SECTION I

MACROECONOMIC ASPECTS OF FINANCIAL STABILITY

I.1.INTRODUCTION

The structure of all sectors in the economy, their interaction with each other and their endurance to shocks are the main issues monitored closely by central banks in recent years. For this reason, when analyzing the financial sector, not only financial institutions but also their interaction with all other sectors in the economy are taken into consideration.

It is obvious that any positive or negative change in one sector can directly influence the liability of another sector based on the fact that one sector's assets constitute the liabilities of others, as indicated by the *"balance sheet approach"*. This interaction, may successively spread to other sectors, thereby increasing the fragility and risks.

In this section, developments in public finance, households, corporates and the external sector, as well as the interaction of these with each other is assessed. The banking sector, which constitutes the major portion of the financial sector (91,4 percent) and also the basic risks arising from the balance sheet (credit, market and liquidity risks) are analyzed in detail in the second section.

I.2.INTERSECTORAL DEVELOPMENTS

The analyses in this section focus on mutual interaction and the transmission mechanisms among the sectors in the Turkish economy. Moreover, domestic and foreign currency composition and maturity mismatch between assets and liabilities are taken into consideration and the risk factors that are likely to affect financial stability are assessed in that context.

I.2.1.Public Finance

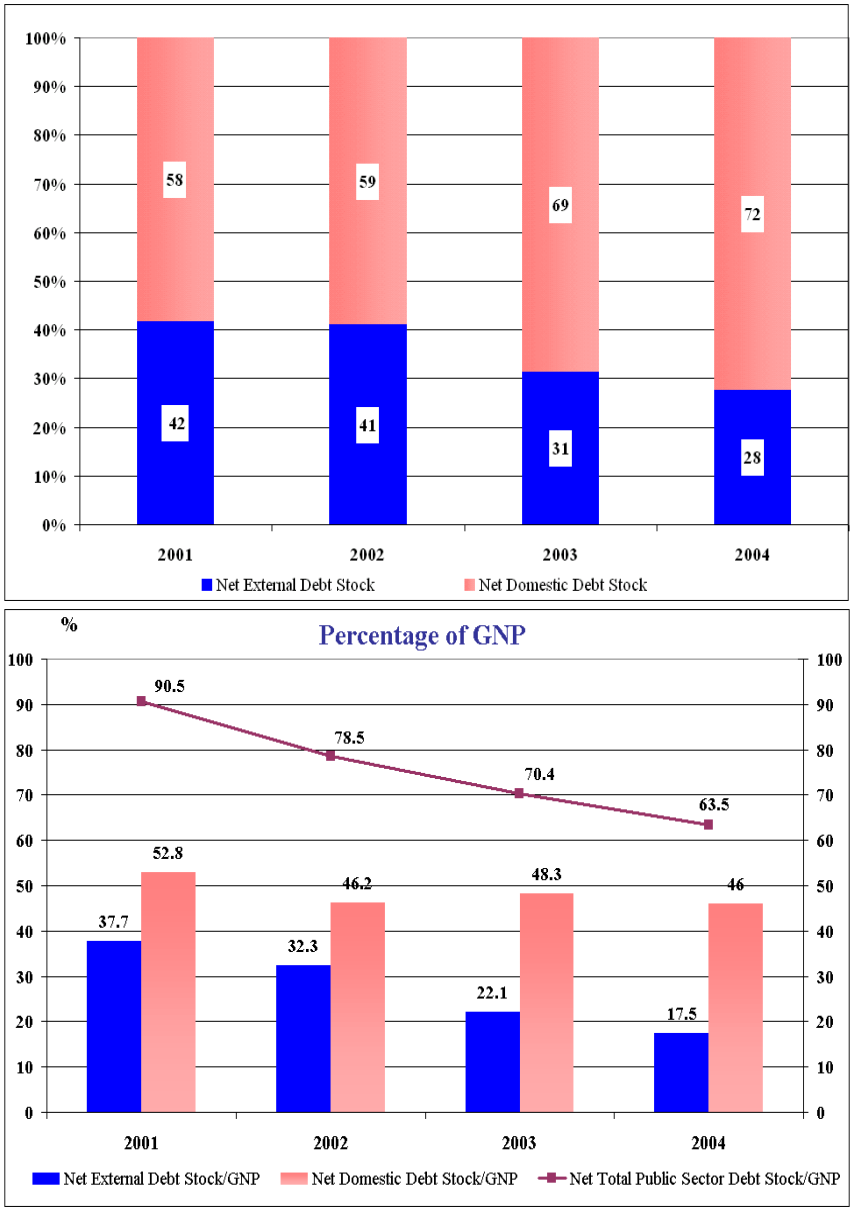
The primary factor in assessing the fragility of the economy is public debt. Hence, public debt to GDP, primary budget surplus and liability structure of the public debt are all of great importance for evaluating the risks arising from the interaction between public finance and other sectors.

Table I.2.1.1
Budget Deficit[1]

	2002	2003	2004
New Member Countries to EU[2]	-4.8	-5.7	-3.9
EU15	-2.2	-2.8	-2.6
Eurozone	-2.4	-2.8	-2.7
Turkey[3]	-12.3	-9.6	-3.9

Source: EU Commission.
[1] Percentage of GDP.
[2] 10 countries that joined EU as of May 2004.
[3] Compatible with the ESA95 definition.

Chart I.2.1.1
Net Total Public Debt and Its Composition[1]



Source: Treasury

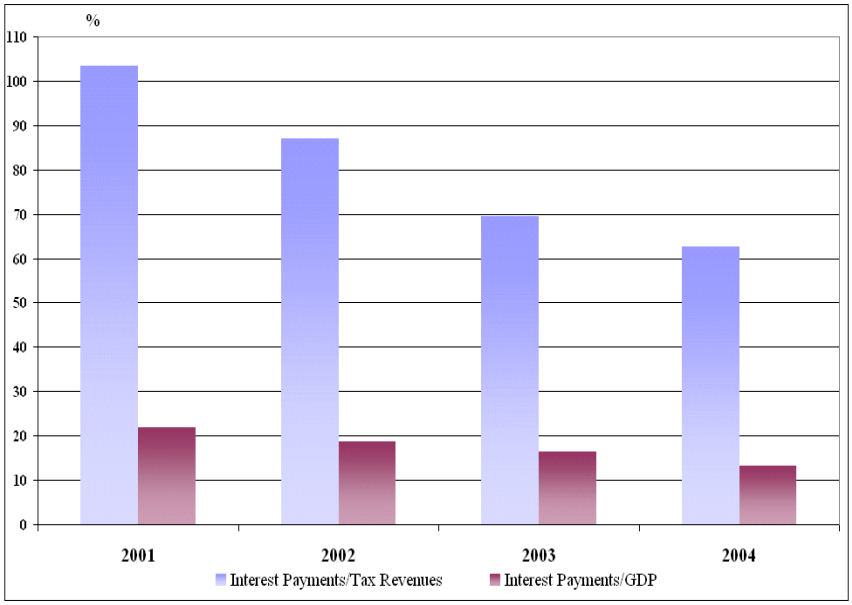
[1] Net public debt stock is calculated by subtracting central bank net assets, public deposits and unemployment insurance fund net assets from public gross debt stock.

After the 2000 and 2001 crises, the economy has begun to recover and the GNP has grown by 7.9 percent on average in the last three years. Besides this improvement, the appreciation of Turkish Lira, the increase in Central Bank's net foreign assets, as well as borrowing strategies and strict monetary and fiscal policies have largely contributed to the ratio of net foreign debt/GNP, causing the above mentioned ratio to decrease from 37.7 percent to 17.5 percent in the last three years. In addition to economic growth, the gradual and permanent decline in nominal interest

In the period between 2001-2004 net total public debt decreased drastically.

rates has positively affected the budget deficit through interest payments. As a matter of fact, according to the EU definition, the general government budget deficit/GDP ratio decreased to 3.9 percent in 2004. When compared to that of ten countries recently joining the EU, the budget deficit/GDP ratio of Turkey has successfully declined to the same level (Table I.2.1.1). Moreover, since the primary surplus shows a trend consistent with the annual targets set, it is expected that the above mentioned ratio will also decrease gradually in the future.

Chart I.2.1.2
Public Interest Expenditures and Tax Revenues[1]

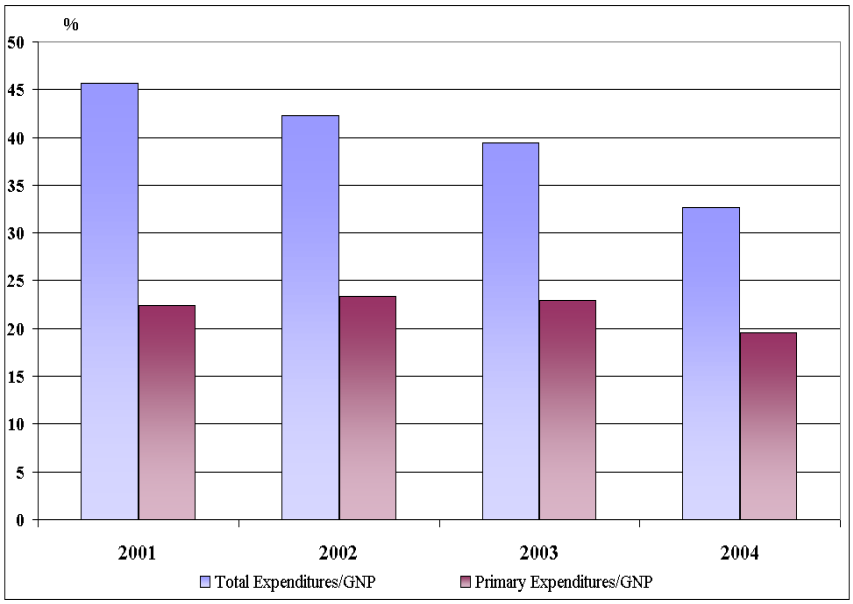


Source: Ministry of Finance– SIS
[1] Excluding the special expenditure deduction in 2004.

Declining tendency in interest expenditures continues in 2005.

As one of the important components of budget expenses, the interest expenses to GDP ratio that reached 21.8 percent in 2001, fell to 13.2 percent in 2004, while the interest expenses to tax revenues ratio declined from 103.3 percent to 62.7 in the same period and fell further to 50.2 percent in the first five-month period of 2005 (Chart I.2.1.2).

Chart I.2.1.3
Total Public Expenditures and Primary Expenditures



Source: Ministry of Finance - SIS

The primary surplus/GNP ratio, which had increased to 23.3 percent in 2002, showed a parallel declining trend to the total public expenditures/GNP ratio in subsequent years and declined to 19.5 percent at the end of 2004 (Chart I.2.1.3). In the first five-month period of 2005, with a relatively slight increase in public expenses and a large increase in revenues, the primary surplus reached 16.6 billion New Turkish Liras.

Box I.2.1.1.Government Domestic Debt Securities

In the assessments regarding government domestic debt securities, banks' own declarations related to government domestic debt securities which are owned by banks and which are in the custody of banks are taken into account.

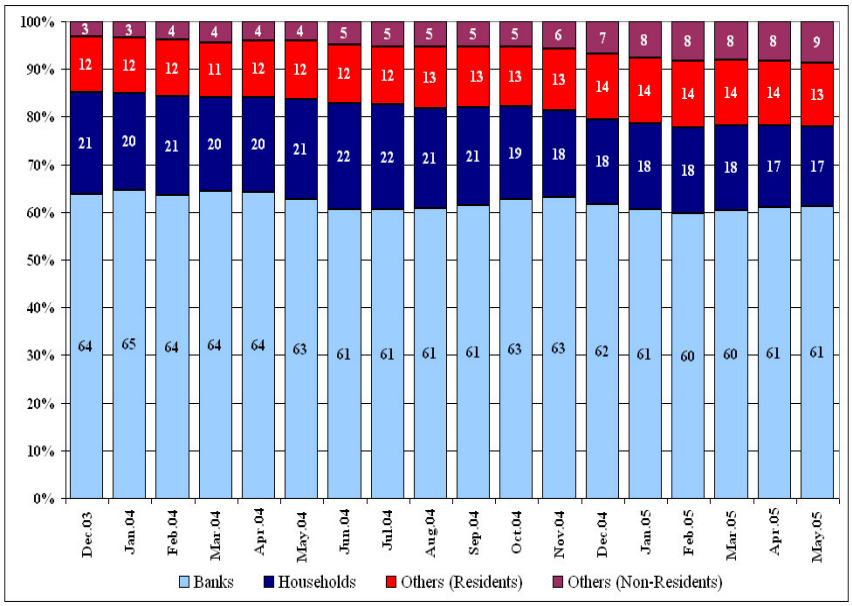
In this framework;

-in the **"banks"** group, there are securities owned by banks at both domestic and foreign branches,

-in the **"household"** group, there are securities kept by banks on behalf of real persons,

-in the **"other"** group, (by making a distinction between domestic and foreign residents) there are securities kept by banks on behalf of insurance companies, other banks, intermediary institutions, other financial sectors, financial institutions and non-financial institutions. Securities owned by the Central Bank, İşkur and the Fund For Employee Savings accounts are not included.

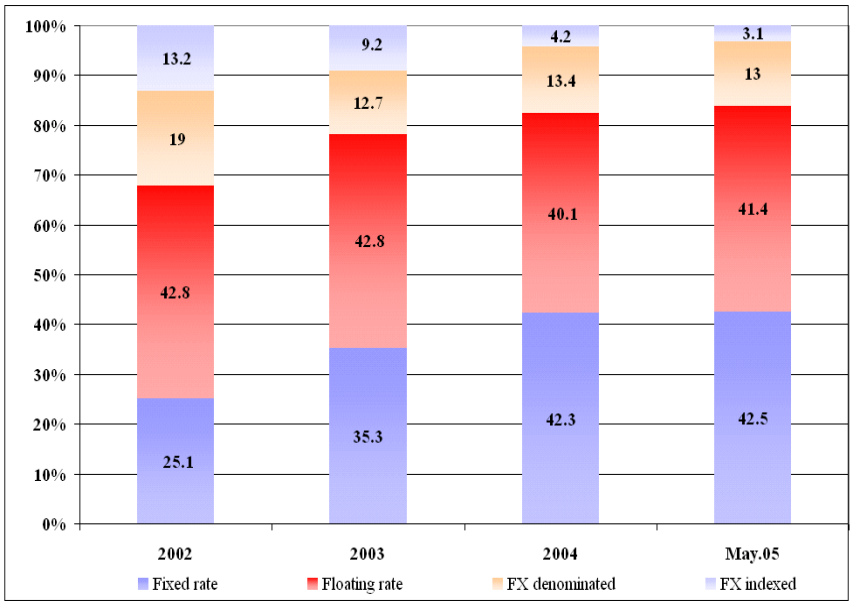
Chart I.2.1.4
Government Domestic Debt Securities by Holders[1]



Source: BRSA – CBRT
[1] Nominal amounts.

