

Turkey's Low-Quality Growth and the Role of Monetary Policy

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- The credibility of the Turkish Central Bank (CBRT), as well as the quality of its monetary policy conduct and communication, are at a rock-bottom at the moment.
- But this is not a new thing; credibility has been eroding for some time, as shown most recently by Demiralp-Cakmak (2020)*.
- I would take the starting point to as early as December 2010, when, with an awkward rate cut against a backdrop of an overheating economy, the CBRT has self-designated itself as the institution that could “fix it all”.
- The Bank’s key motivation was to work around the well-known Monetary Trilemma or the Unholy Trinity of international macroeconomics, so as to appease the political --and to some extent business -- establishment.
- The CBRT was not necessarily being dishonest. There was a genuine --and perhaps partly naïve-- belief that this could be achieved, whereas accumulated wisdom to date on the basics of monetary policy management and frameworks was telling us otherwise.

*Source: A Dynamic Evaluation of Central Bank Credibility: <https://ideas.repec.org/p/koc/wpaper/2015.html>



- So, how did it all play out? It is an old, long story, the nitty gritty of which I will not go into.
- I will cite three references instead. One paper by Hakan Kara, the CBRT's chief economist until last July --who had a leading role in this whole period-- explains and defends the CBRT approach (Kara, 2012)* while the record, which is not a favorable one, is discussed in Domac and Isiklar, 2012*, and Gurkaynak et. al., 2015*.
- My take is simple. Because of its extreme aversion to rate hikes, in all episodes of currency volatility, the CBRT acted entirely reactively, using rate hike as a last resort.
- In order to avoid rate hikes, it has come up with myriad other ways and tricks, as it tried to create, in my view very unconvincingly, the intellectual underpinnings for what was otherwise an extremely discretionary policy framework...
- Unsurprisingly, as a result, not only inflation targets were missed systematically – as we all know — but CBRT *forecasts* have been missed as well, which have become a means to justify the CBRT's pro-growth policy stance.

*Sources: Monetary Policy in Turkey After the Global Crisis, Hakan Kara, June 2012

(<https://www.tcmb.gov.tr/wps/wcm/connect/EN/TCMB+EN/Main+Menu/Publications/Research/Working+Papers/2012/12-17>);

Where is the CBT's unconventional journey heading? Ilker Domac & Gultekin Isiklar, October, 2012, Citi proprietary research; Monetary Policy in Turkey after Central Bank Independence, Refet Gurkaynak et. al., November 2015

(http://refet.bilkent.edu.tr/GKTY_IIF_2015.pdf);

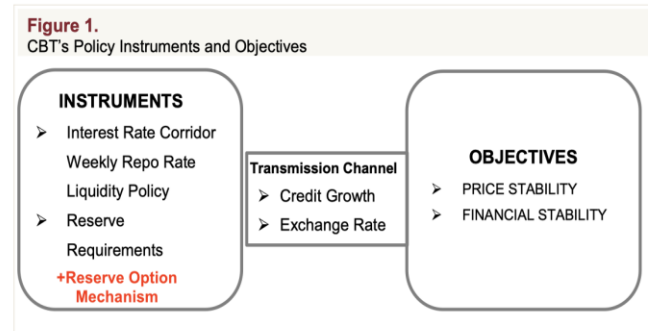


Let me highlight just a few of the arguments the CBRT concocted along the way...

- The CBRT said: Post-GFC monetary policy is changing, so we need new tools...
- Dissenters said: No, you don't – try what we know first... (Ucer, 2011)*
- The CBRT said: “If we maintain credit growth at so and so % and the real effective exchange rate in so and so range, we'll get to “5-5-5”” ...

- Dissenters said: No, we won't because we don't know enough about the economy's structure to speak so precisely
- The CBRT said: “We have lots of tools now, we can achieve multiple objectives (see picture)

- Dissenters said: No, you don't; these are all interrelated, so they cannot be used for multiple objectives. The much-vaunted “corridor” for one was not really a tool, it was just a way of achieving interest rate flexibility around the Trilemma -- and this is one reason why the system has lost its anchor, as the spirit of Inflation Targeting was violated...



