



**TÜRKİYE CUMHURİYET
MERKEZ BANKASI**

Price Stability and Growth in Turkey

Erdem BAŞÇI

Governor

Central Bank of the Republic of Turkey

February 9, 2015

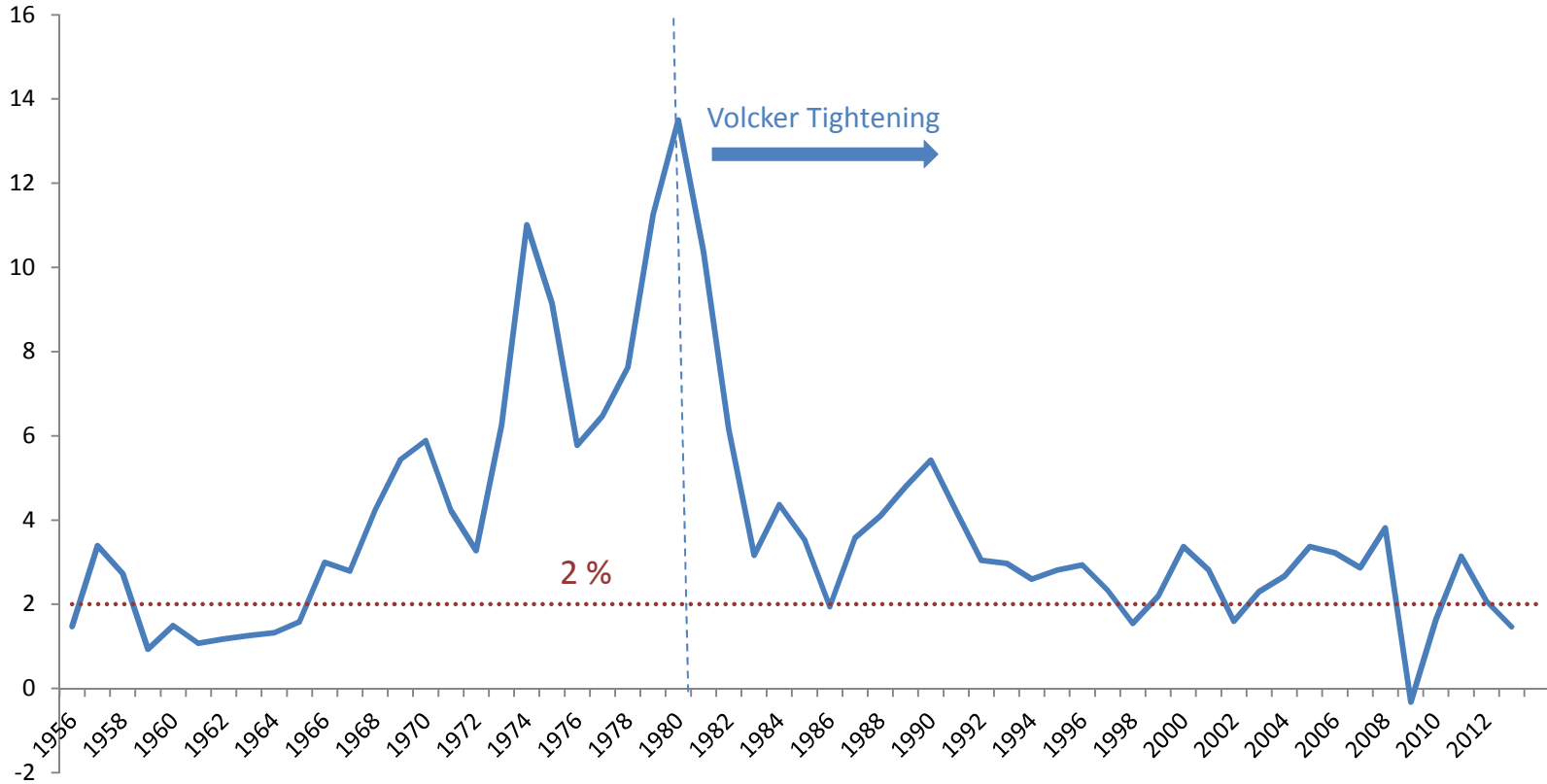
IIF Conference, İstanbul

Overview

- Both high inflation and deflation are detrimental to growth.
- The best contribution to growth from a central bank would be to maintain price stability.
- Reforms in human capital, labor market, technology, innovation and physical infrastructure are going to boost the growth potential in Turkey.

