

CAPITAL MARKETS DEVELOPMENT IN TURKEY AND POLAND

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Why do we need well developed local capital markets ?

Capital markets are critical to accelerate economic growth, create jobs, and reduce poverty.

Capital market development will help:

- Mobilize domestic and international savings and allocate them efficiently;
- Provide the long-term term local currency financing needed for infrastructure investments;
- Finance long-term housing mortgages increasing affordability and access to housing;
- Facilitate equity and debt finance for SMEs and allow them avoid currency risk;
- Enable individuals to save for their old age and purchase retirement products;
- Manage risk through a diversification of funding sources and instruments.

What are the key challenges for capital markets development in both countries?

Turkey	Poland
<ol style="list-style-type: none">1. Narrow Investor Base – banks are main investors & issuers; low domestic savings; scarcity of Domestic Institutional Investors, preference for short term investments2. Illiquid and small secondary debt markets - “Buy and hold” strategy on the part of most investors. The limited supply of corporate securities leads investors to hold onto those that are available;3. High relative cost of funding through domestic capital markets vis a vis financing through banks or international capital markets4. Regulatory/Institutional barriers - Lack of corporate ratings and debt market research, poor disclosure of financial information, and weakness in corporate governance and audit standards for enterprise sector	<ol style="list-style-type: none">1. Growing but relatively small institutional investor base- pension fund’s fixed income portfolios still relatively short term.2. Limited Financing to Enterprises - banking sector continues to play the key role. Banks are focusing on lending to households. The share of corporate loans in the banking sector’s assets is one of the lowest in the EU. This makes growth of NBFIs, corporate bond markets and equity based financing through stock exchange much more important.3. Illiquid and small secondary debt markets - Market for non-Treasury long-term debt instruments growing but from low base

Enabling Environment for a Deeper Local Capital Markets

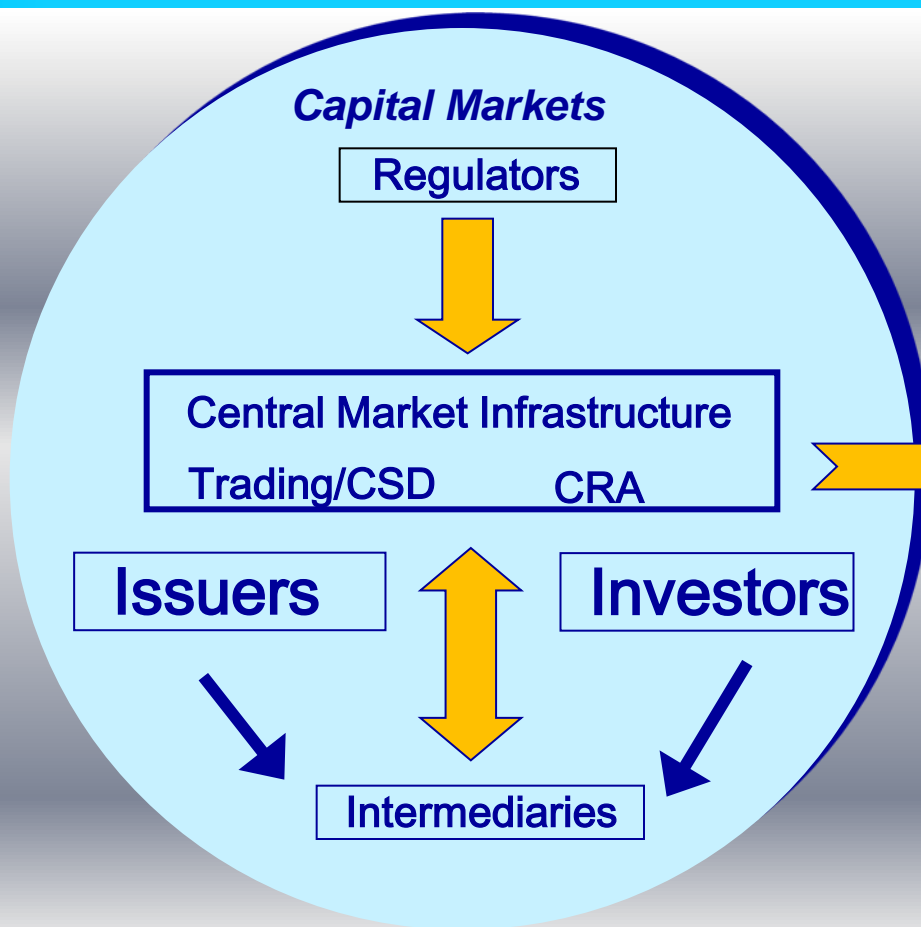
Around: The Enabling Environment

- Macroeconomic
- Tax
- Legal

Across:

