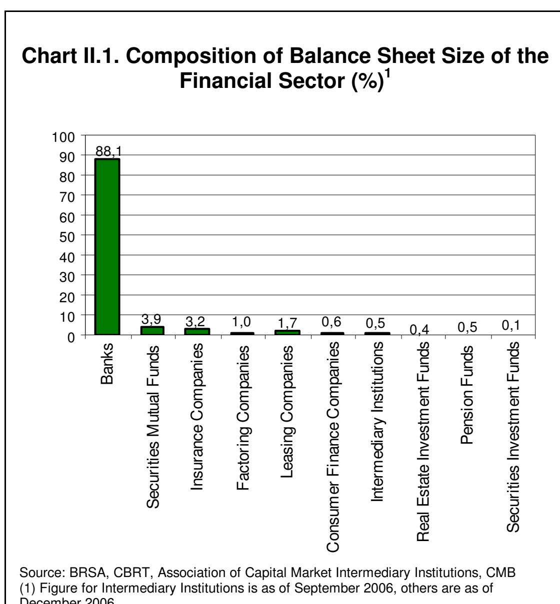
II. STRUCTURE OF THE FINANCIAL SECTOR

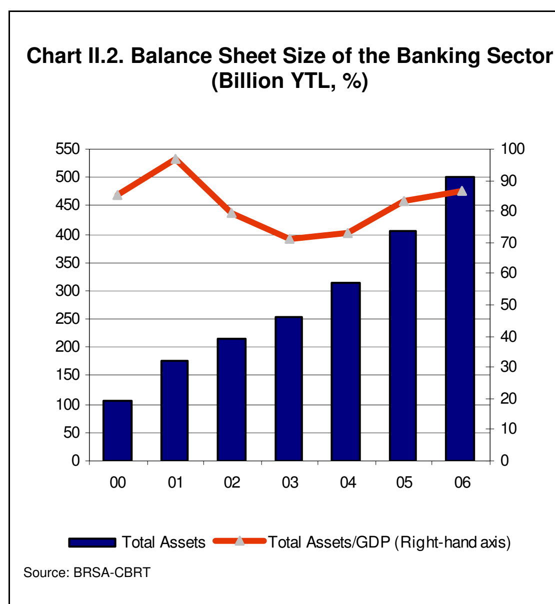
The Turkish financial sector has continued to demonstrate stable growth in 2006, despite the fluctuation period of May-June. Furthermore, the interest of foreign investors in the banking sector has continued to increase in this period.

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



Source: BRSA, CBRT, Association of Capital Market Intermediary Institutions, CMB
(1) Figure for Intermediary Institutions is as of September 2006, others are as of December 2006.

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



Source: BRSA-CBRT

The total asset size of the financial sector increased by 20 percent as of year-end 2006, compared to the previous year-end and reached 567 billion New Turkish Liras. About 88 percent of total financial sector assets are composed of bank assets (Chart II.1).

Even though pension funds have a small share in the financial sector, the increase in these funds is remarkable. The portfolio value of pension funds increased by 142 percent in 2006.

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. The data of participation banks are included in the assessments of this section.

As of year-end 2006, the number of banks in the sector decreased to 50 as a result of the merger of Yapı Kredi Bankası and Koçbank and the number of personnel increased by 12,196 compared to the previous year-end and reached 150,853.

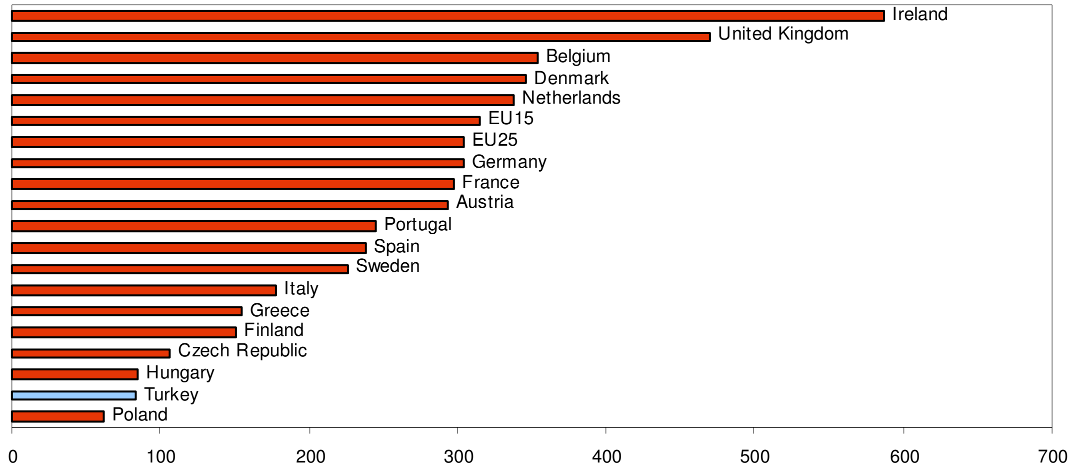
The asset concentration ratio of the largest five banks is 61 percent and the largest 10 banks is 84 percent as of year-end 2006. These ratios have not changed significantly when compared to the previous year-end.

As of year-end 2006, the total asset size of the banking sector increased by 12 percent on a real basis compared to the previous year-end and reached 500 billion New Turkish Liras,

while in USD terms, it increased by 17 percent and reached 303.3 billion from 355.5 billion USD.

The asset size of the Turkish banking sector to GDP ratio, which was realized as 83.5 percent by year-end 2005, reached 86.7 percent as of year-end 2006 (Chart II.2). This indicates that the Turkish banking sector has been growing more rapidly than the GDP, which has been increasing continuously for the last 20 quarters.

