

INTERNATIONAL CAPITAL MOVEMENTS: OLD AND NEW DEBATES

**On Alternative Exchange Regimes
when the Capital Account is Open**

Erdem Başçı

**Deputy Governor
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Cusco (Peru), 19-20 July 2010

Exchange Rate Regimes

- Fixed
- Floating

Issues

- Durability
- Desirability

Argument

‘Floating exchange rate regime is both more durable and more desirable when there are no capital account restrictions.’

Durability

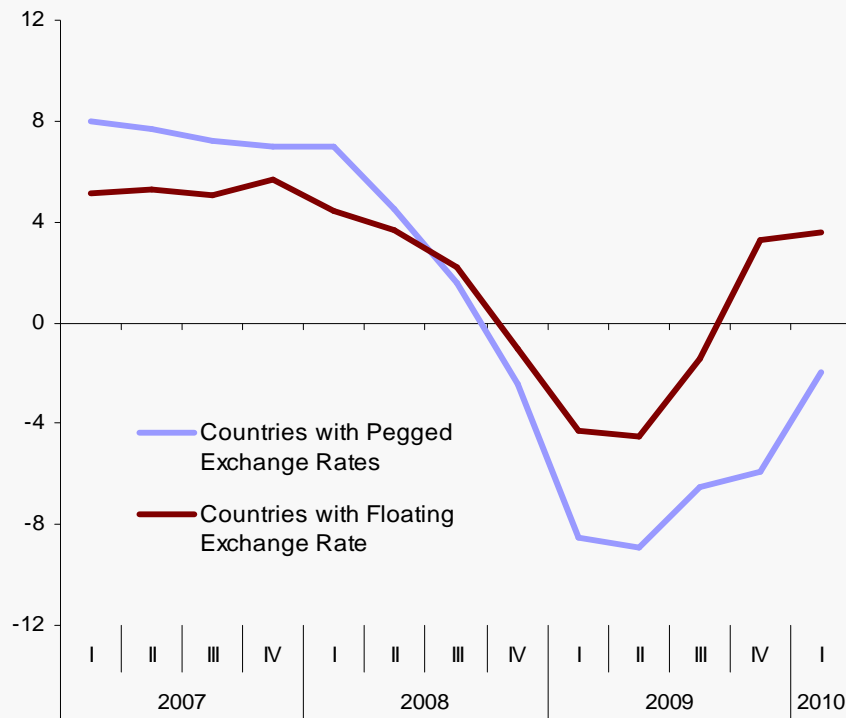
- Credibility
 - Fiscal, debt sustainability
 - Monetary, reserve adequacy
 - Financial, open positions
- Term structure of inflows
 - Debt
 - Foreign Direct Investments

Desirability - 1

- Control of Domestic Money Supply
- Control of Foreign Currency Reserves
- Stabilization of
 - Output
 - Inflation

Desirability - 1

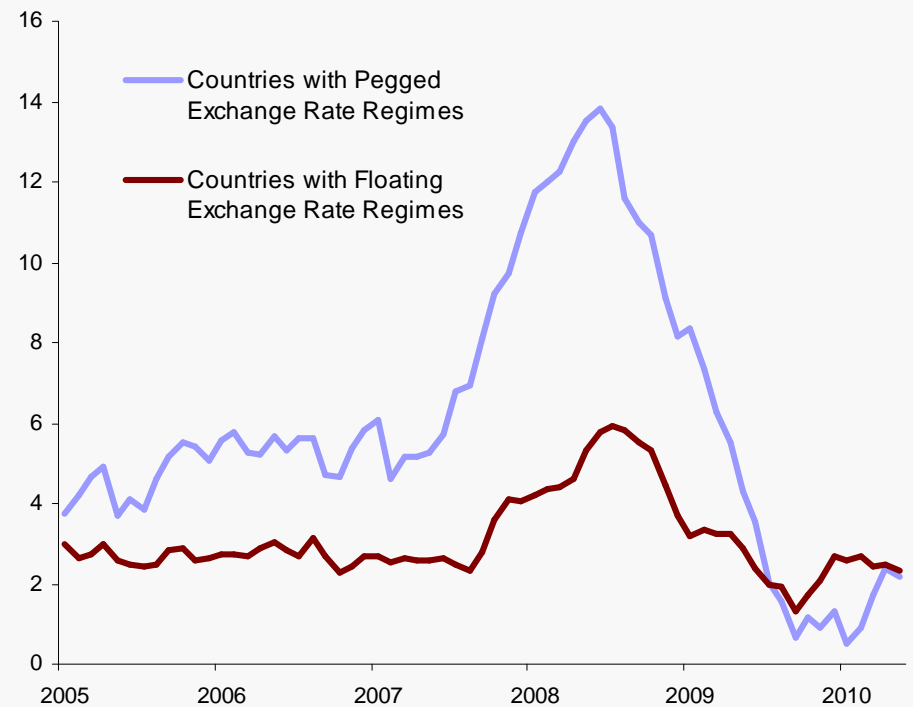
Country Groups with respect to FX regimes and Growth Rates* (2007 Q1 - 2010 Q1, annual percentage)