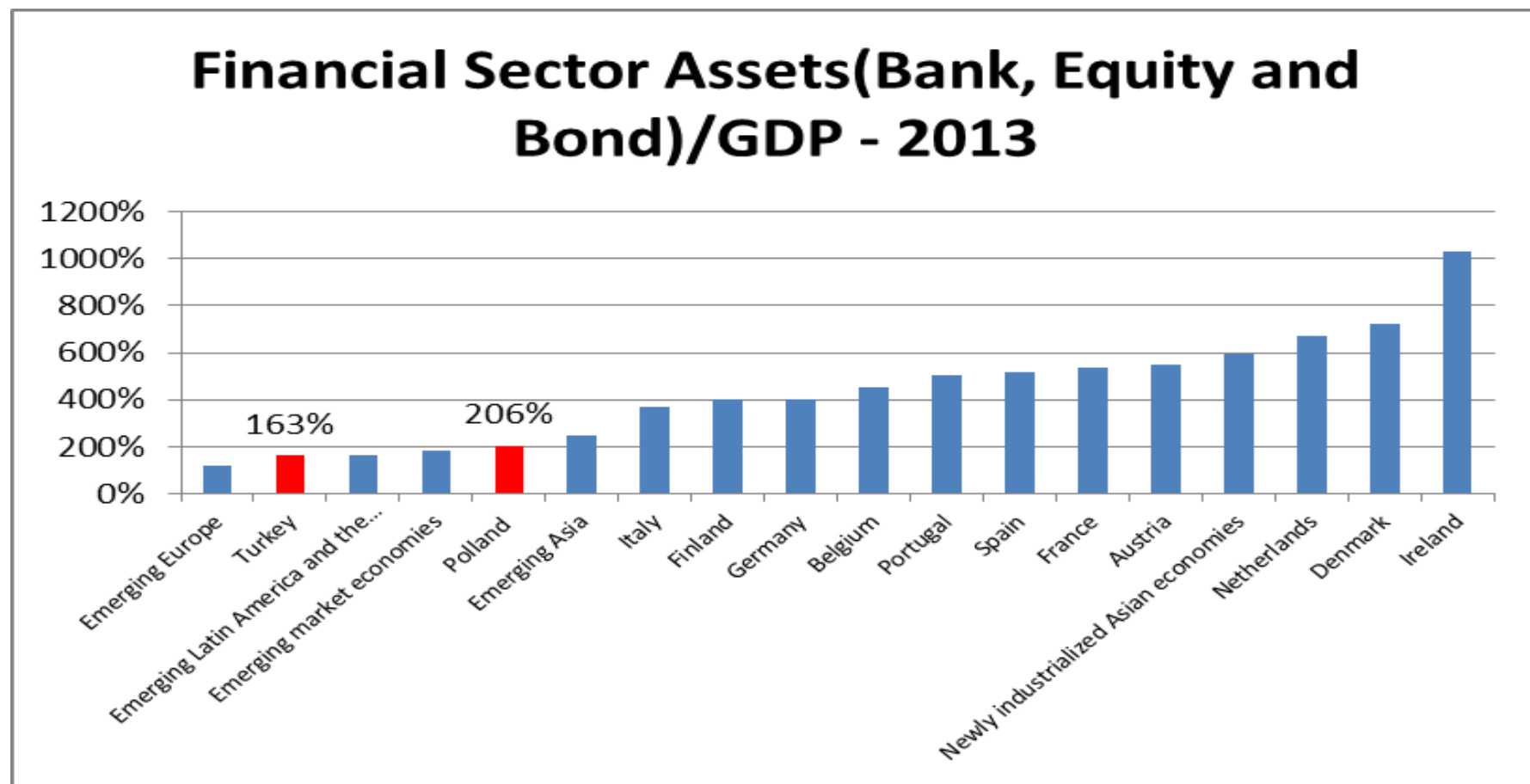
The Financial System

- Bond Market
- Banks
- Equity Market



Size and Structure of the Financial Sector

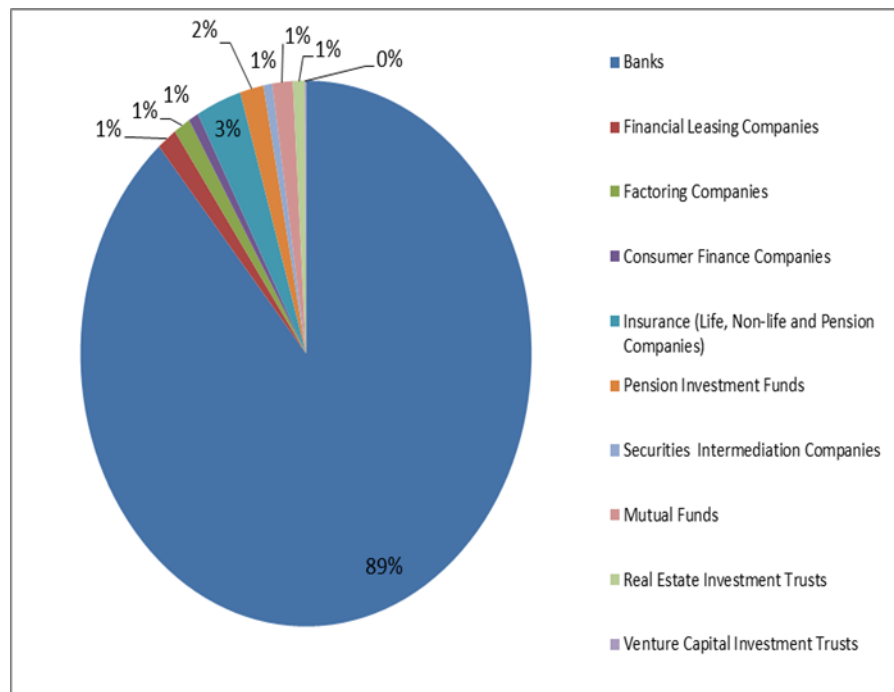
For both of the countries there is room for further financial deepening



Size and Structure of the Financial Sector

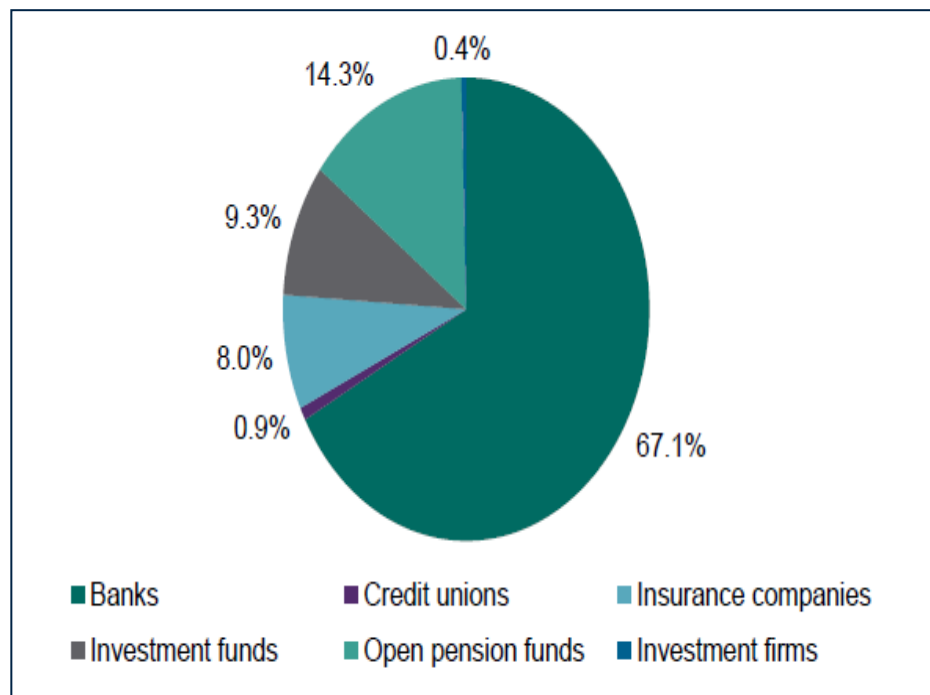
Both countries have financial sectors dominated by banks. Almost 90 percent of the Turkish financial sector consists of bank assets while this ratio is 67 percent for Poland. Poland has a relatively more diversified financial sector but further diversification is needed in both countries for balanced future development

