

SECTION III

BANKING SECTOR RISKS

Participation banks, which have the same legal status as traditional banks but different operating principles, are excluded in the risk analysis of this section.

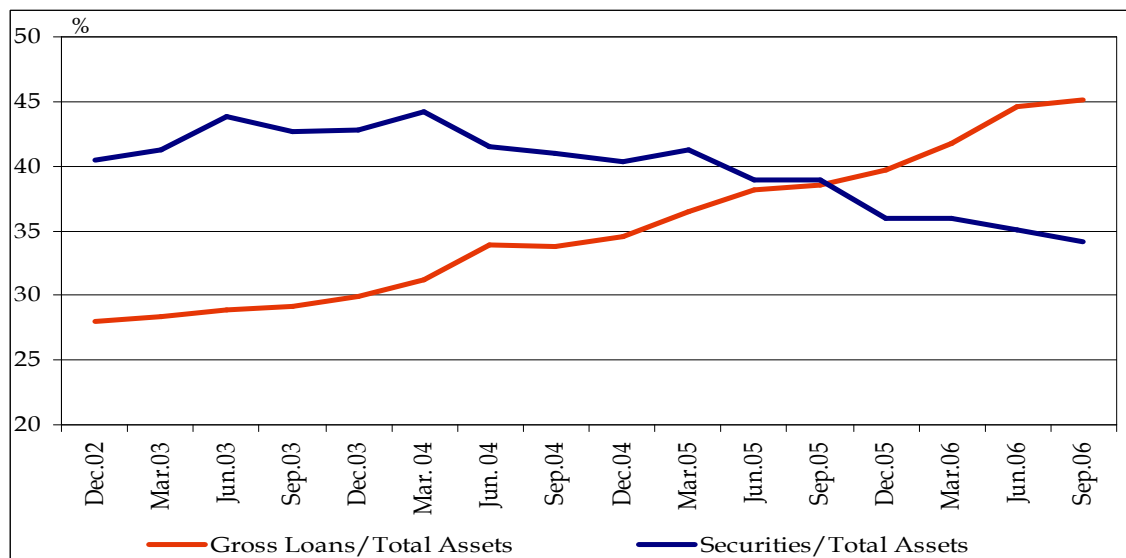
III.1.Credit Risk and Scenario Analysis

III.1.1.Developments in the Credit Portfolio

III.1.1.1.General Structure

The credit volume, which has followed an upward trend since the end of 2002 and completed 2005 with an increase of 34.8 percent in real terms compared to the previous year, also rose by 23.7 percent in real terms in the first nine months of 2006. While retail loans became significant in the growth of the credit volume, the increase in credit interest rates caused the growth rate of consumer loans to decline due to the May-June fluctuation in financial markets. The deceleration trend in the growth rate of credit volume is expected to continue for the next period.

Chart III.1.1.1.1
Shares of Gross Loans and Securities Portfolio in Total Assets



Source: BRSA-CBRT

The share of gross loans¹ in total assets, which used to be 39.7 percent by the year-end 2005, rose to 45.1 percent by September 2006 (Chart III.1.1.1.1).

Table III.1.1.1.1
Some Selected Credit Ratios¹

(Million YTL - %)	2002	2003	2004	2005	Sep.06
First 5 Banks					
Total Gross Loans	32,540	40,888	56,620	87,889	115,980
Share in Total Gross Loans	55	55	54	56	56
NPLs / Total Gross Loans	15	11	5	4	3
Loans / Deposits	38	42	48	55	63
First 10 Banks					
Total Gross Loans	46,028	58,000	83,965	127,913	168,283
Share in Total Gross Loans	77	77	79	81	81
NPLs / Total Gross Loans	20	12	6	5	4
Loans / Deposits	40	43	49	59	67
Sector					
Total Gross Loans	59,411	74,850	105,698	157,440	207,731
NPLs / Total Gross Loans	18	12	6	5	4
Loans / Deposits	43	48	55	65	73

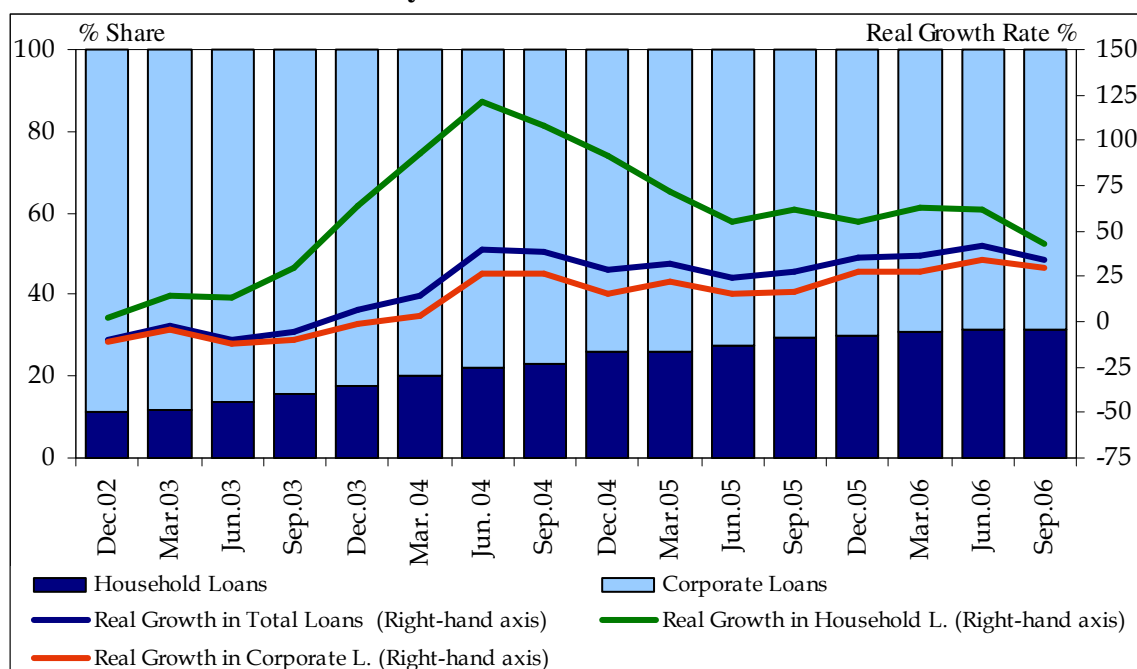
Source: BRSA-CBRT

¹ The first 5 and 10 banks have been taken into consideration according to their total gross loans.

While the shares of the first five and ten banks, which extended the majority of loans, were realized at 56 percent and 81 percent, respectively, as of September 2006, it is observed that the concentration has not changed in either group when compared to 2005. Despite the May-June fluctuations, the loans to deposits ratio in the sector increased, and no increase in the non-performing loans ratio is observed (Table III.1.1.1.1).

² Gross Loans = Total Loans + Gross NPL

Chart III.1.1.1.2
Distribution of Gross Loans by Borrowers and Real Annual Growth Rates^{1,2,3,4}



Source: BRSA-CBRT

¹ They were brought to real terms using the CPI (1994=100).

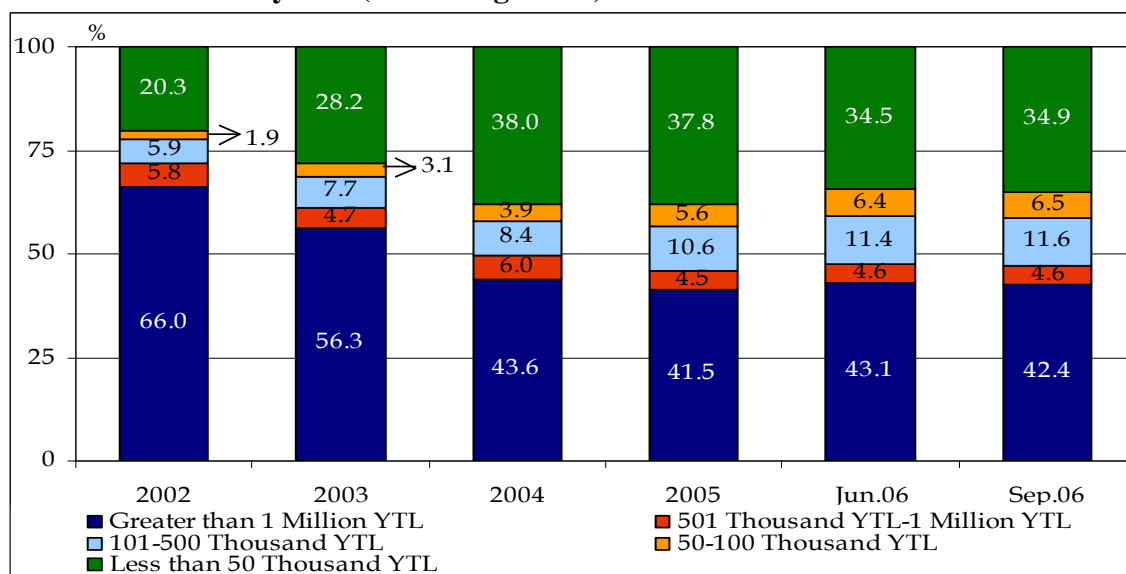
² Annual percentage change as compared to the same month of the previous year.

³ Household Loans = Consumer Loans + Credit Cards

⁴ Corporate Loans = Total Loans – Household Loans

As of September 2006, loans extended to households increased by 30.6 percent in real terms compared to year-end 2005 and their share in total loans continued to rise. Even though corporate loans increased by 20.8 percent in real terms compared to the end of year 2005, their share in total loans decreased from 70.1 percent to 68.5 percent (Chart III.1.1.1.2).

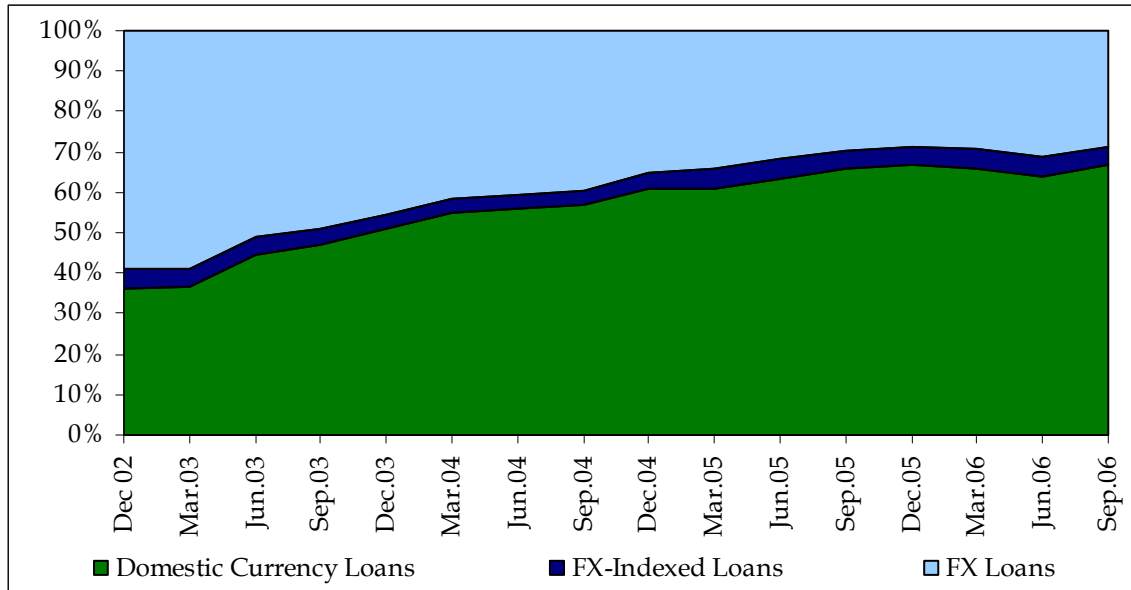
Chart III.1.1.1.3
Loan Distribution by Size (Excluding NPLs)



Source: BRSA-CBRT

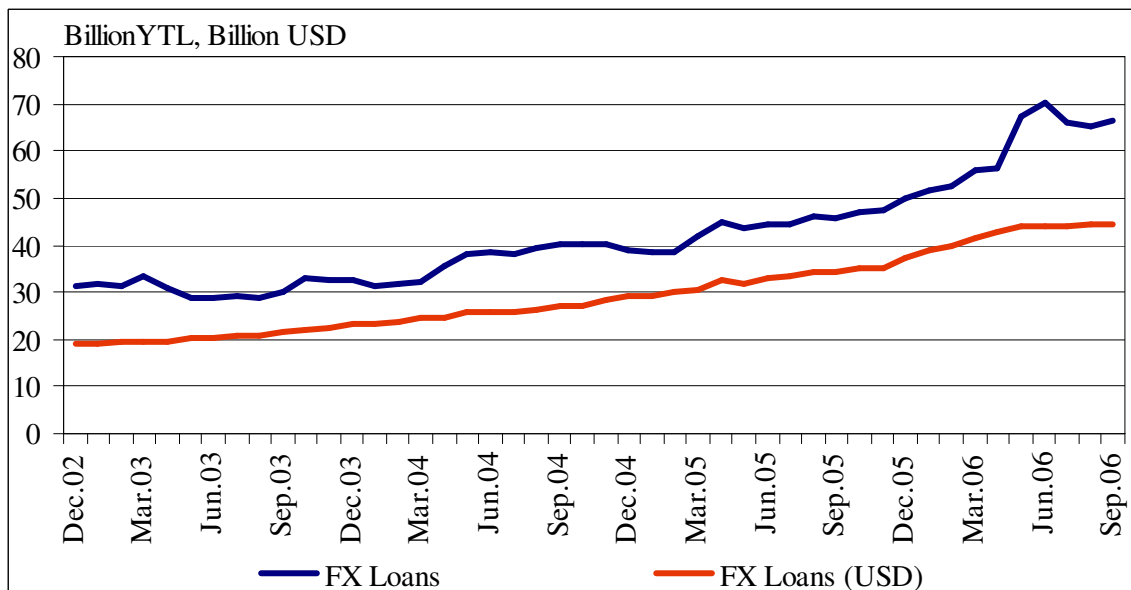
Loans greater than one million New Turkish Lira, which had a decreasing trend till the end of 2005, increased their shares in total loans to 42.4 percent by September 2006. The increase in large exposures stemmed from the increase in working capital loans, other investment loans and export loans, as well as the deceleration of the increase in consumer loans. Also, the rise in large foreign currency exposures was due to the increase in the exchange rate (Chart III.1.1.1.3).

Chart III.1.1.1.4
Currency Composition of Loans (Excluding NPLs)



Source: BRSB-CBRT

Chart III.1.1.1.5
FX Loans^{1,2}



Source: BRSB-CBRT

¹ They were converted to USD using the CBRT buying exchange rate as of month-end.

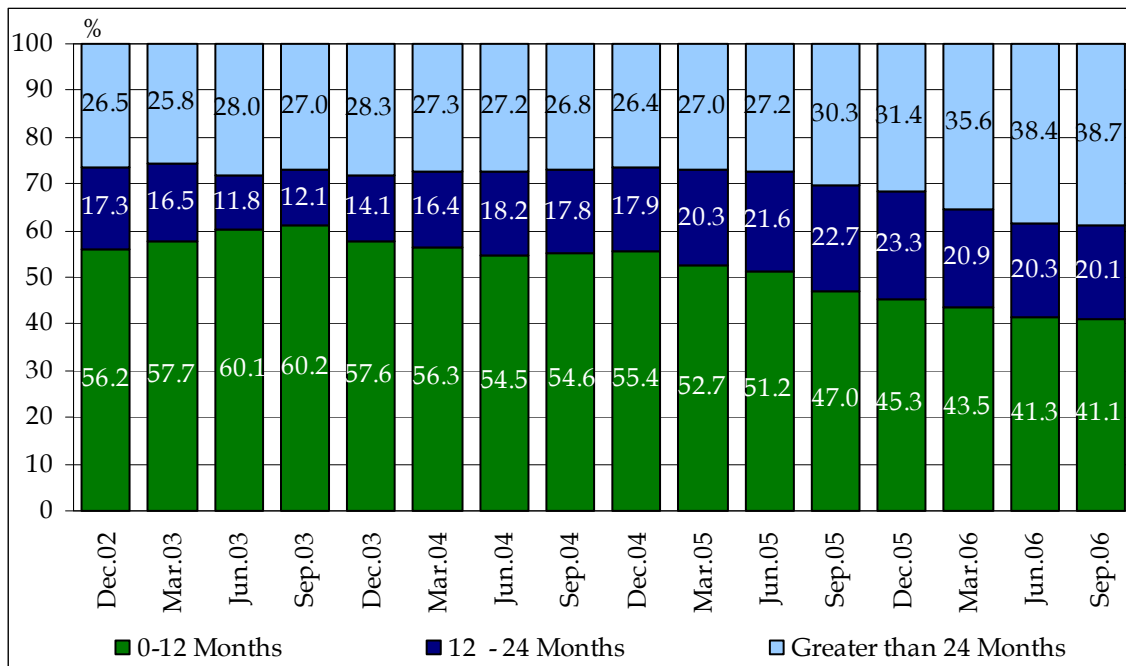
² FX-indexed loans are included in foreign currency loans.

The share of domestic currency loans in total loans, which was 66.8 percent at the end of 2005, fell to 64 percent as of June 2006 due to the increase in FX rates (Chart III.1.1.1.4).

In fact, it can be observed that total FX loans, which amounted 56.4 billion New Turkish Liras by April 2006, rose to 70.3 billion New Turkish Liras with a 24.5 percent increase as of June. However, this increase was only 2.5 percent in USD terms and FX loans increased from 42.8 billion USD to 43.8 billion USD in the same period (Chart III.1.1.1.5).

However, the share of Turkish Lira loans has increased to the level at the end of previous year thanks to the stability in FX rates as of September 2006 (Chart III.1.1.1.4).

