

## CONTENTS

CONTENTS.....	i
LIST OF TABLES.....	iii
LIST OF CHARTS.....	v
LIST OF BOXES.....	xi
ABBREVIATIONS.....	xiii
OVERVIEW.....	xv
<b>I.Macroeconomic Aspects of Financial Stability.....</b>	<b>1</b>
I.1.Intersectoral Developments.....	1
I.2.Public Finance.....	2
I.3.Households.....	10
I.4.Corporate Sector.....	20
I.4.1.General Structure.....	20
I.4.2.Financial Analysis of Companies.....	25
I.5.Developments in the External Sector.....	30
<b>II.General Structure of the Financial Sector.....</b>	<b>37</b>
II.1.Banking Sector.....	38
II.2.Participation Banks.....	46
II.3.Insurance, Reinsurance and Private Pension Companies.....	49
II.4.Consumer Finance Companies.....	53
<b>III.Banking Sector Risks.....</b>	<b>57</b>
III.1.Credit Risk.....	57
III.1.1.Developments in the Credit Portfolio.....	57
III.1.1.1.General Structure.....	57
III.1.1.2.Development of Non-Performing Loans.....	71
III.1.1.3.Development of Non-Cash Loans.....	77
III.1.2. Credit Risk Scenario Analysis.....	78

III.2. Market Risk and Scenario Analyses.....	80
III.2.1. Developments in Market Risk.....	80
III.2.2. Scenario Analyses.....	87
III.2.2.1. Increases in Interest and Exchange Rates.....	87
III.2.2.1.1. Increase in Exchange Rate.....	89
III.2.2.1.2. Increase in Interest Rates.....	89
III.2.2.2. Decreases in Interest and Exchange Rates.....	90
III.2.2.2.1. Decrease in Exchange Rate.....	91
III.2.2.2.2. Decrease in Interest Rates.....	91
III.3. Liquidity Risk.....	92
III.4. Profitability and Capital Adequacy.....	96
III.4.1. Profitability.....	96
III.4.2. Capital Adequacy.....	105
III.5. Financial Strength Index.....	111
<b>IV. Payment Systems.....</b>	<b>115</b>
IV.1. Turkish Interbank Clearing-Real Time Gross Settlement System.....	117
IV.2. Electronic Security Transfer System (TIC-RTGS & ESTS).....	119
IV.3. Cheque Clearing System.....	120

## LIST OF TABLES

Table I.3.1	Private Consumption Expenditures.....	11
Table I.3.2	Household Disposable Income Indebtedness and Interest Payments.....	12
Table I.3.3	Number of Non-Performing Consumer Loans and Credit Card Holders.....	13
Table I.3.4	Composition of Household Financial Assets.....	14
Table I.3.5	The Ratios of Household Liabilities to GDP and to Total Assets in Selected Countries.....	17
Table I.4.2.1	Loans Extended to Firms by Sectors.....	28
Table I.4.2.2	Share of Exports by Sectors in Total Exports.....	29
Table I.5.1	Balance of Payments.....	30
Table I.5.2	Counterparties Funding the Current Account Deficit...	33
Table II.1.1	Comparison Of Selected Balance Sheet Items with Selected EU Countries.....	40
Table II.1.2	Comparison with EU.....	43
Table II.2.1	Participation Funds Raised.....	47
Table II.2.2	Equity of Participation Banks.....	48
Table II.3.1	General Information About the Insurance Sector.....	49
Table II.3.2	Comparison With EU Countries.....	50
Table II.3.3	Premiums Written by the Insurance Sector.....	51
Table II.3.4	Basic Indicators of Private Pension System.....	52
Table II.3.5	Pension Mutual Funds.....	53
Table III.1.1.1.1	Bank Concentrations of Some Selected Credit Ratios.....	58
Table III.1.1.1.2	Shares of Housing Loans in Total Loans and in GDP for Selected Countries.....	69
Table III.1.1.2.1	Distribution of Total NPLs.....	71

