Effect of the Global Economic Crisis on Turkish Banking Sector

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Abstract

The global economic crisis began in 2008 has had major negative effects the economies of all countries in the world. Turkey is also one of the very seriously affected countries by the crisis. However, effects of the global crisis on Turkish Banking Sector remained relatively limited compared to its peers in developed and other developing countries.

Turkish Banking Sector has been less affected by the global crisis because of after November-2000 and February-2001 crises, gaining the banking sector stronger capital structure and stronger equity capital structure as a result of taken structural measures and improvements; effective supervision and regulation of the Banking Regulation and Supervision Agency; the absence of a functioning mortgage sector such as America; several structural and fundamental features of the sector itself; the macroeconomic policies of the Central Bank of Turkey; and some additional measures taken by banks in the process of the global economic crisis.

Key Words: *Global Crisis, Turkish Economy, Turkish Banking Sector.*

JELClassification: E50- E51, E58, G01, G21

1. INTRODUCTION

The repercussions of the crisis in global financial markets hit the real economy, as well and spread across national borders through closing credit lines and sharply slowing capital inflows. This trend was also apparent in the stagnant private consumption and investment figures all over the world. The slowing global demand sharply reduced the international commodity prices, helping the global inflationary prospects. On the other hand, this sudden fall in commodity prices severely hit the economic stability of several commodity exporting countries.

The global developments led to a rapid contraction in the world economy and financial markets and deceleration in trade volume.

The first effect of the global financial crisis that first erupted in the USA in the second half of 2007 has been the contraction in liquidity and credit channels. Marred by unfavorable developments in financing conditions as well as the significant drop in trade volume due to insufficient demand, 2008 was a year when growth performance deteriorated, employment decreased and expectations worsened all over the world. Within the context of the decisions made at the G-20 Summits since the last quarter of 2008, operations intended to increase liquidity in a coordinated manner and to support financial institutions were followed by comprehensive fiscal stimulus packages (CBRT, 2009a;iii).

Central Banks have declined interest rates and raised the level of the liquidity with the introduction new facilities in the financial system. In addition, many governments have launched programs aimed at strengthening the capital adequacy of financial institutions. At the same time, a number of countries introduced substantial economic stimulus packages that include tax breaks, investment incentives and increased public spending on infrastructure projects.

The global economic crisis began in 2008 has had major negative effects the economies of all countries in the world. Turkey is also one of the very seriously affected countries by the crisis.

Turkey's level of integration with the world economy had increased noticeably over the last years, on all indicators. The Turkish economy have benefited significantly from this enhanced integration through increased productivity and competitiveness. Nevertheless, such an integrated country could not stay isolated from to the impacts of this crisis. In parallel with the other emerging market economies, Turkey is negatively being affected from the deceleration of the global economic growth and slowing international capital flows (Çanakcı,2009:12) .

Starting from the last quarter of 2008 in particular, the global issues have had considerable reflections in Turkey. The most important channel from the crisis to the Turkish economy is the sharp decline in world trade in goods and services. Turkey is an open economy: foreign trade is more than 50 percent of gross domestic product, and exports in 2008 were nearly a quarter of gross domestic product. More than half of Turkey's exports go to the EU. As the implications of the crisis on Turkey emerged, a contraction was observed in Gross Domestic Product (GDP) in the last quarter of 2008, compared to the same period of 2007, leading to the GDP growth rate to decelerate throughout 2008. Consequently, impacts of the crisis on the economy were felt more intensively in the last quarter of 2008, resulting to a simultaneous contraction in external and domestic demand. Output and income declined. External financing became more limited. The unemployment rate increased. The current account deficit has narrowed down. In the public sector, the budget deficit expanded and the public sector borrowing requirement increased. On the contrary, inflation and interest rates have fallen (Okonjo-Iweala,2009:2; TBAT,2009a:1; TBAT,2009b:I-3; CBRT,2009a:iii).

2. EFFECTS OF THE GLOBAL CRISIS ON THE BANKING SECTOR

Turkish Banking Sector was not affected by the crisis such as American and European banks, due to Turkish banks have a solid structure on capital adequacy. Turkish banks, between the G-20 countries, are the first place in capital adequacy, assets profitability and equity. In terms of capital adequacy has a solid structure. Turkish Banking System has a positive value in terms of deposits, loans to GDP ratio, financial depth and ratio of loans to deposits that are the important indicators in the banking sector. World's leading banks a lot of damage under the influence of the crisis, while the opposite situation in Turkey has experienced. Banks operating in Turkey have been profit while the world banking system can not escape from 4 trillion dollars loss in the process of this crisis. Banking Regulation and Supervision Agency (BRSA), restructured the sector after the crisis 2001, became a model to many countries.

