I. ECONOMIC ENVIRONMENT

(1) MAJOR FEATURES OF THE ECONOMY

1. The Republic of Turkey covers an area of just over 784,000 square kilometres (including lakes) with a population of nearly 73 million (2010).[1] Around 76% of the inhabitants live in urban areas; the largest cities being Istanbul (12.6 million), Ankara (4.7 million), and Izmir (3.7 million). Some 4 million Turks live abroad.[2] The population growth has been declining steadily in recent years, and currently averages 1.3% per annum. Over 26% are in the 0-14 year age group, and life expectancy at birth is 74.3 years at present. In 2010, Turkey ranked 83rd among 169 countries with comparable data on the Human Development Index.[3]

2. Services, employing nearly 50% of the labour force in Turkey, constitute the largest share of Turkey's GDP (60%), followed by manufacturing (16%), and agriculture (more than 8%). Tourism is a major earner of foreign exchange for Turkey. The manufacturing sector is outward oriented, and Turkey is a major world producer and exporter of several agricultural commodities. The agriculture sector remains an important source of employment in Turkey's rural areas, providing work for around 6 million people.

3. As half of Turkey's population is under the age of 29, the labour market needs to absorb 1 million new entrants every year. The female participation rate in employment remains low. While 72.9% of the male population within the working age are employed, the rate for women is 30.3%.

4. Turkey introduced the new Turkish lira on 1 January 2005, removing six zeros from the old currency. The word "new" was struck with effect from 1 January 2009, and the official name is the Turkish lira (TL). Turkey accepted the obligations of Article VIII of the IMF Articles of Agreement on 22 March 1990, and moved from a crawling peg to a floating exchange rate system on 22 February 2001.

(2) RECENT ECONOMIC DEVELOPMENTS

5. After a highly volatile performance in 1990s, the Turkish economy experienced its most severe recession since the 1940s in 2001. Significant structural reforms were introduced in response to the 2001 crisis, and Turkey subsequently entered an unusually long period of sustained growth and economic stability.[4] A strong appreciation of the Turkish lira in 2006 had a dampening effect on economic growth in 2007, but the economy was still expanding until the arrival of the global financial crisis in mid 2008.

6. Initially, the unprecedented decline in foreign demand prompted a free fall in Turkey's exports, in turn affecting output and investment. The loss of business and consumer confidence

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[1] The population data is based on the "Address Based Population Registration System" as of 31 December 2010.

[2] The migration of workers began with the conclusion of an agreement with the Federal Republic of Germany in October 1961, followed by similar agreements with other European countries in the first half of the 1960s. Turkish workers increasingly picked up jobs in the Middle East from the mid 1970s, and after 1990 also in the Russian Federation.

[3] UNDP online information, "Human Development Index". Viewed at: hdrstats.undp.org/en/countries/profiles/TUR.html

[4] The reforms included fiscal discipline; tight monetary policy with inflation targeting; a floating exchange-rate regime; a strengthened banking system; public sector reform; privatization; and market liberalization. For details, see WTO (2003).

amplified the shock. Turkey's GDP fell by nearly 5% in real terms between 2008 and 2009 (Table I.1). Although the unemployment rate increased from 11% to 14%, the rise was mitigated by employment support measures and wage adjustments.[5]

