STANDING FIRM

Despite concerns about the impact of the adoption of Basel II last summer, Turkish banks came out of the exercise in good shape and are becoming the capital market darlings of 2013.

BY ADRIAN MURDOCH

Turkey finalised its adoption of Basel II in July last year, becoming the 22nd of 27 member countries to implement the regulations of the Basel Committee on Banking Supervision. There were concerns that the country's 44 banks – three public, 41 private – would all have to sprint, cap-in-hand, to raise capital.

The opposite has in fact been true. When the capital adequacy ratio of the banks was revealed at the end of September, it turned out that the banking system's average CAR was 16.5%, comfortably above the 12% minimum CAR level set by the regulator.

"Basel II had been talked about and delayed from as far back as 2007. Although we had thought the impact of the adoption of Basel II was going to be negative and reduce regulatory CAR for the banking sector, in fact, banks were able to build up capital through strong retention of earnings during the interim period.

"In addition, when regulations finally came out, there was some easing of risk weightings assigned to certain asset classes which also softened the impact. In the end, for most banks we saw a capital adequacy ratio erosion of only 0.1% or 0.2%," said Janine Dow, senior director of financial institutions at Fitch.

Building confidence

It is a view confirmed by Coskun Kucukozmen, lecturer on banking, finance and risk management at Izmir Ekonomi Universitesi, and also a former regulator on the country's Banking Regulation and Supervision Agency.

"I should say at the outset that despite the expected fall in average capital adequacy across the Turkish banking sector resulting from the implementation of Basel II, it is clear that there will be no immediate or additional requirements for capital. This situation builds up the confidence in the sector," he said.

Residents gather in front of Ortakoy Mosque on the Bosphorus waterfront in Istanbul to attend celebrations marking the 83rd anniversary of the founding of the Turkish Republic REUTERS/Fatih Saribas

What has helped is the rating of the sovereign. Fitch already rates Turkey as investment grade, while Moody's has the sovereign at Ba1.

"The sovereign ratings are the most relevant and costly for Turkish banks," said Kucukozmen. It has been backed up by the steady hand of the Central Bank of Turkey. Aware of the country's relatively strong GDP growth of 2.2% in 2012 with forecasts of 3.8% for this year and 4.5% for 2014, the Central Bank has managed inflation targets and maintained financial stability through capital and loan-loss reserves and currency market interventions, rather than a knee-jerk rise in interest rates.

Just the beginning

Those in Ankara and Istanbul talk about revitalised and vibrant cities. No wonder then that Najam Khan, head of corporate finance Middle East and Islamic finance for Commerzbank, said: "The Turkish economy is buoyant – the banks are active. This is just the beginning."

A sign, of course, of the standing of the banks is their ability to raise money in the capital markets. While last year saw US$8.7bn offshore issuance from Turkish banks, according to figures from Dealogic, this year has already seen US$2.2bn bank issuance. For the whole year US$12bn is expected with a further volume of up to TL10bn in local currency issued offshore.

At the start of the year, Yapi Kredi, the fourth-largest privately owned bank in the country, led the charge for CEEMEA financial issuers. It drew on the US$500m remaining from its US$1.5bn programme that had been approved last year. Guidance for the seven-year 144a/Reg S was tightened twice from around MS plus 290bp and it eventually priced at MS plus 273bp with an order book of US$3.5bn. Pricing was comfortably inside the bank's secondary curve.

Yapi Kredi was swiftly followed by Halkbank, the country's seventh-largest bank, which sold a US$750m seven-year at MS plus 255bp, again well inside guidance, and then BankPozitif, 65% owned by Bank Hapoalim, which priced a US$150m five-year at US Treasuries plus 415.4bp.

But what looks as though it will become one of the themes of the year for Turkish banks is Eurolira issuance. "Unlike other countries – Turkey has a strong euro currency requirements for business and trading," said Commerzbank's Khan. (See p20)

What all of this activity shows is not just the demand for Turkish credit, but that there is also a sobriety to raising money. Indeed the rumour mill is grinding away enthusiastically and while banks such as Yapi Kredi and Halkbank have led the charge among Turkish banks in bond issuance, many rivals are now expected to issue in the near future.

What everyone has in the back of their minds is that Turkish banks have underissued in the past; outstanding bonds represent only 1.6% of total banking assets as of September 2012, according to Barclays. Compared to that, Russia has bonds outstanding representing around 4.6% of total banking assets. Murat Talayhan, managing director of investment banking, Central Eastern Europe and Turkey at Barclays, said: "There is huge potential and space for issuance in 2013".

For the rest of year industry watchers expect Turkish banks to push out the credit curve. "I expect the market to remain active in general for the rest of the year. You could see deals longer than five years, perhaps up to seven years," said Neil Shuttleworth, head of EEMEA debt capital markets syndicate, at Deutsche Bank. Some say it could go out as far as 10 years. All of this is significant given that Turkey used to be only a one-year market.

Fly in the ointment

While bankers are enthusiastic and ratings agencies remain sanguine, this does not mean the Turkish banking sector is completely problem-free. The potential fly in the ointment remains domestic loans, not syndicated loans. Going back a few years the banking sector saw rapid loan growth and an underserviced loan book.

Barclays' Talayhan said Turkish banks traditionally had a sticky but short-term deposit base as the main source of funding. "Now with the availability of capital market funding, the maturity mismatch has been significantly reduced. This further allows Turkish banks to participate in privatisation and acquisition financing transactions."

Banks, however, have been treading carefully. Basel II's risk weight for retail loans is 75% – down from 100% in the Basel I framework Turkey had been using. But the Turkish Central Bank forces lenders to apply risk weights of anything from 150%–200% instead, with the higher level assigned to loans maturing in more than two years. As if that were not enough, the government has also set a target of 15% loan growth a year, according to the Central Bank.

"The industry's response can be to make fewer loans. But this seems unlikely; instead banks are likely to choose to give loans with shorter maturities [up to one year] and with higher collateral," said Kucukozmen.

Although the latest figures – those from December 2012 – mention that only 0.9% of the banking sector's loans count as non-performing, those with slightly longer memories recall the impact of the sharp economic contraction in the third quarter of 2009. Almost overnight, impaired loans across the board went up to 6%, while those from credit cards spiked as high as 9%, according to Fitch.

The strong economic growth in Turkey's economy saw a boom in lending – loans grew 30% in 2010 and 2011 respectively, according to Fitch. So far this has not been a problem and the ratings agencies saw no difficulties in 2012. In flashpoint sectors like construction there has been little sign of an asset bubble. But, as Fitch's Dow says: "We are keeping an eye on them". (For more on loans, see p23) ●

CAR OF THE TOP SEVEN TURKISH BANKS AS OF Q4 2012

Q4 12 Financials	Akbank	GarantiBank	Halkbank	Isbank	Vakifbank	Yapi Kredi	TSKB
Own Funds (TLM)	22,188.0	21,835.0	12,809.0	24,740.0	13,528.0	19,398.0	1,820.0
Core Capital (TLM)	20,258.0	19,729.0	11,331.0	19,766.0	10,345.0	12,827.0	1,629.0
CAR	18.6	18.2	16.2	16.3	16.1	16.3	20.4
Core Capital	17.0	16.5	14.3	13.0	12.3	10.8	18.2
New CAR	18.4	18.0	15.8	15.5	14.1	13.7	19.6
Additional Contribution (% point)	1.4	1.5	1.5	2.4	1.7	2.9	1.4

Source: Garanti Securities – Research