MONETARY POLICY UNDER STRESS

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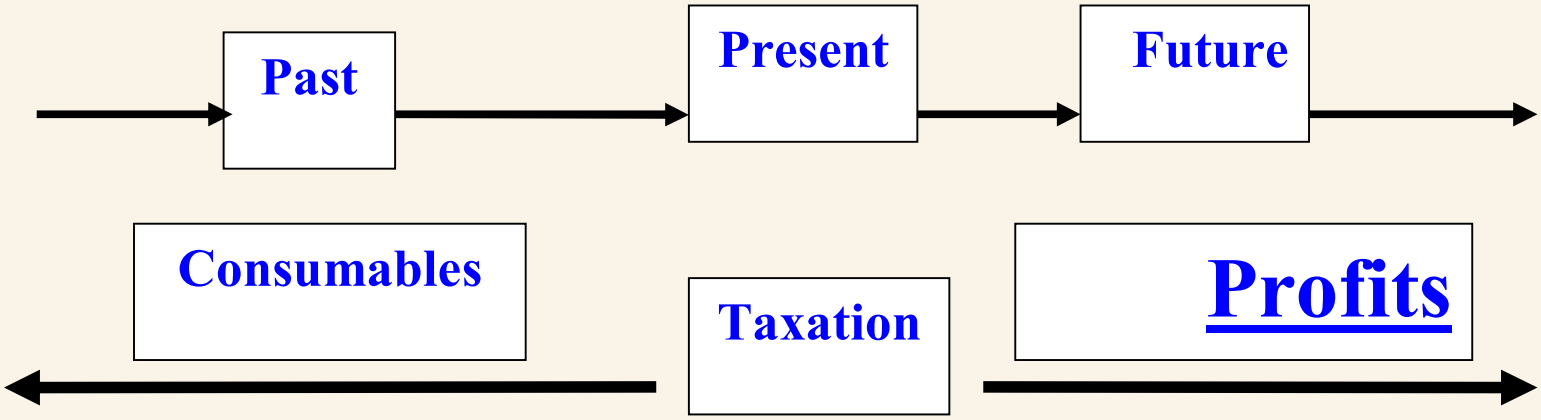
Why do we Need Money?

a. Money is one of the most important invention similar to wheel and fire
b. Empowers division of labour
c. Without a unit of account, trade is very limited because of costs of information.
d. Meltzer (1998):
    a. "n commodities ➔ (n(n-1))/2 number of bilateral exchange ratios (prices).
    b. n = 100 commodities➔ 4,950 prices
    c. n = 500 ➔ 124,750
    d. n = 1,000 ➔ 499,500 prices.
e. With money; number of prices is not (n (n-1)) / 2; **but n**...

What Backs Fiat Money?

Money is recently fiat: Does not have a backing such as gold.

Spectrum of Money may be illustrated as:



For the past, money represents total goods and services consumed.

For the present, taxation is deducted from the consumption.

For the future, money is backed by profit generating productivity supported by entrepreneurial skills. Backing is relative and strength of different monies competes contemporaneously.

Measure of strong money backing is sustainable price stability.

What Weakens Money? Knowns and Unknowns

WEAKENS

Inflation

Financial Instability

Fiscal Imbalances

External Imbalances

Dollarisation

Contagious (external)

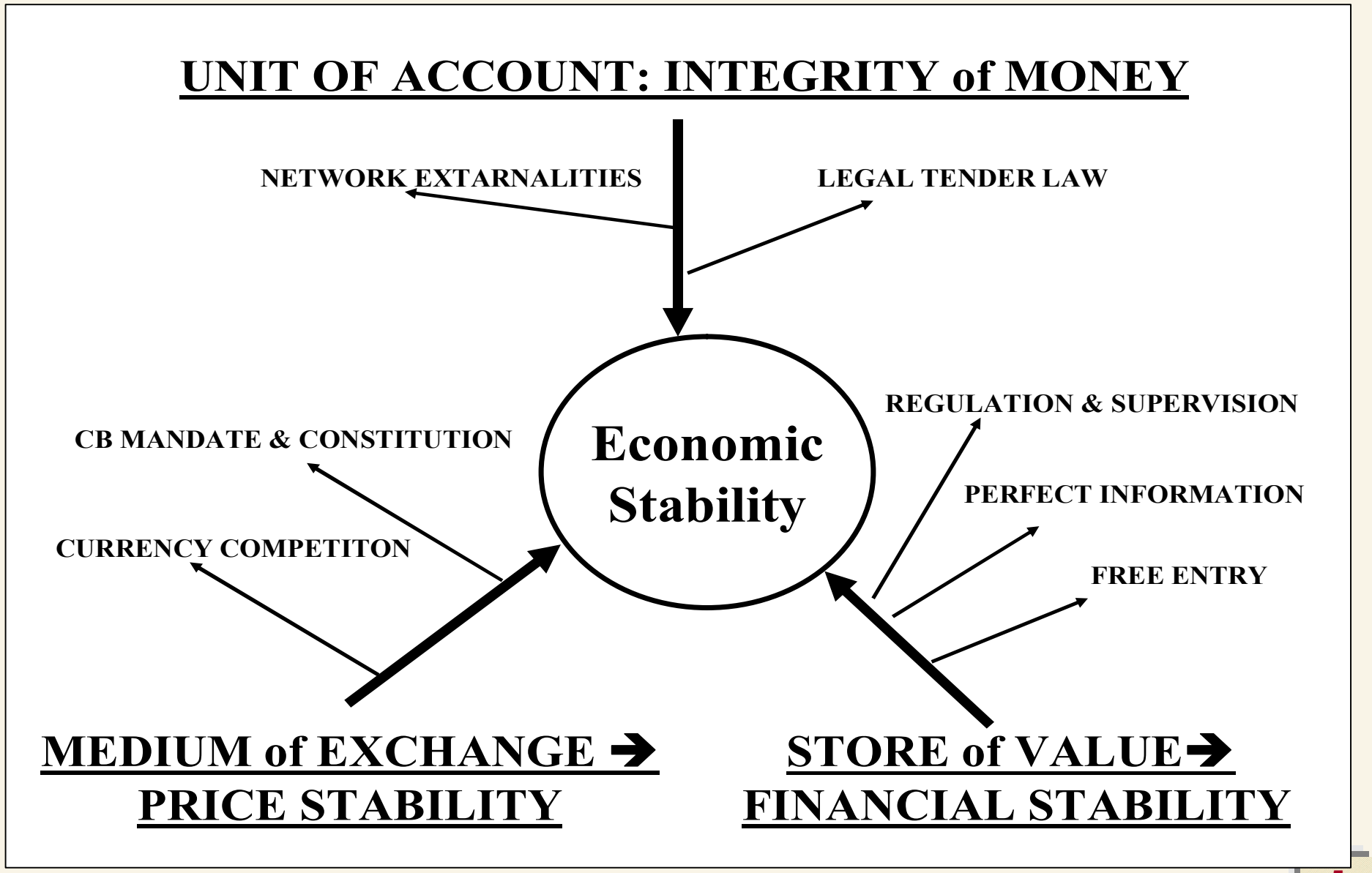
KNOWNS

- Unit of Account
- Medium of Exchange
- Store of Value
- Legal Tender,
- Core to Transmission

