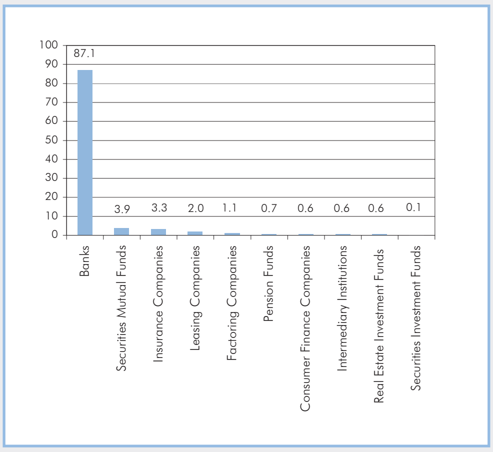
II. STRUCTURE OF THE FINANCIAL SECTOR

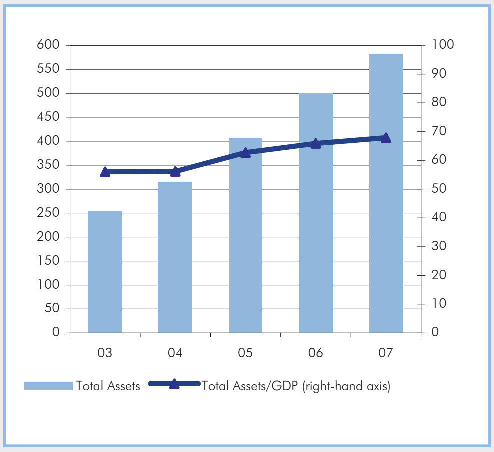
The Turkish financial sector maintained its stable growth trend in 2007. During the same period, the banking sector also continued to attract foreign investments.

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



Source: BRSA,CBRT, Association of Capital Market Intermediary Institutions, CMB
(1) Figures are as of 2007.

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 18 percent compared to the previous year, reached YTL 668 billion as of end-2007. 87 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 end-2007, the number of banking sector staff increased by 16,907 compared to end-2006 and reached 167,760, whereas the number of banks remained at 50. By March 2008, the number of staff rose by 5,265, reaching 173,025.

As of end-2007, the total asset size of the banking sector grew by 7 percent in real terms compared to end-2006 and reached YTL 582 billion, while it increased to 502 billion from 355 billion in USD terms, with a rise of 41 percent. The real increase remained limited, due to the decrease in the New Turkish Lira value of foreign currency items on the balance sheet, which resulted from the appreciation of the Turkish currency. By March 2008, the asset size of the banking sector rose to YTL 634 billion and declined to 485 billion in USD terms.

The ratio of the Turkish banking sector's balance sheet size to GDP increased to 67.9 percent at end-2007 from 65.9 percent at end-2006 (Chart II.2).

Meanwhile, as of end-2007 the concentration ratio of the first five banks was 60 percent, while the concentration ratio of the first 10 banks was 83 percent. The ratios that did not display a remarkable change compared to the end of the previous year, declined by one point each, as of March 2008.

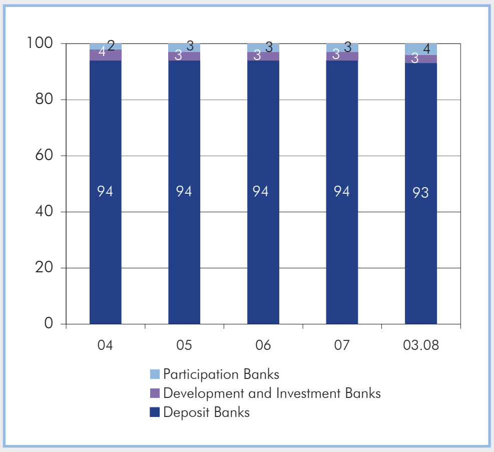
Table II.1.The Financial Depth and Intermediation Level Indicators of the Banking Sector[1,2]

Years	Deposits / GDP	Loans / GDP	Loans / Deposits
2003	35.1	17.2	49.1
2004	35.2	19.8	56.3
2005	38.8	25.3	65.3
2006	40.6	30.0	74.0
2007	41.7	34.6	82.9

(1) Loans include non-performing loans.
(2) Deposits include participation funds, loans include funds extended by participation banks.

