I. MACROECONOMIC DEVELOPMENTS

In this chapter, macroeconomic developments will be explained, taking into account the importance of such developments for financial stability.

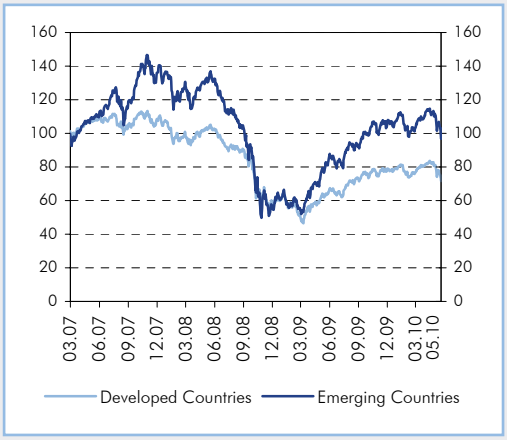
I.1. External Sector

I.1.1. International Developments

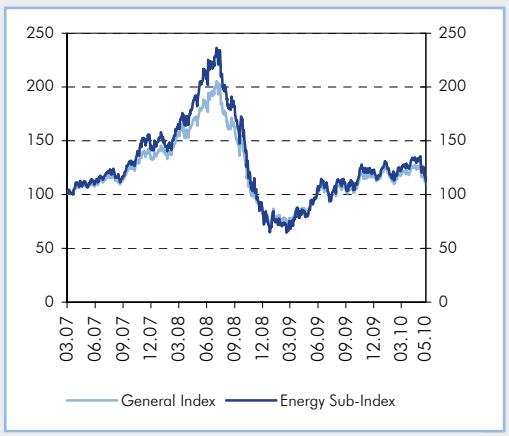
The recovery that started in March 2009 on the back of the perceptions that the exit process from crisis accelerated in financial markets, continued until the last few weeks when concerns over debt sustainability of some EU countries led to sharp movements. The other principal drivers of the recovery in question were the counter-cyclical monetary policies adopted by central banks, the rising risk appetite and capital flows (Chart I.1). The future trend of the markets will be determined by the developments pertaining to debt-sustainability of countries and the reactions to the measures taken thereto.

Chart I.1.
Equity and Commodity Prices

MSCI Equity Price Indices
(01.01.2007=100)

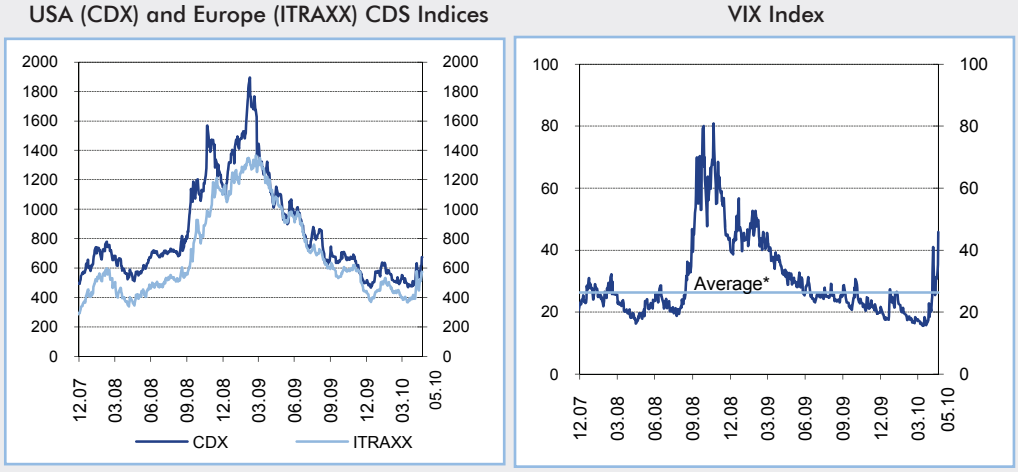


S&P Goldman Sachs Commodity Price Indices
(01.01.2007=100)



Source: Bloomberg

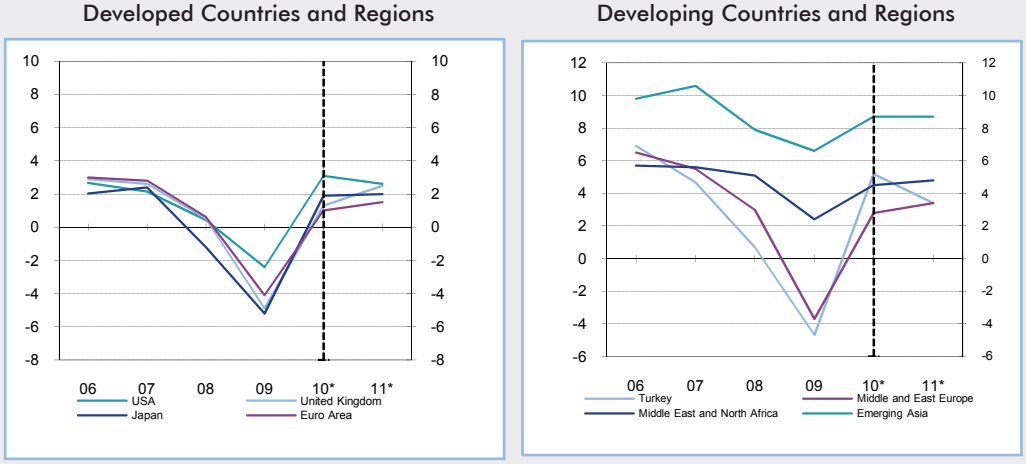
Chart I.2.
CDS Indices in USA and Europe and US Volatility Index



Source: Bloomberg
(*) Average of March 2009-March 2010 period.

Boosted by increased optimism in the markets, the rise in asset prices and the decline in volatility continued in the first few months of 2010 as well. In the same period, significant increments were recorded in price/earning ratios and it was observed that financial markets reflected expectations for a fast and strong recovery in prices. Accordingly, credit default swap ratios, which denote the insurance premia that firms pay as a precaution against default risk, decreased significantly too (Chart I.2). However, concerns over debt-sustainability of some EU-countries fed the volatility in the markets (Chart I.2).

Chart I.3.
Growth Rates in Selected Countries (Annual percentage change)

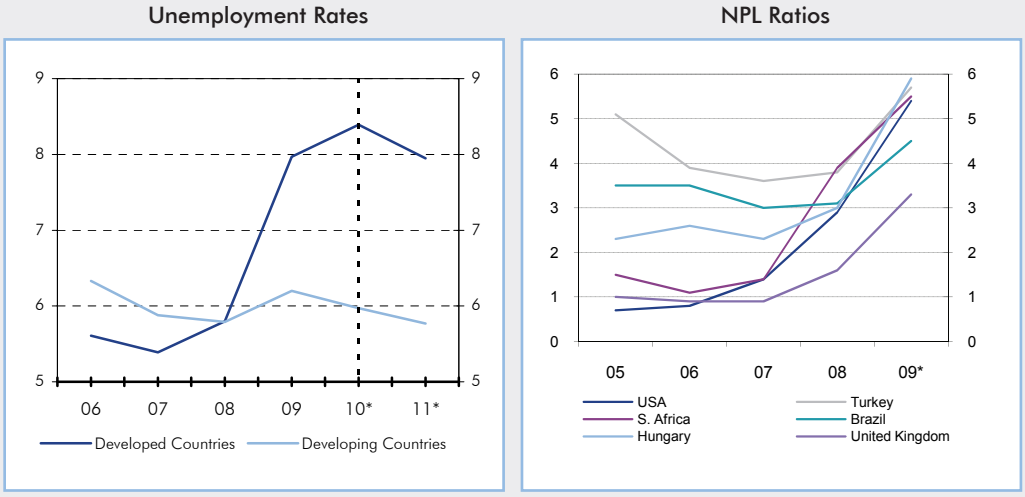


Source: IMF WEO
(*) Forecast (IMF, April 2010)

Developments in financial markets bolstered by the stimulus packages introduced by governments had a favorable impact on aggregate demand and the real economy. Indeed, global growth prospects for 2010 rose to 4.2 percent[1]. This rapid recovery is expected to be driven by developing Asian countries and the USA; and growth in European countries that are struggling with high budget deficits is expected to be slower (Chart I.3).

[1] IMF World Economic Outlook, April 2010.

Chart I.4.
Unemployment and NPL Ratios (%)[1]

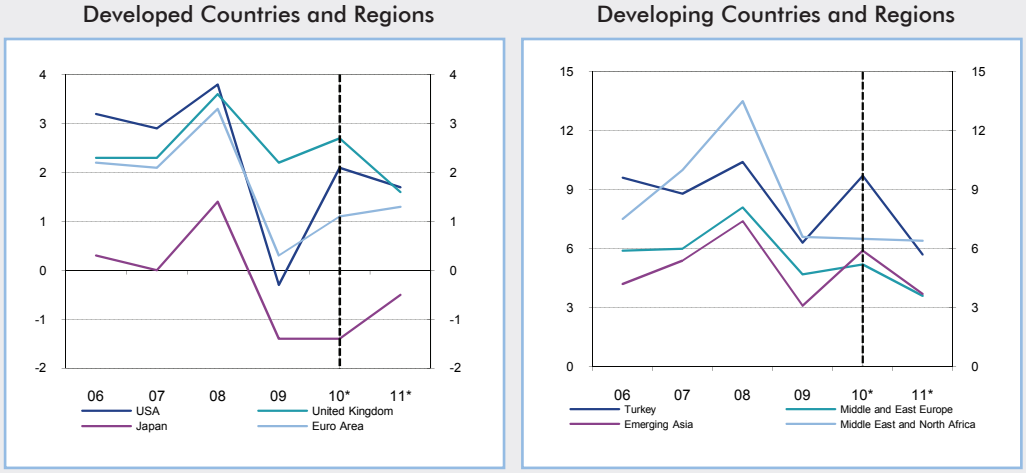


Source: IMF WEO and IMF GFSR, April 2010
(*) Forecast

(*) As of June, September and October for S. Africa, Brazil and Hungary, respectively.

Despite higher growth expectations and favorable financial market conditions, the risks pertaining to global financial stability and the economy in general persist to a great extent. The contribution of high growth expectations worldwide to reducing unemployment rates are estimated to be limited especially in developed economies (Chart I.4). As this development can affect the default rates of consumer loans in developed countries, it could lead to deterioration in asset quality and continue to be a vulnerability factor for the global financial system.

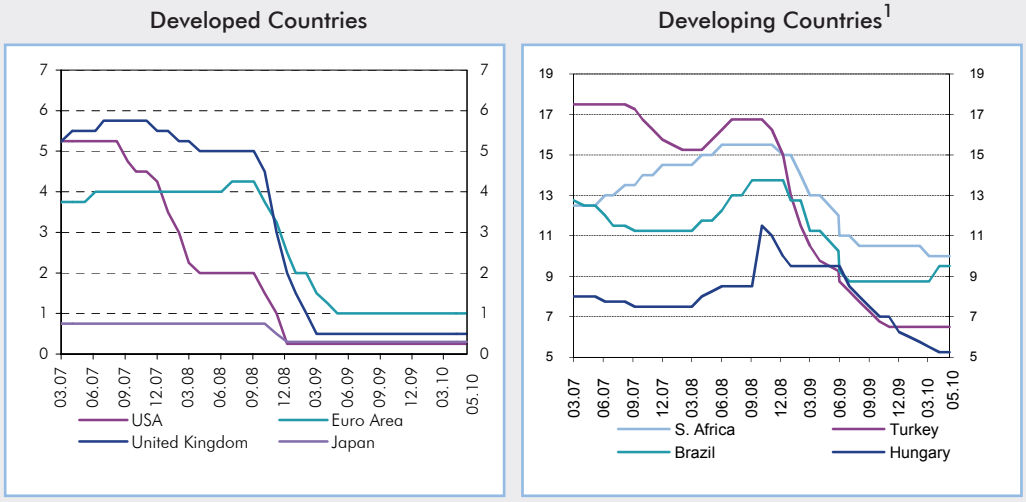
Chart I.5.
Inflation Rates (CPI annual percentage change)



Source: IMF WEO
(*) Forecast

Meanwhile, the recent recovery in global demand, the improvement in growth expectations and the rise in risk appetite has influenced commodity prices too and the prices of many commodities bounced back to September 2008-levels when the crisis hit the bottom (Chart I.1). The surge in commodity prices and the likely price increments in oil prices in the upcoming period might exert an upward pressure on general prices especially in oil-importing countries (Chart I.5). It is highly possible that the number of European Union–member states struggling with debt issues, like Greece, may increase and, hence, growth may become sluggish in the Euro area in the upcoming period, which can curb upward movement in commodity prices.

Chart I.6.
Policy Rates in Selected Countries (%)



Source: National Central Banks
(1) Overnight borrowing rate has been used for Turkey.

In the light of these developments and taking into account the fact that economic recovery is not yet at the desired level, it is estimated that developed economies would not move into the rate-increase cycle for an extended period. However, it is observed that the normalization process in monetary policies of developing countries, where the crisis was less destructive and fiscal positions were stronger, has already started. Indeed, the central banks of some developing countries such as India, Malaysia and Brazil have started to increase policy rates (Chart I.6).

Until recently, inflation rates, which had been heading downwards worldwide because of contracted demand due to the global crisis, have enabled central banks to implement counter-cyclical monetary policies by effectively using monetary policy instruments against the crisis. Budget deficits and high indebtedness levels are expected to continue in countries that increased public expenditures for the sake of boosting domestic demand in spite of declining tax revenues. This, in return, will likely lead to banks' crowding-out the private sector, firstly by keeping more state securities in their portfolio and secondly by limiting credit sources. The still-low level of real interest rates and a recovery that is not yet at the desired level in developed countries decreases the chances of interest rates being increased in the short run, which, in turn, increase the likelihood that the capital requirements of developed countries will not be adversely affected by this "crowding-out effect" in the short and medium run.

Box 1.
The Fiscal Problems of the Countries in the Euro Area and the Possible Effects of These Problems on the Banking Sector

Recent fiscal problems experienced in Greece have raised concerns about the debt sustainability of other countries that also have high budget deficit and indebtedness ratios. Especially, high budget deficits of the Euro Area countries, which are also called PIIGS, such as Portugal, Ireland, Italy, Greece and Spain, have caused selling pressure on their government bonds and as a result, their sovereign Credit Default Swap (CDS) spreads have increased significantly (Chart I.7). These developments require rapid implementation of fiscal reforms in these countries, which have not been able to achieve public savings and have had high budget deficits for a long period of time (Table 1).

Table 1. The Primary Budget Surplus/Deficit (PBS) and Public Debt to GDP Ratios (%)

	2006		2007		2008		2009	
	PBS	Debt	PBS	Debt	PBS	Debt	PBS	Debt
Portugal	-1.2	64.7	0.2	63.6	0.1	66.3	-6.6	76.8
Italy	1.3	106.5	3.5	103.5	2.5	106.1	-0.6	115.8
Ireland	4.0	24.9	1.2	25.0	-5.9	43.9	-12.2	64.0
Greece	0.6	97.8	-0.9	95.7	-3.1	99.2	-8.5	115.1
Spain	3.7	39.6	3.5	36.2	-2.5	39.7	-9.4	53.2

Source: Eurostat

The debt crisis of PIIGS countries threatens the entire European banking system. The size of European banks' exposures to these countries indicates that the problems in PIIGS countries could be a serious threat to financial stability (Table 2).

