

Turkey: Opportunities and Risks

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Turkey: A country of opposing forces

- Is it in Asia or in Europe?
- In EU or outside EU?
- Developed or under-developed?
- Secular or religious?
- Democratic or authoritarian?
- A country of opportunities or a country of risks?

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- Geography and population statistics
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A. Geography and population statistics

Turkey, a huge country...

EU-25: 3,973,452 km²

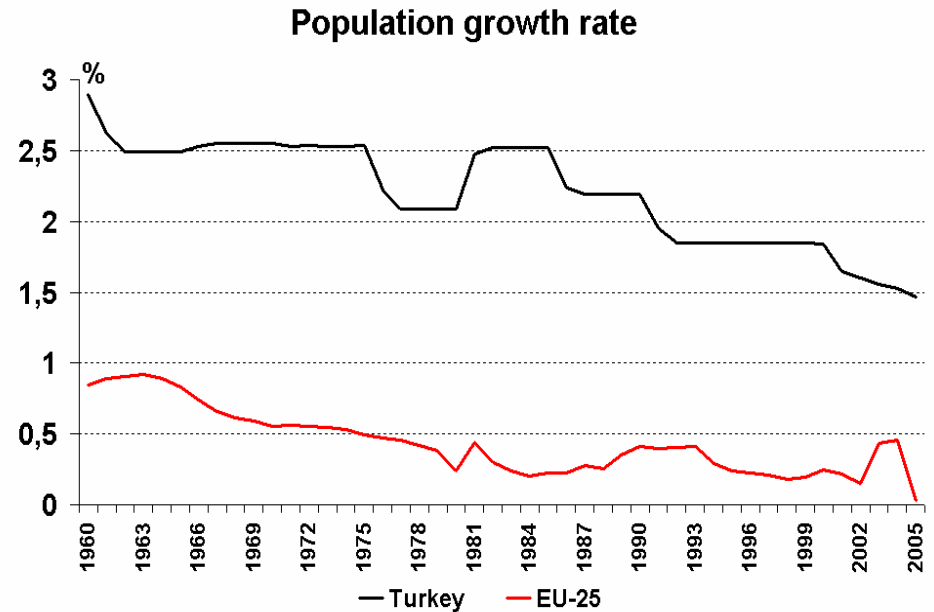
Turkey: 769,604 km²

Greece: 131,957 km²



...of 72 million people

- Second largest population in EU-25, after Germany.
- 50% of Turkey's population is under the age of 25 vs 30% for EU-25.
- 65% of population is urban, compared to 27% in 1960.
- Largest minority: Kurdish about 20%.



Major Cities

Population- 2000 census

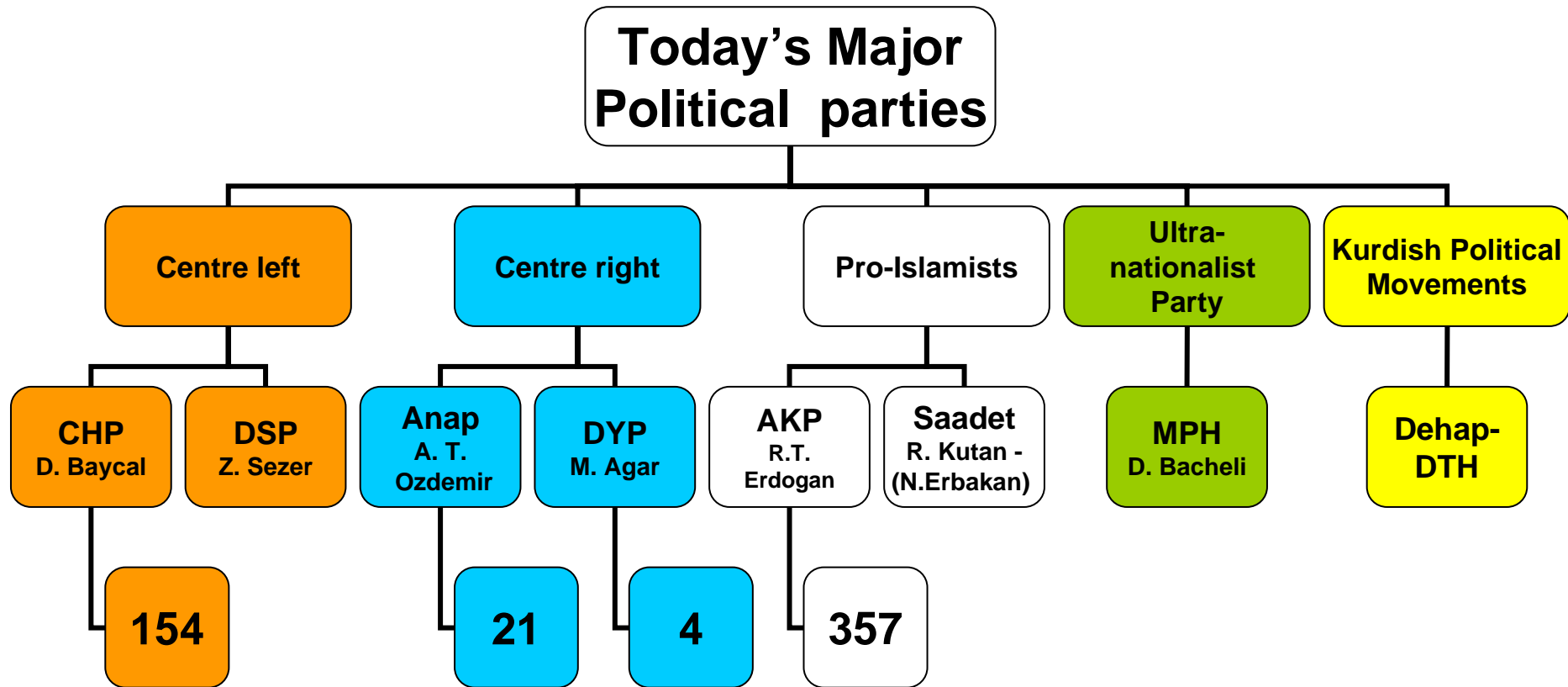
(in millions)

Istanbul	10.02
Ankara	4.01
Izmir	3.37
Konya	2.19
Bursa	2.13
Adana	1.85

B. Politics

- Panorama of major political and election results
- Two sources of political uncertainty influence financial markets:
 - The sequence of prospective presidential and national elections
 - EU entrance negotiations

Turkey's Major Political Parties



Source: Economic Intelligence Unit, 2006

Only two parties in parliament

- Parties that fail to exceed a threshold of 10% of the national vote are excluded, thus over 45% of the votes cast in Nov. 2002 has no representation in parliament
- Public reaction to mismanagement and corruption, resulted in a landslide victory for the 1-month old party of Recep Tayyip Erdogan (Nov 2002).
- Due to resignations and the transfer of deputies from AKP and CHP, the number of parties represented in parliament has increased.

Election Results							
Political Parties	Dec 1995		Dec 1999		Nov 2002		May 2006
	Seats	% of votes	Seats	% of votes	Seats	% of votes	Seats
Republican People's Party (CHP)	49	10.7	0	8.7	178	19.4	154
Democratic Left Party (DSP)	76	14.6	136	22.2	0	1.3	0
Motherland Party (Anap)	132	19.7	86	13.2	0	5.1	21
True Path Party (DYP)	135	19.2	85	12	0	9.5	4
Justice and Development Party (AKP) ¹	-	-	-	-	363	34.3	357
Felicity Party (Saadet) ¹	-	-	-	-	0	2.5	0
Virtue Party (Fazilet) ²	-	-	111	15.4	-	-	-
Welfare Party (Refah) ³	158	21.4	-	-	-	-	-
Nationalist Action Party (MPH)	0	8.2	129	18	0	8.3	0
People's Democracy Party (Hadep) ⁴	0	4.2	0	4.8	-	-	-
Democratic People's Party (Dehap)	-	-	-	-	0	6.3	0
Independents/ others	0	2	3	5.7	9	13.3	10
Total	550	100	550	100	550	100	550

¹ Formed in 2001, following the closure of the Virtue Party
² Formed in 1998, following the closure of the Welfare Party
³ Dissolved by court order in 1998
⁴ Dissolved by court order in 2003; competed in the 2002 election as People's Democracy Party (Dehap)

First source of political uncertainty in financial markets: Prospective Presidential and National elections

- November 2007: Scheduled National elections
- May 2007: Presidential elections
- AKP holds an absolute majority in the current parliament and can easily nominate and elect its own candidate
- This prospect creates uneasiness and discomfort among the opposition
- If early elections were held today, the AKP would likely risk to lose this majority and thus miss the opportunity to install its preferred candidate.

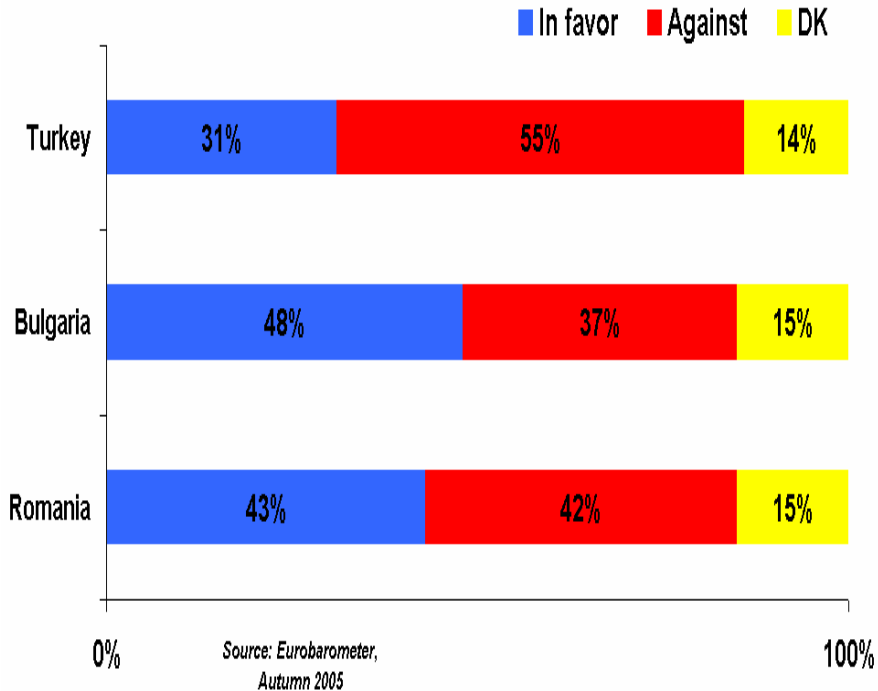
Second source of political uncertainty in financial markets: EU negotiations

- Turkey's EU entry talks started on October 3, 2005 with a screening exercise, whereby Turkish legislation is compared to the EU *acquis communautaire*. This first stage should be finalized by mid-October 2006.
- The risk of a disruption in the short-term has increased recently over the Cyprus issue and a lack of recent progress on human rights, freedom of speech and protection of minorities.
- Almost daily something negative is bound to hit the Turkish press and media, adding to the political noise and uncertainty.
- The negotiations have created a feeling among the public that the EU keeps shifting the 'goalposts'. Local polls indicate a drop on EU-support from 78% a year ago to 60% today.

