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Turkey

Executive summary

3 Highlights

Outlook for 2011-15

4 Political outlook
7 Economic policy outlook
8 Economic forecast

Monthly review: January 2011

12 The political scene
15 Economic policy
16 Economic performance

Data and charts

22 Annual data and forecast
23 Quarterly data
24 Monthly data
26 Annual trends charts
27 Monthly trends charts
28 Comparative economic indicators

Country snapshot

29 Basic data
30 Political structure

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Executive summary

Highlights

January 2011

Outlook for 2011-15

- The Economist Intelligence Unit expects the Justice and Development Party (AKP), boosted by victory in the constitutional reform referendum, to win the 2011 election and remain in office throughout the forecast period.
- Domestic resistance to reforms, notably to resolve the Kurdish issue and improve the judicial system, will continue to hinder Turkey's EU negotiations, as will the Cyprus issue and opposition in some EU states to Turkish accession.
- After a sharp rise in 2009, the budget deficit is expected to ease during the forecast period to 2.5-3% in 2013-15. A smaller primary surplus (excluding interest payments) is expected in 2011 as a result of some election spending.
- We expect the Central Bank of Turkey to start to raise its policy interest rates in late 2011. As the inflation outlook seems fairly benign, despite recent sharp food price increases, we expect rates to remain well below pre-crisis levels.
- After an estimated expansion of 8% in 2010, growth is expected to slow to a still solid 5-5.5% a year in 2011-15, driven by strong domestic demand and a pick-up in exports to key European markets from 2013.
- The current-account deficit is forecast to rise from a six-year low of 2.3% of GDP in 2009 to average about 5.5-6% a year in 2010-15, as domestic demand is expected to be strong and commodity prices have risen compared with 2009.

Monthly review

- The chairman of the main opposition party, the Republican People's Party (CHP), Kemal Kilicdaroglu, who was elected in May 2010, consolidated his position at an extraordinary party congress on December 18th-19th.
- In December the judiciary launched an investigation into the pro-Kurdish Peace and Democracy Party (BDP), which could lead to a lawsuit to try to close the party and ban its leaders from politics.
- The US administration has sought to limit the damage to its ties with Turkey over the publication of confidential diplomatic cables on Wikileaks.
- A combination of loose global liquidity, strong capital inflows, rapid credit growth, strong domestic demand and a large current-account deficit have forced the Central Bank of Turkey to alter its monetary policy stance.
- The budget deficit for January-November 2010 was TL23.5bn (US\$15.7bn), compared with TL46.2bn a year earlier, thanks to strong tax revenue growth.
- GDP growth slowed sharply in the third quarter. It grew by 1.1% quarter on quarter and by 5.5% year on year.
- The lira and share prices weakened in November-December.

Outlook for 2011-15

Political outlook

Political stability The Economist Intelligence Unit's baseline political forecast for Turkey over the next five years is that the religiously conservative Justice and Development Party (AKP) led by the prime minister, Recep Tayyip Erdogan, will remain in government after the general election, which is expected to be held in June 2011 (the parliamentary term ends in July). We expect the political scene to remain volatile up to and beyond the general election, mainly as a consequence of the tension between the AKP and the secularist-nationalist elites, including the Republican People's Party (CHP) and sections of the military and the judiciary, who view the ruling party with suspicion because of its pro-Islamist roots. However, we believe that following the government's victory in the constitutional reform referendum in September 2010, the risk of a political crisis that could destabilise the government and undermine the confidence of the financial markets in Turkey's medium-term economic prospects has diminished.

In the referendum, a larger than expected majority (58%) voted in favour of the AKP's constitutional reform package, which increased civilian oversight of the military and overhauled Turkey's two highest judicial bodies, the Supreme Board of Judges and Prosecutors (HSYK), which is responsible for appointing judges and prosecutors, and the Constitutional Court. The military is likely to continue to keep a low profile, as its reputation has been tarnished by allegations of plots to destabilise the AKP government and the perception that the deaths of many Turkish soldiers fighting the militant Kurdistan Workers' Party (PKK) could have been avoided. The hardline secularist chief prosecutor of the Supreme Court of Appeals, who launched a lawsuit to try to close the AKP during 2008, warned the AKP in October 2010 against another attempt to lift the ban on women wearing the Islamic-style headscarf in universities and public offices. However, the Constitutional Court would probably be reluctant to take up another petition to close the party.

The agenda of the 2011 election is likely to be set by the AKP, based on calls for increased democratisation and a new constitution to replace the current 1982 military-inspired constitution. If the AKP wins a third term, it may try to introduce a presidential system, giving executive powers to the president. This will be hard to achieve, as it will encounter significant political opposition. The debate surrounding such far-reaching institutional change is likely to be a divisive one. However, we believe that it is unlikely to affect Turkey's overall political stability, as illustrated by the September referendum. That campaign was hard fought but generally peaceful and both the CHP and the smaller, right-wing Nationalist Action Party (MHP) immediately acknowledged the legitimacy of the result.

In focus

The Kurdish issue: a threat to stability

The Kurdish issue remains one of Turkey's most enduring sociopolitical and security problems. The outlawed Kurdistan Workers' Party (PKK), which is seeking Kurdish independence, has been engaged in a violent struggle with Turkey's security forces since 1984, barring a unilateral PKK ceasefire in 1999-2004. Since 1984 a total of about 40,000 civilians, soldiers and militants have died, and many atrocities have been committed on both sides. Although less intense than in 1984-99, the violence has gradually escalated after the end of the PKK's ceasefire in mid-2004. The PKK has mainly carried out attacks against the security forces in the Kurdish-inhabited south-east, but also against businesses and civilians sometimes elsewhere in Turkey, including in major tourist destinations.

A unilateral ceasefire announced by the PKK just before the referendum in September 2010 on the government's constitutional reform package has been extended until the general election. However, it appears fragile. The PKK denied responsibility for a suicide bombing in Taksim Square in central Istanbul that injured at least 22 people on October 31st, but it is widely believed that a Kurdish militant group, perhaps a splinter of the PKK, carried out the attack. If the frequency of the attacks escalates again, as it did up until just before the referendum, it could trigger violent ethnic clashes between Turkish and Kurdish civilians. In July Kurds and Turks clashed in the southern province Hatay following a PKK attack in the town of Dortyol. Also fuelling tensions are conspiracy theories that an alleged ultra-nationalist group of active and retired senior military officers and prominent civilians has been involved in some attacks attributed to the PKK in order to cause instability. An escalation of violence could also affect the outcome of the next general election as it might boost support for the Republican People's Party (CHP) and the right-wing Nationalist Action Party (MHP), who have traditionally maintained a hard line on the Kurdish issue.

The Economist Intelligence Unit expects that the issue will continue to pose a threat to political and social stability and hinder Turkey's EU accession prospects during the outlook period as finding a lasting settlement is likely to be difficult. The democratic initiative launched by the ruling Justice and Development Party (AKP) in 2009 to try to improve Kurdish rights and bring about an end to violence has lost momentum owing to hardline nationalist opposition to any concessions to the Kurds and the refusal of pro-Kurdish political parties to distance themselves completely from the PKK. The judicial decision to close the pro-Kurdish Democratic Society Party (DTP) in early 2010 further increased Kurdish suspicions of the state.

Election watch

The next general election is expected to be held in June 2011. Our baseline forecast is that the AKP will win a third term in government, which will last until mid-2015. Opinion polls in the 12 months before the constitutional reform referendum suggested that the AKP's lead over the CHP and the MHP had narrowed enough to prevent Mr Erdogan from winning a majority of seats in parliament. Although such a scenario still cannot be ruled out, the referendum result was a major setback for the two main opposition parties. Both campaigned vigorously for a "no" vote and have put up strong resistance to other reforms required to promote Turkey's EU membership bid, including those aimed at tackling the Kurdish issue, although the latter might benefit

them if PKK violence escalates again. Expectations are high among secularists that the CHP's new leader, Kemal Kilicdaroglu, who was elected in May 2010, will succeed in transforming his party into a credible alternative to the AKP in government. However, the CHP has been beset with internal divisions and Mr Kilicdaroglu's control over the party appeared fragile until he successfully rejuvenated the executive at an extraordinary party congress in December. Persuading voters that the party has moved away from its traditionally hardline secularist/nationalist policy agenda to a more liberal stance on democratic reforms to improve the protection of minority rights and promote freedom of expression will be a tough challenge. The AKP's trump card will be the perception that since first coming to power in 2002 it has managed the economy well.

During the forecast period, Turkey will elect the head of state for the first time by universal direct suffrage. However, uncertainty exists regarding the timing of the election. In August 2007 parliament elected the current president, Abdullah Gul, for a single seven-year term. Subsequent constitutional changes introducing the direct election of the president also reduced the presidential term to five years, for a maximum of two terms. Under Turkey's current parliamentary system, the powers of the president are limited. However, the election will be fiercely contested. As happened in 2007, it is likely to become a battleground in the power struggle between the AKP and the secularist-nationalist elite. If the AKP were to introduce a presidential system, Mr Erdogan would probably be the front-runner to replace Mr Gul once his term is concluded.

International relations

Assuming that the AKP will remain in office after the mid-2011 general election, we expect a good degree of continuity in Turkish foreign policy, although until the election, action aimed at bolstering domestic support for the AKP, such as voicing criticism of Israel and the US, is likely to increase. Beyond the election, the mainstay of the AKP's foreign policy will remain striking a balance between maintaining good relations with Turkey's traditional Western allies and improving ties with its neighbours, notably Iraq, Syria, Iran and Russia, its main energy supplier. Slow progress on EU membership negotiations, closer ties with Iran, and a sharp deterioration in relations with Israel have led to accusations that under the AKP Turkey is turning away from the West. We believe that this view is misplaced. The AKP's policy of "zero problems with neighbours" has been consistent with EU requirements.

The AKP has supported UN-backed efforts to resolve the division of Cyprus. However, whether the AKP stays in power or not, it is unlikely that a solution acceptable to both the Greek and Turkish Cypriots will be found. Before the election, the Erdogan government is unlikely to pressure the nationalist Turkish Cypriot president, Dervish Eroglu, to reach an agreement. Beyond the election, the government will have no pressing reason to facilitate a Cyprus settlement, as Turkey's EU accession process is likely to remain in the doldrums.

