International Journal of Economics, Commerce and Management
United Kingdom Vol. V, Issue 5, May 2017
http://ijecm.co.uk/ ISSN 2348 0386

TURKISH MONETARY POLICY STRUGGLE IN THE INFLATIONARY PROCESS

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Abstract

The targeting of foreign exchange in developed and developing countries during the 1980s and the failure of the monetary target to maintain price stability have led these countries to seek alternative monetary policy strategy. This approach, which was first implemented by New Zealand, has been preferred by many countries as a result of its performance. Turkey is quite eager to implement this approach after the experience of the failed stabilization policies until today. In this study, the applications of monetary policy in Turkey were discussed. In addition, the development and change of the aims and instruments of monetary policy were introduced in a historical process. In this study also, aims to discuss the action of the Turkish Central Bank, which sees the inflation targeting regime as the most effective means of ensuring price stability, in practice.

Keywords: Monetary Policy, Inflation, Financial Crisis, Inflation Targeting, Central Bank

INTRODUCTION

Many central banks throughout the world are running within the aim of price stability whether directly or indirectly. In terms of central banks whose main objective is to ensure price stability in order to improve the economic well-being, central bank independence is the most important institutional elements that were created in historical process (CBRT, 2012:1). In addition to providing price stability, the main duty of the central banks is to make contributions to other economic targets considering the price stability policies and is the concentration on inflationary trends that caused by the short and long term effects of monetary expansion’s being incompatible with each other with the attraction of government spending that is met by monetary expansion (Fischer 1995). In this respect, Central Bank of the Republic of Turkey (CBRT) is trying to reach the targets by using monetary policy tools. Considering both the domestic market price and the foreign exchange market in order to reach the target, CBRT aims to limit the sudden price changes that may occur.

By 1929 economic depression at that time the world is experiencing recession, the first law on the Central Bank of Turkey, the main task of the Central Bank was identified as supporting the country's economic development (Erkan 2003). Central banking in Turkey started in 1930 with the implementation of statist and protectionist policies all around the world. With the transition to export-led industrialization policy from the import-substituting industrialization policy that was put into effect in 1980, in the Central Bank's function a change and the process of modernization began.

The aim of this study is to examine the monetary policies that were implemented by and after the 5 April 1994 decisions and determine to what extend these policies were successful. In the first part of the study, the monetary policies that were implemented from 1995 period to 2008 global financial crisis were investigated. Especially the regime of the inflation targeting that was implemented after 2001 February crisis and the monetary policies after 2008 global crisis were the focus points of this study.

THE MONETARY POLICIES IMPLEMENTED IN TURKEY IN THE PERIOD OF 1994-2001 CRISIS

Turkey’s economy followed an unsteady progress between 1990-1993 with an approximate growth rate 6%. Increasing public deficits were financed through domestic borrowing and Central Bank resources. Making domestic debt even for the repayment of external debt has led to a sharp rise in interest rates. Financing from the Central Bank led to a progressive reduction of the foreign exchange reserves, while rising interest rates increased the entrance of hot money to the country and led to the appreciation of Turkish Liras (TL). As a result, in one hand it caused a reduction in the competitiveness in export and increment in import; on the other hand, it led the deterioration of external balance by increasing the foreign trade deficit (Erdem and Tuğcu 2013).

Policy makers reached an impasse in this period. When they want to barrow from abroad the interest rate were excessively increased as the required financing was not provided;

as a result, domestic banks have also turned to the lucrative and guaranteed debt securities instead of giving credit to the private sector. This has caused some difficulties in the real sector in providing financing.

On 5 April 1994, government has declared a package of new measures to reestablish the lost equilibrium and stability. In order to cut the foreign Exchange and to repay short-term debt in May 1994, it was forced to launch the 400% rate debt paper. As a result of efforts to reduce interest rates without balance correction a much higher rate jump in interest rates occurred (Karabıçak 2010). There should be measures to prevent attacks occurred in the financial markets; but, it has been seen that they are in the direction of reducing of the inflation rate and bring down market (Ertekin and Baştürk 2005).

In the period after the year crisis, 1994, although in the real exchange rate, a slight increase experienced in 1995, at the end of the 1995 it remained in lower rates in comparison to the end of 1993. After the November 1995 elections because of the arising political uncertainties, the presence of unstable coalition government and failure to implement tight fiscal policy, the main objective of the Central Bank was to ensure stability in the markets (Berument 2002).

1996 and 1997 are the years that short-term government came to power so stability in economic policy could not be achieved. The objective of monetary policy laid down in these years was determined as the prevention of and rapid price changes in the short term and the reduction of uncertainty in the market (Günal 2001).

