TÜRKİYE CUMHURİYET
MERKEZ BANKASI

Central Bank of the Republic of Turkey

History and Duties

Contents

2018

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As in other countries around the globe, the Central Bank of the Republic of Turkey is mainly in charge of arranging monetary and exchange rate policies and ensuring circulation of banknotes in Turkey.

The power to print banknotes, which was initially held by the Grand National Assembly of Turkey, has been transferred to the Central Bank by the Assembly indefinitely. Accordingly, the privilege to print and issue banknotes in Turkey is held solely by the Central Bank.

Overview

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Central banks are responsible for the monetary policies of countries.

Unlike other banks, activities of central banks have a direct impact on the daily lives of each individual.

Central banks are the institutions responsible for the monetary policies of their countries. Unlike other banks, activities of central banks have a direct impact on the daily lives of each individual. For example, we need central banks when we go shopping or make payments. Central banks mainly determine the amount of money in the market and print and ensure the circulation of money.

Currently, many central banks are given the job of ensuring price stability, while they may also be held responsible for the exchange rate regime, foreign exchange and gold reserve management and payment systems as well as safeguarding the financial system and stability. What is more, central banks in some countries are also in charge of the surveillance and inspection of banks.

Both the policies pursued by central banks and their organizational structures are integral parts of the political and social developments and economic policies of the country they belong to as a whole. Accordingly, the duties and powers of central banks have evolved over time.

The organizational structure and policies of the Central Bank of the Republic of Turkey have also changed over time to meet the needs of different eras. The history of the Central Bank is analyzed in three periods in this booklet. Then, the organizational structure of the Central Bank is explained, and the duties and powers it assumes today are mentioned.

Attempts to Establish a Central Bank in the Ottoman Period and in the Early Years of the Republic

In the Ottoman Empire, until the second half of the 19th century, operations such as controllingt he quantity of money, arrangement of the credit volume and management of gold and foreign reserves were carried out by the Treasury, the Mint, jewelers, moneylenders, foundations, sections of the bazaar and guilds. The Ottoman Empire minted gold coins under this structure.

The Ottoman Empire exercised the right of seigniorage for the first time in 1839. Hand-made cash banknotes called “Kaime-i nakdiye-i mutebere” served more like interest-bearing debt instruments or Treasury bills than the banknotes in use today. During the Crimean War in 1854, the Empire resorted to foreign borrowing for the first time in its history. Thus, the need arose for an institution that would act as an intermediary between the Ottoman Government and European countries in foreign debt repayment. To this end, the London-based “Ottoman Bank (Bank-ı Osmanî)” was established in 1856 with British capital. The powers of the Bank were limited to extending small loans, making advance payments to the government and discounting certain Treasury bills.

Later, the Ottoman Bank dissolved itself and was reorganized as “Imperial Ottoman Bank (Bank-ı Osmanî-i Şahane or Osmanlı Bankası)”. In 1863, it was restructured to become a state bank as a British-French partnership. The Bank was granted the privilege of and monopoly on issuing banknotes for a period of thirty years. Moreover, the Bank would act as the treasurer of the state and collect the state revenues, perform the payments of the Treasury and discount

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The foreign capital ownership of the Ottoman Bank led to heated debates over the years. Reactions intensified in the period of the Second Constitutional Monarchy when the idea of establishing a national central bank was formed.

Treasury bills as well as making the interest and principal payments regarding domestic and foreign debts.

Over time, the fact that the capital of the Imperial Ottoman Bank belonged to other nations triggered reactions that intensified in the period of the Second Constitutional Monarchy, laying the foundation for the idea of a national central bank. Attempts to establish a domestic capital-based central bank culminated in the establishment of the “Ottoman National Credit Bank (Osmanlı İtibar-ı Milli Bankası)” on 11 March 1917. However, due to the defeat of the Ottoman Empire in the First World War, the Bank failed to achieve its purpose of becoming a national bank that would replace the Ottoman Bank.

Following the end of the First World War, a tendency to establish central banks to issue currency and manage monetary policies had spread throughout the world.

In the same period, Turkey also witnessed efforts towards establishing a central bank to reinforce the political independence achieved by the War of Independence with economic independence. The issue was first raised at the İzmir Economic Congress in 1923, with a special emphasis on the establishment of “a national state bank” that would function as “the bank of issue”. In this regard, Turkey exchanged views with central banks of other countries on establishing the Turkish Central Bank. In 1928, Dr. Vissering, Head of the Board at De Nederlandsche Bank (Central Bank of the Netherlands), was invited to Turkey. In his report, Dr. Vissering underlined the need for establishing an independent central bank unattached to the government. Likewise, Count Volpi, an expert from Italy, maintained that establishing a central bank was essential to ensure the stability of the Turkish currency.

The Central Bank started to operate on 3 October 1931. As a manifestation of its independence and a peculiarity that distinguishes the Central Bank from other public institutions, the Bank was established as a joint stock company.

Inception and Initial Years

After evaluating the suggestions concerning establishing a central bank, the necessary legal framework to do so was launched and a draft bill for this purpose was prepared with the contribution of Prof. Leon Morf from the University of Lausanne.

The draft bill was enacted by the Grand National Assembly of Turkey on 11 June 1930 and published on the Official Gazette of 30 June 1930 as the Law No. 1715 on the Central Bank of the Republic of Turkey.

Having commenced its operations on 3 October 1931, the Central Bank was established as a joint stock company to indicate its independence and distinction from other public institutions.

T.C.
Resmî Gazete
Tesis tarihi: 7 Teşrinievvel 1336

30 HAZİRAN 1930
PAZARTESİ
SAYI: 1533

Türkiye Cümhuriyet Merkez Bankası kanunu

Kanun N° : 1715 *Kabul tarihi: 11/6/1930*

I

Bankanın teşekkülü ve gayesi

Madde 1 — Türkiyede banknot ihracı imtiyazını münhasıran haiz olmak üzere (Türkiye Cümhuriyet Merkez Bankası) unvanı altında anonim şirket olarak bir banka tesis edilmiştir.

