I. MACROECONOMIC DEVELOPMENTS

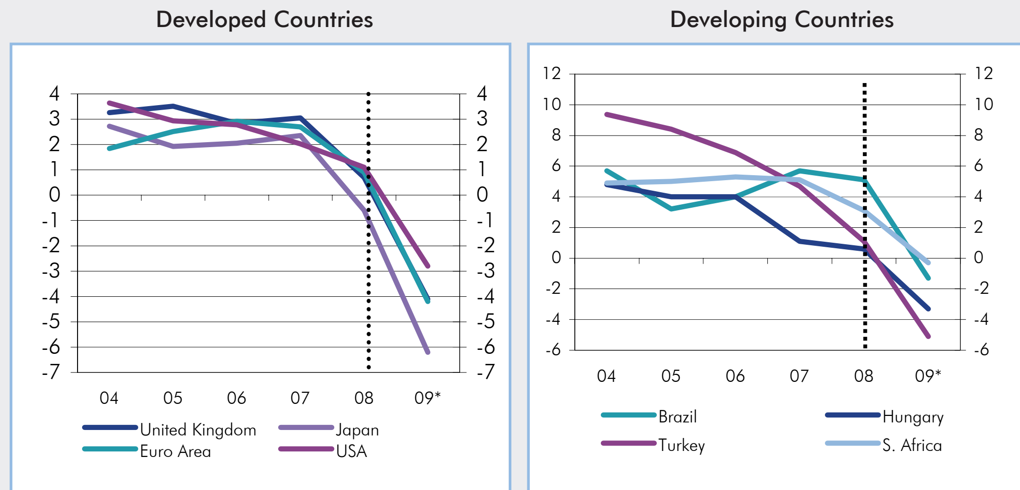
In this chapter, macroeconomic developments will be elaborated, taking into account the importance of such developments for financial stability.

I.1. External Sector

I.1.1. International Developments

Tighter credit channels and deteriorated demand conditions, which were triggered by the financial crisis erupted in the USA, affected global financial markets and led to a significant contraction in global trade volume. The projections for 2009 indicate that the global economy will face a significant contraction in 2009 (Chart I.1 and Box 1).

Chart I.1.
Growth Rates in Selected Countries (Annual Percentage Change)



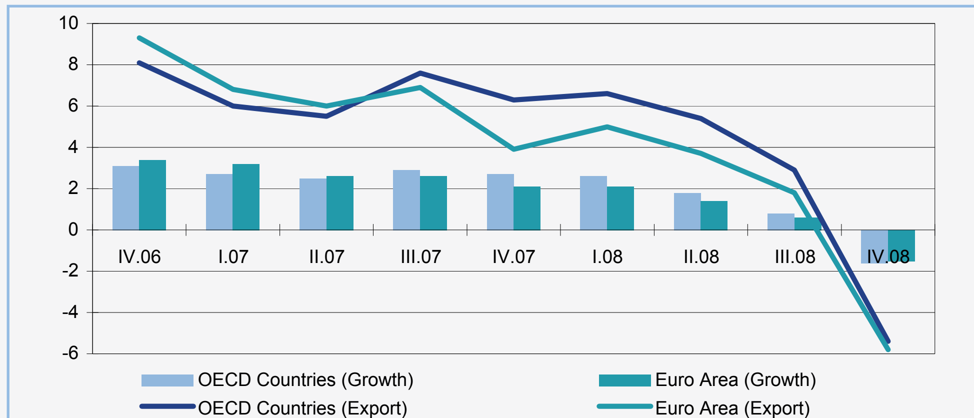
Source: IMF IFS, IMF WEO, EU European Economy
(*) Forecast (IMF, April 2009)

Box 1.
International Trade Developments

Parallel to the acceleration in global growth in recent years, international trade volume has increased rapidly too. However, with the impact of the global financial crisis, trade volume also started to fall. Total global output growth, which was 5.2 percent in 2007, dropped as low as 3.2 percent in 2008.[1] Meanwhile, the rate of increase in international trade in volume terms; realized at 2 percent in 2008, denotes a 4 percent-decline compared to 2007.

OECD member states and Euro area countries, which have a large share in global trade volume, are severely affected by the crisis. The slowdown in growth, which started in the second quarter of 2008, led to a contraction in the final quarter of the year. In this period, foreign trade volume declined further (Chart 1).

Chart 1. GDP and Foreign Trade Volume Growth Rates (%)[1]



Source: OECD
(1) Displays year-on-year change compared to the same quarter of the previous year.

Foreseeing that this trend would continue in the upcoming period, the World Trade Organization (WTO) forecasts that the contraction in global trade volume would become 9 percent in 2009.[2] According to data issued by the International Air Transport Association (IATA), air cargo traffic, which is accepted as an important indicator of global trade volume, decreased by 26 percent in December 2008 compared to the same period of pervious year. The decrease in question is quite noteworthy as it is even higher than the 14 percent-decrease experienced in September 2001 after the "9/11" incident when air transport was temporarily halted.

The WTO lists a number of factors for the unprecedented contraction in global trade such as:

(i) the fall-off in demand is more widespread than in the past, as all regions of the world economy are slowing down at once,

(ii) the supply chains are globally interconnected and any contraction in demand makes an adverse impact on the foreign trade of all countries connected to the supply chains,

(iii) shortage of trade finance due to tighter credit channels driven by problems in financial institutions and

(iv) aggravated protectionism within the framework of measures taken against the global crisis.

Many countries, which enjoyed economic growth thanks to the expansion in trade volume, started to feel the effects of the crisis more deeply due to the rapid contraction in trade. The severity of the decline in global trade volume driven by global economic turmoil increases the possibility of recovery to be prolonged. Especially developed countries tend to resort to protective policies parallel to the aggravated impact of the crisis on the corporate sector. International platforms warn about these policies that can decelerate recovery by recalling the "Great Depression" of 1930s during when global recovery had taken very long because of foreign trade volume decreasing by half due to the protectionist policies adopted at that time.

(1) World Economic Outlook, IMF, April 2009

(2) The European Commission expects global trade to contract by 11 percent.

Global growth, which was 5.2 percent in 2007, dropped to 3.2 percent in 2008 due to the global financial crisis. Both the IMF and the European Commission revised their growth forecasts for global economy downwards[1,2]. While the IMF predicts that global contraction would be 1.3 percent, the European Commission's prospects for global growth in 2009 is minus 1.5 percent. There are different views regarding when growth will be resumed and how the transition to growth will occur. The most optimistic views claim that the first signs of global recovery will be observed as of the second half of 2009 but global growth performance will be able to create new jobs as late as mid-2010.

Meanwhile, the global contraction in credit volume leads to difficulties in access to credits and repayment of credits for firms and households. The increased rate of unemployment, collapse of global demand driven by households that defer their demand as they suffer a decline in income and wealth linked to decreasing asset prices, further deteriorates the financial position of firms.

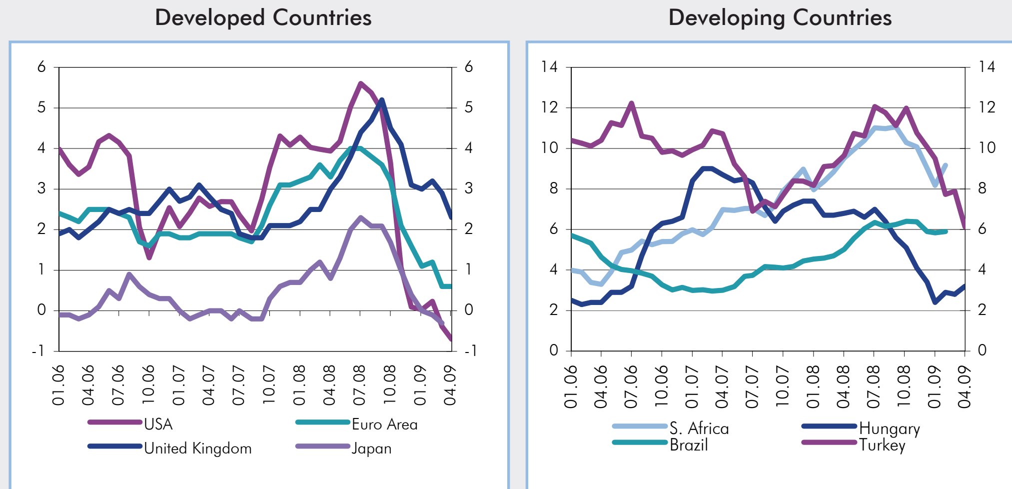
As developed and some developing countries finance their total demand mostly with loans, exiting this "vicious circle" becomes even harder. Related with the recessionary times for developed economies and reduction in international capital flows in the last quarter of 2008, the crisis started to take hold in developing countries as well. The impact of the crisis on these economies varies depending on the macroeconomic fundamentals of each economy. The high FX-denominated indebtedness level of the corporate sector and household of developing countries, especially in Central and Eastern Europe, raise these countries' vulnerability because of their dependence on external financing (Chart III.6).

[1] World Economic Outlook, IMF, April 2009.

[2] Economic Forecast, European Commission, Spring 2009.

As of the last quarter of 2008, inflation started to fall as a consequence of the slowdown in economic activity driven by the contractions in credit channels and battered confidence and the drop in prices of raw materials and energy. However, as of early-2009, inflation risk was overtaken by fear of deflation (Chart I.2).

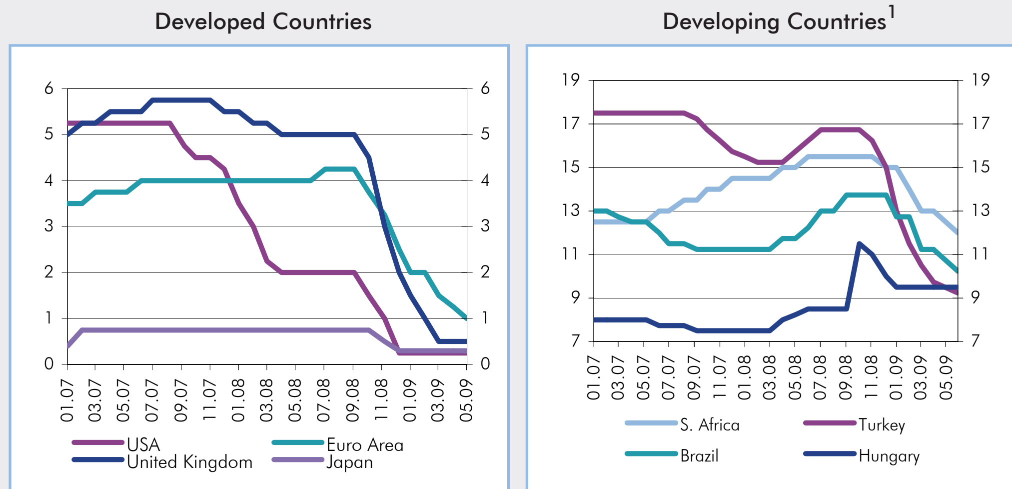
Chart I.2.
Inflation Rates of Some Selected Countries (CPI Annual percentage change)



Source: IMF IFS

Central banks injected liquidity into the markets as of the very beginning of the crisis with the aim of ensuring the smooth running of financial markets and as worries over inflation calmed down, they cut policy rates significantly with the aim of curbing the adverse effects of the crisis (Chart I.3).

Chart I.3.
Policy rates in Some Selected Countries (%)



Source: Central Banks of Countries
(1) The overnight borrowing interest rate has been used for Turkey.

Along with expansionary monetary policies, many countries announced stimulus plans and put fiscal policies into action to reinvigorate economic activity (Box 2).

Box 2.
Fiscal Stimulus Packages Announced Against the Crisis

Both developing and developed countries took several measures against the global economic crisis. Conventional and unconventional monetary policy measures and measures that can be classified as measures taken for the support of financial system were covered in the previous Report.

In addition to these measures, countries introduced fiscal stimulus packages to accelerate the exit from the crisis by reviving domestic demand to curb adverse impact of the crisis on the corporate sector. In the last G-20 Summit, member states committed themselves to implement USD 5 trillion-worth of expansionary fiscal policies until the end of 2010. The table below shows the cost of fiscal stimulus packages already introduced or to be introduced by countries in percent to their GDPs.

Table 1. Fiscal Stimulus Packages in Selected Countries (in percent of GDP,%)

	2008	2009	2010
China	0.4	3.1	2.7
S. Korea	1.1	3.9	1.2
Russia	0	4.1	1.3
USA[1]	1.1	2	1.8
S. Africa[2]	1.7	1.8	-
Canada	0	1.9	1.7
Germany	0	1.6	2
Mexico	0	1.5	-
Japan[3]	0.3	2.4	1.8
France	0	0.7	0.8
India[4]	0.6	0.6	0.6
Turkey[5]	0	0.8	0.3
Brazil	0	0.6	0.8

(1) Support for financial system measures is not included.

(2) Based on fiscal year, stimulus estimates are based on the fiscal year 2009/2010.

(3) Support for financial sector is not included, subsidies to and capital injections in public financial institutions are included.

(4) Based on fiscal year.

(5) Includes measures introduced between September 2008-March 2009.

There are basically three types of fiscal stimulus packages.

(i) Financial stimulus to firms: This type of support comprises corporate tax rebates or subsidies. These measures, which are intended especially for the export earners and SMEs, have been introduced in countries such as USA, India, Canada, Germany, France and Turkey.

(ii) Financial stimulus to consumers: Many countries are planning to help consumers via tax reductions or expansion in social security programs. Tax reductions can be in the form of direct income tax reduction as implemented in the USA, Canada and France or in the form of the reduction of excise tax levied on certain goods (such as automotive, electronics, food, etc.) as implemented in Brazil, India and Turkey. Moreover, in order to mitigate social problems triggered by the crisis, many countries have expanded social security benefits and started to

transfer more resources to people with low income.

(iii) Public Investments in Infrastructure: With the aim of reviving deficient demand, countries either increase infrastructure investments or bring forward the investments that are actually scheduled for a future date. Especially China and France have allocated a significant portion of their budgets to infrastructure investments within the framework of their fiscal expansionary policies.

Although fiscal stimulus packages cause budget deficits to grow and fiscal discipline to deteriorate, they are still inevitable for exit from the crisis. Rebuilding consumer confidence, improving demand conditions and restoring fiscal discipline are of vital importance for achieving and sustaining financial stability.

Sources:
- The Global Plan for Recovery and Reform, 2 April 2009
- Update on Fiscal Stimulus and Financial Sector Measures, IMF, 26 April 2009
- Ortiz, Isabel "Fiscal Stimulus Plans: The Need For A Global New Deal", International Development Economics Associates, IDEAs, March 2009

Upon criticisms claiming that the measures taken by the countries were not handled in a coordinated manner, there was common consensus at the G-20 Washington Summit held between November 14-15, 2008 that the measures formulated to restore growth should be implemented in a coordinated manner. Within this framework, at the London Summit of 1-2 April 2009, it was decided to implement expansionary fiscal policies, to increase the financial resources of international institutions such as the World Bank and the IMF, and that central banks would maintain expansionary policies to meet the global liquidity need (Box 3).

Box 3.
G-20 Leaders Summit

Two Leaders Summits were held in Washington, D.C. and London on November 14-15, 2008 and on April 1-2, 2009, respectively, with the aim of evaluating measures to be taken against the crisis and reforms to reshape the international financial system. At the London Summit, measures that have already been taken and measures to be taken were reviewed and some policy decisions were made to reinvigorate the global economy and to reform the financial system in the light of the reports presented by the four working groups[1] established to implement the immediate and medium-term action plans which were set out on the last meeting of the Leaders. The issues on which a consensus was reached and the planned actions are as follows:

Restoring growth and employment:

- Expansionary fiscal policies will be implemented that will amount to USD 5 trillion by the end of 2010.
- Central banks will maintain expansionary policies and use the full range of monetary policy instruments consistent with price stability to ensure smooth running of the markets.
- All necessary actions will be taken to restore the normal flow of credit through the

financial system and ensure the soundness of systemically important institutions.

- Countries will conduct economic policies considering their impact on other countries; will refrain from competitive devaluation of their currencies and support even-handed IMF surveillance of financial sectors and economies.

Strengthening financial supervision and regulation:

- Financial regulation and supervision activities will be revised so as to promote integrity and transparency, guard against risk across the financial system, dampen rather than amplify the financial and economic cycle; discourage excessive risk taking, support market discipline as well as competition and reduce the scope for regulatory arbitrage.

- As a successor to the Financial Stability Forum, a new Financial Stability Board, which will include all G-20 countries, will be established with a strengthened mandate and it will collaborate with the IMF to provide early warning for macroeconomic and financial risks.

- The scope of regulation and supervision will be extended to cover all systemically important institutions and instruments including the hedge funds.

- Sanctions will be deployed against tax heavens that do not cooperate in protecting public finances and financial systems.

- The accounting standard setters will cooperate with supervisory authorities to improve standards on valuation and provisioning and to achieve a single set of global accounting standards.

- The Credit Rating Agencies will be subject to regulatory oversight and registration to ensure that they meet the international code of good practice.

Strengthening Global Financial Institutions:

- The resources available to the IMF will be increased through immediate financing from members by USD 250 billion and through the New Arrangements to Borrow by USD 500 billion and the IMF will be able to borrow from the market if necessary. Moreover, the general allocation of SDR, which is determined according to the quotas of the individual countries, will be increased to USD 250 billion in order to increase global liquidity.

- The capital of the World Bank and other Multilateral Developments Banks will be supported, their lending capacity will be increased and an additional USD 100 billion will be injected into the global economy by these banks as loans.

- The borrowing limits of countries within the World Bank will be increased.

- The reform process of the IMF and the World Bank will be supported and necessary steps will be taken to make sure that these institutions become more effective by adopting themselves to changing condition of the global economy.

Resisting Protectionism and Promoting Global Trade and Investment:

- New barriers to investment or to trade will not be raised, actions that are inconsistent with the World Trade Organization's rules will not be allowed and sanctions will be imposed upon countries acting otherwise.
- Financial protectionism, particularly measures that constrain worldwide capital flows especially toward developing countries will be avoided.
- A source worth USD 250 billion will be available over the next two years for national and international institutions that are working in the field of foreign trade financing.
- Efforts to reach a balanced conclusion in the Doha Development Round will continue.

