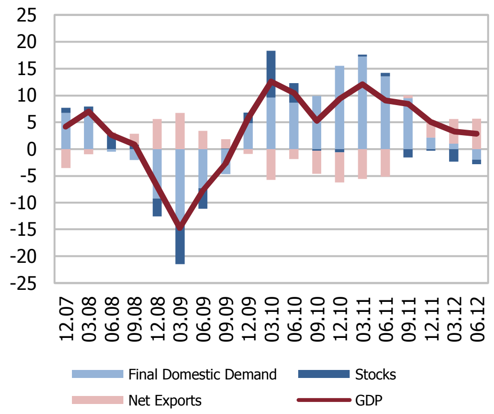
II. DOMESTIC ECONOMIC OUTLOOK

In the first nine months of 2012, the slowdown in economic activity continued and the growth composition showed that demand components were rebalancing. The current account deficit narrowed on the back of net exports' significant contribution to growth. A relative decline in budget performance is observed that can be attributed to the decrease in growth rate of tax revenues driven by the deceleration in economic activity and acceleration in primary expenditures. Growth rate in household liabilities has slowed down owing to measures taken by the authorities; and the rise in corporate indebtedness observed in 2010-2011 halted. Although inflation in the third quarter of 2012 remained above expectations due to energy prices, unprocessed food products prices and public price adjustments; core inflation indicators and moderate growth suggest that inflation will assume a downward trend in the upcoming period. Since mid-2012, the monetary policy became more accommodative in response to the partial improvement in the global risk appetite, the stronger rebalancing process in economy on the back of the policies implemented; and the stronger contribution of domestic demand to disinflation. The reserve option mechanism enhanced the resilience of the banking sector against external financial shocks. The above mentioned mechanism and the rise in export rediscount credits have supported the foreign exchange reserves. With the positive effect of the CBRT'S accommodative policies coupled with the partial improvement in the global risk appetite, domestic market rates decreased and loan rates are gradually decreasing in tandem with the former. It is expected that both demand and supply factors will assume a trend that will support credit volume starting from the final quarter of the year and growth is expected to pick up owing to the moderate recovery in consumption demand. In the upcoming period, the CBRT will continue to take all necessary measures for the sake of financial stability besides its primary objective of price stability.

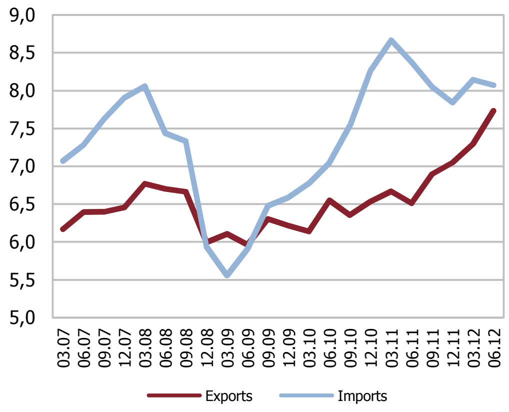
In the first half of 2012, the slowdown in economic activity continued while the growth composition assumed a healthier outlook. GDP grew by 3.3 percent year on year in the first quarter of 2012 and by 2.9 percent in the second quarter. Thus, the GDP, which increased by 8.5 percent in 2011, rose by 4.9 percent in annual terms in the first half of 2012. It can be observed that the economic activity slowed down after the first quarter of 2011. The sounder structure of the growth composition proves that measures taken by the CBRT as well as other relevant institutions and the policies adopted have been mostly successful. As a matter of fact, final domestic demand started to decelerate starting from the second half of 2011; growth was mainly driven by the net exports starting from the final quarter of 2011 and thus, the rebalancing process in the demand composition continued. When contributions to annual growth as of the second quarter of 2012 are analyzed, it is observed that while net external demand was the only factor that made a positive contribution; final domestic demand and stocks made a negative contribution (Chart II.1). While the weak growth in Turkey's main trade partner -the Euro area- curbs Turkey's external demand; exports to Africa and Middle East countries, the shares of which are constantly increasing in Turkey's exports, were favorable starting from the second half of 2011 and imports started to decline due to the slowdown in domestic demand (Chart II.2). The impact of net exports of gold should not be overlooked in analyzing the significant contribution of net exports to annual growth; this contribution is believed to have stemmed from a seasonal increase in the external demand for gold.

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



Source: TURKSTAT

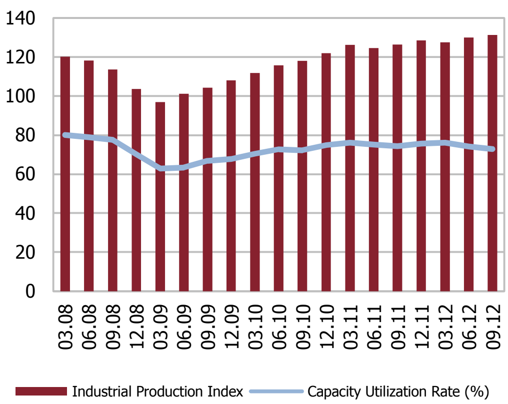
Chart II.2. Imports and Exports of Goods and Services (Billion TL)[1]



Source: TURKSTAT, CBRT
(1) Seasonally adjusted national accounts at 1998 constant prices have been used.

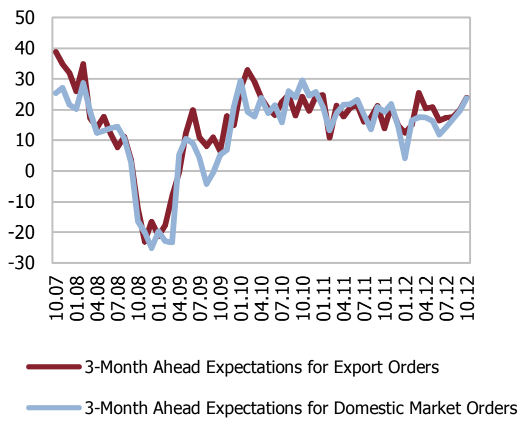
Although data pertaining to the third quarter of 2012 suggest that the slowdown in economic activity continues, leading indicators point to a moderate recovery in consumption demand in the final quarter of the 2012. Using seasonally adjusted data the quarterly average capacity utilization ratio remained below the level of the previous quarter and the quarterly average of the industrial production index displayed a limited rise (Chart II.3). On the other hand, recent leading indicators suggest that economic activity will pick up in the final quarter. As a matter of fact, the leading indicators index, the Turkish Exporters Assembly Index (TIM) and the 3-month ahead expectations for domestic and export orders all point to a slight recovery (Chart II.4). In the Medium Term Program (MTP) announced in October, it was stated that the growth rate for 2012 would be 3.2 percent based on forecasts that the contribution of net exports of goods and services will decline and domestic demand will relatively recover.

Chart II.3. Industrial Production and Capacity Utilization (2005=100, Quarterly Average)[1]



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

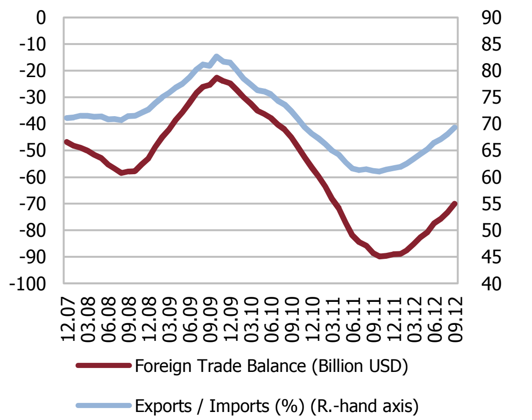
Chart II.4. 3-Month Ahead Expectations for Orders (%)[1]



Source: CBRT
(1) Seasonally adjusted data.

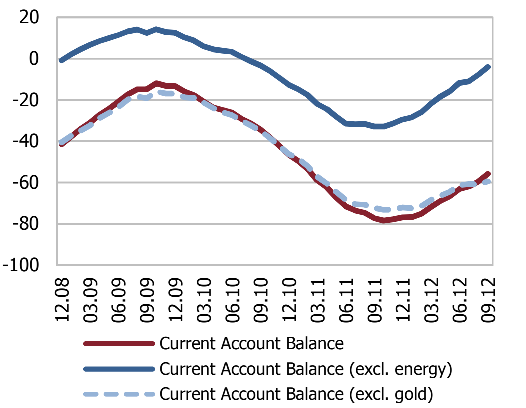
The foreign trade balance and current account balance continue to improve. As a result of the continued rise in exports and decline in imports in the third quarter, the annual foreign trade deficit, which was USD 85.2 billion in March 2012, came down to 70.1 billion in September 2012. The ratio of imports covered by exports was up from 63.4 percent in March 2012 to 69.3 percent in September 2012 (Chart II.5). In tandem with the improvement in the foreign trade balance, the annual current account deficit, which was 71.8 billion in March 2012, decreased to 55.8 percent in September 2012. Meanwhile, the recovery in the current account deficit excluding gold was more limited. The said item, which was USD 68.4 billion in March 2012, became 59.5 percent in September 2012. In the same period, the current account deficit excluding energy became USD 4 billion (Chart II.6). In the MTP, it is projected that the ratio of current account deficit to GDP, which was 10 percent in 2011, will be 7.3 percent by the end of 2012.

Chart II.5. Foreign Trade Balance (Annual)



Source: CBRT

Chart II.6. Current Account Balance (Annual, Billion USD)

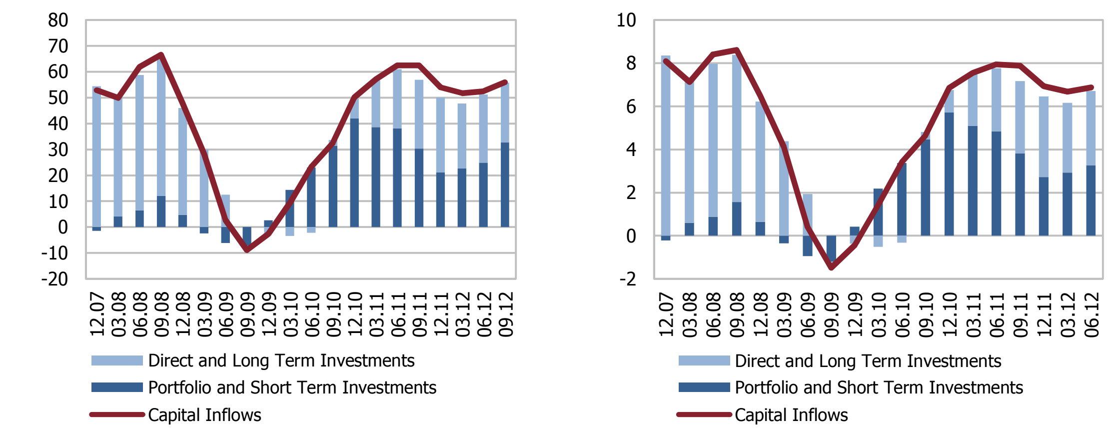


Source: CBRT, TURKSTAT

While the share of long-term borrowing in the financing of the current account deficit is higher compared to that of crisis period, recently the share of short-term borrowing has slightly increased. Annual net capital inflows, which accounted for 6.9 percent of the GDP at the end of 2011, became 6.9 percent by June 2012 again, displaying no change (Chart II.7). While the shares of direct investments and long-term capital inflows significantly increased in 2012 compared to end-2010, in the first nine months of 2012 the share of short-term borrowing displayed a slight rise compared to end-2011, mainly stemming from the decline in long-term borrowing of banks and other sectors, and the increase in banks' short-term deposits.

