

Resilience of the Turkish Financial System to Failed Coup Attempt

Selim Kayhan*
Muhsin Kar**

Abstract

In this study, we aim to analyze the impact of coup attempt carried out on 15th of July on financial sector and the economy of Turkey. In this regard, we investigate a number of variables to see the volatility in financial system and change in the whole economy. Analysis results indicates that the coup attempt did not affect financial system and it works efficiently after a short run recession. In the light of findings, we conclude that the Turkish economy and the financial system are in a good position among emerging market economies.

Keywords

Coup attempt, Turkish economy, financial markets, financial stability, fragile five, CDS premiums

* Assoc. Prof. Dr., Necmettin Erbakan University, Faculty of Social and Human Sciences, Department of Economics – Konya/Turkey
skayhan@konya.edu.tr

** Prof. Dr., Yildirim Beyazit University, Faculty of Political Sciences, Department of Economics – Ankara/Turkey
mkar@ybu.edu.tr

1. Introduction

The Turkish economy has experienced several threats since the global financial crisis in 2008. During this period, along with other emerging market economies, it has felt the effects of the contraction period induced by the crisis. Another source of trouble has been the end of the quantitative easing program in the United States. In addition to economic shocks, social and terroristic actions have affected financial stability in Turkey. The latest of these was the unsuccessful coup attempt by the FETO terrorist organization on July 15, 2016. Although the attempt was defeated, more than 200 civilians were killed and more than 2000 people were injured.

Credit rating institutions interpreted the unsuccessful coup attempt as political instability and immediately reduced the credit rating of Turkey. Standard & Poor downgraded Turkey's outlook from BB+ to BB and its rating outlook to negative. The first sign means that speculative attacks are an important threat to the whole economy and the latter means that a rating may be lowered. Another credit rating institution, Fitch, followed the same path; it downgraded Turkey's long-term credit outlook from BBB to BBB- and determined the outlook as stationary. Moreover, Moody's warned Turkey about the possible downgrade of its outlook because of potential political instability affecting the financial system and insufficient economic growth performance in the medium term.

Are all decisions and warnings about the economy and the financial system of Turkey rational in the context of the theoretical explanations? The basic indicators about the economy and the financial system confirm the situation contrary to the warnings mentioned above. When we take into account basic indicators such as interest rates, the value of the national currency, the credit default swap (CDS) premiums in the economy, and the indices of Borsa Istanbul, the national stock exchange index, the system is still reliable and investible.

Judging from the definitions of financial stability, the system still assesses prices, allocates and manages financial risks (Schinasi 2004), and allocates resources and spreads risks (Deutsche Bank 2013). The statistics on the Turkish financial system just after the coup attempt on July 15 support the view that it did not induce financial instability via political instability. Hence, the "trust" of the players in the financial system may remain.

The remainder of the paper is organized as follows. In the following section, we present the theoretical framework of the financial stability issue. In the third section, we investigate the status in the financial system by employing basic indicators. In the fourth section, we compare the current situation in Turkey with that in the so-called “fragile five” economies, Brazil, India, Indonesia, South Africa and Turkey. The fifth section concludes.

2. What the Theory Says

In finance theory, the stability of a financial system can be thought of in terms of the financial system’s ability to (a) facilitate both an efficient allocation of economic resources and an effectiveness of other economic processes such as wealth accumulation, economic growth, and ultimately social prosperity; (b) assess, price, allocate, and manage financial risks; and (c) maintain its ability to perform these key functions even when affected by external shocks or by a buildup of imbalances, primarily through self-corrective mechanisms (Schinasi 2004). According to the definition of Deutsche Bank (2013), at the steady state, the financial system efficiently performs its key economic functions such as allocating resources, spreading risk, and settling payments, even in the event of shocks, stressful situations, and periods of profound structural change.

Unlike price stability, it is impossible to understand if the system is on a stable path because numerous macro- and micro-level factors play dominant roles in the financial system and its health. Uncertainty is one of the key concepts affecting the financial system. Schinasi (2004) explains uncertainty in the financial system by using human trust. Unlike the fiat money system, the financial system involves human promises to pay back specific amounts of fiat money in the future. By doing so, it existentially embodies uncertainty, and potential benefits and costs are both associated with it. Hence, the system provides the mechanisms for transforming, pricing, and allocating the economic and financial uncertainties and risks built by human trust. Therefore, on the one hand, the financial system provides the advantage of enlarging the pool of liquidity available for borrowers, by accepting that uncertainty has created social welfare gains beyond what fiat money alone could provide. On the other hand, trust is fragile and it easily becomes an important source of instability in the system.

