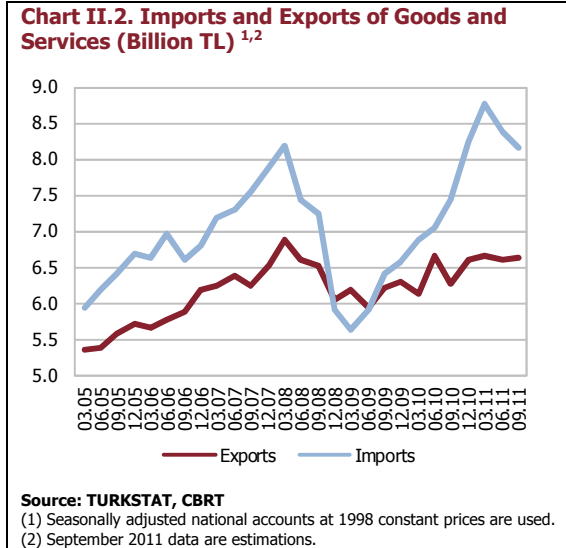
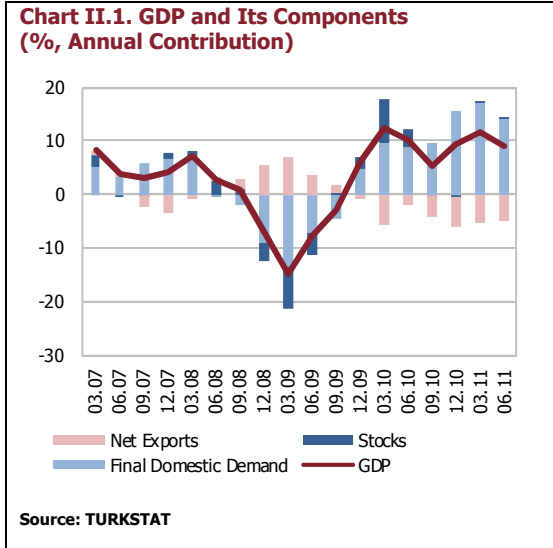


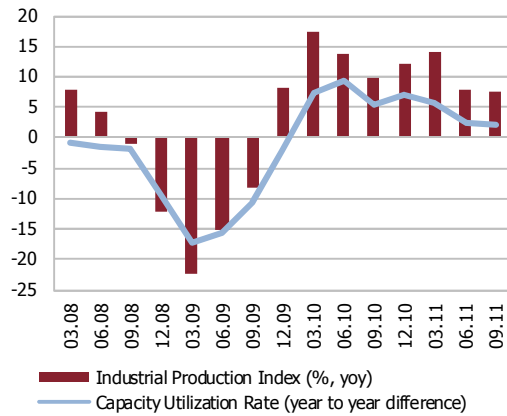
II. DOMESTIC ECONOMIC OUTLOOK

The Turkish economy displayed a high growth performance in the first half of 2011 owing to sound macroeconomic fundamentals, the ongoing capital inflow, low level of interest rates and credit expansion. Domestic demand slowed down on the back of the measures taken, thus, the growth rate lost pace starting from the second quarter of the year, accompanied by the rebalancing of demand components. Parallel to increased concerns over the global economy and deterioration in the risk appetite, Turkey faced capital outflows in the third quarter and the Turkish lira depreciated. Due to the depreciation of the Turkish lira as well as the slowing domestic demand, imports continued to weaken in the third quarter, whereas exports increased slightly. This situation helped control the rapid expansion of the current account deficit in the third quarter and the increased share of long-term borrowings in financing the current account deficit improved the quality of financing. Exchange rate effect adjusted credit growth lost pace in the third quarter. The rate of increase in household liabilities started to decelerate but corporate debt is still on the rise. Meanwhile, the budget balance continued to improve on the back of increased tax revenues owing to strong economic activity and limited public expenditures. Nevertheless, hikes in exchange rates and administered prices had an unfavorable impact on inflation indicators. In this scope, the CBRT has taken a series of measures in order to contain the adverse effects of fluctuations in the foreign exchange market and global economic developments on the domestic economic activity and to prevent the rise of inflation expectations. The CBRT will continue to take all the necessary measures to ensure price stability and financial stability in the upcoming period as well.

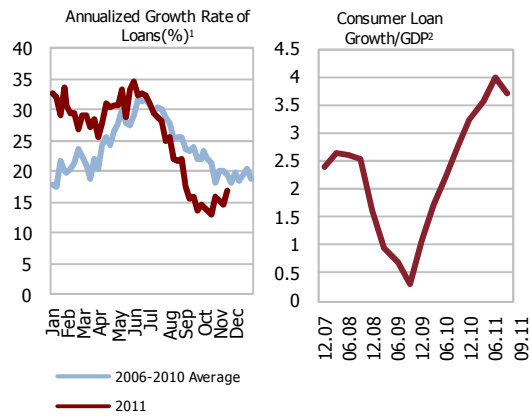
Economic activity remains robust, albeit with decreased pace and the decelerating domestic demand contributes to rebalancing of demand components. In the first and second quarter of 2011, GDP increased by 11.6 percent and 8.8 percent year-on-year, respectively (Chart II.1). Although economic activity displayed a more subdued growth pace in the second quarter compared to the first, it remained robust. Thus, GDP, which had grown by 11.2 percent in the first half of 2010, increased by 10.2 percent in the first half of 2011. The increase in GDP is attributed to the final domestic demand. In the first half of 2011, while the total contribution of final domestic demand to GDP growth was percentage 15.5 points, with a breakdown of percentage 7.6 points from private consumption expenditures, 7.1 percentage points from investment expenditures, 0.7 percentage points from public consumption, the contributions of net exports and stock changes were –5.3 and zero percentage points, respectively. According to seasonally adjusted data, while exports remained weak amid global economic developments in the second quarter of 2011, imports displayed a decline on the back of the slowdown in domestic demand after the measures taken (Chart II.2). Accordingly, seasonally adjusted data reveal that the contribution of net exports to quarterly growth was positive and demand components started to rebalance in the second quarter of 2011.



Data pertaining to the third quarter suggest a slowdown in economic activity. With the contribution of tightening reserve requirement and liquidity policies along with precautionary measures taken by the Banking Regulation and Supervision Agency (BRSA) as well as the tight stance in fiscal policy, growth of domestic demand was taken under control in the third quarter of 2011, whereas external demand remained weak despite a modest increase, due to global economic developments. Industrial production and capacity utilization data pertaining to the third quarter indicate that economic activity continued to slow down in the third quarter as well. Industrial production that had surged by 7.9 percent year-on-year in the second quarter of 2011, increased by 7.5 percent in the third quarter. The capacity utilization rate rose by 2.5 points year-on-year in the second quarter and by 2.3 points in the third quarter (Chart II.3). While, the annual growth trend of exchange rate effect adjusted loans hovered above 2006-2010 average figures in the first half of 2011, it fell below previous averages after this period and the surge in consumer loans lost pace (Chart II.4). The consumer confidence index declined to 89.7 in October 2011 from 96.4 in June 2011, which indicates a deceleration in consumption demand. The MTP announced in October envisages a relative slowdown in the growth rate starting from the second quarter of 2011 due to increased concerns worldwide, yet suggests 7.5 percent growth for the Turkish economy in 2011, despite this slowdown.

Chart II.3. Industrial Production and Capacity Utilization

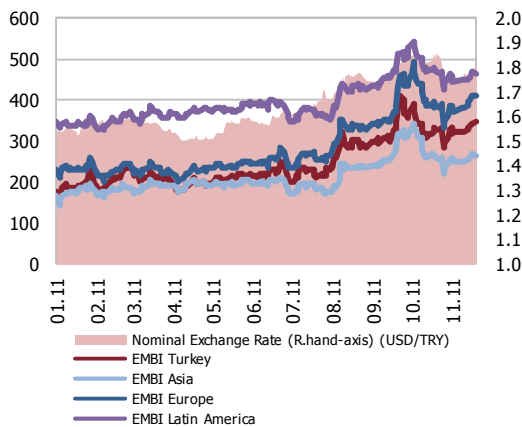
Source: TURKSTAT, CBRT

Chart II.4. Loans

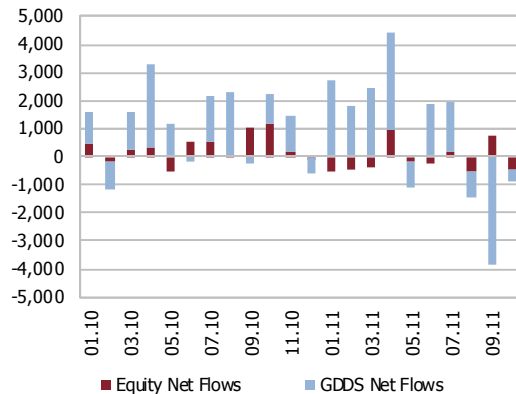
Source: BRSA-CBRT

(1) Adjusted for exchange rate effect
(2) GDP data for 2011 Q3 is estimation.

