Turkish banking crisis: another indication of global turbulence

Nick Beams
6 December 2000

There are increasing signs that the global financial system is heading for another crisis, the consequences of which could be even more severe than the so-called Asian crisis of two years ago.

Last month Argentina announced emergency measures, based on savage cuts in government spending, in order to try to secure a bailout from the IMF and enable it to cover short-term foreign debts falling due next year.

Now Turkey is in emergency discussions with the IMF to secure assistance to counter a financial crisis which has seen overnight interest rates rocket to more than 1,700 percent over the past few days.

Both Argentina and Turkey had earlier won praise from the IMF for their fiscal policies and for "structural reform" of the financial system. But now they are at the eye of a financial storm which could spread rapidly.

The immediate origins of the Turkish crisis lie in the banking system. The government has already placed 10 banks in receivership and the IMF is believed to be pressing it to close more. Many of the failed banks are involved in corruption allegations, including making unsound loans to businesses owned by bank officers and directors and to politically well-connected individuals.

The crisis began to spread to the entire financial system when the central bank last week injected about $6 billion into the economy rather than moving to step up bank closures. The cash infusion was in violation of a disinflationary program that bans domestic credit creation and called into question the sustainability of the exchange rate regime. Banks and other institutions began cutting back on credit, sending overnight interest rates skyrocketing.

The growing fear in financial circles is that the crisis could spread to healthy banks and financial institutions and rapidly impact on other countries.

In a December 3 editorial the *Financial Times* warned that while the country's largest banks were "solid", there were "growing worries that other institutions have weak balance sheets. And in a vicious circle typical of such crises, the rise in interest rates over the last few days has intensified the problems of struggling banks."

According to Dani Rodrik, a Harvard professor of international economics, there is a "real possibility" that the crisis could spread to Russia and Eastern European countries. "Where it could go from there, together with the uncertainties about Argentina, would be anybody's guess."

The Turkish stock market has fallen about 40 percent over the past two weeks, including an 8 percent plunge on Monday, and investment funds are flowing out of the country. Government officials are trying to maintain that the financial problems are not severe, describing them as "temporary market fluctuations." While Turkey has about $18 billion in foreign currency reserves, these could rapidly drain away unless agreement is reached with the IMF for an emergency loan of $5 billion.

While the immediate origins of the crisis lie in the Turkish banking system, the rapidity with which it has developed points to worsening conditions in global financial markets.

The *Financial Times* noted that Turkey has "done much right under its current program for stabilisation and structural reform, improving the fiscal position and strengthening regulation of the financial system while making progress in reducing inflation."

"Yet doing well is, in the present adverse climate for emerging markets, not good enough. With high-risk borrowers having to pay sharply increased interest rates, relatively modest weaknesses, exacerbated by

© World Socialist Web Site

policy errors, can trigger disaster. In Turkey, the weakness has been the banking system. The error was the failure to close fragile banks soon enough."

But it is not only the so-called "emerging markets" where problems lie. In fact their difficulties are the expression of tightening credit conditions worldwide.

In a comment published on November 28, the *Financial Times* noted that the tightening in bank lending is a worrying symptom for the world economy. "Is there an incipient global financial crisis?" it asked. "The risks are certainly rising. Spreads in the high-yield corporate bond market [the difference with yields on government debt] are above their levels at the time of the near-collapse of Long-Term Capital Management in 1998. US equities on the technology oriented Nasdaq exchange rate are down more than 40 percent from this year's peak. Argentina is struggling to avoid default.

"Emerging markets in Asia have been hit by political crises, a higher oil price and a waning US demand for their high-technology exports. Their debt problems have taken a turn for the worse. Meanwhile telecommunications companies across the world are over-indebted thanks to acquisitions and costly bids for third-generation mobile telephone licences."

The comment concluded that while there was not yet a "credit crunch", there was a "worrying combination of contracting credit, declining asset quality and weakening equities."

Last October in a major article, the *Economist* magazine asked whether the big banks in America and Europe were heading for another crisis. The article was based on claims by David Gibbons, who is responsible for American banks' credit risk in the Office of the Comptroller of the Currency. According to Gibbons, the banks have been underestimating their risks.

While the Federal Reserve Board and other regulators do not share this assessment, the *Economist* pointed out that the concerns of Gibbons and his counterparts were "understandable".

"There have been too many banking crises in recent years to put much faith in banks. Just think back to the Latin American debacle of the 1980s; the savings-and-loans trouble in America in the early 1990s; the insolvency of many big Scandinavian banks around the same time; the huge problems at France's Credit Lyonnais; and, last but not least, Japan's rumbling, hugely expensive and still unresolved banking crisis."

According to the *Economist's* assessment problems now stand out: the increase in problem loans in the US, the impact of the turmoil in capital markets on commercial banks which have been expanding their investment-banking business in recent years and the banks' "huge lending exposures to telecom firms."

There were "worries aplenty in both Europe and America that banks may have overstretched themselves." These problems could be overcome provided the US stock market did not crash and the economy stayed out of recession, and if European investors began moving money bank into telecommunications. "But in both regions, there are big 'ifs', and unless they come right, banks look vulnerable."

Since these warnings were issued, the Argentine and Turkish financial crises have erupted and it has become clear that the US economy is headed for a rapid slowdown in growth, if not a recession.

To contact the WSWS and the Socialist Equality Party visit:

wsws.org/contact

© World Socialist Web Site