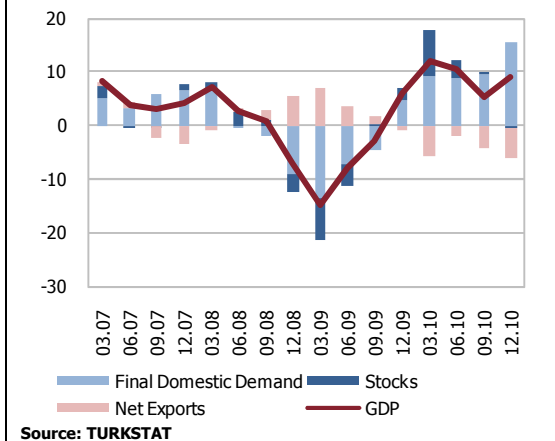
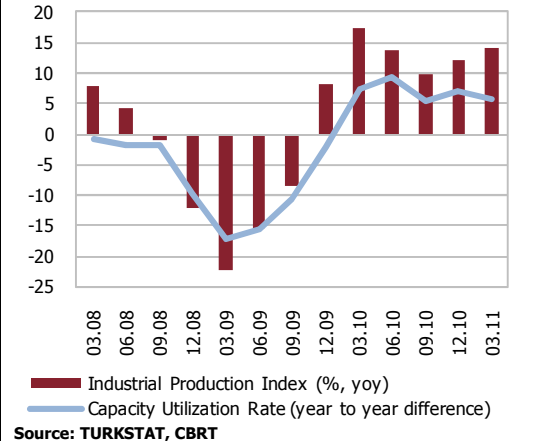


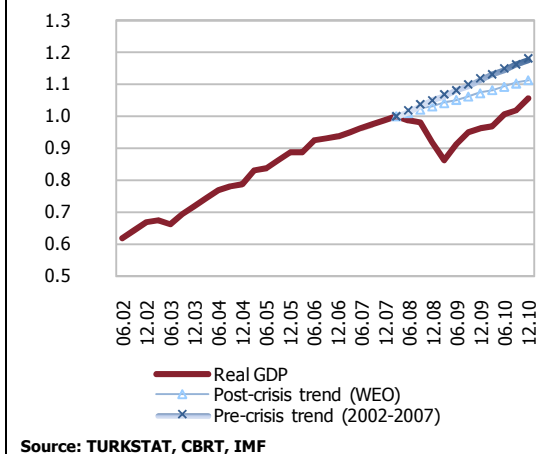
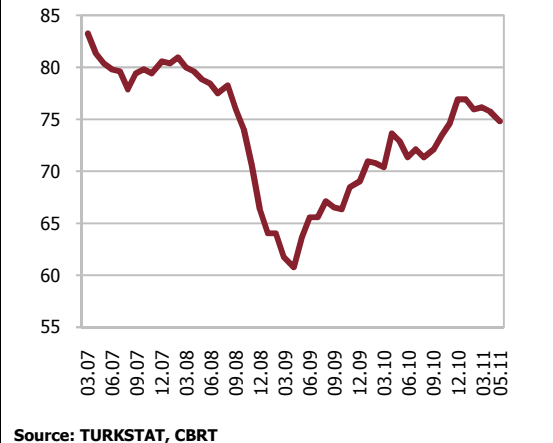
II. DOMESTIC ECONOMIC OUTLOOK

The divergence between growth dynamics of advanced and emerging economies accelerates capital inflows to countries like Turkey, with relatively stronger economic fundamentals. While domestic demand-driven growth continues, unemployment rates decline. These developments give way to concerns of overheating in Turkey, as in other emerging economies. However, the persisting low level of capacity utilization and moderate levels of services inflation suggest that there is no overheating in the economy. Nevertheless, indebtedness that surged on the back of accelerated capital inflows and credit expansion, the widening current account deficit resulting from the significant divergence between internal and external demand as well as the financing of this deficit by rather short-term funds feed the risks related to financial stability, and may hamper price stability over the medium-term. In order to ward off concerns over financial stability the Central Bank of Turkey has started to implement a new policy mix comprised of low policy rate, wide interest corridor and high required reserves in order to curb short-term capital inflows and restrain the surge in credits and the current account deficit. The effects of our bank's policies on short-term capital movements, credit growth and domestic demand have started to be observed in the second quarter of the year. However, both elevated levels of energy and other commodity prices and weaker external demand outlook postpone the improvement in the current account balance to the last quarter. Meanwhile, the budget balance continued to improve on the back of increased tax revenues owing to economic revival and limited public expenditures. The Central Bank will continue to monitor the impacts of the current policy mix on credit growth and the current account balance closely and take additional measures if needed.

Economic growth driven by domestic demand continues. GDP increased by 5.2 percent and 9.2 percent year-on-year, in the third and fourth quarter of 2010, respectively (Chart II.1). The slowdown observed in the third quarter was temporary and there was a strong increase in economic activity in the last quarter. Thus, the national income, which had contracted by 4.8 percent in 2009, grew by 8.9 percent in 2010. The growth of GDP was mainly attributable to final domestic demand. In 2010, while the total share of final domestic demand in GDP growth was 10.9 points, with a breakdown of 4.7 points from private consumption expenditures, 6 points from investment expenditures and 0.2 points from public consumption, the shares of net exports and stock changes were -4.4 points and 2.5 points, respectively. Industrial production and capacity utilization data pertaining to the first quarter of 2011 reveal that the economy continues to grow. In the first quarter of 2011, industrial production and the capacity utilization rate increased by 14.2 points and 5.7 points, respectively, compared to the same period of 2010 (Chart II.2).

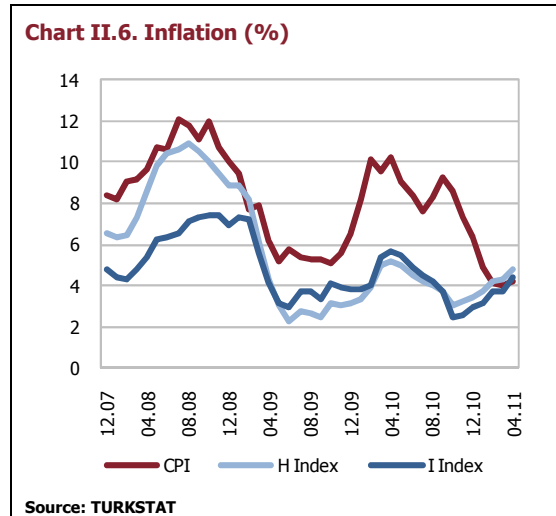
Chart II.1. GDP and Its Components (% Annual Contribution)**Chart II.2. Industrial Production and Capacity Utilization**

The GDP is still below its potential and the capacity utilization rate is yet to reach its pre-crisis level. Rapid recovery in the economy has led to concerns of overheating in Turkey as well as in other emerging economies. However, the real GDP is yet to reach its potential levels due to the weak external demand (Chart II.3). Moreover, the low level of capacity utilization rates in the manufacturing industry, with its recent downward trend, indicates that the total demand is not high enough to put pressure on inflation (Chart II.4).

