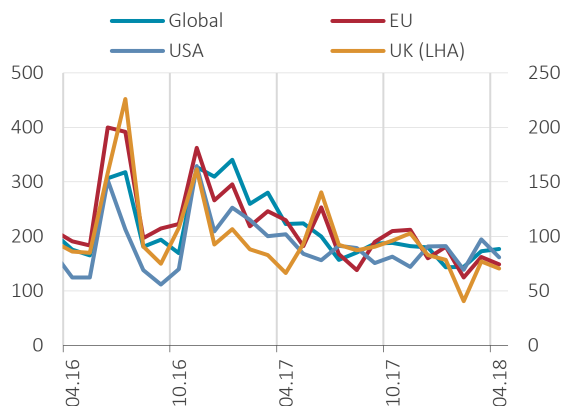
I. Overview

Global economic growth maintains a positive outlook despite rising protectionist trends and geopolitical risks. The growth forecasts for the upcoming period are revised upward for advanced as well as emerging economies, and expectations of normalization in monetary policies of advanced economies are more pronounced, while a monetary tightening trend is foreseen for 2019 in some emerging economies.

The decline in global economic policy uncertainty monitored since January 2017 has recently turned into a rise due to the impact of US-led developments and changes in global trade policies (Chart I.1). There is a discrepancy between advanced economies with respect to the economic policy outlooks. Indeed, together with uncertainties regarding protectionist trade policies and other accommodative fiscal policy expectations, the predictability of economic policy in the United States has reduced. On the other hand, the economic policy uncertainties in the EU and the UK have partially declined since the political uncertainty ended with the completion of elections and the Brexit process has become clearer.

In addition to the acceleration in global economic activity, there was an increase in portfolio flows towards emerging economies thanks to the increasing global risk appetite in the first quarter of 2018 together with the positive growth outlook in emerging economies (Chart I.2). However, owing to the tightening in the global financial conditions since April 2018 and the decline in risk appetite, a weakening in net portfolio flows towards emerging economies has been observed.

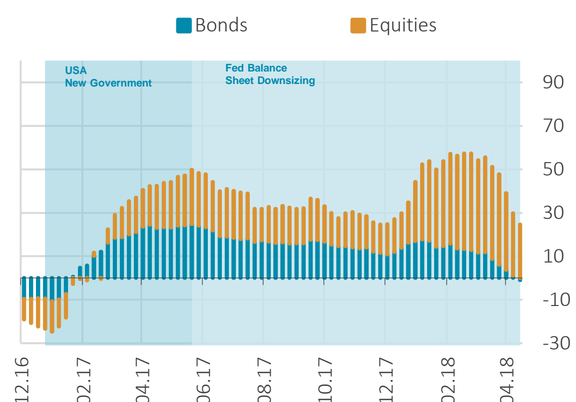
Chart I.1: Economic Policy Uncertainty Indices
(Index, 2012=100)



Source: Bloomberg Latest Data: 04.18

Note: Indices are not comparable among themselves in terms of level.

Chart I.2: Weekly Capital Flows to Emerging Economies
(USD billion, 13 Week Cumulative)



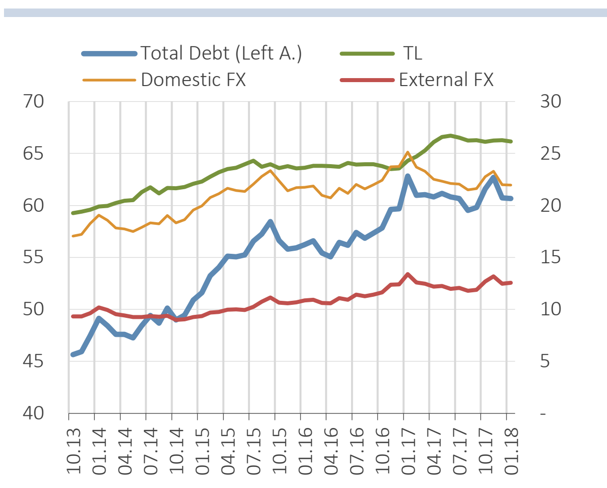
Source: EPFR Latest Data: 09.05.18

Domestic economic activity, on the other hand, preserves its strong trend with measures taken as well as domestic final demand increased through public expenditures. Industrial production and employment developments indicate that the positive outlook will prevail in 2018. Credit growth driven by strengthening of firm collateral especially by the Credit Guarantee Fund (KGF) and with the effects of measures and incentives provided in 2017, converges to long run path as economic activity normalizes.

