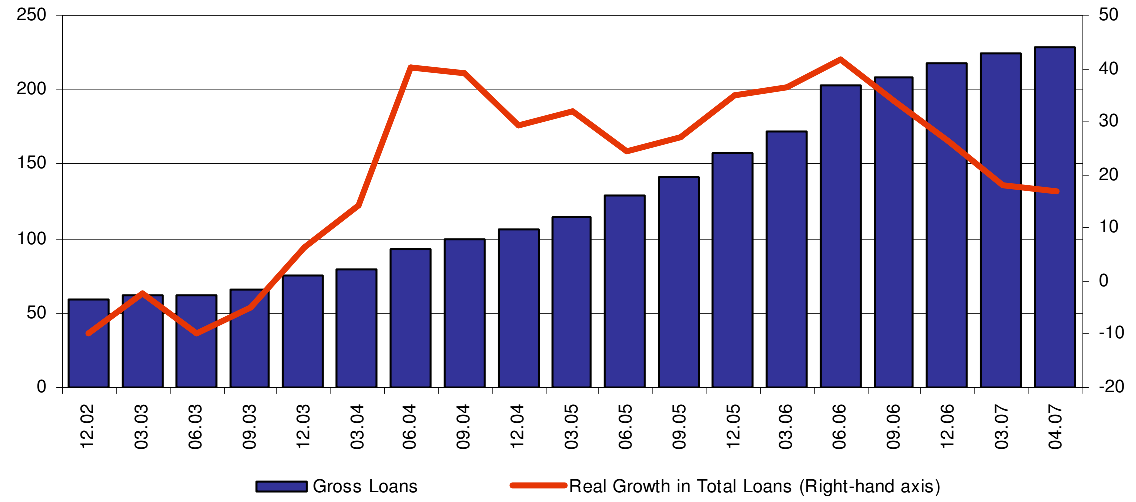
III. BANKING SECTOR RISKS

Participation Banks, which have the same legal status as traditional banks but different operating principles, are excluded from the risk analyses of this section.

III.1. Credit Risk and Scenario Analysis

III.1.1. Credit Portfolio

Chart III.1.1.1 Gross Loans (Billion YTL, %)[1,2]



Source: CBRT
(1) Annual percentage change as compared to the same month of the previous year.
(2) Figures for March and April 2007 are temporary.

Banking sector credit volume reached 217.8 billion New Turkish Liras with an increase of 26.2 percent as of the year-end 2006, compared to the end of the previous year. The slowdown in the growth of the gross credit[5] volume compared to previous years, stemmed from interest rates, which increased following fluctuations in the financial markets in the second quarter of the year. According to provisional data, the slowdown in growth also continued in the first four months of 2007 (Chart III.1.1.1).

[5] Gross Loans= Total Loans + Gross NPL

Table III.1.1.1. Some Selected Credit Ratios (Million YTL, %) [1,2]

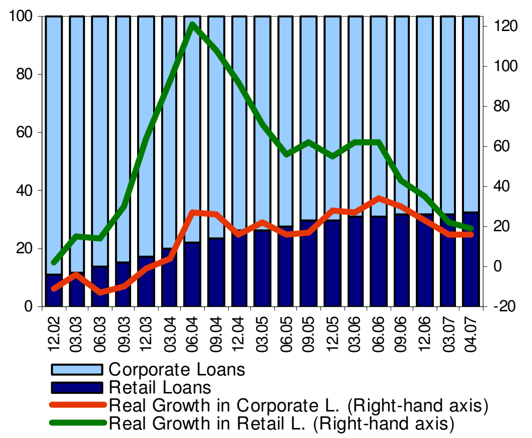
	2002	2003	2004	2005	2006	04.07
First 5 Banks						
Total Gross Loans	32,540	40,888	56,620	87,889	127,494	132,310
Share in Total Gross Loans	55	55	54	56	59	61
NPLs / Total Gross Loans	15	11	5	4	4	4
Loans / Deposits	38	42	48	55	80	79
First 10 Banks						
Total Gross Loans	46,028	58,000	83,965	127,913	183,154	191,316
Share in Total Gross Loans	77	77	79	81	84	88
NPLs / Total Gross Loans	20	12	6	5	4	4
Loans / Deposits	40	43	49	59	69	69
Sector						
Total Gross Loans	59,411	74,850	105,698	157,440	217,846	228,855
NPLs / Total Gross Loans	18	12	6	5	4	4
Loans / Deposits	43	48	55	65	73	73

Source: BRSA-CBRT
(1) The first 5 and 10 banks have been taken into consideration according to their gross loans.
(2) Figures for April 2007 are temporary.

While the share in total loans of both the first five and ten banks which extended the majority of loans, increased, the NPL ratios of the first ten banks and the sector as a whole declined as of year-end 2006. The fast growth in the Loans to Deposits ratio of the first five banks is due to the fact that a state-owned bank, which was in this group at the end of 2005 and held 20 percent of deposits, stayed out of this group by year-end 2006. While the share of the first five and ten banks in total loans continued to increase, the NPL ratios did not change as of April, 2007 (Table III.1.1.1).

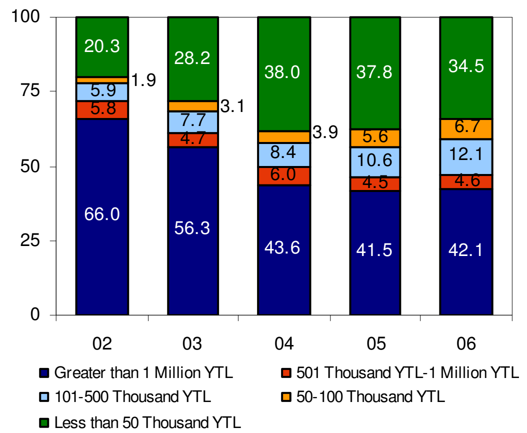
While the loans to deposits ratio of the sector, which reached 73 percent at the end of 2006, its peak for the last five years, indicates a positive development for the intermediation function of banks, the improvement in the NPL ratio in recent years is regarded favorable for credit risk (Table III.1.1.1).

Chart III.1.1.2. Gross Loans by Borrowers and Real Annual Growth Rates (%) [1,2,3]



Source: BRSA-CBRT
(1) They were brought to real terms by using CPI (1994=100).
(2) Annual percentage change as compared to the same month of the previous year.
(3) Figures for March and April 2007 are temporary.

Chart III.1.1.3. Loan Distribution by Size (Excluding NPLs, %)

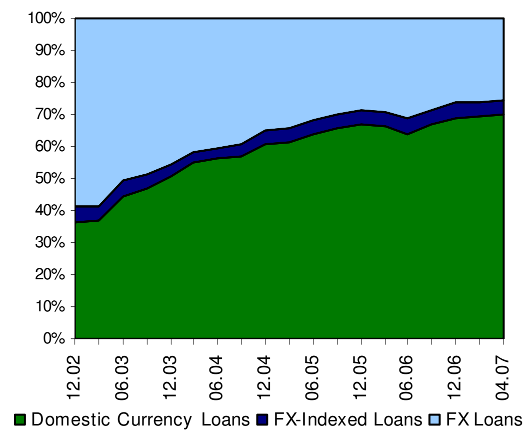


Source: BRSA-CBRT

The tightening of financing conditions after the financial fluctuation in the second quarter of 2006 particularly influenced retail loans and its growth rate of 55.4 percent in 2005 decreased to 34.6 percent in 2006; however, the slowdown in the growth rate of corporate loans remained limited. The share of corporate loans in total loans declined in 2006. The slowdown in real growth rates of retail and corporate loans continued in the first four months of 2007 due to maintenance of high levels of interest rates compared to the first half of 2006 (Chart III.1.1.2).

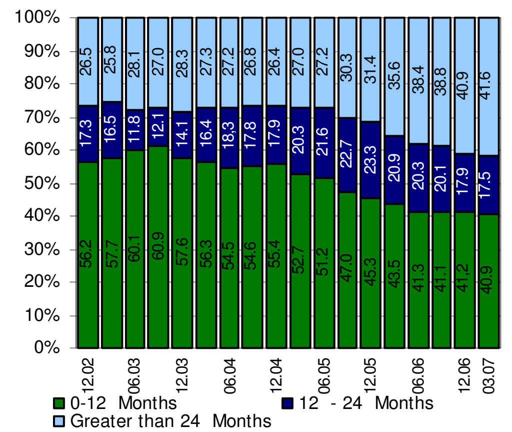
While there is a decrease in the share of loans less than 50,000 New Turkish Liras, there is an increase in the share of other groups as of year-end 2006, compared to the end of the previous year (Chart III.1.1.3). Since the number of customers utilizing loans greater than one million New Turkish Liras is less than other groups, the increase in this group is perceived as a factor that increases credit risk.

Chart III.1.1.4. Currency Composition of Loans (Excluding NPLs) [1]



Source: BRSA-CBRT
(1) Figures for March and April 2007 are temporary.

Chart III.1.1.5. Maturity Structure of the Loans (Excluding NPLs)

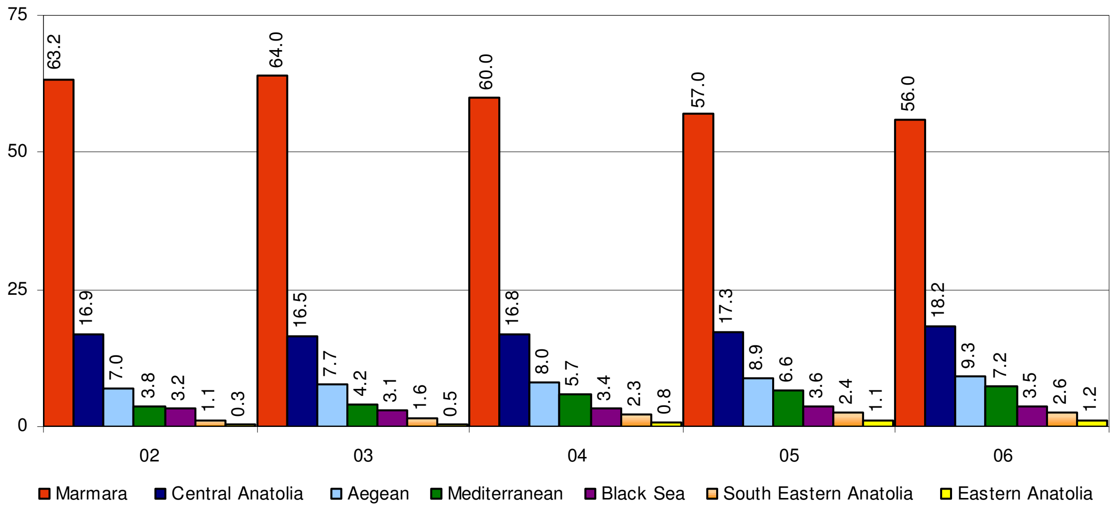


Source: CBRT

The share of domestic currency loans in total loans extended by banks showed fluctuations in 2006, but after the achievement of stability in FX rates, it increased to 69.1 percent as of year-end 2006, and further increased to 69.9 percent as of April, 2007 (Chart III.1.1.4). While approximately all of retail loans are used in YTL, it is clear that FX loans are mainly used by corporates, which makes them more vulnerable to changes in FX rates.