Table I.1
Main economic indicators, 2006-10

	2006	2007	2008	2009	2010
Miscellaneous					
GDP (TL billion)	758.4	843.2	950.5	952.6	1,103.7
GDP (US$ billion)	526.4	648.8	742.1	616.7	734.9
Real GDP growth rate (%)	6.9	4.7	0.7	-4.8	9
Population, total ('000)[a]	69,395	70,215	71,095	72,050	73,003
GDP per capita (US$)[b]	7,583	9,234	10,440	8,578	10,043
Unemployment, total (% of total labour force)	10.2	10.3	11.0	14.0	11.9
Consumer price index (end of period; % change)	9.7	8.4	10.1	6.5	6.4
Monetary sector					
Nominal growth of M2 broad money (%)	23.4	15.4	27.5	12.9	19.0
Money and quasi money (M2) as % of GDP	39.2	40.7	46.0	51.9	53.3
Average nominal treasury bill interest rate (%)	18.1	18.4	19.2	11.6	8.1
GDP by economic activities at current prices			(%)		
Agriculture	8.3	7.6	7.6	8.3	8.4
Industry	20.1	20.0	19.8	19.1	19.2
Mining and quarrying	1.2	1.2	1.4	1.5	1.4
Manufacturing	17.2	16.8	16.2	15.2	15.5
Electricity	1.8	1.9	2.2	2.4	2.3
Services	58.3	60.3	61.0	61.1	59.9
Other[c]	13.2	12.1	11.7	11.5	12.5
Government finance			(% of GDP)		
Public sector primary balance	4.7	3.1	1.6	-1.0	-0.8[d]
Public sector borrowing requirement	1.9	-0.1	-1.6	-5.1	-2.3[d]
Net debt of public sector	34.0	29.5	28.2	32.5	28.8
National accounts			(% of GDP)		
Private consumption	70.5	71.3	69.8	71.5	71.3
Public consumption	12.3	12.8	12.8	14.7	14.3
Gross fixed capital formation	22.3	21.4	19.9	16.9	18.7
Change in inventories	-0.2	-0.4	1.9	-1.9	1.2
XGS / GDP (%)	22.7	22.3	23.9	23.3	21.1
MGS/ GDP (%)	27.6	27.5	28.3	24.4	26.6
Memorandum					
Current account balance (US$ billion)	-32.2	-38.4	-42.0	-14.0	-47.7
Gross external debt (% of GDP; end of period)[e]	39.5	38.5	37.8	43.5	39.4
Gross external debt (US$ billion)[e]	207.7	249.5	280.4	268.4	289.4
Gross foreign reserves (US$ billion)	..	76.2	74.0	73.8[d]	81.3[f]
Official net foreign reserves (US$ billion)	63.3	76.4	74.2	74.8	86.0

Table I.1 (cont'd)

[5] While the number of workers in industry declined from 2008 to 2009, agricultural employment increased. Employment increased in all sectors in 2010.

	2006	2007	2008	2009	2010
Trade in goods and services (% of GDP)	49.9	49.3	52.1	47.6	48.0
Inward FDI stock (% of GDP)	18.1	23.6	10.8	22.8	24.7
Outward FDI stock (% of GDP)	1.7	1.9	2.4	3.6	2.9

.. Not available.
a Mid-Year Population, Turkstat.
b 2011 Annual Programme, Ministry of Development.
c Including net taxes (taxes minus subsidies).
d Preliminary.
e Provisional due to revisions in foreign debt data, figures may change retrospectively.
f Projection.

Source: CBRT Electronic Data Delivery System. Viewed at: http://evds.tcmb.gov.tr/yeni/cbt-uk.html; Turkstat, Undersecretariat of Turkish Treasury; and IMF (2010), *Turkey: Staff Report for the 2010 Article IV Consultation and Post-Program Monitoring – Supplementary Information; Staff Report; Informational Annex; and Public Information Notice on the Executive Board Discussion*, IMF Country Report No. 10/278. Viewed at: http://www. imf.org/ external/pubs/ft/scr/2010/cr10278.pdf

7. The banking sector proved robust, and the financial position of the Turkish Government allowed for discretionary stimulus of the economy. Turkey's economic recovery, led by growth in private consumption and a rebound in exports, began in the second quarter of 2009 and continued through 2010.[6] Real GDP is estimated to have risen by 9% in 2010, and a 7.5% increase has been projected for 2011.

8. Identified as a source of macroeconomic imbalances in the past, Turkey's fiscal position improved markedly from 1999 onwards. The public sector primary balance was consistently in surplus from 2000 through 2008 and the overall balance, although in deficit, was kept below 2% of GDP from 2005 through 2008. As a consequence, net public sector debt, which had stood at 61.5% of GDP in 2002, had fallen to 34% in 2006 and had dropped further (to 28.2%) by 2008. Although the Government's fiscal position deteriorated as a result of the global crisis, the primary and overall deficits were contained, and Turkey has been able to recover from the downturn with net public sector debt remaining at less than 35% of GDP.

9. Turkey's gross external debt also declined steadily during the last decade, from a level equivalent to 56.2% of GDP in 2001 to less than 40% in 2008. While Turkey's gross external debt increased from US$250 billion in 2007 to US$290 billion in 2010, the level of external debt remains around 40% of GDP. During the financial crisis, long-term capital inflows dried up and were replaced by short-term funding and portfolio investments, i.e. non-resident purchases of government debt securities and short-term loans and deposits from foreign banks to Turkish banks. Longer-term capital appears to be returning to Turkey along with the economic recovery, but the crisis highlighted the challenges posed by rapid changes in business and investor sentiment.

