# BULLETIN

## MAIN THEME

### Monetary and Exchange Rate Policy in 2014

The monetary and exchange rate policy of the Central Bank of the Republic of Turkey (CBRT) for 2014 was announced at a press conference on 24 December 2013.

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## CBRT DEPARTMENTS

### Research and Monetary Policy Department

The Research and Monetary Policy Department performs economic analyses needed for the determination of the monetary policy implemented to achieve price stability.
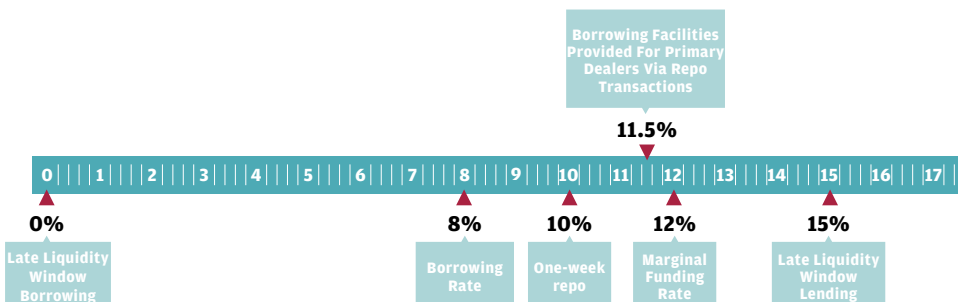
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## THERMOMETER

### *CBRT Balance Sheet: Selected Monetary Aggregates
### *Real Effective Exchange Rate

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## CBRT INTEREST RATES (18 MARCH 2014)

Borrowing Facilities Provided For Primary Dealers Via Repo Transactions

11.5%

0 | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 | 16 | 17

0%

Late Liquidity Window Borrowing

8%

Borrowing Rate

10%

One-week repo

12%

Marginal Funding Rate

15%

Late Liquidity Window Lending

## CBRT RESERVES (BY 7 MARCH 2014)

**GROSS FOREIGN EXCHANGE RESERVES**
106.822 BILLION USD

**GOLD**
21.242 BILLION USD

## INFLATION (FEBRUARY 2014)

**CPI ANNUAL CHANGE**
7.89%

# Monetary and Exchange Rate Policy in 2014

The monetary and exchange rate policy of the CBRT for 2014 was announced at a press conference on 24 December 2013. At the conference, Governor Başçı evaluated recent economic developments and explained in detail the monetary policy strategy to be implemented throughout 2014, the communication tools, the operational framework regarding exchange rates, the liquidity policy and macroprudential arrangements.

## Monetary Policy Framework for 2014

- The CBRT's primary objective is to achieve and maintain price stability. To this end, as was the case for the 2014 and 2015 period, the inflation target for 2016 is set at 5 percent as per the agreement reached with the government.
- While aiming to keep inflation close to target, the CBRT will continue to safeguard financial stability. In this context, the CBRT will maintain its policies to contain the volatility caused by capital flows on domestic economy.
- The main communication documents of the monetary policy are the Monetary Policy Committee (MPC) announcements and the Inflation Report. The Financial Stability Report will continue to be another significant communication tool for the CBRT in the upcoming period.

## Turkish Lira Liquidity Management

- The major factors to influence liquidity conditions in the market in 2014 are the amount of the CBRT's net FX purchase/sale transactions against the Turkish lira (TL) in the market (including export rediscount credits extended by the CBRT), the change in the monetary base (including the effects of the change in the reserve options mechanism (ROM) facility and utilization rate of this facility by the banks), the difference between redemption-issuance of Government securities against the TL by the Treasury and lease certificates in TL.
- Through the liquidity policy practices, the credit growth will be oriented towards business loans rather than consumer loans. To achieve this aim:

- The Funding Need of the System (FNS) will be increased (via ROM and FX sales),
- The funding maturity will be shortened (via 1 week and 1 day),
- Intermediation costs will be decreased gradually with the rise of FNS, also taking into account the pace of credit growth; funding from stable funding rate-1 will be increased in accordance with the Committee's rate guidance.