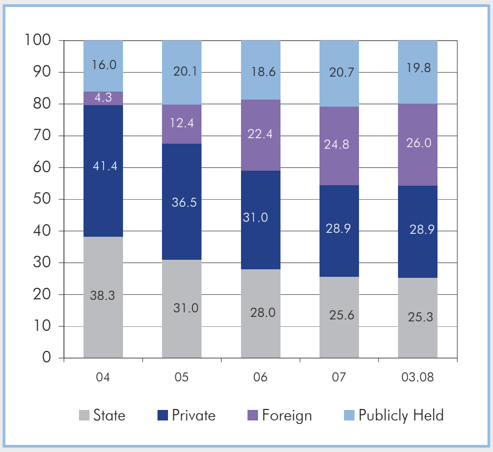
The ratio of deposits and loans to GDP and the ratio of loans to deposits, which reveal the financial depth and intermediation level of the banking sector, continue to increase.

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



Source: BRSA-CBRT

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

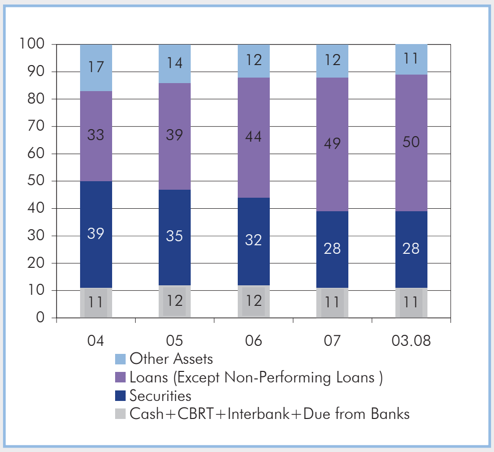


Source: BRSA-CBRT
(1) For publicly held shares no distinction is made between domestic and foreign investors.

By March 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 is dominant in the Turkish banking sector (Chart II.3).

The Turkish banking sector continued to attract foreign investors in 2007. As a consequence, based on their share in paid-up capital, as of March 2008 the share of foreign stockholders in assets stood at 26 percent (Chart II.4). Meanwhile, according to data of the Central Registry Agency for March 2008, the share of foreign participation in publicly held shares was 17 percent of total assets of the sector. When these shares are included, the share of foreign participation in the banking sector reaches 43 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

The share of loan portfolio as the largest asset item continued to grow throughout the year and reached 50 percent by March 2008 (Chart II.5).

As of March 2008, the share of deposits as the largest source of funds remained the same with 62 percent, whereas the shares of shareholders' equity, and due to banks, which followed a rather volatile course , were 12 percent and 13 percent, respectively (Chart II.6).

II.2.Banking Sector Profitability and Capital Adequacy

II.2.1.Profitability[4,5]

Despite fluctuations in the global markets and the world's major banks declaring high losses, profitability of the Turkish banking sector improved in 2007. The net profit of the sector increased by 34.4 percent at end-2007 compared to end-2006, and reached YTL 14.2 billion.

[4] Participation banks are excluded as their operating principles differ from other banks.

[5] Bank under SDIF is excluded.

Table II.2 Net Profit and Its Components (Million YTL)[1]

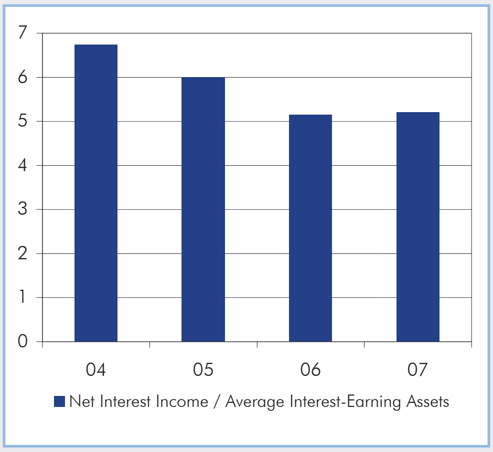
	2006	2007	Change (%)
I. Operating Income (A+B)	31.707	38.465	21.3
A- Net Interest Income	20,376	25,007	22.7
B- Non-Interest Income	11,331	13,458	18.8
II. Non-Interest Expenses (C+D)	18,484	22,249	20.4
C- Prov. for Credits and Other Receiv.	4,068	5,467	34.4
D- Other Operating Expenses	14,416	16,782	16.4
III. Net Operating Profit (I-II)	13,223	16,216	22.6
IV. Other Income	429	1,214	183.0
V. Provision for Taxes	3,070	3,203	4.3
VI. Net Profit (III+IV-V)	10,582	14,227	34.4

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

The upsurge in profitability of the banking sector was triggered by net interest income that increased due to interest income on loans, along with the rise in net fees and commissions income as one of the non-interest income components. The significant increase in other income item mainly stems from extraordinary income (Table II.2).

