

The Turkish Experience

Bank of Indonesia and IMF Joint Conference on
Coping with Asia's Large Capital Inflows in a Multi-Speed
Global Economy

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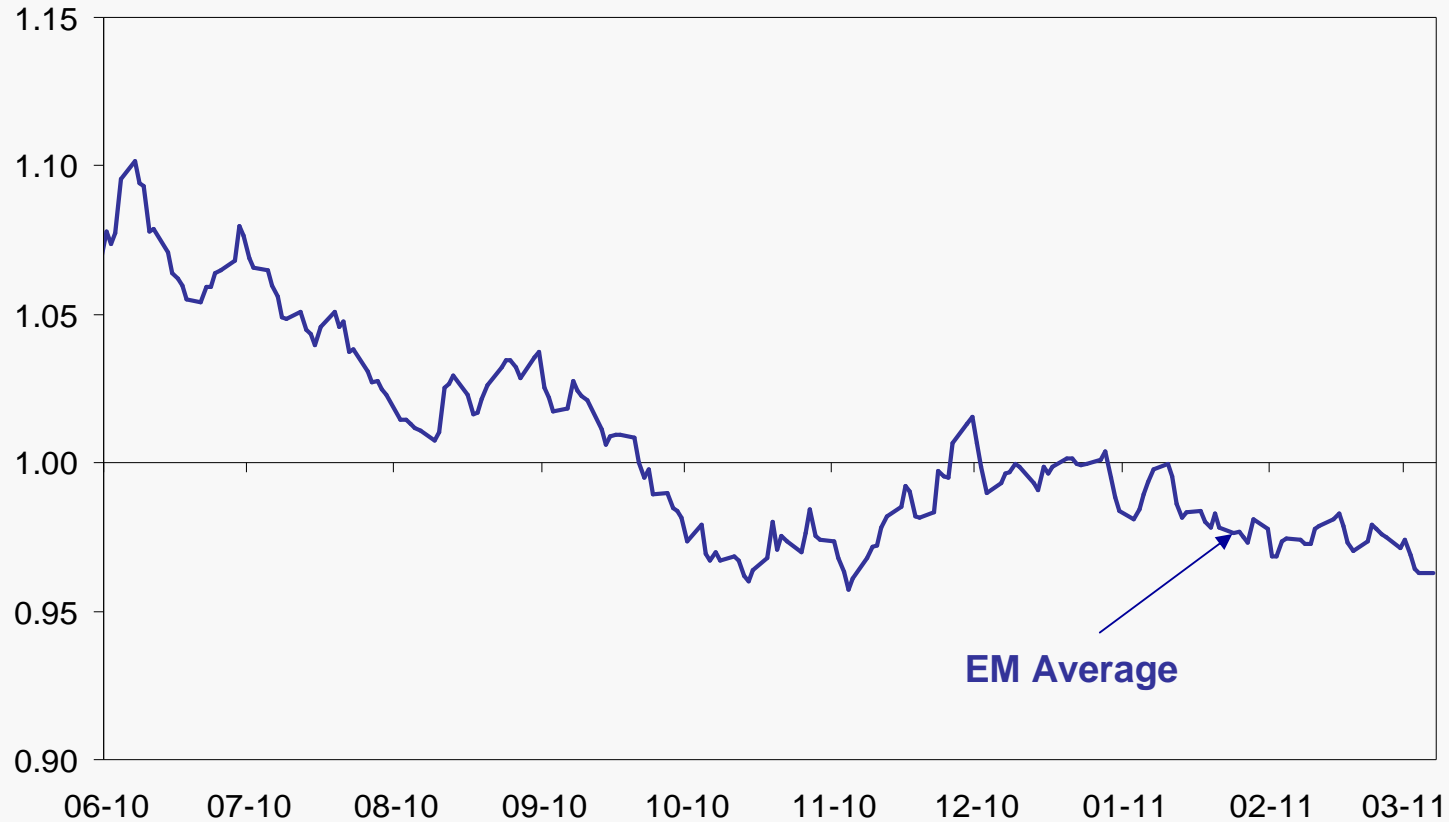
March 11, 2011
Bali, Indonesia

Quantitative Easing vs. Quantitative Tightening

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

Appreciation Pressure

EM currencies against USD*
(4 Jan 2010=1)



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

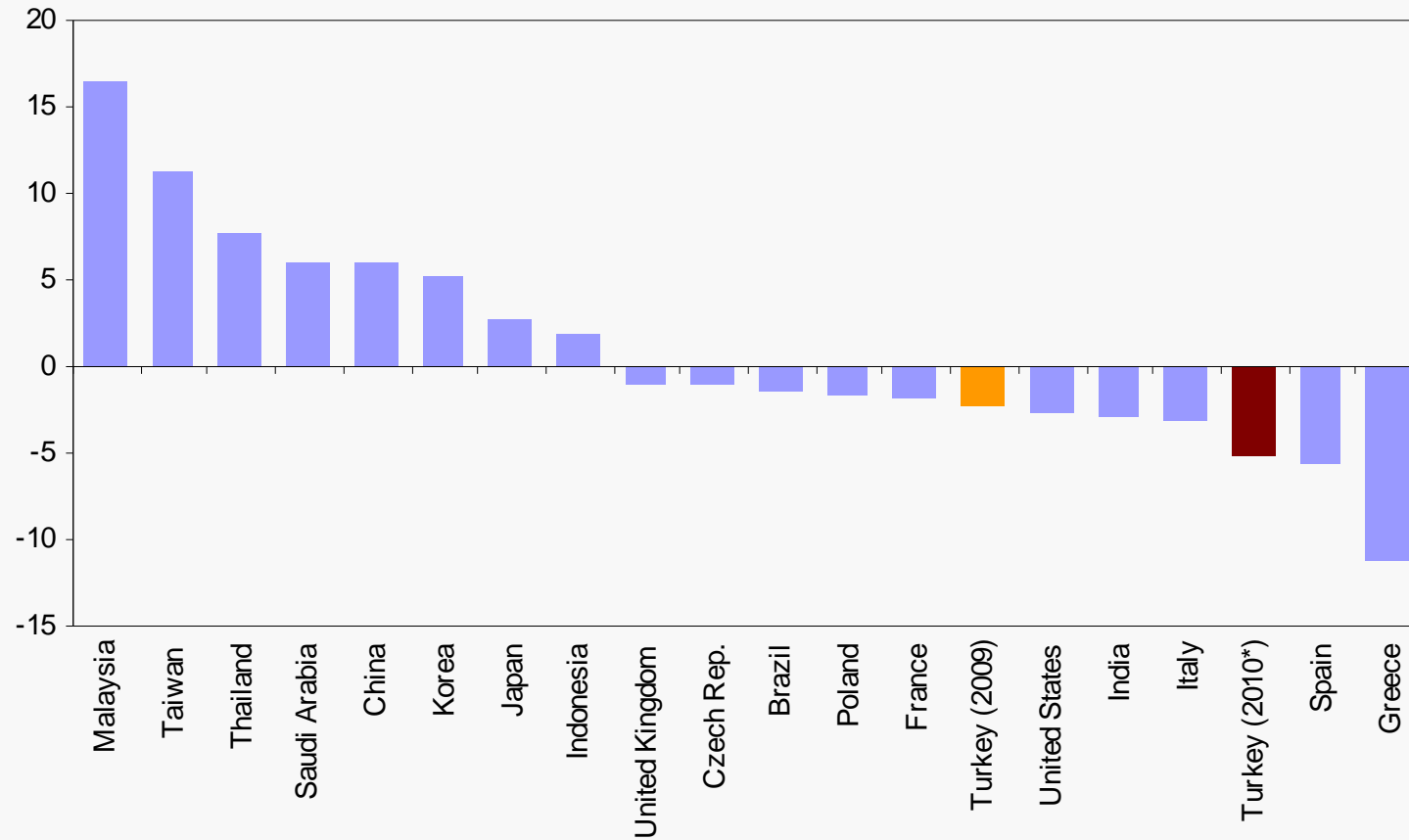
Source: Bloomberg, CBRT

Two Approaches

- **Approach 1:** Use capital account measures to restrict inflows while tightening via interest rates (Brazil, South Korea)
- **Approach 2:** Use macroprudential measures to restrict domestic credit and domestic demand while keeping the short term interest rate differentials as low as possible (Turkey)

