

The Banks Association of Turkey

Turkish Economy and Banking System **“Recent developments and expectations”**

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European Banking Federation
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May 2006

Economic Policy Framework

Turkey is an open economy

Capital flows are free

No exchange rate restriction, under floating exchange rate regime

Signed the “Customs Union” with the EU in 1995

The EU’s economic criteria regarded as the nominal anchor

Turkey is closer to EU membership

The stand-by agreement with the IMF extended until 2008

Main features of the economy

Population of 72 million with GNP USD 361 billion and income per capita USD 5,008

Long term average growth rate is about 5 percent

Domestic consumption with 70 percent of total demand is the main force behind the growth

Services and industry have shares of 58 percent and 30 percent

Unemployment rate is about 10 percent

Foreign trade volume amounts to 55 percent of GNP. Exports and imports amount to USD 70 billion and USD 110 billion

The main trade partner is EU with 50 percent share

Main targets of economic policy

Setting stable rules and institutions eliminating discretionary measures for well functioning market economy

Undertaking fiscal responsibility, focusing to reduce debt to GNP ratio through primary surplus

Channelling sources to private sector, sustaining stable growth at annual rate of 5 percent, focusing on reducing inflation and reaching price stability

Improving fiscal transparency and ensuring better management in the public sector, increasing role of private sector and foreign capital inflows

Main targets of economic policy

Strengthening financial sector

Reaching sustainable stability through structural reforms; social security, widening tax base, bankruptcy law, central bank and regulatory and supervisory institutions' autonomy

Meeting the EU main economic criteria by 2008

Leading Turkey to become a global player

Stronger institutions and rules for market economy

Recent developments

Macro economic policies in conjunction with a positive international environment led to economic performance to improve considerably since 2002.

Disinflationary monetary and tight fiscal policies supported by the structural reforms created an environment for higher growth led by the private sector.

Recent developments

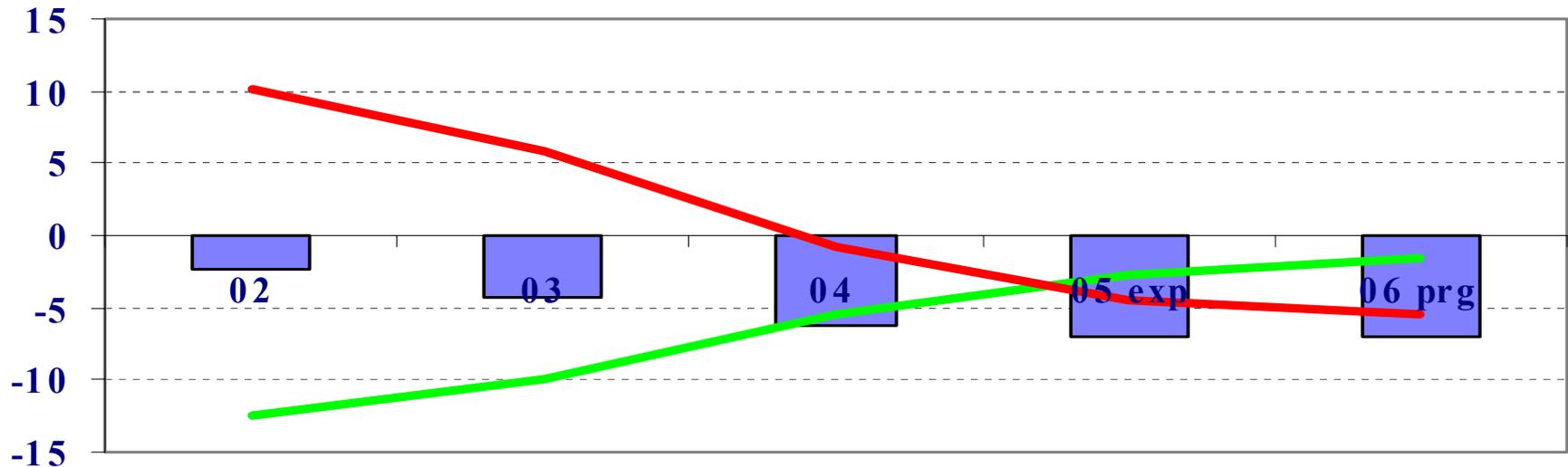
Successfully implemented free market principles encouraged private sector and foreign investment and increased the international competitiveness.

The start of accession negotiations will further reinforce the dynamism of Turkey to complete economic reform enhancing Turkey's integration with the EU.

Selected macro economic outcomes of the recent developments

Savings and investment pattern changed dramatically; private sector gave savings gap since 1986, while public sector's gap narrowed further

Savings gap (as % of GNP)

