

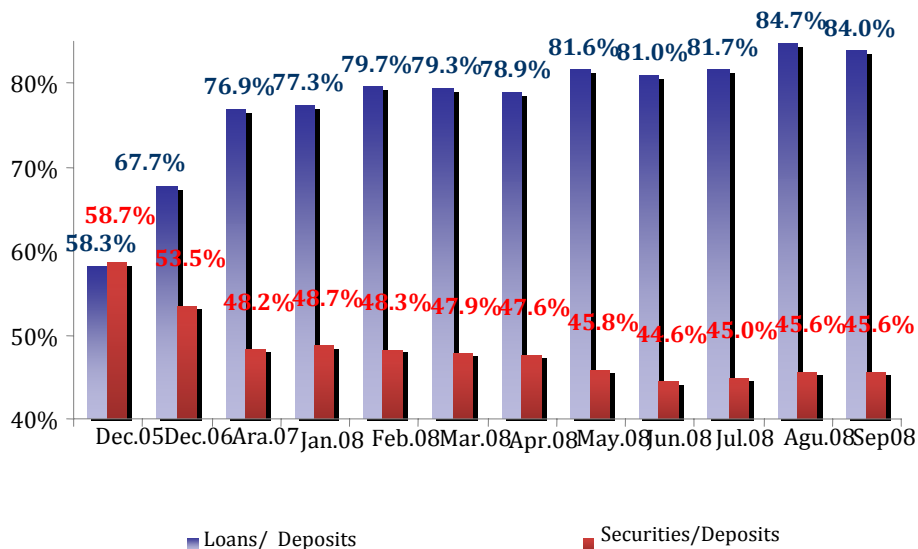
# WEEKLY MARKET COMMENT

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As we entered 2009, it was common currency to look at the post-Lehman world and conjecture that 2010 would be a difficult year for Turkish banks also, along with the U.S. and European banks and financial institutions. Indeed, loan demand had dropped sharply, and the possibility of credit rationing as an equilibrium phenomenon loomed large on the horizon. The ISE 100 was off the hinges right after Lehman, and had seen its lowest level on November 21, 2008. NPLs were trending up sharply, and it looked like provisions for new NPLs could easily wipe out up to half of 2009 estimated net profits, at the –then- current provisioning ratio of c. 80%. Foreign currency liquidity concerns rose amidst worries about the magnitude of c. USD92 billion gross private sector debt due in 2009, financial and real sector ensemble, including trade loans. The loan-to-deposit ratio fell as banks resorted to credit rationing. Furthermore, the syndicated loan market was expected to dry up in 2009. The outlook looked rather dim for a while, and the climax was reached by the end of March 2009. Thereupon, leading indicators to the effect that banks could indeed perform better than anticipated began to pile up. After March, bank equity shares were obviously driving the stock market rally and expectations lined up with new realities quickly.

## Loans/Deposits and Securities/Deposits



Prior to Lehman bankruptcy, the banking sector did not slow down at all. In fact, the September 30 quarterly financials show how credits continued to grow in the first 9 months of 2008. In fact, financial institutions contributed to GDP by x percentage points in Q2 2008, and had it not been for lending to continue, GDP would have been near zero in that period.

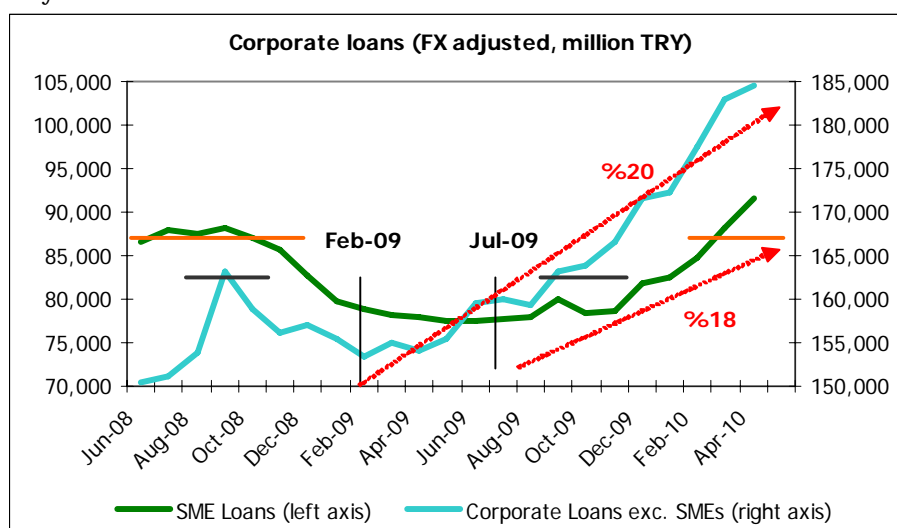
NPLs have been declining since 2001, though part of it came through the Istanbul Approach under which some USD5.5 billion have been restructured. More importantly, NPL provisioning has also improved significantly. Non-core asset disposals went through unaffected over the last five years. Balance sheets were much less loaded with non-financial equity stakes and real estate. Volatility of interest rates implies that the stability of a bank's earnings depends largely on non-interest income, particularly income from commissions and fees. Historically, with the high interest margin earned from investments in government securities, Turkish banks have subsidized other banking business by offering zero fee transactions to gain market share. This practice has been discontinued and fees and commissions have started to contribute to the bottom line. The weighted average (i.e., weighted with assets) commission was 1.4% in 2003. This was in