The crisis experienced between 1997 and 1998 in the Russian economy and continued in Asia created difficulties also for Turkey's economy by adversely affecting goods and money markets. It has become increasingly difficult to control and sustain the public-sector finance deficit and high chronic inflation (Oktar and Dalyancı 2010).

At the end of 1999, Disinflation Program which was come into force in 2000 envisaged a tight fiscal policy, making of structural reforms, accelerating privatization, an implementation of income policy in compatible with target inflation and programming of monetary and currency in order to reduce the inflation (Kadıoğlu, Kotan and Şahinbeyoğlu 2001). In the program, currency basket for the first 18 months is targeted for the exchange rate policy; in the second 18 month, the implementation of gradually widening band basket was targeted (Altınok and Çetinkaya 2001).

The most important difference compared to the previous monetary policy implementation of this program; while Central Bank accepted all the currencies it did not sterilize the TL that is going to be released by the open market operations. CBRT has not received a decision on interest rates but he had agreed to fall due to inflation. In addition to lowering the reserve ratio from 8% to 6% he liquidity needs of the banking sector was met in this manner (Eren 2006). But when it comes to implementation, it is not possible to say that the planned steps are resulted in success. Every time, the opposite situation of the determined objectives have been realized.

The dollar's appreciation against all foreign currencies and dollarization has not been exceeded with failure to break the people's inflation expectations, increase never happened in foreign exchange reserve and therefore, desired decrease in interest rates could not be provided. Moreover, there are not being positive developments in the planned structural reforms and privatizations it has led to an excessive rise in the interest of Government Debt Securities (GDS) (Eren 2006).

After the excessive lost in GDS that are included in banks, the interest's rates raised excessively and the speculative attacks caused the November 2000 "march to dollar crisis" to start. The foreign Exchange reserves decreased in a great amount after the Central Bank's interventions (Karaçor 2006).

In this period, the interest rates were ascent, the due date was shortened, and as a result of this the balances of the banks were spoiled in a great amount. After the political tension on the 22nd of February 2001, the Turkish Liras was exposed to a serious attack and the payments locked the system. Thus, the Program of Decreasing Inflation in 2000-2002 was quit on the 22nd of February 2001 and then wavy currency was accepted (Eren 2006).

With the 4651-number law that was accepted on the 25th April of 2001, the Central Bank of the Republic of Turkey became an independent organization. Thus, the Central Bank has vehicle independence too. Another important change is that the central Bank cannot give advance to public institutions and organizations directly, and cannot take credits (Bakır 2006).

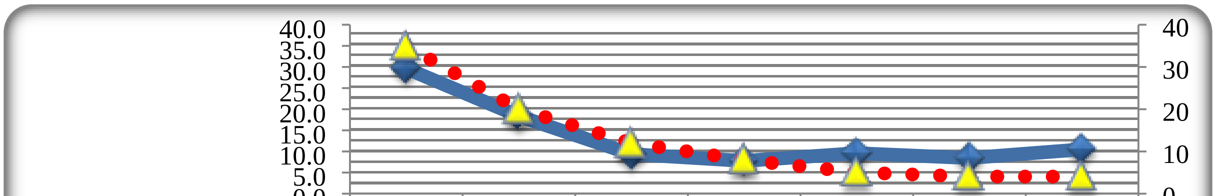
Implicit and Explicit Inflation Targeting (2002-2007)

Along with the economic crisis, in a country that macroeconomic balance was spoiled and trust to the economy policies was decreased; so, "Implicit Inflation Targeting" was put into practice in the beginning of the 2002 after the required preparations were completed (Coşkun 2009). Besides, the money basement was thought as an additional anchor near implicit inflation target. In this respect, short term interests that were used as basic political tools, were aimed to be used to reach inflation targets considering the values that the inflation can take in future. CBRT declared that if the required conditions are obtained, they planned to accept "Inflation Targeting" monetary policy (Erkan 2003).

It was seen that the implemented implicit inflation targeting became successful. In this period, the consumer's inflation stayed under the declared targets and the trust in monetary policy regained again. Significant decreases were seen in inflation and nominal interests, with financial discipline and out of interest policy the shortage in the balance of public finance balance was minimized, there were 100% increases in export besides the valuation of local money (Özeren 2012).

The inflation targets have never exceeded the expected levels throughout the period of implicit inflation targeting. Turkey's credit risk was decreased, the public debt was minimized in a great deal and the banking sector has become more reliable structure. So, these improvements were the signs of abolishing implicit structure. Moreover, the declaration of signing new stand-by treaty with IMF between 2005 and 2007, and EU reform period was on its way, social security and the reforms of taxes and financial service were on the agenda. All of these made easier to pass the explicit inflation targeting (Coşkun 2009).

