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## Country Report

# Turkey

**April 2011**

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ISSN 0269-5464

## **Symbols for tables**

"0 or 0.0" means nil or negligible; "n/a" means not available; "--" means not applicable

Printed and distributed by IntypeLibra, Units 3/4, Elm Grove Industrial Estate, Wimbledon, SW19 4HE

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# Turkey

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# Executive summary

## Highlights

*April 2011*

- Outlook for 2011-15**
- The Economist Intelligence Unit expects the Justice and Development Party (AKP) to win the general election on June 12th and to 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, despite some election spending this year, from an estimated 3.6% of GDP in 2011 to about 2% of GDP by 2015.
  - We expect the Central Bank of Turkey to start to raise its policy interest rates in the second half of 2011. The inflation outlook seems fairly benign, despite higher food and oil prices, so rates are expected to stay below pre-crisis levels.
  - After an estimated expansion of 8.1% 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 expected to remain at current high levels of 6-7% of GDP in 2011-12, as domestic demand is expected to be strong and commodity prices have risen. A moderate decline is forecast in 2013-15.
- Monthly review**
- Twenty-seven parties will run in the June 12th election, but only three or four will enter parliament owing to the threshold of 10% of the vote.
  - The government has come in for criticism over the detention of several journalists in early March in criminal investigations into civilian/military circles for allegedly plotting against the AKP in the early 2000s.
  - In political terms, the government's response to the popular uprisings in the Arab world has differed from country to country. It is opposing international intervention to halt the repression in Libya.
  - Turkey's banking regulator has taken measures to support efforts to curb the growth of bank credit and check the increase in the current-account deficit.
  - The central government budget was in surplus in January-February 2011, after a large deficit in December 2010 caused by a surge in government spending.
  - Economic activity remained strong in early 2011, despite steps to curb credit growth, some financial market volatility, rising oil prices and the potential impact of the Arab uprisings on capital flows, business sentiment and trade.
  - In February consumer price inflation slowed for the fifth consecutive month, to a fresh 41-year low of 4.2% year on year.

# 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, pro-EU Justice and Development Party (AKP), led by the prime minister, Recep Tayyip Erdogan, will win the general election on June 12th 2011, allowing the AKP to form a single-party government for a third consecutive term. We expect the political scene to remain volatile up to and beyond the election, mainly as a consequence of the tension between the AKP and the secularist/nationalist elites, including the main opposition party, 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 and its tightening grip on Turkey's civilian institutions, especially the judicial system. However, following the government's victory in the constitutional reform referendum in September 2010 we believe 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 Constitutional Court and the Supreme Board of Judges and Prosecutors (HSYK), which is responsible for appointing judges and prosecutors. 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 party 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 military, once the most respected institution and self-appointed guardian of the secular state, is likely to maintain 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 AKP is setting the election agenda, based on its calls for increased democratisation and a new constitution to replace the current 1982 military-inspired constitution. This is forcing the CHP and the smaller, right-wing Nationalist Action Party (MHP), also in opposition, to try to refresh their images and revamp their traditional policies. 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, and we do not expect the AKP to have a large enough parliamentary majority to change the constitution without opposition support or a referendum. The debate surrounding such far-reaching institutional change would be highly divisive. However, we believe that it is unlikely to affect Turkey's overall political stability, as illustrated by the constitutional reform referendum in 2010.

That campaign was hard fought but generally peaceful. Both the CHP and the MHP and the conservative sections of the judiciary 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 and will feature strongly in the 2011 general election campaign. In 1984 the outlawed Kurdistan Workers' Party (PKK) began a violent struggle with Turkey's security forces in the name of Kurdish independence. This struggle has continued uninterrupted, except for a unilateral PKK ceasefire in 1999-2004. Since 1984 a total of around 40,000 civilians, soldiers and militants have died, and many atrocities have been committed on both sides. Since the PKK ended its unilateral ceasefire in mid-2004, its demands appear to have been scaled down from independence to political and cultural rights for Kurds, and its campaign of violence has been less intense than in 1984-99. However, the violence gradually escalated up to September 2010, with the PKK carrying out attacks against the security forces, mainly in the Kurdish-inhabited south-east of the country, but also against businesses and civilians, sometimes elsewhere in Turkey, including in major tourist destinations.

At the end of February 2011, the PKK announced that it would refrain from attacks, but effectively ended the unilateral ceasefire announced just before the referendum in September 2010 on the government's constitutional reform package and promised until the mid-2011 general election. This decision was not unexpected. Although the PKK denied responsibility for a suicide bombing in Taksim Square in central Istanbul in October 2010, 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 until just before the referendum, it could trigger violent ethnic clashes between Turkish and Kurdish civilians. In July 2010 Kurds and Turks clashed in the southern province of 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 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), which 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 will 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 made little progress owing to hardline nationalist opposition to concessions to the Kurds and the refusal of pro-Kurdish political parties to distance themselves completely from the PKK. The initiative will not be revived until after the general election, and even then may prove to be inadequate to bring about substantial change. The judicial decision to close the pro-Kurdish Democratic Society Party (DTP) in early 2010 further increased Kurdish suspicions of the state. In late December, proposals by the DTP's successor, the Peace and Democracy Party (BDP), to grant greater autonomy to the Kurdish provinces and allow the use of the Kurdish

language in an official capacity alongside Turkish sparked an investigation by the special prosecutor of the Court of Appeals, whose office has been responsible for closing down Kurdish political parties in the past. The AKP has stated clearly that it is opposed to granting Kurdish provinces greater autonomy—a view which was strongly expressed through the civilian-military National Security Council that met on December 29th 2010. Its position is more nuanced on the use of languages other than Turkish, however. On December 26th the prime minister, Recep Tayyip Erdogan, declared that the official language of Turkey is Turkish, but conceded that many Turkish citizens speak other languages and therefore impediments to their free use should be removed. In the likely event that the AKP is re-elected, it may initiate measures to include the free use of Kurdish in various local and regional governmental capacities. Kemal Kilicdaroglu, the new leader of the CHP, which we expect will remain in opposition in the next parliament, has promised a sea change in his party's traditionally hardline nationalist stance on the issue of Kurdish cultural rights. However, it remains to be seen to what extent the rest of the CHP will be willing to support him after the election if, as we expect, they lose.

### **Election watch**

In the general election to be held on June 12th 2011 we expect the AKP to win a clear majority in the 550-seat parliament, but less than two-thirds of the seats, the special majority needed to change the constitution without opposition support or a referendum. However, the composition of the next parliament and the distribution of seats will depend largely on how many political parties get over the threshold of 10% of the national vote required for political party representation in parliament. A major factor in this regard will be the performance of the MHP. Recent opinion polls suggest that its support is dangerously close to 10%. If the MHP fails to reach the threshold, the AKP might manage to obtain a two-thirds majority.

The new CHP leader, Kemal Kilicdaroglu, who was elected in May 2010, is seeking to transform his party into a credible alternative to the AKP in government. However, the CHP has been beset by internal divisions and Mr Kilicdaroglu's control over the party has been fragile, despite successfully rejuvenating the executive in December 2010. It will be a tough challenge to persuade 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, promote freedom of expression and exclude the military from politics. 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 a head of state by universal direct suffrage for the first time. 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.

### **International relations**

Assuming that the AKP will remain in office after the general election in mid-2011, we expect a good degree of continuity in Turkish foreign policy. However, 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" is consistent with EU requirements. Moreover, as turmoil has spread in the Arab world, from Tunisia to Egypt and Libya, many Western observers have pointed to Turkey as a democratic model for other Muslim countries.

The AKP has supported UN-backed efforts to resolve the division of Cyprus. However, a solution that is acceptable to both the Greek and Turkish Cypriots is unlikely to be found. The differences between the two sides remain considerable and 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 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 Turkey to remain an open, largely market-driven economy with adequate public financial management and a well-regulated financial sector. Although Turkey suffered a deeper recession in 2008-09 than most other emerging markets, financial system stress and interest- and exchange-rate volatility were limited. 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 for the further improvement of 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 deficit in the central government budget, which covers most of the public sector, fell from 5.5% of GDP in 2009 to an estimated 3.6% in 2010. Because of the forecast slowdown in economic activity, we expect the deficit to decline more gradually during the forecast period, to 2% by 2015. An improvement is expected in 2011, despite some election spending. We believe that a substantial portion of the large deficit recorded in December 2010 was actually the result of cash distributed for use this year. The deficit reduction will also be helped by lower interest payments as a percentage of GDP owing to the sharp fall in yields on government securities compared with the period up to the 2008-09 crisis.

The central government debt/GDP ratio rose by about 6 percentage points to 46.3% in 2009 as a result of the severe recession. However, as a result of the smaller deficit and strong GDP growth, it fell to an estimated 43.5% of GDP in 2010. Given our deficit and growth forecasts for 2011-15 and our expectation that privatisation activity will pick up, we expect the downward trend to continue, with the debt/GDP ratio falling to below 40% by 2013-15.

**Monetary policy** Concern about the size of Turkey's current-account deficit and the impact on financial stability of strong capital inflows resulted in a shift in monetary policy in December 2010. Instead of raising rates, as central banks in most booming emerging markets have done, the Central Bank of Turkey cut its key interest rate, the one-week repo (repurchase) lending rate, by 50 basis points in December 2010 and by 25 basis points in mid-January 2011, to 6.25%. Expecting capital flows to emerging markets to ease moderately (the earthquake and tsunami in Japan are expected to halt the yen carry trade), we now think further cuts are unlikely and that by the end of the third quarter of 2011 the Central Bank will have started to raise rates to control inflation. Because of the lower base, they may have to rise more sharply than previously forecast (by 150-200 basis points). We expect that recent increases in banks' reserve requirements will help to curb credit growth, which has fuelled increased spending on imported goods. However, there is a risk that they do not succeed and the current-account deficit continues to rise, requiring much tighter monetary and or fiscal policy. We do not expect the Central Bank to change its consumer price inflation targets, set in agreement with the government on a rolling three-year basis. They are ( $\pm 2$  percentage points) 5.5% at end-2011 and 5% at end-2012 and 2013. 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. We foresee no major change in the operational independence of the Central Bank of Turkey or its conduct of monetary policy in 2011-15.

