Minister of State and Deputy Prime Minister Mr. Ali Babacan

Impacts of the Current Crisis on the OIC Members

3 October 2009

Distinguished Governors, Ladies and Gentlemen, Representatives of the Organization of Islamic Conference, Representatives of SESRIC,

I would like to extend a very warm welcome on behalf of my government and myself. It has always been a great pleasure to meet the governors, deputy governors and directors of the brotherly countries of the Organization of Islamic Conference. First of all, let me express my gratitude to Central Bank of Turkey and SESRIC (Statistical Economic and Social Research and Training Center for Islamic Countries) for giving me the opportunity to address such a distinguished audience and to share my remarks on the recent developments.

The gathering taking place in the wake of the devastating crisis caries special importance for all of us. Its significance stems mainly from two important issues. First of all, it is convened at a time when we are celebrating the 40th anniversary of the Organization of Islamic Conference and the 25th anniversary of COMCEC, Standing Committee for Economic and Commercial Cooperation of the Organization of Islamic Conference. Secondly, a critical decision concerning the regularly meeting of the governors and monetary authorities of the OIC members will most probably be reached at the end of the day. This will definitely be a notable step for us to strengthen our cooperation and ties especially in the field of monetary policy.

The agenda of today's meeting covers the major current economic issues, especially in the context of Islamic Countries. I will try to contribute to this debate by expressing my views on how we see the global developments and also share our experiences in the face of the crisis.

When we look at the turmoil in the financial markets, the crisis that we are going through is probably the deepest since 1929. And when we look at the economic consequences, when we look at the growth figures the world economy is going to see the deepest shrinkage, so to say, since the World War II. So, whichever angle we look at, the crisis is really very large in terms of dimension and in terms of depth.

Interestingly, unlike some of the crisis that we have gone through, this crisis was not rooted in the developing countries. It was rooted in developed countries. So, in a way, I don't think any country around this table has much to take the blame for this crisis. In a way, we are all paying for the mistakes made in some countries.

Nowadays we are observing some signs of recovery. Although it is going to be a fragile recovery, now the mood is probably better than we compare the mood, let's say, three months ago, six months ago. But there are still serious risks involved.

The financial sector is not yet sound enough to stand on its own feet. There are especially some financial sector companies, banks and other actors who should be watched very closely.

Another risk is that unemployment level in many countries has reached to unprecedented levels. When we look at the figures in the United States, in Japan, in Europe there are records after records being broken when we look at the unemployment figures. Why is it important? Because the higher than expected unemployment rates will inevitably put pressure on growth in many countries and it may be a situation where because of low growth, okay we have high unemployment but high unemployment itself could put quite a sustained pressure on growth figures for years to come. Private consumption in many developed economies is a main driver of growth and when people are afraid of losing their jobs it will be very difficult for them to go back to normal spending behavior.

Another important area of concern is that the recovery is not going to be an even recovery. So, some parts of the world will recover much faster than the other parts of the world. The prospects for Asia are not bad. The United States is likely to start the growth period next year. But Europe will be lagging quite behind.

Another area of concern is the commodity prices. The commodity prices in our view are going to continue to be difficult to predict and could be volatile especially depending on the pace of growth in different parts of the world throughout next year.

So, many countries implemented different strategies to cope with this crisis. There were a lot of fiscal stimulus plans, monetary easing almost across all the world, and unconventional and unparalleled measures taken for the financial sector. In the short-term these are all okay, they seem to be working out. But then I think we have to be very careful about the long-term outcomes of these short-term measures.

The exit strategies of the countries are going to be very crucial to follow. The timing of withdrawing the stimulus, the timing of withdrawing monetary easing and also the timing of normalizing the financial sector are going to be very important. If these are done immaturely early, then it may hurt the growth prospects. But then if we are too late, it may threaten the financial sustainability, it may threaten debt sustainability in some countries, it may threaten price stability in some other countries and then for the financial sector we may come up with a moral hazard problem, which is already there by the way, which can get deeper and deeper. So, exit strategies are going to be very important for many countries. Every country has its own circumstances but on the other hand there should be again a global coordination of the exit strategies so that we all do things to get similar results. Otherwise if these efforts are not coordinated, the overall impact on the global economy may not be a favorable one.

Emerging market countries' involvement in the international and global economy and financial issues is going to very important. We are happy that now G-20 is becoming more relevant and more influential. A unilateral approach in time of a crisis is not going to solve anything. We have to set up wide, multilateral entities and come up with converged views, opinions and concerted set of actions to come out of this crisis.

We were happy about the results of G-20 first in Washington, then in London, most recently in Pittsburgh because it takes into account the concerns of not only developed countries but it does take into account the concerns of developing countries, emerging countries, different continents in a way because G-20 is a relatively representative body. And we, as Turkey, when we sit around the table during the G-20s, we do not look at the problem from the perspective of our own country. We look at the problems from the perspectives of many different countries who are not around the table. In a way we feel the responsibility on our shoulder of the countries who are not in G-20 because we know that many countries experience also similar things. So, in a way, when we look at the outcome of the G-20s you would see that even those countries who are not members of G-20 also found most of the, majority of the decisions as good decisions. So, around this table there are countries who are members of G-20, there are countries who are not, but we would be very, very open as Turkey, our Central Bank Governor, me, our Prime Minister. If you have any views, any suggestions please let us know. And we will be voicing the opinions of the members of OIC around the table at G-20s. So, I can promise you doing that all through G-20s meetings. So, we have that channel open for all the members of the OIC. If you would like to voice any idea, anything we can act as communicator and supporter of those views around the table.