Table 2. The Size of the Banks' Exposures to PIIGS Countries in terms of Ownership (Billion US dollar)

Financial Risk (As of the End of December 2009)				
PIIGS/Affected Country	Germany	France	England	Europe
Portugal	47	45	24	241
Italy	190	511	77	1,033
Ireland	184	60	188	635
Greece	45	75	15	189
Spain	238	220	114	851
Total	**704**	**911**	**418**	**2,949**
Total Assets[1]	9,862	9,048	11,070	52,857
The Percentage in the Total Assets (%)	7.1	10.1	3.8	5.6

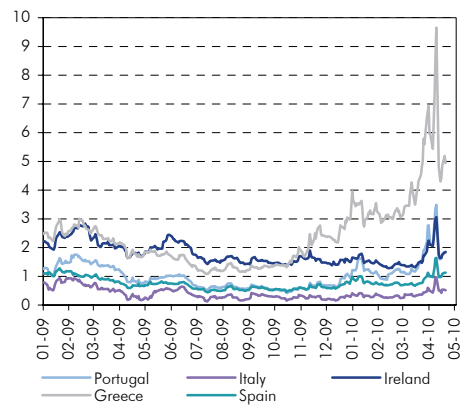
Source: BIS
(1) The size of the total assets of Euro Area institutions, which grant loans, is as of year-end 2008.

The ratio of exposure to PIIGS countries to total assets have reached to 7.1% in Germany, 10.1% in France, 3.8% in England and 5.6% in the entire Europe in 2008. In May, with the decision of Euro Area leaders, a financial support of 750 billion Euro is agreed to be used for countries which may experience difficulties due to fiscal deterioration and precautions have been taken for the possible threats such as extension of the debt problem and destabilizing of the region and the Euro.

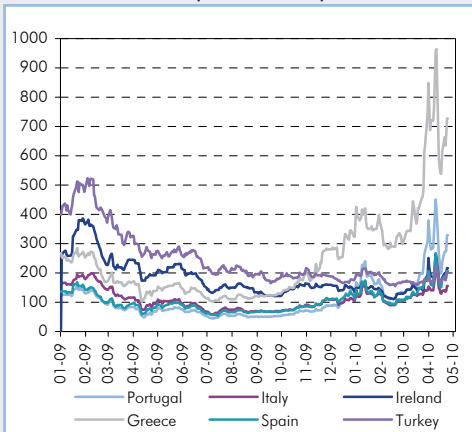
In the continental Europe, the fiscal discipline problems in the so-called PIIGS[2] countries have grown big enough to threaten the markets. As concerns grew over the spread of these risks to other countries, the sale of both public and private securities rallied worldwide. In the markets, the default risk perception for these countries grew bigger and led to sharp rises in the interest rate of their treasury bills (Chart I.7). Due to this development, banks holding treasury bills of these countries in their portfolios might need additional capital.

Chart I.7.
Government Bond Rates and CDS Ratios for PIIGS Countries

Government Bond Rates for PIIGS Countries (%)[1]



CDS Ratios for Turkey and PIIGS Countries (Basis Points)



Source: Bloomberg
(1) Spread between 10-year government bonds of countries that are used by the Bloomberg and the German government bonds of the same maturity.

Box 2. Measures Taken Against The Latest Developments in Europe

The impact of the global financial crisis that initially affected the U.S. and immediately afterwards the Europe in 2008, have been less severe on European banks compared to the U.S. banks. Though there are some views indicating that they are delayed, the measures taken against the crisis have significantly contributed to eliminating unfavorable effects and establishing promising market conditions.

However, rising public debt due to the actions taken during this process has caused concerns about the indebtedness levels of the countries to prevail in markets. In addition, detection of incorrect and misleading data in its statistics has attracted attention on Greece. Furthermore, increasing concerns, which are affected by the downgrade in the country's credit ratings below the investment grade level, have led jumps in CDS spreads in early May. Due to these adverse conditions, on May 8-9 2010, EU countries decided on a new package of measures.

Under the framework of the "European Financial Stability Mechanism", the Economic and Financial Affairs Council (ECOFIN) agreed on a fund of €500 billion, of which € 440 billion comes from the Euro Zone countries whereas €60 billion is provided by emergency funds of the European Commission. An additional €250 billion from the IMF is decided to be part of this fund. The fund is raised to aid member states in extraordinary circumstances, which may

[2] Portugal, Italy, Ireland, Greece and Spain.

happen beyond the control of the countries. Considering the contagion effects of the adverse developments, tightening measures for the public debt and structural reforms in the European region are agreed to be accelerated and in this framework, the measures taken by Spain and Portugal are decided to be monitored. Moreover, fiscal consolidation and crisis resolution efforts have been geared up among the EU countries and the proposed support to ECB for stabilizing the Euro zone is confirmed.

Moreover, several major central banks decided to take some measures to eliminate the negative impacts of the serious problems in the markets on the effectiveness of monetary policy. In this regard, on May 10, 2010, the ECB decided;

- To conduct operations to sterilize excess liquidity due to the prospective interventions within the context of "Securities Market Programme" that covers the Euro zone public and private debt securities markets in order to eliminate the problems in the securities market and to rebuild sound monetary transmission mechanism,
- To adopt a fixed-rate for all the regular 3-month longer-term refinancing operations (LTROs) to be allotted on May 26 and June 30, 2010,
- To conduct a 6-month LTRO with full allotment on May 12, 2010, at a rate which will be fixed at the average minimum bid rate of the main refinancing operations (MROs) over the life of this operation,
- To reactivate the temporary liquidity swap lines with the Federal Reserve in coordination with other central banks, and resume US dollar liquidity-providing operations at terms of 7 and 84 days, where the first operation is set to be carried out on May 11, 2010

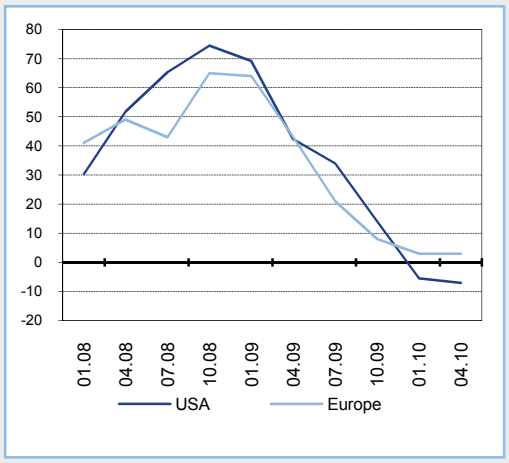
In response to the reemergence of strains in the US dollar short-term funding markets in Europe, the temporary US dollar swap lines reestablished among Bank of Canada, Bank of England, European Central Bank, Federal Reserve, Swiss National Bank and Bank of Japan. Related to this temporary facility, similar to arrangements that were in place previously, Fed will provide Bank of England and Swiss National Bank with the US dollars at fixed rates to be supplied to their local markets. As for the arrangement with the Bank of Canada, drawings up to $30 billion would be financed, as was the case before. These swap arrangements have been authorized through January 2011.

Source: European Commission, ECB, Fed and Central Banks.

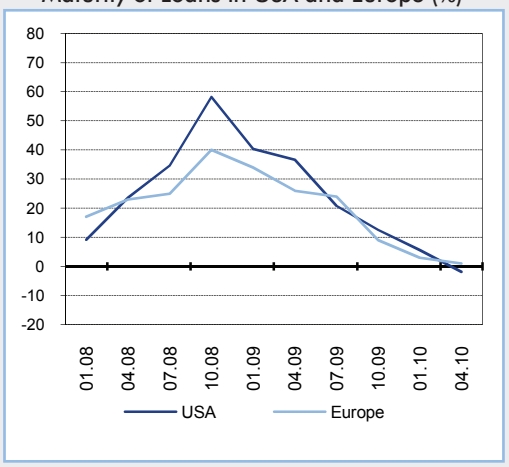
Meanwhile, yield curves have been steeper recently. This increases the countries' debt burden as well as the banking sector's risk of incurring loss because of their security portfolios and also encourages short-term funding in the banks of developed countries. Moreover, the reduced activity in securitization markets makes banks reluctant to extend credits. Indeed, surveys regarding lending conditions reveal that even if the number of banks with tight credit conditions has decreased, the tightness in credit conditions during the crisis has been maintained and banks continue to be cautious (Chart I.8).

Chart I.8.
Credit Survey Results of US and European Banking Sectors (%)

Ratio of Banks That Have Tightened Lending Conditions in USA and Europe (%)[1]



Ratio of Banks That Have Shortened the Max. Maturity of Loans in USA and Europe (%)[2]

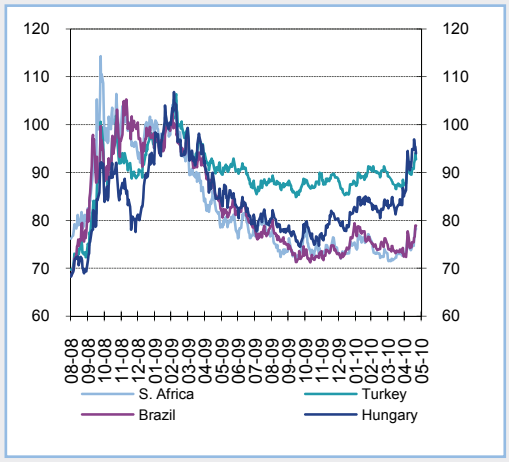


Source: Fed, ECB.
(1) The figures indicate net result generated by subtracting the ratio of the banks that have loosened lending conditions from the ratio of banks that have tightened lending conditions. While a positive number denotes tightening, a negative number denotes loosening.
(2) The figures indicate net result generated by subtracting the ratio of banks that have loosened from the ratio of banks that have shortened the maximum maturity. While a positive number denotes tightening, a negative number denotes loosening the credit conditions.

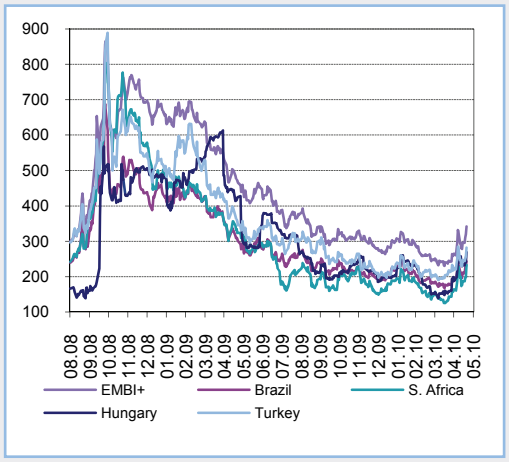
Low short-term interest rates, which are a result of measures taken by countries and are expected to continue for a while, coupled with increased capital flows towards developing countries due to the climbing risk appetite, lead to appreciation of national currencies; decline in risk premia and a rise in asset prices in the countries in question (Chart I.9 and Chart I.1).

Chart I.9.
Exchange Rates and Risk Premia in Selected Developing Countries[1]

Value of National Currencies of Selected Countries in terms of USD (27.02.2009 = 100)



EMBI+



Source: Bloomberg
(1) The country risk premium is the difference between the related country's EMBI+ index and the yield of US Treasury Bills.

While foreign capital is very important for growth in developing countries, the recent rally in asset prices and increased capital flows can potentially threaten financial stability in these countries. In this respect, the timing and strategy of the exit from the extraordinary measures that governments have taken against the crisis is crucial for the stability of the global financial system. For the time being, there are concerns whether the private sector can provide the necessary contribution to growth if the stimulus packages provided by governments in developed countries are withdrawn. The increased liquidity in the markets, which is the result of excessive expansion of balance sheets of central banks, urges banks to opt for short-term funds and to invest these funds in high-risk assets with lower costs. Even if the high net profit margin and the commercial profits that banks generate in this way reinforce the capital structure of the system, it delays recovery in securitization markets, which is a vital source of wholesale funding. Unless the wholesale and long-term funding market mechanisms become operational again, it would take some time for long-term credits to recover. Moreover, once banks return to high profit levels, they would be less willing to adopt risk-oriented restructuring.

To conclude, optimism that the recession had come to an end was rather short-lived and the risks pertaining to the sustainability of recovery without government stimulus, probability of the measures taken against the crisis creating debt crisis on public deficits and concerns over their spill-over effects have replaced this optimism. Within this framework, should these risks materialize, global economies will be able to exit the crisis slower than it had been expected.

Box 3. Systemic Risk and Macro-prudential Policies

Global crisis has revealed that policies aimed at containing a systemic crisis are not sufficiently effective. With their main purpose of achieving price stability, monetary policy actions have been proven ineffective in considering credit growth and asset prices increases as well as in terms of preparedness against crises. On the other hand, micro-prudential policies, focusing on the resilience of individual financial institutions against crises, have been deficient in mitigating system-wide risks.

As a result, macro-prudential policies aimed at minimizing the formation of systemic risks and their potential impact on the society as a whole have attracted attention in international platforms. Especially, their importance as a complement to micro-prudential policies that deal with financial institutions have been clearly recognized.

Macro prudential policies' approach to systemic risk can be assessed with its two aspects. The first is to take into account the evolution of risks in time and to develop counter cyclical measures. Market participants tend to take excessive risk in times of positive market conditions whereas they do just the opposite when market conditions deteriorate. Having this tendency in mind, macro-prudential policies that encourage accumulating resources in good times to be used in bad times are employed to mitigate the propensity for pro-cyclical business practices.

The second aspect of systemic risk is to observe the distribution of risks in a specified period of time and in this context, to analyze the contagion effect among firms and markets as well as the concept of contribution to systemic risk. With this perspective, risks caused by systemically important financial institutions are in focus and work is underway to create measures that would contain such risks by imposing additional requirements and to ensure effective resolution of cross-border financial institutions on international platforms.

In terms of national practices, it is observed that many jurisdictions place more and more importance on systemic risk and they implement various macro-prudential measures, though with different structures and methods. To mitigate systemic risk caused by pro-cyclicality, measures concerning credit markets are of special importance. Imposing a limit on loan utilization of some sectors, controlling rapidly growing risks by additional regulations, increasing risk-weights for some claims or transactions, such as claims on credit cards, to require more capital, tax-like deductions on loans and dynamic provisioning can be counted among such measures implemented by countries.

Some measures that have been taken to prevent links between financial institutions and some vulnerabilities of the system from creating systemic risk are requiring additional capital, limiting inter-bank exposures, risk-based deposit insurance premiums, temporary restrictions on dividend payments, limiting loan to deposit ratios and restrictions on FX risk. Similar measures are also being used effectively in Turkey.

Although these developments at national level are considered constructive, it is obvious that systemic impact of risks cannot be mitigated globally without international cooperation and coordination. Therefore, as a complement to national initiatives and with the coordination of G-20 and Financial Stability Board, various policy measures are being developed by international organizations in order to suppress accumulating macro risks in the financial system. Implementation of counter cyclical capital buffers, compulsory leverage and liquidity ratios, imposing additional capital and liquidity obligations on systemically important financial institutions are issues that are priority items on the agenda of international organizations. Work that is carried out on this issue by the FSB and all the initiatives therein, is being closely monitored in coordination and collaboration with other relevant authorities by the Central Bank of Turkey, which is responsible for representing our country at the FSB.

According to Law No. 1211 primary objective of the Central Bank has been set as "to achieve and maintain price stability" and to support this objective the Bank has been charged with "taking precautions for enhancing the stability in the financial system". Additionally, because of its role in payment and settlement systems and its lender of last resort function, the Bank places great emphasis on monitoring and preventing macro risks. In this context, Systemic Risk Coordination Committee that has been established according to the MoU signed among the Undersecretariat of Treasury, Banking Regulation and Supervision Agency, Central

bank of the Republic of Turkey and Savings Deposit Insurance Funds has assumed an important responsibility for minimizing the systemic impact of the potential problems that could occur in the financial sector by adapting current regulations to deal with systemic risk and directly taking measures to reduce macro risks.