## Economic forecast

International assumptions	2010	2011	2012	2013	2014	2015
<b>Economic growth (%)</b>						
US GDP	2.8	2.9	2.5	2.6	2.6	2.7
OECD GDP	2.9	2.4	2.3	2.4	2.4	2.2
EU27 GDP	1.8	1.7	1.8	1.9	1.8	1.9
World GDP	3.8	3.2	3.1	3.2	3.1	3.2
World trade	12.5	6.9	6.4	6.5	6.6	6.1
<b>Inflation indicators (% unless otherwise indicated)</b>						
US CPI	1.6	2.1	1.9	2.5	2.8	2.8
OECD CPI	1.4	1.8	1.6	2.0	2.1	2.3
EU27 CPI	1.9	2.7	1.8	1.9	2.0	2.1
Manufactures (measured in US\$)	3.4	3.1	0.0	1.0	1.8	2.4
Oil (Brent; US\$/b)	79.6	101.0	85.0	78.3	75.5	76.0
Non-oil commodities (measured in US\$)	24.3	27.9	-11.1	-5.7	-2.5	-0.3
<b>Financial variables</b>						
US\$ 3-month commercial paper rate (av; %)	0.3	0.3	0.7	2.2	4.1	5.1
€ 3-month interbank rate (av; %)	0.8	1.3	1.9	2.8	3.5	3.5
Exchange rate TL:US\$ (av)	1.50	1.60	1.61	1.63	1.62	1.61
Exchange rate US\$:€ (av)	1.33	1.31	1.25	1.20	1.23	1.28

### Economic growth

Following the 2008-09 recession, economic activity rebounded in Turkey in 2010, reflecting some base effects but also strong domestic demand growth driven by low real interest rates, strong capital inflows and a rapid acceleration in bank credit growth. We expect the pace of growth to be more moderate in 2011-15, slowing from around 8% in 2010 to about 5-5.5% a year during the forecast period. This would also be weaker than the average of around 7% in 2003-07. During the second half of the forecast period, we expect growth to be more balanced between external and domestic demand.

After declining 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, 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.

After a collapse in 2008-09, gross fixed investment rebounded by an estimated 26.5% in 2010. Growth is expected to moderate from 2011 owing to base effects and softer external and domestic demand growth. Nevertheless, these factors will be offset by some government spending on construction projects

anticipated because of the 2011 election and companies' need to replace old machinery and equipment.

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. The foreign balance is therefore estimated to have reduced GDP growth by about 4 percentage points. We forecast this negative trend to continue, as we expect import growth to far exceed that for exports as domestic demand growth remains robust and demand in Turkey's main European markets is subdued, especially during the first half of the forecast period. However, the drag on GDP is forecast to a more moderate 1 percentage point in 2013-15.

Our GDP growth forecasts have downside risks attached that could be triggered if economic expansion does not moderate from 2010 levels. Stable economic growth requires Turkey to be able to finance a large current-account deficit and substantial external debt repayments. In 2010 foreign capital inflows fuelled strong domestic credit growth, which—combined with real lira appreciation, also driven by capital inflows—increased the current-account deficit (to an estimated 6.7% of GDP). Private-sector debt is relatively low at around 40% of GDP and capital inflows are expected to remain adequate. However, if private-sector debt levels continue to rise sharply and the current-account deficit is not reduced in two to three years, a decline in global liquidity could cause severe problems, including an abrupt fall in the value of the lira leading to, as it has done in the past, higher inflation and a sharp tightening of monetary policy followed by a rapid slowdown in economic activity, with possible private-sector debt-servicing difficulties.

#### Economic growth

%	2010 <sup>a</sup>	2011 <sup>b</sup>	2012 <sup>B</sup>	2013 <sup>b</sup>	2014 <sup>b</sup>	2015 <sup>b</sup>
GDP	8.1	4.9	5.0	5.3	5.5	5.3
Private consumption	7.0	5.0	5.0	5.2	5.2	5.1
Government consumption	0.5	5.0	4.0	4.5	4.5	4.5
Gross fixed investment	26.5	16.0	9.5	8.5	7.5	7.5
Exports of goods & services	1.9	2.4	5.4	7.3	8.9	8.8
Imports of goods & services	18.2	12.3	8.8	9.1	9.1	9.2
Domestic demand	12.3	7.4	6.0	6.0	5.8	5.7
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	9.9	5.5	6.4	6.8	7.0	6.7

<sup>a</sup> Economist Intelligence Unit estimates. <sup>b</sup> Economist Intelligence Unit forecasts.

#### Inflation

We expect the annual rate of consumer price inflation to accelerate moderately from a 41-year low of 4.2% in February 2011, given base effects and some upward pressure from the impact of low interest rates, a weaker lira and rising commodity prices. That said, we believe that the inflation outlook is fairly benign, as we expect the strong rebound in economic activity to moderate in 2011-15. Our baseline forecast is that end-of-year rates will be slightly over the Central Bank's targets of 5.5% in 2011 and 5% in 2012 and 2013, but within the band of uncertainty of  $\pm 2$  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 4-4.5% in 2014-15.

**Exchange rates** Our baseline forecast is that the lira will average around TL1.60:US\$1 and TL2:€1 in 2011-15, having depreciated moderately in late 2010 and early 2011. Global liquidity is expected to remain loose for most of the forecast period as a result of quantitative easing in the US and loose monetary policy in the euro area, which should ensure adequate capital inflows into Turkish-lira denominated assets to support the exchange rate. That said, our stable annual average forecasts mask our expectation that there will continue to be strong bouts of exchange rate volatility during the forecast period. We see a moderately high risk of a much weaker lira, especially if global risk aversion increases sharply, making it difficult for Turkey to meet its large external financing needs.

**External sector** Strong credit expansion, real currency appreciation and strong domestic demand growth caused Turkey's current-account deficit to rise from a six-year low of 2.3% of GDP in 2009 to an estimated 6.7% in 2010. We expect similarly large deficits of 6-7% of GDP in 2011-12 as the impact of slower credit growth and therefore import demand will be offset by higher than previously expected oil prices and sluggish export demand as a result of fiscal tightening in the EU, Turkey's largest market. In 2013-15 a slight improvement is forecast as we expect export demand to recover gradually and international oil prices to ease. However, the deficit will still be large at 5-6% of GDP.

#### Forecast summary

(% unless otherwise indicated)

	2010 <sup>a</sup>	2011 <sup>b</sup>	2012 <sup>b</sup>	2013 <sup>b</sup>	2014 <sup>b</sup>	2015 <sup>b</sup>
Real GDP growth	8.1 <sup>c</sup>	4.9	5.0	5.3	5.5	5.3
Industrial production growth	13.1	8.2	5.5	5.0	5.5	5.0
Gross fixed investment growth	26.5 <sup>c</sup>	16.0	9.5	8.5	7.5	7.5
Unemployment rate (av)	12.0	11.8	11.3	10.8	10.2	9.7
Consumer price inflation (av)	8.6	5.9	7.3	5.8	4.8	4.0
Consumer price inflation (end-period)	6.4	7.4	6.3	5.7	4.1	4.0
Short-term interbank rate	5.8	6.0	7.5	6.5	8.3	7.5
Government balance (% of GDP)	-3.6 <sup>c</sup>	-2.9	-2.6	-2.9	-2.6	-2.0
Exports of goods fob (US\$ bn)	120.9 <sup>cd</sup>	130.0	138.4	149.7	165.9	185.7
Imports of goods fob (US\$ bn)	177.3 <sup>cd</sup>	192.1	200.0	214.8	229.8	252.4
Current-account balance (US\$ bn)	-48.6 <sup>cd</sup>	-50.9	-50.1	-53.9	-55.3	-58.1
Current-account balance (% of GDP)	-6.7 <sup>c</sup>	-6.8	-6.0	-5.9	-5.4	-5.1
External debt (end-period; US\$ bn)	292.7 <sup>c</sup>	302.7	302.6	307.2	314.0	321.6
Exchange rate TL:US\$ (av)	1.503	1.598	1.613	1.629	1.615	1.609
Exchange rate TL:US\$ (end-period)	1.541	1.605	1.621	1.622	1.612	1.606
Exchange rate TL:¥100 (av)	1.710	1.960	1.991	2.011	1.967	1.927
Exchange rate TL:€ (av)	1.992	2.089	2.016	1.958	1.983	2.052

<sup>a</sup> Actual. <sup>b</sup> Economist Intelligence Unit forecasts. <sup>c</sup> Economist Intelligence Unit estimates. <sup>d</sup> Based on Central Bank of Turkey full-year data.