Parallel to increased uncertainties over the global economy and deterioration in the risk appetite, capital outflows were realized and the Turkish lira depreciated. Concerns over public debt in the Euro area led to a deterioration in global risk perceptions. As downside risks became more pronounced, risk premiums of emerging market economies increased and Turkey's risk premium indicators followed a similar course with other emerging markets (Chart II.5). The unfavorable course of global risk perceptions had an adverse impact on capital inflows to Turkey in the form of portfolio investments and especially the GDDS market posted outflows in August and September 2011 (Chart II.6). In line with capital outflows, Turkish lira depreciated primarily against US dollar (Chart II.5).

Chart II.5. EMBI ¹ and Nominal Exchange Rate

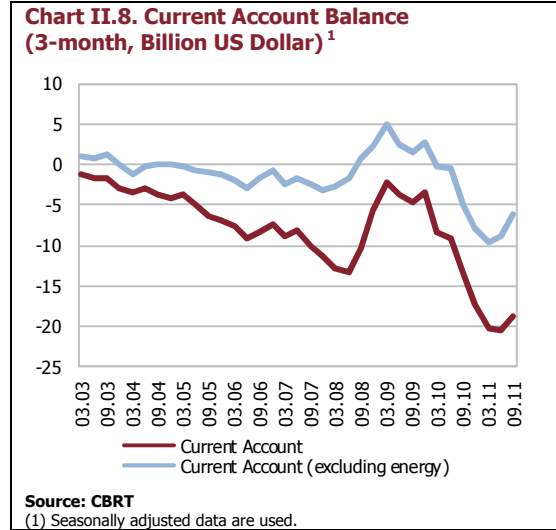
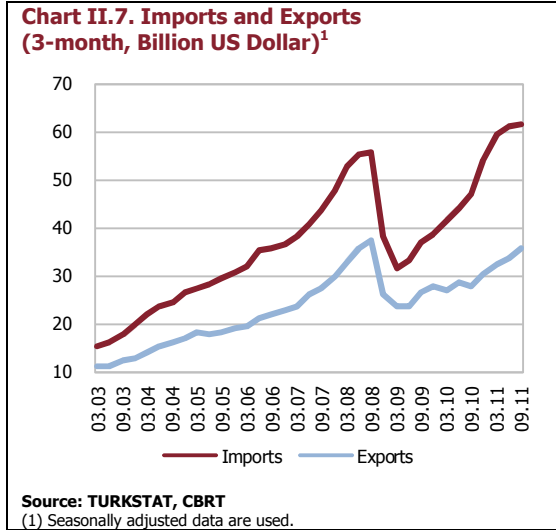
Source: Bloomberg, CBRT

(1) Latin America: Peru, Colombia, Mexico, Brazil, Chile
Asia: Indonesia, Thailand, South Korea, Malaysia, Philippines
Europe: Romania, Poland, Hungary, Czech Republic, Bulgaria**Chart II.6. Net Portfolio Flows of Non-Residents (Monthly, Million US Dollar)**

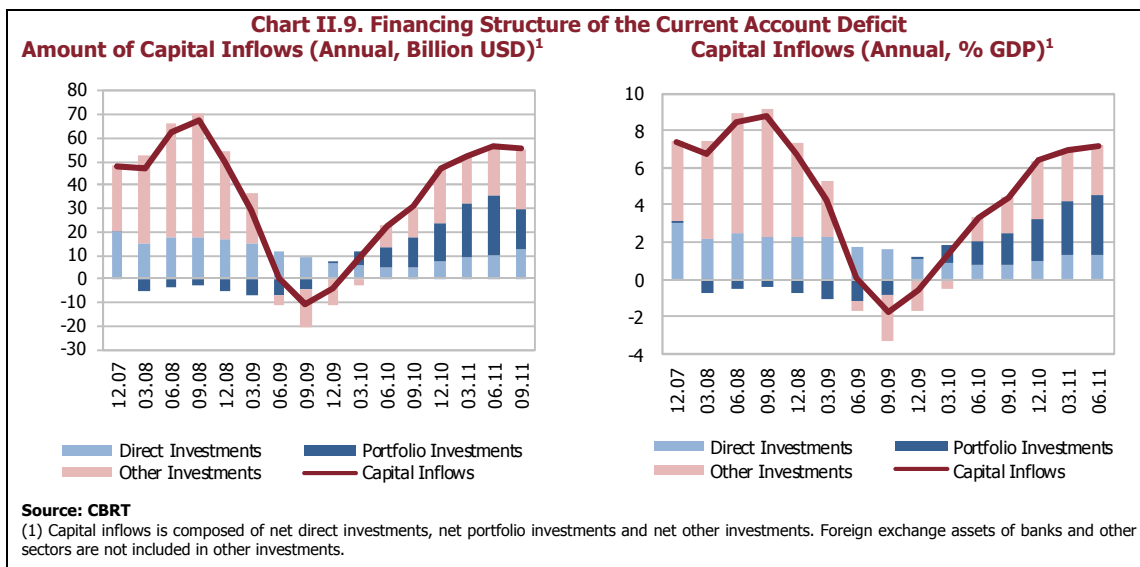
Source: CBRT

The narrowing gap between internal and external demand helped curb the rapidly growing current account deficit. Seasonally adjusted data suggest that on account of the depreciation of the Turkish lira, deceleration in credits and slowdown in domestic demand, imports remained weak in the third quarter as well and exports rose modestly (Chart II.7). Thus, according to seasonally adjusted data, the current account deficit that was USD 20.5 billion in the second quarter of 2011 declined to USD 18.6 billion in the third quarter. The current account deficit excluding energy fell to USD 6 billion from USD 8.9 billion in the same period (Chart II.8). The MTP envisages the

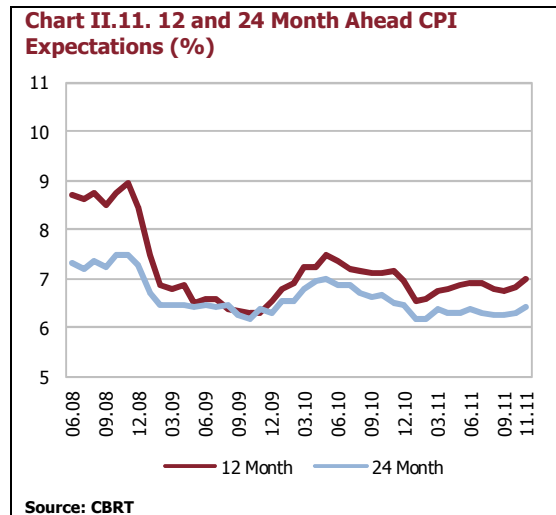
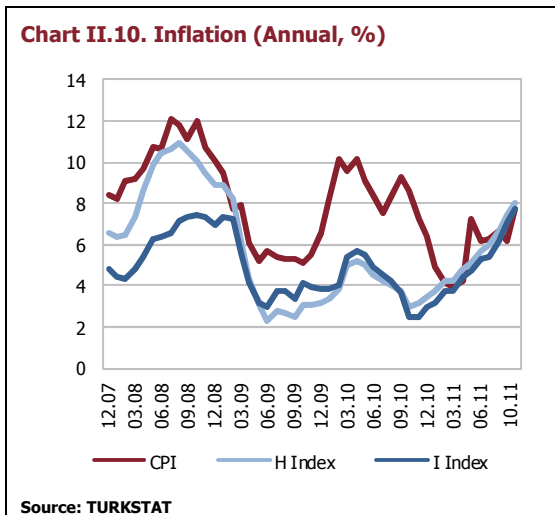
implementation of policies that will increase domestic savings and decrease the high dependency of the production structure of the economy on imports during the course of the Program. Thus, it is targeted to bring the current account deficit, which is expected to materialize at 9.4 percent of GDP by the end of 2011, to 7 percent of GDP by 2014.



