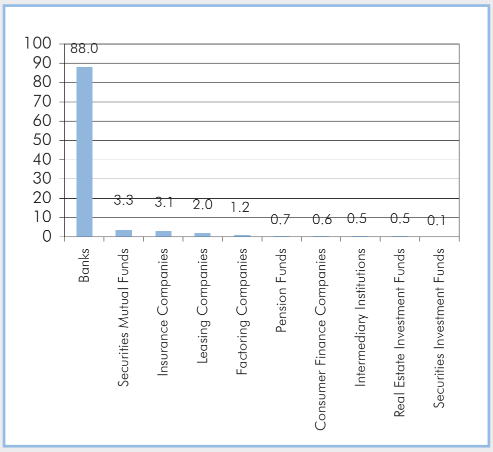
II. STRUCTURE OF THE FINANCIAL SECTOR

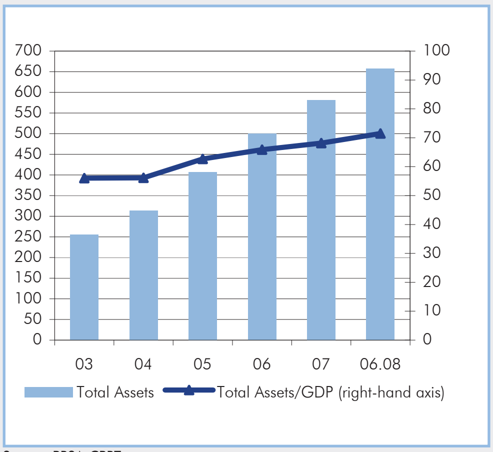
The Turkish financial sector maintained its growth trend in the first half of 2008.

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



Source: BRSA, CBRT, Assoc. of Capital Market Intermediary Institutions, CMB
(1) Figures are as of June 2008

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



Source: BRSA-CBRT

The total asset size of the financial sector, which grew by 12 percent compared to end-2007, reached YTL 746 billion as of June 2008. 88 percent of financial sector assets belong to banks (Chart II.1).

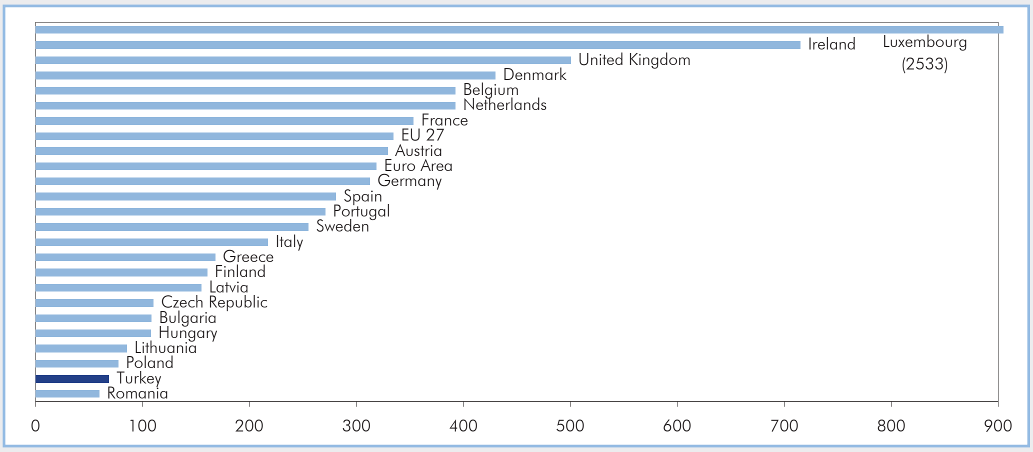
II.1. Banking Sector

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

As of September 2008, the number of banking sector staff increased by 13,769 compared to end-2007 and reached 181,529, whereas the number of banks remained at 50.

As of September 2008, the total asset size of the banking sector grew by 9 percent in real terms compared to end-2007 and reached YTL 680 billion, while it increased to 552 billion in USD terms, with a rise of 10 percent.