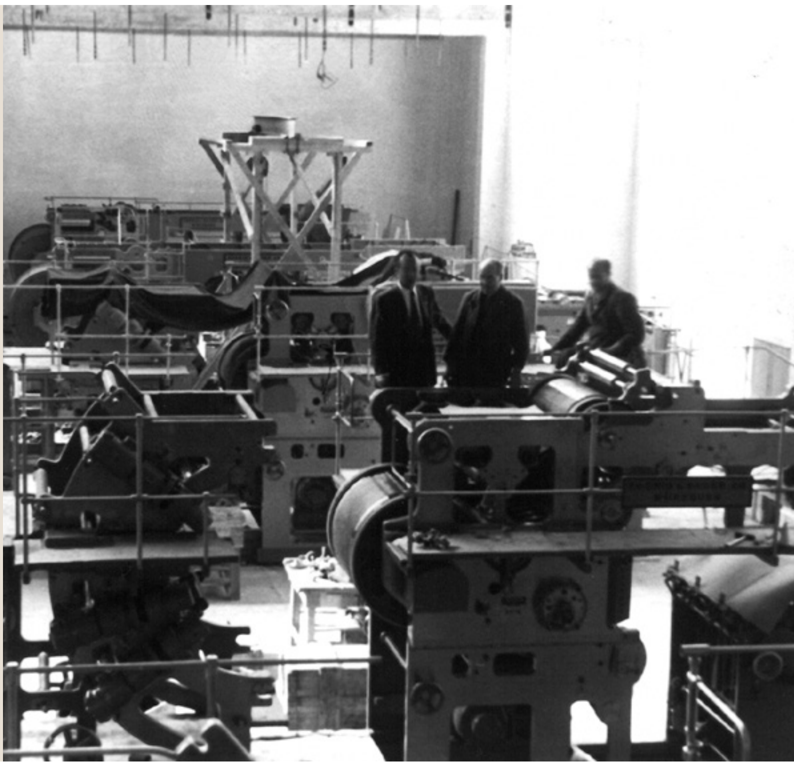
Bankanın ve banknot ihracı imtiyazının müddeti otuz senedir. Bu imtiyazın müddeti, bitmesine beş sene kalıncıya kadar temdit edilebilir.

Madde 2 — Memleketin iktisadî inkişafına yardım gayesile tesis olunan Türkiye Cümhuriyet Merkez Bankasının vazifesi aşağıda gösterilmiştir:

1 - İskonto fiatını tesbit ve para piyasasını ve tedavülünü tanzim etmek;

2 - Hazine muamelelerini ifa etmek;

3 - Hükûmetle müştereken Türk evrakı nakdiyesinin müstakbel istikrarına matuf bütün tedbirleri ittihaz eylemek.



The Bank's shares were divided into class A, B, C and D shares. According to the Central Bank's Articles of Association:

- Each Class A share corresponds to 100 shares at minimum. Class A shares belong solely to the Treasury and their amount shall not exceed fifteen percent of the capital.
- Class B shares were allocated to national banks operating in Turkey.
- Maximum 15,000 Class C shares out of the Bank's capital were allocated to banks other than national banks, and privileged companies.
- Class D shares were allocated to Turkish commercial institutions and legal and real persons of Turkish nationality.

The Central Bank has witnessed structural changes over time. The structure laid out in the Founding Law does not reflect the current situation.

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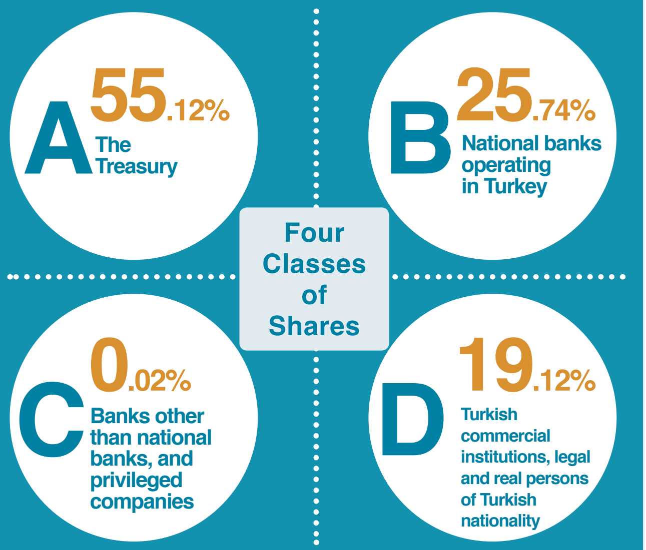
As stipulated by the Founding Law, the primary objective of the Central Bank was to bolster the economic development of the country. The Bank was vested with the exclusive privilege of issuing banknotes in Turkey.

In the inception period, government institutions used gold, shares, jewelry and other assets to buy shares of TL 2,250,000 of the (A) class shares that constitute 15 percent of total shares. National banks invested in (B) class shares. Shares were bought by Ziraat Bank (TL 3,000,000), Emlak ve Eytam Bank[1] (TL 1,000,000), Isbank (TL 500,000), the Police Fund (TL 300,000), and Sanayi ve Maadin Bank[2] (TL 250,000) which totaled TL 5,050,000. This class of shares made up 34 percent of total shares. However, the required amount for sales of shares proved insufficient on the due date. Thus, Ziraat Bank, Emlak ve Eytam Bank and Isbank formed a consortium and completed the remaining TL 500,000. Thus, (B) class shares reached almost 37 percent.

[1]Now-defunct Real Estate and Orphans Bank.

[2]Now-defunct Turkish Industry and Mining Bank.



The Central Bank is a joint stock company. The capital of the Bank is TL 25,000. Although established and organized as a joint stock company, the Central Bank is a non-profit institution. Therefore, unlike other joint stock companies, the Central Bank's capital has a symbolic nature and meaning. The total capital, share amounts and dividend payments are only symbolic.

An additional TL 1,500,000 was allocated to Class (C) shares that made up 10 percent of the shares.

The Imperial Ottoman Bank bought shares of TL 1,000,000, while the rest was bought by Banca Commerciale Italiana and Deutsche Bank. Lastly, during the establishment process, a publicity campaign was carried out to encourage the public, especially civil servants, to purchase (D) class shares of the Bank.

According to the Founding Law, the primary objective of the Central Bank was to bolster the economic development of the country. The Bank was vested with the exclusive privilege of issuing banknotes in Turkey.

Moreover, the Bank was also authorized to set rediscount rates, to regulate the money market and the circulation of money, to execute Treasury operations, and to take all necessary measures for the sake of safeguarding the value of the Turkish currency. The Bank also assumed the role of the treasurer of the government.

Under the fixed exchange rate regime in force at that time, the Government was the sole authority to set exchange rates. The main policy tool of the Bank was rediscount rates. The 1930s were marked by the independence of the Central Bank and were a period of low inflation.

The 1940s were marred by the adverse conditions of the World War II and marked by a tendency towards using central bank resources for public finance. In this period, like many central banks, the Central Bank of Turkey implemented policies to cover the public sector deficit rather than implementing an independent monetary policy. For this reason, the general price level more than tripled between 1938 and 1948.

