



MONETARY AND EXCHANGE RATE POLICY FOR 2014

Central Bank of the Republic of Turkey

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Ankara

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OVERVIEW

1. The CBRT's main objective is to achieve price stability. To this end, as was the case for the 2014-2015 period, the inflation target for 2016 is set as 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 at the end of each quarter deviate from the year-end target by more than 2 percentage points, 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 should inflation at the end of the year realize outside the uncertainty band.

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MONETARY POLICY FRAMEWORK FOR 2014

3. The CBRT has adopted a framework that preserves the price stability-oriented monetary stance and the predictability of monetary policy. In addition, the automatic stabilizing function of the reserve options mechanism will be gradually enhanced.
4. While aiming at keeping inflation close to target, the CBRT will continue to safeguard financial stability. In this context, the CBRT will maintain its policies to contain the volatility led by capital flows on domestic economy. So as to achieve price stability and financial stability, instruments developed under the new policy framework will remain effective alongside the traditional instruments in the forthcoming period. Moreover, to enhance the effectiveness of credit and exchange rate channels, communication channel will be put into use as a supportive instrument when necessary.
5. In the upcoming period, domestic demand is expected to continue to increase but this increase will remain moderate due to tightening financial conditions. It

is anticipated that the cautious monetary policy stance, the macroprudential measures and the weak course of capital flows will pull credit growth rates to more reasonable levels. Accordingly, the balancing of demand components is expected to improve while the economy continues to grow moderately. Under such a demand composition, aggregate demand conditions are not expected to put pressure on inflation.

Communication Tools and Decision-Making

6. 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 be presented at press conferences in order to enhance the effectiveness of communication.
7. 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, booklets, research notes in economics, conferences and workshops held by the CBRT will also remain as major components of the communication policy.

General Principles of Liquidity Management

8. 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 to 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 2013

9. 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 government bonds 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.

10. Meanwhile, 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.

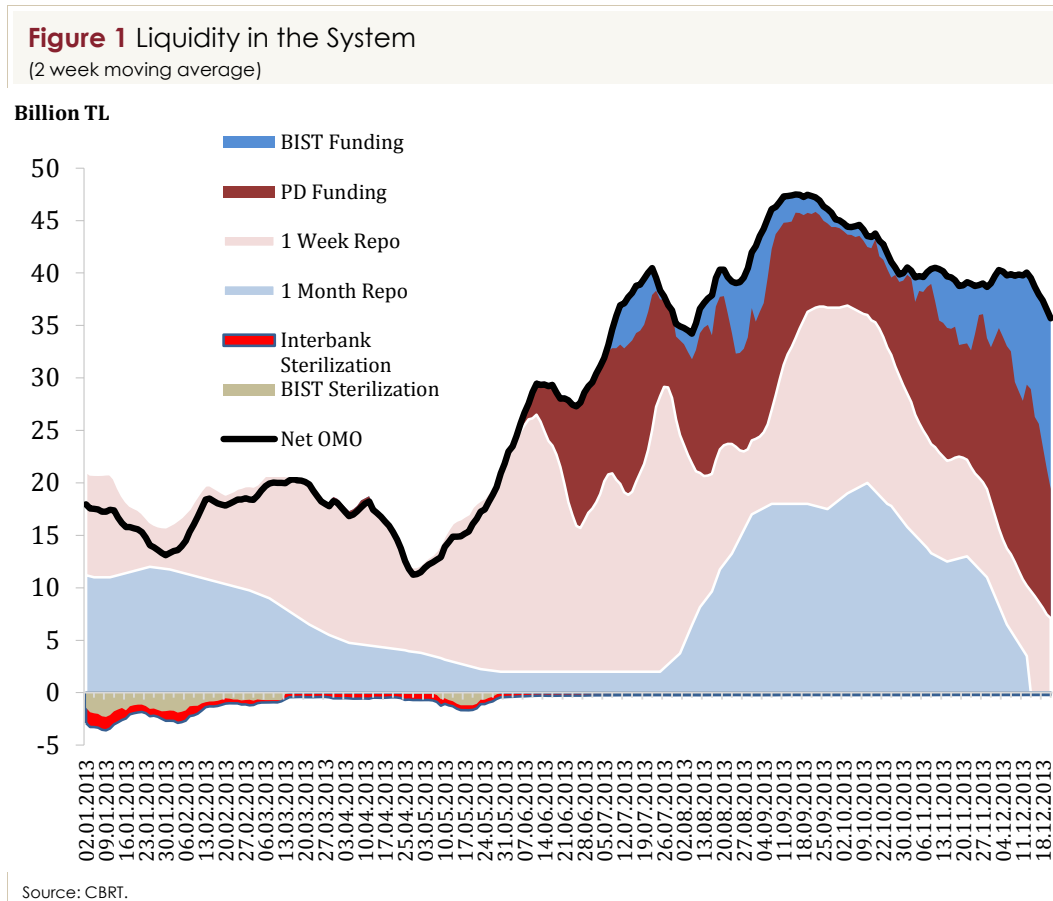
11. Net liquidity shortage in the market (funding need of the system, FNS) increased to 34.5 billion Turkish lira (TL) on 20.12.2013 from 19.4 billion TL at end 2012. Based on provisional data, the main items that affected the system's funding requirement in 2013 are listed in Table 1.

