

Monetary and Exchange Rate Policy for 2018

5 December 2017

Ankara

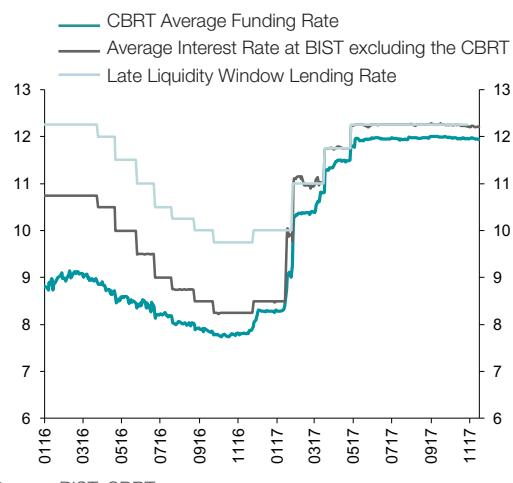
1. The CBRT maintains a price stability-oriented monetary policy framework. Inflation targeting will continue to be the monetary policy regime. Monetary policy decisions will be based on inflation expectations, pricing behavior and other factors that affect inflation. Financial stability will also be considered while inflation is aimed to be kept close to the target. In addition, the CBRT will continue to cooperate with other institutions to remove structural impediments to lowering inflation.
2. The CBRT's main objective is to achieve and maintain price stability. To this end, the inflation target for the 2018-2020 period is set at 5 percent as per the agreement reached with the government. In line with the Medium Term Program, it is anticipated that inflation will gradually converge to the 5 percent target in 2018-2020 period.
3. Being an element of accountability of the CBRT, the uncertainty band is kept at 2 percentage points in both directions, as in previous years. The Bank will submit an open letter to the government if inflation falls outside the uncertainty band at the end of the year.
4. The CBRT continues to implement a floating exchange rate regime. Under the current regime, the exchange rate is not used as a policy instrument. Main determinants of foreign exchange (FX) supply and demand are economic fundamentals, the monetary and fiscal policies in place, international developments and expectations. The CBRT does not have a nominal or real exchange rate target under the current exchange rate regime. If the exchange rate movements permanently affect price stability, the CBRT will give the necessary reaction with its instruments. In addition, if the FX rate is at odds with economic fundamentals and creates a risk for financial stability, it will not remain unresponsive to this situation. The CBRT will continue to closely monitor exchange rate developments and any risk factors related to it, to take necessary measures and to use the relevant instruments in order to enable the FX market to operate effectively. However, under the current exchange rate regime, it is important for the economic actors to hedge their own exchange rate risk.

Monetary Policy Developments and Communication

Monetary Policy Developments

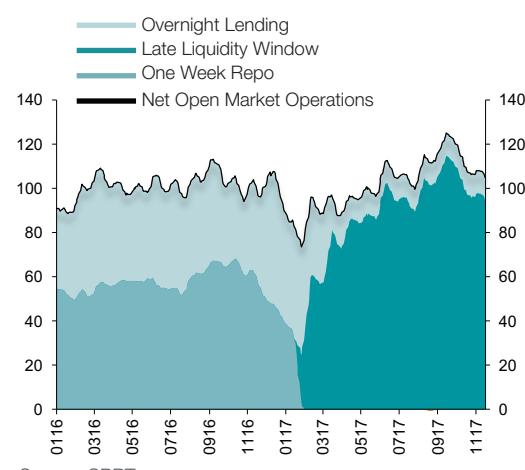
5. The volatility experienced in foreign exchange markets following the significant global and geopolitical shocks experienced in the second half of 2016 and its impact on the inflation outlook has been decisive in monetary policy decisions in early 2017. As exchange rate developments increased upside risks to inflation, the CBRT performed a strong monetary tightening in January to limit the deterioration in inflation outlook; increased lending rates both in overnight lending and under the Late Liquidity Window (LLW) (Chart 1). In addition, the CBRT took some liquidity measures, in order to eliminate the negative effects that these developments may have on price stability and financial stability. In this context, one-week repo auctions were interrupted, the overnight funding amount was gradually reduced, and the system's funding needs began to be provided from the LLW at an increasing extent (Chart 2). In addition, the CBRT took measures to provide flexibility in foreign exchange liquidity management. For this purpose, the CBRT lowered the required reserve ratios of foreign currencies and opened the Turkish Lira Deposits against Foreign Exchange Deposits Market.

