

## I. MACROECONOMIC DEVELOPMENTS

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

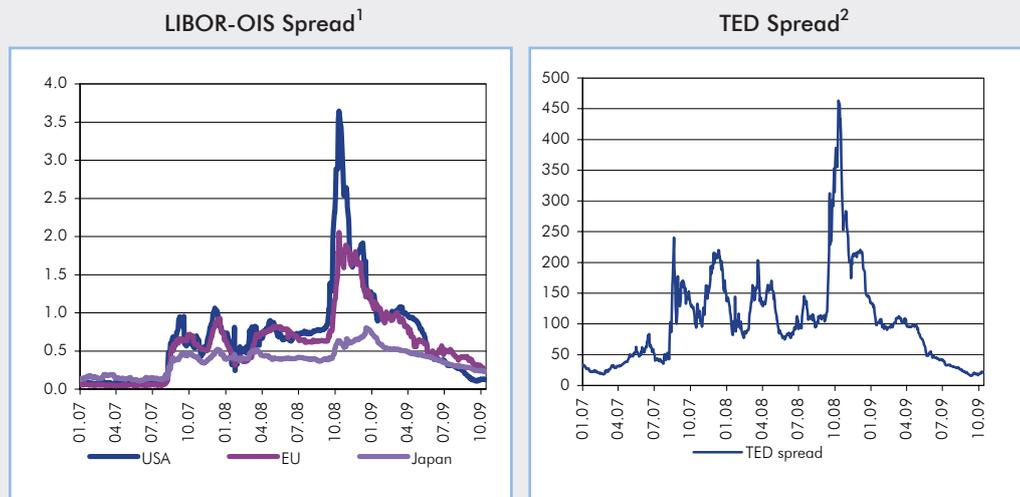
### I.1. External Sector

#### I.1.1. International Developments

The global crisis, which erupted in developed markets and then spread across the world during the last quarter of 2008, has continued to affect the economic outlook, albeit less forcefully during the third quarter of 2009. In this period, data releases on financial system and global economic activity indicated that the global economy has started to recover on the back of fiscal measures implemented by public authorities during the crisis. However, improvements in many leading indicators are still slow and instable, denoting that the recovery will likely be gradual.

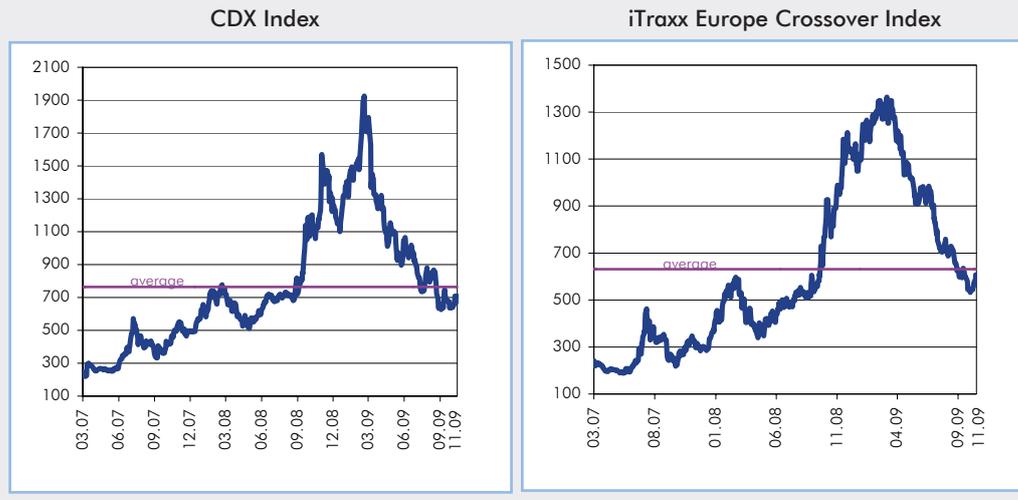
This recovery trend in the economy has bolstered the improvement that started in financial markets in the second quarter of the year. Indeed, the bottleneck in the improperly functioning interbank markets due to counterparty exposure has been remedied significantly as indicated by LIBOR-OIS and TED spreads (Chart I.1).

**Chart I.1.**  
Market Confidence Indicators in Selected Countries (Basis point)



Another outcome of measures taken is the reduction in credit default swap spreads, which are an indicator of the default risks of firms. The value of the CDX index comprising bonds of high-risk firms in US markets declined to levels prior to the bankruptcy of Lehman Brothers and remained well below 764.7, which was the average of the March 2007- October 2009 period. A similar trend was observed in the iTraxx Europe Crossover Index, comprising 50 of the most highly traded sub-investment grade corporate bonds in Europe (Chart I.2).

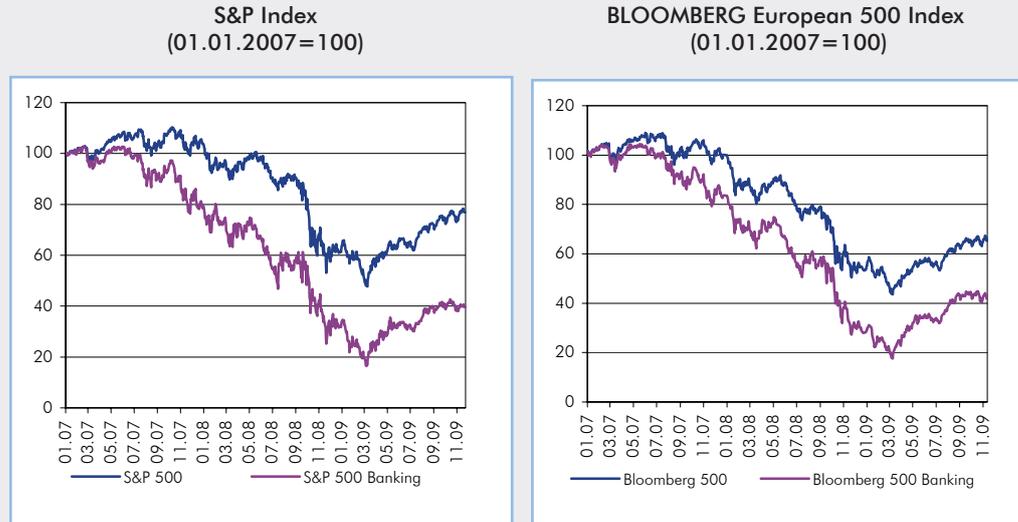
**Chart I.2.**  
Credit Default Swap Indices (Basis point)



Source: Bloomberg

There have been significant improvements in financial asset prices globally on the back of funds provided to the markets by central banks. As a matter of fact, following improvements in the bank balance sheets of developed countries due to government support and capital injections, the rise in stock markets, primarily in banking shares, continue (Chart I.3).

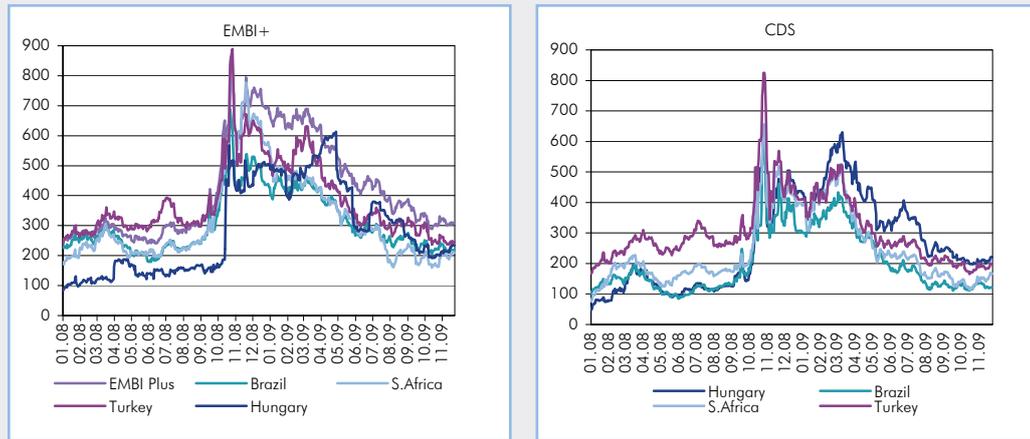
**Chart I.3.**  
Stock Market Developments in Developed Countries



Kaynak: Bloomberg

Capital flows from developed markets to emerging markets rebounded on account of the improvement in global risk perceptions and the sharp reduction in policy rates in developed countries, primarily in the USA. As a result of these flows, the currencies of emerging markets have appreciated against those of developed markets and the recovery in risk premia of emerging markets have further strengthened (Chart I.4 and I.6).

**Chart I.4.**  
Risk Premia<sup>1,2</sup> and Credit Default Swap (CDS) Spreads<sup>3</sup> of Selected Developing Countries (Basis Point)

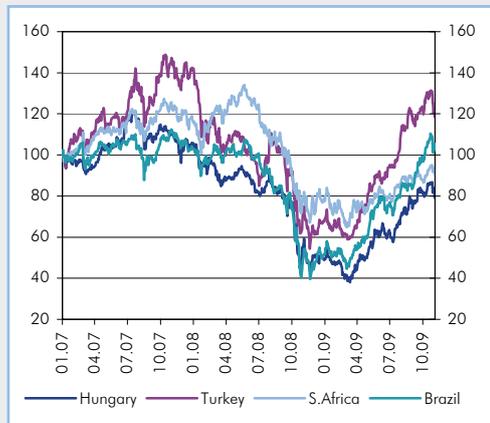


Source: Bloomberg

(1) Country risk premium is the difference between the relevant country's EMBI+ index and returns of US Treasury instruments.  
 (2) EMBI+ index includes Eurobonds of 18 developing countries, Brady bonds and traded loans. The weight of each country in the index is different. For instance, Brazil's weight is 22.49, Turkey's weight is 10.04 and South Africa's weight is 1.82 percent in the EMBI+ index. Also the index is calculated for each country individually.  
 (3) 5 year CDS contracts in USD are taken as benchmark.

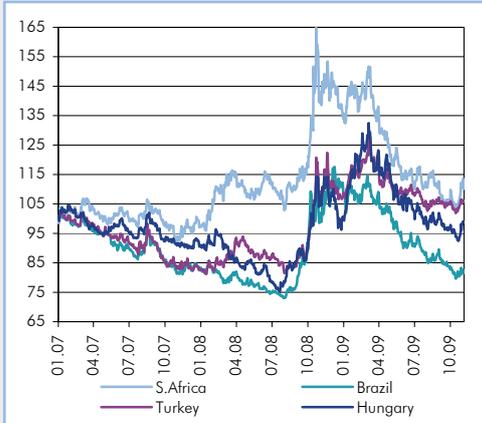
Overall, it is observed that the emerging financial markets recovered faster than the developed markets and financial indicators approached pre-crisis levels. This development is mainly attributable to the rise in portfolio investments in developing countries due to low rates of return in developed countries (Chart I.5 and I.6).

**Chart I.5.**  
Stock Market Developments in Developing Countries



Source: Bloomberg

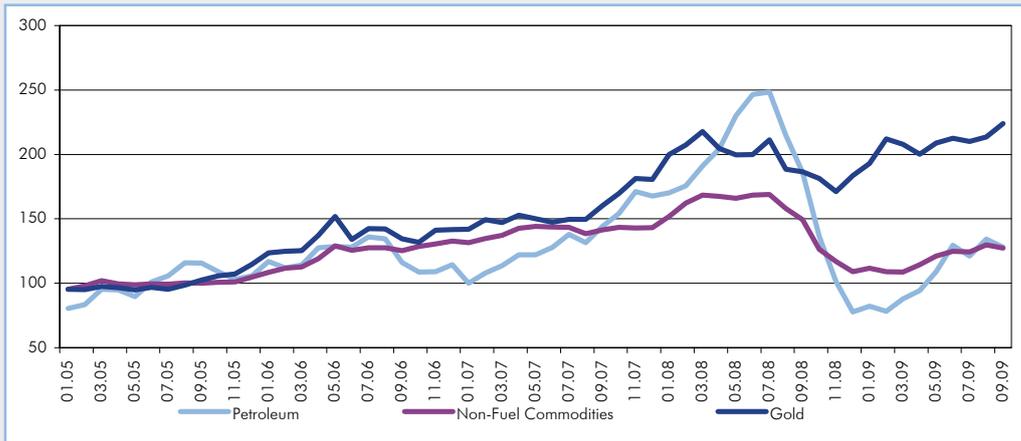
**Chart I.6.**  
Nominal Exchange Rates in Developing Countries (Index 01.01.2007=100)



Source: Bloomberg

In addition to the surge in portfolio investments, the rise in commodity prices also bolsters the recovery in emerging markets. Though this rise has a favorable impact on raw material exporting developing countries, it is considered a threat to global economic recovery and the inflation process (Chart I.7). Another risk that may hit global inflation expectations and long-term global market interest rates is fast-growing budget deficits at global level due to measures taken (Table I.4).

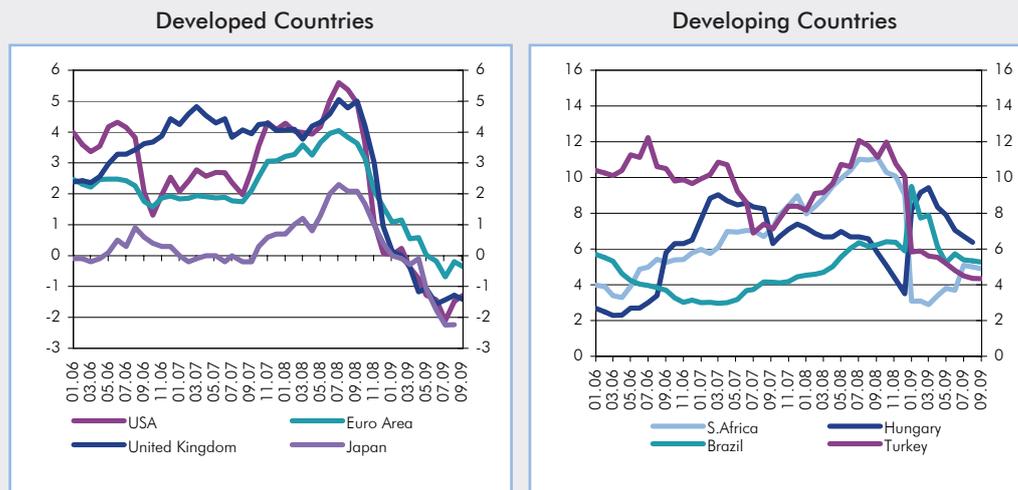
**Chart I.7.**  
Commodities' Price Index



Source: Bloomberg

Downward trend of inflation rates on the back of contracting demand due to global turmoil allowed central banks to focus on curbing economic contraction. Against this backdrop, monetary policies both in developed and developing countries have been markedly loosened (Chart I.8).

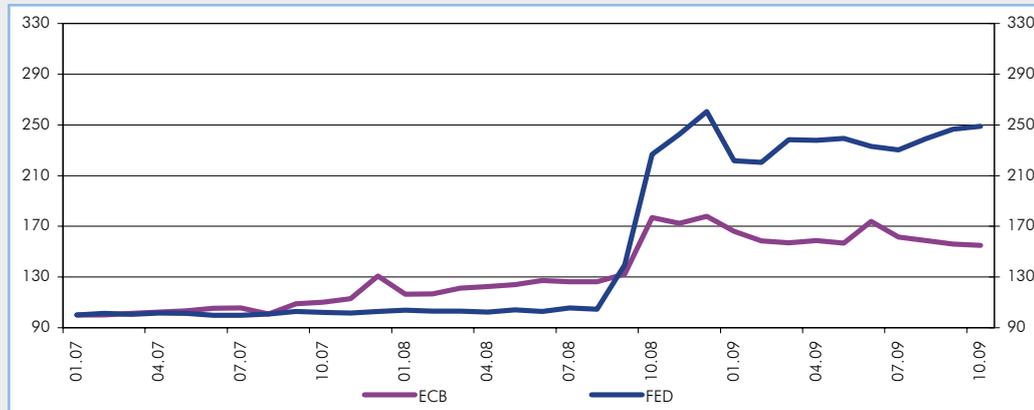
**Chart I.8.**  
Inflation Rates in Selected Countries (CPI annual percentage change)



Source: IMF IFS

Moreover, it has been observed that central banks frequently resorted to non-conventional policy instruments in this period. This led to significant changes in balance sheet aggregates and compositions of central banks chiefly of developed countries (Chart I.9).

