

III. Non-Financial Sector

In the current reporting period, Turkey's household indebtedness ratio of 15% remained far below the EME average. However, credit campaigns of the coronavirus pandemic period have recently caused households' financial liabilities to grow slightly more than assets.

The rise in households' financial assets continued with savings deposits in the lead. The orientation of investors towards gold continued. Thus, growth in households' assets was significantly driven by the rise in precious metal deposit accounts, despite their relatively low share. On the financial liabilities front, the largest contributors of growth in this period were general-purpose and housing loans, which recorded notable increases.

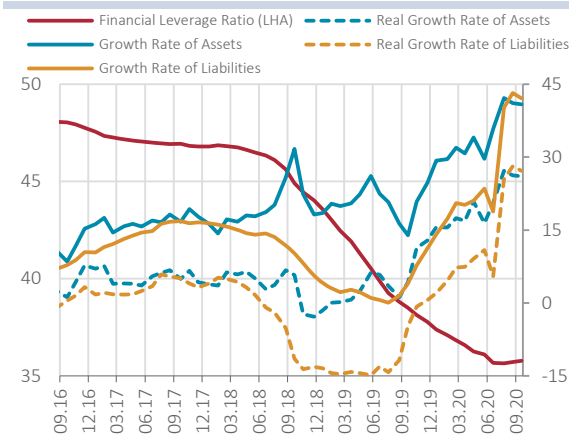
With a rebound owing to the incentives and measures implemented during the pandemic, economic activity enhanced the improvement in expectations and the real sector confidence indices. The strong course of the activity especially in export-related sectors pushed the corporate sector confidence index upwards. Likewise, the construction confidence index gained sizeable momentum due to housing loan campaigns led by state-owned banks. While economic recovery spread across many sectors, tourism and other services sectors accompanied by certain sectors with limited export opportunities remained on a weak path. Investment trend is moving upwards due particularly to the demand from exporting sectors, yet hovers below the pre-pandemic levels.

Amid the measures implemented during the pandemic, the total financial indebtedness ratios of corporate sector firms are on the increase, while the decline in the FX short position continues. The ratio of corporate sector total financial debts to GDP, which was 56% in January 2020, increased by 12 points to 69% in August. The tightening in financial conditions observed as of August is expected to limit indebtedness ratios in the upcoming period. The corporate sector's FX short position amount registered a year-on-year decline by 12% from USD 188 billion to USD 165 billion in August 2020. This is attributed to the weak course of firms' investment trends and their evasion of an additional exchange rate risk on the liabilities front considering the volatility in exchange rates.

III.1 Household Developments

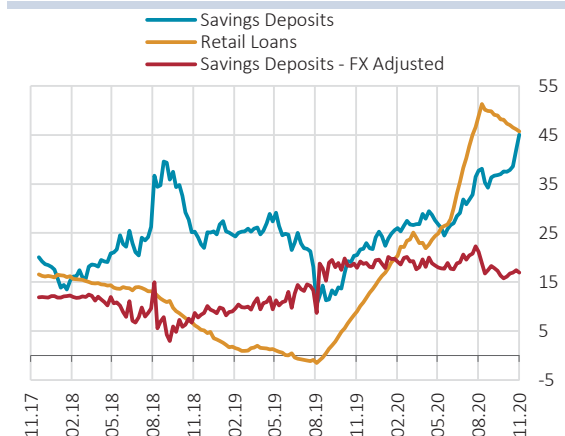
Due to credit campaigns offered during the coronavirus pandemic, growth in household financial liabilities gained momentum and stood slightly above asset growth in September 2020 (Chart III.1.1). Growth rates of assets and liabilities converged in turn. Meanwhile, the uptick in savings deposits, which make up almost three quarters of financial assets, proved significant on the asset front, while growth in general-purpose and housing loans were the drivers on the liabilities front. As a result, the leverage ratio, which has been falling since early 2014, flattened out at 35.8%.

Chart III.1.1: Household Financial Asset vs Liabilities Growth Rates and Financial Leverage ratio (Annual % Change, % Share)



Source: CBRT, BRSA, CMB, MKK, TOKİ Last Observation: 09.20
 Note: The leverage ratio refers to the ratio of average liabilities to average financial assets in the last 12 months. Real growth rates have been calculated using the CPI.

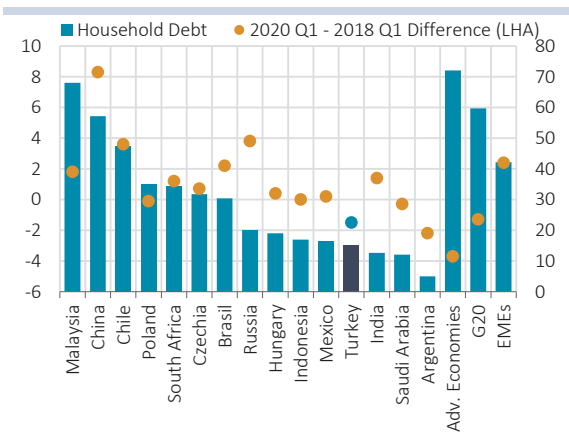
Chart III.1.2: Household Annual Loan and Deposit Growth (%)



Source: CBRT, BRSA Last Observation: 06.11.20
 Note: AER growth is calculated by multiplying the TRY deposit change and FX (dynamic basket) deposit change with the period average of the exchange rate.

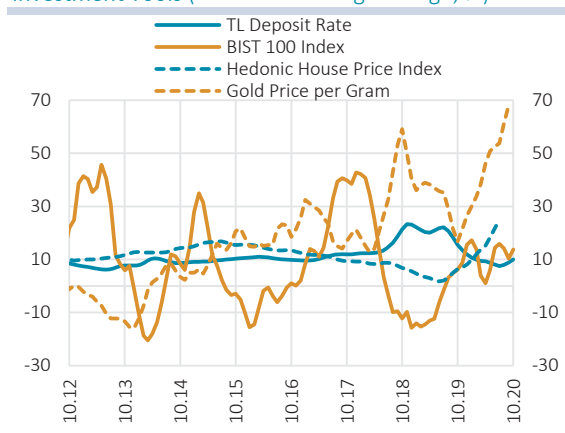
Following the second quarter, which was marked by heavy pandemic-driven limitations and social isolation, expanded credit campaigns dominated the third quarter and caused a strong growth in retail loans, the leading component of household financial debts (Chart III.1.2).

Chart III.1.3: Indebtedness of Countries (% , Points)



Source: BIS, CBRT Last Observation: 03.20
 Note: Spreads denote the two-year change in household indebtedness. Household indebtedness denotes the formula: total of bonds and loans of households and non-profit institutions serving households/GDP.

Chart III.1.4: Returns on Deposit and Alternative Investment Tools (3-Month Moving Average, %)



Source: CBRT Last Observation: 10.20
 Note: Indices and gold prices denote annual percentage change.

On the other hand, the tightening steps taken as of August coupled with terminated credit campaigns caused credit costs to increase. This increase resulted in a deceleration in the retail loan growth, which fell to 45.7% as of 6 November 2020. AER savings deposit growth turned downwards as of August.

The total household indebtedness of Turkey, which was 15.1% in March 2020, still hovers below 42.2%, which is the EME average (Chart III.1.3). Indebtedness, which decreased compared to two years earlier, has diverged from peer countries in this respect.

Relative returns from interest on deposits and alternative investment tools as well as the perceived uncertainty shape the saving preferences of individuals. The recent volatility and uncertainties in financial markets led by the pandemic, the rallying gold prices driven by global markets and geopolitical developments as well as the depreciation in the TRY strengthened precious metal saving trends of depositors (Chart III.1.4).

Table III.1.1: Households' Financial Assets

	09.19		09.20		Percentage Change	Cont. to Change (Point)
	Billion TL	Perc. Share	Billion TL	Perc. Share		
Total Assets	1703.6	100	2407.1	100	41.3	41.3
TL Savings Deposits	682.4	40.1	820.3	34.1	20.2	8.1
FX Savings Deposits	613.9	36.0	786.3	32.7	28.1	10.1
- (Billion USD)	108.5		104.4		-3.8	
Precious Metal Deposits	61.1	3.6	227.1	9.4	271.9	9.7
- (Billion USD)	10.8		30.1		179.4	
Bonds and Bills	43.1	2.5	62.3	2.6	44.6	1.1
- Public Sector	15.8	0.9	36.0	1.5	127.0	1.2
- Private Sector	27.2	1.6	26.4	1.1	-3.3	-0.1
Mutual Funds	172.4	10.1	228.8	9.5	32.7	3.3
Pension Mutual Funds	100.0	5.9	139.7	5.8	39.7	2.3
Other Mutual Funds	72.4	4.2	89.1	3.7	23.0	1.0
Equity Securities	70.2	4.1	164.1	6.8	133.7	5.5
Repo	2.3	0.1	3.5	0.1	50.7	0.1
Currency in Circulation	58.1	3.4	114.5	4.8	97.0	3.3

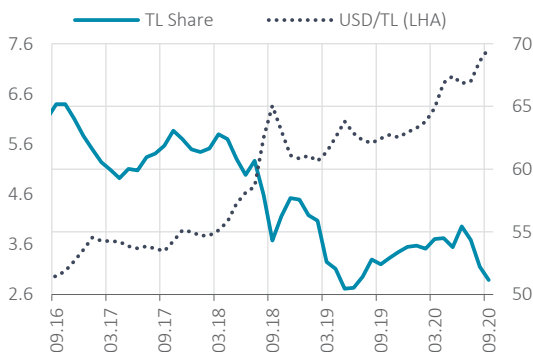
Source: CBRT, CMB, MKK

Last Observation: 09.20

Note: Exchange rate is obtained by the averages of daily data in the respective month. Pension mutual funds show the total funds of participants in the IPS and the AES, excluding state contribution. The last observation is 03.20 according to MKK.