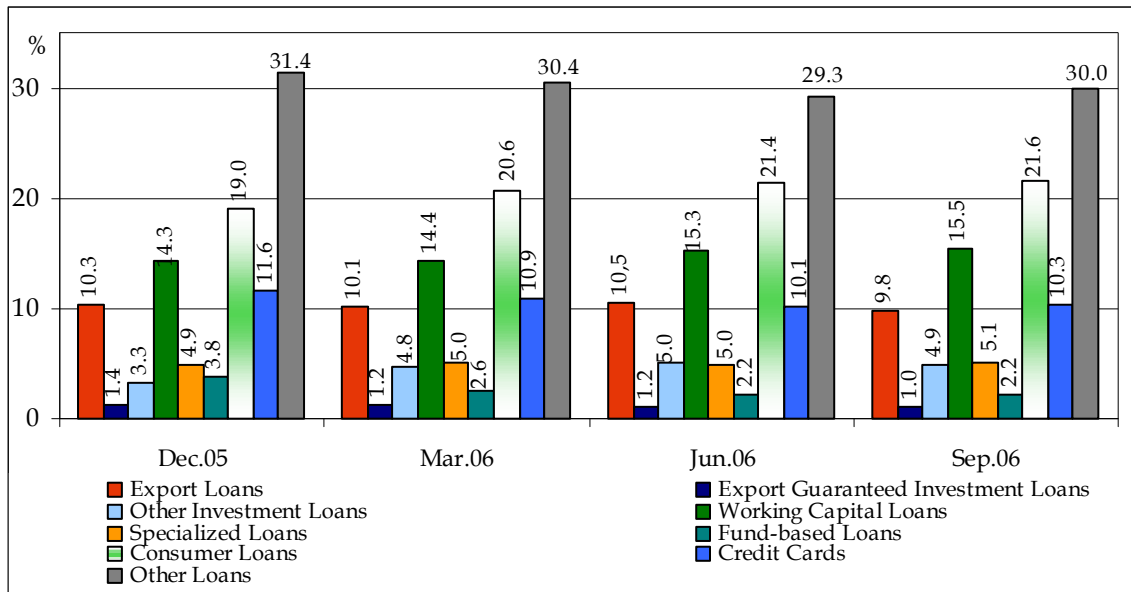
Chart III.1.1.1.6
Maturity Structure of the Loans (Excluding NPLs)



Source: CBRT

The share of long-term loans in total loans, which was 31.4 percent as of year-end 2005, rose to 38.7 percent as of September 2006, especially due to the increase in housing loans (Chart III.1.1.1.6).

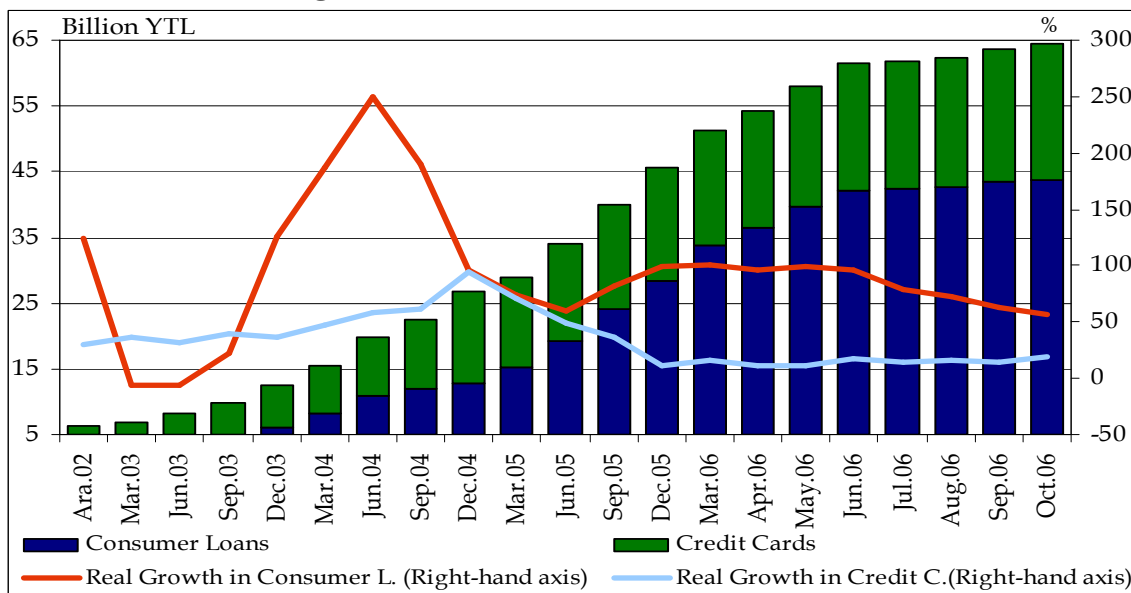
Chart III.1.1.1.7
Loans Extended by Type (Excluding NPLs)



Source: BRSA-CBRT

Regarding the loans extended by type; the fastest increase in September 2006 compared to the end of previous year was realized in other investment loans with 97.6 percent increase and the share of those loans in total loans rose from 3.3 percent to 4.9 percent. The increases in the shares of working capital and other investment loans, which are extended mostly in foreign currency, were also due to the rise in foreign exchange rates. The share of consumer loans in total loans, which had an upward trend until May-June fluctuation and after this period did not show any important increase, also rose (Chart III.1.1.1.7).

Chart III.1.1.1.8
Retail Loans (Excluding NPLs)¹



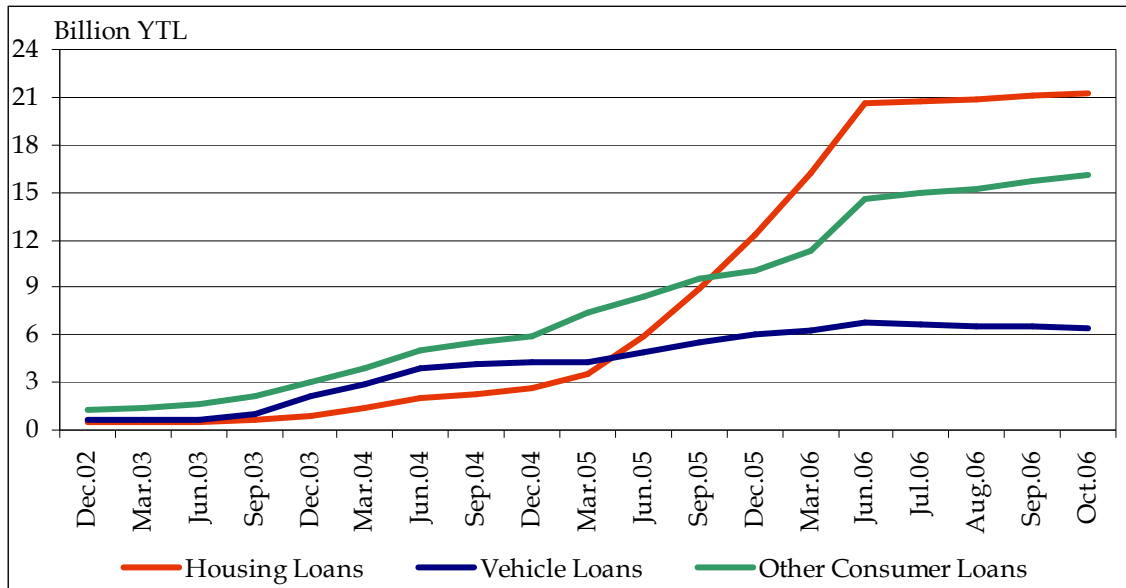
Source: CBRT

¹ Annual percentage change as compared to the same month of the previous year.

Consumer loans rose to 42 billion New Turkish Liras with an increase of 96.5 percent in real terms as of June 2006 compared to the same period of the previous year. After this period, the growth rate slowed down significantly due to the increase in interest rates and consumer loans reached 43.8 billion New Turkish Liras as of October 2006 (Chart III.1.1.1.8).

Credit cards², which were 17 billion New Turkish Liras as of year-end 2005, increased by 18.3 percent in real terms and reached 20.6 billion New Turkish Liras as of October 2006 compared to the same period of the previous year (Chart III.1.1.1.8).

Chart III.1.1.1.9
Consumer Loans by Type (Excluding NPLs)¹

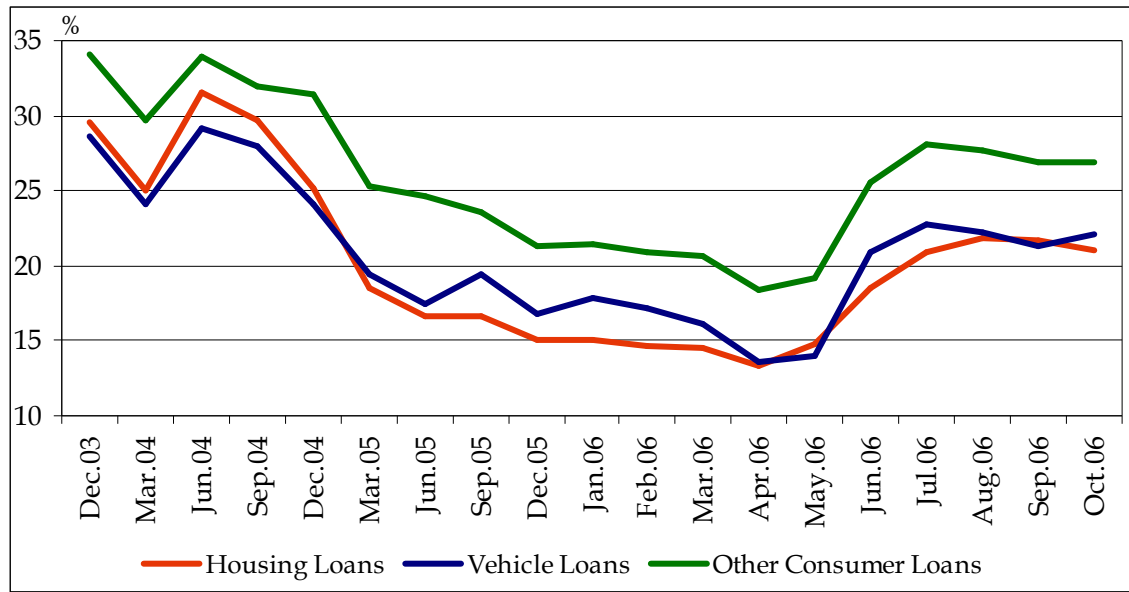


Source: CBRT

¹ Other consumer loans are consumer loans excluding housing and vehicle loans.

² Refers to the balance in the cash loans item, until the credit card spendings and cash withdrawals are paid back to the bank.

Chart III.1.1.1.10
Consumer Loan Interest Rates¹



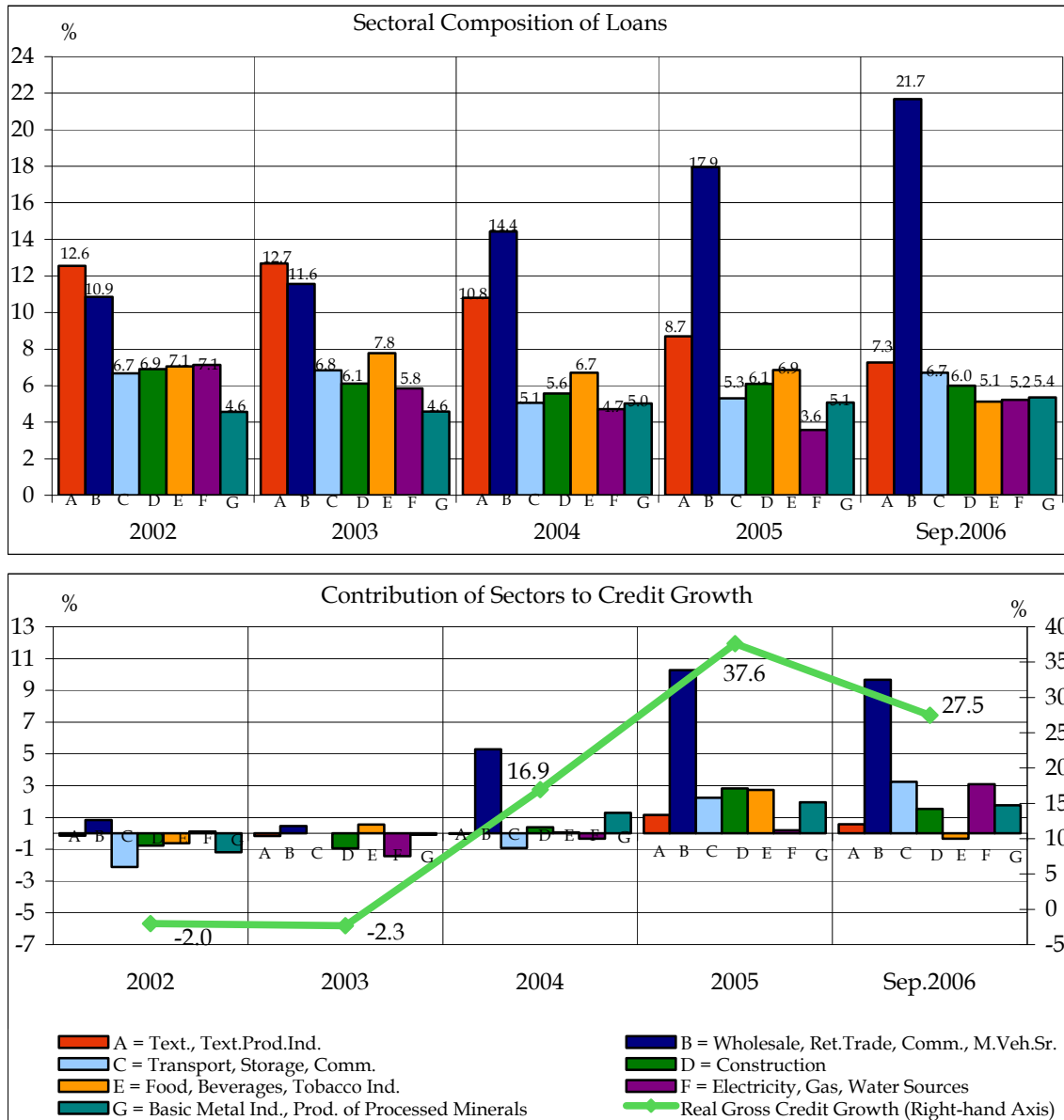
Source: CBRT

¹ Weighted average interest rates of the newly extended loans.

Housing loans are the most important factor in the increase of consumer loans. The share of housing loans in total consumer loans, which was 43.4 percent as of year-end 2005, rose to 48.5 percent due to the 72.1 percent increase in real terms as of October 2006, compared to the end of the previous year, despite the downward trend of such loans in the last period. This increase in housing loans was mainly because of the low level of interest rates on housing loans due to increased competition in the banking sector until June (Chart III.1.1.1.10). Since June 2006, while other consumer loans have increased faster than housing loans, vehicle loans have decreased. The increase in other consumer loans is also due to the fact that households prefer other consumer loans to pay their credit card debts since the interest rates of credit card transactions is higher than the interest rates of consumer loans.

Chart III.1.1.1.11

Sectoral Composition of Corporate Loans and Contributions of Sectors to Credit Growth^{1,2,3}



Source: CBRT

¹ Contributions of sectors to credit growth is the percentage change in loan amounts compared to the previous year for each sector weighted with the share of that sector in total corporate loans.

² Credit Growth is converted to real terms by using WPI (1994=100) index.

³ Loans are compiled based on bank reporting under the scope of Central Bank Law No:1211, Article:44. They include those loans that are greater than ten thousand New Turkish Liras (inclusive); extended to real and legal bodies; by banks (including external loans used by firms with the intermediation of banks). They are inclusive of accrued interest and rediscount amounts and exclusive of non-cash loans. Therefore, they differ from the figures in the balance sheet-based analysis.

According to Central Bank Risk Center data for loan concentrations by sectors, the corporate loans increased by 27.5 percent in real terms as of September 2006 compared to the previous year-end and the contribution of the selected seven sectors to credit growth was realized as 19.6 percent.

The share of selected sectors in total gross corporate loans increased from 53.6 percent as of year-end 2005 to 57.4 percent as of the first nine months of 2006, so it is observed that the sectoral concentration increased (Chart.III.1.1.1.11).

As of September 2006, the sector with the largest share in total corporate loans is the “Wholesale and Retail Trade, Commissions and Motor Vehicles Services” sector with a 21.7 percent share in total. The share of the “Textile and Textile Products Industry” sector and “Food, Beverages and Tobacco Industry” sector in total corporate loans decreased to 7.3 percent and 5.1 percent respectively, compared to the previous year-end.

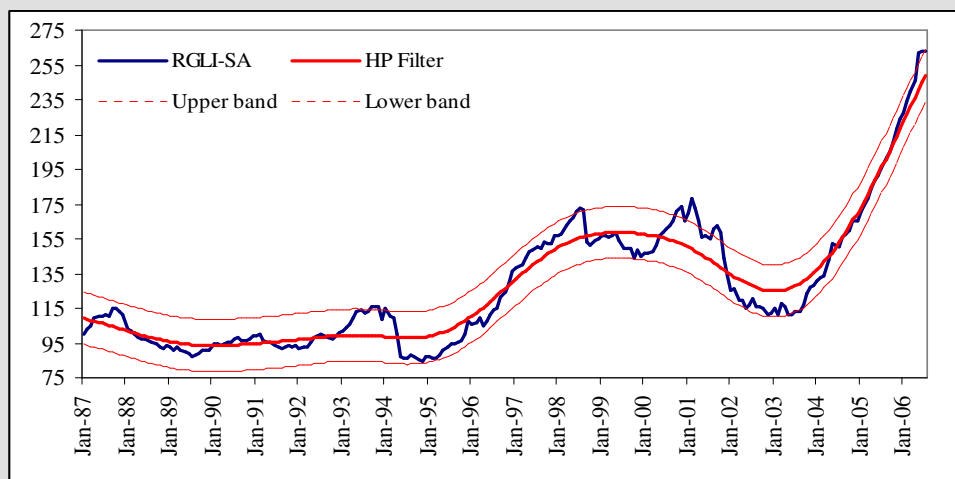
Box III.1.1.1.1. Credit Expansion

Rapid credit expansion is defined as the continuous and strong growth rate of credits extended to private sector. However, there is no measure of value about which growth rate will be accepted as “excessive” for credit expansion. On the other hand, empirical studies show that the circumstances under which the average real credit growth rate exceeds 17¹ percent for 3 consecutive years indicate the phases of credit expansion.

In this context, credit expansion in Turkey was realized as 6.5 percent in 2003, 29.2 percent in 2004, 34.8 percent in 2005 and 41.9 percent as of June 2006 compared to the same period of the previous year in real terms.