# Monthly review: April 2011

## The political scene

### June 12th is the official election date

On March 3rd, the Turkish parliament approved a bill establishing June 12th as the date of the general election. The independent Higher Electoral Council (YSK), whose function is to ensure the fair and orderly conduct of the elections, announced that 27 political parties will run. However, only three or four are expected to enter parliament owing to the high 10% threshold for political party representation. The YSK also set March 10th as the final date for public employees intending to run for office to resign from their current positions (required by Turkish law). Numerous bureaucrats, such as the former Istanbul governor Muammer Guler, and a trade union leader, Suleyman Celebi, have tendered their resignations in order to stand as candidates for the ruling Justice and Development Party (AKP), which is expected to win a third term. The YSK has given the parties until April 11th to submit their candidate lists. The main focus of AKP's campaign is its promise to introduce a new constitution, one which the prime minister, Recep Tayyip Erdogan, declared on February 20th could be "understood by all citizens". As the incumbent with a record of good economic management and some progress on democratic reforms, the AKP has a substantial advantage over its main rival, the Republican People's Party (CHP).

Under Kemal Kilicdaroglu's leadership since May 2010, the CHP has been seeking to change its political stance on a range of political and social issues to appeal to a broader range of voters. On February 28th 2011, Mr Kilicdaroglu acknowledged that in the past the party had lost touch with voters. The CHP has also successfully focused attention on the AKP's hold on institutions, especially the judiciary, arguing that Mr Erdogan has been using the judiciary to eliminate his opponents in the media, judiciary and military (see In focus). But the CHP is also struggling to contain internal divisions, which may erupt over the choice of candidates for the election. Mr Kilicdaroglu will be keen to have elected to parliament those who supported his unexpected rise to leader when his predecessor, Deniz Baykal, resigned over a sex tape scandal. He may find it hard to resist the demands of an influential section of the party to put forward as candidates several individuals who have been detained in connection with the alleged plots to overthrow the AKP government in the early 2000s.

On the Kurdish issue, arguably Turkey's most intractable social and political conflict, the party has sought to revise its hardline nationalist position. In a visit to the south-eastern province, Van, Mr Kilicdaroglu acknowledged that the CHP owed an apology to Turkey's Kurdish population and declared his party's support for a general amnesty for Kurdish militants and the lifting of restrictions on the use of the Kurdish language, including the offering of Kurdish as a free elective course in state middle schools. The Economist Intelligence Unit expects the CHP to increase its share of the total vote to 25-30%, up from about 20% in the 2007 election, but this is still well behind the AKP, which is expected to obtain 45-50%.

## In focus

### The AKP comes in for criticism over plot investigations

The Justice and Development Party (AKP) government led by the prime minister, Recep Tayyip Erdogan, has come in for severe criticism over a series of arrests made between mid-February and early March 2011 in the "Sledgehammer" and "Ergenekon" criminal investigations into various civilian/military circles for allegedly plotting to overthrow the AKP government in the early 2000s. On February 13th, 163 officers from the Turkish Armed Forces (TSK), including many prominent senior active and retired service personnel, were taken into custody and formally charged. This was followed by another, more controversial, wave of arrests on March 4th when ten journalists, including respected investigative reporters Nedim Sener and Ahmet Sik, were taken into custody for alleged connections to the Ergenekon organisation. At the same time, two well-known columnists, Mustafa Balbay and Tuncay Ozkan, who have been in jail for nearly three years, told news agencies that they were being mistreated. About 50 journalists are currently in prison.

The main opposition parties, the Republican People's Party (CHP) and the Nationalist Action Party (MHP) accuse the government of using the trials to eliminate the AKP's opponents in the media, the military and the judiciary. In addition to provoking widespread street protests condemning the journalists' arrests as a violation of press freedom, the arrests caught the attention of the European Parliament and international media organisations. In its annual report on Turkey published on March 9th, the European Parliament expressed concern about excessively long pre-trial detention periods and the need for effective judicial guarantees for all suspects in the cases. It also warned that the detention of well-known journalists such as Mr Sener and Mr Sik might lead to a loss of credibility of the trials, the purpose of which should be to "strengthen democracy".

Mr Erdogan, whose statements about the media and press freedom have raised concern in the past, has been the main focus of the criticism. He insists that the AKP has "no interest [...] in taking over the judiciary" and "we are neither the judge nor the prosecution" and called for a speedy end to the trials, which have been continuing for over three years. Appearing increasingly impatient with criticism, he described the European Parliament's report as "unbalanced".

The trials and the prime minister's repeated clashes with the media have arguably turned into the AKP's biggest weakness ahead of the general election. Although there may be no clear evidence that it is influencing the judiciary's actions, public opinion (particularly among liberals), is increasingly suspicious. It does not help that in February the minister of culture, Ertugrul Gunay, announced that he would not be seeking to continue in his job for another term. Mr Gunay, a seasoned social democrat and former member of the CHP, joined the AKP just before the 2007 general election, helping to give credibility to the ruling party's efforts to broaden its membership and support. Mr Gunay has appeared increasingly uncomfortable in the AKP, after the prime minister described a giant monument symbolising reconciliation between Turks and Armenians as monstrous and called for it to be demolished. In March, Umit Boyner, the head of the influential business association TUSIAD, said Turkey was still waiting for democracy, transparency and justice.

### The government responds carefully to Arab uprisings

In practical terms, the government's response to the spread of popular protests in the Arab world focused on ensuring all Turkish citizens at risk were

evacuated hastily and safely. In political terms, its response has differed from country to country. On February 25th after the authoritarian regimes in Tunisia and Egypt had been toppled and the forces of the Libyan leader, Muammar Qadhafi, had started the violent repression of the opposition, Mr Erdogan pointed out that many of the countries in upheaval had been ruled for over 30 years with no "popular mandate and no account for the people's wishes" and the uprisings were the clearest signal of "mass frustration". The president of Turkey, Abdullah Gul, visited Egypt on March 3rd, after the fall of the Egyptian president, Hosni Mubarak, and was hosted by the interim military ruler, Mohammed Hussein Tantawi. Mr Gul expressed Turkey's desire to see a swift transition to a popularly elected and democratic government.

The AKP's reaction to events in Libya was more cautious. Mr Erdogan talked to Colonel Qadhafi several times by telephone, mainly to facilitate the safe evacuation of over 30,000 Turkish citizens who have business dealings with Libya, predominantly in the construction sector. The Turkish government has expressed strong opposition to sanctions, a no-fly zone or NATO military intervention, arguing that outside interference in the domestic affairs of Libya might exacerbate the violence. The Turkish government also seems acutely aware that Colonel Qadhafi might not be toppled, in which case it would be in Turkey's interests to maintain good relations with his regime, given the important trade ties between the two countries. Under the AKP, Turkish foreign policy has been much more assertive than under previous governments, leading critics at home and abroad to accuse it of turning Turkey away from its traditional Western allies. However, its assertiveness on issues such as Iran and the Israeli-Palestinian conflict has been popular in Turkey and the Arab world.

## Economic policy

### **Banking authority supports efforts to control credit growth**

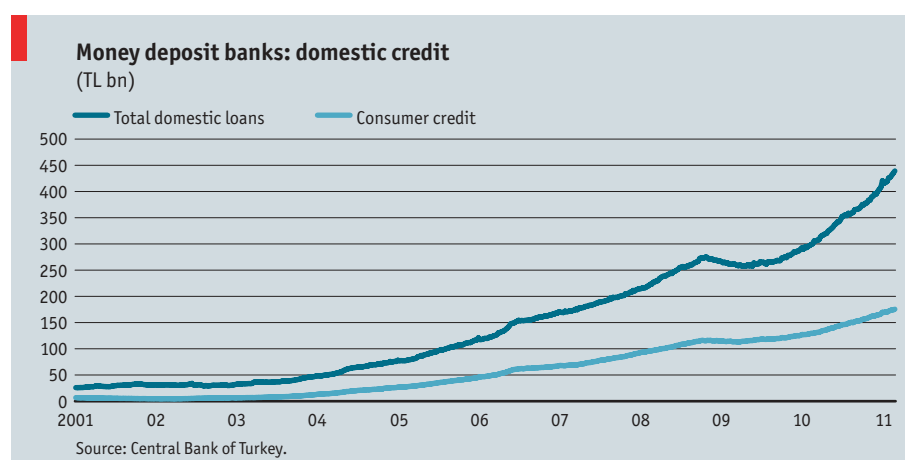
The banking watchdog, the Banking Regulation and Supervision Agency (BRSA), has been supporting the Central Bank of Turkey's efforts since November 2010 to curb the growth of bank credit and hence domestic demand as part of a strategy to control Turkey's current-account deficit, which reached an estimated 6.7% of GDP in 2010. Financed mainly through volatile short-term capital inflows, the large deficit poses risks to macroeconomic and financial sector stability in the event of a reversal of capital flows if global investor sentiment deteriorates sharply. In January 2011 the BRSA established ceilings for loan-to-value ratios on residential and commercial property loans in response to rapid mortgage lending growth and as of March 1st it reversed the temporary easing of loan-loss provisioning rules adopted in January 2009, during the global financial crisis. The regulator has also sought to use its authority to pressure the banks to limit the pace of credit growth to not more than 25% annually—a pace regarded by the Central Bank to be compatible with a sustainable current-account deficit. On March 10th, the BRSA president, Tevfik Bilgin, predicted that bank credit growth in 2011 would work out at 20-25%, and that he did not think there would be a need to "twist the ears" of individual banks. However, he also suggested that the regulator would monitor not only the overall growth in bank credit volume, but also its distribution, implying that growth in export credits, for example, would be regarded more favourably than



growth in credits for vehicle purchases by consumers, given their divergent impacts on the current-account deficit.