On the other hand, maturities were extended in 2006 and this trend continued in 2007 (Chart III.1.1.5). Consumer loans are the dominant factor in the increase in loans with a maturity of longer than 24 months.

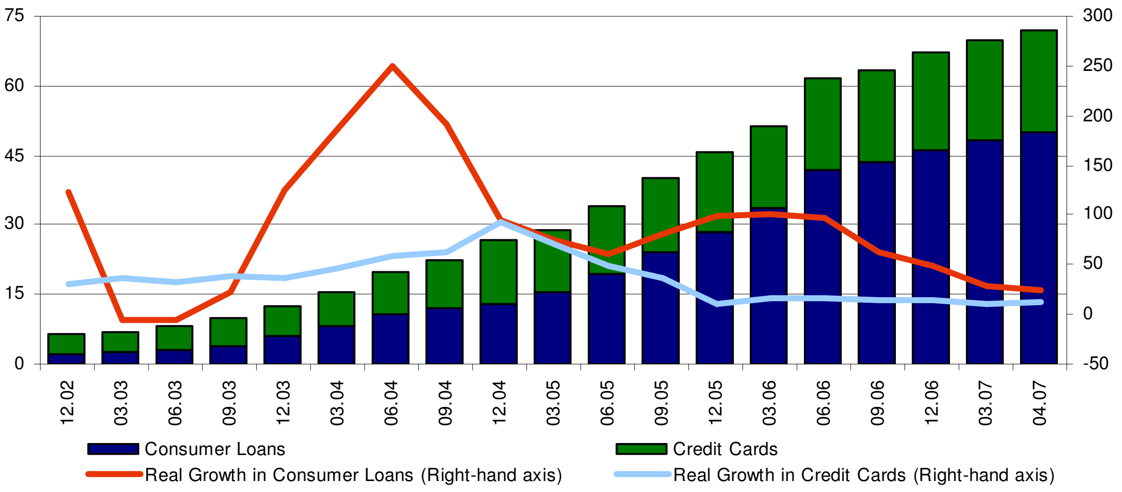
Chart III.1.1.6. Geographical Distribution of Loans (%) [1]



Source: CBRT
(1) Corporate loans include those loans that are greater than ten thousand New Turkish Liras (inclusive) and for retail loans, starting from 28.02.2003, those greater than 5 thousand New Turkish Liras; extended to real and legal bodies; by banks (including external loans used by firms with the intermediation of banks).

The geographical concentration of loans has decreased since 2004 and it is observed that particularly the share of the Marmara Region in total loans decreased, while the share of other regions except the Black Sea Region increased in 2006 (Chart III.1.1.6). This change occurred due to the increase in loans extended to consumers and small firms.

Chart III.1.1.7. Retail Loans (Excluding NPLs, Billion YTL, %) [1]



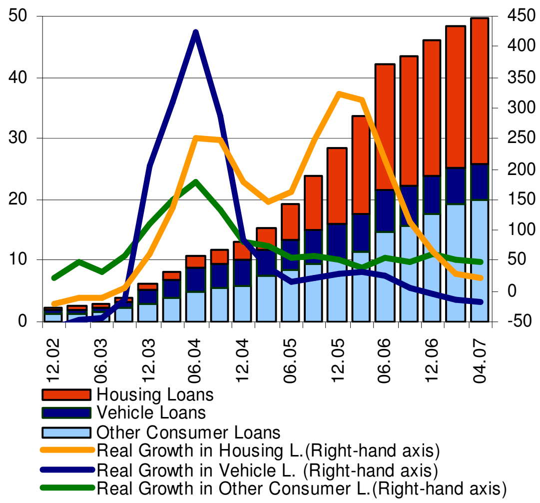
Source: CBRT
(1) Annual percentage change as compared to the same month of the previous year.

In 2006, the slowdown in total loans was more evident in consumer loans. The real growth rate of 99.3 percent in 2005, decreased to 47.8 percent in 2006 and it continued to decline in the first four months of 2007 (Chart III.1.1.7).

Credit cards[6] reached 21.2 billion New Turkish Liras as of year-end 2006, with a 13.5 percent increase in real terms, compared to the end of the previous year. However, the annual real growth rate decreased to 11.6 percent in April 2007 (Chart III.1.1.7).

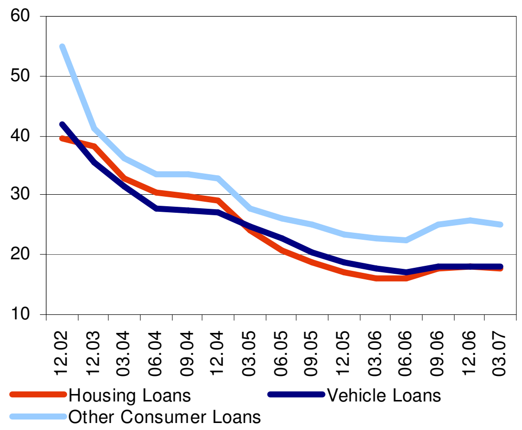
With regard to the results of the Bank Loans Tendency Survey[7] of January-March 2007; banks expect regulations on retail loans to be eased and thus the demand for all types of retail loans will increase for the period of April-June 2007. The Consumer Confidence Index[8] of April 2007 reveals similar results. In fact, according to this index, it is expected that probability of buying durable goods will increase in the next period. However, in the election process and due to tight monetary policy, it is thought that high levels of interest rates will continue to limit credit demand in the next period and no briskness in consumer loans is expected in the short-term.

Chart III.1.1.8. Consumer Loans by Type (Excluding NPLs, Billion YTL, %) [1]



Source: CBRT
(1) Other consumer loans are consumer loans excluding housing and vehicle loans.

Chart III.1.1.9. Interest Rates (%) [1]



Source: CBRT
(1) Weighted average interest rates.

Although a slowdown is observed in the growth of housing loans, which is the most important item in the expansion of consumer credits, due to the rise in interest rates in the second half of 2006, its share in total consumer credits continued to increase (Chart III.1.1.9). Since June 2006, the real growth rate of other consumer loans has displayed an upward trend and this has increased faster than housing loans in the first four months of 2007. The tendency of households to borrow other consumer loans to close their credit card obligations was also effective in this case. The amount of vehicle loans has been declining since the beginning of 2007 (Chart III.1.1.8).

[6] Refers to the balance in the cash loans item, until the credit card spendings and cash withdrawals are paid back to the bank.
[7] CBRT, Bank Loans Tendency Survey, May 1, 2007.
[8] TURKSTAT-CBRT, Consumer Confidence Index, April 2007, Volume 79.

Table III.1.1.2. Shares of Housing Loans in Total Loans and in GDP for Selected Countries (%)

	Housing Loans / Total Loans				Housing Loans / GDP			
	2002	2003	2004	2005	2002	2003	2004	2005
Belgium	22.8	25.0	26.5	26.1	24.4	26.6	27.9	31.8
Czech Republic	12.0	15.3	20.5	23.8	4.5	6.0	7.9	9.9
Estonia	18.6	21.6	25.4	32.4	7.9	11.7	16.6	24.7
Greece	22.2	24.0	25.8	28.1	14.8	17.1	19.6	23.7
Ireland	22.2	26.5	28.2	28.4	33.8	39.5	49.6	59.1
Latvia	11.2	16.2	21.1	25.1	4.0	7.3	11.8	19.4
Lithuania	11.1	14.2	18.3	21.3	1.9	3.4	5.5	9.1
Hungary	13.8	19.5	21.1	19.8	5.3	8.4	10.2	10.3
Poland	11.3	14.5	15.8	17	3.4	4.5	5.3	5.4
Portugal	35.5	35.8	36.5	38	48.5	49	49.7	53.9
Slovenia	4.9	5.3	5.9	8.1	1.9	2.3	2.8	5.0
EU25	30.0	32.5	33.6	34.3	34.1	37.6	39.5	43.2
Turkey[1]	0.9	1.3	2.7	7.8	0.2	0.2	0.6	2.5

Source: EU Banking Structures, October 2006.
(1) Housing Loans/ Total Loans ratio for Turkey is 10,6% and Housing Loans/GDP ratio is 3,8% at the end of 2006.

Despite the fast growth in housing loans in recent years, the share of these loans in total loans and in the GDP was below the average of selected EU countries and the EU-25 average, as of year-end 2005 (Table III.1.1.2). This share is expected to increase with new housing loans by banks which will have a new financing opportunity after the enactment of the secondary regulations required for full implementation of the mortgage system.

Table III.1.1.3. Sectoral Composition of Corporate Loans (%)[1,2]

		Gross Loans			FX Loans / Total Loans		
		2004	2005	2006	2004	2005	2006
1	Wholesale and Ret. Trade, Brokerage, Repair of Mot. Veh	15.4	19.1	22.7	43.8	38.2	37.5
2	Transport, Storage and Communication	5.4	5.7	7.8	79.5	68.8	54.7
3	Textile and Textile Product Industry	11.6	9.3	7.1	75.3	70.5	66.7
4	Construction	6.0	6.5	6.4	65.3	59.5	50.3
5	Industry of Tobacco, Beverages and Food	7.2	7.3	5.5	51.4	47.9	46.2
6	Manufacture of Basic Metals and Fabricated Metal Prod.	5.4	5.4	5.4	76.5	73.9	73.5
7	Sources of Electricity, Gas and Water	5.0	3.8	5.1	95.6	96.0	93.4
8	Agriculture, Hunting and Forestry	5.2	4.7	4.6	22.3	19.5	17.3
9	Manufacture of Machinery and Equipment	3.3	3.1	3.6	66.6	60.2	45.9
10	Hotels and Restaurants (Tourism)	2.8	3.0	3.3	81.8	77.6	75.8
	First 10 Sector	67.2	68.0	71.5	62.5	55.8	51.7

Source: CBRT
(1) Loans are compiled based on bank reportings under the scope of Central Bank Law No:1211, Article:44. They include those loans that are greater than ten thousand New Turkish Liras (inclusive); extended to real and legal bodies; by banks (including external loans used by firms with the intermediation of banks). They are inclusive of accrued interest and exclusive of non-cash loans. Therefore, they differ from the figures in the balance sheet-based analysis.
(2) Excluding Financial Intermediation.