The reasons behind the relatively limited negative effects on the banking system are a high capital adequacy ratio, a high asset quality, low currency and liquidity risks thanks to successful risk management and effective public supervision, and good management of the interest, counterparty and maturity risks. The measures taken by the Central Bank of the Republic of Turkey (CBRT) and the BRSA against the increase in global financial risks aided the banking sector to continue healthy functioning (TBAT,2009a:4).

Global financial crisis did not influence the market structure of Turkish banking sector: The number of branches and personnel preserved its increase tendency despite the global economic crisis in 2007-2009 periods. Turkey's banks have aimed to continue hiring new staff and open new branches in the upcoming period. On the other hand, owing to the acquirements, the trends of benefiting more efficiently from data processing technologies and expanding customer web continued uninterruptedly.

Despite the adverse effects of the economic crisis, Capital Adequacy Ratio (CAR) of the Turkish banking sector experienced no importance decrease in this period. Strong outlook of own-funds indicates the endurance of the sector. The CAR of the banking sector maintains its high level and is still high relative to the CAR of the sectors of many developed and developing countries, suggesting that when capital is considered there is no obstacle regarding the extension of credit and banks maintain their strong capital structure by their prudential behaviour (CBRT,2009a:56; CBRT,2009b:50; BRSA,2009b:21).

At the same time, asset quality recovered stable. Financial intermediation function which has critical importance in procuring a sustainable macroeconomic growth performance has continued to be put into practice effectively. Although the achieved stable growth environment brought along a rapid credit growth, excessive risk-taking of banks was prevented owing to the legal regulations and ratios of non-performing loans were rather low even in the period of the crisis.

The regulations preventing the FX (Foreign Currency) borrowing of economic units without FX incomes prevented that this sector carries open positions and also prevented that the problems were experienced by the countries of Middle and Eastern Europe was experienced by our country (BRSA, 2009a:41-44).

The impact of the liquidity squeeze, which surfaced in the global financial markets due to deterioration in risk perceptions and loss of confidence, has stayed limited on local financial markets also owing to the measures taken by the CBRT (CBRT,2009a:78; CBRT,2009b:68).

Banks were rather conservative in lending due to increased risks and the slowdown in loan demand as well as the rising demand for funds from the Government. In addition there has been an increase in the share of government securities in the total assets. In the period when the global developments began to affect the banking system, the currency risk of banks remained very limited.

The interest risk was higher due to a maturity mismatch caused by long term assets against short term liabilities. But, the rapidly falling interest rates had a positive effect on the interest margin. Meanwhile, banks rapidly introduced measures to limit their operating costs. As a result, the profit volume increased and profitability recorded a growth, albeit slight. Shareholders' equity has continued to strengthen due to capital raises as well as the increase in the profit volume (TBAT,2009a:4).

Deposits, which are the ultimate funding source of the banking sector, restrain the dependency of the baking sector on more volatile wholesale funds. This situation and the liquidity adequacy ratios, which stand above the legal requirement, are evaluated as positive developments in terms of liquidity risk.

The exchange rate risk aversion trend of the banking sector has continued. Although, the levels of on-balance sheet short position and off-balance sheet long position of the sector decreased in line with liquidity conditions in international markets, they started to increase again since March 2009 (CBRT,2009a:v).

The high level of exchange rate volatility during the global financial crisis caused an increase in both risk premiums and vulnerability of the countries where the share of FX loans in total loans is high. The fact that the share of these loans is low in Turkey came forward as one of the most important factors that limited the effects of crisis on the banking sector (CBRT,2009a:60).

Tangible common equity, which recently came forward as a critical soundness indicator of capital in the international arena, is significantly high in the banking sector of Turkey (CBRT,2009a:v).

Shortly, the significant progress achieved in the rehabilitation and restructuring of the banking sector, had put Turkey's regulatory and supervisory framework among the best practices in the world. This very strength of the banking sector is mitigating the risks posed by the global crisis to Turkey (Çanakcı,2009:13).

However, the negative effects of the global financial crisis were felt in the banking sector in Turkey: Not only the fall in credit supply, which was due to contraction and thus the increased cost of the banking sector's international funding sources as a result of crisis in the global market and accompanying anxiety about the increase in troubled credits, but also the fall in demand for credit, stemming from the slowdown of economic activity, led to a decline in credit volume since the last quarter of 2008 (CBTR,2009a:57; CBTR,2009b:53).

