

4. Supply and Demand Developments

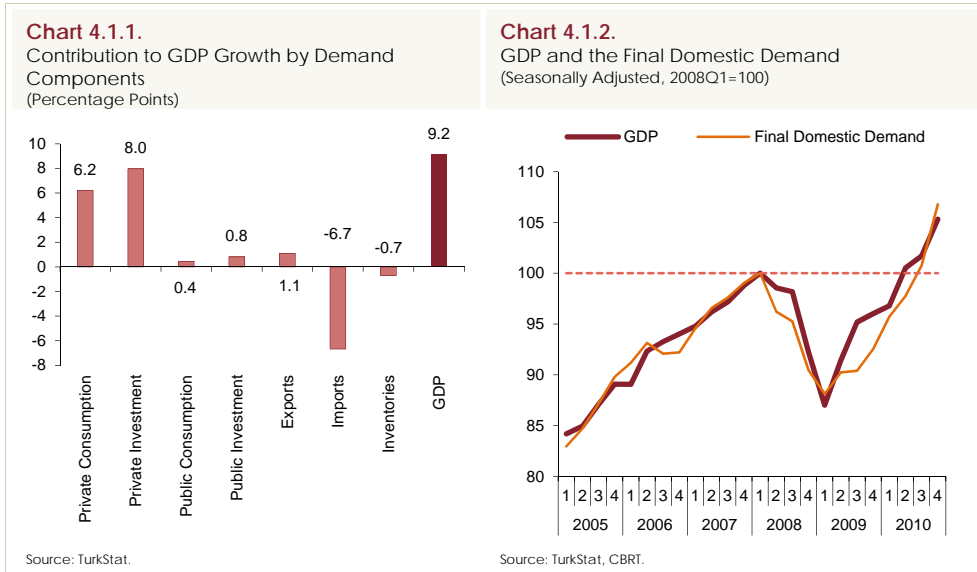
The fourth-quarter national accounts data are consistent with the outlook presented in the January Inflation Report. After growing temporarily at a slower pace in the third quarter due to the worsening European sovereign debt problems since May, the economy displayed a robust growth in the fourth quarter. Domestic demand was the main driver of growth, whereas, despite recovering exports, net external demand made a negative contribution due to rising imports. Thus, the divergence between domestic and external demand growth has become more pronounced during the exit phase. 2011 first quarter data indicate that the economy remains strong amid stronger domestic demand. Weak exports in addition to absence of a marked slowdown in the demand for imports led to further widening of the foreign trade deficit.

Although weak global growth continues to restrain economic activity, domestic demand continues to be stimulated by the lagged effects of the previously implemented expansionary fiscal and monetary policies, while capital flows continue to spur loans. In this regard, it is likely that demand conditions in domestic market oriented sectors no longer support disinflation. Therefore, domestic demand should be kept under control for limiting the pass through of the increases in unit costs into domestic prices.

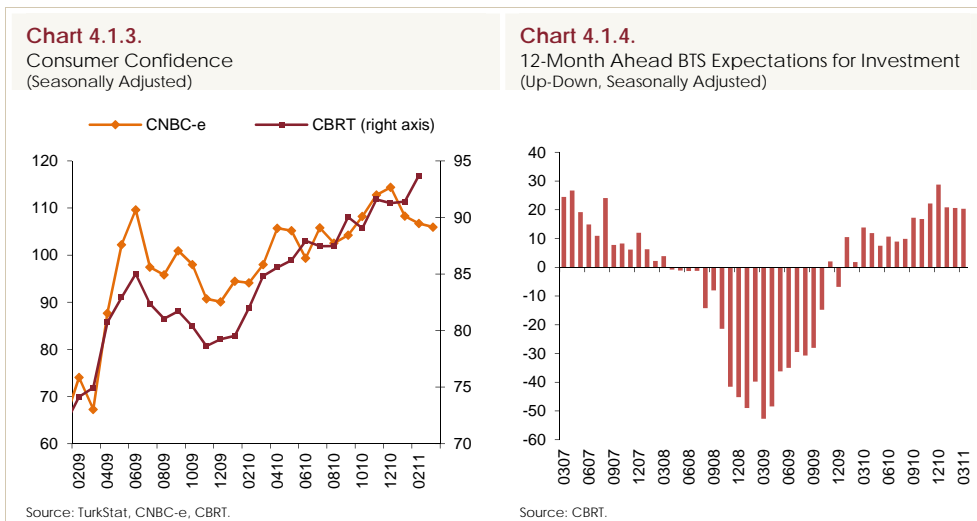
4.1. Gross Domestic Product Developments and Domestic Demand

According to the national accounts data released by TurkStat, GDP increased by 9.2 percent year-on-year during the fourth quarter of 2010. Thus, Turkish economy grew by 8.9 percent in 2010. As in the third quarter, the largest contributor to annual growth in the fourth quarter was private demand comprising of private consumption and private investment. Due to rallying demand for imported goods, net external demand made a negative contribution to annual growth despite soaring exports (Chart 4.1.1).

After slowing in the third quarter, the seasonally adjusted GDP picked up expanding by 3.6 percent quarter-on-quarter. Growing at a strong pace quarter-on-quarter, final domestic demand was the main driver of the quarterly growth (Chart 4.1.2). Meanwhile, external demand remained relatively weak.



