III. Non-Financial Sector

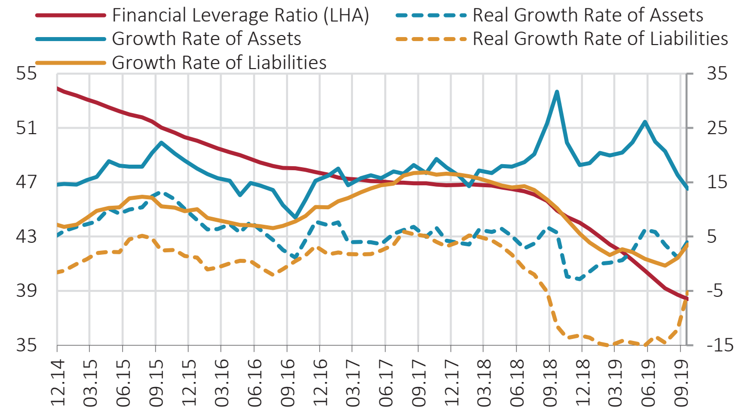
Household financial assets continued to grow faster than household financial liabilities, however, in the current Report period, growth in assets slowed down while growth in liabilities started to accelerate. Consequently, as of September 2019 household financial assets and liabilities grew by 14% and 4%, respectively. As the difference between the growth rates decreased, the decline in household leverage ratio slowed down and stood at 38%. Along with the rise in housing loans, the growth in liabilities was driven by general-purpose loans and personal credit cards (PCC) used to pay for the deferred spending that materialized following the decline in interest rates. Meanwhile, the rise in household financial assets was driven by TL and FX-denominated savings deposits. The contribution of TL deposits to asset growth has been increasing thanks to the stable outlook of the TL and the decelerating dollarization since June 2019. Besides, Turkey ranks significantly lower than the EME average with a household indebtedness ratio of 14% in 2019.

Regarding corporate sector developments, the recovery trend in industrial production, which started in the first quarter of 2019, continued in the second and third quarters and a moderate improvement was observed in corporate sector confidence after June. In this Report period, the sectoral diffusion of the recovery in economic activity by sectors improved gradually. The strong recovery observed in sectors with the capability of generating FX income in the previous Report period, is slightly rebalanced by the increased uncertainty in global trade in the current Report period. Manufacturing and import indicators suggest that the recovery in machinery and equipment investments may take some time. The decline in corporate sector firms' FX debt burden continued, and the net FX open position decreased by USD 33 billion year-on-year and dropped to USD 184 billion. The fall in interest rates, the recovery in economic activity, the improvement in expectations, the enhanced competition among banks thanks to the RR regulation linked to credit growth, and increased liquidity of the banking sector contributed to TL loan supply and demand. Firms' debt rollover capacity is expected to improve as a result of the fall in interest rates and the moderate recovery in economic activity.

III.1 Household Developments

About three-fourths of the financial assets of households are composed of savings deposits, while retail loans account for almost all liabilities. In this Report period, growth in household assets lost pace and converged to the quarterly average, while growth in liabilities increased but remained below the quarterly average. By September 2019, household financial assets increased by 14%, while liabilities grew by 4% on an annual basis (Chart III.1.1). Deposits, the growth of which followed a relatively slow course, played a role in these developments due also to the base effect driven by exchange rate developments on the assets side. Meanwhile, growth in general-purpose loans and PCC balances affected the liabilities side. As the difference in growth between assets and liabilities declined, the fall in household financial leverage ratio lost pace and dropped to 38%.

Chart III.1.1: Growth Rates of Households' Financial Assets and Liabilities, and Financial Leverage Ratio (Annual % Change, % Share)

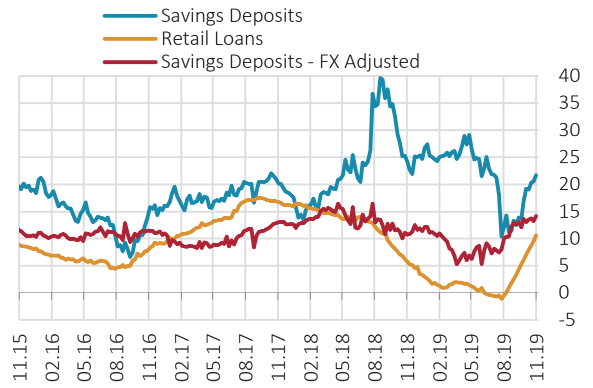


Sources: CBRT, BRSA, CMB, MKK, TOKİ Last Observation: 09.19
Note: The leverage ratio refers to the ratio of average liabilities to average financial assets in the last twelve months. Real growth rates have been calculated using the CPI. Monthly average exchange rate data are used in calculations. The last observation is 03.19 for TOKİ and 08.19 for asset management companies.

The annual growth rate of retail loans -the most important component of household financial debts- was around 11% by mid-November, while the nominal growth rate of savings deposits reached 22% in the second half of the year (Chart III.1.2). Amid the mild recovery in economic activity, aggregate demand conditions offered further contributions to disinflation and reductions in the policy rate led by improved inflation prospects spilled over into loan rates through the transmission mechanism. Against these developments, postponed demand has started to transform into spending. This appeared in the increases in housing and general-purpose loans in particular. In this period of less volatility in exchange rates and the level of exchange rate close to the previous year, TL and FX deposits as well as FX-adjusted savings deposits also increased.

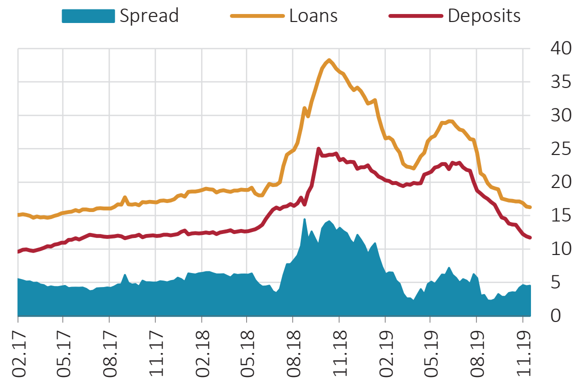
Currency preferences of depositors and exchange rate developments continued to determine the growth of deposits. The relatively stable course of the exchange rate in recent times, the downtrend in inflation and better prospects for expectations have caused depositors to have stronger preference for TL. In the current Report period, alongside the CBRT's policy rate reductions, liquidity conditions improved due to the balancing in the economy, while the external financing need, financial volatility and uncertainties decreased. Due mainly to these developments, consumer loan rates decreased amid the dwindling funding costs of the financial sector (Chart III.1.3). By August 2019, the association of interest rates paid to RR maintained in TL with credit growth has stimulated interbank competition and caused loan interest rates to decline (Box I.1.I). In addition to the fall in the CBRT's policy rate, the improvement in the banking sector liquidity supported the decline in savings deposits rates. Amid the determining effect of the fall in loan rates, consumer loan-savings deposits rate spread hovers below the average.

Chart III.1.2: Household Annual Credit and Deposit Growth (%)



Sources: CBRT, BRSA Last Observation: 15.11.19
Note: FX savings deposits have been adjusted for exchange rate with the (0.6 USD + 0.4 euro) currency basket.

Chart III.1.3: Consumer Loan and Savings Deposit Rate Developments (%)



Source: CBRT Last Observation: 15.11.19
Note: Weighted average interest rates applied to loans and deposits opened and renewed in the respective period by banks.

Following the depositors' more apparent preferences for FX and gold since September 2018, balances of FX and gold deposit accounts rose by USD 29 billion in the last year, but lost pace within the last six months and rose by around USD 10 billion and reached USD 119 billion (Table III.1.1). In this Report period, due to the robust outlook in TL as well as the dollarization that decelerated as of June, growth in FX savings deposits in TL remained more limited at 15%. Nevertheless, this item became the largest contributor of growth in household assets with 5.5 points. When the increase in TL deposits was 7%, the contribution of this item to asset growth was 2.9 points. Investment funds stood out as another item to contribute to growth by 3.3 points. Thus, household financial assets rose by 14% on an annual basis by September 2019.