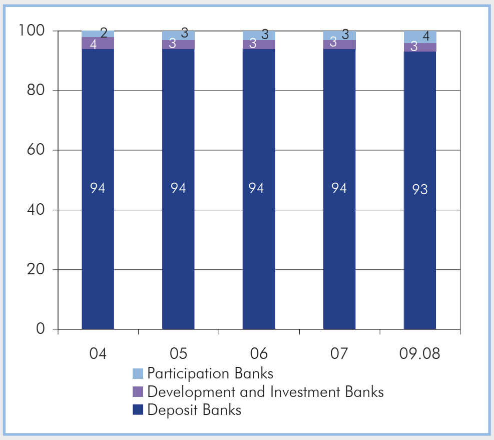
Chart II.3.
Comparison of the Turkish Banking Sector Asset Size/GDP Ratio with Selected EU Countries[1] (%)



Source: TURKSTAT, BRSA-CBRT, ECB Report – 2008
(1)Figures are as of 2007.

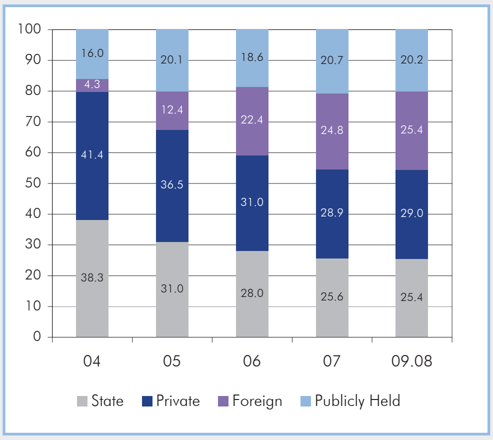
The ratio of the Turkish banking sector's asset size to GDP increased to 71.5 percent as of June 2008 from 68.1 percent at end-2007 (Chart II.2). The share of the Turkish banking sector in the GDP is higher than that of Romania, whereas it is lower than that of other EU countries (Chart II.3).

Chart II.4.
Banking Sector Assets by Groups (%)



Source: BRSA - CBRT

Chart II.5.
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 2008, of the 50 banks in the Turkish banking sector, 33 are deposit banks, 13 are development and investment banks and 4 are participation banks. As can be seen, deposit banking prevails in the Turkish banking sector (Chart II.4).

Based on their share in paid-up capital, the share of foreign stockholders in assets, which stood at 24.8 percent at end-2007, rose to 25.4 percent in September 2008 due to faster growth of banks with foreign capital (Chart II.5). Meanwhile, according to data of the Central Registry Agency for September 2008, the share of foreign participation in publicly held shares was 17.5 percent of the total assets of the sector. When these shares are included, the share of foreign participation in the banking sector reaches 42.9 percent.

Table II.1 Comparison with Selected EU Countries[1,2,3]

Countries	Deposits/ GDP (%)	Loans/ GDP (%)	Loans/ Deposits (%)	Tot. Assets/ Number of Banks (Million Euros)	Share of the 5 Largest Credit Institutions (%)	Number of Credit Institutions	Foreign Part. in the Banking Sector (%)
Germany	119	130	109	3,733	22	2,026	11.1
Austria	111	140	126	1,109	43	803	26.9
Belgium	155	126	81	11,798	83	110	24.8
Bulgaria	69	67	97	1,077	57	29	81.6
Czech Rep.	73	53	72	2,500	66	56	91.5
Denmark	79	221	279	5,174	64	189	19.3
Finland	56	82	146	799	81	360	65.3
France	83	114	137	8,270	52	808	12.9
Holland	157	194	123	6,437	86	341	17.6
UK	290	288	99	25,880	41	390	53.4
Ireland	175	257	147	16,511	46	81	46.7
Spain	144	177	123	8,250	41	357	11.6
Sweden	57	134	234	4,209	61	201	9.3
Italy	73	112	154	4,058	33	821	17.4
Latvia	72	104	145	994	67	31	58.0
Lithuania	42	63	152	298	81	80	83.7
Luxembourg	819	531	65	5,868	28	156	95.0
Hungary	51	65	128	527	54	206	57.4
Poland	48	43	91	329	47	718	70.5
Portugal	118	158	134	2,515	68	175	23.0
Romania	32	35	109	1,717	56	42	82.1
Greece	109	87	80	6,084	68	63	23.2
Ave. Euro Area	**112**	**136**	**121**	**4,620**	**55**	**471**	**19.5**
Ave. EU 27	**136**	**157**	**116**	**4,920**	**59**	**309**	**28.7**
Turkey 2007	**42**	**35**	**83**	**6,819**	**60**	**50**	**24.8**
Turkey 06.2008	**44**	**38**	**87**	**6,826**	**59**	**50**	**25.6**

