The Turkish Experience

Bank of Indonesia and IMF Joint Conference on

Coping with Asia's Large Capital Inflows in a Multi-Speed Global Economy

Erdem Başçı

Deputy Governor, Central Bank of Turkey

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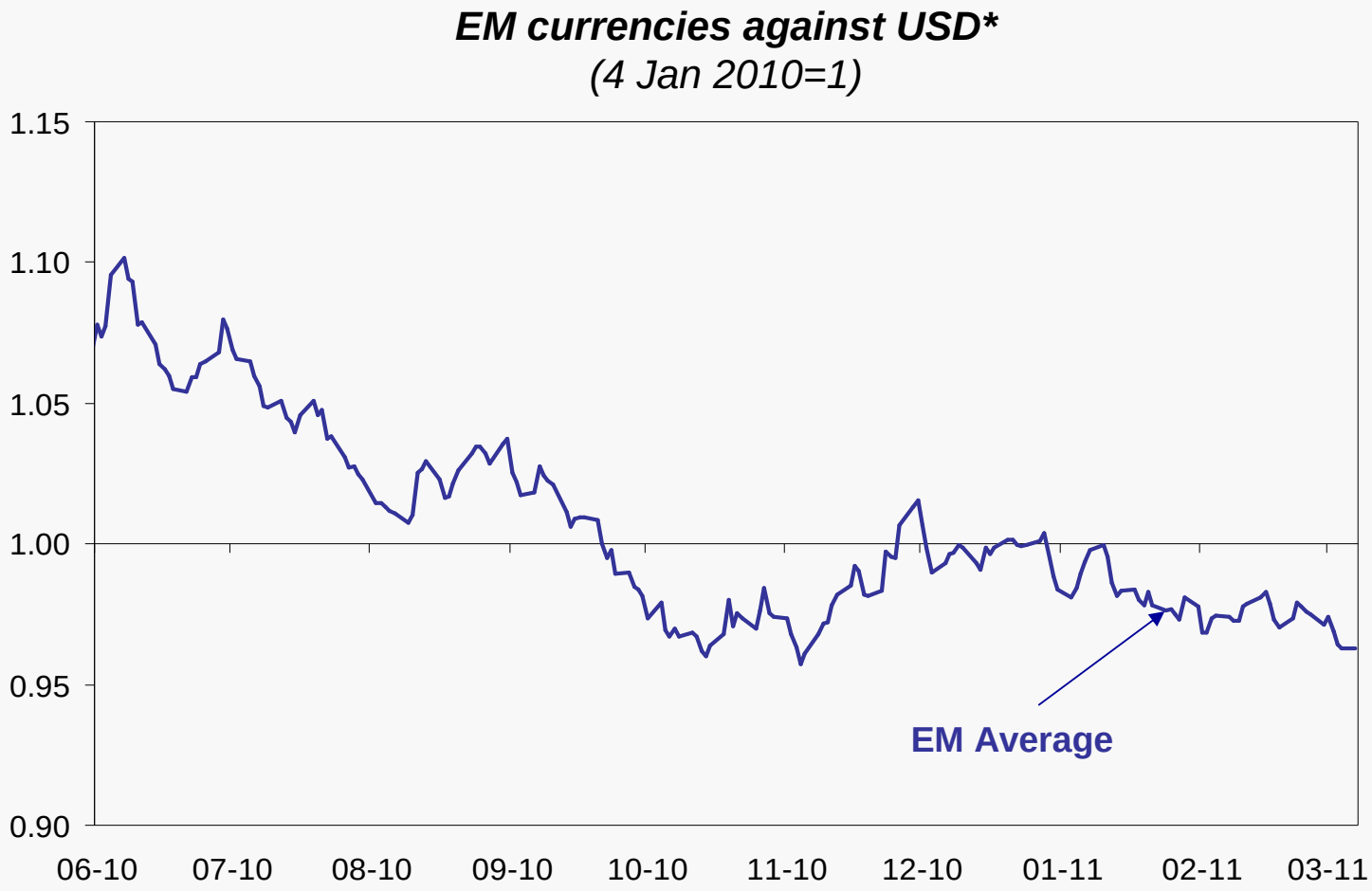
Bali, Indonesia

Quantitative Easing vs. Quantitative Tightening

- Quantitative easing in major economies has continued in response to weakness in economic activity and heightened sovereign risks, resulting in dramatic increases in central banks' balance sheets.
- Facing huge influx of capital, some developing countries have resorted to quantitative macroprudential tightening, even capital controls.
- Turkey has also initiated quantitative tightening, starting from April 2010.

Appreciation Pressure



*Average of emerging market currencies, including Brazil, Chile, Czech Republic, Hungary, Mexico, Poland, South Africa, Indonesia, South Korea and Colombia.

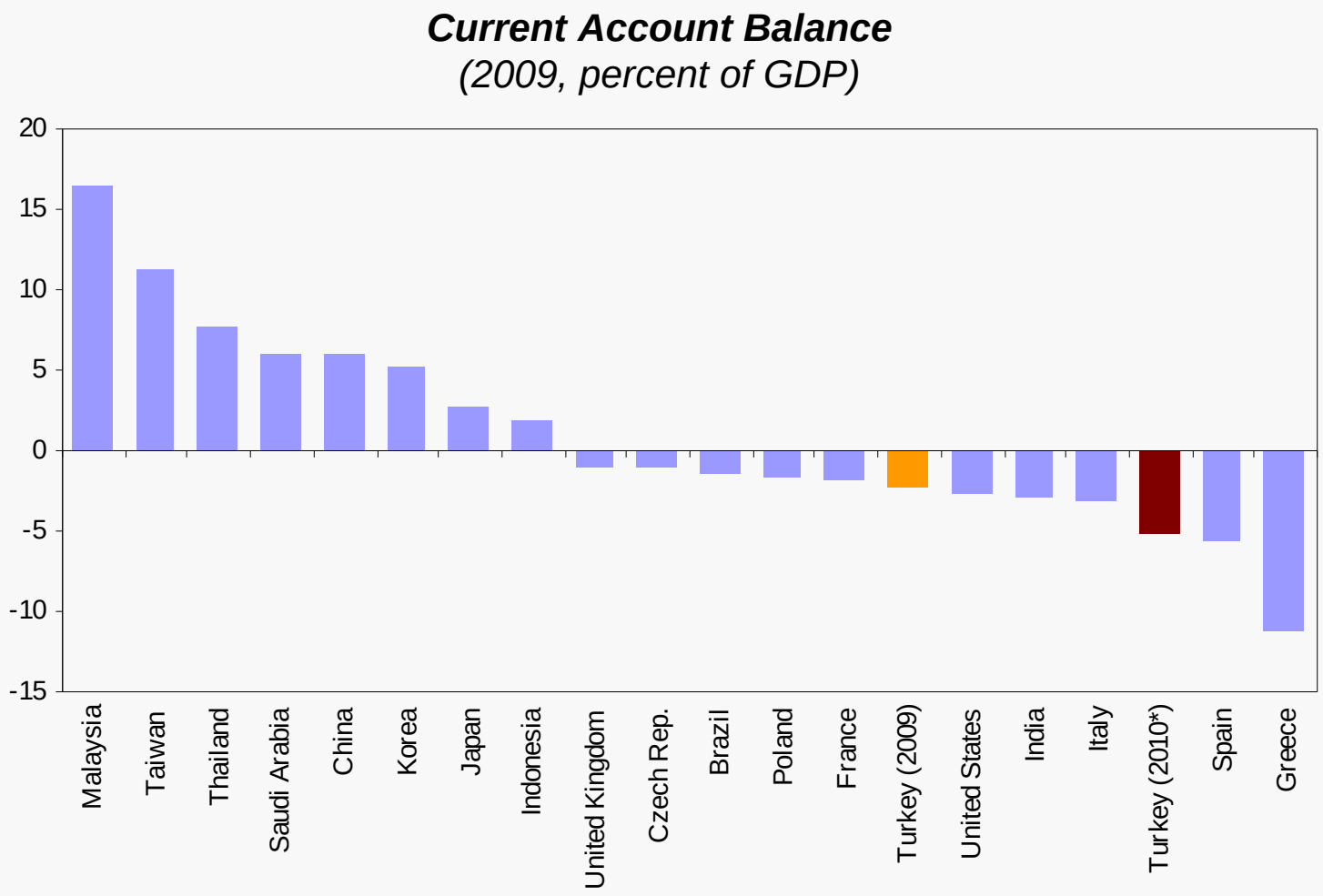
Source: Bloomberg, CBRT

Two Approaches

- **Approach 1:** Use capital account measures to restrict inflows while tightening via interest rates (Brazil, South Korea)