The key factors of credit expansion in Turkey are the improvement in macro economic indicators and expectations depending on the success of the current economic program; channelling funds, which increased due to the decline in public borrowing requirements, to loans especially retail loans; the increase in possibilities and types of funding of banks from abroad; the increase in deferred consumption and investment expenditures due to the low interest rates.

Credit Index



On the other hand, in the OECD Economic Surveys-Turkey (2006), to determine credit boom, the real credit index is calculated using the Hodrick-Prescott method, which shows the long term trend. The same method is applied for 1987 and onwards and the development of the credit index in Turkey is shown

on the graph. It can be said that the fall of the credit index outside the band in the 2006 May-June period is because of the increase in foreign currency loans due to the foreign exchange rate effect.

¹ IMF, World Economic Outlook, April 2005

III.1.1.2. Development of Non-Performing Loans

Despite the market fluctuations during May and June, there was no significant increase in the amount of non-performing loans. In fact, total non-performing loans increased by 3.7 percent compared to the end of previous year and reached 7.8 billion New Turkish Lira.

Table III.1.1.2.1.
Distribution of Total NPLs¹

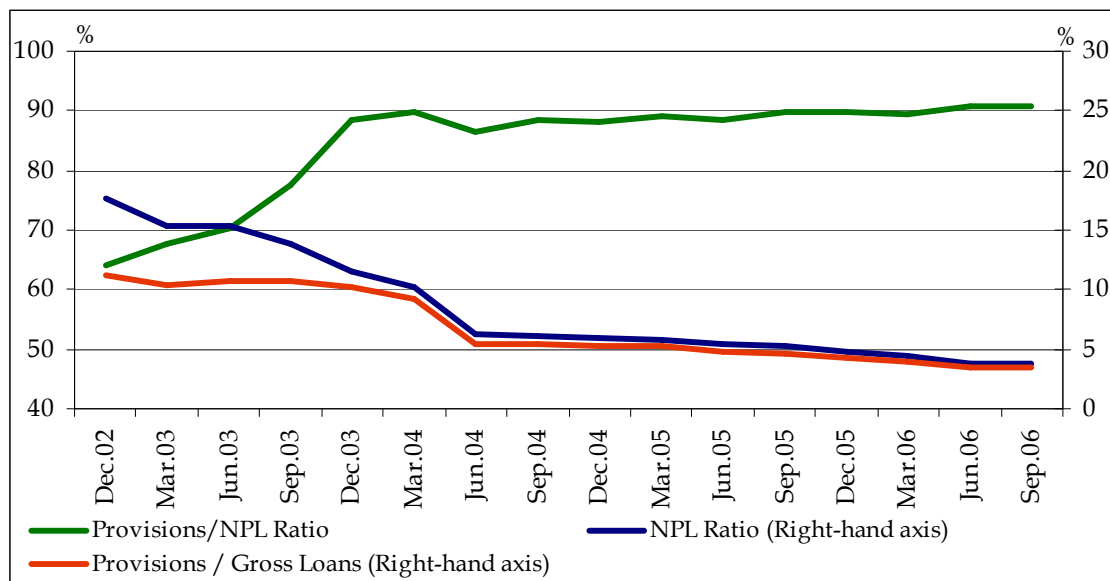
(Million YTL)	2002	2003	2004	2005	Sept.06
Loans and Other Receivables with Limited Collectibility	1,207	924	595	813	961
Doubtful Loans and Other Receivables	2,596	2,296	415	775	902
Loans and Other Receivables Classified as Loss	6,626	5,409	5,342	5,907	5,910
Total NPLs	10,430	8,629	6,353	7,495	7,773

Source: BRSA-CBRT

¹ Excluding İller Bank.

Regarding the distribution of non-performing loans, during the first nine months of 2006, the share of loans and other receivables classified as loss continues its dominance in the total non-performing loans. In fact, 76 percent of total non-performing loans are loans and other receivables classified as loss (Table III.1.1.2.1).

Chart III.1.1.2.1
NPL Ratio and Provisions to NPLs

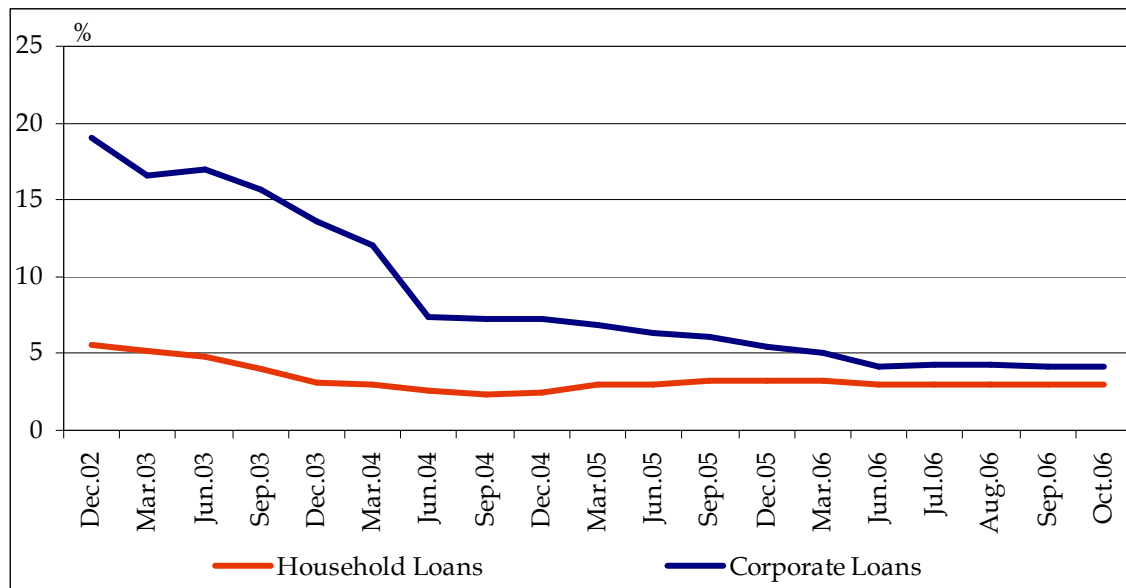


Source: BRSA-CBRT

Due to the rapid increase in the credit volume, the decline in the NPL ratio³ also continued during 2006. In fact, the NPL ratio, which used to be 4.8 percent during the year 2005, dropped to 3.7 percent as of September 2006 (Chart III.1.1.2.1). The continued high provisioning policy for the NPLs during 2006 is regarded as a positive development from a credit risk point of view. Provisions to NPLs ratio, which used to be 89.8 percent as of year-end 2005, was realized as 90.6 percent as of September 2006. However, provisions to total loans ratio declined to 3.4 percent due to the increase in total loans (Chart III.1.1.2.1).

As of September 2006, the banking sector maintains approximately 0.7 percent general provisions for standard and closely monitored cash loans. With the recent Regulation⁴ published in November by the BRSA, the ratio of general provisions to be set aside for loans to be extended after the date of publication of the Regulation has been raised to 1 percent, which is considered as a positive development.

Chart III.1.1.2.2
NPL Ratios for Household¹ and Corporate Loans²



Source: BRSA-CBRT

¹ Household Loans=Consumer Loans+Credit Cards

² Corporate Loans=Total Loans-Household Loans

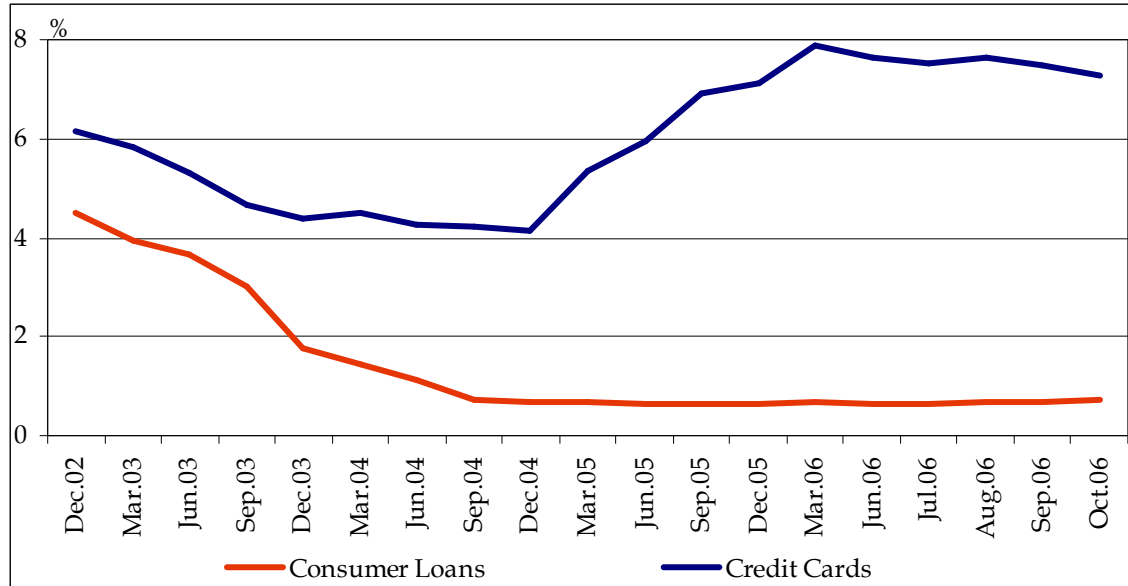
Regarding the development of non-performing loans by economic units, as of October 2006, the increase in household loans is higher than the increase in NPLs compared to the end of the previous year. This led to a fall in the NPL ratio for household loans from 3.2 percent as of year-end 2005 to 2.9 percent as of October 2006. The NPL ratio for corporate loans, which used to be 5.4 percent as of year-end 2005,

³ Non-Performing Loan Ratio=Gross Non-Performing Loans/Gross Loans

⁴ "Regulation on the Principles and Procedures Related to the Determination of the Loans and Other Receivables for which Provisions Shall be Set Aside by Banks and to the Provisions to be Set Aside" published in the Official Gazette No:26333 dated 01.11.2006.

continued its decline until June 2006 being realized as 4.1 percent and has maintained a horizontal trend since then (Chart III.1.1.2.2).

Chart III.1.1.2.3
NPL Ratios for Retail Loans

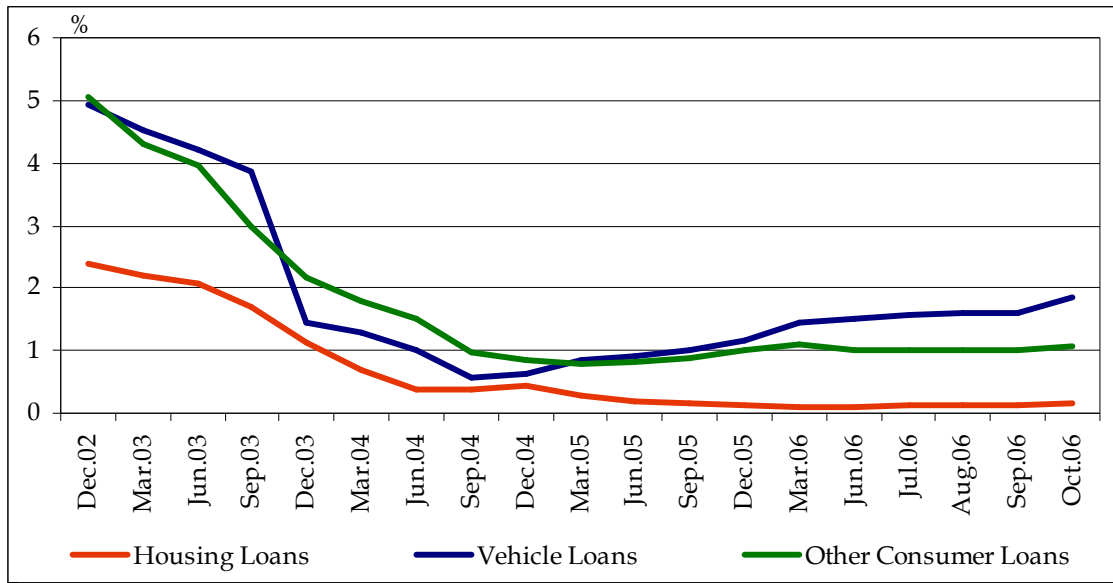


Source: CBRT

Credit card amounts increased faster than the NPLs during 2006. The NPL ratio for credit cards, which used to be 7.1 percent as of year-end 2005, increased to 7.9 percent as of March 2006 and dropped to 7.3 percent by October 2006 (Chart III.1.1.2.3).

The NPL ratio for consumer loans, which are fixed-rated and mostly denominated in domestic currency, did not increase after the fluctuations and was realized as 0.7 percent as of October 2006, with no change from the year-end 2005 (Chart III.1.1.2.3).

Chart III.1.1.2.4
NPL Ratios for Consumer Loans¹

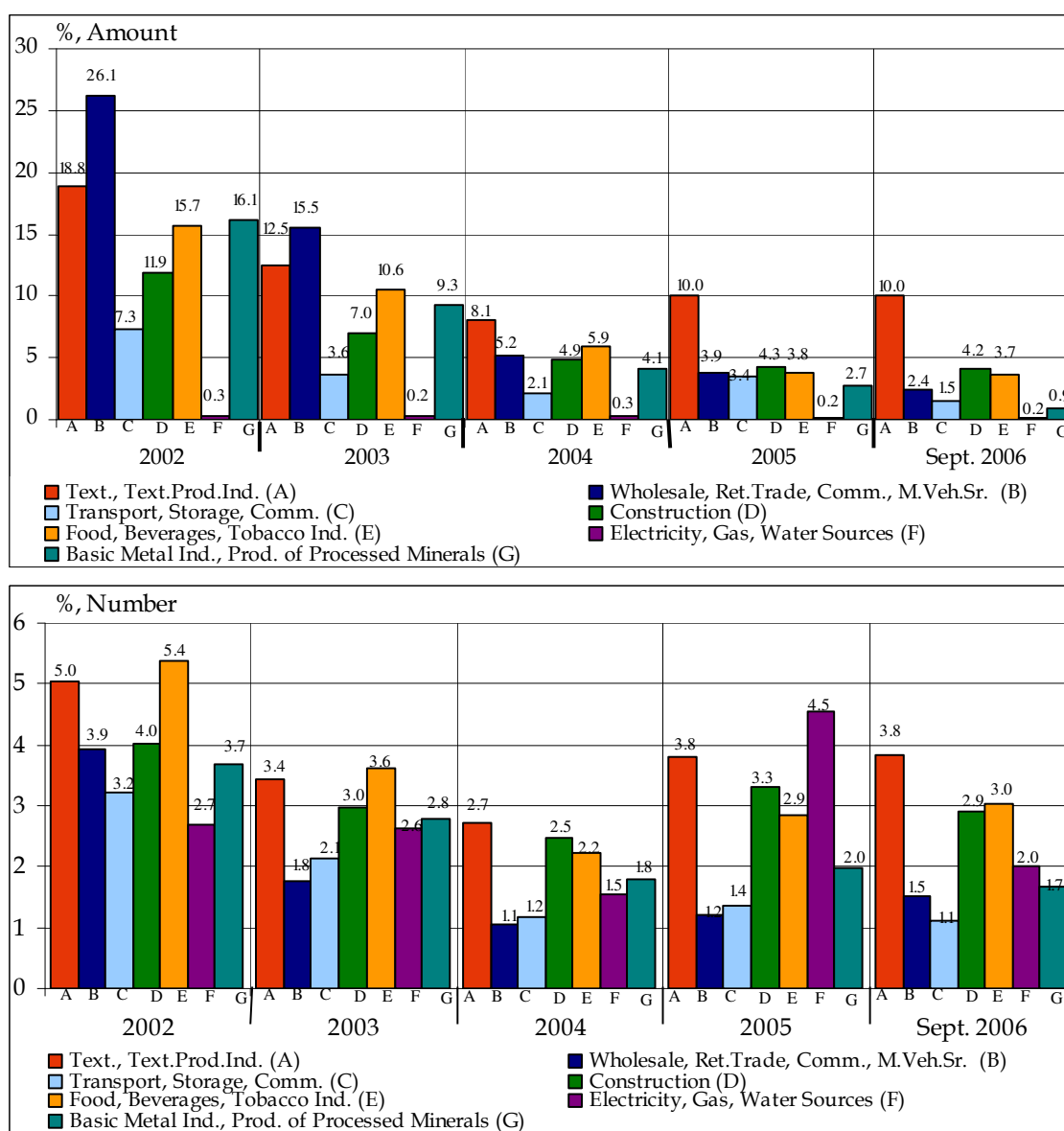


Source: CBRT

¹ Other consumer loans are all consumer loans excluding housing and vehicle loans.

After the fluctuations, starting from July 2006, while vehicle loan amounts started to decrease, non-performing vehicle loan amounts increased. Thus, the NPL ratio for these loans continued its increasing trend. On the other hand, there was no significant change in NPL ratios for housing and other consumer loans compared to year-end 2005 (Chart III.1.1.2.4).

