Banking System in Turkey [1]
"September 2008"

Developments in the Banking Sector

Executive Summary

The fluctuations in the international financial markets have continued to affect Turkey, as well as other countries. The perception of this effect strengthened as from the last quarter of 2008. Slowdown of the growth rate, limited increase of shareholders' equity, increase in loans under follow-up, lower profits, diminishing return of equity, and decrease in the market value of financial institutions are the most important reflections of the fluctuations in the first nine months of the year.

The maturity of deposits continued to be short. Because of the maturity mismatch of balance sheet, interest risk increased, due to upward trend of interest rates.

The growth rate of the balance sheet of the sector slowed down in the second and third quarter. The amount of loans under follow-up continued to increase though a portion of them were sold to asset management companies. The ratio of provisions to loans deteriorated.

Return on assets and return on equity deteriorated.

In the first half of the year, growth of shareholders' equity slowed down, and this impact was compensated by the increase in paid-in capital and extraordinary reserves. In spite of this development, in the third quarter of the year, shareholders' equity increased and the capital adequacy ratio improved.

Derivative financial instruments increased significantly in the first nine months of the year.

During the first nine months of the year, the balance sheet growth rate was 17 percent as compared to the end of the last year. Total assets of the banking system amounted to TRY 655 billion (USD 532 billion) as of September 2008. The ratio of total assets to gross domestic product (GDP) is estimated 70 percent in the same date.

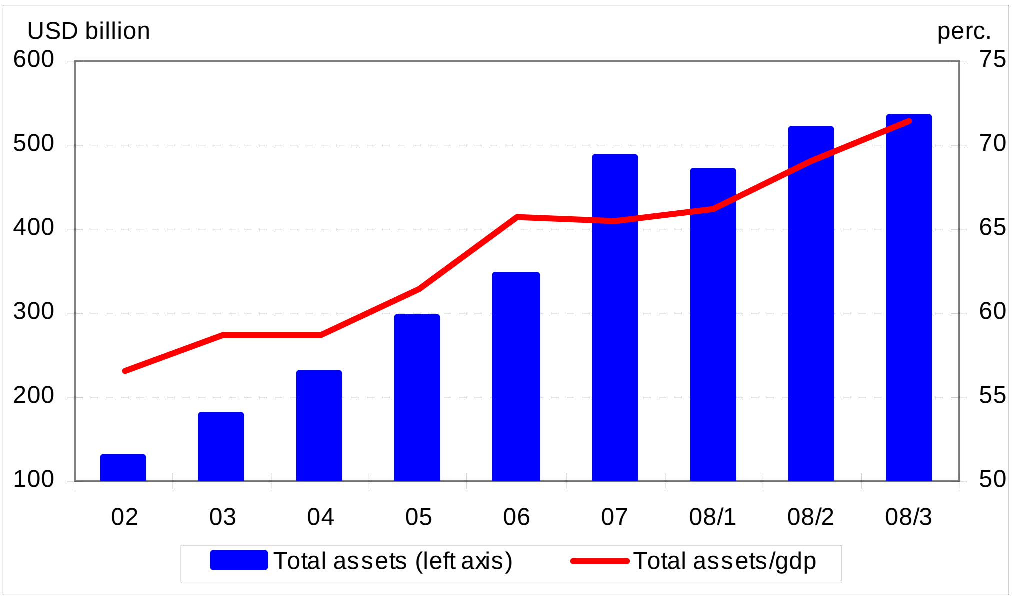
Net foreign exchange position of the banking sector showed a deficit of USD 745 million. The ratio of TRY equivalent of FX assets to total assets decreased by 1 percentage point to 28 percent, while the ratio of TRY equivalent of FX liabilities to total liabilities remained unchanged at 33 percent.

Total assets increased by 17 percent in deposit banks and 13 percent in development and investment banks, as compared to the end of the last year. In the same period, the share of private banks in deposits increased by 1

[1] Deposit banks and development and investment banks are included.

percentage point. The shares of banking groups in assets and loans remained unchanged.

Total Assets and Total Assets to GDP



According to size of assets the share of the largest five banks in assets, loans and deposits remained unchanged. The share of the largest ten banks in assets, deposits and loans increased by 1 percentage point to 86, 90 and 84 percent, respectively.

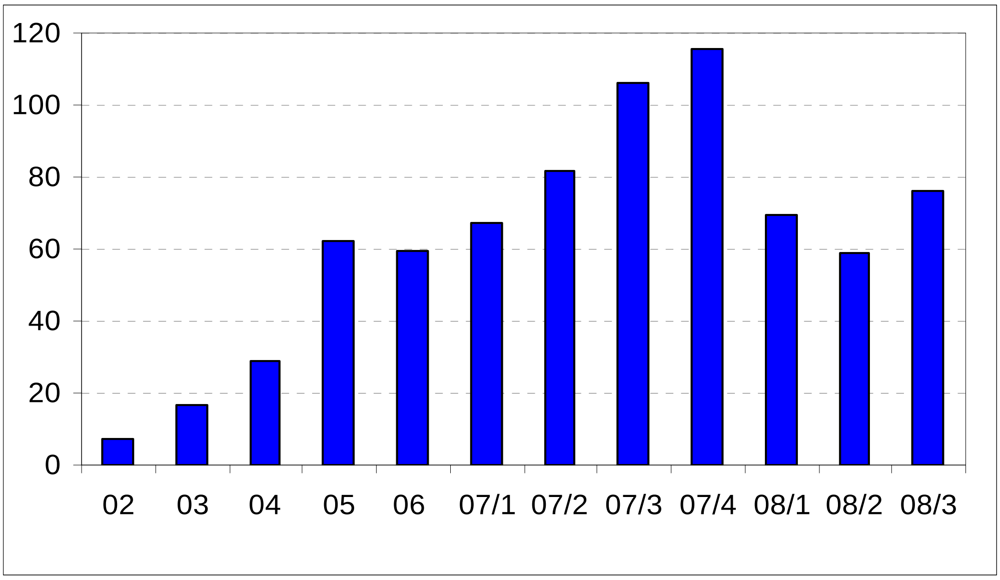
The ratio of loans to total assets reached 54 percent by increasing 4 percentage points as compared to the end of the last year. Loans to deposits ratio was 85 percent by increasing 6 percentage points in the same period. The same ratio was 55 percent in state-owned banks, 92 percent in private banks and 113 percent in foreign banks as of September 2008