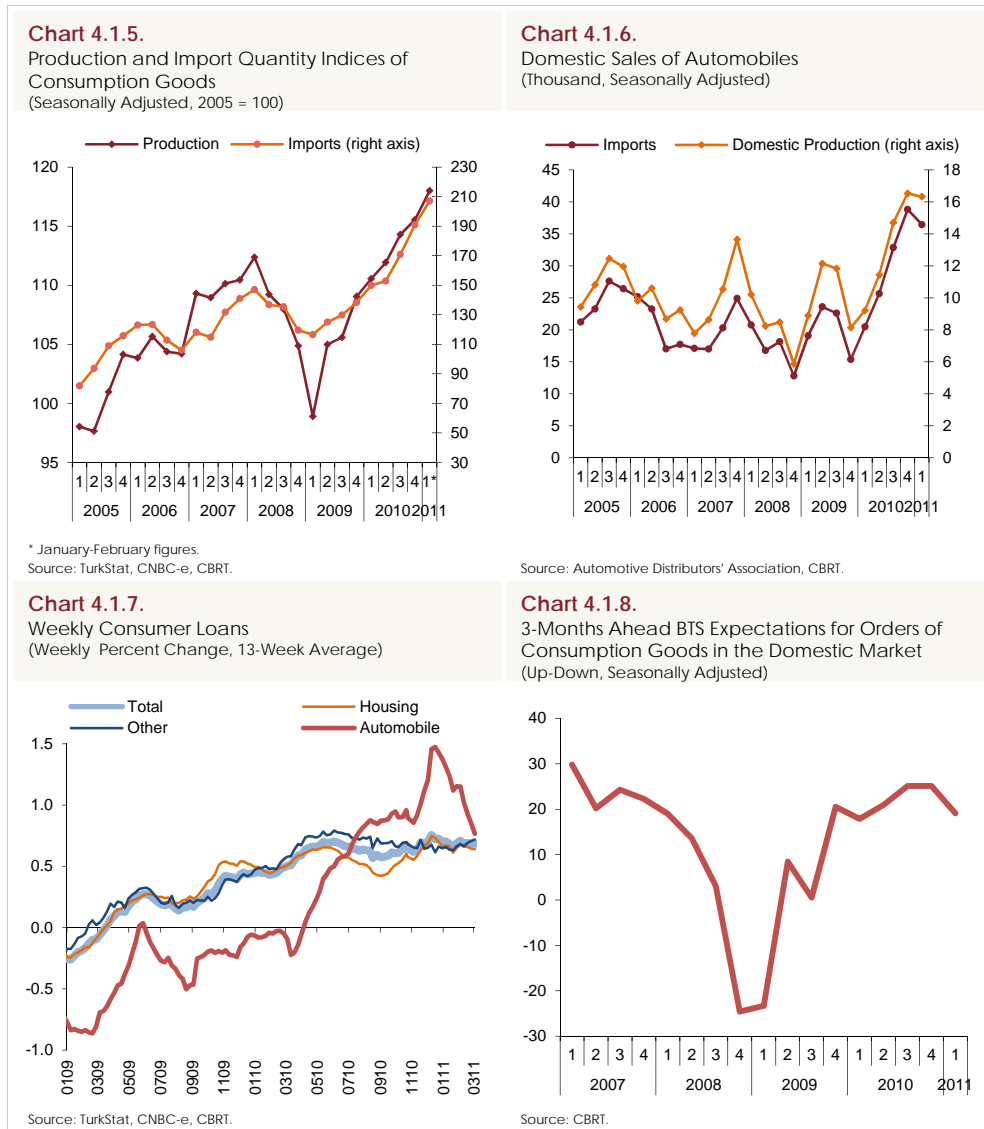
There was no significant slowdown in loan utilization and domestic demand during the first quarter. Both the consumer confidence and the investment sentiment remained robust in the first quarter, while production and imports data indicate that domestic demand continues to recover rapidly (Charts 4.1.3 and 4.1.4).



Production and imports of consumption goods were higher than the fourth-quarter average during January-February (Chart 4.1.5). Despite falling slightly quarter-on-quarter in the first quarter, automobile sales were well above historical averages (Chart 4.1.6). The credit channel continued to support growth in the first quarter even though automobile loans were relatively slower (Chart 4.1.7). Meanwhile, second-quarter order expectations of sectors

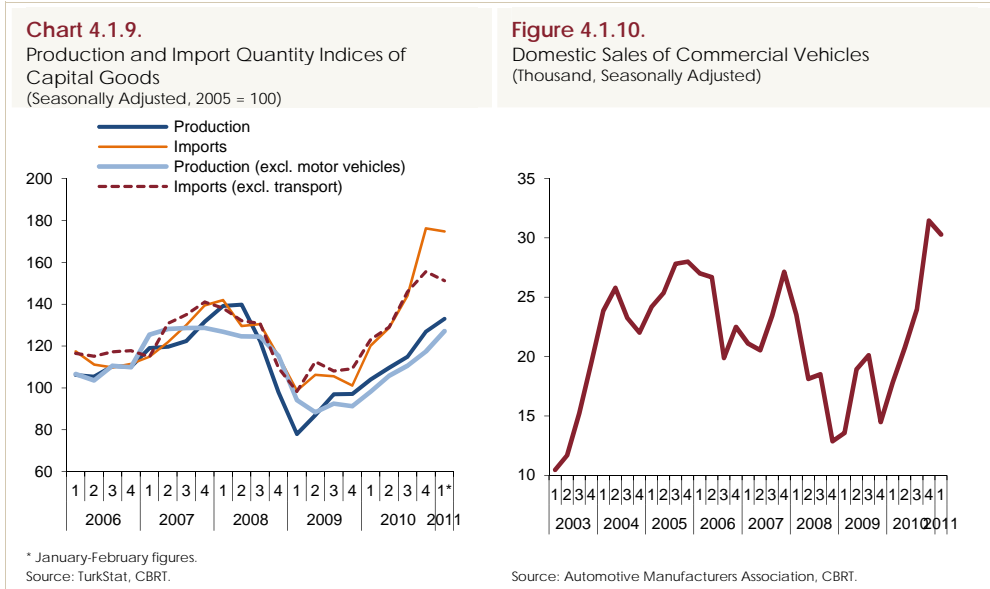
producing consumption goods in the domestic market weakened partly on the tightening effects of the recent policy measures (Chart 4.1.8).