The Central Bank's monetary policy since November 2010 has twice raised reserve requirements for banks (March 2011, Economic policy). According to Central Bank data, domestic loans of deposit money banks (excluding Sharia-compliant "participation banks") stood at TL439.2bn (US\$273.5bn) on February 25th 2011—4.4% higher than on December 31st 2010 and 43.4% higher than a year earlier. Within this total, consumer credit amounted to TL175.5bn, showing an increase of 3.4% over the eight-week period and 35.2% year on year. These percentages may underestimate the pace of credit growth as the volume of credit was seasonally high on December 31st. However, some of the growth of credit in January and February 2011 may be attributable to the recent weakness of the lira, since about one-fifth of domestic loans are denominated in foreign currency. In 2010 as a whole, domestic loans of deposit money banks rose by 44% year on year and consumer credit by 33%.

The deputy prime minister responsible for economic affairs, Ali Babacan, has expressed government approval for the Central Bank's strategy. On March 2nd he was quoted to the effect that while credit growth at most banks had been "quite appropriate" in the first two months of 2011, three or four banks were raising the average. He said that he hoped that the authorities would not be obliged to take "police measures" to stop this. Although the government has generally kept fiscal policy tight during the economic recovery, there is some room for further tightening, which would be supportive of the Central Bank's strategy. However, with an election just three months away, the government will be keen to maintain some room for manoeuvre.



**Central government budget**

(TLbn unless otherwise stated)

	2009			2010			2011	2010	2011	
	Outturn	% of GDP	% change	Target <sup>a</sup>	Outturn	% change	Target	Jan-Feb	Jan-Feb	% change
<b>Total revenue</b>	<b>215.5</b>	<b>22.6</b>	<b>2.8</b>	<b>252.8</b>	<b>254.0</b>	<b>17.9</b>	<b>279.0</b>	<b>39.5</b>	<b>48.1</b>	<b>21.4</b>
Tax revenue	172.4	18.1	2.6	210.2	210.5	22.1	232.2	33.4	40.9	22.2
Other revenue	43.0	4.5	1.1	42.6	43.5	1.1	46.8	6.1	7.2	17.9
<b>Total expenditure</b>	<b>268.2</b>	<b>28.2</b>	<b>18.1</b>	<b>297.0</b>	<b>293.6</b>	<b>9.5</b>	<b>312.6</b>	<b>44.9</b>	<b>46.0</b>	<b>2.5</b>
Non-interest expenditure	215.0	22.4	21.9	247.5	245.3	14.1	265.1	34.3	36.1	5.3
Interest expenditure	53.2	22.6	5.0	49.5	48.3	-9.2	47.5	10.7	10.0	-6.5
<b>Budget balance</b>	<b>-52.8</b>	<b>-5.5</b>	<b>-</b>	<b>-44.2</b>	<b>-39.6</b>	<b>-</b>	<b>-33.5</b>	<b>-5.4</b>	<b>2.0</b>	<b>-</b>
<b>Primary balance</b>	<b>0.4</b>	<b>0.1</b>	<b>-</b>	<b>5.3</b>	<b>8.7</b>	<b>-</b>	<b>14.0</b>	<b>5.3</b>	<b>12.0</b>	<b>-</b>

<sup>a</sup> Revised in October 2010.

Source: Ministry of Finance, General Directorate of Public Accounts.

**Central government budget remains in surplus in February**

The central government budget was in surplus for the second successive month in February, following a large deficit in December 2010 caused by a surge in government spending (February 2011, Economic policy). The budget surplus in the first two months of 2011 amounted to TL2bn compared with a deficit in the same period of 2010. The strong tax revenue growth recorded in 2010, as the economy rebounded from the recession of 2008-9, spilled over into 2011. Revenue from indirect taxes, and especially value-added tax (VAT), remained very strong. VAT collected on imports rose by 20% year on year in the first two months, to TL6bn, while revenue from domestic VAT was up 43%, at TL5.7bn. There was also a noticeable increase in corporation tax revenue, which was 45% higher than a year earlier, at TL6.3bn. Moderate expenditure growth reflected modest increases in both interest and non-interest spending, although some non-interest expenditure items recorded increases well above inflation, particularly personnel costs, which rose by 16% year on year, to TL13bn. However, only TL4bn was transferred to cover social security deficits, which was 22% lower than a year earlier, and agricultural support payments were 45% down, at TL1.1bn. Low expenditure on such items may not be sustainable or may not be maintained ahead of the general election in June. The 2011 budget law foresees a deficit of TL33.5bn, or 2.8% of officially projected GDP.

**Economic performance****Economic activity remained strong in early 2011**

Year-on-year GDP growth slowed to 5.5% in the third quarter of 2010, having rebounded strongly in the wake of the 2008-09 recession, but available data suggest that it may have accelerated again in the fourth quarter. Early indicators for 2011 also point to strong economic activity, notwithstanding the recent policies of the Central Bank, a measure of currency and financial market volatility, rising international oil prices and the potential negative effects of the crises in several Middle East and North African countries on financial flows, business confidence and trade. In January, industrial production increased by 18.9% year on year, with the machinery, refining and automotive sectors continuing to lead the way. On a seasonally and calendar-adjusted month-on-month basis, industrial production increased by 0.5%, after the unexpectedly sharp 5.5% increase in December 2010. Economic activity appears to have

remained buoyant in February 2011. Although capacity utilisation in manufacturing industry, at 73%, was the lowest ratio for five months—partly for seasonal reasons—it remained 5.2 percentage points higher than in February 2010. The automotive sector performed strongly again, producing over 100,000 vehicles—21% more than a year earlier. Helped by robust credit growth, the number of vehicles sold in the domestic market (including imported models) was 62,045—an unusually high figure for February and 92% more than in the same month in 2010.

### Industrial production

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

	2009		2010										2011	
	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan
Mining	17.1	0.4	11.1	7.8	4.2	11.2	3.9	-1.8	-1.7	0.9	-11.5	7.6	1.7	11.9
Utilities	10.9	3.3	5.3	6.8	9.6	8.8	8.3	9.9	15.6	11.1	7.5	4.6	8.4	12.0
Manufacturing	26.3	15.2	19.9	24.3	18.5	16.0	10.5	9.2	10.9	10.8	11.3	10.1	18.5	20.5
Food & beverages	21.8	13.9	14.8	13.9	11.0	7.8	5.3	8.7	3.1	13.2	0.1	-1.4	8.8	6.0
Textiles	32.1	18.5	26.4	26.1	20.6	20.2	11.2	10.9	6.2	4.6	5.9	1.9	7.3	12.1
Clothing	11.8	-0.5	13.3	15.5	17.0	12.5	6.3	10.5	13.9	3.4	3.1	-6.3	12.3	7.2
Refining	12.2	-8.6	-15.9	33.0	11.5	4.1	-3.6	-12.1	14.2	7.2	13.4	20.7	23.6	33.1
Chemicals	48.7	36.0	31.8	30.6	21.1	19.5	15.4	7.9	4.9	8.0	3.7	8.3	17.6	18.1
Metal industry	15.4	-0.7	0.4	16.8	8.9	10.4	1.1	7.8	10.0	11.1	11.1	17.5	31.8	20.8
Miscellaneous machinery	31.7	12.1	15.7	51.8	36.4	21.7	32.5	35.4	26.4	41.0	30.8	41.8	42.5	48.7
Automotive	91.7	80.0	79.4	62.3	30.0	25.8	28.7	6.0	27.8	19.4	31.9	26.7	30.4	29.3
<b>Total industrial production</b>	<b>23.9</b>	<b>12.8</b>	<b>17.6</b>	<b>21.4</b>	<b>16.9</b>	<b>14.9</b>	<b>10.0</b>	<b>8.8</b>	<b>10.8</b>	<b>10.4</b>	<b>9.9</b>	<b>9.4</b>	<b>16.7</b>	<b>18.9</b>
Intermediate goods	33.5	15.7	21.3	29.1	22.4	22.8	13.2	12.1	10.2	12.0	9.2	14.0	23.8	22.2
Durable consumer goods	22.7	31.6	25.9	24.2	21.0	12.0	0.3	8.8	7.1	4.5	21.7	12.8	7.3	15.3
Non-durable consumer goods	22.2	4.4	13.5	13.0	9.9	6.4	2.0	5.1	6.5	4.5	3.6	-1.1	5.2	10.8
Energy	11.0	0.3	1.7	5.4	5.6	6.1	6.2	5.5	12.6	9.6	5.3	6.1	8.7	13.0
Capital goods	21.4	38.2	34.8	35.9	26.6	20.5	25.0	10.4	22.7	20.3	25.5	23.0	33.5	34.9
<b>Total industrial production<sup>a</sup></b>	<b>-2.5</b>	<b>1.2</b>	<b>2.1</b>	<b>1.1</b>	<b>1.2</b>	<b>2.9</b>	<b>-2.7</b>	<b>0.4</b>	<b>2.9</b>	<b>-0.6</b>	<b>3.9</b>	<b>-1.0</b>	<b>5.5</b>	<b>0.5</b>

<sup>a</sup> Seasonally and calendar adjusted; % change month on month.

Source: Turkish Statistical Institute (Turkstat).

### Consumer price inflation bottomed at 4.2% in February

Consumer prices rose by 0.7% month on month in February 2011. As in January, food prices rose for seasonal reasons, albeit by a relatively modest 2.5% month on month. In addition, public transport fares and the prices of transport fuels and durable goods continued to pick up owing to rising global oil prices and the recent weakness of the lira. Clothing prices went on declining owing to winter sales. Year on year, consumer price inflation slowed for the fifth consecutive month, falling to a fresh 41-year low of 4.2%. However, this rate is expected to rise again from March onwards in view of a less favourable baseline in 2010 and the continuing impact of higher global commodity prices and the weakened lira. The official annual inflation target for end-2011 is 5.5%, with a tolerance band of  $\pm 2$  percentage points.

