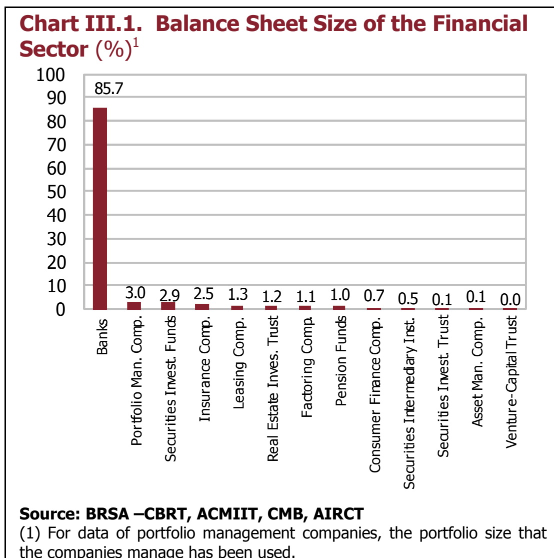
III. RISKS AND DEVELOPMENTS IN THE BANKING SECTOR

Economic activity has decelerated in tandem with heightened uncertainties about the global economy fuelled by the deepening European debt crisis and slower than expected recovery in the economies of developed countries. The authorities, bearing in mind the said global developments as well as developments in domestic economic activity, have taken the required measures, the CBRT has taken the necessary steps to supply required liquidity to the market in a controlled, effective and timely manner. In Turkey, credit growth has been slowed down to reasonable levels on the back of deceleration in economic activity observed since the second quarter and the impact of the measures against credit growth on credit interest rates. Meanwhile, the improvement in employment conditions has bolstered financial stability and the sector's asset quality has improved on the back of the increased debt service capacity of the corporate sector and households. Banks' profitability has been adversely affected by the continued decline in the net profit margin and the rise in non-interest expenditures; however the Turkish banking sector's capital adequacy ratio is still well above the legal and target ratios and the strong capital structure is maintained.

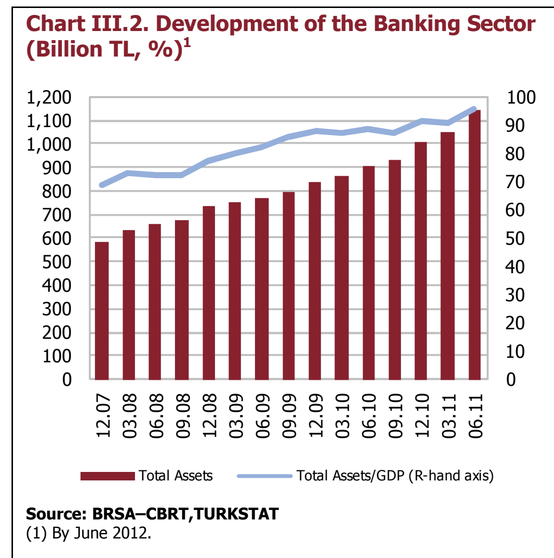
The Turkish financial sector, which is predominantly composed of the banking sector, maintains a sound growth path. The balance sheet of the Turkish financial sector, which has been growing since end-2009, grew by 25.3 percent in June 2011 year-on-year and reached TL 1,337 billion, and its ratio to GDP became 111.3 percent. The share of banks, which accounts for 85.7 percent of the sector assets, increased by 0.5 percentage points compared to the same period last year, whereas there has been no significant change in the share of other financial institutions (Chart III.1). In September 2011, the total asset size of the banking sector, which has the largest share in the financial sector, increased by 20.6 percent in nominal terms and by 15.3 percent in real terms compared to end-2010 and reached TL 1,214 billion. Thus, the ratio of the banking sector's balance sheet size to GDP, which was 91.2 percent at end-2010, rose to 95.4 percent in the second quarter of 2011 (Chart III.2).

Chart III.1. Balance Sheet Size of the Financial Sector (%)[1]



Source: BRSA –CBRT, ACMIIT, CMB, AIRCT
(1) For data of portfolio management companies, the portfolio size that the companies manage has been used.

Chart III.2. Development of the Banking Sector (Billion TL, %)[1]



Source: BRSA–CBRT,TURKSTAT
(1) By June 2012.

As of September 2011, among the 48 banks operating in the Turkish banking sector, the share of the first 5 banks with respect to asset size is 58.8 percent while that of the

first 10 banks is 83.9 percent (Chart III.3). While concentration is seen more on deposits, it is lower on credits. Based on their share in paid-up capital, the share of foreign shareholders in asset size, which was 24.3 percent at end-2010, was realized as 25.8 percent in September 2011. Meanwhile, according to data of the Central Registry Agency, when the share of foreign participation in publicly held shares, which accounts for 17.2 percent, are included as well, the share of foreign participation in the banking sector reaches 43 percent (Chart III.4).

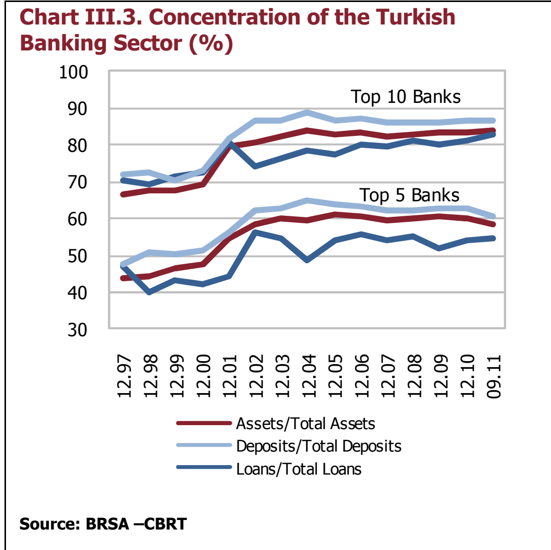


Chart III.3. Concentration of the Turkish Banking Sector (%)

Source: BRSA –CBRT

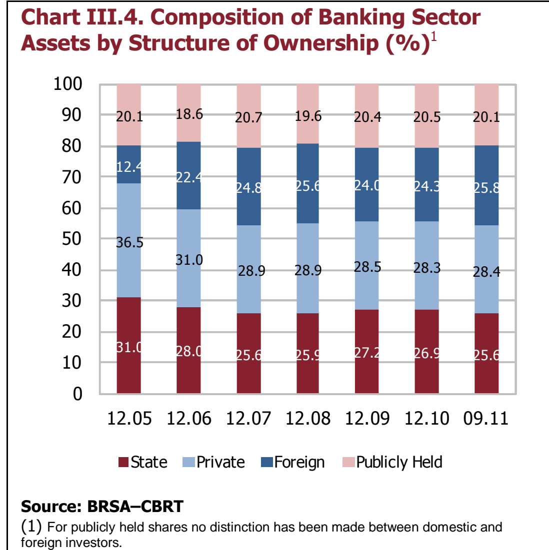


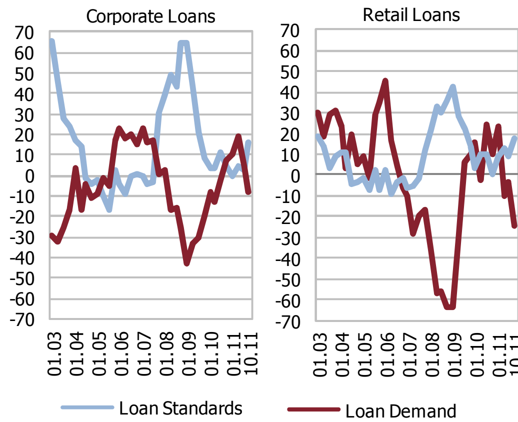
Chart III.4. Composition of Banking Sector Assets by Structure of Ownership (%)[1]

Source: BRSA–CBRT

(1) For publicly held shares no distinction has been made between domestic and foreign investors.

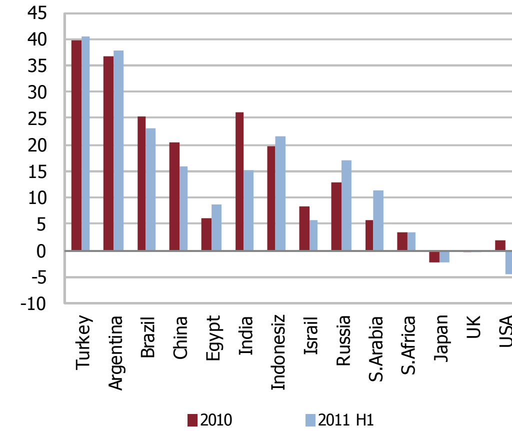
Capital flows into emerging markets has been decelerating due to the decrease in global risk appetite on the back of the problems in European economies and because of the prevailing weakness in global economic confidence, acceleration in credit demand has lost pace in developed economies. Persisting sovereign debt problems in European economies; the social and political repercussions of economic problems and sluggish solutions offered to lingering financial vulnerabilities in developed countries lead to deterioration in expectations for global growth. Parallel to these developments, demand for corporate loans and retail loans in Europe is still weak and the tightening in credit conditions continues (Chart III.5). Capital flows to emerging economies indicating high growth rates, has been decelerating due to increased concerns over the global economy and the deterioration in risk appetite. If it is considered that the deceleration in capital flows might continue in the upcoming period, rapid credit growth in emerging markets, which was observed in the post-crisis period, is expected to lose pace slightly (Chart III.6).

Chart III.5. Credit Standards and Credit Demand in the Euro Area (Percent)[1,2]



Source: ECB, Euro Area Bank Lending Survey, October 2011
(1) A negative value in credit standards indicates an easing in standards, whereas a positive value in credit demand indicates an increase in credit demand.
(2) The demand for retail loans is related to housing loans.

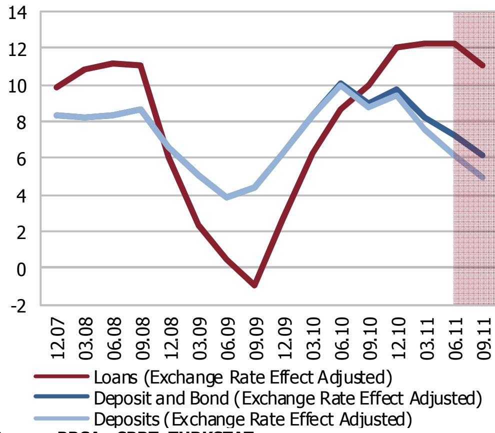
Chart III.6. Annual Change in Credits (%)



Source: IMF, IFS
2011 H1 data is the annualized value of change in the first half of the year.

The credit growth has been decelerating on the back of the precautionary measures taken by the CBRT in the framework of the new policy mix and recent measures introduced by the BRSA. Nevertheless, concerns over financial stability still feature at the top of the agenda due to mounting uncertainties over the global economy and capital outflows from emerging markets. The ratio of exchange rate adjusted credit growth to GDP, which remained flat in the first half of 2011, slowed down slightly in the third quarter. Meanwhile, as the rise in deposits, main source of finance for banking sector, remained limited, the ratio of deposit growth to GDP continues to decline. Should the rapid rise in securities issued by banks observed in 2011 continue in the upcoming period, the sector will have an additional source of finance besides deposits, funds from repo transactions and liabilities to banks abroad. The difference between the ratio of credit growth to GDP and the ratio of deposit growth to GDP point to a savings gap; however one third of all bank securities are issued domestically and they are mostly held by Turkish investors, and this is considered to be a favorable development for private savings (Chart III.7). Domestic demand has recently slowed down on the back of the measures taken by the CBRT with a view to mitigating the macro-financial risks and the risk of overheating in loans; the measures taken by the BRSA with respect to provisioning and capital requirement to address the rise in consumer loans (Box III.3) and deceleration in domestic economic activity. Parallel to these developments, credit growth is declining and the annual growth of credits adjusted for exchange rate effects is expected to become 25 percent by the end of the year if the rate of growth in credits adjusted for exchange rate effects in the first 9 months of the year is sustained in the last quarter as well (Chart III.8).

