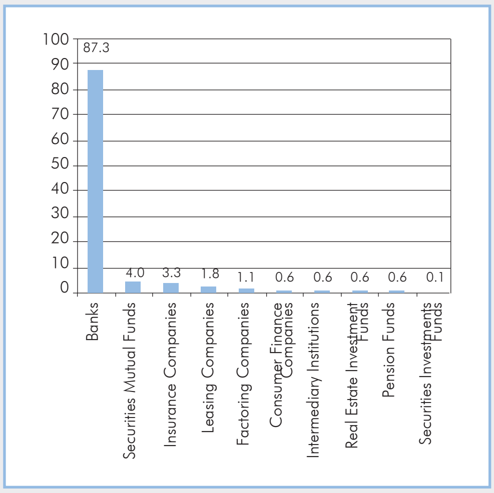
II. STRUCTURE OF THE FINANCIAL SECTOR

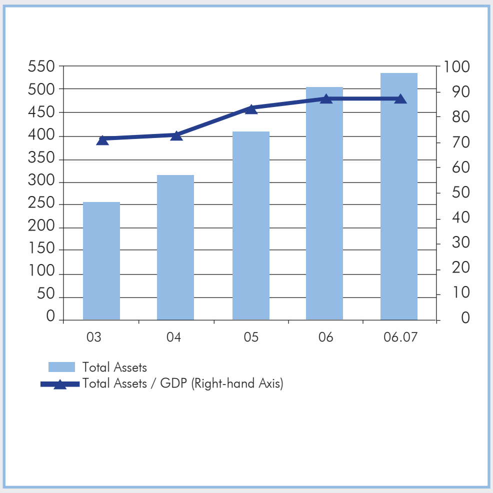
The Turkish financial sector maintained its stable growth trend in the first half of 2007. During the same period, the banking sector also continued to attract foreign investments.

Chart II.1. Composition of Balance Sheet of the Financial Sector (%)[1]



Source: BRSA, CBRT, Association of Capital Market Intermediary Institutions,CMB
(1) Figures are as of June 2007.

Chart II.2. Balance Sheet Size of the Banking Sector (Billion YTL, %)



Source: BRSA-CBRT

The total asset size of the financial sector, which grew by 8 percent compared to year- end 2006, reached YTL 610 billion as of June 2007. 87 percent of financial sector assets belong to banks (Chart II.1).

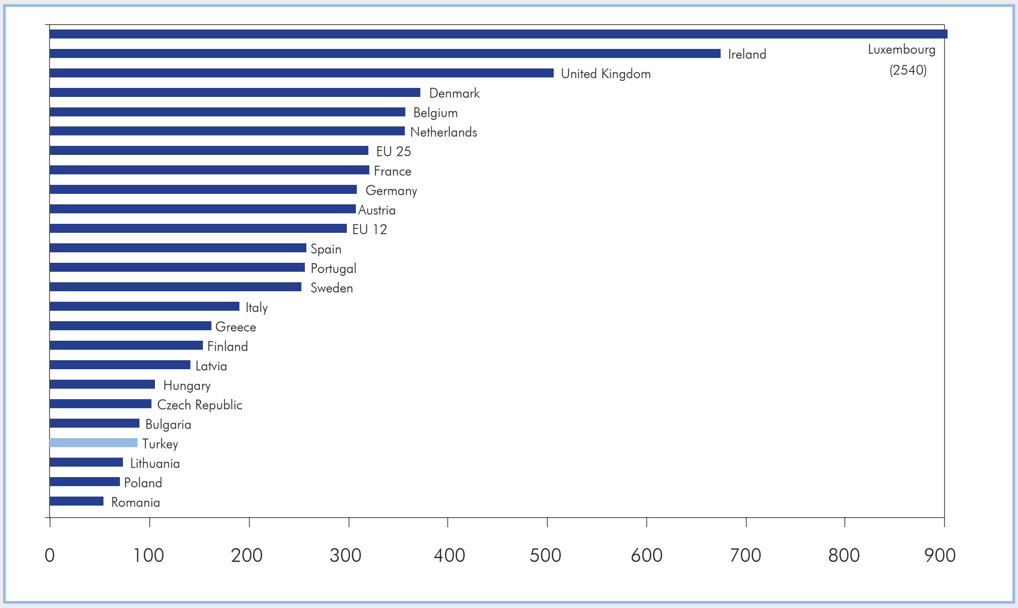
II.1. Banking Sector

The Turkish banking sector consists of deposit banks, development and investment banks and participation banks that operate according to profit/loss sharing principles. Analyses in this section also include participation banks.

