Chapter 21

Impacts of Global Financial Crisis and Changes in Monetary Policy of Central Banks: An Analysis of Central Bank of the Republic of Turkey (CBRT) and Bank of Israel (BOI)

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ABSTRACT

The Great Financial Crisis (GFC) has hit developed and developing countries through a number of transmission channel. Some impacts are already disappearing while others are still to strike. In MENA region developing countries to experience the crisis were those with the most globally integrated financial sectors. Next came the impact on trade, as volumes and prices of commodities and manufactures collapsed across the globe. Successful economic policies pursued in the past do not promise these countries’ immunity from the crisis. In fact, some MENA countries have already shown a limited capacity to learn from other countries’ previous financial crises. Post-crisis spillovers and heightened capital flows have triggered a search for alternative monetary policy frameworks, especially for Turkey and Israel in MENA economies. This paper analyzes the review of the region’s monetary regimes and policies, including: monetary policy expansion of the monetary policy framework in promoting financial stability alongside the primary price stability objective.

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INTRODUCTION

After the Great Moderation Process of the world economy, financial system and real economies face to unexampled crisis (Great Financial Crisis). The GFC has hit developed and developing countries through a number of transmission channels. Some impacts are already disappearing while others are still to strike. It has caused unique responses from central banks of most affected developing and advanced economies. Central banks and supervisions of the economies had to create new framework and unconventional instruments for monetary policy, which have headed to deviations in central banks’ balance sheets, and to arrangements designed for leading expectations concerning long-term interest rates.

During and after GFC recent literature points out a huge number of studies, which examine batten down the hatches by central bank under the monetary policy in many economies as a part of GFC. The GFC has highlighted important shortcomings of the literature on monetary policy, and in particular, huge cavities in the forming of interconnection among the financial system and macroeconomic policies.

Even before the crisis, most central bankers understood that financial disruptions could be very damaging to the economy. This explains the extraordinary actions that central banks took during the crisis to shore up financial markets (Mishkin, 2011). Post-crisis period has brought emerging consensus that financial stability should be an objective of central banks. But, on the contrary opinion remains divided as to what extent it can be considered as an additional objective of monetary policy or completely separated. It is argued that the monetary policy horizon for achieving the inflation target could be lengthened to facilitate taking into account the financial stability concerns. IMF (2010) emphasized that in adopting such an approach, central banks need to lookout against the persistent deviations of inflation which may otherwise dilute policy accountability and create uncertainty of the long-term commitment to price stability.

The view that monetary policy should allow policymakers to lean against the building up of financial imbalances, even if short-term inflation expectations remain anchored, appears to be gaining ground. The balance of views within the central banking community has been shifting in this direction (Cagliarini, Kent & Stevens, 2010; Carney, 2009; Fischer, 2011; Shirakawa, 2009; Trichet, 2009; & Woodford, 2010). However Mishkin (2009, pp. 12-23) argued that the ineffectiveness of the monetary policy during financial crises is not only wrong, but it may also promote policy stagnancy in the face of a severe contractionary shock. To the contrary, monetary policy is more effective during financial crises because aggressive monetary policy easing can make adverse feedback loops less likely.

This paper highlights the main effects of GFC on the monetary policy and central banks behavior. We focus on monetary policy implementations by the Central Bank of the Republic of Turkey (CBRT) and Bank of Israel (BOI) that helped to temper the impact of the global financial crisis and as a result that mitigated the shocks to the economies of these countries. The paper is structured as follows: first the confront conditions of GFC and compulsory monetary policy development under financialization of the world economy is analyzed, then we summarize the changes in monetary policy caused by GFC from inflation targeting to financial stability, from financial stability to macroprudential polices which is named generally as unconventional monetary policy measures. A last study examines the main structure of “new” monetary policy and implementations of Monetary Policy by BOI and CBRT.