

II. Non-Financial Sector

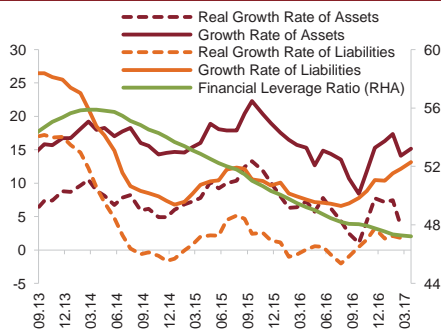
Household financial assets are growing faster than their liabilities. This is mainly due to the fact that the savings deposit growth rate is above the individual loan growth rate. Other financial instruments that are influential in the increase in household assets are the savings in precious metal investments and the savings that are invested in the private pension system. Households' demand for private sector debt securities declined. Housing and general purpose loans began to increase as macroprudential measures for consumer loans were loosened as of September 2016. According to the regulations in force, households cannot borrow in terms of FX and at variable interest rates (except housing loans). Therefore, household liabilities do not bear any market risk arising from exchange rate and interest rate developments. The financial leverage ratio (liability / asset), which represents the relationship between households and the financial sector with respect to relative indebtedness, continues to decline due to the developments in the household balance sheet.

The real sector production volume is on an upward trend in line with the rising exports, the public incentives and the improvement in investment expectations. The ratio of the sector's total financial indebtedness to GDP has been flat since 2015, which is well below the average of emerging countries. Effective measures taken by the public sector, thanks to the room for maneuver provided by the financial discipline, have made it easier for firms, SMEs in particular, to access finance. The rate of increase in the FX open position tends to decline due to the market awareness regarding the management of the foreign exchange risk and the effect of the firms' recent tendency towards TL credits instead of FX credits. The significant lengthening in the maturities of FX credits and the low level of the NPL ratio in FX loans are the factors that reduce the foreign exchange risk of the firms.

The household financial leverage ratio (liability/asset) continues to decline.

Chart II.1.1

Household Financial Assets' and Liabilities' Growth Rates and Financial Leverage Ratio
(Annual Percentage Change, Percentage Share)



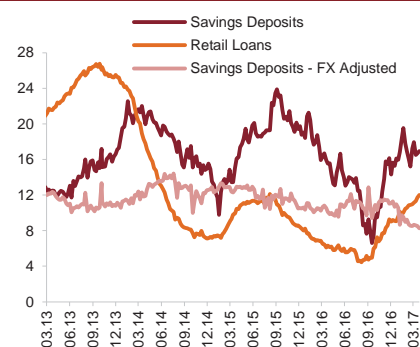
Note: The leverage ratio refers to the ratio of average financial liabilities to the average financial assets in the last 12 months. Real growth rates were calculated using the CPI.

Source: CBRT, BRSA, CMB, MKK, TOKİ (Latest Data: 03.17)

The growth rate of households savings deposits exceeded the growth rate of retail loans.

Chart II.1.2

Household Loans and Deposits Growth
(Annual Percentage Change)

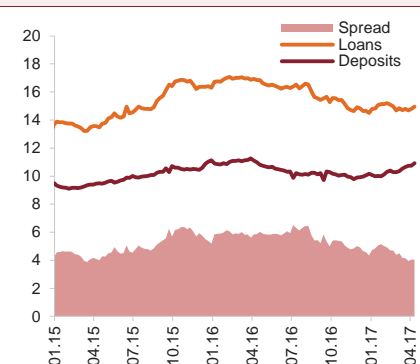


Note: Retail loans refers to loans extended by resident banks and includes credit cards balances. (0.6 USD + 0.4 Euro) currency basket was used to adjust the exchange rate effects on savings deposits.

Source: CBRT, BRSA (Latest Data: 03.17)

Chart II.1.3

Savings Deposits and Consumer Loans Interest Rates (Percent)



Note: Consumer loan rate developments include housing, general purpose and vehicle loan rate developments. Spread refers to the difference between loan rates and savings deposit interest rates.

Source: CBRT (Latest Data: 04.17)

II.1 Household Developments

Households' total asset and liability growth rates began to increase in the first quarter of 2017, following the slowing trend in 2016 (Chart II.1.1). It is assessed that this is due to the increase in total deposits on the asset side and the increase in housing and general purpose loans on the liability side. Household financial assets and liabilities also grew in real terms in March 2017 compared to the same period of the previous year. The household financial leverage ratio (liability / asset), which started declining at the end of 2013, remained on this track in the current financial report period (Chart II.1.1). The majority of the household financial assets are composed of savings deposits and almost all of the liabilities are made up of consumer loans (consumer loans and individual credit cards). Therefore, the positive outlook of the financial leverage stemming from the asset and liability developments is largely determined by the relative growth rates in savings deposits and individual loans. The macroprudential measures, which were loosened as of September 2016, were very effective on the deceleration in retail loan growth rates since 2013 (Chart II.1.2). The financial leverage ratio has been declining since 2014, as the savings deposit growth rate exceeded the retail loan growth rate.

Consumer credit loan rates have remained flat whereas the deposit interest rates have slightly increased compared to the previous reporting period (Chart II.1.3). Accordingly, the loan-deposit spread has declined in this period.

Table II.1.1
Household Financial Assets

	03.16		03.17		Percentage Change	Cont. to Change (Point)
	Billion TL	Perc. Share	Billion TL	Perc. Share		
Total Assets	917.3	100	1,056.1	100	15.1	15.1
TL Savings Deposits	438.1	47.8	487.0	46.1	11.2	5.3
FX Savings Deposits	278.9	30.4	322.9	30.6	15.8	4.8
- (Billion USD)	97.2		88.8		-8.6	
Precious Metal Deposits	9.4	1.0	17.4	1.6	84.7	0.9
- (Billion USD)	3.3		4.8		45.8	
Bonds and Bills	20.2	2.2	17.0	1.6	-15.9	-0.4
- Public Sector	6.2	0.7	6.4	0.6	3.7	0.0
- Private Sector	14.1	1.5	10.6	1.0	-24.4	-0.4
Mutual Funds	84.1	9.2	102.9	9.7	22.3	2.0
Pension Mutual Funds	51.6	5.6	64.6	6.1	25.3	1.4
Other Mutual Funds	32.5	3.5	38.2	3.6	17.6	0.6
Equity Securities	45.9	5.0	50.9	4.8	10.9	0.5
Repo	0.4	0.0	0.7	0.1	51.4	0.0
Currency in Circulation	40.2	4.4	57.3	5.4	42.6	1.9

Note: Currency in circulation as of March 2017 is calculated by taking the household share in total in 2016-III Financial Accounts Report as constant.

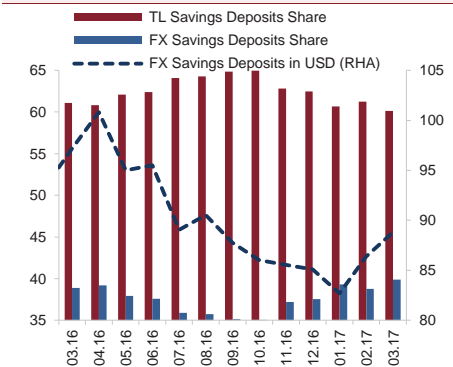
Source: CBRT, CMB, MKK (Latest Data: 03.17)

Household financial assets increased by 15.1 percent compared to the same period of the previous year (Table II.1.1). The largest contribution to the asset growth came from the increase in savings deposits (10.1 points). The contribution of TL deposits to the asset growth was 5.3 points and the contribution of FX deposits was 4.8 points. Other financial instruments that are effective in increasing household assets are savings in precious metal investments and the savings that are invested in the private pension system. Households' demand for private sector debt securities declined in this period (Table II.1.1).