Table III.1.1: Households' Financial Assets

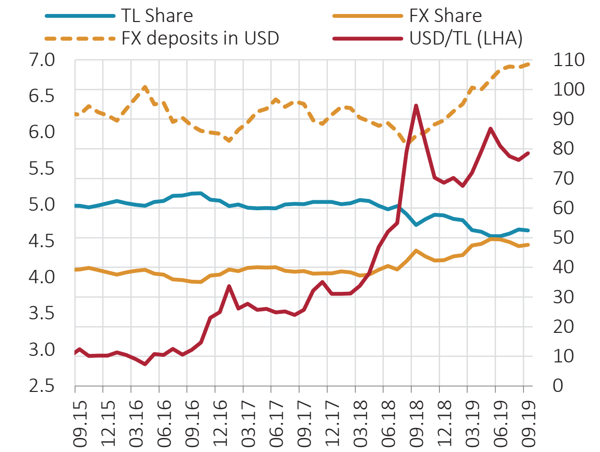
	09.18		09.19		Percentage Change	Cont. to Change (Point)
	Billion TL	Perc. Share	Billion TL	Perc. Share		
Total Assets	**1500.1**	**100**	**1707.3**	**100**	**13.8**	**13.8**
TL Savings Deposits	638.5	42.6	682.4	40.0	6.9	2.9
FX Savings Deposits	537.5	35.8	619.4	36.3	15.2	5.5
- *(Billion USD)*	84.4		108.5		28.5	
Precious Metal Deposits	36.7	2.4	60.0	3.5	63.3	1.6
- *(Billion USD)*	5.8		10.5		82.1	
Bonds and Bills	30.7	2.0	43.1	2.5	40.5	0.8
- Public Sector	12.3	0.8	15.8	0.9	29.1	0.2
- Private Sector	18.4	1.2	27.2	1.6	48.0	0.6
Mutual Funds	121.9	8.1	171.9	10.1	41.0	3.3
Pension Mutual Funds	81.8	5.5	99.5	5.8	21.6	1.2
Other Mutual Funds	40.1	2.7	72.4	4.2	80.7	2.2
Equity Securities	66.9	4.5	70.2	4.1	5.0	0.2
Repo	1.3	0.1	2.3	0.1	79.8	0.1
Currency in Circulation	66.6	4.4	57.9	3.4	-13.1	-0.6

Sources: CBRT, CMB, MKK Last Observation: 09.19
Note: Exchange rate is obtained by the averages of daily data in the respective month.

The share of FX and gold deposit accounts within household's total financial assets increased to 40%, while TL and FX deposit shares have recently remained close (Table III.1.1 and Chart III.1.4).

A breakdown of household deposits reveals that by August 2019, FX-adjusted FX savings deposits grew at a higher rate than TL deposits in the last six month and one-year period (Chart III.1.5). In the previous Report period, the motivation to hedge against high volatility in financial markets, limited deterioration in expectations, rising uncertainties and inflation pushed deposit dollarization upwards. Meanwhile, in the current period, amid falling inflation and improving expectations, households' recent deposit preference in favor of TL caused this trend to disappear. Against these developments, by September 2019, the share of TL savings deposits within total savings deposits increased to approximately 53%.

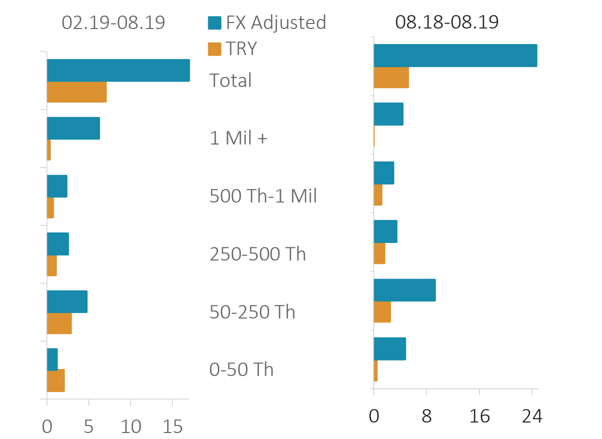
Chart III.1.4: Breakdown of Resident Households' Savings Deposits by TL and FX (% Share, Billion USD, TRY)



Source: CBRT Last Observation: 09.19

Note: FX savings deposits in USD, not including precious metals held by resident real persons. Monthly average exchange rate data are used in calculations.

Chart III.1.5: Change in Households' Deposits across Amounts (% Points)

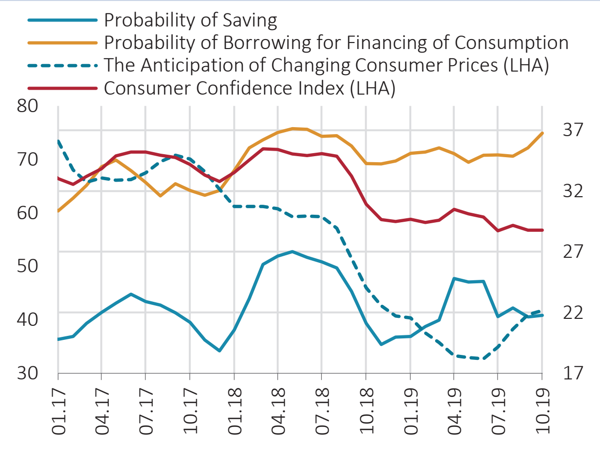


Source: CBRT Last Observation: 08.19

Note: FX deposits held by residents have been adjusted for the exchange rate effect with the (0.6 USD + 0.4 euro) currency basket. Moreover, monthly average exchange rate data is employed in calculations.

The consumer confidence index and the consumer tendency survey, which explain households' spending and saving patterns as well as expectations for economic activity, reveal that these data improved partially by October 2019, yet displayed a relatively flat course (Chart III.1.6). In this Report period, the upward movement in the likelihood of borrowing to finance consumption indicates that the rebound in the credit market will continue in the period ahead. Meanwhile, gold prices have increased since the previous Report period, while the household's gold portfolio has fluctuated upwards (Chart III.1.7).

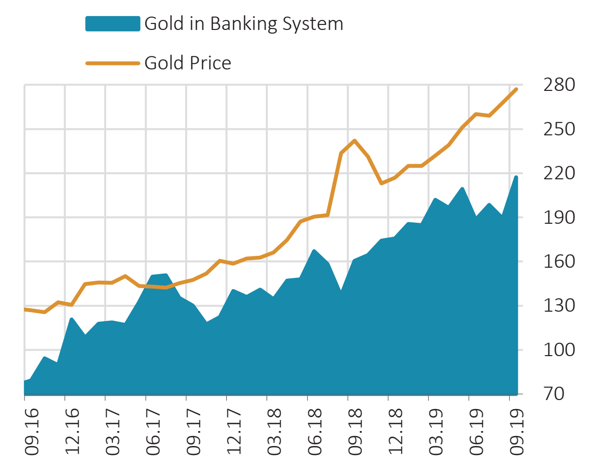
Chart III.1.6: Indices of Questions to Consumer Confidence Index and Consumer Tendency Survey (3-Month MA)



Source: TURKSTAT Last Observation: 10.19

Note: A downward movement in the indices denotes deterioration in expectations. The first three series are for the next 12 and 3 months and the past 12 months, respectively.

Chart III.1.7: Households' Gold Portfolio in the Banking System and Gold Bar Price per Gram (Ton, TRY)

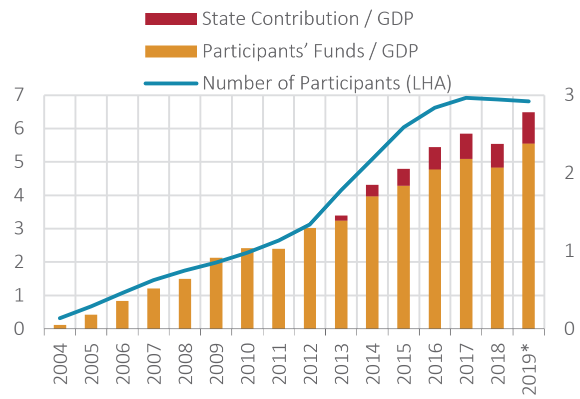


Source: CBRT Last Observation: 09.19

Note: Gold bar selling price per gram. It covers resident real persons' gold in Turkey and abroad.