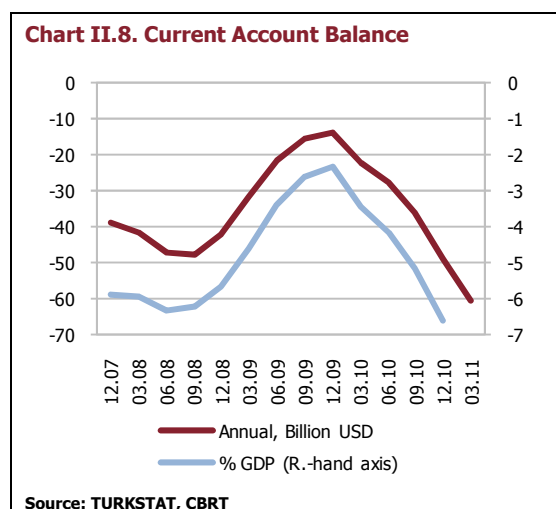
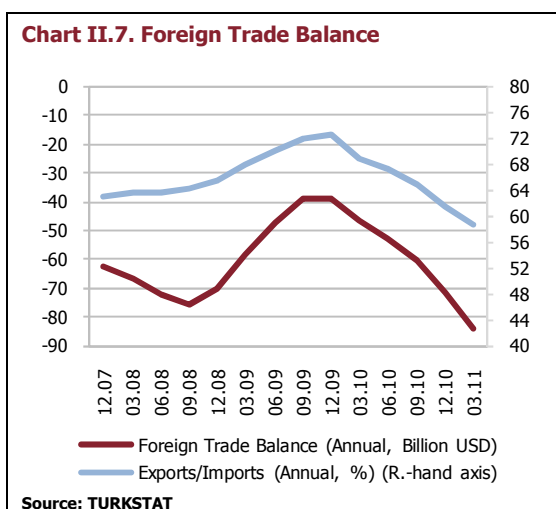
Chart II.3. GDP and Its Trend**Chart II.4. Seasonally Adjusted Capacity Utilization Rate (%)**

Although unemployment rates are approaching pre-crisis levels, core inflation indicators continue to remain consistent with medium-term targets. According to seasonally adjusted figures, unemployment rates, which had increased due to the global turmoil and economic contraction, started to decline in the first quarter of 2009 and approached pre-crisis levels in the first quarter of 2011, on the back of strong booms in employment (Chart II.5). Annual CPI growth remained low. While annual inflation was 4.3 percent in April 2011, core inflation indicators measured with H and I indices stood at 4.8 percent and 4.4 percent, respectively (Chart II.6). Annual inflation for H and I indices surged on the back of the rise in core goods prices stemming from the increase in imports prices and depreciation of the Turkish lira in the first four months of 2011. However, annual CPI inflation experienced a steep decline owing to the weakening of base effects from the January 2010 tax adjustments on fuels, alcoholic beverages and tobacco as well as the changes in unprocessed food prices and the favorable course of services prices. Especially the persisting low

levels of capacity utilization rate and moderate levels of inflation in the services sector signal that there is no overheating in the economy.

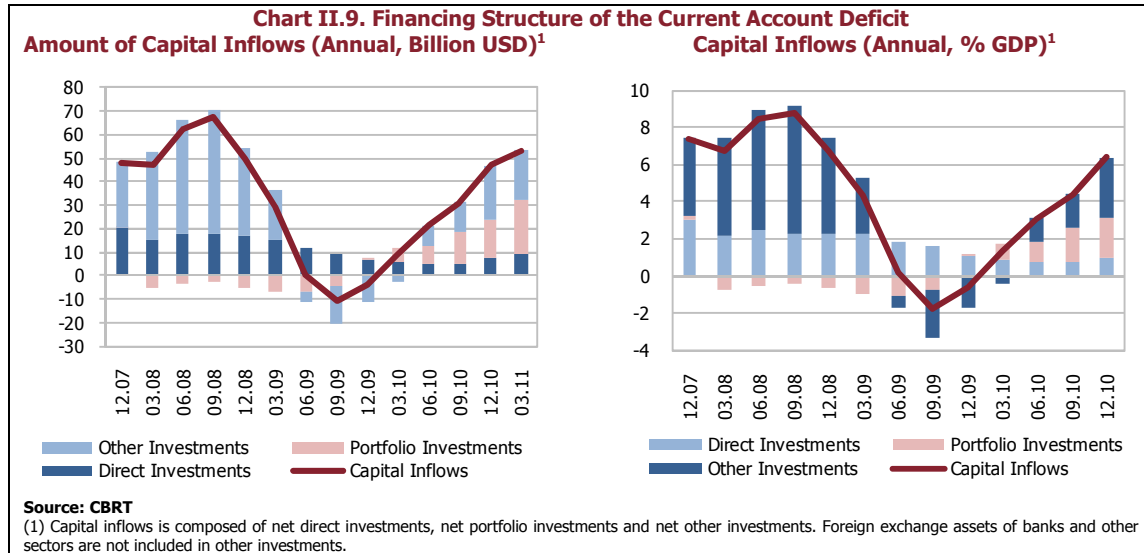


The current account deficit continues to widen. The foreign trade deficit, which contracted on the back of the economic slowdown due to the global crisis and the fall in commodity prices and declined to USD 38.8 billion by the end of 2009, started to gain ground with the economic revival. Despite the recovery in exports, as a result of the acceleration of demand for imported goods, the foreign trade deficit reached USD 83.7 billion year-on-year in March 2011 and recovery paces of internal and external demand diverged further. As a result of these developments, export/import coverage ratio, which had been 72.5 percent at end-2009, declined to 58.8 percent in annual terms in March 2011 (Chart II.7). The current account deficit that had declined to 2.3 percent of GDP at end-2009 due to the global turmoil and economic contraction started to rise again with the economic recovery and reached 6.6 percent of GDP by the end of 2010. Increasing further in 2011, the current account deficit climbed from USD 48.4 billion in 2010 to USD 60.5 billion year-on-year in March 2011 (Chart II.8).



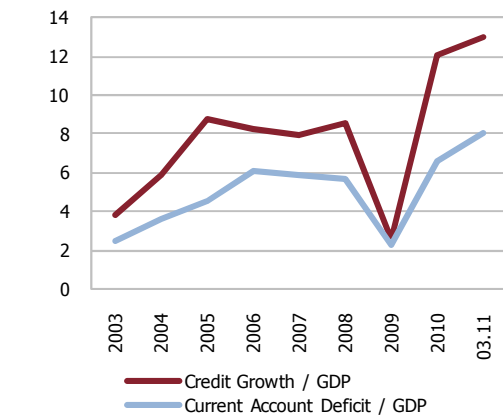
While the share of portfolio investments and other investments in the financing of the current account deficit increases, that of direct investments decreases. Increased global liquidity on the back of expansionary monetary policies implemented by advanced economies in the

aftermath of the global crisis accelerates capital inflows towards emerging economies. Capital inflows to Turkey also accelerated with the exit from the crisis and reached 6.4 percent of GDP by the end of 2010. This trend in capital flows also prevails in 2011. Net capital inflows, which had been USD 46.9 billion by the end of 2010, reached USD 53.2 billion year-on-year by March 2011. The capital inflows were composed of USD 23 billion of portfolio investments and USD 21 billion of other investments, while only USD 9.2 billion were from direct investments (Chart II.9). These figures reveal that short-term resources gained weight in financing the current account deficit.