Current Account Balance

Current Account Balance
(2009, percent of GDP)



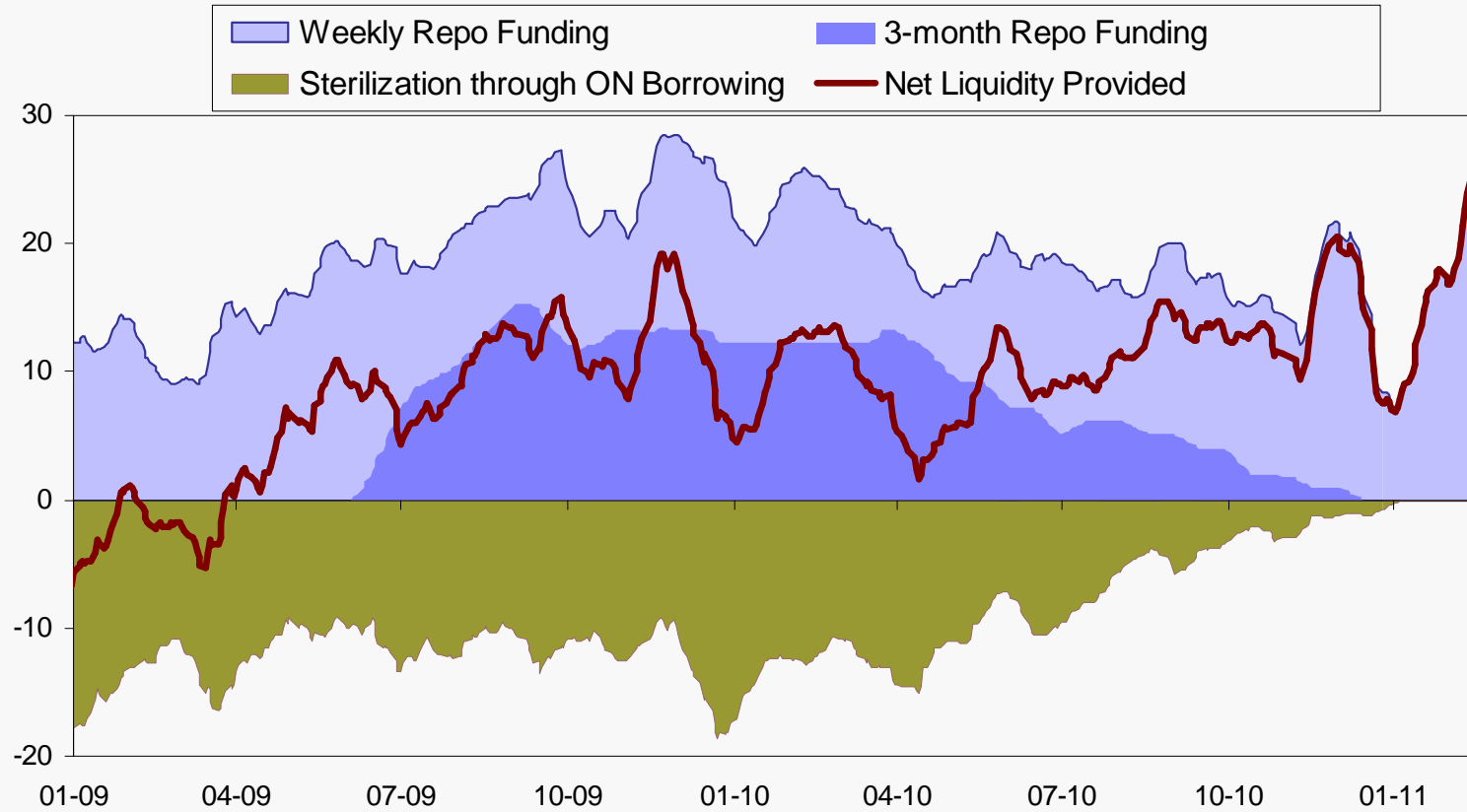
* IMF WEO Estimate
Source: IMF, CBRT

Phases in Monetary Policy

- **Phase-1**: Full Liquidity Support (after the collapse of Lehman Brothers, September 2008)
- **Phase-2**: Monetary Exit Strategy (April 2010)
- **Phase-3**: New Policy Mix (starting from November 2010)

Liquidity after Monetary Exit

Central Bank Liquidity
(billion TRY)



Source: ISE, CBRT

Price Stability after Monetary Exit

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



Source: TurkStat, CBRT

Financial Stability: Objectives

1. **Debt Ratios:** Use of more equity, more prudent borrowing
2. **Debt Maturities:** Extending maturities of domestic and foreign borrowing and deposits
3. **FX Positions:** Strengthening FX positions of public and private sectors
4. **Risk management:** More effective management of exchange rate risk via instruments such as the Turkish Derivatives Exchange

Macroprudential Tools

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

Tools (in the order of priority):

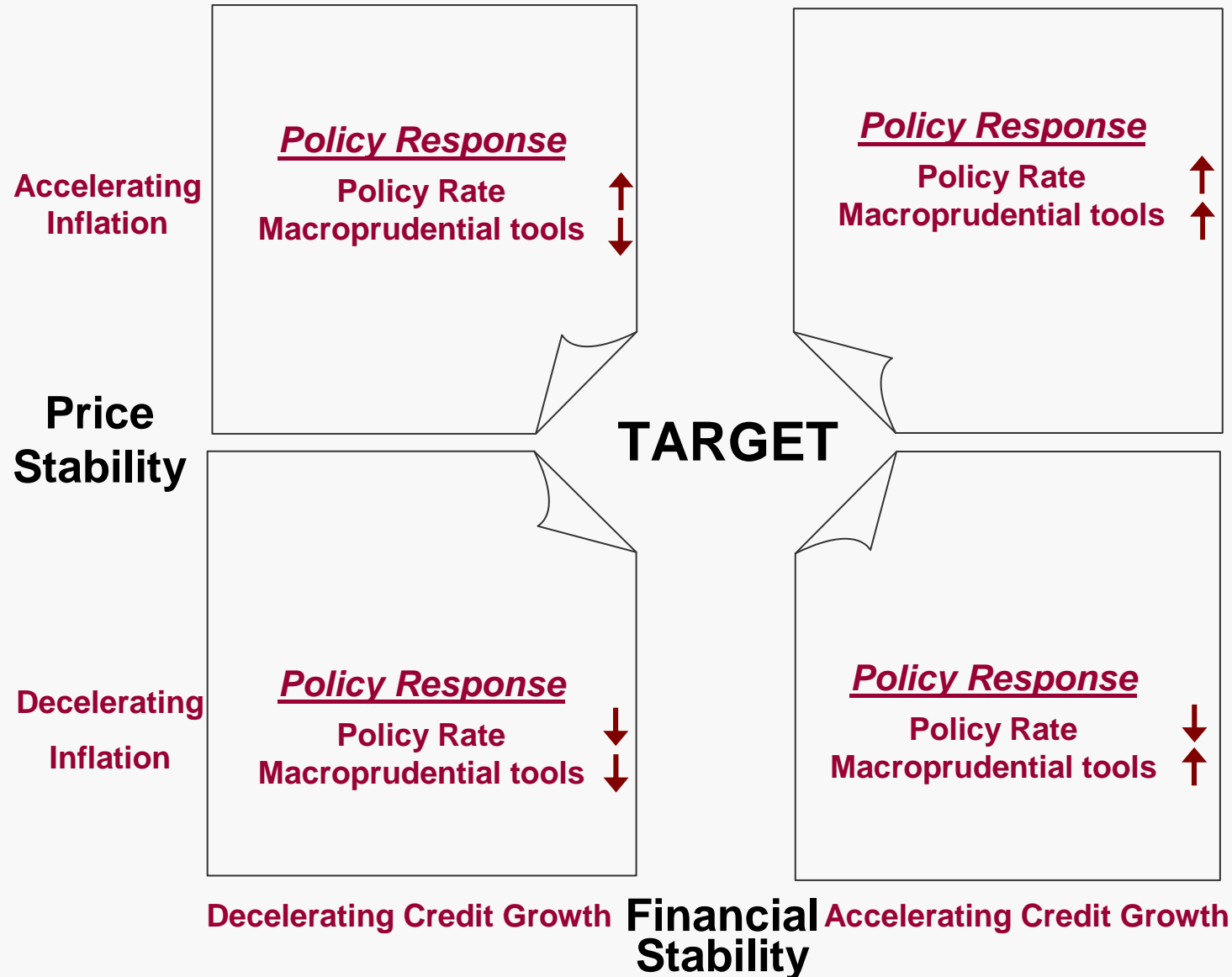
For Financial Stability:

