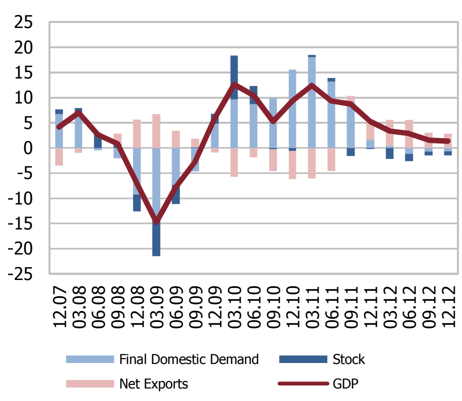
II. DOMESTIC ECONOMIC OUTLOOK

In the first quarter of 2013, final domestic demand started to display a moderate recovery trend and the current account balance was realized in line with predictions. The budget performance, which deteriorated in 2012, improved in the first quarter of 2013. The slowdown in global demand and the outlook of commodity prices have reduced the upside risks to inflation. In the recent period, capital inflows have remained strong and loan growth rates have been hovering above the reference value. The CBRT will continue to implement its flexible monetary policy to reduce likely risks to financial stability triggered by ongoing global uncertainties and to support the balanced growth policy.

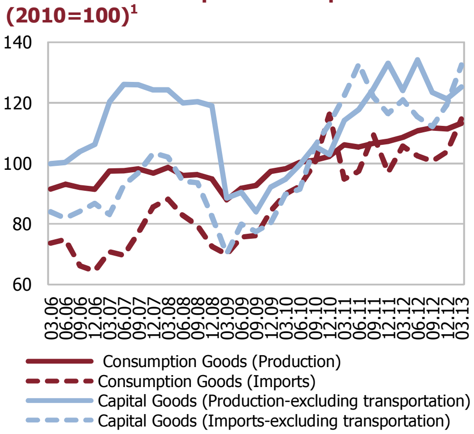
The deceleration trend in economic activity continued in 2012. However, data for the first quarter of 2013 suggest that there is a moderate increase in final domestic demand. GDP, which increased by 8.8 percent in 2011, grew by 2.2 percent in 2012. An analysis of contributions to annual growth as of the second quarter of 2012 reveals that the net external demand was the only item with a positive contribution while final domestic demand and stocks had a negative contribution (Chart II.1). In seasonally adjusted terms, exports of goods and services have registered increases for six consecutive quarters since the second quarter of 2011 whereas imports of goods and services remained weak. Data for the first quarter of 2013 show that there is a moderate increase in final domestic demand. White goods and automobile sales to the domestic market, the consumer confidence index, the production and imports of the other minerals item which is one of the indicators of construction investments, and the production and imports of consumption and investment goods have increased in the first quarter of the year compared to the previous quarter (Chart II.2)

Chart II.1. GDP and Its Components (%, Annual Contribution)



Source: TURKSTAT

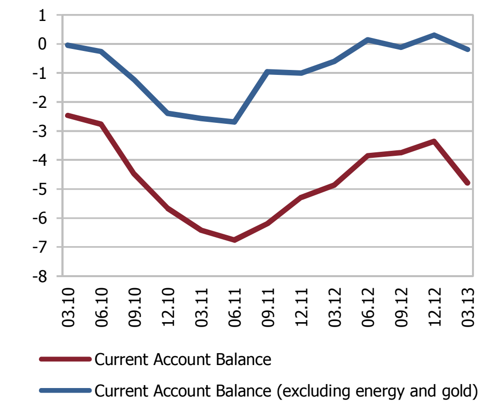
Chart II.2. Production and Imports Quantity Indices for Consumption and Capital Goods (2010=100)[1]



Source: TURKSTAT, CBRT
(1) Seasonally adjusted data.

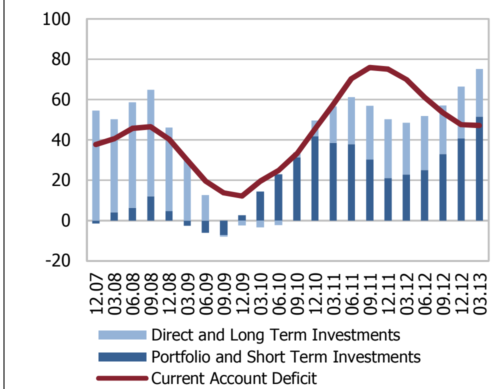
Although there is a slight deterioration in foreign trade and the current account balance as of the first quarter of 2013, the policy framework in place and the course of commodity prices restrain the impact of accelerated economic activity on the current account deficit. Parallel to the rise in domestic demand, demand for imports boomed in the first quarter of 2013. As a result, the current account balance deteriorated slightly. However, the deterioration in the current account balance excluding gold and energy, which is one of the indicators of the main trend, has been more limited (Chart II.3). The share of direct investments and long-term inflows in the financing of the current account deficit has increased considerably compared to end-2010 but the share of short-term borrowings continues to rise in 2013 (Chart II.4). CBRT's current policy implementations have a restricting effect on the worsening of the current account deficit despite the uptrend in capital inflows.

Chart II.3. Current Account Balance (Quarterly Average, Billion USD)[1]



Source: CBRT, TURKSTAT
(1) Seasonally adjusted data.

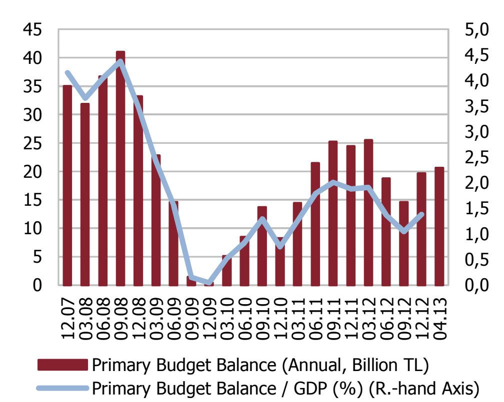
Chart II.4. Financing Sources of Current Account Deficit (12-Month Cumulative, Billion USD)



Source: CBRT

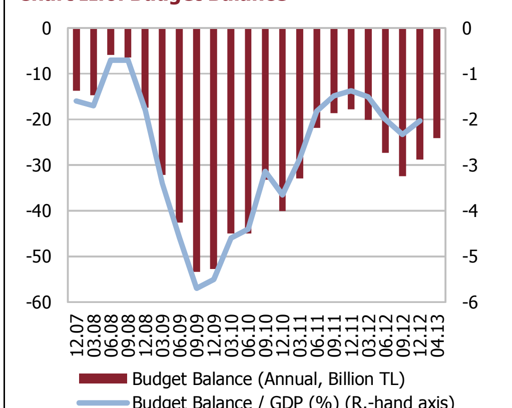
The budget performance, which weakened fairly in 2012, resumed a recovery trend as of the first quarter of 2013 as a result of the measures taken and the relative improvement in domestic demand. In 2012, the budget performance deteriorated due to the slowdown in tax revenues in line with the slowdown in economic activity, the rise in personnel expenditures that have a significant share in primary expenditures and the rise in health, retirement and social aid expenditures. However, tax rates for motor vehicles, fuel oil and alcoholic beverages were raised in the framework of the financial measures put into effect in September; which had a positive impact on budget revenues in the last quarter of the year. As of April 2013, the budget balance improved despite the significant rise in primary expenditures, due to raised tax rates, the increase in consumption-based tax revenues stemming from the revival in economic activity, privatization revenues, and the fall in interest expenditures (Chart II.5 and II.6).

Chart II.5. Primary Budget Balance



Source: Ministry of Finance, TURKSTAT

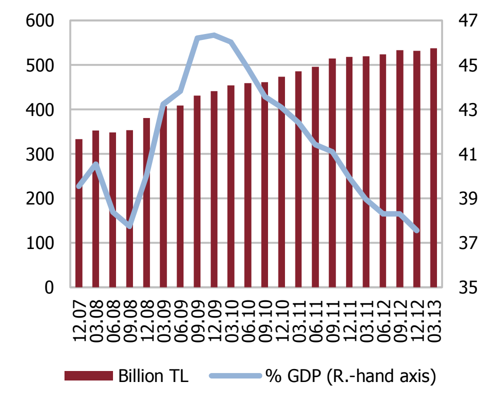
Chart II.6. Budget Balance



Source: Ministry of Finance, TURKSTAT

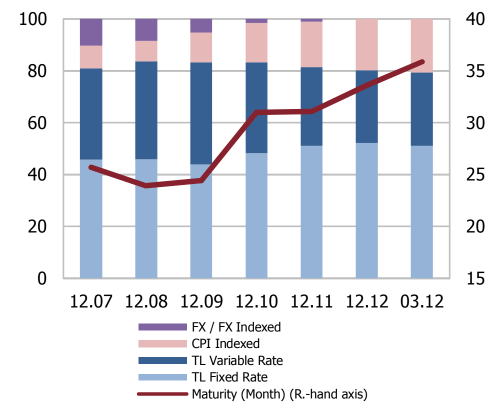
The improvement in public debt stock indicators continues. The ratio of debt stock to GDP, which was 39.9 percent in 2011, declined to 37.6 percent by the end of 2012 (Chart II.7). As of March 2013, 73.1 percent of the central government debt stock was composed of domestic debts. Also, the maturity of domestic debt stock was increased to 35.9 months as of March 2013 (Chart II.8). Sensitivity to the exchange rate was eliminated as the central government domestic debt stock does not include FX-denominated and FX-indexed debts. Moreover, the fall in the share of securities with variable interest rates and the extended maturity also reduce the sensitivity to changes in interest rates.

Chart II.7. Central Government Debt Stock



Source: Undersecretariat of Treasury, TURKSTAT

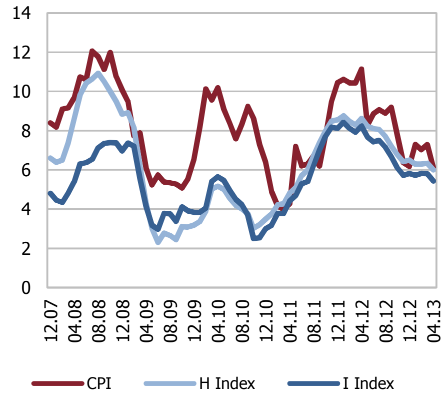
Chart II.8. Composition of Domestic Debt Stock (%)



Source: Undersecretariat of Treasury

The downtrend in inflation has become apparent from the last quarter of 2012 onwards. In 2012, the CPI decreased by 4.3 points to 6.2 percent and thus the end-year CPI hit the lowest level in the last 44-year period. The moderate course of global commodity prices excluding agriculture throughout the year, the steady course of exchange rates and decelerated economic activity have positively contributed to the inflation outlook. The favorable trend of unprocessed food prices that fell below the end-year level of the previous year became the determinant of the decline in inflation. On the other front, public price and tax adjustments, especially in the energy sector, stand as a factor unfavorably affecting inflation. In this period, although services inflation registered a limited increase, the alleviation of cost and demand pressures has led to a downtrend in core inflation indicators. In April 2013, the annual CPI declined to 6.1 percent due to the base effect in energy prices and the fall in unprocessed food prices (Chart II.9). In the last quarter of 2012, 24-month-ahead CPI expectations have registered a marked decline for the first time in a long period. In the first four months of 2013, the gap between 12 and 24-month-ahead CPI expectations narrowed and converged to the target (Chart II.10).