Chart II.1.1. Comparison of the Turkish Banking Sector Asset Size/GDP Ratio with Selected EU Countries (%)[1]



Source: TURKSTAT, BRSA-CBRT, ECB Report – 2006
(1) All figures are as of 2005. The Turkish Banking Sector Asset Size/GDP Ratio is 87 percent in 2006.

The asset size of the Turkish banking sector to GDP ratio is less than all EU countries except Poland (Chart II.1.1). This indicates the growth potential of the Turkish banking sector.

Table II.1.1. Comparison of Selected Balance Sheet Items with Selected EU Countries [1,2]

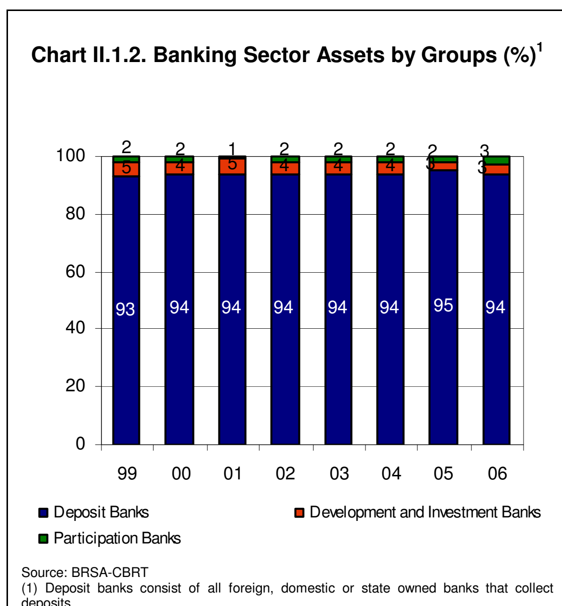
Countries	Deposits / GDP (%)	Loans / GDP (%)	Loans / Deposits (%)	Loans / Total Assets (%)	Total Assets / Number of Banks (Million Euro)
Belgium	154	122	79	34	10,553
Denmark	69	184	269	53	3,665
Germany	115	135	117	44	3,268
Greece	104	84	81	54	4,533
Spain	118	141	120	59	6,180
France	80	99	125	33	5,960
Ireland	143	208	146	35	12,076
Italy	60	90	151	51	3,168
Luxemburg	818	494	60	18	5,112
Holland	136	189	139	56	4,234
Austria	101	134	132	45	819
Portugal	110	142	129	58	1,937
Finland	55	76	138	50	646
Sweden	53	120	225	53	3,266
UK	138	156	113	33	20,801
EU15 Ave.	106	130	123	41	4,554
EU25 Ave.[3]	104	126	121	41	3,787
Turkey 2005	52	32	63	39	5,026
Turkey 2006	53	38	71	44	5,397

Source: BRSA-CBRT, ECB Report – 2006
(1) Figures for EU countries are as of 2005. The figures of "credit institutions" for EU member countries are used, for Turkey, the figures of "banks" are used.
(2) For Turkey, deposits include participation funds and loans include funds extended by participation banks.
(3) EU-25 averages are taken into account since the data of Bulgaria and Romania, EU members since 2007, are not included in the ECB Report – 2006.

Even though deposits and loans to GDP, and loans to deposits ratios, which show the financial depth and intermediation level of the banking sector, have all demonstrated a

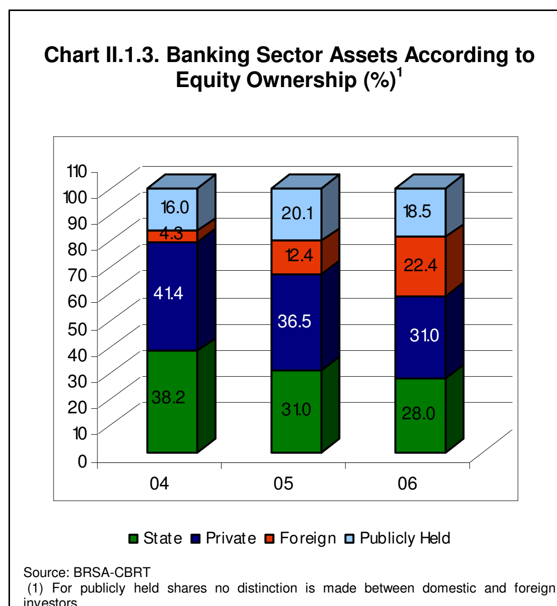
significant increase when compared to the previous year, they remain under the average of the EU countries (Table II.1.1).

Chart II.1.2. Banking Sector Assets by Groups (%)[1]



Source: BRSA-CBRT
(1) Deposit banks consist of all foreign, domestic or state owned banks that collect deposits.

Chart II.1.3. Banking Sector Assets According to Equity Ownership (%)[1]