While favorable developments regarding the sustainability of public debt are observed, how public debt is financed becomes more important. Domestically, the public deficit is basically financed by banks and households. However, while 62 percent and 18 percent of government domestic debt securities are owned by banks and by households, respectively, as of December 2004, both groups' shares declined by one point and the foreign investors' share increased as of May 2005 (Chart I.2.1.4).

Chart I.2.1.5
Composition of Domestic Debt

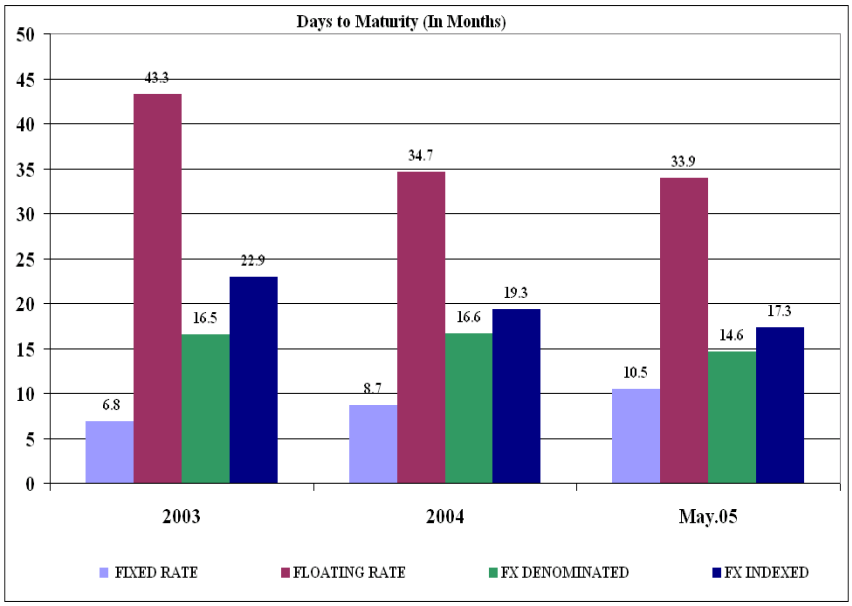


Source: Treasury

The decline in interest rates and stability of exchange rates have also influenced the domestic debt structure. As a matter of fact, the composition of the domestic debt structure in both domestic and foreign currency has shown a change since 2002; the share of FX denominated and FX indexed instruments, which was 32.2 percent at the end of 2002, decreased to 21.9 percent in 2003, 17.6 percent in 2004 and 16.1 percent in the first five-month period of 2005 (Chart I.2.1.5).

As of December 2004, while the shares of floating and fixed rate government securities were approximately 40.1 percent and 42.3 percent respectively, they were realized as 41.4 percent and 42.5 percent as of May 2005. Within this context, although the Treasury is still susceptible to interest rate risk due to the composition of domestic debt, diminishing interest rate volatility can be considered as a positive development.

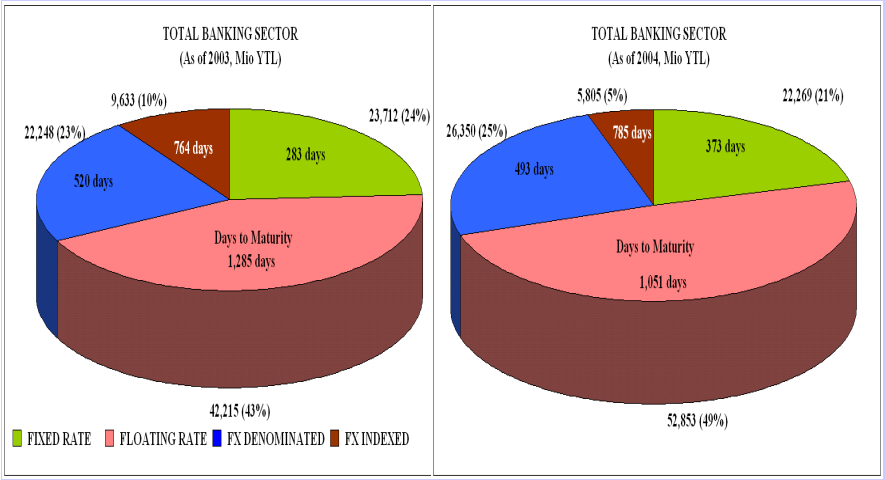
Chart I.2.1.6
Maturity Structure of Government Domestic Debt Securities



Source: Treasury

As of May 2005, compared to 2004, the term to maturity of government domestic debt securities increased from 20.6 months to 20.9 months. Such a trend stems from TL denominated fixed rate instruments. It is also observed that the term to maturity of TL denominated floating rate, FX denominated and FX indexed government domestic debt securities decreased (Chart I.2.1.6).

Box I.2.1.2.Maturity Structure of Government Domestic Debt Securities Owned by Banks

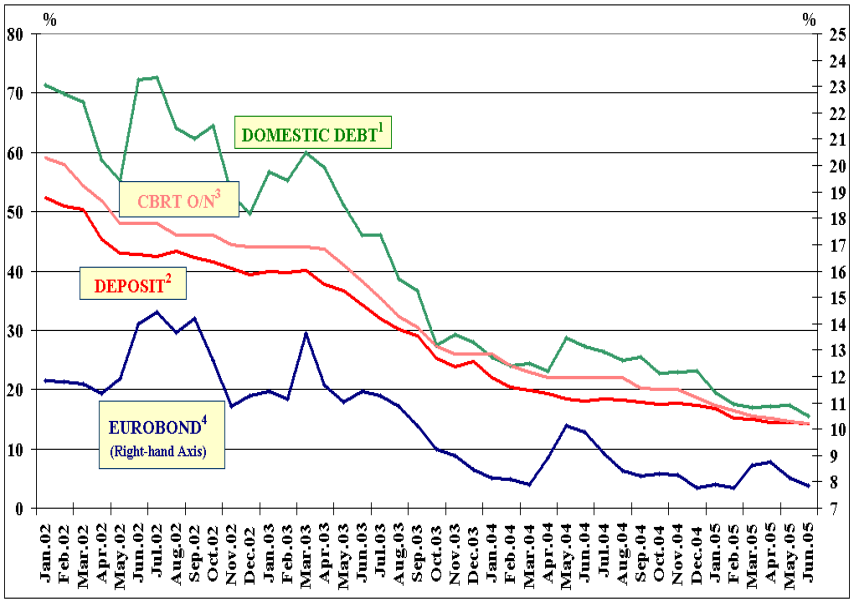


Source:BRSA-CBRT

When the composition of government domestic debt instruments owned by banks is analyzed, it can be seen that the share of floating rate instruments increased from 43 percent in December 2003 to 49 percent in December 2004 and the abovementioned ratio was realized as 50 percent as of 24 June 2005.

While the maturity of government domestic debt instruments owned by banks declined in the period 2003-2004, in parallel to the maturity structure of government domestic debt instruments, compared to the end of 2004 as of June 24, 2005 their term to maturity increased. Basically, such a trend stems from YTL denominated fixed rate and FX denominated government domestic debt securities. On the contrary, the term to maturity of YTL denominated floating rate and FX indexed government domestic debt securities decreased.

Chart I.2.1.7
Interest Rates



Source: Treasury - CBRT

[1] Domestic debt interest rate is weighted by net debt using compound interest rate.

[2] Weighted 3 month deposit interest rate.

[3] Weighted average overnight (O/N) interest rate.

[4] Interest rate of USD denominated Eurobond with maturity date of 2030 is taken as a basis.

With the contribution of positive developments in interest rates, public borrowing costs also diminished drastically. In May 2004, borrowing costs increased abruptly as a consequence of the rise in US interest rates (domestic interest rate 28.8 percent, Eurobond rate 10.1 percent). However, as of June 2005, although the US kept on increasing its interest rates, borrowing costs decreased, thus domestic debt and Eurobond interest rates were realized as 15.6 percent and 7.8 percent, respectively. (Chart I.2.1.7).

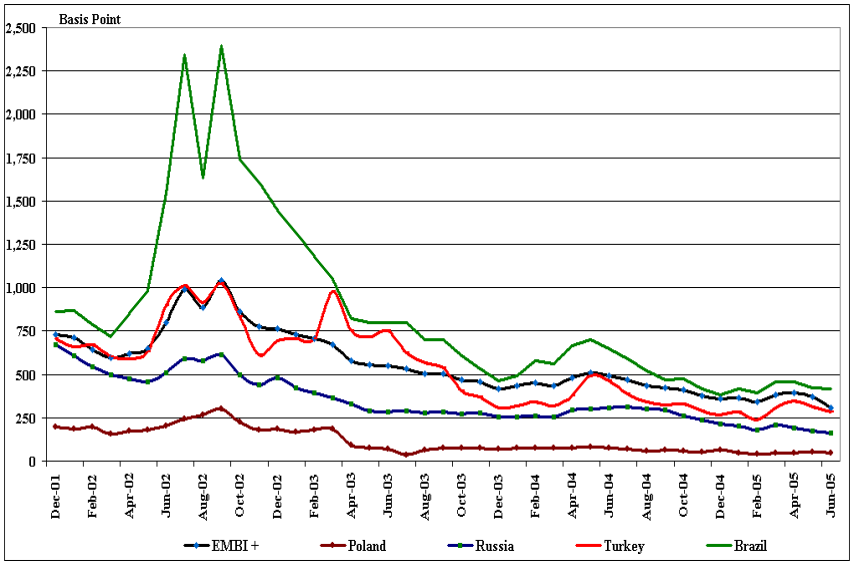
Chart I.2.1.8
Ex-Ante Real Interest Rates[1] on Government Domestic Debt Securities

Source: CBRT

[1] Ex-ante real interest rate=(((1+nominal interest rate)/(1+expected inflation rate))-1)*100
Expected inflation ratio figures are annual expected CPI taken from Monthly Business Tendency Survey released by CBRT.

Positive developments in interest rates are also supported by the ex-ante interest rates calculated according to inflation expectations. Remaining at about 25 percent until the first half of 2003, ex-ante real interest rates declined gradually after that date and fell to 8.6 percent as of June 2005 (Chart I.2.1.8).

Chart I.2.1.9
EMBI+ Index in Various Countries



Source: Bloomberg

Due to favorable developments in the economy, the amount of YTL denominated securities issued by foreign banks in foreign countries reached to 5.1 billion New Turkish Lira as of July 13, 2005. Parallel to these developments, as one of the indicators of country risk, the EMBI+ index of Turkey declined drastically (Chart I.2.1.9).

To conclude, in recent periods, noteworthy improvements are seen, especially in the areas of growth, public finance and inflation. This positive trend is expected to continue in 2005. Since the roll-over ratio, which shows to what extent the Treasury makes its payments by new debts decreased, the interest rate of borrowing declined and the maturity of borrowing increased, public financing became less prone to pressure. Apart from this, the implementation of inflation targeting in 2006 makes it necessary to sustain the fiscal discipline needed to attain the primary surplus targets and reduce the debt burden.

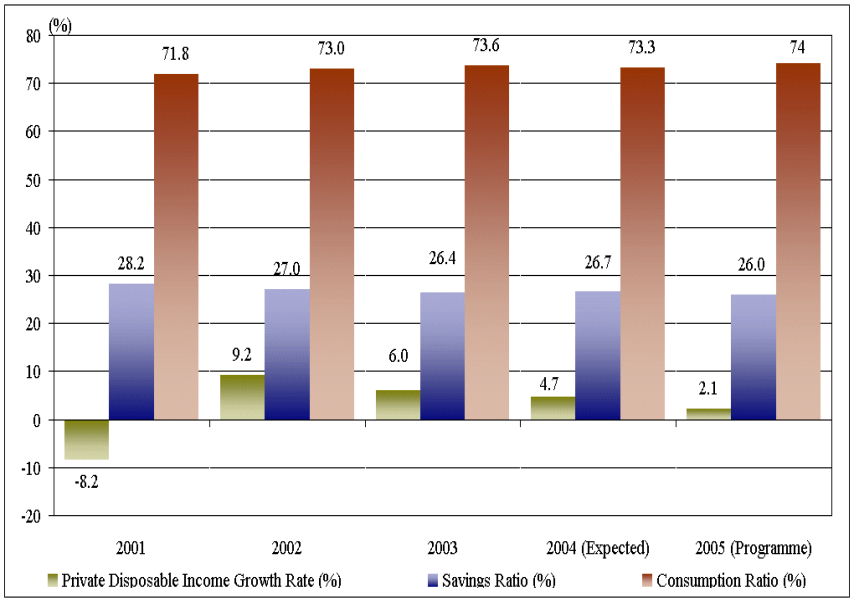
For inflation targeting, maintaining fiscal discipline and attaining fiscal targets are of great importance.

I.2.2.Households

Box I.2.2.1.Households

By creating demand for corporates and investing their savings in financial markets, households play a crucial role in intersectoral assessments. This is because savings and consumption decisions determined by households' future expectations influence household debt composition, thereby largely affecting banking sector credit risk. For this reason, the analyses of assets and liabilities of households are of great importance for work connected to financial sector stability. However, in many international analyses regarding households, it is seen that finding data concerning households' liabilities, especially their total debtedness, is very difficult, in most cases even impossible. In this framework, since the same problem is experienced in our countrys' conditions, this section deals with households' asset composition, consumption and income distribution as well as credits granted to households and the risks arising from credits issued by the banking sector to households are dealt with in section II.2.1.1.2.

