

ACTIVE ACADEMY - RISK MANAGEMENT SUMMIT  
MARCH 5, ISTANBUL

OPENING REMARKS BY ULRICH ZACHAU

- Distinguished guests and participants. Good morning.
- It is my pleasure to be here today for this year's Risk Management Summit. Recent global economic and financial developments make this Summit a very timely initiative. I would like to thank the ACTIVE ACADEMY for hosting it.
- The global economic environment was benign over the last several years, and financial markets were liquid. This **favorable global environment benefited Turkey**. Large capital inflows, both FDI and portfolio flows, helped finance national investment above domestic savings and helped boost economic growth.
- **Today's global economic environment is less favorable**. In the aftermath of the US mortgage crisis, liquidity has tightened in the US and in Western Europe. What does this mean for Turkish financial markets?
- **So far, Turkish financial markets have proven resilient**. This slide shows that the Lira/USD exchange rate, interest rates, money & stock markets have all been broadly stable—until today.

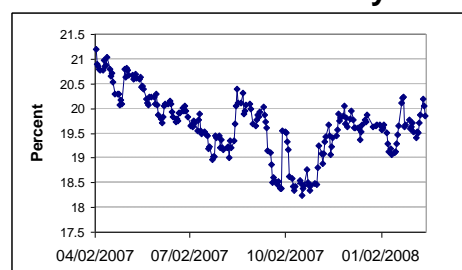
## Turkish Financial Markets 2007-2008



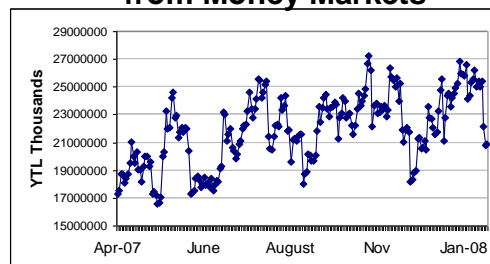
YTL/USD Exchange Rate



Interest Rates: 3-year YTL Government Security



Central Bank Net Borrowing from Money Markets



Stock Market Index (Jan 1986=100)



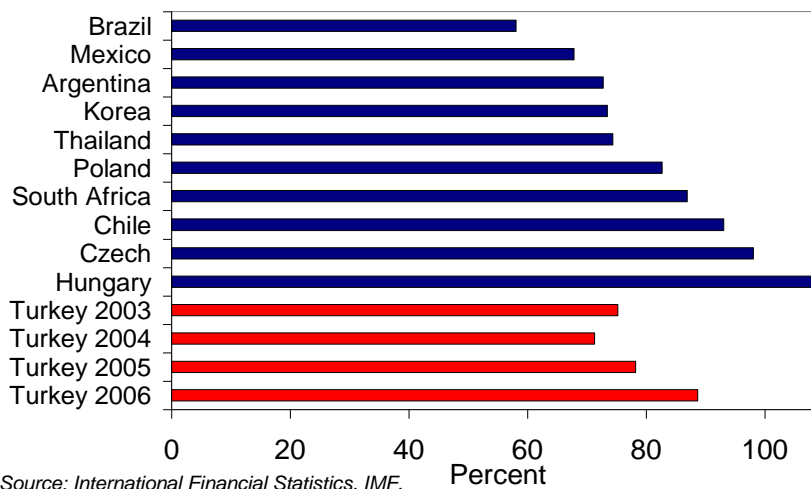
### What are the prospects looking ahead over the near term?

- Prospects are highly uncertain. Nobody knows well the extent of the likely losses from the fall-out of the sub-prime mortgage crisis.
- Many observers believe the global credit crunch will continue for some time.
- **These global uncertainties and risks make it crucial to consider carefully Turkey's reliance on international capital.**
- **Turkey's external debt is substantial. And Turkey has a large structural current account deficit,** because Turkey invests more than it saves.
- **How risky is Turkey's current account deficit? Let's look at 4 questions.**
- **First: how is the current account deficit financed?**

