

Dissecting Turkish Inflation: Theory, Fact and Illusion

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Abstract

The policy debate in Turkey over the impact of interest rate on inflation concerns the question of what policymakers should do when faced with volatile and high inflation. Motivated by this discussion, we provide an empirical analysis by connecting the cost channel to the Phillips relation. Our findings prove the existence of the cost channel. However, other determinants of inflation -labor share of income, prices of imported inputs and consumption goods- dominates the cost channel in Turkey.

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

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