Annual Inflation in the US

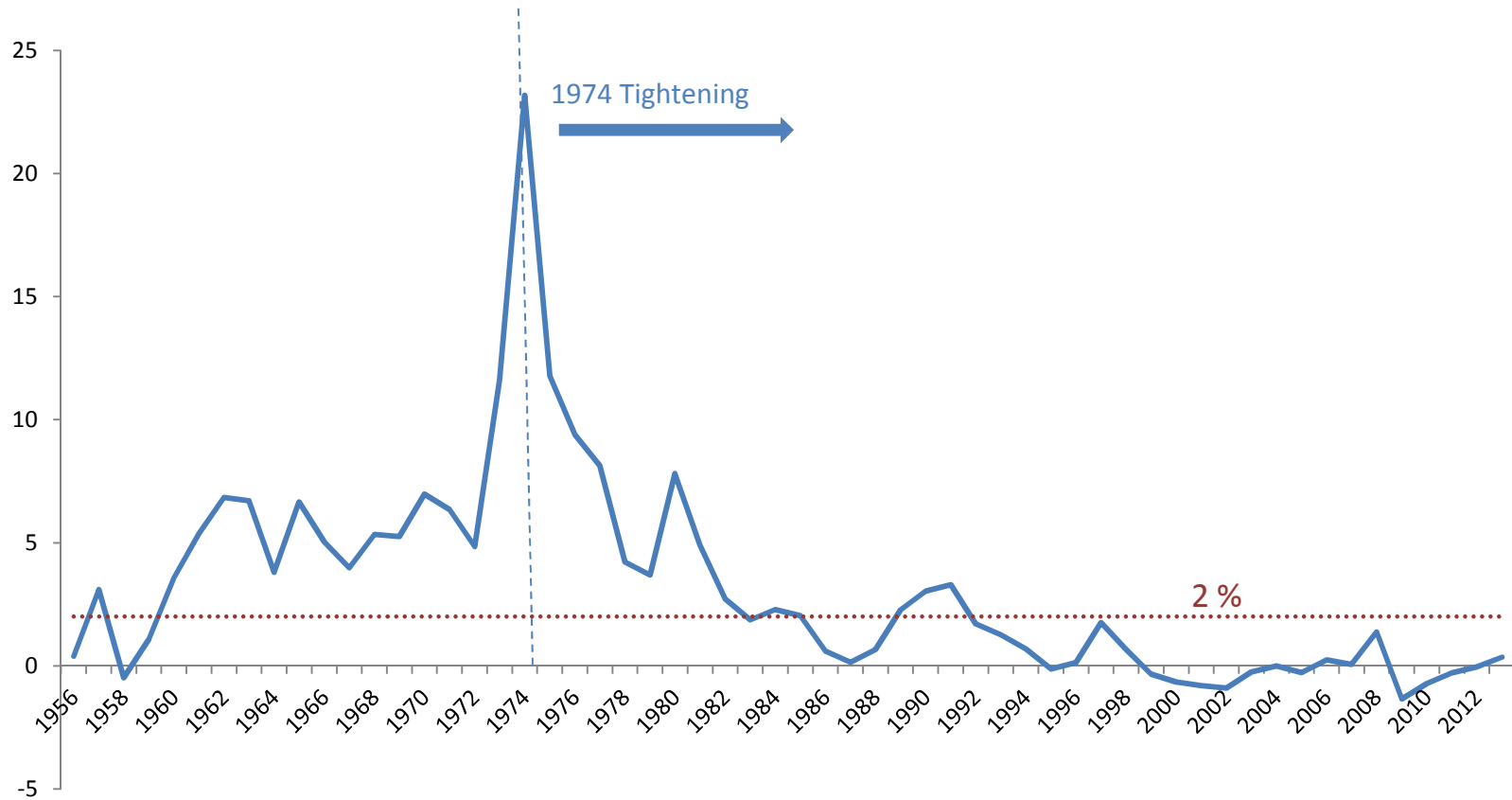
(Percent)