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

For Price Stability:

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

Two Targets, Two Instruments



The New Policy Mix

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

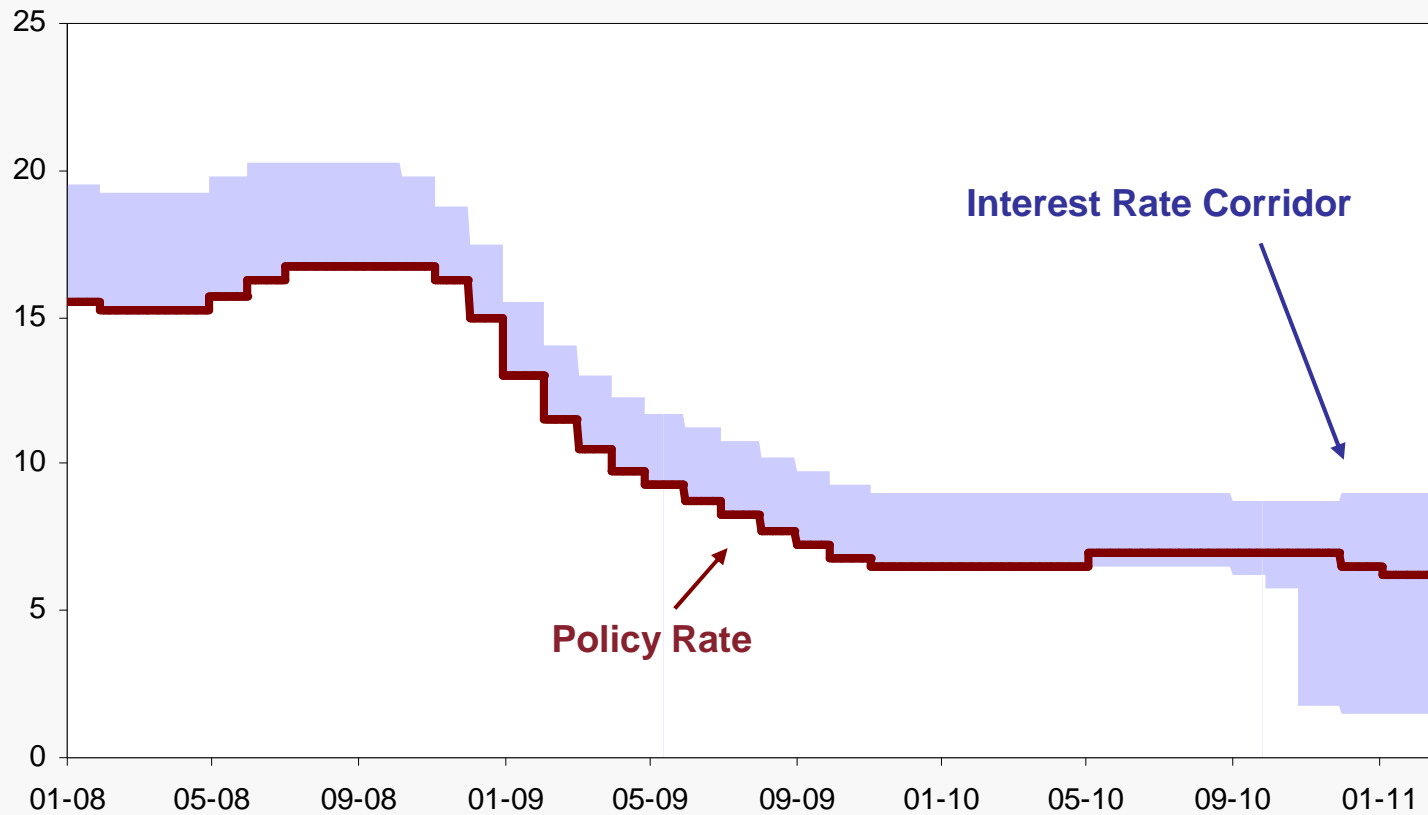
- The framework we adopt in spirit is not significantly different from the conventional inflation targeting framework.
- The only difference is that, previously our policy instrument was the one week repo rate, but now our instrument is a “policy mix”
- We seek to use these instruments in the right combination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

Effectiveness of Required Reserves

- 1. Liquidity Channel (wider corridor)**
- 2. Cost Channel (no remuneration)**

The Policy Rate and the Interest Rate Corridor

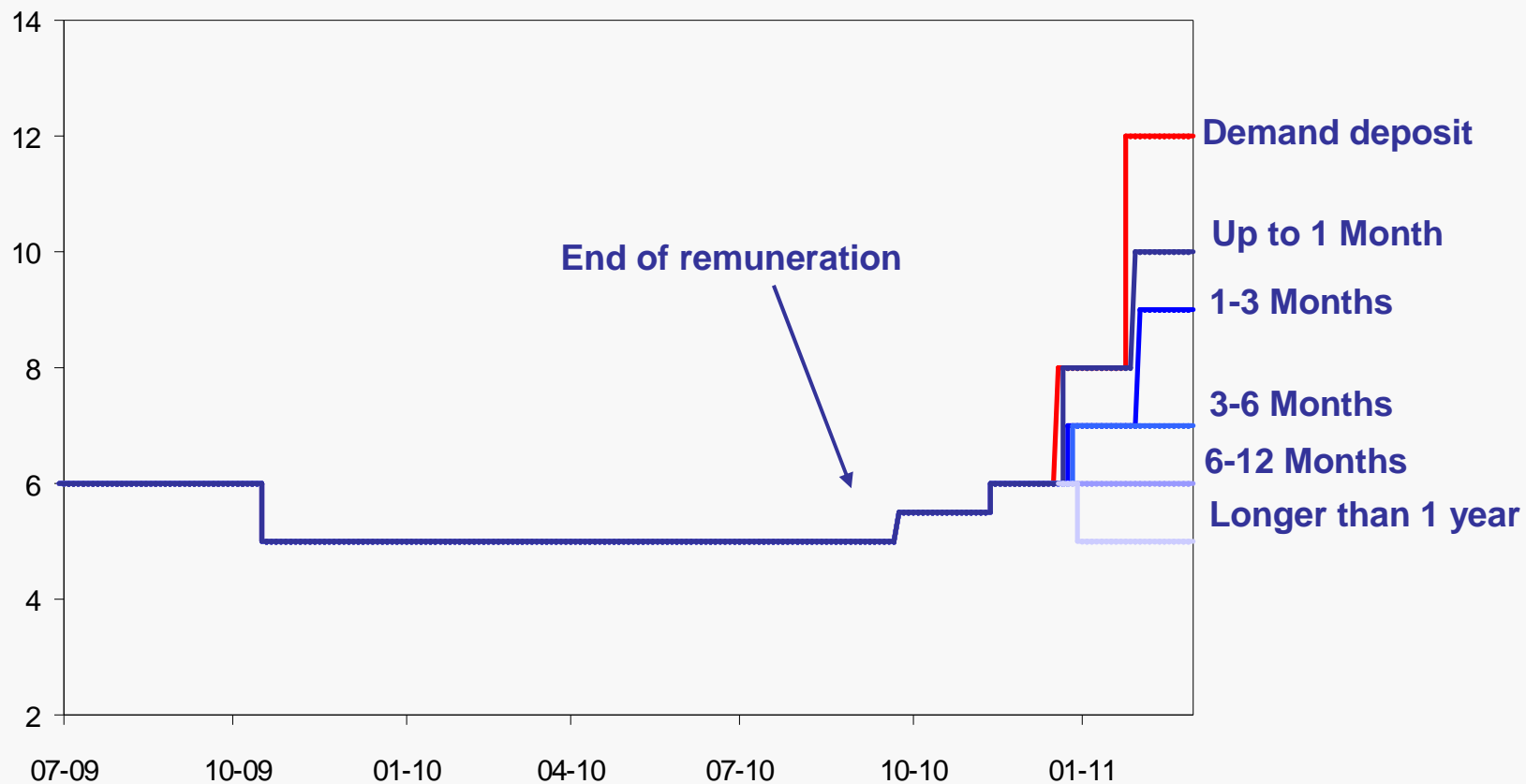
Policy Rate and Interest Rate Corridor
(percent)



