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This report, which aims to inform the public, is based mainly on September 2009 data. However, the report also includes the developments and evaluations until the publishing date of the report in Turkish. This text is fully available at the CBRT web site. The CBRT cannot be held accountable for decisions taken based on the information and data provided in this report.

PREFACE

Since the onset of the global crisis, countries have taken various measures to mitigate its adverse effects on their economies and as a result of these measures a modest recovery has been achieved. In addition to the measures taken, efforts aimed at reforming the global financial system were initiated to prevent similar crises in the future and a concrete action plan was put forward.

Within the framework endorsed by G-20, initiatives led by the Financial Stability Board with the active participation of our country are expected to reshape the global financial architecture. The fact that some of the regulations devised to ensure healthier and more efficient functioning of financial markets, such as the liquidity ratio and the additional capital requirements, have already been implemented in our country is one factor that explains the relative resilience of our financial system in the face of this global crisis. Therefore, we expect the financial sector of our country to easily adapt to the post-crisis international financial structure.

Moreover, there are indications that economic activity, which has significantly slowed due to the repercussions of the global crisis on our country, will gradually recover. In order for this recovery to be strong and sustainable, it is essential that policies implemented so far be supported with the realization of measures stated in the Medium Term Programme.

I hope that the analyses and assessments presented in our Report will contribute to bolstering financial awareness and a more stable financial system.



Durmuş YILMAZ
Governor
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OVERVIEW

The impact of the crisis that started in developed countries before worsening and spreading globally as of the last quarter of 2008, decreased in the third quarter of 2009 with the contribution of monetary and fiscal measures that have been implemented. Despite the developments in the financial markets, slow and unstable improvements of leading indicators for the global economy, continuing high unemployment rates and unsolved problems of the banking sector still carry the risks regarding the sustainable and powerful recovery. Furthermore, concerns about the sustainability of the global economic recovery without the current governmental support measures remain significant.

During the global crisis, sharp decline in exports due to narrowed external demand and postponement of consumption and investment as a result of deteriorated expectations in our country, have led to a serious slowdown in economic activity. In the second quarter of 2009, Turkish economy has shown a rapid recovery, largely due to the tax incentives that increased consumption expenditures. However, after its remarkable rise in the second quarter, consumption demand is expected to be in a weaker trend for the rest of the year. Persistent uncertainty in demand and low capacity utilization will continue to limit investment expenditures. Within this context, it is perceived that a durable recovery in unemployment conditions will take a prolonged period of time. Therefore, recovery in economic activity is expected to show a slow and gradual trend for the rest of the year.

Decline in foreign trade deficit caused by falling energy prices and reduced demand for consumption and investment has led to a significant decline in the current account deficit since the last quarter of 2008. Moreover, it is observed that the financing structure of the current account deficit has changed due to the crisis. While the private sector was financing current account deficit by borrowing long-term external debt in the previous periods, they have recently become net external debt payer. Energy prices and the revival of economic activity are expected to be the determinants of development of the current account deficit in the forthcoming period as well.

Starting from the last quarter of 2008, roll-over rates of long-term foreign debt for both banks and non-bank sector are declining. In addition to the contraction and increased costs of external financing facilities, decline in external financing needs of banks and non-bank sector

due to the contraction of the domestic credit market and the slowdown in economic activity played a role in this development. As was made possible by an amendment in decree number 32 regarding the protection of the value of the Turkish currency, the fact that FX loans obtained from foreign branches of domestic banks have started to decline in favor of an increase in the outstanding amount of the same kind of loans obtained from their domestic branches was an important factor for the decline in roll-over rates of the non-bank sector. When compared with the end of 2008, it is seen that the real sector's usage of credit from foreign commercial banks and other organizations did not show a remarkable change. It is expected that FX loans obtained from foreign branches and subsidiaries of domestic banks will continue to decline in favor of an increase in the outstanding amount of the same kind of loans obtained from their domestic branches. Therefore, the abovementioned amendment should be taken into consideration while the decline in the rollover rates of long-term external loans used by the non-banking private sector is being assessed.

Sharp contraction in total demand and harsh decline in commodity prices led to a rapid decline in the inflation rates in Turkey, as is the case globally. In the coming period, while some periodic increases in the annual inflation rate could be observed due to the base effect, it is expected that core inflation indicators will remain at low levels.

As a consequence of the decrease in income and increase in expenditure in the year 2009 due to the global crisis, central government budget deficit has significantly increased similar to other countries, and thus, public borrowing need has shown a rising trend. Fiscal expansion in the short run should be counterbalanced in the medium term in order to prevent an increase of concerns over fiscal sustainability due to the budget deficit. As a matter of fact, the 2010-2012 Medium Term Programme (the Programme) has introduced a consistent framework with the aim of gradually reducing the budget deficit, which increased rapidly during the crisis period. It is very important that the measures proposed in the Programme are implemented without compromise in order to ease concerns over sustainability of debt and to take public borrowing needs under control.

Household liabilities are still low compared to many countries, although they continued to rise in the first half of 2009. Furthermore, the fact that the interest and foreign exchange risk of their liabilities is limited enables households to be relatively less effected by unfavorable developments in economic conditions. The amendments to the Decree No.32 prevented households from using foreign exchange indexed loans and thus, households were prevented from bearing foreign exchange risk due to their liabilities in the periods ahead.

On the other hand, economic contraction due to the global crisis has caused an increase in the unemployment rate, adversely affecting the repayment ability of households. Although a moderate recovery is expected in economic activity, problems experienced in debt repayments of households are expected to continue, though they are expected to be milder than those of the US and European averages, in particular for mortgage loans.

The sales revenue of firms declined due to the deterioration in both domestic and foreign demand. Due to the decline in their sales revenues, operational profitability and repayment ability of firms also decreased. Nevertheless, the recent stability of Turkish lira has constrained further deterioration in repayment capacity of firms that have high levels of foreign exchange loans and open positions. While the weakening of firms' repayment ability resulted in the tightening of credit supply by banks, slowed economic activity reduced firms' credit demand and

thus, firms have become net debt payers. When firms are assessed by their size, it is observed that the contraction in credit markets has particularly influenced the small and medium size enterprises (SMEs).

Turkish banking sector, on the other hand, maintained its strength thanks to the reforms implemented decisively after the crisis of 2001.

A recovery, albeit limited, has recently been observed in loans with the impact on market interest rates of cumulative policy rate cuts since the last quarter of 2008, the liquidity measures taken and the improvement in risk perceptions. Nonetheless, non-performing loans (NPLs) are still rising and considering the fact that the economic recovery will be gradual, this rise might continue for a while. On the other hand, payment of past-due credit card loans rescheduled as stipulated in Law No: 5464 and on a voluntary basis in the subsequent period, is expected to have a positive effect on the NPL ratios.

Unlike many countries' banking sectors, the capital structures of which were severely affected by the global crisis, the fact that the capital structure of banks in Turkey grew even stronger on the back of recent high profits improved their lending capacity. Within this framework, it is expected that acceleration similar to the one recently observed in housing loans would also be observed in SME loans with the activation of the support provided to the Credit Guarantee Fund and a gradual improvement would take place in credit markets in general.

A relative recovery has been observed in liquidity conditions with the support of the measures taken by the CBRT and the recent improvements in global risk perceptions. Deposits, being the most important funding source of the Turkish banking system, restrain the susceptibility of banks to the volatility of interbank funds. Moreover, the fact that liquidity adequacy ratios of banks are maintained above the regulatory limits, supported also by the fact that banking sector has decreased the share of loans while increasing the share of securities in their portfolios since the end of year 2008, is an indication that the banking sector has pursued a prudent approach in liquidity risk management.

The exchange rate risk aversion tendency of the banking sector continues. The levels of on-balance sheet short position and off-balance sheet long position continues to rise parallel to the recovery in the global risk appetite.

Banking sector profits surged as a result of the increase in net interest income and the rise in net trading income in September 2009. This rapid increase is mainly attributable to the decline in funding costs as a result of the Central Bank's policy rate cuts, as these rate cuts were not reflected proportionally on the interest charged particularly on long-term loans. Nevertheless, competition in credit granting among banks that has spilled over onto prices and expected hikes in non-performing loans lead to an anticipation that the sustainability of a similar performance in profits in 2010 is unlikely.

Particularly in developed economies, in a period when the capital erosion of banks due to the consequences of the crisis was overcome through capital increases and/or government support, the Turkish banking sector maintained its strong capital structure and did not need any government support. As a matter of fact, the capital adequacy ratio (CAR), stayed above the eight percent regulatory ratio and twelve percent target ratio during all the periods examined. According to the scenario analysis, the capital structure of the banking sector is strong enough to absorb the losses likely to be incurred under various shock assumptions.

The Financial Strength Index, which is monitored as an indicator of the soundness of the banking sector, followed a volatile course during the year 2009 and, due to the increases in the capital adequacy and profitability sub-indices in September 2009, rose compared to end-2008 and maintained its favorable level.

In the forthcoming period, the main risks to financial stability are anticipated as the economic recovery being slower than expected, thus leading to high unemployment rates and possible new shocks that might be experienced in the global financial markets. CBRT will continue to take the necessary measures to contain the adverse effects of the global financial crisis on the domestic economy. It is important that, in the medium term, the monetary measures that have been taken are supported by fiscal discipline and structural arrangements. Within this framework, steps to be taken towards the implementation of the structural arrangements that are required by the Medium Term Programme and the European Union adaptation and convergence process maintains its significance.

I. MACROECONOMIC DEVELOPMENTS

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

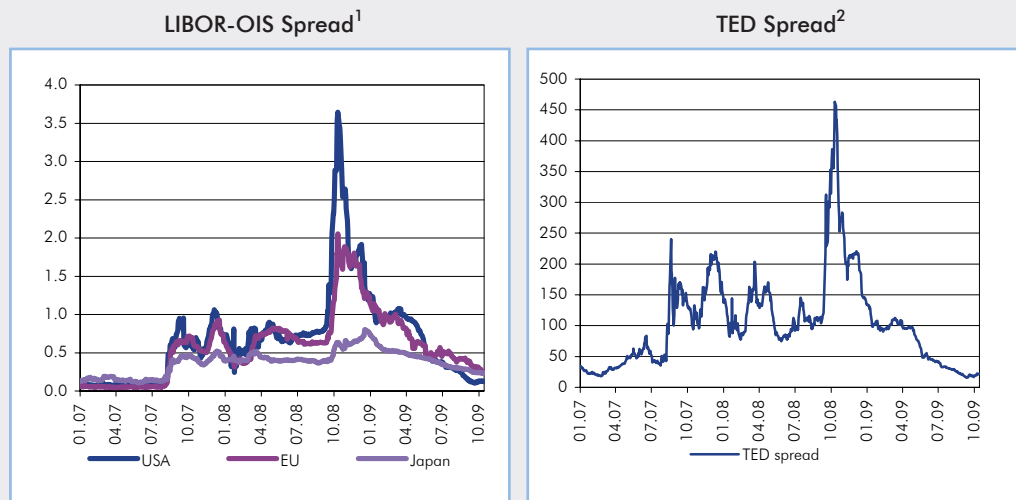
I.1. External Sector

I.1.1. International Developments

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

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

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



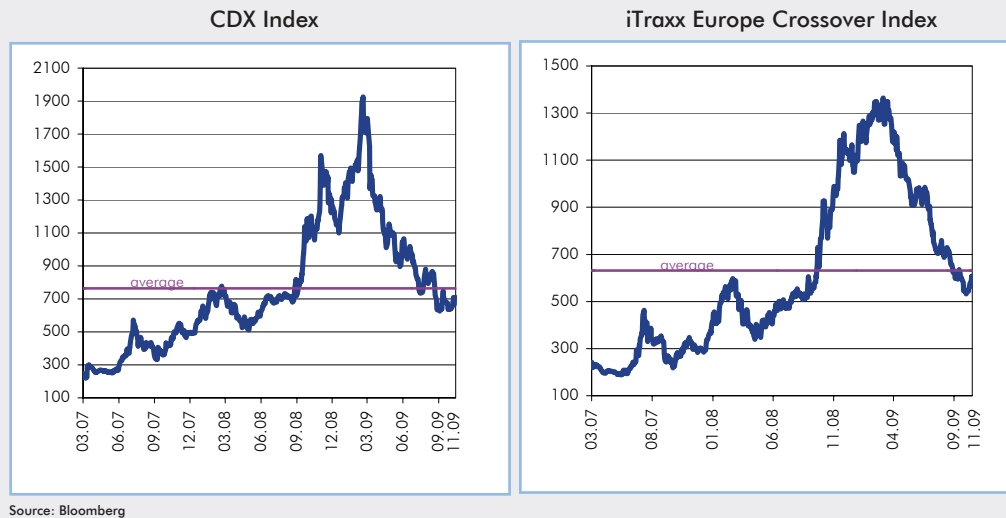
Source: Bloomberg

(1) Spread between 3-month LIBOR and annualized 3-month OIS rate.

(2) Spread between 3-month LIBOR and 3-month US Treasury bill rate.

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

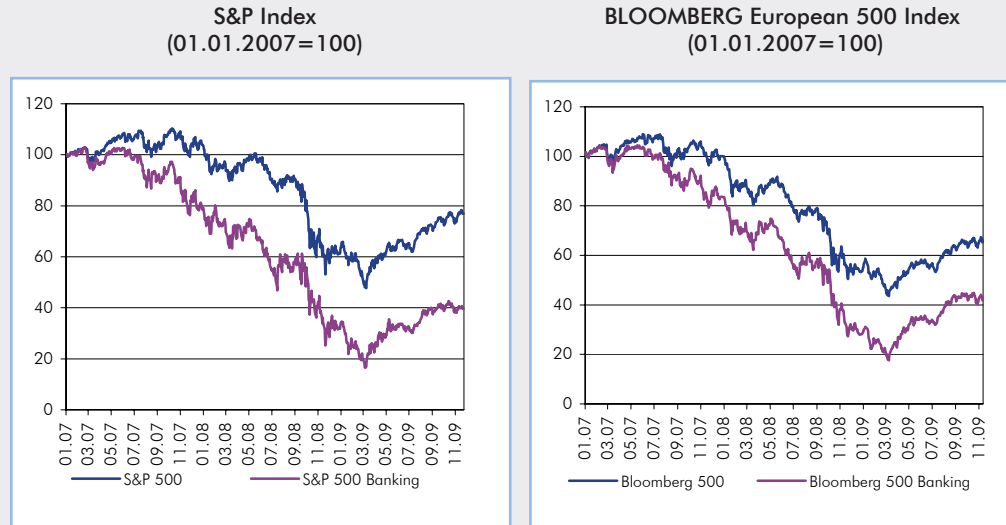
Chart I.2.
Credit Default Swap Indices (Basis point)



Source: Bloomberg

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

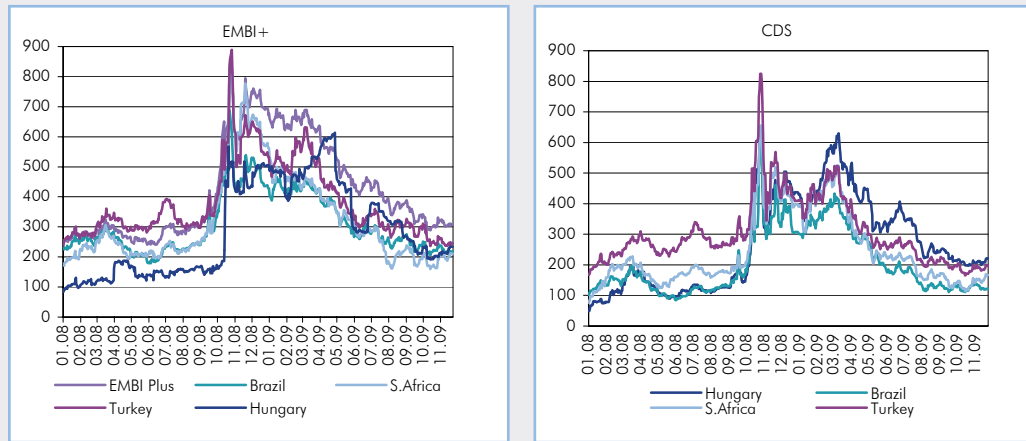
Chart I.3.
Stock Market Developments in Developed Countries



Kaynak: Bloomberg

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

Chart I.4.
Risk Premia^{1,2} and Credit Default Swap (CDS) Spreads³ of Selected Developing Countries (Basis Point)

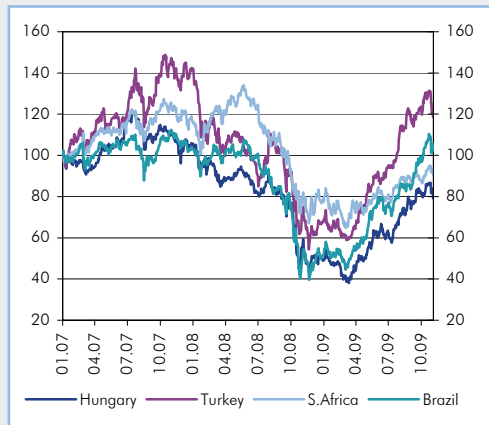


Source: Bloomberg

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

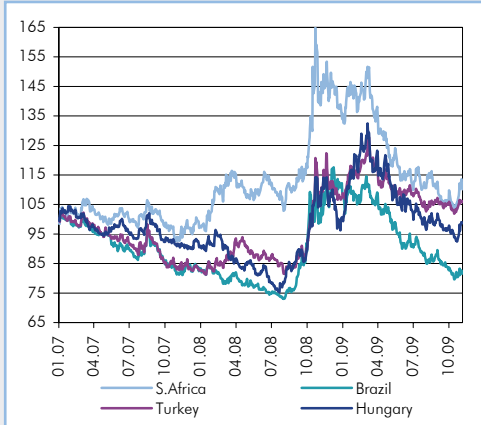
Overall, it is observed that the emerging financial markets recovered faster than the developed markets and financial indicators approached pre-crisis levels. This development is mainly attributable to the rise in portfolio investments in developing countries due to low rates of return in developed countries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

Chart I.5.
Stock Market Developments in Developing Countries



Source: Bloomberg

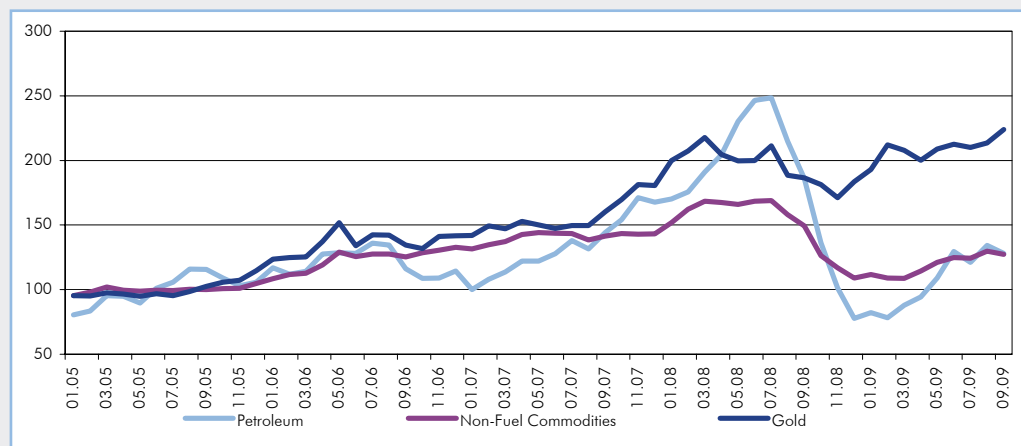
Chart I.6.
Nominal Exchange Rates in Developing Countries (Index 01.01.2007=100)



Source: Bloomberg

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

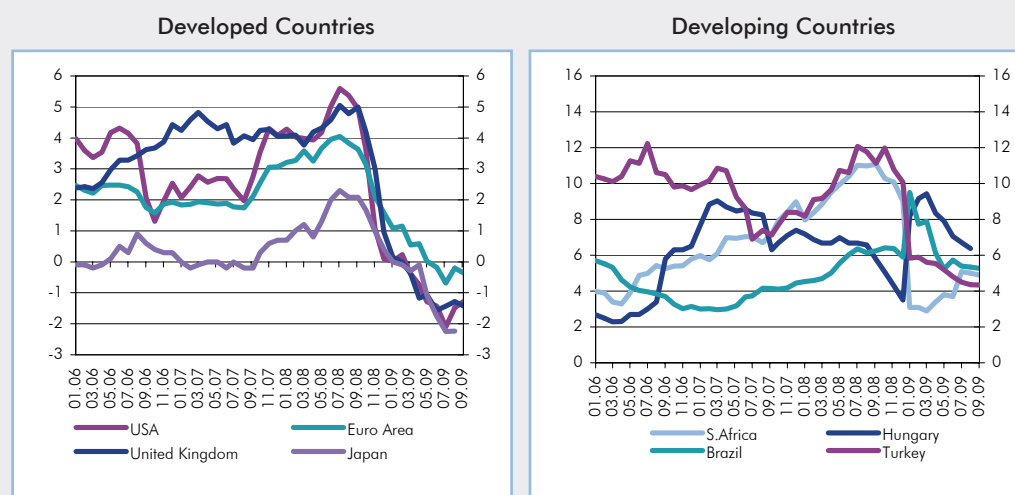
Chart I.7.
Commodities' Price Index



Source: Bloomberg

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

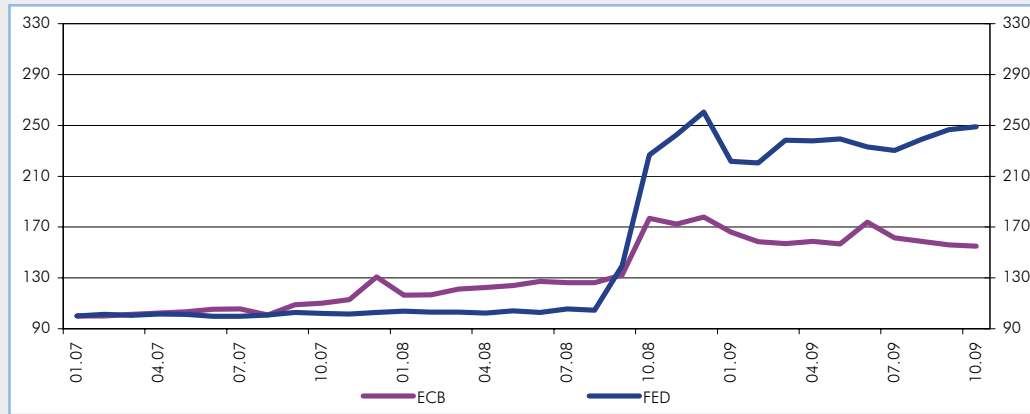
Chart I.8.
Inflation Rates in Selected Countries (CPI annual percentage change)



Source: IMF IFS

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

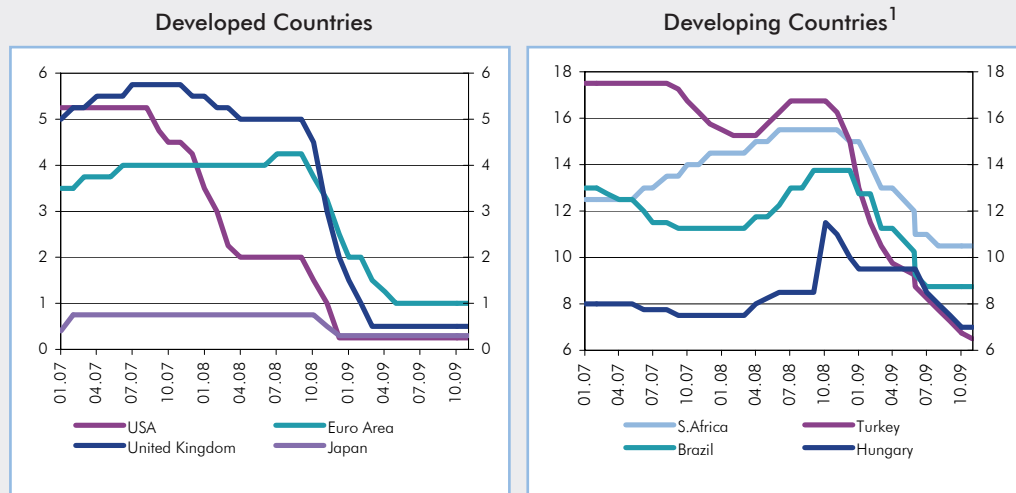
Chart I.9.
Indices of Balance Sheets' Size of Fed and ECB
(31.01.2007=100)