Source: FRED

Annual Inflation in Japan

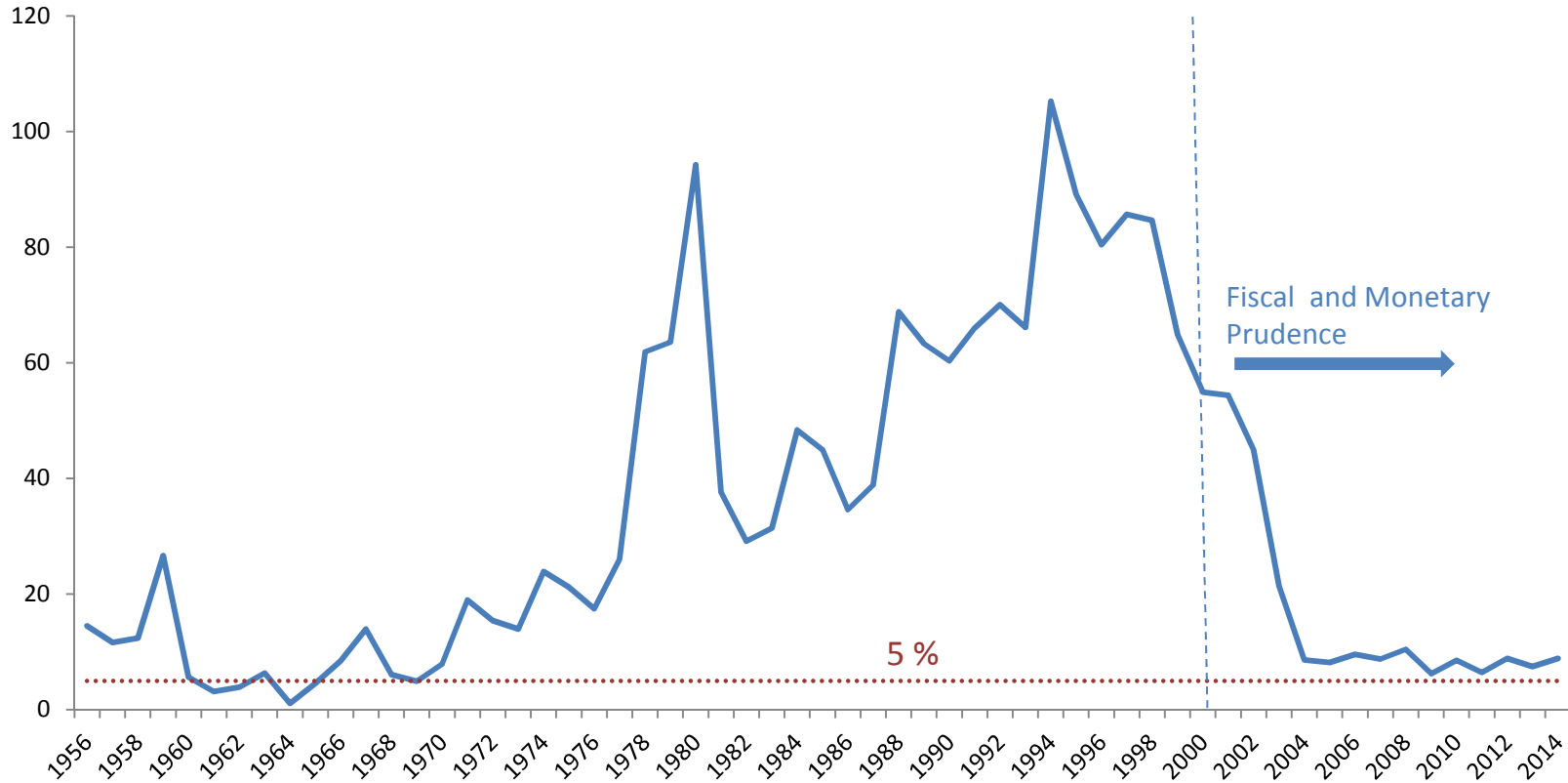
(Percent)