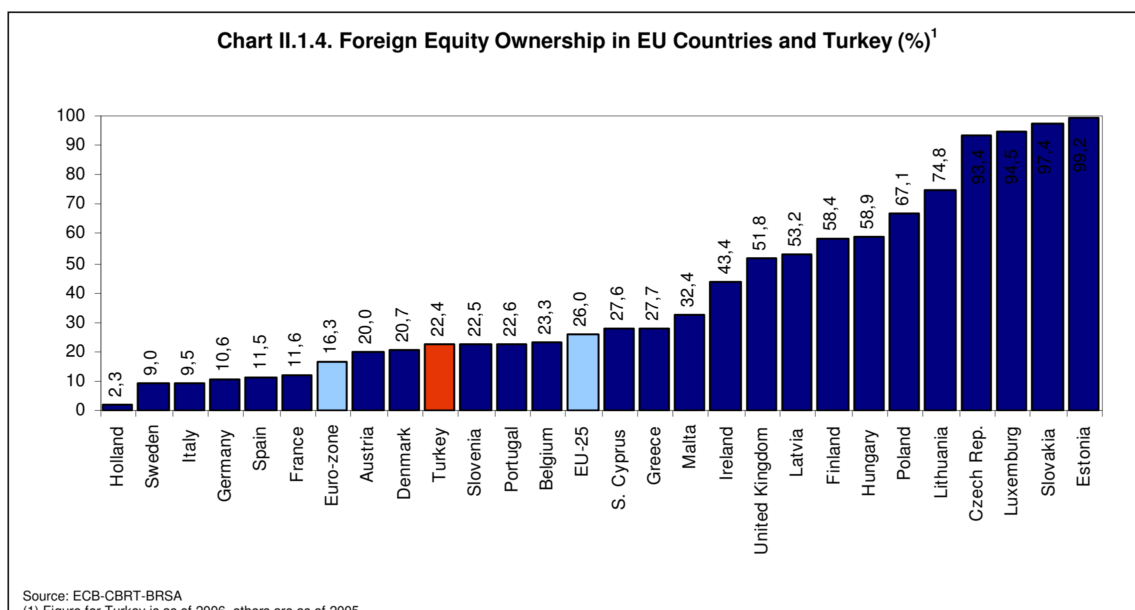


Source: BRSA-CBRT
(1) For publicly held shares no distinction is made between domestic and foreign investors.

Of the 50 banks operating in the Turkish banking sector, 33 are deposit banks, 13 are development and investment banks, 4 are participation banks. The Turkish banking sector is mainly based on deposit banking (Chart II.1.2).

As a result of the increasing interest of foreign investors in the Turkish banking sector in 2006, the share of foreigners reached 22.4 percent of the total assets of the banking sector as of year-end 2006, including those banks whose share transfer process was finalized in April 2007 (Chart II.1.3). On the other hand, according to data of the Central Registry Agency, the share of the foreigners in publicly held shares was 16.4 percent with respect to total assets of the sector for the same period. When these shares are added, the share of foreigners becomes 38.8 percent. Despite the fluctuations of the May-June period, the increasing interest of foreigners in the banking sector indicates that positive expectations are maintained.

Chart II.1.4. Foreign Equity Ownership in EU Countries and Turkey (%)[1]



Source: ECB-CBRT-BRSA
(1) Figure for Turkey is as of 2006, others are as of 2005.

Regarding the share of foreign equity, it is observed that the average of the EU-25 is 26 percent and those countries that joined the Union in the last period remain above the average of the EU-25. As of September 2006, according to the legally finalized acquisitions and mergers by foreigners, Turkey is slightly above the average of Euro zone countries (EU-15) but under the average of the EU-25 (Chart II.1.4).

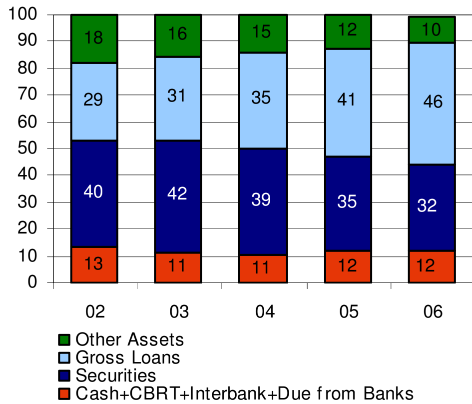
Table II.1.2. Comparison with EU Member Countries[1]

Countries	The Share of the Largest 5 Credit Institutions (%)	Number of Credit Institutions	Total Number of Branches	Total Number of Personnel	Personnel per Branch	Branch per Credit Institution	Banking Sector Personnel to Total Population (%)
Belgium	85	100	4,564	69,481	15	46	0.7
Denmark	66	197	2,114	47,579	23	11	0.9
Germany	22	2,089	44,044	705,000	16	21	0.9
Greece	66	62	3,576	61,295	17	58	0.6
Spain	42	348	41,979	252,829	6	121	0.6
France	54	854	27,075	429,347	16	32	0.7
Ireland	46	78	910	37,702	41	12	0.9
Italy	27	792	31,498	335,910	11	40	0.6
Luxemburg	31	155	246	23,224	94	2	5.1
Netherlands	85	401	3,748	118,032	31	9	0.7
Austria	45	880	4,300	75,303	18	5	0.9
Portugal	69	186	5,427	53,989	10	29	0.5
Finland	83	363	1,616	25,182	16	4	0.5
Sweden	57	200	1,910	39,237	21	10	0.4
UK	36	400	13,694	482,888	35	34	0.8
EU15	54	474	12,447	183,800	15	26	0.7
EU25	60	347	8,050	122,164	15	23	0.7
Turkey 2005	61	51	6,564	138,657	21	129	0.2
Turkey 2006	61	50	7,302	150,853	21	146	0.2

Source: BRSA-CBRT, Eurostat, ECB Report – 2006
(1) Figures for EU member countries are as of 2005. In EU countries, the definition of "cedit institution" may differ and non-bank financial institutions may be included in the definition of credit institutions in some cases. The figures for Turkey contain participation banks.

