



MAIN THEME

Financial Stability and the Financial System in Turkey

As a result of the financial liberalization process, global integration and technological developments of the last 30-year-period, financial instruments have become more complex and diversified. Besides, financial turbulence and crises have been observed more frequently, all of these leading the policy makers to place further emphasis on achieving and maintaining financial stability.

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CBRT DEPARTMENTS

Legal Department

The Legal Department was initially established as the Office of the Legal Counselor in 1931, the year the Bank was founded. The unit, which was restructured into the Office of the Chief Legal Counselor in 1970, has been functioning as the Legal Department since 1 July 1984.

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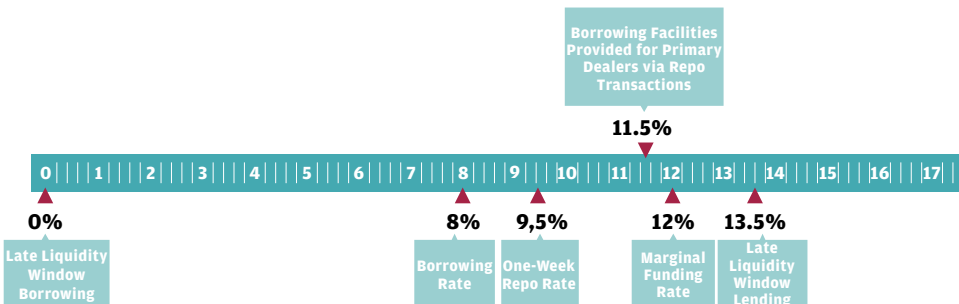


THERMOMETER

- *CURRENT ACCOUNT DEFICIT
- *EMPLOYMENT

→ Page 4

CBRT INTEREST RATES (22 MAY 2014)



CBRT RESERVES (6 JUNE 2014)

GROSS FOREIGN EXCHANGE RESERVES

110,423 BILLION USD

GOLD

20,359 BILLION USD

INFLATION (MAY 2014)

9.66%

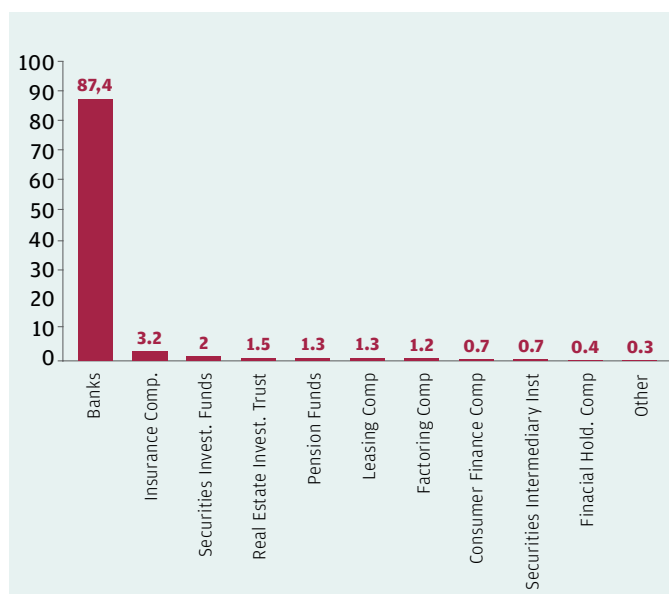
FINANCIAL STABILITY AND THE FINANCIAL SYSTEM IN TURKEY

Banking sector has predominance in Turkish financial system.

The financial system in Turkey is composed of credit institutions and financial institutions. Credit institutions comprise savings banks and participation banks. Financial institutions comprise those established to undertake i) insurance, individual pension or capital market activities, ii) at least one area of activity included in the Banking Law, as well as iii) development and investment banks and iv) financial holdings. Agencies that are in charge of regulating and supervising the financial system are, in addition to the Central Bank of the Republic of Turkey (CBRT), the Banking Regulation and Supervision Agency (BRSA) and the Capital Markets Board of Turkey (CMB). According to the Central Bank Law, among the fundamental duties of the Bank are taking precautions to enhance stability in the financial system and taking regulatory measures with respect to money and foreign exchange markets as well as monitoring the financial markets. Meanwhile, credit institutions as well as financial institutions of development and investments banks, along with financial leasing, factoring and consumer financing companies are supervised by the BRSA. Last but not least, the primary duty of the CMB, authorized to regulate and supervise securities transactions, is to ensure sound functioning of capital markets and protection of the rights and interests of investors.