**Inflation**

(% change year on year, unless otherwise indicated)

	2010											2011	
	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb
<b>Consumer prices (2003=100)</b>	<b>10.1</b>	<b>9.6</b>	<b>10.2</b>	<b>9.1</b>	<b>8.4</b>	<b>7.6</b>	<b>8.3</b>	<b>9.2</b>	<b>8.6</b>	<b>7.3</b>	<b>6.4</b>	<b>4.9</b>	<b>4.2</b>
% change month on month	1.5	0.6	0.6	-0.4	-0.6	-0.5	0.4	1.2	1.8	0.0	-0.3	0.4	0.7
Food & non-alcoholic beverages	14.8	11.2	11.8	6.7	5.6	5.5	10.4	15.3	17.1	12.4	7.0	7.1	4.5
% change month on month	8.0	0.6	0.1	-4.4	-2.5	-0.7	3.0	4.7	4.5	-1.9	-2.7	1.6	2.5
Clothing & footwear	3.8	4.6	4.1	3.8	5.0	5.9	6.3	5.1	4.3	3.7	4.7	5.2	5.3
% change month on month	-5.3	0.4	10.6	11.2	0.4	-5.2	-4.8	-2.2	7.6	3.9	-1.8	-7.8	-5.2
Housing, water, electricity, gas & other fuels	4.6	4.9	6.1	8.6	8.4	8.3	7.7	7.4	5.3	5.2	5.9	4.9	4.4
% change month on month	0.4	0.2	0.1	0.4	0.5	0.3	0.1	0.3	0.2	0.6	1.2	0.6	-0.1
Household goods	-0.8	0.2	3.2	3.6	4.0	3.7	3.5	3.8	1.2	8.6	3.3	3.6	4.7
% change month on month	-0.1	-0.5	0.7	0.1	0.4	0.6	0.0	0.5	-0.1	0.6	0.3	1.0	0.9
Transportation	9.7	12.7	14.7	13.8	10.2	10.1	8.1	8.0	6.2	5.4	6.8	4.6	6.0
% change month on month	0.4	0.7	0.1	0.0	-0.4	0.5	-0.2	0.1	0.4	0.5	1.1	1.4	1.8
<b>Producer prices (1997=100)</b>	<b>6.8</b>	<b>8.6</b>	<b>10.4</b>	<b>9.2</b>	<b>7.6</b>	<b>8.2</b>	<b>9.0</b>	<b>8.9</b>	<b>9.9</b>	<b>8.2</b>	<b>8.9</b>	<b>10.8</b>	<b>10.9</b>
% change month on month	1.7	1.9	2.4	-1.2	-0.5	-0.2	1.2	0.5	1.2	-0.3	1.3	2.4	1.7

Source: Turkstat.

**Financial market volatility continues in March**

Turkish financial markets have remained quite volatile, reflecting the effects of domestic and external factors. The lira, which has depreciated following the Central Bank's shift in monetary policy in November, fluctuated around TL1.60US\$1 and TL2.20:€1 in the first half of March compared with strong points of TL1.39:US\$1 and TL1.94:€1 in early November 2010, when the lira was very strong by historical standards. Concerns about Turkey's large foreign trade deficit, rising oil prices related to developments in the Arab world and heavy dependence on short-term capital flows to meet external financing requirements are likely to keep the lira under pressure in the coming months.

After hovering at around 64,000-65,000 points for several weeks, the main Istanbul Stock Exchange share price index plummeted in late February to close as low as 58,664 on March 2nd. At 64,214 on March 15th, it was still well below the peak of 71,548 recorded on November 9th 2010. Turkish share price movements often correspond closely to global economic prospects and the performance of major markets. In recent months, however, investors have been concerned that reserve requirement hikes will lead to substantially lower bank profits. There were also concerns that listed banks would have to pay heavy fines following a Competition Board enquiry into an alleged gentlemen's agreement over the premiums to be offered to large employers in return for payroll business. In the event, the fines imposed were lower than expected. More recent comments by Central Bank governor Durmus Yilmaz and BRSA chairman, Tevfik Bilgin, that credit growth had slowed were taken as an indication that the Central Bank would not rush to raise reserve requirements further, helping to lift banking stocks.

The yield on the most-traded government bond maturing in November 2012, which serves as the benchmark, rose from about 8.3% in the third week of February 2011 to test 9% in the first week of March before retreating to 8.8-8.9% on March 11th. The benchmark bond yield fell below 7% in early January, as the Central Bank reduced its main policy rate. More recently, however, the

continuing weakness of the lira and higher oil prices have raised concerns about upward inflationary pressures, making further Central Bank rate cuts unlikely. The rise in secondary market bond yields has been reflected in interest rates on fresh government borrowing. At its most recent auction for 21-month bonds on March 8th, the Treasury agreed to pay an average yield of 9% compared with 8.1% on February 1st and 7% on January 10th.

### Balance of payments

(US\$ m unless otherwise indicated)

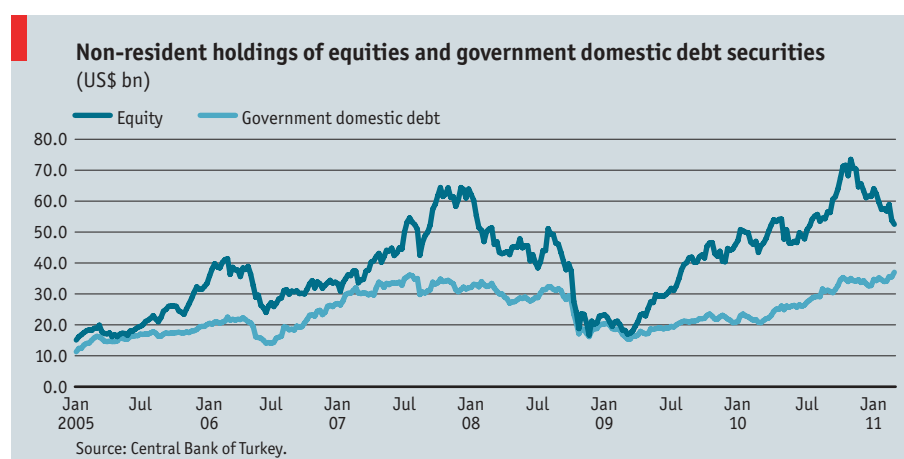
	2008 Year	2009 Year	2010 Year	2010 Jan	2011 Jan
<b>Current-account balance</b>	<b>-41,959</b>	<b>-13,991</b>	<b>-48,561</b>	<b>-3,062</b>	<b>-5,860</b>
Foreign trade balance (fob-fob)	-53,021	-24,850	-56,354	-2,809	-5,888
Services balance	17,311	16,749	14,245	272	338
Incomes balance	-8,362	-8,189	-7,816	-617	-575
Current transfers balance	2,113	2,299	1,364	92	265
<b>Capital account excluding reserves</b>	<b>36,199</b>	<b>9,036</b>	<b>57,344</b>	<b>2,023</b>	<b>3,072</b>
Change in reserve assets <sup>a</sup>	1,057	-111	-12,799	-744	-863
Net errors & omissions	4,703	5,066	4,016	1,783	3,651

<sup>a</sup> Negative indicates an increase.

Source: Central Bank of Turkey.

### Current-account deficit is still worryingly large in January

Concern persists about the potential for currency, macroeconomic and financial instability if global risk aversion rises and Turkey becomes unable to finance its growing current-account deficit. The deficit reached US\$48.6bn, or 6.7% of estimated GDP, in 2010, as strong domestic demand, a strong currency during most of the year and high global commodity prices inflated the import bill. Although the lira has lost value since November, and the Central Bank has been trying to control the growth of credit, the current-account deficit continued to widen in January 2011 compared with the same month of 2010. The deficit for January was the third-largest monthly deficit on record (after November and December 2010) and raised the rolling 12-month deficit above US\$50bn for the first time. The merchandise trade gap has accounted for most of the current-account deficit. In January, it was US\$3.1bn more than a year earlier as import growth far outpaced solid export growth.



The current-account deficit was amply offset by strong capital inflows in 2010. In January 2011, net capital inflows (excluding official reserves) remained positive at US\$3.1bn, according to the balance-of-payments data. The level of capital inflows recorded in January was nevertheless lower than in the preceding months, possibly reflecting, in part, the impact on financial sentiment of shifts in global expectations and political uncertainty in North Africa and the Middle East, but the figure for net errors and omissions, which includes inflows which could not be classified, was high, resulting in an increase in official foreign-exchange reserves of US\$863m.

According to weekly Central Bank data, the official gross foreign-exchange reserves, which are sensitive to exchange-rate movements as well as balance-of-payments developments, rose from US\$80.7bn at end-2010 to US\$82.3bn at the end of January 2011 and US\$83.4bn in the first week of March.

