Central Bank of the Republic of Turkey

Growth and Stability: Challenges and Opportunities from a Regional Perspective

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Distinguished Guests,

At the outset, I would like to welcome everyone to Istanbul. It is a great pleasure for me to be in this conference that has congregated distinguished participants. The Turkish-Arab Forum will provide an invaluable opportunity to discuss our assessments on global economic outlook and also share our experiences regarding our economies.

Taking this opportunity, I would like to share my views regarding the recent developments in the Turkish economy and the importance of strengthening the commercial and financial relations among our countries in coordination and cooperation in order to increase the welfare of the region. But before delving into this issue, I would like to touch upon the recent recovery in global economic activity and the main risks down the road.

Dear Participants,

The global economic recovery has 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 spin similar to the one experienced during the Great Depression. However, there are several risks involved in this recovery process and many challenges lie ahead.

Debt sustainability and fiscal imbalances stand out as the main challenges which not only pose threat in the short-term but also 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 European countries should be resolved in a quick, effective and credible manner. Otherwise, it may bring about substantial repercussions inside and outside of Europe.

The problem of distressed assets in the banking sectors of advanced economies is yet to be solved. The persisting vulnerabilities are impeding effective functioning of the credit mechanism. Credit growth in the US and Europe has not been materialized yet. Another risk factor is persistent unemployment which remains elevated in many countries. Although the number of new employees is on the rise, the employment growth is subdued. Lack of a significant progress in labor market is hindering a sustained recovery in private demand. The persisting uncertainties about exit strategies from the extraordinary monetary and fiscal measures are another headwind that needs to be addressed.

Distinguished Guests,

Now turning our attention to the Turkish economy, the picture is relatively brighter. Turkey used to be one of the emerging economies with historically high volatility and particular sensitivity to global risk perceptions throughout the 90s. However, this time the impact of the crisis has remained relatively limited due to the resilience of our financial system and prudent macro policies. The Turkish economy entered the global financial and economic crisis following a six-year growth surge that was fuelled by far-reaching policy reforms and greater political stability. 2001 crisis was a turning point for Turkey. In some sense, what many countries have experienced today had already been experienced in Turkey in the aftermath of the 2001 crisis at the cost of imposing a heavy burden on the public budget.

Following the crisis it is fair to say that we learned our lesson. Steps were taken to restructure the economy based on sustainable public finance, price stability, and high growth rates led by productivity in private sector. Disciplined fiscal policy has been the cornerstone of the program, allowing lower debt ratios and declining real interest rates. Ambitious fiscal targets were set for primary surplus, as high as 5 percent of GDP. These targets have been almost achieved year after year. Between 2003 and 2007, the realization of primary surplus stood around 4.8 percent of GDP.

Of course, there were also other pillars of the restructuring program that played a major role in normalization of the Turkish economy. Central Bank independence and implicit inflation targeting regime played a key role, along with floating exchange rate regime. More robust and comprehensive legal and institutional framework for better regulation and supervision of the financial system raised the resilience of the sector. Restrictions on excessive risk taking by banks with the introduction of heavy personal liability of bank owners and top managers prevented the build up of vulnerabilities. Strict limits on FX short positions, high level for capital adequacy and leverage ratios provided enough cushion during the downturn.

Esteemed Guests,

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. Growth forecasts of international institutions for 2010 which was around 3 percent last year, revised repeatedly since then and reached ass much as 7.2 percent, the highest among OECD countries. Nevertheless, still-weak foreign demand and the fact that Turkey's exports predominantly rely on products that are susceptible to cyclical developments are retarding a stronger bounce back in our industrial production. Growth forecasts for our largest trade partner, the European Union, suggest that it would take a long time for foreign demand to return to pre-crisis levels. Despite the recent partial recovery as the economy started to new jobs, the unemployment rate is still quite high compared to the pre-crisis period in Turkey.

This global crisis has proved the importance of transparency in policy making and managing expectations. Announcement of credible exit strategies from unconventional fiscal and monetary policy measures is critical in stabilizing the risk perceptions and reinforce the confidence on sustainability of macro policies.

To this end, Turkish government announced a Medium Term Program (MTP) in September 2009. The MTP presents a comprehensive framework of policy actions to halt the rise in public debt-to-GDP ratio in 2010 and trim it down gradually in subsequent years. In addition, the government has introduced a fiscal rule to ensure fiscal discipline, limit the public debt-to-GDP ratio over the long term. The legal structure of the fiscal rule is expected to be completed in mid-2010. On the monetary side, since the Central Bank of Turkey has not used any unconventional measures throughout the crisis, the exit strategy we announced in April was simpler and easier to implement compared to many other central banks.

Dear Participants,

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. 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 in coordination among neighboring countries.

Increasing commercial relations naturally led to an increase in international banking services among our states. Having a sound financial position, Turkish banks can contribute both to these commercial and also financial relationships with these countries. Indeed, Turkish banks are interested in expanding their operations to 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.

However, it should be kept in mind that financial stability is the key to attain stable and sustainable economic growth rates. Within this respect, it is vital to consider grow commercial and financial relations among our countries in coordination and cooperation. To do this, related authorities in the region should strengthen the financial infrastructure and adapt our policies to curb systemic threats for our financial systems.

Within this context, I would like to emphasize the importance of the payment systems. In the last twenty years, rapid technological progress, decrease in restrictions and globalization of financial markets have led to a rise in financial activities. These increasing financial activities have contributed to an increase in the volume and value of domestic and cross-border payments. The increasing number and value of transactions within the payment systems highlight the importance of these systems.

The smooth operation of payment systems promotes the efficiency and effectiveness of the financial system. Therefore, it is important for the effective implementation of monetary policy. Besides, the contagion possibility of participants' problems to other parts of the financial system through payment systems increases the importance of payment systems for financial stability. Hence, central banks give full weight to the determination and mitigation of possible risks inherent in payment systems.

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. In particular, the Turkish real-time gross settlement system (RTGS) has become an efficient funds transfer system and hence an indispensable component of our financial system.

The Middle Eastern countries also pay attention to the payment systems' issues. Turkey tries to improve its economic relations with the countries in the Middle East region. In terms of increasing international trade among our countries, it is believed that smooth functioning and safe payment systems will play a crucial role in this context. When we consider the position of Turkey with its strong payment and settlement systems infrastructure, its relations with international organizations and other central banks, its active role in core organizations dealing with payment and settlement systems, and its candidacy to European Union, it is obvious that Turkey can play an important role in terms of both improving the payment and settlement systems in the region and establishing an international payment network.

Dear Guests,

Before concluding my remarks, let me emphasize the importance of further cooperation in our geography to enable new opportunities for economic and social developments leading to increased welfare in our nations. There is a reason I reiterate this point, because a series of high-level events for central bank governors are going to be held in İstanbul this September, and those meetings will provide ample opportunity to share our views on recent economic developments.

The first meeting will gather COMCEC member countries on September 27, 2010. This is an invaluable platform for central bank governors of the member countries to strengthen our cooperation and an excellent opportunity to discuss current economic issues.

Then, from September 27 to 29, the Global Economic Symposium will be organized in İstanbul. The GES 2010 will address the issue of “Achieving Sustainability in the Face of Systemic Risks”. For three days the world’s most prominent experts from politics, business, academia and NGOs would discuss global problems in economics, politics, civic communities and environment, share their views and formulate their visions.

I invite all of you to these important events and hope to see you in İstanbul again in September. Thank you for your attention.