In the 1950s, the main objectives of the Central Bank were achieving growth and rapid development targets, and economic growth was financed by the Central Bank resources. Accordingly, some amendments were made to the Bank Law to allow the Central Bank to provide short-term advances to the Treasury.

After adopting a planned economy in the 1960s, the Central Bank pursued expansionary monetary policies in line with economic circumstances and industrial development and continued to finance the government budget. In this period, most practices related to foreign exchange control were transferred to the Central Bank as well.

> Efforts towards improving the Central Bank's efficiency culminated in a new founding law in 1970.

Central Bank between 1970 and 2001

Efforts towards improving the Central Bank's efficiency accelerated in the 1960s, and a new era began in the history of the Central Bank with the enactment of a new founding law in 1970. With this law, the Central Bank gained a structure that reflected, albeit partially, innovations both in the economic field and in the field of central banking.

Law No.1211 on the Central Bank of the Republic of Turkey, which was enacted on 14 January 1970, introduced significant changes in the legal status and organizational structure as well as the powers and duties of the Bank. While the legal status of the Bank remained as a joint stock company, it was stipulated that the Treasury's shares would not be less than 51 percent of the Bank's capital.

One of the significant changes made in the organizational structure was the formation of the position of Governor to replace the title "General Manager" with a view to achieving equivalence in foreign representation and protocol. Accordingly, Mr. Naim Talu became the first person assuming the title of "Governor" of the Central Bank and stayed in office between 1967 and 1971.

Law No.1211 introduced many new steps to augment the duties and powers of the Central Bank. Firstly, the Bank's control over the direct and indirect monetary policy instruments was increased. In addition, it was stipulated that the Government shall ask the opinion of the Bank while taking measures regarding money and credits. Moreover, the Bank was authorized to conduct open market operations to regulate money supply and liquidity. Also, the Bank was permitted to conduct rediscount operations and extend medium-term loans for the purpose of supporting investments and economic development. The amount of advances available to the Treasury was raised to 15 percent of the budget appropriation for the related year.

The 1980s were marked by developments that could be defined as milestones for both the Turkish economy and the Central Bank. The decisions of 24 January 1980 started a structural transformation in the Turkish economy. As per the decisions, price controls were abandoned in order to allow prices to be determined under free market conditions and a liberal foreign trade policy was adopted. With the launch of the financial liberalization process, important steps were taken towards establishing an infrastructure that would enable the Central Bank to conduct monetary and exchange rate policies in tune with the free market economy. It was also decided that interest rates for deposits and loans would be determined under market conditions. Moreover, the Turkish lira was devalued and the fixed exchange rate regime was abandoned.

In this period, the Central Bank Law was amended authorizing the Bank to effectively manage the national gold and foreign exchange reserves of Turkey. Furthermore, an article was added to the Law stipulating that the Bank shall carry out its primary functions in line with the key requirements of the economy and in a manner to ensure price stability.

In 1987, the Central Bank started to conduct open market operations and pioneered the establishment of the money and foreign exchange markets in the contemporary sense. To this end, the Money Markets and Fund Management Department was established on 22 October 1987. In 1989, the Decree No. 32 allowed economic units to conduct operations in foreign currency and it was announced that the Turkish lira was a convertible currency and a more flexible exchange rate regime was thus adopted.

In 1990, the Bank announced its monetary program to the public for the first time and it was stated that the target of the program was to meet the market’s liquidity need without undermining the stability of exchange rates and interest rates. Nevertheless, due to problems such as the pressure inflicted on the financial sector by the Gulf War in 1991, coupled with political instability, insufficiently tight fiscal policy and a vulnerable banking sector, a financial crisis erupted in the first quarter of 1994. As a result of the crisis, inflation hit three digits that year.

On 21 April 1994, with an amendment to the related article of the Central Bank Law, the use of Central Bank resources by the Treasury was restricted. In 1997, the Bank and the Treasury signed a protocol agreement that terminated the Treasury’s use of short-term advances from the Central Bank as of 1998.

Between 1995 and 1999, the Central Bank focused on preventing speculative movements in the FX markets and reducing fluctuations in exchange rates and implemented policies towards establishing stability in financial markets. As economic conditions further deteriorated as a result of exogenous shocks, a new economic program based on exchange rates was introduced in 2000. Nevertheless, market confidence began to wane in late 2000 due to the failure to achieve the structural changes envisaged in the economic program. The erosion in market confidence culminated in a financial crisis in Turkey, as a result of which the exchange rate-based stability program was terminated.

Central Bank in 2001 and Beyond

In the wake of the 2001 economic crisis, a floating exchange rate regime was adopted on 22 February 2001 and a structural transformation process started in the economy. The year 2001 was also a milestone with respect to disinflation efforts.

The Turkish economy suffered from high inflation for a long time before 2001. However, the policies implemented and the measures taken proved to be ineffective in bringing inflation down. The reasons can be listed as follows:

- The main objective of the monetary policy had not been specified,
- The Central Bank had been assigned with conflicting duties,
- Central Bank provided advances (loans) to the Treasury.

At the onset of the structural transformation process, significant amendments were made to the Central Bank Law. The most notable of these amendments made on 25 April 2001 was the inclusion of an article in the Law stipulating that “the primary objective of the Bank shall be to maintain price stability”. In this context, the Law stipulates that the Bank shall determine, at its own discretion, the monetary policy that it will implement and the monetary policy tools that it is going to use. Hence, the Bank has gained instrument independence like in many advanced economies. The Law also states that the Bank shall support growth and employment policies of the Government, provided that they are not in conflict with the objective of maintaining price stability.

Another important amendment made to the Law was that the Central Bank was prohibited from granting advances and extending credits to the Treasury or other public institutions, and from purchasing debt instruments issued by the Treasury and public establishments and institutions in the primary market. Thus, the practice of using Central Bank resources in financing public sector deficits was terminated. This amendment is important as it ended the monetization of public deficits, one of the primary causes of inflation.

With an amendment to the Law in 2001, maintaining financial stability was defined as the supporting objective of the Bank.

In this restructuring process, it was decided to change the monetary policy strategy as well. In line with the primary objective of price stability, the "inflation-targeting regime" was adopted in 2002. Accordingly, the Central Bank started to use short-term interest rates as the main policy instrument. In this period, significant achievements were made in the disinflation process.

