



TÜRKİYE CUMHURİYET  
MERKEZ BANKASI

# Financial Development with Financial Stability

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# Outline

- I. Financial Development and the Associated Policy Trade-Offs
- II. Perspectives from the Turkish Experience

# I. Financial Development and the Associated Policy Trade-Offs

# Financial development is a multi-dimensional concept.

- **Different dimensions of financial development:**
  - Financial depth (credit deepening)
  - Access to financial services
  - Intermediation costs
  - Stability of intermediation (non-performing loans)
- **Policies that affect the pace of financial development are multi-dimensional as well:**
  - Fiscal performance (low public borrowing requirement)
  - Monetary policy performance (low and stable inflation)
  - Legal-structural reforms and banking regulations
  - Financial and trade openness
  - Financial literacy
- **Where do financial-stability-oriented policies come into play?**

# Financial development: "Too much" of a good thing might be harmful.

- **Finance and Growth Nexus**

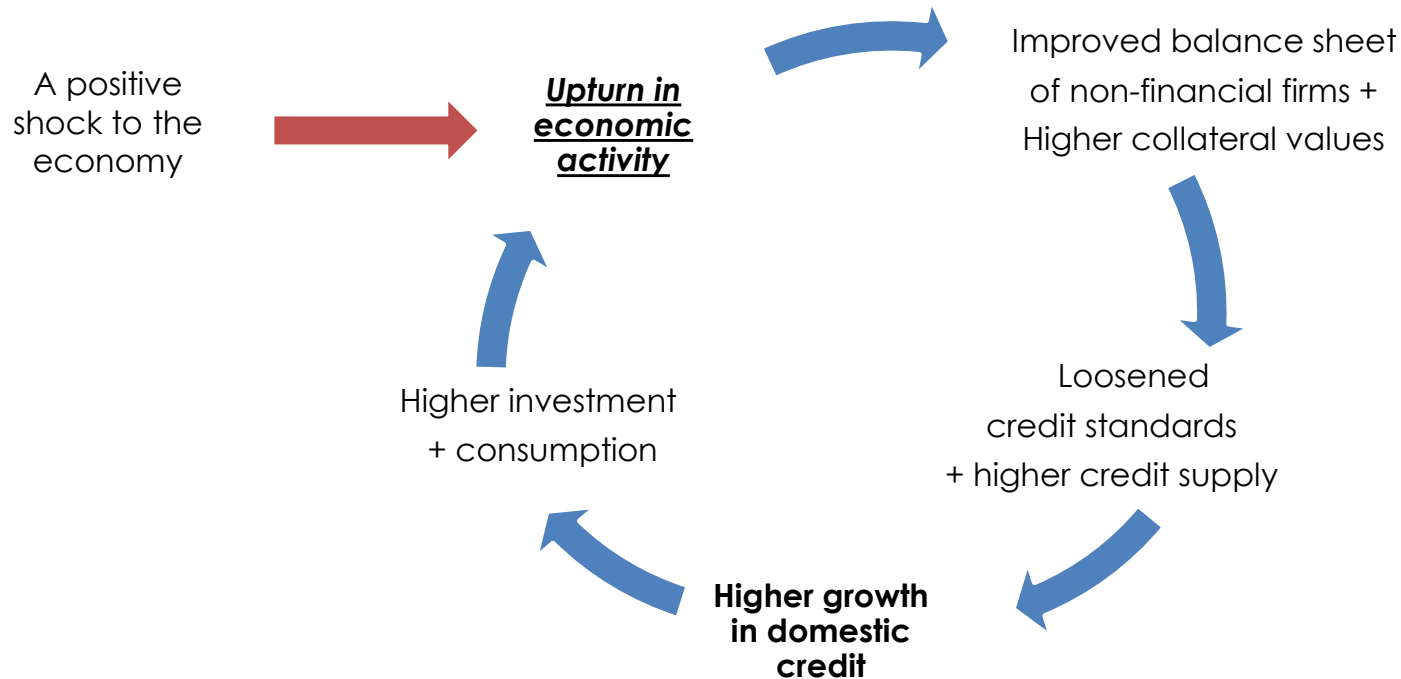
- Financial development promotes capital accumulation and growth especially in an emerging economy with low domestic savings.

- **Credit Booms and Financial Fragility**

- However, rapid credit booms might leave the entire economy more vulnerable to tail events.
- Need to formulate policies that ensure a healthy pace of financial development.

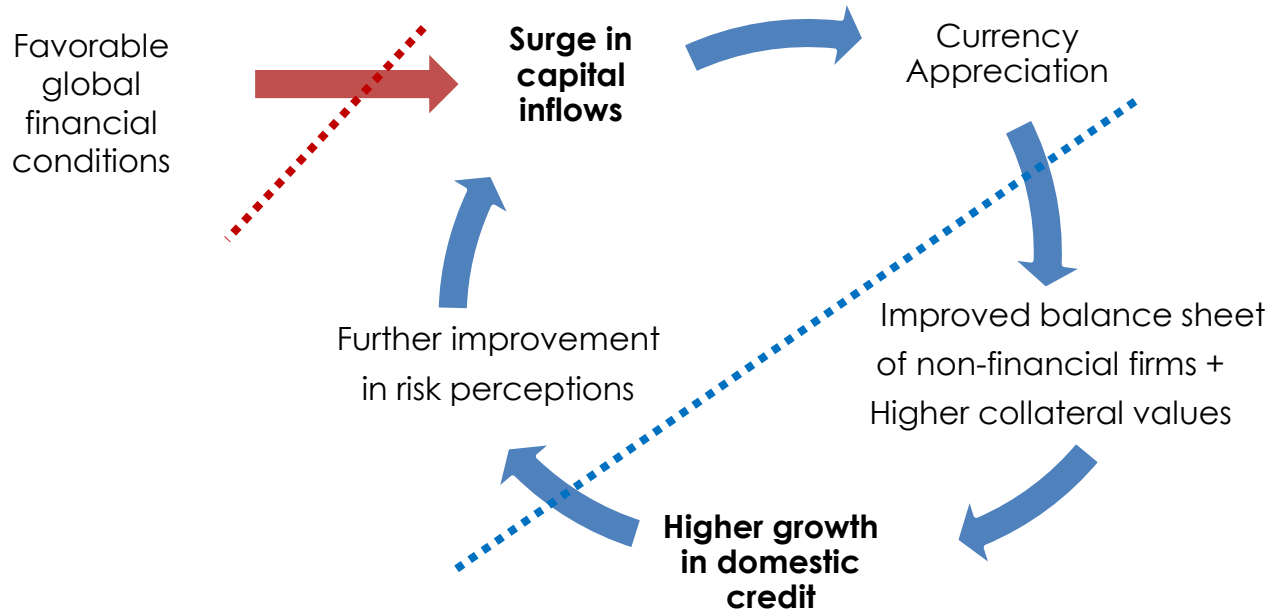
# Taming the financial cycle is important for financial deepening to be permanent.

## Financial Amplification Mechanism



- Opposite cycle happens at downturns bringing a sharp drop in Credit/GDP and leading to a crisis.
- Need to take timely, well-targeted and coordinated policies to tame the financial cycle.

# EM Perspective: Capital flows might amplify the financial cycle....



- Need to take timely, well-targeted and coordinated policies to reduce the sensitivity of:
  - **capital inflows to global financial conditions**
  - **domestic credit cycles to capital inflows**

...adding an extra layer of complication to the policy design problem.