Thus, the recently adopted additional policy measures are expected to restrain loan utilization and domestic demand growth by the second quarter.

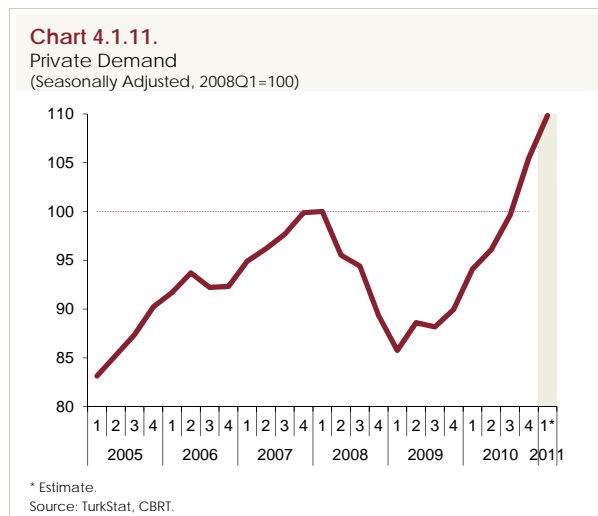


Production of investment goods continued to increase during January-February compared to the fourth-quarter average, while imports of investment goods remained flat at record highs (Chart 4.1.9). Despite slowing modestly, domestic sales of commercial vehicles remained strong during the first quarter, indicating the ongoing rapid recovery in private investments (Chart 4.1.10). The relative stability in expectations of a rise in 12-month ahead investment plans of manufacturing industry firms indicates a less gloomy aggregate demand

outlook (Chart 4.1.4). Yet, investments may slow down amid the recently introduced policy measures.

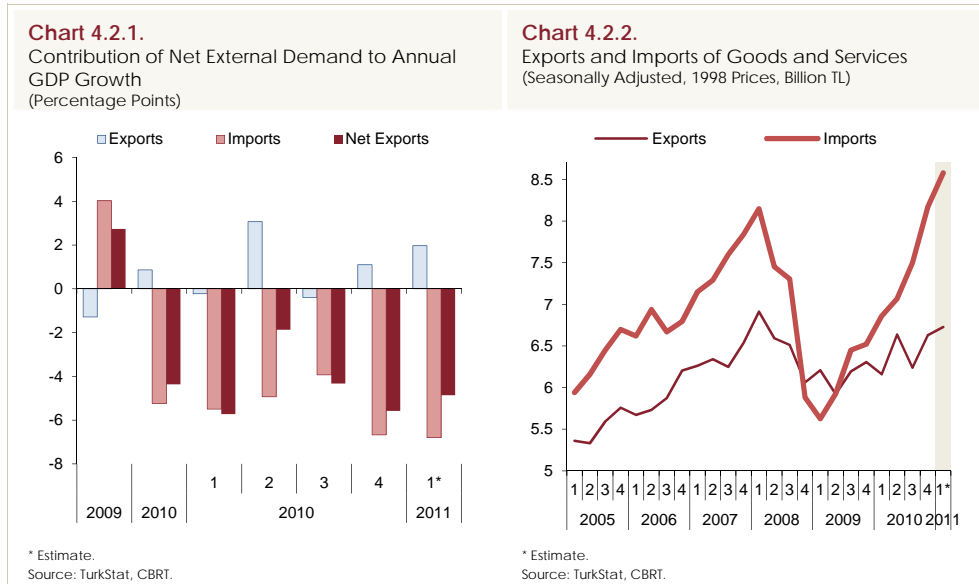


In sum, both the ongoing increases in consumer confidence and loan utilization as well as the investment spending stabilizing at elevated levels suggest that domestic demand remains strong. In view of the production and import data, it is estimated that private demand has increased further in the first quarter of the year. After hovering below pre-crisis levels in the third quarter of 2010, private demand bounced back to resume its previous trend in the last two quarters (Chart 4.1.11). The effects of the recently adopted additional policy measures on loan utilization and domestic demand are expected to be materialized by the second quarter.

