The Role of Low Interest Rates on preference of Savings in Turkey

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THE ROLE OF LOW İNTEREST RATES ON PREFERENCE OF SAVİNGS IN TURKEY

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ABSTRACT

The purpose of this paper is to analyze the role of low interest rates on saving behavior, in Turkey between 1923 and 1980.When the market determines the interest rate, saving is evaluated the only function of interest rate. Historically, in the Turkish Economy, the rate of interest has generally been determined by the public authorities. The Government's reasoning for this was that, due to a lack of accumulated capital, they needed to implement low interest rates to encourage support for the public and private sector, which would in benefit Turkey's industrialization.

In order to collect more deposits, banks used various methods; the most important being is the branching of banks. At the end of the 1970s, both total deposits and time deposits increased despite the negative real interest rate.

Keywords: Interest Rate, Banking, Saving

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INTRODUCTİON

According to neo-classical theory, saving is a positive function of interest rate and disposable income. The rate of interest is the reward of lending money, so household decisions about consumption or savings depend on the return of money. If interest rates are higher than inflation rates, the supply of funds and savings increase due to raised returns of money referred to as" substitution effect of interest rates".

Mainstream theory neglects of the historical background of countries, the effect of institution's behavior and government's interference. This theory analyzes market-based financial systems. Whereas bank-based financial systems have a different structure and saving, preferences are affected by government intervention and the framework of the banking system.

Banks collect deposits and distribute the resources so generally, in developing countries the interest rates are determined by the government due to the lack of capital accumulation for investments. Therefore, the preference of saving cannot be explained by neoclassical theory.

This study will analyze the following, firstly the Ottoman banking system, secondly the development of the banking system in the interwar period and finally, it will investigate the reason for the increase in deposits despite real negative interest rates.

1. BANKING WİTHIN THE OTTOMAN EMPİRE

In the Ottoman Empire, interest rates were banned because of religious beliefs. Thus, banks were developed by non-Muslims sarrafs (Greeks, Armenians, Jews, and Levantines), who were the primary financial intermediaries in the Ottoman Empire.

In the Tanzimat era, to increase state control, the Ottoman economy was monetarized and to finance public expenditures, the government promoted the establishment of banks to replace traditional money lenders. The First Bank, Banque de Constantinopele, was established in 1849 by two sarrafs and the government. It functioned as a foreign exchange stabilization fund for European currencies. Losses of the bank suffered from this role were to be compensated by the Ottoman government. However, in the government debt to the bank increased, so much that the losses of the bank were not covered. Therefore, The bank could not stabilize of money and In 1853 ıt finally/eventually bankrupt. In 1856, the Ottoman Bank was established in London, with British capital, to fund commerce with the Ottoman Empire. French shareholders joined the British founders of the bank and turned it into an international bank in the1860s. The bank also had the exclusive privilege to ıssue banknotes in the Empire. In 1875, the bank became a state bank with new privileges that granted it the authority to pay for governmental expenditures and collect governmental incomes, and also issues banknotes. The bank was successful in eliminating instability, was successful in financing trade.

At the end of the 19th century and the beginning of the 20th century, for the development of national banking, many local commercial banks, and some joint-stock banks were established.

Ziraat Bank, established in 1883, was the most important of these. Originally It was functioned to only an agricultural bank. It played another role due to funding the first World war expense. In the Ottoman empire, the banking system was developed under the dominance of foreign capital. Therefore, it was not created until the establishments of the Turkey that a national banking system was formally established.

Through the independence war, small local commercial banks in Anatolia played a major role in providing food and funds the war. These banks were set up to provide credit to the agricultural sector and protect the small farmer from the adverse effect of higher interest rates. Despite this successful role, the dominance of foreign capital in the banking system continued because of insufficient savings and higher interest rates. Until the establishment of the Republic, the roles of the bank were limited to giving credit or debt, so savings banking did not develop.

2. BANKS, SAVİNGS AND INTEREST RATES IN REPUBLİC OF TURKEY

2.1 1923-1945 THE INTER-WAR PERİOD

After the independence war, the purpose of the government was set up a new economic order to ensure national sovereignty. Initially, ın a view to developing national banking, Isbank was established as a main commercial bank, supported local banks and started to create a central bank. However, not enough saving occurred for industrialization. The lack of capital and credits stimulated government to rearrange banking sector in the 1920s and the 1930s. Until 1930 the ratio deposits, savings to the GDP remained limited.

Due to the impact of the great depression, governments had to implement protective policies.It meant that transitioned from a trade base to an industrial base model. After this period, state banks were established for large investments and finance industry. The central bank determined interest rates. The National Society of Economics worked to develop the habits of savings and confidence to the banks. Until this period money was kept at home or converted to gold because of traditional social structures and banks were not trusted. Between 1923 and 1950 the banking system was established, to support cheap credit for industry low interest rates were determined by central banks.

