

Durmuş Yılmaz: Overview of the Turkish economy in the light of new global realities

Speech by Mr Durmuş Yılmaz, Governor of the Central Bank of the Republic of Turkey, at the International Arab Banking Summit (IABS 2010), Istanbul, 18 June 2010.

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Esteemed governors and distinguished guests,

At the outset, I want to express my gratitude to the Union of Arab Banks along with Turkish Banking Association, Banking Regulation and Supervision Agency and the World Union of Arab Bankers for their efforts in organizing this summit. As the Central Bank of Turkey, we are honored to be a part of this prestigious event congregating such an esteemed group of participants.

In this keynote speech, first I want to discuss the post-crisis episode in a global context. Then I will continue with the extent to which the Turkish economy has been affected by the downturn in global economy. Finally, I will conclude with the opportunities and prospects in our region in the light of the new global realities.

Dear participants,

As we all observe from the latest data, signs of recovery have continued in the first half of 2010, albeit at variable speeds across countries and regions. Coordinated efforts of the global community have been so far successful in averting a downward spiral similar to the one experienced during the Great Depression. Although global economy is back on its feet, there are several risks involved in this recovery process and many challenges lie ahead.

Many countries, especially in advanced economies have spent substantial amount of public funds to boost aggregate demand and to revitalize the financial system. Most of these countries have no fiscal resources left to put forward a similar stimulus package, if the world economy experiences another setback. Therefore it is of utmost importance to keep the recovery intact, which is already too fragile. Debt sustainability and fiscal imbalances stand out as the main challenges for many years to come. As the recent developments in the financial markets revealed, deterioration of sovereign creditworthiness can hamper macroeconomic and financial stability. Therefore, ongoing problems especially in some advanced economies, particularly in Europe should be resolved in a quick, effective and credible manner.

However, we should also keep in mind that supporting global demand is a global responsibility. It is questionable whether emerging market economies would be able to fulfill the gap in global demand, while advanced countries stay on the sideline to clean up their balance sheets. Neither their share on global economy nor their economic and financial structure would be adequate to play that role. Especially emerging economies that are in deficit, still being in convergence stage, need to raise their production capacity to pay off their external debt accumulated during their catch-up.

Therefore, I strongly believe that a holistic approach is a must. While developing any kind of policies, including fiscal tightening or restructuring, one should pay great attention to negative externalities these policies may cause on other economies. In particular, we should avoid beggar-thy-neighbor type of policies. Unless all participants provide appropriate contribution, the global economic recovery will not be safe and sustained. It is obvious that the emerging economies will be the major driving force behind the global

growth but it remains crucial that each country with its capacity should make its contribution to revive global demand.

Currently, there are intense debates within the global community, particularly inside the G20 and FSB, to restructure the financial system and put in place a radical and quite ambitious financial sector reform agenda. It is imperative to repair and rebuild a well functioning financial system that can support growth while maintaining financial stability. These reforms are wide ranging, including implementing new capital and liquidity standards, promoting principles for effective supervision, looking at ways to constrain moral hazard, developing cross-border resolution mechanisms, agreeing to reforms on OTC derivative markets to reduce systemic risk and improve market efficiency and integrity, and agreeing on a single set of high quality, global accounting standards.

We very much welcome the work carried by the Basel Committee. Strengthening capital and improving liquidity standards should be seen as the main tools to reach a more resilient banking sector. Turkey's experience shows that a sound capital base, appropriate liquidity and well supervised leverage are the key elements that assure a healthy banking system. The difficulties faced by advanced economies today may be unprecedented in scale, but not unique in nature. Some countries experienced similar difficulties in the past and they developed comprehensive schemes to satisfy the principle of fair and substantial contribution of financial sector and taxpayer protection as well. For example in our case the amount of bailout we provided to the banking industry in 2001 was as high as almost 30% of the GDP. So we developed a regulatory framework to assure that such a disaster does not happen again, and if it happens how the resolution would be carried and how it would be financed.

Before implementing comprehensive financial regulations on a global scale, all countries should undertake comprehensive impact studies and assess possible spillovers to emerging countries before putting such schemes into action. All necessary measures should be taken so that already fragile recovery is not harmed through rising cost of capital in the global financial markets. We support developing a set of principles around which each country creates its own system based on local conditions. Banking levy or financial activity tax is only one of many options available to promote financial stability and to achieve equal burden sharing. Regulations on capital, leverage and liquidity and other macro prudential tools may also be used to achieve similar results.

Dear participants,

Let me give you some background information on the Turkish economy, before delving on the issue of closer cooperation within the region in the aftermath of global crisis.

Like all other emerging market economies, the Turkish economy was tested by the global turmoil and has proven its strength and resilience. Average annual growth of almost 7 percent between 2002 and 2007 faltered in 2008 and turned into a contraction in 2009 as the exports and investment flows dried up considerably due to the global crisis. However, all signs now indicate that the economy has rebounded quickly and is headed towards renewed growth and an improving fiscal balance in 2010. The resilience of the Turkish financial system, combined with our flexible and effective liquidity management framework shaped by the experiences of past crises, has turned out to be considerable assets in managing the recent crisis. As a result, growth forecasts of international institutions for the Turkish economy have been revised upwards repeatedly and reached as much as 7.2 percent, the highest among OECD countries.