10. The inflation-targeting framework pursued by the Central Bank of Turkey since 2001 has been successful in driving down annual consumer price inflation from 29.7% in 2002 to 10% or less since 2004. Movements year-to-year are influenced by fluctuations in energy prices, the strength of domestic demand, and developments in the real effective exchange rate of the Turkish lira. Using 2003 as the basis, the lira appreciated by nearly 20% until the end of 2007, then went into a decline, which took the (CPI-based) real effective exchange rate close to the 2003 level in the early days of the

[6] Turkey's GDP fell nearly 14% (peak-to-trough) during the crisis; the steepest decline in the OECD area. The subsequent recovery has also been the most pronounced among OECD countries (OECD, 2010b).

financial crisis. A steady appreciation of 10% from early 2009 until the end of 2010 has been followed by a significant decline in 2011.

(3) TRADE PERFORMANCE

11. Turkey's current account has not been in surplus since 2001, and the deficit rose steadily until 2008, primarily due to a widening gap between the value of exports and imports of merchandise. A significant contraction of imports in 2009 reduced the current account deficit to US$14 billion for the year, but the subsequent economic recovery has once again been accompanied by a growing deficit, equal to 6.5% of Turkey's GDP in 2010.

12. The contraction in foreign demand brought a 22.6% decline in Turkey's exports of goods from 2008 to 2009. Nevertheless, Turkey's exports rose threefold in U.S. dollar terms between 2002 and 2010. Turkey is still predominantly an exporter of manufactured goods, in particular automotive products, textiles and clothing, iron and steel, and chemicals. However, the overall share of manufactures in Turkey's exports has declined from a peak of 84% in 2004 to 78.3% at present (Table AI.1 and Chart I.1).[7] Exports of agricultural products, mostly food, have been rising over the last three years and represent around 11% of Turkey's exports at present, the same share as in 2002.

13. The European Union, led by Germany, the United Kingdom, Italy, and France, remains the principal market for Turkish goods. However, the EU share in Turkey's exports declined by nearly 10 percentage points (from 60.1% to 50.8%) from 2006 to 2010, reflecting a successful shift in Turkish export sales to neighbouring countries (Iraq, Iran, Syria and Azerbaijan) as well as to growth markets in the Middle East, North Africa, certain CIS countries, and Asia since 2008 (Table AI.2 and Chart I.2).

14. Turkey's merchandise imports exceeded US$200 billion in 2008, representing a five-fold increase in seven years. Following a 30% fall in 2009, imports were back at US$186 billion in 2010. The structure of Turkey's imports has largely remained unchanged over the last five years, the principal items being machinery and transport equipment (29%), fuels (21%), chemicals (14%), and a broad range of consumer goods (Table AI.3). However, Turkey's imports reflect a significant degree of intra-industry trade whereby intermediate goods are imported, processed and sold for export, notably in motor vehicles and accessories, iron and steel, and machinery.

15. Although imports from the United States, China, India, and Kazakhstan have risen significantly since 2006, the EU (primarily Germany, Italy and France) continues to be the main source of Turkey's imports (Table AI.4 and Chart I.2). In 2010, the Russian Federation, Germany, China, the United States, and Italy all provided goods worth more than US$10 billion to Turkey.

16. On a bilateral basis, Turkey ran a surplus in its trade with countries such as Iraq, the United Kingdom, the UAE, and Egypt in 2010. By contrast, substantial deficits were recorded with the Russian Federation (US$17 billion), China (US$15 billion), the United States (US$8.6 billion), and Germany (US$6 billion). Turkey's merchandise trade is sensitive to movements in foreign exchange rates. Due to importation of fuels, and trade with countries in East Asia, Turkey's imports are mainly denominated in U.S. dollars (over 60%). On the other hand, exports of manufactures to traditional markets result in nearly 50% of Turkey's exports being settled in euros.

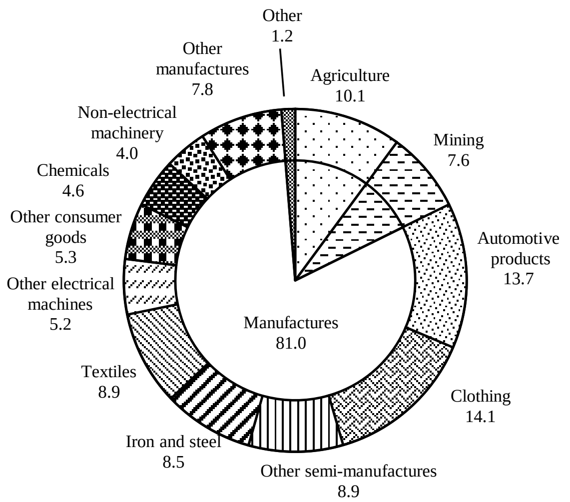
[7] Textiles and clothing, which accounted for 40% of Turkey's merchandise exports in 1995, and 26% in 2005, currently holds a share of 19%. The share has been rising slightly over the last three years.