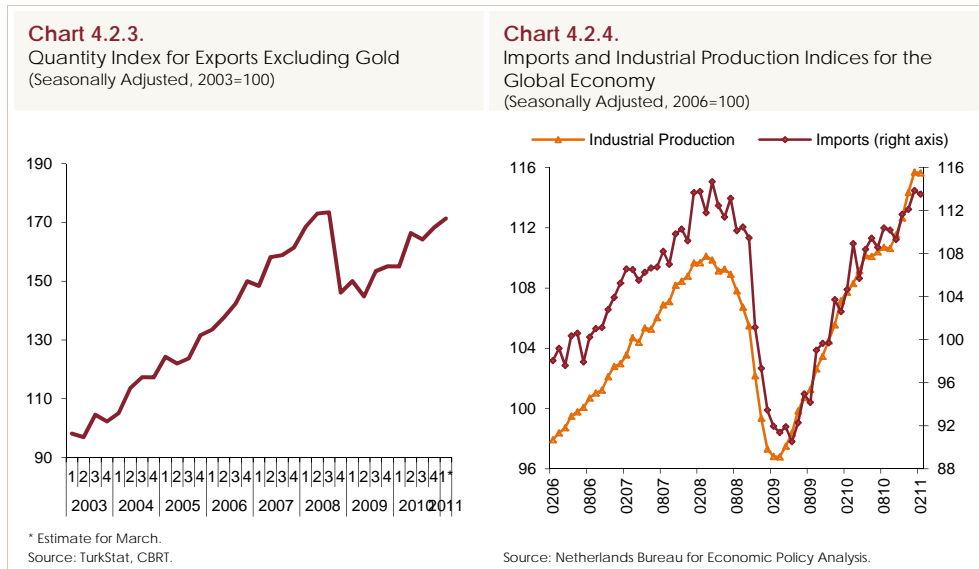


4.2. External Demand

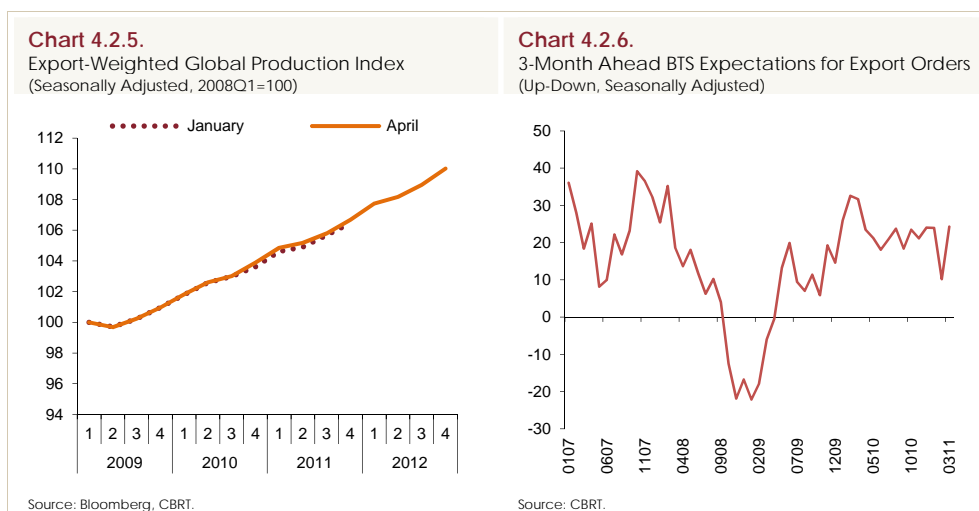
The fourth-quarter outlook for external demand was broadly consistent with the January Inflation Report forecasts. While exports of goods and services increased by 4.3 percent year-on-year, imports of goods and services were up as high as 25.4 percent year-on-year. Despite the recovery in exports, negative contribution of net external demand to annual growth increased quarter-on-quarter due to the accelerated demand for imported goods (Chart 4.2.1). In seasonally adjusted terms, exports remained volatile, while imports rose dramatically quarter-on-quarter (Chart 4.2.2). Hence, the divergence between domestic and external demand growth has become more pronounced in the exit phase.



According to quantity indices, exports of goods continued to recover slowly and gradually in the first quarter of 2011. In fact, the quantity index for exports excluding gold, a key indicator of the underlying external demand, increased modestly in the first quarter (Chart 4.2.3). Given the gradual increase in global import demand, exports of goods and services are expected to continue to recover moderately in coming months (Charts 4.2.4 and 4.2.2).

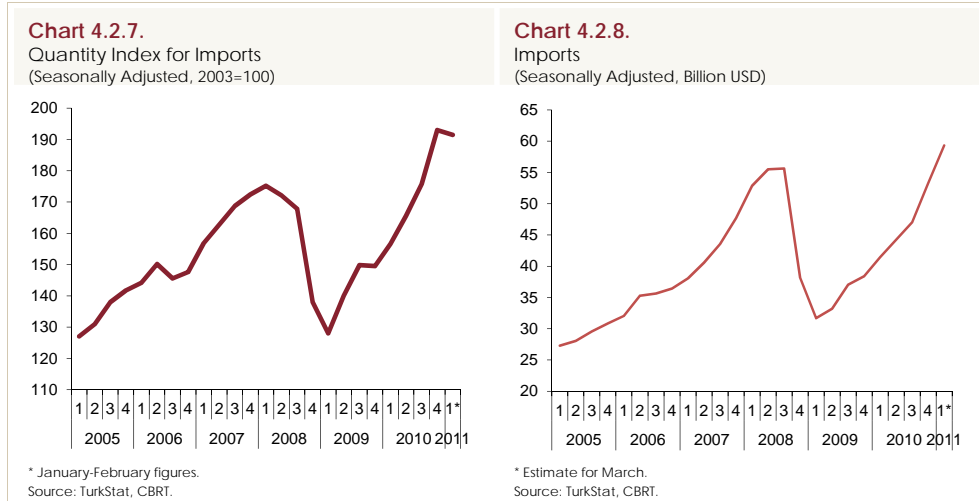


The global economic outlook over the medium term suggests that downside risks to growth in external markets remain. Recently, mounting political tension in North Africa as well as the Japanese earthquake have been the key factors adding to these risks. Yet, there has been no major update to the aggregated growth outlook for Turkey's main export destinations compared to the January Inflation Report (Chart 4.2.5). Given the flattening expectations for export orders, external demand conditions are unlikely to improve strongly in the short term (Chart 4.2.6). Accordingly, exports are expected to recover slowly and gradually amid sluggish external demand.