Once instability occurs, the health of the finance sector deteriorates, and this takes a long time to heal. When trust is broken, it takes months to recover. This is the reason for the asymmetric behavior of investors. They are hesitant and skeptical when risk lowers and react slowly to new conditions. In the case of an increase in risk and/or a break in trust, by contrast, investors react swiftly.

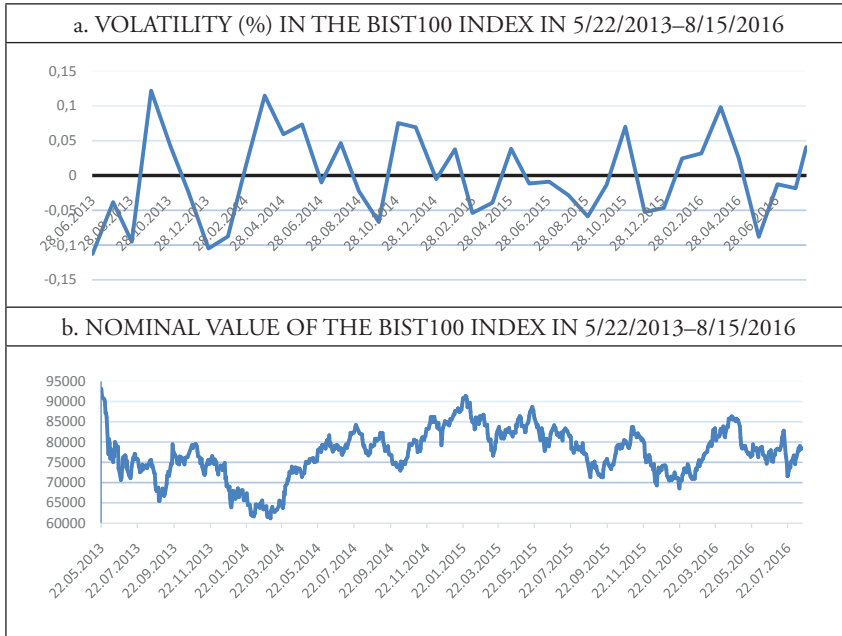
The prevailing political conditions are among the most effective factors influencing the behavior of investors in the context of trust. Political instability has a pass-through effect on financial stability, especially in emerging market economies. The transmission mechanism works through several channels and becomes effective in both the financial system and the real sector. In a politically unstable economy, the risk appetite of investors tends to decrease, causing investors to look for safe havens. This reduces the amount of capital in the economy and contracts the system. As a result, the volatility of the indicators measuring financial stability increases.

3. What the Numbers Say

In this section, we examine the behavior of four key indicators to investigate the stability of the financial system in Turkey, namely stock exchange indices, interest rates, the value of the national currency, and CDS premiums in the country. We obtained all the data belonging to variables IMF (2016). In addition to the actual outlook of the indicators, their long-term trend is reviewed to extract the effect of the coup attempt. We also compare the trend with those in other emerging market economies as well as the group of fragile five countries.

The first indicator reflecting the value of the firms in the stock market is the BIST100 index. As shown in Figure 1(a), the stock index has been volatile since the declaration of the end of the quantitative easing program in the United States. The index decreased by more than 20% in 10 weekdays after May 23, 2013. Even after one year, the index had not fully recovered. Despite this high volatility in the stock market during this period, the trend had a positive slope (see Figure 1(b)). This finding means that the BIST100 index supported continuous economic growth in the Turkish economy throughout the study period.

Figure 1



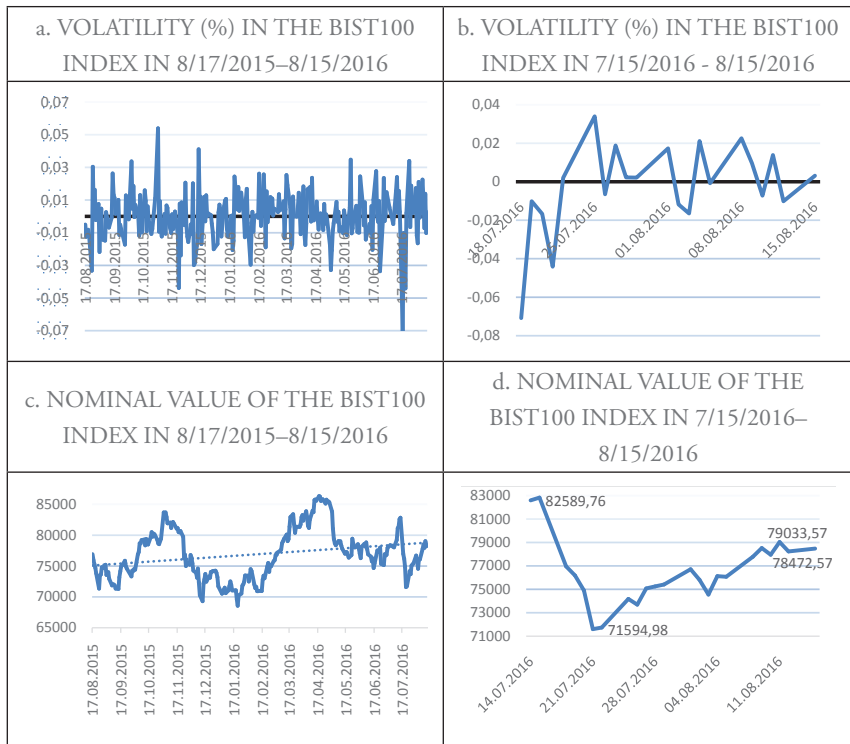
When we examine the BIST100 index over a shorter time period (Figures 2(a) and 2(c)), there are two tails in the volatility: one is positive and the other is negative. The positive tail was more than 5% on November 2, 2015, just after the Turkish elections. The other tail was after the coup attempt on July 15, 2016. While the index was less volatile and increased on a stable path after the elections in November 2015, the index responded positively to the coup attempt.