Chart II.7. Financing Structure of the Current Account Deficit

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

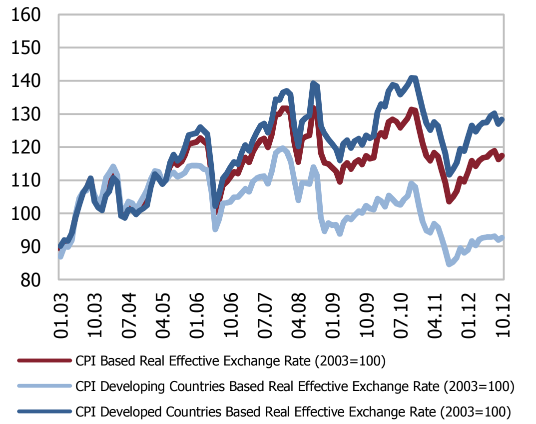


Source: CBRT

(1) Portfolio and short-term capital flows is composed of equities, domestic debt securities of the 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.

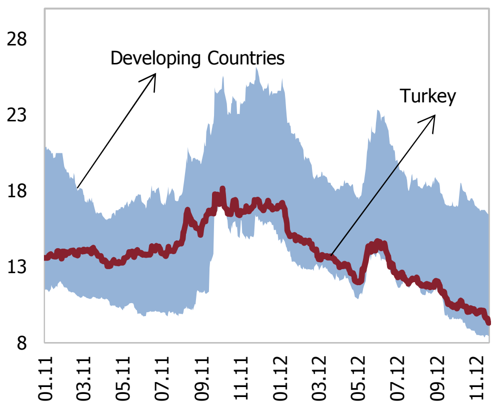
Risk premia of developing countries decreased on the back of the rise in the global risk appetite; meanwhile in Turkey, real effective exchange rates started to appreciate and exchange rate volatility remained limited. As many developing countries implemented expansionary monetary policies in the third quarter of the year, the global risk appetite has been increasing since June and capital flows to developing countries have again been revived. In this period, Turkey's risk premium followed a trend parallel to those of other developing countries. The rise in the global risk appetite, better-than expected macroeconomic indicators – particularly current account deficit data- and the global credit rating agency Fitch's upgrading of Turkey's long-term credit rating in November[1] stimulated a rise in real exchange rates (REER) (Chart II.8). In the third quarter of the year, exchange rate volatility displayed a downward trend on the back of the decline in developing countries' risk premia. The implied volatility of the Turkish lira remained lower compared to other developing countries owing to the favorable trend in its macroeconomic indicators and the policies implemented by the CBRT (Chart II.9). Although the CBRT has no commitment to the level of exchange rates, it will not turn a blind eye to excessive volatility in order to ensure macroeconomic and financial stability.

Chart II.8. Real Effective Exchange Rates (Based on CPI, 2003=100)



Source: CBRT

Chart II.9. Implied Volatility of Exchange Rates (%, 12-month)[1]



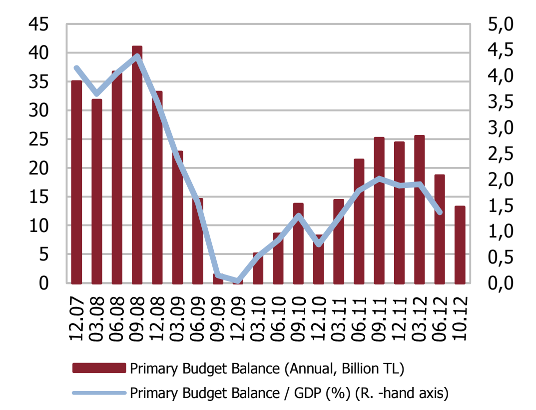
Source: Bloomberg, CBRT
(1) Emerging economies include Brazil, Chile, Czech Republic, Hungary, Mexico, Poland, South Africa, Indonesia, South Korea and Colombia.

Budget performance has relatively weakened due to the decline in growth of tax revenues amid the slowdown in economic activity and acceleration in primary expenditures. Compared to 2011, budget performance slightly deteriorated in the first three quarters of 2012 due to the significant slowdown in tax revenues in tandem with the rebalancing process in economic activity; the rise in primary expenditures mainly stemming from the acceleration in the personnel expenditures and current transfers; and lastly the unfavorable base effect of the decline in tax revenues collected as per the "Law on the Restructuring of Public Receivables". Consequently, the annual central government primary budget surplus, which was TL 24.4 billion at the end of 2011, decreased to TL 13.2 billion in October 2012 (Chart II.10). Meanwhile, the central government budget deficit increased from TL 17.8 billion at end-2011 to TL 34.8 billion in October

[1] The global credit rating agency Fitch upgraded Turkey's Long-term Foreign Currency Issuer Default Rating (IDR) to 'BBB-' from 'BB+' and the Long-term Local Currency IDR to 'BBB' from 'BB+, thus upgrading Turkey's credit rating to investment grade.

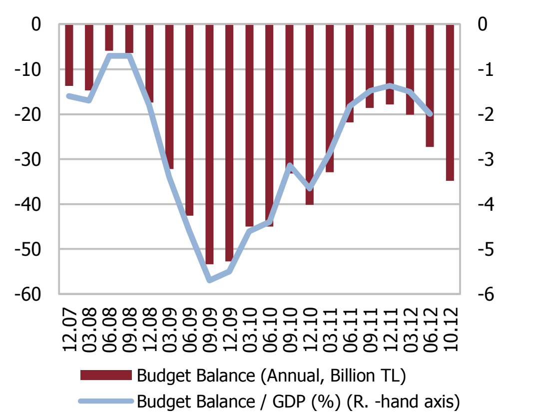
2012 (Chart II.11). The budget deficit, which accounted for 1.4 percent of GDP at the end of 2011, reached 2 percent of GDP by June 2012. Hikes to SCT rates on motor vehicles and the lump-sum taxes on fuel and alcoholic beverages as well as title fees under the fiscal measures enforced in September in order to raise revenues are expected to bolster budget revenues in the last quarter of the year. Therefore, central government budget revenues, which was initially projected to be TL 329.8 billion, is projected to be TL 329.2 billion in the MTP.

Chart II.10. Primary Budget Balance



Source: Ministry of Finance, TURKSTAT

Chart II.11. Budget Balance

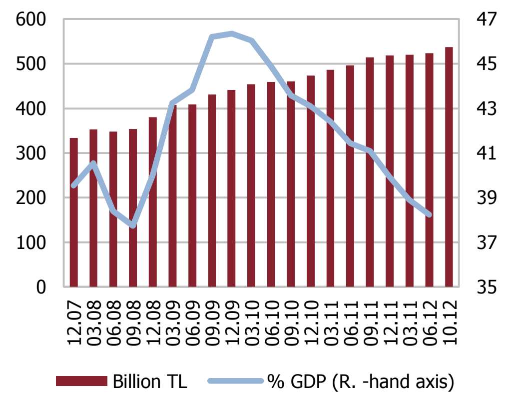


Source: Ministry of Finance, TURKSTAT

The favorable trend in public debt stock indicators continues. Central government debt stock, which reached TL 518.4 billion by the end of 2011 with a 9.5 percent rise compared to 2010, became TL 536.8 billion in October 2012. The ratio of debt stock to GDP decreased from 39.9 percent in 2011 to 38.2 percent in June 2012 (Chart II.12). By October 2012, 72.9 percent of central government debt stock was composed of domestic debts. An analysis of the composition of domestic debt reveals that in 2011 and 2012 till October, the share of TL denominated fixed-rate debt and CPI-indexed debt increased compared to 2010 (Chart II.13). Meanwhile, the maturity of domestic debt stock has been extending; the maturity, which was 31.1 months at the end of 2011, became 32.4 percent by October 2012 (Chart II.13). The share of FX denominated and FX-indexed stock in central government debt stock became zero in February 2012 and this is quite a favorable development as the sensitivity to exchange rate risk is eliminated. Moreover, the rise in the share of fixed income securities and the extension of maturities reduces sensitivity to interest rate movements.

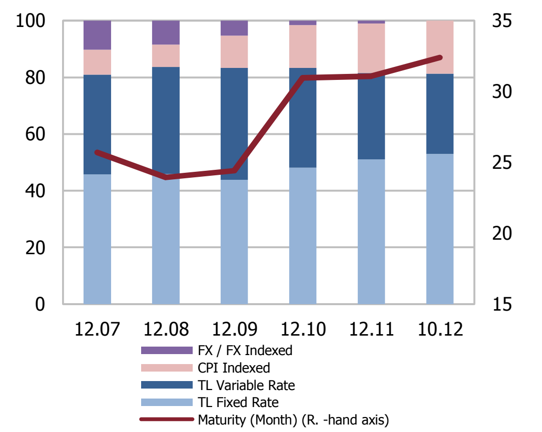
The Undersecretariat of Treasury issued JBIC-guaranteed Treasury bills at the amount of JPY 180 billion with a maturity of 10 years and coupon rate of 1.87 in 2011 and the same type of bills at the amount of JPY 90 billion with a maturity of 10 years and coupon rate of 1.47 in 2012. Moreover, for the first time in its history, the Undersecretariat of Treasury issued rental certificates on 17th September and 3rd October; the issue on 17th September was carried out abroad denominated in USD, in the amount of USD 1.5 billion with a maturity of 5.5 years and the issue on 3rd October was carried out in Turkey denominated in Turkish lira, in the amount of USD 1.6 billion with a maturity of 2 years. Both rental certificate issues drew significant demand and the rate of return of both issues was at reasonable levels. The issues are considered favorable with respect to increasing domestic savings, expanding the investor base and proliferating financing instruments.

Chart II.12. Central Government Debt Stock



Source: Undersecretariat of Treasury, TURKSTAT

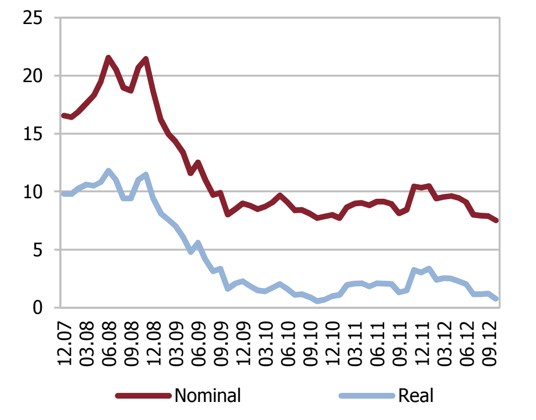
Chart II.13. Composition of Domestic Debt Stock (%)



Source: Undersecretariat of Treasury

Borrowing costs of the public sector remains low and the MTP envisages a tightening in public finance in the upcoming period. The cost of domestic borrowing, which has shown a downward trend since the beginning of 2009, slightly increased in 2011, but started to decline again later on. The interest rate, which was 7.5 percent in October 2012, becomes 0.8 percent when adjusted for 12-month inflation expectations (Chart II.14). The framework for public finances presented in the MTP foresees that compared to 2011, budget performance will slightly deteriorate in 2012 due to the slowdown in economic activity but pick up again in subsequent years. According to the MTP, primary expenditures, which are projected to increase in 2012 and 2013 compared to 2011, will gradually decrease starting from 2014. Moreover, it is planned to boost budget revenues starting from 2013 by introducing legal and administrative arrangements regarding tax increments and ensure the continued decline in the ratio of public debt stock to GDP by increasing the primary surplus (Table II.1).

Chart II.14. Average Cost of Domestic Borrowing (%)[1]



Source: Undersecretariat of Treasury, CBRT
(1) Includes fixed income borrowing.