Source: FRED

Annual Inflation in Turkey

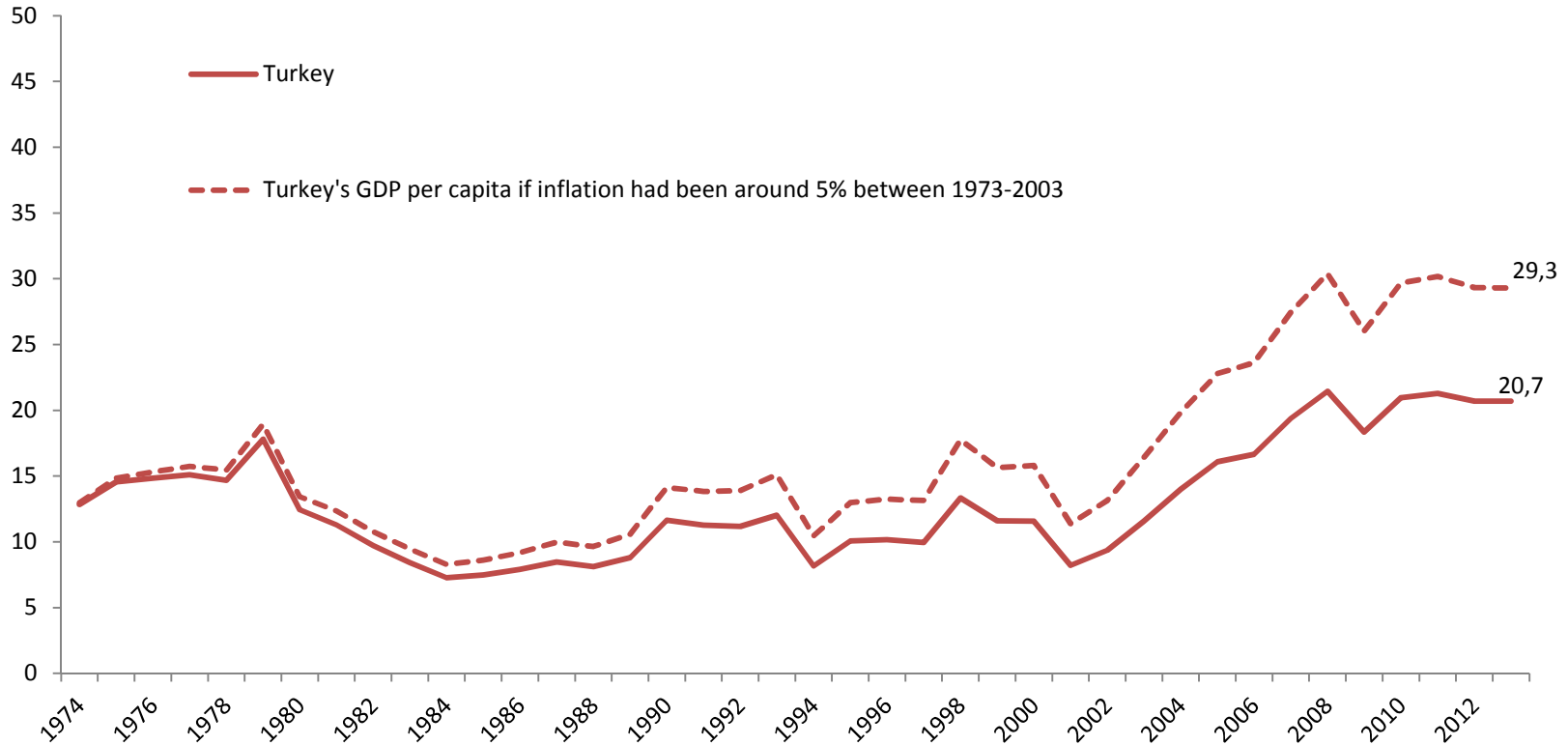
(Percent)



Source: FRED

The Cost of Inflation: A Counterfactual for Turkey*

Per Capita Income with Respect to the US (Percent)



Source: UN, CBRT.

*Average inflation in Turkey between 1973 and 2003 is 54.5 percent. According to growth regressions every 10 percentage points higher inflation leads to a reduction in GDP growth rate by 0.25 percentage points on average.

What's wrong with a deflation?

- Complications in using nominal interest rates.
- Zero lower bound?
- Negative nominal interest rates?
- How negative?
- Will it be enough to raise inflation expectations?
- Channels of transmission?

