Durmuş Yilmaz: Globalization and monetary policy

Speech by Mr Durmuş Yilmaz, Governor of the Central Bank of the Republic of Turkey, at the conference on "Globalization, Inflation and Monetary Policy", Istanbul, 21 November 2008.

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Dear Guests,

I would like to welcome you all to the conference on "Globalization, Inflation and Monetary Policy", organized by the Central Bank of Turkey. This conference will host a select group of central bankers, experts and academics today and tomorrow. It is a great pleasure for us to host this conference and such a distinguished group of participants. During these two days we will have the opportunity to discuss the globalization and monetary policy aspects in the context of current financial turmoil.

Dear Guests,

We have in the midst of fast changing economic agenda. When invited to an international conference in the Spring of 2008, I was requested to make a speech on inflationist pressures faced by world economies. The title of the session was **"Inflation: Is it back to stay?"**. In Fall 2008, a few weeks before the start of the conference, the organizers informed me that they had changed the theme of the conference. The new title was **"How to cope with deflationary risks?"**. In a very short span, the main talking points of the policy makers have shifted from "decoupling", "high energy prices" and "food inflation" to "deflation", "recession" and "credit crunch".

Today, international financial system shaped more and more by globalization is on the brink of a crucial stage. The problems, which started in sub-prime mortgage markets in the United States, have spread the whole financial system and reached a point that threatens the economic stability. Indicators on risk perceptions are at its highest level of all times. We have witnessed some relief in the liquidity shortage after the establishment of temporary reciprocal currency arrangements of Federal Reserve Bank (FED) and Short Term Liquidity Facility established by IMF, which is designed to help member countries that are facing temporary liquidity problems in the global capital markets. However, despite these measures, liquidity squeeze in the credit markets and reluctance in bank's tendency to lend credit have been unabated. One of the adverse features of the current crisis is the freeze in the private credit and the tendency of capital to flow back to where the current crisis originated.

Recent readings on economic activities suggest that ongoing problems in international credit markets have spilled over into the real economy as well. Recent estimates of international institutions point out a prolonged period of recession in developed economies and a sharp slow down in growth rates of developing economies.

Addressing these challenges, G-20 Summit held in Brazil on 8-9 November 2008, issued a communiqué that included the following statement: "We affirmed our determination to take all necessary steps to foster non-inflationary growth in a stable and sustainable manner according to the needs and available instruments in our respective countries, including through monetary and fiscal policy."

Distinguished Guests,

As concerns over inflationary pressures have subsided all over the world, maintaining the smooth functioning of financial system and efficiency of credit markets has become the main priority of policy makers. It will be proper to evaluate the recent developments in Turkish economy in this perspective.

In Turkey, the banking system has been relatively prepared for the current crisis in terms of foreign exchange liquidity. Its foreign exchange short position is also well contained. Foreign exchange position of the public sector is almost negligible. The household sector is net creditor in terms of foreign exchange, while real sector is net debtor.

Since securitized products are rarely used in the Turkish banking sector, the ongoing financial turmoil has not put a marked pressure on local banks through that channel.

Current account deficit, historically a source of vulnerability for the Turkish economy, is likely to experience a sharp drop in the upcoming period due to correction in commodity prices, slow down in economic activity and depreciation in New Turkish Lira.

Still, extraordinary fluctuations in global liquidity conditions have adversely affected Turkey like other countries, which are sensitive to international financial developments.

At this point, I would like to emphasize that we will continue to take the necessary measures to contain the adverse effects of the global financial turmoil on the domestic economy, provided that they do not conflict with the price stability objective.

The general framework of the Central Bank's liquidity management is fairly flexible and well-structured to fulfill its lender-of-last resort role and meet both New Turkish Lira and foreign exchange liquidity requirement of the banking system effectively.

We will not allow any setback in New Turkish Lira money markets and will ensure smooth operation of payment system. In this context, judging that inflation will display a more rapid fall than envisaged before, the Monetary Policy Committee has decided to lower the borrowing rates by 50 basis points on November 19, 2008. In addition, the margin between the lending and borrowing rates was reduced by a further 50 basis points in order to contain the potential volatility in short term interest rates.

Dear Guests,

The Central Bank of Turkey is aware of the significance of foreign exchange liquidity in the banking system and progressively puts into effect necessary measures in order to get through this period with minimal damage.

Accordingly, the Central Bank resumed its activities as an intermediary in Foreign Exchange and Banknotes Markets as of 9 October 2008 and later raised transaction limits in the Foreign Exchange and Banknotes Markets to USD 10.8 billion. Along with the above mentioned measures, in order to ensure orderly liquidity flow in the financial system and efficient functioning of credit markets by stimulating an increased foreign exchange liquidity flow in the interbank foreign exchange market, effective as of today the Central Bank has decided:

a) To extend the maturity of the FX deposit borrowed by the Banks within the predetermined borrowing limits from one week to one month,

b) To reduce the lending rate from 10 percent to 7 percent for USD and 9 percent for Euro in the said market.

In this challenging environment the way developing countries use their foreign currency reserves is of utmost importance. The Central Bank of Turkey, if deemed necessary, will continue to take additional measures prudently within its means in order to ensure the smooth functioning of the FX market and to support FX liquidity.

Dear Guests,

I would like to conclude my speech by giving some information about this conference organized with the aim of discussing the effects of globalization on monetary policy and inflation. The first session today will examine the linkages between globalization, monetary policy and financial stability. In the afternoon, second and third sessions will analyze the impact of globalization on inflation and business cycles. Sessions on Saturday will be more policy oriented. In the morning session, speakers will look at the topic of globalization and monetary policy challenges faced by emerging market economies. Then we will conclude with a panel on the recent global financial turmoil and its policy implications.

Once again I extend my warm welcome to all participants. I also want to thank the distinguished participants for their valuable contributions. I hope you enjoy both the conference and your stay in Istanbul.

Thank you.