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Economist Intelligence Unit

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Executive summary

Highlights

November 2011

Outlook for 2012-16

- The Economist Intelligence Unit expects that the Justice and Development Party (AKP) government led by the prime minister, Recep Tayyip Erdogan, will remain in office until the next general election in 2015, and probably beyond.
- Domestic resistance to reforms, notably to resolve the Kurdish issue and overhaul the constitution, will continue to hinder Turkey's EU negotiations, as will the Cyprus issue and opposition in some EU states to Turkish accession.
- Following a sharp rise in 2009, the budget deficit is expected to ease from 3.6% of GDP in 2010 to 1.7% in 2011, and stabilise around 2% in 2012-16.
- We now expect the Central Bank of Turkey to keep its policy interest rates on hold until the end of 2012 and raise them gradually thereafter. Rates are expected to stay below pre-crisis levels.
- GDP growth is expected to slow from an estimated 7.5% in 2011 to 3.5% in 2012, before picking up to 5-5.5% a year in 2013-16.
- The current-account deficit is estimated to rise to 10% of GDP in 2011, before narrowing gradually in 2012-13 as domestic demand growth moderates and commodity prices ease. Higher commodity prices will push it up in 2015-16.

Monthly review

- From late September to mid-October the Kurdistan Workers' Party (PKK) and related fringe groups escalated their campaign of violence.
- The AKP has begun the process of trying to build consensus on a new constitution, but the main political parties have divergent views.
- Turkey has responded aggressively to Greek Cypriot oil and gas exploration in the eastern Mediterranean.
- As of end-September, the 2011 budget showed a small surplus of TL200m (US\$106m), compared with a deficit of TL21.3bn in January-September 2010.
- The government's Medium-Term Programme (MTP) for 2012-14, published on October 13th, suggests that fiscal policy will be kept tight.
- The Central Bank of Turkey has kept the weekly repo lending rate at 5.75% but has raised its overnight lending rate sharply to tighten Turkish lira liquidity.
- After the lira slid to TL1.90:US\$1 and TL2.52:€1 on October 4th, the Bank has intervened to support the Turkish currency, fearing inflationary effects.
- On a seasonally and calendar-adjusted basis, industrial production fell by 2.6% month on month in August.
- Turkey's current-account deficit remains worryingly large, but it appeared to stabilise in July and August.

Outlook for 2012-16

Political outlook

Political stability The Economist Intelligence Unit expects the religiously conservative, pro-EU Justice and Development Party (AKP), led by the prime minister, Recep Tayyip Erdogan, to remain in government until the next general election in 2015 and probably beyond. The party won 50% of the vote at the election in June 2011, strengthening its hand against its opponents among the secularist/nationalist elites, including the main opposition party, the Republican People's Party (CHP), and sections of the military and the judiciary. They view Mr Erdogan and his party with suspicion because of the AKP's pro-Islamist roots and its tightening grip on civilian institutions, especially the judicial system, but also the Turkish Armed Forces (TSK), which traditionally viewed itself as the guardian of the secular unitary state. Despite winning enough seats to form a single-party government for a third consecutive term, the AKP has a smaller majority than in the previous parliament: 327 out of a total of 550 seats in parliament, down from 341 before the election. This is just short of the three-fifths majority plus a referendum that is needed to change the constitution, one of Mr Erdogan's main election promises.

Constitutional reform and resolving the decades-old Kurdish issue are two of the main challenges facing the government during the forecast period. The two issues are in many ways interrelated and both threaten to increase political and social instability. The AKP's policy platform focuses largely on the need for a new civilian-friendly constitution to replace the current one, which was drafted in 1982 under the guidance of the military and still fails to protect individual rights, despite being amended over the years. Because the AKP's parliamentary majority fell short of the special majority required to bring about constitutional change, it will have to seek support from sections of the opposition unless it gets several more seats as a result of the ban on several members of parliament (MPs) currently in jail taking their seats. Either way, the process of reform will be difficult and could be destabilising, especially if Mr Erdogan seeks to introduce a presidential system. Before the election, the idea that he would seek to carry out such a drastic overhaul of Turkey's institutions fuelled fears of an anti-democratic drift and even deeper political polarisation. After the election, in sharp contrast with the tone of his campaign, Mr Erdogan expressed willingness to engage with the opposition to build consensus for a new constitution. However, we believe consensus is unlikely. Major differences on constitutional reform divide the parties in parliament and renewed in-fighting within the CHP may curtail the ability of its reformist leader to compromise. The escalation of the campaign of violence by Kurdish terrorist groups, notably the Kurdistan Workers' Party (PKK), since the election, and the government's decision to respond with force has increased social and political tension. Tension between the AKP and the secularist/nationalist elites is also likely to continue. Another area of confrontation is likely to be disagreement between the government and the CHP regarding the trials and the ongoing investigation of alleged plots by members of the military and prominent civilians to oust the AKP from power.

The Kurdish issue, which is arguably the single largest threat to political and social stability as well as a major obstacle to Turkey's EU accession prospects, will continue to be a source of instability. The pro-Kurdish Peace and Democracy Party (BDP) has ended its boycott of parliament but the death toll as a result of the attacks by PKK and other fringe Kurdish terror groups has continued to rise. The escalating violence and the state's military response, including crossborder operations into northern Iraq, where the PKK has camps, leaves little room for hope that the government will revive the "democratic opening" that it launched in 2009 to solve the problem by democratic means.

Election watch

The next general election is not due until 2015. Before that Turkey will hold local elections and a presidential election. The local elections are due in early 2014, about a year before the general election. The timing of the presidential election remains uncertain, but the government now appears to be of the view that it should be held in the second half of 2014. When parliament elected the incumbent, Abdullah Gul, to the post in August 2007, it was to serve a single seven-year term. The subsequent constitutional changes introducing the direct election of the president reduced the presidential term to five years, for a maximum of two terms, which if applied to Mr Gul would bring his first term to an end in 2012. Unless the AKP changes its byelaws, Mr Erdogan cannot stand for election to parliament for a fourth term, so he would have to hand over the leadership of the AKP ahead of the next general election in 2015. Consequently, he would be the front-runner for president if Mr Gul serves the full seven-year term. Under Turkey's current parliamentary system, which we expect to remain in place, the powers of the president are limited. Nevertheless, the election will be fiercely contested between the AKP and the secularist/nationalist elite.

International relations

Following its re-election with a strong popular mandate in June 2011, the AKP's approach to foreign policy, especially towards issues in the neighbouring region, has become increasingly assertive. We expect this trend to continue during the forecast period as the government seeks to establish Turkey as the dominant power in the eastern Mediterranean and maintain a degree of independence from Western positions. A policy of "zero problems with Turkey's neighbours", which helped to boost trade links and eliminate visa restrictions with several neighbouring countries, has been seriously challenged by developments in the region. Previously positive ties with Syria have soured since the Erdogan government, after some hesitation, condemned the clampdown on popular protests by the regime of Syria's president, Bashar al-Assad. The traditionally close relations, especially in the military and diplomatic spheres, between Turkey and Israel are also at an all-time low after an Israeli commando raid on a Turkish aid ship destined for Gaza led to the deaths of eight Turkish aid workers and one Turkish-American in May 2010. Tensions with Cyprus are likely to remain high after the resumption of Cypriot hydrocarbon exploration (with Israeli co-operation) in the waters of the eastern Mediterranean. Turkey has sought to maintain positive ties with Iran, but relations are likely to be volatile as the two countries compete for the leadership role in the region.

Although critics of the AKP have frequently called into question the government's commitment to Turkey's traditionally western orientation, we believe maintaining good relations with the US and EU will remain a priority for the government. However, its more assertive approach in the foreign-policy sphere and its desire to remain independent from Western positions, especially on issues such as the Israeli-Palestinian conflict, will continue to cause tension with the EU and the US from time to time.

Since it first entered government in 2002, the AKP has supported UN-backed efforts to resolve the division of Cyprus. However, unless Turkey's stalled EU accession talks start to make progress, which is unlikely, the Turkish government will have no pressing reason to facilitate a settlement for Cyprus. It is now threatening to freeze Turkey's accession negotiations with the EU when Cyprus assumes the six-month rotating EU presidency in July 2012 unless a settlement for the divided island is reached. Turkey's aggressive reaction to the resumption of Greek Cypriot hydrocarbon exploration in the eastern Mediterranean will not help ties with Cyprus and the EU, but we believe that it was largely posturing and that the risk of the situation escalating into military confrontation are extremely low.

Turkish-US relations have been better under the current US president, Barack Obama, than under his predecessor, George W Bush. However, major areas of disagreement persist, and there is a considerable risk that this could lead to another sharp deterioration in the short to medium term. The crisis in Turkey's relations with Israel, Turkey's efforts to maintain positive relations with Iran and periodic initiatives in the US Congress to recognise as genocide the massacre of Armenians by Ottoman Turks in 1915-17 will continue to cause tension.

Economic policy outlook

Policy trends Macroeconomic stability is likely to remain vulnerable to sudden shifts in international sentiment, given Turkey's large external financing needs. However, we expect economic policy to remain tailored to an open, largely market-driven economy with adequately prudent public financial management, a floating exchange rate, inflation targeting (at least nominally) and a well-regulated financial sector. We also expect the government to make some progress in implementing its economic policy programme as presented to parliament on July 8th 2011. *Inter alia*, this focuses on the need to boost employment and reduce labour-market rigidities. It also promised a fairer and simpler tax system, with an increase in the proportion of tax revenue coming from direct taxes through a reduction of unregistered economic activity and employment. The structural current-account deficit is to be tackled by promoting innovation, the domestic production of intermediate goods and the use of alternative energy sources, including, controversially, nuclear power. However, these policies are unlikely to have a major impact on the current-account deficit in the short term. The government will continue to pursue privatisation in the power sector and other areas, but much will depend on market conditions. The full privatisation of state banks appears unlikely to be completed by the end of the forecast period. An ambitious agenda of infrastructure works may be carried out partly through public-private partnership schemes.

