



**TÜRKİYE CUMHURİYET
MERKEZ BANKASI**

Global Imbalances and the New Central Banking

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São Paulo

Outline

I. Global Outlook

II. Current Issues facing Central Banks

III. Mainstream suggestions on the future of Central Banks

IV. CBRT Policy Mix

Outline

I. Global Outlook

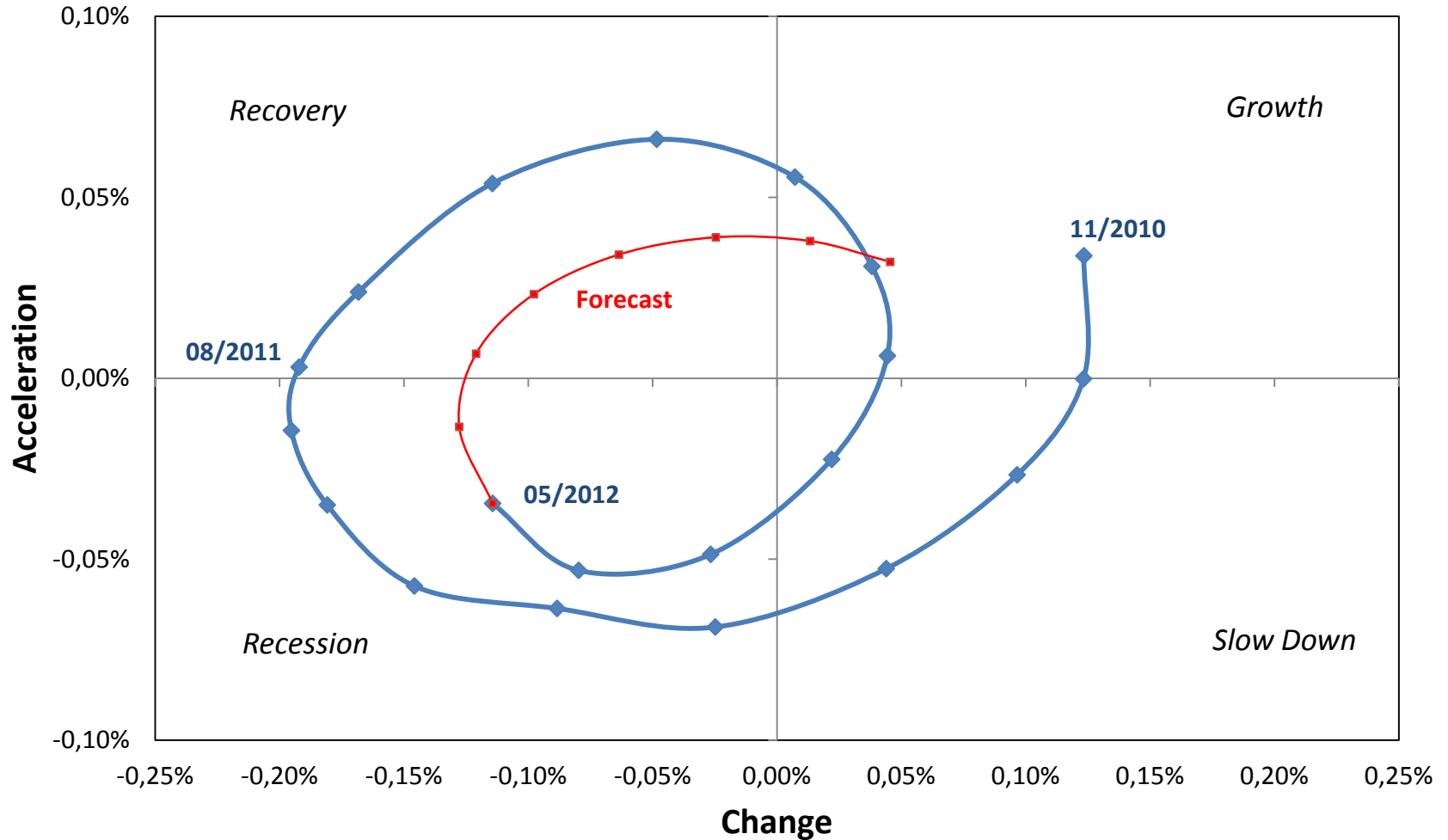
II. Current Issues facing Central Banks

III. Mainstream suggestions on the future of Central Banks

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Global Outlook

World Economy



Source: OECD, CBRT.



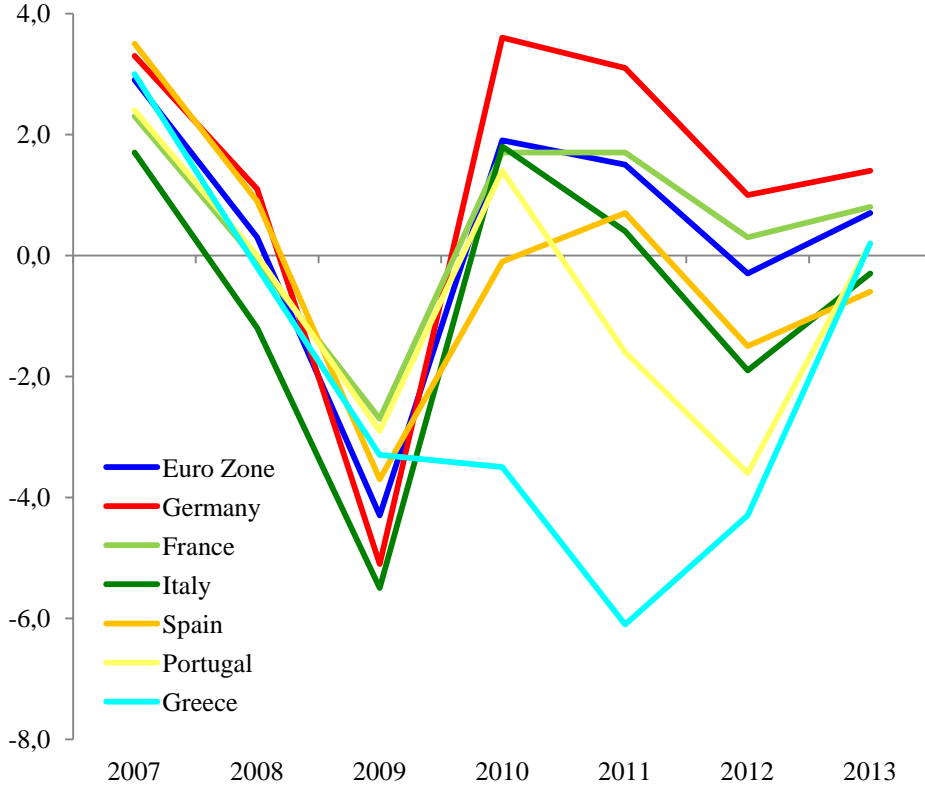
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2012 will be a difficult year for Europe.

**Growth Rates
(annual, %)**



**Growth Forecasts
(annual, %)**

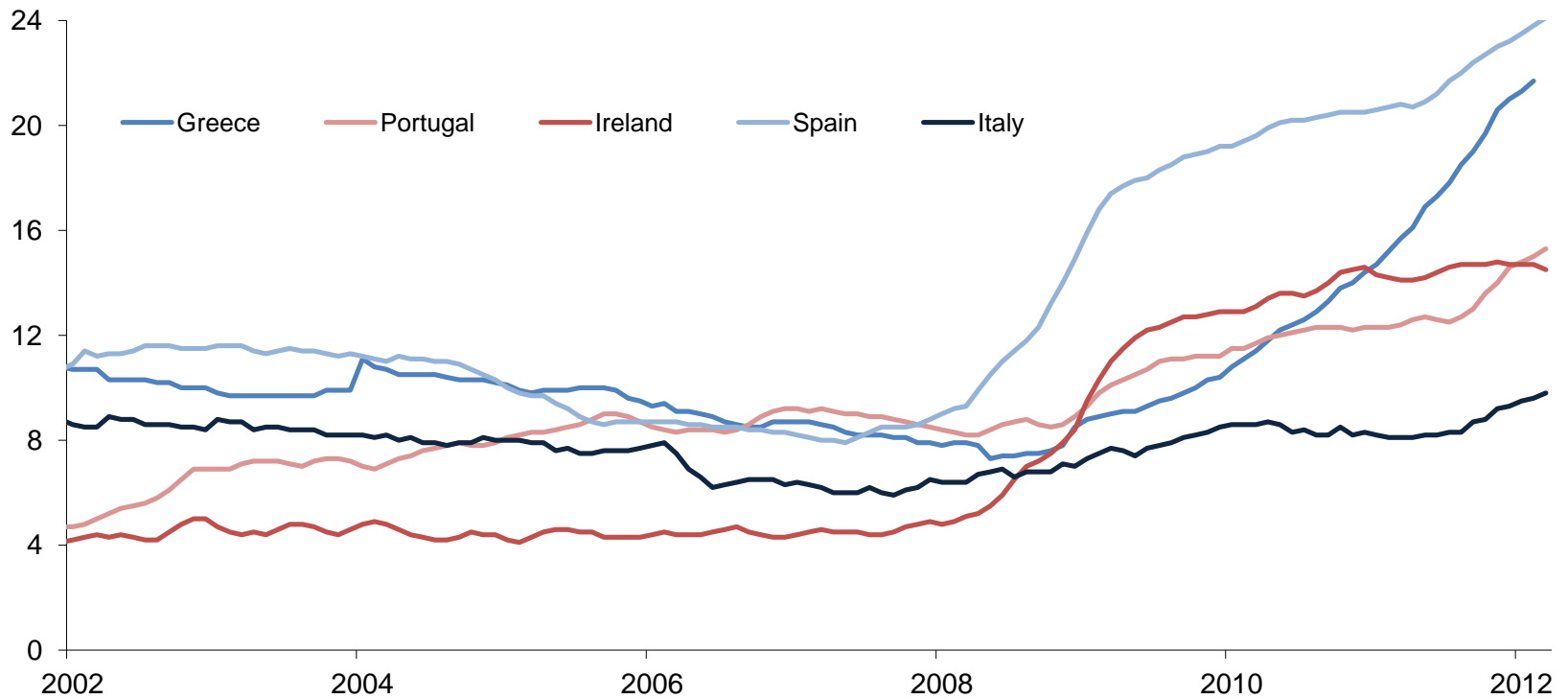
	2012		2013	
	IMF	CE	IMF	CE
Eurozone	-0.3	-0.5	0.7	0.5
Germany	1.0	0.9	1.4	1.3
France	0.3	0.2	0.8	0.7
Italy	-1.9	-2.0	-0.3	-0.3
Spain	-1.5	-1.7	-0.6	-0.9
Portugal	-3.0	-3.4	0.2	-2.2
Greece	-4.3	-6.8	0.2	-2.6

IMF: WEO Update, July 2012
CE: Consensus Economics, July 2012

Source: IMF, July 2012

Unemployment stays at its historically high levels since 2008

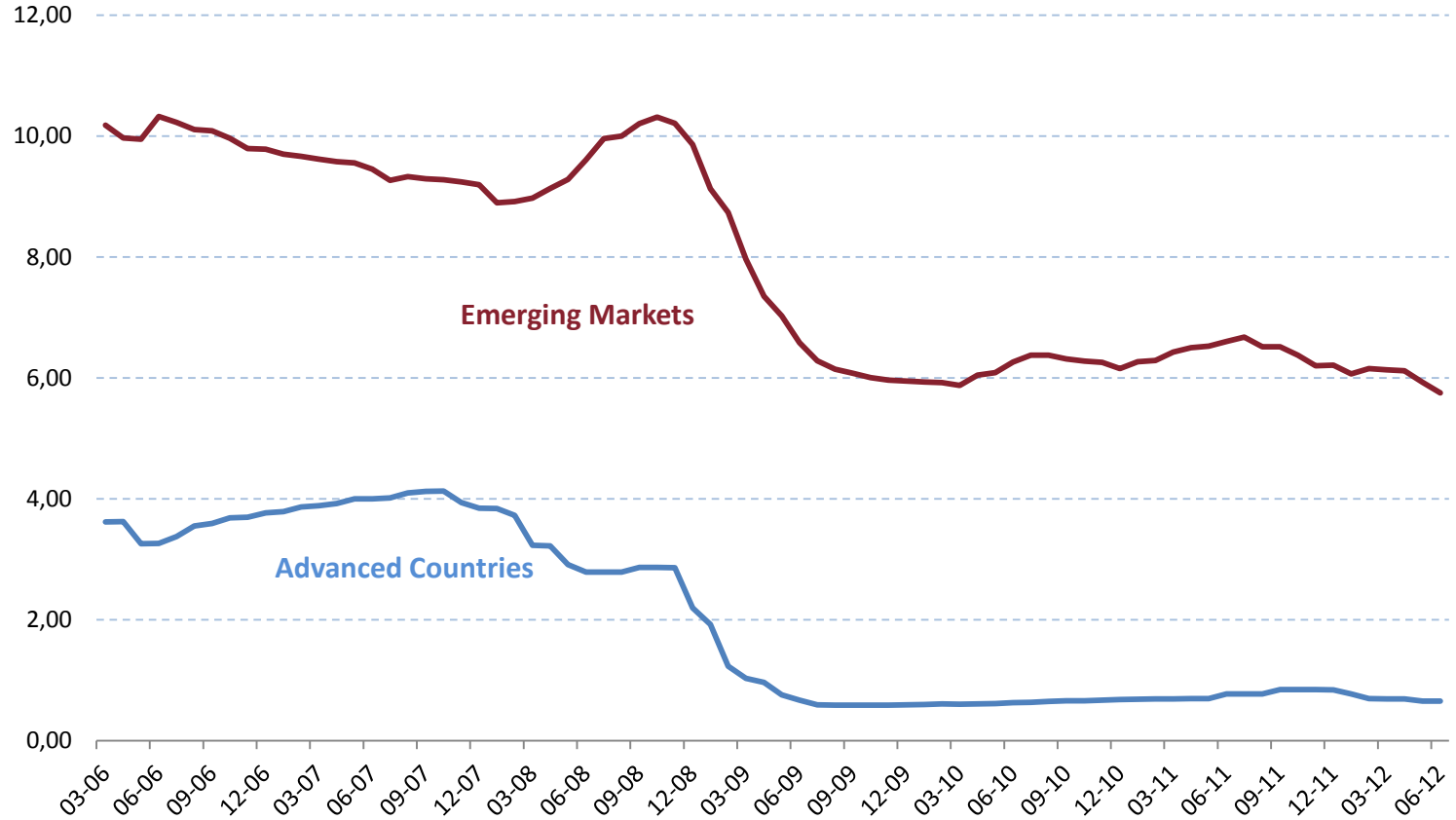
Unemployment (Percent)



Source: Bloomberg, CBRT.