Chart I.2.2.1
Household Consumption, Savings and Income[1]

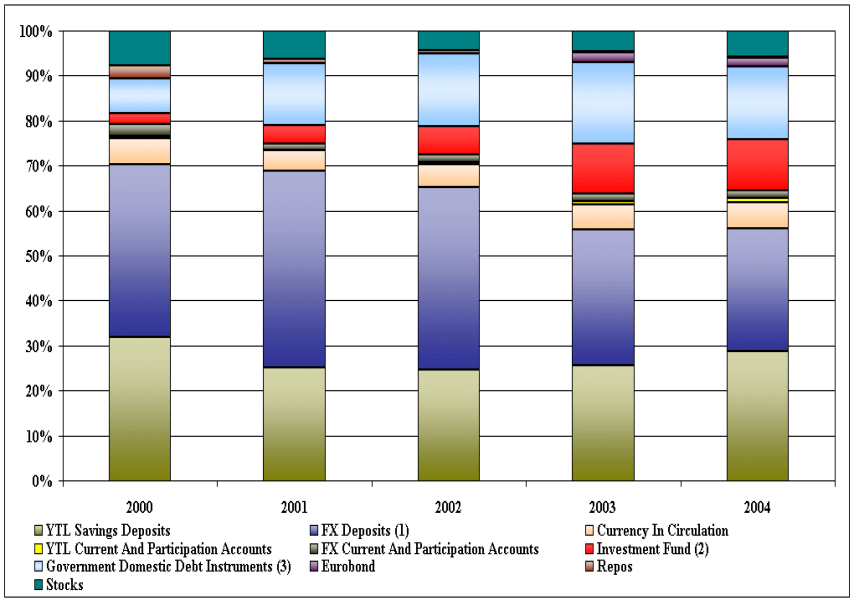


Source: SPO
Savings Ratio = Total Household Savings/ Total Disposable Income
Consumption Ratio = Total Household Consumption / Total Disposable Income

The households' private disposable income growth rate decreased due to the 2001 crisis and consequently, the consumption growth rate also declined. Although the private disposable income and consumption growth rate became positive after the end of 2002, the household consumption ratio moved within the band of 72-73 percent throughout subsequent years (Chart I.2.2.1). After 2002, households increasingly demand consumer credits to finance their consumption. When the households' indebtedness level to banks is analyzed as a whole, it can be seen that in 2004 the share of consumer credits and credit cards in disposable income reached 7 percent. In the State Planning Organization's 2005 yearly programme, disposable income that increased by 4.7 percent in real terms in 2004, is expected to grow by 2.1 percent in real terms in 2005.

[1] Private disposable income and consumption data are brought to real terms by the GDP deflator of the relevant year. For the year 2005, the objective of 8 percent for the deflator is used.

Chart I.2.2.2
Composition of Household Assets



Source: BRSA-CBRT-Treasury.

[1] Composed of domestic real persons' deposits.

[2] There is no real-legal person distinction for investment funds.

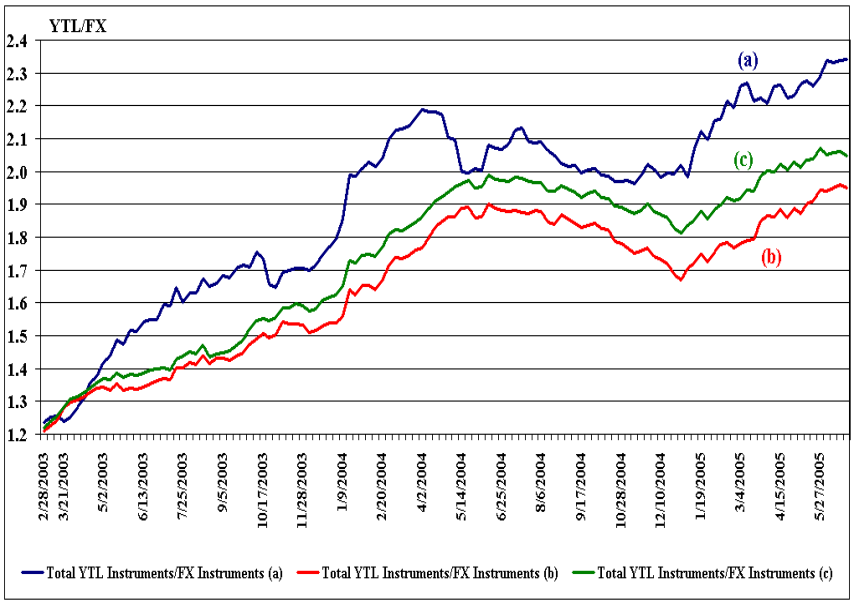
[3] Real-legal person distinction could not be made for government domestic debt securities in 2000, 2001 and 2002.

When the distribution of household assets are analyzed, it can be seen that the total amount of investment instruments determined by savings increased by approximately 52.6 percent in the period between December 2002 and December 2004. While deposits have the largest share of household investment instruments (56 percent), government domestic debt securities and investment funds have shares of 16 and 11 percent, respectively (Chart I.2.2.2).

Deposits are the paramount component of household assets.

When the yield on investment instruments is considered, it can be observed that the declining tendency of interest rates on both domestic debt and Eurobonds has been accelerating since May 2004. The interest rate on domestic debt securities, which was 23.1 percent in December 2004, fell to 15.6 percent as of June 2005. Parallel to this improvement, the banks' weighted three month deposit interest rates declined from 17.3 percent to 14.2 percent (Chart I.2.1.7).

Chart I.2.2.3
Ratio of YTL Denominated Investment Instruments to FX Denominated Investment Instruments
(Weekends and Last Working Day)



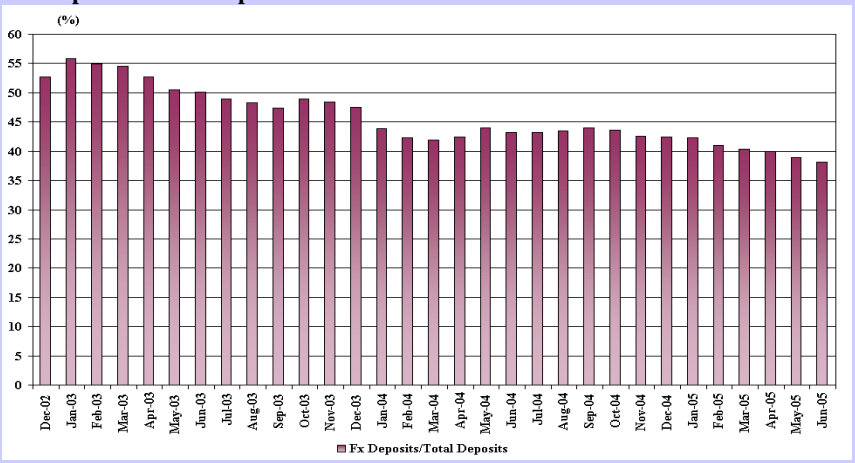
Source: CBRT
YTL Instruments = Deposits + Repos + Inv. Funds + Gov. Dom. Debt Sect. (real person) + Spec. Finance Inst. Participation Accounts + Equity (real persons);
FX Instruments = Deposits + Gov. Dom. Debt Sect. (real person) + Eurobonds (real person) + Spec. Finance Inst. Participation Accounts , (a) current TL value of FX Deposits (b) for FX Deposits, exchange rate prevailing on 31.12.2002 is fixed. (c) for FX Deposits, exchange rate prevailing on 31.12.2002 is used and the parity effect is eliminated.

Exchange rate stability has affected portfolio preferences for YTL and FX denominated investment instruments. As a result of these improvements, as of December 2004, even when the parity effect is eliminated and the exchange rate is fixed, the total YTL denominated instruments were realized as approximately 1.8 times of FX denominated instruments, and the same figure became 2.1 as of June 24, 2005 (Chart I.2.2.3).

Box I.2.2.2.Currency Substitution

Currency substitution, especially experienced during economic instability and high inflation periods, is the use of any FX currency or FX denominated assets by domestic residents in order to avoid a probable loss in value of domestic currency. As for full currency substitution, all three functions of domestic currency (store of value, medium of exchange and measure of value) are fulfilled by another currency.

FX Deposits /Total Deposits Ratio[1]

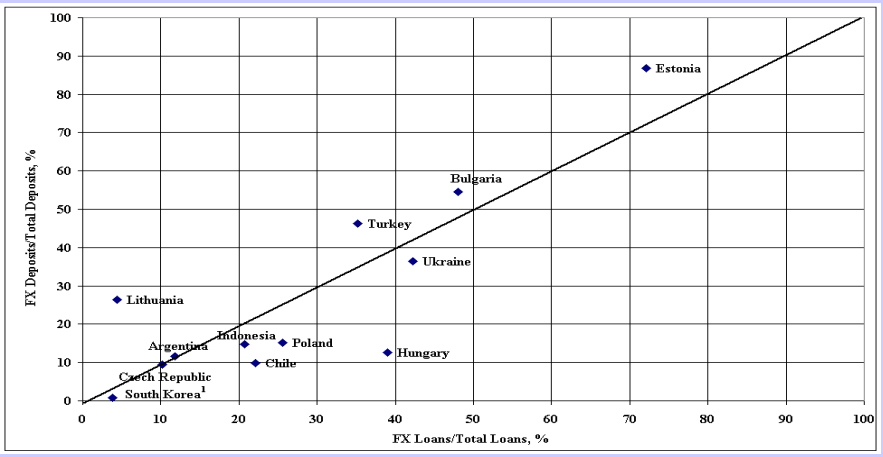


Source: CBRT

[1] Domestic residents' deposits subject to required reserves are taken as bases, but official deposits are not included.

When deposits are analyzed in order to assess currency substitution in Turkey, it can be concluded that the ratio of domestic residents' FX deposits subject to statutory provisions to domestic residents' total deposits subject to statutory provisions (except official deposits), which was 54.1 percent at the end of 2002, became 44.5 percent by the end of 2004 and 40 percent by the end of June 2005. If this declining trend is assessed together with the improvements in YTL and FX denominated investment funds (Chart I.2.2.3), it is obvious that a reversed currency substitution process is underway.

Currency Substitution Related to Credits and Deposits in Various Countries as of the End of 2004

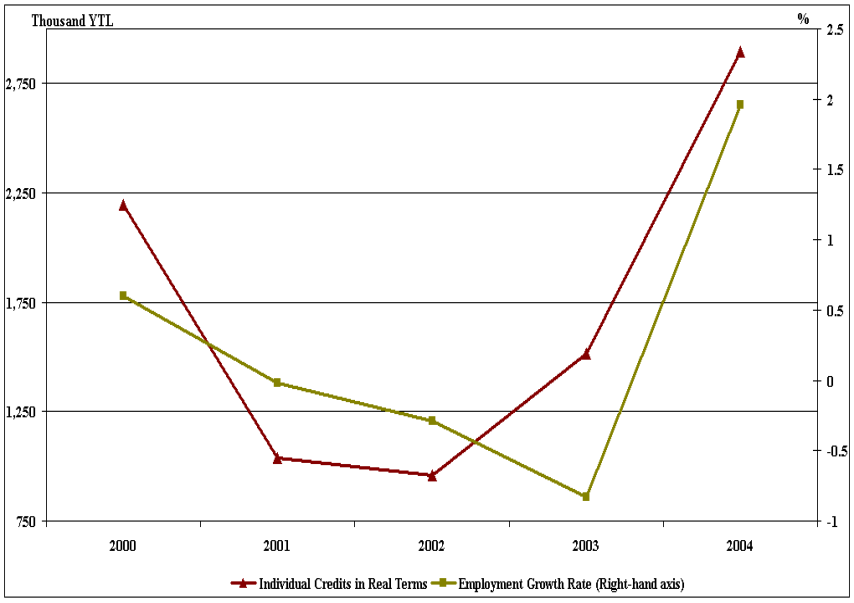


Source: CBRT-Central Banks of Countries

[1] as of June 2004

The comparison of various countries in terms of currency substitution related to credits and deposits as of the end of 2004 is shown above. In Turkey, favorable developments that were experienced with deposit-related currency substitution have also been observed for credit-related currency substitution. That is, the share of FX credits in total credits, which was 49.6 at the end of 2002, fell to 35.2 by the end of 2004 and became 31.2 as of May 2005.

Chart I.2.2.4
Employment Growth Rate and Individual Credits[1]



Source : CBRT-SIS

[1] Individual credits are composed of sum of consumer credits and credit cards. They were brought to real terms by using CPI (1994=100).

Individual credits and employment growth rate moved in the same direction in 2004.

After the 2000 crisis, with the decrease in employment, individual credits declined in real terms. In 2004, parallel to the growing employment rate, individual credits also increased (Chart I.2.2.4). Finally, in March 2005, the employment rate increased by 4.7 percent relative to the same period of the previous year, and in the meantime the growing tendency of individual credits continued.

Table I.2.2.1
Private Consumption Expenditures

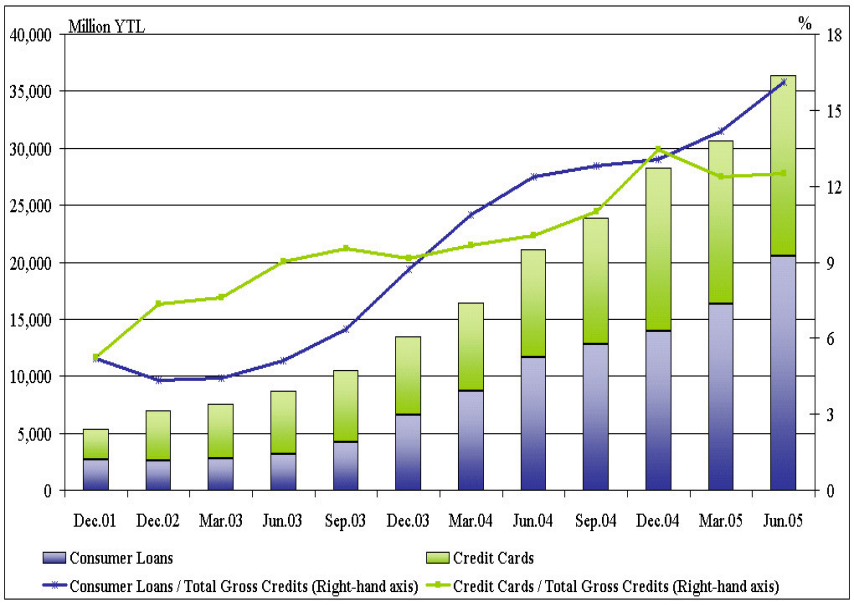
%	2001	2002	2003	2004
Private Final Consumption Expenditure	-9.2	2.1	6.6	10.1
Durable Goods	-30.4	2.1	24.0	29.7
Services	-9.3	8.5	7.5	9.3
Food and Beverages	-3.6	1.1	4.1	2.8
Semi-Durable and Non-Durable Goods	-9.0	3.0	2.1	18.8

Source: SIS

The increase in private consumption expenditures in 2004 stemmed from durable consumer goods, to a large extent.

After 2002, private consumption expenditures began to increase, especially due to the increase in the expenditures on durable consumer goods. At the end of 2004, expenditures on durable consumer goods grew by 29.7 percent. In the above-mentioned development, the slowdown in credit interest rates and realization of deferred consumption expenditures played crucial roles. (Table I.2.2.1).