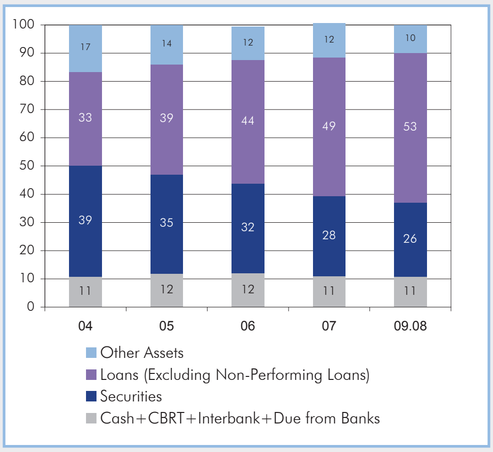
Source: BRSA - CBRT, Eurostat, ECB Report – 2008
(1) The figures of EU countries are as of 2007. There are discrepancies in the definition of "credit institution" in EU countries and some include non-bank financial institutions. For Turkey, bank data are taken into consideration.
(2) For Turkey, deposit data includes participation funds, loan data includes funds extended by participation banks.
(3) In paralel to EU data, non performing loans are included in Turkey's loan data.

Although the ratio of deposits and loans to GDP and the ratio of loans to deposits, which reveal the financial depth and intermediation level of the banking sector, displayed an increase in June 2008 compared to end-2007, it lagged behind EU averages (Table II.1)

The number of banks in the Turkish banking sector is significantly below the EU average. The share of the first five banks in total assets is the same as the EU average (Table II.1). Meanwhile, as of September 2008, the concentration ratios of the first five banks and the first ten banks remained unchanged in comparison to the end of the year, and were realized as 60 percent and 83 percent, respectively.

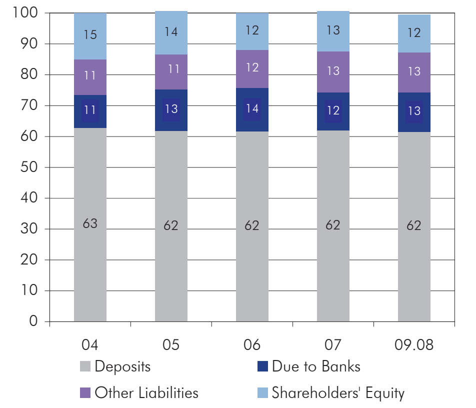
By the end of 2007, the share of foreign participation in the banking sector was 20 percent in the Euro area and 29 percent in the EU27. The share of foreign participation in the Turkish banking sector, which was 25 percent as of the same date, was realized above the Euro area average, albeit below the average of not only the EU27, but also new members of the EU such as Bulgaria, the Czech Republic, Hungary, Poland and Romania (Table II.1)

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



Soruce: BRSA-CBRT

Chart II.7.
Liability Structure of the Banking Sector (%)



Soruce: BRSA-CBRT

The share of the loan portfolio as the largest asset item maintained its upward trend and reached 53 percent, while the share of securities declined to 26 percent as of September 2008 (Chart II.6).