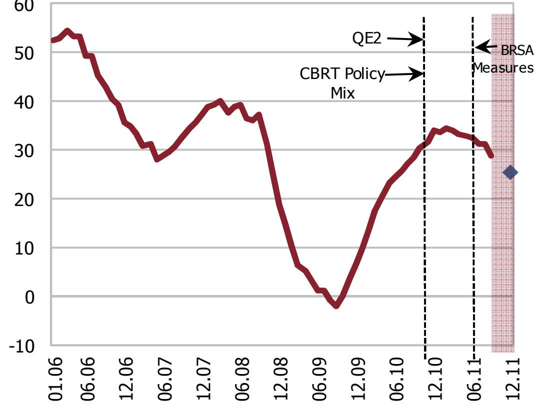
Chart III.7. Loan and Deposit Growth / GDP (Excluding NPLs, %)[1,2,3]



Source: BRSA –CBRT, TURKSTAT

(1) The basket value used to adjust for exchange rate effect is composed of foreign exchange buying rate of 70 percent USD and 30 percent Euro for credits; 60 percent USD and 40 percent Euro for deposits. The average basket rate of December 2007 – September 2011 has been used to adjust for exchange rate effect and FX-indexed credits are included in FX credits.
(2) GDP data for the third quarter of 2011 are estimated values.
(3) Bonds refer to securities that have been issued by banks since September 2010.

Chart III.8. Annual Growth of Credits (%, Excluding NPLs)[1,2,3]



Source: BRSA –CBRT, TURKSTAT

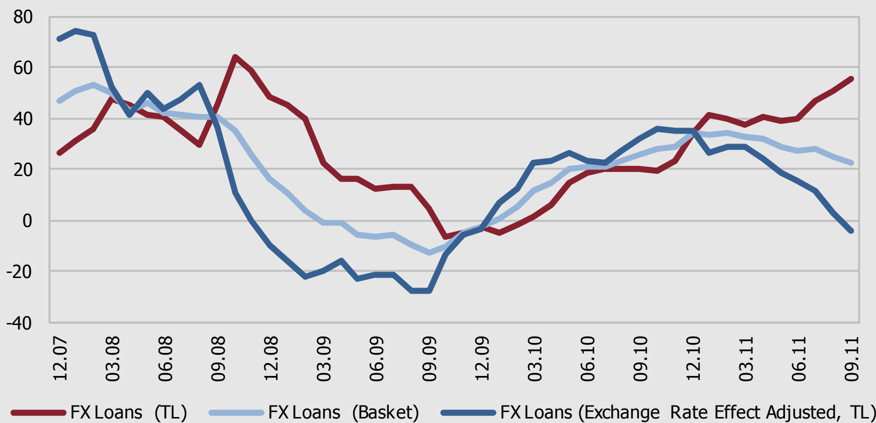
(1) The blue dot shows the forecast value for end-2011.
(2) The basket value used to adjust for exchange rate effect is composed of 70 percent USD and 30 percent Euro. The average basket rate of December 2007 – September 2011 has been used to adjust for exchange rate effect and FX-indexed credits are included in FX credits.
(3) QE2 refers to the second round of quantitative easing introduced by the FED in November 2011.

Box III.1. FX-Denominated Loans and Exchange Rate Effect

In September 2011, 34.1 percent of loans extended by the banking system was either FX-denominated or FX-indexed loans. However, for the aggregate reporting the data in their financial statements collectively, banks show FX-denominated or FX-indexed loans in terms of TL taking into account exchange rates.

Currently, floating exchange rate regime is being implemented in Turkey; thus, any upward or downward change in exchange rates affects the total credit volume on banks' balance sheets. As it has been recently observed, the TL equivalent of FX loans can display a change in a different direction/ magnitude than the movement in exchange rates is supposed to trigger. Therefore, it would be useful either to keep records of FX loans in the foreign currency that they are extended in or to adjust FX loans for exchange rate effect if they are to be compiled along with TL-denominated loans. Adopting this method for other balance sheet items that include FX data would improve the accuracy and effectiveness of the analysis.

Chart 1. Change in Credit Volume (Annual Percentage Change, %)



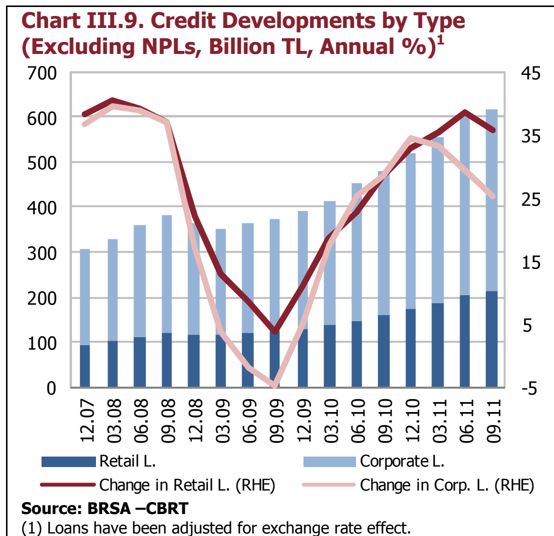
Source: BRSA-CBRT

As illustrated in the chart above, the annual growth rate of FX loans (in TL equivalent) in banks' balance

sheets displayed an upward trend especially in the third quarter of 2011 due to exchange rate movements. Nevertheless, when FX loans are analyzed in terms of exchange rate in that period, it is observed that there has been a slowdown in the annual rate of growth in FX loans in terms of the basket currency since end-2010. Therefore, while examining growth rate in credits, it is important to consider the FX loans after they are adjusted for exchange rate effect. When FX denominated and FX indexed loans are adjusted for exchange rate effect, the annual growth rate of credits is expected to converge to 25 percent by the end of the year if the growth pace observed in total credits throughout 2011 continues.

Credit growth has been slowing down on the back of the measures taken by the authorities. Growth rates of corporate loans and retail loans adjusted for exchange rate effect have been decelerating (Chart III.9). In September 2011, the annual growth of credits became 31 percent in real terms, of which 7.7 percentage points came from consumer loans; 8.2 percentage points from SMEs and 13.5 percentage points from other corporate loans (Chart III.10). Compared to end-2010, total credits grew by 20.3 percent in real terms; while growth in consumer loans -due to the acceleration in other consumer loans - and other corporate loans was higher than sector averages. Nevertheless, when SME loans and other corporate loans are adjusted for exchange rate effect, it is observed that the contribution of the said loans to credit growth has decreased compared to end-2010.

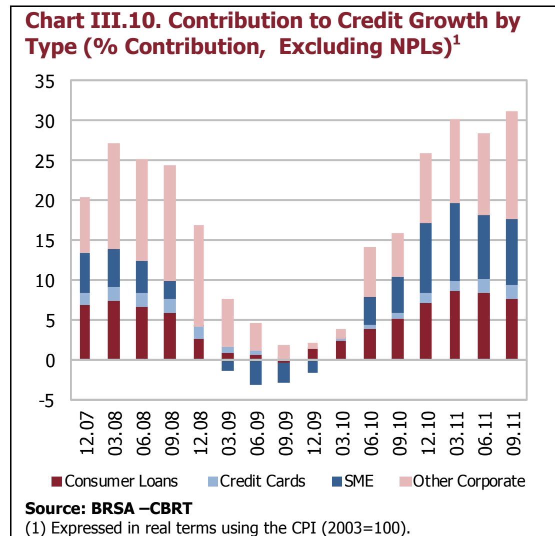
Chart III.9. Credit Developments by Type (Excluding NPLs, Billion TL, Annual %)[1]



Source: BRSA –CBRT

(1) Loans have been adjusted for exchange rate effect.

Chart III.10. Contribution to Credit Growth by Type (% Contribution, Excluding NPLs)[1]

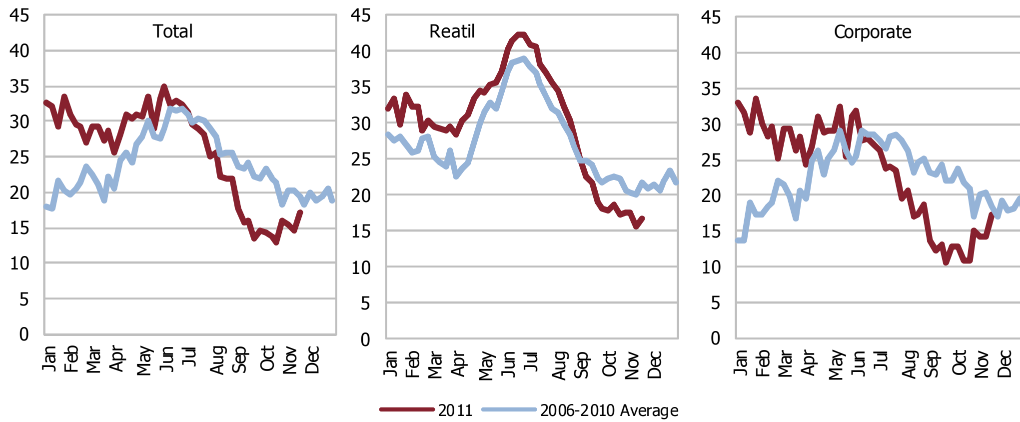


Source: BRSA –CBRT

(1) Expressed in real terms using the CPI (2003=100).

The annual growth trend of loans is lower than the average of past years. While the growth rate of corporate loans fell below previous averages in the third quarter; that of retail loans adjusted for the same effect fell below previous averages in September 2011 with a time lag. This development is believed to be underpinned by the measures taken by the BRSA and the tight stance in fiscal policy fostering the measures taken by the CBRT in the framework of the policy mix (Chart III.11). The recent rebalancing in domestic and external demand would continue in a stable manner provided that the current trend in consumer loans is maintained.

Chart III.11. Developments of Loans Adjusted for Exchange Rate Effect (%)[1]



Source: BRSA –CBRT

(1) The basket value used to adjust for exchange rate effect is composed of 70 percent USD and 30 percent Euro. FX-indexed loans have been compiled under FX Loans. The 13-week average of annualized weekly changes has been calculated.

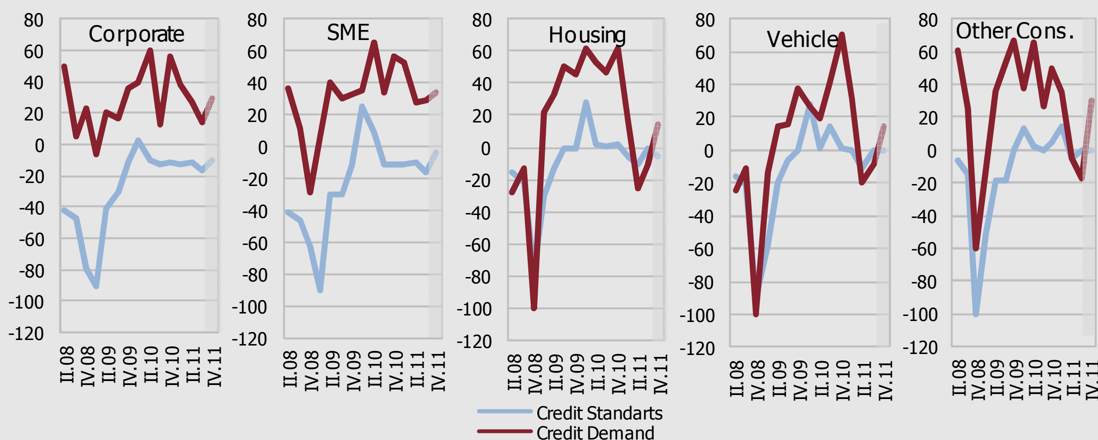
Box III.2. CBRT Banks' Loans Tendency Survey Results

Results of the CBRT's "Banks' Loans Tendency Survey" revealed that banks have tightened credit conditions for corporate loans while they have kept standards for retail loans unchanged. Banks foresee that credit standards for corporate and housing loans would be further tightened while standards for vehicle loans and other consumer loans would be kept unchanged in the last quarter (Chart III.12).

In the third quarter of 2011, standards were tightened the most in long-term loans among corporate loans. While the tightening impact of the constraints on capital adequacy decreased; the impact of factors pertaining to competition and risk perception increased. In this period, the main reasons for the tightening of standards by banks were expectations for overall economic activity and the outlook for industry/ firms. For the final quarter of the year, banks expect credit standards for corporate loans to continue to be tightened.

An analysis of demand for corporate loans reveals that not only the demand of big-scale enterprises but also the demand of medium and small-scale enterprises for corporate loans have increased compared to the previous quarter. With respect to maturity, enterprises' demand for short-term loans has increased while the decline in demand for long-term loans has further accelerated. Factors that strengthened the rise in credit demand have been the financing requirements of firms and discounts and extra payment facilities offered by suppliers in cash payments. Banks expect growth in credit demand to continue in the upcoming period.

Chart 1. Credit Standards and Demand for Credits (Points)[1,2]



Source: Banks' Loans Tendency Survey

(1) Data for 2011-Q4 are expectations for the next quarter.