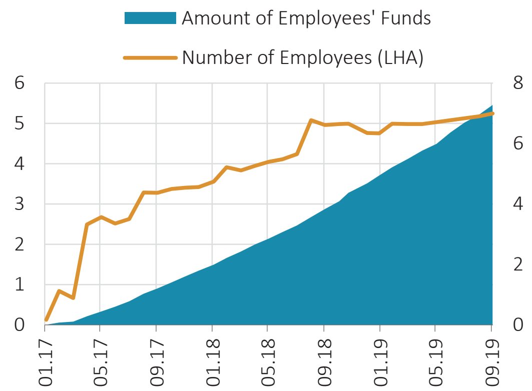
Since 2013, state contribution has been made to the private pension system (PPS) to encourage domestic savings, and households' savings in the PPS system grew further in this Report period (Chart III.1.8). The number of people within the system is currently 6.8 million. The mild fall recorded in the last two year-period was also driven by the exclusion of retirees from the system. Over the last one year, the PPS funds including state contribution grew by 29% to TRY 110.9 billion. The number of employees enrolled in the Auto-Enrollment Pension Scheme (AEPS), which was introduced in 2017 to boost individual savings, stabilized at around five million, while the amount of funds formed in this system increased at a stable pace and exceeded TRY seven billion (Chart III.1.9).

Chart III.1.8: Private Pension System (%, Thousand TRY, Million People)



Source: PMC *Last Observation: 01.11.19
Note: State contribution is paid by the Government for private pension contracts at the amount of 25% of the amount paid by the contractor depending on the period of enrollment in the system.

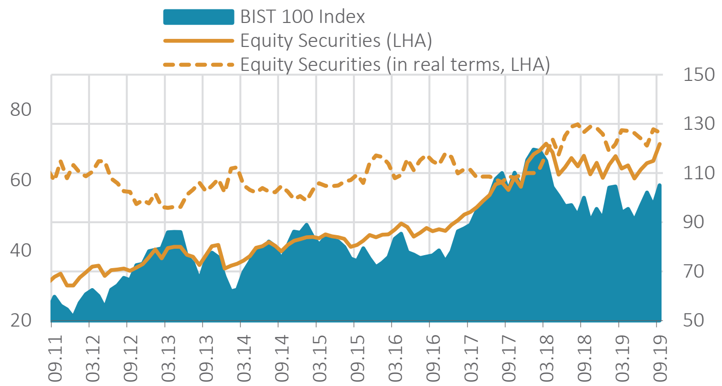
Chart III.1.9: Auto-Enrollment Pension Scheme (Billion TRY, Million People)



Source: PMC Last Observation: 09.19

Households' equity securities portfolio has moved in tandem with the stock exchange index since September 2018 and has fluctuated in a relatively narrow band (Chart III.1.10). An upward trend is seen in equity securities portfolio in the second half of 2019, yet real securities portfolio remains flat on a fluctuating course.

Chart III.1.10: BIST 100 Index and Household Equity Securities Portfolio (Thousand, Billion TRY)



Source: CBRT Last Observation: 09.19
Note: Real equity portfolio has been adjusted for value changes by using stock market index.

Households' financial liabilities increased at a milder pace compared to the previous Report period, yet the distribution of liabilities was roughly the same. Meanwhile, households' inclination towards preferring mostly banks as the source of financing remained almost unchanged. By 2019 September, household financial liabilities rose by 3.8% due to the contributions from general-purpose loans and PCC by 2.9 and 2.2 points (Table III.1.2). However, housing and vehicle loans still have a reducing effect on liabilities. Meanwhile, due to housing loan campaigns initiated by public banks, following June 2019, the total balance of housing loans reversed the decline that persisted over the last one year. Meanwhile, general-purpose loans are projected to remain the driver of loan growth in the near future as well. The rise in general-purpose loans was led by the decline in interest rates as well as the extension of the maximum maturity to 60 months in in February 2019.

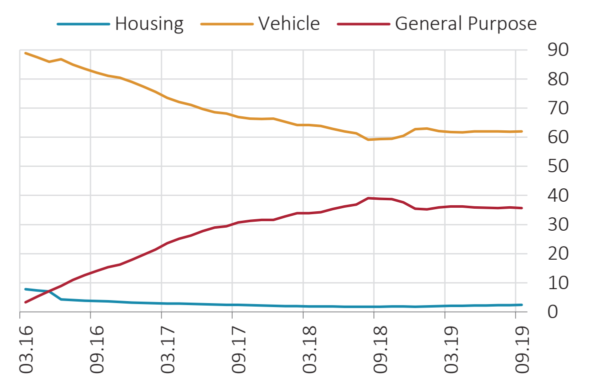
Table III.1.2: Households' Financial Liabilities

	09.18		09.19		Percentage Change	Contributions to Change
	Billion TL	Percentage Share	Billion TL	Percentage Share		
Total Liabilities (Based on Type)	**598.2**	**100.0**	**621.1**	**100.0**	**3.8**	**3.8**
Housing	220.8	36.9	212.7	34.2	-3.7	-1.4
Vehicle	16.9	2.8	13.0	2.1	-23.4	-0.7
General Purpose	228.8	38.3	246.4	39.7	7.7	2.9
Personal Credit Cards	108.5	18.1	121.9	19.6	12.3	2.2
Asset Management Comp' Rec.	23.1	3.9	27.1	4.4	17.6	0.7
Total Liabilities (Based on Counterparty)	**598.2**	**100.0**	**621.1**	**100.0**	**3.8**	**3.8**
Banks	535.4	89.5	558.4	89.9	4.3	3.8
Financing Companies	16.9	2.8	11.3	1.8	-33.4	-0.9
TOKİ	22.8	3.8	24.4	3.9	6.8	0.3
Asset Management Comp'	23.1	3.9	27.1	4.4	17.6	0.7

Sources: CBRT, TOKİ Last Observation: 09.19
Note: Liabilities also include NPLs. The last observation for TOKİ is 03.19, and 08.19 for AMC.

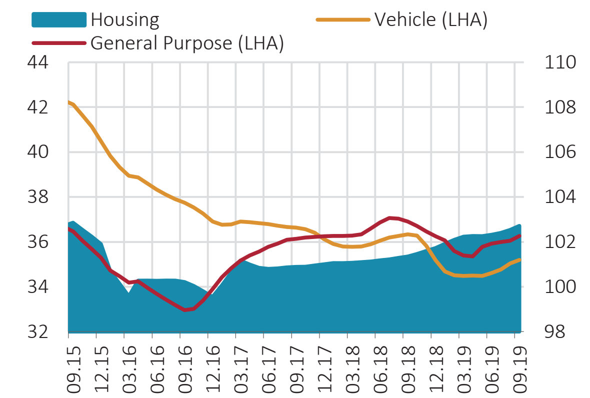
Consumers use finance company loans mostly for vehicle purchases, while they have preferred finance companies also for purchases subject to general-purpose loans since 2016 at an accelerated pace (Chart III.1.11). The share of general-purpose loans within total finance company loans rose from 3% to 36% and remained flat at this level. Meanwhile, consumer loan balance utilized by finance companies since September 2018 has displayed a decline across all items and contracted by 33%.

Chart III.1.11: Consumer Loans Extended by Finance Companies Based on Type (% Share)



Source: CBRT Last Observation: 09.19

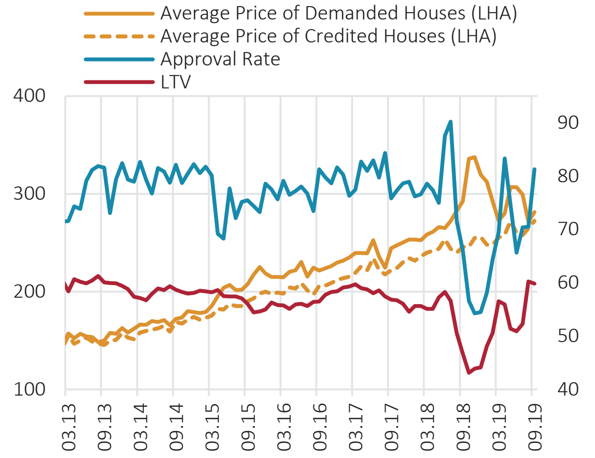
Chart III.1.12: Banking Sector Consumer Loans in Average Maturity (3-month MA, Month)