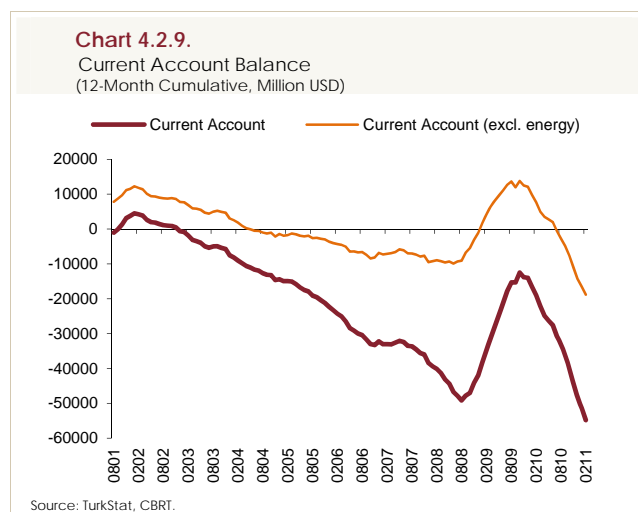


Imports grew sharply amid the acceleration in domestic demand during the final quarter of 2010. Seasonally adjusted quantity indices signal a slightly

slowing import demand as of January-February, while leading indicators for March suggest that imports of goods and services continued to rise in the first quarter (Charts 4.2.2, 4.2.7 and 4.2.8).

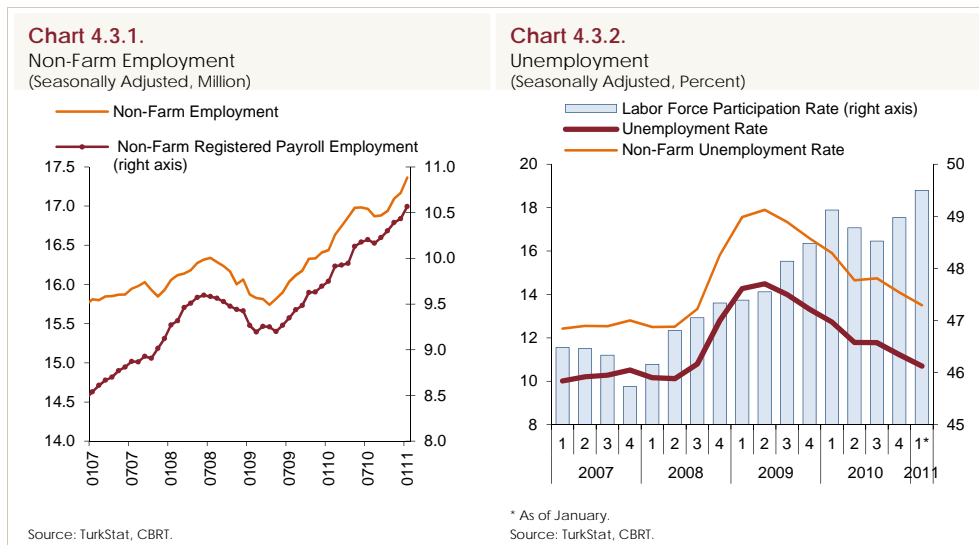


To sum up, recent data releases indicate that the foreign trade balance continued to deteriorate in the first quarter of 2011. Despite rising exports, net external demand continues to make a negative contribution to annual growth due to the increased demand for imported goods (Chart 4.2.1). Indeed, the current account balance continues to deteriorate (Chart 4.2.9). This indicates that the divergence between domestic and external demand growth feeds the risks to financial stability and sustainable growth in the first quarter. Therefore, given the weak external demand, limiting domestic demand remains critical for stabilizing foreign trade deficit and the current account balance.



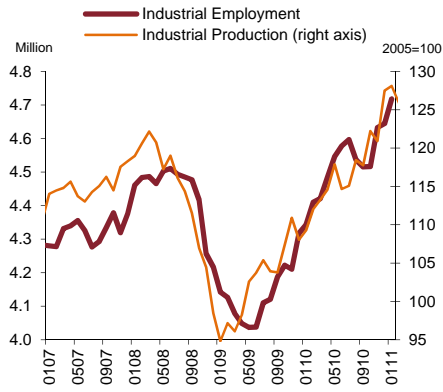
4.3. Labor Market

Fourth-quarter employment developments were consistent with the outlook presented in the January Inflation Report. After falling modestly in the third quarter, non-farm employment increased across all major sectors, particularly in industry and construction, amid strong economic activity (Chart 4.3.1). With the sharp increase in non-farm employment, unemployment declined significantly since the last quarter of 2010 (Chart 4.3.2).



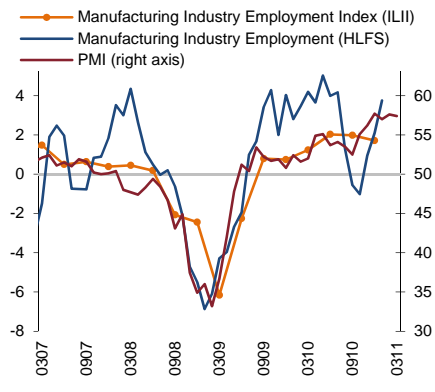
Leading indicators for the first quarter of 2011 signal that employment conditions continue to improve. The manufacturing industry and PMI employment indices indicate that employment continued to increase during the first quarter of 2011 (Charts 4.3.3 and 4.3.4). Moreover, the job opportunities index derived from the Consumer Confidence Index continued to rise in the first quarter (Chart 4.3.5). The job vacancy rate constructed by the Turkish Employment Agency's data to show job opportunities continued to increase and unemployment benefit applications showing employment losses remained unchanged, thereby indicating an improvement in employment conditions for the first quarter (Chart 4.3.6).