In September 2020, household financial assets grew by 41.3% annually (Table III.1.1). Savings deposits proved the largest contributor to growth. In this period, TL savings deposits grew by 20%, while TL equivalent of FX saving deposits grew by 28% and contributed to asset growth by 8.1 and 10.1 points, respectively. The rise in the TL equivalent of FX saving deposits is mainly attributed to the depreciation in the TL. On the other hand, gold and equity securities contributed by 9.7 and 5.5 points, respectively.

Chart III.1.5: Breakdown of Resident Households' Savings Deposits by TL and FX (% Share, TRY)

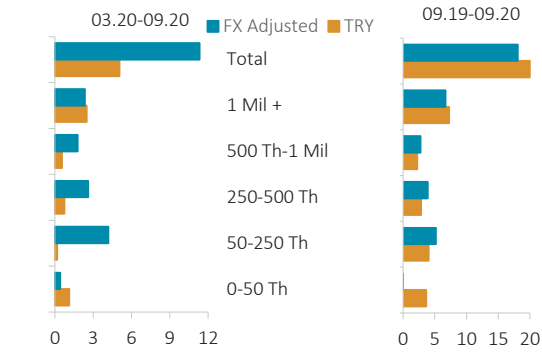


Source: CBRT

Last Observation: 09.20

Note: Monthly average exchange rate data are used in calculations.

Chart III.1.6: Change in Households' Deposits by Amounts (% Points)



Source: CBRT

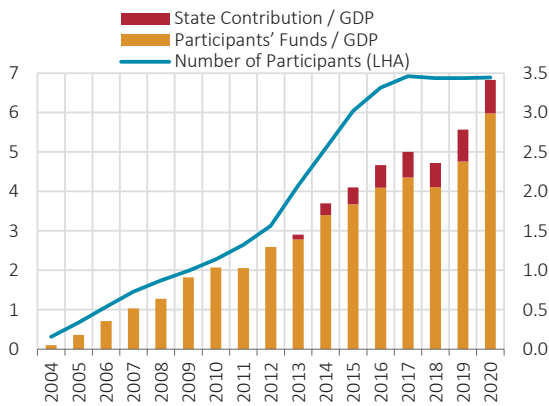
Last Observation: 09.20

Note: AER FX growth is calculated by multiplying the FX (dynamic basket) deposit change with the period average of the exchange rate.

The share of TL savings deposits in total deposits decreased to 51.1% in the third quarter (Chart III.1.5). This was led by the rising exchange rate, preferences towards FX deposits and declining TL savings deposit balances. It is assessed that the deposit dollarization may be contained by the improvement in inflation and exchange rate expectations.

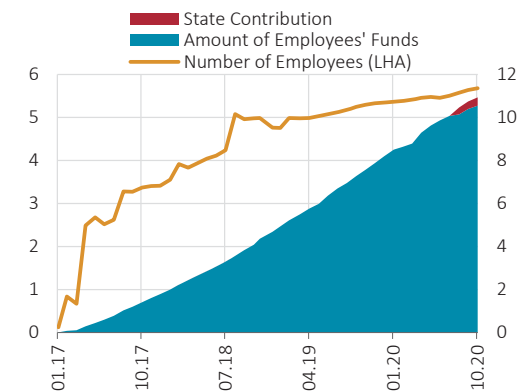
A breakdown of deposits by amount reveals that the rise in TL deposits spread across all ranges, while AER FX deposits displayed a limited movement in the lowest amount (Chart III.1.6). Regarding deposits above TRY 1 million, TL growth proves stronger, while the preference of depositors towards AER FX stands out regarding the movements in deposits between TRY 50,000 and TRY 1 million in the last six-month period.

Chart III.1.7: Individual Pension System (% , Million People)



Source: EGM Last Observation: 31.10.20

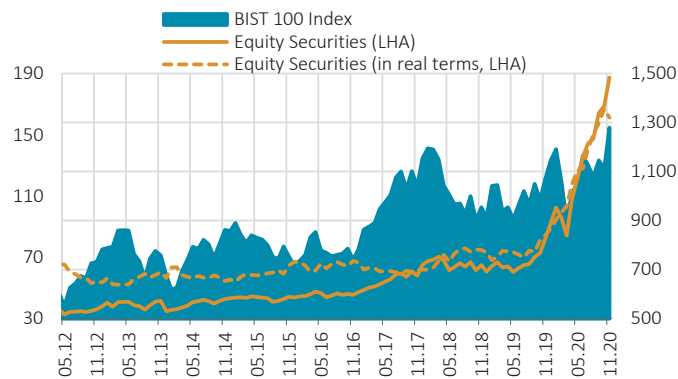
Chart III.1.8: Auto Enrollment System (Billion TRY, Million People)



Source: EGM Last Observation: 31.10.20

Boosted by the state contribution provided under the individual pension system (IPS) since 2013 to encourage domestic savings, households' savings in the IPS system grew further in the current reporting period (Chart III.1.7). The number of people in the system remained stable as people did not leave the system considering the slowdown in economic activity parallel to the increased rate of spread of the virus following March, while the amount of IPS funds rose further.

Chart III.1.9: BIST 100 Index and Household Equity Securities Portfolio (Thousand, Billion TRY)



Source: CBRT Last Observation: 11.11.20
 Note: Real equity portfolio has been adjusted for value changes in the stock market index.

In the same period, the number of people in the Auto Enrollment System (AES) system tended to stabilize further at around 6 million, and the accumulated funds in the system increased steadily. On 31 October

2020, the amount of IPS funds including state contribution rose by around 37% over the past year to TRY 153 billion. On the other hand, as the 3-year period of those enrolled first in the system matured in August 2020, the amount of total funds in the AES hovered at TRY 11 billion on 31 October, which was the date that a certain portion of state contribution was earned (Chart III.1.8).

During the pandemic, the risk sentiment towards EME financial markets and products increased amid the atmosphere of uncertainty in global markets. The BIST 100 index dropped in the first quarter of 2020 due to large capital outflows across the EMEs in general (Chart III.1.9). Despite fluctuations in the ensuing period, the index offset these losses and remained on the increase. Households' equity securities portfolio displayed a steady increase in the same period, while the share of domestic investors in the equity securities market proved higher.

Table III.1.2: Household Financial Liabilities

	09.19		09.20		Percentage Change	Contributions to Change
	Billion TL	Percentage Share	Billion TL	Percentage Share		
Total Liabilities (Based on Type)	622.3	100.0	883.2	100.0	41.9	41.9
Housing	213.4	34.3	302.1	34.2	41.6	14.3
Vehicle	13.0	2.1	19.5	2.2	50.5	1.1
General Purpose	246.4	39.6	391.7	44.3	59.0	23.4
Personal Credit Cards	122.0	19.6	140.2	15.9	14.9	2.9
Asset Management Comp' Rec.	27.6	4.4	29.8	3.4	7.8	0.3
Total Liabilities (Based on Counterparty)	622.3	100.0	883.2	100.0	41.9	41.9
Banks	558.4	89.7	817.6	92.6	46.4	41.6
Financing Companies	11.3	1.8	12.2	1.4	8.3	0.1
TOKİ	25.0	4.0	23.7	2.7	-5.2	-0.2
Asset Management Comp'	27.6	4.4	29.8	3.4	7.8	0.3

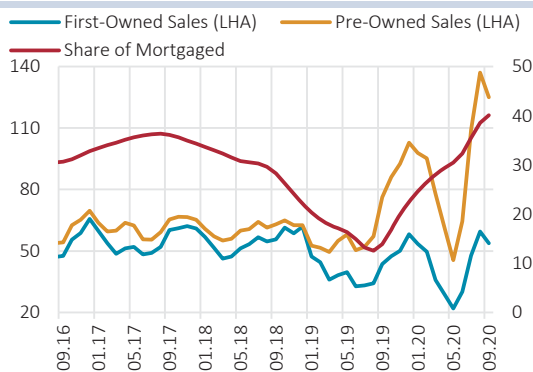
Source: CBRT, TOKİ

Note: Liabilities include NPLs as well.

Last Observation:09.20

Household financial liabilities increased by 41.9% in September 2020 on an annual basis (Table III.1.2). Liabilities increased due particularly to the credit campaigns implemented in the second half of the year. Growth in liabilities was driven by general-purpose loans (contributing by 23.4 percentage points) and housing loans (14.3 points). Personal credit card (PCC) balances contributed to a limited extent, while vehicle loans displayed a similar growth pattern to other consumer loans.