With an aim to underline the determination in disinflation, to enhance the credibility of the Turkish lira and to eliminate the problems arising from the use of large denominations in many spheres of life such as statistical and accounting records, data processing programs and payment systems, six zeros were dropped from the Turkish lira as of 1 January 2005, and YTL (New Turkish Lira) banknotes and YKr (New Kuruş) coins were put into circulation. On 1 January 2009, the prefix "New" was removed from the name of the currency, and new Turkish lira banknotes and coins were put into circulation.

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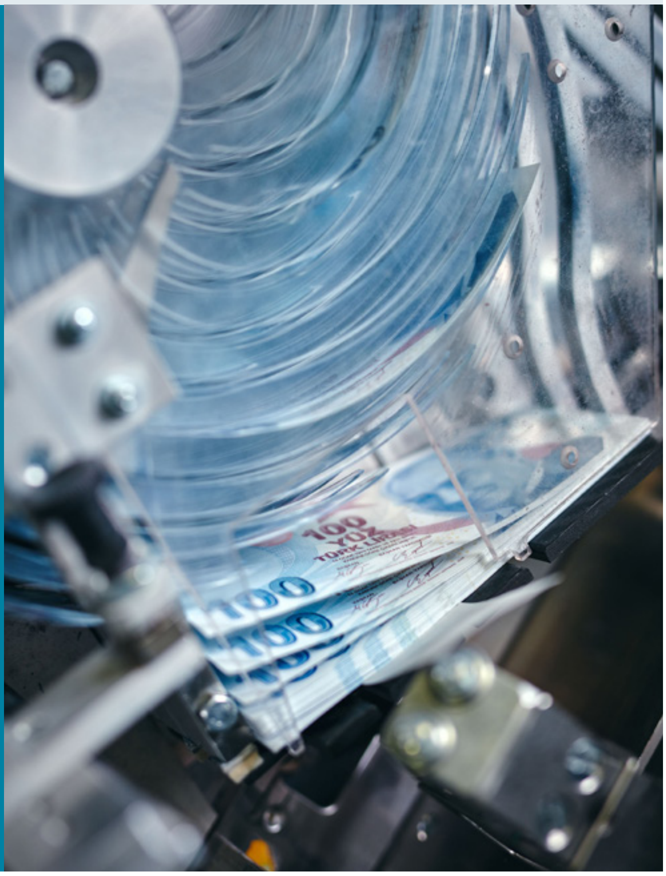


The global financial crisis that swept the world as of 2008 brought along unprecedented problems for both advanced and emerging economies. In this period, the expansionary monetary policies adopted by central banks of advanced economies had significant reverberations on emerging market economies including Turkey. Increased volatility of risk appetite and short-term capital flows as well as risks to financial stability urged emerging market central banks to seek alternative policies. Accordingly, from late 2010 onwards, the Central Bank of Turkey revised the inflation targeting regime that it had been implementing, with a view to safeguarding financial stability and expanded its set of instruments. Besides short-term interest rates that it uses as the main policy instrument, the Central Bank started to use different complementary policy instruments such as reserve requirements, an interest rate corridor, liquidity management and the reserve options mechanism. By using an array of policy instruments, the Central Bank aims at supporting financial stability without prejudice to the price stability objective.

Alongside the start of normalization in global monetary policies, the Central Bank drew up a new roadmap in August 2015 to adapt to this process. Accordingly, the Bank embarked on a policy that entailed narrowing the interest rate corridor and simplifying the funding provided to banks.

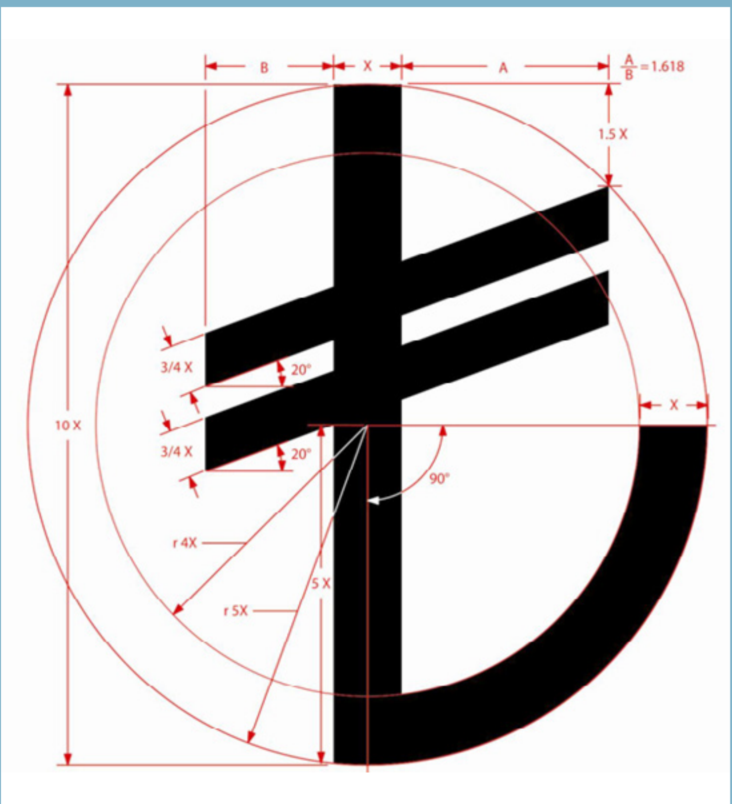
The simplification process was ended as of Jun 2018 and since then, the one week repo rate has been the main policy tool of the Central Bank. The Bank continues to implement its policies within an ever-dynamic process to contribute to economic stability and national welfare by

closely monitoring international and domestic developments in line with the price stability objective.

Accountability and Communication Policy

Another important amendment made to the Central Bank Law in 2001 was stipulation of accountability as a reflection of the Bank's instrument independence. For central banks, accountability means being accountable to the public for the decisions taken, their consequences and corporate governance. An independent and accountable central bank, compared to other institutional structures, is considered more credible by the public. Not only can a credible central bank more easily persuade economic units to attain its objectives, it can also prevent any concern arising in the public in the event of a deviation from the target, and thus, can achieve the price stability objective at lower cost.

The implications of accountability are clearly outlined in Article 42 of the Bank's Law. As a part of the accountability principle, the Bank can have its balance sheet and income statements audited by independent audit institutions. Every year in April and October, the Governor submits a report to the President on the operations of the Bank and the monetary policy pursued. Moreover, the Bank briefs the Committee on Planning and Budget of the Grand National Assembly of Turkey twice a year. Additionally, in the event of a failure to achieve the targets or any possibility of not achieving them in pre-announced periods, the Bank submits information to the Government in writing, and informs the public by disclosing the reasons for the failure and the measures to be taken.