Table 1. Deposits of Saving Percent of GDP Between 1924 and 1933

Year	Deposits of saving/ GDP
1924	% 0.5
1925	% 0.5
1926	% 0.6
1927	% 1.2
1928	% 1.4
1929	%1.3
1930	%2.0
1931	% 2.6
1932	%2.5
1933	%6.1

Source: Statistical Bulletin of the Central Bank of the Republic of Turkey, 1933, page 32

During the second World War, the banks acted according to the requirements of the military. The increase of public expenses and speculation in food prices lead to rising poverty. Under these cırcumstances, the level of savings remained limited and invested in gold was preferred than to saving in bank accounts.

2.2 AFTER THE SECOND WORLD WAR

After the second World War, capital accumulation increase in the private sector because of the high price of agricultural goods and immigration from rural to urban areas caused rapidly in economic growth. In This period private banking system developed and increased competition. A lottery system was efficiently and extensively used for attracting new customers to the banks. At the end of the 1950s, despite high inflation rates, total deposits in all banks had increased. However, in contrast, the real interest rates were usually negative or low due to the higher rate of inflation.

Table 2: Interest Rates on Deposits and Time Deposits Between 1933 and 1979(%)

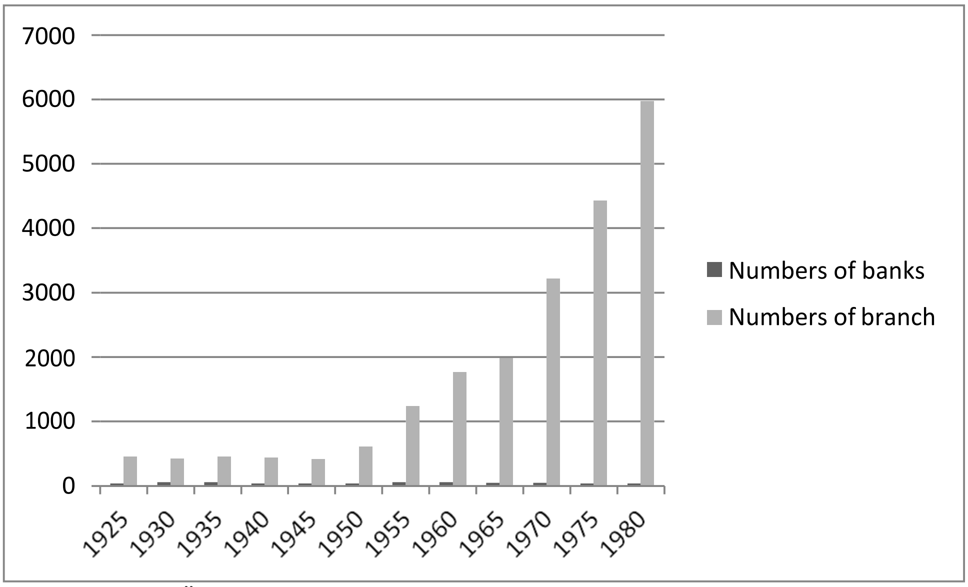
Year	Interest Rates of Deposits %	Real Interest Rates on Deposits	Interest Rates of Time Deposits	Real Interest Rates on Time Deposits
1933	4.5			
1938	4.5	9.8		
1951	2.5	- 3.76	5.0	-1.4
1955	2.5	-4.3	5.0	-1.96
1956	3.5	-1.15	5.0	-1
1960	3.0	-0.2	6.5	1.1
1961	3.0	0.09	6.0	1.03
1964	3.0	1.8	6.0	4.7
1969	3.0	-3.9	6.0	-1.1
1970	3.0	-3.5	9.0	2.16
1973	2.5	-15	7.0	-11.2
1974	3.0	-20.7	9.0	-16
1978	3.0	-32.5	12.0	-26.6
1979	3.0	-37.1	20.0	-26.8

Source: Statistical Bulletin of the Central Bank of the Republic of Turkey, (1933-1979)

Table 2 shows the nominal interest rates and real interest on deposits and time deposits. As can be seen from the table, the interest rates fluctuated although the real ınterest rates were negative after 1950.

According to the neoclassical theory, the increase of saving is impossible under this condition. So what would lead to the savings being increased? Many economists assert that this situation was the result of a promotion of a saving fund. However, the impact of the advancement of a saving fund and lottery was minuscule. It shows that another reason produced this result. If there is a low number of banks, the number of branches increases. Why did the number of branching increase despite low increasing of the number of banks? Because of fixed interest rates, branching banking was pursued to collect more deposits. Many branches mean increasing deposits. The banking system depends on small savers, and this structure continues until the now.

Graph 1: The Numbers of Banks and Branches



Source: Akgüç, Öztin,100 Soruda Bankacılık (1987), Istanbul,p.95-96

In 1960 interest rates on time deposits were 6 percent, to achieve more resources various methods such as lottery, coupons had been tried. However, the main race was to increase the number of branches. Development of branch banking had enabled the development of retail banking. The increase in branching networks had aimed to collect small deposits. While the number of banks nearly remained the same, there had been a significant increase in the total number of branches. An increase in GDP and total deposits occurred together and between 1960 and 1980 the level of national savings occurred nearly 19 percent of GDP.