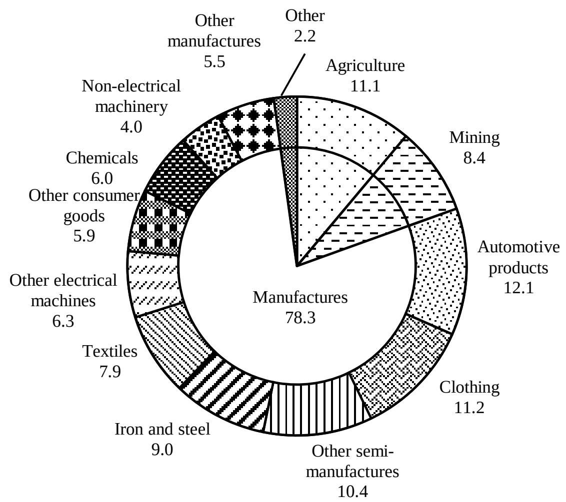
Chart I.1
Composition of merchandise trade, 2006 and 2010

Per cent

2006 **2010**

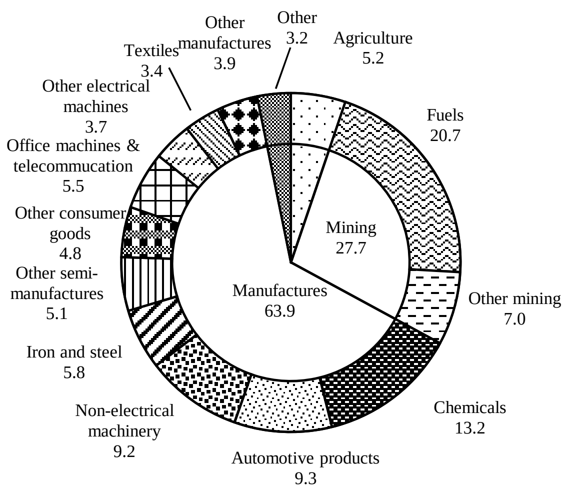
(a) Exports, including re-exports (f.o.b.)

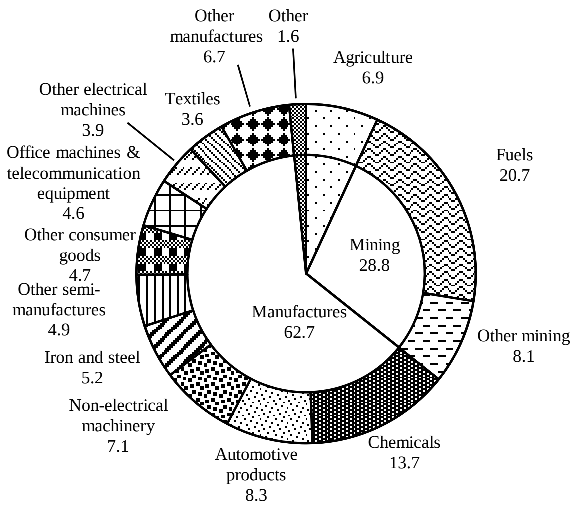




Total: US$85.5 billion **Total: US$113.9 billion**

(b) Imports (c.i.f.)





Total: US$139.6 billion **Total: US$185.5 billion**

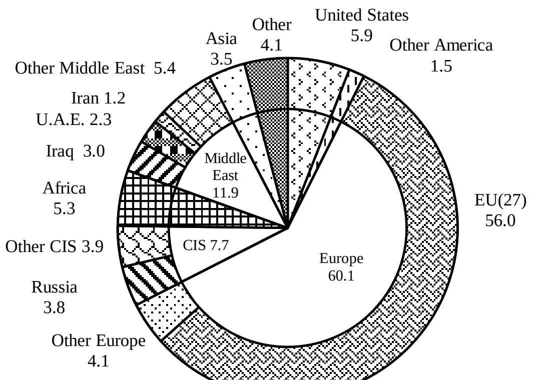
***Source*: UNSD, Comtrade database (SITC Rev.3) and data provided by the Turkish authorities.**

