



**SCREENING CHAPTER 17
ECONOMIC AND MONETARY POLICY**

**AGENDA ITEM II:
MONETARY POLICY**

**Country Session: The Republic of TURKEY
23 March 2006**



MONETARY POLICY FRAMEWORK

(2002-2005 Period)
Preparation to Inflation Targeting Regime



Implicit Inflation Targeting

From January 2006

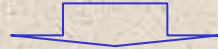


Fully-Fledged Inflation Targeting



MAIN POLICY INSTRUMENTS

Short-term interest rates



How are decisions made? \Rightarrow Based on inflation outlook only
All that matters is inflation target vs. inflation estimate.

Which factors are observed while forecasting future inflation?



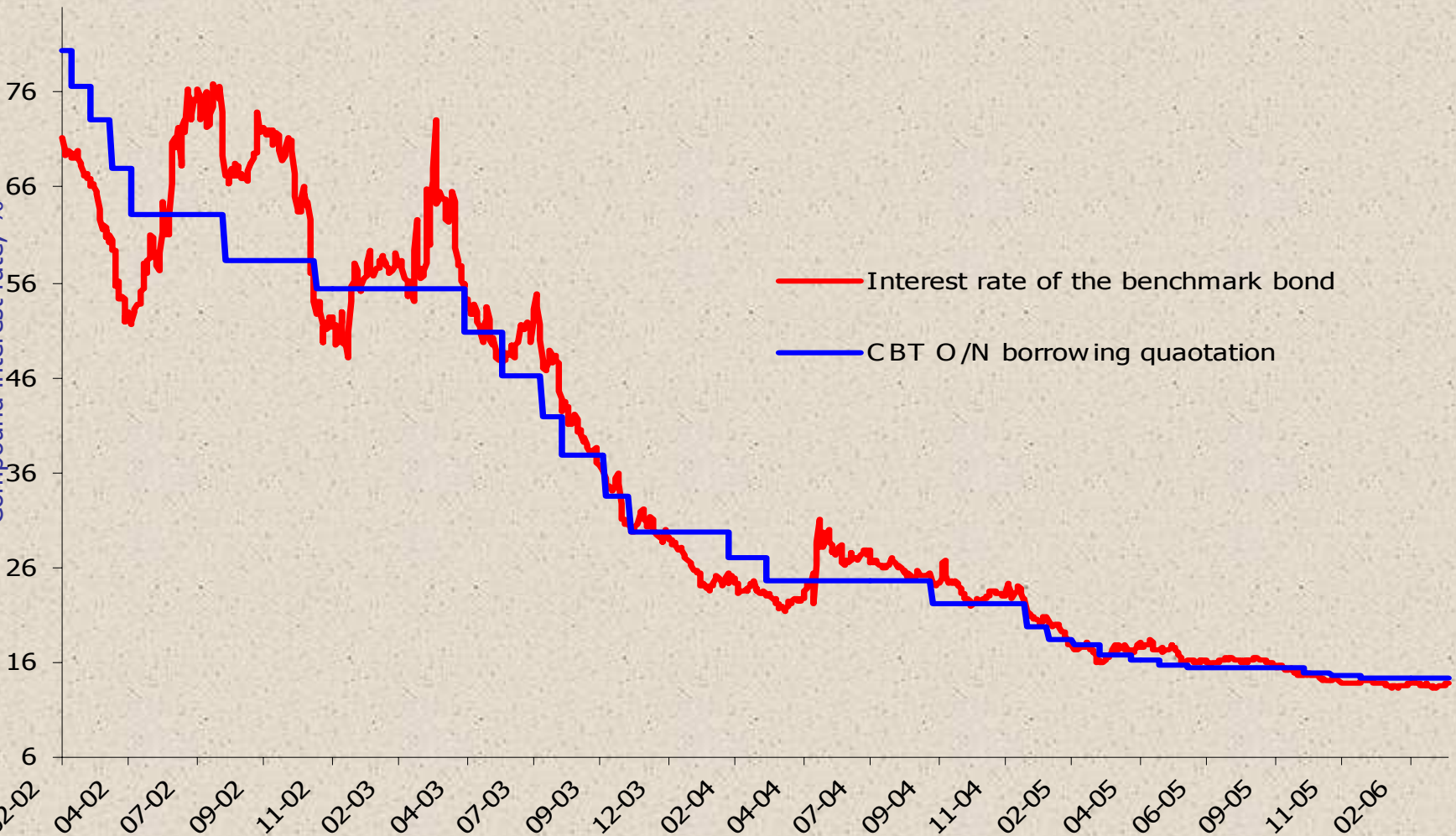
Comprehensive information set

- ✓ Aggregate supply and demand; fiscal policy indicators, monetary and credit aggregates
- ✓ Inflation expectation surveys and CBRT's internal inflation forecasts
- ✓ Wages, employment and unit labor costs, productivity
- ✓ Pricing behaviour of public and private sectors
- ✓ Exchange rates and balance of payments
- ✓ External economic developments

In this framework, consistent with the inflation target and forecasts, the Central Bank of the Republic of Turkey (CBRT) may reduce, raise or leave the interest rates unchanged



INTEREST RATES



Source: CBRT



INFLATION OUTLOOK AND INTEREST RATE DECISIONS

O/N rate cuts [increases] convey some key messages:

- Optimistic [cautious] stance of the CBRT regarding the attainability of targets
- Signals to economic agents
 - “We are on the right track...” [“There are perceivable risks that might jeopardize the targets...”]