As of September 2007, the number of banking sector staff increased by 12,176 compared to end-2006 and reached 163,029, whereas the number of banks remained at 50.

As of September 2007, the total asset size of the banking sector increased by 1 percent in real terms compared to end-2006 and reached YTL 544 billion, while it increased to 451 billion from 355 billion in USD terms, with a rise of 27 percent. The real increase remained limited, due to the decrease in the New Turkish Lira value of the foreign currency items in the balance sheet, which resulted from the appreciation of the Turkish currency.

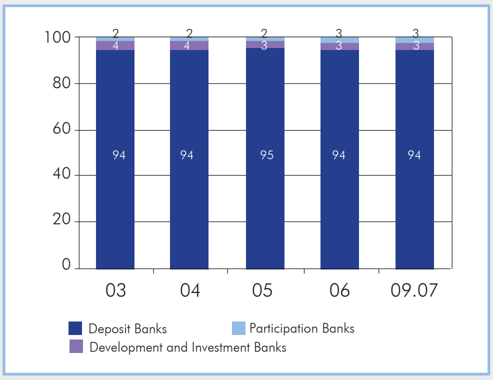
Chart II.3.
Comparison of the Turkish Banking Sector Asset Size/GDP Ratio with Selected EU Countries (%)[1]



Source: TURKSTAT, BRSA-CBRT, ECB Report – 2006
(1) Figures are as of 2006..

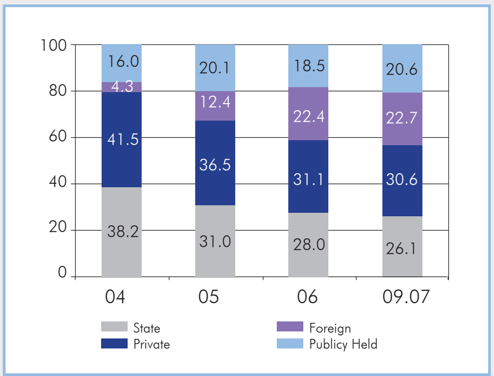
Turkish banking sector's balance sheet size to GDP rose to 87 percent in June 2007 from 86.7 percent as of end-2006 (Chart II.2). The ratio is less than all EU countries except Lithuania, Poland and Romania (Chart II.3). This points to the growth potential of the Turkish banking sector.

Chart II.4.
Banking Sector Assets by Group (%)



Source: BRSA-CBRT

Chart II.5.
Banking Sector Assets According to Equity Ownership (%)[1]



Source: BRSA-CBRT
(1) For publicly held shares no distinction is made between domestic and foreign investors.

Of the 50 banks in the Turkish banking sector, 33 are deposit banks, 13 are development and investment banks and 4 are participation banks, as of September 2007. As can be seen, deposit banking constitutes the main portion of the Turkish banking sector (Chart II.4).

The Turkish banking sector continued to attract foreign investors in 2007. As a consequence, according to their balance sheet size as of September 2007, the share of foreign participation stands at 22.7 percent, including the banks whose authorization process was finalized by September 2007 (Chart II.5). Adding the shares of banks, which have agreed to sell their shares to foreign investors but have not yet finalized the legal authorization and handover processes (Turkish Bank A.Ş., Oyak Bank A.Ş., Türkiye Finans Katılım Bankası A.Ş.), the total share of foreign participation increases to 25.6 percent. Meanwhile, according to Central Registry Agency data, the share of foreign participation in publicly held shares was 17.3 percent total assets of the sector during the same period. When these shares are included, the share of foreign participation in the banking sector reaches 42.9 percent. The continued interest of foreign investors in the Turkish banking sector indicates that the sector has growth potential and that positive expectations are still strong.