UNKNOWNS

- Dollarisation
- Globalised payment instruments and financial services
- Currency Competition
- E-money

Social Function of Central Banking



Central Banking in Retrospect

Central Banks	Law Enactment	Banknote Issue Right	Lender of Last Resort
Sverige Riksbank	1668	1897	1890
Bank of England	1694	1844	1870
Banque de France	1800	1848	1880
Bank of Finland	1811	1886	1890
De Nederlandsche Bank	1814	1863	1870
Austrian Central Bank	1816	1816	1870
Noerges Bank	1816	1818	1890
Danmarks Nationalbank	1818	1818	1880
Banco de Portugal	1846	1888	1870
Belgian National Bank	1850	1850	1850
Banco de Espana	1874	1874	1910
Banco de Espana	1874	1874	1910
Reichsbank	1876	1876	1880
Bank of Japan	1882	1883	1890
Bank D'italia	1893	1926	1900
TCMB	1930	1930	2002

Source: Bank of England

1. Relatively new institutions in practice.
2. Number increased after 1800. Peaked recently.
3. Private institutions in the early stages. Nationalized after 1900.

Central Banking in Retrospect

Number of Central Banks	
1900	18
1910	20
1920	23
1930	34
1940	41
1950	59
1960	80
1970	108
1980	137
1990	161
Source: Bank of England	

Central banking is sort of 20th Century Phenomenon!

What backs Central Banking?

a. A clear mandate for price stability; growth is conditional. Why? (Public aggrement is a must)
b. Sustainable Financial stability enabling regulation and supervision. Internal or outsourced?
c. Remit. (Fiscal rule)
d. Structural reforms to prevent external unsustainabilities
e. Optimal Operational Framework to prevent dollarization
f. Complementary economic policy to disable contagious
g. An efficient and effective payment system infrastructure
h. Capital and money market indepthness
i. Strongest economic analysis skills to challenge any alternative views on the economic outlook

Contestable Central Banking

a. Too many monies as all countries want one.
b. Monetary Unions already here with us
c. Dollar bloc, Euro bloc, Yen Bloc
d. Does globalisation of trade and finance need a global money? No, at least up to now… And the future?
e. Global financial institutions and global lender of last resort?
f. Coordinated monetary policy and complementary monetary policy operations: Swaps now, what is next?
g. Commodity money: Can oil or gold back money?

Future of Central Banking?

a. Number of monies peaked ➔ more monetary unions: What about Greece, Spain or Portugal case?
b. There is a need for a global lender of last resort but how? Some sort of guarantee from the biggest central banks. Why? To distribute unlimited credit…
c. More coordination on monetary policy operations: Instant credit lines or supplementary credit facilities
d. Increasing importance of economic analysis.
e. Transperancy and accountability both to the Parliament and to the Public.

Cental Bank of Turkey

a. Not among the best measured with inflation record
b. Experienced extreme central banking during 1980s and 1990s
c. Had many financial crises: 1983, 1989, 1994, 2001.
d. Learned from mistakes especially after the 2001 crisis.
e. Now an independent central bank with a clear mandate for price stability. No primary public sector credits.
f. Has an efficient and effective operation tool-kit
g. An inflation targeter
h. Managed to increase credibility during the latest global crises with pre-emptive interest rate strategies.

Monetary Policy Framework (1986-1990)

1986-1990 Marketisation

a. Liberalistion of the economy.

b. Liberal banking system without deposit and credit rate floor or ceeling.

c. Two-tier banking system.

d. Closed economy: Capital Controls and exchange rate targeting.

a. Open Market Operations, capital and money market establishment.

b. Treasury Borrowing system: Bonds and bills market.

c. Foreign Exchange and Banknote Market.

d. Reserve Management.

e. Gold Market.

Monetary Policy Framework (1989-1993)

1989-1993
Capital Account Liberalisation and Monetary Targeting

a. Open economy.
b. No Interest rate and exchange rate controls.
c. More controls on the budget with the memorandum of understandings for the short-term advance limitations.
d. Blind Brokerage on the money markets

a. 1989 Implicit Monetary Targeting
b. 1990 Explicit Monetary Targeting
c. Success until 1993 to achieve targets but failure to control inflation
d. No hyperinflation
e. Money and inflation: Complex relations and measurement errors.
f. Collapse of MoU in 1993, back to advances…

Monetary Policy Framework (1994-1999)

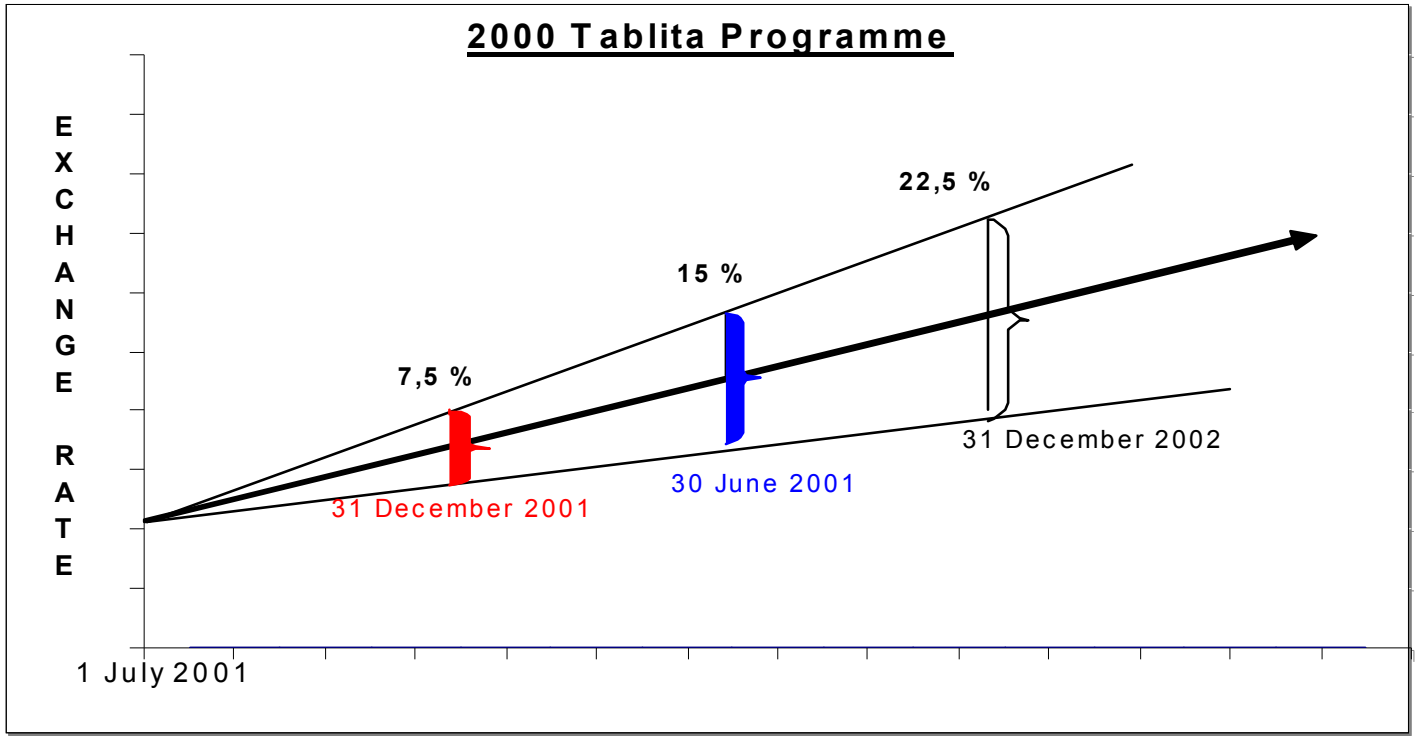
1994-1999 Real Exchange Rate and Financial Stability Targeting

a. Loss of Confidence and Financial Crisis in 1994.
b. Terrible Earthquake in 1998.
c. Mexican, Far East and Russian crises.
d. Heightened political risk and lack of a credible economic stability program.
e. IMF comes and goes: Failure by failure
f. Customs Union with Europe without Convergence Fund Support.