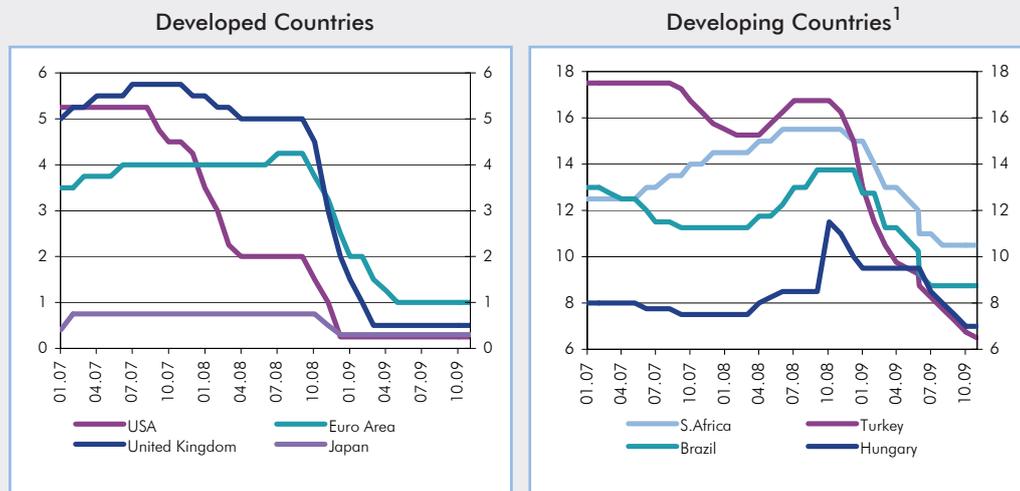
**Chart I.9.**  
Indices of Balance Sheets' Size of Fed and ECB  
(31.01.2007=100)



Source: Bloomberg

Meanwhile, similar to the developed countries, developing countries, under recessionary pressures, also lowered their policy rates to the extent the differences in their economic fundamentals enabled them (Chart I.10).

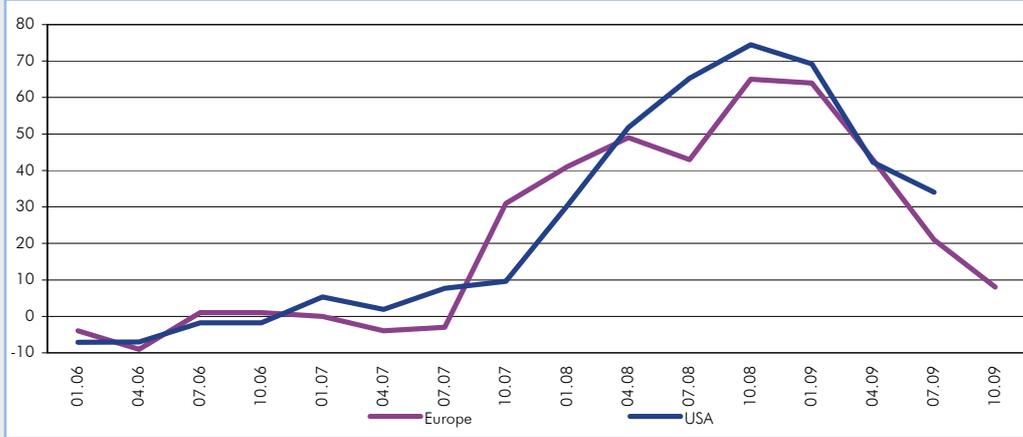
**Chart I.10.**  
Policy Rates in Selected Countries (%)



Source: Central banks of countries  
(1) The overnight borrowing interest rate has been used for Turkey.

Nevertheless, despite the measures taken, it is a widely accepted fact that the positive atmosphere in financial markets cannot fully impact the corporate sector without fixing troubled balance sheets of banks in developed countries. As a matter of fact, results of surveys carried out regarding lending conditions both in the USA and Europe suggest that fewer banks tightened their lending conditions compared to the previous period, yet lending conditions still remained tight in comparison to the pre-crisis period (Chart I.11).

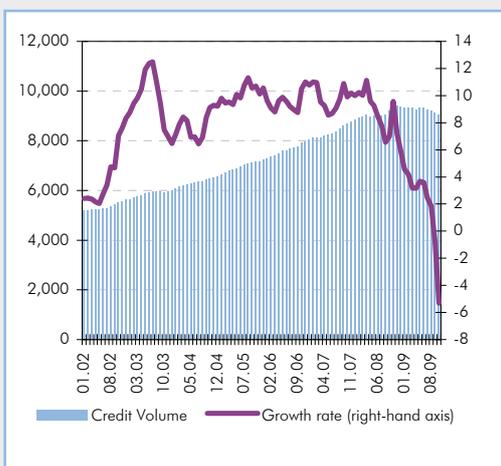
**Chart I.11.**  
Share of Banks that Have Tightened Lending Conditions in the US and European Banking Sectors (%)



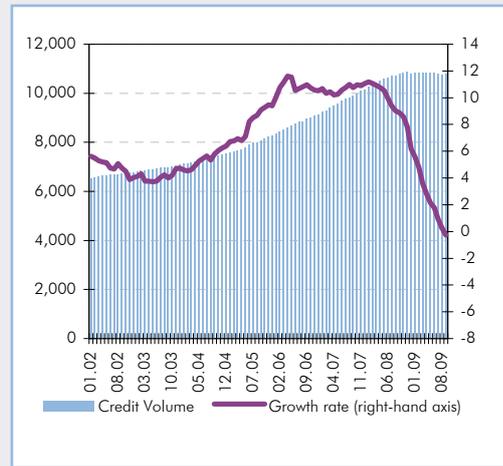
Source: ECB, Fed

While the annual rate of increase in credit volume of the banking sector in the USA and the Euro area slowed down from early 2008 on due to tight credit conditions, it turned into negative as of the second quarter of 2009 and as of September, in the USA and the Euro area, respectively (Chart I.12).

**Chart I.12.**  
Credit Developments in the USA and European Banking Sectors (Billion USD, Billion Euro, %)



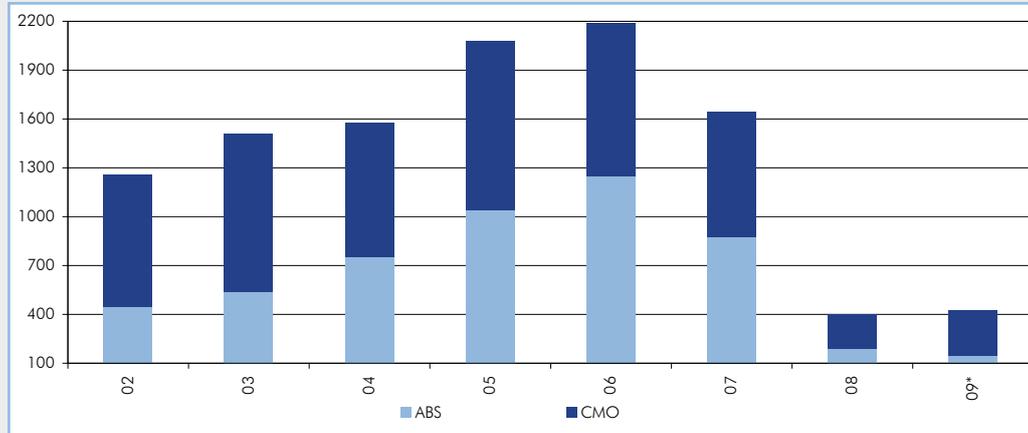
Source: Fed.



Source: ECB.

The contraction in credit volume of developed countries is mainly driven by the significant recession in securitization markets used for funding consumer loans. As a matter of fact, while asset-backed securities and securities backed by housing loans issued in the pre-crisis period of 2006 amounted to a total of USD 2.2 trillion, this figure decreased to USD 428 billion in the first ten months of 2009 (Chart I.13).

**Chart I.13.**  
**Issuance of Asset Based Securities (ABS) and Collateralized Mortgage Obligations (CMO) (Billion USD)**

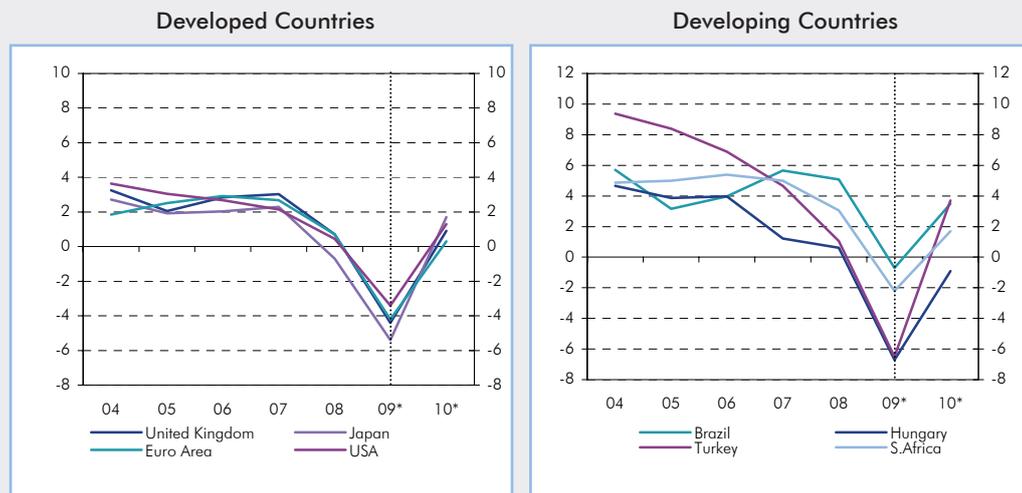


Source: Bloomberg  
 (\*) As of October.

Therefore, it is still a concern that recovery in the global economy will not be sustainable without remedying problems in the credit markets and without public financing.

Nevertheless, international institutions have been revising growth forecasts upwards, considering government subsidies in place, hence, there has been some improvement in expectations. According to IMF forecasts, developed and developing countries are expected to grow by 1.25 percent and 5 percent, respectively in 2010 (Chart I.14).

**Chart I.14.**  
**Growth Rates in Selected Countries (Annual percentage change)**



Source: IMF IFS, IMF WEO, EU European Economy  
 (\*) Forecast (IMF, October 2009)

The recent G-20 and FSB meetings stressed that it was of great importance that countries should mutually coordinate and collaborate their exit strategies from crisis policies. Coordination and collaboration assume particular importance in respect of avoiding the adoption of contradictory strategies (Box 1).

For the purpose of avoiding the reoccurrence of the setbacks and problems experienced during the crisis, the related authorities under the G-20 are working on new regulations that mainly address the financial sector and a road map has been designed for this purpose (Boxes 2,3,4,5).

It is believed that the new regulations, which are planned to be enforced after sustainable growth on a global basis has been ensured, will provide the necessary ground for stable financial markets. Nevertheless, it is also considered that it will be difficult to catch up with growth and profitability levels of the previous periods.

#### Box 1.

##### Exit Strategies: When and How?

Many policy support measures have been implemented in order to mitigate the adverse effects of the global crisis. To end these measures, in other words, to exit from these support measures, has become an important area of concern. Besides, the existence of cross border issues is another significant concern due to the fact that many banks active internationally were adversely affected by the crisis. When we take into account the global and fast moving nature of capital outflows, cooperation among jurisdictions and timely implementation of exit strategies become even more important. Therefore, when and how to implement exit strategies has recently started to be discussed in the international arena.

In this regard, the below mentioned principles for exit have been developed by the IMF and presented at the G-20 Finance Ministers and Central Bank Governors meeting, which was held in St. Andrews on November 6–7, 2009.

Principle 1. The timing of exits should depend on the state of the economy and the financial system, and should not be ceased before sustainable stability is achieved.

Principle 2. With some exceptions, fiscal consolidation should be a top policy priority.

Principle 3. Fiscal exit strategies should be transparent, comprehensive, and clearly communicated, with the goal of lowering public debt to prudent levels within a clearly specified timeframe.

Principle 4. Stronger primary balances should be the key driving force of fiscal adjustment, beginning with actions to ensure that crisis-related fiscal stimulus measures remain temporary.

Principle 5. Unconventional monetary policy does not necessarily have to be unwound before conventional monetary policy is tightened.

Principle 6. Economic conditions, the stability of financial markets, and market-based mechanisms should determine when and how the financial policy support is removed.

Principle 7. Making exit policies consistent will improve outcomes for all countries. Coordination does not necessarily imply synchronization, but a lack of policy coordination could create adverse spillovers.

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Source: IMF document presented at meetings of G-20 Finance Ministers and Central Bank Governors November 6–7, 2009 St. Andrews, United Kingdom.

**Box 2.****Recent Resolutions with respect to the Global Crisis Made Within the G-20 Framework**

Within the framework of the decisions made by the G-20, in order to mitigate the effects of the global crisis and to prevent its reoccurrence, work is in progress to strengthen financial systems, to fill the gaps in the regulatory framework so as to bolster financial strengthening and to support economic growth.

At the G-20 meetings in London and Pittsburgh, the progress that has been made towards the targets put forward at the beginning of the process was assessed. Finally, at their St. Andrews meeting, G-20 Finance Ministers and Central Bank Governors agreed that financial conditions have improved following coordinated response to the crisis, however, recovery is uneven and remains dependent on policy support, and high unemployment remains a major concern.

Within this framework, G-20 Finance Ministers and Central Bank Governors stated that,

- As part of the “Framework for Strong, Sustainable and Balanced Growth”, which was launched at the G-20 Pittsburgh meeting as a new approach to economic cooperation, they have initiated a new consultative mutual assessment process to evaluate whether national policies will collectively deliver the agreed global objectives and that they will be assisted in their assessment by the IMF, the World Bank and other international organizations. Within this framework, national and regional policy frameworks, programmes and projections will be outlined by the end of January 2010, the initial phase of the cooperative mutual assessment process will be conducted in April to assess the collective consistency of national and regional policies with the objectives, a basket of policy options to deliver those objectives will be developed for leaders to consider at their next Summit in June 2010, and more specific policy measures will be developed for leaders at their Summit in November 2010.
- While they will continue to provide support to the economy until recovery is secured, they also committed themselves to further develop their strategies for managing the withdrawal from extraordinary macroeconomic and financial support measures.
- The FSB will continue to work on strengthening the global financial system and within this framework they emphasized the need for the Basel Committee to develop stronger standards by end-2010 and that these standards should be implemented by end-2012.
- To ensure that compensation policies and practices support financial stability, they have committed themselves to incorporating the FSB standards within national frameworks, and call on firms to implement these sound compensation practices immediately.

**Sources:**

- 24-25 September 2009 G-20 Pittsburgh Summit Leaders' Statement
- 7 November 2009, London, G-20 Finance Ministers and Central Governors Meeting Communiqué

**Box 3.****Basel Committee on Banking Supervision's Work on Strengthening Prudential Regulation**

According to decisions to strengthen the global financial system that were taken at G-20 summits, the Basel Committee is expected to complete work on developing stronger standards by end-2010 and these standards are foreseen to be implemented by end-2012. Improving the quality of capital, decreasing the effects of procyclicality, liquidity and leverage ratios very much stand in the forefront in all studies made.

As it is well known, the global crisis revealed that most banks in developed countries have insufficient levels and quality of capital. To tackle this problem a working group was formed and it decided that the predominant form of Tier 1 capital must be common stock and retained earnings in order to strengthen the quality and transparency of capital. In line with this, appropriate principles will also be developed for non-joint stock companies to ensure they hold comparable levels of high quality Tier 1 capital. Besides, deductions from capital will be harmonized internationally and generally applied at the level of common equity. It is also stipulated that all components of the capital base will be fully disclosed.

In addition to the regulatory minimum, the objective is to develop specific mechanisms for countercyclical capital buffers to curb the unfavorable effects of procyclicality. Procyclicality is a mechanism that produces unfavorable secondary effects on the financial system by amplifying the primary effects of cyclical movements. In order to curb such effects, it is aimed to dampen any excess cyclicality of the minimum requirement that is required by the Basel II Capital Accord. By doing this, the main intention is to conserve capital to build up capital buffers in individual banks to be used under stress conditions, and hence to enable them to continue to operate effectively.

High leverage across the financial system is considered to be one of the main reasons responsible for global financial turmoil. In this context, it has been decided to establish a leverage ratio that would supplement the Basel II framework and be mandatory. The intention is to limit the build-up of leverage during boom periods. While developing the proposal, to make it comparable among countries, differences in accounting standards and other related details are being taken into consideration.

Prior to the crisis, many banks treated available liquidity as a free good due to its abundance, increasingly developed and invested in complex structured products, ignored stress scenarios that involved key asset and funding markets drying up and a sustained period of liquidity stress, and the interaction of credit, market and liquidity risks. These factors left the banking sector with inadequate liquidity cushion to absorb the current period of stress and ultimately required massive injections of liquidity by central banks. The lesson drawn from these recent experiences is that the banks' resilience to system-wide liquidity shocks must be significantly increased and the management of this risk must be strengthened. In this context, the Basel Committee continues its work to strengthen the global framework on the regulation, supervision and management of liquidity risk and to set a mandatory liquidity ratio.