Turkey



BRSA, Central Bank

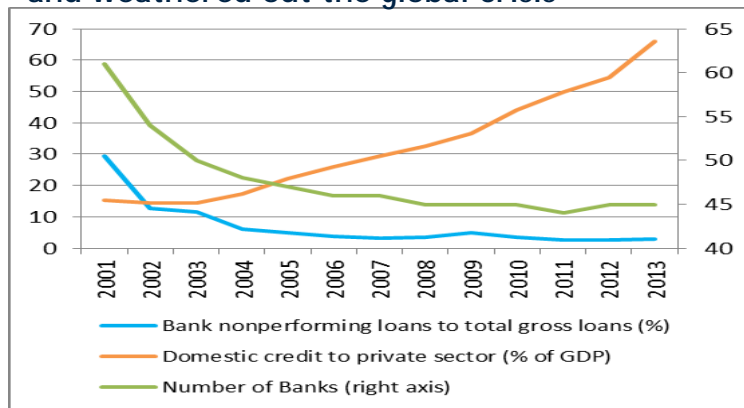
Poland



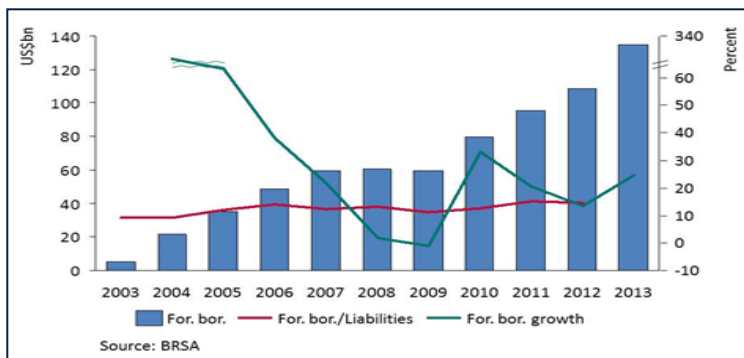
NBP Financial Stability Report

Banking Sector Resilience - Turkey

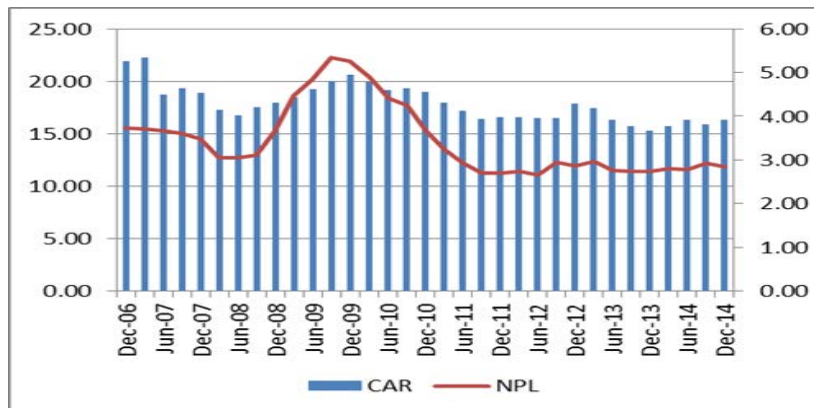
After banking sector restructuring in 2001 banking sector maintained a healthy growth and weathered out the global crisis



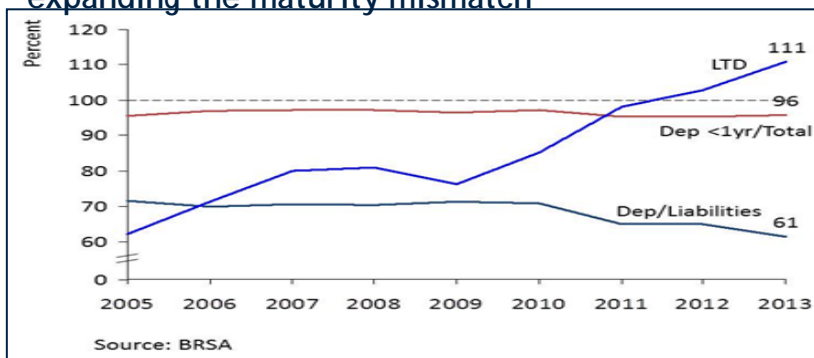
Foreign borrowing of banks has been increasing which is accumulating vulnerability in the system against fluctuations in capital flows