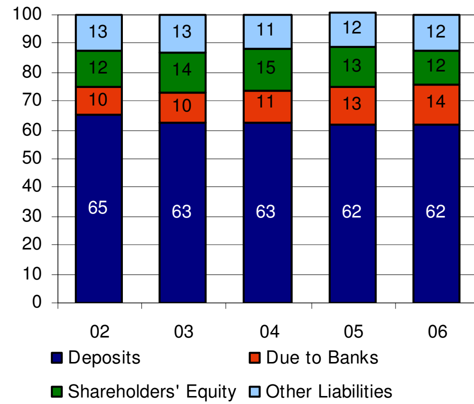
The number of banks and branches in the Turkish banking sector is under the average of EU countries, but the number of personnel is higher than the average of EU-25 countries and lower than the average of EU-15 countries. The number of personnel employed in the banking sector to total population is lower than all EU countries. However, the branch per bank is higher than EU countries as a result of intensive branch banking in Turkey. The number of personnel per branch is higher than the average of EU countries. It is observed that the banking sector concentration is higher than the average of EU countries (Table II.1.2).

Chart II.1.5. Asset Structure of the Banking Sector (%)



Source: BRSA-CBRT

Chart II.1.6. Liability Structure of the Banking Sector (%)



Source: BRSA-CBRT

The share of loan portfolio as the largest asset item continued to increase in 2006 and reached 46 percent as of year-end 2006 from 41 percent as of the previous year-end (Chart II.1.5).

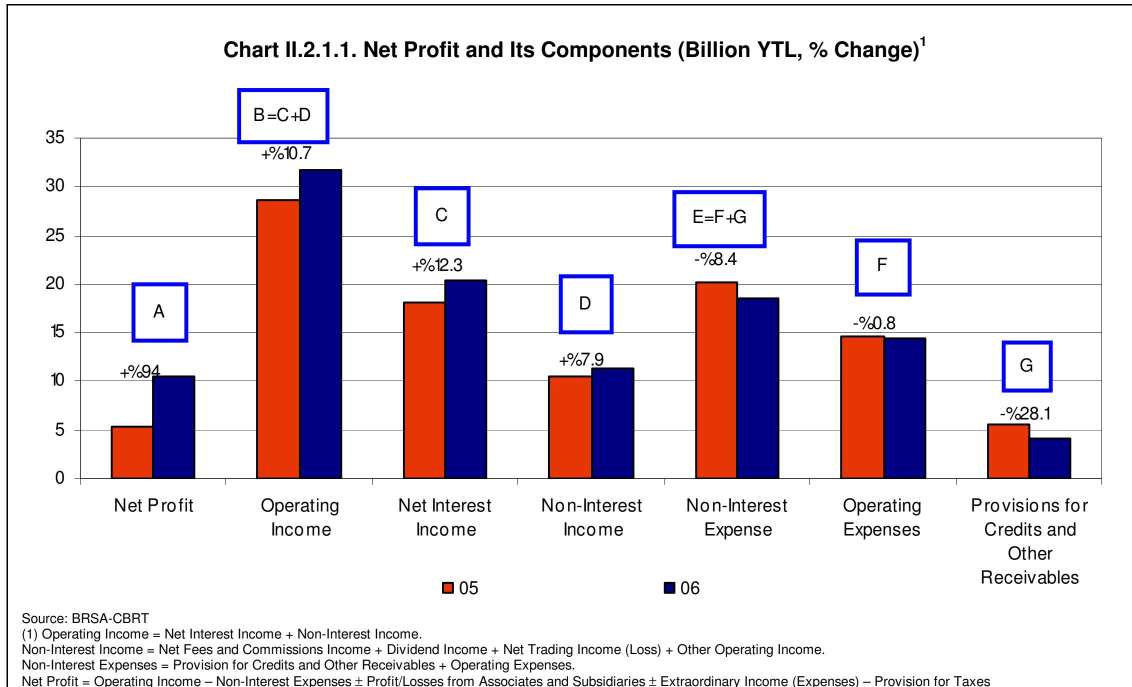
In 2006, the share of shareholders' equity in total liabilities decreased by 1 percent compared to year-end 2005 and stood at 12 percent. The share of deposits in total liabilities remained unchanged and maintained its level at 62 percent (Chart II.1.6).

II.2. Profitability and Capital Adequacy[3]

II.2.1. Profitability[4]

As of year-end 2006, the net profit of the banking sector was realized as 10.6 billion New Turkish Liras, increasing by 94 percent on an annual basis. The fact that one bank, which incurred a high amount of net loss by year-end 2005, made a profit this year, was also effective in the increase in the profit and improved profitability performance of the banking sector.

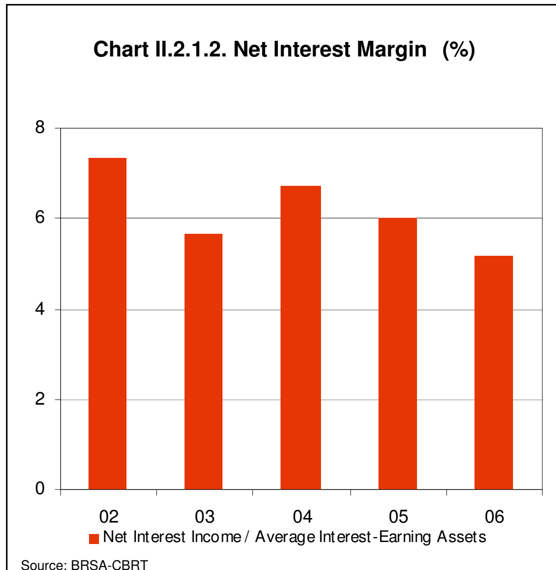
Chart II.2.1.1. Net Profit and Its Components (Billion YTL, % Change)[1]