Accountability also requires a transparent communication policy. Accordingly, since 2001, the Bank has been using its communication policy more effectively. Through effective communication, the Bank has aimed to ensure that its policies are understood and accepted by the public, thereby enhancing its credibility. The communication policy constitutes the core of Central Bank policies as a requisite of the accountability and transparency principles, called for by both central bank independence and the inflation-targeting regime. Accordingly, the Bank endeavors to inform the public of its policies through various communication tools and to contribute to making such policies comprehensible and acceptable to the public.

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Organizational Structure

The organizational structure of the Central Bank is composed of the Head Office, Banknote Printing Plant and branches. The Bank's Head Office is in Ankara. Besides domestic operational units, the Bank has representative offices in various countries.

The **General Assembly,** is the top governing body of the Bank, which is a joint stock company. It is composed of the shareholders who are registered in the share book of the Bank. The General Assembly convenes every year in April.

The Governor is appointed for a term of four years on the decision of the President. The Governor is required to have a higher education degree, with knowledge and experience in the fields of finance, economics and banking. The Governor, in the capacity of the highest executive officer, administers and represents the Bank.

The Board is composed of the Governor andsix members elected by the General Assembly. The Governor is the Chairman of the Board. The term of office of Board members is three years. One-third of Board members are renewed every year. Members, whose terms of office have terminated, are eligible for reelection.

According to the Central Bank Law, the duties and powers of the Board are as follows:

a) to take decisions concerning monetary policy that may be implemented and monetary policy instruments which may be used in compliance with the monetary policy strategy and inflation target,

b) to make regulations and to take decisions on issues concerning the replacement, withdrawal from circulation and destruction of banknotes in circulation,

c) to determine the procedures and principles and to make necessary regulations regarding open market operations, foreign exchange and banknote operations, rediscount and advance operations, rediscount and advance interest rates, reserve requirements and liquidity requirement, other monetary policy operations and instruments, management of gold and foreign exchange reserves of the country,

d) to take decisions on the issues laid out in paragraphs (I) and (III) of Article 40 of the Central Bank Law,

e) to take decision on the establishment of payment, securities transfer and settlement systems under the conditions that shall promote their soundness and effectiveness, to determine the procedures and principles of payment methods and instruments, to make regulations regarding the oversight of clearing houses,

f) to determine the procedures and principles on requesting information and collecting statistical information,

g) to make regulations and render decisions on issues pertaining to opening branches, maintaining correspondents, establishment of representative offices and bureaus, and to the Banknote Printing Plant,

h) to take decisions on issues concerning provisions and reserves and to determine the procedures and principles regarding the transfer of the balance to the Treasury remaining after the allocation of profit,

i) to prepare the budget, annual report, balance sheet, income statements and the agenda of the General Assembly of the Bank,

j) to submit proposals to the General Assembly for increasing the capital and making amendments in the Articles of Association,

k) to approve the regulations prepared with respect to the administration, organization, services and personnel of the Bank,

l) to take decisions on the purchase or acquisition of real property for the need of the Bank; when necessary, on the sale, barter and donation of real property owned by the Bank and on other transactions,

m) to make decisions on donation, amicable settlement, release, waiver and cancellation of the amounts and values which are not within the scope of powers that the Bank will delegate to its other organs,

n) to approve the personnel cadres of the Bank,

o) to take decisions and make regulations on other issues to be submitted by the Office of the Governor for examination and approval, apart from those subject to the decision of the Monetary Policy Committee pursuant to this Law.

The **Monetary Policy Committee** is chaired by the Governor and is composed of Deputy Governors, a member to be elected by and from among Board members, and a member to be appointed on the recommendation of the Governor. The Deputy Treasury and Finance Minister or a unit head to be designated by the Minister may participate in meetings without having the right to vote. Monetary Policy Committee membership of those, whose term of office as Governor, Deputy Governor or Board member comes to an end, terminates as well.

The duties and powers of the Monetary Policy Committee are as follows:

a) to determine the principles and strategy of monetary policy in order to maintain price stability,

b) to determine the inflation target together with the Government within the framework of the monetary policy strategy,

c) to provide information to the public in line with the principles that it will set forth, and provide information to the Government within specified periods by preparing reports regarding monetary policy targets and implementations,

d) to take necessary measures in order to protect the domestic and international value of the Turkish lira and to establish the exchange rate regime to determine the parity of the Turkish lira against gold and foreign currencies jointly with the Government.

Monetary Policy Committee decisions are executed by the Governor and submitted to the Board for information.

The **Auditing Committee** is composed of four members to be elected by the General Assembly.

The term of office of the members is two years.

a) The Auditing Committee audits all the operations and accounts of the Bank.

b) The Office of the Governor is obliged to furnish all the information and documents to be requested by the Auditing Committee.

c) The Auditing Committee, having no administrative power, submits its opinions in writing to the Board and also presents a copy thereof to the Presidency.

d) The Committee submits the report that it will draw up on the operations and accounts at the end of the year to the General Assembly.

The **Executive Committee** is composed of four Deputy Governors under the chairmanship of the Governor. Deputy Governors are appointed for a term of four years by a Presidential Decree.

The duties of the Executive Committee are as follows:

a) to prepare proposals to be submitted to the Board, by examining in advance the issues subject to Board decision, when deemed necessary by the Governor,

b) to draw up regulation on the administration, organization and services of the Bank,

c) to make decisions on issues left by regulations to the decision of the Executive Committee,

d) to ensure coordination in the operations of the Bank,

e) to perform duties such as appointment, determination of the salaries, dismissal and retirement of the personnel other than those appointed by the Board.

What does the Central Bank Do?

> **The Central Bank is not only responsible for printing and distributing banknotes but also for determining the availibility of Turkish lira banknotes in the market.**

Banknote Printing

Besides its critical importance for the economy, money also plays an important role in daily life. Without a practical payment instrument like money, a variety of things we do in everyday life such as buying food or a bus ticket, paying telephone bills, going to the cinema, etc. would be out of the question. However, in addition to being a payment instrument, money has other functions, too. Money can be saved, thus, be used as a store of value. Money also serves as a measure and as a unit of account. In order to serve these functions, money should fulfill two conditions: It should be generally accepted and people should trust that it will preserve its value.

Money nowadays is not only a cash asset that we carry in our pockets. Deposits at our bank accounts are also considered money.

