After mounting anxiety about the prospect of overheating last year, the Turkish economy has slowed down markedly during recent months. This is partly due to deliberate tightening by the authorities but also reflects the increasingly challenging international backdrop. Encouragingly, the slower growth has begun to significantly correct Turkey's main macroeconomic imbalances. The non-oil component of the current account is returning to balance while inflationary pressures are moderating.

- **Economic growth set to decelerate markedly this year.** Even though the authorities have likely successfully avoided the much-feared hard landing scenario, growth has been slowing down sharply and will likely undershoot the government's 4% target for the year. More encouragingly, however, the composition of GDP growth will be much healthier with a far diminished reliance on consumption and a positive contribution from net exports.

- **The policy bias will remain somewhat restrictive.** The Central Bank has pursued fairly consistent monetary tightening since the second half of last year and this bias looks likely to persist, partly in order to ensure sufficient inflows at a time of elevated external stress. The fiscal account improved unexpectedly last year but the positive trend has been reversed and a marked deterioration in June may trigger additional tightening.

- **The key macroeconomic imbalances are correcting.** Although the heavy dependence on energy imports remains a risk, Turkey has benefited from a sharp improvement in the performance of its exports at a time when imports are slowing. The seasonally adjusted non-oil current account deficit is now close to zero. At the same time, last year's inflationary peak seems to have been passed, although continued volatility is possible around a downward trend.

- **External risks remain unusually elevated.** Turkey remains vulnerable to external discontinuities, above all in the Euro-zone. The heavy reliance on energy imports constitutes another risk factor. The vulnerabilities in these areas have diminished somewhat and various policy initiatives are now underway to try to correct them further. Nonetheless, external shocks could result in echoes of 2008-2009 even if the room for maneuver of policy makers has improved of late.
Economic growth slowing

The robust rebound of the Turkish economy from its 2009 recession saw two years of record growth of 9.2% and 8.5%, respectively, in 2010-2011. This robust expansion eventually began to fuel mounting anxiety about the country’s historic boom-bust cycle reasserting itself after a period of overheating. Although both the financial sector and the broad economy remain very resilient by historical standards, the fast growth was increasingly obviously associated with a rapidly deteriorating external imbalance as well as mounting inflationary pressures.

It is obvious now, however, that the robust expansion is over for the time being. The slowdown is driven by a combination of external uncertainty, especially in Europe, and deliberate domestic policy tightening. GDP growth decelerated markedly from 9.1% in 2Q11 to 5.2% by the last quarter of the year and further to 3.2% in 1Q12. This more subdued performance has continued in recent months but, even as external risks are unusually elevated, the hard landing scenario has, at least for now, been successfully avoided. In essence, the Turkish growth miracle appears to be pausing for a long awaited and much needed breather. Nonetheless, the economy can on current projections look forward to an international respectable rate of growth even if the government’s 4% target for the year appears a tad overly optimistic. We expect the Turkish economy to expand by 3.3% this year, although many analysts are more cautious than this with for instance the IMF forecasting growth of only 2.3%. Growth looks likely to once again regain momentum in 2013-2014 with projected annual rates of 4.3% and 5.1%. This rebound is primarily reflective of an expected improvement in the global economic conditions and hence remains potentially vulnerable to exogenous shocks.

An impressive track record of growth

A clear slowdown is expected next year

More balanced growth

Not only has the headline growth rate decelerated markedly but also the breakdown of growth is much more evenly balanced, reflecting a return to more sustainable trends. Much of Turkey’s expansion during the post-crisis rebound was led by consumption and investment both of which, to a degree, fueled...
purchases of foreign goods. This left net imports with a significant negative net contribution to GDP, a state of affairs that has now changed rather markedly. The pace of consumption and investment has slowed down sharply whereas net exports are now making a substantial positive contribution to growth. Q1 growth was mainly driven by exports, which contributed 4.5%, while private consumption contributed almost nothing. Overall, domestic demand contributed by 1 percentage point to the headline GDP growth figure and by a negative 1.4 points if stocks are included. We expect this pattern to continue to obtain with relatively little change in the foreseeable future.

The latest economic data suggests that growth may be picking up somewhat, albeit the year is likely to be marked by relative continuity in the face of exceptional external uncertainty:

- Industrial production in May rose by 5.9% YoY, far ahead of expectations. Capital goods led the way with a 9.6% increase. Industrial production in the first five months of the year was up 3.2% on the same period in 2011. Capacity utilization has trended fairly consistently, albeit moderately down since last summer.