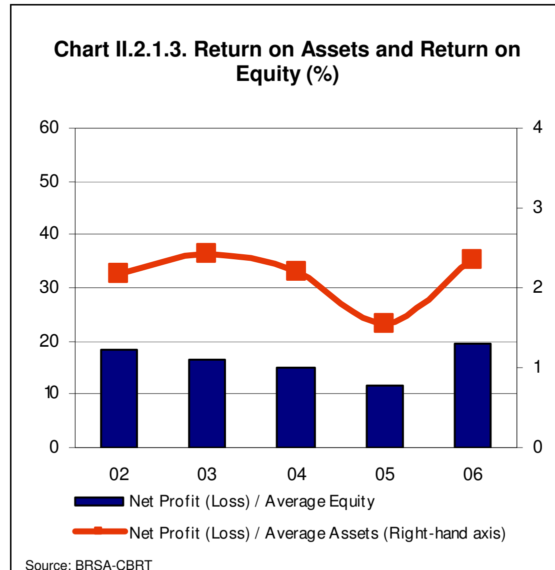


Source: BRSA-CBRT
(1) Operating Income = Net Interest Income + Non-Interest Income.
Non-Interest Income = Net Fees and Commissions Income + Dividend Income + Net Trading Income (Loss) + Other Operating Income.
Non-Interest Expenses = Provision for Credits and Other Receivables + Operating Expenses.
Net Profit = Operating Income – Non-Interest Expenses ± Profit/Losses from Associates and Subsidiaries ± Extraordinary Income (Expenses) – Provision for Taxes

As of year-end 2006, the increase in the operating income and the decrease in the provisions for loans and other receivables are the determinants of the rise in the profit of the banking sector. It is seen that besides the increase in net interest income, the 17.9 percentage increase in net fees and commissions income as a component of non-interest income, contributed to the increase in operating income. On the other hand, the ratio of operating income to operating expenses increased to 219.9 percent in 2006. The increase in this ratio and net fees and commissions income is evaluated positively in terms of profitability (Chart II.2.1.1).

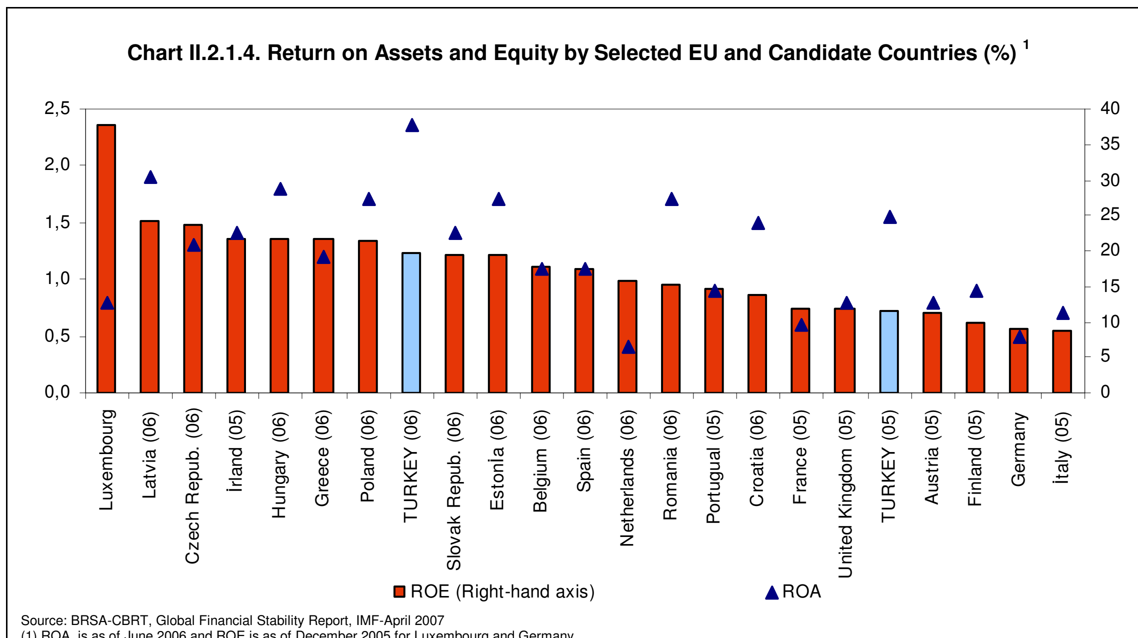
[3] Participation banks are excluded in this section due to their different operating principles.
[4] The SDIF bank is excluded.





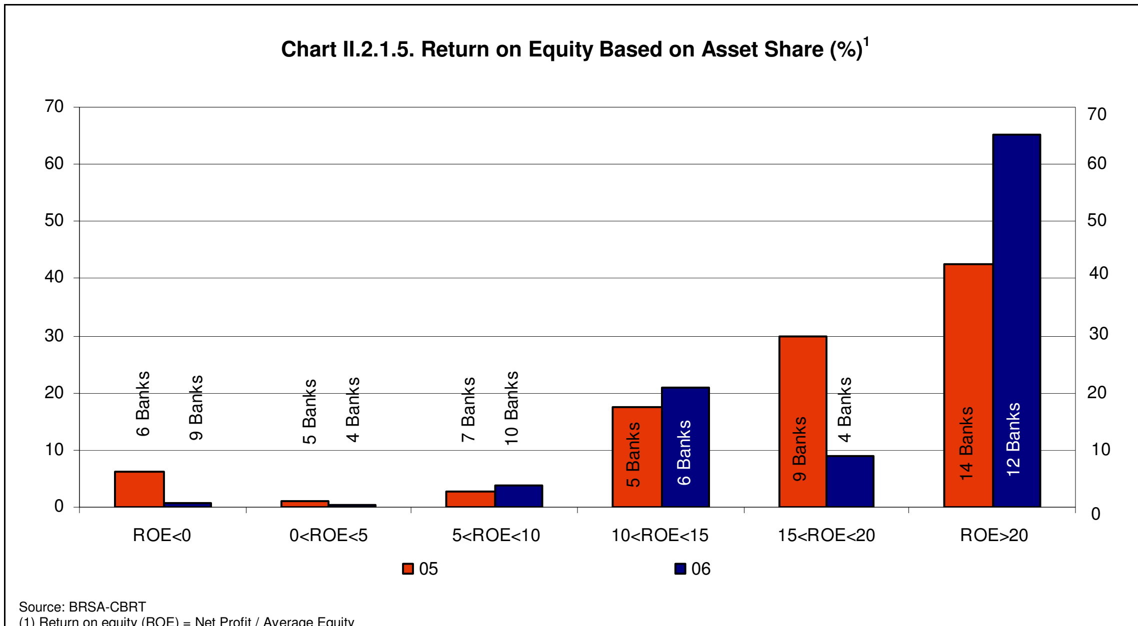
The decreasing trend of the net interest margin, which is the ratio of net interest income to average interest-earning assets, continued in 2006 (Chart II.2.1.2). The decrease in the net interest margin stemmed from the declining trend of interest rates until June 2006. After that period, despite the increase in interest rates, the margin maintained the same level as a result of the strong growth in fixed-rate consumer loans, essentially housing loans, as well as those fixed-rate securities purchased before June.