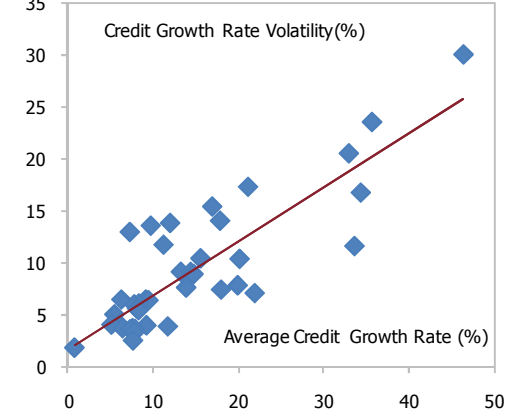
The upsurge in credits and current account deficit creates concerns over financial stability. Credit growth and the current account deficit follow a parallel trend (Chart II.10). Rapid credit growth is considered to cause widening in the current account deficit by strengthening domestic demand. Besides, the surge in the share of short-term capital inflows in financing the current account deficit makes the economy more vulnerable to potential changes in capital flows. Although the credit growth rate in emerging economies, which are in the initial stages of financial deepening, is expected to be higher than that of advanced economies; country cases suggest that important banking and balance of payments crises are related to rapid credit growth. Furthermore, it is observed that there is both a linear and positive relation between the credit growth rate and credit growth rate volatility (Chart II.11).³ High credit volatility also increased the size of fluctuations in economic growth and imposes a risk on financial stability. Therefore, reducing fluctuations in credits will support sustainability of growth by decreasing procyclicality in credit markets.

³ Please refer to: Special Topic V.1. Limitation of Credit Volatility.

Chart II.10. Credit Growth and Current Account Deficit (%)¹

Source: BRSA-CBRT

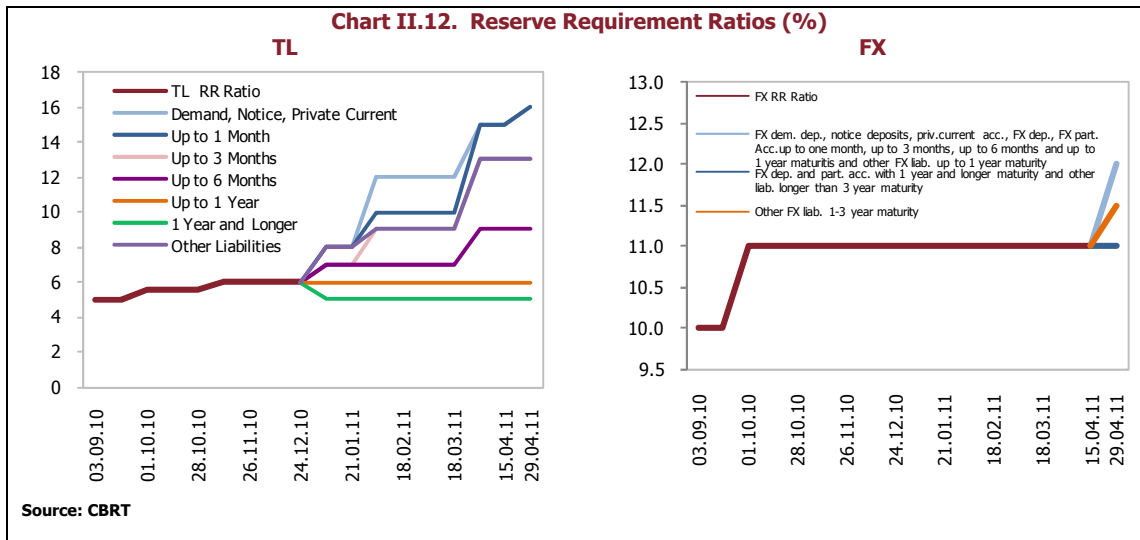
(1) GDP figure for March 2011 is forecast.

Chart II.11. Credit Volatility and Average Credit Growth Rate by Countries (2002-2010)¹

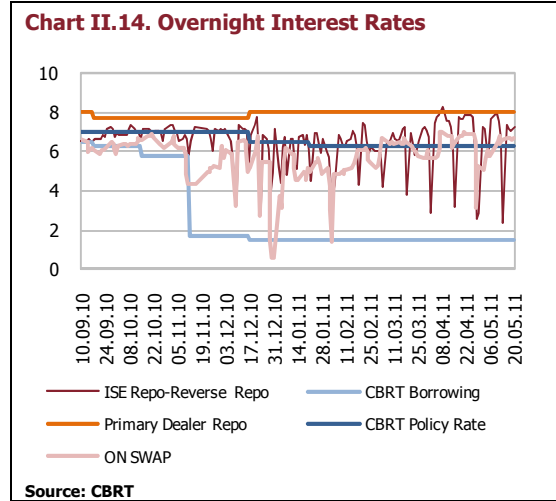
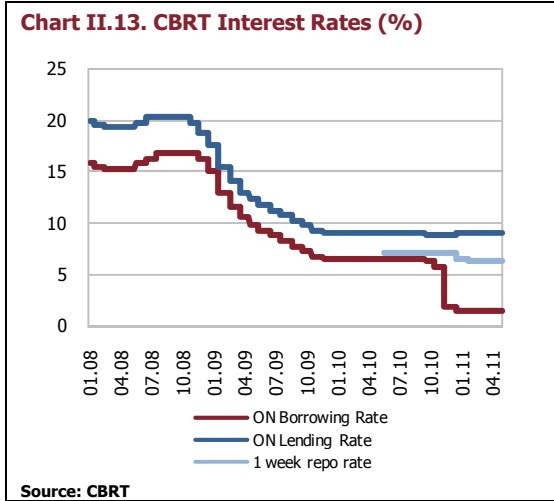
Source: IMF, CBRT Calculations

(1) In order to identify existence of a relation between credit growth rate and credit growth rate volatility, data (derived from the IMF database) regarding credits extended to private sector in 41 countries including Turkey, were used.

