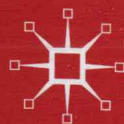


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Turkish Banking

Banking under Political
Instability and Chronic
High Inflation

Yener Altunbaş, Alper Kara
and Özlem Olgu



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Banking under Political Instability and Chronic High Inflation

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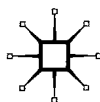
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Preface

Despite the fact that Turkey is the seventeenth-largest economy (in 2007) in the world, and one of the oldest and more developed of emerging markets, its banking system is still relatively small. After financial liberalization in the 1980s, large budget deficits resulting from substantial public sector borrowing, chronic inflation, dollarization in the economy, lack of regulation and supervision, capital inadequacy, and an unstable economic and political environment have all contributed to the poor performance of the Turkish banking industry. The sector has faced four crises since the 1980s, with the most recent occurring in the middle of the International Monetary Fund (IMF)-led restructuring programme in 2001, resulting in the failure of thirteen banks.

However, after years of mounting difficulties that brought Turkey close to economic collapse, a tough recovery programme was agreed with the IMF in 2002 to restore macroeconomic stability through structural reforms. Since then, Turkey has seen impressive progress. Economic growth has averaged over 5 per cent per annum and inflation has fallen significantly. Inspiring economic performance has led to an historical amount of foreign investments to Turkey. The banking industry was one of the recipients of this inflow: between 2004 and 2006, foreign banks – some of them world-leading financial institutions – have invested around USD 14 billion, mainly through acquiring majority shares in locally-established medium-sized banks, to gain a presence in the Turkish banking market. As of 2006, the level of foreign ownership with a controlling share constitutes a third of the total banking sector assets in Turkey. As well as its inspiring economic performance, Turkey's potential EU membership, its successful banking sector restructuring programme, the enforcement of internationally accepted banking regulatory and supervisory standards, and the growth potential of local credit markets were all factors influencing such flows.

We believe these recent developments in the Turkish economy and banking sector make it worthwhile to undertake a comprehensive overview of the developments in the Turkish banking market. This book, intended for both academics and practitioners, has several purposes. First, it aims to portray the phases of banking sector development in Turkey, where the major emphasis will be to examine the features of

financial crises and their repercussions on the banking industry. Second, the financial structure and performance of the banking sector, together with its impact on economic growth, will be analysed, looking at the role of market participants as fund providers and fund users, and the important role of the state. Third, the future prospects of Turkish banking will be considered in the context of EU integration, the potential effects of Basel II, and the newly passed mortgage law's impact on credit markets.

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The views expressed in this book are the authors' own and do not necessarily reflect those of the University of Wales, Bangor, Loughborough University and Koç University. All remaining errors are our sole responsibility. Every effort has been made to contact all copyright-holders, but, if any have inadvertently been omitted the publishers will be pleased to make the necessary arrangement at the earliest opportunity.

YENER ALTUNBAŞ

ALPER KARA

ÖZLEM OLGU

List of Abbreviations

| | |
|------------|--|
| AMA | advanced measurement approach |
| BAT | (The) Banks Association of Turkey |
| BIS | Bank of International Settlements |
| BRSA | Banking Regulation and Supervisory Agency |
| CAD | Capital Adequacy Directive |
| CAR | capital adequacy ratio |
| CB | Central Bank |
| CBT | Central Bank of Turkey |
| CPI | consumer price index |
| CREDITS | level of credit extended to the private sector by commercial banks |
| CRS | constant returns to scale |
| DEA | data envelopment analysis |
| DEPOSITS | outstanding value of deposits in the provinces |
| DMU | decision-making units |
| DRS | decreasing returns to scale |
| EM | emerging market |
| EU | European Union |
| EUR | euro |
| EXCHANGE | exchange rate between US dollar and Turkish lira |
| FDI | foreign direct investment |
| FX | foreign exchange |
| GDP | gross domestic product |
| GNP | gross national product |
| ICAAP | internal capital adequacy assessment process |
| IMF | International Monetary Fund |
| INCENTIVES | investment incentives given to the provinces |
| INTEREST | average interest rates of treasury bills |
| IPO | initial public offering |
| IPP | investment priority provinces |
| IRB | internal rating based |
| IRS | increasing returns to scale |
| ISE | Istanbul Stock Exchange |
| ISI | import substitution industrialization |
| IT | information technology |