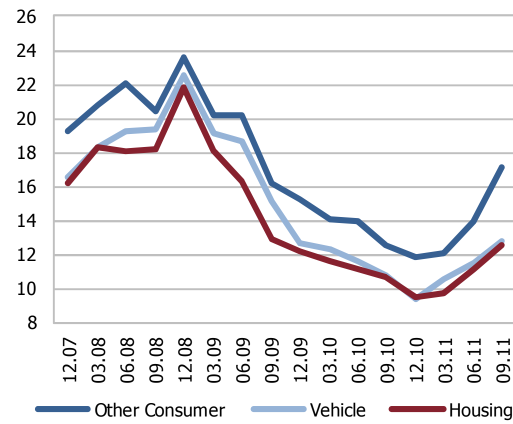
(2) A negative value for credit standards indicates a tightening of standards whereas a positive value in credit demand indicates an increase in credit demand.

As for consumer loans, it is observed that the standards applied to retail loans have remained unchanged in the third quarter. Banks expect standards for housing loans to be tightened and those for vehicle loans and other consumer loans to be maintained in the next quarter.

Demand for consumer loans decreased compared to the previous quarter. Banks participating in the survey stated that the decline in demand was mainly driven by factors pertaining to the financing requirement for housing and vehicle loans and by availability of alternative funding facilities for other consumer loans. Banks expect demand for housing, vehicle and other consumer loans to increase in the final quarter of the year.

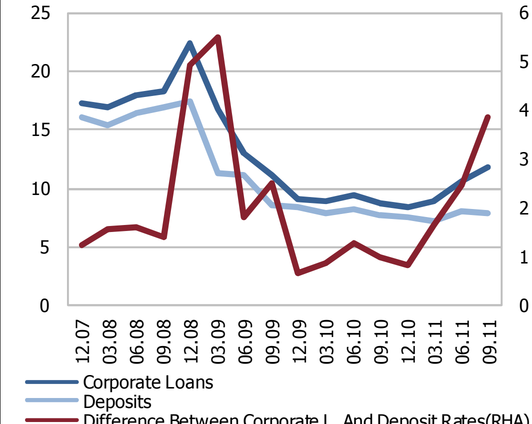
Credit interest rates increased on the back of the measures taken. Credit interest rates, which recorded historic lows at the end of 2010, posted a significant climb in 2011. As of September 2011, annual interest rates of vehicle loans, housing loans, other consumer loans and corporate loans were 12.8 percent, 12.5 percent, 17.2 percent and 11.8 percent, respectively (Chart III.12). Due to the limited rise in interest rates of deposits, the difference between interest rates of corporate loans and interest rates of deposits have been increasing since March 2011 (Chart III.13).

Chart III.12. Interest Rates on Consumer Loans (%, Flow)



Source: CBRT

Chart III.13. Interest Rates on Deposits and Corporate Loans (%, Flow)



Source: CBRT

Box III.3. Measures Taken by the BRSA and the SDIF

Measures taken by the BRSA

On 18 June 2011, the BRSA made some amendments to regulations regarding provisions and capital adequacy. In the BRSA's press release on the issue, it was stated that the highest growth among consumer loans was recorded in other consumer loans [4] and necessity arises to encourage parties to behave more prudential during the credit process.

With the amendment made regarding provisions to be set aside for loans, banks with a ratio of consumer loans to total loans above **20 percent** and banks with a ratio of non-performing loans in other consumer loans to total other consumer loans above **8 percent**, should set aside 4 percent general provision for other consumer loans that fall within Group 1 (loans with standard qualifications and other receivables) and 8 percent general provision for Group 2 (Loans and other receivables that are closely monitored) for other consumer loans that they will extend as of 18 June 2011. Of these loans, those whose contract terms have been changed to extend the payment plan, the banks will set aside a general provision of 2.5 folds or 1.25 folds of the mentioned ratios. Prior to the amendment, general provision ratios were 1 percent and 2 percent and a general provision of 5 and 2.5 folds were set aside for

[4] Other consumer loans comprise all consumer loans other than housing and vehicle loans.

loans subject to a change in the contract.

With the aim of curbing the potential risks that consumer loans could pose in the long run, the BRSA amended the regulation on capital adequacy and raised the risk weights that are taken into account while calculating the capital adequacy ratio for other consumer loans. Accordingly, other consumer loans to be extended as of 18 June 2011 would be classified according to days to maturity and a risk weight of 150 percent shall be applied to loans with days to maturity of between 1-2 years and of 200 percent to loans with days to maturity longer than 2 years.

Consequently, due to the new amendments stipulating higher general provisions and higher capital requirements, the cost of new other consumer loans has increased. By September 2011, 17 banks met the two criteria stipulated in the amendment to the Regulation on Provisions. These 17 banks make up 88.7 percent and 92.3 percent of all consumer and other consumer loans in the sector and these banks shall set aside high general provisions for any new other consumer loans that they will extend.

Measures taken by SDIF

Insurance premiums to be paid by credit institutions are calculated in accordance with the provisions of the "Regulation on Deposits and Participation Funds Subject to Insurance and Premiums Collected by the Savings Deposit Insurance Fund". Premium amounts are calculated by multiplying credit institutions' insured deposits/ participation funds with premium percentages. Credit institutions are evaluated with respect to 14 risk factors under 5 headings such as capital adequacy, asset quality, profitability, liquidity and other risk factors and scored between "0" for the lowest and "100" for the highest over the threshold values prescribed for each heading. According to their total score, credit institutions fall under one of four premium categories A, B, C and D; and, according to their corresponding category, they are subject to a premium of 11-19 basis points.

The "Regulation on Amendments Made to the Regulation on Deposits and Participation Funds Subject to Insurance and Premiums Collected by Savings Deposit Insurance Fund" promulgated in the Official Gazette No: 28069 dated 29.09.2011 introduced some changes. With the amendments, the range for threshold value set for risk factors pertaining to profitability ratios and the insured deposit ratio has been changed, the free capital ratio as a risk factor was replaced by the average maturity (days) of deposit/ participation Fund[5] as a risk factor, while the Free Float of Bank Shares as a risk factor was omitted and other information determined and reported by SDIF to credit institutions as risk factors were added. With the amendment made, the threshold values for banks, which were 85 and 70 points, were lowered to 80 and 65 points. Moreover, a size factor premium rate is added to the premium rate. The size factor premium rate is 2 basis points for credit institutions with a Size Factor equal to and greater than TRL 120 billion and 1 basis point for credit institutions with a Size Factor equal to or greater than TRL 50 billion and less than TRL 120 billion[6].

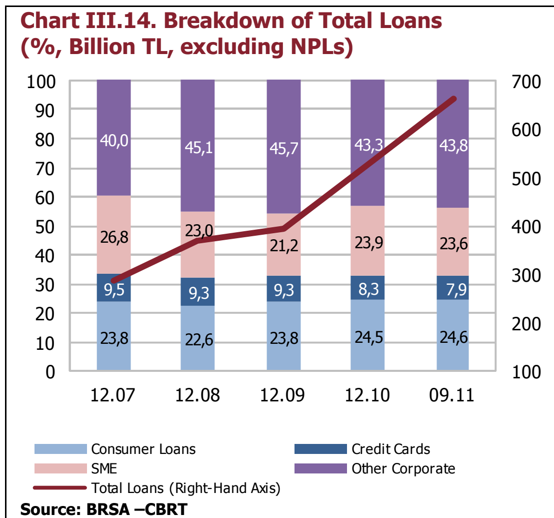
The amendments exert an extra cost on the banks' 3-month premium obligation. While the size factor increases the banks' premium obligations, the change introduced in the threshold values curbs the total costs of the banks.

[5] Average Maturity shall be the weighted average maturity to be calculated by taking into account the following figures: zero for sight deposits, private accounts and 7-day notice deposits; 15 for deposits and participation accounts up to 1-month maturity, 60 for deposits and participation accounts up to 3-month maturity, 135 for deposits and participation accounts up to 6 months, 360 for deposits and participation accounts with maturities up to 1 year, 1 year and longer than 1 year; 360 days for cumulative deposits and participation accounts and special fund pools.

[6] The size factor is composed of the sum of assets, non-cash credits and liabilities commitments (excluding revocable commitments) on the balance sheet of the credit institution. The mentioned amounts will be increased by the average inflation rate in PPI by the TURKSTAT.

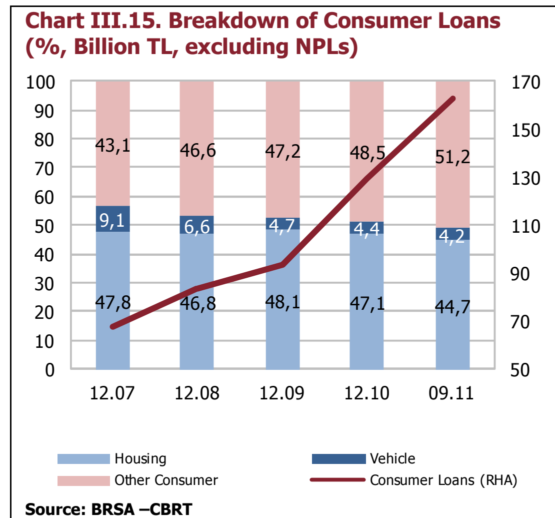
Compared to end-2010, there has not been a significant change in the breakdown of loans. In September 2011, the share of loans extended to SMEs decreased while that of other corporate loans increased due to exchange rates. While the share of credit cards decreased, the share of consumer loans, which started to climb in the aftermath of the crisis, remained relatively flat compared to end-2010. (Chart III.14). The shares of housing and vehicle loans among consumer loans decreased, while the share of other consumer loans increased by 2.7 percentage points (Chart III.15). The rise in other consumer loans is attributed to the fact that credit card holders opted for other consumer loans for their short-term finance needs instead of credit cards as the latter incurs higher interest rates.

Chart III.14. Breakdown of Total Loans (%, Billion TL, excluding NPLs)



Source: BRSA –CBRT

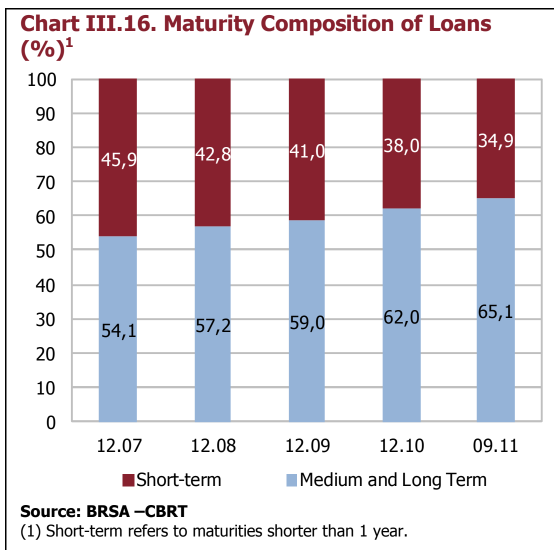
Chart III.15. Breakdown of Consumer Loans (%, Billion TL, excluding NPLs)



Source: BRSA –CBRT

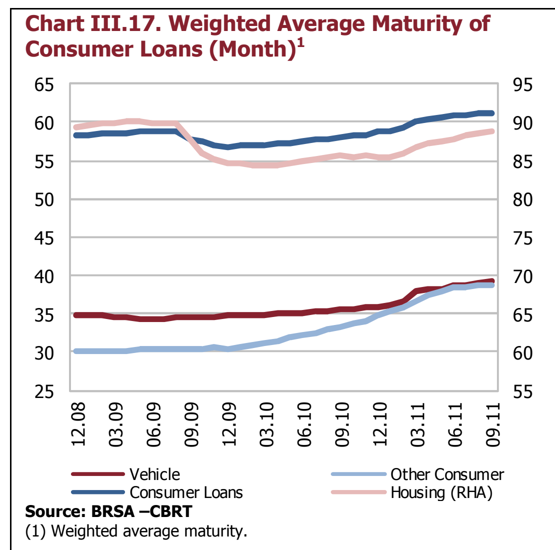
Extension of maturities of credits is perceived as a favorable development for corporate sector and households. Compared to end-2010, the share of medium and long-term loans increased by 3.1 percentage points and reached 65.1 percent by September 2011 (Chart III.16). Even maturities of consumer loans have generally been extended; the extension in other consumer loans which are used to address short-term funding needs and have no collateral other than the debtor's solvency is remarkable (Chart III.17). While consumers prefer other consumer loans with longer maturities, as the monthly payments are smaller, this leads to a higher total interest payment for the loan.

Chart III.16. Maturity Composition of Loans (%)[1]



Source: BRSA –CBRT
(1) Short-term refers to maturities shorter than 1 year.

