

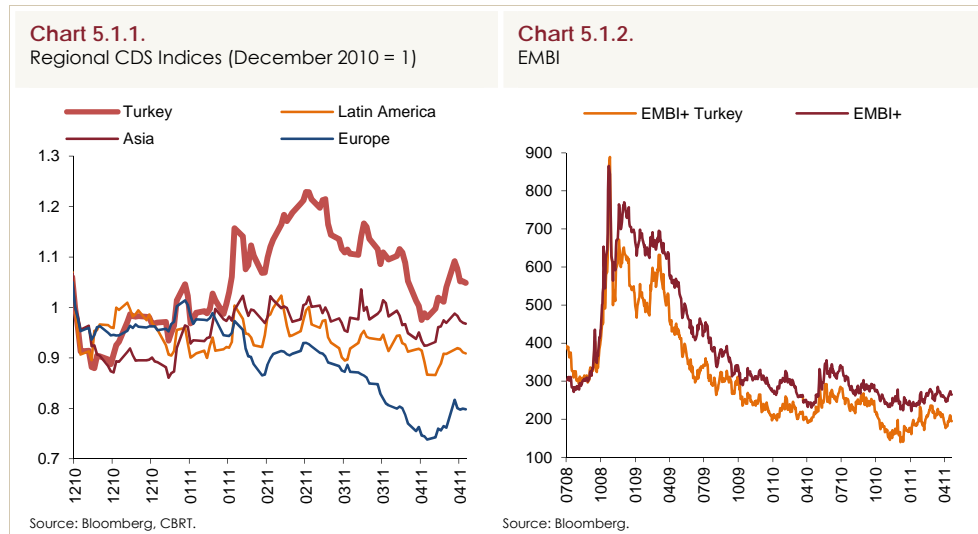
5. Financial Markets and Financial Intermediation

5.1. Financial Markets

The first-quarter data indicate that the global economy continues to recover. Coupled with soaring commodity prices, this has heightened upside risks to inflation across many economies and led to stronger expectations that monetary policy normalization would start earlier than expected in advanced economies. However, downside risks to global economic activity are weaker, but still present. Indeed, the contribution of private consumption and investment spending to the recovery in advanced economies has yet to reach the desired level. Moreover, the ongoing uncertainty about debt sustainability in the first quarter and rising commodity prices pose substantial risk to global recovery.

Despite uncertainties about the recovery in advanced economies, emerging economies remained robust in the first quarter, adding to the upward pressure on inflation. As a result, emerging economies continued to tighten monetary policy in the first quarter. In this regard, many emerging market central banks continued to raise policy rates and actively used non-interest monetary policy tools, such as required reserve ratios, to contain the risks to financial stability arising from large capital inflows.

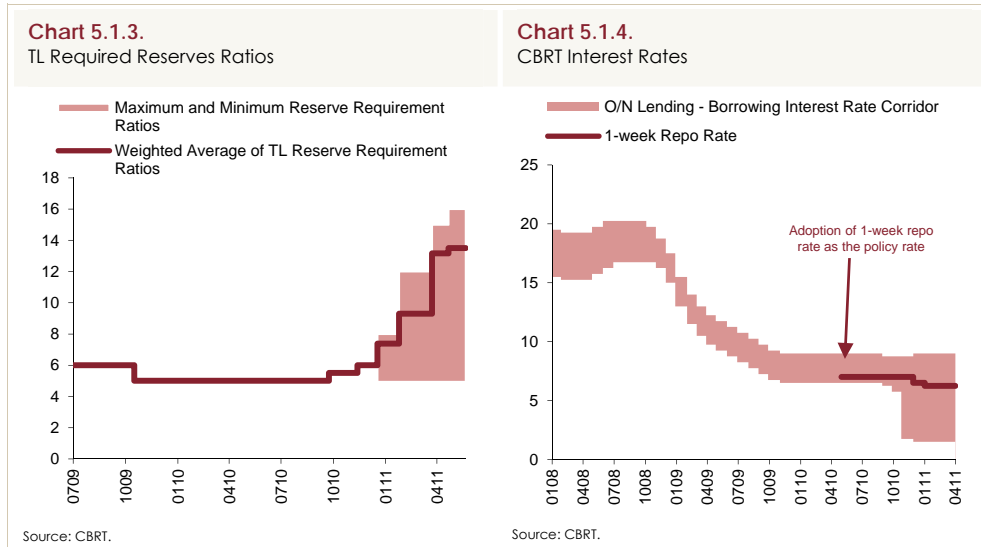
The ongoing concerns about the European sovereign debt problem and the political tension in the MENA region caused global risk sentiment to fluctuate in the first quarter (Chart 5.1.2). This has affected emerging market risk premiums. Turkey's risk premium had a relatively negative performance in this period, while the deterioration became more evident due to escalated problems in MENA (Chart 5.1.1). The main reason for the small rise in Turkey's risk premium was the concurrence of higher oil prices and the growing current account deficit in Turkey. Moreover, it is likely that the proximity and the region's larger share in Turkey's total exports than other peer countries increased Turkey's vulnerability to the tensions in the region.



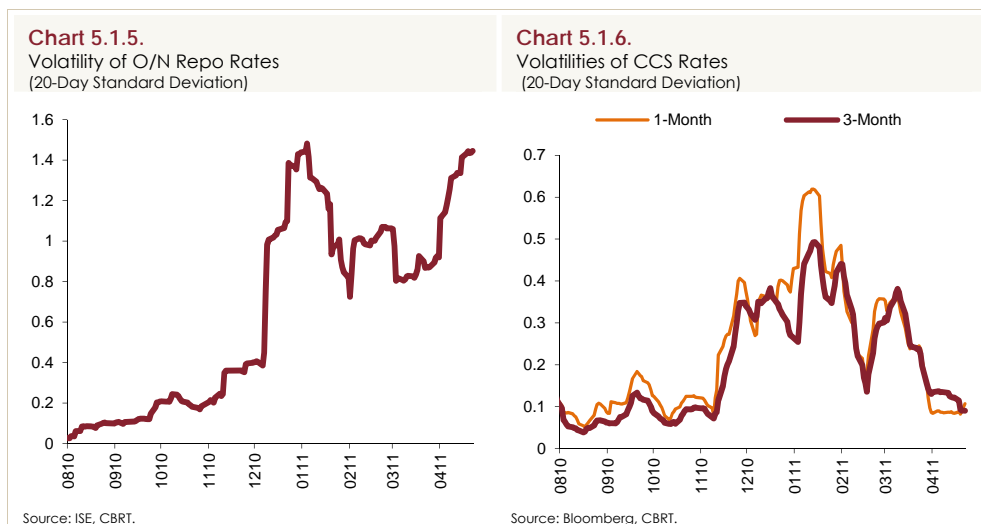
Despite the volatile global risk sentiment, the main factor affecting financial markets in Turkey during the first quarter was the CBRT's launch of a policy mix in the last quarter of 2010. The fact that short-term capital inflows created a greater imbalance between domestic and external demand growth led to a rapid increase in the current account deficit and warranted adopting macroprudential measures. Underlying inflation remained consistent with medium-term targets, allowing monetary policy to focus on macro financial stability. With the new policy mix of low policy rates, wide interest rate corridor and high required reserve ratios, 1-week repo rate, the reference policy rate, was reduced from 7 to 6.25 percent following the December 2010 and January 2011 MPC meetings (Chart 5.1.4). In addition to policy rate cuts, the CBRT's overnight borrowing rate was lowered by 450 basis points to 1.5 percent in the same period. The corridor between O/N borrowing and lending rates was widened to allow for fluctuations in short-term interest rates when needed. These decisions aimed to extend the maturity of short-term capital inflows as well as to prevent the Turkish lira from becoming detached from economic fundamentals.