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 the threat of a full vote in the US Congress in the coming weeks to recognise as genocide the massacre of Armenians by Ottoman Turks in 1915-17 will continue to cause tension.

Economic policy outlook

Policy trends Regardless of the outcome of the general election, we expect the economic reforms introduced with the support of the IMF after the 2001 Turkish crisis to remain in place during the forecast period. Although Turkey suffered a deeper recession in 2008-09 than most other emerging markets, the reforms helped to limit financial system stress and interest- and exchange-rate volatility. After the election, reforms in areas such as taxation and employment are likely to be attempted. Privatisation will continue, particularly under the AKP, with the pace depending on market conditions. The privatisation of the three main state banks is on the government agenda, but may not be completed by 2015 owing to the large size of the banks and political sensitivities. After the election, the government may introduce a "fiscal rule" and other measures to improve further public financial management, but we believe that it will be careful not to limit its ability 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. Although Turkey's strong budget and economic growth performance in 2010 have reassured investors, the economy is likely to remain vulnerable to sudden shifts in international sentiment because of its large external financing needs.

Fiscal policy Aided by indirect tax increases, low global and domestic interest rates, and the positive impact of the economic recovery on tax receipts, the budget deficit is estimated to have fallen from 5.5% of GDP in 2009 to about 3.35% in 2010. Owing to the forecast moderate slowdown in economic activity and some election spending, we expect the deficit to remain around the same level in 2011 as a deterioration of the primary balance, excluding interest payments, is expected to offset the continued positive impact of low interest rates on the government's debt-servicing costs. Solid economic growth and declining interest payments as a percentage of GDP should ensure that the deficit will continue to narrow gradually, falling to about 2.25% of GDP by 2015.

As a result of the large fiscal deficit in 2009, the central government debt/GDP ratio rose to 46.3%, compared with about 40% in 2007-08. However, it is estimated to have fallen slightly in 2010 as a result of the smaller deficit and solid GDP growth. Given our deficit and growth forecasts for 2011-15 we expect the downward trend to continue, with the debt/GDP ratio falling to below 40% by end-2015.

Monetary policy We foresee no major change in the operational independence of the Central Bank of Turkey or its conduct of monetary policy in 2011-15. However, the term in office of the current governor, Durmus Yilmaz, expires in April 2011 so the government's choice for the post will be closely watched. Recent concerns about the impact on financial stability of strong capital inflows have resulted a shift in the Central Bank's interest rate policy. After the Central Bank cut its key

interest rate, the one-week repo (repurchase) lending rate, by 50 basis points to 6.5% on December 16th 2010, we now expect a further 50-basis-point cut in January 2011, possibly followed by another in February, after which the policy rate will remain on hold until late 2011, when we expect interest rates to have to start to rise and possibly more sharply initially than previously forecast (150-200 basis points) because of the lower base. We expect that the decision to hike reserve requirements will help to curb the potential impact on inflation from lower interest rates and a weaker lira. However, there is a risk that the rate cuts will stimulate domestic demand further and push up inflation. We do not expect the Central Bank to change to its consumer price inflation targets set in agreement with the government on a rolling three-year basis. They are (± 2 percentage points) 6.5% by end-2010, 5.5% by end-2011 and 5% by end-2012.

Economic forecast

International assumptions

	2010	2011	2012	2013	2014	2015
Economic growth (%)						
US GDP	2.7	2.2	2.1	2.3	2.2	2.5
OECD GDP	2.7	1.8	2.0	2.2	2.2	2.1
EU27 GDP	1.7	1.1	1.5	1.7	1.9	1.9
World GDP	3.6	2.7	2.9	3.0	3.0	3.1
World trade	12.4	5.9	6.3	6.7	6.7	6.3
Inflation indicators (% unless otherwise indicated)						
US CPI	1.5	1.0	1.9	2.5	2.8	2.8
OECD CPI	1.3	1.1	1.7	2.0	2.1	2.3
EU27 CPI	1.8	1.8	1.8	1.9	2.0	2.1
Manufactures (measured in US\$)	3.2	0.7	0.2	1.8	1.2	1.8
Oil (Brent; US\$/b)	80.0	82.0	81.3	78.3	75.5	71.0
Non-oil commodities (measured in US\$)	23.2	9.5	-4.4	-4.0	1.5	0.1
Financial variables						
US\$ 3-month commercial paper rate (av; %)	0.2	0.3	0.7	2.2	4.1	5.1
€ 3-month interbank rate (av; %)	0.8	1.0	1.5	2.8	3.5	3.5
Exchange rate TL:US\$ (av)	1.50	1.57	1.59	1.61	1.61	1.60
Exchange rate US\$:€ (av)	1.32	1.25	1.20	1.18	1.16	1.17

Economic growth

Having contracted sharply as a result of the global crisis in 2008-09, the Turkish economy has recovered strongly, reflecting base effects as well as a surge in domestic demand supported by low real interest rates and a reversal of the de-stocking recorded in 2009. However, as base effects become less favourable, the impact of stockbuilding diminishes and external demand softens again after the pick-up in the first half of 2010, we expect the pace of growth to ease going into 2011. As a result, GDP growth is forecast to slow from an upwardly revised 8% in 2010 to 5-5.5% in 2011-15, although this will be weaker than the average of about 7% in 2003-07. Growth is forecast to be mainly driven by domestic demand, although as external demand picks up in the second half of the forecast period we expect it to be more balanced between external and domestic demand.

After declining moderately in 2008-09, private consumption has recovered strongly, helped by exceptionally low real interest rates and a strong pick-up in

credit growth. Although unemployment is expected to remain above pre-crisis levels and wage growth is likely to be moderate in real terms, some employment growth and still low interest rates (even taking account of our forecast that the Central Bank raises them in 2011-12) are expected to continue to support household spending growth, which we forecast will average 5-5.5% a year in 2011-15.

In 2010 the government curbed public spending, resulting in a sharp deceleration in government consumption growth from 7.8% in 2009 to an estimated 0.5% in 2010. However, we expect the government to loosen the purse strings to some extent in the first half of 2011, pushing up public consumption growth to 5% for the whole year. In 2012-15 we forecast a moderate deceleration to 4-4.5% per year as the government tightens fiscal policy moderately to reduce the budget deficit.

Following a collapse in 2008-09, gross fixed investment has rebounded in 2010. Growth is expected to moderate in 2011 owing to base effects and softer external and domestic demand growth but this is likely to be partly offset by some government spending on construction projects ahead of the election. In 2012-15 we expect moderate domestic demand and the need to replace old machinery and equipment to sustain annual growth of about 7-7.5%.

In 2009 a sharp fall in exports of goods and services was offset by an even larger contraction in imports, reflecting weak domestic demand. Owing to a rebound in domestic demand and only a moderate recovery in Turkey's main export markets (the EU and Russia), this trend was reversed in 2010. As a result, the foreign balance is estimated to have reduced GDP growth by 4-4.5 percentage points. We forecast that this trend will continue as the impact of the euro area crisis is likely to dampen demand in Turkey's main European markets during most of the forecast period to 2015, although we expect a moderate strengthening of demand in the EU and a continued focus by Turkish companies on more dynamic Middle Eastern markets to lift the pace of export growth gradually in 2012-15.

There are downside risks to our GDP growth forecasts. Demand for Turkish exports may be weaker than we expect (especially if the lira appreciates again sharply against the euro). Also, stable economic growth requires Turkey to be able to finance a large current-account deficit and substantial external debt repayments. Currently, capital inflows are fuelling robust domestic credit growth, which combined with real lira appreciation, also driven by capital inflows, has increased the current-account deficit (to around 6% of GDP in 2010). Private-sector debt is relatively low at around 40% of GDP and capital inflows are ample. However, if private-sector debt levels continue to rise sharply and the current-account deficit is still large in two to three years, a decline in global liquidity could cause severe problems, including a fall in the value of the lira leading to, as it has done in the past, higher inflation and an abrupt tightening of monetary policy followed by a sharp slowdown in economic activity with possible private-sector debt-servicing difficulties.

Economic growth

%	2010 ^a	2011 ^b	2012 ^b	2013 ^b	2014 ^b	2015 ^b
GDP	8.0	5.3	5.2	5.5	5.4	5.2
Private consumption	7.0	5.5	5.0	5.6	5.6	5.5
Government consumption	0.5	5.0	4.0	4.5	4.5	4.5
Gross fixed investment	26.5	16.5	11.5	7.5	7.5	7.0
Exports of goods & services	1.5	1.8	4.7	7.1	10.0	9.7
Imports of goods & services	18.4	12.0	10.0	9.0	10.5	10.6
Domestic demand	12.3	7.9	6.7	6.1	6.0	5.8
Agriculture	-2.0	1.0	0.5	1.0	0.7	0.7
Industry	8.5	5.0	4.0	4.0	4.0	4.0
Services	9.7	6.2	6.8	7.0	7.0	6.4

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

Inflation Although there are some inflationary risks as a result of the Central Bank's decision to cut interest rates in December, we continue to believe that the inflation outlook is fairly benign. Core inflation is low, the lira has remained fairly stable and the strong rebound in economic activity since mid-2009 is expected to moderate in 2011-12. As a result, we forecast that inflation will decline from about 7.5% at end-2010 to 5.5-6% at the end of 2012, that is, slightly over the Central Bank's 5% target but within the band of uncertainty of ± 2 percentage points. Given our forecast that domestic demand growth will stabilise in 2013-15 and international oil prices will ease slightly, we expect inflation to decline to about 4% by 2014-15.

Exchange rates The lira has proved quite resilient since the sharp falls in late 2008 and early 2009, but bouts of volatility in the global foreign-exchange markets owing to shifting risk perceptions have caused fluctuations that are likely to continue, especially if the euro area crisis deepens further. Given the prospect of strong capital inflows as a result of another period of quantitative easing in the US, loose monetary policy in the euro area and the Turkish government's current position that it will not introduce capital restrictions, our baseline forecast is that the lira will remain relatively stable against the dollar at around TL1.50-1.60:US\$1 in 2011-15. Against the euro, which is forecast to depreciate against the dollar, the lira is expected to appreciate from an estimated average of TL1.98:€1 in 2010 to an average of about TL1.85-1.90:€1 in 2011-15. However, the Turkish lira has appreciated substantially in real terms, raising concern that there may be a sharp downward adjustment if the international financial situation does not prove buoyant enough to tolerate the country's persistently large current-account deficits.