According to Central Bank Risk Center data, the share of the first ten sectors in total corporate loans increased from 68 percent as of year-end 2005 to 71.5 percent as of year-end 2006, indicating an increase in sectoral concentration. As of year-end 2006, the sector with the largest share in total corporate loans is still the "Wholesale and Retail Trade, Commissions and Motor Vehicles Services", with a total share of 22.7 percent share. The shares in total corporate loans of the "Textile and Textile Products Industry", "Food, Beverages and Tobacco Industry", "Construction" and "Agriculture, Hunting and Forestry" sectors, decreased compared to year-end 2005. On the other hand, the share of FX loans in the total loans used by corporates decreased for all selected sectors as of year-end 2006 (Table III.1.1.3).

III.1.2. Non-Performing Loans

Non-performing loans increased by 9.2 percent in 2006 compared to the end of the previous year and reached 8.2 billion New Turkish Liras. The aforementioned amount rose to 8.4 billion New Turkish Lira as of April 2007 according to provisional data.

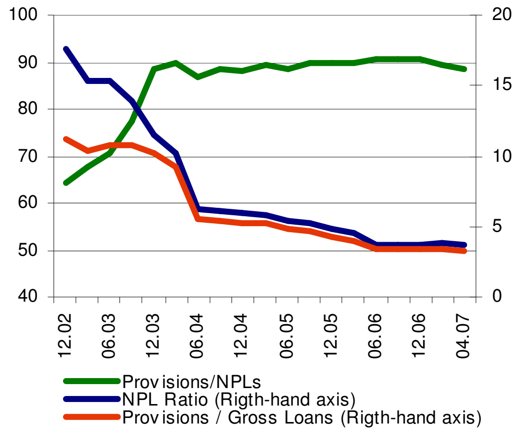
Table III.1.2.1. Total NPLs (Million YTL)[1]

	2002	2003	2004	2005	03.06	06.06	09.06	12.06
Loans and Other Receivables with Limited Collectibility	1,207	924	595	813	878	823	961	1,149
Doubtful Loans and Other Receivables	2,596	2,296	415	775	790	842	902	820
Loans and Other Receivables Classified As Loss	6,626	5,409	5,342	5,907	6,025	5,920	5,910	6,212
Total NPLs	10,430	8,629	6,353	7,495	7,692	7,585	7,773	8,182

Source: BRSA-CBRT
(1) Excluding İller Bank.

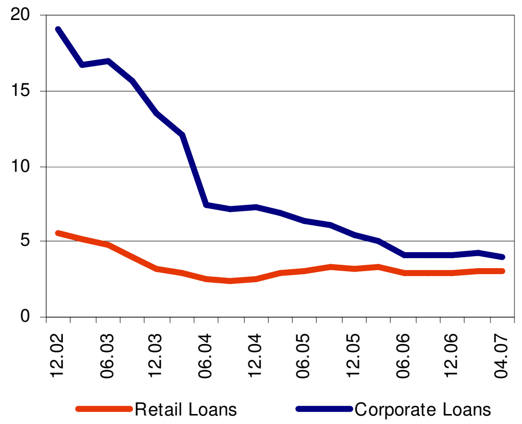
Regarding the distribution of non-performing loans, in 2006, the share of loans and other receivables classified as loss maintains its dominance in the total non-performing loans. It is also remarkable that loans and other receivables with limited collectibility and loans and other receivables classified as loss increased starting from the third quarter of 2006 (Table III.1.2.1).

Chart III.1.2.1. NPL Ratio and Provisions to NPLs (%)[1]



Source: BRSA-CBRT
(1) Figures for March and April 2007 are temporary.

Chart III.1.2.2. NPL Ratios for Retail Loans[1] and Corporate Loans[2] (%)[3]



Source: BRSA-CBRT
(1) Retail Loans=Consumer Loans +Credit Cards
(2) Corporate Loans=Total Loans –Retail Loans
(3) Figures for March and April 2007 are temporary.

The limited decline in the NPL ratio[9] despite the upward trend in NPLs in 2006 resulted from the greater rate of increase in the credit volume in this period (Chart III.1.2.1). Provisions to the credits ratio decreased despite the continued high provisioning policy for NPLs (Chart III.1.2.1). On the other hand, the banking sector maintains approximately 0.8 percent general provisions for standard and closely monitored cash loans in 2006.

Regarding the development of non-performing loans by economic units, the NPL ratios for both the retail loans and corporate loans decreased in 2006. As of April 2007, the NPL ratio for corporate loans continued to decrease, whereas for retail loans it increased slightly (Chart III.1.2.2). It is also expected that the Anatolian Approach that was initiated as of 2006 will have a positive impact on NPL ratios for corporate loans.

[9] Non-Performing Loan Ratio = Gross Non-Performing Loans / Gross Loans

Box III.1.2.1. Anatolian Approach

"Law No.5569 on Restructuring of the Debts of Small and Medium Scale Enterprises (SMEs) to Financial Sector", which is more comprehensive than "Law No:4743 on the Restructuring of Debts to Financial Sector and Amendments to Some Laws" dated January 31, 2002 and which is known as the Anatolian Approach by the general public, was published in the Official Gazette dated December 30, 2006 and numbered 26392. Law No.5569 is aimed at restoring the contribution to the economy of small and medium scale enterprises, which were excluded from the Istanbul Approach, producing commodities and services capable of adding value and having a financial bottleneck that requires restructuring to continue activities, and hence increasing employment by this way.

According to Law No.5569, SMEs are defined as enterprises which employ less than 250 employees annually or whose annual net sales revenue or asset size do not exceed 25 million New Turkish Liras and their loans, which were granted prior to October 31, 2006 and were transferred to the frozen or doubtful receivables accounts of banks or other financial institutions (leasing, factoring, consumer finance and asset management companies and Credit Guarantee Fund Management) will be restructured under certain conditions and time limits that will be determined by the framework agreements of financial restructuring.

The measures to be taken by the agreements of financial restructuring are; extending the maturities of the loans; renewing the loans of enterprises (except for SDIF and Emlak Bankasi under liquidation); granting additional new loans to enterprises (except SDIF and Emlak Bankasi under liquidation); deducting or forgoing principal and/or original interest and/or default interest or dividends; converting fully or partially into a subsidiary (excluding Ziraat Bankasi, Halk Bankasi, Emlak Bankasi under liquidation and SDIF banks), to transfer in return for a certain amount of cash, in kind or by means of collection; liquidating fully or partially against belongings of indebted or third persons; engaging in protocols with other banks.

With Law No.5569, unpaid debts on utilities, taxes and insurance premiums of SMEs that were due by October 31, 2006, shall also be suspended for up to 24 months by applying the legal interest rate and without seeking any guarantee and the application should be filed within 2 months from the contract date.

The Framework Agreement prepared by the Banks Association of Turkey was published on March 20, 2007, following the publication of the secondary regulation dated January 31, 2007 regarding Law No.5569. As of April 3, 2007, the Framework Agreement, which was signed by 9 deposit banks, 3 participation banks, 3 development and investment banks and 7 non-bank financial institutions was approved by the BRSA Decision No:2155 dated April 4, 2007. Commencing on the approval date of agreements, it is necessary for the participating financial institutions and SMEs under scope to sign the agreements of financial restructuring within 2 years.

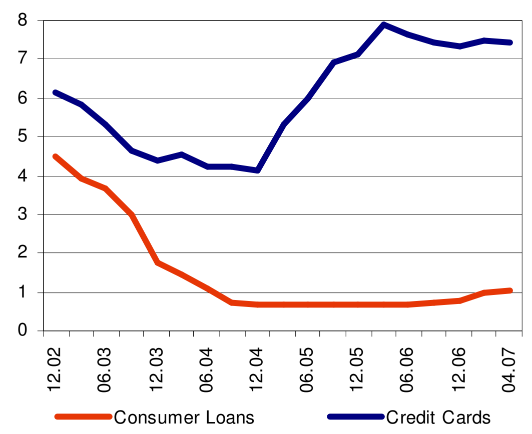
Table III.1.2.2. NPL Ratios and Provisions to NPLs for Selected Countries (%)

	NPL Ratio					Provisions / NPLs				
	2003	2004	2005	2006	Last Data	2003	2004	2005	2006	Last Data
Argentina	17.7	10.3	5.0	3.4	November	79.2	102.9	124.6	128.5	March
Brazil	4.8	3.8	4.4	-	December	144.6	162.1	145.5	-	December
Bulgaria	3.2	2.0	2.2	2.2	December	50.0	48.5	45.3	47.6	September
Czech Republic	4.9	4.1	4.3	4.1	September	76.7	69.4	63.2	62.2	September
Croatia	5.2	4.6	4.0	3.5	December	60.6	60.1	58.2	55.5	June
Hungary	3.0	2.9	2.7	2.7	September	47.3	51.3	54.4	-	December
Latvia	1.4	1.1	0.7	0.5	June	89.4	99.1	98.8	110.0	June
Lithuania	3.0	2.3	0.6	1.1	December	-	-	-	-	
Poland	10.4	9.2	7.7	6.6	June	53.4	61.3	61.6	57.8	September
Romania	8.3	8.1	8.3	8.4	September		45.6	45.6	47.1	September
Russia	5.0	3.8	3.2	2.7	September	118.0	139.5	156.3	159.3	September
Slovakia	3.7	2.6	5.0	3.7	August	85.8	86.4	85.1	99.0	September
Ukraine	28.3	30.0	19.6	17.8	December	22.3	21.0	25.0	23.1	December
France	4.0	3.7	3.3	3.2	June	57.7	57.6	59.7	58.7	June
Germany	5.3	5.1	4.1	4.0	June	-	-	-	-	
Greece	5.1	5.4	5.5	5.5	June	49.9	51.4	61.9	60.9	June
Italy	6.7	6.6	5.3	-	December	-	-	-	-	
United Kingdom	2.5	1.9	1.0	-	December	71.2	64.5	56.1	-	December
USA	1.1	0.8	0.7	0.7	September	140.4	168.1	155.0	148.4	September
Turkey	11.5	6.0	4.8	3.8	December	88.6	88.1	89.8	90.8	December

Source: IMF Global Financial Stability Report, April 2007, BRSA-CBRT

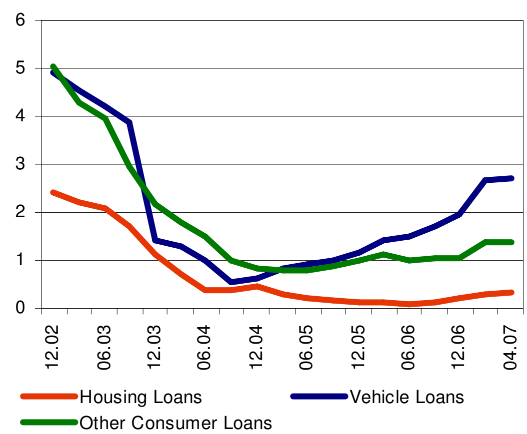
As of 2006, the NPL ratio in Turkey was below certain countries such as the Czech Republic, Poland, Romania, the Ukraine, Greece and Germany; whereas provisions to the NPLs ratio was higher than that of most selected countries except Argentina, Latvia, Russia, the Slovak Republic and the USA (Table III.1.2.2).