In July 2016, the peak of the volatility occurred on the first weekday after the coup attempt. The index then dropped from 82,589 to 71,594 in three days. In the following days, it climbed over the 75,000 level in a week and recovered almost half of the decline in the first week of August, as indicated in Figure 2(d). The index climbed back over the 79,000 level on August 12.

Figure 2(c) indicates that the BIST100 index had an upward trend. Further, the trend line indicates that the index should have reached the pre-coup attempt level by the end of September. The slope of the upward trend is considerably high compared with the slope of the downward trend

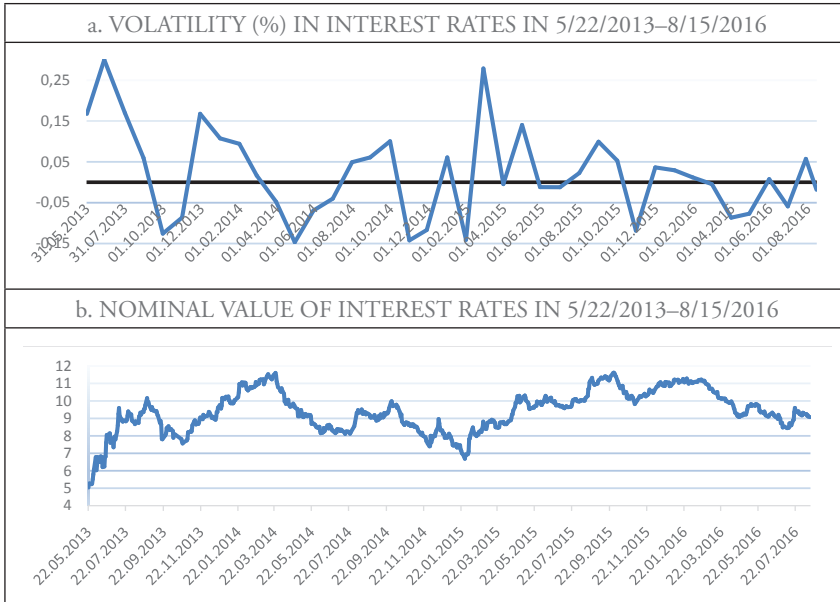
experienced after the coup attempt. To summarize, it is hard to interpret the volatility in the BIST100 index as a sign of financial instability in the Turkish economy. Indeed, the coup attempt may not have induced a politically unstable environment in Turkey.

Figure 2



The second indicator is a two-year yield government bond, which offers insight into the interest rates employed in the financial system. Long-term interest rates exhibit high volatility, too. After May 2013, interest rates increased substantially, rising to 11%. After a brief reduction in 2014, global imbalances increased interest rates again. As shown in Figures 3(a) and 3(b), interest rates fluctuated between 8% and 11% in the long-term.

