Chapter 14

The Role of Financial Innovation and the Derivatives Market in the World and Turkey in the Context of the Global Crisis of 2008

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ABSTRACT

In Derivatives markets, contracts made concerning an asset or a financial instrument between a buyer and a seller entered into today regarding a transaction to be fulfilled at a future point in time. The derivatives markets incorporate forward, swap, futures and options transactions. Banks, the principle actor in financial markets, find derivatives favorable in developing countries like Turkey in which there is high interest rates and inflation. It is crucial to express the role of the derivatives markets, whereas the uncertainty concerns are perceived enormously. 2008 mortgage crises, the main cause is stated as to sheer of expectations, which started in US and spread out to all developed and developing countries evoke to encounter against risks intensely. The aim of this paper is to study how efficient is the use of the derivatives market instruments in Turkey, a developing country, by the banks and other financial market actors after the 2008 Global Crises.

INTRODUCTION

Within the last 30 years, the biggest development experienced in finance markets is the derivatives market that has emerged with the constant increase of the uncertainty in the markets and the volatility of the prices. Derivatives market emerged in 1970s as an inevitable part of the progress of gaining financial depth, for the countries that gained a significant economic development; and, especially since the beginning of 1980s, it has gained a momentum.
After 2008 financial crisis, defined as the biggest crisis after 1929 economic crisis, it was discussed by many parties that the existing system was inefficient and a new structure had to be established, just like it had been discussed after 1929; and, it has been still discussed. After this uncontrollable and regulation-free structure that deeply affected the world economy, to prevent possible more destructive crises in the future, it is crucial to maintain efforts to eliminate the problems that negatively affect the healthy progress of markets, and to reach a solution.

Emerged in the USA in 2007, expanded to almost all over the world in 2008, and progressively lost its impact in 2009, a crisis was experienced. This crisis began as a financial crisis and then it turned into an economic crisis, and it made a history as being an unprecedented crisis. With 2008 crisis, derivatives have become one of the most discussed subjects.

**LITERATURE REVIEW**

Some of the studies, which came to the fore in the literature review carried out with regard to the subject matter, are briefly mentioned below.

Carter and Sinkey (1998) studied the factors affecting the decision of USA commercial banks with size of assets between 100 million $ and 1 billion $ to use interest rate derivatives and utilization volume. Carter and Sinkey determined in this study that interest rate-based derivatives use is positively related to the interest rate risk, that banks with a more sturdy capital structure use interest rate swaps more, that there is a positive relationship between bank size and the decision to enter into interest rate derivatives transactions, but that the size of the bank has no impact on the utilization intensity of interest rate derivatives.

Hundman (1998) studied the factors affecting the utilization of derivatives by USA commercial banks with a size of assets of more than 500 million $ and determined that large banks, banks with a lower interest rate risk exposure, banks with a higher credit risk exposure and banks with a higher capital/assets rate use derivatives more. It was determined that there was no relationship between bank profitability and derivatives use.

Simons (1995) studied the factors affecting the interest rate derivatives use of USA banks and he determined in this study that; (1) there is no significant relationship between the “gap” criterion which is used in determining interest rate risk and the interest rate-based derivatives use, (2) there is a negative relationship between bank size and derivatives use, (3) banks with a sturdy capital use interest rate swaps more and (4) banks with a bad assets quality use swaps and futures contracts more.

Sinkey and Carter (2000) determined in their research, in which they studied the financial characteristics of USA banks which use derivatives and which don’t use derivatives, that the capital structures of the banks which don’t use derivatives are sturdier and their credit portfolios are of better quality and they are less exposed to interest rate risk. In addition, they determined that there is a positive relationship between bank size and derivatives use and pointed out that this finding reinforces the opinion that economies of scale and scope are in use in derivatives markets.

Gunther and Siems (2002) studied the decisions of mid-sized USA banks to enter into interest rate-based derivatives transactions and the utilization intensity for the banks which use these derivatives as the end user. They determined that the objective of hedging balance-sheet positions is an important factor affecting the decision to enter into derivatives transactions and that there is a linear relationship between bank’s capital adequacy rate and derivatives use intensity.