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

	31.12.2012	20.12.2013	Affect
Funding Need of the System (A+B+C)	-19,3	-34,5	-15,2
Monetary Base (A)	77,2	90,2	-13,0
Currency in Circulation	60,5	75,2	-14,6
Free Deposits	16,7	15,0	1,6
The CBRT's Transactions Affecting System Liquidity (B)			4,9
Net Foreign Exchange sale Transactions Against TL			-28,4
Interests Earned and Current Expenditures			-1,0
Government Securities Purchase Transactions			6,3
Export Rediscount Credits (Eximbank)			28,0
The Treasury's Transactions (Excluding Redemptions to the CBRT) (C)			-7,1
Net TL government Bond Redemption (Redemption-Issuance)			16,4
Primary Surplus			-19,2
Privatization Against TL and Other Public Transactions			-4,3

(*)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.

12. The CBRT funded the liquidity shortage with one-week quantity and one-month traditional repo auctions during the first half of the year, but changed the composition by shortening the maturity of funding by the second half of the year (Figure 1).



Liquidity Policy in 2014 and the Operational Framework

13. Major factors to influence liquidity conditions in the market in 2014 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 change in the ROM facility and utilization rate of this facility by the banks), the difference between redemption-issuance of GDDS against TL by the Treasury and lease certificates in 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/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 2014. However, the liquidity gap in the market is envisaged to remain at plausible levels during 2014.

14. 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 lease certificates, issued by the Asset Leasing Company of the Turkish Treasury. In total, TL 3.13 billion of the current portfolio in nominal terms will be due in 2014. Accordingly;

- i) Purchases will be performed in months deemed appropriate in 2014 with GDDS or lease certificates to be announced on the Reuters “CBTL” page 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 nominal TL 100 million at most,
- iv) Other issues related to the auctions will be subject to the current arrangements.

Moreover, OMO portfolio size, which was set as TL 9 billion to minimize operational risks in 2013, is targeted to remain the same in 2014. On the other hand, the additional purchasing option is reserved in the case of a liquidity squeeze.