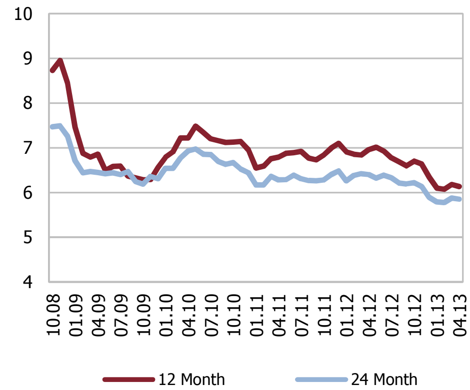
Chart II.9. Inflation (Annual, %) [1]



Source: TURKSTAT

(1) SCA-H is CPI excluding energy, unprocessed food, alcoholic beverages, tobacco and gold. SCA-I further excludes processed food from SCA-H.

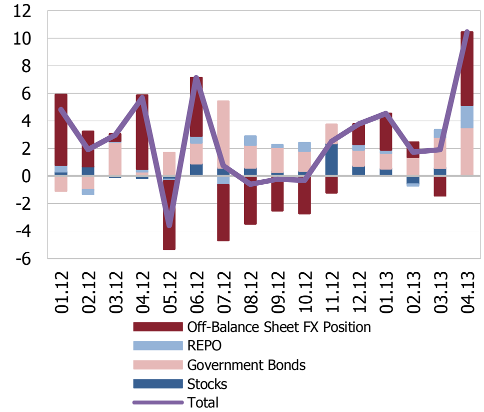
Chart II.10. 12 and 24 Month-Ahead CPI Expectations (%)



Source: CBRT

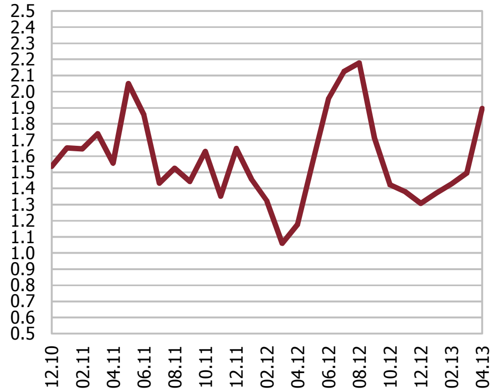
Despite the volatile global risk appetite, Turkey has received net foreign capital inflows in the last six-month period. Continued quantitative easing in advanced economies have boosted capital inflows to emerging economies while ongoing fragilities regarding the global economy have caused risk appetite to follow an unstable course. Accordingly, portfolio inflows to emerging economies have assumed a volatile trend. In the last quarter of 2012 and the first quarter of 2013, capital inflows to Turkey were also strong. An analysis of non-residents' net portfolio movements reveals that government domestic debt securities (GDDS) and off-balance sheet foreign exchange (FX) transactions have been remarkable and that there has been a significant increase in off-balance sheet FX position. Foreign inflows in the GDDS market have been predominantly of a long-term nature and this situation is believed to be a reflection of the favorable expectations regarding the macroeconomic performance of Turkey in the medium and long terms. In this respect, the upgrade by the international credit rating agency Fitch Ratings coupled with the upgrade in May by Moody's, JCR and DBRS of Turkey's long-term foreign currency issuer default rating to investment grade may boost capital inflows. Meanwhile, other portfolio items of non-residents have been volatile (Chart II.11). Despite the strong course of capital flows, the volatility in capital movements has also increased in Turkey parallel with the fluctuation in global capital flows (Chart II.12).

Chart II.11. Net Portfolio Movements of Non-Residents (Billion USD)



Source: BRSA, CBRT

Chart II.12. Volatility of Capital Flows* (13-Week Standard Deviation, Billion USD)

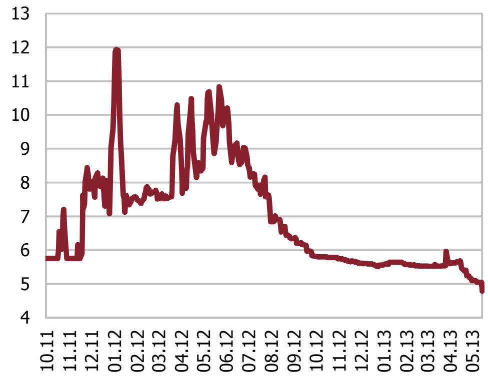


Source: BRSA, CBRT
* Calculated over weekly total portfolio flows.

The CBRT continues to implement its flexible monetary policy taking into account the ongoing macro financial risks triggered by persisting global uncertainties. Within the scope of its main duties to achieve price stability and contribute to financial stability, the Bank uses structural and cyclical instruments that will reduce the sensitivity of the economy to financial shocks. Of the structural instruments, the maturity-based reserve requirement is used to reduce the maturity mismatch between assets and liabilities of the banking sector, the reserve options mechanism (ROM) serves as an automatic stabilizer against capital flows and the leverage-based reserve requirement aims to restrain the indebtedness of banks. In addition, instruments of the policy rate, the interest rate corridor and the Turkish lira liquidity management are effectively used to contain the risks to financial stability originating from cyclical factors.

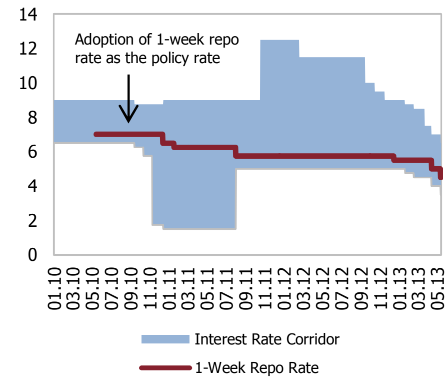
In the last quarter of 2012 and the first quarter of 2013, short-term interest rates were cut and macroprudential measures towards boosting FX reserves were taken to rebalance risks to financial stability in view of the strong course of capital flows. In this respect, the CBRT weighted average funding cost continued to decline gradually and converged to the policy rate, standing at 4.78 percent by 17 May 2013 (Chart II.13). The effective use of the ROM and the relative ease of global financial risks towards end-2012 reduced the need for a wider interest rate corridor. In January and February, overnight lending and borrowing rates were cut by 25 basis points each. In March, the interest rate corridor was narrowed with a 100-basis-point cut in the overnight lending rate. In addition, in view of the continued policy rate cuts in other emerging economies, an expected rise in global liquidity due to decisions by the Bank of Japan, the re-acceleration tendency of capital inflows to Turkey and the positive impact of commodity prices on inflation outlook, the policy rate and the overnight lending and borrowing rates were cut by 50 basis points each in April and May to rebalance risks to price stability and financial stability (Chart II.14).

Chart II.13. CBRT Weighted Average Funding Cost (%) [1]



Source: CBRT

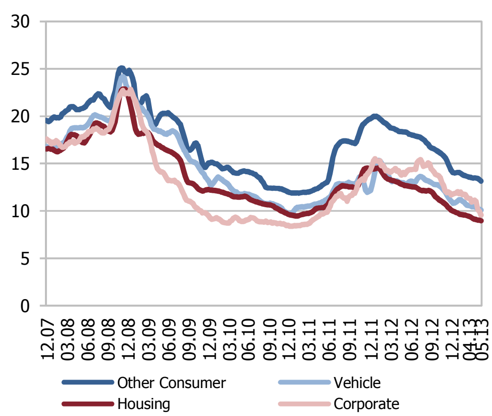
Chart II.14. CBRT Policy Rates (%)



Source: CBRT

In line with the continued supportive policies of the CBRT and interest rate cuts, loan rates have fallen gradually and the rate of increase in loans has gained momentum. With the impact of favorable external financing conditions and the monetary policy in place, the downtrend in loan rates continued in the first quarter of 2013. Consumer loan rates declined for all types and commercial loan rates fell to the 10-percent level with a considerable decline (Chart II.15). As a result of these developments, the growth in total loans accelerated in the first quarter of the year and had a course close to the average of past years. In terms of the exchange rate adjusted daily data, annual growth in loans was 19.8 percent by 17 May 2013, above the reference point (Chart II.16). The sector's annual loan growth to be around the reference point will support price stability and financial stability.

Chart II.15. TL Loan Rates[1] (%)



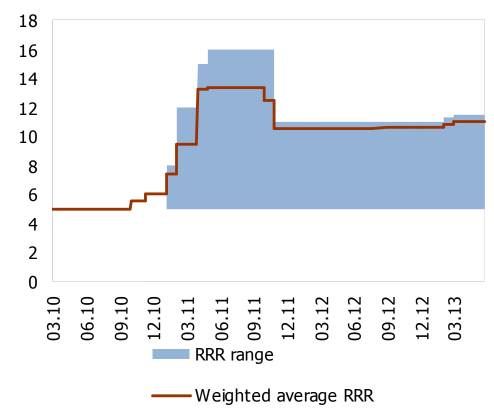
Source: BRSA-CBRT
(1) 4-week moving average.

Chart II.16. Annual Growth in Total Loans[1](%)

Source: BRSA-CBRT
(1) 70 percent of the basket value used for exchange rate adjustment is composed of USD loans and 30 percent is composed of Euro loans. FX-indexed loans are included in FX loans.

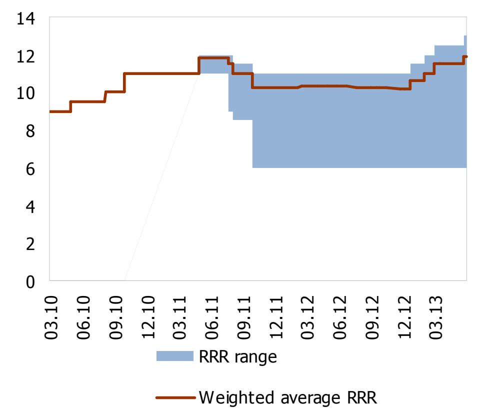
Reserve requirements are used actively to achieve effectiveness in liquidity management, rebalance risks to financial stability and boost reserves. As capital flows remained strong and loans started to increase considerably in November 2012, measured steps were taken towards tightening reserve requirements. Reserve requirement ratios for short-term Turkish lira liabilities were increased by 25 basis points in January and February 2013 while reserve requirement ratios for short-term FX liabilities were increased by 50 basis points in December, January, February and May. Hence, weighted average reserve requirement ratios for Turkish lira and FX liabilities increased to 11 percent and 11.9 percent, respectively (Chart II.17 and Chart II.18).

