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Ulaş Şener

Central Banking and Monetary Policy under the AKP Government

Abstract *This article wishes to contribute to the political-economic debate over monetary policy in emerging countries in times of global crisis. The influence of the Turkish Government on the Central Bank of the Republic of Turkey (CBRT) and empirical consequences of this will be a major point of examination. The main research question will be in which way and under which circumstances monetary policy evolved and changed under the rule of the AKP (2002-2015). The main argument will be that the government asserted significant influence on the CBRT to end monetary tightening in order to cope with the repercussions of the global financial crises. In this regard, the political economic motive, as well as the scope and limits of the government's influence on monetary policy, will be reconsidered.*

1. Introduction

Monetary policy has always been shaped by economic or financial crises. In Turkey, the country's financial crisis in 2001 and the global financial crises in 2007-08 changed the conduct of monetary policy in different ways. The former crisis led to the implementation of the well-known conventional monetary policy framework in Turkey, which involved strong price stability orientation, monetary tightening and an independent central bank (IMF 2010: 5). The latter global crises triggered an end of monetarist tightening and a shift to so-called unconventional monetary policy, as can be observed in many crisis-ridden countries.

In the last few decades, a considerable amount of orthodox economics literature has emerged on the theoretical and empirical prospects of conventional monetary policy. In this context, central bank independence (CBI) has established itself as a strong institutional paradigm in mainstream economics. Nevertheless, critical heterodox theories point out that CBI does not exclude governments from intervening into monetary policy. Since leading central banks adopted highly accommodative monetary policies after the global financial and economic crises, questions on monetary intervention and the relationship between governments and central banks have again gained attention in political-economic debates. Despite some empirical research on the economic impacts of these monetary policies on emerging economies (Mohanty 2014), the academic literature on the experience of peripheral or emerging countries with unconventional monetary policies and CBI is still thin.

This article wishes to contribute to the political-economic debate over monetary policy in emerging countries in times of global crisis. The influence of the Turkish Government on the Central Bank of the Republic of Turkey (CBRT) and its empirical consequences will be a major point of examination. The main research question will be in which way and under which circumstances monetary policy evolved and changed under the rule of the Justice and Development Party (AKP). The main argument will be that the government asserted significant influence on the CBRT to end monetary tightening in order to cope with the negative economic repercussions of the global financial crises. Monetary policy was determined by macroeconomic priorities of the government, which led to a relativisation of the price stability objective in this period. In this regard, the political-economic motive, as well as the scope and limits of the government's influence on monetary policy, will be reconsidered. From a conceptual point of view, I will conclude that the Turkish monetary policy was characterised by relative autonomy during AKP rule, and argue that its lines were drawn by domestic and international political-economic developments.

The second section describes the main pillars of monetary policy and consequences of these in the first term of the AKP (2002-2007). The third section focuses on the new monetary policy strategy during the second (2007-2011) and third terms (2011-2015) of the AKP. First, I will discuss the motives and the influence of the government on monetary policy decisions. Then, I will show and discuss the shift to an accommodative and expansive monetary policy during this period. The last section will conclude and sum up the main insights.

2. Monetary stabilisation under the AKP before 2007

The Justice and Development Party came into power after the coalition government suffered a heavy defeat at the polls in November 2002, leaving all ruling parties (DSP-ANAP-MHP) out of parliament. During its first term, the AKP implemented economic and financial reforms, which the previous government agreed with international creditors after the crisis of 2001. Liberal economic reforms were focused on consolidation and recovery. Public debts were taken under control and international capital was attracted, which promoted investment and growth. Monetary policy was focused on gaining price stability and credibility. The country experienced significant disinflation and a decrease of nominal interest rates to one-digit levels during this period. The Turkish monetary policy gained further credibility after a currency reform in 2005, which introduced the New Turkish Lira (TRY) by dropping six zeros. This credibility in the field of fiscal and monetary policy is one of the reasons why the AKP has been widely perceived as successful in economic policy until today.

The monetary policy framework was based on a standby agreement with the IMF, which rested on conventional wisdom, including the implementation of an inflation targeting regime. The strategy was mainly a policy mix, which consisted of a tight monetary policy, increasing foreign exchange (FX) reserves, and a (managed) floating exchange rate (Şener 2011: 290). The stand-by agreement further stipulated monetarist measures for the transitional period to inflation targeting, such as quantitative targets for monetary aggregates and FX reserves, which should act as a nominal anchor for price stability and reduce inflation expectations. The CBRT announced further that it would seek appreciation and de-dollarisation, in order to increase the credibility of the TRY and ensure control of the domestic banking system (LoI 2002: § 8, 20, 26).

A look at the consumer price index (CPI) outcome shows that inflation decreased substantially after 2001. Inflation targets were initially achieved between 2002 and 2005, as shown in Table 1. Nevertheless, this success did not last long. Turbulence in international capital markets in mid-2006 provoked capital outflows and exchange rate volatility in several emerging countries, including Turkey (Onaran 2007). This resulted in exchange rate losses for the TRY, leading to an upswing in the CPI and failure to meet the inflation target in 2006 (Şener 2008: 194f.). In the following two years, 2007-08, which were marked by the global financial crises, the CPI continued to miss the inflation target. Despite initial hesitation, the CBRT reacted with an upwards revision of the inflation targets, as can be seen in Table 1, where the initial targets were put in parentheses (CBRT 2006: 35f.).