Source: CBRT Last Observation: 09.19

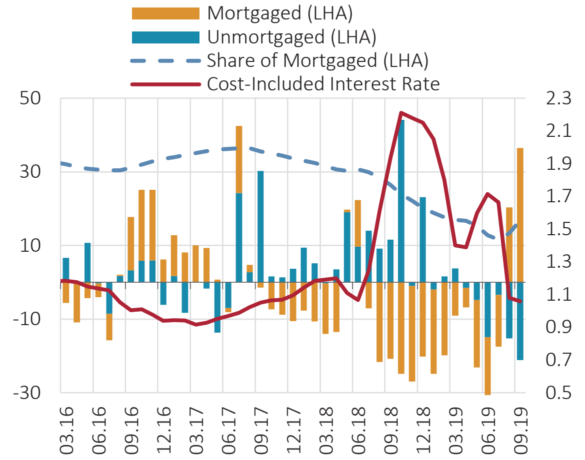
In the current Report period, average maturities in consumer loans are on a mild trend of increase (Chart III.1.12). In February 2019, extension of the maximum maturity for general-purpose loans up to 60 months under countercyclical arrangements caused the average maturity to increase in this item. Cost-included interest rates in housing loans decreased in the current Report period, and the loan to value (LTV) ratio and approval rates increased, and housing loans were stimulated (Charts III.1.13 and III.1.14). Housing sales rose by 15% compared to September 2018, pushed up by 36 points due to mortgage sales, but pulled down by 21 points due to non-mortgage sales. Re-sales added 22 points to the increase in sales, while an increase in initial sales did not occur. Meanwhile, average prices of houses for which loans have recently been demanded and utilized, have diverged occasionally yet remain close in September 2019. In periods of notable divergences in the prices, approval rate and LTV ratio displays a decline.

Chart III.1.13: Approval Rate, Loan to Value Ratio in Housing Loans and Housing Price Developments (Thousand TRY, %)



Source: CBRT Last Observation: 09.19
Note: Approval rate is the ratio of approved housing loans to the number of applications submitted. Average prices of houses are employed for which loans were demanded and extended. LTV ratio can be formulated as the sum of extended housing loan/total value of houses for which loans are extended.

Chart III.1.14: Contribution to Housing Sales Growth and Monthly Cost-Included Interest Rate on Mortgage Loans (%, Percentage Points)

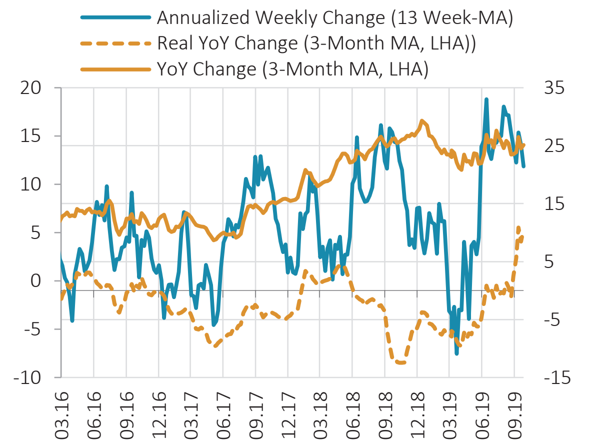


Sources: CBRT, TURKSTAT Last Observation: 09.19
Note: The mortgaged share is the share of mortgaged sales in total house sales over the last 12 months; and the approval rate is the ratio of approved housing loans to the number of applications submitted. Cost-included interest rates includes costs other than the interest (all fees, expenses and commission charged)

Annualized weekly change of PCC balance continued to fluctuate, and the growth rate increased in the last Report period (Chart III.1.15). Nominal and real annual changes of PCC expenditures also remain above quarterly averages. This is attributable to the facilitation of installments in PCC at the end of 2018.

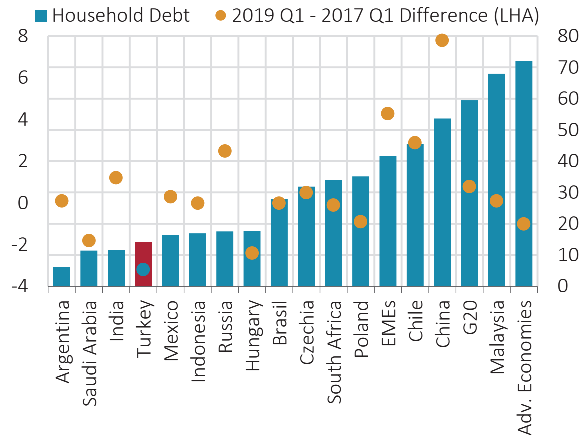
Against these developments, the ratio of loans to GDP extended by the Turkish banking sector to the household hovered around 13% in September 2019. In March 2019, with 14.3%, total household indebtedness of Turkey was well below 42%, the EME average. This is considered to be supportive of financial stability (Chart III.1.16). Macroprudential policies against household indebtedness played an important role in this. Changes in the last two years reveal that household indebtedness of Turkey declined more than selected EMEs.

Chart III.1.15: Change in PCC Balance (%)



Sources: CBRT, TURKSTAT Last Observation: 09.19
Note: Deflated by the CPI.

Chart III.1.16: Indebtedness of Countries (%, Points)



Sources: BIS, CBRT Last Observation: 03.19
Note: Spreads denote the two-year change in household indebtedness. Household indebtedness denotes the formula: total of bonds and loans of households and non-profit institutions serving households/ GDP.

Box III.1.I

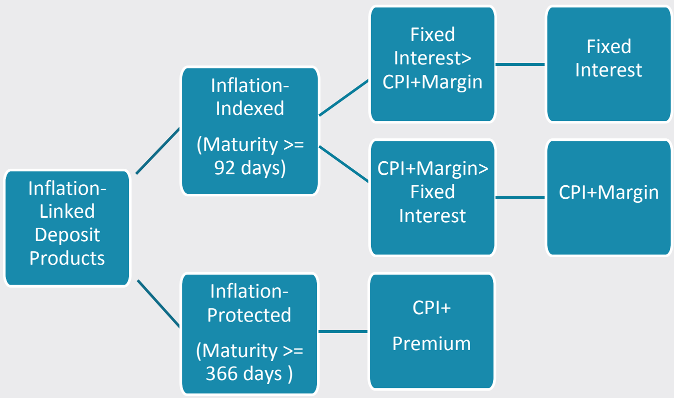
Inflation-Linked Deposit Products

Banks have been offering inflation-linked deposit products as an alternative savings tool since April 2019. These products mainly aim at protecting TL savings against inflation and encouraging customers to keep their savings in TL. Inflation-linked deposit balances have grown notably in a short time. This box will provide an overview of how inflation-linked deposit products function and how their amounts and interest rates have changed in time.

Inflation-Indexed and Inflation-Protected Deposit Products

Banks offer two inflation-linked deposit products: inflation-indexed and inflation-protected. Inflation-indexed deposits have a term of 92 days or longer while inflation-protected deposits are for 366 days or longer. Returns on inflation-indexed deposits are calculated using either the annual CPI inflation plus margin or the fixed interest rate offered by the bank on the date of opening the account, whichever is higher. If the annual CPI plus margin is greater than the fixed interest guaranteed at the beginning of the term, the depositor will earn a return as much as the annual CPI plus margin, or, in the opposite case (fixed interest>CPI+margin), as much as the fixed interest rate. On the other hand, the return paid at maturity of an inflation-protected deposit is the sum of annual CPI and premiums. Although an inflation-protected product protects the depositor against inflation, it does not guarantee a fixed interest rate (Diagram III.2.I.1).

Diagram III.1.I.1: Inflation-Linked Deposit Products



Source: CBRT

Inflation-linked deposit products are available for annually and interim payments. With interim payments, the customer is paid the sum of the percentage change in CPI and the premium or margin ratio at predetermined intervals. Besides offering inflation protection, inflation-indexed and inflation-protected deposit accounts with a term of 366 days or longer are exempt from stoppage tax (Table III.2.I.1).