Not Much Policy Space Left for Interest rate policy

Policy Rates in Advanced Economies and Emerging Markets
(Percent)



Source: CBRT, Bloomberg.

Likely to Monetary Expansion (US)

Excess Reserves (FED)

(Billion USD)

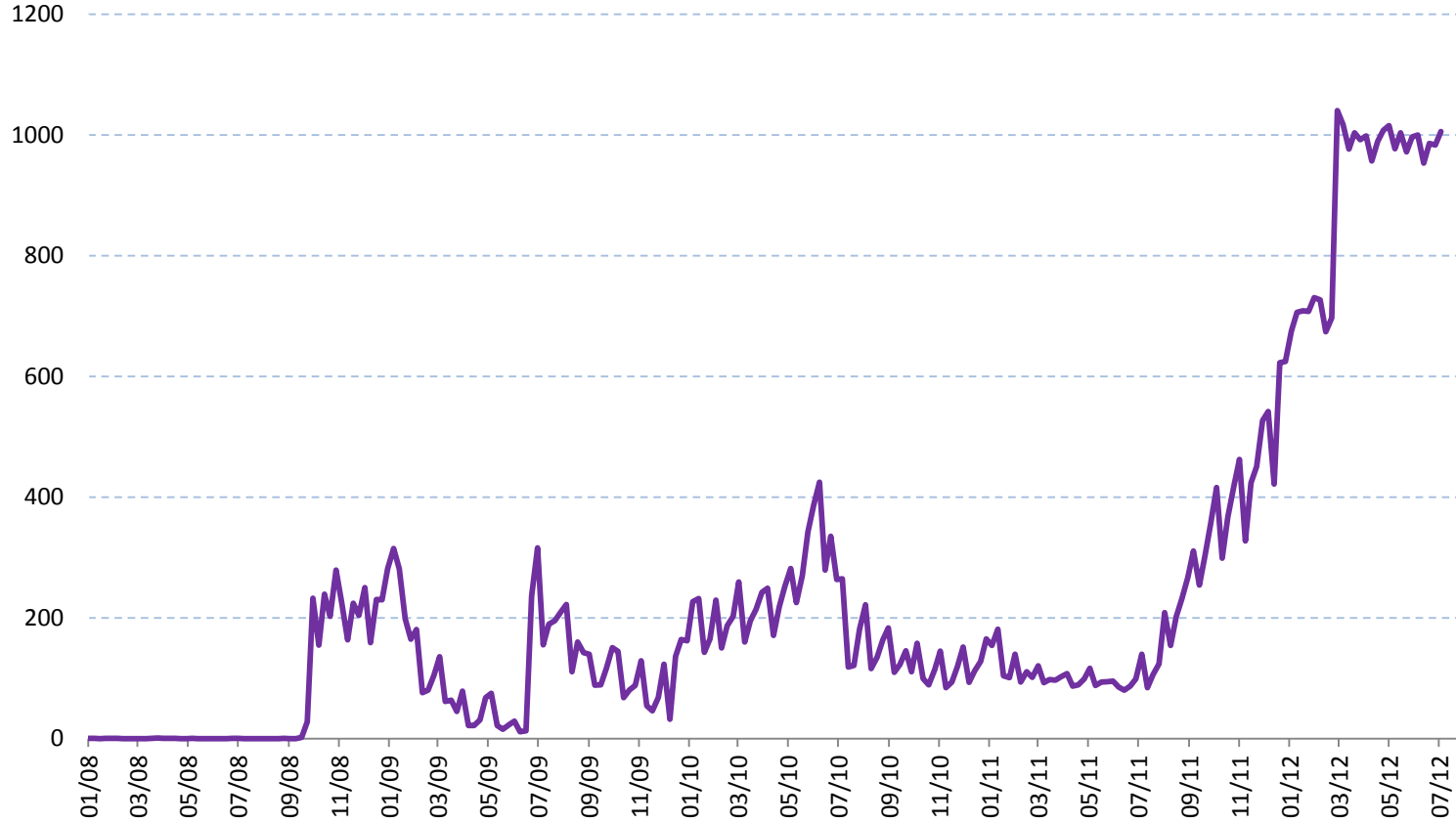


Source: FED, CBRT.

Likely to Monetary Expansion (Eurozone)

Excess Reserves* (ECB)

(Billion Euro)

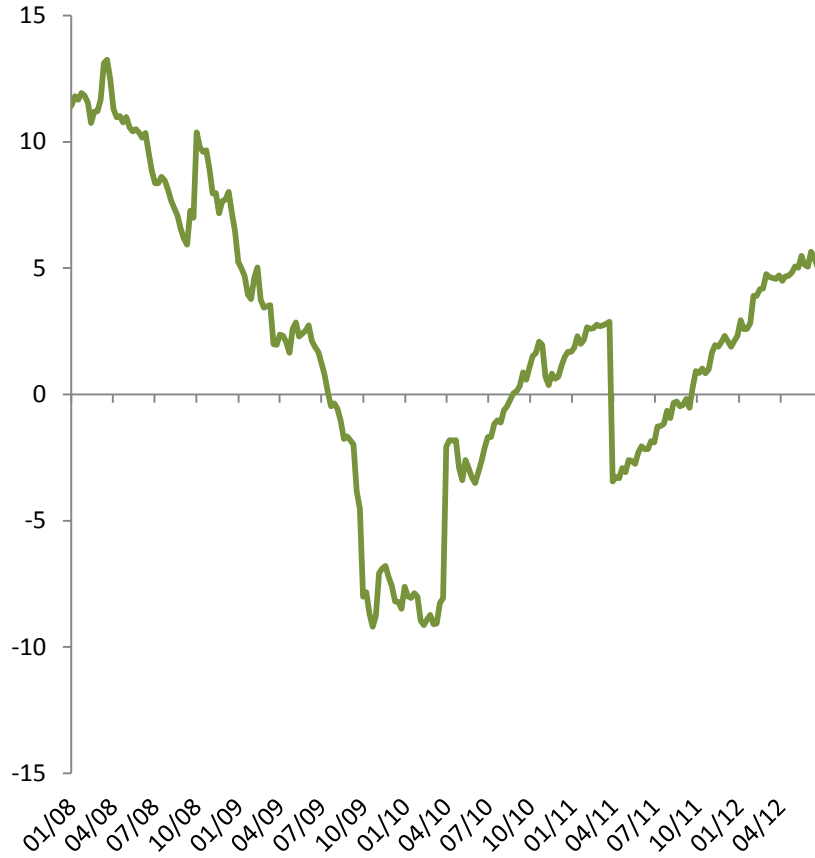


Source: ECB, CBRT.

*Excess Reserves=ECB Balance Sheet Deposit Facility + Fixed Term Deposits

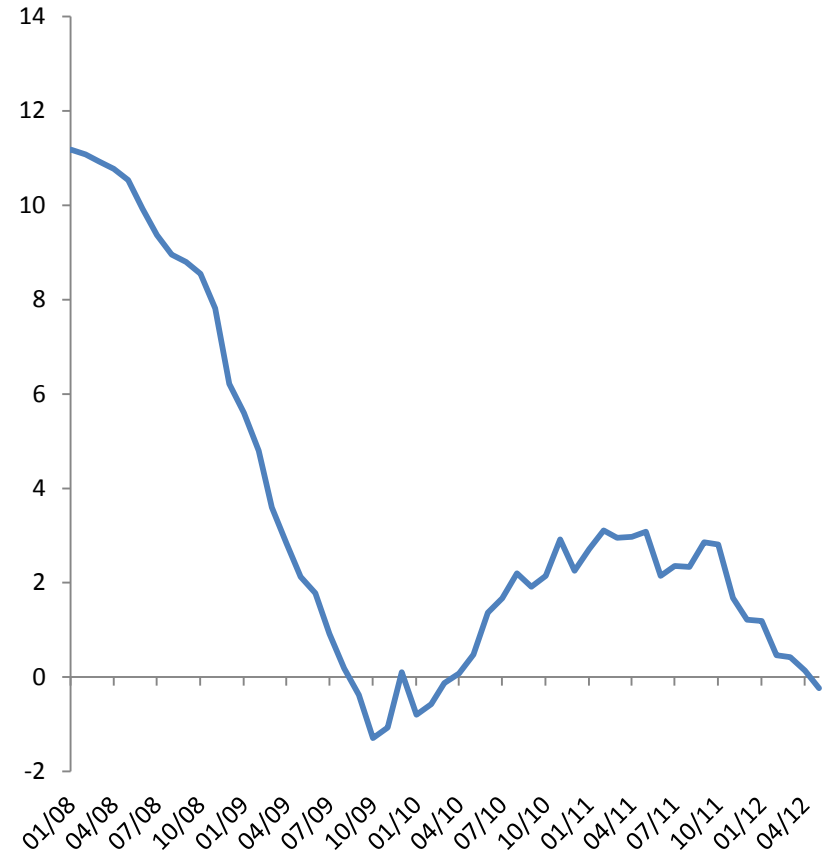
No guarantee for the monetary expansion to work

Credit Growth (US)



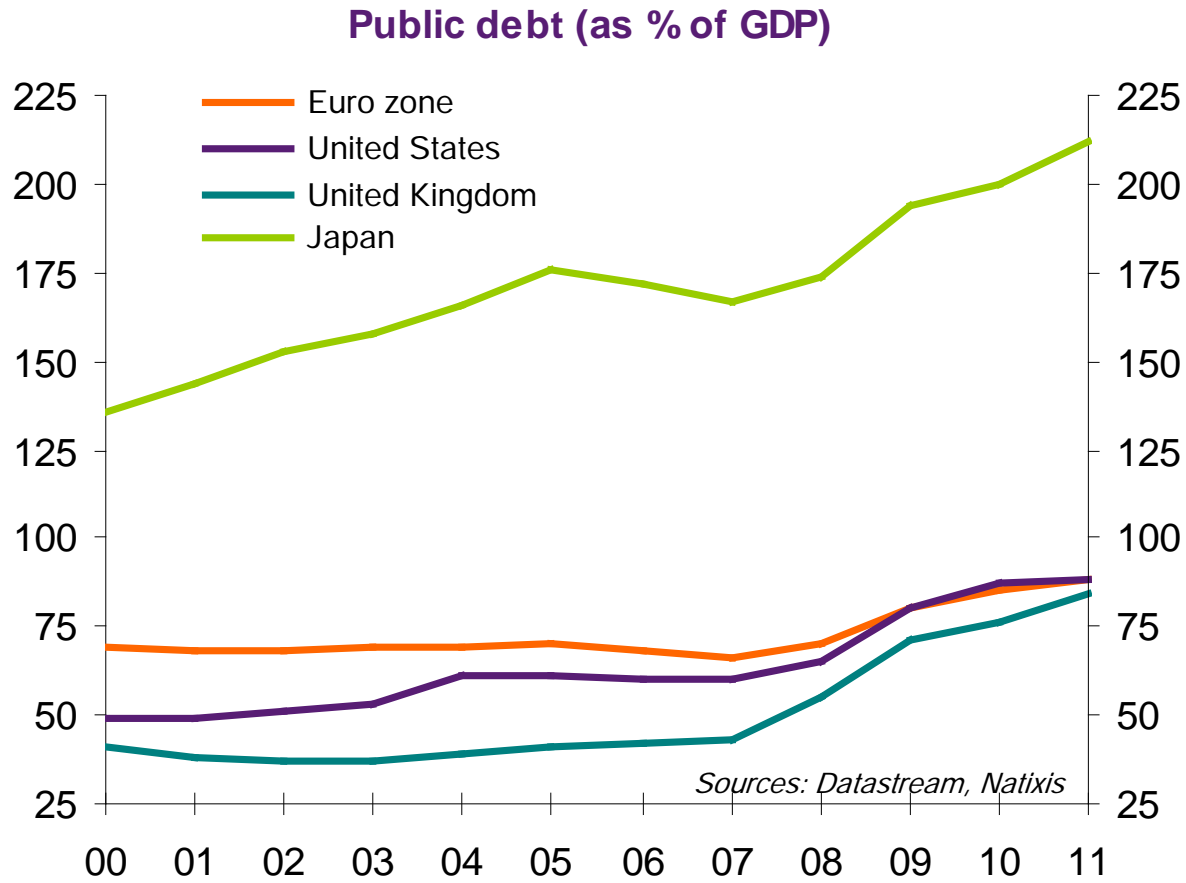
Source: Bloomberg, CBRT.

