

# Central Banks and Financial Stability

## The CEPR/ESI 14th Annual Conference

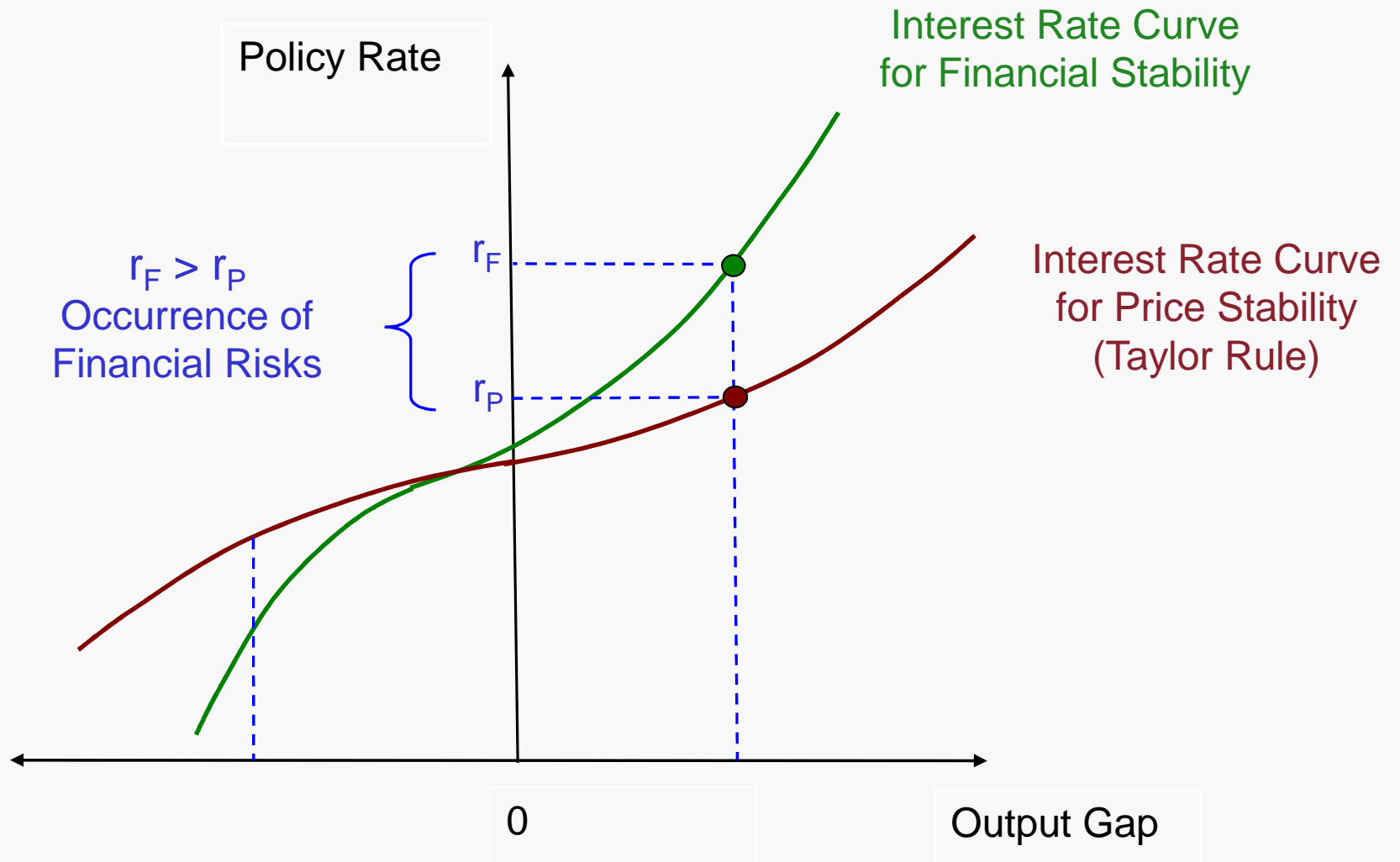
**Erdem BAŐCI**  
Deputy Governor

October 2010

# Presentation Outline

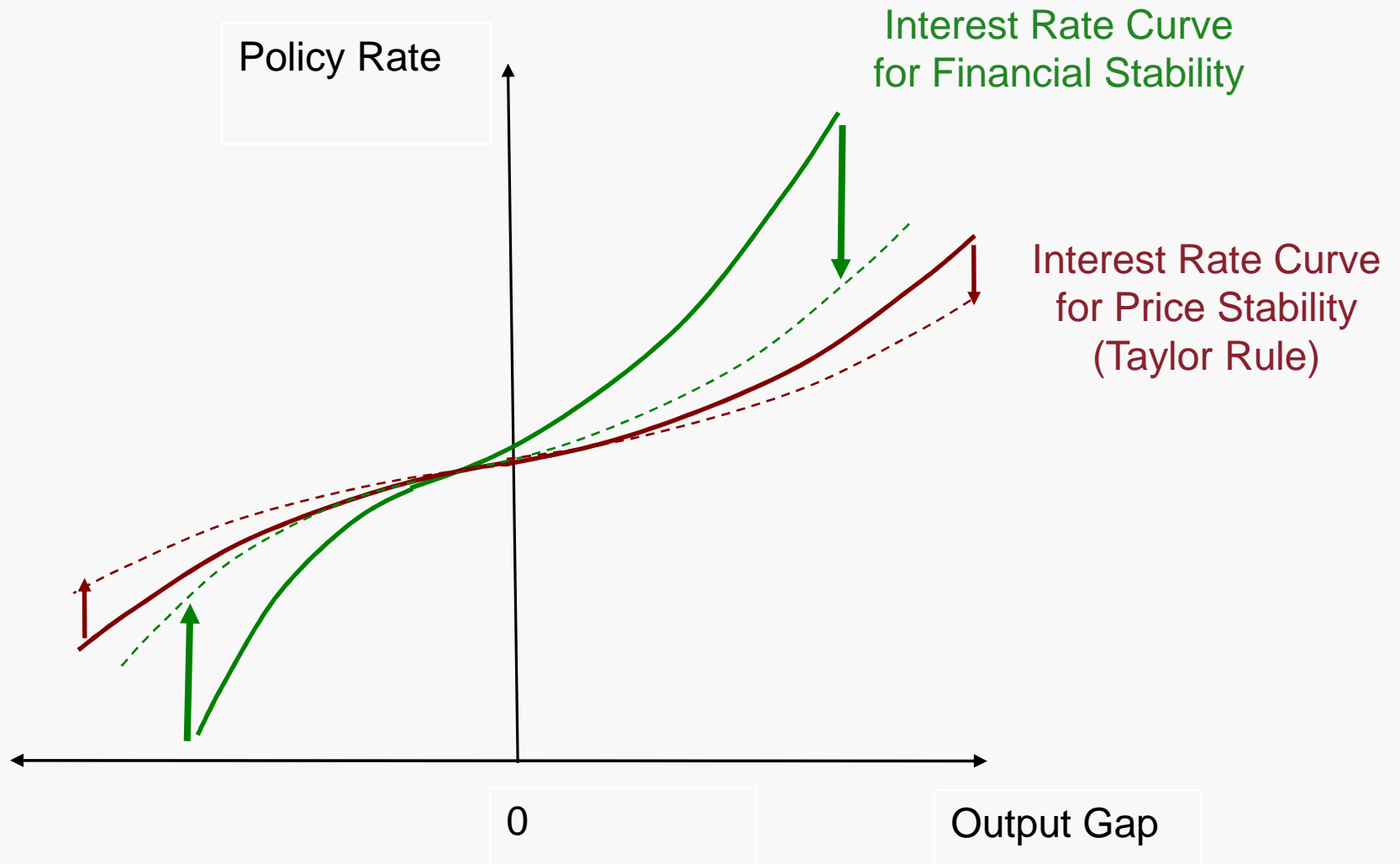
- I. Central Banks and Financial Stability**
- II. Financial Stability: Objectives**
- III. Financial Stability: Instruments**
- IV. Economic Outlook and Risks**
- V. Exit Strategy and Thereafter**