Source: CBRT

Reserve Requirements as a Macroprudential Tool

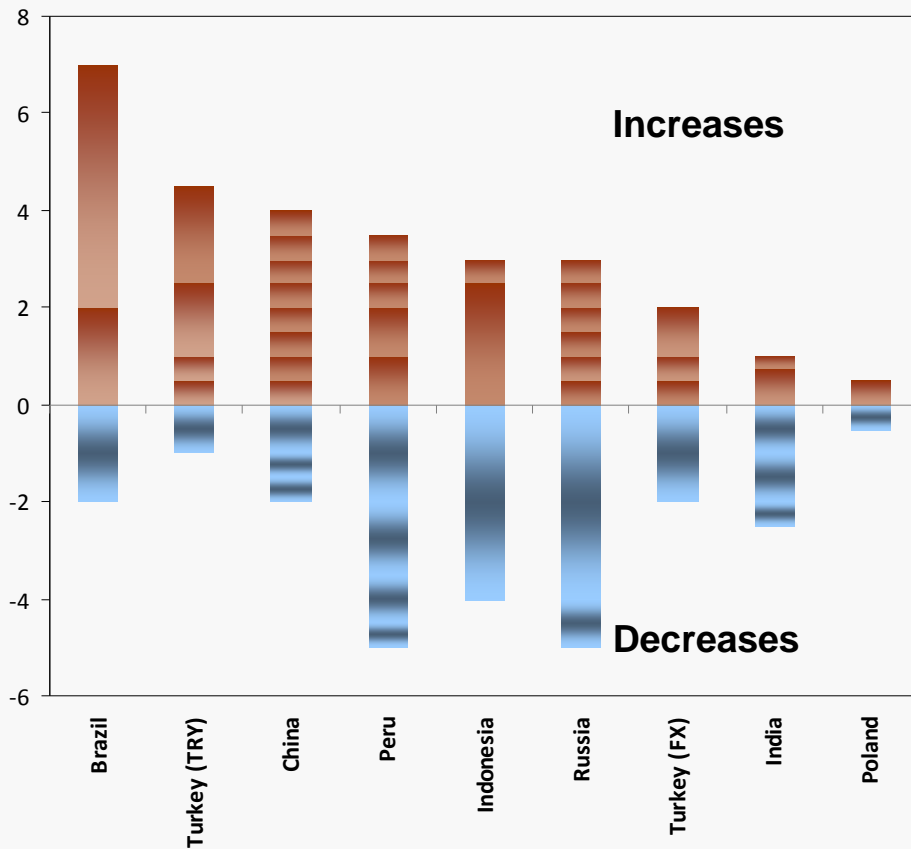
Reserve Requirement Ratios
(percent)



Source: CBRT

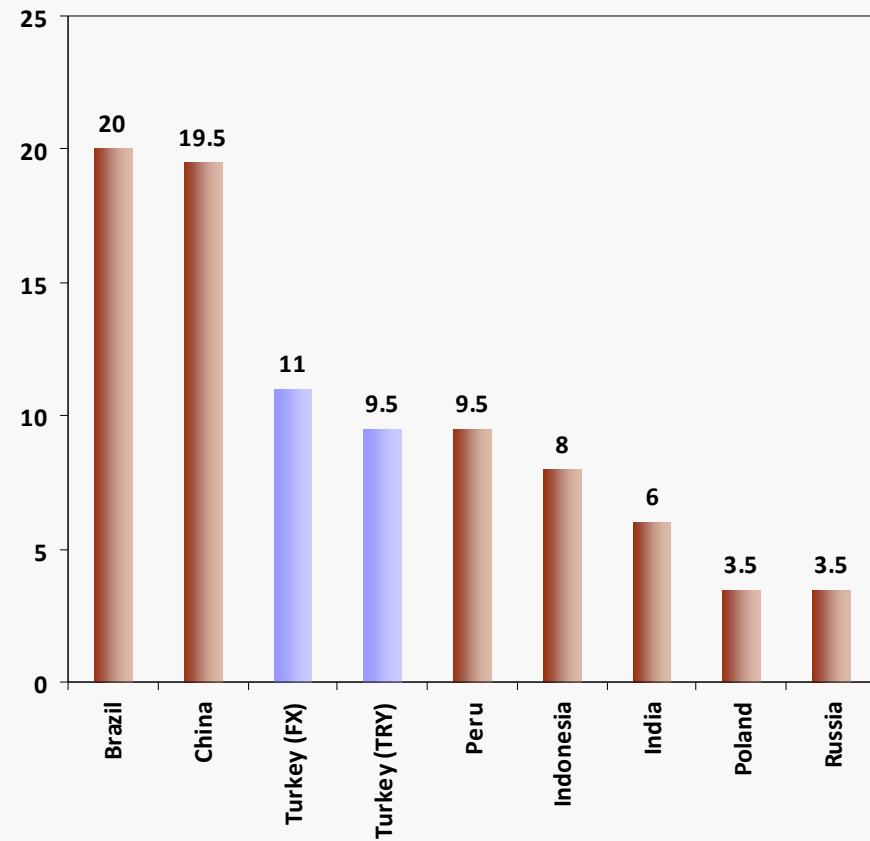
Reserve Requirements as a Macroprudential Tool

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



Source: Central Banks, CBRT

Current RRR
(percent)



