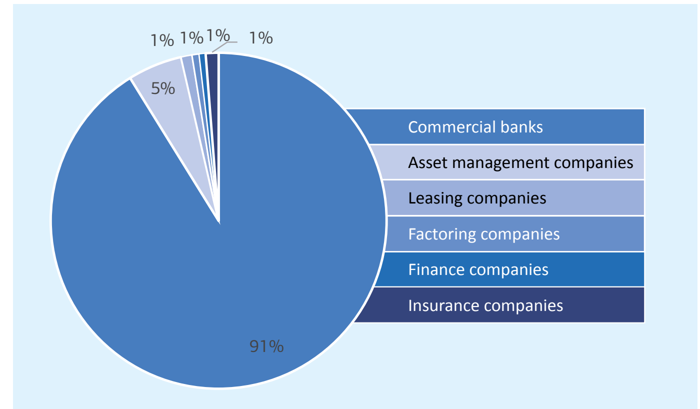
Black Sea Trade & Development Bank

# Overview of the financial sector in Turkey

The financial sector in Turkey mostly consists of commercial banks that account for 91% of total financial sector assets as of the end of 2020. Asset management companies hold 5% of total financial sector assets, while other institutions such as leasing, factoring, insurance, and finance companies are rather small and do not play a significant role in the financial intermediation in the country. The present analysis will focus on commercial banks.

*Figure 1.* **The structure of the financial sector in Turkey, December 2020**

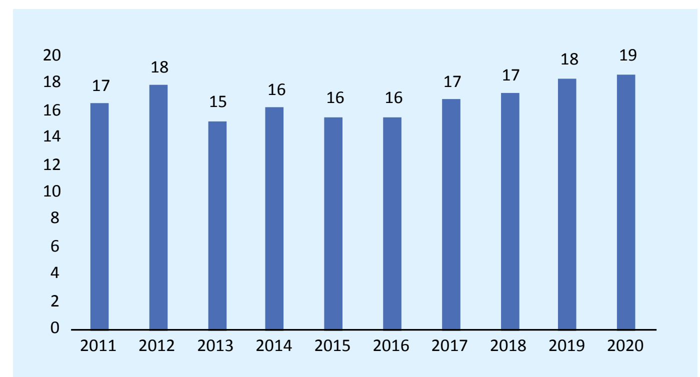



*Source: Banking Regulation and Supervision Agency (BRSA)*

The banking sector in Turkey developed rapidly over the last decade and has become a large sector of the economy. The ratio of the banking sector's assets to GDP increased from 80% in 2010 up to 120% by the end of 2020. Outstanding loans extended by banking institutions in Turkey correspond to 71% of GDP, among the highest in the BSTDB Region. The banking sector in Turkey is characterized by large state participation as state-owned banks hold more than 40% of total banking sector assets. The degree of state participation has increased in recent years from below 30% in 2016, as the growth of the sector in the last 4 years was mostly driven by state-owned banks' balance sheet expansion. Currently, three of the four largest banks in Turkey are state-owned.

The banking sector in Turkey is well capitalized. The CAR ratio has increased over the last 10 years and reached 19% by the end of 2020, indicating that banks maintain capital buffers well above the required minimum of 8%.

*Figure 2.* **Regulatory capital to risk-weighted assets (%)**




*Source: Financial soundness indicators, IMF database*

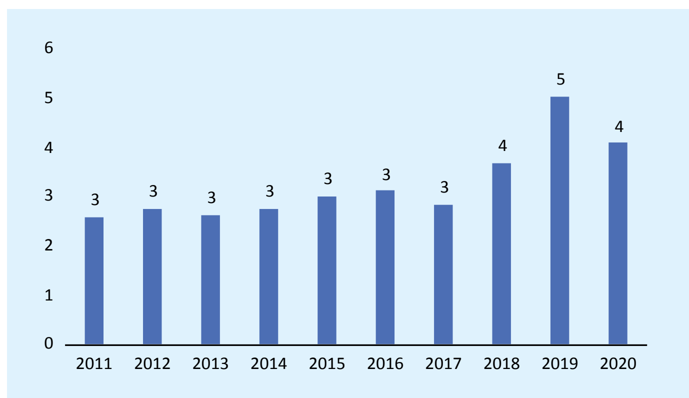
The sector reported strong profitability from 2011-2018 when ROE was on average 17% per year. In the last two years, however, profitability dropped to 11%. The main driver of this drop is lower net interest margins in state-owned banks compared to private banks. Since the growth of the system for the last 2 years was to a higher extent due to the rapid expansion of state-owned banks' balance sheets, this has resulted in lower ROE for the total banking sector. In addition, the pandemic crisis affected negatively the sector's profitability in 2020. The current level of ROE is relatively low compared to other countries with similar credit ratings.