Requirements for Price Stability

$$M * V = P * Y$$



Stable
Money
Growth



Stable
Velocity
(change)



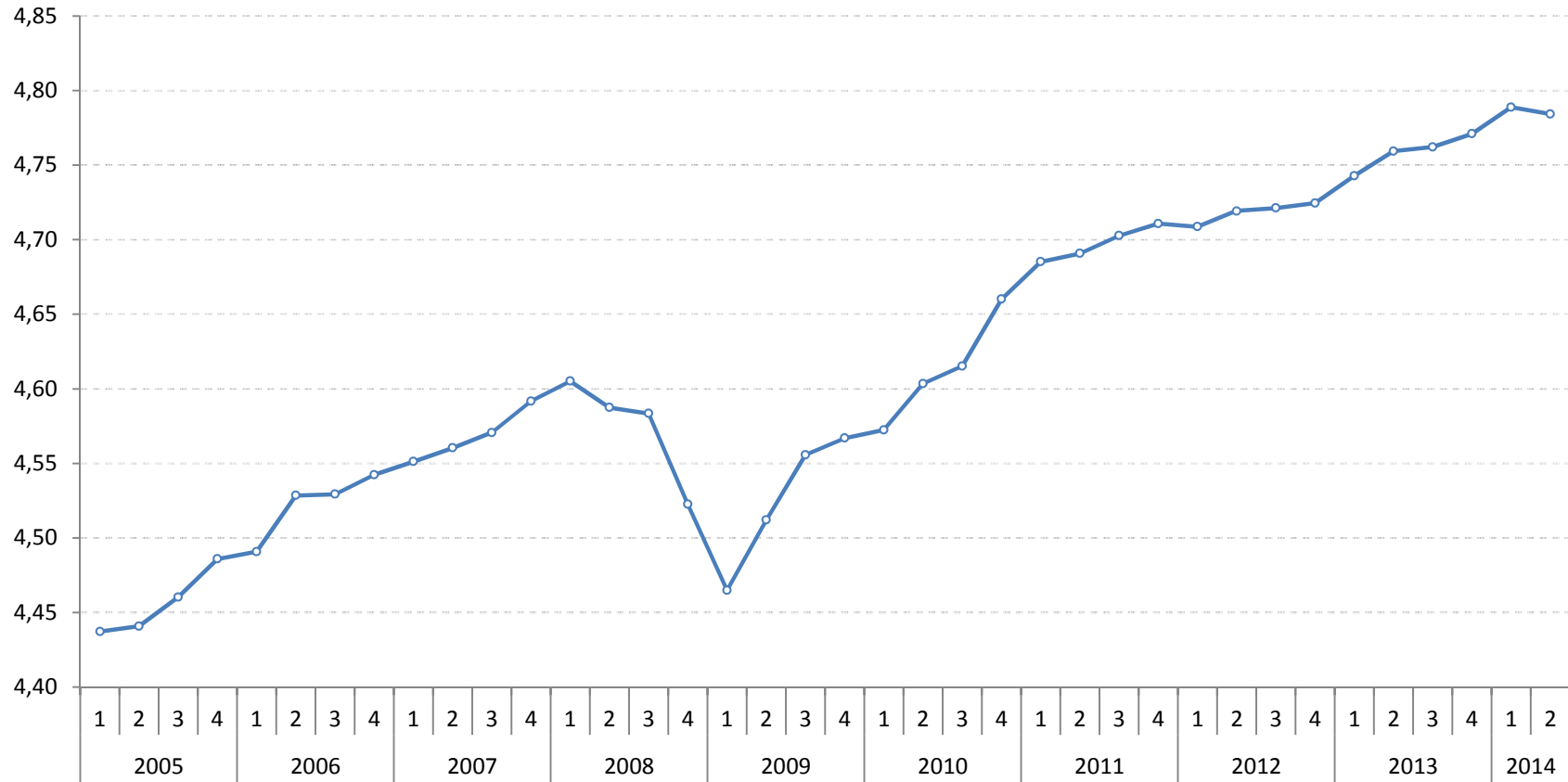
Stable
Output
Growth

Control of Money and Credit Growth

1. Macroprudential Measures (especially to tighten)
2. Quantitative Easing
3. Interest Rates (Including negative territory)