Table III.1.I.1: Product Comparison

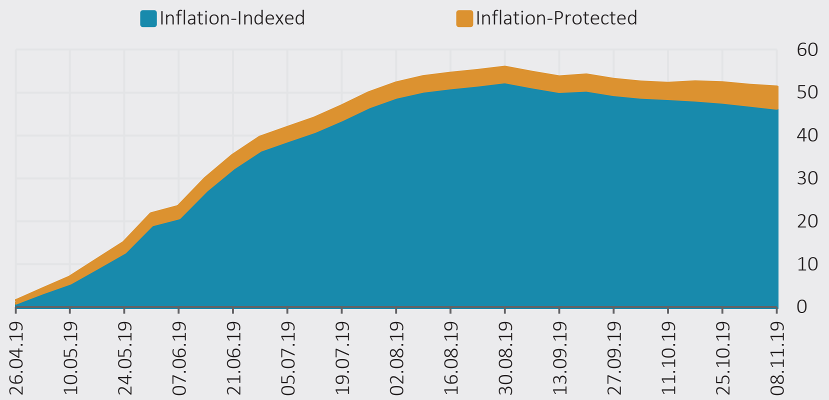
Inflation-Linked Deposit Products	Inflation-Indexed	Inflation-Protected
Inflation Protection	✓	✓
Interest Rate Protection	✓	X
Minimum Maturity (Days)	92	366
Interim Payments-Annual Payments	✓	✓
Stoppage tax exemption	✓	✓

Source: CBRT
Note: The stoppage tax exemption applies to deposits with a term of 366 days or longer.

Developments in Amounts and Maturities

Equaling TRY 4 billion on 3 May 2019, within a short time of their introduction the inflation-linked deposit account balance reached TRY 51 billion on 8 November 2019. In this period, depositors were more attracted to inflation-indexed deposits, which have a share of 91% as of 8 November (Chart III.2.I.1). This inclination is assessed to be largely driven by the constant return that inflation-indexed deposit accounts guarantee and the upward yield potential they carry due to inflation developments. About 80% of the balance accumulated in these inflation-protection providing products belongs to real persons. There has recently been a small decline in the balance of inflation-linked deposit products. The improved inflation outlook and better inflation expectations are assessed to be the key drivers of this development.

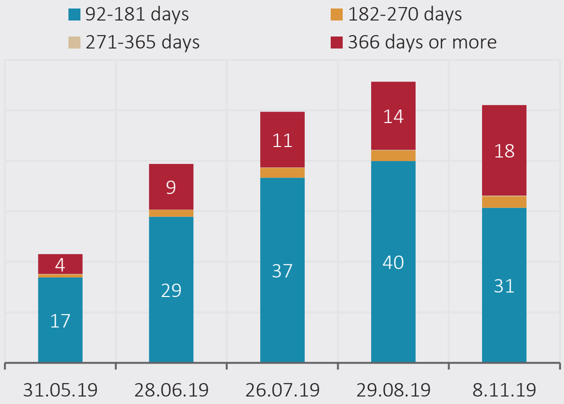
Chart III.1.I.1: Inflation-Linked Deposit Balance (TRY billion)



Source: CBRT Last Observation: 08.11.19

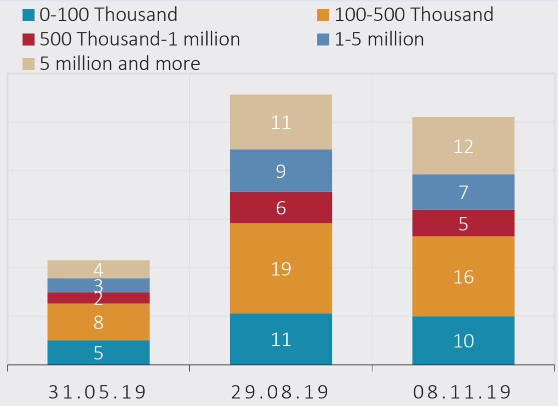
As of the latest data, 60% of inflation-indexed deposit accounts have a term of three to six months (Chart III.2.I.2). The share of inflation-linked deposits with more than one year maturity increased further to TRY 18 billion as of 8 November 2019. This increase seems to have resulted from the 0% stoppage tax applied to returns on inflation-linked deposits with a term of more than one year. This contributes to extend the average maturity of TL deposits. Of 363 thousand customers investing in these products, 97% have an account size of TRY 500 thousand and below, which indicates that depositors with smaller savings prefer inflation-linked products more (Chart III.2.I.3).

Chart III.1.I.2: Maturities of Inflation-Linked Deposit Products (TRY billion)



Source: CBRT

Chart III.1.I.3: Amounts of Inflation-Linked Deposit Products (TRY billion)

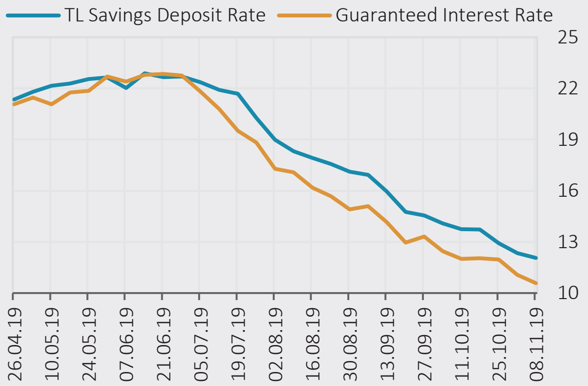


Source: CBRT

Interest Rate Developments

It is observed that, the interest guaranteed on inflation-indexed deposit products and the interest rate on TL savings show a similar pattern (Chart III.2.I.4). On the other hand, since the CPI+margin ratio can be higher than the guaranteed return on inflation-indexed deposits, it would be reasonable for the guaranteed interest rate to hover below the TL savings deposit rate. In addition, premiums paid on inflation-protected deposits are above the margin guaranteed on inflation-indexed deposits (Chart III.2.I.5). The reasons that premiums are above the margin ratio are because inflation-indexed deposit products guarantee a fixed interest rate as minimum return and inflation-protected accounts are maturity premium-included as they have a term of more than one year.

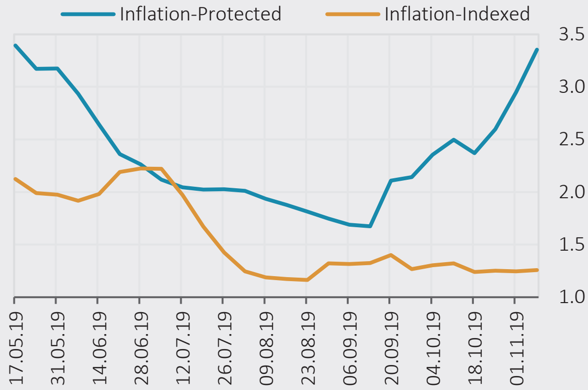
Chart III.1.I.4: TL Savings Deposit Rate and Guaranteed Interest on Inflation-Indexed Deposits* (%)



Source: CBRT Last Observation: 08.11.19

Note: TL savings deposit rate is the weighted average annual interest rate applied to deposit accounts opened in the related week. Guaranteed interest rate is the weighted average annual interest rate of the banks offering the product.

Chart III.1.I.5: Margin Ratio and Premium in Inflation-Linked Deposit Products (4-week MA, %)



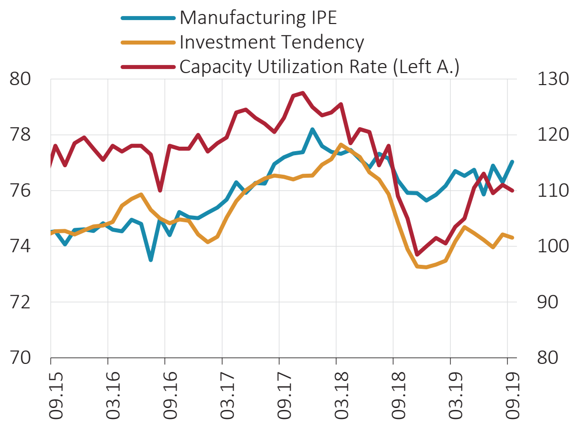
Source: CBRT Last Observation: 08.11.19

In sum, these inflation-protection providing products saw heavy demand in a very short time. Inflation-linked deposit products aimed at encouraging customers to invest their savings in long-term TL deposits brought more diversity to financial markets. Moreover, the relatively longer-term inflation-linked deposit products contribute to extend the maturities of TL deposits.

III.2 Corporate Sector Developments

The modest recovery observed in the manufacturing industry production in the first quarter of 2019 continued in the second and third quarters. On the back of favorable developments in economic activity, the capacity utilization rate and the investment tendency for the next 12 months showed signs of recovery (Chart III.2.1).