Chart I.2
Direction of merchandise trade, 2006 and 2010

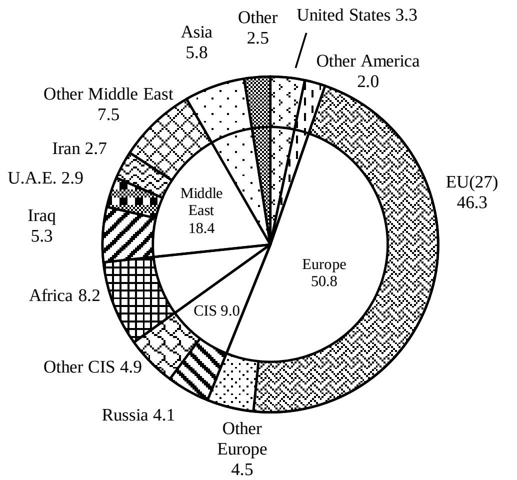
Per cent

2006 **2010**

(a) Exports, including re-exports (f.o.b.)

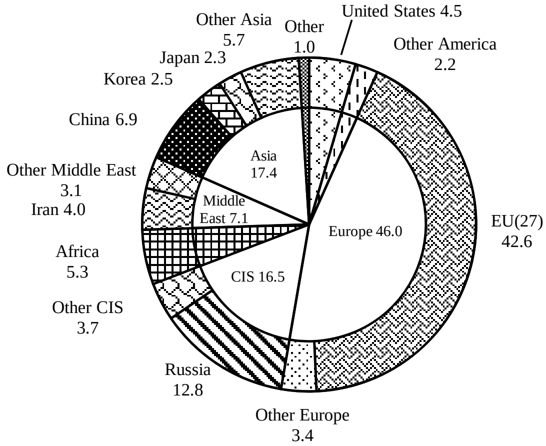


Total: US$85.5 billion

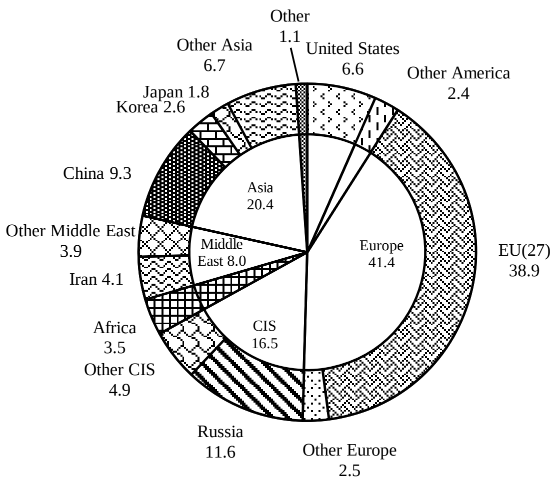


Total: US$113.9 billion

(b) Imports (c.i.f.)



Total: US$139.6 billion



Total: US$185.5 billion

***Source*: UNSD, Comtrade database (SITC Rev.3) and data provided by the Turkish authorities.**

17. Turkey continues to be a net exporter of services due to its significant surplus in travel services, averaging US$16 billion per year from 2006 to 2010. Turkey is normally also a net exporter of construction and transportation services, and a net importer of insurance, banking and other business services (Table I.2). Worker remittances, which were providing foreign exchange worth approximately US$5 billion each year to Turkey in the late 1990s, now amount to less than US$1 billion annually.

Table I.2
Balance of payments, 2006-10
(US$ billion)