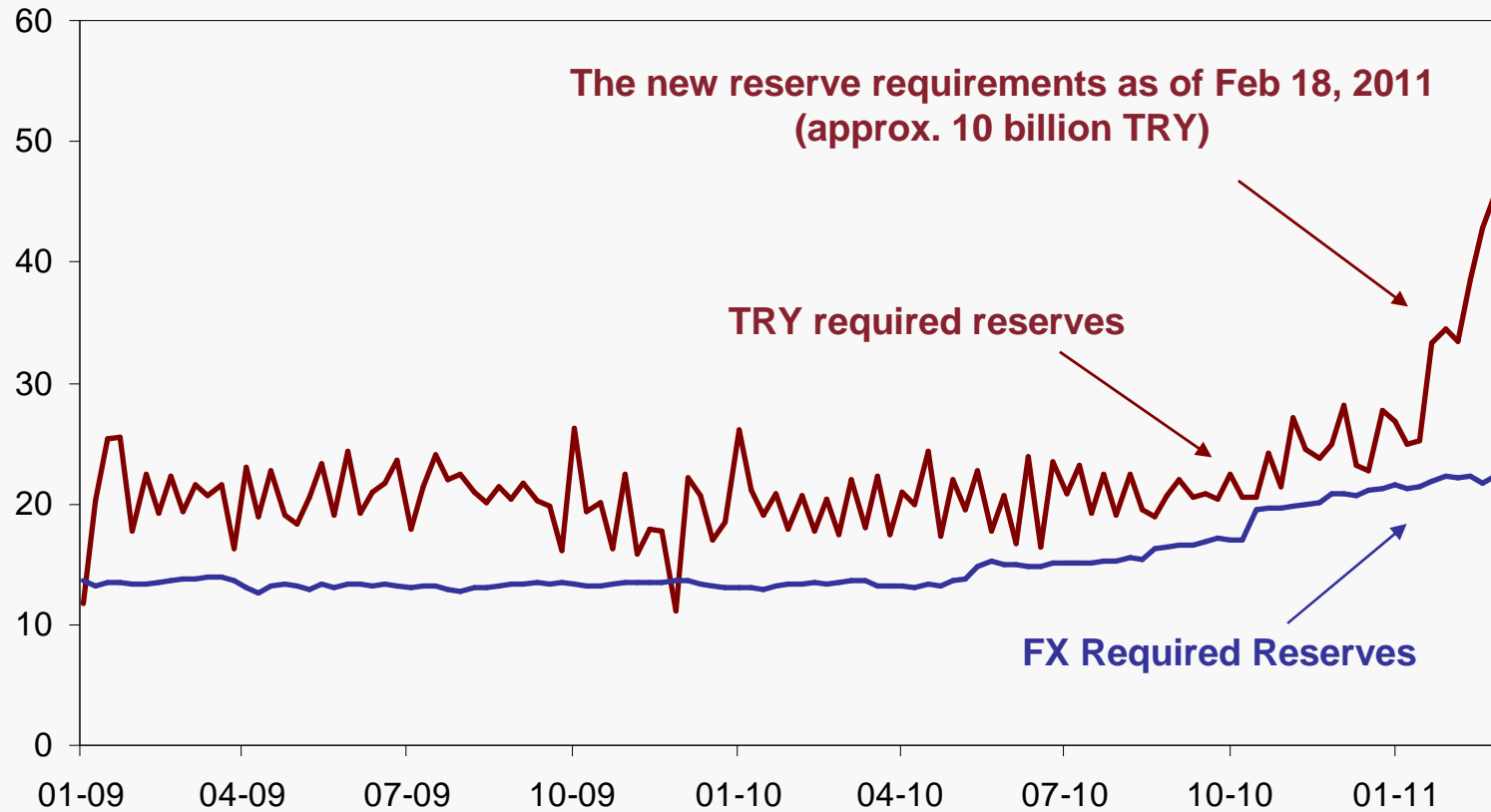
Source: Central Banks, CBRT

Measures by Other Authorities

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

Tightening the Liquidity

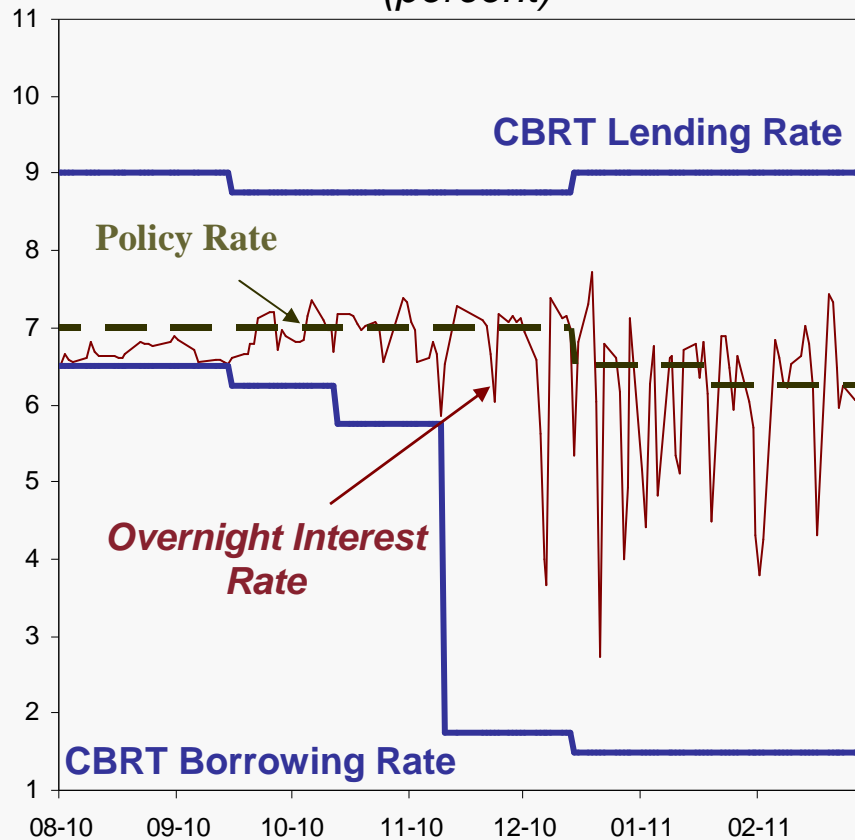
Reserve Requirements Balances
(billion TRY)



Source: CBRT

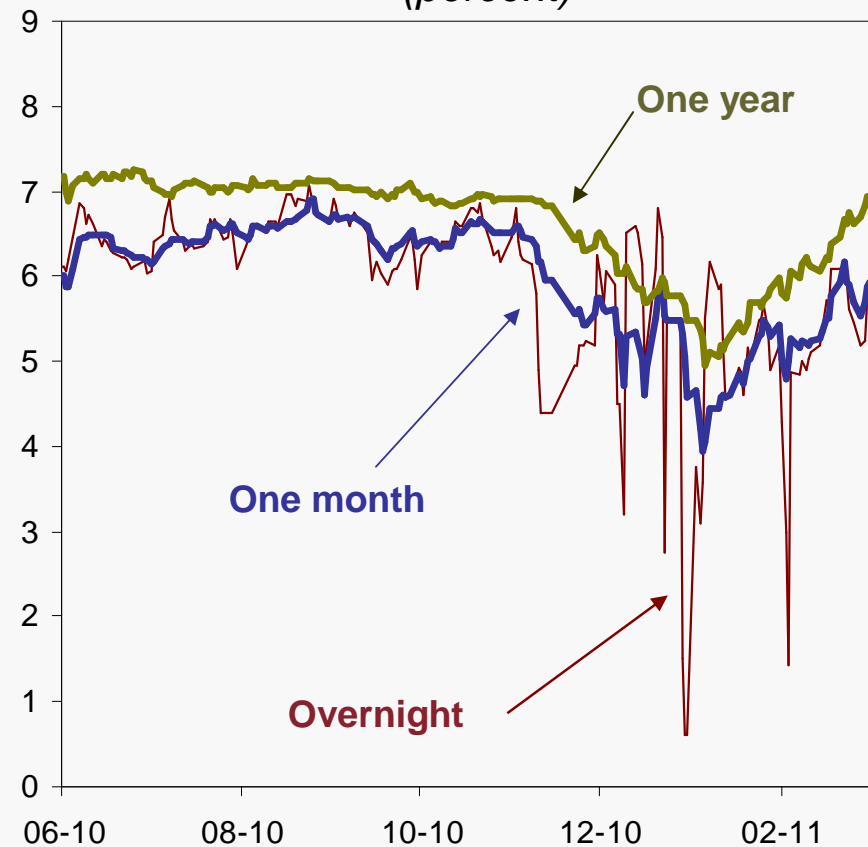
Volatility in Money Markets

Overnight Interest Rates (percent)



