TÜRKİYE CUMHURİYET
MERKEZ BANKASI

MONETARY and EXCHANGE RATE POLICY for 2015

10 December 2014
Ankara

1 OVERVIEW

1. The Central Bank of the Republic of Turkey's (CBRT) main objective is to achieve price stability. To this end, as in the 2015-2016 period, the inflation target for 2017 is set at 5 percent as per the agreement reached with the government during the preparation of the Medium Term Program (MTP).

2. Being an element of the accountability of the CBRT, the uncertainty band will be maintained at 2 percentage points in both directions, as in previous years. Should the inflation rate deviate from the year-end target by more than 2 percentage points at the end of each quarter, the reasons for the deviation as well as the measures taken and those that will be taken to achieve the target rate will be explained via the Inflation Report. The Bank will submit an open letter to the government if inflation falls outside the uncertainty band at the end of the year.

2 MONETARY POLICY FRAMEWORK FOR 2015

3. The CBRT maintains the price stability-oriented monetary policy framework. While aiming to keep inflation close to the target, the Bank will continue to support financial stability. In this context, the CBRT will maintain its policies of containing the domestic market volatility led by capital flows and supporting prudent borrowing. In order to achieve price stability and financial stability, instruments developed under the new policy framework will remain effective alongside the conventional instruments in the forthcoming period. Moreover, to enhance the effectiveness of the credit and exchange rate channels, the communication channel will continue to be used as a supportive instrument.

4. After May 2013, global monetary policy developments were the key drivers behind the movements in financial markets. In this period, all financial assets were re-priced on a global level while emerging economies witnessed portfolio outflows. The CBRT adopted policies to contain the spillover effects of the

global volatility and to improve the deteriorated inflation outlook by actively using the instruments of one-week repo rate, interest rate corridor, TL and foreign-currency liquidity policies and Reserve Options Mechanism (ROM).

5. Volatility in portfolio flows to emerging markets is expected to continue in 2015. The ongoing uncertainty about the normalization of global monetary policies causes the risk appetite and portfolio flows to be data-sensitive. Moreover, the global economic slowdown might postpone the normalization of monetary policies. In such a case, global interest rates may remain low, leading to an over-borrowing tendency in short-term and FX-denominated debt. A prolonged period of over-borrowing might cause financial risks and affect macroeconomic stability negatively by pushing sovereign risk premiums higher. Thus, it is crucial to implement macroprudential policies that contain macrofinancial risks and support prudent borrowing.

6. After May 2013, the marked depreciation of the Turkish lira had adverse effects on inflation and inflation expectations. In order to contain the deterioration in inflation expectations and pricing behavior, the CBRT has implemented a tight monetary policy since early 2014. The macroprudential measures and the tight monetary stance led to a notable improvement in the core inflation trend during the second half of the year. However, elevated food prices and the delayed effects of exchange rates caused inflation to hover significantly above the target over the whole year.

7. In 2015, the ongoing decrease in cumulative exchange rate effects, the return of food inflation to its long-run averages and falling commodity prices, oil prices in particular, are expected to support the disinflation process. On the other hand, the current elevated levels of services inflation and the medium-term inflation expectations suggest that risks related to the pricing behavior are still prevalent. Thus, the CBRT will closely monitor inflation expectations, the pricing behavior and other factors that affect inflation, and maintain a tight monetary policy stance by keeping a flat yield curve until there is a significant improvement in the inflation outlook.

8. In addition to the anticipated fall in inflation over 2015, maintaining economic rebalancing and fostering prudent borrowing will cushion the Turkish economy against likely external shocks and mitigate the spillover of any impending global uncertainty to inflation and macroeconomic stability to a great extent.

Communication Tools and Decision-Making

9. Main communication documents of the monetary policy are the Monetary Policy Committee (MPC) announcements and the Inflation Report. In the upcoming period, the Inflation Report will be published on a quarterly basis as usual. The MPC will continue to hold monthly meetings based on a pre-announced schedule. The monetary policy decision and the brief statement explaining its rationale will be announced on the CBRT website at 2 p.m. on the day of the MPC meeting. The summary of the MPC meeting that contains detailed assessments of the Committee will be released on the CBRT website within five working days following the MPC meeting. The Inflation Report will continue to be presented at briefings in order to enhance the effectiveness of communication.

