Monetary Policy Effectiveness in Turkey: Does the Policy Rate Still Work Well?

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Abstract:

This study aims to materialize an exhaustive analysis on the effectiveness of the pass-through of policy rates in the stance of monetary policy of Turkey. In this regard, we firstly estimate a two-stage PC FAVAR model to use all the available information set and obtain direct responses of all of the variables included in the data set which is lacking in conventional VAR setting. We use 113 number of disaggregated/sectorial series for the period 2005:12-2018:4. Besides, we extend the model setting proposed by Bernanke et al. (2005) by estimating monetary policy factors beside to the policy rate to control other instruments while evaluating the effectiveness of the policy rate under multiple-policy environment and, thus, mimic better the policy stance in Turkey. Then, we make the estimations under two different policy regimes i.e., inflation targeting and new monetary policy regimes. Lastly, the relative effectiveness of selected policy rates is explored with different choices of policy instruments. Among others, BIST overnight repo rate is selected to stand for the effective rates and compared to repo rate under multiple policy environment while Divisia type monetary aggregates as another form of alternative instrument are used for money supply innovations. Hereby, Divisia index based monetary aggregates are constructed under different specifications and preferred to provide a theoretically convincing money stock variable. In broad strokes, it is found weak transmission of officially announced rates through sectorial series under different regimes and compared to alternative instruments.

Keywords: Turkey, monetary transmission, FAVAR model, policy rate, effective rates, Divisa index

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