Source: ISE, CBRT

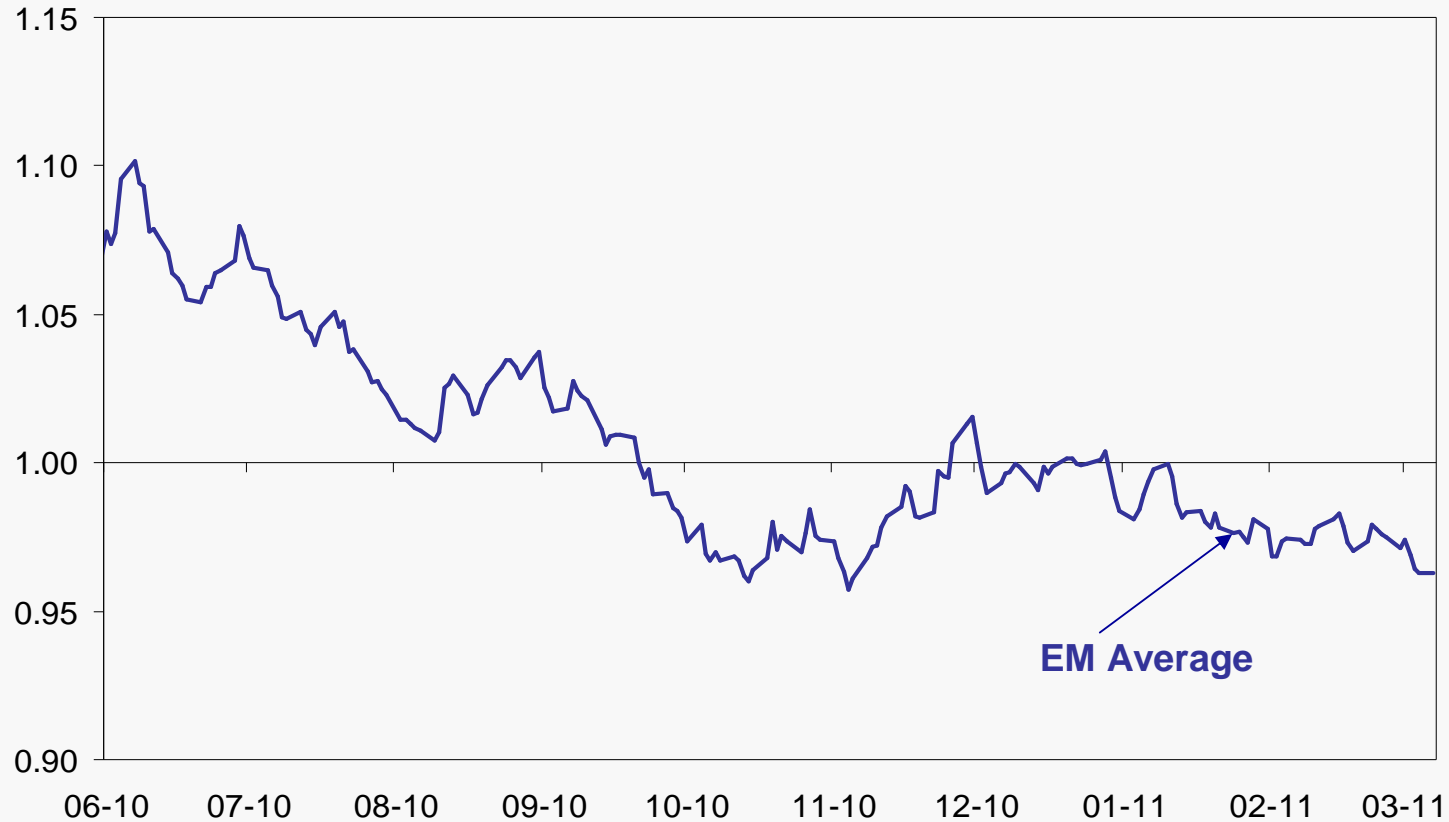
Swap Rates (percent)



Source: Reuters, CBRT

Appreciation Pressure

EM currencies against USD*
(4 Jan 2010=1)

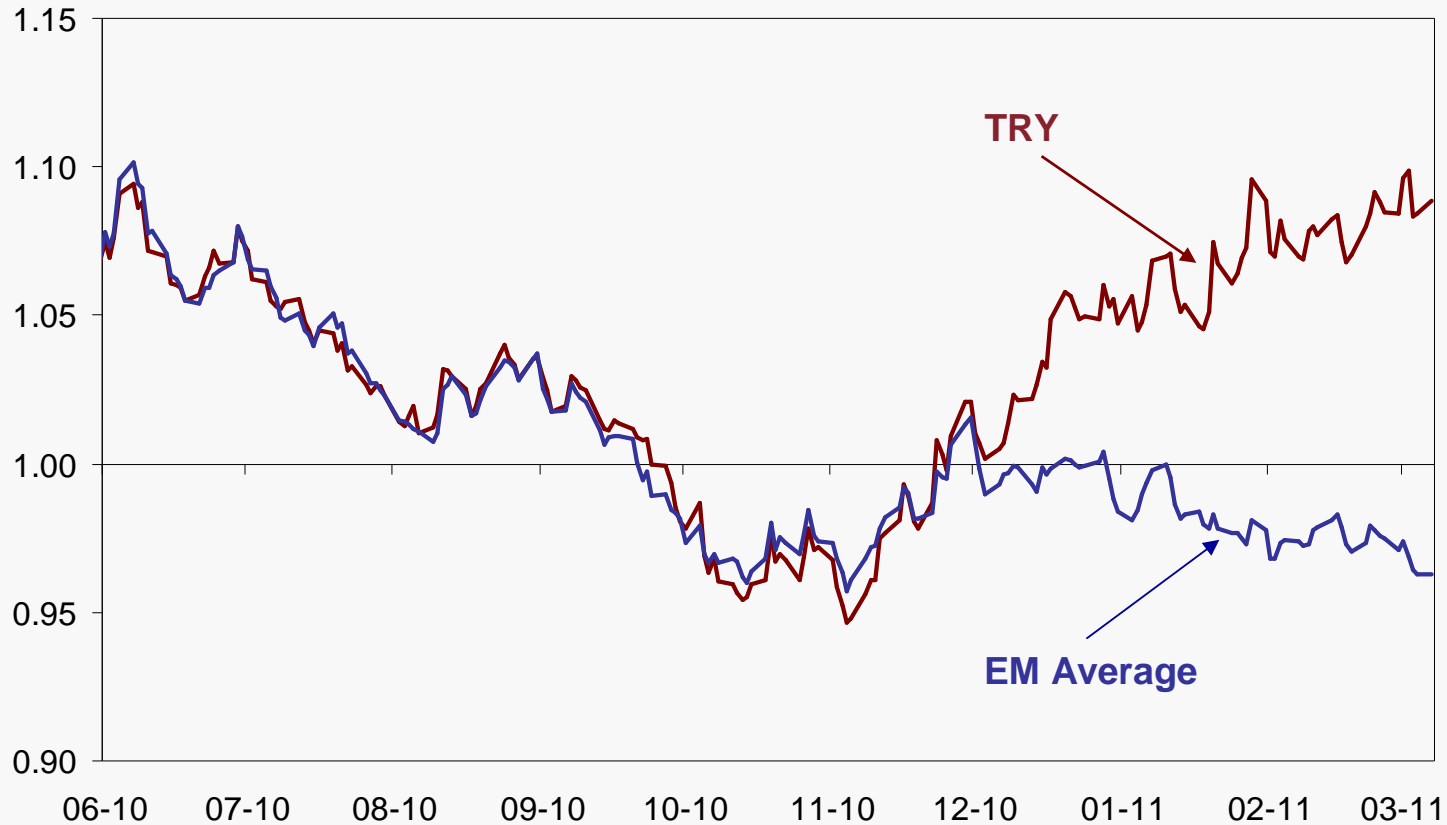


*Average of emerging market currencies, including Brazil, Chile, Czech Republic, Hungary, Mexico, Poland, South Africa, Indonesia, South Korea and Colombia.