Views not in favor of Turkey's candidacy...

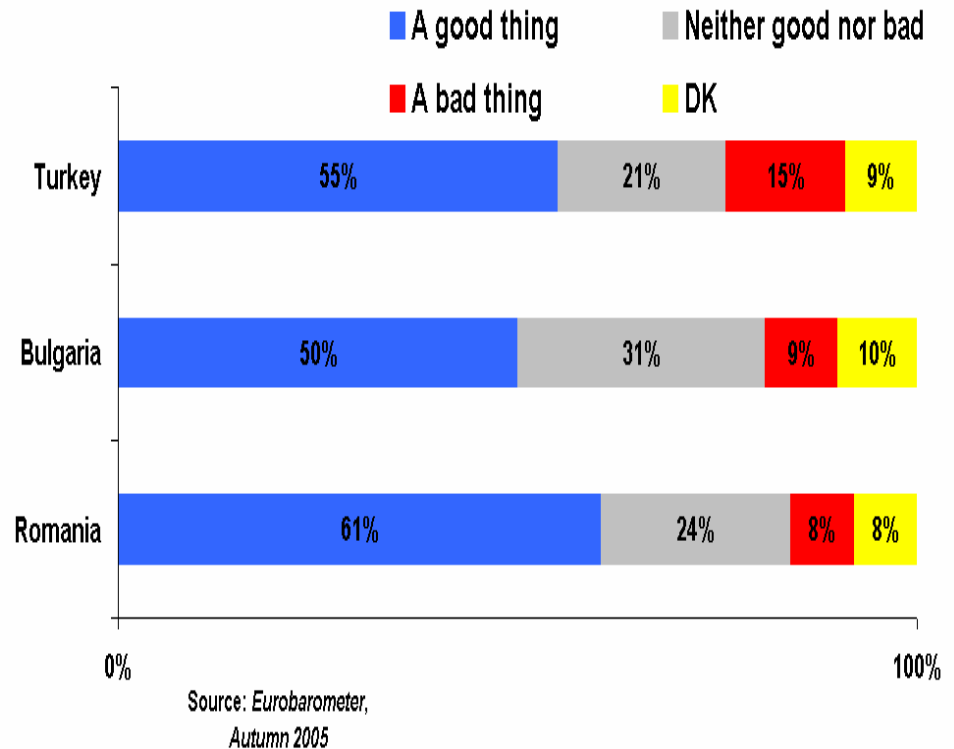
EU-25's Opinion:

For each of the following countries, would you be in favor or against it becoming part of the European Union in the future?



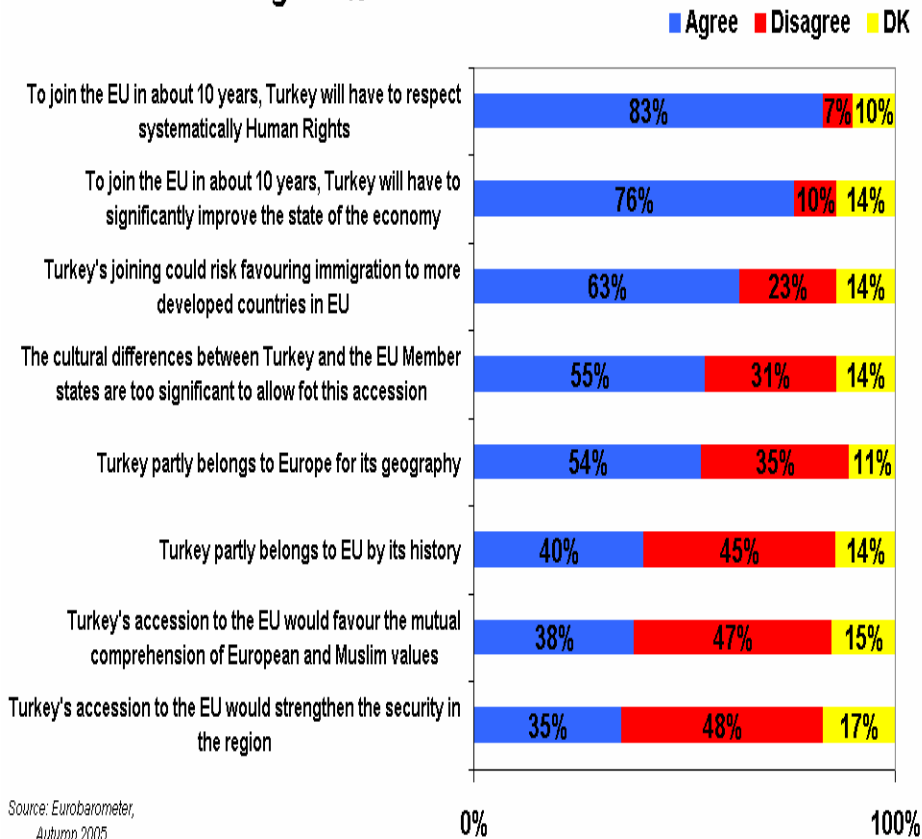
Local Opinion:

Support for the country's future membership in the European Union

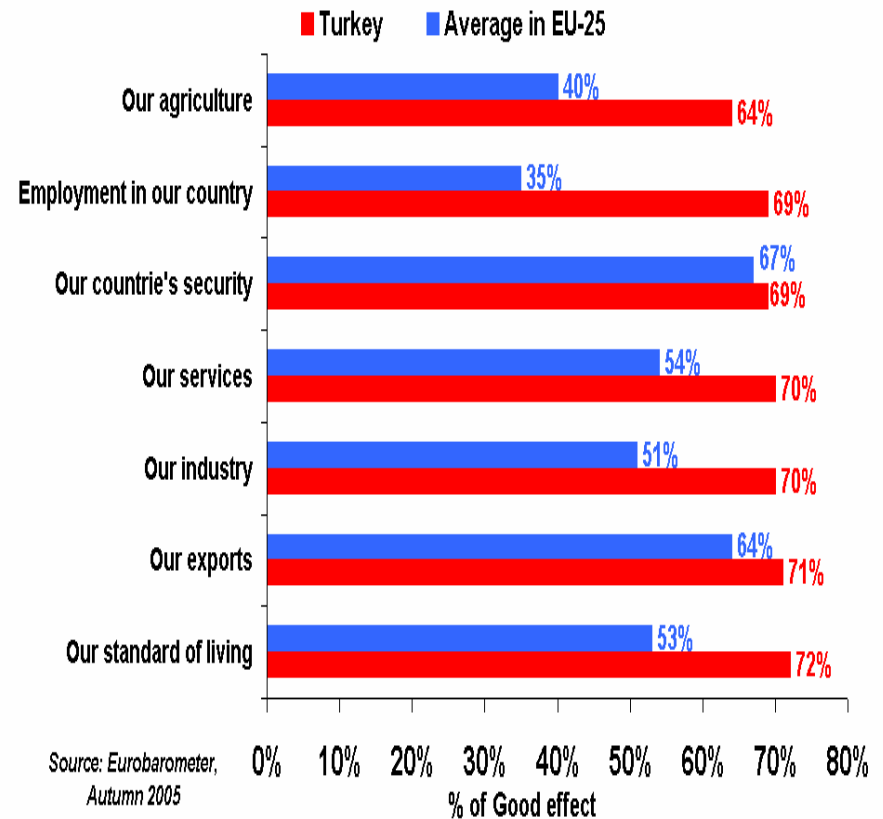


Views not in favor of Turkey's candidacy...