Source: Kara (2012)

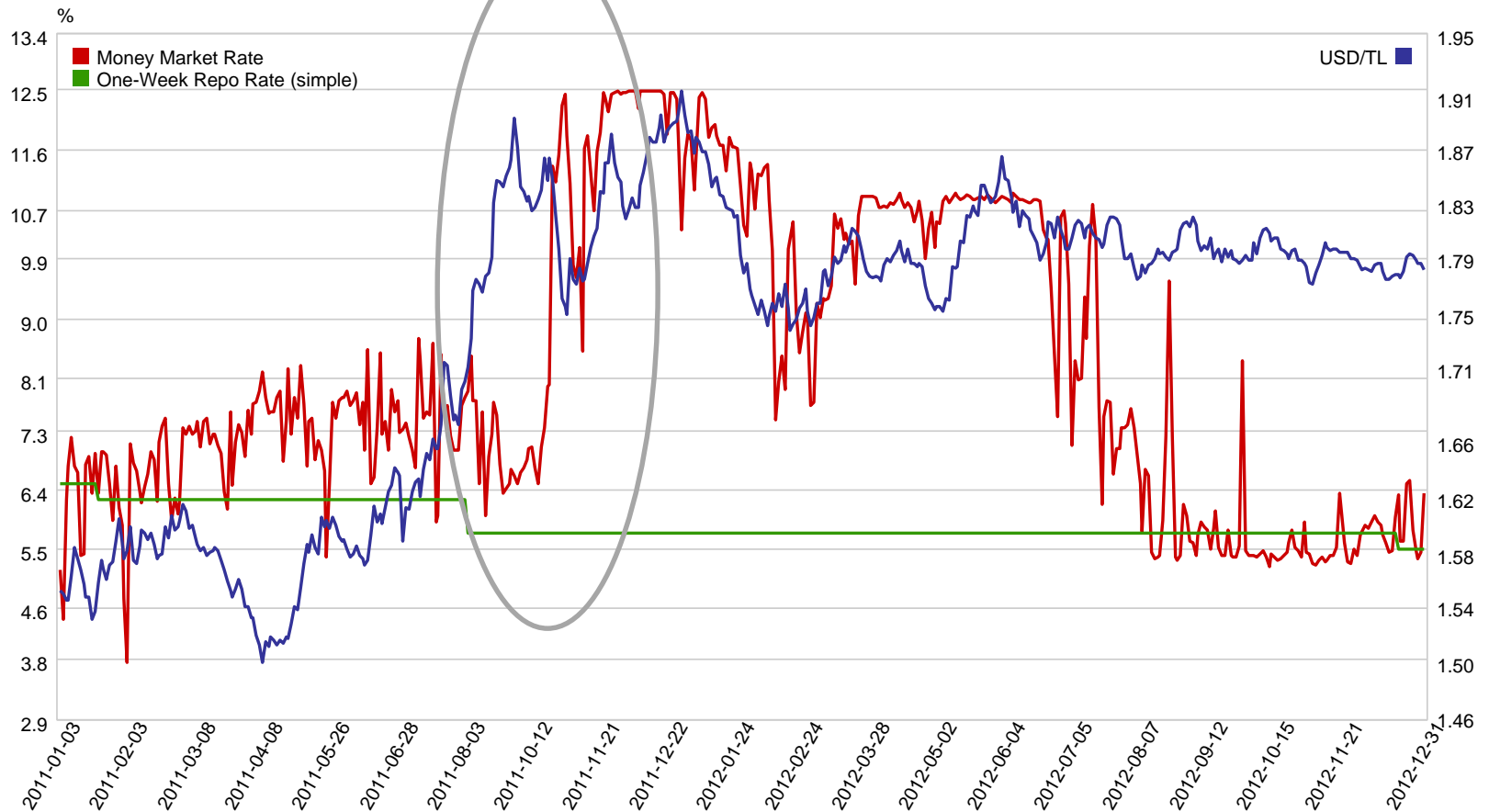
*Source: Observations on the recent monetary policy framework [in Turkish], İktisat isletme ve Finans, May 2011.