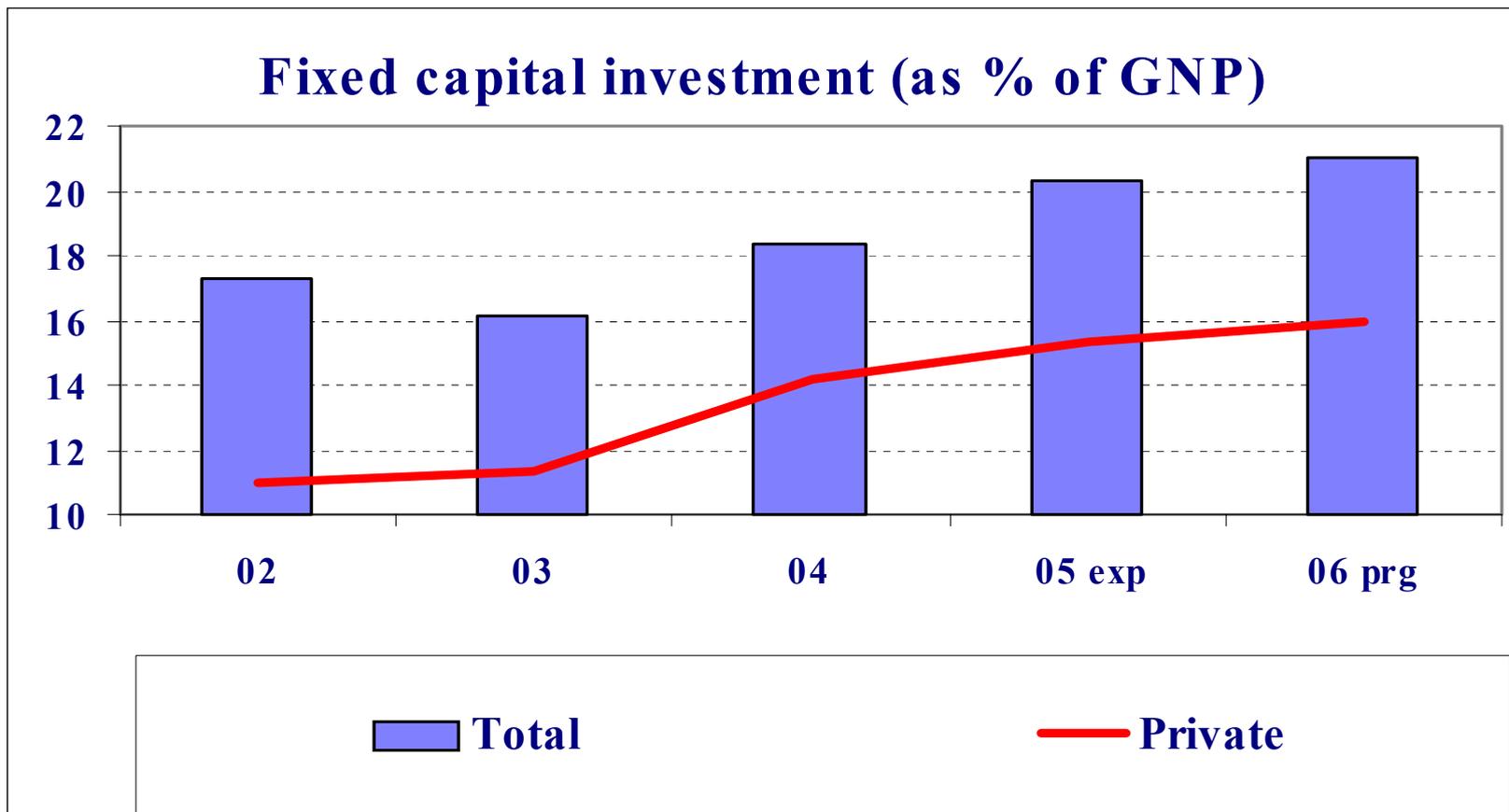


 Savings balance

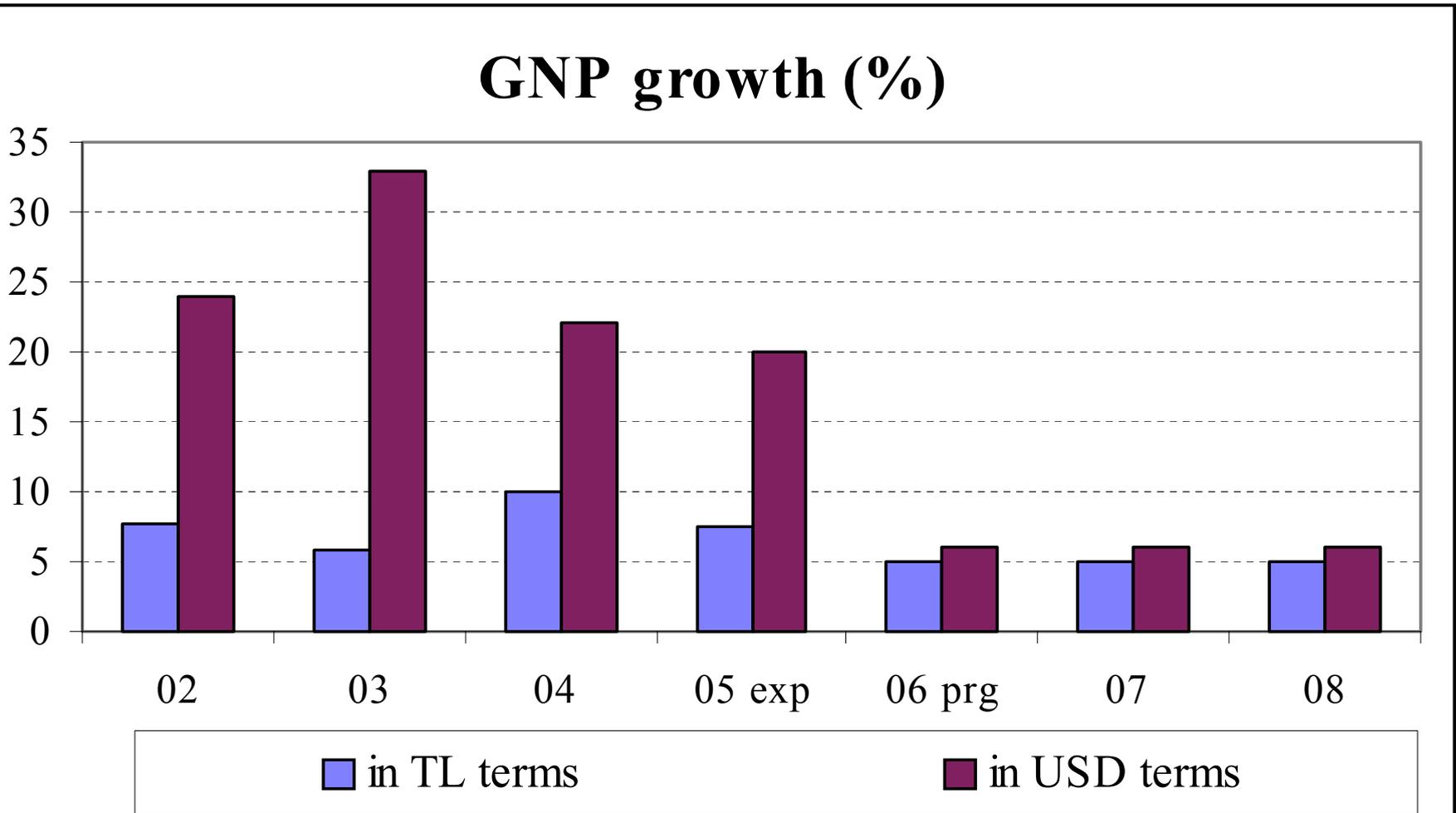
 Public

 Private

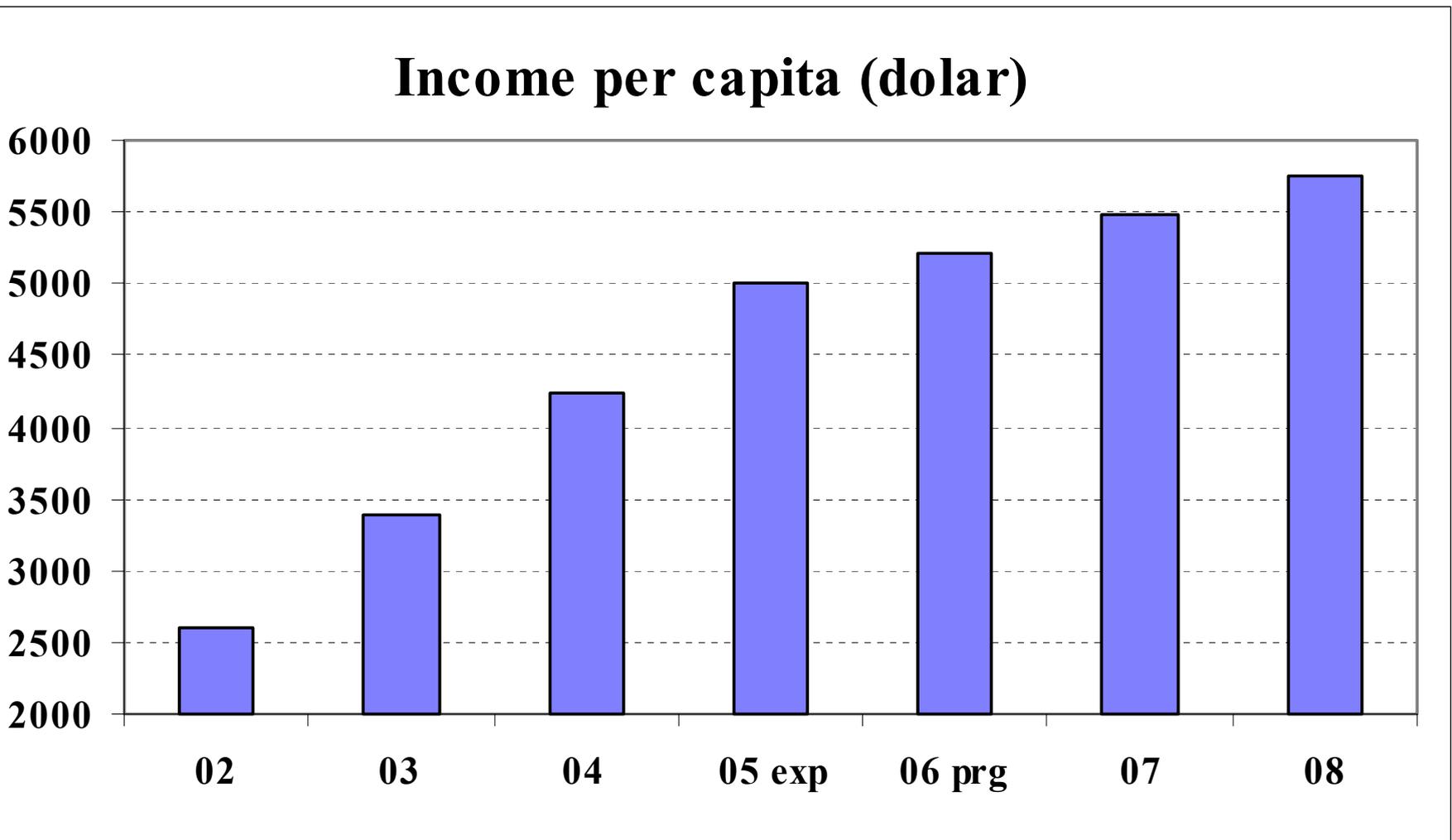
Private sector fixed capital investment accelerated



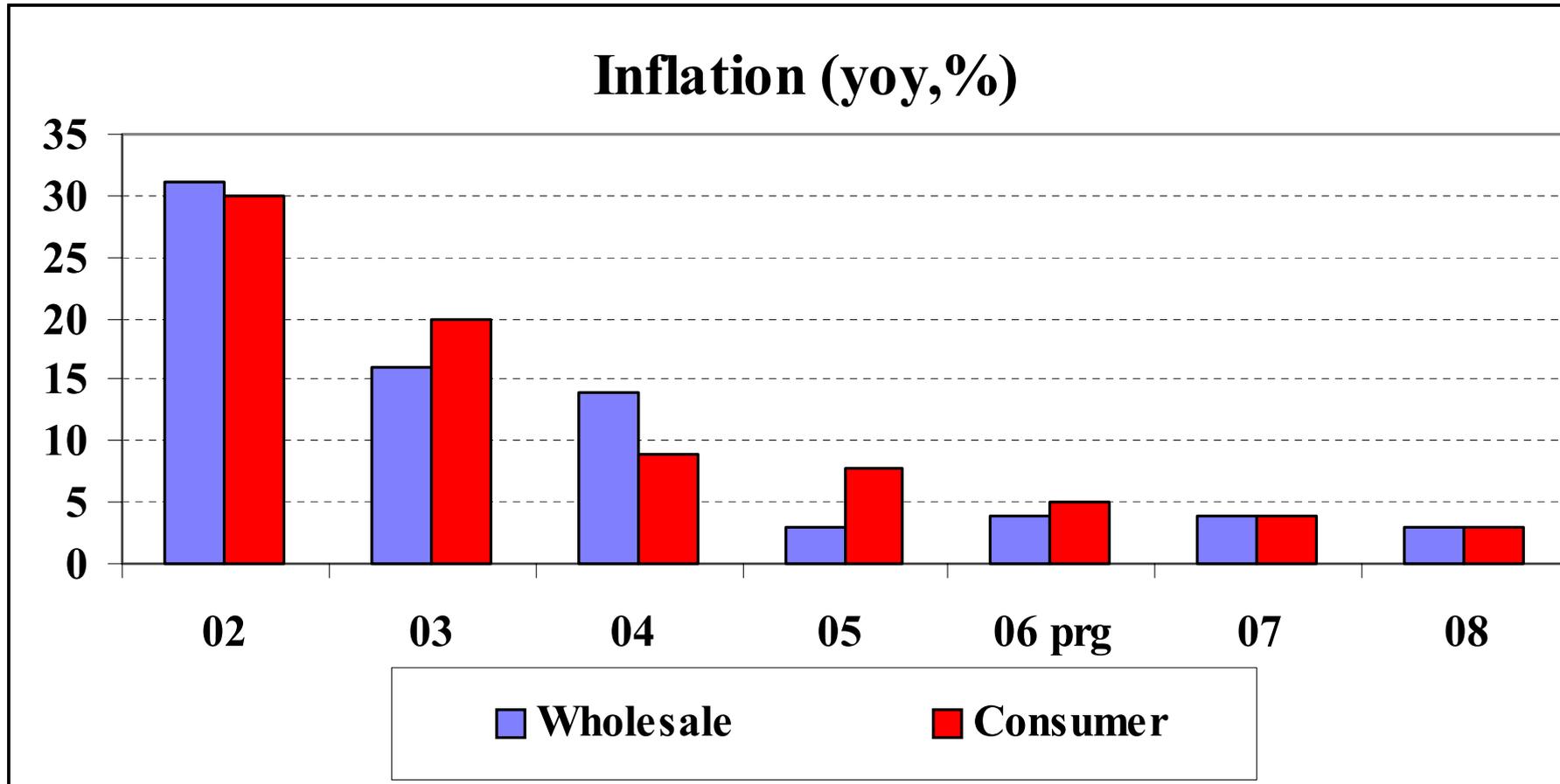
Sustainable growth; over the long term average



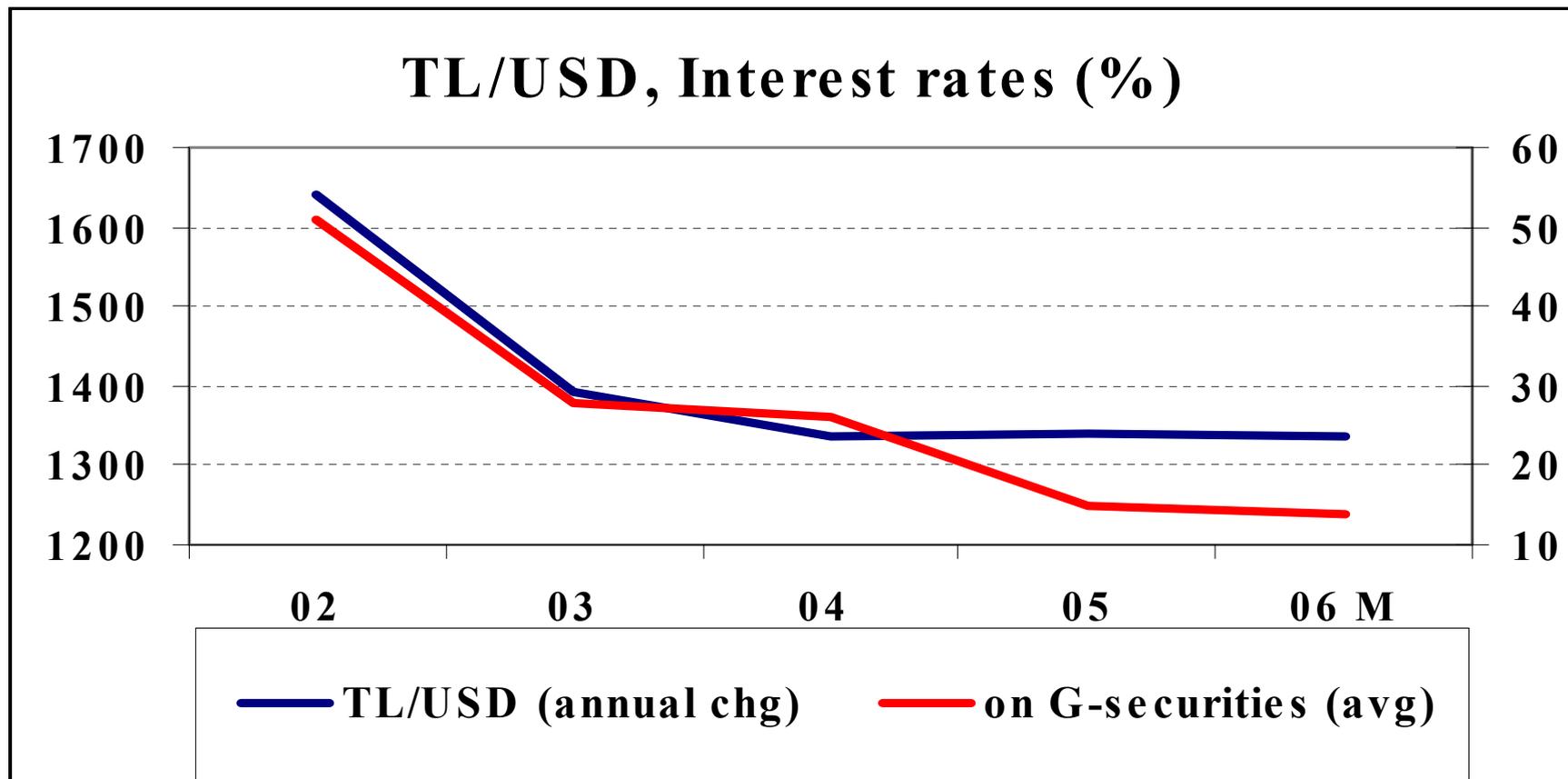
Income per capita in USD terms almost doubled in 2005 from 2002