Fiscal policy The budget deficit has declined sharply after spiking during the 2008-09 recession and the public debt/GDP ratio is quite low, at just over 40%. The government's Medium-Term Programme for 2012-14, which was announced in mid-October 2011, envisages a relatively tight fiscal policy, out of concern for the current-account deficit, a desire to maintain a low level of public debt and a preference for private-sector-led growth. Nevertheless, the economy has started to slow, which will increase the government's desire to maintain some flexibility in its management of the public accounts to support growth in output and jobs and to distribute patronage, in so far as it is able to do so without damaging investor confidence.

Owing to strong economic growth, low global and domestic interest rates and additional revenue from a restructuring of public claims, we estimate that the central government budget deficit, which covers most of the public sector, will decline to 1.7% of GDP in 2011, from 3.6% in 2010 and 5.5% of GDP in 2009. However, because of a forecast slowdown in economic activity in 2012 and the diminishing impact of temporary revenue streams, we expect the deficit to edge up to a still relatively modest 2% of GDP in 2012-16. The government debt/GDP ratio is forecast to decline to about 33% by 2016, reflecting our expectation that privatisation activity will pick up and the government will generate moderate primary surpluses.

Monetary policy Monetary policy will continue to be conducted with a view to addressing varying challenges, including the need to contain the risk of financial instability from Turkey's large current-account deficit, the need to reduce the country's dependence on short-term capital inflows to meet its external financing needs, a weakening currency and mounting inflationary pressures. The Central Bank of Turkey has kept its key interest rate, the one-week repo (repurchase) lending rate, low at 5.75%, and partly reversed banks' required reserve ratios for longer-term liabilities. However, it widened the corridor between its overnight borrowing and lending rates on October 20th, thereby tightening Turkish lira liquidity, and removed references to its willingness to ease policy should the global economic problems deepen. We now expect the MPC to keep its reference rates on hold until late 2012, unless the lira weakens much more sharply and stronger inflationary pressures emerge. From 2013 onwards, we expect interest rates to pick up again, based on our assumption of quickening economic growth and eventual increases in interest rates in major markets.

Economic forecast

International assumptions	2011	2012	2013	2014	2015	2016
Economic growth (%)						
US GDP	1.6	1.3	1.9	2.2	2.4	2.3
OECD GDP	1.7	0.9	1.9	2.1	2.3	2.3
EU27 GDP	1.6	0.3	1.4	1.6	1.8	2.1
World GDP	2.5	2.1	2.8	2.9	3.1	3.1
World trade	6.8	5.2	6.1	6.4	6.6	6.5

	2011	2012	2013	2014	2015	2016
Inflation indicators (% unless otherwise indicated)						
US CPI	3.1	2.1	2.3	2.1	2.2	2.2
OECD CPI	2.8	1.9	2.1	2.1	2.1	2.2
EU27 CPI	2.7	2.0	2.1	2.2	2.1	2.4
Manufactures (measured in US\$)	7.0	0.4	-0.7	0.3	2.0	2.1
Oil (Brent; US\$/b)	110.0	90.0	95.0	100.0	104.0	110.0
Non-oil commodities (measured in US\$)	27.9	-10.9	-4.0	-1.3	2.0	2.6
Financial variables						
US\$ 3-month commercial paper rate (av; %)	0.2	0.2	0.4	1.2	2.2	2.9
€ 3-month interbank rate (av; %)	1.3	1.1	1.1	1.5	2.0	2.5
Exchange rate TL:US\$ (av)	1.68	1.84	1.80	1.80	1.80	1.80
Exchange rate US\$:€ (av)	1.39	1.33	1.28	1.23	1.28	1.27

Economic growth

GDP growth was stronger than anticipated in the second quarter of 2011 but has started to decelerate, as expected. From an estimated 7.5% in 2011 (revised up from 5.7%), we expect growth to slow to 3.5% in 2012 because of a high baseline, the weak global economy and the impact of the recent market turmoil on the Turkish lira and on consumer and investor confidence. Assuming that global conditions do not deteriorate, we forecast that economic growth will pick up to an average of 5-5.5% a year in 2013-16.

There is a substantial risk that the trend in economic activity could prove more volatile than we predict. Stable economic growth requires Turkey to finance a large current-account deficit. Although a general tightening of global liquidity owing to higher interest rates in developed markets now looks unlikely before 2013, further bouts of global financial uncertainty and risk aversion are likely to occur. A sudden reduction or reversal of capital flows could cause the value of the lira to fall further. This would add to inflationary pressures and could prompt monetary tightening and private-sector debt-servicing difficulties, leading to a contraction in economic activity. On the upside, if credit expansion does not slow, above-trend economic growth may continue. This, however, could exacerbate Turkey's imbalances, especially if the current-account deficit stays high and private-sector debt levels continue to rise sharply (although by OECD standards they are low at present, at around 50% of GDP).

Under our baseline scenario, private consumption growth is expected to slow sharply in 2012. We believe that part of the credit-driven consumer spending of 2011 was brought forward in anticipation of tighter credit conditions in 2012, so there will be a strong base effect as spending reverts to more normal levels. We also expect a weaker lira to dampen demand for imported consumer goods. Assuming that the lira and consumer confidence stabilise, we expect private consumption to revert to growth rates of 4-5% a year in 2013-16.

We estimate that the government loosened the purse strings in the first half of 2011 (a substantial portion of a large budget deficit recorded in December 2010 was probably cash to be distributed for use in 2011), pushing up full-year public consumption growth to 4% in 2011. After a slight slowdown in 2012, reflecting base effects, we forecast a moderate acceleration to 4-4.5% as the government will probably raise revenue rather than cut spending to hold down the deficit.

After rebounding in 2010-11, gross fixed investment growth is expected to moderate from 2012 owing to base effects and softer external and domestic demand growth, but it will remain strong at 8-9% a year during 2012-16.

As we expect robust domestic demand to drive import growth, and demand in Turkey's main European markets to remain subdued, especially in the first half of the forecast period, the foreign balance is forecast to reduce GDP growth by about 4.5 percentage points in 2011 and by around 1 percentage point in 2012-16.

Economic growth

%	2011 ^a	2012 ^b	2013 ^b	2014 ^b	2015 ^b	2016 ^b
GDP	7.5	3.5	5.0	5.3	5.0	5.3
Private consumption	9.5	3.0	4.4	4.3	4.4	4.8
Government consumption	4.0	3.5	4.0	4.5	4.5	4.5
Gross fixed investment	20.0	8.0	9.0	8.5	8.0	8.0
Exports of goods & services	4.5	5.0	6.6	7.5	6.3	7.6
Imports of goods & services	20.0	6.1	7.9	7.4	7.1	7.6
Domestic demand	11.6	3.9	5.5	5.4	5.3	5.5
Agriculture	1.0	0.5	1.0	0.7	0.7	0.7
Industry	6.5	4.0	4.0	4.0	4.0	4.0
Services	9.4	3.7	6.4	6.8	6.3	6.8

^a Economist Intelligence Unit estimates. ^b Economist Intelligence Unit forecasts.

Inflation

A weaker lira and the indirect tax increases announced in October 2011 will put upward pressure on consumer prices in the short term, but we expect the strong rebound in economic activity to moderate and commodity prices to ease, which should help to dampen inflationary pressures. Our baseline forecast is that end-of-year rates will exceed the Central Bank targets of 5.5% in 2011 and 5% in 2012-14, but within a band of uncertainty of ± 2 percentage points. The inflationary effects of higher international oil prices in the second half of the forecast period are expected to be offset by the impact of higher interest rates and a stronger lira, helping to reduce inflation below 5% in 2014-16.

Exchange rates

The lira has depreciated substantially against major currencies. Following the turbulence in global markets in early August 2011, the lira remained close to TL1.80:US\$1 compared with about TL1.50:US\$1 a year earlier and as little as TL1.40:US\$1 in early November 2010. A bout of renewed global risk aversion in September—which is unlikely to be the last—briefly pushed the lira beyond TL1.90:US\$1, although the Central Bank then showed its determination to combat further currency weakness by intervening heavily. Our baseline forecast is that the lira will end 2012 at its current level of TL1.80-1.85:US\$1 and average TL1.84:US\$1 in 2012. Given our forecast that the current-account deficit will ease and interest rates will start to rise in 2013-16, we expect a moderate nominal appreciation to about TL1.80:US\$1 later in the forecast period, but there are upside and downside risks. Against the euro, the lira is forecast to average TL2.34:€1 in 2011 and TL2.44:€1 in 2012, before recovering strongly from 2013.

External sector

The rapid rise of Turkey's current-account deficit has raised concerns about its sustainability in the short to medium term. Driven by a credit-fuelled rise in import demand and higher oil prices, we expect it to rise to 10% of GDP in 2011. It is forecast to ease in 2012-14, as oil prices decline and indirect tax hikes

on some goods dampen import demand, but the effects of fiscal tightening in the EU, Turkey's largest market, are expected to continue to dampen demand for exports of goods and services. From 2015 we expect higher commodity prices and real currency appreciation to push the deficit back up to about 7-8% of GDP.

Forecast summary

(% unless otherwise indicated)

	2011 ^a	2012 ^b	2013 ^b	2014 ^b	2015 ^b	2016 ^b
Real GDP growth	7.5	3.5	5.0	5.3	5.0	5.3
Industrial production growth	8.5	3.5	5.5	6.0	5.5	5.5
Gross fixed investment growth	20.0	8.0	9.0	8.5	8.0	8.0
Unemployment rate (av)	10.2	10.1	10.0	9.9	9.7	9.5
Consumer price inflation (av)	5.9	7.4	6.8	5.5	4.4	4.1
Consumer price inflation (end-period)	8.1	6.9	6.5	4.4	4.2	4.0
Short-term interbank rate	1.6	2.7	4.2	5.2	4.6	4.6
Government balance (% of GDP)	-1.7	-1.8	-1.9	-2.0	-1.8	-1.9
Exports of goods fob (US\$ bn)	140.4	149.1	164.0	181.8	203.7	231.6
Imports of goods fob (US\$ bn)	224.5	228.2	245.1	262.4	295.3	335.6
Current-account balance (US\$ bn)	-72.9	-62.4	-61.4	-62.5	-73.3	-86.1
Current-account balance (% of GDP)	-10.0	-8.7	-7.4	-6.7	-7.2	-7.8
External debt (end-period; US\$ bn)	315.9	318.2	322.6	333.4	350.4	362.1
Exchange rate TL:US\$ (av)	1.677	1.841	1.796	1.796	1.796	1.796
Exchange rate TL:US\$ (end-period)	1.841	1.841	1.796	1.796	1.796	1.796
Exchange rate TL:¥100 (av)	2.106	2.396	2.245	2.190	2.138	2.190
Exchange rate TL:€ (av)	2.336	2.444	2.303	2.204	2.290	2.285

^a Economist Intelligence Unit estimates. ^b Economist Intelligence Unit forecasts.