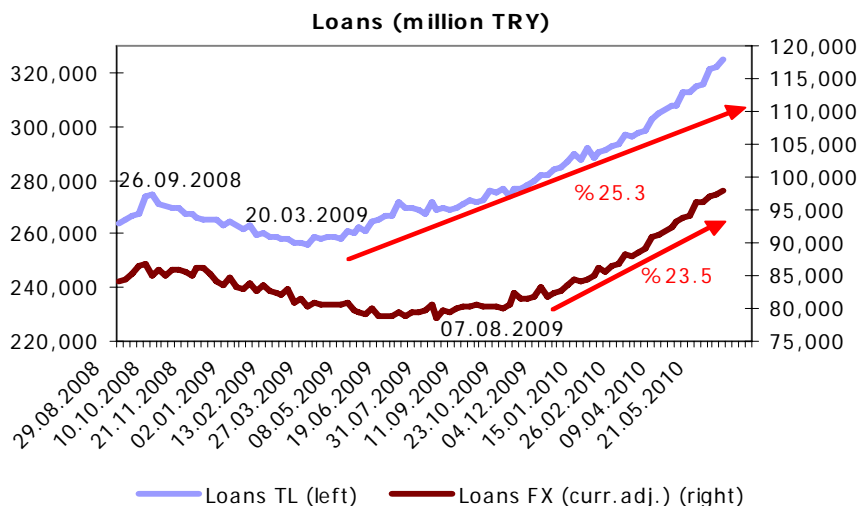
line with ratios in transition economies, from a low of 1.3% for state banks to 1.9% for privatised banks. From there, which is almost from scratch, the system underwent a drastic change. The bulk of commission income is from the consumer business, mainly from credit cards and asset management fees. Net interest margins (NIM) have been declining somewhat in 2007 and 2008. *This trend could continue as all means of monetary easing would be resorted to, and asset growth looked to be the unique remedy here.* This of course implied that shareholder's equity should rise in tandem. All in all, balance sheets were much cleaner and the system as a whole was a lot healthier. The problem is in the risk aversion curvature: banks might exacerbate economic woes through unnecessary credit rationing.

	Deposits			Loans			Change in basket (65% USD, 35% EUR)
	Adjusted with FX valuation			Adjusted with FX valuation			
	TRY	FX	TOTAL	TRY	FX	TOTAL	
2008 IVQ	5.6%	-8.3%	1.0%	-3.8%	-4.1%	-3.9%	27.0%
2009 1Q	1.4%	-0.6%	0.8%	-1.8%	-3.0%	-2.1%	6.7%
2009 2Q	3.3%	4.8%	3.7%	4.9%	-1.7%	3.3%	-5.6%
2009 1H	4.7%	4.2%	4.6%	3.0%	-4.6%	1.2%	0.7%
2009 3Q	1.4%	4.1%	2.2%	1.7%	1.3%	1.6%	-1.2%
2009 4Q	10.2%	3.1%	8.0%	5.0%	5.1%	5.0%	-0.8%
2009	17.0%	11.8%	15.4%	10.1%	1.5%	8.0%	-1.3%
2010 1Q	5.1%	0.2%	3.7%	5.0%	7.8%	5.7%	-1.1%
2010 2Q ...							
11.06.2010	5.8%	-1.2%	3.8%	6.7%	7.7%	6.9%	-0.5%