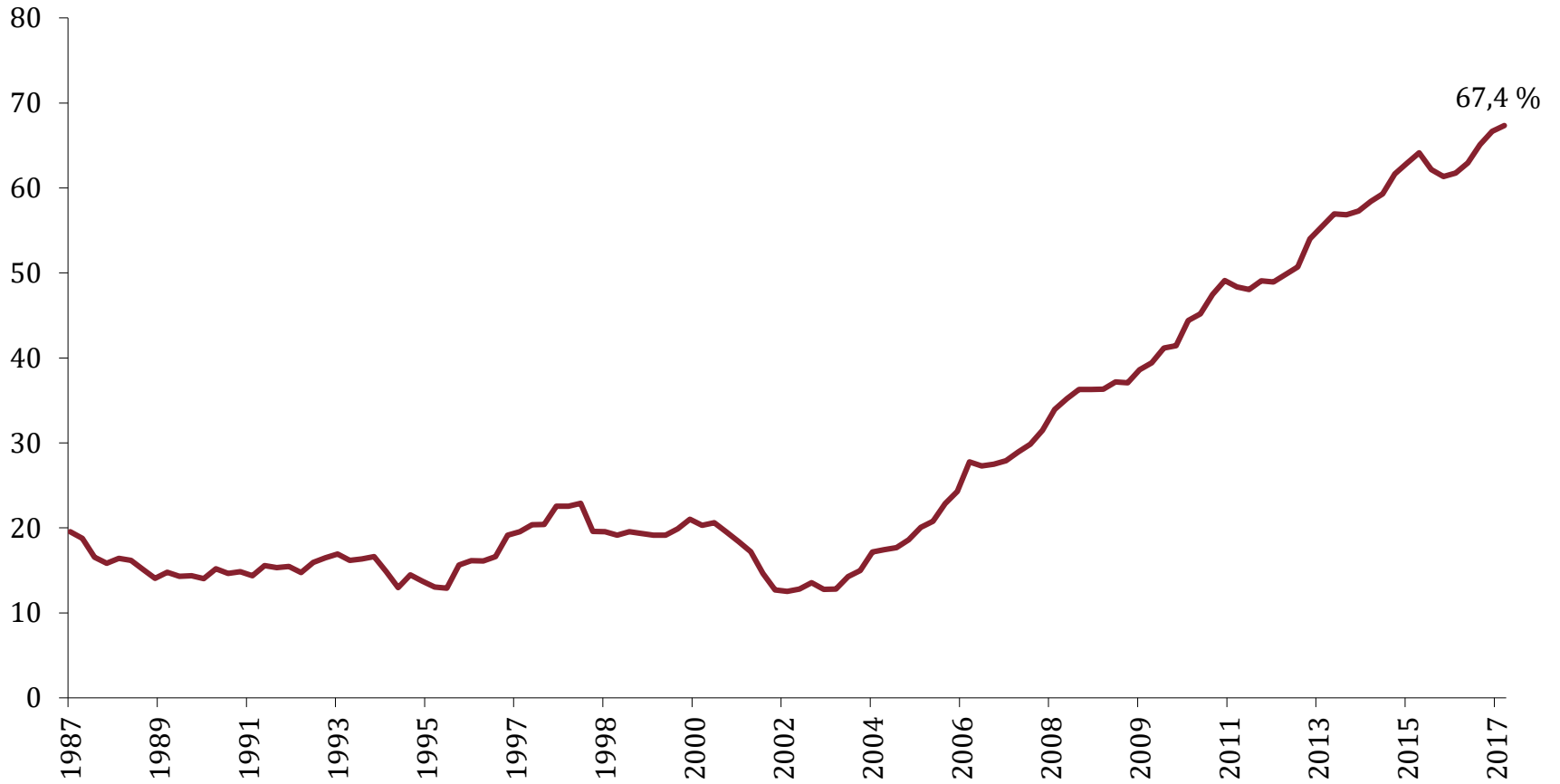
- Significant progress has been made in understanding the perimeter and the effectiveness of macro-financial stability tools in recent years.
- **Key ingredients to consider:**
  - Formulation
  - Assessment
  - Leakages
  - Communication
  - Coordination



## II. Perspectives from the Turkish Experience

# Turkey has gone through a rapid financial deepening process starting in early 2000s...

**Domestic Credit Stock/GDP\***  
(Percent)

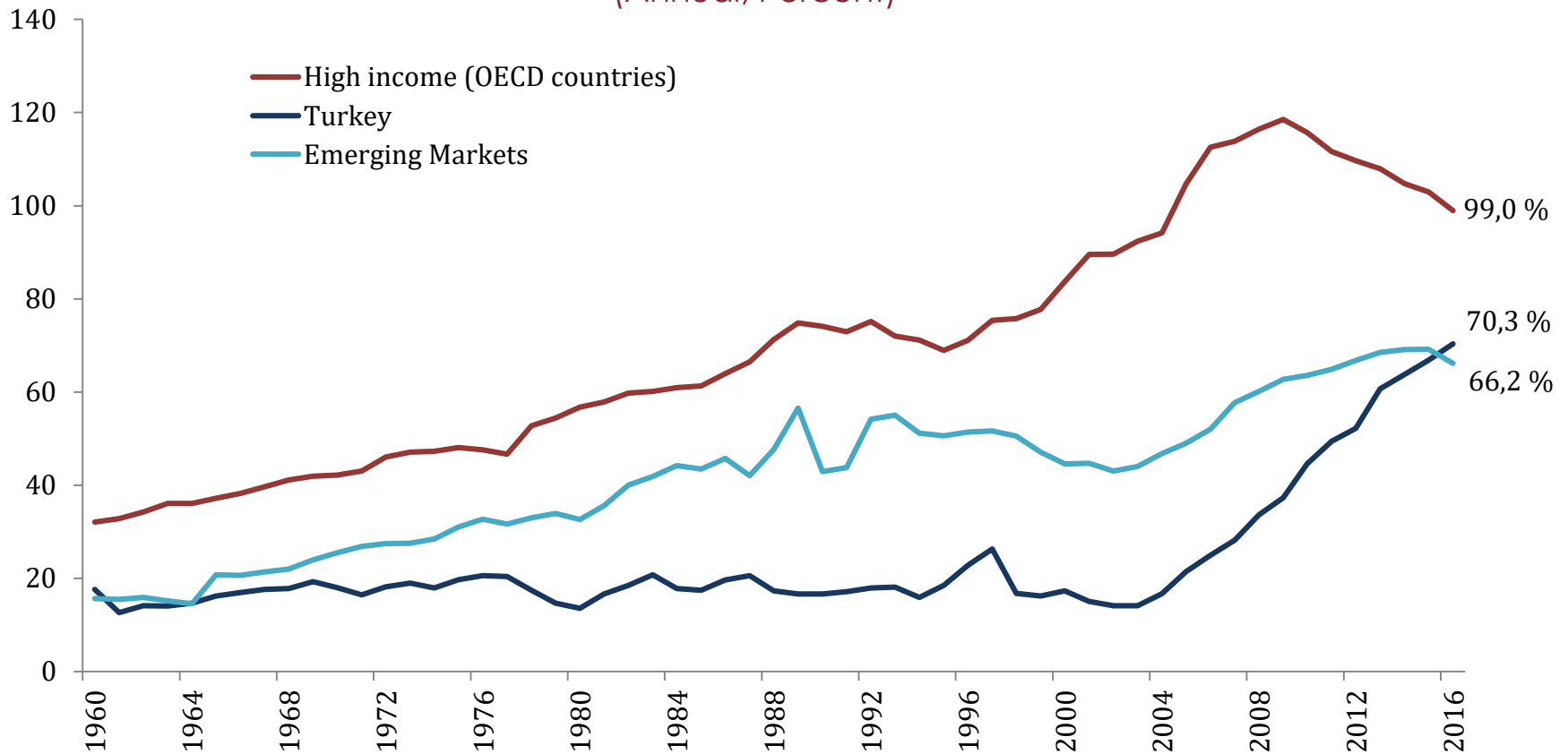


Source: CBRT, TURKSTAT.

\* Last observation for GDP is for 2017Q2.

...quickly catching up with peer emerging economies.

### Domestic Credit Stock/GDP (Annual, Percent)



Source: World Development Indicators.

# Structural reforms paved the way for the acceleration in financial deepening.

- Major structural changes following the 2001 crisis:
  - **New monetary and exchange rate policy framework**
    - ✓ Flexible exchange rate regime
    - ✓ New Central Bank Law
    - ✓ Price-stability-oriented monetary policy
  - **Banking sector reform**
    - ✓ Recapitalization and restructuring of state banks
    - ✓ Establishment of Banking Regulatory and Supervisory Agency (BRSA)
  - **Public sector reforms**
    - ✓ Social Security Reform
    - ✓ Reforms to enhance competition
  - **Strong emphasis on fiscal discipline**

Risk premium and real interest rates fell in tandem with inflation and public debt, all contributing to financial deepening.

### Credit Default Swap (CDS)

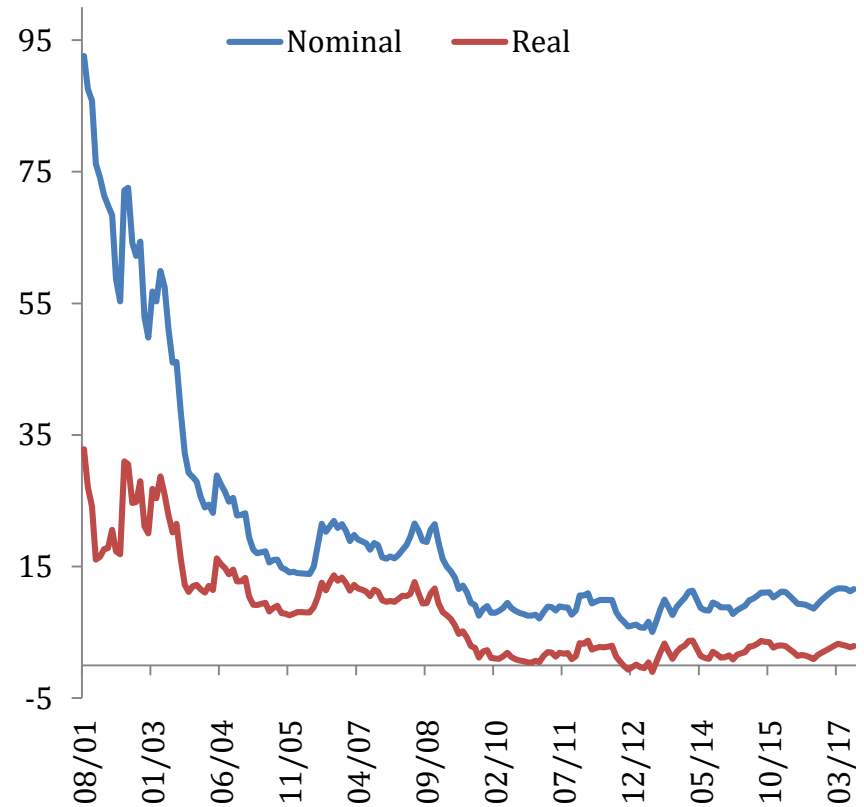
(5-year, Basis Points)



Source: Bloomberg.