15. Operational framework of the CBRT’s liquidity management in 2014 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 deemed necessary, banks will be able to borrow at the CBRT’s lending rate (Marginal Funding Rate, which is the reference 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 practiced. 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 intensively used in 2014 as well. In this framework, composition of the total funding provided via quantity repo auction to be held at Stable Funding Rate-1, primary dealer repo facility at Stable Funding Rate-2 and TL funding to be held at the BIST Repo - Reverse Repo Market and Interbank Repo - Reverse Repo Market and the CBRT Interbank Money Market at the Marginal Funding rate, which is the reference rate, shall be altered when deemed necessary.
- iv) One-week repo auctions will continue to be held at the interest rate set by the Committee for one-week repo auctions via the quantity auction method at Stable Funding Rate-1. In this context, to be effective from 6 January 2014, the upper limit for total amount of bids by each institution that are counterparties to OMO shall be twice the share of the institution within total TL required reserves to be maintained by 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 corresponding to the start of each new four-week period to via the CBRT Payment Systems Auction System (AuS).
- v) In this context, the calculation of the upper limit of the bids to be sent via the AuS to banks on 6 January 2014 shall be based on the average of TL required reserves to be maintained on 6 December and 20 December 2013 (in the last two reserve maintenance period). These limits shall be effective for two maintenance periods (6 January- 31 January 2014). Limits for the new period shall be re-calculated on 3 February 2014 based upon the data from 3 January and 17 January and banks shall be informed thereof via the AuS. Accordingly, limits shall be revised for 4-week periods and declared to banks.

- vi) When the market needs funding, the CBRT will announce the repo auction amount on the Reuters “CBTF” at 10:00 a.m., and when funding is not needed, auctions may not be held. One-week and one month maturity 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 on the Reuters’ “CBTG” page within 30 minutes. Institutions are required to notify the 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.
 - vii) If deemed necessary, traditional repo auctions may be held at maturities not to exceed 91 days should the conditions necessitate.
 - viii) 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.
 - ix) The CBRT will continue to announce overnight interest rates within the interest rate corridor on a daily basis at ISE - Reverse Repo Market and Interbank Repo - Reverse Repo Market.
 - x) 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.
- 16.** 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 line with the arising needs as usual. In this scope, the CBRT will continue to utilize instruments like liquidity management, borrowing and lending interest rates corridor and required reserves.
- 17.** Through the liquidity policy practices, the credit growth will be oriented towards business loans rather than consumer loans. As this will increase the funding

requirement of the system due to the FX sales and the decline in the use of the ROM, the funding maturity will be shortened by one day and one week. Moreover, in tandem with the increased funding requirement of the system, intermediation costs will gradually decrease as the funding obtained by Stable Funding Rate-1 will be raised proportionately and in line with the interest rate projection.

4 FOREIGN EXCHANGE RATE POLICY

Rediscount Credits and Reserve Developments

18. Should the credit growth of 2013 continue in 2014 due to the extension of maturities of export re-discount credits and other facilities introduced, credit utilization is expected to reach USD 18 billion in 2014, and the contribution to the CBRT's reserves will be around USD 13-14 billion. The net effect of this export re-discount credits and the CBRT's FX interventions and auctions on total reserves has amounted to USD 81.5 billion since 2002 (Table 2).

Table 2: Amount of FX Purchases and Sales by CBR
(2002-2013*, million US dollars)