A stable output growth,

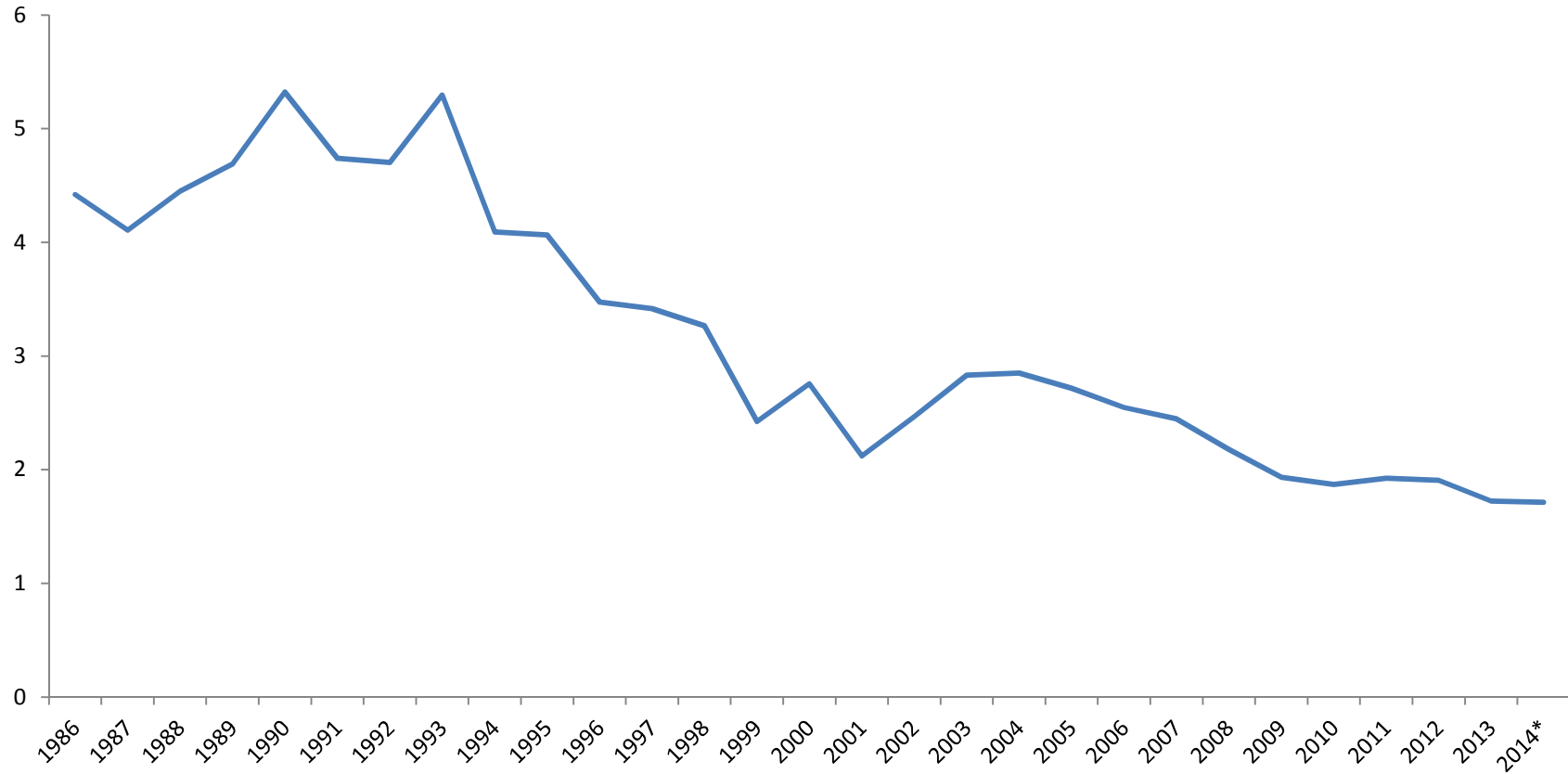
Turkish GDP (Seasonally Adjusted, Natural Logarithm)



Source: TURKSTAT, CBRT.

... a stable velocity change,

Velocity of M2 in Turkey (Nominal GDP/M2)



Source: TURKSTAT, CBRT.

* As of 2014 Q3.

... a stable money growth,

M2 Money Growth in Turkey (Annual Percentage Change)



Source: TURKSTAT, CBRT.

Last Observation: December 2014.