As of September 2008, the share of deposits as the largest source of funds remained the same at 62 percent, whereas the share of shareholders' equity was realized as 12 percent with a 1 percentage point decrease (Chart II.7).

II.2.Banking Sector Profitability and Capital Adequacy

II.2.1.Profitability[3,4]

When the first nine months of 2008 is analyzed, it is seen that the banking sector failed to maintain the profitability performance achieved in the same period of the previous year. As of September 2008, the net profit of the sector declined by 6.4 percent compared to September 2007, and stood at YTL 10.6 billion.

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

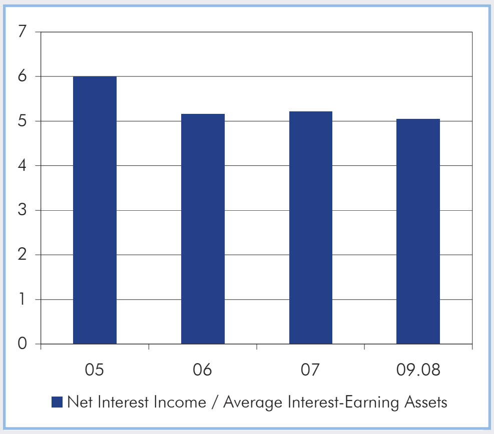
	09.07	09.08	Change (%)
I. Operating Income (A+B)	28,020	32,327	15.4
A- Net Interest Income	18,165	21,928	20.7
B- Non-Interest Income[1]	9,855	10,399	5.5
II. Non-Interest Expenses(C+D)	15,053	20,019	33.0
C- Prov. for Credits and Other Receiv.	3,187	5,276	65.6
D- Other Operating Expenses	11,866	14,742	24.2
III. Net Operating Profit (I-II)	12,968	12,308	-5.1
IV. Other Income[2]	785	957	22.0
V. Provision for Taxes	2,434	2,674	9.8
VI. Net Profit (III+IV-V)	11,318	10,592	-6.4

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).

3 Participation banks are excluded as their operating principles differ from other banks.
4 Bank under SDIF is excluded.

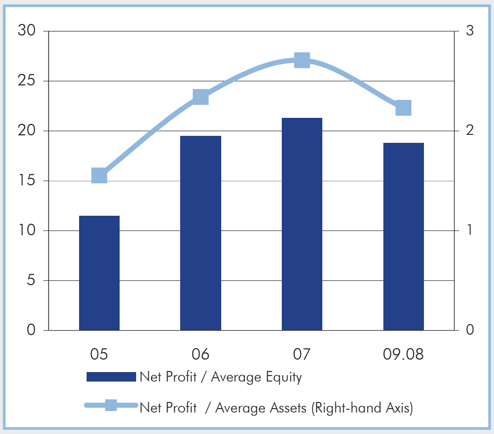
As of September 2008, the decline in the profitability of the banking sector was mainly due to the 33 percent increase in non-interest expenses despite the 15.4 percent rise in operating income. The upsurge in operating expenses, particularly personnel expenses and other non-interest expenses, together with the increase in special and general provisions for credits and other provisions, pushed up non-interest expenses (Table II.2). The rise in non-interest income remained limited, due to the fact that foreign currency gains turned into losses and income from the sale of assets as a one off income item was not realized as high as the previous year.

Chart II.8.
Net Interest Margin[1] (%)



Source: BRSA – CBRT
(1) Data is annualized for September 2008.

