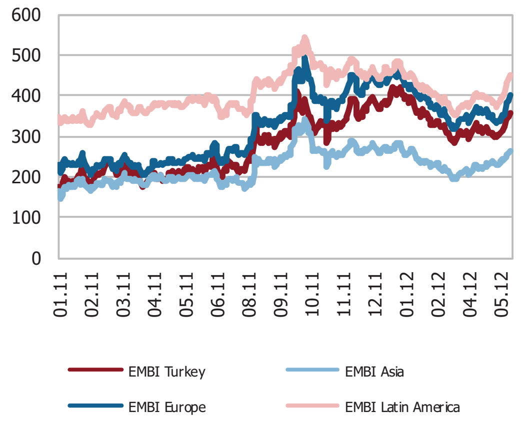
II. DOMESTIC ECONOMIC OUTLOOK

Vulnerabilities in global financial markets and developments in the global economy continue to affect the Turkish economy. In 2011, economic activity remained strong, albeit with a slowdown, and growth in domestic demand was contained with the measures taken by the Central Bank of the Republic of Turkey and other authorities. Meanwhile, the contribution of net exports to growth significantly increased and the rebalancing in demand components continued. Since August 2011, the depreciation of TL against USD has remained limited compared to other currencies owing to the tight monetary policy stance of the CBRT coupled with the favorable global risk appetite in the first quarter of 2012. The positive trend of the foreign trade balance continued in the first quarter of 2012 and consequently, the improvement in the current account balance was markedly reflected in the 12 month cumulative data. Moreover, the share of long-term borrowings in financing the current account deficit remains high. Total loans and consumer loans continue to rise at a moderate pace, the growth rate of household liabilities slow down beginning from the second half of 2011 and corporate liabilities decreased compared to 2011 year-end. Public finance indicators continued to be encouraging on the back of the rise in tax revenues owing to strong economic activity and curbed public spending. Inflation displayed an upturn in the second half of 2011 due to the depreciation of Turkish lira and arrangements in administered prices. Since economic rebalancing continued as predicted and the growth composition achieved a sounder basis, the CBRT started to tighten monetary policy as of October 2011 with the aim of preventing any deterioration in inflation expectations and to control pricing behavior. In the upcoming period, the CBRT will continue to take all necessary measures to ensure the primary objective of price stability as well as financial stability.

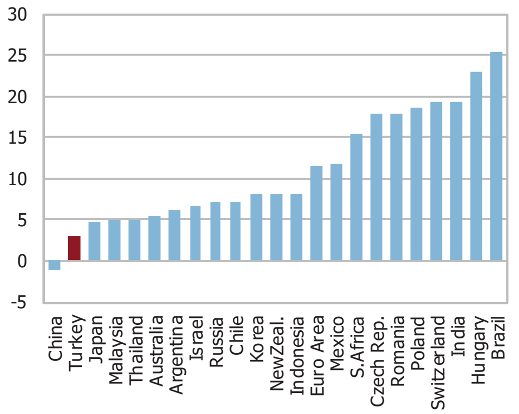
In the first quarter of 2012, Turkey's risk premium decreased due to developments in the global risk appetite and rebounded as of the beginning of the second quarter as the improvement in perceptions regarding the global economy were disrupted. In the last quarter of 2011, the deterioration in risk perceptions towards developing countries continued due to escalating problems in the Euro area. In the first quarter of 2012, concerns over this area were eased stimulating a notable improvement in the global risk appetite and a decline in the risk premia of developing countries; however, the risk premia bounced back as the improvement in perceptions were disrupted at the beginning of the second quarter. In the period subject to analysis, Turkey's risk premium followed a similar path with other developing countries (Chart II.1). Although depreciation of Turkish lira against USD between November 2010 and August 2011 was higher compared to depreciation of other currencies against USD, since August 2011 the depreciation of Turkish lira against USD has been limited compared to the depreciation of other currencies owing to CBRT's provision of foreign exchange liquidity amounting to USD 16 billion, the tight monetary policy stance and the positive global risk appetite in the first quarter of 2012 (Chart II.2).

Chart II.1. EMBI



Source: Bloomberg

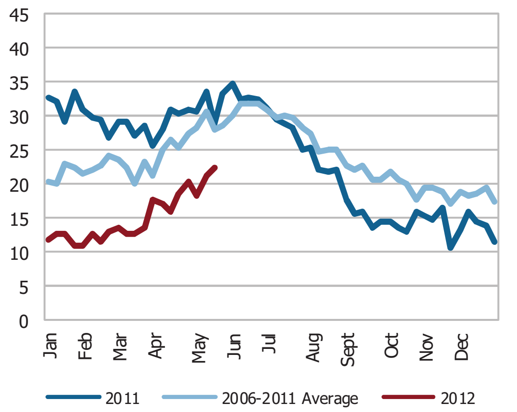
Chart II.2. Nominal Exchange Rates (23.08.2011-16.05.2012, Percentage Change)[1]



Source: Bloomberg, CBRT
(1) A positive value points to depreciation against USD.

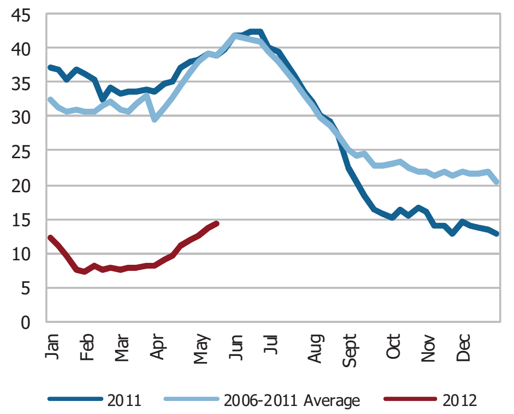
Growth in total loans and consumer loans is reasonable. The annual rate of growth in seasonally adjusted loans, which was higher in the first half 2011 compared to the average value of previous years, has been significantly slowing down since mid-2011. Although credit growth, which was 22.4 percent by mid-May 2012, is below the average values of 2010 and the previous years, it contains some seasonal effects (Chart II.3). Consumer loans grew at a subdued pace and credit growth was mainly driven by corporate loans as intended. By mid-May 2012, growth in consumer loans and corporate loans were 14.4 percent and 25.1 percent, respectively (Chart II.4).

Chart II.3. Growth in Total Loans (%) [1,2]



Source: BRSA- CBRT
(1) Exchange rate effect-adjusted data have been used. The basket value used to adjust for exchange rate effect is composed of 70 percent USD and 30 percent Euro. FX-indexed loans have been compiled under FX Loans.
(2) The 13-week average of annualized weekly changes has been calculated.

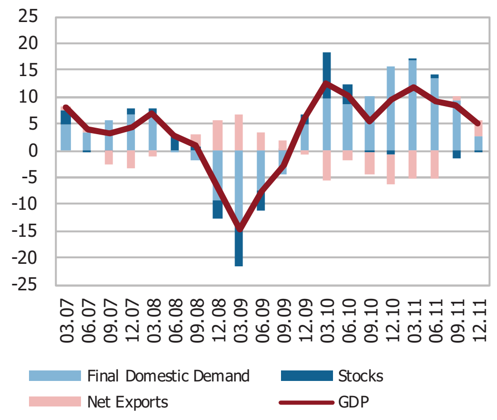
Chart II.4. Growth in Consumer Loans (%) [1,2]



Source: BRSA-CBRT
(1) Exchange rate effect-adjusted data have been used. The basket value used to adjust for exchange rate effect is composed of 70 percent USD and 30 percent Euro. FX-indexed loans have been compiled under FX Loans.
(2) 13-week average of annualized weekly changes has been calculated.

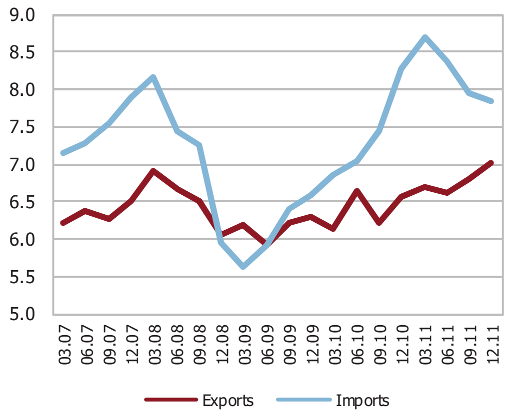
In 2011, economic activity was robust, albeit with decreased pace while growth of domestic demand was contained and the net exports' contribution to growth significantly increased. The GDP grew by 8.4 percent and 5.2 percent annually in third and fourth quarters of 2011, respectively. Thus, GDP, which grew by 9.2 percent in 2010, increased by 8.5 percent in 2011. Economic activity lost pace as of the first quarter of 2011. Even if growth in the GDP was mainly driven by domestic demand, the contribution of domestic demand to growth significantly decreased especially during the last two quarters while that of net exports was positive and net external demand became the expenditure component making the highest contribution to growth (Chart II.5). Underpinned by the depreciation of the Turkish lira and the rise in Turkey's share in alternative markets such as Africa and the Middle East, exports turned positive by mid-2011 while imports decreased due to the depreciation of the Turkish lira and decrease in domestic demand resulted from the measures taken (Chart II.6). This picture suggests that the rebalancing among demand components increasingly continues.

Chart II.5. GDP and Its Components (%, Annual Contribution)



Source: TURKSTAT

Chart II.6. Imports and Exports of Goods and Services (Billion TL)[1]

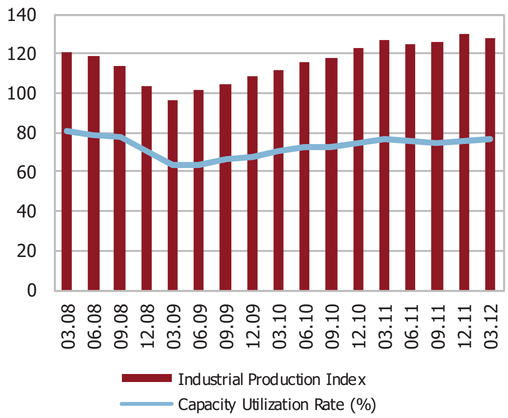


Source: TURKSTAT, CBRT

(1) Seasonally adjusted national accounts at 1998 constant prices are used.

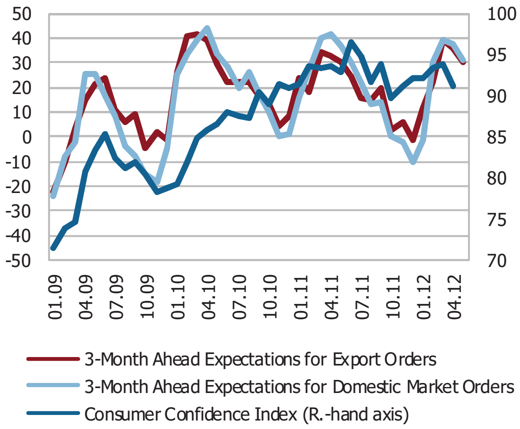
Even if data pertaining to the first quarter of 2012 suggest that the slowdown in economic activity continues, growth is expected to follow a modest trend throughout 2012. Data pertaining to industrial production and capacity utilization for the first quarter of 2012 indicate that the slowdown in economic activity continued in this quarter as well. In seasonally adjusted terms, the quarterly average capacity utilization rates of manufacturing industry in March 2012 are very close to the average values of the previous quarter while the quarterly average of the industrial production index is below the quarterly average of the previous quarter (Chart II.7). Nevertheless, the mentioned developments are believed to reflect mainly some temporary factors such as external uncertainties and adverse weather conditions. As indicators reflecting expectations about the economy such as consumer confidence indices and order expectations exhibit moderate signs of recovery (Chart II.8), it is predicted that production would rebound as of the second quarter and economic growth would continue albeit at a slower pace compared to previous years.