Considering maturity 50 percent of total assets and 79 percent of total liabilities had a maturity of less than 1 year. The maturity of liabilities continued to shorten.

The banking sector shareholders' equity increased by 9 percent in comparison to December 2007, and amounted to TRY 79.8 billion (USD 64.8 billion) as of September 2008. Almost all of the increase was realized in the third quarter of 2008. Thus, both the ratio of free shareholders' equity to total assets and the capital adequacy ratio declined due to credit expansion, as compared to December 2007, but increased as compared to June 2008.

Profit volume decreased by 6 percent to TRY 10.7 billion, as compared to the same period of the last year. Interest margin increased, but its positive impact was restricted by the increase in the other operational costs and and decrease in the net trading profit item. On yearly basis, return on equity continued to decrease to 17.1 percent as compared to the end of last year, and return on assets decreased from 2.6 percent to 2.1 percent.

Market Value of Financial Institutions Traded in ISE (USD billion)



Total market value of financial institutions declined from USD 115 billion as of the end of 2007 to USD 76 billion as of September 2008.

Off balance sheet items rose especially due to the growth in derivative financial instruments.

The number of banks operating in Turkey remained the same at 46 compared to June 2008, whereas the number of branches increased by 370 to 8,544 in the same period. Thus, the number of branches reached its highest level and registered a record in the history of the banking sector.

The Effect of Fluctuations in the International Financial Markets to Banking System[2]

The immediate effects of the global issues on the world and Turkish financial system were, increase in the cost of financing, liquidity squeeze and the contraction of the financial sector. In line with this, the banking sector in Turkey was negatively affected by developments like, the increase in the interest rates, depreciation of the national currency against the foreign currencies, contraction in the fund sources and the shortening of the maturities of the available sources.

In the second phase, the problems are likely to affect the non-financial sector and economic activity is expected to further slow down, which may lead to increase the credit risk of the financial sector. Especially in countries where the indebtedness of the households and the non-financial sector are high, the degree of this effect should be expected to be higher.

[2] Partipication banks are included.

Selected TRY Items (TRY million)

	03.10.08	26.11.08	change	perc. change.
Securities*	180,012	195,013	15,001	8.3
TRY loans	274,479	267,549	-6,930	-2.5
TRY deposits	285,012	302,015	17,003	6.0
Repos	44,810	36,611	-8,199	-18.3
Repos+deposits	329,822	338,625	8,803	2.7

Source: BRSA

* Both TRY and Fx items.

The global crisis was added on Turkey's agenda especially after the Ramadan Holiday. Hence to differentiate the effects of the crisis, the latest figures should better be compared with the figures of October 3, 2008.

In the two months period between October 3, 2008 – November 26, 2008 TRY deposits of the banking sector increased by TRY 17 billion while the repos decreased by TRY 8.2 billion. Hence with respect to these two items, while the TRY liabilities increased by TL 8.8 billion, TRY loans decreased by TRY 6.9 billion. During the mentioned period, securities portfolio which is mainly composed of TRY items, increased by TRY 15 billion.

Selected Fx Items (TRY million)

	03.10.08	26.11.08	change	perc. change.
FX loans	71,268	69,133	-2,135	-3.0
FX deposits	109,075	98,111	-10,964	-10.1
Banks from abroad	55,640	54,293	-1,347	-2.4
Banks from abroad+deposits	164,715	152,404	-12,311	-7.5

Source: BRSA

On the Fx side, Fx deposits and banks from abroad items decreased USD 11 billion and USD 1.3 billion, respectively. Hence with respect to these two items, while the Fx liabilities decreased by USD 12.3 billion, Fx loans decreased only by USD 2.1 billion.

The liabilities of the sector deteriorated in real terms and this was reflected in the assets and the distribution of assets. When the uses and sources both in TRY and Fx terms are considered together, it's seen that the banking sector did not reflect its resource losses to assets completely, continues to fund the real sector and increased its public funding. During this period, the securities portfolio of the foreign citizens decreased by TRY 6.6 billion to TRY 21.6 billion.

As of November 26, 2008, the ratio of loans to deposits, repos and banks from abroad decreased to 76 percent from 78 percent in October 3, 2008.

Selected Ratios (percentage)

	03.10.08	26.11.08	change
TRY loans /TRY deposits	86	79	-7
TRY loans/TRY deposits+repos	83	79	-4
Fx loans/Fx deposits	65	70	5
Fx loans/banks from abroad+Fx dep.	43	45	2
Total loans/T.dep.+repos+bank from abroad.	78	76	2

Source: BRSA

Consequently, the balance sheet of the sector contracted in real terms due to decline in the funds provided from abroad. To restrict the effects of this contraction on the non-financial sector, banks reduced their liquid assets. At this point the credit risks gained utmost importance. When the Fx loans are considered, depreciation of TRY against other currencies and higher risks stemming from credit portfolio and securities portfolio.