Table II.1. Comparison with Selected EU Member Countries[1,2,3]

Countries	Deposits/ GDP (%)	Loans/ GDP (%)	Loans/ Deposits (%)	Total Assets/ Number of Banks (Million Euro)	The Share of the Largest 5 Credit Institutions (%)	Number of credit Institutions	Foreign Participation in the Banking Sector (%)
Germany	119	132	111	3,475	22	2,050	11.1
Austria	104	135	130	976	44	809	19.5
Belgium	148	124	83	10,685	84	105	24.9
Czech Republic	68	45	67	2,013	64	57	96.9
Denmark	70	203	290	4,306	65	191	20.1
Finland	53	79	147	707	82	361	56.5
France	79	105	133	6,910	54	829	11.0
Netherlands	150	196	130	5,429	85	345	14.8
United Kingdom	143	162	113	24,069	36	401	50.3
Ireland	165	230	139	15,208	45	78	43.2
Spain	135	164	121	7,146	40	352	11.4
Sweden	60	132	221	3,793	58	204	8.9
Italy	63	96	153	3,461	26	807	13.9
Latvia	68	95	140	841	69	27	64.8
Lithuania	37	52	141	225	83	77	76.7
Luxembourg	872	482	55	5,452	29	154	94.6
Hungary	52	63	119	442	54	212	56.3
Poland	45	36	79	262	47	723	65.3
Portugal	114	149	130	2,231	68	178	22.3
Greece	108	86	79	5,082	66	62	37.4
EU Zone Ave.	**108**	**129**	**120**	**4,068**	**43**	**511**	**17.9**
EU 25 Ave.	**109**	**132**	**121**	**4,362**	**59**	**338**	**27.1**
Bulgaria	61	47	76	697	50	32	93.4
Romania	22	28	128	1,310	60	39	94.5
Turkey 2006	**53**	**39**	**74**	**5,397**	**61**	**50**	**22.4**
Turkey 06.2007	**54**	**42**	**77**	**6,070**	**60**	**50**	**22.3**

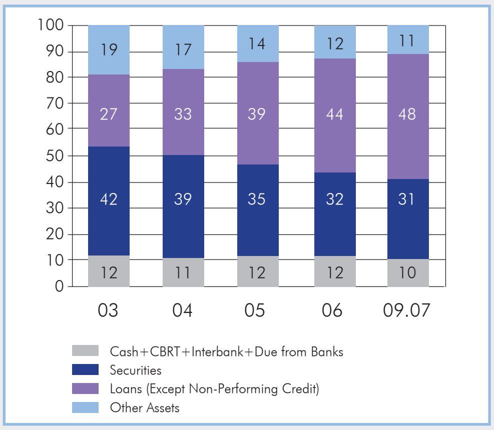
Source: BRSA-CBRT, Eurostat, ECB Report – 2006
(1) Figures for EU countries are as of 2006. In the EU countries, the definition of "credit institutions" may differ and non-bank financial institutions may be included in the definition of credit institutions in some cases. For Turkey the figures of banks are used.
(2) For Turkey, deposits include participation funds and loans include funds extended by participation banks.
(3) Loans include gross non-performing credits.

Although the ratio of deposits and loans to GDP and the ratio of loans to deposits, which reveal the financial depth and intermediation level of the banking sector, rose in June 2007 compared to end-2006, they remain below EU averages (Table II.1).

The number of banks in the Turkish banking sector is significantly below the average of EU countries. The share of the first five banks in total assets was 60 percent as of June 2007, which is above the average of EU countries (Table II.1). As of September 2007, the share of the first five banks was 60 percent, while the share of the first ten banks was 82 percent, with declines of 1 and 2 percentage points compared to end-2006, respectively.