Chart III.1.1.2.5
NPL Ratios of Some Selected Sectors¹



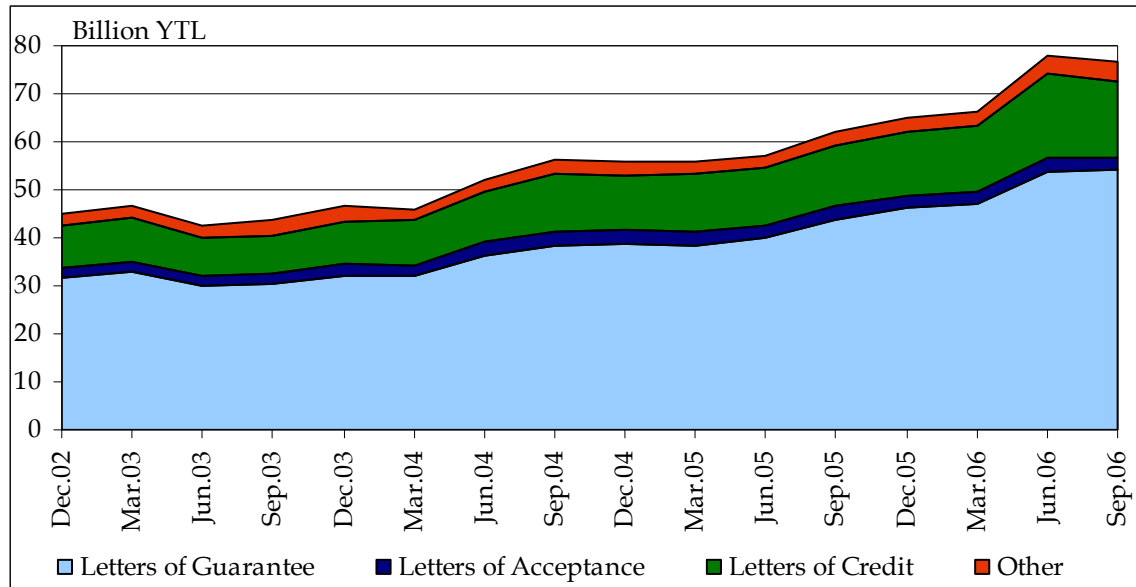
Source: CBRT

¹ Loans are compiled based on bank reporting under the scope of Central Bank Law No:1211, Article:44. They include those loans that are greater than ten thousand New Turkish Liras (inclusive); extended to real and legal bodies; by banks (including external loans used by firms with the intermediation of banks). They are inclusive of accrued interest and rediscount amounts and exclusive of non-cash loans. Therefore, they differ from the NPL figures in the balance sheet-based analysis.

As of September 2006, the NPL ratio in the “Textile and Textile Products” and “Electricity, Gas and Water Sources” sectors remained same as December 2005, while the ratios in the other five sectors decreased. After the increases in the number of NPLs to total number of loans ratios of the selected seven sectors during 2005, the ratio of “Wholesale and Retail Trade, Commissions and Motorvehicle Services” sector continued to increase, the increase in the “Food, Beverages and Tobacco Industry” sector remained limited and the ratios of the rest of the sectors have shown a decreasing trend during the first nine months of 2006 (Chart III.1.1.2.5).

III.1.1.3. Development of Non-Cash Loans

Chart III.1.1.3.1
Non-Cash Loans by Type



Source: BRSA-CBRT

The ratio of off-balance sheet liabilities, which include banks' non-cash loans and commitments, to total balance sheet size, was 16.3 percent as of year-end 2005 and rose to 16.6 percent as of September 2006. This increase stemmed not only from the rise in letters of guarantee in domestic currency but also from foreign currency denominated letters of guarantee, the share of which became 60 percent of the total letters of guarantee due to the depreciation of the Turkish Lira and increase in letters of credit, most of which are foreign currency denominated.

The share of foreign currency denominated non-cash loans in total non-cash loans, which used to be 64.4 percent as of year-end 2005, rose to 65.8 percent mainly due to the FX rate fluctuations in May-June. The ratio of non-cash loans to cash loans decreased from 41.2 percent as of year-end 2005 to 38.4 percent at the end of first nine months of 2006. As of September 2006, the majority of non-cash loans were letters of guarantee with a share of 70.5 percent. Letters of credit, which rank second, had a share of 20.1 percent as of year-end 2005 and 20.6 percent as of September 2006.

III.1.2. Credit Risk Scenario Analysis

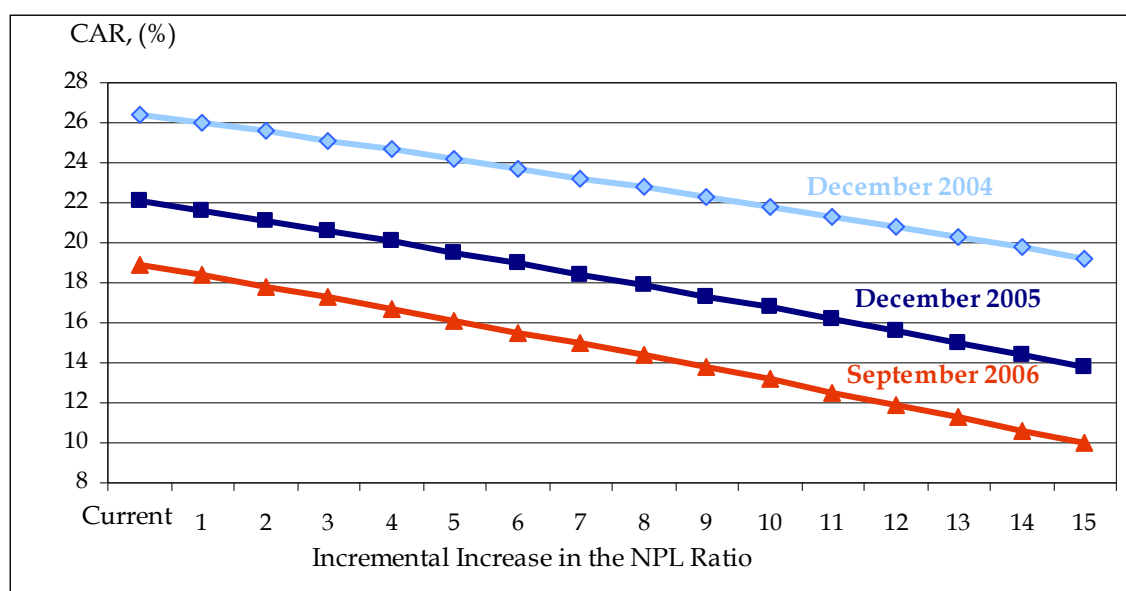
With the aim of assessing the credit risk that the banking sector may be exposed to, analyses were conducted on how the CARs of the banks will be affected by an increase in their NPL ratios, as of September 2006.

Within this framework, scenario analyses were conducted under the following assumptions:

- i) Total credit volumes of banks do not change.
- ii) NPLs resulting from shocks have the same composition as the current non-performing receivables of banks. For banks, which did not have any NPLs before the shocks, after shock NPLs are classified as “loans and other receivables with limited collectibility” setting aside a 20 percent provision.
- iii) New NPLs resulting from shocks were in the 100 percent risk weight group for the calculation of the CARs of banks before the shocks.
- iv) There has been no change in total risk weighted assets and own funds of banks.

Moreover, collateral amounts were not taken into consideration when calculating additional provisions.

Chart III.1.2.1
Effects of Credit Shocks on the CAR of the Sector¹



¹ Excluding the SDIF bank, Iller Bank and banks that do not have loans in their portfolio.

The effects of 1-15 points incremental increases of NPL ratios on the CAR of the banking sector were analyzed ⁵. While a 15 point increase in the NPL ratio of the banking sector led to a 7.2 and 8.3 points fall in the CAR of the banking sector as of year-end 2004 and 2005, respectively, the same increase led to an 8.9 points fall as of September 2006. This is mainly due to the increase in credit volume (Chart III.1.2.1).

Even after the largest shock, the CAR of the banking sector, which used to be 18.9 percent as of September 2006, dropped to 9.97 percent, while still remaining above the regulatory limit.

⁵ After the non-performing receivable classification of credits and additional provisions, the after-shock CAR is calculated as: $(\text{Equity-Additional Provisions}) / (\text{Total Risk Weighted Assets-Additional Provisions}) \times 100$.

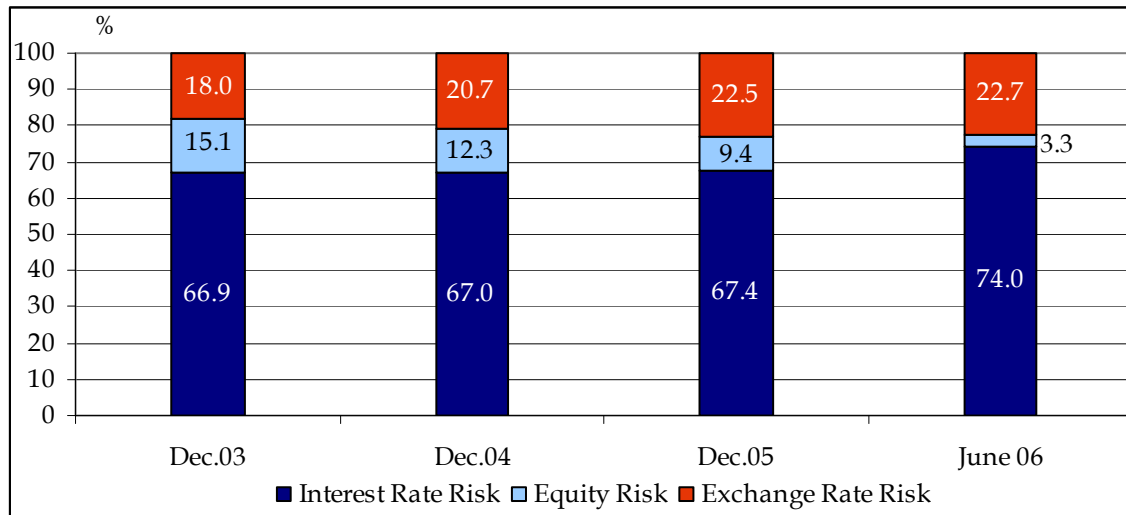
III.2. Market Risk and Scenario Analyses

III.2.1 Developments in Market Risk

Due to the fact that fluctuations in the financial markets increase the vulnerability of the banking sector, analysis of market risk is of vital importance.

In this section, along with the analysis of the effects of the developments in interest rate risk and FX risk on the banks' balance sheets, two hypothetical scenarios based on historical data were designed and their effects were examined.

Chart III.2.1.1
Market Risk Components in Capital Requirement¹

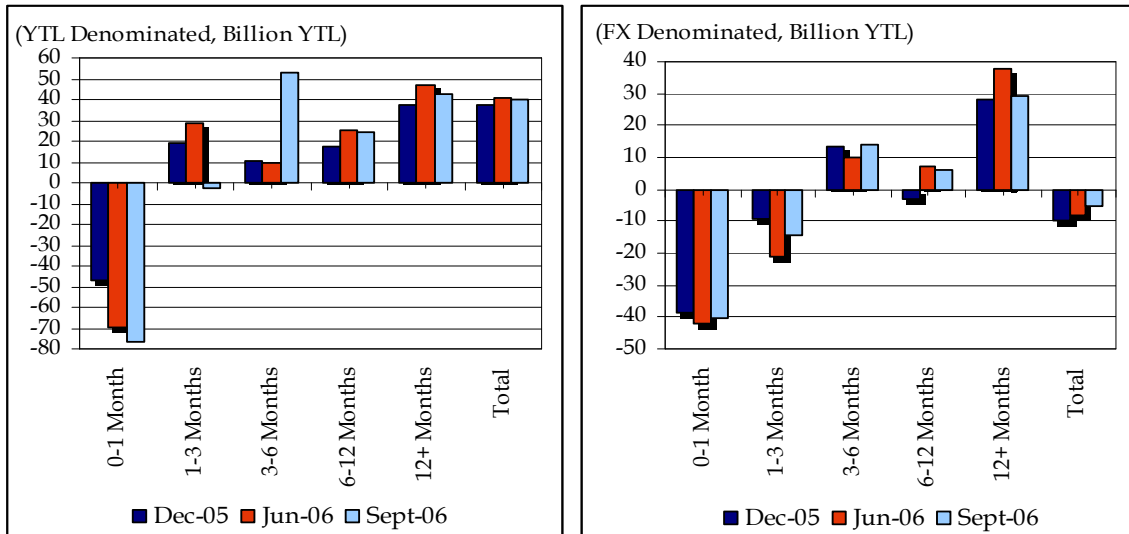


Source: BRSA-CBRT

¹ Excluding the SDIF bank.

The market risk exposure of the banking sector, which is calculated according to the standard method, was 17 billion New Turkish Lira as of year-end 2005 and increased to 19.5 billion New Turkish Lira as of June 2006. Interest rate risk, which is one of the most important components of market risk, increasingly continued its significance during June 2006 and the share of capital charge for interest rate risk increased from 67.4 percent as of year-end 2005 to 74 percent as of June 2006 (Chart III.2.1.1).

Chart III.2.1.2
Interest Rate Sensitivity Gap of the Banking Sector^{1,2}



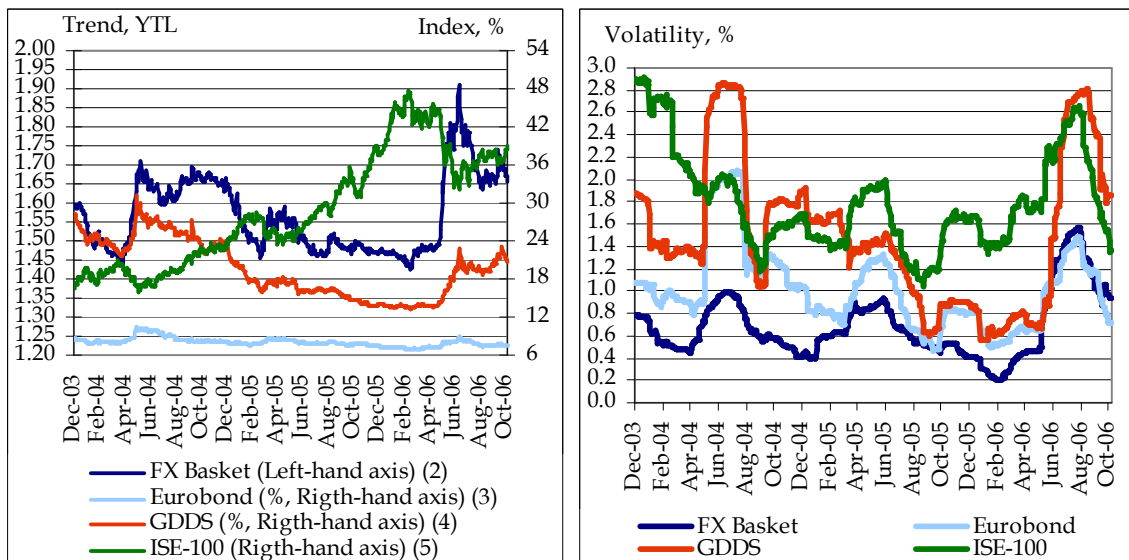
Source: CBRT-BRSA

¹ Time to re-pricing is used.

² Excluding SDIF bank.

In terms of time to re-pricing, the interest rate sensitivity gap of the banking sector concentrates in the 0-1 month maturity bracket. As of September 2006, even though the majority of the banking sector assets have a one year maturity and above, the continued short maturity structure of deposits increases the sensitivity of banks to interest rate risk (Chart III.2.1.2).

Chart III.2.1.3
Foreign Exchange Rate, Interest Rate and Equity Price Developments and Volatilities¹



Source: CBRT

¹ For volatility calculations, standard deviation of daily logarithmic yield of the related market instrument (60 day moving average) is used.

² 50 percent of the Foreign Exchange Basket is in USD and the rest is in Euro.

³ Based on USD denominated Eurobond interest rate with 2030 maturity.

⁴ Based on the interest rate on the GDDS with the largest transaction volume in the secondary market.

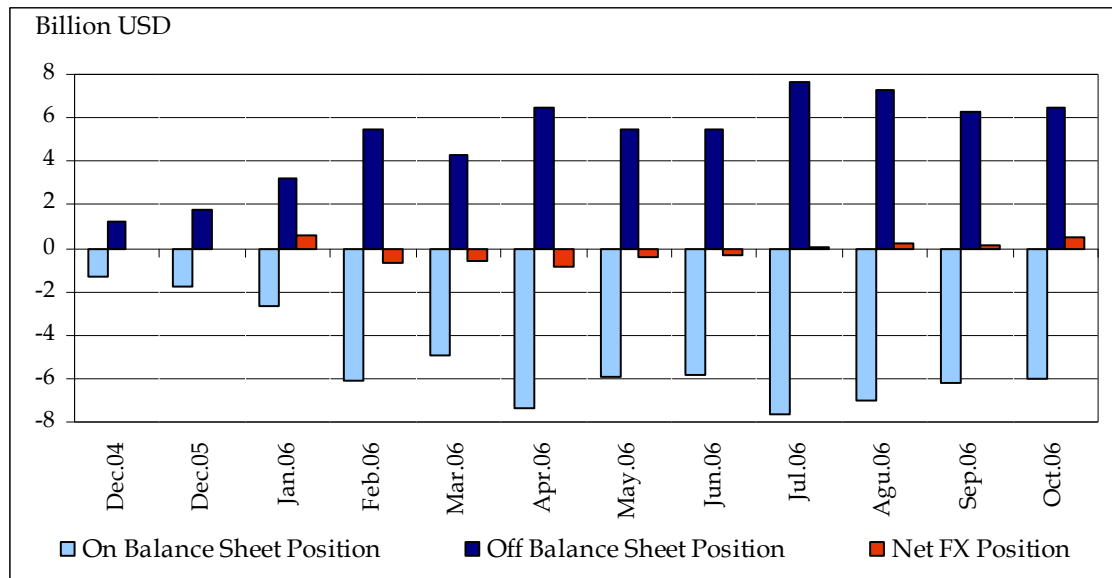
⁵ Calculated by dividing ISE-100 by 1,000.

During the first half of 2006, international developments such as the deterioration in the global liquidity conditions and the declining risk appetite of foreign investors towards developing countries had a negative effect on the FX, securities and bond markets, and increasing volatility, raised the sensitivity of the sector to market risk compared to previous periods.

However, due to the recovery of global liquidity conditions starting from the second half of 2006 and monetary policy tightening, volatility started to decline in July (Chart III.2.1.3).