Chart II.7. Industrial Production and Capacity Utilization (2005=100, Quarterly Average)[1]



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

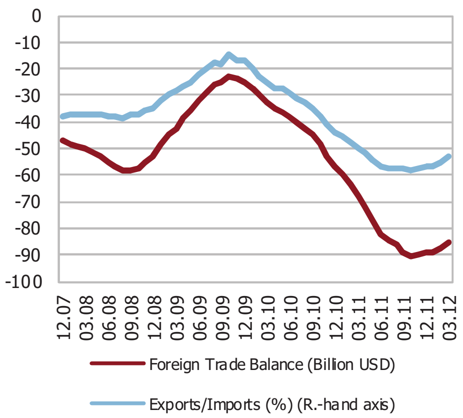
Chart II.8. 3-Month Ahead Expectations for Orders (%) and Consumer Confidence Index



Source: CBRT, TURKSTAT

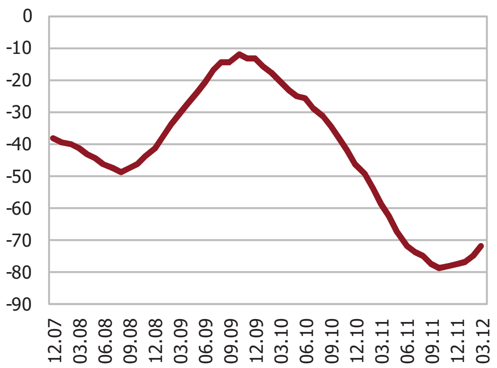
The positive trend in the foreign trade balance continued in the first quarter of 2012 and thus, the improvement in the current account balance is observed evidently on 12-month cumulative data. The foreign trade balance, which was USD 89.5 billion at the end of 2011, decreased to USD 85.5 billion in March 2012, in annual terms. The ratio of imports covered by exports, which was 61.6 percent at the end of 2011, rose to 63.3 percent as of March 2012 (Chart II.9). In tandem with improvement in the foreign trade balance, the current account deficit, which was USD 77.2 billion annually at the end of 2011, decreased to USD 71.8 billion in March 2012 despite the rise in energy prices (Chart II.10). Owing to continued rebalancing in demand components in the first quarter, the improvement in the current account balance became clearer in the 12-month cumulative data.

Chart II.9. Foreign Trade Balance



Source: CBRT

Chart II.10. Current Account Deficit (Annual, Billion USD)

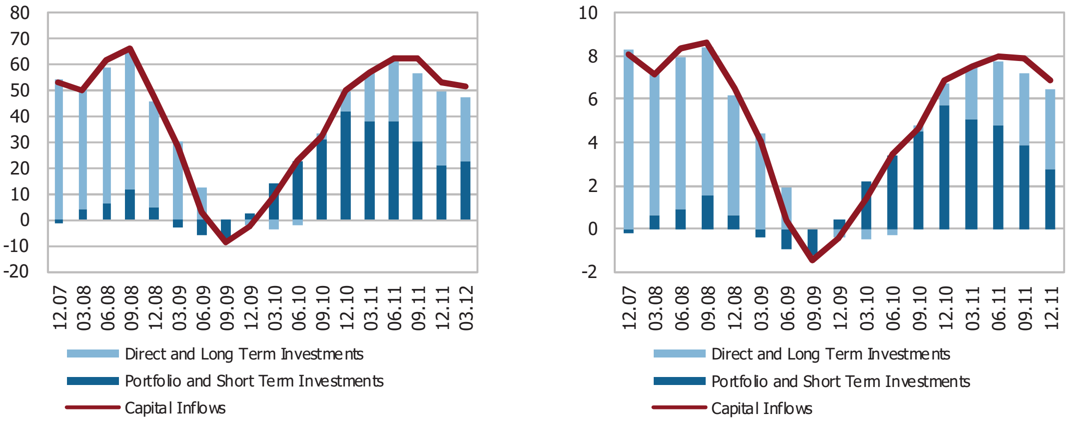


Source: CBRT

The share of long-term borrowing in financing the current account deficit is higher compared to that of the crisis period. The ratio of annual net capital inflows to GDP, which was 6.8 percent at the end of 2010, became 6.9 percent at the end of 2011 (Chart II.11). While the share of direct investments and long-term inflows in capital inflows has increased significantly compared to end-2010, this reveals that the quality of financing of the current account deficit improved and a change has occurred in favor of long-term capital inflows in the said period.

Chart II.11. Financing Structure of the Current Account Deficit

Amount of Capital Inflows (Annual, Billion USD)[1] **Capital Inflows (Annual, GDP%)[1]**

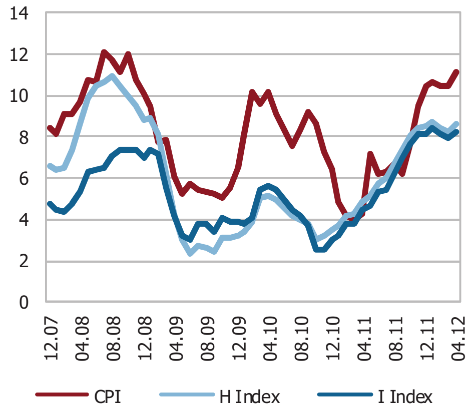


Source: CBRT

(1) Portfolio and short-term capital flows is composed of equities, domestic debt securities of government and banks, short-term loans of banks and other sectors and deposits at banks. Long-term capital flows is composed of long-term net loans of banks and other sectors and bonds issued abroad by banks and the Treasury.

Depreciation of the Turkish lira in the second half of 2011 coupled with price adjustments in administered products and higher energy prices led to a rise in inflation. The annual consumer prices index (CPI), which was 6.4 percent at the end of 2010, rose to 11.1 percent in April 2012 due to increased prices of core goods stemming from the depreciation in the Turkish lira, price adjustments in administered products and the faster-than expected rise in energy prices. In the same period, prices of services, which followed a moderate trend, became a factor curbing a further rise in the CPI. Annual inflation in core inflation indicators H and I, followed a similar to that of annual inflation in core goods and became 8.6 percent and 8.2 percent, respectively (Chart II.12). Inflation expectations, which displayed an upward trend towards the end of the year, remained flat in the first quarter of 2012. Inflation expectations over the next 12 and 24 months became 7 percent and 6.3 percent at the end of May (Chart II.13). Inflation is expected to follow a fluctuating trend in the upcoming period and then assume a downward trend in the last quarter of the year.

Chart II.12. Inflation (Annual, %)



Source: TURKSTAT

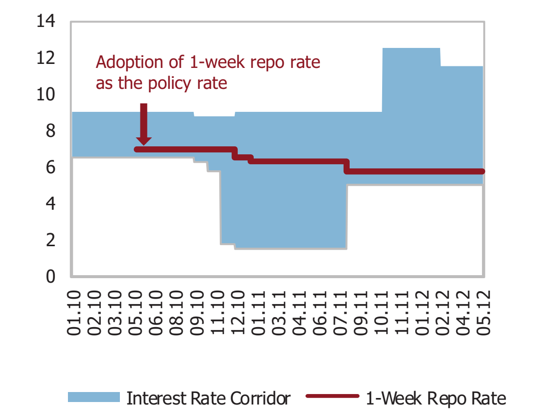
Chart II.13. 12 and 24 Month Ahead CPI Expectations (%)

Source: CBRT

Besides the macroprudential measures that it had been implementing, the CBRT started to focus on price stability from October 2011 to prevent any deterioration in

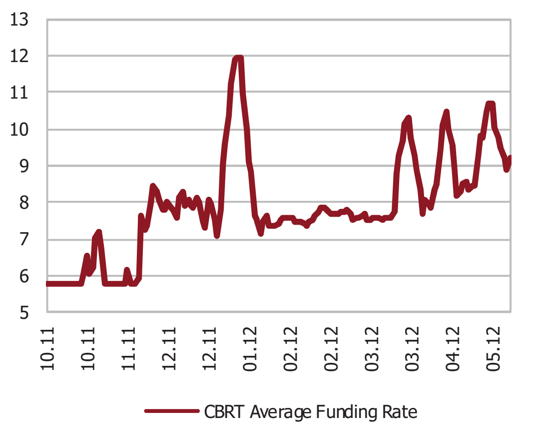
pricing behaviors that can be triggered by the rise in inflation. The economic rebalancing process helped to achieve a sounder structure in the growth composition and the current account deficit started to narrow as predicted. Meanwhile, in order to prevent the recent rise in inflation from causing deterioration in pricing behavior, the CBRT focused on price stability. Accordingly, from October 2011, the interest rate corridor was widened upwards and a strong monetary tightening was implemented with effective liquidity operations. Moreover, taking advantage of the flexibility of the monetary policy implemented, additional monetary tightening operations have been held a total of 4 times: in December, March, April and May. In the mentioned tightening periods, the CBRT decreased the amount of funding in the quantity auctions and thus, raised the average cost of liquidity that it provided to the market. Meanwhile, acting upon the favorable atmosphere related to the agreement reached for the settlement of debt problems in the Euro area and the increased global risk appetite, The Monetary Policy Committee (MPC) slightly decreased the overnight lending rate -the upper limit of the interest rate corridor- to 11.5 percent (Chart II.14, Chart II.15).

Chart II.14. CBRT Interest Rates (%)



Source: CBRT

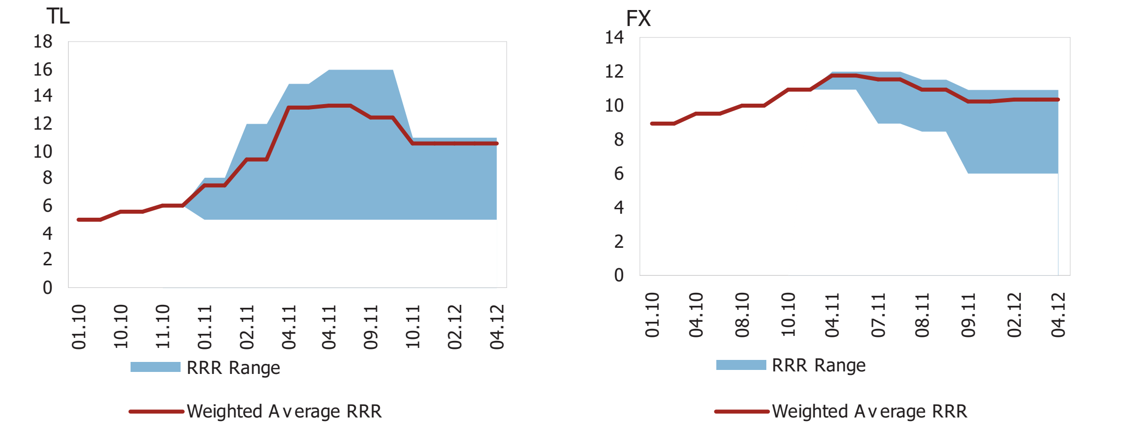
Chart II.15. CBRT Weighted Average Funding Cost (%)



Source: CBRT

The CBRT continues to actively use required reserves and the export rediscount credit facility to maintain effective liquidity management and to strengthen reserves. The reserve requirement ratios have not changed since October 2011 and the weighted average Turkish lira reserve requirement ratio has been 10.5 percent and the foreign exchange reserve requirement ratio has been 10.3 percent (Chart II.16).