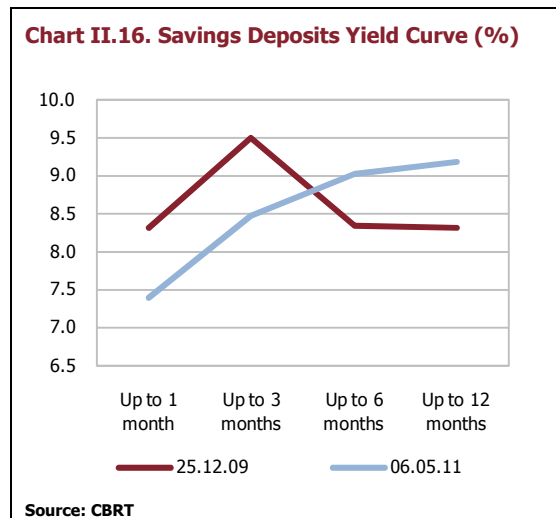
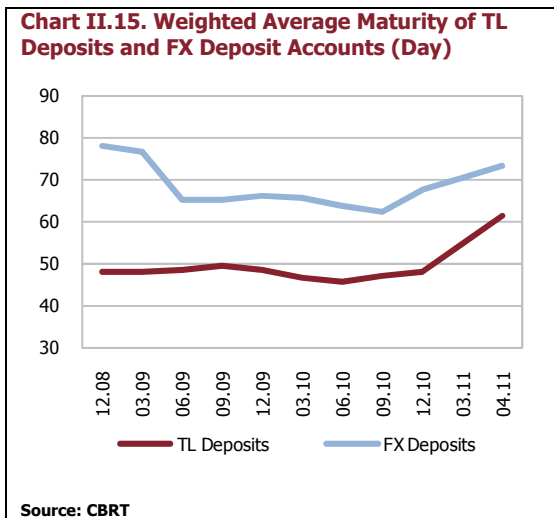
In this framework, reserve requirement ratios were increased and differentiated according to the maturity structure of liabilities in order to curb the credit growth rate and to reduce the maturity mismatch between banks' assets and liabilities. Reserve requirement ratios started to be used as an active policy tool since October 2010. Remuneration of the Turkish lira required reserves was terminated. Besides, reserve requirement ratios were differentiated -set higher for shorter maturities- from December so as to strengthen financial stability by lengthening the maturity structure of liabilities in the banking system (Chart II.12).



Furthermore, the Central Bank embarked on a policy of low policy rate and wide interest rate corridor in order to reduce short-term capital inflows. While the Central Bank decreased policy rates to curb short-term capital inflows, it widened the interest rate corridor and increased the volatility of short-term interest rates (Chart II.13 and II.14). These decisions aimed to extend the maturity of short-term capital inflows as well as to prevent the Turkish lira from becoming detached from economic fundamentals.



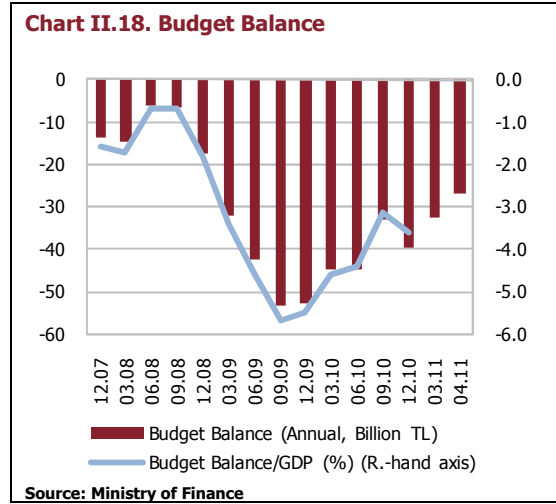
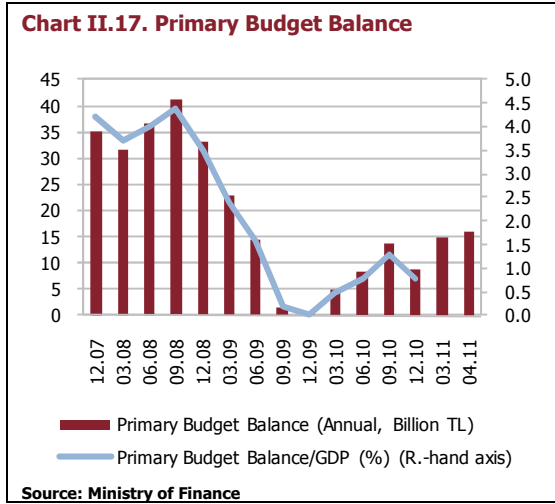
Initial impacts of the policy mix have started to be observed. Following the measures taken by the Central Bank, the acceleration in credits growth ceased, loan interest rates saw limited increases, the average maturity of deposits started to extend⁴ and the yield curve steepened (Chart II.15 and II.16). However, credit growth has not declined to reasonable levels for financial stability in the first quarter of 2011. Nevertheless, credit utilization is expected to slow down in the period ahead on the back of the lagged effect of monetary tightening.



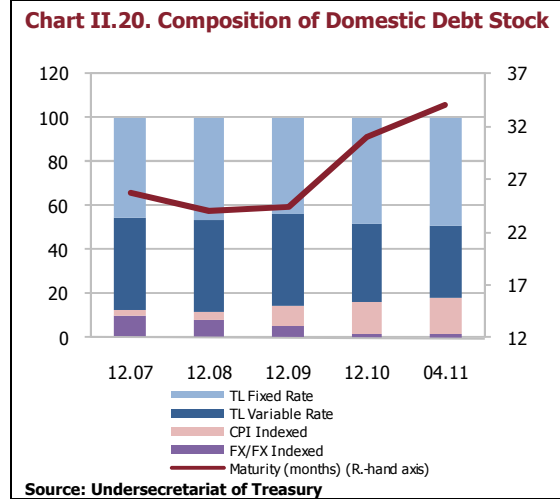
While monetary policy revealed a tight stance; faster than expected recovery of economic activity, public expenditures under control and the decline in interest expenses had a positive impact on public finance balance. In 2010, budget revenues increased on the back of the surge in domestic demand, interest expenses decreased with the fall of interest rates and primary expenditures rose relatively modestly. As a result, budget performance followed a positive trend and central government primary surplus, which had been TL 440 million in annual terms by the end of 2009, increased to TL 8.7 billion at end-2010. Central government budget deficit fell from TL 52.8 billion in 2009 to TL 39.6 billion in 2010. Thus, the budget deficit that had reached 5.5 percent of the GDP in 2009 declined to 3.6 percent in 2010 thereof. The improvement in the budget performance continues in the first four months of 2011. While tax revenues that increased in this period, coupled

⁴ Please refer to: Special Topic V.6. Maturity Structure of Deposits.