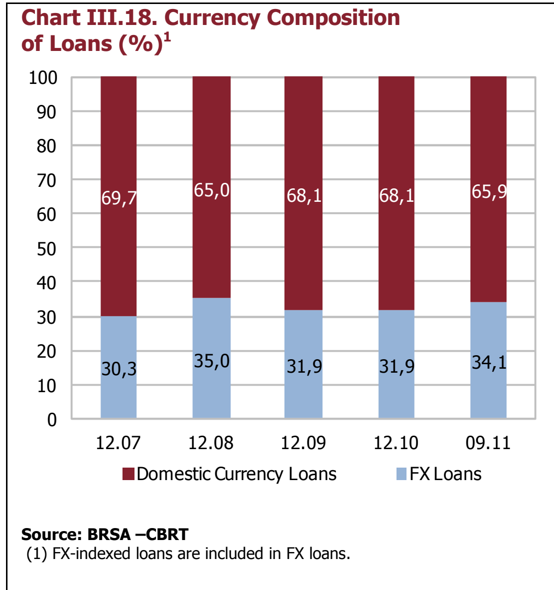
Chart III.17. Weighted Average Maturity of Consumer Loans (Month)[1]



Source: BRSA –CBRT
(1) Weighted average maturity.

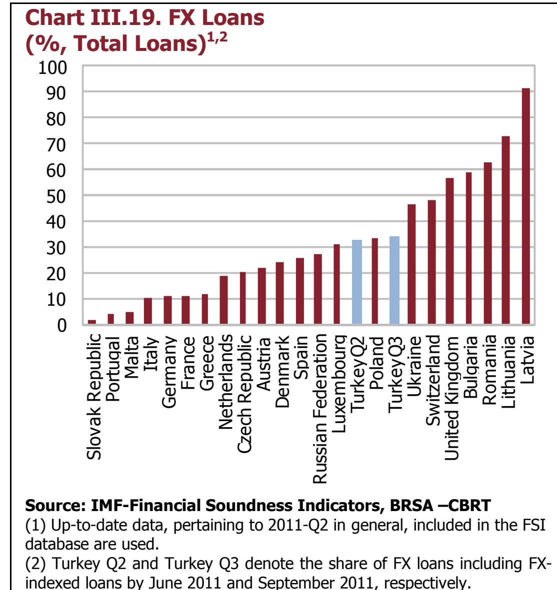
Although the share of FX loans increased due to the recent rise in exchange rates, loans are generally denominated in Turkish lira. Compared to end-2010, the share of FX-loans in total loans increased by 2.2 percentage points and reached to 34.1 percent in September, mainly due to the significant depreciation of TL against foreign currencies (Chart III.18). Nevertheless, it should be taken into consideration that when FX-loans are adjusted for exchange rate effect, it is observed that the share of FX-loans in total loans have decreased compared to end-2010. Compared to other countries, the share of FX loans in the Turkish banking system is close to the EU average (Chart III.19).

Chart III.18. Currency Composition of Loans (%)[1]



Source: BRSA –CBRT
(1) FX-indexed loans are included in FX loans.

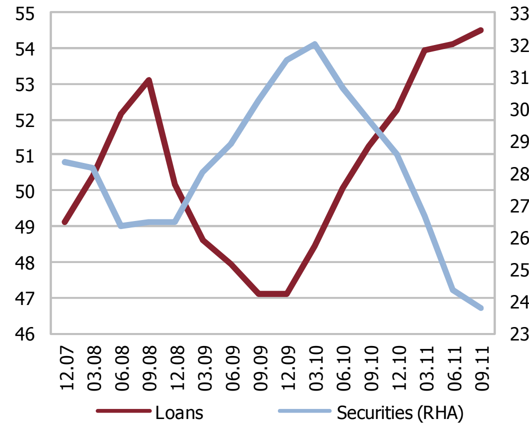
Chart III.19. FX Loans (%, Total Loans)[1,2]



Source: IMF-Financial Soundness Indicators, BRSA –CBRT
(1) Up-to-date data, pertaining to 2011-Q2 in general, included in the FSI database are used.
(2) Turkey Q2 and Turkey Q3 denote the share of FX loans including FX-indexed loans by June 2011 and September 2011, respectively.

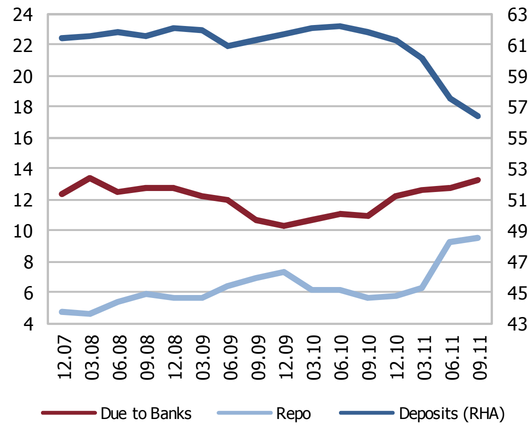
As deposit growth remained flat, alternative sources were employed to finance credit growth. While the share of loans in total assets increased by 2.2 percentage points in September 2011 compared to end-2010, the share of deposits in total liabilities dropped by 5 percentage points in the same period. In this period, banks covered their financing needs with funds from repo transactions, external borrowings, proceeds from securities issued and the sale of securities to some extend due to the measures introduced pertaining to reserve requirements and liquidity. In the first eight months of 2011, the share of funds from repo transactions increased by 4.4 percentage points and reached to 10.1 percent; however, the share of the mentioned item decreased in September 2011. Meanwhile, in September 2011, the share of securities declined by 4.8 percentage points compared to end-2010 (Chart III.20 and Chart III.21).

Chart III.20. Loans and Securities (% Asset)[1]



Source: BRSA –CBRT
(1) NPL is excluded.

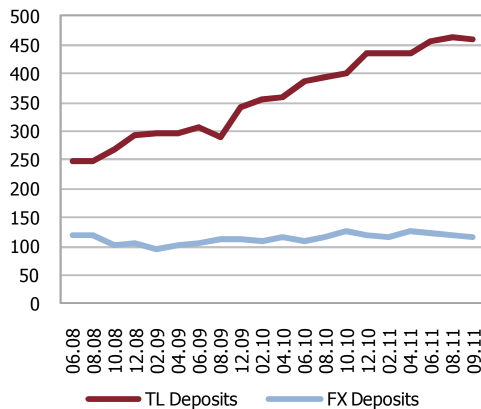
Chart III.21. Funds Obtained from Deposits, Repo Transactions and Due to Banks (% Asset)



Source: BRSA –CBRT

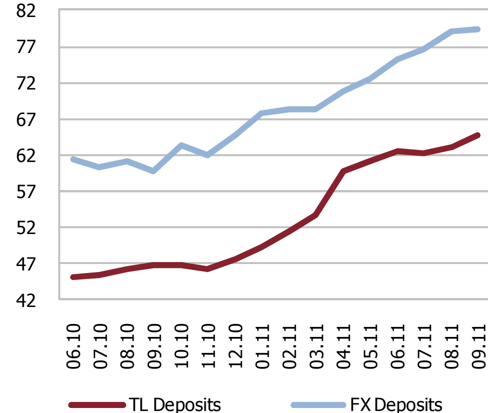
Extension in maturity of deposits continues in the second half, albeit slower. The weighted average maturity of Turkish lira deposit and participation funds, which was 47.9 days in end-2010, increased to 64.7 days in September 2011. Meanwhile, weighted average maturity of FX deposits and FX participation funds, which was 64.8 days at the end of 2010, became 79.2 days in September 2011 (Chart III.22 and Chart III.23).

Chart III.22. Developments in Deposits Subject to Reserve Requirement (Billion TL)



Source: CBRT

Chart III.23. Maturity of Deposits Subject to Reserve Requirement (Weighted Average, Day)[1]



Source: CBRT
(1) Average maturity for deposits up to 1 month, 1-3 months, 3-6 month, up to 1 year and maturities for 1 year and longer have been assumed as 15 days, 60 days, 135 days, 272 days and 360 days, respectively.

The upward trend in banks' foreign liabilities, which started at the end of 2009, went into a decline as of September 2011. In September 2011, the banking sector's foreign liabilities increased by 19.6 percent compared to end-2010 and reached USD 97.9 billion; while 14.9 percent of the total assets were funded by foreign liabilities. The rise in total foreign liabilities observed in the first two quarters of the year was replaced by a decline in the third quarter (Chart III.24 and Chart III.25). This development was fuelled by the deterioration in risk appetite stemming from heightened concerns over sovereign debt sustainability in some European countries and unfavorable data pertaining to global economic activity. With the aim of enhancing mobility of foreign exchange liquidity in the interbank foreign exchange market, the CBRT resumed its activities

as an intermediary in the foreign exchange deposit markets in the Foreign Exchange and Banknotes Markets on November 10, 2011 and will continue this function until heightened uncertainties in international markets disappear. In this framework, banks were offered a facility where they could lend and borrow in the foreign exchange deposit market through the intermediation of the Central Bank; however as this report went to press this facility had only been used minimally.

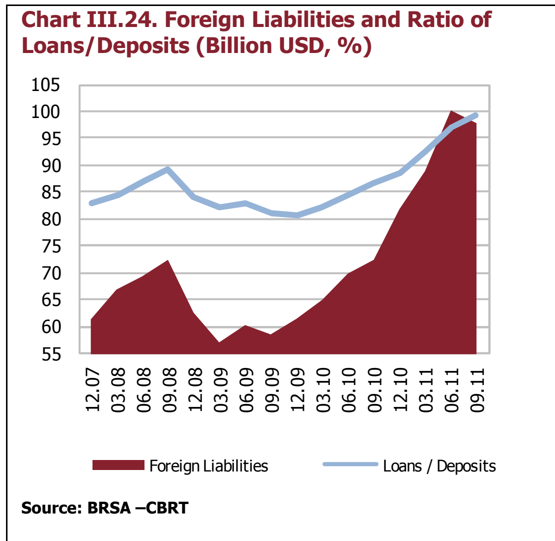


Chart III.24. Foreign Liabilities and Ratio of Loans/Deposits (Billion USD, %)

Source: BRSA –CBRT

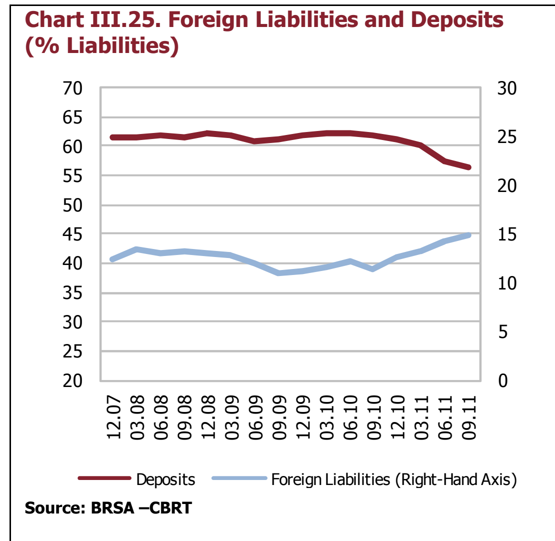


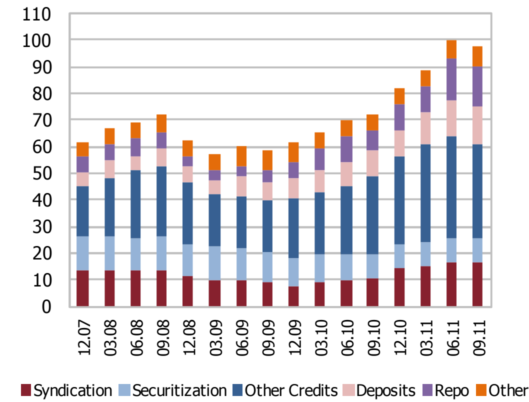
Chart III.25. Foreign Liabilities and Deposits (% Liabilities)

Source: BRSA –CBRT

In the upcoming period, banks are not expected to have problems paying syndication and securitization credits. Compared to end-2010, the sum of syndication and securitization credits went up by 9 percent, reaching USD 25.5 billion in September 2011 (Chart III.26). The share of syndication and securitization credits in foreign liabilities is 26.1 percent, while that in total funding sources is 4.4 percent. The amount of credits other than syndication and securitization credits is USD 35.5 billion and their share in foreign liabilities is 36.2 percent. As this report was being compiled, the amount of banks' foreign liabilities to mature in December 2011 or till the end of 2012 was USD 57.5 billion; and USD 17.8 billion of this total amount was composed of syndication and securitization credits. When the borrowing facility in the foreign exchange deposit market and the reserve requirements maintained in terms of foreign exchange and gold are taken into account, the liquidity facilities available are expected to be adequate to cover the banks' syndication and securitization credits in case of need.

