

İMB BULLETIN

ISTANBUL SCHOOL OF CENTRAL BANKING

Issue:1 / July - December 2013



Central Bank Governors and Nobel Laureate Economist Chris Sims Attended Summer Workshop 2013

The Istanbul School of Central Banking organized its first research workshop on June 1-2, 2013 in Istanbul. The workshop brought together leading scholars from academia and policy makers from various institutions to discuss recent theoretical and empirical advances on issues related to macroeconomics and particularly central banking.

In the first day of the workshop, Minneapolis FED President Narayana Kocherlakota presented his work linking the asset and labor markets. In light of developments in the asset and labor markets since the global crisis, the paper reviewed the connections between asset markets and employment. He concluded his presentation explaining that the effects of asset market shocks on economic activity depend on the wage structure of the labor market.

Chris Sims delivered a speech on why a central bank's balance sheet matters and the consequences of a lack of fiscal support for the central bank. In his research with Marco Del Negro, they argue that it is important to consider "unlikely" scenarios in which the lack of coordination between fiscal and monetary authorities or the excessive size of a central bank balance sheet could generate a conflict between pursuing stable inflation and maintaining central bank solvency. They specifically study the conditions under which a central bank needs fiscal backing including the size of its balance sheet, and examine how a central bank's interest rate policy changes the sensitivity of its balance sheet to shocks to real rates and inflation expectations.



ABOUT US

The Istanbul School of Central Banking (İMB), founded by the Central Bank of the Republic of Turkey (CBRT), provides a setting for thought-provoking discussions and analyses on global economic and financial challenges with a specific interest in central banking topics. The School organizes research activities and training programs and engages in technical cooperation with central banks to promote studies on central banking in emerging and developing economies.

İMB WEBSITE

imb.tcmb.gov.tr



During the policy panel titled *“From Quantitative Easing to Short Term Capital Flows: Liquidity Management”*, moderated by economist Chris Sims, Governor of the Central Bank of the Republic of Turkey (CBRT), Erdem Başçı emphasized price stability, financial stability and productivity growth as the three pillars of growth.

He stated that bringing inflation down to single digits has removed one of the most important obstacles to growth in Turkey, noting the value of financial stability. He emphasized the importance of a multi-instrument monetary policy that supports financial stability by smoothing out fluctuations in credit and currency.

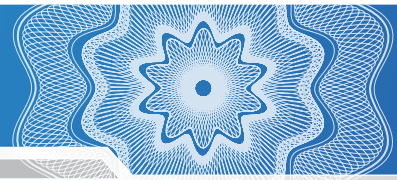
Central Bank of Brazil Governor Alexandre Tombini shared Brazilian experience on Capital Flows

During his speech at the Summer Workshop 2013, the Central Bank of Brazil Governor Alexandre Tombini discussed drivers, features and policy strategies regarding capital flows to Brazil before and after the 2009 crisis. He noted that terms of trade have improved since the crisis and that the floating FX regime has led to a real exchange rate appreciation. The Central Bank of Brazil implemented interventions to smooth the exchange rate volatility without changing its trend. Governor Tombini also emphasized that due to low interest rates in advanced economies, excessive liquidity in global markets led to capital flows into emerging economies, which brought several threats such as excessive expansion of domestic credit, higher bank exposure to FX risk, asset price distortions and inflationary pressures.

He noted that Brazil introduced several measures to safeguard stability including FX intervention through FX swaps, capital requirements on consumer loans

with longer maturities, reserve requirement on banks' short FX position in the spot market and financial transaction tax on certain types of capital inflows and short dollar positions held in futures markets. Governor Tombini argued that these measures were successful in moderating consumer credit expansion, inhibiting riskier types of inflows and reducing short term borrowing. He also stated that Brazil has learned from experience how to manage such capital surges and maintained long-term investors' interest in the country. With its strong international reserve position, rigorous prudential regulation and solid financial sector, Brazil is well prepared to exit from unconventional monetary policies that may lead to potential disruptive capital flows across financial markets and countries. Governor Tombini also explained that on the banks side, rigorous FX exposure regulation such as more stringent FX capital adequacy ratio, maximum leverage ratio on FX and reserve requirements applied to excessive short spot FX position have become effective for stability.

In 2014, the İMB will organize a policy workshop titled **“Monetary Policy in Developing Economies”** which aims to create a platform for exchanging practices, experiences and methodologies, and increasing the interaction between central bankers as well as policy-oriented scholars in a relaxing environment at the CBRT's Summer and Training Facility in Izmir. To this end, the workshop will bring together central bankers and scholars to discuss three major topics for monetary policy making in the current global economic environment. The topics of the workshop are: (i) Monetary Policy, Capital Flows and Exchange Rates, (ii) Macroprudential and Monetary Policies for Financial Stability, (iii) Monetary Policy and Commodity Price Movements.