- **Approach 2:** Use macroprudential measures to restrict domestic credit and domestic demand while keeping the short term interest rate differentials as low as possible (Turkey)

Current Account Balance



* IMF WEO Estimate

Source: IMF, CBRT

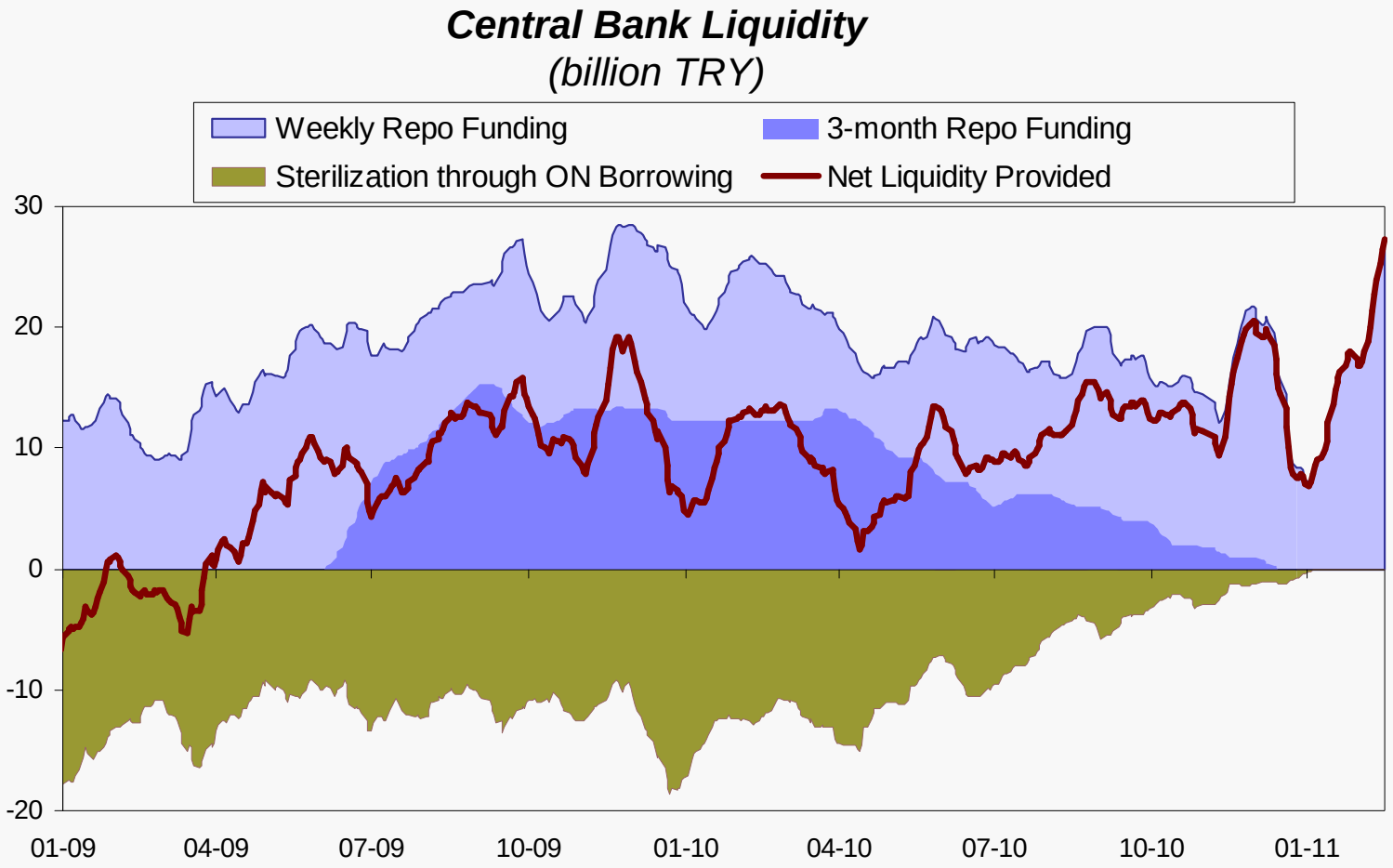
Phases in Monetary Policy

- **Phase-1:** Full Liquidity Support (after the collapse of Lehman Brothers, September 2008)

- **Phase-2**: Monetary Exit Strategy (April 2010)

- **Phase-3:** New Policy Mix (starting from November 2010)

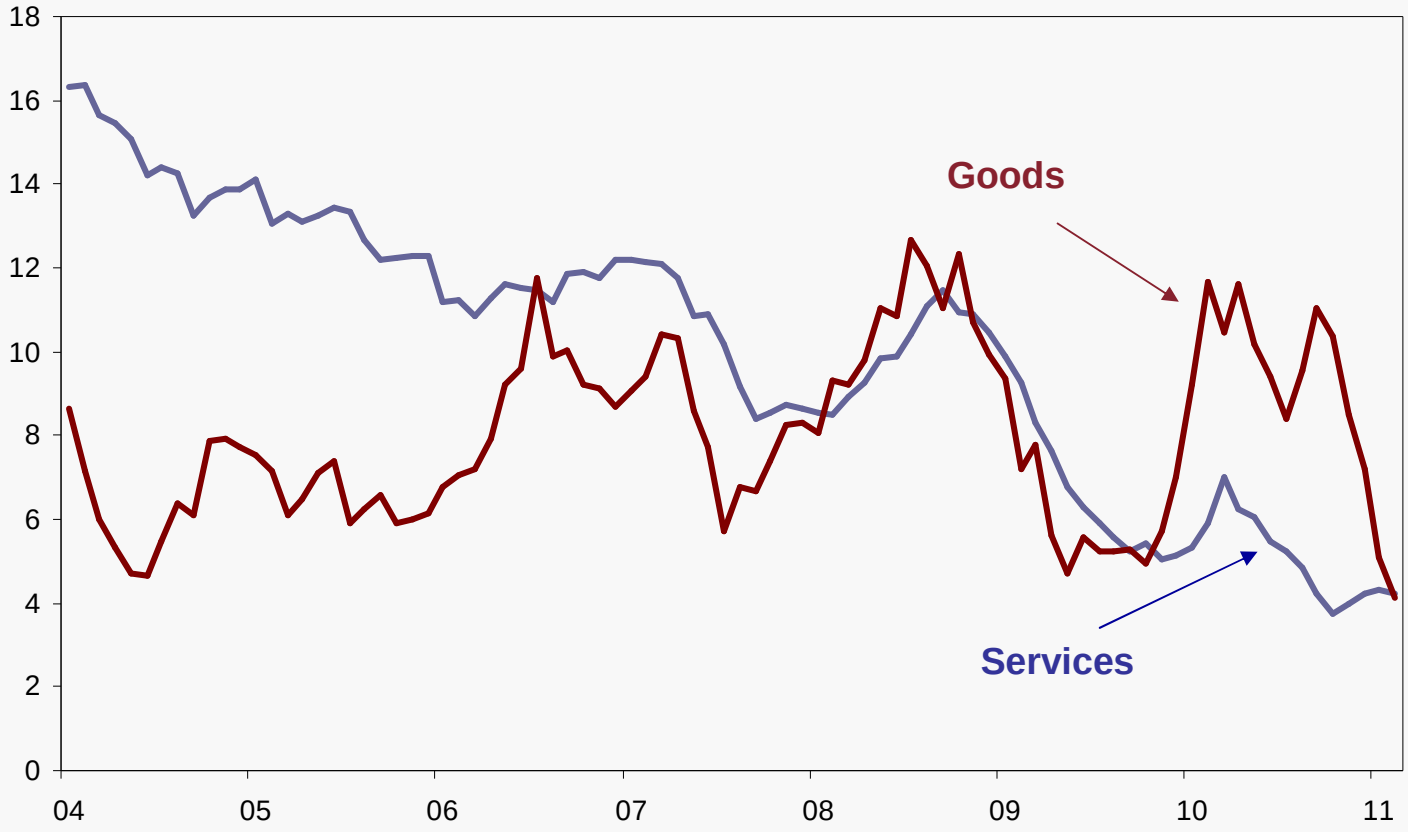
Liquidity after Monetary Exit



Source: ISE, CBRT

Price Stability after Monetary Exit

Goods and Services Inflation
(year-on-year change, percent)



Source: TurkStat, CBRT

Financial Stability: Objectives

1. **Debt Ratios:** Use of more equity, 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