Source: Bloomberg

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

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



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

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

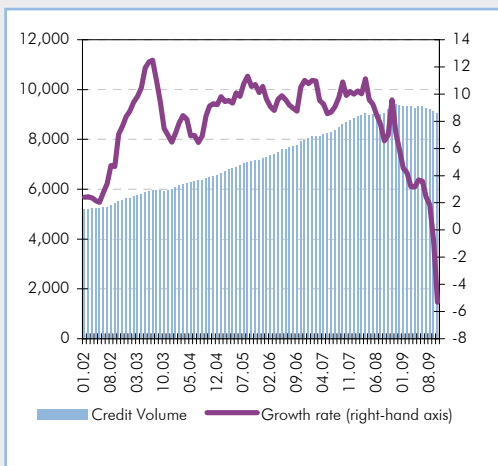
Chart I.11.
Share of Banks that Have Tightened Lending Conditions in the US and European Banking Sectors (%)



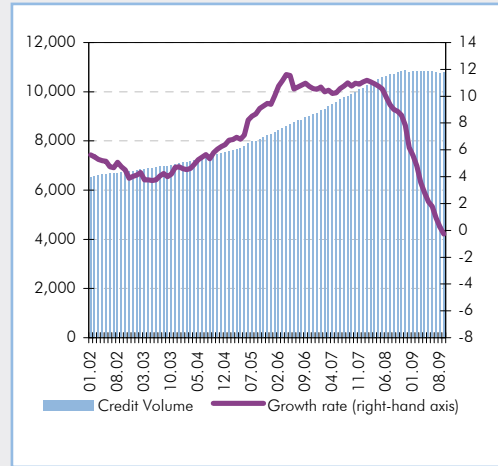
Source: ECB, Fed

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

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



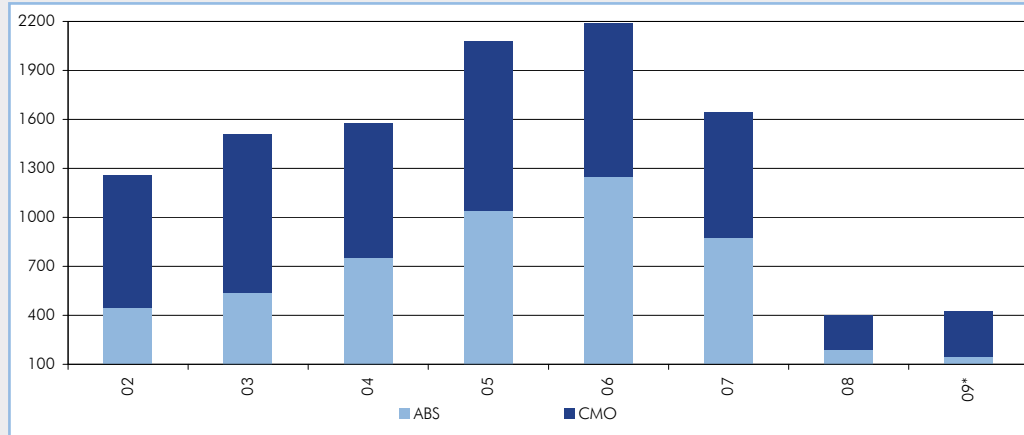
Source: Fed.



Source: ECB.

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

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

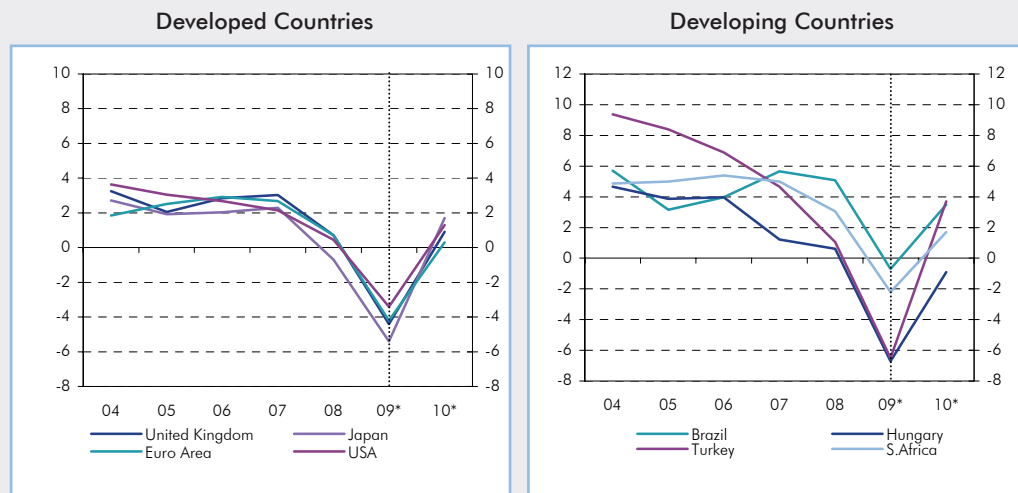


Source: Bloomberg
 (*) As of October.

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

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

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



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

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

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

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

Box 1.

Exit Strategies: When and How?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Sources:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Sources:

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

Box 5. Compensation Policies

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

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

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

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

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

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

Sources:

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

1.1.2. Balance of Payments

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

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

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

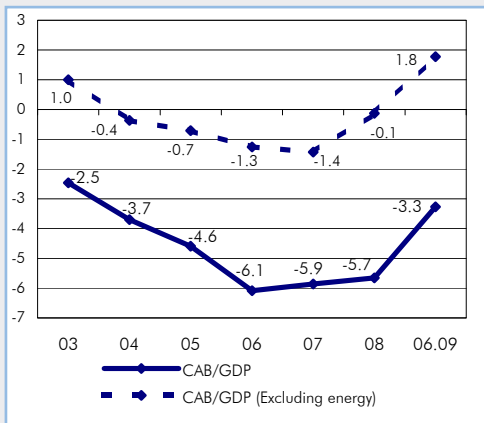
Source: CBRT

(*)Cumulative figures for the last 12 months.

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

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

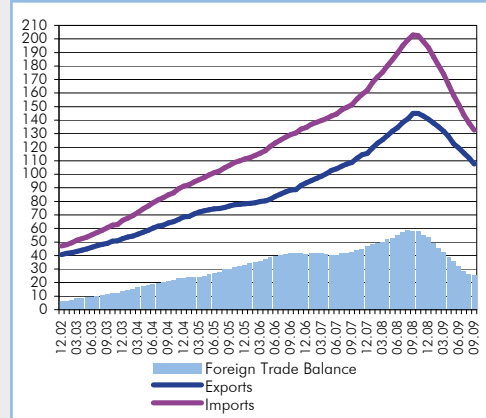
Chart I.15.
Current Account Balance (CAB) to GDP Ratio
and the Impact of Energy Prices¹ (%)



Source: CBRT, TURKSTAT

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

Chart I.16.
Export - Import Volumes and the Trade
Deficit¹ (Billion USD)



Source: CBRT

(1) Cumulative figures for the last 12 months.

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

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

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

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

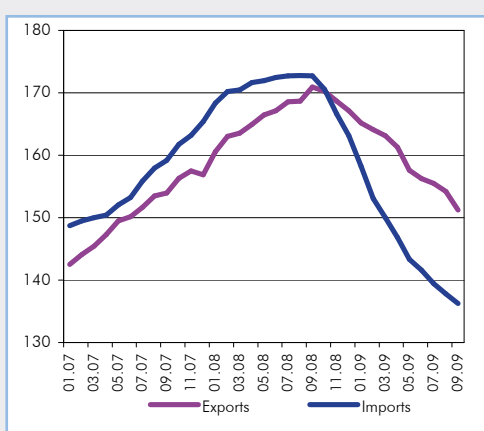
Source: IMF World Economic Outlook, October 2009

(*) Prediction

(**) Forecast

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

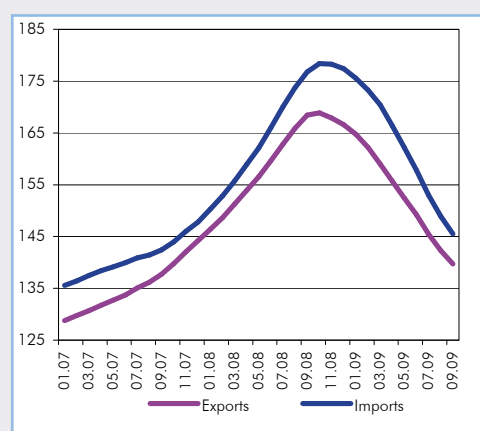
Chart I.17. Imports and Exports Volume Indices¹



Source: CBRT

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

Chart I.18. Imports and Exports Unit Value Indices¹

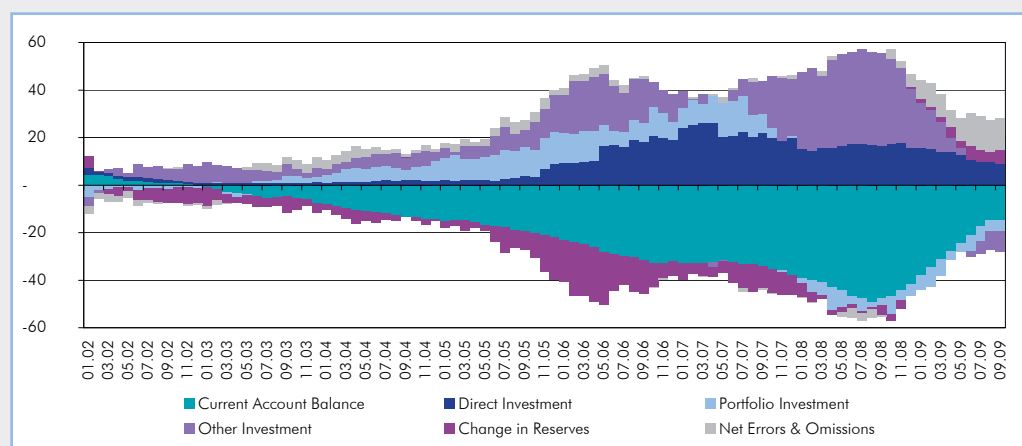


Source: CBRT

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

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

Chart I.19.
Development of the Balance of Payments Items^{1, 2, 3, 4, 5} (Billion USD)



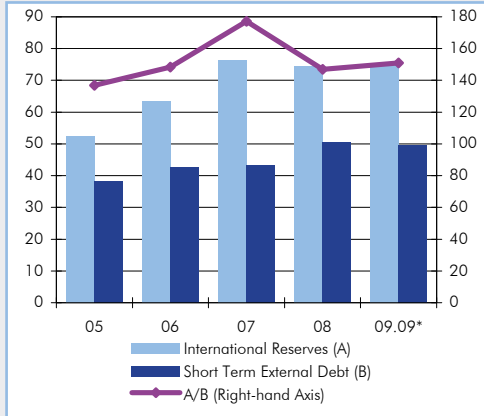
Source: CBRT

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

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

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

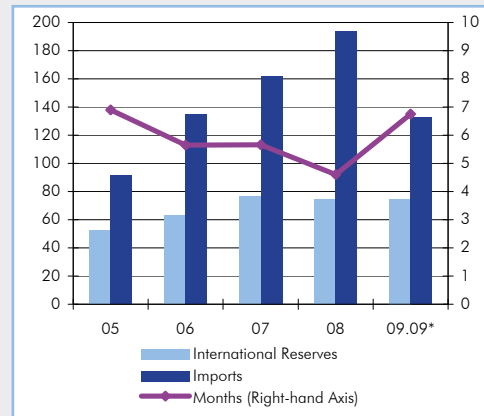
Chart I.20.
Short-Term External Debt¹ and International Reserves² (Billion USD, %)



Source: Undersecretariat of Treasury, CBRT

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

Chart I.21.
Import Coverage Ratio of Reserves^{1,2} (Billion USD, Month)



Source: CBRT

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

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

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

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

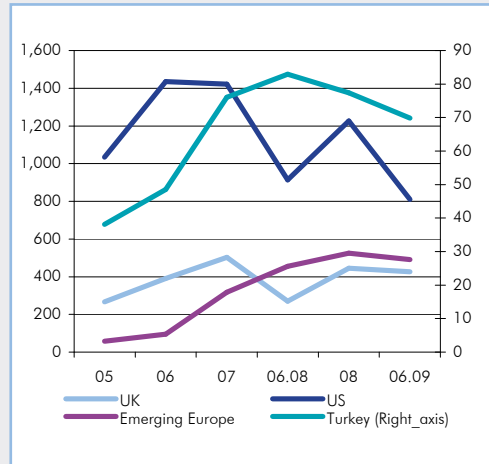
Source: CBRT

(*) Cumulative figures for the last 12 months.

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

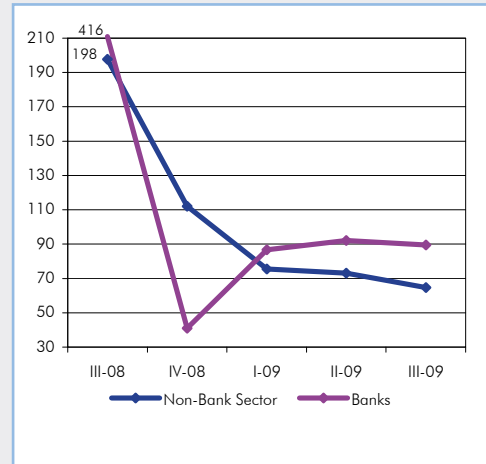
Roll-over rates of external long-term loans borrowed by the banks and the non-bank private sector from abroad decreased significantly compared to the pre-crisis period. While roll-over rates of banks gained stability at around 90 percent, the non-banking sector still maintains its tendency to reduce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

Chart I.22.
Net Receivables of International Banks from Selected Countries¹ (Billion USD)



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

Chart I.23.
Roll-over Ratios for Long-term External Loans¹ of Banks and Non-Bank Sector² (%)



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

Box 6.

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

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

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

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

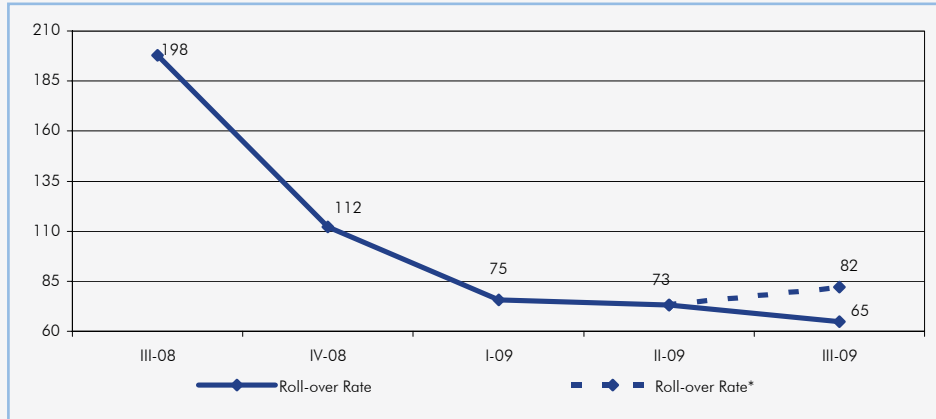
a) With the condition of at least 1 year maturity and a minimum amount of 5 million USD,

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

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

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

Chart 1. The Rollover Ratio of Long Term Loans¹ by the Non-Bank Private Sector²



Source: CBRT

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

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

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

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

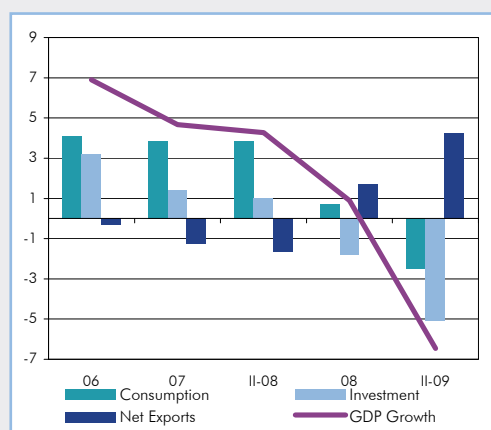
Net receivables of the banks reporting to the Bank for International Settlements (BIS) from the US and UK, still remained below levels of the pre-crisis period, while they remained flat in Emerging Europe. On the other hand, net assets of these international banks in Turkey displayed a downward trend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

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

1.2. Growth and Inflation

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

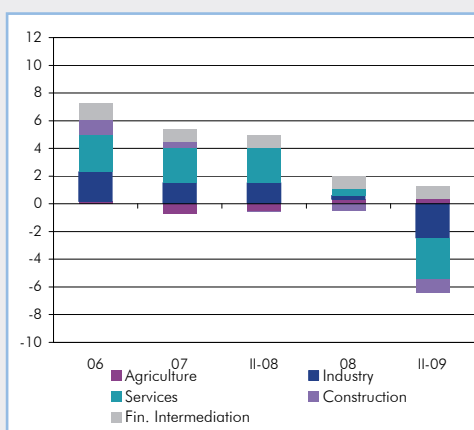
Chart I.24.
Growth Rate and Its Composition^{1, 2}
(%, Points)



Source: TÜRKSTAT

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

Chart I.25.
Contributions of Sectors to Growth¹
(%, Points)



Source: TÜRKSTAT

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

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

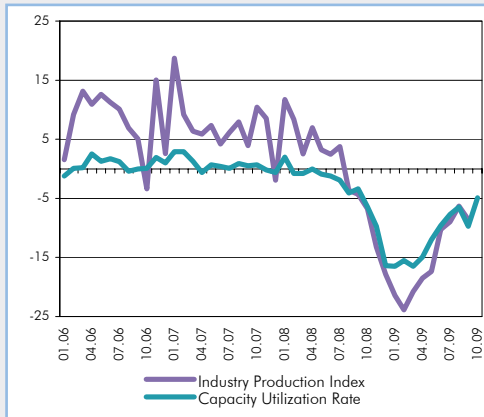
Likewise, while investment expenditures of the private sector, which has a high share in total investment expenditures, declined by 31.6 percent year-on-year in the first half of 2009, those of the public sector rose by 13.3 percent. Despite the rise in public investments, total investment expenditures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

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

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

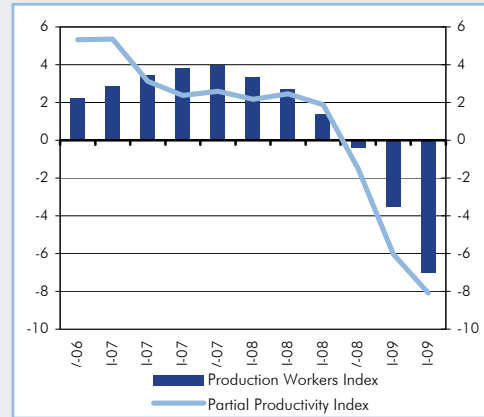
In the Medium-Term Program comprising the 2010-2012 period, the contraction in the Turkish economy, which started in the last quarter of 2008, is predicted to persist in 2009, while 2010 is envisaged to be the starting point of the process of growth. This program suggests that the GDP will decrease by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

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



Source: TURKSTAT

Chart I.27.
Number of Workers and Partial Productivity per Worker for the Manufacturing Industry^{1,2} (Annual % Change)



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

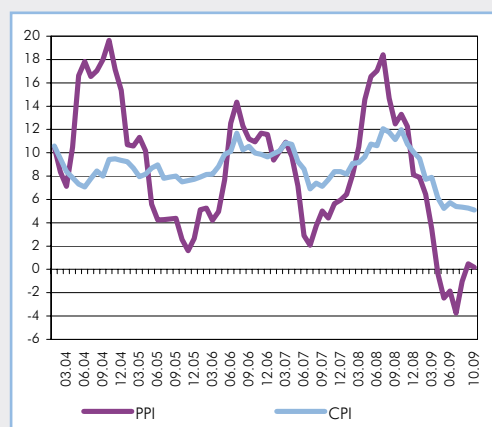
The industrial production index, which started to decline in 2009 due to the contraction in both internal and external demand, fell to its lowest level of 2009 in February, by a decrease of 23.8 percent year-on-year and started to recover after this period. The index fell by 8.6 percent year-on-year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

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

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

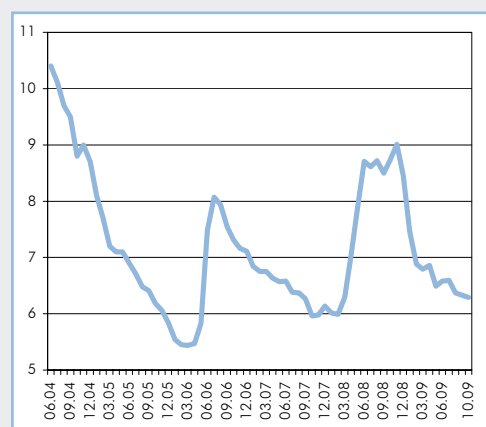
Sharp contraction in total demand coupled with the decline in commodity prices led the annual rate of increase in the CPI, which had been 10.06 percent at end-2008, to fall to 5.08 percent by October 2009 (Chart I.28).

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



Source: TURKSTAT

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



Source: CBRT

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

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

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

I.3. Public Finance

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

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

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

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

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

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

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

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

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

Table 1. Main Indicators of Medium Term Programme

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

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

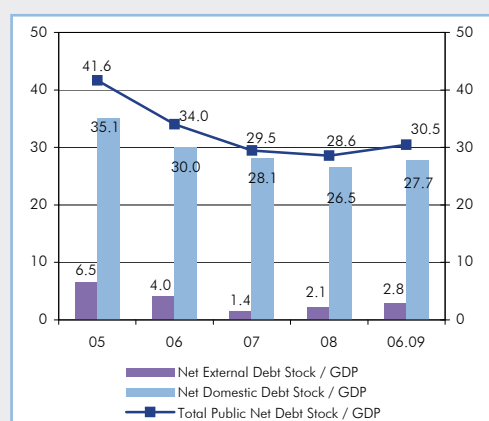
(1) Stands for estimations. Inflation targets are 7.5, 6.5 and 5.5 percent for 2009, 2010 and 2011 respectively.

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

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

The ratio of public net debt stock to GDP, which displayed a decreasing trend until end-2008, rose to 30.5 percent in June 2009 due to the sharp decline in the primary surplus. This was driven by the increase in public gross debt stock and the decline in GDP as opposed to the increase in net assets of the Central Bank, public deposits and unemployment insurance fund net assets (Chart I.30). Public gross debt stock posted an increase mainly due to the rise in domestic debt stock. The ratio of EU-defined general government nominal debt stock to GDP also went up compared to 2008 (Chart I.31). This ratio is expected to reach 47.3 percent by end-2009 according to the Medium Term Programme.

