Overview

Since the release of the previous Financial Stability Report in May 2014, the global economic activity has weakened and inflation rates have remained low on the back of the sharp decline in commodity prices, especially in oil prices. However, the growth trends of the USA and other countries show increasing differentiation. While growth is decelerating in emerging markets including China, the growth outlook in the Euro area and Japan is quite subdued and fragile. Conversely, the US economy is recovering rapidly. The discrepancy between economies is reflected in national monetary policies as well. The Fed, which terminated asset purchases at the end of October, is expected to start raising interest rates in 2015. On the other hand, the European Central Bank (ECB), The Bank of Japan (BoJ) and the Peoples' Bank of China (PBC), which eased their monetary policies by using several instruments, are expected to take further steps towards spurring growth. In case the downtrend in the global economic activity persists, the Fed might delay the normalization of its monetary policy.

The low-interest environment that followed expansionary monetary policies bring along some global financial risks, most of which are concentrated in the non-financial sector. In the coming period, macroprudential policies rather than the monetary policy is expected to be on the forefront of the fight with risks that may originate from the low interest rate climate, if global growth dynamics continue to be vulnerable.

The lingering uncertainties pertaining to normalizing global monetary policies enhance the sensitivity of the global risk appetite and capital flows to data. In the upcoming period, the capital flows are expected to remain sensitive to country-specific factors. In this framework, emerging economies' growth outlooks, inflation rates and external balances will become more important. Meanwhile, the recent weak course of economic activity increases the chances of a delay in normalizing process of global monetary policies. A delay in the normalization of monetary policies of developed economies might bring about excessive borrowing risk. In this case, measures towards enhancing the resilience of the financial system against shocks and encouraging prudent borrowing will be important.

The leading indicators suggest that growth in the Turkish economy, which decelerated in the second quarter of 2014, has been performing better in the second half of the year. There is a moderate recovery in the private consumption and investment demand and the domestic demand has been providing more support to growth. Meanwhile, the contribution of exports to annual growth has relatively declined due to the global economic slowdown. Despite this change in growth composition, the moderate trend in consumer loans and favorable developments in the terms of trade are likely to support the recovery in the current account balance. Thus, the recovery in the CAD is expected to continue, albeit at a slower pace. On the other hand, the uncertainties over the global monetary policies, the geopolitical developments and vulnerable course in external demand still pose a risk to the recovery process.

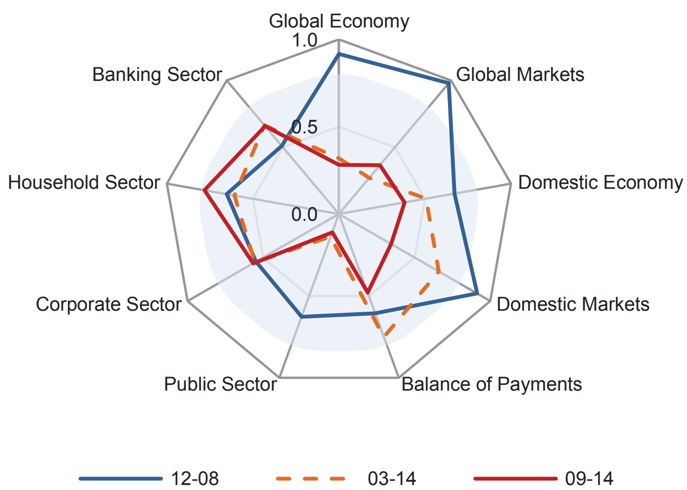
The progressive improvement in the household assets/liabilities balance continues. Growth in household assets continues as a result of the rise in the savings ratio and especially in investment funds. On the liabilities side, the weight of housing loans in retail loans is gradually increasing, while consumer loans are households' primary funding sources. The annual growth of personal credit cards and vehicle loans has been under control with the contribution of macroprudential measures. This is curbing the excessive growth pace of household indebtedness.

The ratio of the financial liabilities of the corporate sector to the GDP continues to increase on the back of the rise in domestic liabilities. The rise in domestic liabilities is mainly driven by TL loans and FX loans remain relatively weak. The outlook on credit conditions and interest rates of loans extended to firms by domestic banks suggest that banks are willing to extend commercial loans. The corporate sector's external liabilities are stable relative to the GDP and the ratio of short-term financial liabilities to external financial sources has slightly decreased since the last Report period.

The banking system remains resilient and strong. The interest rate shock analysis revealed that the sensitivity of the system against interest rate risk is limited. Moreover, despite the fluctuations in global financial markets, the sector has no difficulty in rolling over its external borrowings and has adequate buffers against any FX liquidity shocks that may emanate from abroad. On the other hand, the banking sector has been using non-deposit funding sources in an incremental manner over the last few years. In response to the prospective effects of this tendency on financial stability, the CBRT has put into effect the implementation of remunerating the Turkish lira component of required reserves in a way to support core liabilities. In the upcoming period, with the ultimate aim of supporting financial stability, the reserve requirement ratios might be revised in a way to encourage extension of maturities of non-core liabilities. Additionally, some technical arrangements in reserve option coefficients may be considered to support stability. Thus, a significant rise may be achieved in the ratio of short-term external borrowing covered by foreign exchange reserves in 2015.

The macro display chart below illustrates the schematic reflection of the developments in financial stability in Turkey within the framework of the analysis conducted. Accordingly, while improvement in the global economy has been limited, volatility in global markets has increased over the last six months. In the same period, domestic factors have been in general favoring financial stability. The positive domestic economic outlook can be attributed mainly to the moderate improvement in confidence indices and the recovery in the loan trends. The strong support from domestic markets to financial stability can be attributed mainly to decline in fluctuations in exchange rates and asset prices resulting from the fall in the risk premium and the decreased level and volatility in interest rates.

Financial Stability Map[1,2]



(1) Getting closer to the core means that the contribution of the related sector to financial stability has increased on the positive side. The analysis allows an historical comparison within each sub-sector. A cross-sector comparison is available only in terms of the direction of the change in the positioning as to the core.
(2) For the methodology used in the financial stability map, see Financial Stability Report (FSR) v.13, November 2011-Special Topic IV.10.