Chart I.2.2.5
Consumer Credits and Credit Cards[1,2,3]



Source: BRSA-CBRT

[1] Consumer Credits= Consumer credits of banks + consumer finance companies' gross individual credits + Gross NPL

[2] Total Gross Credits= Total credits issued by Banks and consumer finance companies+ Gross NPL

[3] The increase in credit cards in December 2004 is due to the communique issued by BRSA, named as "Communique Concerning Amendments in the Communique on Uniform Chart of Accounts ". According to this communique, which is promulgated in the Official Gazette no:25608, dated October 9, 2004 and came into force on the same date, credit card data include the amounts of expenditures made on both an installment and noninstallment basis by real persons after 28.10.2004, while the data before this date include the credit cards and individual expenditure amounts that are on a noninstallment basis made by real persons.

As banks began to restructure their assets due to decreasing inflation and interest rates and consumers financed their deferred consumption demands by consumer credits and credit cards, this ended up in an increase in such credits. The share of consumer credits in total gross credits, which was 5.2 percent at the end of 2001, increased to 8.7 percent at the end of 2003, became 13 percent by the end of 2004 and went up to 16.1 by June 2005. On the other hand, the share of credit cards[2] in total gross credits increased till the end of 2004 and began to decline from the beginning of 2005. In fact, this ratio, which was 13.5 percent at the end of 2004, decreased to 12.5 percent as of June 2005 (Chart I.2.2.5).

The increase in individual credits is considerably high.

[2] While 27 percent of total credit cards (except non-performing loans) are made payable on the installment plan by the end of 2004, the stated ratio increased to 29 percent in March 2005.

Box I.2.2.3. The Articles Regarding Consumer Loans and Credit Cards of the Law on the Protection of Consumers

Article 10, related to "Consumer Credits" of the Law on the Protection of Consumers (Law No: 4077), as amended by Law No: 4822, states that the aforementioned credit transaction cannot be changed against a consumer within the contract period. Consumers have the opportunity to close the loans they use prior to maturity.

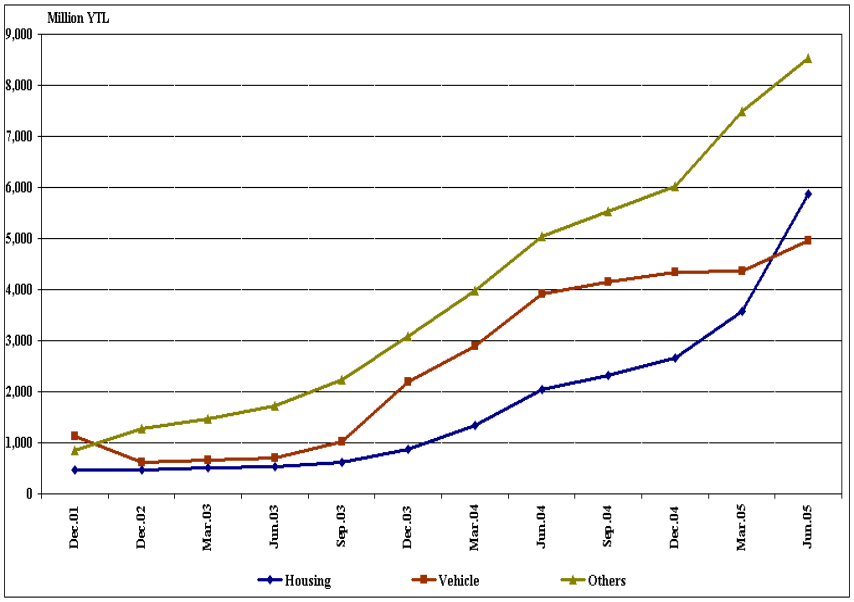
The article regarding "Credit Cards" (No 10/A) states that if the minimum payment amount declared in the account summary is not paid at maturity; the consumer does not enter into an obligation under any name except for the default interest (default interest rate cannot exceed the contract rate by more than 30 percent).

In order to slow down the rate of increase in consumer loans, tax benefit, which was implemented on brand new automobiles, was reduced by half in April 2004 and was eventually abolished by the beginning of 2005. Furthermore, in August 2004, the Resource Utilization Support Fund (RUSF) charge, which was applied to consumer loans was raised from 10 percent to 15 percent. Within this framework, in recent periods, the growth rate of vehicle loans has particularly stabilized (Chart I.2.2.6).

Very large portion of consumer loans has a maturity of more than 1 year.

According to data published by the Banks' Association of Turkey, 80 percent of consumer loans had a maturity of one-year or more as of the end of 2004. During March 2005, it is necessary to note that the above mentioned ratio increased to 85.2 percent. This increase is considered to be influenced by the rise in housing loans in absolute terms. Besides, after the beginning of 2004, the term of consumer loans were between 19-24 month range. Apart from this, due to the mortgage system, the legal arrangements of which will be completed as of the end of 2005, housing loans will become more widespread, thus, the terms are expected to be further extended .

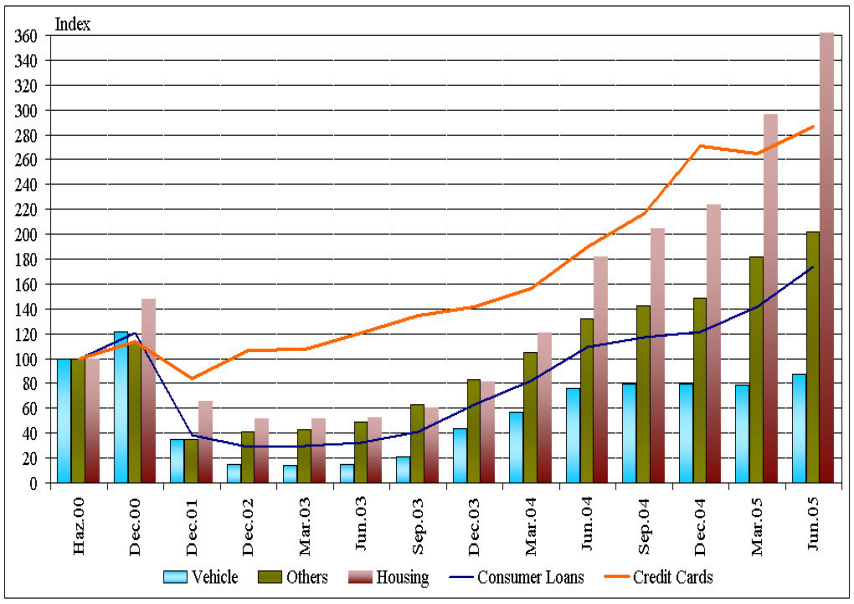
Chart I.2.2.6
Consumer Credits[1] by Type



Source: CBRT
[1] Loans issued by consumer finance companies are not included.

When consumer credits are analyzed based on their types, it is seen that *other consumer loans,* which includes durable consumer goods, professional goals, education, vacation, food and clothing, had the largest share after the end of 2002. On the other hand, at the end of 2004, compared to 2003, the share of vehicle loans rose by 2 percent, other consumer loans decreased by 4 percent, whereas housing loans increased by 6 percent. While all types of consumer loans increased in 2005, housing loans, which increased most, rose by 121.5 percent in June compared to year-end 2004 (Chart I.2.2.6).

Chart I.2.2.7
Consumer Loans and Credit Cards Index[1]

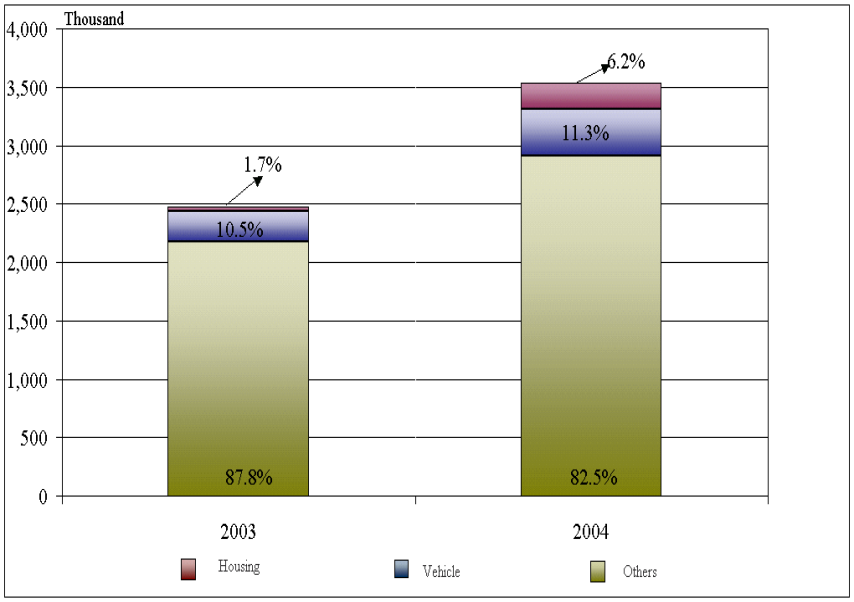


Source: CBRT

[1] Credit cards and consumer credit data are brought to real terms by using CPI (1994=100), and then index is created by taking June of 2000 as a basis.

When consumer loans and credit cards are considered, the rapid increase in credit cards is very obvious. On the whole, the credit card index was realized higher than consumer loans in 2004. Apart from this, if the consumer loan index is analyzed according to its types, it can be observed that the housing loans index increased substantially, while the vehicle loans index still did not reach its level of June 2000. The same tendency continued during the June 2005 period (Chart I.2.2.7).

Chart I.2.2.8
Distribution of Number of Individuals by Types of Consumer Loans.



Source: BAT

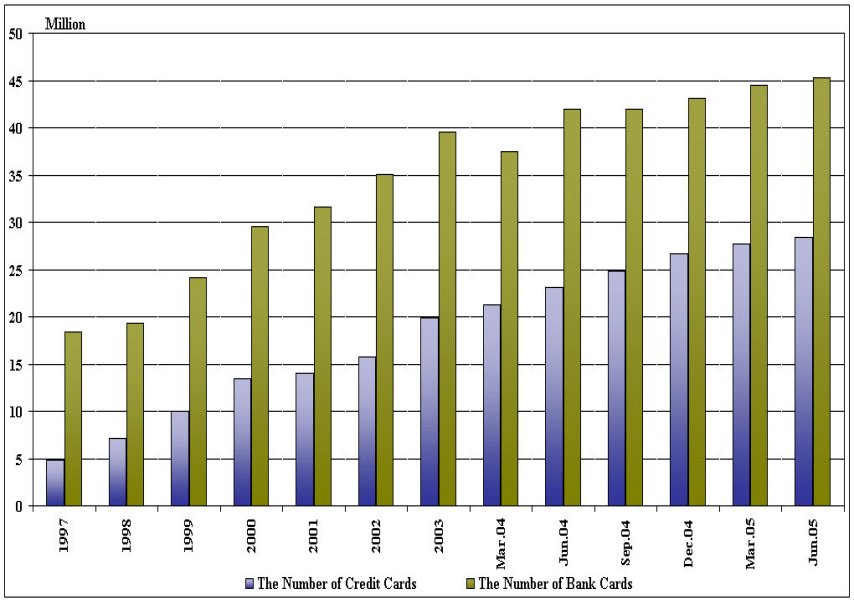
[1] Other Consumer Loans = Durable Consumer Goods + Professional Goal + Education + Vacation + Food + Clothing

The number of individuals using consumer credits increased in 2004.

According to Turkish Banks' Association data obtained from 15 banks granting 95 percent of whole banking sector's consumer loans, the number of individuals using consumer credits increased by 42.8 percent in 2004, compared to the previous year and reached 3.5 million (Chart I.2.2.8). The above-mentioned figure rose by 66.8 percent in the first three months of 2005, relative to the same period of the previous year and became 4.8 million.

Chart I.2.2.8 shows that the share of individuals using other consumer loans decreased in 2004, compared to the previous year, whereas the share of both housing and vehicle loans increased.

Chart I.2.2.9
Number of Bank Cards and Credit Cards



Source: ICC

The number of credit cards and bank cards increased rapidly in 2004

According to data published by Interbank Card Center, the number of credit cards, which was 19.9 million as of the end of 2003, reached 26.7 million as of the end of 2004. On the other hand, the number of bank cards increased from 39.6 million to 43.1 million in the same period. During the first half of 2005, compared to the end of the previous year, the number of credit cards rose by 6.5 percent and became 28.4 million, while the number of bank cards increased by 5 percent and reached 45.2 million. The competition among banks has enabled them to diversify individual banking services for their customers and improve in quality. Moreover, salary payments of institutions entailing the use of bank cards and banks' encouragement of the use of bank cards by opening sight deposit accounts to facilitate bill payments such as telephone, electricity, and cable TV etc. has had a significant effect on the prevalence of bank cards. (Chart I.2.2.9).

As a result of positive economic developments in 2004, the consumption preferences of households were influenced and their future expectations turned out to be positive. Therefore, consumer expenditures increased and a substantial portion of these expenditures were financed by consumer loans and credit cards.

Consequently, the decline in interest rates and inflation, along with positive future expectations, led households to borrow long-term and

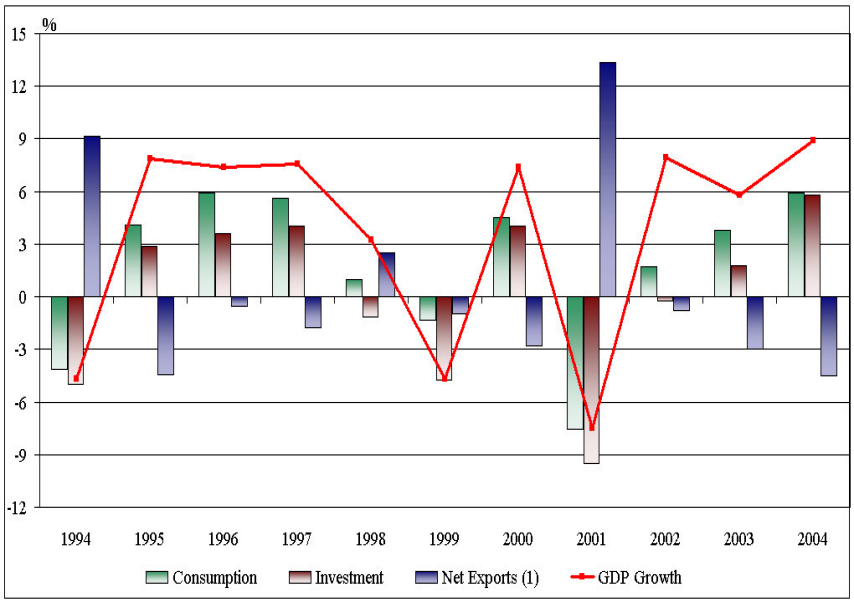
enabled expenditures to increase. The increase in housing loans played an important role in the growth of the construction sector. With the advent of the mortgage system in 2006, the construction sector and its subsidiary industries are expected to grow further. These developments are considered to contribute to economic growth and employment as well as to the households' future expectations positively.