Figure 3



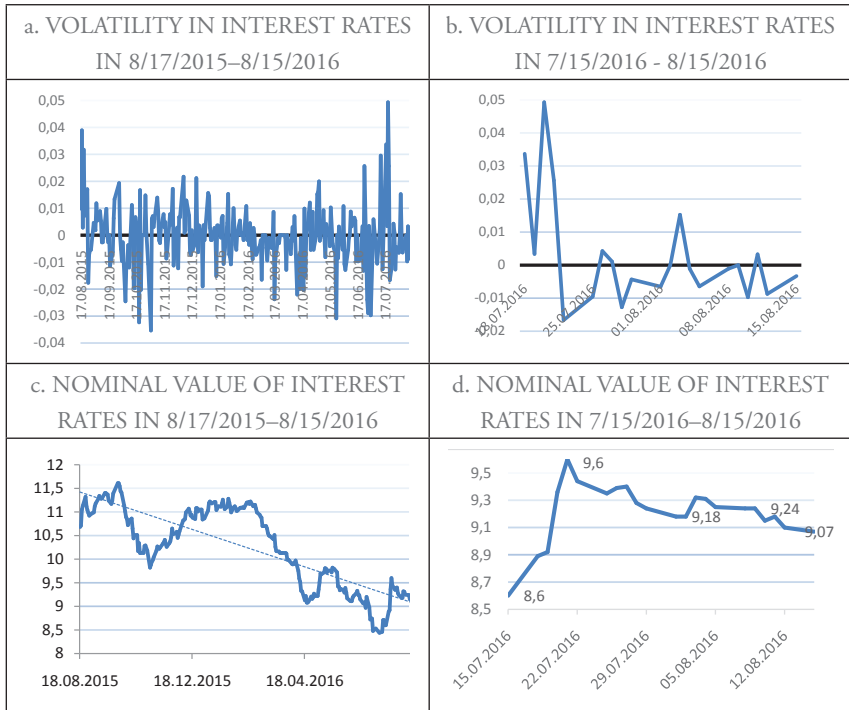
Over the past year, the effects of the coup attempt by the FETO terrorist organization can be seen (see Figures 4(a), 4(b), 4(c), and 4(d)). First, we conclude that interest rates have decreased in the past 12 months (Figure 4(a)). After the November 2015 general elections, rates decreased to around 4%, but changed positively after the coup attempt on July 15 (Figure 4(c)). Despite the shock on July 15, the rates trend remained negative during the year (Figure 4(d)).

Interest rate conjuncture in the third week of July raised rates compared with the week before. However, they started to decline in the last week of July and kept decreasing in the following month. Hence, the impact of the coup attempt had a limited effect on interest rates because financial institutions continued to work efficiently.

Moreover, rates were approximately 11% at the beginning of 2016 and changed by no more than a percentage point between July 18 and July 25, as indicated in Figure 4(d). When we consider the trend in past weeks, we return to the starting point on 15 July, with interest rates dropping to 8.6% on September 15. Although the downward trend was not as steep as the

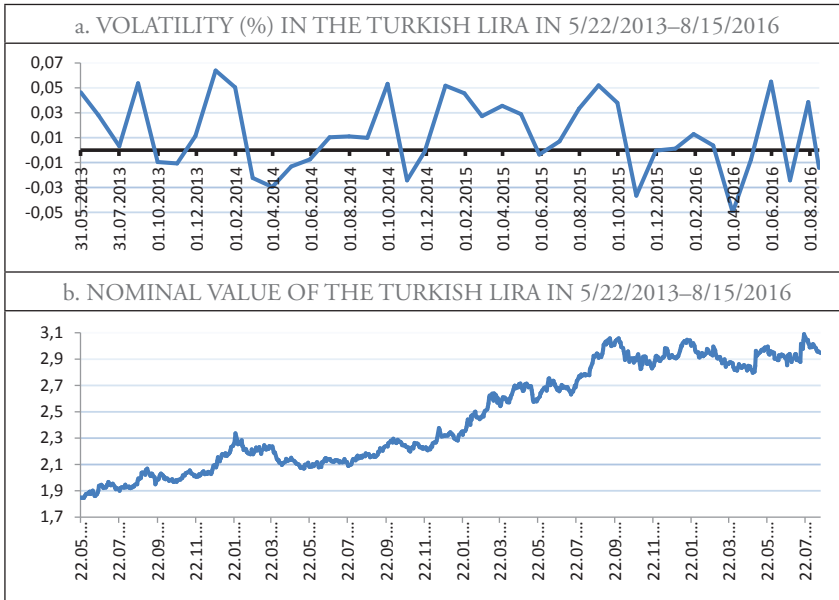
hike in the BIST100 index, the prediction for interest rates was similar to that for the BIST100 index. To summarize, the response of interest rates to the coup attempt improved the stability of the Turkish financial system.

Figure 4



The third indicator used to assess a financial system’s stability is the value of the national currency against foreign currencies. Figure 5 clearly states that the value of the Turkish lira against the U.S. dollar fell after the announcement of the end of the quantitative easing program in the United States. While the volatility of the exchange rate was high, it was generally positive (see Figure 5(a)). When we compare the movement of the Turkish lira value with the other fragile five countries, we conclude that the shocks in the global economy affected these economies in a similar way. Further, the impact of global shocks was higher than that beforehand because of the integration of these economies into a global economic structure. As shown in Figure 5(b), there was also an upward trend in the value of the U.S. dollar against the Turkish lira.