As for the share of foreign participation in the banking sectors of European Union countries, the shares of ten countries that joined the Union in 2005 and the shares of Bulgaria and Romania, which became EU members in 2007, remain above the EU25 average, which is 27 percent. According to legally finalized acquisitions and mergers, the share of foreign participation in the Turkish banking sector is above the Eurozone average and below the EU25 average as of September 2007 (Table II.1).

Chart II.6.
Asset Structure of the Banking Sector (%)



Source: BRSA-CBRT

Chart II.7.
Liability Structure of the Banking Sector (%)

Source: BRSA-CBRT

The share of loan portfolio as the largest asset item continued to grow throughout the year, and rose to 48 percent in September 2007 from 44 percent in end-2006 (Chart II.6).

As of September 2007, the share of due to banks in total liabilities of the banking sector fell by 2 percentage points compared to end-2006, whereas the shares of equity and other liabilities increased by 1 percentage point. These developments chiefly resulted from the decline in the New Turkish Lira value of FX denominated "due to banks" owing to the appreciation of the YTL. Meanwhile, the share of deposits remained unchanged compared to end-2006 (Chart II.7).

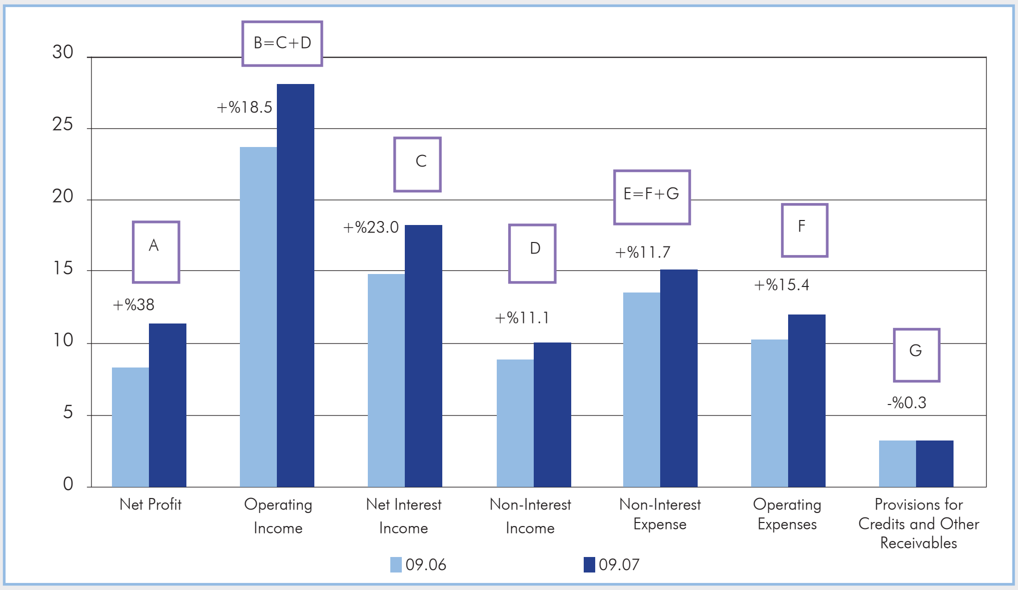
II.2.Banking Sector Profitability and Capital Adequacy

II.2.1.Profitability[4,5]

Profitability of the banking sector improved in 2007. The net profit of the sector increased by 38 percent in September 2007 compared to September 2006, and reached YTL 11.3 billion.

[4] Participation banks are excluded in this section, since their operating principles differ from other banks.
[5] Birleşik Fon Bankası (Bank under SDIF) is excluded.

