

Central Bank Monetary Policy Framework

Structural Changes After the 2001 Crisis

The 2001 crisis was a turning point for the Turkish economy, bringing about structural transformation efforts in numerous areas in the post-crisis period. These measures resulted in the following changes:

a. Floating Exchange Rate Regime

The first change in the post-crisis period was the termination of the exchange rate-based stability program. This program was replaced by the floating exchange rate regime on 22 February 2001 with a joint decision of the Central Bank and the Government.

b. Program of Transition to a Strong Economy

Another development during this period was the adoption of the Program of Transition to a Strong Economy in May 2001. The main objectives of this program were to:

- Introduce measures in the banking sector,
- Ensure fiscal discipline,
- Implement structural reforms,
- Effectively use macroeconomic policies in the fight against inflation,
- Create a sustainable growth environment.

c. Amendment to the CBRT Law

Another important step taken after the crisis was the amendment to the Central Bank Law in May 2001. According to the amended law:

- The primary objective of the Central Bank was set as to achieve and maintain price stability,
- The Bank was tasked with taking the necessary measures to achieve price stability,
- It was stipulated that the Central Bank would support the growth and employment policies of the Government provided that they did not conflict with the price stability objective,
- The Central Bank was vested with the authority to implement monetary policy in Turkey,
- The Central Bank was granted the right to determine at its own discretion the monetary policy instruments it would use (instrument independence),
- Bank financing of the deficits of the Treasury and other public institutions was legally terminated,
- To institutionalize the decision-making mechanism in monetary policy, the Monetary Policy Committee (MPC) was established,
- As a consequence of the independence entrusted to it, the Central Bank also became accountable.

1. Implicit Inflation Targeting Period (2002-2005)

With an announcement in 2002, the Central Bank stated that the ultimate objective of the

monetary policy was to move to inflation targeting.

Between 2002 and 2005, the Bank took steps to remove the factors restricting the effectiveness of monetary policy and ensured the necessary preconditions. The monetary policy practice in this transition period is named the “Implicit Inflation Targeting Regime”. Under this regime, the following steps were taken:

a. Money Base

Inflation targets were determined jointly with the Government on an annual basis. On the other hand, the “Money Base”, the target monetary aggregate, was also defined as an additional anchor. Accordingly, periodic Money Base Targets were set in consistence with the inflation target.

b. Transition to the New Turkish Lira (Money Reform):

Another important step was the transition to the New Turkish lira in 2005 with the removal of 6 zeros from the Turkish lira. This Money Reform was also an indicator of the confidence in the sustainability of the achievements reached.

c. Changes by the Turkish Statistical Institute (TURKSTAT):

In the 2002-2005 period, fundamental changes were made in TURKSTAT’s price indices.

2. Inflation Targeting Period (2006)

On the back of the success achieved in the disinflation process between 2002 and 2005, the Central Bank was convinced that the necessary preconditions were attained. Consequently, the Inflation Targeting Regime was adopted as of 2006.

a. Inflation Targets

During this period, the Central Bank set point inflation targets to facilitate the communication of the inflation targeting regime, and decided to use as its inflation target the year-end inflation rate that is calculated as the year-on-year percentage change of the consumer price index (CPI). It was agreed that the CBRT and the Government jointly determine and announce the inflation targets to be attained over the next three years.

b. Accountability Mechanism

Due to factors beyond the control of monetary policy, the probability of fluctuation in inflation is high, while the probability of inflation rates exactly meeting the point target is very low.

Therefore, an uncertainty band of 2 percentage points has been formulated around the inflation target in either direction. This uncertainty band is also instrumental in terms of the functioning of the accountability mechanism.

Under Article 42 of the Central Bank Law, in case of a deviation or a probability of a deviation from inflation targets, the Bank is obliged to inform the Government and the public of the reasons for the deviation and the measures to be taken.

c. Monetary Policy Committee (MPC)

In the inflation targeting regime, the MPC continued to meet on a monthly basis according to a pre-announced schedule.