III.2.2.Foreign Exchange Risk

Chart III.2.2.1
Foreign Exchange Position of the Banking Sector¹



Source: BRSA

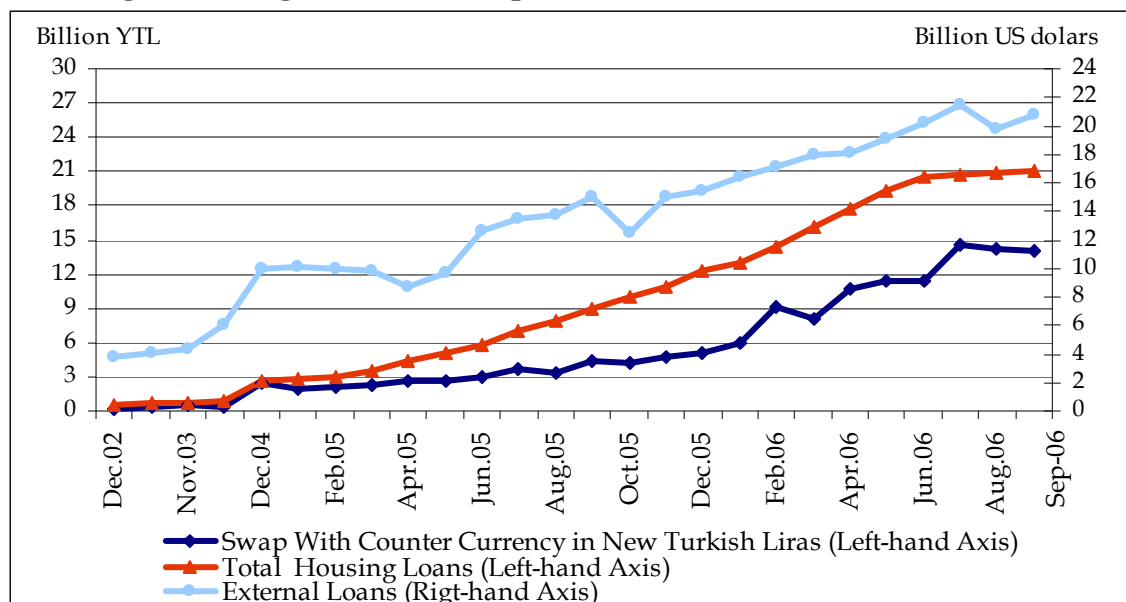
¹ Participation Banks are included.

In the first quarter of 2006, the FX net short position of the banking sector (FXNGP) increased, then showed a declining trend, and turned into a long position by the second half of the year. On the other hand, the on-balance sheet short position of the sector, which exhibited an increasing trend in the first four months of 2006 and reached 9.3 billion USD on May 5, 2006, began to decrease in May and stood at 5.8 billion USD in June 2006, following the fluctuations in the domestic and international markets. With an increasing trend in July and August 2006, it was realized as 6 billion USD as of October 2006. Parallel to the progress of the on-balance sheet short position, the off balance sheet long position was realized as 6.5 billion USD in the same period (Chart III.2.2.1).

Turkish lira credits funded with foreign currency loans used from abroad are the main reason of the short on balance sheet position of the banking sector especially since

the beginning of 2006. Banks transform some part of their long-term FX credits provided from abroad into Turkish lira using swap transactions and lend long-term housing loans.

Chart III.2.2.2
Financing of Housing Loans and Swap Purchases¹



Source: BRSA-CBRT

¹ "External Loans" consist of syndication and securitization loans.

Due to the rapid reduction of interest rates by banks until June 2006, housing loans and parallel to this, external loans and swap transactions increased rapidly. But after the fluctuations in the markets, due to the increase in credit interest rates, the pace of growth in housing loans slowed down, and as a reflection of this, the growth rate of external loans and swap transactions decreased after July 2006.

III.2.3 Scenario Analyses

III.2.3.1 Interest and Exchange Rate Increase Shocks

In this section, the individual and total effects of the interest rate increase and depreciation of YTL shocks on the banking sector are analyzed independently under two scenarios.

Under Scenario A, Turkish Lira is assumed to depreciate by 30 percent against other currencies, Turkish Lira and FX interest rates are assumed to increase by 6 and 5 points, respectively and Eurobond prices are assumed to decrease by 5 percent.

Under Scenario B, it is assumed that Turkish Lira will depreciate by 30 percent, Eurobond prices will decrease by 5 percent and interest rate increases will be twice as much as the interest rate fluctuations during the May and June period⁶.

Table III.2.3.1.1
Interest and FX Rate Increase Scenarios

Types of Scenarios	SCENARIO A	SCENARIO B
A. Depreciation of YTL	30 percent depreciation of YTL against other currencies	30 percent depreciation of YTL against other currencies
B. Interest Rate Increase-YTL	Re-pricing of YTL interest sensitive assets and liabilities falling in 0-1 and 1-3 month maturity brackets at 6 points higher	Re-pricing of YTL interest sensitive assets and liabilities falling in 0-1, 1-3, 3-6 month maturity brackets at 9, 8, 11 points higher, respectively.
C. Interest Rate Increase-FX	Re-pricing of YTL interest sensitive assets and liabilities falling in 0-1 and 1-3 month maturity brackets at 5 points higher	Re-pricing of YTL interest sensitive assets and liabilities falling in 0-1, 1-3, 3-6 month maturity brackets at 1.1, 0.7, 1.1 points higher, respectively.
D. Trading Portfolio-YTL¹	6 points increase in market interest rates of YTL denominated fixed income securities in the trading portfolio	Increase in market interest rates of YTL denominated fixed income securities in the trading portfolio by 9, 8, 11 points for the 0-1, 1-3, 3-6 month maturity brackets, respectively.
E. Eurobond Portfolio	Decrease in prices of Eurobonds in the trading portfolio by 5 percent.	Decrease in prices of Eurobonds in the trading portfolio by 5 percent.

¹BRSA defines the trading portfolio as “Securities in the trading portfolio” and “Securities available for sale” in accordance with the description of the Basel Committee.

For the calculation of the impacts of depreciation scenarios, banks FXNGP data is used. On the other hand, for the calculation of impacts of interest rate increase scenario, re-pricing gap method, implementation of which is recommended by the Basel Committee on Banking Supervision to complement the standard method, is utilized. Within this context, interest rate gap measures, which are the differences between interest rate sensitive assets and liabilities based on the time to re-pricing for 0-1, 1-3 and 3-6 month maturity brackets, are used.

Scenario analysis, which are based on re-pricing gap data, are conducted under the following assumptions:

- Interest rate sensitivity structure of the banks’ assets and liabilities remain unchanged during the analysis period,
- Demand deposits are not interest rate sensitive,
- There are no new fund inflows or outflows,
- Interest rate increase will continue for 3 months under Scenario A and for 6 months under Scenario B.

Moreover, reductions of the value of the YTL denominated fixed income securities and on Eurobond prices stemming from interest rate increases are calculated.

⁶ For the interest rate increases stemming from May-June fluctuations are based on GDDS interest rates.

Table III. 2.3.1.2
Results of Market Risk Scenarios¹

(Million YTL)	Scenario A			Scenario B		
	Dec. 04	Dec. 05	Sep. 06	Dec. 04	Dec. 05	Sep. 06
A. YTL Depreciation						
a. Total	-52	-73	42	-52	-73	42
Profit (Loss)/Equity (%)	-0.1	-0.2	0.1	-0.1	-0.2	0.1
b. Banks Gaining Profits	293	71	173	293	71	173
c. Banks Suffering Losses	-345	-143	-131	-345	-143	-131
Banks Suffering Loss/Equity (%)	-2.1	-0.5	-0.8	-2.1	-0.5	-0.8
B. Interest Rate Increase						
a. YTL	49	8	-782	595	483	527
b. FX	-248	-352	-387	-53	-62	-63
Profit (Loss) due to Interest Rate Increase (a+b)	-198	-345	-1,169	542	421	464
Profit (Loss) due to Interest Rate Increase/Equity (%)	-0.5	-0.8	-2.6	1.5	1.0	1.0
C. YTL Trading Portfolio						
Loss in Value due to Interest Rate Increase	-951	-1,480	-1,602	-1,672	-2,583	-2,797
Loss in Value due to Interest Rate Increase/Equity (%)	-2.6	-3.6	-3.6	-4.6	-6.3	-6.3
D. Eurobond Portfolio						
Loss in Value	-505	-518	-628	-505	-518	-628
Loss in Value/Equity (%)	-1.4	-1.3	-1.4	-1.4	-1.3	-1.4
E. Total Impact						
Profit/Loss	-1,707	-2,415	-3,357	-1,687	-2,752	-2,919
(Profit/Loss)/Equity (%)	-4.6	-5.9	-7.6	-4.6	-6.7	-6.6
Current CAR of the Sector (%)	25.6	21.2	18.1	25.6	21.2	18.1
After-Shock CAR of the Sector² (%)	24.4	20	16.7	24.4	19.8	17

¹ Excluding SDIF bank, T. Kalkınma Bank, İller Bank and Eximbank.

² After-shock profit/loss amounts under the scenarios are assumed to affect only equity but not the risk weighted assets.

III.2.3.1.1 YTL Depreciation

Under the depreciation of the YTL scenario, the banking sector, being in a short position, suffered losses during year-ends of 2004-2005 and incurred profits as of September 2006 owing to its long position. Even though the amount of losses suffered by banks due to their short positions as of September 2006 diminished compared to the previous years, the ratio of such losses to equity increased compared to the previous year. However, the mentioned ratio still standing at low levels indicates that the sector is resilient to a depreciation of the domestic currency (Table III.2.3.1.2).

III.2.3.1.2 Interest Rate Increase

i) As a result of Scenario A, after re-pricing of the interest rate sensitive assets and liabilities, the net interest income of the banking sector decreases owing to the widening of the gap for the 0-1 month maturity bracket as of September 2006, compared to the year-end 2005. As a result of Scenario B, for the same periods, the net interest income of the banking sector increased after re-pricing. The rationale behind the fact that stronger shocks led to a more favorable result under Scenario B than in Scenario A is that Scenario B assumes the interest rate increases to continue for 6 months and that the

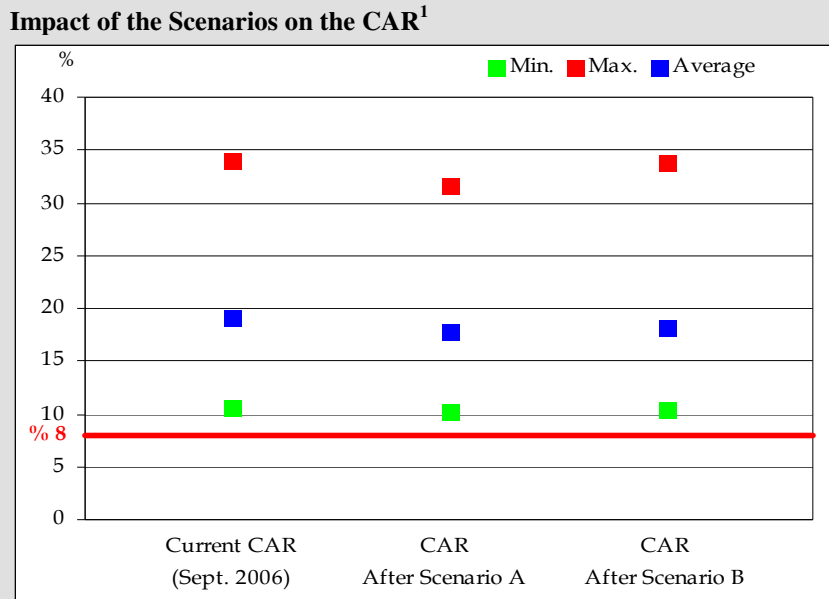
long position of the sector for the 3-6 month maturity bracket increased in September 2006.

ii) It is observed that the ratio of loss in the value of discounted New Turkish Lira securities to equity in September 2006 remained the same as year-end 2005 both under Scenario A and Scenario B. The ratio of loss in value of discounted New Turkish Lira securities to equity as of September 2006 is realized as 3.6 percent under Scenario A and 6.3 percent under Scenario B.

iii) Ratio of loss in value of the Eurobond portfolio resulting from interest rate increases to equity is realized as 1.4 percent as of September 2006 with no significant change from year-end 2005.

In conclusion, interest rate risk of the banking sector increases due to lengthening of the maturity of the discounted New Turkish Lira securities and the increase in volume of the portfolio. However, considering the robust equity structure of the banking sector, the impact of value losses on capital remains insignificant.

Box. III.2.3.1 Impacts of the Scenarios on the Largest 10 Banks of the Sector

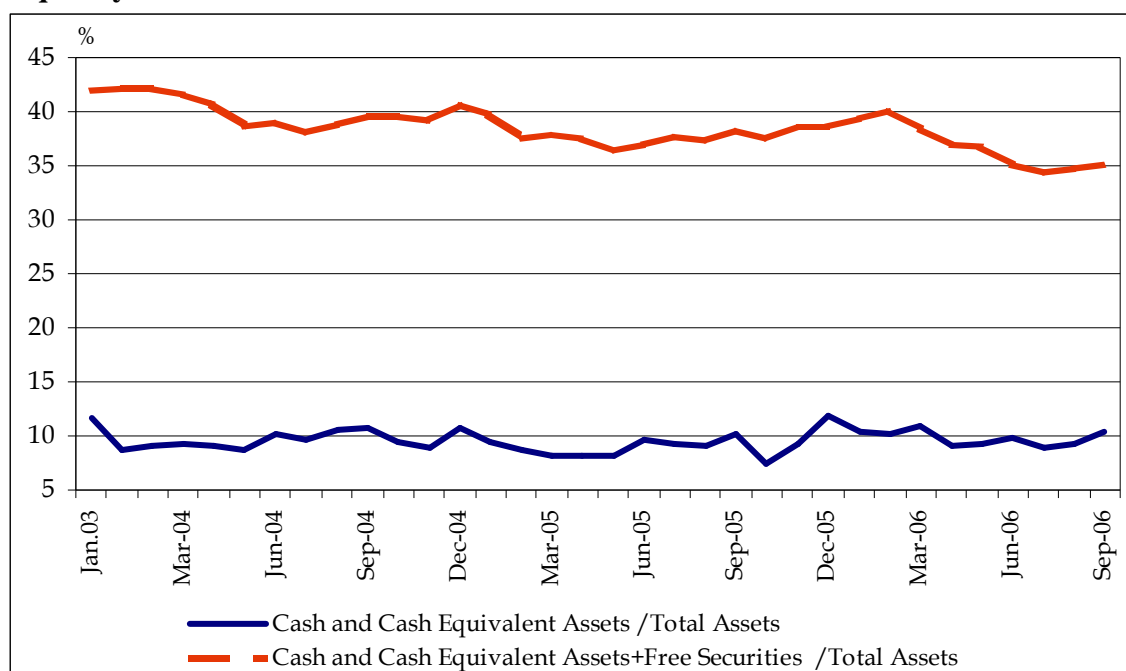


¹ Largest 10 Banks considering their share in total assets are included in the analysis.

Impacts of Scenario A and B on the largest 10 banks of the banking sector according to their asset share, which in total is 85 percent of total assets of the banking sector, are examined. As of September 2006, CAR of those 10 banks was 19.5 percent on average, minimum and maximum CARs were 10.5 and 34 percent, respectively and none of these three figures showed any significant decline in response to the applied scenarios. In fact, under both scenarios, even the minimum CAR remains well above the regulatory limit, which indicates the strong equity structure of the banking sector.

III.3.Liquidity Risk

Chart III.3.1
Liquidity Ratios ^{1,2}



Source: BRSB-CBRT

¹ Cash and Cash Equivalent Assets = Cash + Due from CBRT + Due from Interbank + Due from Banks

² Free Securities = Securities that are not used as collateral or for repo transactions or not held for Structural Position.

The ratio of cash and cash equivalent assets to total assets, and the ratio of cash and cash equivalent assets and free securities portfolio to total assets have decreased since year-end 2005 until July 2006. From this month, as a result of the more prudent behavior of banks after the fluctuations, the aforementioned ratios have followed an increasing trend and were realized as 10.4 percent and 35.1 percent, respectively, as of September 2006 (Chart III.3.1).

Box III.3.1. Policy Measures implemented by the Central Bank of Turkey in response to May-June fluctuations

Even though the fluctuations observed in May-June 2006 stemmed especially from external conditions, they considerably deteriorated expectations.

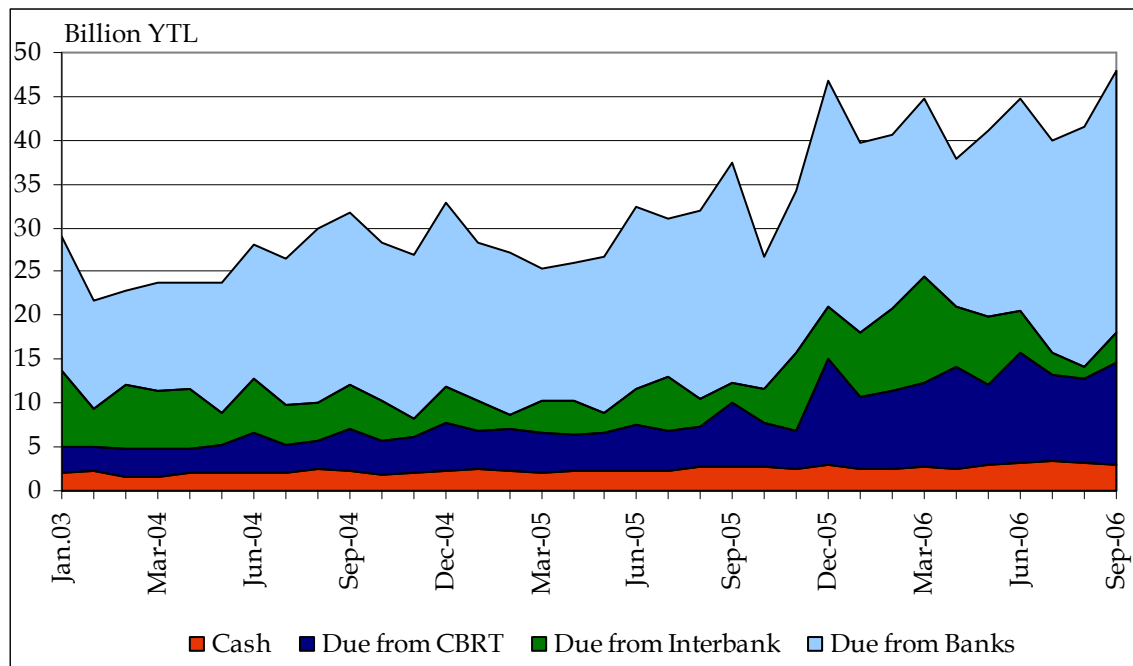
The expectation of continued tightness tendency in monetary policies of developed countries due to inflationary pressures has negatively affected the international liquidity conditions. As a result of this situation, which was one of the risks as defined by the Press release on the “General Framework of Inflation Targeting Regime, and Monetary and Exchange Rate Policy for 2006”, CBRT’s Monetary Policy Committee (Committee) increased policy rates by 175 basis points in an extraordinary meeting. However, in the next Committee meeting, due to the predicted shrinkage in domestic demand and the expectation of the fact that the impact on inflation of the increase in foreign exchange rate will be limited, policy rates were kept unchanged. In light of the continued volatility in the markets, the Committee, in an

extraordinary meeting on June 25, increased interest rates by 225 basis points and subsequently by 25 basis points on July 20, 2006, in an effort to correct the mid-term inflation expectation and to decrease the volatility in the markets.

