Overview

Since the issue of the previous Financial Stability Report in November 2013, the normalization process in the Fed's monetary policy has continued to have an adverse impact on capital flows towards Emerging Market Economies (EMEs) and led EME central banks to opt for tightening in their monetary policies to restore stability to financial markets. In this context, capital flows to Turkey have also weakened and volatility in exchange rates and financial markets has increased due to the contribution of country-specific uncertainties. Taking into account the relative deterioration in the inflation outlook, the CBRT delivered a strong and front-loaded tightening in its monetary policy in January 2014. Thanks to the CBRT's cautious stance, macroprudential measures that took the steam out of consumer credit growth, the relative easing of uncertainties as regards the national economy, and the slight improvement in global risk appetite, concerns over financial stability have recently dissipated to a large extent.

For the upcoming period, the timing and pace of the Fed's rate hike will be the main determinant of capital flows to EMEs. The Fed is expected to start a gradual hiking of rates, probably in the second half of 2015. Furthermore, there are expectations that the European Central Bank may implement monetary expansion to counter deflationary pressures in the euro area. Despite this general positive outlook in terms of global liquidity, it is believed that it will be most beneficial for EMEs to reduce their external financing requirement over the medium term. In this framework, the resilience of the Turkish financial and non-financial sectors in the face of exchange rate, interest rate and financing shocks becomes more of an issue for financial stability.

A reasonable share of core liabilities in overall funding is of utmost importance for the resilience of the banking system in the face of volatilities in domestic and international markets over the medium and long term. In this context, the CBRT closely monitors developments in the loan-to-deposit ratio. If deemed necessary, the Bank may use the remuneration of required reserves as a tool in bringing the loan-to-deposit ratio to desired levels.

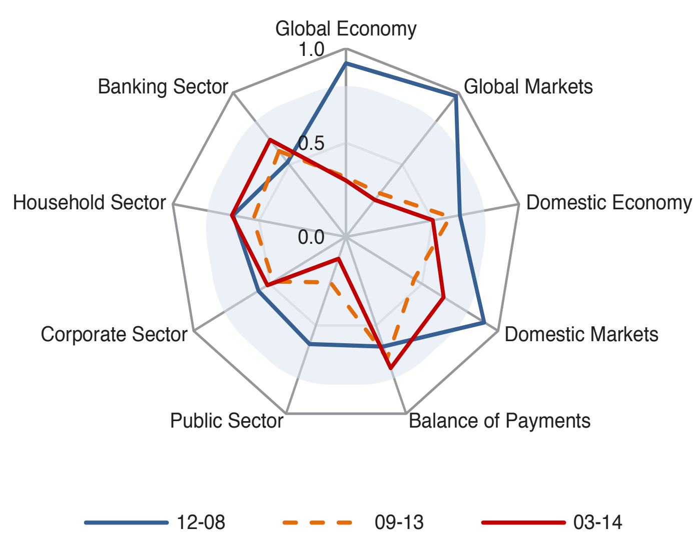
The assets and liabilities of the non-financial sector in Turkey are evolving in such a way as to contribute positively to financial stability. Household indebtedness, which increased in recent years as interest rates recorded historic lows and loan maturities lengthened, has recently assumed a more reasonable growth path, thanks to the contribution of macroprudential measures. Accordingly, a noteworthy slowdown has taken place, particularly in individual credit cards and vehicle loans.

Although corporate sector liabilities increased due to the depreciation of the TL, annual growth rates of both TL and FX-denominated corporate loans have started to record reasonable levels. The long-term maturity structure of external financial liabilities that are limited relative to domestic financial liabilities and the favorable external debt rollover ratio underpin the corporate sector's financial outlook.

The most outstanding development in household and corporate sector assets has been the rise in FX deposits. The rise in real persons' FX deposits predominantly stemmed from large deposit accounts and does not reflect the overall saving tendency of households. Moreover, the rise in FX savings deposits was mainly driven by the uptrend in currency swap transactions as of the second half of 2013. When this effect is excluded, the shift from TL to FX deposits is seen to be rather limited. Similar to those with real persons, currency swaps with legal persons also increased.

When the risks borne by the banking sector are evaluated from an international as well as a national perspective, there was no remarkable deterioration in loan quality in general during the first half of 2014. The same approach demonstrates that the sector has adequate liquidity buffers against any possible liquidity crunch and that the susceptibility to interest rate risk is on the decline. The macro scenario analysis based on the fluctuations caused by the 2008 financial crisis suggests that the deterioration in the NPL ratio and the capital adequacy of the sector would remain limited and the Capital Adequacy Ratio (CAR) of the sector would stand above the legal requirements.

Financial Stability Map[1,2]



(1) The closer a sector is to the core, the more the sector contributes favorably to financial stability. The analysis comprises a time-series for each sub-sector. Cross-sector comparison can be made only in terms of the direction of change recorded in the positioning in relation to the core.
(2) For the methodology used in the chart, please see Financial Stability Report (FSR) v.13, November 2011-Special Topic IV.10.

The chart above is shaped by our assessments and offers a schematic reflection of the developments in financial stability in Turkey. Accordingly, while favorable developments in the global economy have been limited, improvement in global markets has been relatively stronger in the last six months. In the same period, the domestic indicators of the 'public sector' and 'domestic economic developments' have underpinned financial stability in Turkey. Notwithstanding, the fluctuations in domestic markets and high current account deficit had their negative shares. Nevertheless, the current downward course of consumer loans heralds a notable improvement in the current account deficit in 2014.