CENTRAL BANK OF THE REPUBLIC OF TURKEY

Developments in Mediterranean Countries' Banking Sectors and Implications for Financial Stability

Durmuş Yılmaz

Governor

Euro-Mediterranean High Level Meeting

November 26, 2008
Alexandria

Good afternoon.

I would like to take this opportunity to thank the European Central Bank for their kindly invitation and the Bank of Egypt for hosting the Fifth Euro-Mediterranean High Level Meeting here in Alexandria.

Since the beginning of the Barcelona process in November 1995, Turkey has been an enthusiastic partner of the Euro Mediterranean project. Throughout this process Turkey has collaborated on various macroeconomic issues and initiatives. Recent global financial developments have proved that cooperation at the regional level as well as global level has become more important than ever to overcome international financial challenges. It is our joint responsibility as respective individual countries to contribute to the stability in financial sectors and build up a better international financial system.

Distinguished Guests,

The worsening expectations of global growth, problems surfaced in financial institutions in developed countries, and deterioration of global credit conditions have all led to a sharp spike in risk perceptions. De-leveraging process in the developed countries has caused risk indicators of emerging markets to deteriorate significantly. For example, EMBI+ spreads have increased markedly since September reaching almost 900 basis points in late October, before declining to 700 basis points on November 25. Increased risk aversion has led to sizeable capital outflows from emerging markets in the last two months, resulting in an overall depreciation of domestic currencies.

As you may already know, following the 2001 financial crisis, Turkey adopted an ambitious reform agenda to strengthen the financial sector and banking system. Thanks to these measures, resilience of the Turkish economy to external shocks has been improved significantly and the banking system in Turkey has been relatively prepared for the current crisis, as witnessed during current financial turmoil.

Since securitized products are rarely used in the Turkish banking sector, the ongoing financial turmoil has not put a marked pressure on local banks through that channel. In addition, there are no liquidity problems in the system. Deposits have been stable and banks have adequate level of collateral in the form of government securities that can be used in the open market operations. However, considering the severity of the current crisis and Turkey's integration into the global economy, it won't be surprising that the crisis has some effects on Turkish banking sector.

The general framework of the Central Bank's liquidity management is fairly flexible and well-structured to fulfill its lender-of-last resort role and meet both New Turkish Lira and foreign exchange liquidity requirement of the banking system effectively.

We have acted promptly to contain the adverse effects of the global financial turmoil on the domestic economy. To ensure smooth operation of the New Turkish Lira money markets and to contain the potential volatility in short term interest rates, the Monetary Policy Committee, judging that inflation will display a more rapid fall than envisaged before, has lowered the borrowing rates by 50 basis points and the lending rate by 100 basis points on November 19, 2008. This allowed the margin between the lending and borrowing rates to be reduced by a further 50 basis points.

We are also aware of the significance of foreign exchange liquidity in the banking system and progressively put into effect necessary measures in order to get through this period with minimal damage.

To that end, we have resumed our role to act as an intermediary in the FX deposit market as of 9 October 2008, and later doubled the transaction limits to 10.8 billion USD. During times of confidence breakdowns among the participants of the financial markets, central banks can serve as a blind broker to intermediate in the foreign currency lending market. In this FX deposit market, banks can post their bids for foreign exchange without disclosing their identities. It also acts as a market of last resort as the banks can borrow directly from the Central Bank.

Along with the above-mentioned measures, we have also extended the maturity of the FX deposit borrowed by the banks from one week to one month, and reduce the lending rate from 10 percent to 7 percent for USD and 9 percent for Euro in the FX market.

Needless to say, as the high level of volatility in global financial markets prevails, the Central Bank of Turkey will sustain its vigilance and will stand ready to take additional measures prudently within its means in order to ensure the smooth functioning of the financial system.

Dear Colleagues,

In the last part of my speech, let me say a couple of words about the current financial turmoil.

This recent episode provides a good example of how, in a financially integrated environment, a country specific shock can spill over rapidly to seemingly distant markets and countries. The problems, which started in sub-prime mortgage markets in the United States, have spread to the whole financial system all around the world and reached a point that threatens the global economic stability. This shows that countries share not only benefits of financial integration but also the risks associated with it.

In my opinion the most important lesson that we should derive from the current turmoil is the need for a global lender of last resort mechanism. In addition, with the cooperation of local and international authorities an early warning system should be constructed so that the fragilities in the international financial system would be identified and necessary and sufficient measures to fix them would be taken beforehand. In this context I believe that effective and efficient risk management and re-regulation will be the cornerstones of the new global financial architecture where the financial intermediation should not let the direct relationship between lender and borrower to be cut completely under various forms of effective risk diversification and securitization.

Sound domestic policies for a healthy banking sector are necessary but not sufficient for addressing contemporary challenges of the global world. In this respect, improving policy coordination at the regional and international level is a must. Only then, we would be able to attain the optimal level of international financial regulatory rules and guidelines together with adequate tools that would match the complex nature of the international financial markets. With this consensus in mind, G-20 leaders at their summit in mid November, agreed upon an important set of principles on reforming the international financial architecture. We strongly support the promotion of these principles that include strengthening transparency and accountability, enhancing sound regulation, promoting integrity in financial markets, reinforcing international cooperation and reforming international financial institutions. We must lay the foundation for reform altogether to ensure that a global crisis, such as this one, does not occur again.

Thank you.