**Box 4.****Developments in International Financial Reporting Standards**

The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) issued a Memorandum of Understanding (MoU) in February 2006, in order to converge the Generally Accepted Accounting Principles (GAAP) developed by the FASB and International Financial Reporting Standards (IFRS) developed by the IASB and prepared a joint work programme. A progress report and timetable for completion of MoU were published in September 2008.

Along with the global financial crisis since 2007, there has been an urgent necessity to tackle the differences between IFRS and GAAP and other problems related to financial reporting. Within this context, in October 2008, the IASB and FASB set up the Financial Crisis Advisory Group (FCAG) to consider the financial reporting issues arising from the global financial crisis and in November and December 2008, they held three public roundtables to gather views from constituents on the most urgent accounting issues and how to approach them. Moreover, in order to tackle the problems related to the global financial crisis, in line with recommendations of the Financial Stability Board (FSB), G20 Leaders reached the following conclusions about accounting issues in summits held in Washington DC on November 15, 2008, in London on April 2, 2009 and in Pittsburgh on September 24-25, 2009.

- To reduce the complexity of accounting standards for financial instruments,
- To strengthen accounting recognition of loan-loss provisions by incorporating a broader range of credit information,
- To improve accounting standards for provisioning, off-balance sheet exposures and valuation uncertainty,
- To achieve clarity and consistency in the application of valuation and provisioning standards internationally, working with supervisors,
- To improve the IASB's institutional framework, with the involvement of stakeholders, including prudential regulators and emerging markets,
- To enhance the required amount of disclosure in relation to complex financial products by firms to market participants,
- To increase the efforts of international accounting bodies to achieve a single set of high quality, global accounting standards and to complete their convergence project by June 2011.

The IASB classified some of the joint projects with the FASB as "financial crisis related projects", in line with the recommendations of the G20 and other international bodies such as the Financial Stability Forum (FSF), and intensified their efforts to complete these projects. These projects and the timetable for their completion are given in Table 1.

**Table 1. Estimated publication date of Exposure Drafts (ED) and Standards (IFRSs) for financial crisis related projects**

	IV-08	I-09	II-09	III-09	IV-09	I-10	III-10	IV-10
1. Consolidation	ED						IFRS X	
2. Derecognition		ED					IFRS X	
3. Fair value measurement guidance			ED				IFRS X	
4. Financial instruments (IAS 39 replacement)								
a. Classification and measurement				ED	IFRS 9			
b. Impairment					ED		IFRS X	
c. Hedge accounting						ED	IFRS X	

The first phase "Classification and Measurement" of the Financial Instruments project that replace IAS 39 has been completed and a new standard called "IFRS 9 - Financial Instruments" was published on November 12, 2009.

One of the most important amendments of the new standard is the abolition of the current complicated application, which classifies financial assets in four categories, named "fair value", "available for sale", "held to maturity" and "loans and receivables". According to the new application, financial assets are classified and measured in two categories, named "amortised cost" and "fair value". Financial assets are classified by taking into account the entity's business model used to manage its financial instruments and the contractual cash flow characteristics of the financial assets. If the objective of the business model is to hold the financial asset for collection of the contractual cash flows, and the contractual cash flows under the instrument solely represent payments of principal and interest, these financial assets are measured at amortised cost, otherwise at fair value. IFRS 9 requires reclassifications of assets when the entity's business model changes.

The new classification and measurement guidance will be effective as of January 1, 2013; mandatory adoption may require subsequent reconsideration depending on the second phase of the Financial Instruments project, "Impairment". However, early adoption is permitted for 2009 year-end financial statements.

## Sources:

- <http://www.iasb.org/>
- <http://www.g20.org/>

### Box 5. Compensation Policies

The large bonuses generated by short-term profits, which are earned particularly from transactions involving complex financial instruments, paved the way for the ignorance of the risks that might arise from such transactions in the long term. This situation resulted in excessive risk taking and became a factor that impairs stability of the global financial system. Therefore, G-20 Leaders considered firm's compensation policies one of the causes of the crisis and decided to address this issue as an important reform area.

With an aim to determine the main principles on this area, a "Compensation Working Group" was established under the FSB. In April 2009, this Working Group published the main international policy document on firms' compensation practices, titled "FSB Principles for Sound Compensation Practices". The document laid out its principles under 3 main headings:

1. Effective governance of compensation
2. Effective alignment of compensation with prudent risk taking
3. Effective supervisory oversight and engagement by stakeholders

On the other hand, the Basel Committee on Banking Supervision commenced work to ensure that FSB principles are implemented by national authorities and incorporated these principles in the Supervisory Review Process (Pillar 2) of the Basel II framework in July 2009.

At their latest meeting in November 2009, G-20 Finance Ministers and Central Bank Governors committed themselves to urgently incorporate the FSB standards within their national frameworks, and called on firms to immediately implement those sound compensation practices.

Led by the United States and Members of the European Union, work is underway in many countries to align their national regulations with the FSB principles. The FSB will assess and monitor implementation and report back with further proposals, as required, by March 2010.

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Sources:

- "FSF Principles for Sound Compensation Practices", Financial Stability Board, April 2, 2009
- "Overview of the implementation of the FSB Principles on Sound Compensation Practices", Basel Committee on Banking Supervision, August 27, 2009
- "FSB Principles for Sound Compensation Practices-Implementation Standards", Financial Stability Board, September 25, 2009
- G-20 Leaders' Statement, Pittsburgh, September 25, 2009

### 1.1.2. Balance of Payments

Reduced demand for consumption and investment driven by the global crisis and falling energy prices have led to a significant decline in the current account deficit since the last quarter of 2008. Moreover, it is observed that the financing structure of the current account deficit has changed due to the crisis (Table I.1).

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

	2005	2006	2007	2008	09.09*
<b>CURRENT ACCOUNT</b>	<b>-22.1</b>	<b>-32.1</b>	<b>-38.2</b>	<b>-41.8</b>	<b>-14.6</b>
Foreign Trade Balance	-33.0	-41.0	-46.7	-53.0	-25.0
Total Exports of Goods <sup>1</sup>	78.4	93.6	115.4	140.8	107.6
Total Imports of Goods <sup>1</sup>	-111.4	-134.6	-162.0	-193.8	-132.6
Coverage Ratio (%)	70.4	69.6	71.2	72.7	81.2
Balance of Services	15.3	13.7	13.3	17.2	16.5
Balance of Income	-5.9	-6.7	-7.1	-8.2	-7.9
Current Transfers	1.5	1.9	2.2	2.1	1.9
<b>CAPITAL &amp; FINANCIAL ACCOUNT</b>	<b>19.5</b>	<b>32.1</b>	<b>36.6</b>	<b>36.4</b>	<b>1.4</b>
Foreign Direct Investments	9.0	19.3	19.9	15.8	9.0
Portfolio Investments	13.4	7.4	0.7	-5.0	-4.9
Other Investments	14.9	11.5	24.0	24.6	-8.7
Reserve Assets	-17.8	-6.1	-8.0	1.1	5.9
<b>NET ERRORS &amp; OMISSIONS</b>	<b>2.6</b>	<b>0.0</b>	<b>1.6</b>	<b>5.4</b>	<b>13.2</b>

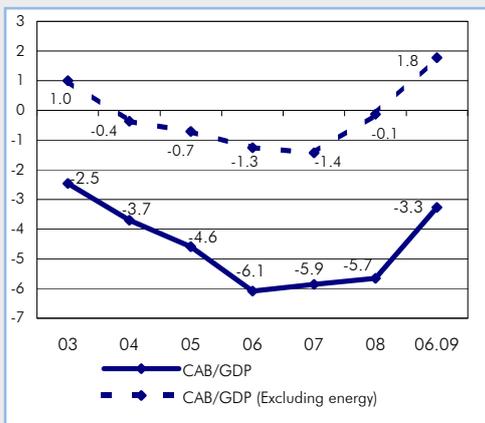
Source: CBRT

(\*)Cumulative figures for the last 12 months.

(1) Including shuttle trade, non-monetary gold and goods procured in ports by carriers.

The current account, which posted the highest deficit amounting to USD 49 billion on an annual basis by August 2008, has sharply contracted since October 2008, when the impact of the global financial crisis on domestic and external demand became apparent, and fell to USD 14.6 billion in September 2009 (Table I.1).

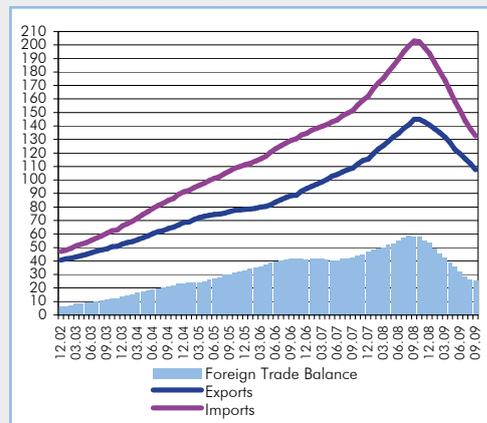
Chart I.15.  
Current Account Balance (CAB) to GDP Ratio  
and the Impact of Energy Prices<sup>1</sup> (%)



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.16.  
Export - Import Volumes and the Trade  
Deficit<sup>1</sup> (Billion USD)



Source: CBRT

(1) Cumulative figures for the last 12 months.

The ratio of current account deficit to GDP, which was 5.7 percent at end-2008, fell to 3.3 percent in the first half of 2009. Meanwhile, excluding imports and exports of energy items, which are the major source of the foreign trade deficit, it is observed that Turkey has been yielding a current account surplus since early 2009 (Chart I.15).

Current account balances of some other developing countries in need of external funding for economic growth due to insufficient domestic saving rates like Turkey also showed significant improvements (Table I.2).

**Table I.2. GDP Growth Rate and Current Account Deficit to GDP Ratio in Selected Economies (%)**

	2008		2009*		2010**	
	Growth	Current Account/GDP	Growth	Current Account/GDP	Growth	Current Account/GDP
Turkey	0,9	5,7	-6,5	1,9	3,7	3,7
Bulgaria	6,0	25,5	-6,5	11,4	-2,5	8,3
Romania	7,1	12,4	-8,5	5,5	0,5	5,6
Poland	4,9	5,5	1,0	2,2	2,2	3,1
South Africa	3,1	7,4	-2,2	5,0	1,7	6,5
Hungary	0,6	8,4	-6,7	2,9	-0,9	3,3
Czech Republic	2,7	3,1	-4,3	2,1	1,3	2,2

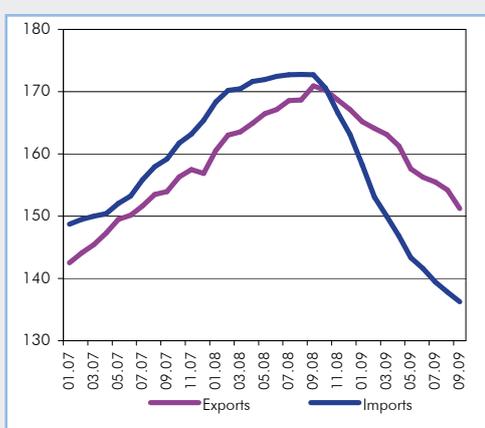
Source: IMF World Economic Outlook, October 2009

(\*) Prediction

(\*\*) Forecast

Exports and imports, the most important components of the current account, which started to trend down on an annual basis in October 2008, are still on the decline. While the drop in energy and commodity prices led to a faster slump in imports compared to exports in terms of value, the diversification in our export markets was instrumental in keeping the decline of exports relatively limited. Thus, a period of sharp contraction was undergone in foreign trade deficit (Chart I.16, Chart I.17, Chart I.18).

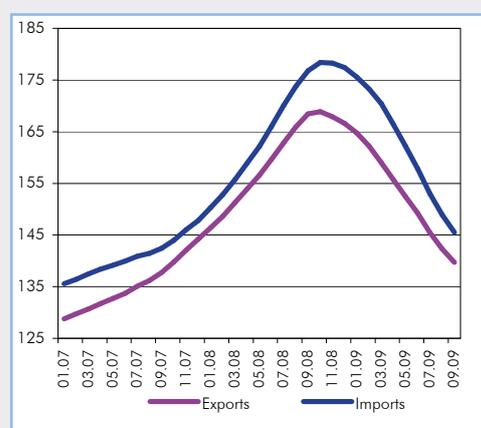
**Chart I.17. Imports and Exports Volume Indices<sup>1</sup>**



Source: CBRT

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

**Chart I.18. Imports and Exports Unit Value Indices<sup>1</sup>**

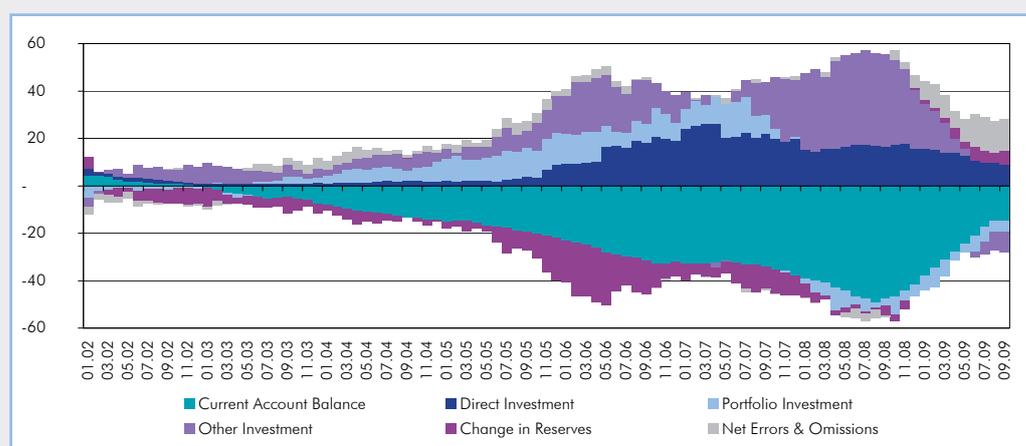


Source: CBRT

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

The surplus in the balance of services, another component of the current account, did not display a remarkable change compared to figures of end-2008 due to the limited decline in tourism revenues and the decrease in freight expenditures. However, the deficit in the balance of income slightly contracted owing to decreasing income transfers of foreign direct investments and falling interest expenditures. Current transfers comprising the amounts granted to the general government and the workers' remittances have not indicated a notable change recently (Table I.1).

**Chart I.19.**  
Development of the Balance of Payments Items<sup>1, 2, 3, 4, 5</sup> (Billion USD)



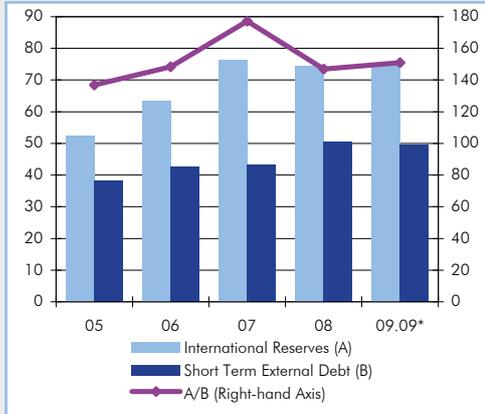
Source: CBRT

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

The financing structure of the current account deficit that narrowed down due to global turmoil also changed significantly. It was observed as of September 2009 that during the past 12-month period, banks and the private sector had been net foreign debt payers, while portfolio investments displayed outflows. In the meantime, although direct investments decreased due to the global liquidity crunch and lingering uncertainties, they became the most stable financing item in relative terms. The payments related to energy sector privatizations of 2008 comprised the major part of direct investments in 2009 (Chart I.19).

The net errors and omissions item, which has boomed recently, reached USD 13.2 billion by September 2009. The reasons for this boom are considered to be the sales of FX savings in cash that were outside the domestic banking system to banks against TL in addition to discrepancies in the accounting of exchange rate movements.

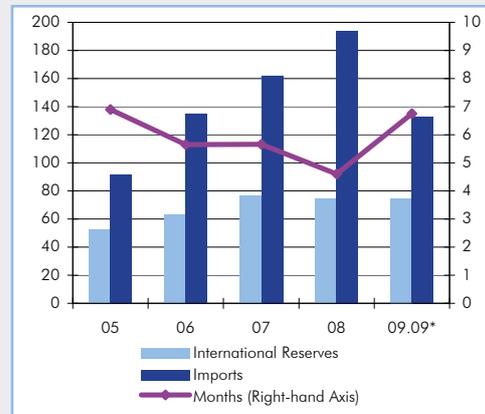
**Chart I.20.**  
Short-Term External Debt<sup>1</sup> and International Reserves<sup>2</sup> (Billion USD, %)



Source: Undersecretariat 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.21.**  
Import Coverage Ratio of Reserves<sup>1,2</sup> (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 that is covered by the year-end international reserve amount of that year.  
(\*) Cumulative figures for the last 12 months is used for imports.