Chart III.1.2.3. NPL Ratios for Retail Loans (%)



Source: CBRT

Chart III.1.2.4. NPL Ratios for Consumer Loans [1] (%)



Source: CBRT
(1) Other consumer loans are consumer loans excluding housing and vehicle loans.

The NPL ratio for credit cards, which had reached its peak level with 7.9 percent as of March 2006, started to decrease after this period. On the other hand, the NPL ratio for consumer credits displayed an increasing trend in the second half of 2006 and this limited increase stemmed from vehicle loans (Chart III.1.2.3, Chart III.1.2.4).

Despite this increase in the NPL ratio for consumer loans, the wider customer base and easier cash convertibility of collaterals of such loans, limit the credit risk for banks.

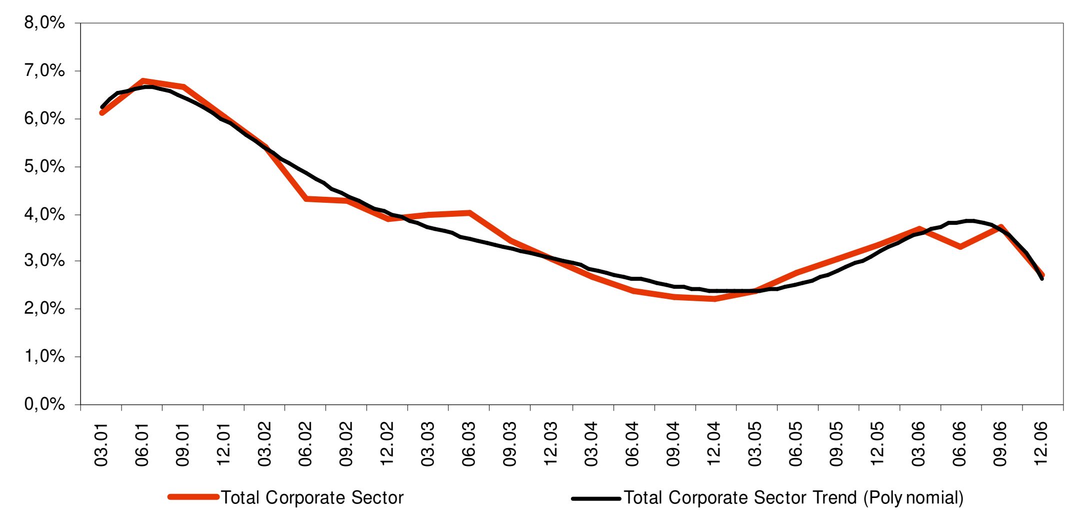
	Table III.1.2.3. NPL Ratios for Some Selected Sectors (%)[1]	2002	2003	2004	2005	2006
1	Wholesale and Ret. Trade, Brokerage, Repair of Mot. Veh	26.1	15.5	5.2	3.9	2.3
2	Transport, Storage and Communication	7.3	3.6	2.1	3.4	1.3
3	Textile and Textile Product Industry	18.8	12.5	8.1	10.0	11.2
4	Construction	11.9	7.0	4.9	4.3	4.0
5	Industry of Tobacco, Beverages and Food	15.7	10.6	5.9	3.8	3.8
6	Manufacture of Basic Metals and Fabricated Metal Prod.	16.1	9.3	4.1	2.7	0.9
7	Sources of Electricity, Gas and Water	0.3	0.2	0.3	0.2	0.2
8	Agriculture, Hunting and Forestry	8.7	6.3	4.7	3.4	3.1
9	Manufacture of Machinery and Equipment	12.5	9.7	4.4	5.0	2.1
10	Hotels and Restaurants (Tourism)	17.9	13.1	5.9	3.1	2.4

Source: CBRT

(1) Loans are compiled based on bank reportings under the scope of Central Bank Law No:1211, Article:44. They include those loans that are greater than ten thousand New Turkish Liras (inclusive); extended to real and legal bodies; by banks (including external loans used by firms with the intermediation of banks). They are inclusive of accrued interest and exclusive of non-cash loans. Therefore, they differ from the NPL figures in the balance sheet-based analysis.

According to the Central Bank Risk Center data, as of year-end 2006, the NPL ratio for "Textile and Textile Products" increased compared to the previous year-end and the NPL ratios for "Electricity, Gas and Water resources" and "Food, Beverages and Tobacco Industry" sectors remained the same, while NPL ratios for all other sectors decreased (Table III.1.2.3).

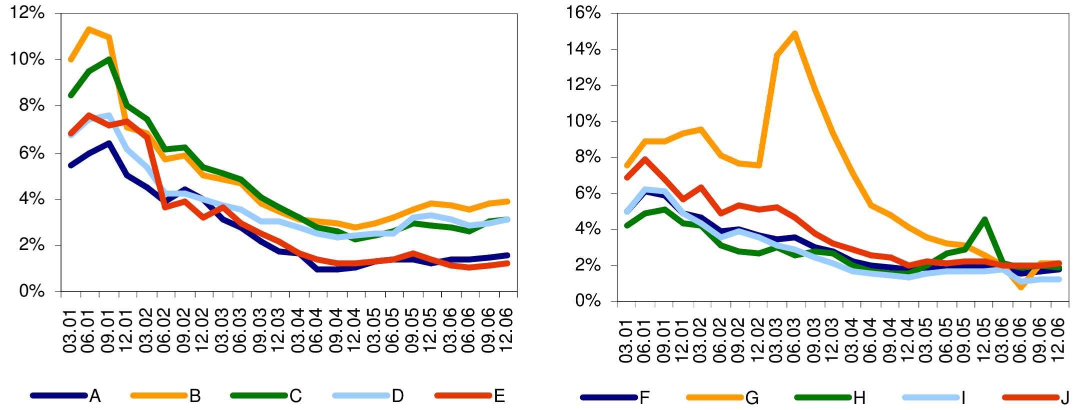
Chart III.1.2.5. Default Rate for Total Corporate Loans (Number, %)



Source: CBRT

For the 29 sectors monitored by the Risk Center, the default rate, which is the ratio of the number of firms in the NPL accounts in the current period to total number of firms using credits, decreased from 3.3 percent as of year-end 2005 to 2.7 percent as of 2006. (Chart III.1.2.5).

Chart III.1.2.6. Default Rates for Some Selected Sectors (%)



Source: CBRT
A = Wholesale and Ret. Trade, Brokerage, Repair of Mot. Veh
B= Textile and Textile Product Industry
C = Industry of Tobacco, Beverages and Food
D= Construction
E= Transport, Storage and Communication

F= Manufacture of Basic Metals and Fabricated Metal Prod.
G= Agriculture, Hunting and Forestry
H= Sources of Electricity, Gas and Water
I= Manufacture of Machinery and Equipment
J= Hotels and Restaurants (Tourism)

Regarding the top ten sectors utilizing most of the credits, the average default rate was 2.6 percent as of the previous year-end, whereas it decreased to 2.2 percent as of year-end 2006. Although its contribution to the manufacturing industry production became negative because of the decline in its production capacity and thus it borrowed less, the highest rate as of year-end 2006 belongs to the “Textile and Textile Products” sector, which has a share of more than 25 percent in total NPLs of the corporate sector (Chart III.1.2.6).

The default rates of the “Wholesale and Retail Trade”, “Food, Beverages and Tobacco Ind.” and “Textile and Textile Products” sectors increased as of year-end 2006, compared to the previous year-end, whereas for all other sectors it decreased (Chart III.1.2.6).

In addition, the default rates of the “Textile and Textile Products”, “Food, Beverages and Tobacco Ind.” and “Construction” sectors are above the sector average as of year-end 2006.

Box III.1.2.2. Correlations Between the Default Rates of Sectors

The correlations between the default rates of sectors are calculated in Table 1. Considering the correlation matrix, it is observed that the default rates of sectors are positively correlated and thus it is thought that any negative developments in the macro variables may affect the whole corporate sector credit portfolio more or less in the same way. Hence, despite the downward trend of default rates, as also indicated in financial literature, credit expansion in periods of economic expansion always increases the exposure of the banking sector to credit risk. In this framework, it is thought that the demand of the corporate sector for bank loans, which are the most important financial resources needed in a growing economy, should be met prudently based on sound and effective techniques of analysis. This is one of the leading ways in the effective risk management of the banking sector and in decreasing the fragility of the financial system.

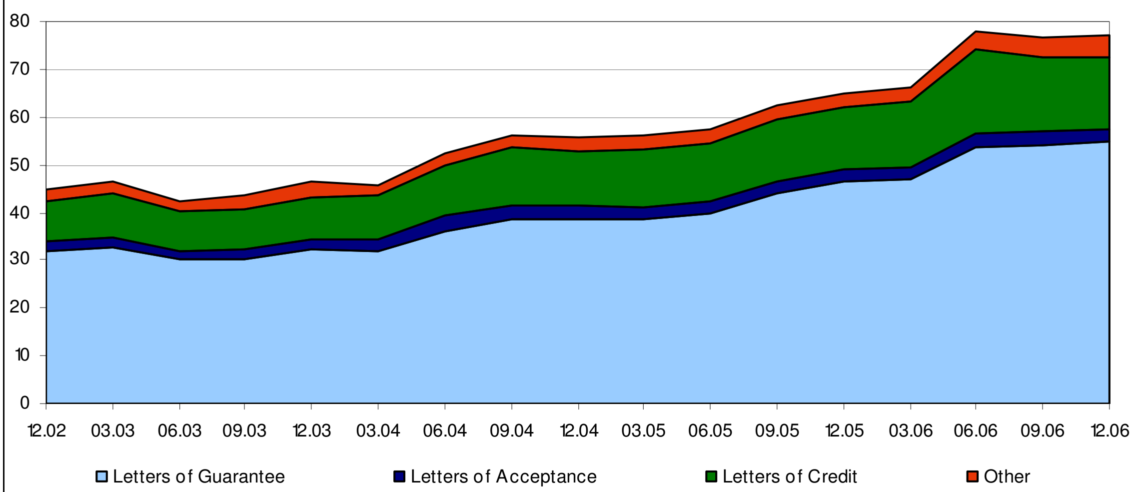
Table 1. Correlation Matrix [1]

		1	2	3	4	5	6	7	8	9	10
1	Wholesale and Ret. Trade, Brokerage, Repair of Mot.Veh	1.00									
2	Transport, Storage and Communication	0.61	1.00								
3	Textile and Textile Product Industry	0.77	0.78	1.00							
4	Construction	0.65	0.88	0.88	1.00						
5	Industry of Tobacco, Beverages and Food	0.38	0.45	0.70	0.69	1.00					
6	Manufacture of Basic Metals and Fabricated Metal Prod.	0.73	0.81	0.93	0.88	0.67	1.00				
7	Sources of Electricity, Gas and Water	0.12	0.15	0.28	0.13	0.25	0.40	1.00			
8	Agriculture, Hunting and Forestry	0.31	0.38	0.55	0.63	0.53	0.57	0.13	1.00		
9	Manufacture of Machinery and Equipment	0.79	0.81	0.90	0.89	0.63	0.92	0.17	0.53	1.00	
10	Hotels and Restaurants (Tourism)	0.67	0.66	0.59	0.53	0.33	0.71	0.51	0.21	0.64	1.00

Source:CBRT
(1) The trend is eliminated by using HP filter.