Chart III.1.10: Housing Sale Statistics (% , Thousand)

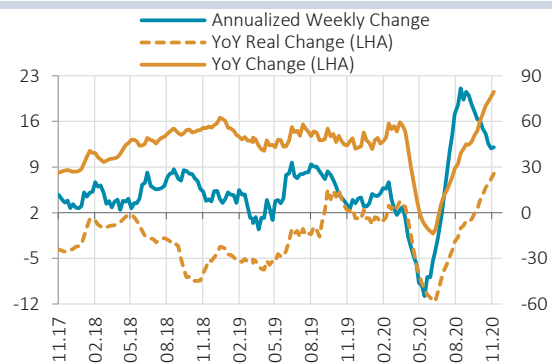


Source: TURKSTAT

Last Observation: 09.20

Note: The mortgaged sale share is the share of mortgaged sales in total housing sales over the last 12 months. Sales are 3-month MA.

Chart III.1.11: Change in PCC Balance (%)



Source: CBRT, TURKSTAT

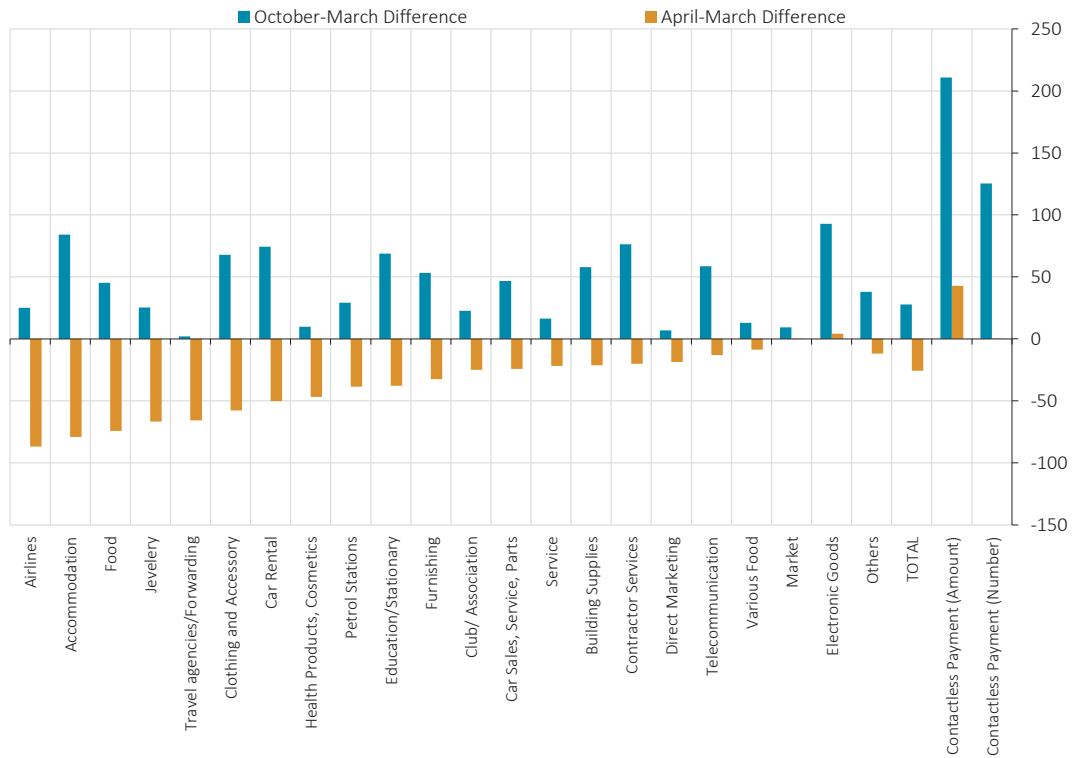
Last Observation: 06.11.20

Note: Real change is calculated by deflating with the CPI. Annualized weekly change is 13 weeks, other series are 3-month MA.

Due to the housing loans offered at low rates with campaigns in the June-July period of 2020 with state-owned banks in the lead, house sales displayed an upsurge in this period. The upward trend in the share of mortgaged house sales continued. First-owned house sales reached the quarterly average, while pre-owned house sales hit a record in July with 161 thousand (Chart III.1.10).

Annual growth in PCC balances increased in the last quarter (Chart III.1.11), which is attributed to the realization of expenditures as of June that were delayed during the pandemic as well as the increase in domestic demand. This kept nominal and real annual growth figures around the upper bound of period averages, while expenditures across all sectors exhibited an increase (Chart III.1.12). Meanwhile, PCC usage habits of individuals have changed due to the pandemic and contactless payment has been highly preferred. TRY 3.8 billion was spent with the contactless method via 86 million transactions in March, while TRY 12 billion was spent via 193 million transactions in September.

Chart III.1.12: Debit Card and Credit Card Expenditures (Weekly Amount, Monthly Average, % Change)



Source: CBRT, BKM

Last Observation: 10.20

Box III.1.1

Regulations on General-Purpose Loan Maturities

Maturities and General-Purpose Loan Balance Developments

To achieve financial stability, general-purpose loans feature varying maturities based on cyclical conditions (Table III.1.1.1).

Table III.1.1.1: Maximum Maturities for General-Purpose Loans (Month)

	Previous Period	31.12.13	27.09.16	01.09.18	26.02.19	04.09.20
General-Purpose Loan (General Provision)	Unlimited	36	48	36	60	36

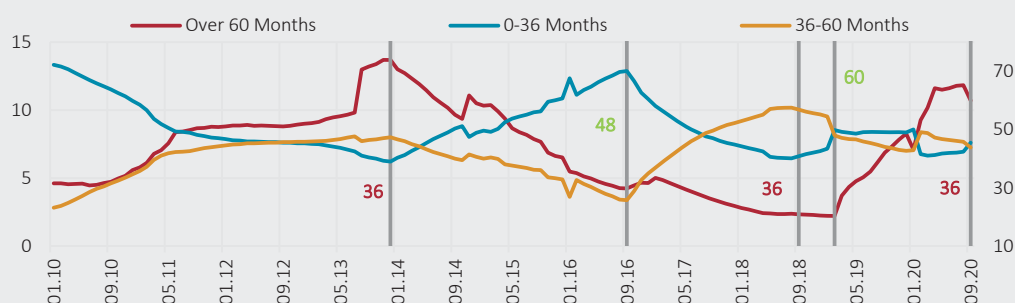
Source: Official Gazette

Last Observation: 09.20

Note: Maturities are a general provision and can vary for different categories of spending such as tuition or pc/tablet purchases. For further detail, see "Regulation on Loan Operations of Banks - Article 12/1".

Having been nonexistent before late 2013 when it was first introduced, the maturity limit for general-purpose loans was set to a maximum of 36 months. In the following years, cyclical conditions called for extensions up to 48 or 60 months in the maturity limit, which was later lowered back to 36 months. Maturity breakdowns for the total balance of general-purpose loans were on par with expectations in the months following each adjustment (Chart III.1.1.1). When maximum maturities increased, the long-term balance accounted for a larger share of the total balance, but with the adjustment in 2020, maturities are expected to increase further within the range of 0 to 36 months, as in previous limitations to 36 months. This indicates that maturity adjustments are efficient macroprudential instruments to manage balance movements. In fact, extended maturities allow individuals to borrow larger sums with a fixed monthly payment whereas shortened maturities result in a decline in the total loan balance (Chart III.1.1.2). As reflected in the 2020 adjustment, the lowering of maximum maturities to 36 months was calculated to cause a contraction of about 29% in each individual's capacity for borrowing general-purpose loans at current interest rates.

Chart III.1.1.1: General-Purpose Loans by Maturity (%)



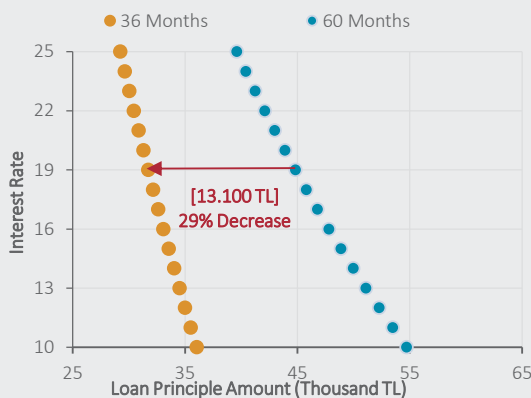
Source: CBRT

Last Observation: 09.20

Note: Original maturities. Maturity brackets exclude/include the lower/upper bounds of the respective maturity period. Vertical lines and numbers denote periods of adjustment and maximum maturity, respectively.

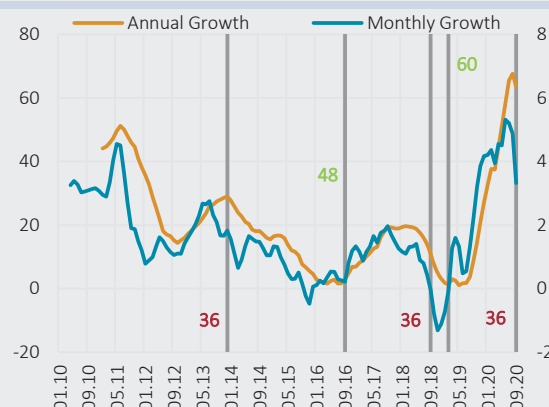
Loan growth decelerated as the impact of adjustments caused maturities to tighten, but accelerated again in the period following the easing steps (Chart III.1.1.3). Loans grew by 1.2% month-on-month on average of two months prior to the tightening and two months after the easing decisions, and contracted by 0.1% vice versa.