Macroprudential Tools

- Under the current economic conditions, it may not be possible to simultaneously ensure price stability and financial stability by means of policy rates alone.
- **Solution:** Using macroprudential tools in coordination with other public authorities.
- **Macroprudential tools:**
    1. *Reserve requirements*
    2. *Liquidity management*
    3. *Capital adequacy ratios*
    4. *Liquidity adequacy ratios*
    5. *Taxes*
    6. *Primary expenditures of government*

Tools (in the order of priority):

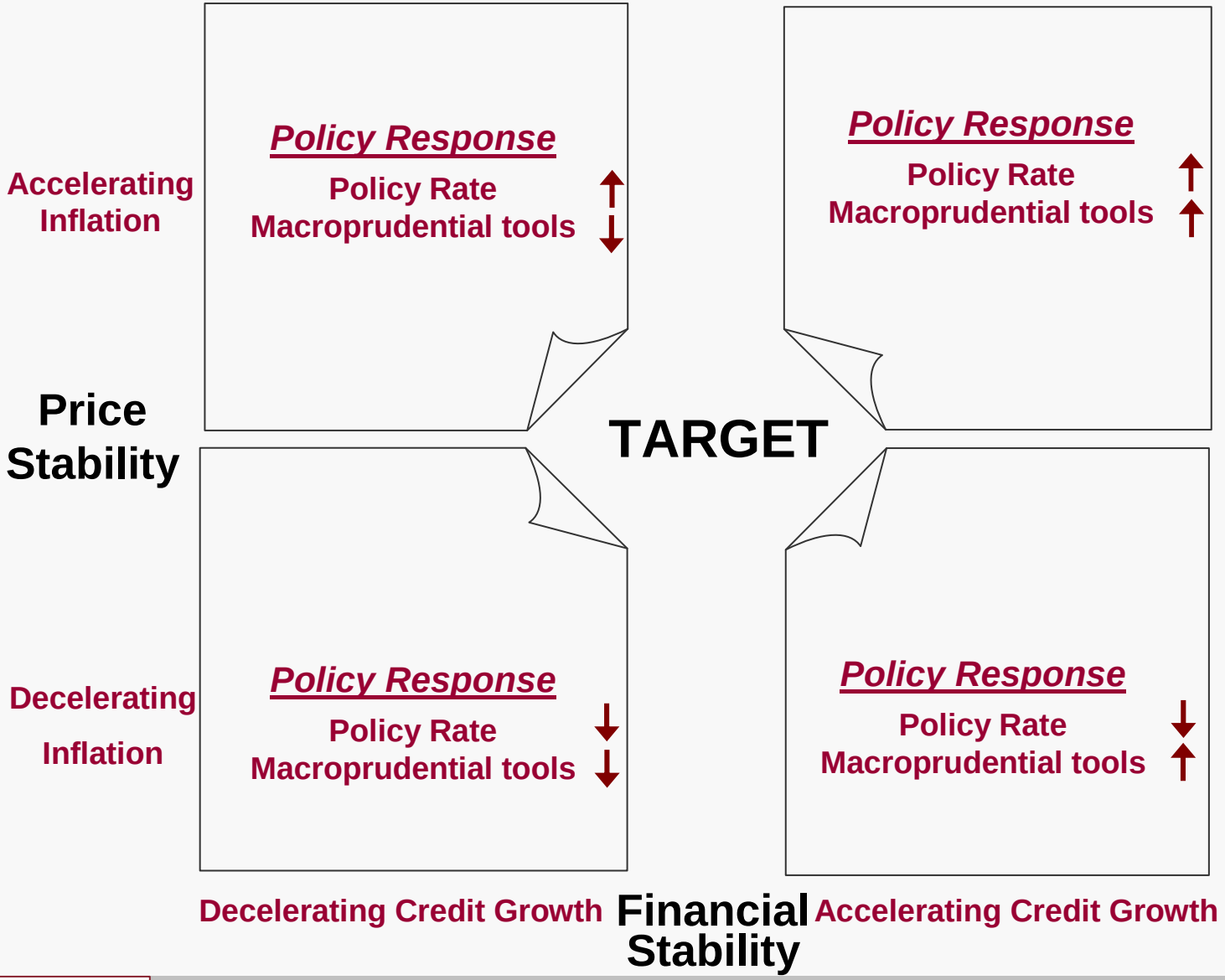
For Financial Stability:

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

For Price Stability:

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

Two Targets, Two Instruments



The New Policy Mix

A lower policy rate, a wider interest rate corridor and higher reserve requirements

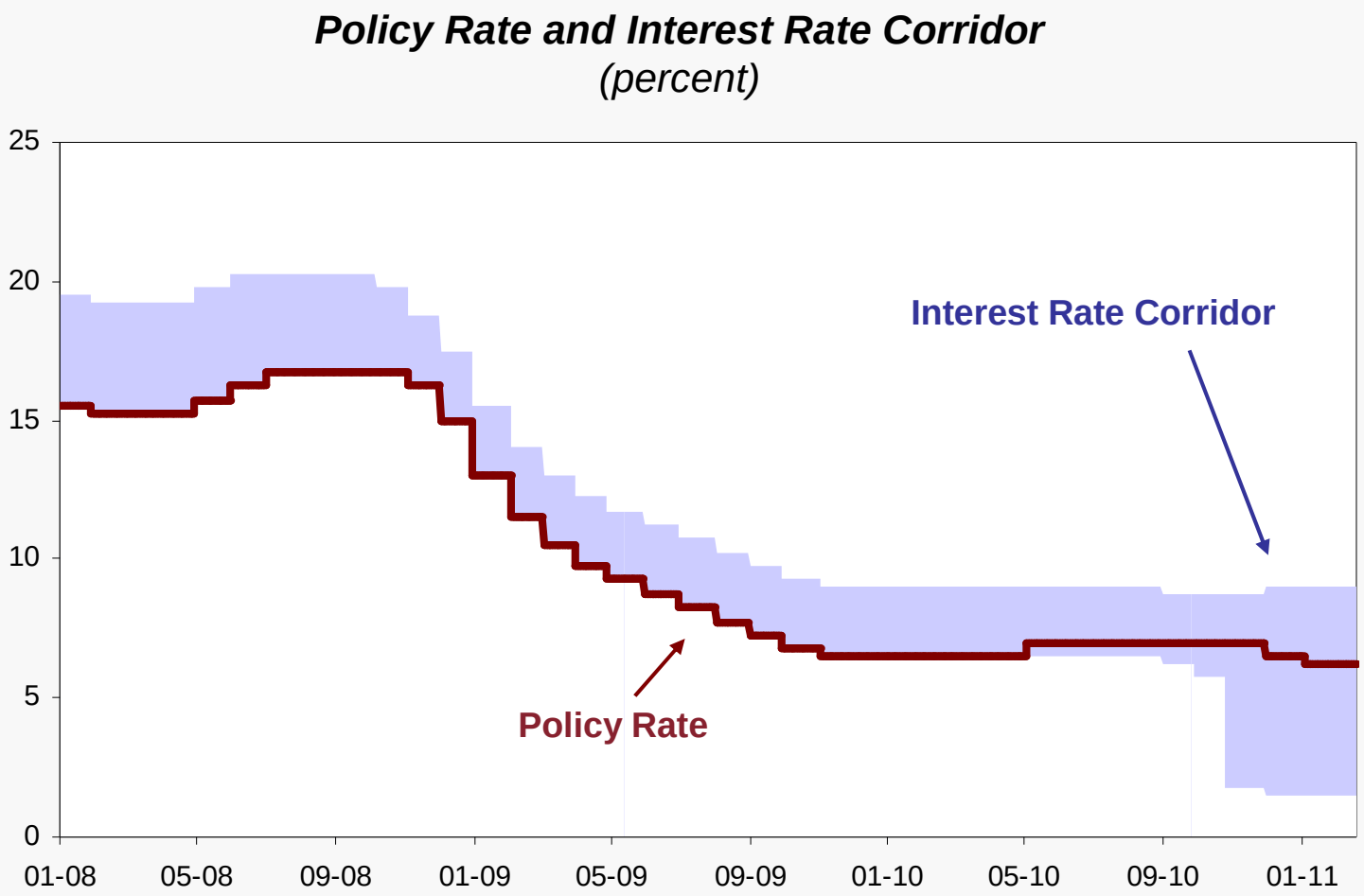
- The framework we adopt in spirit is not significantly different from the conventional inflation targeting framework.
- The only difference is that, previously our policy instrument was the one week repo rate, but now our instrument is a “policy mix”
- We seek to use these instruments in the right combination in order to cope with both inflation and macro-financial risks.
- The monetary policy stance in this framework is not only determined by the path of policy rates, but as a combination of all the policy instruments.

