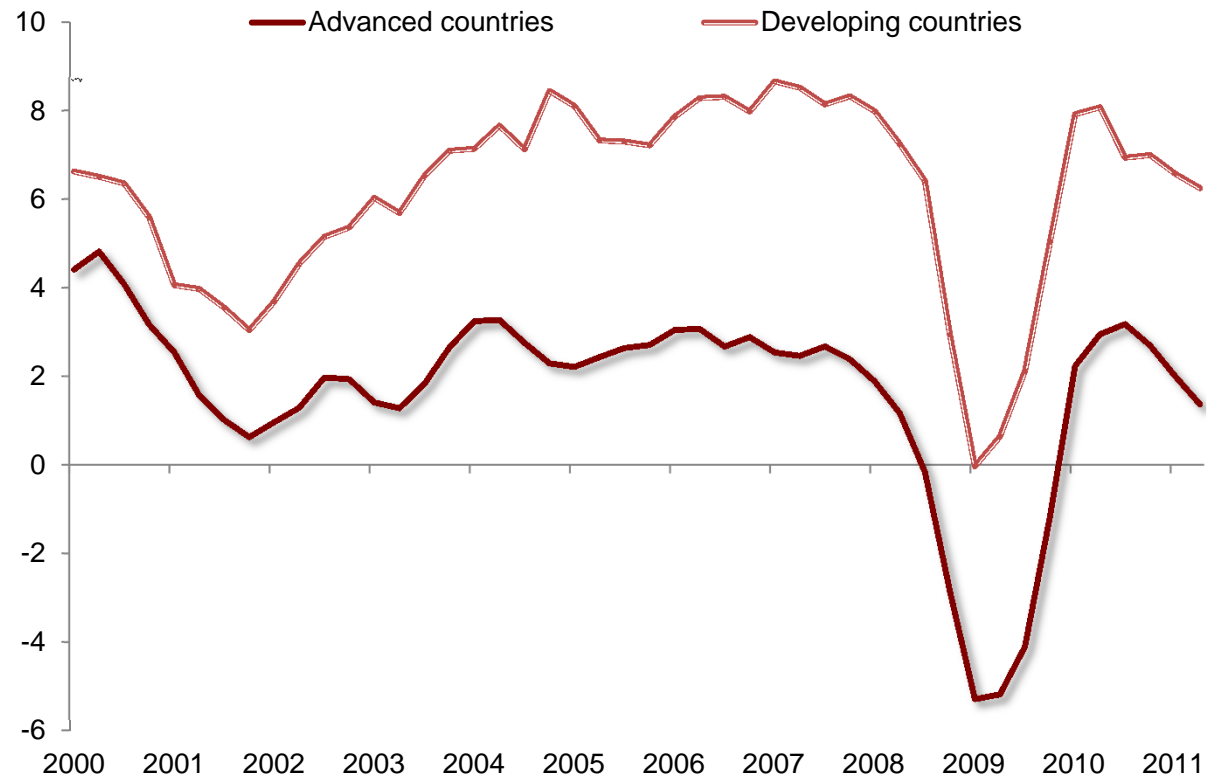
Before crisis: single objective (price stability) single instrument (short term policy rate)

After Crisis: multiple objectives (price stability, financial stability), multiple instruments (credit, liquidity and interest rate policy)

Question: What does this imply for Emerging Market (EM) policy frameworks?

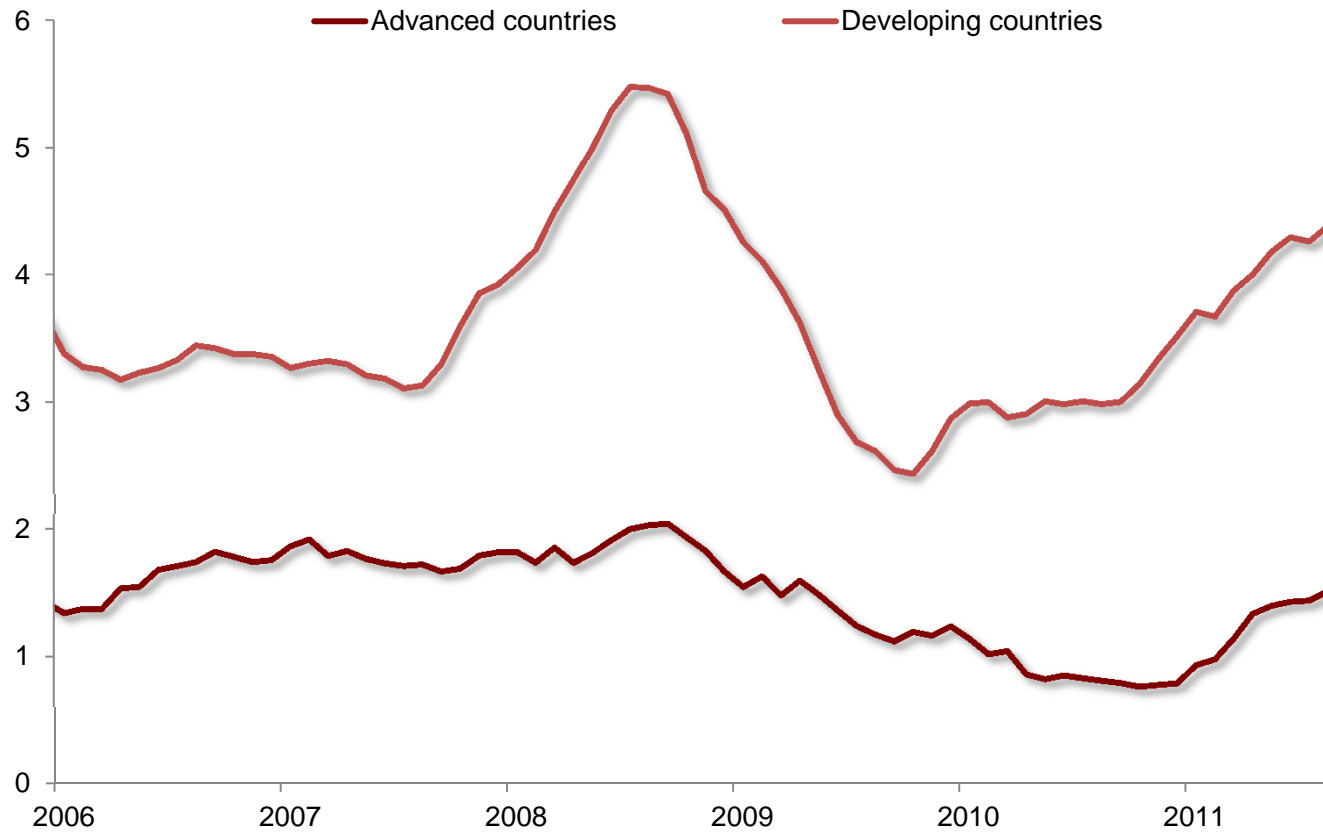
Post Crisis Dynamics, Global Imbalances, and Factors Driving Capital Flows to EMs