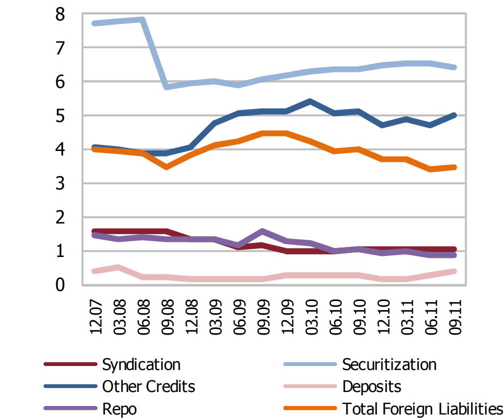
The rise in the share of foreign liabilities in the banking sector's balance sheet continues to contribute to the extension of maturity of liabilities. The weighted average maturity of foreign liabilities assumed a downward trend due to the rise in the share of deposits and repos and became 3.4 years in September 2011. In the same period, the average maturity of syndication credits, which makes up 17.2 percent of foreign liabilities, was 1 year and the average maturity of securitization credits, which makes up 8.9 percent of foreign liabilities, was 6.4 years. (Chart III.27).

Chart III.26. Composition of Foreign Liabilities (Billion USD)



Source: BRSA –CBRT

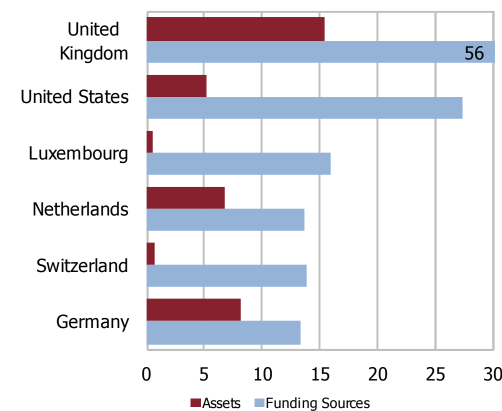
Chart III.27. Average Maturity of Foreign Liabilities (Years)



Source: BRSA –CBRT

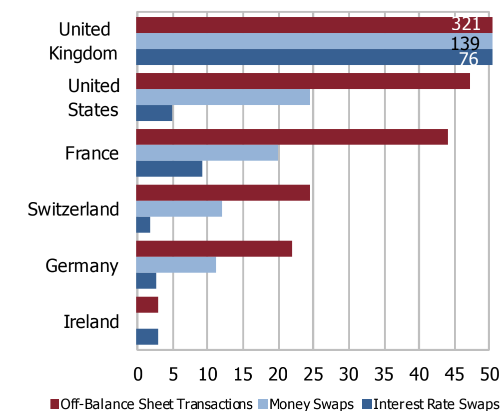
An analysis of the breakdown of banks' total assets and funding sources by countries reveals that the Turkish banking system is a net payer. As of September 2011, 4.8 percent of the total assets of banks in Turkey were composed of investments abroad and 19.3 percent of total funding sources were composed of foreign funding. The United Kingdom, which has the largest share among these countries, has a share of 1.3 percent in total assets and 5.3 percent in funding sources (Chart III.28). When the breakdown of off-balance sheet transactions of the banking sector is evaluated by countries, it is observed that the total share of foreign countries is 35.3 percent and the United Kingdom has the largest share with 22.3 percent (Chart III.29). The share of PIIGS countries is negligibly low with respect to breakdown of assets, funding sources and off-balance sheet transactions. On-balance sheet transactions carried out with foreign countries are mostly composed of receivables from banks and due to banks; while off-balance sheet transactions are mostly money swaps and interest rate swaps.

Chart III.28. Turkish Banks' Foreign Assets and Funding Sources by Countries (September 2011, Billion TL)



Source: BRSA –CBRT

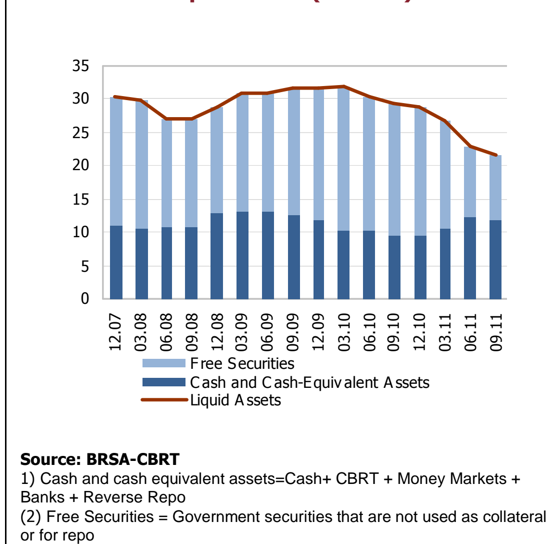
Chart III.29. Turkish Banks' Off-balance Sheet Transactions by Countries (September 2011, Billion TL)



Source: BRSA –CBRT

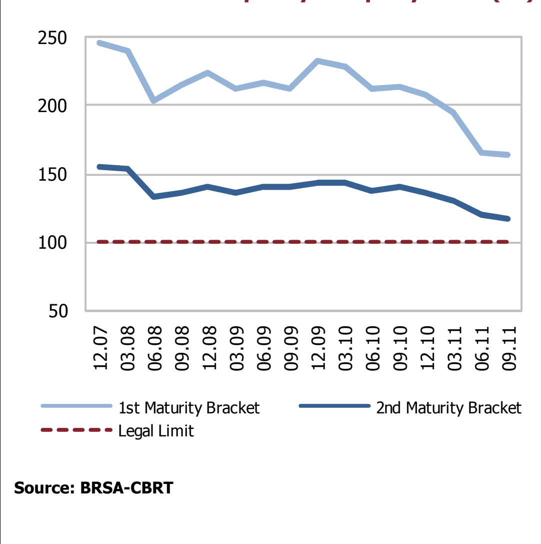
In the first half of 2011, banks met their liquidity requirements, which increased due to their reserve requirement liabilities, by borrowing from the Central Bank via repo auctions. The decline in the government securities portfolio to support credit growth, which started in the first quarter of 2001, continued and further accelerated as of the first quarter of 2011. In September 2011, the ratio of liquid assets to total assets increased by 7.2 percent compared to end-2010 and reached 21.6 percent. This development was mainly driven by the decline in free government securities stemming from repo funding that was on the rise despite the increase in cash and cash-equivalent assets (Chart III.30). Despite the decline in the share of liquid assets to total assets, the total liquidity adequacy ratios of the banking sector, computed in accordance with the Regulation on the Measurement and Assessment of Liquidity Adequacy of Banks, still remains well above the legal ratio of 100 percent[7] (Chart III.31).

Chart III.30. Liquid Assets (%Asset) [1,2]



Source: BRSA-CBRT
1) Cash and cash equivalent assets=Cash+ CBRT + Money Markets + Banks + Reverse Repo
(2) Free Securities = Government securities that are not used as collateral or for repo

Chart III.31. Total Liquidity Adequacy Ratio (%)

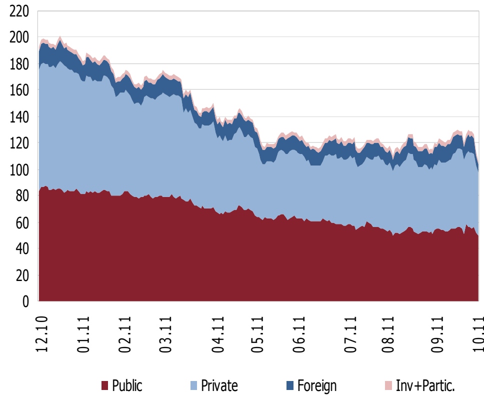


Source: BRSA-CBRT

Free securities and rates pertaining to these securities, which are considered eligible collateral by the Central Bank to meet the liquidity needs of the banks in case of a temporary liquidity shortage, remained relatively flat recently to be followed by a decline as of the last week of October. Free government securities, which had reached TL 200 billion by mid-January, have been declining since then and became TL 113.6 billion by the end of October. Meanwhile, the ratio of borrowing from the ISE and interbank money markets to government securities, which had been on the rise from end-2010 on and had remained flat since July 2011, became 76.6 percent in October 2011. The ratio of free government securities that can be used by the banks in case of a liquidity shortage to deposits, which was approximately 31 percent at the end of 2010, became 15.9 percent in October 2011 (Chart III.32, Chart III.33).

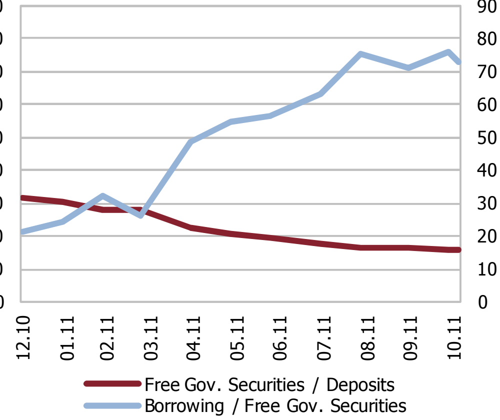
[7] The study on systemic liquidity analysis that discusses legal ratios so as to include their contagion effect is presented in the special topics section.

Chart III.32. Total Securities that the CBRT Accepts as Eligible Collateral (Billion TL)



Source: BRSA-CBRT

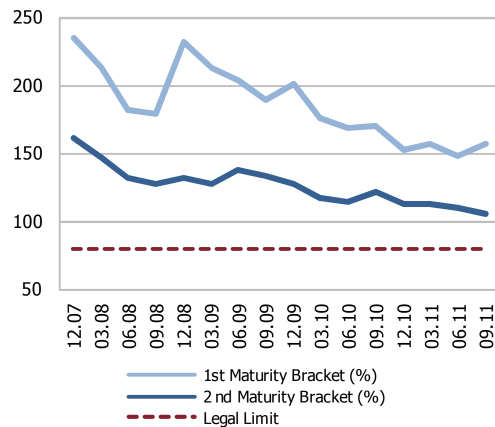
Chart III.33. Total Free Government Securities/ Total Borrowing and Deposits/Free Government Securities (%)



Source: BRSA-CBRT

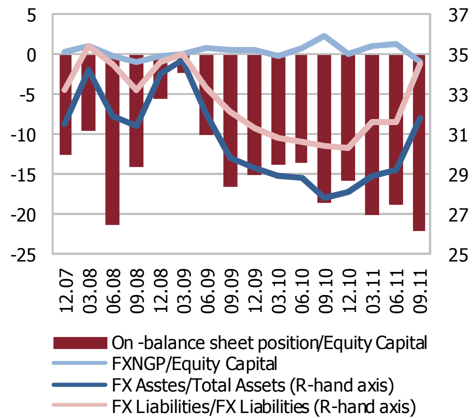
The foreign currency liquidity adequacy ratio, which was above the legal limits, started to decline as of 2010 and the decline continued throughout 2011 as well (Chart III.34). It is noteworthy that the weight of FX assets and FX liabilities on the balance sheet has been on the rise. As of September 2011, the ratio of total FX assets including those indexed to foreign exchange to total assets was 31.8 percent and the ratio of total FX liabilities to total liabilities was 34.5 percent. The on-balance sheet short position, which is closed by off-balance sheet transactions that are mostly composed of swap transactions, increased by USD 3.8 billion compared to end-2010 and reached USD 17.7 billion in September 2011. In the same period, the ratio of the on-balance sheet short position to equity capital was 22 percent, while the ratio of net FX short position to total equity capital, which is calculated by taking into account the off-balance sheet transactions, became 0.8 percent (Chart III.35).