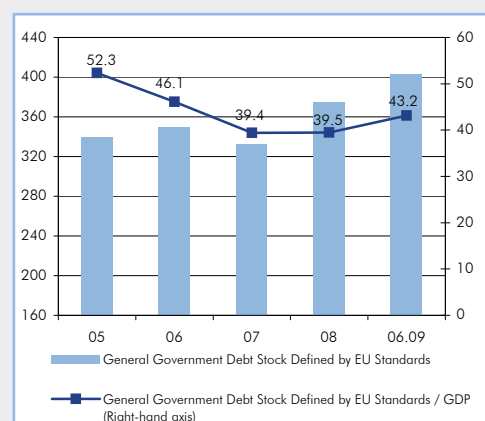
Chart I.30.
Composition of Total Public Sector Net Debt Stock¹ (%)



Source: Treasury

(1) Public sector net debt stock is calculated by subtracting central bank net assets, public deposits and unemployment insurance fund net assets from public gross debt stock.

Chart I.31.
General Government Nominal Debt Stock Defined by EU Standards¹ (% Billion TL)



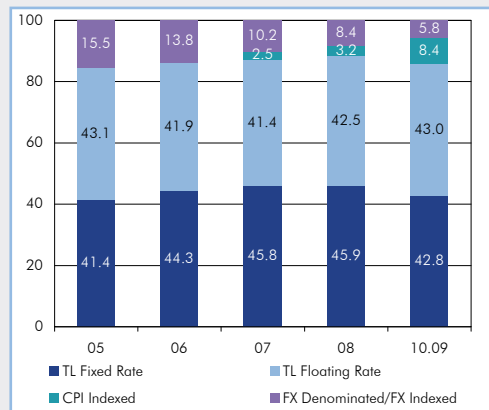
Source: Treasury

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

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

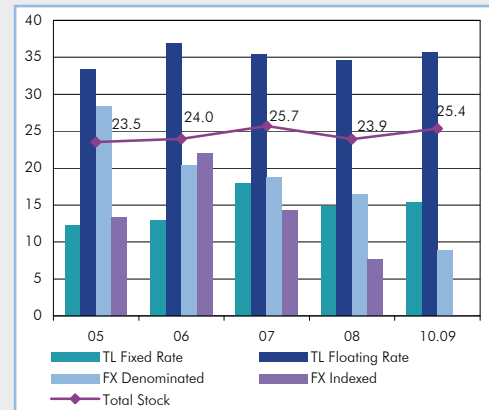
The average maturity of government securities, which decreased to 23.9 months at end-2008, increased to 25.4 months in October 2009, due to the effect of the CPI-indexed bonds issued at long maturities (Chart I.33).

Chart I.32.
Composition of Domestic Debt Stock (%)^{1,2}



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

Chart I.33.
Maturity Structure of Government Domestic Debt Stock (Month)¹



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

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

Chart I.34.
Government Domestic Debt Securities by Holders^{1,2,3} (%)



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

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

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

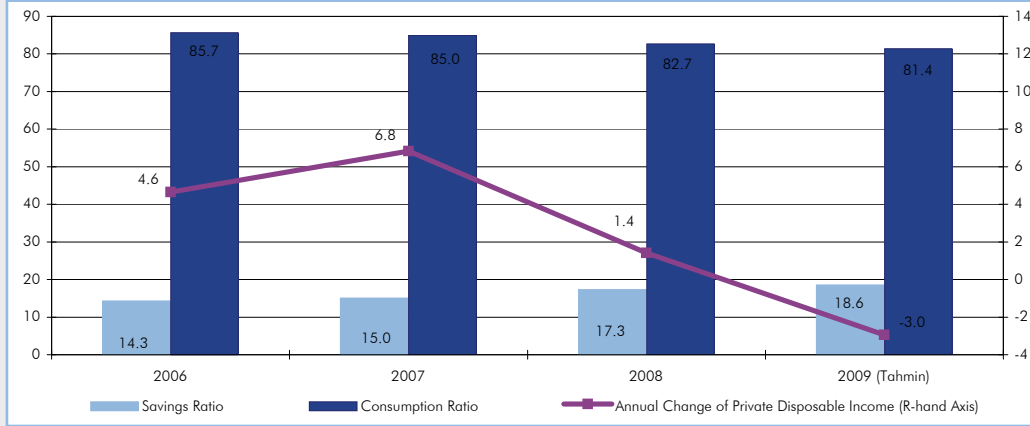
Source: IMF, World Economic Outlook Database, October 2009
* Estimation

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

I.4. Private Sector Developments

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

Chart I.35.
Private Sector Consumption and Savings Ratios and Real Disposable Income (%)^{1,2,3}



Source: SPO

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

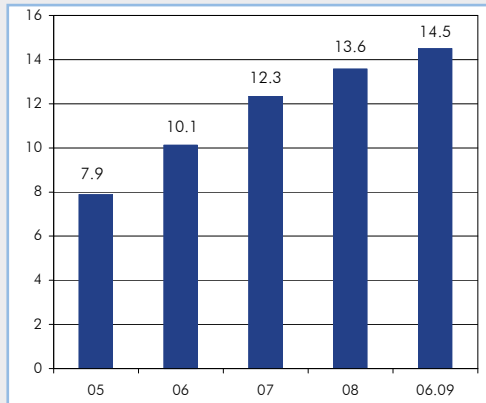
(2) Savings Ratio = Total Private Savings / Private Disposable Income

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

1.4.1. Household

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

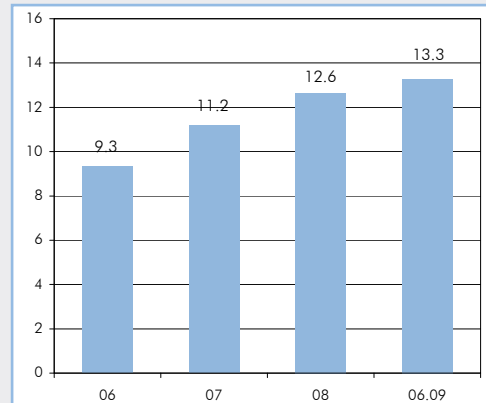
Chart I.36.
Household Liabilities to GDP (%)¹



Source: CBRT-BRSA, TURKSTAT

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

Chart I.37.
Retail Loans to Household Consumption Expenditures (%)¹



Source: CBRT-BRSA, TURKSTAT

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

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

Table I.6. Household Disposable Income, Liabilities and Interest Payments^{1,2,3} (Million TL)

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

Source: BRSA-CBRT, TURKSTAT, SPO

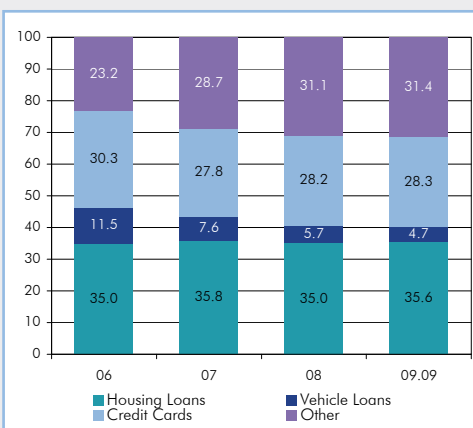
(1) Household liabilities consist of gross consumer credits and credit card balances extended by banks and consumer finance companies and liabilities to TOKI due to TOKI's housing sales with long term maturity.

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

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

By September 2009, household liabilities and interest payments increased by the same rate, at 8.7 percent, compared to end-2008. In the same period, the ratio of household interest payments to disposable income, one of the main indicators of the households' repayment capacity, rose from 3.8 percent to 4 percent, while the ratio of total household liabilities to disposable income increased from 24.8 percent to 26.2 percent (Table I.6).

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

Chart I.38. Decompositon of Household Liabilities (%)^{1,2,3,4}

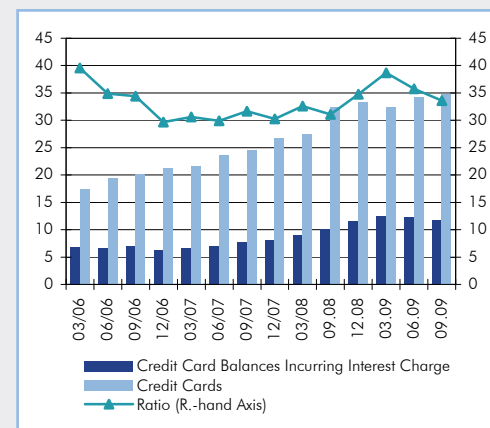
Source: BRSA-CBRT

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

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

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

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

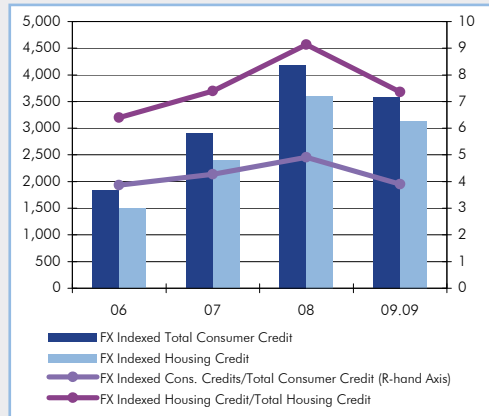
Chart I.39. Credit Card Balances of Deposit Banks and Balances That Incur Interest Charge (Billion TL, %)

Source: CBRT

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

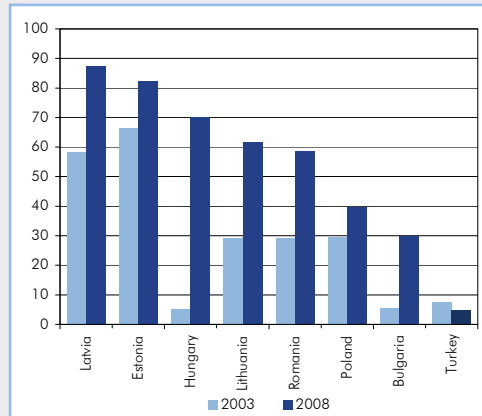
Credit card balances were still on the rise as of September 2009. Credit card balances incurring interest charges went down by 6.8 percent to TL 11.7 billion in September compared to March 2009. The ratio of credit card balances incurring interest charges to total credit card balances, which was 38.7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

Chart I.40.
FX Indexed Consumer Credits and FX Indexed Housing Credits¹ (Million TL, %)



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

Chart I.41.
FX Retail Loans in Total Retail Loans for Selected Countries¹ (%)

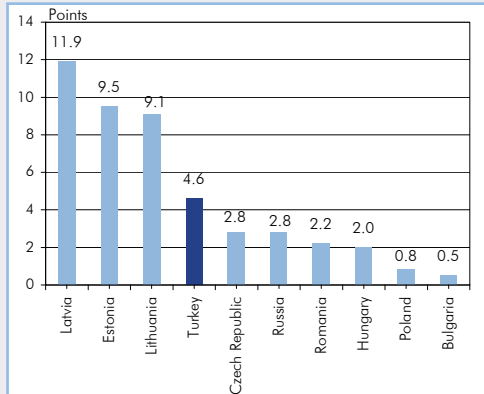


Source: CBRT, Central Bank of Hungary Financial Stability Report, April 2009
(1) FX indexed retail loans are used for Turkey.

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

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

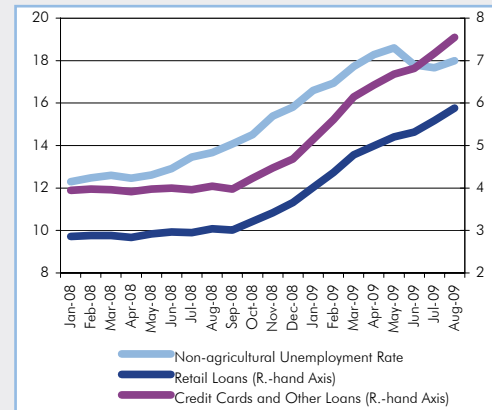
Chart I.42.
Rise in Unemployment Rate for Selected Countries (June 2009– June 2008)¹



Source: IMF

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

Chart I.43.
Unemployment and NPL Ratios (%)¹



Source: BRSA-CBRT, TURKSTAT

(1) Seasonally adjusted non-agricultural unemployment rate.

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

Table I.7. Number of Consumer Loan and Credit Card Defaulters¹

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

Source: CBRT

(1) Customers with more than one registry to a particular financial institution group are counted only once.

(2) Represents non-performing loans taken over by asset management companies from the SDFI and banks.

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

(4) As customers may have registry to more than one financial institution group, the sum of the three rows in the table and grand total are not equal.

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

Credit card receivables scheduled for payment plans within the legal period of 60 days stipulated in the Provisional Article 5 of Law No. 5464 amounted to approximately TL 1 billion; and the number of customers became 421 thousand. Some banks voluntarily extended the application period for debt structuring, which was due on 4 September 2009, until year-end, albeit variations among banks. Thus, by the end of October 2009, total credit card receivables scheduled for payment plans and the number of customers rose to TL 1.3 billion and 543 thousand, respectively (Table I.8).

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

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

Source: BRSA

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

Table I.9. Composition of Household Financial Assets¹ (Billion TL, %)

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

Source: BRSA-CBRT, CMB, CRA

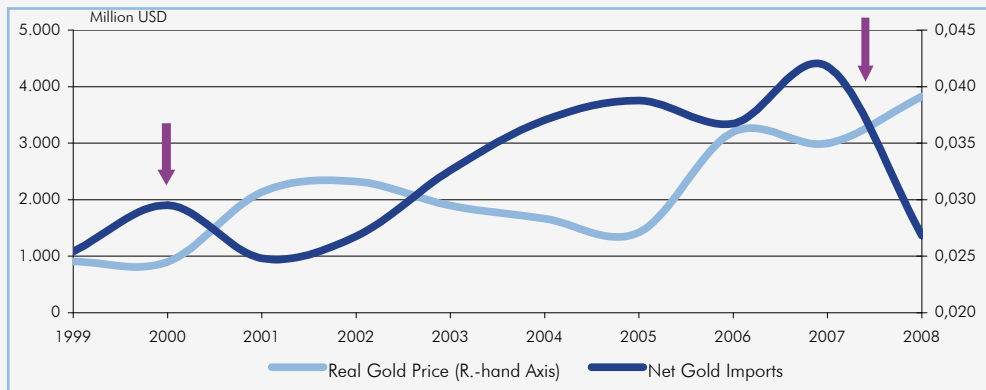
(1) TL and FX deposits include participation funds.

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

Box 8. Gold Imports and Exports

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

Chart 1. Net Gold Imports and Real Gold Prices^{1,2}



Source: CBRT

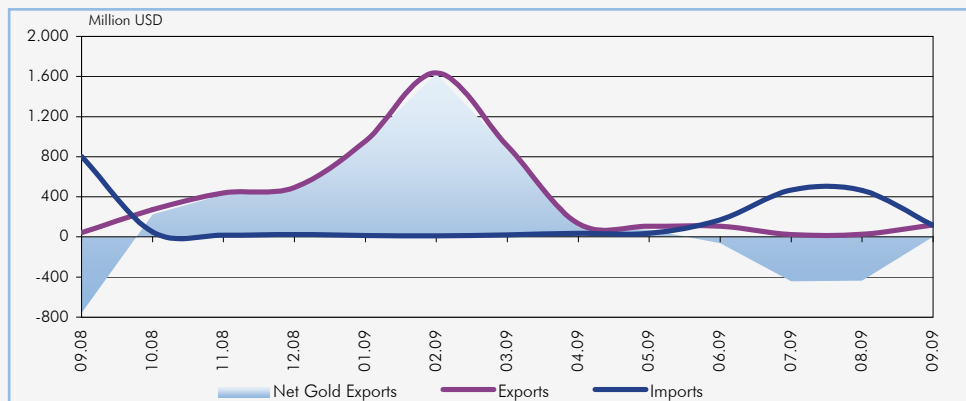
(1) Real gold prices are calculated by dividing the sale price of gold bar (TL/Gr) with the GDP deflator.

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

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

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

Chart 2. Net Gold Exports¹



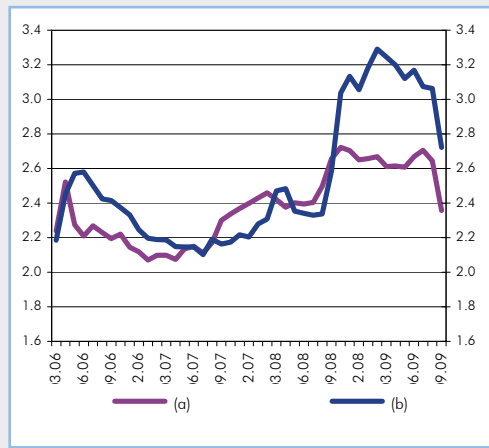
Source: CBRT

(1) Net = Gold Exports – Gold Imports

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

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

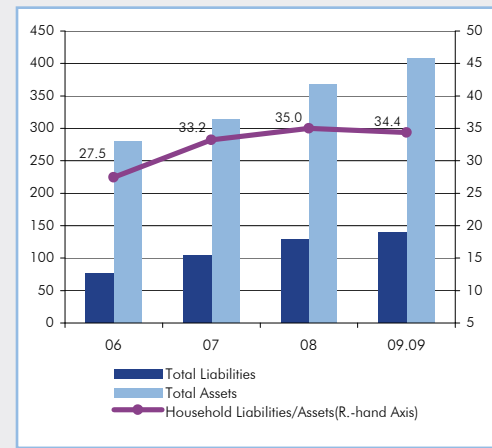
Chart I.44.
Ratio of TL-FX Denominated Investment Instruments¹



Source: BRSA-CBRT, CMB, CRA

(1) TL Instruments = Deposits + Repos + Gov.Dom.Debt.Sec. + Participation Funds (TL) + Stocks + Private Pension Funds + Mutual Funds (starting from April 2006); FX Instruments = FX Deposits + Gov.Dom.Debt.Sec. + Eurobond + Participation Funds (FX).
(a) Current TL value of FX deposits and Participation Funds (FX).
(b) For FX deposits and Participation Funds (FX), exchange rate prevailing on 31.12.2004 is used and the parity effect is eliminated.

Chart I.45.
Households' Financial Assets and Liabilities (Billion TL, %)¹



Source: BRSA-CBRT, CMB, CRA

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

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

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

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

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

I.4.2. Corporate Sector

I.4.2.1. Financial Analysis

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

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

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

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

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

Source: ISE

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

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



Source: ISE

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

Table I.11. Profitability Rates¹ (%)

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

Source: ISE
¹Annualized ROA and ROE.

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

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

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

Table I.12. Indebtedness Ratios¹ (%)

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

Source: ISE

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

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

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

Table I.13. Non-Performing Loan Ratios for Firms (%)^{1,2,3}

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

Source: CBRT

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

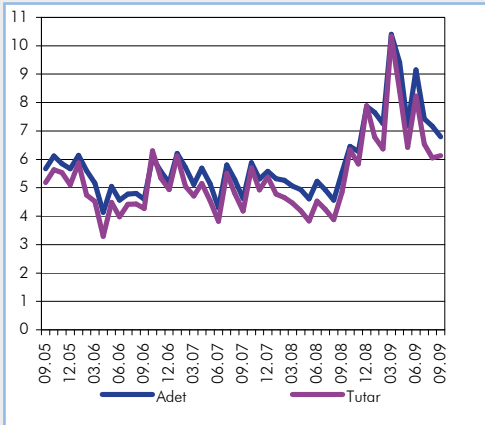
(2) Financial Intermediation as a sector is excluded

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

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

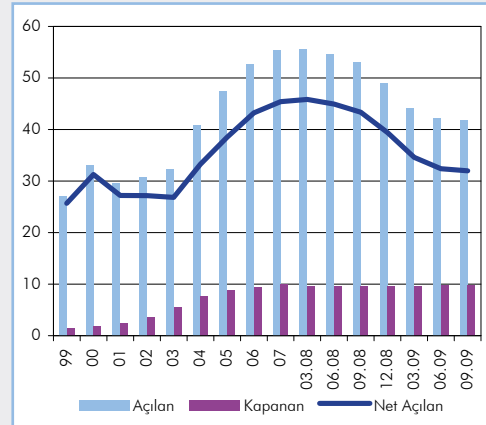
Tobacco Industry”, “Construction” and “Textile and Textile Products Industry” realized above that of the average of the selected 10 sectors (Table I.13).

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



Source: CBRT

Chart I.48.
Number of Newly Established and Liquidated Companies and Cooperatives (Bin adet)¹

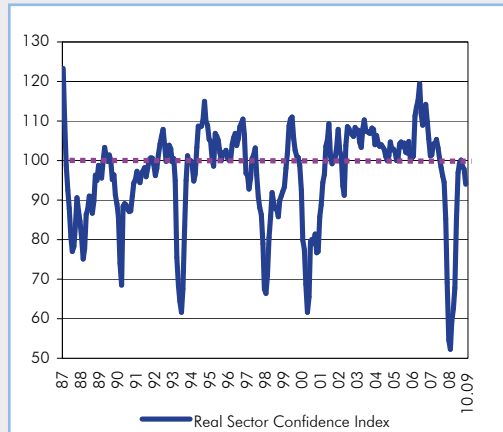


Source: TURKSTAT

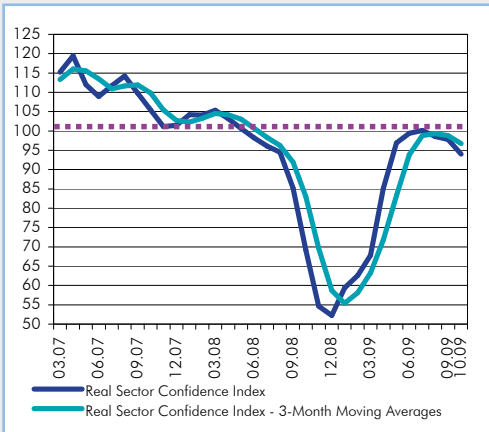
¹) Annualized data is used.

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

Chart I.49.
Real Sector Confidence Index



Source: CBRT



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

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

1.4.2.2. Borrowing Structure of the Corporate Sector

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

Table I.14. Financial Debt of the Corporate Sector¹ (Milyon TL)

	2006	2007	2008	03.09	06.09	09.09
Corporate Sector Loans (I+II)	202,315	246,679	346,912	352,436	341,314	339,633
I. Domestic Loans (i+ii)	125,385	153,322	193,223	190,399	191,988	197,215
i. TL	83,761	105,783	123,203	120,221	127,403	131,967
ii. FX (including FX-indexed)	41,624	47,539	70,020	70,178	64,585	65,248
In USD Terms	29,613	41,007	46,011	42,068	42,359	44,176
II. External Loans	76,930	93,356	153,690	162,037	149,326	142,418
In USD Terms (A+B)	54,731	80,528	100,992	97,133	97,938	96,424
A. Short Term	1,218	1,013	1,468	1,462	1,319	965
B. Long Term (a+b+c+d)	53,513	79,515	99,524	95,671	96,619	95,459
a. Official Creditors (Gov. and Multilateral Org.)	2,316	2,753	2,996	2,932	3,140	2,861
b. Foreign Branches and Affiliates of Resident Banks	17,282	26,951	36,914	35,169	34,986	33,480
c. Nonresident Com. Banks and Nonbank Fin. Corp.	28,735	42,992	51,364	49,650	50,334	51,014
d. Nonfinancial	5,180	6,819	8,250	7,920	8,159	8,104
Total FX Loans² (Million USD)	84,344	121,535	147,003	139,201	140,297	140,600

Source: BRSA-CBRT

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

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

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

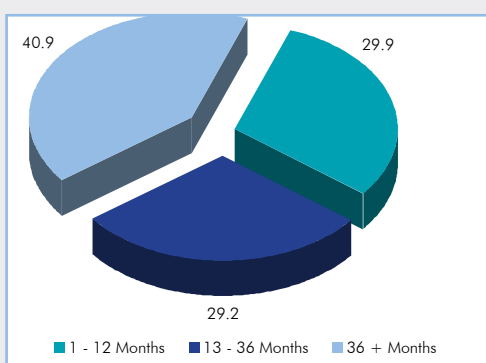
Table I.15.
Sectoral Breakdown of the Remaining Maturity Composition of Long-Term Loans Received from Abroad by Corporate Sector (Million USD)

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

Source: CBRT

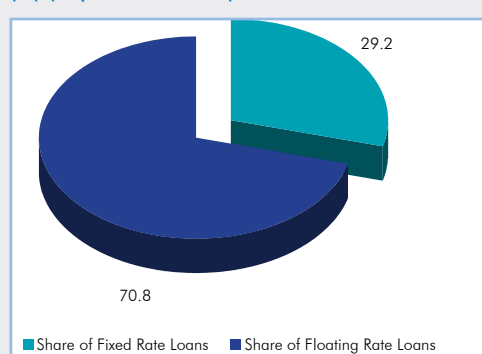
The services sector has the largest share with 57.2 percent in long-term loans received by the corporate sector from abroad. The loans of real estate, renting and the business services sector and the transportation, storage and communication sector, which have a significant share in the services sector,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

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



Source: CBRT

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



Source: CBRT

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

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

1.4.2.3. Foreign Exchange Position of the Corporate Sector

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

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

Table I.16.
FX Assets and Liabilities of Corporate Sector^{1,2}(Million USD)

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

Source: CBRT

(1) Amounts in the table may be different from those published in the preceding issues due to the updates of the data.