One of the intermediate targets of the new policy mix has been to slow down credit growth to avoid the build-up of macro financial imbalances. In this context, required reserve ratios were decided to be used as an active policy tool, and were raised significantly and allowed to vary across maturities in December 2010 and January, March and April 2011, with lower ratios for longer-term maturities (Chart 5.1. 3). This decision aimed to slow down credit growth

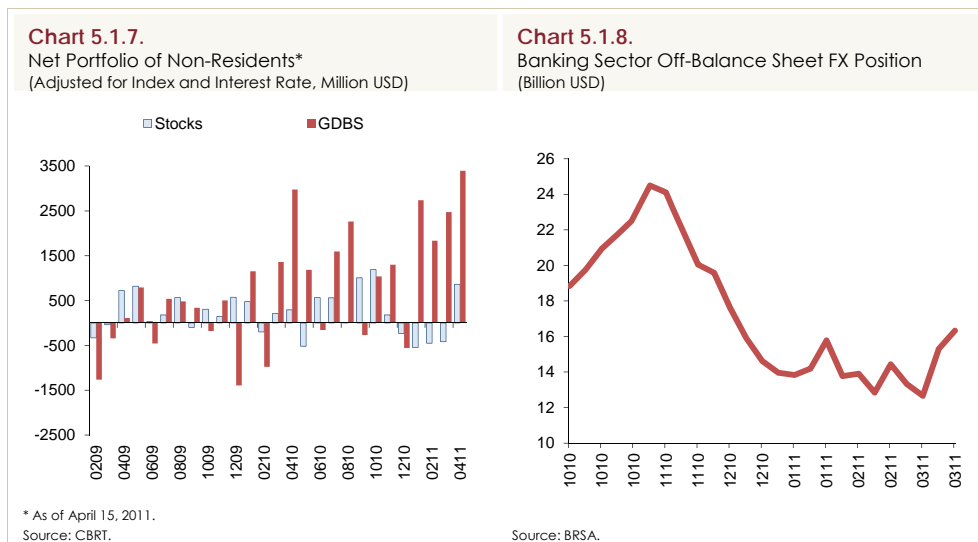
through liquidity and cost channels and increase the maturity of the banking system's liabilities, thereby reducing maturity mismatches (Box 5.1).



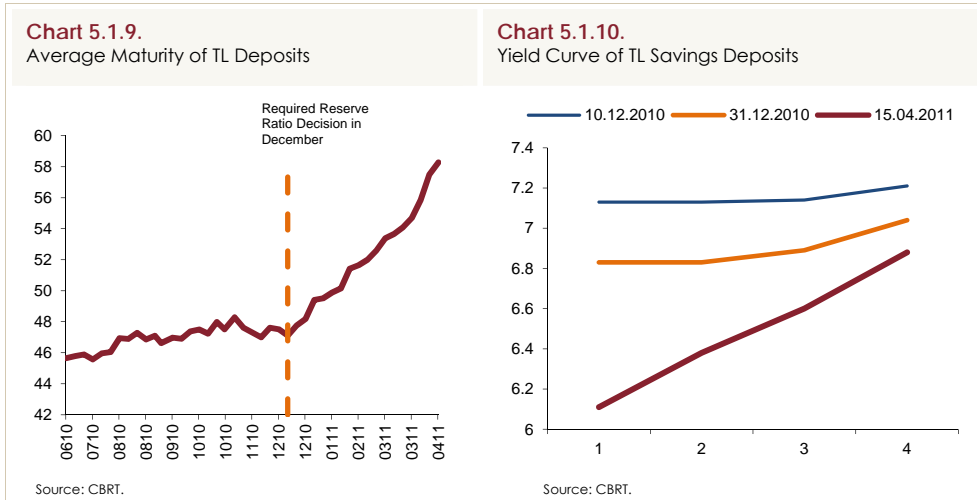
The CBRT's adoption of a new policy mix raised the volatility in short-term money market rates significantly (Charts 5.1.5 and 5.1.6). During this period, the CBRT concluded that a higher volatility in short-term money markets would be necessary to both enhance the efficiency of required reserve ratios and extend the maturity of foreign capital, and took this into consideration in liquidity operations. Moreover, the increased volatility is also believed to reflect the mounting uncertainty arising from the policy adaptation process.



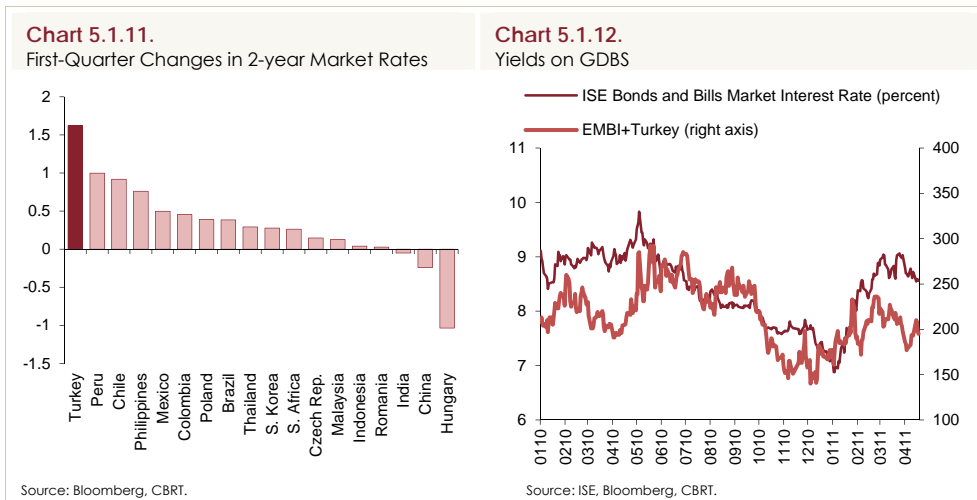
The CBRT's new policy mix continued to affect short-term foreign capital flows in the first quarter. Indeed, comprising a significant portion of short-term CCS transactions, the amount of short-term foreign capital decreased dramatically with the launch of these measures. This is also evident in domestic banks' net off-balance sheet foreign currency positions, an important indicator of the volume of CCS by non-residents (Chart 5.1.8). Furthermore, the deteriorated risk sentiment led to a limited foreign capital outflow from the stock market in the first quarter, while there has been an accelerated foreign capital inflow to the GDBS market (Chart 5.1.7). The increased foreign capital flow into the GDBS market is believed to be led by foreign investors fleeing from short-term CCS transactions towards longer-term GDBS market securities and by higher market rates since the adoption of the new measures.



Lower required reserve ratios for longer-term maturities, as allowed by the new policy mix, extended the average maturity of TL bank deposits (Chart 5.1.9). Moreover, the costs of deposits increased while maturities shortened, causing the yield curve of TL savings deposits to steepen (Chart 5.1.10). In line with the CBRT's targets, the yield variation across maturities of deposits, the largest source of financing for the Turkish banking sector, and the increase in average maturities are expected to continue into the upcoming period.

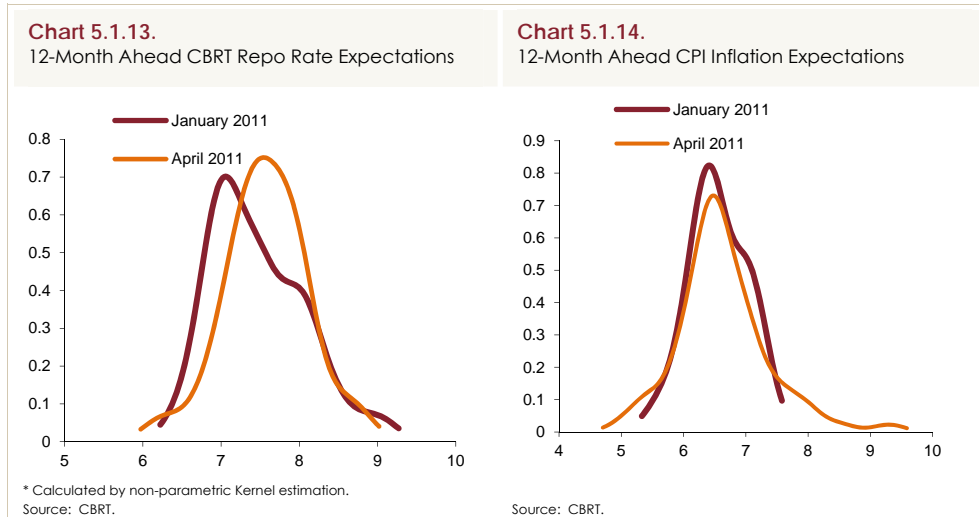


The CBRT's monetary policy actions put upward pressure on market rates. Amid higher global interest rates in the first quarter, market rates increased much faster in Turkey than the general pace across other emerging economies (Chart 5.1.11). The increase in market rates reflects the restrictive impact of the CBRT's new policy mix and the recently adopted prudent monetary policy. In addition, the early first-quarter market uncertainty about the path of this new policy mix is also believed to have driven market rates higher.