Chart III.34. Foreign Currency Liquidity Adequacy Ratio (%)



Source: BRSA-CBRT

Chart III.35. Foreign Currency Position (%)



Source: BRSA-CBRT

Box III.4. Turkish Lira Liquidity Management of the Central Bank of the Republic of Turkey

The operational framework of the Central Bank of the Republic of Turkey is as follows:

i. The Central Bank will continue to announce overnight borrowing and lending rates between 10:00 a.m.– 12:00 p.m. and 1:00 p.m. – 4:00 p.m. on business days, between 10:00 a.m.– 12:00 p.m. on half business days, in the Interbank Money Market within the Central Bank. If a liquidity shortage arises during the day, banks will be able to borrow at the Central Bank's lending rate against collateral within their limits. In case of excess liquidity, banks will be able to lend Turkish lira to the Central Bank at the Central Bank's borrowing rate without any limit.

ii. In the framework of the "Late Liquidity Window Facility", banks will be able to borrow from the Central Bank against collateral, and lend to the Central Bank without any limit between 4:00 p.m. – 5:00 p.m. on business days, between 12:00 p.m. – 12:30 p.m. on half business days and on the last working day of the reserve requirements maintenance period between 4:00 p.m. – 5:15 p.m. on business days, between 12:00 p.m. – 12:45 p.m. on half business days.

iii. The one-week repo auction interest rate is the policy rate. In case of a liquidity shortage, the Central Bank will announce the amount of repo auction on Reuters' "CBTF" page at 10:00 a.m.

iv. One-week maturity repo auctions will be held at 11:00 a.m. on business days, at 10:30 a.m. on half business days and the results will be announced on Reuters' "CBTG" page within 30 minutes. Institutions are required to notify the Bank of the securities against their repo operations until 12:00 p.m. on business days, until 11:30 a.m. on half business days and fulfill their liabilities regarding open market operations until 4:45 p.m. on business days, until 12:30 p.m. on half business days. Auctions will continue to be held at the interest rate set for one-week repo auctions by the Committee, via the quantity auction method.

v. In case of an unforeseen excessive liquidity shortage during the day, which may exert excessive pressure on money market interest rates, the Central Bank may announce one-week maturity "Intra-day Repo Auctions" via the quantity auction method in addition to the regular ones announced at 11:00 a.m.

vi. Each participating institution's bid for the weekly repo auctions is limited to 20 percent of the total auction amount. This 20 percent upper limit is not valid for the one-week maturity "Intra-day Repo Auctions" that the Central Bank may announce in case of an unforeseen excessive liquidity shortage during the day, the upper limit for each participating institution's bid for the weekly repo auctions is limited to the total repo auction.

vii. The amount of funding that the Central Bank plans to provide via one-week repo auctions is announced regularly. Bi-weekly, every Friday morning at 9:30, the planned lower limit of the outstanding amount of funding (one-week repo funding amount) for any day throughout the following maintenance period is announced on Reuters "CBTF" page.

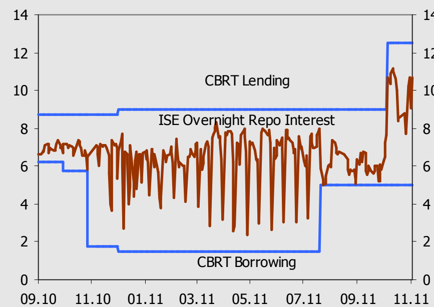
viii. The primary dealer banks can conduct O/N repo transactions within the framework of open market operations, between 10:00 a.m.–12:00 p.m. and 1:00 p.m.– 4:00 p.m. on business days and between 10:00 a.m.–12:00 p.m. on half business days.

ix. In case of increased concerns about the safety and soundness of the banking system and an accelerated run on deposits, within the framework of the principles set out in the Central Bank Regulation on the Liquidity Support Facility, the Central Bank provides liquidity support credit to banks, which are illiquid but solvent and are experiencing uncertainty and concerns regarding soundness, with the aim of preventing these banks from creating systemic risk, to ease uncertainty and lack of confidence in the financial system, and to safeguard financial stability.

Box III.5. Short-term Turkish lira and Foreign Exchange Liquidity Measures Taken by the Central Bank

At its interim meeting of 4 August 2011, the Monetary Policy Committee lowered the one-week repo auction rate - the policy rate- to 5.75 percent, and narrowed the interest rate corridor by increasing the overnight borrowing rate to 5 percent to reduce the potential downside volatility in short-term interest rates. Due to the excessive depreciation of the Turkish lira and with the aim of preventing any adverse impact on the medium-term inflation expectations and outlook, at its meeting of 20 October 2011, the Committee decided to widen the interest rate corridor by raising the overnight lending rate to 12.5 percent; the interest rate on borrowing facilities provided for primary dealers via repo transactions to 12 percent, and the overnight lending rate within the framework of the late liquidity window facility to 15.5.

Chart 1.Overnight Interest Rates (%)

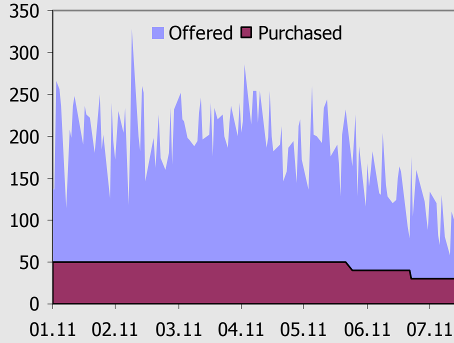


Source: CBRT

The Central Bank of Turkey holds foreign exchange buying auctions to increase the level of foreign exchange reserves without conflicting with the main principles and mechanism of the floating foreign exchange rate regime at times when foreign exchange supply increases relative to foreign exchange demand. However, in response to the slowdown in capital flows to emerging economies due to heightened concerns over sovereign debt sustainability in some European countries and global growth, the daily amount to be purchased in daily foreign exchange buying auctions was decreased from USD 50 million to USD 40 million as of May 31, 2011. On July 25, 2011, foreign exchange buying auctions were suspended to observe the implementation and repercussions of the decisions made at the EU Leaders Summit.

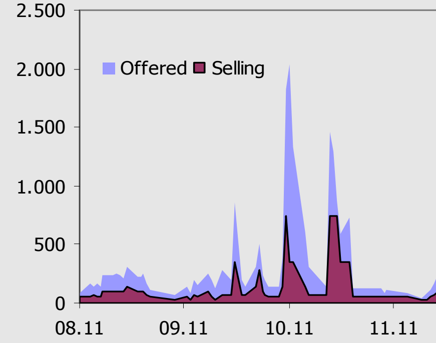
At its interim meeting on August 4, 2011, the Committee decided to supply liquidity to the market via foreign exchange selling auctions in case of unhealthy price formations due to a decrease in the depth of the foreign exchange market and without prejudice to the basic principles of the floating exchange rate regime, and the maximum amount to be offered in the auctions by each bank was limited to 20 percent of the total auction. Meanwhile, as of August 9, 2011, it was decided to reduce the lending rate for transactions, which the Central Bank is a party to, from 5.5 percent to 4.5 percent for US Dollar and from 6.5 percent to 5.5 percent for Euro. On September 12, 2011, it was decided that on the days when the Central Bank decide to sell foreign exchange based on daily market developments, the selling amount announced on Reuters page CBTQ at 11:00 a.m. would be the maximum daily amount that could be sold. The Central Bank of Turkey will continue to take the necessary policy measures to supply liquidity to the market in a timely, controlled and effective manner in case of worsening global liquidity conditions. To this end, in response to global developments, the Central Bank started to supply foreign exchange liquidity to the market via high-volume foreign exchange selling auctions as of October 5, 2011. On October18, the Central Bank directly intervened in the market by selling foreign exchange as unhealthy price formations were observed in exchange rates due to some speculative behavior stemming from a decrease in market depth. Starting from November 10, 2011, the Central Bank, with an aim to enhance the mobility of foreign exchange liquidity in the Interbank Foreign Exchange Market, resumed its activities as an intermediary in the foreign exchange deposit markets in the Foreign Exchange and Banknotes Markets and the Bank will continue to act as an intermediary until the uncertainties in the international markets are eased and only a limited number of transactions have been conducted in this scope.

Chart 2. FX Buying Auctions Against TL (Million USD)



Source: CBRT

Chart 3. FX Selling Auctions Against TL (Million USD)



Source: CBRT

Box III. 6. Central Bank of the Republic of Turkey's Measures Pertaining to Raising Reserve Requirements and Foreign Exchange Reserves

At its interim meeting of August 4, 2011, the Monetary Policy Committee (The Committee) laid the groundwork for a timely, controlled and effective provision of liquidity to the market in case of possible financial turmoil that may be triggered by global developments and decided to gradually implement a comprehensive package of measures when deemed necessary. In this framework, as of the second half of 2011, considering the slowdown in the global economy and developments regarding domestic demand, the Turkish lira and foreign exchange (FX) required reserve ratios were gradually decreased with the aim of supplying liquidity to the market. Turkish lira required reserve ratios were cut so as to encourage the extension of the maturity of deposits with a maturity of up to 3 months and other non-deposit liabilities. On October 28, 2011, Turkish lira required reserve ratios for shorter maturities were lowered to permanently supply the liquidity necessary for the market. With these arrangements, Turkish lira 14.2 billion was supplied to the market. FX required reserve ratios were lowered on July 22, 2011 for longer maturities and on 5 August 2011 and 5 September 2011 across all maturities. The amount of liquidity supplied to the market through these changes became USD 2.8 billion.

In order to meet the Turkish lira liquidity needs of the banking system in a more permanent way; on the one hand at a lower cost, and on the other to support and use the Central Bank's foreign exchange reserves in a timely, controlled and effective manner, banks were offered a facility where they could maintain up to 10 percent of their reserve requirements for Turkish lira liabilities in US dollar and/or euro, effective as of September 16, 2011. On September 30, 2011, this ratio was raised to 20 percent and to 40 percent on October 28, 2011. As a result of this facility, the Central Bank's foreign exchange reserves increased by USD 10 billion.

Gold deposit accounts, which became more popular as an investment instrument due the rise in gold prices and the cancellation of the physical declaration obligation when opening such accounts, has displayed a rapid rise in the last few years and these accounts became subject to reserve requirements as of October 14, 2011. Accordingly, the total amount of reserve requirements for precious metal deposit accounts and up to 10 percent of the reserve requirements for foreign currency liabilities, excluding precious metal deposit accounts, can be maintained as "standard gold". In order to strengthen the build-up of gold reserves and to provide more flexibility to the banking system's liquidity management, up to 10 percent of reserve requirements maintained for Turkish lira liabilities was allowed to be maintained as "standard gold". With a view to strengthening the build-up of gold reserves and granting more flexibility to the banks in their liquidity management, up to 10 percent of reserve requirements maintained for Turkish lira liabilities was allowed to be maintained as "standard gold" to be effective as of October 28, 2011. As a result of this facility, gold reserves increased by USD 2.8 billion, equivalent to 52 tons of gold.

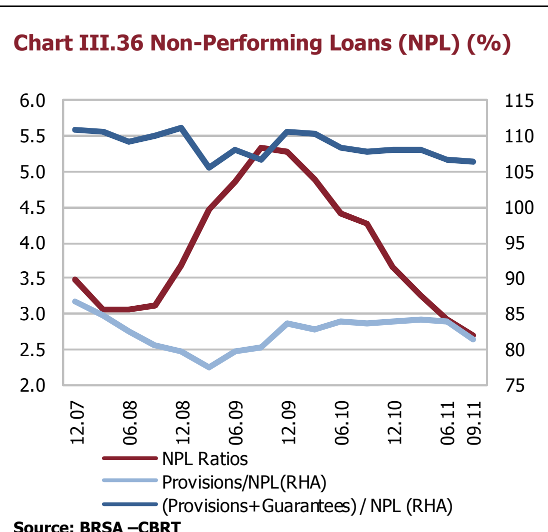
Table.1. Required Reserves as a Macroprudential Tool

01.10.2010	12.11.2010	07.01.2011	04.02.2011	01.04.2011	29.04.2011	22.07.2011	05.08.2011	16.09.2011	30.09.2011	14.10.2011	28.10.2011
TIGTHENING MEASURES						**EXPANDING AND RESERVE BUILDING MEASURES**					
Increase in TL RR, End of renumeration	Increase in TL RR	Differentiation of TL RR according to maturity, Repo was subjected to RR	Increase in TL RR	Increase in TL RR	Differentiation of FX RR according to maturity, Increase in TL RR	Decrease in FX RR	Decrease in FX RR	Facility of holding up to 10% of TL RR as FX	Decrease in FX and TL RR , Differentiation of other TL RR according to maturity, Facility of holding up to 20% of TL RR as FX	Precious Metals was subjected to RR, Facility of maintaining the whole RR held against the precious metal deposit accounts and up to 10% of RR for foreign currency liabilities excluding precious metal deposit accounts as gold	Decrease in TL RR, Facility of maintaining up to 10% of TL RR as gold, Facility of holding up to 40% of TL RR as FX

In addition, the Regulation on Rediscount and Advance Rates has been amended and conditions for lending export rediscount credits have been eased. In this context, the duration of fulfilling the export commitment has been raised from 4 months to 6 months and the limit of export rediscount credits has been increased from USD 2.5 billion to USD 3 billion. These credits are extended in Turkish lira and they are repaid in foreign currency, and the rise in the said credits contributes to the increase in the Central Bank's foreign exchange reserves.