III.1.3. Non-Cash Loans

Chart III.1.3.1. Non-Cash Loans by Type (Billion YTL)



Source: BRSA-CBRT

The ratio of off-balance sheet liabilities, which include non-cash loans and commitments, to total assets, was 16.3 percent as of year-end 2005 and decreased to 15.9 percent as of year-end 2006. This decrease stemmed from the higher growth rate in total assets (Chart III.1.3.1).

The ratio of non-cash loans, which includes mostly letters of guarantee and letters of credit, to cash loans, was 41.2 percent as of year-end 2005 and decreased to 35.4 percent as of year-end 2006. The share of foreign currency denominated non-cash loans was 64.4 percent as of year-end 2006.

III.1.4. Credit Risk Scenario Analysis

With the aim of assessing the credit risk that the banking sector might be exposed to, analyses were conducted on how the CARs of banks will be affected by an increase in their NPL ratios, as of December 2006.

Within this framework, scenario analyses were conducted under the following assumptions:

i) The total credit volume of banks remains unchanged.

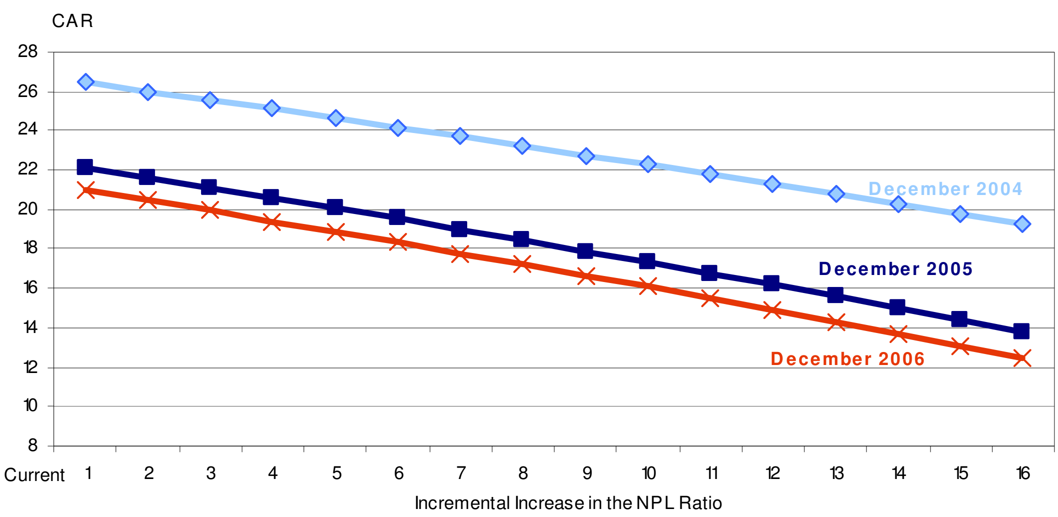
ii) NPLs resulting from shocks have the same composition as the existing NPLs of banks. For banks which did not have any NPLs before the shocks, after shock NPLs are classified as “loans and other receivables with limited collectibility”, setting aside a 20 percent provision.

iii) New NPLs resulting from shocks were accounted for in the 100 percent risk weight category for the calculation of the CARs before such shocks.

iv) There is no change in the total risk weighted assets and own funds of banks other than the shocks.

Moreover, collateral amounts were not taken into consideration when calculating additional provisions.

Chart III.1.4.1. Effects of Credit Shocks on the CAR of the Sector (%)[1]



Source: BRSA-CBRT
(1) Excluding the SDIF bank, Iller Bank and banks that do not have loans in their portfolio.

The effects of 1-15 points incremental increases of the NPL ratio on the CAR of the banking sector were analyzed[10]. While a 15-point increase in the NPL ratio of the banking sector led to a fall of 8.5 points in the CAR of the banking sector as of 2006, this decrease was not so different compared to the effect of the same shock on CAR as of December 2005. Even after the largest shock, the CAR of the banking sector was realized as 12.5 percent as of

[10] After the non-performing receivable classification of credits and additional provisions, the after-shock CAR is calculated as: (Own funds-Additional Provisions) / (Total Risk Weighted Assets-Additional Provisions) x 100.

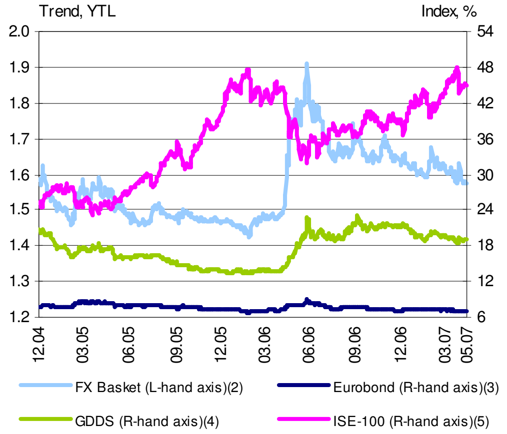
December 2006, despite the fact that the starting level of CAR was lower than that of December 2005 (Chart III.1.4.1).

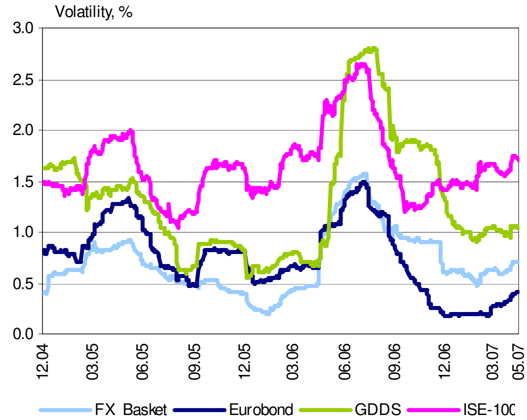
III.2. Market Risk and Scenario Analysis

III.2.1. Market Risk

In this section, along with the analysis of the effects of the developments in interest rate and FX risk on the banks' balance sheets, two hypothetical scenarios based on historical data were designed and their effects were analyzed.

Chart III.2.1.1. Foreign Exchange Rate, Interest Rate and Equity Price Developments and Volatilities [1]

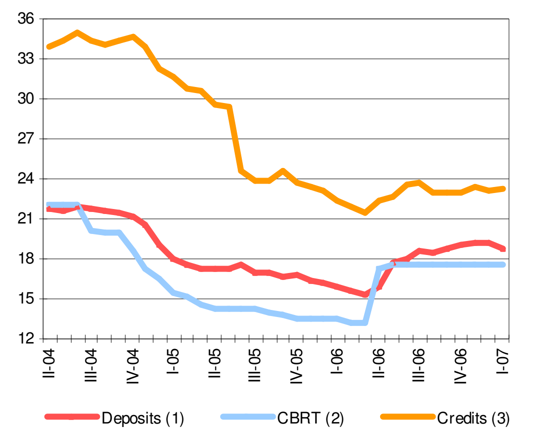




Source: CBRT
(1) For volatility calculations, standard deviation of daily logarithmic yield of the related market instrument (60 day moving average) is used.
(2) 50 percent of the Foreign Exchange Basket is in USD and the rest is in Euro.
(3) Based on USD denominated Eurobond interest rate with 2030 maturity.
(4) Based on the interest rate on the GDDS with the largest transaction volume in the secondary market.
(5) Calculated by dividing ISE-100 by 1,000.

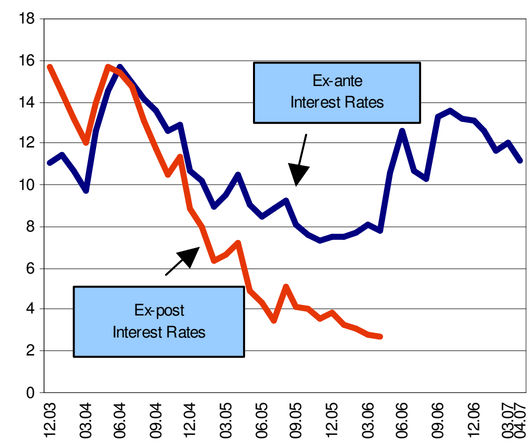
Financial stability in the financial markets has been restored due to the measures taken following the May-June fluctuations. However, the fluctuation in international markets in February 2007 has also had an adverse effect on Turkey, resulting in a depreciation of the YTL and a rapid fall in the ISE index. Despite this fluctuation, interest rates started to decline due to the amelioration in inflation expectations in the first five months of 2007, the increase in global liquidity conditions and increased risk appetite and hence, equity prices increased and YTL appreciated. Nonetheless, the volatility of markets started to exhibit an increasing trend. (Chart III.2.1.1).

Chart III.2.1.2. Interest Rates (%)



Source: ISE, CBRT
(1) Banking sector 3-month weighted "stock YTL deposit" interest rate.
(2) CBRT overnight (O/N) borrowing rate.
(3)Banking sector weighted "stock YTL credit" interest rate.

Chart III.2.1.3. Ex-ante[1] and Ex-post[2] Real Interest Rates of GDDS (%)

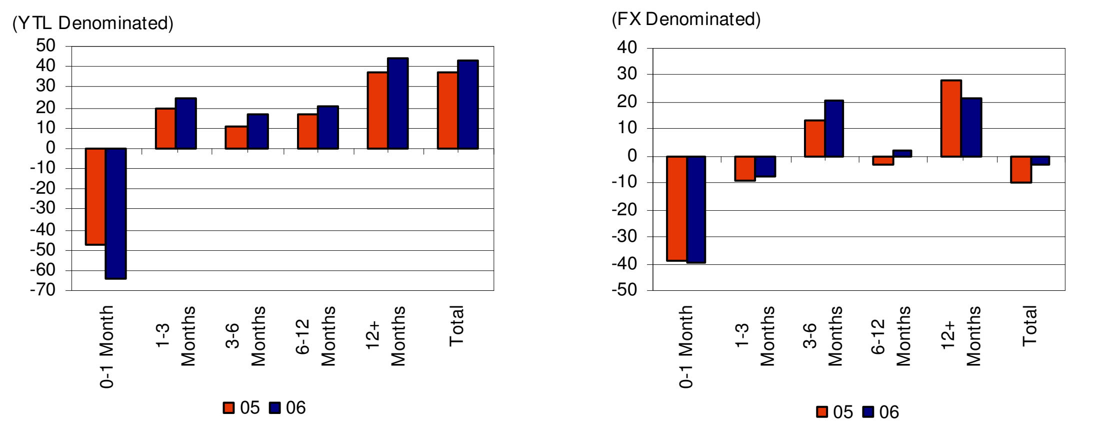


Source: Calculated by using the data of CBRT, ISE and TURKSTAT.
1 Ex-ante interest rate=(((1+ nominal interest rate)/(1+expected inflation rate))-1)*100
2 Ex-post interest rate=(((1+ last year's nominal interest rate)/(1+realized inflation rate))-1)*100
As expected inflation rate, yearly ex-ante CPI figures in the bi-weekly Survey of Expectations published by the CBRT are used.