| | |
|-----------|---|
| NICA | non-interest current account |
| NPL | non-performing loans |
| OECD | Organisation for Economic Co-operation and Development |
| OTC | over the counter |
| PM | prime minister |
| PPS | production possibility set |
| PUBINVEST | public investment expenditures in the provinces |
| QIS | quantitative impact study |
| REPO | repurchase agreement |
| ROA | return on assets |
| ROE | return on equity |
| SASP | Structural Adjustments and Stabilization Programme |
| SDIF | Savings Deposit Insurance Fund |
| SDR | Special Drawing Rights |
| SEC | scale efficiency change |
| SEE | state economic enterprise |
| SFI | special financial institution |
| SME | small and medium enterprises |
| SPO | State Planning Organization |
| TEC | technical efficiency change |
| TFP | total factor productivity |
| TL | Turkish lira |
| TUSIAD | Turkish Industrialists' and Businessmen's Association |
| USD | US dollar |
| USSR | Union of Soviet Socialist Republics |
| VaR | value at risk |
| VRS | variable returns to scale |
| WB | World Bank |
| YTL | new Turkish lira |

About the Authors

Yener Altunbaş is a Professor of Banking and Finance at Bangor Business School. He holds a BSc degree from Hacettepe University, Ankara, and a PhD from Bangor University. He worked first as an analyst with Ziraat, then as an economist with Etibank in Turkey and as a Researcher within the Institute of European Finance in the UK. He was employed as a Research Fellow with the Business School at South Bank University, London, and as a Research Associate at the Centre for Business Research at Cambridge University. Recently, he has held a Visiting Researcher post at the European Central Bank and a guest lectureship at the University of Lecce and at the Free Mediterranean University Jean Monnet (LUM), Bari, Italy. Author of many articles on the structure and efficiency of banking markets, his main fields of research interest include European banks, efficiency, stock market analysis, corporate governance, and urban economics. Recent research has also been concerned with marine biology.

Alper Kara is a Lecturer at the Loughborough University Business School and previously worked as a teaching fellow at the University of Leicester, and as a lecturer at the Robert Gordon University, Aberdeen. He has also been a visiting lecturer at the Bangor Business School and the British Kazakh Technical University of Almaty. He holds a BSc (Economics) degree from Orta Doğu Teknik Üniversitesi, Ankara, and an MBA in Banking and Finance and a PhD in Economics from the University of Wales, Bangor. Co-author of a book on syndicated lending; his main research interests and publication record cover a range of topics, including syndicated loan markets, bank lending, corporate finance and emerging market financing. Before moving to academia, he was employed by Dışbank of Turkey (acquired by Fortis in July 2005) and had four years experience as a trader in the international bond and foreign exchange markets.

Özlem Olgu joined Koç University as an Assistant Professor in Accounting and Finance in September 2007 after completing her MSc Finance and PhD Finance degrees at the University of Leicester. She completed her undergraduate degree in Banking and Finance at the Near East University, Cyprus, and was awarded a scholarship to continue her studies to

Master's level. Prior to joining Koç University she worked as a lecturer in finance at the University of Hertfordshire. Her research interests and publication record cover a range of banking topics. Most recently, the focus has been on production theory, investigating the efficiency and productivity levels of European banking and transition economies, together with a more in-depth analysis of Turkey. In particular, she is interested in dealing with the economies-of-scale effects on performance measurement as well as the effects of macroeconomic factors on productivity growth.

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