



**Keynote Speech at the Meeting of
“Turkish-Austrian Economic Relations in a
European and International Context”**

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Distinguished Participants,

I would like to start by thanking Ewald Nowotny, the Governor of Oesterreichische Nationalbank for hosting the meeting on the “Turkish-Austrian Economic Relations in a European and International Context”. My colleagues from the Central Bank of the Republic of Turkey and myself are pleased and honored to take part in this important event. After this meeting, opening ceremony of the Exhibition titled “Contemporary Turkish Painting and Printmaking in the Republican Era”, which is composed of some examples from our Bank’s collection, will take place. It is my pleasure to invite you all to the opening ceremony which will take place this evening at 7:00pm.

In my speech, first I will share a few observations about the increasing importance of emerging market economies (EMEs) in the global system. Then, I will talk about financial stability in EMEs in general and Turkey in particular. Finally, I will conclude with the developments regarding the economic relations between Austria and Turkey.

Distinguished Guests,

The share and significance of EMEs in the global economy has been on the rise. The share of EME exports in world total exports increased from 13% in 2000 to 23% in 2010. Likewise, exports from EMEs to EMEs increased from \$0.8 trillion to \$3.5 trillion during the same period. The increase in the volume of trade among EMEs has, to some extent, reduced the adverse effects of the weak course of external demand from advanced economies. Thereby, production and employment levels in EMEs have achieved a rapid pace of recovery after the 2008 global crisis.

In line with the increased importance of these economies, we also witness significant changes in decision-making mechanisms worldwide. A wide range of important decisions on issues ranging from food and energy security to strengthening the global financial system are made at the Group of Twenty (G20). In line with the recent increase in their role in the G-20, the voice and representation of EMEs among international institutions such as the IMF, the World Bank, the Basel Committee and the Financial Stability Board is increasing as well.

Distinguished Guests,

EMEs withstood the global turmoil better than expected. A certain degree of decoupling has been observed between emerging and advanced economies in this regard. Underlying this resilience were several distinct factors, including sound fiscal fundamentals, a relatively low degree of leverage in the private sector, a lower reliance on wholesale funding as part of a more traditional banking business model and minimal exposure to toxic financial products. Improvements in the financial sector regulation and supervision frameworks have also added to this resilience.

Although EMEs proved resilient during the global financial crisis, they have experienced new challenges in the aftermath of the crisis. A relatively stronger financial structure constituted the pull factor for the EMEs to attract significant amounts of capital flows. The push factor, on the other hand has been the expansionary monetary policies of advanced countries. Nevertheless, these massive flows led to rapid credit expansion, a relatively stronger domestic demand and appreciation of local currencies. This in turn had adverse effects on EMEs through several channels such as reducing competitiveness and deteriorating external balances.

Faced with these new challenges, some EMEs have resorted to capital controls or other capital flow measures in order to deal with the adverse consequences of capital flow volatility. This approach suffers mainly from difficulties in implementation. Financial flows are extremely difficult to manage. Circumventing a capital account restriction or a cross border transaction tax is possible in many cases. In cases where loopholes are found and closed decisively, there may be the risk of an unintended consequence of a disorderly capital outflow.¹

A second approach would be to keep the capital account open, but not to resist the market forces that would equate cross border returns on securities in a risk adjusted basis. Then the natural question would be how to manage the risk of an unbalanced growth in the recipient country. Credit bubbles, asset price bubbles, higher than sustainable debt to equity and debt to income ratios are examples of problems that can easily arise.

¹ Borio, C. (2011). Central Banking Post-Crisis: What Compass for Uncharted Waters? BIS Working Papers, No. 353.

In financial intermediation, two key dimensions are price and prudence. The answer to the above question lies in the prudential dimension. If the financial intermediaries of the EMEs were able to internalize the macroeconomic risks that arise from the current low interest rate environment, there would be no need for a policy apart from market based return equalization. Since this cannot happen by itself due to agency problems, there is a room for macroprudential policy.

Turkey, following the second approach, has been using mainly macroprudential measures along with a relatively low and yet quite flexible interest rate policy in face of volatile short term capital flows.² The Central Bank and the other government agencies responsible for financial stability, developed new tools and introduced new policies to avoid excessive deviations of the credit growth rates and the exchange rates from economic fundamentals. Examples of macroprudential policies used in Turkey are loan to value restrictions, high risk weights and provisioning requirements on credit with negative externalities, maturity based reserve requirements and leverage based reserve requirements. These policies already helped to start a rebalancing process for domestic and external demand during the rapid post Lehman recovery and the more recent European sovereign debt crisis.³

Distinguished Guests,

The financial stability, when lost, has deep and long-term impacts on both employment and growth.⁴ The cost of preventing a financial crisis is much lower than the cost of living it. The recent developments have reminded us this economic dictum once again.