An analysis of FX savings deposits in US dollar terms reveals that households have preferred FX savings deposits to a lesser extent as of March 2017 compared to the same period last year (Chart II.1.4). FX savings deposits have increased by 15.8 percent in nominal terms compared to the first quarter of 2016. The increase in savings deposits is attributed to the fluctuations in foreign exchange. FX savings deposits measured in US dollars have decreased by 8.6 percent in the last one-year period (Table II.1.1). Consequently, while the share of TL savings deposits in total deposits decreased compared to the previous year due to the depreciation in TL, FX savings deposits increased slightly (Chart II.1.4).

While small balance FX deposits did not change, FX deposits with high balance (worth of 1 million TL and above) FX deposits increased compared to the previous report period. (Chart II.1.5). Similarly, compared to the same period of the last year, only large balance FX deposits showed increase in exchange rate-adjusted terms, while the rise in TL deposits was observed in all quantities. Swap transactions between banks and individuals are believed to be one of the major factors behind the increase in FX deposits in this period. Through these transactions, banks provide foreign currencies in exchange for TL, and they generally ask depositors to hold these FX balances in their bank accounts. At maturity, depositors pay back FX deposits in return for principal and interest in TL. Although the amounts generated by swap agreements, which are generally offered to the holders of large balance deposits, are considered a part of FX accounts, they have the characteristics of TL deposits as depositors invest and retrieve their money in TL.

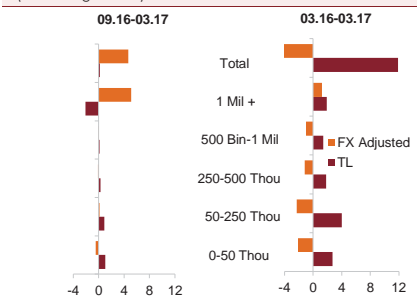
Chart II.1.4
Savings Deposits of Resident Households By TL and FX Breakdown (Percentage Share, Billion USD)



Note: FX savings deposits do not include precious metals held by the banking sector. LHA in the graph shows the shares of TL and FX savings deposits in total. For example, as of 03.17, the share of FX savings deposits is nearly 40 percent whereas the share of TL savings deposits is 60 percent.

Source: CBRT (Latest Data: 03.17)

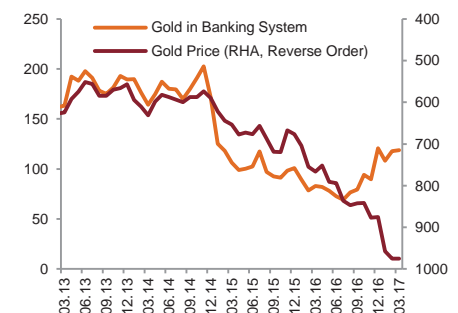
Chart II.1.5
Contribution of Resident Households' Deposit Amounts to Growth by Periods (Percentage Points)



Note: FX savings deposit has been adjusted for exchange rate effect with the (0.6\$+0.4€) currency basket. Refers to the deposits held by residents.

Source: CBRT (Latest Data: 03.17)

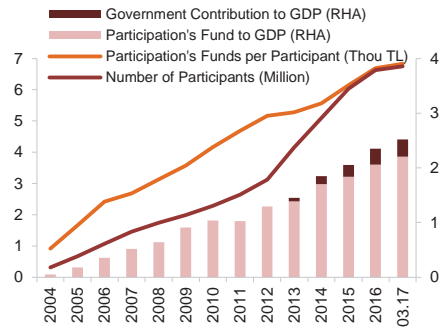
Chart II.1.6
Households' Gold Portfolio in the Banking System and Gold Prices (1 Ton, TL (RHA))



Note: Gold price represents the price of a Turkish Republican coin.

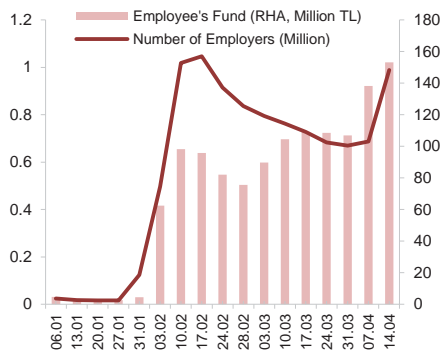
Source: CBRT (Latest Data: 03.17)

Chart II.1.7
Private Pension System in Turkey
(Billion TL (RHA))



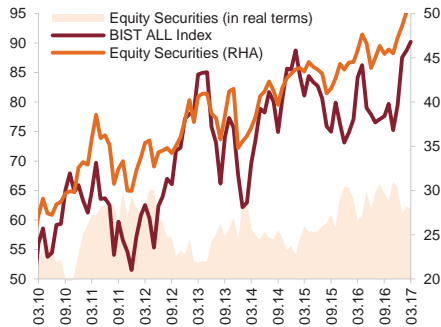
Note: 2016 end year GDP is used for March 2017.
Source: PMC (Latest Data: 03.17)

Chart II.1.8
Automatic Enrollment to Private Pension System



Source: PMC (Latest Data: 19.05.17)

Chart II.1.9
BİST All Index and Household Equity Securities
Portfolio (Thousand, Billion TL (RHA))



Note: Equity securities (in real terms) were calculated using CPI and a constant.
Source: CBRT, Bloomberg (Latest Data: 03.17)

The rise in precious metal investments was another notable development in the household financial assets. Gold prices and the amount of gold in the banking system, which were inversely related in the previous periods, started to move in the same direction as of September 2016 (Chart II.1.6). In this report period, the gold price and the amount of gold held in deposit accounts rose. The increase in gold investments is attributed to the change in households' investment preferences as households substitute FX deposit accounts with gold deposit accounts.

The amount of savings in the private pension system (PPS) showed a dramatic increase in line with the state contribution made since 2013 to boost domestic savings. This tendency continued in the first quarter of 2017. The participants in the PPS and the participants' funds have increased by 8.7 percent to approximately 6 million 750 thousand and by 26.1 percent to 65 billion TL, respectively compared to the previous year (Chart II.1.7). The automatic enrollment mechanism for the PPS came into force in early 2017, through which paid employees under the age of 45 started to be enrolled in the system gradually. As of May 2017, approximately 2 million 900 thousand people have been enrolled in the system via the automatic enrollment mechanism, creating a fund amount of 442 million TL (Chart II.1.8). The automatically enrolled participants and the fund size showed a significant rise in April when the second stage covering mainly civil servants was introduced.

Household equity securities exceeded 50 billion TL as of May 2017 (Chart II.1.9). The positive course of the Borsa İstanbul (BİST) Index was effective in this upward trend. However, it is notable that if the household equity securities investments are deflated by the rise in the BİST Index, as of March 2017 the amount of investments rose by 3.5 percent compared to the same period of last year. In this period, the first real estate certificates were issued under the supervision of the Capital Markets Board. A real estate certificate is an instrument which divides housing projects into smaller shares and allows individuals to buy shares in these projects. In the first public offering of this instrument at end-March 2017, demands were received at a fixed price and 3.4 million certificates were issued at a price of 42.5 TL for each one. 52.7 percent of these certificates are bought by domestic individual investors.

Table II.1.2
Household Financial Liabilities

	03.16		03.17		Percentage Change	Contributions to Change
	Billion TL	Percentage Share	Billion TL	Percentage Share		
Total Liabilities	441.9	100	499.9	100	13.1	13.1
(Based on Type)						
Housing	161.3	36.5	190.1	38.0	17.8	6.5
Vehicle	16.0	3.6	17.3	3.5	8.4	0.3
General Purpose	167.1	37.8	186.3	37.3	11.5	4.4
Individual Credit Cards	85.1	19.2	89.4	17.9	5.1	1.0
Asset Management Comp ¹ Rec.	12.5	2.8	16.8	3.4	34.4	1.0
Total Liabilities	441.9	100	499.9	100	13.1	13.1
(Based on Counterparty)						
Banks	406.0	91.9	453.2	90.7	11.6	10.7
Financing Companies	10.6	2.4	13.9	2.8	31.4	0.8
TOKİ	12.8	2.9	16.0	3.2	24.7	0.7
Asset Management Comp ¹	12.5	2.8	16.8	3.4	34.4	1.0

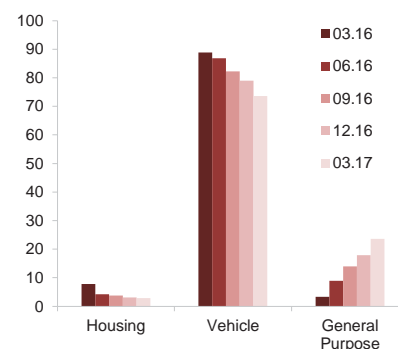
Source: CBRT, TOKİ (Latest Data: 03.17)

Following the deceleration in the last report period, household financial liabilities started to increase due to the easing in September 2016 of macroprudential measures¹ for consumer loans. The main determinant of the 13.1-percent growth in household financial liabilities was the rise in housing and general purpose loans which account for nearly three quarters of total financial liabilities. Household financial liabilities to asset management companies increased due to the NPL portfolio sales of banks compared to the previous year (Table II.1.2).