From Courses and Seminars in 2013



The İMB organized one course and two seminars in the second half of 2013. The *“Formulation, Estimation and Policy Analysis with DSGE Models”* course was given by Lawrence Christiano from Northwestern University on September 16-20 in Istanbul. The course reviewed the basic tools of modern macroeconomic analysis, discussing model solution and simulation methods, as well as methods for estimating and testing dynamic stochastic general equilibrium (DSGE) models using aggregate data.

The *“Short-term Forecasting at Central Banks”* seminar was an introduction to the use of some practical econometric tools which are suitable for short-term forecasting of inflation and GDP. This seminar presented a summary of relevant theory and provided practical sessions using data from the Turkish economy.

The *“Inflation Targeting Practices”* seminar introduced participants to the inflation targeting framework, covering the theory of inflation dynamics and empirical models to measure and forecast inflation. The seminar also presented a unified theoretical model that incorporates flexible inflation targeting and explained the operational framework.

The İMB hosted Juan Pablo Nicolini from the Minneapolis Fed and Nobuhiro Kiyotaki from Princeton University as visitors



Juan Pablo Nicolini and Nobuhiro Kiyotaki visited the İMB for two weeks in June 2013.

During his stay at the İMB, Nobuhiro Kiyotaki gave a seminar on resolving the well-known exchange rate disconnect puzzle in international trade literature. Trade theory suggests that exports will rise and imports fall as the real exchange rate depreciates. Aggregate data shows the contrary that real exports and the real exchange rate hardly co-move or move in opposite directions in many countries as well as in Japan. However, firm-level studies suggest a more robust positive relationship between real exports and the real exchange rate.

Kiyotaki mentioned that this difficulty in reconciling the results of aggregate and firm-level studies is known as the exchange rate disconnect puzzle, which is one of six major puzzles in international macroeconomics. In his paper

“Dynamics of Firms and Trade in General Equilibrium” with Robert Dekle and Hyeok Jeong, Kiyotaki showed that firm and product level heterogeneity and firms’ endogenous choices of which products to produce and which products to export prove to be crucial in explaining this disconnect puzzle.

During the same two week period, Juan Pablo Nicolini delivered a seminar at the İMB presenting his research on the macroeconomic effects of monetary policy and liquidity traps during a credit crunch. His findings suggest that if policy does not react to tightened collateral requirements, large deflation and severe contraction with private debt occur. Monetary policy that targets constant inflation, on the other hand, moves the economy into liquidity trap and crowds out private investment. In this scenario, a credit crunch leads to less pronounced recession but slower recovery.

In 2014, within the scope of its visiting program, Ayşegül Şahin from the New York Fed, Vincenzo Quadrini from The University of Southern California, Mark Aguiar from Princeton University and Tony Smith from Yale University will be among the visitors that the İMB is planning to host.

More sharing, More learning

In an era where the world is much more inter-connected than ever, especially in terms of economic and financial links across countries, understanding economic and financial activities, identifying the challenges in the regions and learning from each other's experiences are essential.

The İMB organizes research activities and training programs and engages in technical cooperation with central banks to promote studies on central banking in emerging and developing economies. For this purpose, the İMB mini workshops and experience sharing activities endeavor to bring central bankers from various regions together to learn from each other, develop bilateral relationships and discuss the possible ways of cooperation.

The İMB organized its first mini workshop titled *"Understanding Macroeconomic Dynamics and Financial Markets: Practices and Experiences"* on December 17, 2013 in Istanbul.

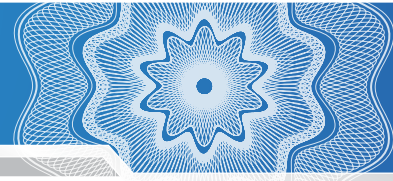
The program, opened by a speech from CBRT Board Member Sabri Orman, provided a discussion platform among representatives from central banks of Morocco, Tunisia and Turkey about imbalances, external risks and fiscal challenges.



During his presentation, Mokhtar Benlamin, Head of the Macroeconomic Studies Section from the Central Bank of Morocco, presented Moroccan macroeconomic dynamics and the effects of the global crisis on their economy by emphasizing how to mitigate the negative effects of the global crisis.