a. Try to achieve real exchange rate stability.
b. Prioritize financial stability.
c. Prevent extreme interest rate levels such as 720 percent realized during the 1994 crises.
d. Empower wholesale and retail payment system stability.
e. IMF comes and goes: Failure by failure.
f. Demand macro and micro reforms as part of an economic stability program

Monetary Policy Framework (2000-2001)

2000-2001
Disinflation Programme with a Crawling Peg Exchange Rate Regime: Tablita



Monetary Policy Framework (2000-2001)

2000-2001
Disinflation Programme with a Crawling Peg Exchange Rate Regime: Tablita

a. Crawling peg: Pre-announced targets for the nominal exchange rate.
b. Inflation inertia was extremely high.
c. Risk premium was at the peak
d. Lack of confidence since 1994
e. Not many options as a solution (Currency Board was even worse than tablita)
f. Extensive macro reforms agenda
g. Demand for rapid privatisation (Telecomm)

a. Passive monetary policy.
b. Classic IMF equation➔ BM = NDA + NIR
c. Net Domestic Asset ➔ ceiling
d. Net International Reserves ➔ floor
e. Buy and sell USD depending on TRY supply and demand
f. Performance criteria were set on analytical balance sheet

Monetary Policy Framework (2001)

2001
Collapse of Tablita and Economic Crisis

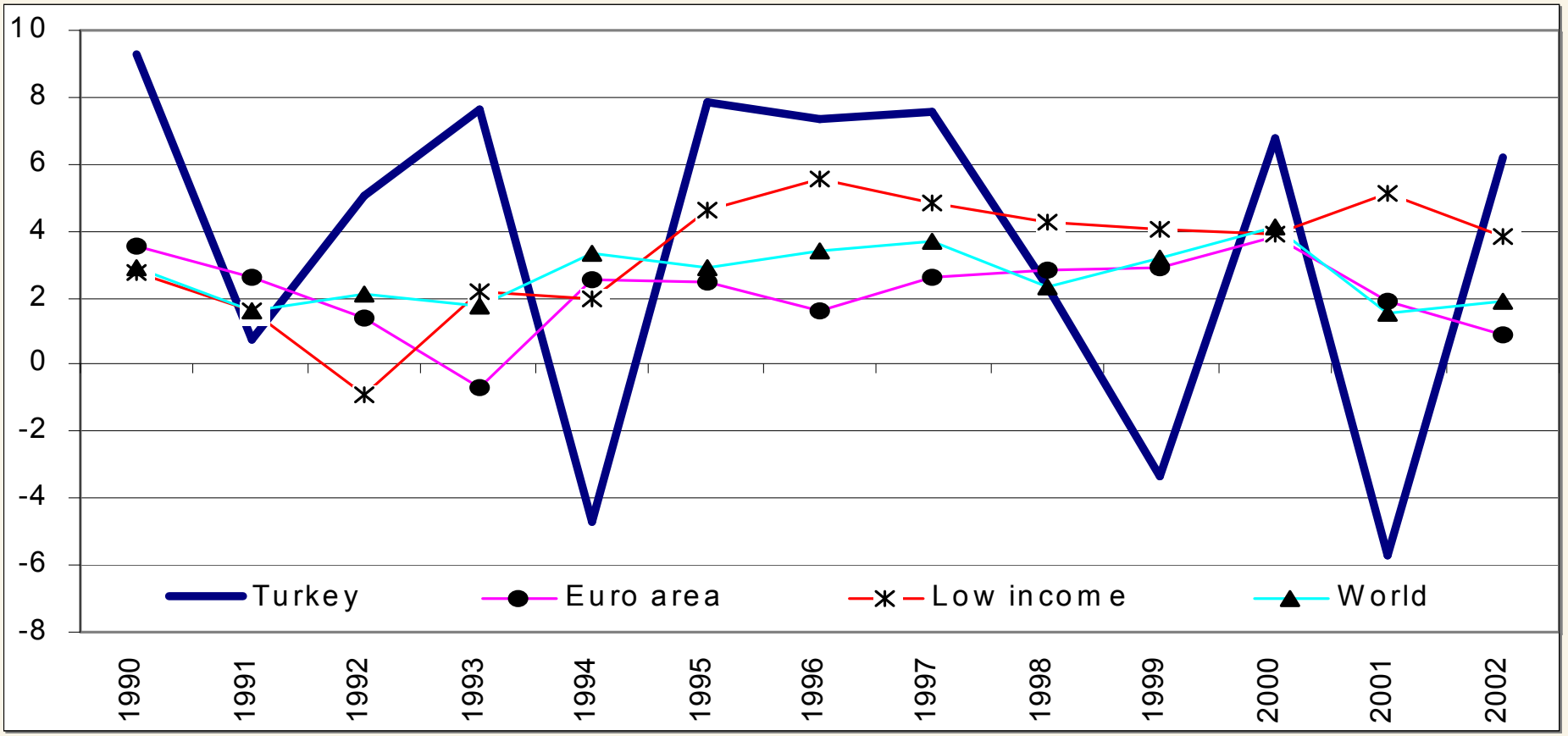
a. Lack of ownership.
b. Lack of crisis management or Plan B
c. Inflexible IMF approach to the program
d. Inadequate funding
e. Reform Fatigue
f. Risk premium inertia
g. Lack of public relationship management to create awareness of the risk of collapse
h. Cost: 20 percent /GNP for banking restructuring

a. Extreme interest rate to defend tablita: Overnight rates jumped to 6200 percent.
b. Loss of reserves
c. Back to active central banking