*Figure 3.* **Return on equity (%)**

*Source: Financial soundness indicators, IMF database*

The ratio of non-performing loans to total gross loans has remained low for the last decade in Turkey. It increased slightly in 2019-2020 and reached 4% by the end of last year. The low level of NPLs in Turkey is a result of several factors such as the debt restructuring and installment deferral practices during the pandemic, the strong growth of credit and also easing standards of non-performing loan classifications by the Banking Regulation and Supervision Agency (BRSA). NPLs may rise as the economic impact of the pandemic will have its full impact on asset quality and the regulatory forbearance measures are lifted.

*Figure 4.* **Non-performing loans to total gross loans (%)**




*Source: Financial soundness indicators, IMF database*

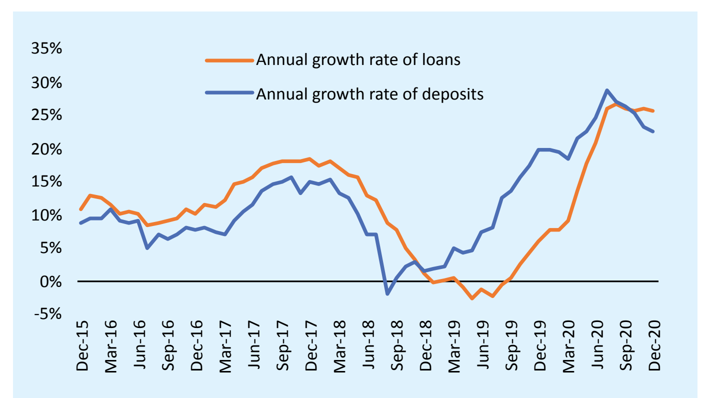
The loan to deposit ratio had increased consistently until 2017 when it reached 132%, a level that was one of the highest among peer countries. On the backdrop of the strong growth of deposits for the last three years the loan to deposit ratio has declined and stood at 108% by the end of last year. It should be noted that the Turkish lira loan to deposit ratio is at a very high level of 150%, while for foreign currency loans and deposits the same indicator is 64%. Despite the high loan to deposit ratio, banks maintain strong liquidity buffers as the Liquidity Coverage Ratio (LCR) stays well above the required minimum and reached 148% at the end of 2020.

*Figure 5.* **Total (non-interbank) loans to customer deposits (%)**

*Source: Financial soundness indicators, IMF database*

The banking sector in Turkey has reported very strong growth of balance sheet over the last 5 years. Growth accelerated particularly in 2019-2020 when, excluding the exchange rate effect both for loans and deposits, it reached more than 20%. Given the high level of dollarization in loans (34%) and deposits (55%) and exchange rate fluctuations, it would be more informative to look at growth rates excluding the exchange rate effect in Turkey. The growth of the sector was mostly driven by state-owned banks that expanded their balance sheets mainly through domestic currency lending. At the same time, these banks relied more on foreign currency deposits as a source of funding. As a result, the FX position on the balance sheet of the banking sector has shortened significantly. The short FX positions in the balance sheet are covered with off-balance sheet exposures such as swaps and forwards. However, their size has increased rapidly over the last two years and reached around 10% of GDP and 70% of gross international reserves.

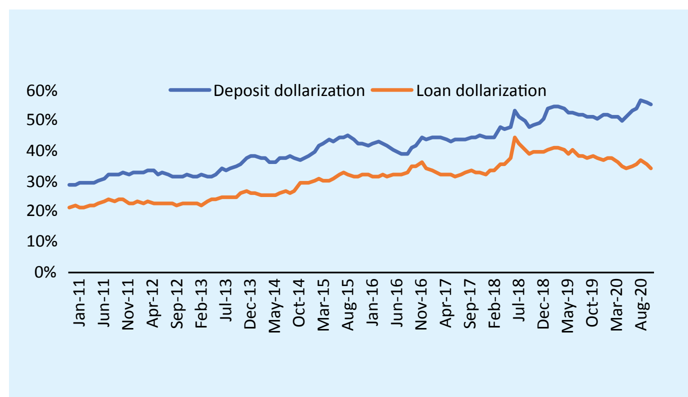
*Figure 6.* **Growth rate of loans and deposits**




*Source: Banking Regulation and Supervision Agency (BRSA)*

Over the last decade, frequent episodes of exchange rate depreciation along with relatively high inflation in Turkey have led to a rise in dollarization. For example, deposit dollarization increased from 30% in 2010 to 55% at the end of 2020. The loan dollarization also increased in the same period but compared to deposits with slower pace from 20% in 2010 to 34% at the end of 2020.