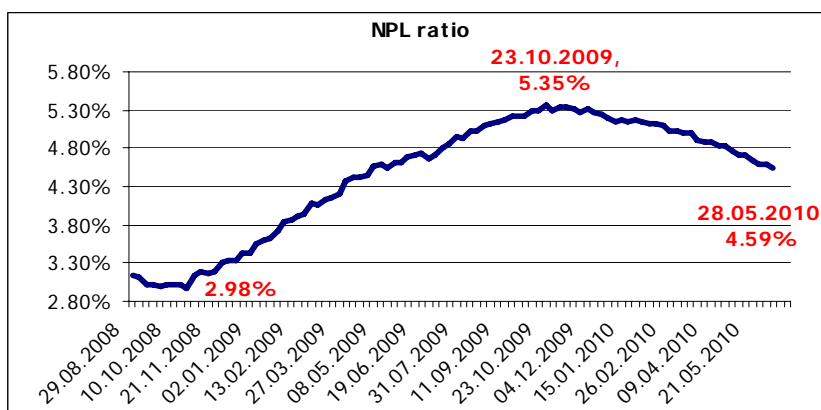
In the aftermath of the Lehman bankruptcy there was much to worry about. However, the TCMB (Central Bank of Turkey) began easing rapidly, and that move proved essential. The equity capital of the sector grew at an accelerating rate after October 2008. By the end of 2009, the rate of increase in shareholders' equity had grown by 39% after Lehman Brothers' bankruptcy. The equity base of the system stood at TL112.8 billion by the end of 2009 had it tracked its normal trend since 2002. Hence, the equity capital grew by over 15% above trend in 2009. The growth in equity was due to 30% from retained earnings as the sector distributed 47% of net profits as cash dividends in 2007 but increasingly refrained from so doing as cash dividends fell to 27% in 2008 and to 16% in 2009; 26% due to valuation effects, i.e. the securities portfolio booked as AFS (available for sale) gains value as interest rates fall and the gains go under equity unless such securities are sold; 25% rise from current period's net profit; 18% capital increases.

After March 2009, loan growth subsumed on the backdrop of VAT & SPT cuts, as demand for durables and cars spiked. Total loans grew by 24% between March 2009 and May 2010. Corporate lending returned to positive growth in March 2009 whereas SME loans only picked up after July 2010.





NPLs peaked On October 23, 2009 at 5.35% and they stand at 4.59% in May 2010, returning to the May 2009 level. The NPL ratio fell down because new NPL creation rate has fallen and some NPLs were sold. The NPL ratio increased by 13\*19% in 9M 2009, only by 3.4% in Q4 2009, and dropped by 0.7% in Q1 2010. In Q2 2010 the decline reached 1%.



The table below shows the potential impact of Group 2 loans on profitability and the equity basis, assuming 50% of Group 2 loans would turn into genuine NPLs eventually. In other words, the restructuring allowed by the B RSA has had in our opinion up to an impact of that kind of magnitude.

2009 Group 2 Loans													
	X1	X2	X3	X4	X5	X6	X7	X8	X9	X10	X11	X12	Avg
NPL Ratio	0,5%	5,4%	4,3%	4,3%	6,4%	6,0%	7,7%	4,6%	5,1%	3,5%	7,7%	7,7%	5,3%
NPL Ratio(including Group 2)	2,4%	9,7%	5,8%	10,8%	12,1%	11,9%	18,6%	9,6%	13,9%	7,6%	15,2%	19,4%	10,3%
(*)	X1	X2	X3	X4	X5	X6	X7	X8	X9	X10	X11	X12	Avg
Impact of Group 2 on 2009 net profit	-21%	-46%	-10%	-49%	-70%	-55%	-137%	-61%	-92%	-83%	-149%	-157%	-48%
Impact of Group 2 on shareholders equity	-4%	-8%	-2%	-9%	-11%	-11%	-17%	-8%	-16%	-12%	-8%	-28%	-9%

\*Assuming 50% of Group 2 turns eventually into NPLs and the actual bank-specific provisioning rates are maintained

*The Turkish banking sector did not respond to new conditions in the first phase of the crisis. The sea change came in right after the Lehman Brothers bankruptcy in mid-September 2008. Non-performing loans skyrocketed, both quantity (credit) rationing and risk rationing set in, and fears of foreign currency-denominated liquidity shortages became widespread. Hence, an extremely risk-averse attitude as regards lending, especially to SMEs, became a key feature of bank policies in Q4 2008. At that point, it looked like at the then going loan-provisioning rate, provisions for new non-performing loans could wipe out nearly half of 2009 estimated net profits. However, two major interventions prevented that gloomy picture to become a reality. first, the Central Bank of Turkey quickly adopted an easing path and cut its policy rate continually throughout 2009, and the Banking Regulation and Supervision Agency, the banking sector's regulator, amended a previously existing regulation to allow banks with room for restructuring non-performing loans with a very low provision requirement. In the end, both profitability in terms of return on average equity (ROAE) and the equity base of banks grew above trend, effectively compartmentalizing the economy into two parts. In effect, the Turkish banking sector actually outperformed its past track during the crisis whereas the real sector was severely hit by the global storm.*