Ensuring a Fair and Sustainable Recovery:

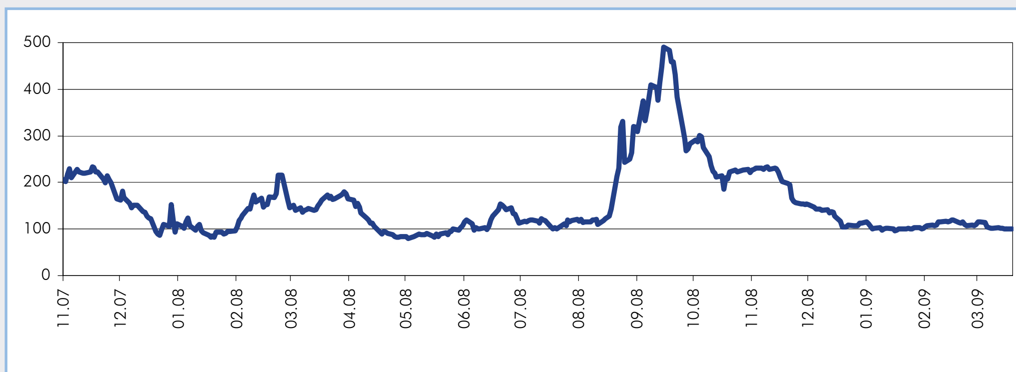
- Necessary measures will be taken to mitigate the social impact of the crisis to minimize long-lasting damage to global growth potential. Within this framework, USD 50 billion will be provided to increase social support and ensure economic development in low-income countries.
- The UN, working with other global institutions, will establish an effective mechanism to monitor the impact of the crisis on the poorest and the most vulnerable.
- Over the next 2-3 years, the IMF will provide USD 6 billion concessional finance for the poorest countries.
- Making sure that the investments funded by fiscal stimulus programs are clean, resource efficient and have low carbon emission will be the primary objective.

(1) The 4 working groups in question have been established in line with: Enhancing Sound Regulation and Strengthening Transparency (WG1), Reinforcing International Cooperation and Promoting Integrity in Financial Markets (WG2), Reform of the IMF (WG3) and the World bank and other Multilateral Development Banks.

Sources:
- The Global Plan for Recovery and Reform, 2 April 2009
- http://www.g20.org/Documents/Fin_Deps_Fin_Reg_Annex_020409_-_1615_final.pdf
- http://www.g20.org/Documents/Fin_Deps_IFI_Annex_Draft_02_04_09_-__1615_Clean.pdf

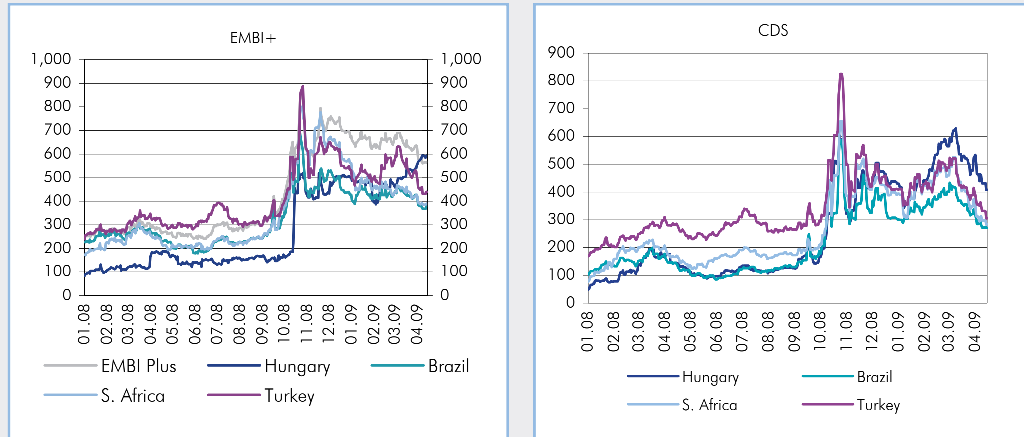
It is observed that thanks to the measures taken, tensions have eased in the markets and volatility has declined. Recently, fears of inflation have been dissipating and there has been some improvement in the risk premium of developing countries and in the TED spread that denotes the difference between the borrowing costs of the Treasury and the banks in the USA where the crisis first started. (Chart I.4 and I.5).

Chart I.4.
TED Spread (Basis Points)



Source: Bloomberg

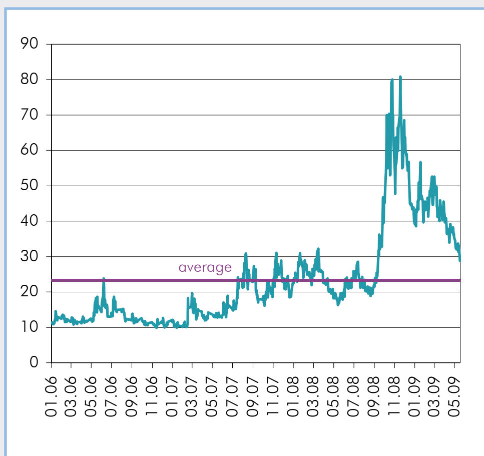
Chart I.5.
Risk Premia[1,2] and Credit Default Swap (CDS) Spreads[3] of Selected Developing Countries and Turkey (Basis Points)



Source: Bloomberg
(1) Country risk premium is the difference between the relevant country's EMBI+ index and returns of US Treasury instruments
(2) EMBI+ index includes Eurobonds of 18 developing countries, Brady bonds and traded loans. The weight of each country in the index is different. For instance, Brazil's weight is 22.49,Turkey's weight is 10.04 and South Africa's weight is 1.82 percent in the EMBI+ index. Also the index is calculated for each country individually.
(3) 5 year CDS contracts in USD are taken as benchmark

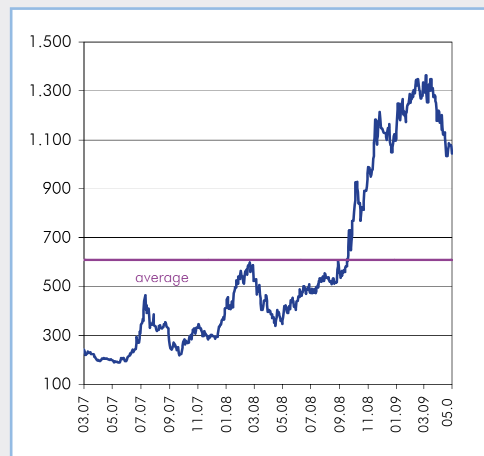
The VIX index, a widely accepted core volatility measure for the US stock market, which had an average of 23 in January 2006- April 2009 period, reached a record high of 80 in November 2008. The VIX Index retreated significantly in May 2009, however it could not come down to the pre-crisis level (Chart I.6). A similar trend was observed in the iTraxx Europe Crossover Index, comprising 50 of the most highly traded sub-investment grade corporate bonds. The index in question climbed as high as 1,363 in March 2009, coming down to 1,075 in May 2009(Chart I.7). The relative recovery in the European capital markets is slower and this can be attributed to the fact that unlike the Fed, the ECB does not accept corporate bonds as collateral.

Chart I.6.
VIX Index



Source: Bloomberg

Chart I.7.
iTraxx Europe Crossover Index

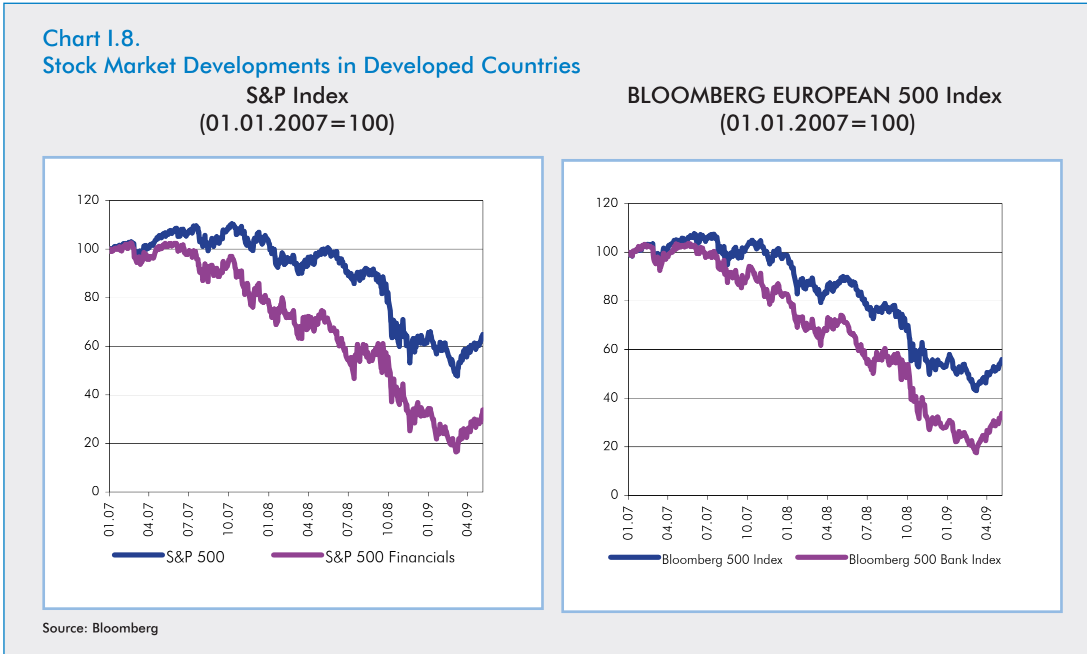


Source: Bloomberg

The announcement of USD 750 billion-worth of fiscal policy intended to clear balance sheets of 19 banks from toxic assets, the "Financial Stability Plan" announced on February 3,

2009 and the "Public-Private Investment Program" declared thereto (Box 4) as well as the results of the "Supervisory Capital Assessment Program"(SCAP) announced on May 7, 2009 enhanced optimism in the market.

Chart I.8.
Stock Market Developments in Developed Countries

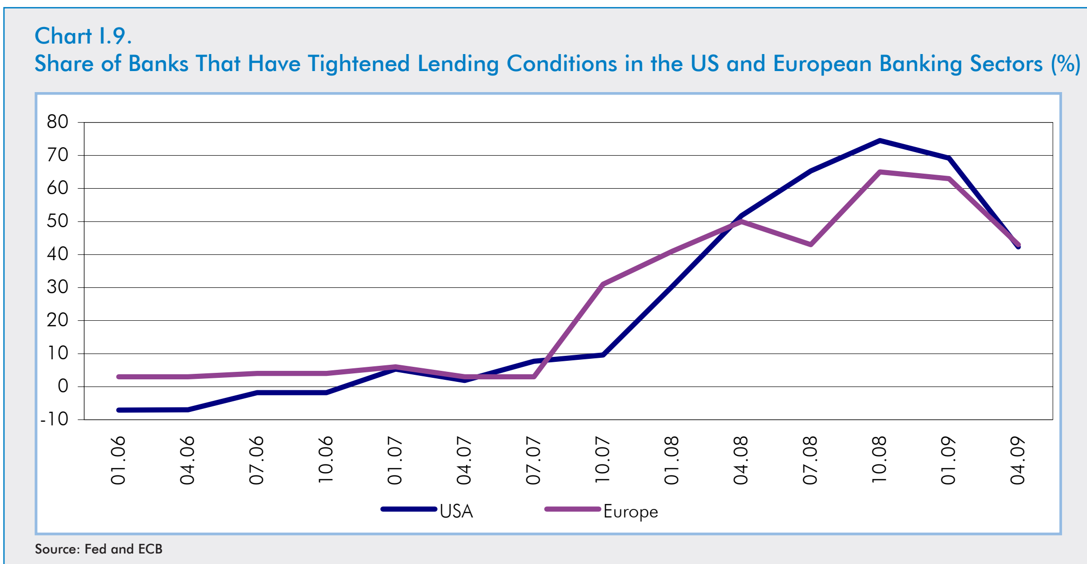


Source: Bloomberg

An important source of uncertainty was diminished as the losses incurred by banks due to subprime mortgage loans and securities linked to such loans were listed on the end-year balance sheets of the banks. Moreover, expectations for a movement back into profit in the US banking sector in the first half of 2009 after so long started to have a positive effect on the stock market and especially the securities of banks (Chart I.8).

On the other hand, the US and European banking sectors had been tightening lending conditions starting from the end-2007. Although this trend has been decreasing since early-2009, the banks are still reluctant to extend new loans (Chart I.9).

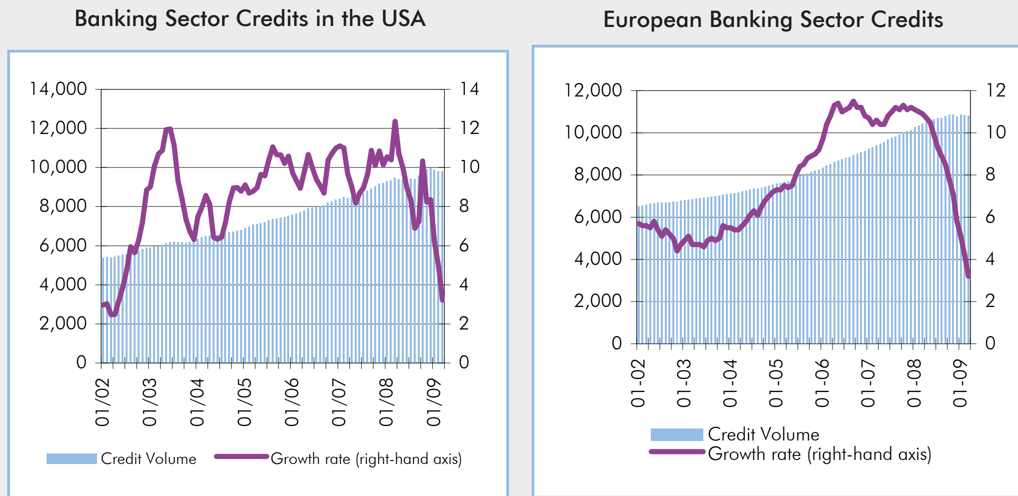
Chart I.9.
Share of Banks That Have Tightened Lending Conditions in the US and European Banking Sectors (%)



Source: Fed and ECB

As banks tightened their lending conditions, there has been a contraction in the credit volume of the banking sector especially in the USA and Europe (Chart I.10).

Chart I.10.
Credit Developments in the USA and European Banking Sectors (Billion USD, Billion Euro, %)



Source: FED

Source: ECB

To sum up, despite the measures taken and the positive atmosphere dominating the markets, problems in the banking sectors of Europe and the USA-that is the place where the crisis first erupted- have not been fully solved and therefore credit channels are not functioning well, an atmosphere of confidence has not yet been achieved and activity in financial markets is still far from its pre-crisis performance. Restoring activity in financial markets, reinvigorating international trade on a global level and thus restoring growth depends on the termination of nourishing reciprocal problems in credit channels and the recessionary pressures on the global economy.

Box 4.
US Treasury Department's Public Private Investment Program[1]

The Public Private Investment Program (PPIP) launched on March 23, 2009 by the US Treasury Department, as a part of its Financial Stability Plan[2] – alongside the American Recovery and Reinvestment Act that was published at the end of January 2009 - is based on the creation of Public-Private Investment Funds (PPIF) which will purchase asset pools under public-private partnership, in order to boost private demand for troubled legacy assets that are currently held by banks and facilitate market-priced sales of troubled assets. The Public Private Investment Program aims to ensure that private sector participants share risks with taxpayers and in return receive profits on the investments made. Thus, it is intented to increase market liquidity and to accelerate the credit flow. Initially, the Program will generate USD 500 billion in purchasing power to buy legacy assets, with the potential to expand to USD 1 trillion over time. Besides, a tranche of USD 75 to USD 100 billion in TARP (Troubled Assets Relief Program) capital, created

to bail out banks, will be allocated to these investment funds.

The funds to be created within the scope of the Plan are designed around three basic principles:

1. In addition to Treasury funding, financing from the FDIC and the Federal Reserve may also be provided to the private sector.

2. Funds will be open to all investor groups (pension plans, etc), thus a broad array of investors will be able to participate in the Program.

3. Private sector investors competing with one another will establish the price of loans and securities purchased under the program, which will reduce the likelihood of the government paying too much for these assets.

Although eligible assets under the Plan will primarily include residential or commercial mortgage loans and securities backed by these loans, other asset categories may also be included as required by market demand.

The deadline for applications to obtain the US Treasury Department's approval for the funds to be created within the scope of the Plan is April 29, 2009. The Treasury has announced that it will start notifying approved funds on May 15, 2009.

In general terms, the goal of the program is to improve asset prices, stimulate the extension of new credits by banks and to reduce the uncertainty surrounding banks about the extent of the loss they incur by restarting the market for legacy securities.

Although the Program was welcomed with enthusiasm in the markets, some concerns arose as well. Above all, there are concerns that the program will not be able to clear the balance sheets, as the distressed assets held by banks will be larger than the fund to be created. Another concern is the probability of underpricing of the assets to be addressed within the scope of the plan. In this case, the banks may avoid selling their distressed assets; therefore liquidity problems and uncertainties may persist in the markets. Another point facing criticism is related to the government guarantee provided for these funds. It is owing to this guarantee that the private sector will be able to invest with high leverage and make large profits; however, in the event of loss, a major portion of these losses will be borne by the public sector.

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(1) Public-Private Investment Program, March 23, 2009, http://www.treas.gov/press/releases/reports/ppip_fact_sheet.pdf

(2) Financial Stability Plan, February 10, 2009, http://www.financialstability.gov/docs/fact-sheet.pdf

Box 5.
Supervisory Capital Assessment Program (SCAP) Conducted by the US Banking Supervisory Authorities

The on-going crisis, which started in the American financial markets as a liquidity problem at the onset, transformed into distrust in financial institutions. Restoring confidence in the financial sector, which is a crucial factor for a sound growth process, still holds good as a policy priority.

