

# De-dollarization in Turkey

**Erdem BAŐÇI**

**Governor**

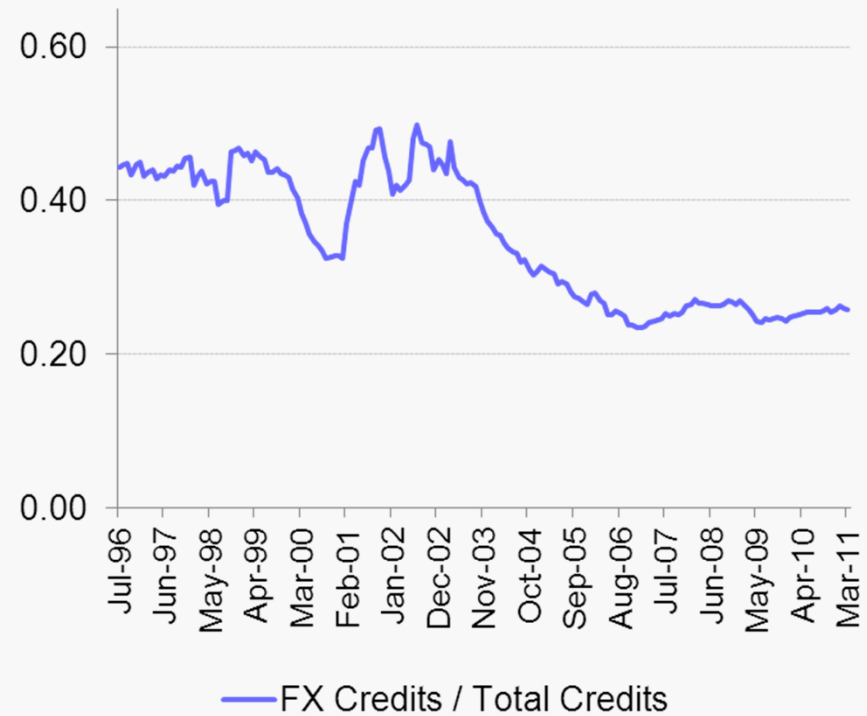
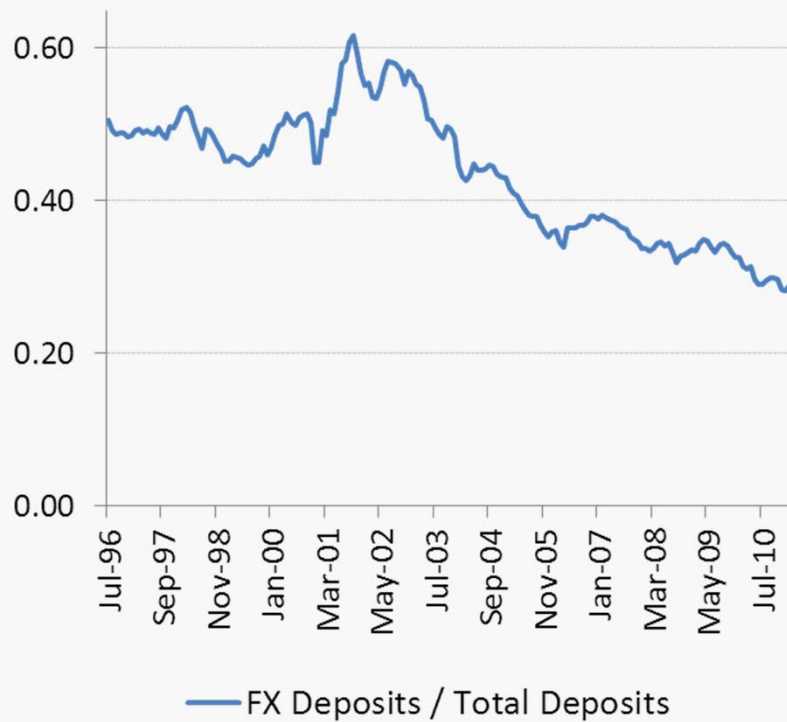
**Central Bank of the Republic of Turkey**

**Developing Local Currency Finance and Local Capital Markets  
Conference**

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# Dollarization in Turkey

- Turkey experienced high levels of dollarization during 1990s.