Chart III.1.1.2: Demand Curve for General-Purpose Loans by Maturity



Sources: CBRT, author's calculations Last Observation: 09.20
 Note: Each instalment equals half of the net minimum wage for 2020 (TRY 1,162.35). The difference in the loan amount and the percentage change was calculated for September's average weighted general-purpose loan rate of 19%. Current value of the principal payment.

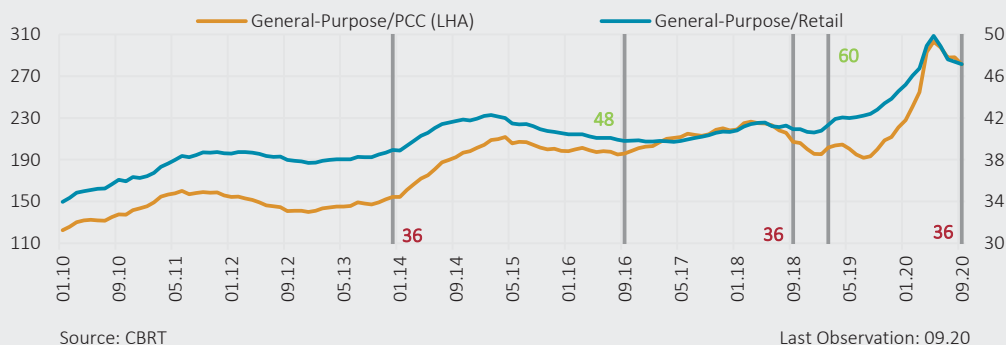
Chart III.1.1.3: Growth of General-Purpose Loans (%)



Sources: CBRT, TURSKTAT Last Observation: 09.20
 Note: 3-month moving average monthly growth data.

Consumers might use credit cards rather than borrow general-purpose loans to meet smaller cash needs, and maturity adjustments might therefore cause credit cards to be a substitute for general-purpose loans, and vice versa. Thus, when a maturity limit was first introduced for general-purpose loans in 2013, a ceiling was imposed on credit card instalments (9 months), which, being a complementary policy step, restricted this substitution and helped bring the ratios of general-purpose loans to credit cards and retail loans higher (Chart III.1.1.4). The ratio of general-purpose loans to retail loans surged rapidly after the maximum maturity for general-purpose loans was raised to 60 months in February 2019. However, after the second quarter of 2020, postponed expenditures were mostly financed by credit cards, causing general-purpose loans to grow at a slower pace than credit cards. As of August, relatively lower maximum credit card interest rates make credit cards a substitute for general-purpose loans. The new maximum interest rates for credit card adjustment in place since the end of October is expected to limit this substitution.

Chart III.1.1.4: Share of General-Purpose Loans (%)



Source: CBRT

Last Observation: 09.20

Conclusion

General-purpose loans have been highly sensitive to the maturity adjustments since 2013. Such adjustments can be used as an effective counter-cyclical and macroprudential policy instrument.

Kutu III.1.II

Individual Pension System and Auto Enrollment System

The Individual Pension System (IPS), which is a private and voluntary retirement savings system, aims to direct employees' contributions that they have accumulated during active working time to long-term investments, thereby allowing them both to earn an additional income that supports the social security system and to maintain their life standards during retirement.

In Turkey, the IPS started in 2003 led by insurance companies. Currently, nearly 7 million participants have accumulated approximately TRY 152 billion, including the state contribution. The Auto Enrollment System (AES) was introduced at the beginning of 2017 as a complement to this system. Public employees were included in the system in two phases, in April 2017 and in January 2018. For private sector employees, a two-year gradual transition period was implemented to be completed by 2019 and the transition started in companies with a high number of employees. Currently, there are more than 5.7 million employees in the system and the total amount of savings and the AES portfolio including the state contribution is approximately TRY 11 billion. Funds that have accumulated in the IPS and AES, excluding the state contribution, constitute approximately 6% of total household assets. The uptrend in savings observed during the pandemic and maintaining this trend point to the system's contribution to establishing a saving habit (Box II.1.II). Participation and payment principles of the two systems are summarized in Table III.1.II.1.

Table III.1.II.1: General Characteristics of the IPS and AES

	IPS	AES
Conditions for Retirement	At least 10 years of enrollment in the system and minimum age of 56 years	Same
Target Group	Everyone with judicial capacity	Employees of under 45 years of age
Availability for Non-Nationals	Available	Not available
Withdrawal Right	Yes	Yes
Contribution Amount ¹	Minimum payment amount stipulated in the Plan and above	Minimum 3% of gross salary income
Opt-Out Option ²	Yes	Yes
State Contribution	25% of the amount paid by the employee	Same+ several additional contributions ³
Max Level of State Contribution ⁴	TRY 8,829 for 2020	Same

Source: EGM

Notes: ¹Individuals have the right to suspend their payments. In retirement, pensioners can receive their retirement payment in a lump-sum, programmed withdrawal or a life-annuity form. ²In case of leaving the system before filling 10 years, an income tax of 15% shall be applied; in case the participant stays in the system for 10 years but leaves the system before retirement, an income tax of 10% shall be applied; and in case of leaving due to retirement, death or disability, the income tax shall be 5%. ³If the participant continues to stay in the system after the initial period, the state will make a one-time contribution of TRY 1,000; if the participant chooses to receive pension payments with a minimum 10 years, the state contribution will be 5% of the savings. ⁴The conditions to qualify for state contribution are based on the duration of stay; 15% of the amount in the account for 3 years, 35% for 6 years, 60% for 10 years, and 100% in case of retirement, death and disability.

Private Pension System

The Private Pension System (IPS) is a system aimed at maintaining the welfare of the individual during retirement, creating long-term resources for the economy, increasing employment and contributing to economic growth. The IPS system does not provide other services such as health

services that are available in the Social Security Institution and it is not an alternative but a complement to the mandatory social security system. The companies that provide IPS services offer different plans based on the criteria determined by the individual or the employer, compatible with the expectations of the individuals for retirement, income level and age. Participants make monthly regular payments to their IPS accounts in accordance with the minimum contribution amount determined in the plan, and the amount corresponding to 25% of these contributions is paid to the private pension account as state contribution. The maximum amount of state contribution amount that a participant can receive in a calendar year is limited to 25% of the total gross minimum wage for the relevant year.

Table III.1.II.2: Fund Groups in the IPS and Fund Volumes of Participants

	Description
Variable Fund (Share in total is 27.4%)	No interchange between other fund types due to portfolio limitations.
Precious Metal Funds (19.1%)	Minimum 80% of the fund is composed of precious metals and monetary and capital market instruments backed by precious metals.
Borrowing Instruments (FX) (14.3%)	Minimum 80% of the fund is composed of FX-denominated borrowing instruments.
Borrowing Instruments (TRY) (12.1%)	Minimum 80% of the fund is composed of TRY-denominated borrowing instruments.
Standard Fund (8.4%)	Minimum 60% of the fund is composed of TRY-denominated Treasury bills, maximum 40% is composed of deposits, participation accounts, reverse repo and some other borrowing instruments.
Securities Fund (4.3%)	Minimum 80% of the fund is composed of shares of domestic/foreign issuers.
Other Funds (14.4%)	Composed of money market, index, participation, composite, fund basket, life cycle and contribution funds.

Source: EGM

Last Observation: 13.03.2020

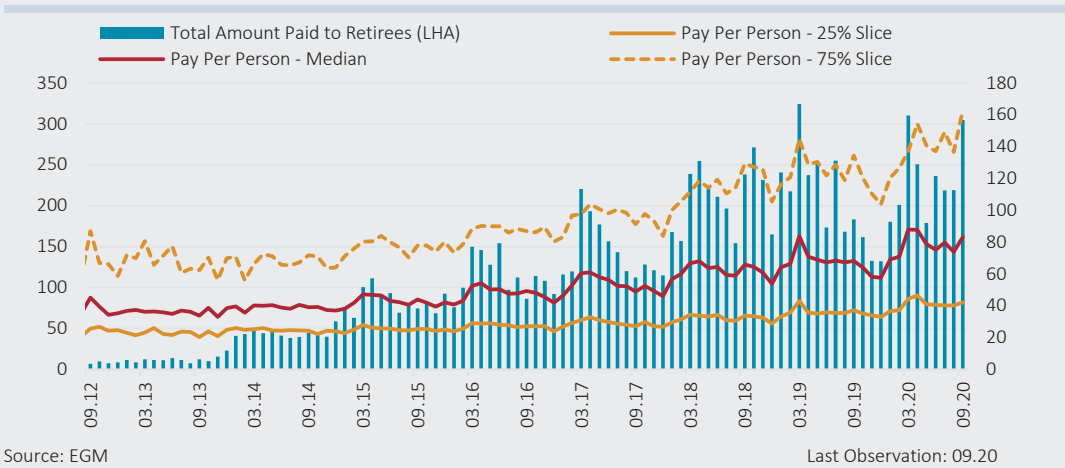
The most important feature of the IPS is that it allows individuals to choose the fund or funds that their savings will be invested in. The decisions made by the participants in line with their risk and expectation preferences can affect the amount of payments that they will receive in their retirement. Although there are 12 different fund types with interest and non-interest income in the system, approximately half of current savings have been invested in precious metals and variable funds (Table III.1.II.2). If a participant does not choose a fund distribution, the savings are invested in the standard fund within the scope of the pension plan. The amount automatically invested in the standard fund constitutes 8% of total savings. This relatively low share indicates that individuals in the system actively decide in which accounts their funds will be invested.