Inflation has come down historically the lowest during the free market economy and is likely to decline further in coming years

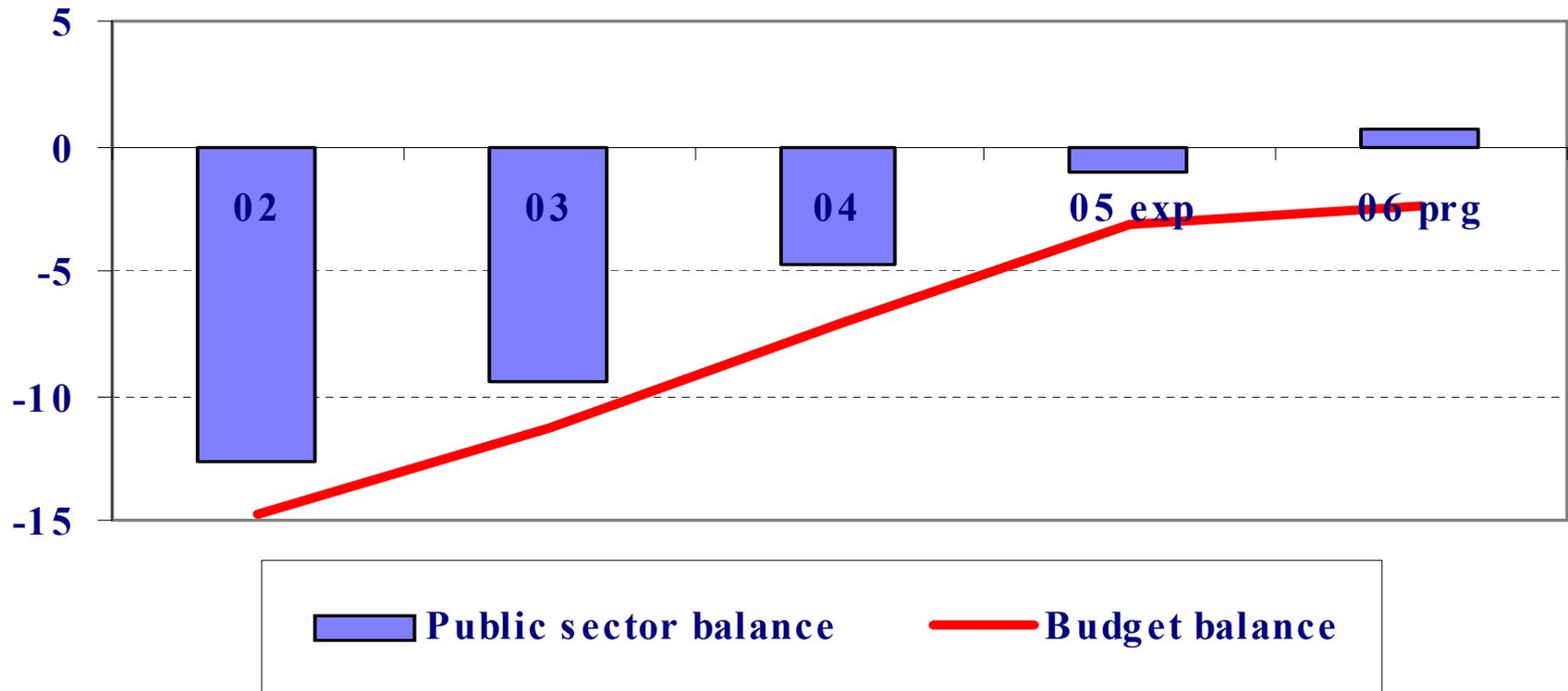


TL and fx markets remained rather stable; TL appreciated against major currencies as interest rates followed a descending trend



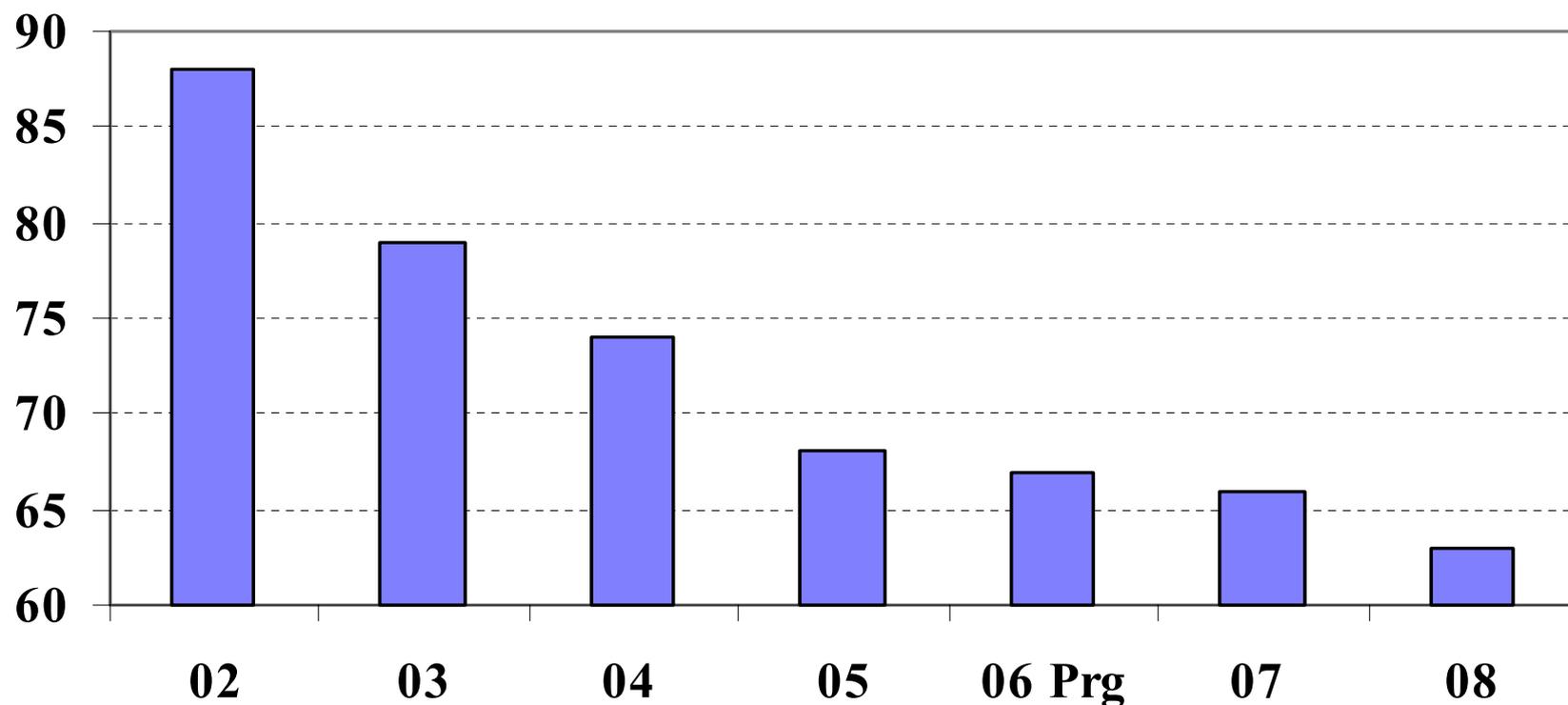
One of the the main reasons behind these positive outcomes was the tight fiscal policy which led to a substantial decline in PSBR and budget deficit

Public sector balance and budget balance (as % of GNP)



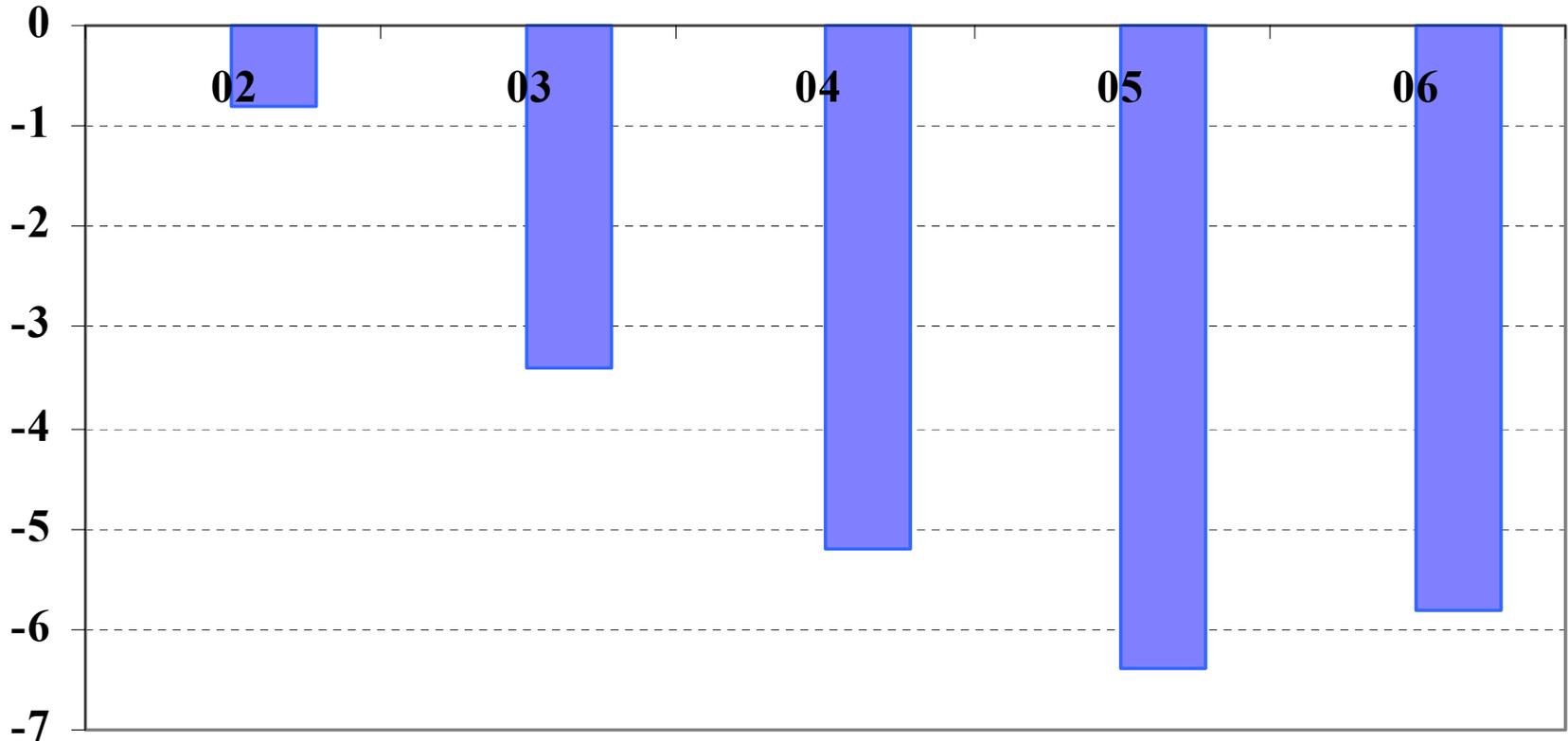
Public sector debt stock to GNP has declined steadily