The decline in non-performing loans (NPL) continues. NPLs, had increased annually by 56 percent in nominal terms, and reached TL22 billion by the end of 2009 due to the global financial crisis, posted a decline during the exit from the crisis, and compared to end-2009, by decreasing 16 percent, going down to TL 18.4 billion in 2011. This development was driven by the rise in collected debts due to the improvement in the economic units' solvency capacity and the elimination or sale of certain non-performing loans. The contribution of the amount that was eliminated from the assets to NPL ratio became 0.2 percent during the first nine months of 2011. Consequently, the NPL ratio, which was 5.3 percent at the end of 2009, decreased to 2.7 percent in September 2011. When the collaterals received for loans are considered along with provisions set aside for NPLs, it is observed that the sector is strong enough to cover the credit risk it is exposed to (Chart III.36, Table III.1).

Chart III.36 Non-Performing Loans (NPL) (%)



Source: BRSA –CBRT

Table III.1. NPL Ratios (%)

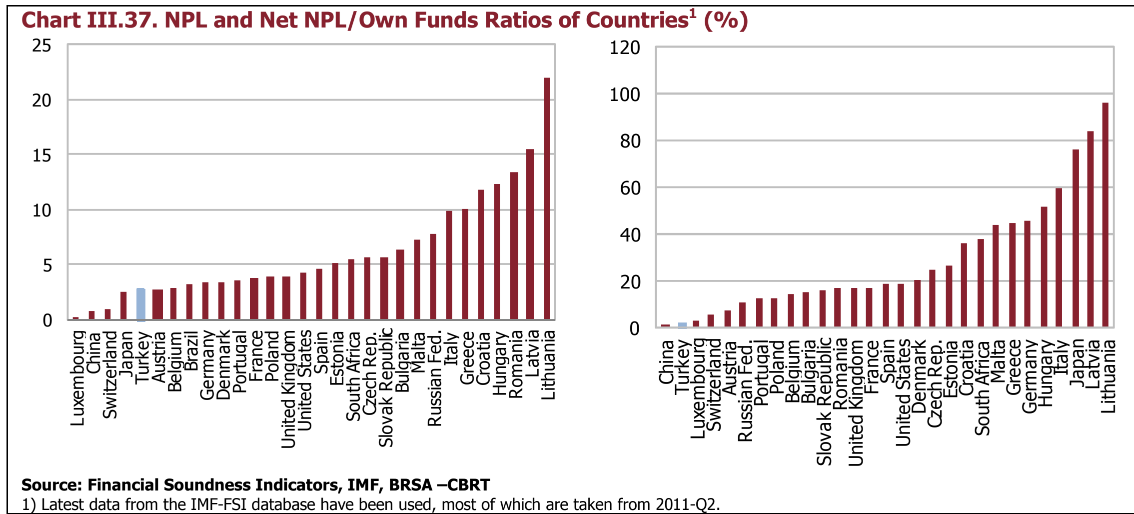
	2009	2010	09.11
Total Loans	5.3	3.7	2.7
Corporate	4.9	3.4	2.5
-SME Loans	7.6	4.5	3.1
-Other Copr. L.	3.6	2.8	2.2
Retail Loans	6.0	4.1	3.1
-Consumer Loans	4.1	2.7	1.9
--Housing	2.1	1.4	1.0
--Vehicle	10.3	6.0	3.9
--Other	5.5	3.7	2.6
-Credit Cards	10.4	8.0	6.5

Source: BRSA –CBRT

The NPL ratio for retail loans is higher than that of corporate loans. In 2009, when NPL ratios were on the rise, NPL ratios in retail loans and corporate loans were 6.0 percent and 4.9 percent respectively; in September 2011, the mentioned ratios became 3.1 percent and 2.5 percent. During the crisis, NPL ratios of vehicle loans, credit cards and SME loans were higher than those of other types of loans (Table III.1).

Compared to other countries, the Turkish banking sector performs better with regard to NPLs. The relatively slow recovery in economic activity in advanced economies and troubles experienced in the financial systems of some EU countries led the ratio of NPLs remain high in these countries (Chart III.37).

Chart III.37. NPL and Net NPL/Own Funds Ratios of Countries[1] (%)

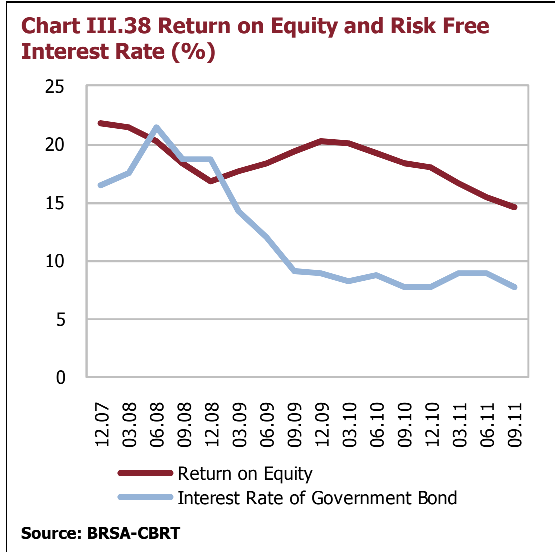


Source: Financial Soundness Indicators, IMF, BRSA –CBRT

1) Latest data from the IMF-FSI database have been used, most of which are taken from 2011-Q2.

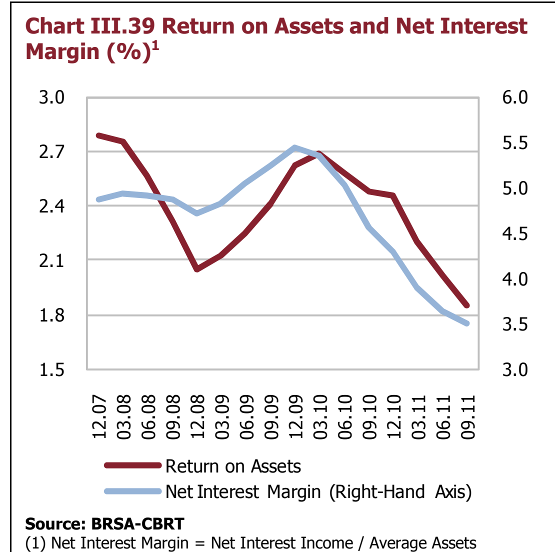
The decline in the profitability performance of the banking sector continues. In September 2011, the net profit of the banking sector was realized as TL 14.6 billion with a year-on-year decrease of 13.2 percent. Despite the favorable impact of the decline in special provisions for non-performing loans, net profit decreased due to the decrease in net interest income and the rise in non-interest expenses. The increase in non-interest expenses was due to the fact that personnel expenses, provision for general loan losses and other non-interest expenses increased and net trading income (which is the sum of net capital market transactions profits (losses) and net foreign currency gains (losses)) turned into losses. The rise in provision for general loan losses, which underpinned the increase in non-interest expenses, stemmed from the amendments made by the BRSA on 16 June 2011 to the Regulation regarding provisions set aside for loans. Meanwhile, according to the annualized data, the net profit decreased by 10 percent compared to end-2010 and became Turkish lira 19.9 billion. Although the return on equity fell by 3.5 points to 14.6 percent by September 2011 compared to end-2010 figures, the return received is still above the alternative risk-free rate of return (Chart III.38). In the same period, the sector's return on assets decreased by 0.6 points compared to the end of last year and became 1.8 percent, while the net interest margin contracted by 0.8 points and went down to 3.5 percent (Chart III.39).

Chart III.38 Return on Equity and Risk Free Interest Rate (%)



Source: BRSA-CBRT

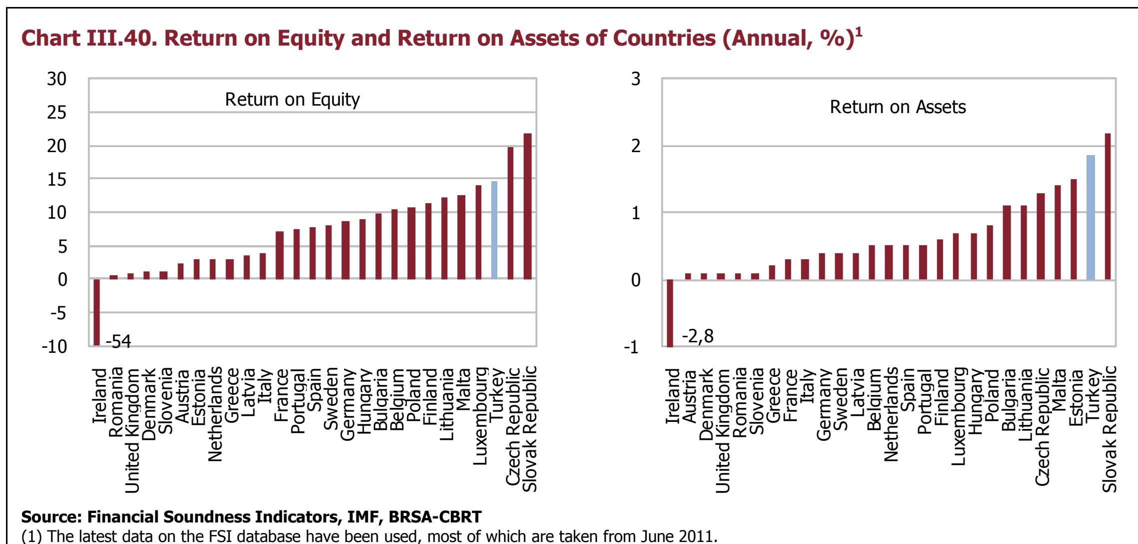
Chart III.39 Return on Assets and Net Interest Margin (%)[1]



Source: BRSA-CBRT
(1) Net Interest Margin = Net Interest Income / Average Assets

Although the profitability performance indicators of the banking sector indicate a downward trend, they are still high compared to other countries. The return on equity and return on assets of the Turkish banking sector are well above those of EU-member countries (Chart III.40).

Chart III.40. Return on Equity and Return on Assets of Countries (Annual, %)[1]

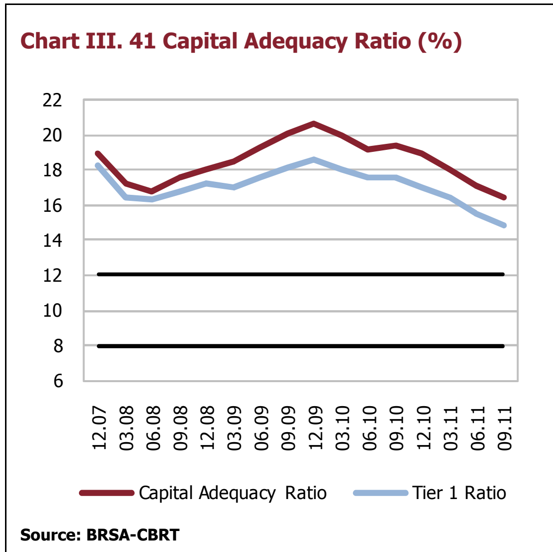


Source: Financial Soundness Indicators, IMF, BRSA-CBRT
(1) The latest data on the FSI database have been used, most of which are taken from June 2011.

Continued credit growth has led to a decline in the capital adequacy ratio. The capital adequacy ratio, which was 19 percent at the end of 2010, dropped to 16.4 percent in September 2011. This decline was driven by the faster growth of risk-weighted assets compared to own funds. (Chart III.41). Moreover, the rise in the risk weight of long-term other consumer loans had a downward impact on the capital adequacy ratio. The capital adequacy ratio is above the legal limit of 8 percent and the target ratio of 12 percent. As of September 2011, the ratio of Tier I capital within own funds is approximately 90 percent which indicates that own funds is composed of high-quality elements. In fact, in September 2011, the Tier 1 capital ratio was only 1.6 points lower than the capital adequacy ratio, which was realized as 14.9 percent. In the same period, the ratio of equity to total assets decreased by 1.7 points compared to end-2010 and came down to 11.7 percent

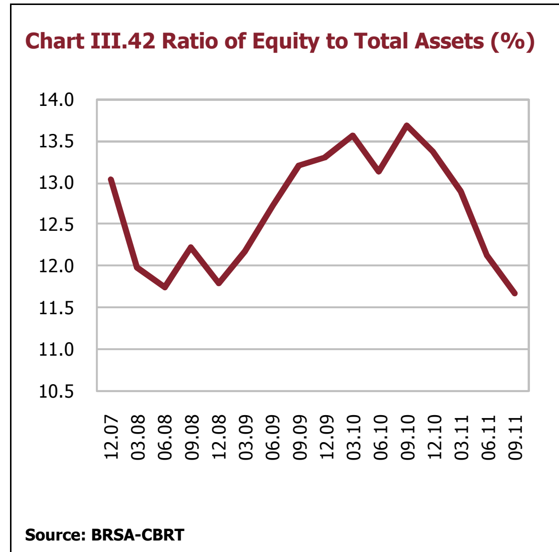
(Chart III.42). This decline was driven by the decrease in equity stemming from the downward trend in the sector's profitability performance and the fall in the Securities Revaluation Fund.