While the ratio of international reserves to short-term external debt stock, one of the indicators of external debt service capacity, was 147 percent at end-2008, it became 151 percent by September 2009 due to the fall in short-term external debt stock (Chart I.20). The ratio of international reserves to total imports of a country indicates how long that country can provide the inputs needed from external markets without depending upon any external support. Although international reserves did not display a considerable change recently, this ratio went up owing to the sharp decline in imports (Chart I.21).

**Table I.3. Developments in Financial Accounts (Billion USD)**

Financial Account	2005	2006	2007	2008	09.09*
Financial Account	19,5	32,1	36,6	36,4	1,4
General Gov. (incl. CBRT and CBRT Reserves)	-16,5	-2,9	-15,5	-1,4	3,6
Private Sector (incl. Banks)	36,0	35,0	52,1	37,8	-2,3

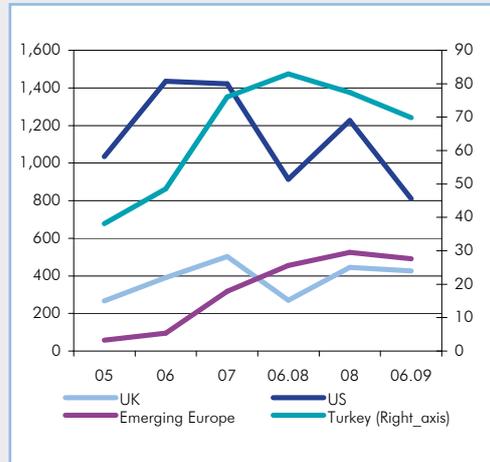
Source: CBRT

(\*) Cumulative figures for the last 12 months.

While the main determinant of financial account was formerly long-term funds obtained by the private sector, including banks, this has changed recently and the private sector has now become net foreign debt payer. Meanwhile, official reserves have declined (Table I.3).

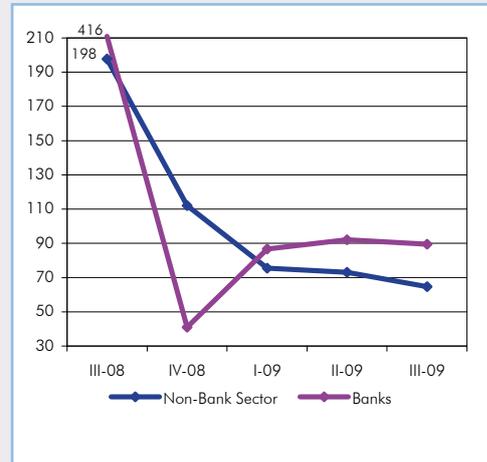
Roll-over rates of external long-term loans borrowed by the banks and the non-bank private sector from abroad decreased significantly compared to the pre-crisis period. While roll-over rates of banks gained stability at around 90 percent, the non-banking sector still maintains its tendency to reduce external debt. (Chart I.23). A great deal of the non-banking sector's net external debt payments was made to foreign branches and subsidiaries of banks located in Turkey. This is mainly attributable to the fact that resident banks shifted part of their loans, which they extended through their foreign branches, towards domestic branches as allowed by the amendment to Decree No. 32 (Box. 6, Table I.14).

**Chart I.22.**  
Net Receivables of International Banks from Selected Countries<sup>1</sup> (Billion USD)



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

**Chart I.23.**  
Roll-over Ratios for Long-term External Loans<sup>1</sup> of Banks and Non-Bank Sector<sup>2</sup> (%)



Source: CBRT  
(1) Non-Bank Sector comprises all real and legal persons (public and private) excluding banks and general government.  
(2) Average roll-over ratio for 3 months of the specified quarter.

### Box 6.

#### Amendment to Decree Number 32 Regarding the Protection of the Value of the Turkish Currency

With the publication of Decree Number 2009-15082 in the Official Gazette No. 27260, dated 16 June 2009, the articles related to foreign exchange (FX) loans in “Decree Number 32 Regarding the Protection of the Value of the Turkish Currency” have been amended. Accordingly;

1) Consumers have been prevented from taking FX risk by borrowing FX loans or FX-indexed loans, by prohibiting them from borrow such loans from both foreign banks and domestic banks.

2) Banks are allowed to extend FX credits to firms incorporated in Turkey which have no FX income but favor FX loans

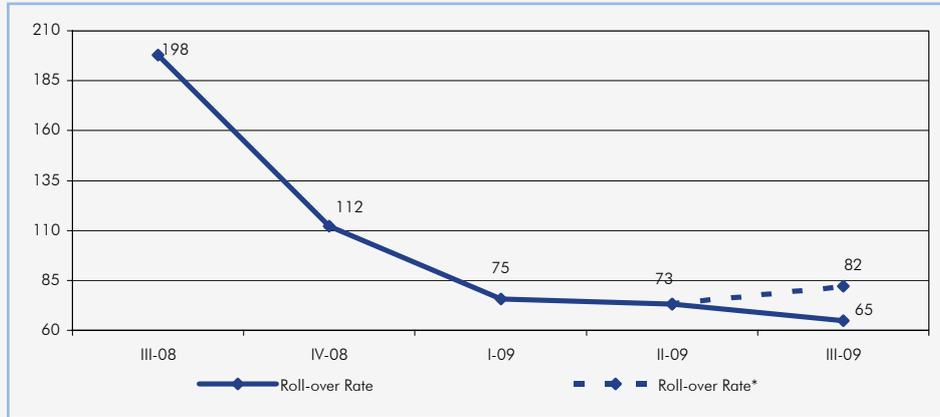
a) With the condition of at least 1 year maturity and a minimum amount of 5 million USD,

b) Without any condition on maturity or amount, if collateral is in the form of foreign currency deposits in the domestic branches of banks or foreign currency denominated bonds which are issued or guaranteed by central governments or the central banks of OECD countries.

Before the abovementioned amendment, banks were able to extend FX loans only to exporters or a very limited number of customers who have FX revenues or operate in sectors which are determined by the Turkish Treasury. Firms incorporated in Turkey –with no FX revenues–, and in need of FX loans for any operation other than allowed in the Decree, had been using either FX-indexed loans from banks operating in Turkey or FX loans from foreign banks or the foreign branches of banks established in Turkey.

With this amendment, it is aimed that the statistical data related to the total amount of foreign debt figure, thus the creditworthiness of Turkey will be improved by removing loans obtained by Turkish residents from foreign branches of Turkish banks, which are actually domestic debt, from Turkey's total amount of foreign debt. As a matter of fact, it has been observed that since the date amendments took effect FX loans obtained from foreign branches of domestic banks have started to decline in favor of an increase in the outstanding amount of the same kind of loans obtained from their domestic branches. If such an amendment had not been made, in other words, if residents continued to obtain FX loans from foreign branches of Turkish banks, the rollover ratio of long term loans by the non-bank private sector for the third quarter of the year 2009 would be 82 instead of 65 (Chart 1).

**Chart 1. The Rollover Ratio of Long Term Loans<sup>1</sup> by the Non-Bank Private Sector<sup>2</sup>**



Source: CBRT

(1) The non-bank private sector includes real persons and all private institutions other than the banks and the government.

(2) The average of the rollover ratio of the months in the related quarter are used.

(\*) The ratio for the third quarter of the year 2009 is calculated by excluding the total amount of the net loan repayments of both real sector and non-bank financial corporations from foreign branches and the affiliates of domestic banks.

To conclude, with this amendment, it is expected that some of the FX loans that were granted by foreign branches of banks established in Turkey will be extended by their domestic branches. Therefore, the abovementioned amendment should be taken into consideration while assessing the decline in the rollover ratio of long term loans by the non-bank private sector.

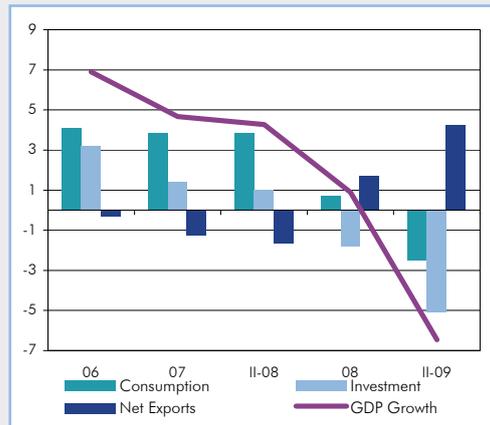
Net receivables of the banks reporting to the Bank for International Settlements (BIS) from the US and UK, still remained below levels of the pre-crisis period, while they remained flat in Emerging Europe. On the other hand, net assets of these international banks in Turkey displayed a downward trend with the onset of the crisis and declined to USD 69.9 billion by June 2009 (Chart I.22).

In conclusion, the slowdown in economic activity, coupled with the decline in energy prices since the last quarter of 2008 due to the global crisis, have caused the current account deficit to undergo a rapid contraction. The said factors are expected to be the determinants of progress of the current account deficit in the forthcoming period as well.

## 1.2. Growth and Inflation

Gross Domestic Product (GDP) displayed a sharp contraction due to the global crisis that also had an impact on Turkey in the last quarter of 2008. Despite the favorable effects of fiscal measures taken in the second quarter of 2009, the GDP shrank annually by 6.5 percent (Chart I.24).

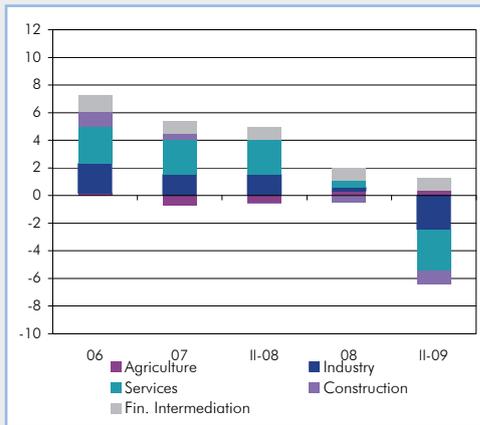
**Chart I.24.**  
Growth Rate and Its Composition<sup>1, 2</sup>  
(%, Points)



Source: TÜRKSTAT

(1) Percentage change compared to the same period of the previous year.  
(2) Net exports = Exports of Goods and Services-Imports of Goods and Services

**Chart I.25.**  
Contributions of Sectors to Growth<sup>1</sup>  
(%, Points)



Source: TÜRKSTAT

(1) Construction and financial intermediation are not included in the services sector.

The household consumption expenditures item, the major component of the GDP by expenditures approach, declined by 10.2 percent year-on-year in the first quarter of 2009, whereas this trend of decline decelerated owing to tax incentives in the second quarter of the year. This resulted in household consumption expenditures falling by 5.7 percent year-on-year in the first half of 2009. Meanwhile, public consumption expenditures grew by 2.7 percent year-on-year in the first half of 2009. Consequently, in the second quarter of 2009, total consumption expenditures contracted by 3.2 percent annually and their contribution to growth became minus 2.5 percent (Chart I.24).

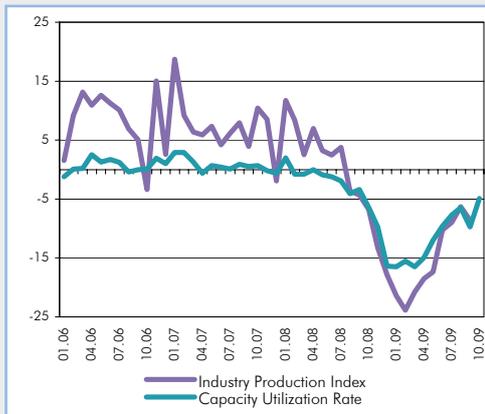
Likewise, while investment expenditures of the private sector, which has a high share in total investment expenditures, declined by 31.6 percent year-on-year in the first half of 2009, those of the public sector rose by 13.3 percent. Despite the rise in public investments, total investment expenditures decreased by 20.1 percent annually in the second quarter of 2009 due to the decline in private sector investments. Thus, their contribution to growth decreased by 3.3 points to minus 5.1 points compared to the figures of end-2008. (Chart I.24).

As the decline in imports of goods and services outpaced the decline in exports of goods and services, the annual contribution of net exports to growth increased by 2.5 points to stand at 4.2 points in the second quarter of 2009, compared to the figures of end-2008 (Chart I.24).

An analysis of GDP by sectors with respect to production reveals that in the second quarter of 2009, the contribution of all sectors to annual growth, excluding financial services and agriculture, turned negative compared to end-2008 (Chart I.25).

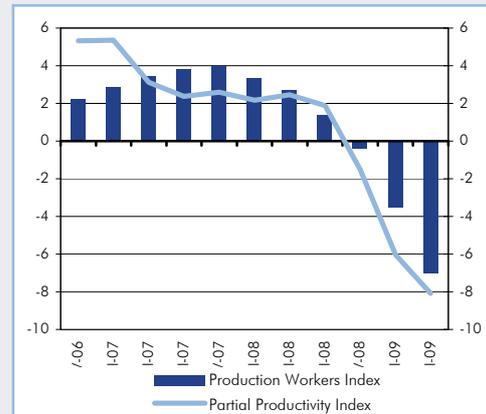
In the Medium-Term Program comprising the 2010-2012 period, the contraction in the Turkish economy, which started in the last quarter of 2008, is predicted to persist in 2009, while 2010 is envisaged to be the starting point of the process of growth. This program suggests that the GDP will decrease by 6 percent in 2009, whereas it will grow by 3.5 percent in 2010.

**Chart I.26.**  
Industrial Production (2005=100, Annual % Change) and Capacity Utilization Rate (Annual Point Difference)



Source: TURKSTAT

**Chart I.27.**  
Number of Workers and Partial Productivity per Worker for the Manufacturing Industry<sup>1,2</sup> (Annual % Change)



Source: TURKSTAT

(1) Annualized data is used in calculations.  
(2) 2005=100 index is used.

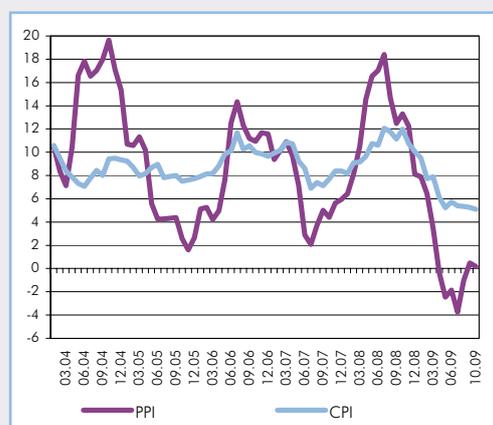
The industrial production index, which started to decline in 2009 due to the contraction in both internal and external demand, fell to its lowest level of 2009 in February, by a decrease of 23.8 percent year-on-year and started to recover after this period. The index fell by 8.6 percent year-on-year in September 2009, mainly arising from the decline in the manufacturing industry (Chart I.26).

The capacity utilization rate of the manufacturing industry dropped by 4.9 points year-on-year in October 2009 to become 71.8 percent. According to Manufacturing Industry Tendency Survey results, insufficient domestic demand stood as the main reason for workplaces operating under capacity in this period. Other reasons have been cited as insufficient external demand, financial restraints and deficiency of raw material.

The rate of increase in partial productivity per worker employed in the manufacturing industry dropped by 1.5 percent annually at end-2008 and decreased further by 8.1 percent in the second quarter of 2009 due to the slowdown in production (Chart I.27). Meanwhile, the rate of increase in the workers index continued to fall and declined by 0.7 percent per annum by the second quarter of 2009.

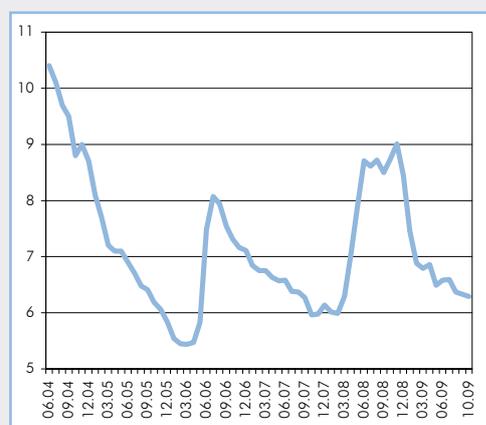
Sharp contraction in total demand coupled with the decline in commodity prices led the annual rate of increase in the CPI, which had been 10.06 percent at end-2008, to fall to 5.08 percent by October 2009 (Chart I.28).