The crisis and slowly emerging global architecture in its aftermath present major opportunities that have once again highlighted the importance of economic cooperation

and coordination among countries and economies. In the case of the Middle East this is perhaps best embodied in the multiple synergies in financial integration and joint investment opportunities between Turkey and the Arab world.

It is a great pleasure to see that the relations within our region have been strengthening on a solid ground. The strong historical, cultural and social ties among our countries constitute a solid basis to further develop multilateral relations. Commercial relations between Turkey and the Middle East have been increasing quite rapidly in the last few years, as well as cooperation and exchange of information and dialogue between public authorities. Global crisis made clear that especially our region is one of the high growth bases in the world, which in turn, constitutes a potential to grow tight commercial and financial relations. Recently, Turkey, Jordan, Lebanon and Syria signed a joint declaration on Thursday to launch an initiative to form a free trade zone and a visa-free zone. These nations will also set up a joint cooperation council.

Significant steps have been taken towards developing our commercial relations as witnessed by trade volumes between countries. On the heels of 2001 crisis, the trade volume of Turkey with the Middle East Region was just about USD 6 billion. It reached USD 43 billion just before the financial crisis and stood at USD 29 billion as of 2009. In the same period, the share of Middle East in Turkish trade volume climbed up by 5 percentage points to 12 percent, where as the share of European Union declined by 10 percentage points to 43 percent.

Let me give you several country specific examples. Syrian-Turkish economic relations have strengthened rapidly in the past few years, particularly following the implementation of a free trade agreement between the two countries in 2007. All in all, trade volume between Syria and Turkey has doubled since 2006 and reached to 1.75 billion USD in 2009.

Trade volume between Turkey and Egypt has also steadily increased from USD 500 million in 2003 to USD 3.2 billion in 2009. It is expected that these figures will reach up to USD 5 billion in the next three-years. One reason for this rapid increase is that both countries have completed the legal ground which secures free trade between countries. The Free Trade Agreement, which has recently been put into effect, does not only provide opportunities for higher trade volumes but also functions as a framework that brings together investors from both countries.

Turkey has long provided a significant conduit for the flow of humanitarian and economic assistance to Iraq. Today, the volume of bilateral trade is also rapidly rising. The bilateral trade volume has been increased significantly since 2006 and reached to 6 billions USD in 2009. The high-level official visits between Turkey and Iraq have been providing impetus to the diversification and advancement of our economic cooperation. Moreover, Turkish companies play a leading role in the reconstruction of Iraq.

Our trade with Jordan and Lebanon exceeded USD 1 billion in 2009. With the conclusion of the ongoing negotiations on the Free Trade Agreement between Turkey, Lebanon and Jordan, trade relations among our countries are expected to gain volume.

Dear guests,

Increasing commercial relations naturally led to an increase in international banking services among our economies. Having a sound financial position, Turkish banks can contribute both to building commercial and financial links within the region. Today, several Turkish banks are interested in expanding their operations to the Middle East, considering the growth potential in commercial relations and considerable amount of

liquidity in the region. Besides, the Middle East is one of the world's fastest growing markets in the banking and capital sector.

Islamic finance is yet another venue through which financial links across the countries in the region may be strengthened. The global crisis has given an opportunity to Islamic financial institutions to prove their potential. As their products limit the excessive leverage and the disruptive financial innovations, they have confirmed their products' advantages to ensure macroeconomic stability. This may lead the way for Islamic financial institutions to further expand and improve. Islamic banks support GDP growth through the use of funds they collect exclusively for the financing of real sector, rather than investing in non-productive financial assets. This understanding will not only contribute to the potential growth of the Islamic banks, but also help to maintain a sound structure of the financial system. I believe that such a forward-looking and constructive vision will contribute the financial stability to a great extent going forward.

One crucial prerequisite for closer commercial links within the region is the existence of strong, efficient and effective payment system. In the last twenty years, rapid technological progress, decrease in restrictions and globalization of financial markets have led to a rise in financial activities and a rapid growth in the volume of domestic and cross-border payments. The Central Bank of Turkey has played a leading role in the modernization of payment services in Turkey. It has developed secure, reliable and efficient inter bank payment and settlement systems. According to a recent IMF report, payment systems in Turkey have a sound legal basis and the country is "in observance of the great majority of the provisions of the Committee on Payment and Settlement Systems and Core Principles for Systemically Important Payments Systems".

The Middle Eastern countries have made significant progress in this area. For example, Saudi Arabia is a member of the Committee on Payment and Settlement Systems like Turkey and tries to improve its payment systems infrastructure by establishing new payment systems with respect to the needs of its financial markets. Egypt has a project of establishing a real-time gross settlement system. There are also some other low value – large value payment systems in other countries.

As you already know the regulation on International Bank Account Number (IBAN) has been implementing in Turkey and the use of IBAN is effectively overseen by the CBRT since 2008. The use of IBAN in region countries like Lebanon and Saudi Arabia contributes to the effective and safe money transfers between Turkey and these countries.

A sceptic might say: "What counts is the profit one makes and the economic gains one gets. It does not matter whether we like each or not." In our case this approach is wrong. We have shared common destiny for centuries and now we should be ready for dialogue, cooperation and coordination. Above all, when we want to push through common interest in the future, we should work together in order to get a joint view of the events past and present.

Thank you for your attention.