The share of long-term borrowings in the financing of the current account deficit increased. Capital inflows which were 6.4 percent of GDP at end-2010 reached 7.2 percent in the first half of 2011. Net capital inflows, which stood at USD 56.4 billion by June 2011, decreased to USD 55.2 billion by September 2011 due to outflows stemming from global economic problems (Chart II.9). Capital inflows were composed of USD 12.7 billion of direct investments, USD 17.4 billion of portfolio investments and USD 25.1 billion of other investments. Compared to June 2011, the share of portfolio investments in net capital inflows declined to 31.5 percent from 44.8 percent while that of other investments rose from 36.5 percent to 45.6 percent and the share of direct investments increased from 18.8 percent to 23 percent. This reveals that the quality of financing the current account deficit improved and changed in favor of long-term capital inflows in the said period.



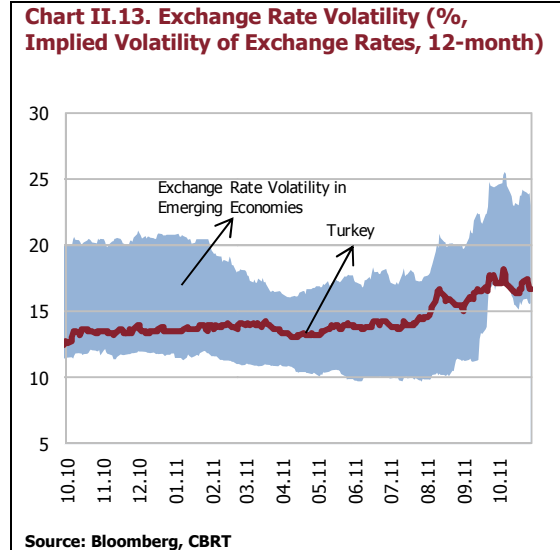
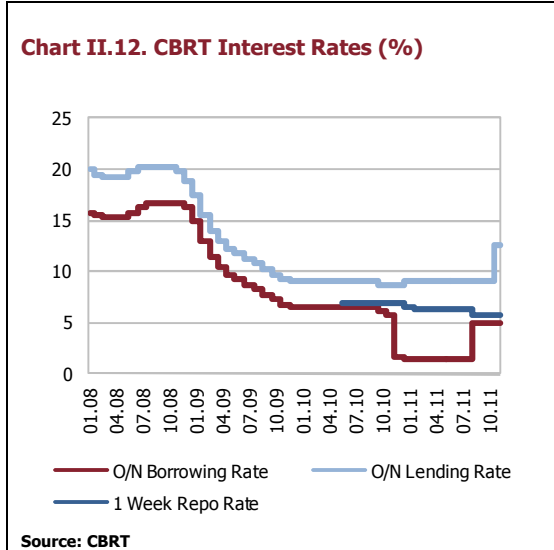
Depreciation of the Turkish lira and the hikes in administered prices have affected inflation indicators adversely, whereas inflation expectations displayed a modest rise in November. In the second quarter, the CPI increased by 6.2 percent year-on-year due to the rise in food inflation, lagged effects of cumulative increases in Turkish lira denominated import prices and the base effect. Core inflation indicators calculated by H and I indices rose on the back of core goods inflation and materialized as 5.7 percent and 5.3 percent, respectively. As of October 2011, the annual increase in the CPI rose to 7.7 percent along with the increases in H and I indices to 8 percent and 7.7 percent, respectively (Chart II.10). Despite the decline in annual inflation of the food group due to the base effect in unprocessed food prices in the said period, inflation indicators surged mainly driven by the depreciation of the Turkish lira and adjustments in administered prices¹ While core good prices were adversely affected by exchange rate developments, services prices maintained their moderate course. Inflation expectations, which displayed a rise in the first half of 2011, followed a flat course in the third quarter and annual inflation expectations for 12 and 24 months ahead rose slightly in November, due to the hikes in administered prices (Chart II.11).



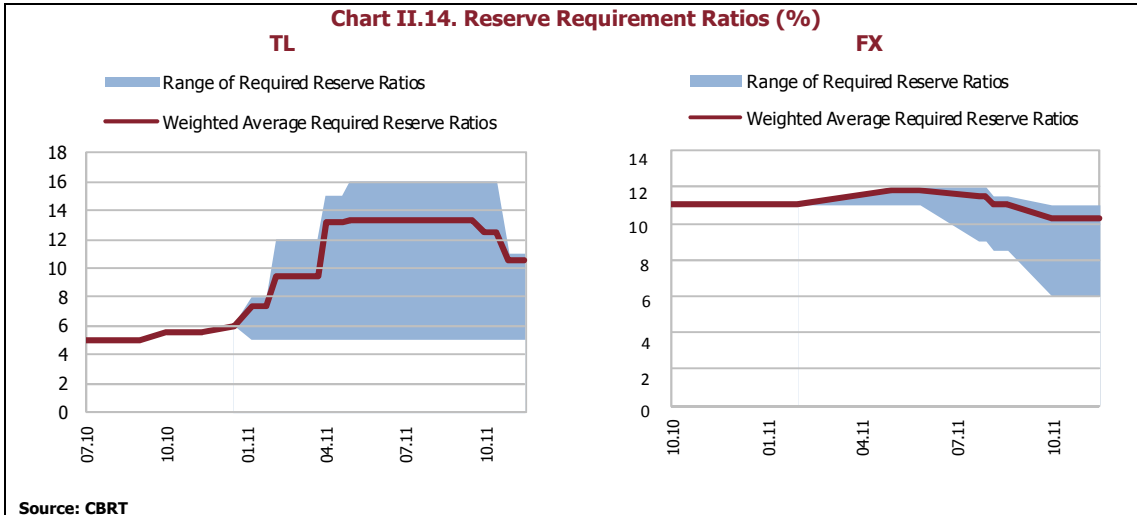
The CBRT has taken measures to contain the adverse effects of fluctuations in the foreign exchange market and global economic developments on domestic economic activity and to prevent an increase in inflation expectations. At the interim meeting of the Monetary Policy Committee (MPC), which gathered on August 4, 2011 to reduce any risk of recession in domestic economic activity driven by global economic problems, the policy rate was cut by 50 basis points and the interest rate corridor was narrowed significantly by increasing the overnight borrowing rate by 350 basis points in order to limit the potential downside volatility in the short-term interest rates (Chart II.12). Moreover, the CBRT started to hold foreign exchange selling auctions in order to alleviate the adverse effects of the excessive volatility of exchange rates on economic and financial stability during July and August and the lending rate in transactions, which the CBRT is party to, was reduced for both the USD and the euro. In October 2011, the CBRT overnight lending rate was increased by 350 basis points to ward off any negative impact of the depreciation of the Turkish lira on medium-term inflation expectations and outlook (Chart II.12). Furthermore, the Bank decided to resume its activities as an intermediary in the foreign exchange deposit markets in Foreign Exchange

¹ Rates of SCT on certain motor vehicles, mobile phones, alcoholic beverages and tobacco products were increased.

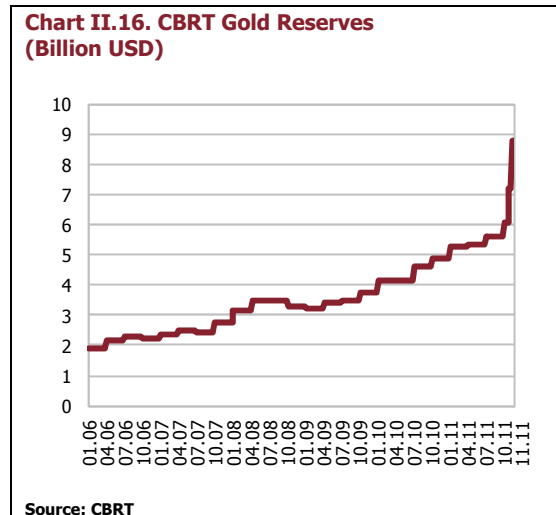
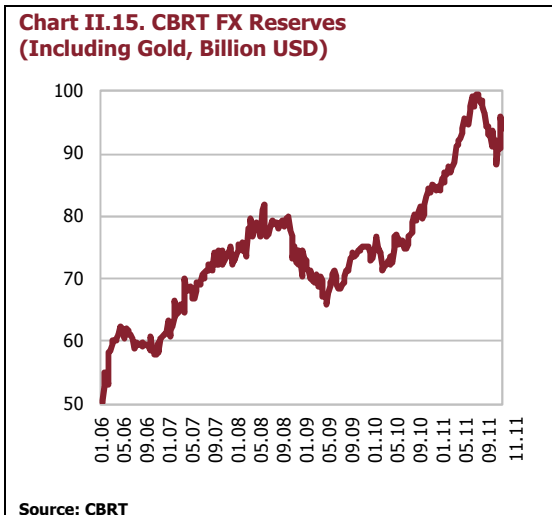
and Banknotes Market starting from November 10, 2011 with the aim of enhancing the mobility of foreign exchange liquidity until the heightened uncertainties in international markets disappear. Recently, depreciation of the Turkish lira and volatility of exchange rates remained subdued relative to other developing countries in response to the measures taken (Chart II.13).