As part of the studies conducted thereto, the U.S. banking supervisory authorities have been engaged in a comprehensive capital assessment exercise known as the Supervisory Capital Assessment Program (SCAP) with the aim of determining the additional capital that the largest U.S. banks might need in case of a significantly more adverse economic environment than is currently anticipated.

19 domestic banks with year-end 2008 assets exceeding USD100 billion were required to participate in the SCAP as part of the ongoing supervisory process. These 19 firms collectively hold two-thirds of the assets and more than half of the loans in the U.S. banking system.

With the aim of testing resilience of the banks, two alternative macroeconomic scenarios were provided. The "baseline" scenario was established upon the average of the projections published by three forecast institutions[1] to calculate the effect of deterioration in growth and unemployment and decline in housing prices on bank loans. The "adverse" scenario has been designed to reflect a deeper and longer recession than in the baseline (Table1).

Table 1. Scenarios

	2009	2010
Real GDP(%)		
Baseline Scenario	-2.0	2.1
Adverse Scenario	-3.3	0.5
Unemployment Rate (%)		
Baseline Scenario	8.4	8.8
Adverse Scenario	8.9	10.3
Housing Prices (%)		
Baseline Scenario	-14	-4
Adverse Scenario	-22	-7

19 Bank holding companies (BHC) that participated in the Supervisory Capital Assessment Program (SCAP) were asked to create estimates for their credit losses and revenues for 2009 and 2010 under two economic scenarios, and to render their capital, which will be calculated accordingly, to be able to cover the expected losses.

In the determination of the additional capital required, besides Tier 1 capital, Tier 1 Common Capital was used as an indicator of capital adequacy, which has greater loss absorption capacity than preferred shares and which is intended to constitute a vast part of the Tier 1 Capital.

- the amount of Tier 1 Capital needed for a minimum of 6 percent "Tier 1 risk based ratio",
- the amount of Tier 1 Common Capital needed for a minimum of 4 percent "Tier 1 common capital risk based ratio"

was estimated under the scenarios.

Table 1. Results of the Scenarios

Indicated SCAP Buffer as of 31 December 2008 (USD Billion)	
Tier 1 Capital	836.7
Tier 1 Common Capital	412.5
Risk-Weighted Assets	7,814.8
Tier 1 Capital Ratio (%)	10.7
Tier 1 Common Capital Ratio (%)	5.3
Estimates for 2009 and 2010 for the Adverse Scenario (USD Billion)	
Total Estimated Losses	599.2
Resources Other Than Capital to Absorb Losses	362.9
Need for Tier 1 Capital Buffer estimated under SCAP	185
Capital Actions taken since December 2008	110.4
Need for additional Tier 1 Capital Buffer	74.6

The results of the SCAP suggest that if the economy were to track the adverse scenario, losses at the 19 firms during 2009 and 2010 could be USD 600 billion. The estimated two year cumulative losses on total loans is 9.1 percent at the 19 participating BHCs; for comparison, this two year rate is higher than during the historical peak loss years of the 1930s. In combination with the losses already incurred by these firms since mid-2007, the SCAP results suggest financial losses at these firms, if the economy were to follow the more adverse scenario, could total nearly USD 950 billion by the end of 2010.

At the end of the program, it was estimated that additional capital of USD 185 billion was needed in the aggregate. After taking account of the measures that have been implemented since end-2008 to improve capital structures, the additional capital need drops to USD 75 billion (Table 2). It is stated that the whole of this amount should be held as Tier 1 Common capital as it gives a BHC greater loss absorption capacity . Banks that are in need of additional capital are required to compile a detailed capital plan within one month following the release of the program results and adopt these plans by November 2009 at the latest.

Economic and financial milieus criticized this program for scenarios not being severe enough and estimates for revenues and losses not being commensurate with those made by other institutions. However, the results of the program were welcomed by the markets and appreciation in banking shares was observed.

(1) Concensus Forecasts, Blue Chip, Survey of Professional Forecasters

Sources:
- The Supervisory Capital Assessment Program: Design and Implementation (http://www.federalreserve.gov/newsevents/speech/bcreg20090424a1.pdf)
- The Supervisory Capital Assessment Program: Overview of Results (http://www.financialstability.gov/docs/SCAPresults.pdf)

Box 6.
Financial Stability Board

In 1999, an international platform called "FSF – Financial Stability Forum" was founded by the G-7 with a view to ensure information exchange and cooperation and enhancing international financial stability among its members. The mandate of this platform was to address vulnerabilities of the global financial system and identify and oversee action needed to address them, and promote coordination and information exchange among authorities responsible for financial stability.

Considering the need to place more emphasis on the importance of global financial stability with regard to the last financial crisis and its impact, at the London summit of April 2009, the Leaders of the G-20 countries decided to place the FSF on stronger institutional ground with an expanded mandate. Accordingly, with the inclusion of new members, the FSF was re-established as the Financial Stability Board (FSB) with a broadened mandate. The Board is chaired by Mario Draghi, governor of the Bank of Italy. The secretariat is based at the Bank for International Settlements' (BIS) headquarters in Basel, Switzerland.

As per the decision taken at the London G-20 summit, the range of members of the FSB was extended to include all G-20 countries, Spain and the European Commission. In addition to this, international institutions such as the OECD, BIS, IMF and the World Bank; international standard setting bodies such as the IASB, IOSCO, IAIS, BCBS, CGFS and CPSS are also represented in the FSB.

Alongside the current mandate of the FSF, the additional responsibilities of the FSB will be to:

- monitor and advise on market developments and their implications for regulatory policy;
- undertake joint strategic reviews of the policy development work of the international standard setting bodies to ensure their work is coordinated, focused on priorities, and addressing gaps;
- set guidelines for and support the establishment of supervisory colleges;
- manage contingency planning for cross-border crisis management, particularly with respect to systemically important firms; and
- collaborate with the IMF to conduct Early Warning Exercises.

The FSB Plenary is the highest decision making organ of the FSB. Members participate in the Plenary Meeting with one or more institutions which could be the Treasury, the Central Bank and/or the Financial Supervisiory Authority, and are represented by the chairmen of these institutions. Another organ of the FSB is the Steering Committee. This Committee provides operational guidance between plenary meetings -normally held twice a year- to carry forward the directions of the FSB. Its composition will be decided by the FSB Chair in a manner that ensures maximum effectiveness in taking forward the FSB's work while having regard to balanced representation in terms of geographic regions and institutional functions.

To support its functions, the FSB Plenary established three standing committees called "The Vulnerabilities Assessment Committee", "The Supervisory and Regulatory Cooperation Committee" and "Standards Implementation Committee". The Plenary may establish other standing committees and ad hoc working groups as necessary.

Turkey was accepted for FSB membership on March 12, 2009 and was granted one representative seat in the Plenary. Following the evaluations made by the respective authorities in Turkey, it was decided that the Central Bank of the Republic of Turkey would represent Turkey on the Financial Stability Board. In addition, other authorities would also take part in the works to be carried out by the Board.

I.1.2. Balance of Payments

As envisaged in the previous report, the decline in energy prices coupled with the decrease in domestic and external demand resulting in the relative slowdown in growth, led to a contraction in the current account deficit.

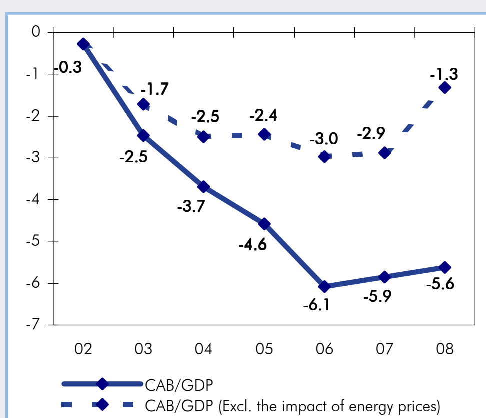
Table I.1. Balance of Payments (Billion USD)

	2005	2006	2007	2008	Mar.09*
CURRENT ACCOUNT	**-22.1**	**-32.1**	**-38.2**	**-41.6**	**-30.5**
Foreign Trade Balance	-33.0	-41.0	-46.7	-53.1	-42.0
Total Exports of Goods[1]	78.4	93.6	115.4	140.8	131.7
Total Imports of Goods[1]	-111.4	-134.6	-162.0	-193.9	-173.7
Coverage Ratio(%)	70.4	69.6	71.2	72.6	75.8
Balance of Services	15.3	13.7	13.3	17.5	17.4
Balance of Income	-5.9	-6.7	-7.1	-8.0	-7.9
Current Transfers	1.5	1.9	2.2	2.0	2.0
CAPITAL & FINANCIAL ACCOUNT	**19.5**	**32.1**	**36.6**	**37.0**	**21.2**
Foreign Direct Investments	9.0	19.3	19.9	15.6	14.0
Portfolio Investments	13.4	7.4	0.7	-5.0	-6.9
Other Investments	14.9	11.5	24.0	25.4	11.8
Reserve Assets	-17.8	-6.1	-8.0	1.1	2.3
NET ERRORS & OMISSIONS	**2.6**	**0.0**	**1.6**	**4.6**	**9.3**

Source: CBRT
(*) Cumulative figures for the last 12 months.
(1) Including shuttle trade, non-monetary gold and goods procured in ports by carriers.

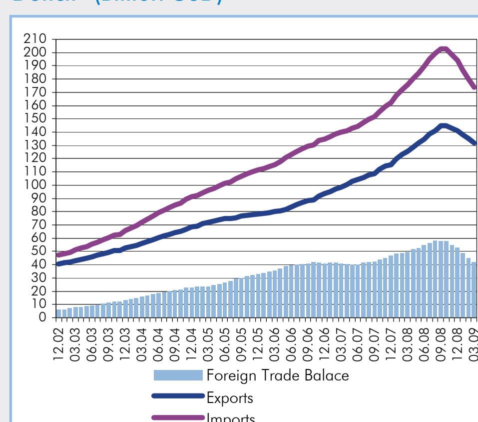
The current account, which posted the highest deficit amounting to USD 49 billion on an annual basis by August 2008, has sharply contracted since October, when the impact of the global financial crisis on domestic and external demand became apparent, and stood at USD 41.6 billion at end-2008. Current account deficit went down to USD 30.5 billion in March 2009 on an annual basis and this contracting process still continues (Table I.1).

Chart I.11.
Current Account Balance (CAB) to GDP Ratio & The Impact of Energy Prices[1] (%)



Source: CBRT , TURKSTAT
(1) The impact of energy price increases on the current account through the period 2003- 2008 was calculated by keeping the prices of 2002 intact. Energy sub-items taken into account are stone coal and lignite, crude oil and natural gas under the mining and quarrying sector, and coke coal, refined petroleum products and nuclear fuels under the manufacturing industry.

Chart I.12.
Export and Import Volumes and the Trade Deficit[1] (Billion USD)



Source: CBRT
(1) Cumulative figures for the last 12 months.

While the ratio of current account deficit to GDP was 5.9 percent at end-2007, despite the slowdown in GDP in the last quarter of 2008, it fell to 5.6 percent in 2008. When the impact of

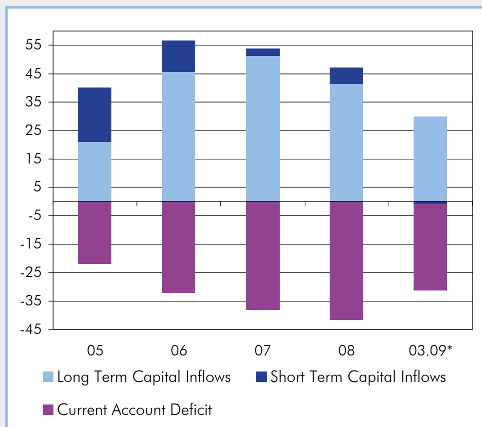
energy prices is excluded, the decline in the current account deficit becomes more pronounced (Chart I.11). The main reason underlying this decline is the faster decline of imports compared to exports on a quantity basis, as well. Recently, Turkey has been a country that generates a current account surplus, excluding energy.

An analysis of the foreign trade balance, which is the most important component of the current account, suggests that exports of the last 12 months recorded growth of 4.9 percent by March 2009 compared to the same period of the previous year and reached USD 131.7 billion. Imports, on the other hand, decreased by 1 percent and became USD 173.7 billion in the same period.

When analyzed on an annual basis, imports and exports, which have been incessantly growing since February 2002, recorded a decline for the first time in October 2008 and then continued to decline parallel to the overall trend of contraction in world trade volume. The decline in imports apparently outpaced the decline in exports, thereby leading the foreign trade deficit to undergo a rapid contraction process (Chart I.12).

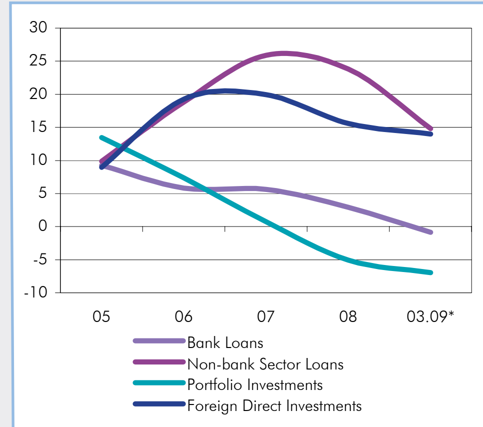
The surplus that is caused by tourism revenues in the balance of services, which is another component of the current account, did not mark a remarkable change compared to the figures of end-2008. However, the deficit in the balance of income slightly contracted owing to decreasing income transfers of foreign direct investments. Current transfers comprising the amounts granted to the general government and the workers' remittances have not indicated a notable change recently. (Table I.1).

Chart I.13.
Current Account Deficit and Capital Inflows[1,2] (Billion USD, %)



Source: CBRT
(1) Long-term capital inflows consist of foreign direct investment, debt securities of generalgovernment and banks, long-term cash loans, long-term trade loans and long-termdeposits at CBRT.
(2) Short-term capital inflows consist of portfolio investments including equities and government bonds, short-term cash loans, short-term trade loans, short-term deposits at CBRT and banks and other short-term liabilities.
(*) Cumulative figures for the last 12 months.

Chart I.14.
Main Financing Items of The Current Account Deficit[1,2,3,4] (Billion USD)



Source: CBRT
(1) Bank loans: Net short-term and long-term loans borrowed by the banking sector from abroad.
(2) Non-bank sector loans : Net short-term and long-term loans borrowed by the nonbank sector (general government excluded) from abroad.
(3) Foreign Direct Investments: Foreign direct investment inflows (real estate purchases included).
(4) Portfolio investments: Government bonds, Treasury bills and stock purchases (+) and sales (-) of non-residents.
(*) Cumulative figures for the last 12 months.

It is observed that the most important financing item of the current account is still the long-term capital inflows and that the major part of these inflows is provided through external borrowings made by the private sector. As a matter of fact, in the last 12–month-period as of March 2009, the share of the "other investments" item, comprising long-term external borrowings of the private sector and banks, in total financing decreased and a slight

outflow occurred in short-term capital movements. The share of direct investments, which followed a horizontal course compared to end-2008, within total capital inflow, increased due to the relatively fast decline in other financing resources (Chart I.13, Chart I.14).

Net capital inflows to our country through direct investments and other investments amounted to approximately USD 25.8 billion in the last 12-month period by March 2009. Meanwhile, the outflow in portfolio investments continued due to the ongoing crisis in international markets and became USD 6.9 billion in the same period. It is noteworthy that banks have become net debt repayers in the last 12 months (Chart I.14).

The net errors and omissions item which has boomed recently has reached USD 9.3 billion by March 2009. The reasons for this boom are considered to be discrepancies in the accounting of exchange rate movements, sales of FX savings in cash that were outside the domestic banking system to banks against TL and the high amounts of change in residents' deposits at foreign banks. As a matter of fact, data released by the BIS and studies carried out on trial balances of banks' foreign branches confirm the effect of decreasing deposits abroad on the net errors and omissions item (Table I.14).

Box 7.
International Capital Movements

The global financial crisis has also decelerated international capital movements remarkably. Countries that were mostly affected by this deceleration are developing countries that financed their rapid growth in the pre-crisis period mostly by foreign capital inflows. As a matter of fact, according to estimates of the "Institute of International Finance"[1] the net amount of external funds that developing countries obtained in 2007 reached USD 929 billion. However, due to the effect of unfavorable developments in the last quarter of 2008, this amount is expected to drop to USD 466 billion for the year 2008. IIF estimates that the net external fund inflow to developing country markets may fall to USD 165 billion for the year 2009 due to negative expectations regarding global growth. The most noteworthy development in this trend of decline is expected to be loans utilized by banks. The reason for this is that while fund inflow through loans obtained by banks was USD 410 billion in 2007, this amount is expected to go down to USD 167 billion by end-2008. Meanwhile, fund flow is estimated to reverse in 2009, thereby rendering banks net loan repayers of approximately USD 61 billion (Table 1).

Table 1. Private Capital Movements – Developing Countries

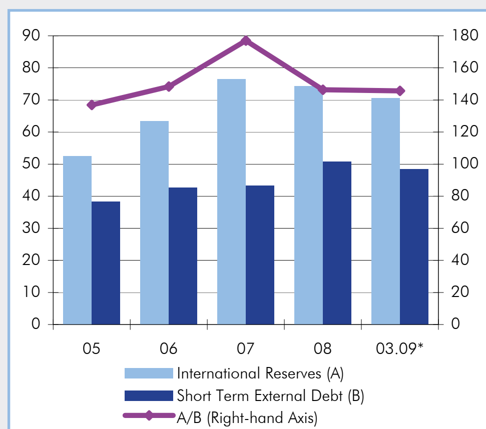
(Million USD)	2006	2007	2008[1]	2009[2]
Private Capital Movements (Net)	564,909	928,553	465,792	165,328
Net Capital Market Investments	222,309	296,131	174,065	194,823
Net Direct Investments	170,911	304,146	263,358	197,476
Net Portfolio Investments	51,478	-8,015	-89,293	-2,653
Credits Utilized (Net)	342,599	632,422	291,727	-29,495
Banks (Net)	211,915	410,259	166,643	-60,642
Non-Banking Institutions (Net)	130,684	222,163	125,083	31,147

Source: Institute of International Finance
(1) Estimate
(2) Forecast

The slowdown in capital movements toward developing countries mostly stems from the global financial crisis and the loss of confidence driven by this crisis. In addition to this, given the mutually-fuelling process between growth and capital movements, the contraction in global growth inevitably brings about a slowdown in capital movements. This is because the slowdown in capital movements exacerbates the contraction in global growth on the one hand, and arises as an outcome of this contraction, on the other.