Chart II.17. TL Reserve Requirement Ratios (%)



Source: CBRT

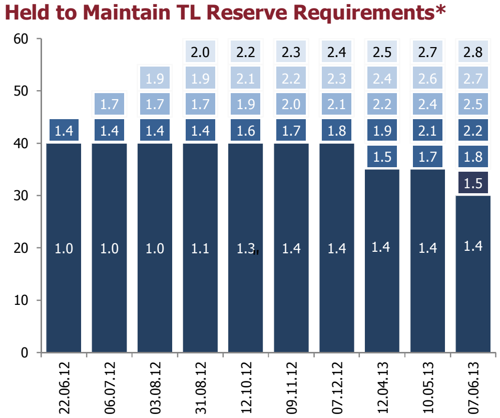
Chart II.18. FX Reserve Requirement Ratios (%)



Source: CBRT

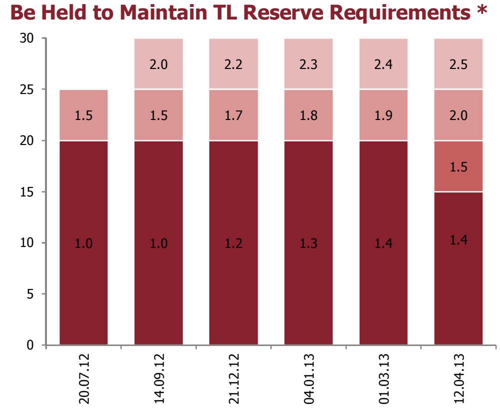
The effectiveness of the ROM has been gradually enhanced in the face of increased volatility in capital flows. The automatic stabilizer role of this mechanism reduces the need for a wider interest rate corridor to a great extent and also boosts FX reserves. Of the 60-percent upper limit for FX reserves that might be held to maintain Turkish lira reserve requirements, the reserve option coefficients (ROC) for the first tranche corresponding to 30 percent and subsequent tranches of 5 percent have been set between 1.4 and 2.8 in an increasing manner. (Chart II.19). Meanwhile, of the 30-percent upper limit for gold reserves that might be held to maintain Turkish lira reserve requirements, the ROCs for the first tranche corresponding to 15 percent and subsequent tranches of 5 percent have been set between 1.4 and 2.5 in an increasing manner (Chart II.20).

Chart II.19. ROCs for FX Reserves That Might Be Held to Maintain TL Reserve Requirements*



Source: CBRT
*Dates show maintenance periods.

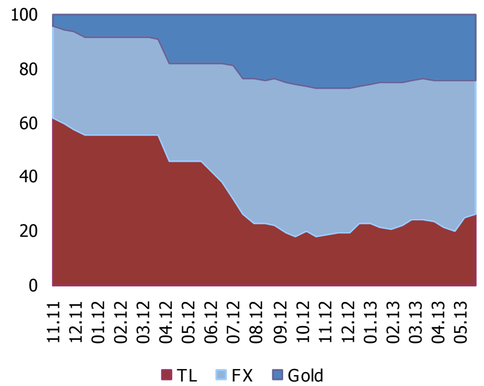
Chart II.20. ROCs for Gold Reserves That Might Be Held to Maintain TL Reserve Requirements *



Source: CBRT
*Dates show maintenance periods.

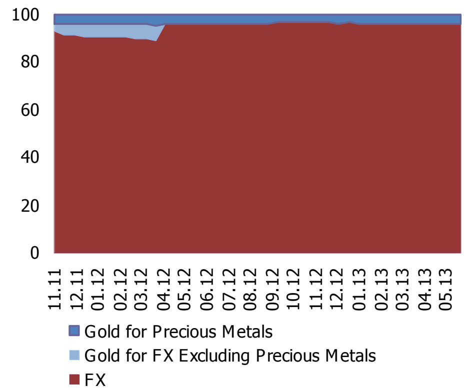
Banks have been widely and consistently using the facility to hold Turkish lira reserve requirements in FX and gold. By 24 May 2013, the utilization rates of FX and gold facilities in the sector were 82.6 percent and 80.6 percent, respectively (Chart II.21). Also, banks can hold standard gold for precious metal deposit accounts; the utilization ratio of this facility is around 72.5 percent (Chart II.22).

Chart II.21. TL Reserve Requirements (% share)



Source: CBRT

Chart II.22. FX Reserve Requirements (% share)

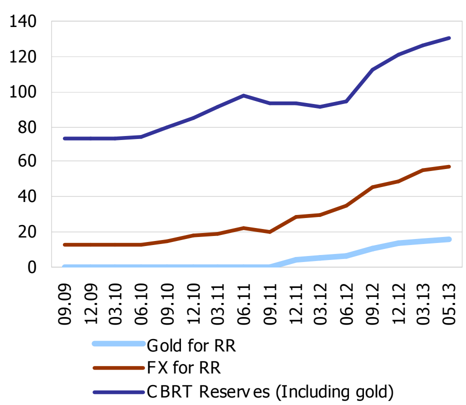


Source: CBRT

FX reserves of the CBRT continue to be in the uptrend of the recent period with the support of reserve requirement facilities and export rediscount credits. CBRT's reserves including gold, which were USD 120.3 billion at end-2012, reached approximately USD 131 billion by 24 May 2013 (Chart II.23). USD 30.5 billion of FX reserves belong to FX held in the scope of the ROM while USD 26.5-billion portion is composed of FX held as FX reserve requirements. Also, the USD 21.2-billion portion of these reserves is made up of gold reserves.

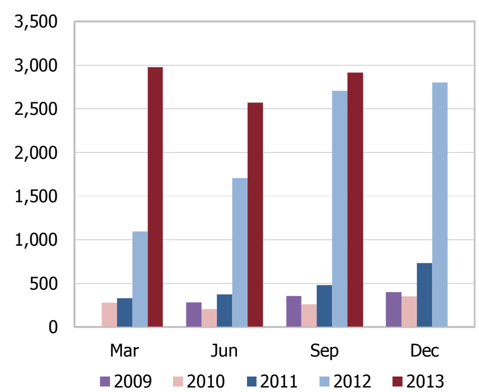
The contribution of export rediscount credits, which are extended in Turkish lira with a maximum maturity of 120 days and paid back in foreign exchange on the date of maturity, to net FX reserves was USD 8.2 billion in 2012. The amount of credits, which were USD 10.5 billion throughout the entire year in 2012, stood at USD 4.6 billion by 24 May 2013. The total amount of export rediscount credits used is expected to be USD 12 to 15 billion for the whole year in 2013 and contribute to FX reserves by USD 10 to 12 billion (Chart II.24).

Chart II.23. CBRT Reserves and Reserve Requirements (Billion USD)



Source: CBRT

Chart II.24. Contribution of Rediscount Credits to CBRT's FX Reserves (Million USD)[1,2]

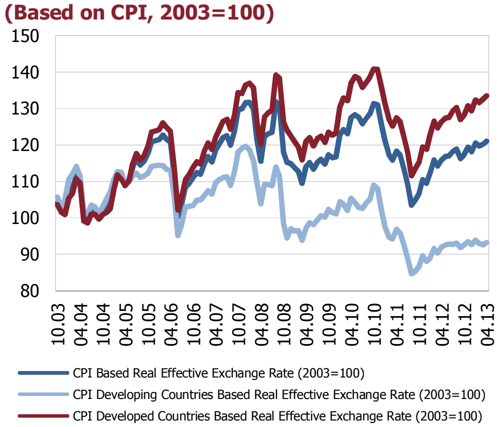


Source: CBRT
(1) Data for the second and third quarters of 2013 are estimates.
(2) Data for the third quarter of 2013 is as of 23 September.

As a result of the volatility in risk appetite and the consequent unstable outlook of capital flows, currencies of emerging economies displayed a fluctuating course, the real effective exchange rate in Turkey continued to rise and the exchange rate volatility in

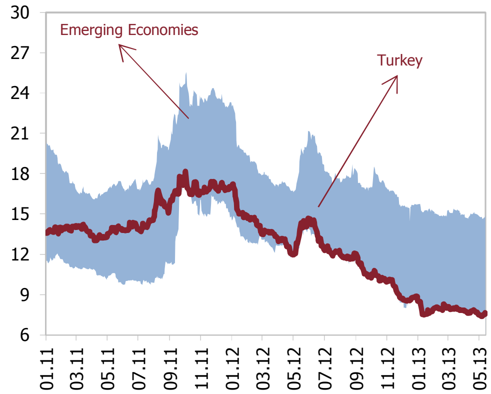
Turkey had a more favorable performance compared to other emerging economies. In the first quarter of the year, risk premia and FX markets of emerging economies had a fluctuating course. The real effective exchange rate increased due to ongoing favorable risk perceptions for Turkey and the expectation that the decisions of the Bank of Japan would increase global liquidity. Policy implementations of the CBRT helped contain the appreciation in the exchange rate (Chart II.25). Fluctuations in the risk premia and FX markets of emerging economies in the first quarter of the year had their effect on implied volatility of exchange rates. Policies implemented by the CBRT helped the implied volatility of exchange rates for the Turkish lira to remain at its low level relative to currencies of emerging economies with a current account deficit (Chart II.26). The CBRT has no commitment as to the level of exchange rate; yet, for the sake of financial stability, it is important not to be indifferent to excessive volatility.

Chart II.25. Real Effective Exchange Rates (Based on CPI, 2003=100)



Source: CBRT

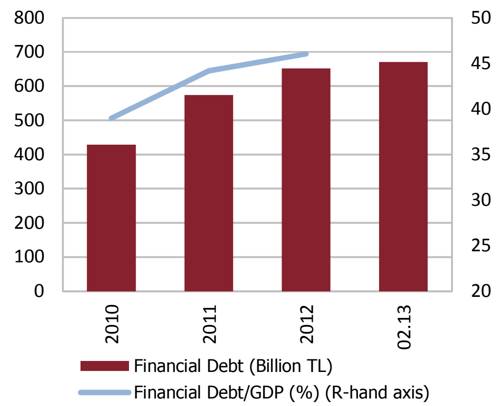
Chart II.26. Implied Volatility of Exchange Rates (12-month ahead) [1]



Source: Bloomberg
(1) Emerging economies include Brazil, Chile, Czech Republic, Hungary, Mexico, Poland, South Africa, Indonesia, Romania and Colombia.
The latest data belongs to 15 May 2013.