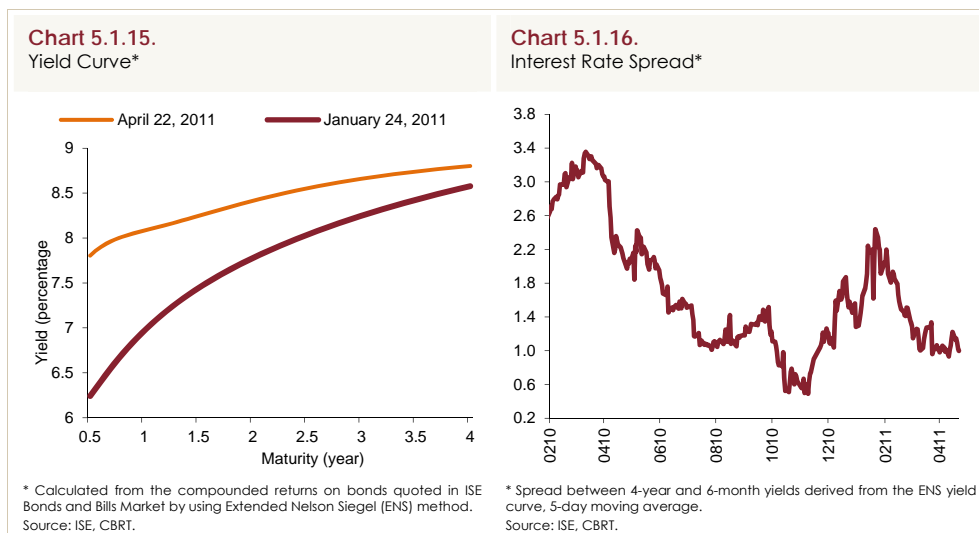


The rise in market rates is also attributed to the slight increase in inflation expectations. In fact, rising prices of oil, food and other imported products and the weak Turkish lira caused 12-month ahead inflation expectations to increase, albeit modestly (Chart 5.1.14). Furthermore, the CBRT's adoption of a more cautious stance and shift towards a tighter monetary policy led to an increase

in future policy rate expectations (Chart 5.1.13). This increase seems to have a limited effect on market rates.

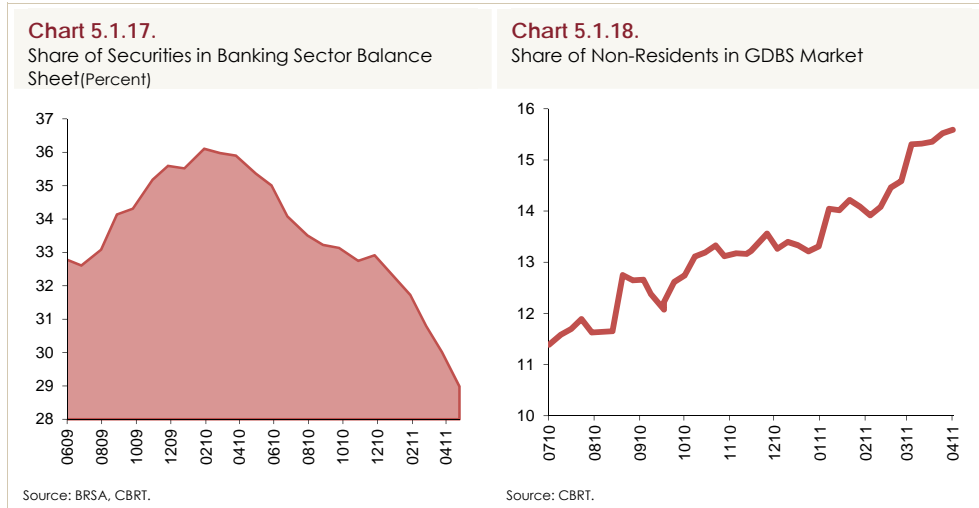


The increase in market rates is more significant across shorter maturities and more limited across longer maturities. Therefore, the yield curve flattened quarter-on-quarter (Charts 5.1.15 and 5.1.16).

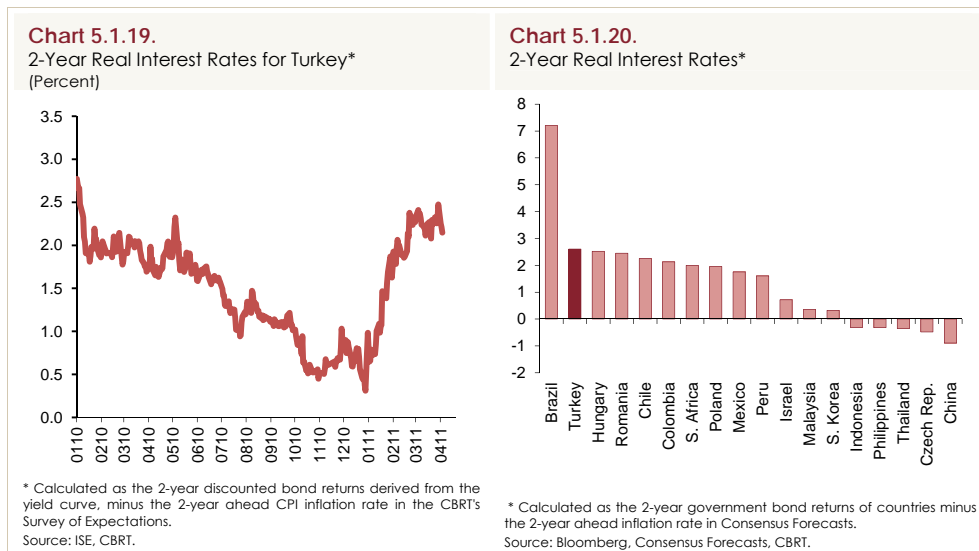


The increase in market rates is more pronounced across shorter maturities as the CBRT's shift towards net tightening has a greater effect on short- and medium-term interest rates. Indeed, after renewed required reserve ratios, banks tended to sell short-term GDBS to meet their increasing liquidity needs (Chart 5.1.17). As a result, the share of GDBS in domestic banks' balance sheets decreased, boosting foreign ownership in this market (Chart 5.1.18). Meanwhile,

the main determinants of long-term market rates are long-term structural dynamics of the economy, such as long-term sovereign riskiness. Despite the volatile global risk sentiment, long-term interest rates remained relatively stable at historically low levels, reflecting prospects of a prolonged period of low interest rates in Turkey.