10. The Financial Stability Report will remain as a significant means of communication of the CBRT in the upcoming period. Furthermore, announcements regarding the monetary and exchange rate policy frameworks, biannual presentations given by the Governor before the Council of Ministers and the Planning and Budget Commission of the Grand National Assembly of Turkey, "Monthly Price Developments" reports released on the subsequent working day of the announcement of the inflation data, meetings with the economists, presentations and speeches delivered by the CBRT officials in Turkey and abroad, and other press releases will play an important role in communicating with the public. Working papers, research notes in economics, booklets and conferences held by the CBRT will also remain as major components of the communication policy.

3 TURKISH LIRA LIQUIDITY MANAGEMENT

General Principles of Liquidity Management

11. While setting the framework of liquidity management, the CBRT targets the followings;

i) maintaining the level of short term interest rates within the interest rate corridor and around the level determined by the Committee,

ii) ensuring the efficient and stable operation of money markets in accordance with the liquidity management strategy,

iii) ensuring the smooth functioning of payment systems,

iv) ensuring that the instruments in use support the efficiency of the monetary policy,

v) having an operational structure with sufficient flexibility against unexpected developments in the markets.

In order to attain these objectives and enhance the efficiency of the monetary policy, the liquidity level in the market and the distribution of liquidity in the banking system are also taken into consideration while formulating the outline of the liquidity management.

Factors Affecting Liquidity and Liquidity Developments in 2014

12. Liquidity in the market is mainly determined by the following factors:

i) Changes in monetary base,
- (a) Changes in the volume of currency issued,
- (b) Changes in banks' TL free deposits.

ii) The CBRT's transactions against TL in the market,
- a) Net foreign exchange purchase/sale transactions against TL,
- b) Interests paid/earned, current expenditures,
- c) Export rediscount credits, government securities (GDDS) and lease certificate purchase/sale transactions in the market.

iii) The Treasury's transactions against TL,
- a) The difference between the redemption and issuance of net TL GDDS and lease certificates, excluding redemptions to the CBRT,

b) Primary surplus/deficit inflows/outflows,

c) Privatization and Savings Deposit Insurance Fund (SDIF)-related TL transfers and other public transactions.

13. On the other hand, as they determine the TL-denominated borrowing requirement, the net FX-denominated collections or payments including domestic and external borrowing, the Treasury's redemption to the CBRT and the CBRT's profit transfers indirectly affect the liquidity in the market.

14. Net liquidity shortage in the market (funding need of the system, FNS) increased to 42.6 billion Turkish liras (TL) on 05.12.2014 from 38.9 billion TL at end-2013. Based on provisional data, the main items that affected the system's funding requirement in 2014 are listed in Table 1.

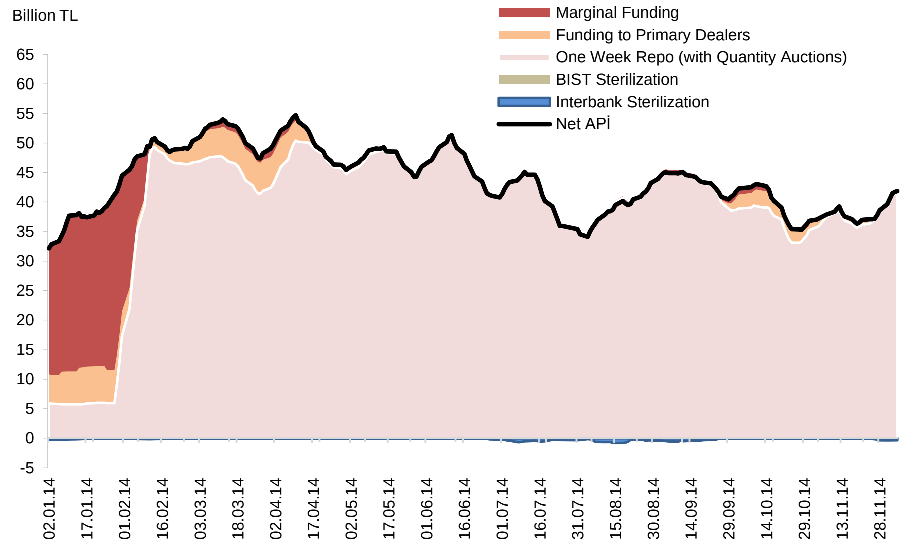
Table 1: Factors Affecting the System's Liquidity (Billion TL)

	31.12.2013	05.12.2014	Effect
Funding Need of the System (A+B+C)	**-38.9**	**-42.6**	**-3.7**
Monetary Base (A)	**90.9**	**96.9**	**-6.1**
Currency in circulation	74.8	84.1	-9.3
Free deposits	16.1	12.9	3.2
CBRT Transactions Affecting System Liquidity (B)			**3.1**
Net FX Sales against TL			-28.4
Interests earned and Other payments			-2.9
Purchase of government bonds			3.1
Export rediscount credits (Eximbank and Banks)			31.2
Treasury Transactions (excl. Redemptions to the CBRT) (C)			**-0.7**
Net TL government bond redemption (redemption-issue)			26.0
Primary surplus			-26.4
Privatization in TL and Other transactions			-0.3

(*) The funding need of the system represents the net liquidity need in the market. A negative number means a net liquidity shortage in the market.