Chart II.9.
Return on Assets and Return on Equity[1] (%)

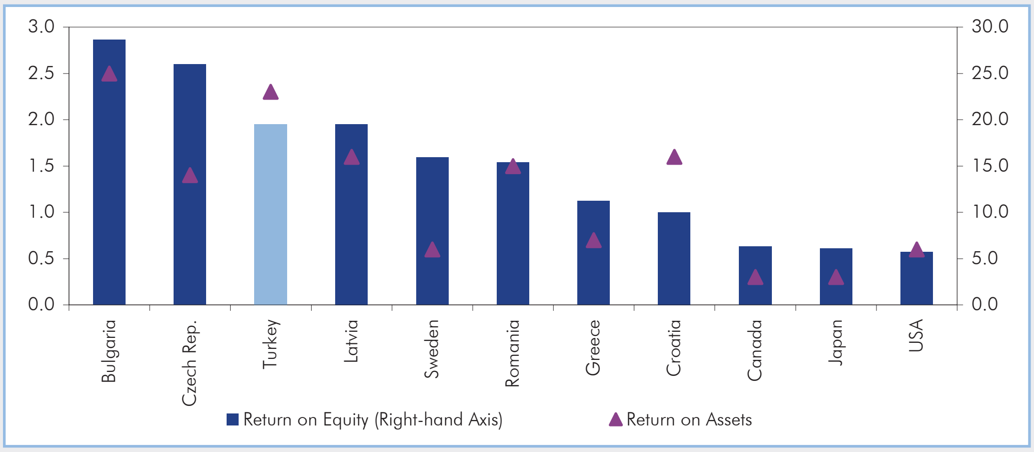


Source: BRSA - CBRT
(1) Data is annualized for September 2008.

The ratio of net interest income to average interest-earning assets, which was 5.2 percent at end-2007, did not change significantly and stood at 5.0 percent in September 2008 (Chart II.8).

As of September 2008, the return on assets and the return on equity were 2.2 percent and 18.8 percent, respectively. Both of these ratios display a downward trend compared to end-2007 (Chart II.9).

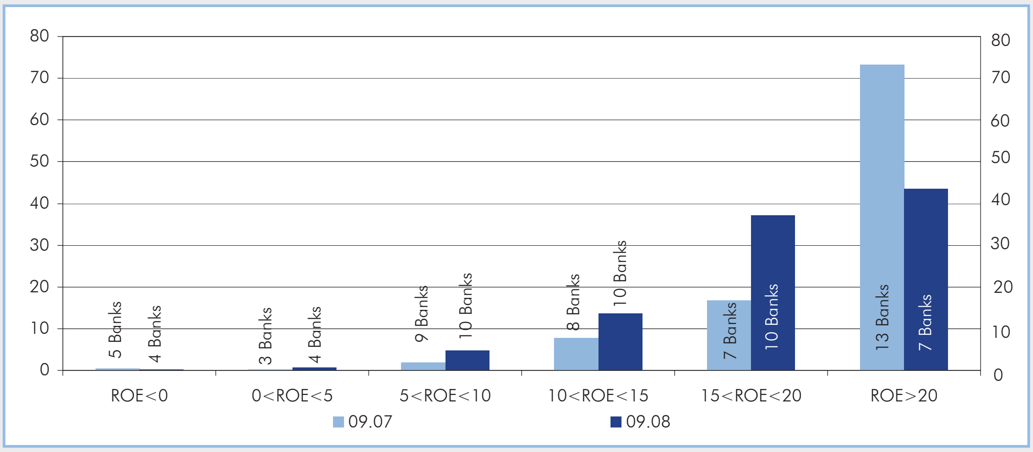
Chart II.10.
Return on Assets and Equity by Selected Countries (March 2008) (%)



Source: Global Financial Stability Report, IMF-September 2008

When compared with selected countries as of March 2008, the Turkish banking sector displays a good performance, especially with regard to return on assets (Chart II.10).

Chart II.11.
Return on Equity Based on Asset Share[1] (%)



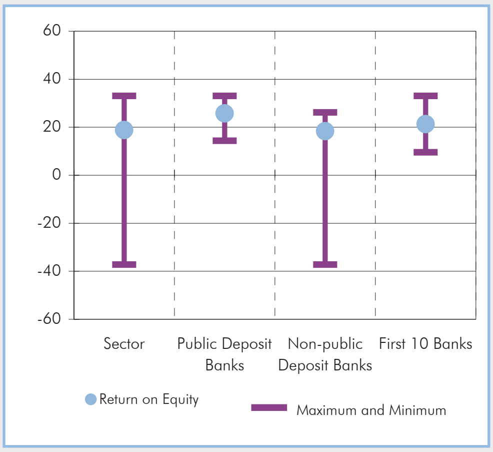
Source: BRSA - CBRT
(1) ROE data is annualized.

