

From Asia to Europe: Global Financial Restructuring Conference
October 19, 2011, TOBB Plaza, Istanbul
Ulrich Zachau

Ladies and Gentlemen. Good morning.

Today, about 3 years after its onset, the global crisis has entered a new phase.

- **What started as a financial private debt crisis is now a crisis of confidence.**
- **Critical and prompt action is needed, both on the part advanced economies**—to address longstanding structural fiscal and banking issues—**and of emerging market economies (EME's)**—to fend off the spillover effects of the crisis on their countries.
- **The crisis in the euro area has deepened and broadened.** Sovereign bond spreads for economies in the euro area and its periphery reached new highs, most recently exceeding 400 basis points for Italy and Spain, more than 1000 points for Ireland and Portugal, and in Greece's case exceeding 7000 points!
 - ***Perceived policy indecision has exacerbated uncertainty*** and added to financial strains, feeding back into the real economy.
 - ***Multiple sovereign and bank downgrades***, most recently in Spain and Italy, increased and compounded risk aversion. European interbank markets showed renewed strains, with spreads reaching 100 points over LIBOR.
 - ***Globally, stock prices have suffered sharp corrections***, dragged down by concerns about weak activity and the health of financial sectors in advanced economies.
 - ***Economic performance has also become increasingly bipolar.*** Growth has been robust in economies with pre-crisis strong fundamentals, such as

Turkey, but anemic in economies with large pre-crisis imbalances. While global growth is expected to be about 4 percent in 2012, mostly driven by emerging Asia, risks to the growth forecast are clearly on the downside.

- ***While G20 finance ministers outlined a basic strategy for addressing the roots of the crisis just last weekend in Paris***, market participants are looking for more concrete policy actions to emerge from the upcoming G20 leaders' summit taking place in Cannes in early November.

The question is then: “How can Turkey and other Emerging Market Economies best position themselves to deal with re-emerging global risks?”

In my view, there are two key policy areas EMEs could focus on: *first, getting macro-prudential policies right and enhancing banking sector resilience; and second, enhancing global competitiveness*

Starting with macro policies and banking:

- *Until only a few months ago*, strong fundamentals in EMEs coupled with low interest rates in advanced countries had led to a strong rebound in net private capital flows and a surge in credit growth.
- *Then* the challenge was how to mitigate overheating risks, the formation of asset bubbles, and a weakening of lending underwriting standards.
- *With foresight, countries such as Turkey, Brazil, China and Chile adopted a series of macro-prudential measures*, in an effort to deal with the price versus financial stability challenge posed by strong capital inflows. Such measures included implicit and explicit taxation of short-term capital inflows, strict loan-to-value ceilings, and higher capital requirements.

- *Now, only a few months later, despite these efforts, emerging markets are facing sharp capital reversals prompted by weaker global growth and a rise in funding costs that could potentially weaken domestic banks.*
- Turkey's financial sector is today strong, transparent, and resilient because of the tough reforms undertaken in 2001, when Turkey fundamentally reformed, cleaned up, and recapitalized its banking sector and overhauled regulations and regulatory agencies.
- Similar, and equally successful, banking restructuring efforts took place in Mexico (1990s), Chile (1980s), and in Emerging Asia, after the Asian crisis.
- **Because of these past efforts, banks can now better navigate the impact of the global crisis—in Turkey, in Mexico, Chile, and Emerging Asia.**

Second, strengthening global competitiveness for the medium and long term.

Long-term capital and investment flows are more globally competitive today, so Emerging like Advanced Economies must build *global* competitiveness.

For building global competitiveness, I would like to highlight 3 particular policy areas: Investment climate reforms, promoting innovation, and strengthening education and skills-matching.

- To start with the **Investment Climate**: Emerging Economies are catching up rapidly with Advanced Economies in the **Ease of Doing Business**.
- This is an area where Turkey still faces significant challenges, however, particularly in increasing *labor market flexibility* and *in construction permits*.
- According to **last year's Doing Business Report**, Turkey ranks 65th in the World Bank's Doing Business rankings. Turkey's neighbors have made more progress, faster: Georgia ranks 12th in the world, and Azerbaijan and Bulgaria all rank ahead of Turkey. This year's Doing Business Report will be issued tomorrow and is expected to highlight similar priorities for Turkey as last year's report.

- Countries now more than ever need to have the foresight to accelerate fundamental competitiveness reform ...
- ... and Turkey has already begun doing so: For example, the adoption of the **Commercial Code** earlier this year will go far in enhancing the transparency and competitiveness of the non-financial private sector—most importantly the SME sector, as the 2001 reforms did for the banking sector. Labor reforms that protect people better but also make creating jobs easier are on the way.
- Second, in addition to the investment climate, **knowledge and innovation** will be key for *global competitiveness*, growth, and jobs over the medium and long term—in Emerging and Advanced Economies alike.
- The recent global crisis has also shown us that emerging market economies need a ***new model for sustainable growth***:
 - a model ***based on productivity gains and innovation***;
 - a model that does ***not rely as much on external financing***;
 - a model that will lead to **sustainable** improvements in living standards and reduce the vulnerability of economies to external shocks.
- In order to increase growth in the long term, while also maintaining the resiliency of their economies to future shocks in global demand, countries stand to benefit from further efforts to stimulate innovation efficiently.
- **Innovation**, this “silent” engine of prosperity, will be key in generating growth and wealth and lead to the expansion of an internationally competitive private sector, including most importantly **the SME sector—the largest generator of employment in most countries around the world.**
- Finally, experience has shown that having the **proper innovation policy framework is not enough**. What makes the difference in these countries, it turns out, is simultaneous advances in improving education, R&D systems, and infrastructure, while promoting joint private-public collaboration.

In conclusion:

- The return to a sustainable global recovery will be inextricably linked to steps to be taken by policymakers in Advanced Economies in dealing with their structural and political problems.
- Emerging Market Economies have done their part in putting their houses in order—it is now up to crisis countries to achieve credible fiscal consolidation and restore confidence in their governments and banking systems!
- Emerging Market Economies would nevertheless need to remain vigilant over the recent reversal of capital flows and its impact on the banking sector. Such reversal, in an environment where credit has been exceeding nominal income growth, could potentially lead to higher non-performing and/or overvalued assets in many EMEs. **So, vigilance is the word!**
- **Emerging Economies could do well to position themselves for an eventual return to normalcy in global economic conditions.** With that mind, they must look to actions that will enhance their medium and long term competitiveness.
- **Most importantly, the key to success will be a comprehensive and simultaneous effort to improve the investment environment, a policy framework supportive of innovation and knowledge, and a serious effort to reform education and promote skills building and matching.**
- **Thank You!**