Table III.1.1.2.2	NPL Ratios and Provisions to NPLs for Selected Countries.....	72
Table III.2.1.1	Selected Foreign Exchange Assets and Liabilities.....	85
Table III.2.1.2	Selected Derivative Financial Instruments With Counter Currency in New Turkish Lira.....	86
Table III.2.2.1.1	Increased Interest and Exchange Rate Scenarios.....	88
Table III.2.2.1.2	Results Under Increased Interest and Exchange Rate Scenarios.....	88
Table III.2.2.2.1	Decreased Interest and Exchange Rate Scenarios.....	90
Table III.2.2.2.2	Results of Decreased Interest and Exchange Rate Scenarios.....	90
Table IV.1.1	Real Time Gross Settlement Payment Systems- Country Comparisons.....	118

## LIST OF CHARTS

Chart I.2.1	Consolidated Budget Balance.....	2
Chart I.2.2	Net Total Public Sector Debt Stock and Its Composition.....	3
Chart I.2.3	Composition of Domestic Debt Stock.....	4
Chart I.2.4	Maturity Structure of Government Domestic Debt Securities (Month).....	5
Chart I.2.5	Distribution of Government Domestic Debt Securities by Holders.....	6
Chart I.2.6.	Interest Rates.....	7
Chart I.2.7	Ex-ante and Ex-post Real Interest Rates of Government Domestic Debt Securities.....	8
Chart I.2.8	Country Risk Premiums in Selected Developing Countries.....	9
Chart I.3.1	Private Sector's Consumption and Savings Ratios and the Real Disposable Income.....	11
Chart I.3.2	Employment Growth Rate and Retail Loans.....	13
Chart I.3.3	Ratio of YTL-FX Denominated Investment Instruments of Households.....	15
Chart I.3.4	Households' Financial Assets and Liabilities.....	16
Chart I.4.1.1	Growth Rate and Its Composition.....	20
Chart I.4.1.2	Contribution of Sectors to Growth.....	21
Chart I.4.1.3	Industrial Production and Capacity Utilization Rate.....	22
Chart I.4.1.4	Number of Workers and Partial Productivity per Worker for the Manufacturing Industry.....	23
Chart I.4.1.5	Number of Newly Established and Liquidated Companies and Cooperatives.....	24

Chart I.4.2.1	Selected Financial Structure Ratios.....	25
Chart I.4.2.2	Profitability Ratios.....	26
Chart I.4.2.3	Liquidity Ratios.....	27
Chart I.4.2.4	Cash Loans Extended to Firms.....	28
Chart I.5.1	Major Net Exporters and Importers of Capital in 2005.....	31
Chart I.5.2	The Composition of New Turkish Lira Bonds Issued By Foreigners in the Period 2005-6 April 2006.....	32
Chart I.5.3	Short-Term External Debt and International Reserves.....	32
Chart I.5.4	Net Receivables of International Banks from Selected Countries.....	34
Chart I.5.5	Developments in the Current Account Deficit and Direct Investments of Selected Countries.....	35
Chart II.1	Balance Sheet Size of the Financial Sector.....	37
Chart II.1.1	Development of Banking Sector.....	38
Chart II.1.2	Comparison of the Turkish Banking Sector Asset Size/GDP Ratio with Selected EU Countries.....	39
Chart II.1.3	Distribution of Banking Sector Assets by Groups....	41
Chart II.1.4	Distribution of Turkish Banking Sector Assets According to Equity Ownership.....	41
Chart II.1.5	Number of Banks and Personnel.....	42
Chart II.1.6	Asset Structure of the Banking Sector.....	44
Chart II.1.7	Liability Structure of the Banking Sector.....	45
Chart II.2.1	Selected Balance Sheet Items of Participation Banks.....	47
Chart II.2.2	Return on Equity and Return on Assets of Participation Banks.....	49

