Turkey: Quarterly Banking & Financial Stability Monitor

March 2018

Deniz Ergun
Key messages

1. Since 3Q 2017, credit growth converged to its historical average and stabilized at these levels as a result of the expected normalization

2. The increase in FX deposits and the acceleration in TL loans urged banks to find additional TL funding causing a further increase in interest rates

3. The banking sector preserves its strong liquidity position against possible shocks with high Liquidity Coverage Ratios

4. The asset quality of the banking sector remains strong. With the push of the credit channel and the pick up in economic activity, the decreasing amount of additions to NPLs and write-offs as well as the restructuring processes contributed to the preservation of asset quality
Global

Improved Bank Lending Conditions in EMs
Bank lending conditions in EMs eased for two consecutive quarters in 4Q`17 and are expected to ease further in 1Q`18. Upward trend in demand for loans suggests a recovery in global trade and economic activity.

Source: IIF, Garanti Research
In 1Q18, local funding conditions are expected to improve somewhat where funding from international markets is expected to remain unchanged.

**EM Banks International Funding Conditions**

- **Levels**
- Easing Area
- Tightening Area

**EM Banks Domestic Funding Conditions**

- **Levels**
- Easing Area
- Tightening Area

Source: IIF, Garanti Research
Global debt/GDP ratio in 3Q’17 declined for a fourth consecutive quarter as synchronized global growth boosted the denominator. The biggest build-up in EMs is in non-fin. corporates, though with some decline in the latest data.
International debt securities issuance by developing countries declined by almost 26% in 3Q’17 compared to the previous quarter

**International Debt Securities Issued**  
(Net Issuance, USD bln)

**International Debt Securities Issued by EMs**  
(Net Issuance, USD bln)

Source: BIS, Garanti Research
Rollover risk for EMs is high in 2018: USD 1.5 trillion of bonds & syndicated loans come due through end-2018

Source: IIF, Garanti Research
In loans borrowers’ profile, non-bank borrowers in Turkey seem to somewhat switch to Euro based credits.

According to the BIS definition, non-bank borrowers refer to all entities other than those defined as banks. Total credit by currency of denomination is composed of credit extended by all (foreign and domestic) lenders. Specifically, it is composed of loans extended by banks and purchases of debt securities by both banks and non-banks (as proxied by issues of debt securities).

Source: BIS, Garanti Research
Turkey: Monetary Policy and Interest Rates

Tight Monetary Policy Stance, Contained Monetary Transmission
The CBRT maintains the tight policy stance by utilizing only Late Liquidity Window (LLW) interest rate. The average funding rate increased to 12.75% by around 450bps during 2017.

**TURKEY: Interest Rate Corridor (%)**

**TURKEY: CBT Funding Composition (Bln TRY)**

Source: CBT, Garanti Research
Consumer interest rates increased more than commercial rates contributing to widening spreads, though the transmission mechanism remained contained on high loan growth rates due to the CGF in 2017.

**Interest rates**

(4 week mov.avg.)

- Commercial Loans
- Consumer Loans
- CBRT Average Funding Rate

**Interest Rate Spreads**

(4 week mov.avg.)

- Commercial Loan* - Deposit Rate
- Consumer Loan - Deposit

Source: Garanti Research, CBRT
Interest rates spread between USD and TL deposits continues to widen since 2017 with increasing TL rates.

**Spread btw TL and USD Deposit Rates (%)**

- Feb-06: 16
- Feb-07: 14
- Feb-08: 12
- Feb-09: 10
- Feb-10: 8
- Feb-11: 6
- Feb-12: 4
- Feb-13: 2
- Feb-14: 0
- Feb-15: 2
- Feb-16: 4
- Feb-17: 6
- Feb-18: 8

**Deposit Interest Rates in TL & EUR & USD (% 4 week mov.avg.)**

- TL: 12%
- EUR: 8%
- USD: 6%
- CBT avg. funding rate: 4%

Source: Garanti Research, CBRT
Turkish Banking Sector: Credit Developments

Normalization in Credits
Decline in NPLs
Supportive fiscal and macroprudential policies assisted credit growth through both supply and demand channels in 2017. As of 1Q’18, with the waning impact of these incentives, loan growth slowed and converged to its historical average.

Credit Growth
(Fx adj. Yoy and 13-week annualized)

- From 3Q 2016 until 3Q 2017, credit volume has increased significantly owing to the macro-prudential policies, domestic public measures and incentives, and the CGF credit support, both in commercial and consumer loans.

- Since 3Q 2017, credit growth converged down to its historical average.

- As of end of Feb’17 annual credit growth stands at 19.4%

Source: BRSA, CBT and Garanti Research
Corporate loan growth rates accelerated throughout 1H’17, mainly thanks to Treasury-backed CGF scheme. Since 2H’17, it converges to its historical averages as the loan issuance reaches the upper limit of the CGF scheme.