**Chart I.28.**  
Annual PPI and CPI Developments  
(Annual % Change)



Source: TURKSTAT

**Chart I.29.**  
12 Months Ahead CPI Expectations (%)



Source: CBRT

The annual rate of change in the producer price index (PPI), which bears importance in the evaluation of the cost-side effects on consumer inflation, stood at 8.11 percent in 2008, yet declined to 0.19 percent by October 2009 (Chart I.28). Although import prices displayed a slight increase in terms of US dollar in the third quarter of the year, appreciation of the Turkish Lira restrained the effect of the rise of import prices on domestic unit costs, thus producer prices did not exert significant cost pressure on consumer prices.

12 months ahead CPI expectations that stood at 8.45 percent by the end of 2008 declined to 6.29 percent as of October 2009 and presented an outlook below the target set for 2010 (Chart I.29). Sharp rate cuts implemented by the Central Bank on the back of improving inflation outlook and contracting economic activity in the said period, along with the substantiation of its decisions by the economic data released, contributed to the improvement of inflation expectations.

It is predicted that in the upcoming period, the gradual recovery in economic activity will continue and the growth rate will start to post positive year-on-year figures in the last quarter of the year. Nevertheless, demand uncertainty and the low level of resource utilization are expected to restrain investment and employment for an extended period, therefore the outlook for unit labor cost and domestic demand is expected to maintain their contribution to the disinflation process.

### I.3. Public Finance

Global turmoil had significant adverse effects on the performance of public finance in Turkey. Measures taken to encourage spending for mitigating the effects of the crisis, along with the reduction in tax revenues arising from the slowdown in economic activity and tax cuts implemented to support the corporate sector, led to a surge in the central government budget deficit.

Table I.4. Central Government Budget Performance (Billion TL)

	Jan.-Oct. 2008	Jan.-Oct. 2009	Change (%)	2008 Budget Realization	2009 Budget Target	Real./An- nual Real. (Jan.-Oct. 2008) (%)	Real./Bud- get Target (Jan.-Oct. 2009) (%)	2009 Realization Forecast <sup>1</sup>
<b>Expenditures</b>	180.7	218.6	21.0	227.0	259.2	79.6	84.3	266.8
Interest Expenditures	43.4	50.2	15.7	50.7	57.5	85.6	87.3	55.5
Primary Expenditures	137.3	168.4	22.7	176.4	201.7	77.8	83.5	211.3
<b>Revenues</b>	175.8	175.4	-0.2	209.6	248.8	83.9	70.5	203.9
Tax Revenues	140.3	139.2	-0.8	168.1	202.1	83.5	68.9	163.6
Revenues to Expend. (%)	97.3	80.2	-	92.3	96.0	-	-	76.4
<b>Budget Deficit</b>	-4.9	-43.2	781.6	-17.4	-10.4	28.2	415.4	-62.8
<b>Primary Surplus</b>	38.5	7.0	-81.8	33.2	47.1	116.0	14.9	-7.3

Source: Ministry of Finance, SPO  
(1) 2010 Annual Programme

In the first ten months of 2009, central government budget expenditures rose by 21 percent, while revenues decreased by 0.2 percent compared to the same period of 2008. As a result, the ratio of expenditures covered by revenues declined year-on-year and stood at 80.2 percent. Primary expenditures that rose by 22.7 percent were instrumental in the surge in expenditures (Table I.4). A detailed analysis of the said expenditures suggests that the 34.4 percent rise in the current transfers item was influential in this development. This increase is triggered by the fact that 5 percentage points of the employer's social security insurance premia, has been covered by the Treasury since October 2008, coupled with the rise in transfers made to the Social Security Institution for financing its deficit due to the slowdown in collection of the Institution's premium revenues.

In the first ten months of 2009, non-tax revenues increased by 2 percent on the back of interest revenues of TL 1.9 billion transferred from the Unemployment Insurance Fund; whereas tax revenues decreased by 0.8 percent. When analyzed in terms of tax types, it is observed that while Value Added Tax (VAT), special consumption tax and income tax increased by 20.4 percent, 1.4 percent and 1 percent, respectively; corporate tax decreased by 2.5 percent and VAT on imports declined by 18.9 percent due to the decline in imports.

Parallel to these developments, the primary surplus posted by the central government budget, which was TL 38.5 billion in the first ten months of the previous year, declined to TL 7 billion in the same period of 2009. In the meantime, the central government budget deficit rose significantly from TL 4.9 billion to TL 43.2 billion (Table I.4). In the 2010 Annual Programme, it is indicated that total revenues for end-2009 are expected to stay below the central government budget target by TL 44.8 billion and that total expenditures are expected to outpace the initial appropriation by TL 7.6 billion, therefore the budget deficit, which was targeted as TL 10.4 billion in the 2009 budget, is predicted to reach TL 62.8 billion.

### Box 7. The Medium Term Programme (2010-2012)

The Medium Term Programme, covering 2010-2012 period, was made public on September 16, 2009. The main priorities of the Programme are to ensure the transition of the economy into a sustainable growth period once again, increase employment, maintain the disinflation trend and improve public balances, which have been deteriorating by the influence of the global crisis. During the Programme period, a comprehensive structural reform programme, which will ensure lasting improvement in growth and fiscal balances and enhance competitiveness, will be implemented. The GDP, which is expected to decrease by 6 percent in 2009, is targeted in the Programme to increase by 3.5 percent in 2010 and gradually reach 5 percent by 2012. It is anticipated that the unemployment rate, which is estimated to increase to 14.8 percent in 2009, will decline to 13.3 percent by 2012. The current account deficit is expected to increase as a result of the expected increase in both exports and imports, but is anticipated to remain at sustainable levels. On the other hand, year on year CPI inflation, which is expected to be 5.9 percent in 2009, is projected to be 5.3 percent, 4.9 percent and 4.8 percent for years 2010, 2011 and 2012, respectively.

**Table 1. Main Indicators of Medium Term Programme**

	2009	2010	2011	2012
GDP (% Change)	-6.0	3.5	4.0	5.0
Year-end CPI (% Change) <sup>1</sup>	5.9	5.3	4.9	4.8
Unemployment Rate (%)	14.8	14.6	14.2	13.3
Current Account Balance / GDP (%)	-1.8	-2.8	-3.3	-3.9
IMF-Defined Central Government Primary Surplus / GDP	-2.2	-0.8	-0.2	0.4
IMF-Defined Public Sector Primary Surplus / GDP	-2.1	-0.3	0.4	1.0
Central Government Budget Expenditures / GDP	28.2	27.9	26.7	25.6
Central Government Budget Revenues / GDP	21.5	23.0	22.6	22.4
Central Government Budget Deficit / GDP	-6.6	-4.9	-4.0	-3.2
Central Government Primary Expenditures / GDP	22.3	22.4	21.8	21.1
Central Government Interest Expenses / GDP	5.9	5.5	4.9	4.5
Central Government Tax Revenues / GDP	17.3	18.8	18.8	18.7

Source: The Medium Term Programme, Medium Term Fiscal Plan (2010-2012)

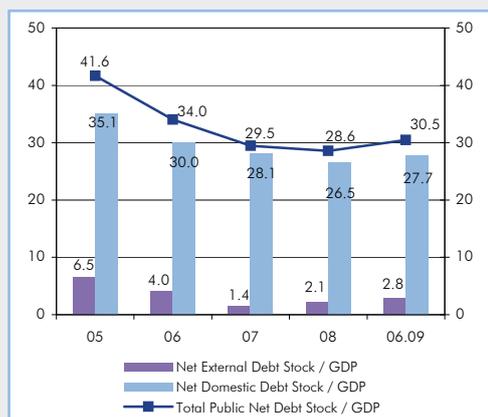
(1) Stands for estimations. Inflation targets are 7.5, 6.5 and 5.5 percent for 2009, 2010 and 2011 respectively.

It is stated in the Programme that the main target of fiscal policy that will be pursued in the 2010-2012 period is to gradually reduce public sector deficit, which has increased with the impact of the economic crisis, to reasonable levels. In this context, in order to ensure budget discipline and contain public deficit in the medium term, as of the 2011 budget period, public financial management will be implemented in accordance with the fiscal rule determined. The objective of the fiscal rule is to secure a public deficit to GDP ratio in the medium to long term that is compatible with a sustainable debt structure. The legal infrastructure to the

mentioned fiscal rule is targeted for completion in the first quarter of 2010. According to the Programme, efforts aimed at strengthening fiscal transparency will be maintained, expenditure programs will be reviewed, investments will be directed towards the infrastructure that meets social needs and supports productive activities, efforts on broadening the tax base will be continued and privatization activities of SEEs in line with a pre-determined schedule and strategy will be maintained. It is targeted in the Programme to gradually decrease primary expenditures during the 2010-2012 period and to increase tax income by strengthening the tax audit. In this framework, the ratio of central government budget deficit to GDP, which is expected to be 6.6 percent in 2009, is targeted to decrease to 3.2 percent by 2012 and the IMF defined public sector primary surplus to GDP, which is expected to be minus 2.1 percent in 2009, is targeted to increase to 1 percent.

The ratio of public net debt stock to GDP, which displayed a decreasing trend until end-2008, rose to 30.5 percent in June 2009 due to the sharp decline in the primary surplus. 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 unemployment insurance fund net assets (Chart I.30). 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.31). This ratio is expected to reach 47.3 percent by end-2009 according to the Medium Term Programme.

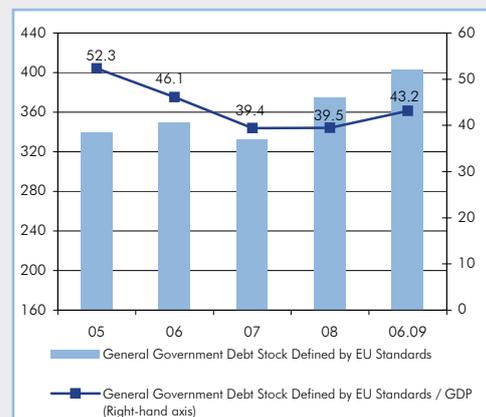
**Chart I.30.**  
Composition of Total Public Sector Net Debt Stock<sup>1</sup> (%)



Source: 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 gross debt stock.

**Chart I.31.**  
General Government Nominal Debt Stock Defined by EU Standards<sup>1</sup> (% Billion TL)



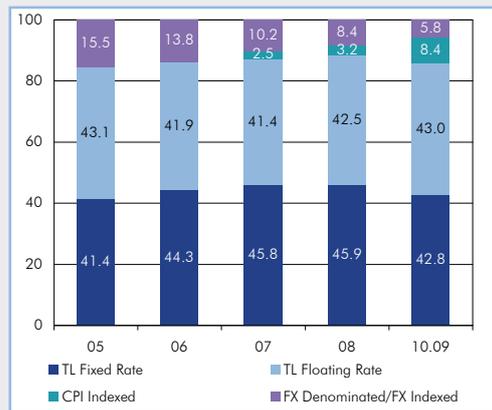
Source: Treasury

(1) Consolidated nominal debt stock as defined in European Settlement of Accounts 95 (ESA 95) deficit and debt manual.

Regarding the composition of domestic debt stock, the issuance of CPI-indexed bonds of TL 18.669 million in the February -October 2009 period led the share of CPI-indexed debt stock to rise compared to end-2008. In addition, the share of floating-rate debt stock increased, while shares of FX-denominated, FX indexed and fixed-rate debt stocks went down (Chart I.32). Despite the fall in fixed-rate debt stock, the increase in the share of CPI-indexed debt stock restricts the sensitivity of domestic debt stock to interest rate risk.

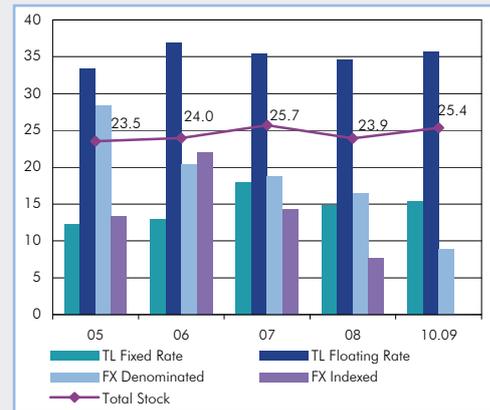
The average maturity of government securities, which decreased to 23.9 months at end-2008, increased to 25.4 months in October 2009, due to the effect of the CPI-indexed bonds issued at long maturities (Chart I.33).

**Chart I.32.**  
Composition of Domestic Debt Stock (%)<sup>1,2</sup>



Source: Treasury  
 (1) CPI-indexed bonds have been issued since February 2007.  
 (2) The TL denominated RIB is classified in TL Floating Rate Debt Stock and FX denominated RIB is classified in FX Denominated/FX Indexed Debt Stock.

**Chart I.33.**  
Maturity Structure of Government Domestic Debt Stock (Month)<sup>1</sup>



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

A large portion of total government bonds is owned by banks, comprising a major part of banking sector assets. The share of banks kept increasing, whereas that of non-residents and households maintained its downward trend as of October 2009 (Chart I.34).

**Chart I.34.**  
Government Domestic Debt Securities by Holders<sup>1,2,3</sup> (%)



Source: BRSA-CBRT  
 (1) Based on nominal amounts  
 (2) "Bank" includes GDDS owned by banks operating in Turkey; "Household" includes GDDS that belong to real persons kept at domestic banks; "Other domestic residents" includes GDDS of domestic legal persons except banks and households 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.

**Table I.5. General Government Balance (% of GDP)**

	2008	2009*	2010*
Austria	-0.5	-4.2	-5.6
Belgium	-1.2	-5.9	-6.3
Finland	4.4	-2.9	-4.2
France	-3.4	-7.0	-7.1
Germany	-0.1	-4.2	-4.6
Greece	-5.0	-6.4	-7.1
Ireland	-7.3	-12.1	-13.3
Italy	-2.7	-5.6	-5.6
Portugal	-2.6	-6.9	-7.3
Spain	-3.8	-12.3	-12.5
Canada	0.1	-4.9	-4.1
Japan	-5.8	-10.5	-10.2
United Kingdom	-5.1	-11.6	-13.2
USA	-5.9	-12.5	-10.0

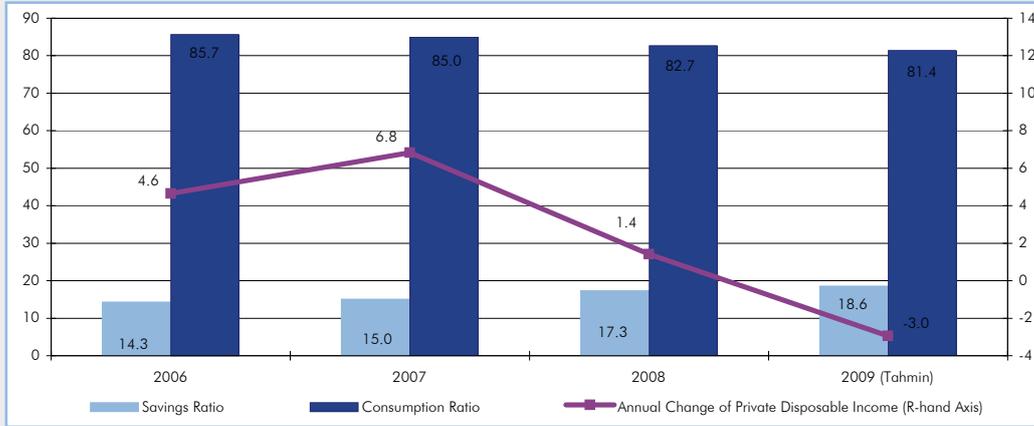
Source: IMF, World Economic Outlook Database, October 2009  
\* Estimation

In conclusion, the central government budget deficit increased remarkably due to the decline in revenues and the increase in expenditures in 2009, which resulted in rising public borrowing requirement. Given the current economic conjuncture, rising budget deficit is a worldwide phenomenon, and not exclusive to Turkey. A comparison of 2008 and 2009 indicates that the ratio of budget deficit to GDP displayed an increase in other countries as well and budgets of some countries that had previously posted a surplus began to post deficits due to the global financial crisis (Table I.5). In order to avert growing concerns over financial sustainability due to budget deficits, short-term fiscal expansion should be backed by a credible medium-term fiscal framework. Indeed, the Medium-Term Programme of Turkey presents a consistent outline for 2010-2012 period with the aim of gradually diminishing budget deficits that soared in the financial crisis period. Commitment to enforcing the measures laid down in the Programme is of the utmost importance to control the public borrowing requirement and to prevent any concerns over debt sustainability in the upcoming period.