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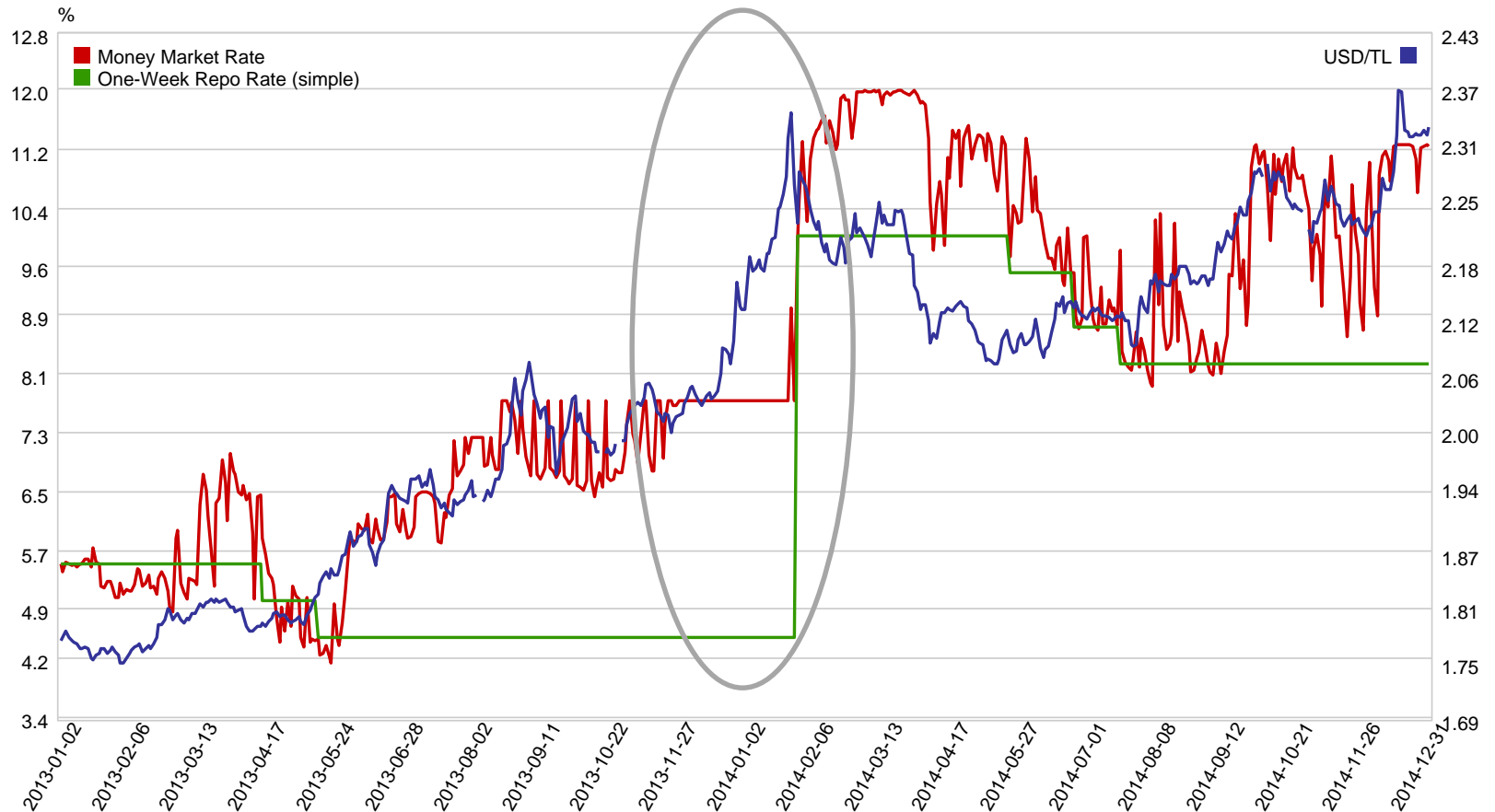