Credit Growth (Eurozone)



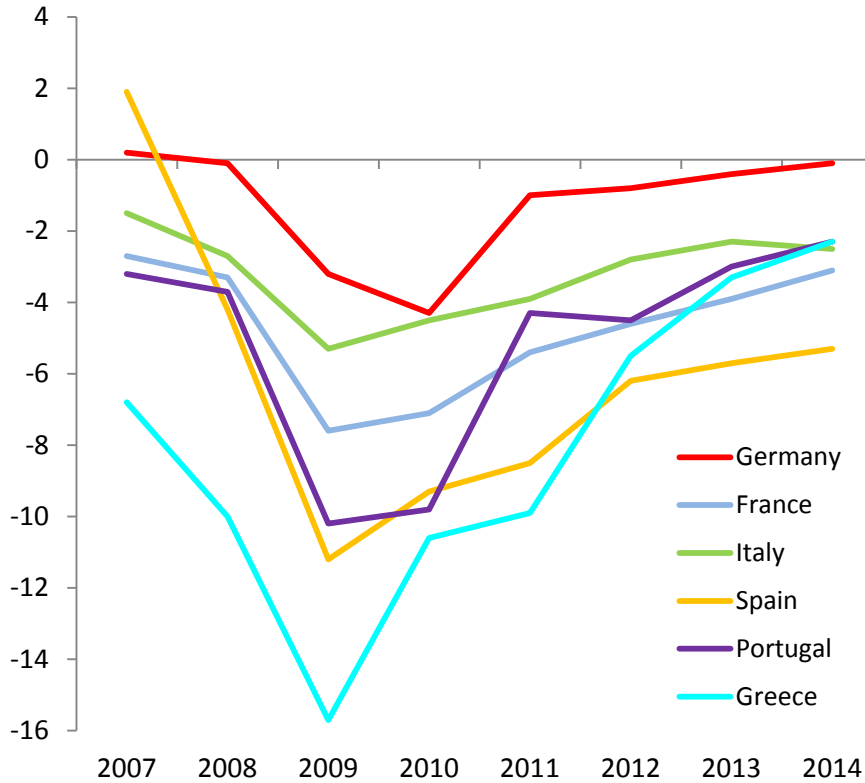
Source: Bloomberg, CBRT.

There is no space for fiscal expansion either.



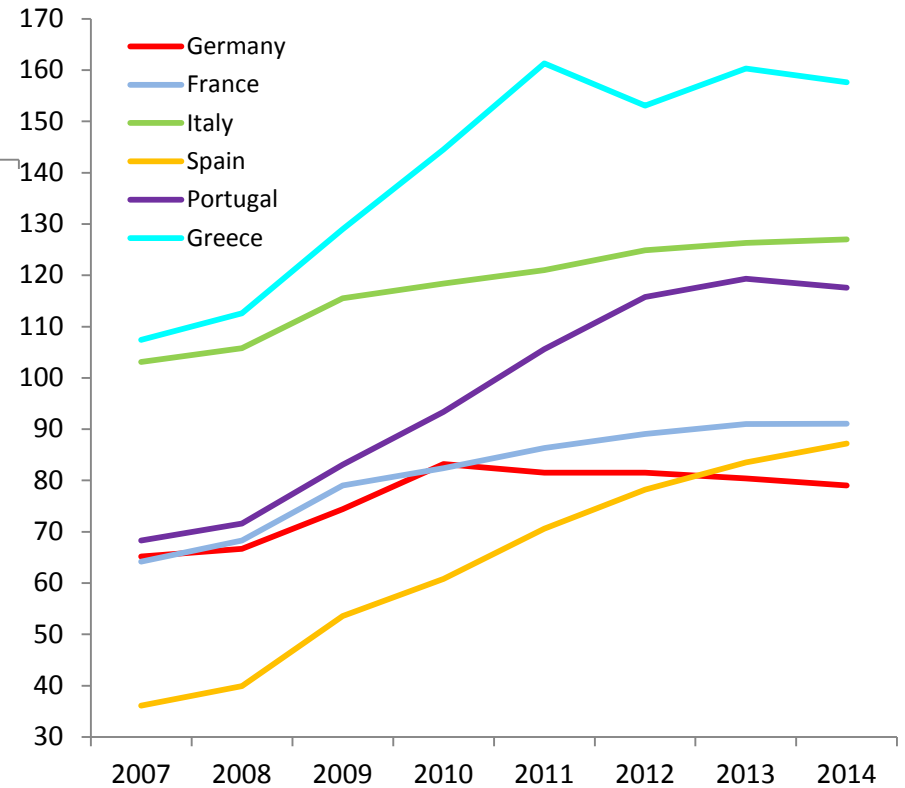
Sovereign Debt problem is even worse for Europe

General Government Budget Balances (% of GDP)



Source: IMF, April 2012

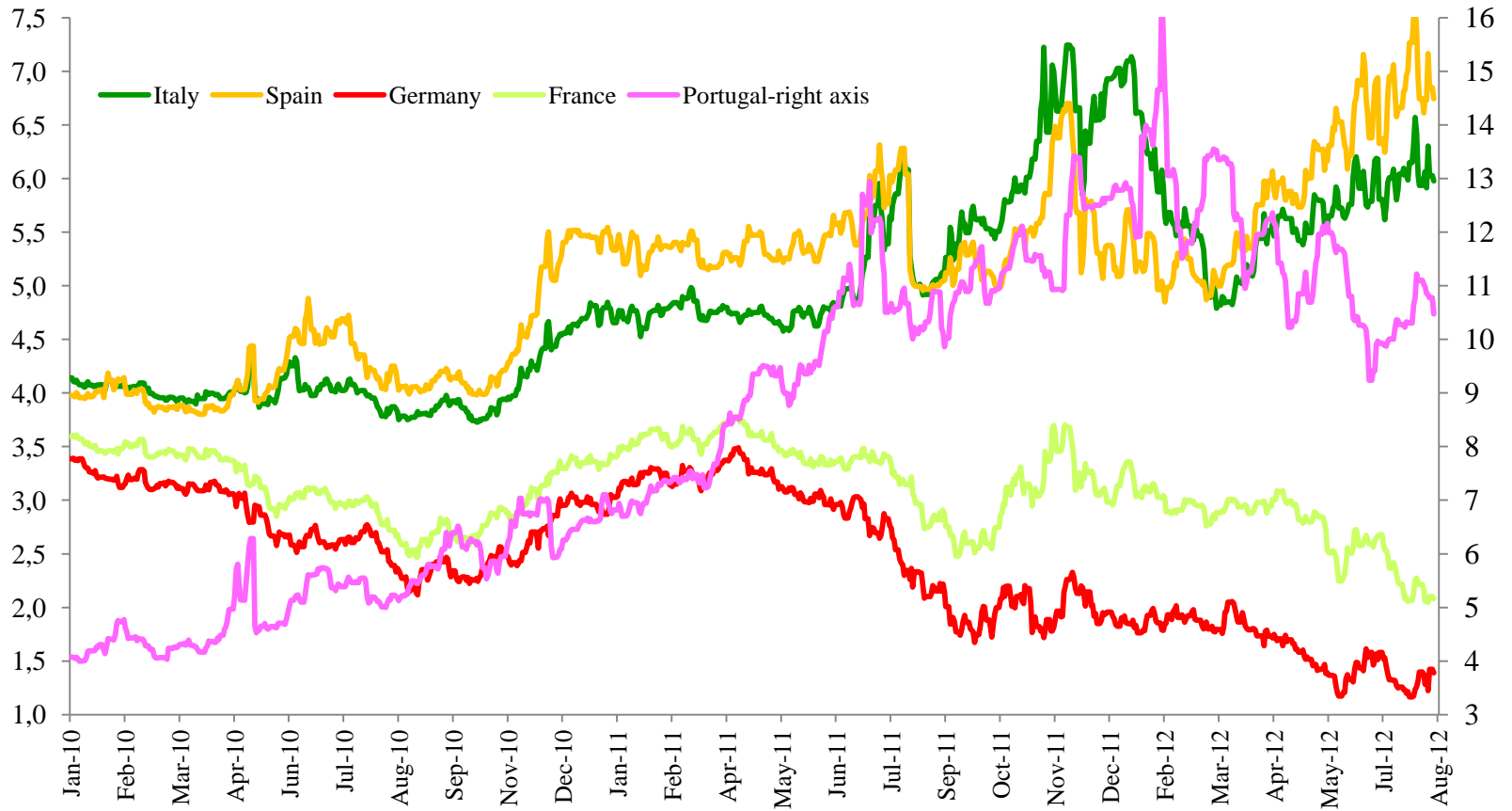
Public Debt (% of GDP)



Source: IMF, April 2012

Divergence among government bonds of Eurozone countries...

10 year Government Bond Yields (%)

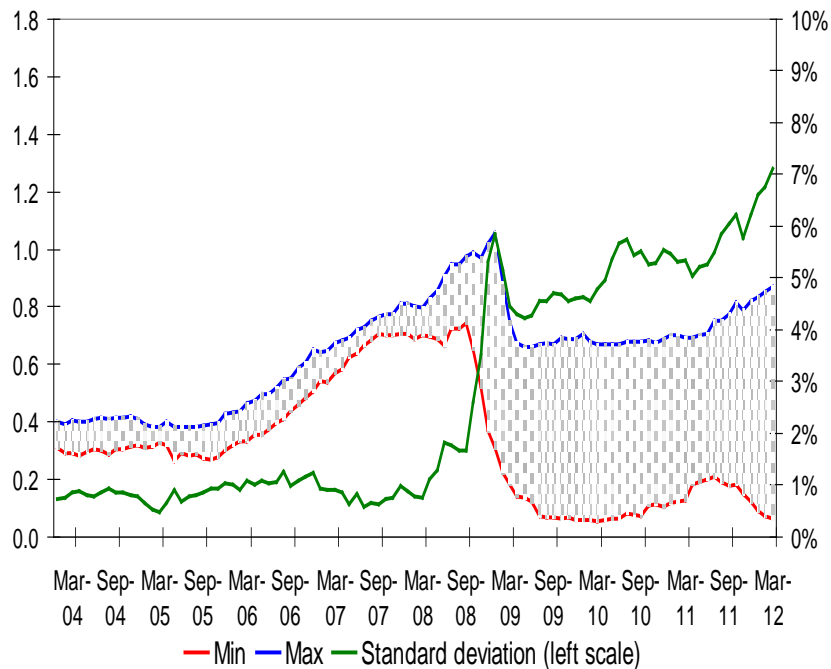


Source: Bloomberg

Also fragmentation in financial sectors of Eurozone countries.

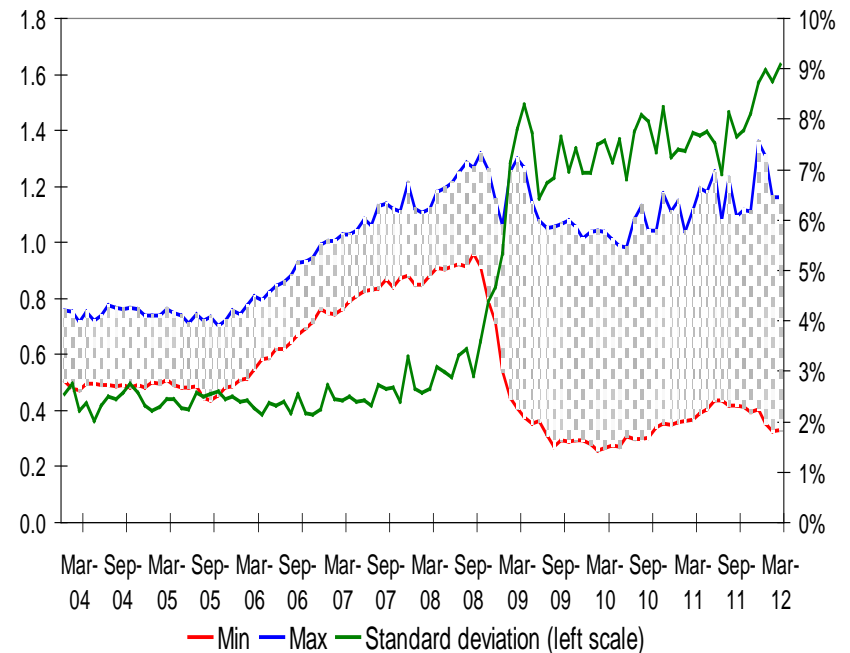
Dispersion of euro area deposit rates

(units and percentages)



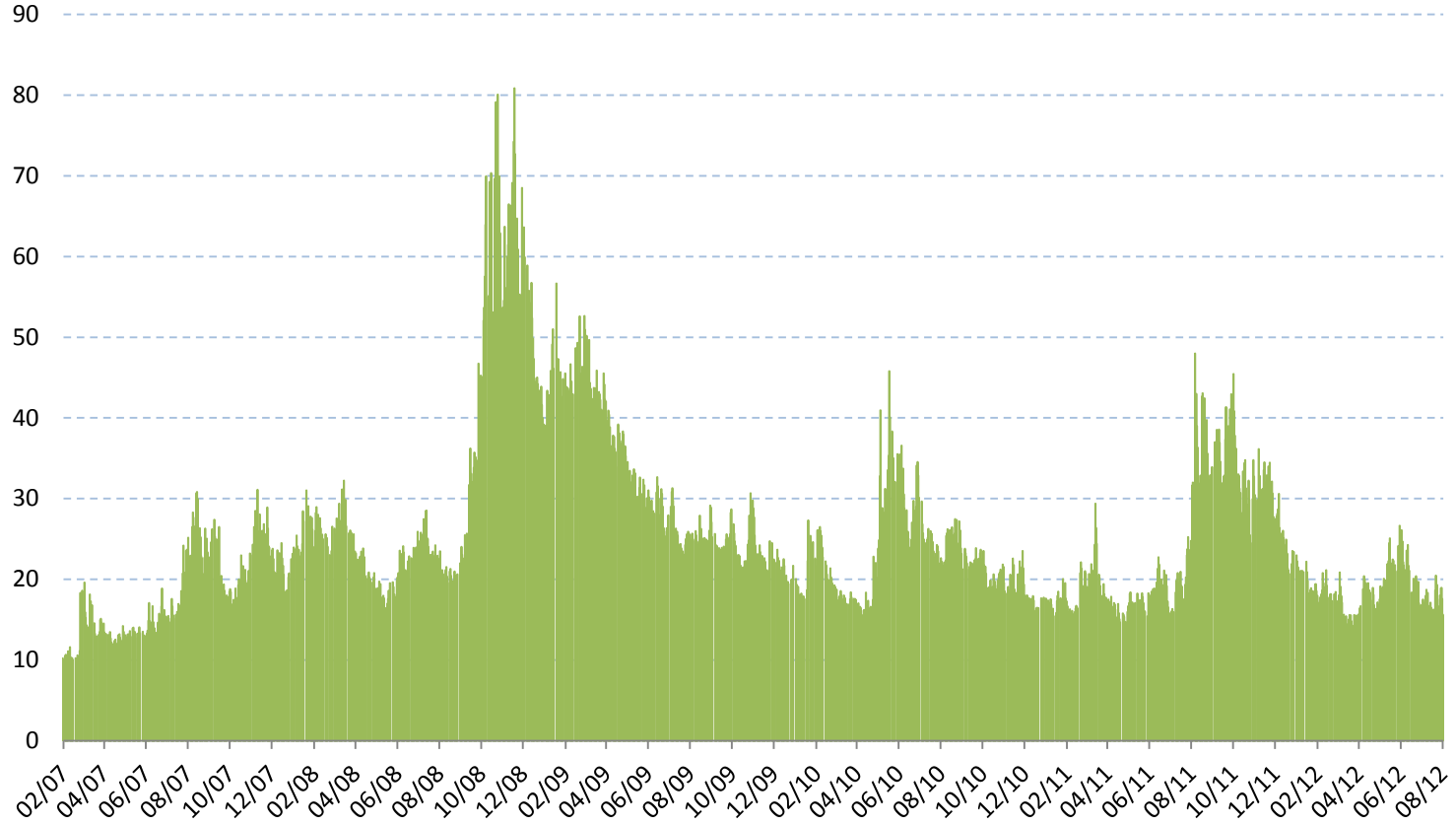
Dispersion of euro area loan rates

(units and percentages)



Volatility Continues.