Chart II.8.
Net Profit and Its Components (Billion YTL, % Change)[1]

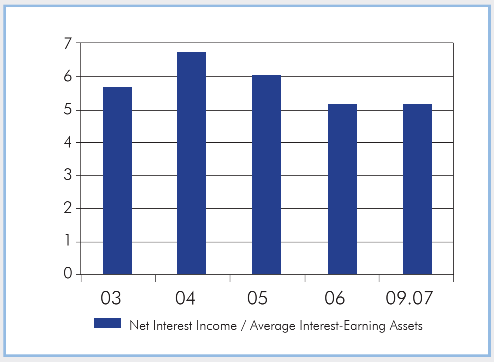


Source: BRSA-CBRT
(1) Operating Income = Net Interest Income + Non-Interest Income.
Non-Interest Income = Net Fees and Commissions Income + Dividend Income + Net Trading Income (Loss) + Other Operating Income.
Non-Interest Expenses = Provisions for Credits and Other Receivables + Operating Expenses.
Net Profit = Operating Income – Non-Interest Expenses ± Profit/Losses from Associates and Subsidiaries ± Extraordinary Income (Expenses) – Provision for Taxes.

The surge in profitability of the banking sector in September 2007 was mainly driven by the 18.5 percent rise in operating income (Chart II.8). This rise was triggered by the net interest income, which increased due to interest income on loans. Moreover, the 20.1 percent increase in net fees and commission income as one of the non-interest income components also boosted the operating income.

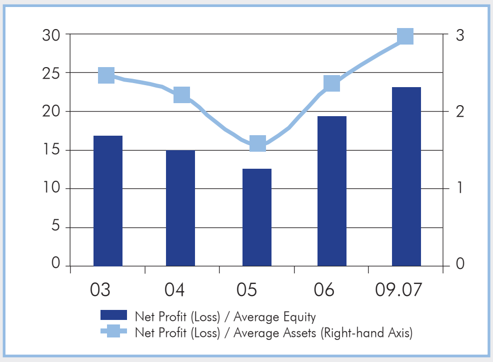
Unlike the same period of the previous year, the sector incurred losses from capital markets transactions in September 2007, whereas net foreign currency losses turned into profits.

Chart II.9.
Net Interest Margin (%)[1]



Source: BRSA-CBRT
(1) Data is annualized for September 2007.

Chart II.10.
Return on Assets and Return on Equity (%)[1]



Source: BRSA-CBRT
(1) Data is annualized for September 2007.

The downward trend in the net interest margin, which is the ratio of net interest income to average interest-earning assets, came to a halt in 2007 and remained at its end-2006 level of 5.2 percent (Chart II.9).

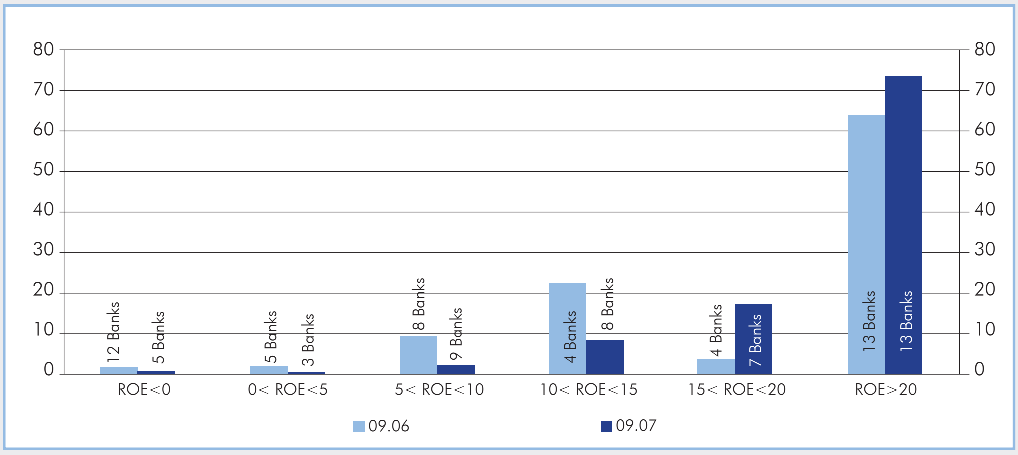
As of September 2007, the average return on assets and the average return on equity were 2.9 percent and 23.3 percent, respectively. Both of these items display an upward trend compared to end-2006 (Chart II.10).