(2) Data on non-financial public enterprises is not included.

(3) Participation funds in participation banks are included.

(4) "Deposits-Foreign Banks" data covers the data of foreign branches of the banks established in Turkey. On the other hand, it should be taken into consideration that the deposits of real persons and non-bank financial institutions may be included in this data. June 2009 data is provisional.

(5) Funds extended by participation banks are included.

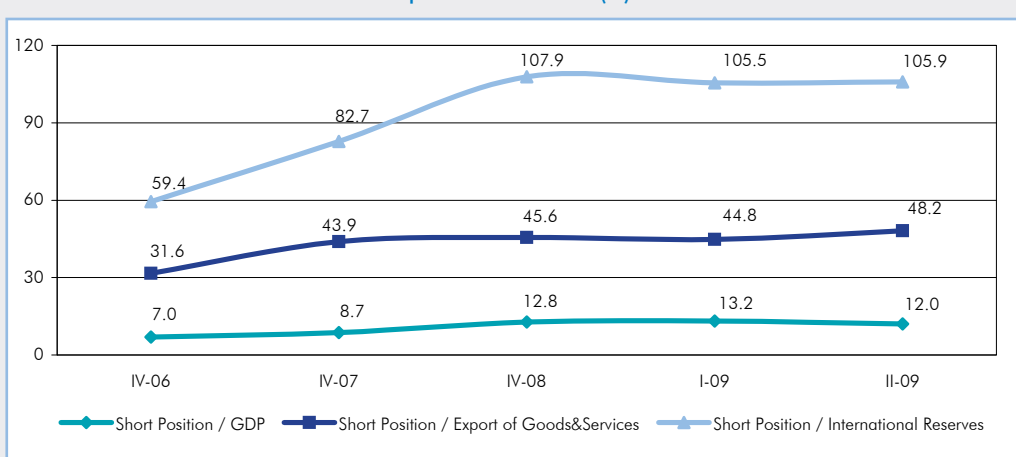
(6) FX indexed loans are included.

(7) It consists of leasing, factoring and consumer finance companies.

(8) Loans extended by foreign branches of the banks established in Turkey are included.

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

Chart I.52.
Ratios Related to FX Position of the Corporate Sector^{1,2,3} (%)



Source: CBRT, TURKSTAT

(1) GDP and exports of goods & services are computed on a yearly basis. International reserves are outstanding amounts at the end of period.

(2) International reserves are gross foreign exchange reserves of CBRT (including gold).

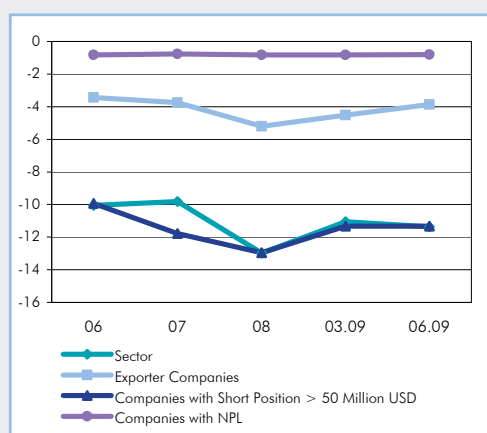
(3) The short position is converted into TL using the foreign exchange rate of the related period and divided by GDP.

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

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

This section analyzes the foreign exchange positions and credit obligations of corporate sector firms listed on the ISE to the banking sector. The analysis covers 184 non-financial firms⁴ whose financial statements are published by the ISE and which disclose their foreign exchange positions in their balance-sheet footnotes, and do not include any financial institutions in their consolidated financial statements.

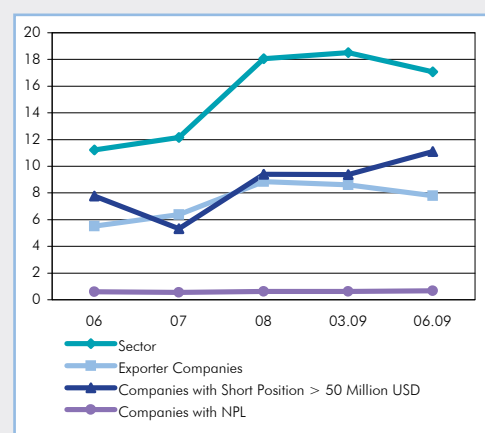
Chart I.53.
FX Position of ISE Companies^{1,2} (Billion USD)



Source: ISE

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

Chart I.54.
Cash Loans Extended to ISE Companies¹
(Including NPL, Billion TL)



Source: CBRT

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

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

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

⁴ Firms that are consolidated under another company, the shares of which are publicly traded at ISE, have not been re-included in the analysis. Moreover, firms, functional currency of which is foreign currency, are excluded from the exchange rate risk analyses.

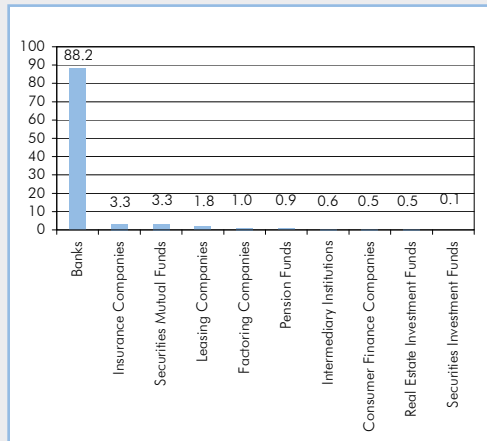
Total loans including NPL of firms analyzed fell by 5.4 percent to TL 17.1 billion in June 2009 compared to end-2008 (Chart I.54).

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

II. STRUCTURE OF THE FINANCIAL SECTOR

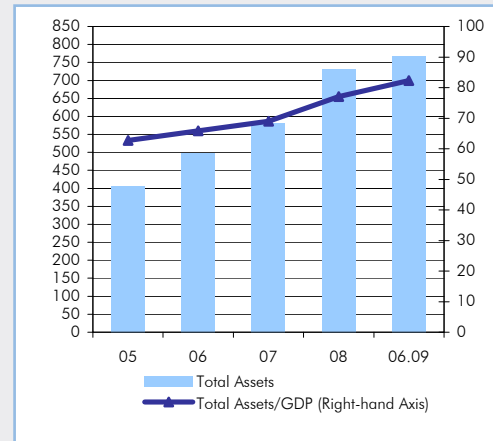
The Turkish financial sector maintained its growth trend in the first half of 2009, as well.

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



Source: BRSA, CBRT, Associ. of Capital Market Intermediary Institutions, CMB
(1) Figures are as of June 2009.

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



Source: BRSA-CBRT, TURKSTAT

The total asset size of the financial sector, which grew by 5.3 percent compared to the end of the previous year, reached TL 871 billion by the first half of 2009. 88.2 percent of financial sector assets belong to banks (Chart II.1).

II.1. Banking Sector

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

In August 2009, the number of banking sector staff reduced by 882 compared to end-2008 to become 181,788, whereas in September 2009, the number increased to 182,226. The number of banks, which was 49, remained unchanged.

In September 2009, the total asset size of the banking sector grew by 6.7 percent in real terms compared to the end of previous year and reached TL 798 billion, while it climbed by 12.3 percent to 541 billion in USD terms.

The ratio of the Turkish banking sector's asset size to GDP increased to 82.3 percent in the first half of 2009 from 77.1 percent at end-2008 (Chart II.2).

Meanwhile, as of September 2009, the concentration ratios of the first five banks and the first ten banks were realized as 60 percent and 83 percent, respectively, and these ratios remained unchanged in comparison to the end of 2008.

Table II.1 Indicators of the Banking Sector's Financial Depth and Intermediation Function^{1,2,3}

Years	Deposits/GDP	Loans/GDP	Loans/Deposits
2005	38	25	66
2006	40	30	74
2007	42	35	83
09.08	44	39	89
2008	47	40	84
06.09	50	41	83

Source: BRSA-CBRT, TURKSTAT

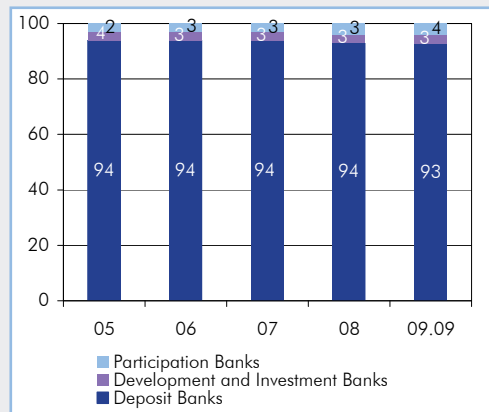
(1) Non-performing loans are included in loans.

(2) Deposits include participation funds, loans include funds extended by participation banks.

(3) Due from banks and due to banks are excluded.

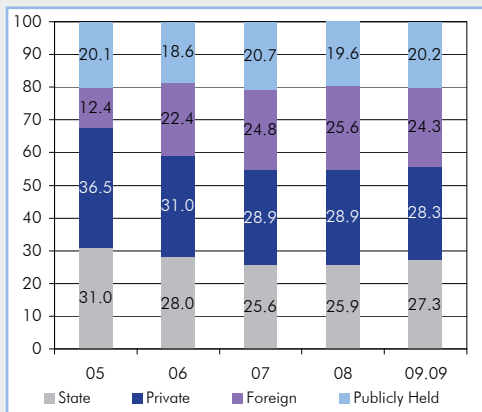
The ratios of deposits and loans to GDP, which reveal the financial depth and intermediation level of the banking sector, kept increasing; while the ratio of loans to deposits decreased. (Table II.1)

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



Source: BRSA-CBRT

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



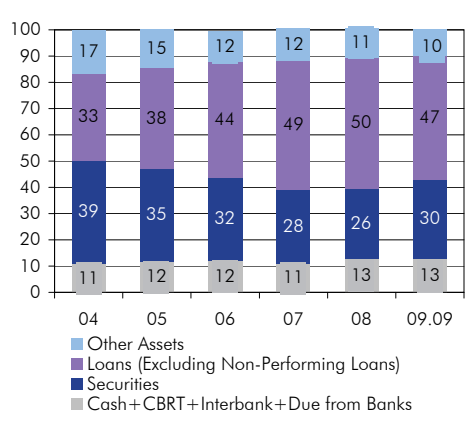
Source: BRSA-CBRT

(1) For publicly held shares no distinction is made between domestic and foreign investors

By September 2009, of the 49 banks in the Turkish banking sector, 32 are deposit banks, 13 are development and investment banks and 4 are participation banks, thus pointing to the prevalence of deposit banking in the Turkish banking sector (Chart II.3).

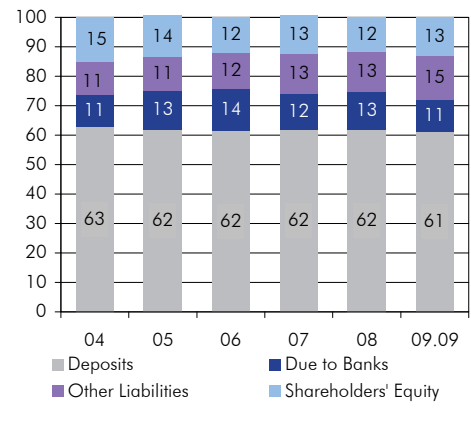
Based on their share in paid-up capital, the share of foreign stockholders in assets, which was 25.6 percent at end-2008, was realized as 24.3 percent in September 2009 (Chart II.4). Meanwhile, according to data of the Central Registry Agency, when the share of foreign participation in publicly held shares, which stood at 17.5 percent, are included, the share of foreign participation in the banking sector reaches 41.8 percent.

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



Source: BRSA-CBRT

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



Source: BRSA-CBRT

Loans, having the largest share in asset items, decreased by 3 points compared to end-2008, while the share of securities increased by 4 points to 30 percent as of September 2009 (Chart II.5).

As of September 2009, the share of deposits as the largest source of external funds increased by 1 point and the share of due to banks decreased by 2 points compared to end-2008, whereas the share of equity and other liabilities increased by 1 point and 2 points, respectively (Chart II.6).

II.2. Banking Sector Profitability and Capital Adequacy

II.2.1. Profitability^{1,2}

Net profit of the sector was TL 15.1 billion in the first 9 months of 2009, after having increased by 42.3 percent over the same period of the previous year.

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

	09.08	09.09	Change (%)
I. Operating Income (A+B)	32,339	42,954	32.8
A- Net Interest Income	21,928	29,924	36.5
B- Non-Interest Income ¹	10,411	13,030	25.2
II. Non-Interest Expenses (C+D)	19,981	24,953	24.9
C- Prov. for Credits and Other Receiv.	5,239	9,658	84.3
D- Other Operating Expenses	14,742	15,295	3.7
III. Net Operating Profit (I-II)	12,357	18,001	45.7
IV. Other Income ²	957	756	-24.5
V. Provision for Taxes	2,681	3,621	22.6
VI. Net Profit (III+IV-V)	10,633	15,136	42.3

Source: BRSA - CBRT

(1) Non-Interest Income=Net fees and Commissions Income (including Banking Services Income) + Dividend Income + Net Trading Income (Loss) + Other Operating Income

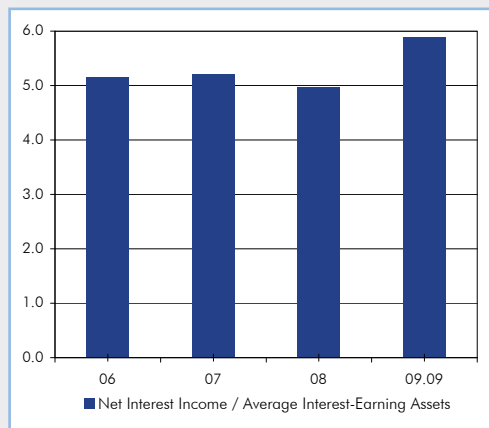
(2) Other Income = Profit Share Received Excluding Dividend Income + Extraordinary Income (Expenses)

¹ Due to variations in operating principles, assessments in this section do not include participation bank.

² The bank taken over by SDFI is not included.

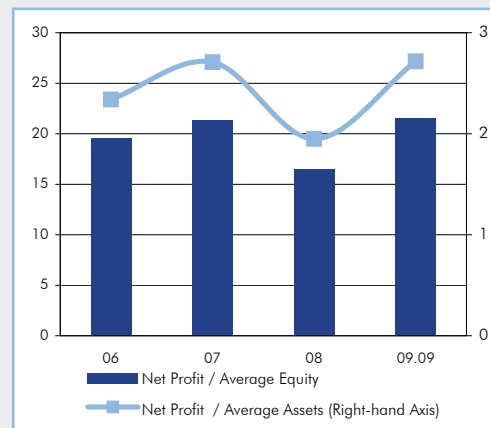
In September 2009, operating income was instrumental in the surge of banking sector profits; and the increase in operating income was essentially driven by net interest income. Besides, the increase in net trading income resulting from the increase in profits obtained from capital market transactions due to the rise in profits in securities purchases and sales also pushed up non-interest income. Meanwhile, the significant surge in provisions for credits and other receivables continue to hamper profitability. The rise in non-performing loans is expected to further affect profitability adversely in the rest of 2009 (Table II.2).

Chart II.7.
Net Interest Margin (%)



Source: BRSA-CBRT

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

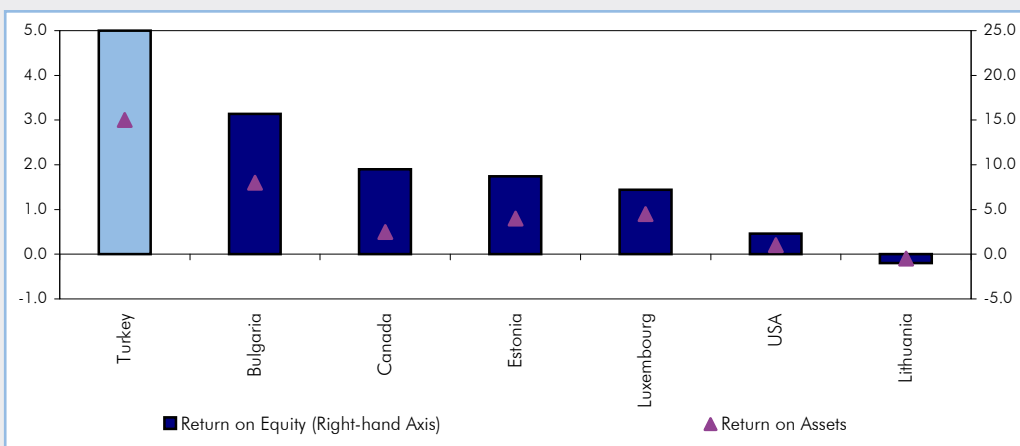


Source: BRSA-CBRT

The ratio of net interest income to average interest-earning assets, which was 5 percent at end-2008, went up to 5.9 percent in September 2009 (Chart II.7). This rapid increase is mainly attributable to the decline in funding costs due to the Central Bank’s policy rate cuts along with the increase in net interest income as the said rate cuts were not reflected on interest on loans at the same rate.

As of September 2009, the return on assets and the return on equity of the banking sector displayed a remarkable increase compared to end-2008 and was realized as 2.7 percent and 21.6 percent, respectively (Chart II.8).

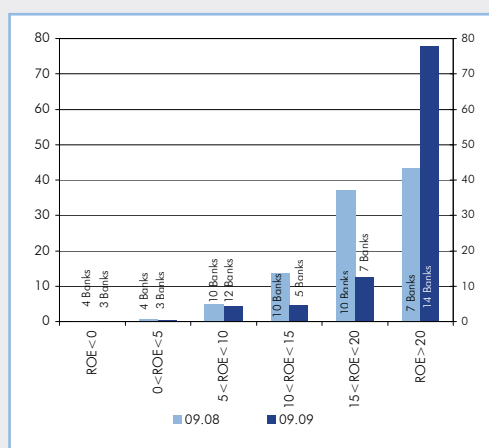
Chart II.9.
Return on Assets and Equity by Selected Countries (March 2009) (%)



Source: Global Financial Stability Report, IMF-October 2009

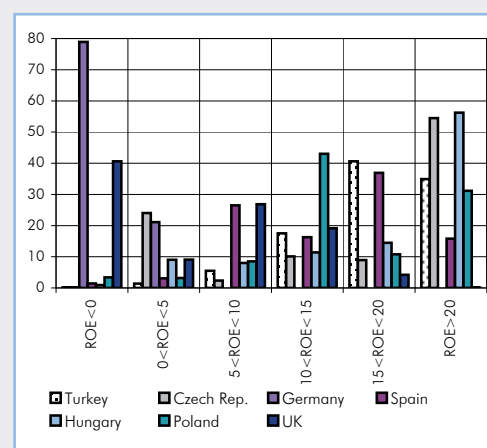
A comparison of the Turkish banking sector with selected countries for the March 2009 period suggests that both return on assets and return on equity perform well on the Turkish side (Chart II.9).

Chart II.10.
Return on Equity Based on Asset Share (%)



Source: BRSA-CBRT

Chart II.11.
Return on Equity Based on Asset Share by Selected Countries (%) (December 2008)



Source: BRSA-CBRT, EU Banking Sector Stability, ECB, August 2009

A comparison of September 2009 and September 2008 indicates that the number of banks with return on equity above 15 percent rose from 17 to 21; while their share within total assets went up from 80.6 percent to 90.3 percent. On the other hand, the surge in asset share of banks with return on equity above 20 percent is more remarkable. The number of banks declaring losses went down from 4 to 3 (Chart II.10).

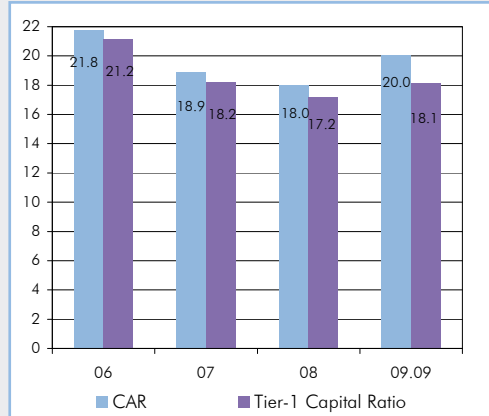
A comparison between asset shares in terms of return on equity of banks in selected countries suggests that the asset share of banks with a return on equity above 15 percent is far too high in Turkey compared to both developed and developing countries. While the asset share of banks declaring losses stood at 0.1 percent in Turkey and the Czech Republic, it emerged higher in other countries (Chart II.11).

The surge in both net interest income and net trading income due to the decline in interest rates in the first nine months of 2009 had a favorable effect on the sector's profitability. Nevertheless, competition in credit granting among banks that has spilled over onto prices and expected hikes in non-performing loans lead to anticipation that the sustainability of a similar performance in profits in 2010 is highly unlikely.

II.2.2. Capital Adequacy

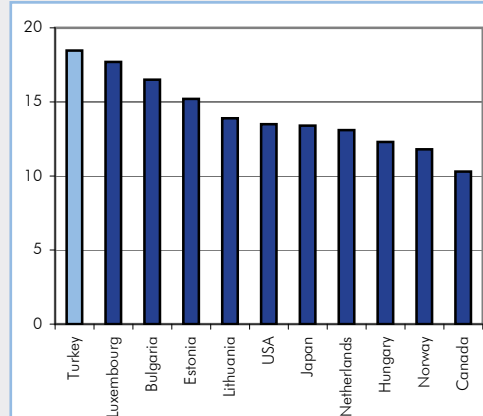
The unconsolidated capital adequacy ratio (CAR) of the banking sector, which is the ratio of own funds to total exposure stemming from credit, market and operational risks, is above both the minimum requirement of 8 percent and the target ratio of 12 percent for all periods under review.

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



Source: BRSA-CBRT

Chart II.13.
CAR by Selected Countries (March 2009)



Source: Global Financial Stability Report, IMF-October 2009

Although the CAR of the banking sector displayed a decrease in 2007 and 2008 due to not only the convergence process to Basel II but also the growth in loans, it went up by 2 points in September 2009 compared to end-2008 and reached 20 percent (Chart II.12). This essentially stemmed from high profitability and the strengthening of own funds due to the effect of the Securities Revaluation Fund.

