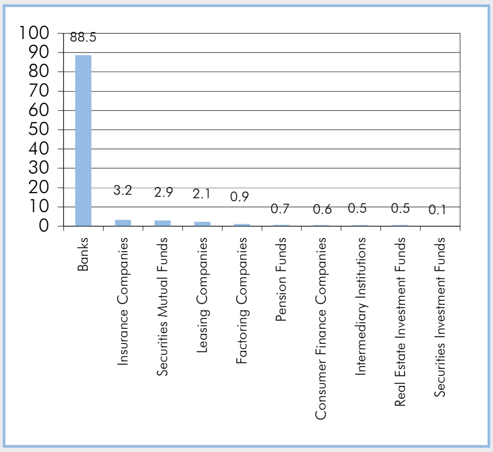
II. STRUCTURE OF THE FINANCIAL SECTOR

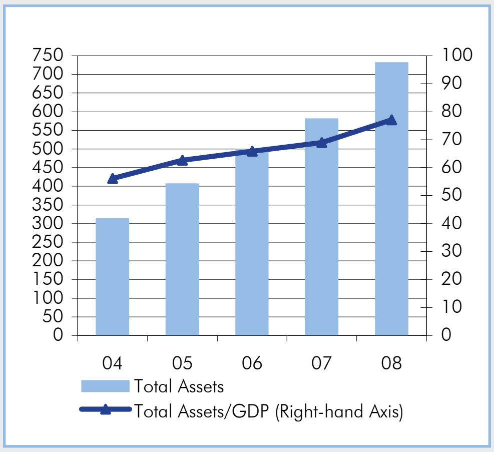
The Turkish financial sector maintained its growth trend in 2008.

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



Source: BRSA, CBRT, Associ. of Capital Market Intermediary Institutions, CMB
(1) Figures are as of December 2008.

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



Source: BRSA-CBRT, TURKSTAT

The total asset size of the financial sector, which grew by 24 percent compared to the end of the previous year, reached TL 828 billion as of end-2008. 88.5 percent of financial sector assets belong to banks (Chart II.1).

II.1. Banking Sector

The Turkish banking sector consists of deposit banks, development and investment banks and participation banks that operate according to profit/loss sharing principles.

As of end-2008, the number of banking sector staff increased by 14,910 compared to end-2007 and reached 182,670, whereas in March 2009, the number decreased by 558 to 182,112, compared to end-2008.

The number of banks which was 50 at end-2008, decreased to 49 due to the voluntary liquidation process of the Turkish branch of a foreign bank, whose share in the banking sector's balance sheet is 5 per thousand.

At end-2008, the total asset size of the banking sector grew by 14 percent in real terms compared to the end of previous year and reached TL 733 billion, while it dropped by 4 percent to 481 billion in USD terms, in parallel with depreciation of TL. As of March 2009, the total asset size of the banking sector grew by 3 percent in nominal terms and 1.9 percent in real terms compared to the end of the previous year, and reached TL 754 billion.

The ratio of the Turkish banking sector's asset size to GDP increased to 77.1 percent at end-2008 from 69 percent at end-2007 (Chart II.2).

Meanwhile, as of March 2009, the concentration ratios of the first five banks and the first ten banks were realized as 60 percent and 83 percent, respectively, and these ratios remained unchanged in comparison to the end of 2007.