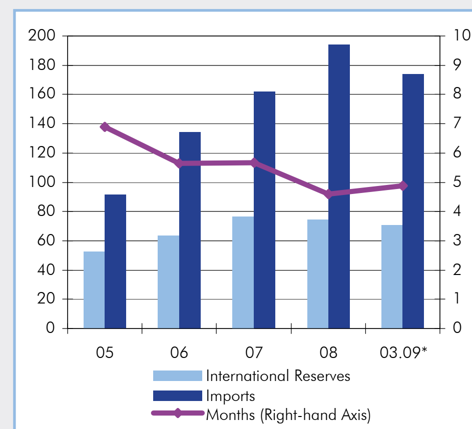
(1) Institute of International Finance, January 27, 2009

Chart I.15.
Short-Term External Debt[1] and International Reserves[2] (Billion USD, %)



Source: TREASURY, CBRT
(1) Short-Term External Debt = General Government + CBRT + commercial banks +other sectors.
(2) International Reserves = CBRT gross foreign exchange reserves (including gold)
(*) Short-Term External Debt data are provisional.

Chart I.16.
Import Coverage Ratio of Reserves[1,2] (Billion USD, Months)



Source: CBRT
(1) International Reserves = CBRT gross foreign exchange reserves (including gold)
(2) Months figure indicates the number of months of imports that is covered by the year-end international reserve amount of that year.
(*) Cumulative figures for the last 12 months is used for imports.

The ratio of international reserves to short-term external debt stock, one of the indicators of external debt service capacity, did not lead to a remarkable change by March 2009 and stood at 145.7 percent (Chart I.15). The ratio of international reserves to total imports of a country indicates how long that country can provide the inputs needed from external markets without depending upon any external support. Despite the recent decline in international reserves, this ratio went up owing to the sharp decline in imports (Chart I.16).

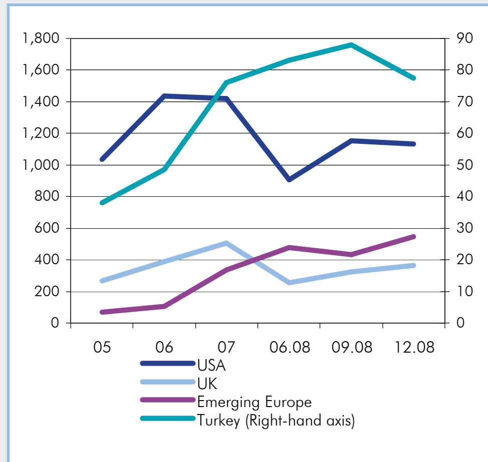
Table I.2. Parties Financing the Current Account Deficit (Billion USD)

	2005	2006	2007	2008	Mar.09*
Current Account Balance	-22.1	-32.1	-38.2	-41.6	-30.5
Finance Accounts	19.5	32.1	36.6	37.0	21.2
General Gov. (incl. CBRT and CBRT Reserves)	-16.5	-2.9	-15.5	-4.1	-4.3
Private Sector (incl. Banks)	36.0	35.0	52.1	41.1	25.4
Net Errors and Omissions	2.6	0.0	1.6	4.6	9.3

Source: CBRT
(*) Cumulative figures for the last 12 months.

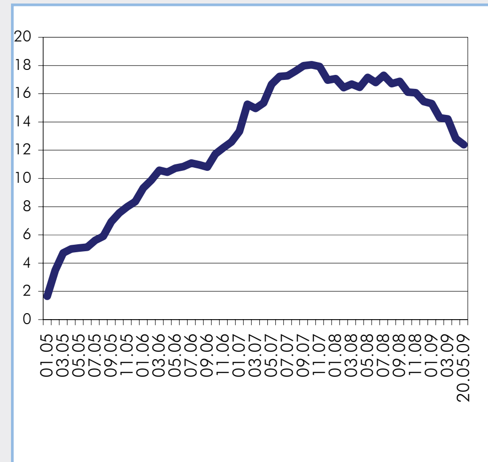
In general terms, the long-standing current account deficit was financed by long-term funds obtained mainly by the private sector, including banks, as in previous years (Table I.2).

Chart I.17.
Net Receivables of International Banks from Selected Countries[1]
(Billion USD)



Source: BIS
(1) Data for December 2008 are provisional.

Chart I.18.
TL-Denominated Bonds Issued by Foreigners
(Outstanding Amount in Billions of TL)



Source: CBRT

Net receivables of the banks reporting to the Bank for International Settlements (BIS) from the US and UK, remained below the levels of the pre-crisis period, while it continued to rise in Emerging Europe, albeit at a slower pace. On the other hand, the net assets of these international banks in Turkey continued to increase in the first phase of the crisis; but displayed a downward trend in the last quarter of 2008 and dropped to USD 77.5 billion at end 2008 (Chart I.17).

Subsequent to a sharp increase, the amount of bonds denominated in TL issued by foreigners has followed a horizontal course as of the second half of 2007, when the the global financial crisis began. In the following period, this amount displayed a trend of decline starting from October 2008, when the impact of the financial crisis began to weigh on the currencies of the developing countries. No new bonds have been issued since then, while redemptions have continued, which led the total amount of outstanding bonds to decrease to TL 12.4 billion by May 20, 2009 (Chart I.18).

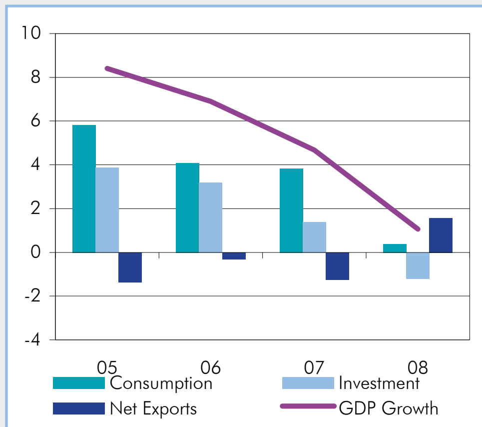
In sum, domestic and external demand conditions deteriorated due to the financial crisis, which erupted in the US and gained a global dimension by spreading across other countries in the subsequent period, and this deterioration coupled with the decline in energy prices since the last quarter of 2008, led the current account deficit to undergo a rapid contraction. The current account deficit is expected to maintain its downward trend in the short-run.

I.2. Growth and Inflation

I.2.1. Growth

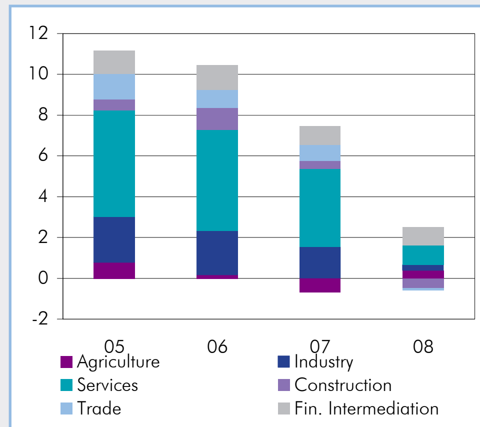
Due to the impact of the global financial crisis on Turkey, the Gross Domestic Product (GDP) displayed an annual contraction of 6.2 percent in the last quarter of 2008. As a result of this contraction, GDP growth dropped to 1.1 percent throughout 2008.

Chart I.19.
Growth Rate and Its Composition[1, 2]
(%, Points)



Source: TURKSTAT
(1) Percentage change compared to the same period of the previous year.
(2) Net exports = Exports of Goods and Services-Imports of Goods and Services

Chart I.20.
Contributions of Sectors to Growth[1]
(%, Points)



Source: TURKSTAT
(1) Construction, trade and financial intermediation are accepted as sub-sectors of services sector and are included therein.

The household consumption expenditures item, which is the major expenditure component of the GDP, went down by 4.6 percent year-on-year, parallel to uncertainties led by the global financial crisis in the last quarter of 2008. This resulted in the household consumption expenditures growing by only 0.3 percent. Thus, household consumption expenditures contributed to growth by 0.2 percent, which is 3 points lower than end-2007 figures. On the other hand, public consumption expenditures grew by 6.1 percent year-on-year in the last quarter of 2008 and by 1.8 percent annually.

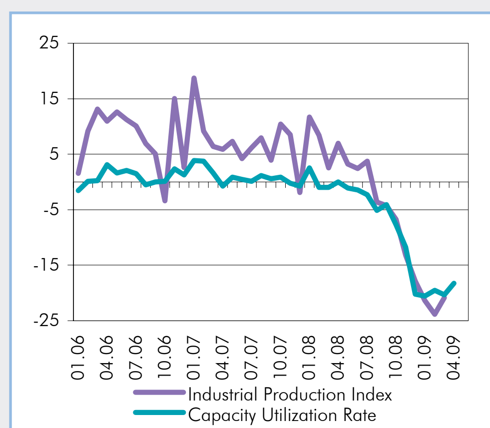
Similarly, while investment expenditures of the private sector, which has a high share in total investment expenditures, decreased annually by 7.3 percent, those of the public sector rose by 13.1 percent, in the last quarter of 2008. Despite the rise in public investments, the contribution of total investment expenditures to growth decreased by 2.6 points to -1.2 points compared to the figures of end-2007 due to the decline in private sector investment expenditures (Chart I.19).

As the decline in imports of goods and services outpaced exports of goods and services, the contribution of net exports to growth turned out to be positive compared to the figures of end-2007, rising by 2.8 points and standing at 1.6 points (Chart I.19).

An analysis of the GDP by sectors with respect to production reveals that at end-2008, the contribution of the construction sector and trade to growth turned negative. While the contribution of agriculture became positive, that of industry and services decelerated. On the other hand, financial intermediaries remained strong in terms of their contribution to growth (Chart I.20).

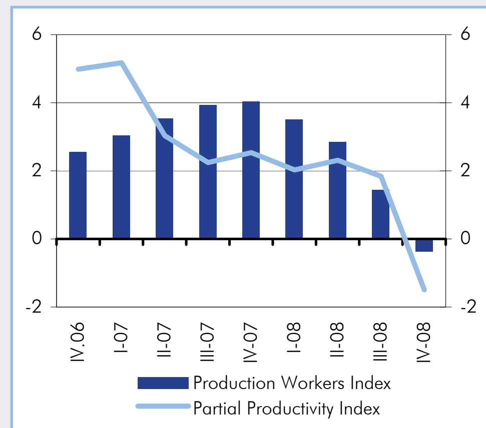
In the Pre-Accession Economic Program 2008, the contraction in the Turkish economy, which was experienced in the last quarter of 2008, is predicted to persist in 2009, while 2010 is envisaged to be the starting point of the process of growth. This program suggests that the GDP will decrease by 3.6 percent by end-2009 and increase by 3.3 percent by end- 2010.

Chart I.21.
Industrial Production and Capacity Utilization Rate[1] (Annual % Change)



Source: TURKSTAT
(1) The Monthly Industry Production Index, which has been published with the base year 1997=100 according to ISIC, Rev.3, since 1999, was decided to be renewed due to the fact that it became outdated stemming from the developments in the economy in the course of time. In addition, the quality differentiation in the selected products and the change in the sector weights contributed to this decision. As a result of this, an index with a base year at 2005=100 according to NACE Rev.1.1 was started to be calculated in order to provide the international comparison.

Chart I.22.
Number of Workers and Partial Productivity per Worker for the Manufacturing Industry[1,2] (Annual % Change)



Source: TURKSTAT
(1) Annualized data is used in calculations.
(2) 2005=100 index is used.

Industrial production displayed a sharp decrease in the last quarter of 2008 and went down by 23.8 percent compared to the same month of the previous year in February 2009. This deterioration originates from the manufacturing industry. The contraction in the industrial production index lost pace and stood at 20.9 percent in March 2009 (Chart I.21).

Manufacturing industry production dropped by 23.5 percent in March 2009 compared to the same month of the previous year. This deterioration stems primarily from the manufacturing of Motor Vehicles, Trailers and Semi-Trailers with a decline of 53.1 percent; Office Equipments and Computers with a decrease by 41.8 percent and Coke Coal and Refined Petroleum Products with a decrease of 40.7 percent.

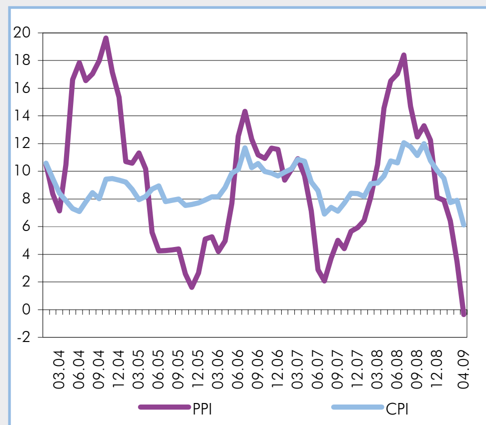
The capacity utilization rate of the manufacturing industry maintained a decline through three quarters starting mid-2008. The deteriorating trend in capacity utilization rates halted in April owing to the contribution of tax reductions that became effective in March 2009 with a view to underpinning domestic demand. Meanwhile, the capacity utilization rate fell by 14.9 points year-on-year. According to the Manufacturing Industry Tendency Survey results, the shortfall of both domestic and external demand still stood as the main reason for workplaces operating under capacity in this period.

The rate of increase in partial productivity per worker employed in the manufacturing industry increased by 2.5 percent at end-2007, leading to a decline of 1.5 percent on an annual basis at end-2008. This stemmed from the decline in the rate of increase in production (Chart I.22). Meanwhile, the rate of increase in the workers index continued to fall and closed the year 2008 with a decline of 0.4 percent per annum.

I.2.2. Inflation

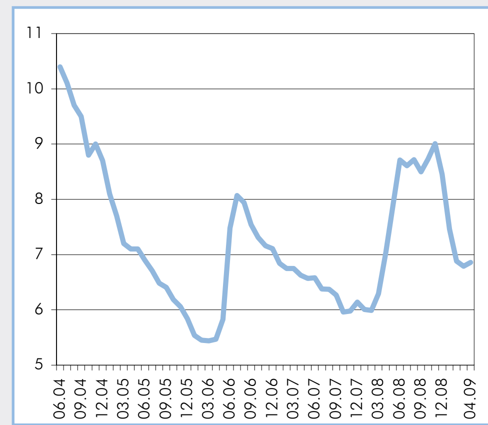
Annual Consumer Price Index (CPI) inflation, which was 8.39 percent in 2007, rose to 10.1 percent at end-2008, remaining above the upper limit of the uncertainty band set around the path consistent with the end-year inflation target. Developments in the global economy became the main determinant of the course of domestic inflation throughout 2008. Annual CPI inflation, which went up due to the hikes in food and energy prices in the first three quarters of 2008, became 11.1 percent by September 2008. Owing to the apparent slowdown in global economic activities in the last quarter of 2008, energy and other commodity prices went down and together with the fall in domestic energy and processed food prices resulted in a CPI of 10.1 percent by December 2008. Despite considerable increases in exchange rates in the last quarter of 2008, the effect of exchange rate movements on prices remained below levels of the previous years due to the marked slowdown both in economic activities and import prices (Chart I.23).

Chart I.23.
Annual PPI and CPI Developments
(Annual % Change)



Source: TURKSTAT

Chart I.24.
12 Months Ahead CPI Expectations
(%)



Source: CBRT

In the first quarter of 2009, due to the positive developments in cost-based effects and further slowdown in economic activities, the annual rate of increase in CPI maintained its downward trend and remained within the uncertainty band by March at a level of 7.89 percent. In the first quarter of 2009, it is observed that the effect of exchange rate movements on inflation remained limited. Due to the slowdown especially in services items coupled with the reductions in SCT and VAT, the annual rate of increase in CPI fell to 6.13 percent by April (Chart I.23).

The annual rate of change in the producer price index (PPI), which bears importance in the evaluation of the cost-side effects on consumer inflation, stood at 5.94 percent in 2007, rising to 8.11 percent at end-2008 (Chart I.23). Producer prices, which markedly increased in the first half of the year in line with the developments in international commodity markets, adopted a downward course in the second half of 2008. This downturn was mainly attributable to the easing of base metal and petroleum product prices. In the first four months of 2009, the annual rate of increase in the PPI continued to decelerate and became –0.35 percent

by April (Chart I.23). Easing commodity prices coupled with the contracting external demand constrained the effect of exchange rate movements on producer prices during the last quarter of 2008. Thus, no cost-related pressures emanating from producer prices were exerted on consumer prices.

The marked increase in inflation expectations in the first half of 2008 came to a halt when the Central Bank announced the new targets in June. Nevertheless, inflation remained high due to the effects of supply-side shocks, which led expectations to follow a course above the medium-term targets. A marked recovery is observed in expectations in line with inflation realizations that display a favorable outlook since November on the back of easing commodity prices and contracting demand (Chart I.24). The Central Bank, underlining the recovery in the inflation outlook, opted for a rapid cycle of policy rate cuts in that period and the announced inflation data confirmed the accuracy of these decisions, thereby contributing to the recovery in inflation expectations.

The rapid policy-rate cuts coupled with the fiscal measures towards reviving the domestic market are expected to support domestic demand in the coming periods. Nevertheless, it is projected that the global economy will not gain stability and a pronounced acceleration will not be visible in domestic economic activities in the short-run. Therefore, aggregate demand conditions are predicted to continue to support the disinflation process for a while.