Source: Bloomberg, CBRT

Initial Impact on Currency

TRY and other EM currencies against USD*
(4 Jan 2010=1)

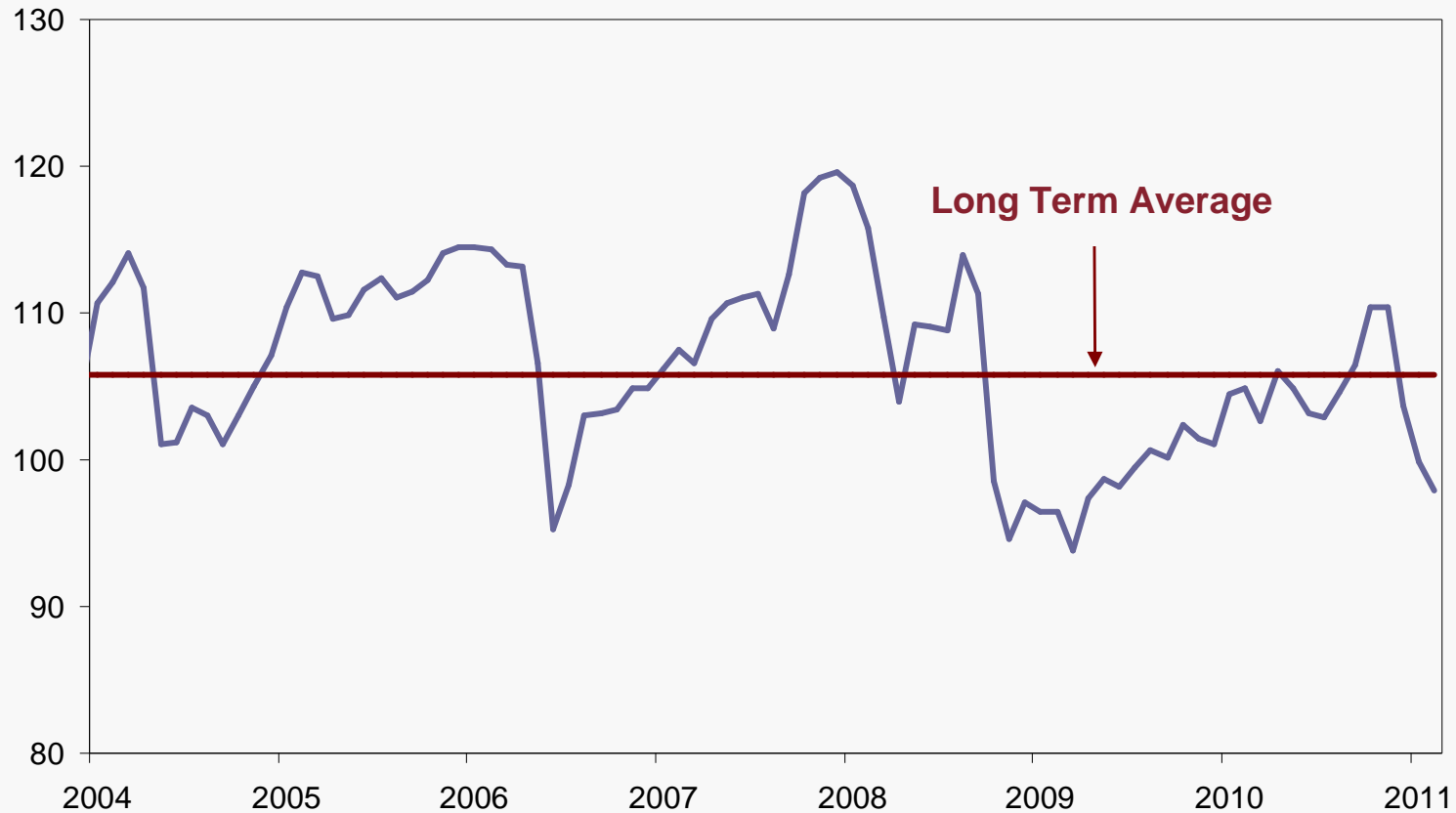


*Average of emerging market currencies, including Brazil, Chile, Czech Republic, Hungary, Mexico, Poland, South Africa, Indonesia, South Korea and Colombia.

Source: Bloomberg, CBRT

Initial Impact on Currency

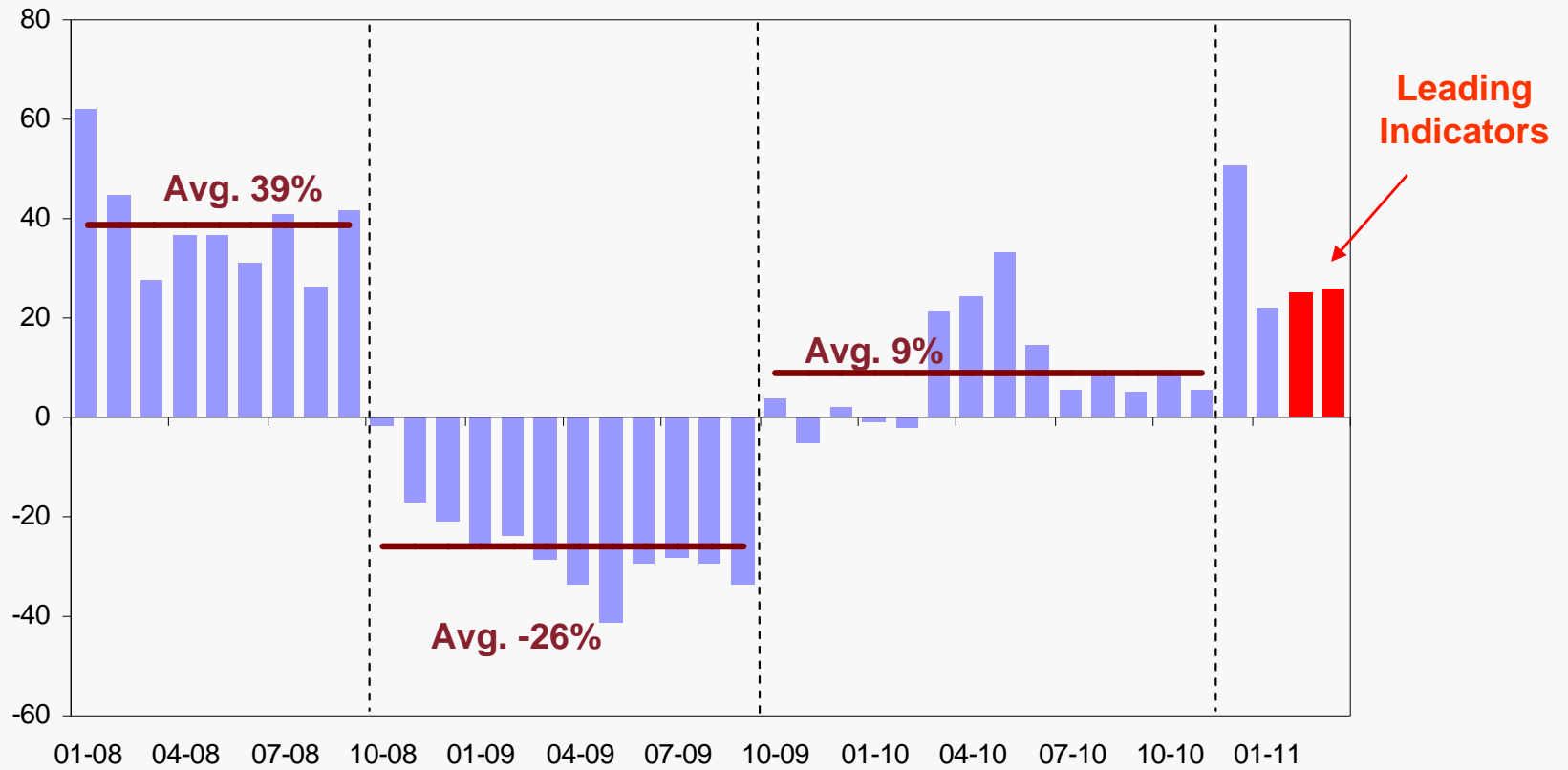
Real Effective Exchange Rate
(CPI-based, against developing countries, 2003=100)