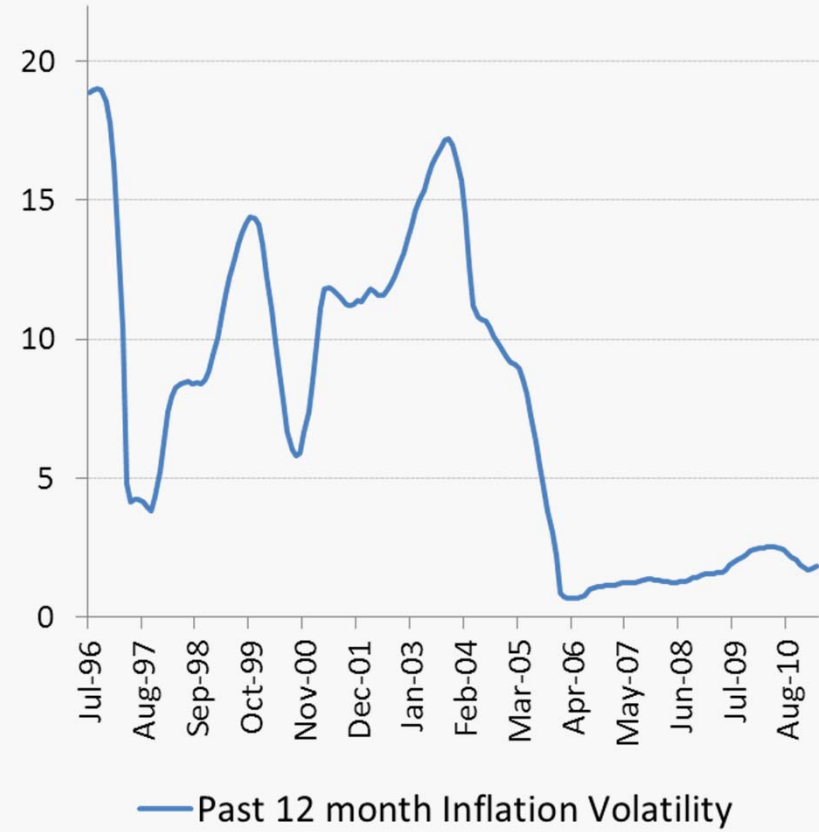
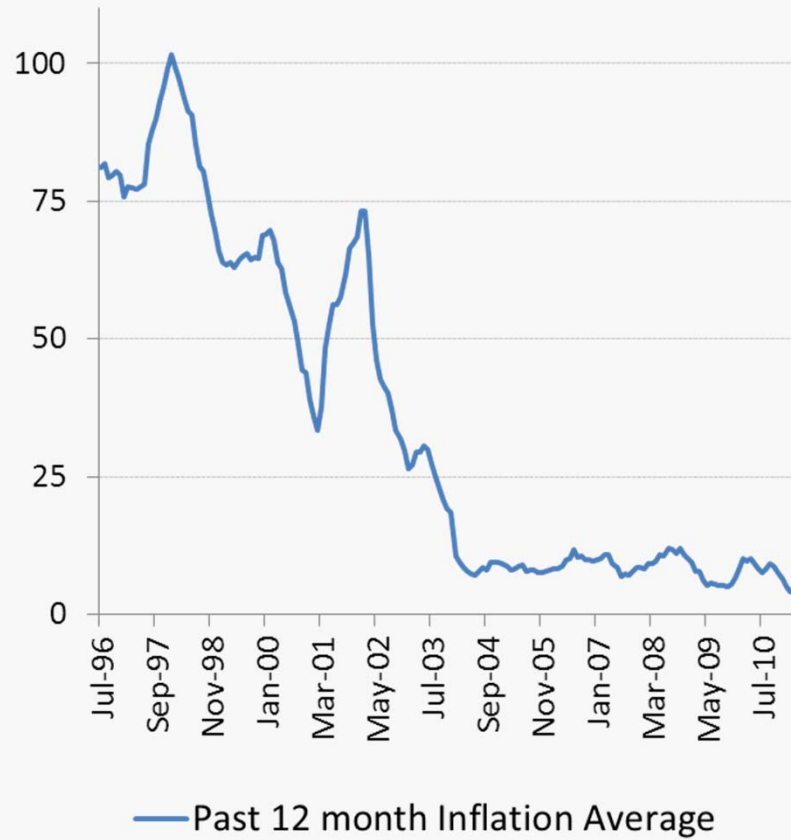