External sector Strong credit expansion, real currency appreciation and strong domestic demand growth have caused Turkey's current-account deficit to rise from a six-year low of 2.3% of GDP in 2009 to an estimated 6% in 2010. We expect similarly large deficits of 5-6% of GDP in 2011-15, the financing of which could become a problem if international market conditions deteriorate.

Forecast summary

(% unless otherwise indicated)

	2010 ^a	2011 ^b	2012 ^b	2013 ^b	2014 ^b	2015 ^b
Real GDP growth	8.0	5.3	5.2	5.5	5.4	5.2
Industrial production growth	12.5	6.0	5.5	5.0	5.5	5.0
Gross fixed investment growth	26.5	16.5	11.5	7.5	7.5	7.0
Unemployment rate (av)	12.2	12.2	12.2	12.0	11.7	11.0
Consumer price inflation (av)	8.6	7.0	5.6	5.7	4.2	4.1
Consumer price inflation (end-period)	7.5	6.3	5.7	4.7	4.1	4.0
Short-term interbank rate	6.5	6.8	7.5	7.5	8.0	8.0
Government balance (% of GDP)	-3.3	-3.1	-2.6	-2.3	-2.4	-2.5
Exports of goods fob (US\$ bn)	117.9	122.8	131.7	148.4	173.6	202.0
Imports of goods fob (US\$ bn)	169.1	177.8	190.4	211.0	240.1	273.8
Current-account balance (US\$ bn)	-42.6	-44.9	-48.1	-51.8	-55.1	-58.3
Current-account balance (% of GDP)	-5.9	-5.8	-5.7	-5.6	-5.4	-5.2
External debt (end-period; US\$ bn)	278.6	274.9	277.1	283.5	291.6	299.1
Exchange rate TL:US\$ (av)	1.501	1.572	1.587	1.611	1.605	1.599
Exchange rate TL:US\$ (end-period)	1.515	1.569	1.599	1.608	1.602	1.596
Exchange rate TL:¥100 (av)	1.706	1.908	1.926	1.989	1.955	1.915
Exchange rate TL:€ (av)	1.987	1.965	1.905	1.901	1.862	1.871

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

Monthly review: January 2011

The political scene

Congress consolidates Kemal Kilicdaroglu's party leadership

With the next general election just a little over six months away, Turkey's main opposition party, the hardline secularist/nationalist Republican People's Party (CHP), faces a tough challenge to close the gap on the ruling Justice and Development Party (AKP) in opinion polls. The level of support for the AKP has varied in recent polls between 35% and 45% of the vote, depending on the pollster, but the CHP consistently obtains 30%, with the smaller right-wing opposition party, the Nationalist Action Party (MHP), on 10-15%. This would be a considerable improvement for the CHP compared with the 2007 general election, when the party obtained around 20% of the vote. However, it might not be sufficient to prevent the AKP from winning an overall majority if only three parties clear the 10% threshold for parliamentary representation.

Under the leadership of Kemal Kilicdaroglu, who was elected in May 2010 following the resignation of Deniz Baykal over a sex tape scandal, the CHP is seeking to renew its policy agenda and broaden its appeal. However, the push for change within the party has met with staunch resistance from the old guard, forcing Mr Kilicdaroglu to hold an extraordinary party congress on December 18th-19th. The congress was called to elect a new executive body in an attempt to put an end to a power struggle between Mr Kilicdaroglu and the former secretary-general, Onder Sav, who until his recent removal from the position controlled the party from behind the scenes. In the event, delegates elected many of the candidates put forward by Mr Kilicdaroglu, helping to strengthen his hand against Mr Sav and end the uncertainty over whether he would lead the party at the next general election.

Following the congress, an emboldened Mr Kilicdaroglu said that if elected to government, his goal was to "return to a welfare state" that would end unemployment, implement universal healthcare and tackle poverty, although he failed to explain where the funding for such spending plans would come from, given that indirect taxes are already high and tax evasion is widespread. Mr Kilicdaroglu is likely to promote a more liberal position than his predecessor on several issues such as minority rights and attempts to lift the ban on women wearing the Islamic-style headscarf in universities and public offices, as well as a tough stance against corruption at the level of state institutions.

The Kurdish issue dominates the pre-election period

The Kurdish issue attracted increased attention in December when it was announced that the judiciary had launched an investigation into the pro-Kurdish Peace and Democracy Party (BDP), which has 20 members of parliament (MPs), over a meeting of academics and politicians in Diyarbakir to discuss a plan for "democratic autonomy" for the Kurds. It is possible that the investigation will result in a lawsuit calling for the party's closure and the banning of its leaders from politics. As happened after the judiciary closed the BDP's predecessor, the Democratic Society Party (DTP), in December 2009, a lawsuit could trigger a renewed campaign of violence by the militant Kurdistan

Workers' Party (PKK). In September 2010 the PKK announced a ceasefire until after the general election.

Also in December, two BDP MPs caused a stir by addressing the Turkish parliament in Kurdish, drawing a stern reprimand from the parliamentary speaker, Mehmet Ali Sahin, and a warning from the military published on the Turkish Armed Forces' website. Turkey's EU membership bid has resulted in some improvements in minority rights, including some easing of restrictions on the use of minority languages, mainly Kurdish. In 2009 all remaining restrictions were lifted on local broadcasting in Kurdish and other languages by private and public channels. In April 2010 changes to the law on the fundamental principles of elections and the electoral registry effectively allowed the use of Kurdish in election campaigns. However, the use of any language other than Turkish in parliament is still illegal.

With an election looming, the Kurdish issue will be high on the political agenda as the CHP and the AKP are seeking to win Kurdish votes, but without upsetting their nationalist voters. Although the AKP may favour further measures to tackle the Kurdish problem, including, for example, the increased use of the Kurdish language in official correspondence, the government is unlikely to risk putting forward legislation until after the election.

US engages in damage limitation over Wikileaks

At the end of November, the whistle-blowing Internet site Wikileaks published confidential cables sent by US diplomatic personnel in Turkey to the State Department. Thus far, approximately 7,000 memos relating to Turkey have appeared on the website, many revealing aspects of how the US administration has viewed the AKP government in Turkey since it came to power in 2002. A former US ambassador is supposed to have described the attempt to close down the AKP in 2007 as nothing short of a "judicial coup d'état". Another cable alleges that the prime minister, Recep Tayyip Erdogan, has secret bank accounts in Switzerland, an accusation which he has strenuously denied. Other documents, unsurprisingly, show US diplomats' concern about Turkey's friendly ties with Iran and its unwillingness to support sanctions against the country.

The US administration appeared keen to limit the damage that the leaks might have been done to Turkish-US relations. As soon as they appeared, the US secretary of state, Hillary Clinton, apologised to her counterpart, the Turkish minister of foreign affairs, Ahmet Davutoglu, on behalf of her administration. This was followed by a telephone call by the US president, Barack Obama, to Mr Erdogan on December 12th. Mr Erdogan publicly denounced the leaks as "dirty American games" on December 2nd and has threatened to sue the US officials responsible for the cables. However, this was probably done to appease domestic public opinion, which is starkly anti-US. The Economist Intelligence Unit does not expect the leaks to alter dramatically Turkey's generally positive ties with the US administration. The embarrassment caused to Mr Obama's administration may give Mr Erdogan's government more leverage to prevent in the coming weeks a full vote in Congress on a resolution calling for recognition of the massacre of Armenians by Ottoman Turks in 1915-17 as genocide.

Democracy index: Turkey

The Economist Intelligence Unit's 2010 democracy index ranks Turkey 89th out of 167 countries, down from 87th place in 2008 despite a slight improvement in the score. Turkey trails well behind Croatia (53rd) and Macedonia (73rd), which are also EU accession candidates, as well as Romania (56th) and Bulgaria (51st), which joined the EU in 2007. Turkey is among the 33 countries considered "hybrid regimes". The transfer of power is a well-accepted process, but the military continues to play a role in politics. That said, EU-related reforms have gradually reduced its influence and civilian oversight of the security forces has increased. The high level of support for a wide-ranging constitutional reform package in a referendum in September 2010 suggests that popular demand for democratic reforms is strong, although it remains to be seen whether democratic reforms will ensue from the changes to constitution, as much will depend on implementation and enforcement.

Democracy index

	Regime type	Overall score	Overall rank
2010	Hybrid regime	5.73 out of 10	89 out of 167
2008	Hybrid regime	5.69 out of 10	87 out of 167

Turkey's law of political parties falls well below European standards

Turkey's score for the *electoral process* is high, reflecting high voter turnout and free and fair elections. However, since 2008 there has been no improvement in the Political Parties Law, which falls well below European standards, or the electoral system. Several parties have been banned in recent years, even if they do not use violence or advocate violence. The ruling Justice and Development Party (AKP), which was elected with 46% of the national vote in 2007, narrowly avoided being closed down by the Constitutional Court in 2008 for becoming a "focus for anti-secular activity". The pro-Kurdish Democratic Society Party (DTP), which had to present its candidates as independents at the July 2007 general election to get around the 10% threshold, was closed in December 2009 and around 40 of its members, including two members of parliament (MPs), were banned from politics for five years. Its successor, the Peace and Democracy Party (BDP), is also under investigation and could face a closure case ahead of the general election in mid-2011. The participation of women and minorities in national politics is low. After the 2007 general election, just 50 MPs were female out of a total of 550. Legislation to protect minority rights has been passed as part of Turkey's EU membership bid, but it is often inadequate and implementation is still weak.

Freedom of expression is not well protected

The number of lawsuits brought against journalists either by politicians or public prosecutors remains high. Several articles in the Turkish Penal Code, including Article 301 (despite amendments in April 2008), can still be used to prosecute individuals for insulting Turkey or its institutions. Under the new version of Article 301, insults against the "Turkish nation" and the "Republic of Turkey" are still deemed criminal offences. The maximum prison sentence has been reduced from three years to two and comments and remarks made in "criticism" are not deemed punishable. The decision to try an individual under Article 301 has to be approved by the minister of justice, which makes the judicial process vulnerable to politicisation. Internet sites are frequently banned and the right to protest is also restricted.