# Data and charts

## Annual data and forecast

	2006 <sup>a</sup>	2007 <sup>a</sup>	2008 <sup>a</sup>	2009 <sup>a</sup>	2010 <sup>b</sup>	2011 <sup>c</sup>	2012 <sup>c</sup>
<b>GDP</b>							
Nominal GDP (US\$ m)	530,917	647,140	730,325	614,619	722,425	753,298	837,814
Nominal GDP (TL m)	758,391	843,178	950,534	952,635	1,085,693	1,203,475	1,351,449
Real GDP growth (%)	6.9	4.7	0.7	-4.7	8.1	4.9	5.0
<b>Expenditure on GDP (% real change)</b>							
Private consumption	4.6	5.5	-0.3	-2.2	7.0	5.0	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	16.0	9.5
Exports of goods & services	6.6	7.3	2.7	-5.3	1.9	2.4	5.4
Imports of goods & services	6.9	10.7	-4.1	-14.3	18.2	12.3	8.8
<b>Origin of GDP (% real change)</b>							
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	9.9	5.5	6.4
<b>Population and income</b>							
Population (m)	70.4	71.2	71.9	72.6	73.3	74.0	74.7
GDP per head (US\$ at PPP)	11,714 <sup>b</sup>	12,490 <sup>b</sup>	12,716 <sup>b</sup>	12,109 <sup>b</sup>	13,141	13,932	14,902
Recorded unemployment (av; %)	10.3	10.3	11.0	14.1	12.0 <sup>a</sup>	11.8	11.3
<b>Fiscal indicators (% of GDP)</b>							
Central government revenue	22.9	22.6	22.1	22.6	23.4	23.3	23.4
Central government expenditure	23.5	24.2	23.9	28.2	27.0	26.2	26.0
Central government balance	-0.6	-1.6	-1.8	-5.5	-3.6	-2.9	-2.6
Gross public debt	45.5	39.6	40.0	46.3	43.6	42.0	40.0
<b>Prices and financial indicators</b>							
Exchange rate TL:US\$ (end-period)	1.409	1.171	1.526	1.491	1.541 <sup>a</sup>	1.605	1.621
Exchange rate TL:€ (end-period)	1.859	1.710	2.121	2.137	2.093 <sup>a</sup>	2.023	1.977
Consumer prices (end-period; %)	9.7	8.4	10.1	6.5	6.4 <sup>a</sup>	7.4	6.3
Stock of money M1 (% change)	10.7	20.1	14.5	17.1	28.9 <sup>a</sup>	10.8	12.3
Lending interest rate (av; %)	28.0 <sup>b</sup>	27.0 <sup>b</sup>	26.5 <sup>b</sup>	21.0 <sup>b</sup>	19.0	16.0	17.0
<b>Current account (US\$ m)</b>							
Trade balance	-41,059	-46,795	-53,021	-24,893	-56,354 <sup>d</sup>	-62,126	-61,548
Goods: exports fob	93,610	115,361	140,800	109,647	120,923 <sup>d</sup>	129,995	138,436
Goods: imports fob	-134,669	-162,156	-193,821	-134,540	-177,277 <sup>d</sup>	-192,120	-199,984
Services balance	13,610	13,344	17,121	16,305	14,245 <sup>d</sup>	14,386	15,345
Income balance	-6,656	-7,103	-8,159	-8,121	-7,816 <sup>d</sup>	-4,609	-5,489
Current transfers balance	1,908	2,243	2,113	2,299	1,364 <sup>d</sup>	1,422	1,582
Current-account balance	-32,197	-38,311	-41,946	-14,410	-48,561 <sup>d</sup>	-50,927	-50,110
<b>External debt (US\$ m)</b>							
Debt stock	206,833	249,181	277,277	268,281 <sup>be</sup>	292,716	302,713	302,594
Debt service paid	40,170	47,848	54,422	67,224 <sup>b</sup>	58,308	54,828	65,217
Principal repayments	30,505	35,966	41,368	58,467 <sup>b</sup>	50,054	45,294	54,580
Interest	9,665	11,882	13,054	8,758 <sup>b</sup>	8,254	9,534	10,637
<b>International reserves (US\$ m)</b>							
Total international reserves	63,265	76,507	73,657	74,995	86,080 <sup>a</sup>	85,589	83,772

<sup>a</sup> Actual. <sup>b</sup> Economist Intelligence Unit estimates. <sup>c</sup> Economist Intelligence Unit forecasts. <sup>d</sup> Based on Central Bank of Turkey full-year data. <sup>e</sup> Based on full-year Treasury data.

Source: IMF, *International Financial Statistics*.

## Quarterly data

	2009				2010			
	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr
<b>General government finance (TL m)</b>								
Revenue	45,627	53,309	53,674	56,872	54,816	62,571	64,993	64,537
Expenditure	65,949	56,419	70,857	68,888	67,126	66,040	71,106	83,360
Balance	-20,322	-3,110	-17,183	-12,015	-12,310	-3,469	-6,113	-18,823
<b>Output</b>								
Real GDP at constant 1998 prices (TL m)	20,884.7	23,297.7	27,265.3	25,696.0	23,357.5	25,679.1	28,762.1	n/a
Real GDP at constant 1998 prices (% change, year on year)	-14.6	-7.6	-2.7	6.0	11.8	10.2	5.5	n/a
Industrial production index (2005=100) <sup>a</sup>	96.5	100.4	103.4	110.8	113.1	114.4	113.7	124.0
Industrial production index (% change, year on year)	-21.3	-15.3	-8.7	8.1	17.2	13.9	10.0	11.8
Manufacturing production index (2005=100) <sup>a</sup>	92.3	97.6	100.8	108.3	110.7	112.2	111.2	122.7
Mining production index (2005=100)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
<b>Employment, wages and prices</b>								
Employment ('000)	3,886	3,837	3,989	4,111	n/a	n/a	n/a	n/a
Employment (% change, year on year)	-7.7	-9.7	-7.3	-1.3	n/a	n/a	n/a	n/a
Unemployment rate (%)	16.1	13.6	13.4	13.1	14.4	11.0	11.4	11.0
Hourly earnings, manufacturing (2000=100) <sup>b</sup>	145	146	151	156	158	161	169	174
Consumer prices (2003=100)	161.1	162.9	163.7	169.6	176.1	177.9	177.4	182.2
Consumer prices (% change, year on year)	8.4	5.7	5.3	5.7	9.3	9.2	8.4	7.4
Producer prices (2003=100)	158.0	160.4	161.0	164.1	169.5	175.0	175.1	178.9
Producer prices (% change, year on year)	5.9	-1.6	-1.5	2.5	7.2	9.1	8.7	9.0
<b>Financial indicators</b>								
Exchange rate TL:US\$ (av)	1.654	1.566	1.495	1.485	1.506	1.535	1.512	1.458
Exchange rate TL:US\$ (end-period)	1.672	1.528	1.481	1.491	1.519	1.578	1.447	1.541
Deposit rate (av; %)	19.3	18.0	17.1	16.2	15.9	15.9	15.8	13.5
Interbank money market rate (av; %)	12.6	9.6	8.0	6.7	6.5	6.5	6.5	3.8
M1 (end-period; TL m)	59,802	61,263	66,121	69,660	71,388	79,104	85,115	89,809
M1 (% change, year on year)	15.6	13.4	16.2	17.1	19.4	29.1	28.7	28.9
M2 (end-period; TL m)	283,905	285,361	295,721	313,431	331,601	355,732	366,341	389,905
M2 (% change, year on year)	20.9	18.0	15.7	11.0	16.8	24.7	23.9	24.4
ISE National-100 index (end-period; Jan 1986=1)	25,764	36,949	47,910	52,825	56,538	54,839	65,774	66,004
Stockmarket index (% change, year on year)	-48.0	5.3	32.9	96.6	119.4	48.4	37.3	24.9
<b>Sectoral trends</b>								
Crude steel production ('000 tonnes)	5,644	6,294	6,761	6,606	6,074	7,423	n/a	n/a
Cement production ('000 tonnes)	10,764	15,883	14,803	13,649	11,849	17,321	n/a	n/a
Car production ('000)	123	224	195	211	219	236	n/a	n/a
<b>Foreign trade (US\$ m)</b>								
Exports fob	24,474	23,238	25,377	29,054	25,981	28,727	26,997	32,196
Imports cif	-28,878	-33,489	-38,152	-40,410	-38,490	-44,894	-47,134	-54,978
Trade balance	-4,404	-10,251	-12,775	-11,356	-12,509	-16,167	-20,137	-22,782
<b>Foreign payments (US\$ m)</b>								
Merchandise trade balance fob-fob	-1,255	-6,809	-9,405	-7,381	-8,845	-12,139	-16,630	-18,740
Services & income balance <sup>c</sup>	-1,146	970	6,916	1,820	-1,487	985	5,666	1,265
Net transfer payments	456	465	484	894	270	278	369	447
Current-account balance	-1,945	-5,374	-2,005	-4,667	-10,062	-10,876	-10,595	-17,028
Reserves excl gold (end-period)	67,418	66,106	71,103	70,874	69,411	71,216	77,782	80,713

<sup>a</sup> Seasonally adjusted. <sup>b</sup> Gross earnings per production worker. <sup>c</sup> Including other goods.