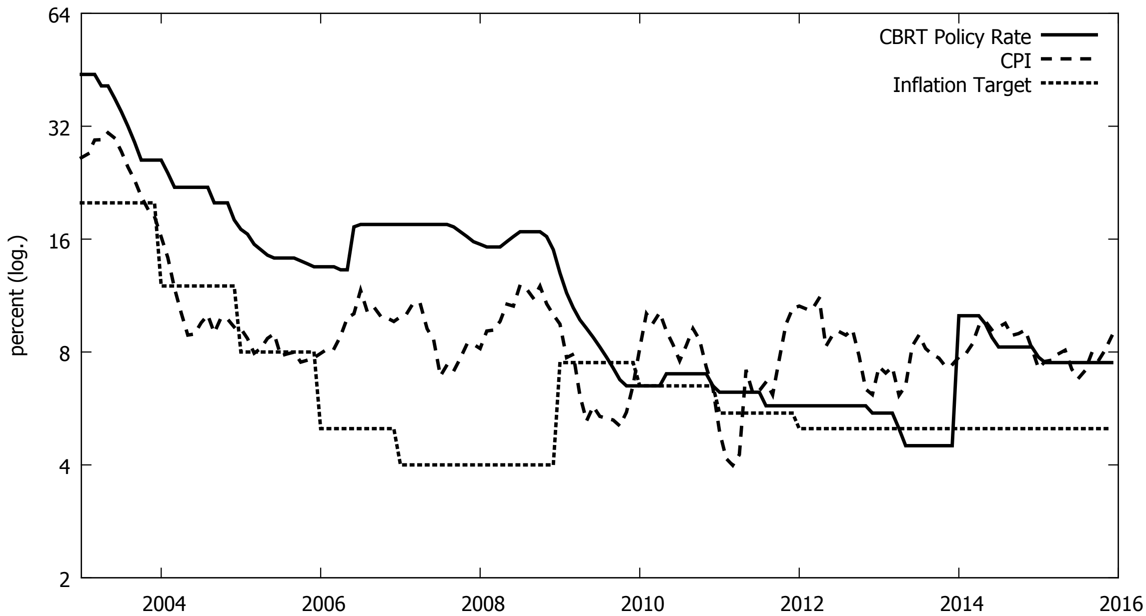
	2001	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Target	12	35(10)	20	12	8	5	4	4
CPI	68.5	29.7	18.4	9.3	7.7	9.7	8.4	10.1

	2009	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Target	7.5 (4)	6.5 (4)	5.5	5	5	5	5
CPI	6.5	6.4	10.4	6.2	7.4	8.2	8.8

Table 1: CPI and Inflation Targets (2001-2015)
Source: CBRT-EDDS; own elaboration

While the revised inflation targets for 2009 and 2010 were achieved, targets again performed poorly from 2010 to the present. This raises serious doubts regarding the success of the inflation targeting policy in Turkey (Yeldan et al. 2007; Şener 2008; 2011). In order to comprehend the reactions of the CBRT to this development, a further look at the interest rate policy is necessary.

Since the central bank reform of 2001 declared price stability as the primary goal, the mainstream expectation was that the CBRT would set interest rates according to inflation (Blinder 1998). In accordance with the disinflation, the nominal interest rates were lowered step by step, at least until 2006. This came by no surprise, because Turkey showed a significant negative output gap, which measures the degree of productive capacity utilisation, in the post-2001 crisis period, mainly due to the economic slump. The economic recovery and GDP growth occurring in this period did not lead to an overheating economy, thus producing inflationary pressure from the aggregate demand side. In the light of a sharply decreasing CPI (see Graph 1), the Central Bank had room to lower interest rates in this period (Şener 2016: 228). Having said this, the question arises as to what extent the CBRT actually lowered the policy rates. To answer this question, the real interest rates have to be taken into account, which can be illustrated as the area between the CPI and the policy rate line in Graph 1. As can be seen here, the policy rate stood continuously over the inflation targets until 2009, which meant that the CBRT sought a policy of keeping real interest rates relatively high in this period (Ekzen 2006; Yeldan et al. 2007). The real interest rates averaged 7.4 percent between 2002 and 2007. So, in this case, lowering the nominal policy rate did not mean that the monetary policy was not tight in this period.



Graph 1: Policy rate, inflation and inflation targets (2003-2015)
Source: CBRT-EDDS; own elaboration

This observation raises the question as to why it was necessary for the CBRT to ensure relatively high real interest rates in this period. The answer can be found in the chronic balance of payment problems in Turkey. The IMF considers positive real interest rates as a precondition to attracting international capital, if balance of payment problems occur or a shortage of domestic capital constrains economic performance. This view is backed by mainstream economic theory, which views high real interest as a risk premium, in other words as a return in excess of a risk-free rate of return.

Due to currency hierarchy, developing or emerging countries in financial trouble are typically expected to offer higher than usual rate of returns if international capital is to be attracted (Fritz et al. 2014). Since Turkey's imports regularly exceed its exports, leading to persistent current account deficits (Şener 2016: 319), it needs to offer positive and high real interest rates in order to ensure capital inflows. The CBRT followed this conventional wisdom until 2009. So did the Turkish banking system, which offered high real yields for TRY deposits between 2002 and 2010 (ibid. 302). This attracted capital inflows and contributed directly to the appreciation of the Turkish currency.

The appreciation of the TRY promoted an increase in imports and consumer goods, as well as primary and intermediary goods for production uses, making these goods relatively cheap. An empirical indicator for this is the relative share of imports to GDP, which increased in the last decade from around 20 to 28 percent (ibid. 320). It can therefore be concluded that a flood of cheap imports contributed to the disinflation in Turkey. The post-Keynesian economist Minsky underlined the possibility of reducing inflation by condoning external trade deficits (Minsky 2008: 316). The explanation is that the expected appreciation of the national currency makes imports cheaper and contributes to disinflation (Arestis/ Sawyer 2004: 80). Therefore, it is assumed that a central bank can try to achieve inflation targets through monetary policy transmission channels.[1]

If the exchange rate channel is effective, it also implies the opposite effect, which is described in economic theory as the cost-push effect. This means that currency depreciation leads to higher inflation, counter-factors notwithstanding. One of the initial goals of the CBRT was to lower the effect of the pass-through effect, i.e. decoupling inflation from the exchange rate (Özatay 2005: 285). Nevertheless, after inflation increased in 2006, the CBRT explained that the failure of the inflation target was a result of external supply shocks, mainly due to higher energy and food prices (CBRT 2007: 28). As inflation continued to miss the targets, reaching two digit levels in 2008, this response became a common explanation, since they were not within the direct reach of monetary policy (CBRT 2008: MPC PR Nr. 2008-20). This development indicates the inertia of cost-push effects on inflation in the Turkish case, as the CBRT itself later acknowledged in several reports (BSB 2007: 39; Bakır 2007: 188).