### Treasury Bill Rate

(Annual Average, Compound)

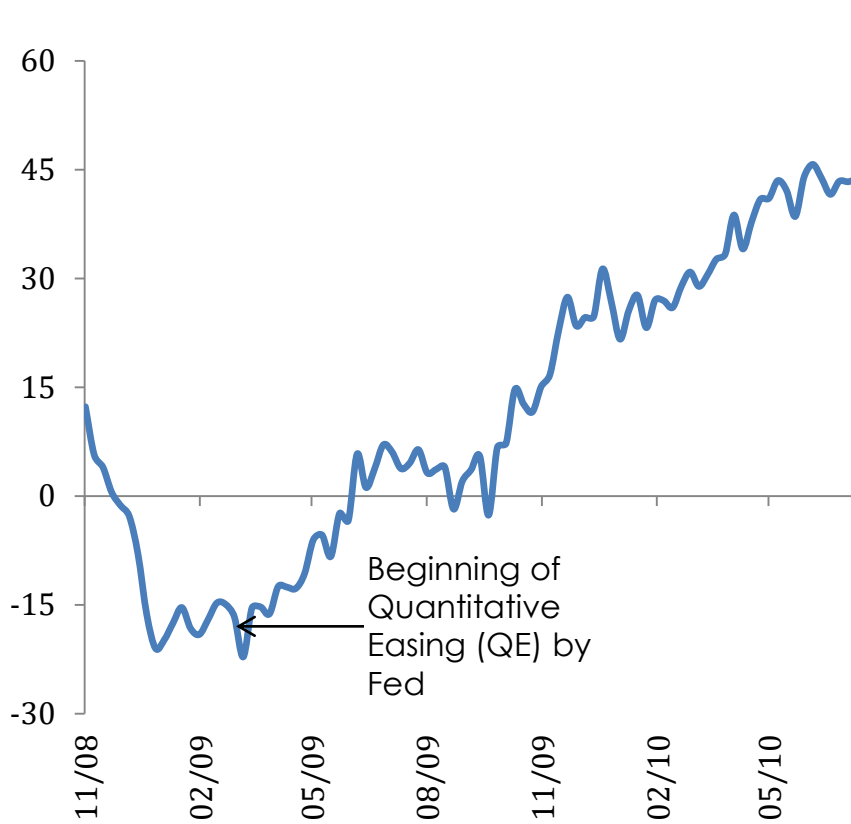


Source: Bloomberg.

# Towards the road to the introduction of financial stability tools

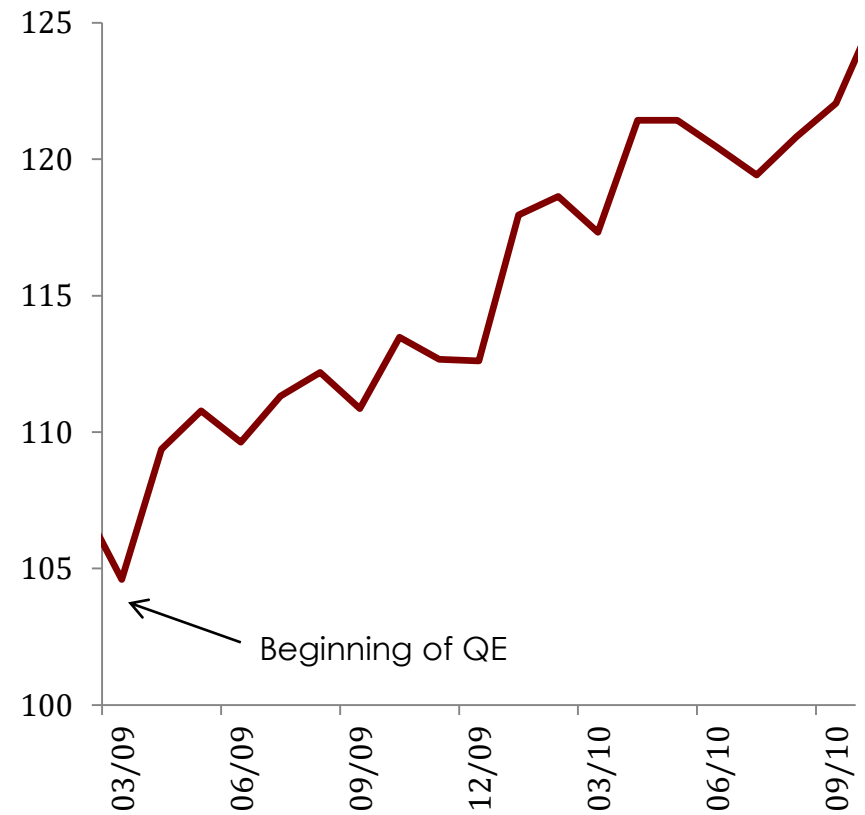
# Credit growth accelerated due to strong capital inflows in the aftermath of the global financial crisis.

**Total Loan Growth Rates**  
(13 Weeks Moving Average,  
Annualized, FX Adjusted, Percent)



Source: CBRT

**Real Exchange Rate**  
(2003=100)



Source: CBRT

# Widening in the current account deficit, financed with short-term inflows called for an immediate policy action.

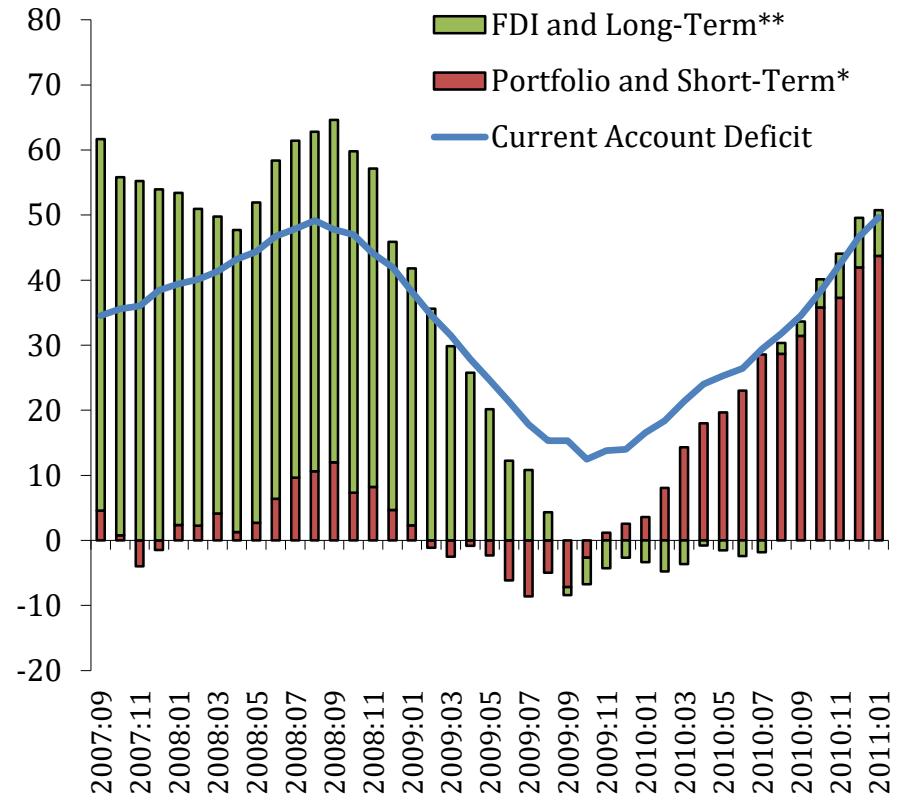
## Current Account Balance

(Seasonally Adjusted, Quarterly Average, Billion USD )



## Main Sources of External Financing\*

(12-months Cumulative, Billion USD)



Source: TURKSTAT, CBRT.