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



## Monthly data

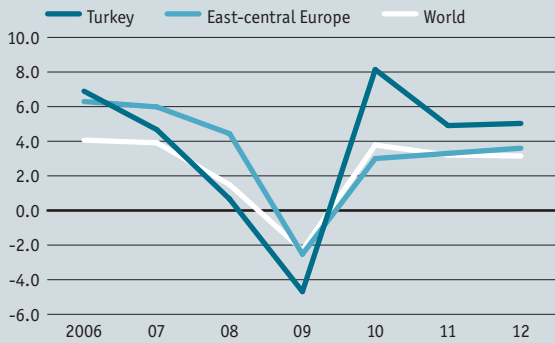
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
<b>Exchange rate TL:US\$ (av)</b>												
2009	1.595	1.659	1.707	1.602	1.554	1.542	1.517	1.483	1.487	1.468	1.484	1.502
2010	1.472	1.515	1.531	1.489	1.542	1.574	1.537	1.507	1.492	1.423	1.436	1.516
2011	1.561	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
<b>Exchange rate TL:€ (av)</b>												
2009	2.111	2.121	2.228	2.114	2.122	2.161	2.137	2.116	2.165	2.175	2.213	2.195
2010	2.101	2.073	2.077	1.996	1.937	1.922	1.963	1.943	1.949	1.978	1.962	2.005
2011	2.085	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
<b>M1 (end-period; % change, year on year)</b>												
2009	15.8	17.2	15.6	12.3	14.3	13.4	13.6	13.3	16.2	12.8	17.7	17.1
2010	21.9	21.0	19.4	21.8	26.6	29.1	30.4	31.3	28.7	29.6	34.7	28.9
2011	33.3	32.2	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
<b>M2 (end-period; % change, year on year)</b>												
2009	26.5	24.5	20.9	16.0	17.7	18.0	17.6	17.0	15.7	12.3	11.1	11.0
2010	12.8	14.3	16.8	19.1	22.4	24.7	25.1	24.4	23.9	22.7	24.2	24.4
2011	25.3	23.8	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
<b>Industrial production index (% change, year on year; seasonally adjusted; 2005=100)</b>												
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	12.6	7.5	15.2
2011	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
<b>Unemployment rate (%)</b>												
2009	15.5	16.1	15.8	14.9	13.6	13.0	12.8	13.4	13.4	13.0	13.1	13.5
2010	14.5	14.4	13.7	12.0	11.0	10.5	10.6	11.4	11.3	11.2	11.0	n/a
2011	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
<b>Deposit rate (av; %)</b>												
2009	21.2	18.5	18.3	18.0	18.0	18.0	17.4	17.1	16.9	16.2	16.1	16.2
2010	15.9	15.9	15.9	15.8	15.9	16.0	15.7	15.8	15.8	13.8	13.8	12.9
2011	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
<b>Money market rate (av; %)</b>												
2009	14.1	12.6	11.0	10.3	9.5	9.0	8.5	8.0	7.6	7.0	6.7	6.5
2010	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.4	6.0	3.8	1.6
2011	1.5	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
<b>ISE National-100 stockmarket index (end-period; Jan 1986=1.00)</b>												
2009	25,934	24,027	25,764	31,652	35,003	36,949	42,641	46,551	47,910	47,185	45,350	52,825
2010	54,651	49,705	56,538	58,959	54,385	54,839	59,867	59,973	65,774	60,404	65,351	66,004
2011	63,278	61,284	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
<b>Consumer prices (av; % change, year on year; 2003=100)</b>												
2009	9.5	7.7	7.9	6.1	5.2	5.7	5.4	5.3	5.3	5.1	5.5	6.5
2010	8.2	10.1	9.6	10.2	9.1	8.4	7.6	8.3	9.2	8.6	7.3	6.4
2011	4.9	4.2	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
<b>Producer prices (av; % change, year on year; 2003=100)</b>												
2009	7.9	6.4	3.5	-0.3	-2.5	-1.9	-3.8	-1.0	0.5	0.2	1.5	5.9
2010	6.3	6.8	8.6	10.4	9.2	7.6	8.2	9.0	8.9	9.9	8.2	8.9
2011	10.8	10.9	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
<b>Total exports fob (US\$ m)</b>												
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	7,831	8,263	9,887	9,396	9,795	9,536	9,571	8,519	8,907	10,962	9,386	11,848
2011	9,561	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
<b>Total imports cif (US\$ m)</b>												
2009	9,281	9,075	10,522	10,120	10,868	12,501	12,856	12,811	12,485	12,773	12,618	15,019
2010	11,691	11,779	15,020	14,941	14,724	15,229	16,063	15,431	15,640	17,294	17,130	20,554
2011	16,873	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
<b>Trade balance fob-cif (US\$ m)</b>												
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	-3,860	-3,516	-5,133	-5,545	-4,929	-5,693	-6,492	-6,912	-6,733	-6,332	-7,744	-8,706
2011	-7,312	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
<b>Foreign-exchange reserves excl gold (US\$ m)</b>												
2009	67,152	67,289	67,418	64,456	67,966	66,106	67,142	70,195	71,103	71,372	71,394	70,874
2010	70,630	67,906	69,411	73,167	72,290	71,216	74,088	76,455	77,782	79,244	79,094	80,713
2011	82,901	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

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

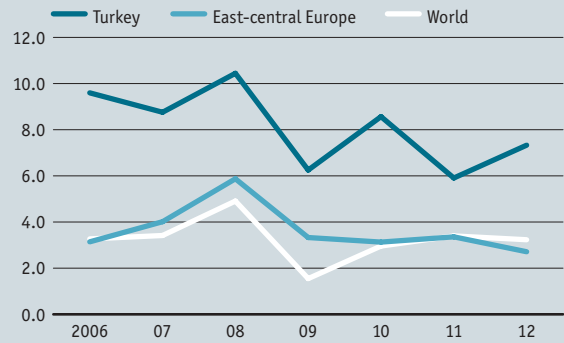
### Annual trends charts

**Real GDP growth**  
(% change)



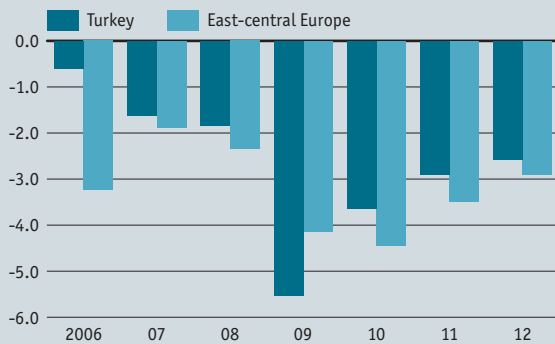
Source: Economist Intelligence Unit.

**Consumer price inflation**  
(av; %)



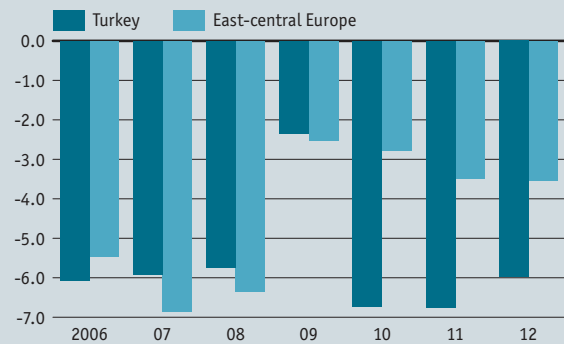
Source: Economist Intelligence Unit.

**Budget balance**  
(% of GDP)



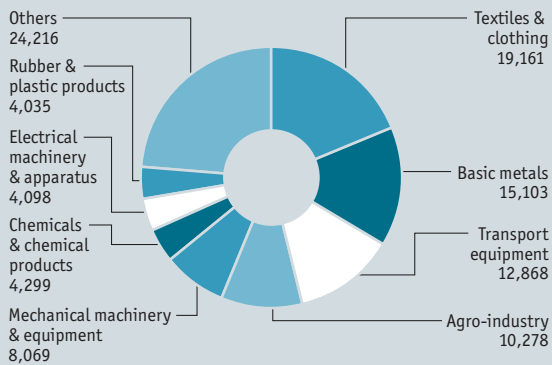
Source: Economist Intelligence Unit.

**Current-account balance**  
(% of GDP)



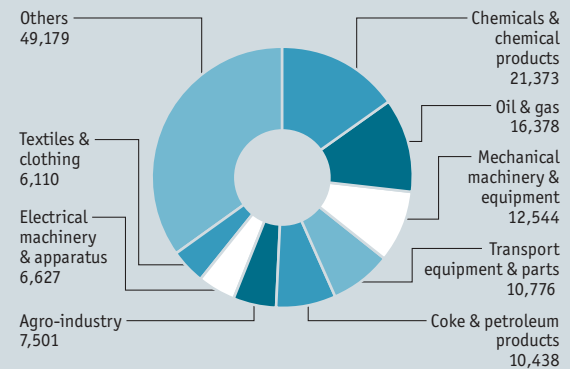
Source: Economist Intelligence Unit.

**Principal exports, 2009**  
(US\$ m)



Source: Economist Intelligence Unit.

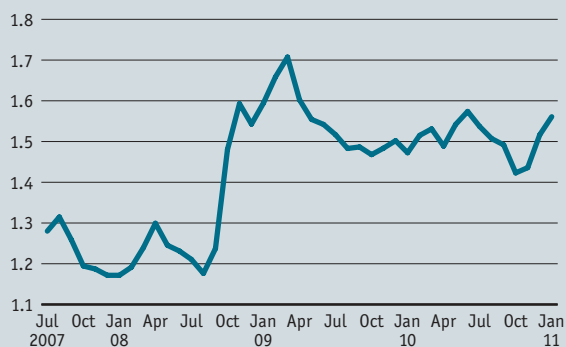
**Principal imports, 2009**  
(US\$ m)



Source: Economist Intelligence Unit.

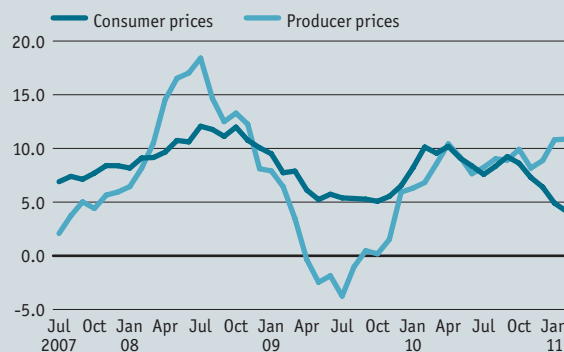
## Monthly trends charts

**Exchange rate**  
(TL:US\$; av)



Source: Economist Intelligence Unit.