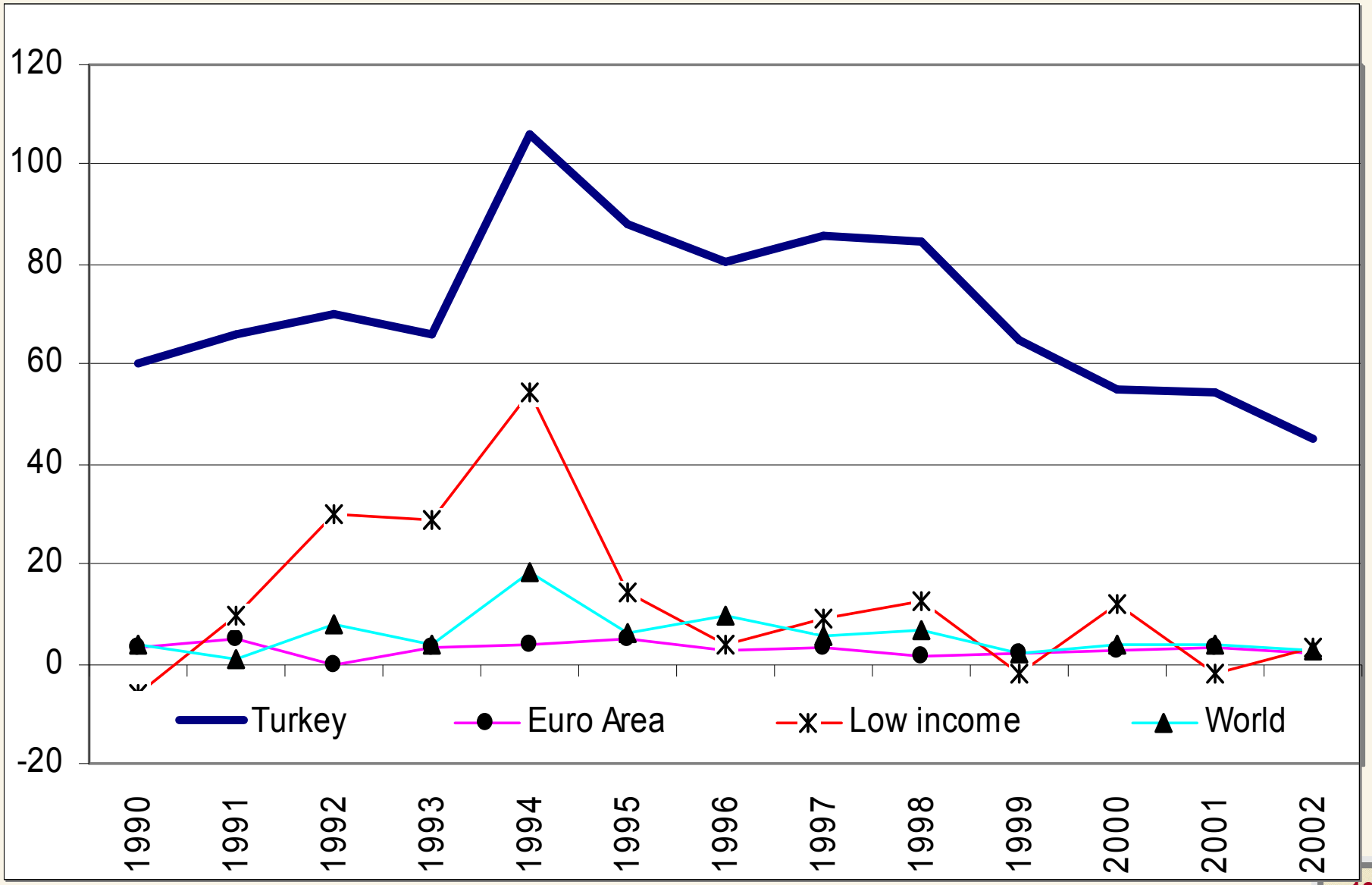
The End:

a. Dedication to reforms including the Central Bank.
b. Fastened privatisation
c. Change the rule of game forcefully: Paradigm Shift…