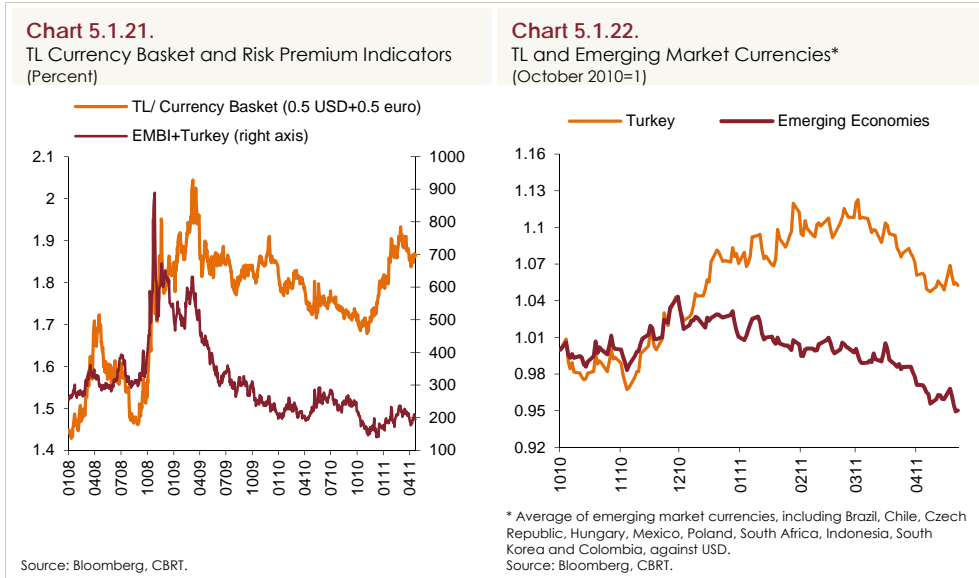


The market rate increase spilled over into real interest rates, leading to higher real interest rates in Turkey than in other emerging economies (Chart 5.1.20). The rise in real interest rates indicates that the net impact of the CBRT's recent policy mix decisions is restrictive.

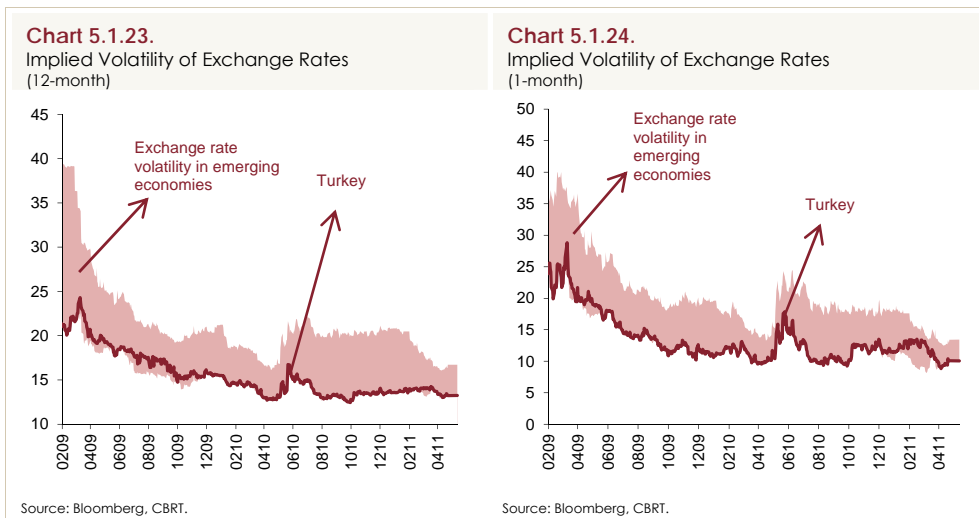


The CBRT's policy decisions also affected exchange rates. Indeed, following the release of the November 2010 Financial Stability Report, the Turkish

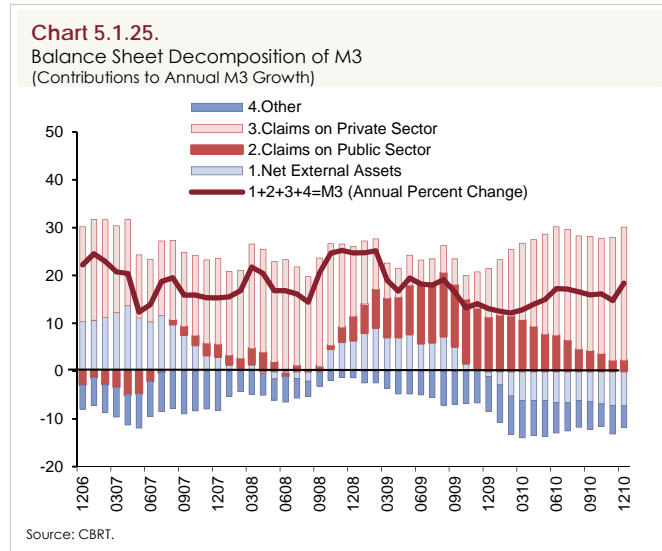
lira began to depreciate, contrary to the general trend of other emerging market currencies (Chart 5.1.22). Recently, the reduced regional risk and soaring market rates offset some of the relative depreciation of the Turkish lira.



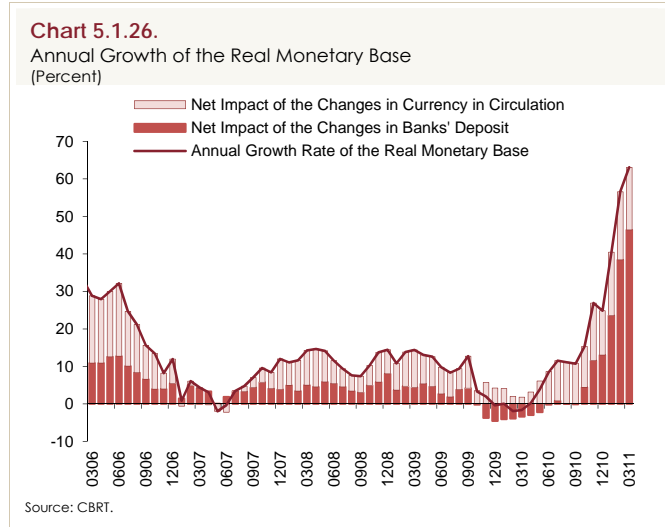
Notwithstanding the recent volatility, the Turkish lira remains among emerging market currencies with low long-term implied volatility, owing mainly to the improved post-crisis investor sentiment toward Turkey (Chart 5.1.23). On the other hand, the short-term implied volatility of the Turkish lira increased slightly after the CBRT's policy mix decisions (Chart 5.1.24). This is expected to discourage short-term capital flows. The fact that volatility is more evident for shorter maturities is a result of the perceptions that exchange rate uncertainty is temporary.



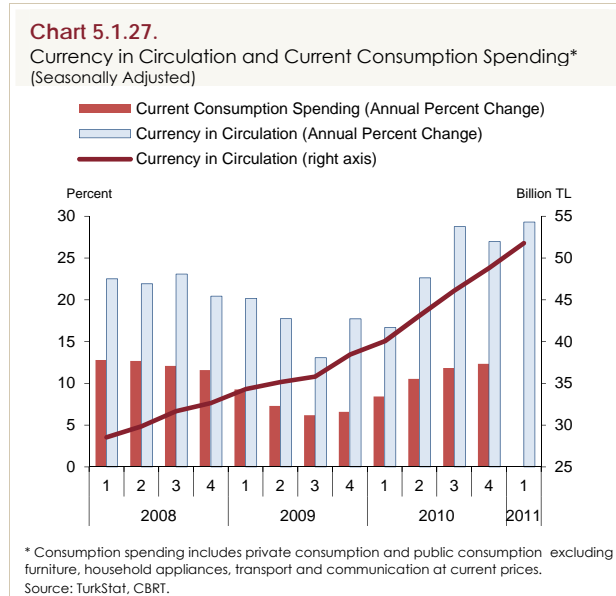
Following the recent improvement in financial markets, monetary indicators also reflect the robust economic activity. In fact, the balance sheet decomposition of the broad measure of money supply, M3, showing the total consolidated liabilities of the monetary sector, including the CBRT and the banking sector, indicate that Claims on Private Sector, mostly consisting of bank loans to non-financial private individuals and institutions, continue to grow strongly amid increased consumer and investor confidence. Moreover, the slowdown in the contribution of Claims on Public Sector to the M3 growth since end-2009 paused in the last quarter. Net External Assets continue to fall due to the increase in commercial banks' external borrowing. Lastly, the negative contribution of the item Other, i.e. the monetary sector's non-deposit resources, to the M3 growth has slightly decreased amid reduced bank profitability (Chart 5.1.25).