\*Short-term capital movements are sum of banking and real sectors' short term net credit and deposits in banks.

\*\*Long-term capital movements are sum of banking and real sectors' long term net credit and bonds issued by banks and the Treasury.

Source: CBRT.



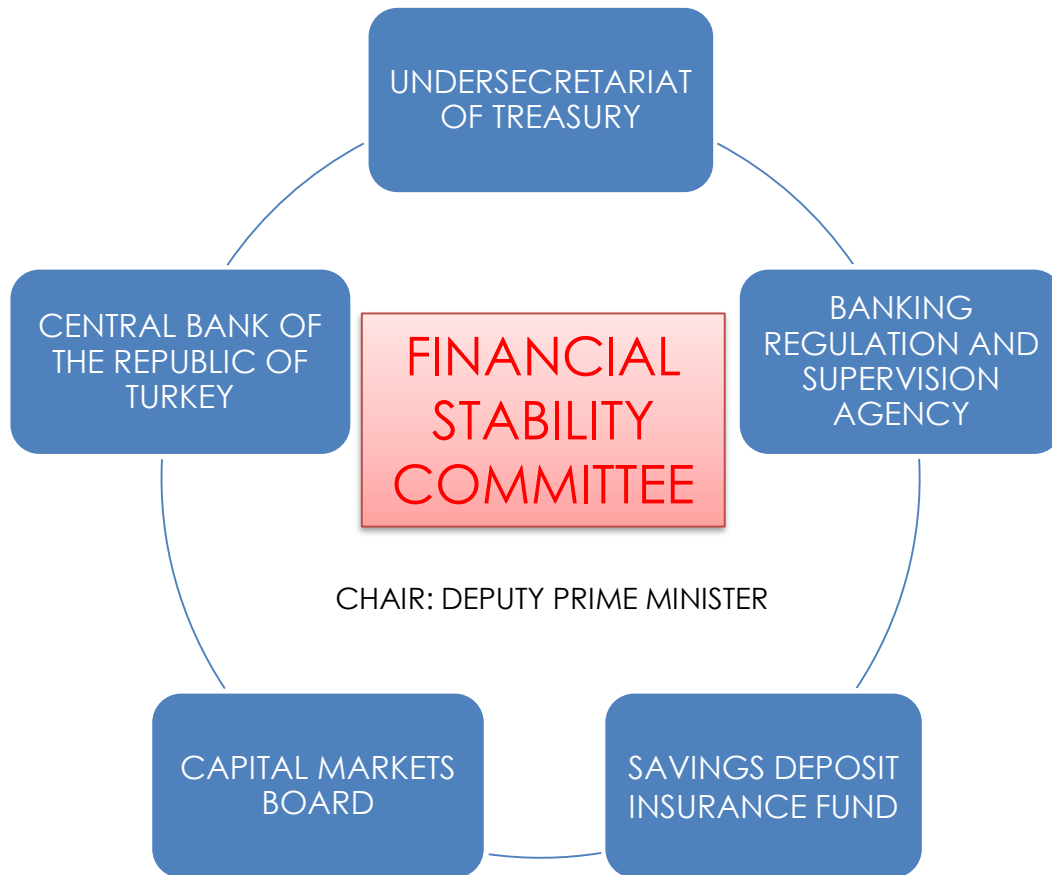
# Macroprudential Policy Design

Starting from 2010, Inflation Targeting (IT) is augmented with a financial stability objective.

- **2006-2010:** Conventional Inflation Targeting
- **2011-2016 April:** Financial Stability and IT
- **2016 April to date:** Strengthened focus on the price stability with a structural emphasis and coordination

Financial Stability Committee (FSC) was established to ensure coordination in macroprudential policy (MaP) framework.

## Organization Structure



- Founded in June 2011.
- Enhances information sharing, coordination and cooperation.
- Main duties are to assess the systemic risks, identify necessary measures, and make relevant policy recommendations.
- No decision power or tools; the power rests with the authorities represented in the Committee.
- Each institution has its own mandate and responsibility.

# Turkey has gone through three main phases of macroprudential regulation to smooth credit cycle

## **First Round (2011)**

- Higher risk weights and provisions for consumer loans.
- Limits to credit card payments
- LTV cap for housing loans

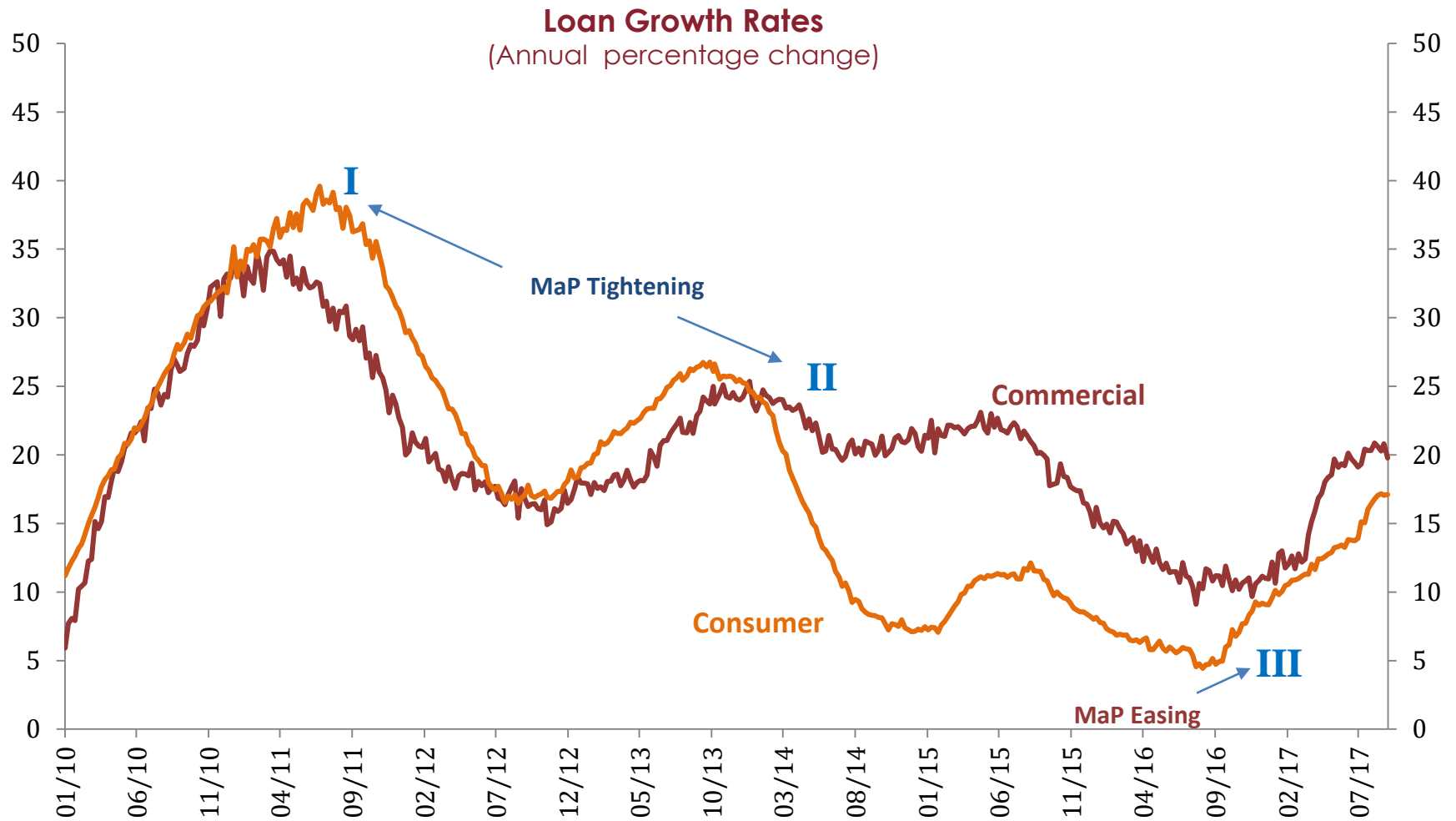
## **Second Round (2013-2014)**

- Caps, limits, and higher risk weights on credit cards
- Maturity restrictions (36 months) for uncollateralized consumer loans
- LTV cap for vehicle loans