Chart 4.3.3.
Industrial Employment and Production
(Seasonally Adjusted)



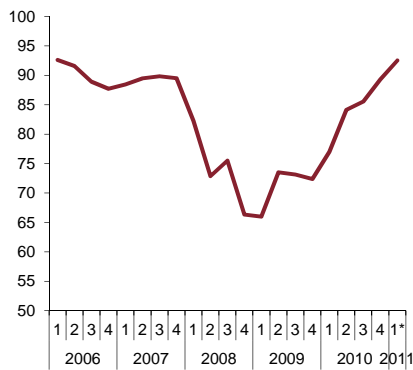
Source: TurkStat, CBRT.

Chart 4.3.4.
Manufacturing Industry Employment
(Quarterly Percent Change) and PMI Employment Index
(Seasonally Adjusted)



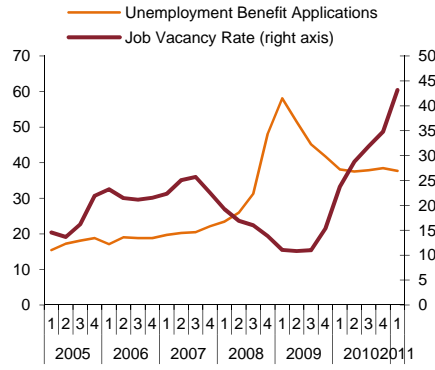
Source: TurkStat, Markit, CBRT.

Chart 4.3.5.
Job Opportunities over the next 6 Months
(Seasonally Adjusted)



Source: TurkStat, CBRT.

Chart 4.3.6.
Private Sector Job Vacancy Rate (Percent, Trend) and Unemployment Benefit Applications
(Seasonally Adjusted, Thousand)

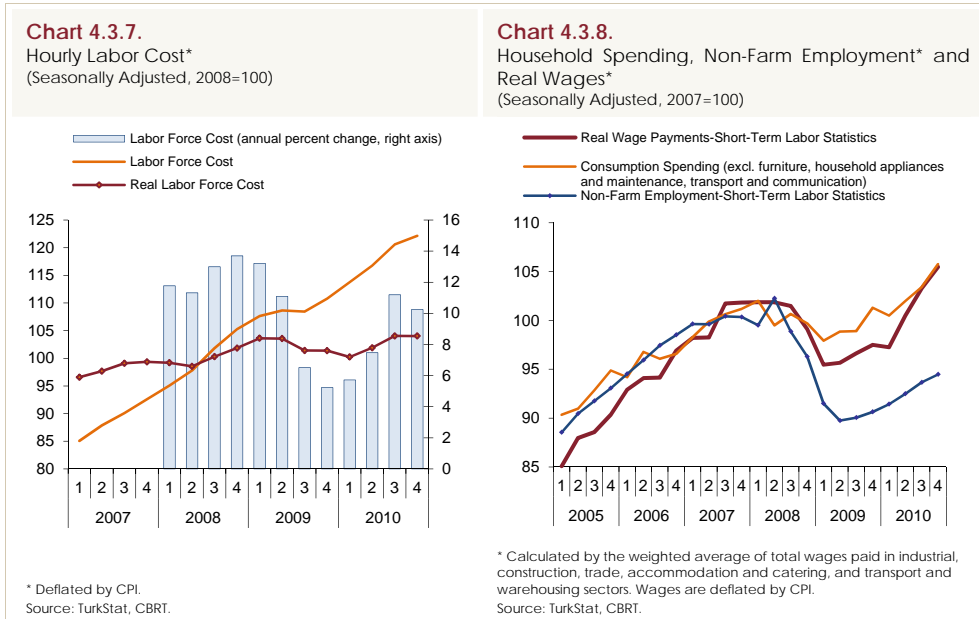


* January-February figures.

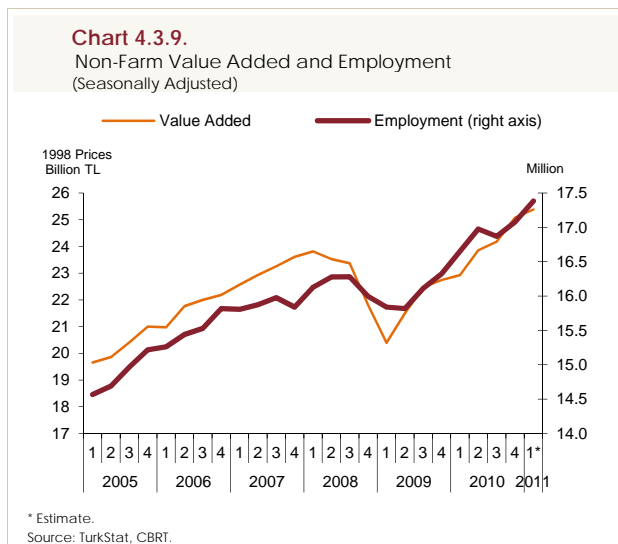
Source: Turkish Employment Agency, CBRT.

Non-farm employment is likely to uphold recovery, while unemployment is expected to fall further in the upcoming period. However, the uptrend in labor force participation may restrain the decline in unemployment rates and unemployment rates are unlikely to reach pre-crisis levels in the short term.

High unemployment rates continue to limit labor cost. In seasonally adjusted terms, real labor costs remained flat across non-agricultural sectors during the fourth quarter of 2010. (Chart 4.3.7). However, the minimum wage hikes for 2011 indicate an increase in real terms given the inflation target. Therefore, with other cost factors to consider, it is even more essential to keep domestic demand under control in order to maintain disinflation.