Households continued to prefer banks as a major source of funding as they did in the previous period. However, the share of bank loans in households' total liabilities decreased by 1.2 points (Table II.1.2). The increased diversity of consumer loans due to the emergence of new financing companies has been effective in this decline. Consumers were using financing company loans largely in vehicle purchases in the past, and since last year, they have also preferred financing company loans in purchases subject to general purpose loans. General purpose loans extended by financing companies reached 3.3 billion TL as of March 2017. Accordingly, the share of general purpose loans extended by financing companies in total consumer loans was approximately 25 percent in this period (Chart II.1.10).

General purpose loans provided by financing companies continued to increase.

Chart II.1.10
Consumer Loans Extended by Financing Companies
Based on Type (Percentage Share)

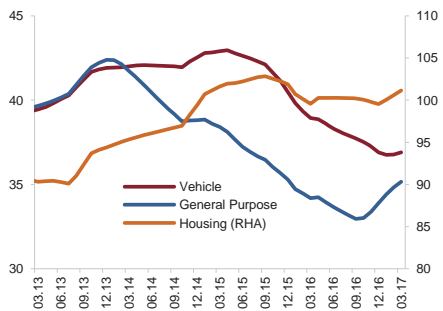


Source: CBRT (Latest Data: 31.03.17)

¹For further information, please see the table in "Annex 1: Macroprudential Regulations on Retail and Commercial Loans and Related Effective Dates"

Average maturity of housing and general purpose loan has been increasing since the last quarter of the previous year.

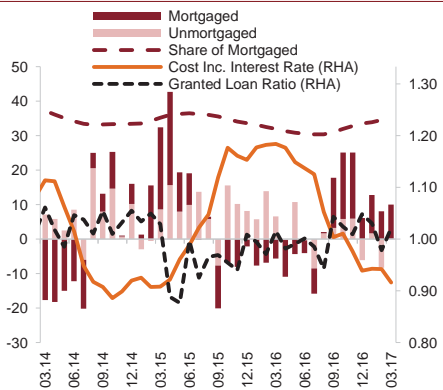
Chart II.1.11
Average Retail Loan Maturity
(3 Month MA, Month (RHA))



Note: The average retail loan maturity is calculated according to original loan maturity.
Source: CBRT (Latest Data: 03.17)

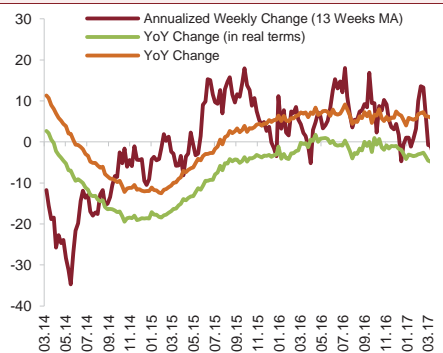
Mortgaged residential sales have significant contribution to the acceleration in the housing market in recent months.

Chart II.1.12
Contribution to Housing Sales Growth, Housing Loan Monthly Interest Rate and Granted Loan Ratio
(Percent, Percentage Point)



Note: The share of mortgaged represents the share of mortgaged sales in the total housing sales in the last 12 months. Granted loan ratio represents share of granted housing loans in the total application, the average of 2014-2017 (78) is indexed to 1.
Source: CBRT, TURKSTAT (Latest Data: 03.17)

Chart II.1.13
Individual Credit Card Balance
(Percent)



Note: YoY Change (in real terms) were calculated using CPI.
Source: CBRT, TURKSTAT (Latest Data: 03.17)

The macroprudential policies for consumer loans, which were intensively implemented in Turkey in the aftermath of the global financial crisis, were loosened to some extent at end-2016. The average maturity of the newly extended general purpose and housing loans lengthened due to the increase in the maturity cap for general purpose loans from 36 months to 48 months and the rise in the loan-to-value ratio for housing loans from 75 percent to 80 percent (Chart II.1.11). Another factor affecting the increase in the average maturity of general purpose loans was the facility of restructuring of standard loans with a maturity of up to 72 months.

New housing loans contributed to the increase in the share of mortgaged sales in total housing sales as well as to the lengthening in average maturities (Chart II.1.12). Mortgaged house sales have contributed positively to the growth rate of house sales since September (Chart II.1.12). The improvement in financial conditions for housing loans was another factor effective in the increased housing sales. The ratio of the number of people who were granted housing loans to the number of people who applied for a loan (granted loan ratio) has been above the period average since September 2016. The higher granted loan ratio indicates that in addition to higher demand due to interest rate developments, banks also have a higher motivation for granting loans.

Consumer credit card balances have remained flat in the recent period (Chart II.1.13). On the other hand, when the annual change in individual credit card expenditures is adjusted for the rise in general price level, there was a slight decline.

To sum up, the household financial leverage ratio continues to decline in line with the household financial balance sheet developments. Household financial liabilities do not bear a significant market risk arising from exchange rates and interest rates in Turkey since regulations in force do not allow households to borrow in FX and at floating rates (except housing loans).

The traditional demand for gold in our country has urged banks to offer new savings products. With the "Accumulation Accounts", where the savings are directed to regular gold purchases every month and the banks have paved the way for converting gold into revenue-generating financial products by organizing gold collection days. In 2011, the Reserve Option Mechanism (ROM), a facility allowing holding a fraction of required reserves for TL liabilities in gold, accelerated this process. In this context, physical gold is transformed into gold deposits and transferred to gold storage accounts, which are then included in the Central Bank reserves within the scope of the ROM.

In the financial system, there are gold products such as gold deposit, gold swap, gold credit and Gold Exchange Traded Fund (ETF). Gold ETFs, which are liquid investment instruments, are traded as stocks, have primary and secondary markets and trace gold prices. These tools are a good option for investors willing to invest in physical gold but do not want to deal with operational burdens and costs such as gold custody, clearing and insurance.

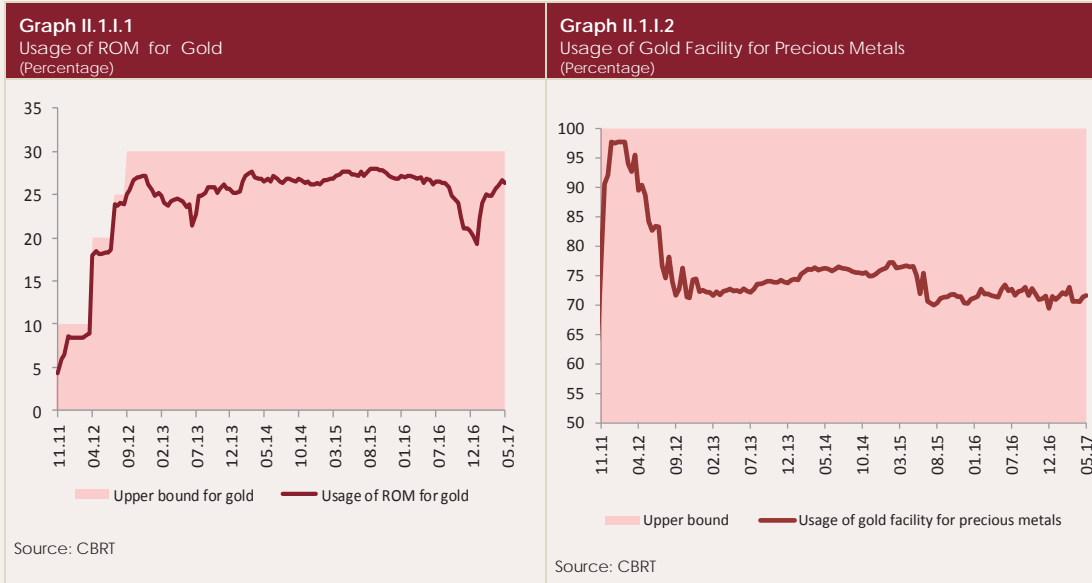
Central banks hold some of the country's reserves in gold. This gold, expressed as monetary gold, is held in liquid markets, on secure accounts and in liquid gold tools. They are used as per the rules specified in the legislation of the relevant central bank or monetary authority and in line with market developments. During the last crisis in international markets, gold played an important role as a source of liquidity. While the Fed has provided countries with US dollar liquidity against gold through the swap lines it has established, some central banks (Sveriges Riksbank) have provided liquidity to their banking systems by pledging their country's gold reserves as collateral.