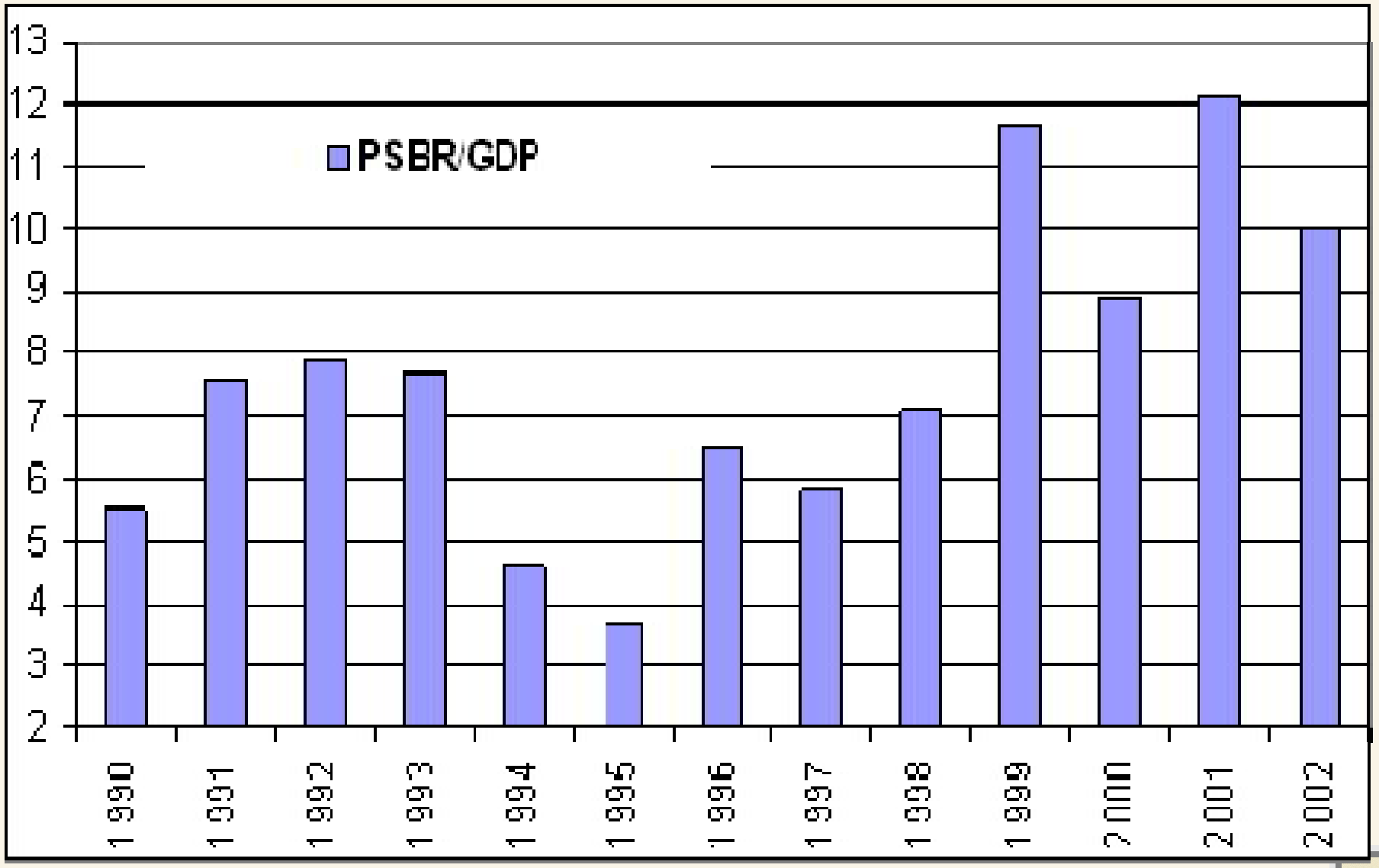
1990s Comparative Indicators: Growth



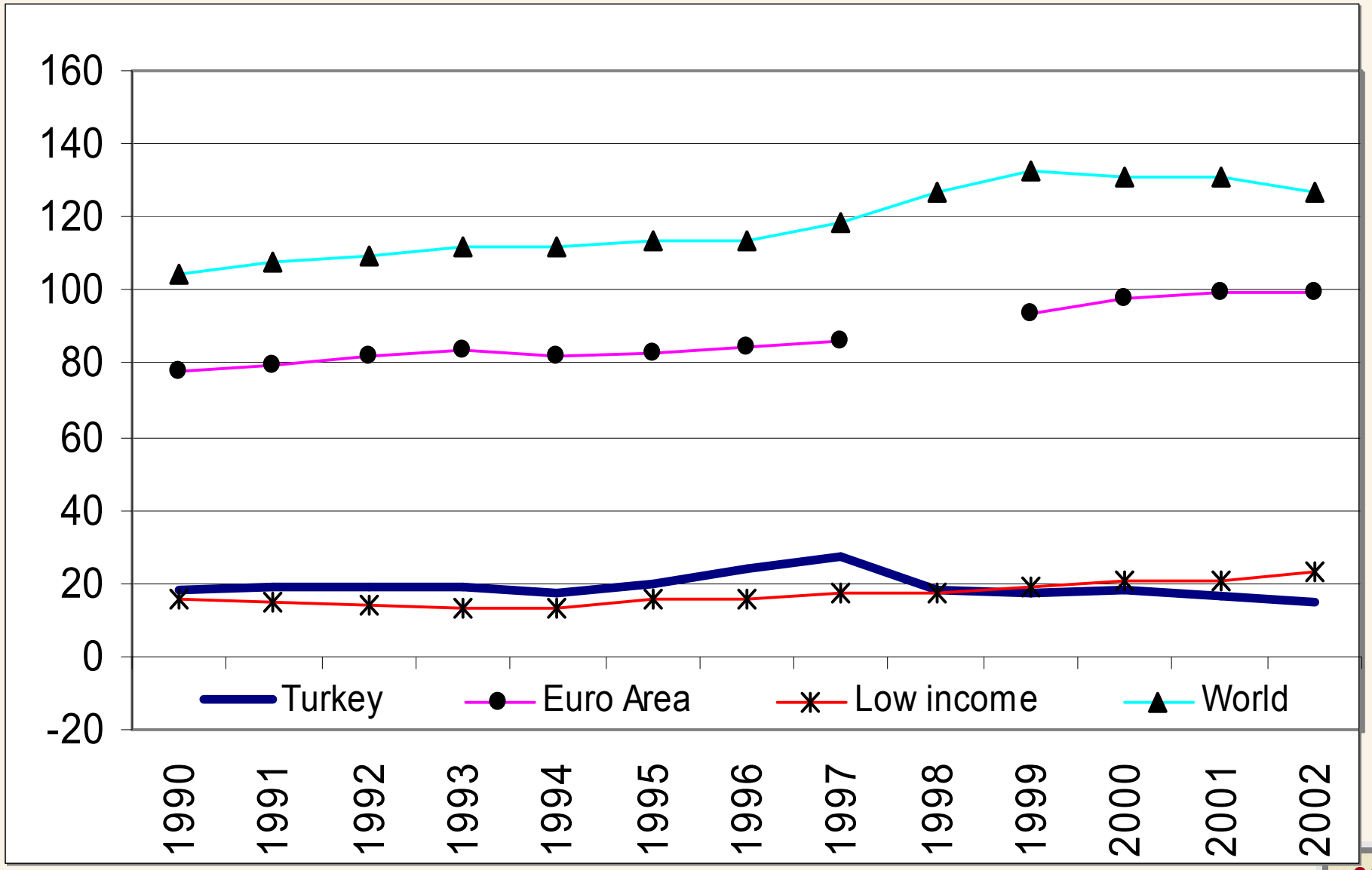
1990s Comparative Indicators: Inflation