In sum, non-farm employment remains on a steady upward trend as of end-2010. Strong demand indicators suggest that non-farm employment would continue to improve in coming months. Yet, labor supply developments may restrain the fall in unemployment rates (Box 4.1). Employment conditions are expected to provide further support for aggregate demand growth, while high unemployment rates would put a cap on rising labor costs (Chart 4.3.8 and Chart 4.3.9).



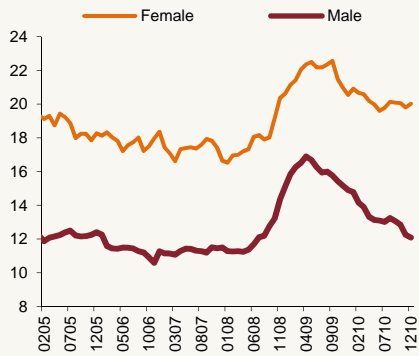
Box
4.1

Changing Trends in the Labor Market

This Box discusses the reasons for non-farm unemployment to hover above pre-crisis levels as of end-2010 and makes projections about the upcoming course of unemployment rates. Because of gender differences in labor force participation and employment, the comparison between post-crisis and pre-crisis non-farm unemployment is broken down into male and female categories. Despite focusing on unemployment rates, the following analysis gives a detailed account of post-crisis female employment and proceeds with the effects of the gender gap on sectors.

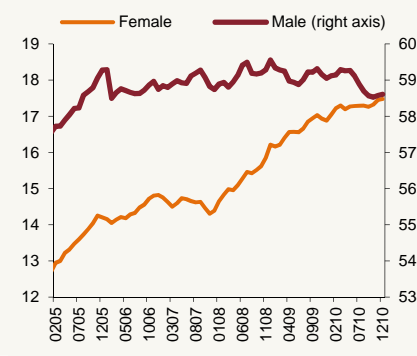
Across genders, both male and female unemployment increased at similar rates during the crisis, while the decline in female unemployment has been slower than male unemployment during the process of recovery (Chart 1). This is largely due to the rising female labor force participation (Chart 2).

Chart 1.
Non-Farm Unemployment Rates
(Seasonally Adjusted, Percent)



Source: TurkStat, CBRT.

Chart 2.
Non-Farm Labor Force/15+ Population
(Seasonally Adjusted, Percent)



Source: TurkStat, CBRT.

As of the end of 2010, non-farm male unemployment is 0.6 percentage points higher from end-2007 (Table 1). The increases in employment as well as the falling participation rate brought male unemployment down during this period (Chart 2). Employment and labor force participation contributed by -3.6 and -0.2 percentage points, respectively, to the decline in male unemployment. Female non-farm unemployment is 3.5 percentage points above the pre-crisis level, mainly due to the increase in female labor force participation (Table 1).

All in all, as of end-2010, non-farm unemployment is 1.4 percentage points above the end-2007 level. Female unemployment, male unemployment and rising female labor force participation accounted for about 0.7, 0.5 and 0.2 percentage points of this difference, respectively.

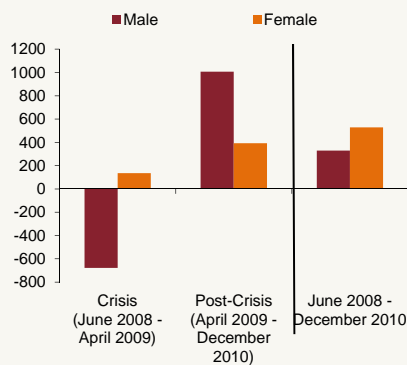
Table 1. Contributions to Changes in Non-Farm Unemployment (Percent, December 2007-December 2010)

	Total	Participation Rate	Population Growth	Employment Growth
Female	3.5	15.8	3.9	-16.2
Male	0.6	-0.2	4.4	-3.6
Total	1.4	3.6	4.2	-6.4

Source: TurkStat, CBRT.

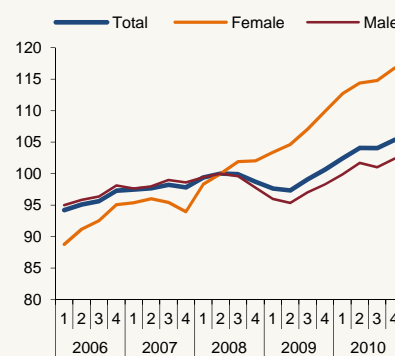
This gender gap is also evident across sectors. On the employment side, the 2008 global crisis has particularly affected the industrial sector. Men suffered the most job loss as they comprise a larger share of non-farm employment and the industrial sector is the hardest-hit-sector by the crisis. On the other hand, in the relatively less affected services sector, female employment continued to increase. While female employment continued to rise during the recovery process, the loss of employment for men during the crisis is compensated. As a result, non-farm male employment increased by a net 319 thousand during and after the crisis, while the contribution of women to non-farm employment rose to 528 thousand (Charts 3 and 4). A substantial part of female employment that increased during the crisis is self-employed and unregistered (Charts 5 and 6).

Chart 3. Changes in Non-Farm Employment (Seasonally Adjusted, Thousand)



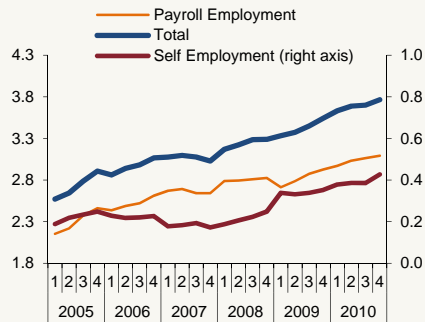
Source: TurkStat, CBRT.