By May 2017, the CBRT had 447.6 tons of gold reserves worth US \$ 17.8 billion and accounting for 16.8 percent of total FX reserves. The amount covered by the reserve requirement accounts constituted approximately 73 percent of these gold reserves. In this context, the reserve requirement facilities that have contributed to the accumulation of gold reserves since 2011 have been diversified as follows:

- 1- The ROM facility allowing maintaining up to 30 percent of reserve requirements for TL liabilities in gold
- 2- The ROM facility allowing maintaining up to 5 percent of reserve requirements for TL liabilities in scrap gold
- 3- The ROM facility allowing holding up to the entire amount of reserve requirements for precious metal deposit accounts in the form of gold

With the help of these facilities allowing maintaining reserve requirements in gold, the CBRT's gold reserves have been strengthened, and cost and liquidity channels of the system have been supported by providing more flexibility in the banking system's liquidity management.

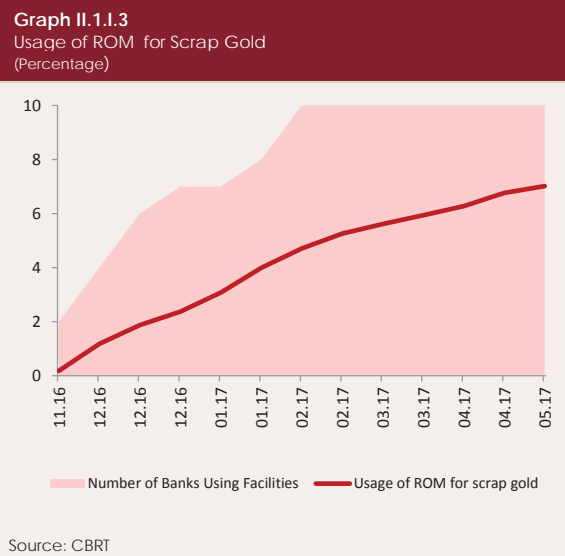
By 21.04.2017, 25 establishments were benefiting from the facility of keeping gold for TL required reserves and 306 tons of gold, worth TL 45.7 billion in total, was established (Chart II.1.1.1).



Within the scope of the facility allowing keeping gold for precious metal deposit accounts, as of the maintenance period starting on 21.04.2017, 12 banks out of 23 banks with precious metal deposit accounts were benefiting from the facility and a total of 12 tons of gold worth TL 1.8 billion was kept (Chart II.1.1.2).

In order to bring out residents' gold savings into the economy, on 21.10.2016, the CBRT introduced an additional tranche of 5 percent also known as the scrap gold option, in addition to the existing facility of 30 percent allowing reserve requirements to be maintained in "standard gold" within the context of the Reserve Option Mechanism. The aim of the new implementation was to draw gold savings, called gold under the mattress, into the economy and for this purpose, only wrought or scrap gold collected from residents by banks as of 03.10.2016 was eligible for this new tranche. By 07.04.2017, 2.2 tons of scrap gold worth TL 322 million was maintained. The scrap gold option utilization rate is 6.8 percent and 10 banks use the option.

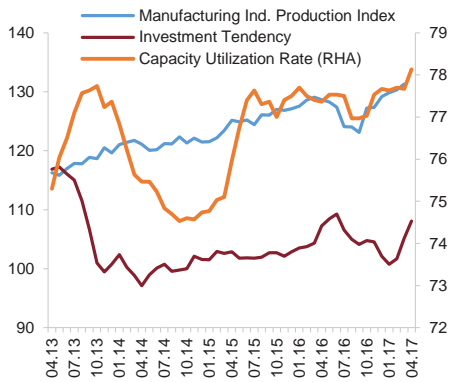
For investors, keeping gold savings under the mattress has some burdens such as storage, security and opportunity cost. The opportunity cost is important for both the investor and the Turkish economy, because this type of savings has no fixed income and holding a high amount of gold



means waiving any gain from debt securities. Therefore, gold-denominated bonds and lease certificates, which are planned to be issued by the Undersecretariat of Treasury in return for scrap gold to be collected from investors, will play an important role in integrating the idle gold stockpiled under the mattress or kept with a custody service into the financial system. The mentioned issues will not only help attract gold out of the mattress but also will allow investors to earn additional income from their gold savings.

Industrial production and investment tendency are recovering.

Chart II.2.1
Industrial Production and Investment Tendency
(Seasonally Adjusted, 3-Month Moving Average)

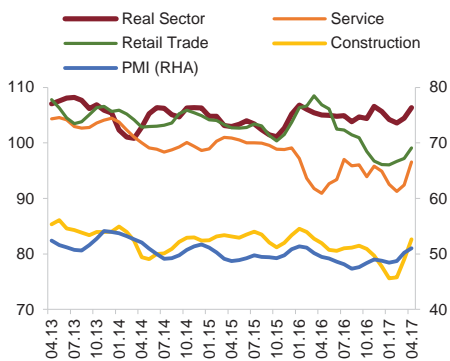


Note: The investment tendency is obtained by adding the difference between those who expressed the investment expectation for the next 12 months as up and those who expressed it as down to 100. Latest data of industrial production index: 03.17

Source: TURKSTAT, CBRT (Latest Data: 04.17)

Confidence indices are increasing in all sectors.

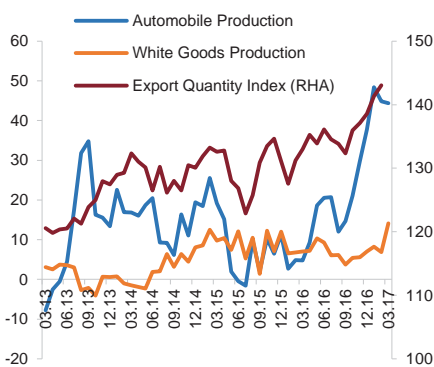
Chart II.2.2
Real Sector Confidence Index
(Seasonally Adjusted, 3-Month Moving Average)



Source: TURKSTAT, CBRT (Latest Data: 04.17)

Production volume is increasing due to accelerating exports.

Chart II.2.3
Automobile and White Goods Production Volume Annual Growth and Seasonally Adjusted Export Quantity Index
(Annual Percent Change, 3-Month Moving Average)



Source: TURKSTAT (Latest Data: 04.17)

II.2 Real Sector Developments

The moderate recovery in industrial production and the leading surveys indicate that the real sector will make an upward contribution to growth in 2017 (Chart II.2.1). The declining industrial production and capacity utilization rates after a series of shocks in the third quarter of 2016 have compensated for their losses and contributed to growth above the expectations in the fourth quarter. The investment tendency in the real sector, which had a limited contribution to growth during 2016, has been recovering since the end of the year. The Economic Coordination Committee (ECC) investment incentive packages announced in December 2016 as well as the diminishing uncertainties are believed to be influential in this recovery. Particularly, incentives such as increasing the share of government contribution to investment in the manufacturing industry, supporting firms' access to finance and decreasing the corporate tax rate strengthen the production volume and investment tendency in the sector. The prospect of recovery in investment expectations and the increase in foreign demand implies that the growth in the upcoming period will gain upward momentum.