Democracy index 2010 by category

(on a scale of 0 to 10)

Electoral process	Functioning of government	Political participation	Political culture	Civil liberties
7.92	7.14	3.89	5.00	4.71

Democracy index 2010: Democracy in retreat, a free white paper containing the full index and detailed methodology, can be downloaded from www.eiu.com/DemocracyIndex2010.

Note on methodology

There is no consensus on how to measure democracy and definitions of democracy are contested. Having free and fair competitive elections, and satisfying related aspects of political freedom, is the sine qua non of all definitions. However, our index is based on the view that measures of democracy that reflect the state of *political freedom* and *civil liberties* are not "thick" enough: they do not encompass sufficiently some crucial features that determine the quality and substance of democracy. Thus, our index also includes measures of *political participation*, *political culture* and *functioning of government*, which are, at best, marginalised by other measures.

Our index of democracy covers 167 countries and territories. The index, on a 0 to 10 scale, is based on the ratings for 60 indicators grouped in five categories: *electoral process and pluralism*; *civil liberties*; the *functioning of government*; *political participation*; and *political culture*. The five categories are inter-related and form a coherent conceptual whole. Each category has a rating on a 0 to 10 scale, and the overall index of democracy is the simple average of the five category indices.

The category indices are based on the sum of the indicator scores in the category, converted to a 0 to 10 scale. Adjustments to the category scores are made if countries fall short in the following critical areas for democracy:

- whether national elections are free and fair;
- the security of voters;
- the influence of foreign powers on government; and
- the capability of the civil service to implement policies.

The index values are used to place countries within one of four types of regimes:

- full democracies—scores of 8 to 10;
- flawed democracies—score of 6 to 7.9;
- hybrid regimes—scores of 4 to 5.9;
- authoritarian regimes—scores below 4.

Economic policy

Capital inflows prompt a shift in monetary policy

A combination of loose global liquidity, strong short-term capital inflows, rapid credit growth, strong domestic demand, weak external demand and a large current-account deficit has forced the Central Bank of Turkey to alter its monetary policy stance to reduce financial risks. At its monthly meeting on December 16th, the Monetary Policy Committee (MPC) reduced the main policy rate, the weekly repo (repurchase) lending rate, from 7% to 6.5%, further increased the spreads between its overnight lending and borrowing rates, and recommended changes in required reserve ratios, with higher requirements for short-term liabilities. On December 17th the Central Bank duly announced new required reserve ratios for lira deposits, ranging from 5% for deposits of one year or more to 8% for deposits of one month or less. Previously, reserve requirements were 6% for all maturities. The new reserve requirements are to apply to repo agreements for domestic and non-resident customers as well as to deposits. Banks were also forbidden to pay more than 0.25% interest on current accounts. Reserve requirements on foreign-currency deposits were left unchanged, for the time being, at 11%.

On December 21st the governor, Durmus Yilmaz, announced the Central Bank's monetary and foreign-exchange policies for 2011. He made clear that the Bank was prepared to continue its recent policies directed towards reducing financial risk. The amount of its daily foreign-exchange purchases will rise as of January 3rd 2011, from US\$40m to US\$50m.

The Central Bank expects that higher reserve requirements will offset the loosening effect of its decision to lower its main policy rate. It estimates that the changes in the levels and scope of reserve requirements announced on December 17th will reduce market liquidity by TL7.6bn (US\$5bn) and US\$200m. The Bank appears confident that the interest rate cut will not trigger a reversal of the recent downward trend of inflationary pressures. Its thinking in this respect may have been reinforced by the low inflation figure for November and the sharp slowdown in GDP growth during the third quarter of 2010 (see Economic performance).

Central Bank interest rates

(%)

	Before Dec 16th, 2010	After Dec 16th, 2010
Central Bank lends		
Weekly repo	7.0	6.5
Overnight—main rate	8.8	9.0
Overnight—for market-maker banks	7.8	8.0
Overnight—late liquidity window	11.8	12.0
Central Bank borrows		
Overnight—main rate	1.8	1.5
Overnight—late liquidity window	0.0	0.0

Source: Central Bank of Turkey.

Tax revenue growth holds down the budget deficit

The central government budget continued to perform strongly in October and November, compared with 2009, when the full-year deficit reached 5.5% of GDP. The deficit in January-November 2010 was TL23.5bn compared with TL46.2bn a year earlier thanks to strong tax revenue growth. Three major indirect taxes accounted for 56% of the tax take: on a year-on-year basis, receipts from special consumption tax (SCT), which is charged mainly on petroleum products, transport vehicles, cigarettes and alcoholic drinks, rose by 31%, revenue from value-added tax (VAT) on imports increased by 38%, and domestic VAT receipts rose by 42.1%. These figures reflect partly changes in prices and adjustments in tax rates, but mainly a surge in domestic consumption. Government non-interest expenditure in the same period rose by 11.7% year on year, which represents only a modest real increase after allowing for inflation. Meanwhile, interest expenditure declined owing to the lagged effect of the sharp decline in interest rates in 2008-09. Although the budget deficit often surges in December, the figure for the whole of 2010 looks certain to come in well below both the government's estimate in October of TL44.2bn.

Central government budget

(TL bn unless otherwise stated)

	2008	%	%	2009	%	%	2010	2009	2010	%
	Outturn	GDP	change	Outturn	GDP	change	target ^a	Jan-Nov	Jan-Nov	change
Total revenue	209.6	22.1	9.9	215.1	22.5	2.6	252.8	193.2	232.3	20.2
Tax revenue	168.1	17.7	10.0	172.4	18.1	2.6	210.2	154.2	192.6	24.8
Other revenue	41.5	4.4	10.6	42.6	4.5	2.8	42.6	38.9	39.7	2.0
Total expenditure	227.0	23.9	11.3	267.3	28.0	17.7	297.0	239.5	255.8	6.8
Non-interest expenditure	176.4	18.6	13.6	214.1	22.4	21.4	247.5	187.2	209.3	11.7
Interest expenditure	50.7	5.3	3.9	53.2	5.6	5.0	49.5	52.2	46.5	-10.9
Budget balance	-17.4	-1.8	-	-52.2	-5.5	-	-44.2	-46.2	-23.5	-
Primary balance	33.2	3.5	-	1.0	0.1	-	5.3	5.1	23.0	-

^a Revised in October 2010.

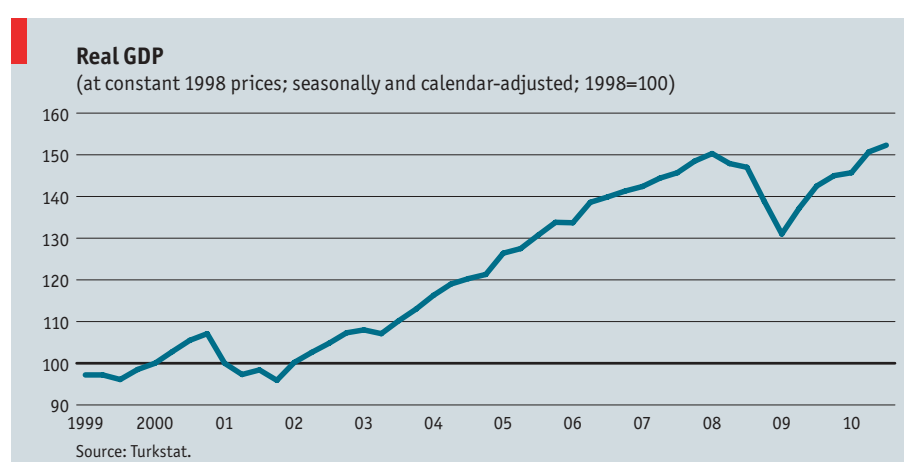
Source: Ministry of Finance General Directorate of Public Accounts.

Economic performance**GDP growth slows to 5.5% year on year in the third quarter**

GDP grew by 5.5% year on year in the third quarter of 2010—down from 11.8% and 10.2%, respectively, in the first two quarters. For January-September, GDP was 9.8% higher than a year earlier. The lower year-on-year growth rate in the

third quarter compared with preceding quarters is largely the result of a base effect: by the third quarter of 2009, the worst of the 2008-09 recession was over. In quarter-on-quarter terms, GDP grew by a calendar- and seasonally adjusted 1.1% in the third quarter of 2010, down from 3.7% in the second quarter, but higher than 0.4% in the first quarter. As of the third quarter, GDP was back above the pre-crisis level reached in the first quarter of 2008.

Despite the baseline effect, domestic demand was particularly strong in the third quarter of 2010. The year-on-year growth rate of private consumption, which accounts for about 70% of GDP, was higher than in the second quarter, at 7.8%. Meanwhile, gross fixed investment increased by 31.3% year on year in July-September—and by 34.4% in the private sector alone. Both these rates of growth were higher than those for the second quarter. Among the components of domestic demand, only government consumption declined year on year, by 1.1%. By contrast, the external balance deteriorated sharply as exports of goods and services contracted and imports continued to rise steeply.



Gross domestic product by expenditure

(% real change, year on year; 1998 prices; non-calendar adjusted, unless otherwise indicated)

	2007	2008	2009				2010			
	Year	Year	1 Qtr	2 Qtr	3 Qtr	4 Qtr	Year	1 Qtr	2 Qtr	3 Qtr
Private consumption	5.5	-0.3	-10.1	-1.7	-1.9	5.0	-2.2	8.6	6.2	7.8
Government consumption	6.5	1.7	5.1	0.5	5.2	17.9	7.8	0.9	3.5	-1.1
Gross fixed capital formation	3.1	-6.2	-27.6	-24.4	-18.5	-4.6	-19.1	15.2	28.7	31.3
Public sector	6.3	12.7	11.8	0.2	-5.7	-8.6	-2.3	-25.6	14.6	17.9
Private sector	2.6	-9.0	-32.2	-28.6	-21.0	-3.5	-22.3	23.1	32.2	34.4
Exports of goods & services	7.3	2.7	-11.5	-11.1	-5.4	7.4	-5.3	-0.4	11.6	-2.0
Imports of goods & services	10.7	-4.1	-31.0	-20.6	-11.7	11.0	-14.3	22.3	18.8	16.9
GDP	4.7	0.7	-14.6	-7.6	-2.7	6.0	-4.7	11.8	10.2	5.5
Quarter on quarter ^a	-	-	-5.5	4.7	3.7	1.8	-	0.4	3.7	1.1

^a Seasonally and calendar-adjusted.