As of September 2008, the number of banks with a ROE over 15 percent dropped from 20 to 17, while their share in total assets fell from 89.9 to 80.6 percent. The number of banks declaring losses also fell from 5 to 4 (Chart II.11).

Chart II.12.
Return on Equity of Deposit Banks[1] (%)

Source: BRSA – CBRT
(1) Data is annualized for September 2008.

Chart II.13.
Return on Equity: Maximum and Minimum (September 2008) (%)[1]



Source: BRSA – CBRT
(1) ROE data is annualized.

The ROE of deposit banks, which had been on the rise since 2005, declined in the last period. In September 2008, 75 percent of deposit banks had a ROE lower than 18.6 percent with a tendency to decline (Chart II.12). The asset size of deposit banks with a ROE over 18.6 percent comprises 56.1 percent of the total assets of the sector.

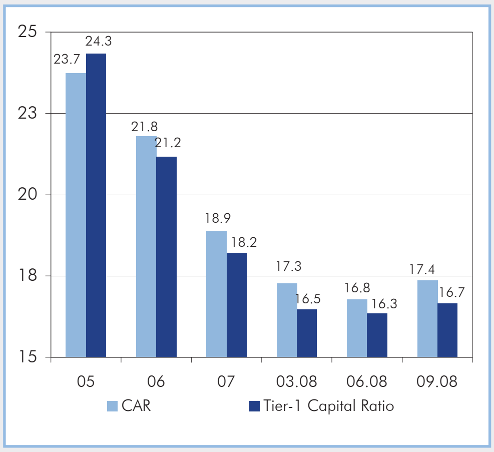
As of September 2008, the value range for the ROE is narrow for both public deposit banks and the largest ten banks in terms of asset size. The broader range for non-public deposit banks is due to the effect of small banks (Chart II.13).

Profitability performance of the Turkish banking sector displayed a tendency to decline in the third quarter of 2008. The increased credit risk of banks and the need to remain liquid may also unfavorably affect the profitability performance of banks in the upcoming period. However, profitability may improve as a result of amendments to Turkish Accounting Standard 39 (TMS 39) and Turkish Financial Reporting Standard 7(TFRS 7) that allow the reclassification of financial assets measured at fair value through profit or loss.

II.2.2.Capital Adequacy

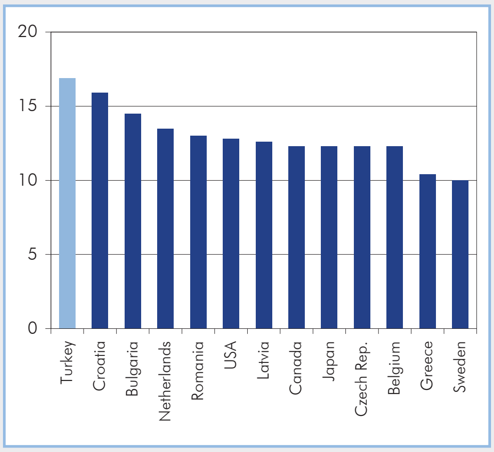
The unconsolidated capital adequacy ratio (CAR) of the banking sector, which is the ratio of own funds to total exposure stemming from credit, market and operational risks, is above both the minimum requirement of 8 percent and the target ratio of 12 percent for all periods under review.