To avoid the deterioration in inflation expectation and excessive volatility, in addition to the increase in policy interest rates, the CBRT took effective precautions in the foreign exchange markets and also in liquidity management in order to restrain speculative behaviors. In this framework, because of the shrinkage of liquidity in foreign exchange markets due to the global liquidity conditions, foreign exchange borrowing has been stopped especially starting from May 16,¹ direct intervention in the foreign exchange market took place on June 13 and 23 as excessive volatility has continued. Despite the direct interventions and policy rate decisions, because of the continued volatility of the foreign exchange rate mostly due to speculative behaviors, CBRT both intervened efficiently in foreign exchange market, and started to sterilize excessive liquidity in New Turkish Lira, which plays a role in foreign exchange market volatility. To this end, a Foreign Exchange Selling Auction was organized on June 26-27, 2006 to supply foreign exchange; direct selling intervention in the foreign exchange market was realized on June 26, 2006. Moreover, New Turkish Lira Deposit Buying Auctions with standard one-week and two-week maturities were initiated to effectively sterilize the excessive liquidity in New Turkish Lira and increase the flexibility of monetary tightening when it is necessary. New Turkish Lira Buying Auctions continued as long as the liquidity was over the expected level and as it has started to shrink, the CBRT stopped these Auctions as of August 25, 2006. In addition, the CBRT enhanced the flexibility of liquidity management by raising the lending interest rate by 200 basis points. As a result of decisive applications of CBRT, the volatility in the markets decreased considerably since July.

¹ Foreign exchange market had relatively stabilized due to the precautions taken by CBRT against these fluctuations and better global liquidity conditions. Since November 10, 2006 CBRT has started daily foreign exchange buying auctions again to accumulate foreign exchange reserves to keep economic stability

Chart III.3.2
Distribution of Liquid Assets

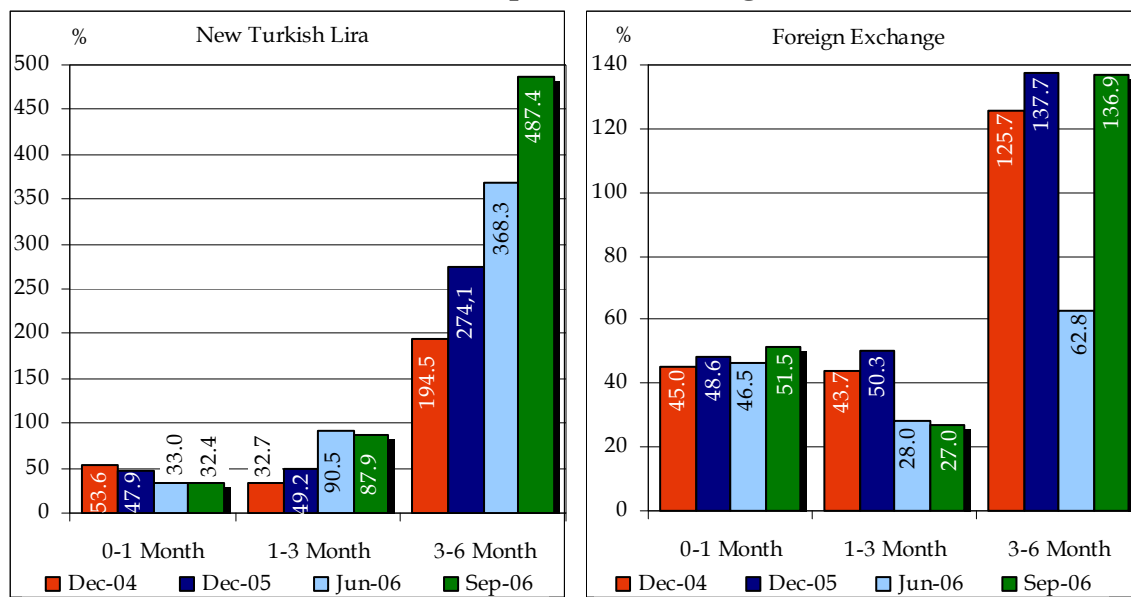


Source: BRSA-CBRT

When the distribution of the cash and cash equivalent assets, which consist of cash, due from the CBRT, the Interbank and from banks, is analyzed, it is observed that the due from banks item has the highest share in liquid assets. The decrease of due from the Interbank and the increase of due from the CBRT items since May 2006 were the main developments of this period.

Since July 2006, the increase of due from banks has stemmed from the fact that banks have invested their FX deposits in the banks instead of extending loans (Chart III.3.2).

Chart III.3.3
Ratio of Assets to Liabilities with Respect to Remaining Maturities



Source: BRSA-CBRT

In the 0-1 month maturity bracket (with respect to remaining maturity), the coverage ratio of assets to liabilities in domestic currency continued to decrease, whereas in foreign exchange it increased (Chart III.3.3). In this maturity bracket, the coverage ratio of assets to liabilities in foreign currency was higher than the ratio in domestic currency and it was realized around 50 percent.

As of June 2006, the coverage ratio of assets to liabilities in the 1-3 month maturity bracket, decreased in foreign currency and increased in domestic currency, compared to the end of 2005. This development mainly occurred because of the fact that banks exchanged their foreign currency liabilities into the domestic currency by means of short-term swap transactions.

The concentration of deposits, as the main funding source for banks, in 0-3 month maturity bracket and the securities portfolio and loans, as the main asset items, in longer maturity brackets reveal the maturity mismatch problem of the banking sector. Despite the short-term nature of deposits, the adverse impact of maturity mismatch relatively declines due to the fact that a large proportion of time and saving deposits consist of core deposits.

Box III.3.2. The Regulation Regarding Measurement and Assessment of Liquidity Requirement of Banks

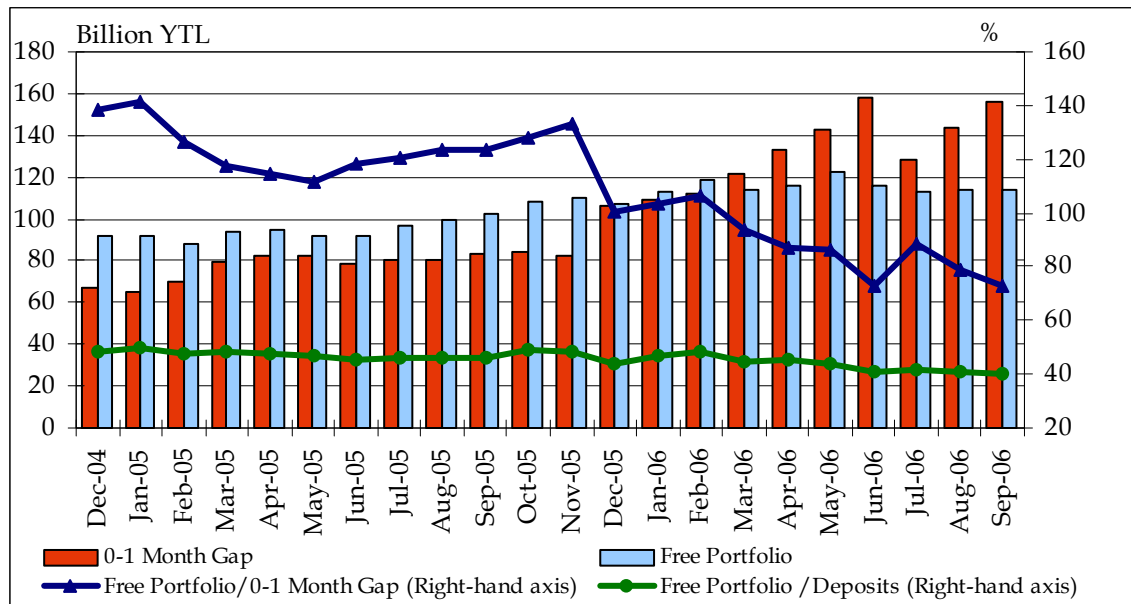
According to Article 46 of Banking Law No. 5411, banks have to calculate, achieve, perpetuate and report the minimum liquidity level in accordance with the principles and procedures to be set by the BRSA upon the approval of the CBRT.

According to “The Regulation Regarding Measurement and Assessment of Liquidity Requirement of Banks”, published in the Official Gazette, No: 26333, dated November 1, 2006, banks are required to measure and maintain two liquidity ratios in terms of total and foreign exchange on a daily basis for the maturity bracket up to 1 week and on a weekly basis for the maturity bracket up to 1 month.

According to the Regulation, in calculating the liquidity ratio, stock values of some of the assets and liabilities are considered by discounting at a specific rate based on their liquid/demand features and for others, cash inflows and outflows in the calculated maturity bracket, are considered.

In this framework, the total liquidity ratio, which is the ratio of total assets in domestic and foreign currency to total liabilities, should be at least 100 percent, and the foreign exchange liquidity ratio, which is the ratio of the assets in foreign currency to liabilities in foreign currency, should be at least 80 percent, and banks are required to maintain these ratios beginning from June 1, 2007. It is also stated that the ratio of some specified assets to specified liabilities, shall be at least 5 percent until June 1, 2007. In this calculation the stated assets and liabilities are taken into account as inventory values without considering their remaining maturity, and it is required that the ratio will be calculated on a daily basis and the simple average of the week will be taken.

Chart III.3.4
The Coverage Ratio of Collaterals to Liabilities¹



Source: BRSA-CBRT

¹ Free Portfolio: Securities Portfolio less Securities used as Collateral or for Repo Transactions.

The ratio of free securities portfolio, which is among the collaterals to be accepted by the CBRT in providing liquidity in case of a temporary liquidity squeeze, to the difference between assets and liabilities in the 0-1 month remaining maturity bracket, was realized over 100 percent until February 2006, and thereafter it has followed a declining trend.

The ratio of free portfolio to deposits is also important since it shows the liquidity obtainable by using the collateral in case of sudden deposit withdrawals. Within this framework, the ratio of the securities, which can be accepted as collateral, to total deposits was realized as 44 percent at end-2005. After that, it started to decline and was realized as 41.1 percent as of June 2006 and 40.1 percent as of September 2006 (Chart III.3.4).

III.4.Profitability and Capital Adequacy

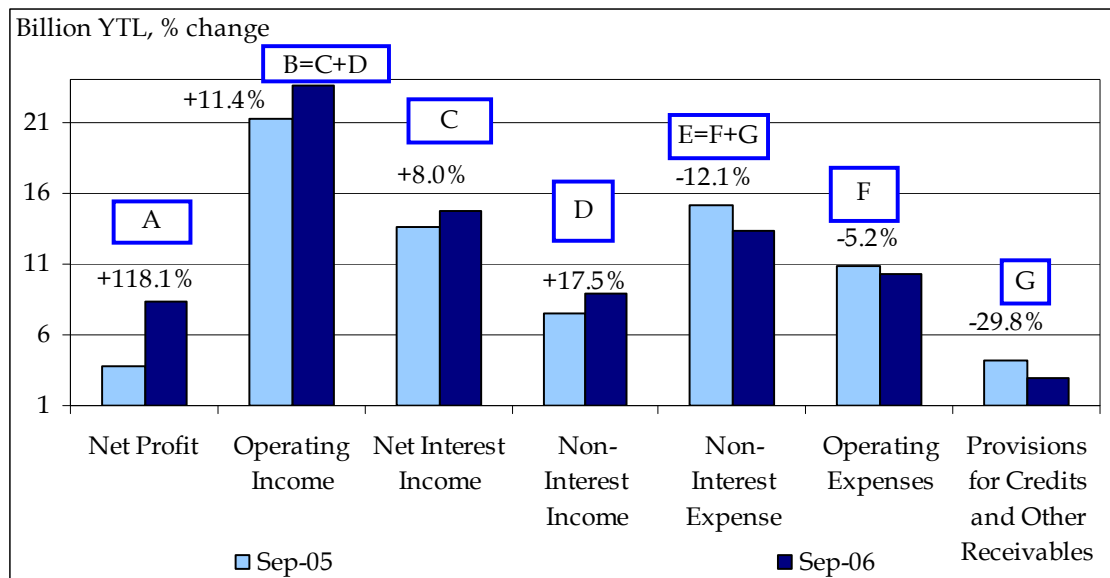
III.4.1.Profitability⁷

As of September 2006, net profit of the banking sector was realized as 8.4 billion New Turkish Liras, increasing by 118.1 percent compared to September 2005. When a bank, which incurred a high amount of net loss in September 2005, is excluded, the increase in the net profit of the banking sector becomes 30.7 percent.

In the aforementioned period, the increase in the net interest margin and in net profit on capital market transactions stemming from the rise in net profit on derivative financial instruments along with the decrease in provisions for credits and other receivables had a positive impact on the profitability of the banking sector. Besides, the decrease in the provision for taxes due to the decline in the corporate tax ratio, which is effective starting in 2006, contributed to the increase in profitability.

As a result of the fluctuations in the financial markets in May-June 2006, the net foreign currency loss of the banking sector was realized as 2.4 billion New Turkish Liras as of September 2006. However, taking into consideration that the positive foreign exchange difference of FX indexed securities and loans are shown in the other operating income account and the net profit on derivative financial instruments are shown in the net profit on capital market transactions account, it is observed that the movements in the foreign exchange rates had a limited impact on the profitability of banks.

Chart III.4.1.1
Net Profit and Its Components



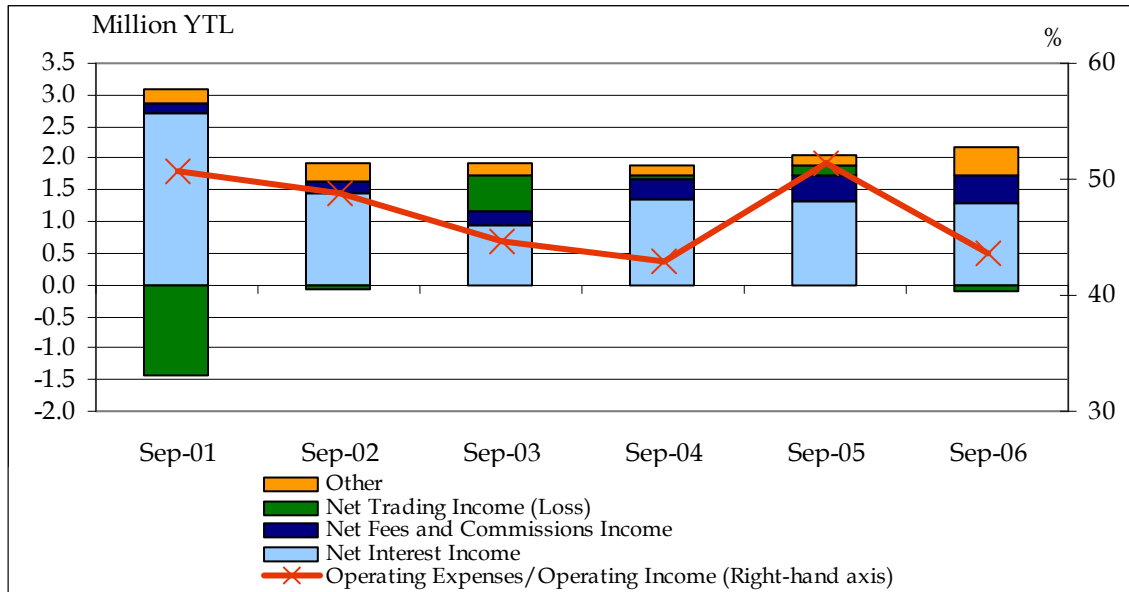
Source: BRSA-CBRT

⁷ Assessments regarding the sector are made by excluding the SDIF and participation banks.

When the components⁸ of net profit are analyzed, the increase of 11.4 percent in operating income was especially due to the increase in other operating income (foreign exchange difference of FX indexed assets) and net interest income.

As of September 2006, non-interest expenses have decreased by 12.1 percent, compared to September 2005. On the other hand, when a bank, which incurred a high amount of net loss in September 2005, is excluded, non-interest expenses increased by 7.8 percent (Chart III.4.1.1).

Chart III.4.1.2
Operating Income¹



Source: BRSA-CBRT

¹ It is expressed in real terms by using the “1994=100 CPI”

Net interest income has the highest share in total operating income. It is also important to note that net fees and commissions income, which is a stable source of income, has an increasing trend through the years (Chart III.4.1.2).

As of September 2005, the ratio of operating expenses to operating income was high due to a private bank, which incurred a net loss and this ratio decreased to 43.7 percent by September 2006. When this bank is excluded, a slight increase of 0.8 points was realized in this ratio (Chart III.4.1.2).

In contrast to the 2001 financial crisis, the turbulence in the financial markets in May-June 2006 had a limited impact on the profitability of the sector. The lower current FX open position compared to the one in the 2001 financial crisis period, banks’

⁸ Operating Income = Net Interest Income + Non-Interest Income.