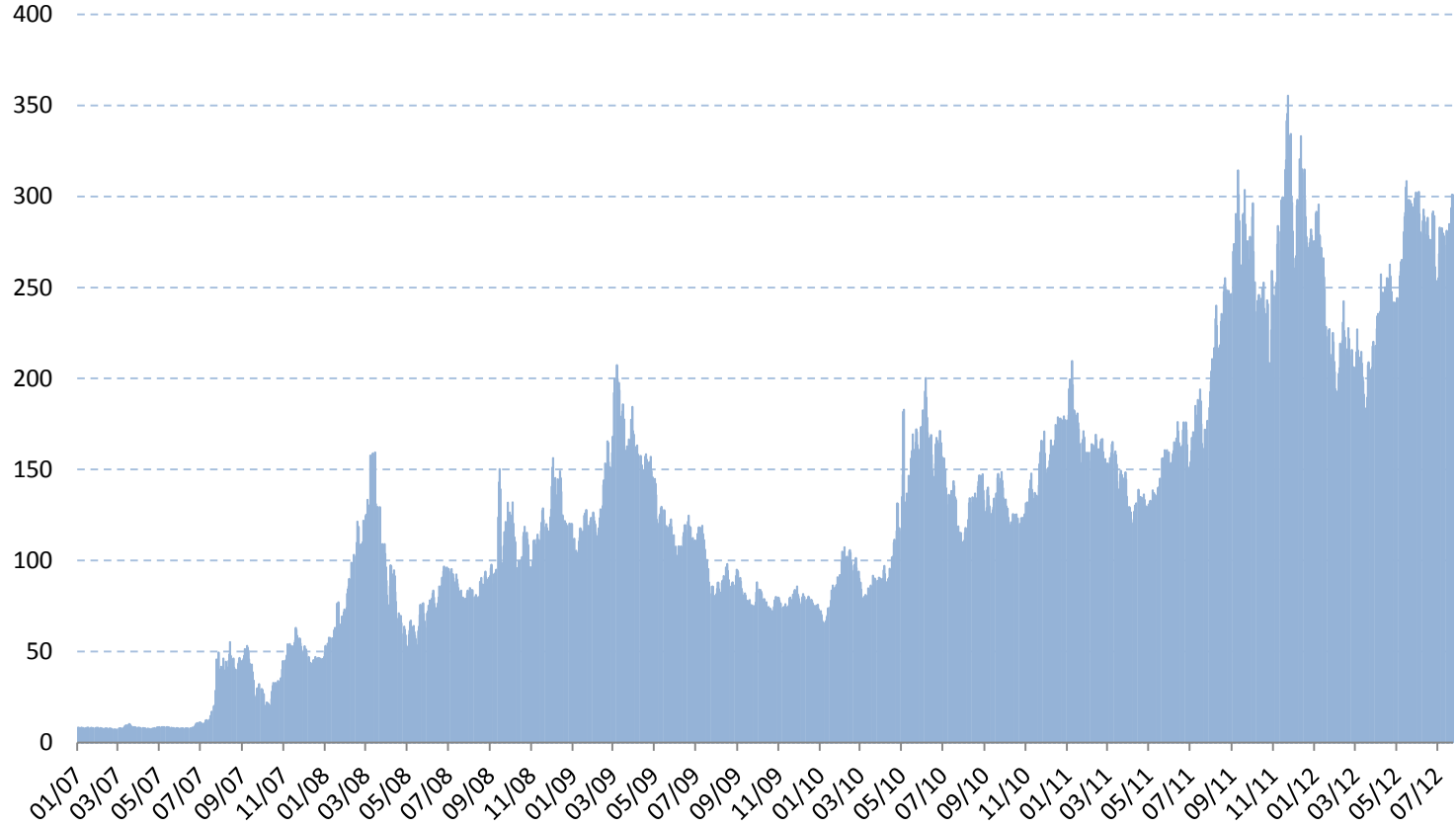
VIX



Source: CBRT, Bloomberg.

Volatility Continues.

ITRAXX Senior Financials



Source: CBRT, Bloomberg.

Outline

I. Global Outlook

II. Central Banking is rewritten

III. Mainstream suggestions on the future of Central Banks

IV. CBRT Policy Mix

Critics on Conventional Central Banking

- The conventional approach fails to account adequately for financial-sector risk and is therefore too narrowly focused.
- The conventional framework assumes limited or nonexistent cross-border spillovers of monetary policies
- The incompatibility of national monetary policies in the face of spillovers is heightened when countries follow different monetary policy regimes
- The period in which the IT regime was tested was exceptionally benign, leaving question marks for the period ahead
- High levels of government debt in advanced countries and the slowing growth of traditional export markets for developing countries create pressure on central bank independence

Challenges Ahead : The Need for IT++

- Uneasy coexistence: floaters and fixers
- Controlling inflation in the age of volatility
- Destabilizing channels of financial transmission
- A journey to uncharted territories in monetary policy

Financial Stability and Central Banks

- From Micro-to-Macroprudential tools in financial regulation
- The «lean vs. clean» debate, when should CBs act?
- A joint optimization problem: Using monetary and regulatory policies in concert to pursue price and financial stability
- Should Central Banks be primary institution responsible for financial stability?
 - Coordinated approach
 - Unified approach

Macroprudential Toolkit

- Countercyclical capital buffers
- Systemic levy for leveraged financial institutions
- Limits to the loan-to-value and service-to-income ratios on bank lending
- Better resolution regimes for Systemically Important Financial Institutions (SIFIs)
- Surcharges on capital requirements for «too big to fail» institutions

Two Approaches

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

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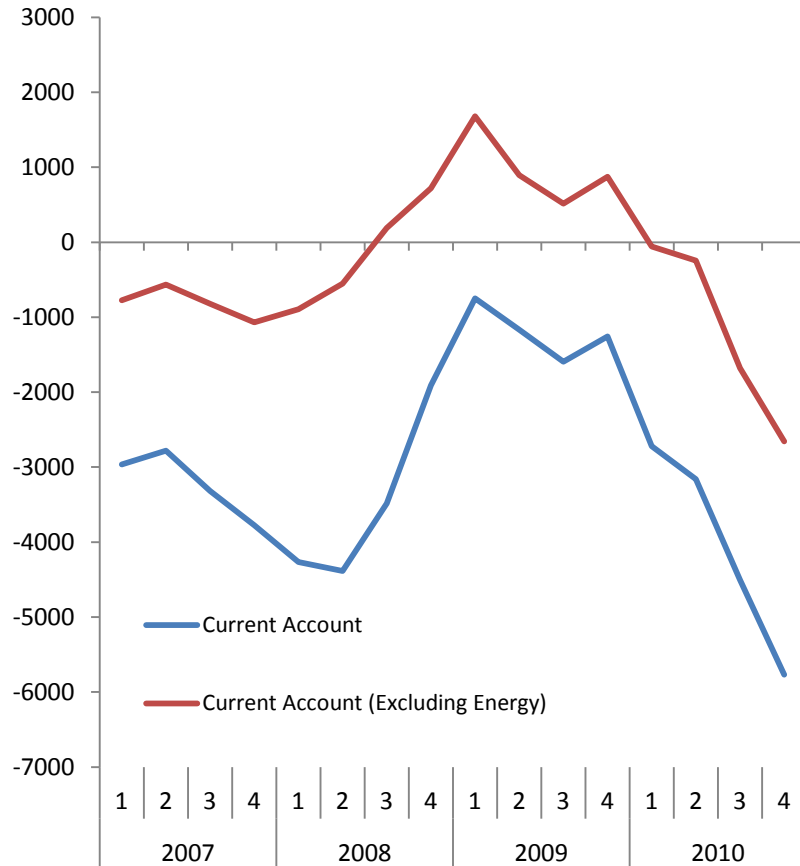
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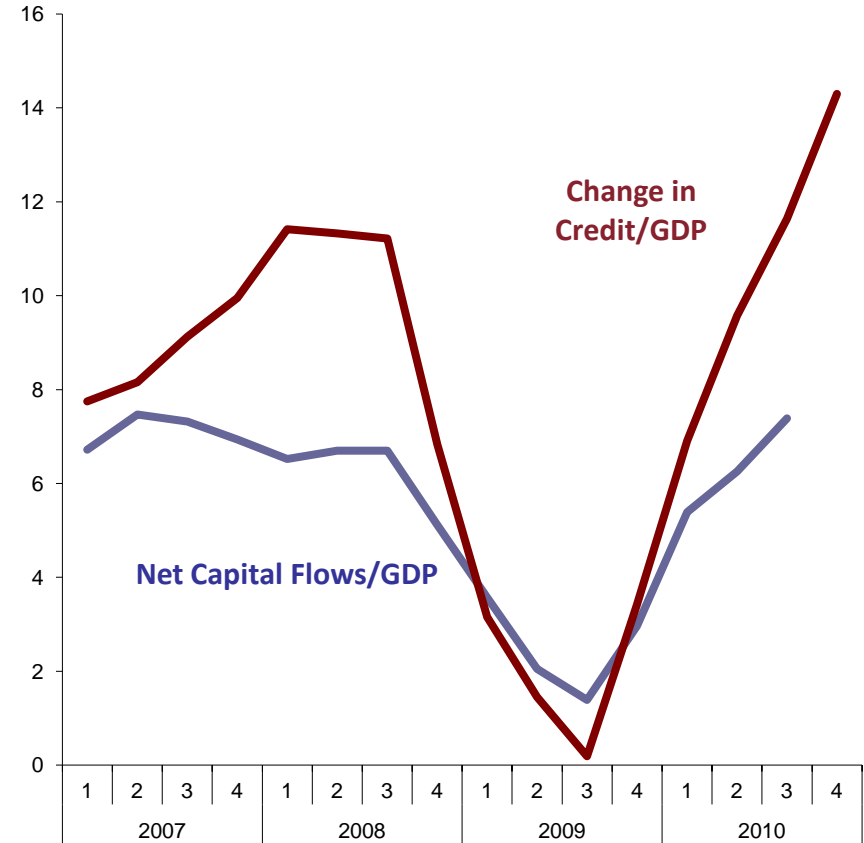
Need for Rebalancing

Current Account Balance

(Seasonally Adjusted, Monthly Average, Million USD)



Capital Flows and Credit Growth (percent)



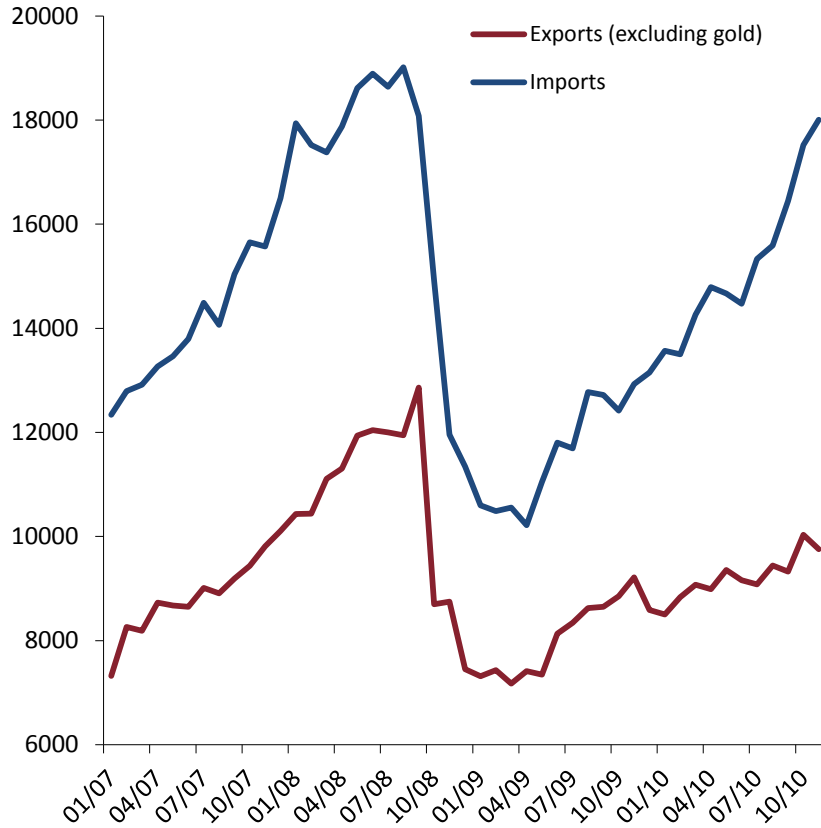
Source: TURKSTAT, CBRT.