Chart II.11.
Return on Assets and Equity by Selected Countries (December 2006) (%)

Source: BRSA-CBRT, Global Financial Stability Report, IMF-September 2007

When compared with selected countries as of December 2006, the Turkish banking sector displays higher performance, especially with regard to return on assets (Chart II.11).

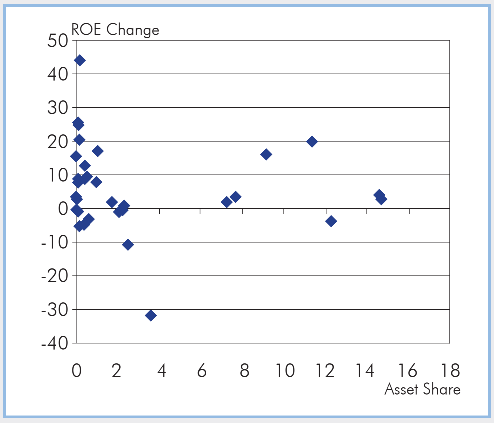
Chart II.12.
Return on Equity Based on Asset Share[1]



Source: BRSA-CBRT
(1) ROE data is annualized.

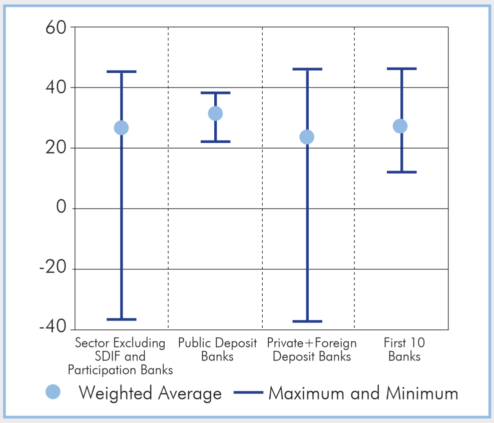
In September 2007, the number of banks with returns on equity over 15 percent rose to 20 from 17, while their share in total assets hiked to 89.9 percent from 66.3 percent. Meanwhile, the number of banks that incurred losses declined to five from twelve banks (Chart II.12).

**Chart II.13.
Change in Deposit Banks' Return on Equity (September 2006-2007) (%)[1]**



Source: BRSA-CBRT
(1) ROE data is annualized.

**Chart II.14. ROE:
Weighted Average, Maximum and Minimum (September 2007) (%)[1]**



Source: BRSA-CBRT
(1) ROE data is annualized.

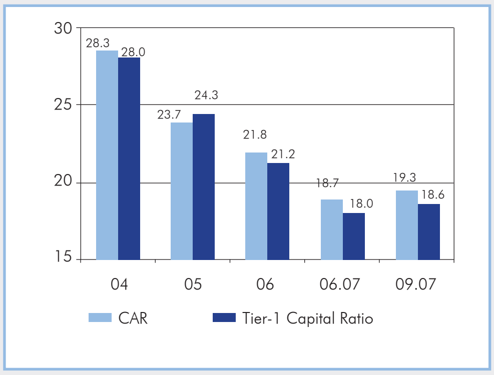
A comparison between the September 2007 and September 2006 periods reveals that the change in return on equity is more significant in small banks. The change in return on equity of the banks with a share exceeding 6 percent of total assets is moderate, except for two banks with higher asset shares. The changes in the structures of these banks have affected their profitability (Chart II.13).

As of September 2007, the value range for the return on equity (ROE) is narrow for public deposit banks and the largest ten banks. The broader range for private and foreign deposit banks results from the effect of small banks (Chart II.14).