Unlike the previous implicit inflation targeting period, the MPC started making its interest rate

decisions through a voting procedure at the meeting, and announcing these decisions, along with their rationale, on the same day.

In other words, the role of the MPC in monetary policy decisions changed from an advisor to a decision-maker.

3. Monetary Policy After the Global Crisis (Post-2010 Period)

The global financial crisis in the 2008-2009 period hit both the emerging and advanced economies significantly. One of the lessons learnt from the global crisis was that ignoring financial stability might threaten macroeconomic stability and price stability in the medium and long term. These global conditions led central banks to seek alternative policies.

a. New Monetary Policy

As of end-2010, to contain the adverse effects of the global crisis, the Central Bank of the Republic of Turkey also devised a new unconventional monetary policy that would respond to shocks. Accordingly, the inflation targeting regime implemented since 2006 was enhanced to safeguard financial stability as well. Through this revision, the Central Bank introduced into the existing regime an asymmetric and wide corridor system in which more than one interest rate is used as an instrument, and a flexible framework based on an active liquidity policy.

b. New Policy Instruments

The CBRT also diversified its policy instruments in this period. Thus, using instruments such as required reserves and the Reserve Options Mechanism, the Bank took steps towards ensuring financial stability without prejudice to price stability.

c. Adjustments in the Wide Interest Rate Corridor

Although the wide interest rate corridor used by the Central Bank has contributed to reducing the volatility in capital movements during the period of increased global uncertainty, it also involves some problems with respect to the understanding of the monetary policy stance. In the conventional monetary policy, the policy rate determines the monetary policy stance whereas in the wide interest rate corridor, the monetary policy stance is contingent on different funding rates. This makes it difficult to understand the monetary policy stance. Due to these factors and considering its contribution to the effective functioning of the monetary transmission mechanism, the upper bound of the interest rate corridor (the CBRT overnight lending rate) was gradually reduced by a total of 250 basis points in the March-September 2016 period.

Thus, the monetary policy was simplified in 2016 and rendered a more clearly perceived framework. Additionally, structural factors hindering permanently low inflation were identified, and increased public awareness of this issue was set as an aim.

In the framework of the duties assigned to it in law, the Central Bank continues to contribute to a balanced and sustainable growth process in the Turkish economy, in view of the price stability objective and by safeguarding financial stability. In this respect, the Bank duly uses its monetary and liquidity policies for disinflation purposes when needed.

4. Communication Policy of the Central Bank

MPC announcements and quarterly Inflation Reports are the main communication tools of the Central Bank's monetary policy.

a. MPC Meetings and Announcements

As per the Central Bank Law, MPC meetings are held at least eight times a year. It was planned that a total of twelve meetings would be held in 2021 on a pre-announced **schedule**.

The monetary policy decision and its rationale are announced at 2:00 p.m. immediately after the meeting, and the summary of the meeting including the assessments of the MPC is published on the website of the Bank within 5 working days.

b. Reports and Other Announcements

Monthly Price Developments Report published following the release of inflation data, and the Financial Stability Report that includes detailed analyses of the financial system are also important components of the Central Bank's communication policy.

Press releases on the monetary and exchange rate policy framework also have a significant role in the Bank's communication.

c. Presentations by the Central Bank

The public is also informed of the Central Bank's activities and monetary policy implementations via presentations delivered by the Governor at the Council of Ministers, the Budget and Planning Commission of the Grand National Assembly of Turkey, and other platforms.

d. Changes in the Communication Policy

The Central Bank made some revisions in its communication policy in 2016 to meet the information requests from different target groups and enhance its communication with the public. Accordingly, the following changes were introduced:

- Arranging regular meetings with real sector representatives and financial institutions,
- Increasing the number and scope of technical meetings with investors and analysts,
- More actively using social media channels in line with the technological developments in the field of communication,
- Opening the CBRT Blog to enable the Central Bank staff to share their views with the public, open these views to discussion and contribute to the economic agenda.

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