Quarterly forecasts

	2011				2012				2013			
	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr
GDP												
% change, quarter on quarter	2.8	0.4	-0.3	-0.4	1.5	1.5	2.0	0.8	0.8	1.3	2.0	1.3
% change, year on year	10.6	8.6	8.6	2.5	1.2	2.3	4.7	5.9	5.1	4.8	4.8	5.4
Private consumption												
% change, quarter on quarter	5.5	-2.7	4.4	-1.3	1.0	1.0	1.5	0.2	0.8	1.3	2.1	1.3
% change, year on year	12.7	9.2	10.5	5.8	1.2	5.1	2.1	3.7	3.5	3.9	4.5	5.7
Government consumption												
% change, quarter on quarter	-1.5	1.2	-2.9	-0.6	2.0	2.0	2.5	1.3	0.1	0.6	1.3	0.6
% change, year on year	7.2	8.2	5.1	-3.9	-0.4	0.4	6.1	8.1	6.0	4.4	3.2	2.5
Gross fixed investment												
% change, quarter on quarter	3.8	4.1	-7.7	6.3	2.4	2.4	3.0	1.7	1.7	2.2	3.0	2.2
% change, year on year	33.8	29.0	15.0	6.1	4.7	3.0	14.8	9.9	9.1	8.8	8.8	9.3
Exports of goods & services												
% change, quarter on quarter	2.1	-1.7	2.3	-2.2	2.3	2.3	2.8	1.5	0.9	1.4	2.2	1.4
% change, year on year	9.0	-0.1	8.9	0.5	0.7	4.8	5.2	9.2	7.7	6.7	6.1	6.0
Imports of goods & services												
% change, quarter on quarter	7.5	-2.4	7.3	0.8	0.9	1.0	1.5	0.3	2.2	2.6	3.4	2.6
% change, year on year	27.4	18.7	21.4	13.5	6.5	10.3	4.3	3.8	5.0	6.8	8.7	11.2
Domestic demand												
% change, quarter on quarter	4.3	0.0	1.2	0.4	0.7	1.6	1.7	0.6	1.2	1.5	2.2	1.5
% change, year on year	15.4	13.4	12.0	6.0	2.4	4.1	4.5	4.7	5.1	5.0	5.6	6.5
Consumer prices												
% change, quarter on quarter	0.8	2.5	0.2	3.3	1.9	1.6	0.2	3.3	1.6	1.6	0.2	3.1
% change, year on year	4.3	5.9	6.4	7.0	8.1	7.1	7.1	7.1	6.8	6.8	6.8	6.6
Producer prices												
% change, quarter on quarter	4.8	2.1	1.7	3.0	2.6	3.0	2.0	1.5	2.0	2.2	1.6	1.5
% change, year on year	10.6	9.3	11.2	12.1	9.8	10.8	11.1	9.5	8.8	7.9	7.5	7.5
Exchange rate TL:US\$												
Average	1.57	1.56	1.73	1.84	1.84	1.84	1.84	1.84	1.80	1.80	1.80	1.80
End-period	1.54	1.62	1.79	1.84	1.84	1.84	1.79	1.84	1.80	1.80	1.80	1.80
Interest rate (%; av)												
Money market rate	1.5	1.5	1.6	1.7	2.1	3.0	2.9	3.0	3.5	4.0	4.5	4.8

Monthly review: November 2011

The political scene

Kurdish issue and reform of the constitution top the agenda

Two of the most difficult policy challenges facing the Justice and Development Party (AKP) government led by the prime minister, Recep Tayyip Erdogan, are the Kurdish issue and the need to build a broad consensus to overhaul Turkey's 1982 military-inspired constitution. Both have dominated the domestic political agenda since the general election in June 2011. From late September to mid-October, a pro-Kurdish terrorist organisation, the Kurdistan Workers' Party (PKK), and related fringe groups escalated their campaign of violence by carrying out a series of attacks across Turkey, leaving many dead and injured. Unlike other attacks since the general election, Kurdish militant groups have begun to target civilians in cities outside the south-east (notably in the capital, Ankara, on September 20th). Traditionally, the PKK and other groups have targeted military and state personnel predominantly in the south-eastern provinces.

In response to the attacks, parliament voted on October 5th to extend the authorisation of crossborder military operations for another year, allowing the armed forces to carry out ground and air military incursions specifically targeted at PKK camps in northern Iraq. Air strikes and shelling of PKK positions have been going on since August, but until October 20th no crossborder ground operations had been carried out since February 2008. The Iraqi government has criticised Turkey's bombing of PKK positions and the incursion of troops, but the Turkish minister of foreign affairs, Ahmet Davutoglu, said Turkey would only refrain from incursions if Iraq were able to police its own borders effectively. In addition, the Turkish authorities have continued their clampdown on pro-Kurdish political representatives suspected of supporting the PKK.

The pro-Kurdish Peace and Democracy Party (BDP) issued a rare condemnation of attacks in September that left several civilians dead, but this has done little to silence Turkish public outrage or alter the perception among Turks that the BDP is the political wing of the PKK. Under pressure, not least from its own constituents, to end its boycott of parliament since the June election, the BDP announced on September 29th that its elected members would take their seats. This will allow the BDP to resume its efforts in parliament to advance Kurdish demands for improved minority rights and greater autonomy in the Kurdish-inhabited south-eastern provinces of Turkey.

The president calls for consensus on new constitution

The AKP has begun an initial process of consultation as it prepares to draft a new constitution to replace the mainly military-inspired 1982 constitution. Speaking at the opening of parliament on October 1st, the president, Abdullah Gul, a former deputy leader of the AKP, told parliamentarians that the new constitution should establish a more accountable state and should not bear the "stamp of any political party" or promote any political ideology. The outcome of the consultation process remains unclear as the main political parties have divergent positions on what they want to see changed. The AKP is in favour of drafting an entirely new document but will focus in the consultation process on

increasing civilian control over the armed forces and possibly the introduction of a French-style presidential system. This is a radical reform that Mr Erdogan is keen on, but one which his opponents fear would lead to the concentration of too much power in the hands of one man. The traditionally nationalist/secularist Republican People's Party (CHP), the largest party in opposition, and the far-right Nationalist Action Party (MHP) are strongly opposed to changing the first four articles (which define Turkey as a secular unitary nation, with one language and flag). The BDP, however, wants the new constitution to recognise that Turkey is multicultural and multiethnic, which would require Article 3 to be amended to guarantee the use of and education in Kurdish (as well as in the other minority languages). The BDP also wants a "democratisation package" included in the new constitution. In 2009 the AKP launched a "democratic initiative" to tackle the Kurdish issue but it lost momentum in the face of strong nationalist opposition and a lack of support from Kurdish political groups.

The divergence of views will make it difficult for the AKP to build consensus for reform. At the same time, the government's majority falls just short of the three-fifths majority with approval by referendum that is required to change the constitution. To try to overcome these obstacles, the AKP set up a "reconciliation committee" comprising three members from each political party in parliament, including the BDP. The government has also begun to involve constitutional experts, non-governmental organisations and other non-state actors by giving them a formal channel through which to contribute to the drafting process.

Tension rises with Cyprus over oil and gas exploration

Since first coming to power in late 2002, the AKP's core foreign-policy objective has been "zero problems with Turkey's neighbours". However, that policy now appears to be in tatters. Turkey's formerly close ties with the Syrian regime are frozen after the Turkish government's condemnation of the harsh repression of the popular uprising in Syria. Tension has also escalated with both Israel, a long-time strategic ally, and Iran, which after several years of co-operation with Turkey now sees Turkey as a rival for regional leadership. Against the backdrop of a stalemate in UN-backed settlement Cyprus negotiations between Turkish and Greek Cypriots, Turkey's relations with the Greek Cypriot government of the Republic of Cyprus have deteriorated further over oil and gas exploration in the eastern Mediterranean. On September 19th Cyprus, in co-operation with Israel, resumed oil and gas exploration in disputed waters between the internationally recognised Republic of Cyprus and the self-declared Turkish Republic of Northern Cyprus (TRNC), which is only recognised by Turkey. In response, Turkey and the TRNC signed a bilateral agreement to allow the Turkish state oil company to start hydrocarbon exploration off Cyprus. A Turkish exploration vessel, Piri Reis, is currently in the same waters as the Cypriot-authorized and US-owned drilling platform operated by Noble Energy. While Israeli fighter jets have been spotted circling the drilling platform, Turkish navy vessels have accompanied the Turkish ship, and other frigates could be deployed to the area to monitor the situation. The brinkmanship initially raised fears that an incident could spark military confrontation. Mr Erdogan informed the UN secretary-general that Turkey would act calmly but that it would only withdraw its vessels if Cyprus ceased exploration in disputed waters. In mid-October, tensions eased when both sides agreed to call off annual military

exercises in the region, although Turkey has not withdrawn its threat unilaterally to suspend its EU accession negotiations when Cyprus takes over the six-month rotating presidency of the EU in July 2012.