Chart II.3.1	Assets and Equity in the Insurance Sector.....	51
Chart II.4.1	Asset Structure of Consumer Finance Companies.....	53
Chart II.4.2	Liability Structure of Consumer Finance Companies.....	54
Chart II.4.3	Non-Performing Loan Ratio of Consumer Finance Companies.....	55
Chart III.1.1.1.1	Shares of Gross Loans and Securities Portfolio in Total Assets.....	57
Chart III.1.1.1.2	Distribution of Gross Loans by Borrowers and Real Annual Growth Rates.....	59
Chart III.1.1.1.3	Loan Distribution by Size (Excluding NPLs).....	59
Chart III.1.1.1.4	Currency Composition of Loans Extended (Excluding NPLs).....	60
Chart III.1.1.1.5	Fixed and Floating Interest Rate Loans (Excluding NPLs).....	61
Chart III.1.1.1.6	Maturity Structure of the Total Credit Portfolio (Excluding NPLs).....	62
Chart III.1.1.1.7	Geographical Distribution of Loans.....	63
Chart III.1.1.1.8	Loans Extended by Type (Excluding NPLs).....	64
Chart III.1.1.1.9	Development of Retail Loans (Excluding NPLs).....	65
Chart III.1.1.1.10	Number of Credit Cards.....	66
Chart III.1.1.1.11	Consumer Loans by Type (Excluding NPLs).....	68
Chart III.1.1.1.12	Consumer Loan Interest Rates.....	68
Chart III.1.1.1.13	Sectoral Composition of Corporate Loans and Contributions of Sectors to Credit Growth.....	70
Chart III.1.1.2.1	NPL Ratio and Provisions to NPLs.....	71
Chart III.1.1.2.2	NPL Ratios for Household and Corporate Loans.....	73

Chart III.1.1.2.3	NPL Ratios for Retail Loans.....	74
Chart III.1.1.2.4	NPL Ratios for Consumer Loans.....	75
Chart III.1.1.2.5	NPL Ratios of Some Selected Sectors.....	76
Chart III.1.1.3.1	Non-Cash Loans by Type.....	77
Chart III.1.2.1	Effects of Credit Shocks on the CAR of the Sector.....	78
Chart III.2.1.1	Share of Market Risk Components in Capital Requirement.....	80
Chart III.2.1.2	Interest Rate Sensitivity Gap of the Banking Sector.....	81
Chart III.2.1.3	Foreign Exchange Rates Interest Rates and Equity Prices.....	82
Chart III.2.1.4	Foreign Exchange Position of the Banking Sector.....	84
Chart III.2.1.5	Financing of Housing Loans and Swap Purchases.....	86
Chart III.3.1	Liquidity Ratios.....	92
Chart III.3.2	Ratio of Assets to Liabilities with Respect to Remaining Maturities.....	93
Chart III.3.3	The Coverage Ratio of Collaterals to Liabilities.....	94
Chart III.4.1.1	Net Profit and Its Components.....	96
Chart III.4.1.2	Operating Income.....	97
Chart III.4.1.3	Net Interest Income.....	99
Chart III.4.1.4	Net Interest Margin of the Banking Sector.....	100
Chart III.4.1.5	Return on Assets and Return on Equity.....	101
Chart III.4.1.6.a	Return on Assets by Countries.....	102
Chart III.4.1.6.b	Return on Equity by Countries.....	102