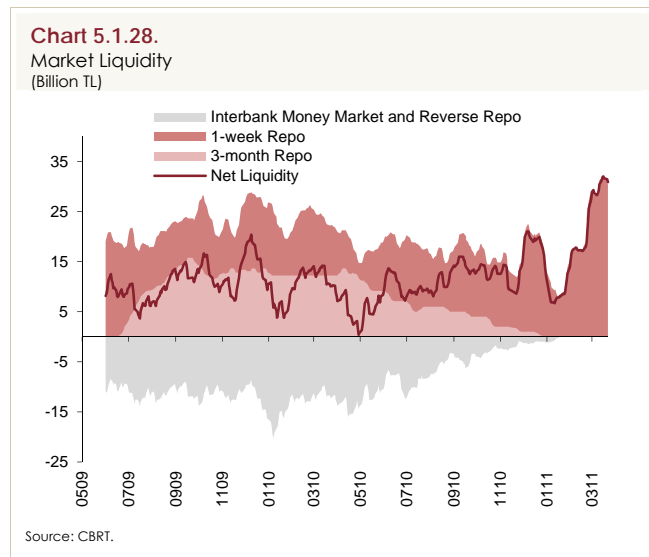
The stable economic growth was also reflected in the monetary base during the first quarter, leading to a real year-on-year growth in the monetary base. During this period, the currency in circulation continued to increase steadily, while the monetary base expansion was largely driven by the increase in banks' deposits at the CBRT (Chart 5.1.26). Indeed, the hike in TL required reserve ratios led to a sharp increase in banks' deposits.



The upward trend of the money in circulation, another component of the monetary base, may be attributable to the increase in consumer spending amid economic recovery. Moreover, the ongoing strong uptrend in the seasonally adjusted figures for money in circulation during the first quarter suggests that consumption spending continues to support economic recovery (Chart 5.1.27). The stable post-crisis growth in money in circulation may also be attributed to historically low nominal interest rates, i.e. the opportunity cost of holding cash.

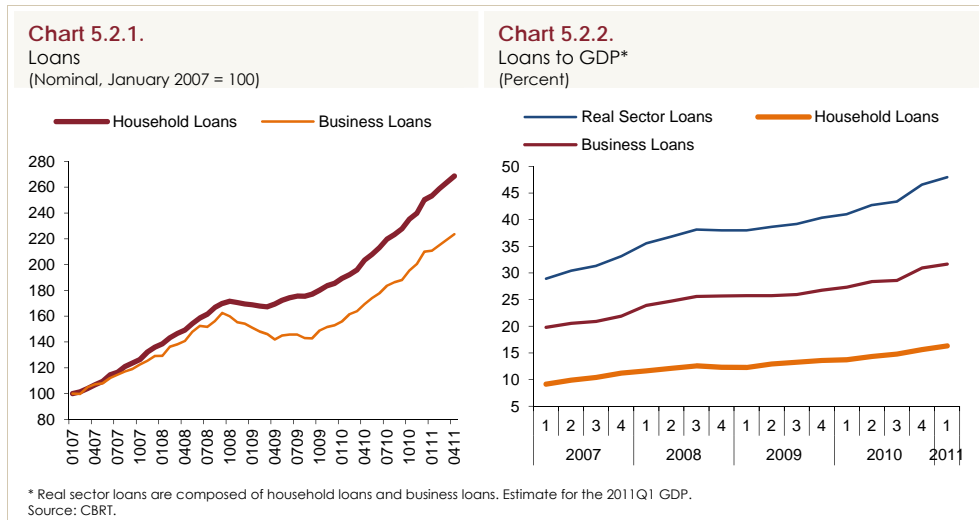


The CBRT's measures and the volatile global risk sentiment caused foreign capital inflows to decelerate in the first quarter. As a result, the amount of foreign currency withdrawn from the market through FX buying auctions decreased significantly quarter-on-quarter to USD 2.7 billion. FX buying auctions helped reduce the interbank liquidity shortage. Meanwhile, the Treasury's average account balance at the CBRT decreased quarter-on-quarter, easing the liquidity shortage. However, the moderate increase in money in circulation and particularly the notable hike in banks' required reserves caused the net liquidity gap of the banking system to widen quarter-on-quarter (Chart 5.1.28).

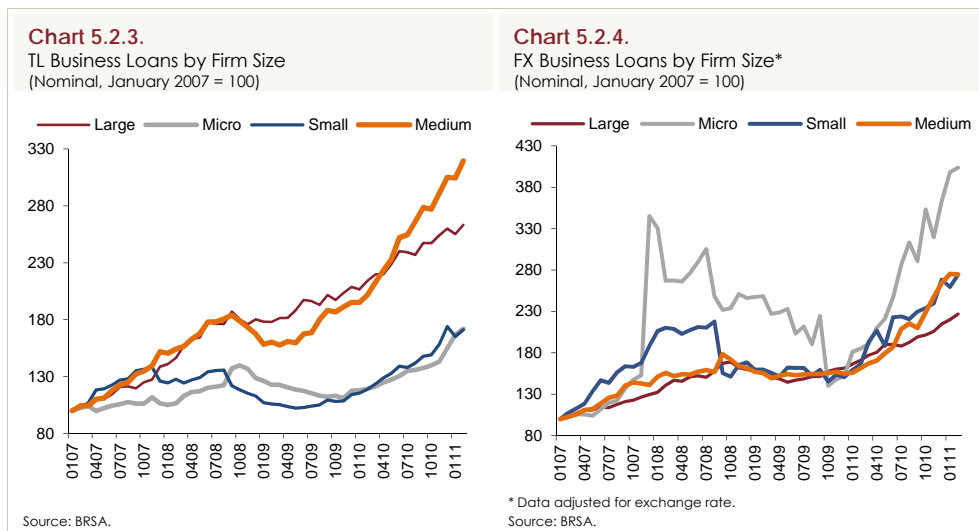


5.2. Financial Intermediation and Loans

Real sector loans by domestic banks continued to accelerate in the first quarter of 2011, albeit at a slightly slower pace (Chart 5.2.1). Business loans and consumer loans grew by an annualized 29 and 41 percent, respectively, while real sector loans increased by 33 percent. The slower growth in business loans was largely due to the more significant year-end balance sheet corrections for business loans. Indeed, the gap between the consumer and business loan growth closed remarkably in March. Overall, the loans to GDP ratio appears to have remained on the rise in the first quarter (Chart 5.2.2).

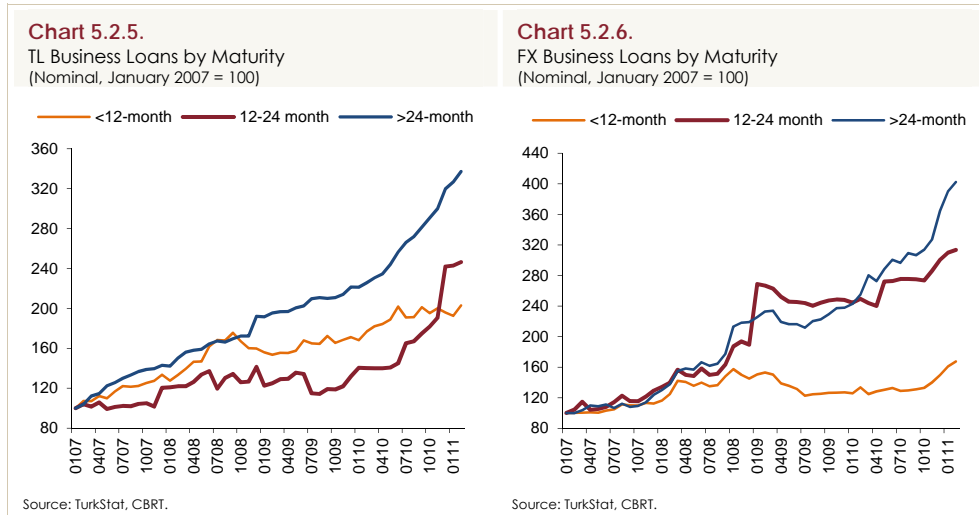


The rapid post-crisis growth in loans has mostly been driven by the improved risk perceptions of financial institutions and the resulting decrease in credit risk aversion. This led to a dramatic increase in business loans amid rising loan demand. The impact of the improved risk sentiment on business loans is evident across all firm sizes and loan maturities. Indeed, small business loans falling into a higher-risk category increased at a faster pace than large-scale business loans. As a result, the share of small business loans in total loans exceeded pre-crisis levels (Charts 5.2.3 and 5.2.4).