GDP Growth Rates (YoY, per cent)



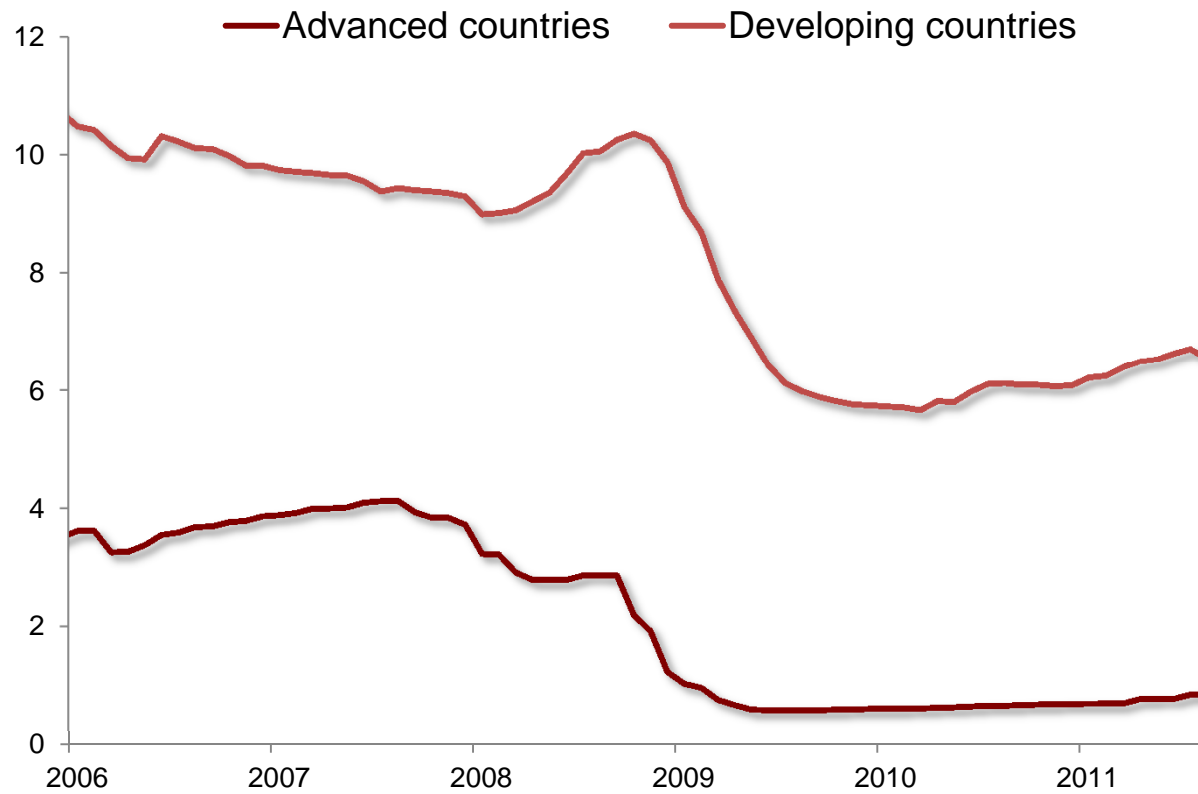
Source: Bloomberg, CBRT calculations.

Core Inflation (YoY, per cent)



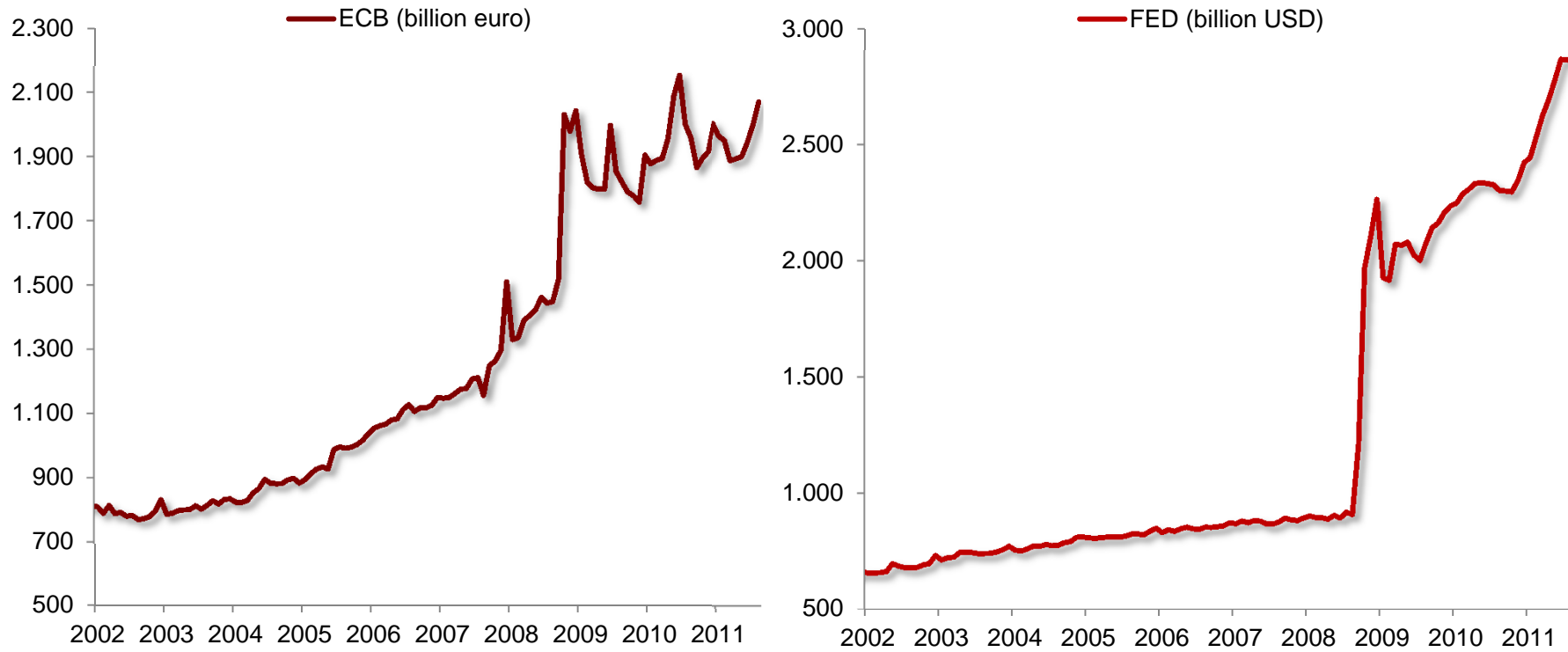
Source: Bloomberg, CBRT calculations.