*July and August figures are realization, September and Q4 figures are forecast.

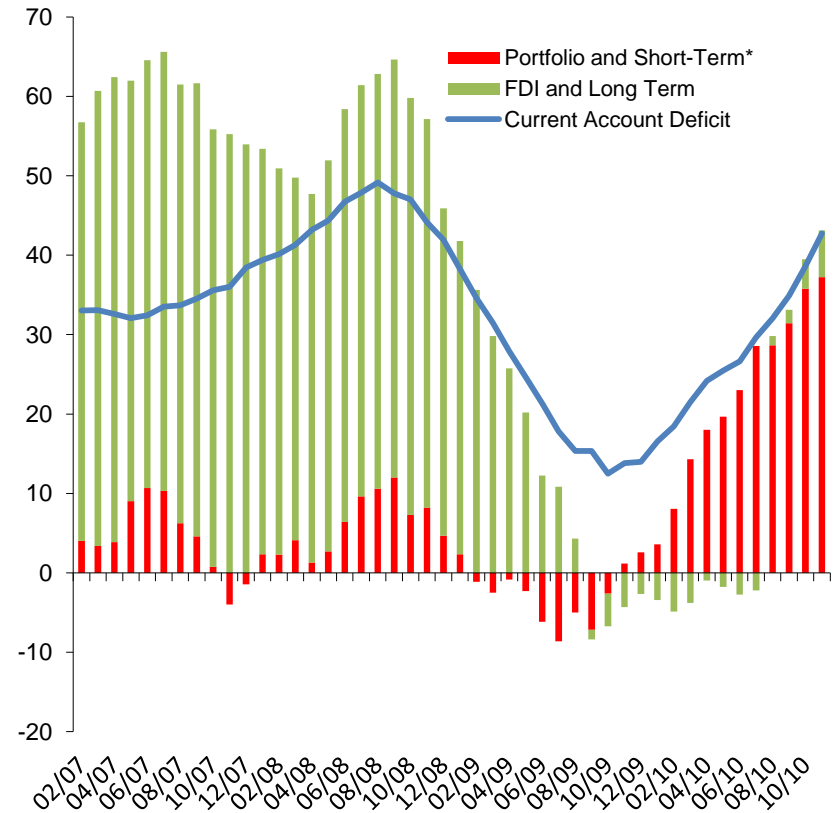
Source: TurkStat, CBRT.

Need for Rebalancing

Monthly Imports and Exports (Seasonally Adjusted, Million USD)



Main Sources of Current Account Deficit Finance (12-months Cumulative, Billion USD)



Source: TurkStat, CBRT.

Source: CBRT.

*Short-term capital movements are sum of banking and real sectors' short term net credits and deposits in banks.

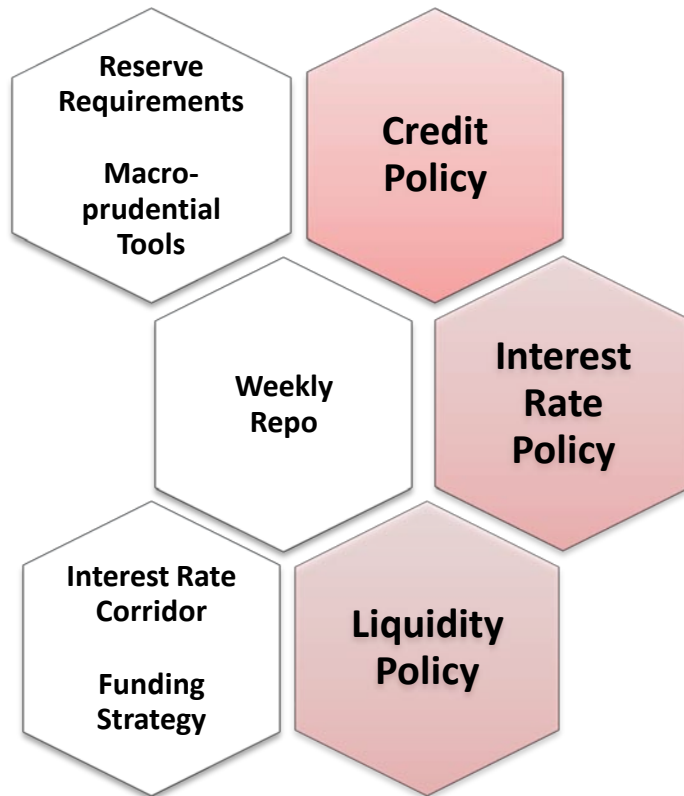
The New Policy Mix

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

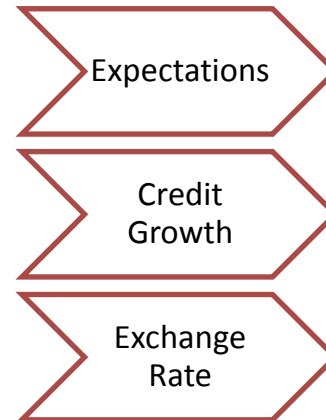
- The framework we adopt in spirit is not significantly different from the conventional inflation targeting framework.
- The only difference is that, previously our policy instrument was the one week repo rate, but now our instrument is a “policy mix”
- We seek to use these instruments in the right combination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

Multiple Instruments, Multiple Objectives

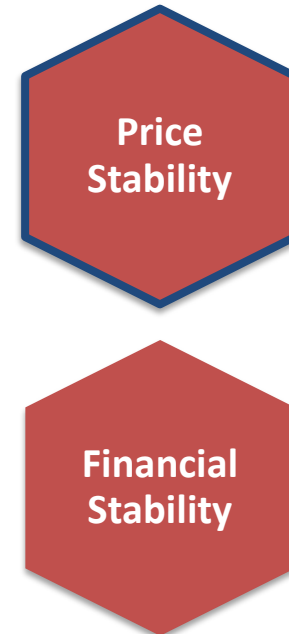
INSTRUMENTS



KEY INDICATORS



OBJECTIVES



Policies Against Short Term Capital Flows

Strong Inflows

FX Purchases

Decreasing the lower bound of the interest rate corridor

RRR hikes

Outflows/Weak Inflows

FX Sales

Increasing the upper bound of the interest rate corridor

RRR cuts

Measures Against Excessive Credit Growth

Predominant Policy

Before August 2011

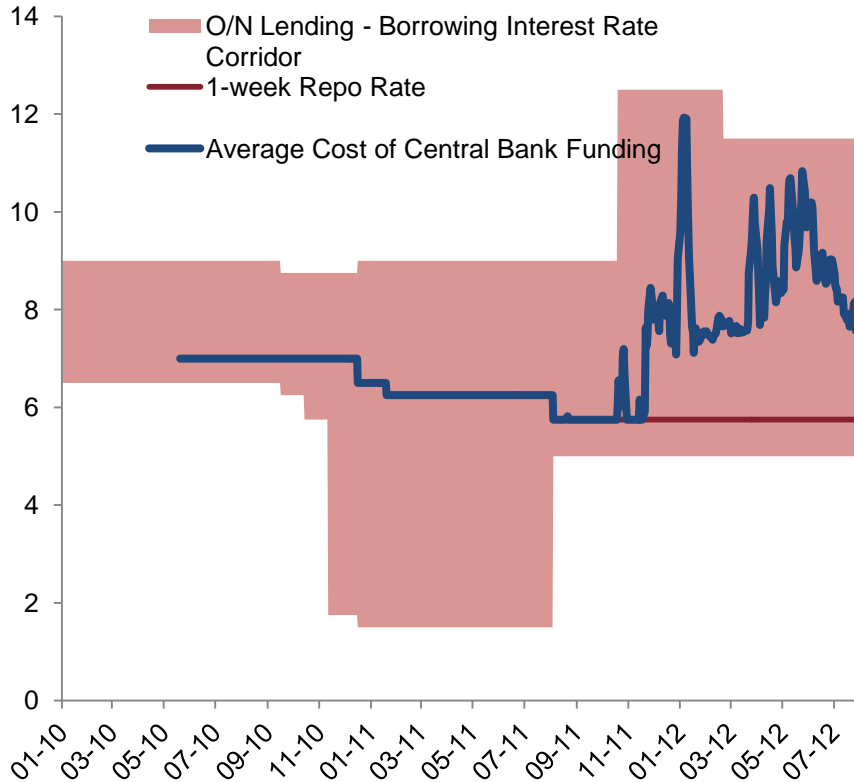
Macroprudential Tightening

After October 2011

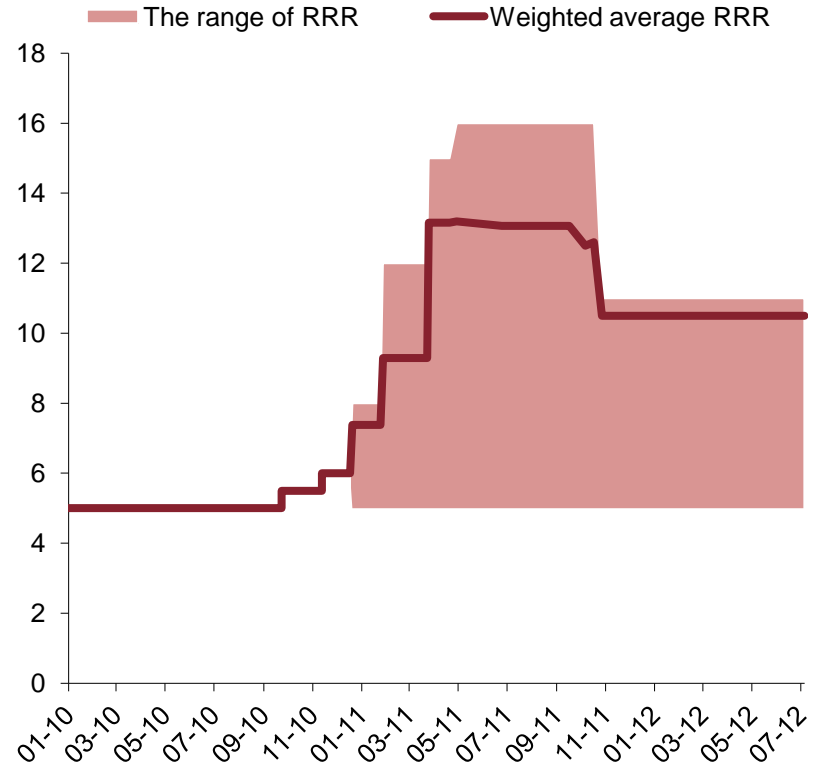
Monetary Tightening

CBRT started to implement monetary tightening.

CBRT Policy Rates (Percent)



TL Required Reserve Ratios (Percent)



Source: CBRT.

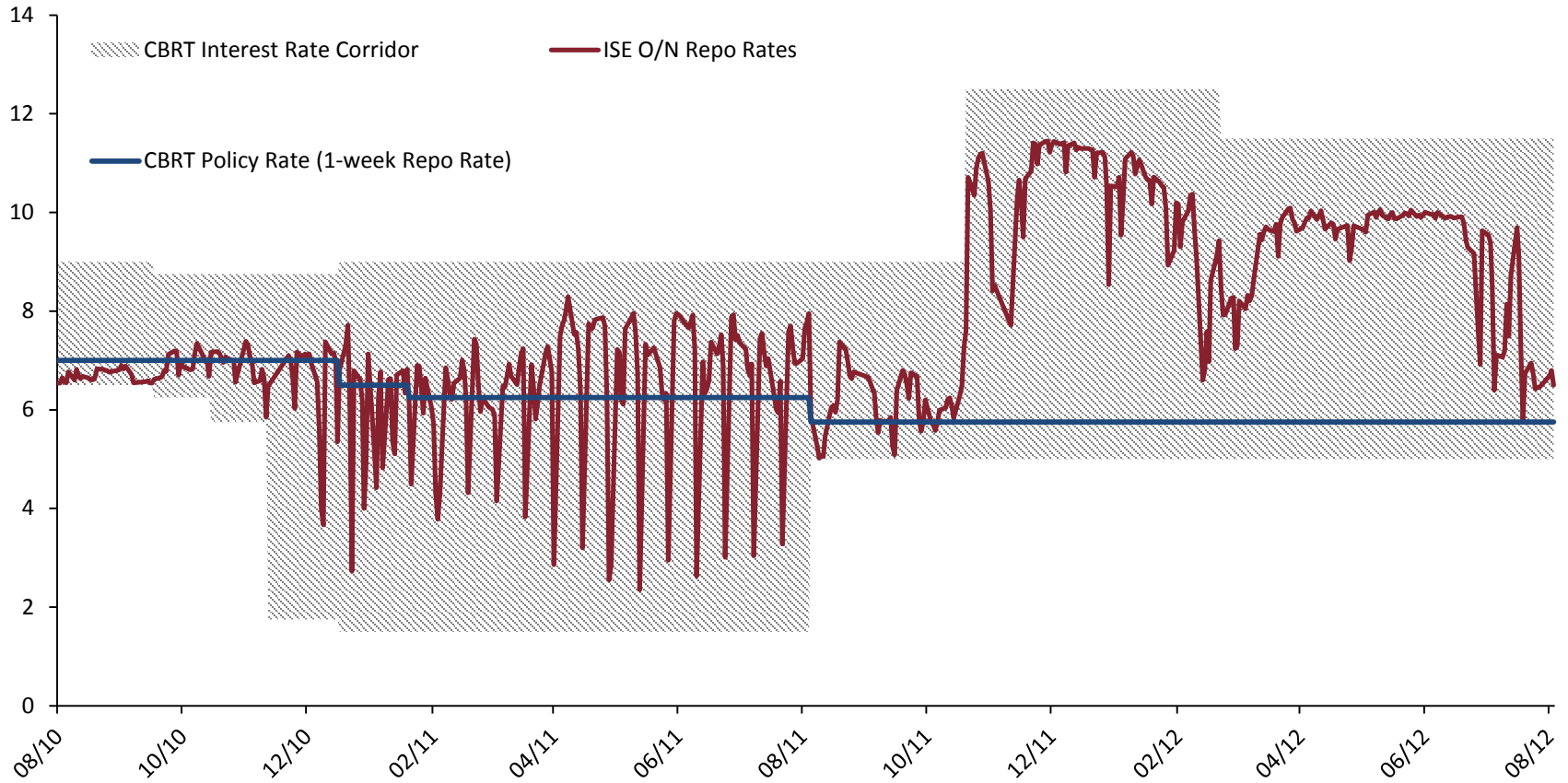
Latest Observations: August 3, 2012.