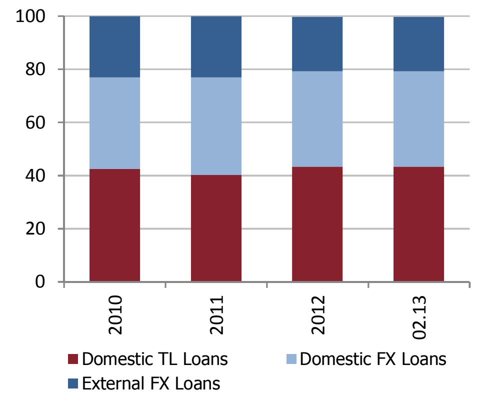
Indebtedness of the corporate sector continued to increase in 2012. The total financial debts of the corporate sector, which have increased gradually since the start of 2010 and reached 652.2 billion Turkish liras by end-2012, stood at 670.5 billion Turkish liras by February 2013. The ratio of firms' financial debts to the GDP was 46 percent in 2012 (Chart II.27). By February 2013, 56.6 percent of firms' financial debts were composed of FX loans; however, the majority of FX loans had long maturities. While loans extended to the corporate sector have increased, debt composition has not changed since mid-2012. By February 2013, 43.4 percent of total financial loans were Turkish lira denominated, 35.7 percent were FX loans obtained from domestic and foreign branches and affiliates of Turkish banks and 20.5 percent were FX loans obtained from abroad (Chart II.28).

Chart II.27. Financial Debt of Corporate Sector (Billion TL, %)



Source: CBRT

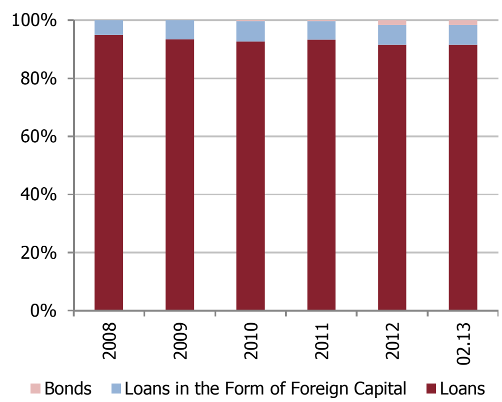
Chart II.28. Composition of Financial Debt of Corporate Sector (%)



Source: CBRT

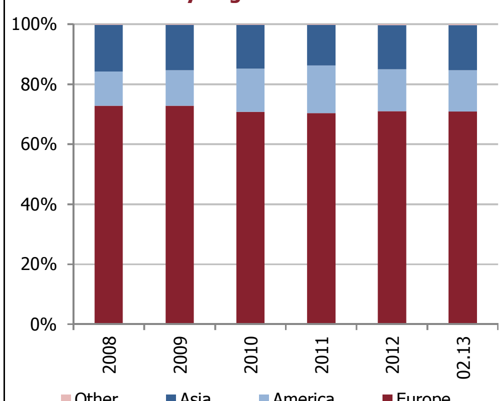
The corporate sector's external loans have been diversifying both in terms of quality and regional distribution. The share of loans in the form of foreign capital reached 6.8 percent by February while firms have recently increased their bond issues abroad albeit in small amounts (Chart II.29). An analysis of the regional distribution of external loans shows that in the same period, the share of Europe as the dominant source of external loans declined from 72.8 percent in 2008 to 70.9 percent while the shares of the USA and Asia were 15 percent and 13.8 percent, respectively (Chart II.30). Despite its small share, the fact that the corporate sector has received loans from the regions other than Europe, America and Asia is a favorable development in terms of diversification.

Chart II.29. Breakdown of Corporate Sector's External Loans by Type



Source: CBRT

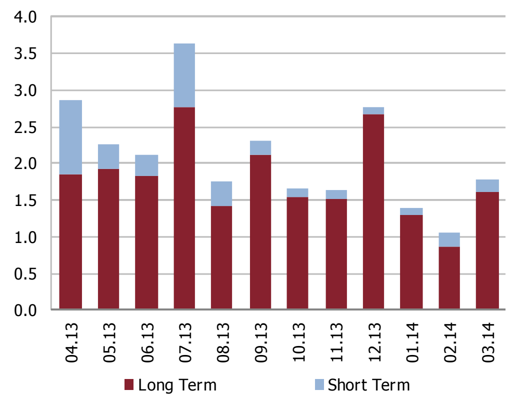
Chart II.30. Breakdown of Corporate Sector's External Loans by Regions



Source: CBRT

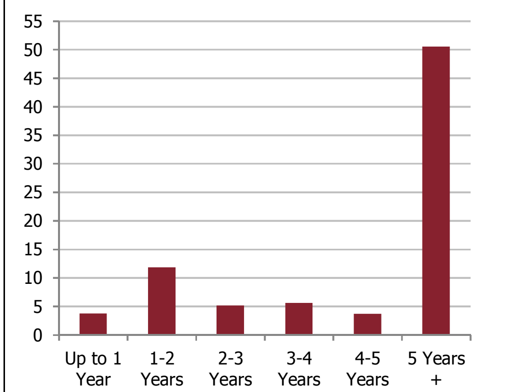
Most of the external loans of the corporate sector are long-term loans. By March 2012, firms' external loans that were due within one year amounted to USD 25.2 billion, of which USD 3.8 billion was short-term and USD 21.4 billion was long term. These loans, which were due within one year, accounted for 28.7 percent of all external loans (Chart II.31). The weighted average maturity of external loans is 4.6 years and 63 percent of these loans have maturities of 5 years and longer (Chart II.32). Taking into account the recent upgrade of Turkey's credit rating to investment grade by two leading credit rating agencies, borrowing costs are expected to fall.

Chart II.31 Corporate Sector's External Loans Due within One Year (Billion USD)



Source: CBRT
As of March 2013.
Short-term commercial loans excluded.

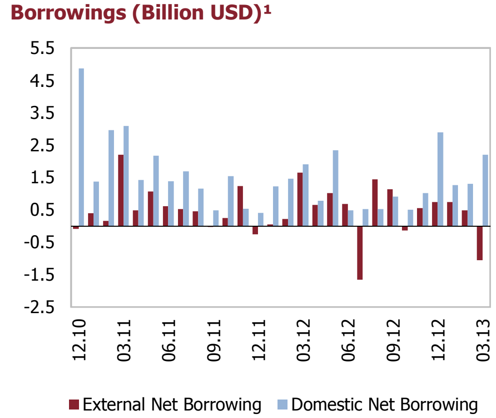
Chart II.32. Breakdown of Maturities of Corporate Sector's External Financial Debts (Billion USD)



Source: CBRT
As of March 2013.
Loans that are registered as foreign capital in balance of payments methodology have been excluded.

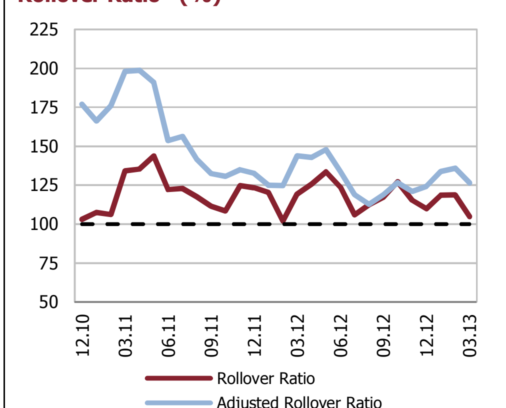
The external debt rollover ratio of the corporate sector has been displaying a relatively horizontal trend since the end of 2012. The amount of loans extended to the corporate sector by foreign branches and affiliates of Turkish banks and also by foreign banks, which had increased by USD 1.7 billion in 2012 compared to 2011, decreased by approximately USD 0.8 billion in the first quarter of 2013. In the same period, FX loans extended to the corporate sector by the domestic branches of Turkish banks increased to USD 121.6 billion by February 2013 (Chart II.33). The sector's external debt rollover ratio remained favorable in 2012 and became 126 percent in March 2013 (Chart II.34).

Chart II.33. Non-Bank Sector's Net FX Borrowings (Billion USD)[1]



Source: CBRT
(1) Non-bank sector's net FX loans are calculated by deducting repayments from loans in the respective month.

Chart II.34. Non-Bank Sector External Debt Rollover Ratio* (%)

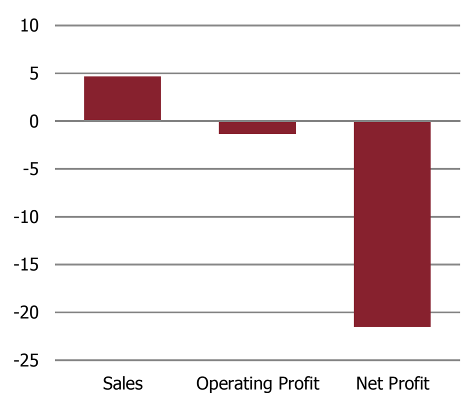


Source: CBRT
(1) The external debt rollover ratio is computed from the balance of payment statistics, by dividing non-banks' borrowing with repayments. The external debt rollover ratio of non-banks, which decreased after the amendment to Decree No: 32, has been re-calculated taking into account the rise in FX loans extended by domestic branches of Turkish banks and the rise in repayments to those branches.
(2) 3–month moving average.

To stimulate longer maturities for FX loans in the corporate sector, the Resource Utilization Support Fund (RUSF) have been differentiated according to the maturity structure of loans. . With the amendment by the Council of Ministers in January 2013, maturity tranches were increased for external FX and gold loans extended to Turkish residents other than banks and financing companies, which used to have two maturity tranches of less than 1 year and longer than 1 year. The RUSF ratio, which was 3 percent for loans with a maturity of less than 1 year previously, has been changed as 3 percent for loans with a maturity of less than 1 year, 1 percent for loans with a maturity of 1 to 2 years and 0.5 percent for loans with a maturity of 2 to 3 years. The RUSF exemption, which used to be applied to loans with a maturity of longer than 1 year, is now applicable to loans with a maturity of longer than 3 years. This amendment, which aims to encourage external borrowing with longer maturities, is expected to have its positive effects on the borrowing structure of the corporate sector in the upcoming period and contribute to financial stability in this way.