Policy Rates (per cent)



Source: Bloomberg, CBRT calculations.

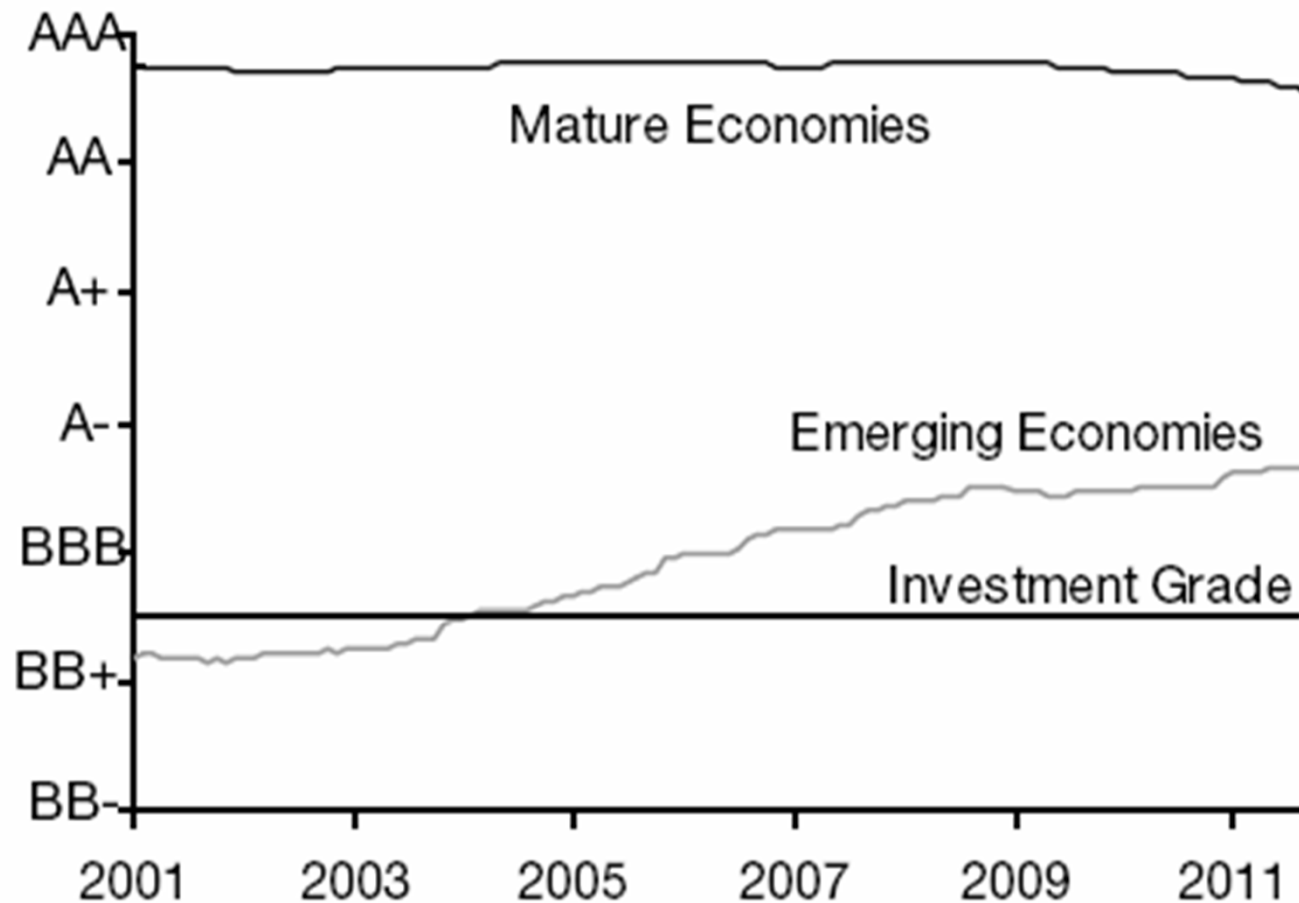
Central Bank Balance Sheets



Source: ECB, FED.

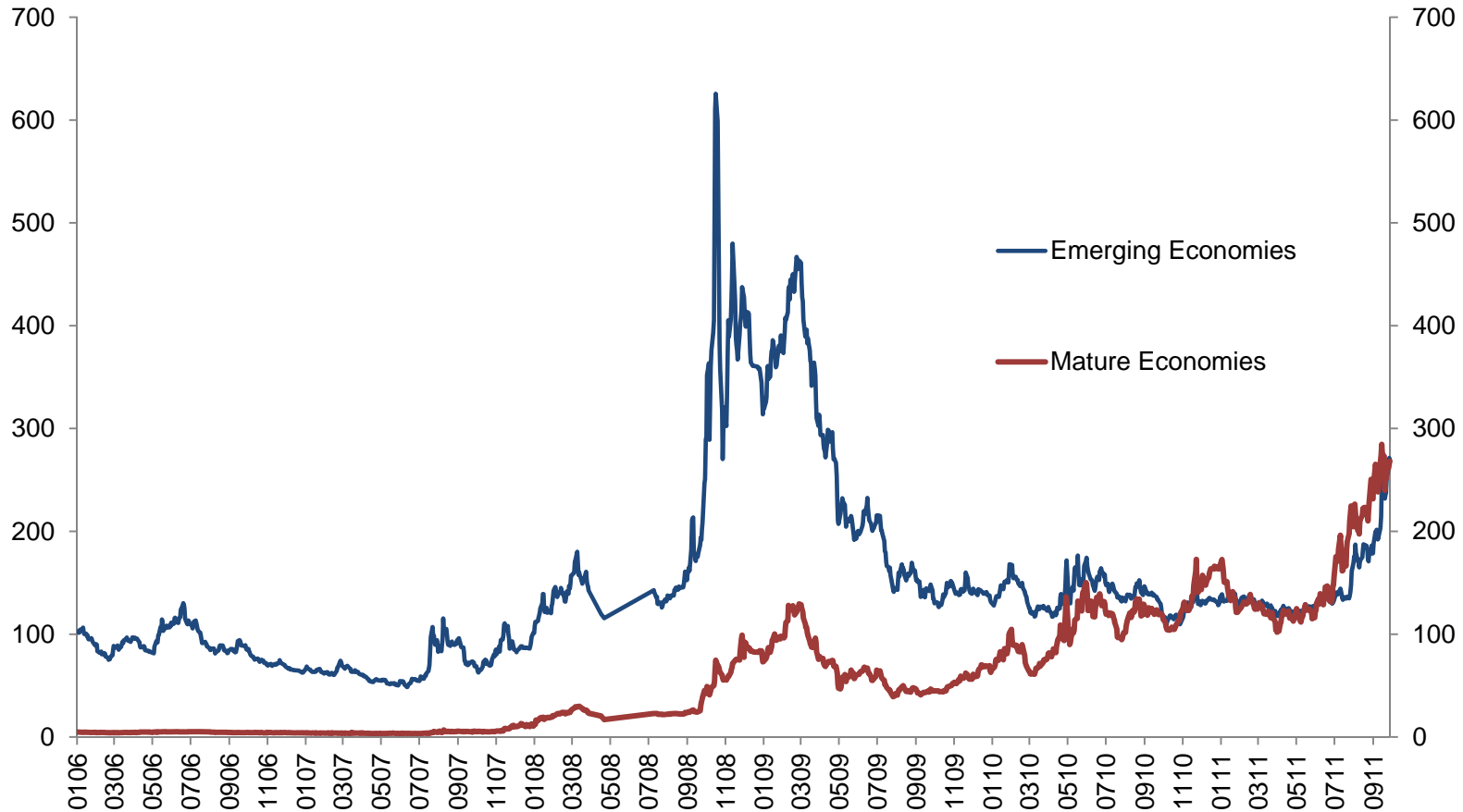
Sovereign Credit Ratings on Long-Term Debt

