İSTANBUL FINANCE SUMMIT 2012

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Distinguished Guests and Esteemed Members of the Press,

I am glad to address you at the third İstanbul Finance Summit. I would like to greet distinguished participants and guests on behalf of the Central Bank of the Republic of Turkey and myself.

In my last year's summit speech, I mentioned that İstanbul is the candidate to be the most beautiful global financial center in the world. I tried to demonstrate the relationship between aesthetics and stability by referring to the golden ratio that is frequently used in geometry. However, in today's speech, I would like to place particular emphasis on how the harmony between credit growth and economic growth is linked to financial stability. I will start my speech by addressing the importance of financial stability and potential problems that might emerge if financial stability is overlooked. Then, I will mention Turkey's achievements regarding financial stability and the country's contributions to global financial stability.

There are three essential factors that determine the growth potential of a country; these are price stability, financial stability and productivity. Any weakness in any of these three factors may cause considerable harm to growth prospects. Economic history has many examples of this.

The social costs of loss of price stability are now very well known by economists. Academic studies indicate that an inflation rate that is on average higher by 10 percentage points leads to a reduction in the GDP growth rate an average of a quarter point[1].

Meanwhile, the loss of financial stability has deep and long-term impacts on growth and employment.[2] The cost of preventing a financial crisis is much lower than the cost of the crisis itself. Turkey's recent history is a very good example of this statement. The economic crisis, which Turkey went through in 2001, increased the country's sovereign debt by 30 percentage points, and severely

[1] Barro, Robert J. (1995). "Inflation and Economic Growth." NBER Working Paper Series, No: 5326.
[2] 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.

affected growth and employment prospects. As of 2002, Turkey focused on establishing price stability, financial stability and introducing structural reforms aimed at increasing productivity. As a result, while the country's economic prosperity grew at a rapid pace, the financial sector gained a structure resilient to external shocks. The steps taken towards fostering financial stability helped Turkey recover rapidly after the 2008-2009 global financial crisis and it weathered the European sovereign debt crisis of 2011-2012 with minimum damage.

Recent experiences by advanced and emerging economies reveal that there are two predominant approaches to financial stability, each with fundamentally different principles. The first of these is the approach adopted by Alan Greenspan, who was the Chairman of the Federal Reserve between 1987 and 2006; in my presentation I will call it "the Greenspan Doctrine". The other approach is the one followed by Stefan Ingves, currently the Governor of the Sveriges Riksbank and at the same time the Chairman of the Basel Committee on Banking Supervision; I will call this approach "the Ingves Doctrine". While the Greenspan Doctrine asserts that financial crises are unavoidable, the Ingves Doctrine states that financial crises are avoidable if the necessary measures are taken by central banks and other supervisory authorities.

First of all, let's see what happens in the case of the Greenspan Doctrine. Excessive credit growth due to loosening of financial regulations, and the resulting financial balloons might severely damage the economy in subsequent years if they are ignored by policymakers. This process is triggered by a rapid financial meltdown on the back of pricing behavior detached from economic fundamentals. Those who have become home owners through mortgage loans might lose their homes as the value of their assets falls short of covering their debts. Increased credit risk and a rapid tightening in credit conditions take hold of the whole economy, and unemployment rates soar. Meanwhile, outstanding loans continue to increase, which eventually leads to further decline in house prices and financial firms carrying a large amount of housing sector-based financial instruments on their balance sheets come under strain. This situation triggers a massive public response. To protect depositors, banks are nationalized and injected with capital. Besides, fiscal expansion is implemented by increasing public expenditures and reducing tax rates in order to revive the economy. This, in turn, leads to a rapid increase in the

public debt burden. Thus, an ignored financial problem results in a reduction in future generations' welfare. Meanwhile, central banks opt for monetary expansion by injecting liquidity into the system.

The Ingves Doctrine, however, defends the concept that financial crises are avoidable by adopting effective and prudent arrangements. According to this doctrine, macro-prudential measures taken to this end can prevent excessive credit growth and asset bubbles, the two main causes of financial crises.

Distinguished Guests,

The cost of preventing a financial crisis is much lower than the cost of the crisis itself. The most important leading indicator of a financial crisis is excessive credit growth. Developing countries learned this lesson by experiencing it several times. Developed countries, however, learned this lesson only in the financial crisis of 2008-2009. The importance of systemic risk along with macro-prudential measures to mitigate this risk to ensure financial stability has necessitated reconsidering the link between regulatory frameworks and central banks. The enforcement of the Dodd-Frank Act in the US and the European Systemic Risk Board (ESRB) in Europe as well as new regulations introduced in other countries all aim to mitigate systemic risk by means of macro-prudential measures.

In this context, the Financial Stability Committee was established on 3 June 2011 in Turkey. The Committee is composed of the Central Bank of Turkey, the Banking Regulation and Supervision Agency (BRSA), the Capital Markets Board of Turkey (CMB), the Savings Deposit Insurance Fund (SDIF) and the Undersecretariat of Treasury. Monetary easing policies implemented by central banks of advanced economies in the wake of the global financial crisis led to excessive credit growth in many emerging market economies with strong economic fundamentals including Turkey, and credit growth in Turkey exceeded 35 percent by the end of 2010. The authorities set the target for credit growth as 25 percent for end-2011 and below 15 percent for end-2012. These targets have been attained on account of the macro-prudential measures taken. Today, credit growth in Turkey has smoothly been brought to sustainable levels.

Distinguished Guests,

Now I would like to briefly mention Turkey's contributions to global financial stability. Turkey became a member of the Financial Stability Board (FSB) on 29 April 2009. In 2014, Turkey will participate in G20 Troika and assume Annual Presidency of the G20 in 2015. During the period from 2014 to 2016, when Turkey will be taking part in G20 Troika, our representative from the Undersecretariat of Treasury will be assigned to the FSB Steering Committee.

The Central Bank of Turkey became a member of the Basel Committee on Banking Supervision (BCBS) on 25 May 2009 and the Group of Governors and Heads of Supervision (GHOS) on 4 June 2009. The Bank will participate in the FSB Steering Committee during the period 2013 – 2015 when it will chair the FSB Regional Consultative Group for the Middle East and North Africa (MENA).

At G-20 meeting held in Los Cabos, a number of emerging market countries including Turkey declared their intention to contribute to global financial stability by increasing the resources of the IMF. The Central Bank of the Republic of Turkey intends to contribute to IMF resources up to USD 5 billion, to be counted as part of its international reserves.

As part of the governance reform of the International Monetary Fund (IMF), a New Constituency was established with countries Turkey, Austria, Hungary, the Czech Republic, the Slovak Republic, Slovenia, Belarus and Kosovo. According to this agreement, in the new group that will act from 2012 to 2022, Turkey will assume the Executive Director position for two-year term between 2014 – 2016 and 2018 – 2020. Austria will assume the Executive Director position between 2012-2014; the Czech Republic between 2016-2018, and Hungary between 2020-2022.

In the upcoming period, the Central Bank of the Republic of Turkey will continue to play its part in order to achieve and maintain price stability and to contribute to financial stability within the limits of its purview. Turkey will continue to contribute to global financial stability by sharing at

global platforms the lessons the country has learned from past experiences and the outstanding performance delivered on the back of the policies implemented for the past 10 years.

Thank you very much for your attention.