The weak trend of external demand despite the moderate recovery in domestic demand has led to a real decline in firms' turnover while the increase in financing expenditures due to depreciation of the Turkish lira has negatively affected their profitability. In the first quarter of 2013, the total amount of the sales revenue of firms quoted on Borsa İstanbul increased by 4.7 percent year-on-year whereas it declined by 2.6 percent in real terms. Moreover, depreciation of the Turkish lira has also unfavorably affected corporate profitability by driving a rise in financial expenditures stemming from exchange rate movements (Chart II.35). The return on equity, which was 15.1 percent in 2012, fell to 14.1 percent in the first quarter of 2013 and the indebtedness of the sector increased modestly. The return on assets, which rose in 2012, declined to 6.4 percent in the first quarter of 2013 (Table II.1).

Chart II.35. Sales and Profitability of Firms in the First Quarter of 2013 (Annual % Change)[1]



Source: PDP
(1) Consolidated data of 227 firms quoted on Borsa İstanbul.

Table II.1. Return on Equity and Its Components[1]

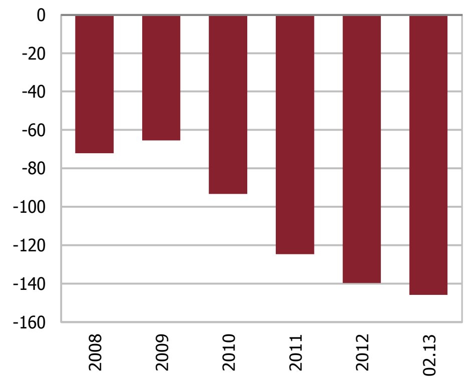
	2011	2012	03.13[2]
Net Profit / Equity (%)	12.6	15.1	14.1
Liabilities / Equity (%)	1.2	1.1	1.2
Net Profit / Assets (%)	5.7	7.1	6.4
Sales / Assets	1.1	1.1	1.0
Net Profit / Sales (%)	5.4	6.6	6.2
Operationg Profit / Sales (%)	8.6	7.8	7.7
Financial Income (Expenditures) / Sales (%)	-2.0	-0.2	-0.6

Source: PDP
(1) Consolidated data of 227 firms quoted on Borsa İstanbul.

(2) Annualized data.

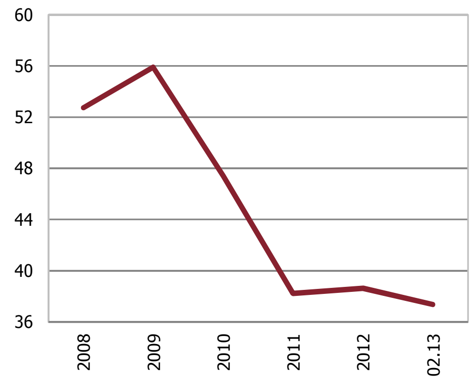
An analysis of FX assets and liabilities of firms suggests that the net FX short position increased, while foreign exchange risk still remains an important issue for these firms. The net short position of the corporate sector, which assumed an upward trend with the economic recovery after the global crisis and became USD 139.8 billion at the end of 2012, reached USD 145.9 billion in February 2013 mainly due to the rise in domestic and external FX loans (Chart II.36). The ratio of FX assets to FX liabilities, which has been decreasing since March 2012, came down to 37.4 percent in February 2013 (Chart II.37).

Chart II.36. Foreign Exchange Position of the Corporate Sector (Billion USD)[1]



Source: CBRT
(1) Data for February 2013 is provisional.

Chart II.37. FX Assets to FX Liabilities Ratio of the Corporate Sector (%)[1]



Source: CBRT
(1) Data for February 2013 is provisional.

Box II.1. Export Rediscount Credits Extended to the Corporate Sector

In the scope of Article 45 of the CBRT Law, for the financing of their receivables from forward sales or the exports they undertake, exporters can obtain rediscount credits in Turkish lira with a maturity of maximum 120 days, via presenting foreign exchange bills for rediscount. The return on bills is received in foreign exchange on the date of maturity.

The limit for export rediscount credits was raised to USD 6.0 billion in 2012. USD 5.5 billion of this amount was allocated to Eximbank for the finance of pre and post shipment export and USD 500 million to banks for the finance of post shipment export. Credit limits for firms have been set as USD 120 million for foreign trade capital companies and USD 90 million for other firms in 2013.

These credits are extended with quite reasonable interest rates based on LIBOR/EURIBOR rates, which reduces financing costs for exporters. The rise in the number and the enriched sectoral and regional distribution of beneficiary firms contribute to the diversification of Turkey's export markets and export goods as well as to the rebalancing in foreign trade. Interest rates for export rediscount credits extended in US dollars have followed a fluctuating course since 2010 and assumed a downtrend since the start of 2012. Interest rates for export rediscount credits extended in Euro were on the rise from March 2010 to September 2011 and have declined since then (Chart 1).

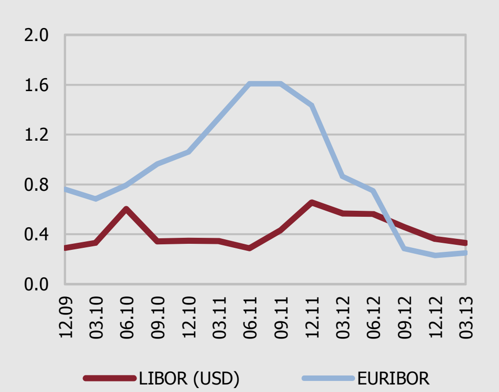
With the impact of the facilitated use of credits, the amount of credits extended, which was USD 3.1 billion in 2011, rose to USD 10.5 billion in 2012. As for 2013, USD 4.6 billion worth of export rediscount credits were extended up to 24 May 2013 with an outstanding balance of USD 3.9 billion (Table 1, Chart 2). In 2013, 81 percent of the credits were extended in USD and 19 percent were extended in Euro.

Table 1. Export Rediscount Credits

	2009	2010	2011	2012	2013[1]
Credit Amount (Million USD, Flow)	1,365	1,227	3,082	10,486	4,643
Outstanding Balance (Million USD, Stock)	325	449	1,612	3,802	3,903
Number of Beneficiary Firms	176	103	281	711	527
Number of Loans	559	416	1107	4014	2013

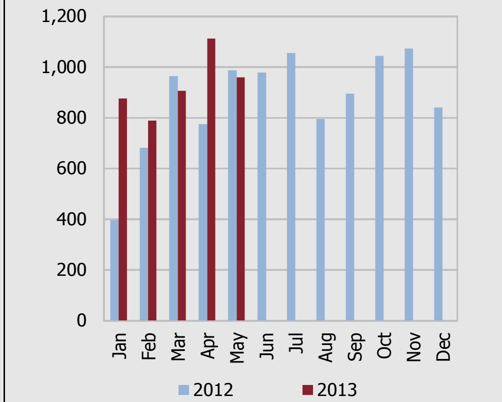
(1) As of 24 May 2013.

Chart 1. Libor/Euribor Rates on Rediscount Credits (%)[1]



(1) As of 31 March 2013.

Chart 2. Monthly Export Rediscount Credit Utilization (Million USD)[1]

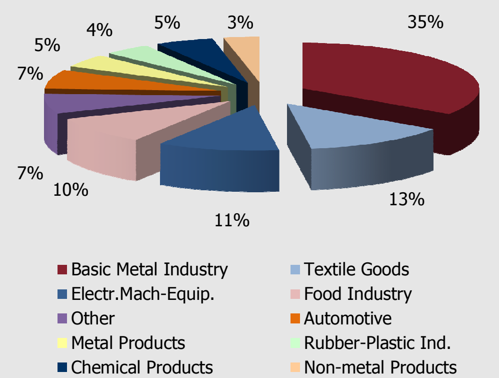


(1) As of 24 May 2013.

In 2013, export rediscount credits were extended predominantly to finance the exports of products in the basic metal industry, the textile and textile goods industry and the electrical machinery and equipment industry (Chart 3).

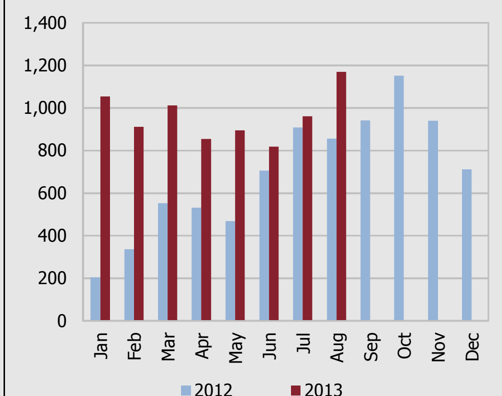
Export rediscount credits contributed USD 8.3 billion to net FX reserves of the CBRT. If credits continue to be used at the current rate, rediscount credits are expected to contribute approximately 10-12 billion US dollars to net FX reserves of the CBRT in 2013 (Chart 4).

Chart 3. Sectoral Breakdown of Rediscount Credits in 2013 (%)[1]



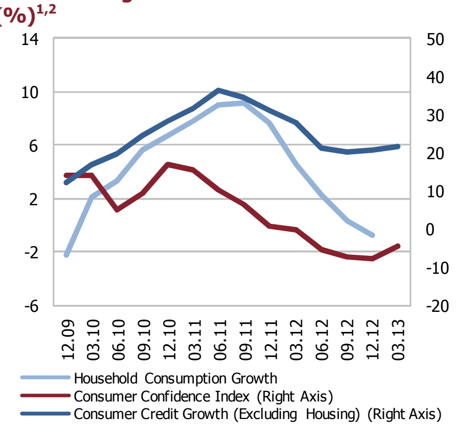
(1) As of 24 May 2013.

Chart 4. Contribution of Rediscount Credits to CBRT's FX Reserves (Million USD)



Growth in households' consumption expenditures decelerated but savings have not reached desired levels yet. Measures taken in 2012 to slow down domestic demand in the framework of a balanced growth policy have supported the continuing downward trend in the growth of consumption expenditures (Chart II.38). An analysis of average figures pertaining to the last five-year period reveals that the household savings rate in Turkey is 8.8 percent, which is above the 6.1-percent average of other countries analyzed (Chart II.39). However, it should be noted that the savings rates have been declining over the past years. Boosting savings rates is essential for sustaining a stable and high growth. In this respect, it would be useful to sustain implementations geared towards increasing the savings rate and to implement income-boosting macro policies as well as micro policies that will encourage households to save more. In the Private Pension System, which is one of the significant steps taken to boost savings, the application of the tax advantage comprising a deduction of the contribution from the tax base was terminated and replaced by the "government contribution" system to be effective as of 1 January 2013. From January 2013 up to 10 May, the number of participants in the system and the amount of these people's funds reached 3.6 million people and 23.2 billion Turkish liras, respectively. Taking into account the favorable effects of savings on investment, growth and financial stability, the Central Bank of Turkey started preparations for a nation-wide campaign to increase savings rates and raise awareness to encourage the use of Kurus.