## **Recently (end-2016)**

- Reversal of MaP, and introduction of Treasury-backed credit guarantees

# Macprudential policies have succeeded in smoothing credit cycles...

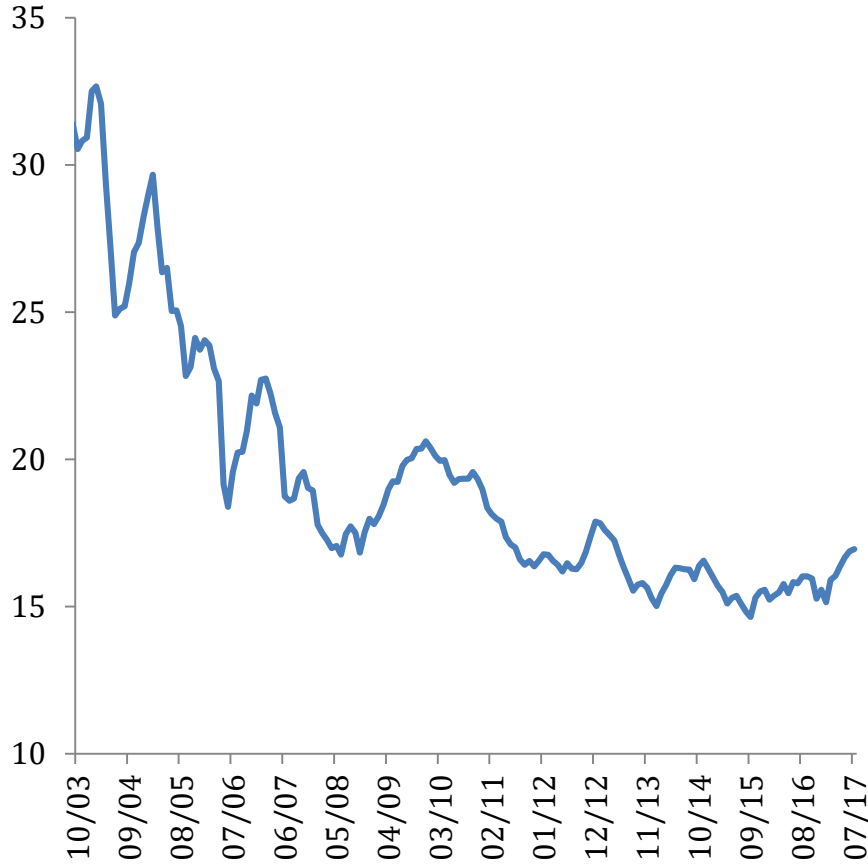


Source: CBRT.

Inclusive of loans extended by all types of banks (deposit banks, Participation banks, and development/investment banks). FX adjusted.

...while banking sector has been kept well-capitalized and liquid,...

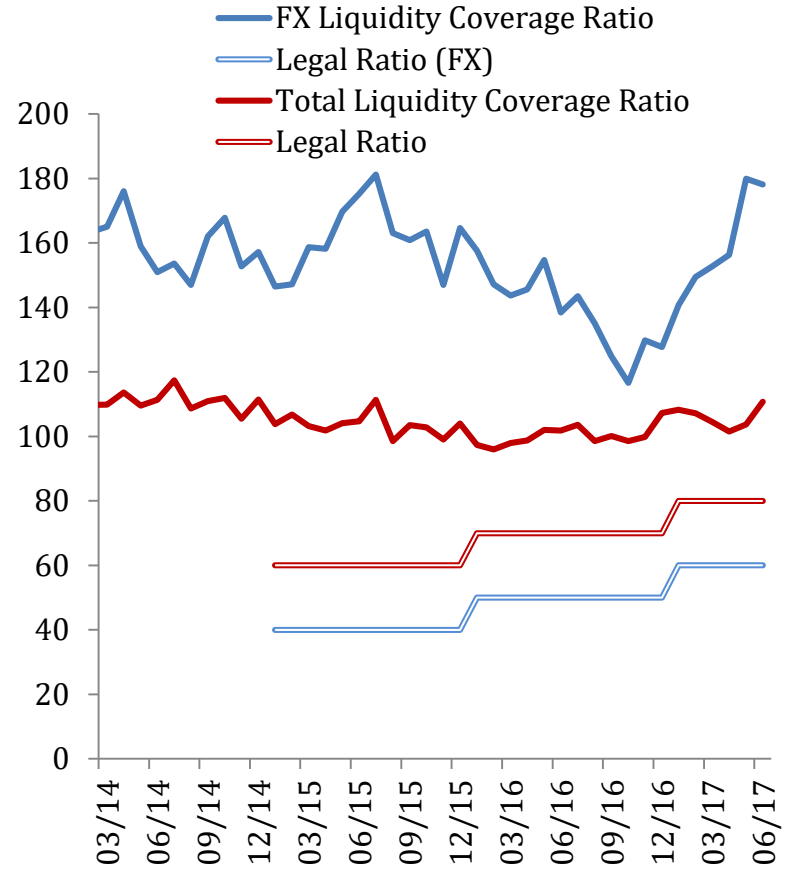
**Capital Adequacy Ratio**  
(Percent)



Note: Capital Adequacy Ratio: Bank capital-to-risk-weighted assets ratio.

Source: BRSA.

**Liquidity Coverage Ratio**  
(Percent)

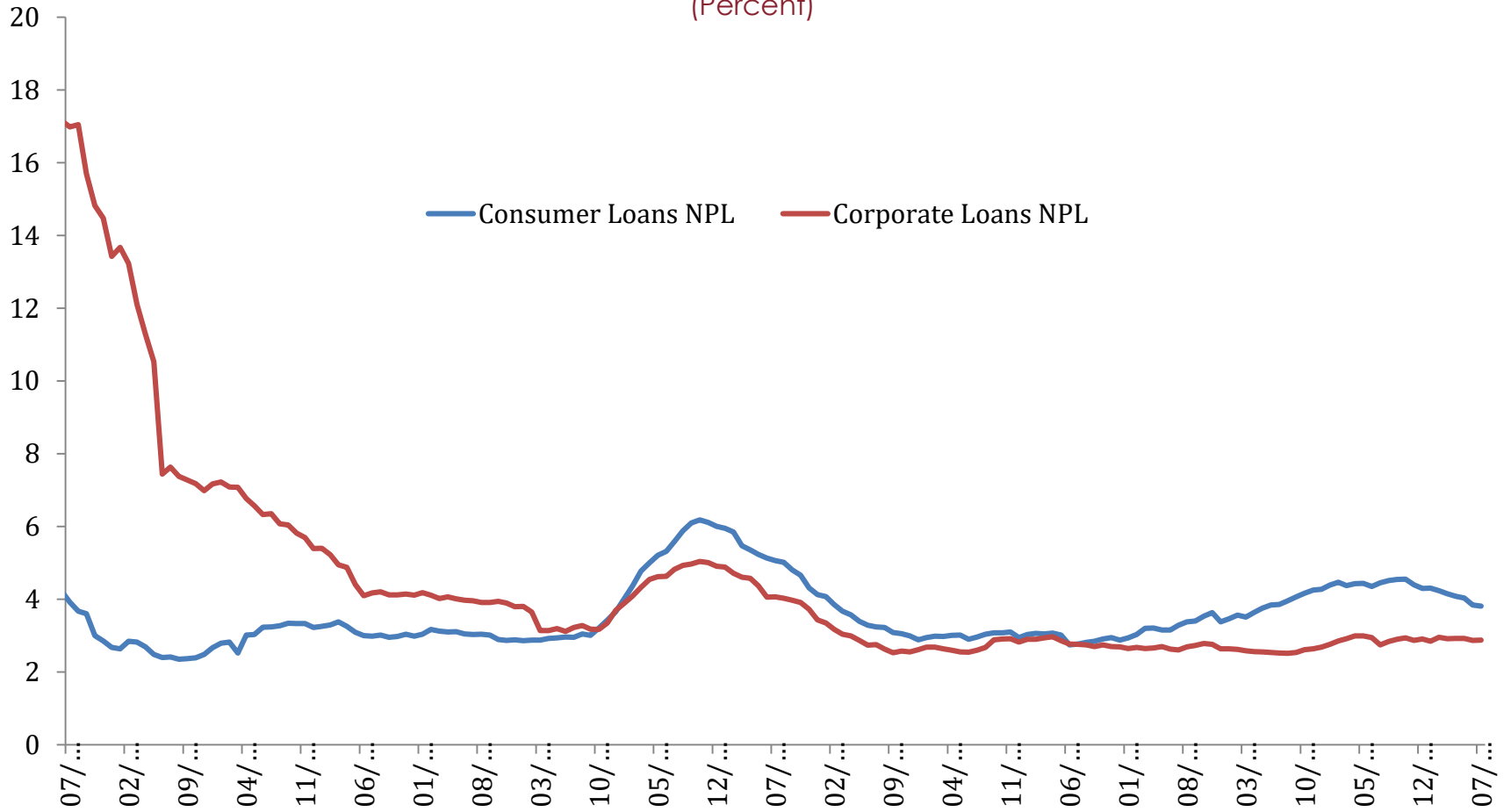


Note: Excluding development and investment banks. Based on non-consolidated reportings.

Source: BRSA.