IPS participants started to leave the system due to retirement as of 2010, and so far, more than 130 thousand people out of nearly 7 million participants in the IPS have retired from the system. Although there are periodic differences in the total amounts paid to retirees, those who are currently retired from the system left the system with an average saving of TRY 80 thousand (Chart III.1.II.1).

Auto-Enrollment Pension Scheme

As per the provisions on automatic enrollment of the Private Pension Savings and Investment System Law No. 4632 that took effect by 1 January 2017, employers have been obliged to include their employees in the AES. Employees have the right to stay in the system as long as they wish. Meanwhile, the fact that the government contribution increases in tandem with the time an individual stays in the system, encourages people to stay in the system longer.

Chart III.1.II.1: Total Amount of Pensions and Payments per Participant (Million TRY, Thousand TRY)



Note: Retiree candidates apply for retirement after making an additional contribution payment in the first month of the new year in order to use the limit of both the finished year and the new year, for this reason, the lump-sum payments increase in March when the transactions are made.

Fund types in the AES are classified differently than the IPS system. The fund types available in the AES are initial fund, standard fund and conservative / cautious, balanced, aggressive / dynamic / growth and aggressive funds classified according to the risk value of the fund.¹ In the initial fund, savings can be invested in various assets such as TL deposits, participation accounts, debt instruments, income partnership securities, and lease certificates. There are also interest-bearing and non-interest-bearing initial fund types. The asset structure of the standard fund is similar to that of the initial fund, and the maximum and minimum investment options are available for these funds.

Conclusion

Individuals are included in IPS and AES with the objective of earning additional income during retirement. The facts that fund performance can be followed easily and the accounts are kept at Takasbank make the system more transparent. Moreover, the opportunity to choose and change funds, funds encouraged by state contribution and the flexible structure in contribution payments make the system attractive. The system safeguards/underpins financial stability as it encourages long-term savings.

¹ The risk values of other funds, which differ according to the calculation principles, were determined as 1-2 in the conservative / cautious fund group, 3-4 in the balanced fund, 4-5 in the aggressive / dynamic / growth fund group, and 5-7 in the aggressive funds.

III.2 Corporate Sector Developments

Economic activity, which has been experiencing a downturn since March 2020 with the economic lockdown due to the coronavirus pandemic, assumed a strong trend of recovery in the third quarter amid the gradual alleviation of pandemic measures and the precautions and policy steps implemented during the pandemic (Box I.1.I). Thus, expectations improved and corporate sector confidence indices moved upwards in July (Chart III.2.1). In the current reporting period, the strong course of economic activity in export-related sectors pushed the corporate sector confidence index considerably upwards. Meanwhile, thanks to the housing loan incentives with non-paid terms and maturities up to 180 months that were offered by state-owned banks at low rates in June and July, the construction confidence index accelerated to a sizeable extent and went beyond the pre-pandemic levels (Box IV.1.I).

Chart III.2.1: Corporate Sector Confidence Indices and Investment Trend (Seasonally-adjusted, 3-Month MA)

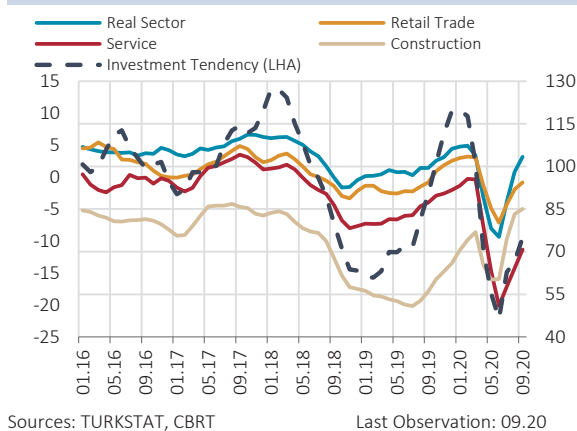
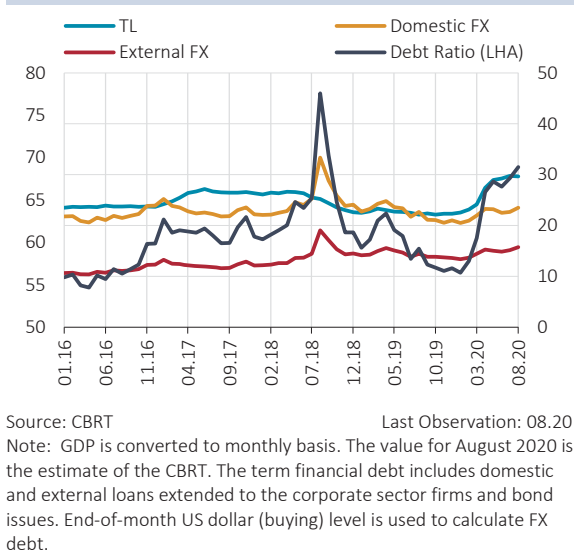


Chart III.2.2: Corporate Sector Financial Debts to GDP Ratio (%)



Sectoral diffusion of the economic rebound increased further, while tourism and other services sectors and certain facilities with limited export opportunities remain weak (Part II.2). In fact, the pandemic-led social isolation as well as individuals' self-induced precautionary travel constraints have a further depressing impact on tourism and the subcategories of the tourism-related services sector such as travel agents, accommodation, transport and restaurants. Accordingly, with the rebound in overall economic activity, pandemic policies were gradually tightened in August, while the KGF-guaranteed tourism support package was launched aiming at relieving the adverse impacts on businesses operating in the tourism sector as well as their suppliers (Box I.1.I). The 12-month-forward investment trend in the manufacturing industry had plunged until July 2020 due to the pandemic-led atmosphere of uncertainty. Thanks to dwindled uncertainties and the trend of economic recovery on account of public incentives and eased financial conditions of the third quarter, the investment trend assumed an upward trend in July. In this period, the demand led particularly by exporting sectors was the determining factor in the upward trend of investments.

III.2.1 Corporate Sector Indebtedness

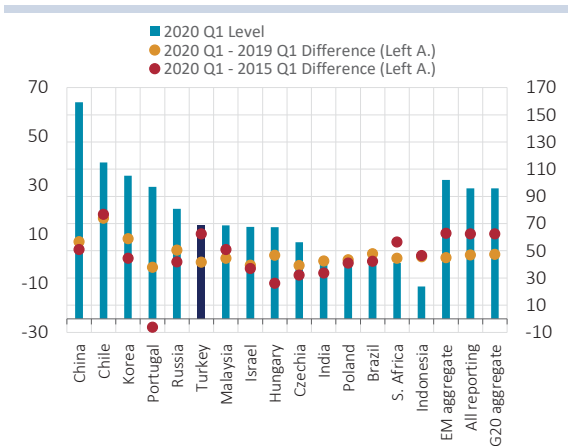
The corporate sector's total financial indebtedness increased parallel to the CBRT's rate cuts and RR practices associated with credits extended to the corporate sector that were enforced as a macroprudential tool, and steps taken against the coronavirus pandemic. Moreover, other public incentives and practices became another element to contribute to TL corporate loans. The corporate

sector’s financial debt to GDP ratio rose by 12 points from 56% in January 2020 to 69% in August (Chart III.2.2). This rise was led mainly by the 7 percentage-point-increase in the TL indebtedness ratio, which was also driven by the pandemic incentives. FX indebtedness ratio of corporate sector firms crept up by 2.1 points year-on-year to 39% in August 2020 due to the increased exchange rate despite the ongoing decline in FX loans.

The comprehensive measures taken to limit the implications of slowing economic activity during the pandemic on the corporate sector firms and ensure the effective functioning of the credit mechanism supported the access of corporate sector firms to credits and the continuity of cash inflows, with goods and service-exporting SMEs in the lead. With the increased KGF guarantee limit and credit extensions in this respect, KGF-guaranteed cash credit balance reached TRY 342.7 billion on 30 September 2020, and 71% of this balance was provided by state deposit banks. Regarding these credits, repayments of TRY 35.4 billion and TRY 128.5 billion are expected to be made in the remainder of 2020 and in 2021, respectively.

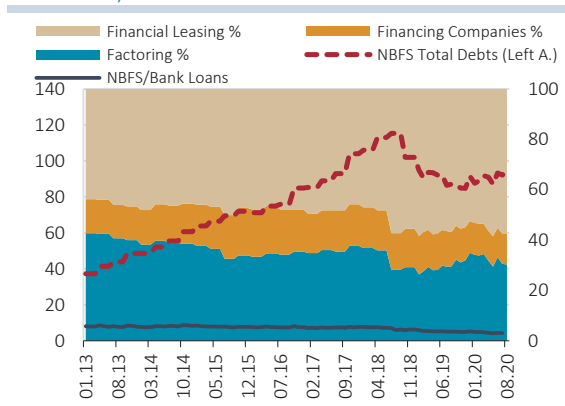
The corporate sector indebtedness ratios of Turkey are behind the averages of EME, G20 and the world (Chart III.2.3). In fact, the corporate sector’s total financial debt to GDP ratio in Turkey was 69% in March 2020, but it stood at 96%, 102% and 96% in G20, EME and the world, respectively in the same period. Compared to other countries and country groups, the corporate sector total financial debts to GDP ratio of Turkey increased less than the EME average for the last 5-year and 1-year periods.