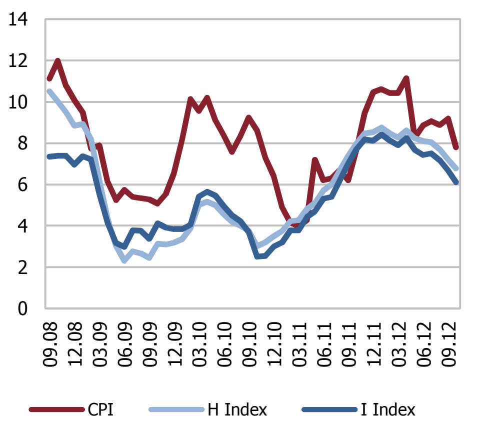
Table II.1. Main Indicators Related To Public Finance (Ratio to GDP, %)

	2012*	2013**	2014**	2015**
Central Gov. Budget Balance	**-2,3**	**-2,2**	**-2**	**-1,8**
Central Gov. Budget Revenues	22,9	23,6	23,1	22,6
Central Gov. Tax Revenues	19,4	20,2	19,9	19,6
Central Gov. Budget Expenditures	25,3	25,7	25,1	24,4
Primary Expenditures	21,9	22,3	21,9	21,4
Total Public Primary Balance (Program-Defined)	**1,8**	**2**	**2,2**	**2,2**
Central Gov.Budget Balance (Program-Defined)	**0,2**	**0,5**	**0,6**	**0,7**
Central Gov. Revenues (Program-Defined)	22	22,8	22,5	22,1
Central Gov. Expenditures (Program-Defined)	21,9	22,3	21,9	21,4
EU Defined Nominal Debt Stock	**36,5**	**35**	**33**	**31**

Source: Medium Term Program (2013-2015)
* Forecast
** Target

Although inflation saw single-digit levels in May 2012, it has trended above the target and the downward trend only became remarkable as of the final quarter. Annual CPI inflation, which climbed to 11.1 percent in April 2012, assumed a downward course as of May to be followed by a flat trend afterwards. Even if inflation trended above forecasts due to recent hikes in oil and unprocessed food prices as well as public price adjustments, the disinflation trend became clearer in the fourth quarter and CPI inflation became 7.8 percent in October 2012 (Chart II.15). The downward trend in annual inflation of core goods continued on the back of the gradual decline of the cumulative impact of last year's movements in exchange rates and imports prices coupled with the slowdown in economic activity. The moderate trend in services prices persists. Even if the disinflation process is expected to continue in the upcoming period, a cautious stance in pricing behavior will be very important as inflation will still hover above the target due to the increments in administered/directed prices and energy prices. Meanwhile, core inflation indicators calculated by H and I indices moved in tandem with annual core goods inflation and became 6.8 percent and 6.1 percent in October, respectively (Chart II.15). Despite price adjustments in administered/directed prices, inflation expectations are still flat. Inflation expectations over the next 12 and 24 months became 6.64 and 6.13 percent by end-November and it is noteworthy that expectations are converging to the medium-term target of 5 percent (Chart II.16).

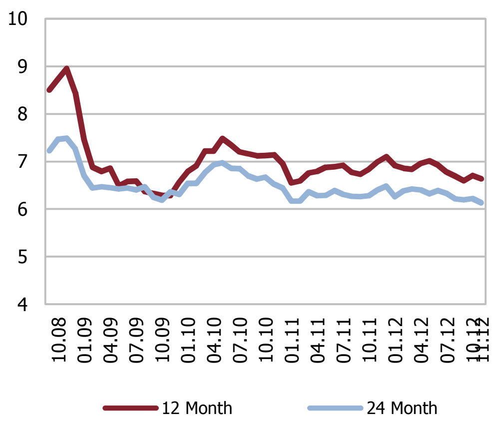
Chart II.15. Inflation (Annual, %)[1]



Source: TURKSTAT

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

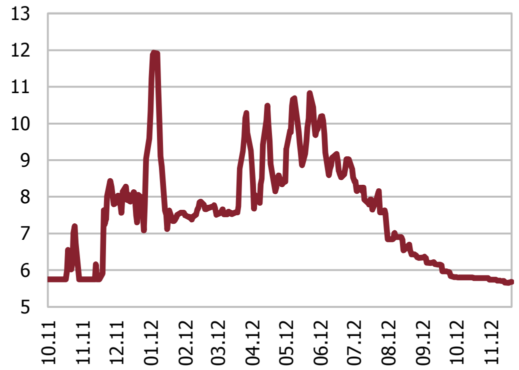
Chart II.16. 12 and 24 Month-Ahead CPI Expectations (%)



Source: CBRT

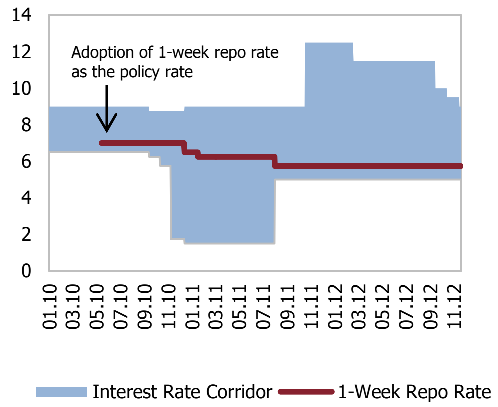
As of mid-2012, the monetary policy gradually became more accommodative in response to the partial recovery in global risk perceptions, the stronger contribution of domestic demand to disinflation and the rebalancing process in the economy. With the new policy mix that it put into practice as of end-2010, the CBRT introduced some additional instruments to support financial stability. From the final quarter of 2011 till mid-2012, monetary tightening operations have been held in response to fluctuations in risk appetite and risks to the inflation outlook. Recently, the global risk appetite has to some extent assumed a recovery trend, credit growth and the current account balance have been favorable; rebalancing in economy has become stronger and the contribution of domestic demand to disinflation has become more remarkable. As a consequence of these developments, the CBRT has been increasing the amount of liquidity that it injects into the market since June to gradually decrease the average funding cost. In November 2012, the CBRT weighted average funding cost dropped below the policy rate of 5.75 (Chart II.17). Moreover, taking into account the fact that the tail risks pertaining to the global financial system waned by September and in order to support the credit market, the CBRT gradually lowered the upper limit of the interest rate corridor. In September 2012, the Monetary Policy Committee lowered the overnight lending rate to 10 percent with a 1.5-percentage point drop and further decreased the said rate to 9.5 percent in October and to 9 percent in November with limited falls (Chart II.18).

Chart II.17. CBRT Weighted Average Funding Cost (%)[1]



Source: CBRT
(1) Latest data by 22 November 2012.

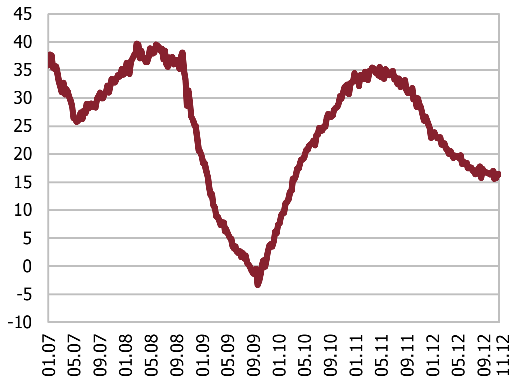
Chart II.18. CBRT Policy Rates (%)



Source: CBRT

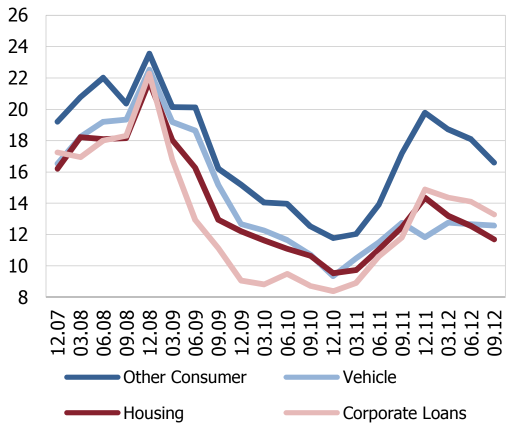
As a consequence of the policies implemented, the acceleration in credit growth has come down to a reasonable level in terms of financial stability and credit interest rates are gradually decreasing in tandem with market rates. In the third quarter, credit growth continued to slow down due to sluggish domestic demand. The annual growth rate of credits adjusted for exchange rates became 16.41 percent by 16 November 2012 (Chart II.19). As a consequence of the CBRT's accommodative policies as well as the partial improvement in the global risk appetite, domestic market rates fell and the downward trend in consumer loan rates continues (Chart II.20). Meanwhile, the cuts in the upper bound of the interest rate corridor have gradually started to pushdown corporate loan rates; this downward trend is expected to continue in the upcoming period. Both supply and demand conditions are likely to be more supportive for credit growth in the final quarter of the year and the annual rate of growth in total credits is expected to materialize around 14 percent at the end of the year. Annual average credit growth of the sector not exceeding 15 percent would underpin price stability and financial stability.

Chart II.19. Annual Growth in Total Credits (%)



Source: BDDK –CBRT
(1) Adjusted for exchange rates.
(2) Latest data 16 November 2012.

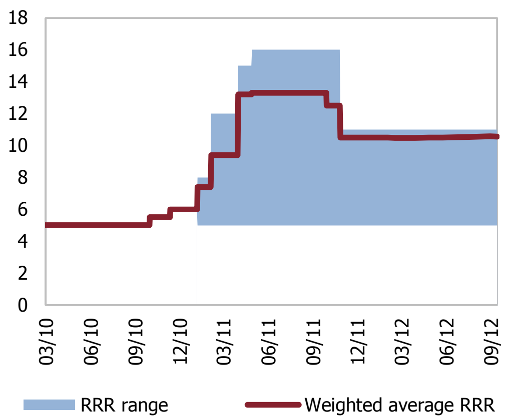
Chart II.20. Loan Rates (%)



Source: CBRT

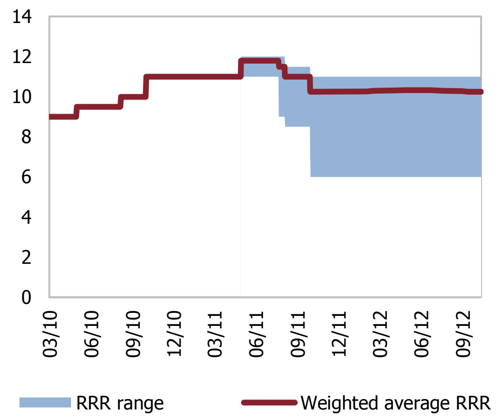
The reserve option mechanism (ROM) has gradually been introduced to alleviate the adverse effects of volatilities in capital flows on the economy and to support financial stability. In this framework, no change has been made to reserve requirement ratios since October 2011 and in this period, the weighted average TL reserve requirement ratio was maintained at 10.6 percent and the foreign exchange reserve requirement ratio at 10.3 percent (Chart II.21, Chart II.22). Meanwhile, in the framework of macroprudential policies, reserve requirements were used in order to strengthen foreign exchange and gold reserves and also to allow banks to manage their foreign exchange liquidity flexibly in the face of external financing shocks. Accordingly, the upper limits for foreign exchange and gold that might be held to meet TL reserve requirements were raised to 60 and 30 percent, respectively (Special Topics IV.1).