Reserve requirements continued to be used as an active policy tool for the management of Turkish lira and foreign exchange liquidity and for the enhancement of reserves. In order to supply foreign exchange liquidity to the market and to lengthen the maturity structure of liabilities, the foreign exchange reserve requirement ratios were decreased in July, August and October (Chart II.14). Thus, liquidity amounting to USD 2.8 billion was supplied to the market. With a view to meeting the TL liquidity requirement permanently and at a lower cost, the Turkish lira reserve requirement ratios were reduced twice in October. Hence, the weighted average Turkish lira reserve requirement ratio materialized as 10.5 percent (Chart II.14) and liquidity amounting to TL 14.2 billion was provided to the market. Moreover, the Turkish lira reserve requirement ratio was set to encourage the lengthening of the maturities of the Turkish lira liabilities other than the deposit/participation funds (particularly those of TL-denominated bonds that started to be issued by banks as a new financing source). In order to meet the TL liquidity requirement of the Turkish banking system permanently and at a lower cost and to strengthen the build-up of foreign exchange reserves, up to 10 percent of the reserve requirements maintained for Turkish lira liabilities was allowed to be maintained as foreign exchange in September. The said upper limit was increased to 20 percent in October and to 40 percent in November. Gold deposit accounts that had displayed a surge recently were also included in the coverage of the reserve requirements in September. The facility of maintaining reserve requirements as "standard gold" in the accounts of Central Bank against the total amount of reserve requirements to be maintained for precious metal deposit accounts and up to 10 percent of reserve requirements for foreign currency liabilities excluding precious metal deposit accounts were provided. Besides, up to 10 percent of the reserve requirements maintained for Turkish lira liabilities were permitted to be maintained as gold.

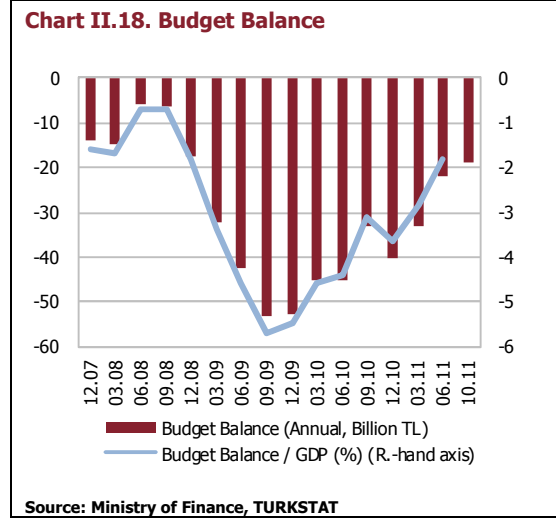
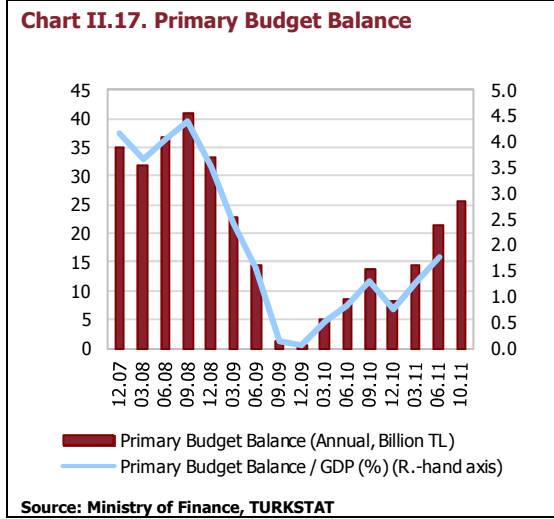


Parallel to the policies implemented, CBRT's gold reserves rose, accompanied by an increase in the FX reserves including gold in November. Owing to changes in implementation of the reserve requirement ratios (Box III.6), CBRT FX reserves increased to reach USD 94 billion as of November 18, 2011 (Chart II.15). Gold reserves of the CBRT surged by USD 2.7 billion in the period of September-November and stood at USD 8.8 billion (Chart II.16). Meanwhile, the Regulation on Rediscount and Advance from the CBRT was revised in September 2011 and the duration for fulfilling the export commitment was raised from 4 months to 6 months and the overall limit of export rediscount credits was increased to USD 3 billion. As the said credits are extended in Turkish lira but collected in foreign exchange, the increase in the utilization of these credits raise CBRT foreign exchange reserves.

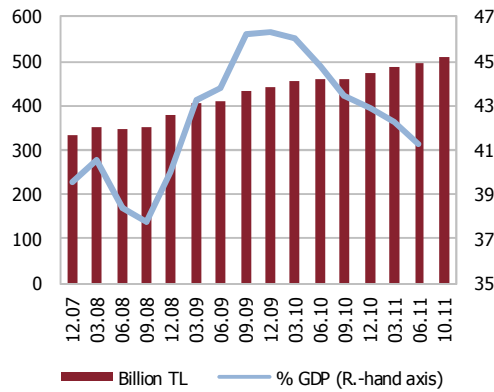


Strong economic activity, public spending under control and the decrease in interest expenses support the favorable outlook in the public finance. In the first ten months of 2011, budget revenues increased with respect to the same period in 2010 due to the surge in tax revenues, interest expenses decreased and primary expenditures surged at a relatively limited level. Moreover, additional revenues incurred via the restructuring of tax claims within the context of the "Law on Restructuring of Public Receivables" became TL 11.7 billion as of October 2011 and contributed to the public finance positively. These developments led to a positive performance on the budget and the

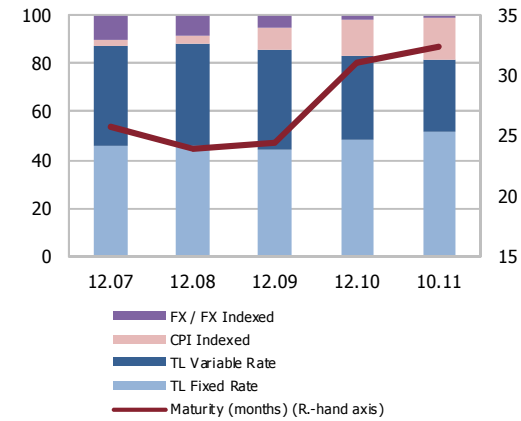
central government primary budget surplus, which had been TL 8.2 billion at end-2010, increased to TL 25.6 billion by October 2011 (Chart II.17). While the central government budget deficit was TL 40.1 billion at the end of 2010, it decreased to TL 18.7 billion by October 2011. The budget deficit, which was 3.6 percent of GDP at end-2010, was down to 1.8 percent of GDP by June 2011 (Chart II.18).



Public debt stock indicators continue to have a positive outlook. Central government debt stock, which was up by 7.3 percent in 2010 to become TL 474 billion, materialized as TL 511 billion with a year-on-year increase by 11.1 percent as of October 2011. The ratio of GDP to debt stock that had been 42.9 percent in 2010, dropped to 41.3 percent in June 2011 (Chart II.19). As of October 2011, 72 percent of the central government debt stock accounted for domestic debt. As to the composition of domestic debt stock, the share of TL denominated fixed-rate debts and CPI-indexed debts increased in 2011 compared to 2010. In October 2011, the share of TL denominated fixed-rate debts in domestic debt stock increased by 3.1 points to become 51.4 percent and CPI-indexed debts increased by 2.1 points to become 17.1 percent, compared to end-2010. Moreover, the maturity of domestic debt stock also increased from 31 months at end-2010 to 32.3 months in October 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.