average of Moody's S&P, and Fitch long-term ratings



Source: IIF

CDS Rates for Selected Countries



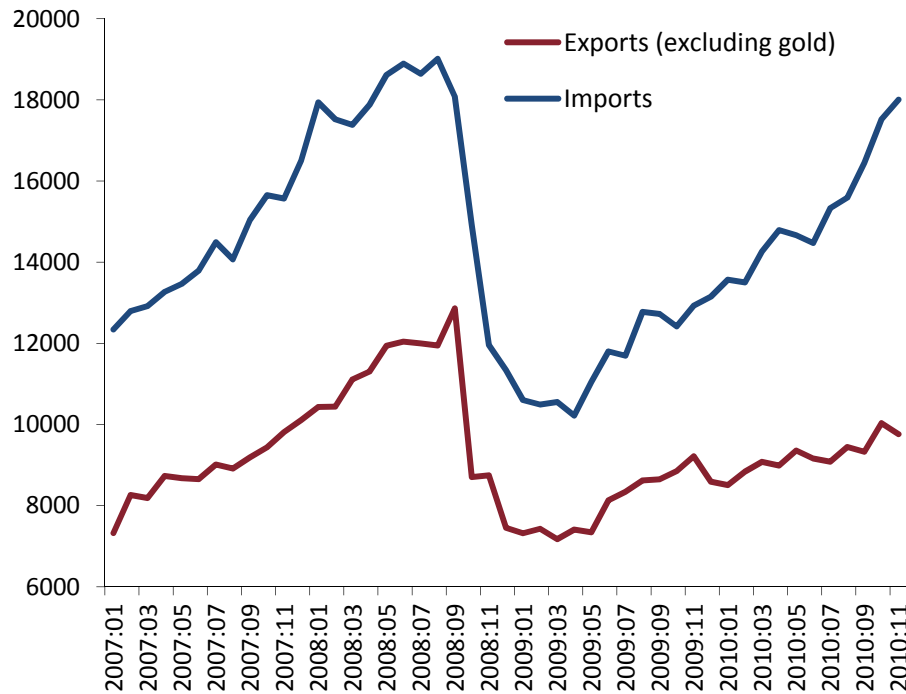
Source: Bloomberg, CBRT calculations.

Mature economies include Germany, France, Italy, Spain and Japan. Emerging economies include Brazil, Chile, Colombia, Peru, Mexico, Hungary, Poland, Russia, Turkey, Thailand, Indonesia, Philippines, China and Malaysia.

- Surging capital inflows
- Real exchange rate appreciation
- Rapid credit growth

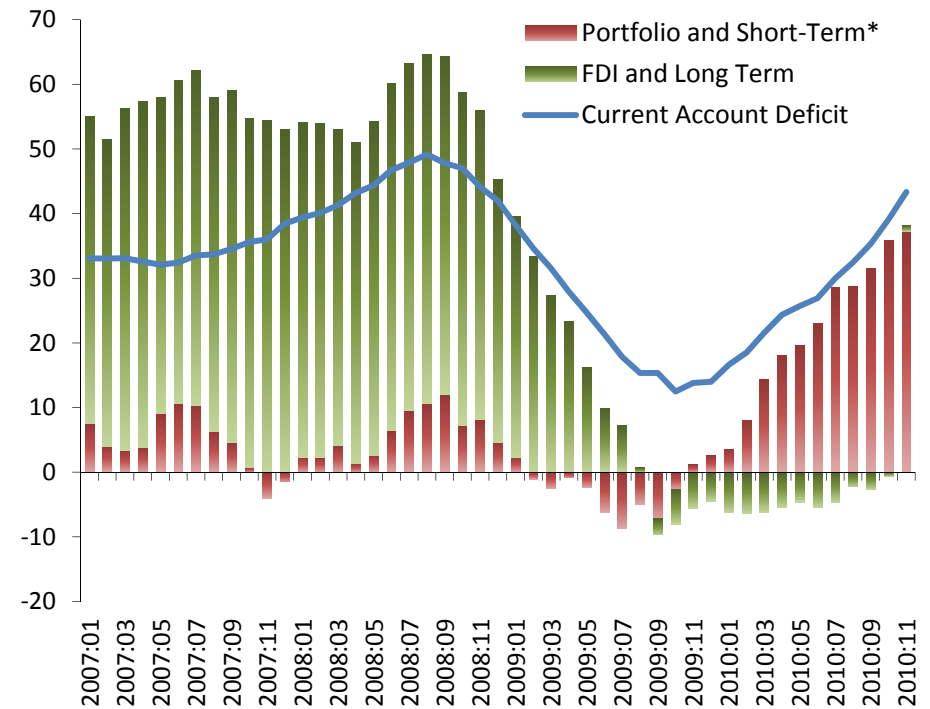
Reflections on the Turkish Economy and the Policy Response of the CBRT

Monthly Imports and Exports
(Seasonally Adjusted, Million USD)



*Source: TurkStat.

Main Sources of Current Account Deficit Finance
(12-months Cumulative, Billion USD)



*Short-term capital movements are sum of banking and real sectors' short term net credits and deposits in banks.