15. The CBRT funded the liquidity shortage basically with one-week quantity repo auctions following the MPC decision at the interim meeting on 28 January 2014. Yet, in view of changes in money and credit markets throughout the year, the liquidity policy was adjusted to keep a flat yield curve (Chart 1).

Chart 1 Market Liquidity*
(Two-week moving average)



*Marginal funding is O/N funding quoted at the upper limit of the corridor.
Source: BIST, CBRT.

Liquidity Policy in 2015 and the Operational Framework

16. Major factors to influence liquidity conditions in the market in 2015 are the amount of the CBRT's net FX purchase/sale transactions against TL in the market (including export rediscount credits extended by the CBRT), change in the monetary base (including the effects of the changes in the ROM facility and in the utilization rate of this facility by the banks), the difference between the Treasury's redemption and issuance of GDDS and lease certificates against TL. Rapid changes in the global market outlook and the risk appetite may lead to sizeable fluctuations in capital inflows towards emerging economies including Turkey. Therefore, uncertainties regarding the utilization of the ROM facility by the banks and other institutions and/or the amount of the FX purchase/sales transactions of the CBRT with the market against TL are challenges against clear-cut projections on liquidity conditions in 2015. However, the liquidity gap in the market is envisaged to remain at plausible levels during 2015.

17. Considering all possibilities in liquidity conditions, to be able to control interest rates at the BIST Repo-Reverse Repo Market and the Interbank Repo-Reverse Repo Market and to preserve instrument variety for liquidity management and operational flexibility, the CBRT needs to hold sufficient amount of GDDS and TL-denominated lease certificates, issued by the Asset Leasing Company of the Turkish Treasury (ALCTT), for technical reasons. In nominal terms, a total of TL 3.1 billion of the open market operations portfolio will be due in 2015. Accordingly;

i) The maturing securities will be replaced with purchases that will be performed in months deemed appropriate in 2015 with GDDS or lease certificates to be announced via data distribution companies at 10:00 a.m. on the first working day of the respective month,

ii) Buying auctions will be held on Wednesdays and Fridays with value dates as the subsequent working days,

iii) Each auction amount will be a nominal of TL 100 million at most,

iv) Other issues related to the auctions will be subject to the current arrangements.

Moreover, the OMO portfolio size, which was set as TL 9 billion to minimize operational risks in 2014, is targeted to remain the same in 2015. On the other hand, the additional purchasing option is reserved in the case of a liquidity squeeze.

18. The operational framework of the CBRT's liquidity management in 2015 is as follows;

i) The CBRT will continue to announce overnight borrowing and lending rates between 10:00 a.m.–12:00 p.m. and 1:00 p.m.–4:00 p.m. on working days, between 10:00 a.m.–12:00 p.m. on half working days, in the Interbank Money Market within the CBRT. If they deem it necessary, banks will be able to borrow at the CBRT's lending rate against collateral within their limits. In case of excess liquidity, banks will be able to lend Turkish lira to the CBRT at the CBRT's borrowing rate without any limit.

ii) The Late Liquidity Window Facility (LON) will continue as currently structured. Banks will be able to borrow from the CBRT against collateral, and lend the CBRT without any limit between 4:00 p.m.–5:00 p.m. on working days, between 12:00 p.m.–12:30 p.m. on half working days and on the last working day of the required reserve maintenance period between 4:00 p.m.–5:15 p.m. on working days, between 12:00 p.m.–12:45 p.m. on half working days.

iii) The interest rate corridor shall be actively used in 2015 as well. In this regard, the composition of the Turkish lira funding provided by the CBRT shall be altered when deemed necessary.