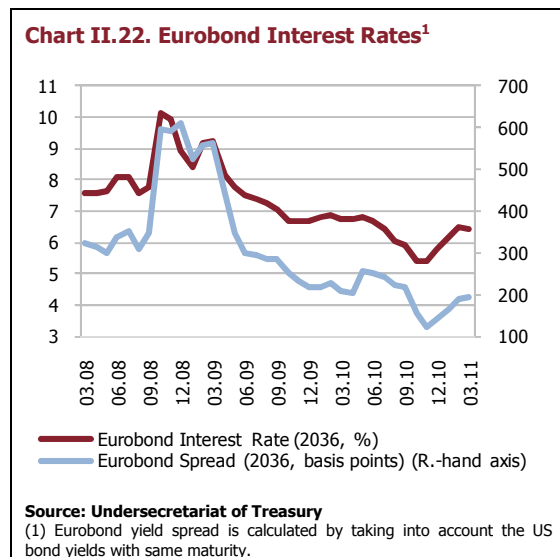
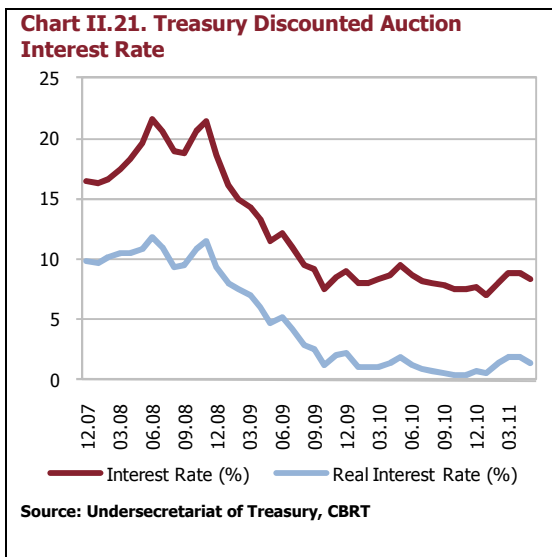
with the decline in interest expenses had a positive contribution to budgetary developments, the slowdown in the growth rate of primary expenditures supported the improvement in budget performance. Thus, the primary budget surplus was up to TL 16.2 billion year-on-year, whereas budget deficit was down to TL 26.9 billion by April 2011 (Chart II.17 and II.18). Containing public expenditures should be evaluated as a development supporting financial stability. Adherence to fiscal discipline in the medium-term is important in terms of ensuring its continuance and sustainability of the relative improvement in our sovereign risk.



Faster than envisaged recovery in economic activity and the limited rise in primary expenditures from the last quarter of 2009 affected public debt stock indicators positively. The rate of increase of central government debt stock, which had increased by 16.1 percent in 2009 to reach TL 441.5 billion, slowed down and increased by 7.3 percent in 2010 to reach TL 474 billion by year-end. Thus, the ratio of debt stock to GDP that had increased to 46.3 percent in 2009, declined to 42.9 percent in 2010 (Chart II.19). This positive outlook prevailed in the first quarter of 2011 as well. 74.1 percent of central government debt stock, which rose by 7 percent in annual terms to reach TL 486 billion by March 2011, is composed of domestic debts. As to the composition of domestic debt stock, the share of TL denominated fixed-rate debts and CPI-indexed debts increased in 2010 and 2011. In March 2011, the share of TL denominated fixed-rate debts in domestic debt stock increased by 5.6 points to become 49.5 percent and CPI-indexed debts increased by 7.2 points to become 16.2 percent, compared to end-2009. Moreover, the maturity of domestic debt stock also increased from 24 months in 2009 to 34 months in March 2011 (Chart II.20). The decline in the share of FX denominated and FX-indexed stock reduces sensitivity to exchange rate risk while the increase in the share of fixed income securities and extension of maturities reduces sensitivity to interest rate hikes, therefore both of them should be evaluated as a positive development.

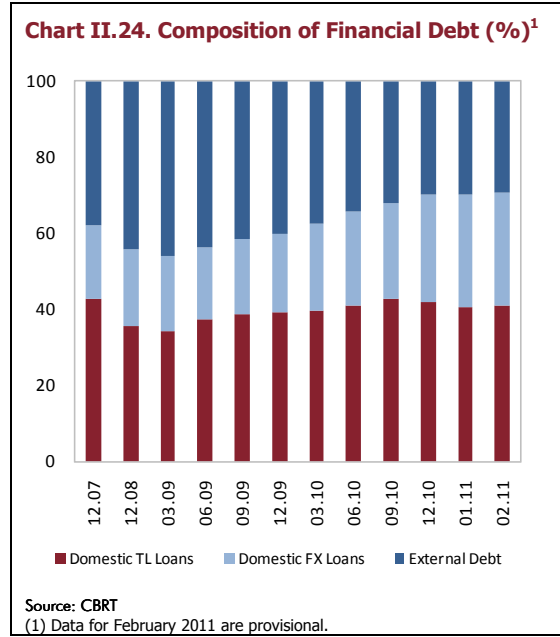
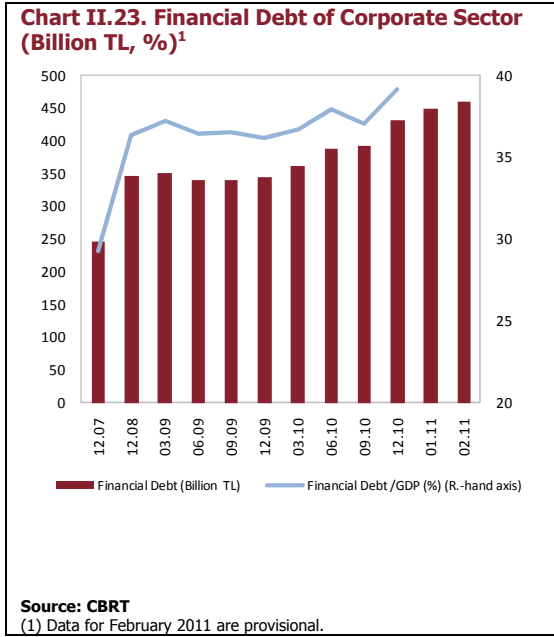


Borrowing costs of the public sector hover below the pre-crisis levels. The treasury discounted auction interest rate displayed a downward trend from early 2009 and is still at low levels despite increases in February and March 2011. The rate that was 8.9 percent as of March 2011 stands at 2 percent after being adjusted for 12-month inflation expectations (Chart II.21). The Eurobond interest rate to mature in 2036, which was 5.8 percent in December 2010, increased to 6.5 percent as of March 2011 on the back of concerns driven by the political unrest in MENA region and overlapping of oil price hikes with the widening of the current account deficit in Turkey. However, it still hovers somewhat below the pre-crisis level (Chart II.22).

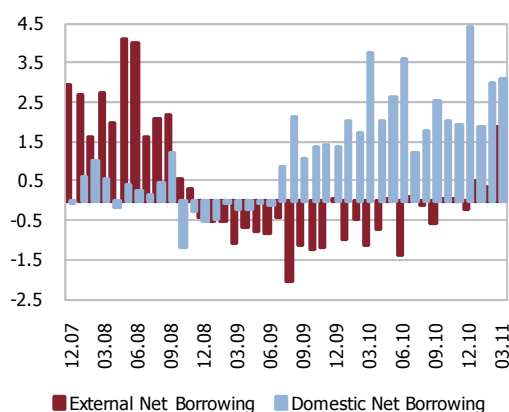


Corporate sector debt increases while the share of their foreign borrowing decreases. While no significant change was observed in corporate sector total financial debt in 2009, it increased gradually in 2010 and became TL 461 billion by February 2011. Consequently, the ratio of the corporate sector financial debt to GDP increased by 2.9 points year-on-year at end-2010 and reached 39.1 percent (Chart II.23). As of February 2011, 59 percent of corporate sector financial debt was denominated in foreign currency; however, the majority of this debt was long term. In the same period, the share of foreign borrowing in total loans was 29.2 percent, whereas the share of loans extended to the corporate sector by domestic and foreign branches and affiliates of Turkish banks in

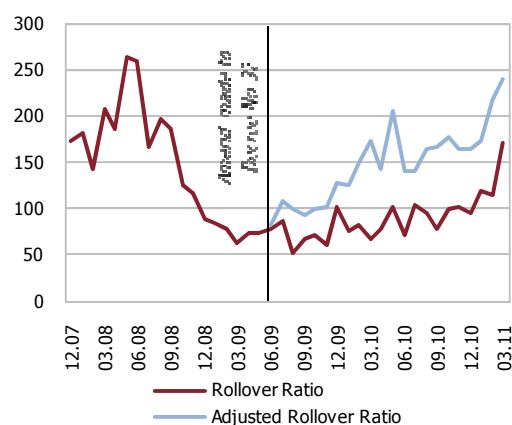
total loans increased by 1.8 points compared to September 2010 and reached 79.8 percent (Chart II.24).



