

I. Overview

Rising recession expectations in advanced economies result in a sluggishness in global economic activity. There are discrepancies among countries in frameworks and communications in monetary policies due to differences in economic growth and inflation outlooks. The volatility in long-term bond yields of advanced economies and the increase in their funding costs keep risks on portfolio inflows alive in emerging market economies.

Household indebtedness, which is considerably lower in Türkiye compared to its peers, has been on a steady decline for the last 10 quarters. In addition to the impact of low household indebtedness on reducing financial risks, the fact that the debts of fixed-income earners account for the largest share of household indebtedness further strengthens the indicators regarding debt-service performance of households. While there is a strong upward trend in household financial assets, a reflection of the Central Bank's liraization strategy, the share of TL denominated assets increases, too. The share of TL deposits in the financial system increases owing to the policies encouraging a shift towards TL denominated household financial assets; on the other hand, there is a low appetite for FX deposits as a result of alternative instruments and dynamics evolving in favor of TL for domestic capital markets. The households' increasing interest in financial assets other than deposits is considered a positive development in terms of achieving a broader base for alternative financial instruments.

The corporate sector's financial assets have been on a stronger growth path compared to liabilities, and its liquidity, profitability and debt payment indicators remain favorable. Exchange rate and commodity price developments, as well as inflationary pressures, have increased the working capital needs and financial liabilities of corporates. Their assets, on the other hand, have been bolstered by increased turnover and profitability amid buoyant economic activity. Corporate sector firms continue to reduce their FX debts, while the exchange rate risk outlook continues to improve. Meanwhile, corporates' access to funds from abroad and external debt rollover ratios remain high. The profitability in corporate sector has been rising on the back of robust economic activity, exports and inventory revaluations. The improvement in the solvency and liquidity indicators for the corporate sector continues. With the contribution of macroprudential measures, the loan share of those manufacturing sector firms that account for a higher ratio in exports and investments continues to rise.

While TL commercial loans are the main driver of total loans, the acceleration in loan growth has been curbed since the macroprudential measures taken in April 2022 and onwards. The demand for TL corporate loans remains strong due to firms' increased need for working capital and stock financing caused by rising commodity prices, but the growth of SME, export and investment loans, along with an increase in their share in total loans, diverge favorably thanks to macroprudential policies. This development contributes to increasing the share of sustainable components in the growth composition, strengthening employment and narrowing the structural current account deficit. While it is of great importance that loans feed into economic activity in a way that supports investment, exports and potential growth, the effects of the measures taken are closely monitored. Retail loan growth, on the other hand, has been moderate thanks to the tightening measures taken in June regarding the loan-to-value ratio of housing loans and the maturities of general-purpose loans. The spread between the policy rate and the rates on TL commercial loan has narrowed down following the new policy requirement, which was introduced to enhance the effectiveness of the monetary transmission mechanism, of maintaining securities based on TL commercial loan rates.

The banking sector's asset quality indicators, which are at their historic best, are improving further. Owing to the moderate course of nominal loan growth together with limited new NPL additions, the NPL ratio is declining further, and this decline is observable across all loan types. The ratio of retail and corporate NPL collections to the NPL balance is above its historical average. The improvement in the ratio of closely monitored (Stage 2) loans continues. The fact that a significant portion of Stage 2 loans consists of loans that are not in default and banks' prudence in setting aside high levels of provisions for all loan classes since the pandemic limit risks on asset quality.

The banking sector's FX external debts continue to decline, while the maintenance of strong FX liquidity buffers increases banks' resilience to liquidity shocks. Although external borrowing costs have increased due to tightening global financial conditions and geopolitical risks, banks have exhibited a strong

debt repayment and renewal performance. Banks also have high levels of FX liquidity despite their diminishing external debt. This contributes to the resilience of the system against potential shocks. While the liraization of balance sheets and the strong growth in TL deposits support the overall liquidity outlook, TL loan growth lags behind TL deposit growth.

Banks' interest rate risk is limited, and their balance sheet is healthy enough to manage interest rate shocks. The average maturity of banks' TL assets has recently moved slightly upwards as banks have shifted towards fixed-rate long-term securities. While the growth in the sector's variable-rate loans continues, the share of floating-rate TL securities in balance sheets has declined since the last reporting period. The regulations put into practice on security maintenance against loans and deposits have had a limited impact on balance sheets. While most banks already hold FX long positions, the number of banks holding a long position further rises and their asset size shares remain high.

The sector-wide strong profitability performance in banking sector supports their capital adequacy. The sector's strong profit performance was driven by the loan-deposit interest margin, the returns on CPI-indexed securities and the volume effect arising from loan growth. While the positive asset quality outlook supports profitability, the increase in banks' free provisions to build up precautionary buffers limits profitability. The capital adequacy ratios (CAR) of the banking sector even if adjusted for regulatory effects remain above legal limits. On the other hand, banks' excess capital above the regulatory minimum increased compared to the end of the year. Capital buffers are important for banks to meet unexpected losses and to sustain financing to the economy during times of stress.