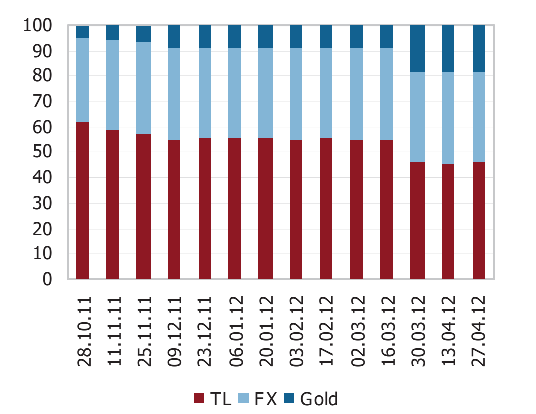
Chart II.16. Reserve Requirement Ratios (%)



Source: CBRT

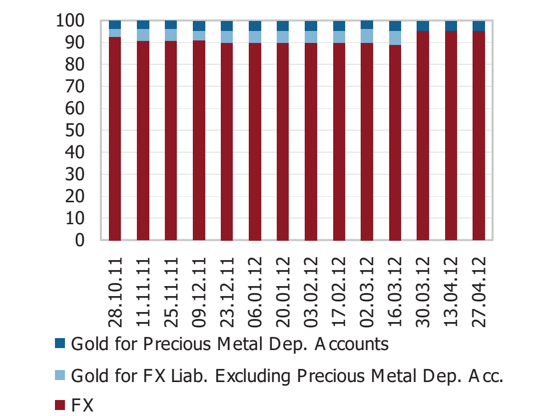
In the framework of the macroprudential policies, in March 2012, the reserve requirement implementation was changed so as to strengthen foreign exchange and gold reserves and meet banks' liquidity requirements in a lasting and flexible manner. Accordingly, while the upper limit for gold that may be held to meet Turkish lira reserve requirements was raised from 10 percent to 20 percent; the limit for gold that may be held to meet reserve requirements for foreign currency liabilities excluding precious metal deposit accounts was decreased from 10 percent to 0 percent. Owing to the new regulation, which took effect as of the calculation period starting on 30 March 2012 and from the maintenance period commencing on 13 April 2012, the ratio of gold maintained for Turkish lira required reserves increased from 8.9 percent to 18.2 percent as of the maintenance period starting on 27 April 2012 (Chart II.17, Chart II.18). The changes stimulated a rise of USD 1.3 billion in CBRT's FX reserves and USD 1.5 billion in gold reserves (27 tons) and TL 4.9 billion were injected to the market.

Chart II.17. TL Required Reserves (%)



Source: CBRT

Chart II.18. FX Required Reserves (%)



Source: CBRT

The banks have been intensely and steadily using the facility of maintaining the Turkish lira reserve requirements in foreign currencies. The across-the-sector utilization ratio of this facility was 89.3 percent by 11 May 2012. With a recent change announced on 29 May 2012, the upper limit of the above-mentioned facility, which was 40 percent, was raised to 45 percent. With the aim of narrowing the cost differential between maintaining the Turkish lira reserve requirements in Turkish lira or in FX, and enabling banks to fully benefit from the new facility, banks are allowed to hold Turkish lira reserve requirements in US dollar and/or euro by multiplying the additional 5 percent with a coefficient of "1.4". Should the new facility, which will be effective as of the calculation period dated 8 June 2012 and the maintenance period will begin on 22 June 2012, be used effectively, CBRT reserves will increase by USD 2.1 billion and the CBRT will inject TL 2.8 billion to the market (Table II.1). The upper limit of the mentioned facility can gradually be raised to 60 percent if the necessary conditions are fulfilled and a different coefficient will be used for each level. Likewise, the upper limit for gold that may be held to meet Turkish lira reserve requirements can gradually be raised to 30 percent with increasing coefficients. This facility is based on voluntary participation and with this, banks will choose to keep their FX assets at the Central Bank when sources are plentiful, and they will be able to draw their assets when they need to. Thus, the CBRT's urge to intervene in the market by either selling or buying foreign exchange will diminish and required reserves will contribute to decreasing exchange rate volatility by assuming the role of an automatic stabilizer.

Table II.1 Reserve Requirements as a Macroprudential Policy Tool[1]

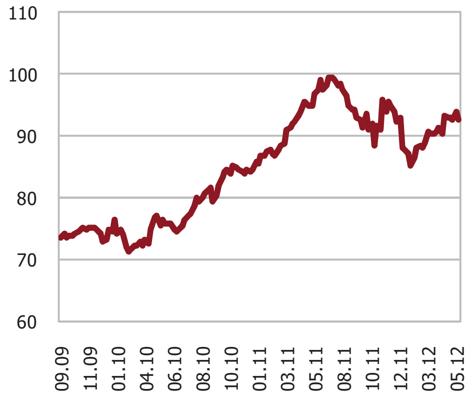
A. Tigthening Measures		B. Expanding and Reserve Building Measures	
30.04.10	Increase in FX RRR	22.07.11	Decrease in FX RRR
06.08.10	Increase in FX RRR	05.08.11	Decrease in FX RR
01.10.10	Increase in TL and FX RRR	16.09.11	Facility of holding up to 10% of TL RR as FX
12.11.10	Increase in TL RRR	30.09.11	Decrease in FX and TL RRR , Differentiation of other TL RRR according to maturity, Facility of holding up to 20% of TL RR as FX
07.01.11	Differentiation of TL RRR according to maturity, Repo was subjected to RR	14.10.11	Precious Metals was subjected to RR, Facility of maintaining the whole RR held against the precious metal deposit accounts and up to 10% of RR for foreign currency liabilities excluding precious metal deposit accounts as gold
04.02.11	Increase in TL RRR	28.10.11	Decrease in TL RRR, Facility of maintaining up to 10% of TL RR as gold, Facility of holding up to 40% of TL RR as FX
01.04.11	Increase in TL RRR	30.03.12	Facility of maintaining up to 20% of TL RR as gold and abolishing of the facility of maintaining up to 10% of RR for foreign currency liabilities excluding precious metal deposit accounts as gold
29.04.11	Differentiation of FX RRR according to maturity, Increase in TL RRR	08.06.12	Facility of holding up to 45% of TL RR as FX, maintaining of last %5 bracket by multiplying wtih 1,4 coefficient

(1) Dates show calculation period.
Source: CBRT

CBRT's reserves including gold have started to increase owing to the recent policy implementations. At the end of 2011, CBRT reserves dropped to USD 88.2 billion due to foreign exchange sales. CBRT reserves, which was USD 86.4 billion in January, started to rise again following the MPC meeting suspending foreign exchange selling auctions and reached USD 92.8 billion by 18 May 2012 owing to the rise in the upper limit for foreign exchange that may be held to fulfill the Turkish lira reserve requirement, to the rise of the upper limit for standard gold reserves that may be held to fulfill the Turkish lira reserve requirement from 10 percent to 20 percent and increased utilization of export rediscount credits (Chart II.19). USD 12.8 billion of these reserves is made up of gold reserves and has increased by 111.6 percent since September 2011 (Chart II.20).

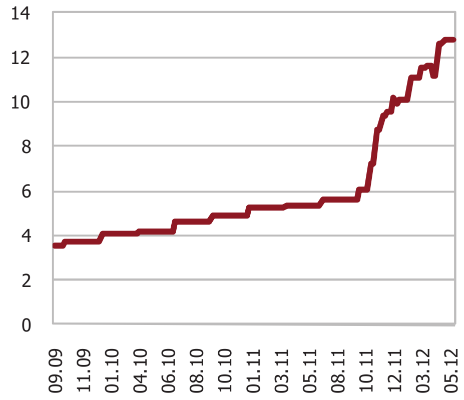
Export rediscount credits, which are extended in Turkish lira and repaid in foreign currencies, make a significant contribution to foreign exchange reserves. The utilization of export rediscount credits started to gain pace from the second half of 2011 onwards owing to the rise in credit limits and easing of credit conditions. USD 1.6 billion worth of export rediscount credits extended in the September-December 2011 period made a contribution to CBRT reserves of the same amount in the first four months of 2012. The total amount of export rediscount credits, which increased to USD 3.1 billion in2011, became USD 2.8 billion in the first four months of 2012 and reached USD 3.2 billion by 18 May 2012. Should the rise in demand for export rediscount credits continue at this pace, the total amount of export rediscount credit utilization in 2012 is expected to reach USD 10 billion and make an overall contribution of USD 8 billion to foreign exchange reserves.

Chart II.19. CBRT Reserves (Gold included, Billion USD)



Source: CBRT

Chart II.20. CBRT Gold Reserves (Billion USD)



Source: CBRT

Box II.1. Export Rediscount Credits as a Tool to Raise Reserves and Support Exports

The export rediscount credits that are extended to exporters in Turkish liras with a maturity of 4 months by the Central Bank of Turkey via banks by accepting FX-denominated bills for rediscount pursuant to Article No: 45 of the Bank Law is a tool that raises reserves as they are repaid in foreign exchange on the due date. Moreover, they also contribute to the rebalancing of trade by supporting exports.

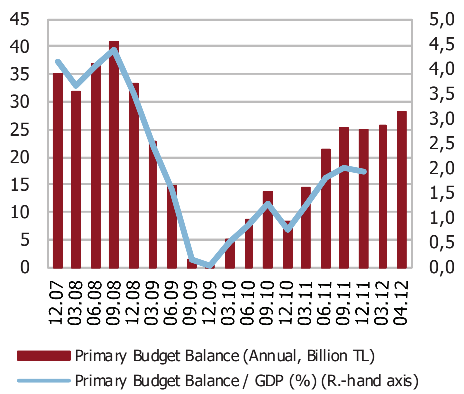
The upper limit for export rediscount credits, which was determined as USD 3 billion in September 2011, was raised to USD 5.5 billion in 2012; while USD 5 billion was allocated to Eximbank for pre-shipment and post-shipment financing of exports; USD 500 million was allocated to banks for post-shipment financing. Credit limits based on the type of company have increased to USD 90 million for foreign trade capital companies and USD 50 million for other companies.

The utilization of export rediscount credits gained pace from the second half 2011 onwards due to the easing of credit conditions and the rise in the upper limit and became USD 3.1 billion in 2011. Should the demand for export rediscount credits, which further accelerated in 2012 and reached USD 3.2 billion by 18 May 2012, continue to rise at this pace, the total amount of export rediscount credit utilization in 2012 is expected to reach USD 10 billion and make an overall contribution of USD 8 billion to foreign exchange reserves.

Interest rates for export rediscount credits are based on LIBOR/EURIBOR interest rates which make them quite convenient and lower exporters' financing costs; the rise in the number of firms utilizing these credits, as well as the sectoral and regional distribution of these firms, contributes to the diversification of export markets and export products.