# Reasons for Dollarization in Turkey

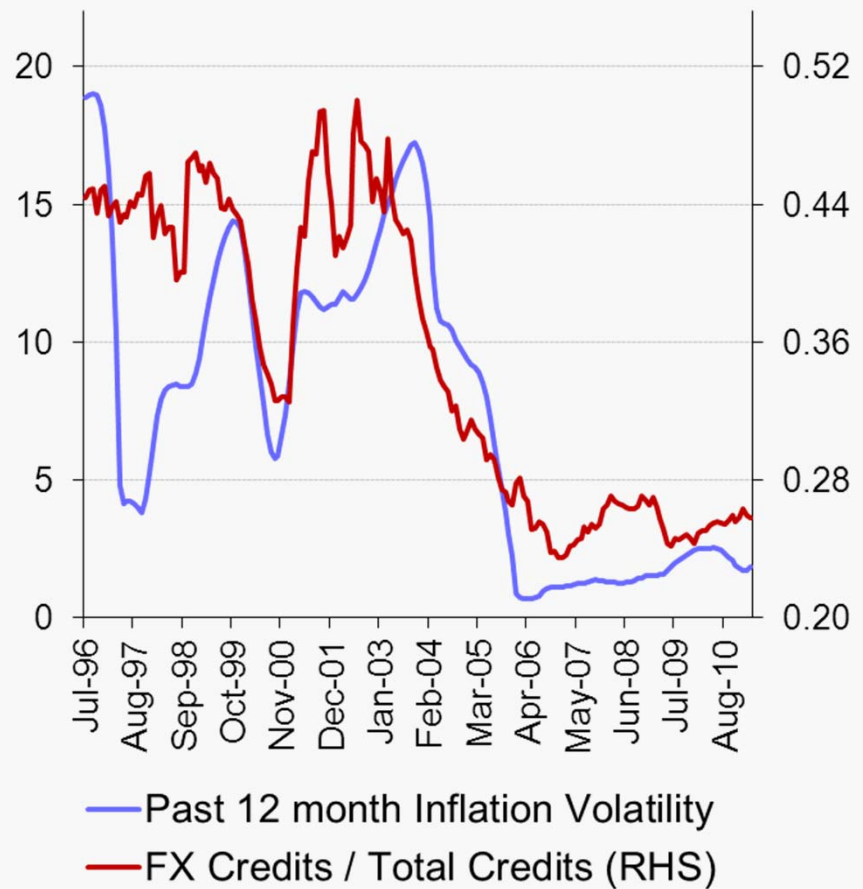
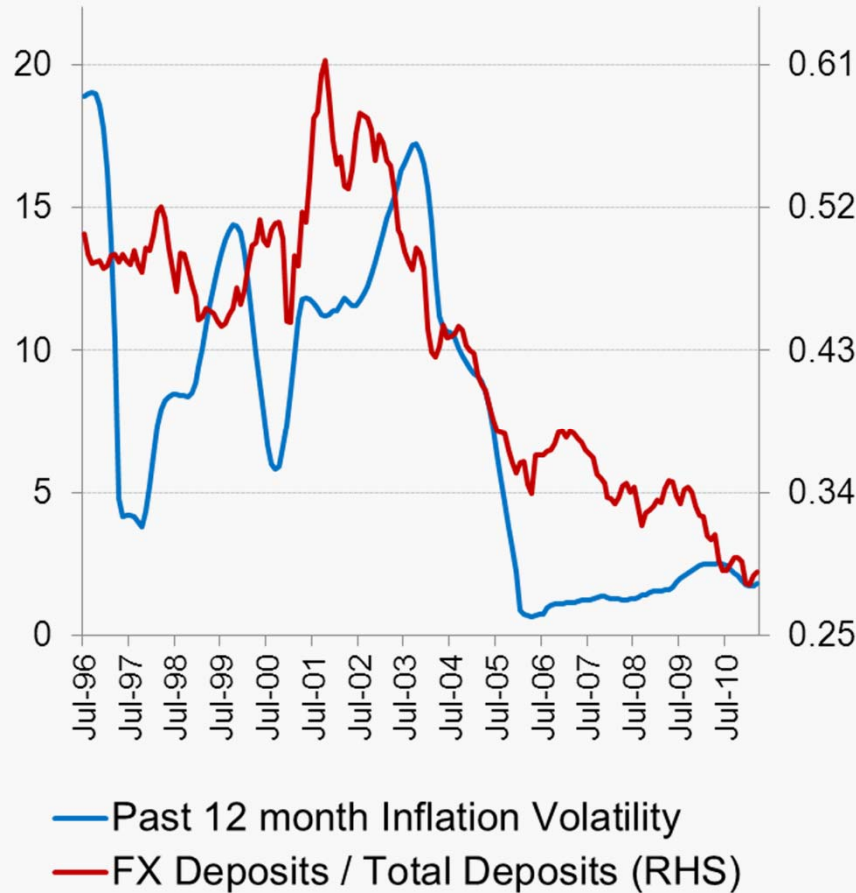
Main reasons for dollarization in Turkey were:

- High and volatile inflation
- Fiscal dominance in financial markets
- Lack of prudent financial measures

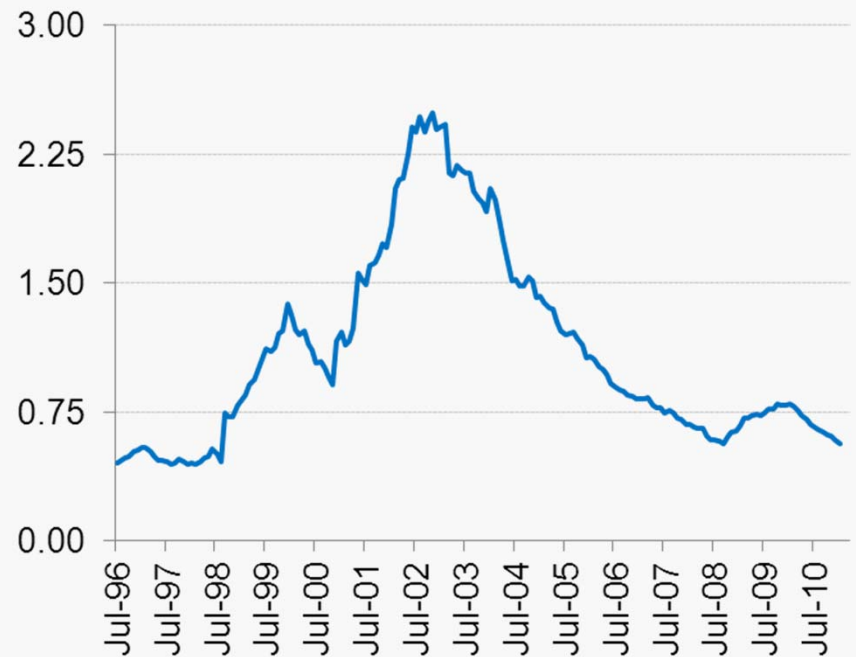
# Inflation



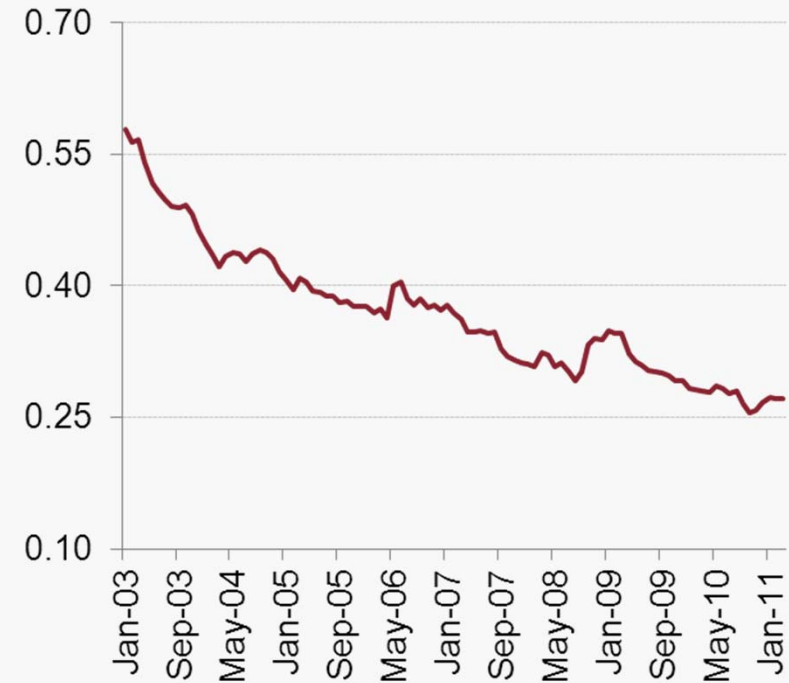
# Inflation and Dollarization



# Fiscal Dominance in Financial Markets and FX borrowing by Public Sector

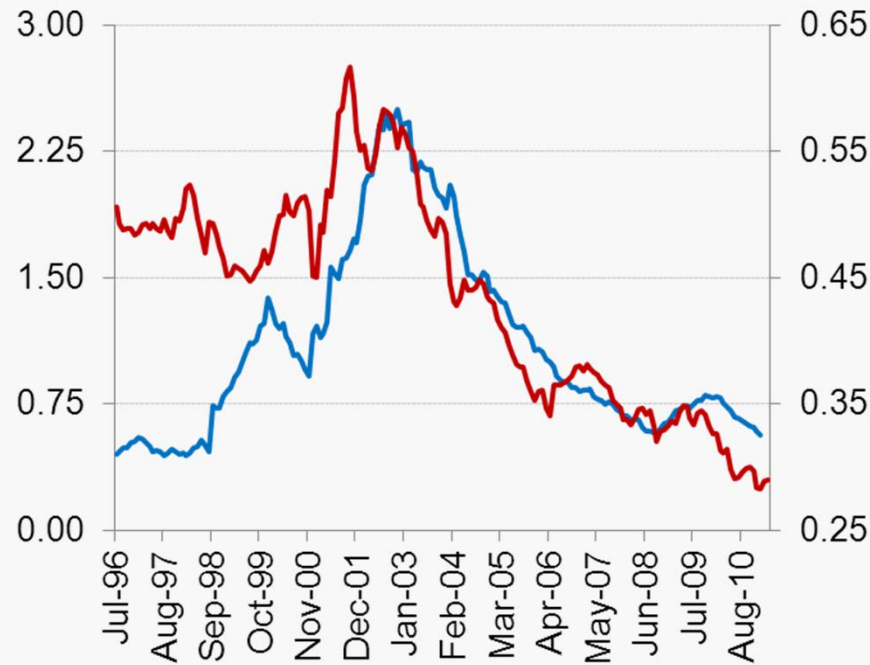