iv) One-week repo auctions will be held at the interest rate set by the Committee for the quantity auction method. In this context, the upper limit for total amount of bids to be offered by each institution, which are counterparties to OMO shall be calculated by multiplying the announced auction amount with twice of the share of TL required reserves to be maintained by the institution within the amount of the total TL required reserves to be maintained by all banks. Bank-based limits shall be effective for two maintenance periods. Limits shall be renewed once in four weeks and banks shall be notified on the second working day of the reserve maintenance period corresponding to the start of each new maintenance period via the CBRT Payment Systems Auction System (AuS).

v) When the market needs funding, the CBRT will announce the repo auction amount via data distribution companies at 10:00 a.m., and when funding is not needed, auctions may not be held. One-week repo auctions will be held at 11:00 a.m. on working days, at 10:30 a.m. on half working days and the results will be announced via data distribution companies no later than 30 minutes. Institutions are required to fulfill notifications of their securities against their repo operations until 12:00 p.m. on working days, until 11:15 a.m. on half working days and fulfill their liabilities regarding open market operations until 4:45 p.m. on working days, until 12:45 p.m. on half working days.

vi) If deemed necessary, traditional one-month repo auctions may be held at maturities not to exceed 91 days.

vii) If deemed necessary, “Intraday Repo Auctions” with one-week maturity via traditional auction method may be held. The total amount of bids to be submitted will be limited to the announced auction amount.

viii) The CBRT will continue to announce overnight interest rates within the interest rate corridor on a daily basis at BIST Repo - Reverse Repo Market and Interbank Repo - Reverse Repo Market.

ix) All participants are entitled to use overnight repo facility via the quotation method against TL-denominated lease certificate issued by ALCTT, while primary dealers will be able to conduct overnight repo transactions under the scope of the OMO, between 10:00 a.m.–12:00 p.m. and 1:00 p.m.–4:00 p.m. on working days and between 10:00 a.m.– 12:00 p.m. on half working days.

19. Charged with the legal task of achieving price stability, the CBRT will continue to maintain financial stability in consideration of macroeconomic risks in 2014 as usual. To this end, practices will be sustained to render monetary policy and liquidity management more effective. In the upcoming period, the CBRT may change its liquidity management strategy in consideration of emerging needs as usual. In this context, the CBRT will continue to utilize the instruments like liquidity management, borrowing and lending interest rates corridor and required reserves.

20. Liquidity policy will be implemented to support the maintenance of the achieved reasonable levels in credit growth.

4 EXCHANGE RATE POLICY

Export Rediscount Credits and Reserve Developments

21. Export rediscount credits extended to exporters in TL with a maturity up to 240 days through the Turkish Eximbank and commercial banks by the acceptance of FX bills for rediscount pursuant to the Article 45 of the Central Bank Law remained as an instrument to boost the CBRT's net FX reserves in 2014.

22. To spur balanced growth, considering the contribution of export rediscount credits to reduce the current account deficit and to strengthen the CBRT'S FX reserves, credit limits, which were set as USD 12 billion on 15 August 2013, were raised to USD 15 billion on 20 October 2014. Additionally, with the changes introduced on the same day,

i) Across firms, the credit limit per company for Foreign Trade Capital Companies was raised from USD 240 million to USD 300 million and from USD 180 million to USD 250 million for other companies. They were provided with the facility to use whole of these limits in their loan demands with maturities up to 120 days, and maximum 50 percent for those with maturities from 121 to 240 days.

ii) Credits with maturities up to 120 days were subject to 1-month LIBOR or EURIBOR interest rate, while the cost of credits with maturities longer than 120 days was reduced by 20 basis points and 6-month LIBOR or EURIBOR interest rate was applied to these credits.

iii) The CBRT provided the exporter companies with a new type of post shipment facility of export credit by the acceptance of bills for rediscount that are based on export receivables by exporter companies, transferred to factoring companies and endorsed to the Turkish Eximbank by factoring companies.

23. The arrangements that reduced costs and increased limits rendered the export rediscount credits more attractive for firms. Thus, the number of firms to demand credits and the contribution of these credits to the CBRT's reserves are expected to increase. Accordingly,

i) Credit utilization is estimated to be around USD 15.5 billion in 2014 and add USD 13 billion to the CBRT's FX reserves.

ii) Due to the raised credit limits and other facilities introduced, credit utilization is expected to reach USD 17 billion in 2015, and the contribution to the CBRT's reserves to be around USD 16 billion.

24. The net effect of this export re-discount credits and the CBRT's FX interventions and auctions on total reserves has amounted to USD 79 billion since 2002 (Table 2).