#### I.4. Private Sector Developments

In 2008, private disposable income rose by 1.4 percent, whereas private consumption expenditures contracted by 0.5 percent. Due to the decline in private consumption expenditures, the savings ratio climbed to 17.3 percent in 2008. In the 2010 Annual Programme it is estimated that private disposable income will go down by 3 percent in real terms in 2009, while the rate of increase in private consumption will decline by 3.1 percent (Chart I.35).

**Chart I.35.**  
Private Sector Consumption and Savings Ratios and Real Disposable Income (%)<sup>1,2,3</sup>



Source: SPO

(1) Private sector's consumption and savings ratio is in current prices, private sector's disposable income is calculated using CPI (1998=100).

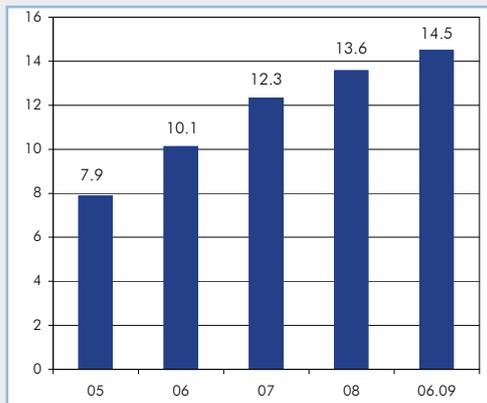
(2) Savings Ratio = Total Private Savings / Private Disposable Income

(3) Consumption Ratio = Total Private Consumption / Private Disposable Income

#### 1.4.1. Household

Household liabilities continued to increase in the first six months of 2009.

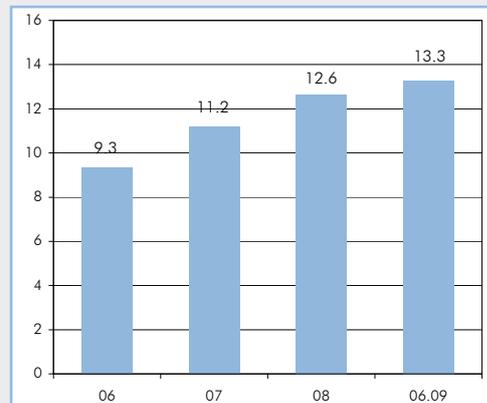
**Chart I.36.**  
Household Liabilities to GDP (%)<sup>1</sup>



Source: CBRT-BRSA, TURKSTAT

(1) Household liabilities consist of gross consumer credits and credit card balances extended by banks and consumer finance companies and liabilities to TOKI due to TOKI's housing sales with long term maturity.

**Chart I.37.**  
Retail Loans to Household Consumption Expenditures (%)<sup>1</sup>



Source: CBRT-BRSA, TURKSTAT

(1) Retail loans consist of gross consumer credits and credit card balances extended by banks and consumer finance companies less housing credits.

The ratio of total household liabilities to GDP rose to 14.5 percent in the first half of 2009 from 13.6 percent at end-2008 (Chart I.36). In the same period, the portion of household consumption expenditures financed by retail loans, increased from 12.6 percent to 13.3 percent (Chart I.37).

**Table I.6. Household Disposable Income, Liabilities and Interest Payments<sup>1,2,3</sup> (Million TL)**

	2007	2008	09.09
Household Interest Payments	15,576	19,653	21,356
Household Liabilities	104,111	128,966	140,222
Household Disposable Income	459,212	520,001	534,690
Interest Payments / Disposable Income (%)	3.4	3.8	4.0
Liabilities / Disposable Income (%)	22.7	24.8	26.2

Source: BRSA-CBRT, TURKSTAT, SPO

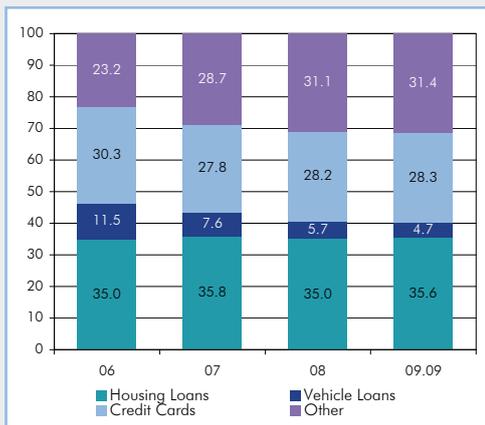
(1) Household liabilities consist of gross consumer credits and credit card balances extended by banks and consumer finance companies and liabilities to TOKI due to TOKI's housing sales with long term maturity.

(2) As the repayment related to liabilities due to TOKI's housing sales with long term maturity are indexed to civil servant salaries, they are not included in interest payments.

(3) Household disposable income is calculated by using private sector disposable income estimation for 2007, 2008 and 2009 as mentioned in the 2010 Annual Programme, under the assumption that the 2005 ratio of household disposable income to private sector disposable income has not changed.

By September 2009, household liabilities and interest payments increased by the same rate, at 8.7 percent, compared to end-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 3.8 percent to 4 percent, while the ratio of total household liabilities to disposable income increased from 24.8 percent to 26.2 percent (Table I.6).

When the development of household liabilities is analyzed by type, it is observed that housing loans increased by 10.4 percent, other loans by 9.8 percent and credit card balances increased by 9 percent, whereas vehicle loans decreased as of September 2009 compared to end-2008 figures. Household precautionary savings increased due to negative future expectations during the crisis period. However, household's appetite for consumer loans is anticipated to grow in the upcoming period on the back of the decline in borrowing costs and policy rate-cuts by the Central Bank.

**Chart I.38. Decompositon of Household Liabilities (%)<sup>1,2,3,4</sup>**

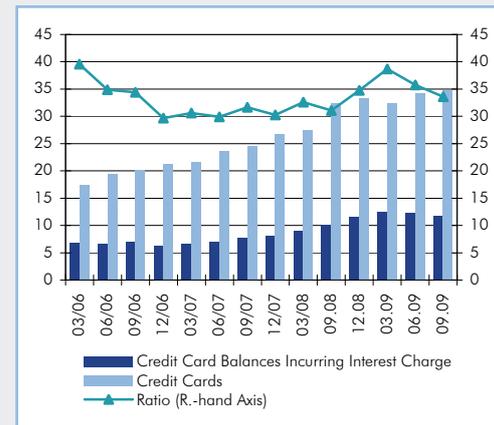
Source: BRSA-CBRT

(1) Household liabilities consist of gross consumer credits and credit card balances extended by banks and consumer finance companies and liabilities to TOKI due to TOKI's housing sales with long term maturity.

(2) Liabilities to TOKI due to TOKI's housing sales with long-term maturity are also included in housing loans.

(3) Since liabilities to TOKI due to TOKI's housing sales with long-term maturity are included in total household liabilities, the shares differ from those in previous Financial Stability Reports.

(4) Other loans consist of all consumer loans excluding housing and vehicle loans.

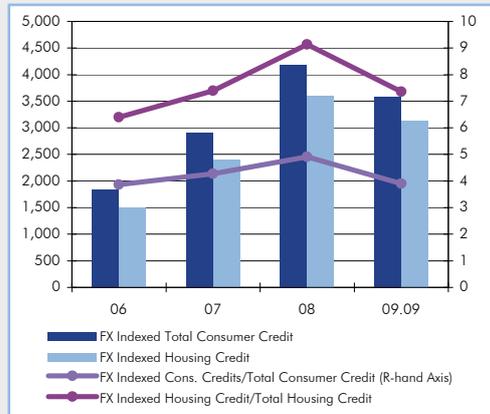
**Chart I.39. Credit Card Balances of Deposit Banks and Balances That Incur Interest Charge (Billion TL, %)**

Source: CBRT

As for the decomposition of household liabilities, housing loans has the largest share followed by other loans and credit cards, respectively. Meanwhile, the share of vehicle loans is still on the decline (Chart I.38).

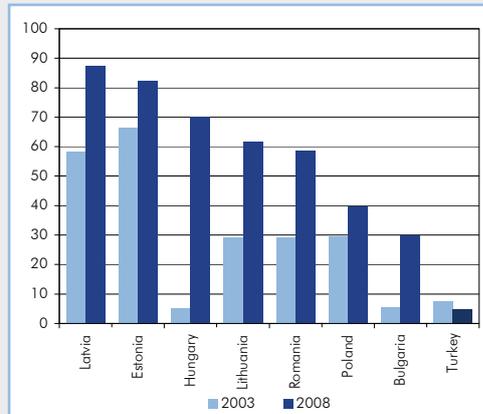
Credit card balances were still on the rise as of September 2009. Credit card balances incurring interest charges went down by 6.8 percent to TL 11.7 billion in September compared to March 2009. The ratio of credit card balances incurring interest charges to total credit card balances, which was 38.7 percent in March 2009, became 33.6 percent in September (Chart I.39). The decline in credit card balances incurring interest charges indicates that credit cards are less preferred by individuals as loan instruments.

**Chart I.40.**  
FX Indexed Consumer Credits and FX Indexed Housing Credits<sup>1</sup> (Million TL, %)



Source: BRSA-CBRT  
(1) Consumer finance companies are excluded.

**Chart I.41.**  
FX Retail Loans in Total Retail Loans for Selected Countries<sup>1</sup> (%)

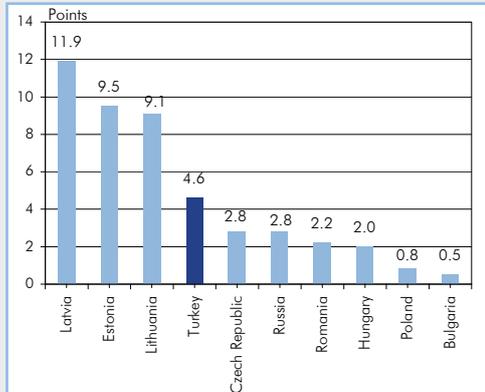


Source: CBRT, Central Bank of Hungary Financial Stability Report, April 2009  
(1) FX indexed retail loans are used for Turkey.

The ratio of FX-indexed consumer loans to total consumer loans, which was 4.9 percent in 2008, decreased to 3.9 percent as of September 2009, while the share of FX-indexed housing loans in total housing loans declined from 9.1 percent to 7.4 percent in the same period (Chart 1.40). The share of FX-indexed retail loans in total retail loans in Turkey declined compared to 2003 as opposed to other countries analyzed. Moreover, the utilization of FX-indexed loans in Turkey is quite low compared to other countries, which renders households relatively less vulnerable to exchange rate shocks (Chart 1.41). Besides, with the amendment to Decree No. 32 on the Protection of the Value of the Turkish Currency, households are precluded from utilizing FX-indexed loans as well as FX-denominated loans, which will relieve households from exchange rate risks stemming from their liabilities in the forthcoming period.

Meanwhile, in Turkey, CPI-indexed variable interest rates are only allowed for housing loans within consumer loans and the aforementioned loans constitutes only 0.03 percent of total housing loans as of October 2009. As interest rates are fixed for consumer loans, consumers incur no additional costs in periods of interest rate increases; while they are allowed to restructure their debts to take advantage of lower interest rates in periods of rate-cuts. The fact that terms of housing loans are longer than those of other consumer loans makes the refinancing of these loans more reasonable despite the 2 percent restructuring penalty applicable to these loans.

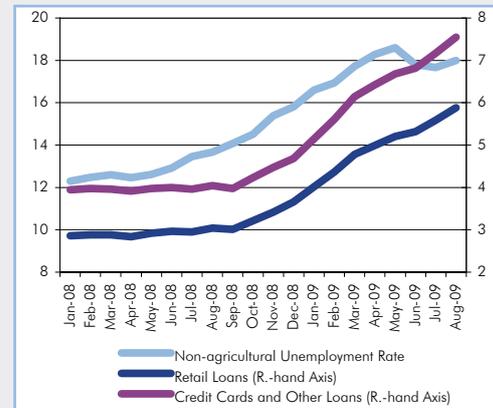
**Chart I.42.**  
Rise in Unemployment Rate for Selected Countries (June 2009– June 2008)<sup>1</sup>



Source: IMF

(\*) The latest figure for Bulgaria is as of March 2009.

**Chart I.43.**  
Unemployment and NPL Ratios (%)<sup>1</sup>



Source: BRSA-CBRT, TURKSTAT

(1) Seasonally adjusted non-agricultural unemployment rate.

The global crisis has adversely affected labor markets throughout the world (Chart I.42). Economic contraction driven by the global crisis led to an increase in unemployment, in turn exacerbating the vulnerability of debtors, in particular. As a matter of fact, while non-agricultural unemployment has climbed since the second quarter of 2008, the NPL ratio of retail loans, which was 3 percent in September 2008, rose to 5.9 percent in August 2009. Especially in housing loans, repayments are regularly made due to concerns over potential loss of ownership of the property, thus leading to a lower NPL ratio for retail loans compared to that for credit cards and other loans (Chart I.43).

**Table I.7. Number of Consumer Loan and Credit Card Defaulters<sup>1</sup>**

	12.07	12.08	03.09	06.09	09.09
Banks	641.708	997.095	1.080.487	1.252.267	1.475.620
Asset Management Companies <sup>2</sup>	0	139.862	130.623	252.916	282.856
Finance Companies <sup>3</sup>	12.898	21.884	25.207	27.826	23.079
Total <sup>4</sup>	651.911	1.093.474	1.174.525	1.415.791	1.664.301

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 SDFI and banks.

(3) The decline in the number of defaulters for finance companies in September 2009 is due to the transfer of one finance company's receivables to an asset management company.

(4) 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 Central Bank Risk Center data, as of September 2009, the number of consumer loan and credit card defaulters increased by 52.2 percent in comparison to end-2008 and reached 1,664.301 (Table I.7).

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, albeit variations among banks. Thus, by the end of October 2009, total credit card receivables scheduled for payment plans and the number of customers rose to TL 1.3 billion and 543 thousand, respectively (Table I.8).

**Table I.8.**  
**Restructured Credit Card Receivables in Accordance with Law No.5464 Provisional Article 5**  
**(Thousand TL, Number of Persons)**

	Restructured Receivables within Legal Terms (07.07.2009-04.09.2009)			Voluntarily Restructured Receivables (05.09.2009-31.10.2009)			TOTAL		
	Total Credit Card Receivables	Credit Card Rec. After Resch.	Number of Customers	Total Credit Card Receivables	Credit Card Rec. After Resch.	Number of Customers	Total Credit Card Receivables	Credit Card Receivables After Resch.	Number of Customers
Banks	945,311	1,276,373	406,904	259,187	361,064	115,415	1,204,498	1,637,438	522,319
Asset Man. Comp.	34,091	64,141	14,535	11,692	22,318	5,928	45,783	86,459	20,463
Total	979,402	1,340,514	421,439	270,879	383,382	121,343	1,250,281	1,723,897	542,782

Source: BRSA

Total financial assets of households increased by 10.8 percent compared to end-2008 and became TL 408 billion by September 2009 (Table I.9).

**Table I.9. Composition of Household Financial Assets<sup>1</sup> (Billion TL, %)**

	2007		2008		09.09	
	Billion TL	% Share	Billion TL	% Share	Billion TL	% Share
TL Deposits	142.5	45.4	188.7	51.2	197.4	48.4
FX Deposits	78.5	25.0	89.0	24.2	98.9	24.3
- FX Deposits (Billion USD)	67.0		59.1		67.1	
Currency in Circulation	26.2	8.4	30.6	8.3	35	8.6
GDDS+Eurobond	19.6	6.3	19.7	5.3	16	3.9
Mutual Fund	22.6	7.2	20.8	5.6	26.7	6.5
Stocks	17.5	5.6	10.6	2.9	22.9	5.6
Private Pension Funds	4.6	1.5	6.4	1.7	8.5	2.1
Repos	1.9	0.6	2.2	0.6	1.8	0.4
Precious Metal Deposits	0.2	0.0	0.3	0.1	0.8	0.2
Total Assets	313.6	100.0	368.3	100.0	408.0	100.0

Source: BRSA-CBRT, CMB, CRA

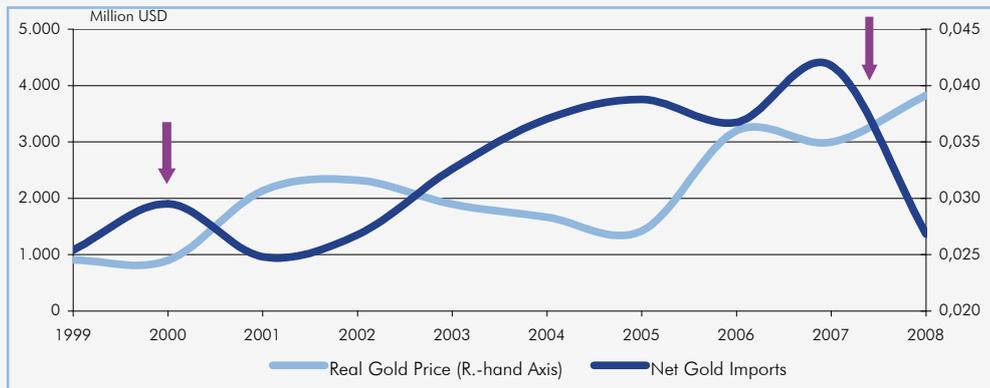
(1) TL and FX deposits include participation funds.