Besides the policy rate, open market operations (OMO) were used by the central bank for liquidity regulation. The CBRT took excess liquidity from the money markets between 2002 and 2008, in order to prevent potential inflationary effects. In this regard, OMO supported the appreciation of the TRY in this period. Nevertheless, the capital outflow of 2006 seemed to show the limits of this instrument. Confronted with exchange rate losses of the TRY in the second quarter of 2006, the CBRT increased its demand for TRY by selling TRY nominated assets, in order to bolster the TRY and avoid capital outflows. Nevertheless, as the situation became more critical, the CBRT decided not to widen OMO, but to raise the policy rate drastically by 400 points. Depreciation stopped suddenly after this first interest rate hike since the 2001 crises, and the Turkish lira began to appreciate again (see Graph 3).

The second leg of monetary policy rested on a systematic and regular increase of FX reserves. The CBRT increased its reserves by a net amount of 80.4 Billion USD through regular FX buying auctions and direct interventions between 2002 and 2010, increasing total net FX reserves from 30 to 140 Billion USD (Şener 2016: 309f.). In previous decades, emerging economies and developing countries have pursued a policy of high FX reserves (Rodrik 2006; Mohanty/Turner 2006). After the Asian financial crisis in 1997, the IMF promoted high FX reserves as a confidence measure to ensure the solvency of emerging countries which were open to volatile international capital flows (IMF 2001). The hope was that the reserves would act as a crisis prevention tool, i.e. as a buffer in the case of an abrupt withdrawal of capital, in order to protect the exchange rate against a rapid devaluation (Rodrik 2006: 254).

The political economic implications of the measures described above are not uncontroversial. First, stockpiling FX reserves rather than reducing short-term debt, which typically has a higher interest burden due to risk premiums, withholds financial resources which could alternatively be used for public investment. In this regard, building high FX reserves during periods of high debt, high unemployment and poverty, as well as low investment, is associated with high social costs (Rodrik 2006; Mohanty/Turner 2006). Rodrik calculates the cost to developing countries for the high reserve requirements as up to one percent of their GDP (2006: 254). He recommends that emerging countries should not try to accumulate costly reserves, but instead increase financial stability through direct regulation of short-term capital flows (ibid. 265).

Second, despite falling nominal interest rates in this period, the CBRT held monetary policy tight with high real interest rates. Critical commentators claim that the stability programme of 2001 gave rentier interests priority, because a tight monetary policy and high FX reserves favoured creditors. This primarily helped the banking and financial sectors obtain international capital on favourable terms, because a strong national currency makes access to foreign capital cheaper (Ekzen 2006; Epstein/Yeldan 2007). Indeed, the Turkish Banking Sector increased its net profits from 0.8 percent to 1.7 percent of GDP (2002-2012), mainly due to expanded credit lending and an increase in private debts (Şener 2016: 209).[2] In the Turkish case, it was not only the financial sector that did well in this period. There was also a broader consensus among economic actors on the monetary policy strategy. Despite some principal objections from the Turkish Exporters Assembly to high real interest rates and currency appreciation however, criticism was rather muted.[3] The economy grew remarkably in this period; between 2002 and 2007, GDP averaged 6.8 percent and the industry, construction and service sectors profited from low wages, high foreign direct investment and growing exports.[4] Since appreciation makes the import of input factors relatively cheaper, it compensated for higher export prices for industry, at least as long as the economy and especially exports continued to grow. The state also benefited directly from this development, since lower nominal interest rates reduce the costs of borrowing money and financing investment, for the private as well as the public sector. And, indeed, while private sector borrowing increased and investment boomed in this period, the public budget was consolidated. Despite high FX reserve holding, lower interest rates enabled the government to relieve the burden of public debts and reallocate these funds to public spending. The share of public spending on interest payments was reduced from 17 percent of the GDP to one digit levels after 2005, and the share of public debt to GDP was reduced from 73.7 percent in 2002 to 36.2 percent in 2014.

To conclude, during the first term of the AKP government, the CBRT committed to its anti-inflationary policy stance with a tight monetary policy, which led to a significant appreciation of the currency and also attracted international capital. The AKP was successful at taking the political credit for reducing inflation and lowering interest rates in this period. Under these circumstances, it seemed that there was no substantive disagreement between the Central Bank and the government regarding monetary policy decisions. As I will show in the next section, however, this picture changed in the AKP's following two terms.

3. Modification of monetary strategy after the global financial crises

The global financial crises marked a decisive turning point for monetary policy worldwide. Worries about a global economic collapse and deflation determined the global economic agenda. While many states implemented immediate fiscal measures, leading central banks intervened with unconventional monetary measures, namely increasing the money supply and cutting policy rates sharply, which led to negative real interest rates in the USA and across the Eurozone. Due to historically low interest rates in the core countries, high-interest, yield-seeking capital flowed into emerging economies, affecting monetary policy in those countries (Mohanty 2014).

The second and third terms of the AKP government were marked by counter-cyclical economic intervention. However, since the CBRT was formally independent, monetary policy, especially interest rate policy, became a controversial issue in the Turkish political-economic landscape, due to the efforts of the government in the direction of an accommodative monetary policy. Tensions between the government and the Central Bank, but also between supporters and opponents of CBI, were on the agenda, especially during the AKP's third term. I will first discuss the new approach of the AKP government to monetary policy, its impact and motives. Then, I will turn to the empirical picture, showing that the CBRT shifted from a tight to an accommodative monetary policy.

3.1 The new stance of the AKP government on monetary policy

The economic repercussions of the global financial crises started to hit Turkey in 2008. GDP growth dropped from a prior 4.7 to just 0.7 percent. As in many crisis-affected countries, 2009 was even worse, when the economy shrank by 4.8 percent and fell into recession. Declining economic activity and production increased unemployment from around 10 to 16.1 percent. The real dimension of unemployment was worse, since Turkey's labour supply is characterised by a large share of young workers, and youth unemployment (15-25 years) reached 28.6 percent. Under these circumstances, the AKP government pursued a counter-cyclical fiscal policy and implemented several measures to support the economy. An indicator for this effort is the lower rate of primary surplus to GDP, which declined from an average of 5.6 percent (2002-2007) to 1.48 percent after the crises started (2008-2012).

The economic downturn in 2008 sparked a sharp controversy over interest rates and too low inflation targets. While the AKP government was relatively silent on monetary policy issues in its first term, the second and third terms were characterised by an interventionist approach to monetary policy, which led to tensions with the Central Bank. I will point out three indicators for this new stance.