Figure 5



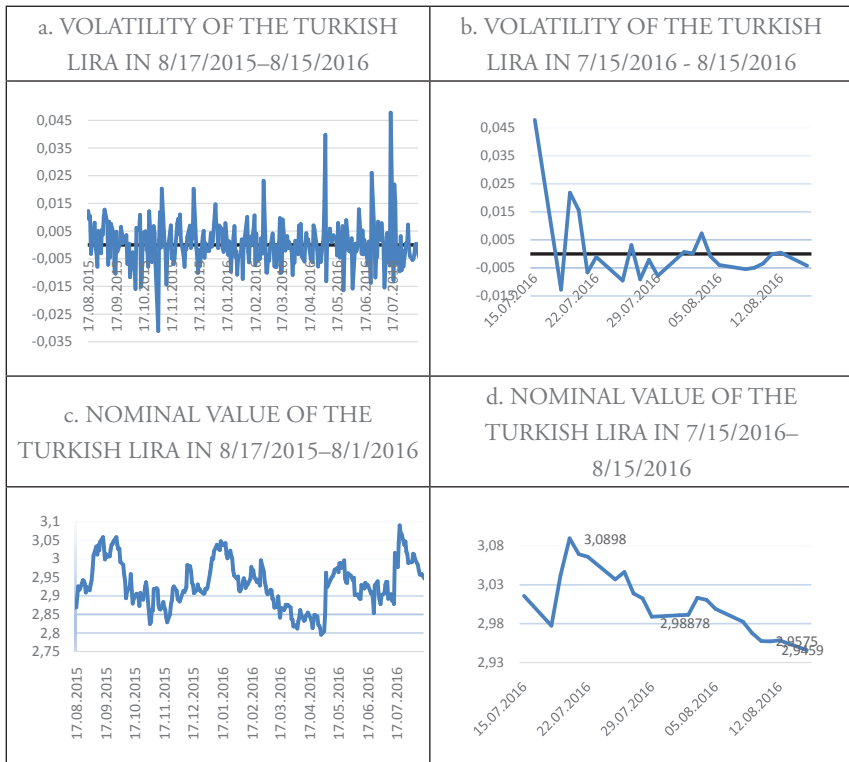
In the short-term, the value of the Turkish lira started to recover after the elections in November 2015. There was a downward trend after these elections. Indeed, the volatility and reduction in the value of the Turkish lira somewhat balanced. However, the strong economic indicators of the U.S. economy announced at the beginning of May and the results of the Brexit election in June had a level effect on the value of the Turkish lira against the U.S. dollar (see Figures 6(a) and 6(c)).

Moreover, the depreciation of the lira has not been corrected during the past year. Another high volatility period occurred after the coup attempt in July; however, it had no level effect. Figures 6(b) and 6(d) show that after the depreciation of the lira to around 4.5%, there was an appreciation trend. While it rose to 3.09, the TL/USD nominal exchange rate was 2.94 a month after the coup attempt. Despite the high volatility in the following days, the total depreciation of the Turkish lira was only 3%. Despite the capital outflow after the coup attempt, domestic investors prevented the possible depreciation of the Turkish lira by selling U.S. dollars in their portfolios. The week after the coup attempt, citizens sold more than \$8.5 billion in the financial system. Although there is no rational explanation of

this behavior in such a capitalistic system, Turkish citizens prevented the coup attempt not only physically but also economically. In other words, while they protected democracy on the streets, they also protected economic stability in their bank accounts.

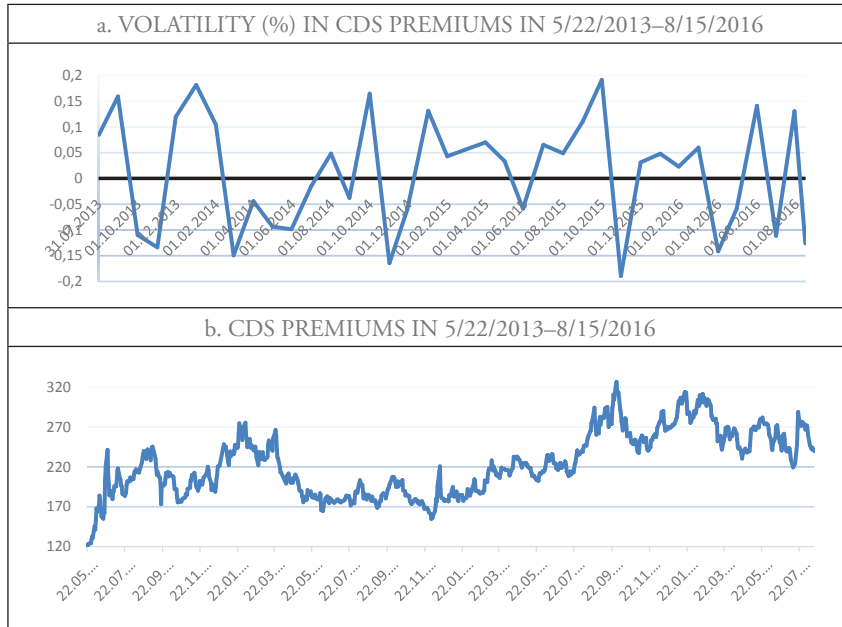
Another issue is that the value of the Turkish lira became stable and dropped compared with the pre-coup attempt (2.94), while the depreciation of the British pound against the U.S. dollar was still about 10%, keeping its position for more than a month. In light of the situation in the United Kingdom, the recovery of the Turkish lira was admirable for an emerging economy. When we predict the movement of the Turkish lira in the short-term, we conclude that the appreciation period of the Turkish lira may continue. Indeed, the slope of the downward trend was considerably steep.