The share of savings deposits, which constitutes the largest portion of household assets, went down in 2009, becoming 48.4 percent by September. The share of savings deposits in total deposits, which was 68 percent at end-2008, decreased to 66.6 percent as of September 2009 (Table I.9). As exchange rate movements gained relative stability in 2009, households increased their holdings of FX deposits. Meanwhile, the decline in the share of total deposits within assets was mainly driven by the increase in the value of equities and the increased appetite of households for other investment tools, primarily investment funds, due to the decline in deposit interest rates.

### Box 8. Gold Imports and Exports

Especially for households, gold is perceived as one of the traditional investment tools in our country. Most of the investment in gold takes the form of possessing gold tangibly and storing it. Other methods facilitating investment in gold, although very limited in size, are precious metal deposits at banks, gold investment funds, exchanging gold contracts in the futures and options exchange and the purchase and sale of gold on the gold exchange.

**Chart 1. Net Gold Imports and Real Gold Prices<sup>1,2</sup>**



Source: CBRT

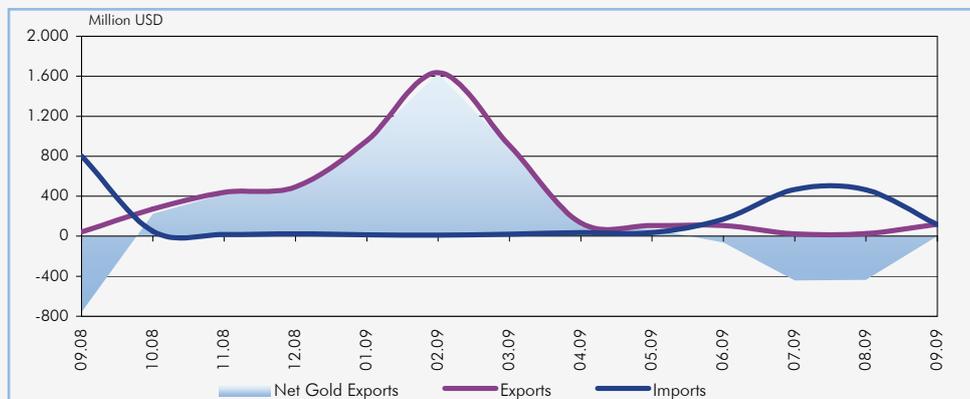
(1) Real gold prices are calculated by dividing the sale price of gold bar (TL/Gr) with the GDP deflator.

(2) Net Gold Imports = Gold Imports – Gold Exports

As gold is a traditional investment tool and the jewellery tradition is common, gold processing and the sales volume of retail gold-jewellery is high in Turkey. However, as raw gold production is limited, our country is a net importer of gold.

During crises periods, with the effect of depreciation of the Turkish lira, gold prices increase and as a result gold imports decrease (Chart 1). The increase in domestic gold supply as a result of the sale of gold by households in order to benefit from high gold prices might also be influential on this development.

**Chart 2. Net Gold Exports<sup>1</sup>**



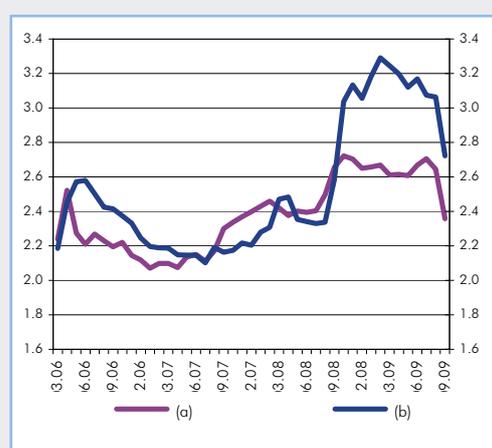
Source: CBRT

(1) Net = Gold Exports – Gold Imports

During the current crisis, domestic gold prices increased due to developments abroad and gold imports came to a halt in the first five months of 2009. In order to benefit from the increasing prices, households sold a portion of their gold savings and consequently gold exports increased substantially (Chart 2).

When adjusted according to exchange rate and parity effect, the ratio of total Turkish currency instruments to foreign currency instruments displayed a sharp increase between September 2008 and March 2009 and assumed a declining trend in the following period (Chart I.44).

**Chart I.44.**  
Ratio of TL-FX Denominated Investment Instruments<sup>1</sup>



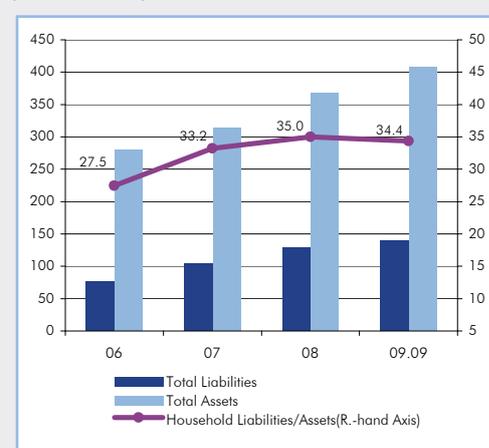
Source: BRSA-CBRT, CMB, CRA

(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 31.12.2004 is used and the parity effect is eliminated.

**Chart I.45.**  
Households' Financial Assets and Liabilities (Billion TL, %)<sup>1</sup>



Source: BRSA-CBRT, CMB, CRA

(1) Household Assets = Savings Deposits + FX Deposits + Money in Circulation + Gov.Dom.Debt.Sec. + Eurobonds + Repos + Stocks + Pension Funds + Mutual Funds (starting from April 2006). Household liabilities consist of gross consumer credits and credit card balances extended by banks and consumer finance companies and liabilities to TOKI due to TOKI's housing sales with long term maturity.

FX-indexed liabilities of households to the banking sector are USD 2.4 billion as of September 2009, whereas FX assets of households are USD 70 billion and households carry a long position in FX. Nevertheless, it is possible that on an individual basis, households, which have FX liabilities, may not possess FX assets; so it is obvious that the repayment ability of households without foreign exchange income will be adversely affected if the Turkish Lira depreciates.

The ratio of household financial liabilities to financial assets dropped to 34.4 percent as of September 2009 (Chart I.45).

The slowdown in production as a result of the global crisis imposed pressure on employment, which exacerbated the vulnerability of households. Nevertheless, household indebtedness in Turkey still maintains its low level. Moreover, as the interest and exchange rate risk on household liabilities is limited, households are affected relatively less by unfavorable developments in economic conditions. This has also had a favorable effect on the resilience of the Turkish economy against the consequences of the global crisis up to now.

Meanwhile, despite expectations of economic recovery in the coming period, the repayment difficulties of households is expected to continue for a while on account of increased unemployment.. However, these troubles, especially those related to housing loans, are expected to be milder in Turkey compared to US and European averages.

## I.4.2. Corporate Sector

### I.4.2.1. Financial Analysis

The financial crisis that started in developed financial markets in 2007 led to significant deceleration in global economic growth rates in 2008. Both the domestic and the foreign sales of firms were negatively affected by the global economic crisis. Easing in the credit supply led by the increasing risk perception along with the regressive borrowing appetite driven by the decline in aggregate demand affected corporate indebtedness.

In order to analyze corporate sector developments, basic financial ratios were calculated using data pertaining to the selected 186 firms traded on the ISE, 142 of which operate in the manufacturing industry. The ratio of revenues from total sales of firms analyzed in relation to GDP became 15.3 percent at end-June 2009.

However, firms listed on the ISE are large companies, which have high export opportunities and many funding alternatives other than banking credits, primarily capital markets, and their shareholders equity is relatively stronger, compared to those not listed on the ISE. Therefore, it should be taken into consideration that these firms' financial indicators may differ from those of other firms. Moreover, when data of firms listed on the ISE is distributed according to sub-sectors, it should also be noted that some concentrations occur within specific sectors, thus sectoral impacts may be reflected in the ratios.

**Table I.10. Income Statement Items of Selected ISE Firms (Million TL)**

	All Companies			Manufacturing Comp.			Other Comp.		
	06.08	06.09	Change (%)	06.08	06.09	Change (%)	06.08	06.09	Change (%)
Net Sales	83,589	67,268	-19.5	61,979	44,956	-27.5	21,610	22,311	3.2
Operating Profit	7,988	4,912	-38.5	5,586	2,797	-49.9	2,402	2,114	-12.0
Net Fin. Inc. (Expenses)	-324	-702	122.2	-647	-842	31.4	324	140	-56.8
Net Profit	5,820	3,026	-48.0	3,681	1,353	-63.2	2,146	1,698	-20.9

Source: ISE

Total sales revenues of firms listed on the ISE indicated an annual decline of 19.5 percent in the first half of 2009. While sales revenues of firms in the manufacturing industry decreased by 27.5 percent, those of other sectors climbed by 3.2 percent (Table I.10). Therefore, the slowdown in economic activity mostly affected firms operating in the manufacturing industry.

**Chart I.46.**  
**Number of Firms that Incurred Profit/Loss**



Source: ISE

The decline in sales revenues had unfavorable consequences on firms' profitability. In the first half of 2008, total net profits of firms listed on the ISE, which was TL 5.8 billion, went down by 48 percent to TL 3 billion in the first half of 2009. Although the number of firms suffering losses increased, this decline in profitability performance stemmed especially from the contraction in the total amount of profits of firms that made profits (Chart I.46).

**Table I.11. Profitability Rates<sup>1</sup> (%)**

	Total		Manufacture		Others	
	06.08	06.09	06.08	06.09	06.08	06.09
Net Profit Margin (N.Profit / N.Sales)	7.0	4.5	5.9	3.0	9.9	7.6
Operating Profit Margin (Op. Profit / N. Sales)	9.6	7.3	9.0	6.2	11.1	9.5
Net fin. Inc.-Expenses/ Net Sales	-0.4	-1.0	-1.0	-1.9	1.5	0.6
Fin. Exp. Coverage Ratio (Oper. Profits / Net fin. Inc.-Exp) (time)	-24.7	-7.0	-8.6	-3.3	7.4	15.1
Profitability of Assets (ROA)	8.3	4.3	7.3	2.9	10.6	6.7
Profitability of Equity (ROE)	16.9	8.8	15.3	6.2	20.3	13.4

Source: ISE  
<sup>1</sup>Annualized ROA and ROE.

The decline in profitability performance also reflected on the return on assets and return on equity. While the return on assets of selected ISE firms, with an asset size of TL 142,8 billion as of June 2009, was 8.3 percent in the first half of 2008, it decreased to 4.3 percent in the first half of 2009. Return on equity, on the other hand, went down to 8.8 percent from 16.9 percent in the same period (Table I.11).

The net profit margin, which had been 7 percent in June 2008, declined to 4.5 percent as of June 2009, particularly due to the contraction in the operating profit margin. The descending operating profit led to a decline in firms' repayment ability of their financial expenses (Table I.10 and I.11).

While the loan demand of firms decreased parallel to their volume of sales, low performance in profitability exacerbated firms' financial debt service capacity, and caused banks to tighten their credit supply to those firms. All these developments led to a contraction in both domestic and foreign loans supplied to firms, and firms became net debt payers.

**Table I.12. Indebtedness Ratios<sup>1</sup> (%)**

	TOTAL		MANUFACTURE		OTHERS	
	12.08	06.09	12.08	06.09	12.08	06.09
Total Debt / Equity	111,8	106,6	113,2	110,8	109,0	99,2
Net Debts* / Equity	84,3	81,4	91,6	88,1	70,2	69,8
Financial Debts / Total Debts	47,6	44,4	49,8	45,8	43,3	41,6
Short Term Debt / Total Debt	65,5	68,4	69,4	72,1	57,8	61,1
Short Term Financial Debt / Total Debt	23,3	22,7	27,8	25,8	33,5	39,9
Cash Equivalent / Short Term Debt	37,5	34,6	27,5	28,4	61,5	48,6

Source: ISE

(1) Net debt = Total Debt – Cash and Cash Equivalents

The fact that firms are net financial debt payers in this period had implications on their financial structure ratios. The leverage ratios of firms listed on the ISE showed a decline in June 2009 compared to end-2008 figures. Moreover, the share of financial debts within total debts went down (Table I.12).

In June 2009, the ratio of short-term debts within total debts soared and the coverage ratio of short-term debts by liquid assets decreased, indicating that the liquidity risks of firms went up in that period. However, the decline in the share of financial debts within short-term debts reveals that the surge in short-term liabilities stems from trade payables (Table I.12).

**Table I.13. Non-Performing Loan Ratios for Firms (%)<sup>1,2,3</sup>**

		08	09.09
1	Wholesale and Ret. Trade, Brokerage, Repair of Motor Vehicle	6,5	11,0
2	Agriculture, Hunting and Forestry	10,3	11,3
3	Textile and Textile Product Industry	11,6	15,8
4	Industry of Tobacco, Beverages and Food	9,0	13,0
5	Construction	8,5	11,6
6	Hotels and Restaurants (Tourism)	7,8	10,2
7	Sources of Electricity, Gas and Water	6,1	8,5
8	Manufacture of Machinery and Equipment	5,5	8,4
9	Manufacture of Basic Metals and Fabricated Metal Prod	5,9	9,3
10	Transport, Storage and Communication	4,6	6,7
	Total of 10 sectors	7,8	10,8
	Total of all sectors	8,1	11,2

Source: CBRT

(1) Loans are compiled based on bank reporting under the scope of Central Bank Law No:1211, Article 44. They include corporate loans that are greater than ten thousand New Turkish Liras (inclusive); extended to real and legal bodies by banks (including external loans used by firms with the intermediation of banks). Firms have been disclosing their NPLs without any limits.

(2) Financial Intermediation as a sector is excluded

(3) The important difference for December 2008 period with respect to previous report is due to revision made retrospectively.

As for analysis by sectors, the default rate, which is calculated by dividing the number of firms monitored in NPL accounts to the total number of firms, increased to 11.2 percent in September 2009 for all sectors due to the weakening of firms' repayment abilities. As of September 2009, default rates in "Agriculture, Hunting and Forestry", "Food, Beverage and

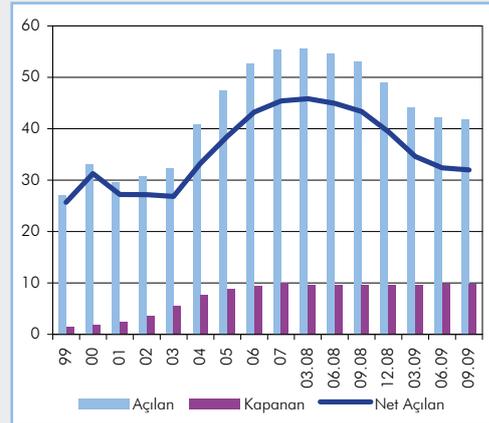
Tobacco Industry”, “Construction” and “Textile and Textile Products Industry” realized above that of the average of the selected 10 sectors (Table I.13).

**Chart I.47.**  
The Ratio of Over-Drawn Cheques Presented to the ICH to the total Cheques Presented to the ICH (%)



Source: CBRT

**Chart I.48.**  
Number of Newly Established and Liquidated Companies and Cooperatives (Bin adet)<sup>1</sup>

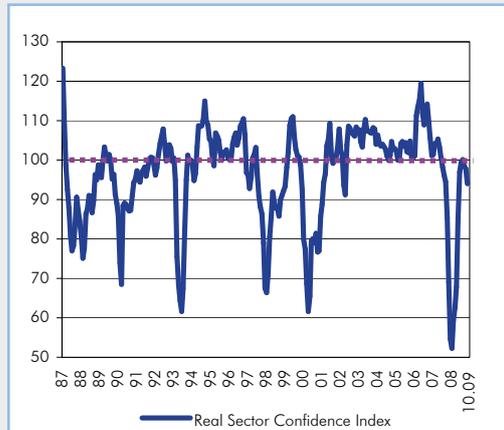


Source: TURKSTAT

1) Annualized data is used.

The ratio of over-drawn cheques presented to the Interbank Clearing House (ICH) to total cheques presented to the ICH has been rising both in terms of number and value since September 2008. However, this ratio indicated a trend of decline following the second quarter of the year and stood at 6.1 and 6.8 percent, respectively, in September 2009 (Chart I.47). The slowdown in economic activity had reverberations on the establishment of new firms as well. The net number of newly-established firms plummeted by 18.8 percent year-on-year in the first nine months of 2009. However, in the third quarter of 2009, this rate of decline slowed down (Chart I.48).