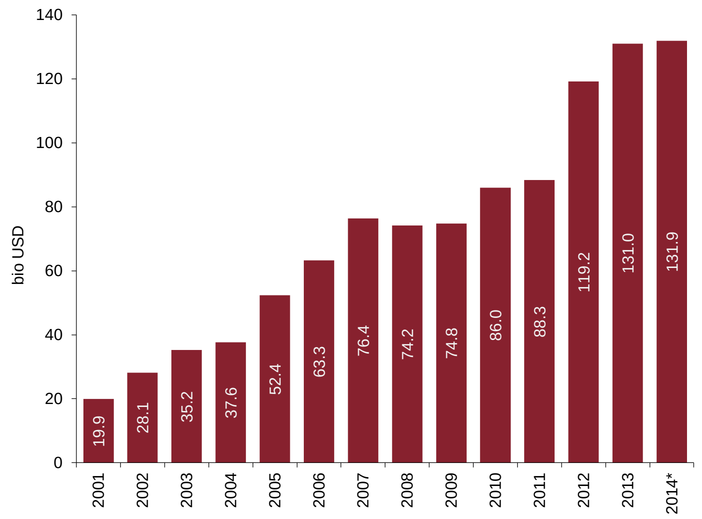
Table 2: Amounts of FX Purchases and Sales by CBRT (2002-2014*, million USD)

Year	Auctions		Interventions**		Export Rediscount Credits	Total Net FX Purchases
	PURCHASE	SALES	PURCHASE	SALES	NET	
2002	795	0	16	12	25	824
2003	5.652	0	4.229	0	34	9.915
2004	4.104	0	1.283	9	27	5.405
2005	7.442	0	14.565	0	25	22.032
2006	4.296	1.000	5.441	2.105	4	6.636
2007	9.906	0	0	0	2	9.908
2008	7.584	100	0	0	5	7.489
2009	4.314	900	0	0	1.040	4.454
2010	14.865	0	0	0	1.104	15.969
2011	6.450	11.210	0	2.390	1.920	-5.230
2012	0	1.450	0	1.006	8.295	5.839
2013	0	17.610	0	0	12.664	-4.946
2014*	0	9.109	0	3.151	12.986	726
Total	**65.408**	**41.379**	**25.534**	**8.673**	**38.131**	**79.021**

* December 5, 2014.
** Amounts of purchases/sales are published following 15 working days of intervention.
Source: CBRT

25. Under the floating FX rate regime implemented since 2001, instruments like direct net FX purchases, export rediscount credits and ROM have been used and the CBRT FX reserves have seen a cumulative increase by around USD 112 billion (Chart 2).

Chart 2. CBRT Gross FX Reserves (Gold Included)



* December 5, 2014
Source: CBRT

Foreign Exchange Rate Policy in 2015

26. The CBRT will continue to implement floating FX rate regime in 2014. The FX rate is determined by supply and demand conditions in the market under the floating exchange rate regime. Main determinants of FX supply and demand are the monetary and fiscal policies in practice, economic fundamentals, international developments and expectations. The CBRT does not have a nominal or real exchange rate target under the current exchange rate regime. Nonetheless, with a view to limiting the risks to the financial stability, the CBRT does not remain unresponsive to the excessive appreciation or depreciation of the Turkish lira.

27. The FX deposits that the banks can borrow from the CBRT within their borrowing limits at the FX and Banknotes Markets remains as 7.5 percent for the USD and 6.5 percent for the Euro. Consistent with the outlook of global monetary policies, for USD rates are projected to be 8.5 percent and 9 percent for 2016 and 2017, respectively and for euro rates are projected to be 6.5 percent for 2016 and 2017.

28. Considering the growth of banks' balance sheets and the increase in the CBRT's reserves, the limits for those banks entitled to operate in the FX and Banknotes Markets for borrowing in the FX deposit market and operating transactions in banknote purchase-sales market against FX was raised to USD 21.62 billion in December 10, 2014.

29. To prevent the simultaneous use of FX Deposit Markets at the FX and Banknotes Markets with the FX facility of ROM, considering the ROM has 2-week blocking structure, while the FX deposit has one week maturity, if the due date of the FX deposit includes the first day of the maintenance period, and if the amount of the use of the ROM FX facility is not reduced as much as the outstanding deposit, payment of the whole deposit will be antedated. Likewise, if a bank not using the FX facility of ROM uses FX deposit, this deposit will be antedated if this bank demands to utilize FX facility of ROM in the new maintenance period. Moreover, banks demanding deposits in the first day of the new maintenance period will be able to use deposits following the construction of lists regarding the ROM FX facility utilization amounts exclusive to them.