Chart 1. Short Term Interest Rates
(5-Day Moving Average, Percent)



Source: BIST, CBRT.

Chart 2. CBRT Funding
(2-Week Moving Average, Billion TL)



Source: CBRT.

6. In addition to the volatility observed in foreign exchange rates at the beginning of the year, developments in commodity prices and import prices in US dollars also led to increased cost pressures; inflation has increased significantly in 2017. The high levels of inflation expectations and the development of core inflation outlook poses a risk for pricing behavior, and requiring a continued stance in monetary policy. For this reason, in March and April the CBRT progressively increased the monetary tightening, that began in January 2017, maintaining its tight stance in June and July; gradually strengthening the caution level of monetary policy with the communication made in September and October.

In October and November, exchange rate movements along with geopolitical risks and increases in oil prices pose an upward risk to inflation outlook. In this context, in November, the borrowing limits of banks in the Interbank Money Market, which operates under the CBRT, have been reduced to zero for overnight transactions, and the entire CBRT funding has started to be provided from LLW. Thus, the average cost of the CBRT funding was raised by 25 basis points to 12.25 percent. Currently, the CBRT has a LLW lending rate of 12.25 percent, an overnight lending rate of 9.25 percent and a weekly repo rate of 8 percent.

7. In order to support price stability and financial stability, the CBRT lowered the upper limit of foreign exchange facility within Reserve Options Mechanism (ROM) from 60 percent to 55 percent and reduced all tranches by 5 points each at the beginning of November. In addition to this decision, the Bank allowed for the repayment of rediscount credits whose maturities are until 1 February 2018, to be made in Turkish lira, provided that they are paid at maturity. Furthermore, the Turkish Lira-Settled Forward Foreign Exchange Sale Auctions was started in November.
8. In 2017, the CBRT's stance has been tight against inflationary outlook, stabilizing in the foreign exchange market and supportive of financial stability. Moreover, the predictability of monetary policy has significantly increased over the course of 2017, largely due to the fact that the CBRT funding is largely made through the LLW channel. In 2018, the Central Bank will continue to use all available instruments in pursuit of the price stability objective. Tight stance in monetary policy will be maintained decisively until inflation outlook displays a significant improvement and becomes consistent with the targets. If needed, further monetary tightening will be delivered.

Decision Making Process and the Communication Policy

9. The Monetary Policy Committee (MPC) will hold eight meetings on a pre-announced timetable in 2018.¹ The monetary policy decision and a brief statement explaining its rationale will be announced, together with its English translation, on the CBRT website at 2 p.m. immediately after the meeting. The summary of the MPC meeting that contains detailed assessments of the MPC will be released on the CBRT website within five working days following the meeting.
10. Communication policy will be used effectively as a supportive instrument in the upcoming period. Main communication documents of monetary policy are the MPC announcements and the Inflation Report. The Inflation Report will be published on a quarterly basis as usual. The Inflation Report will be presented at briefings for a more effective communication.

¹The meeting and reports schedule for 2018 is reported in the Appendix.

-
11. Moreover, further technical meetings will be set up with investors and analysts, and regular meetings will be organized with investors in financial centers abroad. Additionally, as part of its holistic approach, the Bank will continue to hold meetings with chambers of industry and commerce and other corporate sector representatives in 2018 to provide a forum for an exchange of views. Regional and sectoral studies will continue, which aim to closely monitor and assess real economic activity, and to strengthen communication with the real sector. These studies, which intend to understand the developments in the Turkish economy in its all dimensions, will be incorporated into the monetary policy decision-making process.
 12. The Financial Stability Report will remain a significant means of communication of the CBRT. Furthermore, announcements regarding the monetary and exchange rate policy framework and presentations given by the Governor about the CBRT's measures and monetary policy actions before the Council of Ministers and the Planning and Budget Commission of the Turkish Grand National Assembly and other platforms will also play an important role in communicating with the public.
 13. A key priority of the communication policy is to share the importance of price stability for economic stability and its benefits for all economic actors with the public. To this end, the Bank will continue to raise public awareness and collaborate with relevant stakeholders about structural elements causing additional inertia and volatility in inflation, particularly those under the Food and Agricultural Product Markets Monitoring and Evaluation Committee.
 14. Sustaining fiscal discipline has been one of the key factors in reducing the sensitivity of the Turkish economy against adverse external shocks. In order to achieve the price stability as well, it is essential to maintain the fiscal discipline. It is important that these achievements are protected and taken forward. A central bank focused on price stability as required by the law has to closely follow developments in the budget and fiscal policy. Therefore, in the upcoming period, developments in fiscal policy, administered prices and tax adjustments will continue to be monitored with regard to their effects on inflation outlook.