I.3. Public Finance

Box 8.
Pre-Accession Economic Programme 2008

With a view to harmonizing economic policies and reforms on route to membership of the European Union and establishing the structure for accession to the Economic and Monetary Union following the accession, "Pre-Accession Economic Programme 2008", prepared annually by the State Planning Organization (SPO), was announced on 13 April 2009. The Programme primarily elaborates the current developments and data regarding growth, employment, balance of payments, monetary and exchange rate policy, the financial sector, inflation and public finance. These are followed by projections for the period 2009-2011. In this Programme, macroeconomic projections were reviewed in consideration of the global financial crisis, and targets for the basic economic indicators in "2009 Annual Programme" were revised.

In this context, the growth target, which was set as 4 percent in 2009 Annual Programme, was revised as –3.6 percent in the Pre-Accession Economic Programme; whereas the inflation target remained unchanged. The ratio of central government budget revenues to GDP was reduced from 22.4 percent to 21.9 percent; while the ratio of central government budget expenditures to GDP was raised from 23.6 percent to 26.9 percent. Accordingly, the central government budget deficit, which was projected as TL 10.4 billion in the Budget Law, was targeted to become TL 48.3 billion. In the Programme, a collective assessment of expectations of revenues and expenditures suggests that the general government budget balance, which has been posting a deficit since 2007, will continue to post a deficit in the period between 2009-2011 as well. Moreover, the ratio of the General Government Budget Deficit to GDP, which was estimated to be 0.3 percent in 2009 Programme, was revised as 4.6 percent.

Table 1. Year 2008 Pre-Accession Economic Programme Targets

	2008	2009[1]	2009[2]	2010	2011
GDP (% Change)	1.1	4.0	-3.6	3.3	4.5
Year-end CPI (% Change)	10.1	7.5	7.5	6.5	5.5
General Government[3] Budget Deficit / GDP	1.5	0.3	4.6	3.2	2.8
IMF-Defined Central Government Primary Surplus / GDP	1.9	2.4	-0.5	-	-
Central Government Budget Expenditures / GDP	23.8	23.6	26.9	-	-
Central Government Budget Revenues / GDP	22.0	22.4	21.9	-	-
Central Government Primary Expenditures / GDP	18.5	18.4	21.0	-	-
Central Government Interest Expenses / GDP	5.3	5.2	6.0	-	-
Central Government Tax Revenues / GDP	17.7	18.2	17.6	-	-
Central Government Budget Deficit / GDP	1.8	1.2	5.0	-	-

Source: SPO
(1) Targets laid down in 2009 Annual Programme.
(2) Targets laid down in the Pre-Accession Economic Programme.
(3) General Government comprises central government budget, local administrations, revolving fund organizations, Unemployment Insurance fund, social security institutions and extrabudgetary funds.

Central government budget revenues and primary expenditures rose by 9.7 and 12.9 percent respectively in 2008. As the rise in total expenditures became 10.7 percent, the ratio of expenditures covered by revenues decreased by 0.9 percentage points compared to 2007 (Table I.3). The largest increase in primary expenditures was attributable to the capital expenditures item due to the investment expenditures in GAP (Southeastern Anatolia Project). Tax revenues went down and were realized below the target due to contracting domestic demand in the last quarter of 2008. Primary expenditures increased remarkably and tax revenues remained below the target. On the other hand, capital revenues increased due to transfer of TL 7.3 billion from the Privatization Fund and Unemployment Insurance Fund to the Treasury. This development, coupled with interest expenses remaining below the expected figures, led the central government budget deficit to remain slightly below the target (Table I.3).

Table I.3. Central Government Budget Performance (Billion TL)

	2007	2008	Change (%)	2008 Budget Target	Jan.-April 2008	Jan.-April 2009	Change (%)	2009 Budget Target	Real. /Annual Real. (Jan.-Apr.2008) (%)	Real. /Budget Target (Jan.-Apr.2009) (%)
Expenditures	204.1	226.0	10.7	222.6	70.2	87.4	24.5	259.2	31.1	33.7
Interest Expenditures	48.8	50.7	3.9	56.0	17.9	21.1	17.9	57.5	35.3	36.7
Primary Expenditures	155.3	175.3	12.9	166.6	52.3	66.3	26.8	201.7	29.8	32.9
Revenues	190.4	208.9	9.7	204.6	64.8	67.4	4.0	248.8	31.0	27.1
Tax revenues	152.8	168.1	10.0	171.2	53.2	51.0	-4.1	202.1	31.6	25.2
Revenues to Expend. (%)	93.3	92.4	-	91.9	92.3	77.1	-	96.0	-	-
Budget Deficit	-13.7	-17.1	24.8	-18.0	-5.4	-20.1	272.2	-10.4	31.6	193.3
Primary Surplus	35.0	33.6	-4.1	38	12.5	1.1	-91.2	47.1	37.2	2.3

Source: Ministry of Finance

In 2009, a trend of an evident increase is observed in the budget deficit, which is driven by the fiscal measures taken to alleviate the unfavorable effects of the global financial crisis

on Turkey and to revive domestic demand besides falling tax revenues led by the slowdown in economic activities.

In the first four months of 2009, while expenditures posted an increase of 24.5 percent, revenues rose by only 4 percent compared to the same period of 2008. As the rate of increase in expenditures was far beyond that in revenues, the ratio of expenditures covered by revenues decreased compared to the same period of the previous year and stood at 77.1 percent. While the rise in total expenditures is mainly attributable to the increase in primary expenditures of 26.8 percent, interest expenses also accelerated the increase in expenses with a rise of 17.9 percent (Table I.3). A detailed analysis of primary expenditures indicates that the increase in the current transfers item is influential. This increase is triggered by the fact that 5 percentage points of the employer's social security insurance premia has been covered by the Treasury since October 2008, coupled with rise in transfers made to the Social Security Institution.

In the first four months of 2009, despite the increase in non-tax revenues on the back of TL 1.3 billion transferred to the budget from the Unemployment Insurance Fund and besides TL 1.8 billion obtained from the sale of 3rd generation GSM license excluding Value Added Tax (VAT), the decrease in tax revenues by 4.1 percent led the increase in revenues to remain limited. When analyzed in terms of tax types, it is observed that while income tax and domestic VAT increased by 8.9 and 12.1 percent, respectively, VAT on imports, corporate tax and special consumption tax decreased by 31.9, 15 and 3.4 percent, respectively.

Parallel to these developments, the primary surplus posted by the central government budget, which was TL 12.5 billion in the same period of the previous year, became TL 1.1 billion in the first four months of 2009. The central government budget deficit recorded a significant increase from TL 5.4 billion to TL 20.1 billion (Table I.3).

Box 9.
"Fiscal Measures Taken Against the Crisis and Their Cost on the Budget" Announced in the Pre-Accession Economic Programme

In order to alleviate the effects of the global financial crisis, which has indicated its negative reflections on the Turkish economy as of the last quarter of 2008, several measures have been taken in Turkey, as have been other countries. In this context, with a view to underpinning exports, the paid-in capital of Eximbank was raised and the amount of loans to be extended by SMIDO (Small and Medium Industry Development Organization) and Eximbank was increased and re-payment conditions were facilitated. Aimed at reducing the labor costs of the employer, it was decided that 5 points of the employer's share of the social security premium would be covered by the Treasury and that the employer's premia for employment of women and the young would be subsidized by the government. Moreover, in order to support domestic demand, the resource utilization support fund deductions in consumer loans were reduced, VAT and SCT rates implemented on various goods were reduced for 3 months, and the amount of short-time working benefits and the period for the utilization of these benefits was extended.

These measures are estimated to create a burden on the budget of as much as TL 19.1 billion in 2009 and the ratio of this cost to GDP is expected to become 1.98 percent. Measures to avert the crisis will impose additional costs on public finance. Nevertheless, as these costs are incurred in order to stimulate economic activities, the measures taken are considered to be reasonable.

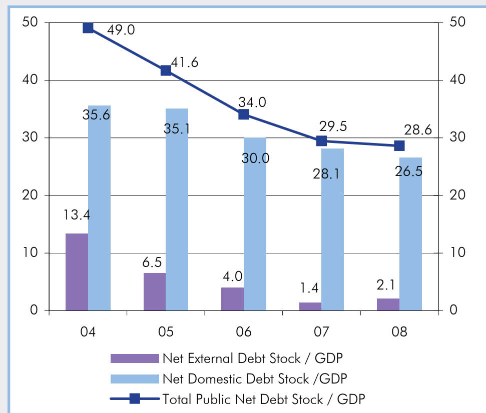
Table 1. Fiscal Measures Taken Against the Crisis and their Estimated Fiscal Costs in 2009

Measures	Cost (Million TL)
Measures that Decrease Public Revenues	8,043
Tax on Individuals	80
Business Taxes	4,909
Consumption Taxes on Goods and Services	1,905
Contributions to Employment and Social Security Payments	274
Other Income Measures	875
Measures that Increase Public Expenditures	11,085
Public Consumption and Investments	5,630
Transfers to Households	172
Transfers to Businesses	2,594
Other Transfers to Public	2,189
Other Expenditures	500
Total	19,128
Share within GDP (%)	1.98

Source: Pre-Accession Economic Programme

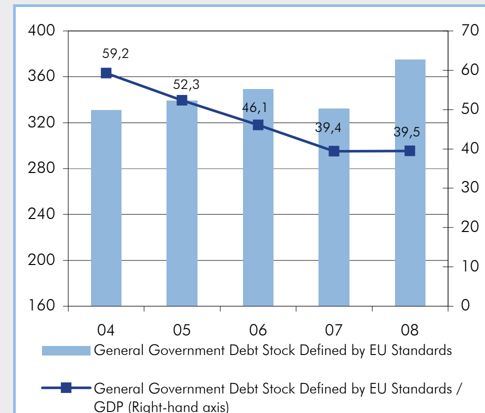
The ratio of public net debt stock to GDP continued to decline and became 28.6 percent at end-2008. Although an increase was observed in public net debt stock in 2008 as opposed to the previous years, the rise in GDP outpaced this increase, which was influential in this decline (Chart I.25). Public gross debt stock posted an increase compared to 2007 due to the rise both in domestic and external debt stock. The ratio of EU-defined general government nominal debt stock to GDP displayed a limited increase (Chart I.26).

Chart I.25.
Composition of Total Public Sector Net Debt Stock[1,2] (%)



Source: Treasury
(1) Public sector net debt stock is calculated by subtracting central bank net assets, public deposits and unemployment insurance fund net assets from public gross debt stock.
(2) Figures for 2007 and 2008 are provisional.

Chart I.26.
General Government Nominal Debt Stock Defined by EU Standards[1,2] (Billion TL, %)



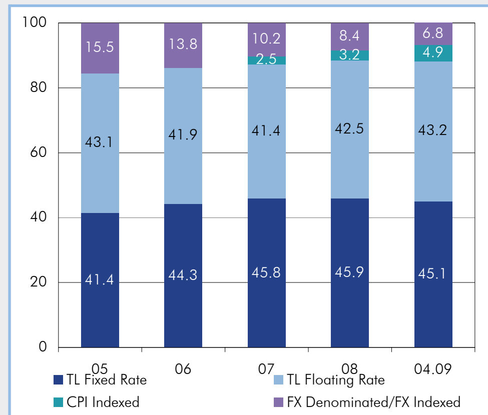
Source: Treasury
(1) Consolidated nominal debt stock as defined in European System of Accounts 95 (ESA 95) deficit and debt manual.
(2) Figures for 2007 and 2008 are provisional.

Regarding the composition of domestic debt stock, the issuance of CPI-indexed bonds of TL 5,997 million in February and April 2009 led the share of CPI-indexed debt stock to

rise compared to end-2008. In addition, the share of floating-rate debt stock increased with the contribution of Revenue Indexed Bonds (RIB) that started to be issued in January 2009. Moreover, the shares of FX denominated and FX indexed debt stock besides fixed-rate debt stock went down (Chart I.27).

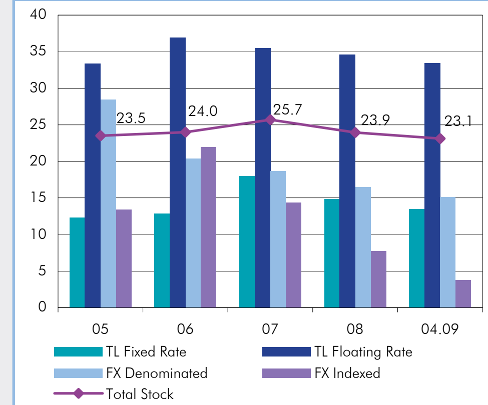
The average maturity of government securities, which increased to 25.7 months at end-2007, decreased to 23.9 and 23.1 months in 2008 and April 2009, respectively (Chart I.28).

Chart I.27.
Composition of Domestic Debt Stock (%)[1,2]



Source: Treasury
(1) CPI-indexed bonds have been issued since February 2007.
(2) The TL denominated RIB is classified in TL Floating Rate Debt Stock and FX denominated RIB is classified in FX Denominated/FX Indexed Debt Stock.

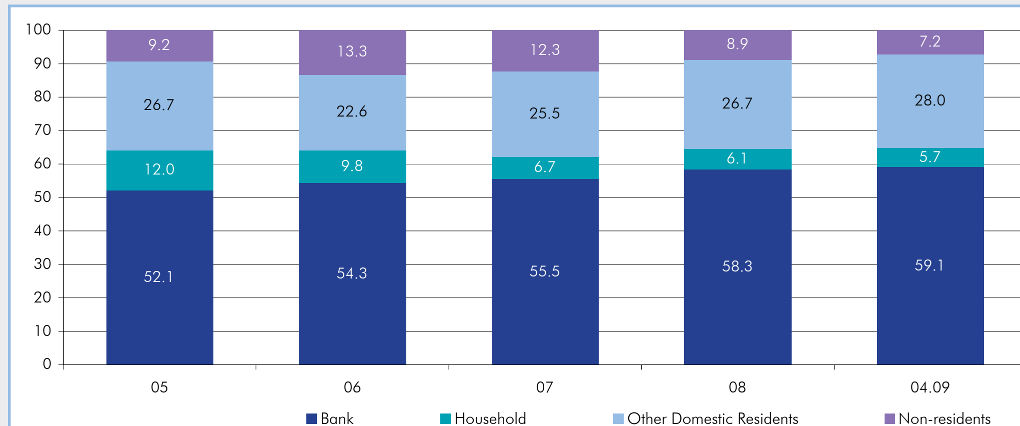
Chart I.28.
Maturity Structure of Government Domestic Debt Stock (Month)[1]



Source: Treasury
(1) Calculation is based on term to maturity.

A large portion of total government bonds is owned by banks, thus comprising a major part of banking sector assets. The share of banks increased, whereas that of non-residents maintained its downward trend in the first four months of 2009 (Chart I.29).

Chart I.29.
Government Domestic Debt Securities by Holders[1,2,3] (%)



Source: BRSA-CBRT
(1) Based on nominal amounts.
(2) "Bank" includes GDDS owned by banks operating in Turkey; "Household" includes GDDS that belong to real persons kept at domestic banks; "Other domestic residents" includes GDDS of domestic legal persons except banks and households also GDDS of mutual funds kept at banks and "Non-residents" involves non-resident real and legal persons' GDDS kept at domestic banks.
(3) GDDS owned by the Central Bank are excluded.

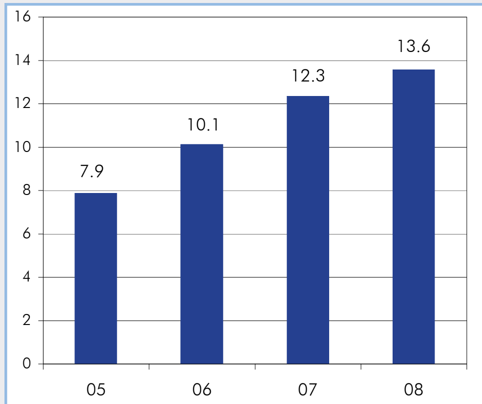
In the first four months of 2009, the figures related with central government budget were parallel to the macroeconomic developments and to the fiscal measures enforced with a view to containing the adverse effects of the financial crisis. Moreover, budget appropriations were rapidly released in that period. Given the current economic conjuncture, rising budget deficit is a worldwide phenomenon. The current debt structure of the public sector provides some room for maneuver, albeit limited, to implement a counter-cyclical fiscal policy. However, it should be kept in mind that the average maturity of public debt is still short and that financial depth is relatively low in Turkey. In order to obtain the desired outcome from fiscal measures, building a mechanism that will safeguard fiscal discipline in the medium term as well as supporting short term fiscal easing with a concrete medium term fiscal framework are of great importance.

I.4. Private Sector Developments

I.4.1. Household

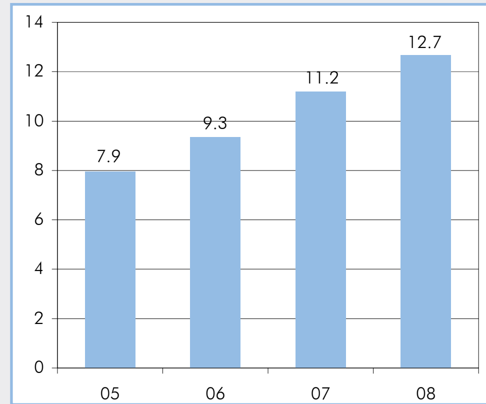
Household liabilities continued to increase in 2008.

Chart I.30.
Household Liabilities to GDP (%)[1,2]



Source: CBRT-BRSA, TURKSTAT
(1) Household liabilities consist of gross consumer credits and credit card balances extended by banks and consumer finance companies and liabilities to TOKİ due to TOKİ's housing sales with long term maturity.
(2) Since liabilities to TOKİ due to TOKİ's housing sales with long-term maturity are included in total household liabilities, the ratios differ from those in previous Financial Stability Reports. Total household liabilities to TOKİ as of 2005, 2006, 2007 and 2008 are 1,149 million TL, 3,405 million TL, 4,617 million TL and 5,703 million TL respectively.

