Simultaneous Monetary Policies in the Context of the Trilemma: Evidence from the Central Bank of Turkey

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Many central banks that have opted for monetary autonomy have also been reluctant to relinquish control over the value of their currencies. As a result, they have operated through both interest rate and foreign exchange interventions. However, in the context of the monetary trilemma, both effects can potentially offset each other. Using daily data from the Central Bank of Turkey during the period of 2002 - 2010, we study the effects of simultaneous policies by first purging the intended monetary decisions from responses to real-time macroeconomic variables, and then determining their impact on economic activity. We find that the Central Bank of Turkey adjusted its policy rate mostly in response to inflation levels relative to both the yearly target and agents' expectations, and conducted purchases and sales of foreign currency in response to exchange rate behavior. These responses varied depending on whether interventions were pre-announced. We also find that unannounced purchases of foreign currency had a significant effect in reducing exchange rate volatility but appeared to have no effect on exchange rate changes. On the other hand, changes in the policy rate significantly affected inflation but had no discernible effect on output growth.

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