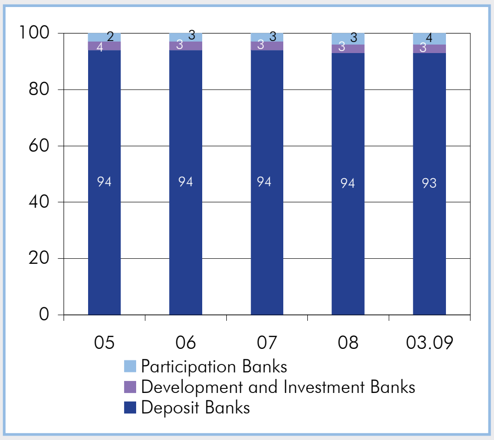
Table II.1 Indicators of the Banking Sector's Financial Depth and Intermediation Function[1,2]

Years	Deposits/GDP	Loans/GDP	Loans/Deposits
2004	35.2	19.8	56.3
2005	38.8	25.3	65.3
2006	40.6	30.0	74.0
2007	42.3	35.1	82.9
09.08	44.6	39.7	89.0
2008	47.8	40.2	83.9

Source: BRSA-CBRT, TURKSTAT
1) Non-performing loans are included in loans.
(2) Deposits include participation funds, loans include funds extended by participation banks.

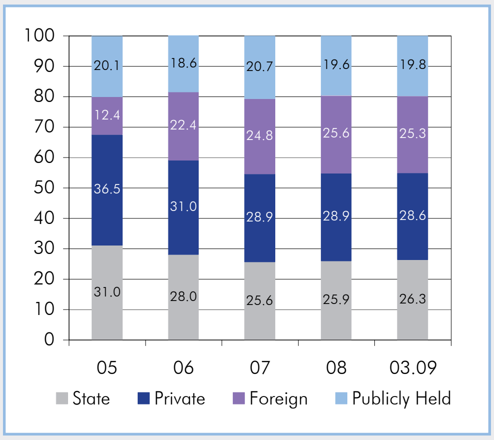
Although the ratio of deposits and loans to GDP and the ratio of loans to deposits, which reveal the financial depth and intermediation level of the banking sector, continued increasing, the ratio of loans to deposits decreased by 5 points in the last quarter of 2008 due to the tightening of credit conditions.

Chart II.3.
Banking Sector Assets by Groups (%)



Source: BRSA–CBRT

Chart II.4.
Banking Sector Assets According to Equity Ownership (%)[1]

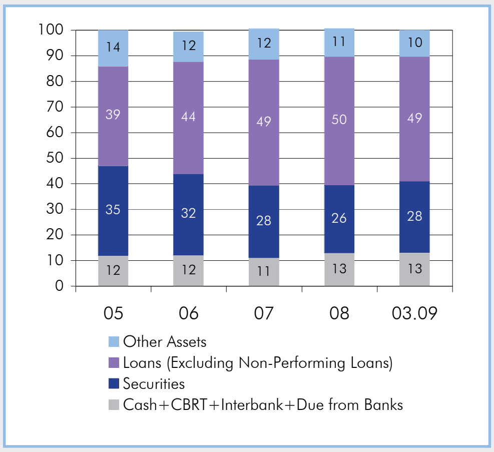


Source: BRSA-CBRT
(1) For publicly held shares no distinction is made between domestic and foreign investors.

By March 2009, of the 49 banks in the Turkish banking sector, 32 are deposit banks, 13 are development and investment banks and 4 are participation banks. As can be seen, deposit banking prevails in the Turkish banking sector (Chart II.3).

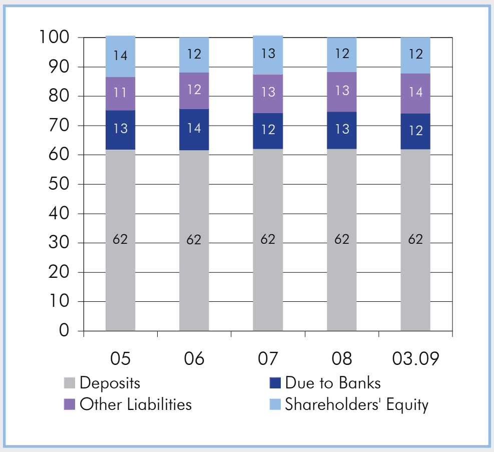
Based on their share in paid-up capital, the share of foreign stockholders in assets, which stood at 25.6 percent at end-2008, was realized as 25.3 percent in March 2009 (Chart II.4). Meanwhile, according to data of the Central Registry Agency, when the share of foreign participation in publicly held shares, which stood at 16 percent, are included, the share of foreign participation in the banking sector reaches 41.3 percent.