**Chart I.49.**  
Real Sector Confidence Index



The Real Sector Confidence Index (RSCI), which started to increase as of January 2009, went above the threshold value of 100 in July; but fell back to 94 in October (Chart I.49).

Realizations in the first half of 2009, besides the industrial turnover and new order indices issued by TURKSTAT and export data suggest that firms' sales revenues will fall short of last year's figures in the year-end financial tables as well. Firms' operating profits are expected to contract on account of the decline in their sales revenues. Parallel to the contraction in operating profits, the firms' coverage ratio of financial costs may deteriorate and distressed loans may rise. Meanwhile, it is assessed that the stabilization of Turkish Lira will be a factor to curb the increase in firms' distressed loans.

#### 1.4.2.2. Borrowing Structure of the Corporate Sector

The corporate sector financial debt became TL 339.6 billion as of September 2009. Approximately 61.1 percent of it accounted for FX denominated debt. Therefore, exchange rate fluctuations affected the corporate sector debt significantly.

Table I.14. Financial Debt of the Corporate Sector<sup>1</sup> (Milyon TL)

	2006	2007	2008	03.09	06.09	09.09
<b>Corporate Sector Loans (I+II)</b>	<b>202,315</b>	<b>246,679</b>	<b>346,912</b>	<b>352,436</b>	<b>341,314</b>	<b>339,633</b>
<b>I. Domestic Loans (i+ii)</b>	<b>125,385</b>	<b>153,322</b>	<b>193,223</b>	<b>190,399</b>	<b>191,988</b>	<b>197,215</b>
i. TL	83,761	105,783	123,203	120,221	127,403	131,967
ii. FX (including FX-indexed)	41,624	47,539	70,020	70,178	64,585	65,248
In USD Terms	29,613	41,007	46,011	42,068	42,359	44,176
<b>II. External Loans</b>	<b>76,930</b>	<b>93,356</b>	<b>153,690</b>	<b>162,037</b>	<b>149,326</b>	<b>142,418</b>
In USD Terms (A+B)	54,731	80,528	100,992	97,133	97,938	96,424
A. Short Term	1,218	1,013	1,468	1,462	1,319	965
B. Long Term (a+b+c+d)	53,513	79,515	99,524	95,671	96,619	95,459
a. Official Creditors (Gov. and Multilateral Org.)	2,316	2,753	2,996	2,932	3,140	2,861
b. Foreign Branches and Affiliates of Resident Banks	17,282	26,951	36,914	35,169	34,986	33,480
c. Nonresident Com. Banks and Nonbank Fin. Corp.	28,735	42,992	51,364	49,650	50,334	51,014
d. Nonfinancial	5,180	6,819	8,250	7,920	8,159	8,104
<b>Total FX Loans<sup>2</sup> (Million USD)</b>	<b>84,344</b>	<b>121,535</b>	<b>147,003</b>	<b>139,201</b>	<b>140,297</b>	<b>140,600</b>

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

While TL-denominated loans extended to firms rose by TL 8.8 billion, FX-denominated loans fell by approximately USD 6.4 billion in the first nine months of 2009. FX-loans used by the corporate sector, which displayed a downward trend in the last quarter of 2008 due to global turmoil, fell to USD 141 billion in September 2009. The said decline in FX loans was mainly attributable to the decline in loans extended by resident banks. No major change is observed with respect to loans extended by non-resident commercial banks and other corporations (Table I.14).

USD 77.7 billion of FX loans came from domestic and foreign branches of resident banks, whereas USD 51 billion came from non-resident banks and non-bank financial corporations. Accordingly, following a horizontal course, 55.2 percent of total FX loans of the corporate sector was extended by banks established in Turkey. On the other hand, as per the amendment made to Decree No. 32, restrictions on the extension of FX loans by resident banks were eased as of June 16, 2009. Thus, the source (domestic vs. foreign) composition of FX loans extended by resident banks has changed (Box 6). As a matter of fact, in the June - September 2009 period, FX loans extended to the corporate sector by foreign branches and affiliates of resident banks decreased by approximately USD 1.5 billion, whereas FX loans extended by domestic branches of the resident banks rose by USD 1.8 billion (Table I.14).

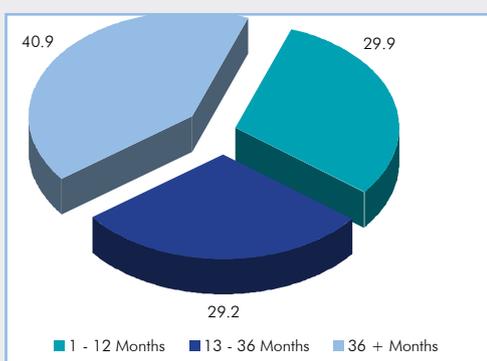
**Table I.15.**  
**Sectoral Breakdown of the Remaining Maturity Composition of Long-Term Loans Received from Abroad by Corporate Sector (Million USD)**

(September 2009)	1 - 12 Months	13 - 24 Months	25 - 36 Months	37 - 60 Months	61 - 120 Months	120 + Months	Total
CORPORATE SECTOR	28,538	15,223	12,667	17,082	18,853	3,096	95,459
AGRICULTURAL SECTOR	147	70	72	81	68	0	437
INDUSTRIAL SECTOR	12,637	6,686	4,848	6,446	8,347	1,467	40,431
1. Manufacturing	9,993	4,566	3,651	3,929	5,589	518	28,246
- Food, Beverage and Tobacco Prod.	3,395	880	638	635	150	426	6,124
- Basic metals and fabric. met. products	1,508	760	569	640	2,283	54	5,814
- Textiles and textile products	1,009	616	560	473	399	3	3,061
- Transport equipment	1,029	350	345	328	986	13	3,051
- Electrical and optical equipment	513	187	507	388	503	13	2,111
- Chem. Prod. and man-made fibres	648	415	193	345	426	0	2,027
- Other non-metallic mineral products	285	372	293	461	373	0	1,784
- Machinery and equipment	497	371	116	120	60	0	1,163
- Rubber and plastic products	381	238	158	181	71	0	1,028
- Others	728	378	274	357	337	9	2,083
2. Elect., Gas and Water Supply	1,730	1,623	715	1,775	1,687	949	8,479
3. Mining and Quarrying	914	497	482	742	1,071	0	3,706
SERVICES	15,754	8,467	7,747	10,555	10,439	1,629	54,591
1. Real Estate, Rent. and Business Services	5,808	3,366	3,572	2,912	2,798	99	18,554
2. Transports, Storage and Communic.	2,474	1,715	1,988	4,150	3,525	1,189	15,042
3. Construction	3,021	1,267	667	1,055	1,865	291	8,165
4. Wholesale and Retail Trade	2,560	959	591	1,151	1,173	11	6,445
5. Hotels and Restaurants	900	542	414	577	560	7	3,000
6. Other com., soc. and person. serv. Act.	714	370	383	504	233	32	2,235
7. Others	277	249	132	206	286	0	1,150

Source: CBRT

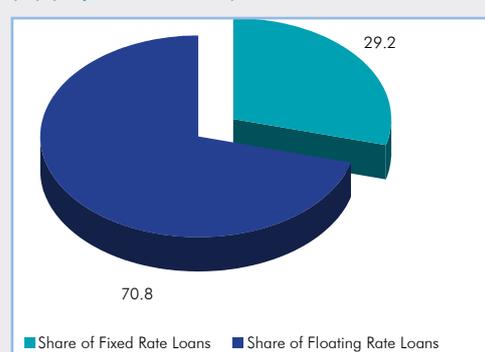
The services sector has the largest share with 57.2 percent in long-term loans received by the corporate sector from abroad. The loans of real estate, renting and the business services sector and the transportation, storage and communication sector, which have a significant share in the services sector, include external loans received by a number of firms with foreign capital operating in these sectors in order to pay acquisition (including privatization) costs. The share of industrial sector loans in total loans is 42.4 percent and the majority of these loans were received by the manufacturing industry (Table I.15).

**Chart I.50.**  
Remaining Maturity Composition of Long-Term Loans Received from Abroad by Corporate Sector (%) (September 2009)



Source: CBRT

**Chart I.51.**  
Interest Rate Composition of Long-Term Loans Received from Abroad by Corporate Sector (%) (September 2009)



Source: CBRT

By September 2009, 29.9 percent of long-term loans received by the corporate sector from abroad were loans with a maturity of up to one-year (Chart I.50).

By September 2009, 29.2 percent of long-term loans received by the corporate sector from abroad were fixed rate, whereas 70.8 percent were floating rate loans (Chart 1.51). In September 2009, no significant change was observed in the interest rates of external borrowings of the corporate sector compared to end-2008. 61.5, 36.2 and 2.3 percent of the said loans were denominated in USD, EURO and other foreign currencies, respectively. Moreover, the share of EURO-denominated loans increased by 2.5 points compared to end-2008.

#### 1.4.2.3. Foreign Exchange Position of the Corporate Sector

Foreign exchange positions of firms operating in Turkey cannot be calculated by referring to their balance sheets, since the financial statements of firms are prepared in terms of Turkish currency, regardless of currency composition. However, in order to provide a general idea concerning the exchange rate risk of firms, the table of Foreign Exchange Assets and Liabilities of Non-Financial Companies prepared by the CBRT is posted quarterly on our website. Besides, the foreign currency positions of non-financial firms listed on the ISE, which constitute an important part of the corporate sector, have been calculated by referring to footnotes in their disclosed financial statements, and the exchange rate risks, as well as the cash loan risks of those firms have been examined.

The exchange rate risk of firms in the corporate sector has been analyzed and assessed from a macro perspective. Hence, considering that some firms have short positions while others have long positions, it would be more accurate to evaluate the vulnerability of the corporate sector to exchange rate risk by making individual analyses for each firm.

**Table I.16.**  
**FX Assets and Liabilities of Corporate Sector<sup>1,2</sup>(Million USD)**

	2006	2007	2008	03.09	06.09	Change 2008- 06.09 (%)	Change 03.09- 06.09 (%)
<b>Assets</b>	<b>62,688</b>	<b>76,169</b>	<b>81,379</b>	<b>77,795</b>	<b>80,100</b>	<b>-2</b>	<b>3</b>
A. Deposits	45,450	54,834	60,371	57,073	58,586	-3	3
-Domestic Banks <sup>3</sup>	18,756	24,402	27,261	25,092	27,133	0	8
-Foreign Banks <sup>4</sup>	26,694	30,432	33,110	31,981	31,453	-5	-2
B. Securities	933	830	695	636	799	15	26
C. Export Receivables	8,848	10,314	8,591	8,312	8,556	0	3
D. Foreign Dir. Invest. to Abrd.	7,457	10,191	11,722	11,774	12,159	4	3
<b>Liabilities</b>	<b>100,309</b>	<b>139,404</b>	<b>161,453</b>	<b>152,240</b>	<b>153,536</b>	<b>-5</b>	<b>1</b>
A. Cash Loans	83,364	119,562	144,695	137,306	138,252	-4	1
-Domestic <sup>5,6</sup>	29,613	41,007	46,010	42,068	42,359	-8	1
Non-bank Fin Inst. <sup>7</sup>	4,869	8,220	8,576	7,849	8,213	-4	5
-Foreign <sup>8</sup>	53,751	78,555	98,685	95,238	95,893	-3	1
B. Import Payables	11,754	14,544	14,703	13,462	13,820	-6	3
C. Protocol Receiv. of SDIF	5,191	5,298	2,055	1,472	1,464	-29	-1
<b>Net Position</b>	<b>-37,621</b>	<b>-63,235</b>	<b>-80,074</b>	<b>-74,445</b>	<b>-73,436</b>	<b>-8</b>	<b>-1</b>

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. June 2009 data is provisional.

(5) Funds extended by participation banks are included.

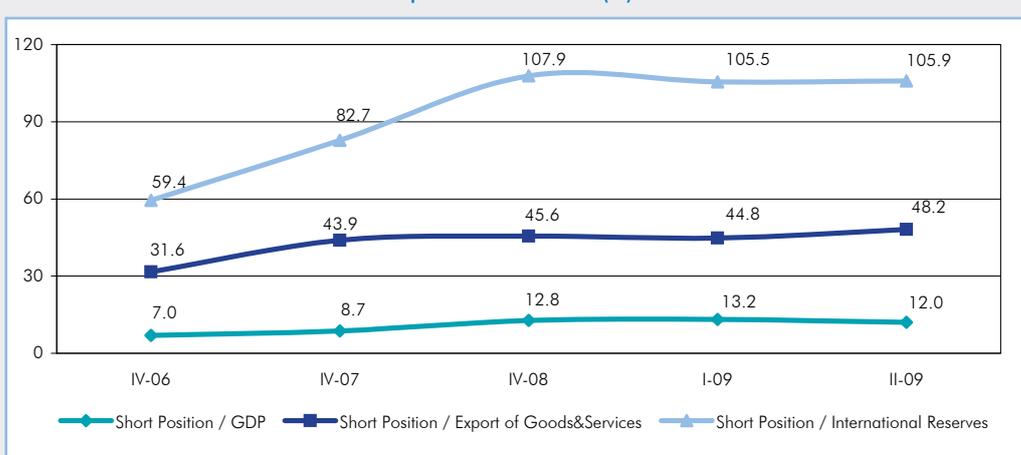
(6) FX indexed loans are included.

(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 net short position of the corporate sector went down by 8 percent to USD 73.4 billion in June 2009 compared to end-2008, and fell by 1 percent compared to March 2009 (Table I.16).

**Chart I.52.**  
**Ratios Related to FX Position of the Corporate Sector<sup>1,2,3</sup> (%)**



Source: CBRT, TURKSTAT

(1) GDP and exports of goods & services 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).

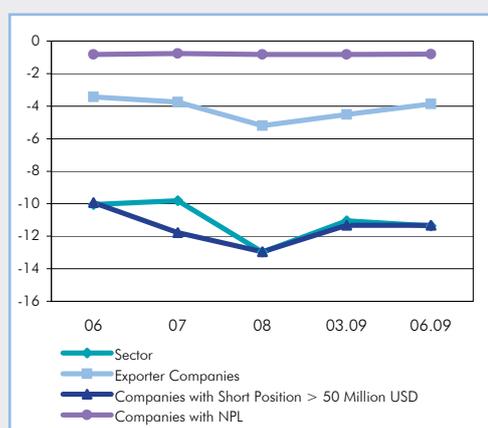
(3) The short position is converted into TL using the foreign exchange rate of the related period and divided by GDP.

In June 2009, the ratio of the short position of the corporate sector to GDP and international reserves decreased, while that to exports and services revenues increased compared to end-2008 (Chart I.52).

#### I.4.2.3.1. Foreign Exchange Position of Corporate Sector Firms Listed on the ISE

This section analyzes the foreign exchange positions and credit obligations of corporate sector firms listed on the ISE to the banking sector. The analysis covers 184 non-financial firms<sup>4</sup> whose financial statements are published by the ISE and which disclose their foreign exchange positions in their balance-sheet footnotes, and do not include any financial institutions in their consolidated financial statements.

**Chart I.53.**  
FX Position of ISE Companies<sup>1,2</sup> (Billion USD)



Source: ISE

(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.

**Chart I.54.**  
Cash Loans Extended to ISE Companies<sup>1</sup>  
(Including NPL, Billion TL)



Source: CBRT

(1) According to Risk Centre records, the cash loans are the loans which are extended directly by domestic banks or extended by foreign banks with guarantee or through intermediation of domestic banks.

The short position of firms analyzed, which was USD 13 billion at end-2008, went down to USD 11.4 billion in June 2009 (Chart I. 53). By end-2008, while 137 of firms analyzed had short positions, the number of firms with short positions decreased to 126 in June 2009. The short position of these firms, which amounted to USD 14.5 billion at end-2008, fell to USD 12.6 billion in June 2009.

While the number of firms with a short position over USD 50 million was 43 at end-2008, it decreased to 41 by June 2009. While the short position of these firms was USD 13 billion at end-2008, it went down to USD 11.3 billion by June 2009. The short position of non-exporting firms, which was USD 7.8 billion at end-2008, decreased to USD 7.5 billion in June 2009 (Chart I.53).

<sup>4</sup> 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, are excluded from the exchange rate risk analyses.

Total loans including NPL of firms analyzed fell by 5.4 percent to TL 17.1 billion in June 2009 compared to end-2008 (Chart I.54).

No significant change was observed in the number of firms with NPLs and the amount of their short positions and loans in the first half of 2009 compared to end-2008. 16 of 18 firms with NPLs had short positions amounting to USD 796 million, while the amount of their cash loans became TL 668 million, TL 568 million of which were NPLs, by June 2009 (Chart I.54).