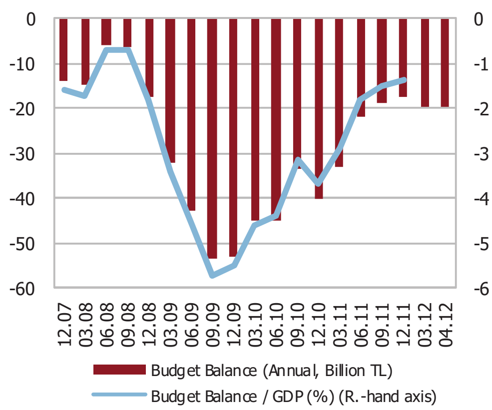
Strong economic activity and curbed public spending continue to support the favorable outlook in public finance. The improvement in budget performance in 2011 compared to 2010 was mainly driven by the rise in tax revenues owing to faster-than-predicted growth and decline in interest expenditures. Moreover, the relative slowdown in the growth pace of non-interest expenditures and extra budget revenues amounting to USD 13.3 billion incurred in the framework of the "Law on Restructuring of Public Receivables" made a significant contribution to public finances. Consequently, budget performance followed a favorable trend and central government primary budget surplus, which was TL 8.2 billion at the end of 2010, reached TL 24,8 billion by the end of 2011 (Chart II.21). Meanwhile, the central government budget deficit, which was TL 40.1 billion at the end of 2010, decreased to TL 17.4 billion by the end of 2011. The budget deficit, which accounted for 3.6 percent of GDP at end-2010, was down to 1.3 percent of GDP by the end of 2011. By April 2012, the central government budget deficit slightly increased compared to end-2011 and became TL 19.4 billion (Chart II.22). This rise was mainly driven by the 32 percent year-on-year increase in interest expenditures in the January-April period of 2012. Actually, the central government primary budget surplus became TL 28 billion indicating a rise compared to end-2011 (Chart II.21). The rise in interest expenditures emanated from the maturity structure of debt stock and it is expected to decelerate in the upcoming months. Moreover, the relative decline in tax revenues point to a slowdown in economic activity.

Chart II.21. Primary Budget Balance



Source: Ministry of Finance, TURKSTAT

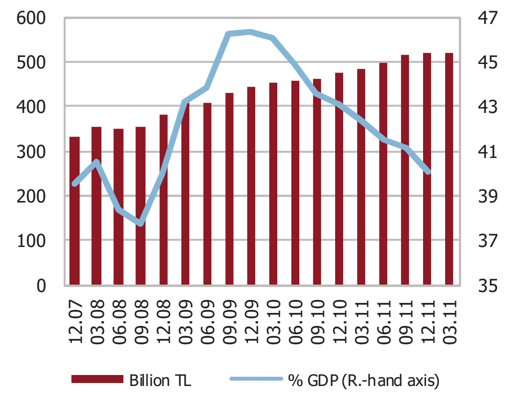
Chart II.22. Budget Balance



Source: Ministry of Finance, TURKSTAT

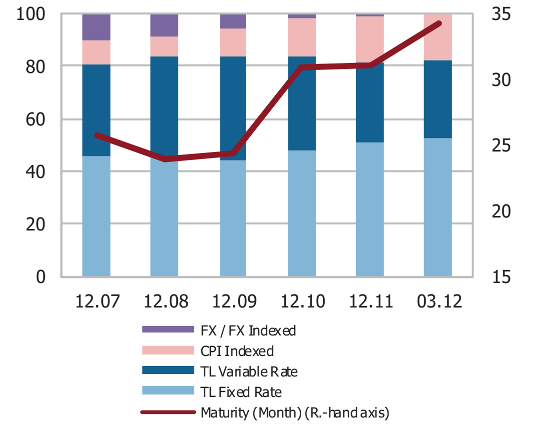
The positive outlook for public debt stock indicators continues. Central government debt stock, which was up by 7.3 percent in 2010 to become TL 474 billion, increased by 9.5 percent and became TL 518 billion in 2011 and reached to TL 520 billion at the end of the first quarter of 2012. The ratio of debt stock to GDP, which was 43.1 percent at the end of 2010, dropped to 40 percent (Chart II.23). As of March 2012, 72.2 percent of central government debt stock was composed of domestic debts. An analysis of the composition of domestic debts reveals that in 2011 and as of March 2012, the share of TL denominated fixed-rate debt and CPI-indexed debt increased compared to 2010 (Chart II.24). Meanwhile, the maturity of domestic debt stock has been extending; the maturity, which was 31 months at the end of 2010, became 34.2 months by March 2012. The share of FX denominated and FX-indexed stock in central government debt stock became zero in February 2012 and this is regarded as a favorable development as sensitivity to exchange rate risk is eliminated. Meanwhile, the rise in the share of fixed rate securities and extension of maturity reduces sensitivity to interest rate movements.

Chart II.23. Central Government Debt Stock



Source: Undersecretariat of Treasury, TURKSTAT

Chart II.24. Composition of Domestic Debt Stock (%)

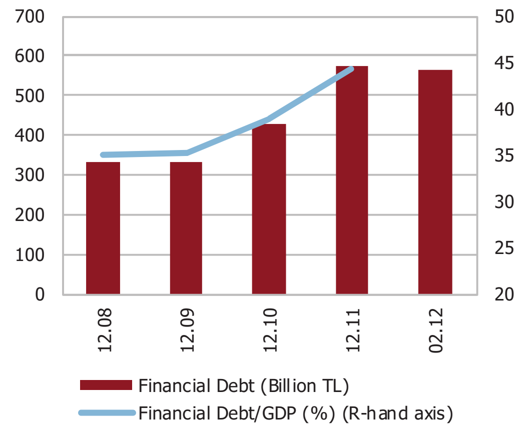


Source: Undersecretariat of Treasury

The new incentive package has been introduced to bolster economic growth, accelerate investments and employment, mitigate regional discrepancies and reduce the current account deficit to reasonable levels while the package is expected to decrease public savings in the short term and to make a favorable impact on public revenues and the public finances outlook in the medium to long term. In the package, which was shared with the public on April 5, 2012, Turkey has been divided into 6 regions according to level of socioeconomic development. The main objectives of the new incentive scheme have been defined as providing higher investment incentives to the least-developed regions, removing differences across regions with respect to their level of development, narrowing the current account deficit by expanding the investment and production of intermediate goods and products with high import dependency, and supporting high and medium-high technology investments. Incentive tools to achieve the objectives are VAT exemption, customs duty exemption, tax reduction, social security employer premium support, interest support, land allocation and VAT refund. The use of each incentive depends on the region as well as the size of the investment. The new incentive system is expected to bolster economic growth, enhance investment and employment, mitigate regional socioeconomic discrepancies and reduce the structural current account deficit to reasonable levels by enhancing competition and decreasing import dependency. Meanwhile, measures such as tax reductions and other government investments may lead to a decrease in public savings in the short run. Moreover, with the aim of supporting entrepreneurship, the principles of the individual participation capital system – also known as the angel investor system- will be regulated. Accordingly, the introduction of a new financial instrument for early-stage companies with limited access to financial resources, establishing a code of ethics and behavioral culture and ensuring a professional stance in this market, making individual participation capital an institutionalized and accountable finance market and making these investments more attractive by providing government incentives are envisioned.

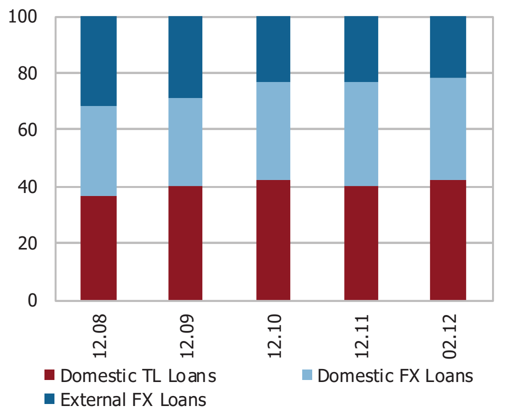
The upward trend observed during 2010-2011 in corporate debts halted and the share of foreign borrowing remained flat in 2012. Total financial debts of the corporate sector has gradually been increasing since the turn of 2010 and reached TL 574.6 billion by the end of 2011 to come down to TL 566.4 billion in February 2012 due to the appreciation of Turkish lira. The ratio of financial debts of the corporate sector to GDP was 44.4 percent at the end of 2011 (Chart II.25). As of February 2012, 57.7 percent of financial debts of the corporate sector were composed of FX loans; however, the majority of FX loans has long maturities. In the same period, the share of foreign borrowing (excluding those from branches and affiliates) in total loans was 21.9 percent, whereas the share of loans extended to the corporate sector by domestic and foreign branches and affiliates of Turkish banks in total loans decreased by 0.8 percentage points compared to end-2011 and reached 35.9 percent. In the period subject to analysis, TL loans extended to the corporate sector increased and became 42.3 percent in February 2012 (Chart II.26).

Chart II.25. Financial Debt of Corporate Sector (Billion TL, %)[1]



Source: CBRT
(1) Since "Sectoral breakdown of Private Sector's Outstanding Loans Received From Abroad" data have been disseminated according to the Statistical Classification of Economic Activities in the European Union NACE Rev. 2 instead of NACE Rev.1.1 as of Mart 2012, the data may differ from previous Reports.

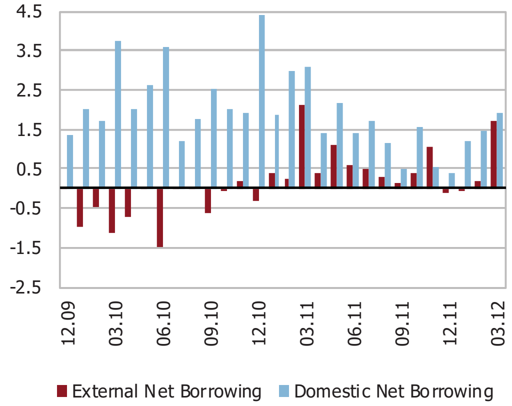
Chart II.26. Composition of Financial Debt of Corporate Sector (%)[1]



Source: CBRT
(1) Since "Sectoral breakdown of Private Sector's Outstanding Loans Received From Abroad" data have been disseminated according to the Statistical Classification of Economic Activities in the European Union NACE Rev. 2 instead of NACE Rev.1.1 as of Mart 2012, the data may differ from previous Reports.

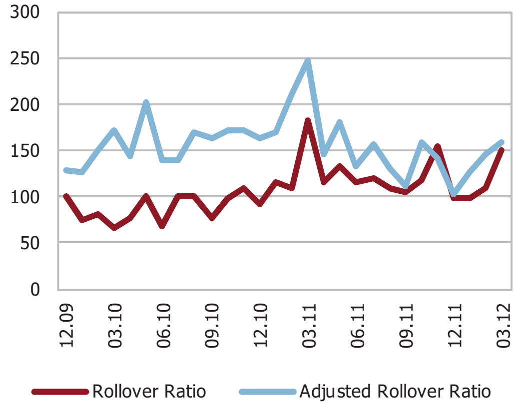
Firms had opted for loans from domestic markets since the amendment to Decree No. 32 in June 2009, however, the rollover ratio of external loans displayed an upward trend in the first quarter of 2012., The amount of loans extended to the corporate sector by foreign banks and foreign branches and affiliates of Turkish banks, which decreased by USD 1.5 billion in 2011 year-on-year, remained flat in the first quarter of 2012 whereas FX loans extended by banks' domestic branches increased by USD 11.2 billion in the first quarter (Chart II.27). The external debt rollover ratio of the corporate sector maintained the upward trend it assumed in 2011 and became 159 percent by March 2012. The rise in the external debt rollover ratio in March 2012 compared to end- 2011 was mainly driven by the increase in long-term external borrowing (Chart II.28). 27.6 percent of external loans used by the corporate sector will mature in 1 year and the highest repayment will be made in December 2012.