Public sector debt as % of GNP



Current account deficit widened rapidly mainly due to strong demand for imports fueled by private sector investments

Current account (as % of GNP)

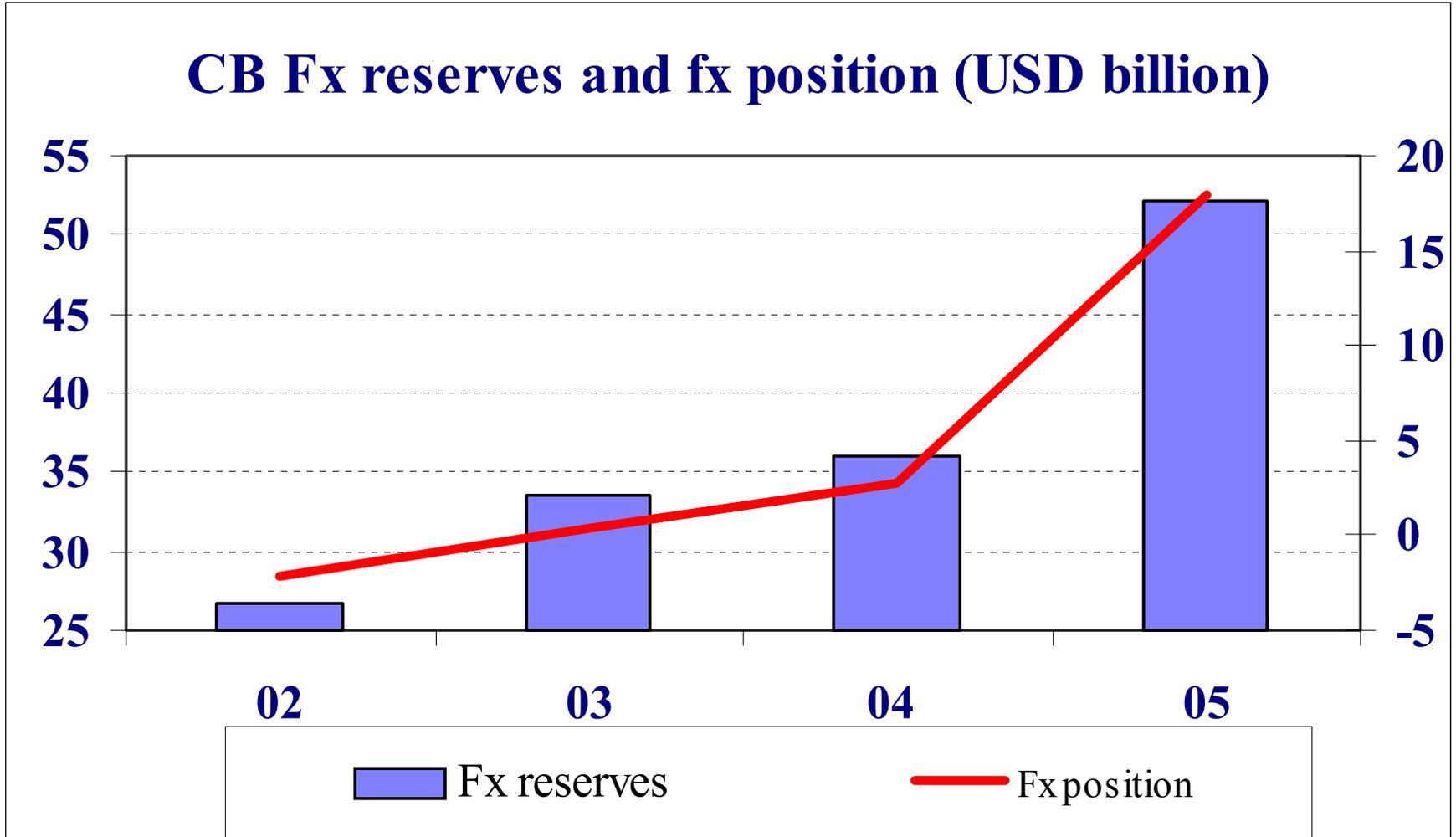


Capital inflows jumped dramatically; but financed easily; thanks to private sector and foreign investors' interest to capital markets

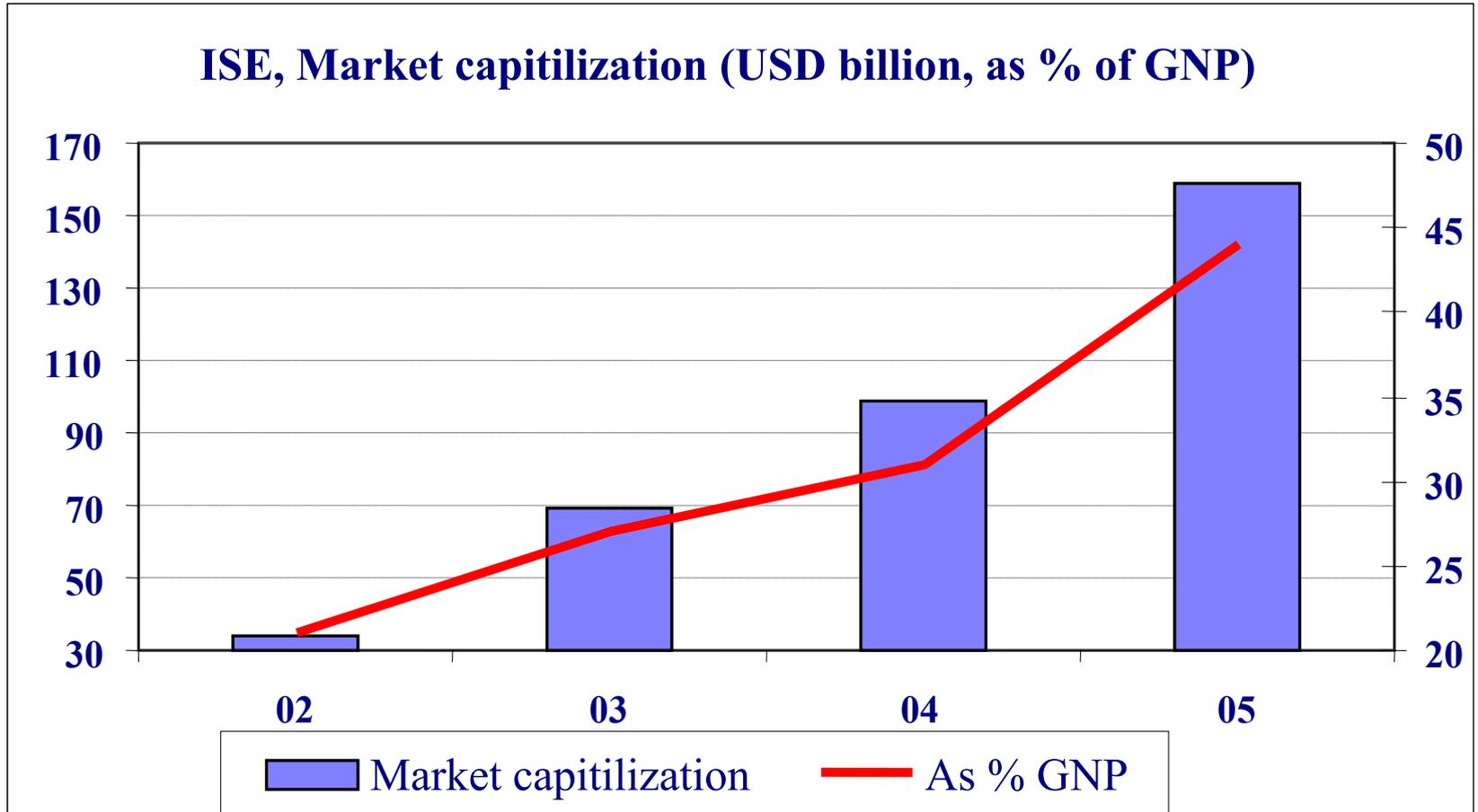
Balance of payments (USD million, annual)

	2002	2005	2003-05 Cumulative
I. Current account	-1.524	-23.007	-46.647
II. Capital flows	1.406	20.898	37.330
II. Reserves (minus indicates an increase)	-5.559	-18.244	-28.356
Official reserves	-6.153	-17.847	-22.718
Banks reserves	594	-397	-5.638
III. Financial requirement	-7.083	-41.251	-75.003
IV. Financing	7.083	41.251	75.003
A. Debt creating activities	8.899	19.213	37.930
1. Private	838	24.101	45.987
2. Government	12.863	-1.220	1.216
3. Central Bank	-4.802	-3.668	-9.273
B. Non-debt creating activities (net)	-1.816	22.038	37.073
1. Direct investment	962	8.626	11.867
2. Investment in shares	-16	5.669	8.001
3. Investment in G-securities	929	5.934	13.573
4. Net error-omission	118	2.109	9.317
5. Others	-3.809	-300	-5.685

CB fx reserves reached USD 52 billion, the record level; while fx position climbed up USD 18 billion from negative term.



Improved economic performance positively reacted by the investors in the Istanbul Stock Exchange



Expectations for the near future

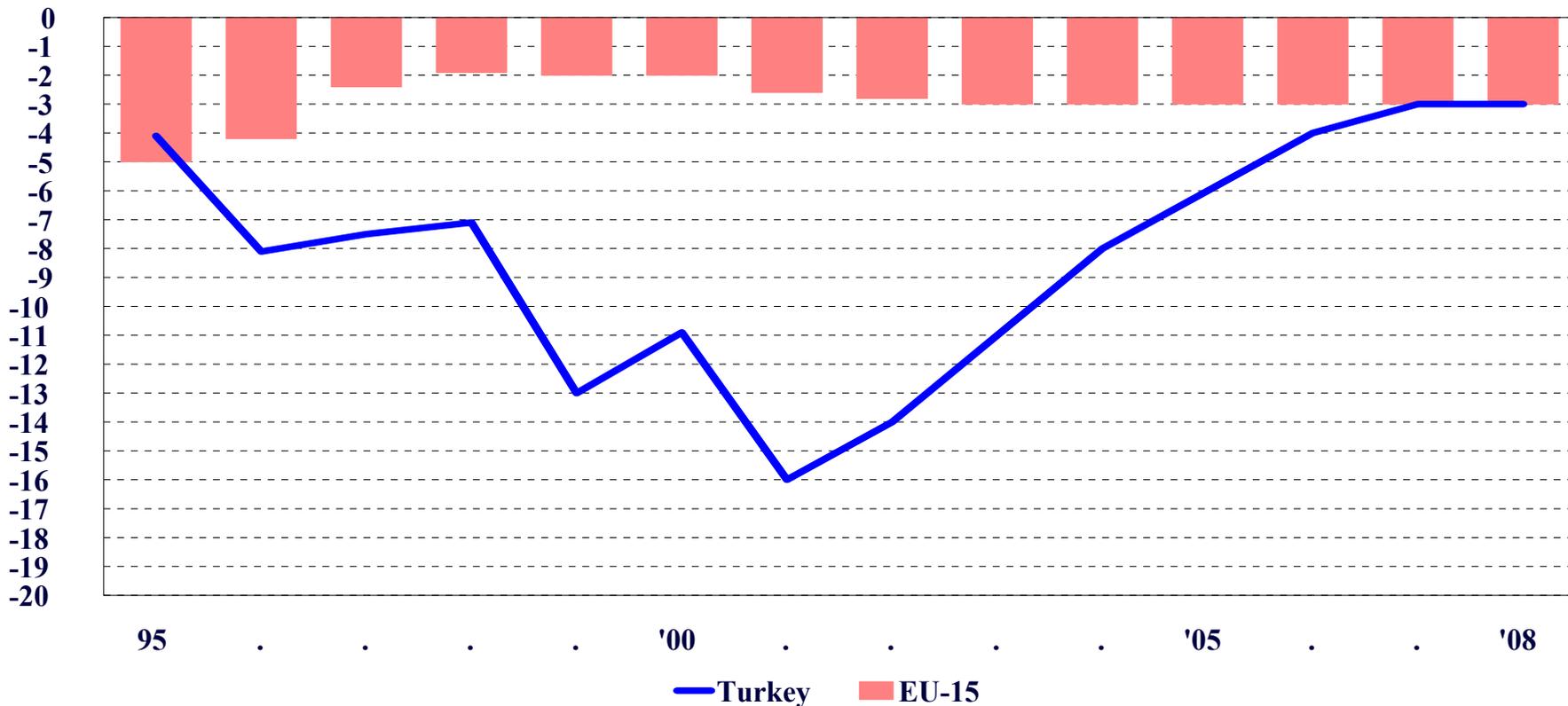
Should current program successfully implemented, macroeconomic aggregates are likely to approach to Maastricht criteria by 2008

Thus, an atmosphere for well functioning of market economy is likely to be further improved.