I.2.3.Corporate Sector

I.2.3.1.General Structure

Developments in the corporate sector, which has a pioneering role in the realization of growth, are among the factors that determine the risks in both the real economy and the banking sector as corporates obtain the funds needed for their operations from operating profits, financial system or by increasing their equity. Besides, it is a fact that banks, which extend loans to companies with declining performance may face problems with collection and the consequent deterioration in the financial structure of these banks may have a negative effect on the proper functioning of the credit channel. In this section, due to their direct connection with the corporate sector, growth, the manufacturing industry production index, capacity utilization rates, productivity in the manufacturing industry and changes in the number of companies are analyzed first hand. Subsequently, in order to evaluate the risks that might spillover from the corporate sector to the banking sector, the financial analysis of companies is presented.

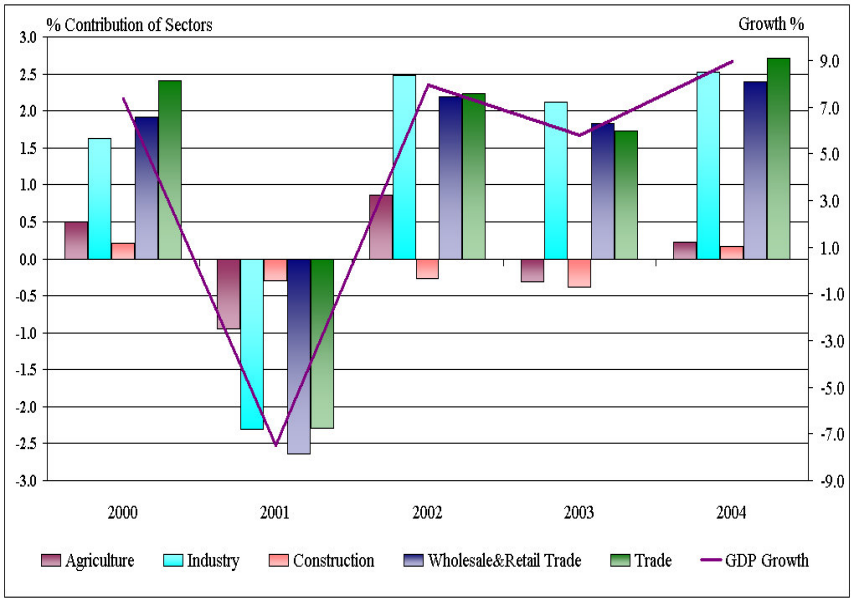
Chart I.2.3.1.1
Growth Rate and Its Composition



Source: SIS
[1] Net Exports= Exports-Imports

The main factors behind the 8.9 percent GDP growth in 2004 are private consumption and investment expenditures, which are influenced by the behavior of households and corporate sector (Chart I.2.3.1.1). As a result of tight fiscal policies implemented in recent years, the source of growth tended to be private expenditures rather than public expenditures. As a matter of fact, private consumption expenditures increased by 2.1 percent in 2002 compared to the previous year, while 10.1 percent increase was realized in the year 2004. The annual rate of increase in public consumption expenditures, on the other hand, was 5.4 percent in 2002 compared to the previous year, but declined to 0.5 percent in 2004. The share of private sector investments in total investments also increased. In 2002, private investment expenditures decreased by 5.3 percent compared to the previous year and public investment expenditures increased by 8.8 percent. This situation reversed in 2004 and public investment expenditures decreased by 4.7 percent, whereas private investment expenditures increased by 45.5 percent. The trend observed regarding private and public consumption and investment expenditures at the end of 2004 continues in the first quarter of 2005.

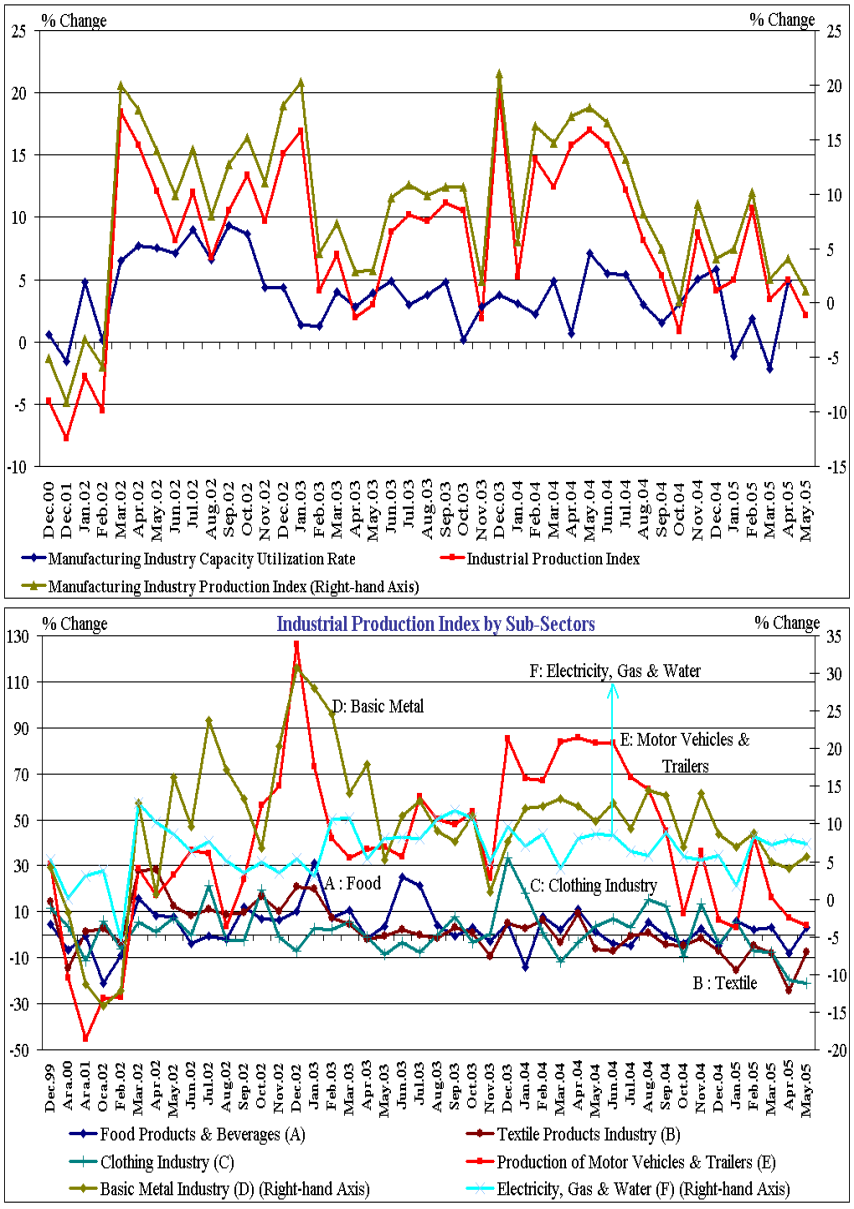
Chart I.2.3.1.2
Contribution of Sectors to Growth



Source: SIS

The industry and service sectors have been influential in GDP growth especially in recent periods (Chart I.2.3.1.2).

Chart I.2.3.1.3
Monthly Industrial Production Index and Capacity Utilization Rate
1,2



Source: SIS

[1] Percentage change as compared to the same month of the previous year.

[2] 1997=100 index prepared according to the new definition is used for the Industrial Production Indices.

The monthly manufacturing industry production index, which is a leading indicator for the corporate sector, decreased by 9.8 percent on average in 2001 due to the crises. However, parallel to developments in the economy, especially in line with the output growth triggered by domestic and external demand, the index followed an increasing trend beginning in 2002 and increased by 9 percent and 10.4 percent on average in 2003 and 2004, respectively (Chart I.2.3.1.3). The increase in

the automotive and durables consumption demand and exports has been influential in output growth in 2004. The increase is attributable to the production of motor vehicles and trailers, chemicals and machinery and equipment industries. Coal and refined petroleum and the food products and beverages industry, on the other hand, restricted the growth in output.

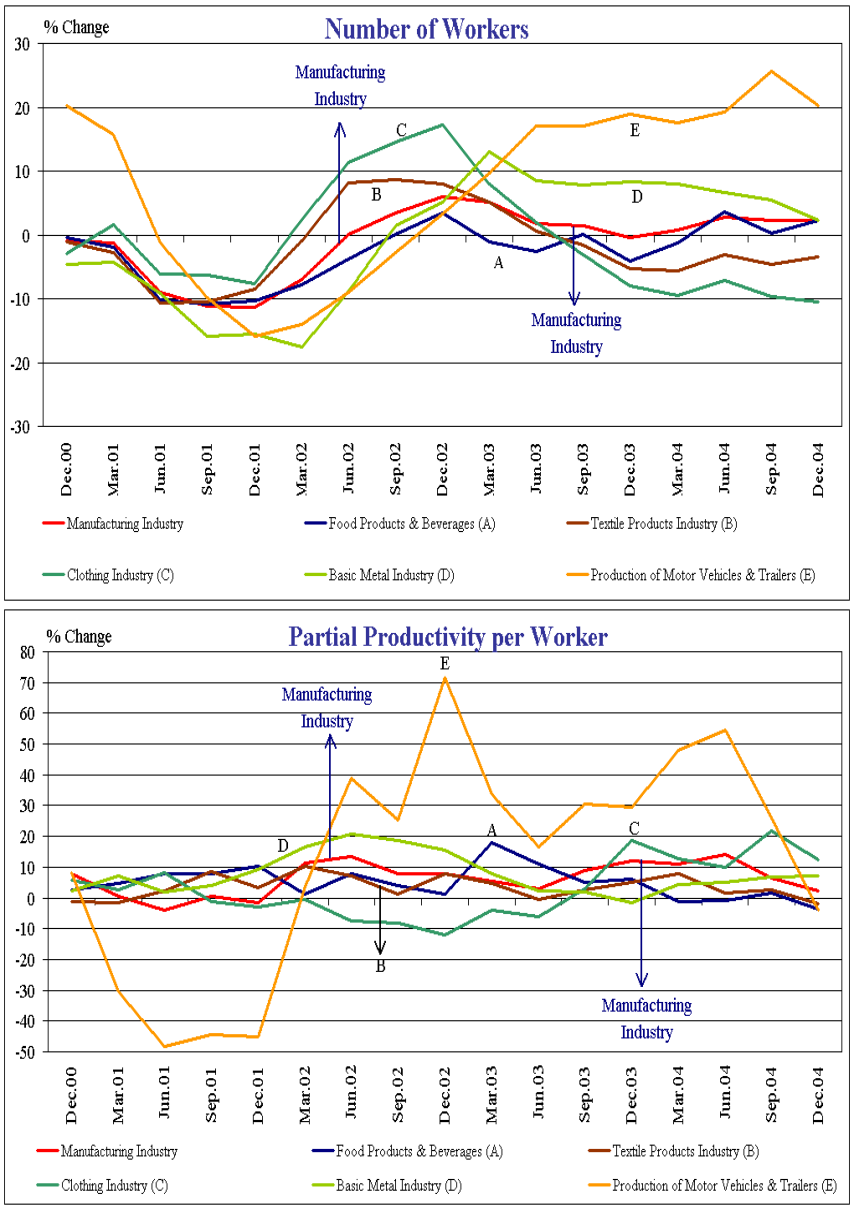
In May 2005, the manufacturing industry production index increased by 1.1 percent as compared to the same month of the previous year. The production capacity of the automotive sector, which contributed most to industrial production in 2004, achieved very low growth in January 2005. However, despite this contraction in the domestic market, 42.6 percent increase was realized in February due to the growth in exports, whereas a limited 4.2 percent increase was realized in May 2005. This limited growth in the manufacturing industry production index is attributable to the production of chemicals, metal products, rubber and plastics products, medical, precision, optical instruments and furniture, in addition to the increase in the automotive sector. The negative growth rates realized in the production of coal and refined petroleum, machinery and equipment, textile products and clothing, which all have high shares in the manufacturing industry, restricted the growth of manufacturing industry production. Despite their low shares in the manufacturing industry, the excessive drop in the production of the leather industry, tobacco products industry, other transport equipment industry, publishing and printing industry and radio, TV and communication equipment industry also restricted production growth in the manufacturing industry.

The reduction in domestic demand after the crises led to a reduction in company sales. Accordingly, company stocks increased and the capacity utilization rates significantly deteriorated. The manufacturing industry capacity utilization rate showed signs of improvement starting from 2002, as uncertainties diminished, and as external demand, exports and productivity increased. By the end of 2004, the manufacturing industry capacity utilization rate was 84 percent. This figure, which was 84.5 percent in June 2004, decreased to 81.5 percent in June 2005. It is our opinion that the excessive increase in the capacity utilization rate in 2004, together with exchange rate stability and the reduction in interest rates, will positively effect the investment decisions

Manufacturing industry capacity utilization rate was realized as 84.4 percent in 2004, the highest level since 1997. This rate was 81.5 percent in June 2005.

of corporates, which in return will increase credit demand in the coming periods.