Figure 6



The last indicator to check is CDS premiums. CDS can be employed to assess the stability of the financial system in a country. An increase in CDS means that the economy is worsening. The path of the CDS premiums in the Turkish economy is similar to those of the other indicators we investigate herein. After the end of the quantitative easing program, the CDS of emerging market economies increased because of capital outflows. As one of the most international capital-dependent economies, the Turkish economy has experienced the most volatile CDS premiums in recent years. Indeed, it is possible to see the effects of both internal and external shocks. One of the largest fluctuations was in the last quarter of 2015 because of the general election. CDS premiums increased sharply from 211 points to 312 points because of the unstable political environment. Following the victory of the AK party, premiums reduced gradually to 239 in April 2016 (see Figure 7).

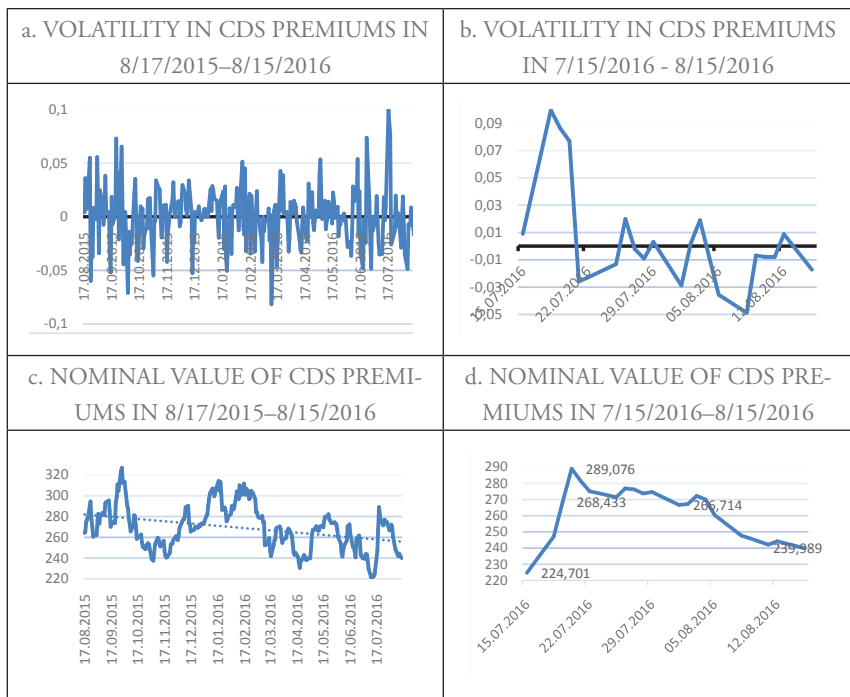
Figure 7



When we analyze CDS in depth, we note the volatility during the past year as well as throughout the study period (see Figures 8(a) and 8(b)). Shocks such as FED meetings, terroristic attacks, and the crisis in Syria influence

emerging economies and affect CDS negatively. The coup attempt on July 15 influenced CDS premiums in a similar way. The hike was about 29%, increasing from 224 to 289 points. However, after a short time, it started to reduce gradually. A month after the coup attempt, it was 239 points again. The trend in the CDS premiums of Turkey suggests that CDS premiums will continue to reduce gradually. The steepness of the slope of CDS premiums was lower than that of the other indicators, while the impact of the coup attempt on CDS premiums was not as high as that in an unstable political environment (i.e., between the two elections in 2015). Further, the index decreased to almost the same level as when the election results were announced. In conclusion, CDS premiums were close to the pre-coup attempt level when we compare the volatility range. Hence, there is no need to make a prediction for the normalization of CDS premiums.