After the amendment to Decree No. 32 in June 2009, firms shifted their credit utilization towards the domestic market and the external loans rollover ratio has displayed an upward trend since end-2010. Between June 2009, when Decree No.32 was amended, and February 2011, the amount of loans extended to the corporate sector by foreign branches and affiliates of Turkish banks decreased by USD 9 billion, whereas loans extended by foreign banks declined by USD 6.4 billion. On the other hand, FX loans extended by domestic branches of banks, increased by USD 43.9 billion (Chart II.25). According to balance of payments data, the external debt rollover ratio of non-banks was 171 percent as of March 2011; however, taking into consideration the increase in the volume of FX loans extended by domestic branches, the ratio is realized as 239 percent. The rapid increase in the external debt rollover ratio in March 2011 compared to end-2010 was mainly attributable to the surge in long-term external borrowing (Chart II.26).

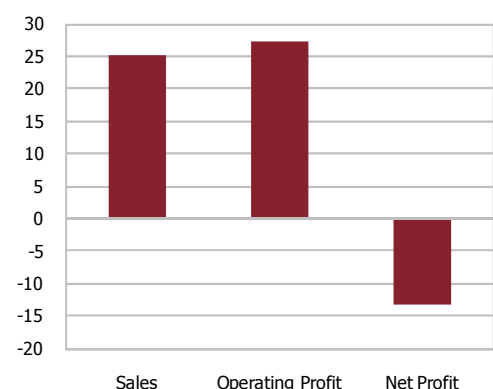
Chart II.25. Non-Bank Sector Net FX Borrowing (Billion USD)¹**Source: CBRT**

(1) Corporate sector net FX borrowing is computed by subtracting repayments from borrowings in the respective month.

Chart II.26. Non-Bank Sector External Debt Rollover Ratio (%)¹**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 due to the amendment to Decree No: 32, has been re-calculated by taking into account the rise in FX loans extended by domestic branches of Turkish banks and the rise in repayments to domestic branches of Turkish banks.

In addition to the rise in borrowing, corporate sector revenues from sales have also increased. While total amount of sales revenues of firms quoted on the Istanbul Stock Exchange (ISE) increased by 25 percent year-on-year in March 2011, operating profits increased by 28 percent; however, net profits decreased by 13.1 percent. Despite higher sales revenues and operating profits of firms, financial expenditures that increased on the back of increased provisions for exchange rate movements were instrumental in the decline of the net profit (Chart II.27). As a result of these developments, the return on equity, which was 3.72 percent in March 2010, declined to 2.95 percent in March 2011 (Table II.1). The decrease in the profit margin was influential on the decline of return on equity of firms. The surge in financial expenditures, which are excluded from operating profits, affected their profit margin negatively.

Chart II.27. Sales and Profitability of Firms by March 2011 (Annual % Change)¹**Source: PDP**

(1) Consolidated data of 227 manufacturing industry firms quoted on the ISE.

Table II.1. Return on Equity and Its Components¹

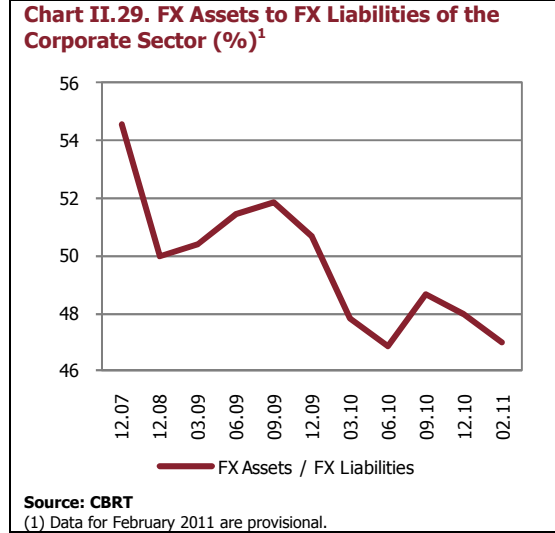
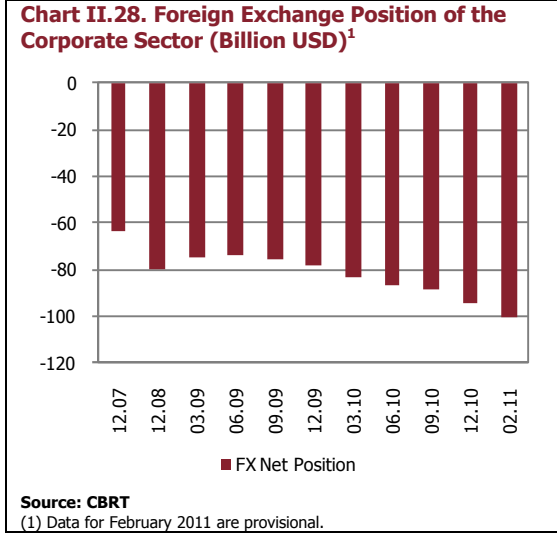
	Mar.10	Mar.11
Net Profit / Equity (%)	3.73	2.95
Assets / Equity	2.07	2.13
Net Profit / Assets (%)	1.80	1.38
Sales / Assets	0.23	0.25
Net Profit / Sales (%)	7.87	5.45
Operating Profit / Sales (%)	8.00	8.15
Financial Income (Expenditures) / Sales (%)	1.47	-1.31

Source: PDP

(1) Consolidated data of 217 manufacturing industry firms quoted on the ISE.

The FX assets and liabilities of firms suggest that the net FX short position has increased and currency risk still remains important for them. The net short position of the corporate sector, which started to decrease after the global crisis, assumed an upward trend with the

economic recovery. The FX short position that declined by 2.5 percent year-on-year in 2009 increased by 28.6 percent in February 2011 and reached USD 100.1 billion (Chart II.28). As of February 2011, the ratio of FX assets to FX liabilities went down by 1.6 points from the last quarter of 2010 and declined to 47 percent (Chart II.29).



While household liabilities increased, the ratio of interest payments to disposable income decreased. The rebound in economic activity and increased consumer confidence boost the demand for consumer loans; as a result, household indebtedness continues to rise. The ratio of household liabilities to GDP, which had been 15.4 percent in 2009, went up to 17.3 percent in 2010 (Chart II.30). However, household disposable income increased owing to the recovery in the labor market and their borrowing costs dropped on the back of lower interest rates on loans. Thus, the ratio of household interest payments to disposable income, which had been 5.2 percent in 2009, declined to 4.4 percent in 2010 (Table II.2).