Chart II.21. TL Reserve Requirements (%)



Source: CBRT

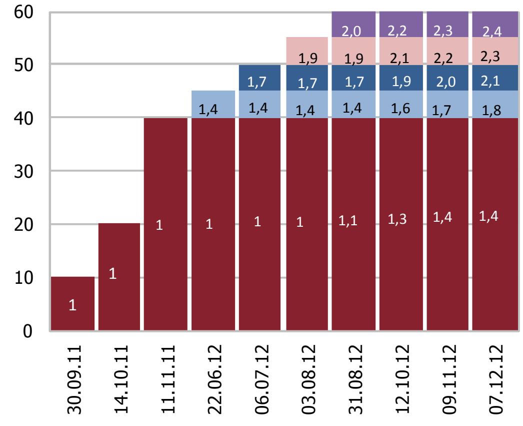
Chart II.22. FX Reserve Requirements (%)



Source: CBRT

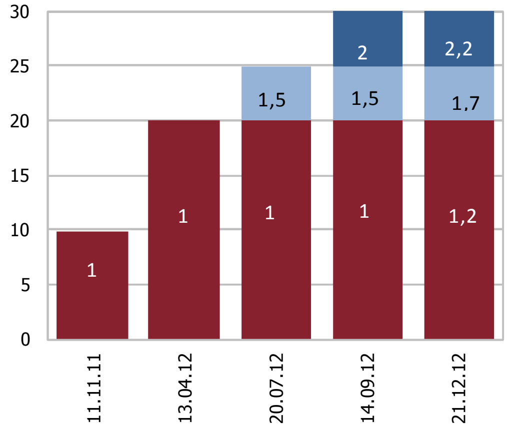
In order to narrow the cost differential of maintaining Turkish lira reserve requirements in Turkish lira or in FX, and to enable banks to fully benefit from this facility to meet their liquidity needs, the Reserve Option Mechanism (ROM) has been introduced. From June 2012 onwards, the upper limit for FX reserves that might be held to maintain Turkish lira reserve requirements, which was 40 percent, has gradually been raised to 60 percent in 5 percent increments; the incremental ROCs (Reserve Option Coefficient) for the first tranche corresponding to 40 percent of Turkish lira reserve requirements and subsequent tranches of 5-percent were set between 1.4 and 2.4 in an increasing manner (Chart II.23). Meanwhile, the upper limit for gold reserves that might be held to maintain Turkish lira reserve requirements was gradually raised from 20 percent to 30 percent with 5-percent increments from July 2012 onwards; the incremental ROCs for the first tranche corresponding to 20 percent of Turkish lira reserve requirements and subsequent tranches of 5-percent were set between 1.2 and 2.2 in an increasing manner (Chart II.24).

Chart II.23. ROCs for FX Reserves that might be Held to Maintain TL Reserve Requirements[1]



Source: CBRT
(1) Dates show maintenance periods.

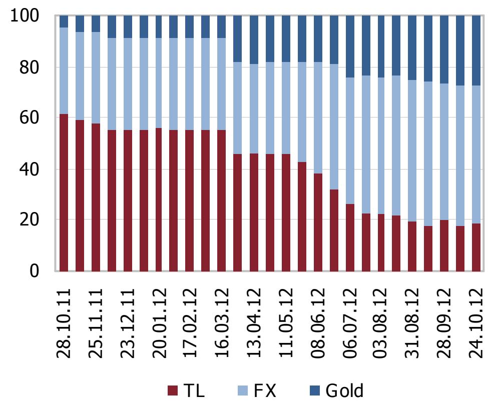
Chart II.24. ROCs for Gold Reserves that might be Held to Maintain TL Reserve Requirements[1]



Source: CBRT
(1) Dates show maintenance periods.

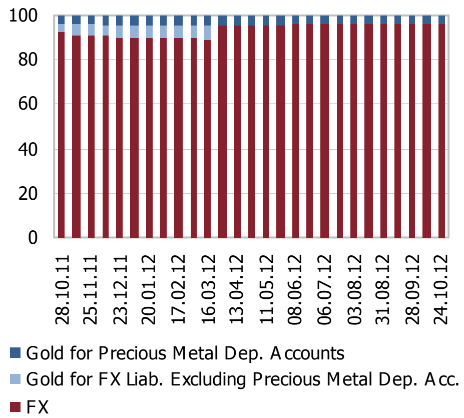
Banks have been using the ROM facility that allows them to maintain TL reserve requirements in FX or gold widely and consistently. In the maintenance period starting on 9 November 2012, the utilization ratio across the sector is 90.5 percent for FX and 90 percent for gold (Chart II.25). Meanwhile, banks are allowed to keep standard gold for their precious metal deposit accounts and the utilization ratio of this facility is approximately 70 percent. (Chart II.26).

Chart II.25. TL Reserve Requirements (% share)



Source: CBRT

Chart II.26. FX Reserve Requirements (% share)

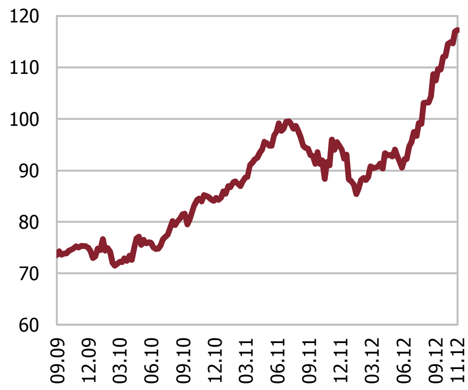


Source: CBRT

Underpinned by the ROM facility implemented in the scope of reserve requirements and export rediscount credits, the CBRT's gross foreign exchange reserves continue to increase. Owing to the rise in the upper limits for FX and gold reserves that might be held to maintain Turkish lira reserve requirements along with the increase in reserve option coefficients and the effect of export rediscount credits, the CBRT's gross reserves displayed a rapid rise, increasing from USD 91.6 billion in May 2012 to USD 117.3 billion in 9th November 2012 (Chart II.27). On the same date, the CBRT's FX reserves, which was calculated as USD 99.2 billion, was composed of USD 28.8 billion of FX maintained in the scope of ROM and USD 21.2 billion of FX maintained as FX reserve requirements. While USD 18.1 billion of the total reserves was composed of gold reserves; USD 11.1 billion-worth of gold is maintained in the scope of ROM (Chart II.28, Special Topics IV.1). The contribution to net FX reserves of export rediscount credits, which are extended with a maximum maturity of 120 days and paid back in foreign exchange on the due date, will be USD 8.2 billion in

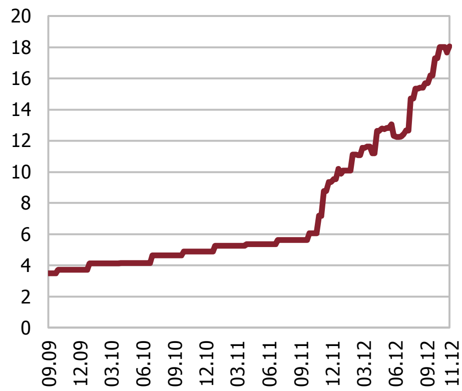
2012. The total amount of credits, which was USD 3.8 billion throughout the entire year in 2011, became USD 9.2 billion in cumulative terms by 15th November 2012 with a monthly total of approximately USD 1 billion. The total amount of rediscount credits in 2012 is expected to reach USD 11 billion and should current demand for these credits continue as it is, they are expected to contribute to FX reserves by USD 12 billion in 2013.

Chart II.27. CBRT Reserves (Gold included, Billion USD)



Source: CBRT

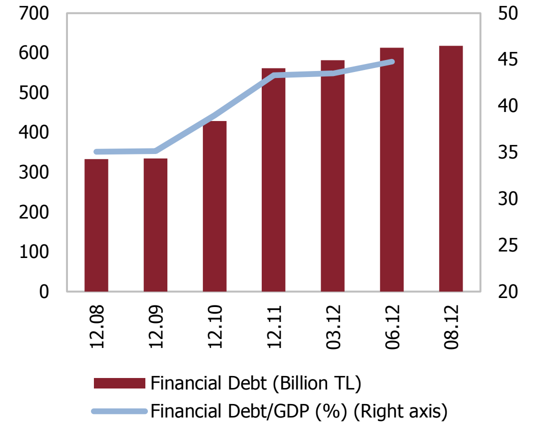
Chart II.28.CBRT Gold Reserves (Billion USD)



Source: CBRT

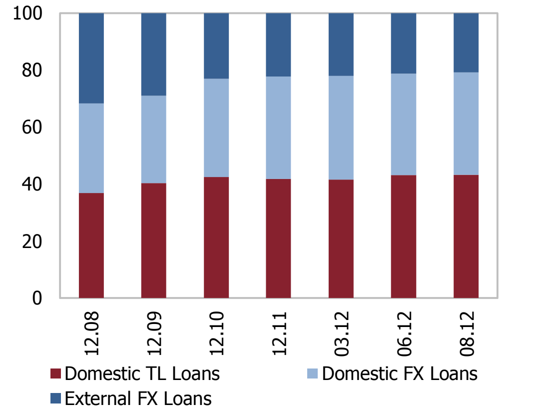
The upward trend observed in 2010-2011 in the corporate sector's indebtedness decelerated and the share of foreign liabilities remained flat throughout 2012. Total financial debts of the corporate sector, which have gradually been increasing since the turn of 2010, became TL 560.7 billion at the end of 2011 and reached TL 617.5 billion in August 2012. In the second quarter of 2012, the ratio of financial debts of the corporate sector to GDP was 44.8 percent (Chart II.29). By August 2012, 56.7 percent of the financial debts of the corporate sector were composed of FX loans; however, the majority of FX loans had long maturities. In the period subject to analysis, the share of TL loans extended to the corporate sector increased to reach 43.3 percent as of August 2012. In the same period, the share of FX loans extended to the corporate sector by domestic and foreign branches and affiliates of Turkish banks in total loans displayed no change compared to end-2011 and became 35.9 percent. The share of external borrowing (excluding that from branches and affiliates) of the corporate sector in total loans decreased compared to end-2011 and became 20.8 percent (Chart II.30).

Chart II.29. Financial Debt of Corporate Sector (Billion TL, %)



Source: CBRT

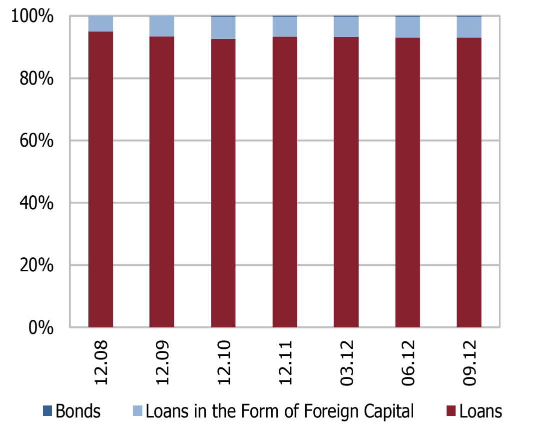
Chart II.30. Composition of Financial Debt of Corporate Sector (%)



Source: CBRT

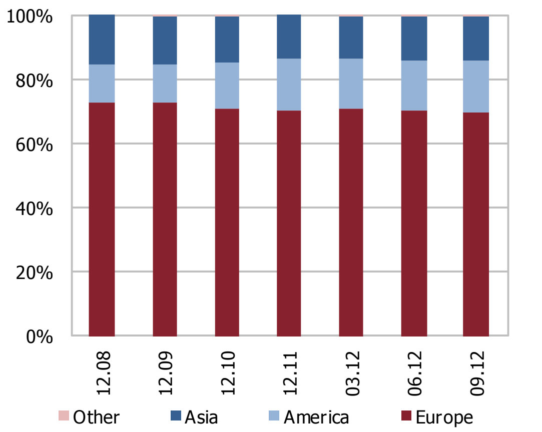
The corporate sector's external loans have been diversifying both in terms of quality and regional distribution. While the share of loans in the form of foreign capital reached 6.7 percent in September 2012, firms have recently started to issue bonds abroad, albeit in small amounts (Chart II.31). In the same period, an analysis of the regional distribution of external loans shows that the share of Europe, which has the highest share of these loans, decreased from 72.8 percent in 2008 to 69.5 percent; whereas the shares of the America and Asia in external loans became 16.6 percent and 13.8 percent, respectively (Chart II.32). Despite its small share, the fact that the corporate sector has received loans from the regions other than Europe, America and Asia is a favorable development in terms of diversification.