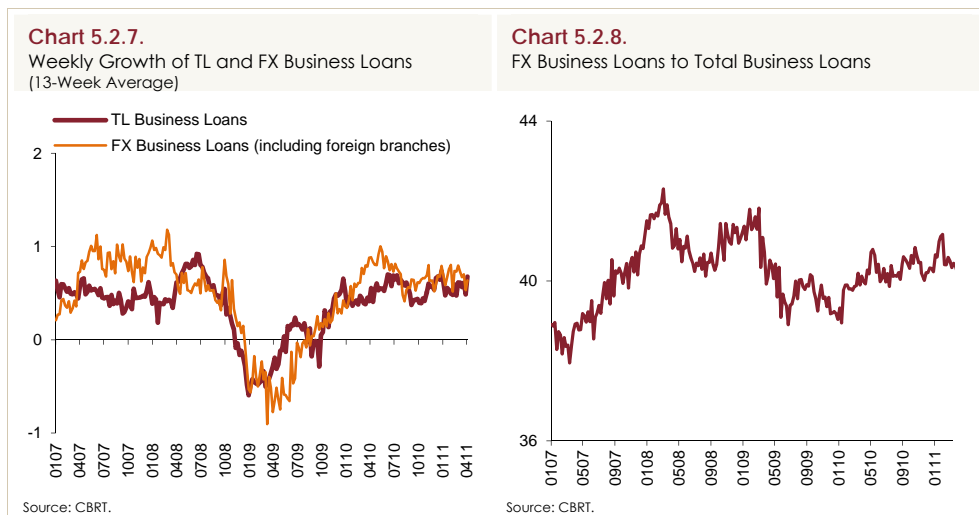


The improved risk perceptions of financial institutions have also affected the maturity distribution of business loans. In fact, the share of short-term loans with lower interest rate risk in total loans continued to decline in the first quarter.

Therefore, the average maturity of business loans surpassed the pre-crisis levels (Charts 5.2.5 and 5.2.6).

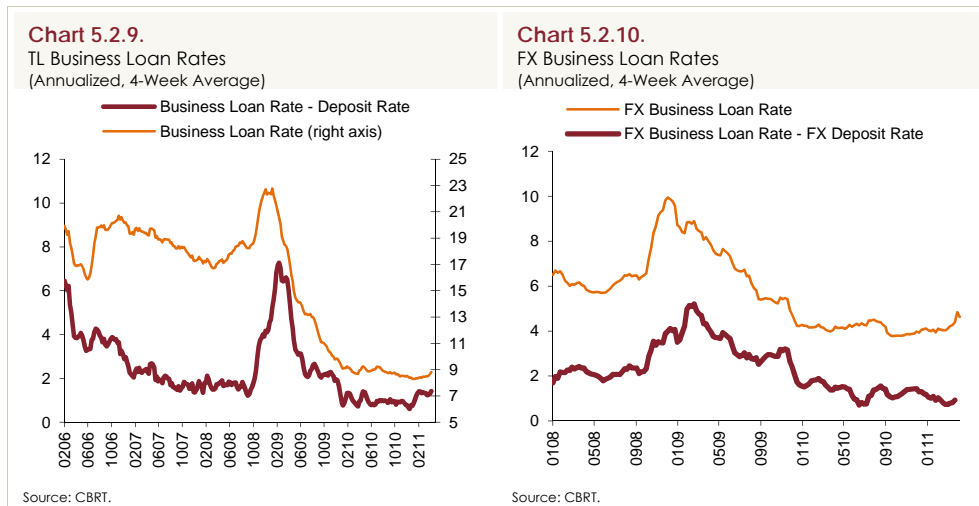


After a steady uptrend in 2010, the share of FX business loans in total business loans continued to increase in the first quarter of 2011 (Charts 5.2.7 and 5.2.8). In this context, there has been a notable growth in FX loans granted to SMEs and micro-scale enterprises (Chart 5.2.4). This trend should be closely monitored as it implies an increased FX risk for firms and an increased credit risks for banks.



Credit market indicators show that both supply and demand conditions were the drivers of credit expansion. Despite the robust growth in credit volume and the additional costs of decisions on required reserves, loan rates have yet to increase markedly, pointing to a strong credit market competition on the

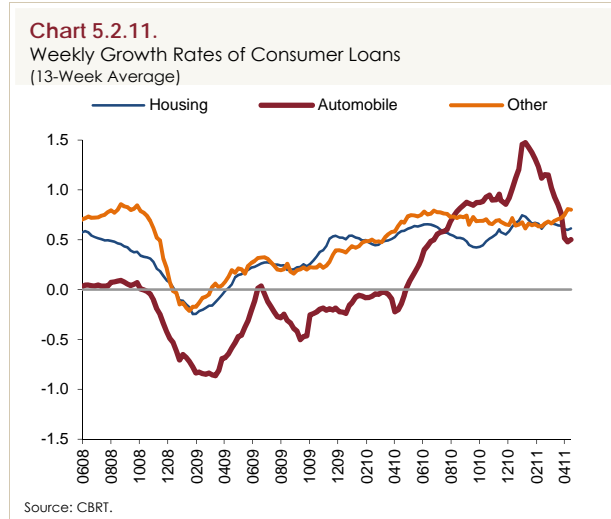
supply side (Chart 5.2.9). Notwithstanding the post-crisis growth in FX credit volume, the spread between FX business loan rates and deposit rates has yet to increase significantly, again pointing to the support of supply conditions for credit expansion. This is also confirmed by the fourth-quarter results of the lending survey. According to the survey, banks expect SME lending standards to ease slightly in the first quarter.



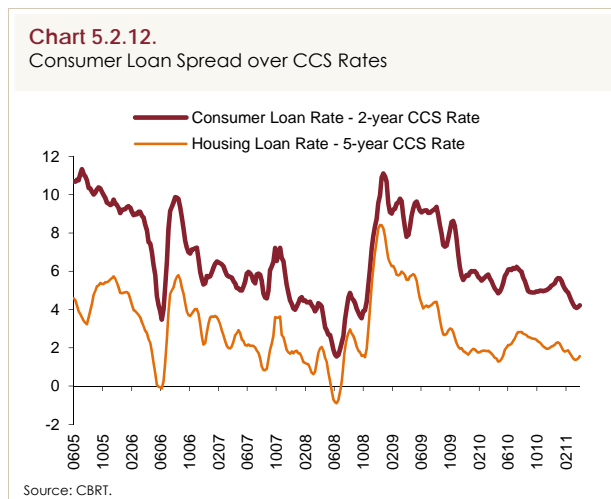
There are indicators suggesting that demand-side factors have also played a major role in the growth of business loans, especially FX business loans. The 2010 Fall-term results of the investment survey mentioned in the January Inflation Report pointed to a marked increase in the investment demand of enterprises. In line with the survey, private investment spending accelerated at a record pace in the last quarter of 2010. Furthermore, the lending survey for the banking sector also indicate that the demand for business loans was higher in the last quarter and would rise further in the first quarter. In view of the fact that investment loans are often denominated in foreign currencies and the assumption that business loans are recently demanded to finance the growing investment spending, it is possible to state that demand-side factors played a major role in the sharp increase in FX loans.