Consequent to the fact that banking sector grew slower in 2009 due to the developments in domestic and abroad, enhancement in the number of branch and staff considered as direct access canals were limited when compared to the last years. At the same time, the global crisis was effective in the interest rates of the loans the banks accredited. Particularly, credit interest rates increased thus interest margin increased (BRSA,2009b:21,27).

Because of slowing economic growth, the sector has faced with a decrease in credit growth, deterioration in asset quality and an increase in non-performing loan ratio. Loans in the banking sector slowed down since the last quarter of 2008, as the effects of global crisis became evident. Banks were down the growth rate of loans by following a cautious strategy in the crisis process. During the crisis, banks have preferred to evaluate in the securities portfolio a significant portion of their collecting deposits. In the first period of the global financial crisis, banking system remained slow in adequate financial support to the real sector, but started to correct the situation in 2009. Some banks called back a portion of their loan or processed checks before the date. On the other hand, non-performing loans increased. Banks in Turkey have become problems to place as credit of their cash resources, rather than liquidity problems. Banks were forced to keep liquidity for the foreign currency liquidity and against the motion of interest-sensitive deposits. Apart from this, the most important problem related with liquidity has been significantly reduced the liquidity opportunities provided from abroad.

Another problem in the sector is a non-compliance term between the assets and liabilities. Most significant risk related to deposits is short of the term. After the September-2008 started the crisis, one of the problems experienced by Turkish banking system has been the growth problem. During the crisis, branch speed and staff number of the banking sector were also slowing down. Another biggest risk in Turkish banking sector is the quality of assets.

2.1. Global Crisis' Causes of Limited Effects on the Turkish Banking Sector

The global financial crisis has also impressed the banking sector in Turkey. In spite of this, effects of the crisis on Turkish Banking Sector remained relatively limited compared to its peers in developed and other emerging countries.

Turkish banking sector had been restructured and modernized following back-to back economic crises in late 2000 and early 2001. Banks with weak financial structures had been either eliminated or merged into stronger banks. Under the regulatory framework of the BRSA, the sector had become more efficient and competitive, spurred by increasing foreign direct investment (Erdilek,2008).

Establishing a sound legal infrastructure in post-crises period and reflecting the experiences of crisis to this structure increased the power of the sector against possible crisis. New financial architecture developed for maintaining the stability supported by structural reforms, is the primary factor in protecting economic stability and the economy to become more flexible and resistant against external fluctuations during the global crisis.

Following the crisis in 2001 and the restructuring process, the banking sector showed a rapid growth performance in 2002-2008. In this period, the numbers of branches and staff improved tremendously. At the same time, the financial structure of the sector also became stronger, and the risk management systems improved and public supervision became more effective in this period. These positive developments recorded by the banking system in 2002-2008 period have several reasons, including the relevant domestic and international economic condition and the change in the risk management conception. Another important reason is the achievement of the "Banking Sector Restructuring Program (BSRP)" (Conkar-Keskin-Kayahan,2009:32; Okonjo-Iweala,2009:3; TBAT,2009a:5). The BSRP, initiated in May 2001, focused on the intermediation function and aimed at transitioning to an internationally competitive banking sector which will be resilient to internal and external shocks. The priorities of the BSRP were identified as recovering the deterioration caused by the 2000-2001 crises in the sector and building a strong base for the system by clearing it from weak banks. The BSRP intended at restructuring state-owned banks, resolution of the banks transferred to the Savings Deposit Insurance Fund (SDIF), rehabilitating the private banking system, strengthening the regulation and supervision framework, and increasing efficiency in the banking sector. Consequently, the program was established upon four main blocks. These blocks are (BRSA,2009a:12);

- Restructuring of public banks financially and operationally,
- Prompt resolution of the banks under the SDIF,
- Bringing a healthy structure to private banks which were affected negatively from the crisis,
- Realization of legal and corporate regulations which will increase the effectiveness of surveillance and supervision in banking sector and which will bring a more effective and competitive structure to the sector.

Recovering the banks under the ruling of SDIF, restructuring the state banks from their financial and operational loss, recovering the private banks affected negatively from the crisis, realize legal and institutional regulations to increase the efficiency of supervision in the banking sector and form a more effective and competitive structure in the sector (Conkar-Keskin-Kayahan,2009:33). Reform efforts implemented after the financial crisis and political stability secured after 2002 caused evident recovery in basic indicators.