Chart I.2.3.1.4
Number of Workers and Partial Productivity per Worker for Selected Sectors of the Manufacturing Industry[1,2]



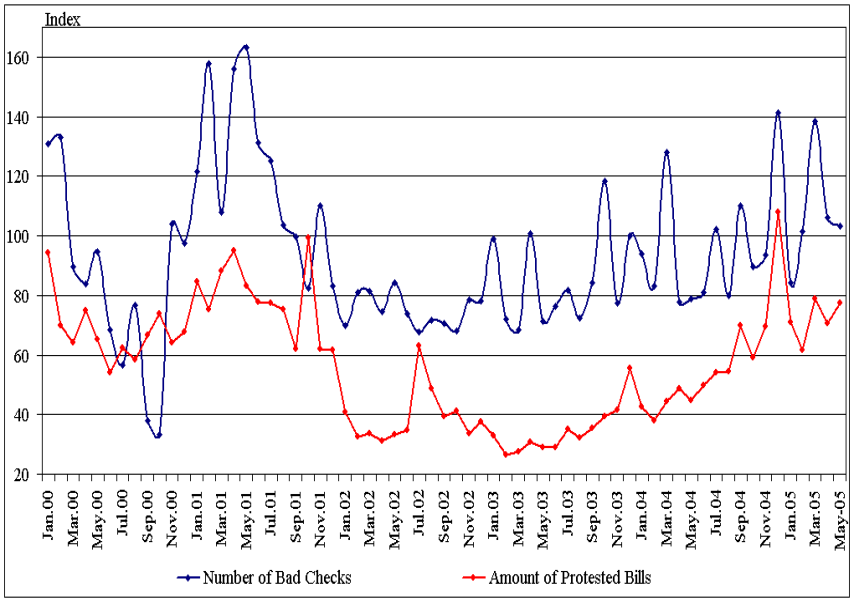
Source: SIS
[1] Percentage change as compared to the same month of the previous year.
[2] 1997=100 index is used.

While manufacturing industry production increased by 10.4 percent on average and the capacity utilization rate increased by 3.7 percent in 2004, partial productivity per worker increased by 8.2 percent and the number of production workers increased by only 2 percent. This shows

that the source of growth in 2004, as was the case in the period after the crises, was not an increase in employment but rather an increase in productivity per worker. However, the growth in the private manufacturing industry production capacity is attributable to utilization of capital as well as the increase in labor productivity, especially taking into consideration that private investment expenditures increased by 45.5 percent and that machinery and equipment investment increased by 60.3 percent in 2004. Besides, the growth in investment expenditures supports the rise in productivity and also augments the potential production capacity, thus making rapid growth feasible.

As for the sub-sectors of the manufacturing industry, the automotive industry, which contributed most to industrial production in 2004, achieved the highest rise in index of production workers by 20.7 percent. On the other hand, production workers in the clothing and textile products industries decreased by 10.7 percent and 4.1 percent respectively, due to declining competitive advantages of these industries abroad. The highest rise in labor productivity was achieved in the automotive industry by 27.8 percent. Despite the rapid decrease in domestic automotive sales starting from the third quarter of 2004, due to the saturation in domestic demand, this increase is attributable to the rise in exports. The partial productivity indices in the clothing and textile industries, where a decline in the number of workers was observed, increased on average by 14.3 percent and 2.4 percent respectively, as compared to 2003. In addition, the growth tendency in the world economy in 2004 increased the demand for metal products. Consequently the number of production workers and productivity per worker increased in the basic metal industry throughout the year (Chart I.2.3.1.4).

Chart I.2.3.1.5
Indices for Number of Bad Checks and Amount of Protested Bills[1]

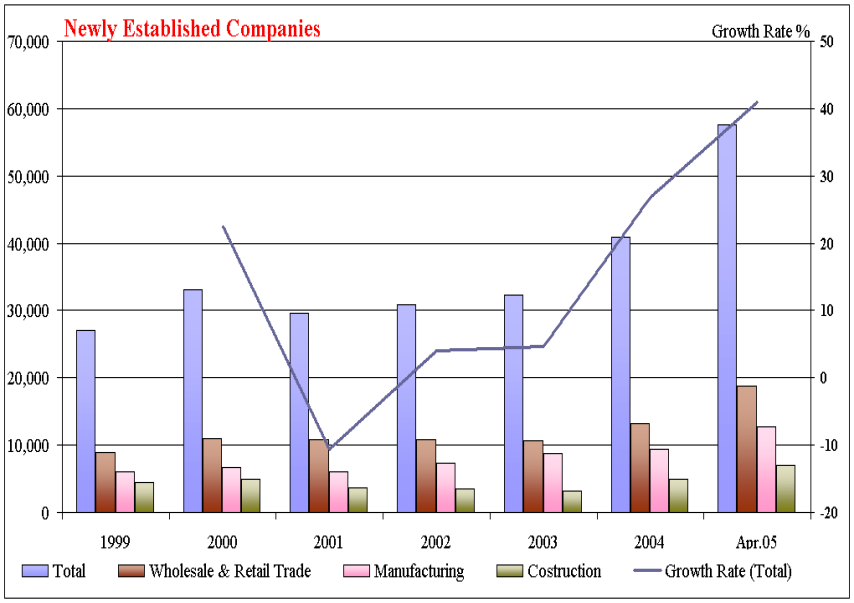


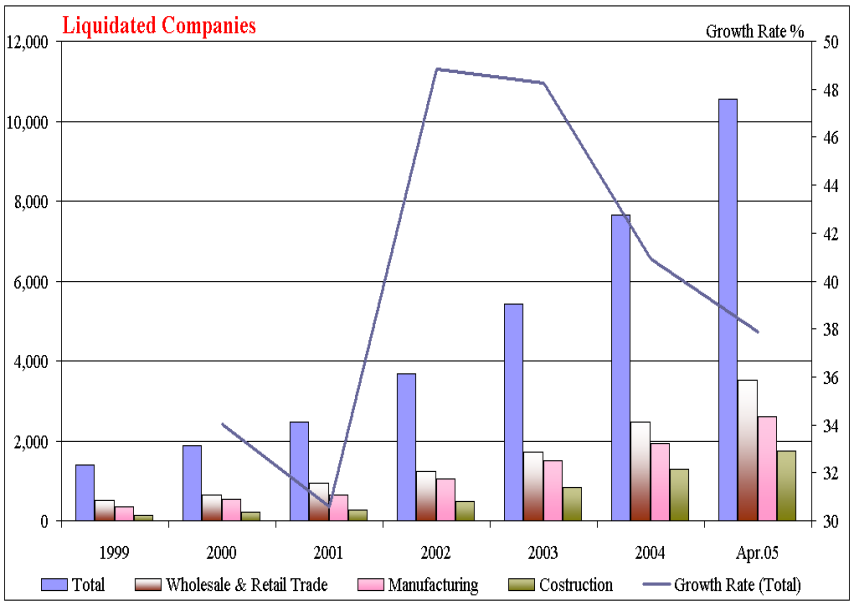
Source: CBRT

[1] Amount of protested bills was expressed in real terms using 1994=100 CPI index. Indices for number of over-drawn checks and amount of protested bills was formed by taking December 1997 as 100.

The indices for both numbers of bad checks and the amount of protested bills show seasonality and have increased in April 2005 compared to the same month of the previous year (Chart I.2.3.1.5).

Chart I.2.3.1.6
Number of Newly Established and Liquidated Companies and Cooperatives





Source: SIS

[1] Growth rate shows the increase in the number of newly established/liquidated companies and cooperatives as compared to the end of the previous year.

The change in the number of newly established/liquidated companies is a useful indicator for pinpointing the periods of economic expansion and recession. In 2004, as a result of the economic recovery, the growth rate in the number of newly established firms accelerated, whereas the growth rate in the number of liquidating firms slowed down. This trend, which continued in the first quarter of 2005, is regarded as a

positive development in terms of the value added the corporate sector can contribute during the year 2005 (Chart I.2.3.1.6).

I.2.3.2.Financial Analysis of Companies

Box I.2.3.2.1.Data Sets for Companies

The financial analysis of companies was primarily based on the financial statements prepared on a historical-cost basis for the years 1999-2003 of 186 companies operating in the manufacturing industry whose stocks are actively traded on the İstanbul Stock Exchange (ISE), for which information can be obtained and financial statements can be consolidated. The aim of using this data is to examine the behavior of big companies with reliable financial statements which have access to capital markets for funding in addition to bank credit. Moreover, since the time it takes for related bodies to complete and publish the balance sheets of companies is longer, taking into consideration the date that this report was published, for the year 2004 it was a necessity to use the data for those companies that are being actively traded on the ISE.

On the other hand, the Communique Volume:XI, No:20[3] published by the Capital Markets Board (CMB), requires that all firms registered by the CMB prepare their financial statements according to inflation accounting principles starting from 01.03.2003. Moreover, the provision in section 15[4] of the communique Volume:XI, No:25[5], prepared in line with International Financial Reporting Standards (IFRS), states that those companies listed on the stock exchange may choose to start inflation adjustments on interim or annual accounting periods starting from 31.12.2003. In this framework, it became impossible to compare the financial statements with the previous years since the companies that prepare their financial statements in accordance with Communique Volume:XI, No:25 or IFRS, are not required to publish their financial statements prepared on the basis of historical cost. Therefore, the charts that have been prepared using ISE data do not include the data for the year 2004. The data are analyzed on a "consolidated" and "unconsolidated" basis compared to inflation adjusted financial statements only for the year 2003. Besides, in the analysis covering years 2003 and 2004 with inflation adjustments, the 186 companies used for the analysis of the 1999-2003 period were not considered. Instead, 190 firms operating in the manufacturing industry for which the financial statements could be obtained were used.

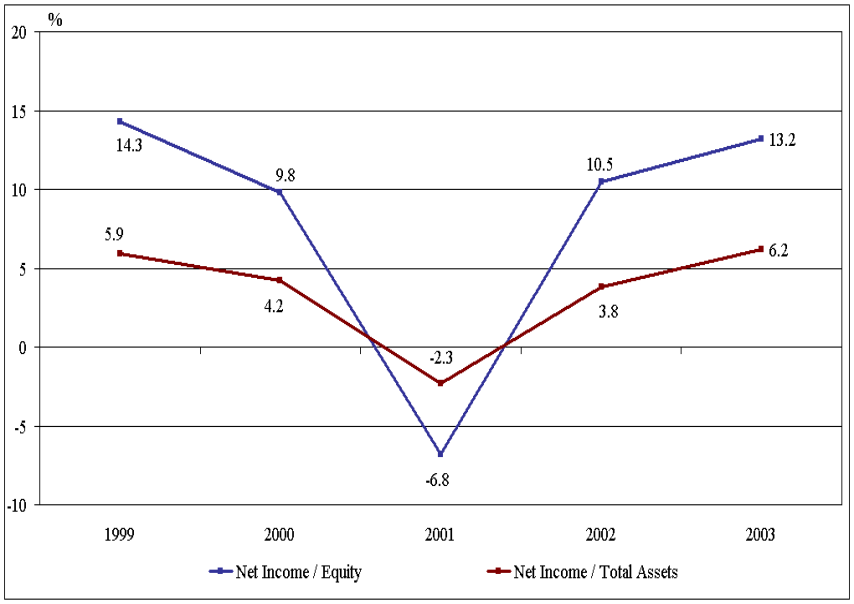
This part was prepared using the financial statements of the companies listed on the ISE. When companies are categorized according to the subsectors of the manufacturing industry, it can be seen that there is concentration in specific sectors (Basic metal Industry, Textile, Clothing, Leather Industry etc.)

[3] "Communique on Principles and Procedures for Adjusting Financial Statements in High Inflation Periods" was published in the Official Gazette No. 24597 dated 28.11.2001 and was amended by the Communique published in the Official Gazette No. 24643 dated 17.01.2002, Comminique published in the Official Gazette No. 25024 dated 18.02.2003 and the Comminique published in the Official Gazette No. 25387 dated 28.02.2004. In addition, according to the "Communique on Accounting Principles and Procedures in the Capital Market for Consolidated Financial Statements and Subsidiaries" published in the Official Gazette No. 24582 dated 13.11 .2001 as amended by the Comminique published in the Official Gazette No. 24643 dated 17.01.2002, the consolidated financial statements to be prepared by the parent company are also inflation adjusted.

[4] The standard to be taken into consideration for the preparation of inflation adjusted financial statements within the framework of IFRS is standard No.29 (IFRS 29: Financial Reporting in Hyperinflationary Economies).

[5] "Comminique on Capital Market Accounting Standards" was published in the Official Gazette No. 25290 dated 15.11.2003 and was amended by the Comminique published on the Official Gazette No. 25677 dated 21.12.2004.

Chart I.2.3.2.1
Profitability Ratios[1] (ROA[2] and ROE[3])



Source: ISE

[1] Financial statements of 186 firms prepared on the basis of historical cost for 1999-2003 period are used.

[2] Return on Assets (ROA) = Net Income / Total Assets

[3] Return on Equity (ROE) = Net Income / Equity

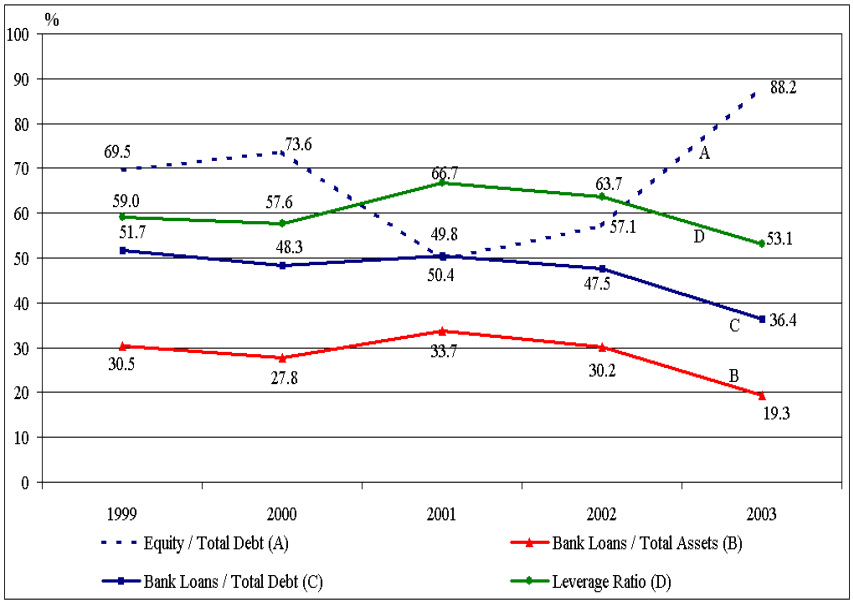
There has been a significant deterioration in the financial structure of corporates after the crises of 2000 and 2001. As a result of rising interest rates on loans, profitability of corporates declined considerably. As a matter of fact, both Net Income/Total Assets and Net Income/Equity, which are the main indicators for corporate sector profitability, dropped to negative figures by the end of 2001. In 2002 and 2003, these ratios reached positive figures (Chart I.2.3.2.1). This was due to the decrease in funding costs, as a result of the reduction in interest rates and appreciation of domestic currency following economic stability, which ended up in diminished financing costs and increased net income. However, the ratio of operating profits to total net sales was 7.6 percent in 2002, whereas this ratio was realized as 7 percent in 2003.

Financial structure of corporates improved since 2002 as the deteriorating effects of the crises diminished.