First, after the 2006 retirement of CBRT governor Süreyya Serdengeçti, who was known for his strong independent stance on a tight monetary policy, the AKP government appointed Durmuş Yılmaz as the new governor. Since the era of high chronic inflation had ended under Serdengeçti, Yılmaz had more space to work with the government on macroeconomic issues. After the global crises, Yılmaz appealed openly to Article 4 of the Central Bank Law, which states that monetary policy should support growth and employment policies of the government if price stability is not hampered. The CBRT stressed that this new active role should not be regarded as interference into their institutional independence, but as a response to external shocks (CBRT 2008: 9). Nevertheless, it would not be far-fetched to suppose that the accentuation of financial stability and the support of government policies at that point in time corresponded to a willful neglect of the price stability objective up to a certain degree, as I showed in the previous section.

Second, the appointment of Zafer Çağlayan as Minister for Industry and Trade in 2007 indicates that the government had reconsidered its stance on monetary policy and would pressure for a more accommodative monetary policy. Çağlayan was the former head of the Ankara Chamber of Industry and was known for his criticism of an appreciated currency and tight monetary policy. He served later in the third term of the AKP government as Minister for Economic Affairs. During his term as minister, he criticised the CBRT several times for hesitating to lower interest rates and not counteracting the strong appreciation of the TRY. In this regard, he held the CBRT jointly responsible for declining capacity utilisation and allowing economic downturn after the global financial crises. These interventions exerted political pressure on the CBRT. Çağlayan was supported by Prime Minister Erdoğan, who declared several times in public the unwillingness of the government to leave monetary policy solely to the Central Bank (Şener 2016: 246ff.).

Third, the government did not extend the expiring stand-by agreement with the IMF in 2008. This move can be regarded as a deliberate strategy by the government to expand its manoeuvre room in fiscal and monetary policy, as it was facing recession due to the global economic slump.[5] Since the stand-by agreement favoured a tight monetary policy to fight inflation, it can be argued that differences on future monetary policy were decisive in the 2008 decision. Actually, this came as no surprise. Erdoğan had already expressed in 2003, after he was elected, that he was not in favour of extending the stand-by agreement with the IMF, due to political interference and unpopular conditions. Despite these remarks by the prime minister, the government preferred not to come out with strong criticism on monetary policy decisions. The government extended the agreement, because economic recovery had just began and debts to the IMF were high. The stand-by agreement with the international creditors was already in place and the Central Bank had just recently been declared independent when the AKP came to power. Any serious controversy over the status of the CBRT in this period could have flurried capital markets and triggered economic turbulences, which would most likely have weakened the government in the era of post-crisis recovery in which the AKP had just begun to establish its political power.

The AKP started to abandon its restraint on monetary issues after its electoral win in 2007 and the end of the stand-by agreement. The negative attitude towards the IMF was strengthened when Turkey paid off its debts to the IMF in 2013, and the international creditor institutions lost further influence on Turkish monetary policy.[6] Expert circles in Turkey close to the government welcomed this move as a strategic achievement which would enhance the decision-making capacity of the government.[7] Motives were similar to Brazil's and Argentina's decisions in 2005 to pay off their IMF loans, end political tutelage and interference by the IMF, and strengthen domestic political support (The Economist, 20 December 2005).

Under these circumstances, relations between the government and the central bank started to strain, mainly during the AKP's third term, when Erdem Başçı succeeded Governor Yılmaz in 2011. The former was close to the economic technocrat faction within the government which defended CBI. This position was represented at that time by State and Deputy Prime Minister Ali Babacan, who was also the former Minister of Economic Affairs in the first AKP period, and Minister of Finance Mehmet Şimşek. After Başçı came into office, the section which affirmed the possibility of monetary policy support to government policies was removed from the strategic plan (CBRT 2010, 2011: 26). Another sign of this stance was that, while in the annual reports from 2009 and 2010 issues like transparency, accountability, credibility, good governance, effective communication and public interest were highlighted as principles of monetary policy (CBRT 2009: 24; 2010: 26), the annual reports from 2011 and 2012 stressed CBI as the main principle (CBRT 2011; 2012a).

One of the disputes on monetary policy erupted in 2012, when the CBRT kept the key policy rate unchanged at 5.75 percent at 11 consecutive meetings. This can be interpreted as an effort by the CBRT to limit accommodative monetary policy (see Şener 2016: 275). It was the Minister of Economy, Çağlayan, who took the lead in criticising the interest rate policy in October 2012, when the economic downturn became clear. He called for lower interest rates, describing high interest rates as an obstacle to growth and the Turkish economy. Finally, the CBRT relented and lowered the key policy rate from 5.75 to 5.5 percent at its last annual meeting (CBRT 2012b: PR No. 2012-57).

Pressure on the CBRT also continued in the following years. The CBRT tried to defend its independence against growing criticism by government officials in early 2013, with a booklet entitled Central Bank Independence (CBRT 2012c), which presented historical and theoretical arguments in favour of CBI. However, in April 2013, the CBRT gave in and lowered the policy rate further from 5.5 to 5 percent (CBRT 2013: MPC PR No. 2013-16), shortly after repeated heavy criticism by Erdoğan and Çağlayan (Şener 2016: 248). An echo of Babacan on statements made by Çağlayan revealed a controversy within the government on this issue. At a meeting in early March 2013, Babacan stressed the point that the independence of the CBRT needed to be respected. This development provoked significant media coverage, since commentators regarded the macroeconomic explanation for the interest rate cut given by the CBRT as ambiguous, thereby suggesting that political motives played a role in this decision. The economic department of the daily newspaper Milliyet commented that the CBRT had understood the political signal (Milliyet Haber, 17 April 2013). Certainly, this example is only one indication of the political influence on the central bank. However, the temporal proximity of the criticism and the interest rate move indicates that political pressure on monetary policy was controversial but effective in the third term of the AKP government.

The government's pressure in this period for low interest rates can partly be understand as an attempt to keep the promise it had made before local and parliament elections in 2014 and 2015, respectively. The AKP wanted to protect their electoral base from higher borrowing costs, due to the high indebtedness in the real estate sector. However, small and medium-sized companies which were indebted or relied heavily on credit lending were also expected to be affected by a sharp increase in interest rates. At the same time, parts of the export sector that criticised an overvalued currency had welcomed the depreciation of the TRY, which began in 2013 (see Graph 3). From their point of view, an interest rate hike and efforts to re-appreciate the currency would be an incorrect method. However, many experts warned that Turkey could not afford negative real interest rates for an extended period of time, as this would eventually lead to capital flight, depreciation and higher inflation (Bloomberg View, 17 January 2014).