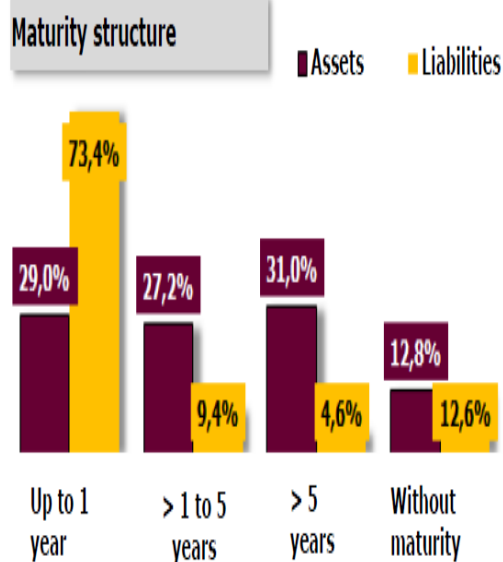
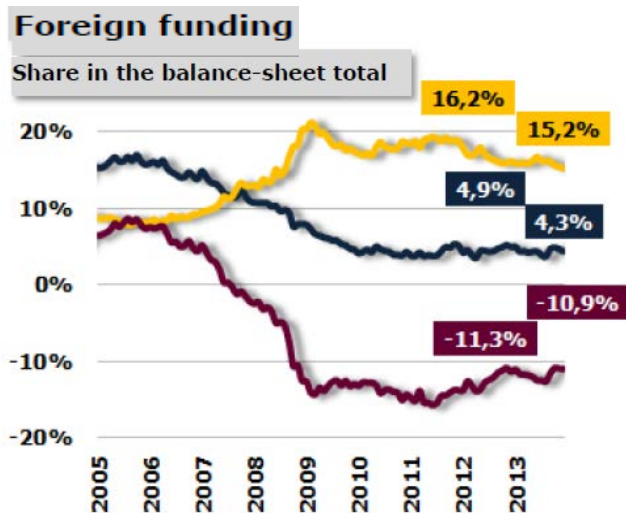
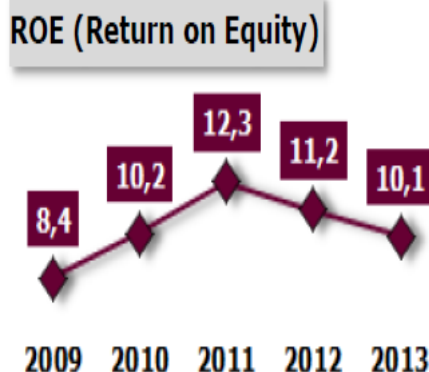
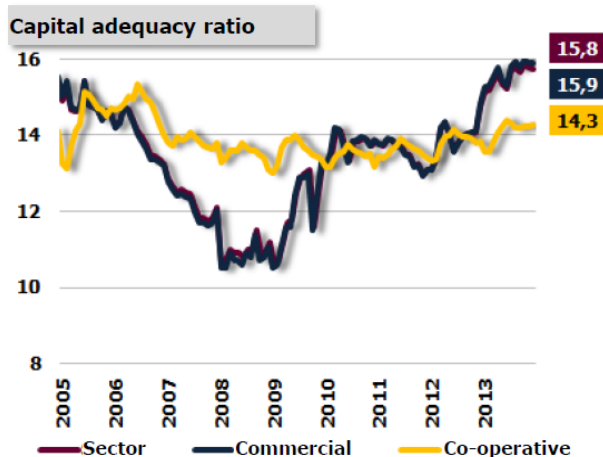
The banking system is well capitalized, shows low levels of non-performing loans, and is fairly profitable and liquid



Bank liabilities are short term and 57 percent of liabilities are funded by deposits with less than 3 months average maturity while loan maturities are growing which is expanding the maturity mismatch



Banking Sector Resilience - Poland



	Portfolio share		
	2011	2012	2013
TOTAL LOANS	7.3%	7.7%	7.4%
Financial sector	0.5%	0.3%	0.5%
Non-financial sector	8.2%	8.9%	8.5%
Public sector	0.3%	0.4%	0.3%
Households	7.2%	7.4%	7.0%
Consumer	18.0%	17.2%	14.6%
Housing	2.3%	2.8%	3.1%
Other	9.3%	10.5%	10.9%
Business entities	10.4%	11.8%	11.5%
SMEs	12.3%	13.1%	13.0%
Large companies	7.4%	9.8%	9.3%
Overdue > 30 days			
Consumer	19.7%	18.9%	16.1%
Housing	2.8%	3.3%	3.4%

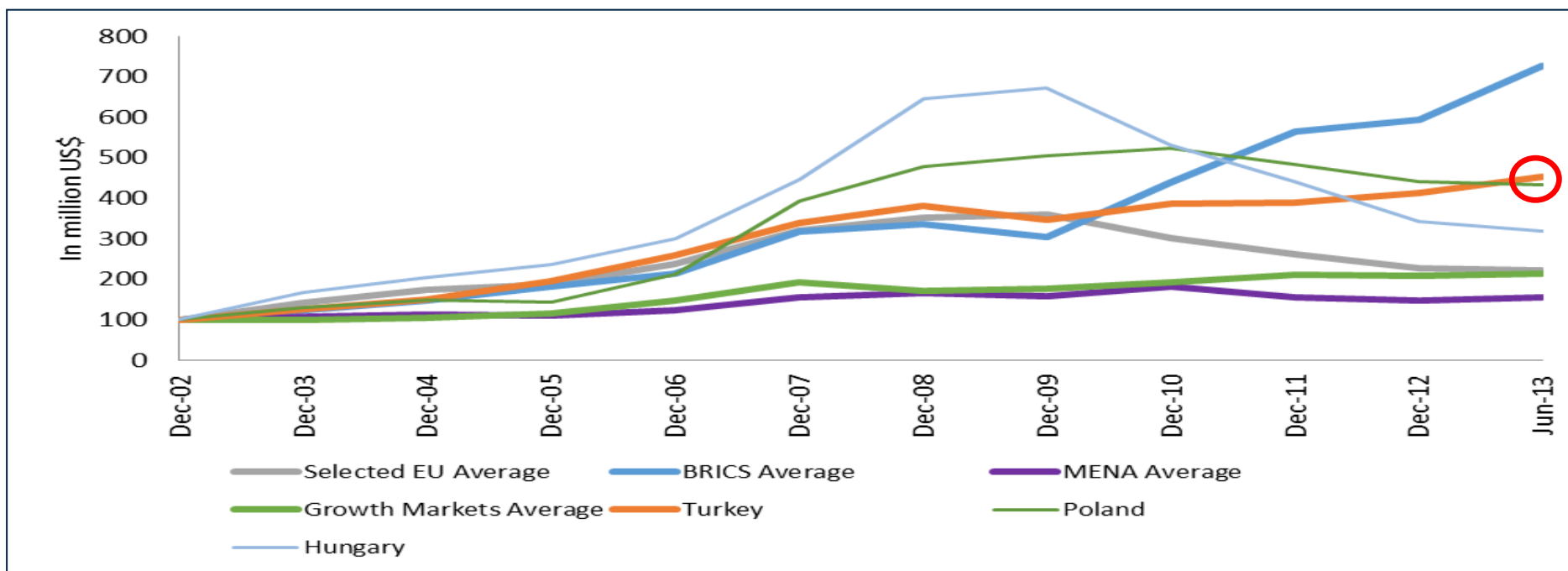
■ Receivables from non-resident ■ Liabilities to non-resident ■ Funding gap

Source: Polish Financial Supervision Authority -KNF- Condition of Banks in 2013

Impact of European Bank Deleveraging

Foreign-owned banks control about 63 percent of the banking sector's assets in Poland while foreign owned banks account for 19 percent of the banking system assets in Turkey. Poland has consequently been more affected by European banks' deleveraging than Turkey but much less than others in European periphery.