Source: CBRT.

Latest Observations: August 3, 2012.

O/N rates fluctuate close to the upper bound of the interest rate corridor.

ISE O/N Repo Rates (Percent, Daily)

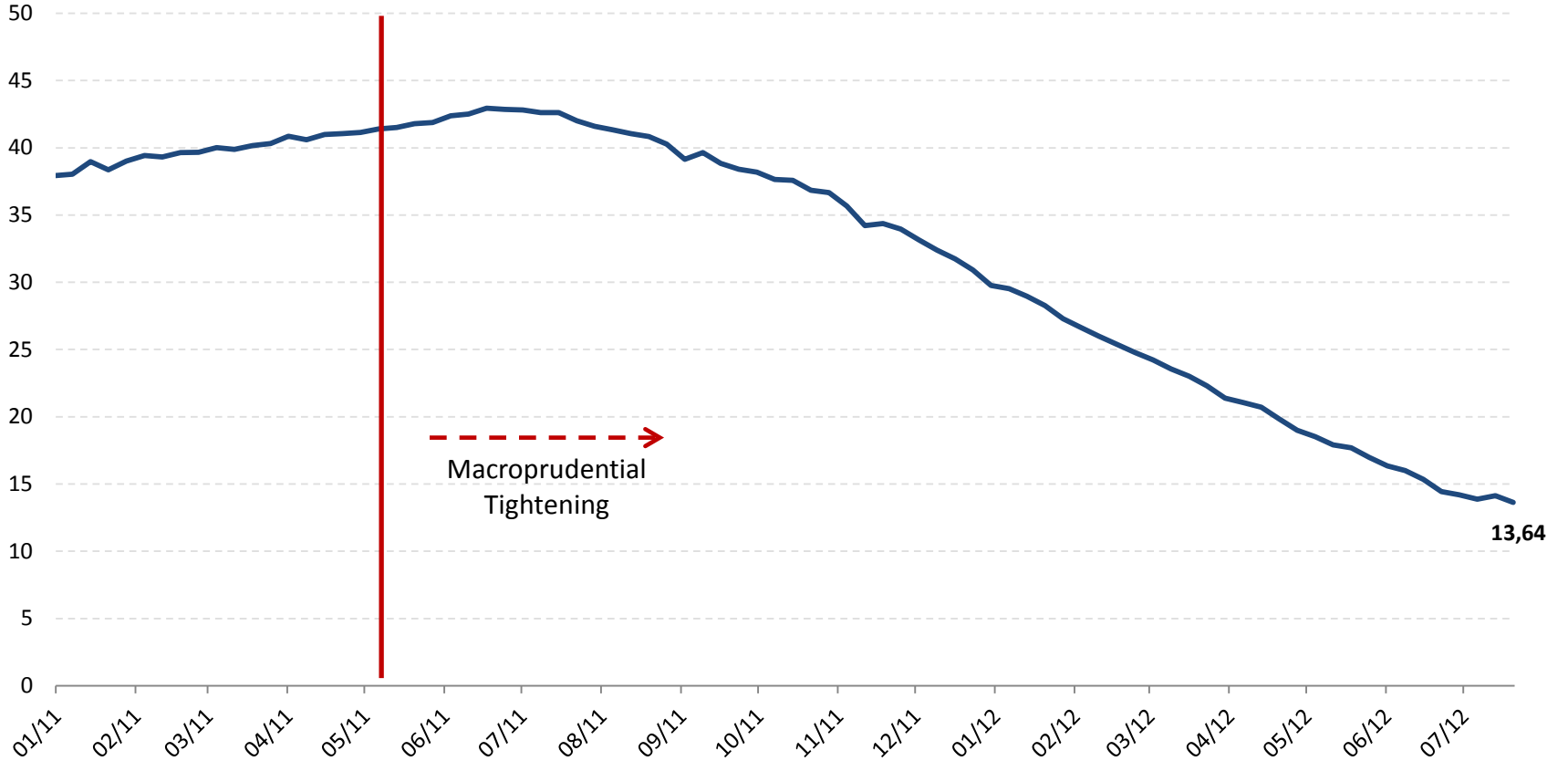


Source: ISE, CBRT.

Latest Observation: August 3, 2012.

Consumer loan growth decreased.

Consumer Loan Growth Rates (Annual, Percent)

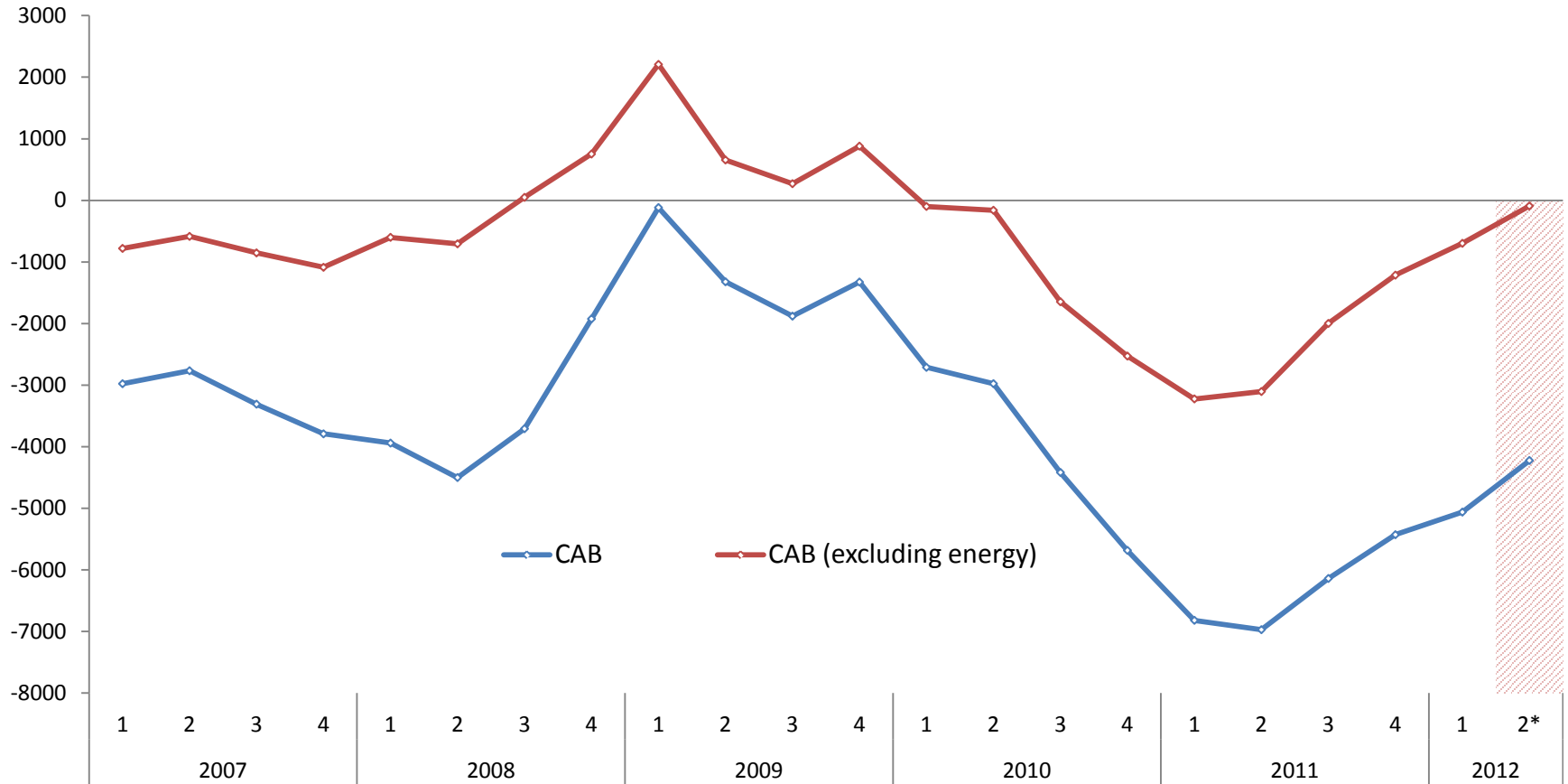


Source: CBRT.

Latest Observation: July 20, 2012

Rebalancing is on the way

Current Account Balance (CAB) (Seasonally Adjusted, Quarterly Average, Million USD)

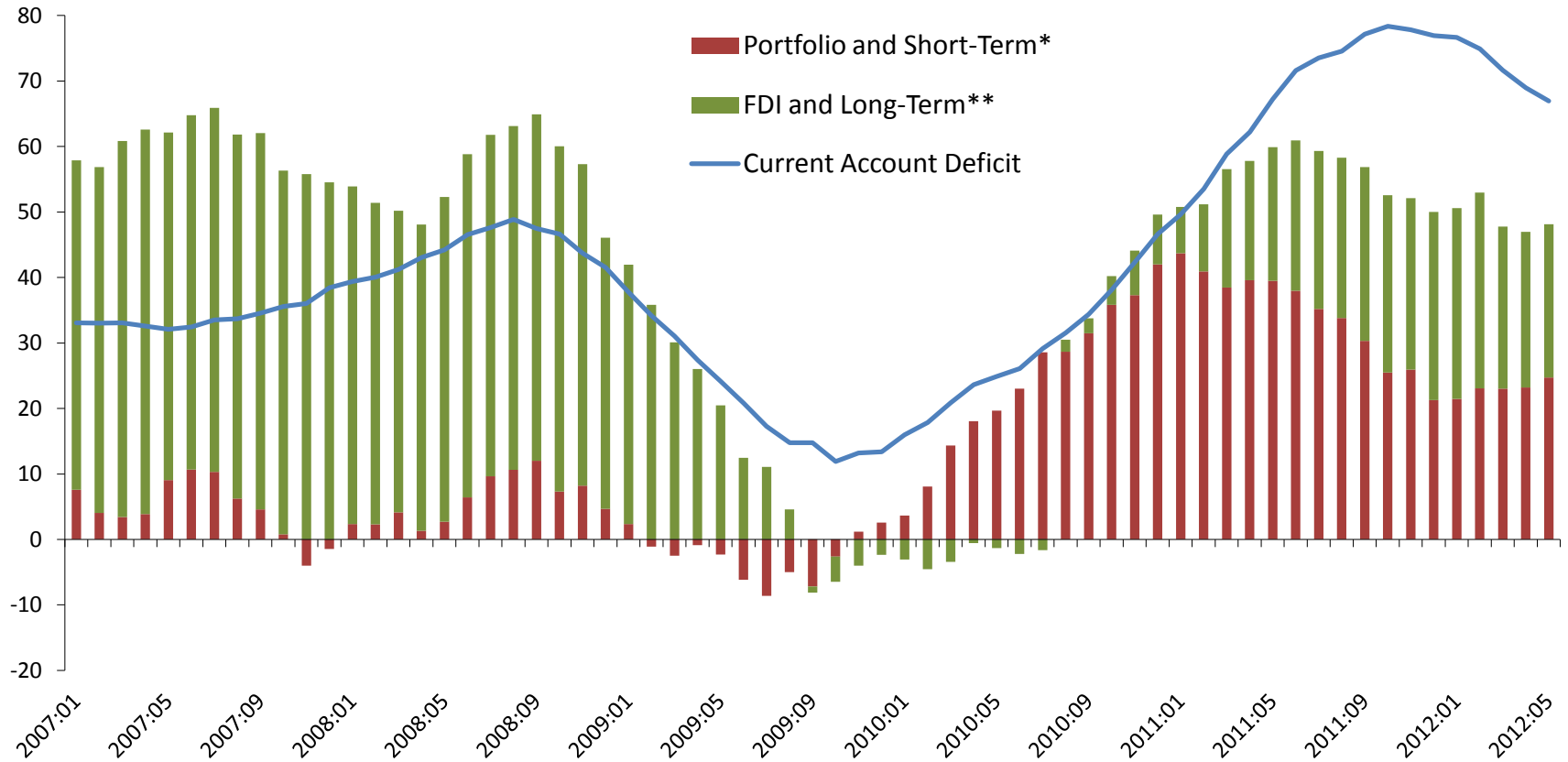


Source: TurkStat, CBRT.

*Latest observations are as of May.

Improved Financing Quality

Composition of Capital Flows (12-Month Rolling Sum, Billion USD)



Source: CBRT.