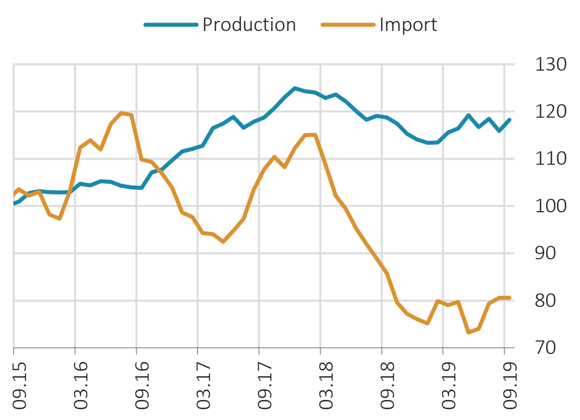
Chart III.2.1: Industrial Production, Investment Tendency and Capacity Utilization (Seasonally Adjusted, Index, %)



Sources: TURKSTAT, CBRT Last Observation: 09.19

Note: The investment tendency is obtained by adding the difference between those who expressed a higher (manufacturing industry) investment expectation in for the next 12 months and those who expressed a lower investment expectation to 100, and the index is established using three-month moving average values.

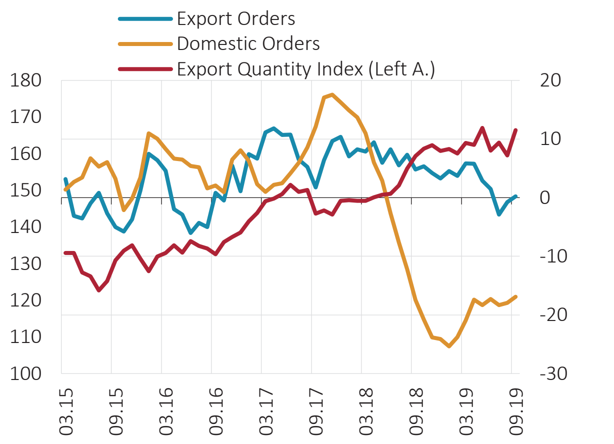
Chart III.2.2: Capital Goods Production and Import Quantity Indices (Seasonally Adjusted, 3-Month Moving Average 2015=100)



Sources: TURKSTAT, Ministry of Treasury and Finance Last Observation: 09.19

In the current Report period, sluggish outlook of capital production and capital goods imports remained (Chart III.2.2).

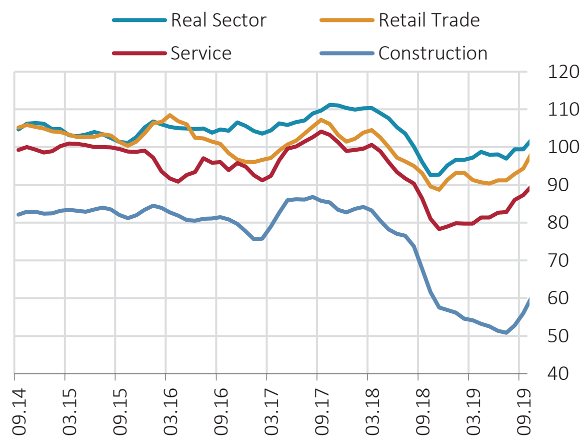
Chart III.2.3: Exports and Domestic Market Orders (% Difference, 3-Month Moving Average, 2010=100)



Sources: TURKSTAT, CBRT Last Observation: 09.19

Note: Orders data indicate the difference between the shares of firms expressing export and domestic market orders as upside and downside in the last three months in the business tendency survey. Values above zero indicate increases in the amount of orders.

Chart III.2.4: Corporate Sector Confidence Indices (Seasonally Adjusted, 3-Month Moving Average)



Sources: TURKSTAT, CBRT Last Observation: 10.19

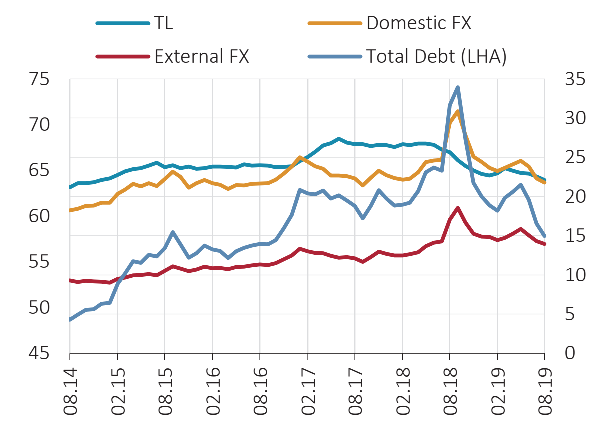
The export quantity index posted a limited decline after May 2019 and increased slightly in September (Chart III.2.3). In the period ahead, the contribution of exports to growth is expected to continue albeit at a lesser degree on the back of the support from the real exchange rate level despite slowing global economic activity. Domestic market orders have been rising since early 2019. The mild recovery in economic activity continues thanks to the favorable developments seen in financial markets and credit conditions following June 2019. Additionally, strong exports, reviving domestic demand, the capacity utilization rate that has been on the rise for some time, and the improvement in financial conditions may support investments.

The weakening witnessed in corporate sector confidence indices following heightened volatilities in financial markets in the third quarter of 2018 was replaced by a modest recovery in expectations in 2019. In the current reporting period, corporate sector confidence indices trended upwards (Chart III.2.4). Economic confidence increased further in the third quarter of the year, signaling that the revival in economic activity continued to diffuse across subsectors.

III.2.1 Corporate Sector Indebtedness

In the second and third quarters of 2019, corporate sector's total financial indebtedness, which includes firms' domestic and external loans as well as bond issues, continued to decline and stood at 58% by August 2019. Although corporate sector's FX debts have recently decreased, the slowing economic activity limited the decline in the ratio of firms' total financial liabilities to GDP (Chart III.2.5). In this period, the ratio of TL debts to GDP remained flat due to the IVME (advanced, productive, indigenous, industry) financing package announced in May 2019 as well as the revisions made to RR ratios in the same month (Box I.1.I). The economic recovery that has become more evident since the third quarter is expected to increase corporate sector firms' need for working capital above all, and to limit the decline in their TL indebtedness that has been in place for a while.

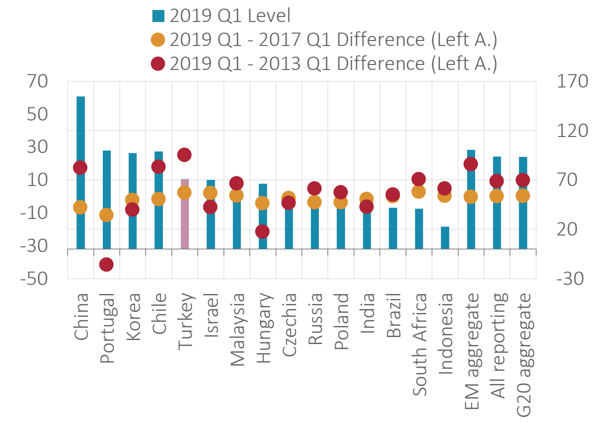
Chart III.2.5: Share of Corporate Sector's Financial Debt in GDP (%)



Source: CBRT Last Observation: 08.19

Note: GDP is converted to monthly basis. August 2019 data is estimate of the CBRT.

Chart III.2.6: Corporate Sector Total Loans/GDP Ratio International Comparison (%, % Difference)



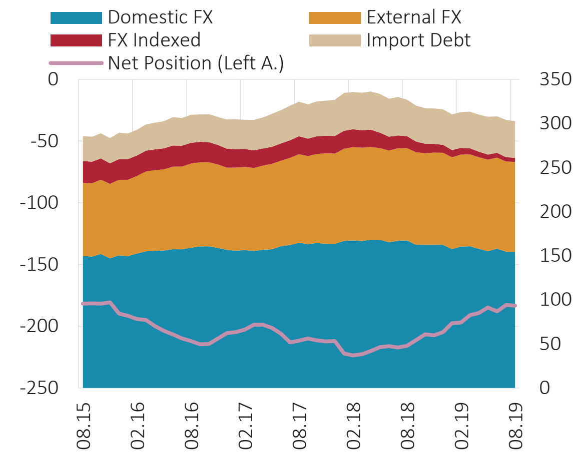
Source: BIS Last Observation: 03.19

Note: Total loans cover performing and non-performing loan receivables, bond issues and loan rate rediscounts.