External loans and deposits of reporting banks vis-à-vis all sectors (BIS)



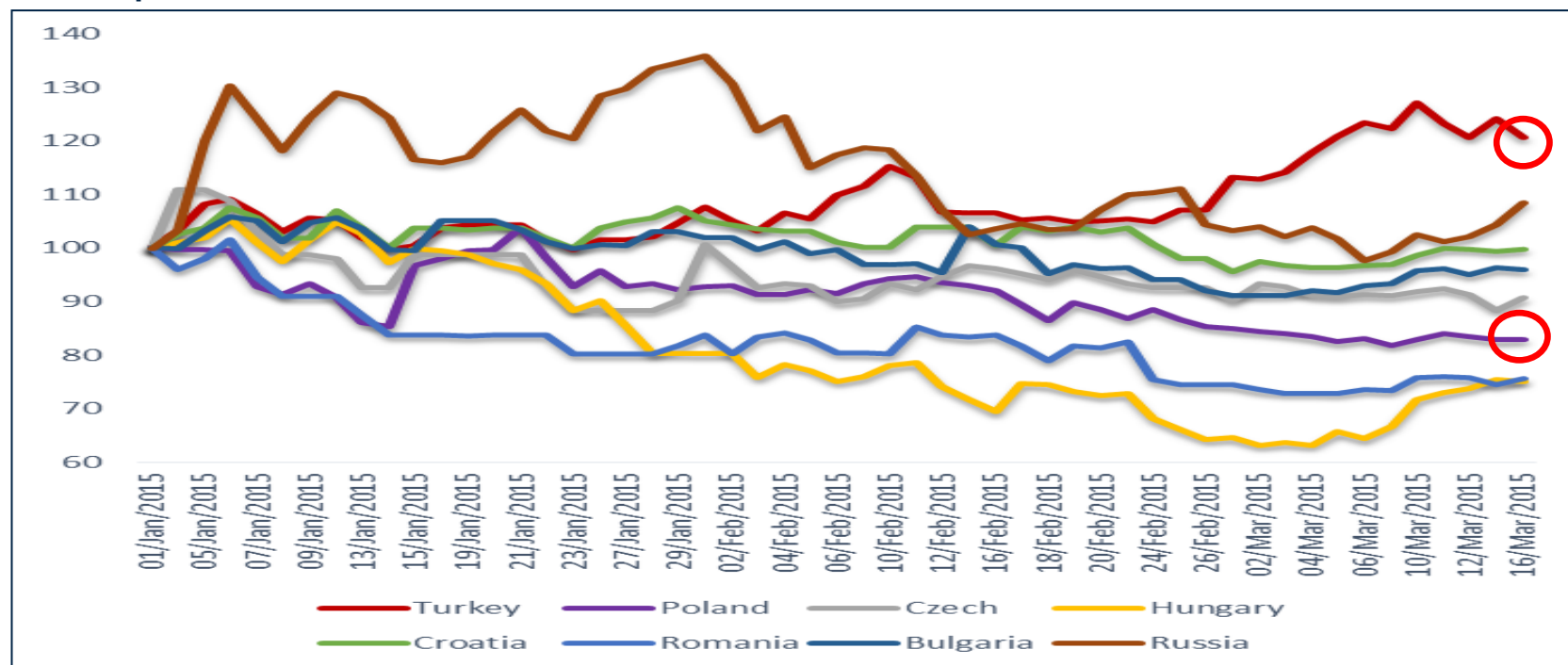
Macro Stability

Macro Stability is a prerequisite for capital markets development. Volatile and high inflation and lack of macroeconomic policy credibility

☐ Constrains development of long term local currency savings

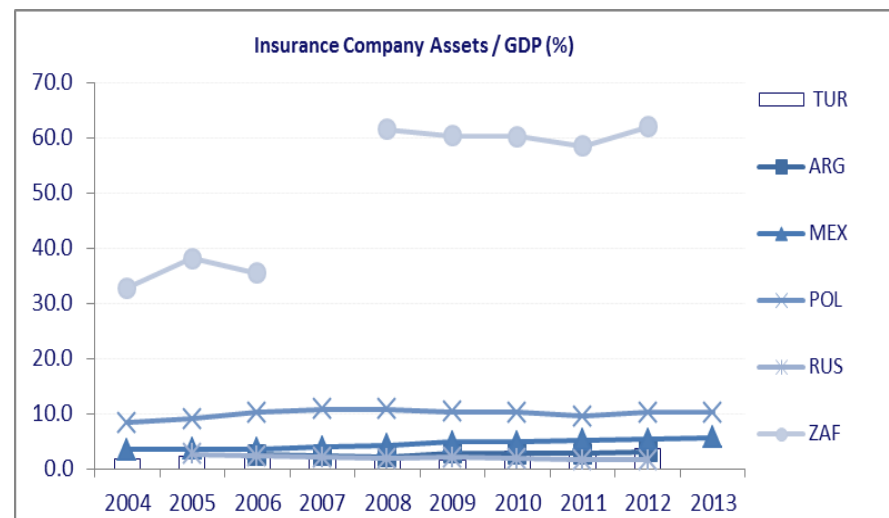
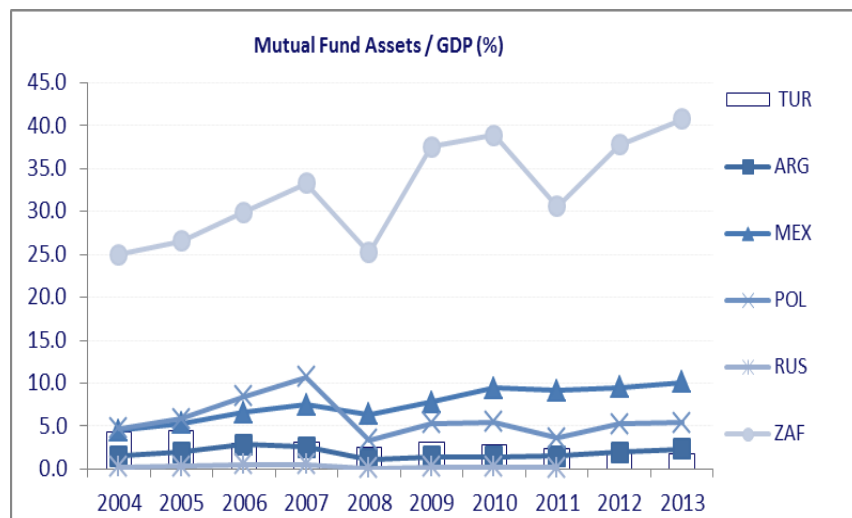
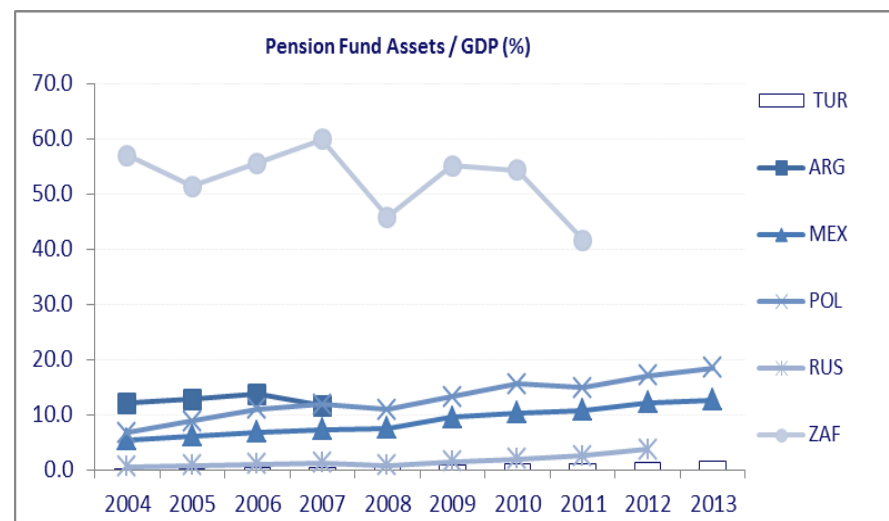
☐ Makes local currency borrowing very expensive at longer maturities