Chart III.4.1.7	Asset Share of the Banks Based on Return on Equity.....	102
Chart III.4.1.8	Return on Equity and Its Components.....	103
Chart III.4.2.1	Capital Adequacy Ratio (Unconsolidated).....	105
Chart III.4.2.2	Asset Share of Banks Based on Capital Adequacy Ratio.....	106
Chart III.4.2.3	Free Capital of the Banking Sector.....	108
Chart III.4.2.4.a	CAR by Countries.....	108
Chart III.4.2.4.b	Equity/Total Assets by Countries.....	108
Chart III.4.2.5	Distribution of Assets According to Risk Weights.....	109
Chart III.4.2.6	Distribution of Regulatory Capital Requirement With Respect to Credit and Market Risk.....	110
Chart III.5.1	Financial Strength Sub-Indices.....	112
Chart III.5.2	Financial Strength Index (FSI).....	114
Chart IV.1.1	Transaction volume and value of TIC-RTGS.....	117
Chart IV.2.1	Volume and value DVP transactions in ESTS.....	120
Chart IV.3.1	Transaction volume and value of Cheque Clearing System.....	121

(This page is intentionally left blank)

## LIST OF BOXES

Box I.3.1	Distribution of Household Income Resources (2004).....	10
Box I.3.2	Distribution of Household Expenditures (2004).....	12
Box I.3.3	Demographic Structure and Housing Loans.....	18
Box I.4.2.1	Data Set for Companies.....	25
Box.II.1.1	Development of Foreign Equity in the Turkish Banking Sector.....	42
Box.II.1.2	Important Changes Introduced by Turkish Banking Act No: 5411.....	45
Box.II.2.1	Participation Banks.....	46
Box II.3.1	Private Pension System.....	52
Box III.1.1.1.1	Bank Cards and Credit Cards Law No: 5464.....	66
Box III.1.1.1.2	Maximum Interest Rates Applied to Credit Card Transactions.....	67
Box III.2.1	Recent Fluctuations in Financial Markets in May 2006.....	83
Box III.3.1	Liquidity Management of the Central Bank of the Republic of Turkey.....	95
Box III.4.1.1	Assessment of Income and Asset Diversity.....	98
Box III.4.2.1	CAR Recalculated - FX Government Debt Securities Classified In The Highest Risk Category.....	107
Box III.5.1	Financial Strength Index Variables.....	111
Box IV.1	Core Principles for Systemically Important Payment Systems.....	116

(This page is intentionally left blank)

## ABBREVIATIONS

BIS	: Bank for International Settlements
BRSA	: Banking Regulation and Supervision Agency
CAR	: Capital Adequacy Ratio
CBRT	: Central Bank of the Republic of Turkey
CIF	: Cost Insurance Freight Price Included
CMB	: Capital Markets Board
CPI	: Consumer Price Index
DvP	: Delivery versus Payment
ECB	: European Central Bank
EIB	: European Investment Bank
EMBI	: Emerging Market Bond Index
ESA95	: European System of Accounting 95
ESTS	: Electronic Security Transfer System
EU	: European Union
EUROSTAT	: Statistical Office of the European Communities
FED	: Federal Reserve Bank
FOB	: Free on Board
FSI	: Financial Strength Index
FX	: Foreign Exchange
FXNGP	: Foreign Exchange Net General Position
GDDS	: Government Domestic Debt Security
GDP	: Gross Domestic Product
GNP	: Gross National Product
ICC	: Interbank Card Center
ICH	: Interbank Cheque Clearing Houses Center
IMF	: International Monetary Fund

ISE	: İstanbul Stock Exchange
NPL	: Non Performing Loans
OECD	: Organization for Economic Cooperation and Development
POS	: Point of Sale
PPI	: Producer Price Index
ROA	: Return on Assets
ROE	: Return on Equity
RTGS	: Real Time Gross Settlement System
SDIF	: Savings Deposits Insurance Fund
SME	: Small and Medium Sized Enterprises
SPO	: State Planning Organisation
SWIFT	: Society for Worldwide Interbank Financial Telecommunication
TAKASBANK	: ISE Settlement and Custody Bank Inc.
TARGET	: Trans-European Automated Real Time Gross Settlement System
TBA	: Turkish Banks Association
TIC-RTGS	: The Turkish Interbank Clearing-Real Time Gross Settlement System
TURKSTAT	: Republic Of Turkey, Prime Ministry Turkish Statistical Institute
YTL	: New Turkish Lira