Economic policy

The 2011 budget remains in surplus in September

The government's fiscal performance was almost as strong in the third quarter of 2011 as it was in the first half of the year. According to figures for the central government budget, which covers about 70% of the public sector, tax revenue growth continued to outstrip inflation, notwithstanding signs of slower economic growth, while real increases in spending on personnel continued to be offset by lower expenditure on other items, including subsidies to social security institutions. As of end-September, the 2011 budget showed a small surplus of TL200m (US\$106m), compared with a deficit of TL21.3bn in the first nine months of 2010. The strong growth in tax revenue and the improvement in the finances of the social security institutions in 2011 reflect both the strength of the economy and the positive impact of the restructuring of public claims approved by parliament in February (March 2011, Economic policy). The 2011 budget has also been boosted by lower interest costs than a year earlier, although this was not the case in the third quarter.

Central government budget

(TL bn unless otherwise stated)

	2009			2010			2010		2011	
	Outturn	% GDP	% change	Outturn	% GDP	% change	Jan-Sep	Jan-Sep	% change	
Total revenue	215.5	22.6	2.8	254.0	23.0	17.9	187.5	221.1	17.9	
Tax revenue	172.4	18.1	2.6	210.5	19.1	22.1	153.8	188.4	22.5	
Other revenue	43.0	4.5	1.1	43.5	3.9	1.1	33.7	32.7	-3	
Total expenditure	268.2	28.2	18.1	293.6	26.6	9.5	208.8	220.9	5.8	
Non-interest expenditure	215.0	22.4	21.9	245.3	22.2	14.1	169.5	186.1	9.8	
Interest expenditure	53.2	22.6	5.0	48.3	4.4	-9.2	39.3	34.8	-11.5	
Budget balance	-52.8	-5.5	-	-39.6	-3.6	-	-21.3	0.2	-	
Primary balance	0.4	0.1	-	8.7	0.8	-	18.0	35.0	-	

Source: Ministry of Finance General Directorate of Public Accounts.

Towards the end of the year, budget expenditure typically rises more quickly than revenue owing to delayed payments and capital transfers. Accordingly, government's full-year estimate continues to show a deficit of TL22.2bn, or 1.7% of projected GDP, at the end of 2011.

The 2012 draft budget presented to parliament in mid-October foresees a similar sized deficit of TL21.1bn, 1.5% of projected GDP, with expenditure projected to be TL350.9bn and revenue TL329.8bn. According to a statement by the minister of finance, Mehmet Simsek, on October 19th, the government's revenue projection is in line with official projections for economic growth and inflation. However, he would not rule out the possibility that further tax increases could be needed to achieve the revenue target, reflecting uncertainty regarding economic growth prospects next year. The primary budget balance, excluding interest payments, is projected to be TL29.2bn, or 2% of GDP, in 2012.

Some indirect taxes are increased

On October 13th the government announced increases in indirect taxes, which generally account for around 70% of total revenue in Turkey. The rates and minimum amounts of special consumption tax (SCT) were raised. The SCT is charged on tobacco products, alcoholic drinks, mobile-phone handsets and some categories of motor vehicles—especially passenger cars with engine capacities over 1600cc. The finance minister, Mr Simsek, noted that some of the items subject to SCT increases were mostly imported and said that the tax hikes would help to reduce Turkey's worryingly large current-account deficit. In addition, the "resource utilisation support fund" levy on import finance facilities was raised from 3% to 6%. The hikes are projected to raise an extra US\$5.5bn in tax in 2012.

In focus: The government's Medium-Term Programme 2012-14

On October 13th the Justice and Development Party (AKP) government published its Medium-Term Programme (MTP) for 2012-14. This annual three-year rolling programme contains the government's macroeconomic projections and sets the overall fiscal framework for 2012-14. According to the MTP, the government intends to keep fiscal policy tight and expects the private sector to drive economic growth.

It accepts that the GDP growth rate will slow sharply, from an estimated 7.5% in 2011 to 4% in 2012 before recovering to 5% a year in 2013-14 (the Economist Intelligence Unit's forecast for 2012 is slightly less optimistic, at 3.5%, but we also expect growth to pick up to about 5% a year in 2013-16). In line with forecasts by the Central Bank of Turkey, the government believes year-end consumer price inflation will rise in the short term before retreating from an estimated 7.8% at end-2011 to 5.2% in 2012 and 5% in 2013 and 2014.

The deficit/GDP ratio of the central administration budget is slated to fall from an anticipated 1.7% of GDP in 2011 to 1.5% in 2012, 1.3% in 2013 and 1% in 2014. These ratios are significantly lower than those envisaged in the MTP for 2011-13. One reason is stronger-than-expected budget performance so far in 2011, which reflects windfall revenue from a restructuring of state claims, including unpaid taxes, customs duties and social security premiums, related fines and similar items (March 2011, Economic policy)—some of which are still to come in 2012-13—as well as the positive impact of stronger-than-anticipated GDP growth on tax revenue. These fiscal targets also assume a continuing decline in interest expenditure and, less convincingly, higher privatisation receipts, up from a disappointing TL4.3bn in 2011 to about TL12.5bn-13bn in 2012-14. The privatisation programme has not been going well recently and market conditions are likely to deteriorate further next year, not improve.

Based on all these assumptions—and given a small positive balance from off-budget parts of government (mainly the Unemployment Insurance Fund)—the government expects to be able to reduce the general government nominal debt stock, according to the EU definition, from an estimated 39.8% of GDP in 2011 to 32% by 2014.

The MTP assumes that capital inflows will be sufficient to finance a dwindling but still large current-account deficit, which is projected as a percentage of GDP to ease from 9.4% in 2011 to 7% in 2014. It also assumes that the lira will make a recovery from its recent weakness—it stood at TL1.85:US\$1 on October 21st—to average TL1.73:US\$1 in 2012 and TL1.77:US\$1 in 2013 but depreciate again to average TL1.82:US\$1 in 2014.

Central government budget—official projections

(TL bn unless otherwise indicated)

	2011	2012	2013	2014
Central government budget balance	-22.2	-21.1	-21.7	-18.1
% GDP	-1.7	-1.5	-1.3	-1.0
Revenue	290.9	329.8	359.4	390.5
% GDP	22.7	23.1	22.9	22.5
Expenditure	313.2	350.9	381.1	408.6
% GDP	24.4	24.6	24.2	23.6
Memorandum items:				
GDP	1,281	1,426	1,572	1,733
GDP deflator	8.0	7.0	5.0	5.0

Source: Development Ministry, Medium-Term Programme 2012-14.

MPC widens overnight rate corridor to tighten lira liquidity

Convinced that bank lending growth will ease and that Turkey's huge current-account deficit, which is expected to reach about 10% of GDP in 2011, will narrow to a more manageable level and reduce the country's dependence on short-term capital inflows, the Central Bank of Turkey has kept its main policy interest rate, the weekly repo lending rate, low, at 5.75% since early August 2011. However, by widening sharply the corridor between its overnight borrowing rate, left at 5% at the meeting of the Monetary Policy Committee (MPC) on October 20th, and the overnight lending rate, which was raised to 12.5% from 9% at the meeting, the Central Bank has tightened Turkish lira liquidity in an effort to stabilise the currency and curb future inflationary pressures arising from the recent sharp weakening of the lira and adjustments in administered prices (see Economic performance). In its October 20th press release the MPC also dropped references to its willingness to ease policy should the global economic problems deepen, which had featured in previous statements.

Concerned about the pace of the expected economic slowdown, the Bank also partly reversed some of the aggressive hikes in the reserve requirement ratios on bank liabilities that were introduced between November 2010 and July 2011.

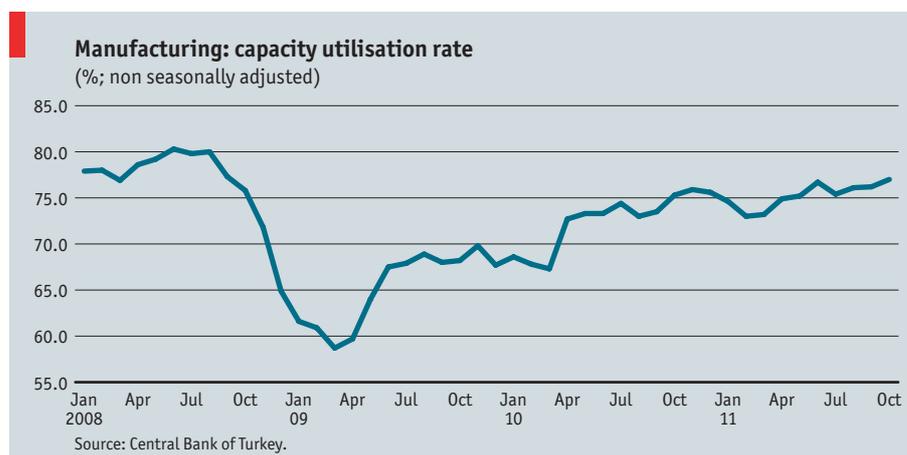
Central Bank supports the lira

The Central Bank's decision to cut its benchmark interest rate by a total of 125 basis points between December 2010 and August 2011 was in part intended to allow the lira, which had appreciated in real trade-weighted terms by 20% in March 2009-November 2010, to weaken, which it did, depreciating from an average of TL1.43:US\$1 in October 2010 to TL1.67:US\$1 in July. In this period the Bank intervened generally just to smooth volatility. Since early August 2011, however, the pace of depreciation has become a source of concern for the Bank. After the lira slid to TL1.90:US\$1 and TL2.52:€1 on October 4th, the Bank decided to take stronger action: the next day, it reduced reserve requirements for banks' foreign-exchange liabilities, thereby creating US\$1.3bn in foreign-exchange liquidity. It also raised the limit at its foreign exchange selling auctions to US\$1.35bn. At the same time, the Bank announced an increase from 10% to 20% in the proportion of required reserves for Turkish lira liabilities that banks are permitted to hold in the form of foreign exchange, which the Bank stated could add up to US\$3.6bn to official foreign-exchange reserves, which had declined by almost US\$10bn between early July and early October. As of October 21st, the lira was valued at TL1.85:US\$1 and TL2.54:€1.