Turkish Lira Liquidity Management

General Principles of Liquidity Management

15. When setting the framework of liquidity management, the CBRT targets:
- I - Maintaining the level of short term interest rates established at the level deemed appropriate within the interest rate corridor determined by the Committee,
 - II - Ensuring the efficient and stable operation of money markets in accordance with the liquidity management strategy,
 - III - Ensuring the smooth functioning of payment systems,
 - IV - Ensuring that the instruments in use foster an effective monetary policy,
 - V - Having an operational structure with sufficient flexibility against unexpected market developments.

In order to attain these objectives and enhance the efficiency of the monetary policy, the liquidity level in the market and the distribution of liquidity in the banking system are also taken into consideration while formulating the outline of the liquidity management.

Factors Affecting Liquidity and Liquidity Developments in 2017

16. The funding need of the banking system is mainly determined by the following factors:
- I - Changes in monetary base,
 - a) Changes in the volume of currency issued,
 - b) Changes in banks' Turkish lira (TL) free deposits at the CBRT.
 - II - The CBRT's Turkish lira transactions in the market,
 - a) FX purchase/sale transactions against TL,
 - b) FX deposits against TL deposits transactions,
 - c) Export rediscount credits,
 - d) Government domestic debt securities (GDDS) and lease certificate purchase/sale transactions,
 - e) Interest paid/earned, current expenditures.
 - III - The Undersecretariat of Treasury's Turkish lira transactions in the market,
 - a) The difference between the redemption and issuance of GDDS and lease certificates (excluding redemptions to the CBRT),
 - b) Primary surplus inflows,
 - c) Privatization and Savings Deposit Insurance Fund (SDIF)-related transfers and other public transactions.
17. Table 1 shows the main factors affecting the funding need of the system for 2017 as of 20 November. The funding need of the system has risen to 119.1 billion TL on 20 November 2017 from 95.5 billion TL at the end of 2016.

18. In 2017, TL market liquidity increased by 9.3 billion TL due to the changes in currency in circulation and banks' free deposits at the CBRT while decreasing by 3 billion TL and 29.9 billion TL due to the CBRT and Government transactions, respectively.

Table 1: Factors Affecting the Funding Need of the System
(Billion TL)

	30.12.2016	20.11.2017	Effect
Funding Need of the System (A+B+C)*	-95.5	-119.1	-23.6
Money Base (A)	166.5	157.2	9.3
Currency in Circulation	123.0	132.1	-9.2
Free Deposits	43.6	25.1	18.5
CBRT Transactions Affecting the Funding Need of the System (B)			-3.0
FX Transactions Against TL**			-41.0
Export Rediscount Credits			50.4
GDDS Purchases			3.0
Interest Earned and Other Payments			-15.4
Public Transactions (Excl. Redemptions to the CBRT) (C)			-29.9
Net TL GDDS Redemption (Redemption-Issue)***			-29.9
Primary Surplus			13.6
Privatization in TL and Other Transactions			-13.5

(*): The funding need of the system represents the net liquidity need in the market. Negative numbers mean net liquidity shortage in the market.

(**): Also includes FX sales to energy importing SOEs by the Treasury and outstanding amount of FX deposits against TL deposits auctions.

(***): Including premium income.

(****): Excluding premium income.