Source: Turkish Statistical Institute (Turkstat).

Year-on-year growth in manufacturing industry, trade and transport worked out at 8.7%, 7.5% and 6.7%, respectively, in the third quarter, according to national accounts data. These growth rates were much slower than those recorded in the first and second quarters. Growth in the construction sector accelerated to 24.6%

in July-September, reflecting the strength of the recovery in investment. Housing starts were up by 32.3% year on year in January-September. Agriculture contracted by 0.8%, after tepid growth of 0.1% and 0.7% in the first two quarters, mainly reflecting the impact of weather conditions.

The economy remains lively in October and November

GDP growth may have slowed further in the fourth quarter, as the baseline effect became more marked, particularly for investment demand. However, initial data on the performance of industry suggest that the economy remained lively. In October industrial production increased by 9.8% year on year and by a calendar- and seasonally adjusted 3.1% month on month. In November capacity utilisation in manufacturing industry was 75.9%—about 6 percentage points above the year-earlier level and the highest since August 2008. Automotive production, although lower than in October, was up by 17% year on year, at 87,642 units. Credit growth remained strong, with domestic loans of deposit money banks (excluding non-interest "participation banks") reaching TL395.7bn as of November 26th—3.2% higher than on October 28th and 35.2% higher than at the end of 2009. The consumer confidence index reached its highest level of 2010 in November, although at 91.3 points it remained below the neutral level of 100 points.

Industrial production

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

	2009				2010									
	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct
Mining	-3.2	6.5	4.0	17.1	0.4	11.1	7.8	4.2	11.2	3.7	-1.9	-1.7	0.9	-11.4
Utilities	-3.9	6.3	0.6	10.9	3.2	5.4	6.6	9.9	8.6	8.1	10.0	15.6	10.9	7.6
Manufacturing	-10.7	6.2	-3.8	26.3	15.3	19.9	24.3	18.5	16.0	10.6	9.2	10.9	10.6	11.3
Food & beverages	-13.5	13.1	-1.3	21.8	13.8	14.8	13.9	11.0	7.9	5.3	8.6	2.9	13.3	0.2
Textiles	-11.1	4.1	-6.6	32.1	18.5	26.4	26.1	20.6	20.2	11.2	10.9	6.2	4.6	6.3
Clothing	-12.3	3.0	-7.0	11.8	-0.9	12.9	15.1	17.1	12.8	6.3	10.7	13.9	3.6	3.3
Refining	-32.5	-15.9	-3.7	12.2	-8.6	-15.9	33.0	11.5	4.1	-3.6	-12.1	14.2	7.2	13.6
Chemicals	5.5	23.7	20.5	48.7	36.1	31.9	30.7	21.2	19.6	16.0	8.0	4.9	8.0	3.3
Metal industry	-11.5	14.1	-2.7	15.4	-0.7	0.4	16.8	8.9	10.4	1.1	7.8	10.0	11.1	10.3
Miscellaneous machinery	-21.5	-1.2	-18.5	31.7	12.1	15.7	51.8	36.4	21.7	32.5	35.1	26.4	34.2	31.4
Automotive	-14.2	0.1	15.7	91.7	80.0	79.4	62.3	30.0	25.8	28.7	6.0	27.8	19.4	31.9
Total industrial production	-9.6	6.2	-3.0	23.9	12.8	17.5	21.3	16.9	15.0	10.0	8.8	10.8	10.2	9.8
Intermediate goods	-8.4	11.0	-0.5	33.5	15.7	21.3	29.1	22.4	22.8	13.2	12.1	10.2	12.0	8.9
Durable consumer goods	8.6	5.4	-10.3	22.7	31.6	25.9	24.2	21.0	12.0	0.3	8.8	7.1	4.5	21.7
Non-durable consumer goods	-8.4	8.5	-4.2	22.2	4.7	13.4	13.0	10.0	6.5	2.0	5.2	6.5	4.6	3.7
Energy	-8.5	3.1	-1.3	11.0	0.2	1.8	5.3	5.8	6.0	6.0	5.6	12.6	9.5	5.5
Capital goods	-21.2	-5.9	-5.3	21.4	38.1	34.8	35.9	26.7	20.7	25.2	10.3	22.7	19.0	25.6
Total industrial production^a	0.4	3.1	2.0	0.2	1.2	1.1	1.1	0.8	1.8	-1.8	0.5	2.6	0.0	3.1

^a Seasonally and calendar-adjusted, % change month on month.

Source: Turkstat.

Inflation cools off in November as food prices fall

In November the consumer price index (CPI) rose by just 0.03% month on month and by 7.3% year on year, down from an annual rate of increase of 8.6% in October and 9.2% in September. The main reason for the deceleration in November was the partial reversal of the surge in food prices, which pushed the CPI higher in September and October. Prices of food and non-alcoholic beverages declined by 1.9% month on month, although they remained 12.4%

higher than in November 2009. Price inflation in most other categories remained subdued in November 2010, reflecting spare capacity, increased competition and an earlier appreciation of the lira. Clothing and footwear prices rose by 3.9% month on month, but this was purely a seasonal increase; on a year-on-year basis they were up by only 3.7%. Prices of alcoholic drinks rose by 16.2% month on month owing to a tax increase.

Inflation

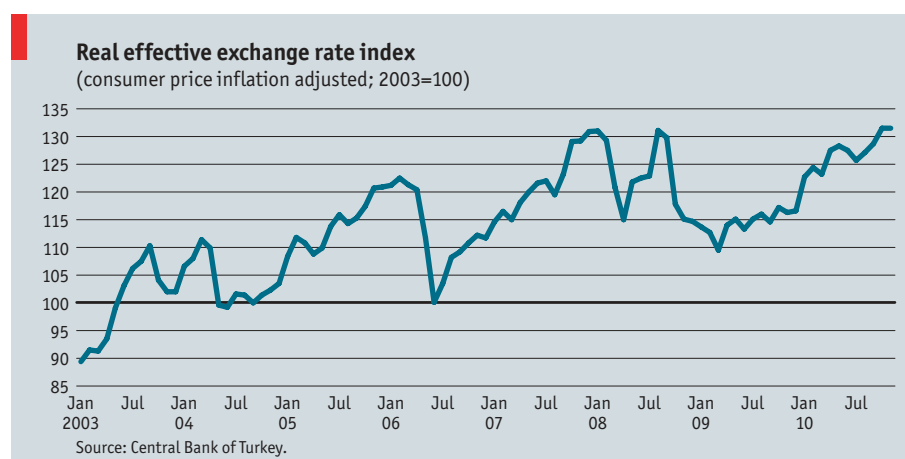
(% change year on year, unless otherwise indicated)

	2009		2010										
	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov
Consumer prices (2003=100)	5.5	6.5	8.2	10.1	9.6	10.2	9.1	8.4	7.6	8.3	9.2	8.6	7.3
% change month on month	1.3	0.5	1.9	1.5	0.6	0.6	-0.4	-0.6	-0.5	0.4	1.2	1.8	0.0
Food & non-alcoholic beverages	7.4	9.3	9.4	14.8	11.2	11.8	6.7	5.6	5.5	10.4	15.3	17.1	12.4
% change month on month	2.2	2.2	1.6	8.0	0.6	0.1	-4.4	-2.5	-0.7	3.0	4.7	4.5	-1.9
Clothing & footwear	2.2	2.4	3.4	3.8	4.6	4.1	3.8	5.0	5.9	6.3	5.1	4.3	3.7
% change month on month	4.6	-2.8	-8.2	-5.3	0.4	10.6	11.2	0.4	-5.2	-4.8	-2.2	7.6	3.9
Housing, water, electricity, gas & other fuels	1.3	2.3	3.1	4.6	4.9	6.1	8.6	8.4	8.3	7.7	7.4	5.3	5.2
% change month on month	0.7	0.5	1.5	0.4	0.2	0.1	0.4	0.5	0.3	0.1	0.3	0.2	0.6
Household goods	-1.8	-2.7	-1.7	-0.8	0.2	3.2	3.6	4.0	3.7	3.5	3.8	1.2	8.6
% change month on month	-0.7	-0.4	0.7	-0.1	-0.5	0.7	0.1	0.4	0.6	0.0	0.5	-0.1	0.6
Transportation	5.5	7.9	10.7	9.7	12.7	14.7	13.8	10.2	10.1	8.1	8.0	6.2	5.4
% change month on month	1.3	-0.3	3.5	0.4	0.7	0.1	0.0	-0.4	0.5	-0.2	0.1	0.4	0.5
Producer prices (1997=100)	1.5	5.9	6.3	6.8	8.6	10.4	9.2	7.6	8.2	9.0	8.9	9.9	8.2
% change month on month	1.3	0.7	0.6	1.7	1.9	2.4	-1.2	-0.5	-0.2	1.2	0.5	1.2	-0.3

Source: Turkish Statistical Institute (Turkstat).