I.1.2. Balance of Payments

The current account deficit, which hit the historically high level of USD 49.2 billion on an annualized basis in August 2008, assumed a rapid downward trend due to the unfavorable impact of the global crisis on investment and consumption demand, and decreasing energy prices. The current account deficit fell to as low as USD 12.6 billion in October 2009, which is the lowest level recorded since August 2004. The current account deficit started to increase again as of the last quarter of 2009 due to imports demand underpinned by the revival in domestic demand and reached USD 21.9 billion as of March 2010 (Table I.1).

Table I.1. Balance of Payments (Billion USD)

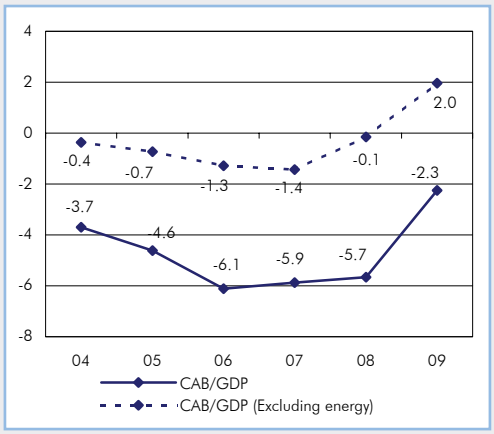
	2006	2007	2008	2009	03.10*
CURRENT ACCOUNT	**-32.2**	**-38.3**	**-41.9**	**-14.0**	**-21.9**
Foreign Trade Balance	-41.1	-46.8	-53.0	-24.9	-32.1
Total Exports of Goods[1]	93.6	115.4	140.8	109.7	111.6
Total Imports of Goods[1]	-134.7	-162.2	-193.8	-134.6	-143.7
Coverage Ratio (%)	69.5	71.1	72.6	81.5	77.7
Balance of Services	13.6	13.3	17.1	16.3	15.9
Balance of Income	-6.7	-7.1	-8.2	-7.7	-7.8
Current Transfers	1.9	2.2	2.1	2.3	2.1
CAPITAL & FINANCE ACCOUNT	**32.1**	**36.7**	**36.3**	**9.0**	**20.2**
Direct Investments	19.3	19.9	15.7	6.1	5.0
Portfolio Investments	7.4	0.7	-5.0	0.2	6.0
Other Investments	11.5	24.1	24.6	2.8	11.5
Reserve Assets	-6.1	-8.0	1.1	-0.1	-2.3
NET ERRORS & OMISSIONS	**0.1**	**1.6**	**5.6**	**5.0**	**1.7**

Source: CBRT
(*) Cumulative figures for the last 12 months.
(1) Including shuttle trade, goods procured in ports by carriers and non-monetary gold.

The current account deficit, which was USD 41.9 billion at the end of 2008, decreased to USD 14 billion at the end of 2009 with the effect of the crisis, while the ratio of current account deficit to GDP decreased from 5.7 to 2.3 percent in the mentioned period. When imports and

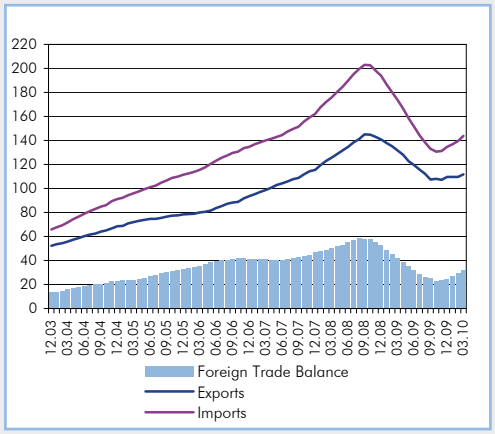
exports of energy items -the primary source of current account deficit- are excluded, Turkey's current account for 2009 is in surplus and this shows the determining role that Turkey's dependency on external energy resources plays on her current account deficit (Chart I.10).

Chart I.10.
Ratio of Current Account Balance to GDP[1] (%)



Source: CBRT, TURKSTAT
(1) Current account balance excluding energy is calculated by subtracting the net energy imports from the current account deficit. According to International Standard Industrial Classification (ISIC, Rev. 3), energy sub-items taken into account while calculating the net energy imports are stone coal and lignite, crude oil and natural gas under the mining and quarrying sector, and coke coal, refined petroleum products and nuclear fuels under the manufacturing industry.

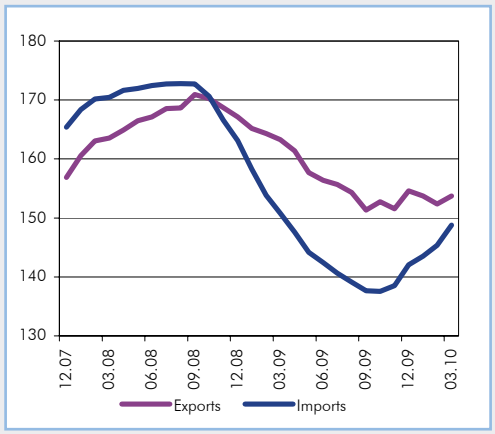
Chart I.11.
Export - Import Volumes and the Trade Deficit[1] (Billion USD)



Source: CBRT
(1) Cumulative figures for the last 12 months.

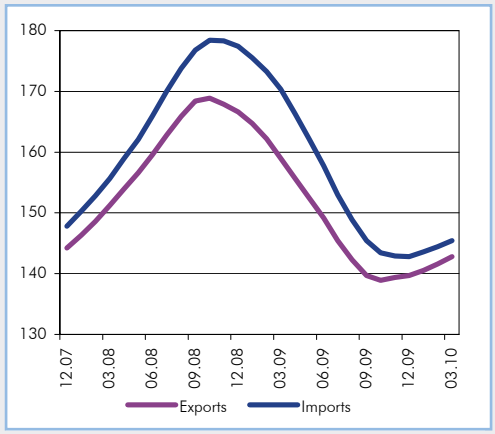
The downward trend in imports and exports, the major components of the current account, which started in October 2008 in annual terms, halted in the last quarter of 2009 and, as of early 2010, imports once again started to climb rapidly. Meanwhile, the recovery in exports, which displayed a relatively limited decline during the crisis, lags behind due to the weak course of external demand conditions and this pushes the foreign trade deficit up (Chart I.11, Chart I.12, Chart I.13).

Chart I.12.
Imports and Exports Quantity Indices[1]



Source: CBRT
(1) 12-month moving averages (2003=100).

Chart I.13.
Imports and Exports Unit Value Indices[1]

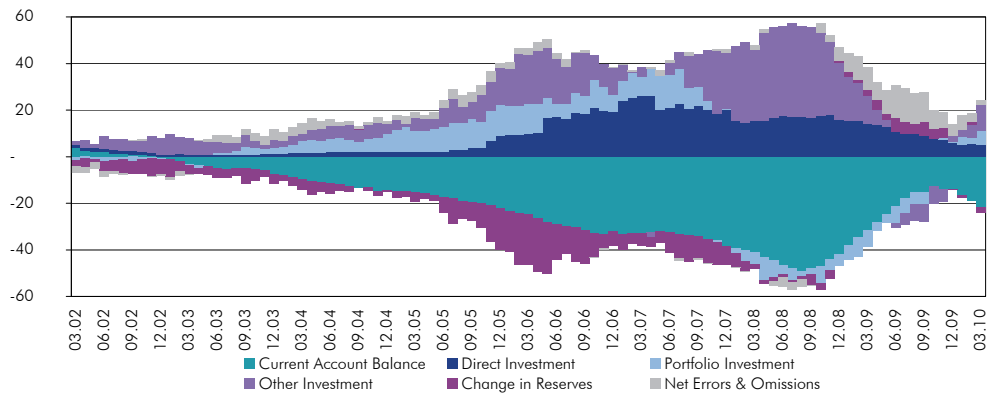


Source: CBRT
(1) 12-month moving averages (2003=100).

Although supported by the limited decline in tourism revenues and increased transportation revenues, the surplus in the balance of services, which is another component of the current account, decreased because of the decline in commissions collected from the trade of goods and revenues from financial services. Meanwhile, the deficit in the balance of income slightly contracted as income transfers decreased and interest expenses fell, as the private sector became net external debt payer.

There has been no significant change in the current transfers that is composed of grants received by the general government and workers' remittances (Table I.1).

Chart I.14.
Development of the Balance of Payments Items[1, 2, 3, 4, 5] (Billion USD)



Source: CBRT
(1) Direct Investments: Net inflows by direct investment (including real-estate)
(2) Portfolio Investment: Net securities purchases (+) / sales (-) of non-residents
(3) Other Investments: Net loan utilization (short-term and long-term) from abroad and deposit movements
(4) Change in Reserves: Increase (-) / decrease (+) in official reserves
(5) Cumulative figures for the last 12 months.

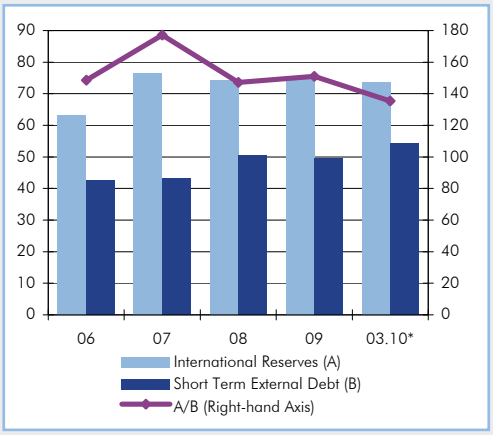
The finance account, which displayed a sharp fall due to the decline in capital inflows and even some outflows due to the global crisis, decreased as low as USD 2.2 billion on an annualized basis in August 2009 coming down to the lowest level recorded since October 2003. As of the second quarter of 2009, capital inflows accelerated again and reached USD 20.2 billion by March 2010 (Chart I.14, Table I.1).

An analysis of the finance account by main sub-items reveals that although foreign direct investments followed a downward trend throughout 2009 due to the global financial crisis, they still remained the most stable financing item of the current account deficit. Meanwhile, capital flows in the form of portfolio investments, which turned outwards in the second half of 2008 due to the global turmoil, turned generally inwards again as of the second quarter of 2009; but followed an unstable trend. The capital inflows in question reached USD 6 billion annually by March 2010 (Chart I.14, Table I.1).

As a result of the crisis, many international financial institutions decreased their leverage, which in return led to tighter credit conditions abroad. Consequently, banks and the corporate sector became net foreign debt payers and this development was reflected on the finance account as capital outflows. However, as of the last quarter of 2009, the value of the finance account

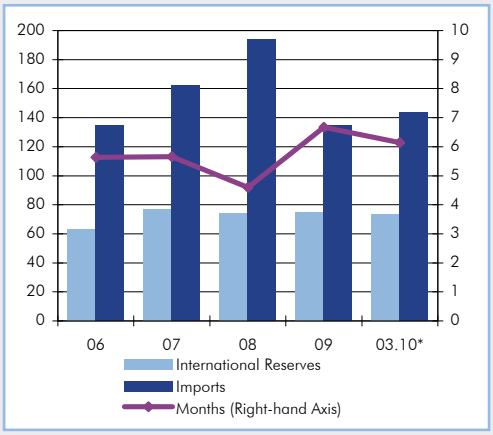
turned positive again as domestic banks decreased their FX assets held at their correspondent banks abroad and non-residents increased their deposits in Turkey.

Chart I.15.
Short-Term External Debt[1] and International Reserves[2] (Billion USD, %)



Source: Undersecreatariat of Treasury, CBRT
(1) Short-Term External Debt = General Government + CBRT + commercial banks+other sectors.
(2) International Reserves = CBRT gross foreign exchange reserves (including gold)
(*) Short-Term External Debt data are provisional.

Chart I.16.
Import Coverage Ratio of Reserves[1,2] (Billion USD, Month)



Source: CBRT
(1) International Reserves = CBRT gross foreign exchange reserves (including gold)
(2) Months figure indicates the number of months of imports covered by the year-end international reserve figure.
(*) Cumulative figures for the last 12 months are used for imports.

One of the indicators of external debt service capacity, the ratio of international reserves to short-term external debt stock, which was 147.2 percent at end-2008, became 135.4 percent in March 2010 due to the rise in short-term external debt-stock and the fall in reserves (Chart I.15). The ratio of international reserves to total imports, which shows for how long a country can provide the inputs needed from external markets without depending on any external support, followed an upward trend throughout 2009 due to the fact that there has been no significant change in reserves despite the slump in imports during the crisis period. The ratio in question has slightly eased by March 2010 parallel to the run-up in imports since the last quarter of 2009(Chart I.16).

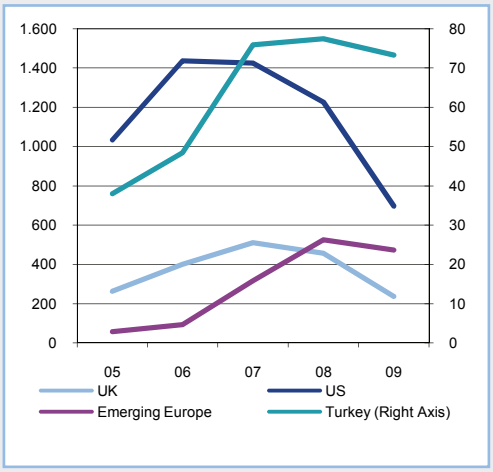
Table I.2. Developments in Financial Accounts (Billion USD)

	2006	2007	2008	2009	03.10*
Current Account	-32.2	-38.3	-41.9	-14.0	-21.9
Finance Accounts	32.1	36.7	36.3	9.0	20.3
General Government (incl. CBRT and reserves)	-2.9	-15.5	-1.4	1.6	5.4
Private Sector (incl. Banks)	35.0	52.2	37.7	7.3	14.9
Net Errors & Omissions	0.1	1.6	5.6	5.0	1.7

Source: CBRT
(*) Cumulative figures for the last 12 months.

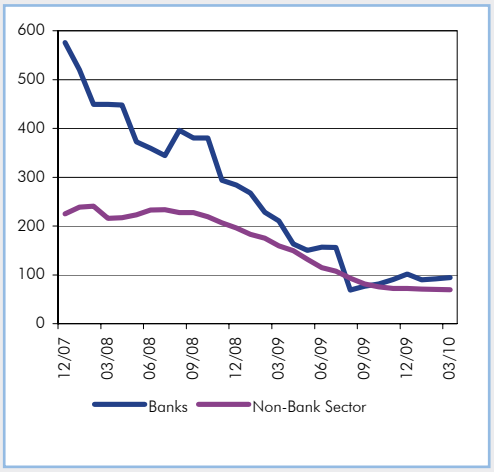
While the main determinant of the financial account used to be long-term funds obtained by the private sector including banks, this has changed recently and in addition to the funds obtained by the private sector, the general government has started to engage in the financing of the current account deficit via loans from abroad and government bond issues (Table I.2).

Chart I.17.
Net Assets of International Banks in Selected Countries[1] (Billion USD)



Source: BIS
(1) Data for end-2009 are provisional.

Chart I.18.
Roll-over Ratios1 for Long-term Loans of Banks and Non-Bank Sector[2] (%)



Source: CBRT
(1) 12-month moving averages of the roll-over ratios are used.
(2) Non-Bank Sector comprises all real persons and public and private entities excluding banks and the general government.

By the end of 2009, net assets of banks reporting to the Bank for International Settlements (BIS) in the US and UK remained below the pre-crisis level, while they remained flat in emerging European countries. Meanwhile, net assets of these international banks in Turkey displayed a downward trend with the onset of the crisis and declined to USD 73.3 billion by the year-end (Chart I.17).