Chart II.31. Breakdown of Corporate Sector's External Loans by Type



Source: CBRT

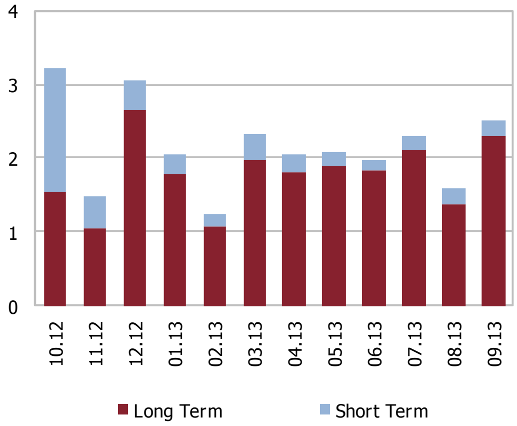
Chart II.32. Breakdown of Corporate Sector's External Loans by Regions



Source: CBRT

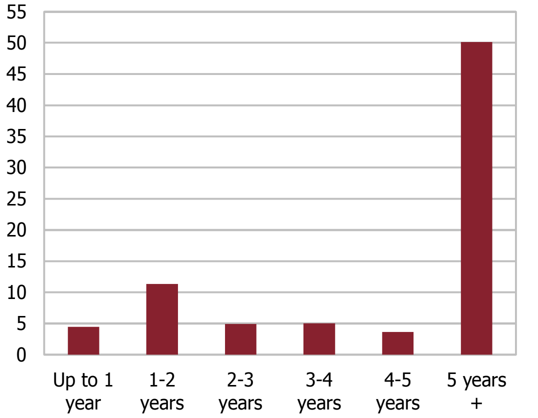
Most of the external loans of the corporate sector are long-term loans. By September 2012, firms' external loans which are due within one year amount to USD 25.9 billion, of which USD 4.5 billion is short-term and USD 21.4 billion is long term (Chart II.33). These loans, which are due within one year, account for 30.9 percent of all external loans. The weighted average maturity of external loans is 4.6 years and 63 percent of these loans have maturities of 5 years and longer (Chart II.34). Taking into account the recent upgrade in Turkey's credit rating followed by the rise in the corporate sector's credit rating, it is expected that the roll-over of external debts will not pose a problem and borrowing costs will fall.

Chart II.33. Corporate Sector's External Loans Due Within One Year (September 2012, Billion USD)[1]



Source: CBRT
(1) Short-term commercial loans excluded.

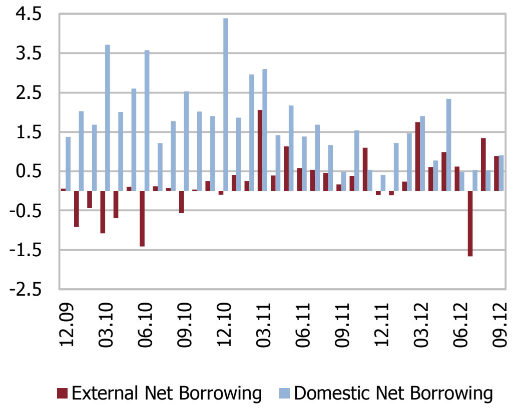
Chart II.34. Breakdown of Maturities of Corporate Sector's External Financial Debts (September 2012, Billion USD)[1]



Source: CBRT
(1) Loans that are registered as foreign capital in balance of payments methodology have been excluded.

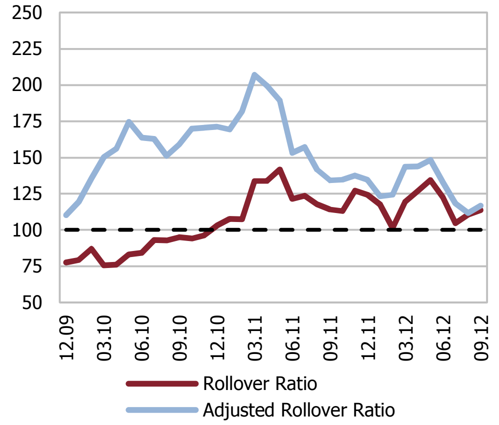
The external debt rollover ratio of the corporate sector displayed an upward trend in the first eight months of the year. The amount of loans extended to the corporate sector by foreign branches and affiliates of Turkish banks and foreign banks, which had decreased by USD 1.7 billion in 2011 compared to 2010, remained relatively flat throughout the first eight months of 2012. On the other hand, FX loans extended to corporate sector by the domestic branches of Turkish banks increased by USD 9.5 billion (Chart II.35). The sector's debt rollover ratio remained favorable in 2012 too (Chart II.36) and became 117 percent in September 2012.

Chart II.35. Non-Bank Sector's Net FX Borrowings (Billion USD)[1]



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

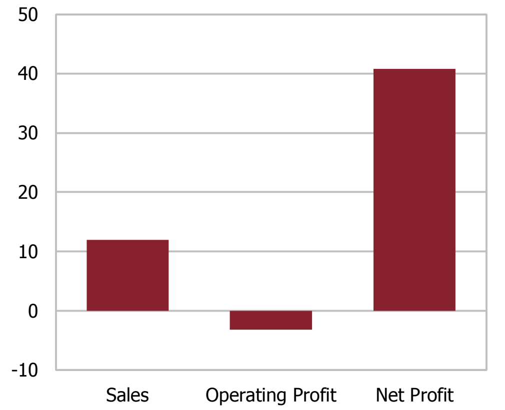
Chart II.36. Non-Bank Sector External Debt Rollover Ratio (%)[1,2]



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

While the ratio of corporate debts to equity capital decreased, firms' profits rose significantly owing to the run up in sales and fall in financial expenditures. In the third quarter of 2012, the total amount of sales revenue of firms quoted on the Istanbul Stock Exchange (ISE) increased by 11.9 percent year-on-year; nevertheless, the rise in their sales revenue was not reflected on operating profits. Despite the decline in operating profits, firms' net profits increased by 40.7 percent. Appreciation of the Turkish lira underpinned corporate profitability by driving a decrease in financial expenditures stemming from exchange rate movements (Chart II.37). As a result of these developments, the return on equity, which was 12.5 percent in 2011, reached 14.9 percent by the third quarter of 2012 in annual terms. The ratio of debt to equity capital decreased from 119.2 percent in 2011, to 116.8 percent in the third quarter of 2012 (Table II.2).

Chart II.37. Sales and Profitability of Firms by September 2012 (Annual % Change)[1]



Source: PDP
(1) Consolidated data of 240 manufacturing industry firms quoted on the ISE.

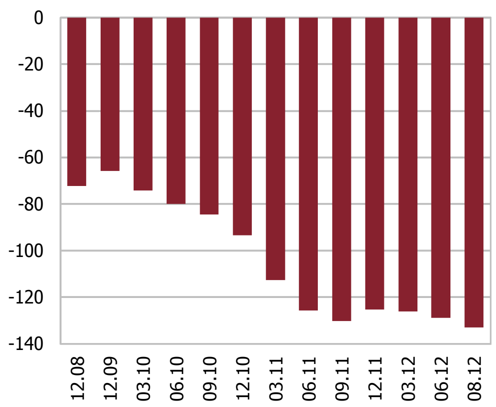
Table II.2. Return on Equity and Its Components[1,2]

	2010	2011	09.12
Net Profit / Equity (%)	13.6	12.5	14.9
Liabilities / Equity (%)	109.9	119.2	116.8
Net Profit / Assets (%)	6.5	5.7	6.9
Sales / Assets	1.0	1.1	1.1
Net Profit / Sales (%)	6.6	5.4	6.4
Operationg Profit / Sales (%)	8.6	8.5	7.6
Financial Income (Expenditures) / Sales (%)	-0.5	-1.9	-0.1

Source: PDP
(1) Consolidated data of 240 manufacturing industry firms quoted on the ISE.
(2) Data for September 2012 have been annualized.

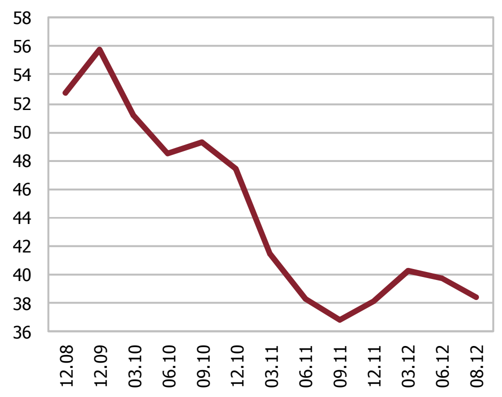
An analysis of FX assets and liabilities of firms suggests that the net FX short position remains flat, while foreign exchange risk still remains an important issue for them. The net short position of the corporate sector, which started to decrease as the global crisis loomed, assumed an upward trend with the economic recovery and became USD 125.2 billion at the end of 2011 and USD 133.1 billion by August 2012 (Chart II.38). The ratio of FX assets to FX liabilities, which has been decreasing since March 2012, came down to 38.5 percent (Chart II.39).

Chart II.38. Foreign Exchange Position of the Corporate Sector (Billion USD)[1]



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

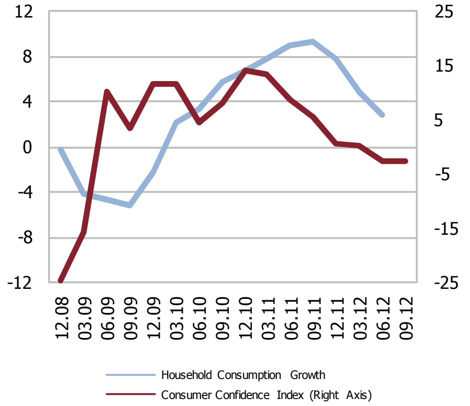
Chart II.39. FX Assets to FX Liabilities Ratio of the Corporate Sector (%)[1]



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

Measures taken to slow down domestic demand were successful and growth in households' consumption expenditures decelerated. Growth in households' consumption expenditures started to decrease as of the final quarter of 2011 due to lingering global problems and increased interest rates stimulated by the monetary tightening implemented by the CBRT and measures taken by other relevant authorities. The CBRT consumer confidence index, which is accepted as a leading indicator, has recently been decreasing and the deterioration in expectations had impact on consumption expenditures as well (Chart II.40). Households' expenditures on food, housing, furniture, gas and electricity account for almost half of total consumption expenditures and there has been no significant change in shares of the mentioned items compared to last year's figures (Chart II.41).

Chart II.40. Real Growth of Household Consumption and Annual Change in Consumer Confidence Index (%)[1,2]

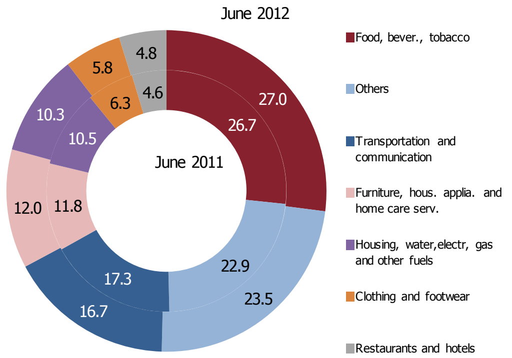


Source: CBRT, TURKSTAT

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

(2) The Consumer Confidence Index has been calculated by Annual changes in quarterly averages.

