

Durmuş Yılmaz: Turkey's economy and the financial crisis

Opening speech by Mr Durmuş Yılmaz, Governor of the Central Bank of the Republic of Turkey, at The Society for Economic Dynamics Annual Meeting, Istanbul, 1 July 2009.

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I would like to welcome all the participants of the annual meeting of the Society for Economic Dynamics to Istanbul, the oldest metropolis of the world, which has been elected as European capital of culture for 2010.

The global financial crisis, which has deeply depressed global economic activity and rendered the effectiveness of decision-making and supervision mechanisms questionable, still persists with its direct and indirect effects. Although recent weeks have accommodated signals of the diminishing effect of the crisis and the start of recovery; these signals still remain weak. While recent data on economic activity indicate that the worst is over, problems in credit markets linger, and unemployment figures are still on the rise, suggesting that the recovery will be slow and gradual.

Therefore, I believe that the expectation of "cautious optimism" should prevail not only for the Turkish economy, but also for the world economies as a whole. If you ask what is the most significant factor that requires us to be cautious, it is possible to answer in a single word: uncertainty.

Due to growing uncertainty, error margins in forecasts may get wider in the near future. This is because the main reasons underlying the outbreak of the current financial crisis are deficiencies and mistakes in the establishment of economic policies along with the fulfillment of regulatory and supervisory activities. Nevertheless, we all know that the reconstruction of economic balances under normal conditions relies on the proper execution of these functions.

Another factor leading to uncertainty is the enforcement of global financial and monetary measures of a size, speed and coordination that has never been witnessed before. This raises ambiguity pertaining to the responses to these measures from financial markets and economies in the upcoming period.

In the current conjuncture there is a consensus that the recovery in global economic activity will not be anytime soon and what worries the global community is what will follow the crisis. The question about mechanisms to avert any future global financial crisis similar to the current one will completely occupy the agenda of academics and policy-makers in the near future. Moreover, the extent and pace of the reversion for financial measures and non-traditional monetary policy exercises against the financial crisis on the back of stabilization in economies will top agenda very soon.

The global financial crisis has led to a significant slowdown in economic activity in Turkey as in other developing countries. A remarkable tightening in lending conditions and a surge in interest on loans were experienced during the worst period of the financial crisis.

The easing of concerns over inflation has allowed the Central Bank of Turkey to focus on curbing the potential destruction of the crisis on the Turkish economy without conflicting with the primary goal of maintaining price stability. The majority of policy rate cuts to compensate the additional tightening in financial conditions was antedated. Subsequent data releases on inflation and economic activity have bolstered the credibility of the Central Bank. I would like to underline the gradual decline in interest rates on commercial loans as a positive development in this period.

The common denominator of the Central Bank's policy preferences and the recent choices should also be emphasized. The primary objective of the Central Bank is to achieve and maintain price stability and this primary objective does not conflict with any other objective of the Bank. The policy stance we have recently adopted clearly reflects this.

Although recent data releases indicate that the worst may be over, the recovery is expected to be protracted given credit market problems and rising unemployment rates. The tightness in financial conditions still persist to some extent, and uncertainties regarding the impact of the problems across financial markets on the real economy are ongoing, suggesting that downside risks still remain.

Although downside risks are still more significant, recent signs of partial recovery in economic activity should not be discarded. Nonetheless, we are of the opinion that most of the recent increases in economic activity were attributable to the short-term effects of the global fiscal measures implemented. There needs to be a robust revival in consumer demand in order for the increases in the capacity utilization rate to be sustainable over the medium term. Uncertainties regarding aggregate demand and lower capacity utilization continue to suppress fixed capital investments. The current trend in investment demand is far from signaling a robust economic recovery.

Subsequent to the recent rate cuts and fiscal measures, we anticipate that domestic demand in Turkey might gain relative stability in the second quarter of 2009 and growth will post positive figures from the last quarter onwards. In other words, the recovery in the Turkish economy might start earlier than that of the global economy. Our expectation is underpinned by two main factors.

The first of these is the sound and stable structure of our financial system. The restructuring plans along with regulatory and supervisory reforms, which were put into effect in the aftermath of the 2001 financial crisis at the cost of imposing a heavy burden on the public budget, reinforced the Turkish banking system's resilience to shocks compared to the banking systems of other countries.

Another factor that will facilitate a relatively faster recovery for the Turkish economy is the household indebtedness ratio, which is lower than those of many other emerging economies. Households have been affected relatively less by exchange rate shocks owing to the significantly low share of FX loans in consumer loans.

However, I would like to underline once more that economic recovery is expected to be gradual and slow as opposed to the rapid recovery in economic activity after the 1994 and 2001 crises experienced in Turkey and that a significant acceleration in aggregate demand is not expected anytime soon. Persistent tightness in external financing conditions, the lagged and gradual recovery in our primary export markets and the large share of durables and capital goods exports, which are sensitive to foreign demand, indicate that recovery in the Turkish economy will be different from what we have experienced so far.

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It is a widely accepted fact that in modern economics, decision-makers act rationally and their decisions form a dynamic system in the field of economy. While measuring the efficiency of policies, their response to such policies over time is examined within a dynamic framework.

As we can see in the conference program, almost every single topic in the economic literature is addressed from a dynamic perspective. We are on the brink of starting a two-day conference during which we will be listening to pioneer studies covering a wide range of topics from game theory to the labor market, from education economics to the functioning of the real estate market. There is no doubt that this is an invaluable experience for economists to catch up with the global economic agenda and to follow recent developments.

I would like to thank everyone, particularly Bahçeşehir University and Koç University, who have contributed to the organization of this conference. I hope that it will be a productive conference and I would also like to extend my regards to the contributors of this event, to the participants and all the guests.