# Central Banks and Financial Stability

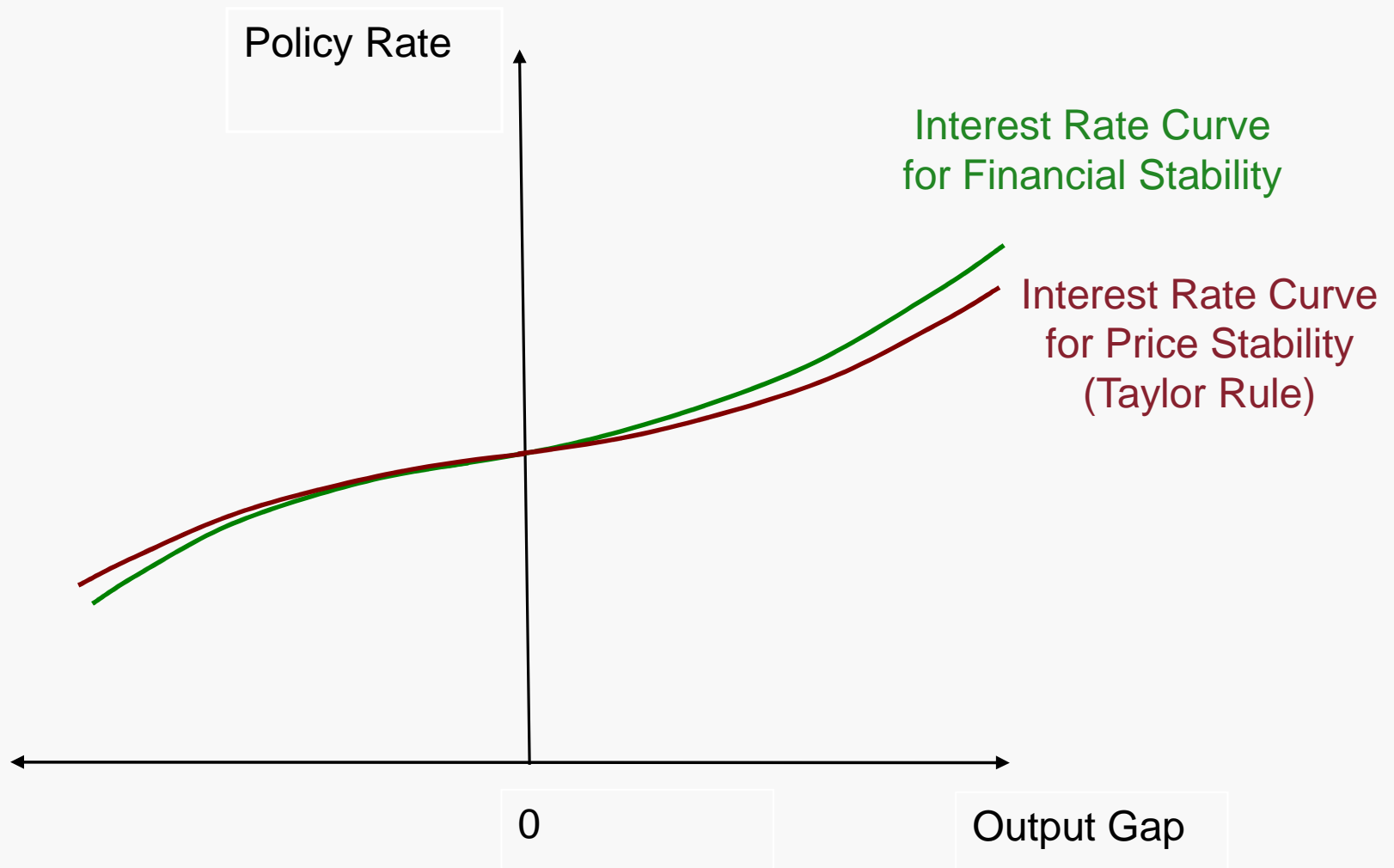


Note: Where non-interest instruments are not used

# Case Where Macroprudential Instruments are Used



# Case Where Macroprudential Instruments are Used



# Central Banks and Financial Stability

- **The additional measures we have taken recently should be evaluated as a preparation for the new world economic and financial outlook.**
- **The main feature of this new outlook is the potential risks of overheating, excessive credit growth and emergence of asset bubbles as a result of increasing capital inflows towards reliable and dynamic emerging market economies.**