Rollover ratios of long-term loans borrowed by the banks and the non-bank sector from abroad decreased significantly compared to the pre-crisis period. Both the banks and the non-bank sector have been net payers of long-term loans for the last year and they have held onto a decreasing trend for their external debt (Chart I.18).

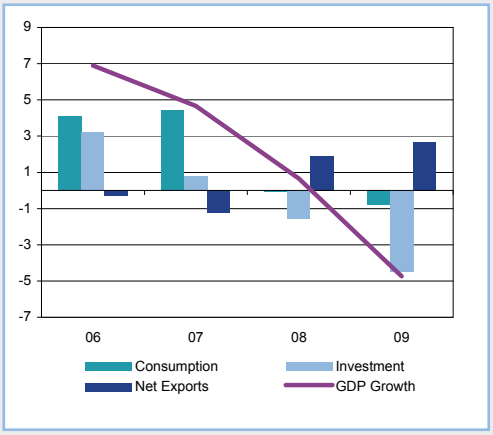
To conclude, the current account deficit, which rapidly narrowed starting from the last quarter of 2008 owing to the slowdown in economic activity due to the crisis and the decline in energy prices, has begun to widen again as of the last quarter of 2009 with the rise in imports propelled by the recovery in domestic demand on the back of the fading effects of the crisis. Moreover, growth in European countries, which are the most important trade partners of Turkey, has not accelerated yet and this creates an expansionary effect on the current account deficit by adversely affecting our exports performance. Therefore, Turkey's export performance, which is closely related to the recovery in European economies, and the course of energy prices that have a significant weight in Turkey's imports will determine the course of current account deficit in the upcoming period.

I.2. Growth and Inflation

In 2009, the Gross Domestic Product (GDP) shrank by 4.7 percent due to global financial turmoil (Chart I.19). The economic contraction observed as of the last quarter of 2008 was reversed as of the last quarter of 2009. It is projected that a high growth rate will be achieved,

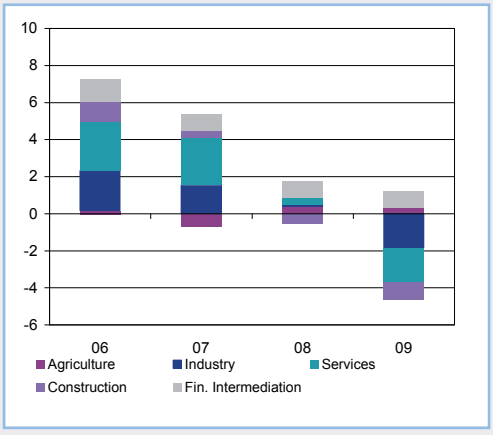
thanks to continued growth in the first quarter of 2010 and the low base effect. However, the pace of recovery is still unknown as developments in global markets will affect external demand directly and domestic demand indirectly in the upcoming period.

Chart I.19.
Growth Rate and Composition[1, 2]
(%, Points)



Source: TURKSTAT
(1) Annual percentage change.
(2) Net exports = Exports of Goods and Services-Imports of Goods and Services

Chart I.20.
Contributions of Sectors to Growth[1]
(%, Points)



Source: TURKSTAT
(1) Construction and financial intermediation agencies are not included in the total for the services sector.

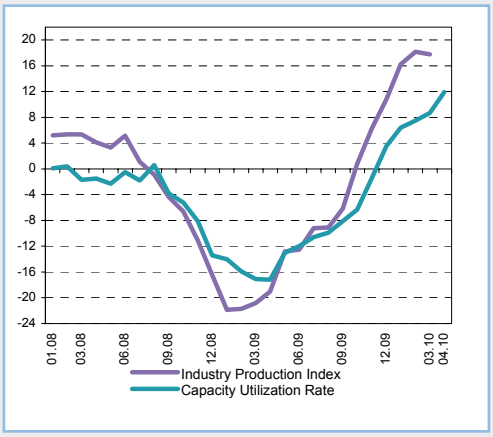
When the composition of growth is analyzed with respect to expenditures, it is observed that the 19.2 percent-fall in investment expenditures in 2009, which had started to decline in 2008, played an important role in the economic contraction observed throughout 2009. The private sector slashed investment expenditures significantly because of uncertainty driven by the crisis, the decline in direct foreign investments and difficulty in finding long-term financing resources (Chart I.19).

The contraction in total consumption expenditures remained limited as the public sector increased its expenditures throughout 2009 with the aim of mitigating the effects of the crisis. The rise in total consumption expenditures, which started in the last quarter of 2009, is expected to continue in the first quarter of 2010 with the contribution of the low base effect (Chart I.19).

As imports contracted faster than exports throughout 2009, net exports made a positive contribution to growth. Nevertheless, parallel to the economic recovery in the last quarter of 2009, imports grew faster than exports. Under the assumption that the recovery in demand in Turkey's largest trade partner, Europe, will take a long time, the rise in exports is expected to be gradual. Within this framework, the current trend is expected to continue throughout 2010 and net exports are expected to have a negative effect on growth (Chart I.19).

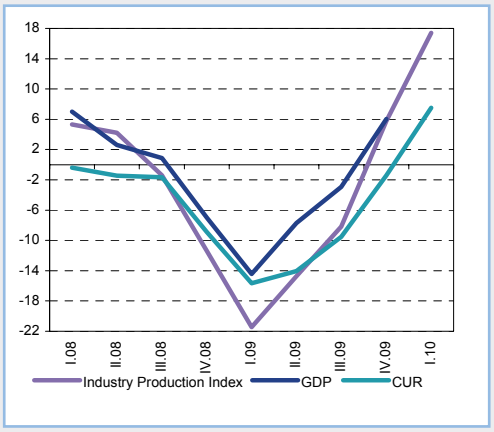
When GDP is analyzed with respect to production, it is observed that all sectors, except financial services and agriculture, have made negative contributions to growth in 2009. The surge in industry, financial services and trade in the last quarter of 2009 led to a rise in GDP in the last quarter of 2009 compared to the same quarter of 2008. The rapid growth trend especially in the industrial sector continued in the first quarter of 2010 with the contribution of the low base effect (Chart I.20).

Chart I.21.
Industrial Production[1] (2005=100, Annual % Change) and Capacity Utilization Rate[2] (Annual Point Difference)



Source: TURKSTAT and CBRT
(1) Industrial Production Index data adjusted for calendar effects were used.
(2) Data for "Manufacturing Industry Capacity Utilization Rate" are based on answers of manufacturing industry sector firms in CBRT's "Business Tendency Survey".

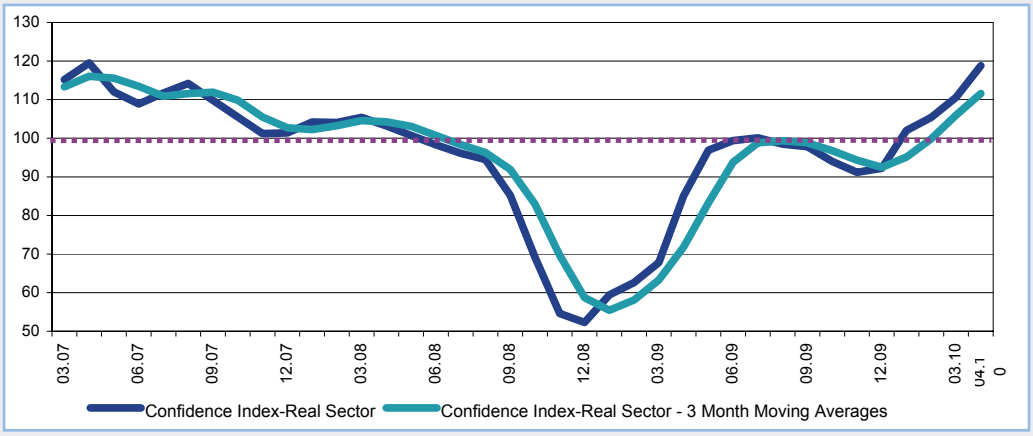
Chart I.22. Industrial Production[1], Capacity Utilization Rate[1] and Growth



Source: TURKSTAT
(1) In order to be able to compare with GDP growth, the year-on-year change of Capacity Utilization Rate and the quarterly Industrial Production Index adjusted for calendar effects were used.

Manufacturing industry capacity utilization rate and the industrial production index, which started to decline in 2009 due to the contraction in both domestic and external demand, came down to their lowest level in March 2009 to be followed by a rapid recovery. Also underpinned by the low base, the industrial production index started to pick up as of October 2009 y-o-y (Chart I.21 and I.22).

Chart I.23.
Corporate Sector Confidence Index

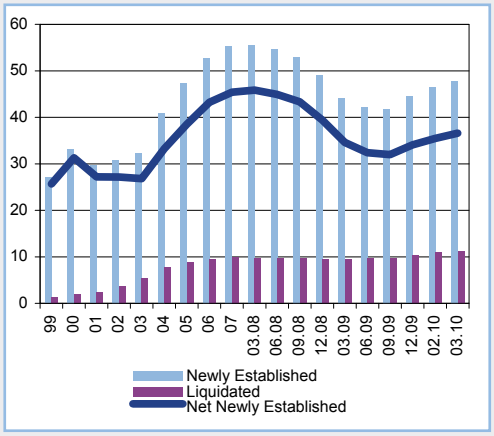


Source: CBRT

The recovery trend in economic activity was reflected onto the real sector confidence index and to the establishment of new companies. The real sector confidence index, which started to climb as of the beginning of 2009 and surpassed the threshold value of 100 in July, however, fell as of this date and came down to 91.2 of index value by the end of November. As of December 2009, the real sector confidence index started to rise again and reached 118.8 in April 2010 (Chart I.23). The establishment of new firms, which had decreased due to the

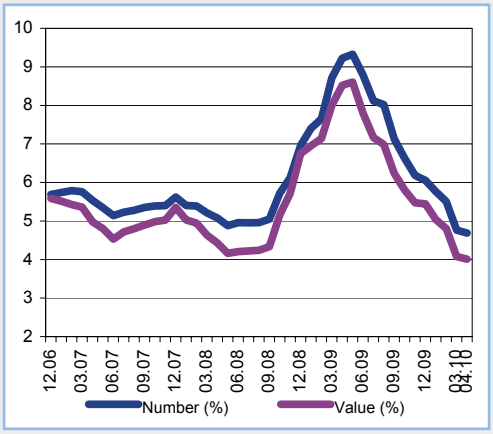
slowdown in economic activity, started to pick up again as of the last quarter of 2009. The net number of newly established firms, which had reached a peak by the end of March 2008 with 45,842 firms, came down to 31,994 in September 2009. In the last quarter of 2009, the decline in the net number of new firms ended and the number of newly established firms became 34,077 in December 2009 and 36,581 in March 2010 (Chart I.24).

Chart I.24.
Number of Newly Established and Liquidated Companies and Cooperatives (Thousand)[1]



Source: TURKSTAT and TOBB
(1) Annualized data used.

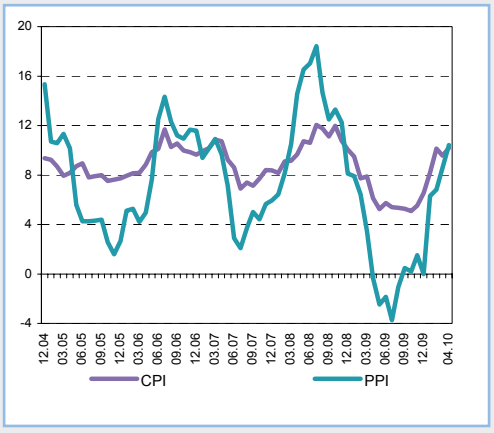
Chart I.25.
The Ratio of Over-Drawn Cheques Presented to the ICH to the total Cheques Presented to the ICH[1] (%)



Source: CBRT
(1) 3-month moving average

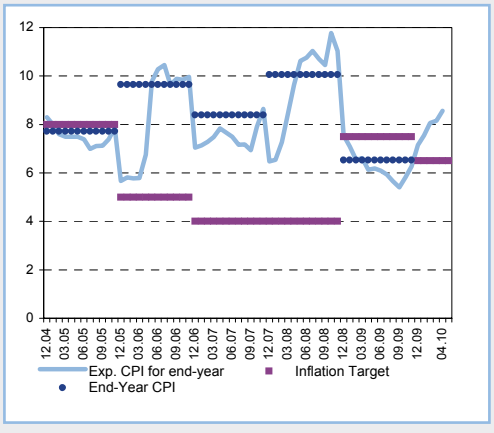
The ratio of overdrawn cheques presented to the Interbank Clearing House (ICH) to total cheques presented to the ICH, which had been rising since September 2008 in terms of both number and value, headed down as of the second quarter of 2009 and stood at 4.7 and 4.0 percent, respectively in April 2010 (Chart I.25).

Chart I.26.
12-Month PPI and CPI Developments (Annual % Change)



Source: TURKSTAT

Chart I.27.
End-Year CPI Expectations (%)



Source: CBRT and TURKSTAT

Annual Consumer Prices Index (CPI) inflation increased by 3.7 percent in the first four months of 2010 and reached 10.19 percent in April. The rise in question was mainly driven by price increments stemming from tax adjustments introduced in January covering fuel-oil products, alcoholic beverages and tobacco products; the surge in unprocessed food prices and the low base stemming from last year's tax cuts. Meanwhile, the Producer Prices Index (PPI) also rose to 10.4 percent in the said period due to the price increments in agriculture and basic metal and the pressure of producer prices on consumer prices became more clear (Chart I.26).

Actually, CPI expectations for end-2010 are hovering above the 6.5 percent target. Inflation, which followed an upward trend in the first quarter of 2010 due to the cost-push pressures and the low base effect due to tax cuts, is expected to gradually head downwards as the mentioned effects fade away. Within the framework of the recent developments, CPI expectations for end-2010 have risen to 8.6 percent that is parallel to the CBRT's year-end inflation forecast of 8.4 percent (Chart I.27).

The recovery trend observed in economic activity as of the second quarter of 2009 is expected to continue in the first quarter of 2010. Despite the steady recovery in domestic demand, the uncertainties pertaining to external demand still linger due to the problems in EU countries, which make up 45 percent of our total exports. Therefore, the projection that the recovery in economic activity will be gradual is retained and total demand conditions are expected to underpin disinflation for quite some time.

I.3. Public Finance

In 2009, declining tax revenues due to the economic contraction and measures taken to mitigate the effects of global turmoil led to deterioration in the public fiscal balance in Turkey, as was the case in many countries.

In 2009, central government revenues increased by 2.6 percent and primary expenditures were up by 21.4 percent compared to 2008. As the rise in total expenditures was 17.8 percent, the ratio of expenditures covered by revenues declined by 11.8 points (Table I.3). The increase in primary expenditures is triggered by the fact that 5 percentage points of the employers' social security insurance premia has begun to be paid by the Treasury since October 2008, coupled with the rise in transfers made to the Social Security Institution due to the slowdown in collection of the Institution's premium revenues. As revenues from privatization and taxes also lagged significantly behind the targets, the central government budget deficit surged significantly and reached TL 52.2 billion (Table I.3). Nevertheless, owing to the boost in economic activity in the final quarter of the year, tax revenues surpassed the estimations presented in the Medium-Term Program (MTP), while interest expenditures remained lower than expected, thus leading the central government budget deficit to remain below the MTP forecast.