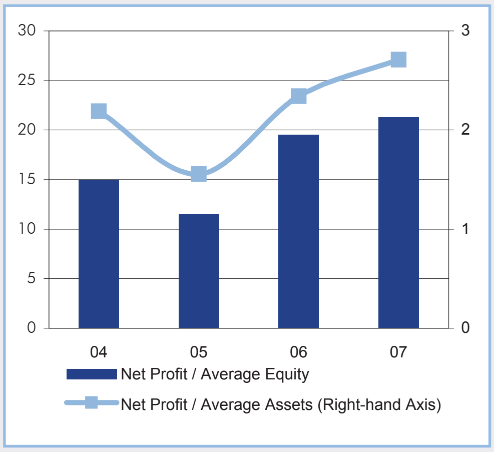
As a result of the sector moving away from securities towards loans, the ratio of interest income on loans to total interest income, which was 51.1 percent as of end-2006, rose to 55.1 percent by end-2007,whereas the ratio of interest income on securities to total interest income dropped to 35.8 percent from 39.8 percent.

Chart II.7.
Net Interest Margin (%)



Source: BRSA-CBRT

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

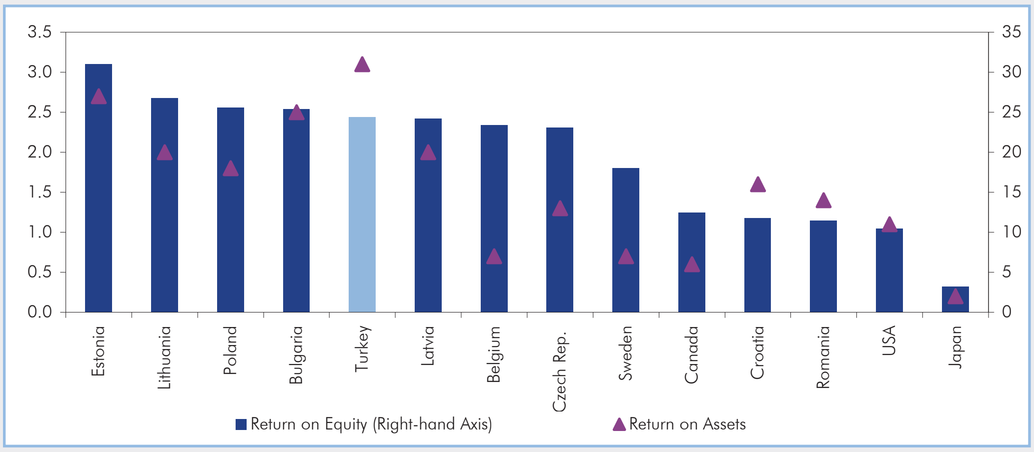


Source: BRSA-CBRT

The downward trend in the ratio of net interest income to average interest-earning assets ceased in 2007 and by end-2007, this ratio stood at 5.2 percent with a limited increment (Chart II.7).

As of year end-2007, the return on assets and the return on equity were 2.7 percent and 21.3 percent, respectively. Both of these ratios display an upward trend compared to end-2006 (Chart II.8).

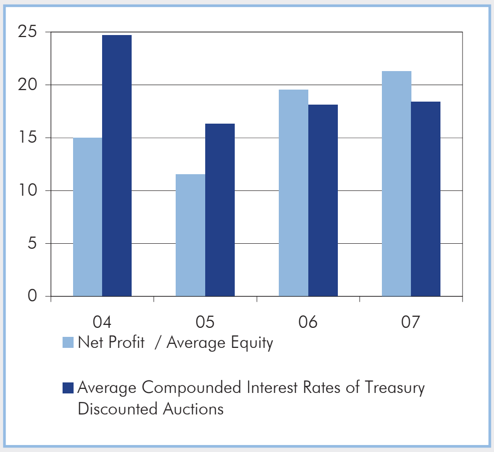
Chart II.9.
Return on Assets and Equity by Selected Countries (September 2007) (%)



