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## The stance of monetary policy with the new governor

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After months of uncertainty about the new governor of the Turkish Central Bank (CBRT), the government appointed Deputy Gov. Murat Çetinkaya as the new chief. The appointment of the governor of the CBRT has become much more important than ever before taking into account the political pressure on the outgoing chief, Erdem Baçi, in terms of cutting the rates and supporting the economic growth policies of the government. The markets were skeptical about whether the bank would be subject to an increasing political pressure in the new term and whether the monetary policy would become highly expansionary. The first reactions from the domestic currency and bond and stock markets reveal that markets are comfortable that an insider has become the new chief.

Although the initial response of the market to the new governor is positive, the markets will closely watch whether the stance of monetary policy will significantly change during Çetinkaya's term. The CBRT has been adopting an explicit regime of targeting inflation since 2006. Under an inflation targeting regime, the simplest way of evaluating the performance of monetary policy is to see whether the targets have been achieved. Over the last decade, the CBRT was able to reach the target inflation in just three of the years. However, one can't say the bank has been unsuccessful simply by looking at the target and actual inflation rates. For instance, since 2012, the bank has not been able to achieve its targets despite the slowdown in economic activity. However, some external factors that are beyond the control of the bank, like the large depreciation of domestic currency and the increase in food prices, have contributed to the failure to hit the inflation target.

Mr. Baçi became the governor of the bank when Turkey's economy was growing at a rate of 9 percent. However, at that time, the current account deficit was around 10 percent of GDP and the actual inflation rate was above 10 percent when the target was 5.5 percent. Therefore, during his term, reducing the current account deficit, which generates a fragile environment for financial stability, and bringing actual inflation in line with target inflation have become much more important than economic growth. The bank achieved some improvements in these areas during this period, but this occurred with a significant slowdown in economic activity. Mr. Baçi was also unlucky that his term coincided with the signal by the U.S. Fed that it would end its largely accommodative policy, thereby initiating a period of depreciation for emerging market currencies.

The main issue for the bank over the next months will be whether there will be a structural change in the stance of monetary policy. The law on the CBRT explicitly mentions that the main objective of the bank is to maintain price stability. In the same article of the law, it is also stated that the bank may support the growth and employment policies of the government provided that this does not conflict with price stability. One may argue that whether a given policy that supports economic growth will harm price stability is a subjective evaluation. Actually, this is why there has been some disagreement between government officials and the bank regarding the stance of monetary policy. President Recep Tayyip Erdoğan and some government officials have criticized the CBRT in the past, as they think that the monetary policy is unnecessarily tight. The main idea behind this criticism is that cutting the rates will support domestic demand and will not conflict with price stability.

Taking into account some recent developments in global markets, like the slowdown in the Chinese economy and the possibility of the Fed postponing rises in interest rates, it seems that the bank has some discretion to cut interest rates. The speed of these rate cuts and the response of the bank to the developments in inflation will determine the credibility of the new governor.

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