The financial leverage ratio of the real sector has been moving steadily around 60 percent since the beginning of 2017 (Chart I.3). Although the Turkish Lira (TL) loan volume increased significantly in 2017 with the support of the KGF, the TL financial debt / GDP ratio of the real sector has been flat owing to the rapid growth in economic activity. The share of real sector’s FX financial liabilities in GDP decreased in 2017 because of the rise in the exchange rate level and volatility as well as growing market awareness of managing the FX risk. On the other hand, the household debt/GDP ratio registered at 18 percent by the

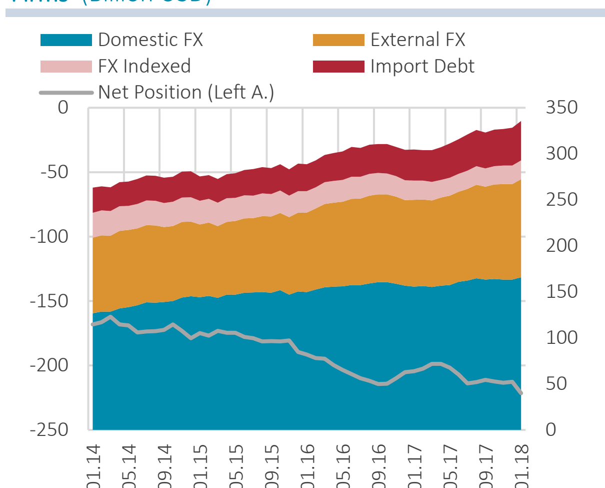
end of 2017 and remains below the average of 30 percent of peer emerging economies. Macroprudential measures regarding consumer loans and credit card usage show that indebtedness indicators maintain a positive outlook.

Chart I.3:Share of Real Sector Financial Debt in GDP (%)



Source: CBRT, BRSA Latest Data: 01.18

Chart I.4: FX Liabilities and Net FX Position of Real Sector Firms (Billion USD)

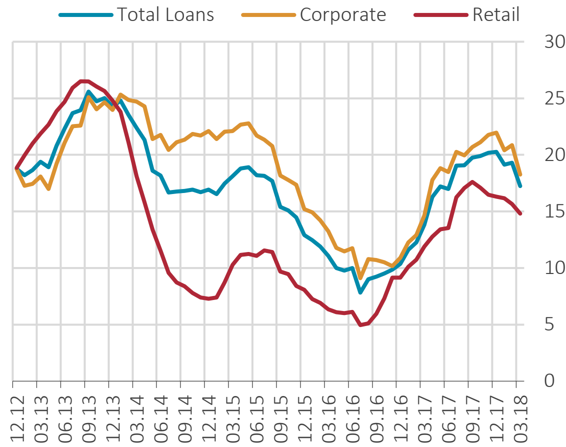


Source: CBRT Latest Data: 01.18

Although the upward trend in the real sector's FX open position moderately slowed down in 2017, the size of the open position was USD 223 billion as of the latest data (Chart I.4). High levels of FX liabilities may increase the vulnerability to exchange rate shocks of firms with insufficient amount of FX income and assets or with maturity mismatches in their balance sheets. Also, in times of rising macroeconomic uncertainty, high FX liabilities may urge firms to purchase large amounts of FX from the market in order to reduce the exchange rate risk on their balance sheets. For this reason, the measures intended to reduce the FX debt burden of firms without FX income are essential both for the financial strength of the firms' balance sheets and for the financial stability of the country. In this context, efforts based on FX debt regulation for the firms with insufficient FX income and prohibition of FX indexed loans pursuant to the amendment made in decree no.32 as well as the Systemic Risk Data Tracking System (SRVTS) which was initiated for the FX debt management of large corporates are expected to make a structural contribution to the financial stability.