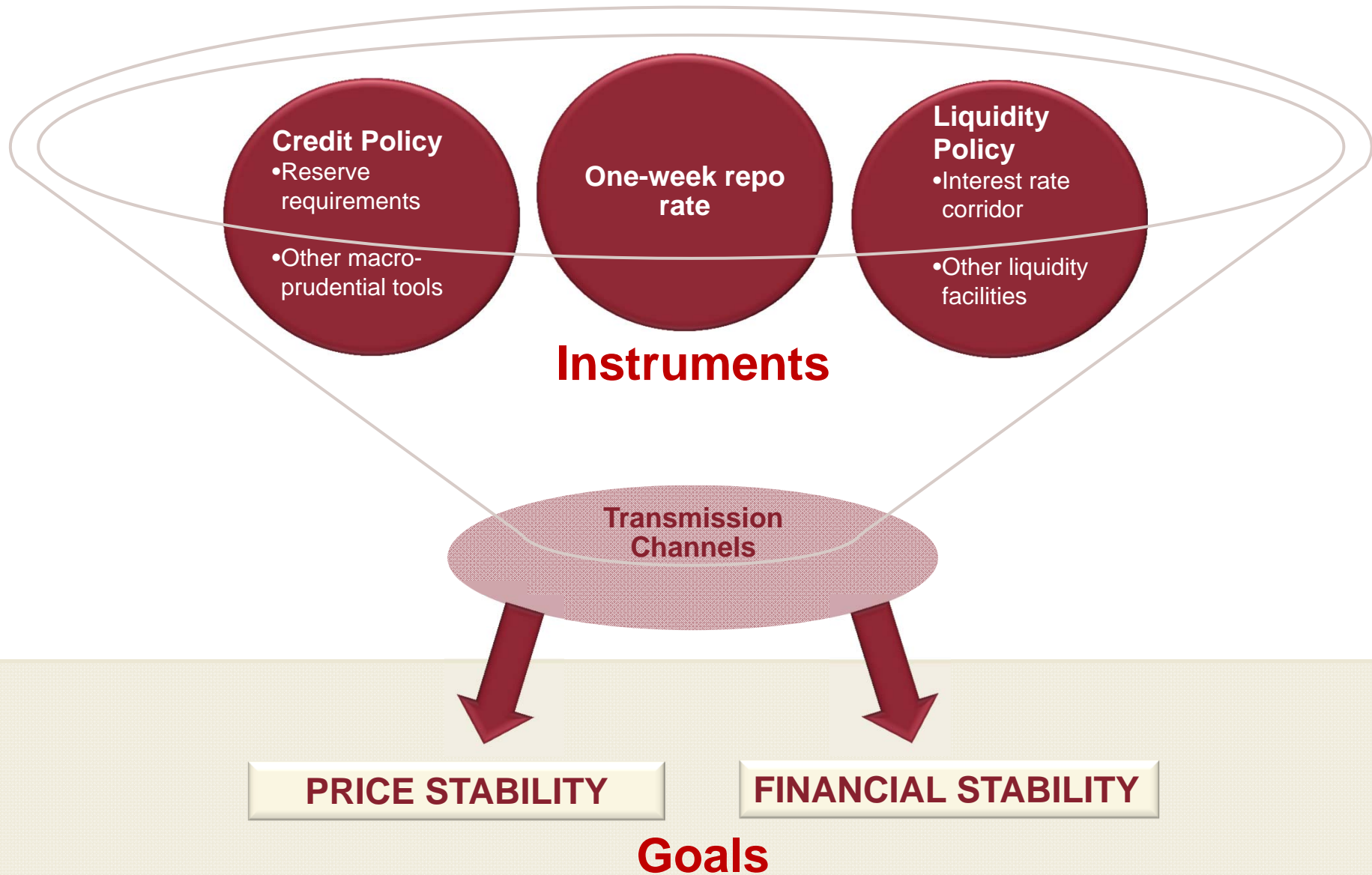
Source: CBRT.

Global imbalances combined with the post-crisis dynamics led to a divergence between external and domestic demand and a surge in short term capital inflows.

- Financial stability from a macro perspective:
How to reduce the risk of a sudden stop?
- Main Task: Engineer a soft-landing without hampering the price stability objective.

Modifying the conventional IT framework:

- Enrich the set of policy instruments
- Supplementary objective: Financial Stability
- Rebalance the economy through a slowdown in credit growth and a realignment of the exchange rate



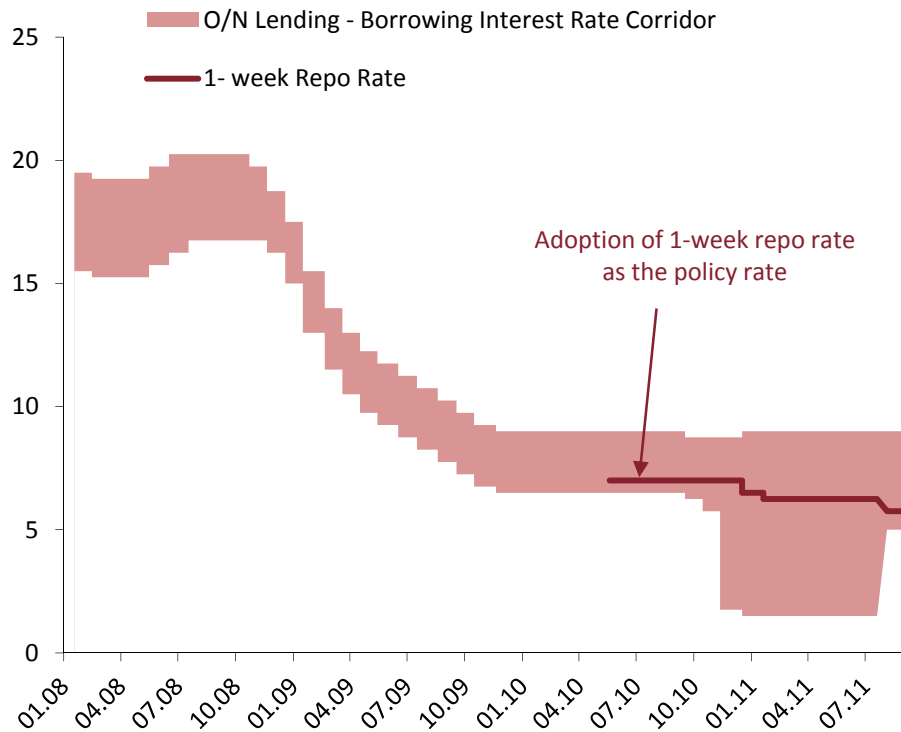
- **One-week Repo Rate**
- **TL Required Reserve Ratios**
 - Remuneration strategy of TL required reserves
 - Differentiating across maturities
 - Changing the scope of liabilities subject to reserve requirements
 - Flexibility in the currency denomination of required reserve balances
- **FX Required Reserve Ratios**
- **Interest Rate Corridor**
- **Other Liquidity Facilities**
 - Changes in liquidity management strategies and operational rules
- **FX Liquidity Facilities**
 - FX Purchasing/Selling Auctions
 - Changes in the auction methods according to liquidity conditions
 - Adjustments in the FX liquidity provision facilities
 - Changes in the export rediscount credit facilities

1. No clear definition of financial stability
 2. Uncertain transmission mechanisms
- Solution: Communicate in terms of observables
 - Current account deficit and its financing
 - Exchange Rate
 - Credit growth

Step 1: Keep short term rates as low as possible and use interest rate corridor to discourage short term capital inflows to allow an orderly realignment in exchange rates.