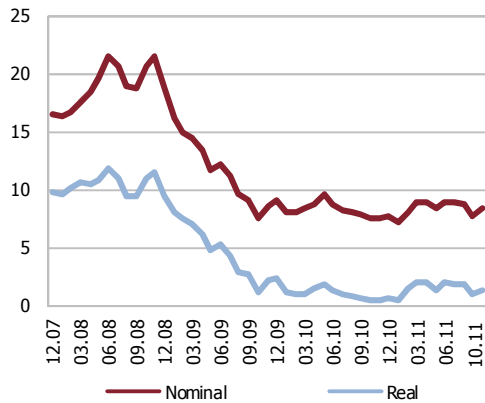
Chart II.19. Central Government Debt Stock

Source: Undersecretariat of Treasury, TURKSTAT

Chart II.20. Composition of Domestic Debt Stock (%)

Source: Undersecretariat of Treasury

Borrowing costs of the public sector hover around low levels and the MTP envisages a tightening in public finance in the upcoming period. The treasury discounted auction interest rate displayed a downward trend from early 2009 and is still at low levels despite a slight increase in 2011. The rate that was 8.3 percent as of October 2011 stands at 1.4 percent after being adjusted for 12-month inflation expectations (Chart II.21). According to the framework outlined in the MTP regarding public finance, primary budget expenditures will gradually be reduced during the Program period. Furthermore, it is targeted to increase tax revenues and the total public primary surplus as well as to decrease the ratio of debt stock to GDP by way of legal and administrative regulations (Table II.1).

Chart II.21. Treasury Discounted Auction Interest Rate (%)

Source: Undersecretariat of Treasury, CBRT

Table II.1. Main Variables Related To Public Finance (Ratio to GDP, %)

	2011*	2012**	2013**	2014**
Central Gov. Budget Balance	-1.7	-1.5	-1.4	-1.0
Central Gov. Budget Revenues	22.7	23.1	22.9	22.5
Central Gov. Budget Expenditures	24.4	24.6	24.2	23.6
Total Public Primary Balance (Program-Defined)	1.2	1.1	1.3	1.5
Central Government Primary Balance (Program-Defined)	0.9	1.0	1.2	1.4
Central Gov. Revenues (Program-Defined)	22.0	22.1	22.0	21.8
Central Gov. Primary Expenditures (Program-Defined)	21.1	21.1	20.9	20.4
EU Defined Nominal Debt Stock	39.8	37.0	35.0	32.0

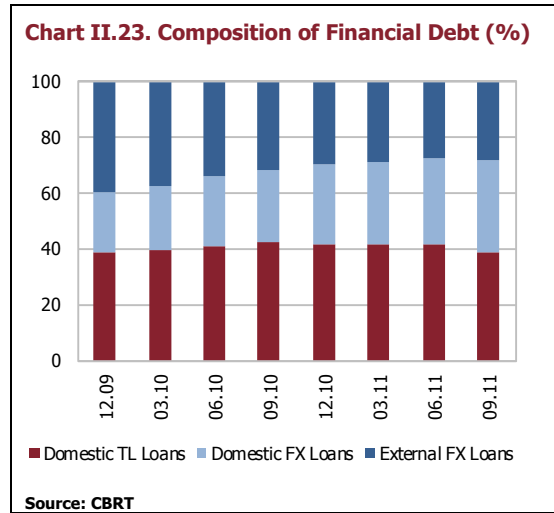
Source: Medium Term Program (2012-2014)

* Forecast

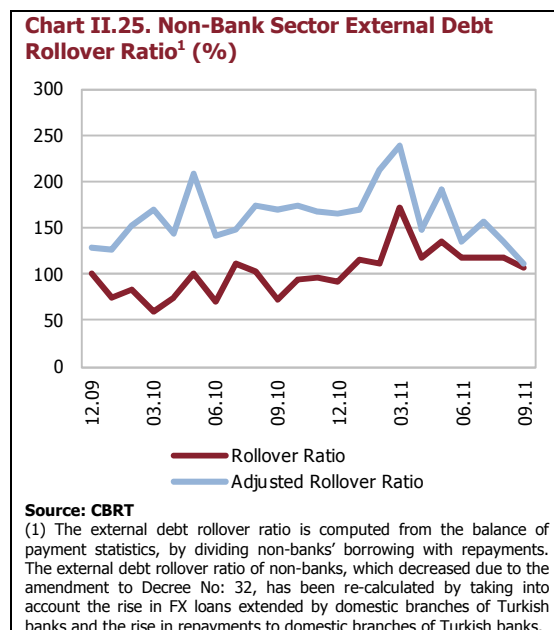
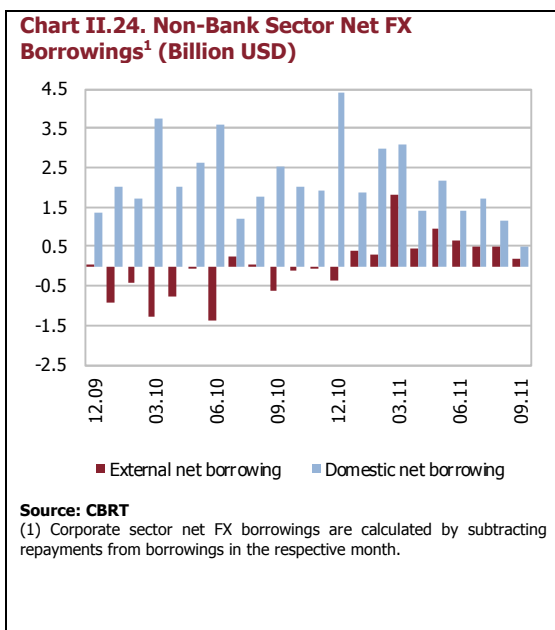
** Target

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 early 2010 and became TL 563 billion by September 2011. Consequently, the ratio of the corporate sector financial debt to GDP increased by 3.4 points in the first half of 2011 compared to end-2010 and reached 42.6 percent (Chart II.22). As of September 2011, 60.8 percent of corporate sector financial debt was denominated in foreign currency; however, majority of this debt was long term. In the same period, the share of foreign borrowing in total loans (excluding branches) was 20 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 3.3 points compared to end-2010, reaching 40.9 percent. TL loans extended to the corporate sector dropped in the reporting period and became 39.2 percent as of September 2011(Chart II.23).



After the amendment to Decree No. 32 in June 2009, firms opted for FX loans from the domestic market and the external loans rollover ratio displayed a downward trend in the second half of 2011. From end-2010 to August 2011, the amount of loans extended to the corporate sector by foreign branches and affiliates of Turkish banks decreased by USD 1.4 billion, whereas loans extended by foreign banks increased by USD 2.5 billion. On the other hand, FX loans extended by domestic branches of banks increased by USD 21.8 billion (Chart II.24). According to balance of payments data, the external debt rollover ratio of non-banks was 107 percent as of September 2011; however, taking into consideration the increase in the volume of FX loans extended by domestic branches, the ratio is calculated as 112 percent. The decrease in the external debt rollover ratio in September 2011 compared to March 2011 was mainly attributable to the decline in long-term external borrowing (Chart II.25).



Corporate sector's profits decreased despite increased sales. While the total amount of sales revenues of firms quoted on the Istanbul Stock Exchange (ISE) increased by 28 percent year-on-year in September 2011, operating profits increased by 30 percent; however, net profits decreased by 14 percent. Despite higher sales revenues and operating profits of firms, financial expenditures that rose on the back of increased provisions for exchange rate movements were instrumental in the decline of the net profit (Chart II.26). As a result of these developments, the return on equity, which was 12 percent in September 2010, declined to 9.5 percent in September 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 margins negatively.

Chart II.26. Sales and Profitability of Firms by September 2011 (Annual % Change)¹



Source: PDP

(1) Consolidated data of 224 manufacturing industry firms quoted on the ISE.

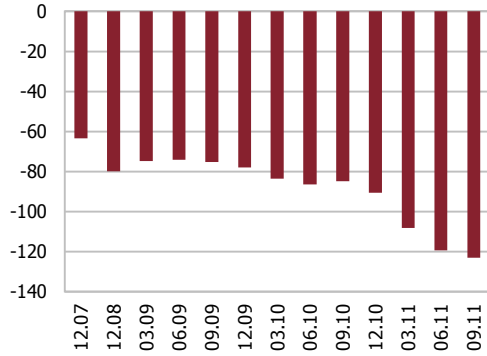
Table II.2. Return on Equity and Its Components¹

	09.10	09.11
Net Profit / Equity (%)	12.0	9.5
Assets / Equity	2.1	2.2
Net Profit / Assets (%)	5.9	4.2
Sales / Assets	0.7	0.8
Net Profit / Sales (%)	7.8	5.3
Operating Profit / Sales (%)	9.2	9.4
Financial Income (Expenditures) / Sales (%)	0.3	-2.8

Source: PDP

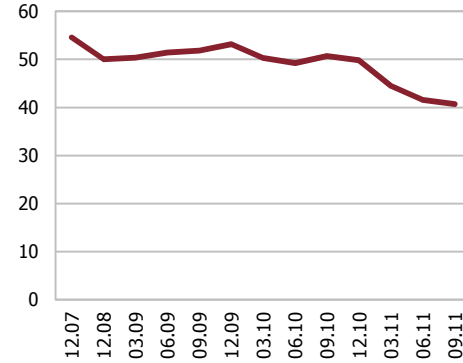
(1) Consolidated data of 224 manufacturing industry firms quoted on the ISE.