Indeed, the influence of the government encountered external limits at the beginning of 2014, when pressure from currency markets and severe exchange losses for the TRY became unstoppable, and the CBRT drastically raised the policy rate from 4.5 to 10 percent at an emergency meeting. This was a desperate move, after several attempts by the CBRT and the government failed to reduce the pressure on the currency.[8] The reactions revealed not only the opposing positions of different interest groups, but also the deep division within the government on the matter. While Prime Minister Erdoğan reiterated that he was against higher interest rates, Minister of Finance Şimşek announced that investor confidence was restored within the country and abroad.[9] The banking and financial sectors, as well as large capital groups, welcomed the decision by the CBRT, since higher interest rates attracted international financial capital. The largest Turkish business association, TUSIAD, also welcomed higher interest rates as a confidence-building measure. The IMF acknowledged the decision, albeit as a belated reaction to restore international investor confidence. On the other hand, criticism came from the ranks of small and medium capital groups. The AKP-related business association MUSIAD condemned the sharp increase in interest rates as impeding economic growth, and urged the government to take specific measures to stop the negative impact on small and medium enterprises.

Despite this setback in 2014 for those in the government who favoured an accommodative monetary policy, subsequent political developments showed that the influence of the government on monetary policy had not been completely lost. The AKP emerged as the strongest political party in the local elections of March 2014, despite broad social protest, corruption and manipulation allegations, while Erdoğan was leading election polls for the forthcoming presidential elections. When it became clear that the AKP was going to consolidate its political power, the CBRT cut interest rates again in mid-2014, although the inflation target of 5 percent would clearly be missed (see Table 1). Despite ongoing, higher-than-targeted inflation, further interest rate cuts followed in January and February 2015 (see Graph 1).

3.2 The shift to an accommodative monetary policy

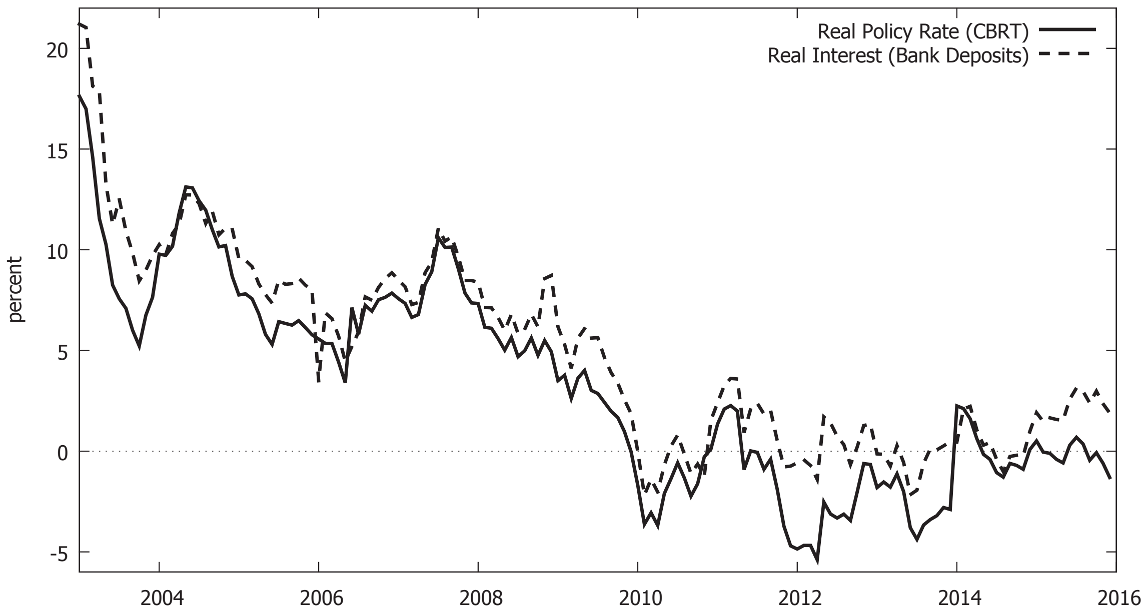
The rapid decline of economic activity and further contractionary expectations after the global financial crises triggered a change in the course of monetary policy. At the end of 2008, the CBRT reacted to the crises with a set of unconventional monetary measures. First, a shift to an accommodative monetary policy was carried out by means of sharp interest rate cuts (CBRT 2008: 9). Starting in November 2008, the policy rate was lowered from 16.65 to 6.5 percent within 11 months. Second, open market policy changed direction and increased the money supply to the banking system. Third, an active interest rate corridor and reserve requirement policy was pursued to support and regulate liquidity.

The new approach called for a broadening of monetary objectives and implementation of multiple instruments. In this context, financial stability was declared a strategic objective of monetary policy (CBRT 2008; 2012b: 9, 30). A comparison of the CBRT annual reports of 2011 and 2012 shows that the relevance of financial stability was enhanced in the wake of the crises and identified as a condition and prerequisite for price stability (CBRT 2011: 26; 2012a: 26). Besides surging capital flows, volatile exchange rates and financial instability were also identified as risks the CBRT should act against. This new approach aimed to intervene more directly in the macroeconomic fundamentals, with a focus on foreign trade imbalances and overshooting credit lending. The continuously growing high current account deficits and short-term capital flows were seen as endangering economic stability. Table 2 illustrates the monetary policy before and after the global economic crises, labeling the new approach a shift from a Monetarist(-inspired) to a more Keynesian monetary policy.