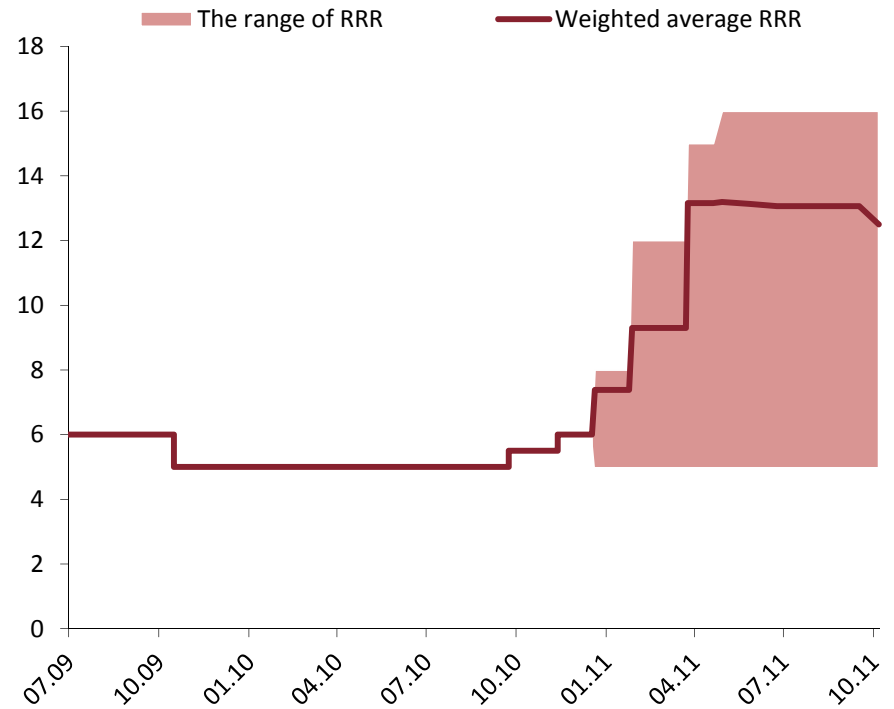
Step 2: Tighten through macro prudential instruments to curb credit growth and domestic absorption (in coordination with other authorities).

CBRT Policy Rate and Interest Rate Corridor



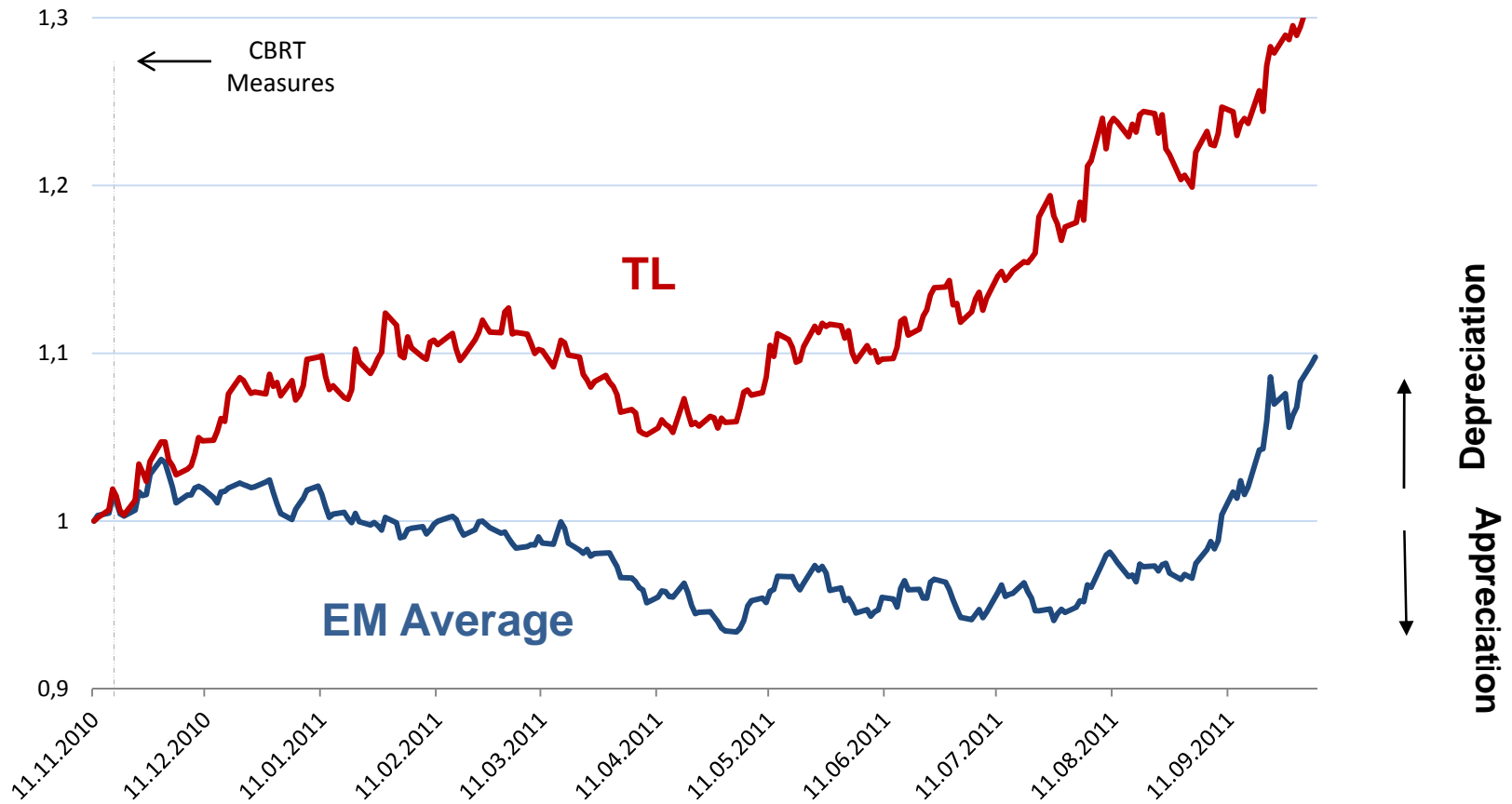
Source: CBRT.