The lira and share prices weaken from November

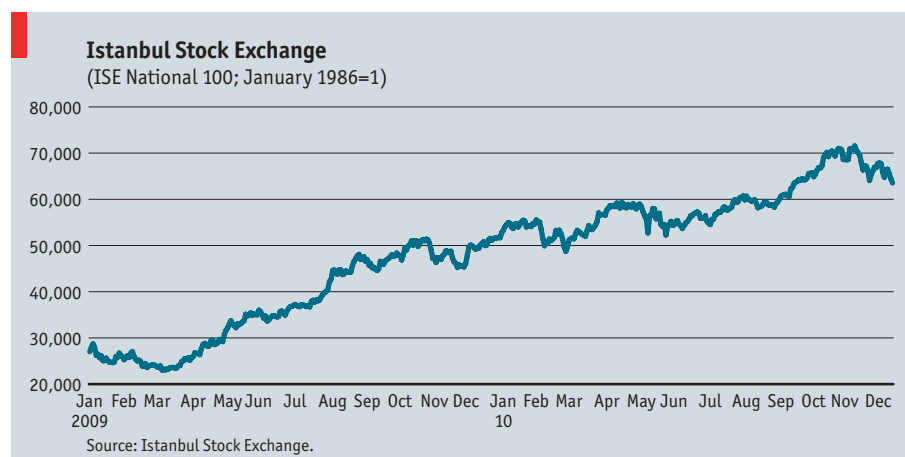
After a period of steady appreciation, the lira softened in nominal terms against major currencies in late November and December, amid growing domestic debate on the need to control capital inflows. As of December 17th, following the Central Bank's decision to cut its benchmark interest rate, the lira traded at about TL1.54:US\$1, compared with a strong point of TL1.39:US\$1 on November 4th. The lira also weakened against the euro, reaching TL2.04:€1 on December 17th compared with TL1.94-1.98:€1 during November.



However, the Central Bank's trade-weighted real effective exchange rate index shows that the lira in real terms—that is, its value after allowing for both

nominal exchange-rate fluctuations and inflation differentials—appreciated sharply in 2010. The index stood at 130.5 in November, just above the peak reached at the beginning of 2008 before the global financial crisis caused the lira to weaken.

The main Istanbul Stock Exchange (ISE) index, which closed at an all-time high of 71,543 points on November 9th at the end of a strong rally, was on a general downward trend in late-November-December. On December 17th, the index closed at 63,524 points. The prices of bank shares were especially hard hit by the actions of the Central Bank, which are expected to erode their profits.



The trade and current-account deficits remain large

In October Turkey's current-account deficit was US\$3.7bn, bringing the total for January-October to US\$35.7bn, compared with just US\$9.2bn a year earlier. The main reason for the rapid increase in 2010 has been the steady expansion of the merchandise trade deficit as imports have rebounded in line with the recovery in domestic demand, high global commodity prices and an appreciating lira (up to early November), whereas export growth has been tempered by weak European demand, among other factors. In January-October the merchandise trade deficit amounted to US\$42.7bn, with the value of imports up by 30.5% year on year, to US\$141.2bn, while exports rose by 10.2% in value, to US\$98.5bn. Among the other components of the current account, the services surplus in January-October was only US\$12.3bn, compared with US\$15bn a year earlier. The decline reflects lower tourism revenue, higher foreign tourism spending by Turkish citizens, and a decline in net income from transport and overseas contracting services. The deficit on the income account, which comprises mainly profits and interest earnings repatriated by foreign investors, was slightly lower than in the same period of 2009.

In October capital inflows, headed by foreign investment in the Turkish stock and bond markets and net foreign borrowing by Turkish banks, were sufficient to finance the current-account deficit and enable the Central Bank to go on adding to its foreign-exchange reserves. Net capital inflows (exclusive of official reserves) totalled US\$43.8bn in the first ten months of 2010, reflecting ample global liquidity and positive sentiment towards emerging markets.

Balance of payments

(US\$ m unless otherwise indicated)

	2008 Year	2009 Year	2009 Jan-Oct	2010 Jan-Oct
Current-account balance	-41,946	-14,283	-9,199	-35,723
Foreign trade balance	-53,021	-24,893	-18,819	-42,660
Services balance	17,121	16,432	15,037	12,291
Income balance	-8,159	-8,121	-6,950	-6,461
Current transfers balance	2,113	2,299	1,533	1,107
Capital account excluding reserves	35,248	9,850	4,527	43,830
Change in reserve assets ^a	1,057	-111	642	-9,403
Net errors & omissions	5,641	4,544	4,030	1,296

^a Negative indicates an increase.

Source: Central Bank of Turkey.

By the first week of November, official gross foreign-exchange reserves had reached US\$80.3bn, compared with US\$70.7bn at end-2009, according to weekly data from the Central Bank. The reserves went on to hover at about the same level in the rest of November and early December. As of December 10th, gross foreign-exchange reserves were put at US\$79.7bn.

Data and charts

Annual data and forecast

	2006 ^a	2007 ^a	2008 ^a	2009 ^a	2010 ^b	2011 ^c	2012 ^c
GDP							
Nominal GDP (US\$ m)	530,917	647,140	730,325	614,619	724,160	779,440	850,877
Nominal GDP (TL m)	758,391	843,178	950,534	952,635	1,086,834	1,225,218	1,350,451
Real GDP growth (%)	6.9	4.7	0.7	-4.7	8.0	5.3	5.2
Expenditure on GDP (% real change)							
Private consumption	4.6	5.5	-0.3	-2.2	7.0	5.5	5.0
Government consumption	8.4	6.5	1.7	7.8	0.5	5.0	4.0
Gross fixed investment	13.3	3.1	-6.2	-19.1	26.5	16.5	11.5
Exports of goods & services	6.6	7.3	2.7	-5.3	1.5	1.8	4.7
Imports of goods & services	6.9	10.7	-4.1	-14.3	18.4	12.0	10.0
Origin of GDP (% real change)							
Agriculture	1.4	-6.7	4.3	3.5	-2.0	1.0	0.5
Industry	10.2	5.8	-1.3	-8.4	8.5	5.0	4.0
Services	6.0	6.1	1.6	-3.2	9.7	6.2	6.8
Population and income							
Population (m)	70.4 ^b	71.2 ^b	71.9 ^b	72.6 ^b	73.3	74.0	74.7
GDP per head (US\$ at PPP)	11,714 ^b	12,490 ^b	12,716 ^b	12,109 ^b	13,027	13,821	14,721
Recorded unemployment (av; %)	9.9	10.3	11.0	14.1	12.2	12.2	12.2
Fiscal indicators (% of GDP)							
Central government revenue	22.9	22.6	22.1	22.6	23.0	22.5	22.8
Central government expenditure	23.5	24.2	23.9	28.1	26.3	25.7	25.4
Central government balance	-0.6	-1.6	-1.8	-5.5	-3.3	-3.1	-2.6
Gross public debt	45.5	39.6	40.0	46.3	44.4	42.3	40.9
Prices and financial indicators							
Exchange rate TL:US\$ (end-period)	1.409	1.171	1.526	1.491	1.515	1.569	1.599
Exchange rate TL:€ (end-period)	1.859	1.710	2.121	2.137	2.022	1.882	1.903
Consumer prices (end-period; %)	9.7	8.4	10.1	6.5	7.5	6.3	5.7
Stock of money M1 (% change)	10.7	20.1	14.5	17.1	24.4	12.7	10.2
Lending interest rate (av; %)	28.0 ^b	27.0 ^b	26.5 ^b	21.0 ^b	19.0	18.3	19.5
Current account (US\$ m)							
Trade balance	-41,059	-46,795	-53,021	-24,896	-51,276	-54,980	-58,615
Goods: exports fob	93,610	115,361	140,800	109,640	117,855	122,806	131,735
Goods: imports fob	-134,669	-162,156	-193,821	-134,536	-169,131	-177,786	-190,350
Services balance	13,610	13,344	17,121	16,305	14,311	12,286	13,009
Income balance	-6,656	-7,103	-8,159	-7,671	-7,266	-3,958	-4,406
Current transfers balance	1,908	2,243	2,113	2,299	1,623	1,746	1,906
Current-account balance	-32,197	-38,311	-41,946	-13,963	-42,609	-44,906	-48,105
External debt (US\$ m)							
Debt stock	206,833	249,181	277,277	268,274 ^{bd}	278,560	274,883	277,095
Debt service paid	40,170	47,848	54,422	67,224 ^b	62,320	57,252	60,311
Principal repayments	30,505	35,966	41,368	58,467 ^b	54,083	48,397	50,843
Interest	9,665	11,882	13,054	8,758 ^b	8,237	8,855	9,468
International reserves (US\$ m)							
Total international reserves	63,265	76,507	73,657	74,995	84,631	86,074	83,118

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

Source: IMF, *International Financial Statistics*.