Table I.3. Central Government Budget Realizations (Billion TL)

	2008	2009	Change (%)	Budget Target for 2009	Jan.-Apr. 2009	Jan.-Apr. 2010	Change (%)	Budget Target for 2010	Real. /Ann. Real. (Jan-Apr 2009) (%)	Real. / Budget Target (Jan-Apr2010) (%)
Expenditures	227,0	267,3	17,8	259,2	87,4	93,5	7,0	287,0	32,7	32,6
Interest Expenditures	50,7	53,2	4,9	57,5	21,1	22,1	4,7	56,8	39,7	38,9
Primary Expenditures	176,4	214,1	21,4	201,7	66,3	71,5	7,8	230,2	31,0	31,1
Revenues	209,6	215,1	2,6	248,8	67,4	77,8	15,4	236,8	31,3	32,9
Tax Revenues	168,1	172,4	2,6	202,1	51,0	63,2	23,9	193,3	29,6	32,7
Revenues to Expenditures (%)	92,3	80,5	-	96,0	77,1	83,2	-	82,5	-	-
Budget Deficit	-17,4	-52,2	200,0	-10,4	-20,1	-15,8	-21,4	-50,2	38,5	31,5
Primary Surplus	33,2	1,0	-97,0	47,1	1,1	6,3	472,7	6,6	110,0	95,5

Source: Ministry of Finance

The budget balance improved on the back of tax revenues rising parallel to the revival in economic activity in 2010. In the first four months of 2010, central government budget expenditures and revenues increased by 7 percent and 15.4 percent, respectively, compared to the same period of 2009. As a result, the ratio of expenditures covered by revenues rose year-on-year and stood at 83.2 percent (Table I.3).

Primary expenditures, which were up by 7.8 percent, were instrumental in the surge in expenditures (Table I.3). A detailed analysis of the said expenditures reveals that personnel expenditures and current transfers rose by 11.5 percent and 10.1 percent, respectively, whereas the purchase of goods and services declined by 10 percent. The said decline was mainly attributable to the decrease in health expenditures on the back of the coverage of public employees' health expenditures by the universal health insurance scheme from January 2010 onwards, in addition to the reduction in health expenditures of green card holders. Meanwhile, within the scope of the same scheme, universal health insurance started to be paid for public employees, which led to a 55.4 percent-increase in premia paid by the state to the Social Security Institution.

In the first four months of 2010, while non-tax revenues decreased by 17.6 percent, tax revenues increased by 23.9 percent. The decrease in non-tax revenues is attributable to the base effect created by the transfer of TL 1.3 billion from the Unemployment Insurance Fund to the budget in February 2009 and TL 1.8 billion obtained from the sale of the 3rd Generation GSM license in April 2009. Owing to the revival in economic activity, VAT on imports and corporate tax rose by 57.8 percent and 34.5 percent, respectively, with special consumption tax and domestic VAT increasing by 30.2 percent and 23.7 percent, respectively, in the first four months of 2010.

Parallel to these developments, the central government budget deficit, which was TL 20.1 billion in the first four months of 2009, declined to TL 15.8 billion in the same period of 2010. In the meantime, the primary surplus posted by the central government budget, which was TL 1.1 billion, rose to TL 6.3 billion (Table I.3).

Box 4. Draft Law on Fiscal Rule

It was declared on the Medium Term Programme (MTP) that, starting from 2011 budget year, public fiscal management would be carried out in accordance with the determined fiscal rules, in order to ensure budget discipline and contain public deficit in the medium term. In this framework, Fiscal Rule Draft Law was announced on May 11, 2010.

The "Fiscal Rule" aims to establish long-term predictability on fiscal policy, enhance confidence and stability in the economy, minimize public sector borrowing cost by lowering risk premium through increasing credibility, enable private sector access to longer term resources at lower costs by increasing the predictability of long term borrowing requirement of public sector and entrench fiscal discipline. According to the Fiscal Rule, in any given year, the ratio of the general government deficit to GDP cannot exceed the figure arrived at by adding the general government deficit adjustment to the ratio of the general government deficit to the GDP in the previous year. Public deficit adjustment was defined in MTP as shown below:

$$\Delta a_t = y\,(a(t\text{-}1) - a^*) + k\,(b_t - b^*)$$

Δat: Adjustment in the public deficit / GDP

a(t-1): Previous year's public deficit / GDP

a* : Medium-long term public deficit target/GDP

bt : Real GDP growth rate

b* : Long term average of real GDP growth rate

y : Convergence coefficient of public deficit to medium-long term target

k : Reflection coefficient of cyclical effects

(y and k coefficients are negative. The negative Δa indicates a decrease in public deficit).

With the Draft Law that was announded on May 11, 2010, the definition of public deficit, parameters related to public deficit adjustment, essentials related to implementation, reporting and auditing were identified. Accordingly, public deficit was determined as general government deficit1, y and k coefficients were determined as -0.33, medium-long term public deficit target to GDP was determined as 1 percent, and long term average of real GDP growth rate was determined as 5 percent. As a result, adjustment in the general government deficit to GDP (Δa) was finalized as below:

$$\Delta a = -0.33\,(a(t\text{-}1) - 1) - 0.33\,(b - 5)$$

According to the Draft Law, general government deficit ceilings for the next three years calculated in accordance with fiscal rule will be determined in the Medium Term Program and Fiscal Plan, in case of a change in general government deficit to GDP ratio of the pervious year and/or real GDP growth rate in a given year, the deficit ceiling will be updated and announced to the public, whether there is a deviation from the rule in a given year shall be determined

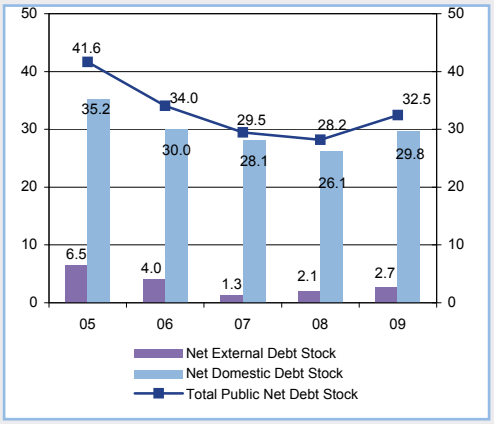
by comparing general government deficit to GDP ratio with the final ceiling, fiscal statistics on general government shall be disclosed quarterly and annually by the Ministry of Finance through the Fiscal Rule Surveillance Report. The Turkish Court of Accounts will assess and announce the accuracy, reliability and conformity with pre-determined standards of the data provided in Fiscal Rule Surveillance Report within three months following its publication.

Law on Fiscal Rule will be an important step towards controlling budget deficits in Turkey. It is anticipated that transparent fiscal policies will have a positive effect on economic stability and growth.

Source: Treasury
(1) General government consists of central government, Social Security Institution, local administrations, revolving funds, Unemployment Insurance Fund and other institutions.

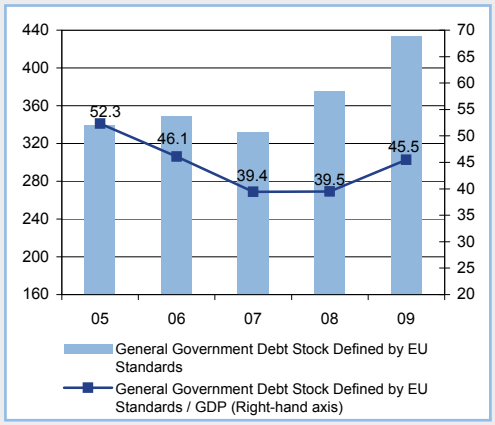
The ratio of public net debt stock to GDP, which displayed a decreasing trend until end-2008, rose to 32.5 percent in 2009. This was driven by the increase in public gross debt stock and the decline in GDP as opposed to the increase in net assets of the Central Bank, public deposits and net assets of unemployment insurance fund (Chart I.28). Public gross debt stock posted an increase mainly due to the rise in domestic debt stock. The ratio of EU-defined general government nominal debt stock to GDP also went up compared to 2008 (Chart I.29).

Chart I.28.
Composition of Total Public Sector Net Debt Stock[1] (%)



Source: Undersecretariat of Treasury
(1) Public sector net debt stock is calculated by subtracting Central Bank net assets, public deposits and unemployment insurance fund net assets from public sector gross debt stock.

Chart I.29.
General Government Nominal Debt Stock Defined by EU Standards[1] (%, Billion TL)

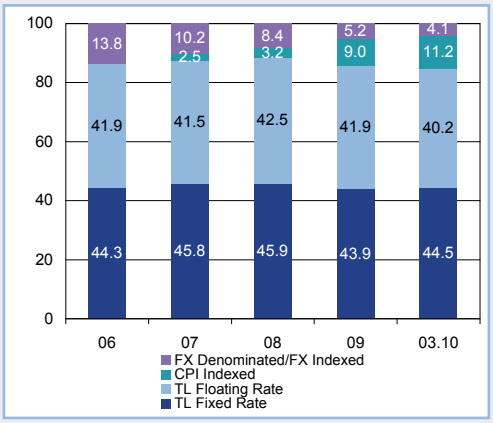


Source: Undersecretariat of Treasury
(1) Consolidated nominal debt stock as defined in the European System of Accounts 95 (ESA 95) deficit and debt manual.

Regarding the composition of domestic debt stock, the issue of CPI-indexed bonds of TL 20.973 million in the February-November 2009 period led the share of CPI-indexed debt stock to rise compared to end-2008, whereas the shares of floating-rate, FX-denominated, FX indexed and fixed-rate debt stocks went down (Chart I.30). While the decline in the share of floating-rate debt stock and the increase in the share of CPI-indexed debt stock continued by

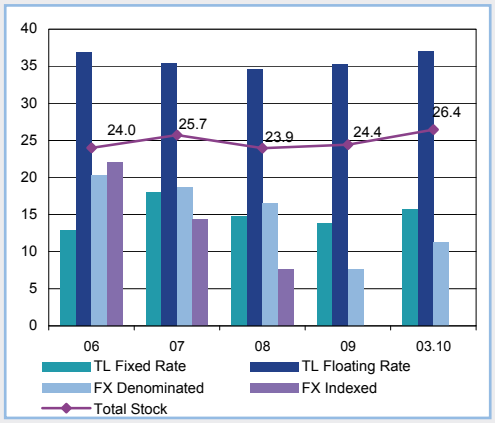
March 2010, the share of fixed-rate debt stock rose by a small margin compared to end-2009 (Chart I.30). Despite the fall in fixed-rate debt stock compared to 2008, the increase in the share of CPI-indexed debt stock restricts the susceptibility of domestic debt stock to interest rate risk.

Chart I.30.
Composition of Domestic Debt Stock (%)[1,2]



Source: Undersecretariat of Treasury
(1) CPI-indexed bonds began to be issued in February 2007.
(2) The TL denominated RIB that began to be issued in January 2009 is classified in TL Floating Rate Debt Stock and FX-denominated RIB is classified in FX Denominated/FX Indexed Debt Stock.

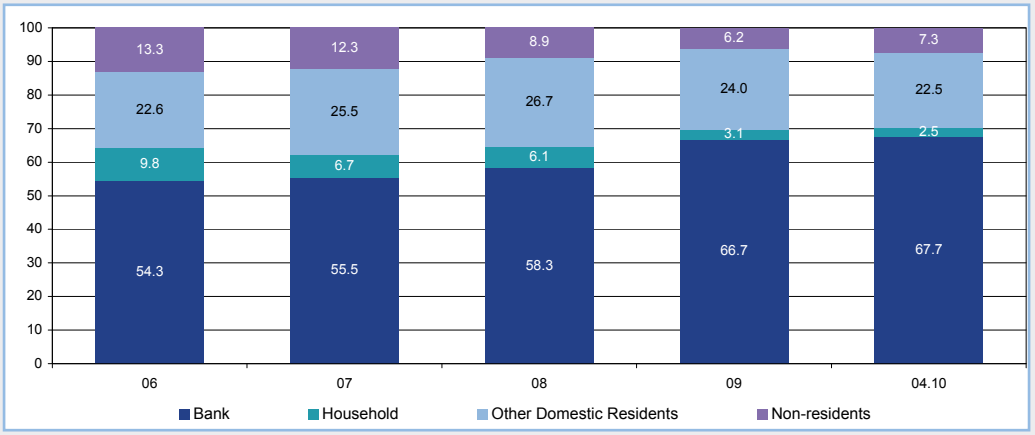
Chart I.31.
Maturity Structure of Government Domestic Debt Stock (Month)[1]



Source: Undersecretariat of Treasury
(1) Calculation is based on term to maturity.

The average maturity of government securities, which decreased to 23.9 months by the end of 2008, increased to 24.4 months by end-2009 and to 26.4 months as of March 2010, as CPI-indexed bonds issued have long-term maturities (Chart I.31).

Chart I.32.
Government Domestic Debt Securities by Holders[1,2,3] (%)



Source: BRSA-CBRT
(1) Based on nominal amounts.
(2) "Bank" includes GDDS owned by banks operating in Turkey; "Households" includes GDDS that belong to real persons kept at domestic banks; "Other domestic residents" includesGDDS of domestic legal persons other than banks and households, and also GDDS of mutual funds kept at banks; and "Non-residents" involves non-resident real and legal persons' GDDS kept at domestic banks.
(3) GDDS owned by the Central Bank are excluded.

Banks hold the bulk of government securities, which make up a major part of banking sector assets. As of April 2010, the share of banks kept increasing, whereas that of households maintained its downward trend (Chart I.32).

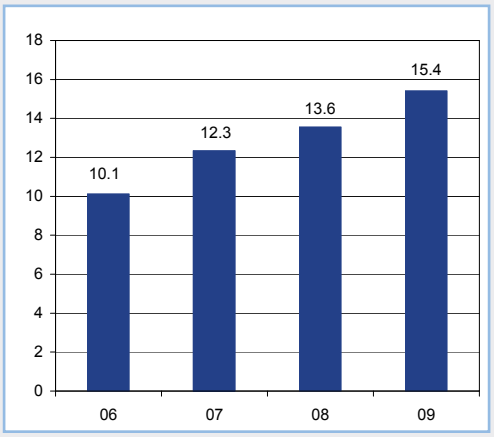
In conclusion, global turmoil had significant adverse impact on the performance of public finance in Turkey in 2009, as was the case in many countries. The surge in the central government budget deficit resulted in an upswing in the public borrowing requirement. However, in the MTP, ways to ensure fiscal discipline in the 2010-2012 period was addressed, and it was targeted to gradually decrease primary expenditures, increase tax income, reduce central government budget deficit and to raise the IMF-defined public sector primary surplus. Furthermore, with the draft bill on Fiscal Rule announced on 11 May 2010, it is aimed to ensure budget discipline and to contain public debt in the medium term. The central government budget performance for 2010 indicates an improvement in public finance. In order to make this improvement sustainable, it is essential that the fiscal rule and the measures set out in the MTP will be implemented.

I.4. Private Sector Developments

I.4.1. Households

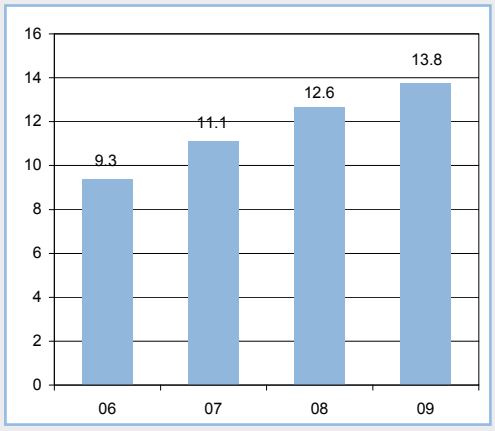
Household liabilities continued to increase throughout 2009 that was marked by the global crisis.

Chart I.33.
Household Liabilities to GDP (%)[1]



Source: CBRT-BRSA, TURKSTAT
(1) Household liabilities consist of gross consumer credits and credit card balancesextended by banks and consumer finance companies and liabilities to TOKI due toTOKI's housing sales with long-term maturity.