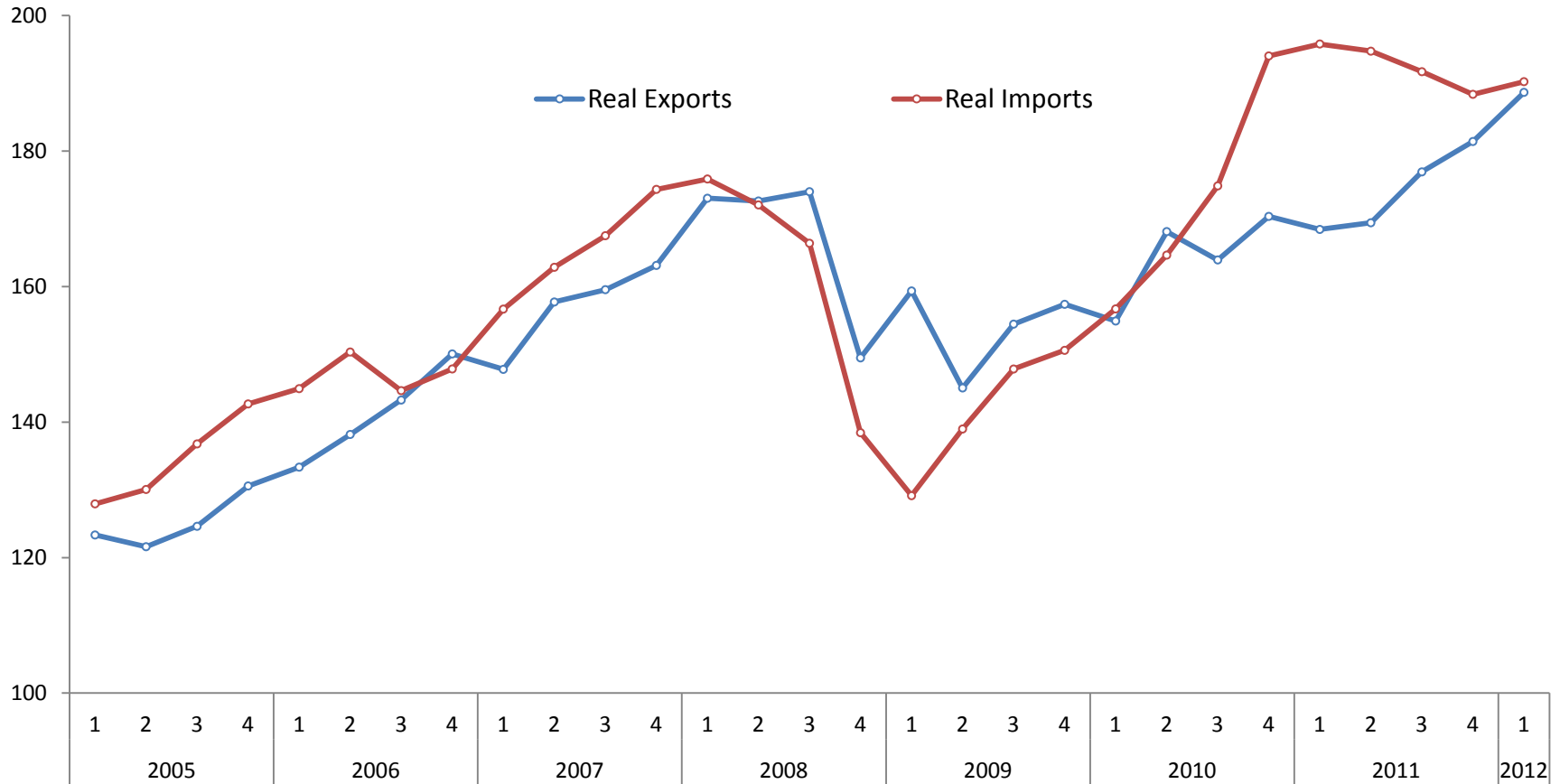
*Portfolio and Short-Term: Equities, Domestic government bonds, short-term credits of banks and non-banks and deposits held in banks.

**FDI and Long-Term: FDI, bonds issuance of banks and government and long-term credits of banks and non-banks.

Latest Observations: May 2012

Rebalancing is taking place.

Real Exports and Imports (2003=100, Seasonally Adjusted)

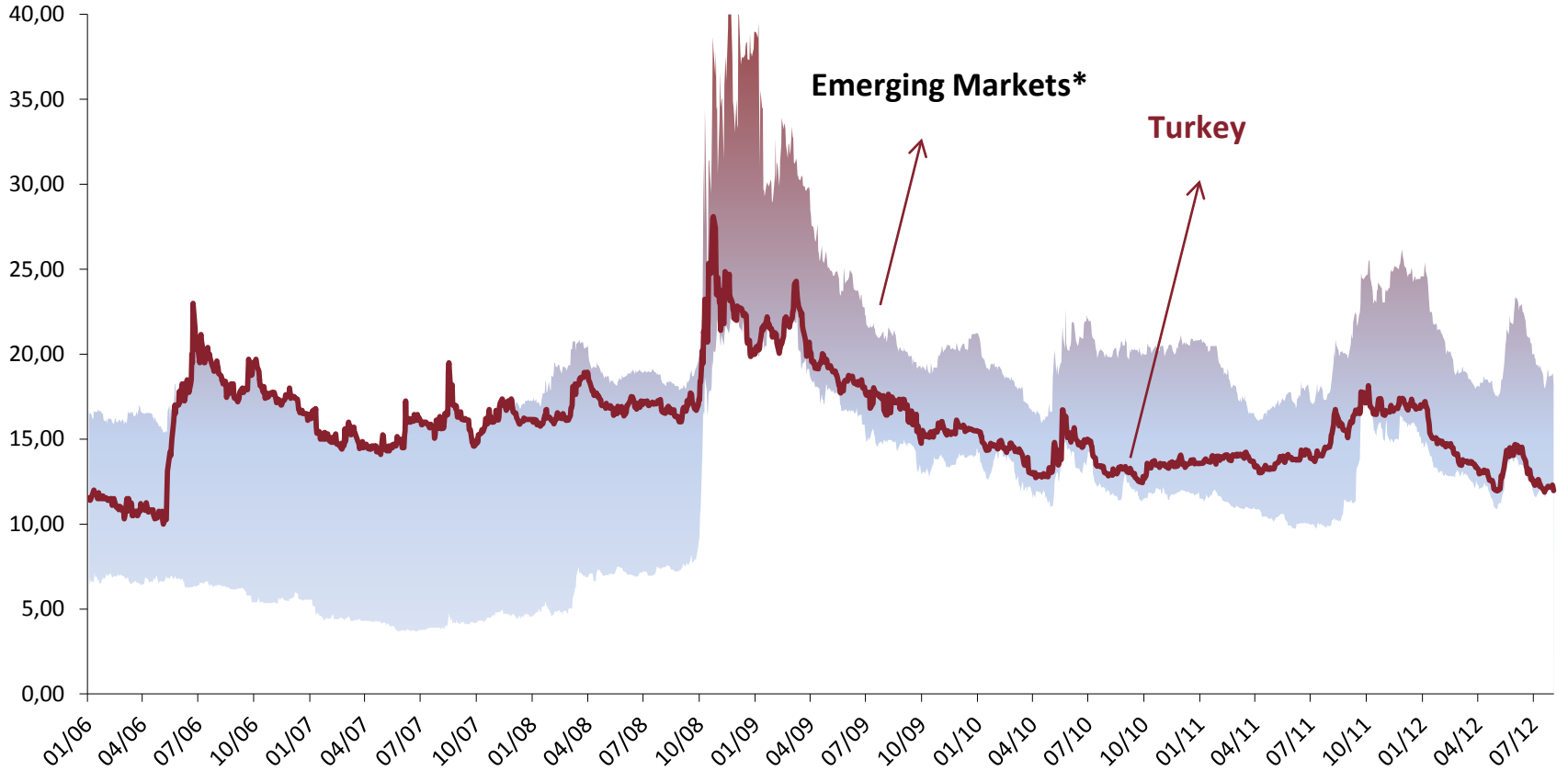


Source: TurkStat, CBRT.

Latest Observations: 2012 Q1

Relatively benign volatility of TL

Implied Volatility: Emerging Markets vs. Turkey (12-Month, Percent)



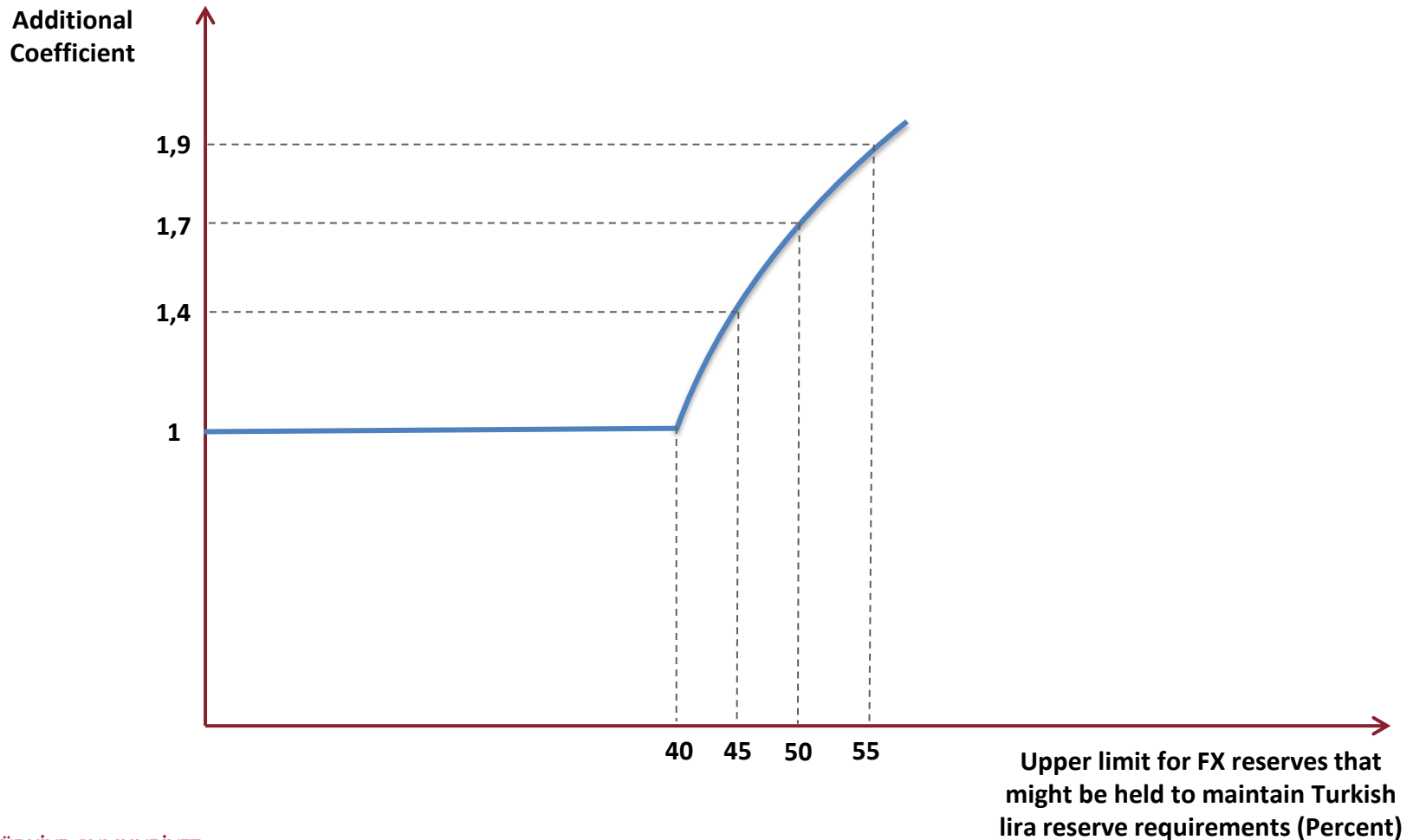
Source: Bloomberg, CBRT.

*Emerging markets include Brazil, Chile, Czech Republic, Hungary, Mexico, Poland, South Africa, Indonesia, Korea and Colombia.

Latest Observations: August 3, 2012

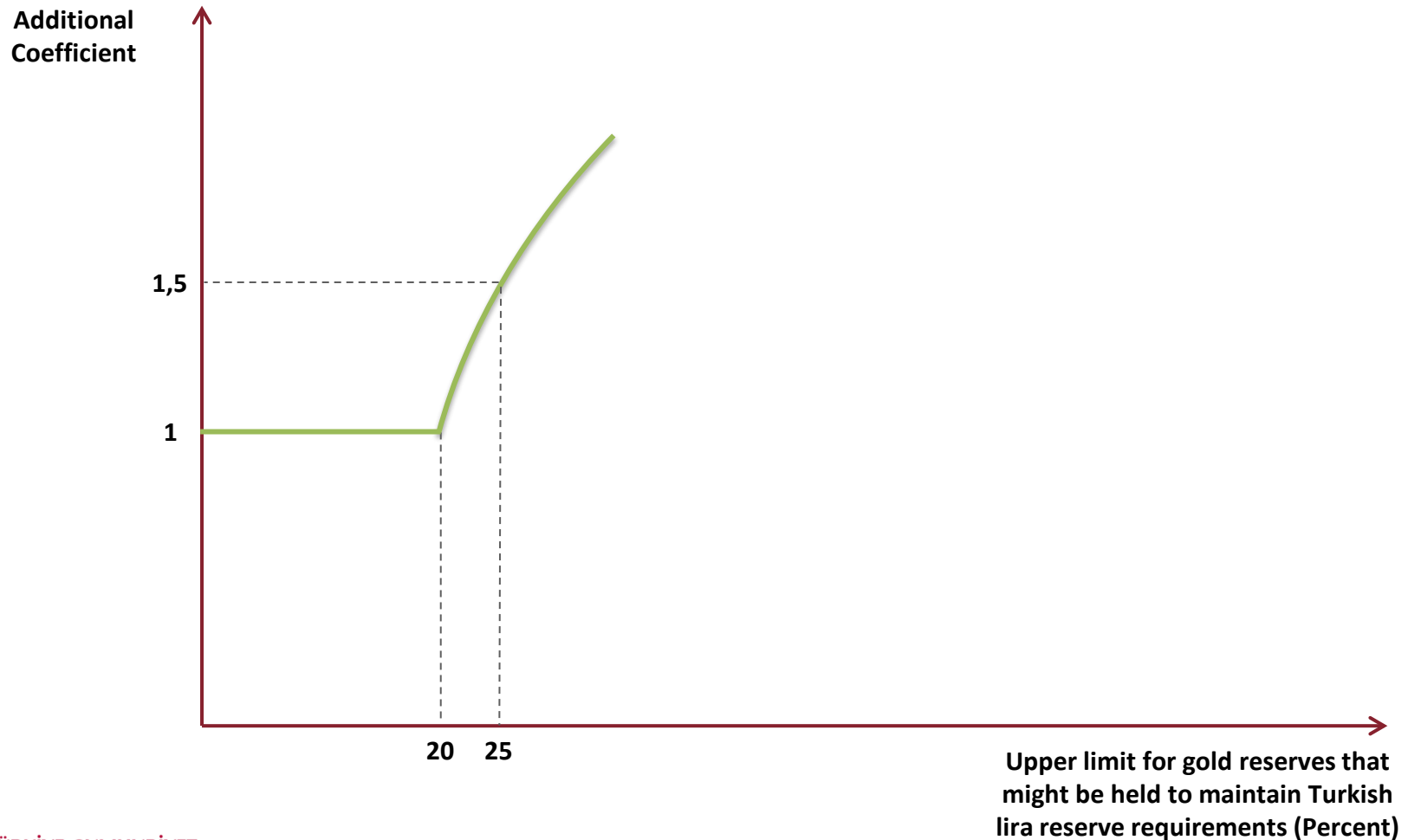
Automatic Stabilizer

FX



Automatic Stabilizer

Gold



- The policy actions required to take in these “interesting times” depend on country specific conditions.
- Policies should be flexible and able to adapt to the fast pace of the global economic conditions and volatile risk appetite.
- Ultimate goal of the policies used should be achieving sustainable growth coupled with price and financial stability.
- In order to reach this goal all policy makers should cooperate in tackling the imbalances and structural deficiencies in the economy.