II.2.2. Capital Adequacy[6]

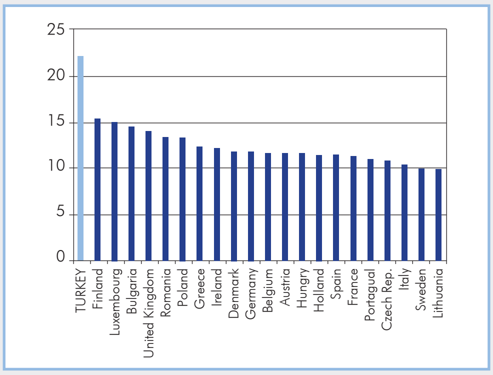
Although the unconsolidated capital adequacy ratio (CAR) of the banking sector, which is the ratio of own funds to risk weighted assets, pursues a declining trend, it is well above both the minimum requirement of 8 percent and the target ratio of 12 percent for all periods under review.

**Chart II.15.
Capital Adequacy Ratio (Unconsolidated) (%)**



Source: BRSA-CBRT

**Chart II.16.
CAR-Selected EU Countries and Turkey (December 2006) (%)**



Source: BRSA-CBRT, EU Banking Sector Stability, November 2007

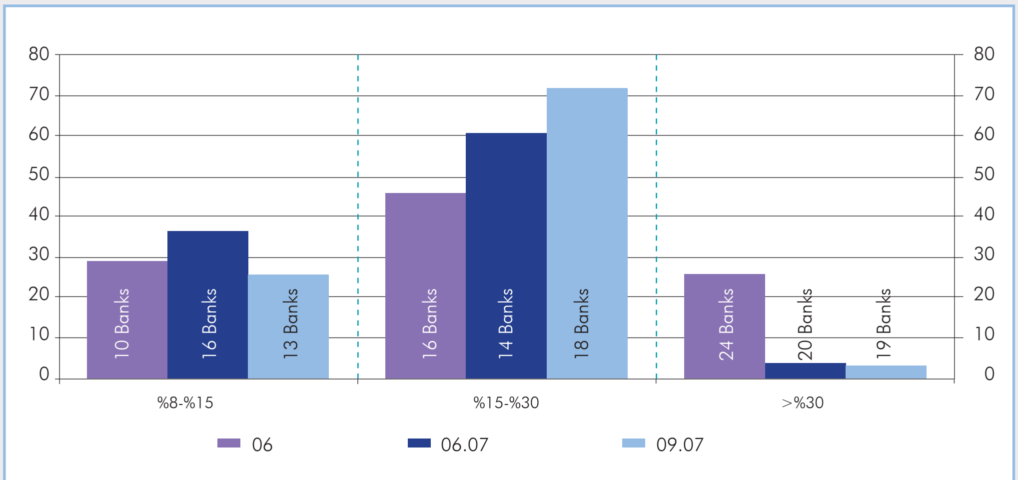
[6] Assessments in this section include participation banks.

The CAR of the banking sector decreased by 2.5 percentage points in September 2007 compared to end-2006 and became 19.3 percent (Chart II.15). The fall in CAR in June 2007 essentially resulted from the fact that the requirement for banks to hold additional capital to cover operational risks was stipulated as of that period. The additional capital held to cover operational risks in September 2007 stimulated a 2.8 percentage point decline in the CAR. However, the increase in net profit has helped raise the CAR to 19.3 percent from 18.7 percent in the last three months.

The tier-1 capital ratio, which is the ratio of core capital to risk weighted assets, declined compared to end-2006 owing to the increased amount of capital required to cover operational risks and the growth in loans. However, this ratio was still as high as 18.6 percent as of September 2007, which indicates that the Turkish banking sector has a high-quality capital structure.

In comparison with selected EU countries, the CAR of the Turkish banking sector is high due to the fact that Turkish banks hold large portfolios of risk-free Government Debt Securities (Chart II.16). The tier-1 capital ratio of the Turkish banking sector, which was 18.6 as of September 2007, outstripped the tier-1 capital ratio of the Eurozone banking sector, which was 8,2[7] as of end-2006.