Chart I.34.
Retail Loans to Household Consumption Expenditures (%)[1]



Source: CBRT-BRSA, TURKSTAT
(1) Retail loans consist of gross consumer credits and credit card balances extended bybanks and consumer finance companies deducted housing credits.

The ratio of total household liabilities to GDP rose to 15.4 percent by 2009 from 13.6 percent in 2008 (Chart I.33). This increase was mainly driven by the development in GDP. In the same period, the ratio of household consumption expenditures financed by retail loans also increased from 12.6 percent to 13.8 percent (Chart I.34).

Table I.4. Household Disposable Income, Liabilities and Interest Payments[1,2,3] (Million TL)

	2007	2008	2009
Household Interest Payments	15,576	19,653	21,113
Household Liabilities	104,111	128,966	147,083
Household Disposable Income	335,157	379,524	390,245
Interest Payments / Household Disposable Income (%)	4.6	5.2	5.4
Liabilities / Household Disposable Income (%)	31.1	34.0	37.7

Source: BRSA-CBRT, TURKSTAT, SPO
(1) Household liabilities consist of gross consumer credits and credit card balances extended by banks and consumer finance companies and liabilities to TOKİ due to TOKİ's housing saleswith long-term maturity.
(2) As the repayments related to liabilities fromTOKI's housing sales with long-term maturity are indexed to civil servant salaries, they are not included in interest payments.
(3) Household disposable income has been calculated by using private sector disposable income estimation for 2008 and 2009 as mentioned in the 2010 Annual Programme, assuming that the ratio of household disposable income for 2007, which was generated from the Income and Living Conditions Survey, to private sector disposable income has not changed. Since household disposable income generated from Income and Living Conditions Survey has been utilized, the figures differ from those in the previous Financial Stabilty Reports.

In 2009, household liabilities and interest payments increased by 14 percent and 7.4 percent, respectively, compared to 2008. In the same period, the ratio of household interest payments to disposable income, one of the main indicators of the households' repayment capacity, rose from 5.2 percent to 5.4 percent, while the ratio of total household liabilities to disposable income increased from 34 percent to 37.7 percent (Table I.4).

Box 5.
Income and Living Conditions Survey

In December 2009, Turkish Statistical Institute published the results of its "Income and Living Conditions Survey" for the years 2006-2007. With this research, statistics on equalized household disposable income distribution are produced for the first time. Since individual welfare level comes into prominence in equalized disposable income distribution, the number of members in a household is as important as the total household income in the calculations and total household disposable income should be converted into per capita income by taking into consideration the number of members in the household. For making an accurate comparison, the equivalent size in terms of adult persons of each household is determined by using an equivalence scale.

Table 1. Equalized Household Disposable Income Groups* (%)

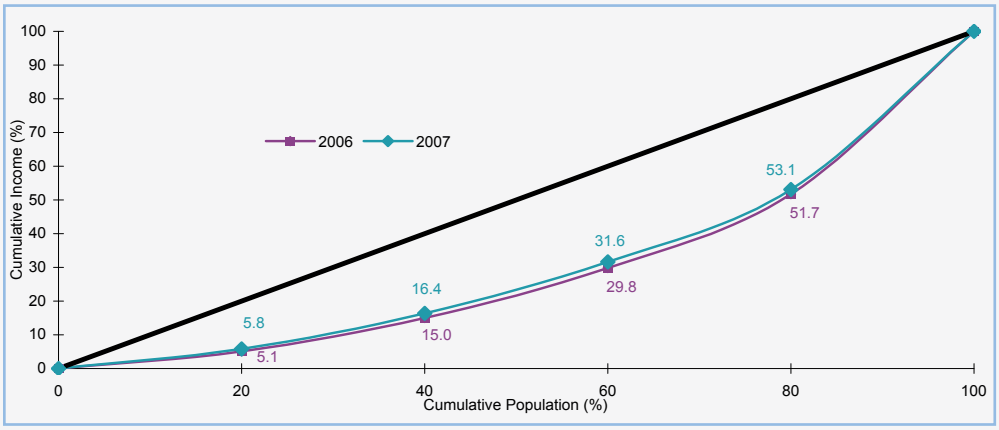
	Turkey		Urban		Rural	
	2006	2007	2006	2007	2006	2007
First 20 %**	5.1	5.8	5.5	6.2	5.6	6.4
Second 20 %	9.9	10.6	10.3	11.0	10.2	11.1
Third 20 %	14.8	15.2	15.0	15.3	15.3	16.0
Fourth 20 %	21.9	21.5	21.8	21.2	22.6	22.3
Fifth 20 %**	48.4	46.9	47.5	46.2	46.3	44.2
Total	100.0	100.0	100.0	100.0	100.0	100.0
Gini Coefficient	0.43	0.41	0.42	0.39	0.41	0.38
Fifth 20%/First 20%	9.5	8.1	8.6	7.5	8.3	6.9

Source: TÜRKSTAT
(*) Reference period for income information is the previous calendar year.
(**) When individuals are listed from the least amount to the most by equalized household disposable income and divided into 5 equal parts, the bottom income group is defined as "the first 20 %" and the top income group is defined as "the fifth 20 %".

According to the survey results of 2007, among the five quintile groups of the population, the share of the highest income group in total income is 8.1 times the share of the lowest income group. In comparison to the previous year when the ratio was 9.5, it is observed that the share of the three lowest income groups in total income rose whereas that of the two highest income groups fell.

Gini coefficient, which is an indicator of income inequality, represents greater inequality in income distribution as it approaches "1" and it represents greater equality in income distribution as it approaches "0". Gini coefficient is 0.43 according to the results of 2006 and it is calculated as 0.41 according to the results of 2007.

Chart 1. Lorenz Curve for Turkey



Source: TURKSTAT

Lorenz curve is a graphical demonstration of inequality in distribution of income among the population. The curve intersects the endpoints of a square's diagonal. Cumulative shares of income are indicated by percent on the vertical side of the square while cumulative shares of income are indicated by percent on the horizontal side of the square. The fact that the Lorenz curve for 2007 is closer to the diagonal than the curve for 2006 indicates an improvement in income distribution.

Between 2006 and 2008, the ratio of total household liabilities to GDP in EU-member developed countries declined, while it has been displaying an increase in Turkey and new EU-member developing countries in general. Despite this rise, the ratio of household liabilities excluding housing loans to GDP in Turkey is close to that of new EU-member states; and the ratio of its total liabilities to GDP is still below that of many EU countries including the new members (Table I.5)

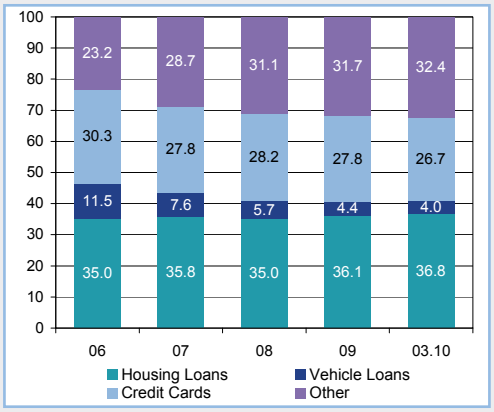
Table I.5. Ratio of Household Liabilities to GDP in Selected Countries (%)

	Ratio of Household Liabilities Excluding Housing Loans to GDP[1]			Ratio of Total Household Liabilities to GDP[2]		
	2006	2007	2008	2006	2007	2008
Germany	20.0	18.7	18.1	61.9	58.5	56.6
Austria	20.9	20.7	20.1	44.6	44.7	45.5
Belgium	8.7	8.5	8.3	42.4	42.4	33.4
Bulgaria	11.4	14.5	15.5	18.3	24.4	27.2
Czech Republic	5.3	6.2	6.6	17.3	21.5	22.1
Denmark	18.0	20.6	20.5	116.9	126.2	129.4
Estonia	7.0	8.6	9.1	39.4	45.2	48.3
Finland	13.6	13.6	14.0	46.7	48.2	50.6
France	12.3	12.3	12.0	43.8	46.2	47.5
Holland	9.6	8.4	8.1	78.0	75.3	71.3
United Kingdom	14.1	12.7	10.9	73.4	66.5	54.2
Ireland	16.1	16.6	17.7	78.9	81.7	79.6
Spain	20.7	21.2	21.1	76.4	80.3	80.7
Sweden	22.4	22.5	20.9	62.5	62.9	60.1
Italy	12.6	12.9	13.0	29.0	30.1	29.8
Latvia	9.4	8.8	8.2	38.6	40.9	39.2
Lithuania	6.6	8.5	8.3	19.2	25.5	27.1
Luxembourg	40.8	36.8	33.9	76.2	77.1	77.3
Hungary	9.2	10.9	13.6	21.1	23.1	27.5
Poland	10.7	12.9	12.3	18.2	23.5	25.2
Portugal	15.1	16.4	17.0	74.2	78.4	80.3
Romania	9.7	12.8	14.2	11.9	16.0	18.0
Slovakia	6.0	6.1	6.3	17.7	18.4	19.4
Slovenia	11.0	12.0	11.9	17.4	19.8	21.1
Greece	13.0	13.3	12.9	37.5	41.1	39.8
EU 27	15.3	15.0	14.6	56.1	55.4	52.7
Turkey	**6.6**	**7.9**	**8.8**	**10.1**	**12.3**	**13.6**

Source: ECB, CBRT, TURKSTAT
(1) The figure is 9.9 percent in 2009 for Turkey.
(2) The figure is 15.4 percent in 2009 for Turkey.

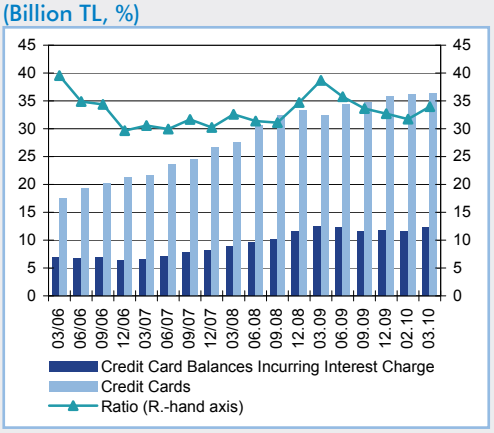
When the development of household liabilities is analyzed by type, it is observed that housing loans increased by 17.6 percent, other consumer loans went up by 16.4 percent and credit card balances increased by 12.3 percent, whereas vehicle loans decreased in 2009 compared to end-2008 figures. In March 2010, housing loans, other consumer loans and credit cards increased by 6.7 percent, 7.1 percent and 0.7 percent, respectively; while, vehicle loans went down by 3.1 percent compared to end-2009 figures. As a result of these developments, while the shares of housing loans and other consumer loans within household liabilities increased, those of vehicle loans and credit cards decreased (Chart I.35).

Chart I.35.
Decomposition of Household Liabilities (%)[1,2,3]



Source: BRSA-CBRT
(1) Household liabilities consist of gross consumer credits and credit card balances extended by banks and consumer finance companies and liabilities to TOKİ due to TOKİ's housing sales with long term maturity.
(2) Liabilities to TOKİ due to TOKİ's housing sales with long-term maturity are also included in housing loans.
(3) Other loans consist of all consumer loans excluding housing and vehicle loans.

Chart I.36.
Credit Card Balances of Deposit Banks and Balances that Incur Interest Charge (Billion TL, %)



Source: CBRT

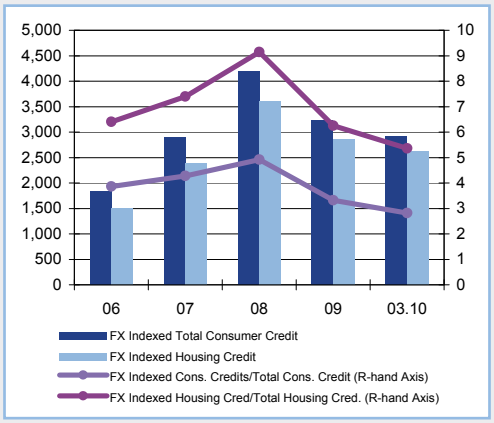
Credit card balances have been on the rise during 2009. Credit card balances incurring interest charges went down to TL 11.7 billion in end-2009 from TL 12.5 billion in March 2009; then went up to TL 12.3 billion in March 2010. The ratio of credit card balances incurring interest charges to total credit card balances became 32.7 percent, 38.7 percent and 34 percent in the said periods, respectively (Chart I.36).

Meanwhile, overdraft deposit accounts held by households have recently been on the increase and accordingly the portion of these accounts extended as loans increased as well. Considering that interest rates of these types of accounts are relatively higher than those of consumer loans, individuals should beware of using overdraft deposit accounts except for their short-term cash needs.

The ratio of FX-indexed consumer loans to total consumer loans, which was 4.9 percent in 2008, decreased to 3.3 percent at end-2009 and went down to 2.8 percent in March 2010. Meanwhile, the share of FX-indexed housing loans in total housing loans declined from 9.1 percent to 6.2 percent and 5.4 percent for the same periods (Chart 1.37). With the amendment made to Decree No. 32 on the Protection of the Value of the Turkish Currency on 16 June 2009, households are precluded from utilizing FX-indexed loans as well as FX-denominated loans, which has steered the continuation of the slowdown in the share of FX-indexed consumer loans.

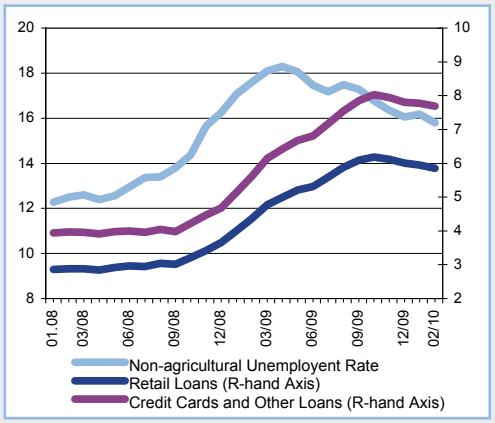
Meanwhile, in Turkey, CPI-indexed variable interest rates are allowed only for housing loans among consumer loans and the aforementioned loans constitute only 0.03 percent of total housing loans as of March 2010. The indirect interest rate risk for households is very limited, as variable interest rate consumer loans are at negligible levels.

Chart I.37.
FX-Indexed Consumer Credits and FX Indexed Housing Credits (Million TL, %)[1]



Source: BRSA-CBRT
(1) Consumer finance companies are not included.

Chart I.38.
Unemployment Rate and NPL Ratios (%)[1]



Source BRSA-CBRT, TURKSTAT
(1) Seasonally-adjusted non-agricultural unemployment rate.

Also owing to the increase in loans, the NPL ratio of retail loans and credit cards and other consumer loans has started to decrease, albeit to a limited extent as of the last quarter of 2009. Besides, the surge in non-agricultural unemployment driven by the global crisis starting from the second quarter of 2008, started to decrease in the second quarter of 2009; leading to expectations that the NPL ratio will continue to go down (Chart I.38).

Table I.6. Number of Credit Card and Consumer Loan Defaulters[1]

	12.08	06.09	09.09	2009	03.10
Banks	997,095	1,252,267	1,475,620	1,489,131	1,400,177
Asset Management Companies[2]	139,862	252,916	282,856	330,156	430,197
Finance Companies	21,884	27,826	23,079	23,463	22,991
Total[3]	1,093,474	1,415,791	1,664,301	1,721,004	1,690,726

Source: CBRT
(1) Customers with more than one registry to a particular financial institution group are counted only once.
(2) Represents non-performing loans taken over by asset management companies from the SDIF and banks.
(3) As customers may have registry to more than one financial institution group, the sum of the three rows in the table and grand total are not equal.

According to the Central Bank Risk Center data, the number of consumer loan and credit card defaulters, which was 1,721,004 at end-2009, decreased to 1,690,726 in March 2010 (Table I.6).