TL Reserve Requirement Ratios (RRR)



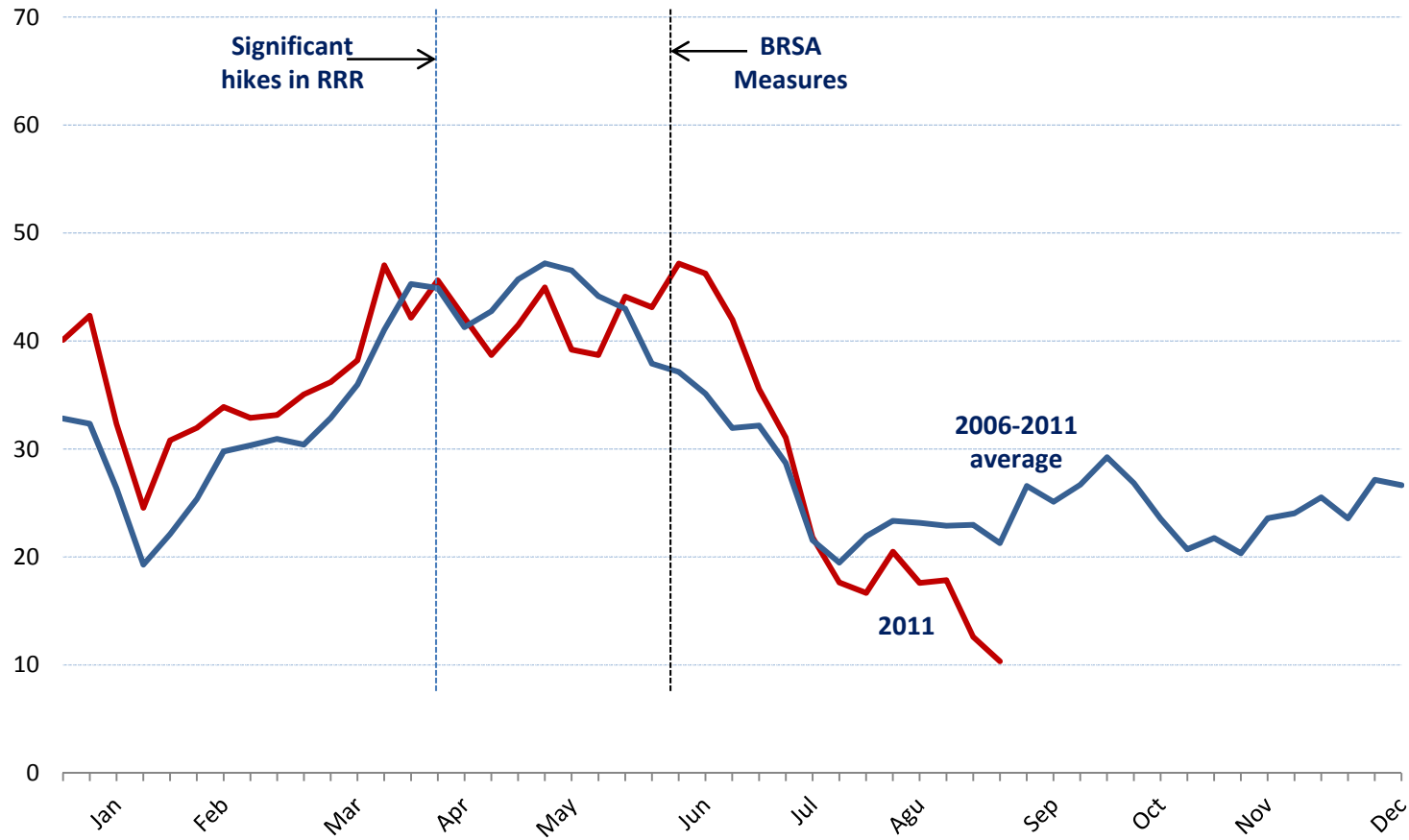
Source: CBRT.

TL and Other EM Currencies Against USD* (11 Nov. 2010=1)



Average of EM countries: Brazil, Chile, Czech Republic, Hungary, Mexico, Poland, S. Africa, Indonesia, South Korea and Colombia.
Latest observation: October 4, 2011.
Source: CBRT and Bloomberg.

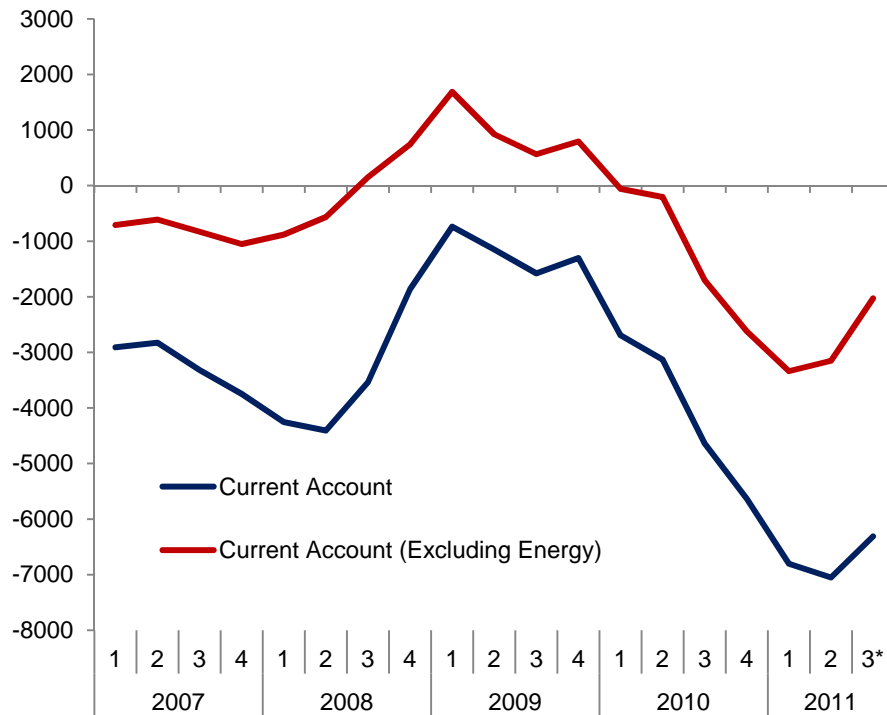
Consumer Loans
(Annualized growth, percent, 4 weeks moving average)



Source: CBRT

Current Account Balance

(Seasonally Adjusted, Quarterly Average, Million USD)