Source: BRSA, CBT and Garanti Research
TL commercial loans grew across all firm sizes. Contrary to TL loans, firms decreased their FX loan utilization in all segments in spite of higher TL loan interest rates and lower domestic FX loan rates*

TL Commercial Loans Growth Rate

FX Commercial Loans Growth Rate

*Due to data restriction, FX indexed credits are included in TL loans.

Source: Garanti Research, BRSA
Real sector’s credit demand targeted debt restructuring purposes

CBRT Bank Loans Tendency Survey Financing Needs of the Real Sector

Source: Garanti Research, CBT, IMF
Credit growth rate is higher in public banks thanks to the incentives provided to public banks

**Commercial Credits by Public & Private Banks**

<table>
<thead>
<tr>
<th></th>
<th>Feb-16</th>
<th>Apr-16</th>
<th>Jun-16</th>
<th>Aug-16</th>
<th>Oct-16</th>
<th>Dec-16</th>
<th>Feb-17</th>
<th>Apr-17</th>
<th>Jun-17</th>
<th>Aug-17</th>
<th>Oct-17</th>
<th>Dec-17</th>
<th>Feb-18</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public</td>
<td>17.5%</td>
<td>9.9%</td>
<td>4.0%</td>
<td>3.1%</td>
<td>3.1%</td>
<td>3.5%</td>
<td>4.0%</td>
<td>4.5%</td>
<td>4.6%</td>
<td>4.5%</td>
<td>3.7%</td>
<td>3.1%</td>
<td></td>
</tr>
<tr>
<td>Private</td>
<td>14.1%</td>
<td>9.9%</td>
<td>4.0%</td>
<td>3.1%</td>
<td>3.1%</td>
<td>3.5%</td>
<td>4.0%</td>
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<td>4.5%</td>
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<td>3.1%</td>
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</tbody>
</table>

**Consumer Credits by Public & Private Banks**

<table>
<thead>
<tr>
<th></th>
<th>Feb-16</th>
<th>Apr-16</th>
<th>Jun-16</th>
<th>Aug-16</th>
<th>Oct-16</th>
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<td>3.7%</td>
<td>3.1%</td>
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</tbody>
</table>

Source: Garanti Research, BRSA
Consumer credits follow a slower path in 1Q’18 with general purpose loans standing as the fastest growing loan type. Weak auto sales is followed by weak auto credits.

Source: Garanti Research, Turkstat, CBRT
Housing credits stood as the fastest growing consumer loan type in 1H2017*. In the first 2 months of 2018, with increasing housing loan interest rates, both house sales and housing credits decelerated sharply.

* This development is also related to the fact that the maximum loan-to-value ratio limit applied to housing loans were increased from 75% to 80% in September 2016. 
Source: Garanti Research, Turkstat, CBRT
Thanks to the CGF and high momentum in economic activity, NPL additions and write-offs have declined and the collections within the period have increased.

NPL Ratio of the Banking Sector

- NPL Ratio (%)
- NPL Growth YoY - rhs

NPL Ratio (adj.for NPL sales)

- Sector NPL Ratio with Write-Off
- Sector NPL Ratio without Write-Off

Source: Garanti Research, BRSA, Public Disclosure Platform KAP 4q’17

*Peer 1 banks.
NPL ratio of the sector fell below 3% as a result of the acceleration in credit growth, restructuring opportunities and NPL sales to asset management companies.

Source: BRSA, Garanti Research
Restructuring opportunities for existing loans supported debt service capacities have been effective on the falling NPL ratios. Group 2 Loans (Loans under Close Watch) have increased by 73bps in 4Q’17 compared to 4Q’16.

**Group 2 Loans to Gross Loans***

<table>
<thead>
<tr>
<th></th>
<th>4Q’14</th>
<th>1Q’16</th>
<th>3Q’16</th>
<th>4Q’16</th>
<th>4Q’17</th>
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<tr>
<td><strong>%</strong></td>
<td>2.7</td>
<td>3.0</td>
<td>3.5</td>
<td>4.0</td>
<td>4.5</td>
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**Restructured Performing Loans to Gross Loans***

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<thead>
<tr>
<th></th>
<th>4Q’14</th>
<th>1Q’16</th>
<th>3Q’16</th>
<th>4Q’16</th>
<th>4Q’17</th>
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<tbody>
<tr>
<td><strong>%</strong></td>
<td>1.0</td>
<td>2.0</td>
<td>3.0</td>
<td>3.5</td>
<td>4.0</td>
</tr>
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</table>

*Peer 1 group of banks

Source: Public Disclosure Platform KAP 4q’17, Garanti Research
Turkish Banking Sector: Liquidity
Depositors stronger preference for USD throughout 2H’17 continues at the start of the year

Deposit growth rate (YoY)

<table>
<thead>
<tr>
<th>Month</th>
<th>TP</th>
<th>FX (in $)</th>
<th>Total</th>
<th>Total FX adj.</th>
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<tbody>
<tr>
<td>May-16</td>
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<td>Aug-16</td>
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<td>Nov-16</td>
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<td>Feb-17</td>
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</tbody>
</table>

FX Deposits and USDTRY (Level)

Source: Garanti Research, BRSA, Bloomberg
Depositors’ FX deposit preferences and the higher demand for TL loans led to a widening in the gap between TL and FX LTD ratios. Liquidity Coverage Ratio of the banking sector is well above the minimum legal ratio.