Distinguished Guests,

I would like to also spend just a short time on what happened in Turkey during this crisis, how we reacted and what is our exit strategy.

Turkey had its own banking crisis in 2000-2001. It cost us one third of our GDP during those years. 22 banks were taken out of the system. Then we started to do reforms. We did reforms so that whatever happened will not happen again. We passed a new banking law. We passed a new mortgage law and we have been very strict when it comes to regulation, supervision and so forth. And also we strengthened the enforcement mechanisms. We did stress tests in 2003, 2004. We silently asked some of the banks to recapitalize, some of the M&As which happened in Turkey were mainly because of the pressure from the relevant authorities on the banks so that they should do something to strengthen their balance sheets. And at the end of 2006 that operation was completed. So, when we did the stress test at the end of 2006 things were quite okay in our banking system. Then we also asked for an FSAP study, Financial Sector Assessment Program study. The result of that study was quite a favorable one and our capital adequacy ratio in the banking sector was quite high at the beginning of the crisis and it remained quite high even at the end of the crisis. Right now we are at 18 percent of capital adequacy ratio that is the average of our banking system. So, we did not have to bail out any bank during this crisis, we did not have to put any government money to any bank, we did not have to change our guarantee scheme throughout this crisis.

So, that gives us in a way strength to go through this crisis in a relatively strong way. But then we were influenced through the trade channel. We have been a very open economy over the last six, seven years. Our exports increased from 36 billion to 132 billion in a matter of six years. And when the European economies started to perform bad, more than half our exports go to Europe so our exports decreased 30 percent in dollar terms, 10 percent in terms of the quantity. So, our economy was mainly influenced through the trade channel which will cost us a -6 percent of growth this year. But then starting from next year we expect the recovery in Turkey to take place and reach a growth figure of 3.5 percent next year. Some market analysts even expect higher figures but when we made our new medium term program we wanted to be more on the conservative side. And then another impact on our economy was on the budget side. Four years in a row our budget deficit was below 3 percent threshold of the European Union. But this year, mainly because of the reduce tax revenues but because of some fiscal stimulus measures that we have taken our budget deficit will go up to 6.6 percent this year. In our Medium Term Program, in our exit strategy we have already declared that we were going to start reducing this budget deficit from 2010 to 2011, 2012 and so forth. Next year's target, for example, is going to be 4.9 percent and this budget deficit will go down to 3.2 percent of our GDP in 2012. So, we have already started fiscal tightening. We have withdrawn all the fiscal stimulus which we have started. So, as of end of September all those stimulus plans have expired but what is more, we have started to take measures to enhance the revenues and also save on the spending side. Actually without these measures our budget deficit this year would have been 7.2 percent. So, with the measures the deficit is down to 6.6 percent.

Why did we do this? Because with higher budget deficits Turkish Treasury was forced to borrow more and more from the domestic markets and we have seen an overcrowding effect of the Treasury borrowing in the domestic markets. So, the domestic roll-over rates went all the way up to 113 percent. Whereas the growth model of Turkish economy is almost always through private sector activity: private spending, private consumption I would say and private sector investments. So, in a way, by reducing our budget deficits we are going to decrease public sector borrowing requirements and hence leave more room in our banking system for private sector to borrow from our banks.

One last important aspect of our Medium Term Program is in 2011 we are going to start implementing a fiscal rule and this fiscal rule will have long-term target for our fiscal balances and this long-term target will hint, will imply a long-term target for our debt to GDP ratio. In a way, for the first time ever in the history of the Republic, we are going to bring long-term predictability to where the fiscal balance of the country is heading to. This fiscal rule will have aspects related to how fast we want to get to the deficit target and it will have also aspects about how much we should save in good years to use in bad years. So, two important aspects are going to be embedded. So, this is in a nutshell what has happened in Turkey and what we are planning to do.

Ladies and Gentlemen, Distinguished Guests, Governors,

In closing, it is time for us to be proactive. We, as the policymakers, should put necessary policy actions into effect that will avert the buildup of global imbalances and ultimately lower the probability of a widespread panic and crisis. Securing better policy coordination on a global level is of vital importance for the global economic and financial system. In this context, we should embark upon policies to enhance the existing relations and cooperation among the members of OIC. Furthermore, we need to expand the global presence of our organization. Annual meetings of the central banks’ governors will be an appropriate platform to exchange views and share invaluable experiences. In the same vein of the governor Yılmaz offer Istanbul will be the best fit for this important event.

So, we do sincerely wish as an outcome of this meeting, a common stance among the members of OIC to have these meetings on a regular basis annually. We believe that we are all going to benefit from it. Exchanging views, trying to come up with common policies, common way of looking at issues is going to help each and every of our country.

With these words I close my address and wish the meeting all success that it deserves and thank you very much for your attention.