## Foreign Exchange Rate Policy

- The maturity and interest rate of the FX deposits that the banks can borrow from the CBRT within their borrowing limits, which the CBRT is a party to, for both US dollar and euro, will be maintained at one week and 10% respectively in 2014.
- Regular FX sale auctions will be continued as needed. Reserve options coefficients will be increased gradually. As a result, FNS will gradually increase and the growth rate of consumer loans will go down.
- FX liquidity of approximately USD 1 billion will be provided to the system via simplifications in reserve requirements.
- In case of unhealthy price formations due to speculative behavior stemming from a loss in the market depth, the CBRT may intervene directly or through flexible auctions in the market in either direction.

## Macroprudential Arrangements

- To simplify the structure of reserve requirements, which are used as a monetary policy and a macroprudential instrument, the approach of subtracting certain items from total domestic liabilities will be abandoned and a new approach adopted in calculating liabilities subject to reserve requirements.
- The ROM is expected to further contribute to the efficient functioning of the liquidity management and contain the unfavorable effects of volatile capital flows on macroeconomic indicators. In this context, the automatic stabilization feature of the ROM will be gradually strengthened in the upcoming period. Thus, the funding need of the financial system from the CBRT will be increased.

*Monetary Policy Committee Meeting held on 28 January 2014*
*Recent domestic and external developments are having an adverse impact on risk perceptions, leading to a significant depreciation in the Turkish lira and a pronounced increase in the risk premium. In addition, exchange rate movements in Turkey have increased the risk of inflation hovering significantly above the target for an extended period. Besides rapid depreciation of the TL, recent tax adjustments and adverse developments in food inflation were also influential in the deterioration in the inflation outlook. Thus, in the meeting held on 28 January 2014, the MPC announced that it will implement necessary measures at its disposal to contain the negative impact of these developments on inflation and macroeconomic stability. Accordingly, the MPC opted for a strong monetary tightening and simplification of the operational framework. As a result, (i) the one-week repo rate has been increased from 4.5 percent to 10 percent; (ii) the CBRT liquidity will be provided primarily from the one-week repo rate instead of the marginal funding rate in the forthcoming period. The MPC stated that tightening the monetary policy under current circumstances will not only contribute to price stability, but also support the macroeconomic stability by reducing the exchange rate uncertainty and risk perceptions. Moreover, increasing the predictability of the monetary policy should be helpful amid weakening capital inflows. The MPC ascertained that the current policy stance will suffice to anchor inflation expectations.*

*The CBRT announced that in line with the simplification decision announced at the MPC meeting of 28 January 2014, the additional monetary tightening policy, which was initiated with the CBRT's Press Release of 11 June 2013 with number 2013-25, will end as of 29 January 2014.*

# Research and Monetary Policy Department

As of today, the basic responsibilities of the Research and Monetary Policy Department is to perform economic analyses needed for the determination of the monetary policy implemented to achieve price stability, which is the primary objective of the Bank.

The Research and Monetary Policy Department was established in 1979 as the "Planning and Research Department". In 1992, it was named the "Research Department". In 2002, before the transition to an inflation targeting regime, the Department went through a major transformation and its estimation methods and data set were improved. In 2005, the Department was reorganized and hence received its current name, the "Research and Monetary Policy Department". As of today, the basic responsibilities of the Research and Monetary Policy Department are the following:

• To perform economic analyses needed for the determination of the monetary policy implemented to achieve price stability, which is the primary objective of the Bank,

• To conduct reviews, analyses and research on monetary and exchange rate policies to determine the main policy options with a view to achieving price stability,
• To develop models to be used for designing monetary policies implemented by the Bank,
• To perform studies on communication strategies with respect to monetary policy,
• To ensure coordination with the other units of the Bank in the decision-making process relating to monetary policy,
• To prepare the Inflation Report and other reports requested by the Monetary Policy Committee,
• To conduct economic analyses for the CBRT's main scope of duties,
• To make assessments identifying the current situation of the Turkish economy,