**Loan/Deposit Ratio (LTD) (%)**

Source: Garanti Research, BRSA, Public Disclosure Platform KAP 4q’17

**Liquidity Coverage Ratio (LCR)* (%) 4 week mov.avg.**

*The average of last three months’ liquidity coverage ratio for Peer 1 banks.*
Turkish Banking Sector: Asset Quality

Sizable Increase in Profit
Asset Quality Improved
Net profit of banking sector reached almost TL50 bn (12 month cumulative) in Dec’17 indicating 60% YoY growth compared to the previous year.

Banking Sector Net Profit
(bn TL)

Net Interest Margin (NIM) & ROE Banking Sector
(%)
The growth in total credit risk slowed down thanks to the decrease in risk weight of some assets and loans given under the CGF guarantee. Hence, the sector's capital adequacy ratios continued their upward trend.

Capital Adequacy Ratio & CET 1 & Tier 1 Ratio

EM CAR & Tier 1 Ratio

*Banks have to maintain additional capital conservation buffer of +0.625% CET1 for 2016; phased-in to reach +2.5% CET1 until 2019. Besides, banks that are determined as domestically systemic important (D-Sib) are required to add a certain additional amount of capital. This is max.+0.5%CET1 for 2016; phased-in to reach max.+2%CET1 until 2019.

Source: IMF FSI latest data 3q’17&Dec’17, Garanti Research, BRSA
External Debt Indicators

Roll-over Ratios Stand above 100%, New Regulation on Corporates’ FX loans
The whole picture of External Debt: mostly borrowed by banks & corporates, in hands of private creditors (loans) and denominated in USD

External Debt
(Details as % of GDP, $bn, 3Q 2017)

by borrower

- Private Credit. 31% 267$bn
- Bonds 13% 114$bn
- Loans 20% 20$bn
- Public Sector 11% 93$bn
- Non-banking inst. 2.3% 152$bn
- Corp. 17.8% 172$bn

by lender

- TRY 3% 26$bn
- USD 30% 257$bn
- Euro 16.4% 140$bn
- Official 7% 57$bn
- Other 0.5% 5$bn
- JPY 1.1% 9$bn

by currency

- Short Term 13.0% 110$bn
- Long Term 38.2% 328$bn
- Bonds 13% 114$bn
- TRY 3% 26$bn
- USD 30% 257$bn
- Official 7% 57$bn
- Euro 16.4% 140$bn
- Other 0.5% 5$bn
- JPY 1.1% 9$bn

by maturity

- Maturing within 1 year 170$bn
- Long Term 38.2% 328$bn
- Bonds 13% 114$bn
- TRY 3% 26$bn
- USD 30% 257$bn
- Official 7% 57$bn
- Euro 16.4% 140$bn
- Other 0.5% 5$bn
- JPY 1.1% 9$bn

Source: Garanti Research, CBT, BRSA
LT external debt roll-over ratios of both banks and real sector are normalizing with banks at 102% and real sector at 112% by end 2017. There has been a moderate increase in the external debt of the banks.

LT External Debt Roll-over Ratio of Banks & Real Sector
(12 month rolling, %)

Banks’ External Liabilities
(yoy %)

Source: Garanti Research, CBT, BRSA
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Open FX position of corporates declined in Dec'17 thanks to increased FX deposits and decreased FX lending from both domestic and foreign banks.

Corporate Sector Open FX Position (USD bln)

Corporate Short Term FX Position (%)
New regulation: a further step to limit risks on financial stability with some limits for FX borrowing of the corporates

Companies with FX debt exposure under $15mn

No Mismatch (FX Revenues): foreign exchange income of the previous three years will be the total available limit

Mismatch (No FX Revenues): cannot roll-over, redeem the debt at the maturity of the liability

Companies with FX debt exposure above $15mn

No restriction even if the company has no FX revenues; the Government now works in some hedging options

Exceptions

Public institutions, banks, leasing companies, factoring and financing companies, lenders under investment incentive, investors in machinery, public-private partnership firms
Despite the higher volatility in gross reserves, CBRT’s net reserves recovered only marginally during 2017. Increasing trend in external debt keeps risks alive.

### Central Bank Reserves
(USD bln)

### CBRT Gross Reserves / External Debt to be paid within one year
(%)
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