Effectiveness of Required Reserves

1. **Liquidity Channel (wider corridor)**

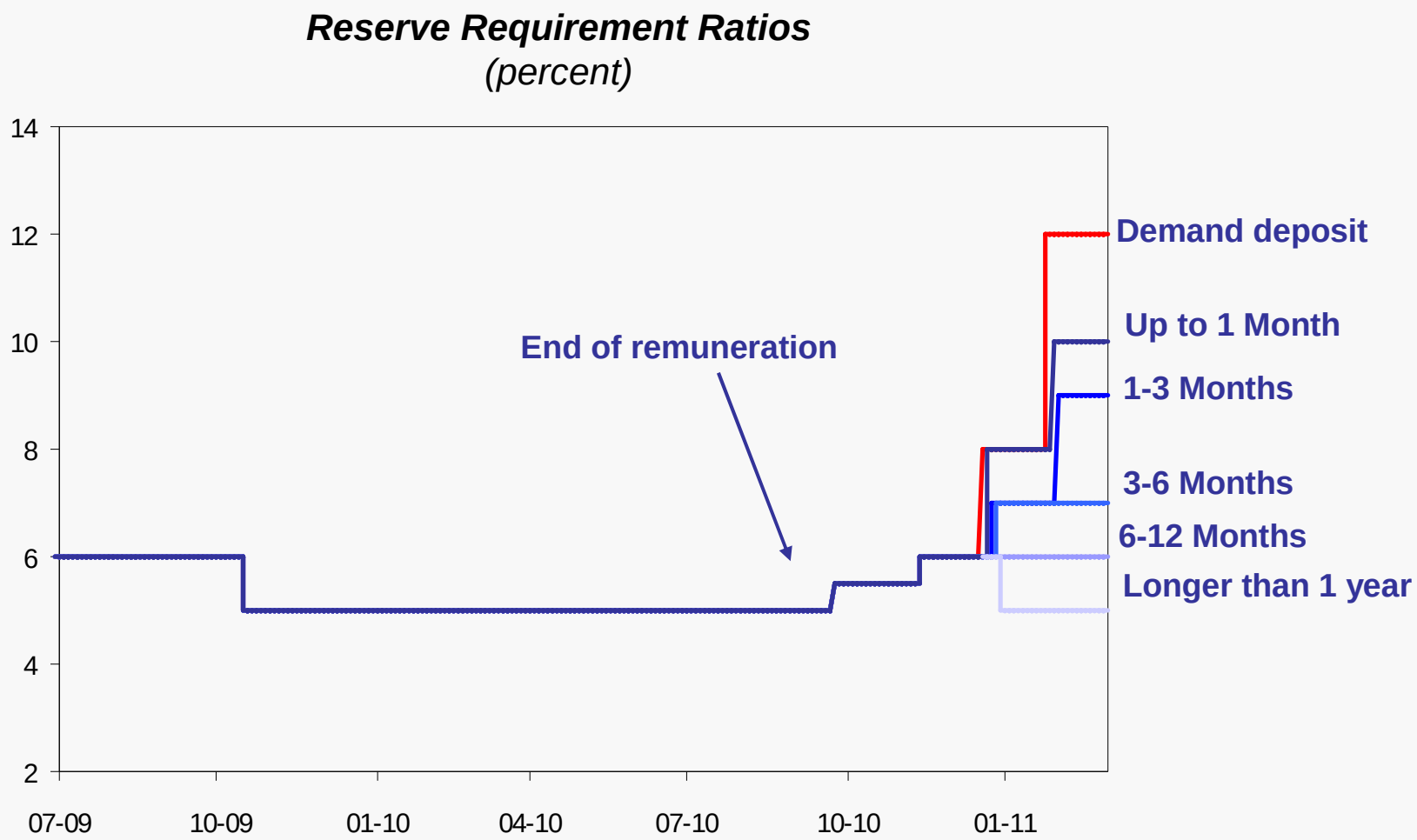
2. **Cost Channel (no remuneration)**

The Policy Rate and the Interest Rate Corridor



Source: CBRT

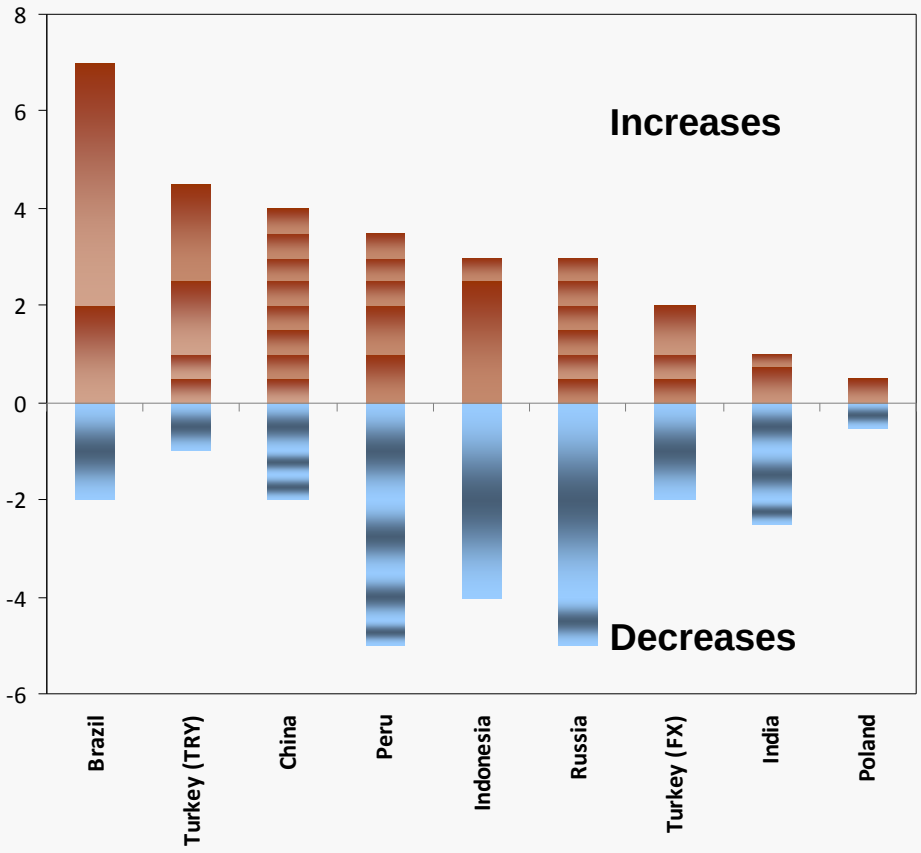
Reserve Requirements as a Macroprudential Tool



Source: CBRT

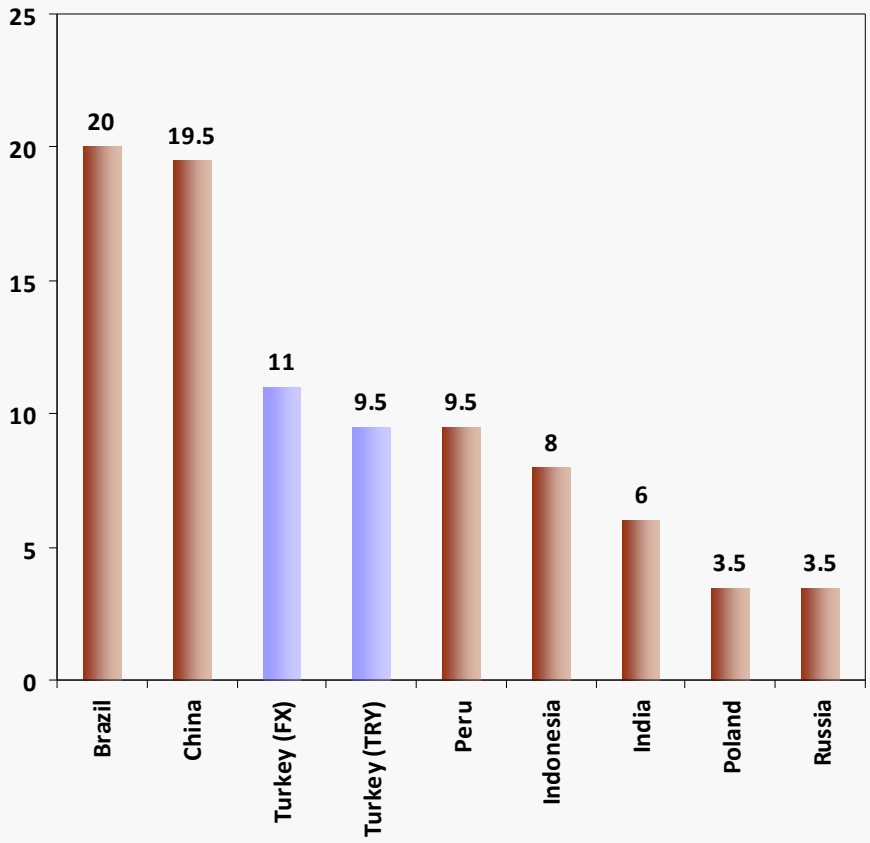
Reserve Requirements as a Macroprudential Tool