In September 2009, the tier-1 capital ratio, which is the ratio of core capital to total exposure stemming from credit, market and operational risks, also displayed a similar tendency and became 18.1 percent with an increase of 0.9 points compared to end-2008 (Chart II.12).

In spite of the negative impact of the global crisis, the CAR of the banking sector maintained its high level in comparison with the selected countries (Chart II.13). Particularly in developed economies, in a period when the capital erosion of banks due to the consequences of the crisis was overcome through capital increase and/or government support, the Turkish banking sector did not need any capital support.

Table II.3. The Ratio of Capital Intervention by Government to GDP by Selected Countries

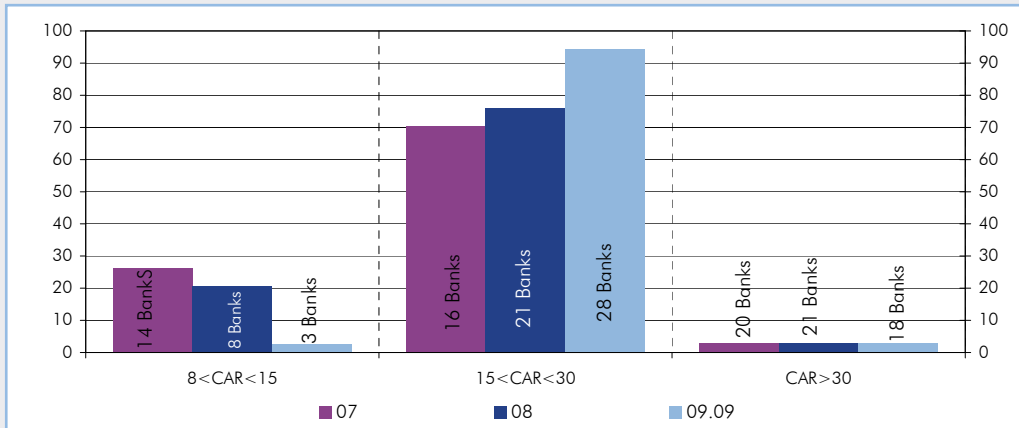
Countries	Recapitalization (%)
Euro Area ¹	1.82
Japan	0.02
Sweden	1.95
Switzerland	1.06
UK	2.19
USA	3.19

Source: Global Financial Stability Report, IMF- October 2009

(1) GDP-weighted composite of Austria, France, Germany, Greece, Ireland, Italy, Netherlands, and Spain

Capital interventions of countries to their financial sectors added up to an enormous amount. To exemplify, capital support granted in the USA by the government reached 3.19 percent of the national income (Table II.3).

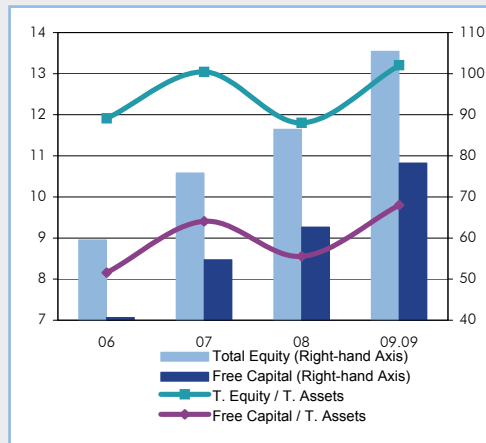
Chart II.14.
Asset Share of Banks Based on Capital Adequacy Ratio (%)



Source: BRSA-CBRT

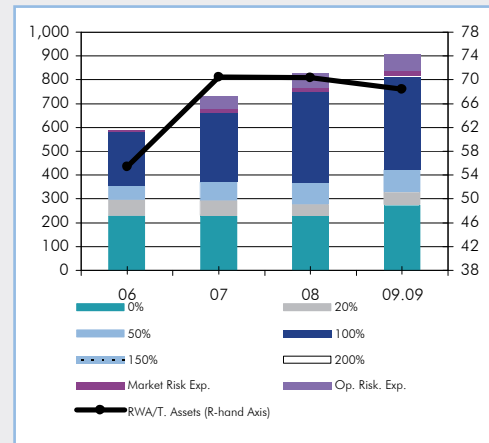
The CAR of 42 banks, which held 79.2 percent of sector assets, remained above 15 percent at end-2008; whereas that of 46 banks holding 97.4 percent of sector assets realized above 15 percent in September 2009 (Chart II.14). Meanwhile, shares of sector assets of banks with CARs between 8 and 15 percent fell from 20.8 percent to 2.6 percent.

Chart II.15.
Free Capital of the Banking Sector
(%, Billion TL)



Source: BRSA-CBRT

Chart II.16.
Composition of Total Risk Exposure
(Billion TL, %)



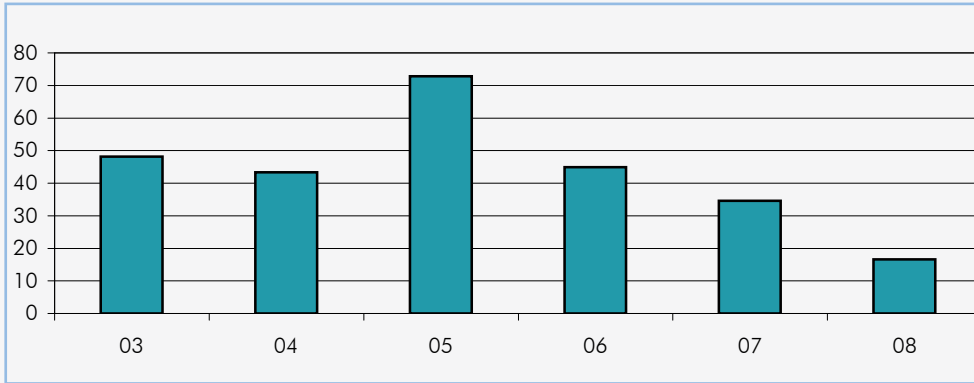
Source: BRSA-CBRT

The ratios of free capital to total assets and total shareholders' equity to total assets indicated an increase in September 2009 compared to the figures of end-2008. The surge in free capital, despite the rise in NPLs, signifies the high quality of the banking sector's capital (Chart II.15).

The ratio of total exposure stemming from credit, market and operational risks to total assets decreased from 70.4 percent at end-2008 to 68.4 percent in September 2009 (Chart II.16).

Box 9. Dividend Payout Ratio of Deposit Banks

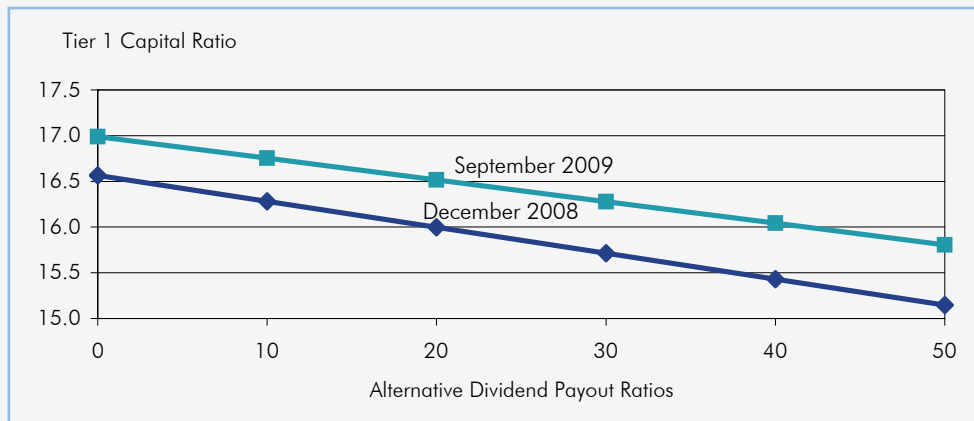
Chart 1. Dividend Payout Ratio of Deposit Banks (%)



Source: BRSA-CBRT, Audit Reports of Banks

For deposit banks, dividends paid amounted to TL 2 billion at end 2008, decreasing by 57.1 percent compared to the end of the previous year. The dividend payout ratio of deposit banks decreased from 34.6 percent at end-2007 to 16.6 percent at end-2008 (Chart 1). The global crisis has reinforced the significance of maintaining a strong capital structure for banks. In this respect, banks' retaining their profits is regarded as a positive development.

Chart 2. Effects of Alternative Dividend Payout Ratios on Tier 1 Capital Ratio (%)



Source: BRSA-CBRT, Audit Reports of Banks

The effects of a partial dividend payment or total suspension of dividend payments from profits of 2007 and 2008, on the tier 1 capital ratio of deposit banks, were analyzed. Accordingly, a total suspension of 2007 dividend payments would have increased the tier 1 capital ratio by 1 percentage point in 2008, from 15.6 percent to 16.6 percent.

The total suspension of dividend payments from the profit for end-2008 would have increased the tier 1 capital ratio from 16.6 percent to 17 percent as of September 2009, while the 50 percent dividend payment from profit for 2008 would have decreased the tier 1 capital ratio to 15.8 percent (Chart 2).

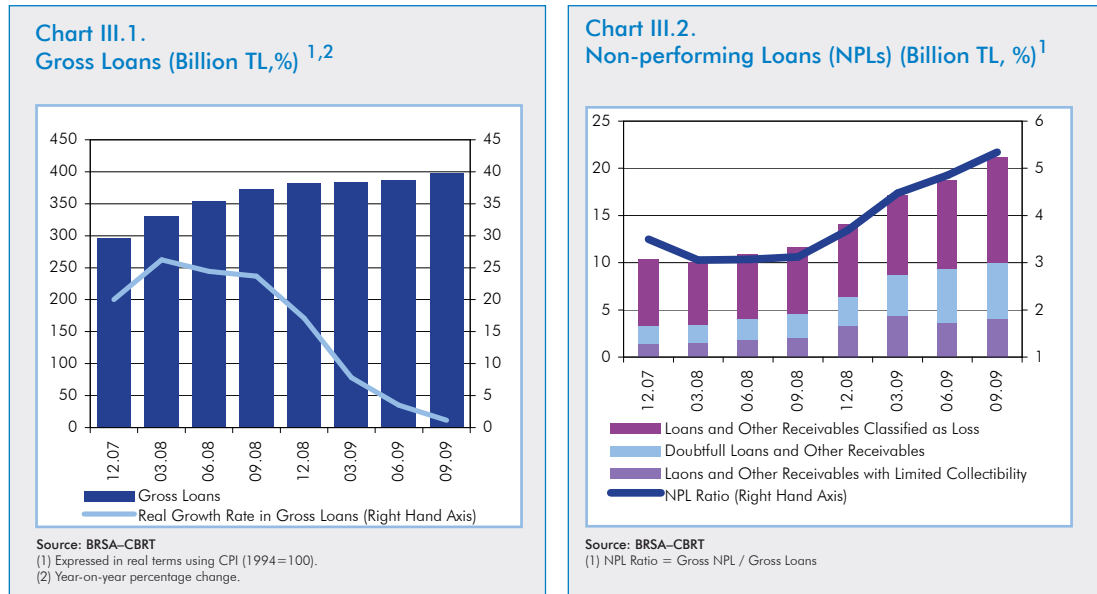
III. BANKING SECTOR RISKS

III.1. Credit Risk and Scenario Analysis

III.1.1. Credit Risk

The growth rate of credits decreased due to tighter credit conditions and a slowdown in economic activity stemming from the global economic crisis.

Nonetheless, a recovery, albeit limited, has recently been observed in loans as a result of the impact of cumulative policy rate cuts since the last quarter of 2008 on market interest rates, liquidity measures and the improvement in risk perceptions.



Credit volume reached TL 396.9 billion by September 2009 (Chart III.1). As a result of the decline in purchasing power of the corporate sector and households, the amount of non-performing loans reached TL 21.2 billion in September 2009 and the NPL ratio became 5.3 percent. An analysis of the breakdown of non-performing loans reveals that the “Loans and Other Receivables Classified as Loss” group had the largest share (Chart III.2).

Table III.1. NPL Ratios in Selected Countries

	2006	2007	2008	2009	Latest data
Brazil	3.5	3.0	3.1	4.3	May
Bulgaria	2.2	2.1	2.4	3.2	March
Czech Republic	3.7	2.8	3.3	4.4	June
Croatia	5.2	4.8	4.9	6.0	June
Serbia	4.1	3.8	5.3	9.7	June
Hungary	2.5	2.5	3.0	4.8	June
Latvia	0.4	0.4	3.6	10.7	May
Lithuania	1.0	1.0	4.6	11.3	June
Poland	7.4	5.2	4.4	5.7	April
Romania	8.0	9.7	13.8	-	December
Russia	2.4	2.5	3.8	7.6	June
UK	0.9	0.9	1.6	-	December
USA	0.8	1.4	3.0	3.8	March
Turkey	3.8	3.5	3.6	5.3	August

Source: IMF Global Financial Stability Report, October 2009.

A comparative analysis of NPL ratios in selected countries shows that, with the effect of the crisis, this ratio has significantly increased in most countries, similar to the trend in Turkey (Table III.1).

Table III.2. Selected Credit Ratios¹ (Million TL, %)

	2007	09.08	2008	09.09
First 5 Banks				
Total Gross Loans	162.452	204.063	211.543	211.313
Share in Total Gross Loans	54,9	54,8	55,5	53,2
NPLs / Total Gross Loans	3,8	3,1	3,7	5,4
Loans / Deposits	88,8	93,6	89,4	83,8
Provision/NPL	89,5	84,3	84,8	88,1
First 10 Banks				
Total Gross Loans	236.833	298.601	309.321	318.576
Share in Total Gross Loans	80,0	80,1	81,1	80,3
NPLs / Total Gross Loans	3,6	3,0	3,5	5,1
Loans / Deposits	77,2	82,6	79,0	75,8
Provision/NPL	89,4	84,2	83,5	84,9
Sector				
Total Gross Loans	295.962	372.717	381.497	396.933
NPLs / Total Gross Loans	3,5	3,1	3,7	5,3
Loans / Deposits	82,9	89,0	83,9	81,2
Provision/NPL	86,8	80,5	79,8	80,0

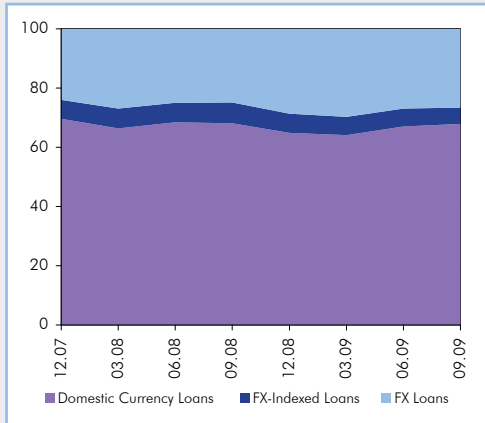
Source : BRSA-CBRT

(1) The first 5 and 10 banks ranked according to their gross loans.

80.3 percent of total loans as of September 2009 were extended by the first 10 banks. The loans to deposits ratio of the banking sector has been declining since the last quarter of 2008. The loans to deposits ratio, which reached 89 percent in September 2008 as its highest level, came

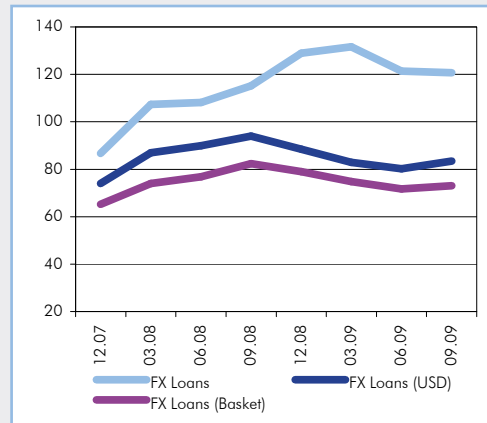
down to 81.2 percent, marking a 7.8 point fall. While the share of the first 5 and 10 banks in terms of total credits has been declining, that of other banks has been increasing (Table III.2).

Chart III.3.
Currency Composition of Loans
(%, Excluding NPLs)



Source: BRSA-CBRT

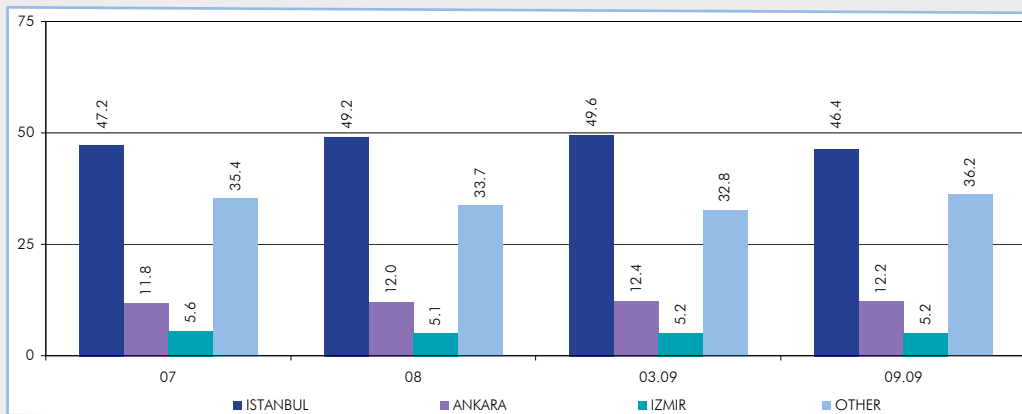
Chart III.4.
FX Loans
(Billion, Excluding NPLs)^{1,2}



Source: BRSA -CBRT
(1) Converted to USD using the CBRT buying exchange rates as of month-end.
(2) FX basket is composed of 70 percent of the USD buying exchange rate and 30 percent of the Euro buying exchange rate.

67.9 percent of total loans extended in September 2009 were Domestic Currency Loans while 26.6 percent were FX loans and 5.5 percent FX-indexed loans. While the rise in the share of FX-loans in the September 2008-March 2009 period was mainly driven by the depreciation of TL, FX-loans in terms of USD and based on the FX-basket reveals that there has been a decline compared to September 2008 (Chart III.3 and Chart III.4).

Chart III.5.
Distribution of Loans by Provinces (%)¹

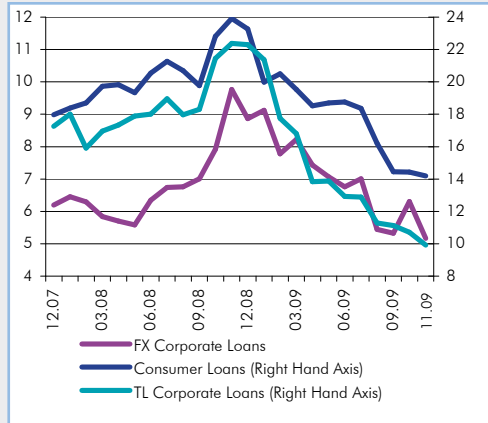


Source: CBRT

(1) Loans are compiled based on bank reporting under the scope of Central Bank Law No:1211, Article:44. They include corporate loans greater than 10 thousand Turkish Liras (inclusive) and retail loans greater than 5 thousand Turkish Liras (inclusive); extended to real and legal bodies by banks (including external loans used by firms with the intermediation of banks). They are inclusive of non-performing loans and accrued interest and exclusive of non-cash loans. Since October 2007, NPL's are being disclosed on the basis of firms without being subject to any limits.

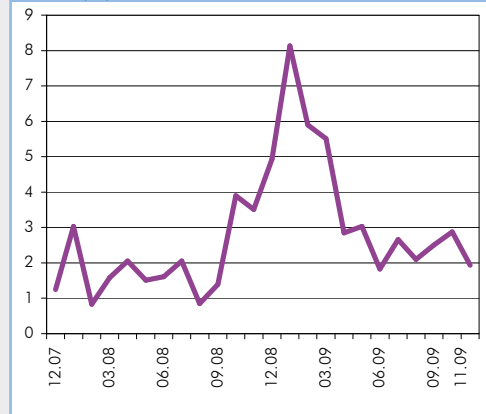
The geographical breakdown of loans shows that the share of Istanbul in total loans decreased while the shares of Ankara, Izmir and other provinces increased in September 2009 compared to end-2008 (Chart III.5).

Chart III.6.
Loan Interest Rates (%)^{1,2}



Source: CBRT
(1) Weighted average flow interest rate.
(2) November 2009 data is as of 6 November 2009.

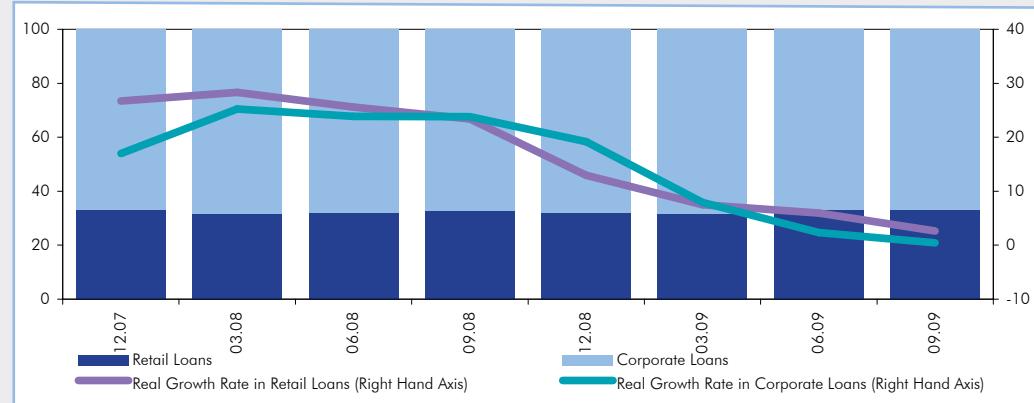
Chart III.7.
Spread between Corporate Loan and Deposit Rates (%)^{1,2}



Source: CBRT
(1) Weighted average flow interest rate.
(2) November 2009 data is as of 6 November 2009.

Although the effects of the increased funding costs of the banking sector and adverse expectations about economic activity brought about an increase in loan rates in October 2008, these rates have decreased as an effect of the interest rate cuts of the CBRT and fell even below the September 2008 level (Chart III.6). The spread between corporate loan and deposit rates, an indicator of the tightness in credit conditions, which climbed till February 2009, decreased till June 2009 due to the improvement in risk perceptions and economic recovery, and followed a stable trend afterwards (Chart III.7).

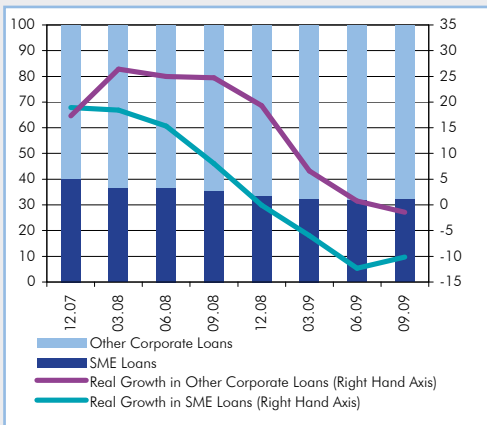
Chart III.8.
Breakdown of Gross Loans and Real Growth Rates (%)^{1,2}



Source: BRSA - CBRT
(1) Expressed in real terms using CPI (1994=100).
(2) Annual percentage change as compared to the same period of last year.

As of September 2009, 33.1 percent and 66.9 percent of total loans were composed of retail loans and corporate loans, respectively. While the slowdown in growth rate of total loans mainly stemmed from corporate loans, the annual real growth rate of retail loans and corporate loans decreased to 2.6 and 0.5 percent, respectively, as of September 2009 (Chart III.8).