## Foreign Capital & Emerging Markets: Rewards and Risks?



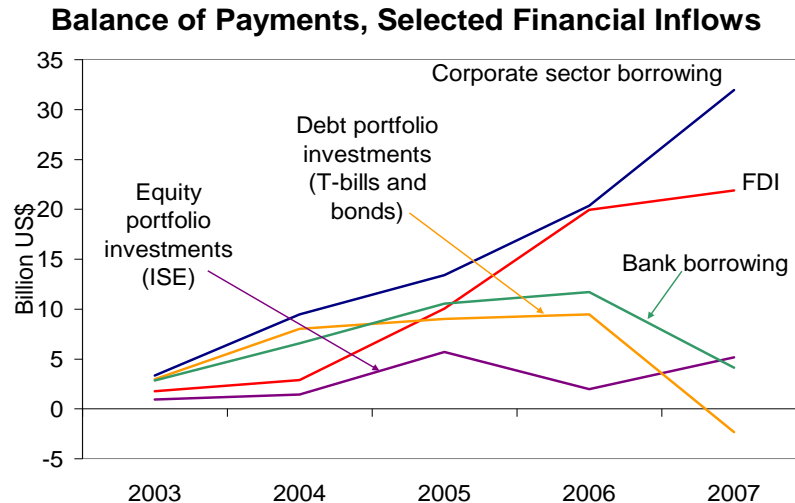
Gross Foreign Non-FDI Liabilities/GDP, 2006



- Turkey has been able to greatly increase FDI. This is a huge achievement.
- Still, foreign capital inflows other than FDI have also increased.
- This picture shows the increase in foreign non-FDI funds as a share of GDP.
- The picture shows that Turkey, like most emerging markets, does rely on foreign non-FDI capital to finance investments.
- This is a good thing, because it helps fund economic growth.
- But it's also a risk—because non-FDI funds are more likely than FDI to leave if investors' confidence in Turkey should deteriorate.

- **A second question is: who bears the risk? Let's look at the composition of capital inflows, which shows us which investor classes bear how much risk.**

## The Corporate Sector Share in Foreign Borrowing is Growing



Source: Central Bank of the Republic of Turkey.

- **Overall, the more risk foreign investors take, the better for Turkey.**
  - *Government securities* carry the least risk for foreign investors.
  - *Lending to banks* involves somewhat greater liquidity and credit risk.
  - *Listed equities on the ISE* carry greater price risk, and *direct lending to firms* involves even greater credit risk.
  - *Foreign direct investment* is a long-term commitment. It is riskiest for the foreign investor, and is best for Turkey from a risk management perspective.
    - Of course FDI is also important for technology adoption, productivity growth, and long-term competitiveness.
- In the slide you can see a **large shift in the composition of foreign capital inflows—and a large shift in the allocation of risk.**
  - Government issues and bank borrowing account for a much smaller share of foreign capital. In 2007, foreigners *sold* Government issues on a net basis.
  - FDI and corporate sector borrowing account for a much larger share of foreign capital today than in earlier years.
  - **As a result, more risk is borne by foreign investors, and the exposure of the financial system to international liquidity events has declined.**

- **Third, let's look at the corporate foreign borrowing—the component that has grown fastest and probably constitutes the most significant risk.**
  - Good data on corporate foreign data are scarce. What do we know?
  - Data on Istanbul Stock Exchange firms show that the **very large majority of corporate foreign borrowing is by large firms.** These firms are not SMEs, and they are probably best able among Turkish firms to bear FX risk.
  - We also know that **about ¾ of the direct foreign loans to firms have a maturity of greater than one year.** This means that the loans are medium term, so foreign lenders cannot immediately demand repayment.
  - **So Turkish firms do face a substantial risk of withdrawal of foreign capital, but the risk is largely medium term, and it is probably borne by those firms best able to bear it.**
- We have looked at the financing of the CAD, at who bears the risk, and at corporate foreign borrowing. **Let's now ask: how well are Turkish banks positioned to handle a possible sharp increase in the demand for liquidity from Turkish firms if their access to foreign capital should fall?**
- **If we look at the Turkish banking system overall, the liquidity and capital adequacy ratios are sound.** :

## Aggregate Liquidity & Capital Adequacy Ratios Are Sound



Turkey: Selected Bank Balance Sheet Data and Ratios  
 (YTL Millions November 07)

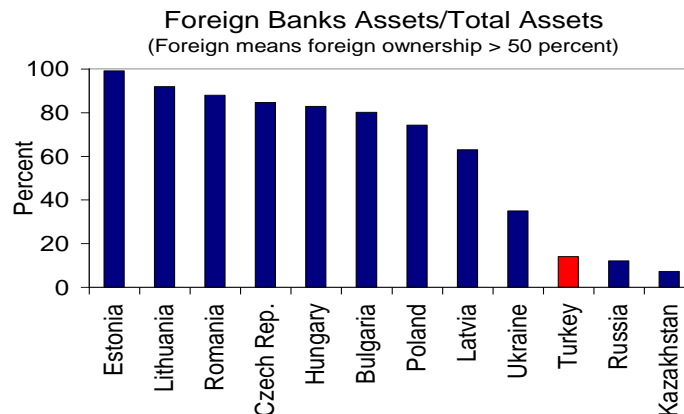
	Dom Priv	State	Foreign
Ratios			
Liq to Assets	23.8%	32.7%	19.3%
Loans to Deposits	90.7%	54.0%	111.1%
Capital Adequacy	17.2%	20.7%	14.9%

Selected Balance Sheet Data and Ratios

- Of course, there are some stronger and some weaker banks. But by the standard measurements of liquidity and solvency risks, Turkish banks' overall position is strong.