Change in RRR Since the Start of the Crisis
(percentage point)



Source: Central Banks, CBRT

Current RRR
(percent)



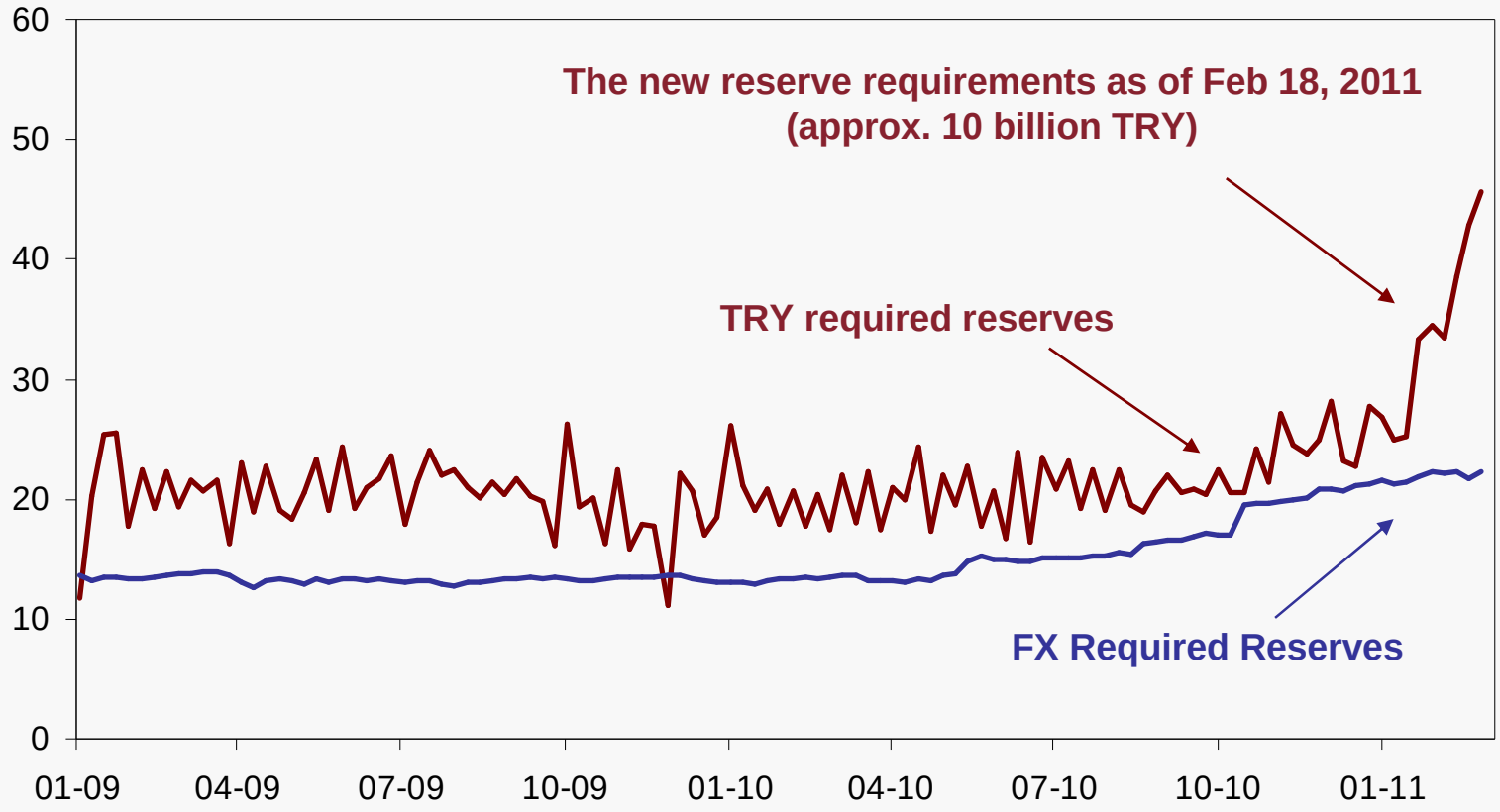
Source: Central Banks, CBRT

Measures by Other Authorities

1. Fiscal discipline
2. No FX loans to households
3. Domestic currency bond market
4. Loan/value restrictions
5. Tax hikes on certain consumer loans
6. Restrictions on credit card borrowing

Tightening the Liquidity

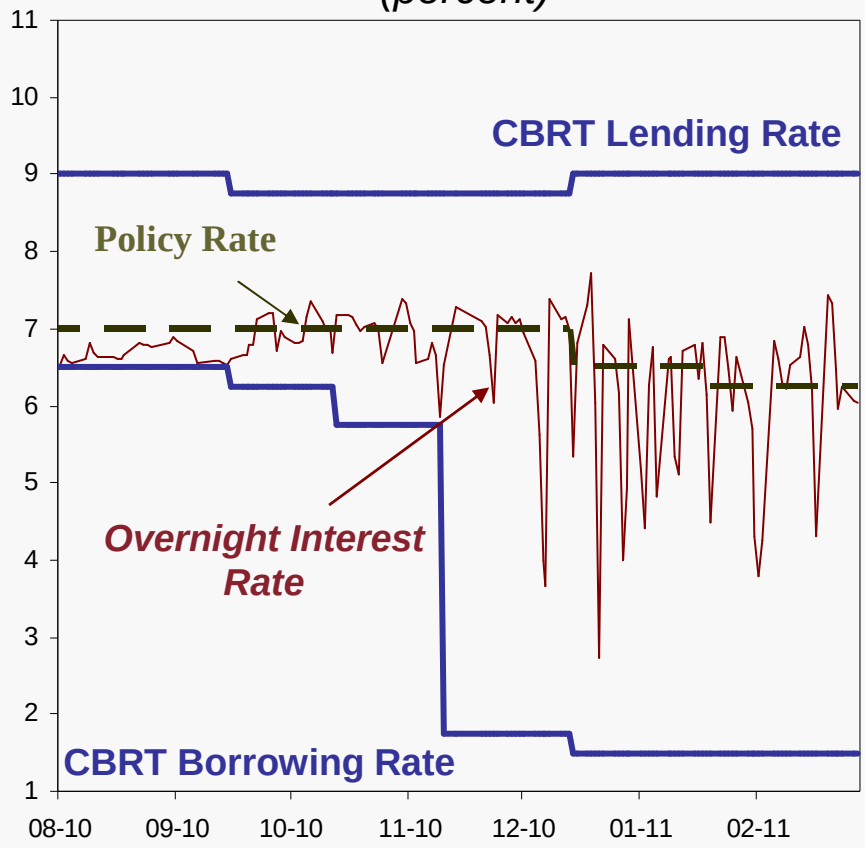
Reserve Requirements Balances
(billion TRY)