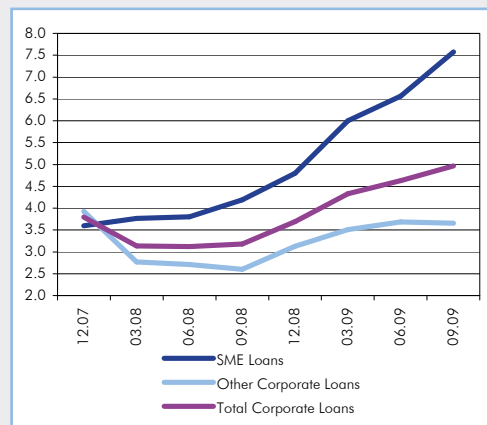
Chart III.9.
Corporate Loans by Type (Excl. NPLs, %)^{1,2}



Source: BRSA –CBRT

- (1) Growth rates were brought to real terms by using CPI (1994=100).
(2) Annual percentage change as compared to the same period last year.

Chart III.10.
NPL Ratios of Corporate Loans (%)^{1,2}



Source: BRSA –CBRT

- (1) NPL Ratio = Gross NPL / Gross Loans
(2) Other corporate loans calculated by subtracting SMEs from total corporate loans.

Due to the global liquidity squeeze and tighter credit conditions, the amount of corporate loans decreased to TL 252.4 billion in September 2009. The flat outlook in loans extended to Small and Medium-sized Enterprises (SMEs)³ that comprise 32.5 percent of corporate loans persists (Chart III.9). While the NPL ratio of corporate loans other than SME loans increased by 1 percentage point and reached 3.7 percent in the September 2008-September 2009 period, the same ratio for SME loans increased by 3.5 percentage point to reach 7.6 percent (Chart III.10). However, in the upcoming period, SME loans are expected to assume an upward trend and the NPL ratio of SME loans is expected to decrease, as the support provided for the Credit Guarantee Fund becomes operational.

³Enterprises that are included in the Regulation on "Definition, Properties and Classifications of Small and Medium Sized Enterprise", prepared by the Ministry of Industry and Trade and published in the Official Gazette dated 18.11.2005 and numbered 25997.

Box 10.**The Council of Ministers Decision on the Principles and Procedures of Treasury Support that will be Provided to Credit Guarantee Fund Inc.**

SMEs have encountered financial difficulties due to tightening the lending terms that resulted from the reflection of the global crisis on our country. In order to help alleviate these difficulties, a provisional article has been added to the Law on Regulating Public Finance and Debt Management No: 4749 with Law No: 5909 published in the Official Gazette dated June 24, 2009 and the Undersecretariat of Treasury is authorized to transfer cash funds of up to TL 1 billion to credit guarantee institutions that provide guarantees for loans and/or issue private placement domestic government bonds. "The Decision on Principles and Procedures of Treasury Support that will be Provided to Credit Guarantee" was published in the Official Gazette No: 27289 dated July 15, 2009, and in the framework of the mentioned decision, a protocol was signed between Credit Guarantee Fund Inc (CGF) and the Undersecretariat of Treasury on October 13, 2009. After the signing of the protocol between CGF and the banks that provide loans, the mentioned fund will come into effect as a credit guarantee.

In order to take advantage of the stated opportunity, SMEs have to fulfill the requirements in "The Decision on Principles and Procedures of Treasury Support that will be Provided to Credit Guarantee Institutions".

The loans available in these circumstances, will be TL, FX or FX indexed and will have a maturity from a minimum of six months to a maximum of four years. The amount of guarantee that will be provided is limited to TL 1 million per beneficiary and as for beneficiaries of the same risk group, it is limited to TL 1.5 million. With the provision of the mentioned fund, it is aimed to provide a guarantee to loans by the CGF in an amount equivalent to TL 10 billion in the period ahead. We are of the opinion that this amount, which is equal to almost one eighth of cash loans extended to SMEs, will provide significant support to the said firms.

Table III.3. Sectoral Composition of Corporate Loans (Excluding NPLs) ^{1,2}

		Loans			FX Loans/Total Loans		
		2007	2008	09.09	2007	2008	09.09
1	Wholesale and Ret. Trade, Brokerage, Repair of Mot. Veh.	19.7	18.1	17.1	35.6	42.9	38.1
2	Transport, Storage and Communication	8.5	8.2	8.5	58.3	62.1	59.1
3	Textile and Textile Products Industry	5.9	5.2	4.7	63.9	66.6	63.2
4	Construction	8.5	9.5	10.2	51.0	59.1	55.7
5	Industry of Tobacco, Beverages and Food	5.8	5.3	5.4	43.5	50.7	48.8
6	Manuf. of Basic Metals and Fabr. Metal Prod	5.8	6.1	5.7	70.6	71.7	69.7
7	Sources of Electricity, Gas and Water	4.1	5.0	5.5	90.3	90.9	92.5
8	Agriculture, Hunting and Forestry	5.6	5.1	5.1	24.4	25.6	20.8
9	Manuf. of Mach. and Equipment	3.2	3.0	2.7	41.7	50.6	52.9
10	Hotels and Restaurants (Tourism)	3.1	3.4	3.9	71.2	79.1	78.3
	Total of 10 Sectors	70.2	68.9	68.8	50.3	56.7	54.4

Source: CBRT

(1) Loans are compiled based on bank reporting under the scope of Central Bank Law No: 1211, Article:44. They include corporate loans greater than 10 thousand Turkish Liras (inclusive); extended to real and legal bodies; by banks (including external loans used by firms with the intermediation of banks). They are inclusive of accrued interest and exclusive of non-cash loans.

(2) Excluding Financial Intermediation

According to the Central Bank Risk Center data, the share of ten selected sectors in total corporate loans continued to decline and stood at 68.8 percent in September 2009. The sector

with the largest share in total corporate loans is “Wholesale and Retail Trade, Brokerage and Motor Vehicles Maintenance and Repair Services” with 17.1 percent. The shares of “Construction”, “Electricity, Gas and Water Sources” and “Hotels and Restaurants (Tourism)” sectors in total corporate loans increased, while the share of the “Agriculture, Hunting and Forestry” sector remained unchanged and the shares of other sectors diminished compared to the end of 2008. Again compared to end-2008, the share of FX loans in total loans decreased in September 2009 (Table III.3).

Table III.4. Sectoral Composition of NPL Ratios of Corporate Loans (%)¹

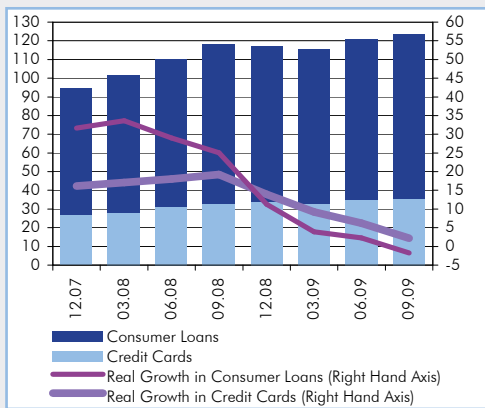
	2008	09.09
1 Textile and Textile Products Industry	10.1	12.6
2 Agriculture, Hunting and Forestry	4.2	5.9
3 Wholesale and Ret. Trade, Brokerage, Repair of Mot. Veh.	3.9	5.9
4 Industry of Tobacco, Beverages and Food	4.4	5.0
5 Hotels and Restaurants (Tourism)	2.6	3.2
6 Construction	2.6	3.9
7 Manuf. of Mach. and Equipment	2.1	2.9
8 Transport, Storage and Communication	1.7	2.4
9 Manuf. of Basic Metals and Fabr. Metal Prod	1.2	2.3
10 Sources of Electricity, Gas and Water	0.1	0.2
Total of 10 Sectors	3.4	4.6

Source: CBRT

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

According to the Central Bank Risk Center data, NPL ratios of corporate loans increased compared to the end of 2008 in all sectors analyzed. The highest rise came from the “Textile and Textile Products Industry” with a 2.5 percentage points rise in the NPL ratio (Table III.4).

Chart III.11. Retail Loans^{1,2} (Excluding NPLs, Billion TL, %)

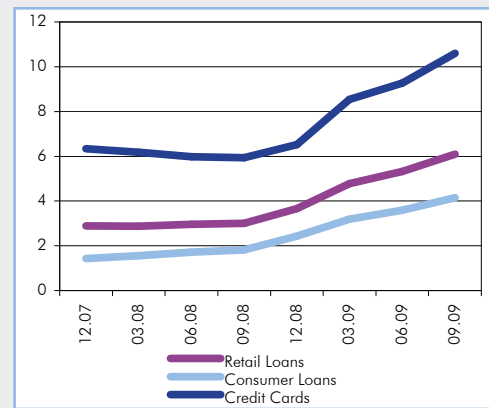


Source: BRSA - CBRT

(1) Expressed in real terms using CPI (1994=100).

(2) Year-on-year percentage change.

Chart III.12. NPL Ratios for Retail Loans (%)¹



Source: BRSA - CBRT

(1) NPL Ratio = Gross NPL / Gross Loans

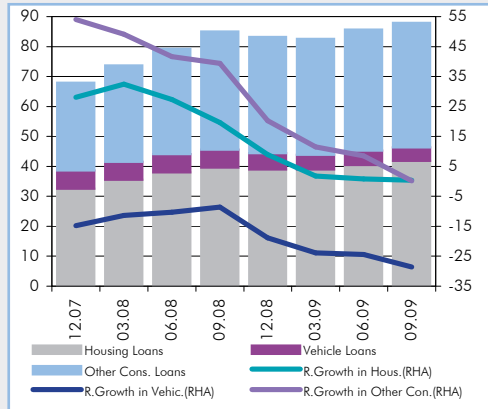
As of September 2009, retail loans amounted to TL 123.3 billion. As of the same period, consumer loans contracted by 1.8 percent in real terms year-on-year and credit cards⁴

⁴ Refers to the balance in the cash loans item, until credit card spending and cash withdrawals are paid back to the bank by the cardholders.

increased by 2.2 percent in real terms year-on-year (Chart III.11). Compared to March 2009, retail loans increased by 5.5 percent in real terms in September 2009 and this rise mainly stemmed from the temporary tax reductions on consumer durables.

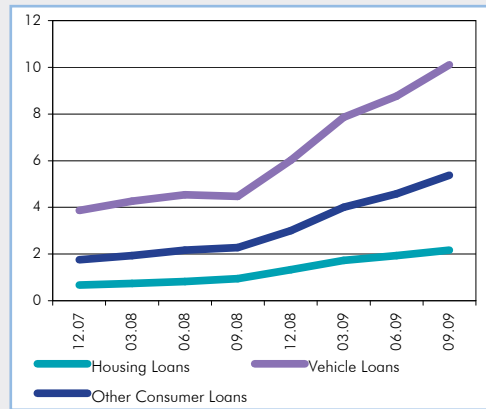
The NPL ratio of retail loans, which was 3 percent in September 2008, climbed to 6.1 percent in September 2009 due to the decline in the coverage ratio of household liabilities. In the same period, the NPL ratio of credit cards increased from 5.9 percent to 10.6 percent (Chart III.12). TL 1.2 billion-worth of non-performing credit cards were restructured within the scope of the Law No: 5464 and on a voluntary basis in the subsequent period, and therefore, these rescheduled payments are expected to have a positive effect on the NPL ratios of credit cards (Table I.8).

Chart III.13.
Consumer Loans^{1,2}
(Excluding NPLs, Billion TL, %)



Source: BRSA -CBRT
(1) They were brought to real terms using CPI(1994=100).
(2) Annual percentage change as compared to the same month of the previous year.

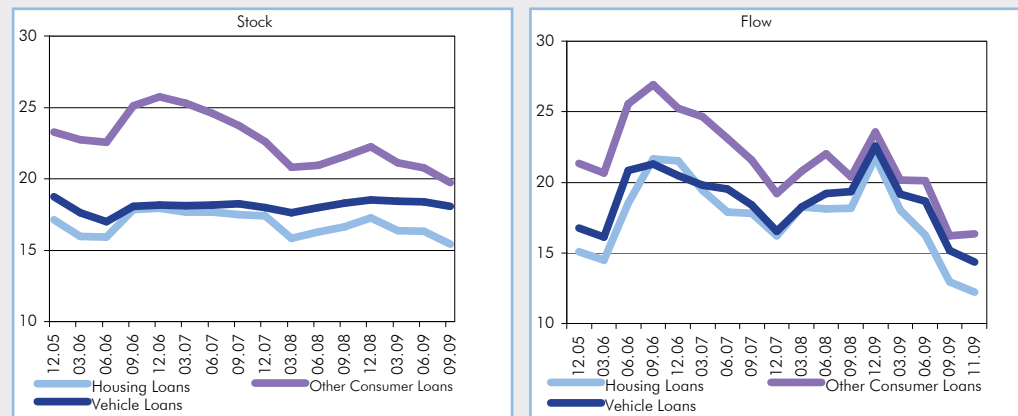
Chart III.14.
NPL Ratios for Consumer Loans¹ (%)



Source: BRSA -CBRT
(1) NPL Ratio = Gross NPL / Gross Loans

In September 2009, housing loans and consumer loans increased by 0.4 percent and 0.2 percent, respectively, in real terms year-on-year, while vehicle loans decreased by 28.6 percent, thus, total consumer loans became TL 87.9 billion (Chart III.13). As to non-performing consumer loans, the rise in non-performing housing loans remained limited while the rise in vehicle loans became more significant (Chart III.14).

Chart III.15
Consumer Loan Interest Rates (%)^{1,2,3}



Source: CBRT
(1) Other consumer loans are consumer loans excluding housing and vehicle loans.
(2) Weighted average interest rates.
(3) November 2009 data is as of 6 November 2009 for flow interest rates.

It is observed that flow interest rates referring to interest rates on newly extended consumer loans, which increased in the last quarter of 2008 due to the global financial crisis, started to decline in 2009 with the effect of CBRT's cumulative policy rate cuts and other measures pertaining to liquidity (Chart III.15).

III.1.2. Credit Risk Scenario Analysis

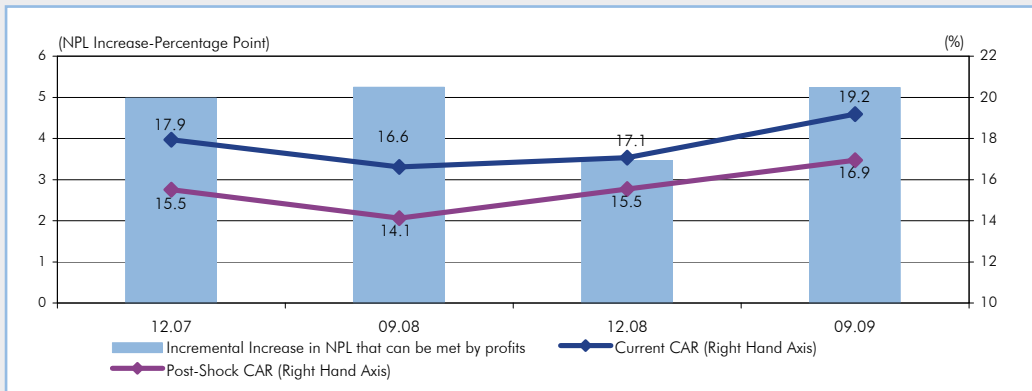
With the aim of assessing the credit risk that the banking sector might be exposed to, an analysis was conducted on how CARs and the profitability of banks might be affected from a potential increase in NPL ratios as of September 2009⁵.

The scenario analysis was conducted under the following assumptions;

- a. The total credit amount of banks remained unchanged.
- b. NPLs resulting from shocks have the same composition as the existing NPLs of banks. For banks that did not have any NPLs before the shocks, the NPLs that came into existence due to the shock implemented are classified as "loans and other receivables with limited collectibility", setting aside a 20 percent provision.
- c. Post-shock NPLs were categorized as 100 percent risk-weighted loans in the calculation of the pre-shock CAR.
- d. There is no change in the total risk-weighted assets and equity capital of the sector except for the shocks.

Collateral amounts were not taken into account while calculating additional provisions.

Chart III.16.
Effect of Credit Shock on the Profitability of the Sector^{1,2}



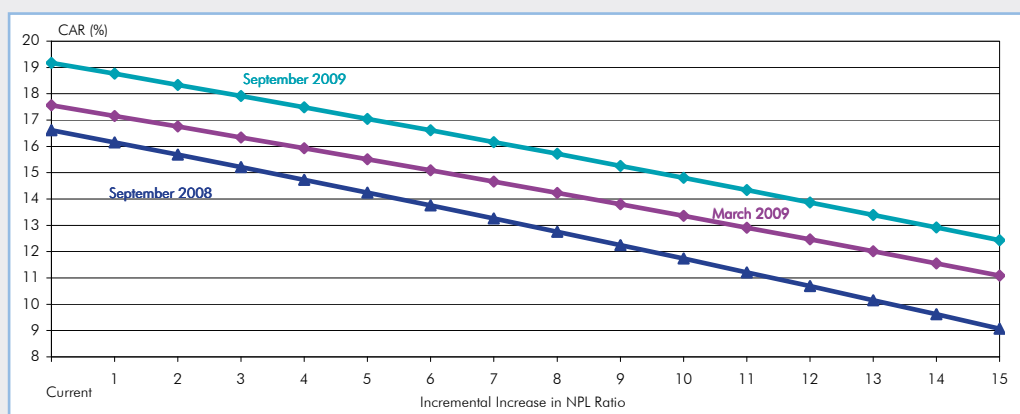
Source: BRSA - CBRT

(1) Excluding the SDIF Bank, Iller Bank and banks that do not have loans in their portfolio.
(2) Post-shock CAR is calculated based on the increase in NPL, which is not covered by the annualized profit.

An analysis of how much additional NPLs can be covered by the net profit of the banking sector reveals that an increase of 5.2 percentage points in NPLs can be covered by that period's net profit in September 2008, whereas at the end of 2008, the figure drops to 3.5 percentage points. However, as a result of the increase in sector profitability in September 2009, the increase in NPLs that can be covered by net profits rebounded to the level of September 2008 (Chart III.16).

(5) After loans are classified as NPLs and additional provisions are set aside, the post-shock capital adequacy ratio is calculated as follows: $(\text{Equity capital} - \text{Additional Provisions}) / (\text{Risk Weighted Assets} - \text{Additional Provisions}) * 100$.

Chart III.17.
Effects of Credit Shocks on the CAR of the Sector (%)¹



Source: BRSA - CBRT

(1) Excluding the SDIF Bank, Iller Bank and banks that do not have loans in their portfolio.

The scenario analysis conducted assesses the effects of a 1-15 point incremental increase in the NPL ratio on the CAR of the banking sector. Accordingly, the shock from a 15-point increase in the NPL ratio of the banking sector reduced the CAR of the sector by 7.6 percentage points in September 2008 when the global crisis started to affect Turkey, an increase-driven shock of the same amount, however, reduced the CAR of the sector by 6.7 percentage points in September 2009 due to the limited rise in risk-weighted assets. As a result of the maximum shock, the CAR of the sector remained above the legal limit of 8 percent, and the target ratio of 12 percent (Chart III.21).

Unlike many countries' banking sectors, which were severely affected by the global crisis, the capital structure of banks in Turkey grew stronger on the back of recent high profits and this increased the banks' lending capacity. Within this framework, it is expected that an acceleration similar to the one in housing loans would be observed in SME loans with the support provided for the Credit Guarantee Fund and a gradual improvement would be observed in credits in general.

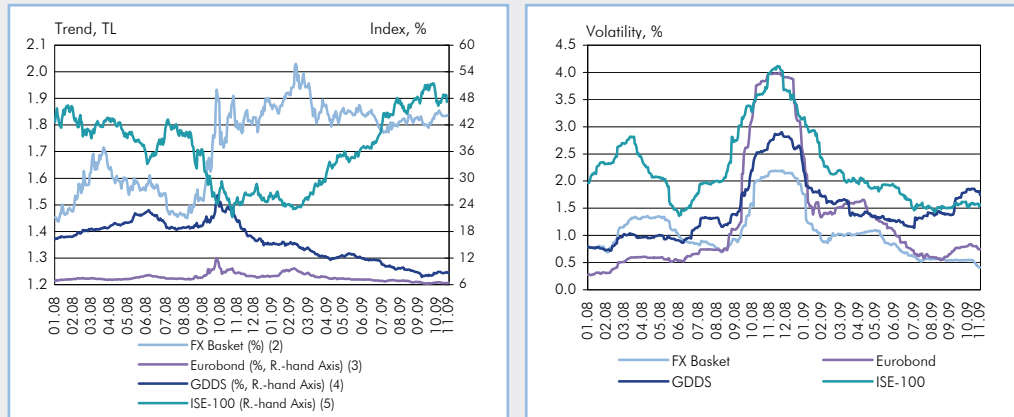
III.2. Market Risk and Scenario Analyses

In this section, where the implications of the developments in interest rate and FX risk on bank balance sheets are assessed, the impact of two scenarios based on hypothetical data are also analyzed.

III.2.1. Market Risk

The volatility in the Turkish financial system tapered off compared to the previous periods, on account of measures taken by the Central Bank of Turkey coupled with the improvements in global risk perceptions. As a matter of fact, the Turkish lira appreciated against the US dollar and Euro basket in March 2009 and maintained this level moving within a narrow band in the successive periods. The upward trend in the ISE, which started in March 2009, continued till October and retreated by a small margin recently. The downward trend in interest rates on GDDSs continued, their average level to become 8.7 percent in November 2009 (Chart III.18).

Chart III.18.
Foreign Exchange Rates, Interest Rates and Equity Prices¹

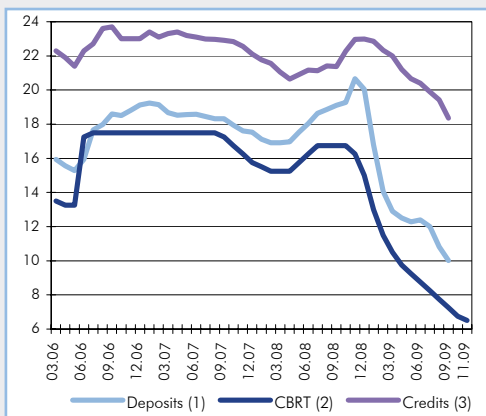


Source: CBRT
 (1) For volatility calculations, standard deviation of daily logarithmic yield of the related market instrument (60 business -days moving average) is used.
 (2) 50 percent of the Foreign Exchange Basket is in USD and the rest is in Euro.
 (3) Based on USD denominated Eurobond interest rate with 2030 maturity.
 (4) Based on the interest rate on the benchmark GDDS.
 (5) Calculated by dividing ISE-100 by 1,000.

Policy rate-cuts that started in November 2008 continued and the overnight borrowing rate decreased to 6.5 percent by November 2009.

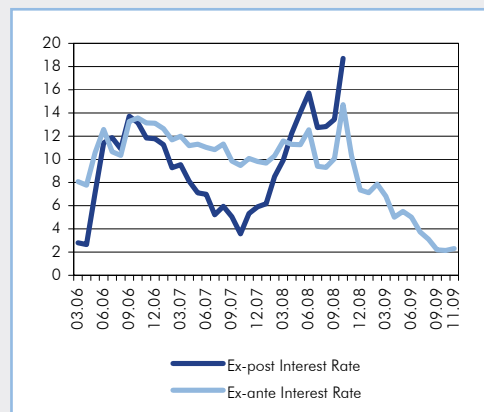
Within this framework, interest rates on deposits and loans continued to decrease as well. However, the fall in interest rates on deposits was sharper than that on loans (Chart III.19).

Chart III.19.
Interest Rates (%)



Source: CBRT
 (1) Banking sector 3-month weighted "stock TL deposit" interest rate.
 (2) CBRT overnight (O/N) borrowing rate.
 (3) Banking sector weighted "stock TL credit" interest rate.