• To develop short-term forecasting models, update models in line with changing conditions, and make predictions regarding the short-term course of macroeconomic variables,
• To develop a system of leading indicators in order to determine the future potential course of macroeconomic variables, primarily inflation, and to monitor and evaluate these indicators,
• To develop surveys in coordination with the Statistics Department and assess the results thereof.
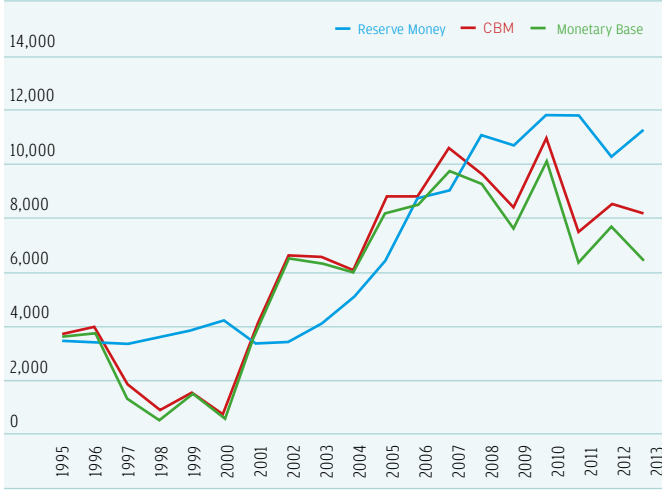
The Research and Monetary Policy Department is comprised of around 100 employees, and is at the heart of the monetary policies implemented by the CBRT.

# THERMOMETER

# Selected Monetary Aggregates

# Real Effective Exchange Rate

## CHART 1: CENTRAL BANK MONEY, MONETARY BASE AND RESERVE MONEY (Real,* Thousand TL)



Last Observation: 31 December 2013
*Deflated by the CPI (1995=100)
Source: CBRT, TURKSTAT

## CHART 2: CPI BASED REAL EFFECTIVE EXCHANGE RATE (2003=100)
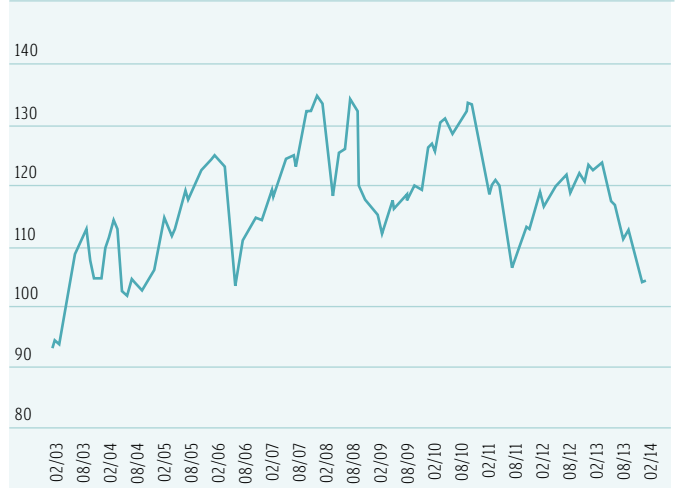


Last Observation: February 2014
Source: CBRT

### CBRT Balance Sheet - Selected Monetary Aggregates

Monetary aggregates derived from the central bank balance sheet are important indicators to observe the results of monetary policy implementations. The sum of central bank liabilities, which is affected by the use of monetary policy instruments, essentially represents central bank's total liabilities. Central Bank Money (CBM), which is on the liabilities side of the CBRT Analytical Balance Sheet, consists of reserve money and other CBM components. Rendering data for liabilities in terms of Turkish lira, CBM is the most important monetary indicator in the balance sheet through which the impact of the monetary policy implementations on the Turkish lira liquidity can be observed. Reserve Money is obtained by adding the banks' required reserves held at the CBRT and free deposits, deposits of the non-banking sector and extra budgetary funds to the currency issued. The monetary base is the sum of cash liabilities due to open market operations and the amount of reserve money. In 2013, the amount of the reserve money increased by 9.47%, the CBM decreased by 4.43%, while the monetary base decreased by 16.23%.

### Real Effective Exchange Rate

The real effective exchange rate (REER) released by the CBRT, is computed as the weighted geometric average of the prices in Turkey relative to the prices of its principal trade partners in international markets. The REER adjusts the nominal effective exchange rate for the effects of relative prices. An increase in the REER represents an appreciation of the TL in real terms, denoting a rise in the value of Turkish commodities in terms of foreign commodities. A glance at the 2013 developments reveals that the REER depreciated after April. The depreciation became more evident in December. It is expected that this depreciation will support the improvement in the current account deficit in the coming months.

For the Real Effective Exchange Rate Statistics compiled by the CBRT, see www.tcmb.gov.tr

For the Analytical Balance Sheet published by the CBRT, see www.tcmb.gov.tr