The confidence of the real sector in the economic activity, which had been on a downward trend since the second quarter of 2016, began to rise in almost every sector as of early 2017 (Chart II.2.2). The measures taken by the public sector in coordination with other regulatory authorities had a significant contribution to this development. The negative economic outlook in the services and retail trade sectors, which were most affected by the economic slowdown in the third quarter of 2016, showed a positive turnaround in the first half of 2017, suggesting that the economic recovery is not limited to certain sectors and has a potential to spread across all sectors. Furthermore, the campaigns for housing sales and the VAT refund facility in investment-oriented construction projects are supporting the construction sector.

Among the leading indicators for economic activity, the production of automobile and white goods has steadily increased since the last quarter of 2016 (Chart II.2.3). The rapid production increase observed in the automotive sector is mostly related to the

production of new models and the strong export demand. The increase in production in the last quarter of 2016 reflects the contribution of the domestic demand which was brought forward due to the Special Consumption Tax (SCT) regulation and the increase in foreign sales. The rise in the output of white goods was driven by growing exports, increased housing sales and brought forward consumption. In addition to this, the VAT and SCT reductions applied on the sales of furniture and white goods in February 2017 also prevented possible price movements due to the exchange rate fluctuations and kept the demand in the sector alive. Within the scope of the ECC decisions, incentives such as the loan facility with 100 percent KGF collateral for exporting firms and the granting of interest-free loans to contracting companies for the financing of domestic intermediate goods were introduced. With the help of the aforementioned incentives, it is estimated that the competitiveness and market diversity of exporting companies increased and this had a contribution to the climb in exports. The positive signals for economic growth in the EU, which is the biggest export partner of the sector, and the increase in the demand by trade partners due to rising oil prices will support the real sector production volume in the forthcoming period.

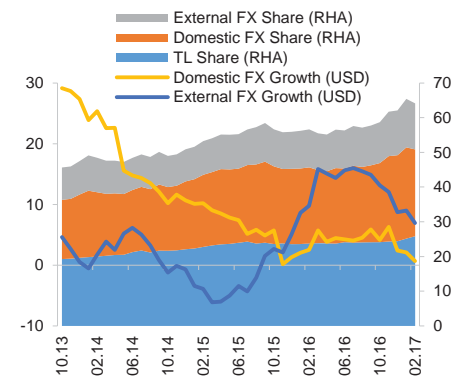
II.2.1 Indebtedness of Real Sector Firms

While the FX borrowing by real sector companies has slowed down recently, the ratio of total financial liabilities to GDP is on the rise (Chart II.2.4). The main factor in this increase is the rise in the TL value of domestic and external FX loans starting from the third quarter of 2016. Since the growth rate of the USD value of FX loans has decreased recently as opposed to the surge in their TL equivalents, the increase in the total debt has been mainly caused by the rise in the exchange rate. The recent slowdown in the use of FX loans by firms suggests that the share of firms' total liabilities in GDP will follow a steady course in the coming period.

The ratio of total corporate credits to GDP was below the G20, emerging countries and world average as of the third quarter of 2016 (Chart II.2.5). As of September 2016, while the developing countries' average increased by about 10 percentage points compared to the previous year, the growth rate of Turkish firms remained very limited. After 2011, the period when global liquidity has been abundant, there has been a 23-point increase in the financial leverage of Turkish firms. This rise is almost half of the increase in developing countries.

Firm Indebtedness is increasing due to exchange rate movements.

Chart II.2.4
Share of Real Sector Financial Debt in GDP and Annual Growth of FX Loans
(Annual Percentage Change, Percent Share)

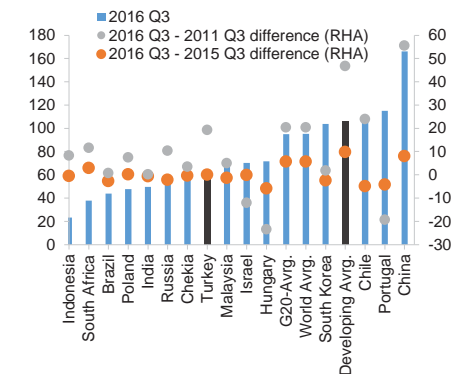


Note: FX growth rates are annual percentage changes of FX loans in terms of USD.

Source: CBRT, BRSA (Latest Data:02.17)

Firms' financial leverage is below the average of developing countries.

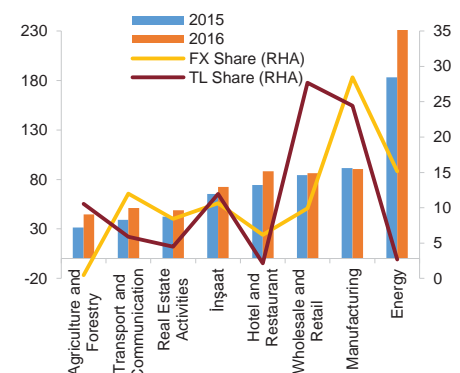
Chart II.2.5
International Comparison of Real Sector Credit / GDP Ratio
(Percent, Percent Difference)



Source: BIS (Latest Data: 09.16)

Financial leverage of the energy sector is at high levels due to investment projects

Chart II.2.6
Share of the Loan Debts of Main Sectors in the Sectoral Value Added and Total Loan Volume
(Percent, Percent Share)



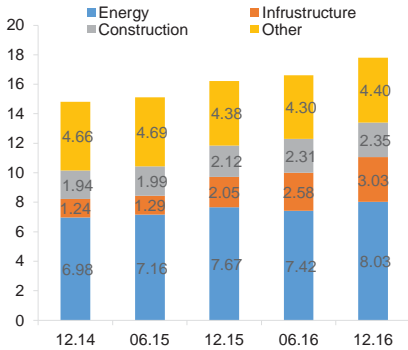
Note: Debts include domestic loans and intermediated external loans via a domestic bank.

Source: BAT Risk Center, TURKSTAT (Latest Data: 12.16)

The share of project financing loans is increasing.

Chart II.2.7

Share of Loans Granted for Project Financing in Total Loans
(Percent Share)



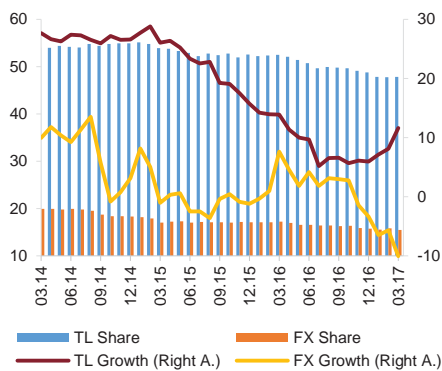
Note: As of the date of original allocation, it includes loans of at least 20 million USD with at least 5 years of maturity
Source: BAT Risk Center (Latest Data: 12.16)

When we look at the ratio of the main sectors' debt to the value added by these sectors, we see that the energy sector (electricity, gas and water resources) has the highest leverage (Chart II.2.6). The leverage ratio in the manufacturing industry and the wholesale-retail trade sectors, where FX and TL loans are used the most, is 80 percent. The relatively low leverage level in the construction sector, which makes a significant contribution to the economic activity, is a positive indicator. Investments subject to various incentives, such as the construction of power plants, are considered to have an important role in the loan usage by the energy sector that holds the highest leverage ratio. This argument is supported by the fact that the share of loans used for investment project financing in total loans has increased in recent years (Chart II.2.7). The increase in the share of loans extended for large investment projects that create employment as well as the fact that these loans have very long maturities are positive factors with regard to potential economic growth.

The use of TL loans by SMEs gained momentum.