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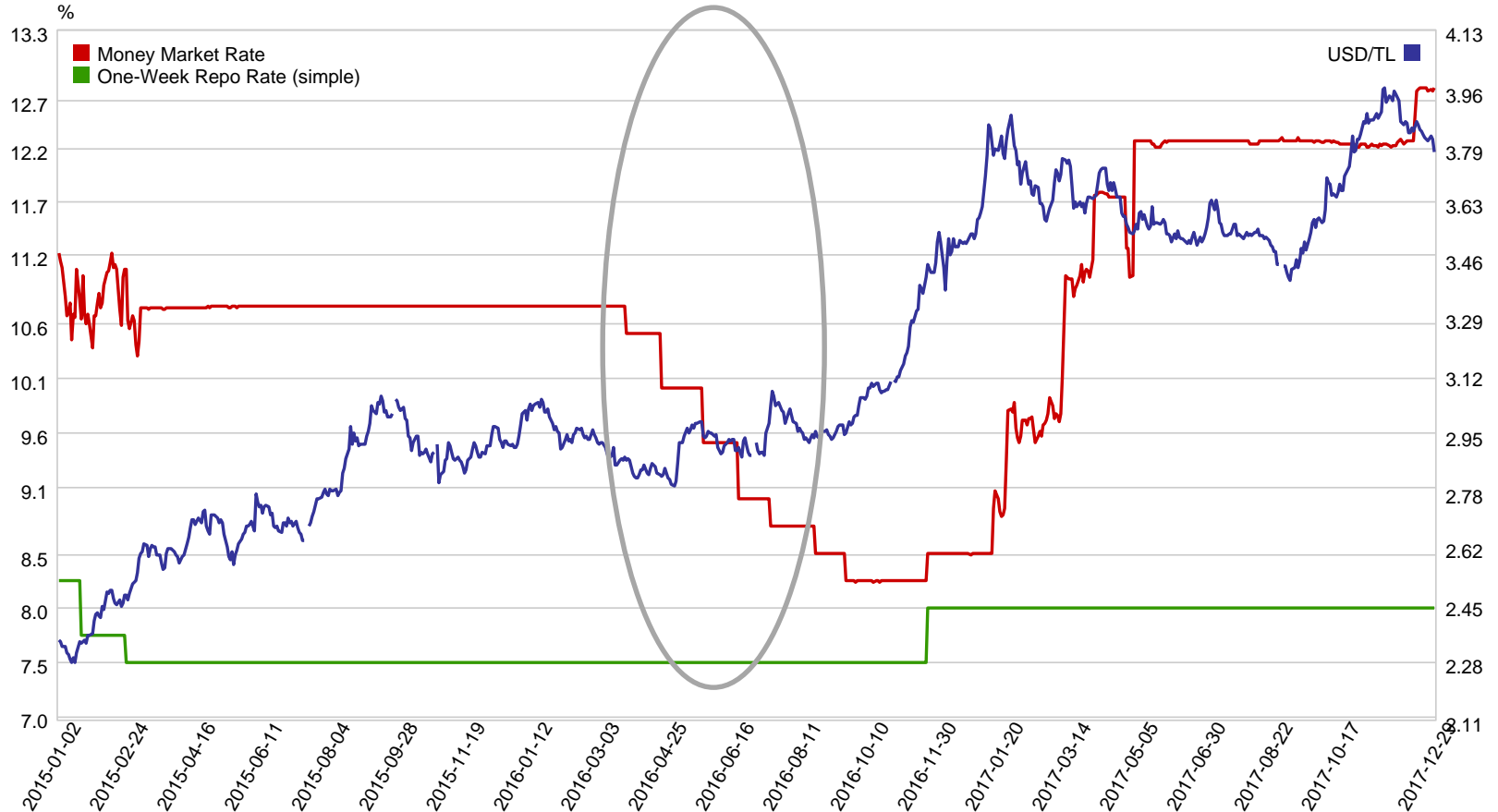
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Interest Rates and the Lira: 2015-17

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EM Sell-off, No Hike, Delayed Hike by Cetinkaya





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Onur Arnt and Ali Berat Meric
August 27, 2013, 2:27 PM GMT+3

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Turkey's central bank Governor Erdem Basci said he won't increase interest rates to fight a deepening slump in the lira, and instead promised to use "surprise" tools to reverse the trend.

The bank has \$40 billion in reserves it can use to defend the lira, which fell to a record low against the dollar today, Basci said in a televise with state-run AAFinans. He said the bank won't change its overnight lending rates, the top end of its interest-rate corridor, and will announce "new tools" to support the currency.