Chart II.17.
Asset Share of Banks Based on Capital Adequacy Ratio (%)

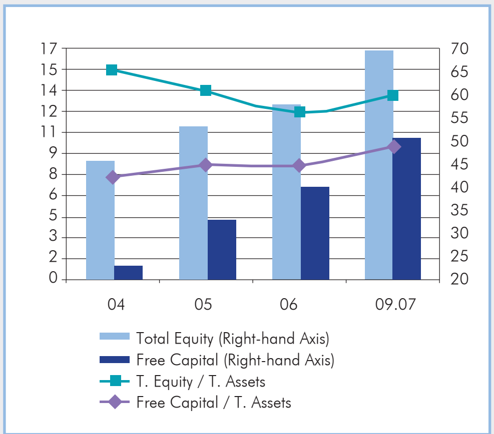


Source: BRSA-CBRT

The capital adequacy ratio of the 34 banks, which hold 63.8 percent of the sector assets, remained above 15 percent as of June 2007, while that of the 37 banks holding 74.6 percent of the sector assets remained above 15 percent in September 2007 (Chart II.17). It is observed in June 2007 that there is a dramatic decline in asset shares of the banks which had a capital adequacy ratio above 30 percent. This stemmed from the fact that two banks having large asset shares migrated to the group with a capital adequacy ratio of 15-30 percent due to the capital that they reserved for operational risks.

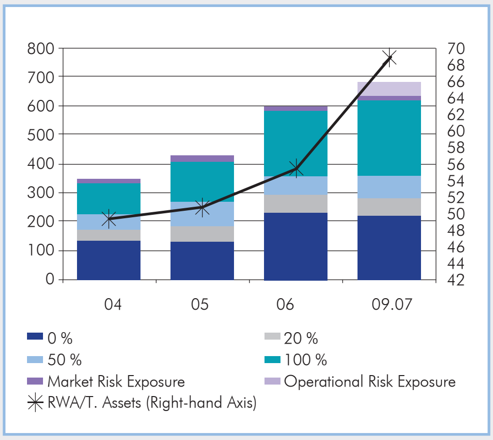
[7] EU Banking Sector Stability, November 2007

Chart II.18.
Free Capital of the Banking Sector
(%, Billion YTL)



Source: BRSA-CBRT

Chart II.19.
Assets According to Risk Weights
(Billion YTL, %)



Source: BRSA-CBRT

The ratio of free capital to total assets and the ratio of total equity to total assets increased remarkably as of September 2007. The higher rate of increase of free capital and total equity compared to that of total assets has been influential in this increase in the said ratios (Chart II.18).

As a result of the faster growth rate of risk-weighted assets, the ratio of risk-weighted assets to total assets, which was 55.4 percent in end-2006, increased to 68.8 percent in September 2007 (Chart II.19). This rise mainly stemmed from the amount subject to operational risk which makes up 7 percent of the risk-weighted assets. In the same period, another determinant of this rise was the growth of 100 percent risk-weighted assets by YTL 38.2 billion compared to the end of the previous year due to the upsurge in loans (Chart II.19).

Box 7.
Transition to Basel II

Work for harmonization with Basel II carried out by the Turkish financial sector, primarily the BRSA is underway. Recently, the QIS-TR2 study was conducted by the BRSA based on the September 2006 figures, with the participation of 31 banks holding nearly 97 percent of total sector assets. The results of the study, announced in July 2007, have indicated that the current capital adequacy ratios of banks will decrease by 5.6 points along with the transition to Basel II.

Meanwhile, in an announcement made in July 2007, the BRSA underlined that most of the EU countries that were foreseen to adhere to Basel II at the turn of 2007 had failed to complete this process. It was also stated that the real sector's deficiencies in financial reporting are an obstacle to the adoption of the concept of rating. The BRSA also announced that the majority of Turkish banks call for the postponement of Basel II implementation, since FX denominated government debt securities with a 0 percent risk weight under current practice will be weighted on the basis of country note in accordance with Basel II and accordingly, the capital requirements of banks for such assets will increase. Due to the requirements and rationales mentioned above, the BRSA has postponed implementation relating to the ratings-based calculation of credit risk that will be taken as the basis in the measurement of the capital adequacy of banks, to the start of 2009, instead of early-2008 as announced earlier.