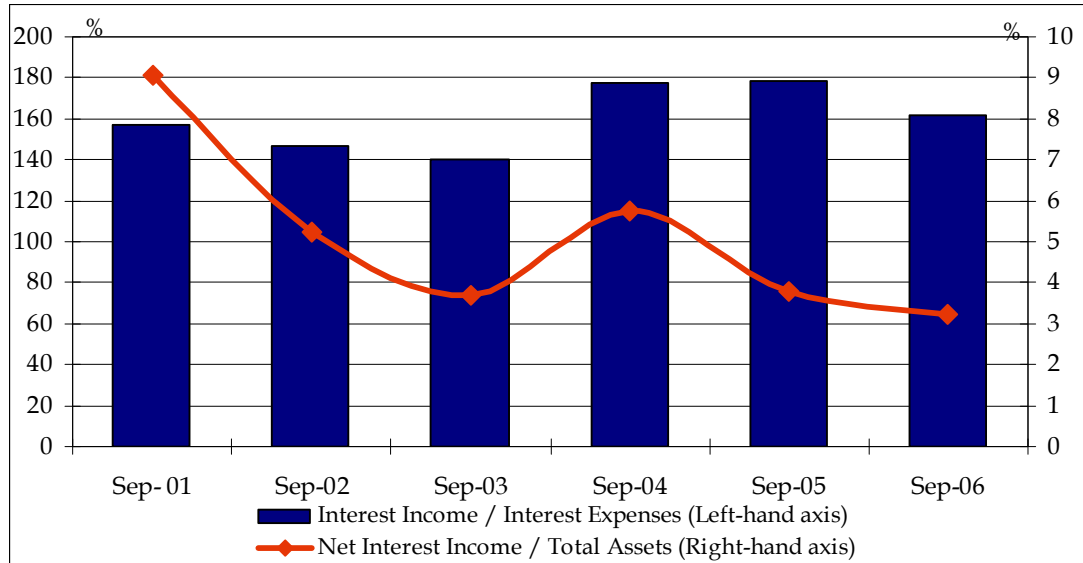
Non-Interest Income = Net Fees and Commissions Income + Dividend Income + Net Trading Income (Loss) + Other Operating Income.

Non-Interest Expenses = Provision for Credits and Other Receivables + Operating Expenses.

Net Profit = Operating Income – Non-Interest Expenses ± Profit/Losses from Associates and Subsidiaries ± Extraordinary Income (Expenses) – Provision for Taxes.

improved risk management procedures and their increased emphasis on off balance sheet operations to decrease FX risk, contributed to this development.

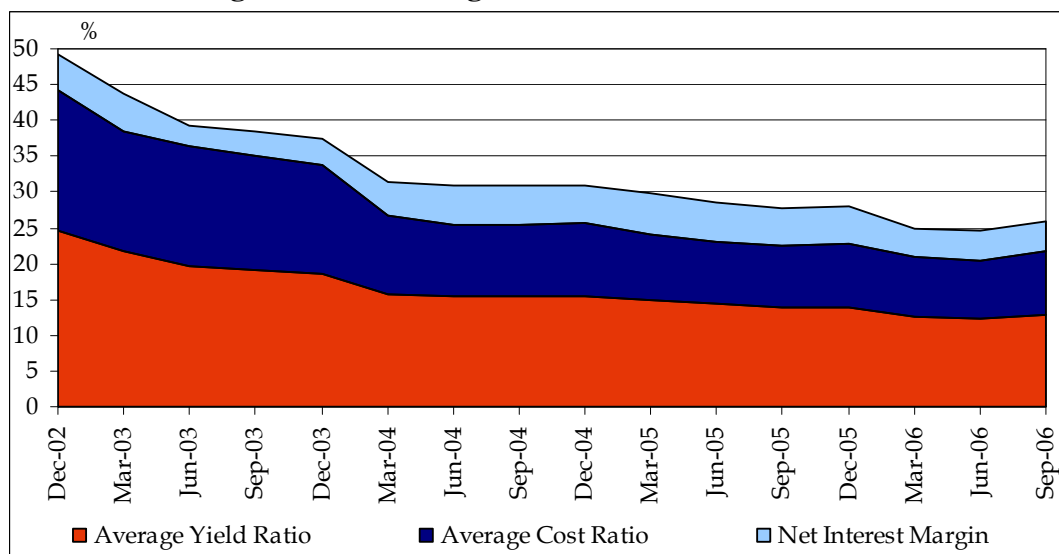
Chart III.4.1.3
Net Interest Income



Source: BRSA-CBRT

As of September 2006, the ratio of interest income to interest expenses decreased from 178.5 percent to 161.4 percent, compared to the same period of the previous year. This is due to the greater rate of increase in interest expenses compared to interest income. Additionally, the declining trend in the ratio of net interest income to total assets has continued (Chart III.4.1.3). The rapid increase in interest expenses was a consequence of the rising funding costs due to the increase in interest on deposits and interest on banks.

Chart III.4.1.4
Net Interest Margin of the Banking Sector¹

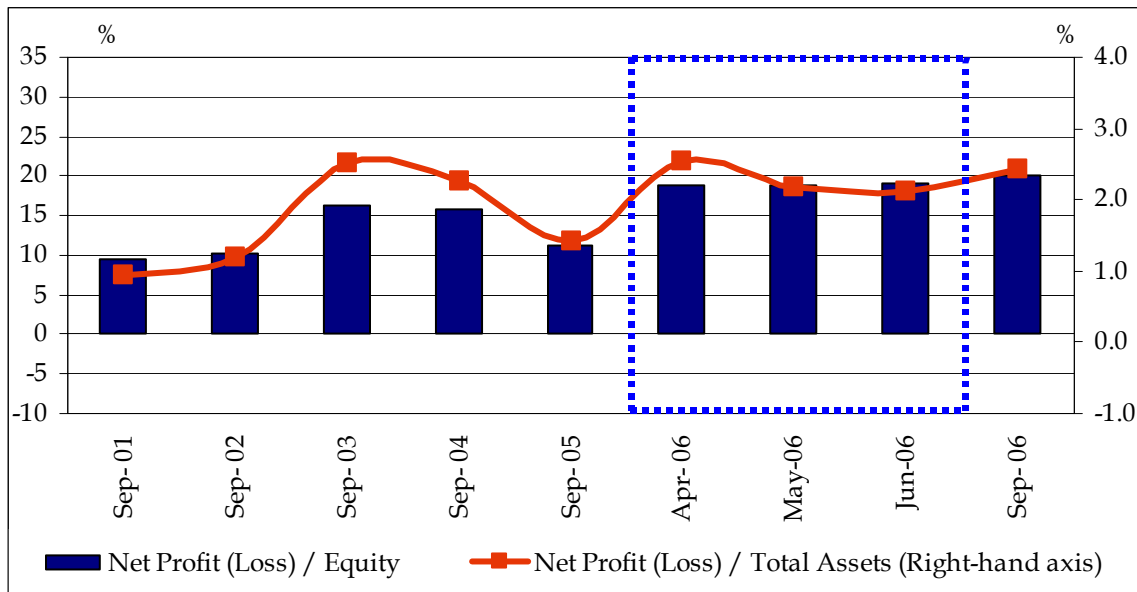


Source: BRSA-CBRT

¹ Total yield is interest income as a percentage of the average interest-earning assets and total cost is interest expense as a percentage of the average interest-bearing liabilities. In order to annualize, the ratios are multiplied by 4, 2 and 1.33 for March, June and September, respectively.

In the first nine months of 2006, due to the greater rate of decrease in the yield on assets compared to the rate of decrease in the cost of liabilities, the net interest margin declined to 4.1 percent. Banks' liabilities have shorter maturity and assets have longer maturity. In this regard, the net interest margin was expected to decline attributable to re-pricing due to the rise in interest rates since May 2006, however it has remained unchanged. This is mainly due to the rapid pricing of commercial loans compared to the liabilities (Chart III.4.1.4).

Chart III.4.1.5
Return on Assets and Return on Equity¹

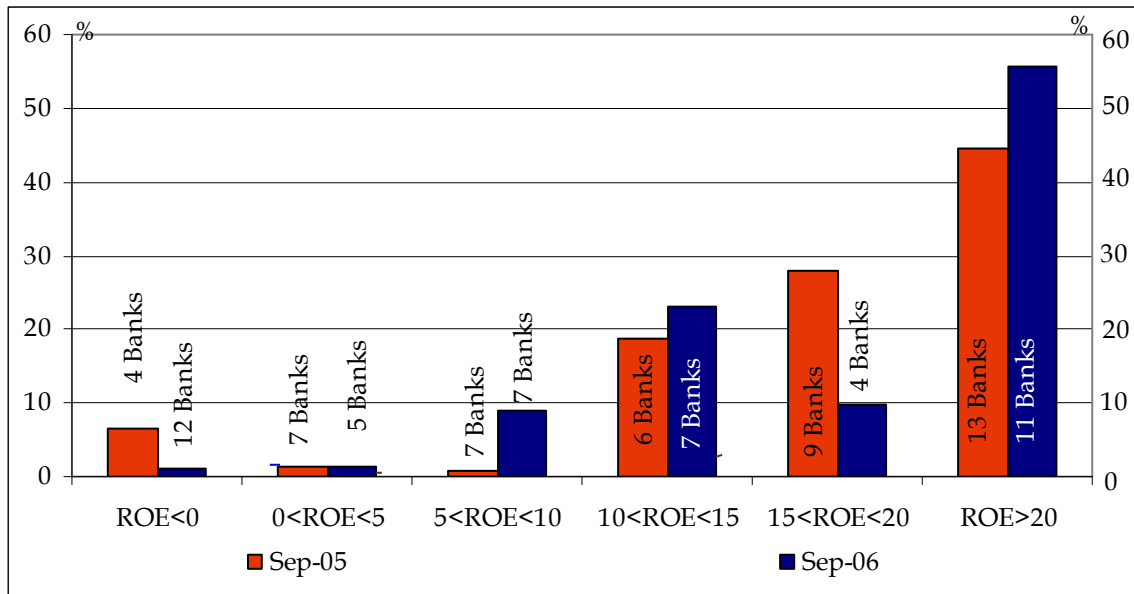


Source: BRSA-CBRT

¹ In order to annualize, the ratios are multiplied by 4, 3, 2.4 and 1.33 for March, April, May and September, respectively.

As of September 2006, the return on assets and return on equity of the banking sector was realized as 2.4 percent and 20 percent, respectively. The return on assets of the sector has been declining since April 2006, due to the greater rate of increase in total assets compared to net profit. As of September 2006, this ratio has increased again due to the rise in net profit. On the other hand, return on equity has been increasing since April 2006, due to the decrease in shareholders' equity and it continued to increase by September 2006, due to greater rate of increase in net profit compared to the shareholders' equity (Chart III.4.1.5).

Chart III.4.1.6
Asset Share of the Banks Based on Return on Equity^{1,2}



Source: BRSA-CBRT

¹ Return on equity (ROE) = Net Profit / Equity

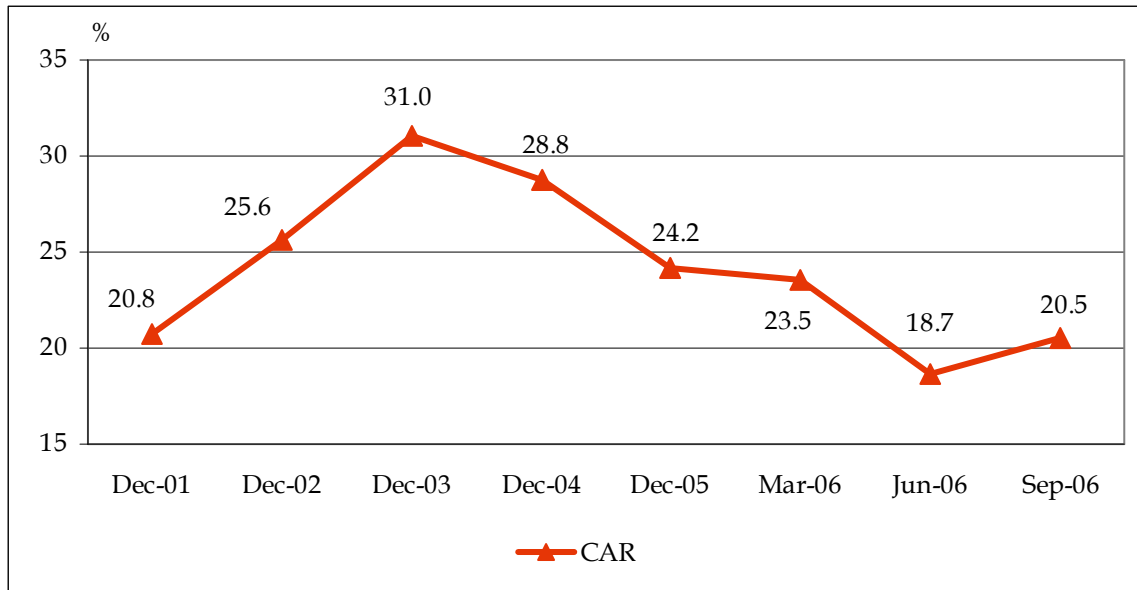
² In order to annualize, the ratios are multiplied by 1.33 for September.

As of September 2006, the asset share of those banks with a return on equity over 20 percent has increased. The number of banks that incurred losses increased from 4 to 12, but their asset shares remained low in the sector. The increase in the number of banks that incurred losses was due to the increase in non-interest expenses of these banks as of September 2006 (Chart III.4.1.6).

III.4.2.Capital Adequacy

Although the unconsolidated capital adequacy ratio (CAR) of the banking sector, which is the ratio of own funds to risk weighted assets, has a declining trend, it was realized well above both the minimum requirement of 8 percent and target ratio of 12 percent for all periods under review.

Chart III.4.2.1
Capital Adequacy Ratio (Unconsolidated)



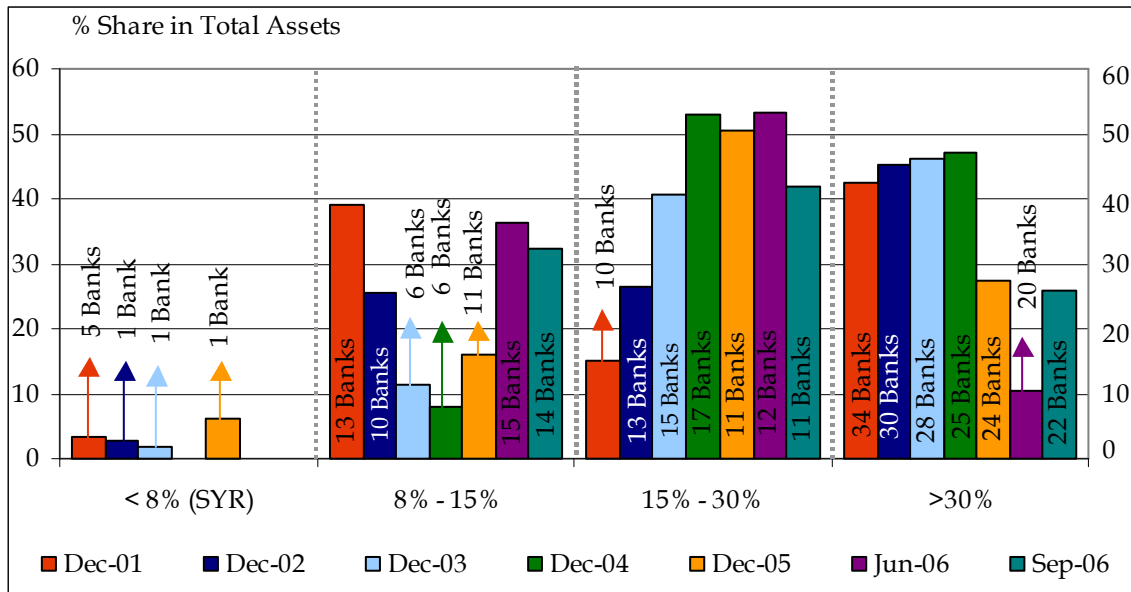
Source: BRSA-CBRT

The CAR of the banking sector, which was 24.2 percent at end-2005, continued to decrease in 2006 and was realized as 18.7 percent as of June 2006. However, the CAR reversed its declining trend in September 2006 and reached 20.5 percent.

The securities value increase fund had a negative balance due to the increase in interest rates since May 2006. Related to this, tier 2 capital and therefore own funds decreased by 4.7 percent as of June 2006, compared to the end of 2005. Along with the decrease in own funds, the increase of 23 percent in the risk weighted assets of the sector, especially resulting from the expansion in loans and FX differences related to FX operations, was also effective in this decline of the CAR (Chart III.4.2.1).

The increase in own funds, due to the increase in the profit of the sector and securities value increase fund, was effective on the increase of CAR as of September 2006. Furthermore, loan growth has slowed down in this period and this has also restricted the increase of risk-weighted assets.

Chart III.4.2.2
Asset Share of Banks Based on Capital Adequacy Ratio

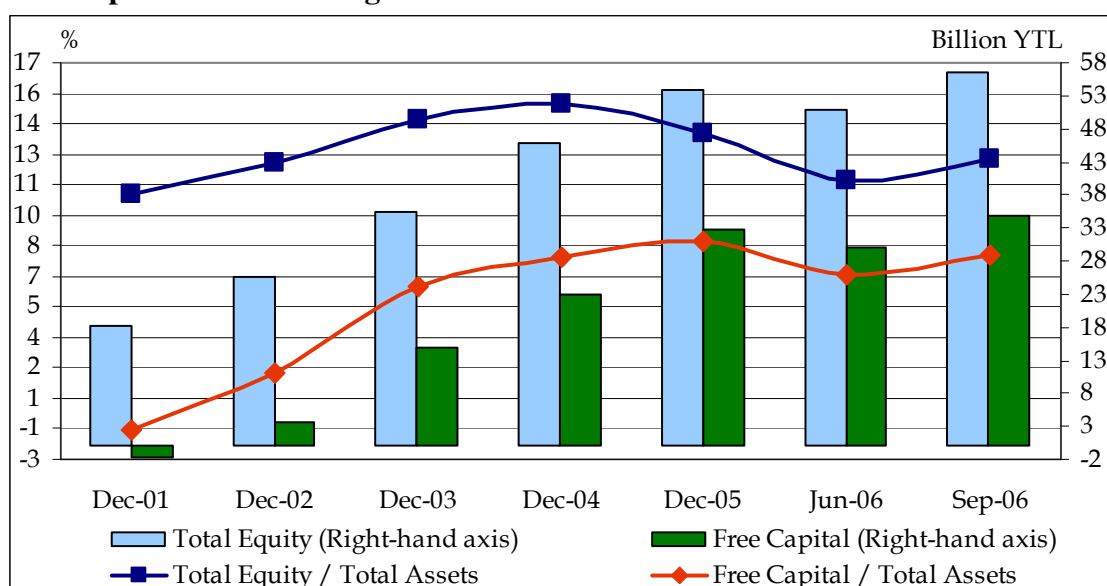


Source: BRSA-CBRT

The asset share and number of banks with capital adequacy ratios within the 8-15 percent range increased significantly as of June 2006 compared to the year-end 2005. As of September 2006, the asset share of banks with capital adequacy ratios over 30 percent had a remarkable increase.