Chart II.41. Breakdown of Household Consumption Expenditures (%)[1]

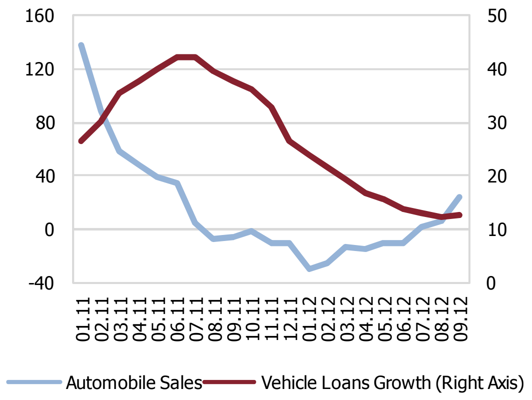


Source: TURKSTAT

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

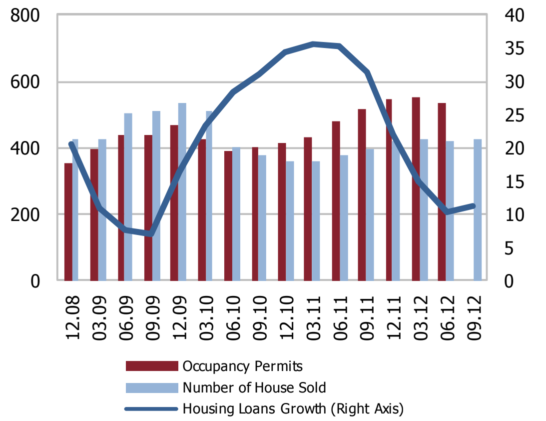
While automobile sales have picked up slightly, there have been no remarkable change in house sales. Automobile sales have followed a downward trend throughout 2012 and slightly increased with the news that special consumption taxes would be raised. The deceleration in automobile loans persists (Chart II.42). Meanwhile, growth in housing loans decreased as a result of the rise in interest rates and measures taken regarding the said loans. Nevertheless, the rebound in the third quarter is noteworthy. House sales are sluggish due to the slowdown in housing loans. The supply of completed housing, which had been increasing since end-2010, decreased slightly and is actually favorable for destocking the excess supply (Chart II.43). As the construction sector is a very important one with respect to employment and the economy in general, risks that might arise from this sector should be monitored carefully for the sake of financial stability.

Chart II.42. Annual Growth of Vehicle Loans and Annual Change in Automobile Sales (%)



Source:BRSA-CBRT, ODD

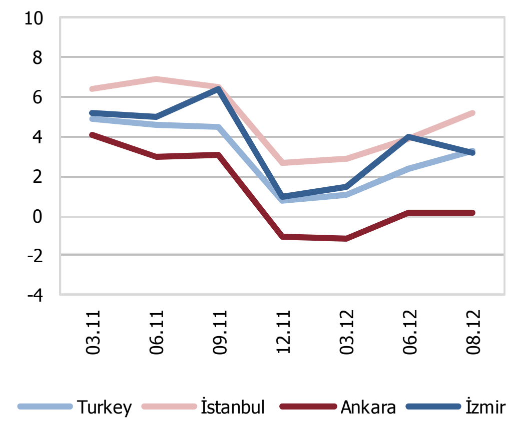
Chart II.43. Annual Growth of Housing Loans, Number of Houses sold and Building Occupancy Permits (Thousand,%)[1]



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

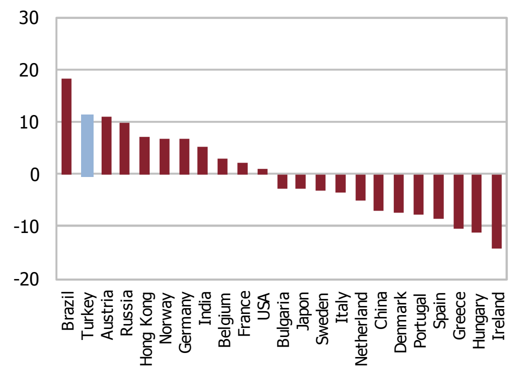
The rise in house prices started to pick up at the beginning of 2012. In August 2012, prices rose by 3.3 percent in real terms throughout Turkey. Among the three largest cities, the highest rise in house prices was recorded in İstanbul (Chart II.44). The problems, which were mostly in the financial sector at the onset of the crisis, started to spread across the entire economy and inevitably, housing sector have also been affected negatively by these developments and housing prices have decreased significantly. In Turkey less affected by the continued global problems house prices increased by 11.5 percent nominally and it became one of the countries at the top of list of high house prices in June 2012 (Chart II.45). Closely monitoring the developments in house prices is very important for financial stability as any excessive volatility in house prices in either direction might pose risk to financial stability.

Chart II.44. Annual Change in House Price Index in Real Terms (%)[1]



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

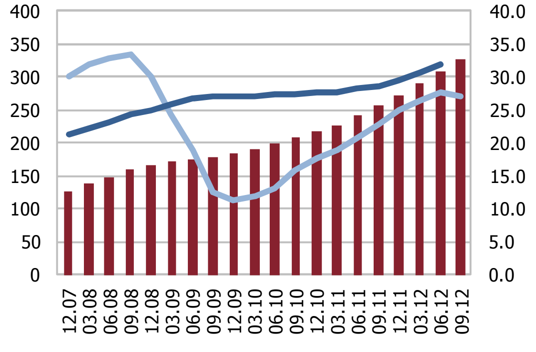
Chart II.45. Annual Nominal Change in House Prices in Selected Countries (June 2012, %)



Source: Knight Frank Global House Price Index, CBRT

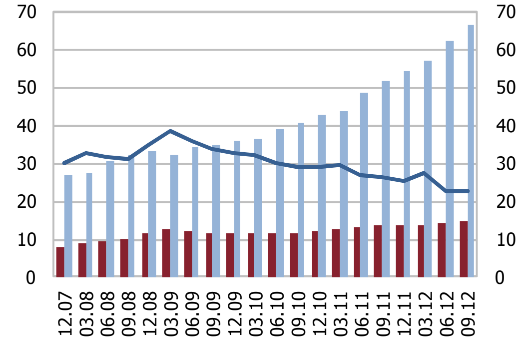
Debit and credit card utilization decreased in tandem with the decline in consumer expenditures driven by the slowdown in the economy. While the share of expenditures by debit and credit cards in consumer expenditures was up in the first half 2012, the growth of expenditures by debit and credit cards slightly decreased in the third quarter due to the economic slowdown (Chart II.46). As the utilization of credit cards as a credit instrument decreased, the rise in credit card balances incurring interest charges remained limited, which in turn led to a fall in the ratio of credit card balances incurring interest charges to total credit card balances (Chart II.47).

Chart II.46. Expenditures by Debit and Credit Cards and Resident Household Consumption (Billion TL, %)[1]



Source: TURKSTAT, BKM
(1) Spending by debit and credit cards is calculated by annualizing the use of debit and credit cards in domestic and international purchases.

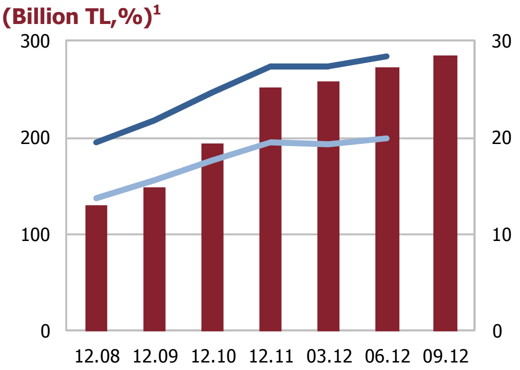
Chart II.47. Credit Card Balances of Deposit Banks and Balances that Incur Interest Charges (Billion TL, %)[1]



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

The rise in household liabilities slowed down on the back of measures taken by authorities. Parallel to the slowdown in liabilities, consumption expenditures financed with consumer loans slightly increased (Chart II.48). Borrowing costs, which increased due to monetary tightening policies and the BRSA's measures, pushed interest payments of households up. The ratio of household liabilities to disposable income showed no significant change year-on-year and became 48.1 percent. (Table II.3).

Chart II.48. Household Liabilities (Billion TL,%)[1]



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

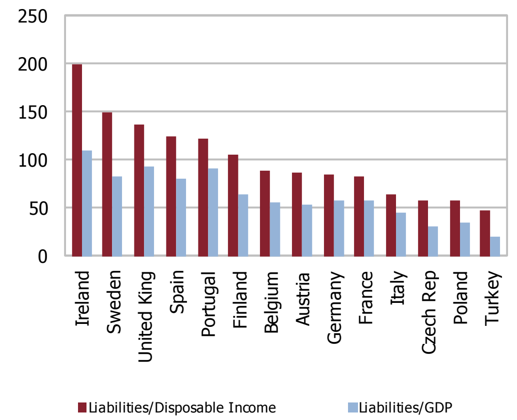
Table II.3. Selected Financial Indicators Pertaining to Households[1,2,3] (Billion TL, %)

	12.10	12.11	09.12
Household Disp. Income	448.8	531.2	591.3
Household Liabilities	195.1	252.0	284.4
Household Interest Payments	20.4	23.1	29.3
Interest Paym. / Hh. Disp. Income (%)	4.5	4.4	4.9
Liabilities / Hh. Disp. Income (%)	43.5	47.4	48.1

Source: BDDK-CBRT, TURKSTAT, Ministry of Development
(1) Household liabilities consist of gross consumer credits (including NPLs) extended by banks and consumer finance companies, credit card balances (including NPLs), credit claims from the frozen consumer loans taken over by asset management companies, and liabilities to TOKI due to TOKI's housing sales with long-term maturity.
(2) As the repayments related to liabilities from TOKI's housing sales with long-term maturity are indexed to civil servant salaries, they are not included in interest payments.
(3) Household disposable income for 2012 has been calculated by using the private sector disposable income estimation for 2012 as foreseen in the 2013 Program, under the assumption that the ratio of household disposable income for 2011, which was generated from "the Household Budget Surveys", to private sector disposable income has not changed.

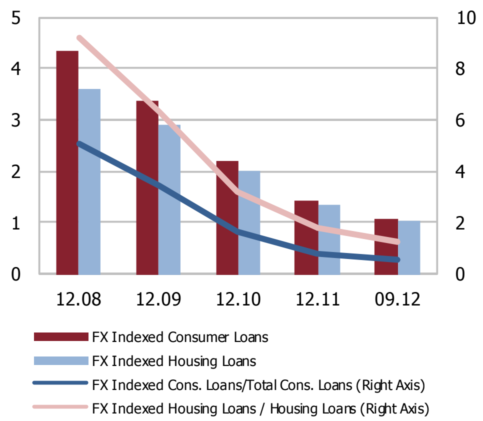
The ratio of household liabilities to GDP and disposable income remain low in comparison to the selected countries and carry no exchange rate and interest rate risk. The ratio of household liabilities to GDP, which stood at 19.4 percent at end-2011, rose to 19.9 percent in June 2012 and remained low compared to the selected countries (Chart II.49). Meanwhile, interest rate and exchange rate risk arising from households jeopardized financial stability in some countries during the global crisis, whereas Turkey remained unaffected owing to the regulations implemented. The fact that variable interest rates are only allowed for housing loans and the remarkable low level of loans with variable interest rates contain the household interest rate risk exposure. The household exchange rate risk was eliminated by impeding households borrowing in FX, and later with the amendment to Decree No. 32 in June 2009, also from FX-indexed borrowing (Chart II.50).