# Financial Stability: Objectives

1. **Debt Ratios:** *Use of equity capital in higher amounts, more prudent borrowing*
2. **Debt Maturities:** *Extending maturities of domestic and foreign borrowing and deposits*
3. **FX Positions:** *Strengthening FX positions of public and private sectors*
4. **Risk management:** *More effective management of exchange rate risk via instruments such as the Turkish Derivatives Exchange*

# Financial Stability: Instruments

- 1. Required Reserve Ratios**
- 2. Liquidity Management of the Central Bank**
- 3. Capital Adequacy Ratios**
- 4. Liquidity Adequacy Ratios**
- 5. Taxes**
- 6. Primary Expenditures of the Public Sector**



# Liquidity Management Instruments of the Central Bank

## 1. FX Purchases

## 2. Weekly Repo Auctions

## 3. 3-Month Repo Auctions

## 4. Corridor System

- [...] the difference between borrowing and lending rates, or the difference between these and the policy rate (one-week repo auction rate) will be determined as an element of the operational framework of monetary policy (Exit Strategy 2010, paragraph 16.b.iii)

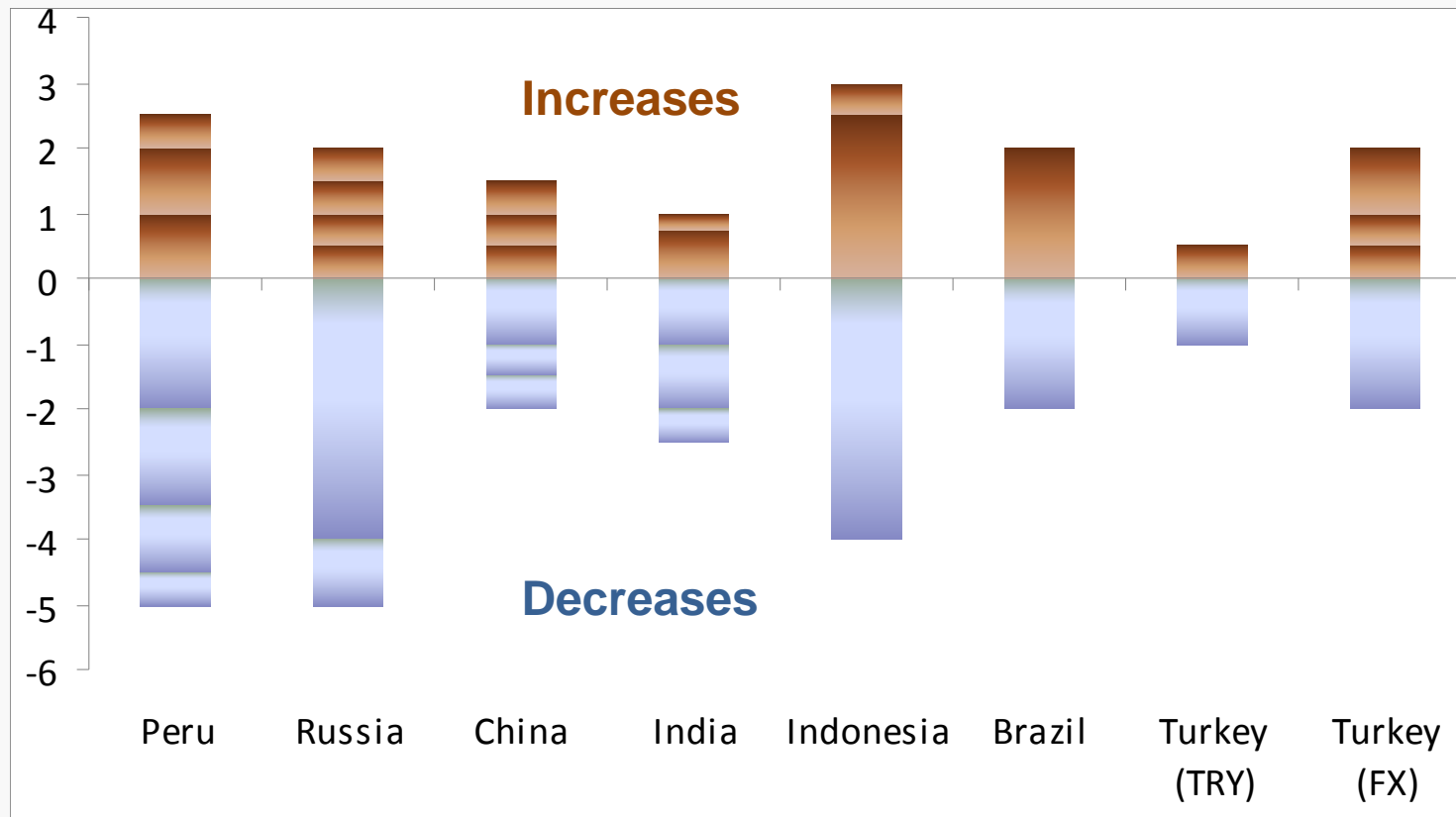
# Required Reserves

## 1. Liquidity Channel

## 2. Cost Channel

# Required Reserves

## The Use of Required Reserves as a Policy Instrument



# Central Bank's Policy Instruments

## Instruments for Price Stability (in the order of priority):

1. Short Term Interest Rates
2. TRY Liquidity Management
3. Required Reserve Ratios

# Central Bank's Policy Instruments

## Instruments for Financial Stability (in the order of priority):

1. Required Reserve Ratios
2. TRY Liquidity Management
3. Short Term Interest Rates

# Central Bank's Policy Instruments

## Frequency of Use (Higher to Lower):

1. TRY Liquidity Management
2. Short Term Interest Rates
3. Required Reserve Ratios

# Central Bank's Policy Instruments

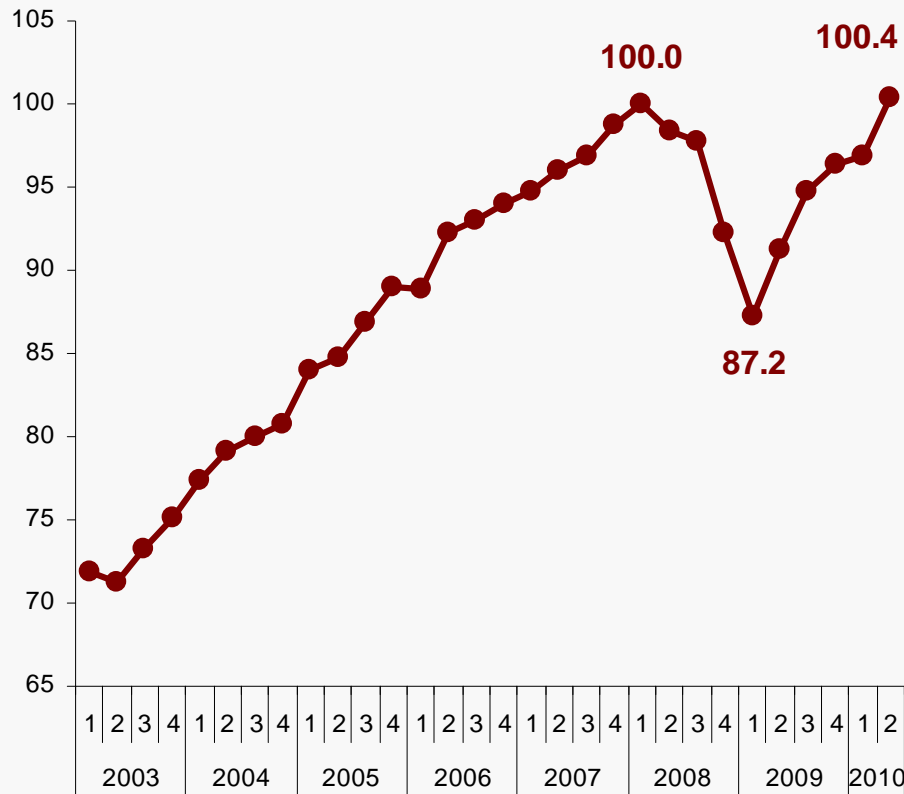
## Predictability (Higher to Lower):