- Vehicle sales in the first five months of the year totaled 269,565, down 20.8% on a year earlier. However, there was a seasonally adjusted 9% MoM increase in domestic passenger car sales in June.

- Housing sales in 1Q12 fell by 19.2% QoQ, although the figure was 5.5% up on the same period a year earlier. The slowdown in the market may be partly due to an initiative seeking to apply 18% value added tax to apartments of less than 150 sq m which are currently taxed at 1%.

- The Markit Purchasing Managers' Index fell by 2% MoM in May to 50.2. Turkeys' consumer confidence index fell from 92.1 in May to 91.8 in June. The index values range from 0 to 200.

- Unemployment declined to 9% in April, sharply down on 9.9% in March. The positive trend is expected to continue in the summer months.

**Breakdown of quarterly GDP growth**

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**Unemployment nearing historical lows**

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Source: TurkStat
The capital adequacy of the Turkish banking sector was a robust 16.4% as of April even if this may fall close to 15% with the introduction of Basel II as of July.

Turkey’s economic resilience received international recognition when Moody’s Investors Service in late May increased the country’s sovereign rating from Ba1 to Ba2 and maintained a positive outlook. The positive decision was based on a favorable dynamic in the government’s financing which has improved Turkey’s ability to withstand exogenous shocks. Further upgrades to investment grade are still likely to depend on increased stability in the balance of payments. Moody’s decision stands in contrast to a controversial move by Standard & Poor’s earlier in May to reduce Turkey’s outlook from positive to stable. The agency cited concerns over Turkey’s large current account deficit and a heavy dependency on external funding. Reflecting the resilience of the economy, the Istanbul Stock Exchange has been the best performer globally among bourses during the first half of the year. By mid-July, the main index had climbed 23% YTD.
A significant policy tightening

One of the main causes of the pronounced deceleration in Turkey’s GDP growth has been deliberate policy tightening in the second half of last year by the fiscal and monetary authorities alike. While the improvement in the fiscal situation was to an extent driven by temporary factors, the Central Bank looks committed to maintaining its restrictive bias for now. Indeed, even as interest rate differentials vis-à-vis other emerging markets have grown, further tightening measures may become necessary should Turkey run into difficulties in financing its current account deficit in the current challenging external economic environment.

Unconventional policy-making by the Central Bank continues

The Central Bank has been widely criticized for an unorthodox approach to monetary policy that has tended to rely on a far wider range of instruments than is customary elsewhere. The flexible stance has been due to the desire to pursue a number of simultaneous objectives in a highly volatile global market environment. While seeking to curb speculative inflows, the authorities have also worked to contain price pressures and finance the large current account deficit.

Although the Central Bank has deliberately maintained a high degree of flexibility in its options, the actual implementation of monetary policy has generally become much more consistent in recent months. The main policy rate has remained at 5.75% since a 50 bps cut in August. The overnight lending rate was cut by 100 bps to 11.5% in February, reversing some of the 350 bps increase since October. The borrowing rate is 5.0%. Beyond this, the Central Bank has engaged in daily liquidity management using combination with a low policy rate and an actively managed overnight interest rate corridor. For instance in the last week of March and mid-April, the Central Bank did not hold 1-week repo operations and opened daily 1-week auctions instead. This had the consequence of pushing funding cost for the banks above 10%, up from below 7% while the Lira outperformed its peers. The funding costs have declined fairly consistently since June, reaching just over 8% by mid-July.

Interest rate indicators

Source: Central Bank of the Republic of Turkey, Bloomberg

A Lira rebound

Source: Bloomberg
The Central Bank has further sought to influence the liquidity conditions by raising the upper limit for the portion of the Lira required reserves that is allowed to be held in gold from 10% to 20% in March and ultimately to 25% in June. By contrast, gold can no longer be used to meet any foreign exchange reserves. The proportion of Lira reserves that can be held in foreign currencies was increased from 40 to 45% in May, to 50% in June, and finally to 55% in July. This was expected to increase Central Bank reserves by USD2.9bn. Altogether, these reserve decisions were projected to boost market liquidity by TRY17.3bn while adding some USD9.0bn to the foreign exchange reserves and as much as USD4.4bn to the gold reserves.