Chart II.49. Ratio of Household Liabilities to Disposable Income and GDP in Selected EU Countries (June 2012, %)[1]



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

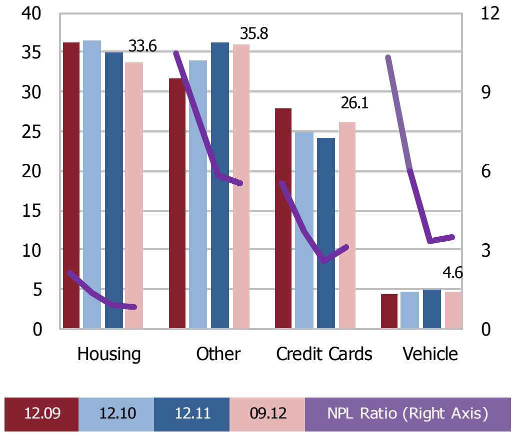
Chart II.50. FX-Indexed Consumer and Housing Loans (Billion TL, %)



Source: BRSA-CBRT

On the back of arrangements regarding utilization of housing loans, the share of housing loans in household liabilities declined. Meanwhile, the sharp fall in NPL ratios ended as expected. Although housing and other loans preserved their weight in household liabilities, their share in liabilities declined during the period until September 2012. The slowdown in economic activity also reflected in NPL ratios. Accordingly, the downward trend in NPL ratios pertaining to housing and other loans in the first three quarters of 2012 decelerated and those of credit cards and vehicle loans rose (Chart II.51). In line with the course of NPL ratios, the number of consumer loan and credit card defaulters inched up in the same period (Table II.4).

Chart II.51. 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 (Thousand People)[1]

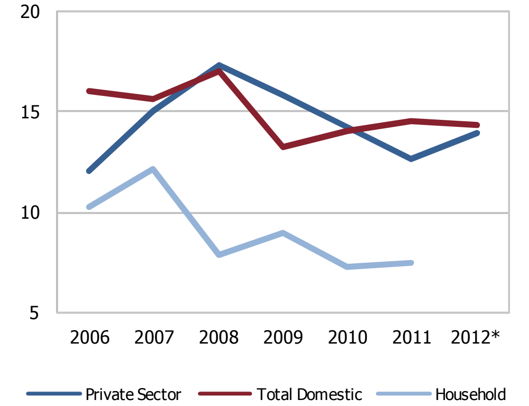
	12.09	12.10	12.11	09.12
Banks	1,489	1,319	1,225	1,483
Asset Management Companies[2]	330	575	688	722
Finance Companies	23	18	11	12
Total[3]	1,721	1,690	1,658	1,897

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

The low level of savings maintains its importance for Turkey. Chronic structural problems related to the current account deficit will be solved once savings increase. The low level of domestic savings, used to finance investments, hence economic growth, causes uncertainty regarding the sustainability of growth by increasing dependency on external savings in funding investments. The limited increase in total domestic saving rates in the 2009-2011 period was driven by the public sector; whereas private sector savings decreased. Falling interest rates, increased credit facilities and favorable expectations led to a surge in household consumption versus income and resulted in a decline in household savings (Chart II. 52). However, with the implementation of policies, which would ensure a balanced growth of consumption and income and raise the awareness of saving in both public and private sector in the recent period, the decline in the saving rate of households halted in 2011. Whereas, the private sector's saving rate is expected to rise in 2012 (Chart II.53).

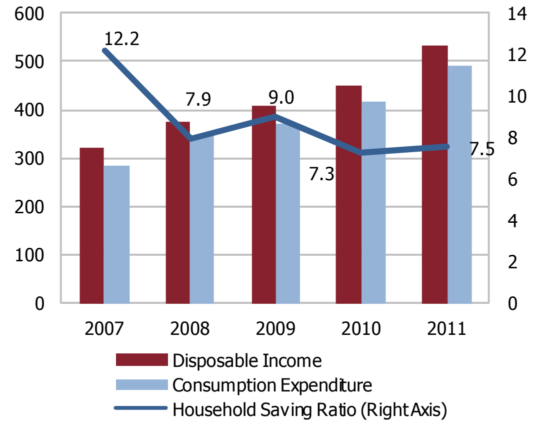
One of the measures taken to increase savings is the individual pension system, which is progressively gaining importance. With the Law Amending Individual Pension Savings and Investment System Law and Certain Other Laws and Statutory Decrees, published in the Official Gazette of 29 June 2012 and No. 28338, the application of the tax advantage comprising a deduction of the contribution from the tax base was ended. This was replaced by the "government contribution" system effective as of 1 January 2013 and some other stipulations were also made such as charging withholding tax only on the amount of revenues instead of on the savings amount defined as returns on stocks and bonds, which incur withholding tax, when leaving the system. Besides, the upper limit of the contribution that employers deduct from the income tax base they pay on behalf of their employees, which was 10 percent of the gross salary, was increased to 15 percent. These amendments are expected to enhance the efficiency of the individual pension system and increase savings. The implementation of savings-boosting measures is important to further strengthen financial stability.

Chart II.52. 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.

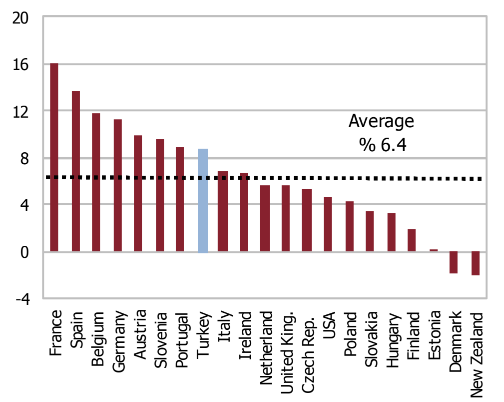
Chart II.53. Household Expenditures, Disposable Income and Saving Rates (Billion TL, %)[1,2]



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.

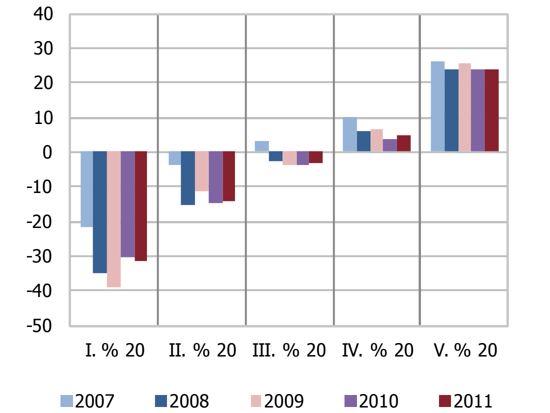
Although household savings in Turkey are above the average of countries analyzed, it is a fact that only those households with high income can save. An analysis of average figures pertaining to the last five years indicates that the household saving rate in Turkey is 8.8 percent - a level higher than the average of those countries analyzed, which is 6.4 percent (Chart II.54). However, it should be kept in mind that saving rates have headed downwards over the years, the bottom three income groups have a negative saving rate and the top two quintile-group households (fourth and fifth quintiles) can only save (Chart II.55). Increasing the saving rates is essential for sustaining a stable and high growth. In this context, it is considered beneficial to maintain policies geared towards increasing the level of savings and to implement income-boosting macro policies as well as micro-policies that will encourage households to save more.

Chart II.54. Household Saving Rates in Selected Countries (2007-2011, %)[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 2007-2011 period.

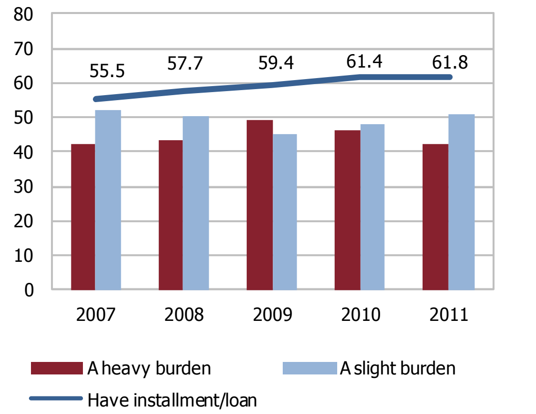
Chart II.55. Household Saving Rates as per Income Quintiles (%)[1,2]



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.

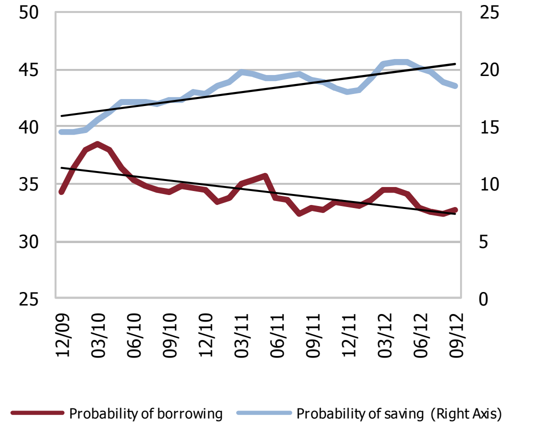
In 2011 the increase in the ratio of indebted households slightly decelerated, future borrowing prospects continued to decrease. The results of the *Income and Living Conditions Survey*, 2011 conducted by TURKSTAT suggest that 61.8 percent of the non-institutional population had outstanding installments and loans (other than mortgage and housing costs). The same survey also reveals that the ratio of the population claiming these payments were a heavy burden decreased year-on-year to 42.4 percent (Chart II.56). 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.57). The slowdown in the growth of consumer loans also verifies this trend.

Chart II.56. 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).

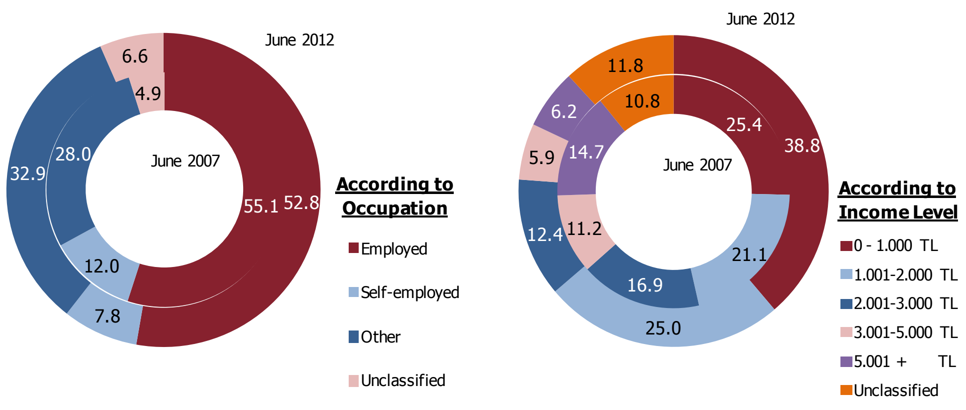
Chart II.57. Probability of Household Borrowing and Saving (%)[1,2]



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 3 months?". (quarterly moving averages)

The majority of households who has consumer loan is composed of wage earners included in the low-income group. Households' access to loans is determined by occupation and regular income. The distribution of number of borrowers and the amount of loans extended according to occupational groups indicates that the majority of the borrowers are composed of wage earners, who also borrowed the most. This situation is attributable to the fact that compared to the self-employed, who are affected much more by economic developments, those with a regular salary carry less risk for banks with regard to debt redemption, and thus their access to loans is higher. The distribution of number of borrowers and the amount of loans extended according to income level suggests that the largest share belongs to the low-income group. It is a well-known fact that low-income households have difficulty meeting their needs, and hence borrow more. However, banks should be more cautious in lending to those groups and assess the risks bearing in mind the fact that households with low incomes would be affected more and faster by potential unfavorable developments in the economy and the fact that they might have difficulty paying their debts (Chart II.58).