Source: CBRT

Exports

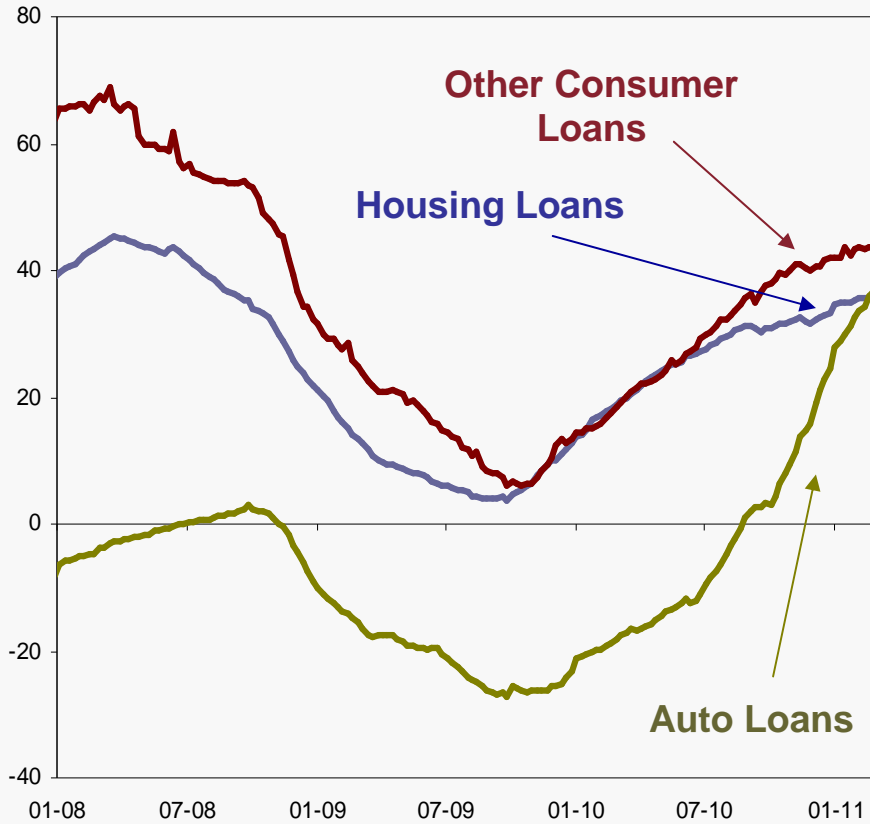
Goods Exports
(year-on-year percentage change)



Source: TurkStat, Turkish Exporters Assembly, CBRT

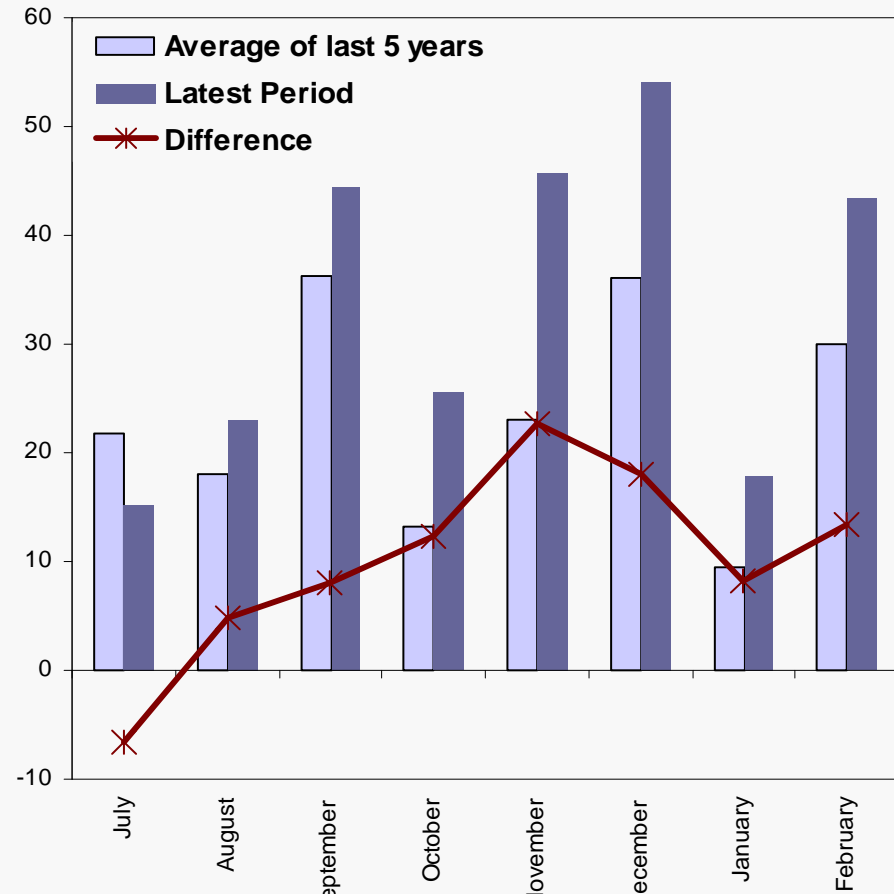
Credit Growth

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



Source: CBRT

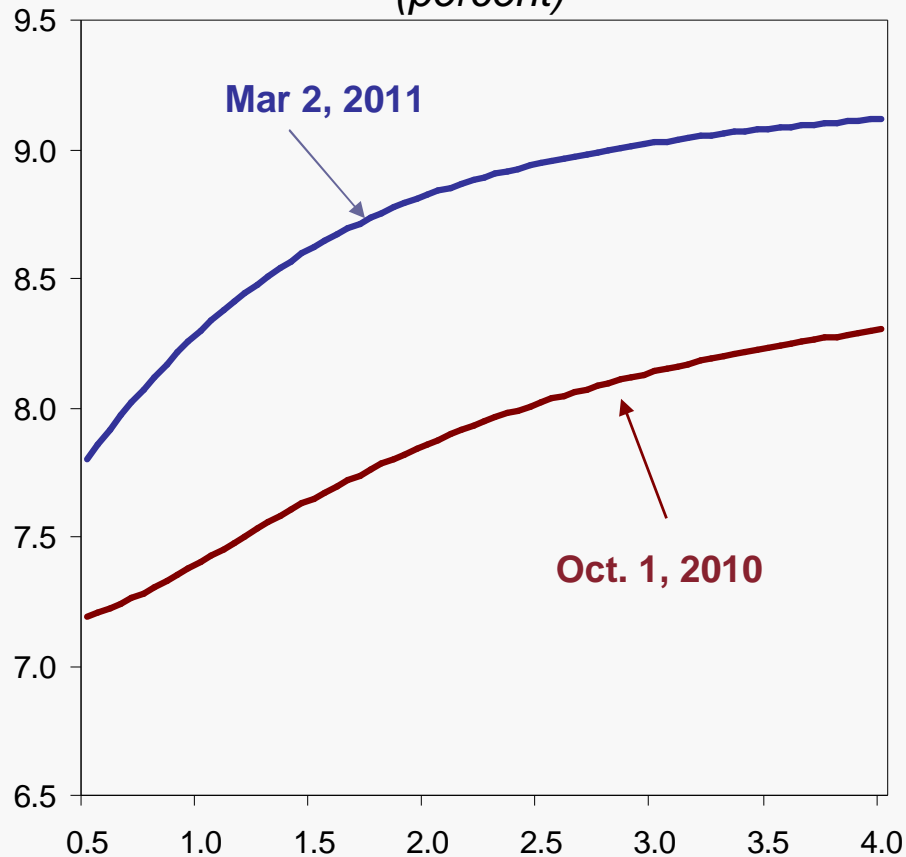
Total Loans
(annualized monthly change, percent)



Source: CBRT

QT and Inflation Expectations

Yield Curve*
(percent)



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

Inflation Expectations*
(percent)



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

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