19. Within the scope of FX transactions made in 2017;
- I - As of 20 November, 2017, TL liquidity decreased by 15.7 billion TL due to 4.1 billion USD FX liquidity provided to banks with the FX Deposits Against Turkish Lira Deposits transactions.
 - II - TL liquidity decreased by 25.4 billion TL due to the fact that 6.9 billion USD of the FX needs of energy-importing state-owned enterprises) were directly met by the Undersecretariat of Treasury and the CBRT.
20. The changes announced with the press release dated 6 November 2017, in the upper limit and tranches of the FX maintenance facility within ROM resulted in a tightening effect on TL liquidity.
21. With the two distinct press releases made on 17 February and 6 November 2017 for export rediscount credits, rediscount credits whose maturities are between the announced dates were allowed to be paid in Turkish lira.
22. In line with the 15 billion nominal portfolio target determined for 2017, 3.0 billion nominal securities were bought during the year for the Open Market Operations (OMO) portfolio, which was 13.9 billion TL at the beginning of the year, taking 2.0 billion nominal securities to be redeemed within the year into consideration, and hence the year-end target was achieved.

-
23. From the beginning of 2017, the CBRT implemented a framework to limit the effects of the volatility and unhealthy pricing in foreign exchange rates that were inconsistent with economic fundamentals on price stability and financial stability. In line with this framework:
- I - Starting from 12 January 2017, the one week repo auctions with quantity method were not held. The overnight borrowing limits within the Interbank Money Market, which had been abolished following
 - II - July 2016, were reduced to 22 billion TL as of 11 January 2017, to 11 billion TL as of 16 January 2017, and finally to zero as of 22 November 2017.
 - III - Starting from 16 January 2017, the funding through the BIST Repo - Reverse Repo Market and the Interbank Repo - Reverse Repo Market was limited when deemed necessary and the BIST funding was not provided in certain days starting from 10 March 2017, and no funding was provided through this channel starting from 3 May 2017.
 - IV - With the suspension of funding through quotation and repo auctions, the remaining funding needed at the end of the day was provided through Late Liquidity Window (LLW) deposit and repo operations without limit at the LLW interest rate. Throughout 2017, a substantial part of the liquidity need was met at LLW lending rate.
 - V - After the initiation of LLW Facility practice, a separate Intraday Liquidity Facility (IDLF) Limit was allocated to banks equal to their ON borrowing limits starting from 6 March 2017 in order to enable them to have a more efficient liquidity management by allowing them to use their ON borrowing limits intraday. Also with an amendment, the CBRT made it possible to credit IDLF at the end of the day to LON operations (transforming the repayments of IDLF borrowings into LON borrowings). Lastly, starting from 22 November 2017, the IDLF limits for banks were set as two times the ON borrowing limits available as of 21 November 2017.

24. The technical work on achieving simple and transparent collateral conditions in TL operations within the CBRT was continued in 2017. In this respect, within the Common Collateral Project aiming at executing collateral operations through a common platform, starting from 11 August 2017;
- I - The collateral accounts for all operations conducted in Interbank Money Market (TL deposit, LON deposit and IDLF) were combined.
 - II - As in open market operations, the discounting method was adopted in calculating limits that could be used against collateral securities brought in for Interbank Money Market operations.

Liquidity Policy in 2018 and the Operational Framework

25. The operational framework of the CBRT's liquidity policy and liquidity management in 2018 is as follows:
- I - One-week repo transactions are intended to be the main funding instrument of the CBRT. On the other hand, one-week repo auctions will not be held on days deemed necessary according to monetary policy and liquidity management framework.
 - II - Should conditions require, traditional repo auctions and TL deposit selling auctions may be held with maturities no longer than 91 days.