Economic performance

Industrial production dips in August

Having recovered strongly from the recession of 2008-09 owing to strong private-sector demand spurred by historically low interest rates, economic activity has showed further signs that GDP growth will be substantially weaker in the second half of 2011 than in the first. In July, industrial production was 6.9% higher than a year earlier, but the increase in August was only 3.8%. On a seasonally and calendar-adjusted basis, industrial production rose by 2.6% month on month in July before falling by 2.6% month on month in August.



Industrial production

(2005=100; % change, year on year, unless otherwise indicated)

	2010					2011							
	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug
Mining	-1.7	0.9	-11.5	7.6	1.7	11.9	6.4	4.6	1.2	0.4	-2.2	1.5	-4.0
Utilities	15.6	11.1	7.5	4.6	8.4	11.9	11.8	12.2	8.8	5.1	3.9	7.1	-0.4
Manufacturing	10.9	10.8	11.3	10.1	18.5	20.5	14.6	10.2	9.2	8.8	7.6	7.2	4.9
Food & beverages	3.1	13.2	0.1	-1.4	8.8	6.0	3.2	6.1	6.7	8.1	13.7	5.0	3.1
Textiles	6.2	4.6	5.9	1.9	7.3	12.5	3.3	-0.6	-1.9	-3.4	-2.2	-11.2	-3.9
Clothing	13.9	3.4	3.1	-6.3	12.3	7.2	1.0	-4.0	-2.9	3.0	4.1	-3.8	-1.8
Refining	14.2	7.2	13.4	20.7	23.6	33.1	47.5	25.8	7.9	10.9	10.0	3.2	7.6
Chemicals	4.9	8.0	3.7	8.3	17.6	18.0	14.5	7.1	13.6	5.2	-4.9	2.3	3.1
Metal industry	10.0	11.1	11.1	17.5	31.8	20.8	19.8	2.4	7.7	5.7	7.9	0.7	0.2
Miscellaneous machinery	26.4	41.0	30.8	41.8	42.5	47.7	37.2	25.4	24.9	27.7	23.7	18.8	25.2
Automotive	27.8	19.4	31.9	26.7	30.4	29.3	31.2	27.1	26.6	15.2	13.1	35.1	1.4
Total industrial production	10.8	10.4	9.9	9.4	16.7	19.0	13.9	10.2	8.8	8.0	6.8	6.9	3.8
Intermediate goods	10.2	12.0	9.2	14.0	23.8	22.4	16.4	7.0	7.1	6.2	4.1	5.0	4.7
Durable consumer goods	7.1	4.5	21.7	12.8	7.3	15.3	13.3	14.3	12.1	13.1	12.1	9.7	9.9
Non-durable consumer goods	6.5	4.5	3.6	-1.1	5.2	10.8	2.6	2.7	3.2	5.9	6.9	-2.0	1.2
Energy	12.6	9.6	5.3	6.1	8.7	13.0	13.8	13.8	8.8	6.0	3.2	4.8	-0.8
Capital goods	22.7	20.3	25.5	23.0	33.5	34.8	28.9	26.0	21.8	16.2	14.6	28.8	9.7
Total industrial production^a	3.4	-0.7	3.8	-1.2	5.4	0.3	-1.8	-0.5	-0.2	-0.3	-0.9	2.6	-2.6

^a Seasonal and calendar adjusted, % change, month on month.

Source: Turkish Statistical Institute (Turkstat).

Industry may have performed slightly better in September than in August. The capacity utilisation rate in manufacturing industry reached its second-highest

level since the recession, albeit partly for seasonal reasons, at 76.2%—up from 76.1% in August and 73.5% in September 2010. The manufacturing sector confidence index remained above the neutral threshold of 100 and partly recovered to 112.4 after a steep fall to 109.8 in August. The number of vehicles produced in September was 7.1% higher year on year, at 103,280—a substantial rise, although not as robust as those seen earlier in 2011. However, vehicle exports were stagnant in September and just 1% higher in January-September on a year-on-year basis. Having soared in January-July, domestic vehicle sales fell year on year for the second successive month in September.

Energy price hikes add to concern about inflation

The annual rate of consumer price inflation fell back to 6.2% in September, from 6.7% in August. Month on month, prices rose by 0.75%, compared with 1.23% in September 2010. Prices in the transport sector rose by 1.9% month on month as a weaker lira continued to prompt rises in fuel and vehicle prices and public transport fares. Prices for most other goods and services also rose, less rapidly.

Inflation

(% change, year on year, unless otherwise indicated)

	2010				2011								
	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep
Consumer prices (2003=100)	9.2	8.6	7.3	6.4	4.9	4.2	4.0	4.3	7.2	6.2	6.3	6.7	6.2
% change, month on month	1.2	1.8	0.0	-0.3	0.4	0.7	0.4	0.9	2.4	-1.4	-0.4	0.7	0.8
Food & non-alcoholic beverages	15.3	17.1	12.4	7.0	7.1	4.5	3.5	2.8	12.6	8.1	7.6	6.0	2.2
% change, month on month	4.7	4.5	-1.9	-2.7	1.6	2.5	-0.4	-0.5	4.7	-6.4	-1.2	1.4	1.0
Clothing & footwear	5.1	4.3	3.7	4.7	5.2	5.3	5.4	5.7	6.2	6.5	6.9	7.4	6.3
% change, month on month	-2.2	7.6	3.9	-1.8	-7.8	-5.2	0.8	10.9	11.7	0.6	-4.8	-4.3	-3.2
Housing, water, electricity, gas & other fuels	7.4	5.3	5.2	5.9	4.9	4.4	4.6	4.9	5.0	4.8	4.6	5.0	5.3
% change, month on month	0.3	0.2	0.6	1.2	0.6	-0.1	0.4	0.4	0.5	0.2	0.1	0.5	0.6
Household goods	3.8	1.2	8.6	3.3	3.6	4.7	6.1	7.3	7.4	7.6	7.2	8.1	8.6
% change, month on month	0.5	-0.1	0.6	0.3	1.0	0.9	0.9	1.8	0.3	0.6	0.3	0.8	0.9
Transportation	8.0	6.2	5.4	6.8	4.6	6.0	6.9	8.0	8.7	9.5	9.8	12.1	14.1
% change, month on month	0.1	0.4	0.5	1.1	1.4	1.8	1.6	1.0	0.6	0.3	0.8	1.9	1.9
Producer prices (1997=100)	8.9	9.9	8.2	8.9	10.8	10.9	10.1	8.2	9.6	10.2	10.3	11.0	12.1
% change, month on month	0.5	1.2	-0.3	1.3	2.4	1.7	1.2	0.6	0.2	0.0	0.0	1.8	1.5

Source: Turkstat.

Inflation is likely to pick up again by year-end. Administered rises in electricity and natural gas prices, necessitated by high global commodity prices and the recent weakness of the lira, took effect at the start of October and are expected to have a follow-through effect on other prices. Prices of other internationally traded goods were also expected to be affected by the lira's depreciation. The SCT increases announced on October 13th will also put upward pressure on consumer prices, while seasonal increases in fresh food prices are expected to be felt in October, especially after heavy rain and flooding early in the month.

The official end-year targets for 2011 and 2012 are 5.5% and 5%, respectively, with a tolerance band of ± 2 percentage points. The Central Bank expects inflation to overshoot this in 2011, but to be close to the central target in 2012.

In August reserves help to finance current-account deficit

The current-account deficit remains high, reflecting the large merchandise trade deficit, and in particular the impact of strong domestic demand and high oil

prices on the import bill. The current-account deficit for the first eight months of 2011 was more than twice as high as a year earlier. Nevertheless, July and August witnessed a relative improvement. In August, the monthly current-account deficit amounted to US\$4bn—the lowest since October 2010. While the lower monthly deficit was partly the result of strong seasonal tourism earnings, it also reflected a modest narrowing of the merchandise trade deficit, as the pace of growth in exports outstripped that of imports for the first time since 2009. The relative improvement in recent trade figures suggests weakening domestic demand and a positive impact on exports from the weaker lira. Much of the year-on-year increase in merchandise trade figures since 2010—and especially of the increase in imports—has resulted from higher prices rather than increases in volumes.

Balance of payments

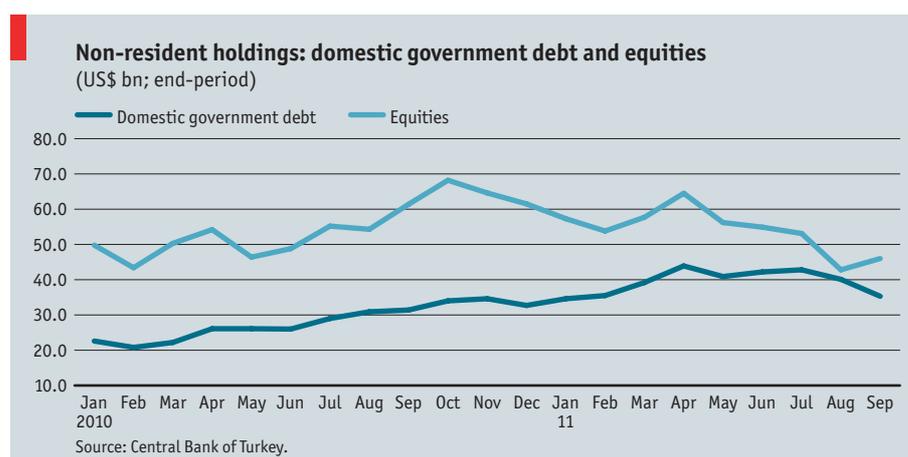
(US\$m unless otherwise indicated)

	2008	2009	2010	2010	2011
	Year	Year	Year	Jan-Aug	Jan-Aug
Current-account balance	-41,959	-13,991	-47,695	-26,814	-54,261
Foreign trade balance (fob-fob)	-53,021	-24,850	-56,445	-32,003	-61,435
Services balance	17,311	16,749	14,624	8,828	11,678
Incomes balance	-8,362	-8,189	-7,322	-4,483	-5,552
Current transfers balance	2,113	2,299	1,448	844	1,048
Capital account excluding reserves	36,199	9,036	55,823	34,607	49,280
Change in reserve assets ^a	1,057	-111	-12,809	-10,033	-4,662
Net errors & omissions	4,703	5,066	4,681	2,240	9,643

^a Negative indicates an increase.