Chart III.2.3: International Comparison of Corporate Sector Total Loans/GDP Ratio (% , % Difference)



Source: BIS Last Observation: 03.20
 Note: The financial debt definition covers performing and nonperforming loan receivables, bond issues and loan rate discounts.

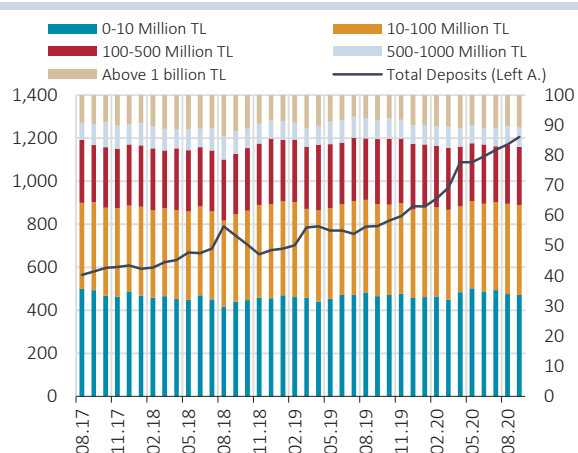
Chart III.2.4: Breakdown of Debt and Volume of Corporate Sector to Non-Bank Financial Institutions (% , Billion TRY)



Source: CBRT Last Observation: 08.20

Corporate sector firms’ debts to Non-Bank Financial Institutions (NBFI) such as domestic factoring, financial leasing and other financial institutions stood at TRY 95 billion as of August 2020, TRY 47 billion of which was comprised of TL debts (Chart III.2.4). Out of this debt, 58%, 30% and 12% is comprised of debts to financial leasing, factoring and financing companies, respectively. Corporate sector firms’ debt to external NBFI became TRY 6 billion in July 2020. Loans extended by other financial institutions, which have declined since the second quarter of 2018 and flattened across 2019, rose slightly at end-2019. However, having been on the decline since end-2017, the ratio of bank loans to debts to NBFI became 3.02% (including external NBFI) in July 2020 due to the strong credit impulse led by the increased credit supply of banks.

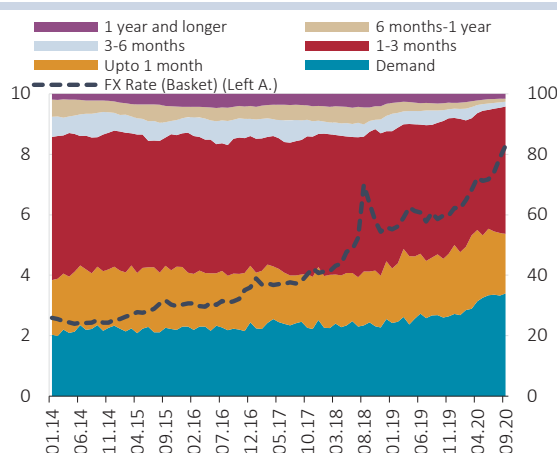
Chart III.2.5: Breakdown of Commercial Deposits by Amount (% ,TRY Billion)



Source: BRSA

Last Observation: 09.20

Chart III.2.6: Maturity Breakdown of Commercial Deposits (Percentage Share, Value)



Source: CBRT

Last Observation: 09.20

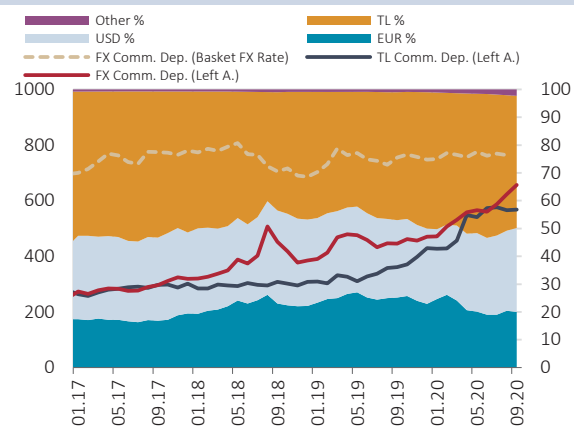
Note: Currency basket calculation includes 60% USD and 40% euro.

Commercial deposit balance, one of the important liquid asset indicators of the corporate sector, has surged by 37% since January 2020 and went beyond TRY 1.2 trillion in August (Chart III.2.5). The rate of increase in commercial deposit is consistent with inflation and exchange rate developments, whereas this was also driven by expanded money supply and increased credit volume during the pandemic. A maturity breakdown of commercial deposits reveals the predominance of term deposits with up to 3-month maturity accompanied by an increased share of demand deposits particularly in the current reporting period (Chart III.2.6). The share of demand deposits within total commercial deposits was 23% on average before 2018, but it became 34% in August 2020. This is attributed to the firms’ need to prefer holding cash during the pandemic and the loans extended under the recent stimulus packages, some portion of which has not turned into expenditures according to payment schedules.

In September 2020, the corporate sector’s TL commercial deposits became TRY 568 billion, and FX commercial deposits stood at TRY 634 billion. Around TRY 22 billion of FX commercial deposits is made up of precious metal deposit accounts (Chart III.2.7). The share of TL commercial deposits within total commercial deposits trended upwards in tandem with the rising credit volume. In September 2020, total commercial deposits were composed of TL deposits with 47%, US dollars with 30%, euro with 20%, and other foreign exchange and gold deposits with the remaining portion. Meanwhile, FX commercial deposits included 58% of US dollars, 38% of euro deposits, and 4% of other foreign exchange and gold. In terms of the currency basket, the flat course of the FX commercial deposit amount in recent years shows that the dollarization trend in firms does not exhibit a significant uptick.

In the current reporting period, the corporate sector’s FX short position receded further. In August 2020, net FX short position amount declined by 12% from USD 188 billion to USD 165 billion year-on-year (Chart III.2.8). Total FX liabilities of the corporate sector including import debts fell from USD 307 billion to USD 295 billion in August 2020 year-on-year. The decline in the firms’ FX indebtedness exerted pressure on the exchange rate, yet alleviated the sensitivity of the corporate sector against volatilities in the exchange rate. External FX debt renewal ratios of corporate sector firms have been on the decline since the second quarter of 2019. This decline is attributed to demand-side factors such as the rise in the sovereign risk premiums, the subsided course of the investment trend, and firms’ avoidance of additional exchange rate risk on the liabilities side due to exchange rate volatility.

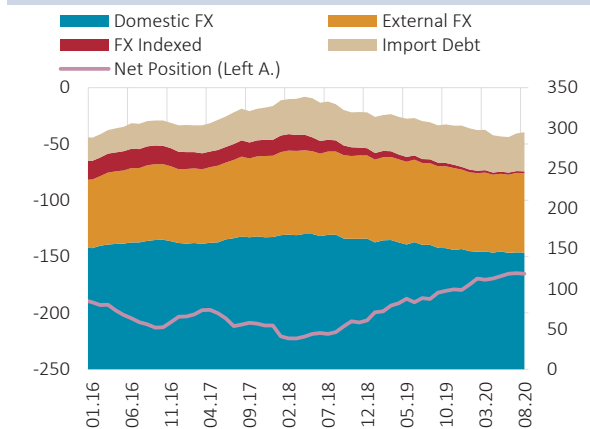
Chart III.2.7: Currency Breakdown of Commercial Deposits (Percentage Share and Billion Currency Basket, TRY Billion)



Sources: CBRT, BRSA Last Observation: 09.20

Note: Precious Metal – Deposits are shown in FX commercial deposits. Commercial deposit values show amounts including participation banks. Currency breakdown excludes participation banks. End-of-month US dollar (buying) level is used to calculate TL equivalent of FX deposit.

Chart III.2.8: Corporate Sector’s FX Liabilities and Net FX Position (USD Billion)

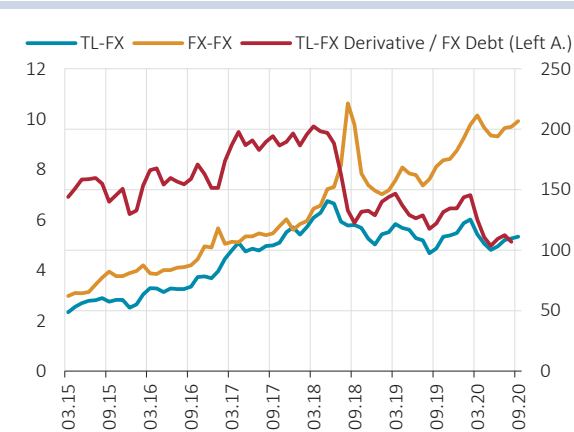


Source: CBRT Last Observation: 08.20

Note: Corporate sector FX liabilities cover domestic FX loans (including FX-indexed credits), credits extended from abroad, import debts and domestic and external bond issues. On the assets side, domestic FX deposits are included, while export receivables, net position in derivatives products and external FX assets are excluded.