Credit card receivables scheduled for payment plans within the legal period of 60 days stipulated in the Provisional Article 5 of Law No. 5464 amounted to approximately TL 1 billion; and the number of customers became 421 thousand. Some banks voluntarily extended the application period for debt structuring, which was due on 4 September 2009, until year-end. Thus, by the end of 2009, total credit card receivables scheduled for payment plans and the number of customers rose to TL 1.3 billion and 553 thousand, respectively (Table I.7).

Table I.7.
Restructured Credit Card Receivables as per the Provisional Article No. 5 of the Law No. 5464
(Thousand TL, Number of Persons)

	Restructured Receivables within Legal Terms(07.07.2009-04.09.2009)			Voluntarily Restructured Receivables (05.09.2009-31.12.2009)			TOTAL		
	Total Credit Card Receivables	Credit Card Recv. After Resch.	Num. of Customers	Total Credit Card Receivables	Credit Card Recv. After Rescheduling	Number of Customers	Total Credit Card Recv.	Credit Card Receivables After Rescheduling	Number of Customers
Banks	945,311	1,276,373	406,904	276,773	385,037	125,622	1,222,084	1,661,411	532,526
Asset Man. Companies	34,091	64,141	14,535	12,543	24,070	6,679	46,634	88,211	21,214
General Sum	979,402	1,340,514	421,439	289,316	409,107	132,301	1,268,718	1,749,622	553,740

Source: BRSA

Total financial assets of households increased by 14.2 percent from end-2008 to reach TL 420.6 billion at end-2009. They became TL 429.9 billion in March 2010 (Table I.8).

Table I.8. Composition of Household Financial Assets[1] (Billion TL, %)

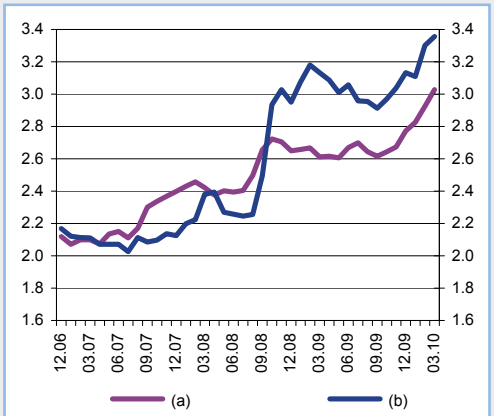
	2008		2009		03.10	
	Billion TL	% Share	Billion TL	% Share	Billion TL	% Share
TL Deposits	188.7	51.2	209.5	50.0	220.3	51.2
FX Deposits	89.0	24.2	97.0	23.1	94.1	21.9
- FX Deposits (Billion USD)	59.1	-	64.5	-	61.7	-
Currency in Circulation	30.6	8.3	35.4	8.4	36.6	8.5
GDDS+Eurobond	19.7	5.3	14.1	3.4	12.5	2.9
Mutual Funds	20.8	5.6	26.1	6.2	26.4	6.1
Stocks	10.6	2.9	24.6	5.9	27.3	6.4
Private Pension Funds	6.4	1.7	9.0	2.1	9.7	2.3
Repos	2.2	0.6	2.3	0.5	1.8	0.4
Precious Metal Deposits	0.3	0.1	1.1	0.3	1.2	0.3
Total Assets	368.3	100.0	419.1	100.0	429.9	100.0

Source: BRSA-CBRT, and FX CMB, CRA
(1) TL and FX deposits include participation funds.

The share of TL deposits, which constitutes the largest portion of household assets, went down to 50 percent in 2009, later to resume its end-2008 levels in March 2010 (Table I.8). The share of TL deposits in total deposits, which was 68 percent at end-2008, went up to 68.4 percent at end-2009 and to 70.1 percent in March 2010. As exchange rate movements gained relative stability in 2009, the amount of FX deposit accounts, which increased until September 2009, started to decrease from that date. Accordingly, the ratio of exchange rate and parity-adjusted total TL investment instruments to FX investment instruments of the

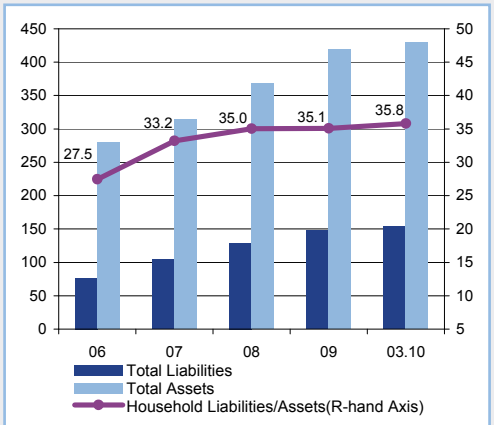
households decreased until September 2009, but went up later (Chart I.45). Moreover, the share of government securities and Eurobonds decreased, while that of equities increased within household financial assets (Table I.8).

Chart I.39.
Ratio of Household TL Investment Instruments to FX Investment Instruments[1]



Source BRSA-CBRT, CMB, CRA
(1) TL Instruments = Deposits + Repos + Gov.Dom.Debt.Sec. + Participation Funds(TL) + Stocks + Private Pension Funds + Mutual Funds (starting from April 2006);FX Instruments = FX Deposits + Gov.Dom.Debt.Sec. + Eurobond + Participation Funds(FX).
(a) Current TL value of FX deposits and Participation Funds (FX).
(b) For FX deposits and Participation Funds (FX), exchange rate prevailing on 29.12.2006is used and the parity effect is eliminated.

Chart I.40.
Household Financial Assets and Liabilities (Billion TL, %)[1]



Source: BRSA-CBRT, CMB, CRA
(1) Household Assets = Savings Deposits + FX Deposits + Money in Circulation+Gov. Dom.Debt.Sec. + Eurobonds + Repos + Stocks + Pension Funds + MutualFunds (starting from December 2006). Household liabilities consist of gross consumer credits and credit card balances extended by banks and consumer finance companies and liabilities to TOKİ dueto TOKİ's housing sales with long term maturity.

FX-indexed liabilities of households to the banking sector are USD 1.9 billion in March 2010 while FX-denominated assets are USD 64 billion, implying that households have a long position in FX. Nevertheless, on an individual basis, as those with FX liabilities and those with FX assets may be different, in the event that the Turkish lira depreciates, it is clear that the debt service capacity of those with FX liabilities and no FX incomes will be adversely affected.

The ratio of total financial liabilities of households to their assets did not change at end-2009 compared to end-2008. However, this ratio went up to 35.8 percent as of March 2010 as the increase in liabilities outpaced that of assets (Chart I.40).

Household indebtedness in Turkey is still low compared to many countries. Moreover, the interest rate and exchange rate risks of household liabilities are limited, which alleviates the vulnerability of households. Slowdown in production driven by the global crisis exerted pressure on employment and decreased the repayment capacity of households. Nevertheless, the non-agricultural unemployment rate assumed a downward trend starting from the second quarter of 2009 and the NPL ratio began to decrease since the last quarter of 2009, albeit to a limited extent; both being positive developments. Yet, since the unemployment rates may remain high for a while compared to pre-crisis periods, it is likely that households may be facing repayment difficulties in the coming period.

I.4.2. Corporate Sector

I.4.2.1.Financial Debts of the Corporate Sector and the Development of Foreign Exchange Position

The corporate sector financial debt became TL 358 billion as of March 2010 and the share of FX-denominated loans is on the decrease, but still remains important.

FX borrowings of the corporate sector, which were USD 146.4 billion at end-2008, went down to USD 142 billion at end-2009 and to USD 141.7 billion in March 2010. TL-denominated loans extended to firms started to increase as of the last quarter of 2008 and reached TL 135.2 billion and TL 142.4 billion at end-2009 and in March 2010, respectively (Table I.9).

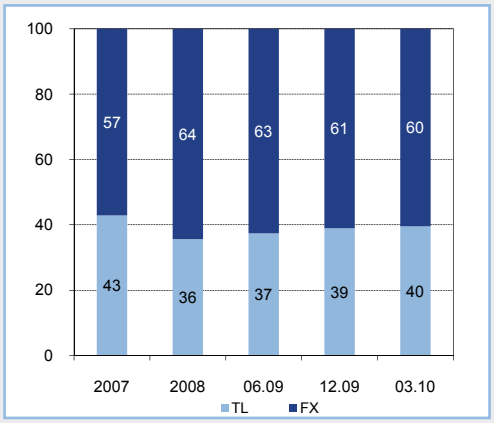
Table I.9. Financial Debt of the Corporate Sector[1] (Million TL)

	2007	2008	06.09	09.09	12.09	03.10
Corporate Sector Loans (I+II)	**246,555**	**345,968**	**340,495**	**341,079**	**346,471**	**358,049**
I. Domestic Loans (i+ii)	**153,322**	**193,223**	**191,988**	**199,541**	**208,296**	**222,399**
i. TL	105,783	123,203	127,403	131,809	135,210	142,377
ii. FX (including FX-Indexed)	47,539	70,020	64,585	67,732	73,086	80,0223
In USD terms	41,007	46,011	42,359	45,858	49,140	52,594
II. External Loans	**93,232**	**152,745**	**148,507**	**141,538**	**138,175**	**135,650**
In USD (A+B)	80,421	100,372	97,401	95,828	92,903	89,155
A. Short Term	1,012	1,508	1,038	959	712	906
B. Long Term (a+b+c+d)	79,409	98,864	96,363	94,869	92,191	88,249
a. Official Creditors (Gov. and Multilateral Org.)	2,734	2,986	3,166	2,887	2,756	2,593
b. Foreign Branches and Affiliates of Resident Banks	26,997	37,050	35,029	33,515	32,753	31,262
c. Nonresident Com. Banks and other fin. Inst.	42,819	50,476	49,840	50,188	48,346	45,832
d. Nonfinancial Institutions	6,859	8,352	8,328	8,279	8,337	8,563
Total FX Loans[2] (Million USD)	**121.428**	**146.383**	**139.760**	**141.686**	**142.043**	**141.749**

Source: BRSA-CBRT
(1) Amounts in the table may be different from those published in the preceding issues due to the updates of the data.
(2) Although TL loans received from abroad are included, they are ignored since their amount is very low.
(3) Provisional data.

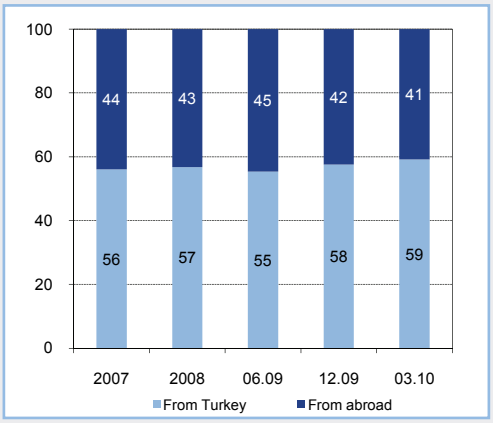
Following the amendment made to Decree Number 32 on June 16, 2009, loans obtained from foreign branches and affiliates of banks established in Turkey and FX loans obtained from foreign banks went down by USD 3.7 billion and USD 4 billion, respectively by March 2010 (Table I.9).

Chart I.41.
Currency Composition of Loans Received by the Corporate Sector (%)



Source: CBRT

Chart I.42.
Currency Composition of FX Loans Received by the Corporate Sector (%)

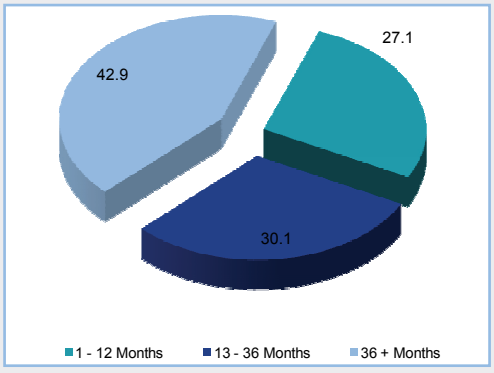


Source: CBRT

The share of FX loans within total cash loans, which was on the rise until 2008, went down as a result of exchange rate movements and the economic crisis and has hovered around 61 percent since September 2009 (Chart I.41). The decline in FX loans was mainly attributable to the fall in external borrowings.

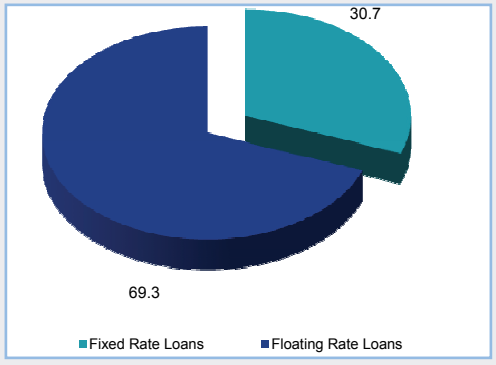
FX loans extended to the corporate sector by domestic and foreign branches and affiliates of Turkish banks increased by USD 6.5 billion compared to June 2009 and reached USD 83.9 billion in March 2010, which led the share of domestic FX loans within total FX loans to become 59 percent (Chart I.42, Table I.9).

Chart I.43.
Remaining Maturity Composition of Long-Term Loans Received from Abroad by Corporate Sector (%) (March 2010)



Source: CBRT

Chart I.44.
Interest Composition of Long Term Loans Received from Abroad by Corporate Sector (%) (March 2010)



Source: CBRT

By March 2010, 27.1 percent of the long-term external borrowings obtained by the corporate sector were those with a maturity of up to one-year and were 2.9 points less than their end-2008 level (Chart I.43).

By March 2010, 30.7 percent of the long-term loans obtained by the corporate sector from abroad were fixed rate, whereas 69.3 percent were floating rate (Chart I.44).

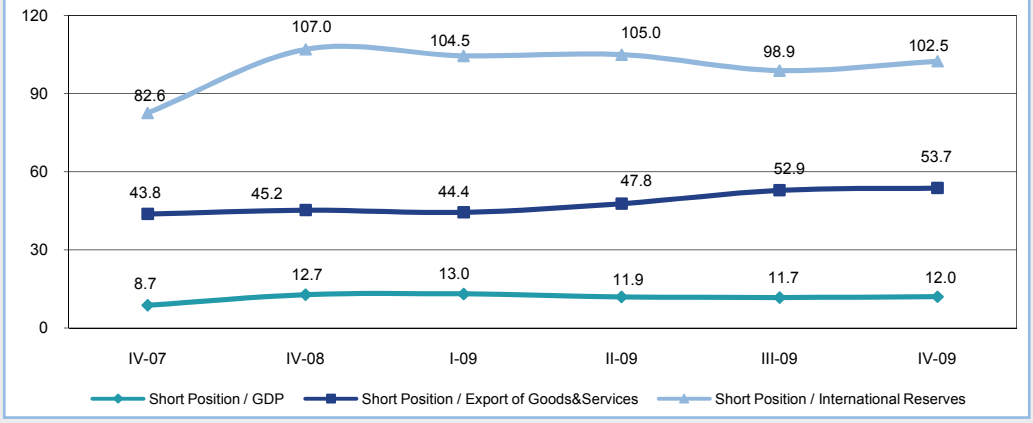
Table I.10.
FX Assets and Liabilities of Corporate Sector[1,2](Million USD)

	2007	2008	03.09	06.09	09.09	12.09	Change 2008-2009 (%)	Change 06.09-12.09 (%)
Assets	**76,130**	**81,364**	**77,763**	**80,088**	**82,175**	**80,762**	**-1**	**1**
A. Deposit	54,795	60,357	57,041	58,576	60,136	57,269	-5	-2
-Domestic Banks[3]	24,402	27,261	25,092	27,133	28,991	29,833	9	10
-Foreign Banks[4]	30,393	33,096	31,949	31,443	31,145	27,436	-17	-13
B. Securities	830	695	636	801	822	992	43	24
C. Export Receivables	10,314	8,591	8,312	8,552	8,906	9,989	16	17
D. Foreign Dir. Invest. to Abr.	10,191	11,722	11,774	12,159	12,311	12,512	7	3
Liabilities	**139,275**	**160,801**	**151,490**	**152,893**	**155,970**	**157,414**	**-2**	**3**
A. Cash Loans	119,458	144,074	136,583	137,630	139,497	140,274	-3	2
-Domestic[5,6]	41,007	46,011	42,045	42,359	45,858	49,140	7	16
Non-bank Fin. Inst.[7]	8,220	8,576	7,849	8,213	8,156	7,985	-7	-3
-Foreign[8]	78,451	98,063	94,538	95,271	93,639	91,134	-7	-4
B. Import Payables	14,519	14,673	13,435	13,799	14,584	15,282	4	11
C. Prot. Receivables of SDIF	5,298	2,055	1,472	1,464	1,890	1,858	-10	27
Net Position	**-63,145**	**-79,437**	**-73,727**	**-72,805**	**-73,795**	**-76,652**	**-4**	**5**

Source: CBRT
1) Amounts in the table may be different from those published in the preceding issues due to the updates of the data.
(2) Data on non-financial public enterprises is not included.
(3) Participation funds in participation banks are included.
(4) "Deposits-Foreign Banks" data covers the data of foreign branches of the banks established in Turkey. On the other hand, it should be taken into consideration that the deposits of real persons and non-bank financial institutions may be included in this data. December 2009 data is provisional.
(5) Funds extended by participation banks are included.
(6) FX indexed loans are included.
(7) It consists of leasing, factoring and consumer finance companies.
(8) Loans extended by foreign branches of the banks established in Turkey are included.