Chart II.5.
Asset Structure of the Banking Sector (%)



Soruce: BRSA-CBRT

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



Soruce: BRSA-CBRT

The share of the loan portfolio as the largest asset item decreased by 1 point compared to the end of the previous year and decreased by 4 points compared to September 2008, while the share of securities increased by 2 points to 28 percent as of March 2009 (Chart II.5).

As of March 2009, the share of deposits as the largest source of funds remained unchanged and the share of due to banks decreased by 1 point compared to the end of the previous year and became 12 percent, whereas the share of other liabilities increased by 1 point to 14 percent (Chart II.6).

II.2.Banking Sector Profitability and Capital Adequacy

II.2.1.Profitability[5,6]

The negative repercussions of the global crisis on our country have been first observed in the last quarter of 2008. Within this context, the net profit of the sector declined by 10.8 percent, compared to the end of the previous year and stood at TL 12.7 billion as of year-end 2008.

[5] Participation banks are excluded as their operating principles differ from other banks.
[6] Bank under SDIF is excluded.

Table II.2 Net Profit and Its Components (Million TL)

	2007	2008	Change (%)
I. Operating Income (A+B)	38,586	43,030	11.5
A- Net Interest Income	25,007	29,635	18.5
B- Non-Interest Income[1]	13.579	13.395	-1,4
II. Non-Interest Expenses (C+D)	22,248	28,355	27.4
C- Prov. for Credits and Other Receiv.	5,467	8,172	49.5
D- Other Operating Expenses	16,782	20,183	20.3
III. Net Operating Profit (I-II)	16,338	14,675	-10.2
IV. Other Income[2]	1.093	1.041	-4,7
V. Provision for Taxes	3,203	3,022	-5.7
VI. Net Profit (III+IV-V)	14,227	12,695	-10.8

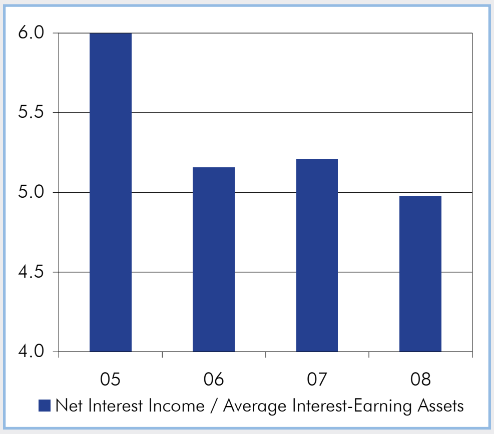
Source: BRSA - CBRT
(1) Non-Interest Income = Net Fees and Commissions Income (including Banking Services Income) + Dividend Income + Net Trading Income (Loss) + Other Operating Income
(2) Other Income = Profit Share Received Excluding Dividend Income + Extraordinary Income (Expenses).

At end-2008, despite the 11.5 percent rise in operating income due to the increase in net interest income and net fees and commissions income, the 27.4 percent rise in non-interest expenses resulted in a decline in the profitability of the banking sector. The decline in non-interest income was due to the fact that foreign currency gains turned into losses and income from the sale of assets in this period was not realized as high as the previous year (Table II.2).

In the last quarter of 2008, 84.1 percent rise in special provisions for non-performing loans, which increased significantly due to the negative repercussions of the global crisis on our country and slowdown in economic activity, and the upsurge in operating expenses, particularly personnel expenses and other non-interest expenses, pushed up non-interest expenses. The increase in non-performing loans and its adverse impact on profitability are expected to continue in 2009.

