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# Turkish Banking

## Banking under Political Instability and Chronic High Inflation

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Softcover reprint of the hardcover 1st edition 2009 978-1-4039-9711-1

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First published 2009 by  
PALGRAVE MACMILLAN

Palgrave Macmillan in the UK is an imprint of Macmillan Publishers Limited, registered in England, company number 785998, of Houndmills, Basingstoke, Hampshire RG21 6XS.

Palgrave Macmillan in the US is a division of St Martin's Press LLC, 175 Fifth Avenue, New York, NY 10010.

Palgrave Macmillan is the global academic imprint of the above companies and has companies and representatives throughout the world.

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ISBN 978-1-349-54611-4 ISBN 978-0-230-58206-4 (eBook)  
DOI 10.1057/9780230582064

This book is printed on paper suitable for recycling and made from fully managed and sustained forest sources. Logging, pulping and manufacturing processes are expected to conform to the environmental regulations of the country of origin.

A catalogue record for this book is available from the British Library.

Library of Congress Cataloging-in-Publication Data  
Altunbaş, Yener.

Turkish banking : banking under political instability and chronic high inflation / Yener Altunbaş, Alper Kara, Özlem Olgu.

p. cm. — (Palgrave Macmillan studies in banking and financial institutions)

Includes bibliographical references and index.

1. Banks and banking—Turkey. I. Kara, Alper, 1977– II. Olgu, Özlem, 1979– III. Title.

HG3256.5.A6A48 2008

332.109561—dc22

2008029939

10 9 8 7 6 5 4 3 2 1  
18 17 16 15 14 13 12 11 10 09

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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.

The authors are very grateful to Emre Erşen, Sinem Munanoğlu Gökdel, Phil Molyneux, Saduman Hacer Okumuş and Aziz Özben, as well as to the participants of the 2007 Annual Conference of the European Association of University Teachers of Banking and Finance (The 'Wolpertinger Club') conference held in Valladolid, and the Turkish Bankers' Association for very helpful comments, suggestions and support on the papers that provided original material for the various chapters of the text. Thanks are also due to Lisa von Fircks, Elodie Lecoq and Hazel Woodbridge for editing the manuscript. Finally, thanks to our families and loved ones for their patience and support during the project.

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

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**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.