The tight monetary stance has in turn contributed to – and been amplified by – an appreciation in the Lira which further benefited from a general reduction in global risk aversion in the spring. The authorities had previously sought to weaken the currency in a bid to rebalance growth and the Lira weakened by 17% against the USD-EUR basket in the course of 2011. The benefits of the policy were partly lost to rising prices, however as inflation last year accelerated to 11.1%, more than double the Central Bank’s 5% target. While the stronger Lira has been generally welcome, concerns are now emerging that the growing interest rate differential between Turkey and other emerging markets may contribute to speculative inflows. However, policy reversals may prove gradual as restrictive monetary conditions may be needed to ensure adequate inflows should international risk aversion once again increase. Moreover, even as inflationary pressures are waning, the Central Bank seems committed to maintaining its restrictive bias for as long as the headline rate is above its 5.0% target. The Central Bank has repeatedly indicated that it will not react to temporary changes in commodity prices but will act on changes in inflation expectations.

The tighter monetary policy has gone hand in hand with a more restrictive stance by the Bank Regulation and Supervision Agency BDDK, which has boosted capital and provisioning requirements for consumer credit. As a result, credit growth has been slowing fairly sharply from the 33% pace recorded in 2010. It decelerated to 23% in 2011. Commercial loans grew at an annual 20.3% in June while the pace of consumer loans decelerated to 17.2%. Moreover, there are
signs that banks are having to draw down their foreign assets to support domestic lending.

**Mixed progress on the fiscal front**

The fiscal situation has generally weakened this year with the June data marking a particularly abrupt deterioration. This stands in contrast to a significant improvement previously when the government deficit contracted from 3.6% of GDP in 2010 to just 1.3% in 2011. However, any comparisons with last year are somewhat distorted by a sharp 20.5% increase in tax collections in 2011 over the year before. This was in large part due to temporary measures such as to a trade-related boost to indirect tax receipts, which further benefited from measures designed to curb important demand through excise and special consumption taxes as of October last year. Moreover, substantial proceeds were generated by a tax amnesty.

After a TRY0.4bn deficit in the preceding five months of the year, the July shortfall was TRY6.3bn, taking the total for 1H12 to TRY6.7bn. This compares to a surplus of TRY2.9bn during the corresponding period last year. The non-interest surplus contracted from TRY25.3bn in 1H11 to TRY19.6bn this year. In particular, value added tax receipts fell back to last year’s levels reflecting the slowdown in private consumption. Overall, revenues in 1H12 were TRY162.2bn, up 11% YoY while expenditures grew by 17.9% to TRY168.9bn. The rise in government spending was led by salaries and pensions. In spite of the sudden deterioration, the 1H deficit still compares favorably to the government’s TRY21.1bn target for the year as a whole. The fiscal plan envisages a budget deficit of 1.5% and a primary surplus of GDP this year.

The fiscal outlook for the year as a whole points toward a growing shortfall. Apart from the deteriorating outlook on the revenue side, government spending may exceed expectations due to higher interest rates as well as the need for the government to directly fund some key infrastructure projects, most notably a planned third bridge over the Bosphorus after a private sector funding solution failed in January. The overall shortfall could reach more than 2% of GDP. These negative factors may well persist into 2013, pushing the deficit above 3% of GDP.
In spite of this, the general government debt as a percentage of GDP is likely to continue to edge down from some 40% of in 2011 to some 35% by 2014. The public debt to GDP ratio fell from 38% in 4Q11 to 37% in 1Q12.

The mounting fiscal pressures may lead the government to undertake some further tightening in the 2013 budget. The latest official statements suggest that new taxes may be considered while initiatives are also underway to boost the efficiency of tax collection. After falling behind their previous targets, the authorities are also reportedly planning to launch the next wave of privatization. Turkey has raised USD43.1bn from roughly 200 privatization deals since the process began in 1986. Privatization revenues last year reached USD1.4bn and the target for this year is TRY12.5bn. Other ongoing privatizations projects include the Ankara gas grid and the Bosphorus bridges in Istanbul. Moreover, the Turkish Treasury has earned close to TRY3.5bn from property sales since November 2002 and is considering the sale of some 769.7mn sq m of deforested land with an aggregate market value of TRY15-26.5bn. The sale of 10.3% of the petrochemicals producer Petkim to Socar (State Oil Company of Azerbaijan) for USD168.5mn was approved in May and Socar now owns 51% of the company.
Imbalances are correcting

A persistent large current account deficit remains Turkey’s primary macroeconomic imbalance, leaving the country highly vulnerable to exogenous shocks in an uncertain global economic environment. The problem deteriorated rapidly over the past two years as Turkey’s rebound from the 2009 crisis far outpaced the growth of its leading trade partners. During much of this period, strong domestic demand and a robust Lira contributed to the shortfall along with increasing energy prices. Last year, the current account deficit widened by 65% over 2010, reaching an unprecedented USD77.1bn or over 10% of the country’s GDP. The current account deficit reached its absolute peak – calculated as a 12-month cumulative total – in October 2011 when it stood at USD78.6bn. This is the second largest imbalance globally only eclipsed by the US deficit. The past year also saw a significant pick-up in inflationary pressures.