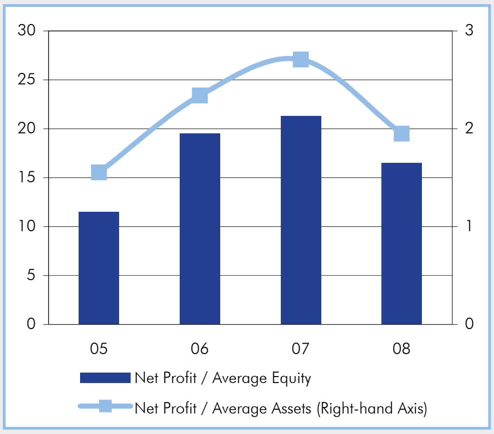
Amendments were made by the Turkish Accounting Standards Board so as to allow reclassification of “financial assets at fair value through profit or loss” and “financial assets available for sale”, to be effective as of 1 July 2008. The aim with this amendment was to limit the adverse effects of financial fluctuations on profitibality. However, although the interest rates on government domestic debt securities increased significantly since September 2008, when the negative repercussions of the global crisis first became noticable on our country, after November 2008 they dropped in parallel with the decrease in CBRT policy rates. Therefore, the advantage of the reclassification resulting from the rise in rates ended during the period the interest rates declined.

Chart II.7.
Net Interest Margin (%)



Source: BRSA–CBRT

Chart II.8.
Return on Assets and Return on Equity (%)

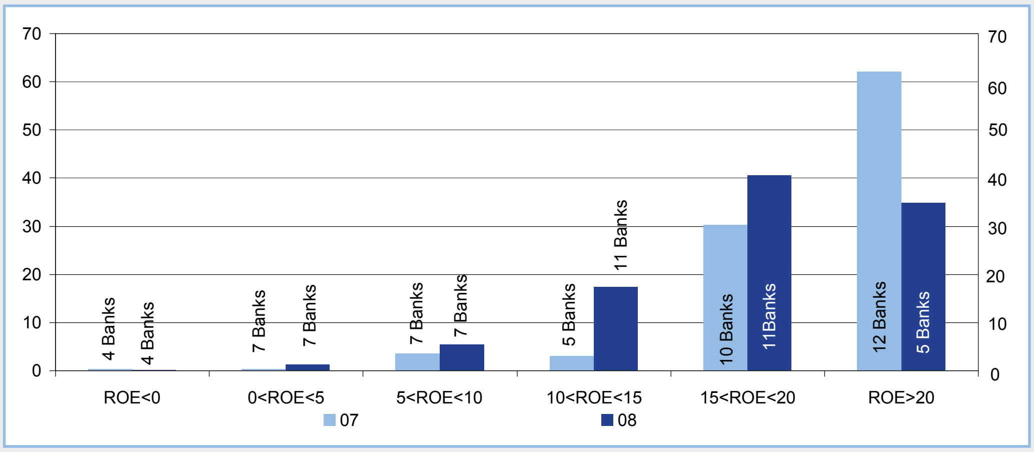


Source: BRSA–CBRT

The ratio of net interest income to average interest-earning assets, which was 5.2 percent at end-2007, decreased to 5 at end- 2008 (Chart II.7).

As of year end-2008, the return on assets and the return on equity were 1.9 percent and 16.5 percent, respectively. Both of these ratios which had been on rise previously, declined in 2008 (Chart II.8).

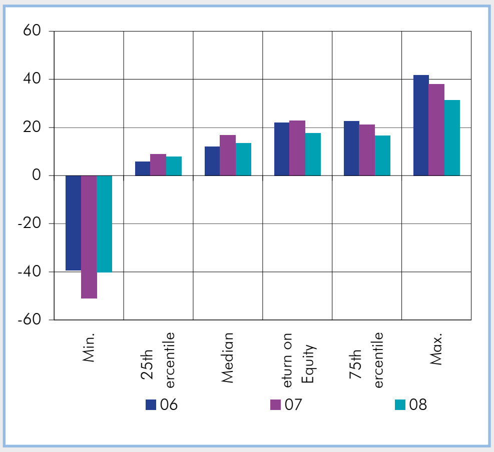
Chart II.9.
Return on Equity Based on Asset Share (%)