Chart II.2.8

Developments in SME Loans
(Percent Share, Annual Percentage Change)



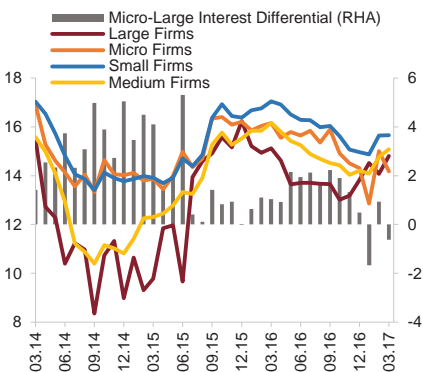
Source: CBRT (Latest Data: 03.17)

The share of SME loans in total domestic loans has increased since the beginning of 2017 (Chart II.2.8). With the introduction of incentives such as KGF, Respite Credits and KOSGEB loans, the annual growth of SMEs' TL loans has gained momentum. With these incentives, SMEs, which are primarily influenced by economic fluctuations, have gained the opportunity to acquire working capital that will increase their commercial activities and to realize postponed investments.

The interest rate differential between the SME and large corporate loans has narrowed.

Chart II.2.9

TL Financial Costs of SMEs
(Percent, Percent Difference)



Source: CBRT (Latest Data: 03.17)

The interest rate differential between the SME and large corporate loans has tended to decrease since the last quarter of 2016 (Chart II.2.9). The interest-free KOSGEB loans and TOBB Respite Credits, which are known to be extended predominantly to SMEs, and the guarantees provided by the KGF have played a major role in this development. When SMEs are examined on the basis of segment breakdown, it is observed that micro enterprises gained the most advantage in terms of financing costs, in particular from Respite and KOSGEB loans. Thanks to the room provided by the fiscal discipline, various measures taken by the public sector to prevent downside risks in economic activity have provided substantial support to the firms through the improvement in credit conditions.

II.2.2 FX Position of the Real Sector

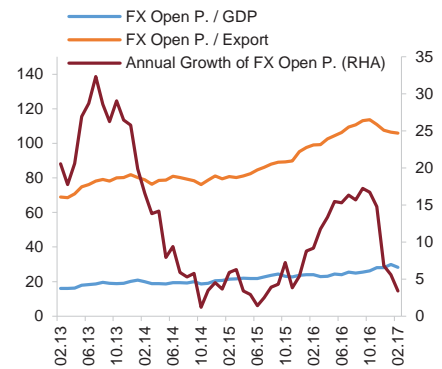
The annual growth rate of FX open positions of non-financial companies tends to decrease (Chart II.2.10). The net open position of the real sector, which increased more rapidly compared to exports until the last quarter of 2016, started declining as of that period. In addition to the strong performance in exports, the fact that firms preferred TL loans instead of FX loans by acting cautiously due to exchange rate movements has been effective in this development. As a matter of fact, in the first three quarters of 2015, in which similar exchange rate movements appeared, the growth rate of open positions had also remained limited. Furthermore, the market awareness raised in various platforms, primarily the Financial Stability Committee, concerning the management of foreign exchange risk and the avoidance of FX contracts by the public sector in the transactions with the private sector are believed to be important factors in putting a brake on the acceleration in the open position.

Real sector domestic FX loans with original maturities of five years and above constitute more than 50 percent of total domestic FX loans and their share continues to increase (Chart II.2.11). As for external liabilities, loans with maturities of more than five years have the largest share in total, with a further upward trend. The prolonged maturities in FX loans and the external debt roll-over ratio at nearly 120 percent indicate that companies do not have difficulty in accessing external financial markets.

Of the total FX debt, 83 percent is concentrated in two thousand of the nearly 30 thousand firms having FX loans (Chart II.2.12). When examined in more details, 10 firms account for 10 percent of the total FX debt, 100 firms for 35 percent and 500 firms for 63 percent. Hence, monitoring the stock FX positions and short-term FX cash flows of the aforementioned firms, in which FX loans are concentrated, is important in terms of effective management of FX risk. In this context, it is planned to strengthen the supervision infrastructure for the FX risk of companies in the forthcoming period with the systemic data monitoring system which is currently in the process of being completed by the CBRT.

The rate of increase in the open position has slowed down.

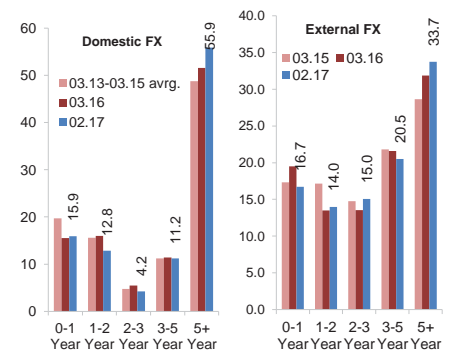
Chart II.2.10
FX Open Position of Non-Financial Companies
(Percent Share, Percentage Change)



Source: CBRT (Latest Data: 02.17)

The maturity of FX liabilities continues to lengthen.

Chart II.2.11
Maturity Breakdown of Domestic FX Loans and External FX Liabilities
(Percent Share)

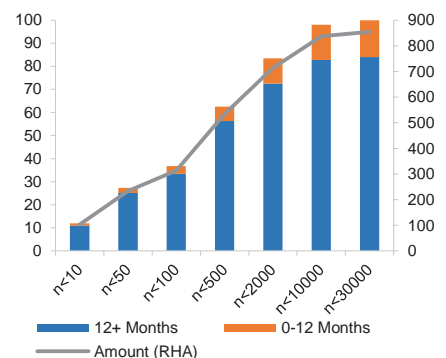


Note: Domestic loans are grouped by original maturity and external debts are by remaining maturity.

Source: CBRT (Latest Data: 02.17)

Most of the FX loans are concentrated in a small number of firms.

Chart II.2.12
Distribution of FX Loans by Firm Number
(Percent Share, Billion TL)

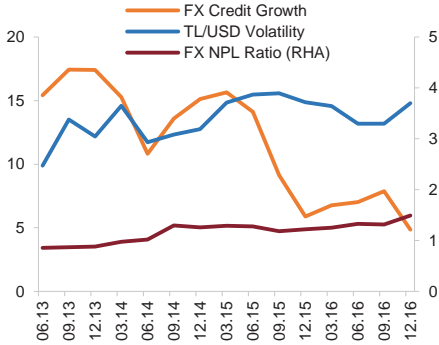


Note: Firms are ranked according to their total FX loan balance (domestic plus external). There are 29,457 companies using FX loans.

Source: BAT Risk Center (Latest Data: 02.17)

The NPL ratio in FX loans is very low.

Chart II.2.13
NPL Ratio in FX Loans
(Percent Growth, Percent Share)

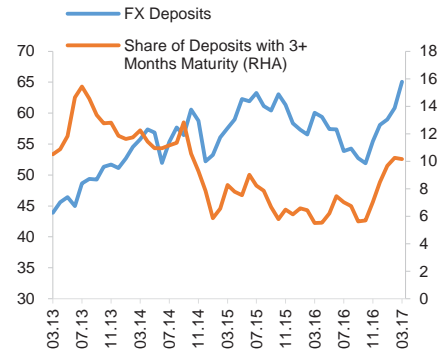


Note: Compiled from quarterly independent audit reports of 10 banks with the largest FX loan receivables by making exchange rate adjustment. The 3-month volatility of the TL / USD exchange rate implied by the option prices has been used and shown in the left axis.

Source: CBRT (Latest Data: 12.16)

FX deposits of domestic firms are increasing.

Chart II.2.14
Developments in FX Deposits of Domestic Firms
(Billion Basket, Percentage Change)

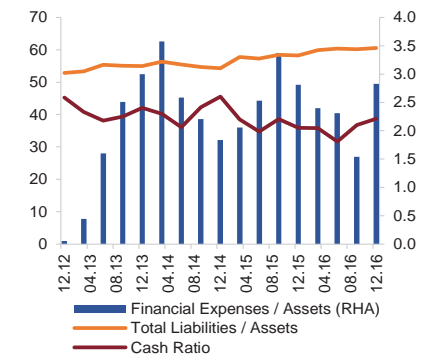


Note: TL equivalents of FX deposits were converted into basket value using weights 0.6 for TL / USD rate and 0.4 for TL / euro.