Even though the interest rates of deposits and credits increased in 2006 compared to 2005, the margin decreased. It is thought that the contraction in margin is due to consumer loans which are fixed rated (Chart III.2.1.2).

The ex-ante real interest rate, which used to be 7.6 percent as of year-end 2005, increased to 13.1 percent as of year-end 2006 due to the increase in interest rates. However, the ex-ante real interest rates declined to 11.2 percent as of April 2007, due to the downward trend in raw-material prices in the last period, global liquidity conditions in favor of developing countries and the decline in interest rates beyond inflation expectations. (Chart III.2.1.3).

Chart III.2.1.4. Interest Rate Sensitivity Gap of the Banking Sector (Billion YTL) [1,2]

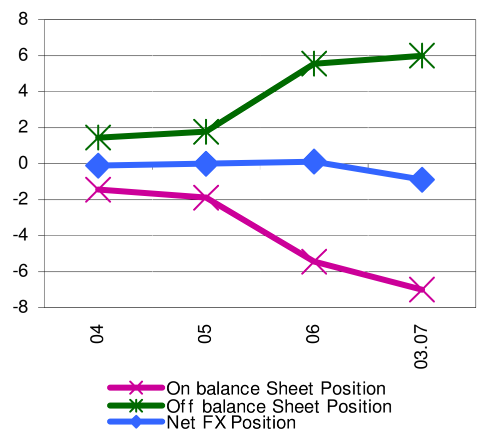


Source: BRSA-CBRT
(1) Time to re-pricing is used.
(2) Excluding SDIF bank.

In terms of time to repricing, the interest rate sensitivity gap of the banking sector both in YTL and FX is concentrated in the 0-1 month maturity bracket as of December 2006, just as in the previous periods. In the December 2005-2006 period, while the YTL denominated interest rate sensitivity gap increased in the 0-1 month maturity bracket, the positive gap in all other brackets increased. This situation indicates a shortening in the maturity structure of banks' liabilities in this period.

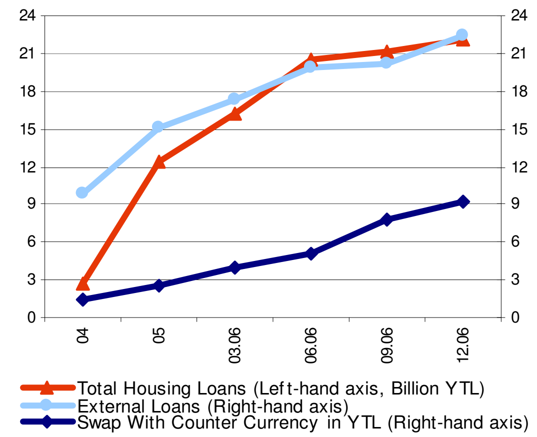
In the same period, the FX denominated sensitivity gap in 0-1 month maturity bracket remained nearly the same, whereas the gap in the 6-12 month maturity bracket became positive. In total, the YTL denominated positive gap increased by 2 billion New Turkish Liras, while the FX denominated gap decreased by 5.5 billion New Turkish Liras (Chart III.2.1.4).

Chart III.2.1.5.Foreign Exchange Position of the Banking Sector (Billion USD)[1]



Source: BRSA
(1) Participation Banks are included

Chart III.2.1.6. Financing of Housing Loans and Swap Purchases (Billion YTL, Billion USD)[1,2]



Source: BRSA – CBRT
(1) "External Loans" consist of syndication and securitization loans.
(2) "The banks which extend housing loans are taken into consideration.

The FX net general position (FXNGP) of the banking sector was almost balanced in 2006 and then turned into a short position starting in 2007. On the other hand, parallel to the progress of the off-balance sheet long position, the on balance sheet short position was in the 5-7 billion US dollar range starting from the first quarter of 2006 (Chart III.2.1.5)

Turkish lira credits funded with foreign currency sources used from abroad are the main reason of the short on balance sheet position of the banking sector, especially in 2006. Due to the increasing number of YTL denominated bond issues by foreign institutions since 2005, banks convert part of their long-term FX credits provided from abroad into YTL with swap transactions and lend long-term housing loans without taking any FX risk (Chart III.2.1.6).

The total amount of the selected derivatives with counter currency in YTL (YTL/FX) of the banking sector, which balances its on balance sheet short position with the off balance sheet long position, was almost 14.2 billion USD as of December 2006 and an amount equivalent to 12.5 billion US dollars was realized by financial sector institutions.

III.2.2. Scenario Analyses

III.2.2.1. Interest and Exchange Rate Shocks

In this section, based on the assumption that the interest rate increase and depreciation of YTL shocks occur independently, their individual and total impact on the banking sector are analyzed in two scenarios.

In Scenario A, it is assumed that Turkish Lira depreciates by 30 percent against other currencies, New Turkish Lira and FX interest rates increase by 6 and 5 points, respectively and Eurobond prices decrease by 5 percent.

In Scenario B, it is assumed that Turkish Lira will depreciate by 30 percent, Eurobond prices will decrease by 5 percent and interest rate increases will be twice as much as interest rate fluctuations during the May and June period[11].

Table III.2.2.1.1. Interest and FX Rate Increase Scenarios

	SCENARIO A	SCENARIO B
A. Depreciation of YTL	30 percent depreciation of YTL against other currencies	30 percent depreciation of YTL against other currencies
B. Interest Rate Increase-YTL	Re-pricing of YTL interest sensitive assets and liabilities falling in 0-1 and 1-3 month maturity brackets at 6 points higher	Re-pricing of YTL interest sensitive assets and liabilities falling in 0-1, 1-3, 3-6 month maturity brackets at 9, 8, 11 points higher, respectively.
C. Interest Rate Increase-FX	Re-pricing of YTL interest sensitive assets and liabilities falling in 0-1 and 1-3 month maturity brackets at 5 points higher	Re-pricing of YTL interest sensitive assets and liabilities falling in 0-1, 1-3, 3-6 month maturity brackets at 1.1, 0.7, 1.1 points higher, respectively.
D. Trading Portfolio-YTL[1]	6 points increase in market interest rates of YTL denominated fixed income securities in the trading portfolio	Increase in market interest rates of YTL denominated fixed income securities in the trading portfolio by 9, 8, 11 points for the 0-1, 1-3, 3-6 month maturity brackets, respectively.
E. Eurobond Portfolio	Decrease in prices of Eurobonds in the trading portfolio by 5 percent	Decrease in prices of Eurobonds in the trading portfolio by 5 percent

(1) BRSA defines the trading portfolio as “Securities in the trading portfolio” and “Securities available for sale” in accordance with the description of the Basel Committee.

For the calculation of the impact of depreciation scenarios, FXNGP data of banks is used. On the other hand, to calculate the impact of interest rate increase scenario, the re-pricing gap method, which complements the standard method and the implementation of which is recommended by the Basel Committee on Banking Supervision, is utilized. Within this context, the difference between interest rate sensitive assets and liabilities in the “time to re-pricing” maturity brackets of 0-1, 1-3 and 3-6 months are used.

Scenario analyses, which are based on re-pricing gap data, are conducted under the following assumptions:

[11] GDDS interest rates are used for the interest rate increase in Scenario B.

- Interest rate sensitivity of the banks' assets and liabilities remain unchanged during the analysis period,
- Demand deposits are not interest rate sensitive,
- There are no new fund inflows or outflows,
- Interest rate increases will last for 3 months under Scenario A and for 6 months under Scenario B.

The loss in value of YTL denominated fixed income securities and Eurobond portfolio stemming from interest rate increases are also calculated.

Table III. 2.2.1.2. Results of Market Risk Scenarios (Million YTL)[1]

	Scenario A			Scenario B		
	2004	2005	2006	2004	2005	2006
A. YTL Depreciation						
a. Total	-52	-73	80.4	-52	-73	80.4
Profit (Loss)/Equity (%)	-0.1	-0.2	0.2	-0.1	-0.2	0.2
b. Banks Gaining Profits	293	71	269.7	293	71	269.7
c. Banks Suffering Losses	-345	-143	-189.4	-345	-143	-189.4
Banks Suffering Loss/Equity (%)	-2.1	-0.5	-1.4	-2.1	-0.5	-1.4
B. Interest Rate Increase						
a. YTL	49	8	-172.2	595	483	258.3
b. FX	-248	-352	-290.2	-53	-62	-2
Profit (Loss) due to Interest Rate Increase (a+b)	-198	-345	-462.4	542	421	256.3
Profit (Loss) due to Interest Rate Increase/Equity (%)	-0.5	-0.8	-0.9	1.5	1	0.5
C. YTL Trading Portfolio						
Loss in Value due to Interest Rate Increase	-951	-1,480	-1,549	-1,672	-2,583	-2,701
Loss in Value due to Interest Rate Increase/Equity (%)	-2.6	-3.6	-3	-4.6	-6.3	-5.2
D. Eurobond Portfolio						
Loss in Value	-505	-518	-632	-505	-518	-632
Loss in Value/Equity (%)	-1.4	-1.3	-1.2	-1.4	-1.3	-1.2
E. Total Impact						
Profit/Loss	-1,707	-2,415	-2,563	-1,687	-2,752	-2,997
(Profit/Loss)/Equity (%)	-4.6	-5.9	-5	-4.6	-6.7	-5.9
Current CAR of the Sector (%)	25.6	21.2	19.8	25.6	21.2	19.8
After-Shock CAR of the Sector[2] (%)	24.4	20	18.8	24.4	19.8	18.6

(1) Excluding SDIF bank. T. Kalkınma Bank. Iller Bank and Eximbank.
(2) After-shock profit/loss amounts under the scenarios are assumed to affect only equity but not the risk weighted assets.

III.2.2.1.1. YTL Depreciation

In the depreciation of YTL scenario, the banking sector, which suffered losses as of December 2005 due to its short position, incurred profits as of December 2006 owing to its long position. The amount of losses suffered by banks due to their short positions as of December 2006 increased, compared to December 2005. Due to the increased amount of losses suffered and the low level of shareholders' equity held by those banks that suffered losses, the ratio of such losses to equity also increased. On the other hand, the total amount of profits incurred in the said scenarios, increased between December 2005 and December 2006 (Table III.2.2.1.2).

III.2.2.1.2. Interest Rate Increase and Loss in Value

i) As a result of Scenario A, both the YTL and FX denominated net interest income of the banking sector decreased as of December 2006. Under Scenario B, the YTL denominated net interest income increased, while FX denominated interest income decreased.