The corporate sector's share of domestic and foreign FX financial debts in GDP declined thanks to the policy steps taken, exchange rate volatility and increased awareness of exchange rate risk management. The initial amount and TL equivalent balance of FX loans posted a decrease in this period. In conclusion, corporate sector indebtedness indicators converged to the levels seen in the first two quarters of 2018 during which the exchange rate volatility was low. Given the recently-accelerated credit growth, firms' total liabilities to GDP ratio might increase moderately in the upcoming period.

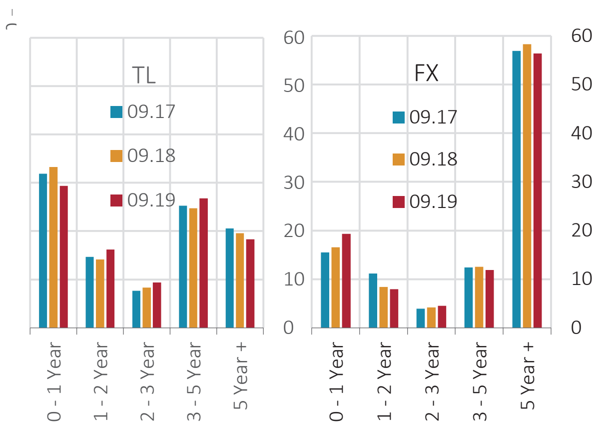
The corporate sector's total loans to GDP ratio, calculated by adding bond issues, NPLs and loan rate rediscounts to corporate sector loans, stood at 71%, and thus continued to hover below G20, EME and the world average as of the first quarter of 2019 (Chart III.2.6). A comparison between the changes in indebtedness ratios of Turkey and EMEs indicates that the ratio of corporate sector loans to GDP is above the EME average and Turkey's indebtedness ratio has been on the decline in recent years compared to the past.

Chart III.2.7: Corporate Sector's FX Liabilities and Net FX Position (USD Billion)



Source: CBRT Last Observation: 08.19

Chart III.2.8: Maturity Breakdown of Domestic TL and FX Loans at the Time of Credit Extension (%)



Source: CBRT Last Observation: 09.19

In the current Report period, the corporate sector's FX short position continued to decline. In August 2019, the net FX short position declined by USD 33 billion year-on-year to USD 183 billion. This decline is attributed to a contraction in FX loan balances due to the limitations on the issuance of FX-indexed and FX loans introduced with amendments made to the Decree No.32 Regarding the Protection of the Value of the Turkish Currency in May 2018, the decline in investment demand, and the enhanced awareness of FX risk management. In the current Report period, while import loans increased slightly to USD 42 billion, the total FX liability amount was USD 303 billion by August 2019 (Chart III.2.7).

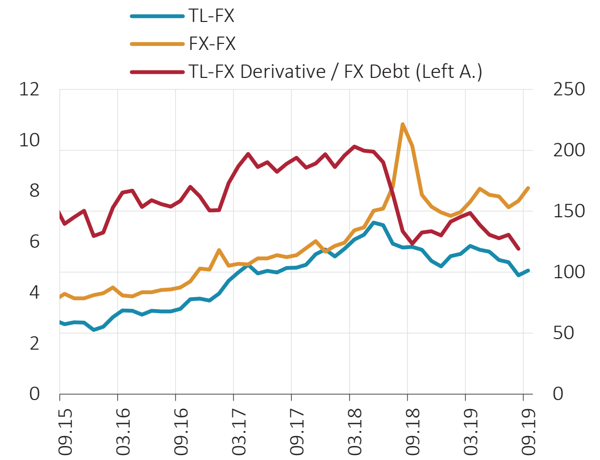
As of September 2019, the share of domestic long-term TL and FX loans used by the corporate sector somewhat decreased compared to the previous year. In the current Report period, while the share of TL loans with maturities below one year, five years and above five years in total TL loans decreased, that of FX loans with shorter-than-one year maturities increased (Chart III.2.8). Subsidized loans supported the extension of TL loan maturities.

The volume of derivative transactions that the corporate sector carries out with banks has declined in line with firms' decreasing FX debts. As of September 2019, the volume of derivative transactions executed between firms and banks (nominal contract amount) stood at TRY 274 billion (Chart III.2.9). Of this amount, TRY 169 billion consisted of FX against FX, TRY 101 billion FX against TL, and TRY 4 billion TL against TL buy-sell transactions. In the current Report period, the TL-FX derivative transaction amount, which is important to exchange rate risk management, posted a decrease by TRY 21 billion. The ratio of this amount to total corporate FX indebtedness declined to 6% by August 2019.

In addition to the transaction volume, the number of firms engaging in derivative transactions also increased in the current Report period. As of September 2019, the number of firms that were parties to derivative transactions with domestic banks was 2,090. As exchange rate volatility was down, the amount of forward FX and options, used as a hedge against exchange rate risk, also declined. Between March and September 2019, while the volume of forward FX transaction volume decreased by TRY 15 billion, that of options was down by TRY 8 billion. While the currency swap transaction volume decreased slightly, that of interest rate options remained flat. Interest rate swaps that are used by firms to convert variable rate

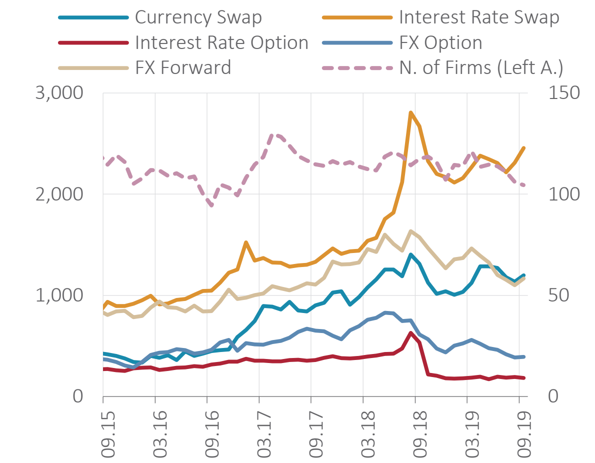
FX loans into fixed rate loans showed fluctuations due to increased uncertainty over benchmark interest rates abroad (Chart III.2.10). With a more widespread use of TLREF in the upcoming period, a significant benchmark rate indicator will be formed for TL-TL interest rate swaps, which will boost the liquidity of interest rate swaps and help firms manage maturity and interest rate risks effectively (Box II.1.III).

Chart III.2.9: Breakdown of Derivatives Transactions by Currency (TRY Billion, %)



Source: CBRT Last Observation: 09.19

Chart III.2.10: Breakdown of Derivatives Transactions by Type (TRY Billion, Level)

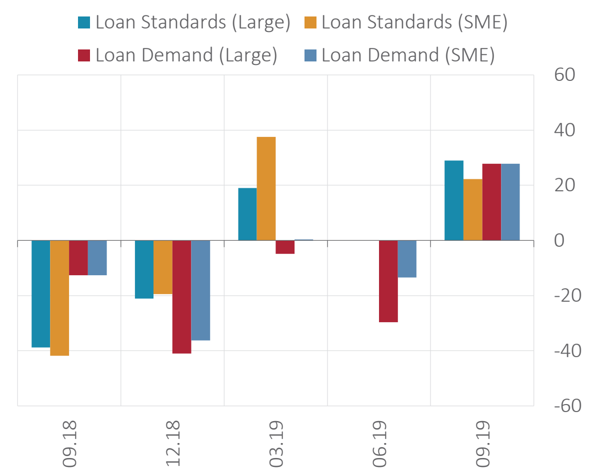


Source: CBRT Last Observation: 09.19

III.2.2 Loan Standards

According to the results of the Bank Loans Tendency Survey, loan standards remained tight in the second quarter of 2019. In the third quarter of 2019, corporate loan standards eased due to the fall in interest rates, the recovery in economic activity as well as the improvement in expectations, the enhanced competition among banks thanks to the RR regulation linked to credit growth, and increased liquidity of the banking sector. This development implies that banks, which were overcautious during the financial turbulence, started to normalize, and that credit supply conditions improved.