The banking sector has predominance in the Turkish financial system. Accordingly, the sector accounted for 87% of the financial sector as of end-2012.

Balance Sheet Size of the Financial Sector⁽¹⁾



⁽¹⁾ CBRT, FSR May 2013.

⁽²⁾ <http://www.tcmb.gov.tr/yeni/banka/history.html>

⁽³⁾ For unconventional measures taken by the CBRT in the post-crisis period, see Başçı, Kara (2012) and CBRT Bulletin of December 2012.

Crisis Period and Restructuring of the Banking Sector (post-2001 Period)

An exchange rate-based stability program was launched in early 2000 to reduce chronically high inflation and to restore an environment of sustainable growth in the economy. Initially, interest rates slumped and significant progress made in reducing public deficits and effecting structural reforms. However, due to unfulfilled commitments accompanied by a slower-than expected decline in public debt, market confidence started to fade by the end of 2000. Moreover, the turbulence in international financial markets led to a slowdown in external funding and a liquidity crunch. In November 2000, interest rates surged considerably, there was a significant capital flight, foreign exchange reserves slumped and stock prices posted a sharp decline. A series of measures was introduced in November and December which led to a relative recovery in the markets. However, confidence in the program was completely lost in February 2001, triggering a speculative attack on the Turkish lira. Consequently, the floating exchange rate regime has been adopted on 22 February 2001. In the wake of the crisis, the Turkish economy went through a structural transformation process. A new program called The Transition Program for Strengthening the Turkish Economy was launched to:

- smooth away the macroeconomic instability caused by the crisis,
- fighting inflation,
- ensure a sustainable growth environment,
- restructure the banking sector so that it could perform its intermediation functions in an efficient manner,
- strengthen the balance of public finances in a way that would prevent deterioration in the future,
- form a legal framework that would facilitate structural reforms.

Accordingly, i) reforms were introduced to achieve fiscal discipline and alleviate the public debt burden, ii) the Banking Regulation and Supervision Agency (BRSA) implemented the Banking Sector Restructuring Program, and iii) with significant amendments to the Central Bank Law on 25 April 2001, the utilization of Central Bank funds for the purpose of public finance – a practice which was believed to be the primary cause of previous crises – was abandoned. So were prohibited the practices of granting advances and extending credit to the Treasury and other public institutions and agencies, as well as Central Bank purchasing, in the primary market, of debt instruments issued by these institutions.⁽²⁾

Achieving Stability in the Banking Sector and the Immediate Situation

In the aftermath of the 2001 crisis, in line with the stability achieved in domestic economic activities and the developments in other economic indicators, the structure of the banking sector changed from a financing source for the public sector to a financing source for companies and households. In this way, the banking sector was able to focus on its fundamental duties. While the share of credits in the sector's total assets increased, that of the securities portfolio decreased relatively. On the other hand, the share of deposits in total liabilities remained stable throughout the period. There were no serious withdrawals from banks even during the 2008 global crisis, which is important in terms of the credibility of the sector. In the post-crisis period, CBRT's monetary policy implementations⁽³⁾ that included unconventional measures also made a significant contribution to financial stability.

LEGAL DEPARTMENT

Ensuring legal certainty

The Legal Department performs its duties to reinforce the current legal structure; at the same time emphasizing the element of independence, to ensure legal certainty, to help increase the effectiveness of the Bank in fulfilling its duties.

The Legal Department was initially established as the Office of the Legal Counselor in 1931, the year the Bank was founded, and the first legal counsel of the Bank was Osman Nuri Uman. The unit, which was restructured into the Office of the Chief Legal Counselor in 1970, has been functioning as the Legal Department since 1 July 1984.