As of year-end 2006, the return on assets and return on equity of the banking sector were realized as 2.3 percent and 19.5 percent, respectively. Both of these figures showed a significant increase compared to year-end 2005 (Chart II.2.1.3).



When compared with selected EU and candidate countries, the Turkish banking system has a higher performance especially with regard to the return on assets. On the other hand, the lower return on equity stems from the low level of financial leverage in the Turkish banking sector (Chart II.2.1.4).

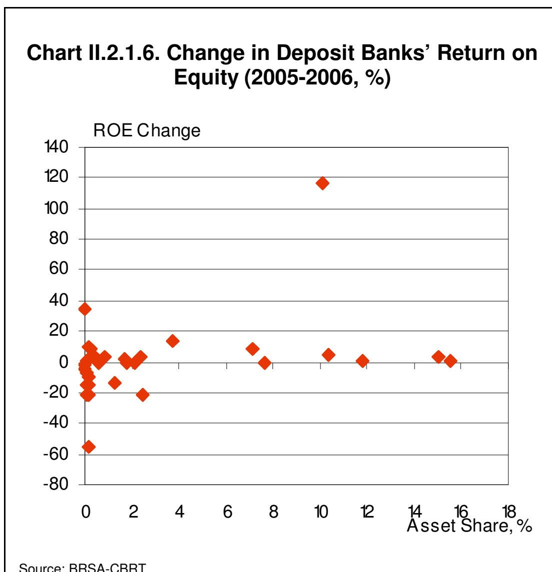
Chart II.2.1.5. Return on Equity Based on Asset Share (%)[1]



Source: BRSA-CBRT
(1) Return on equity (ROE) = Net Profit / Average Equity

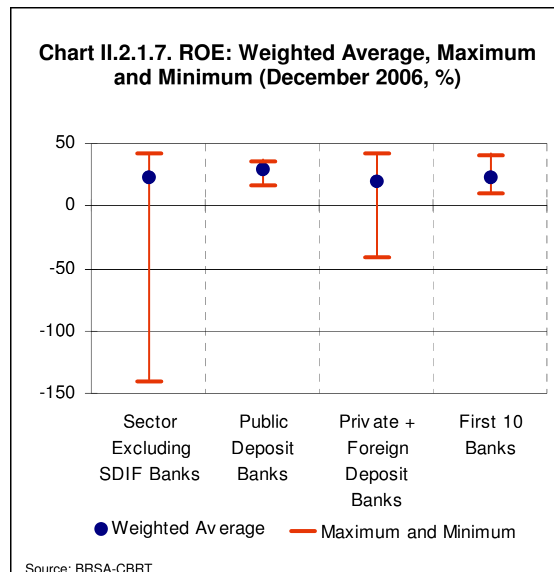
As of year-end 2006, while the number of banks with a return on equity over 20 percent has decreased, the asset share of those banks has increased. The number of banks that incurred losses increased from 6 to 9, but their asset share remained very low in the sector (Chart II.2.1.5).

Chart II.2.1.6. Change in Deposit Banks' Return on Equity (2005-2006, %)



Source: BRSA-CBRT

Chart II.2.1.7. ROE: Weighted Average, Maximum and Minimum (December 2006, %)



Source: BRSA-CBRT

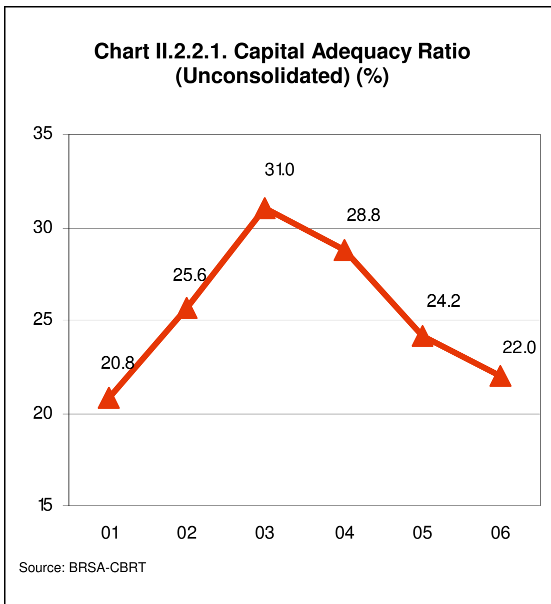
As of the end of 2006, compared to the previous year, it is seen that the change in return on equity is more significant in small banks. The change in return on equity of the banks with a share exceeding 6 percent of total assets is limited, except a bank, which incurred a net loss the previous year and made a profit in 2006 (Chart II.2.1.6).