Source: BRSA–CBRT

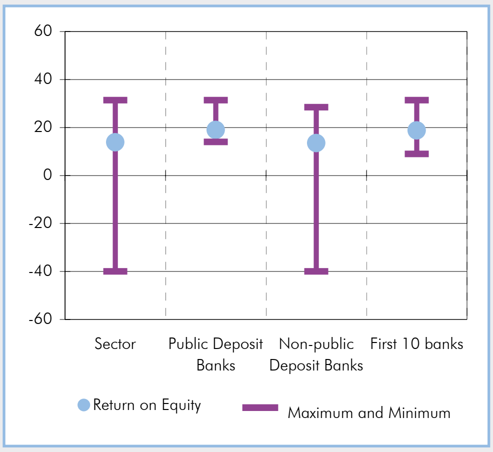
At end-2008, the number of banks with a ROE over 15 percent dropped from 22 to 16, while their share in total assets fell from 92.6 to 75.5 percent. Meanwhile, the number of banks declaring losses remained unchanged (Chart II.9).

Chart II.10.
Return on Equity of Deposit Banks (%)



Source: BRSA–CBRT

Chart II.11.
Return on Equity: Maximum and Minimum (December 2008) (%)



Source: BRSA–CBRT

In parallel with the sector, the ROE of deposit banks declined at end-2008. At end-2008, 75 percent of deposit banks had a ROE lower than 16.4 percent with a tendency to decline (Chart II.10). The asset size of deposit banks with a ROE over 16.4 percent constitutes 44.5 percent of the total assets of the sector.

At end- 2008, the value range for the ROE is narrow for both public deposit banks and the largest ten banks in terms of asset size. The broader range for non-public deposit banks is due to the effect of small banks (Chart II.11).

The net profit of the sector, which had been on the fall as of year end-2008, increased by 32.4 percent in the first quarter of 2009 compared to the same period of the previous year, and stood at TL 5 billion (Table II.3).

Table II.3 Net Profit and Its Components (Million TL)

	03.08	03.09	Change (%)
I. Operating Income (A+B)	10,886	14,198	30.4
A- Net Interest Income	7,297	9,503	30.2
B- Non-Interest Income[1]	3,589	4,695	30.8
II. Non-Interest Expenses (C+D)	6,704	8,439	25.9
C- Prov. for Credits and Other Receiv.	2,179	3,562	63.5
D- Other Operating Expenses	4,525	4,877	7.8
III. Net Operating Profit (I-II)	4,182	5,759	37.7
IV. Other Income[2]	522	388	-24.5
V. Provision for Taxes	931	1,151	22.6
VI. Net Profit (III+IV-V)	3,774	4,996	32.4

Source: BRSA – CBRT
(1) Non-Interest Income = Net Fees and Commissions Income (including Banking Services Income) + Dividend Income + Net Trading Income (Loss) + Other Operating Income
(2) Other Income = Profit Share Received Excluding Dividend Income + Extraordinary Income (Expenses).