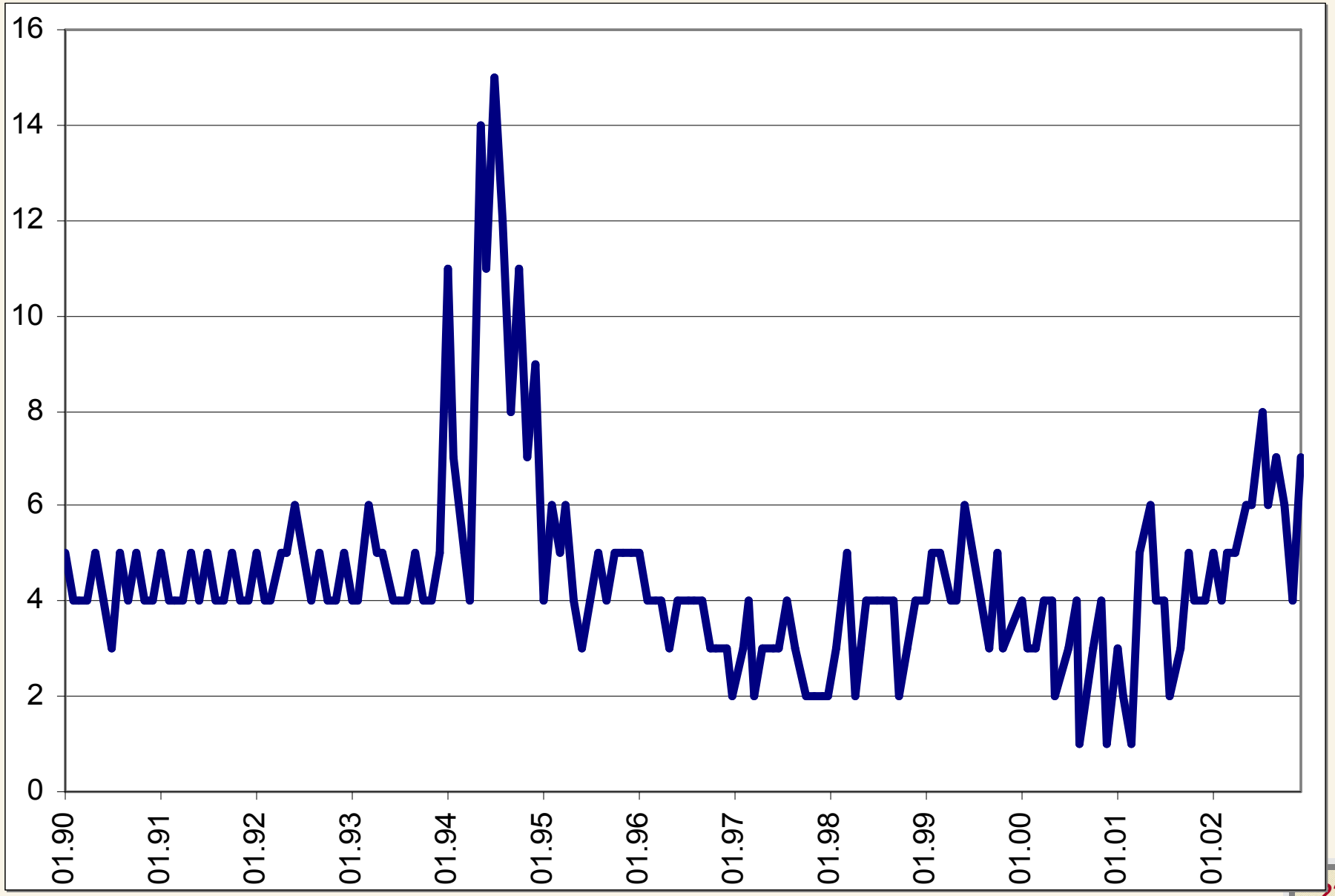
1990s Comparative Indicators: PSBR



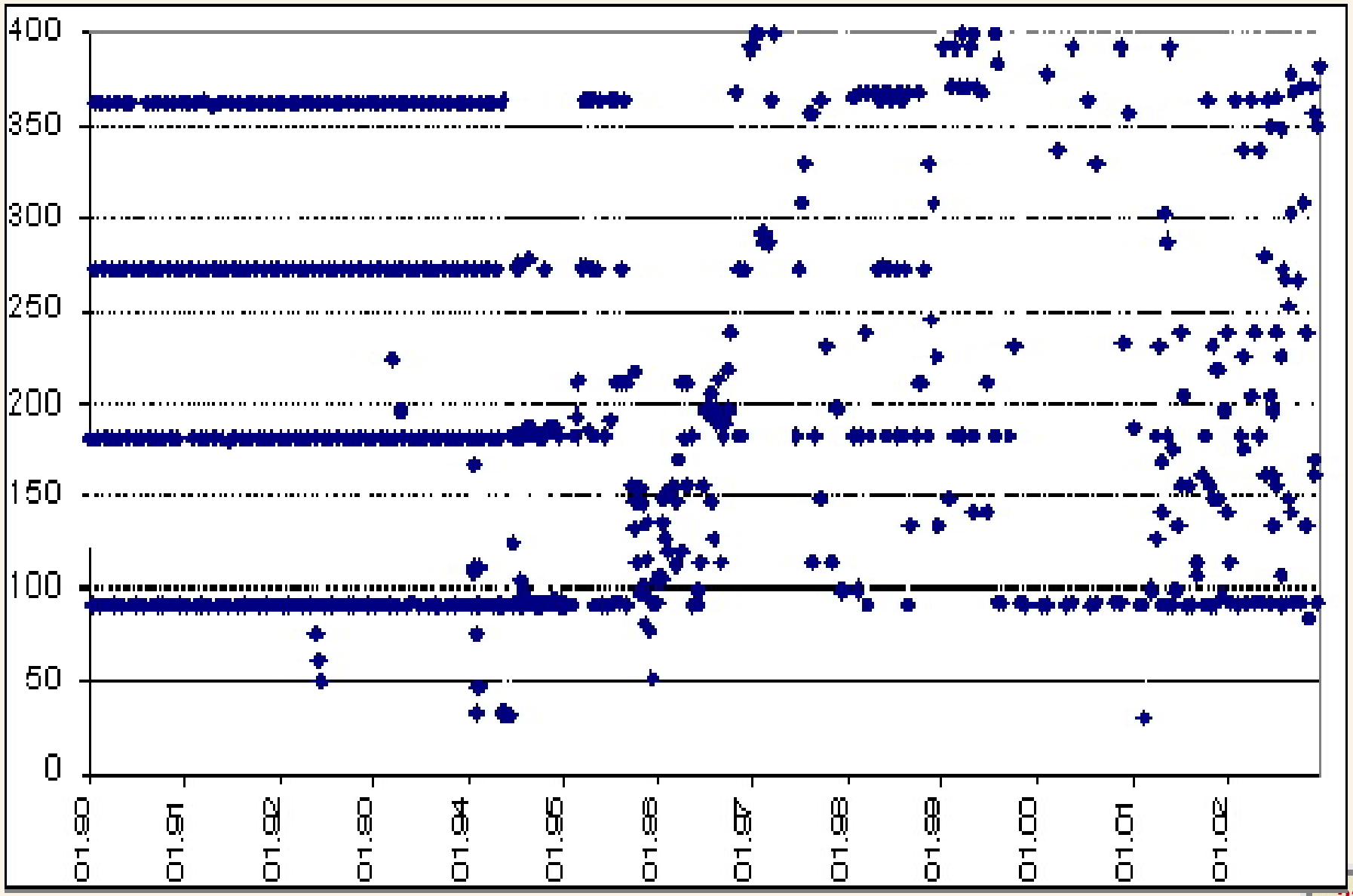
1990s Comparative Indicators: Private Credit to GNP