Chart I.31.
Retail Loans to Household Consumption Expenditures (%)[1]

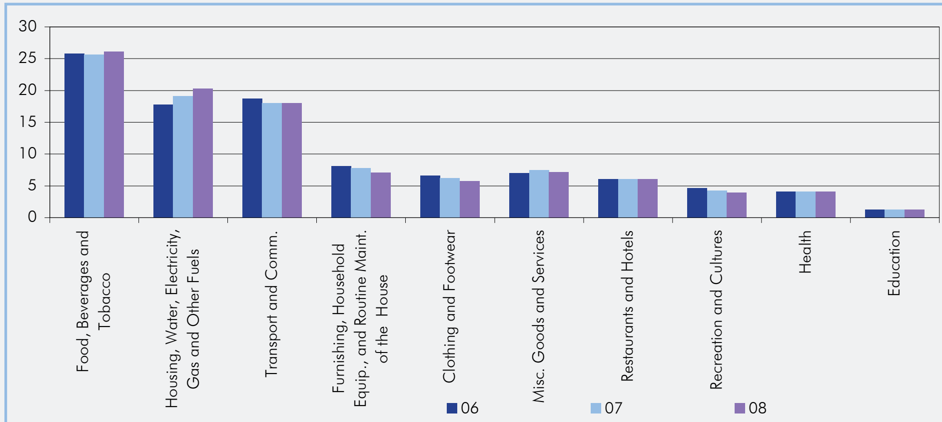


Source: CBRT-BRSA, TURKSTAT
(1) Retail loans consists of gross consumer credits and credit card balances extended by banks and consumer finance companies less housing credits.

The ratio of total household liabilities to GDP rose to 13.6 percent at end-2008 from 12.3 percent in 2007 (Chart I.30). In the same period, the portion of household consumption expenditures financed by retail loans, increased from 11.2 percent to 12.7 percent (Chart I.31).

Box 10.
Decomposition of Final Consumption Expenditures

Chart 1. Decomposition of Final Consumption Expenditures[1]



Source: TURKSTAT
(1) Final consumption expenditures consist of domestic final consumption expenditures of resident and non-resident households.

Final consumption expenditures were TL 693.8 billion in 2008. The largest share in these expenditures belongs to expenditures on Food, Beverages and Tobacco with 26.1 percent, followed by Housing, Water, Electricity, Gas and Other Fuels with 20.3 percent and expenditures on Transportation and Communication with 18 percent. The total share of these three items of expenditure is 64.5 percent. The rise in expenditures on Housing, Water, Electricity, Gas and Other Fuels continued in 2008 as well, and this item recorded the highest increase among other expenditure items in 2008.

Table I.4. Household Disposable Income, Liabilities and Interest Payments[1,2,3] (Million TL)

	2006	2007	2008
Household Interest Payments	12,109	15,576	19,653
Household Liabilities	76,814	104,111	128,966
Household Disposable Income	404,677	465,992	545,377
Interest Payments / Disposable Income (%)	3.0	3.3	3.6
Liaibilites / Disposable Income (%)	19.0	22.3	23.6

Source: BRSA-CBRT, TURKSTAT, SPO
(1) Household liabilities consist of gross consumer credits and credit card balances extended by banks and consumer finance companies and liabilities to TOKİ due to TOKİ's housing sales with long term maturity.
(2) As the repayment related to liabilities due to TOKİ's housing sales with long term maturity are indexed to civil servant salaries, they are not included in interest payments.
(3) Household disposable income is calculated by using private sector disposable income estimation for 2006, 2007 and 2008 as mentioned in the 2009 Annual Programme, under the assumption that the 2005 ratio of household disposable income to private sector disposable income has not changed.

By the end of 2008, household liabilities and interest payments increased by 23.9 percent and 26.2 percent, respectively, compared to end-2007. In the same period, the ratio of household interest payments to disposable income, one of the main indicators of households' repayment capacity, rose from 3.3 percent to 3.6 percent whereas the ratio of total household liabilities to disposable income increased from 22.3 percent to 23.6 percent (Table I.4).

Box 11.
Consumer Loan Borrower Profile

The Consolidated Report on Consumer Loans and Housing Loans published by the Banks Association of Turkey by compiling the data of 36 banks reveals that 94 percent of those who obtained consumer loans in the third quarter of 2008 obtained other loans, while 3 percent obtained housing loans and the remaining 3 percent obtained vehicle loans. The breakdown of loans by amount shows that the shares of other, housing and vehicle loans are 66.9 percent, 23.6 percent and 9.5 percent, respectively.

The breakdown of borrowers according to income level reveals that the largest share belongs to the lowest income group, with 46 percent in the third quarter of 2008. The average per capita loan amount used by the lowest and the highest income groups materialized as TL 5.6 thousand and TL 24.9 thousand, respectively (Table 1).

Table 1. Breakdown According to Monthly Income Level of Borrowers

	0 - 1,000 TL	1,001- 2,000 TL	2,001- 3,000 TL	3,001- 5,000 TL	5,001 + TL	Unclassified
Number of Borrowers	798,648	448,738	151,556	103,961	119,477	112,941
Consumer Loans Ext. (Million TL)	4,456	3,541	1,896	1,764	2,979	1,084
Average Amount (Thousand TL)	5.6	7.9	12.5	17.0	24.9	9.6
% Breakdown	46.0	25.9	8.7	6.0	6.9	6.5

The demographic structure of borrowers indicates that the 36-55 years group has the largest share with 45.4 percent, and that the same group takes the lead in holding the largest amounts of loans used per capita. Meanwhile, the lowest amount per capita belongs to those above the age of 66 with 5.6 thousand TL (Table 2).

Table 2. Breakdown According to Age of Borrowers

	18-25	26-35	36-55	56-65	66+	Unclassified
Number of Borrowers	141,912	472,506	788,703	228,793	98,099	5,308
Consumer Loans Ext. (Million TL)	997	4,459	7,929	1,718	551	68
Average Amount (Thousand TL)	7.0	9.4	10.1	7.5	5.6	12.8
% Breakdown	8.2	27.2	45.4	13.2	5.7	0.3

The breakdown of borrowers according to occupation reveals that the wage earners have the largest share with 51.4 percent owing to their fixed incomes, whereas the self-employed have a share of only 7.8 percent (Table 3).

Table 3. Breakdown According to Occupation of Borrowers

	Wage Earner	Self-Employed	Other	Unclassified
Number of Borrowers	892,616	135,788	566,408	140,509
Consumer Loans Ext.(Million TL)	7,711	2,141	4,711	1,158
Average Amount (Thousand TL)	8.6	15.8	8.3	8.2
% Breakdown	51.4	7.8	32.6	8.1

34.8 percent of borrowers are graduates of primary and middle school, whereas 31.7 percent are graduates of high school. Meanwhile, it is observed that individuals with a higher level of education use higher amounts of loans (Table 4).

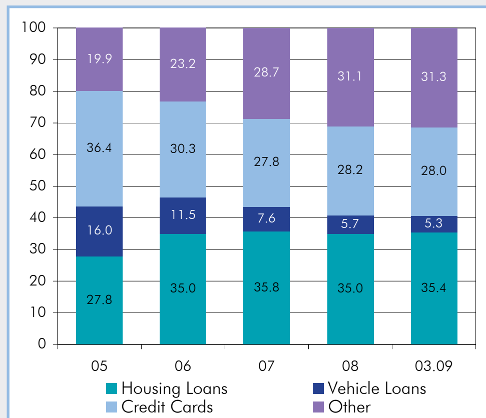
Table 4. Breakdown according to education level of borrowers

	Primary and Middle School	High School	University+	Unclassified
Number of Borrowers	604,115	550,472	328,152	252,582
Consumer Loans Ext. (Million TL)	4,135	4,856	4,171	2,559
Average Amount (Thousand TL)	6.8	8.8	12.7	10.1
% Breakdown	34.8	31.7	18.9	14.6

To sum up, the analysis of the consumer loan borrower profile suggests that the majority of borrowers use other loans, they have low income levels, and are in the middle age group. The analysis also concludes that these borrowers are wage earners and their education level is below university.

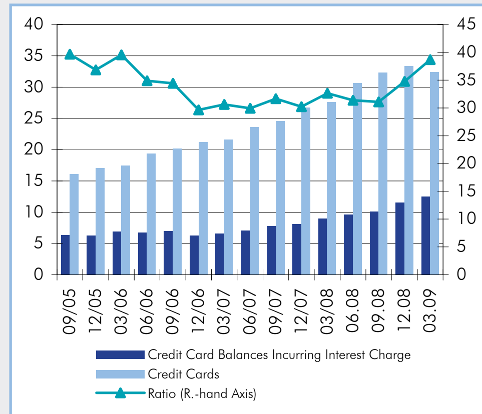
Source: Banks Association of Turkey, Consolidated Report on Consumer Loans and Housing Loans, September 2008.

Chart I.32.
Decompositon of Household Liabilities (%)[1,2,3]



Source: BRSA-CBRT
(1) Household liabilities consist of gross consumer credits and credit card balances extended by banks and consumer finance companies and liabilities to TOKİ due to TOKİ's housing sales with long term maturity.
(2) Liabilities to TOKİ due to TOKİ's housing sales with long-term maturity are also included in housing loans.
(3) Since liabilities to TOKİ due to TOKİ's housing sales with long-term maturity are included in total household liabilities, the shares differ from those in previous Financial Stability Reports.

Chart I.33.
Credit Card Balance of Deposit Banks and Balances That Incur Interest Charge (Billion TL, %)



Source: CBRT

When the development of household liabilities is analyzed by type, it is observed that housing loans increased by 21 percent, other loans by 33.9 percent and credit card balances increased by 25.7 percent, whereas vehicle loans decreased in 2008 compared to 2007. By March 2009, vehicle loans and credit card balances decreased by 7.1 percent and 0.7 percent, respectively, while housing loans and other loans increased by 1.1 percent and 0.8 percent compared to end-2008. As a result of these developments, the share of other loans and housing loans rose whereas that of vehicle loans and credit card balances declined compared to end-2008 (Chart I.32).

Credit card balances were still on the rise by the end of 2008 compared to 2007. Credit card balances incurring interest charges rose to TL 11.6 billion in 2008 from TL 8.1 billion in 2007 and reached TL 12.5 billion by March 2009. The ratio of credit card balances incurring interest charges to the total credit card balances became 30.2 percent, 34.7 percent and 38.7 percent, respectively during the aforementioned periods (Chart I.33).

A comparison between September 2008 and March 2009 reveals that while consumer loans declined, credit card balances incurring interest charges increased by 24.6 percent. This is, as expected, the result of the increased tendency of consumers to resort to credit cards as an instrument of credit due to stricter terms applied by banks on consumer loans. Given that credit card interest rates are higher than consumer loan interest rates, the vulnerability of households increases.

Regarding consumer loans in Turkey, the floating-rate is only applicable to housing loans. However, the negligibly low share of such loans limits the interest rate risk of households.

Table I.5. FX Indexed Total Consumer Credits and FX Indexed Housing Credits[1] (Million TL, %)

	2006	2007	2008	03.09
FX Indexed Total Consumer Credit	1,836	2,903	4,187	4,035
FX Indexed Housing Credit	1,497	2,398	3,603	3,496
FX Indexed Cons. Credits/Total Consumer Credit (R-hand Axis)	3.9	4.3	4.9	4.7
FX Indexed Housing Credit/Total Housing Credit	6.4	7.4	9.1	8.8

Source: BRSA-CBRT
(1) Consumer finance companies are excluded.

The ratio of FX-indexed loans to total consumer loans increased to 4.9 percent as of end-2008 from 4.3 percent in 2007, whereas the share of FX-indexed housing loans in total housing loans increased from 7.4 percent to 9.1 percent during the same period. In March 2009, these figures declined to 4.7 percent and 8.8 percent, respectively (Table I.5). FX-indexed retail loans still have a relatively low share in total retail loans in Turkey compared to many countries.

Table I.6. Number of Consumer Loan and Credit Card Defaulters[1]

	12.07	06.08	09.08	12.08	03.09
Banks	641,708	754,307	832,698	962,190	1,080,487
Asset Management Companies[2]	0	82,315	123,251	139,862	130,623
Finance Companies	12,898	15,005	17,627	21,884	25,207
Total[3]	651,911	812,571	911,456	1,059,737	1,174,525

Source: CBRT
(1) Customers with more than one registry to a particular financial institution group are counted only once.
(2) Represents non-performing loans taken by Asset Management companies from the SDIF banks.
(3) As customers may have registry to more than one financial institution group, the sum of the three rows in the table and grand total are not equal.

Meanwhile, according to Central Bank Risk Center data, as of March 2009, the number of consumer loan and credit card defaulters increased by 10.8 percent in comparison to end-2008 and reached 1,174,525 (Table I.6). The decline in the number of consumer loan and credit card defaulters belonging to asset management companies was mainly attributable to the fact that asset management companies increased their collection and they did not purchase any new assets during this period.

Table I.7. Composition of Household Financial Assets[1] (Billion TL, %)

	2007		2008		03.09	
	Billion TL	% Share	Billion TL	% Share	Billion TL	% Share
TL Deposits	142.5	45.5	188.7	51.3	192.7	49.7
FX Deposits	78.5	25.0	89.0	24.2	94.4	24.3
FX Deposits (Billion USD)	67.0	-	59.1	-	57.3	-
Currency in Circulation	26.2	8.4	30.6	8.3	32.0	8.2
GDDS+Eurobond	19.6	6.3	19.7	5.4	20.8	5.4
Mutual Fund	22.6	7.2	20.8	5.7	25.3	6.5
Stocks	17.5	5.6	10.6	2.9	13.9	3.6
Private Pension Funds	4.6	1.5	6.4	1.7	6.9	1.8
Repos	1.9	0.6	2.2	0.6	2.0	0.5
Total Assets	313.4	100.0	368.0	100.0	388.0	100.0

Source: BRSA-CBRT, CMB, CRA
(1) TL and FX deposits include participation funds.

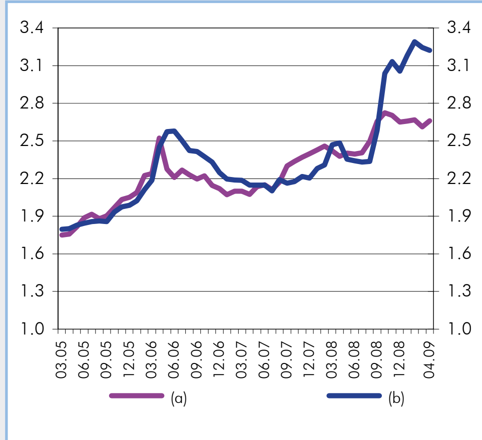
With the effect of the depreciation of TL, the total financial assets of households rose by 17.4 percent in comparison to end-2007 and reached TL 368 billion at end-2008 and became TL 388 billion in March 2009 (Table I.7).

The share of savings deposits, which constitutes the largest portion of household assets, continued to grow and reached 51.3 percent in 2008, but declined to 49.7 percent by March 2009. This was mainly driven by the increased appetite of households for other investment tools, primarily investment funds, due to the decline in deposit rates and by the increase in the value of equities. The share of savings deposits in total deposits, which was 64.5 percent at end-2007, increased to 68 percent at end-2008 and decreased to 67.1 percent in March 2009 (Table I.7). Due to the depreciation of the Turkish currency in October 2008, real persons converted their FX deposit accounts into Turkish Lira, which in turn, resulted in a significant decline in the amount of FX deposit accounts. FX deposit accounts remained flat in the November 2008-February 2009 period and started to pick up again in the following period.

FX indexed liabilities of households to the banking sector are USD 2.4 billion as of March 2009, whereas FX assets of households are USD 59.8 billion and households carry a long position in FX. Nevertheless, it is possible that on an individual basis, households, which have FX liabilities, may not possess FX assets; so it is obvious that the repayment ability of households without foreign exchange income will be adversely affected if the Turkish Lira depreciates.

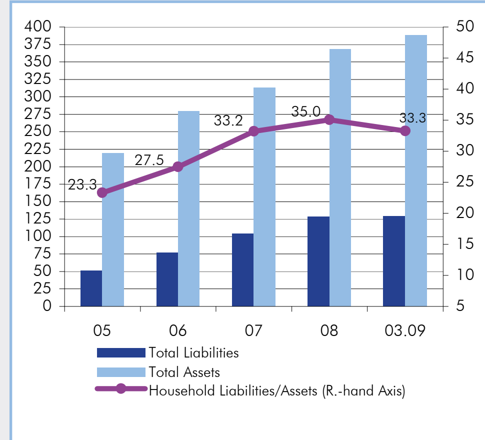
When adjusted according to the exchange rate and parity effect, the ratio of total Turkish currency instruments to foreign currency instruments started to increase as of September 2008 (Chart I.34).

Chart I.34.
Ratio of TL-FX Denominated Investment Instruments[1]



Source: BRSA-CBRT, CMB, CRA
(1) TL Instruments = Deposits + Repos + Gov.Dom.Debt.Sec. + Participation Funds (TL) + Stocks + Private Pension Funds + Mutual Funds (starting from April 2006); FX Instruments = FX Deposits + Gov.Dom.Debt.Sec. + Eurobond + Participation Funds (FX).
(a) Current TL value of FX deposits and Participation Funds (FX).
(b) For FX deposits and Participation Funds (FX), exchange rate prevailing on 31.12.2004 is used and the parity effect is eliminated.

Chart I.35.
Households' Financial Assets and Liabilities (Billion TL, %)[1]



Source: BRSA-CBRT, CMB, CRA
(1) Household Assets = Savings Deposits + FX Deposits + Money in Circulation + Gov.Dom.Debt.Sec. + Eurobonds + Repos + Stocks + Pension Funds + Mutual Funds (starting from April 2006). Household liabilities consist of gross consumer credits and credit card balances extended by banks and consumer finance companies and liabilities to TOKİ due to TOKİ's housing sales with long term maturity.