A currency is a country's symbol of sovereignty and independence. In Turkey, the power to issue banknotes is held by the Grand National Assembly. However, the Assembly has transferred the sole privilege of printing and issuing banknotes exclusively and indefinitely to the Central Bank. Banknotes are designed and printed by the Central Bank's Banknote Printing Plant Department that started operations in 1958.

Banknote designs are inspired by important places, figures, events, and eminent persons in the historical and cultural heritage of Turkey. The Central Bank exercises due diligence to ensure that banknotes have high security features. The Bank, through its branches nationwide, distributes banknotes and if needed, replaces banknotes in circulation with new ones. In addition, it puts new banknotes into circulation and replaces worn-out ones via its cash centers as well as via banknote depots of Ziraat Bank branches in some cities.

The Central Bank is not only responsible for printing and distributing banknotes but also for determining the availibility of Turkish lira banknotes in the market. In Turkey, coins are minted and distributed by the Turkish State Mint, which is a body of the Ministry of Treasury and Finance.

The E9 Emission Group banknotes currently in circulation are composed of six denominations. The obverse sides of the banknotes include the portrait of Atatürk, and the reverse sides carry portraits of prominent Turkish characters who are internationally renowned.

Characters on the Reverse Sides of Banknotes

TL 5: Aydın Sayılı: A prominent Turkish scientist who established the historiography of science in Turkey.

TL 10: Cahit Arf: A Turkish mathematician and scientist.

TL 20: Mimar Kemaleddin (Kemaleddin the Architect): A Turkish architect known for his work in the early 20th century who was one of the leading representatives of the First National Architectural Movement.

TL 50: Fatma Aliye: The first Turkish female novelist and philosopher.

TL 100: Itri (Buhurizade Mustafa Efendi): The founder of Turkish classical music.

TL 200: Yunus Emre: A bard and a pioneer of mysticism in Anatolia and Turkish mystic poetry.

Monetary Policy and Price Stability

The Central Bank is responsible for implementing the monetary policy in Turkey. The primary objective of the Bank is to achieve price stability. In other words, the primary goal of monetary policy in Turkey is to achieve price stability. Short-term interest rates are the main policy tool of the Central Bank. The short-term interest rate is the interest rate that the Central Bank employs in its transactions with banks and intermediary institutions.

Price stability refers to an inflation level in an economy so low that it can be ignored, and to the sustainability of such level of inflation. Inflation is an increase in the general level of goods and services prices in an economy. In an inflationary environment, the amount of goods and services that a certain amount of money can buy decreases over time, which means that the value or the purchasing power of money diminishes. This consequently leads to weakening confidence in a currency, shorter maturities in investments, and shift of investments to unproductive fields such as foreign currency and real estate. High inflation impairs economic agents' ability to make sound decisions about investment, consumption and saving.

High inflation also ruins income distribution. The distribution gradually deteriorates since people who have the means to save can further increase their wealth by taking advantage of high real interest rates in an inflationary environment, whereas people with low income cannot. This inequality in income distribution damages social unity and integrity, and consequently destroys peace and stability.

The ultimate objective of economic policies is to increase economic welfare of individuals. When price stability is achieved, all economic agents can make better decisions about their investments, consumption, and savings. Accordingly, sustainable growth and rising employment are attained and economic stability and social welfare rise.

The Central Bank uses short-term interest rates set by the Monetary Policy Committee as a tool to achieve the price stability objective. To make interest rate decisions, the Monetary Policy Committee convenes eight times a year on a pre-announced timetable. While making interest rate decisions, the Committee adopts a medium-term perspective in view of the consistency of the future course of inflation with the inflation target. The decision, along with its rationale, is announced the same day via a press release in Turkish and English posted on the Central Bank website. In line with the transparency principle, the Summary of the Monetary Policy Committee Meeting, which includes the Committee's evaluations and its stance regarding the inflation outlook, is also published within five working days following the meeting. In addition, on a quarterly basis, the Bank presents its Inflation Report, which encompasses the overall inflation outlook, the risks involved and the Bank's inflation forecasts, via press conferences.

How do Interest Rate Decisions Affect the Economy? (Monetary Transmission Mechanism)

The Central Bank endeavors to influence the level of supply and demand in the economy to achieve the price stability objective. To this end, it uses short-term interest rates as its main tool. The process through which short-term interest rates affect economic activity and the general price level is called the monetary transmission mechanism.

A change by the Central Bank in short-term interest rates that it uses in its transactions with commercial banks affects the lending costs of banks. For example, a rate cut by the Central Bank facilitates borrowing as it leads to a fall in the interest rates that banks charge on loans they extend. People who borrow at lower costs will be disposed to spend and invest more, which consequently increases the demand for goods and services. On the other hand, a rate hike by the Central Bank heightens the borrowing cost. This corresponds to an increase in interest income that consumers earn from their savings, and so makes saving more appealing for consumers than spending. However, for investors, it becomes costlier to invest. Consequently, people’s disposition to spend and invest decreases, thereby reducing the demand for goods and services.

Interest rate changes by the Central Bank also affect asset prices. Prices of financial assets such as stocks and bonds are directly related to interest rates. An increase in interest rates induces a fall in stock and bond prices. Accordingly, the total wealth of people holding these assets decreases, which causes them to avoid spending, and thus weakens the demand for goods and services.

Changes introduced by the Central Bank in interest rates may also affect supply and demand conditions through the exchange rate channel. When interest rates rise, the return on Turkish lira assets such as stocks and bonds increases. Those who want to purchase these high-return assets need more Turkish lira. Increased demand for the Turkish lira causes it to appreciate. In this case, prices of domestic goods and services get higher than those of other countries. Higher prices, in turn, lead to a fall in the demand for goods and services.

The Central Bank’s decisions also affect the supply and demand conditions in the economy through the expectations channel since expectations play an important role in price and wage-setting. For example, when people have a high inflation expectation for the periods ahead, they ask for higher wages. Higher wages elevate production costs, which leads to a rise in prices. Thus, the expectation of inflation brings about inflation. To avoid that, central banks introduce measures to increase the confidence in monetary policy. Consistency between expectations and the Central Bank’s projections helps achieve price stability. Long-term interest rates are influenced by the expectations for the future course of short-term interest rates. Therefore, policy rate expectations also affect the medium and long-term interest rates.