Rym Kolsi, Director of the Monetary Policy Strategy from the Central Bank of Tunisia, examined macro financial connections that design the interactions between money, credit, asset prices, expectations, business cycle and inflation. She discussed the effects of the financial crisis on the economies and presented the macro financial associations of the Tunisian economy.





Yavuz Arslan, Deputy Executive Director of the Research and Monetary Policy Department from the CBRT, gave a presentation on economic developments and the monetary policy framework in Turkey. His presentation started with an analysis of recent economic developments and financial stability challenges of capital flows, followed with the new monetary policy framework of Turkey.

The second mini workshop titled “*Banking Sector and Economic Activity: Identifying the Real and Financial Challenges*” was held on December 19, 2013 in Istanbul. Opening remarks were made by CBRT Board Member Lokman Gündüz. The discussions in the mini workshop, which brought together representatives from Central Banks of Bosnia and Herzegovina, Macedonia, Kosovo and Turkey, included the credit channel, deleveraging process and non-performing loans and their impact on the economic performance of the countries.

Amir Hadžiomerađić, Head of the Department for Statistics and Publication from the Central Bank of Bosnia and Herzegovina, explained the transition of his country to the market economy. Hadžiomerađić discussed the sensitivity of his country’s economy to the changes in the Eurozone banking system, and noted that the banking sector exhibited strong expansion and good performance before the recession.

Aneta Krstevska, Chief Economist from the Central Bank of Macedonia, gave a brief analysis of the main challenges of countries in the East European region. She emphasized the credit growth and economic activity, and completed her presentation by summarizing the economic activity and credit growth in the Macedonian economy during the global crisis. Arben Mustafa, Director of the Economic Analysis and Financial Stability Department from the Central Bank of the Republic of Kosovo, delivered a speech on the economy of Kosovo, during which he stated that in Kosovo, stable macroeconomic conditions continue and the banking sector is profitable.

Central Bankers visited the İMB

In the context of experience sharing, the İMB hosted officials from other central banks as visitors. To name a few, Hamza Ali Malik, Director of the Monetary Policy Department from the State Bank of Pakistan, presented his paper “*Monetary Policy under Fiscal Dominance*” and shared Pakistan’s experience in dealing with the implications of the fiscal position of the country for monetary policy during his visit on September, 2014. Malik discussed the reliance on indirect taxes and its implications for inflation and increased risk premium due to damaged expectations. Malik also presented the recent reforms in monetary policy, including the introduction of the interest rate corridor, increase in the frequency of monetary policy reviews to reduce uncertainty, the change in the amendments in the State Bank of Pakistan (SBP) Act to limit government borrowing from the central bank, separation of debt management from monetary management and removal of SBP support for oil payments. Moreover, Nikola Bokan, Director of the Econometric Modelling Department from the Croatian National Bank, visited the İMB in December, 2013.

SEMINAR TALKS 2013

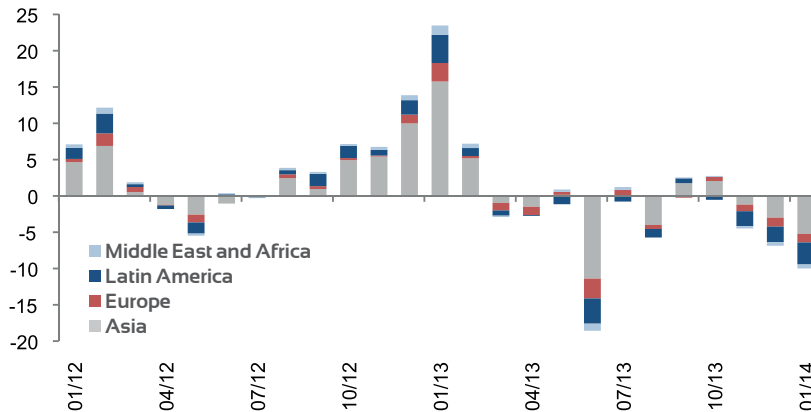
- ≡ Nobuhiro Kiyotaki (*Princeton U*)
- ≡ Juan Pablo Nicolini (*Minneapolis FED*)
- ≡ Fatih Güvenen (*U of Minnesota*)
- ≡ Loris Rubini (*U of Carlos III*)
- ≡ Livio Stracca (*ECB*)
- ≡ Serdar Ozkan (*FED Board*)
- ≡ Kerem Coşar (*U of Chicago*)

- ≡ Ramon Marimon (*European U Institute*)
- ≡ Mete Karakaya (*U of Chicago*)
- ≡ Murat Şeker (*Ziraat Bank*)
- ≡ Ayşe Kabukçuođlu (*Koç U*)
- ≡ İnci Gümüş (*Sabancı U*)
- ≡ Murat Taşçı (*Cleveland FED*)
- ≡ Hamza Ali Malik (*State Bank of Pakistan*)