For each of the followings please tell me whether you agree- % EU-25



Perceived effects of European Union membership on each country

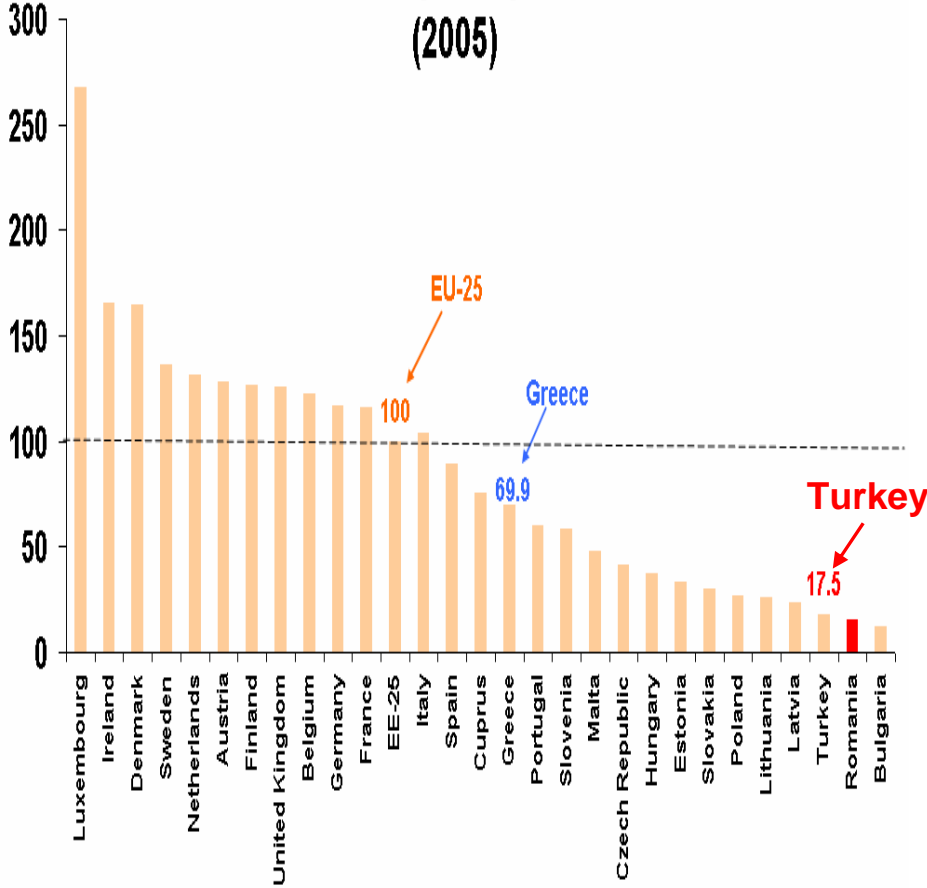


C. Macroeconomic Environment

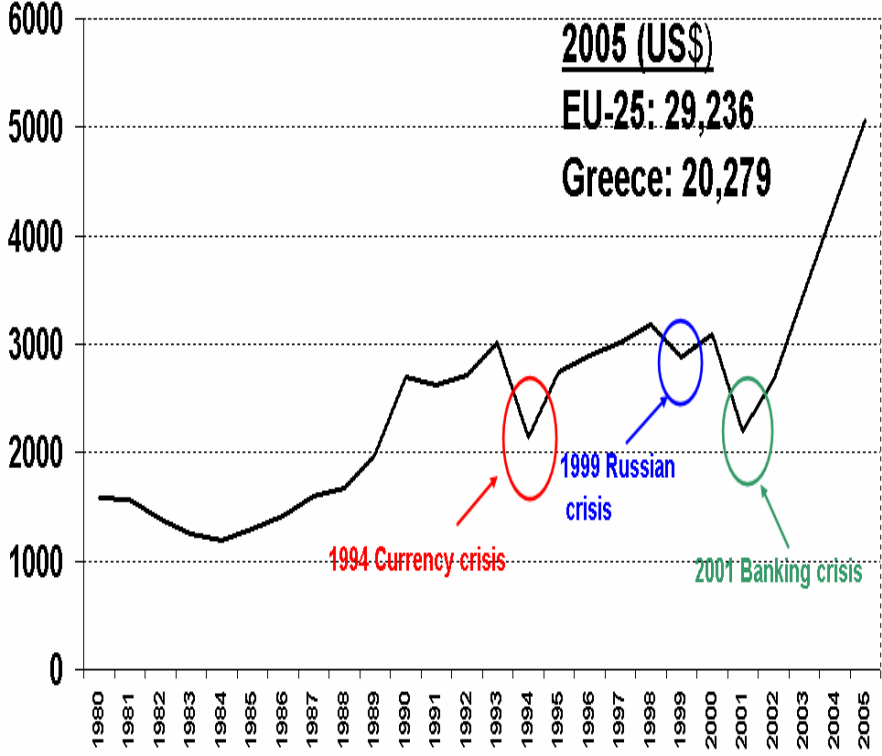
- Standard of living remains low
- Very volatile economy
- High inflation & interest rates
- Substantial progress since 2001 in inflation, interest rates, budget deficit and debt
- However,
 - inflation failed to decline below 7% (June 2004)
 - current account deteriorates
 - currency & stock markets crisis
- Economy will not be affected as much by the current crisis as it did in 2001, but will slow down

Standard of living much lower than in the EU-25

GDP per capita (2005)

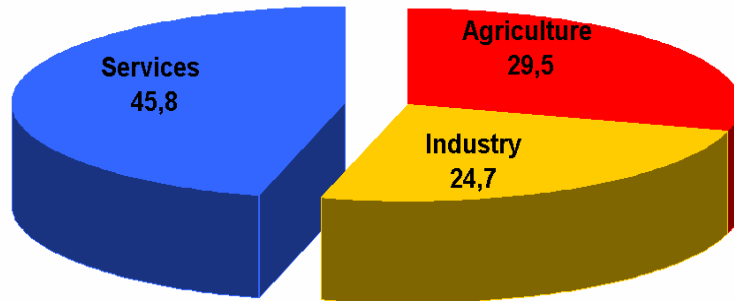


Turkey's GDP per capita (US \$)

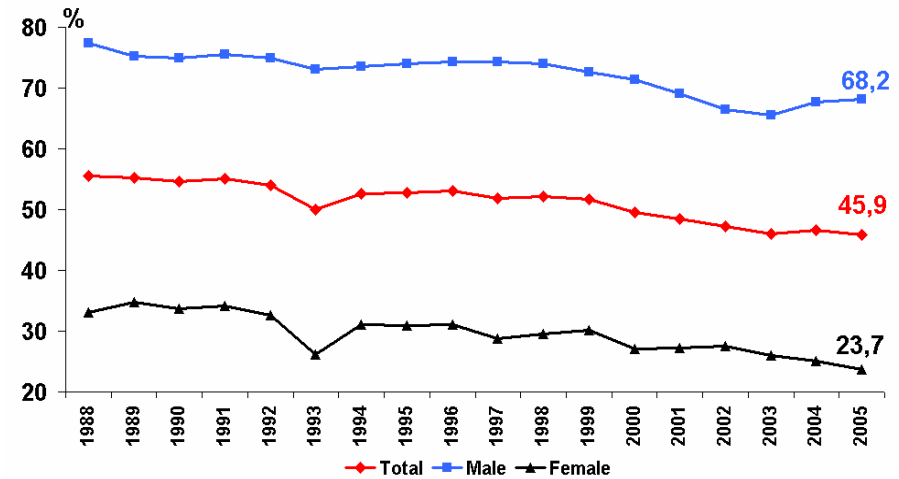


Employment patterns indicate there is room for further development

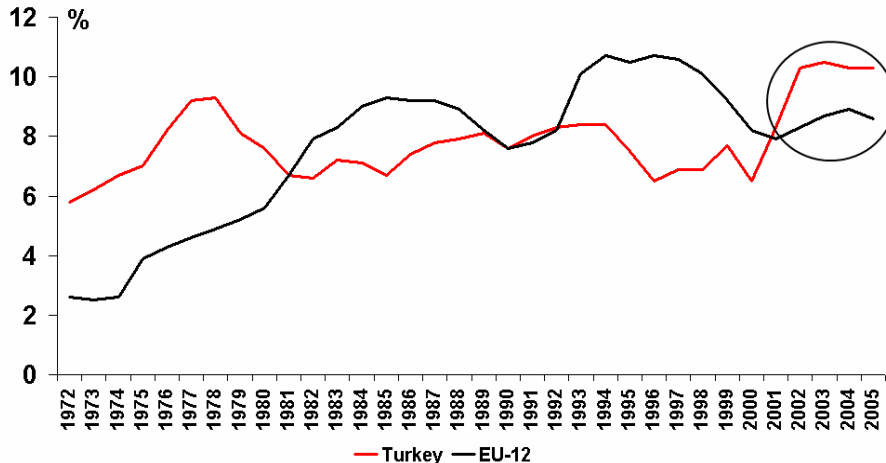
Distribution of employment by sectors (2005)