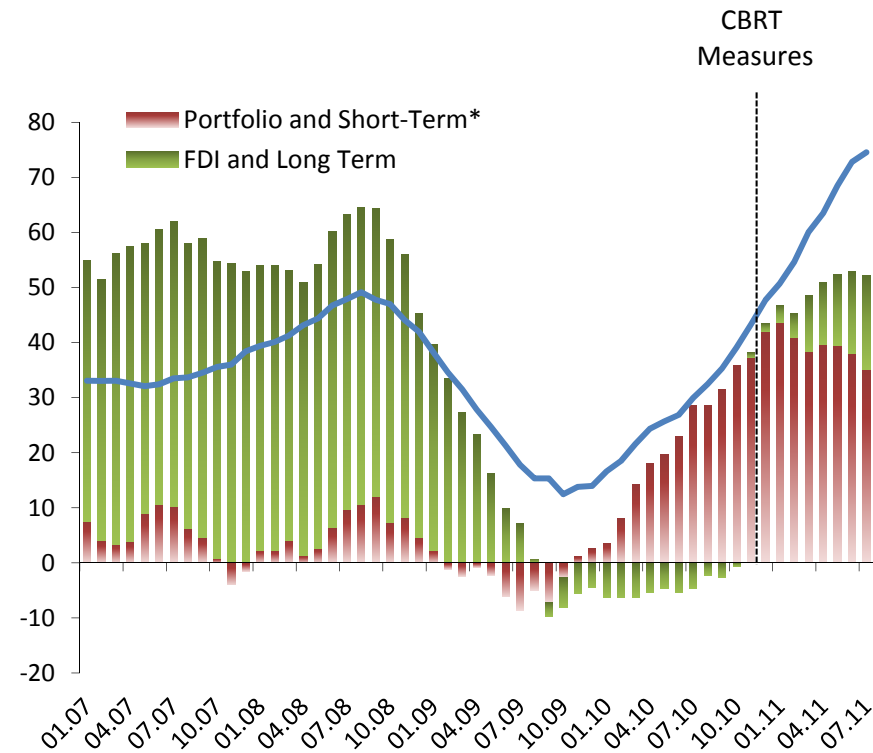


*Forecast for August and September.

Source: TURKSTAT, CBRT.

Main Sources of Current Account Deficit Finance

(12-months Cumulative, Billion USD)

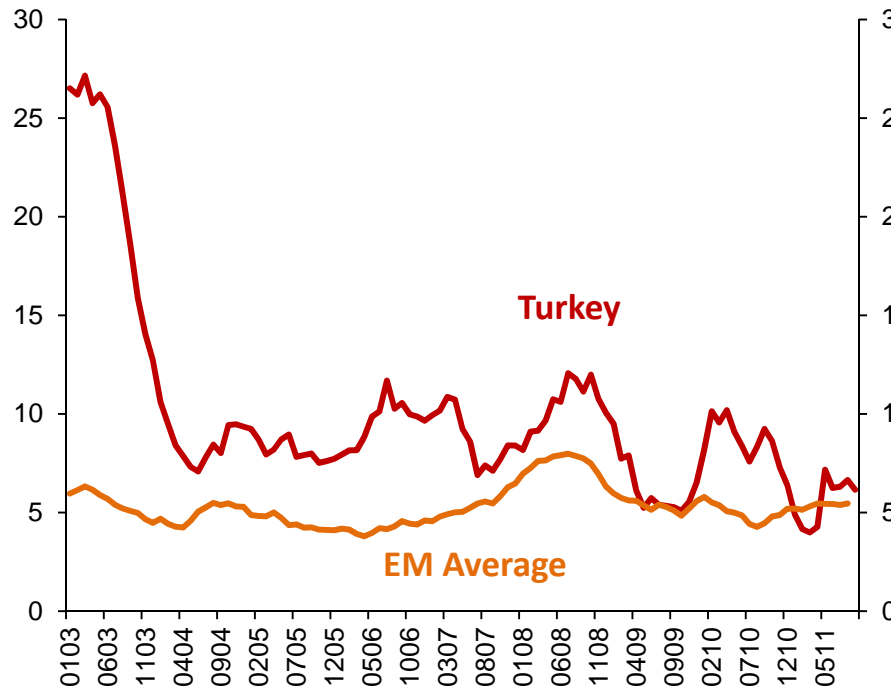


Source: CBRT.

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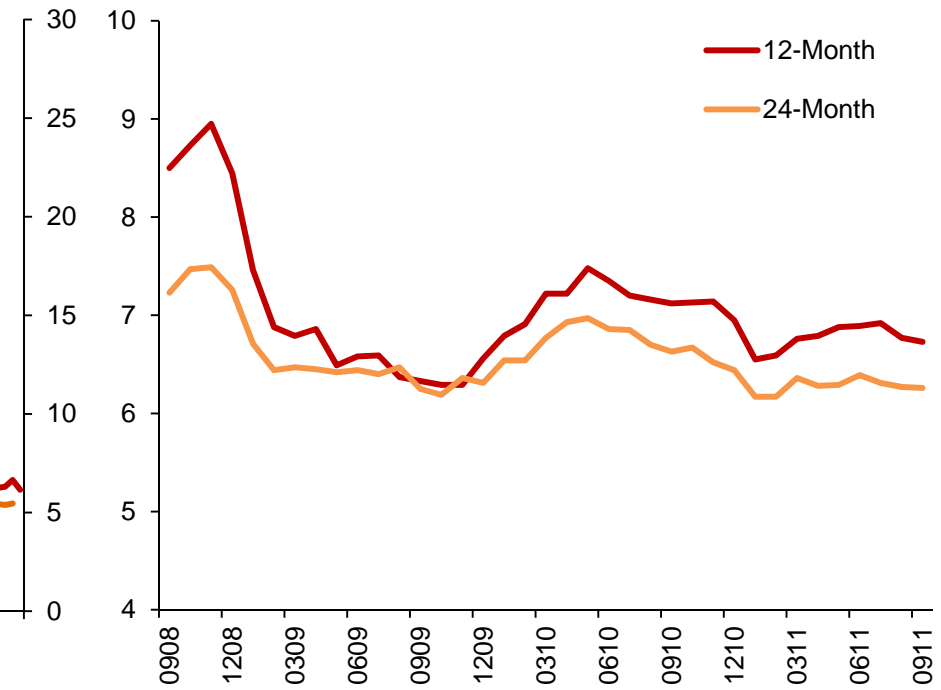
Outcome: Inflation and Inflation Expectations

Inflation



Source: CBRT and Bloomberg.
Average of EM countries: Brazil, Mexico, Czech Rep., Hungary, Poland, S. Africa, China, India, Russia.

Medium Term Inflation Expectations



* CBRT Survey of Expectations.

Source: CBRT.

- Post crisis dynamics have highlighted the crucial role of financial stability, leading central banks to be more "creative" in the conduct of monetary policy.
- The CBRT has formulated and implemented a new strategy to deal with macro financial risks posed by extraordinary global circumstances.
- The new policy mix has been effective in rebalancing the economy while controlling inflation expectations.



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