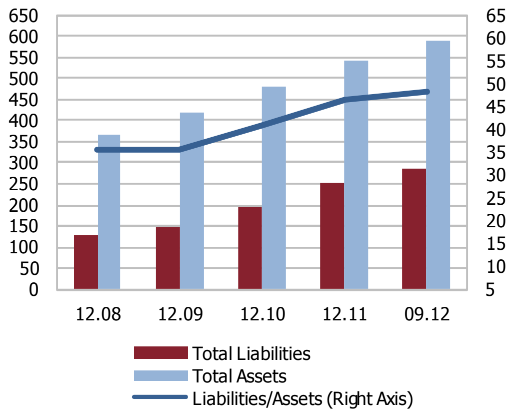
Chart II.58. Distribution of Borrowers According to Occupation and Income (Loans Extended and Number of People) (June 2012,%)[1]



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

The ratio of household financial liabilities to assets continues to increase moderately. On the back of the tight monetary policy in place and measures taken, the increase in consumer loans slowed down and became instrumental in the ratio of household financial liabilities to assets (Chart II.59). By September 2012, despite its declining share in the financial assets held by households, savings deposits continued to be the predominant item of household assets. Foreign exchange (FX) deposit accounts, which stood at USD 58.5 billion by end-2011, rose to USD 66.2 billion in September 2012. Banks began to offer new investment instruments based on gold, which increased precious metals deposit accounts, composed mostly of gold deposit accounts, to TL 15 billion in September 2012 (Table II.5).

Chart II.59. 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.

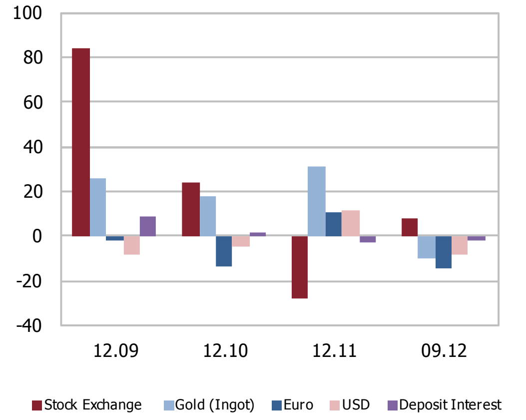
Table II.5. Household Financial Assets[1]

	12.10		12.11		09.12	
	Billion TL	% Share	Billion TL	% Share	Billion TL	% Share
TL Deposits	253.8	52.9	281.9	51.9	303.0	51.5
FX Deposits	94.6	19.7	111.6	20.6	118.0	20.0
- FX Deposits (Billion USD)	*59.7*		*58.5*		*66.2*	
Currency in Circulation	44.4	9.3	49.3	9.1	54.8	9.3
GDDS+Eurobond	9.4	2.0	10.5	1.9	7.1	1.2
Mutual Funds	28.5	5.9	25.8	4.7	25.5	4.3
Stocks	32.6	6.8	30.0	5.5	34.2	5.8
Private Pension Funds	12.1	2.5	14.3	2.6	18.5	3.1
Repos	1.5	0.3	1.4	0.3	2.6	0.4
Precious Metal Deposits	2.3	0.5	13.4	2.5	15.0	2.6
Bonds and Bills	0.403	0.1	4.9	0.9	9.8	1.7
Total Assets	**479.57**	100	**543.2**	100	**588.5**	100

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

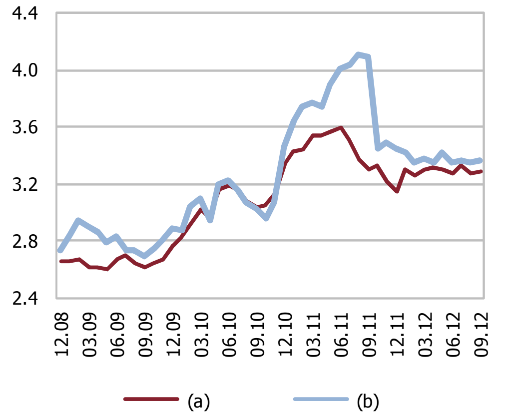
The behavior of financial markets is influenced by global developments and hence, has repercussions on the returns on investment instruments and affects the risk perception, hence, the portfolio preferences of households. Annual real returns on investment instruments suggest that the Istanbul Stock Exchange performed better compared to other instruments. This development also impacted the composition of household financial assets and led to an increase in the share of equity securities in the first three quarters of 2012 (Chart II.60, Table II.5). Meanwhile, exchange rate developments against Turkish lira also affect portfolio preferences for financial assets in domestic currency and those in foreign currency. It is seen that the ratio of investment instruments denominated in Turkish lira to those denominated in FX, adjusted for exchange rate effect, declined until the first quarter of 2012; however, it then started to follow a flat course (Chart II.61).

Chart II. 60. Real Return on Financial Investment Instruments by Types (%)[1]



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

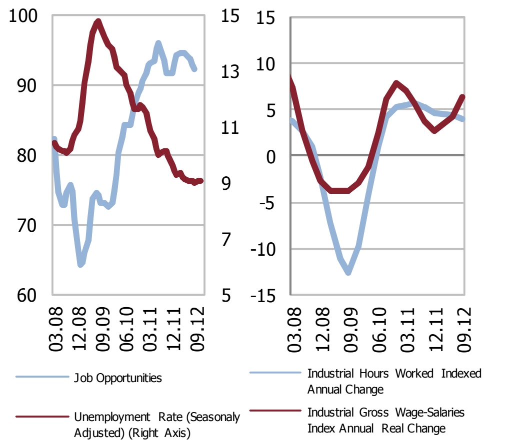
Chart II. 61. Ratio of Household TL Investment Instruments to FX Investment Instruments[1]



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.

Measures to boost employment and rapid economic recovery in the aftermath of the crisis increased employment prospects and the unemployment rate continued to decline. The unemployment rate that increased due to the crisis has been declining since 2009. However, the recent slowdown in the unemployment rate particularly curbed the surge of employment in the industrial sector and led to an increase in the working hour index, instead of new employment opportunities. As a matter of fact, the working hours index that rose rapidly in 2010 followed a horizontal course in 2011. Meanwhile, household expectations regarding future employment prospects have been on the decline since March 2012 (Chart II.62). The rise in employment and gross wage payments has been affecting household disposable income favorably as well (Table II.3). Yet, another issue that might curb employment growth in the upcoming period is the uncertainty over the global economy. Within this framework, unemployment, which is one of the main risk factors for households, continues to be a major problem, especially in debt-ridden EU countries (Chart II.63).

Chart II.62. Selected Indicators for the Labor Market (%)[1,2]

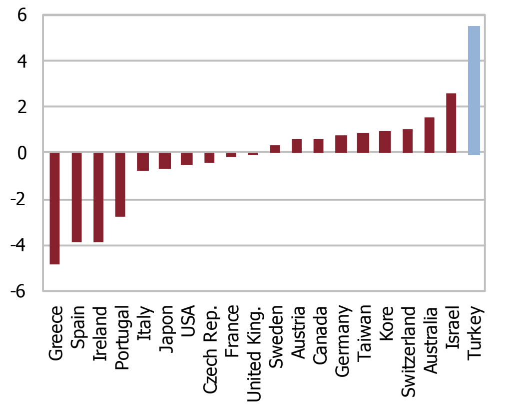


Source: TURKSTAT

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

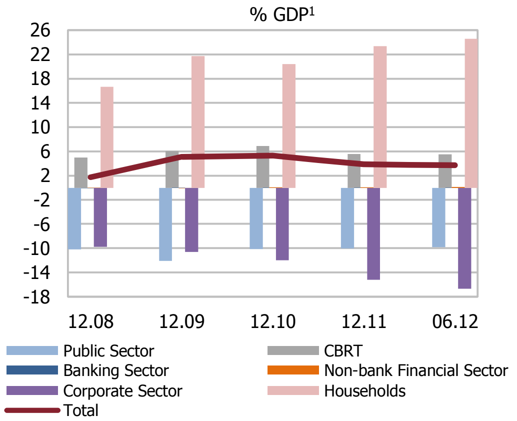


Source: IMF WEO, TURKSTAT

(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 to assess the exchange rate risk incurred by economic units. As of September 2012, Turkey's foreign currency (FX) short position was USD 84.7 billion and by June 2012, its ratio to GDP was 11.1 percent. Turkey's FX short position and its ratio to GDP have been re-calculated with the inclusion of the country's gold stocks. Turkey's gold stocks have been estimated as USD 115.5 billion by August 2012. Data pertaining to gold stocks was included in the FX assets of households. As a result, both households' and the total FX short positions were replaced by long positions and materialized as USD 191.2 billion and USD 30.8 billion, respectively, as of September 2012. The ratio of FX net long position to annual GDP became 4.2 percent by June 2012 (Chart II.64). An analysis by years indicates that in Turkey, the public and corporate sectors have FX short positions, the CBRT and households have long positions, whereas the banking sector and non-bank financial sector have a position of almost zero. This means that the public and corporate sectors are those that may be adversely affected by the depreciation of the Turkish lira. As of September 2012, the corporate sector posted a short position of USD 133.1 billion, followed by USD 75.9 billion of the public sector; while households had a long position of USD 191.2 billion. This was followed by USD 45.8 billion of the CBRT, USD 1.4 billion of the banking sector and USD 1.4 billion of the non-bank financial sector (Chart II.64).

Chart II.64. Turkey's FX Position



SECTORS (September 2012) (Million USD)	Assets	Liabilities	Net Position
Public Sector [2]	9.243	85.112	-75.869
CBRT	118.996	73.235	45.761
Banking Sector	360.222	358.811	1.411
Non-bank Financial Sector	12.575	11.154	1.421
Corporate Sector [3]	83.159	216.219	-133.060
Households [4]	191.763	612	191.151
TOTAL	**775.959**	**745.143**	**30.815**

Source: CBRT-BRSA, Undersecretariat of Treasury
(1) The figures are different from what was indicated in previous Financial Stability Reports due to the inclusion of gold stocks in the household data.
(2) Public FX liabilities are the sum of central government FX-denominated data by September 2012 and other public external debt stock data by June 2012.
(3) August 2012 data is used.
(4) For the amount of FX-indexed loans extended by consumer finance companies June 2012 data is used. Gold stocks are also included in household assets and August 2012 data is used for gold stocks.

In the upcoming period, uncertainties regarding the global economy and fluctuations in capital flows continue to be important for financial stability, while the launch of the fiscal framework and structural reforms envisaged in the MTP are still crucial in order to enable Turkey to decouple from other emerging economies in a positive direction. If domestic demand hovers above the GDP for a long period, this might lead to accumulation of the risks regarding financial stability. Therefore, parallel growth of domestic demand and production is essential. With the recent measures taken in Turkey, divergence between domestic demand and production has started to fade, inflation has been contained, and the rate of increase in household and corporate liabilities has slowed down while the improvement in the current account balance has continued. In the upcoming period it is expected that growth will gain pace in response to the moderate recovery in the demand for consumption and inflation will assume a downward track. The three main determinants of the growth rate in the medium and long run are price stability, financial stability and structural reforms increasing productivity. Bringing inflation down to single digits has removed the biggest obstacle to the growth potential of Turkey. The stabilization of inflation around the 5 percent target will prove beneficial for both growth and financial stability. Moreover, inter-institutional cooperation and coordination has always been important for financial stability. Hence, the Financial Stability Committee (FSC) established in June 2011 assumes an important role.

Nevertheless, uncertainties pertaining to the global economy still remain, as does volatility in capital flows to emerging market economies. Improvement in the global economy is not yet at a desired level, which leads advanced economies to maintain their monetary expansion policies. A potential acceleration in short-term capital flows, rapid credit growth and potential appreciation pressure on the national currency might expose Turkey to macro financial risks and curb the pace of the rebalancing process in the economy. During this period of uncertainty, flexible policies become more of an issue. Accordingly, the CBRT has various policy tools at hand to be used when needed. CBRT will continue to monitor global economic developments closely and take the necessary measures to safeguard stability in domestic markets. Meeting the financial requirements of investments made in

Turkey as much as possible by national savings is one of the prerequisites of sustainable growth. Therefore, in the upcoming period, in order to underpin both growth and financial stability, it is essential to implement measures that will boost savings, launch the fiscal framework as well as other institutional and structural regulations envisaged in the MTP, so that Turkey will be able to decouple from other emerging economies in a positive direction.