Chart II.38. Real Growth of Household Consumption, Growth of Consumer Credits and Annual Change in Consumer Confidence Index (%)[1,2]

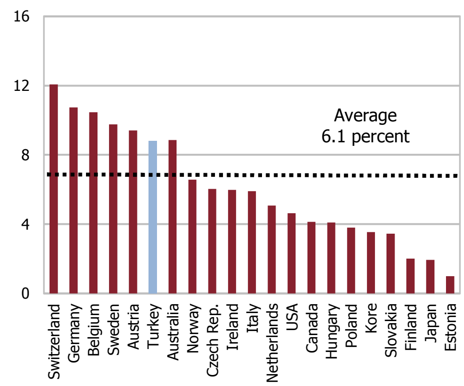


Source: CBRT, TURKSTAT

(1) The rise in household consumption denotes annual change in resident expenditures calculated by the GDP-expenditures method and in constant prices (1998).

(2) The Consumer Confidence Index is calculated by annual changes in quarterly averages.

Chart II.39. Household Savings Rates in Selected Countries (2008-2012, %)[1]



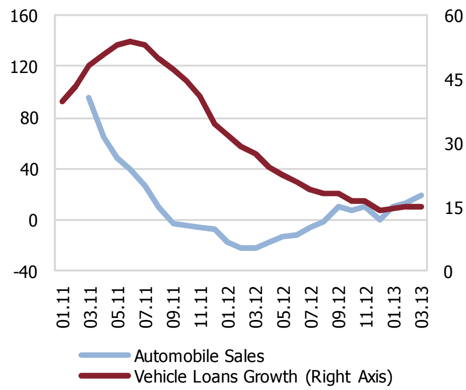
Source: OECD Economic Outlook No.92, TURKSTAT

(1) Savings rates show the ratio of household savings to disposable income. Rates have been calculated by 2007-2011 data for Turkey and 2008-2012 estimates of the OECD for other countries.

Due to the fall in interest rates, the slowdown in the rate of increase of vehicle loans has stopped, while the increase in housing loans has regained pace. On the back of the improvement in banks' external financing conditions and the fact that the CBRT's policy has gradually become supportive of the economy, interest rates on loans have declined. This decline has had a positive impact on the demand for automobiles; consequently, automobile sales have started to pick up (Chart II.40).

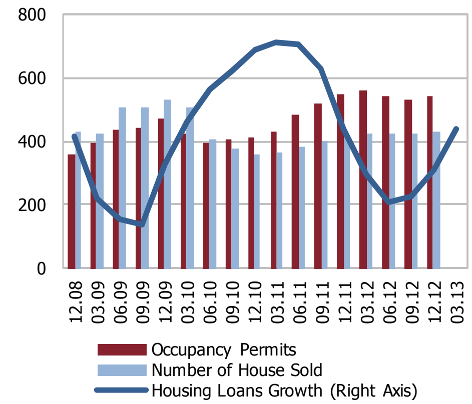
The housing sector is another contributor to economic growth and employment. Important regulations have been implemented recently, such as urban transformation, the 2B law, the law of reciprocity enabling foreigners to purchase real estate in Turkey and the new VAT practice. These practices, coupled with the increase in housing loans, have led to an annual 3 percent rise in the number of properties sold (Chart II.41).

Chart II.40. Annual Growth of Vehicle Loans and Annual Change in Automobile Sales (%)[1]



Source: BRSA-CBRT, ODD
(1) Automobile sales reflect 3-month moving averages.
(2) Data pertaining to consumer financing firms are also included in vehicle loans.

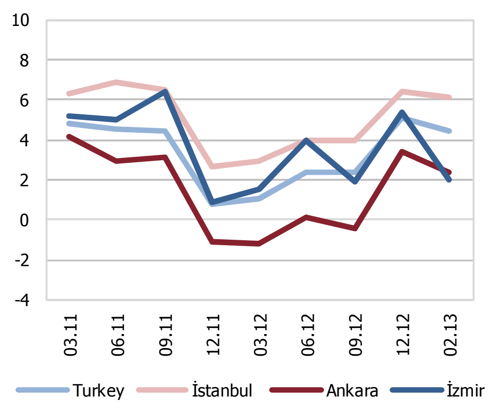
Chart II.41. Annual Growth of Housing Loans, Number of Houses Sold and Building Occupancy Permits (Thousand, %)[1]



Source: TURKSTAT
(1) Data represent 12-month sum of apartments at buildings used for residence purposes.

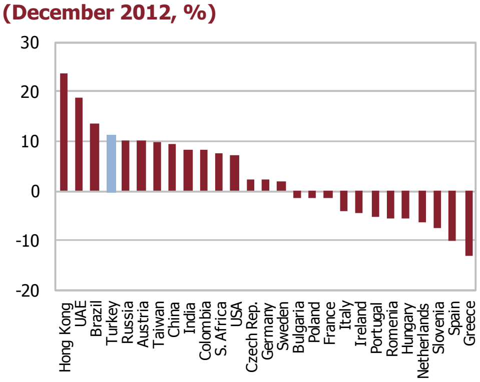
However, the increase in housing prices displays a slight slowdown. Both the regulations geared towards the housing market and the decline in interest rates affect supply and demand conditions for houses and reflect prices across the country. Actually, in February 2013, house prices rose by 4.4 percent in real terms throughout Turkey. The highest rise was recorded in İstanbul at 6.1 percent (Chart II.42). Nevertheless, the decline in house prices, particularly in advanced economies that are still under the influence of the adverse effects of the global crisis, is noteworthy. Among selected countries, Turkey is ranked near the top in price increases due to the inflation in the housing market (Chart II.43). Meanwhile, closely monitoring the developments in house prices is very important for financial stability as any excessive volatility in house prices in either direction might pose a risk to financial stability.

Chart II.42. Annual Change in House Price Index in Real Terms (%)[1]



Source: CBRT, TURKSTAT
(1) Expressed in real terms by using the CPI (2003=100).

Chart II.43. Annual Nominal Change in House Prices in Selected Countries (December 2012, %)

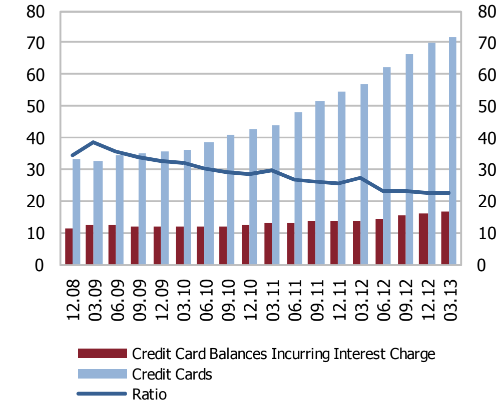


Source: Knight Frank Global House Price Index, CBRT

Households continue to use credit cards intensively. The ongoing widening use of credit cards that play an important role in formalizing the shadow economy has been increasing credit card balances largely due to credit installments. The decline in interest rates on other consumer loans has become instrumental in less use of credit cards as a credit instrument. The ratio of credit card balances incurring interest charges to total credit card balances has continued to fall (Chart II.44).

Developments in credit card balances with and without installment options suggest that individuals have opted more for installments over the years. As a matter of fact, by March 2013, credit card balances with installment balances increased to 55 percent of the total credit card balances (Chart II.45).

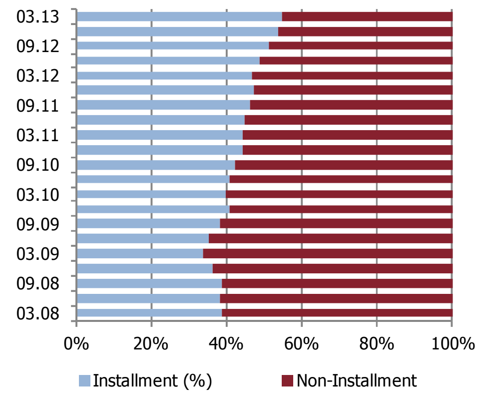
Chart II.44. Credit Card Balances of Deposit Banks and Balances that Incur Interest Charges (Billion TL, %)[1]



Source: CBRT

(1) Of credit card balances, the part incurring interest charges.

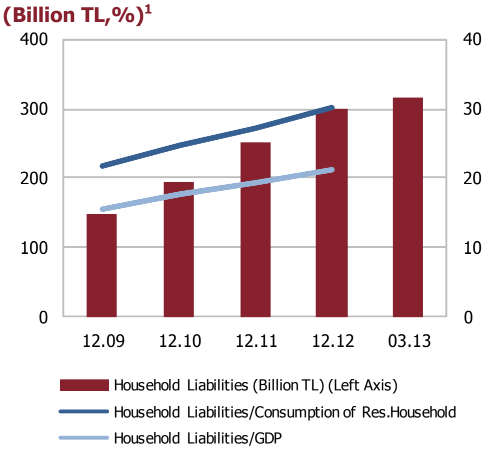
Chart II.45. Individual Credit Cards With and Without Installment Options (%)[1]



Source: CBRT

Despite the decline in interest rates, household interest payments rose on the back of increased credit utilization. Interest rates that dropped in the second half of 2012 increased the ratio of consumer loans and thus household liabilities to GDP (Chart II.46). In line with increased use of loans, the ratio of both interest payments and household liabilities to disposable income surged (Table II.2). In the meantime, the decline in interest rates particularly has allowed households to restructure their housing loans, thereby leading to a reduction in the interest cost.

Chart II.46. Household Liabilities (Billion TL,%)[1]



Source: BRSA-CBRT, TURKSTAT

(1) Household liabilities consist of consumer loans extended by banks and consumer finance companies (including NPLs), credit card balances (including NPLs), non-performing consumer loans taken over by asset management companies and liabilities to TOKI due to TOKI's housing sales with long-term maturity.

Table II.2. Selected Financial Indicators Pertaining to Households [1,2,3] (Billion TL, %)

	12.10	12.11	12.12
Household Disp. Income	448.8	531.2	591.3
Household Liabilities	195.1	252.0	299.9
Household Interest Payments	20.4	23.1	30.0
Interest Paym. / Hh. Disp. Incom	4.5	4.4	5.1
Liabilities / Hh. Disp. Income (%)	43.5	47.4	50.7

Source: BRSA-CBRT, TURKSTAT, Ministry of Development

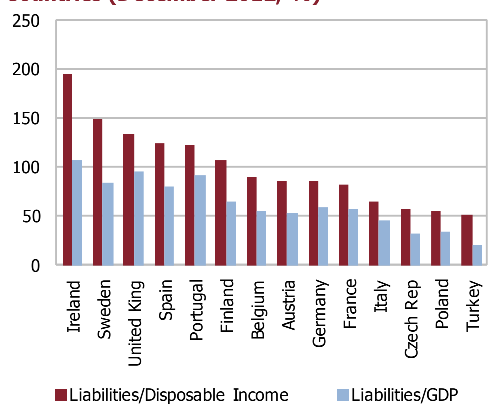
1) Household liabilities consist of gross consumer credits (including NPLs) extended by banks and consumer finance companies, credit card balances (including NPLs), credit claims from the frozen consumer loans taken over by asset management companies, and liabilities to TOKI due to TOKI's housing sales with long-term maturity.