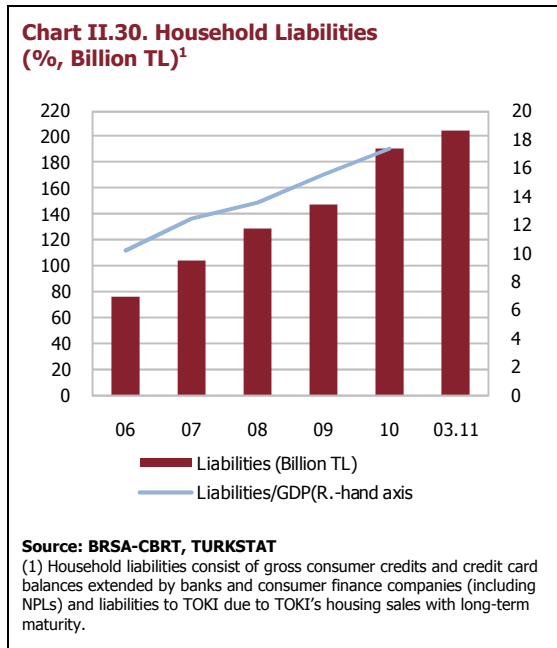


Table II.2. Household Disposable Income/Liabilities and Interest Payments (Billion TL)^{1,2,3}

	2008	2009	2010
Household Disp. Income	352.8	408.9	463.9
Household Liabilities	128.9	147.1	191.1
Household Interest Payments	19.7	21.1	20.4
Interest Paym. / Hh. Disp. Income (%)	5.6	5.2	4.4
Liabilities / Hh. Disp. Income (%)	36.6	36	41.2

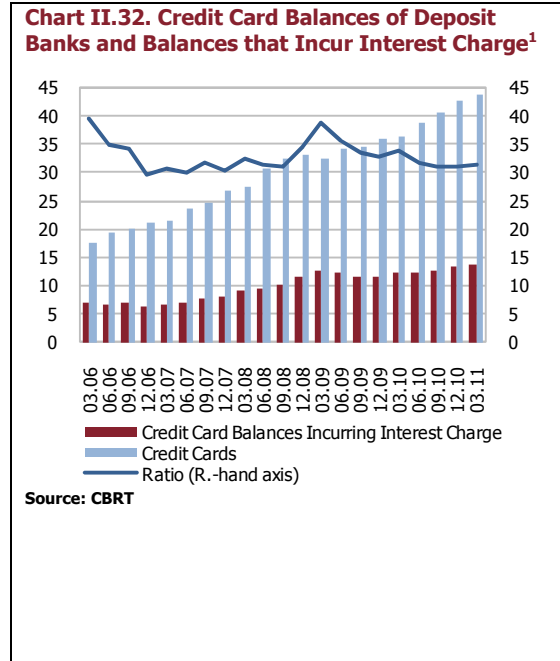
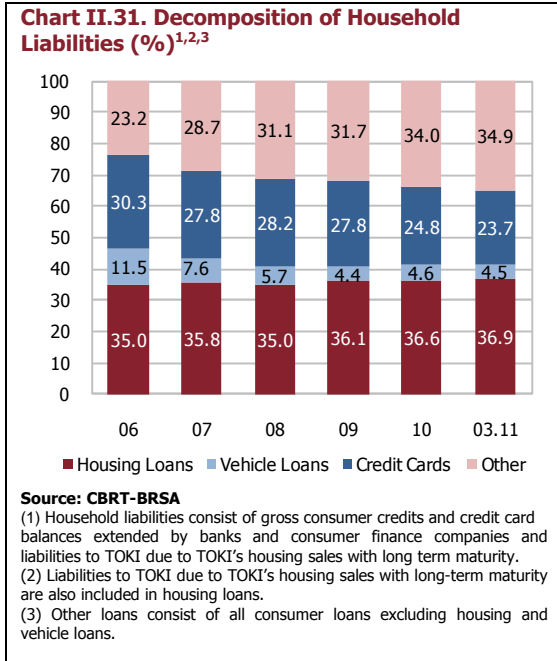
Source: BRSA-CBRT, TURKSTAT, SPO

(1) Household liabilities consist of gross consumer credits and credit card balances extended by banks and consumer finance companies (including NPLs) 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 has been calculated by using the private sector disposable income estimation for 2010 as mentioned in the 2011 Annual Program, assuming that the ratio of household disposable income for 2009, which was generated from the Income and Living Conditions Survey, to private sector disposable income has not changed.

While the share of other and housing loans within household liabilities has increased, that of vehicle loans has increased modestly and the share of credit cards has decreased. When the development of household liabilities is analyzed by type, it is observed that other loans increased by 53 percent, housing loans went up by 42 percent, vehicle loans surged by 43.6 percent and credit card balances increased by 18.4 percent in March 2011 compared to end-2009 figures. As a result of these developments, while the share of other loans, housing loans and vehicle loans within household liabilities increased, that of credit cards decreased (Chart II.31). Although credit card balances continued to rise in 2010 and 2011, the ratio of credit card balances that incur interest charges to total credit card balances declined compared to end-2009 (Chart II.32).



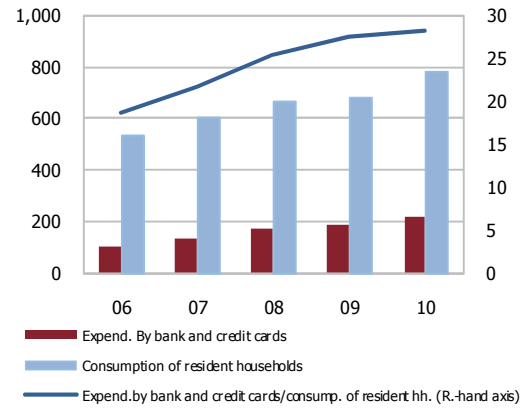
The number of consumer loan and credit card defaulters has decreased while the share of utilization of bank and credit cards in expenditures has increased. According to the Central Bank Risk Center data, the number of consumer loan and credit card defaulters, which was 1,721,004 at end-2009, decreased to 1,626,024 by March 2011 (Table II.3). The ratio of expenditures by bank and credits cards in private final consumption expenditures was 18.8 percent in 2006, this ratio increased gradually over years and though with a lower rate of increase in 2010, it reached 28.2 percent (Chart II.33).