Source: CBRT

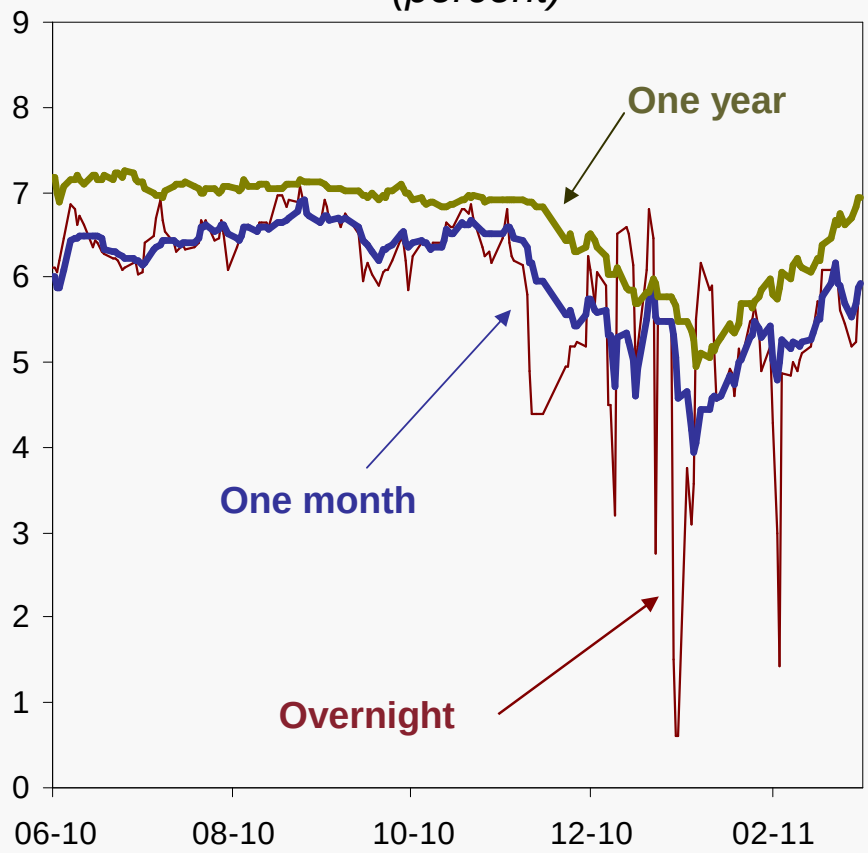
Volatility in Money Markets

Overnight Interest Rates
(percent)



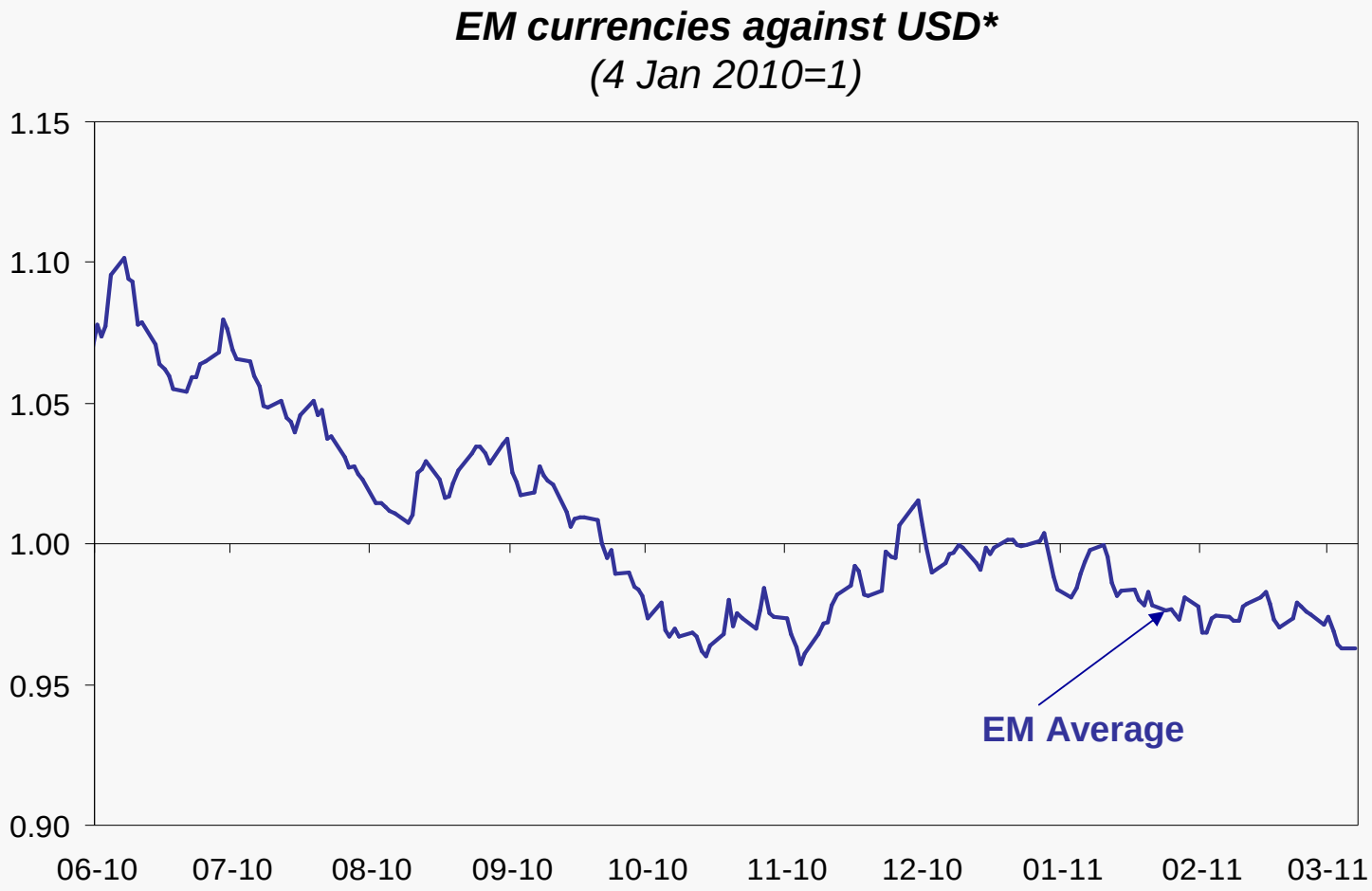
Source: ISE, CBRT

Swap Rates
(percent)



Source: Reuters, CBRT

Appreciation Pressure



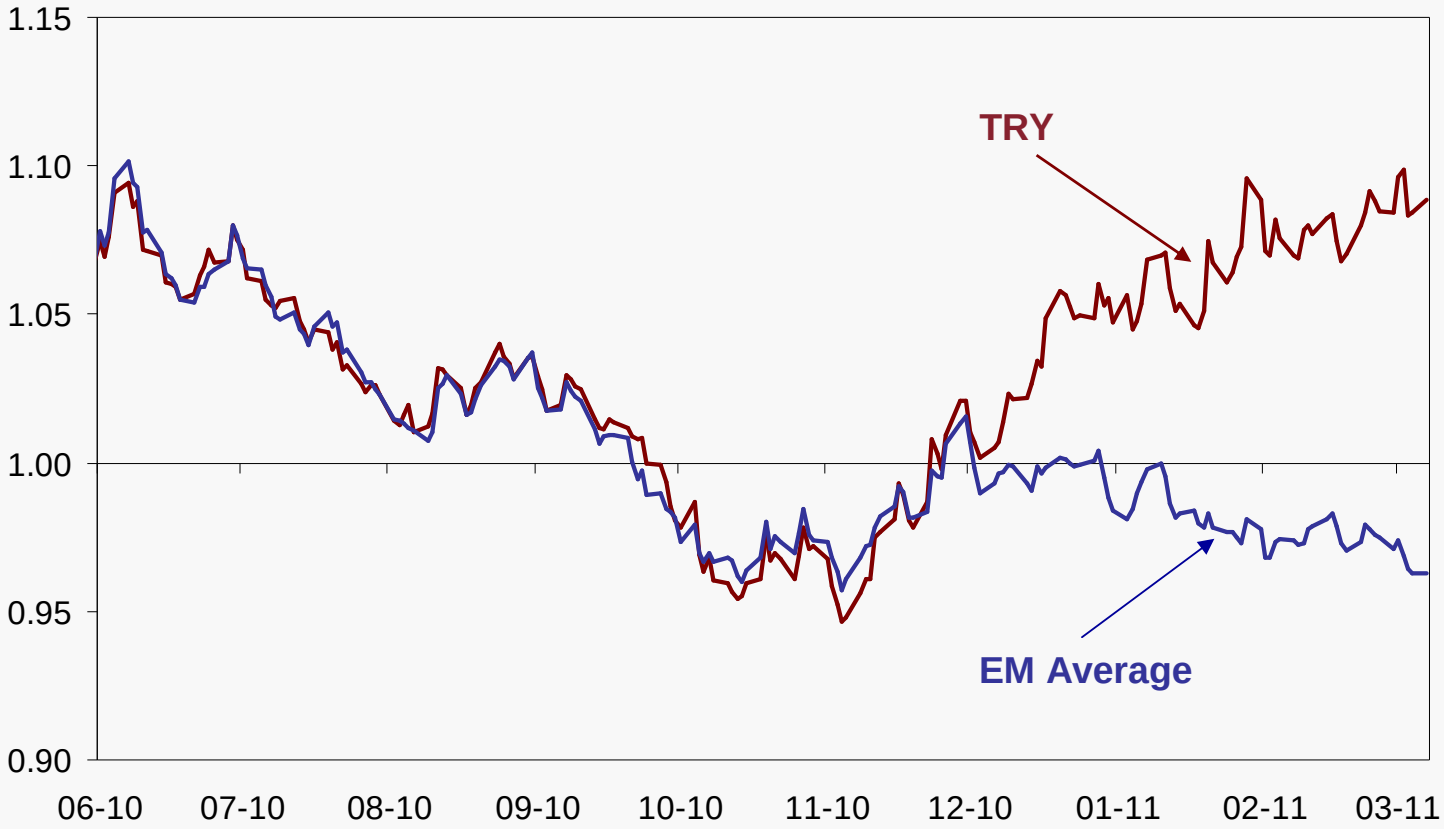
*Average of emerging market currencies, including Brazil, Chile, Czech Republic, Hungary, Mexico, Poland, South Africa, Indonesia, South Korea and Colombia.