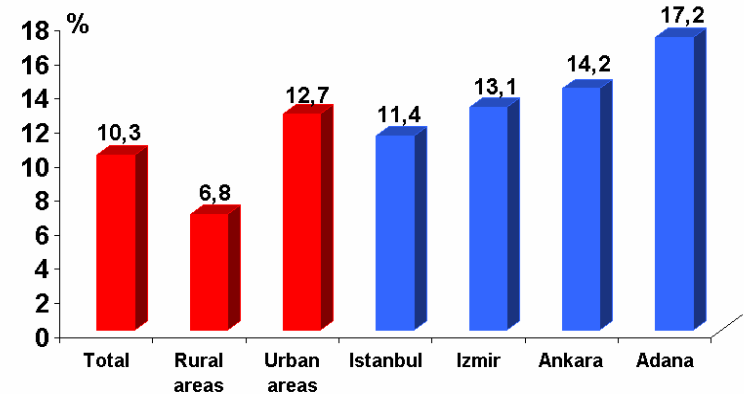
Employment rates



Unemployment rate

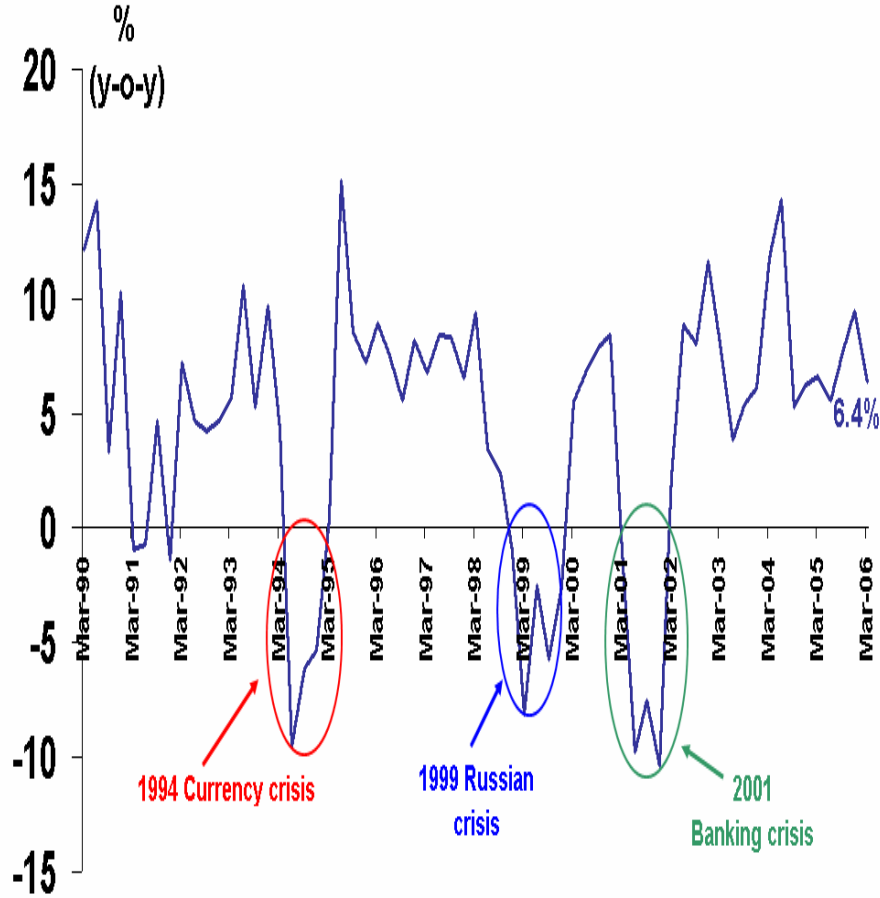


Unemployment rate in rural vs urban areas

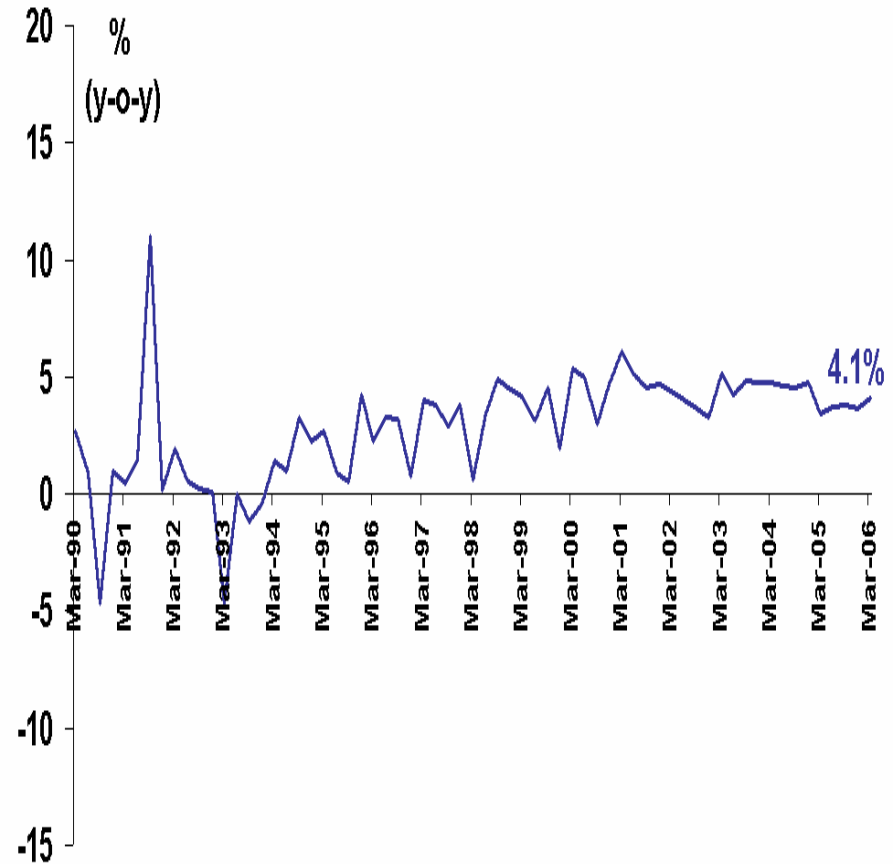


A very volatile economy...

Turkey: Real GDP growth rate

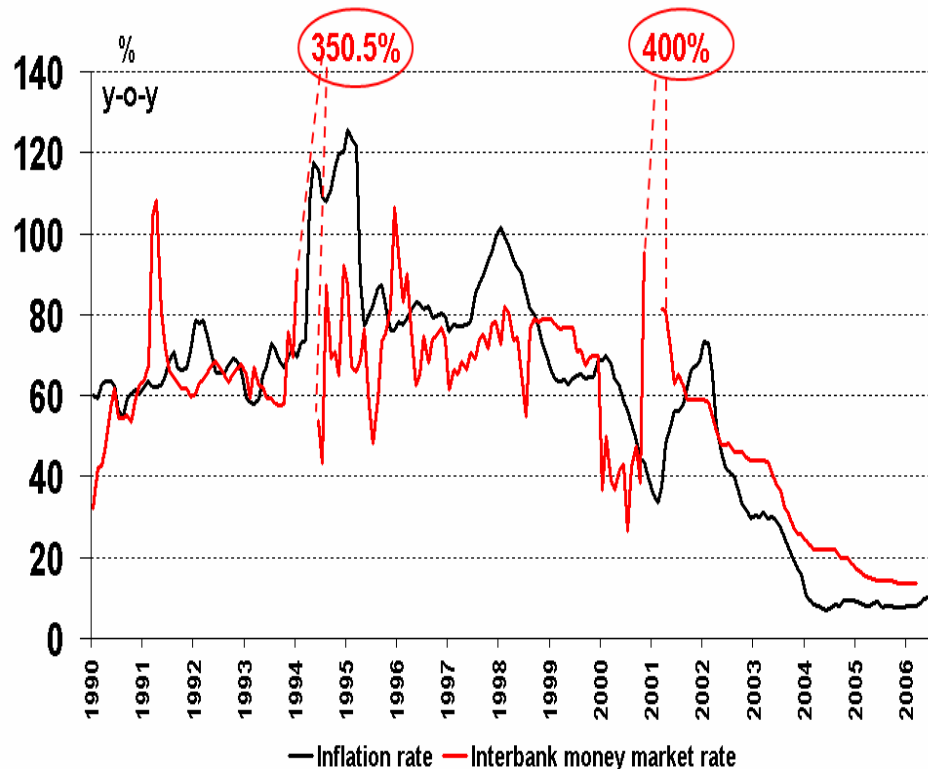


Greece: Real GDP growth rate



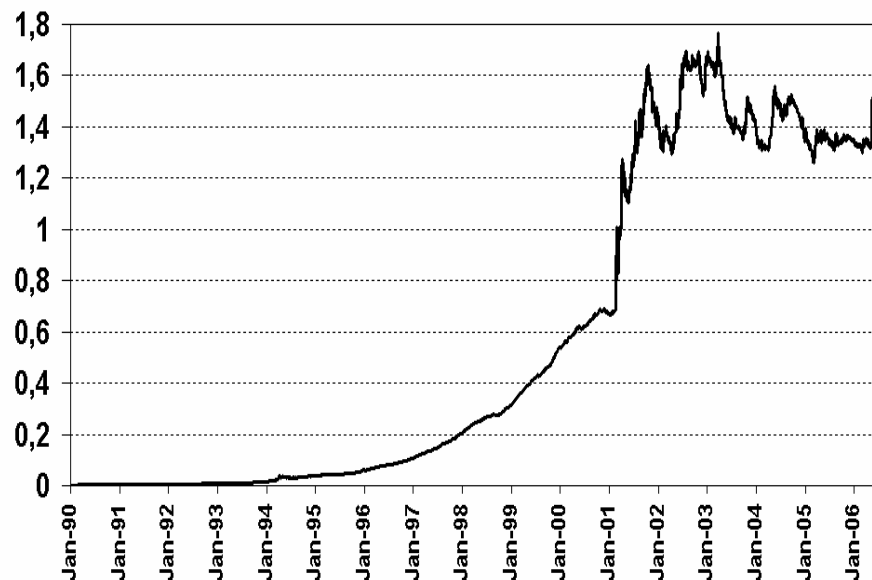
...with high inflation and interest rates... but with substantial progress since 2001

Inflation rate vs interest rates



Turkish liras per US dollar

(Increase implies depreciation)



CBRTs actions

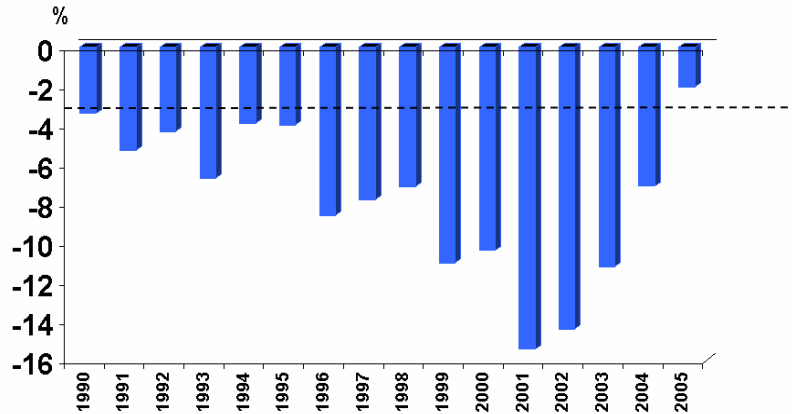
June 25: A 225bp hike to its key overnight borrowing rate (17.25%)

June 28: A 200bp hike to its key overnight lending rate (22.25%)

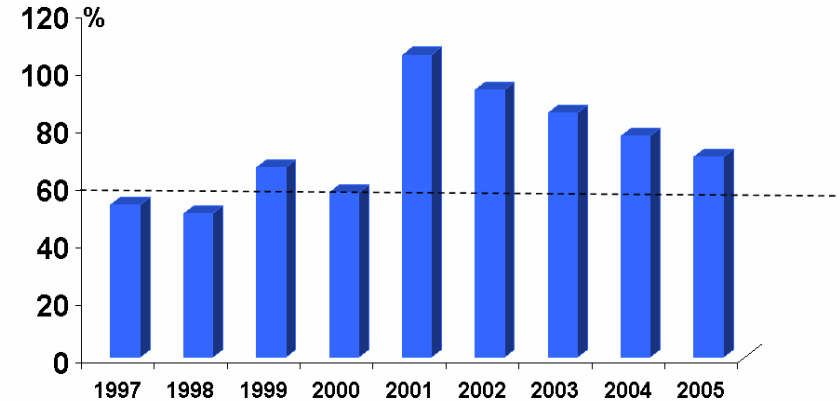
- It also initiated daily dollar selling auctions

After 2001, restrictive fiscal policy improves the budget balance and reduces debt/GDP but current account deteriorates

