

An Analysis of the Cost Channel of Monetary Transmission on Turkish Inflation Dynamics

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Abstract:

This paper investigates the role of the cost channel of monetary transmission, i.e., the supply-side effect of monetary policy based on firms' costs of holding working capital, in Turkish inflation dynamics in the context of a New Keynesian Phillips curve (NKPC). To do so, assuming a CES production function, we first derive an open economy NKPC with bank lending rate, import price index, and unit labor cost. Continuously-updated Generalized Method of Moments estimates document that the cost-channel-augmented Phillips equation is a pertinent description of short-run inflation dynamics in Turkey. Regardless of whether the price level is measured by GDP deflator, producer price index, or consumer price index, the cost channel is dominated by other inflation determinants. We believe that the results of the analysis contribute to the policy debate over the address of what policymakers ought to do when confronted with unstable and high expansion.

Keywords: Inflation dynamics, Cost channel, Open economy New Keynesian Phillips curve, Generalized Method of Moments

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