During the final quarter of 2010, the year-end balance sheet adjustments and the BRSA's renewed loan/value ratio effective January 1 resulted in a significant acceleration in consumer loans. Subsequently, after a temporary slowdown in January, the rapid growth of consumer loans continued into February and March. During this period, automobile loans, accounting for less than 10 percent of consumer loans, diverged from the general trend in

consumer loans. In fact, after a record surge in the fourth quarter, the increase in automobile loans slowed significantly during January and February. Against this background, consumer loans increased by more than 41 percent year-on-year in the first quarter, while home, other and automobile loans were up 37, 47 and 31 percent, respectively (Chart 5.2.11).



Despite the rapid increase in consumer loans during the first quarter, loan rates remained mostly flat. The stable course of consumer loan rates vis-à-vis the increase in long-term market rates reflects the intense competition in the market (Chart 5.2.12). On the other hand, the economic recovery and the increased consumer confidence boost the demand for consumer loans and support loan growth. The uptrend in the consumer confidence index and the ongoing improvement in employment conditions suggest that the demand for consumer loans may remain robust in the upcoming period.



As of the turn of the year, external borrowing is the most important source of funding for banks. On the other hand, deposits, the primary source of funding for banks, increased only modestly during the first two months of the year, accounting for only about 32 percent of the credit expansion. During this period, the amount of newly issued securities accounted for almost 8 percent of the increase in loans.

Table 5.2.1.
Changes in Main Balance Sheet Items
(Million TL)

| | | 2010Q4 | | January-February 2011 | |
|-------------|--|--------|-------|-----------------------|-------|
| | | TL | FX | TL | FX |
| Assets | Loans | 30866 | 19581 | 13051 | 13362 |
| | Securities | 10344 | 2806 | -2548 | 334 |
| | Cash+Required Reserves+Receivables from Central Bank | 7260 | 5755 | 21348 | 386 |
| | Receivables from Banks | 3545 | -6750 | -359 | -8 |
| Liabilities | Deposits (Participation Funds) | 40480 | 3538 | 7313 | 1154 |
| | Payables to Banks | 5468 | 15451 | -796 | 7292 |
| | Funds from Repo Transactions | 3725 | 1982 | 12748 | 3931 |
| | Securities Issued (Net) | 1095 | 94 | 2269 | 771 |
| | Total Equity | 7833 | -160 | 768 | -561 |

Source: BRSA.

Another noteworthy development in the banking sector was the contraction in banks' security portfolios, corresponding to 8 percent of the credit growth. During this period, banks sold some of their GDBS to meet the need for additional liquidity due to required reserve adjustments. This indicates increased tendency of banks to change their asset composition rather than using CBRT funds to meet their liquidity needs. The weakening substitution between CBRT funding and other sources of funding is very important in terms of the effectiveness of required reserve adjustments. This may cause banks to be more cautious on lending over the upcoming period.

In sum, both business loans and consumer loans continued to rise rapidly in the first quarter. Loan growth was driven by both supply-side and demand-side factors. On the supply side, the intense competition in credit markets cause supply conditions to remain loose. On the other hand, the positive course of economic activity, the improvement in employment conditions, and hence, the growing optimism about the economic outlook help boost the loan demand. Credit markets have already started to reflect the first round effects of the decisions on required reserves intended to restrain the rapid credit growth. These effects are expected to become more pronounced in coming months. Indeed, the fact that banks changed their asset composition to meet their need for additional liquidity following the latest decision is a key indicator that the restrictive effects of the required reserve hike will be more significant in the upcoming period (Box 5.2).

Box
5.1

Credit Expansion and the Current Account Deficit

The ample global liquidity driven by the post-crisis extraordinary expansionary monetary policies of advanced economies led to strong capital flows into emerging economies. Although higher credit growth rates relative to advanced economies are normal in emerging economies which are at the initial stages of financial deepening, it should be noted that rapid credit expansion could hamper financial stability beyond a certain point for country experiences show that rapid credit growth is a leading indicator for major banking and balance of payments crises. Therefore, it is highly crucial to monitor credit growth closely. In this context, this Box analyzes the relationship between credit expansion and financial crises, and gives a brief account of the relevant findings in the economics literature. Finally, the recent rapid credit expansion in Turkey and the widening current account deficit are discussed, and the CBRT's corresponding measures are listed accordingly.

Many studies in the economics literature have concluded that rapid credit growth is a leading indicator for balance of payments and banking crises.¹ Rapid credit growth can hamper macroeconomic stability by damaging external balance and the stability in FX markets. In other words, a sudden contraction in external funds exposes the banking system's FX liquidity to a negative shock, and consequently leads to a financial and economic crisis. This fact was experienced by advanced and emerging economies in the past.² In addition, rapid credit growth has the potential to affect financial stability directly. Still having spillover effects, the latest global crisis is the most recent experience. The extremely competitive environment in times of easier access to funds and lower cost of funding reduces banks' susceptibility to risk. Moreover, when loans grow rapidly both in volume and number, it is very difficult to make sound assessments about the inherent risks. Another mechanism that may cause credit growth to evolve into a threat to financial stability is through the "financial accelerator" such that excessive optimism for the future and rising asset prices during rapid economic growth not only have a positive effect on loan demand but also increase banks' willingness to lend. This cycle is reversed if an economy begins to underperform due to a negative shock, leaving the financial system vulnerable to a crisis.

¹ See Borio and Lowe (2002), Jorda *et al.* (2010).

² See Hilbers *et al.* (2005).

Credit growth cycles resulting in a crisis are found to have similarities. Rapid credit expansions occur around the same time in similar countries, that is, they are synchronized. This finding points to a common external factor, such as capital flows. In addition, more than 50 percent of rapid credit growth cycles is associated with strong capital flows. Of rapid credit expansions, 75 percent is associated with the banking crisis while 85 percent is associated with the current account deficit. Moreover, banks have increased external borrowing by changing their balance sheet composition in this process.³

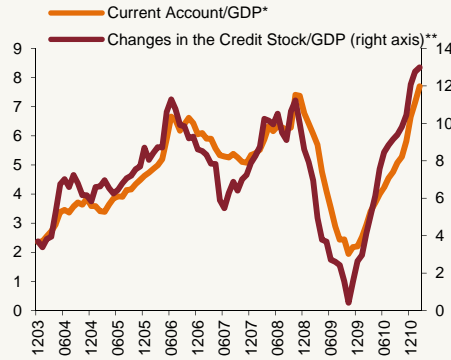
The recent Jorda *et al.* (2010) study analyzed whether the current account balance, alongside other economic fundamentals, contains any information on a possible financial crisis. To this end, a data set for 14 developed countries over the 1870-2008 period is used to build a logit model to determine the variables affecting the likelihood of a financial crisis.⁴ The rapid credit expansion in the last five years is found to be an important indicator for the risk of experiencing a financial crisis. Although the current account deficit is also predictive of a financial crisis, it is not as statistically significant as credit expansion. As changes in global capital flows during the past 35 years may make long-term comparisons problematic, the analysis focuses on post-1945 and post-1975 periods. The results reveal that the statistical significance of the variable showing the interaction between credit growth and current account balance is higher for the post-1975 period. There is also a statistically significant and higher correlation between credit growth and current account deficit for the post-1975 period. This result suggests that rapid loan growth after 1975 is synchronized with widening current account imbalances. These findings indicate that credit expansion is an important variable that should be monitored to prevent a financial crisis.

There is also a strong correlation between credit growth and current account deficit in Turkey (Chart 1). The current account imbalance and the gradual increase in the share of portfolio investments and short-term capital inflows in financing the imbalance increase the fragility of the economy against sudden changes in global risk appetite, and raise concerns about macroeconomic and financial stability (Chart 2).

³ See IMF (2004).