Chart 4. Non-Farm Employment (Seasonally Adjusted, 2008Q2=100)



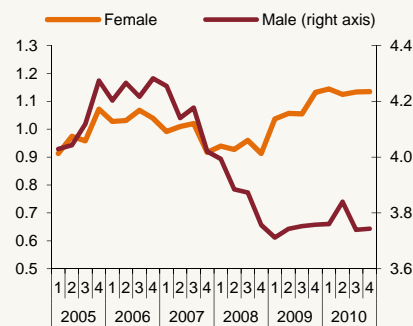
Source: TurkStat, CBRT.

Chart 5.
Female Non-Farm Employment
(Seasonally Adjusted, Million)



Source: TurkStat, CBRT.

Chart 6.
Unregistered Non-Farm Employment
(Seasonally Adjusted, Million)

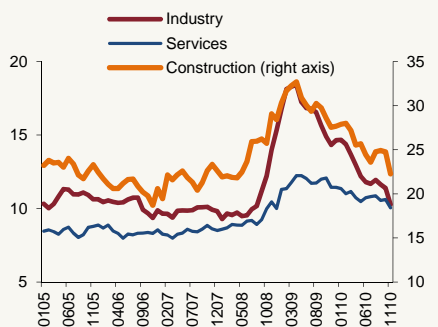


Source: TurkStat, CBRT.

The gender gap has also affected sectoral unemployment rates. Indeed, while industrial and construction sectors were severely hit by the crisis, services sector was moderately affected (Chart 7).¹ Employment losses in the industrial sector and rising labor force participation in construction and services sectors were the main drivers of unemployment. The most affected sector by labor force participation is the services sector with limited employment losses.

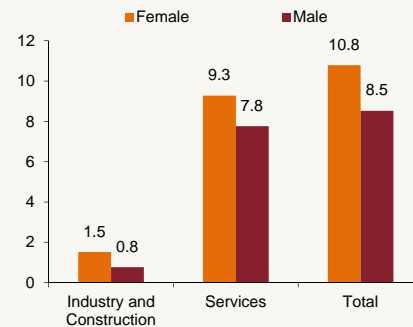
Although services unemployment is relatively less affected, the recent decline in this sector has been more limited compared to other sectors (Chart 7). Female labor force has been the main factor causing services unemployment to remain above pre-crisis levels. As of end-2010, non-farm unemployment is up 19.3 percent from end-2007, with the services sector accounting for a significant portion (17.1 percentage points) of this increase (Chart 8). Women account for a larger share of the rising number of unemployed in the services sector.

Chart 7.
Sectoral Unemployment Rates
(Seasonally Adjusted, Million)



Source: TurkStat, CBRT.

Chart 8.
Contributions to Changes in Non-Farm
Unemployment in 2007Q 4 – 2010Q4 (Percent)

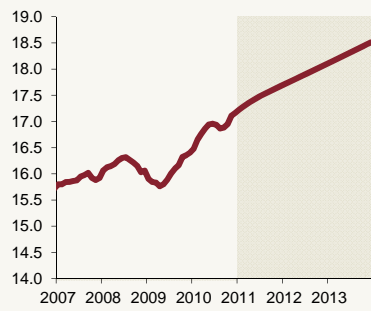


Source: TurkStat, CBRT.

¹ The calculation of sectoral unemployment rates is based on the sectors the job-seekers had worked prior to becoming unemployed. First-time job-seekers are not included in the calculations.

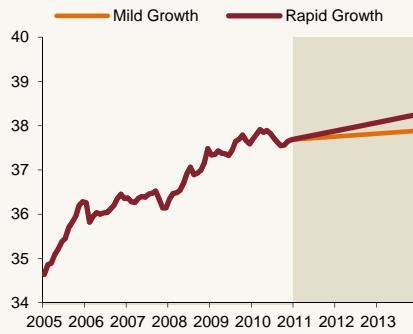
In sum, non-farm unemployment remains above pre-crisis levels as of the end of 2010, largely due to increasing female labor force participation. Although the crisis had a less negative effect on women's employment, increases in employment failed to meet the change in labor force participation. As women had a major impact on non-farm labor force participation, changes in the contribution of female population to labor force and employment may have various implications for the rate of decline in unemployment. The following charts show the effects of the different paths of non-farm labor force participation on non-farm unemployment, based on the assumption of an ongoing gradual increase in non-farm employment (Charts 9 and 11). Accordingly, if participation increases mildly, non-farm unemployment reaches pre-crisis levels by mid-2012. If participation grows rapidly, it will take longer to reach pre-crisis levels.

Chart 9.
Non-Farm Employment Projection
(Seasonally Adjusted, Million)



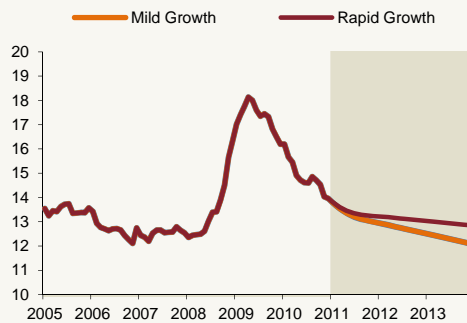
Source: TurkStat, CBRT.

Chart 10.
Non-Farm Labor Force/15+ Population
Projection
(Seasonally Adjusted, Percent)



Source: TurkStat, CBRT.

Chart 11.
Non-Farm Unemployment Projection
(Seasonally Adjusted, Percent)



Source: TurkStat, CBRT.

Overall, the rapid post-crisis increase in female labor force participation has limited the decline in unemployment, particularly in the services sector. This has also limited the increase in labor costs. An evidence to this is the relatively low services inflation despite the recent upsurge in domestic demand.