While the capital adequacy ratios of 35 banks in the sector, which held 78 percent of the sector assets, exceeded 15 percent by year-end 2005, the capital adequacy ratios of 33 banks in the sector, which hold 67.6 percent of the sector assets, exceed 15 percent as of September 2006. It is also worth mentioning that by year-end 2001, following the 2001 financial crisis, five banks had a CAR below 8 percent, whereas there is no bank with a CAR below 8 percent as of September 2006 (Chart III.4.2.2).

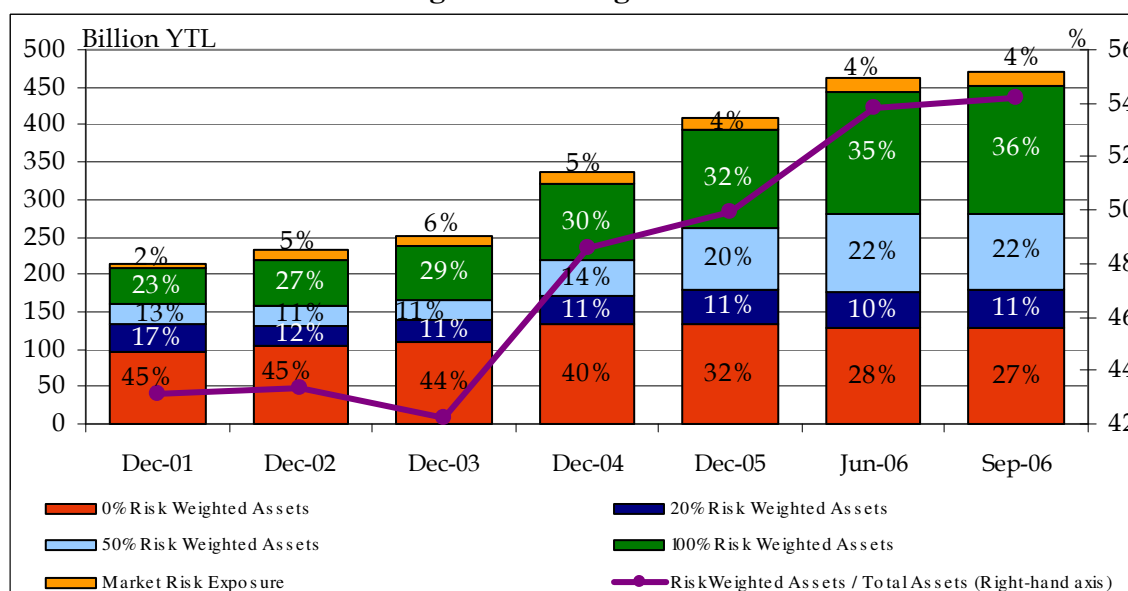
Chart III.4.2.3
Free Capital of the Banking Sector



Source: BRSA-CBRT

Free capital to total assets and equity to total assets have decreased in the first half of 2006, due to the decline in equity. As of September 2006, these ratios increased to 7.6 percent and 12.2 percent, respectively, resulting from the increase in equity (Chart III.4.2.3).

Chart III.4.2.4
Distribution of Assets According to Risk Weights

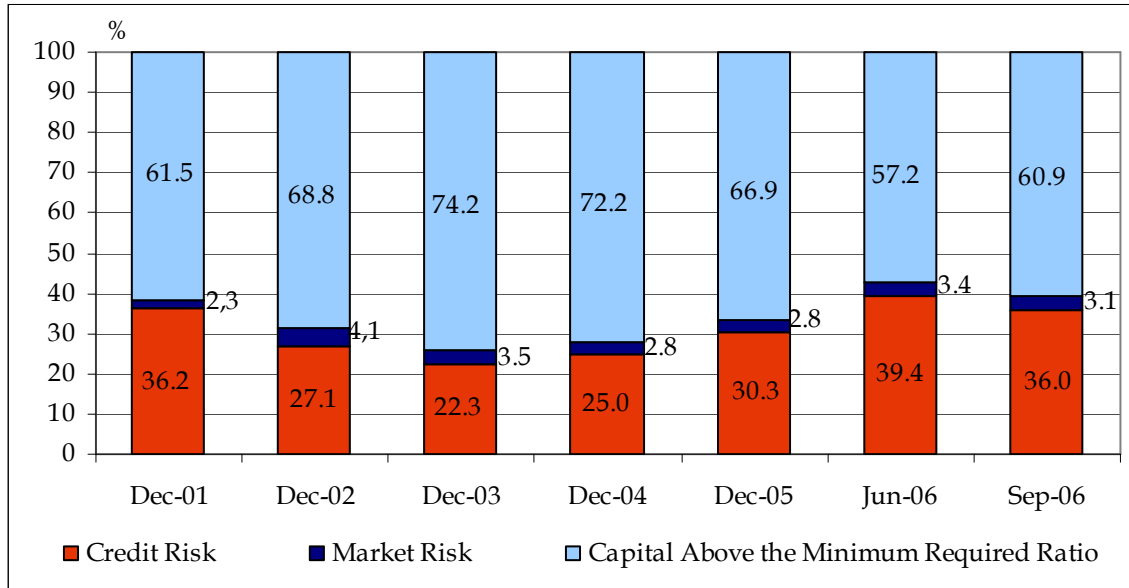


Source: BRSA-CBRT

As of September 2006, the share of 50 percent risk weighted assets increased to 22 percent and the share of 100 percent risk weighted assets rose to 36 percent due to the increase in loans. The increase in 50 percent risk weighted assets was attributable to the increase in housing loans.

Since the share of loans, which have higher risk weights, exceeded the share of securities in the banking sector balance sheet, total risk weighted assets grew faster than total assets. As a result, the ratio of total risk weighted assets⁹ to total assets increased from 50 percent at end-2005 to 54.2 percent as of September 2006 (Chart III.4.2.4).

Chart III.4.2.5
Distribution of Regulatory Capital Requirement with Respect to Credit and Market Risk



Source: BRSA-CBRT

As of June 2006, the ratio of own funds maintained for credit risk to total own funds increased by 9.1 points compared to year-end 2005 and then decreased in September 2006 due to the increase in own funds. Moreover, own funds maintained for market risk constituted 3.1 percent of total own funds and increased by 0.3 points compared to year-end 2005 (Chart III.4.2.5).

Consequently, the recent turbulence in the financial markets had a limited impact on the profitability performance of the sector, due to improved risk management by banks and their increased emphasis on operations related to decreasing foreign exchange risk. Additionally, when the short maturity structure of liabilities and long maturity structure of assets is taken into account, net interest margin was expected to decline attributable to repricing resulting from the rise in interest rates. However, interest margin remained unchanged mainly due to the rapid pricing of commercial loans compared to liabilities. Therefore, the recent turbulence in the financial markets had a limited impact on the profitability performance of the sector regarding interest rate risk.

The impact of the fluctuations in the financial markets in May-June 2006 was greater on capital compared to profitability. The own funds of the sector decreased by

⁹ Total risk weighted assets refers to the denominator of the capital adequacy ratio. In other words, risk weighted assets are calculated by adding market risk exposure to the assets weighted by the relevant risk categories (0, 20, 50, 100 percent).

10 percent between March and June 2006 and this decrease was offset as of September 2006. It is important to note that the banking sector has own funds well above the minimum capital requirement.

III.5. Financial Strength Index

When compiling the Financial Strength Index (FSI), specific ratios that reflect the risks and fragility of the sector are applied to form an “aggregate indicator”, and the direction of the movement of this index was used to analyze the strength of the sector. Six sub-indicators are utilized to create the index, which are asset quality, liquidity, exchange rate risk, interest rate risk, profitability and capital adequacy indices (Box III.5.1).

Box III.5.1. Financial Strength Index Variables¹⁰

	Financial Strength Indicators	Direction of the Impact	Weights
Asset Quality	Gross Non-Performing Loans / Gross Loans	negative	0.33
	Net NPL / Equity	negative	0.33
	Fixed Assets / Total Assets ¹	negative	0.33
Liquidity	Liquid Assets / Total Assets ²	positive	0.40
	Assets with a Maturity up to 3 Months / Liabilities with a Maturity up to 3 Months	positive	0.60
Exchange Rate Risk	On-Balance Sheet FX Position / Own Funds ³	negative	0.50
	FX Net General Position / Own Funds ⁴	negative	0.50
Interest Rate Risk	(YTL Assets with a Maturity up to 1 Month - YTL Liabilities with a Maturity up to 1 Month) / Equity ⁵	negative	0.50
	(FX Assets with a Maturity up to 1 Month - FX Liabilities with a Maturity up to 1 Month) / Equity ⁵	negative	0.50
Profitability	Net Profit / Total Assets	positive	0.50
	Net Profit / Equity	positive	0.50
Capital Adequacy	Free Capital / Total Assets ⁶	positive	0.50
	Capital Adequacy Ratio	positive	0.50

¹ Fixed Assets consist of subsidiaries, assets to be sold, fixed assets and net non-performing loans.

² Liquid Assets consist of cash, due from the CBRT, due from money market, due from banks and receivables from reverse repo transactions.

³ Own funds is the regulatory capital, and it is different from the equity in the balance sheet. The calculation is in absolute values.

⁴ Foreign exchange net open position is the sum of on and off balance sheet foreign currency positions. The calculation is in absolute values.

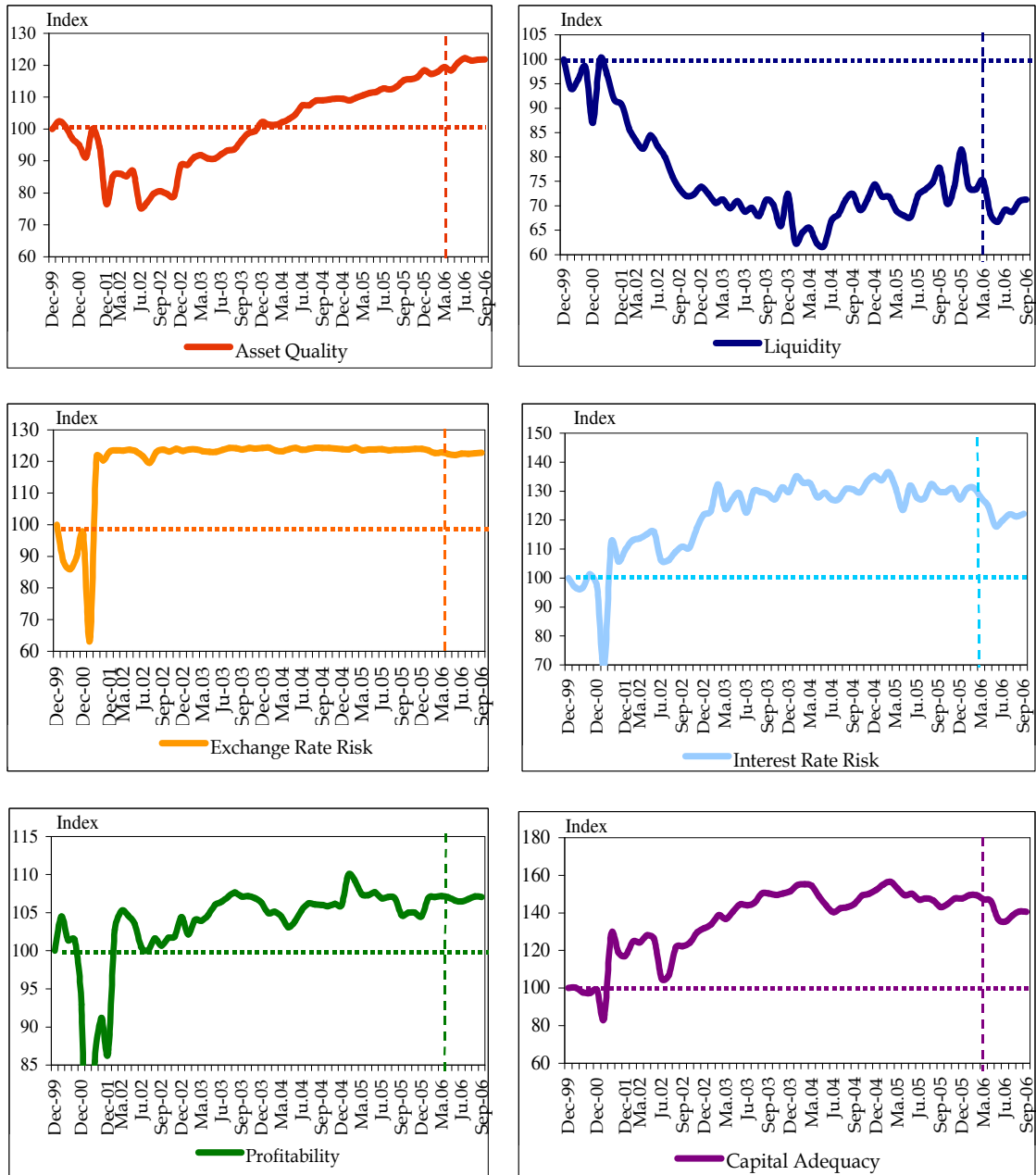
⁵ The calculation is in absolute values.

⁶ Free capital is calculated by deducting fixed assets from equity.

The weights of the ratios that form the indices and the direction (positive/negative) of their impact on the indices are presented in the table above.

¹⁰ To develop this index, the method used in these two studies; “BIS, Measuring and Forecasting Stress in the Banking Sector: Evidence from Switzerland”, April 2005 and the Bank of Canada, “An Index of Financial Stress for Canada,” June 2003, has been utilized.

Chart III.5.1
Financial Strength Sub-Indices



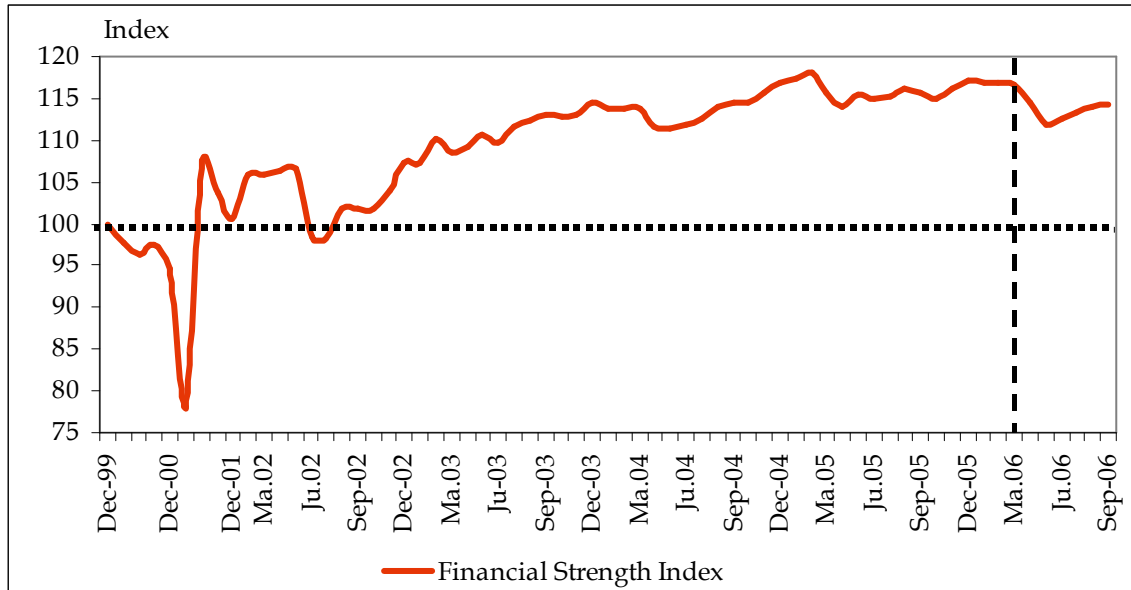
Source: BRSA-CBRT

The assessment of the sub-indices that form the FSI is explained below (Chart III.5.1);

- i. **Asset Quality Index:** Asset quality index, which was 118.3 by year-end 2005, continued to increase during 2006 due to the decrease in fixed assets to total assets and NPL ratio and was realized as 121.9 as of September 2006. The fluctuations during May-June period did not have an adverse impact on the asset quality of the banking sector for the time being.

- ii. **Liquidity Index:** By year-end 2005, liquidity index has reached its peak level for the last 3 years but then has decreased until June 2006. After this period, the index started to show an increasing trend due to the prudential behaviour of the banks against the turbulence and was realized as 71.3 as of September 2006.
- iii. **Exchange Rate Risk Index:** Exchange rate risk index has a stable trend and reached 124 by year-end 2005. The index declined to 122 as of May 2006, due to the increased on-balance sheet open FX position of the sector, then started to recover and reached 122.8 as of September 2006. The turbulence didn't have an important impact on the exchange rate risk index due to the limited open position of the banking sector.
- iv. **Interest Rate Risk Index:** Interest rate risk index, which was 127.2 by year-end 2005, decreased to a low of 117 as of May and June 2006. This decrease came as a consequence of the increase in the ratios to equity of the difference between interest earning assets in the maturity bracket up to 1 month and interest bearing liabilities with the same maturity, which are both denominated in YTL and FX. As of September 2006, the index was realized as 122.1.
- v. **Profitability Index:** The profitability index was realized as 104.5 by year-end 2005, which was primarily affected by the net loss incurred by a particular private bank. After the profit realization of the aforementioned bank, the index displayed an increasing trend and was realized as 107 by September 2006. The recent turbulence in the financial markets had a small impact on the profitability performance of the banks.
- vi. **Capital Adequacy Index:** The index decreased from 147.7 at end-2005 to 146 as of April 2006 and 135.3 as of June 2006. The decrease in the index in May-June period was mainly due to the decline in own funds and increase in risk weighted assets partially affected by the increase in foreign exchange rate. As of September 2006, the index reached 140.5 due to the rise in own funds.

Chart III.5.2
Financial Strength Index (FSI)



Source: BRSA-CBRT

FSI, which was 117.2 by year-end 2005, decreased to 111.8 as of May 2006 due to the decrease in sub-indices except the asset quality index, which were affected by the turbulence in financial markets, and the index increased to 114.3 in September 2006.

Despite the turbulence in May-June period, the decline in FSI was very limited, which reflects the increased resilience of the banking sector against fragilities (Chart III.5.2).