CDS Spreads



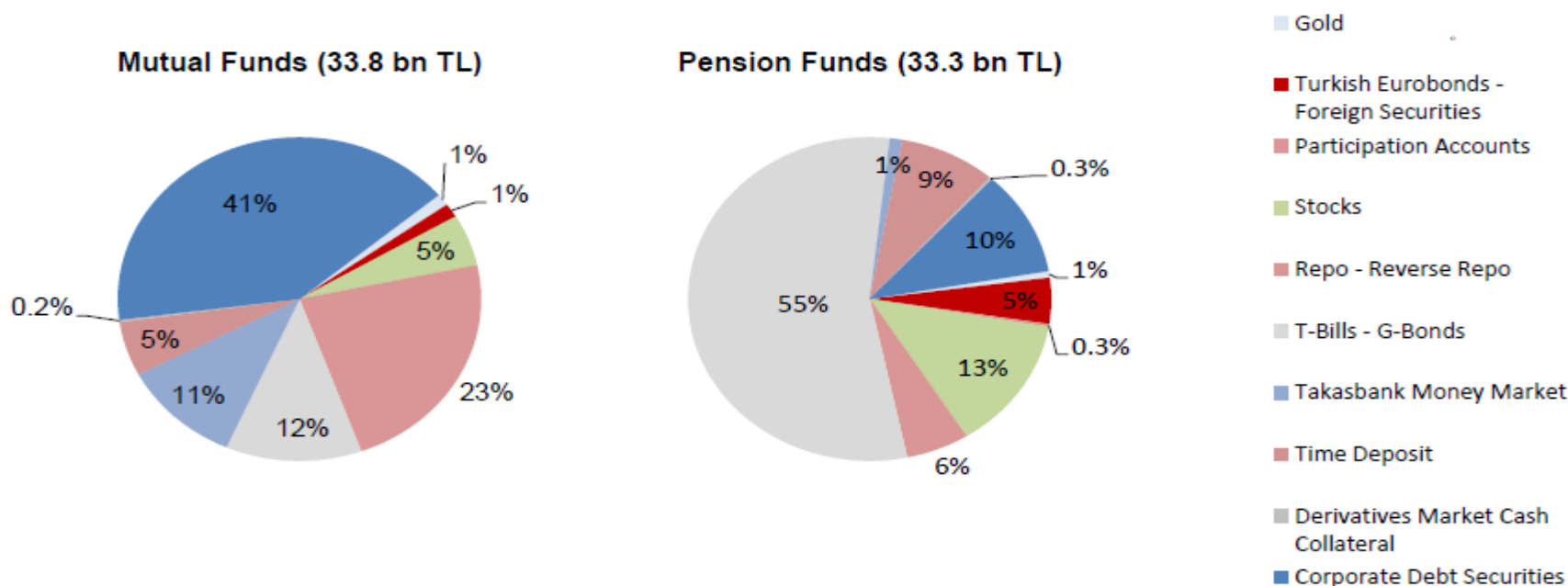
Demand: Institutional Investors

- Limited institutional investor base is the main challenge for capital markets development in both countries.
- Thanks to pension reform in late 90's Poland ahead of Turkey, recent private pension incentives in Turkey leading to rapid increase from very low base



Demand Side: Institutional Investor Portfolio Distribution - Turkey

Asset composition of institutional investors indicates an investment portfolio dominated by instruments with short to medium term maturity. This is limiting the demand for long term securities.