(2) As the repayments related to liabilities from TOKI's housing sales with long-term maturity are indexed to civil servant salaries, they are not included in interest payments.

(3) Household disposable income for 2012 has been calculated by using the private sector disposable income estimation for 2012 as foreseen in the 2013 Program, under the assumption that the ratio of household disposable income for 2011, which was generated from "the Household Budget Surveys", to private sector disposable income has not changed.

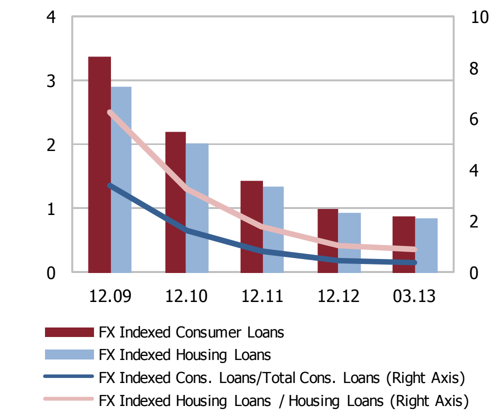
Although household liabilities continue to increase, their ratios to GDP and to disposable income remain low in comparison to those of the selected countries. By the end of 2012, the ratios of liabilities to GDP and to disposable income, which were 21.2 percent and 50.7 percent, respectively, maintained their low levels compared to those in advanced economies (Chart II.47). With the effect of the regulations that have already been enforced, household liabilities carry no exchange rate and interest rate risk. The remarkably low level of loans with variable interest rates, despite the fact that variable interest rates are only allowed for housing loans, contains the household interest rate risk exposure. The household exchange rate risk was eliminated by impeding households borrowing in FX, and later with the amendment to Decree No. 32 in June 2009, also from FX-indexed borrowing (Chart II.48).

Chart II.47. Ratio of Household Liabilities to Disposable Income and GDP in Selected EU Countries (December 2012, %)[1]



Source: BRSA-CBRT, TURKSTAT, Ministry of Development, ECB
(1) Disposable incomes for the EU countries are gross figures.

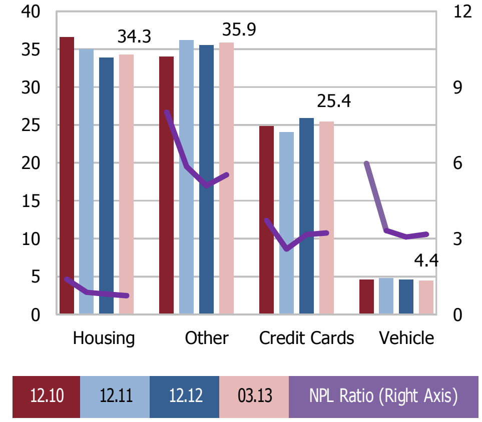
Chart II.48. FX-Indexed Consumer and Housing Loans (Billion TL, %)



Source: BRSA-CBRT

While housing and other loans preserved their weight in household liabilities, the NPL ratios of types of loans other than housing loans displayed a slight increase. The effect of measures taken to restrain housing loans has diminished parallel to the decline in interest rates, whereas the share of these loans in household liabilities has increased again in the recent period. While NPL ratios of housing loans decelerated in the first quarter of 2013 on account of the acceleration of the increase in housing loans, other loan types increased slightly in the same period (Chart II.49). The number of consumer loan and credit card defaulters displayed a limited rise in the same period (Table II.3).

Chart II.49. Composition of Household Liabilities and NPL Ratios by Type (%)[1,2,3,4]



Source: CBRT-BRSA
(1) Household liabilities consist of gross consumer credits and credit card balances extended by banks and consumer finance companies and liabilities to TOKI due to TOKI's housing sales with long-term maturities.
(2) Liabilities to TOKI due to TOKI's housing sales with long-term maturity are also included in housing loans.
(3) Other loans consist of all consumer loans excluding housing and vehicle loans.
(4) TOKI loans and loans extended by consumer financing companies are not included in the calculation of NPL ratios.

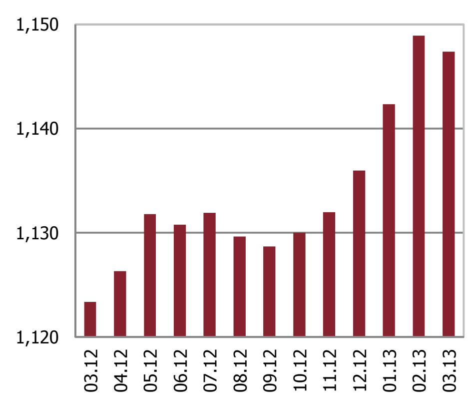
Table II.3. Number of Credit Card and Consumer Loan Defaulters (Thousand People)[1]

	12.10	12.11	12.12	03.13
Banks	1,407	1,225	1,487	1,480
Asset Management Companies[2]	447	688	782	804
Finance Companies	23	11	8	9
Total[3]	1,701	1,658	1,949	1,986

Source: CBRT
(1) Customers with more than one registry to a particular financial institution group are counted only once.
(2) Represents frozen loans taken over by asset management companies from the SDIF and banks.
(3) As customers may be registered in more than one financial institution group, the sum of the three rows in the table and grand total are not equal.

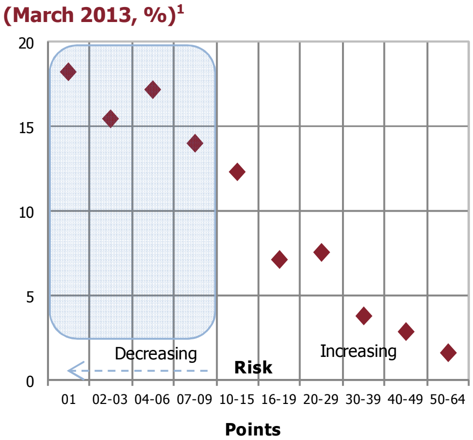
The risk status of loan applicants presents a positive outlook in terms of NPL developments in the period ahead. The increase of "Individual Credit Rating" in most part of the past one year period is considered positive for the development of NPL ratios in the upcoming period (Chart II.50). The Individual Credit Rating is calculated by taking into account factors such as loan re-payment performance and debt levels of individuals as well as increase in loan volumes to predict the riskiness of individuals. Likewise, the "Individual Indebtedness Index", used to predict individuals who are inclined to get into excessive borrowing despite the fact that they are not likely to have payment difficulty and who might potentially become defaulters and lead to an increase in NPL ratios in more than one year's time, also presents a favorable outlook. In fact, an analysis of the distribution of inquiries for loan applications based on their index values reveals that the low risk group (9 points and below) accounted for 65% of the inquiries in March 2013 (Chart II.51).

Chart II.50. Individual Credit Rating - Average (Points)[1]



Source: KKB (Credit Bureau of Turkey)
(1) Individual Credit Rating is calculated to fall between 1 and 1600. 1 denotes the highest risk, whereas 1600 denotes the lowest risk for a specified situation. The figures have been calculated by taking into account the application inquiries only.

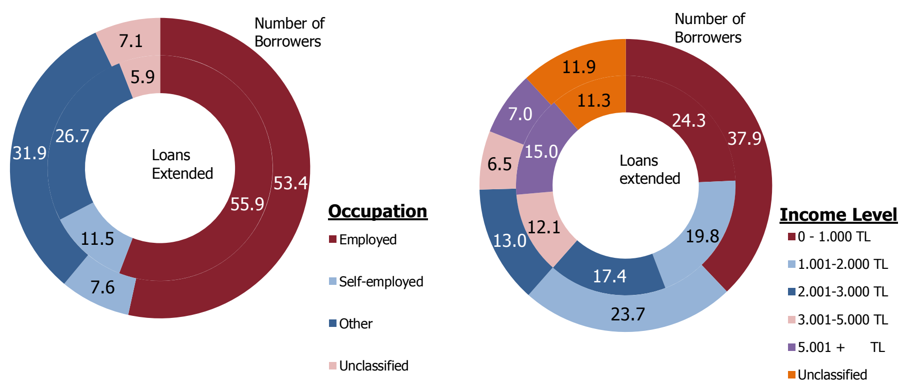
Chart II.51. Individual Indebtedness Index (March 2013, %)[1]



Source: KKB (Credit Bureau of Turkey)
(1) Individual Indebtedness Index is calculated to fall between 1 and 64. 1 denotes the lowest risk group, whereas 64 denotes the highest risk group. The figures have been calculated by taking into account the application inquiries only.

Wage-earners in the low income group account for the majority of the households who have consumer loan debts. An analysis of occupation and income groups of the households with consumer loan debts suggests that occupation and a regular income are the determinants of access to loans. The distribution of the number of borrowers and the amount of loans according to occupational groups indicates that the majority of the borrowers are composed of wage earners who also borrowed the most. The distribution of the number of borrowers and the amount of loans extended according to income level suggests that the largest share belongs to the low-income group (Chart II.52).

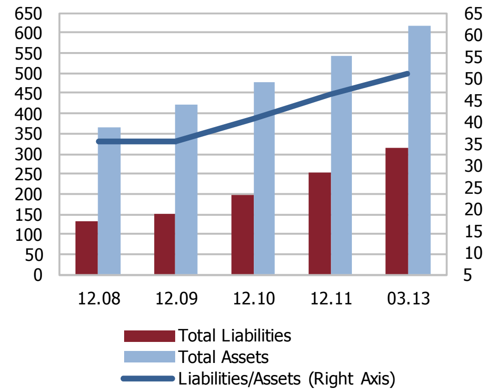
Chart II.52. Distribution of Borrowers According to Occupation and Income (Loans Extended and Number of People) (September 2012,%)[1]



Source: The Banks Association of Turkey
(1) Data of 36 lending banks out of the total 46 affiliated to the Banks Association of Turkey.

In line with the increase in consumer loans, the ratio of household financial liabilities to assets continues to increase. The decline in consumer loan rates in parallel with the decline in banks' funding costs has led to a rise in the ratio of household financial liabilities to assets (Chart II.53). As opposed to complex investment instruments used in advanced economies, more conventional investment instruments, such as deposits and gold, continue to be preferred in Turkey. In fact, by March 2013, savings deposits standing at 51.1 percent, was the predominant item in household assets. As a result of valuation of equity securities, widespread use of gold and gold-based investment instruments, incentives for the individual pension system and the interest in increased bond issues, the shares of investment funds, equity securities, pension funds, precious metal deposits as well as bonds and bills in household financial assets have been on the rise (Table II.4). It is considered beneficial for households to take into account the effects of potential fluctuations in global markets on gold value, equity securities and exchange rates.

