

**Mr. Erçel reports on medium and long-term prospects for the Central Bank of the Republic of Turkey** Address by the Governor of the Central Bank of the Republic of Turkey, Mr. Gazi Erçel, before the 66<sup>th</sup> Shareholders' General Meeting, in Ankara, on 28/4/98.

A detailed account of economic developments during 1997 is given in our annual report for that year which has already been delivered to you. We are keeping the public informed of our expectations for this year through the quarterly announcements of our monetary programme. Today, instead of repeating these short-term perspectives, I would like to speak of the medium and long-term prospects of the Central Bank. For the last two years, my discourse has touched on what kind of institution an ideal central bank should be. Today, I want to consider this matter in a more detailed way.

In recent years, there has been a worldwide trend towards simplification of the goals of central banking. This has led to a reduction of the responsibilities they take on. Funding their governments, for example, is no longer the main purpose of central banks. There is none among the western central banks that aims at achieving full employment of the highest level of production. Today's modern central banks have only one aim: to maintain price stability.

It is not surprising that the Central Bank of Turkey, one of the most important institutions of the Turkish economy, which hopes to become integrated with the western economies, is affected by these trends in modern central banking as it maps out its medium and long-term strategies.

Accordingly, the main goal of the Central Bank of Turkey, like that of other central banks, should be to maintain the stability of prices in the economy.

At this stage I would like to clear up two points with respect to the price stability target. First, the Central Bank's price stability target and its responsibility for price stability are two different issues. The price stability target assumes a stability which exists under conditions of low inflation. Therefore, the economy has to undergo a "disinflationary process" before the Central Bank assumes responsibility for price stability.

It is well known that in Turkey, which has been experiencing high inflation for years, reducing inflation to the levels of the western economies will require a comprehensive effort and is not a process which can be accomplished by the Central Bank alone. The Central Bank can track the price stability target as a part of the larger disinflationary programme. I believe that once low inflation rates have been achieved by means of such a programme, it will be a rational decision to make the Central Bank responsible for maintaining price stability.

The second point I want to stress concerning the price stability target concerns microeconomic functions of central banks. Efficient operation of a payments system and supervision of the banking sector are two other basic functions of a central bank. These two functions can also be performed in a way that supports price stability targets: indeed, a sound, effective financial sector and payments system are necessary conditions for price stability.

Duties assumed by the Central Bank of Turkey in the economy, which aims at price stability, should be consistent with the target. Functions that conflict with the price stability target or which cause difficulties for the achievement of this target should not be assigned to the Central Bank. And this should be the basic theme of the Bank's medium and long-term strategic planning.

Whether or not those functions assumed by the Central Bank as a result of such factors as the country's geographic size, history, legal structure and degree of technological development operate as impediments to the achievement of stability targets, can be examined by means of several criteria. Effective use of monetary policy is an absolute necessity for a central bank that takes price stability as its first priority. We must therefore review those functions of the Central Bank that interfere with the effectiveness of monetary policy.

At this point, I would like to emphasise the importance of increasing the Central Bank's control over its own balance sheet, which is one of the main conditions required for the effective implementation of policies, mainly monetary policy, that must be adopted in order to achieve the price stability target. Over the past decade, substantial improvements have been visible in the Central Bank's balance sheet, especially on the asset side. Foreign assets increased, while domestic assets dropped sharply due to the decrease in loans to the public sector, including valuation accounts. The final step to be taken in this area will be to reduce, by law, the advances made by the Central Bank to the Treasury to zero. Pursuant to the protocol between the Central Bank and the Treasury, signed in the second half of last year, the effectiveness of the monetary policies pursued by the Central Bank increased during this period. An amendment to our laws will ensure the continuance of this favourable condition. And the revision of the financial relationship between the Central Bank and the Treasury and the increase in the Central Bank's control over its balance sheet will aid the achievement of the price stability target.

But the structural improvements seen on the asset side of the Central Bank's balance sheet in recent years have not been matched by similar improvements on the liability side. Our Turkish lira liabilities represent a minor share in our total liabilities. To improve this unfavourable situation, which can be seen as the reflection in our balance sheet of high inflation, will require a lasting reduction in the inflation rate, which is the basic reason for this problem. Converting our liabilities into Turkish lira is one of our goals for the medium term.

Independence is of great importance in the medium and long-term perspectives of the Central Bank. An independent central bank, with respect both to its goals and its instruments, will promote the achievement of the price stability target. A central bank which is independent with respect to instruments will implement its monetary policy effectively.

It is also recognised that a central bank which is independent of political authority will play an important role in minimising fluctuations arising from political uncertainties.

Today, it is apparent that economies with independent central banks that have maintained monetary and financial stability are very strong.

The basic features of the Central Bank's medium and long-term strategies are to choose price stability as its main target, to establish consistency between its functions and its main target, and to revise any functions that may impede the implementation of its monetary programme and in this context to achieve its independence.

On the other hand, the organisational efficiency of the Central Bank can be seen as the complementary element of this strategy. There is no doubt that a central bank with qualified personnel, which fulfils its duties with high productivity, will earn full credibility. Distinguished guest, here let me quote one of the economists: "Credibility cannot be purchased, it must be acquired. And this is achieved step by step, through consistent policy implementations."

To carry the Central Bank, one of Turkey's most credible institutions, into the future with this in view is the fundamental mission of my fellow workers and myself.