Source: Global Financial Stability Report, IMF-April 2008

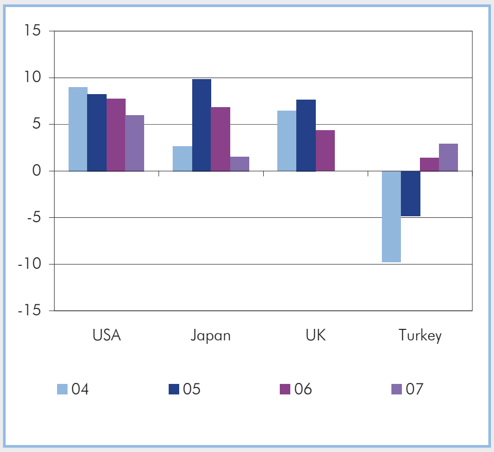
When compared with selected countries as of September 2007, the Turkish banking sector displays a good performance, especially with regard to return on assets (Chart II.9).

Chart II.10.
Return on Equity and Treasury Interest Rate (%)



Source: Treasury, BRSA-CBRT

Chart II.11.
Difference Between Return on Equity and Yield on Government Bonds (%)[1,2]



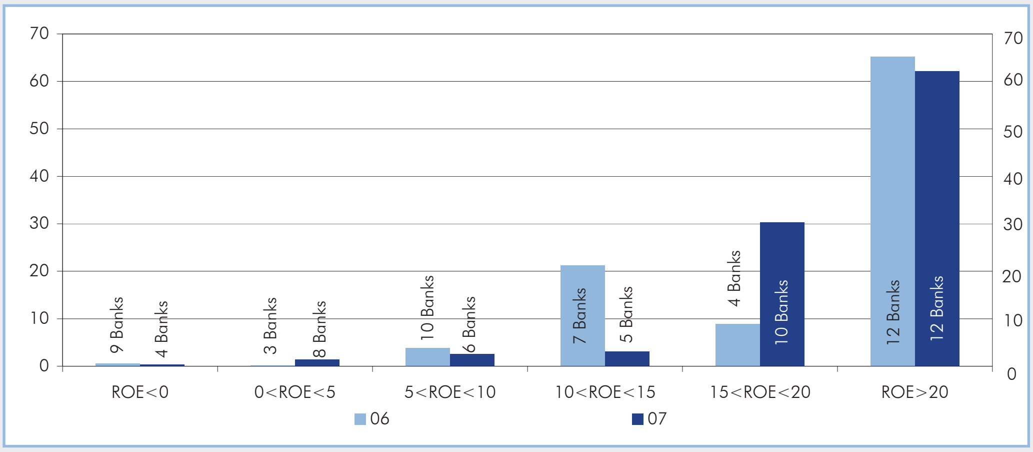
Source: Treasury; BRSA-CBRT, IMF-IFS, Global Financial Stability Report, IMF-April 2008

(1) In 2007, the data is as of September 2007 for USA and Japan, and it is as of December 2007 for Turkey. There is no data for UK as of 2007.

(2) Average compounded interest rates of Treasury discounted auctions are used for Turkey and 10-year government bond yield is used for other countries.

Before 2006, the ROE of the Turkish banking sector was lower than the average compounded interest rate of the Treasury auctions (Chart II.10). Starting from 2006, steady increase in the ROE has been above the yield on government bonds, assessed as risk-free . The difference, which was 1.4 points at end -2006, reached 2.9 points by end-2007, indicating a favorable development, yet it is still low when compared to developed countries (Chart II.11). The high risk premium of our country is influential on this difference being low. On the other hand, the expectation that implemented policies will provide macroeconomic and financial stability in the medium and long run and consequently the risk premium will drop, ensures the growth of the banking sector and the persistent interest of foreign investors.