- **How does ownership affect risk?**

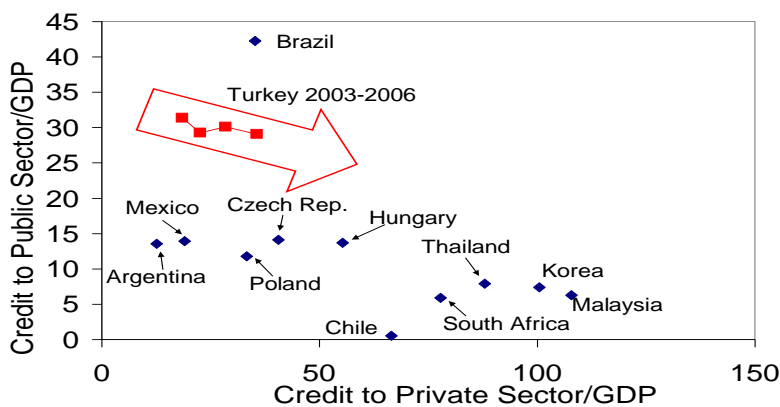
### Foreign Banking Sector Investments: Minority Stakes Dominate in Turkey



Source: EBRD Transition Report (2007) and BDDK.

- **In case of an external or global liquidity crunch, foreign ownership may lead to greater withdrawals of liquidity from banks, while domestic banks may be better able to sustain liquidity.**
- This risk may be somewhat lower, because most foreign ownership stakes in Turkey are not controlling stakes—the slide shows that this is different from many other countries in Europe and Central Asia. But the risk remains.
- **And the key point is that the liquidity and capital positions of the banking system overall are strong.**
- So far I have focused on banking sector risks in the current global economic environment. **Let me now briefly take a medium term view.**

### Financial Sector Deepening is Ongoing: Turkey & Emerging Market Comparators



Source: International Financial Statistics, IMF.

- **The Turkish financial sector has deepened over the last five years.**
  - **The key point, which this slide illustrates, is that financial sector deepening is ongoing and will likely continue over the medium term.**
  - New markets create new risks, and credit growth is an important challenge for risk managers.
  - **Strong risk management will become even more important in the future.**
- **Now the \$64,000 question: how to manage these risks?**

## Managing Financial Risks ...



- Maintaining investor confidence. Continuing sound macroeconomic policies & implementing microeconomic reforms, e.g. social security, energy, labor markets
  - Good debtor data and information sharing
  - Effective collateral & bankruptcy system
  - Deepening capital markets: developing mortgage markets and securitization
- ... and of course:
- Adequate capital and provisions
  - Careful management of external borrowing
- 
- Obviously strong solvency and careful debt management are important.
  - But **I would like to highlight the fundamental importance of continuing Turkey's good economic policies of the last several years:** sound fiscal and monetary policies and growth promoting microeconomic reforms. This will be especially importance in today's uncertain global economic environment.
  - **I would also like to highlight three factors that have to do with completing the ongoing systemic reforms in the financial sector.**
  - *First, better data will be important*— (1) to comply with Basle II requirements, and (2) to help financial institutions manage risks while expanding credit. Completing the already successful credit bureau initiative is one way to go.
  - *Second, fine-tuning the collateral and bankruptcy regime*. There is some evidence that the bankruptcy system can be improved, for example, as regards the suspension of bankruptcy, which can take years. The priority and registration of movable collateral will help in the medium term.
  - *Third, mortgage reform is ongoing & asset securitization is being considered*. Over the medium term, these instruments to deepen capital markets have great potential to help manage future risks.

## CLOSING REMARKS

- I would like to close with a picture that speaks for itself.



- Global warming and climate change will have major economic and financial consequences for the whole world, including for Turkey, and they carry very large long-term risks.
- The World Bank Group stands ready to be a partners with people, institutions, and countries around the world to begin capturing, measuring, and better understanding the impact of global warming and climate change and the risks—and addressing them.
- Thank you very much. Cok Tesekkur ederim.