Quarterly data

	2008	2009				2010		
	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr
General government finance (TL m)								
Revenue	46,567	45,627	53,309	53,674	56,872	54,816	62,571	64,993
Expenditure	59,629	65,949	56,419	70,857	68,888	67,126	66,040	71,106
Balance	-13,062	-20,322	-3,110	-17,183	-12,015	-12,310	-3,469	-6,113
Output								
Real GDP at constant 1998 prices (TL m)	24,240.2	20,884.7	23,297.7	27,265.3	25,696.0	23,357.5	25,679.1	28,762.1
Real GDP at constant 1998 prices (% change, year on year)	-7.0	-14.6	-7.6	-2.7	6.0	11.8	10.2	5.5
Industrial production index (2005=100) ^a	102.5	96.5	100.4	103.4	110.8	113.1	114.4	113.7
Industrial production index (% change, year on year)	-12.1	-21.3	-15.3	-8.7	8.1	17.2	13.9	10.0
Manufacturing production index (2005=100) ^a	99.9	92.3	97.6	100.8	108.3	110.7	112.2	111.2
Mining production index (2005=100)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Employment, wages and prices								
Employment ('000)	4,166	3,886	3,837	3,989	4,111	n/a	n/a	n/a
Employment (% change, year on year)	-0.7	-7.7	-9.7	-7.3	-1.3	n/a	n/a	n/a
Unemployment rate (%)	12.6	15.8	13.8	13.2	13.2	14.2	11.2	11.1
Hourly earnings, manufacturing (2000=100) ^b	144	145	146	151	156	158	161	n/a
Consumer prices (2003=100)	160.4	161.1	162.9	163.7	169.6	176.1	177.9	177.4
Consumer prices (% change, year on year)	10.9	8.4	5.7	5.3	5.7	9.3	9.2	8.4
Producer prices (2003=100)	160.1	158.0	160.4	161.0	164.1	169.5	175.0	175.1
Producer prices (% change, year on year)	11.2	5.9	-1.6	-1.5	2.5	7.2	9.1	8.7
Financial indicators								
Exchange rate TL:US\$ (av)	1.539	1.654	1.566	1.495	1.485	1.506	1.535	1.511
Exchange rate TL:US\$ (end-period)	1.526	1.672	1.528	1.481	1.491	1.519	1.578	1.443
Deposit rate (av; %)	25.4	19.3	18.0	17.1	16.2	15.9	15.9	15.8
Interbank money market rate (av; %)	16.3	12.6	9.6	8.0	6.7	6.5	6.5	6.5
M1 (end-period; TL m)	59,462	59,802	61,263	66,121	69,660	71,388	79,104	85,115
M1 (% change, year on year)	14.5	15.6	13.4	16.2	17.1	19.4	29.1	28.7
M2 (end-period; TL m)	282,278	283,905	285,361	295,721	313,431	331,601	355,732	n/a
M2 (% change, year on year)	27.1	20.9	18.0	15.7	11.0	16.8	24.7	23.9
ISE National-100 index (end-period; Jan 1986=1)	26,864	25,764	36,949	47,910	52,825	56,538	54,839	65,774
Stockmarket index (% change, year on year)	-62.9	-33.7	5.3	32.9	96.6	119.4	48.4	37.3
Sectoral trends								
Crude steel production ('000 tonnes)	5,378	5,644	6,294	6,761	6,606	6,074	7,423	n/a
Cement production ('000 tonnes)	11,522	10,764	15,883	14,803	13,649	11,849	17,321	n/a
Car production ('000)	136	123	224	195	211	219	236	n/a
Foreign trade (US\$ m)								
Exports fob	26,841	24,474	23,238	25,377	29,054	25,984	28,732	27,010
Imports cif	-38,421	-28,878	-33,489	-38,152	-40,410	-38,489	-44,894	-47,128
Trade balance	-11,580	-4,404	-10,251	-12,775	-11,356	-12,505	-16,162	-20,118
Foreign payments (US\$ m)								
Merchandise trade balance fob-fob	-7,956	-1,266	-6,823	-9,418	-7,386	-8,849	-12,152	-16,650
Services & income balance ^c	1,560	-1,128	906	6,793	1,740	-1,530	826	5,379
Net transfer payments	431	456	465	484	894	275	280	375
Current-account balance	-5,965	-1,938	-5,452	-2,141	-4,752	-10,104	-11,046	-10,896
Reserves excl gold (end-period)	70,428	67,418	66,106	71,103	70,874	69,411	71,216	77,782

^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

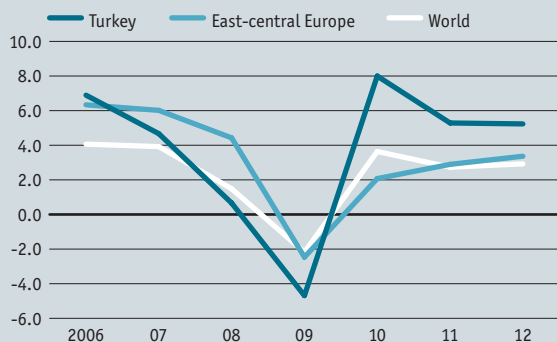
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Exchange rate TL:US\$ (av)												
2008	1.172	1.192	1.239	1.299	1.245	1.231	1.211	1.176	1.237	1.480	1.593	1.543
2009	1.595	1.659	1.707	1.602	1.554	1.542	1.517	1.483	1.487	1.468	1.484	1.502
2010	1.472	1.515	1.531	1.489	1.542	1.574	1.537	1.507	1.488	1.420	n/a	n/a
Exchange rate TL:€ (av)												
2008	1.724	1.757	1.925	2.047	1.937	1.915	1.909	1.761	1.778	1.972	2.028	2.075
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	1.945	1.973	n/a	n/a
M1 (end-period; % change, year on year)												
2008	16.6	20.1	25.6	26.5	21.3	18.4	17.8	16.6	18.6	17.3	20.0	14.5
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	n/a	n/a	n/a
M2 (end-period; % change, year on year)												
2008	21.4	22.4	24.4	27.6	22.5	21.6	20.8	19.1	21.5	24.7	27.6	27.1
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	n/a	n/a	n/a
Industrial production index (% change, year on year; seasonally adjusted; 2005=100)												
2008	11.4	4.7	6.9	6.0	1.7	4.9	1.7	-0.7	-5.2	-7.8	-10.4	-18.6
2009	-22.7	-20.4	-20.7	-19.8	-14.8	-11.3	-10.5	-6.0	-9.4	6.3	-3.4	24.1
2010	15.7	17.6	18.5	16.3	15.5	10.1	8.7	11.9	9.3	n/a	n/a	n/a
Unemployment rate (%)												
2008	11.6	11.9	11.0	9.9	9.2	9.4	9.9	10.2	10.7	11.2	12.6	14.0
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	n/a	n/a	n/a
Deposit rate (av; %)												
2008	21.2	21.2	21.2	21.2	21.7	22.9	23.1	23.1	23.2	24.8	25.7	25.7
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	n/a	n/a
Money market rate (av; %)												
2008	15.7	15.4	15.3	15.3	15.5	16.0	16.5	16.8	16.8	16.8	16.6	15.6
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	n/a	n/a
ISE National-100 stockmarket index (end-period; Jan 1986=1.00)												
2008	42,698	44,777	38,838	43,468	39,970	35,090	42,201	39,844	36,051	27,833	25,715	26,864
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	n/a
Consumer prices (av; % change, year on year; 2003=100)												
2008	8.2	9.1	9.2	9.7	10.7	10.6	12.1	11.8	11.1	12.0	10.8	10.1
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	n/a
Producer prices (av; % change, year on year; 2003=100)												
2008	6.4	8.1	10.5	14.6	16.5	17.0	18.4	14.7	12.5	13.3	12.2	8.1
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	n/a
Total exports fob (US\$ m)												
2008	10,632	11,078	11,429	11,364	12,478	11,771	12,595	11,047	12,793	9,723	9,396	7,722
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	7,832	8,264	9,888	9,397	9,796	9,539	9,574	8,522	8,914	10,982	n/a	n/a

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Total imports cif (US\$ m)												
2008	16,339	16,027	16,812	17,889	19,306	19,477	20,557	19,251	17,885	14,942	12,074	11,405
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	11,690	11,779	15,020	14,941	14,724	15,229	16,063	15,428	15,637	17,310	n/a	n/a
Trade balance fob-cif (US\$ m)												
2008	-5,707	-4,949	-5,383	-6,525	-6,828	-7,706	-7,962	-8,204	-5,092	-5,219	-2,678	-3,683
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	-3,858	-3,515	-5,132	-5,544	-4,928	-5,690	-6,489	-6,906	-6,723	-6,328	n/a	n/a
Foreign-exchange reserves excl gold (US\$ m)												
2008	74,493	75,099	76,583	74,574	73,893	75,954	75,874	75,847	76,683	70,977	70,673	70,428
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	n/a	n/a

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

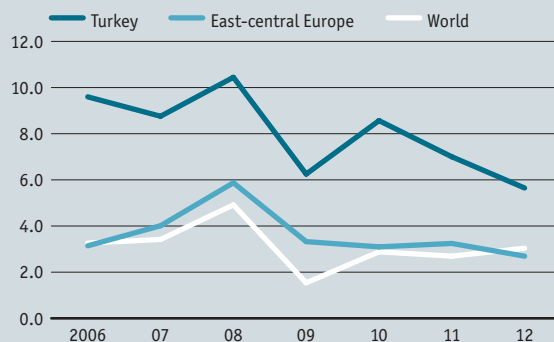
Annual trends charts

Real GDP growth
(% change)



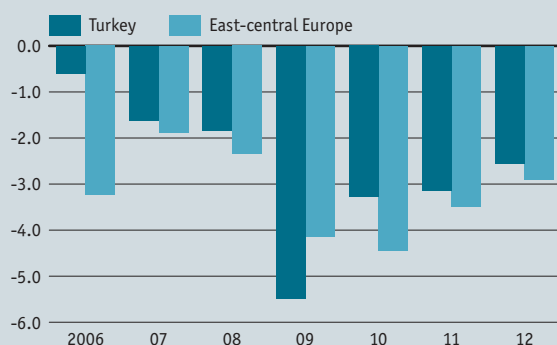
Source: Economist Intelligence Unit.

Consumer price inflation
(av; %)



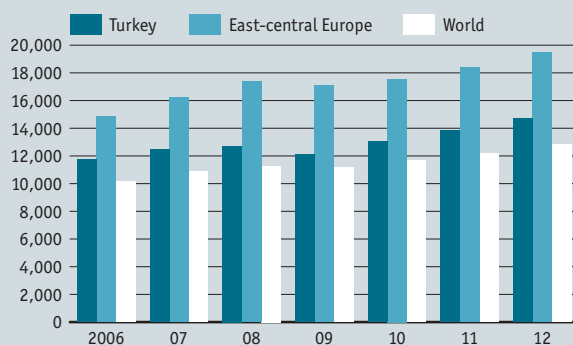
Source: Economist Intelligence Unit.

Budget balance
(% of GDP)



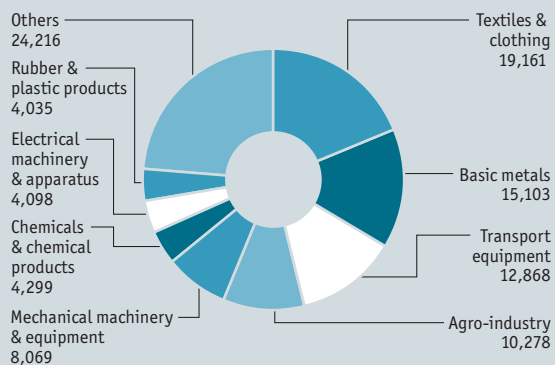
Source: Economist Intelligence Unit.

GDP per head
(US\$, PPP)



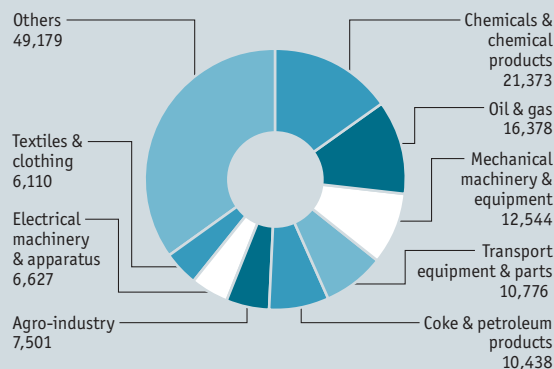
Source: Economist Intelligence Unit.