The impact of the measures and incentives initiated in the last quarter of 2016 has declined in the last quarter of 2017, and due to both supply and demand-side factors and the base effect, credit growth has entered a period of balanced path converging to historical average (Chart I.5). In this period, as the increase in funding costs were reflected in loan rates, the credit-deposit spread has widened and financial conditions started to tighten. The balancing in credit growth has been driven by the slowdown in housing and commercial credit growth rates and low growth in FX loans as a result of exchange rate developments. General-purpose loans maintain high growth rates through increased employment opportunities and prolonged maturities, despite interest rate developments and the termination of fiscal stimulus policies supportive of household demand. As a result, the credit to GDP ratio has followed a horizontal course and the annual difference in the ratio has narrowed (Chart I.6). The moderate slowdown in total loan growth is expected to continue.

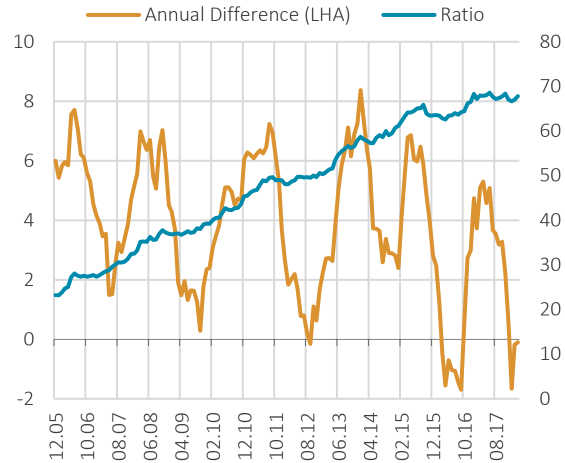
Chart I.5: Annual Loan Growth (Adjusted for Exchange Rate, %)



Source: CBRT Latest Data: 03.18

Note: FX-indexed loans are included in FX loans and adjusted for exchange rate using a weighted basket of 0.3 for the euro and 0.7 for the US dollar.

Chart I.6: Credit/GDP Ratio (%)

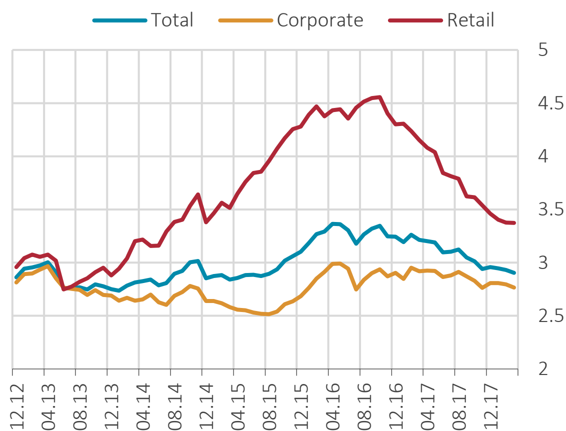


Source:: CBRT, TURKSTAT Latest Data: 03.18

Note: The ratio takes stock of credit over the sum of monthly GDP over the past 12 months.