To reinforce the current legal structure while at the same time emphasizing the element of independence, to ensure legal certainty, and accordingly, to help increase the promptness and effectiveness of the Bank in fulfilling its duties and exercising its authority by minimizing legal reservations, the Legal Department performs the following duties:

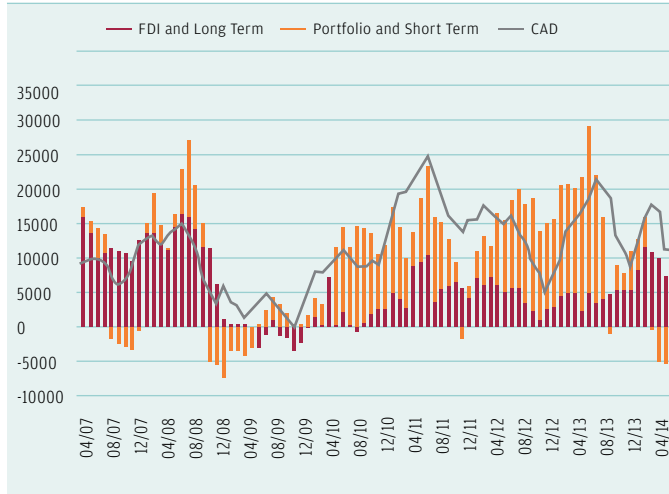
- Submits its legal opinions on various legal matters as requested by the Office of the Governor or by the units of the Head Office upon the directive of the Office of the Governor,
- Examines the drafts of regulations, contracts, written engagements and other such regulatory documents sent by the Office of the Governor, and presents its opinions thereupon,
- Participates in the preparatory work of the regulation and contracts concerning the Bank, with the approval of the Office of the Governor,
- Follows, monitors, defends, carries out all necessary procedures to conclude the administrative and judicial (legal and criminal) lawsuits and debt enforcement procedures in which the bank is a party to at the relevant courts and authorities (including the disputes submitted to arbitration) or have such duties carried out,
- Monitors and supervises the lawyers hired with the decision of the competent authority as an exception and restricted to a specific job,
- In exceptional cases, asks for legal advice from sources outside the Bank, with the decision of the competent authority and when necessary,
- Attends and offers legal assistance in meetings within the Bank or at public institutions and agencies and other institutions, with the permission and approval of the Office of the Governor,
- Follows new legislation concerning the primary duties and powers of the Bank and informs the concerned units at the Bank,
- Receives notifications from judicial and administrative courts, arbitrators, debt enforcement offices and public notaries sent to the Head Office and divisions of the Head Office on behalf of the Head Office; informs the former of the legal requirements and procedures,
- Determines the fundamentals and procedures and gives instructions for transfer to the Head Office of the lawsuit, legal proceeding and debt enforcement notifications to the branches without an Office of the Legal Counselor,
- Prepares general instructions to ensure uniform practice in addressing legal matters that the branches encounter,
- Creates files pertaining to the lawsuits and legal proceedings pursued by the Head Office and the Branches.



THERMOMETER

CURRENT ACCOUNT
DEFICIT

EMPLOYMENT

CHART 1: CURRENT ACCOUNT FINANCING
(3-Month Cumulative, Million USD)

Last Observation: APRIL 2014
Source: CBRT

The current account deficit, which widened in the final quarter of 2013, maintained its high levels in the first two months of 2014 but declined in March and April 2014. In April 2014, the current account balance posted a deficit of USD 4.788 million; thus, the current account deficit contracted by USD 8.283 million compared to the first four months of 2013 and fell to USD 16.372 million. The CBRT expects the improvement in current account deficit to continue during the rest of the year.

An analysis of the financial accounts in the balance of payments suggests that the direct investments item, which displayed an uptrend in the final quarter of 2013, remained high in the first four months of 2014. The downward trend in portfolio investments which was observed in the final quarter of 2013, has been continued in the first quarter of 2014 but stopped in April 2014.

For the Balance of Payments
Statistics published by the
CBRT, see www.tcmb.gov.tr

**CHART 2 : UNEMPLOYMENT RATE**
(Percent)

Last Observation: MARCH 2014
Source: TURKSTAT

In Household Labour Force Survey, new regulations in order to ensure full compliance with the European Union have been started since the period of February 2014. According to these changes, the reference week of the survey and duration of unemployment in unemployment criteria have been changed, and also the new administrative division and new population projections were based on.

According to the revised Household Labor Force Statistics the unemployment rate has been climbing since July 2013. In the final quarter of 2013, deceleration in employment became more apparent and labour force participation decreased. But in February and March 2014 employment began to increase again.

In March 2014, the unemployment ratio increased by 0.3 percentage point year-on-year to 9.7 percent. In the same period, non-farm unemployment increased by 0.4 percentage point to 11.6 percent while unemployment among the young population, of ages between 15-24, decreased by 0.8 percentage point to 16.7 percent. In this period, the employment ratio increased by 1.8 percentage point year-on-year and increased from 43.3 to 45.1 percent.

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