— Claims on Public Sector / Credit to Private Sector in Banking Assets

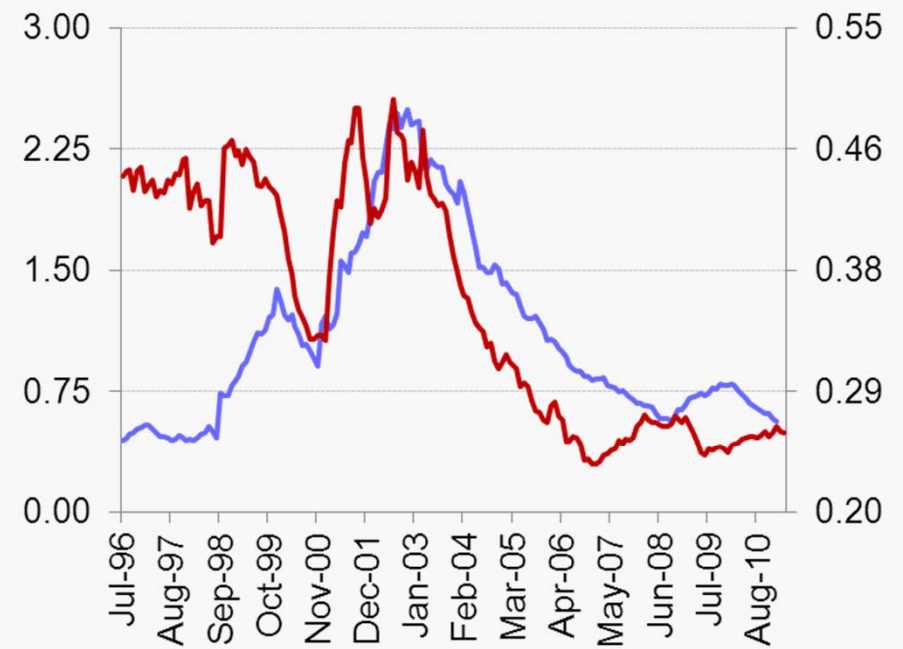


— FX Share in Gross Public Debt

# Fiscal Dominance in Financial Markets and Dollarization



— Claims on Public Sector / Credit to Private Sector in Banking Assets  
 — FX Deposits / Total Deposits (RHS)