The FX assets and liabilities of firms suggest that the net FX short position has increased and currency risk still remains significant 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 rose by 16.4 percent year-on-year in 2010 increased by 35.7 percent in the first nine months of 2011 and reached USD 123 billion (Chart II.27). As of September 2011, the ratio of FX assets to FX liabilities went down by 3.8 points from the first quarter of 2011 and declined to 40.7 percent (Chart II.28).

Chart II.27. Foreign Exchange Position of the Corporate Sector (Billion USD)¹

Source: CBRT

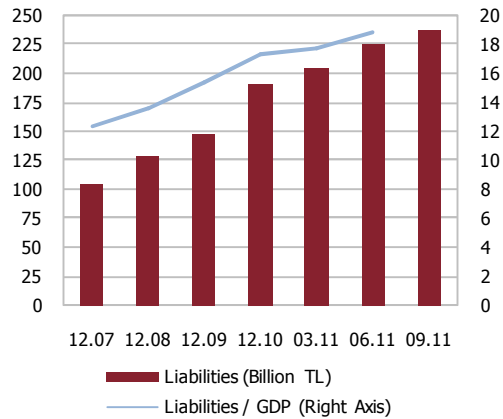
(1) Data for September 2011 are provisional.

Chart II.28. FX Assets to FX Liabilities Ratio of the Corporate Sector (%)¹

Source: CBRT

(1) Data for September 2011 are provisional.

As a result of measures taken to curb credit growth, the increase of household liabilities declined gradually in 2011. Apart from measures taken by the authorities, deterioration of the global risk appetite, which led to depreciation of the Turkish lira, and decreased consumer confidence arising from external developments were influential in the deceleration of the growth of household indebtedness (Chart II.29). Meanwhile, rising costs incurred by banks due to the measures taken as well as external risk developments became instrumental for them in setting loan rates, which led to rise in household borrowing cost. This situation was also reflected on the interest payments of households (Table II.3).

Chart II.29. Household Liabilities (% , Billion TL)¹

Source: BRSA-CBRT, TURKSTAT

(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.

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

	12.09	12.10	09.11
Household Disp. Income	408.9	463.4	529.7
Household Liabilities	147.1	191.1	236.6
Household Interest Payments	21.1	20.4	22.3
Interest Paym. / Hh. Disp. Income (%)	5.2	4.4	4.2
Liabilities / Hh. Disp. Income (%)	36.0	41.2	44.7

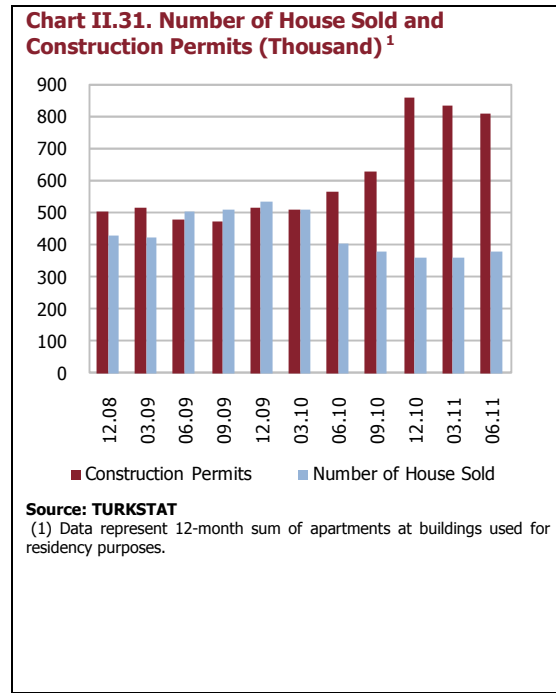
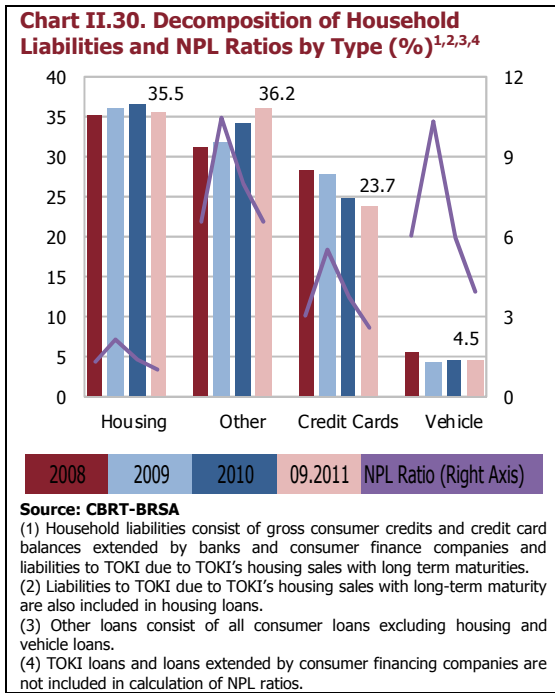
Source: BRSA-CBRT, TURKSTAT, Development Bank of Turkey

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 for 2010 and 2011 September has been calculated by using the private sector disposable income estimation for 2010 and 2011 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.

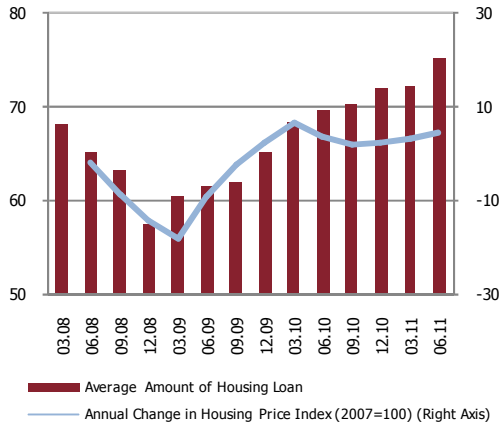
Housing loans that have the largest share in household liabilities were replaced by other loans in the third quarter of 2011 on the back of measures taken and decline in housing demand. Housing loans and number of house sold increased due to the fall of interest rates and the recovery in economic activity during the post-crisis period. However, with the decision of BRSA limiting the loan amount to 75 percent of the value of the house² the interest rates on loans surged, as a result of which the growth rate of housing loans decelerated and other loans had the largest share in households liabilities in September 2011 (Chart II.30). The number of house sold, which had reached 532 thousand at end-2009, was down to 380 thousand in June 2011 due to the decline in housing loans and demand for purchase of house (Chart II.31).



The increase of housing prices is one of the factors that have led households to use higher amount of loans. The annual growth rate of housing loans, which fell due to the crisis, recovered in 2009 on the back of the decline in housing stock and followed a stable course due to the excess supply arising from the increase of construction permits starting from 2010 (Chart II.31 and Chart II.32). The change in housing prices also has an impact on the average amount of housing loan used by households (Chart II.32). Rebounds in housing prices may lead households to use higher loans than they can afford. However, the increase of housing prices in Turkey seems more reasonable than that in selected countries (Chart II.33).

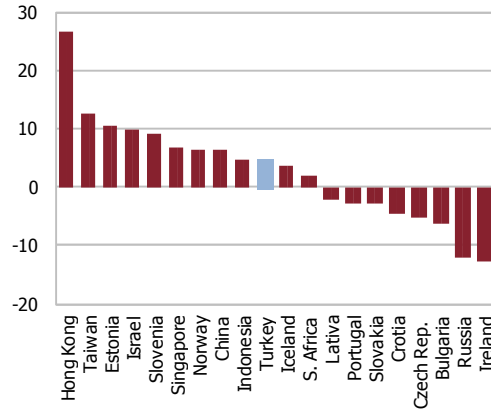
² With the BRSA decision No. 3980, published in the Official Gazette No. 27789 dated December 18, 2010, the amount of the credit that can be extended was limited to 75 percent of the value of the real estate subject to collateral, to be effective as of January 1, 2011.

Chart II.32. Average Amount of Housing Loan and Annual Change in Housing Price Index (Thousand TL, %)¹



Source: The Banks Association of Turkey, Reidin.com-The Association of Real Estate Investment Companies
 (1) Average amount of housing loans are computed by dividing annualized housing loans by annualized number of borrowers, which are issued by the BAT.