According to the Government programme public sector deficit targeted to recede to 3% of GDP by 2008

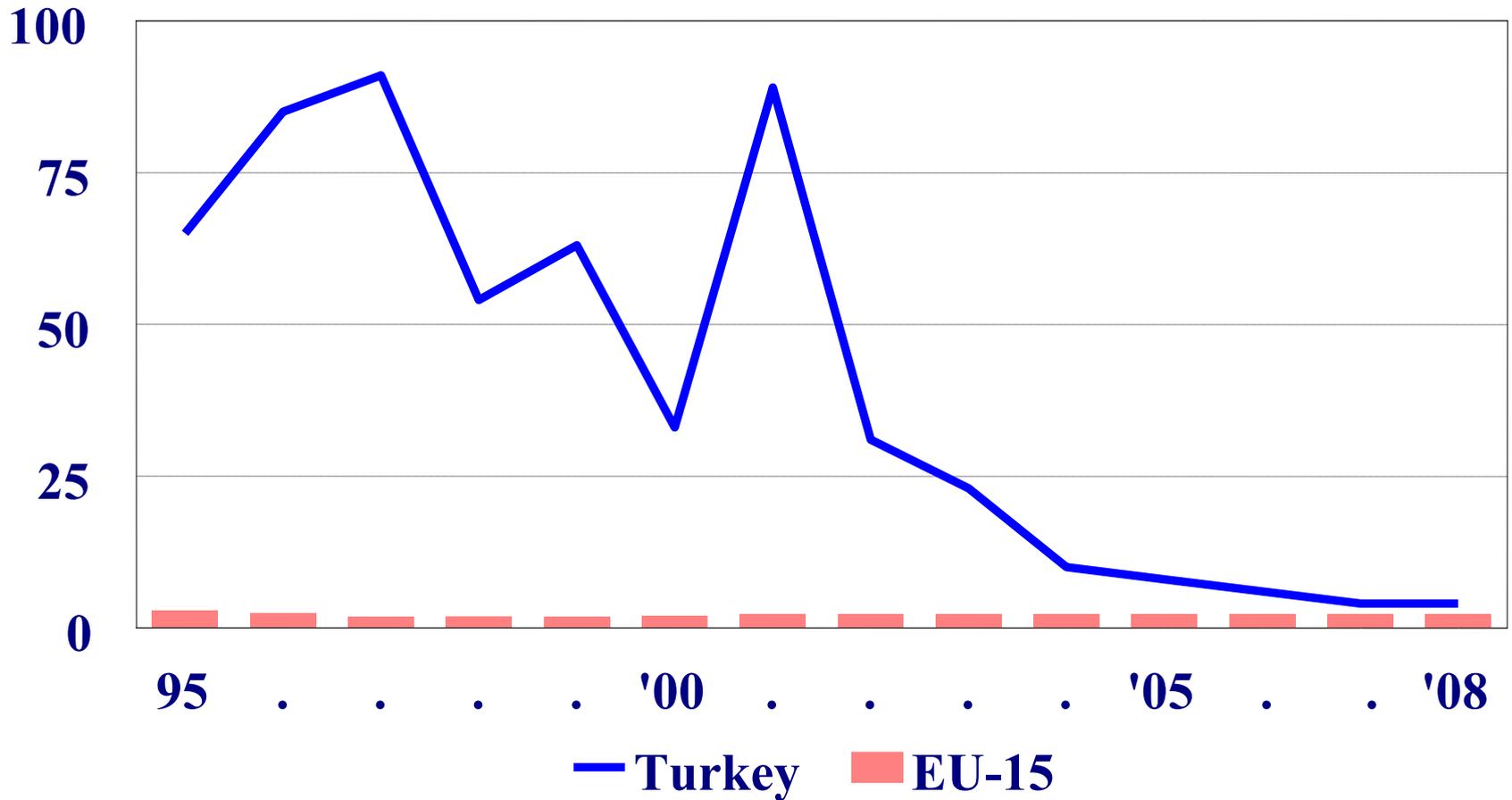
Government deficit

As % of GDP



Inflation is down 4 percent in 2008

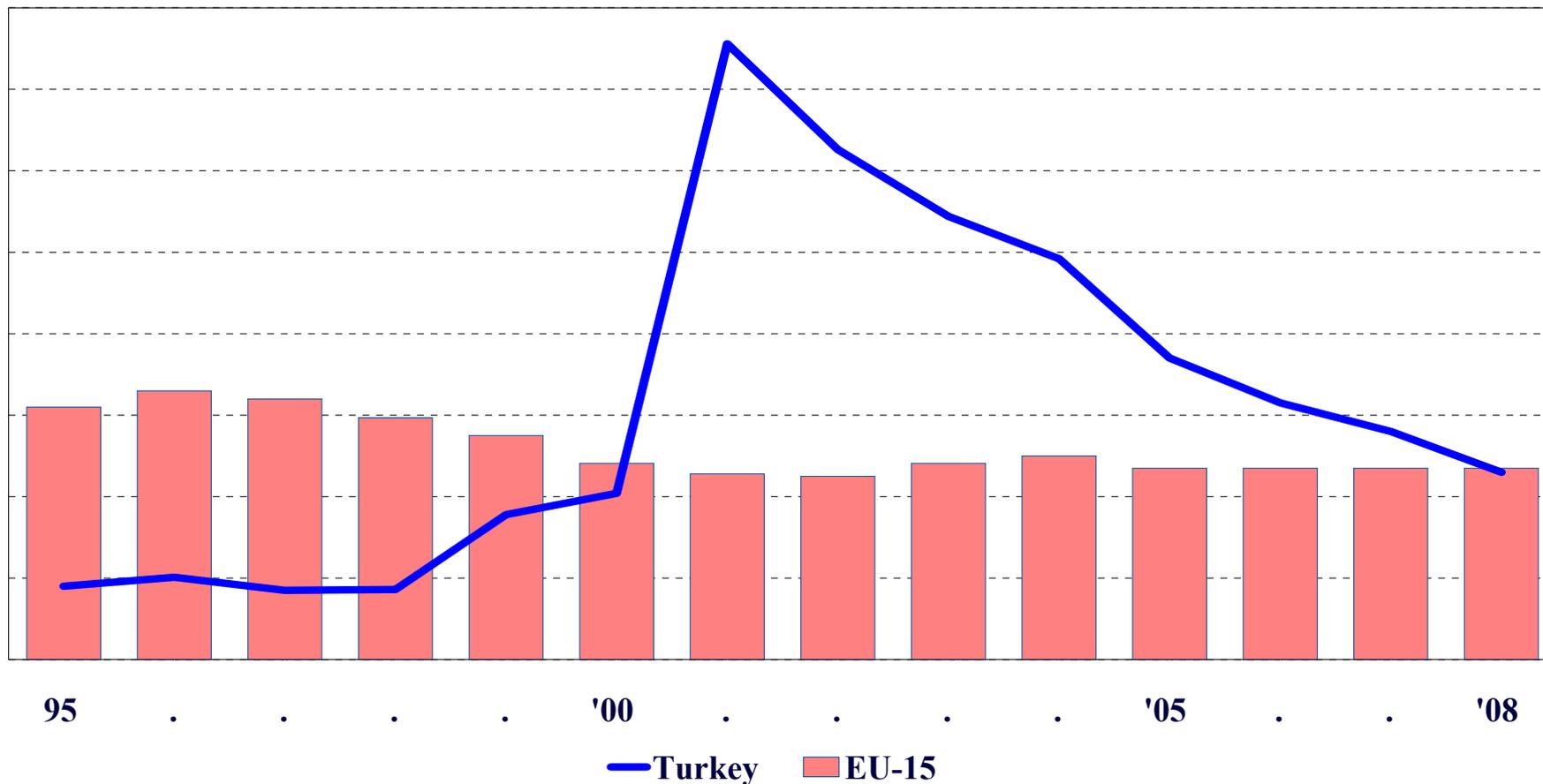
Inflation



Government debt is likely to meet EU level in 2008

Government debt

As % of GDP



Turkish Banking System

As a natural outcome of new transition period, a new era of structural change has emerged in the financial sector. Transition of operational environment as well as regulations related financial institutions towards international standards, capital flows and accelerated entries of foreign banks have stimulated competition in the banking the sector.

Main issues affecting banks

Since 2002, banks have been operating in a considerably less risky atmosphere

Decline in inflation and strong demand for TL stimulated the competition and restructuring the balance sheet

Governments pressures on financial markets lessened

Better expectations and vital activity stimulated consumer business

Foreign investors' interest intensified

Basel II road map was announced

Operational environment

Regulation likely to meet the international standards, notably to EU directives

Banks subject to Banking Act in their universal activities and to Capital Market Act in capital market activities

Banking Regulation and Supervisory Board is an autonomous authority of the banking sector since 2000 and supervision strengthened further.