When the **inflation adjusted and consolidated** financial statements of 124 companies (mainly large manufacturing companies and holdings) are analyzed, it can be observed that the Net Income / Total Assets ratio decreased from 5.1 percent in 2003 to 4.4 percent in 2004 and Net Income / Equity ratio decreased from 12.1 percent to 10.6 percent during the same period. On the other hand, when the unconsolidated financial statements of 66 firms are analyzed, it can be seen that the Net Income / Total Assets ratio increased from 5.7 percent

in 2003 to 9.7 percent in the year 2004 and the Net Income / Equity ratio increased from 3.1 percent to 5.3 percent during the same period. The different trends in the Net Income / Equity ratio between the two groups is attributable to the increase in equity rather than changes in "Net Income". The increase in equity is due to several factors. Firstly, big companies, which prepare their financial statements on a consolidated basis, increased their equity in time and although financial and commercial debts are not adjusted as monetary items, capital is re-priced for "inflation adjustment". Similarly, the Net Income / Total Assets ratio moved in different directions for the two groups. This is because of the increase in total assets of big companies due to the inflation adjustment of fixed assets.

Chart I.2.3.2.2
Selected Financial Structure Ratios[1]



Source: ISE
[1] Financial statements of 186 firms prepared on the basis of historical cost for 1999-2003 period are used.
[2] Leverage Ratio=Total Debt/Total Assets

The decrease in funding costs, which is an important factor for the rising profitability of companies, is attributable to the reduction in debt, the decrease in loan interest rates and appreciation of domestic currency, which is especially important for companies that obtain FX-denominated loans. As a matter of fact, the ratio of equity to total debt increased from 49.8 percent in 2001 to 88.2 percent in 2003 (Chart I.2.3.2.2). The increase in profitability ratios was the most important factor contributing to the strengthening of equity. This can be regarded as a positive

development from the perspective of the banking sector in terms of the repayment capacity of the corporate sector.

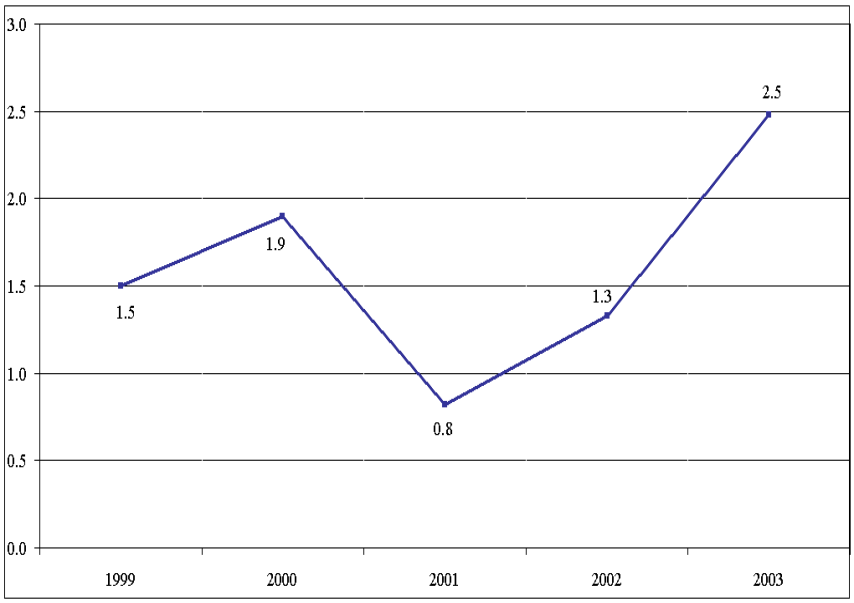
Although the leverage ratio (Total debt / Total Assets) follows a declining trend, total debt still has a higher share than equity in the funding of assets. The ratio decreased from 66.7 percent in 2001 to 53.1 percent in 2003 (Chart I.2.3.8).

When the **inflation adjusted and consolidated financial statements** (of 124 companies) are analyzed, it can be observed that the ratio of equity to total assets was realized as 41.2 percent and the ratio of equity to total debt was realized as 70 percent in 2004. On the other hand, the ratio of bank loans to total assets, the ratio of bank loans to total debt and the financial leverage ratio were 11.2 percent, 18.8 percent and 58.8 percent respectively. The **unconsolidated financial statements** (of 66 companies) on the other hand, show that the ratio of equity to total debt and total assets increased in 2004 and that preference for equity continues. However, the effects of inflation adjustment on equity should also be taken into account when interpreting this development.

In the year 2004 corporates used their equity as the main source of funding.

On the other hand, although the ratio of bank loans to total debt fell, the amount of funds corporates raised from abroad increased considerably due to the increase in their creditworthiness (See Part I, Chart I.2.4.3. and Part II.2.1.1.1, Chart II.2.1.1.1.14). However, although there are cost advantages, the exchange rate risk the corporates are exposed to as a result of this development should be carefully monitored. It is essential that exchange rate risk is well managed by corporates.

Chart I.2.3.2.3
Coverage Ratio [1,2]

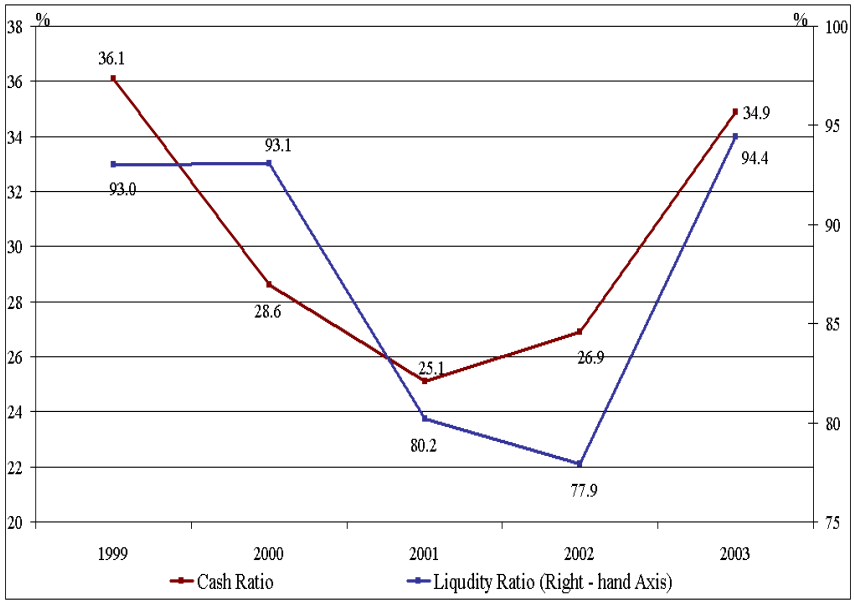


Source: ISE
[1] Financial statements of 186 firms prepared on the basis of historical cost for 1999-2003 period are used.
[2] Coverage Ratio = (Operating Income + Interest Income) / Funding Costs

The coverage ratio has increased starting from year 2002.

Another indicator for the corporate sector repayment capacity is the coverage ratio, which shows the relationship between income and financial obligations. The coverage ratio declined significantly in 2001 reflecting the effects of the crises, whereas it increased considerably in 2003. The movement in both periods is attributable to changes in funding costs. In 2002 and 2003 the ratio improved as a result of declining loan costs and increasing equity financing (Chart I.2.3.2.3). When the **inflation adjusted financial statements** for 2004 are analyzed, the ratio continues to show an increasing trend as a result of decreasing funding costs and increasing equity financing.

Chart I.2.3.2.4
Liquidity Ratios [1,2,3]



Liquidity ratios improved in 2003.

Source: ISE

[1] Financial statements of 186 firms prepared on the basis of historical cost for the 1999-2003 period are used.

[2] Cash Ratio = (Liquid Assets + Marketable Securities) / Short-term Liabilities)

[3] Liquidity Ratio (Acid-Test Ratio) [Current Assets - (Inventories + Prepayments and Accrued Income for the Next Months + Other Current Assets)] / Short-term Liabilities

The liquidity ratio, which shows the ability of firms to cover their short term liabilities, started to decrease in 2000 and hit the lowest level in 2002 due to the increase in short term liabilities. The ratio increased in 2003 as a result of the increase in current assets as well as the decrease in short-term liabilities due to the tendency of corporates to use their equity as a source of funding, as mentioned before. However, the liquidity ratio alone may be insufficient to determine the liquidity level since current assets include items such as "receivables", which are less liquid and the collection of which is positively correlated with developments in the macroeconomic indicators. In this framework, when the cash ratio is analyzed it can be observed that this ratio is lower compared to the liquidity ratio, although starting from 2002 both ratios reveal an increasing trend.

When the **inflation adjusted consolidated financial statements** are analyzed (of 124 companies); it can be observed that the liquidity ratio decreased from 92 percent in 2003 to 83,2 percent in 2004, whereas the cash ratio decreased from 46.2 percent to 32.1 percent during the same period. The decline in the liquidity ratio is attributable to the increase in short term liabilities as well as the fact that inventories increased more than current assets. The decline in the cash ratio, on the

other hand, is attributable to the increase in short term liabilities and the decrease in securities. When the **unconsolidated financial statements** are analyzed (of 66 companies), it can be seen that the liquidity ratio increased from 96.5 percent in 2003 to 97.9 percent in 2004, whereas the cash ratio increased from 39 percent to 44.9 percent during the same period. The increase in both ratios is mainly attributable to the limited decrease in other current assets and short term liabilities, in spite of the increases in other items.

Box I.2.3.2.2. Sector Balance Sheets

In the above analysis the financial statements between 1999-2003 for companies operating in the manufacturing industry whose stocks are actively traded on the İstanbul Stock Exchange (ISE), for which information can be attained and financial statements can be consolidated were used. The "Sector Balance Sheets" data published by the CBRT, covering the financial statements of 14 main sectors and 34 sub-sectors (7461 private company data for 2003), also support the results of the foregoing analysis:

I. Financial Structure of Companies

i. Equity was the item that achieved the highest increase (38 percent) in 2003 as compared to the previous year, despite the insignificant increase in supplementary capital and prior year's loss.

ii. The share of debt in total liabilities, which was 68 percent in 2000 increased to 73.2 percent in 2001 due to the pressure on interest rates as a result of crises, and decreased to 63.3 percent in 2003.

iii. In 2003, the share of financial obligations in total liabilities was 41.1 percent. 94 percent of these financial obligations consisted of short and long term bank loans including principal and interest payments on loans.

iv. The share of bank loans in total debt was 39.1 percent in 2000. This ratio increased to 42.2 percent in 2001 due to the crises and in 2003 it decreased back to 35.5 percent as a result of positive developments in the economy.

v. In 2000 when the exchange rate was fixed, 32 percent of assets was funded by equity. This ratio decreased to 26.8 percent in 2001 due to crises and increased to 36.7 percent in 2003.

II. Profitability of Companies

i. The profitability of companies increased by 11.4 percent in 2003 as compared to 2002. This increase is attributable to the increase in foreign exchange gains and the decrease in funding costs due to the decrease in interest rates and appreciation of domestic currency, as a result of the economic stability achieved.

ii. Foreign exchange gains increased by 50 percent in 2003, whereas funding costs decreased by 38.7 percent. These developments compensated for the decrease in operating profits in 2003 and net profit margin was realized as 2.2 percent, a figure not significantly different from that in 2002.

III. Liquidity Structure

i. The current ratio increased from 109.2 percent in 2001 to 120.2 percent in 2003, whereas the acid-test ratio increased from 79.2 percent to 86.9 percent during the same period.

ii. The cash ratio, which was 26.3 percent in 2000, decreased to 22 percent in 2001 and then increased to 24.6 percent in 2003.

In conclusion, the financial structure of companies, which significantly deteriorated after the crises, improved considerably in 2003 due to the reduction in funding costs, increase in profitability and equity financing. The inflation adjusted consolidated and unconsolidated financial statements for the year 2004 also indicate that the stability in the financial structure of companies and the improvement in the quality of equity continues. However, despite the improvements regarding repayment capacity and hence credit risk, the exchange rate risk as a result of increasing funds obtained by companies from abroad must be carefully observed.

When the positive developments in the economy are taken into consideration, it is expected that the financial structure of companies will continue to improve in 2005. However, the fact that Basel II will be implemented in Turkey starting from 2008 requires that both the corporate sector and the banking sector be under strict discipline to follow higher international standards. With the implementation of Basel II , banks will be more selective in their credit decisions and will prefer companies with high credit-worthiness and transparent and reliable financial statements. In order to achieve transparency, the financial statements of small, medium and large sized companies operating in the corporate sector, should be prepared in line with international standards, be reliable and be made public on a timely basis. Also, information regarding changes in ownership structure and transactions with related parties should be made available.

The investment decisions of corporates are influenced by institutional factors such as macroeconomic stability, tax regulations and legal infrastructure, whereas credit extensions of banks to companies are influenced by transparency, compliance with corporate management standards as well as the financial strength of companies.