Source: CBRT (Latest Data: 03.17)

Cash positions improve as financing costs increase.

Chart II.2.15
Financial Indicators of Publicly Listed Real Sector Companies
(Percent, Percent)



Note: Interest Coverage Ratio= EBITDA / Interest Expenses. Exchange rate-driven interest expenses have also been included in interest expenses. Cash Ratio = (Liquid Assets + Securities) / Short Term Debt. As of the latest data, 236 real sector companies are included.

Source: FİNNET (Latest Data: 12.16)

The NPL ratio in FX loans, one of the most important indicators regarding the measurement of the risk level of firms' foreign exchange debt, is at 1.5 percent level (Chart II.2.13). The FX NPL ratio generated from quarterly independent audit reports of the 10 banks with the largest FX loan volume is quite low compared to the TL NPL ratio. Moreover, it is observed that the effect of exchange rate movements and loan growth developments on the FX NPL ratio is rather limited, and the aforementioned ratio stayed in the band of 1 to 1.5 percent even in periods when the exchange rate volatility was high.

Firms' FX deposits have increased recently (Chart II.2.14). It is estimated that this increase has been due to the prudent attitude of the companies regarding future FX payments. When the maturity breakdown of FX deposits of firms is examined, the share of demand deposits within total deposits has decreased while the share of FX deposits with maturities of three months and above has increased rapidly. As the global and political uncertainties diminish, the expected results of the monetary policy are achieved and the volatility of the exchange rate is stabilized, it is expected that the real sector's FX demand, which is above the macroeconomic dynamics, will return to its natural path.

II.2.2 Financial Risk Analysis of the Real Sector

An analysis of the basic financial indicators of the publicly listed firms reveals that the ratio of total liabilities to assets continues to trend upward (Chart II.2.15). However, the rise in the leverage ratio has been rather limited since 2015, in line with the banks' cautious stances. The cash rate, which shows the ratio of the company's liquid assets to total short-term debt, started to increase from the second half of 2016. The rise in the liquidity position in this period when the economic activity tended to weaken is attributed to the cautious attitudes of firms and their eagerness to protect their cash positions. Moreover, as mentioned above, it is considered that the increase in the FX deposits of companies in the period concerned also boosted their cash position. Although the ratio of companies' financial expenses to their assets rose in the last quarter of 2016, this rise remained below the increases in the second half of

2013 and the third quarter of 2015, where similar exchange rate movements had occurred.

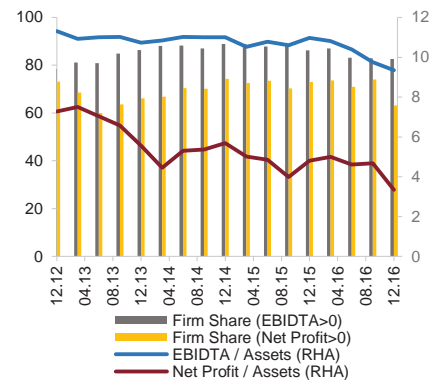
Companies' net end-of-period profits as well as their earnings before interest, tax, depreciation and amortization (EBITDA) decreased in the second half of 2016 (Chart II.2.16). The decline in net profit was due to the decrease in the EBITDA as well as the increase in financing expenses. Although the total EBITDA dropped, this did not increase the number of firms with EBITDA losses. It is foreseen that firm profitability will be even stronger in the upcoming period due to the disappearing uncertainties, the significant recovery in the economic activity, and the decrease in exchange rate volatility.

According to the general view in the related literature, firms with an interest coverage ratio (ICR) below 1.5 and a leverage ratio (Debt / Asset) above 60 percent are considered to have a low level of solvency, while those above and below these values, respectively, are defined as strong companies in terms of solvency. The interest coverage ratio in the majority of the sectors is above 1.5 (Chart II.2.17). Among these sectors, the food and the basic metal industry sectors can be considered as the strongest sectors with low leverage ratios. Although holdings operating in many sub-sectors that play a significant role in the country's economy have a leverage ratio of 75 percent, the fact that their ICR is close to 4 indicates that these companies have a high ability to manage their debt with operating profits. Despite the fact that the ICR of the hotel and restaurant sector, which incorporates the tourism sector, fell below 1.5, the low level of the financial leverage of the sector is believed to be a risk reducing factor. The energy sector has high leverage due to the recent large investments and the net cash flows that have not yet been generated. However, the potential risk for this sector is anticipated to be low because the loans used by the sector are long-term and cash flows will start to recover with the completion of investments. On the other hand, the high leverage in the wholesale and retail trade sector is attributed to the large working capital loans required by the sector.

A close look at the ratio of foreign exchange open positions relative to the assets of the sectors suggests that the energy, the

Profitability of firms declined.

Chart II.2.16
Firms' Profitability
(Percent Share, Percent)

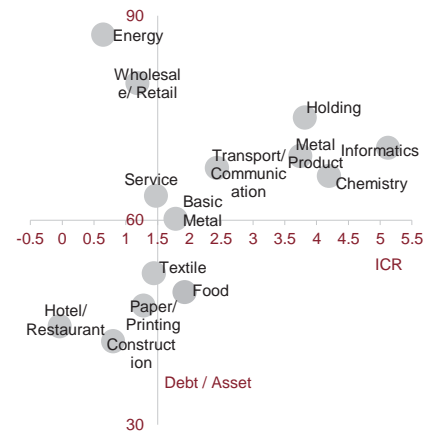


Note: EBITDA: Net Profit + Financial Expenses + Tax Expense + Depreciation and Amortization Costs. Firm share is the ratio of the number of firms with positive profits to the total number of firms in the sample. As of the latest data, 236 real sector companies are included.

Source: FİNNET (Latest Data: 12.16)

Sectors' ability to pay off debt is high.

Chart II.2.17
Sectoral Indebtedness and Interest Coverage Ratio
(Percent)

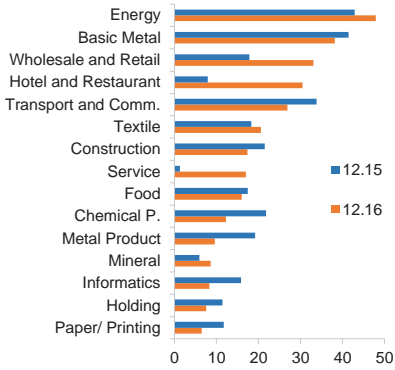


Note: Interest Coverage Ratio= Net Operating Profit (EBITDA) / Interest Expenses. FX rate expenses are included in the interest expenses. In the literature, the generally accepted Debt / Asset lower limit is 60 percent and the ICR value is 1.5. As of the latest data, there are 262 companies including holding companies.

Source: FİNNET (Latest Data: 12.16)

The open positions of holding companies relative to their assets are very low.

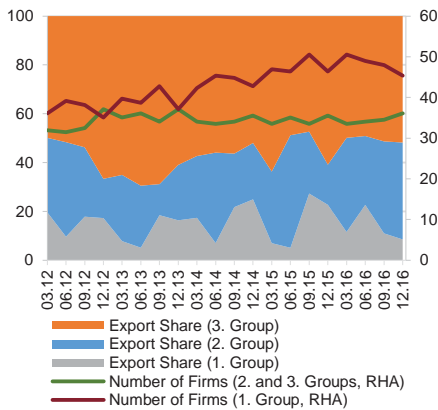
Chart II.2.18
Sectoral FX Open Position / Assets
(Percent)



Note: As of the latest data, there are 262 companies including holding companies.
Source: FİNNET (Latest Data: 12.16)

There is a strong correlation between export revenues and FX open positions.

Chart II.2.19
FX Open Position and Export Revenues
(Percent Share, Percent Share)



Note: Group 1 represents firms with no open position; Group 2 represents companies that are below the median value by open position / asset ratio and Group 3 is above the median. As of the latest data, 236 real sector companies are included.