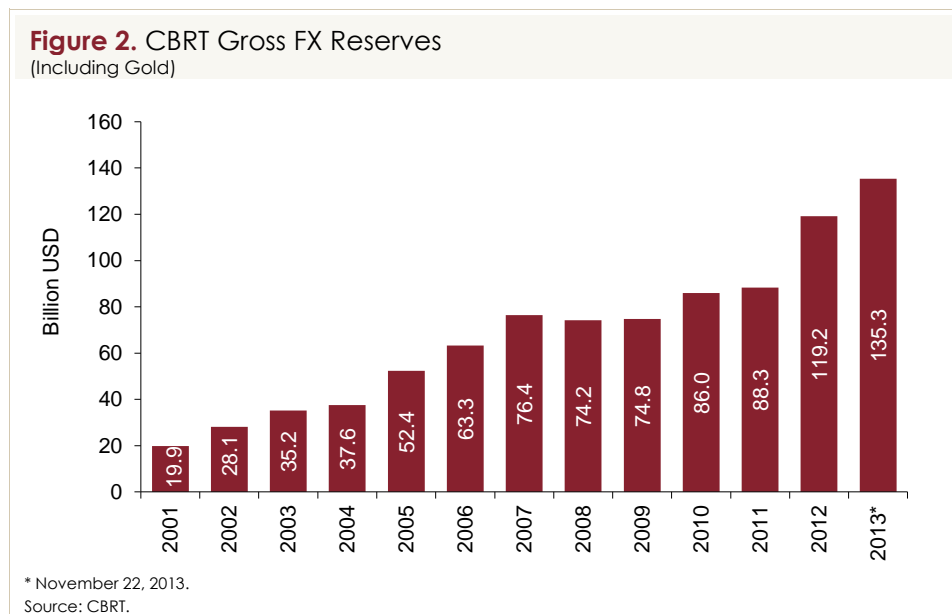
Year	Auctions		Interventions**		Export re-discount credits	Total Net FX Purchases
	Purchase	Sale	Purchase	Sale	Net	
2002	795	0	16	12	25	824
2003	5.652	0	4.229	0	34	9.915
2004	4.104	0	1.283	9	27	5.405
2005	7.442	0	14.565	0	25	22.032
2006	4.296	1.000	5.441	2.105	4	6.636
2007	9.906	0	0	0	2	9.908
2008	7.584	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	14.360	0	0	12.664	-1.696
Total	65.408	29.020	25.534	5.522	25.145	81.545

* by December 20, 2013.

** Amounts of purchases/sales are published after 15 working days of intervention.

Source: CBRT

19. As a result, under the floating FX rate regime implemented since 2001, instruments like direct net FX purchases, export rediscount credits and reserve options mechanism were used and the CBRT FX reserves saw a cumulative increase by around USD 115 billion (Figure 2).



Foreign Exchange Rate Policy in 2014

20. 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.

21. The maturity and interest rate of the FX deposits that the banks can borrow from the CBRT within their borrowing limits, which the CBRT is a party to, for both USD and Euro, will be maintained at one week and 10 % respectively in 2014.

- 22.** 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 2014 as usual.
- 23.** The CBRT may intervene directly or through flexible auctions in the market in both directions, in case of unhealthy price formations due to speculative behavior stemming from a loss in the market depth.
- 24.** 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 2014.
- 25.** In view of the fact that financial stability is one of the prerequisites for price stability, the CBRT has always taken the necessary measures in order to ensure the efficient functioning of the FX markets in Turkey and will continue to do so. However, under the current exchange rate regime, keeping in mind that, the economic agents operate in a market where the exchange rate risk is carried by the market players, they should establish and employ mechanisms that will ensure efficient risk management.

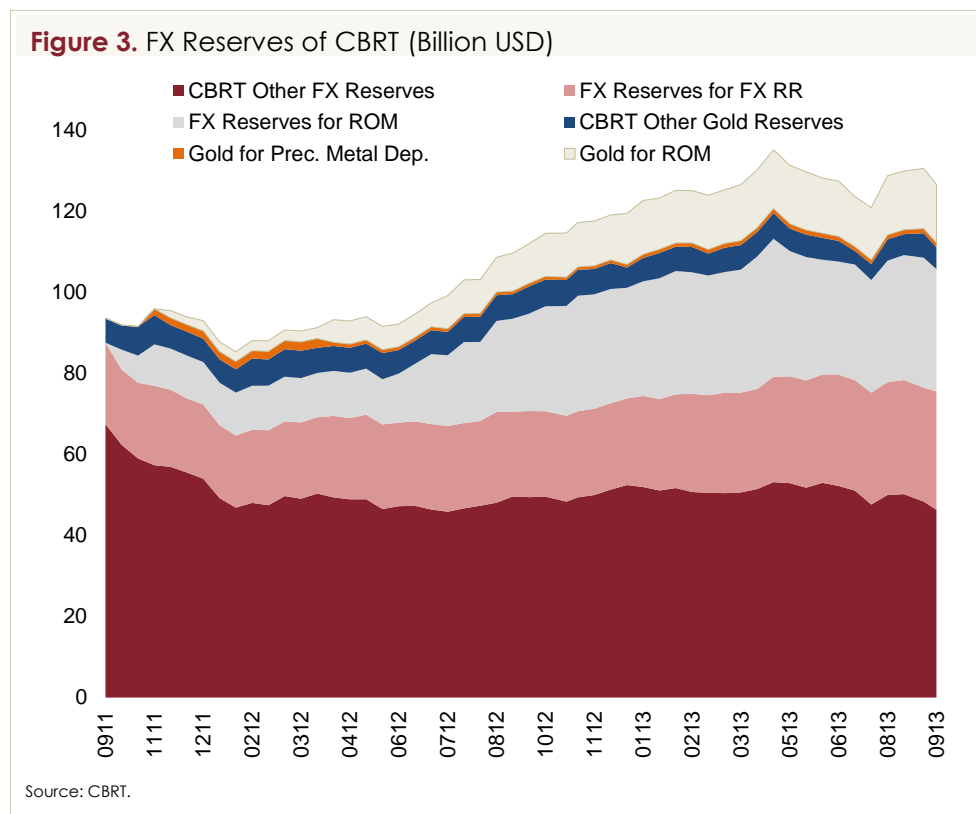
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ARRANGEMENTS AND OPERATIONAL FRAMEWORK FOR FINANCIAL STABILITY