Graph 1: The Inflation Rates between the Implicit and Explicit Inflation Periods



	2002	2003	2004	2005	2006	2007	2008
Realized Inflation	29.7	18.4	9.3	7.7	9.6	8.4	10.5
Targeted Inflation	35	20	12	8	5	4	4

Source: CBRT and Turkish Statistical Institute (TSI)

What a pity that the inflation targeting which was put into action with great expectations was not successful as the previous implicit inflation targeting. In the implementation period, inflation rates were always over the expected values. The target in 2006 was 5%, but it became 9,6; in 2007 the target was 4%, but it was 8,4; and in 2008, the inflation target was determined as 4%, but the realized inflation level became 10,5.

The Implemented Policies in the 2008 Global Crisis Period

However, the initial symptoms of the financial crisis were seen with the shortage of liquidity in the mortgage marketing in the USA, the marketing was shocked by a trust lost with the bankrupt of Lehman Brothers on the 15th September of 2008. Stock exchanges that cannot be ruled out collapsed and loaning between banks was stopped. The trust in financial market was decreased significantly (Soylu 2009). This case, in the developing countries, was resulted in the diminishing the export and minimizing the economy. The unemployment was increased immediately in the countries that were economically diminished (Somel 2009).

The financial crisis started in the developed counties, but from the middle of November 2008 it started to affect developing countries. In many developing countries, significant damage was seen in stock exchange, there were devaluation in money, the risk insurance premium was ascended and the foreign investment to these countries was diminished in a significant ratio (Erdönmez 2009).

In the last quarter of the 2008, economic policies were tried to put into practice to diminish the damage of the crisis in all countries. In this period, Turkey also moved in this direction and directed her monetary and economic policies. On the contrary to the movements that effected inflation negatively, CBRT started to diminish the interest rates and became pioneering among the rising marketing. It also took some precautions in order not to be seen the shortage of liquidity in financial system and credit marketing (Yılmaz 2009).

With these precautions in the first quarter of the 2009, there seemed to be a quick improvement in the expectations. The general acceptance of the durability of Turkey's financial system to crisis by economical units and temporary encouraging packets that were declared by the government and middle period program were very helpful for diminishing the indefiniteness and recovering of the marketing (Çınar, Erdoğan, Gürgür andTandoğan 2010).

The Implemented Monetary Policies after Global Crisis

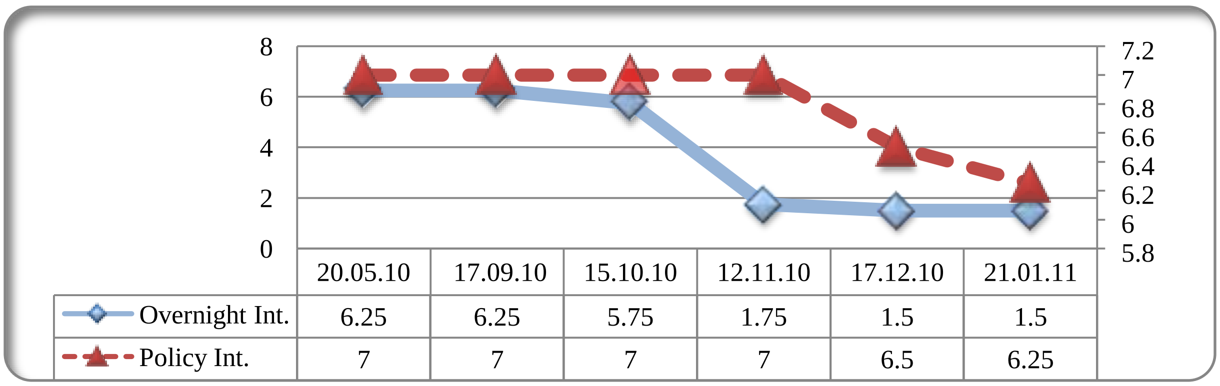
After the 2008 global financial crisis, the implications of expanding monetary policies of developed countries to diminish the damage of crisis on economic activities caused to accelerate of flow of capital to developing countries and a high volatility. Considering the sudden changes in the global risks, an implementation of a new monetary policy was agreed by CBRT that accepted both price and financial stability against the risks that were resulted in the corrupted current balance and the accelerated credit volume by billfold investment (Keleş, Kasapoğlu and Kocagöz 2013).

CBRT started to mention largely about the macro financial risks that arouse in the middle of 2010. Basically, two interval targets were defined: to minimize the short-term capital entrance and to slow down the ascending credit broadening. With this regard, in addition to political interests to continue financial stability without compensation to price stability, compulsory equivalency and the use of interest corridors as tools of active monetary policy were decided (Başçı and Kara 2011).