The FX short position of the corporate sector, which started to decline in the last quarter of 2008, has re-surged since the second half of 2009. At end-2009, deposits of non-financial sector firms in banks abroad dropped by 13 percent compared to June 2009 while the cash loans they obtained from domestic banks increased by 16 percent, resulting in a 5 percent increase in their net FX short position (Table I.10).

Chart I.45.
Ratios Related to FX Position of the Corporate Sector[1,2,3] (%)



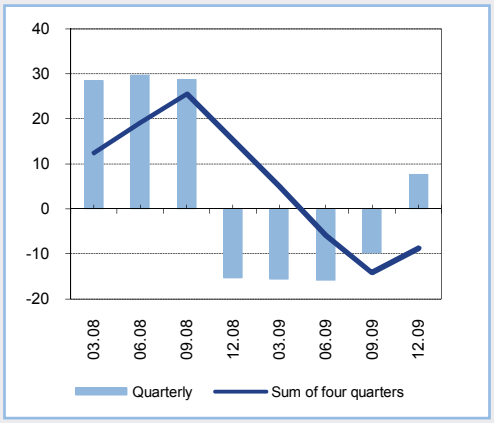
Source: CBRT, TURSTAT
(1) GDP and exports and services revenues are computed on a yearly basis. International reserves are outstanding amounts at the end of period.
(2) International reserves are gross foreign exchange reserves of CBRT (including gold).
(3) The short position amount is converted into TL using the foreign exchange rate of the related period and divided by GDP.

The ratio of the short position of the corporate sector to GDP and international reserves decreased, whereas the ratio to exports and services revenues increased at end-2009 compared to end-2008 (Chart I.45).

I.4.2.2. Profitability and Debt Structures of the Firms Listed on the ISE [3]

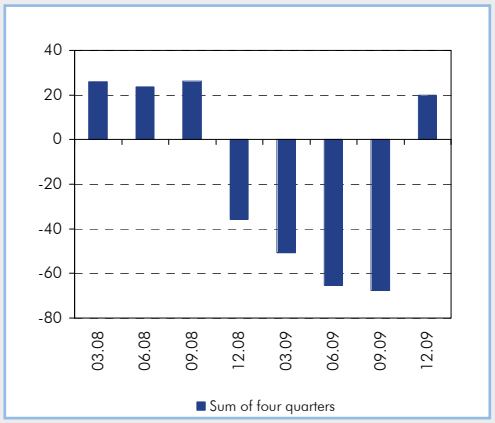
The deceleration in global economic activity that started in the second half of 2008 led to a contraction in the sales volume of firms. Total sales revenues of firms indicated an annual decline of 8.8 percent in 2009. An analysis of the annual change in quarterly sales revenues reveals that sales revenues, which started to decrease in the last quarter of 2008, rebounded in the last quarter of 2009 and increased by 7.7 percent per annum (Chart I.46). Firms' total sales revenues decreased across 2009; however, that period's profit went up by 20 percent (Chart I.47).

Chart I.46.
Sales revenues (Annual % Change)



Source: ISE-PDP

Chart I.47.
Profit by Quarters (Annual % Change)



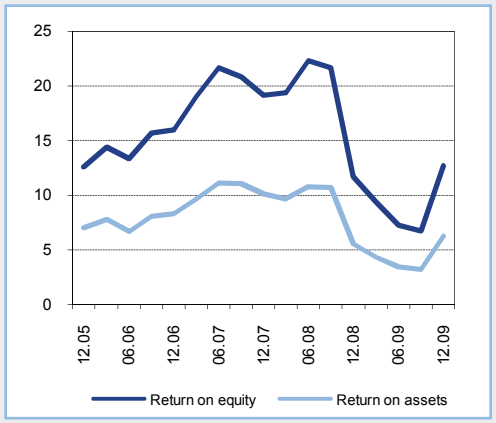
Source: ISE-PDP

Contrary to the decline in sales, the profitability performance indicators of companies improved along with the increase in the respective period's profits . The return on assets, which was 5.6 percent in 2008, went up to 6.3 percent in 2009; while return on equity increased from 11.7 percent to 12.7 percent (Chart I.48). The rebound in profitability performance of firms was attributable to the surge in their profit margins. As a matter of fact, while the asset turnover ratio dropped, the net profit margin, which was 4.9 percent in 2008, (respective period's profit/ sales revenues) climbed to 6.4 percent in 2009 (Chart I.49).

[3] Data regarding the balance sheet and income tables of 185 firms listed on the ISE were aggregated to analyze developments in the corporate sector's profitability and debt ratios. Selected firms are those operating in the non-financial sector, excluding holding companies, sport service sector's companies and those operating in the secondary national, new economy and watch list market.

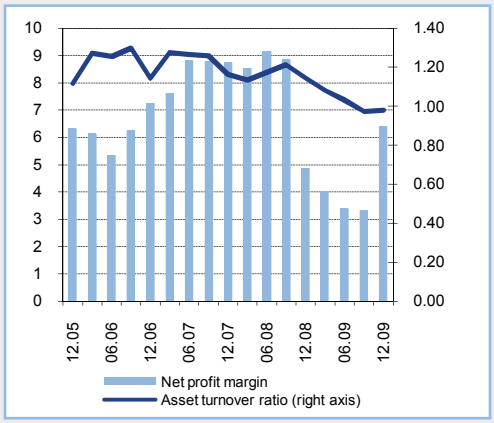
[4] Income statement data is annualized by adding up the data for the last four quarters to calculate profitibality ratios.

Chart I.48.
Return on Equity and Assets (%)



Source: ISE-PDP

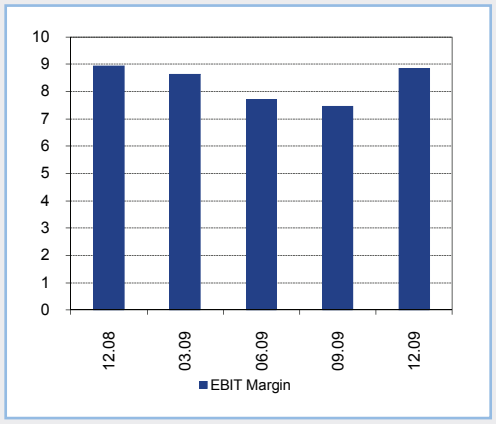
Chart I.49.
Asset Turnover Ratio (times) and Net Profit Margin (%)



Source: ISE-PDP

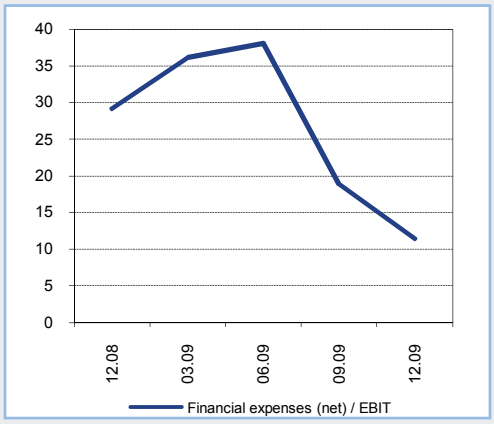
While the decline in firms' financial expenses positively affected profit margins, no improvement occurred in operational profits. Earnings before interest and tax (EBIT) margin (EBIT / sales revenues), which was 8.9 percent in 2008, decreased to 8.8 percent in 2009 (Chart I.50). Meanwhile, firms' financing expenses significantly decreased in 2009 as expenses stemming from exchange rate differences went down. The ratio of net financial expenses to EBIT, which was 29.1 percent in 2008, dropped to 11.5 percent (Chart I.51).

Chart I.50.
EBIT Margin (%)



Source: ISE-PDP

Chart I.51.
Financial Expenses (Net) / EBIT (%)



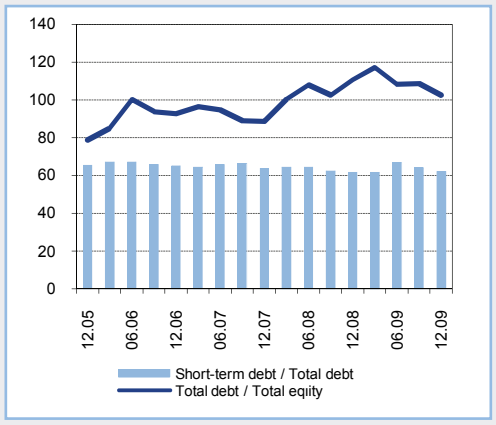
Source: ISE-PDP

The debt-equity balance, which started to deteriorate in 2008, assumed a trend of recovery after the first quarter of 2009. The leverage ratio (debt/equity), which was 88.6 percent at end-2007, reached 110.8 percent in 2008 and dropped to 102.4 percent at end-2009.

Meanwhile, short-term debt structures of firms are preserved and the share of short-term debt within total debt was realized as 61.9 percent in 2009 (Chart I.52). Moreover, it is striking that firms' debt burdens are higher than those of the EU countries. According to the IMF Global Financial Stability Report, the ratio of total debt to equity for firms in Europe became 89.5 percent in 2008.

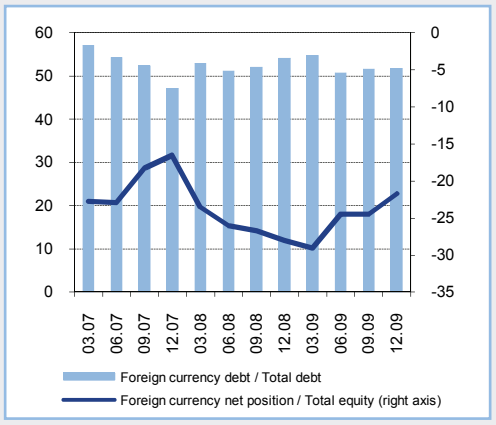
Despite favorable developments in exchange rate risk indicators, the share of firms' FX debts and short positions still maintain their high levels. The share of FX debt within total debt, which was 54.2 percent in 2008, went down to 51.7 percent in 2009, while the ratio of FX short position to equity decreased from 28 percent to 21.7 percent (Chart I.53).

Chart I.52.
Leverage Ratio and Short Term Liabilities (%)



Source: ISE-PDP

Chart I.53.
FX Liabilities and Short Position (%)



Source: ISE-PDP

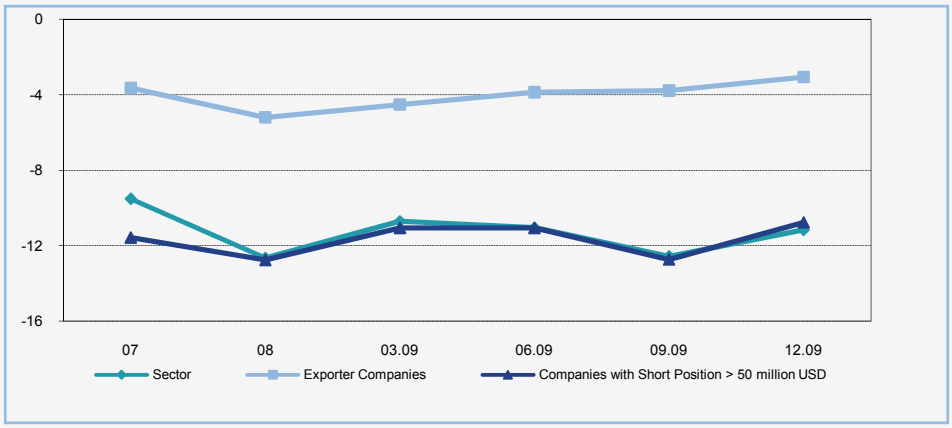
Along with the contraction in aggregate demand in 2009, firms' sales revenues indicated a decline. This decline adversely affected firms' operational profits. In spite of these negativities in sales revenues, firms' operational profits displayed a year-on-year increase in 2009. This was triggered by the decline in financial expenses led by foreign currency gains parallel to the appreciation of the Turkish lira. Despite the assessment that the debt problem that emerged in Europe coupled with the depreciation of the Euro will slightly decelerate the trend of recovery in the economy, a mild rebound is expected in firms' sales revenues in 2010. As a matter of fact, sales revenues started to improve in the last quarter of 2009.

As a conclusion, it is highly probable that especially firms' operational profits will go up and debt service capacities will improve in 2010. Dollarization of the liabilities of firms and their high FX short position keep exposing the debt burden and profitability performance vulnerable to exchange rate movements. This trend points to the fact that the pre-crisis vulnerability of firms still continues.

Box 6.
Foreign Exchange Position of Corporate Sector Firms Listed on the ISE

This section analyzes the foreign exchange positions of corporate sector firms listed on the Istanbul Stock Exchange[1].

Chart 1.
FX Position of ISE Companies[1,2] (Billion USD)



Source: ISE-Public Disclosure Platform
(1) As of year-end periods, companies for which the share of exports in net sales is equal to or greater than 30 percent, are considered exporter companies.
(2) Off-balance sheet positions are included since end-2008.

While, as of end-2008, 130 of 176 firms analyzed had short positions, this number decreased to 121 at end-2009. The short position of these firms, which amounted to USD 14.2 billion at end-2008, fell to USD 12.2 billion at end-2009.

While the number of firms with a short position over USD 50 million was 41 at end-2008, it decreased to 33 by end-2009. While the short position of these firms was USD 12.8 billion at end-2008, it fell down to USD 10.8 billion by end-2009. The short position of non-exporting firms, which was USD 7.5 billion at end-2008, increased to USD 8.1 billion at end-2009 (Chart 1).

(1) The analysis covers 176 non-financial firms, which disclose their foreign exchange positions in their balance-sheet footnotes, and do not include any financial institutions in their consolidated financial statements. Firms that are consolidated under another company, the shares of which are publicly traded at ISE, have not been re-included in the analysis. Moreover, firms, functional currency of which is foreign currency, firms, which possess special accounting period and firms, stocks of which are de-listed from ISE markets temporarily, are excluded from the exchange rate risk analyses.