Chart II.14.
Capital Adequacy Ratio (Unconsolidated) (%)



Source: BRSA - CBRT

Chart II.15.
CAR by Selected Countries (March 2008) (%)



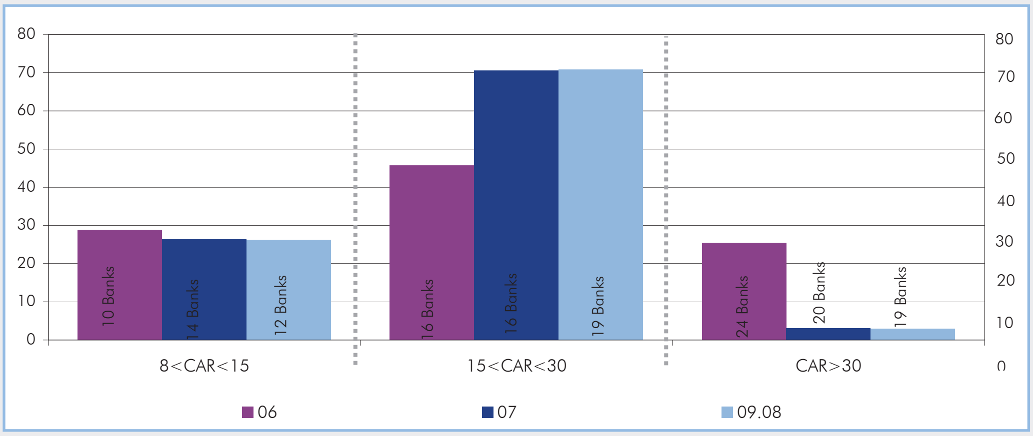
Source: Global Financial Stability Report, IMF – September 2008

The CAR of the banking sector decreased by 2.1 percentage points as of June 2008 compared to end-2007 and became 16.8 percent (Chart II.14). This decline essentially stemmed from the increase in loans as well as the amendments to legislation changing the risk weights for letters of guarantee and letters of credit, effective from January 2008.

Meanwhile, the CAR of the sector increased by 0.6 percentage point in September 2008 compared to June and became 17.4 percent. This increase was triggered by the faster growth of own funds compared to risk-weighted assets. 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 (Chart II.14).

Compared to selected countries, the CAR of the banking sector maintained its high level as of March 2008 (Chart II.15).

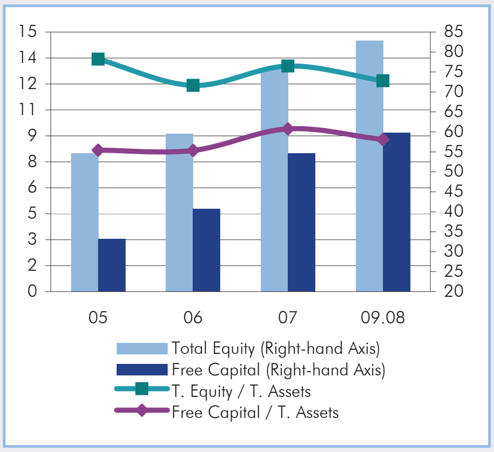
Chart II.16.
Asset Share of Banks Based on Capital Adequacy Ratio (%)



Source: BRSA - CBRT

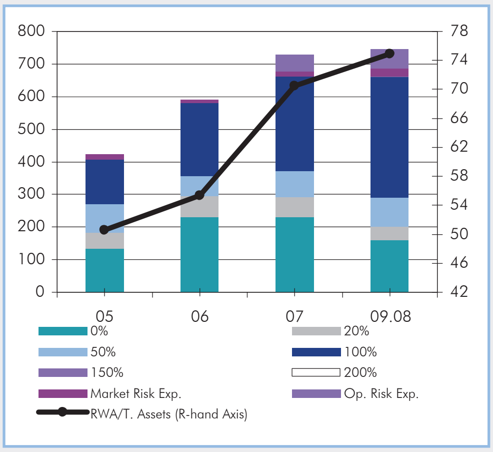
The CAR of 36 banks, which held 73.6 percent of sector assets, remained above 15 percent at end-2007, while that of 38 banks holding 73.8 percent of sector assets was realized above 15 percent in September 2008 (Chart II.16).