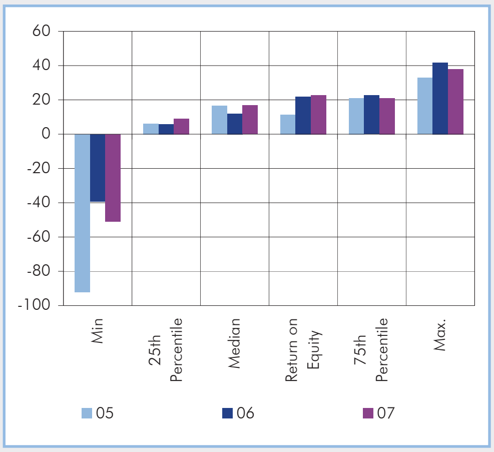
Chart II.12.
Return on Equity Based on Asset Share (%)



Source: BRSA-CBRT

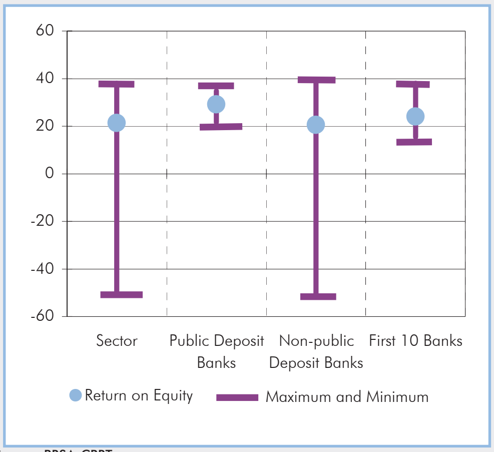
As of year-end 2007, the number of banks with a ROE over 15 percent rose to 22 from 16 and their share in total assets surged to 92.6 percent from 74.2 percent. The number of banks declaring losses dropped to 4 from 9 (Chart II.12).

Chart II.13.
Return on Equity of Deposit Banks (%)



Source: BRSA-CBRT

Chart II.14.
Return on Equity: Maximum and Minimum (December 2007) (%)



Source: BRSA-CBRT

The ROE of deposit banks have been increasing over the last three years. At end-2007, 75 percent of deposit banks have a ROE lower than 21.2 percent and though limited, it has a tendency to decline (Chart II.13). However, the asset size of deposit banks with a ROE over 21.2 percent comprises 47 percent of the total assets of the sector.

As of end-2007, the value range for the ROE is narrow for 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.14).

Table II.3 Net Profit and Its Components (Million YTL)[1]

	03.07	03.08	Change (%)
I. Operating Income (A+B)	8,815	11,222	27.3
A- Net Interest Income	5,825	7,297	25.3
B- Non-Interest Income	2,990	3,925	31.3
II. Non-Interest Expenses (C+D)	4,853	7,147	47.3
C- Prov. for Credits and Other Receiv.	1,235	2,198	78.0
D- Other Operating Expenses	3,618	4,949	36.8
III. Net Operating Profit (I-II)	3,962	4,075	2.8
IV. Other Income	86	522	507.0
V. Provision for Taxes	771	945	22.6
VI. Net Profit (III+IV-V)	3,277	3,652	11.4

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
Other Income = Revenue from Profit Share Excluding Dividend Income + Extraordinary Income (Expenses).

Upon analyzing the first quarter of 2008, it is seen that the banking sector has failed to maintain the profitability performance of 2007. By March 2008, net profit of the sector rose by only 11.4 percent in comparison to the same period of the previous year and was YTL 3.7 billion (Table II.3). It is remarkable that in this period non-interest expenses has had a downward effect on profitability.

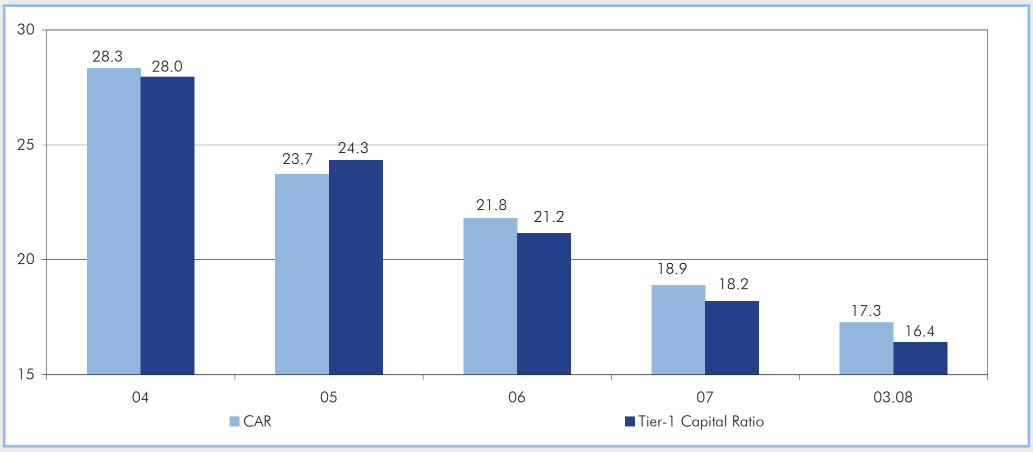
As of March 2008, in comparison to the same period of the previous year, the ROA of the banking sector dropped to 2.4 percent from 2.6 percent and the ROE to 20.1 percent from 21.3 percent. The net interest margin of the sector remained the same at 5.2 percent.