Figure 8

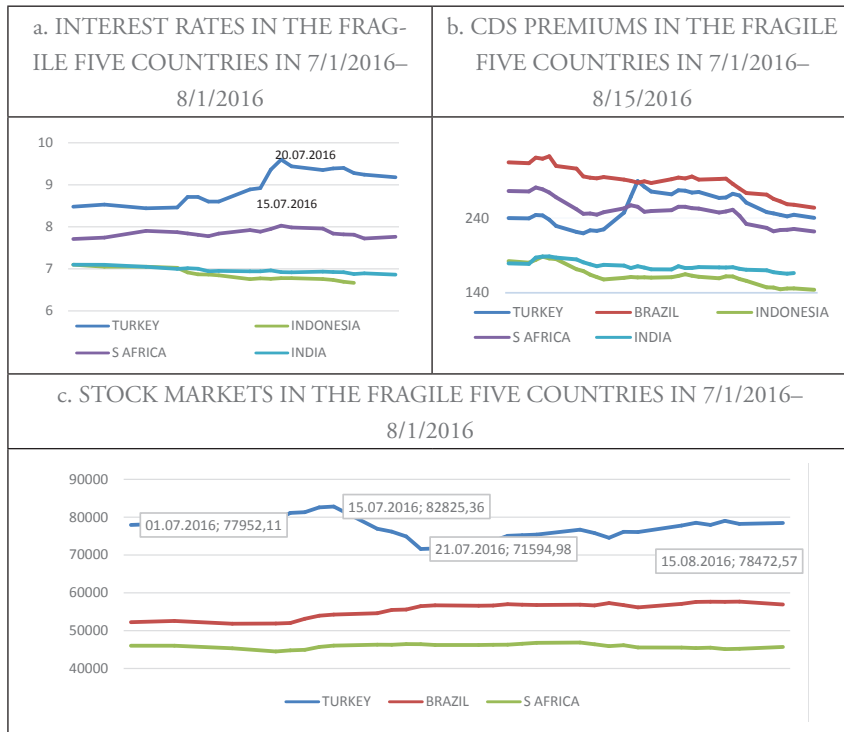


4. Recent Developments in the Fragile Five Countries

The comparison of recent developments in the fragile five economies may offer some insight into the impact of the coup attempt on July 15. The trends of CDS premiums and interest rates were in line with those of other countries. However, the coup attempt influenced interest rates and CDS premiums (both series have steeper trends). Hence, neither the CDS premium nor the interest rate indicators behaved differently from those in other economies. A month after the coup attempt, the trend lines of the CDS and stock exchange indices of the countries were similar again. It is thus clear that the Turkish economy recovered quickly.

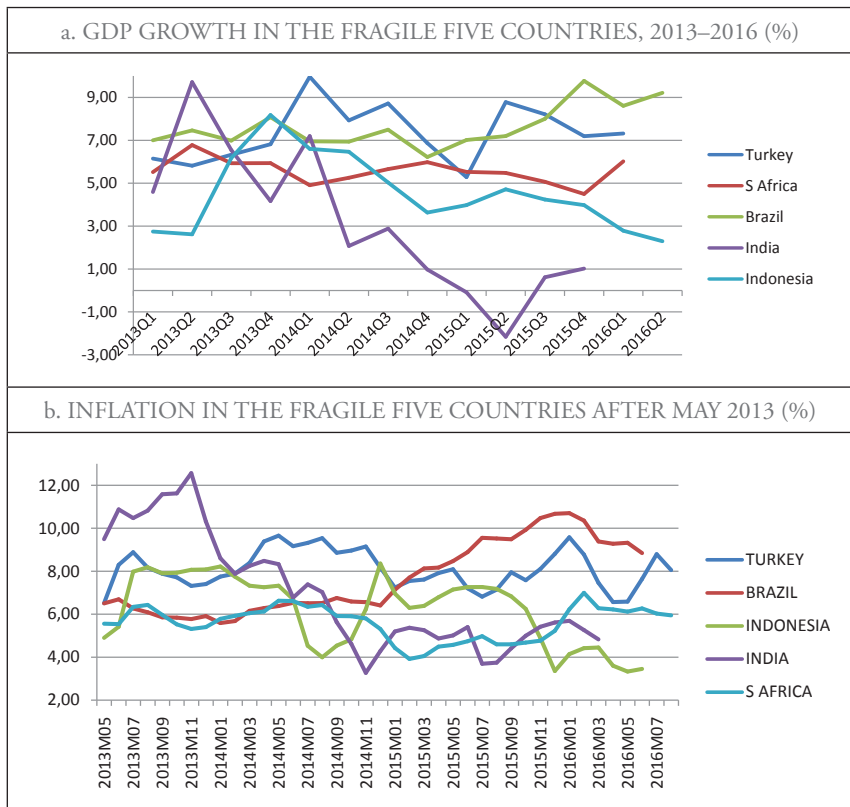
Stock markets had an upward trend during the first half of July 2016, as did the BIST100 index. However, the coup attempt cut the period sharply. In the last week of July, the BIST100 index recovered quickly and the upward trend was steeper than those of the other stock exchange indexes (Figure 9).