Within the framework of exit strategy, Central Bank raised the compulsory reserve requirement ratios in three times on 30th of April, 6th August and 23rd September 2010. Home Exchange ratio was increased 0,5 portion and the interest payments were ended in order to decrease the effectiveness of the required reserves. Furthermore, repurchasing agreement interests for a week was determined as "political interest" and the interest corridor system was maintained.

As a first step of the combination of policies, limiting of the waves in foreign exchange currency by deterring the short-term capital entrance and minimizing the macro financial risk were aimed. With this regard, the loaning interest per night was diminished 475 base point to the 1,5 % ratio; political interest was diminished 75 base point to the 6,25 % ratio. Beside these, increasing the indefiniteness by expanding the interest corridor and limiting the credit expenditure were aimed (Başçı and Kara 2011).

Graph 2: The Interest Rates of CBRT per Overnight and Policy Interest Rates



Source: CBRT

When coming to the middle of 2011, the global expenditure and with the deepening problems of public loaning especially in Euro region, the waves of the global risk appetite ascended to historical level. In this period, upon slowing down of capital flow towards the economies of the developing countries, CBRT narrowed the interest corridors by ascending the loaning interests per night and took some precautions in foreign exchange to limit the sudden stop in financing. Moreover, CBRT made moderate descent in political interest for the dullness of domestic economic activities (CBRT 2010).

In the last quarter of the 2011, the inflation made a sudden jump because of many negative elements and the year was completed at 10,5 level. So, it exceeded the expected formal target level of 5,5 (Kara 2012).

In the first half of the year CBRT continued the firm liquidity policy since the beginning of 2012. In the second half, after controlling the inflation, monetary policy took more supportive position progressively. In this regard, increasing the liquidity that was given to the marketing, short term interest was verified to follow near the bottom frontiers of the corridor (CBRT 2012).

After May period in 2013, the evident devaluation in Turkish liras effected inflation and inflation expectations negatively. CBRT, in order to limit the corruption of the inflation expectations and pricing behavior, took a firm position in monetary policy since the beginning of 2014. With the effect of macro deliberation precautions and taking firm position in monetary policy, a significant recovery was seen in the second half of the core inflation tendency (CBRT 2014).

Central Bank decreased gradually banks' borrowing from the Foreign Exchange Deposit Market Interest Rate in order to reduce uncertainty regarding global monetary policy since the end of 2014. It also showed a tight monetary policy stance since the beginning of 2014 to ensure the stability of inflation expectations and price. Since the beginning of 2015, the average funding rate gradually increased and the formation of the interest rate corridor on the upper band of the inter-bank overnight repo rate has been achieved (CBRT 2015).

DISCUSSION

Among the economy policies the place of the monetary policy is gaining more and more importance day by day. When looking at past, it is seen that monetary policy had such aims as price stabilization, exact employment, development and the balance of payment. Among these aims the price stability was one of the pioneering characteristics. In order to obtain price stability various monetary strategies had been implemented. However, because of the failure of foreign exchange currency and monetary targeting, inflation targeting was put into practice.

After the high inflation experience in the 90s, in order to decrease the chronical inflation, Central Bank of the Republic of Turkey started to implement implicit inflation targeting at the beginning of 2002 by accomplishing the required preparations at the end of the 2001. As a result of the implemented implicit inflation targeting, it was seen that Turkey's credit risk was decreased, the public debt was diminished in a great extent, and the banking sector became more healthy structure.

After the transition period called as implicit inflation targeting period, the regime of explicit inflation targeting was accepted. But, explicit inflation targeting was not as successful as implicit inflation targeting. In the implementation period the inflation rates were always over the expected levels.

In the process of 2008 financial crisis, some important differences were seen in the monetary policy implementations. One of the most important differences was seen that CBRT should also provide financial stability besides price stability. So, since April of 2010, two different monetary policies have been implemented as the compulsory equivalency ratio and interest corridor besides political interest that is for financial stability.

In monetary policy it is possible to say that the stability is obtained by inflation targeting. However, in long term, it can be said that monetary policy itself is not enough or insufficient to provide price stability. So, besides the monetary policy implementation, tighter fiscal policy, tighter income policy, foreign exchange currency policy and the continuity of the harmony between government and CBRT are of great importance.

It can be said that the application of the inflation targeting regime and the information gained from the experience of the countries applying the regime will not be effective in the inflation targeting regime in Turkey. From all these, it can be said that a comprehensive reform of the financial sector is needed to strengthen the financial system and reduce the financial burden in order to be able to target inflation in Turkey. In other words, if this reform is done, the conditions necessary for the transition to inflation target in Turkey will be met and there will be no obstacle to the inflation targeting.

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