... driven by a sustainable credit growth,

Total Credit* Growth Rate in Turkey (YoY Change, Percent)



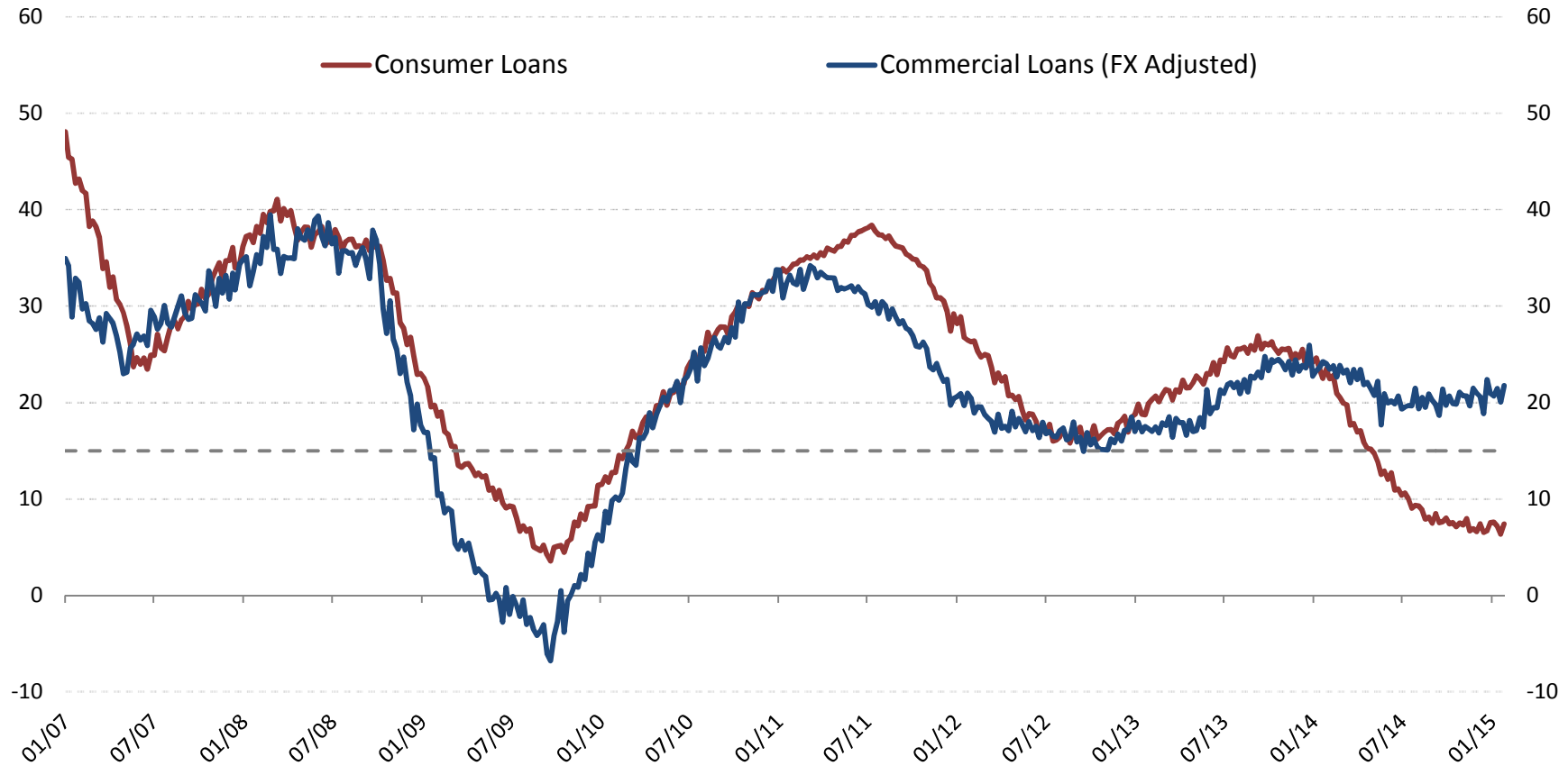
Source: CBRT.

* Total banking sector (including participation banks, excluding NPLs), including credit cards, FX adjusted.