Chart II.27. Non-Bank Sector Net FX Borrowings (Billion USD)[1]



Source: CBRT
(1) Net FX borrowings of sectors excluding CBRT, Undersecretariat of Treasury and banks are calculated by subtracting repayments from borrowings in the respective month.

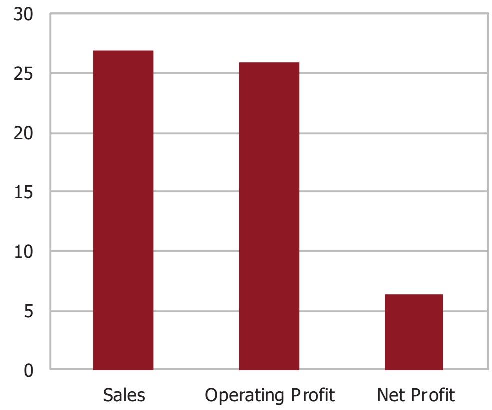
Chart II.28. Non-Bank Sector External Debt Rollover Ratio (%)[1]



Source: CBRT
(1) The external debt rollover ratio is computed from the balance of payments 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.

While the ratio of corporate debts to equity capital is increasing, despite the run up in sales, the rise in firms' profits remains subdued because of increased provisions for exchange rate movements. While the total amount of sales revenues of firms quoted on the Istanbul Stock Exchange (ISE) increased by 27 percent in 2011 in annual terms and operating profits increased by 26; net profits just slightly increased by 6.3 percent (Chart II.29). The subdued rise in net profits was mainly driven by increased financial expenditures that rose on the back of increased provisions for exchange rate movements. As a result of these developments, the return on equity, which was 13.5 percent in 2010, declined to 12.9 percent in 2011. The ratio of debts to equity capital was up 119.7 percent in 2011 from 109.9 percent in 2010 (Table II.2). A provision of the "Law on Collection Procedure of Public Claims" discussed at the Turkish Grand National Assembly, which stipulates that firms cannot write off up to 10 percent of their interest expenditures as losses/expenses, is believed to encourage firms to use equity capital rather than borrowing and thus contribute to financial stability.

Chart II.29. Sales and Profitability of Firms in 2011 (Annual % Change)[1]



Source: PDP
(1) Consolidated data of 239 manufacturing industry firms quoted on the ISE.

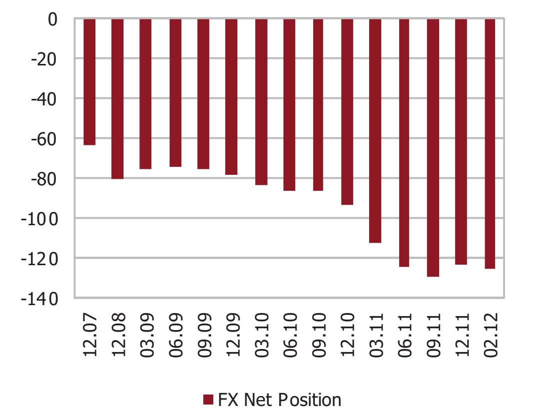
Table II.2. Return on Equity and Its Components[1]

	2009	2010	2011
Net Profit / Equity (%)	12.1	13.5	12.9
Assets /Equity (%)	107.0	109.9	119.7
Net Profit / Assets (%)	5.9	6.4	5.9
Sales / Assets	1.0	1.0	1.1
Net Profit / Sales (%)	6.1	6.6	5.5
Operating Profit / Sales (%)	8.7	8.6	8.5
Financial Income (Expenditures) / Sales (%	-1.2	-0.5	-1.9

Source: PDP
(1) Consolidated data of 239 manufacturing industry firms quoted on the ISE.

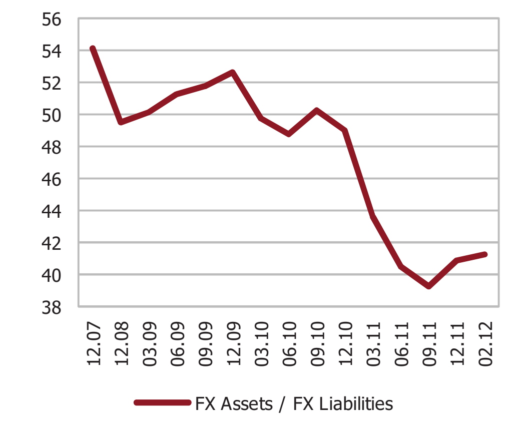
An analysis of FX assets and liabilities of firms suggests that the net FX short position is relatively flat, however foreign exchange risk still remains significant for them. The net short position of the corporate sector, which had assumed a downward trend after the global crisis, started to increase again with the economic recovery. The net short position of the corporate sector was recorded at USD 93.5 billion, 122.7 billion and 124.8 billion in 2010, 2011 and in February 2012, respectively (Chart II.30). Meanwhile, the ratio of FX assets to FX liabilities, which had been increasing as of the final quarter of 2011, became 41.3 percent in February 2012 (Chart II.31).

Chart II.30. Foreign Exchange Position of the Corporate Sector (Billion USD)[1]



Source: CBRT
(1) Data for February 2012 is provisional.

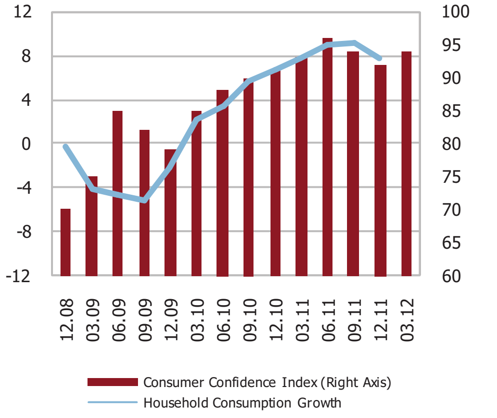
Chart II.31. Ratio of FX Assets to FX Liabilities of Corporate Sector (%)[1]



Source: CBRT
(1) Data for February 2012 is provisional.

In the period following the global financial crisis, household consumption increased in tandem with restored consumer confidence on the back of GDP growth and recovery in the economic outlook. Household consumption increased throughout 2010 and in the first half of 2011 owing to restored political and economic stability, increased availability of loans underpinned by the decline in interest rates and the realization of deferred consumption demand. In the rest of 2011, growth in demand remained moderate as a result of the measures taken by the authorities intended to decelerate domestic demand and the decline in consumer confidence (Chart II.32). An analysis of the consumption composition of households in the last 10 years reveals that compulsory expenditures such as food, beverages, tobacco, clothes, housing, water, electricity, gas and other fuels in the total share of household consumption decreased whereas the share of expenditures on transportation, communication and other services sector increased (Chart II.33).

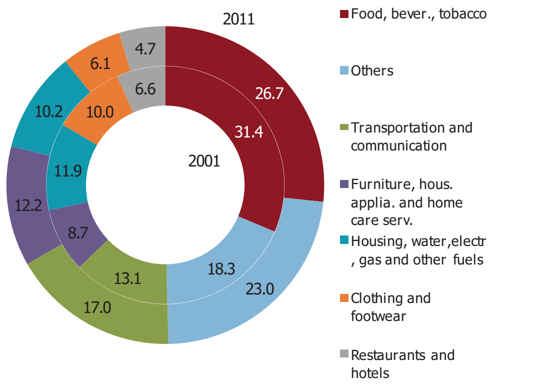
Chart II.32. Rise in Household Consumption in Real Terms and Consumer Confidence Index (%, Index)[1]



Source: CBRT, TURKSTAT

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

Chart II.33. Breakdown of Household Consumption Expenditures (%)[1]

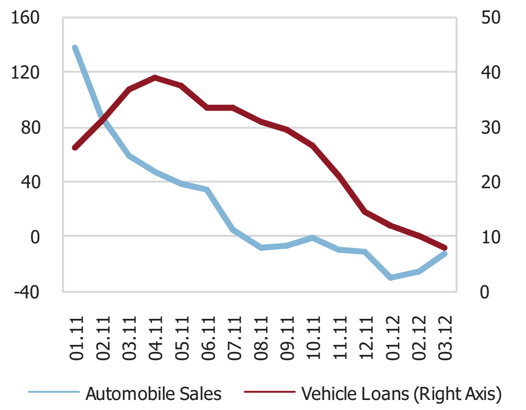


Source: TURKSTAT

(1) Resident and non-resident household consumption expenditures in 1998 constant prices. Other item comprises health, entertainment and culture, education and various expenditures on goods and services.

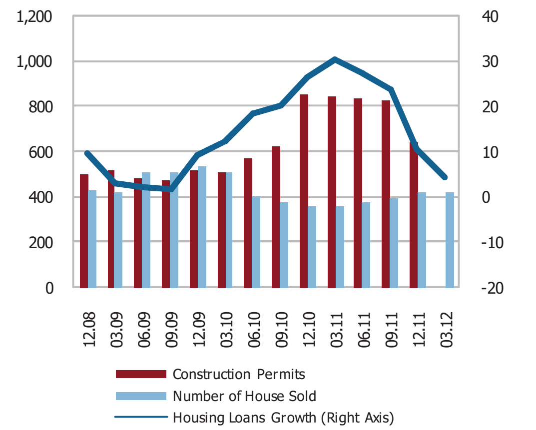
In 2011, household demand for automobiles declined while that for housing displayed slight increase. In 2011, automobile sales significantly dropped due to decreased demand for loans stemming from the rise in credit costs driven by the increase in interest rates as well as the rise in Special Consumption Tax and soaring automobile prices triggered by depreciation of the Turkish lira (Chart II.34). House sales, which reached 519 thousand at the end of 2009 underpinned by the waning effects of the crisis and low interest rates, indicated a rise in the supply of housing in 2010. Although house sales decreased at the end of 2011 compared to 2009 due to rising interest rates as well as measures introduced regarding housing loans, they displayed a rise compared to 2010. The decline in the number of construction permits in the last quarter of 2011 after a flat course throughout the year rendered some decline in surplus (Chart II.35).

Chart II.34. Annual Real Rise in Vehicle Loans and Annual Change in Automobile Sales (%)



Source: BRSA-CBRT, ODD

Chart II.35. Annual Real Rise in Housing Loans, Number of House Sold and Construction Permits (Thousand, %)[1]



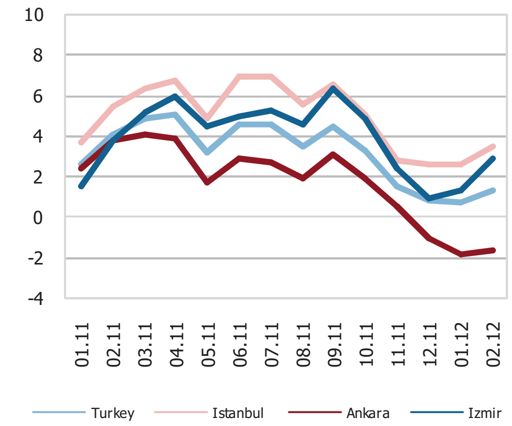
Source: TURKSTAT

(1) 12-month sum of the number of apartments used as dwelling.