Source: Bloomberg, CBRT

Initial Impact on Currency

TRY and other EM currencies against USD*

(4 Jan 2010=1)



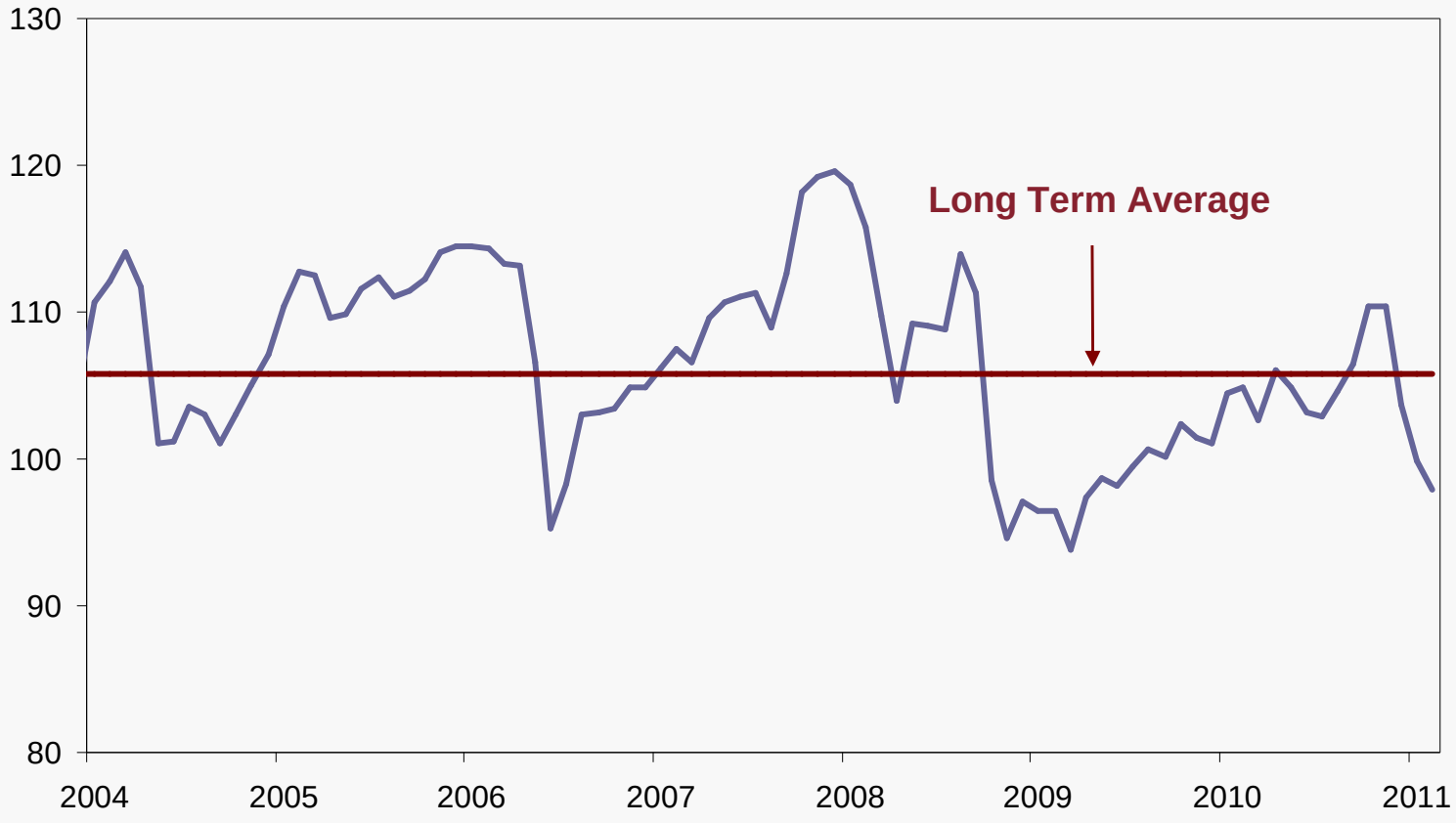
*Average of emerging market currencies, including Brazil, Chile, Czech Republic, Hungary, Mexico, Poland, South Africa, Indonesia, South Korea and Colombia.

Source: Bloomberg, CBRT

Initial Impact on Currency

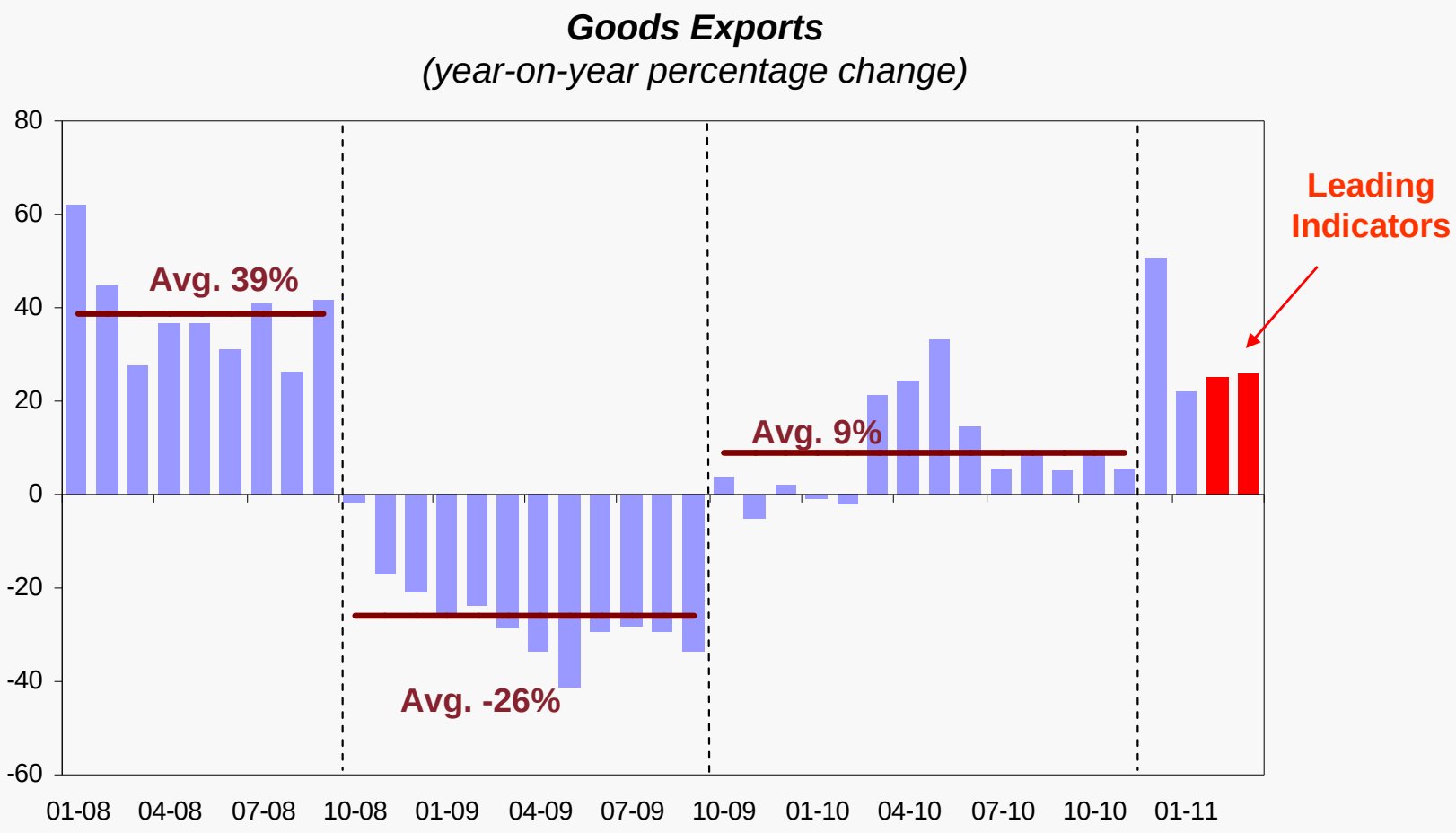
Real Effective Exchange Rate

(CPI-based, against developing countries, 2003=100)