-
- III - When deemed appropriate, one-week “Intraday Repo Auctions” may be held via the traditional auction method. The total amount of bids to be offered will be limited to the announced auction amount.
 - IV - Within the liquidity management framework, provided that the overnight repo facility through quotation against TL-denominated lease certificates issued by the Asset Leasing Company of the Turkish Treasury (ALCTT) exists, all participants are entitled to use it.
 - V - LON repo funding against TL-denominated lease certificates issued by the ALCTT and/or government domestic debt securities (GDDS) will be continued.
 - VI - On days deemed necessary, it could be continued to restrict funding amount at the BIST Repo - Reverse Repo Market and the Interbank Repo - Reverse Repo Market provided at overnight rates within the interest rate corridor.
 - VII - The CBRT will continue to announce overnight borrowing and lending rates in the Interbank Money Market within the CBRT. Should banks need, they will be able to borrow at the CBRT's lending rate against collateral within their limits, and in case of excess liquidity, banks will be able to lend Turkish lira to the CBRT at the CBRT's borrowing rate without any limit.
 - VIII - The CBRT will continue to announce borrowing and lending rates for the Late Liquidity Window (LON) Facility as in the current practice. Banks will be able to borrow from the CBRT against collateral without any limit or lend to the CBRT.
 - IX - The CBRT will continue to announce the details and the results of liquidity operations through data dissemination companies.
26. As in 2017, the CBRT will continue to use liquidity tools with an appropriate composition and in a manner to support predictability in line with its objective of achieving price stability.
27. Considering all possibilities in liquidity conditions; to be able to control interest rates at the BIST Repo-Reverse Repo Market and the Interbank Repo-Reverse Repo Market, to manage the funding need of the financial system, to preserve the instrument diversification for liquidity management and operational flexibility, the CBRT needs to maintain a sufficient amount of GDDSs or TL-denominated lease certificates issued by the Asset Leasing Company of the Turkish Treasury (ALCTT) for technical reasons. Accordingly,
- I - Without prejudice to the additional purchasing option, the OMO portfolio, which was set as TL 15 billion nominal for 2017, is set as TL 16 billion nominal for 2018,
 - II - Outright purchase operation of 6.8 billion TL nominal, including the TL 5.8 billion nominal to be redeemed in 2018, will be conducted in 2018,
 - III - Outright purchase operations will be conducted in a balanced and predictable framework by taking into account the CBRT OMO portfolio redemption schedule, liquidity conditions in the market and internal borrowing program of the Undersecretariat of Treasury, and the securities to be purchased by the CBRT will be announced through data dissemination companies at 10:00 a.m. on the first working day of the respective month,
 - IV - Buying auctions will be held on Mondays, Wednesdays and/or Fridays with value the next business day,
 - V - Each auction amount will be no more than a nominal of TL 150 million,
 - VI - Other issues related to the auctions will be subject to the existing regulations and may be changed if deemed necessary.

FX Liquidity Management and Reserve Developments

FX Liquidity and Reserve Developments in 2017

28. In 2017, foreign exchange deposits against Turkish lira deposits, FX sales to energy-importing state-owned enterprises and required reserves were the main tools used in FX liquidity management by the CBRT. In addition to these tools, Turkish lira-settled forward foreign exchange sale auctions were launched on 20 November 2017. On the other hand, despite being among FX liquidity tools, direct FX purchases/sales against TL and FX auctions were not deemed necessary in 2017. Similarly, although banks have a total limit of around USD 50 billion from the CBRT for FX deposits, they did not make use of this facility in 2017.
29. The CBRT provided USD 6.25 billion temporary FX liquidity at the most through foreign exchange deposits against Turkish lira deposits auctions started on 18 January 2017. The volume of Turkish lira-settled forward foreign exchange sale auctions started on 20 November 2017 reached USD 1.2 billion as of 30 November 2017.
30. In 2017, approximately USD 6.9 billion was sold to energy-importing state-owned enterprises. No direct FX sales or FX auctions were made in 2017 (Table 2).

Table 2: FX Amounts Purchased-Sold by the CBRT
(2002-2017*, million USD)