	2002-2007	**2008-2015**
Macroeconomic environment	Recovery with high growth	Recession due to global economic crises, Recovery with low or moderate growth
Capital flows	High FDI & portfolio capital	FDI recovered, volatile capital flows
Policy objectives	Price stability	Financial stability & price stability, + macroeconomic objectives
Inflation	Significant disinflation, inflation targets were mostly achieved	Inflation targets were not achieved
Monetary strategy	Mix of monetarism/inflation targeting	Inflation targeting, discretionary (Interest corridor + active reserve requirement)
Policy rates	Lowered	Further interest rate cuts
Real interest rates	High/positive	Low/negative
Currency	Appreciation	Depreciation
Reserve policy	Continuous reserve building (regular buying auctions)	Relative decline due to FX interventions
Liquidity policy/OMO	Restrictive	Expansive
Relations with IMF	Stand-by with the IMF	Stand-by not extended, debts paid off
CBRT independence	Consent	Disputed

Table 2: Shift from Monetarist to Keynesian Monetary Policy
Source: own elaboration

One consequence of the shift to an accommodative monetary policy was that real interest rates, the policy rate of the CBRT, as well as the TRY deposit rates offered by commercial banks, all either became negative or oscillated around zero after 2009 (see Graph 2). When monetary easing continued and adhered between 2010 and 2013, policy rates were cut further by the central bank, despite missing the inflation targets. This can be interpreted as a shift to a 'zero real interest policy', which was openly called for by Prime Minister Erdoğan during his last two terms on several public occasions (Şener 2016: 247).



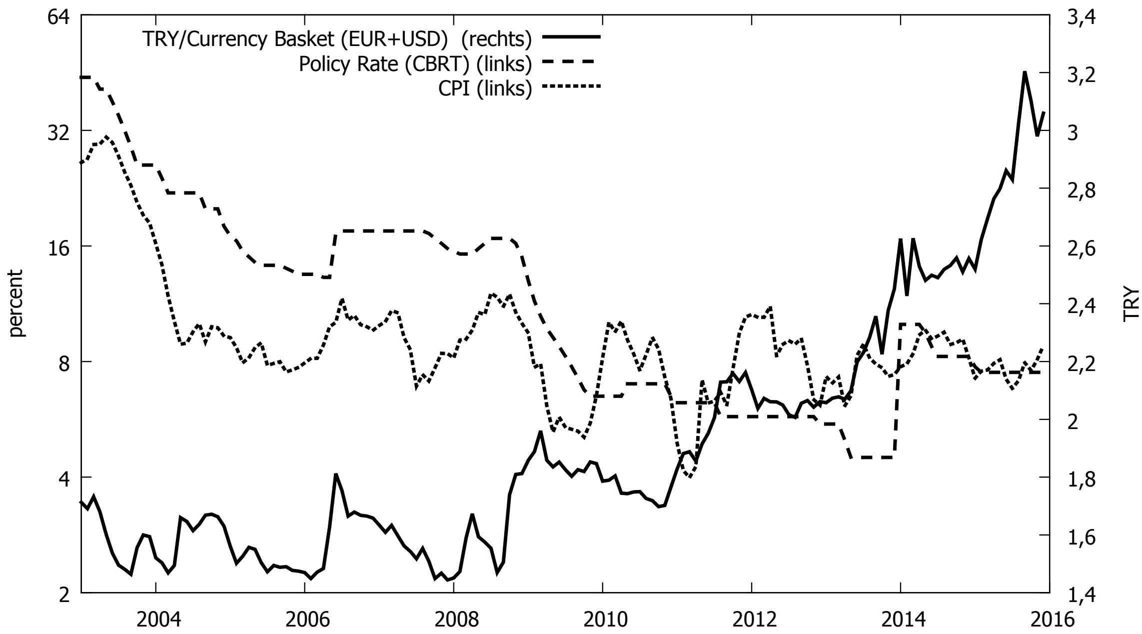
Graph 2: Real Interest Rates in Turkey (2003-2015)
Source: CBRT-EDDS; own elaboration

After the economy began to recover in the last quarter of 2009, the CBRT avoided any further policy rate cuts. Many experts warned that Turkey could not afford negative real interest rates and that this would eventually lead to capital flight, depreciation and higher inflation (Bloomberg View, 17 January 2014). Encouraged by the high liquidity in the global financial markets and the recovery in the first two quarters of 2010, the average growth was 11.5 percent, and the CBRT declared a monetary exit strategy in April 2010 to end the expansionary course (CBRT 2010: 8). A series of new measures were decided to combat macroeconomic and financial instability and risks that could arise from massive capital inflows and credit expansion (CBRT 2010c: 43). Also decisive for the new strategy was a greater emphasis on exchange rate fluctuations to eliminate macroeconomic imbalances.

The main change was a replacement of the daily interest rate with the one week repurchase (repo) rate as the new key policy rate (CBRT 2010). This new model was meant to enable the central bank to carry out short-term interest rate or reserve requirement adjustments, and to withdraw excess liquidity from the money markets, without changing the policy rate. CBRT Governor Başçı confirmed a stronger intervention by the central bank as part of the stability of the financial system and macroeconomic development, for example when they might be threatened by excessive capital flows, exchange rate fluctuations, or highly rated credit expansion. With the announcement of these interventions, Başçı based the monetary policy on two perspectives: first, prevention of the overvaluation of the Turkish currency, and second, increased control of loan growth and domestic demand in order to reduce high current account deficits (see CBRT 2011: 8).

When the European debt crisis in the Autumn of 2011 triggered severe capital flight from emerging markets, Turkey was again affected by financial instability. This led to a slowing economy and growing exchange rate instability in Turkey. As it became clear that GDP growth had declined in all four quarters, the CBRT cut the policy rate further from 6.25 to 5.75 percent in August 2011. However, the downward trend continued in 2012, when GDP growth fell to 2.2 percent and continued falling in 2013, bringing economic downturn back on the agenda.