Principal exports, 2009
(US\$ m)



Source: Economist Intelligence Unit.

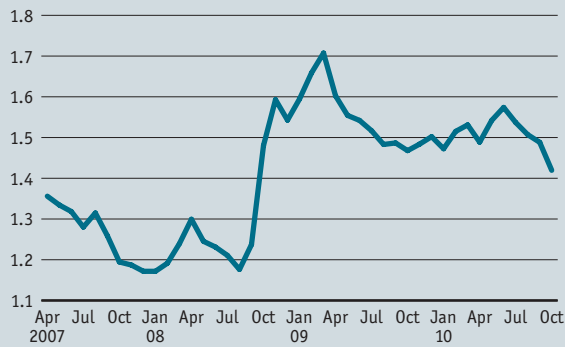
Principal imports, 2009
(US\$ m)



Source: Economist Intelligence Unit.

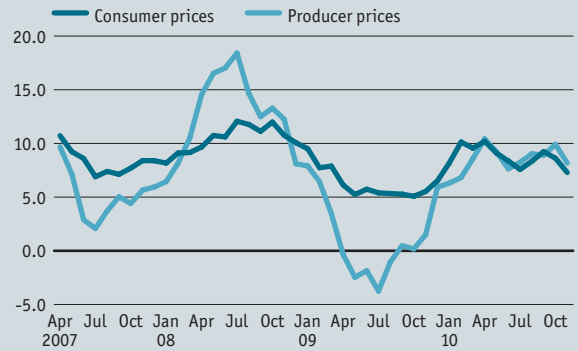
Monthly trends charts

Exchange rate
(TL:US\$; av)



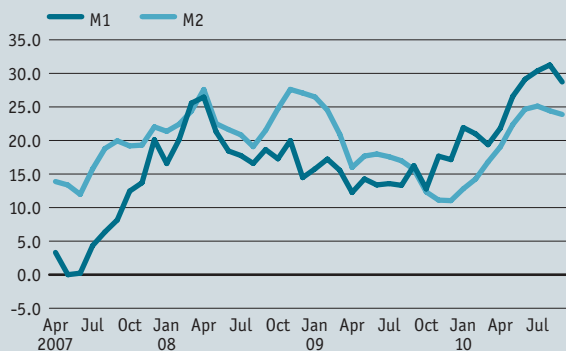
Source: Economist Intelligence Unit.

Price inflation
(% change, year on year)



Source: Economist Intelligence Unit.

Monetary aggregates
(% change, year on year)



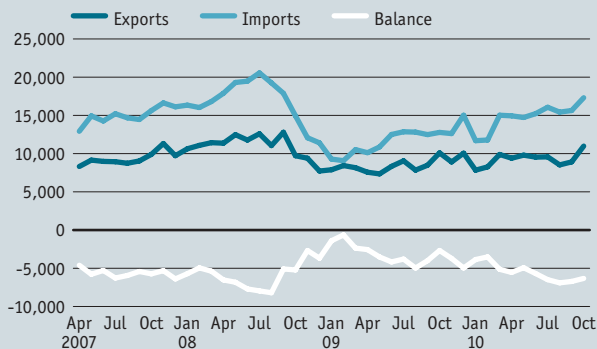
Source: Economist Intelligence Unit.

Index of industrial activity
(av; 1996=100)



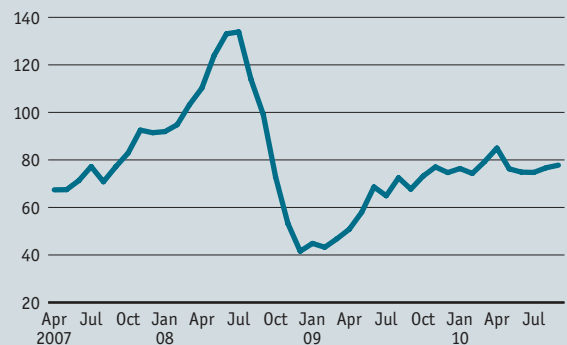
Source: Economist Intelligence Unit.

Foreign trade
(US\$ m; goods only)



Source: Economist Intelligence Unit.

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

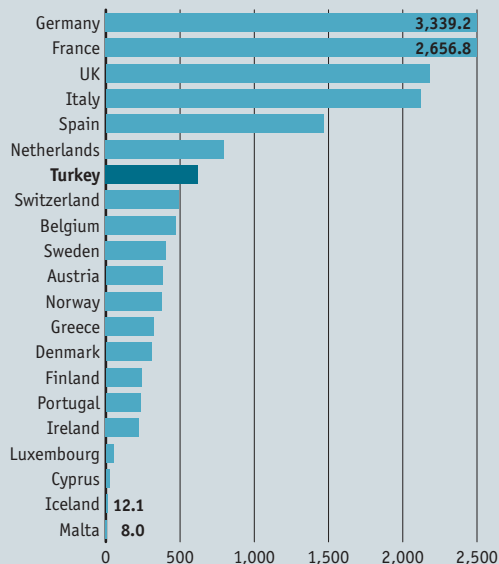


Source: Economist Intelligence Unit.

Comparative economic indicators, 2009

Gross domestic product

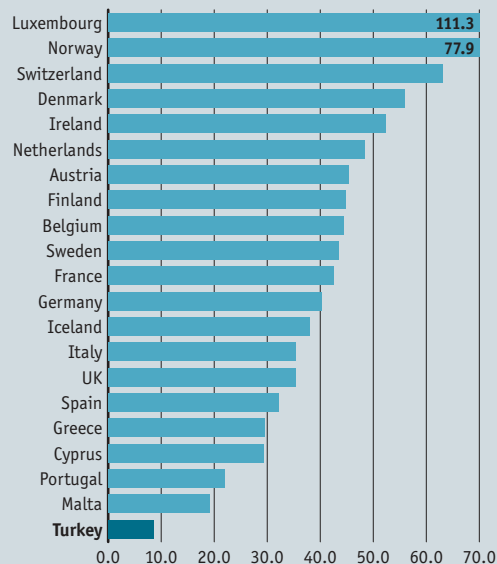
(US\$ bn; market exchange rates)



Sources: Economist Intelligence Unit estimates; national sources.

Gross domestic product per head

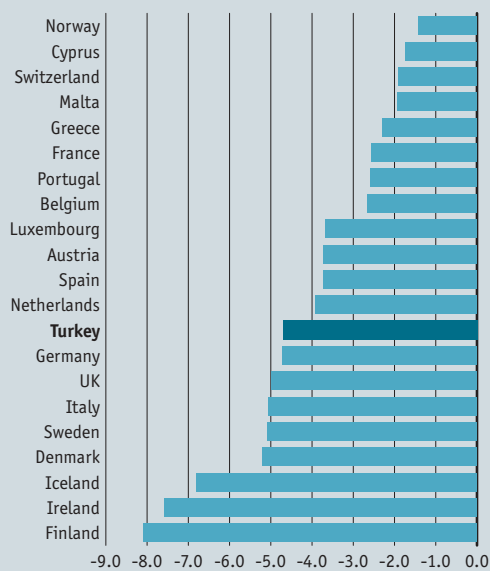
(US\$ '000; market exchange rates)



Sources: Economist Intelligence Unit estimates; national sources.

Gross domestic product

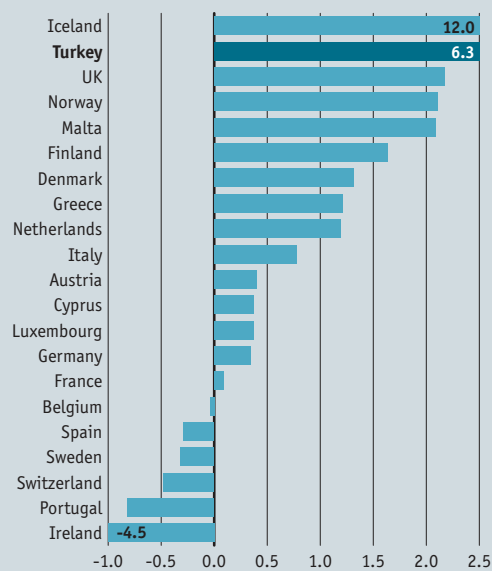
(% change, year on year)



Sources: Economist Intelligence Unit estimates; national sources.

Consumer prices

(% change, year on year)



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. Average exchange rate in 2009: TL1.550:US\$1; TL2.159:€1	
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	July 22nd 2007; next election July 2011	
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-right: Motherland Party (Anap), Democrat Party (DP); centre-left: Republican People's Party (CHP), Social Democrat Populist Party (SHP), Democratic Left Party (DSP); nationalist right: Nationalist Action Party (MHP); pro-Kurdish: Peace and Democracy Party (BDP), the successor of the banned Democratic Society Party (DTP). In the 2007 election the AKP, CHP/DSP and MHP exceeded the 10% national vote threshold. Members of the DTP and two other parties were elected as independents	
Council of Ministers	Prime minister	Recep Tayyip Erdogan
	Deputy prime ministers & ministers of state	Bulent Arinc Ali Babacan (Economy) Cemil Cicek
Ministers of state	Mehmet Aydin Egemen Bagis Hayati Yazici Faruk Nafiz Ozak	Mehmet Zafer Caglayan Faruk Celik Cevdet Yilmaz Selma Aliye Kavaf
Key ministers	Agriculture & rural affairs Culture & tourism Defence Education Employment & social security Energy & natural resources Environment & forestry Finance Foreign affairs Health Interior Justice Public works & housing Tourism & culture Trade & industry Transport	Mehmet Mehdi Eker Ertugrul Gunay Vecdi Gonul Nimet Cubukcu Omer Dincer Taner Yildiz Veysel Eroglu Mehmet Simsek Ahmet Davutoglu Recep Akdag Besir Atalay Sadullah Ergin Mustafa Demir Ertugrul Gunay Nihat Ergun Binali Yildirim
Central Bank governor	Durmus Yilmaz	