The primary objective of the Central Bank of the Republic of Turkey is to achieve and maintain price stability. Besides price stability, contributing to financial stability within its scope of operations has been also listed among the primary duties of the Bank in the Central Bank Law. To that end, CBRT has used a combination of macroprudential tools and

² Akçelik, Y., Başçı, E., Ermişoğlu, E. and Oduncu, A. (2013). The Turkish Approach to Capital Flow Volatility. CBRT Working Papers, No: 13/06.

³ For sustainable debt levels, see: Cecchetti, S., Mohanty, M. S. and Zampolli, F. (2011). The Real Effects of Debt. BIS Working Papers, No. 352.

⁴ Reinhart, Carmen M., and Kenneth S. Rogoff. (2009). This Time is Different: Eight Centuries of Financial Folly. Princeton, NJ: Princeton Press.; Taylor, A. (2012). The Great Leveraging, NBER Working Papers, No. 18290.

automatic stabilizers. We view both price stability and financial stability as two indispensable components of balanced growth.

Distinguished Guests,

Comprehending the importance of systemic risk along with macroprudential measures to mitigate this risk to ensure financial stability has necessitated reconsideration of the regulatory framework at global level. The enactment of the Dodd-Frank Act in the US and the establishment of the European Systemic Risk Board (ESRB) in Europe as well as new regulations introduced in other countries aim to mitigate systemic risk via coordinated action across agents responsible for financial stability. To this end, Turkey established the Financial Stability Committee in the summer of year 2011. Along with the Central Bank, the Committee is composed of the Banking Regulation and Supervision Agency, the Capital Markets Board of Turkey, the Savings Deposit Insurance Fund and the Undersecretariat of Treasury.

In the international arena, Turkey became a member of the Financial Stability Board (FSB) in 2009. It will take part in G20 Troika in 2014 and assume the Annual Presidency of the G20 in 2015. Moreover, Turkey's representative from the Undersecretariat of Treasury will join the FSB Steering Committee during the 2014-2016 period when Turkey will be in G20 Troika.

Moreover, Turkey became a member of the Basel Committee on Banking Supervision (BCBS) and the Group of Governors and Heads of Supervision (GHOS) in 2009. The Central Bank of the Republic of Turkey will take part in the FSB Steering Committee during the period 2013-2015 when Turkey will be chairing the FSB Regional Consultative Group for the Middle East and North Africa (MENA).

As part of the governance reform of the International Monetary Fund (IMF), a New Constituency was established with the countries Turkey, Austria, Hungary, Czech Republic, Slovak Republic, Slovenia, Belarus and Kosovo. According to this agreement, the Executive Director position will rotate among Austria, Hungary, Czech Republic and Turkey. This is perhaps a symbolic but, in my personal view, a very significant step in the right direction regarding the future of the Turkish-Austrian relations.

Distinguished Guests,

At this point, I would like to exemplify increasing commercial and economic relations between Austria and Turkey. Our export to Austria was 1.1 billion USD and import from Austria was 1.6 billion USD at the end of 2012. These numbers are quite small compared to the potential. On the financing side, however, there is good news. Austria is the leading country in foreign direct investment flows to Turkey for the period after 2008 with 7 billion USD in total. Direct investments are mainly focused on the energy sector. There are currently 643 Austrian firms operating in Turkey.

Distinguished Guests,

The European Union is a success story regarding peace and cooperation among nations with rather bitter historical memories. No wonder the European Union obtained the Nobel Peace Prize in year 2012. Despite all the debates and a high degree of uncertainty regarding the new economic governance structure in the EU, I sincerely believe Turkey's closer cooperation with Austria will bring invaluable outcomes in line with the European spirit.

To conclude, I would like to express my view that the future of the commercial, financial and economic relations between Austria and Turkey looks more promising than ever. Today's joint meeting and the opening ceremony of the Exhibition "Contemporary Turkish Painting and Printmaking in the Republican Era" are small, symbolic, yet quite significant steps to mark the start of this new and healthy trend.

Thank you very much for your attention.