

**KEYNOTE ADDRESS BY**

**GAZÝ ERÇEL**

**GOVERNOR**

**CENTRAL BANK OF THE REPUBLIC OF TURKEY**

**AT EUROMONEY'S CONFERENCE "TURKEY: BUSINESS, FINANCE AND  
INVESTMENT"**

**MAY 14, 1997**

**CONRAD HOTEL, ISTANBUL**

Several times for different purposes I had the chance to introduce the main structure of the Turkish Economy. The general outline of those detailed analysis included the strength and weakness of our economy. Instead of repeating them in detail in the first part of my remarks I will give you a quick overview of the analysis of economic situation. In the second part I want to discuss the main feature of Turkish financial system. I want to conclude with the prospects for the Turkish Economy.

Turkey after the structural adjustment program supported with liberalization reforms launched in 1980 relied more on an outward looking economic policy. The most significant accomplishment of the Turkish structural adjustment and liberalization efforts is that it has restructured economic relations. Now I want to explain what I understand by the "changing economic relation" in Turkey.

First of all market mechanism began to play a central role in the allocation of resources in Turkey. Free market principles replaced the command economy. The establishment of money and capital markets, liberalizing the exchange and interest rates and other prices are the key elements of this process. These reforms institutionalize the markets and put them on a solid legal footing.

Second, after the liberalization of both the capital and current account, the effectiveness of the monetary, fiscal and income policies have changed. The opening up of the economy gives rise to some fiscal complexities. Any fiscal imbalances in a small open economy lead to more sensitive financial prices, like exchange rates and interest rates. This may require more sound monetary and fiscal policy. Therefore formulation of macroeconomic policies needs now deeper analysis than before.

Those changing economic relations can be reflected in the economic structure. Therefore now, I want to give you the headlines of our current economic background.

- Along with the rapid and continuous economic growth, the composition of our GNP has drastically changed. The share of industrial and especially the service sector in gross domestic production has been increasing for the last two decades. Moreover, the share of public sector in industrial production has also decreased. During the 1980s, foreign

trade was the main driving force for the Turkish economy. Today, the share of external economy in GNP is around 40 percent, indicating a considerable degree of openness of the economy.

- Turkish economy is dynamic economy. The dynamism comes mainly from the private sector. It is the private sector that has been mainly responsible for capital formation. The recovery of non agricultural private sector from the financial crises in spite of unsettled political conditions and extremely high interest rates was astonishing.
- Official records indicate that our unemployment rate has been holding fairly constant at around 7 or 8 percent, which is fairly low compared to some other OECD countries. The urban unemployment rate is higher than rural unemployment rate in Turkey. In addition, Turkey was among the top ten countries in terms of improving its score on the United Nations human resource development index, which is based on a country's literacy rate, per capita income and life expectancy
- Even if the official current account and trade balance indicate considerable deficit, I want to emphasize that the level of merchandise export is understated due to the omission of significantly growing but unrecorded shuttle trade with some formerly Soviet Union Countries. In addition, there has been serious under reporting of the value of transactions connected with some of Turkey's direct investment abroad. By taking into account these developments one can understand the accumulation of foreign exchange reserves especially for the last couple of years. Official foreign exchange reserves reached at a level of 16 billion. This level is satisfactory compared with our short term external debt. When we subtract our short term external debt from our gross foreign exchange reserves we still have an excess of over 6 billion dollars of reserves. This, on the hand, shows the reserve accumulation and on the other, an improvement in our external debt position. Our debt service ratio falls from over thirties to 23 percent.
- Privatization is an important part of our liberalization efforts. Telecommunication and energy sectors are great targets for the global partnership. Approximately 25 percent of total realized privatization proceeds came from sales in Stock Exchange. The main purpose of our privatization efforts is to take public sector out of the business, and hence help to reduce the burden coming from the inefficient management of public enterprises and therefore to increase the efficiency of the privatized enterprises.
- After the financial liberalization and reform program Turkish financial system indicated remarkable improvement in economic activities. Even though Turkish financial system is still dominated by the banking sector, Istanbul Stock Exchange is one of the best performing of all the emerging markets. Its total market capitalization is increasing both in nominal terms and as a percentage of GNP, indicating that it is playing an increasing role in the allocation of domestic savings. Also there is a considerable amount of foreign investors acting in this market. Istanbul Stock Exchange is volatile as in most emerging markets.
- Finally, we all know that inflation has been the major problem for our country over the past two decades. We also be aware of the main causes of this high and persistent inflation rate. Inflation in Turkey was mainly fed by the high public deficits and entrenched inflationary expectations. The cure of this problem only require political will as well as persistence. I believe we have the ability to overcome our economic problems.

I gave the outline of the main characteristics of our economy under six headings. Now I want to describe our financial system.

Turkish financial system consists of money and capital markets, banks and other financial institutions. However most financial savings are still channeled through banking sector. Therefore in our financial system banks have a special place. By keeping this in mind, we concentrated on the soundness and effectiveness of our banking system. Our Banking Law governs the establishment of banks, their capital structure, their foreign exchange positions, branch banking and all other activities related to banking. We keep the law up-to-date to satisfy the needs arose from the changing environment. For that purpose, for exempla, the anti money laundering legislation works are being intensified. In addition to that as the Central Bank we also give special attention to the careful supervision of the banking sector. Because we need a safe, sound and competitive banking system. In addition to this legal aspect I should also emphasize with gratification that our banking system is well integrated with international financial markets. Its strength comes from its modern technical infrastructure, its well trained staff and its qualified and experienced management. As result of these characteristics our banking system can easily adapt itself to different financial environment.

Now I want to explain our money markets. Our money markets consist of interbank domestic currency money market, interbank foreign exchange and deposit markets, open market operation market and government debt instruments auction market. As you all know those markets have been established as a part of the financial liberalization reform during 1985-1988. Today they are very important for the efficient functioning of the financial system. They are all used for the efficient conduct of monetary policy. The types of transactions increased in these markets since that time as a results of the needs of the market. We as the Central Bank, pay special attention to the stability in these markets. As a matter of fact, when we look at the volatility measures like variance and coefficient of variations of interbank overnight rates, we can conclude that for the last couple of years the volatility of these markets was lowered. As a result of this development uncertainty in the cost of funds of banks is decreased implying a lower perceived risks of market participants.

As a result I can say that Turkey now has a well established, modern, and efficient financial system. The main obstacle at present to the effective functioning of the financial markets is our sizeable public sector borrowing requirements, which crowds out other demands for financing.

After stating our current economic and financial situation, I would like to express my belief that Turkey has great opportunities in the region she placed. In addition, toward the integration with the European Union Turkey will face more opportunities and challenges. I believe we should be able to take advantage of this developments. We are aware of our economic difficulties and we are able to overcome them. What we need is persistence, public consensus, and political will on these issues.

Turkey, especially Istanbul has the potential of being an international financial center in this region as long as we satisfy the necessary conditions of financial centers. Economic and political stability is the precondition of all. Those lead price stability and sound real economy. Even if our financial system is in a pretty good shape, there are still steps need to be taken to improve the strength of our financial system. We also need strong information processing and electronic communication.

Turkey's short term economic prospects seem to me relatively encouraging. But if serious and necessary measures are not taken to achieve a structural improvement such short run development is unlikely to be sustained. Turkey, in order to be able to take advantage of this

favorable conditions, has to have a longer term vision. Macroeconomic stability and political soundness are the keys for the solution of our main dilemma, namely sustainable growth under low inflation environment.



[info@tcmb.gov.tr](mailto:info@tcmb.gov.tr)