I.2.4. Developments in the External Sector

Table I.2.4.1
Current Account Balance

Mio USD	1999	2000	2001	2002	2003	2004
CURRENT ACCOUNT	**-1,344**	**-9,819**	**3,390**	**-1,522**	**-8,037**	**-15,543**
Foreign Trade Balance	-10,185	-21,959	-3,733	-7,283	-14,010	-23,925
Exports f.o.b.	26,587	27,775	31,334	36,059	47,253	63,120
Imports c.i.f.	-40,671	-54,503	-41,399	-51,554	-69,340	-97,540
Coverage Ratio (%)	65.4	51.0	75.7	69.9	68.1	64.7
Balance on Services	7,487	11,368	9,130	7,879	10,505	12,774
Balance on Investment Income	-3,537	-4,002	-5,000	-4,554	-5,559	-5,519
Current Transfers	4,891	4,774	2,993	2,436	1,027	1,127
CAPITAL & FINANCIAL ACCOUNT	**-377**	**12,581**	**-1,719**	**1,373**	**3,001**	**12,695**
Direct Investments	138	112	2,769	863	1,254	1,874
Portfolio Investments	3,429	1,022	-4,515	-593	2,465	8,023
Other Investments	1,782	11,801	-2,667	7,256	3,329	3,622
Reserve Assets	**-5,726**	**-354**	**2,694**	**-6,153**	**-4,047**	**-824**
NET ERRORS AND OMISSIONS	**1,721**	**-2,762**	**-1,671**	**149**	**5,036**	**2,848**

Source: CBRT

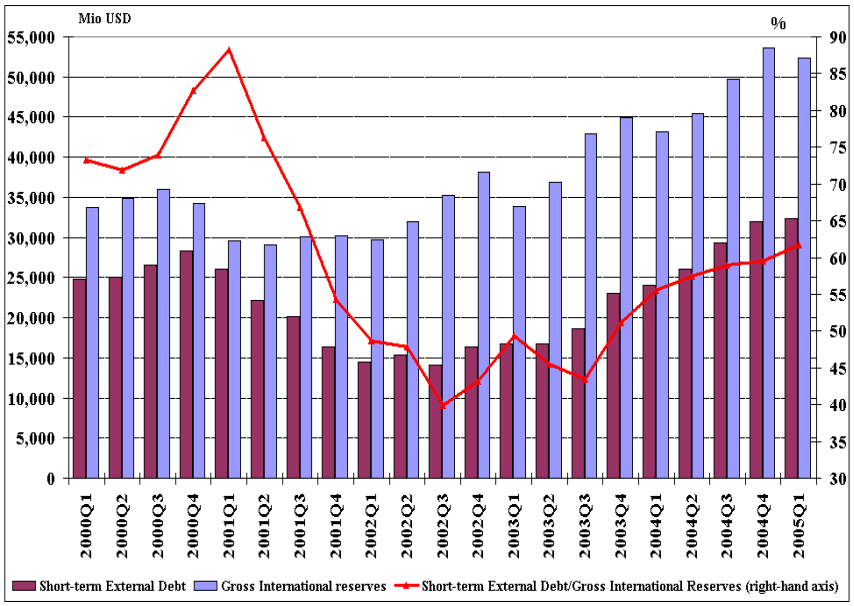
The current account deficit increased due to the fact that domestic investment increased at a higher rate than domestic savings. In this framework, in 2003 and 2004, the foreign trade deficit increased significantly parallel to economic growth and reached nearly 24 billion USD. Despite the growth in exports, the ratio of exports to imports was realized as 64.7 percent, as a result of the rapid increase in imports of intermediate goods and consumer durables (Table I.2.4.1). The ratio of current account deficit to GDP was realized as 5.2 percent. Nevertheless, in 2004, Turkey was among the top six countries in terms of export performance[6], which grew by 3.2 percent. The projections for the year 2005 reveal that Turkey has the second best export performance growth (5.3 percent) following China (14 percent)[7]. Exports increased in the first six months of the year 2005 as compared to the same period of 2004[8].

[6] Export performance is calculated as the ratio of total export volume to total goods and services export markets. In the calculation of export markets, the weighted average of trade volume for each exporting country, based on trade flows of the year 2000 is taken into consideration.

[7] The top six countries for 2004 are the Czech Republic (11.5 percent), China (10.2 percent), South Korea (7.9 percent), Hungary (7.1 percent) and Japan (3.3 percent).

[8] According to Turkish Exporters Council data, exports which amounted to 24. 7 billion USD in the first six months of 2004 increased by 23 percent to 30.4 billion USD in the first six months of 2005.

Chart I.2.4.1
Short-Term External Debt[1] and International Reserves[2]



Source: Treasury, CBRT

[1] Short-Term External Debt= General Government + CBRT + commercial banks + other sectors.

[2] International Reserves= CBRT gross foreign exchange reserves (including gold)+deposit banks' gross foreign exchange reserves.

The fact that international reserves reached 52.4 billion USD in the first quarter of 2005 and that domestic currency appreciated under the flexible exchange rate regime indicates that current account deficit was well financed (Chart I.2.4.1). It is our opinion that Turkey will not encounter difficulties regarding financing of the current account with the continuation of the positive developments in the economy and structural reforms.

Table I.2.4.2
Sources of Finance for the Current Account Deficit

Mio USD	1998	1999	2000	2001	2002	2003	2004	2005 (first five months)
Current Account	1,984	-1,344	-9,819	3,390	-1,522	-8,037	-15,543	-11,116
Financial Accounts	-1,287	-377	12,581	-1,719	1,372	3,001	12,695	8,191
General Government (including CBRT and CBRT's reserves)	-5,827	-3,765	4,772	8,044	2,862	-2,624	2,379	-1,295
Private Sector (including banks)	4,540	3,388	7,809	-9,763	-1,490	5,625	10,316	9,486
Net Errors and Omissions	4,943	1,721	-2,762	-1,671	150	5,036	2,848	2,925

Source: CBRT

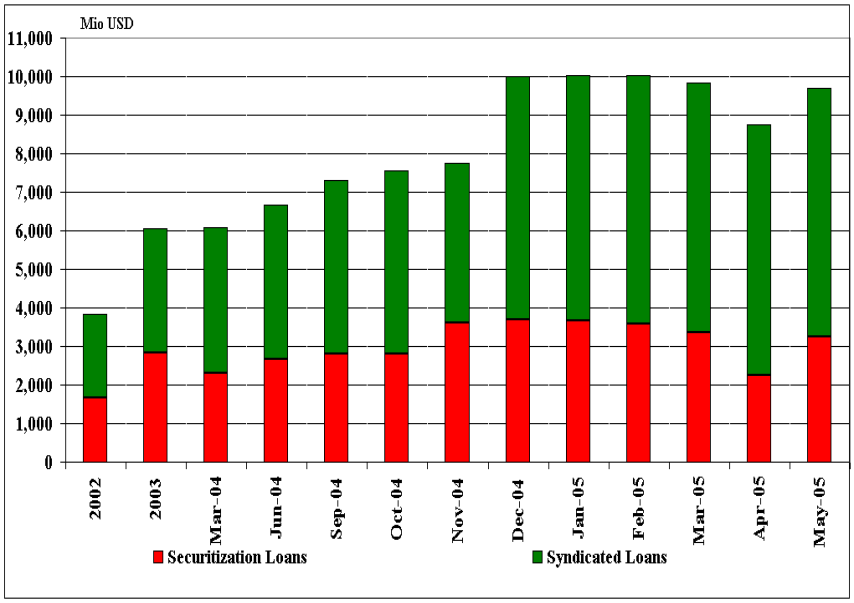
As a matter of fact, the increase in the current account deficit in the last three years was financed by the private sector rather than government sources. The funds obtained by the private sector (including banks) from abroad increased from 8.2 billion USD in the January-May period of 2004 to 9.5 billion USD in the same period of 2005 (Table I.2.4.2).

Box I.2.4.1.Syndicated and Securitization Loans

Syndicated loans, are loans that are extended collectively by two or more banks with the leadership of one bank. In other words, it is the underwriting of a loan by a group of banks. Underwriting is not carried out by one bank alone since the loan is too large to be extended by one bank and therefore the risk too substantial . The maturity of syndicated loans is generally 5-7 years. In Turkey, however, the maturity of such loans is limited to 1-2 years.

Securitization loans are funds obtained from abroad by showing the future cash flows of instruments in the bank portfolio, in other words, diversified payment rights, as collateral. Several Turkish banks obtain loans from banks abroad showing credit card receivables from abroad, remittance flows from abroad and other payments to be received in the future as collateral. The maturity of securitization loans Turkish banks obtain from abroad are generally 7-8 years. However, recently, parallel to the positive developments in the economy, there is a tendency to lengthen the maturity and reduce the borrowing costs.

Chart I.2.4.2
Banking Sector Syndicated and Securitization Loans

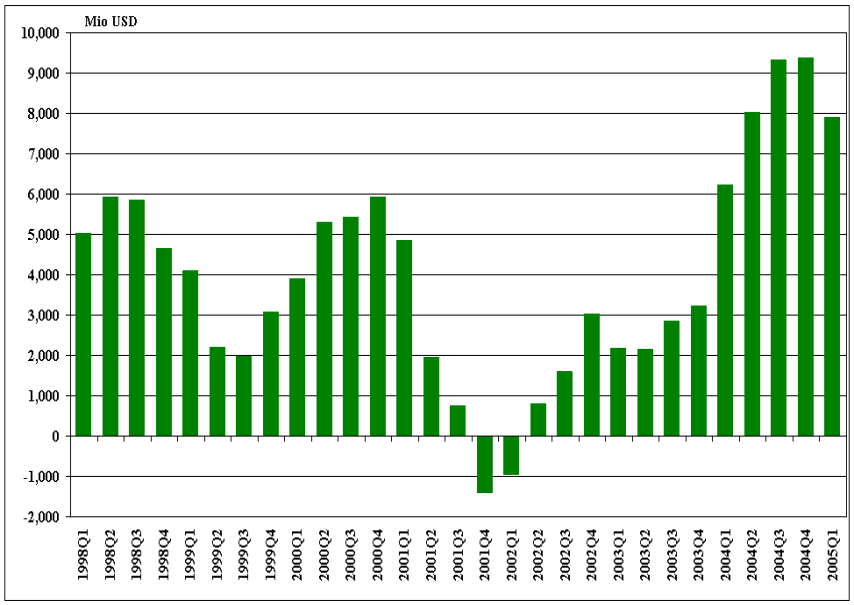


Source: CBRT

Syndicated and securitization loans increased.

Syndicated and securitization loans increased by 55 percent from 6 billion USD in 2003 to 10 billion USD in 2004 (Chart I.2.4.2). In 2003, 85.8 percent of securitization loans and 88.4 percent of syndicated loans were received by private banks. The figures for 2004 were 91.9 percent and 83.4 percent, respectively. In this period, syndicated loans increased faster than securitization loans.

Chart I.2.4.3
Borrowings of Companies from Abroad[1]

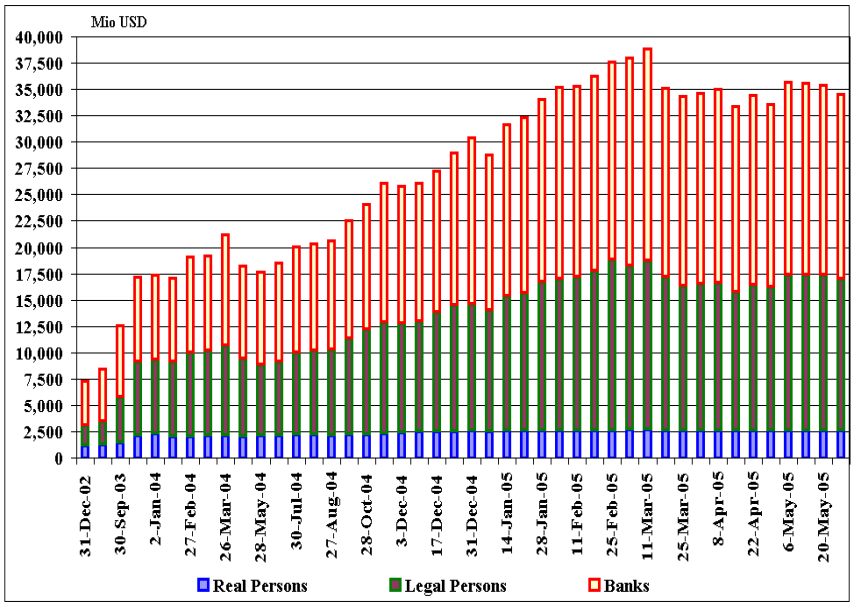


Source: CBRT

[1] Shows non-financial debt in the balance of payments excluding General Government, CBRT and banks and includes non-cash loans. That data is annualized.

The direct funds obtained by companies from abroad is important both for the financing of the current account deficit and for contributing to production growth. During the post-crisis period, parallel to the increase in sovereign credibility, these funds increased and reached 9.4 billion USD in 2004. The balance of payments figures for the January-May period of 2005 reveal that companies obtained 3.6 billion USD funds from abroad.

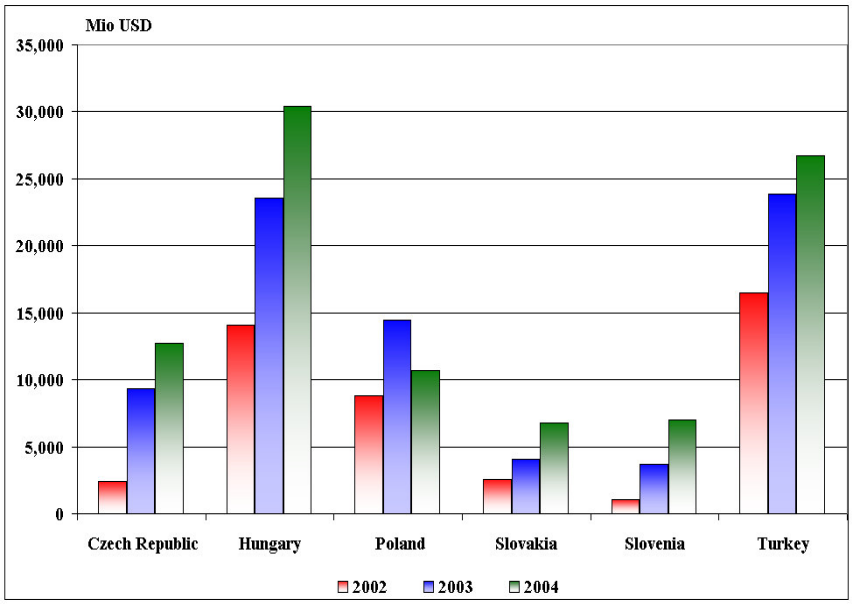
Chart I.2.4.4
Portfolio Investments by Non-Residents[1,2]



Source: CBRT
[1] Includes stocks, government securities, Eurobonds, deposits and repos.
[2] Stock data.

Portfolio investments by non-residents, which is another important item for the financing of the current account deficit, reached 30.4 billion USD by the end of 2004, increasing to 13 billion USD as compared to the same period of the previous year (Chart I.2.4.4). This trend continued in 2005 and by March 2005 the figure reached to 38.8 billion USD. As of May 27, 2005, the total portfolio investments by non-residents was 34.5 billion USD.

Chart I.2.4.5
Net Receivables of International Banks from Selected Countries



Source: BIS-Eurostat

The funds extended by banks of those countries reporting to the Bank for International Settlements (BIS) are important external sources for developing countries. Although the net receivables of international banks from Turkey show a tendency to increase, the ratio of these funds to the GDP did not change significantly (Chart I.2.4.5)

In conclusion, the implementation of flexible exchange rate policy and the improvement in financing opportunities due to macroeconomic stability, diminishes the anxieties regarding the current account deficit. Besides, it is our opinion that the increase in maturity of capital inflows, which continue its increasing trend in 2005, is a positive development for the financing of the current account deficit. It is expected that foreign direct investment will increase parallel to improvements in the economic indicators. However, the effective management of exchange rate risk by companies gains importance taking into consideration the increase in the external debt of the private sector.

(Page intentionally left blank)