The rise in house sales started to decelerate as of the final quarter of 2011. In December 2011, housing prices across Turkey was up 0.8 percent in real terms. Among the largest three cities, Istanbul became the one with the highest rise in house prices while Ankara became the one with the lowest. In fact, recently, housing prices have been decreasing in Ankara in real terms (Chart II.36). Problems in banking sectors in crisis-hit EU, especially in Ireland, Spain and Greece have an adverse impact on the housing sector and in turn housing prices. Turkey displays a better economic performance compared to EU countries and housing prices were nominally up 11.3 percent at the end of 2011. Among all countries subject to analysis, Turkey was among the top countries, but the impact of inflation on this rise shall be taken into account (Chart II.37).

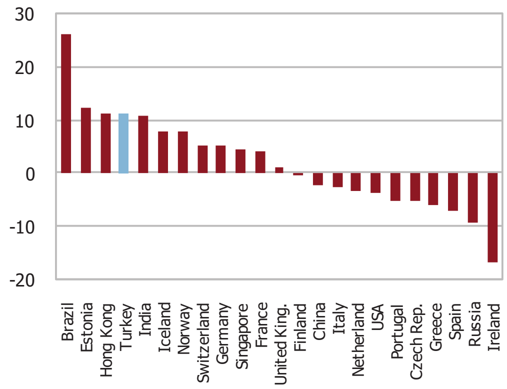
As for housing prices, excessive fluctuations in either direction might pose a risk to financial stability. In fact, in countries most severely affected by the global crisis, the decline in property prices, which ballooned in the pre-crisis period, put not only households, but also the banks in a difficult situation; the former through over borrowing as a result of using housing loans, and the latter due to having the said property in their portfolio as collaterals and issuing housing loan-backed securities. In this context, close monitoring of housing price developments is crucial for financial stability.

Chart II.36. Housing Price Index Annual Real Change (%)[1]



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

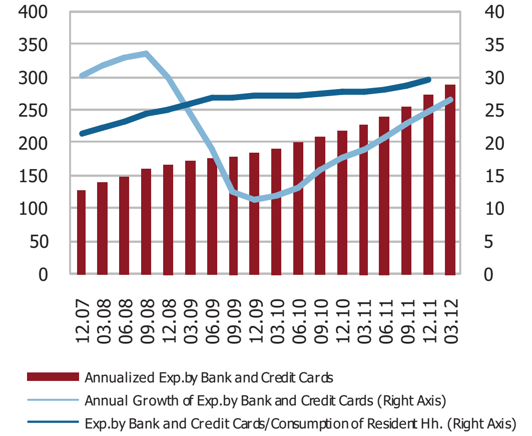
Chart II.37. Annual Nominal Change in Housing Prices in Selected Countries (Dec 2011, %)



Source: Knight Frank Global House Price Index, CBRT

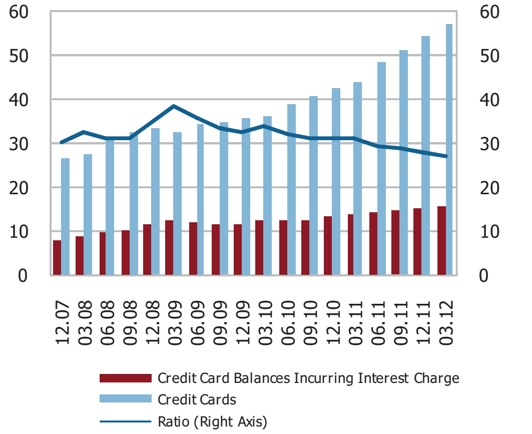
With the ever increasing use of debit and credit cards, which plays an important role for the registered economy, consumption expenditures of households via credit cards continue to increase, while the ratio of credit card balances incurring interest charges to total credit card balances continues to decline favorably. The decline in consumption expenditures in the period when the effects of the global crisis were felt reflected on credit card use and its annual growth rate decelerated. Yet, with the recovery in the economy, credit card – and relatively low – debit card expenditures skyrocketed (Chart II.38). In line with the year-by-year increase in household demand for consumer loans, the share of credit cards in overall household liabilities is in decline. The ongoing upward trend in credit card balances and the downward trend in credit cards being used as an instrument of credit has facilitated a modest rise in the level of credit card balances incurring interest charges and a fall in the ratio of credit card balances incurring interest charges to total credit card balances, demonstrating the favorable course of the economy (Chart II.39).

Chart II.38. Expenditures by Bank and Credit Cards and Resident Household Consumption (Billion TL, %)[1]



Source: TURKSTAT, Interbank Card Center (ICC)
(1) Spending by bank and credit cards are obtained by annualizing the transactions of these credit cards in domestic and international purchases.

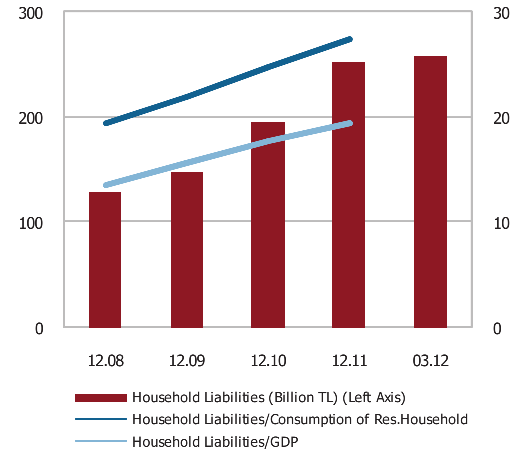
Chart II.39. Credit Card Balances of Deposit Banks and Ratio of Balances that Incur Interest (Billion TL, %)[1]



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

While household opted to finance the larger part of their consumption expenditures with consumer loans, the ratio of household liabilities to national income rose as well. The increase in household liabilities can be attributed to the steady course of the economy, global capital inflows, quite low levels of interest rates, as well as the credit supply of banks. The increase in the 'liabilities/GDP' ratio somewhat moderated in 2011. Instrumental in this were the slowing growth rate of household liabilities as of the second half of 2011 onwards as a result of the precautionary measures taken within the scope of the CBRT's policy mix accompanied by steps taken by the Banking Regulation and Supervision Agency (BRSA) (Chart II.40). Interest payments of household rose in line with the increase in borrowing costs as a result of the measures taken by the authorities whereas the increase in disposable income enabled interest payments to maintain their share in household disposable income (Table II.3).

Chart II.40. Household Liabilities (Billion TL, %)[1]



Source: BRSA-CBRT, TURKSTAT
(1) Household liabilities consist of 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.

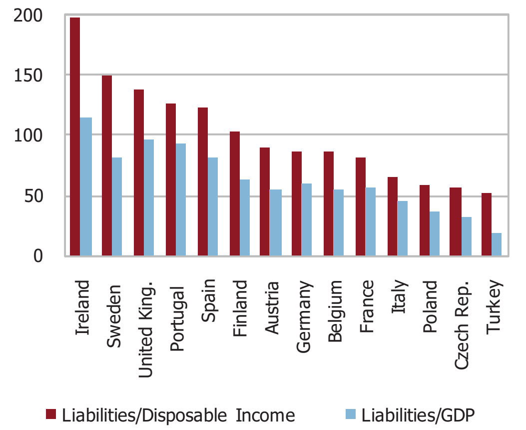
Table II.3. Selected Financial Indicators Pertaining to Households[1,2,3] (Billion TL, %)

	12.09	12.10	12.11
Household Disp. Income	408.9	426.3	487.2
Household Liabilities	148.8	195.1	251.9
Household Interest Payments	21.1	20.4	23.1
Interest Paym. / Hh. Disp. Income (%)	5.2	4.8	4.8
Liabilities / Hh. Disp. Income (%)	36.4	45.8	51.7

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), non-performing 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 2011 has been calculated by using the private sector disposable income estimation for 2011 as foreseen in the 2012 Program, under the assumption that the ratio of household disposable income for 2010, which was generated from "the Income and Living Conditions Survey", to private sector disposable income has not changed.

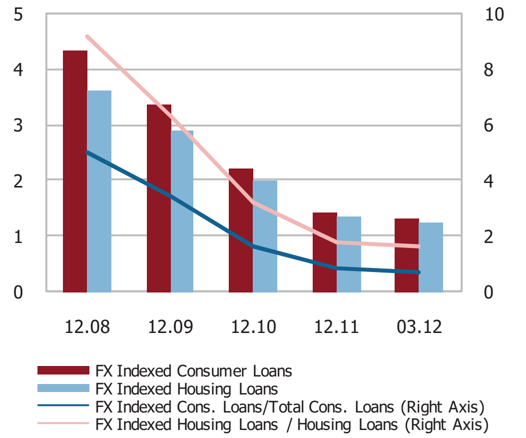
Despite following an upward course, household liabilities maintain their low level in comparison to the selected countries and carry no exchange rate or interest rate risk. End-2011 ratios of household liabilities to GDP and to disposable income are 19 percent and 51.7 percent respectively, and stand at lower levels compared to EU countries (Chart II.41). Meanwhile, the exchange rate and interest rate risks for household loans which are high especially in eastern and central European countries are at negligible levels in the case of Turkey. The household exchange rate risk was eliminated by impeding household from borrowing in FX, and later with the amendment to Decree No. 32 in June 2009, also from FX-indexed borrowing (Chart II.42). The fact that variable interest rates are only allowed for housing loans and the remarkably low level of loans with variable interest rates contain the household interest rate risk exposure.

Chart II.41. Ratio of Household Liabilities to Disposable Income and GDP in Selected EU Countries (Dec 2011, %)[1]



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

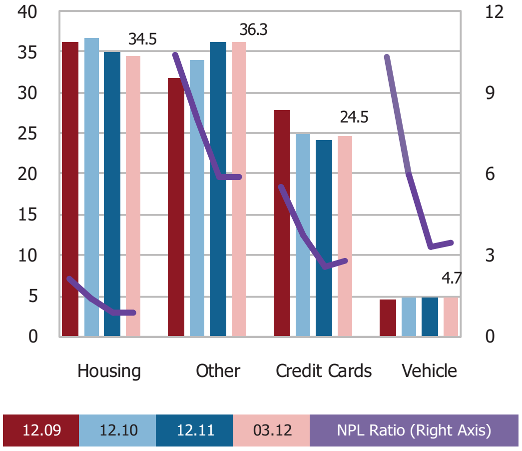
Chart II.42. FX-Indexed Consumer and Housing Loans (Billion TL, %)



Source: BRSA-CBRT

While housing and consumer loans maintained their shares in household liabilities, the decline in the NPL ratios of consumer loans is observed to have come to an end. Measures taken with regard to housing loans contributed to the ongoing decline in the share of the said loans in overall household liabilities. Meanwhile, NPL ratios, which have been on a downward trend for years, remained flat, due also to the slowdown in consumer credits (Chart II.43). In line with the course of NPL ratios, the number of consumer loan and credit card defaulters has inched up in the first quarter of 2012 as compared to end-2011 (Table II.4).

Chart II.43. The 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.