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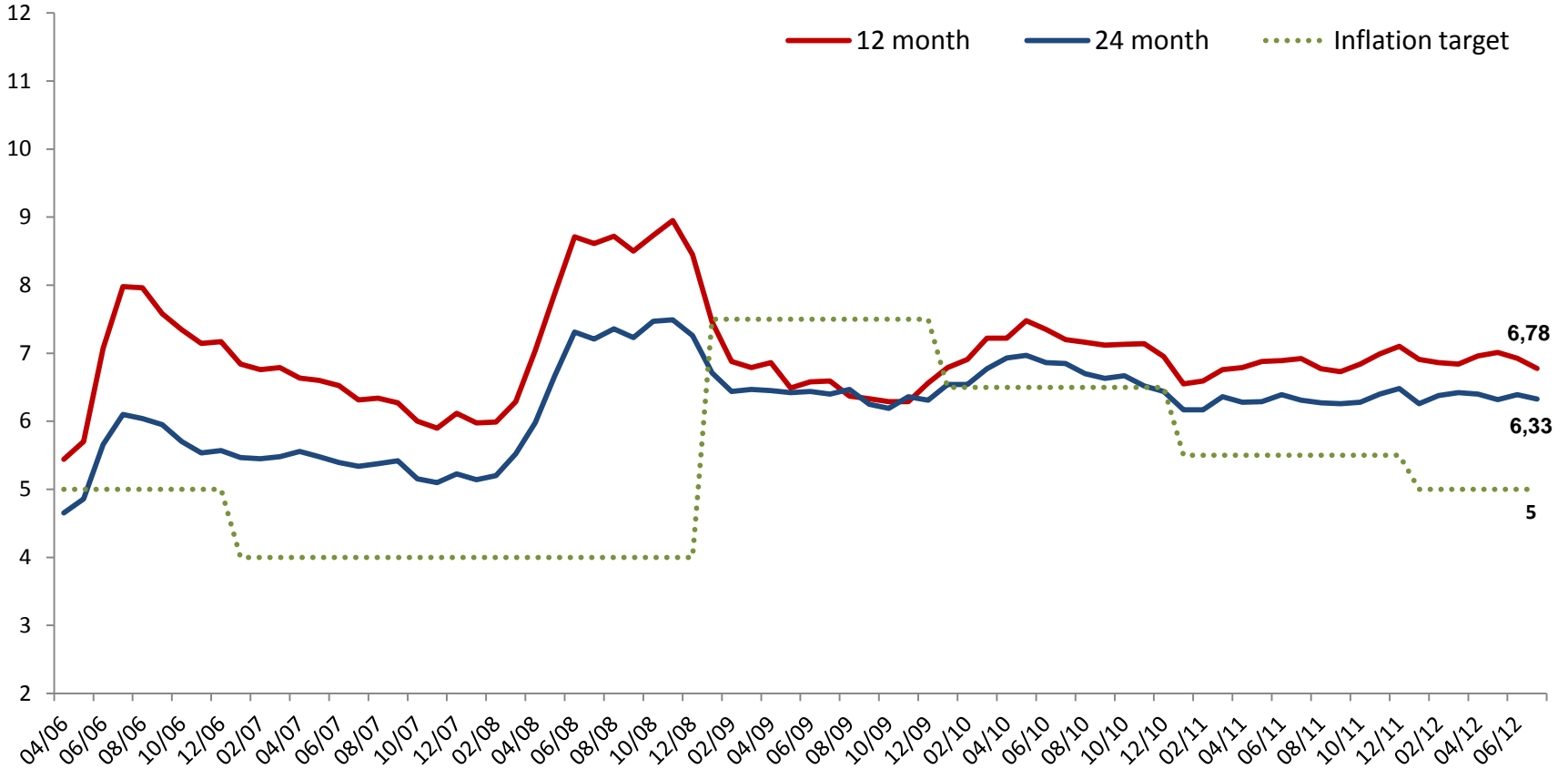
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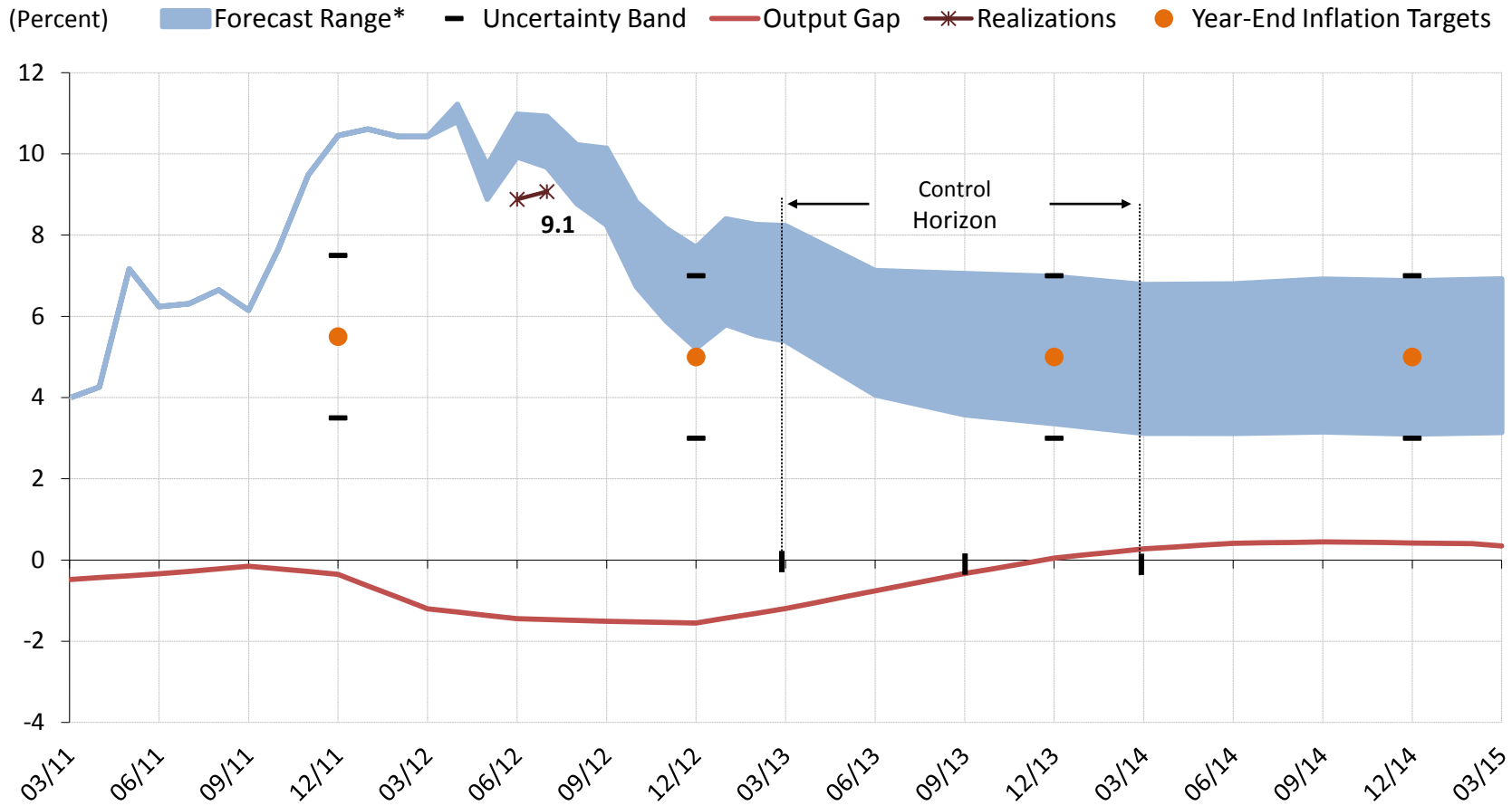
Inflation expectations are well anchored.

Inflation Expectations



Source: CBRT.

Inflation

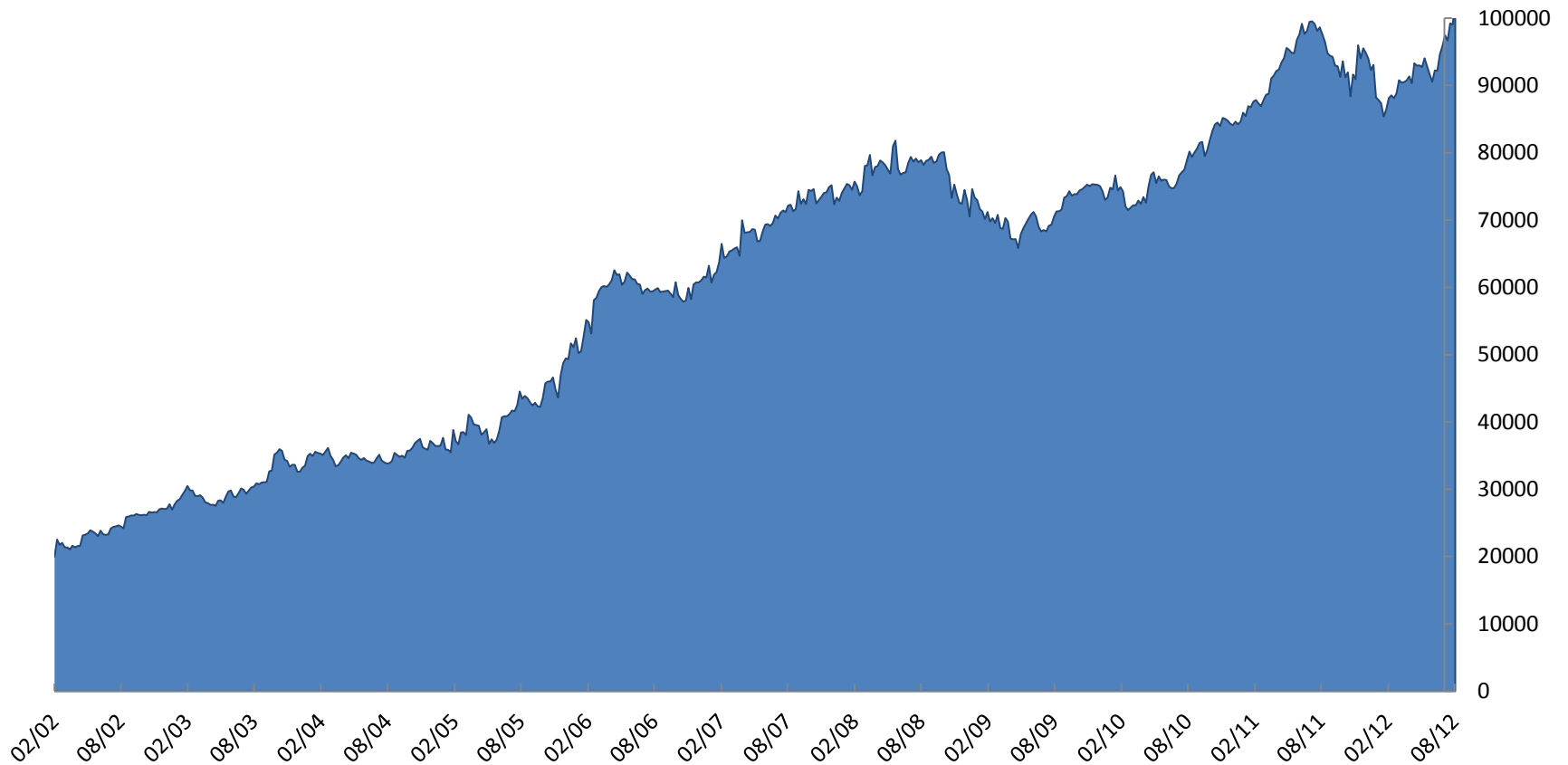


Source: CBRT.

* Shaded region indicates the 70 percent confidence interval for the forecast.

CBRT reserve level remain solid

Reserves of the CBRT
(FX and Gold, Million USD)



Source: CBRT.