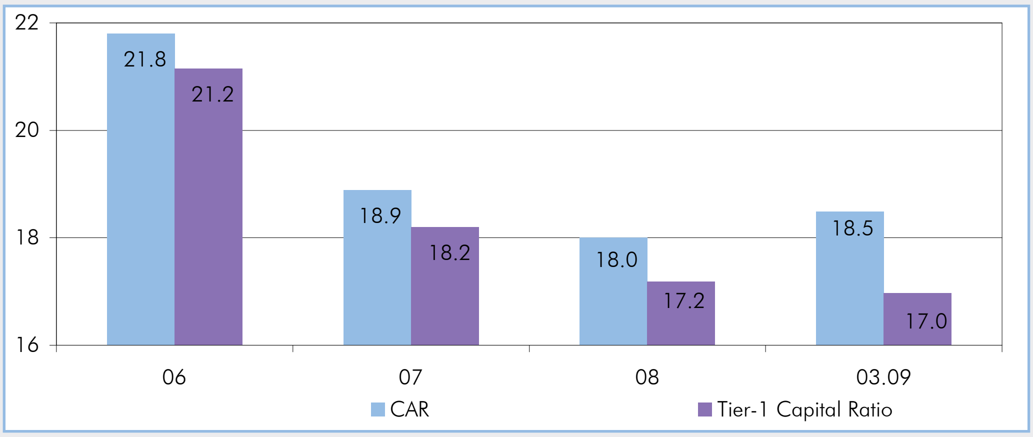
In the first quarter of 2009, the increase in the profitability of the banking sector was mainly due to the rise in operating income. Net interest income was the most important factor behind the increase in operating income. The ratio of net interest income to average interest-earning assets, which stood at 5 percent at end-2008, increased to 5.8 percent in this period. This rapid increase was mainly driven by the decline in funding cost resulting from the fact that the rate of decline in interest rate of loans lagged behind that of deposits due to the decline in CBRT policy rates. Moreover, non-interest income increased due to the fact that net trading losses turned into gains. The increase in net trading income was due to the increase in profits from the transactions in securities and the decrease in foreign currency losses. Another important development peculiar to this period was the 63.5 percent rise in provisions for credits and other receivables. The negative impact of the upward trend in non-performing loans on the profitability of the sector is expected to continue during the rest of 2009.

When the profitability ratios of the sector is analyzed, the return on assets which was 2.5 percent as of March 2008 and 1.9 percent at year-end, increased to 2.8 percent in March 2009, whereas the return on equity which stood at 20.7 percent and 16.5 percent in March 2008 and year-end respectively, increased to 22.9 percent as of March 2009.

II.2.2.Capital Adequacy

The unconsolidated capital adequacy ratio (CAR) of the banking sector, which is the ratio of own funds to total exposure stemming from credit, market and operational risks, is above both the minimum requirement of 8 percent and the target ratio of 12 percent for all periods under review.

Chart II.12.
Capital Adequacy Ratio (Unconsolidated) (%)



Source: BRSA – CBRT

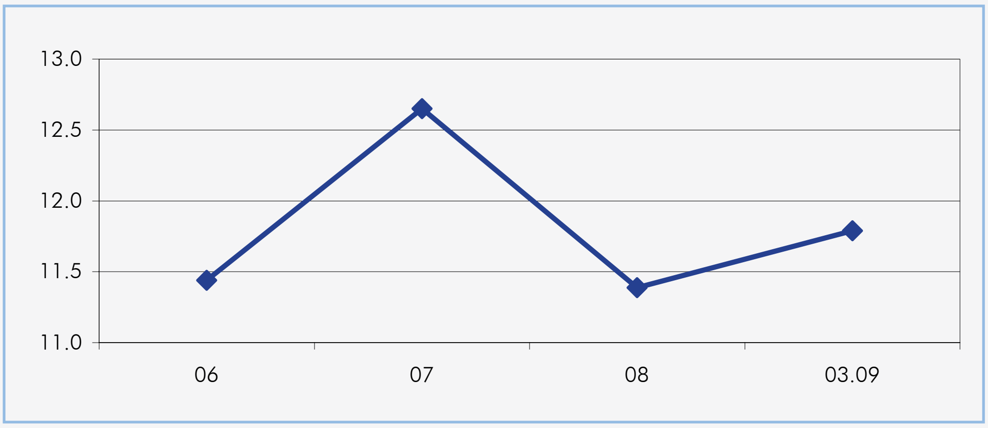
The CAR of the banking sector decreased by 0.9 points at end-2008, compared to end-2007 and became 18 percent (Chart II.12). This decline essentially stemmed from the increase in loans as well as the amendments to legislation changing the risk weights for letters of guarantee and letters of credit being effective from 2008. Meanwhile, the decline in Securities Revaluation Fund and profitability performance had an adverse effect on own funds.