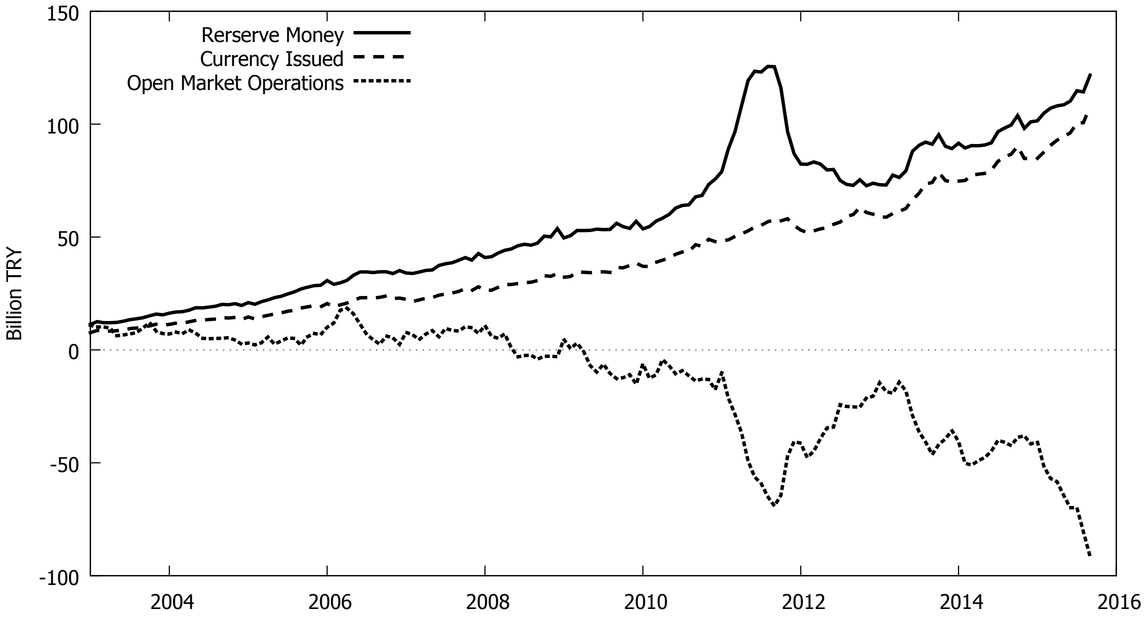
Under these circumstances, exchange rates played an important role in monetary policy decisions. I presented empirical evidence elsewhere that interest rate reactions of the CBRT were primarily focused on the exchange rate in this period (Şener 2016: Chapter 8). When the TRY started to lose against the EUR in 2011 and the TRY/EUR exchange rate increased from 2.07 to 2.5 by August, the CBRT reacted twofold. It lowered the one week policy rate in August from 6.25 to 5.75 to counteract the falling GDP. After the exchange rate continued to fall, the CBRT expanded the interest rate corridor in October upwards from 9 to 12.5 percent, offering higher short term ON interest rates, while the policy rate was held at its present level. This intervention temporarily helped to stop the depreciation. Moreover, in order to ease liquidity constraints on the banking sector, minimum reserve requirements were lowered so that Turkish banks would not face liquidity problems that could arise from the higher daily interest rates (Şener 2016: 236).



Graph 3: Exchange Rate Development, Inflation and Policy Rates (2003-2015)
Source: CBRT-EDDS; own elaboration

Another reaction occurred in July 2013, after the EUR passed beyond 2.5 TRY, the USD rose to 1.9 TRY, and inflation climbed to about 8 percent. The CBRT extended the interest rate corridor upwards by raising the interest rate ceiling from 6.5 to 7.75 percent, while the one week policy rate was not raised again. Instead, it was reduced even further in May 2013 to 4.5 percent and kept constant until the end of the year, mainly due to pressure by the government, although the price and exchange rate developments suggested a contrary reaction. This time however, the intervention by the government had severe consequences. After the CBRT cut interest rates further in May 2013, capital started to flow out and the exchange rate for the TRY came under huge pressure. The TRY lost up to 30 percent of its external value between early 2013 and January 2014. Depreciation only stopped when the CBRT drastically increased the policy rate in January 2014. However, as Graph 3 clearly shows, the TRY depreciated again in 2015, after the CBRT cut the policy rate from 10 to 7.5 percent and the ON lending rate from 12 to 10.75 percent. The currency basket started to increase in January 2015 from 2.5 to above 3 TRY. This can be interpreted as a clear sign that the CBRT had accepted the depreciation of the TRY in the previous two years, which would be in line with its declared focus on macroeconomic stability and trade imbalances. Since depreciation of the currency makes imports relatively more expensive, the CBRT tried to moderate high imports and lower currency account deficits in this period. However, this also implies that higher-than-target inflation was accepted, which can be seen as empirical evidence for the relativisation of the price stability objective, in favour of lowering financial instability and pursuing an accommodative monetary policy to stimulate economic growth. Governor Başçı explained the rise in inflation in this period as being due to the depreciation of the TRY, which was itself triggered by a deteriorating global investment climate, decreasing risk willingness, and an adjustment of administered prices in the last quarter of 2012 (CBRT 2012: 25).

The open market policy in this period indicates that monetary policy at this time was not as tight as the CBRT had declared in 2010. The first striking point is that after 2010 more money was put into the Turkish banking and financial system to ease the access to credit and liquidity. In the election year of 2011, the volume of OMO expanded to 74 Billion TRY at the end of October 2011. As a result, reserve money, which is an important determinant of the supply of demand deposits in the banking sector, increased sharply (see Graph 4), and helped to support demand.



Graph 4: Quantitative Liquidity Indicators (2003-2015)
Source: CBRT-EDDS; own elaboration

Indeed, GDP growth in these two years was 9.2 and 8.8 percent, respectively. Only after the European Debt crisis started to pull capital from emerging countries and the TRY started to lose value against the EUR and USD, was the volume of the expansive OMO partially reversed, and lowered, in order to limit liquidity. However, this did not go so far that the central bank pulled liquidity out of the market. The CBRT continued to pursue an expansive liquidity policy, as can be seen in Graph 4. In mid-2013, the CBRT decided to widen OMO again; interestingly, this happened immediately afterwards the Gezi Park protests began, which led to political protests across the country against the government. After the interest rate hike in January 2014, the expansion of OMO slowed, only to be extended again in the following election year of 2015.

4. Conclusion

Mainstream scholars acknowledge CBI as the 'state of the art' in monetary policy. Nevertheless, independent central banks do not exclude governments from intervening in monetary policy. This article argued that the Turkish government under AKP rule tried to increase its national autonomy in monetary policy by relativising the institutional autonomy of its central bank. The AKP legitimised political pressure on the central bank, with the belief that governments bear the political responsibility for economic policy as a whole, which naturally includes monetary policy. As I showed in this article, the critical stance of the AKP government towards interest rates and CBI started to become a major political issue after the global financial crises in 2008. With the end of the stand-by agreement, the Turkish government regained initiative and influence in its conduct of monetary policy. This articulated itself in a shift from a Monetarist to a more Keynesian monetary policy, in order to boost investment and employment and prevent financial instability. Interest rates were cut, and massive liquidity was given to the Turkish banking and financial sectors. The relatively weak policy responses to the misconduct of the inflation targets attest to the shift in political-economic priorities in this period.