Table II.3. Number of Credit Card and Consumer Loan Defaulters¹

	2008	2009	2010	03.11
Banks	997,095	1,489,131	1,319,111	1,254,737
Asset Management Companies ²	139,862	330,156	574,541	578,475
Finance Companies	21,884	23,463	18,003	17,324
Total ³	1,093,474	1,721,004	1,689,788	1,626,024

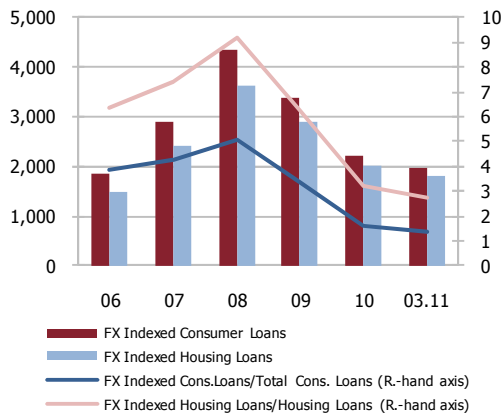
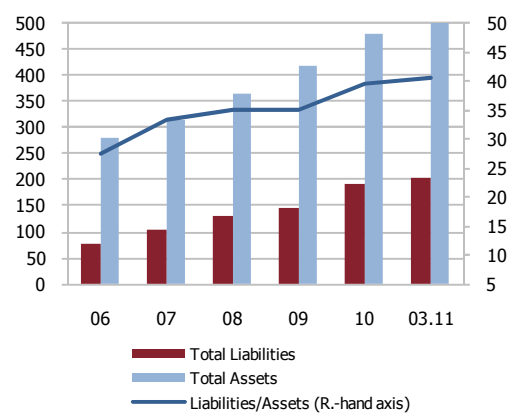
Source: CBRT

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

Chart II.33 Expenditures by Bank and Credit Cards and Consumption of Resident Households (Billion TL, %)¹**Source: TURKSTAT, ICC**

- (1) In order to calculate the amount of expenditures by bank and credit cards amounts derived from domestic and external utilization of bank and credit cards issued in Turkey are used.

Household liabilities do not bear interest rate and exchange rate risk. Most household liabilities in Turkey are denominated in Turkish liras. As households in Turkey are not allowed to borrow in foreign currency as per the amendment to Decree No. 32 in June 2009, the share of FX-indexed credits decrease gradually and households do not take on FX-denominated debts. The ratio of FX-indexed consumer loans to total consumer loans, which was 3.4 percent in 2009, decreased to 1.6 percent at end-2010 and went down to 1.3 percent in March 2011 (Chart II. 34). Besides the low level of exchange rate risk they are exposed to, most of the loans granted to households do not bear a significant interest rate risk, as they are fixed-rate loans.

Chart II.34. FX-Indexed Consumer Loans and FX-Indexed Housing Loans (Million TL, %)**Source: CBRT-BRSA****Chart II.35. 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 (since December 2006). Household liabilities consist of gross consumer credits (including NPLs) and credit card balances (including NPLs) extended by banks and consumer finance companies and liabilities to TOKI due to TOKI's housing sales with long-term maturity.

The ratio of household liabilities to assets has increased. The ratio of household liabilities to financial assets, which had declined slightly during the crisis, increased to 39.7 percent due to liabilities rising faster than assets in 2010 and went up to reach 40.7 percent by March 2011

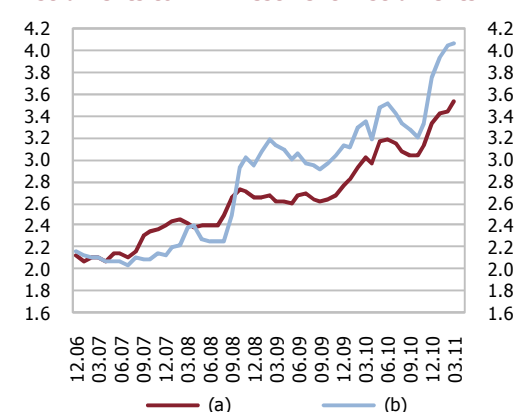
(Chart II.35). The total assets of household, which was TL 420 billion in 2009, surged to TL 482 billion in 2010 and to TL 503 billion in March 2011. The share of TL deposits, which constitutes the largest portion of household assets, went up in 2010 and 2011 compared to 2009. The share of FX deposit accounts in financial assets declined compared to 2009. Accordingly, the ratio of TL investment instruments to FX investment instruments increased compared to end-2009. Moreover, the share of government securities and Eurobonds decreased due to their low yields, while the share of equities and private pension funds increased (Table II.4 and Chart II.36).

Table II.4. Composition of Household Financial Assets (Billion TL, %)¹

	2009		2010		03.11	
	Billion TL	Share	Billion TL	Share	Billion TL	Share
TL Deposits	209.6	49.9	253.8	52.7	266.9	53.1
FX Deposits	98.2	23.4	96.9	20.1	96.3	19.2
- FX Deposits (Billion USD)	65.2	-	62.7	-	62.3	-
Currency in Circulation	35.4	8.4	44.6	9.3	47.1	9.4
GDDS+Euro bond	14.1	3.3	9.4	2.0	10.1	2.0
Mutual Funds	26.1	6.2	28.5	5.9	28.7	5.7
Stocks	24.6	5.9	32.6	6.8	35.8	7.1
Private Pension Funds	9.0	2.1	12.1	2.5	12.4	2.5
Repos	2.3	0.5	1.5	0.3	1.9	0.4
Precious Metal Deposits	1.1	0.3	2.3	0.5	3.3	0.7
Total Assets	420.4	100	481.7	100	502.5	100

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

Chart II. 36. Ratio of Household TL Investment Instruments to FX Investment Instruments¹



Source BRSA-CBRT, CMB, CRA

(1) TL Instruments = Deposits + Repos + GDDS. + Participation Funds (TL) + Stocks + Private Pension Funds + Mutual Funds (starting from April 2006); 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 29.12.2006 is used and the parity effect is eliminated.

In the forthcoming period, the vulnerability of financial stability might increase in the face of short-term capital inflows that may remain strong, high growth rate in credit volume and persistent expansion in the current account deficit. While downside risks regarding the global economy persist, upside risks become important as well. Uncertainties over sustainability of debt dynamics and problems regarding credit, real estate and labor markets prevail in many developed countries. Besides, hikes in oil prices also impose a downside risk on the pace of global economic recovery. Short-term capital inflows might remain strong in the case of a slower than expected recovery in advanced economies, hence the rise in credits and the current account deficit may continue. Meanwhile, faster than expected recovery in global economic activity might give way to inflationary pressures in advanced economies in the upcoming period. This development might lead to a rise in global policy rates and a deviation in the direction of capital flows. The CBRT, considering external demand, capital flows and increased indebtedness of households and firms, will continue to use macroprudential policy instruments effectively in the forthcoming period as well.

Recent concerns over sustainability of increased public debt especially in some Euro area countries have relatively weakened short-term capital inflows towards emerging economies. Accordingly, the daily auction amount of our foreign exchange buying auctions was reduced from USD 50 million to USD 40 million. Should this trend continue, the CBRT might continue to reduce the daily auction amount for FX purchases gradually. In such a case, the amount of TL liquidity to be provided to the market by this channel will also decrease, which, in turn, will ease the

potential need for additional increases in required reserve ratios with respect to credit growth in the second half of 2011. In the upcoming period, additional measures that might be taken by other public authorities in coordination with the CBRT will similarly reduce the need for further increases in reserve requirement ratios.