The non-oil current account is nearing a balance

Deliberate monetary tightening, along with a pronounced slowdown in growth, has begun to sharply correct Turkey’s external deficit. The Q1 shortfall of USD16.3bn marked a significant improvement on USD21.6bn a year earlier. Most encouragingly, thanks to a strong export performance, the non-energy component of the deficit was only USD3.7bn in sharp contrast to USD11.3bn in Q111. Turkey’s external imbalance has hence become increasingly obviously an energy story. Even this component of the shortfall has benefited from the Brent benchmark price falling from its Q1 average of USD119/barrel below the USD100 mark by early June even if it subsequently recovered somewhat.

An improving current account outlook

Thanks to these trends, as well as a growing service sector surplus, the current account deficit has generally continued to contract. The monthly figure fell by an annual 25.9% to USD5.8bn in May, taking the deficit in the first five months of the year to USD27.1bn, which is USD9.9bn below the corresponding figure a year earlier. The 12-month cumulative deficit stood at USD66.9bn following seven
consecutive months of improvement. The non-energy current account deficit contracted to USD14.3bn in May, the lowest levels since January 2011. On current projections, with seasonal effects further set to boost the positive momentum in the coming months, the current account deficit could now close the year at around 7.5% of GDP. The main risk to this outlook is posed by possible disruptions to the oil market that might bring about a renewed energy spike. A USD10 increase in the oil price would push up the deficit by some USD4.5-5.0bn.

The turnaround in the current account position has been underpinned by favorable trends in Turkey’s foreign trade performance with the trade deficit narrowing by 15.5% YoY to USD8.5bn in May. This followed a 27.3% drop in April. Recent months have seen a sharp improvement in Turkish exports while imports have been largely flat. Exports rose by 20.3% YoY to USD13.1bn in May whereas imports advanced by a much more modest 3.1% to USD21.7bn. In the first five months of the year, exports rose by 12.7% while imports actually contracted by 1.4% YoY.

One of the main risks associated with Turkey’s external deficit has been the challenge of financing it, especially with the reliance on short-term funding growing markedly over the past year. Although the quality of funding Turkey’s current deficit has improved somewhat in recent months, it still leaves Turkey vulnerable to changes in risk appetite. In Q1, 14% of the deficit was funded through FDI as compared to 32.3% from portfolio investments. In the 12-month rolling figures the percentage of short-term inflows (portfolio and short-term liabilities of banks and firms) exceeded 40% as opposed to a 36% aggregate share of FDI and long-term liabilities. This marks a clear improvement on a breakdown of 73 to 23% in the same period a year earlier. One item making a fairly consistent positive contribution to financing the deficit has been errors and omissions with net errors fairly consistently running at a positive USD10-12bn per year. Some of this has been linked money flows associated with the Arab Spring and the Euro-zone crisis but there have also been periodic complaints about the way tourism revenues are estimated.
Turkey's economic resilience is also lending growing support to foreign direct investment. According to the latest UNCTAD data, FDI flows into Turkey rose by 75.7% to USD15.9bn last year. This compares to a global increase of 16.6%. FDI in Turkish industry during Q1 was up 251% YoY to nearly USD2.5bn. However, FDI in the services sector declined by 70.5% to USD1.4bn, led by lower investments in financial services. The main sources of FDI were the UK, the Netherlands, and France. At the same time, 241 M&A deals worth USD15bn constituted an all-time record last year, according to TÜSİAD (Turkish Industry and Business Association) estimates. Foreign investors accounted for 74% of the total. On current projections, the proportion of FDI could well rise to a quarter of the total current account shortfall by the end of the year.