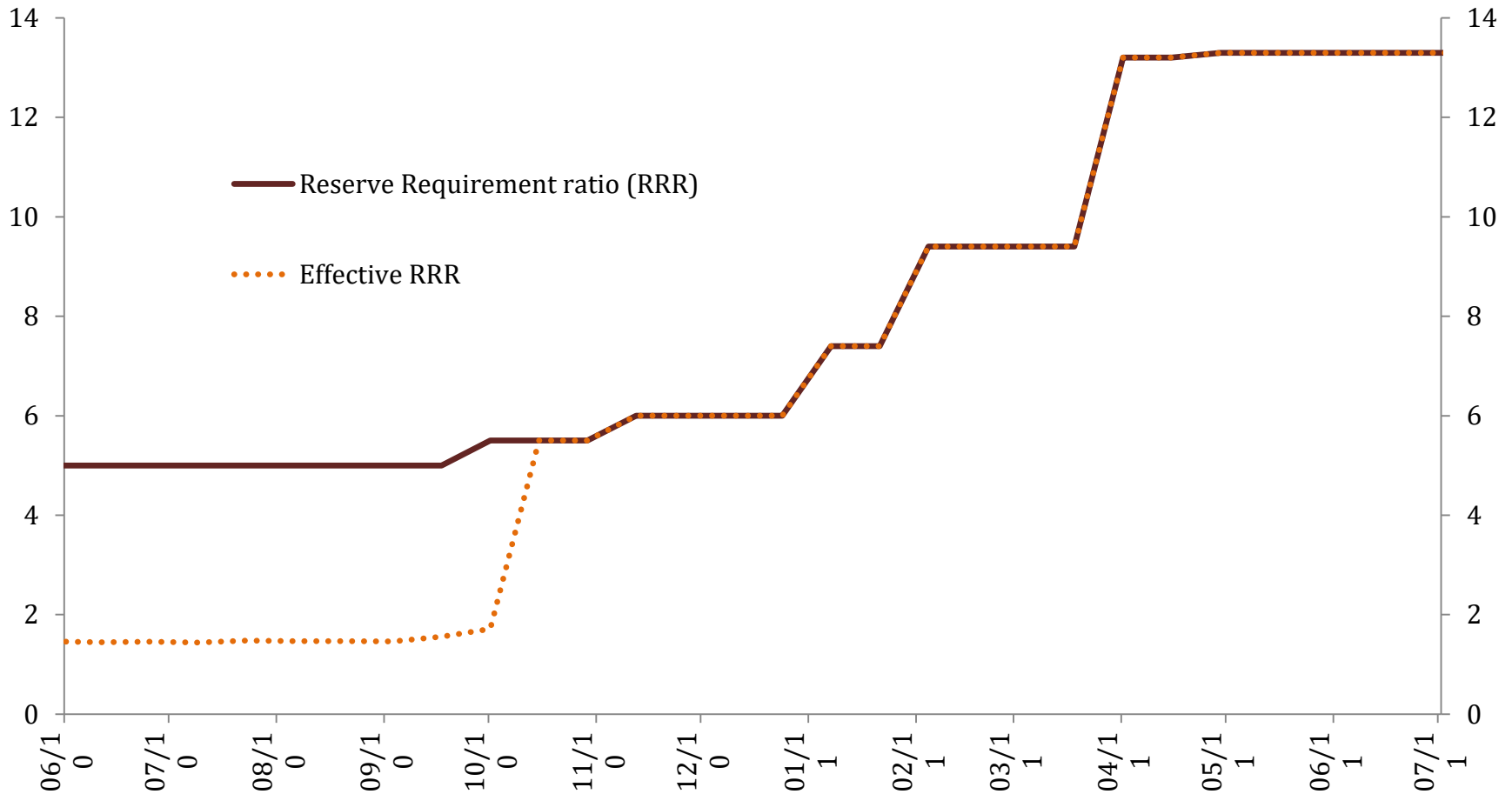
... with stable and relatively low non-performing loan ratios.

### Non-Performing Loans (NPL) (Percent)



Source: BRSA.

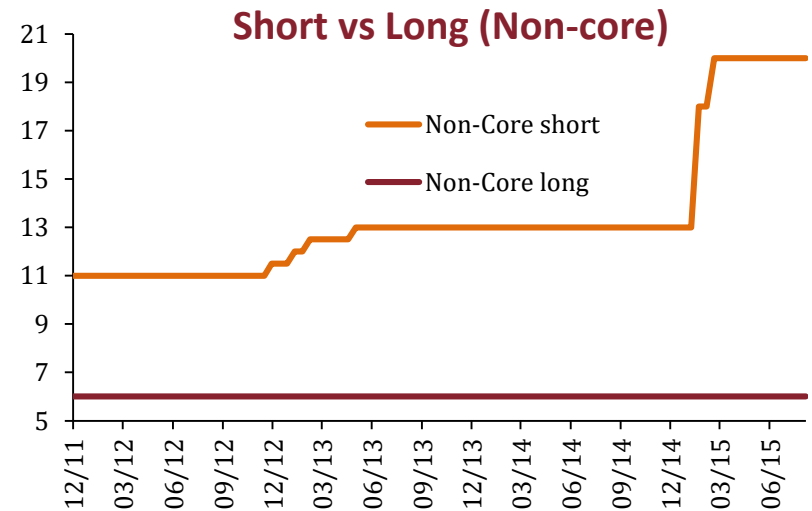
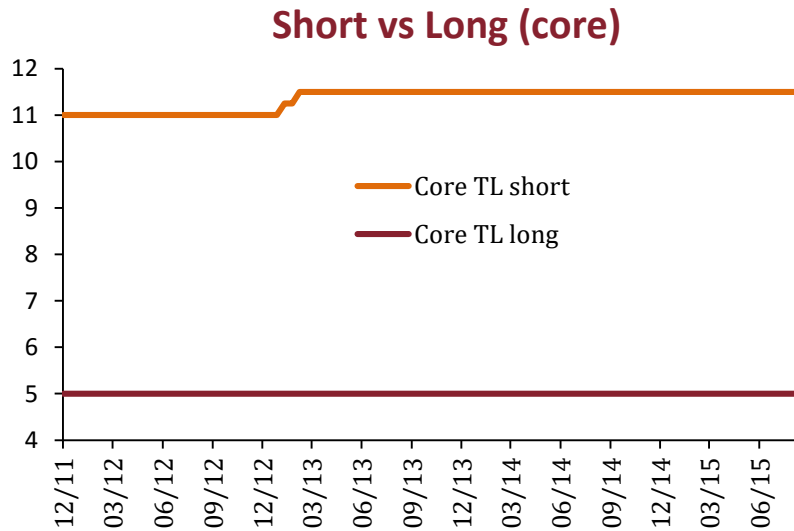
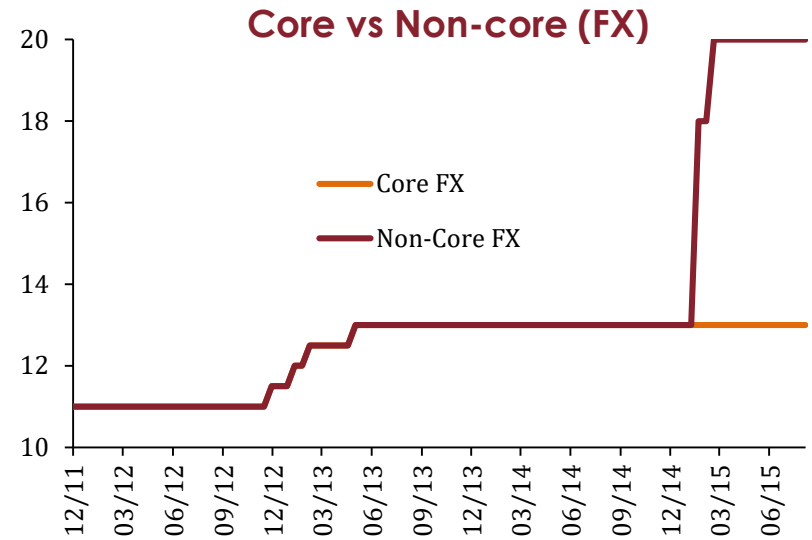
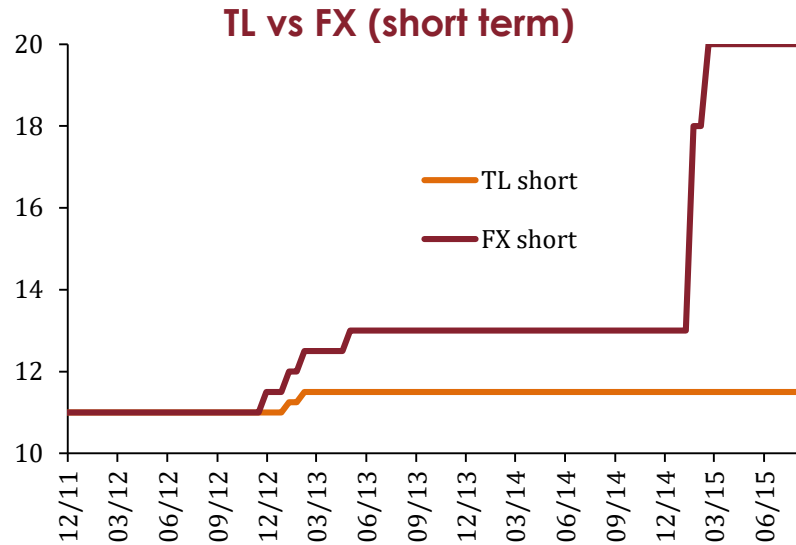
# Required Reserve Ratios (RRR) were actively used to curb excessive credit growth ...