Macprudential Arrangements

- 26.** To simplify the structure of reserve requirements, which are used as a monetary policy and a macroprudential instrument, an approach to directly involve items subject to reserve requirements will be adopted in calculating liabilities subject to reserve requirements as of 2014 instead of subtracting certain items from total domestic liabilities. With this approach, many small items that have no direct effect on the monetary policy and reduce the efficiency of operational process will be exempted from the scope of required reserve liability. Effective as of the calculation period of 17 January 2014, this practice, the introduction of which will start on 31 January 2014, is expected to provide the market with a limited amount of TL and FX liquidity.

27. On the other hand, facilities introduced by the ROM are intensively used by banks (Figure 3). The ROM is expected to further contribute to the efficient functioning of the liquidity management and containing the unfavorable effects of volatile capital flows on macroeconomic indicators. In this context, the automatic stabilization feature of the ROM will be gradually strengthened in the upcoming period. Thus, the funding need of the financial system from the Central Bank will be increased.



28. The leverage-based required reserves system that aims at controlling the indebtedness of banks was put into effect in 2013. The leverage ratio of the sector amounted to around 7.5 percent in this period. As per the arrangement, an additional reserve requirement of 1 to 2 percent in three stages is imposed on the banks with an average 3 to 3.5 percent leverage ratio in the last quarter of 2013 to be effective as of 2014. However, when there is no change in the course of current data, an additional reserve requirement is not expected for banks in 2014. In the following years, the upper limit of the leverage ratio, for

which the additional reserve requirement ratio will apply, will be raised to 5 percent gradually.

- 29.** Meanwhile, recent arrangements introduced by the Banking Regulation and Supervision Agency (BRSA) to credits and credit cards will contribute to plausible levels of credit growth and maintenance of financial stability by containing household liabilities.

Schedule for the 2014 MPC Meetings and Reports			
MPC Meetings	Summary of the MPC Meeting	Inflation Report	Financial Stability Report
21 January 2014	28 January 2014	28 January 2014	
18 February 2014	25 February 2014		
18 March 2014	25 March 2014		
24 April 2014	30 April 2014	30 April 2014	
22 May 2014	29 May 2014		29 May 2014
24 June 2014	1 July 2014		
17 July 2014	24 July 2014	24 July 2014	
27 August 2014	3 September 2014		
25 September 2014	2 October 2014		
23 October 2014	31 October 2014	31 October 2014	
20 November 2014	27 November 2014		27 November 2014
24 December 2014	31 December 2014		

Note: Monetary and Exchange Rate Policy for 2015 will be published on 10 December 2014.