Source: Central Bank of Turkey.

For most of 2011 the large current-account deficit has been adequately financed by substantial capital inflows. However, net capital inflows in August were negative, reflecting the impact of international risk aversion, which caused financial market volatility and net outflows of capital from the Turkish bond and stock markets. In these circumstances, the current-account deficit was financed through a fall in official foreign-exchange reserves.



According to weekly Central Bank data, official gross foreign-exchange reserves, which peaked at US\$93.9bn in early July, stood at US\$85.1bn on October 7th, their lowest level since February.

Data and charts

Annual data and forecast

	2007 ^a	2008 ^a	2009 ^a	2010 ^a	2011 ^b	2012 ^c	2013 ^c
GDP							
Nominal GDP (US\$ m)	646,804	730,267	613,764	733,680	727,857	717,864	832,205
Nominal GDP (TL m)	842,740	950,459	951,310	1,102,607	1,220,885	1,321,388	1,494,495
Real GDP growth (%)	4.7	0.7	-4.8	9.0	7.5	3.5	5.0
Expenditure on GDP (% real change)							
Private consumption	5.4	-0.3	-2.4	6.7	9.5	3.0	4.4
Government consumption	6.7	1.7	7.0	1.9	4.0	3.5	4.0
Gross fixed investment	3.0	-5.8	-19.4	29.5	20.0	8.0	9.0
Exports of goods & services	7.4	2.8	-5.5	3.5	4.5	5.0	6.6
Imports of goods & services	10.5	-3.6	-14.9	20.7	20.0	6.1	7.9
Origin of GDP (% real change)							
Agriculture	-6.7	4.3	3.6	2.4	1.0	0.5	1.0
Industry	5.8	-1.3	-8.6	13.4	6.5	4.0	4.0
Services	6.1	1.6	-3.3	7.0	9.4	3.7	6.4
Population and income							
Population (m)	71.2	71.9	72.6	73.3 ^b	74.0	74.7	75.4
GDP per head (US\$ at PPP)	12,461 ^b	12,691 ^b	12,085 ^b	13,198 ^b	14,310	15,035	16,026
Recorded unemployment (av; %)	10.3	11.0	14.1	12.0	10.2	10.1	10.0
Fiscal indicators (% of GDP)							
Central government revenue	22.6	22.1	22.7	23.0	24.3	24.3	24.0
Central government expenditure	24.2	23.9	28.2	26.6	26.1	26.1	25.9
Central government balance	-1.6	-1.8	-5.5	-3.6	-1.7	-1.8	-1.9
Gross public debt	39.6	40.0	46.4	43.0	41.6	40.2	37.4
Prices and financial indicators							
Exchange rate TL:US\$ (end-period)	1.171	1.526	1.491	1.541	1.841	1.841	1.796
Exchange rate TL:€ (end-period)	1.710	2.123	2.137	2.064	2.476	2.421	2.209
Consumer prices (end-period; %)	8.4	10.1	6.5	6.4	8.1	6.9	6.5
Stock of money M1 (% change)	20.1	14.5	17.1	28.9	21.9	17.4	20.9
Lending interest rate (av; %)	27.0 ^b	26.5 ^b	21.0 ^b	19.0 ^b	16.0	17.0	15.3
Current account (US\$ m)							
Trade balance	-46,852	-53,021	-24,850	-56,445	-84,098	-79,152	-81,089
Goods: exports fob	115,361	140,800	109,647	120,902	140,363	149,055	163,974
Goods: imports fob	-162,213	-193,821	-134,497	-177,347	-224,461	-228,207	-245,062
Services balance	13,283	17,311	16,749	14,699	17,972	21,953	24,353
Income balance	-7,108	-8,362	-8,189	-7,322	-8,411	-6,830	-6,613
Current transfers balance	2,243	2,113	2,299	1,329	1,682	1,659	1,924
Current-account balance	-38,434	-41,959	-13,991	-47,739	-72,854	-62,370	-61,425
External debt (US\$ m)							
Debt stock	235,984	263,532	251,372	289,205 ^{bd}	315,936	318,163	322,555
Debt service paid	49,033	54,605	61,367	53,993 ^b	52,853	58,089	60,519
Principal repayments	36,499	42,079	49,803	46,317 ^b	43,738	48,427	51,955
Interest	12,534	12,526	11,563	7,677 ^b	9,115	9,662	8,564
International reserves (US\$ m)							
Total international reserves	76,507	73,657	74,995	86,080	92,191	93,046	95,383

^a Actual. ^b Economist Intelligence Unit estimates. ^c Economist Intelligence Unit forecasts. ^d Based on full-year Treasury data.

Source: IMF, *International Financial Statistics*.

Quarterly data

	2009		2010			2011		
	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr
General government finance (TL m)								
Revenue	53,674	56,872	54,816	62,571	64,993	64,537	66,287	76,050
Expenditure	70,857	68,888	67,126	66,040	71,106	83,360	72,178	67,681
Balance	-17,183	-12,015	-12,310	-3,469	-6,113	-18,823	-5,891	8,369
Output								
Real GDP at constant 1998 prices (TL m)	24,711.7	25,293.4	25,677.2	26,249.4	26,168.8	27,626.9	28,409.9	28,513.0
Real GDP at constant 1998 prices (% change, year on year)	-3.0	5.8	11.1	10.0	5.9	9.2	10.6	8.6
Industrial production index (2005=100) ^a	103.7	110.4	113.3	114.2	114.2	123.2	130.1	123.0
Industrial production index (% change, year on year)	-8.7	8.1	17.2	13.9	10.1	11.6	14.8	7.7
Manufacturing production index (2005=100) ^a	101.1	108.1	111.1	111.7	111.6	122.2	128.1	120.8
Mining production index (2005=100)	147	132	108	126	146	131	116	126
Employment, wages and prices								
Employment ('000)	22,108	21,741	21,267	23,055	23,195	22,854	22,802	24,445
Employment (% change, year on year)	0.2	3.5	7.5	7.5	4.9	5.1	7.2	6.0
Unemployment rate (%)	13.4	13.1	14.4	11.0	11.4	11.0	11.5	9.4
Hourly earnings, manufacturing (2000=100) ^b	151	156	158	161	169	174	171	n/a
Consumer prices (2003=100)	163.7	169.6	176.1	177.9	177.4	182.2	184	188
Consumer prices (% change, year on year)	5.3	5.7	9.3	9.2	8.4	7.4	4.3	5.9
Producer prices (2003=100)	161.0	164.1	169.5	175.0	175.1	178.9	187	191
Producer prices (% change, year on year)	-1.5	2.5	7.2	9.1	8.7	9.0	10.6	9.3
Financial indicators								
Exchange rate TL:US\$ (av)	1.495	1.485	1.506	1.535	1.512	1.458	1.57	1.56
Exchange rate TL:US\$ (end-period)	1.481	1.491	1.519	1.578	1.447	1.541	1.54	1.62
Deposit rate (av; %)	17.1	16.2	15.9	15.9	15.8	13.5	12.1	14.2
Interbank money market rate (av; %)	8.0	6.7	6.5	6.5	6.5	3.8	1.5	1.5
M1 (end-period; TL m)	66,121	69,660	71,388	79,104	85,115	89,809	94,228	102,220
M1 (% change, year on year)	16.2	17.1	19.4	29.1	28.7	28.9	32.0	n/a
M2 (end-period; TL m)	295,721	313,431	331,601	355,732	366,341	389,905	411,317	n/a
M2 (% change, year on year)	15.7	11.0	16.8	24.7	23.9	24.4	24.0	n/a
ISE National-100 index (end-period; Jan 1986=1)	47,910	52,825	56,538	54,839	65,774	66,004	64,435	63,269
Stockmarket index (% change, year on year)	10.8	96.6	119.4	48.4	37.3	24.9	14.0	15.4
Sectoral trends								
Car production ('000)	129	136	149	164	131	160	169	167
Foreign trade (US\$ m)								
Exports fob	25,377	29,054	25,978	28,739	26,997	32,169	31,423	34,169
Imports cif	-38,152	-40,410	-38,495	-44,902	-47,156	-54,991	-56,065	-63,659
Trade balance	-12,775	-11,356	-12,517	-16,163	-20,159	-22,822	-24,642	-29,490
Foreign payments (US\$ m)								
Merchandise trade balance fob-fob	-9,405	-7,381	-8,856	-12,139	-16,653	-18,797	-20,705	-25,804
Services & income balance ^c	6,916	1,820	-947	1,179	5,867	1,324	-1,632	2,092
Net transfer payments	484	894	264	273	365	427	404	302
Current-account balance	-2,005	-4,667	-9,539	-10,687	-10,421	-17,046	-21,933	-23,410
Reserves excl gold (end-period)	71,103	70,874	69,411	71,216	77,782	80,713	86,802	93,737

^a Seasonally adjusted. ^b Gross earnings per production worker. ^c Including other goods.

Sources: Central Bank of Turkey; Turkish Statistical Institute; OECD, *Main Economic Indicators*; IMF, *International Financial Statistics*; Bloomberg.