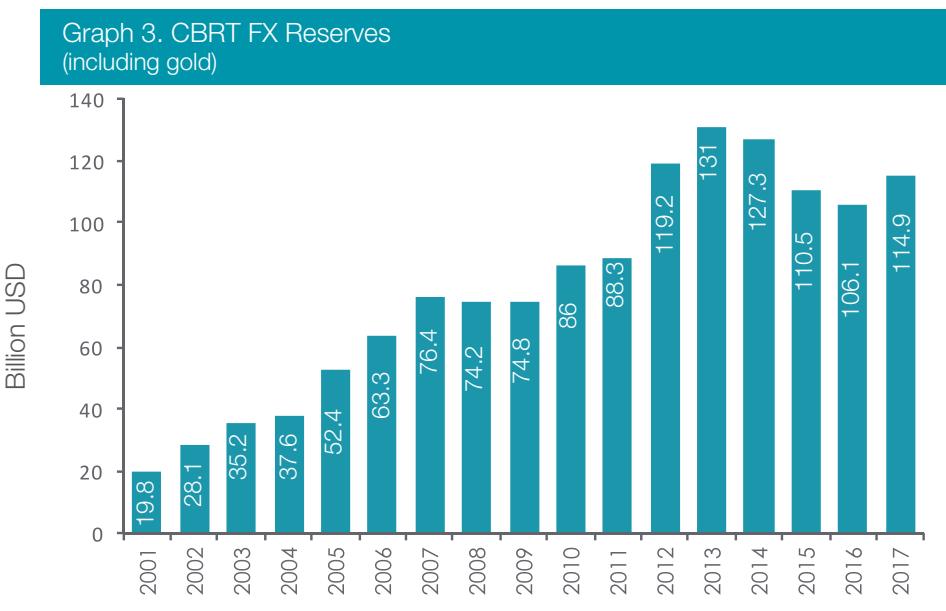
Year	Auctions		Interventions		Sales to Energy-Importing SOEs	Export Rediscount credits
	PURCHASES	SALES	PURCHASES	SALES	SALES	NET
2002	795	0	16	12		25
2003	5.652	0	4.229	0		34
2004	4.104	0	1.283	9		27
2005	7.442	0	14.565	0		25
2006	4.296	1.000	5.441	2.105		4
2007	9.906	0	0	0		2
2008	7.584	100	0	0		5
2009	4.314	900	0	0		1.040
2010	14.865	0	0	0		1.104
2011	6.450	11.210	0	2.390		1.920
2012	0	1.450	0	1.006		8.295
2013	0	17.610	0	0		12.664
2014	0	9.879	0	3.151	1.321	13.000
2015	0	12.366	0	0	10.505	15.182
2016	0	3.400	0	0	5.083	15.022
2017*	0	0	0	0	6.903	12.208
Total	65.408	57.915	25.534	8.673	23.812	80.557

* As of 30 November 2017

Source: CBRT

-
31. Reserve requirements and ROM are other important instruments affecting FX reserves and FX liquidity. In 2017, the FX reserve requirement ratios have been reduced by 50 basis points for all maturity brackets, thus providing the market with FX liquidity of approximately 1.5 billion US dollars. Moreover, with the press release on 6 November 2017, as a result of lowering the upper limit of FX maintenance facility within ROM from 60 percent to 55 percent and reducing all tranches by 5 points, approximately 1.4 billion US dollars of FX liquidity was provided to the system.
 32. In October 2016, in order to bring out gold savings into the economy and to increase reserves, a new separate tranche of 5 percent within the context of ROM was introduced to allow standard gold transformed from wrought or scrap gold to be accepted for required reserves and the reserve option coefficient for that tranche was set as 1. This additional facility has been used by banks at a gradually increasing rate.
 33. Financial institutions consistently use ROM facilities and adjust their ROM utilization rates in each reserve requirement period, taking into consideration the change in relative costs of TL and foreign currencies as well as their short term liquidity needs.
 34. On the other hand, pursuant to the Article 45 of the Central Bank Law, rediscount credits extended in TL to exporters and FX earning services providers through the Export Credit Bank of Turkey (Türk Eximbank) and commercial banks via the acceptance of FX bills for rediscount have remained as an instrument to boost the CBRT's FX reserves in 2017 with its feature of FX reimbursement at the maturity.
 35. The CBRT applies the interest rates to export rediscount credits varying according to maturities as follows:
 - I - 1-month LIBOR/EURIBOR interest rate for credits with maturities up to 120 days,
 - II - 6-month LIBOR/EURIBOR interest rate for credits with maturities from 121 to 360 days.
 36. The diversification of export rediscount credits by sectors and regions and the increase in the number of firms using credit contribute the balancing of foreign trade. In addition, the expansion of export markets and the production of high value added products have also been encouraged.
 37. In the first and last quarters of the year, considering the developments in the markets and high volatility in exchange rates, in order to support financial stability, it was aimed to ease firms using rediscount credits to make the payment of foreign currency denominated liabilities in TL. In this framework:
 - I - With the amendment made in February 2017; rediscount credits granted before 1 January 2017 and mature until 31 May 2017 (inclusive) are allowed to be paid in TL provided that they are paid at maturity; and the FX buying rates announced by CBRT on 2 January 2017 was decided to be taken as the basis rate for these transactions. In this context, 1714 rediscount credits of a total of about 4 billion US dollars granted to 683 firms were repaid in TL.