* Fixed exchange rate countries: Lithuania, Estonia, Latvia, Russia, Bulgaria, Denmark, Hong Kong (IMF, 2008, De Facto Classification of Exchange Rate Regimes and Monetary Policy Frameworks, Washington, DC)

Source: Cinar B., Erdogan O., Gurgur T., Polat T. (2010), "Global Crisis, Propagation Channels and Turkish Economy", CBT Economy Notes; Bloomberg; IMF; TURKSTAT; CBT

Country Groups with respect to FX regimes and Inflation Rates* (Jan 2005 – May 2010, annual percentage)



* Fixed exchange rate countries: Lithuania, Estonia, Latvia, Russia, Bulgaria, Denmark, Hong Kong (IMF, 2008, De Facto Classification of Exchange Rate Regimes and Monetary Policy Frameworks, Washington, DC)

Source: Cinar B., Erdogan O., Gurgur T., Polat T. (2010), "Global Crisis, Propagation Channels and Turkish Economy", CBT Economy Notes; Bloomberg; IMF; TURKSTAT; CBT

Desirability - 1

	Floating	Fixed
Control of money	✓	
Control of FX reserves	✓	
Output stabilization	✓	
Inflation stabilization	✓	

Desirability - 2

- Predictability
 - Exchange rates
 - Interest rates
- Efficiency (under price stickyness)
 - Productivity and taste shocks
 - Financial (expectations) and fiscal shocks

Desirability - 2

	Floating	Fixed
Exchange rate predictability		✓ (?)
Interest rate predictability	✓	
Efficiency under real shocks	✓	
Efficiency under financial shocks		✓ (?)

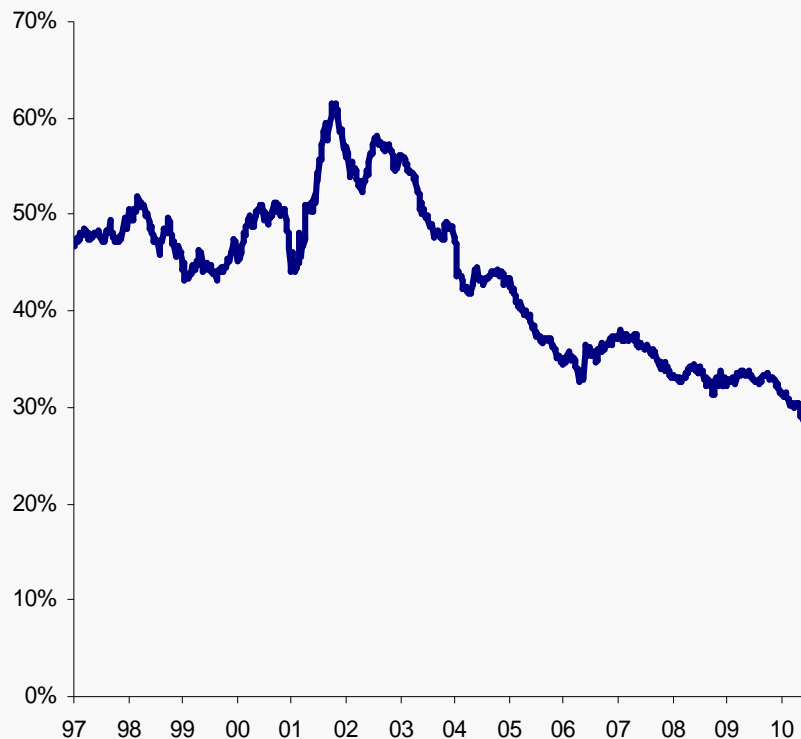
Learning to live under Float

How to avoid 'fear of floating'?