Figure 9



By comparing other macroeconomic indicators, we see that the Turkish economy had a similar performance during the post-2013 period. The growth performance of the Turkish economy was considerably better than that in the other fragile five countries (Figure 10). In terms of price stability, Turkey does not have the best performance compared with the fragile five countries, but its volatility is considerably low. Despite the lack of macroeconomic data on the post-coup attempt period, it is possible to predict that Turkey is following the same trend as other emerging market economies.

Figure 10



5. Conclusion

The fragility of the financial system, especially in emerging economies, is influenced by numerous factors. One is political stability. In an unstable political environment, the financial system does not work well and does

not meet the needs of the economy. In this regard, political stability is a precondition for a healthy financial system. Moreover, once an unstable political environment exists, the stability of the financial system worsens rapidly and heals only gradually.

The failed coup attempt on July 15 showed the strengths of the Turkish economy as well as its financial system. The main indicators of the financial market in the country worsened in the short-term as expected theoretically. In contrast to the theory, however, the recovery of the financial market was just as fast. Indeed, the indicators healed sharply, not gradually. Although the recent shocks in the economy have healed gradually, financial institutions and state agencies have worked well and have coordinated the economy efficiently.

Moreover, when we compare the situation with the other fragile five countries, the impact of the coup attempt can clearly be seen. However, the recovery trend makes it possible to catch them. Most of the indicators are already halfway there. One of the main reasons for the fast economic recovery is that the Turkish economy is closely connected to the international financial system, which helps prevent external and internal shocks in the context of perfect competition theory.

The comparison of the Turkish economy with the fragile five countries for the period of the pre- and post-coup attempts offers insight into how the economy responded to the shock. We conclude that the Turkish economy has already started to heal. The economic environment in Turkey is no worse than that in other economies. Moreover, the coup attempt did not create an unstable political environment and did not diminish the credit rating of the Turkish economy.

References

- Deutsche Bank (2003). *Report on the Stability of the German Financial System*. Monthly Report, December.
- International Monetary Fund (2016). *International Financial Statistics*. Access Date: 25/08/2016.
- Schinasi, J. G. (2004). *Defining Financial Stability*. IMF Working Paper, no. WP/04/187.

Türk Finansal Sisteminin Başarısız Darbe Girişimine Direnci

Selim Kayhan*
Muhsin Kar**

Öz

Bu çalışma, 15 Temmuz darbe girişiminin finansal sistem ve Türk ekonomisine etkilerini analiz etmeyi amaçlamaktadır. Bu bağlamda finansal sektördeki dalgalanmayı görmek için birkaç değişkenin davranışını ve ekonomideki değişimi incelenecektir. Analiz sonuçları, finansal sistemin darbe girişiminden etkilenmediğini ve sektörün kısa süreli bir daraldıktan sonra etkin bir şekilde çalıştığını göstermektedir. Bu bulgular ışığında, yükselen piyasa ekonomiler arasında Türkiye ekonomisinin konumunun iyi konumda olduğu değerlendirilmiştir.

Anahtar Kelimeler

Darbe girişimi, Türkiye ekonomisi, finansal piyasalar, finansal istikrar, kırılma beşli, CDS primleri

* Doç. Dr., Necmettin Erbakan Üniversitesi, Sosyal ve Beşeri Bilimler Fakültesi, İktisat Bölümü – Konya/Türkiye
skayhan@konya.edu.tr

** Prof. Dr., Yıldırım Beyazıt Üniversitesi, Siyasal Bilgiler Fakültesi, İktisat Bölümü – Ankara/Türkiye
mkar@ybu.edu.tr

Соппротивление Турецкой Финансовой Системы против неудачного переворота

Селим Кайхан*

Мухсин Кар**

Аннотация

В данном исследовании мы стремимся проанализировать влияние попытки государственного переворота 15 июля на финансовый сектор и экономику Турции. В связи с этим, мы исследуем ряд переменных, чтобы увидеть волатильности в финансовой системе и изменения в экономике в целом. Результаты анализа показывают, что попытка переворота не повлияло на финансовую систему, и она работает эффективно после короткого сокращения. В заключении, мы приходим к выводу о том, что турецкая экономика и финансовая система находится в хорошем положении среди стран с формирующимся рынком.

Ключевые слова

Переворот, Экономика Турции, Финансовые рынки, финансовая стабильность, хрупкий квинтет, премии КДС

* доц. док., Университет Нежметтин Эрбакан, факультет гуманитарных и социальных наук, факультет экономики - Конья / Турция
skayhan@konya.edu.tr

** Проф. док., Университет Йилдирим Бейазит, факультет политических наук, факультет экономики - Анкара / Турция
mkar@ybu.edu.tr