No discretionary regulation for foreign banks operating in Turkey

Regulatory capital for establishment of a bank is currently about USD 15 million

Financial sector is small and has low degree of deepening

Despite gradual improvement, deposits have very short term maturity

Traditionally banks occupy majority, 95 % of financial sector

Financial services subject to various heavy tax burdens increasing intermediation cost dramatically, although some positive steps taken recently

The share of fx or fx denominated items in the balance sheet still high albeit shrinking recently

High technology utilization on services

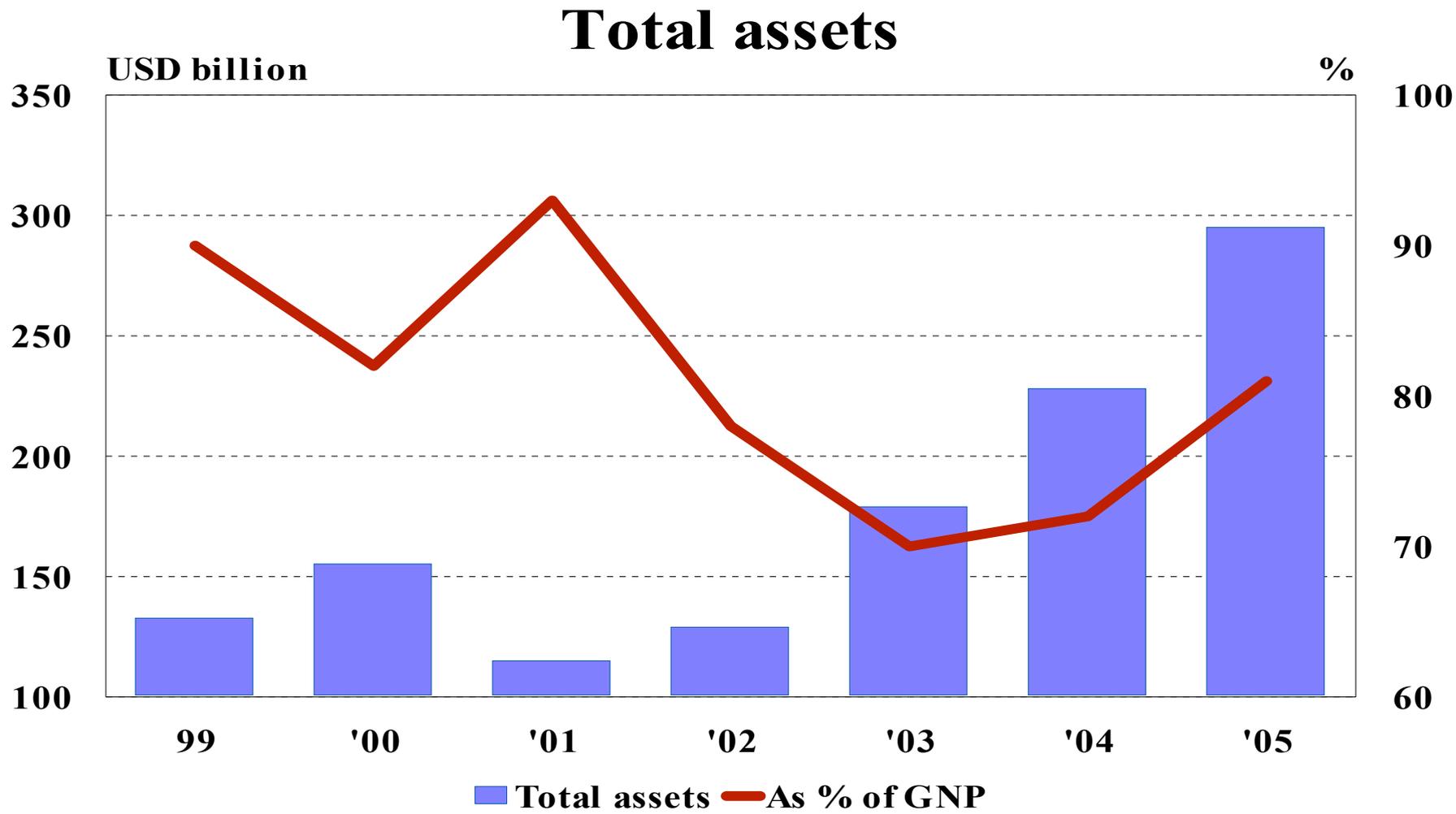
Supervision and Regulation in the Financial Sector

Financial Sector Institutions		Supervisory and Regulatory Authorities
<input type="checkbox"/> Deposit Banks* <input type="checkbox"/> Development and Investment Banks*	→ →	BRSA
<input type="checkbox"/> Participation banks*	→	BRSA
<input type="checkbox"/> Insurance Companies	→	Treasury
<input type="checkbox"/> Leasing Companies	→	BRSA
<input type="checkbox"/> Factoring Companies	→	BRSA
<input type="checkbox"/> Consumer Finance Companies	→	BRSA
<input type="checkbox"/> Investment Trusts	→	CMB
<input type="checkbox"/> Private Pension Funds	→	CMB
<input type="checkbox"/> Intermediary Institutions	→	CMB

Selected Figures of the Financial Sector Institutions in Turkey, 2005

	Number of institutions	Share in total assets (%)
Banks	51	93
Deposit Banks, Dev.and Inv. Banks	47	91
Participation Banks	4	2
Non-bank financial institutions	301	7
Insurance Companies	55	3
Leasing Companies	39	1
Factoring Companies (as of June)	94	1
Consumer Finance Companies	5	1
Intermediary Institutions in Capital Marke	108	1
Total	352	100

Total assets doubled in 2005 compares with 2002; and began to climb as percentage of GNP



As % of GNP loans increased substantially while that of securities declined indicating the success of the restructuring

Selected balance sheet items

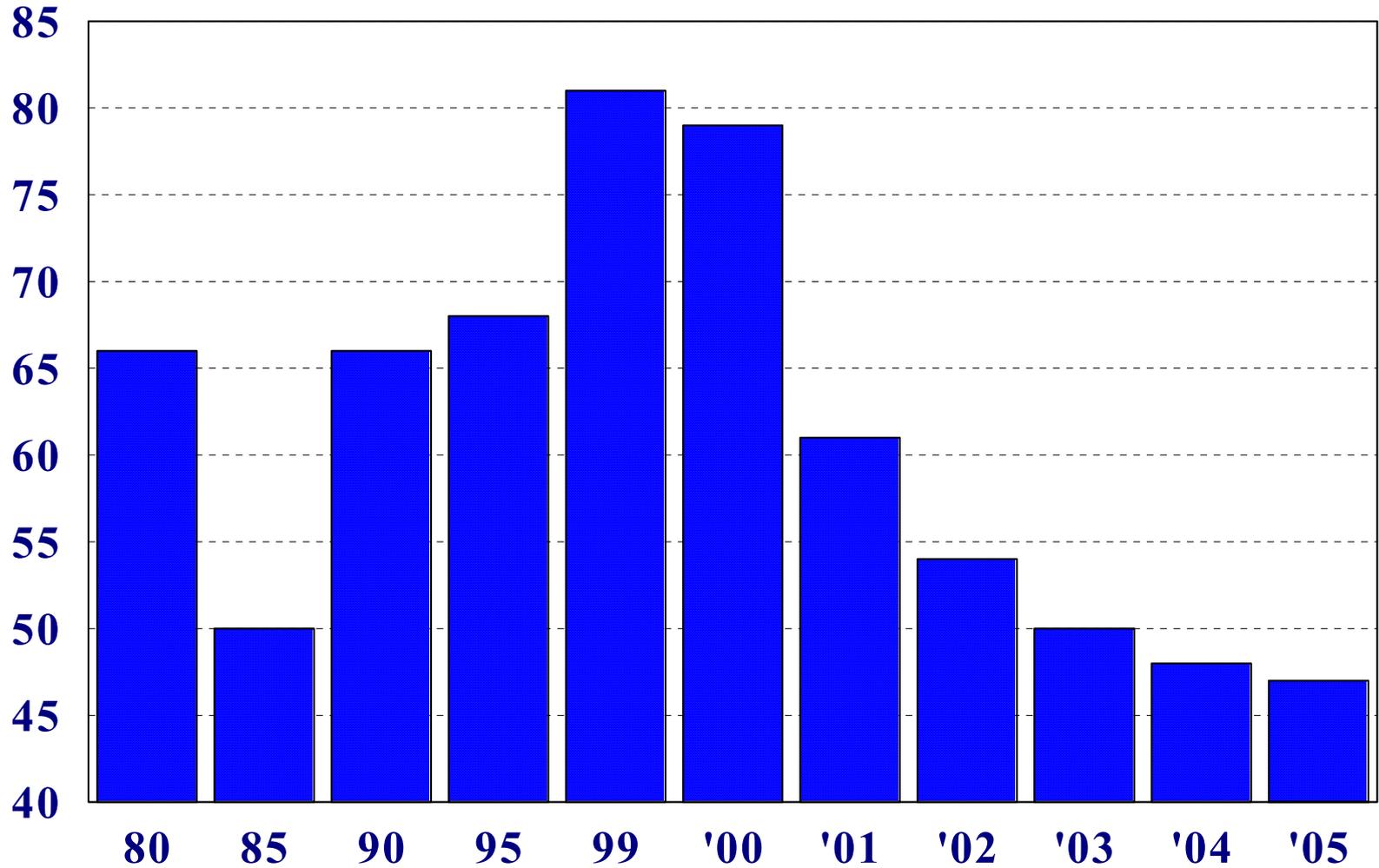
As % of GNP

	2005	2004	2003	2002
Securities	29	29	30	31
Loans	31	23	19	18
Total assets	82	71	70	78
Deposits	50	45	44	50
Funds borrowed	16	12	13	13
Shareholders' equity	11	11	10	9

Turkish bankings system

	Banks	Employment	Branches
Deposit banks	34	127.857	6.228
State-owned	3	38.046	2.035
Private-owned	17	78.806	3.799
Fund	1	395	1
Foreign banks	13	10.610	393
Non-deposit banks	13	4.401	19
Total	47	132.258	6.247

Number of banks operating



Market shares 2005, %

	State	Private	Foreign	Invetst&dev.
Assets	31,8	59,7	5,2	3,2
Loans	21,0	68,2	6,8	4,0
Securities	45,8	49,7	3,1	1,5
Deposits	38,9	57,0	4,1	

Large banks increase their market share

Concentration

	80	90	00	05
First five*				
Asset	63	54	48	63
Deposits	69	59	51	66
Loans	71	57	42	56
First ten*				
Asset	82	75	69	85
Deposits	88	85	72	89
Loans	90	78	71	78

* according to asset size

Assets and liabilities have been reshaped; the share of lending increased

Selected balance sheet items % share

	2005	2002
<u>Assets</u>		
Liquid assets	17	18
Securities	36	40
Loans	38	23
NPLs (net)	0	2
Permanent assets	5	9
Accrued items	3	6
Others	2	2
Total	100	100

The share of deposits came down due to TL appreciation

Selected balance sheet items % share

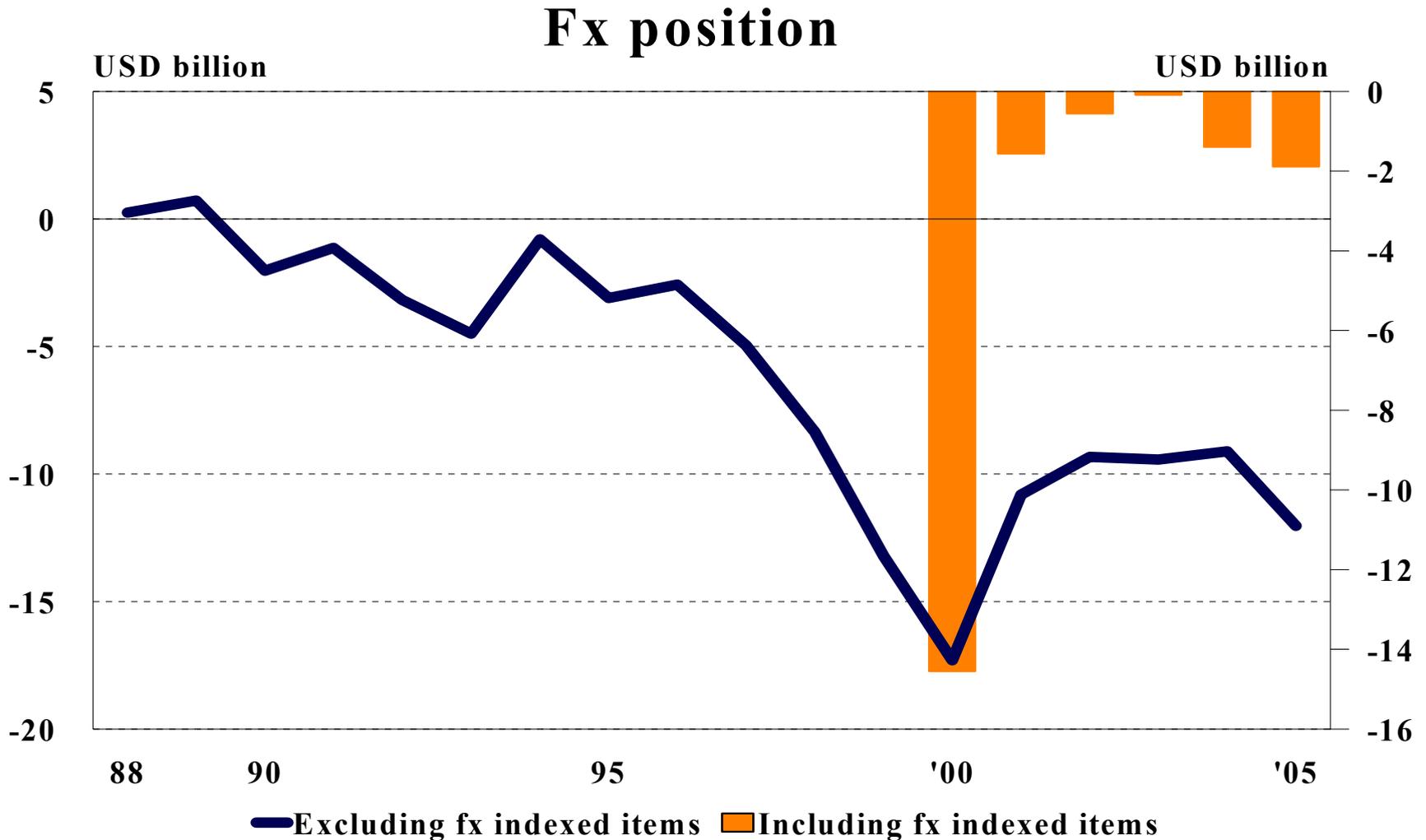
	2005	2002
<u>Liabilities</u>		
Deposits	61	65
Funds borrowed	20	17
Shareholders' equity	14	12
Accrued items	1	1
Others	5	5
Total	100	100