Turkey's foreign exchange reserves have been recovering fairly consistently since January, highlighting stronger capital inflows into the country. This has been partly linked to relatively tighter monetary conditions in Turkey which have further strengthened the relative value of the Lira. Some of the progress has been due to the return of funds held by domestic corporates and individuals, whether abroad or outside the formal banking system. A further major boost has been provided by the recent regulations allowing banks to hold a growing proportion of their Lira reserves in foreign currencies or gold. According to the Central Bank, banks have used 98.6% of this facility. Turkey's foreign exchange reserves reached USD78.6bn in May while the gold reserves stood at USD13.1bn. The reserves now cover some 4.6 months worth of imports. Because of tighter monetary conditions and regulatory changes, the foreign exchange reserves are expected to climb from the current USD93bn to USD100bn by the end of the year.

**Inflationary pressures are waning**

Rapidly mounting price pressures last year emerged as the second main macroeconomic imbalance in Turkey. Inflation reached more than double the Central Bank’s 5% target by December. Recent months have seen a pronounced

![Inflation dynamics](source: TurkStat)
improvement in the inflation picture, however. May inflation at 8.3% YoY was sharply down on the 11.1% three-year high recorded in April. This was the first time the CPI returned to the single digits since November 2011. The favorably dynamic continued in June with consumer prices falling by 0.9% while producer prices fell by 1.5%. Nonetheless, the annual pace of consumer price inflation accelerated somewhat to 8.9% due to base effects, while producer prices advanced by 6.4%. Food prices were the main reason for the MoM drop. Core inflation indicators fell to 9-month lows, suggesting a continued decline in demand-side pressures. The I index, which excludes food, tobacco, and energy prices, fell from 7.7% to 7.4% in June.

After a downward revision in July due to lower food and energy prices, the Central Bank now expects inflation to decelerate to 6.2% by the end of this year, followed by a further slowing to 5.1% by the end of 2013. The Central Bank's latest expectations survey puts year-end inflation at just under 7.0%. Should Brent prices stay in the range of USD95-100 per barrel, inflation could even fall below 6% by the end of the year.

The main upside risks to inflation would appear to come from supply side risks with commodities such as oil and agricultural products, given poor harvests in a number of producers countries, even though Turkey’s own substantial production naturally does provide a cushion. The Central Bank’s revised oil price projection is USD110/barrel this year, followed by USD100/barrel in 2013. Oil prices have a 6.4% weight in the Consumer Price Index. The Q1 increase in oil prices added 0.7 percentage points to headline inflation. Also, utility price increases in April contributed some 0.5 percentage points.
Responding to external uncertainties

Turkey's track record in recent years has been one of growing economic resilience and the main risk factors facing the economy are now almost certainly external. In particular, a sharp deterioration in the situation of the Euro-zone would inevitably have repercussions on Turkey through tighter credit conditions and weaker external demand. However, one of the most welcome developments of Turkey's economic strategy in recent years has been a growing emphasis on solutions to reduce the country's structural vulnerabilities. Even if meaningful changes in some areas may require years to bear fruit, for instance the country trade dynamics have already changed markedly.

Trade diversification is bearing fruit

One of the key tenets of Turkey's foreign policy in recent year has been a greater focus on its immediate geographic neighborhood. In the past, it tended to receive less attention because of the country's traditional Western orientation and strong trade links with Europe. The reorientation in part reflects the strong growth of some of the emerging markets of the Middle East and the former Soviet Union. Commercial relations constitute an important dimension of these initiatives as they represent an opportunity to develop new export markets and to foster mutual investment flows. In reflection of Turkey's evolving priorities, the Ministry of the Economy recently revised its list of target countries that Turkey wishes to establish closer commercial relations with. The new list has 17 target countries and 27 priority countries which have the potential to be upgraded. The new target countries include Indonesia, Iran, Kazakhstan, Ukraine, South Africa, and Japan. Beyond this, a number of new initiatives and bilateral treaties have sought to target the Black Sea region as well as a number of Middle Eastern economies. For instance, Turkey's trade with Arab League countries rose from USD6bn in 2002 to USD35bn in 2011, some 9% of the total. The target is to boost trade to USD100bn over the coming five years.

Reduced dependency on Europe

Turkey's top export markets

Source: Central Bank
Source: TurkStat
Reflecting the changing dynamics of Turkey's foreign trade, Iran was the country's most important export destination in May after a 513.2% YoY increase to a total of USD1.6bn. This was above all due to gold exports which jumped to USD1.3bn and obviously largely reflect the sanctions-related economic uncertainty in the country. The other leading export destinations were Germany, Iraq, the UK, and Russia. As a result of the deepening crisis in the Euro-zone and the regionally focused strategy of Turkey’s foreign trade policy, the EU accounted for 36.2% of exports, as compared to 46.8% in May 2011. Exports to the EU declined by 6.9% YoY in May to USD4.8bn. The growing role of Iran made precious stones and metals the most important category exports. Russia, because of energy, was the most important source of imports at USD2.2bn. It was followed by Germany, China, and the US.