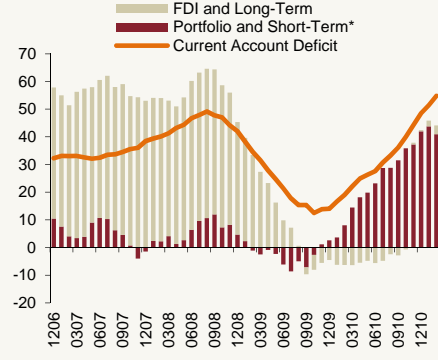
⁴ Countries analyzed are the United States, Canada, Australia, France, Germany, Italy, Japan, the Netherlands, Denmark, Norway, Spain, Sweden, Switzerland and the United Kingdom.

Chart 1.
Credit Growth and Current Account Deficit



* 12-month cumulative current account deficit to GDP ratio.
** Yearly change in credit stock to GDP ratio.
Source: BRSA, CBRT.

Chart 2
Main Sources of Funding for Current Account Deficit
(12-Month Cumulative, Billion USD)



* Short-term capital movements are the sum of net banking and real sector loans and bank deposits.
Source: CBRT.

The risks associated with the deteriorated current account balance and the rapid credit expansion led to a search for alternative policies. In this context, limiting the growth rate of loans to reduce the risks to financial stability has been adopted as an intermediate target. Without sacrificing its primary objective of maintaining price stability, the CBRT adopted a new policy strategy combining various complementary policy tools to contain macro financial risks. In this regard, alongside policy rates, required reserves and the interest rate corridor (the difference between O/N lending and borrowing rates) are decided to be used as active monetary policy instruments.

References

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Box
5.2

Effects of Decisions on Required Reserves

Noting that the rapid divergence between domestic and external demand coupled with short-term capital inflows has added to the risks to financial stability since mid-2010, the CBRT adopted a monetary policy strategy combining alternative policy instruments to reduce the risks associated with the new economic environment. In this regard, putting a cap on short-term capital inflows and domestic credit expansion to contain macro financial risks is adopted as an intermediate target. Under the new monetary policy strategy, the CBRT, without sacrificing price stability, diversified its set of instruments to maintain financial stability. Thus, 1-week repo rate, the reference policy rate, the O/N interest rate corridor and required reserve ratios have been used jointly as policy instruments. This Box focuses on the effects of the decisions on required reserves.

The preparations for the transition to a new policy strategy began with the exit strategy in April 2010. In this context, the anti-crisis liquidity measures were gradually withdrawn, while required reserve ratios were gradually brought back to pre-crisis levels until end-2010. In line with the goal of reducing macro financial risks, required reserve ratios have been gradually increased to control the TL liquidity and the credit supply in the market since November 2010. To this end, interest payments on required reserves were ended and the coverage of liabilities subject to required reserves was widened. Moreover, the higher required reserve ratios for shorter maturities are aimed to extend the average maturity of liabilities and to enhance financial stability.⁵ Upon these decisions, the weighted average TL required reserve ratios was raised to 13.5 percent as of April 2011 (Table 7.1.1). In this context, following the latest decision effective May 13, 2011, the required reserve adjustments will have withdrawn about TL 40 billion from the market since October 2010.

⁵ See Başçı, E. and H. Kara, (2011), "Finansal İstikrar ve Para Politikası", *İktisat İşletme ve Finans*, 26(302), 9-25 (in Turkish) for an extensive study on the purpose and the implementation of the new policy mix.

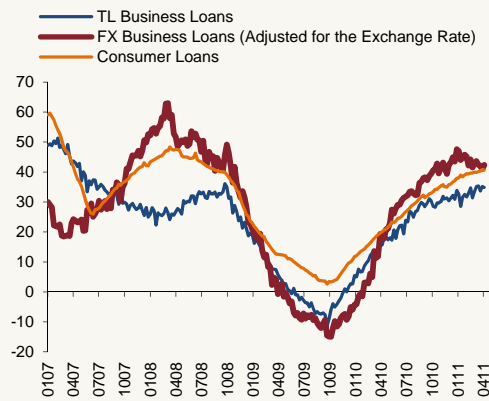
In the inflation targeting regime, the impact of required reserves on the macro economy is transmitted through the cost and liquidity channels. The cost channel basically operates through the impact of the changes in central bank's reserve requirements on the spread between banks' loan and deposit rates, while the liquidity channel operates through the impact of the changes in required reserves on the lending behavior, changing banks' need for central bank's short-term funding.⁶

The new monetary policy approach has lagged effects on the rapid credit expansion, a primary risk factor for financial stability. Following the decisions on required reserves over November 2010-January 2011, the acceleration in consumer loans that started in the last quarter of 2010 stopped in the first quarter of 2011, but the annual growth rate of loans remained high (Chart 1). During this period, banks incorporated

most of the additional costs imposed by the hike in required reserve ratios into deposit rates, lowered profit margins and refrained from raising loan rates. Meanwhile, banks relied heavily on CBRT funds to close the liquidity gap resulting from increased required reserves. Therefore, the initial impact of required reserve decisions on loans was

relatively limited. This is largely attributed to the intense competition in the banking sector and the growing optimism about the macroeconomic outlook. Moreover, prolonged structural changes in banks' portfolios have also limited the short-term impact of required reserve adjustments.

Chart 1.
Annual Growth Rates of Loans
(Annual Percent Change)

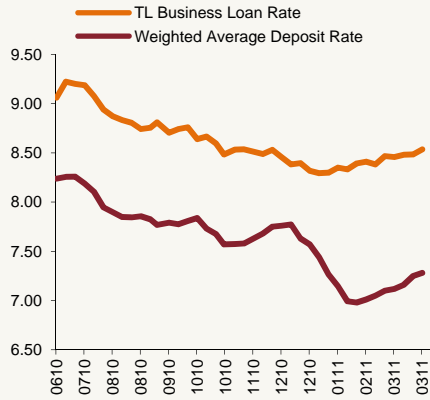


Source: CBRT.

⁶ See Alper, K. and S. T. Tiryaki (2010), "The Role of Required Reserves in Monetary Policy", CBRT Economic Notes No. 11/08.

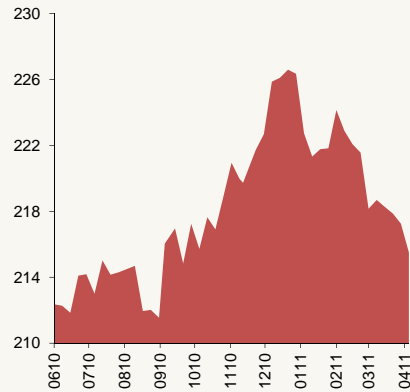
The decisions on hiking required reserve ratios in January 2011 and onwards received different responses from banks and the effects of the liquidity channel have become more pronounced. After required reserve ratios were increased by 200 basis points on January 24, 2011 across maturities with larger deposits, deposit rates began to move upward, contrary to previous decisions (Chart 2). In addition, after this decision, banks started to sell out GDBS to meet a substantial portion of the credit expansion (Chart 3). These developments indicate that banks tend to maintain their balance sheet liquidity ratios and change the structure of their balance sheets on the assets and liabilities side. However, due to the fact that total deposits do not show rapid changes in the short term and the funds in securities portfolios are limited, these resources seem unlikely to provide banks with sufficient flexibility to sustain the rapid credit growth. In this context, the impact of the decisions on loan growth is expected to be more pronounced by the second quarter of 2011.

Chart 2.
Loan and Deposit Rates
(Percent, 4-Week Average)



Source: CBRT.

Chart 3.
Banking Sector TL Securities Portfolio
(Billion TL)



Source: BRSA, CBRT.

Another objective of the CBRT for enhancing financial stability is to extend the maturity of liabilities in the banking system. In this regard, the distribution of required reserve ratios, with higher ratios for shorter maturities, is aimed to extend the average maturity of liabilities and to enhance financial stability. Following the relevant decisions, deposit rates saw an upward-sloping yield curve, while the average maturity of deposits was gradually extended (Chart 5.1.9).

In sum, the recent decisions on required reserves has started to change banks' behavior, which is reflected through banking sector balance sheets. Changes in the structure of balance sheets indicate that banks tend to reduce their dependence on short-term funding. This finding is supported by the increases in deposit and loan rates.