	2006	2007	2008	2009	2010
Current account	-32.2	-38.4	-42.0	-14.0	-47.7
Goods	-41.1	-46.9	-53.0	-24.9	-56.4
Exports	93.6	115.4	140.8	109.6	120.9
Imports	-134.7	-162.2	-193.8	-134.5	-177.3
Services	13.6	13.3	17.3	16.7	14.6
Credit	25.5	28.9	35.1	33.5	34.1
Debit	-12.0	-15.6	-17.8	-16.7	-19.4
Transportation (net)	0.3	-0.4	-0.2	1.3	0.7
Travel (net)	14.1	15.2	18.4	17.1	16.0
Construction services (net)	0.9	0.8	1.0	1.1	0.9
Insurance services (net)	-0.6	-0.9	-0.7	-0.5	-0.5
Financial services (net)	-0.2	-0.2	-0.1	-0.4	-0.2
Other business services (net)	-0.4	-0.8	-1.0	-1.3	-1.3
Government services (net)	-0.9	-0.7	-0.8	-0.8	-0.9
Other services (net)	0.5	0.4	0.7	0.3	0.0
Income	-6.7	-7.1	-8.4	-8.2	-7.3
Credit	4.4	6.4	6.9	5.2	4.5
Debit	-11.1	-13.5	-15.3	-13.4	-11.8
Current transfers	1.9	2.2	2.1	2.3	1.4
Official transfers	0.6	0.8	0.7	1.2	0.6
Workers remittances	1.1	1.2	1.4	0.9	0.9
Capital and financial account	32.1	36.7	37.3	8.9	43.0
Capital account	0.0	0.0	-0.1	0.0	-0.1
Financial account	32.1	36.7	37.3	9.0	43.1
Direct investment	19.3	19.9	17.0	6.9	7.8
Abroad	-0.9	-2.1	-2.5	-1.6	-1.5
In Turkey	20.2	22.0	19.5	8.4	9.3
Portfolio investment	7.4	0.8	-5.0	0.2	16.1
Assets	-4.0	-1.9	-1.2	-2.7	-3.5
Liabilities	11.4	2.8	-3.8	2.9	19.6
Other investment	11.5	23.9	24.3	2.0	32.0
Assets	-13.5	-5.0	-12.1	11.0	7.0
Liabilities	25.0	28.9	36.4	-9.0	24.9
Reserve assets	-6.1	-8.0	1.1	-0.1	-12.8
Net errors and omissions	0.2	1.8	4.7	5.1	4.7

Source: CBRT online information. Viewed at: http://www.tcmb.gov.tr.

(4) OUTLOOK

18. According to the Turkish Government's Medium-Term Programme of the for 2012-14, the main objectives are to sustain growth, increase employment, improve public balances, and reduce the current account deficit to increase Turkey's welfare level. The programme is accompanied by a Medium-Term Fiscal Plan setting specific targets for the central government budget.[8] Public expenditures are to be reviewed carefully to maximize the resources available for economic growth led by the private sector. The fiscal plan foresees a steady improvement in the public sector primary balance to reach a surplus of 1.5% in 2014, with the public sector borrowing requirement declining to 0.4% of GDP.[9]

19. The programme and fiscal plan are based on macroeconomic indicators suggesting that the Turkish economy should expand by 4.5%, 4%, and 5% in real terms over the next three years, led by rising output in services and in manufacturing industries. The annual consumer price inflation is expected to average around 6% on a declining trend. The current account deficit is projected to fall from 8% of GDP in 2012 to 7.5% in 2013, and 7% in 2014.

20. Over the medium and longer term, Turkey intends to focus on infrastructure investments supporting efficiency and productivity, notably investments in education, health, research and development, transportation, energy, the provision of drinking water, and the development of information and communication technologies. Priority is also given to projects to reduce regional imbalances.

21. With a GDP of more than US$750 billion, Turkey is currently the 17th largest economy in the world. In 2009, Turkey ranked 22nd among the world's exporters of merchandise and 14th amongst exporters of services. For imports, Turkey's ranking was 24th (merchandise) and 26th (services).[10] The government of Turkey has set ambitious targets for 2023, marking the 100th anniversary of the establishment of the Turkish Republic. The 2023 Export Strategy provides a general framework for the objectives. The Ministry of Economy, the Ministry of Development, and the Turkish Exporters Assembly are preparing detailed roadmaps.[11] Amongst its goals, Turkey is aspiring to be among the world's top ten economies, with a GDP per capita of more than US$25,000, as well as to reach exports worth US$500 billion annually.

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[8] The three-year Medium-Term Fiscal Plan has been prepared by the Ministry of Finance and finalized by the High Planning Council.

[9] Data for the first months of 2011 indicate that the Government is ahead of its targets due to rapidly rising tax receipts, while the growth in expenditures is being contained.

[10] WTO (2009). Turkey's position is calculated treating the European Union as one entity and excluding intra-EU trade. Turkey's standing remained the same as in 2005 except for services imports, where Turkey slipped two places.

[11] The Turkish Grand National Assembly approved the Long-Term Development Strategy (2001-2023) and the 8th Five-Year Development Plan (2001-05) on 27 June 2000. The Long-Term Development Strategy, which set the target for Turkey to enter the world's top ten economies, is the main guide for the economic and social transformation. The objective is retained in the Ninth Development Plan. Targets are prioritized and incorporated in three-year medium-term programmes and annual programmes. Related governmental organizations prepare, coordinate, and implement sectoral strategies considered to be roadmaps for the specified targets.