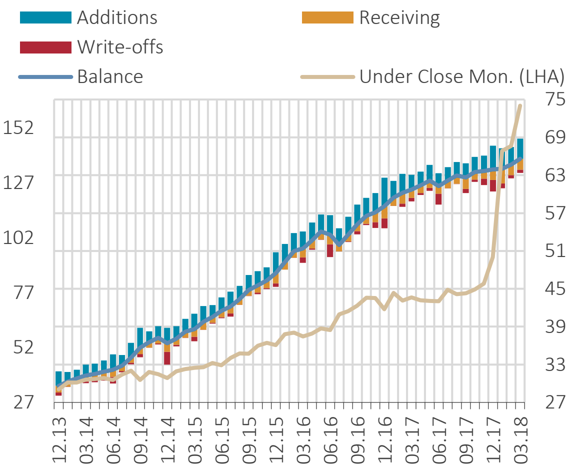
The banking sector maintains a stable outlook on its asset quality. Despite the recent slight increase in additions, the favorable outlook for non-performing loan (NPL) receivables has led to a limited increase in the NPL balance. As a result of these developments, the NPL ratio has fallen below 3 percent (Chart I.7). The increase in the closely monitored loans in 2018 is due to the change in financial reporting standards (Chart I.8). Turkish banks starting to use the new Turkish Financial Reporting Standard (TFRS-9) from the beginning of the year in financial reporting, and utilizing their own internal credit models in loan classifications have been effective in this increase. While the restructuring in large corporations' loans has seen a limited increase, the supportive nature of economic growth and macroprudential policies support the sector's strong asset quality outlook in 2018. As strong export growth and domestic demand both support economic activity, and limit the adverse effects of exchange rate developments on balance sheets and cash flows of large-scale firms. The restructuring of loans in the recent period is not a general reflection of the sector's needs, but rather serve the purpose to extend loan maturities to match that of cash flows of these companies.

Chart I.7: NPL Ratios (%)



Source: BRSA Latest Data: 03.18

Chart I.8: NPL Components (Billions TL)

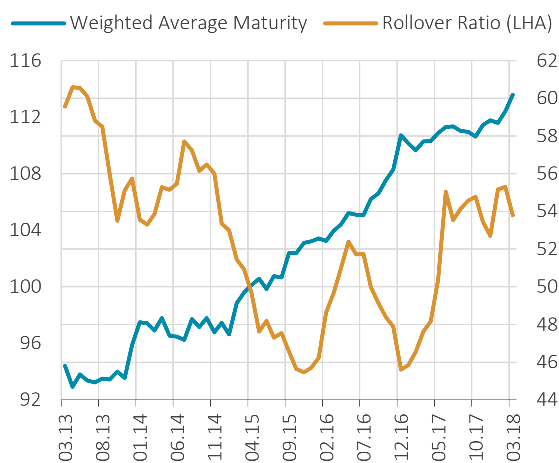


Source: CBRT Latest Data: 03.18

The banking sector, which maintains its strong liquidity position, is increasing its use of foreign sources (Chart I.9). Strong loan growth which was above the historical averages in the first three quarters of 2017 led to an increase in banks' funding requirements. However, the fact that loan growth was driven mainly by TL sources and the fact that loan growth also creates increases in deposits led to a moderate course of foreign source demand by banks. As of the last quarter of 2017, the TL loan growth rate has converged to its historical averages and a modest upward trend in FX loans has been observed, while the use of foreign funding by banks has increased. The average maturity of external debts stands at 60 months (Chart I.9). The favorable outlook in the sources borrowed by banks from abroad should be noted as a factor supporting financial stability in terms of the management of risks that may arise from maturity mismatch.

Banks' foreign borrowing costs in US dollars continue to increase depending on the developments in global interest rates (Chart I.10). Moreover, a limited improvement in the spreads of banks' external debts, the fact that the external debt roll-over ratio continues its path above 100 percent despite increases in costs, and the fact that banks could borrow syndicated loans with up to two years of maturity indicate that there is no significant change in the credit supply of foreign financial institutions.