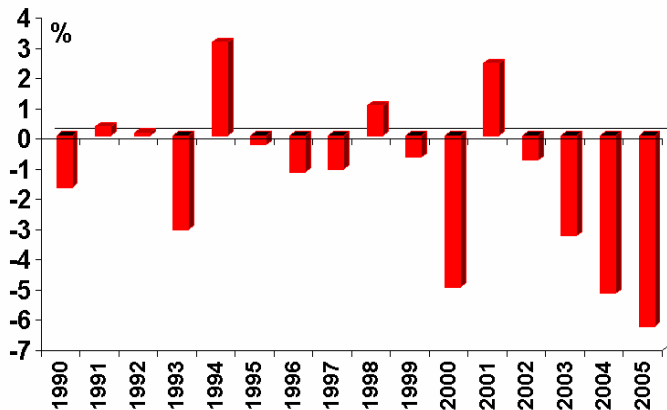
Budget Balance



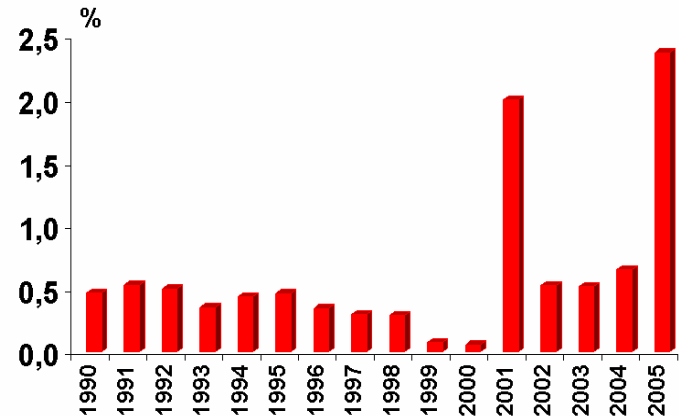
General government debt (% GDP)



Current Account Balance

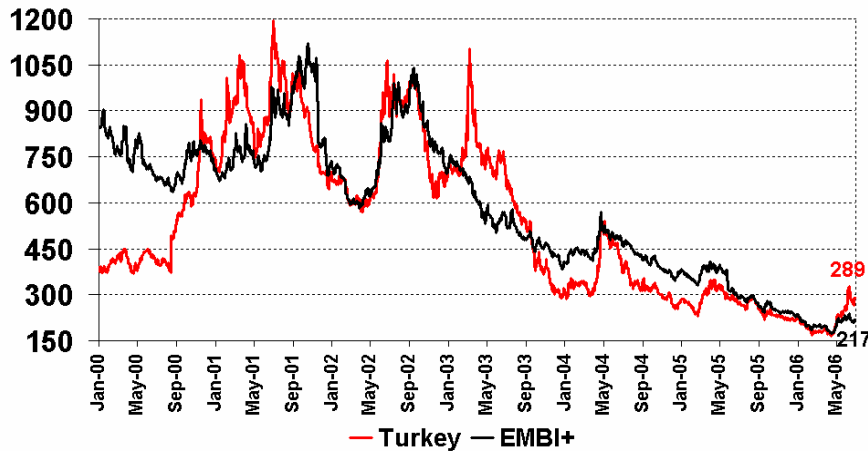


Net FDIs/GDP



2006 crisis- Can it be compared to 2001 crisis?

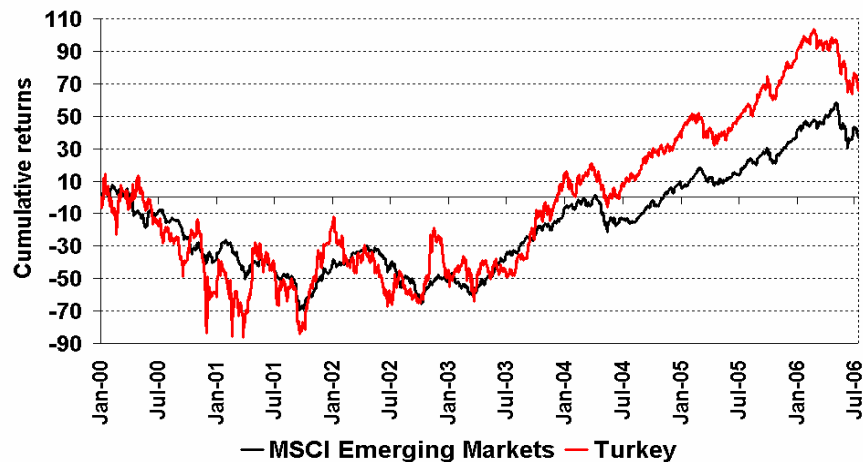
EMBI+ spreads Index



% change from 28/04 to 14/07 2006

	Stock Market	Exchange rate	Stock market in \$
Turkey	-22.9	-19.6	-35.5
Romania	-2.9	-2.9	-5.9
Bulgaria	0.9	0.43	1.2

Stock Market indices



	2001 crisis			2006 crisis	
	31/01/01	28/02/01	31/12/01	28/04/06	26/06/06
Key O/N Borrowing rate	40%	100%	59%	13.3%	17.3%
USD/TRY	0.68	0.93 (-36.8%)	1.45	1.32	1.58 (-19.7%)
Stock Index	10,685	8,791 (-17.7%)	13,782	43,880	33,831 (-22.9%)

Economy will slow down but not plunge

- Real GDP growth rate: 4.5% in 2006, 4% in 2007
- Inflation: 10% in 2006, lower in 2007
- Current account may improve
- No banking crisis

WHY?

- IMF oversight on fiscal policy, which continues to be restrictive as public sector wages were set before the crisis
- Central bank has managed to contain the crisis
- Structural reforms have changed the economy's ability to adapt
- Banks do not have the FX exposure they had in 2001

Bank profitability expected to decline in the next 1,5 year due to

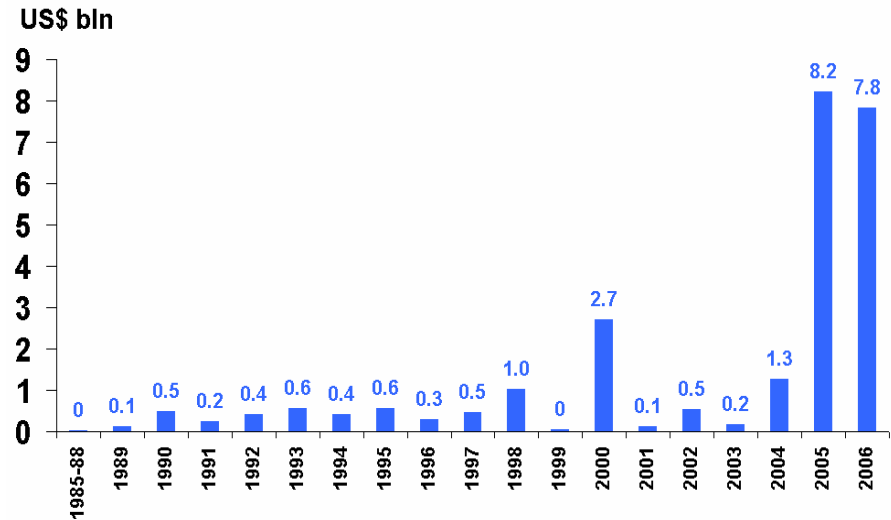
- Higher interest rates (positive duration gap)
- Deceleration in credit expansion
- Slowdown in economic growth

D. Structural reforms

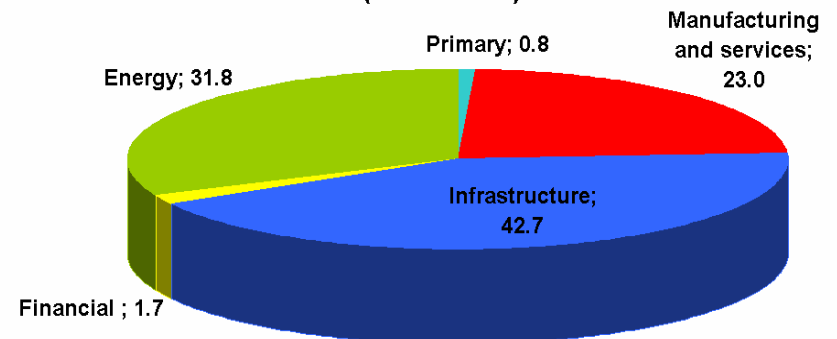
- Speedy privatization program
- Social security reform
- Reforms needed in
 - battling bureaucratic red tape
 - reducing the size of the informal economy

Very fast privatization program

Privatization Revenues, 1985-2006



Privatization Revenues by sector (2002-2006)



- During the last two years privatization proceeds exceeded those collected the previous 17 years.

- Privatizations:
 - improve efficiency
 - bring revenues
 - reduce the political power of the deep state.

Still a lot to be privatized

- 66% of state-owned enterprises has been privatized.
- A major success was the privatization of Turk Telecom. (Sale of 55% to an international consortium led by Saudi Arabia's Oger Telecom. The transaction value reached 6.5 US\$. However, the buyer will pay in 4 annual installments and thus only US\$ 1.31 bln entered the Treasury in 2005).
- Only 38% of SOEs were acquired by foreign investors.
- Electricity distribution companies, Halkbank, parts of Tekel, Petchem and seaports are in the pipeline to be privatized.