In March 2009, the loans decreased while the securities portfolio with a zero risk weight increased compared to year-end, and this in turn limited the increase in risk weighted assets, despite the increase in exposure stemming from operational risk. Additionally, the high profitability performance of banks had a positive impact on own funds. As a result, CAR of the sector increased to 18.5 percent as of March 2009.

At end-2008, the tier-1 capital ratio, which is the ratio of core capital to total exposure stemming from credit, market and operational risks, also displayed a similar tendency (Chart II.12). Meanwhile, the tier-1 ratio decreased by 0.2 points as of March 2009, compared to the end-2008 and stood at 17 percent. This decline was due to the fact that some items that had been deducted from total capital previously, started to be deducted from tier-1 capital according to the provisional clause of the Regulation Regarding Banks' Own Funds published in the Official Gazette No. 26333 dated 1 November 2006, to be effective from 1 January 2009.

Box 12.
Tangible Common Equity

Chart 1. The Ratio of Tangible Common Equity to Tangible Assets (%)[1,2]



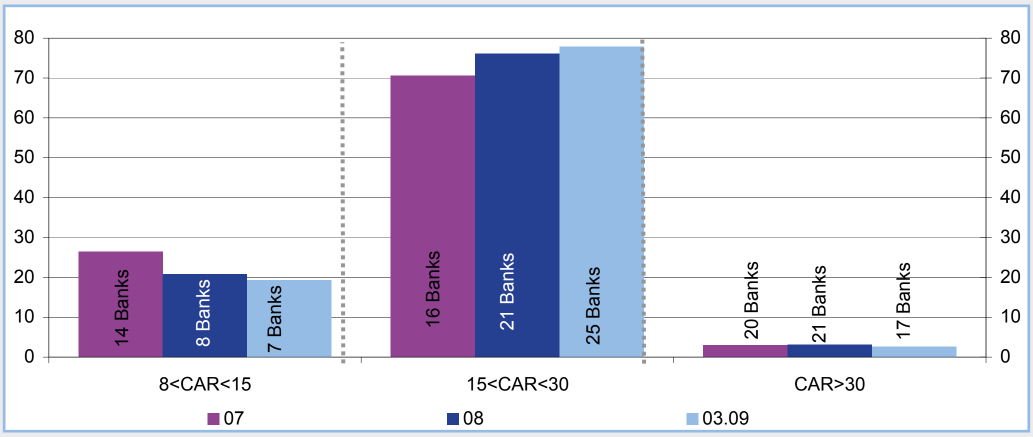
Source: BRSA-CBRT
(1Tangible Common Equity= Total Equity – Intangible Assets – Preferred Equity
(2) Tangible Assets= Total Assets – Intangible Assets

Another capital definition that has been on the agenda lately is the tangible common equity. In case of a deterioration in the financial structure of a bank, the value of intangible assets may decrease significantly, which in turn could lower the capacity of these sources to meet losses, and for that reason it is considered that these items should be deducted from equity.

In case of bankruptcy of a bank, preferred equity holders have a priority over common stockholders but other creditors. Moreover, preferred equity holders generally have the right to receive dividends at predetermined rates, which are like interest payments, and to sell back their shares to the company/bank at some predetermined date in the future. For this reason, preferred equity is a weaker source relative to common equity and has a lower capacity to meet losses. That is why it is argued that banks should have predominantly common equity in their tier-1 capital and should not solely rely on preferred equity. Therefore, it is expressed that tangible common equity, derived by deducting intangible assets and preferred equity from total equity, is more resilient to potential losses relative to capital adequacy ratio or tier-1 capital ratio.