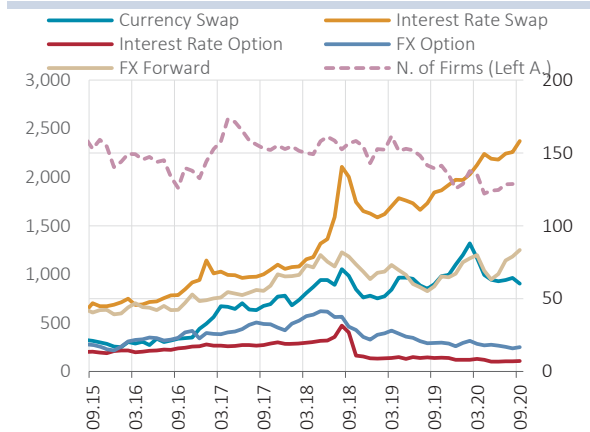
In the current reporting period, the volume of FX-FX derivatives transactions that the corporate sector carries out with domestic banks increased, while the volume of TL-FX derivatives transactions declined amid the fall in the March-May period of 2020 (Chart III.2.9). In September 2020, the volume of derivatives transactions (nominal contract amount) that firms carried out with banks receded by TRY 5 billion compared to March 2020, the previous reporting period, and stood at TRY 323 billion. Out of this total amount, TRY 207 billion corresponding to 64% of the total amount was FX against FX; and TRY 111 billion corresponding to 34% was FX derivatives transactions against TL, which is important in terms of exchange rate risk management. The decline in the volume of derivatives transactions, which started in 2018, continued in the current reporting period amid the contraction in the FX credit volume, the rise in derivative costs and the fall in the number of firms engaging in derivatives transactions. The ratio of TL-FX derivatives transactions amount to total FX credits fell to 5.13% in August 2020 due to shrinking FX credits.

Chart III.2.9: Currency Breakdown of Derivatives Transactions (Billion TRY, %)



Source: CBRT Last Observation: 09.20

Chart III.2.10: Breakdown of Derivatives Transactions by Type (Billion TRY, Level)



Source: CBRT Last Observation: 09.20

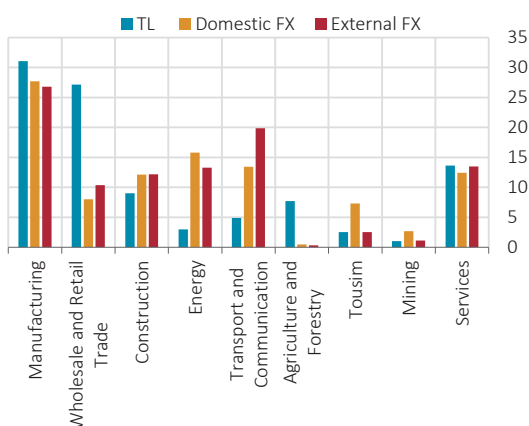
Note: Derivatives transactions reflect singularized values in buying and selling transactions.

The number of firms engaging in derivatives transactions declined further in the current reporting period, yet increased slightly due to exchange rate movements after May and reached 1,991 in September (Chart III.2.10). Interest rate swaps that are used by firms to manage interest rate risk in variable rate FX credits increased further in the current reporting period and hit TRY 158 billion. The uptrend in interest rate swaps is also attributed to the wider use of the Turkish Lira Overnight Reference Rate (TLREF) introduced to allow a more effective interest rate management.

III.2.2 Sectoral Developments

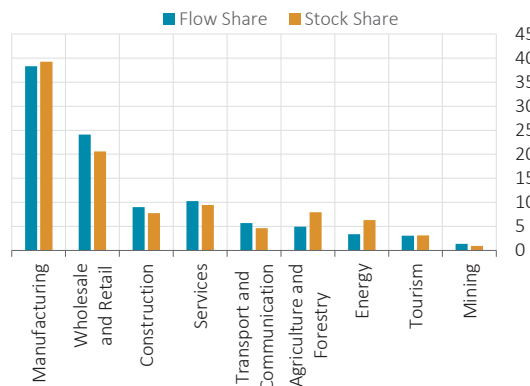
The domestic TL corporate loans and total corporate loans were again predominantly used by the manufacturing industry, wholesale and retail trade sectors and general services sectors (Chart III.2.11). A comparison of stock and flow loan shares of corporate loans provides guiding information about the use of financial sources and sectoral indebtedness. In the current reporting period, primarily pandemic-hit sectors such as wholesale and retail trade, general services and transport-communication utilized credits above their share of stock loans (Chart III.2.12). The rise in flow loans in these sectors is attributed to the rising loan demand aiming at debt restructuring and operating capital financing of the sectors that experienced a slowdown in activity.

Chart III.2.11: Sectoral Breakdown of Credits (% Share)



Sources: CBRT, BAT
Last Observation: 09.20
Note: Loans include domestic loans and intermediated external loans via domestic banks.

Chart III.2.12 Sectoral Breakdown of Credits Extended since the Last Reporting Period (03.20) (Flow) (%)



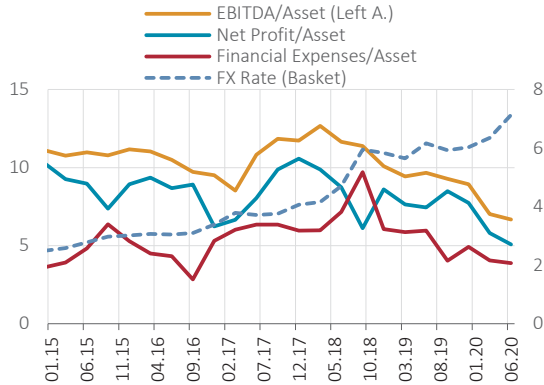
Source: CBRT
Last Observation: 09.20
Note: Flow data shows loans extended between 03.20 and 09.20, and stock data shows the loan breakdown in 09.20.

Earnings of firms quoted on Borsa Istanbul (BIST) before interest, depreciation and amortization and tax (EBITDA) as well as their net profitability have been declining since early 2020 due to price pressures driven by domestic demand that lost pace amid the pandemic and high input costs, despite the support of export revenues, which halted due to the pandemic and then strengthened (Chart III.2.13). In June 2020, the EBITDA /Asset ratio of firms quoted on BIST went below 7%, while the Net Profit/Asset ratio fell to 2.7%. Firms’ financing costs, which peaked in the third quarter of 2018 due to exchange rate fluctuations and high interest rates, took a downtrend in the following period as interest rates decreased and exchange rates rebalanced. In the current reporting period, the Financing Costs/Asset ratio remains stable at 2%.

Measuring the ability of firms to cover interest expenditures with operating income, the interest coverage ratio trended upwards amid falling loan rates and the stable exchange rate in the second half of 2019. This uptrend continued modestly thanks to the measures such as the postponement of debt installments amid the pandemic despite the rise in exchange rates (Chart III.2.14). Calculated as the amount of debts of firms with operating income failing to cover interest expenditures, the debt at risk ratio has been flat

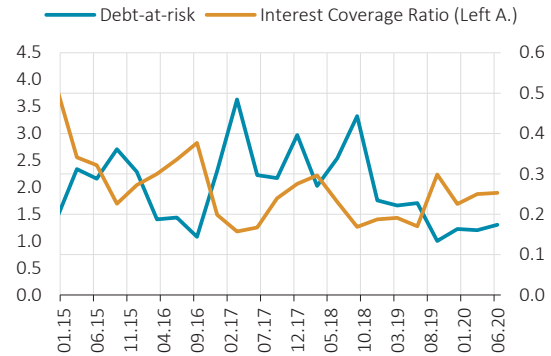
since the third quarter of 2019. Despite the pandemic, the debt at risk level did not record a significant increase, which has been positive regarding the support of the enforced measures and firms' balance sheet resilience.

Chart III.2.13: BIST Firms Profitability Indicators (Ratio, Currency Basket and Ratio)



Source: FINNET, CBRT Last Observation: 06.20
 Note: EBITDA: Net Profit + Financial Expenses + Tax Expenses + Depreciation and Amortization Costs. As of the latest data, 339 corporate sector firms were included in the analysis.

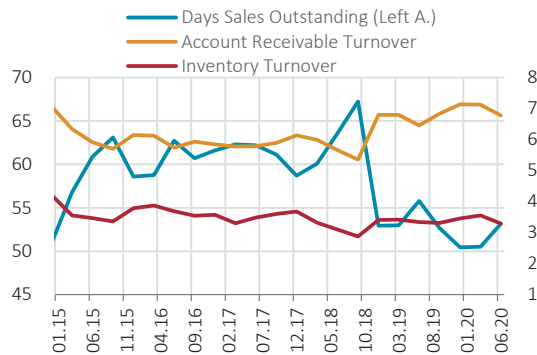
Chart III.2.14: BIST Firms' Interest Coverage and Debt-at-Risk Ratios (% , Ratio)



Source: FINNET Last Observation: 06.20
 Note: Interest Coverage Ratio (ICR)= EBITDA / Interest Expenses. Exchange expenses led by exchange rates are also included in interest expenses. Debt-at-risk ratio is the ratio the entire debts of firms with an ICR below 1.5 to the debts of firms included in the total sample.