Source: CBRT.

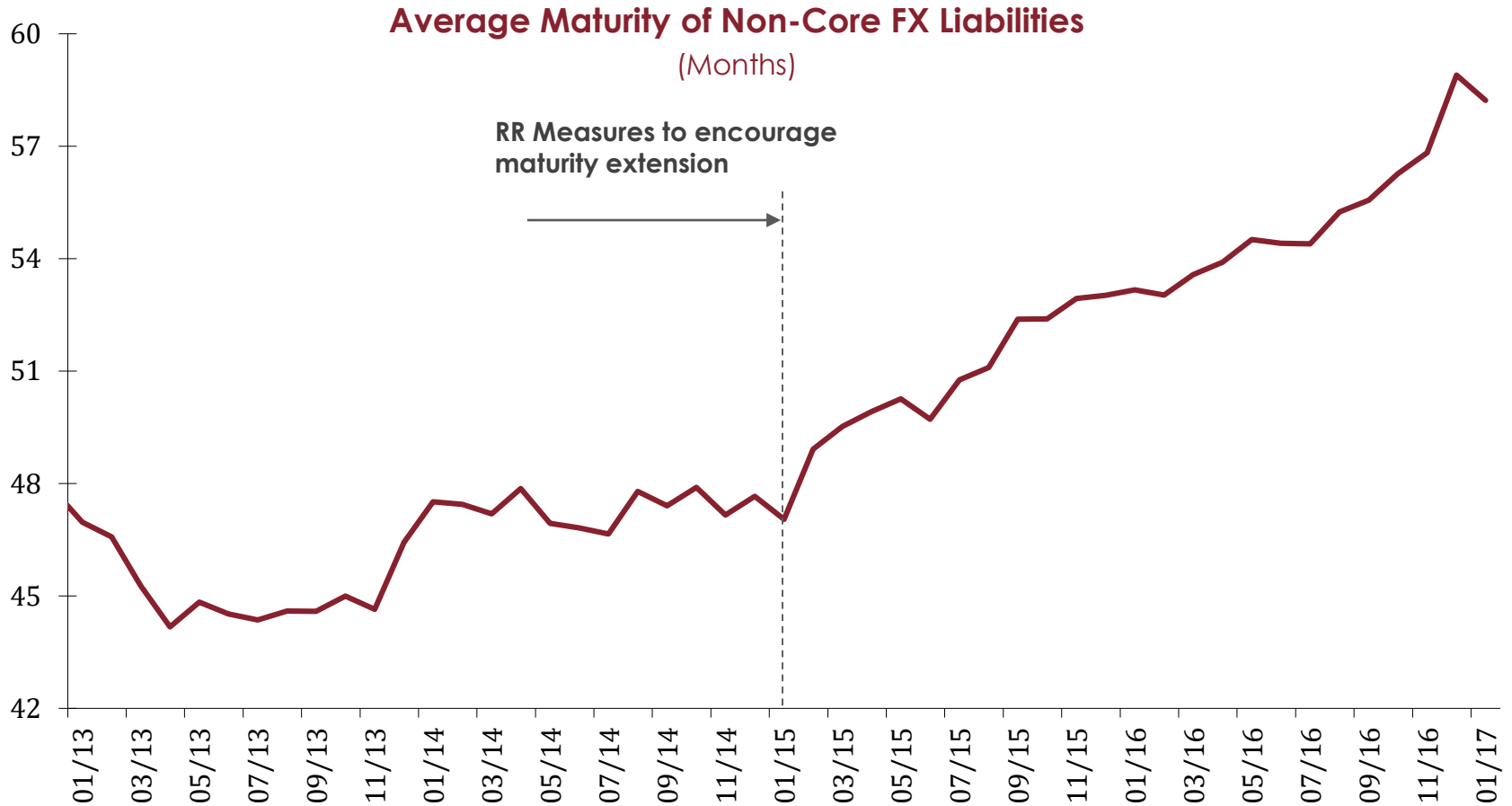


... and to ensure prudence by banks in several dimensions.



Source: CBRT.

...as a result of which maturity of banks' external liabilities has increased considerably.

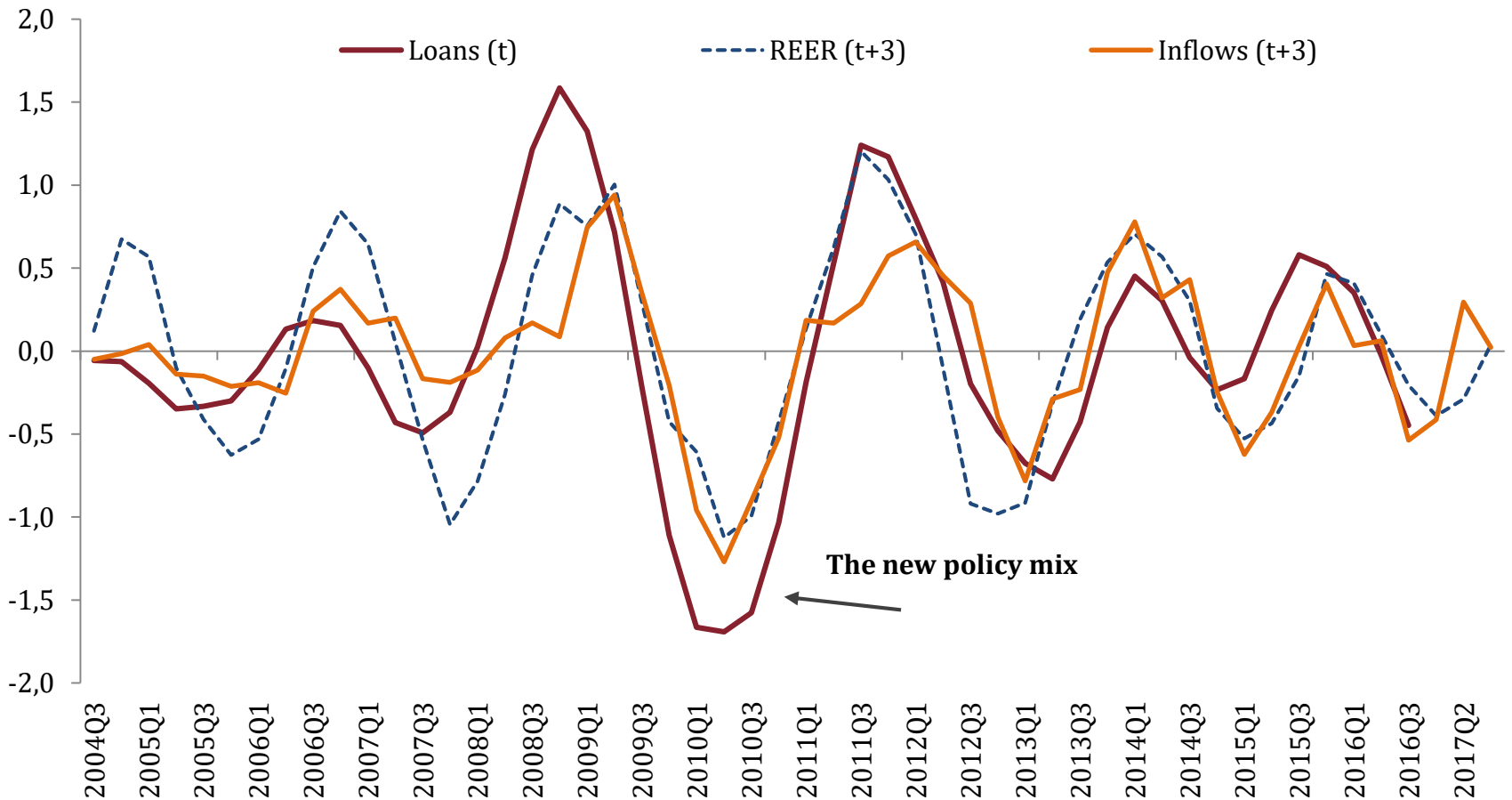


Source: CBRT, CMB, PDP

The interaction between capital flows, exchange rate and bank loans have been dampened since the implementation of MaPs.