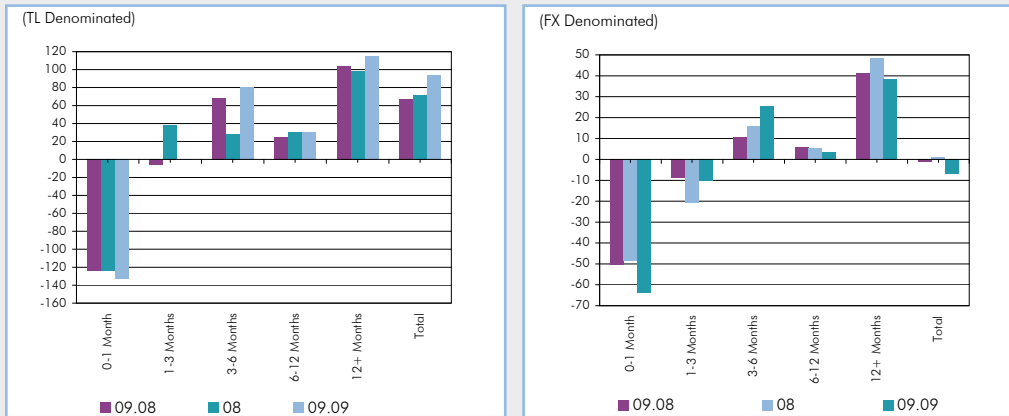
Chart III.20.
Ex-ante¹ ve Ex-post² Real Interest Rates³ of GDDS(%)



Source: Calculated by using the data of CBRT, ISE and TURKSTAT
 (1) Ex-ante interest rate= $\frac{(1 + \text{nominal interest rate})}{(1 + \text{expected inflation rate})} - 1$ * 100
 (2) Ex-post interest rate= $\frac{(1 + \text{last year's nominal interest rate})}{(1 + \text{realized inflation rate})} - 1$ * 100. As expected inflation rate, yearly ex-ante CPI figures in the bi-weekly Survey of Expectations published by the CBRT are used.
 (3) GDDS interest rates are the monthly average interest rates on the benchmark GDDS.

Expected real interest rates continued to decline as nominal interest rates decreased faster than the expected inflation, and stood at 2.3 percent by November 2009 (Chart III.20).

Chart III.21. Interest Rate Sensitivity Gap of the Banking Sector(Billion TL)^{1,2}

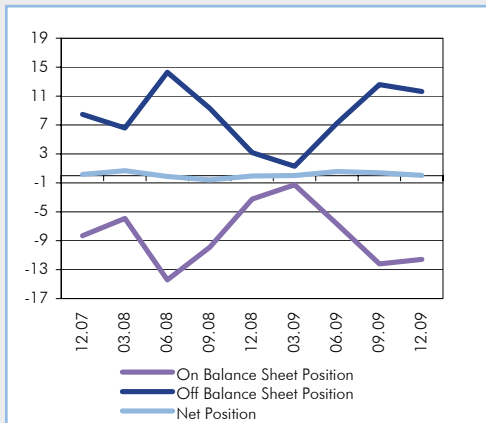


Source: BRSA-CBRT
 (1) Time to re-pricing is used.
 (2) Excluding SDIF bank

In terms of days to re-pricing, negative interest-rate sensitive TL and FX gaps of the banking sector were mainly observed in the 0-1 month maturity bracket similar to previous periods, and in September 2009, the gap in this maturity bracket widened compared to previous year-end (Chart III.21).

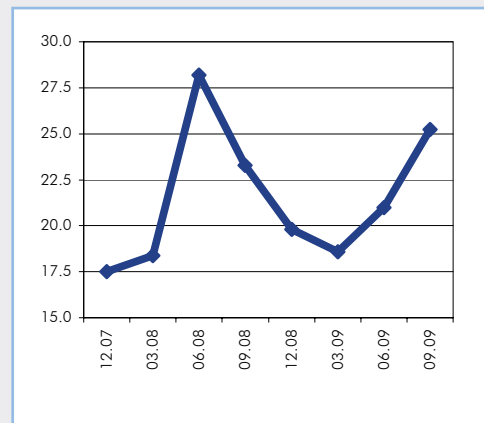
In September 2009, there was a rise in the overall long position of the banking sector due to the upswing in the long position in the 3-6 month maturity bracket for TL. For FX, the banking sector displays a short position in the 0-1 month and 1-3 month maturity brackets while holding a long position for longer terms. In terms of overall position, the sector is short as a result of the rise in the open position in the 0-1 month maturity bracket and the decline in the long position in the 12-month and longer maturities (Chart III.21).

Chart III.22. Foreign Exchange Position of the Banking Sector¹ (Billion USD)



Source: BRSA
 (1) Participation Banks are included.

Chart III.23. Swap Transactions in TL/FX¹ (Billion USD)



Source: BRSA-CBRT
 (1) Participation Banks are included.

The net overall FX position of the banking sector is almost balanced (Chart III.22).

The banking sector's tendency to invest its foreign currency funds in Turkish lira loans through derivatives, especially through swap operations, with an on-balance sheet short position and an off-balance sheet long position, was interrupted during the crisis but later resumed on the back of the positive atmosphere in global financial markets since April 2009. Accordingly, the on-balance sheet short and off-balance sheet long position of the banking sector resumed its upward trend (Chart III.22, Chart III.23).

The banking sector, which balances its on-balance sheet short position with its off-balance sheet long position, held USD 35 billion of selected TL/FX derivative assets by September 2009. For USD 31.3 billion of this amount, the counterparty is a financial institution.

III.2.2.Scenario Analyses

III.2.2.1.Interest Rate and Exchange Rate Increases

In this section, the individual and collective effects of the interest rate and exchange rate increases on the banking sector have been analysed under two scenarios assuming that the two increases occur independently.

Table III.5. Interest and FX Rate Increase Scenarios

	SCENARIO A	SCENARIO B
A. Depreciation of TL	30 percent depreciation of TL against other currencies	40 percent depreciation of TL against other currencies
B. Interest Rate Increase-TL	Re-pricing of TL interest sensitive assets and liabilities falling in 0-1 and 1-3 month maturity brackets at 6 points higher	Re-pricing of TL interest sensitive assets and liabilities falling in 0-1, 1-3, 3-6 month maturity brackets at 12 points higher
C. Interest Rate Increase-FX	Re-pricing of TL interest sensitive assets and liabilities falling in 0-1 and 1-3 month maturity brackets at 5 points higher	Re-pricing of TL interest sensitive assets and liabilities falling in 0-1, 1-3, 3-6 month maturity brackets at 10 points higher
D. Trading Portfolio-TL ¹	6 points increase in market interest rates of YTL denominated fixed income securities in the trading portfolio	12 points increase in market interest rates of TL denominated fixed income securities in the trading portfolio
E. Eurobond Portfolio	Decrease in prices of Eurobonds in the trading portfolio by 15 percent	Decrease in prices of Eurobonds in the trading portfolio by 25 percent

(1) Trading portfolio consists of "financial assets at fair value through profit or loss" and "securities available for sale"

Under Scenario A, it is assumed that the Turkish lira depreciates by 30 percent against other currencies, interest rates for the Turkish currency and foreign currencies increase by 6 and 5 percentage points, respectively, and Eurobond prices decline by 15 percent.

Under Scenario B, it is assumed that the Turkish lira depreciates by 40 percent against other currencies, interest rate increases are twice the increases given in Scenario A and Eurobond prices decrease by 25 percent.

FXNGP data was used to calculate the effects of exchange rate increase on the sector. To calculate the impact of interest rate increases on the sector, the repricing gap method, which complements the standard method and is recommended by the Basel Committee on Banking Supervision, has been applied. In this framework, the difference between interest-rate sensitive assets and liabilities in the days to repricing maturity brackets of 0-1, 1-3, and 3-6 months were used.

In scenario analyses based on repricing, it was assumed that:

- The interest rate sensitivity of banks' assets and liabilities remains unchanged throughout the analysis period,
- Demand deposits are not interest-rate sensitive,
- There are no new fund inflows or outflows,
- Interest rate increases would last for 3 months in Scenario A and for 6 months in Scenario B.

The loss of value in Turkish lira-denominated discount securities within the trading portfolio and the Eurobond portfolio, stemming from the rise in interest rates, has also been calculated.

III.2.2.1.1. Depreciation of TL

Under Scenarios A and B, the banking sector makes profit amounting to TL 159.9 million and TL 213.2 million, respectively, owing to its FX long position as of September 2009. As a result of the shocks, the ratio of losses of banks – arising from their open positions – to their own funds increased by a small margin compared to March 2009 and became 0.6 percent and 0.9 percent, respectively under the two scenarios (Table III.6).

III.2.2.1.2. Interest Rate Increases and Loss in Value

i) Under Scenarios A and B, the TL denominated interest income declines as of September 2009. Under both scenarios, the amount of decline in TL denominated interest income decreased. The decline under Scenario B, which assumes that the shock will last for 6 months, is higher compared to Scenario A, owing to the rise in long position for the 3-6 month maturity bracket.

As for foreign currency, in Scenario A, the decrease in interest income is higher compared to March 2009 owing to the rise in open positions in the 0-1 and 1-3 month maturity brackets. In Scenario B, the amount of decline in interest income is lower compared to March 2009 due to the increase in the long position in the 3-6 month maturity bracket.

While the overall amount of decline in interest income does not indicate a significant change under Scenario A, it is significant under Scenario B. As a matter of fact, under Scenario B, the ratio of loss – due to interest rate increases – to own funds, which was 3.5 percent in March 2009, was down to 1.8 percent in September 2009.

ii) There has been a rise in the banking sector's securities portfolio owing to the increase in the banks' demand for GDDSs as banks deem GDDSs to be risk-free investment instruments.

As they expected the Central Bank to cut policy rates, banks classified the newly acquired securities in their trading portfolios. Therefore, the loss in value due to the shocks in both scenarios increased compared to March 2009 owing to the rise in trading portfolios. As a matter of fact, the ratio of loss of value due to interest rate increases to own funds under Scenario A and Scenario B, which were 2.1 percent and 3.9 percent in March 2009, rose to 2.7 and 5.1 percent in September 2009, respectively.

iii) The loss of value in the Eurobond portfolio increased slightly compared to March 2009 under both scenarios.

Table III.6. Results of Market Risk Scenarios¹ (Billion TL)

	Scenario A			Scenario B		
	09.08	03.09	09.09	09.08	03.09	09.09
A. TL Depreciation						
a. Total Profit (Loss)	-325.5	147.8	159.9	-434.0	197.0	213.2
Profit (Loss)/Own Funds (%)	-0.4	0.2	0.2	-0.6	0.2	0.2
b. Banks Gaining Profits	155.7	352.5	376.8	207.5	470.0	502.3
c. Banks Suffering Losses	-481.1	-204.8	-216.9	-641.5	-273.0	-289.1
Losses of Banks Suffering Loss/Own Funds (%)	-1.2	-0.5	-0.6	-1.6	-0.7	-0.9
B. Interest Rate Increase						
a. TL	-1,393.6	-1,449.8	-1,332.2	-1,531.3	-1,621.8	-556.5
b. FX	-466.6	-547.0	-594.3	-1,344.1	-1,338.0	-1,125.7
Profit (Loss) due to Interest Rate Increase (a+b)	-1,860.1	-1,996.8	-1,926.5	-2,875.4	-2,959.8	-1,682.3
Profit (Loss) due to Interest Rate Increase/Own Funds (%)	-2.4	-2.4	-2.0	-3.8	-3.5	-1.8
C. TL Trading Portfolio						
Loss in Value due to Interest Rate Increase	-2,089.9	-1,754.0	-2,589.9	-3,914.6	-3,291.9	-4,852.0
Loss in Value due to Interest Rate Increase/Own Funds (%)	-2.7	-2.1	-2.7	-5.1	-3.9	-5.1
D. Eurobond Portfolio						
Loss in Value	-2,627.6	-2,135.0	-2,297.8	-4,379.3	-3,558.4	-3,829.7
Loss in Value/Own Funds (%)	-3.5	-2.5	-2.4	-6.3	-4.2	-4.0
E. Total Impact						
Profit (Loss)	-6,902.9	-5,738.0	-6,654.3	-11,603.2	-9,613.1	-10,150.9
Profit (Loss)/Own Funds (%)	-9.1	-6.8	-7.0	-15.2	-11.4	-10.7
Current CAR of the Sector (%)	16.0	17.1	18.8	16.0	17.1	18.8
After-Shock CAR of the Sector2 (%)	14.6	16	17.5	13.6	15.2	16.8

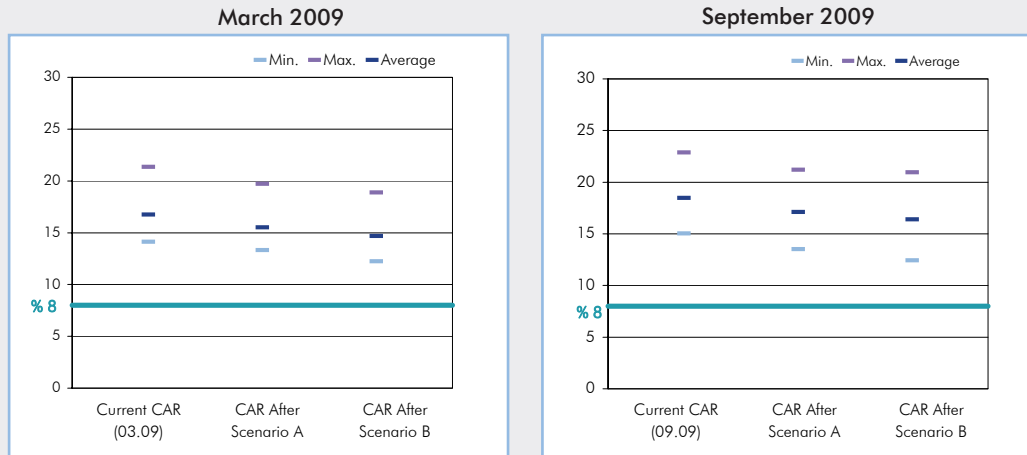
Source: CBRT

(1) Excluding SDIF bank. T. Kalkınma Bank. İller Bank and Eximbank.

(2) After-shock profit/loss amounts under the scenarios are assumed to affect only own funds but not the risk weighted assets.

In conclusion, in September 2009, the losses resulting from both Scenario A and Scenario B increased compared to March 2009 owing to the loss in value shocks in the trading portfolios. Although the CAR of the sector declined by 1.3 percentage points under Scenario A and by 2.0 percentage points under Scenario B, it still stands above the legal ratio of 8 percent and the target ratio of 12 percent.

Chart III.24.
Impacts of the Scenarios on the Largest 10 Banks of the Sector¹



(1) Largest 10 Banks considering their share in total assets are included in the analysis.

When the impacts of Scenario A and Scenario B on the CARs of the 10 banks with the highest share in assets are analyzed, it is observed that post-shock CARs increased by a small margin compared to March 2009, in parallel to the current increase in CAR. Under both scenarios, the minimum CAR level remained above the target ratio of 12 percent by September 2009 (Chart III.24).

III.3. Liquidity Risk

A relative recovery has recently been observed in liquidity conditions with the support of the measures taken by the CBRT and the improvement in risk perceptions.

Due to its ability to directly control Turkish Lira liquidity, the Central Bank may effectively support the smooth operation of the markets by providing the necessary liquidity. Even if external conditions play a significant role in FX liquidity, the Central Bank of the Republic of Turkey continues to take the necessary measures in order to ensure that the FX market performs well and to bolster FX liquidity management by banks.

With the aim of enhancing sound functioning of the banks' liquidity management and transfer mechanism, in addition to the measures mentioned earlier in this report and to the one-week maturity repo auctions that are the basic funding instruments, the Central Bank started to use repo transactions, when necessary, with maturities up to 3 months actively as of June 19, 2009. Moreover, the Turkish Lira required reserve ratio, which was 6 percent, was reduced by 1 percentage point to 5 percent in October 2009, with the aim of supporting the upward trend in credit growth by reducing intermediation costs and injecting permanent liquidity into the market. With this reduction in the Turkish Lira required reserve ratio, a permanent liquidity that is equivalent to approximately TL 3.3 billion has been provided to the banking system.

Considering that a suitable environment for the CBRT to build up foreign exchange reserves had been achieved based on the relative stability attained in the FX market, it was decided to resume the foreign exchange buying auctions, which were suspended in October 2008, as of 4 August 2009. Approximately USD 3.2 billion worth of foreign exchange was bought and approximately TL 4.7 billion worth of liquidity was injected into the market.

Box 11. Market Liquidity Index (MLI)¹

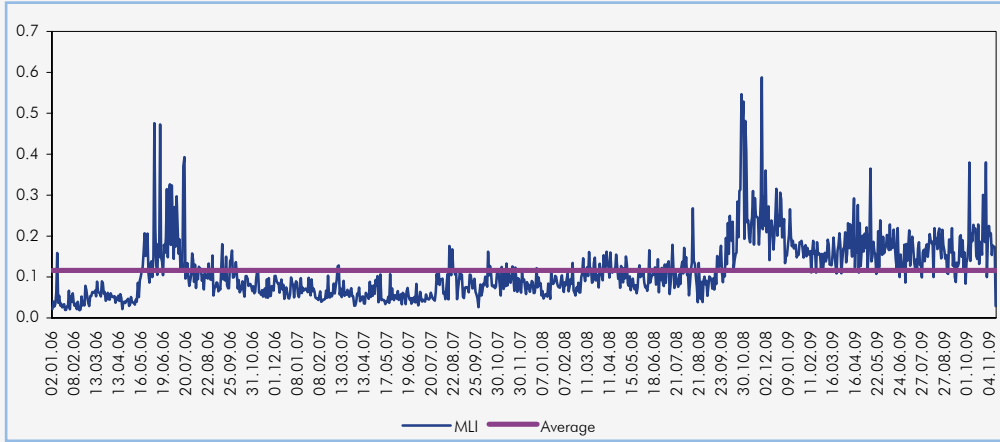
As it is known, liquidity is the ability of economic agents to exchange their wealth for goods and services or other assets. The three most widely accepted liquidity concepts are central bank liquidity, funding liquidity and market liquidity. Central bank liquidity is the liquidity supplied by the central banks to the economy to the need of the financial system, whereas funding liquidity, which is related to balance sheet composition, is the banks' ability to meet their liabilities on time. In line with this, a bank is said to be liquid as long as its cash inflows meet its cash outflows. Finally, market liquidity is the ability to trade an asset in a short time at minimum cost with little impact on its price. Consequently, a liquid market is the market where bid-ask prices are quoted, the spread between these prices is low and small transactions are executed rapidly without significant effect to prices.

Interactions among these liquidity concepts are of paramount importance, such that during normal periods they are very likely to contribute to the stability of the financial system; however, during periods of stress they may trigger the instability embedded in the system. Especially, sudden declines in market liquidity may place restrictions on monetary policy instruments and subsequent volatility in asset prices may give rise to uncertainties in the fundamental indicators such as the exchange rate and interest rate.

Within this framework, in order to measure market liquidity in Turkey, a MLI is compiled. The markets included in the index are those with high transaction volume and in which banks play an intensive role, as well as where the selection of these markets is justified by the Principal Component Analysis. Eventually, the Bonds and Bills Market-Outright Purchases and Sales Market within the Istanbul Stock Exchange (ISE) and the TL/USD Exchange Rate Market compose the index. The related indicators for these markets are the Relative Spread (RS) and the Illiquidity Ratio (IR) of which formulas are presented below. All in all, an increase in the index implies a decrease in market liquidity.

Indicator	Markets
<p>Tightness</p> $RS = \frac{\text{Best Ask-Best Bid}}{(\text{Best Ask} + \text{Best Bid})/2}$	<ul style="list-style-type: none"> Bonds and Bills Market-Outright Purchases and Sales Market TL/USD Exchange Rate Market
<p>Depth</p> $IR = \frac{ \text{Daily percentage price change} }{\text{Transaction Volume to the Outstanding (Turnover Ratio)}}$	<ul style="list-style-type: none"> Bonds and Bills Market-Outright Purchases and Sales Market

Chart 1. Market Liquidity Index

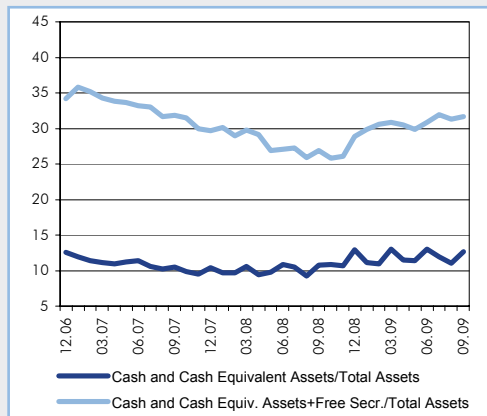


Source: ISE, CBRT

As seen from the course of the MLI, thanks to the robust financial infrastructure and the timely measures taken by the Central Bank, the adverse effects of global turbulence have been limited to a short period of time and the liquidity of Turkish financial markets has faced temporary high volatility. With the decreasing risk appetite, the MLI increased during the last quarter of 2008 and since the beginning of 2009 it has started to decline and has relatively stabilized, however, the vulnerability of financial markets still remains (Chart 1).

(1) The methodology introduced in the BoE's Financial Stability Report (April 2007) has been adapted to Turkey.

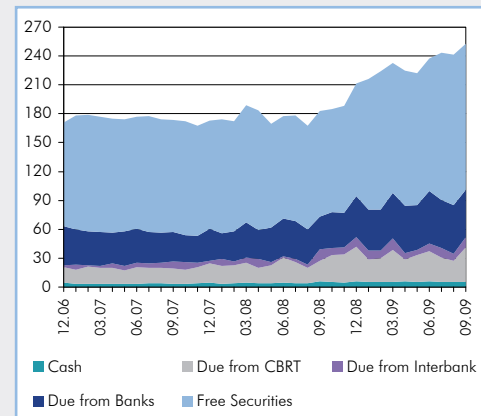
Chart III.25. Basic Liquidity Indicators (%)^{1,2}



Source: BRSA-CBRT

(1) Cash and Cash Equivalent Assets=Cash + Due from CBRT + Due from Interbank + Due from Banks.
 (2) Free Securities= Securities that are not used as collateral or for repo transactions.

Chart III.26. Liquid Assets (Billion TL)



Source: BRSA-CBRT

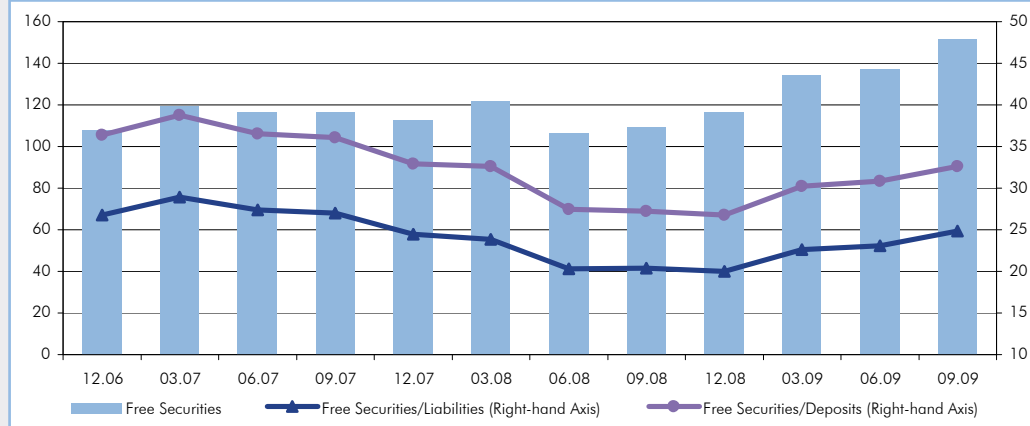
When the basic liquidity indicators of the banking sector are analyzed, it is observed that the ratio of cash and cash-equivalent assets to total assets generally maintained a horizontal

course but increased in periods when the “Due from CBT” and “Due from Banks” items were on the rise (Chart III.25).