- II - With the amendment made in November 2017; rediscount credits granted before 6 November 2017 maturing until 1 February 2018 (inclusive) are allowed to be paid in TL at an exchange rate of 3.70 for the US dollars, 4.30 for the euro, and 4.80 for the GBP, provided that they are paid at maturity. In case the exchange rate on the date of credit extension is higher than these rates, the exchange rate on the date of credit extension will be applicable.
38. It is estimated that the rediscount credits utilization, which is estimated to be approximately 20 billion US dollars at the end of 2017, is expected to be at similar levels in 2018, and its contribution to CBRT foreign exchange reserves is expected to be approximately 12.3 billion US dollars at the end of 2017 and around 18 billion US dollars in 2018.
39. 39. As a result of these transactions affecting the FX liquidity, gross FX reserves recorded a year-on-year increase by USD 9 billion in 2017 (Graph 3).



*As of 30 November 2017

40. Remuneration rates applied for USD required reserves, reserve options and free reserves held at the CBRT were increased by 50 basis points in 2017 in line with the developments in the reference interest rate in international markets.
41. The commission rates applied for Euro-denominated FX balances at blocked required reserves and at the noticed FX deposit accounts of the banks and financing companies held at the CBRT were kept unchanged in 2017 as 0 percent.

FX Liquidity Management in 2018

42. Banks will continue to be provided with the FX liquidity facility with 1-week maturity at the CBRT FX Deposit Market of around 50 billion USD in total.
43. Banks are allowed to place FX deposits with the CBRT as collateral with 1-week, 2-weeks and 1-month maturity within their limits.
44. A portion deemed appropriate of the FX needs of the energy-importing state-owned enterprises will be met directly by the CBRT and the Undersecretariat of Treasury.
45. Foreign Exchange Deposits against Turkish Lira Deposits and Turkish lira-settled forward foreign exchange sale auctions may be continued in 2018.
46. The CBRT may intervene directly or through flexible auctions in the market, in case excessive volatility and unhealthy price formations occur due to speculative behavior stemming from a loss in the market depth.
47. FX transactions against FX banknotes conducted between the CBRT and those institutions entitled to operate in the FX and Banknotes Markets will continue in 2018.
48. With the aim of boosting reserves by bringing residents' gold savings into the economy, the facility provided to banks regarding purchases of standard gold transformed from wrought or scrap gold collected from residents and standard gold domestically produced from ore against TL will be continued in 2018.
49. The CBRT will continue to closely monitor FX supply and demand conditions and will take the necessary measures to ensure the healthy functioning and balancing of the FX market and to support the FX liquidity in 2018 as usual.

ANNEX: SCHEDULE FOR THE 2018 MONETARY POLICY COMMITTEE MEETINGS AND REPORTS

Schedule for the 2018 MPC Meetings and Reports			
MPC Meetings	Summary of the MPC Meeting	Inflation ReportF	inancial Stability Report
18 January 2018	25 January 2018	30 January 2018	
7 March 2018	14 March 2018		
25 April 2018	30 April 2018	30 April 2018	
			31 May 2018
7 June 2018	18 June 2018		
24 July 2018	31 July 2018	31 July 2018	
13 September 2018	20 September 2018		
25 October 2018	31 October 2018	31 October 2018	
			30 November 2018
13 December 2018	20 December 2018		

Note: Monetary and Exchange Rate Policy for 2019 will be published on 5 December 2018.