PRIMARY OBJECTIVE: PRICE STABILITY

The primary objective of the Central Bank is to achieve and maintain
price stability

Inflation Target set by



CBRT + Government

Design and practice of
the monetary policy by



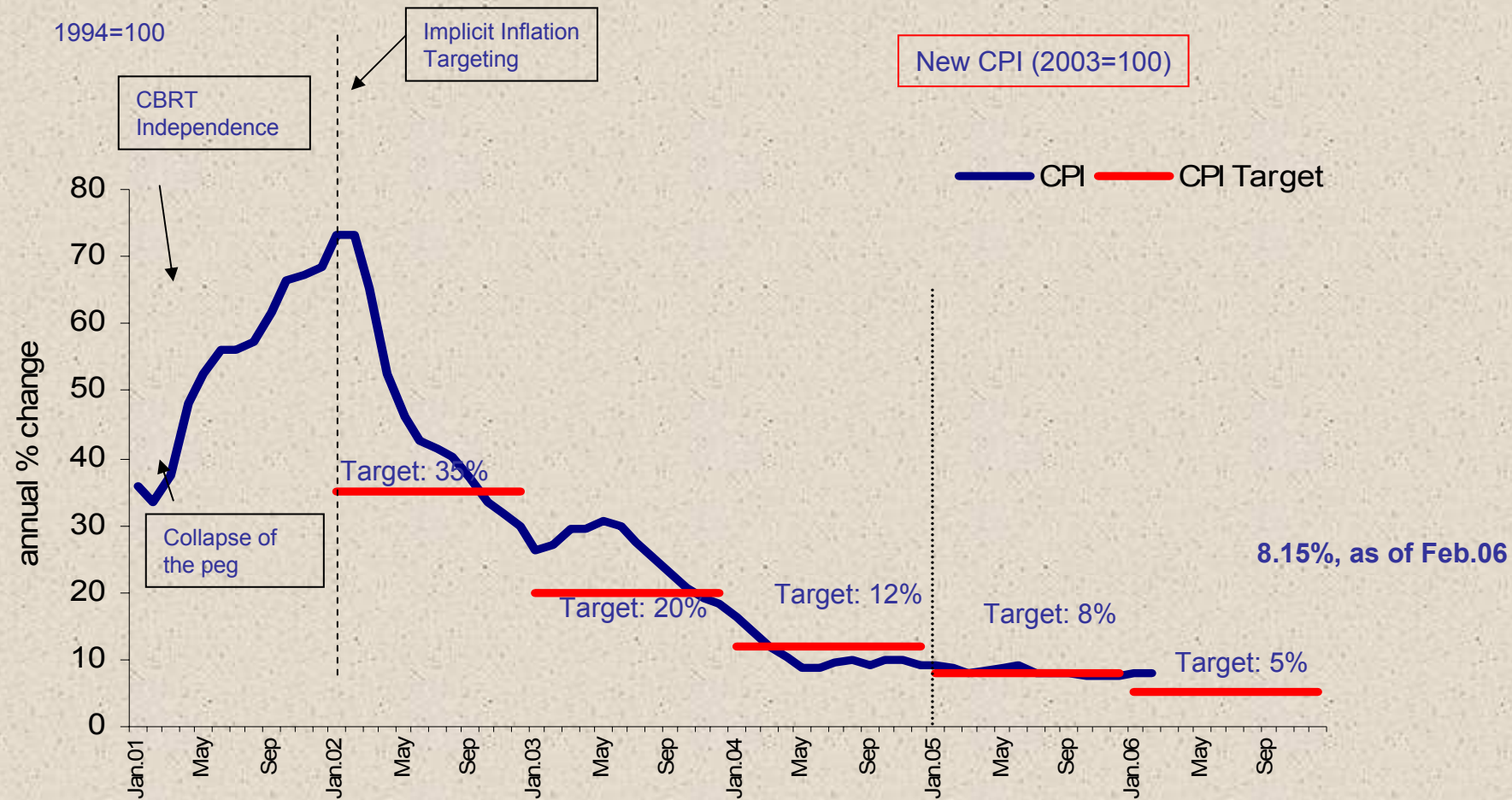
CBRT only

Price stability...

- 1st stage [transitory stage]: reducing inflation rate to lower levels (disinflation) ~2001-2005
- 2nd stage [perpetual stage]: maintaining a stable (i.e. horizontal) target ~2006 onwards
- Inflation rate onwards will converge to **Maastricht criteria** (Inflation rate (Harmonised Index of Consumer Prices-HICP) cannot exceed the average of the three best performing countries more than 1.5 percentage points)



INFLATION AT A GLANCE



Source: TURKSTAT



FLOATING EXCHANGE RATE REGIME

Difference from ERM II



Committed to the floating exchange rate regime

✓ **The choice of the exchange rate regime is made jointly with the Government**

✓ **Exchange rate policy implementation is the responsibility of the CBRT**



FLOATING EXCHANGE RATE REGIME THE CBRT's EXCHANGE RATE POLICY

I – Intervening against Excessive Volatility



- ✓ To prevent excessive volatility on either side
- ✓ Depending on the assessment of the volatility
- ✓ Announcements and warnings

II – Foreign Exchange Purchases with a view to Reserve Build-Up



- ✓ Through **sterilizing excess foreign exchange supply** led by capital inflows and portfolio switch to YTL
- ✓ Aim is not to affect the level of the exchange rate; mechanism consistent with the floating exchange rate regime
- ✓ Using **transparent** methods



THE NEW TURKISH LIRA

Six zeros was dropped from the Turkish lira and the New Turkish Lira has been introduced as of 1 January 2005



Dropping six zeros from the Turkish lira has been an indicator of the determination in bringing inflation to single-digit figures.



THANK YOU FOR YOUR ATTENTION