Chart II.53. Household Financial Assets and Liabilities (Billion TL, %)[1]



Source: BRSA-CBRT, CMB, CRA
(1) Household Assets = Savings Deposits +FX Deposits + Currency in Circulation + GDDS + Eurobonds + Stocks + Repos + Pension Funds + Mutual Funds + Bonds and Bills (since 2010). Household liabilities consist of gross consumer credits (including NPLs) extended by banks and consumer finance companies, credit card balances (including NPLs), non-performing consumer loans taken over by asset management companies, and liabilities to TOKI due to TOKI's housing sales with long-term maturity.

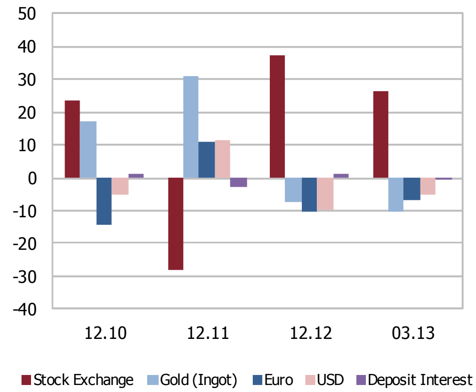
Table II.4. Household Financial Assets[1]

	12.11		12.12		03.13	
	Billion TL	Pay	Billion TL	Pay	Billion TL	Pay
TL Deposits	281.9	51.9	307.1	50.7	316.3	51.1
FX Deposits	111.6	20.6	121.5	20.1	120.7	19.5
- FX Deposits (Billion USD)	*58.5*		*68.2*		*66.6*	
Currency in Circulation	49.3	9.1	54.6	9.0	54.7	8.8
GDDS+Eurobond	10.5	1.9	5.9	1.0	5.7	0.9
Mutual Funds	25.8	4.7	26.1	4.3	27.7	4.5
Stocks	30.0	5.5	38.0	6.3	40.6	6.6
Private Pension Funds	14.3	2.6	20.3	3.4	22.0	3.5
Repos	1.4	0.3	3.8	0.6	2.0	0.3
Precious Metal Deposits	13.4	2.5	17.4	2.9	19.4	3.1
Bonds and Bills	4.9	0.9	10.4	1.7	10.3	1.7
Total Assets	**543.2**	100	**605.1**	100	**619.4**	100

Source: BRSA-CBRT, CMB, CRA
(1) TL and FX deposits include participation funds

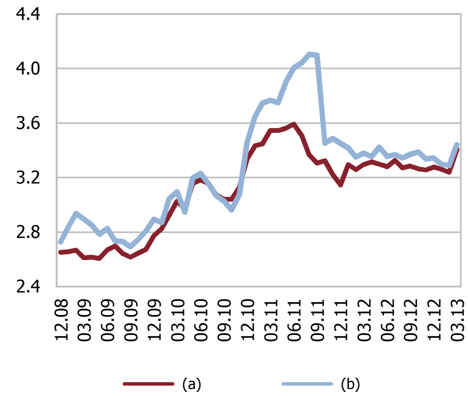
The dynamic outlook of the financial sector is mirrored in returns on investment instruments and also leads to a change in portfolio preferences of individuals who are willing to make investments. On the back of the sovereign rating upgrades and the decline of policy rates in the previous period, the Borsa İstanbul (BIST) index performed better compared to other investment instruments (Chart II.54). On the other hand, the portfolio preference between national currency and foreign currency denominated financial assets did not display a significant change throughout 2012 owing also to the CBRT's policy geared towards alignment of exchange rate. Data adjusted for the exchange rate effect confirms that investment instruments denominated in Turkish lira were preferred more in the first quarter of 2013 (Chart II.55).

Chart II. 54. Real Return on Financial Investment Instruments by Types (%)[1]



Source: TURKSTAT
(1) Expressed in real terms by using the CPI.

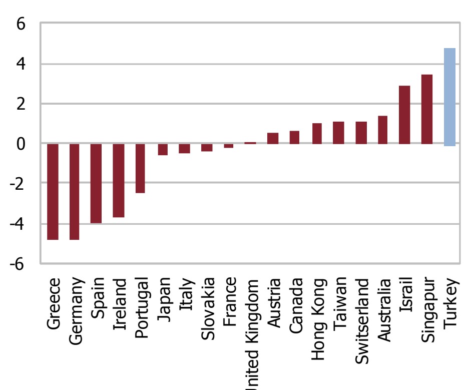
Chart II. 55. Ratio of Household TL Investment Instruments to FX Investment Instruments[1]



Source BRSA-CBRT, CMB, CRA
(1) TL Instruments = Deposits + Repos + GDDS + Participation Funds (TL) + Stocks + Private Pension Funds + Mutual Funds + Bills and Bonds (starting from September 2010);
FX Instruments = FX Deposits + GDDS + Eurobond,
(a) Current TL value of FX deposits and Participation Funds (FX).
(b) For FX deposits and Participation Funds (FX), exchange rate prevailing on 26.12.2008 is used and the parity effect is eliminated.

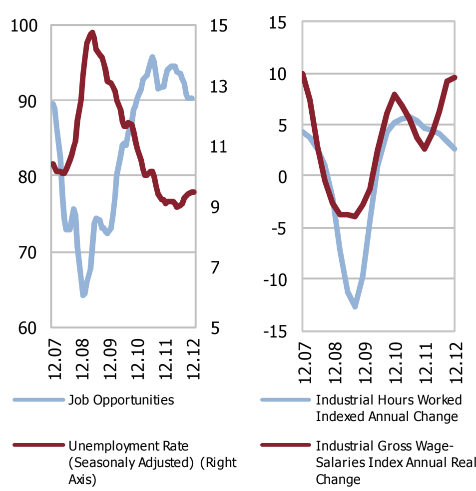
Employment growth hovers above that of the countries analyzed. While unemployment - one of the significant risk factors for households - continues to be a major problem for EU countries which have not yet recovered from the adverse effects of the global crisis, it remains on a positive track in Turkey (Chart II.56). On the other hand, although non-farm employment increased in the last quarter of 2012, it was outpaced by the employment participation rate, which resulted in a higher unemployment level compared to the previous period. In the first two months of 2013, the unemployment rate dropped again and materialized as 9.2 percent in February. While the rise in gross wage payments has affected household disposable income favorably since the last quarter of 2011, it has also contributed to domestic consumption expenditures (Chart II.57).

Chart II.56. Average Annual Growth Rate of Employment in Selected Countries (2008-2012, % Growth)[1]



Source: IMF World Economic Outlook, TURKSTAT
(1) Annual average increases in employment are calculated by taking natural logarithm differences.

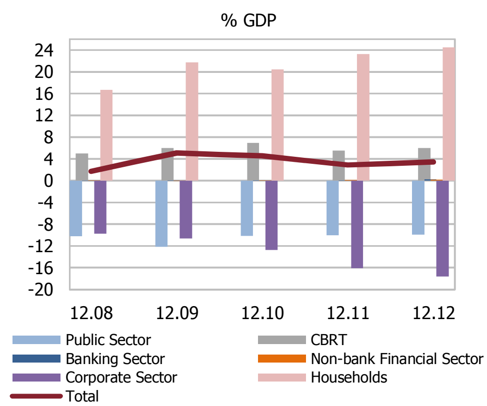
Chart II.57. Selected Indicators for the Labor Market (%)[1,2]



Source: TURKSTAT
(1) The data pertaining to job opportunities and the unemployment rate are quarterly moving averages. Job opportunities are quantified by using "the expectations of finding a job in Turkey in the next 6 months", as expressed by the surveyed in the Consumer Confidence Survey.
(2) The indices for total working hours and gross industrial wages/salaries are of quarterly periods. The data is calculated by taking the moving averages of three quarters. The gross wage and salary index (2005=100) is expressed in real terms by using the PPI (2003=100)

Monitoring Turkey's macro foreign exchange position is crucial in assessing the exchange rate risk incurred by economic units. As of April 2013, Turkey's foreign currency (FX) short position was USD 89.3 billion and its ratio to GDP of 2012 was 11.3 percent. Turkey's gold stocks were estimated as USD 112 billion as of February 2013. With the inclusion of Turkey's gold stocks in the country's FX short position data, the total FX short position was replaced by long position and became USD 22.8 billion as of April 2013. The ratio of FX net long position to GDP of 2012 materialized as 2.9 percent (Chart II.58). An analysis by years indicates that in Turkey, the public and corporate sectors have FX short positions, the CBRT and households have long positions, whereas the banking sector and non-bank financial sector have a position of almost zero. This means that the public and corporate sectors are those that may be adversely affected by the depreciation of the Turkish lira.

Chart II.58. Turkey's FX Position



SECTORS (April 2013, Million USD)	Assets	Liabilities	Net Position
Public Sector [1]	8,531	84,759	-76,228
CBRT	141,096	91,742	49,354
Banking Sector	400,572	397,565	3,008
Non-bank Financial Sector [2]	13,533	11,543	1,989
Corporate Sector [3]	87,033	232,922	-145,889
Households [4]	191,011	485	190,526
TOTAL	**841,776**	**819,016**	**22,760**

Source: CBRT-BRSA, Undersecretariat of Treasury
(1) Regarding public FX-denominated assets, April 2013 data is used for deposits of the Undersecretariat of Treasury held with the CBRT and March 2013 data is used for other public assets. Public FX liabilities are the sum of central government FX-denominated data by March 2013 and sum of other public external debt stock data by December 2012.
(2) December 2012 data is used.
(3) February 2013 data is used.
(4) March 2013 data is used. Gold stocks are also included in household assets and February 2013 data is used for gold stocks. For the amount of FX-indexed loans extended by consumer finance companies December 2012 data is used.

In the upcoming period, uncertainties regarding the global economy and fluctuations in capital flows continue to be important for financial stability. This situation highlights the importance of having a flexible and multi-instrument monetary policy framework. Developments in the first quarter of the year signal that the global economy is still vulnerable. While uncertainties over economic policies of developed countries linger on, data regarding the global economic activity is far from presenting a stable outlook. Capital inflows towards emerging economies have recently accelerated. A likely persistence of this trend, accompanied by a weak global growth outlook, may feed macro financial risks. The CBRT will continue to implement the instruments it has developed to balance these risks within a flexible framework in the direction of containing the adverse effects of global economic vulnerabilities on the domestic economy.