Meanwhile, the ratio of household financial liabilities to financial assets rose to 35 percent at end-2008, but dropped to 33.3 percent as of March 2009 (Chart I.35).

While household indebtedness and its ratio to the GDP display an upward trend in Turkey, they are still low compared to many countries. The monetary tightening in 2006 has also been instrumental in this development. Moreover, as interest and exchange rate risk on household liabilities is limited, households are affected relatively less by unfavorable developments in economic conditions. The liability structure of households, as well as the fact that households faced the economic crisis with relatively low indebtedness levels, restrained the unfavorable effects of the crisis on the Turkish economy. However, the repayment ability of households might weaken on account of increased unemployment due to the slowdown in economic activity.

I.4.2. Corporate Sector

I.4.2.1. Financial Analysis

The financial crisis that erupted in developed financial markets in 2007 led to a significant deceleration in global economic growth rates in 2008. While the global recession affected Turkish firms through the channel of commerce, the funding costs of firms surged in response to the global liquidity crunch and therefore their financial structures were affected adversely.

In order to analyze corporate sector developments, basic financial ratios were calculated using data pertaining to the selected 187[3] firms traded on the ISE, 143 of which are involved in the manufacturing industry. The ratio of total asset size and revenues from total sales of firms analyzed in relation to the GDP was 14.9 percent and 17.6 percent, respectively, while the ratio of their revenues from foreign sales to total exports was 23.7 percent as of end-2008.

However, firms listed on the ISE are large companies, which have high export opportunities and many funding alternatives other than banking credits, primarily capital markets, and their shareholders equity is relatively stronger, compared to those not listed on the ISE. Therefore, it should be taken into consideration that these firms' financial indicators can differ from those of other firms. Moreover, when the data of firms listed on the ISE is distributed according to sub-sectors, it should also be noted that some concentrations occur within specific sectors, thus sectoral impacts may be reflected in the ratios.

Table I.8. Financial Ratios of Selected ISE Firms (%)

	All Companies		Manufacturing Companies	
	2007	2008	2007	2008
Financial Structure Ratios				
Leverage Ratio	46.2	52.3	46.1	52.6
Short-Term Debt / Total Liabilities	31.6	33.8	31.4	35.7
Bank-Loans/Total Debt	41.0	49.0	43.2	52.0
Bank Loans/Total Liabilities	18.9	25.6	19.9	27.4
Net Financial Income(Expense)/Total Assets	0.03	-3.0	0.8	-5.0
Net Financial Income(Expense)/Total Sales	0.03	-2.6	0.6	-3.8
Interest Coverage Ratio (Times)	4.4	2.4	4.6	1.7
Liquidity Ratios				
Cash Ratio	37.6	42.9	27.2	30.0
Liquidity (Acid Test) Ratio	106.7	100.6	105.1	93.5
Profitability Ratios				
Net Profit / Assets (ROA)	9.0	4.3	8.8	2.1
Net Profit / Equity (ROE)	16.7	9.0	16.3	4.4
Turnover Ratios				
Inventory Turnover Ratio (Cost of Sales / Aver. Invent.)	-	2.4	-	2.5
Receivables Turnover Ratio (Net Sales / Trade Receiv.)	7.0	7.9	6.5	7.7
Asset Turnover Ratio (Net Sales / Total Assets)	1.2	1.2	1.3	1.3

Source : ISE

The balance sheet size of firms increased by 17.4 percent in nominal terms and by 6.7 percent in real terms and reached TL 141.7 billion in 2008 compared to 2007.

Significant depreciation of the TL in the last quarter of 2008 increased the indebtedness ratios of firms with a high level of foreign exchange denominated liabilities. As a result, trade payables of firms surged by 14.3 percent in 2008 compared to 2007, while their financial debts rose by 58.8 percent. Therefore, the leverage ratio of firms reached 52.3 percent with an increase by 6.1 points in 2008. Their interest coverage ratio in the same period declined by approximately 50 percent (Table I.8). The weakening in the debt service capacity of firms is expected to exacerbate the NPL of the banking sector.

[3] Due to the change in the accounting period of a firm operating in the Tourism Sector and Retail Trade Sector, the number of firms differs from the number given under the "Foreign Exchange Position of the Corporate Sector" heading due to the inaccessibility of the firm's December 2007 financial statements as per the "Communiqué on Principles Regarding Financial Reporting Standards in Capital Markets" (Serial: XI, No: 29) of the Capital Markets Board of Turkey.

Although the short-term debt of firms increased in 2008, the cash ratio climbed due to the fact that firms raised their cash and cash equivalent items further in line with their need to remain liquid. However, the acid test ratio declined as a result of the limited increase that occurred in relatively less liquid items in the current assets (Table I.8).

In response to increasing financing costs due to tightening global liquidity conditions and deepening mistrust in 2008, the financing cost of firms surged. As a matter of fact, the ratio of net financial revenues (expenditures) to total revenues from sales, which was 0.03 percent in 2007, dropped to –2.6 in 2008 owing to the 128 percent rise in financial expenditures despite the 68.5 percent increase in financial revenues (Table I.8).

The profit, which had been TL 10.9 billion at end-2007, fell to TL 6.1 billion at end-2008. This decline in profitability pushed ROE and ROA down (Table I.8 and Table I.9).

Table I.9. Income Statement Items of Selected ISE Firms

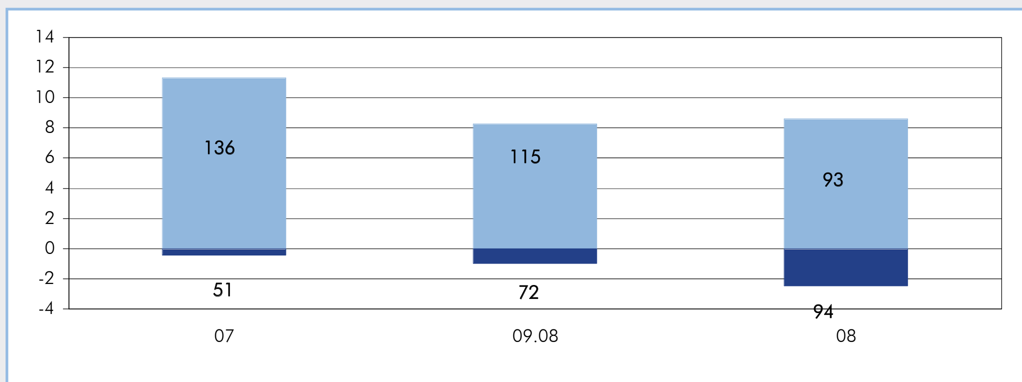
	All Companies		Manufacturing Comp.	
(Million TL)	2007	2008	2007	2008
Sales Income	146,396	166,780	106,382	122,207
Sales Cost	119,315	137,353	89,858	104,482
Gross Profit (Loss) on Business Operation	27,081	29,427	16,524	17,725
Operating Profit (Loss)	**12,661**	**12,179**	**7,789**	**7,410**
(Main non-Operating) Financial Incoıme	7,340	12,366	5,286	7,914
(Main non-Operating) Financial Expenses	7,300	16,643	4,617	12,605
Profit/Loss Before Taxes on Cont. Operations	**13,292**	**8,054**	**8,935**	**2,738**
Profit (Loss)	**10,858**	**6,072**	**7,337**	**1,948**

Source: ISE

Despite the 13.9 percent rise in the sales revenues of firms in 2008, profit of the period plunged by 44 percent. This development mainly stemmed from climbing financing costs due to upward movements in exchange and interest rates (Table I.9).

Net foreign exchange revenues, which accounted for 9.5 percent of the net profit of the period at end-2007, led to a significant decline in profitability by turning into net foreign exchange expenditure due to the depreciation of the TL especially in the last quarter of 2008. The sector’s net foreign exchange profit of TL 1 billion at end-2007 turned into a loss of TL 2.7 billion.

Chart I.36.Profitability of Selected ISE Firms (Billion TL, Number of Firms)



Source: ISE

While the number of firms that made a profit was 136 and the total amount of their profits was TL 11.3 billion by the end of 2007, the number of such firms fell to 93 and the profit became TL 8.6 billion with a decrease of 24.3 percent. The number of firms that suffered losses rose from 51 to 94 and the total amount of their loss climbed to TL 2.5 billion from TL 0.5 billion in the same period (Chart I.36).

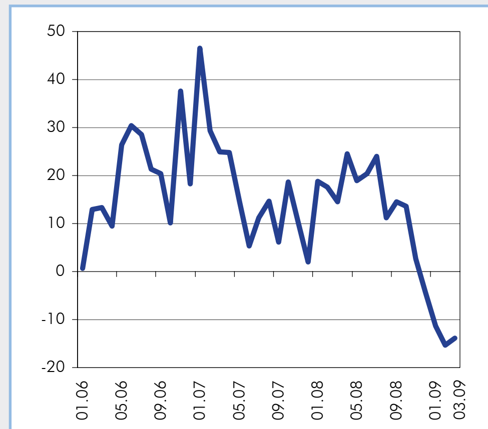
Table I.10. Profit/Loss Analysis of the ISE Firms which made loss in 2008 (Million TL)

	2007	2008
Net Profit of All Companies	**10,858**	**6,072**
- Net Profit of the Companies which made profit in 2008	9,829	8,591
- Net Profit (Loss) of the Companies which made loss in 2008	1,030	-2,519
FX Profit of the Companies which made loss in 2008	**1,065**	**-2,086**
- Net FX Profit (Loss) of the Companies which made loss in 2008)/Total Profit (Loss) (%)	*103.4*	*82.8*

Source: ISE

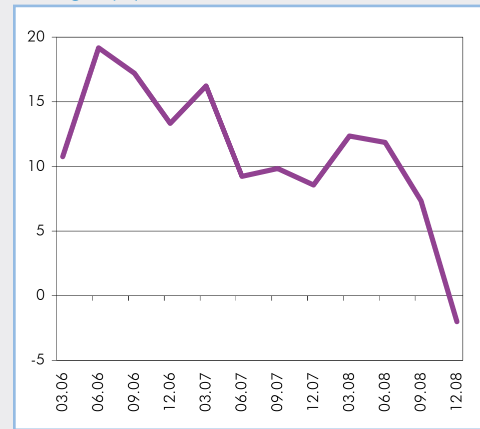
Foreign exchange expenditures of 94 firms that declared a loss in 2008 were instrumental in the loss of these firms and the same firms gained net foreign exchange profit in the sum of TL 1.1 billion in 2007 (Chart I.10).

Chart I.37.
Industrial Turnover Index Yearly Change[1] (%)



Source: TURKSTAT
(1) Industrial Turnover Index 2005=100.

Chart I.38.
Trade and Services Turnover Index Yearly Change[1] (%)



Source: TURKSTAT
(1) Trade and Services Turnover Index 2005=100.

Although there was an increase in the 2008 sales revenues of the ISE-listed firms analyzed, the industrial turnover index, which shows the changes in sales of medium and large scale companies that account for a major portion of the industrial sector and the turnover index, indicating the developments in turnover amounts of firms operating in trade and service sector lost, significant ground. This situation underpins the expectation of a possible decline in sales revenues of firms in the said period. Nevertheless, the rate of decrease in the industrial turnover index slowed down in March 2009 (Chart I.37 and Chart I.38). A similar trend is also observed in the changes of the industrial production index and the capacity utilization rates (Chart I.21).

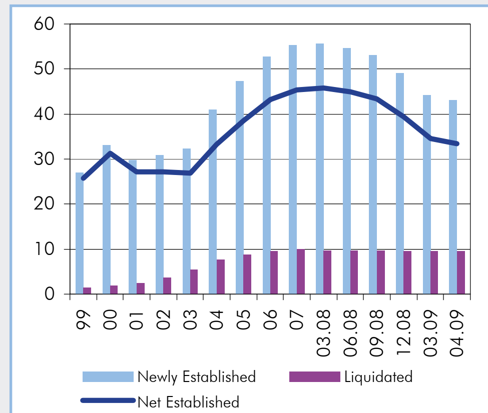
Table I.11. The First 5 Sectors with the Largest Share in Exports as of April 2009 (Million USD)

	April (Monthly)				October-April (7 Months)			
Sectors	April 08	April.09	Change (%)	Share (%)	Oct. 2007-April 2008	Oct. 2008-April 2009	Change (%)	Share (%)
Motor Vehic. And Rel. Ind.	2,512	1,239	-50.7	16.5	15,861	8,630	-45.6	16.0
Cloth. and Ready-Wear	1,306	996	-23.7	13.2	9,811	7,337	-25.2	13.6
Iron and Steel Prod.	1,617	959	-40.7	12.7	8,106	6,747	-16.8	12.5
Chem. and Chem. Prod.	1,235	757	-38.7	10.1	7,585	5,009	-34.0	9.3
Electric-Electronic	800	614	-23.3	8.2	5,939	4,698	-20.9	8.7
The First 5 Sectors in Total	7,471	4,564	-38.9	60.6	47,303	32,421	-31.5	60.2
Total	**11,363**	**7,528**	**-33.7**	**100.0**	**72,944**	**53,835**	**-26.2**	**100.0**

Source : TEA

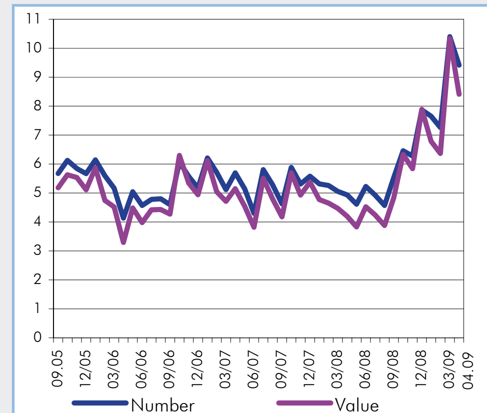
The decrease in volume of exports was also instrumental in the decline of the sales of firms. As a matter of fact, according to Turkish Exporters Assembly (TEA) data, Motor Vehicles and Related-Industry, Clothing and Ready-Wear Sector, Iron and Steel Products, Chemicals and Chemical Products, and Electric-Electronic sectors, which altogether account for 60.6 percent of total exports, started to post lower export figures, and total exports underwent contraction of 26.2 percent year-on-year in the period October 2008–April 2009 (Table I.11).

Chart I.39.
Number of Newly Established and Liquidated Companies and Cooperatives (Thousand)[1]



Source: TURKSTAT
(1) Annualized data is used.

Chart I.40.
The Ratio of Over-Drawn Cheques Presented to the ICH to the Total Cheques Presented to the ICH(%)

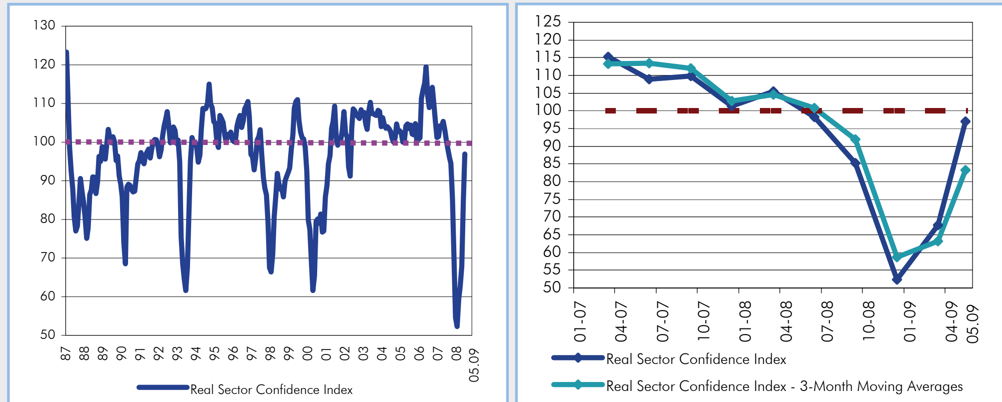


Source: CBRT

Despite the number of liquidated companies that followed a relatively stable course, the net number of newly established companies has been declining steadily since June 2008 due to the downward trend observed in the number of newly established companies since that date. The net number of newly established companies decreased by 26.9 percent year-on-year in April 2009 (Chart I.39).

The ratio of over-drawn cheques presented to the Interbank Clearing House (ICH) to total cheques presented to the ICH has been rising both in terms of number and value since September 2008. The ratios, which soared month-on-month in March 2009 due to the effect of the abolishment of the directive on the payment of stopped cheques, with Law no. 5838, becoming 9.4 percent and 8.4 percent respectively as of April 2009 (Chart I.40).

Chart I.41.
Real Sector Confidence Index



Source: CBRT

The aforementioned developments affected the expectations of the economic sector adversely. As a matter of fact, the downward trend of the CBRT Business Tendency Survey and Real Sector Confidence Index (RSCI), which started in March 2008, persisted in the last quarter of the year and fell to its lowest level of 52.3 in December 2008. Although the index is still below 100, it has been on the rise since January 2009 (Chart I.41). An analysis of the diffusion indices pertaining to survey questions that made up the CBRT Business Tendency Survey and the Real Sector Confidence Index suggests that the relative improvement in 2009 has been driven by the overall improvement in all of the indices, primarily the volume of output over the next three months, the general business situation, the total amount of orders over the last three months and export orders over the next three months.

In conclusion, certain measures have been taken at global and national level in order to contain the adverse effects of the deepening crisis. The expansionary monetary and fiscal policies implemented within this scope both remedied bottlenecks in the credit channel to some extent and stopped the deterioration of expectations in general. Stimulus packages including tax cuts, along with efforts to facilitate financing are expected to help Turkish firms recover.

I.4.2.2. Borrowing Structure of the Corporate Sector

The corporate sector financial debt became TL 352.2 billion, approximately 65.9 percent of which accounted for FX denominated debt, as of March 2009. Therefore, exchange rate fluctuations affect corporate sector debt significantly.