Status	Number of SOEs	Government Stake
SOEs Privatized	180 (66%)	90 fully state-owned and 90 partially state-owned
SOEs Not-yet-privatized remaining in PA's portfolio	70 (26%)	Majority fully state-owned
SOEs Not-yet-privatized remaining in Treasury's portfolio	21 (8%)	All fully state-owned

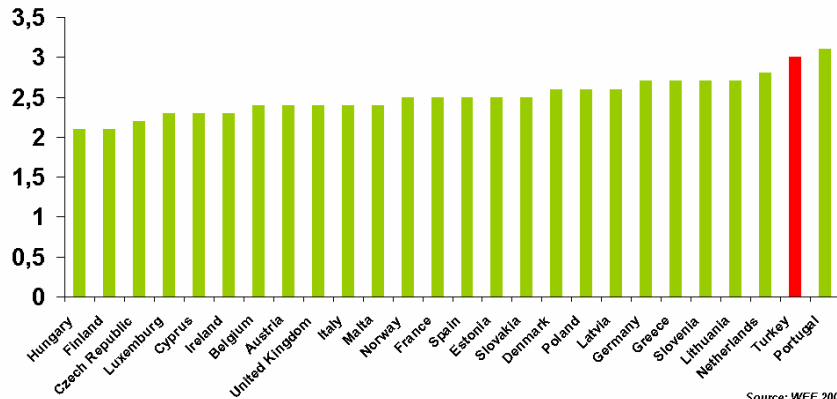
The 5 most profitable privatizations realized in 2005-06

Company	Sector	Contract Date	Sales' Proceeds (\$ bn)
Turk Telecom	Tellecommunications	14/11/2005	6.55
Tüpraş	Petroleum Industry	4/3/2005 26/1/2006	4.59
ERDEMİR	Steel Industry	27/2/2006	2.77
Vakif Bank	Banking Sector	15/11/2005	1.27
Mersin Port	Infrastructure	7/11/2005	0.76

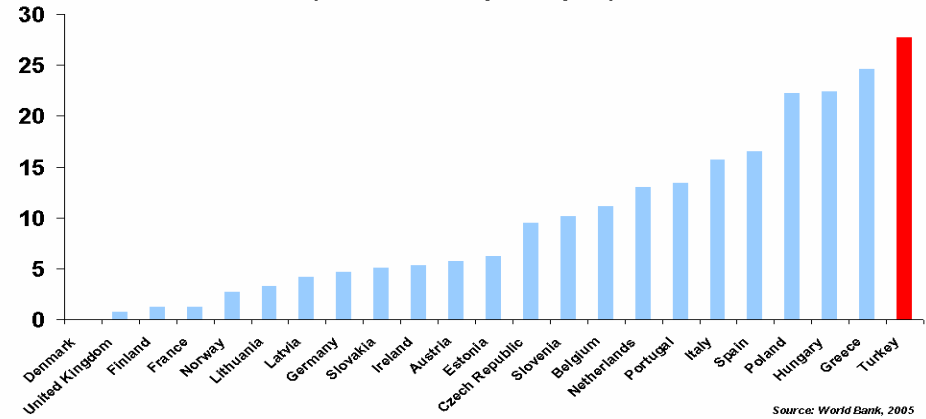
Reforms needed in battling bureaucracy and the informal economy

Extent of bureaucratic red tape

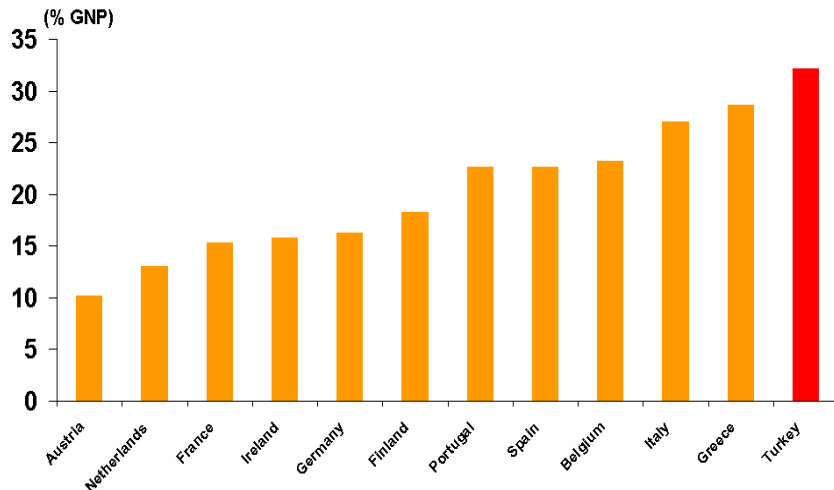
How much time does your firm's senior management spend dealing with government officials (as a % of work time)? (1=0%, 2=1-10%, 3=11-20%, 8=81-100%)



Cost of starting a business (% of income per capita)

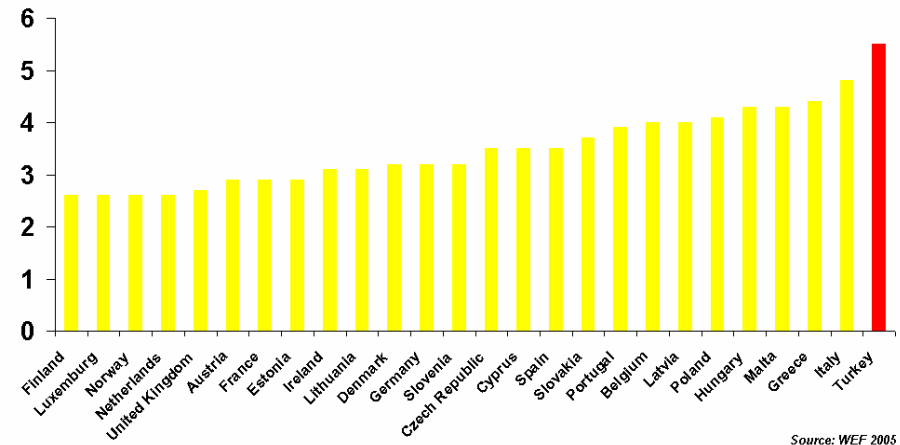


Informal economy (World Bank, 2000)



Informal sector

How much business activity in your country would you estimate to be unofficial or unregistered? (1=none, all businesses are registered, 7= more than 50% of economic activity is unrecorded)

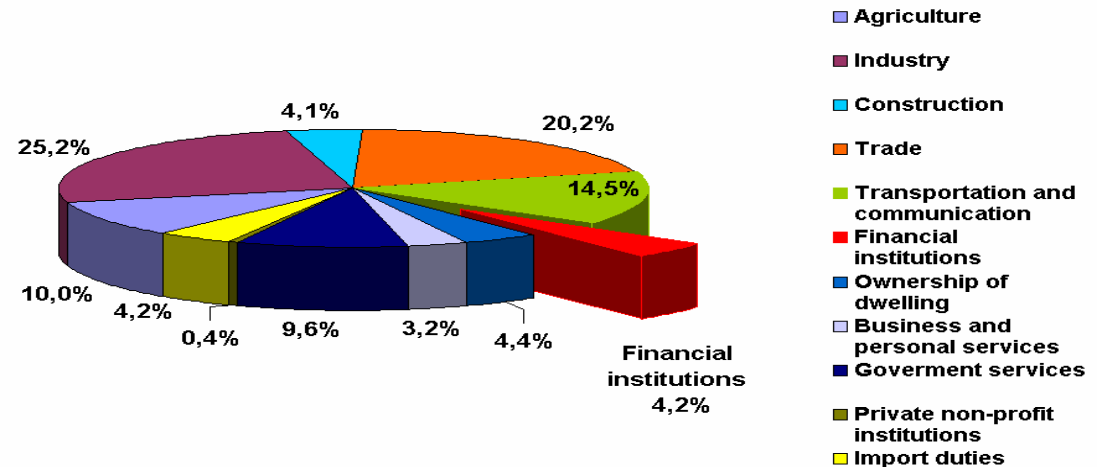


E. The Banking System

- **A bank-based financial system**
- **Small banks with ownership shifting to foreigners**
- **An under-banked economy with strong credit expansion, which is expected to decelerate**
- **Well-capitalized banks with**
 - less FX exposure than in 2001
 - less NPLs too
- **But with lower future profitability as they operate in**
 - a riskier environment
 - an environment of higher interest rates than a few months ago
- **The million \$ question: Did Greek banks overpay?**

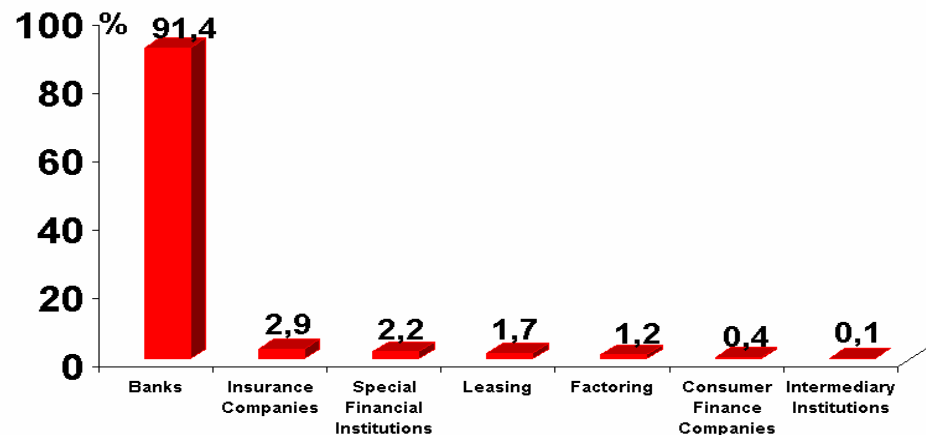
A bank-based financial system

Sectoral contribution to GNP, 2005



- Financial institutions accounted for 4.2% of gross value added in 2005.

Balance Sheet Size of the Financial Sector (2004)