### Capital flows, Exchange Rate and Credit Cycles

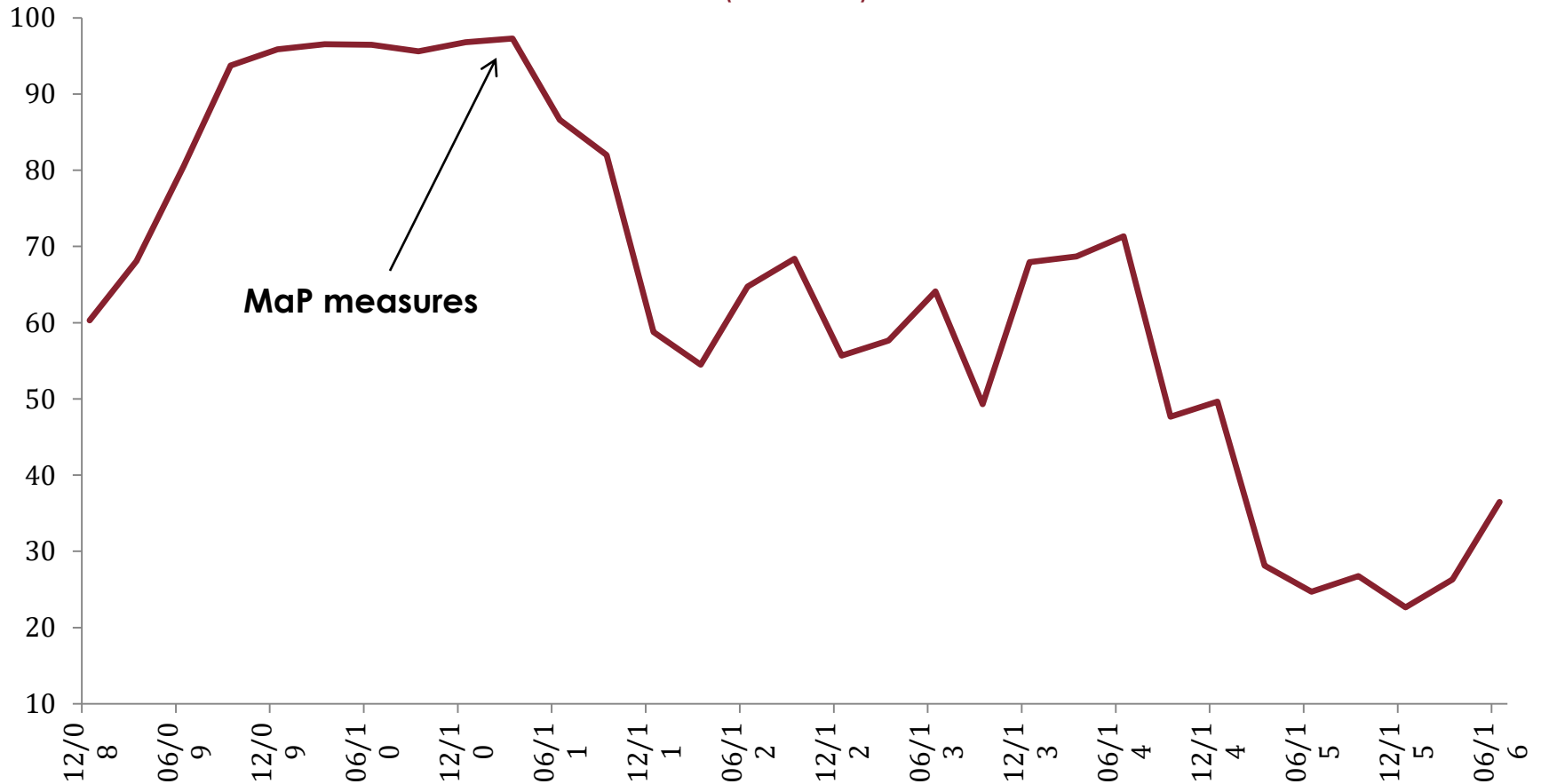
(HP filtered, standardized)



Source: Kara, Özlü and Ünalımsı (2015)

The contribution of global factors to Turkey's monetary and financial conditions have declined after the implementation of MaP policies.

### Share of Global Factors\* in Explaining Turkey's Financial Conditions (Percent)



\*Global Factors are VIX, global growth, US treasury 10-year yield and 10-2 year spread.

Source: Kara, Özlü and Ünalmiş (2015)

# Final Remarks

- Well-targeted and coordinated financial stability policies help support long-run financial development.
- Central banks may contribute by:
  - Deploying the tools at their disposal (e.g. Multiple RRRs, ...)
  - Formulate well-targeted policies to directly address the structural issues and facilitate coordination between relevant parties.

while keeping the main focus on price stability.



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# APPENDIX

# Macroprudential Policies



# Macroprudential Measures (Timeline)

<u>Measure</u>	<u>Description</u>	<u>Adoption Date</u>
Dividend Policy	Requires banks to seek approval from the BRSA before distributing dividends. The maximum dividend payout for CAR>18 percent is 20 percent, for 18 percent<CAR<16 percent is 15 percent and for 13 percent<CAR<16 percent is 10 percent.	October 2008; extended in 2010 and 2011
Restrictions on FX lending	Allows non FX-earnings companies to borrow in FX from local banks (previously, only FX-earning companies could borrow FX), provided FX loan amount is greater than US\$5 million and maturity date is longer than a year; bans consumers from taking out FX-linked loans.	June 2009
Loan-to-value (LTV) ceilings	Implements loan-to-value ceilings on housing loans to consumer (at 75 percent) and on purchases of commercial real estate (at 50 percent).	December 2010
Guidance to Cap Credit Growth	The authorities provided guidance to banks that credit growth (adjusted for FX movements) in 2011 should not exceed 25 percent.	Spring 2011
Higher risk weights for consumer loans	Higher risk weights introduced for fast growing consumer loans. For new general purpose loans with maturities below two years, the capital adequacy risk-weight is increased to 150 percent (from 100 percent). For new general purpose loans with a maturity greater than two years, the risk-weight is increased to 200 percent (from 100 percent).	June 2011
Increased provisions for consumer loans	For new (performing) general purpose standard loans (Group 1), general provisions were increased from 1 percent to 4 percent. Specific provisions for closely followed up loans (Group 2) increased from 2 percent to 8 percent. The higher provisioning requirements are for banks having a consumer loan portfolio exceeding 20 percent of total loans or having a general purpose loan NPL greater than 8 percent. If there is a restructuring of the loan allowing maturity extension a minimum of 10 percent provisioning is required.	June 2011
Limits to credit card payments	If three or more monthly payments within a calendar year are less than half of the outstanding balance for the period, the individual credit card limits cannot be increased and cash advances for such credit cards cannot be permitted, unless the outstanding balance for the period is fully covered.	June 2011

# Macroprudential Measures (Timeline)

<b><u>Measure</u></b>	<b><u>Description</u></b>	<b><u>Adoption Date</u></b>
Changes to minimum Capital Adequacy Requirements	Amended by the BRSA in September 2011 to apply to banks with foreign strategic shareholders as of January 2012. The minimum ratio would depend on various factors such as the CDS spread of the parent and its sovereign, EBA stress test results and the public debt ratio in the country of origin.	September 2011
Some sectoral measures for provisions	Determining higher provisions by the BRSA taking into account the riskiness of the particular sectors .	September 2012
Differentiation of Tax Rate for Interest Income of Deposits	Amended by cabinet decision (01.01.2013) to differentiate 15 % tax rate taken from interest income of deposits according to maturity of the deposit. New tax rates are as follows: In TL deposits rates are 15% for 6 months, 12% for 6 - 12 months and 10% for more than one year. In FX deposits rates are 18% for 6 months, 15% for 6 - 12 months and 13% for more than one year.	January 2013
Differentiation of Resource Utilization Fund Rates	Amended by cabinet decision (01.01.2013) to differentiate resource utilization fund rate taken from credit users. New rates are as follows: 3% for loans given for less than one year, 1% for loans given for 1 - 2 years (before it was 0%), 0,5% for loans given for 2 - 3 years (before it was 0%) and 0% for loans given for more than 3 years.	January 2013
Withdrawal from a time deposit account before maturity	Depositors can withdraw half of their time deposits at most two times without losing interest income if maturity of their account is one year and longer. For cumulative deposit account, the same process is valid if half of the amount is withdrawn at most three times.	January 2013
Leverage, capital buffers, capital adequacy	BRSA has issued the several regulations within the framework of the harmonization process for Basel III on leverage, capital Conservation and countercyclical capital buffers	January 2014
Measures on credit card usage and consumer loans	The scope of the incremental provision ratios increased for consumer loans. Risk weights of receivables from credit cards and long-term automobile loans that were used in calculating capital adequacy ratios were increased. The minimum payment ratio for credit cards increased, card limits reduced for the first time users and lower income group.	January 2014