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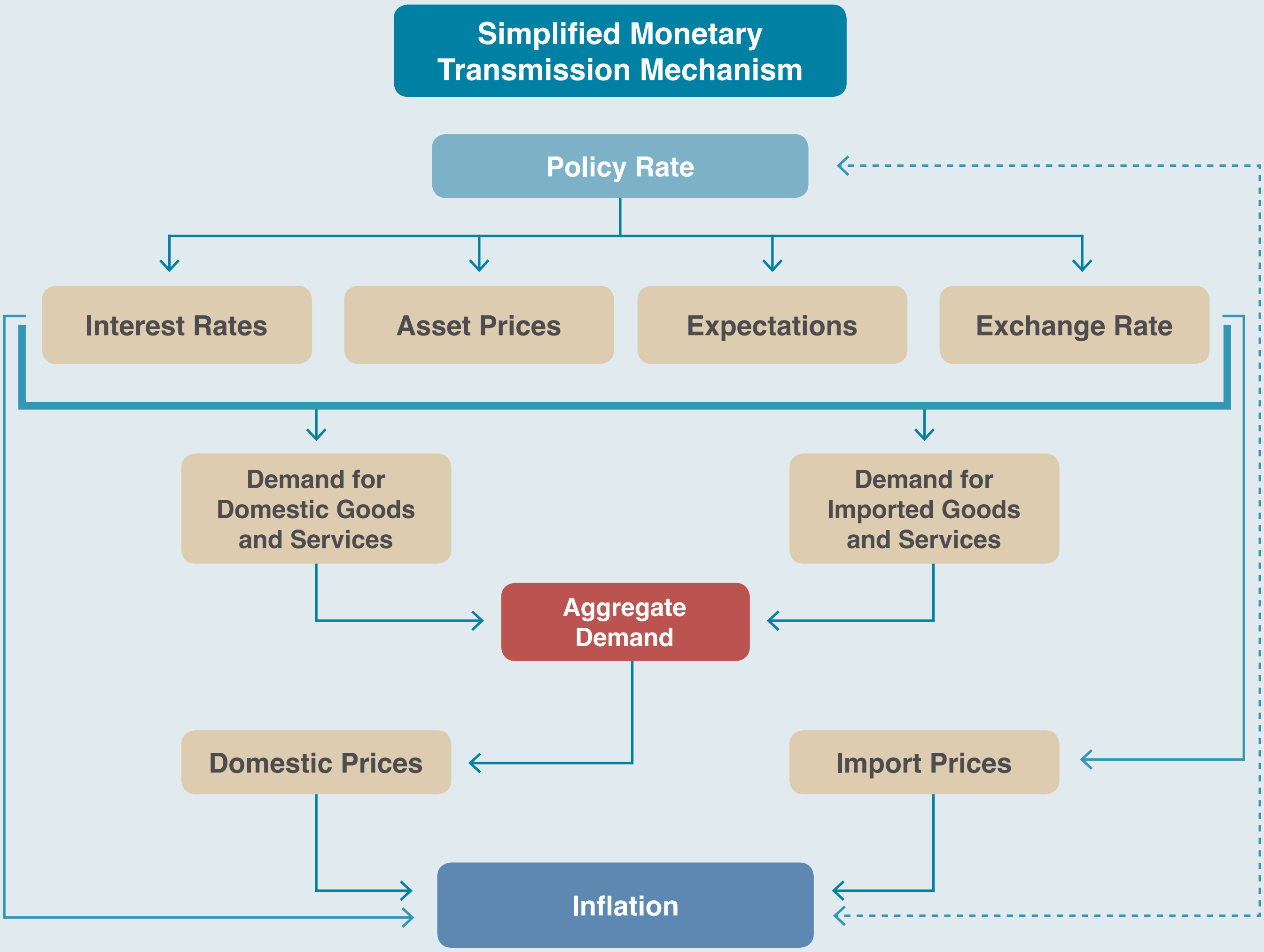
It takes time for the economy to adjust to a change in interest rates. Some channels of the transmission mechanism may have more immediate effects than others. These effects may vary depending on factors such as the time it takes for policy changes to be reflected in contracts and the time it takes people to change their consumption patterns.

Moreover, the effects of policy changes are weaker in economies with backward-looking decision-making routines that are based on past inflation rates.

The medium-term inflation target that the Central Bank and the Government have jointly set is 5 percent. The Inflation Report is one of the main communication tools of the Bank. This quarterly report presents an assessment of overall macroeconomic developments with a focus on the medium-term trend of inflation. Also, the Central Bank shares its inflation forecasts and the underlying assumptions via this report.



The Relation between Central Bank Independence and Price Stability

Central bank independence is one of the most important prerequisites of price stability. It refers to central banks' discretion in making their policy and instrument decisions in pursuit of the primary objective of price stability. Price stability can be achieved through long-term, stable and decisive policy implementations. Independence creates an environment conducive for central banks to avoid policies that may disrupt price stability for the sake of short-term and temporary objectives, and enables them to issue the necessary warnings.

When the primary objective of the central bank is not defined and the bank is not independent, monetary policies may be used for purposes other than price stability but this usually ends in high inflation. Therefore, central banks in many countries have been tasked to achieve price stability and accordingly vested with instrument independence.

However, independence of a central bank does not mean that it has a free hand in implementing its policies. Central banks are accountable and they inform the Government, the Parliament, and the public about their operations, objectives, and implementations in a transparent manner.

Financial Stability

Sustaining a sound financial system is also one of the main tasks of modern central banks.

The financial system is composed of savers (suppliers of funds), investors (demanders of funds), financial instruments, financial intermediaries, and legal and administrative controls. The core function of the financial system is to transfer funds from savers to individuals, firms or governments that need to borrow funds.

In a well-functioning financial system, savers can make the best use of their funds and investors in need of financing have easy access to funds. A stable financial system is one in which there is a smooth and continuous flow of funds from savings into investment as well as resilience to potential shocks. In a stable financial environment, the monetary transmission mechanism works well, which in turn makes central bank decisions more effective. Moreover, the efficient use of funds boosts investments and thus contributes to economic growth. Therefore, a smoothly operating financial system is key to economic welfare and stability.

On the other hand, a defective financial system can harm economic growth, aggravate unemployment, render monetary policy ineffective and threaten price stability.

Thus, the Central Bank is in charge of maintaining a stable financial system and taking regulatory measures related to money and foreign exchange markets. Other regulatory and supervisory authorities in the system include the Banking Regulation and Supervision Agency, the Capital Markets Board, the Ministry of Treasury and Finance, and the Savings Deposit Insurance Fund. The Central Bank works in cooperation with other institutions responsible for surveillance and supervision in order to manage macro financial risks. As a lender of last resort, the Bank also provides liquidity to banks if necessary. In addition, it plays an active role in establishing and operating payment systems.