Source: FİNNET (Latest Data: 12.16)

basic metal and the wholesale-retail trade sectors had a relatively higher open position rate as of the last quarter of 2016 (Chart II.2.18). This situation in the energy and basic metal industry is explained by long-term FX loans required for investment projects. Also, the fact that the pricing in these sectors is FX indexed and the high export earnings of the basic metal industry limit potential risks. With tourism revenues falling, the FX open position rate in the hotel-restaurant sector increased in 2016. An analysis of the consolidated balance sheets of holding companies that have a significant portion of total FX open positions reveals that the ratio of their FX open positions to assets is low. Given that the FX risks of firms operating under the sub-sectors of a holding company are also managed by the parent company, the risk of open positions in other sectors may be considered to be lower.

When firms with FX open positions are examined, there is a strong correlation between export revenues and open positions (Chart II.2.19). Firms have been categorized in three groups; firms with no open position (1st group), firms below the median open position to asset ratio (2nd group) and firms above the median (3rd group). It is found out that the group's share in total export revenues increases as its open position expands. Although the first group, which does not have an FX open position, constitutes 50 percent of the total number of firms, its share of export revenues is around 10 percent. When we look at the other two groups consisting of equal number of firms, the share of the 2nd group in total exports is around 30 percent while the share of the 3rd group with high open positions is about 50 percent. The fact that the FX open position is concentrated in firms with foreign sales and foreign exchange income stands as a factor reducing the FX related balance sheet risks of firms.

Box
II.2.1Rediscount Credits and Amendments Made to the CBRT Regulations on
Rediscount

In the scope of Article 45 of the Law on the Central Bank of the Republic of Turkey, rediscount credits are extended to exporters and foreign exchange earning firms with a maturity of up to 240 days – 360 days for the exports of high-tech industrial products, the exports to new markets and foreign exchange earning services – via the acceptance of foreign exchange bills for rediscount. As the repayments of these credits, which are extended in Turkish liras through the Export Credit Bank of Turkey (Türk Eximbank) and other commercial banks, are made in foreign exchange on the date of maturity, they help boost the CBRT's net foreign exchange reserves.

The interest rate to be applied to rediscount credits with a maximum maturity of 120 days is the monthly LIBOR or EURIBOR interest rate, and the interest rate to be applied to rediscount credits with a maturity of 121-360 days is the 6-month LIBOR or EURIBOR rate. These favorable interest rates and maturities help significantly to reduce exporters' financing costs. Hence, the rise in the number of firms that are extended rediscount credits as well as the increase in credit distribution by sectors and regions contribute to the diversification of Turkey's export markets and export products, and improve balancing of the foreign trade by also bolstering exports and FX-earning services sectors.

In view of the contribution of rediscount credits to the reduction of the current account deficit and to the strengthening of the CBRT's foreign exchange reserves, various amendments have been made to the CBRT regulations on rediscount credits to increase the effectiveness of this facility as well as broaden its accessibility for the exporters. Within this context, the global credit limit, which was set at USD 17 billion on 23 January 2015, was raised to USD 20 billion on 26 July 2016. Out of this amount, USD 17 billion was allocated to Türk Eximbank and USD 3 billion was allocated to commercial banks.

The credit limits per company have also been raised over the years. Currently, the rediscount credit limit per company is USD 400 million for foreign trade capital companies and USD 350 million for other companies. The entire limit can be used for credits with a maturity of up to 120 days whereas only up to 60 percent of the limit can be used for credits with a maturity of 121-360 days. Moreover, firms with a net sales revenue above TL 10, 15 and 20 billion in the latest financial year can utilize this credit facility up to two, three and four times, respectively, the limit set for them.

There have been some amendments in the implementing regulations recently so as to increase both the credit utilization facility and the rediscount credits' contribution to CBRT's foreign exchange reserves. In October 2016, the requirement of a minimum of three signatures on the bills to be accepted for rediscount was reduced to two signatures. Consequently, the amount of rediscount credits extended through commercial banks has increased rapidly due to reduced credit costs while at the same time the number of firms that utilize rediscount credits has grown significantly as a result of broadened accessibility to credits by the exporters. As a matter of fact, the amount of rediscount credits extended through commercial banks, which was around USD 180 million in 2014 and 2015, reached USD 1.5 billion during the November-December 2016 period. Also, in 2016, the number of

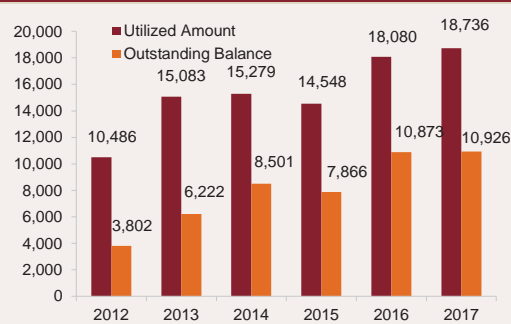
firms that used rediscount credits increased by 360 to 1,670 and the number of projects for which these loans were extended rose by 14 percent to 10,415 compared to 2015.

To support firms against high financial market volatility, it was decided in November 2016 that the maximum maturity of rediscount credits, which would be due by 31 December 2016, could be extended until 31 March 2017. According to the same decision, in case of payment on maturity without utilizing the maturity extension option, credit repayments could be made in Turkish liras and the Central Bank buying exchange rates prevailing on the maturity date would be applicable in these transactions. Within the context of the TL repayment facility, 37 credits with a total amount of USD 51 million were repaid as TL 171 million in December 2016. Furthermore, USD 330 million worth of 75 credits' maturities were extended by 3 months.

In February 2017, during the high FX rate volatility and consequent poor price formation period, with the intention of facilitating firms' repayment of foreign exchange debt by safeguarding the financial stability, it was decided that the repayments of rediscount credits, which were extended before 1 January 2017 and would be due by 31 May 2017, could be made in Turkish liras provided that they were paid at maturity. The Central Bank buying exchange rates announced on 2 January 2017 would be applicable for these transactions. Within the context of this facility, 1,322 credits with a total amount of USD 3 billion were repaid in Turkish liras as of the 20 February-28 April 2017 period.

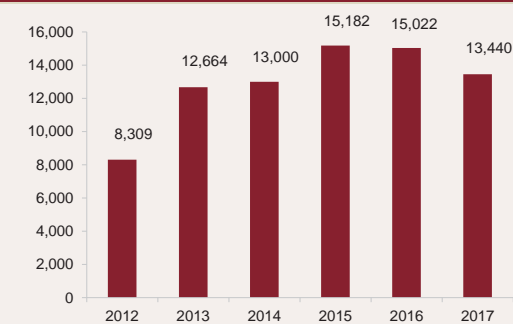
Since the changes in regulations that allowed for reduced costs, extended maturities, raised limits and widened scope have made rediscount credits more attractive for companies, it is expected that the number of firms demanding credit will escalate and the credit utilization will become prevalent. Within this context, rediscount credit extensions, which amounted to USD 18.1 billion in 2016, are expected to reach USD 19 billion in 2017 (Chart II.2.1.1). Rediscount credits' contribution to the Central Bank's foreign exchange reserves, which was USD 15 billion in 2016, is expected to be around USD 14 billion in 2017 (Chart II.2.1.2).

Chart II.2.1.1
Rediscount Credit Utilization and Outstanding Balance
(Million US dollars)



Note: 2017 credit utilization is 12 month cumulative data.
Source: CBRT (Latest Data: 28.04.2017)

Chart II.2.1.2
Contribution to CBRT Reserves
(Million US dollars)



Source: CBRT (Latest Data: 28.04.2017)

The rediscount facility of the CBRT has also started to be employed to promote the use of local currencies in foreign trade. To this end, it was decided in December 2016 that the CBRT would extend rediscount credits to banks via the acceptance of Chinese yuan (CNY) bills for rediscount, to finance the trade and investment activities between Turkey and China. The overall limit of these credits will be CNY 2 billion. The funding source of these credits is the fund in CNY obtained as part of the swap agreement signed between the CBRT and the People's Bank of China (PBOC). This credit is extended and repaid only in CNY, with a maximum maturity of 365 days and a maximum credit limit of CNY 400 million per company.