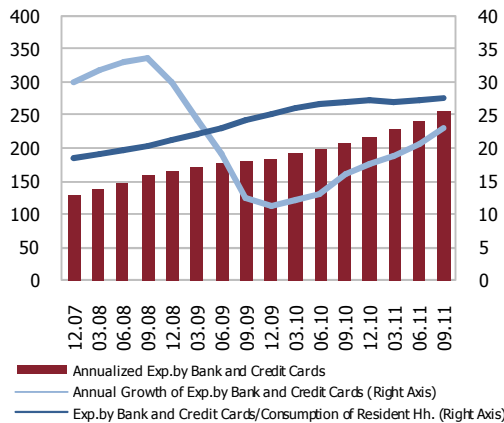
Chart II.33. Annual Change in Housing Prices in Selected Countries (2011 June, %)



Source: Knight Frank Global House Price Index

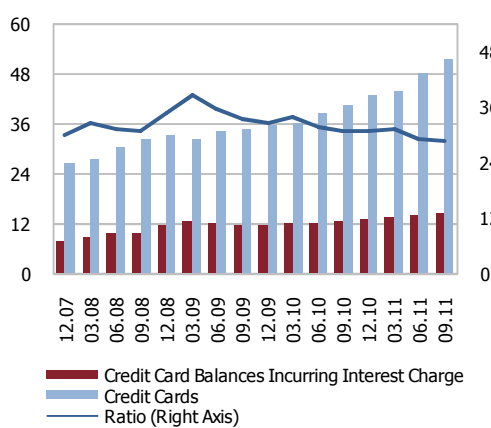
Household expenditures by bank and credit cards continued to rise over the years, whereas the ratio of credit card balances that incur interest charges to total credit card balances is in decline. With more widespread use of credit cards, the share of expenditures by bank and credit cards in household consumption increased. The increase in expenditures by cards, which plays an important role for the registered economy as well, slowed down during the crisis, however it gained pace afterwards (Chart II.34). Credit card balances continued to rise albeit with a decreased share in household liabilities by years. In the meantime, the ongoing favorable economic outlook reduces the ratio of credit card balances that incur interest charges to total credit card balances (Chart II.35).

Chart II.34. Expenditures by Bank and Credit Cards and Resident Household Consumption (Billion TL, %)¹



Source: TURKSTAT, Interbank Card Center (ICC)
 (1) Spending by deposit and credit cards are calculated by annualizing the use of local bank and credit cards in domestic shopping.

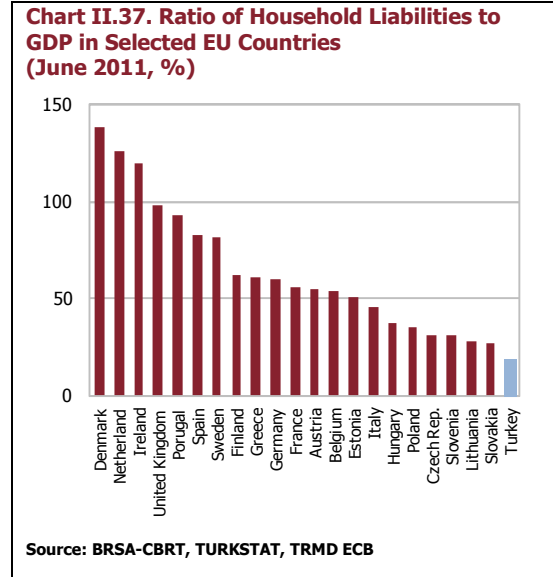
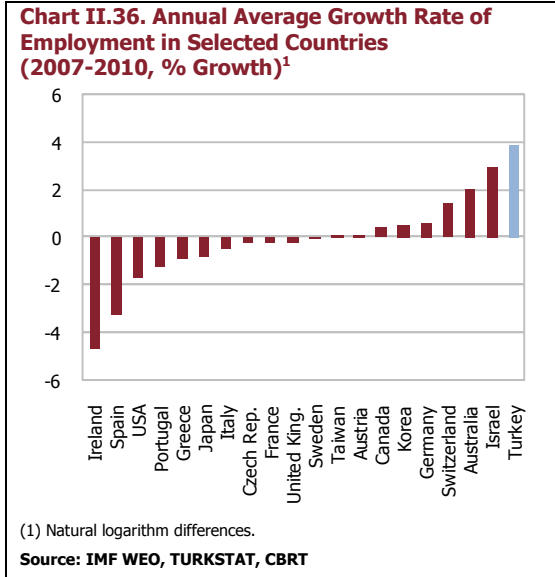
Chart II.35. Credit Card Balances of Deposit Banks and Balances that Incur Interest Charge¹



Source: CBRT

Recovery in the employment market added to the household disposable income and facilitated access to loans. Unemployment, the biggest risk for households continued to be a serious problem particularly in developed countries in the post-crisis period. As for Turkey, the unemployment rate returned to its pre-crisis average levels thanks to increased employment on the back of high growth performance (Chart II.36). Improvement in the employment market had a

positive impact on household disposable income; however it also led to a surge in liabilities. Accordingly, the ratio of household liabilities to disposable income continued to rise (Table II.3). Nevertheless, the ratio of household liabilities to GDP, which was 18.8 percent by June 2011, is still at low levels compared to EU countries (Chart II.37).



The number of credit card and consumer loan defaulters decreased and the Non-performing Loan (NPL) ratio for consumer loans declined. The number of credit card and consumer loan defaulters declined owing to the economic recovery and the surge in employment (Table II.4). The NPL balances also displayed a similar outlook and the NPL ratio for consumer loans started to fall in 2009 (Chart II.30).

The exchange rate and interest rate risk on consumer loans observed in some EU countries is quite low in Turkey. Housing loans extended in FX and generally with variable rates have surged significantly primarily in Eastern and Central European countries in the recent period. Therefore, mortgage risks coupled with problems in the EU have increased. Thus, some countries (Hungary, Romania, etc.) have taken measures related to FX-denominated loans in order to safeguard financial stability. As for Turkey, with the amendment to Decision No. 32 in June 2009, households, unable to borrow in foreign exchange, were prevented from borrowing FX-indexed loans as well; hence, hedging against FX risk was provided (Chart II.38). Moreover, the minority of housing loans are variable-rate loans, which reduces the interest rate risk of households.

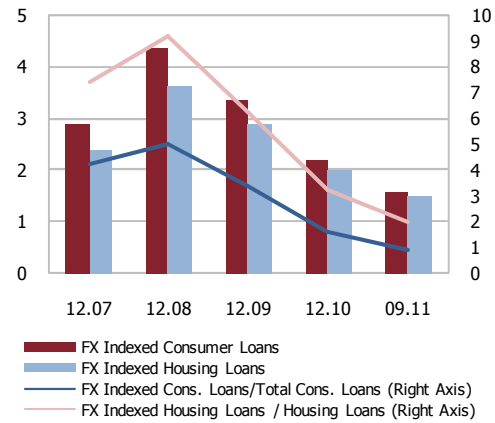
Table II.4. Number of Credit Card and Consumer Loan Defalters¹

	12.08	12.09	12.10	09.11
Banks	997,095	1,489,131	1,319,111	1,204,213
Asset Management Companies ²	139,862	330,156	574,541	625,127
Finance Companies	21,884	23,463	18,003	15,313
Total ³	1,093,474	1,721,004	1,689,788	1,616,436

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 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.

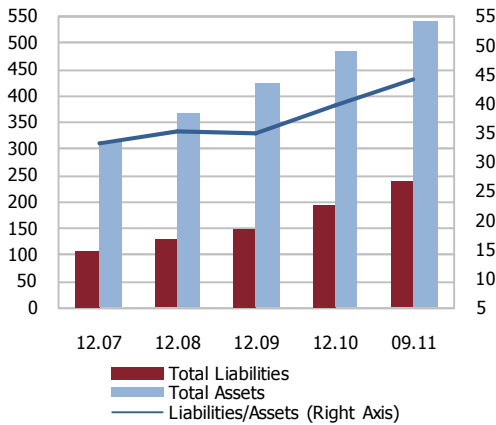
Chart II.38. FX-Indexed Consumer Loans and FX-Indexed Housing Loans (Billion TL, %)



Source: BRSA-CBRT

The ratio of household liabilities to assets has increased. The ratio of household liabilities to financial assets is on the rise due to the fact that liabilities increase faster than assets (Chart II.39). As of September 2011, the share of TL deposits continued to have the largest share in household assets. In the said period, the shares of precious metal deposit, repos and private pension funds in household assets increased compared to end-2010, whereas the share of other financial assets declined (Table II.5).