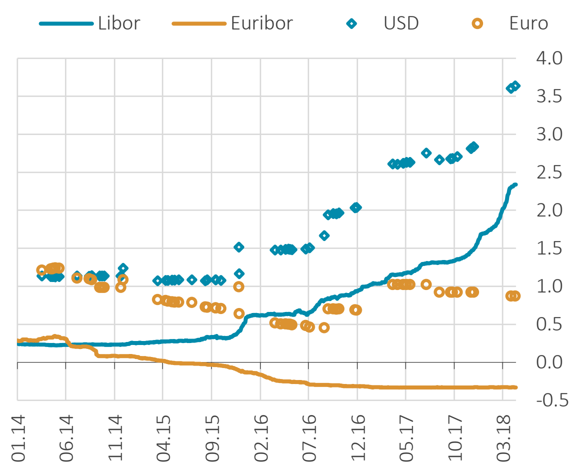
Chart I.9: External Debt Roll-Over Ratio and Its Average Maturity (%, Month)



Source: CBRT, MKK Latest Data: 03.18

Note: The external debt roll-over ratio is calculated based on 6-month moving totals of banks' borrowings and repayments of total external liabilities including securities issued abroad.

Chart I.10: Cost of Syndicated Loans with a Maturity of 367 days (Transaction-Based, %)



Source: PDP Latest Data: 11.04.18

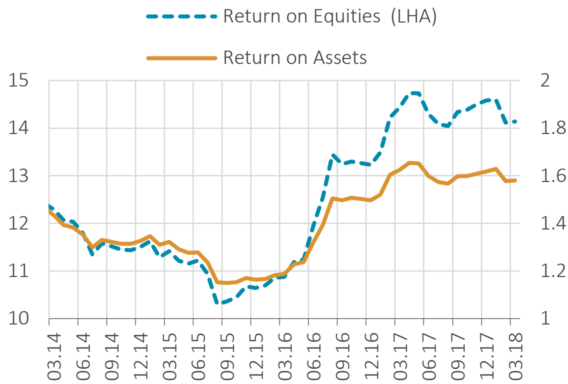
Note: Includes largest 10 banks.

Banking sector profitability indicators have preserved their strong levels in the current Report period (Chart I.11). The increasing loss from capital market transactions and the limited increase in interest expenses on deposits had a rebalancing effect on the horizontal course of return on equity and return on assets. With tightening financial conditions in 2018, the sector is expected to maintain its profitability through effective management of interest margins and operational costs.

Besides the decisive effect of profitability increase and subordinated debt provisions, the positive effect of security valuation as a domestic source has supported the strong capital adequacy ratio (CAR). The sector's strong CAR is maintained (Chart I.12).

There is no significant change in the composition of risk weighted assets during the current Report period. Loan growth converging to its historical average as a result of KGF-guaranteed loan utilization approaching its upper limit in the last quarter of 2017 has constrained credit risk and asset growth temporarily. Policy measures in 2018 regarding a new guarantee facility and additional guarantee limits during the year depending on loan repayments have contributed to the rebalancing of the above-mentioned growth rates.

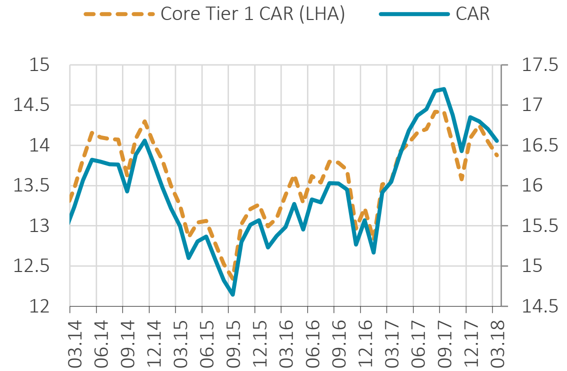
Chart I.11: Profitability Indicators (%)



Source: CBRT Latest Data: 03.18

Note: Profitability ratios are calculated by dividing the 1-year cumulative profit by the 1-year average denominator

Chart I.12: Capital Adequacy Indicators (%)



Source: CBRT Latest Data: 03.18

The spread of the US-led protectionist tendencies in foreign trade onto the global scale, the tightening in financial conditions, low profitability in the EU banking system with high non-performing loan ratios of some major EU banks in particular, and geopolitical developments are among the risk factors for global financial stability. Nevertheless, the Turkish banking sector remains resilient against the aforementioned risks given its strong capital base and high return-on-equity ratios, sound asset quality and adequate level of liquid assets.