- Reduce liability dollarization
- Reduce pricing in foreign currencies
- Diversify your industrial organization (Helpman, 2006)

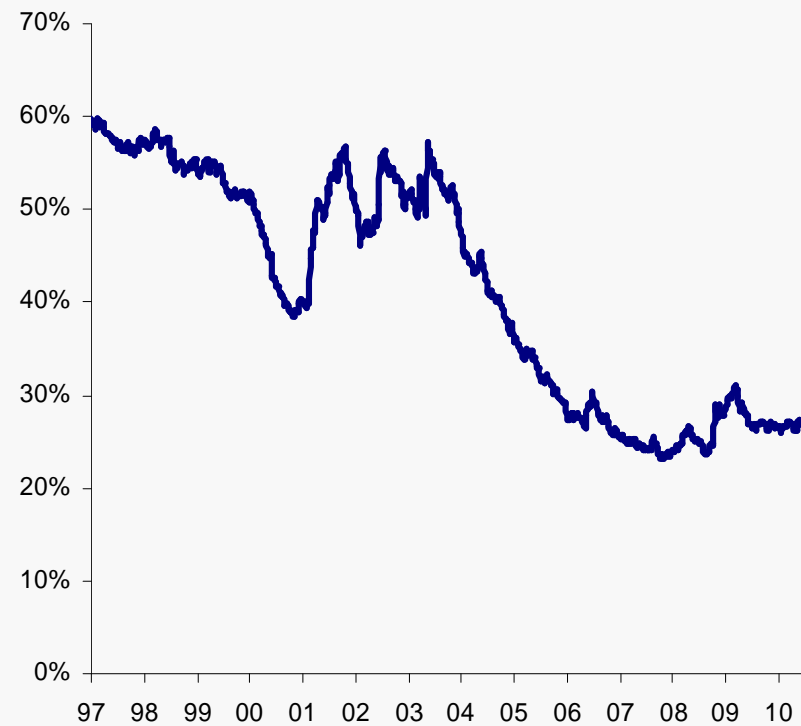
Dollarization in Turkey

Share of FX Deposits in Total Deposits*
(Mar 97 – Jun 10)



*Deposit Banks
Source: BRSA, CBT

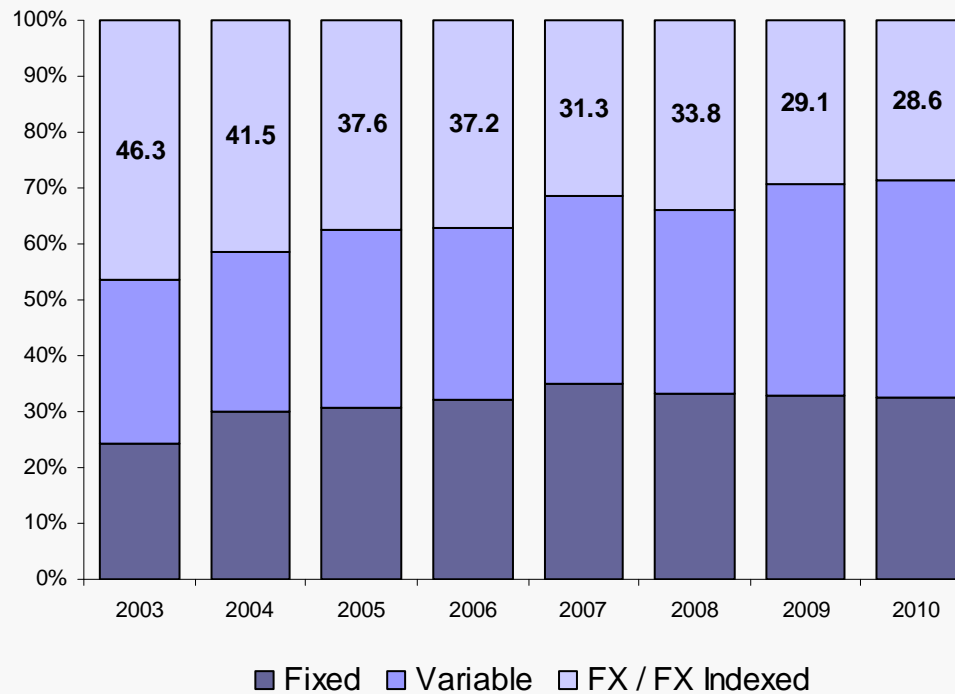
Share of FX Loans in Total Loans*
(Mar 97 – Jun 10)



*Total credits extended by deposit, development, investment and participation banks along with consumer financing firms (including the credits granted by the domestic banks' branches abroad)
Source: BRSA, CBT

Dollarization in Turkish Public Debt

**Currency and Interest Rate Composition of
Gross Outstanding Debt of Central Government
(2003 - 2010)**



Source: Treasury, CBT

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