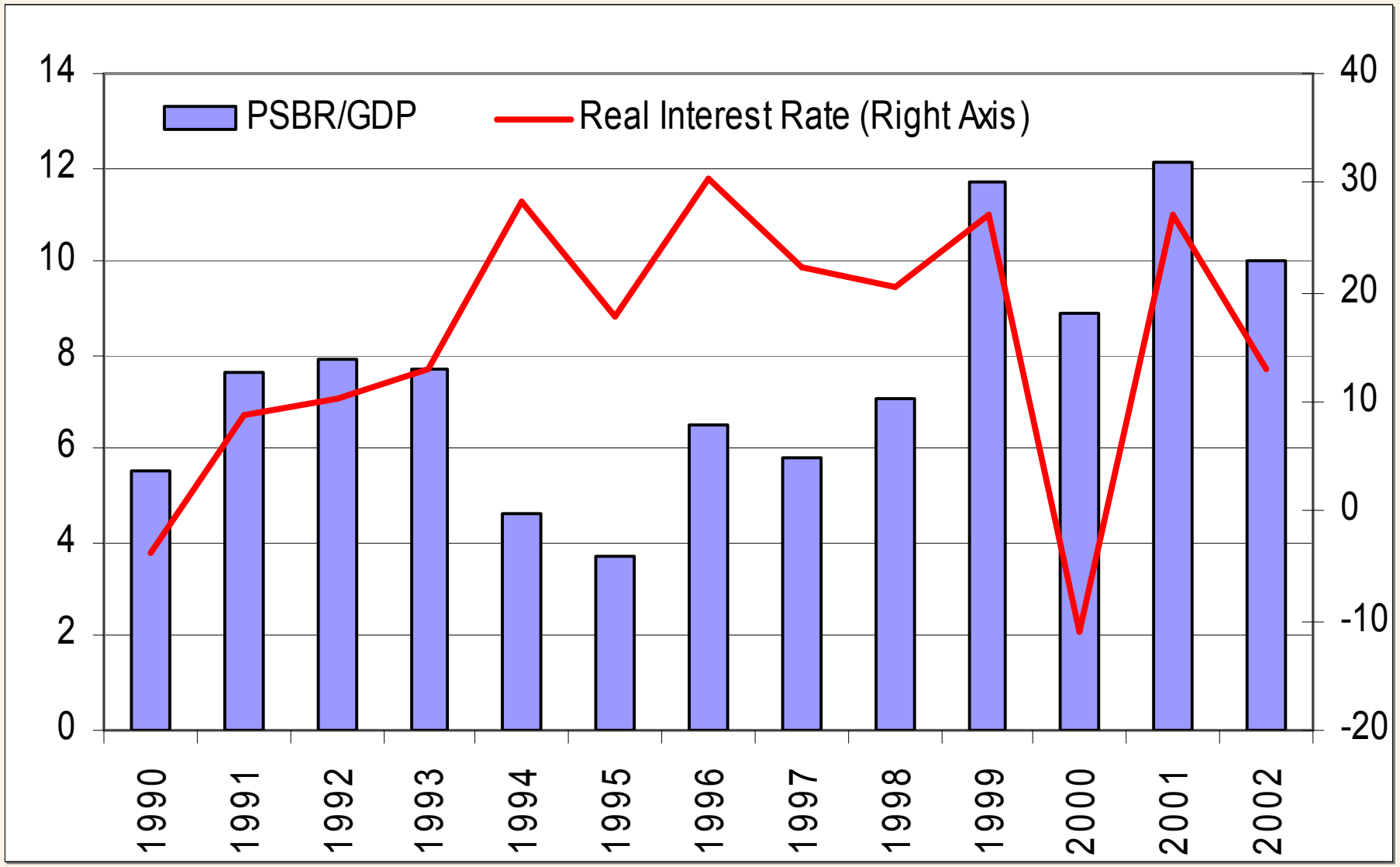
Monthly Treasury Borrowing Auctions



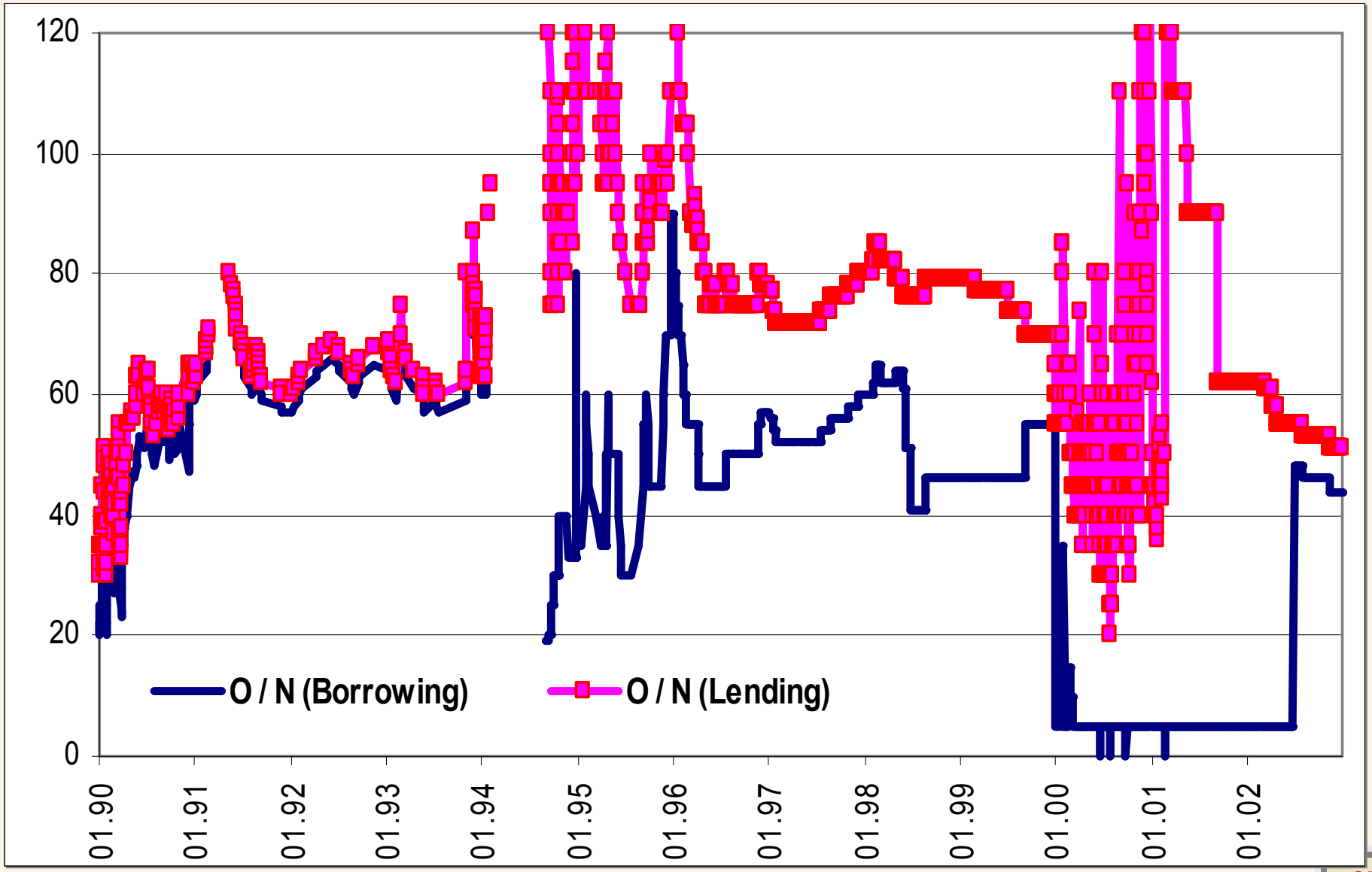
1990s Term Treasury Borrowing Auctions



1990s PSBR and Real Interest Rates



1990s Short-term Interest Rate Quotes

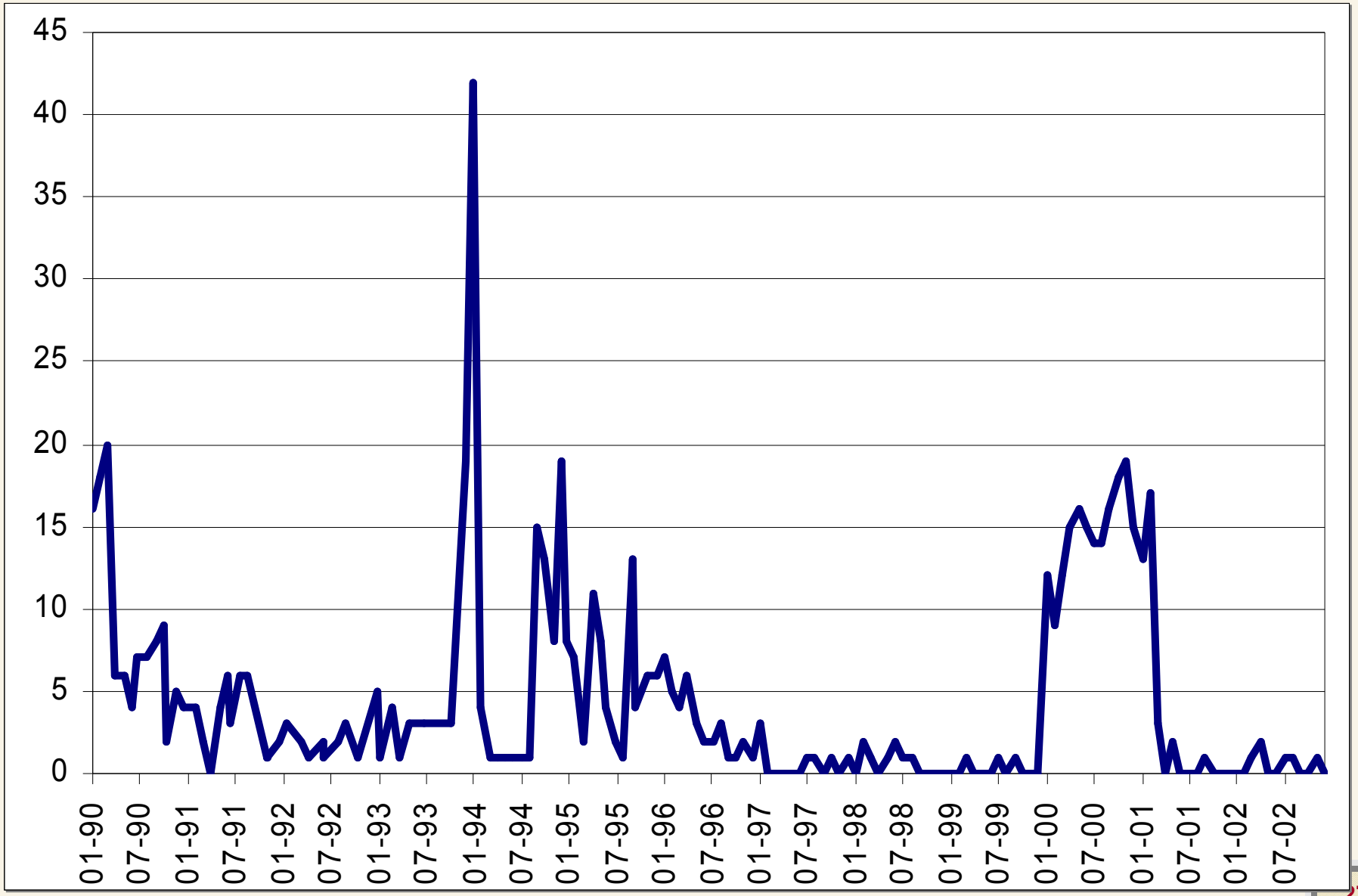


1990s Extreme Short-term Interest Rates

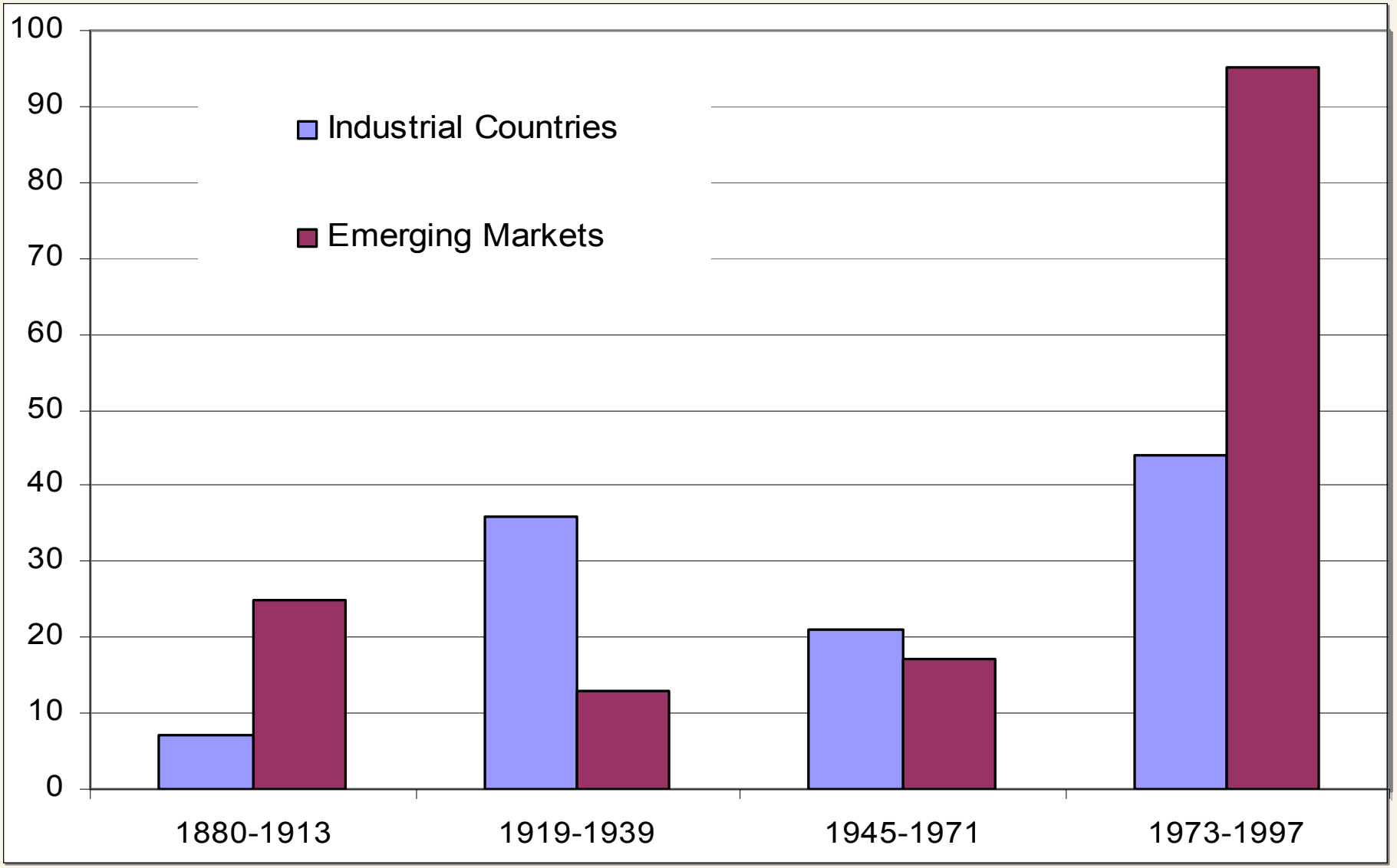
Extreme Short-term Simple Interest Rates (%): 1994 Crisis	
10-03-1994	240.00
11-03-1994	720.00
21-03-1994	400.00
22-03-1994	450.00
23-03-1994	500.00
25-03-1994	700.00
29-03-1994	600.00

Extreme Short-term Simple Interest Rate (%): 2000 and 2001 crises	
30-11-2000	400.00
01-12-2000	999.00
04-12-2000	1950.00
05-12-2000	600.00
20-02-2001	2300.00
21-02-2001	6200.00
22-02-2001	3000.00
23-02-2001	800.00

1990s Monthly Short-term Rate Changes



Number of Crises around the World



Concluding Remarks

- Turkey has experienced various forms of monetary regimes in the past 30 years.
    - Monetary targeting,
    - Real exchange rate targeting,
    - Crawling pegs,
    - Inflation targeting,
- 1990s was one of the worst decade measured with growth and inflation.
- Central banking and Treasury financing faced many challenges.
- More than 14 borrowing auctions were held in some stage.
- More than 40 short-term interest rate quotation changes have been observed.
- Monetary policy under extreme conditions proved costly.
- Dedication to price stability since then increased social welfare.

QUESTIONS, QUERIES, CORRECTIONS COMMENTS, and CONTRIBUTIONS PLEASE….

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