As of year-end 2006, the value range for the return on equity is narrow for the largest 10 banks and public deposit banks. The broader range for private and foreign deposit banks is due to the small banks (Chart II.2.1.7).

II.2.2. Capital Adequacy

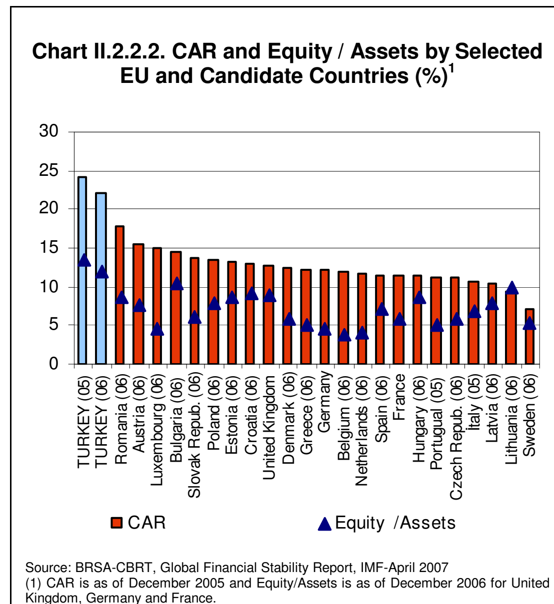
Although the unconsolidated capital adequacy ratio (CAR) of the banking sector, which is the ratio of own funds to risk weighted assets, has a declining trend, it was realized well above both the minimum requirement of 8 percent and the target ratio of 12 percent for all periods under review.

Chart II.2.2.1. Capital Adequacy Ratio (Unconsolidated) (%)



Source: BRSA-CBRT

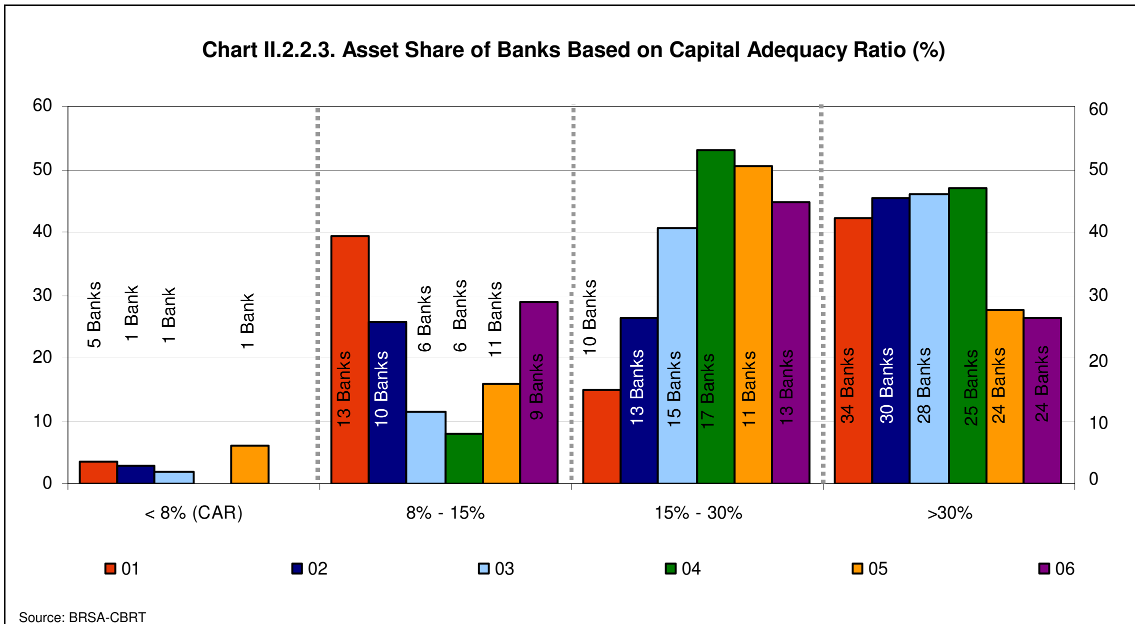
Chart II.2.2.2. CAR and Equity / Assets by Selected EU and Candidate Countries (%)[1]



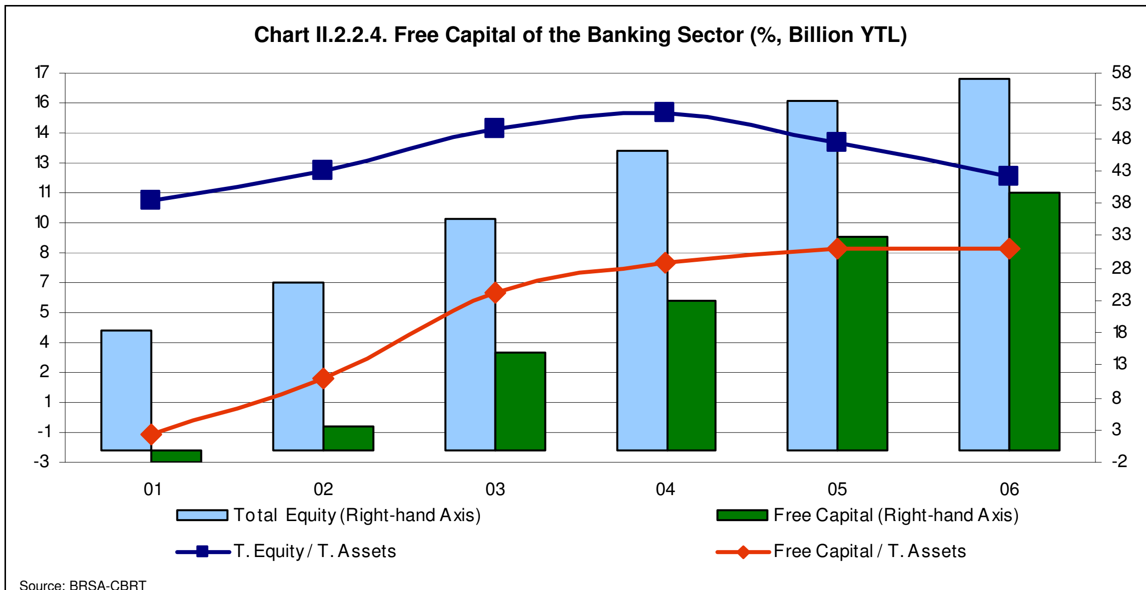
Source: BRSA-CBRT, Global Financial Stability Report, IMF-April 2007
(1) CAR is as of December 2005 and Equity/Assets is as of December 2006 for United Kingdom, Germany and France.