When current Turkish Banking Sector is compared to its peers in other markets with a focus on factors that created and intensified the crisis, several essential discrepancies are revealed (Yüce,2009:34):

- Unlike its counterparts in developed markets, retail banking in Turkey still remains underpenetrated and carries high potential. As a result, banks have focused on traditional retail and corporate banking and refrained from risks driven by sub-prime mortgages and complex financial instruments.
- Although lower as compared to other emerging markets, loan volume in Turkey has grown significantly in recent years.
    - However, loan growth was accompanied by healthy deposit funding, which in turn decreased vulnerability of banks created by high exposure to foreign funding. Loans/Deposits ratio remained at 70% in Turkey, while the same ratio was over 100% in many markets
    - Moreover, loan growth was achieved with effective risk management and prudent lending policies. Consequently, non-performing loan ratios remained relatively low.
- Extensive FX borrowing had created significant risks in other countries while FX borrowing in Turkey was retained at relatively low levels.
- High capital adequacy ratio well above targeted minimum of 12% has cushioned Turkish banks' balance sheets against risks.
- The sector operated under a superior regulatory and supervisory framework as compared to its peers.
- Moreover, macroeconomic policies of the Central Bank were also effective in mitigating the effects of the global economic crisis.

2.2. The Measure Taken by CBRT and BRSA during the Crisis

In response to the problems in the global credit markets governments and central banks have taken several measures to avert or at least contain the adverse effects of the global financial turmoil on their economies and financial markets. In this context, a series of measures were adopted by the Turkish authorities and organizations to ease the negative effects of the global financial crisis on Turkey. Within this framework the CBRT took the following measures (Yılmaz,2009:20-22; TBAT,2009a:2; TBAT,2009b:I-4):

- Resumed its activities as an intermediary in the foreign exchange deposit market until the removal of uncertainties in international markets;
- Raised its transaction limits by twice to USD 10.8 billion and extended the lending maturity to 1 month from 1 week in the foreign exchange deposit market;

- Adopted a strategy to use foreign exchange reserves to primarily support the foreign exchange liquidity need of the banking system.
- The reserve requirement ratio was unchanged at 6 percent in TL liabilities, but it was lowered to 9 percent from 11 percent in foreign exchange liabilities. With this measure, the CBRT provided an additional liquidity of USD 2.5 billion to the banking system;
- Increased the exports rediscount credit limit by USD 500 million to USD 1 billion in order to contain the effects of the crisis on industry sectors. Additionally, the rules and principles applicable to the exports rediscount loan limit were rearranged for rendering the use of these loans easier.

The BRSA adopted certain measures aimed at preserving the financial strength of banks and containing the effects of abrupt changes in the financial asset prices on banks' capital adequacies. For this purpose, the BRSA (TBAT,2009a:3):

- Required banks to get permission for distribution of the 2008 earnings;
- Allowed banks to reclassify the securities in their balance sheet from trading portfolio to investment portfolio for once only;
- Allowed banks to restructure the loans apparently posing no problems in order to ensure smooth functioning of the loan relations between banks and non-financial institutions.

The Government sought authorization from the Parliament for increasing and determining for a period of two years the deposit insurance coverage, which was TL 50,000. CBRT cut its interest rates and extended the maturity in foreign exchange deposit market in order to prevent a possible foreign exchange squeeze in the financial market. Additional measures were continued to be implemented also by various organizations in 2009 as the global volatility continued to affect the markets (TBAT,2009a:3-4).

3. CONCLUSION

Turkish financial system, which was reinforced in the light of the past experience, helped curb the impact of the global crisis that emerged in the second half of 2007 on Turkish financial markets.

Turkish Banking Sector has been less affected by the crisis because of after 2000 and 2001 crises, gaining the banking sector stronger capital structure and stronger equity capital structure as a result of taken structural measures and improvements; the absence of a functioning mortgage sector such as America; several structural and fundamental features of the sector itself; the macroeconomic policies of the CBRT; effective supervision and regulation of the BRSA; and some additional measures taken by banks in the process of the global economic crisis.

Turkish Banking Sector yet has a significant potential for growth in addition to its higher performance as opposed to its peers. Penetration indicators are too low when compared to developed markets. Some basic financial products that have significant revenue generation potential are still in development phase in Turkey. Furthermore, population that is unbanked and potentially bankable in the medium term is sizable. Considering Turkey's population, economic potential and power, per capita deposit and per capita loan figures, the Turkish banking sector is still in a development process and it has further growth potential.

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