Last Observation: January 30, 2015

... which favors production over consumption,

Consumer* and Commercial Credit Growth Rates in Turkey (YoY Change, Percent)



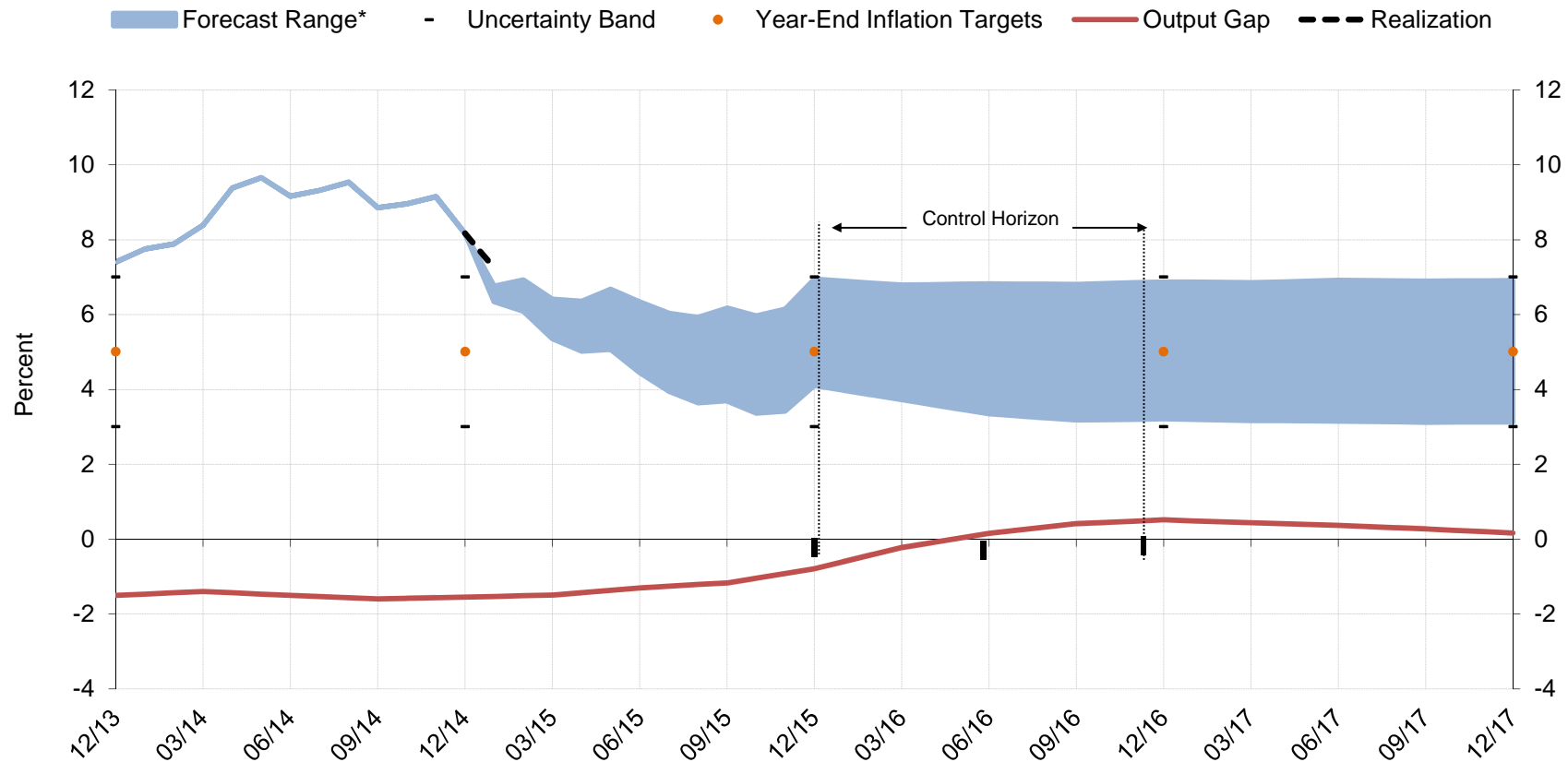
Source: CBRT.

* Total banking sector (including participation banks, excluding NPLs), including credit cards, FX adjusted.

Last Observation: January 30, 2015

... are the main drivers of disinflation in Turkey.

Inflation and Output Gap Forecasts for Turkey (Percent)



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

Real Pillars of Growth Strategy in Turkey

- i. Human Capital and Labor Market
- ii. Technology and Innovation
- iii. Physical Infrastructure

Summary

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- The best contribution to growth from a central bank would be to maintain price stability.
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