In an important initiative, Turkey has adopted measures to foster trade in local currencies with key trade partners such as Russia and China. Also Turkey and Iran are looking into ways of applying this model even at a time when Turkey has cut its oil imports from Iran by with the state oil company Tüpras committed to a 20% cut. Turkey was Iran's fifth-largest oil customer in 2011 with purchases of some 200,000 b/d, which was approximately 30% of Turkish oil imports and 7% of Iranian oil exports. Following average imports of 210,000 b/d in January-April, Turkey cut its imports from Iran to 140,000 b/d in May. Tüpras intends to make up for any shortfall through larger shipments from Saudi Arabia and Libya.

In another fresh initiative which will likely deepen Turkey’s relations with its regional neighbors, the legislation on real estate purchases by foreigners was liberalized this spring. Consequently, foreign real estate acquisitions in May alone rose to USD1.1bn, four times the USD310mn total seen in all of 2011 and up sharply on a total of USD114mn in January-April. The bound was led by European buyers. There is considerable growth potential with an estimated total of 300,000 potential Russian and Arab buyers alone.

In search of structural solutions

The Turkish authorities are pursing structural reform with a view to boosting the country’s sustainable growth by better utilizing its productive resources while cutting its dependency on imports. Key initiatives in this regard are designed to boost overall economic efficiency, increase savings, and develop alternative sources of energy. Any strategy to boost Turkey’s trend growth will have to rely on successful reforms to the education system and the labor market. These in turn are needed to meet the government's long-term growth objectives and to ensure Turkey’s transition from its current middle income economy status.

The room for improvement in these areas is obvious and increasingly well understood. In spite of considerable improvement in recent years, Turkey’s competitive position leaves significant room for improvement. The country is currently ranked 71st out of 183 on the World Bank’s Doing Business Index. The OECD recently estimated that relative policy continuity would give Turkey a trend growth rate of 4.4% up to 2030. However, if labor markets are reformed to a point
where participation increases from the current 49% to 60% by 2030, the trend growth would increase by an estimated 0.6 percentage point. Boosting the average time spent in formal education from eight to 10 year over the same time period along with significant quality improvements would make a contribution of 0.8 percentage points. Structural reform therefore can have a transformative impact on the longer-term economic prospects of the country boosting the output by as much as a quarter.

Efforts are also underway to boost employment with the National Employment Strategy of 2011 identifying a number of objectives with a view to creating more flexible labor markets. Among key steps, severance pay will be reduced, minimum wages determined on a regional basis, and various steps take to encourage female labor force participation. Turkey has the lowest number of families with two working parents among OECD members. The rate of 15% compares to an OECD average of 57%.

Various initiatives are designed to increase employment opportunities while cutting the country’s reliance on imports, many of which in fact are intermediate goods needed to feed its exports. Turkey has an incentive scheme to promote import substitution by subsidizing investments with import dependency of less than 60%. Priority will be given to the least developed regions of the country. The Ministry of the Economy recently accounted that they had received applications for USD3.2bn worth of initiatives which could be expected to create 12,000 jobs.

Another new incentive package supports Turkey’s aerospace, defense, and automotive sectors in a bid to cut reliance on imports. Turkey is similarly seeking to boost its energy independence by creating a national network of 12 nuclear power stations. Moreover, the country is planning a new industrial zone in Karapınar to support the development and generation of solar energy. Along with a planned iron and steel zone in Filyos, the project is expected to draw investments of some USD17bn. Turkey also intends to increase its R&D spending to 3% of its national income by 2023. As an example, the government is hoping to position Turkey as a hub for pharmaceutical research and production. Turkey currently has some 300 pharmaceutical companies employing 25,000 people. The government recently introduced a stimulus package to support investment in the sector.

One element of the government's strategy has been to reduce the scale of economic activity, which indeed seems to be bearing fruit. Finance Minister Mehmet Şimşek recently announced that the size of the informal economy now stands at some 27.7% of GDP, down markedly on 32.4% in 2002. The Ministry hopes to reduce the size of the informal economy by another five percentage points over the next decade. In another bid to boost domestic savings, the government is seeking to stimulate retirement savings by matching 25% of private contributions capped at an annual USD5,910. This modifies a previous practice of a 25% tax exemption which disproportionately favored wage earners.
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