When the free securities not used as collateral or for repo transactions are taken into account, this ratio displayed a tendency to increase as of end-2008 (Chart III.25).

Being the largest item in liquid assets, the recent increase in free securities is noteworthy. The mentioned development can mainly be attributed to the tendency of private banks to invest in government bonds as a result of their reluctance to extend credits (Chart III.26).

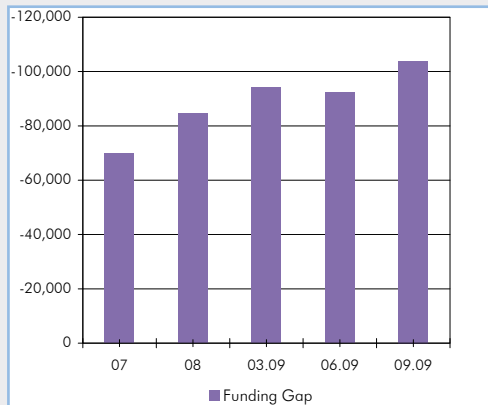
Chart III.27.
Free Securities and Liabilities¹ (Billion TL, %)



Source: CBRT-BRSA
(1) Participation banks are not included in this calculation

The ratio of free securities, which can be accepted as collateral by the Central Bank in providing liquidity to banks in the event of a temporary liquidity shortage to liabilities and to deposits maintained an accelerating trend as of the end of 2008. In September 2009, the aforementioned ratios reached 25 percent and 33 percent, respectively (Chart III.27).

Chart III.28.
Funding Gap¹ (Billion TL)



Source: BRSA-CBRT
Funding Gap = Credits - Deposits

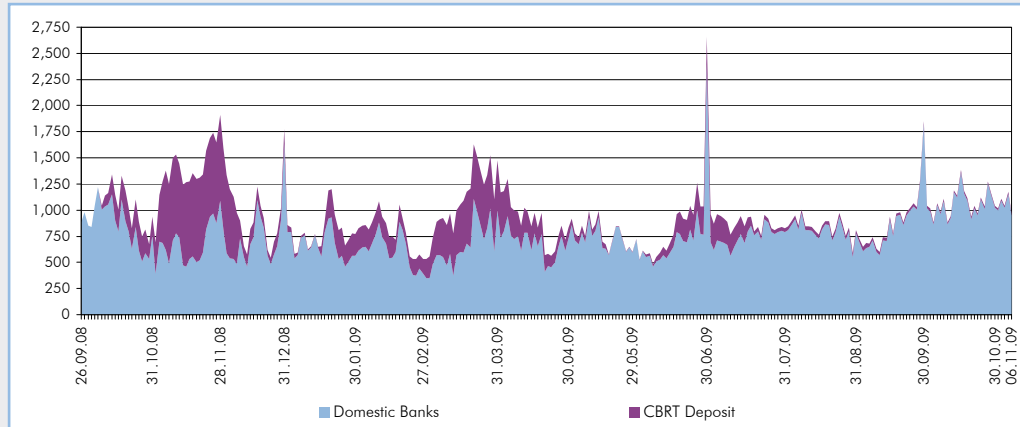
Chart III.29.
Funding Gap (September 2009)^{1,2} (%)



Source: BRSA-CBRT
(1) Funding Gap = (Credits-Deposits) / Credits
(2) Bank under SDIF is excluded.

Deposits, as the most important source of the Turkish banking system, restrain the susceptibility of banks to the volatility of interbank funds. In September 2009, negative funding gap of the sector reached TL 104 billion (Chart III.28). While public banks enjoy a high negative funding gap on average, foreign banks have positive funding gap to a limited extent, as they are funded from abroad (Chart III.29).

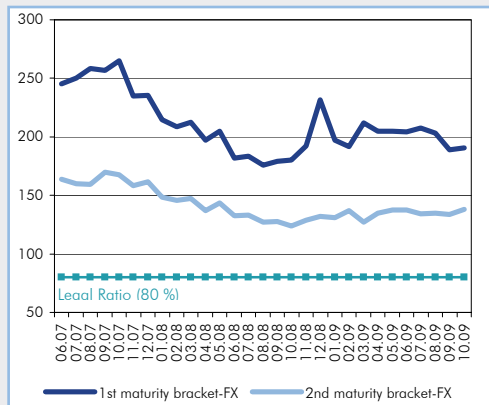
Chart III.30.
FX Interbank Operations (Million USD)



Source: BRSA-CBRT

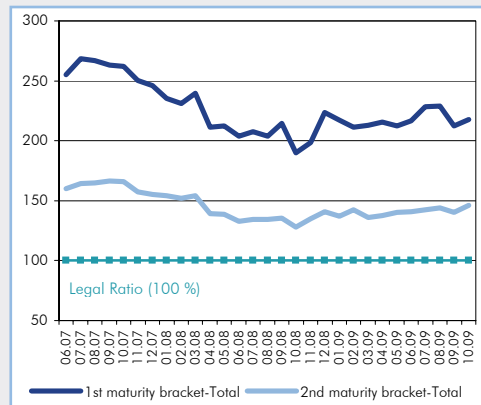
The Central Bank of Turkey resumed its activities as an intermediary in the foreign exchange deposit market on October 9, 2008 with the aim of enhancing the flow of foreign exchange liquidity. Yet, the transaction volume in this market declined and banks have started to increase interbank transactions again (Chart III.30).

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



Source: BRSA-CBRT

Chart III.32.
Total Liquidity Adequacy Ratio (%)

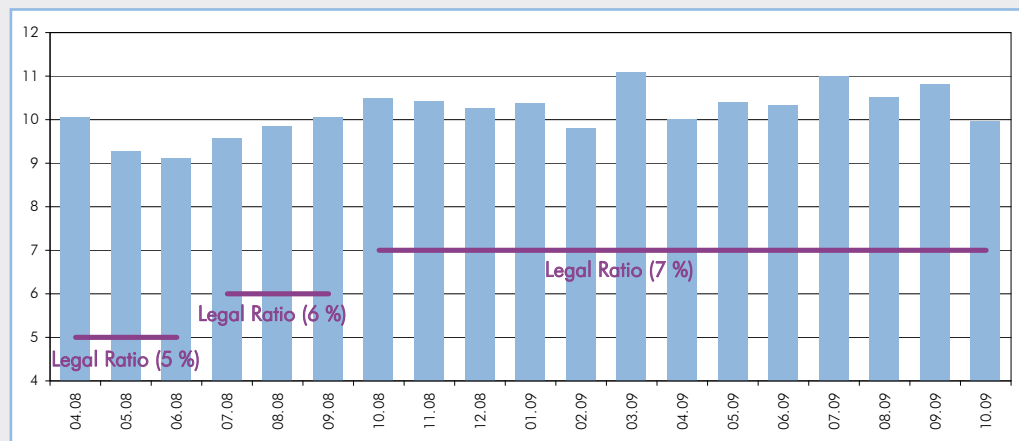


Source: BRSA-CBRT

The liquidity adequacy ratios of the banking sector, calculated pursuant to the “Regulation Relating to the Measurement and Assessment of Liquidity Adequacy of Banks”, for both total and foreign currency in 1st and 2nd maturity brackets⁶ are well above the legal limit and have been following a stable trend lately (Chart III.31 and Chart III.32).

⁶ Assets and liabilities with 0 to 7 days to maturity are included in the 1st maturity bracket and those with 0 and 31 days to maturity are included in the 2nd maturity bracket.

Chart III.33.
Liquidity Ratio of the Banking Sector Calculated By Using Stock Values of Selected Assets and Liabilities (%)



Source: BRSA-CBRT

A third liquidity adequacy ratio, which was introduced with an amendment to the “Regulation Relating to the Measurement and Assessment of Liquidity Adequacy of Banks” on April 5, 2008 and calculated by using the full stock values of selected assets and liabilities, also stands above the legal ratio of 7 percent (Chart III.33).

Since the last quarter of 2008, the free securities and basic liquidity indicators of banks have been increasing and banks have maintained their cautious stance.

Box 12. Liquidity Stress Test¹

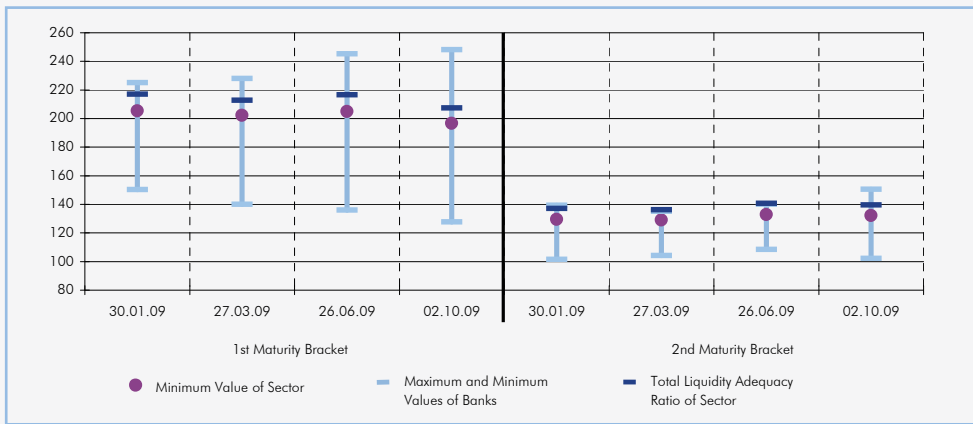
To analyze the robustness of the Turkish banking sector against the funding liquidity risk embedded in the system, a liquidity stress test is carried out on the first 10 banks in terms of their asset size, excluding public banks. With this, the liquidity adequacy ratios of the 1st and 2nd maturity brackets, calculated pursuant to the Regulation Relating to the Measurement and Assessment of the Liquidity Adequacy of Banks issued by the BRSA, are exposed to stochastic analyses based on some probability distributions.

The items liquid assets and unstable liabilities that are considered in the analysis are selected based on the current regulation. For liquid assets, the haircut ratios correspond to the ratios by which the items can lose value and the fractions of items that may not result in cash inflow as opposed to what is expected due to counterparty risk. As for unstable liabilities, the run-off rates represent the ratio of liability items, which may emerge as a non-renewable funding source. These haircut and run-off rates are simulated based on the Monte Carlo Simulation Technique and initial parameters for the simulation are taken to be the official ratios in the regulation.

The simulation results have shown that there was no significant change in the haircut and run-off rates of important balance sheet items, even in the case of the highest decrease in the legal liquidity ratio of the sector. This shows that the ratios of consideration stated in the regulation are prudential enough to reflect the stress cases.

According to the results, as of October 2, 2009, the total liquidity adequacy ratios for the sector, which are calculated for the 1st and 2nd maturity brackets, may at most decline to 197 percent and 132 percent respectively (Chart 1). On the other hand, while conducting the simulation for each bank, the haircuts and the run-off rates which lead to the lowest liquidity ratios for each, are used. In this case, as of the same date, for the maturity brackets stated above, the highest ratios among the 10 banks are 248 percent and 150 percent, respectively, whereas the lowest ones are 128 percent and 102 percent. Consequently, with this analysis, there are no banks which go below the legal ratio of 100 percent amongst the 10 banks.

Chart 1. Total Liquidity Ratio For the 1st and 2nd Maturity Brackets (%)



(1) The methodology presented in Van den End, J. W. (2008): Liquidity Stress-Tester: A Macro Model for Stress-Testing Banks' Liquidity Risk, De Nederlandsche Bank (DNB) WP No. 175, has been adapted to Turkey.

III.4. Financial Strength Index

Table III.7 Financial Strength Index Variables

	Financial Strength Indicators	Direction of the Impact	Weight
Asset Quality	Gross Non-Performing Loans / Gross Loans	negative	0.33
	Net NPL / Shareholders' Equity	negative	0.33
	Fixed Assets / Total Assets ¹	negative	0.33
Liquidity	Liquid Assets / Total Assets ²	positive	1.00
Exchange Rate Risk	On-Balance Sheet FX Position / Own Funds ³	negative	0.50
	FX Net General Position / Own Funds ^{3,4}	negative	0.50
Interest Rate Risk	(Int. Sens. TL Assets with a Mat. Up to 1 Month – Int. Sens. TL Liab. With a Mat. Up to 1 Month) / Own Funds ⁵	negative	0.50
	(Int. Sens. FX Assets with a Mat. Up to 1 Month – Int. Sens. FX Liab. With a Mat. Up to 1 Month) / Own Funds ⁵	negative	0.50
Profitability	Net Profit / Total Assets	positive	0.50
	Net Profit / Shareholders' Equity	positive	0.50
Capital Adequacy	Free Capital / Total Assets ⁶	positive	0.50
		positive	0.50

(1) Fixed Assets consist of subsidiaries, assets to be sold, fixed assets and net non-performing loans.

(2) Liquid Assets consist of cash, due from the CBRT, due from money market, due from banks and receivables from reverse repo transactions.

(3) Own funds is the regulatory capital, and it is different from the equity in the balance sheet. The calculation is in absolute values.

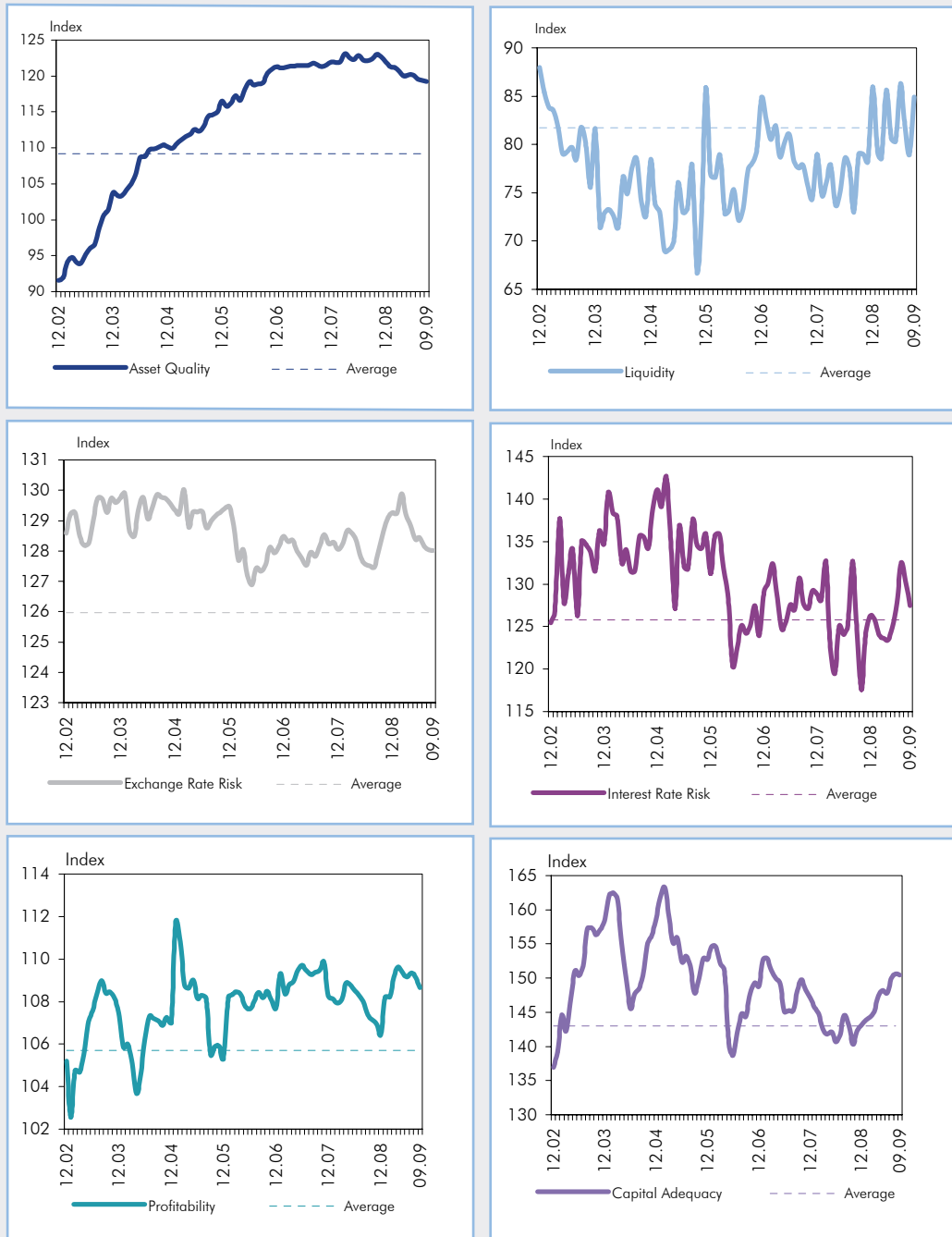
(4) Foreign exchange net open position is the sum of on and off balance sheet foreign currency positions. The calculation is in absolute values.

(5) The calculation is in absolute terms.

(6) Free capital is calculated by deducting fixed assets from equity.

The Financial Strength Index (FSI) is computed with the aim of forming an “aggregate indicator” relating to the direction of the financial strength of the banking sector. Six sub-indices (asset quality, liquidity, exchange rate risk, interest rate risk, profitability, and capital adequacy) were used to form this index. Ratios projecting the risks and fragilities of the banking sector were selected under each sub-index and these ratios, reflected in certain weights, constitute the index (Table III.1.7).

Chart III.34.
Financial Strength Index Variables¹ (1999=100)



Source: BRSA-CBRT
(1) The averages used are the averages of related sub-indices between December 1999 – September 2009.

The assessment of the sub-indices forming the FSI is as follows (Chart III.34);

i. Asset Quality Index: The Asset Quality Index, which was 122 at the end of 2008, denoted a downward trend in 2009 and became 119.2 in September 2009. This decline was mainly driven by the rise in the NPL ratio.

ii. Liquidity Index: The liquidity index, which was 86 at the end of 2008, was down to 84.9 in September 2009. Despite the fall in the index, the ratio of liquid assets to total assets that makes up the index has been hovering between 10.9 percent and 13.0 percent in the last one-year period.

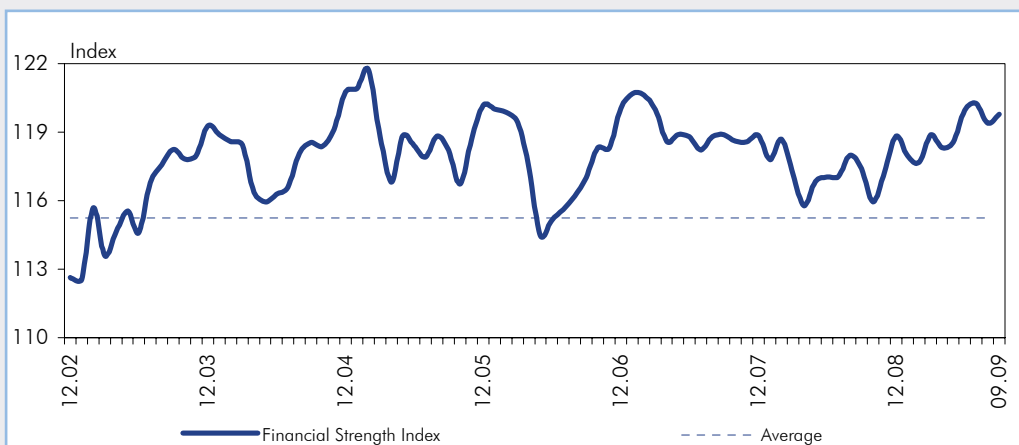
iii. Exchange Rate Risk Index: The Exchange Rate Risk Index, which was 129.3 at the end of 2008, has declined since March 2009 due to the rise in the on-balance sheet open position and was 128 in September 2009.

iv. Interest Rate Risk Index: Despite the rise in the FX interest-sensitive gap in December 2008, Interest Rate Risk Index showed some improvement and became 126.3 owing to the decline in the TL interest-sensitive gap. The index became 127.5 in September 2009 due to the increase in the ratio of the difference between TL -denominated interest-sensitive assets and liabilities with a maturity of up to 1 month to own funds.

v. Profitability Index: The Profitability Index, which was down to 106.5 in December 2008 – the lowest level of the last three years- exhibited an upward trend in 2009 owing to the rise in the interest margin parallel to easing interest rates and became 108.7 in September 2009. The rise in the profitability performance of the sector in the first nine months of the year was mainly driven by the rise in net interest income. Meanwhile, as profit from securities purchases and sales increased capital market transaction profits, net trading income, which is an important factor of non-interest income, also increased.

vi. Capital Adequacy Index: The index, which had been on an upward trend since October 2008, continued to increase throughout 2009 owing to the rise in the capital adequacy ratio and the ratio of free capital to total assets and became 150.5 in September 2009.

Chart III.35.
Financial Strength Index¹ (1999=100)



Source: BRSA-CBRT

(1) The average used is the average of financial strength index between December 1999 and September 2009.

The Financial Strength Index, monitored as an indicator of the soundness of the banking sector, which was 118.8 at the end of 2008, became 120.3 in July 2009 owing to the rises in the capital adequacy index, profitability index and interest rate risk index. In September 2009, the index fell by a small margin and was down to 119.8 due to the decline in the interest rate risk index (Chart III.35).

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ABBREVIATIONS

BCBS	: Basel Committee on Banking Supervision
BIS	: Bank for International Settlements
BRSA	: Banking Regulation and Supervision Agency
CAR	: Capital Adequacy Ratio
CBRT	: Central Bank of the Republic of Turkey
CDS	: Credit Default Swap
CGF	: Credit Guarantee Fund
CMB	: Capital Markets Board
CMO	: Collateralized Mortgage Obligation
CPI	: Consumer Price Index
CRA	: Central Registry Agency
ECB	: European Central Bank
EMBI	: Emerging Markets Bond Index
ESA	: European System of Accounts
EU	: European Union
FASB	: Financial Accounting Standards Board
FCAG	: Financial Services Advisory Group
FED	: Federal Reserve System
FSB	: Financial Stability Board
FSI	: Financial Strength Index
FSF	: Financial Stability Forum
FX	: Foreign Exchange
FXIL	: Foreign Exchange Indexed Loans
FXNGP	: Foreign Exchange Net General Position
G-20	: Group of 20
GAAP	: Generally Accepted Accounting Principles
GDDS	: Government Domestic Debt Security
GDP	: Gross Domestic Product
IAS	: International Accounting Standards
IASB	: International Accounting Standards Board
IFRS	: International Financial Reporting Standards
IFS	: International Financial Statistics
IMF	: International Monetary Fund
ISE	: Istanbul Stock Exchange
MLI	: Market Liquidity Index

NPL	: Non Performing Loans
OECD	: Organization of Economic Co-operation and Development
O/N	: Overnight
PPI	: Producer Price Index
RIB	: Revenue Indexed Bonds
ROA	: Return on Assets
ROE	: Return on Equity
S&P	: Standard and Poor's
SDIF	: Savings Deposit Insurance Fund
SEE	: State Economic Enterprise
SME	: Small and Medium Size Enterprise
SPO	: T. R. Prime Ministry State Planning Organization
TL	: Turkish Lira
TOKI	: Housing Development Administration of Turkey
Treasury	: Republic of Turkey Undersecretariat of Treasury
TURKSTAT	: Turkish Statistical Institute
UK	: United Kingdom
USA	: United States of America
USD	: United States Dollar
VAT	: Value Added Tax
WEO	: World Economic Outlook