Saving is a function of interest rates and disposable income. When GDP increases, saving increase, but not at the same rate because there is also growth in consumption. If high inflation rates occur, the cost of holding money rises. In this context consumption patterns change, savings affect negatively because of the high inflation rate. However, in the Turkish economy, saving is not defined by only the function of interest rates and income. After 1950, even though increasing saving rates were due to increase GDP, the main reason for the increase in the number of branches. Refer to Table In 1924 the total number of banks was 35, and the number of branches was 439.By 1947 the number of banks remained about 35 and the number of branches had risen slightly to 500. The number of branches rose shockingly to 2.551 by the 1960s and it reached 5.975 by 1980 while the total number of banks had only increased by five to forty.

TABLE 3 Total Deposits Ratio Between 1963-1980

Year	Total deposits/GDP	Real interest rates
1963	%16.8	% 1.6
1964	%16.5	% 4.7
1965	%17.2	% -1.9
1966	%19.2	% 1.14
1967	%19.9	% - 1.48
1968	%24.0	% 2.71
1969	%25.6	% - 1.1
1970	%25.8	% 2.16
1971	%26.8	% -5.95
1972	%29.4	% -7.6
1973	%27.3	% -11.2
1974	%24.0	% -16
1975	%27.8	% -0.9
1976	%28.9	% -5.7
1977	%28.8	% -12.16
1978	%25.1	% -26.6
1979	%22.0	% -26.8
1980	%18.1	

SOURCE: Annual balance sheet of the banks of The Banks Association of Turkey (1963- 1980), Ankara

Table 3 shows the increasing ratio of total deposits to GDP after 1960 and the volatility of interest rates due to high inflation. If interest rates are determined in the market, the nominal interest rate is adopted according to price theory, and real interest rate is negative.

TABLE 4 Total Quantity of Deposits

Year	Total quantity of deposits
1926	44.334.100
1929	133.498.400
1932	132.806.300
1938	249.837.600
1948	996.309.500
1961	8.541.794.000
1962	9.690.623.300
1963	10.774.176.600
1965	15.701.823.000
1972	70.872.819.000

SOURCE: Statistical Bulletin of Central Banks of Republic Turkey (1926,1929,1932,1938) and Annual Reports of the Banks Association of Turkey (1961,1962,1963.1965,1972)

Table 4 shows the changing of the total deposits, especially after 1950 the total amount of deposits increased substantially. The amount and also the rate of deposits increased after this date.

3.CONCLUSİON

In 1923, the deposit rate was low, because of low interest rate, low GDP and traditional structure of society. After the great depression, according to statism policy, the increasing rates in deposits were on account the establishment of an official state bank. However, after 1950 savings rates rose despite negative real interest rate. It was an inverse relationship between interest rates and savings. Because the theory of price (price is interest rate for this model) did not work and quantity (quantity or income is defined deposits for banks) was determined in the banking system.

The preference of savings of individuals was not only determined by interest rates, but Other factors such as the culture of savings, the government's economic policy, the depth of the financial system, the behavior of banks and industrialization may also be significant and generally, could not be neglected. In the history of Turkish economy because of supporting cheap credit to the private and public sector, interest rates were kept low many years and the banking system negatively impacted it. Despite negative real interest rates, the total amount of deposits in national banks increased. To achieve this result, rather than other financial institutions, e.g. bonds, stock. Banks had campaıgns, and notably branch banking was implemented. In conclusion, the branching reduced the negative effect of low interest and savings increased. It was this branching policy, not high-interest rates, that developed saving habit within the Republic of Turkey.

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Appendix Table1.Total deposits /GDP

Year	Total deposits/ GDP
1924-1931	8,8
1932-1943	12,5
1944-1960	14,3
1960-1970	18,2
1971-1980	20,2

Source: Turkiye Isbankası Tarihi (2001)

Table2.The number of Banks and Branches

Year	The number of total banks	The number of total branches
1924	35	439
1925	42	452
1926	42	433
1927	49	--
1928	57	444
1929	59	446
1930	61	424
1931	62	424
1932	60	483
1933	57	486
1934	54	463
1935	55	449
1936	53	439
1937	49	435
1938	50	436
1939	46	436
1940	44	436
1941	44	434
1942	43	435

1943	42	436
1944	43	405
1945	40	411
1946	42	444
1947	40	469
1948	42	521
1949	43	594
1950	44	611
1951	43	694
1952	45	763
1953	49	893
1954	52	1079
1955	56	1235
1956	58	1364
1957	60	1506
1958	62	1653
1959	60	1720
1960	59	1759
1961	53	1736
1962	52	1759
1963	52	1840
1964	49	1909
1965	49	1981
1966	47	2058
1967	47	2223
1968	48	2551
1969	48	2948
1970	48	3210
1971	47	3427
1972	46	3682
1973	44	4023
1974	44	4425
1975	43	4605
1976	44	4835
1977	44	5238
1978	44	5485
1979	44	5769
1980	44	5975

Source: Akgüç, Öztin, 100 Soruda Bankacılık (1987), Istanbul, p. 95-96