Chart II.39. 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.

Table II.5. Household Financial Assets (Billion TL, %)¹

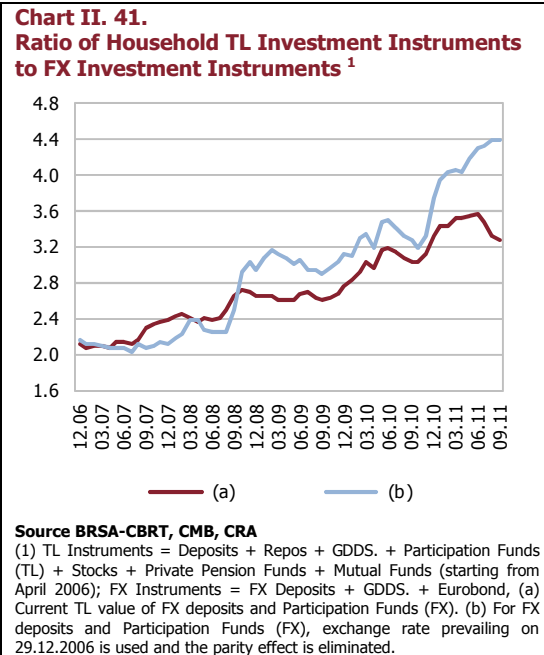
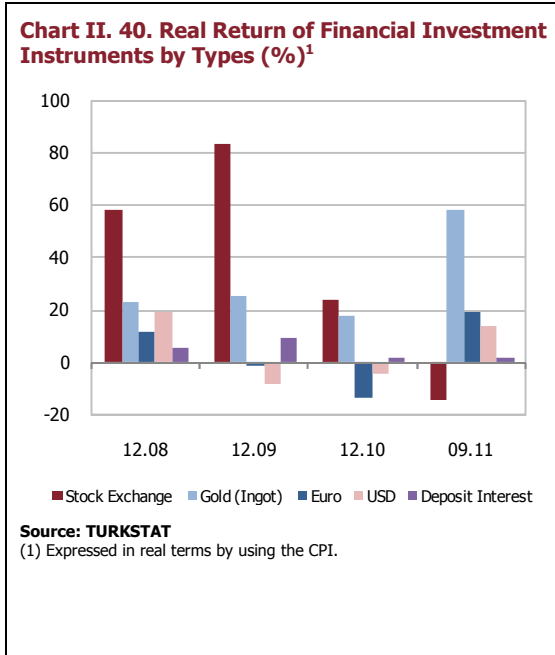
	12.09		12.10		09.11	
	Billion TL	% Share	Billion TL	% Share	Billion TL	% Share
TL Deposits	209.6	49.9	253.8	52.7	280.4	52.1
FX Deposits	98.2	23.4	96.9	20.1	106.9	19.9
- FX Deposits (Billion USD)	65.2	-	62.7	-	58.0	-
Currency in Circulation	35.4	8.4	44.6	9.3	52.1	9.7
GDDS+Eurobond	14.1	3.3	9.4	2.0	8.8	1.6
Mutual Funds	26.1	6.2	28.5	5.9	28.3	5.3
Stocks	24.6	5.9	32.6	6.8	32.4	6.0
Private Pension Funds	9.0	2.1	12.1	2.5	14.1	2.6
Repos	2.3	0.5	1.5	0.3	2.2	0.4
Precious Metal Deposits	1.1	0.3	2.3	0.5	12.5	2.3
Total Assets	420.4	100	481.7	100	537.7	100

Source: BRSA-CBRT, CMB, CRA

- (1) TL and FX deposits include participation funds.

Households' portfolio preferences are shaped according to risk perceptions, expectations on future and yields of financial assets. In the first three quarters, gold yielded the highest real return while the ISE index performed the worst. This development reverberated on the financial assets of households as well (Chart II.40 and Table II.5). The stable course of foreign exchange rate also reflects on portfolio preferences between TL and FX financial assets. Adjusted for

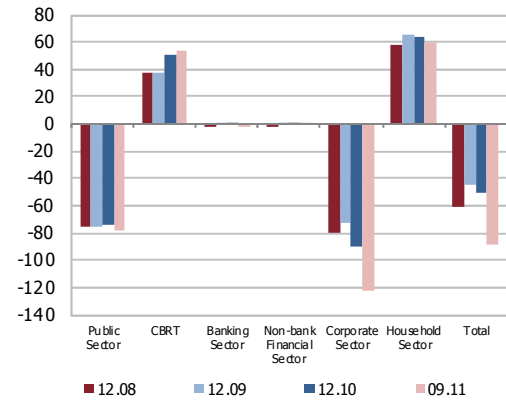
exchange rates, it is observed that the ratio of TL investment instruments to FX investment instruments continued to increase by years (Chart II.41).



Monitoring Turkey's macro FX position is important for the assessment of the exchange rate risk of economic units. Turkey's FX short position stood at USD 88.9 billion as of September 2011. An analysis by years indicates that in Turkey, the public and corporate sector have FX short positions, the CBRT and households have long positions and the banking sector and non-bank financial sector have a position of almost zero. In this framework, the public and corporate sectors are those that will be adversely affected by the depreciation of the Turkish lira. As of September 2011, the corporate sector posted a short position of USD 123 billion, followed by USD 78.4 billion of the public sector, USD 0.5 billion of the banking sector; whereas households had a long position of USD 59.1 billion, followed by USD 53.9 billion of the CBRT, and USD 0.1 billion of the non-bank financial sector (Chart II.42). In September 2011, Turkey's FX short position materialized as 11.2 percent of GDP³ (Special Topic IV.8).

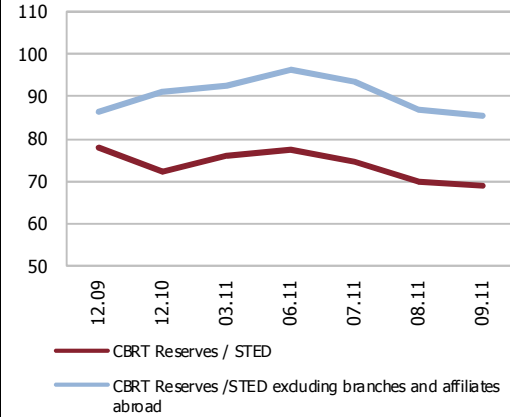
While CBRT reserves are on the rise, the ratio of reserves to short-term external debt stock according to days to maturity excluding foreign branches and affiliates is 85.3 percent. The ratio of CBRT reserves to short-term external debt stock according to days to maturity excluding foreign branches and affiliates declined to 85.3 percent in September 2011 from 96.2 percent in June 2011 (Chart II.43). The amount of reserves that surged on the back of policy measures taken is expected to drive this ratio upwards in the coming period.

³ The GDP figure for 2011 Q3 is estimation.

Chart II.42. Turkey's FX Short Position (Billion USD) ¹

Source: CBRT-BRSA, Undersecretariat of Treasury

(1) Public FX liabilities for September 2011 consist of central government external debt stock data and central government FX-denominated and FX-indexed domestic debt stock data.

Chart II.43 Ratio of CBRT Reserves to Short-Term External Debt (STED) According to Days to Maturity (%) ¹

Source: CBRT

(1) Represents external debt with days to maturity of one year or less, regardless of the original maturity.

Uncertainties over global economic activity remain important in terms of financial stability in the period ahead. Primarily, problems over the sovereign debt in the Euro area spill over to the banking sector and sustain the downside risks on the global economy. Despite the counter-cyclical effects of policy measures taken to deal with the deterioration of the global growth outlook on domestic demand, the likeliness of deepening of global problems constitutes a major risk factor for Turkey as well. The CBRT, owing to its sound balance sheet and strong policy tools, has the room for maneuver to minimize the adverse effects of global concerns on the Turkish economy and will monitor economic developments closely and continue to take the necessary measures to ensure stability in domestic markets. In the forthcoming period, implementation of the fiscal framework envisaged in the MTP as well as the institutional and structural arrangements are of great importance for both supporting financial stability and for the decoupling of the Turkish economy and other emerging market economies in favor of the former. Moreover, the implementation of structural reforms that increase savings and reduce external dependency with regard to energy as set out in the MTP; and, thus, providing a lasting solution to the current account deficit is crucial to bolster financial stability.