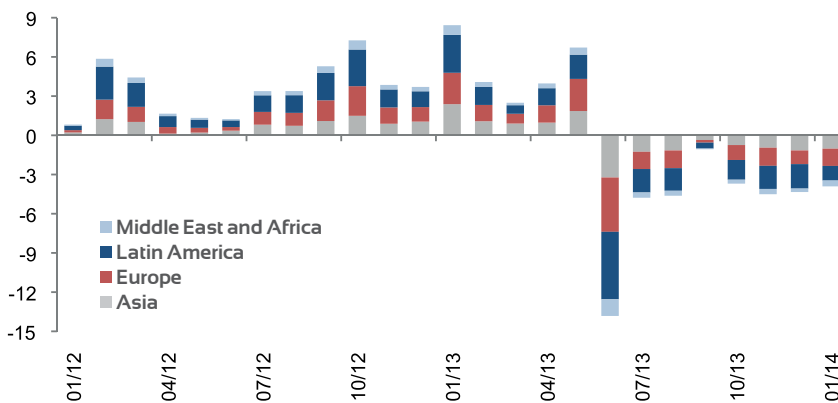


Emerging Markets Snapshot

Equity Fund Flows to Emerging Markets by Regions (monthly, US\$ billion)



Bond Fund Flows to Emerging Markets by Regions (monthly, US\$ billion)



Source: EPFR

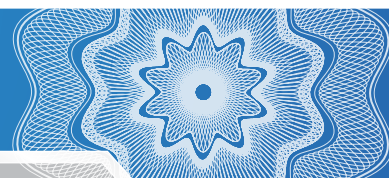
DID YOU KNOW?

- ▶ The Dutch Tulip Bulb Bubble 1636
- ▶ The South Sea Bubble in the United States 1720
- ▶ The Mississippi Bubble in the United States 1720
- ▶ The Late 1920s Stock Price Bubble in the United States 1927-29
- ▶ The Surge in Bank Loans to Mexico and Other Developing Countries in the 1970s
- ▶ The Bubble in Real Estate and Stocks in Japan 1985-89

Big Financial Bubbles in the History

- ▶ The 1985-89 Bubble in Real Estate and Stocks in Finland, Norway and Sweden
- ▶ The Bubble in Real Estate and Stocks in Thailand, Malaysia, Indonesia and Several Other Asian Countries 1992-97
- ▶ The Surge in Foreign Investment in Mexico 1990-93
- ▶ The Bubble in Over-the Counter Stocks in the United States 1995-2000
- ▶ The Bubble in Real Estate in the United States 2007

Source: C.P. Kindleberger and R. Z. Aliber: Manias, Panics and Crashes, A History of Financial Crises, 2011
 *Quoted from the presentation of Seppo Honkapohja's presentation at ASTIN 2009 Colloquium, Helsinki



Events from the İMB Catalog 2014

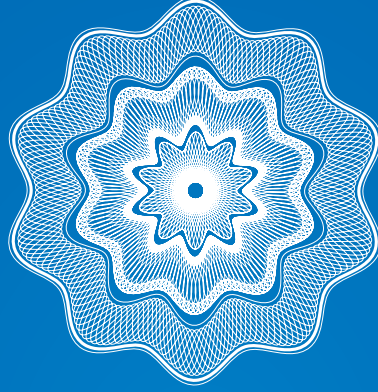
The İMB organizes its activities under five main categories: courses, seminars, workshops, customized bilateral programs and visiting programs. The İMB will organize two **courses**, seven **seminars** and two **workshops** in 2014.

The 2014 İMB catalog has been published. For details please visit the İMB website: imb.tcmb.gov.tr

Courses	Dates
Introduction to Modelling for Policy Analysis	March 31–April 4
Financial Crises and Credit Frictions in Open Economies	December 15-19

Seminars	Dates
Balance of Payments and External Statistics	April 28-30
Payment Systems and Instruments	May 5-7
Bayesian Econometric Methods and Forecasting	August 25 - 29
Inflation Targeting after the Crisis: Foundations, Results and Policy Challenges	September 8-12
Financial Stability, Financial Crises and Monetary Policy	September 15-19
Foreign Exchange Reserves and Risk Management	September 29 – October 1
Short-term Forecasting at Central Banks	November 10-14

Workshops	Dates
Monetary Policy in Developing Economies	May 21-24
Macro Workshop 2014	June 2-4



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