The CAR of the banking sector decreased by 2.2 points with respect to end of previous year and was realized as 22 percent as of year-end 2006 (Chart II.2.2.1). Since own funds grew by 23 percent while the risk weighted assets increased by 35 percent, the ratio of the sector fell as of year-end 2006. While the increase in net profit was effective in the increase in own funds, the increase in risk weighted assets was due to the loan growth in the 100 percent risk-weighted assets category.

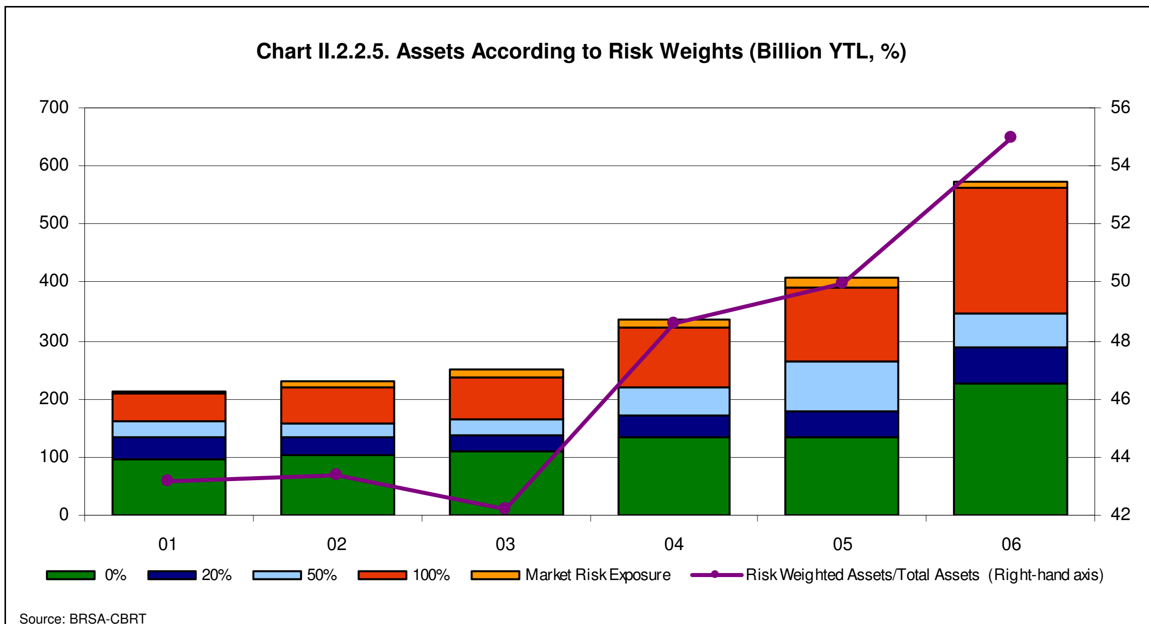
It is observed that the capital adequacy and equity to total assets ratios for the Turkish banking sector have the highest values when compared to EU and candidate countries. While the acceptance of the large portfolio of Government Debt Securities as risk free in the calculation of the capital adequacy ratio causes the CAR to maintain a high level, the low levels of financial leverage gives rise to a high equity to total assets ratio (Chart II.2.2.2).



While the capital adequacy ratios of 35 banks in the sector, which hold 78 percent of the sector assets, exceeded 15 percent by year-end 2005, the capital adequacy ratios of 37 banks, which hold 71 percent of the sector assets, exceeded 15 percent as of year-end 2006 (Chart II.2.2.3).



Since free capital and total assets have displayed the same level of increase in the last year, no change is observed in the free capital to total assets ratio. Although the equity to total assets ratio has a declining trend, it is still high when compared to EU countries (Chart II.2.2.4).



As of year-end 2006, the share of 100 percent risk weighted assets increased to 38 percent from 32 percent due to the increase in loans (Chart II.2.2.5).

The increase of 100 percent risk weighted assets was also influenced by the change of the risk category of the "commitments on credit card spending limits", from 50 percent to 100 percent, according to "The Regulation on Measurement and Assessment of Capital Adequacy of Banks", which has been put into effect on November 1, 2006**.** On the other hand, as the "securities available for sale" are taken into account within the context of credit risk instead of market risk as of year-end 2006, the share of zero percent risk weighted assets increased from 32 to 40 percent and the amount of market risk exposure decreased from 4 percent to 2 percent (Chart II.2.2.5).

As of year-end 2006, since the total risk weighted assets had increased more, the ratio of risk weighted assets to total assets had increased to 55 percent from 50 percent, compared to year-end 2005.