In the current reporting period, the stagnation in economic activity in the March-May period led by the pandemic spilled over into activity and liquidity ratios of BIST firms as well (Chart III.2.15). Amid the spreading impacts of the pandemic across sectors and the deepening of these impacts, debt collection periods got longer and hit 53 days in June 2020. Similarly, accounts receivable and inventory turnover rates, which increased in 2019, slowed after March 2020 with the pandemic outbreak. Arrangements are still in force that aim at postponing any deterioration in credit records of firms defaulting because of the effects of the pandemic, ensuring corporate sector firms' continued access to credits and contributing to uninterrupted cash flow of firms. (FSR May 2020, Box I.1.1). Accordingly, records such as the failure in the payment of credits, bad cheques and protested bills filed at the Risk Center unit of the TBB may not be taken into account by other banks and financial institutions, provided that these debts are either paid or restructured by 31 December 2020. These arrangements restrained the adverse impacts of the pandemic on firms' access to financing and their liquidity positions.

Chart III.2.15: Firms' Activity and Liquidity Indicators (Value, Day)



Source: FINNET Last Observation: 06.20
 Note: EBITDA: Accounts Receivable Turnover = Sales / Commercial Receivables. Inventory Turnover= Cost of Sales / Inventory. Debt Collection Period=365 * Commercial Receivables / Sales.

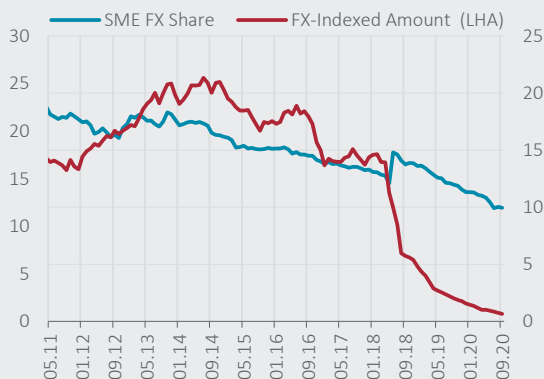
Box III.2.1

Recent Developments in FX Credits of the Corporate Sector

The FX-denominated credit debt of the corporate sector increased due to the dampening effect of expansionary policies implemented by advanced economies after the global financial crisis on FX funding costs and the easing of restrictions on firms' domestic FX borrowing in 2009. Accordingly, as of the first quarter of 2018, the total FX credit debt and FX open position of firms exceeded USD 290 billion and USD 230 billion, respectively (Corporate Sector Developments, Chart III.2.8). A large FX open position damages the balance sheets of firms, of those without FX revenue in particular, in times of increased exchange rate volatility and may ruin the asset quality of banks through disruptions in credit repayments. In this respect, with an amendment to the Decree No. 32 on the Protection of the Value of the Turkish Currency in May 2018, FX credit utilization of firms with an FX loan balance below USD 15 million was linked to their FX revenues, and FX-indexed loan utilization was abolished. This amendment and the exchange rate volatility that rose as of the second half of 2018 increased the awareness of firms against FX risk management, leading them to start reducing the total FX debt burden.

FX credit debt of the corporate sector has been on the decline since 2018 and decreased to USD 245 billion as of August 2020, while the sector's FX open position also dropped to USD 162 billion. Broken down by firm scale, the decline in FX credit debt is faster in SMEs than in large-scale firms (Credit Developments and Credit Risk, Chart IV.1.6). This is primarily due to the fact that the amendment of 2018 has addressed firms with an FX debt below USD 15 million and abolished the FX-indexed credit utilization that was mostly preferred by SMEs as well as due to the fact that campaigns supporting the financing of SMEs have led TL borrowing costs to remain well below the exchange rate-driven costs of FX borrowing. As of September, the FX-indexed credit balance of firms dropped below one billion US dollars, and the share of SMEs in FX credits decreased to 10% (Chart III.2.1.1). This decrease in the FX debt burden of the SME segment, whose financial experience in FX risk management is relatively lower, is deemed to be a positive development in terms of financial stability and the management of Turkey's total FX open position risk.

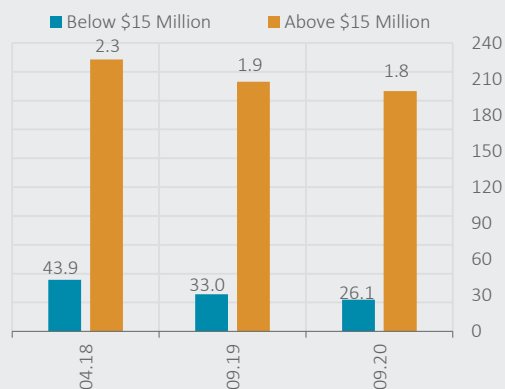
Chart III.2.1.1: Share of SMEs in Total FX Credits and FX-Indexed Loan Amount (% , USD Billion)



Source: CBRT

Last Observation: 09.20

Chart III.2.1.2: Total FX Credit Amounts and Number of Firms (USD Billion, Thousand)



Source: CBRT

Last Observation: 09.20

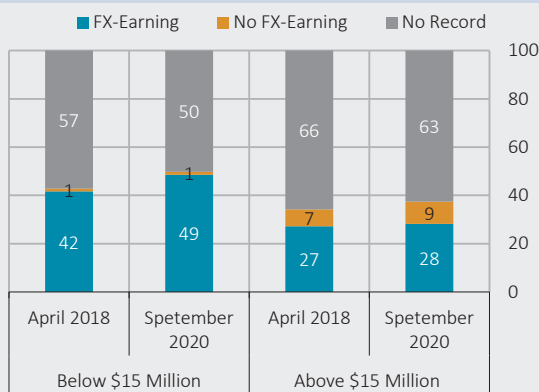
Note: The number of firms (thousand) in the related group is shown above the columns.

The amendment in 2018 and the exchange rate developments in the following period have also affected the number of firms that use FX credits. The number of firms with an FX credit debt below USD 15 million decreased from 44,000 in April 2018 to 33,000 in September 2019 and 26,000 by

September 2020. The FX credit debt burden of these firms also dropped from USD 42.8 billion before the amendment to USD 26.3 billion as of the latest data. Though not subject to the restrictive amendment, the number of firms with an FX credit debt above USD 15 million also declined significantly due to the downtrend in FX debt burden. While the number of firms in this group dropped from 2,326 in April 2018 to 1,769 as of the latest data, the FX debt balance decreased from USD 226 billion to USD 200 billion in September 2020. The chart also shows that the bulk of the FX debt burden of corporate sector firms is concentrated on a small number of firms with a high level of credit debt. These large-scale firms are financially experienced in exchange rate risk management, predominantly exporters, and some of them are granted guaranteed FX revenue under PPP projects.

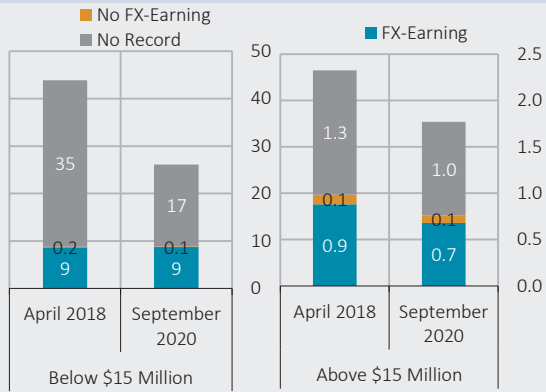
An analysis of firms' FX credits by their FX revenues reveals that the firm profile of FX credits has changed since the amendment in May 2018 due to implementation and conjuncture-related factors. Among the firms with a credit amount below USD 15 million, the share of FX-earning firms in total credits increased after April 2018 (Chart III.2.1.3). This increase mainly resulted from the decline in FX credits of firms that do not have a record of FX revenue. The upward change in the share of FX-earning firms in FX credits covered by the amendment is deemed to be a favorable development in terms of the FX risk management of firms. Since the new FX credit utilization of firms with an FX credit amount below USD 15 million has been linked to their FX revenues, the increase in the share of FX-earning firms is also expected to continue in the upcoming period. The ratio and number of firms with no record of FX revenue in the system have declined over time, both in the segment covered by the amendment and in larger-scale firm credits (Chart III.2.1.4). The decline in the amendment-covered group of firms was driven by the FX revenue stipulation for FX credit utilization as well as by the abolishment of FX-indexed credit utilization. Although the number of FX-earning firms has slightly decreased among the firms with an FX credit amount above USD 15 million, their weight in the credit amount has increased moderately (Chart III.2.1.4).

Chart III.2.1.3: Distribution of FX Credit Amounts Based on Firms' Revenues (Including FX-Indexed Loans, % Share)



Source: CBRT Last Observation: 09.20

Chart III.2.1.4: Distribution of Firms with FX Credit Debt Based on Revenues (Thousand)



Source: CBRT Last Observation: 09.20

Note: Firms with no available FX credit data are the ones that do not have FX revenue records in the system. It is possible that this group may also include FX-earning firms.

To conclude, FX credit debt of the corporate sector has markedly decreased due to the amendment in May 2018, TL interest rates that remained low from the second half of 2019 to September 2020, favorable TL credit conditions, and the increased awareness of exchange rate risk. Although the FX demand triggered by this decrease in a period of deposit dollarization has exerted pressure on the exchange rate, the exchange rate risk of the corporate sector has declined significantly.