— Claims on Public Sector / Credit to Private Sector in Banking Assets  
 — FX Credits / Total Credits (RHS)

# Lack of Prudent Financial Measures

- Lack of Prudent Financial Measures
  - No regulation and supervision agency until end of 1990s.
  - No restrictions on FX positions of banks, firms or households.
  - Full insurance on Turkish Lira and FX currency deposits.
- Systemic risk-taking by agents. Everyone on the negative FX position. Agents expect the government to intervene and save the system in case of a depreciation shock,

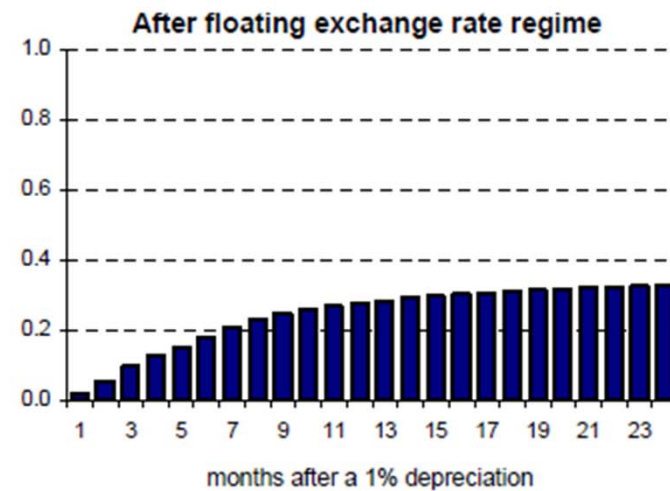
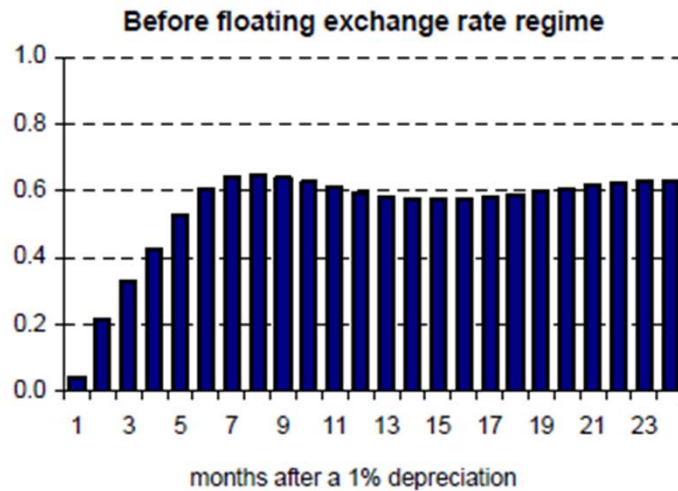


# De-dollarization in Turkey: Monetary Policy Reforms

- After the 2001 crisis, Turkey has taken significant steps to reform the economy and successfully managed to de-dollarize during 2000s.
- Monetary Policy Reforms:
  - Central Bank independence in 2001: Its mandate has been amended to explicitly include the price stability as the main objective.
  - Direct Central Bank lending to government was abolished.
  - Inflation Targeting has been implemented since 2006. Flexible exchange rate policy has been followed.
  - *Result:* Central Bank has managed to decrease the level and volatility of inflation significantly. Exchange rate pass-through decreased and monetary policy became more effective.
- Helped to de-dollarize the economy thanks to lower inflation risk and higher FX risk.