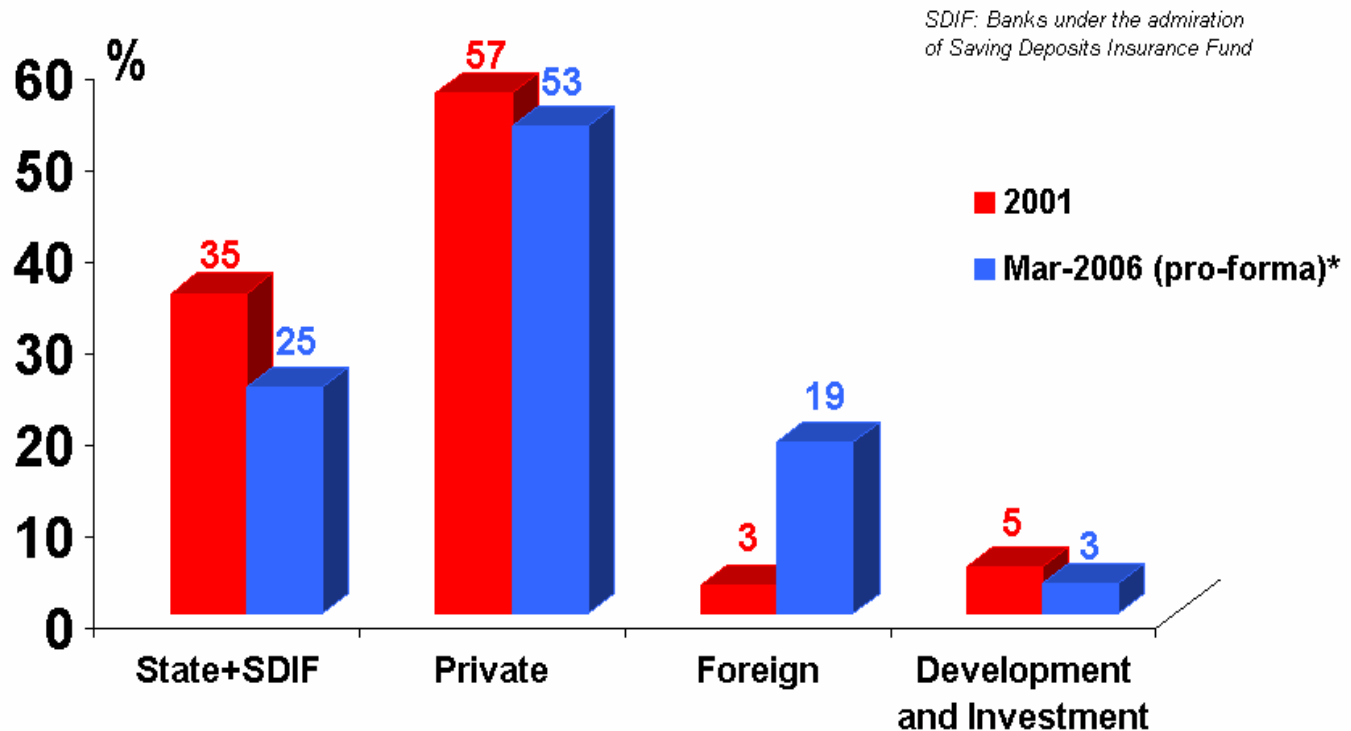
- Financial sector comprises mainly of banks.

Small banks ...

March 2006- Banks		Groups	Date of Establish.	Total Assets (EUR Bln- Market Share)	Total Loans* (EUR Bln- Market Share)	Total Deposits (EUR Bln- Market Share)	Total Share- holders' Equity (EUR Bln- Market Share)	No. of Branch Offices (Market Share)	No. of Employees- (Market Share)	Market Cap (EUR Bln- 18/07/06**)
1	Türkiye Cumhuriyeti Ziraat Bankası A.Ş.	State-owned	1863	40.6 (16.0%)	7.4 (7.2%)	32.9 (20,2%)	3.8 (11.0%)	1,146 (18%)	20,150 (15%)	-
2	Türkiye İş Bankası A.Ş.	Privately-owned	1924	40.2 (15.9%)	14.5 (14.0%)	24.5 (15.1%)	6.5 (18.9%)	877 (14%)	17,603 (13%)	7.7
3	Akbank T.A.Ş.	Privately-owned	1948	32.1 (12.7%)	15.1 (14.6%)	19.8 (12.2%)	3.9 (11.4%)	660 (10%)	11,233 (8%)	12.4
4	Türkiye Garanti Bankası A.Ş.	Privately-owned	1946	23.9 (9.4%)	12.7 (12.3%)	15.2 (9.4%)	2.6 (7.5%)	436 (7%)	10,847 (8%)	3.9
5	Türkiye Vakıflar Bankası T.A.O.	State-owned	1954	20.9 (8.3%)	8.3 (8.1%)	14.7 (9.0%)	2.5 (7.2%)	306 (5%)	7,211 (5%)	3.9
6	Türkiye Halk Bankası A.Ş.	State-owned	1938	18.5 (7.3%)	4.4 (4.3%)	14.4 (8.8%)	2.1 (6.1%)	585 (9%)	10,451 (8%)	-
7	Yapı ve Kredi Bankası A.Ş.	Privately-owned	1944	14.4 (5.7%)	7.4 (7.1%)	9.7 (5.9%)	1.1 (3.1%)	405 (6%)	10,076 (8%)	2.2
9	Finans Bank A.Ş.	Privately-owned	1987	8.4 (3.3%)	5.0 (4.9%)	4.3 (2.6%)	0.9 (2.6%)	221 (4%)	6,702 (5%)	3.8
28	Tekfenbank A.Ş.	Privately-owned	1992	0.5 (0.2%)	0.2 (0.2%)	0.3 (0.2%)	0.06 (0.2%)	30 (0.5%)	567 (3%)	-
Total (47 banks)				253.8 (100%)	103.2 (100%)	162.9 (100%)	34.3 (100%)	6,308 (100%)	134,120 (100%)	34.8
1	National Bank of Greece	State-owned	1841	54.2 (19.9%)	32.3 (17.2%)	41.4 (25.4%)	3.2 (13.4%)	567 (16.2%)	13,185 (23%)	13.5
2	Alpha Bank	Privately-owned	1879	45.4 (16.7%)	28.1 (14.9%)	19 (11.7%)	2.3 (9.7%)	365 (10.5%)	7,179 (12%)	7.6
3	Eurobank EFG	Privately-owned	1990	44.1 (16.2%)	30.1 (16%)	25.6 (15.7%)	2.4 (10.3 %)	332 (9.5%)	7,044 (12%)	8.1
Total (61 banks)				272.6 (100%)	188.2 (100%)	162.9 (100%)	23.6 (100%)	3,492 (100%)	6,0138 (100%)	50.3

... with ownership shifting to foreigners

Ownership structure of the banking system

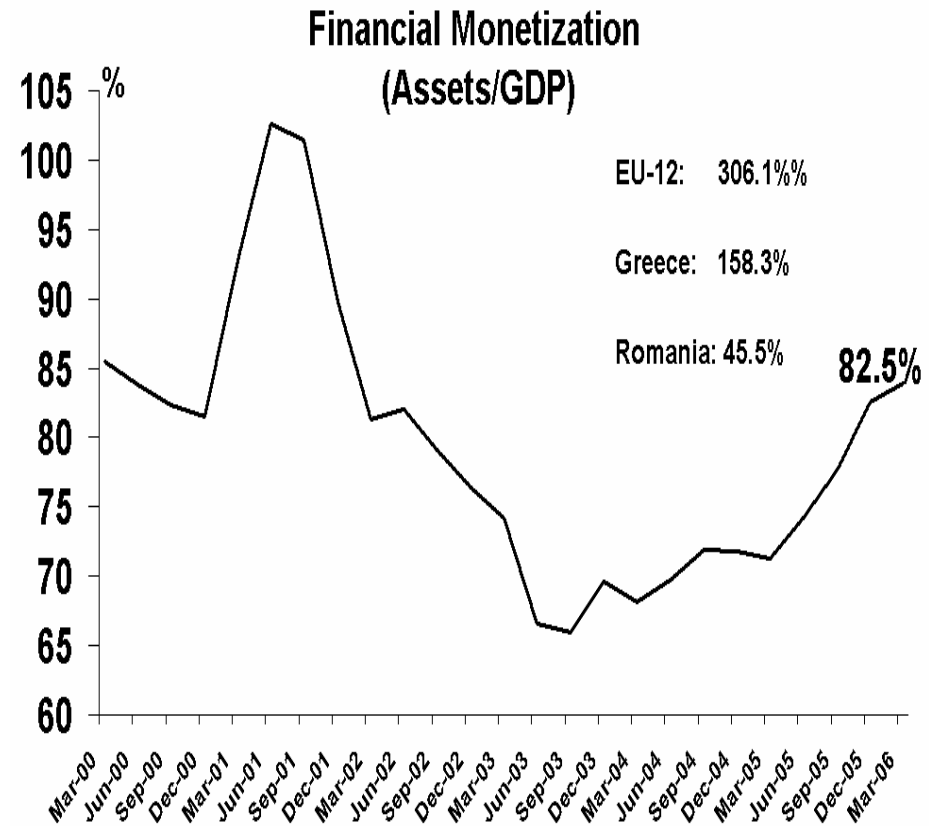
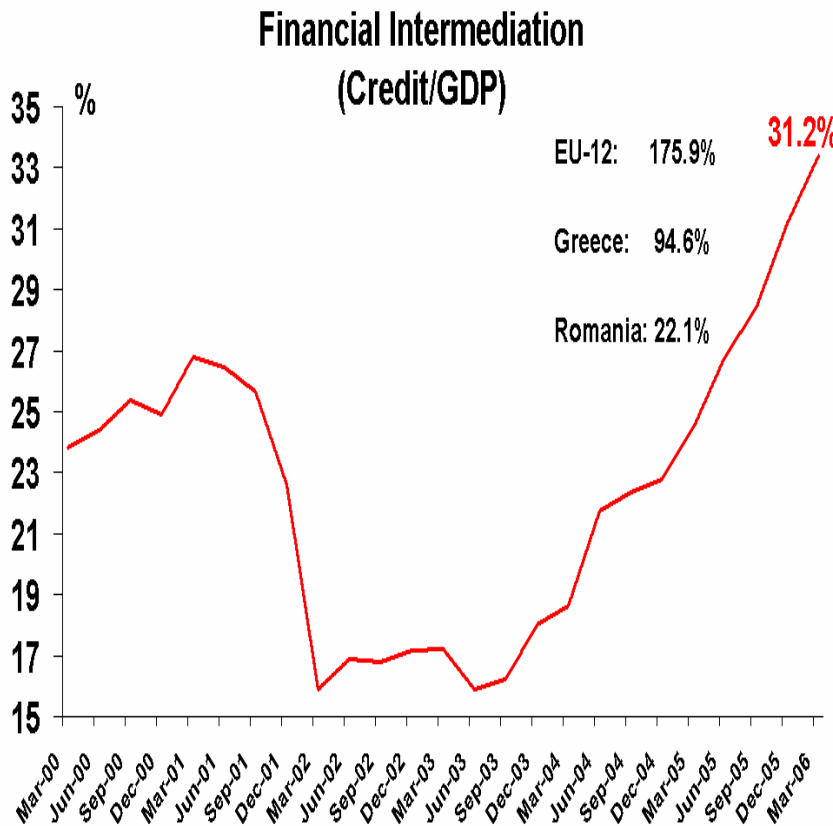


* *Finansbank, Tekfenbank, Denizbank are included in foreign banks. Halk bank is supposed to be acquired by foreign investors as well*

2001: 61 banks

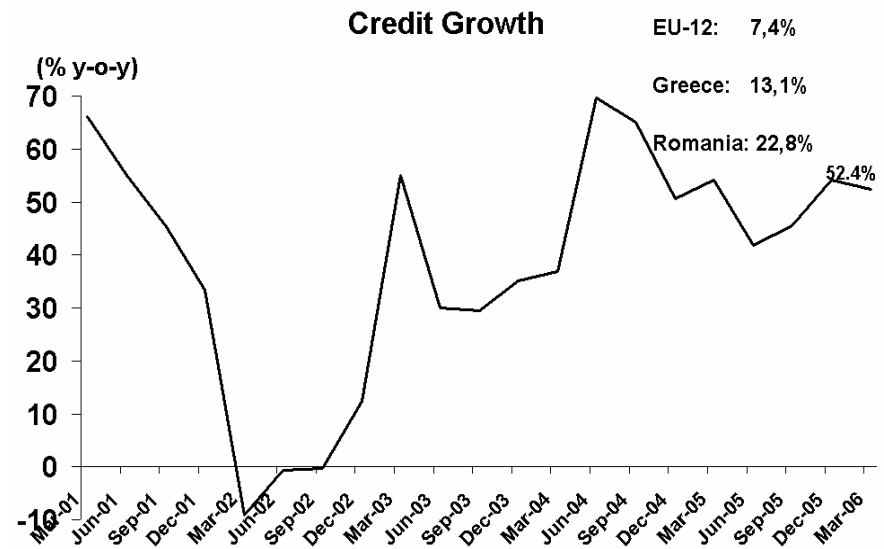
2005: 47 banks

Turkish economy remains under-banked...