The ongoing global fluctuations might continue to have unfavorable effects on profitability during the rest of 2008.

II.2.2.Capital Adequacy

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

Chart II.15.
Capital Adequacy Ratio (Unconsolidated) (%)

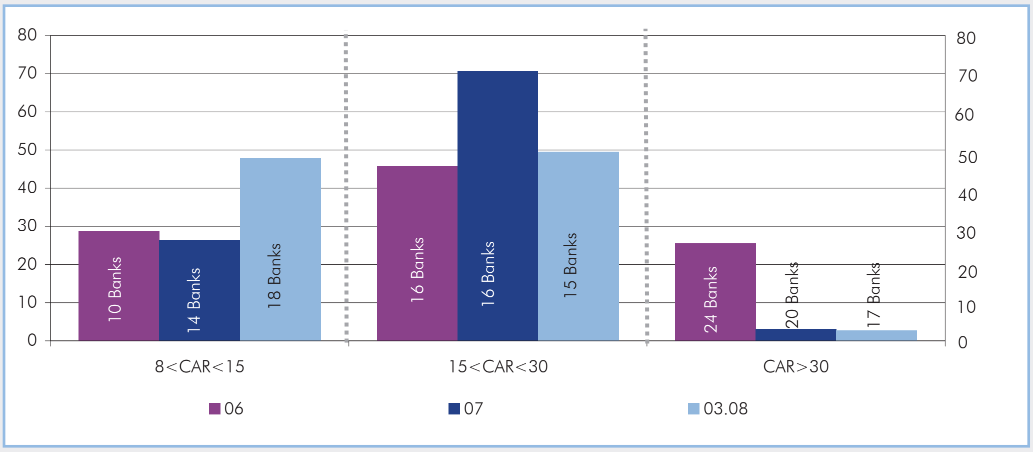


Source: BRSA-CBRT

The CAR of the banking sector decreased by 2.9 points at end-2007 compared to end-2006 and became 18.9 percent (Chart II.15). This fall in the CAR is essentially due to the requirement for banks to hold additional capital to cover operational risks beginning from June 2007. Moreover, in March 2008 the CAR of the sector dropped by another 1.6 points to 17.3 percent. This decline essentially stemmed from the increase in loans as well as the amendments in legislation changing the risk weights for letters of guarantee and letters of credit, effective from January 2008.

Even though the tier-1 capital ratio, which is the ratio of core capital to the total exposure stemming from credit, market and operational risks, continued its tendency to decline due to the above mentioned reasons; it stood at a high level of 18.2 percent as of December 2007, but dropped to 16.4 percent by March 2008. Despite the decline, the fact that the tier-1 capital ratio maintains its high level indicates that the Turkish banking sector has a high-quality capital structure.

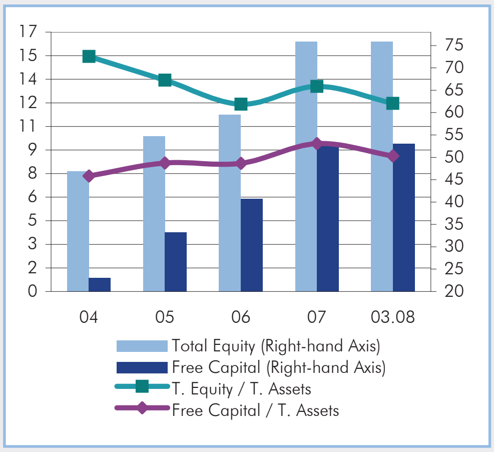
Chart II.16.
Asset Share of Banks Based on Capital Adequacy Ratio (%)