1. Required Reserve Ratios
2. Short Term Interest Rates
3. TRY Liquidity Management

# Economic Outlook and Risks

## Seasonally Adjusted GDP

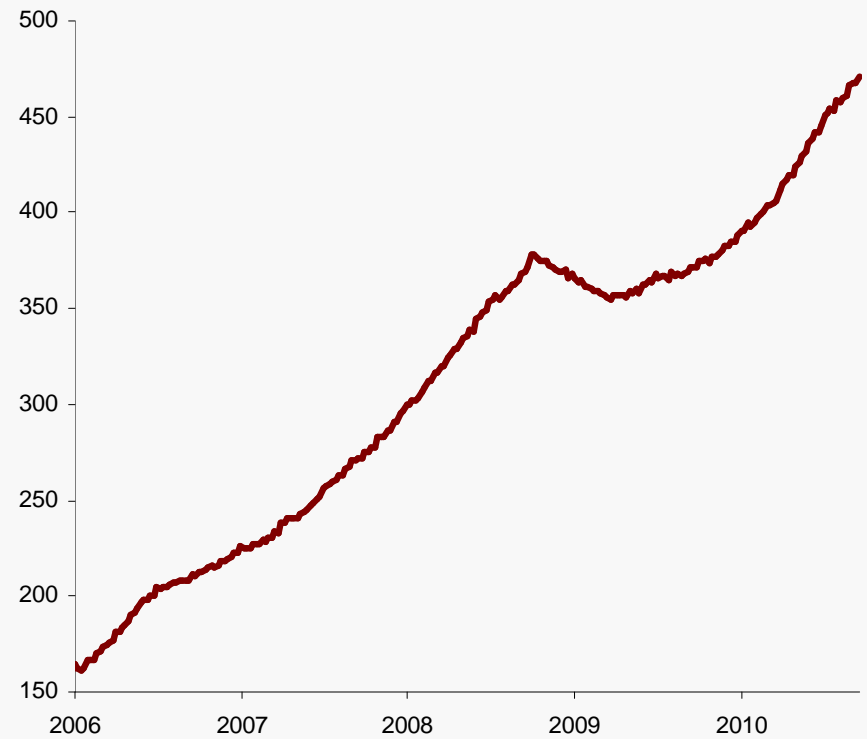
(2003 Q1 – 2010 Q2, constant prices, 2008 Q1 = 100)



Source: TurkStat, CBT

## Total Credit Volume\*

(Jan 2006 – Sept 2010, billion TL)



\* Total credits extended by deposit, development, investment and participation banks along with consumer financing firms; exchange rate adjusted

Source: BRSA, CBT



# Economic Outlook and Risks

**“ [...] Should the divergence in the growth rates between domestic and external demand continue in the forthcoming period, it would be necessary to utilize other policy instruments such as reserve requirement ratios and liquidity management facilities more effectively.” (Inflation Report, July 2010)**

# Policy Instruments Affecting the Current Account Deficit

- 1. Primary Budget Surplus**
- 2. Taxes**
- 3. Capital Adequacy Ratios (Basel III)**
- 4. Liquidity Adequacy Ratios (Basel III)**
- 5. Required Reserve Ratios**
- 6. Central Bank's Liquidity Management**

# Exit Strategy and Thereafter

- **Inflation Report (July 2010):** “[...] the measures outlined in our exit strategy to be completed to a large extent throughout the rest of the year, ...” (baseline scenario)
- **Decision of the Monetary Policy Committee (16 September 2010):** “[...] the Committee has indicated that it would be appropriate to proceed with the measures outlined in the exit strategy that were envisaged to be implemented by end-2010.”

# Exit Strategy and Thereafter

- **Turkish lira required reserve ratio is likely to be raised to 6 percent by the end of the year.**
- **We will communicate the likely course of the required reserve ratios throughout 2011 in December 2010.**

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