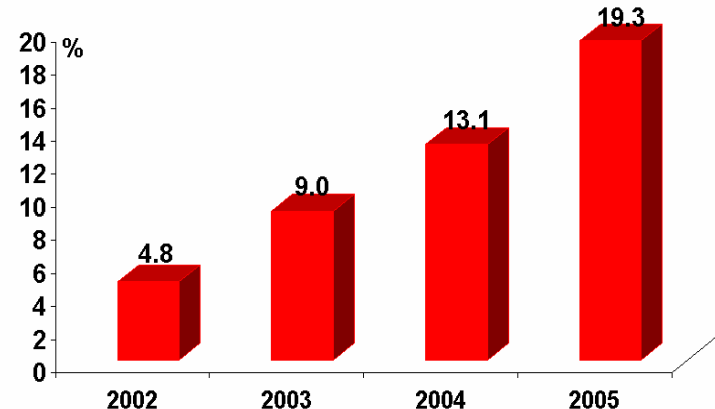


...but credit expansion is rapid

- The fall in interest rates caused an acceleration in credit expansion
- Housing loans (44% of consumer loans) presented a five-fold increase in 2005, starting though from a low level
- Consumer loans have fixed rates by Law
- Credit growth rates are expected to decline as interest rates have risen

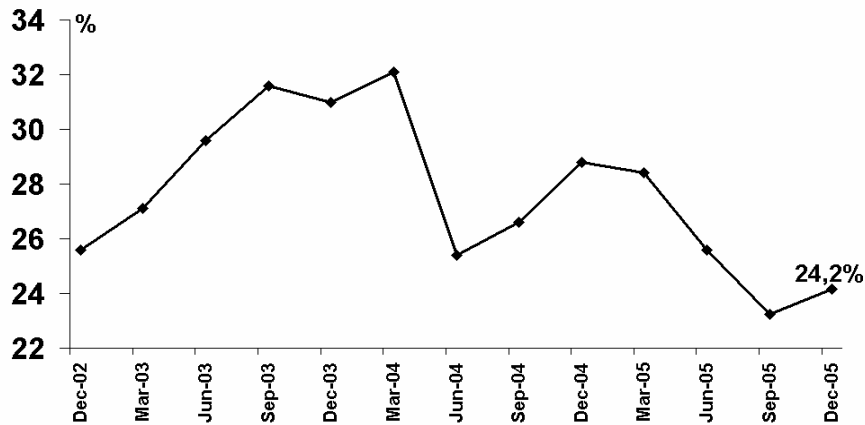


Share of consumer and mortgage loans
(% total loans)

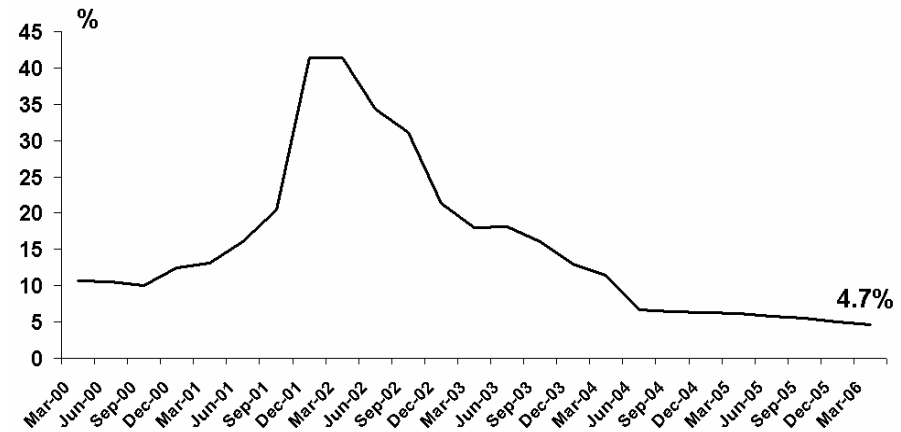


Well-capitalized banks with reduced NPLs and FX exposure

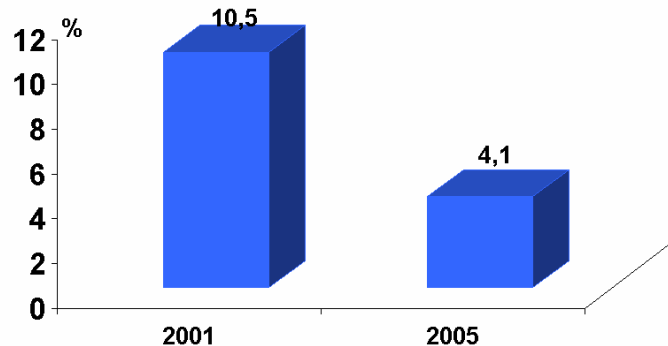
Capital adequacy ratio



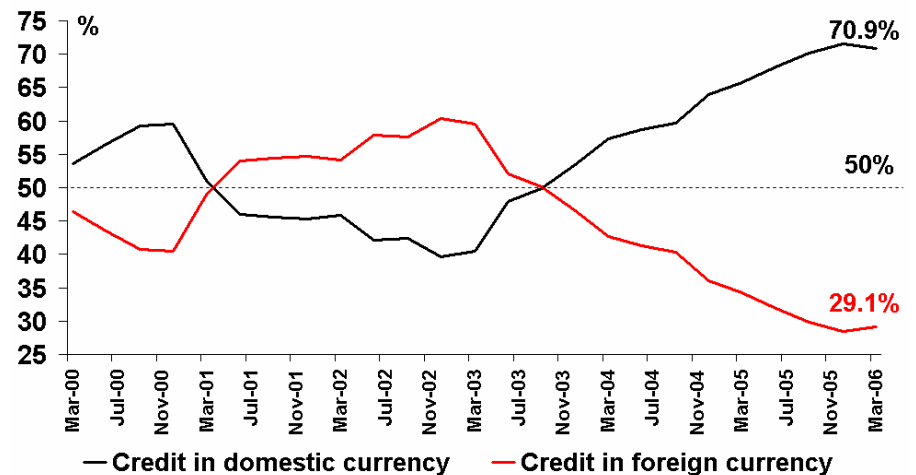
Ratio of non-performing loans to total loans



(FX Liabilities-FX Assets)/ Total Assets



Composition of total credit by currency



Recent bank deals

Acquisitions of banks in Turkey during the last two years

Target	Date	Acquirer	P/BV*	Stock price % change in \$
Halk Bank	?	?	?	-
Denizbank	31/5/2006	Dexia	3.9	-
Tekfenbank	8/5/2006	Eurobank EFG	3.6	-
Finansbank	3/4/2006	NBG	3.6	-
Garanti Bank	25/8/2005	GE Capital	2.5	-44.4
Yapi Kredi	9/5/2005	Unicredito	1.1	-38.8
Fortis (Disbank)	12/4/2005	Fortis	1.9	-49.7
Sekerbank	15/6/2005	Rabo	1.1	-57.4

- Valuations were high before the crisis
- Acquirers paid \$13 bln during 2005-06

Eurobank EFG builds a position in Turkey, avoiding large exposure

- Acquired 70% of Tekfenbank (including banking and leasing operations) from Tekfengroup.
- Headquartered in Istanbul, Tekfenbank is a medium-sized bank that provides a complete range of commercial banking products and services.
- Tekfenbank to acquire EFG Istanbul Securities.
- Future strategy focus on:
 - Network expansion
 - Client base expansion
 - Cross selling to affluent clients
 - Introduction of mortgage lending and asset management services

Tekfenbank	
March 2006	Key Information
Total Assets (EUR Million)	454
Total Loans* (EUR Million)	226
Total Deposits (EUR Million)	311
Total Shareholders' Equity (EUR Million)	60
No.of Branch Offices	30
No.of Employees	567

**Total Loans= Short term + Medium and Long Term + Loans under Follow up - Specific Provisions*

Summary

- **Turkey: Is the cup half full or half empty?**
- **Pluses:**
 - Large & growing potential market
 - Process of EU accession imposes economic discipline and brings further democratization
 - Irreversible structural reforms improve efficiency and shift political power away from the “deep state”
 - Macroeconomic stability may last as its fruits are dispersed and visible, hence, difficult to undermine in the future
 - Under-banked economy with a stable banking system
- **Minuses:**
 - Macroeconomic stability may not last if we return to coalition governments
 - Structural reforms may stall if we return to coalition governments
 - What if EU negotiations stall? There is ambivalence across the political spectrum on Turkey entering the EU, but everyone agrees that it is the process that matters.
 - What if the Kurdish minority becomes stronger and more vocal or militant?
- **NBG took a brave step at a bad time**
 - Profitability in Turkey will decline in the short run
 - Major long-run risks is the creation of brand name and its ability to manage its employees in Turkey
- **EFG follows a more conservative approach**