Chart III. 41 Capital Adequacy Ratio (%)



Source: BRSA-CBRT

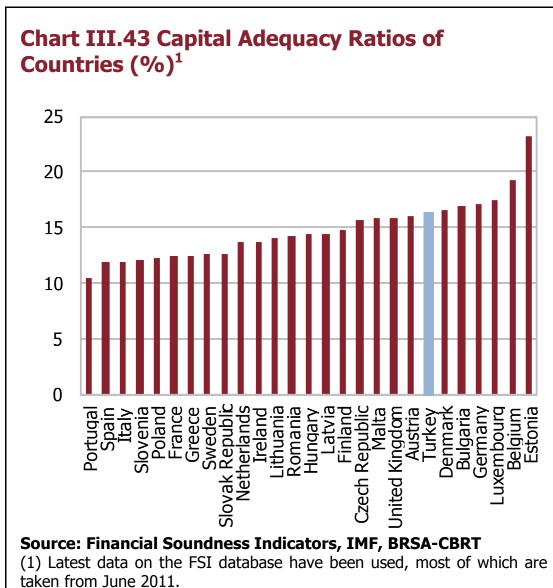
Chart III.42 Ratio of Equity to Total Assets (%)



Source: BRSA-CBRT

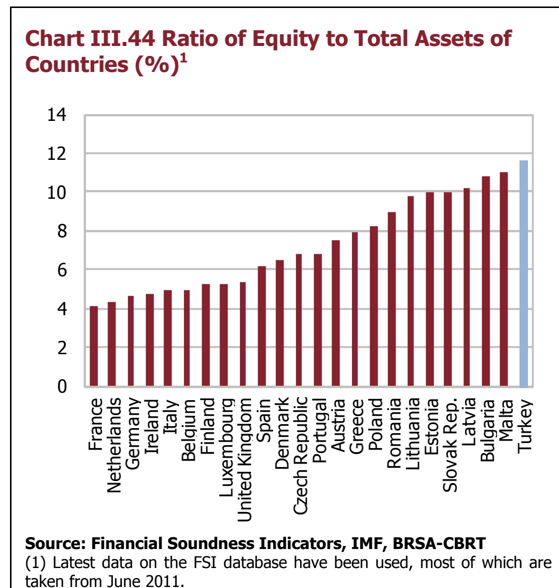
The Turkish banking sector has high capital adequacy ratio. Compared to other countries, Turkey is one of the countries that enjoy high ratios with regard to both capital adequacy ratio and the ratio of equity to total assets (Chart III.43 and Chart III.44).

Chart III.43 Capital Adequacy Ratios of Countries (%)[1]



Source: Financial Soundness Indicators, IMF, BRSA-CBRT
(1) Latest data on the FSI database have been used, most of which are taken from June 2011.

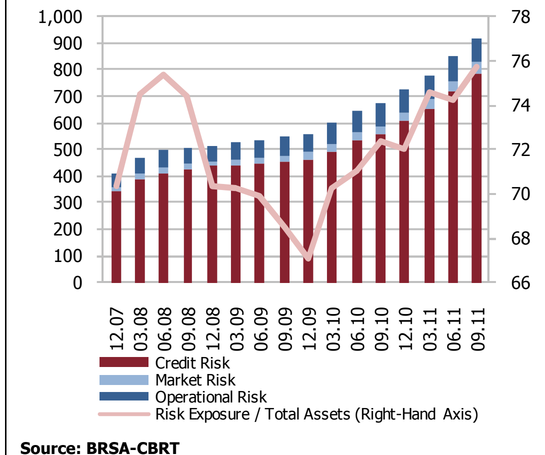
Chart III.44 Ratio of Equity to Total Assets of Countries (%)[1]



Source: Financial Soundness Indicators, IMF, BRSA-CBRT
(1) Latest data on the FSI database have been used, most of which are taken from June 2011.

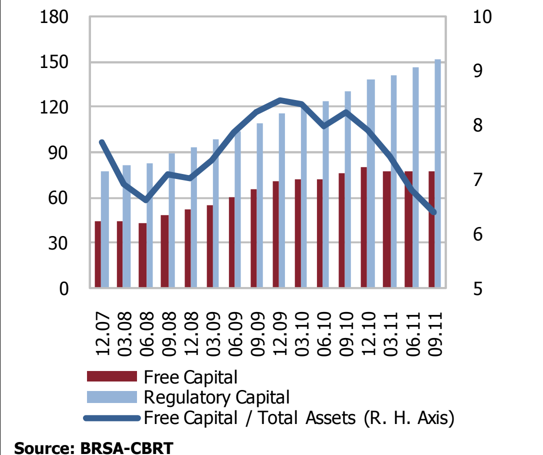
The rise in the share of total risk exposure of the banking sector in total assets continues on the back of credit growth. In September 2011, the mentioned share increased by 3.7 points compared to end-2010 and reached 75.8 percent (Chart III.45). Again, in the same period, the ratio of free capital to total assets decreased by 1.5 points down to 6.4 percent (Chart III.46). This decline was mainly driven by the rapid rise in the risk-weighted assets.

Chart III.45. Composition of Total Risk Exposure (Billion TL, %)



Source: BRSA-CBRT

Chart III.46. Developments in Free Capital (Billion TL, %)



Source: BRSA-CBRT

As stated in Box III.2 regarding the measures taken by the BRSA, the risk weight of long-term other consumer loans was increased with the amendment to the Regulation on Measurement and Evaluation of Capital Adequacy of Banks on 18 June 2011. Another important measure taken by the BRSA was the Regulation Pertaining to Measurement and Assessment of Interest Rate Risks Arising from Banking Accounts with Standard Shock Method, which was promulgated in the Official Gazette of 23 August 2011. The Regulation stipulates that the standard ratio of interest rate exposure arising from banking accounts shall not exceed 20 percent. Moreover, the BRSA would be able to discriminate standard ratios of interest rate exposure arising from banking accounts by banks or bank groups. In case the upper limit of 20 percent is exceeded, the excess amount in the last period shall be deducted from the own funds that will be used to calculate the standard ratio of capital adequacy for the same period. The change will take effect as of 1 July 2012.

After the announcement of the results of the latest Quantitative Impact Study (QIS-TR3) measuring the impact of Basel II on the sector's capital adequacy ratio, the one-year parallel run period, during which Basel-I and Basel-II was to be implemented simultaneously, started in July 2011. Turkey will have fully implemented Basel II by the time the parallel run period terminates in July 2012. The BRSA issued the third Quantitative Impact Study for Basel-II in March 2011. Consolidated data for March 2010 has been used in the study in which 45 banks participated; and, while the banks' consolidated capital adequacy ratio was 18.4 percent, it became 17 percent with a 1.4-point decline after the implementation of the Basel II standardized approach. The fact that the sector's capital adequacy ratio is well above 8 percent indicates that the banks' capital requirements are adequate in the scope of the Basel II harmonization process. In Turkey, the capital adequacy ratio is high and the fact that own funds is mostly composed of paid-up capital and retained earnings that have a higher capacity of covering losses indicates that Turkey will not have difficulty achieving harmonization with Basel III implementations. Studies are already underway for the implementation of Basel-III principles and the BRSA is expected to incorporate Basel III principles into Turkish legislation and start implementation in line with the timetable determined by the Basel Committee.

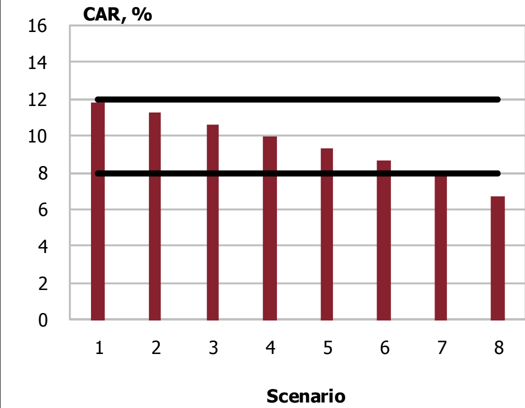
Scenario analysis, which tests the resilience of the banking sector to shocks originating from credit and market movements, shows that the sector has the capacity to absorb shocks. According to the scenario analysis, when exchange rates, Eurobond returns, interest rates and NPLs are exposed to maximum shocks simultaneously, the capital adequacy ratio only decreases below the legal ratio in the final scenario (Table III.2 and Chart III.47).

Table III.2 Scenarios Applied[1,2]

Scenario	Exchange Rate (% increase)	Eurobond (% loss of value)	Interest Rate (point increase)[2]	NPL (point increase)
1	30.0	5.0	10.0	3.0
2	31.5	5.3	10.5	4.0
3	33.0	5.5	11.0	5.0
4	34.5	5.8	11.5	6.0
5	36.0	6.0	12.0	7.0
6	37.5	6.3	12.5	8.0
7	39.0	6.5	13.0	9.0
8	40.5	6.8	13.5	11.0

Source: CBRT
(1) In scenario analysis, taking into account past crises, shocks are applied to risk factors simultaneously.
(2) It refers to the Turkish Lira interest rate shock. The FX interest rate shock is about 1/3 of that applied to Turkish lire interest rate. In the shocks applicable commercial portfolios, impairment is about 17 percent on sectoral basis.

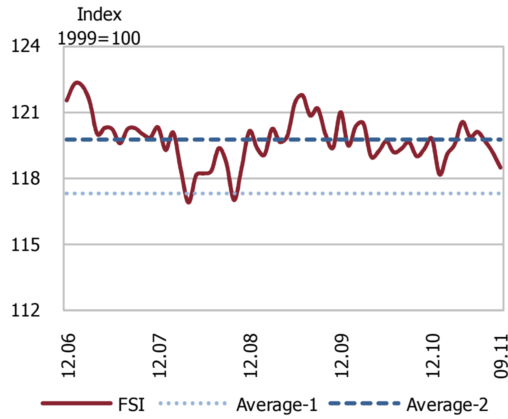
Chart III.47 Results of Scenario Analysis



Source: CBRT

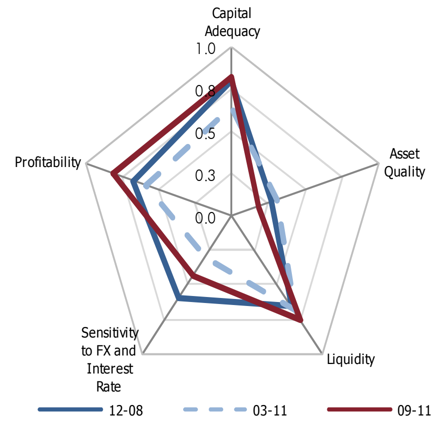
Banking sector indicators show that the financial strength of the system pervades. Despite the favorable trend in the sector's asset quality, indicators of profitability performance assumed a downward trend due to the contraction in the net interest margin and the rise in non-interest expenses. Even if the capital adequacy ratio decreased owing to credit growth, it is still above the regulatory and target ratios. While the on-balance sheet foreign exchange open position is on the rise, the net overall foreign exchange position is quite low owing to the excess off-balance sheet foreign exchange position. The banking sector's liquidity adequacy ratios for the 1st and 2nd maturity brackets are above the legal limit both in terms of total amount and in foreign exchange. However, the liquidity ratios assume a downward trend due to the significant decline in securities and the changes in the required reserves affect these ratios. Due to all these changes, the financial strength index became 118.5 in September 2011 and the sector remains strong (Chart III.48 and Chart III.49).

Chart III.48. Financial Strength Index [1,2]



Source: BRSA-CBRT
(1) "Average 1" is the average of December 1999 – September 2011 and "average 2" is the average of January 2004- September 2011.
(2) Since they have different operating principles, participation banks are excluded.

Chart III.49. Banking Sector Stability Map[1]



Source: BRSA-CBRT
(1) Computed as a sub field of the Financial Stability Map.

In the upcoming period, the slowdown in credit growth is expected to continue as uncertainties over the global economy are mounting and the impact of the measures taken pertaining to loans will become clearer. External demand is expected to remain subdued due to lingering global uncertainties and domestic demand to further decelerate because of the impact of measures taken. Besides, it is important to ensure the stable sustainability of the current balance in internal and external demand. In this framework, further decreasing the already decelerating credit growth in consumer loans would be very useful. The Central Bank of the Republic of Turkey will closely monitor the global economic developments and will take the necessary policy measures to domestic stability within the framework of the strategy.