The decrease in the net interest income under Scenario A is due to the widening of the gap for the 0-1 month maturity bracket as of December 2006. In Scenario B, while the long position in the 3-6 month maturity bracket led to an increase in income compared to year 2005, the widening of the gap for the 0-1 month maturity bracket had a limiting effect on this increase.

Considering the effects of interest rate increases on FX denominated assets and liabilities, even though there has been a decline in interest income in both Scenario A and B, the decline is lower compared to December 2005.

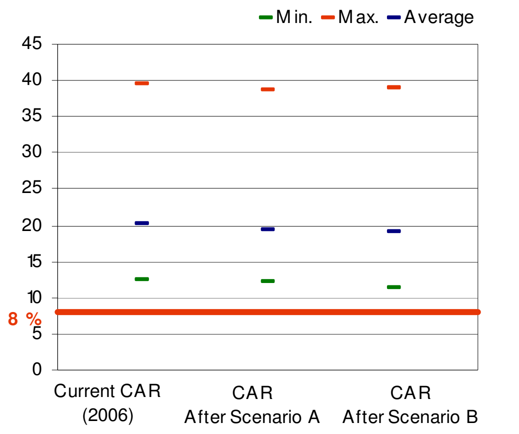
ii) Although, the loss of value in the discounted New Turkish Lira securities resulting from the interest rate increases rose in both scenarios, the ratio of these losses to shareholders' equity decreased as of December 2006 compared to December 2005.

iii) While the loss of value in the Eurobond portfolio increased in amount, its ratio to shareholders equity decreased due to the strengthened equity structure.

In conclusion, considering the strengthened equity structure of the banking sector in December 2006, the ratio of possible losses arising from shocks to equity declined.

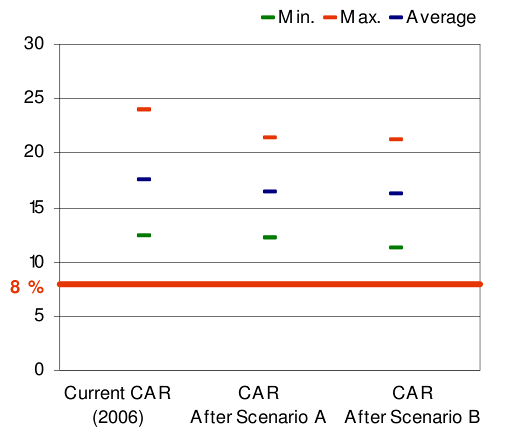
The analysis of the impact of Scenario A and B on the CARs of the largest 10 banks in relation to asset size indicates that the maximum, minimum and average CARs are not affected significantly.

Chart III.2.2.1.2.1. Impacts of the Scenarios on the Largest 10 Banks of the Sector[1]



(1) Largest 10 Banks considering their share in total assets are included in the analysis.

Chart III.2.2.1.2.2. Impacts of the Scenarios on the Largest 10 Private Banks of the Sector[1]



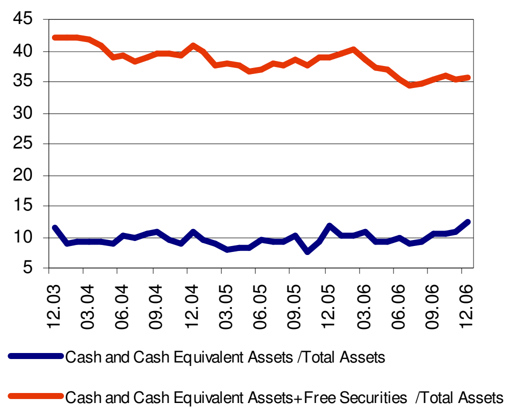
(1) Largest 10 Private Banks considering their share in total assets are included in the analysis.

When the market risk shocks of Scenario A are applied to the underlying indicators of the Financial Strength Index, the index decreased from 117.6 to 113.8 by year-end 2006.

III.3. Liquidity Risk

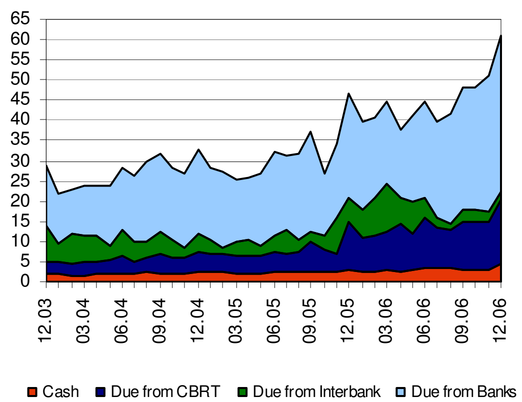
Despite credit expansion, it is remarkable that the liquid assets of the banking sector, consisting of cash and cash equivalent assets, maintained a certain level and display an increasing trend since July 2006. Their share in total assets was realized as 12.5 percent as of December 2006, reaching its peak level for the last three years. However, the ratio becomes 35.8 percent, when the "free" securities that are not used as collateral or for repo transactions are taken into consideration (Chart III.3.1). The decreasing trend in this ratio has stemmed from the fact that the balance sheet structure of banks has changed in favor of loans and the share of the securities portfolio has decreased.

Chart III.3.1. Liquidity Ratios (%) [1,2]



Source: BRSA-CBRT
(1) Cash and Cash Equivalent Assets = Cash + Due from CBRT + Due from Interbank +Due from Banks
(2) Free Securities = Securities that are not used as collateral or for repo transactions or not held for Structural Position.

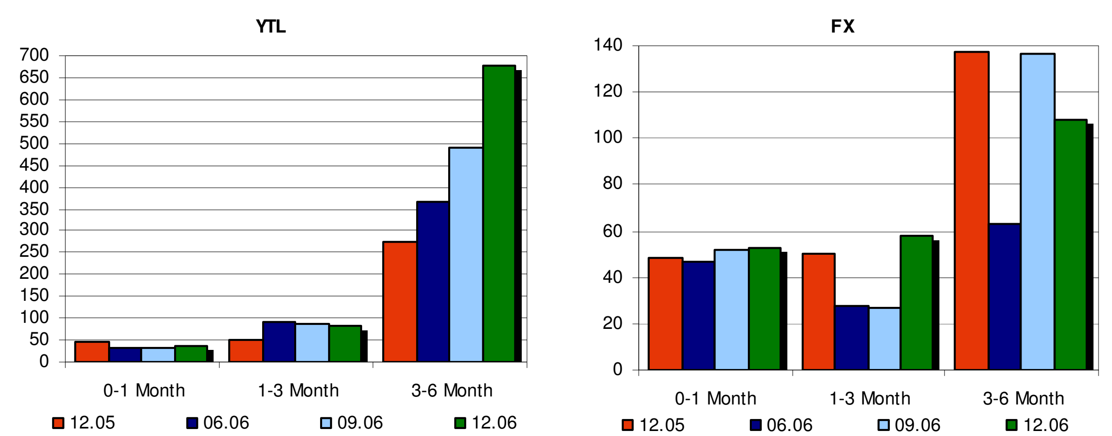
Chart III.3.2. Liquid Assets (Billion YTL)



Source: BRSA-CBRT

When the distribution of the cash and cash equivalent assets consisting of cash, due from the CBRT, the Interbank and banks, is analyzed, it is observed that the due from banks item has the highest share in liquid assets. The decrease of due from the Interbank item since May 2006 continues. On the other hand, the due from the CBRT maintains its increase (Chart III.3.2).

Chart III.3.3. Ratio of Assets to Liabilities with Respect to Remaining Maturities (%)

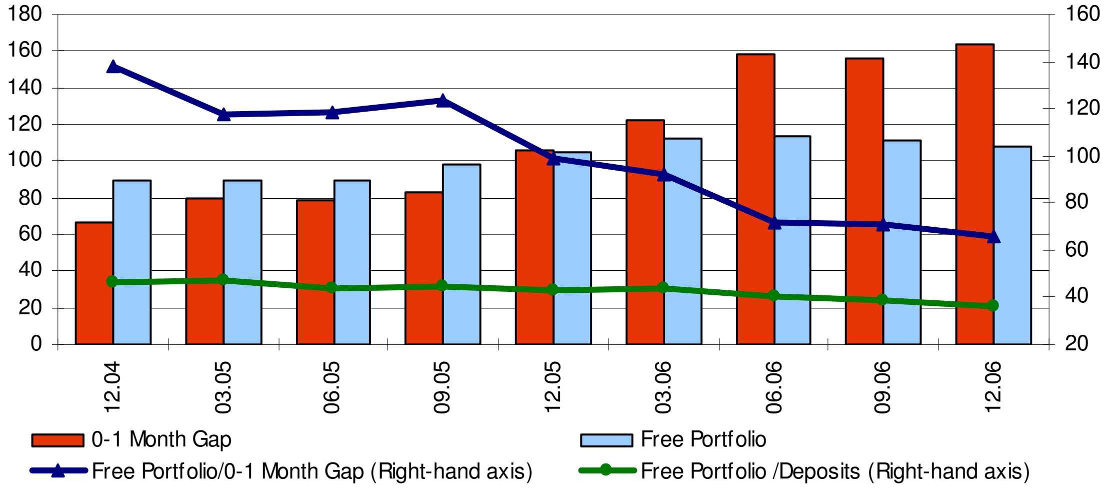


Source: BRSA-CBRT

In the 0-1 month bracket with respect to the remaining maturity, the coverage ratio of assets to liabilities in domestic currency was low due to the short-term nature of liabilities. On the other hand, in the last quarter of 2006, the coverage ratio of assets to liabilities in the 3-6 month maturity bracket with respect to remaining maturity continues to increase due to the increase of assets in this bracket.

In foreign currency, in the 0-1 month and 1-3 month brackets with respect to remaining maturity, the coverage ratio of assets to liabilities increased and was realized above 50 percent, as of December 2006. This increase was due to the increase in assets of this maturity bracket in the last quarter. On the other hand, in the 3-6 month maturity bracket with respect to the remaining maturity, the coverage ratio of assets to liabilities decreased as a result of the increase in liabilities in this maturity bracket (Chart III.3.3).

Chart III.3.4. The Coverage Ratio of Collaterals to Liabilities (Billion YTL, %)[1]



Source: BRSA-CBRT
(1) Free Portfolio: Securities Portfolio less Securities used as Collateral or for Repo Transactions.

The ratio of the free securities portfolio, which is among the collaterals to be accepted by the CBRT to provide liquidity in case of a temporary liquidity squeeze, to the difference between assets and liabilities in the 0-1 month maturity bracket was realized over 100 percent until year-end 2005, and thereafter it followed a declining trend until the end of June 2006. After this, it followed a relatively constant course. The ratio of free portfolio to deposits decreased from 43 percent at end-2005 to 36.4 percent at end-2006 (Chart III.3.4).