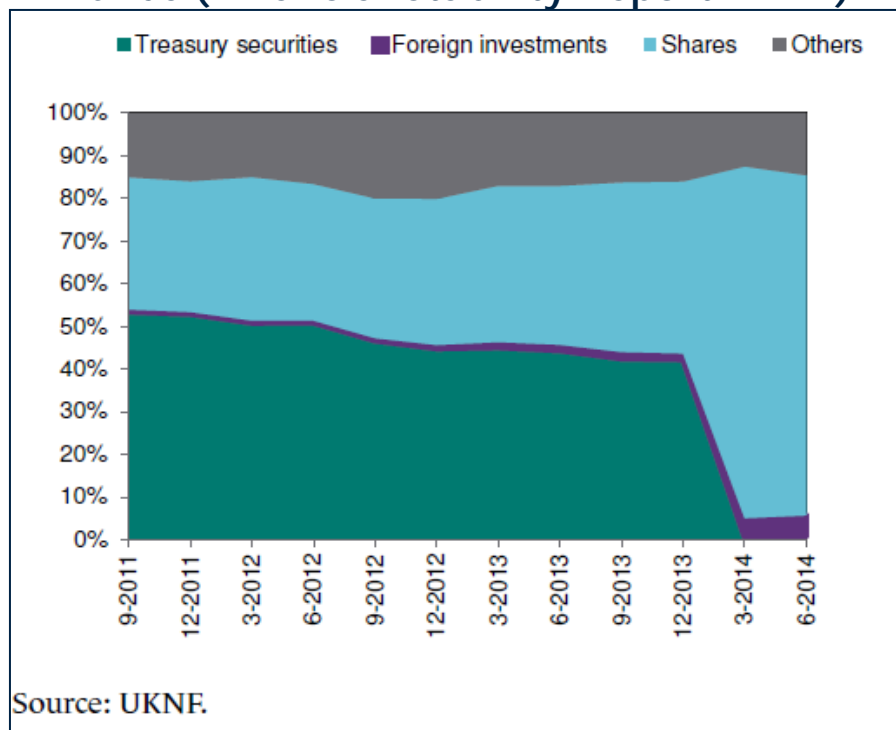


- Having a 41% share in their portfolio, corporate debt securities have become a major investment tool for the mutual funds in Turkey.
- Ten percent of pension fund assets are currently invested in corporate securities

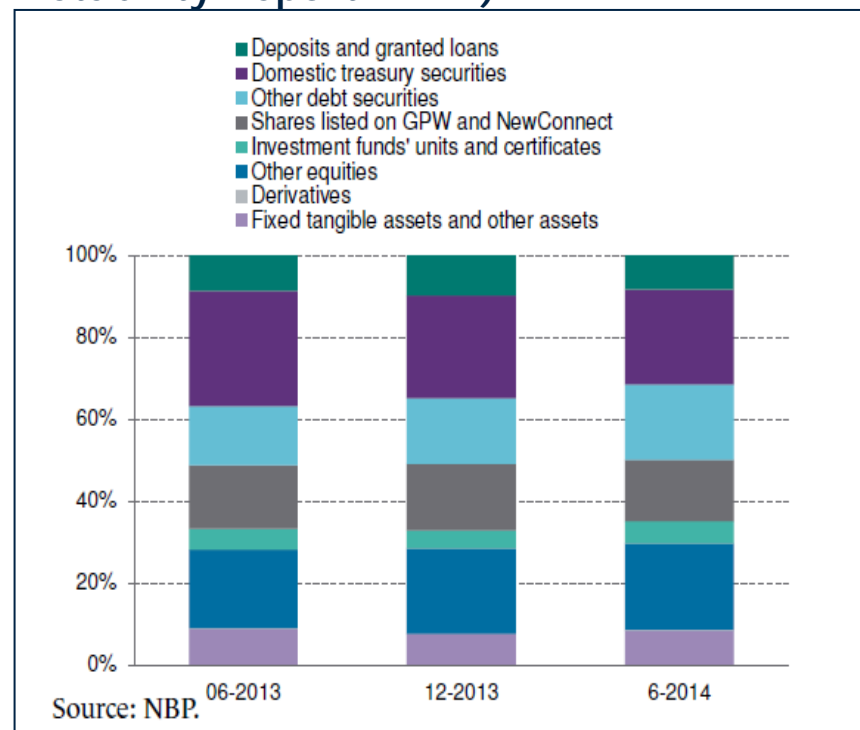
Demand Side Institutional Investor Portfolio Distribution- Poland

In Poland institutional investor investment portfolios are better diversified with higher share of private sector debt instruments and shares. Duration is a concern especially for pension funds. The key will be to offer savers portfolios that better reflect lifecycle investment strategies.

Investment Portfolios of Investment Funds (Financial Stability Report - NBP)



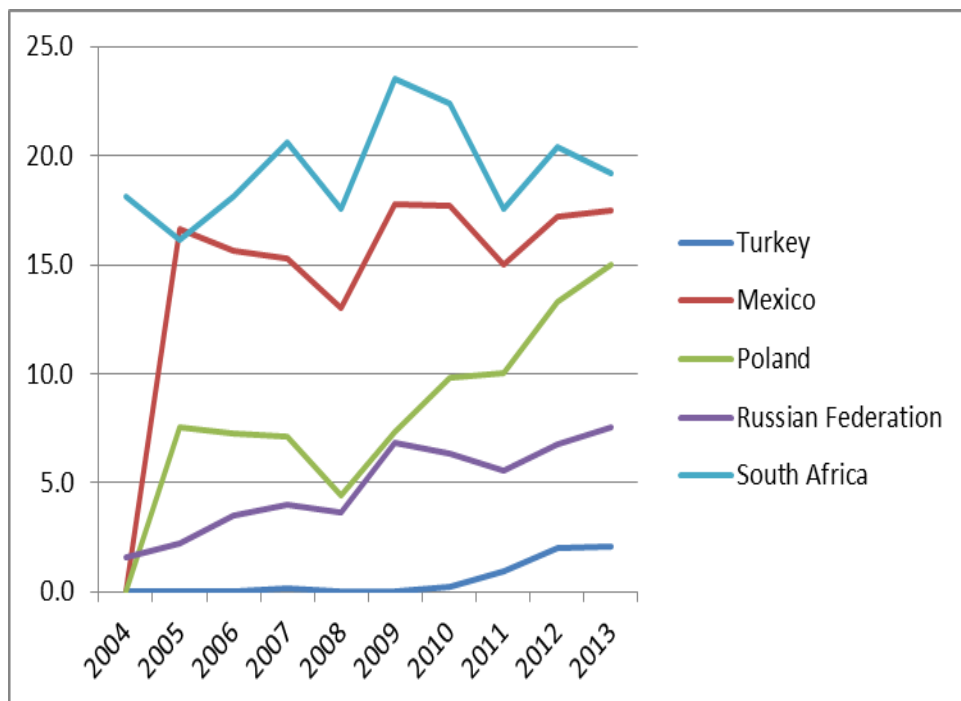
Assets of Investment Funds (Financial Stability Report - NBP)