Source: CBRT

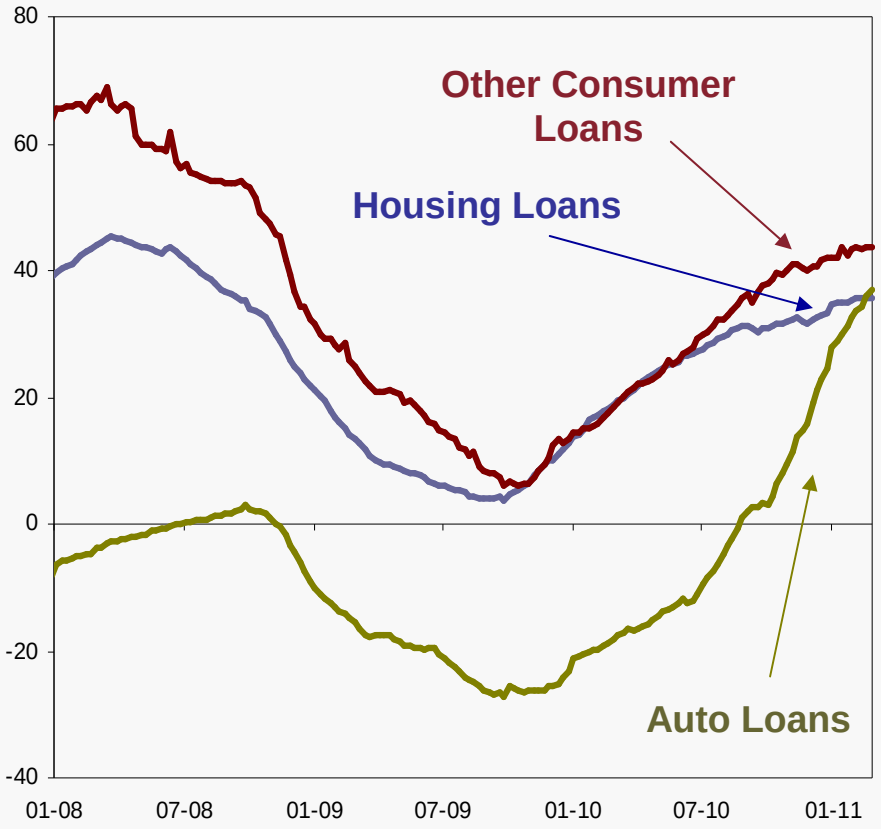
Exports



Source: TurkStat, Turkish Exporters Assembly, CBRT

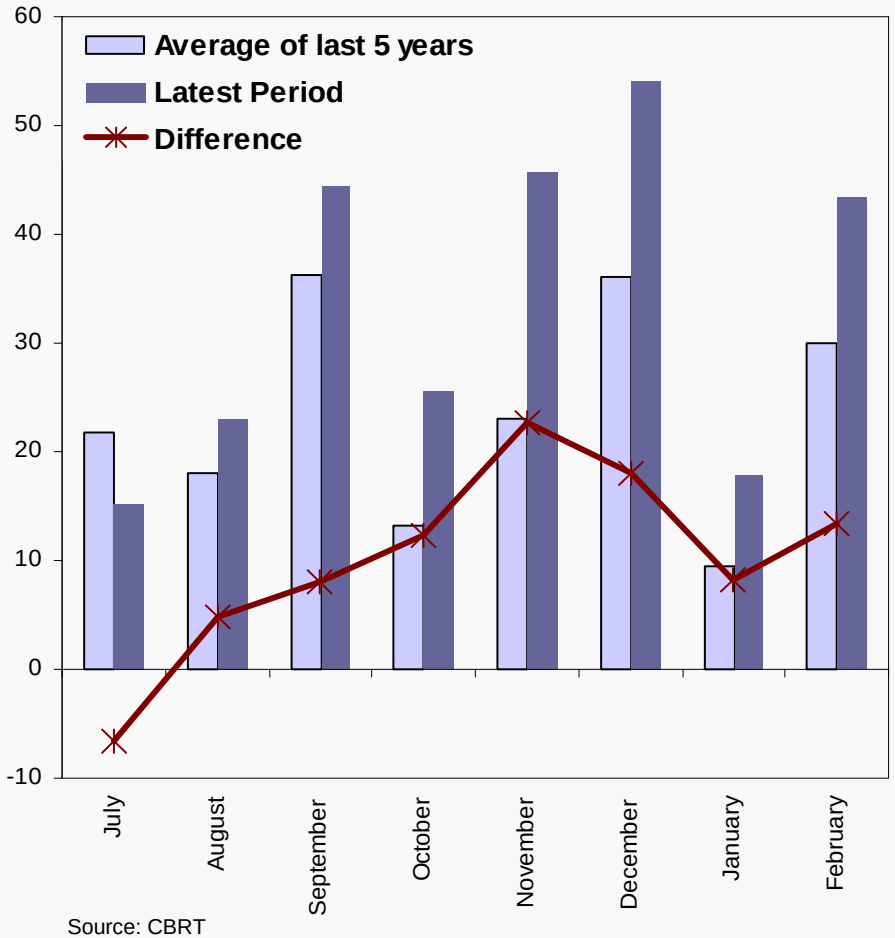
Credit Growth

Household Loans
(year-on-year change, percent)



Source: CBRT

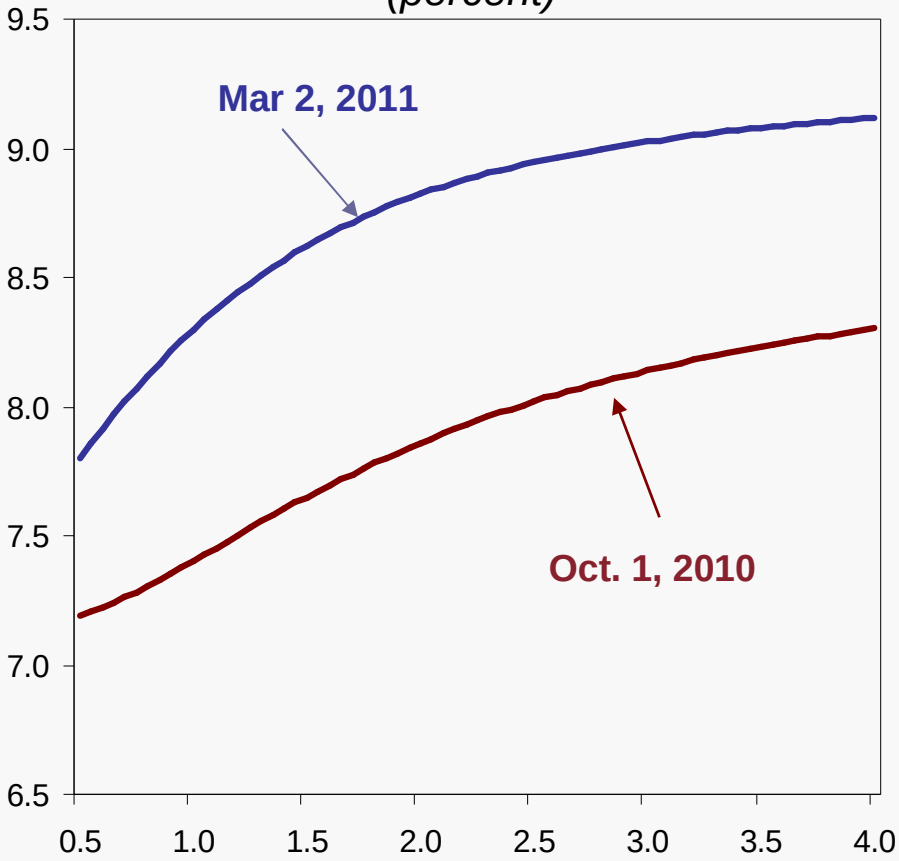
Total Loans
(annualized monthly change, percent)



Source: CBRT

QT and Inflation Expectations

Yield Curve*
(percent)



* Calculated from the compounded returns on bonds quoted in ISE Bills and Bonds Market by using ENS method.
Source: ISE, CBRT

Inflation Expectations*
(percent)

* CBRT Expectations Survey results from the second survey period.
Source: ISE, CBRT

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