Strong demand for TL

YTL-Fx breakdown of balance sheet %

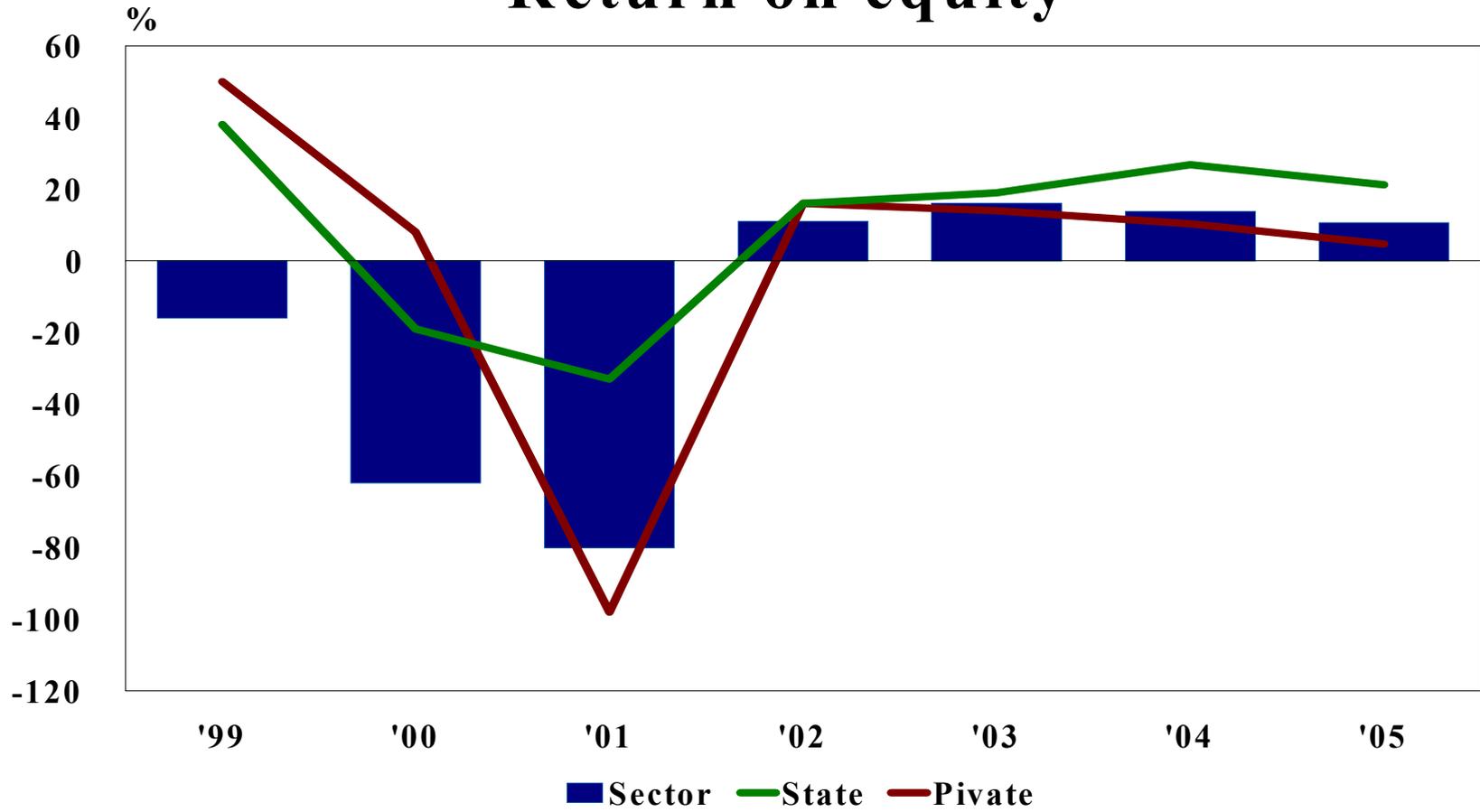
	2005	2004	2003	2002
TL assets in total	68	64	62	57
TL liabilities in total	64	60	57	50
Fx assets in total	32	36	38	43
Fx liabilities in total	36	40	43	50
TL loans in total loans	72	65	55	41
TL deposits in total deposits	64	55	51	43