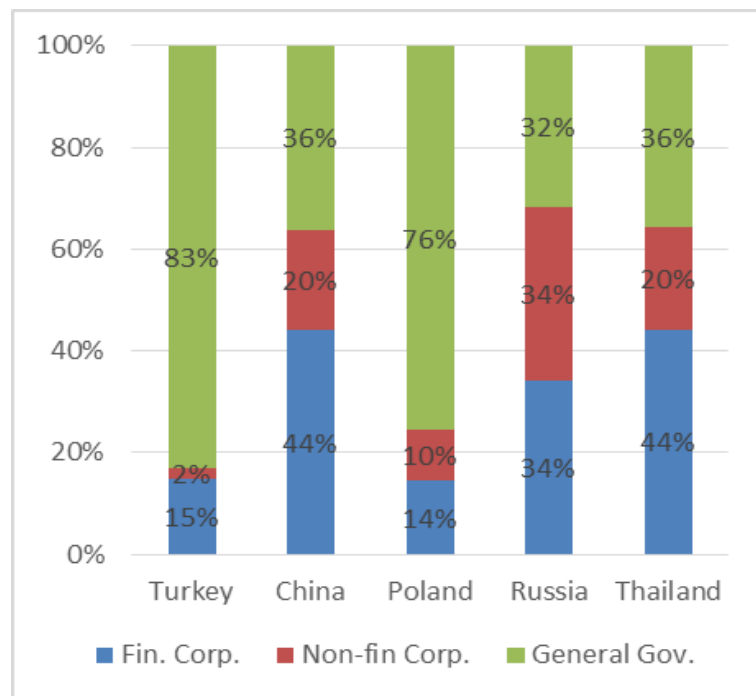
Supply Side: Corporate bond issuances

Corporate Bond issuances are driven by banks and financial institutions and mostly short term

Outstanding Domestic Private Debt Securities/ GDP (%) - Finstat WBG

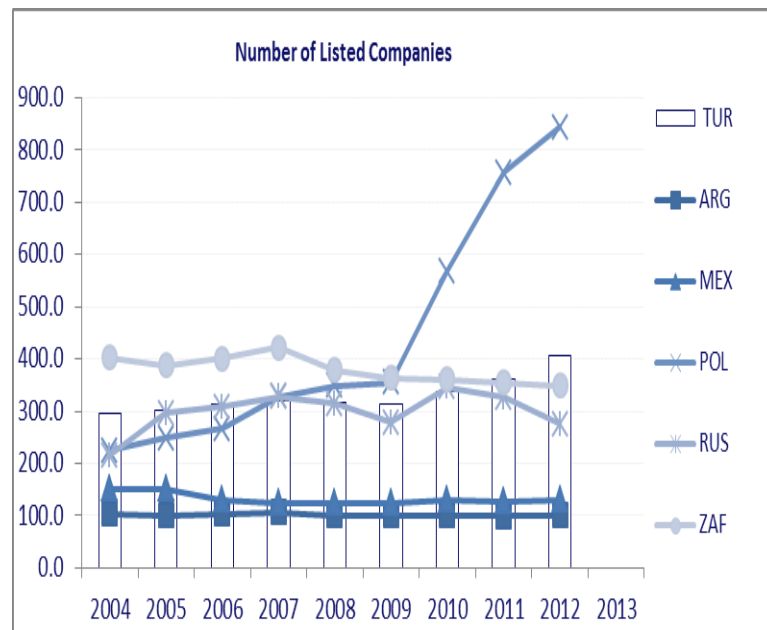
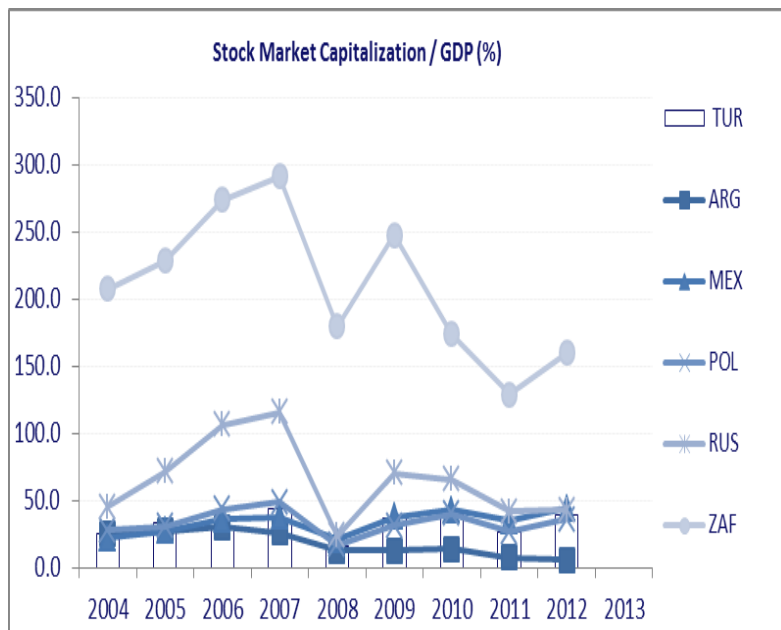


Total Outstanding Debt Securities by Sector, 2014 - BIS



Supply Side: Stock Exchange

Although stock market capitalization of both countries is comparable, SMEs have a larger share in Warsaw Stock Exchange (and rapid growth post 2009) while blue chips are dominant in Turkish equity markets.



Conclusions and opportunities for further reform

Scarcity of long term local currency financing is limiting growth and putting financial stability at risk. Nascent institutional investors, bank dominated financial sectors, short term orientation, low saving rates, and underdeveloped corporate bond markets are the main challenges for capital markets development.

Opportunities

Turkey

1. Improved macroeconomic performance makes securities better risk/return proposition
2. Supportive Reforms – new capital markets law
3. New Instruments- Turkish banks are expected to issue mortgage covered bonds (Garanti, Vakif, Ak are expected to come to mortgage CB market)
4. Pension funds and mutual funds are growing with increasing share of private sector securities
5. Government’s commitment to capital markets development (Recent action plans on savings and Istanbul Financial Center Project)

Poland

1. Capital Markets Union - integration of Poland into an EU wide capital markets union can yield both opportunities (larger pool of investors) and challenges (larger pool of issuances from other member states)
2. Work on improving the regulatory environment for wider issuing of covered bonds could make a significant contribution to capital market development
3. Capital markets can also be a source for financing for municipalities to leverage the private sector to meet the co-financing requirements for EU projects

World Bank Group Proposed Action Plan for Capital Markets Development in Turkey