Monthly data

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Exchange rate TL:US\$ (av)												
2009	1.595	1.659	1.707	1.602	1.554	1.542	1.517	1.483	1.487	1.468	1.484	1.502
2010	1.472	1.515	1.531	1.489	1.542	1.574	1.537	1.507	1.492	1.423	1.436	1.516
2011	1.561	1.587	1.576	1.518	1.571	1.598	1.651	1.754	n/a	n/a	n/a	n/a
Exchange rate TL:€ (av)												
2009	2.111	2.121	2.228	2.114	2.122	2.161	2.137	2.116	2.165	2.175	2.213	2.195
2010	2.101	2.073	2.077	1.996	1.937	1.922	1.963	1.943	1.949	1.978	1.962	2.005
2011	2.085	2.167	2.206	2.192	2.254	2.300	2.354	2.516	n/a	n/a	n/a	n/a
M1 (end-period; % change, year on year)												
2009	15.8	17.2	15.6	12.3	14.3	13.4	13.6	13.3	16.2	12.8	17.7	17.1
2010	21.9	21.0	19.4	21.8	26.6	29.1	30.4	31.3	28.7	29.6	34.7	28.9
2011	33.3	33.6	32.0	32.5	30.3	29.2	30.2	30.9	n/a	n/a	n/a	n/a
M2 (end-period; % change, year on year)												
2009	26.5	24.5	20.9	16.0	17.7	18.0	17.6	17.0	15.7	12.3	11.1	11.0
2010	12.8	14.3	16.8	19.1	22.4	24.7	25.1	24.4	23.9	22.7	24.2	24.4
2011	25.3	24.9	24.0	24.4	23.6	21.5	20.8	21.9	n/a	n/a	n/a	n/a
Industrial production index (% change, year on year; seasonally adjusted; 2005=100)												
2009	-22.6	-20.1	-20.6	-19.5	-15.2	-11.3	-10.7	-6.3	-9.0	5.9	-3.0	24.1
2010	15.3	17.7	18.5	16.4	16.0	9.5	8.9	11.6	9.8	11.7	8.1	14.7
2011	19.9	14.1	10.5	8.5	8.9	5.6	n/a	n/a	n/a	n/a	n/a	n/a
Unemployment rate (%)												
2009	15.5	16.1	15.8	14.9	13.6	13.0	12.8	13.4	13.4	13.0	13.1	13.5
2010	14.5	14.4	13.7	12.0	11.0	10.5	10.6	11.4	11.3	11.2	11.0	11.4
2011	11.9	11.5	10.8	9.9	9.4	9.2	n/a	n/a	n/a	n/a	n/a	n/a
Deposit rate (av; %)												
2009	21.2	18.5	18.3	18.0	18.0	18.0	17.4	17.1	16.9	16.2	16.1	16.2
2010	15.9	15.9	15.9	15.8	15.9	16.0	15.7	15.8	15.8	13.8	13.8	12.9
2011	12.1	12.2	12.2	12.9	14.8	14.9	15.0	n/a	n/a	n/a	n/a	n/a
Money market rate (av; %)												
2009	14.1	12.6	11.0	10.3	9.5	9.0	8.5	8.0	7.6	7.0	6.7	6.5
2010	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.4	6.0	3.8	1.6
2011	1.5	1.5	1.5	1.5	1.5	1.5	1.5	5.0	n/a	n/a	n/a	n/a
ISE National-100 stockmarket index (end-period; Jan 1986=1.00)												
2009	25,934	24,027	25,764	31,652	35,003	36,949	42,641	46,551	47,910	47,185	45,350	52,825
2010	54,651	49,705	56,538	58,959	54,385	54,839	59,867	59,973	65,774	60,404	65,351	66,004
2011	63,278	61,284	64,435	69,250	63,046	63,269	62,296	53,946	59,693	n/a	n/a	n/a
Consumer prices (av; % change, year on year; 2003=100)												
2009	9.5	7.7	7.9	6.1	5.2	5.7	5.4	5.3	5.3	5.1	5.5	6.5
2010	8.2	10.1	9.6	10.2	9.1	8.4	7.6	8.3	9.2	8.6	7.3	6.4
2011	4.9	4.2	4.0	4.3	7.2	6.2	6.3	6.7	6.2	n/a	n/a	n/a
Producer prices (av; % change, year on year; 2003=100)												
2009	7.9	6.4	3.5	-0.3	-2.5	-1.9	-3.8	-1.0	0.5	0.2	1.5	5.9
2010	6.3	6.8	8.6	10.4	9.2	7.6	8.2	9.0	8.9	9.9	8.2	8.9
2011	10.8	10.9	10.1	8.2	9.6	10.2	10.3	11.0	12.1	n/a	n/a	n/a
Total exports fob (US\$ m)												
2009	7,884	8,435	8,155	7,562	7,346	8,330	9,056	7,840	8,481	10,096	8,903	10,055
2010	7,829	8,263	9,886	9,396	9,800	9,543	9,565	8,523	8,909	10,964	9,382	11,823
2011	9,549	10,061	11,813	11,870	10,942	11,357	11,871	11,268	n/a	n/a	n/a	n/a

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Total imports cif (US\$ m)												
2009	9,281	9,075	10,522	10,120	10,868	12,501	12,856	12,811	12,485	12,773	12,618	15,019
2010	11,691	11,782	15,022	14,943	14,726	15,233	16,078	15,434	15,644	17,297	17,135	20,559
2011	16,903	17,519	21,643	20,952	21,104	21,603	20,892	19,498	n/a	n/a	n/a	n/a
Trade balance fob-cif (US\$ m)												
2009	-1,397	-640	-2,367	-2,558	-3,522	-4,171	-3,800	-4,971	-4,004	-2,677	-3,715	-4,964
2010	-3,862	-3,519	-5,136	-5,547	-4,926	-5,690	-6,513	-6,911	-6,735	-6,333	-7,753	-8,736
2011	-7,354	-7,458	-9,830	-9,082	-10,162	-10,246	-9,021	-8,230	n/a	n/a	n/a	n/a
Foreign-exchange reserves excl gold (US\$ m)												
2009	67,152	67,289	67,418	64,456	67,966	66,106	67,142	70,195	71,103	71,372	71,394	70,874
2010	70,630	67,906	69,411	73,167	72,290	71,216	74,088	76,455	77,782	79,244	79,094	80,713
2011	82,901	83,066	86,802	90,221	91,863	93,737	93,003	89,100	n/a	n/a	n/a	n/a

Sources: IMF, *International Financial Statistics*; OECD, *Main Economic Indicators*; Haver Analytics.

Annual trends charts

Real GDP growth
(% change)



Source: Economist Intelligence Unit.

Consumer price inflation
(av; %)



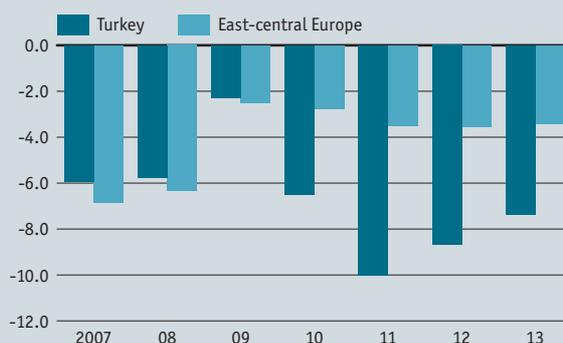
Source: Economist Intelligence Unit.

Budget balance
(% of GDP)



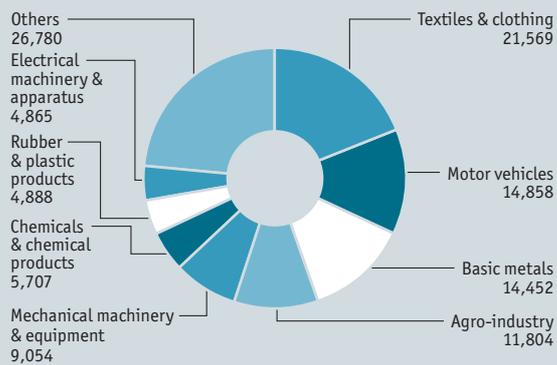
Source: Economist Intelligence Unit.

Current-account balance
(% of GDP)



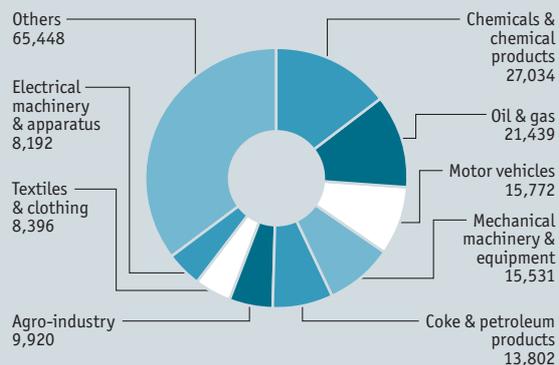
Source: Economist Intelligence Unit.

Principal exports, 2010
(US\$ m)



Source: Economist Intelligence Unit.

Principal imports, 2010
(US\$ m)



Source: Economist Intelligence Unit.

Quarterly trends charts

Real GDP growth
(% change)



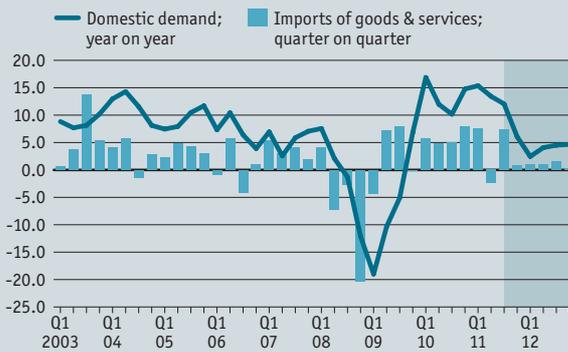
Source: Economist Intelligence Unit.

Consumer price inflation
(av; %)



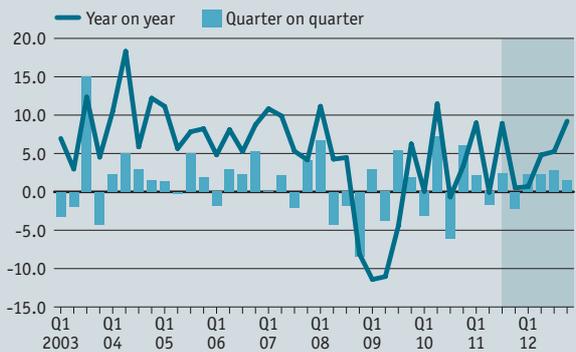
Source: Economist Intelligence Unit.