# Effectiveness of Monetary Policy: Exchange Rate Pass-Through

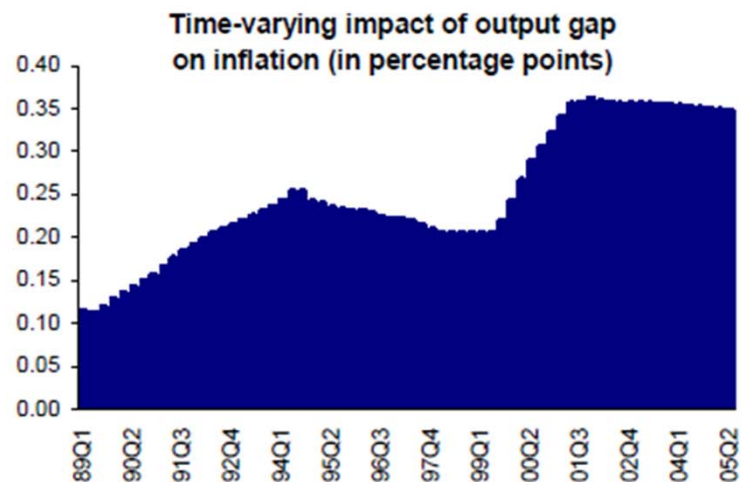
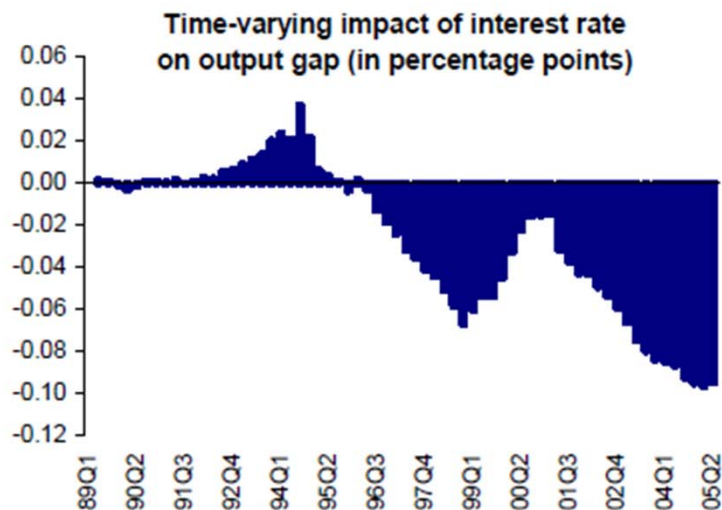
## Cumulative exchange rate pass-through to consumer inflation: VAR evidence<sup>1</sup>



<sup>1</sup> For more detailed information on the subject and the methodological explanations, see Kara and Ögüncü (2005).

# Effectiveness of Monetary Policy: Interest Rate Channel

## Evolution of the interest rate channel<sup>1</sup>



<sup>1</sup> Time-varying coefficients are estimated through the extended Kalman filter method. For more detailed information on the subject and the methodological explanations, see Kara et al (2007).

# De-dollarization in Turkey: Fiscal Policy Reforms

- Fiscal Policy Reforms:
  - Significant fiscal consolidation after 2001. Government debt as a share of GDP has decreased steadily.
  - With fiscal consolidation, fiscal dominance has ended in financial markets.
  - Longer term domestic currency bonds market has developed further as government started increasing the share of domestic currency financing.
  - *Result:* Strong public finances and rapid development of domestic financial markets.
- Helped to de-dollarize the economy thanks to improved domestic financial markets and easier access of agents to domestic currency financial instruments.

# De-dollarization in Turkey: Financial Market Reforms

- Financial Market Reforms:
  - Banking Regulation and Supervision Agency has applied prudential measures on the financial sector.
  - Open FX positions of the banks have been restricted.
  - FX borrowing by non-FX income earning firms has been restricted.
  - FX borrowing of households has been restricted.
  - Full deposit insurance has been abolished.
  - *Result:* More resilient financial sector with lower balance sheet mismatches.
  
- Helped to de-dollarize the economy as new prudential measures along with flexible exchange rates have increased the awareness of agents on the risks of FX borrowing and decreased systemic risk. Hedging opportunities in FX derivatives markets have improved.

# De-dollarization in Turkey

- The 2009 crisis showed the importance of financial stability and de-dollarization.
- Central Bank and other economic authorities continue to support and encourage the de-dollarization process and overall financial stability
- Main avenues of the policy are:
  - Maintaining the overall economic stability
  - Keeping inflation at low and stable levels
  - Educating economic agents about the risks of FX borrowing
  - Encouraging the more widespread use of hedging opportunities
  - Using additional prudential measures when necessary

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