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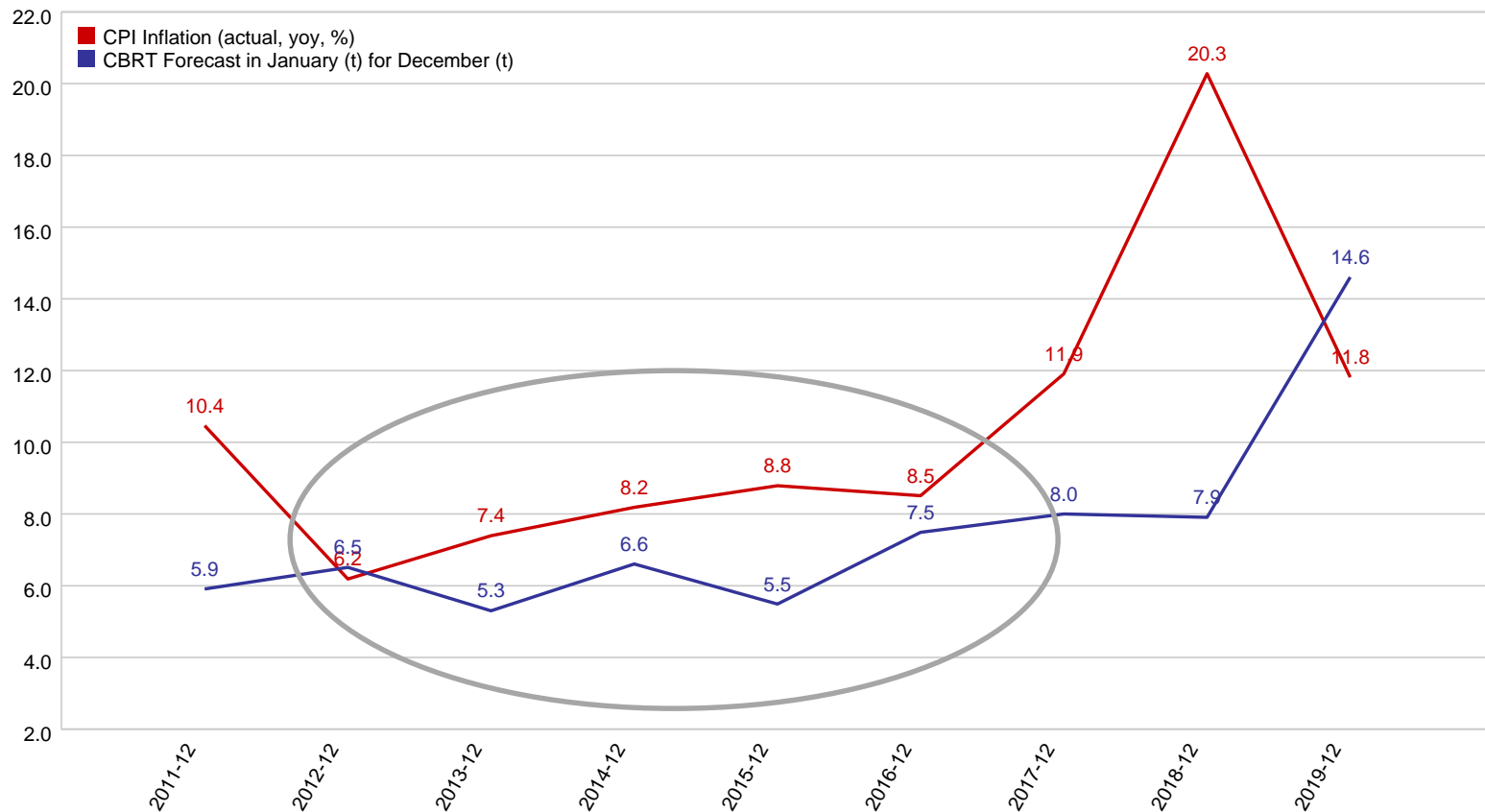