Imports and domestic demand
(% change)



Source: Economist Intelligence Unit.

Exports of goods and services
(% change)



Source: Economist Intelligence Unit.

Long-term bond yield interest rates
(av; %)



Source: Economist Intelligence Unit.

Exchange rate
(TL:US\$, av)



Source: Economist Intelligence Unit.

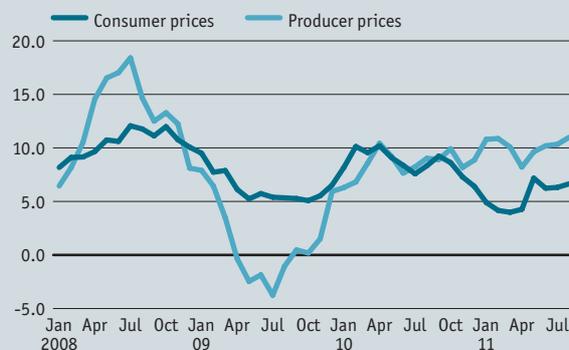
Monthly trends charts

Exchange rate
(TL:US\$; av)



Source: Economist Intelligence Unit.

Price inflation
(% change, year on year)



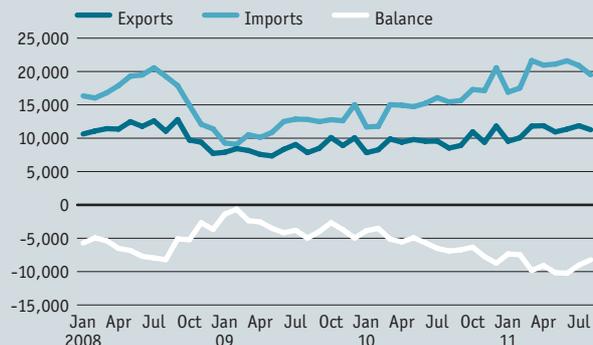
Source: Economist Intelligence Unit.

Index of industrial activity
(av; 1996=100)



Source: Economist Intelligence Unit.

Foreign trade
(US\$ m; goods only)



Source: Economist Intelligence Unit.

Foreign-exchange reserves
(US\$ m)



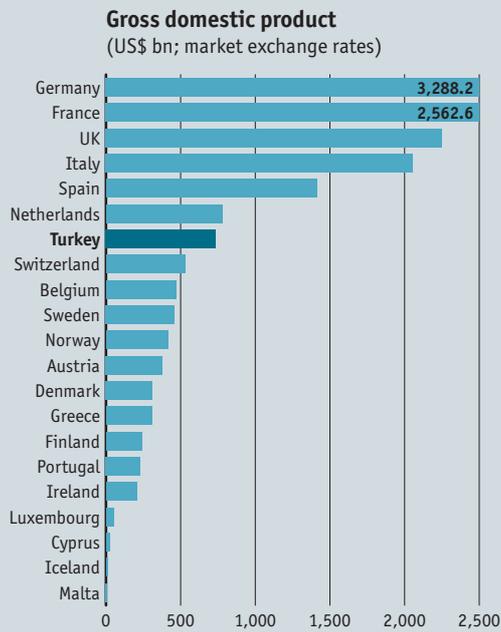
Source: Economist Intelligence Unit.

Oil: Brent crude price
(US\$/b; av)

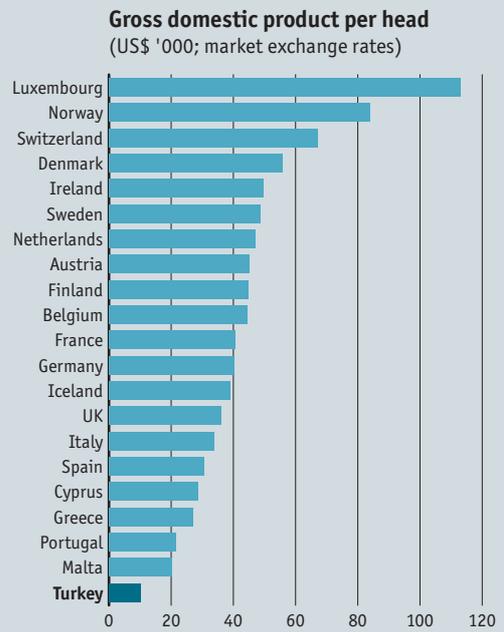


Source: Economist Intelligence Unit.

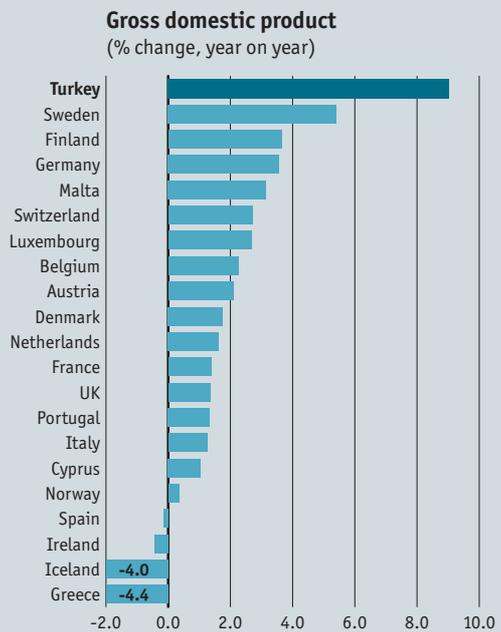
Comparative economic indicators, 2010



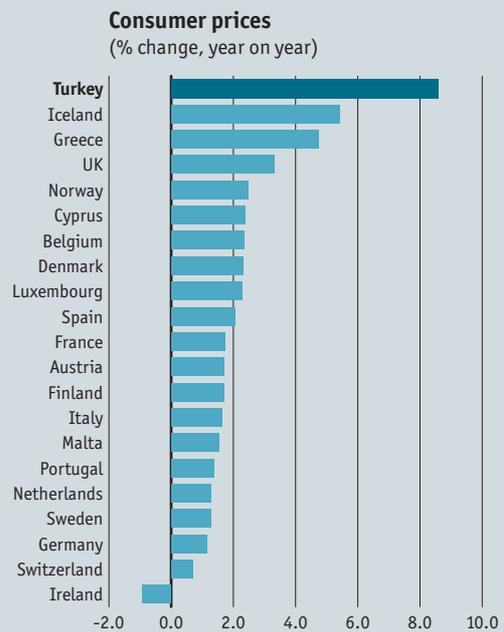
Sources: Economist Intelligence Unit estimates; national sources.



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Sources: Economist Intelligence Unit estimates; national sources.

Country snapshot

Basic data

Land area	783,562 sq km (including lakes and islands), of which 30% arable, 3% orchards, olive groves and vineyards, 26% classified as forest	
Population	71,158,000 (mid-year estimate, US Census Bureau)	
Main towns	Population (2007 census)	
	Istanbul	11,174,257
	Ankara (capital)	4,140,890
	Izmir	3,175,133
	Bursa	1,979,999
	Adana	1,611,262
Climate	Mediterranean on the south coast, continental inland	
Weather in Ankara (altitude 861 metres)	Hottest month, August, 15-31°C (average daily minimum and maximum); coldest month, January, -4-4°C; driest month, August, 10 mm average rainfall; wettest month, December, 48 mm average rainfall	
Language	Turkish	
Measures	Metric system	
Currency	Turkish lira	
Time	2 hours ahead of GMT; 3 hours ahead in summer	
Fiscal year	Calendar year	
Public holidays	January 1st; April 23rd; May 19th; three days for Ramadan and four days for Kurban or Eid (dates vary according to the Muslim calendar); August 30th; October 28th (half-day); October 29th	

Political structure

Official name	Republic of Turkey	
Form of state	Parliamentary republic	
Legal system	Based on European models and constitution of 1982	
National legislature	Unicameral Meclis (parliament) of 550 members directly elected for a four-year term	
Electoral system	Universal direct suffrage over the age of 18. Only parties with more than 10% of the national vote are eligible for seats in parliament. Individuals may run as independents	
National elections	June 12th 2011; next election by June 2015	
Head of state	The current president, Abdullah Gul, was elected by parliament for a single seven-year term in August 2007, but the subsequent introduction of election by universal direct suffrage and a maximum of two consecutive five-year terms makes the timing of the next presidential election uncertain	
National government	The present government is formed by the Justice and Development Party (AKP)	
Main political parties	Islamist-liberal: Justice and Development Party (AKP); Islamist: Prosperity Party (Saadet, SP); centre-left: Republican People's Party (CHP) and Democratic Left Party (DSP); nationalist right: Nationalist Action Party (MHP); pro-Kurdish: Peace and Democracy Party (BDP). In the 2011 election the AKP, CHP and MHP exceeded the 10% national vote threshold. Members of the BDP were elected as independents	
Council of Ministers	Prime minister	Recep Tayyip Erdogan
	Deputy prime ministers	Bulent Arinc Besir Atalay Ali Babacan Bekir Bozdag
Key ministers	Agriculture, food & animal resources	Mehmet Mehdi Eker
	Culture & tourism	Ertugrul Gunay
	Defence	Ismet Yilmaz
	Development	Cevdet Yilmaz
	Economy	Zafer Caglayan
	Education	Omer Dincer
	Employment & social security	Faruk Celik
	Energy & natural resources	Taner Yildiz
	Environment & urban planning	Erdogan Bayraktar
	EU affairs	Egemen Bagis
	Family & social policy	Fatma Sahin
	Finance	Mehmet Simsek
	Foreign affairs	Ahmet Davutoglu
	Forestry & water	Veysel Eroglu
	Health	Recep Akdag
	Interior	Idris Naim Sahin
	Justice	Sadullah Ergin
	Science, technology & industry	Nihat Ergun
	Sport & youth	Suat Kilic
	Tourism & culture	Ertugrul Gunay
	Trade & customs	Hayati Yazici
	Transport	Binali Yildirim
Central Bank governor	Erdem Basci	