Chart II.17.
Free Capital of the Banking Sector
(%, Billion YTL)



Source: BRSA - CBRT

Chart II.18.
Composition of Risk Exposures
(Billion YTL, %)



Source: BRSA - CBRT

The ratios of free capital to total assets and total shareholders' equity to total assets decreased as of September 2008. This decrease was mainly driven by the fact that the rate of increase of shareholders' equity and free capital lagged behind that of assets, due to the decline in the Securities Revaluation Fund and profitability performance (Chart II.17).

The ratio of total exposure stemming from credit, market and operational risks to total assets surged to 74.9 percent in September 2008 from 70.5 percent at end-2007 (Chart II.18).

The global crisis has reinforced the significance of maintaining a strong capital structure for banks. In this respect, the decision of the BRSA to make the distribution of 2008 profits of banks subject to permission is a positive development.

Box 6.
Delay in the Adoption of Basel II

It was stated in the announcement of the BRSA on 25 June 2008 that in the light of recent fluctuations in global financial markets, the Basel II Accord was found to have some drawbacks especially in terms of securitization and liquidity risk, and amendment studies in the documents concerned were carried out at international level with a view to overcoming the above-mentioned drawbacks. The announcement also emphasized that in view of the fact that the Turkish Commercial Code Draft, whose implementation implications would be considerably important during the Basel II process, was not yet enacted and also in light of the comments of financial and corporate sector representatives on the timing of the adoption of Basel II, the ratings-based measurement of capital requirement for credit risk, which had been announced to be effective in Turkey as of early-2009, was postponed further.

Box 7.
Amendments to TMS 39 and TFRS 7

There are two main sets of standards in the world with regard to accounting and financial reporting systems. One of the most significant differences between these two standard sets used to be that the Generally Accepted Accounting Principles (GAAP) established by the Financial Accounting Standards Board (FASB) allowed the reclassification of assets in certain circumstances, whereas the International Financial Reporting Standards (IFRS) established by the International Accounting Standards Board (IASB) did not allow any such reclassification.

However, in line with the suggestions of the Financial Stability Forum (FSF) regarding the crisis in international markets and with a view to preventing the competitive inequality arising from differing accounting standards of especially European and American companies, the IASB issued amendments on 13 October 2008, allowing reclassification of certain financial assets and harmonized the GAAP and IFRS in this respect.

Within this framework, the International Accounting Standard No.39 (IAS 39) and the International Financial Reporting Standard No.7 (IFRS 7) were amended so as to allow reclassification of “financial assets at fair value through profit or loss” and “financial assets available for sale”. With the Communiqués No. 105 and 106 published in the Official Gazette No. 27040 dated 31 October 2008, the Turkish Accounting Standards Board also made parallel amendments to TMS 39 and TFRS 7, to be effective as of 1 July 2008.

Communiqué No.105 permits an entity to reclassify its non-derivative financial assets held for trading, which are classified under the financial assets at fair value through profit or loss category into other categories (such as loans and receivables, financial assets available for sale and financial assets held to maturity) in certain circumstances. According to this, in the first place, a financial asset that would meet the definition of loans and receivables on the date of reclassification may be reclassified out of this category if the entity has the intention and ability to hold the said financial assets for the foreseeable future or until maturity. In the second place, in rare circumstances such as the crisis in international markets in 2008, financial assets held for trading may be reclassified into other categories, provided the instrument meets the definition of that category.

Another amendment introduced with the said Communiqué is the permission for the reclassification of financial assets classified as available for sale into the loans and receivables category, on the condition that these assets meet the definition of loans and receivables on the date of reclassification and the entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity.

Amendments in Communiqué No.106 include provisions regarding the disclosure requirements about the amendments in Communiqué No.105. In this respect, the entity will be liable to disclose in the footnotes to its balance sheet, the reason for the reclassification, change in value before and after the reclassification, along with the effective interest rate and estimated cash flows the entity expects to recover as of the date of reclassification of the financial asset.

These amendments would assist in easing the adverse effects of possible large-scale market fluctuations on balance sheets.