30. The CBRT will continue to closely monitor FX supply and demand conditions and will take the necessary measures to ensure the healthy functioning of the FX market and to support the FX liquidity in 2015 as usual.

31. The CBRT may intervene directly or through flexible auctions in the market, in case of unhealthy price formations due to speculative behavior stemming from a loss in the market depth.

32. Moreover, FX transactions against FX banknotes conducted between the CBRT and those institutions entitled to operate in the FX and Banknotes Markets will continue in 2015.

33. In view of the fact that financial stability is one of the prerequisites for price stability, the CBRT will continue to take the necessary measures in order to ensure the efficient functioning of the FX markets in Turkey. However, it has to be kept in mind that under the current exchange rate regime, economic agents should establish and employ mechanisms that will ensure efficient risk management.

5 ARRANGEMENTS AND OPERATIONAL FRAMEWORK FOR FINANCIAL STABILITY

34. To spur balanced growth and domestic savings, the CBRT started to remunerate required reserves of banks and financing companies maintained in TL, as of November 2014. Starting from 2015, in a way to encourage core liabilities , financial institutions whose ratio of deposits and equity to loans are higher than the sector average will be remunerated at a higher rate unless they worsen their own situation. Moreover, the remuneration of required reserves is expected to strengthen the automatic stabilizing feature of the ROM as it was designed to reduce the sensitivity of the cost of maintaining TL required reserves of institutions subject to reserve requirements to the funding rate.

35. Containing short-term and FX denominated borrowing is crucial to restrict macrofinancial risks. The analysis of external borrowings of the private sector indicates that the maturity of the external borrowings of the corporate sector is quite long, whereas that of banks is relatively shorter. In addition, a sizeable portion of the short-term external borrowing, which is used in economic analysis as an important indicator of fragility, belongs to the banking sector. Extension of maturities in the banking sector and raising the core liability's ratio will restrict macrofinancial risks by enhancing prudent borrowing and hence contribute to balanced growth. In this context, to support financial stability, reserve requirement ratios of FX-denominated non-core short-term liabilities will be raised in a way to prompt the extension of maturities

36. ROM continues to be used intensively by banks. Through this mechanism, not only total reserves registered an increase, but also the effects of capital flow volatilities on the economy were contained. Moreover, FX reserves of the financial sector maintained through the ROM at the CBRT function as a buffer against potential changes in external financing conditions. To strengthen the automatic stabilizing feature of the ROM against fluctuations in capital flows, technical adjustments will be implemented in reserve option tranches and coefficients, in a way also to provide the needed FX liquidity from changes in reserve requirement ratios.

37. Export rediscount credits will offer a considerable contribution to the foreign exchange reserve accumulation in 2015. Moreover, along with the measures on short-term FX borrowing, the FX reserves' coverage ratio of short-term foreign borrowings will notably increase.

38. A new method was developed in the determination of the maximum interest rates for credit cards aiming at protecting financial stability as well as the consumer and it was made public to enhance transparency and predictability. In this framework, it is aimed to prevent frequent changes in maximum rates on credit cards; to restrict the use of credit cards by consumers in periods of low interest rates and to direct them towards consumer loans; to prevent the increase in past-due loans in the financial system in periods of high interest rates by alleviating the interest rate burden on consumers.

39. Macroprudential measures taken by the Banking Regulation and Supervision Agency (BRSA) regarding consumer loans and credit cards in 2014 contributed to the realization of credit growth at plausible levels and maintenance of financial stability. Sustaining this favorable level of consumer loan growth in 2015 is critical to containing financial risks and maintaining the rebalancing process.

ANNEX: SCHEDULE FOR THE 2015 MONETARY POLICY COMMITTEE MEETINGS AND REPORTS

Schedule for the 2015 MPC Meetings and Reports			
MPC Meetings	Summary of the MPC Meeting	Inflation Report	Financial Stability Report
20 January 2015	27 January 2015	27 January 2015	
24 February 2015	3 March 2015		
17 March 2015	24 March 2015		
22 April 2015	30 April 2015	30 April 2015	
20 May 2015	27 May 2015		29 May 2015
23 June 2015	30 June 2015		
23 July 2015	30 July 2015	30 July 2015	
18 August 2015	25 August 2015		
22 September 2015	1 October 2015		
21 October 2015	28 October 2015	28 October 2015	
24 November 2015	1 December 2015		30 November 2015
22 December 2015	29 December 2015		

Note: Monetary and Exchange Rate Policy for 2016 will be published on 9 December 2015.