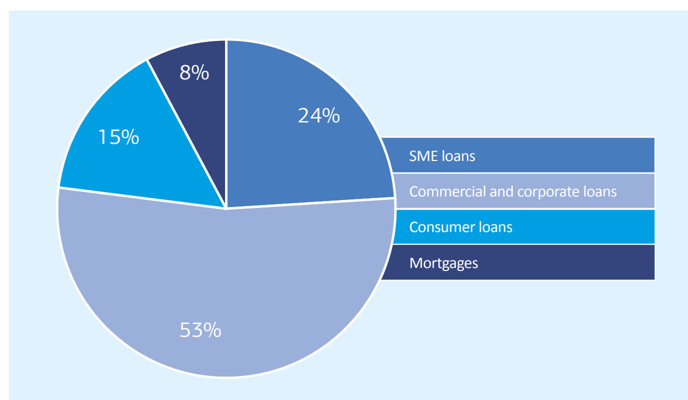
*Figure 7.* **Evolution of loan and deposit dollarization**




*Source: Central Bank of the Republic of Turkey*

The structure of the total credit portfolio of the banking sector is supportive to growth as most loans are extended to businesses. Corporate and commercial sectors account for 53% of the total loan book while another 24% is provided to SMEs. Mortgages constitute only 8% of the portfolio and consumer loans 15%.

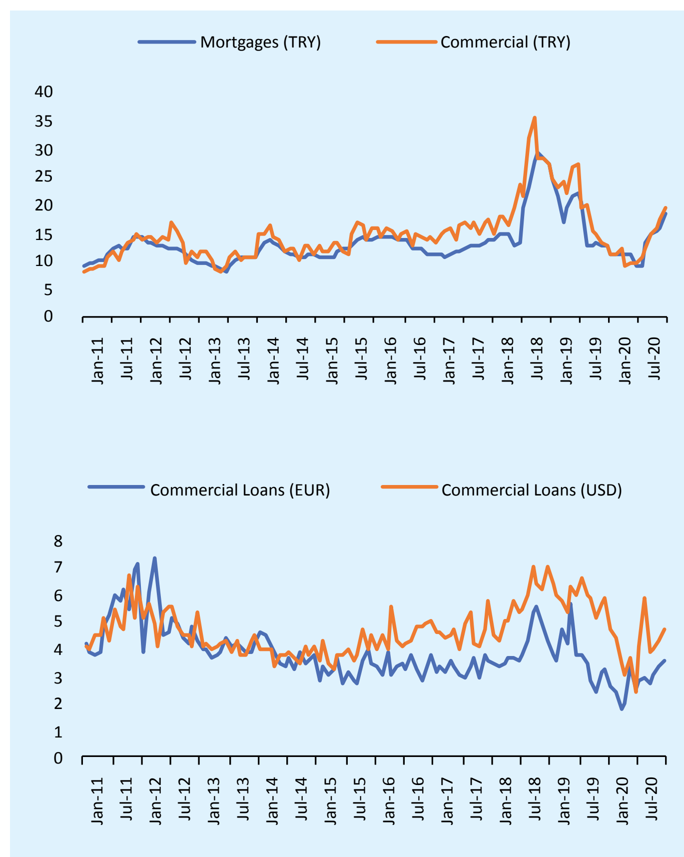
*Figure 8.* **The structure of the credit portfolio in the banking sector**




*Source: Banking Regulation and Supervision Agency (BRSA)*

Interest rates for domestic currency loans in Turkey are relatively high compared to other countries in the region due to the high inflation that the country experiences. To combat inflationary pressures, the Central Bank of the Republic of Turkey tightened monetary policy and increased the key rate up to 24% in 2018. Lending rates for Turkish lira loans followed and jumped up to close to 30%. In 2019 the monetary authorities started to ease the policy and cut the key rate. However, with the pandemic spreading and inflationary risks intensifying, the Central Bank reversed to the tightening policy. As a result, domestic currency lending rates increased again and reached 19% for mortgages and 20% for business loans by the end of 2020.

*Figure 9.* **Interest rates for different type of loans**




*Source: Central Bank of the Republic of Turkey*

Banking in Turkey is a large sector of the economy with strong capital and liquidity buffers. The sector's ratio to GDP increased particularly rapidly in the last two years with total assets increasing from 100% of GDP to 120% of GDP by the end of 2020. Although the banking sector is very competitive in Turkey, state participation is large, and it has increased even more in the last four years. The reported NPLs are low at 4% but this may not reflect the actual picture accurately as the full impact of the pandemic related economic crises has not yet been seen. As the country has experienced a prolonged period of high inflation and exchange rate depreciation, financial sector dollarization has increased, especially for deposits, which were up to 55% in 2020.