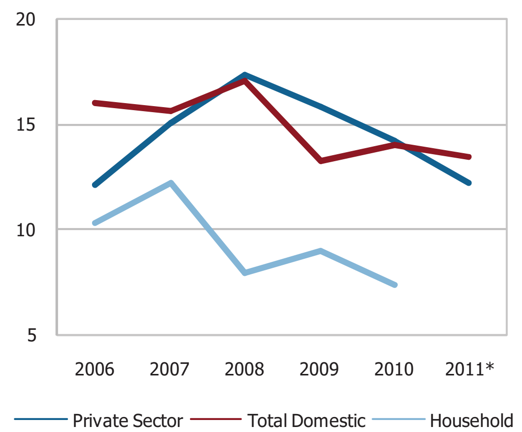
Table II.4. Number of Credit Card and Consumer Loan Defaulters[1,2,3]

	12.09	12.10	12.11	03.12
Banks	1,489,131	1,319,111	1,224,668	1,272,065
Asset Management Companies[2]	330,156	574,541	687,946	694,303
Finance Companies	23,463	18,003	11,052	11,298
Total[3]	1,721,004	1,689,788	1,657,500	1,693,057

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.

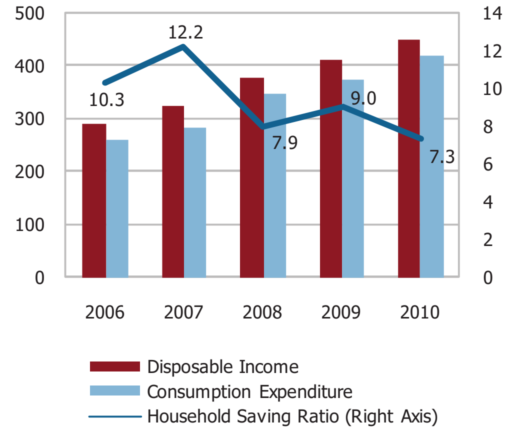
Household saving rates have been declining, despite having exhibited a fluctuating course by years. The improvement in public savings thanks to tight fiscal policy was not enough to offset the decrease in private sector savings, the result of which was the decline in domestic savings (Chart II.44). In the case of household, increased consumption expenditures limited the favorable effect of income increase generated by economic growth on savings and led to a downward trend in saving rates (Chart II.45). In Turkey, the top two quintile-income group households (fourth and fifth quintiles) are keen to save, while the bottom three income groups have a negative saving rate (Chart II.46). In this context, raising social awareness for income-based-consumption is significant for increasing household and hence overall savings.

Chart II.44. Saving Rates (%)[1,2]



Source: TURKSTAT-Household Budget Surveys, Ministry of Development
(1) Saving rates have been calculated by the division of household, private sector and total domestic savings by their respective disposable income.
(2) Household saving rates have been calculated by using the consumption expenditures and disposable income data generated from the household budget survey.
(*) Estimate.

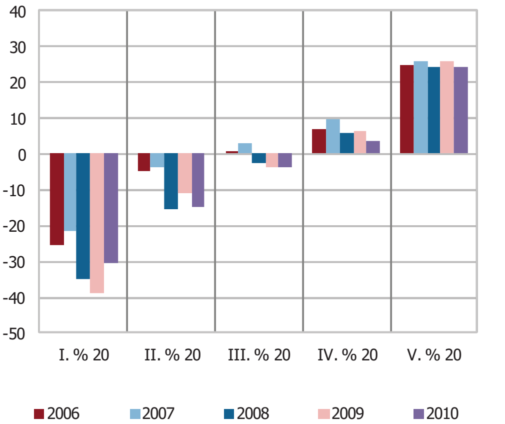
Chart II.45. Household Expenditures, Disposable Income and Saving Rates (Billion TL, %)[1,2]



Source: TURKSTAT-Household Budget Surveys
(1) Renewed population projections are being used since 2007.
(2) Household saving rates have been calculated by using the consumption expenditures and disposable income data generated from the household budget survey.

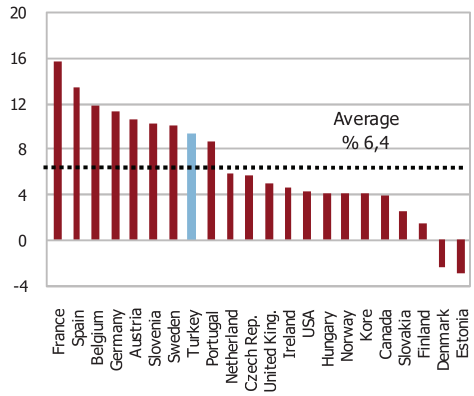
Difficulties experienced by countries, where domestic consumption boomed, highlight the importance of increasing household savings. Although the household saving rate in Turkey is above the average of the countries analyzed, the fact that it has been heading downwards should be kept in mind (Chart II.47). Introducing policies that encourage households to save and implementing regular studies for raising social awareness to edge towards income-based-consumption are prerequisites of achieving sustainable growth. As a matter of fact, recently new regulations are being made by the authorities to serve this purpose (Box II.1).

Chart II.46. Household Saving Rates as per Income Quintiles (%)[1,2]



Source: TURKSTAT-Household Budget Surveys
(1) Renewed population projections are being used since 2007.
(2) Household saving rates have been calculated by using the consumption expenditures and disposable income data generated from the household budget survey.

Chart II.47. Household Saving Rates in Selected Countries (2006-2010, %)[1]



Source: OECD Economic Outlook: Issue 90
(1) Saving rates denote the ratio of savings to household disposable income. Five-year averages are calculated for the 2006-2010 period.

Box II.2. Arrangements Introduced to Encourage Household Savings

Household savings, which have been decreasing recently, are actually very important for a country's economic performance. An inadequate level of saving in a national economy increases the dependence on foreign savings, which in turn fuels concern over the sustainability of growth performance that Turkey has achieved. In this framework, the relevant institutions were commissioned to carry out studies to encourage household savings. Studies and regulations that have already been carried out or are planned to be carried out can be summarized as follows:

I. The private pension system, which was introduced in Turkey in 2003, is an important tool encouraging household savings. The current system needs to be further developed to make it more attractive, ensure sectoral growth and increase household savings. The most important incentive offered to private pension participants is that they can deduct the amount of contributions that they pay into the system from their income tax. However, the current system does not function at maximum performance due to several problems: some participants are not tax payers, there are operational problems regarding the tax deduction process and other problems. Accordingly, "The Draft Law Amending Individual Pension Savings and the Investment System Law and some Laws and Decrees in Power of Law" have been prepared to replace the current system with a new one that encourages participants in a more effective way by direct government participation. The Draft Law stipulates that:

a. Instead of deducting the contribution amount from the tax base, the government will pay a "government contribution" to the "government contribution" sub-account of the participant that is equivalent to 25 percent of the contribution paid by the participant provided that this amount shall not exceed 25 percent of the gross annual minimum wage,

b. Taxation on pension investment funds and government contribution will continue following the current implementation,

c. During the payment of deposits, tax will only be levied on the interest and in order to encourage participants to remain within the system longer, individuals shall gradually qualify for the government contribution and interest; such as; 15 percent in the 3rd year, 35 percent in the 6th year, 60 percent in the 10th year and 100 percent upon retirement.

II. The amendments incorporated in the same Draft Law are aimed at effectively encouraging two other important systems to stimulate savings, namely life insurance and health insurance.

III. With an aim to strengthen the build-up of the Central Bank's gold reserves and to provide the banking system with more flexibility in liquidity management, the Central Bank introduced a facility allowing banks to hold up to the entire amount of reserve requirements for precious metal deposit accounts, and up to 20 percent of reserve requirements for TL liabilities in "standard gold". The facility is expected to encourage banks to proliferate gold deposit accounts and offer new products so that the "gold under the mattress" will be brought out and registered (Special Topic V.9).

IV. Another facility that is expected to boost savings is the "Severance Pay Fund". Studies for the establishment of the fund are still underway and in the framework of the facility, an account will be opened for each worker, severance pay for each worker will be deposited in this account and interest will be probably be accrued on these accounts. Workers will be able to draw this severance pay gradually and follow their accounts on the Internet.

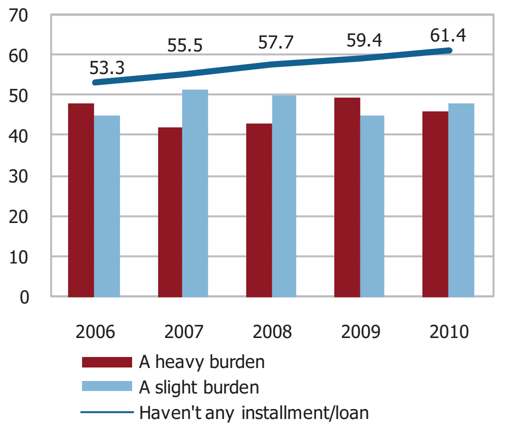
V. The relevant authorities are carrying out studies on a system in which gradual withholding ratios will be applied to deposits based on their maturities. The withholding ratio, which is currently 15 percent for interest income across all maturities, is planned to be decreased for longer maturities that aims to increase longer term savings.

VI. Commissioned by the Financial Stability Board, the relevant institutions have been working on projects to enhance financial awareness and financial education (Special Topic V.4). Increasing financial literacy will contribute to the more efficient functioning of financial markets and consequently, social welfare, and boost saving awareness.

Increasing household savings is an important factor for ensuring sustained economic growth. Therefore, introducing macropolicies to increase household income in tandem with micropolicies to encourage household savings would play in instrumental role in achieving this goal.

With the decline in the saving rate, the ratio of indebted household rose, but the probability of borrowing in the future started to decrease and the probability of saving in the future started to increase. The results of the *Income and Living Conditions Survey, 2010* conducted by TURKSTAT suggest that 61.4 percent of the non-institutional population had installments and loans to pay (other than mortgage and housing costs) and these payments are a heavy burden for 46.2 percent of households (Chart II.48). Meanwhile, according to the results of the *Consumer Confidence Index*, in spite of displaying fluctuations, the probability of household borrowing is on a downward course, whereas the probability of household saving is on an upward course (Chart II.49). The slowdown in the growth of consumer loans also verifies this trend.

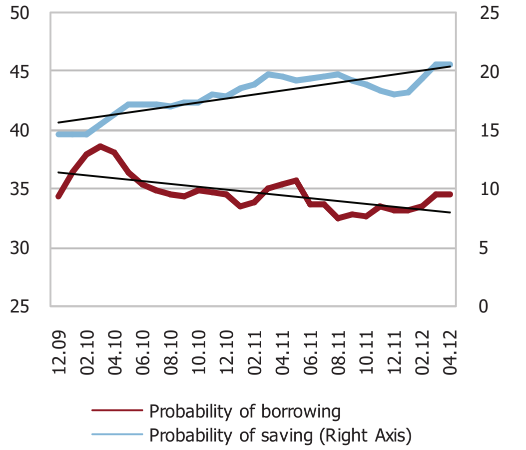
Chart II.48. Financial Condition of Indebted Households (%)[1]



Source: TURKSTAT-Household Income and Living Conditions Survey

(1) Calculated by the percentages of the responses (of "a heavy burden" or "a slight burden") of those with installments and loans, assessing their debt (other than mortgage -for the main dwelling- and housing cost).