Source: BRSA-CBRT

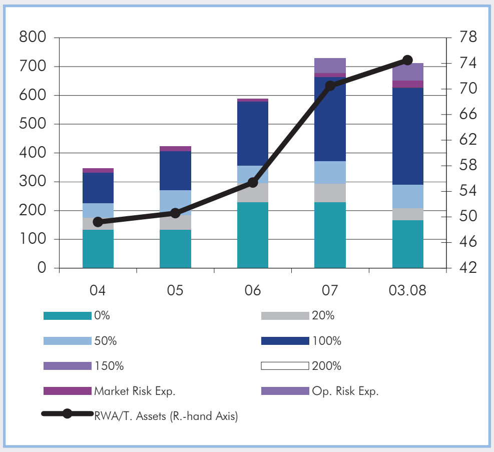
The CAR of the 40 banks, which hold 71.2 percent of sector assets remained above 15 percent at end-2006, while that of the 36 banks holding 73.6 percent of sector assets remained above 15 percent at end-2007 (Chart II.16). As of year-end 2007, the dramatic decline observed in asset shares of the banks which had a CAR above 30 percent stemmed from the fact that two banks having large asset shares migrated to the group with a CAR of 15-30 percent due to the capital that they had reserved for operational risks. As of March 2008, the CAR of the 32 banks which hold 52.2 percent of sector assets, exceed 15 percent.

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 increased remarkably by end-2007. However, in March 2008, these ratios declined as the Securities Revaluation Fund produced a negative balance, reducing shareholders' equity and hence free capital, the rate of increase of which then lagged behind that of the assets (Chart II.17).

The ratio of the total exposure stemming from credit, market and operational risks to total assets surged to 74.5 percent in March 2008 from the 70.5 percent figure of end-2007 (Chart II.18).

It is known that the CAR of the Turkish banking sector is high due to the fact that Turkish banks hold large portfolios ofgovernment debt securities classisfed under 0 percent risk category. In an environment of increasing credit volume and in the process of convergence with Basel II, and despite the new application for reserving capital for operational risks and changing weights of some risks, the fact that the ratio maintains its high level is considered to be a positive development.

Today, it is observed that the fluctuations in the global financial markets have limited effects on Turkish markets. However, keeping in mind the intertwined nature of global markets and the persistence of problems, as well as the increasing volume of retail and corporate loans, strong capital and sound profitability structure are of crucial importance for the banking sector. Hence, the banking sector should avoid policies that might undermine its capital structure during such a period when the carried risks are more likely to materialize with the effects of developments.

Box 10.
Amendments to the Regulation Regarding the Measurement and Assessment of Capital Adequacy

BRSA has been amending the capital adequacy regulation within the context of developments in the financial markets and convergence with Basel II, which was announced to be adopted by the beginning of 2009.

The most important of these amendments in regards the effects it has is the requirement for banks to hold additional capital for operational risks beginning from June 2007. Moreover, apart from those subject to lower risk weight, the temporary application indicating that letters of guarantee will be subject to 20 percent and letters of credit to 50 percent risk-weight ended in January 2008 and the risk weights of these items have been increased. Both of these amendments had a decreasing effect on the capital adequacy ratio.

With another amendment published in the Official Gazette on October 10, 2007, the "10 percent" category has been added to the risk-weighted assets. This category includes mortgage securities available for sale and held to maturity , which possess the qualifications stipulated by the legislation of the capital market and are issued by domestic banks and banks of the OECD countries, as well as their income accruals . An additional change, effective as of January 2008, is that in case the share of securities available for sale on the balance sheet is more than 10 percent of total securities, they will be accepted as trading accounts and assessed within the market risk exposure, thus capital will be calculated accordingly. This application decreased the zero percent risk-weighted assets category.

With the amendment published in the Official Gazette on March 22, 2008, the credit conversion rates of credit card limit liabilities and limit liabilities for deposit accounts with overdraft facilities were decreased to 20 percent from 50 percent. Another significant amendment was related to the installment credit card receivables that used to be treated as 100 percent risk-weighted. These receivables will be subject to maturity distinction and those with a remaining maturity of more than 6, less than 12 month-installments will be risk weighted at 150 percent, and those with a remaining maturity of more than 12 month-installments will be risk weighted at 200 percent. Since this will lead to an increase in the required capital , an indirect limitation is being imposed on installment credit card expenditures.