**Price inflation**  
(% change, year on year)



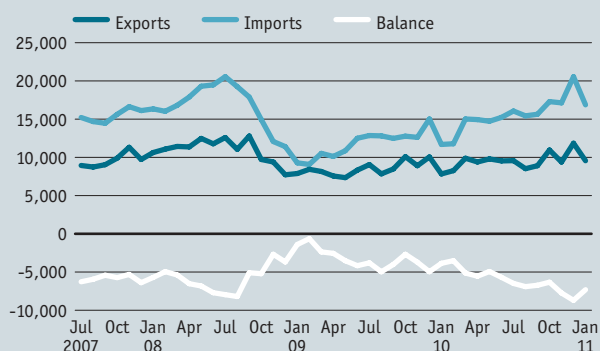
Source: Economist Intelligence Unit.

**Index of industrial activity**  
(av; 1996=100)



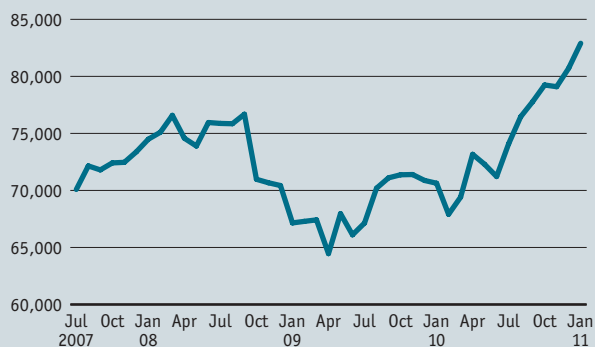
Source: Economist Intelligence Unit.

**Foreign trade**  
(US\$ m; goods only)



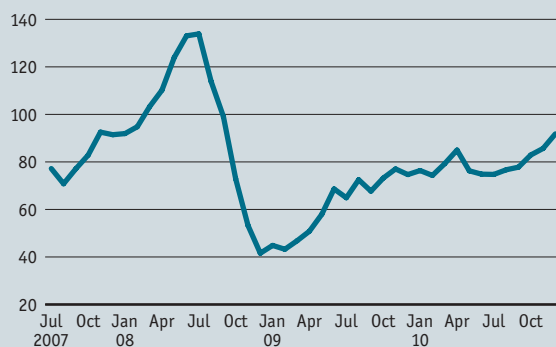
Source: Economist Intelligence Unit.

**Foreign-exchange reserves**  
(US\$ m)



Source: Economist Intelligence Unit.

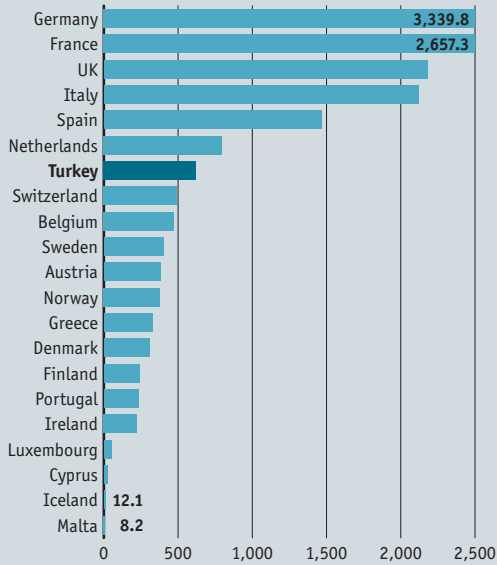
**Oil: Brent crude price**  
(US\$/b; av)



Source: Economist Intelligence Unit.

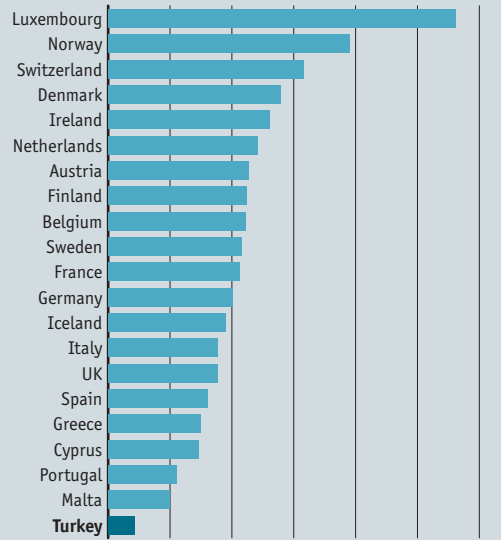
### Comparative economic indicators, 2009

**Gross domestic product**  
(US\$ bn; market exchange rates)



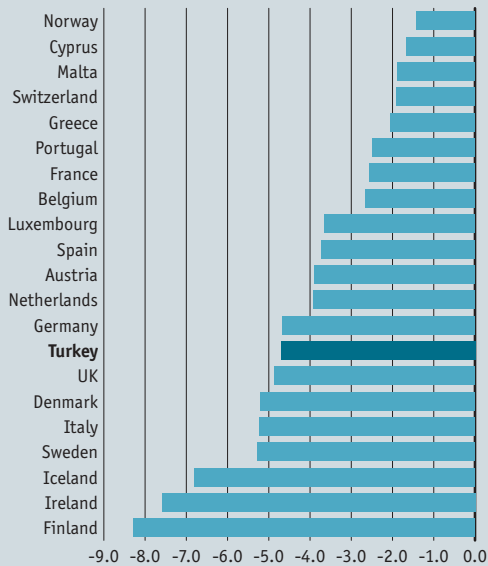
Sources: Economist Intelligence Unit estimates; national sources.

**Gross domestic product per head**  
(US\$ '000; market exchange rates)



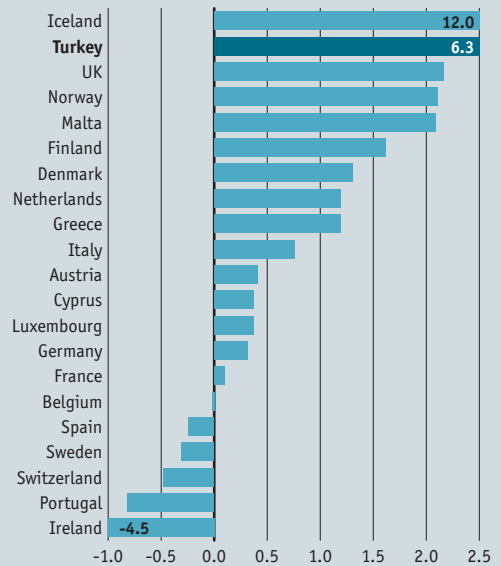
Sources: Economist Intelligence Unit estimates; national sources.

**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

<b>Land area</b>	783,562 sq km (including lakes and islands), of which 30% arable, 3% orchards, olive groves and vineyards, 26% classified as forest
<b>Population</b>	71,158,000 (mid-year estimate, US Census Bureau)
<b>Main towns</b>	Population (2007 census)
	Istanbul 11,174,257
	Ankara (capital) 4,140,890
	Izmir 3,175,133
	Bursa 1,979,999
	Adana 1,611,262
<b>Climate</b>	Mediterranean on the south coast, continental inland
<b>Weather in Ankara (altitude 861 metres)</b>	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
<b>Language</b>	Turkish
<b>Measures</b>	Metric system
<b>Currency</b>	Turkish lira
<b>Time</b>	2 hours ahead of GMT; 3 hours ahead in summer
<b>Fiscal year</b>	Calendar year
<b>Public holidays</b>	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 29 <sup>th</sup>

## Political structure

<b>Official name</b>	Republic of Turkey	
<b>Form of state</b>	Parliamentary republic	
<b>Legal system</b>	Based on European models and constitution of 1982	
<b>National legislature</b>	Unicameral Meclis (parliament) of 550 members directly elected for a four-year term	
<b>Electoral system</b>	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	
<b>National elections</b>	July 22nd 2007; next election by July 2011 (June 12th is the expected date)	
<b>Head of state</b>	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	
<b>National government</b>	The present government is formed by the Justice and Development Party (AKP)	
<b>Main political parties</b>	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	
<b>Council of Ministers</b>	<b>Prime minister</b>	Recep Tayyip Erdogan
	<b>Deputy prime ministers &amp; ministers of state</b>	Bulent Arinc Ali Babacan (Economy) Cemil Cicek
<b>Ministers of state</b>	Mehmet Aydin Egemen Bagis Hayati Yazici Faruk Nafiz Ozak	Mehmet Zafer Caglayan Faruk Celik Cevdet Yilmaz Selma Aliye Kavaf
<b>Key ministers</b>	<b>Agriculture &amp; rural affairs</b>	Mehmet Mehdi Eker
	<b>Culture &amp; tourism</b>	Ertugrul Gunay
	<b>Defence</b>	Vecdi Gonul
	<b>Education</b>	Nimet Cubukcu
	<b>Employment &amp; social security</b>	Omer Dincer
	<b>Energy &amp; natural resources</b>	Taner Yildiz
	<b>Environment &amp; forestry</b>	Veysel Eroglu
	<b>Finance</b>	Mehmet Simsek
	<b>Foreign affairs</b>	Ahmet Davutoglu
	<b>Health</b>	Recep Akdag
	<b>Interior</b>	Besir Atalay
	<b>Justice</b>	Sadullah Ergin
	<b>Public works &amp; housing</b>	Mustafa Demir
	<b>Tourism &amp; culture</b>	Ertugrul Gunay
	<b>Trade &amp; industry</b>	Nihat Ergun
	<b>Transport</b>	Binali Yildirim
<b>Central Bank governor</b>	Durmus Yilmaz	