Chart II.49. Probability of Household Borrowing and Saving (%)[1,2]



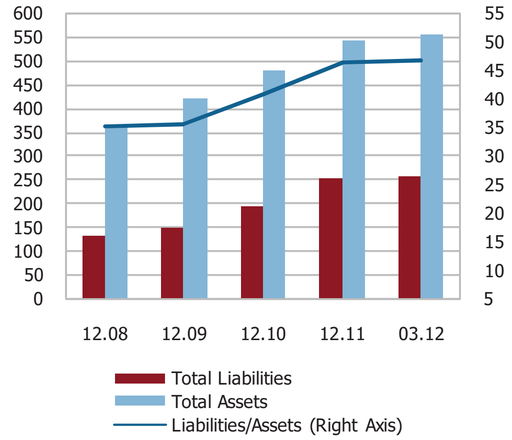
Source: TURKSTAT-Consumer Confidence Index

(1) 'Probability of borrowing' denotes the index constituted by the responses to the question 'What is the likelihood for you to finance your or your households' expenditures by borrowing (via consumer loan or else) in the next 3 months?". (quarterly moving averages)

(2) 'Probability of saving' denotes the index constituted by the responses to the question 'What is the likelihood for you to save (in Turkish lira, foreign currency, gold, deposits, other instruments of financial investment, etc.) in the next 6 months?". (quarterly moving averages)

In line with the slowdown in the growth of consumer loans, the increase in household financial liabilities to assets ratio halted. The slowdown in the growth of consumer loans as a result of the measures taken reflected on the course of the households' financial liabilities to assets ratio (Chart II.50). By March 2012, despite its declining share in the financial assets held by households, savings deposits continue to be the predominant item of household assets. Foreign exchange (FX) deposit accounts, which stood at USD 59.7 billion by end-2010, rose to USD 62.3 billion in March 2012. Precious metals deposit accounts, majority of which is composed of gold deposit accounts, rose in line with the increasing in return on gold since 2010 and the beginning of banks' offering new investment instruments based on gold (Special Topic V.9). In the said period, the shares -within household assets- of not only FX or precious metal deposit accounts, but also of retirement funds and repurchase agreements rose, while those of other investment instruments fell (Table II.5).

Chart II.50. 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.

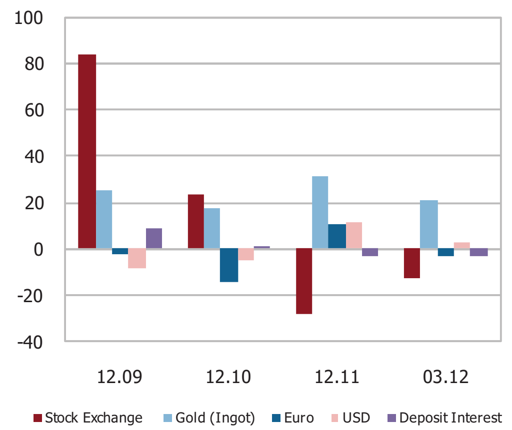
Table II.5. Household Financial Assets[1]

	12.10		12.11		03.12	
	Billion TL	% Share	Billion TL	% Share	Billion TL	% Share
TL Deposits	253.8	52.9	281.9	51.9	284.5	51.4
FX Deposits	94.6	19.7	111.6	20.5	110.4	19.9
- FX Deposits (Billion USD)	*59.7*		*58.5*		*62.3*	
Currency in Circulation	44.6	9.3	49.7	9.1	48.0	8.7
GDDS+Eurobond	9.4	2.0	10.5	1.9	10.1	1.8
Mutual Funds	28.5	5.9	25.8	4.7	25.3	4.6
Stocks	32.6	6.8	30.0	5.5	35.4	6.4
Private Pension Funds	12.1	2.5	14.3	2.6	15.8	2.9
Repos	1.5	0.3	1.4	0.3	2.5	0.4
Precious Metal Deposits	2.3	0.5	13.4	2.5	14.6	2.6
Bonds and Bills	0.403	0.1	4.9	0.9	6.9	1.3
Total Assets	**479.8**	100	**543.5**	100	**553.4**	100

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

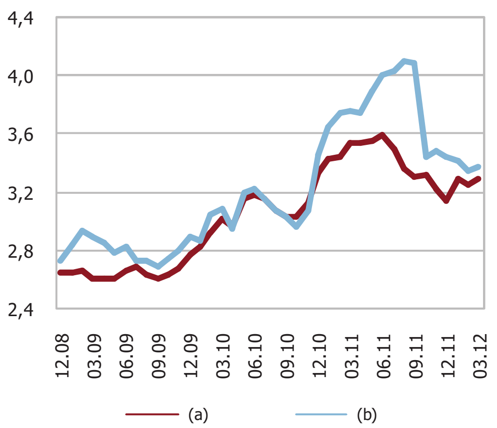
Market developments influence not only the returns on financial assets, but also the risk perception – and hence, portfolio preferences – of households. The return on US dollar was the highest in real terms, in the first quarter of 2012, while the Istanbul Stock Exchange performed badly. This development reflected on the composition of financial assets held by households (Chart II.51, Table II.5). This is because the adverse developments in the exchange rate (those affecting the Turkish lira unfavorably) affect portfolio preferences for financial assets in domestic currency and those in foreign currency. The ratio of investment instruments denominated in Turkish lira to those denominated in FX, adjusted for exchange rate effect, has been on a downward course as of the last quarter of 2011 (Chart II.52).

Chart II. 51. Real Return of Financial Investment Instruments by Types (%)[1]



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

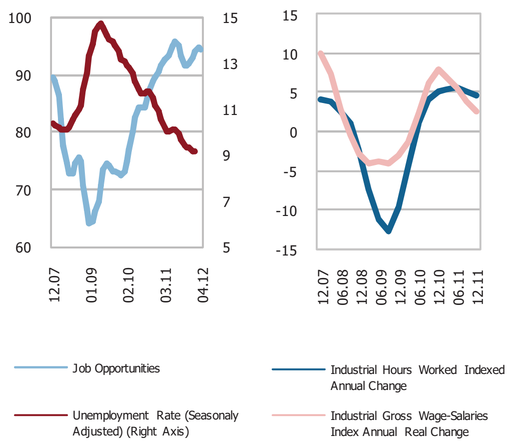
Chart II. 52. Ratio of Household TL Investment Instruments to FX Investment Instruments[1]



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.

Robust economic growth performance reflected favorably on the labor market and the unemployment rate continued to decrease while working hours and wages/salaries in the industrial sector increased. In the post-global crisis period, in line with the slowdown in Turkey's economic activity, the unemployment rate went up. However, this trend reversed by 2009 and the labor market displayed a fast recovery. In parallel to the decline in the unemployment rate, total gross wage payments and the working hours index went up - in a rapid fashion in 2010 and rather modestly in 2011. Households' expectations pertaining to job prospects also demonstrate the improvement in the labor market (Chart II.53). The increase in employment has been affecting household disposable income favorably as well (Table II.3). Yet, unemployment, which is the main risk for household, continues to be a major problem, especially in advanced economies (Chart II.54).

Chart II.53. Selected Indicators for the Labor Market (%)[1,2]

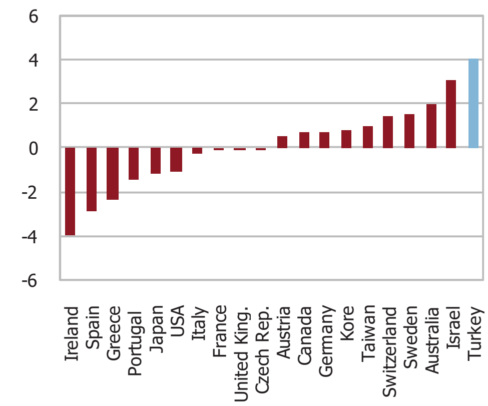


Source: TURKSTAT

(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).

Chart II.54. Annual Average Growth Rate of Employment in Selected Countries (2007-2011, % Growth)[1]

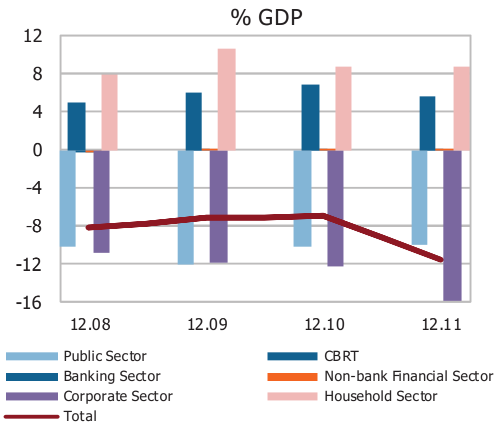


Source: IMF WEO, TURKSTAT

(1) Annual average increases in employment are calculated by taking natural logarithm differences. The data for Spain, Greece, Czech Republic, Taiwan, Korea, Israel and Italy are projections.

Monitoring Turkey's macro foreign exchange position is crucial for assessment of the exchange rate risk incurred by economic units. Turkey's foreign currency (FX) open position is USD 79.8 billion as of March 2012. In Turkey, public and corporate sectors carry short, the CBRT and households carry long, and banking and non-banking financial sectors carry an almost zero position in foreign currency. Within this framework, the sectors susceptible to depreciation of the Turkish lira are the public sector and the corporate sector. As of March 2011, the corporate sector and the public sector carry FX open positions amounting to 124.8 billion and USD 69.6 billion, respectively; while the households, the CBRT, the banking sector and the non-banking financial sector are long in FX positions by USD 73.8 billion, USD 40.5 billion, USD 0.2 billion and USD 0.1 billion, respectively. The ratio of Turkey's foreign currency open position to GDP is 11.5 percent as of end-2011 (Chart II.55).

Chart II.55. Turkey's FX Short Position



SECTORS (March 2012) (Million USD)	Assets	Liabilities	Net Position
Public Sector [1]	12,060	81,683	-69,623
CBRT	97,200	56,721	40,479
Banking Sector	336,085	335,871	215
Non-bank Financial Sector [2]	9,679	9,554	125
Corporate Sector [3]	87,763	212,541	-124,779
Households	74,514	733	73,781
TOTAL	617,301	697,103	-79,803

Source: CBRT-BRSA, Undersecretariat of Treasury
(1) Public FX liabilities by the given date, consist of central government FX-denominated and FX-indexed debt stock data.
(2) December 2011 data is used.
(3) February 2012 data is used.

In the upcoming period, uncertainties with regard to the global economy continue to be important for financial stability, while the launch of reforms currently underway, which are aimed to encourage investments and savings, is of crucial value to underpin financial stability. Domestic demand growth has been contained with the help of the measures taken, as the rate of increase in household liabilities declines, the indebtedness of the corporate sector decreased from its end-2011 level and the improvement in the current account balance persists. The rise in inflation has been controlled by monetary tightening and the measures taken, and a moderate growth performance is foreseen for the upcoming period. Nevertheless, uncertainties pertaining to the global economy still remain, as does the volatility in capital flows to emerging market economies. Within this framework, as foreseen in both the Medium Term Program (MTP) and the new incentive system, structural reforms to increase domestic saving rates and to reduce the heavy reliance on external sources of energy and intermediary goods, which will eventually serve as a lasting solution to the current account deficit, are of utmost importance. Furthermore, reinforcing structural reforms aimed at achieving lasting fiscal discipline in the medium term will bolster financial stability and ensure that long-term public borrowing rates maintain their low levels. The CBRT has the flexibility needed to minimize the unfavorable effects of global adversities on the Turkish economy and will continue to monitor economic developments closely and take the necessary measures to safeguard stability in domestic markets.