In general, deposits, which are the main source of funds for the Turkish banking sector, are concentrated in the 0-3 month maturity bracket, whereas the securities portfolio and loans are longer term. Despite the short-term nature of deposits, the adverse impact of the maturity mismatch relatively declines since a large proportion of time–savings deposits have core quality.

III.4. Financial Strength Index

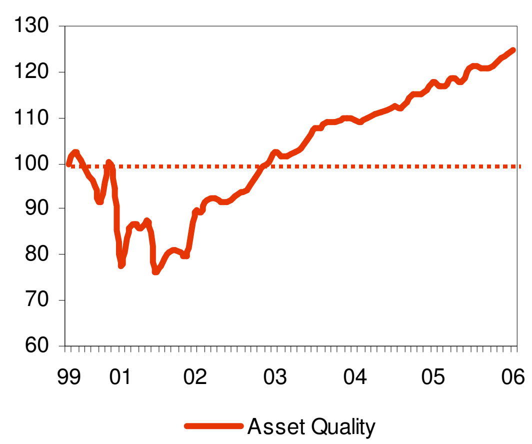
When compiling the Financial Strength Index (FSI), specific ratios that reflect the risks and fragility of the sector are selected to form an "aggregate indicator", and the direction of the movement of this index has been used to analyze the strength of the sector. Six sub-indicators are utilized to create the index, which are asset quality, liquidity, exchange rate risk, interest rate risk, profitability and capital adequacy indices (Box III.4.1)

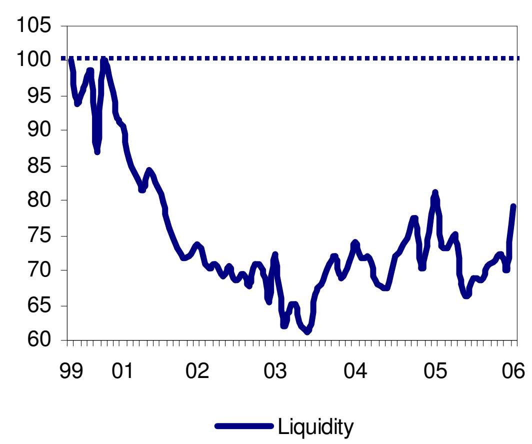
Box III.4.1. Financial Strength Index Variables

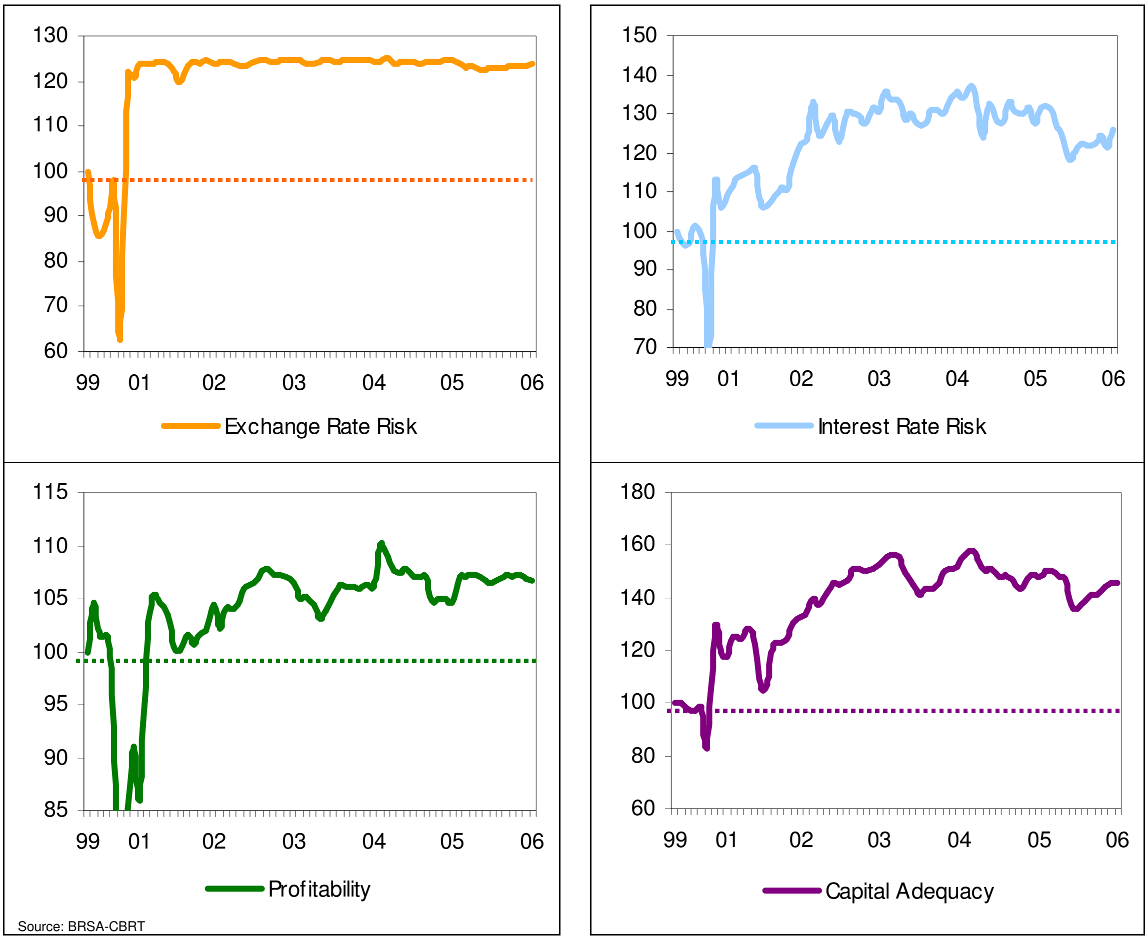
	Financial Strength Indicators	Direction of the Impact	Weights
Asset Quality	Gross Non-Performing Loans / Gross Loans	negative	0.33
	Net NPL / Shareholders Equity	negative	0.33
	Fixed Assets / Total Assets [1]	negative	0.33
Liquidity	Liquid Assets / Total Assets [2]	positive	0.40
	Assets with a Maturity up to 3 Months / Liabilities with a Maturity up to 3 Months	positive	0.60
Exchange Rate Risk	On-Balance Sheet FX Position / Own Funds [3]	negative	0.50
	FX Net General Position / Own Funds [4]	negative	0.50
Interest Rate Risk	(Interest Sensitive YTL Assets with a Maturity up to 1 Month – Int. Sensitive YTL Liabilities with a Maturity up to 1 Month) / Equity [5]	negative	0.50
	(Interest Sensitive FX Assets with a Maturity up to 1 Month – Int.Sensitive FX Liabilities with a maturity up to 1 Month) / Equity [5]	negative	0.50
Profitability	Net Profit / Total Assets	positive	0.50
	Net Profit / Shareholders Equity	positive	0.50
Capital Adequacy	Free Capital / Total Assets [6]	positive	0.50
	Capital Adequacy Ratio	positive	0.50

(1) Fixed Assets consist of subsidiaries, assets to be sold, fixed assets and net non-performing loans.
(2) Liquid Assets consist of cash, due from the CBRT, due from money market, due from banks and receivables from reverse repo transactions.
(3) Own funds is the regulatory capital, and it is different from the equity in the balance sheet. The calculation is in absolute values.
(4) Foreign exchange net open position is the sum of on and off balance sheet foreign currency positions. The calculation is in absolute values.
(5) The calculation is in absolute terms.
(6) Free capital is calculated by deducting fixed assets from equity.

Chart III.4.1. Financial Strength Sub-Indices







Source: BRSA-CBRT

The assessment of the sub-indices that form the FSI is as follows (Chart III.4.1);

i. Asset Quality Index: The asset quality index, which was 117.8 by year-end 2005, continued to increase throughout 2006 due to the decrease in fixed assets to total assets and NPL ratio and was realized as 124.6 by year-end 2006.

ii. Liquidity Index: The liquidity index dropped to 66.4 in May 2006, and, after a rapid recovery, it increased to 79.2 at end-2006.

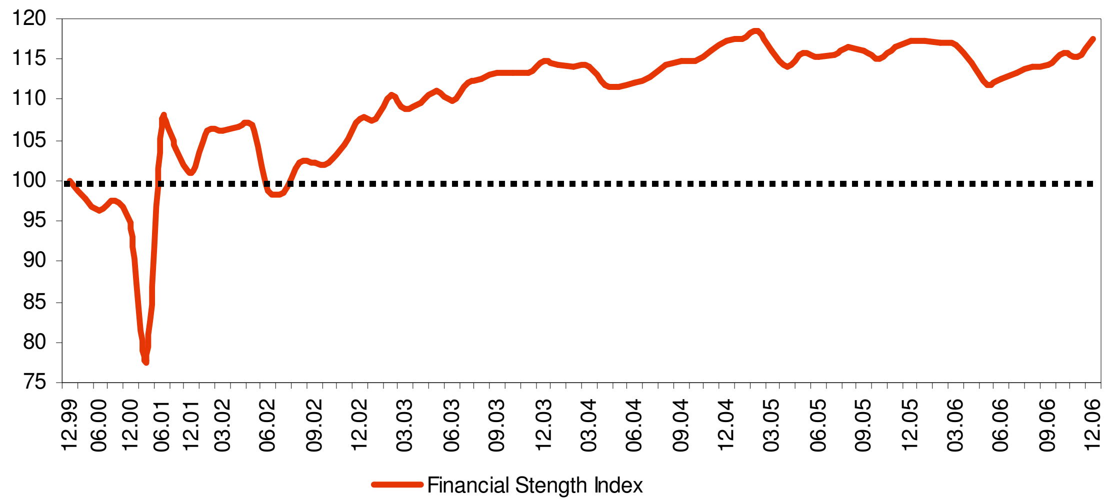
iii. Exchange Rate Risk Index: The exchange rate risk index displays a stable trend and was realized as 123.7 by end-2006. The turbulence did not have an important impact on the exchange rate risk index due to the limited open position of the banking sector.

iv. Interest Rate Risk Index: The interest rate risk index, which was 127.6 by year-end 2005, decreased to 125.7 by year-end 2006. This decrease came as a result of the increase in the ratio to shareholders equity of the difference between interest sensitive assets in the maturity bracket up to 1 month and interest sensitive liabilities with the same maturity, which is denominated in YTL.

v. Profitability Index: The said index, which was 104.6 by year-end 2005, increased to 106.7 by year-end 2006 due to the increase in return on assets and return on equity of the banking sector.

vi. Capital Adequacy Index: The said index, which was 148.5 by year-end 2005 decreased to 145.5 by year-end 2006, due to the decline in the capital adequacy ratio.

Chart III.4.2. Financial Strength Index (FSI)



Source: BRSA-CBRT

The FSI, which was 117.4 by year-end 2005, decreased to its lowest level to 111.9 as of May 2006, due to the turbulence in financial markets and it recovered after June 2006, reaching 117.6 by year-end 2006 (Chart III.4.2).