Since the share of preferred equity is high in shareholders' equity of banks in developed countries and its capacity to meet losses is low relative to common equity, in many international reports the focus is on tangible common equity calculation. In the Morgan Stanley's report regarding Turkish Banks, dated 27 March 2009, it is stated that the ratio of tangible common equity to tangible assets in European banks range between 2-4 percent. Since the share of preferred equity in total equity is 0.2 percent and the share of intangible assets in total assets is 0.4 percent in our country, both the amount of tangible common equity and the ratio of tangible common equity to tangible assets are high. The ratio of tangible common equity to tangible assets decreased from 12.7 percent at end-2007 to 11.4 percent at end-2008, and as of March 2009, it is realized as 11.8 percent, with a limited increase (Chart 1).

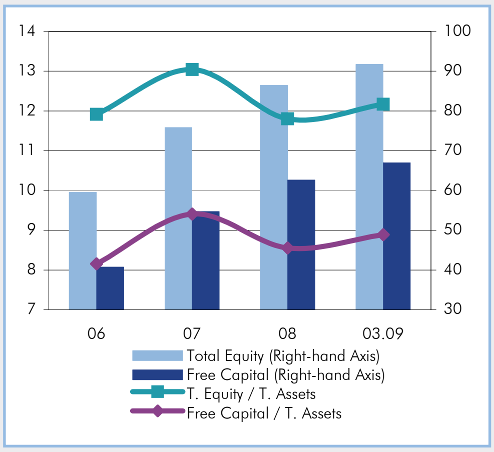
Chart II.13.
Asset Share of Banks Based on Capital Adequacy Ratio (%)



Source: BRSA-CBRT

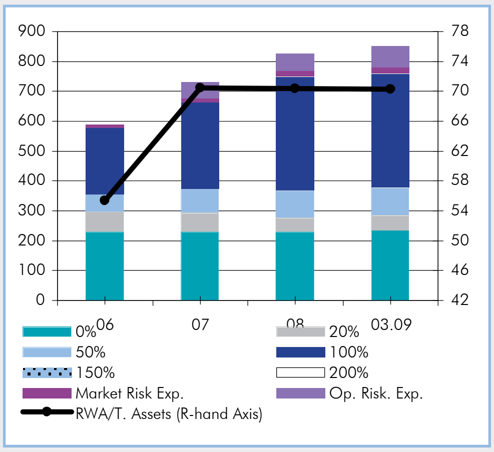
The CAR of 36 banks, which held 73.6 percent of sector assets, remained above 15 percent at end-2007, while that of 42 banks holding 79.2 percent of sector assets was realized above 15 percent at end-2008. As of March 2009, the CAR of the 42 banks which hold 80.6 percent of sector assets, exceeded 15 percent. (Chart II.13).

Chart II.14.
Free Capital of the Banking Sector
(%, Billion TL)



Source: BRSA-CBRT

Chart II.15.
Composition of Total Risk Exposure
(Billion TL, %)



Source: BRSA-CBRT

The ratios of free capital to total assets and total shareholders' equity to total assets decreased at end-2008. This decrease was driven by the fact that the rate of increase of shareholders' equity and free capital lagged behind that of assets, due to the decline in the Securities Revaluation Fund and profitability performance. Meanwhile, both ratios increased as of March 2009 compared to year-end 2008, due to the increase in shareholders' equity (Chart II.14).

The ratio of total exposure stemming from credit, market and operational risks to total assets was realized as 70.5 percent at end-2007 and remained unchanged at end-2008. However, it decreased to 70.3 percent as of March 2009 (Chart II.15).

Despite the adverse effects of the global crisis, the CAR of the Turkish banking sector maintains its high level and is still high relative to the CAR of the banking sectors of many developed and developing countries, suggesting that when capital is considered there is no obstacle regarding the extension of credit and banks maintain their strong capital structure by their prudential behaviour.