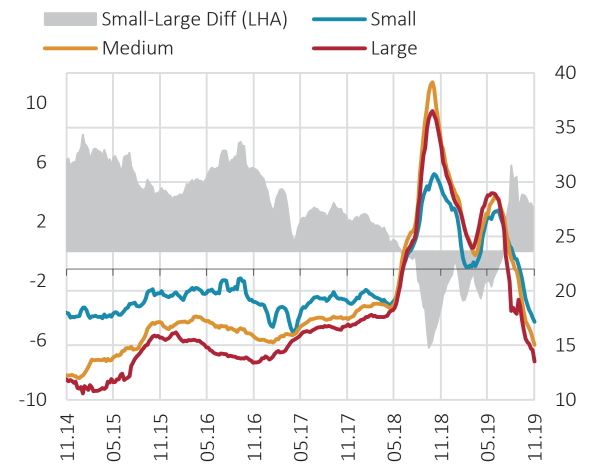
Chart III.2.11: Loan Standards and Loan Demand (% Difference)



Source: CBRT Last Observation: 09.19

Note: Refers to the difference between the share of those who answered "increased" and those who answered "decreased" to the questions about loan demand and loan standards for the last 3-month period. Values above zero denote easing and values below zero denote tightening in loan standards.

Chart III.2.12: Average TL Funding Costs of SMEs and Large Firms (4-Week Moving Average, %, % Difference)



Source: CBRT Last Observation: 15.11.2019

Note: Micro-scale firms are included in the small-scale category. The interest rate charged to small-scale firms is the weighted average of interest rates charged to small and micro-scale firms.

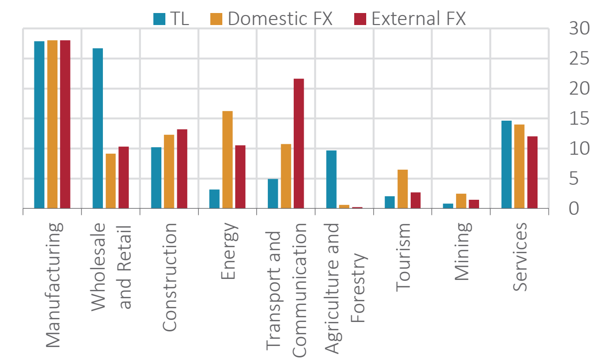
Meanwhile, the downtrend seen in the loan demand in the past one year reversed in the third quarter of 2019 and firms' loan demand increased (Chart III.2.11). This development seen in the loan demand of large firms as well as small and medium-size enterprises (SME) was determined by the significant fall in loan rates, the recovery in economic activity and the improvement in expectations.

In the current Report period, the downtrend in the newly-extended TL loan rates continued (Chart III.2.12). The TL loan rate spread that narrowed in favor of subsidized loans and small-scale firms in the previous Report period reassumed its historical average amid easing loan standards. The decline of loan rates for large-scale firms was more noticeable than that for SMEs.

III.2.3 Sectoral Developments

Corporate loans extended in the domestic market were predominantly used by manufacturing industry, and wholesale and retail trade sectors, whereas those extended in foreign markets concentrated in manufacturing industry, which has a large share in exports volume, and in transport-communication sectors (Chart III.2.13). On the other hand, the general services sector, which has a relatively high utilization of domestic and external loans, maintained its borrowing trend in this period.

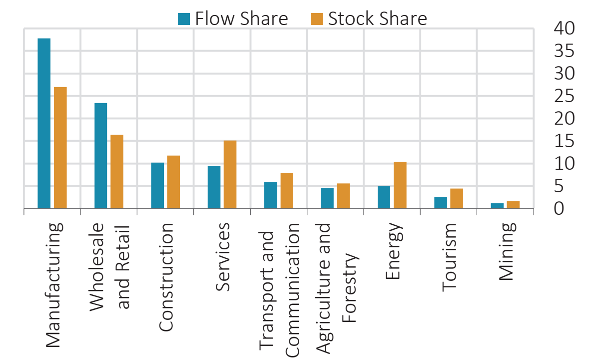
Chart III.2.13: Sectoral Breakdown of Loans (% Share)



Sources: CBRT, KKB Last Observation: 09.19

Note: Loans include domestic loans and intermediated external loans via domestic banks.

Chart III.2.14: Sectoral Breakdown of (03.19) (Flow) Loans Extended Since the Last Report Period (%)



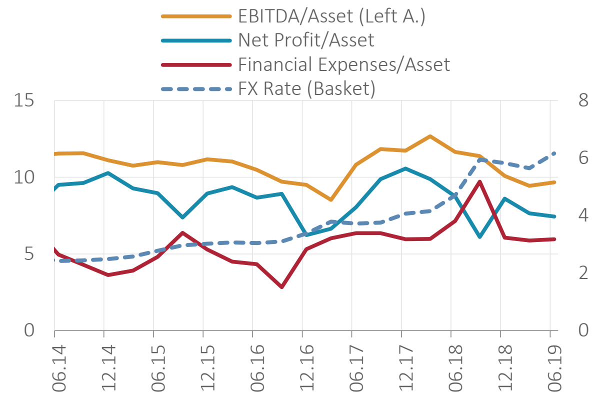
Source: CBRT Last Observation: 09.19

Note: Flow data shows loans extended between 03.19 and 09.19, and stock data shows the loan breakdown in 03.19.

A comparison of stock and flow loan shares provides guiding information about the drivers of economic growth and sectoral indebtedness. In the current Report period, while the share of flow loans remained below the shares of stock loans in the construction, general services, energy and transport-communication sectors, it stood above the shares of stock loans in the manufacturing industry and the retail and wholesale trade sectors. As of September 2019, the manufacturing industry, and retail and wholesale trade sectors posted the largest loan growth in flow loans. These sectors' shares of flow loans outpacing stock loans suggest that the potential contribution of these sectors to economic activity may be relatively higher in the upcoming period (Chart III.2.14).

The profitability of the companies quoted on Borsa Istanbul, which fell due to the exchange rate volatility seen in the second half of 2018, started to rise on the back of improving profitability ratios posted particularly by exporting firms in 2019 (Chart III.2.15). Firms' financing costs that increased due to the volatile and high course of exchange and interest rates in the third quarter of 2018, flattened out around the levels seen in the previous Report period in the first two quarters of 2019. The EBITDA/Asset ratio that indicates firms' operating incomes maintained its course at around 10%.

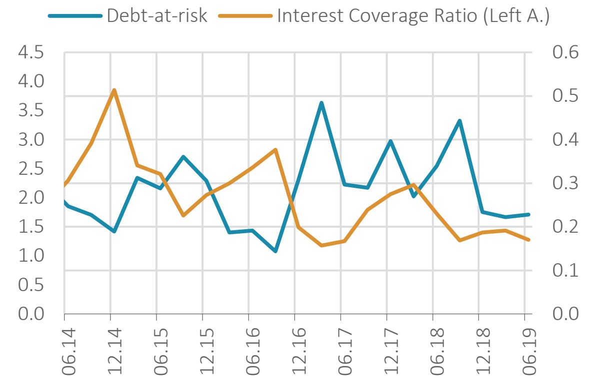
Chart III.2.15: Profitability Indicators of BIST Firms (%)



Sources: Finnet, CBRT Last Observation: 06.19

Note: EBITDA: Net Profit + Financial Expenses + Tax Expenses + Depreciation and Amortization Costs. As of the latest data, 283 corporate sector firms were included in the analysis.

Chart III.2.16: Interest Coverage and Debt-at-Risk Ratios of BIST Firms (%, Ratio)



Source: Finnet Last Observation: 06.19

Note: Interest Coverage Ratio (ICR)= EBITDA / Interest Expenses. Exchange expenses led by exchange rates are also included in interest expenses. Debt-at-risk ratio is the ratio the entire debts of firms with an ICR below 1.5 to the debts of firms included in the total sample.

The interest coverage ratio that shows firms' capacity to roll over debts with operating costs declined in 2018 due to increased exchange rate and interest expenses, and followed a horizontal course in the first half of 2019. The debt-at-risk ratio, calculated by the amount of debts pertaining to firms which lack sufficient operating income to cover interest expenses, remained flat in 2019. The course of the debt-at-risk ratio close to historical averages implies that corporate sector firms quoted on Borsa Istanbul do not have an across-the-board debt rollover problem. Furthermore, it is anticipated that the declines seen in loan rates in the third quarter of 2019 will reduce interest expenses, thereby affecting firms' interest coverage ratio positively.