The Central Bank publishes relevant insights and analyses in its biannual Financial Stability Report.

Payment Systems

A payment system is a structure providing the infrastructure and common rules required for clearing and settlement transactions that authorize fund transfers resulting from transfer orders given by three or more participants.

An efficient and secure payment system is of vital importance not only for monetary policy, financial stability and economic development, but also for the institutions and individuals that use it.

Central banks play an increasingly important role in payment systems due to their widespread use and their potential risks to financial stability. Therefore, the Central Bank is authorized by law to make all legal and technical arrangements necessary to ensure the smooth operation of payments systems.

The Bank is responsible for establishing and securing the uninterrupted functioning of payment, security transfer and settlement systems and, thus, enabling the safe and fast transfer of money and securities.

The payment and securities settlement systems operating under the Central Bank include the Electronic Funds Transfer System (EFT) and the Electronic Security Transfer System (ESTS).

The EFT System is the real-time electronic transfer and gross settlement of Turkish lira interbank payments. The ESTS System is the real-time electronic transfer and gross settlement of banks' securities in book-entry form.

The Central Bank is both the owner and the operator of these systems.

Exchange Rate Policy

An exchange rate is the price of a nation's currency in terms of another currency. One of the main duties of the Central Bank is to determine the exchange rate regime in Turkey jointly with the government. After the economic crisis in 2001, the Bank and the government agreed to adopt a floating exchange rate regime on 22 February 2001.

In this regime, exchange rates are determined by supply and demand conditions in the forex market and the Turkish lira is allowed to float freely in relation to other currencies. In addition, the exchange rate is not used as a policy instrument and the Bank does not formally seek to achieve a certain target level for the exchange rate.

Factors determining the FX supply and demand are economic fundamentals, monetary and fiscal policies, international developments, and expectations. Even though there is no exchange rate target, if extreme FX volatility or substantial deviations from economic fundamentals pose potential harm to price and financial stability, the Bank may allow for a change in the exchange rate by interventions to FX supply and demand conditions. Furthermore, the Bank may also intervene directly in the foreign exchange market to influence the level of the exchange rate. The FX market operations conducted by the Bank are as follows:

Foreign Exchange Auctions and Direct FX Interventions:

The Central Bank may carry out foreign exchange buying and selling transactions against Turkish lira in the FX market via auctions or direct interventions, when deemed necessary.

Foreign Exchange Deposits against Turkish Lira Deposits Auctions:

The market of foreign exchange deposits against Turkish lira deposits is used to enhance the flexibility and instrument diversity of the Turkish lira and FX liquidity management within the current monetary and exchange rate policy framework.

Foreign Exchange Deposit Transactions:

Foreign exchange deposit transactions are carried out under the guarantee of the Central Bank between those banks that are temporarily in need of foreign exchange liquidity and the banks that have excess foreign exchange liquidity, at a certain interest rate and maturity. Banks can also borrow foreign exchange liquidity at the interest rate determined by the Central Bank. In this context, the Bank provides euro and US dollar liquidity to banks that are members of the foreign exchange and banknotes market, within their limits.

Foreign Banknotes against Foreign Exchange Transactions:

Banks that are members of the foreign exchange and banknotes market may conduct foreign banknotes against foreign exchange buying/selling transactions with the Bank, within their pre-specified limits.

TL-Settled Forward FX Sale Auctions:

A TL-settled forward foreign exchange contract is a derivative in which parties do not exchange the principal amount at the end of one, three or six months and the transaction is based on the principle of cash settlement in TL.

Reserve Management

International reserves are readily convertible assets controlled by monetary authorities and used for international payments.

The Bank is in charge of holding and managing Turkey's gold and FX reserves.

The reasons for holding reserves are to:

- Establish and maintain confidence in monetary and exchange rate policies,
- Provide FX liquidity for the Treasury's domestic and foreign debt service,
- Reduce the economy's vulnerability to internal and external shocks, and
- Strengthen the trust of international markets in the Turkish economy.

In its reserve management program, the Bank gives priority to the country's interests. To this end, adhering to capital preservation and liquidity supply, the Bank invests international reserves only in instruments that carry the lowest risk. The Bank employs an effective risk management strategy designed to identify, assess and contain potential risks. The level of international reserves is published on the Central Bank website on a regular basis.

Glossary

Convertibility

Convertibility is the ability to freely exchange a country's currency for currencies of other nations in the foreign exchange market and the ease of using this currency as a medium of exchange in international trade.

Devaluation

Devaluation is the loss of value of a country's currency with respect to foreign currencies in a fixed exchange-rate system.

Discount

Discount is a credit transaction in which commercial papers are bought prior to the maturity date and then converted to money at a certain discount rate.

Inflation Targeting

Inflation targeting is a monetary policy regime in which a central bank has an explicit target inflation rate, typically jointly determined by the government and the central bank. In this regime, the inflation target is expected to provide a nominal anchor for expectations. Unlike other policies, the inflation target should be announced to the public and central banks must accept full responsibility for inflation. As policy implementers, central banks are given instrument independence to achieve their goals. In other words, central banks have the freedom to set exchange rate and interest rate policies as they see fit to curb inflation. Such practices may also be inevitable when economic aggregates no longer provide a nominal anchor. The success of this policy relies on a solid and sound fiscal structure, an observable and stable relationship between inflation and monetary policy tools, credibility, independence, accountability, and transparency..

Monetary Expansion

An unconventional monetary policy approach that allows central banks to increase money supply by buying financial assets from commercial banks or other private institutions. After the global financial crisis, the Bank of England, the European Central Bank, the Bank of Japan, and particularly the US Federal Reserve adopted quantitative easing programs of varied sizes to support the financial sector, boost private spending and prevent inflation from falling below the target.

Open Market Operations

In line with the Bank's monetary policy objectives, open market operations (OMOs) are outright purchases and sales of securities, repurchase agreements (repos), and reverse repurchase agreements (reverse repos) in Turkish lira terms, and purchases and sales of TL deposits that help ensure an effective management of money supply and liquidity. OMOs allow central banks to stabilize short-term interest rates around the policy rate(s) and to regulate the liquidity in financial markets.

Rediscount

Rediscount means exchanging (rediscounting) securities against a price that is already exchanged (discounted) before. It is a monetary policy instrument known as the rediscount window with which a central bank rediscounts securities on its own terms.

Seigniorage

Seigniorage is the real revenue made by the money-printing authority from the printing of money. It is the ratio of a money stock change to the general price level. If inflation is only caused by an increase in money supply, the seigniorage is equal to the inflation tax.