Fx position lowered due to fx indexed securities of the Treasury



From losses to sustained profitability; likely to encourage investors

Return on equity



2002-04 according to inflation accounting

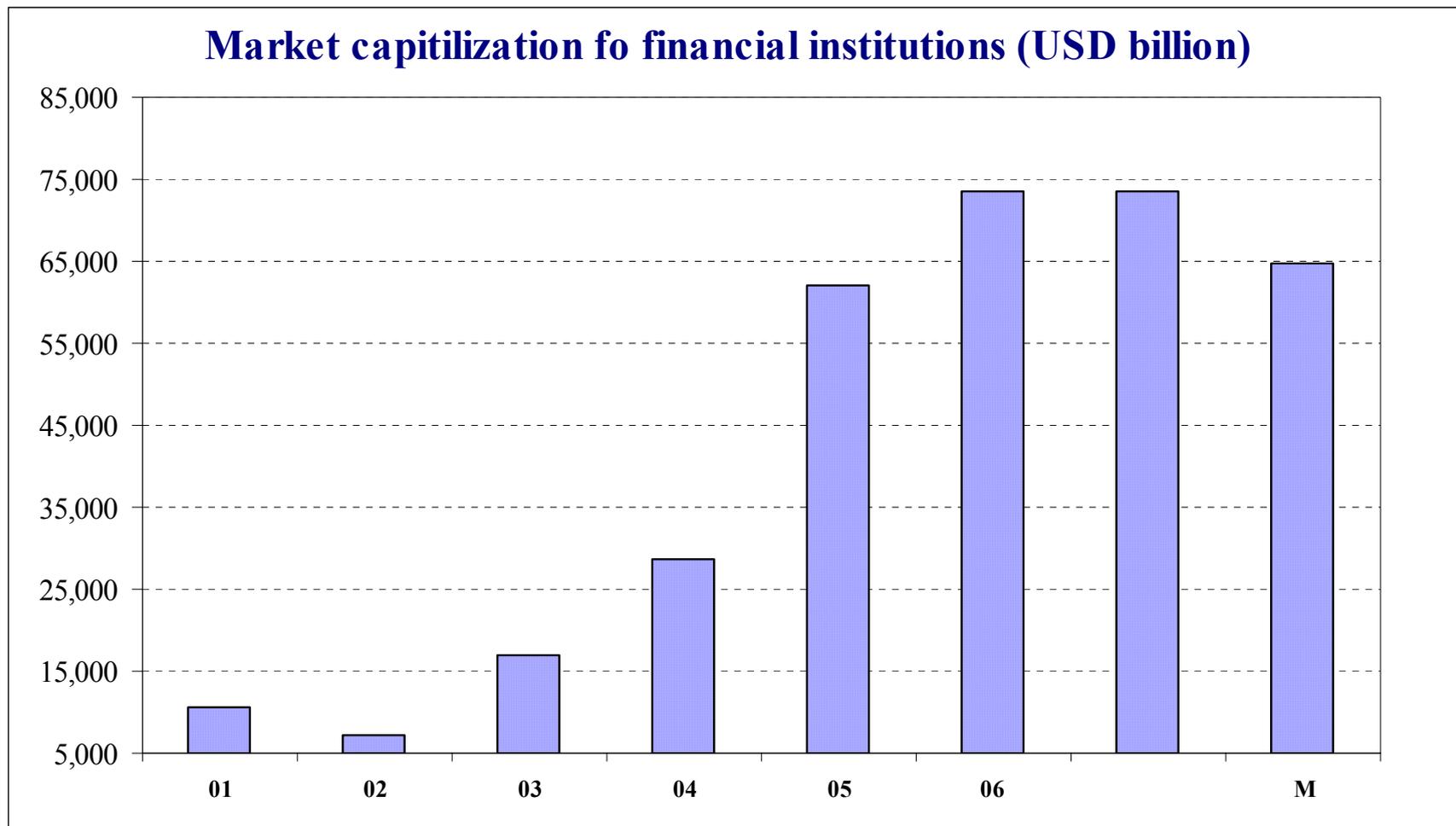
Improved performance

Selected ratios

%

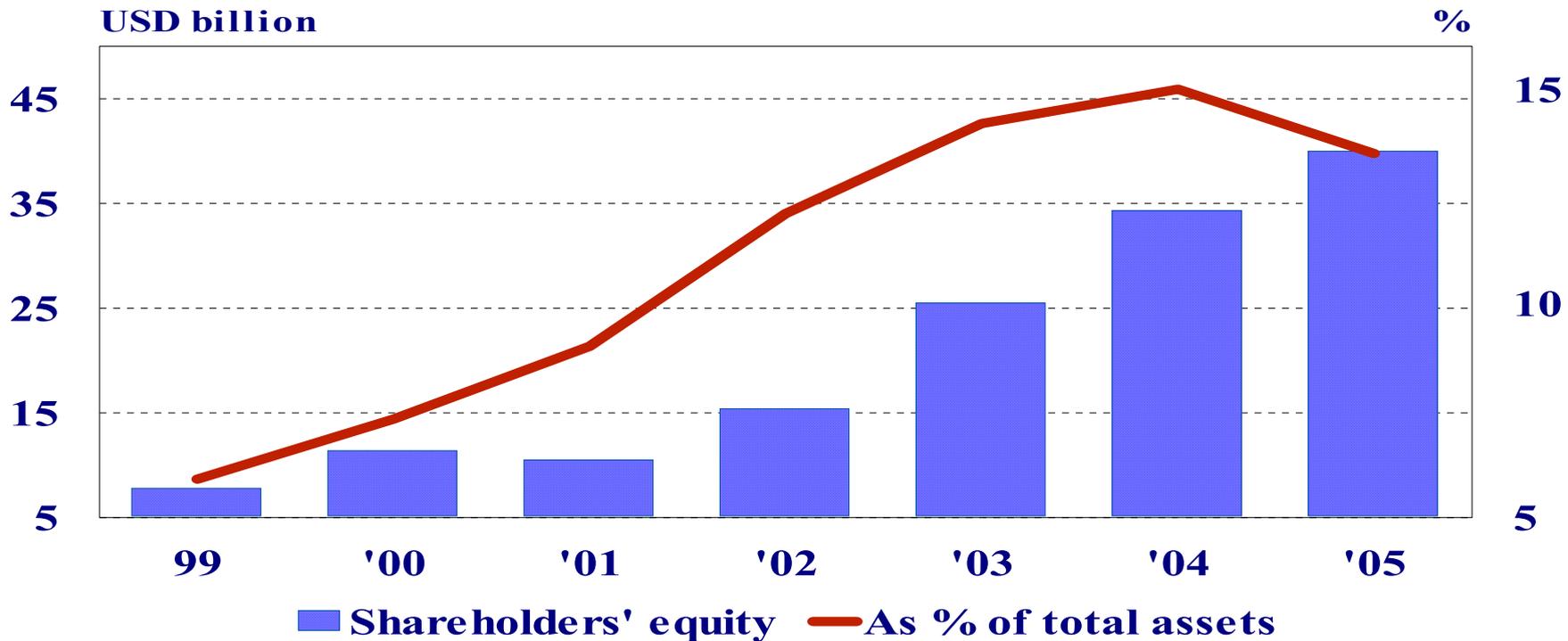
	2005	2004	2003	2002
Shareholders' equity/total assets	13,5	15,0	14,2	12,1
Free capital/total assets	8,2	7,5	6,0	1,7
Liquid assets/total assets	16,5	15,1	15,6	17,9
Loans/total assets	38,0	32,7	26,9	24,8
Securities portfolio/total assets	36,0	40,4	42,8	40,5
NPLs (net)/loans	0,5	0,8	1,5	7,1
NPLs before provisions/loans	5,0	6,4	13,0	21,3
Provisions for NPLs	89,8	88,1	88,5	64,2
Loans/deposits	62,0	52,4	43,3	38,2
Permanent assets/total assets	5,3	7,5	8,2	10,4
Return on equity	10,6	14,0	15,8	11,2
Return on assets	1,4	2,1	2,2	1,4
Net interes margin on assets	4,1	5,3	3,5	4,3

Positive developments in the banking system also positively reacted by the investors



Stronger capital; thanks to the restructuring program, recovery in economic activity and profitability

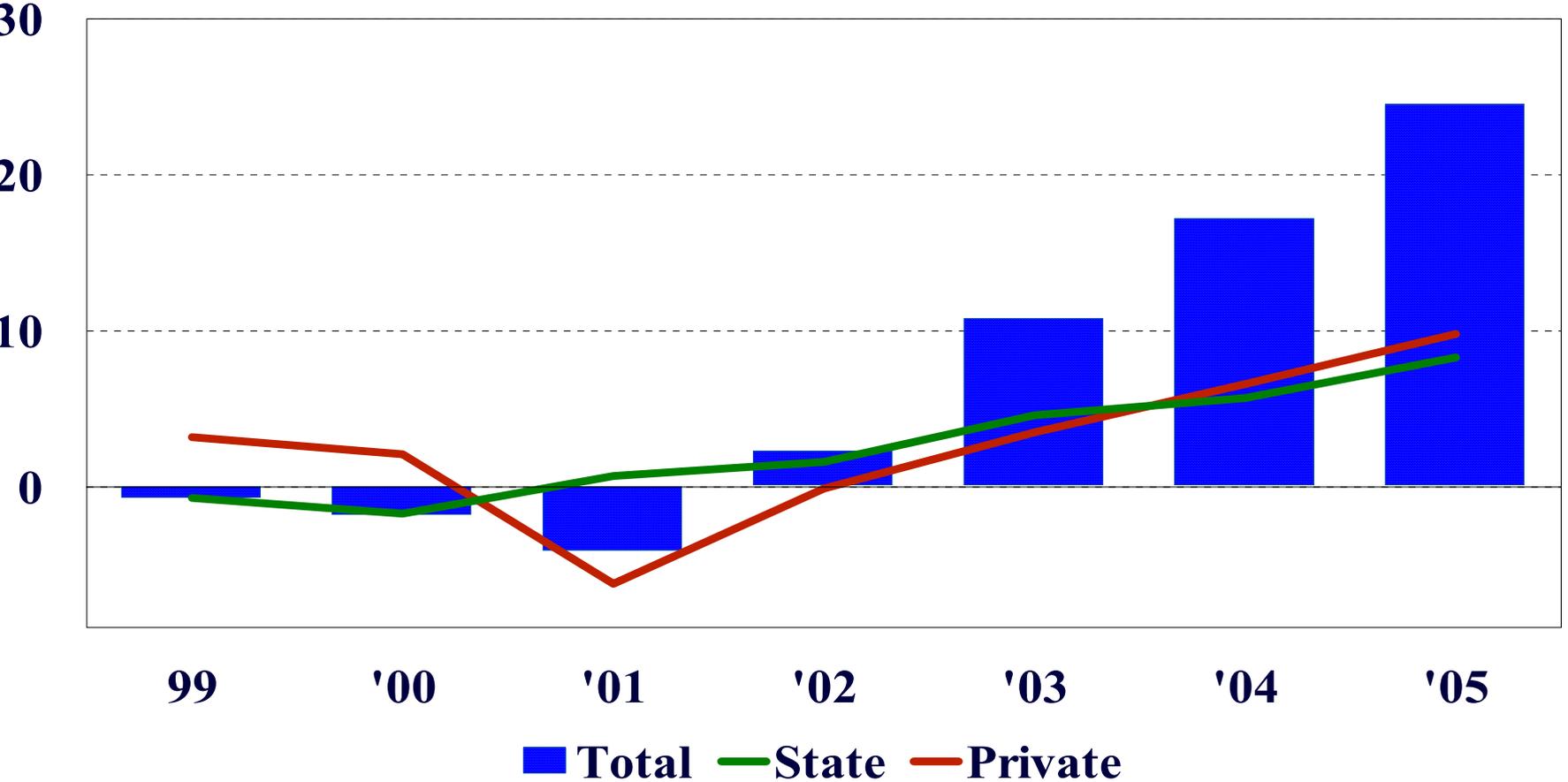
Shareholders' equity



* Including current year income

Free capital*

USD billion

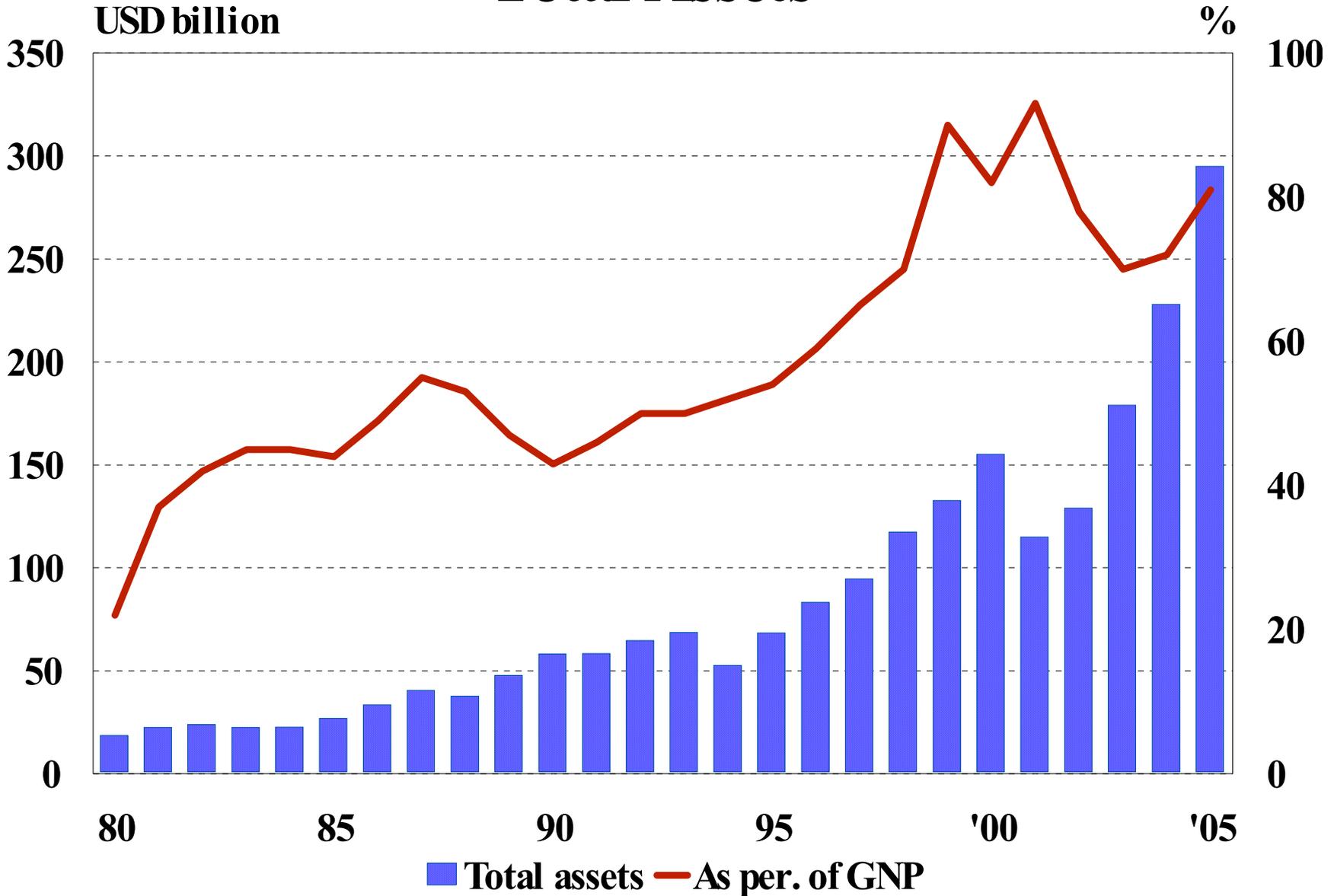


* Sahreholders' equity+current year income-permanent assets-NPLs (net)

Expectations for the near future

- **Larger and deeper financial markets**
- **Lengthening the maturities**
- **Higher lending to private sector**
- **Sufficient earnings to feed capital**
- **Decline in margin with widening business activity**
- **Positive atmosphere for foreign investors**
- **Intense competition on behalf of depositors and borrowers**
- **Improvement in transparency and accounting rules for better financial system**

Total Assets



Selected figures of deposit banks

(for inhabitants)

80 00 05

Number of banks (1000)

1.111 1.105 2.120

Number of branches

7.471 8.636 11.571

Number of employees

356 409 564

Assets (USD)

382 2.196 3.972

Selected figures of deposit banks

(for inhabitants)

80 00 05

Branches per bank

149 128 183

Employment per bank

3.123 2.702 3.761

Assets per bank, USD million

424 2.427 8.419

Selected figures of deposit banks

USD	80	00	05
Shareholders' equity per bank	16	101	1.041
Assets over branch	2.854	18.963	45.962
Assets over employees	136	898	2.239

Selected banking sector indicators

		EU-25 2004	Turkey* 2005
Income per capita	Euro	22.508	4.225
Total assets per capita	Euro	63.027	3.468
Total assets to GDP	%	280	81
Loans to GDP	%	118	32
Housing loans to GDP	%	40	3
Consumer credits to GDP	%	8	6
Loans to deposits	%	123	65
Number of credit institutions	per inhabitants	54.965	1.538.298
Number of branches	per inhabitants	2.306	11.574
Number of employment	per inhabitants	151	547

* Figures for deposit and investment & development banks