The outcome of the change of monetary course after the global financial crises was quite fundamental for Turkey. During the second and third terms of the AKP government, the policy of high real interest rates came to an end. Since it is not clear what the long term outcome of this monetary policy will be, the AKP is widely seen as being successful in terms of economic policy, and gaining political support and consent in several ensuing elections, despite several corruption charges and controversial political and economic developments in recent years. The government regularly refers to its success in achieving lower one digit interest rates, and claims to have re-established national sovereignty on economic policy decisions. However, this picture did not come without constraints. The interventionist actions by the Turkish government in the aftermath of the 2008 crisis and subsequent interest rate cuts were carried out at a time when interest rates were declining worldwide due to the global financial and economic crisis and the expansionary monetary policy of the FED and the ECB. They were in line with global reactions to the crisis, which appealed to the state to intervene. Therefore, I conclude that Turkish monetary policy was characterised by relative autonomy during AKP rule, confirming the fact that the political influence of governments on monetary policy depends on strong domestic support and the global political economic conjuncture. If the political credibility of a government is damaged and general uncertainty increases, investors may demand a higher risk premium. In general, the central bank and the government then have to submit to these demands when capital markets are free and act on a massive scale, as the spectacular interest rate move by the CBRT exemplified in January 2014. Therefore, cross-border capital flows continue to constitute an effective political economic power which relativises states' autonomy regarding monetary policy.

The Turkish case shows that emerging countries can pursue an accommodative and expansionary monetary policy under certain national and international conditions and circumstances. The global financial and economic crisis of 2007-09 represented such a historic situation. The decisive point, however, is that a country like Turkey, which suffers from a chronically unfavourable balance of payments, higher inflation and growing foreign debts, and is dependent on international financial capital, regularly does not have the same structural manoeuvering space in monetary policy as do core countries with internationally strong currencies or even emerging countries with high current account surpluses.

1 Many commentators attributed disinflation to the independence of the CBRT and the ban on the monetisation of public deficits (Şener 2011: 294). While others highlight the role of increasing control of the state budget, reducing public deficits and the weight of public debt, critical voices highlight the disinflationary effects of increased unemployment and a general collapse of wages after 2001, along with an appreciated currency, which triggered an import boom in cheap consumer goods. I showed elsewhere that, after an initial increase in 2004, real wages stagnated and still remain behind productivity gains (Şener 2016: 201f.), and that current account deficit increased drastically during AKP rule (ibid. 319).

2 Usually, the producers of non-internationally competing goods and services, international trade and investment groups and the banking sector benefit from a revalued currency. In contrast, export-oriented sectors and economic activities that compete with imported products prefer a rather weak currency (Frieden 1991: 445).

3 The interest rate increase by the CBRT in mid-2006 provoked no substantive criticism or reaction from the government or other political parties. A report which was published by the Izmir Chamber of Commerce summed up international and domestic reactions to the interest rate move in 2006 (ICC 2006); most of them regarded this interest rate move as a confirmation of the CBRT's independence.

4 In the first term of the AKP, total FDI increased massively from 16.3 to 151.9 Billion USD, in the industrial but especially in the service sector, with an average of 52.5 percent. One decisive factor was substantive privatisations as agreed upon in the neoliberal reform programme with the international creditors, and the lower market value of Turkish financial and real assets and companies after the collapse of 2001.

Nevertheless, many joint ventures were also founded in this period, which increased the internationalisation of Turkish capital groups and their export prospects.

5 The IMF was not per se refusing counter-cyclical measures due to the global crises, but there was no agreement with the government on macroeconomic assumptions and economic strategy. A leaked US embassy cable from 16.1.2009 stated that the IMF demanded structural reforms, especially the adoption of fiscal rule in order to control the public budget, a tax reform to reduce the informal economy, more auditing capacity in the public administration to increase revenues, and a local government reform that would enhance local governments' revenue-generating capacities while tightening their accounting (Wikileaks).

6 In this regard, a revelation by former central bank governor Durmuş Yılmaz is instructive. Yılmaz revealed in a 2013 interview with the Wall Street Journal that the IMF pressured the CBRT in 2006 to raise interest rates in order to thwart a massive capital outflow. Yılmaz claimed that the CBRT initially planned to intervene directly with foreign exchange sales in order to end fluctuations and stabilise the TRY. The IMF, however, categorically refused this plan and demanded a further increase of reserves and higher interest rates. According to Yılmaz, the IMF was able to intervene in the monetary policy decisions because of the stand-by agreement, which was then still in force and gave the IMF political influence (Karakaya 2013).

7 For a recent critique of the IMF's approach to Turkey, see Ertem (2016).

8 The CBRT tried to alleviate the pressure on the TRY through direct foreign exchange selling amounting to 3 Billion USD. Also, the government had unsuccessfully tried to stop the depreciation. The two ministers Babacan and Şimşek, who were known for their support of CBI, met with big institutional investors in New York and London in order to attract investor confidence.

9 Şimşek pointed to the international political-economic dimension of the interest rate decision, since emerging economies were confronted with increased pressure from the financial markets due to the Fed's announcement on plans to slowly end the expansionist monetary policy, signaling an end to negative real interest rates. This would turn capital flows back to the core countries. Countries like Argentina and South Africa found themselves in a comparable situation at the same time as these events in Turkey (Braunberger et al. 2014).

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Abstract *Dieser Artikel leistet einen Beitrag zur polit-ökonomischen Debatte über die Geldpolitik in Schwellenländern im Zeichen der globalen Wirtschaftskrise. Im Fokus der Analyse steht die Einflussnahme der Regierung auf die türkische Zentralbank und wie sich diese empirisch auf die Geldpolitik auswirkte. Ich werde zeigen, dass die türkische Zentralbank nach der globalen Wirtschaftskrise die zuvor monetaristisch geprägte Geldpolitik hoher Realzinsen beendet hat und zu einer akkommodierenden Geldpolitik übergegangen ist, um die negativen ökonomischen Auswirkungen abzuwenden. Unter diesem Gesichtspunkt diskutiere ich sowohl die polit-ökonomischen Motive, als auch die Reichweite und Grenzen des Einflusses der AKP-Regierung auf die Geldpolitik.*

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