Table I.12. Financial Debt of the Corporate Sector[1] (Million TL)

	2006	2007	09.08	12.08	03.09
Corporate Sector Loans (I+II)	**202,429**	**246,721**	**317,693**	**346,358**	**352,171**
I. Domestic Loans (i+ii)	**125,385**	**153,322**	**193,100**	**193,221**	**190,629**
i. TL	83,761	105,783	130,277	123,203	120,221
ii. FX (Including FX-indexed)	41,624	47,539	62,823	70,018	70,408
In USD terms	29,613	41,007	51,009	46,010	42,206
II. External Loans	**77,044**	**93,399**	**124,594**	**153,137**	**161,542**
In USD terms (A+B)	54,812	80,565	101,164	100,629	96,836
A. Short Term	1,244	1,046	1,549	1,582	1,591
B. Long Term (a+b+c+d)	53,568	79,519	99,615	99,047	95,245
a. Official Creditors (Governmental and Multilateral Organizations)	2,067	2,547	2,522	2,711	2,661
b. Foreign Branches and Affiliates of Resident Banks	17,368	26,968	37,660	36,955	35,166
c. Nonresident Commercial Banks and Nonbank Financial Corporations	28,867	43,108	51,241	51,371	49,722
d. Nonfinancial	5,266	6,896	8,192	8,010	7,696
Total FX Loans[2] (Million USD)	**84,425**	**121,572**	**152,173**	**146,639**	**139,042**

Source: BRSA-CBRT
(1) Amounts in the table may be different from those published in the preceding issues due to the updates of the data.
(2) Although TL loans received from abroad are included, they are ignored since their amount is very low.

FX-loans used by the corporate sector, which soared in the first half of 2008, entered a downward trend in the last quarter of 2008 due to global turmoil and became USD 139 billion in March 2009 (Table I.12). The decline in FX loans was mainly attributable to the decline in loans extended by domestic and foreign branches of resident banks and through their affiliates, in addition to US dollar/Euro parity changes. No major change is observed with respect to loans extended by non-resident commercial banks and non-bank financial corporations.

USD 77.4 billion of FX loans came from domestic and foreign branches of resident banks and their affiliates, whereas USD 49.7 billion came non-resident commecial banks and non-bank financial corporations. Accordingly, 55.6 percent of the total FX loans of the corporate sector were extended by banks established in Turkey (Table I.12).

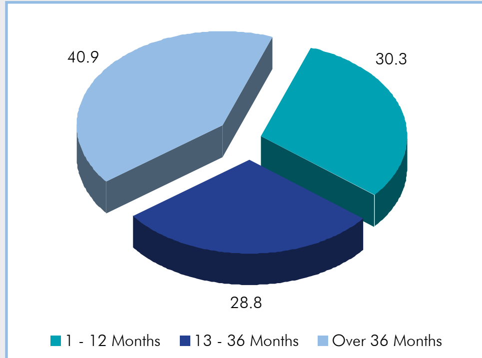
Table I.13.
Sectoral Breakdown of the Remaining Maturity Composition of Long-Term Loans Received from Abroad by Corporate Sector (Million USD)

(March 2009)	1 - 12 Months	13 - 24 Months	25 - 36 Months	37 - 60 Months	61 - 120 Months	120+ Months	Total
CORPORATE SECTOR	28.826	14.602	12.859	18.208	18.440	2.310	95.245
AGRICULTURAL SECTOR	101	66	64	69	57	0	357
INDUSTRIAL SECTOR	12.687	6.219	5.704	7.704	6.814	689	39.818
1. Manufacturing	10.711	4.505	3.720	4.990	4.170	124	28.220
- Metal Products	1.784	852	781	1.205	1.288	54	5.964
- Food, Beverage and Tobacco Prod.	3.496	849	724	796	137	36	6.038
- Textiles and Wearing Apparel	1.076	605	399	575	368	3	3.026
- Motor Vehicles	1.078	415	307	307	633	14	2.754
- Office Machinery and Computers	521	203	243	592	528	9	2.096
- Chemical Products	672	377	220	265	499	0	2.034
- Other Non-Metallic Mineral Prod.	413	331	307	616	272	0	1.938
- Mechanical Products	590	266	280	90	43	0	1.269
- Paper, Paper Products, Print & Publ.	325	198	156	185	60	8	933
- Others	756	409	303	359	342	0	2.168
2. Elect., Gas and Water Supply	1.127	1.285	1.356	1.643	1.578	561	7.550
3. Mining and Quarrying	849	429	627	1.072	1.067	4	4.048
SERVICES SECTOR	16.038	8.317	7.090	10.435	11.569	1.621	55.070
1. Real Est., Renting and Bus. Serv.	5.585	3.104	3.160	2.677	2.624	108	17.259
2. Trans., Storag. And Comm.	2.594	1.701	1.743	3.960	4.499	1.126	15.624
3. Wholesale and Retail Trade	2.947	1.144	652	1.321	1.679	86	7.829
4. Construction	3.061	1.233	637	958	1.714	240	7.842
5. Hotels and Restaurants	777	574	360	648	544	8	2.912
6. Others	1.074	561	539	870	508	53	3.604

Source: CBRT

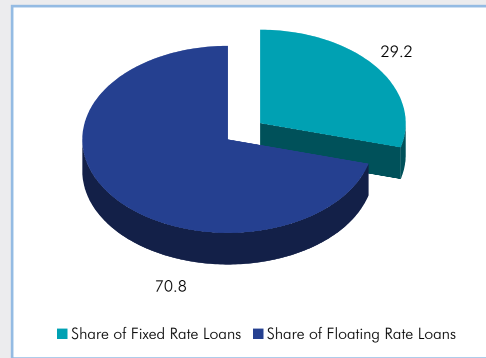
The services sector has the largest share with 57.8 percent in long-term loans received by the corporate sector from abroad. The loans of real estate, renting and the business services sector and the transportation, storage and communication sector, which have a significant share in the services sector, include external loans received by a number of firms with foreign capital operating in these sectors in order to pay acquisition (including privatization) costs. The share of industrial sector loans in total loans is 41.8 percent and the majority of these loans were received by the manufacturing industry (Table I.13).

Chart I.42.
Remaining Maturity Distribution of Long-Term Loans Received from Abroad by Corporate Sector (%) (March 2009)



Source: CBRT

Chart I.43.
Interest Distribution of Long-Term Loans Received from Abroad by Corporate Sector (%) (March 2009)

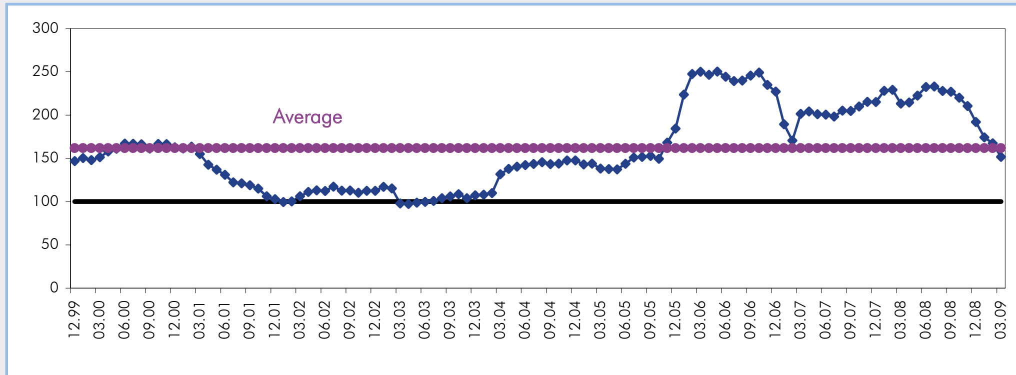


Source: CBRT

By March 2009, 30.3 percent of long-term loans received by the corporate sector from abroad were loans with a maturity of up to one-year (Chart I.42).

By March 2009, 29.2 percent of long-term loans received by the corporate sector from abroad were fixed rate, whereas 70.8 percent were floating rate loans. 64.1, 33.7 and 2.2 percent of the said loans were denominated in USD, EURO and in other foreign currencies, respectively (Chart I.43). In March 2009, no significant change was observed in the FX composition and interest rates of corporate sector debts compared to end-2008.

Chart I.44. Roll-over Ratio of Long-term Loans by the Non-banking Private Sector[1] (%)



Source: CBRT
(1) The roll-over ratio was calculated by dividing long-term loans received from abroad by the non-banking private sector by loan repayments in the relevant period according to annualized monthly balance of payments data.

It is seen that the roll-over ratio of annualized external long-term loans of the non-banking private sector became 152 percent as of March 2009, which was slightly below the 1999/12 – 2009/3 average of 161.8 percent (Chart I.44). This decline was driven by the decrease of loans extended by foreign branches and subsidiaries of banks established in Turkey (Table I.12).

I.4.2.3. Foreign Exchange Position of the Corporate Sector

Foreign exchange positions of firms operating in Turkey cannot be calculated by referring to their balance sheets, since the financial statements of firms are prepared in terms of the Turkish currency amount, regardless of currency composition. However, in order to provide a general idea concerning the exchange rate risk of firms, the table of Foreign Exchange Assets and Liabilities of Non-Financial Companies prepared by the CBRT is posted quarterly on our website and sheds light on the foreign exchange position of the corporate sector. Besides, the foreign currency positions of non-financial firms listed on the ISE, which constitute an important part of the corporate sector, have been calculated by referring to footnotes in their disclosed financial statements, and the exchange rate risks, as well as the cash loan risks of those firms have been examined.

The exchange rate risk of firms in the corporate sector has been analyzed and assessed from a macro perspective. Hence, considering that some firms have short positions while others have long positions, it would be more accurate to evaluate the vulnerability of the corporate sector to exchange rate risk by making individual analyses for each firm.

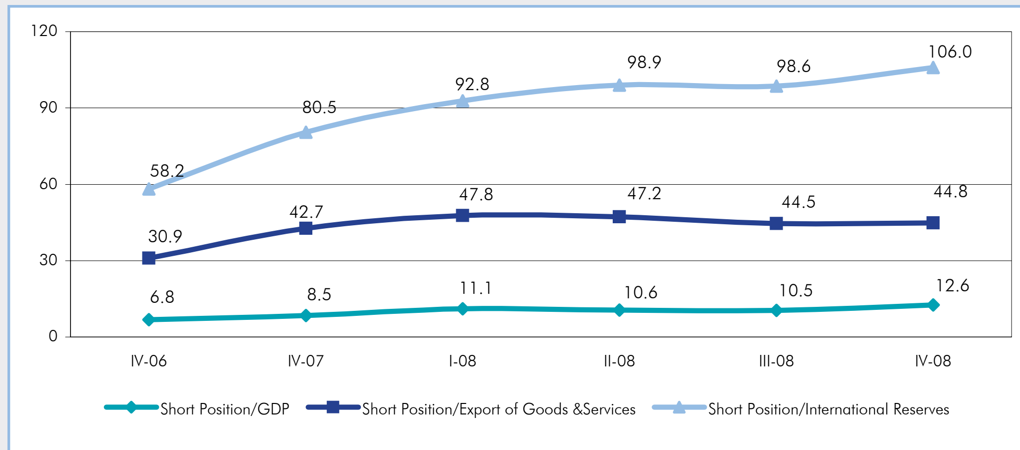
Table I.14.
FX Assets and Liabilities of Corporate Sector 1,2 (Million USD)[1,2]

	2006	2007	03.08	06.08	09.08	12.08	Change 09.08-12.08 (%)	Change 12.07-12.08 (%)
Assets	**63,424**	**77,862**	**80,830**	**89,014**	**92,473**	**82,382**	**-11**	**6**
A. Deposits	45,450	54,834	55,377	61,516	65,515	60,357	-8	10
-Domestic Banks[3]	18,756	24,402	24,051	26,092	26,494	27,261	3	12
-Foreign Banks[4]	26,694	30,432	31,326	35,424	39,021	33,096	-15	9
B. Securities	933	830	898	851	731	695	-5	-16
C. Export Receivables	9,584	12,007	14,152	15,487	14,721	9,608	-35	-20
D. Foreign Dir. Invest. to Abrd.	7,457	10,191	10,403	11,160	11,506	11,722	2	15
Liabilities	**100,250**	**139,401**	**155,072**	**167,543**	**172,138**	**161,036**	**-6**	**16**
A. Cash Loans	83,310	119,563	135,918	145,455	149,663	144,282	-4	21
-Domestic[5,6]	29,613	41,007	48,139	48,629	51,009	46,010	-10	12
Non-bank fin. institutions[7]	4,869	8,220	8,715	9,119	9,059	8,575	-5	4
-Foreign[8]	53,697	78,556	87,779	96,826	98,654	98,272	0	25
B. Import Payables	11,749	14,540	15,618	18,512	18,869	14,699	-22	1
C. Protocol Receiv. of SDIF	5,191	5,298	3,536	3,576	3,606	2,055	-43	-61
Net Position	**-36,826**	**-61,539**	**-74,242**	**-78,529**	**-79,665**	**-78,654**	**-1**	**28**

Source: CBRT
(1) Amounts in the table may be different from those published in the preceding issues due to the updates of the data.
(2) Data on non-financial public enterprises is not included.
(3) Participation funds in participation banks are included.
(4) ""Deposits-Foreign Banks" data covers the data of foreign branches of the banks established in Turkey. On the other hand, it should be taken into consideration that the deposits of real persons and non-bank financial institutions may be included in this data. December 2008 data is provisional.
(5) Funds extended by participation banks are included.
(6) FX indexed loans are included.
(7) It consists of leasing, factoring and consumer finance companies.
(8) Loans extended by foreign branches of the banks established in Turkey are included.

While the net short position of the corporate sector rose to USD 78.7 billion at end-2008, with a 28 percent upsurge compared to end-2007, it displays a decline by 1 percent compared to September 2008 (Table I.14). Provisional data for January and February 2009 indicate that the short position of the corporate sector is still in decline.

Chart I.45.
Ratios Related to FX Position of the Corporate Sector[1,2,3] (%)



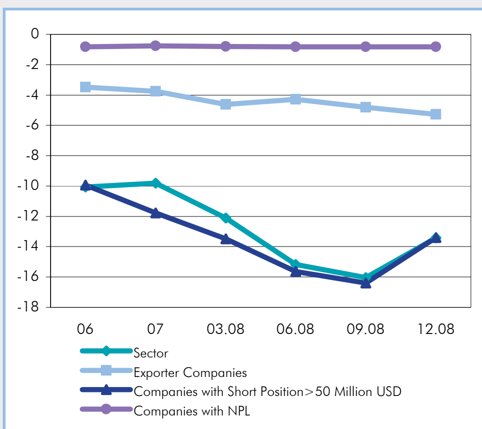
Source: CRBT, TURKSTAT
(1) GDP and exports of goods & services are computed on a yearly basis. International reserves are outstanding amounts at the end of period.
(2) International reserves are gross foreign exchange reserves of CBRT (including gold).
(3) The short position is converted into TL using the foreign exchange rate of the related period and divided by GDP.

The ratio of the corporate sector short position to GDP, export of goods and services, and international reserves rose at end-2008 compared to September (Chart I.45).

I.4.2.3.1. Foreign Exchange Position of Corporate Sector Firms Listed on the ISE

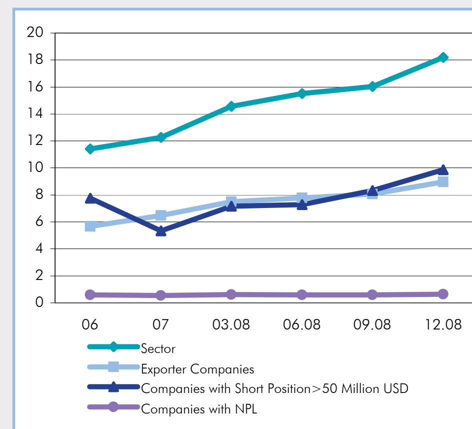
This section analyzes the foreign exchange positions and credit obligations of corporate sector firms listed on the ISE to the banking sector. The analysis covers 189 non-financial firms[4] whose financial statements are published by the ISE and which disclose their foreign exchange positions in their balance-sheet footnotes and, do not include any financial institutions in their consolidated financial statements.

Chart I.46.
FX Position of ISE Companies[1] (Billion USD)



Source: ISE
(1) As of year-end periods, companies for which the share of exports in net sales is equal to or greater than 30 percent, are considered exporter companies.

Chart I.47.
Cash Loans Extended to ISE Companies[1] (Including NPL, Billion TL)



Source: CBRT
(1) According to Risk Centre records, the cash loans are the loans which are extended directly by domestic banks or extended by foreign banks with guarantee or through intermediation of domestic banks.

[4] Firms that are consolidated under another company, the shares of which are publicly traded on the ISE, have not been re-included in the analysis.

The short position of firms analyzed, which was USD 9.8 billion at the end of 2007, increased to USD 16 billion by September 2008 and became USD 13.4 billion at end-2008 (Chart I.46). By the end of 2007, while 128 of firms analyzed had a short position, the number of firms with short positions rose to 138 in September 2008 and reached 140 by the end of 2008. The short position of these firms, which amounted to USD 13.3 billion at end-2007, surged to USD 17.8 billion in September 2008 and declined to USD 14.9 billion by the end of 2008.

While the number of firms with a short position over USD 50 million was 41 at end-2007, it increased to 47 by September 2008 and declined to 45 at end-2008. While the short position of these firms was USD 11.8 billion at end-2007, it increased to USD 16.4 billion by September 2008 and fell to USD 13.4 billion by the end of 2008 (Chart I.46).

The short position of non-exporting firms, which was USD 6.1 billion at end-2007, increased to USD 11.2 billion by September 2008, but fell to USD 8.1 billion by the end of 2008 due to global liquidity conditions.

Total loans of firms analyzed, including NPL, reached TL 18.2 billion by the end of 2008, with a 48.2 percent rise compared to the end of 2007 (Chart I.47). The increase of TL equivalent of FX denominated loans was also instrumental in this rise.

No significant change was observed in the number of firms with NPLs and the amount of their short positions and loans by the end of 2008 compared to end-2007. 16 of 17 firms with NPLs had short positions amounting to USD 815 million, while the amount of their cash loans became TL 630 million, TL 528 million of which were NPLs, at the end of 2008 (Chart I.47).