Actual inflation exceeded not only targets but forecasts, too



Yearend CPI Inflation: Actual vs CBRT Forecasts

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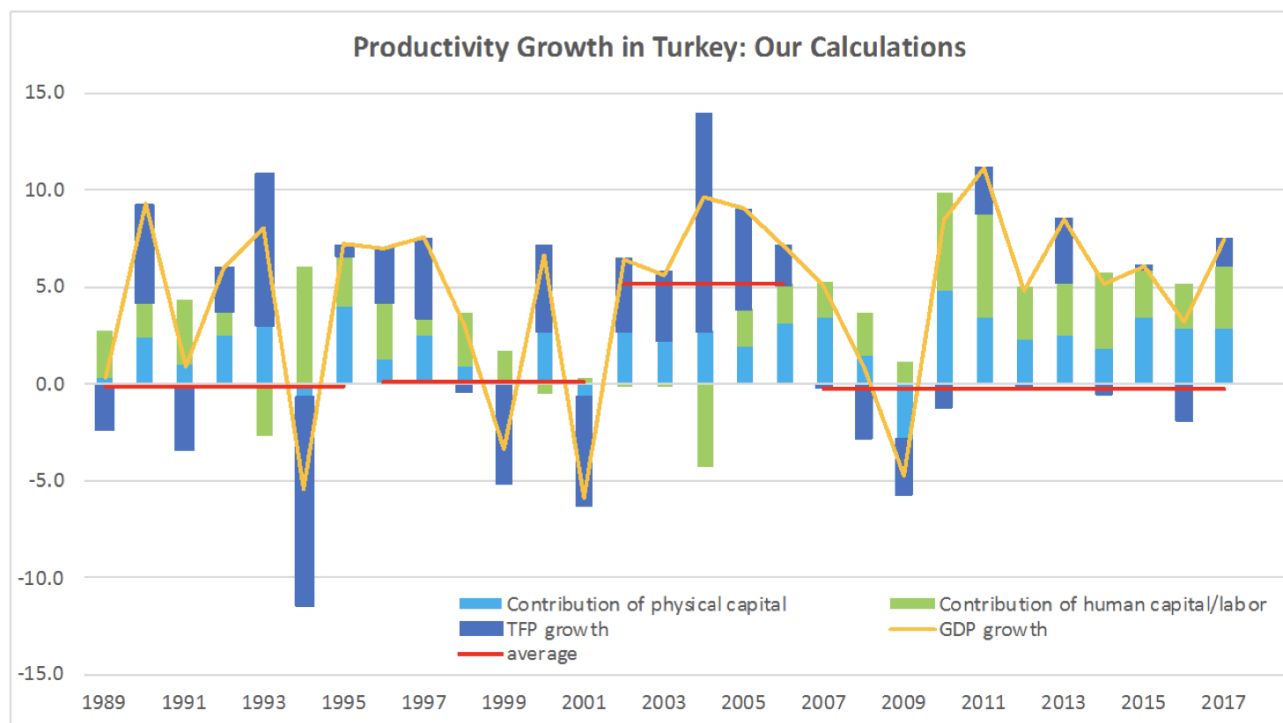


- How is all this related to “low quality growth”? What is LQG anyway?
- It is essentially growth without total factor productivity -- and it often comes with deteriorating income equality, as discussed in Acemoglu-Ucer (2019)*.
- There, we talk about how institutional erosion –central banking and monetary policy independence included—led to low quality growth in Turkey, starting around 2007.
- No TFP growth since 2007 or so, on average, vs. substantial growth during 2002-06 has nowadays become a stylized fact of Turkish macro.
- Other than paying some lip service, however, the CBRT never focused on productivity (which, to recall, is “almost everything in the long run”) or the low-quality nature of growth --that it was credit-fueled, construction-led, unbalanced, and so on.
- One very important job of a good central bank, however, should be to educate the public on what monetary policy can and cannot do, help the society focus on the right issues and understand the trade-offs (notably costs of inflation complacency).
- We have been badly miseducated, in this regard.
- By creating the illusion that monetary policy can fix it all, while placing the priority squarely on boosting --*cyclical* and *unproductive*-- growth to please the establishment, monetary policy of the past decade has been an important contributor to Turkey’s low-quality growth era.

*Source: Acemoglu-Ucer, High-Quality vs Low-Quality Growth in Turkey: Causes and Consequences, October 2019 (<https://economics.mit.edu/files/19567>); forthcoming in *Turkish Economy at the Crossroads* (<https://worldscientific.com/worldscibooks/10.1142/11682>)



Figure 6



Source: Our calculations.

Note: Calculations are based on a standard growth accounting framework as in Hall and Jones (1999), with weights of 1/3 and 2/3 assigned for capital and labor shares, respectively. Capital stock series has been derived from gross fixed capital formation, applying the standard perpetual inventory method and has been adjusted for capacity utilization, while human capital stock stands for employment adjusted for education using Mincerian returns.

Source: Acemoglu-Ucer, High-Quality vs Low-Quality Growth in Turkey: Causes and Consequences, October 2019 (<https://economics.mit.edu/files/19567>); forthcoming in *Turkish Economy at the Crossroads* (<https://worldscientific.com/worldscibooks/10.1142/11682>)

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