

Banking Sector Fragility and Turkey's 2000-01 Financial Crisis

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Abstract

This paper analyzes the underlying causes of Turkey's most recent financial crisis (from mid-November 2000 to February 2001) and concludes that the root cause was the combination of banking sector fragility and a set of triggering factors. While the role of banking sector fragility has been noted in other studies, this paper examines for the first time the structural characteristics of the Turkish banking system and provides a precise definition for the sector's fragility in the precrisis Turkish context. The paper then presents the mechanics of the crisis process.

The root cause of the banking sector fragility was the debt financing of the high public sector borrowing requirement and the way this debt was carried in bank balance sheets-mainly by extremely short-term bank liabilities and increasing currency and maturity mismatches in the balance sheets. The authors note that risk accumulation was not homogenous throughout the system but was dichotomized: private banks versus state banks and within the private banks themselves. This risk accumulation was a result of the weak regulatory and institutional structure of the banking system and measures to alleviate such risks were envisaged by the 2000-02 reform program. However, delays in banking reform played an igniting role in the crisis.