noted that banks appear well-positioned for the introduction of Basel III, ahead of schedule. Directors encouraged continued vigilance and a broadening of macro-prudential tools to mitigate risks to banks' balance sheets. They looked forward to swift action to address deficiencies in the AML/CFT legal framework.

Directors observed that the savings rate had fallen significantly over the past decade. While welcoming the recent reform of private pensions, they noted that fiscal policy also has an important role to play. Most Directors were of the view that a significant increase in the primary surplus could raise national savings, thus reducing the country's vulnerabilities to volatile capital flows and boom-bust cycles.

Directors emphasized the need to improve competitiveness and the business climate. Efforts should continue to reduce the large informal sector, improve the functioning of the labor market, and streamline regulations in the product and service markets. Directors also encouraged steps to diversify energy sources and improve efficiency in energy production and distribution.

Turkey: Selected Economic Indicators, 2007–13

Population (2011): 74.7 million
Per capita GDP (2011): $10,362
Quota (2012): SDR 1,455.8 million

	2007	2008	2009	2010	2011	2012	2013 Proj.
				(Percent)			
Real sector							
Real GDP growth rate	4.7	0.7	-4.8	9.2	8.5	3.0	3.5
Private consumption growth rate	5.5	-0.3	-2.3	6.7	7.8	0.0	2.8
Private gross fixed investment growth rate	2.6	-9.0	-22.5	33.6	23.1	-2.3	2.9
Contributions to GDP growth							
Private domestic demand	5.0	-1.8	-8.3	12.6	9.7	-1.0	3.1
Public spending	0.8	0.6	0.8	0.9	0.3	0.5	0.6
Net exports	-1.2	1.9	2.7	-4.4	-1.5	3.5	-0.1
GDP deflator growth rate	6.2	12.0	5.3	5.7	8.9	6.2	7.9
Nominal GDP growth rate	11.2	12.7	0.2	15.4	18.1	9.3	11.7
CPI inflation (12-month; end-of period)	8.4	10.1	6.5	6.4	10.4	7.5	6.2
PPI inflation (12-month; end-of-period)	5.9	8.1	5.9	8.9	13.3	3.2	6.2
Unemployment rate	10.3	11.0	14.1	12.0	9.8	...	...
Average nominal treasury bill interest rate	18.1	19.3	11.4	8.4	9.1	...	...
Average ex-ante real interest rate	6.9	12.2	2.6	1.8	1.1	...	...
				(Percent of GDP)			
Nonfinancial public sector							
Primary balance	3.2	1.6	-1.0	0.8	2.0	0.1	0.4
Net interest payments	4.9	4.4	4.6	3.7	2.6	3.0	2.9
Overall balance	-1.8	-2.8	-5.6	-2.9	-0.6	-2.8	-2.5
General government structural primary balance 1/	0.8	0.5	2.5	1.3	-0.6	-1.1	-0.7
Debt of the public sector							
General government gross debt (EU definition)	39.9	40.0	46.1	42.4	39.3	38.5	36.9
Nonfinancial public sector net debt	34.4	34.5	39.5	36.8	33.4	32.3	31.4
External sector							
Current account balance	-5.9	-5.7	-2.2	-6.4	-10.0	-7.5	-7.2
Nonfuel current account balance	-1.5	-0.1	2.1	-2.0	-3.8	-1.4	-1.3
Gross financing requirement	17.6	17.1	18.6	19.3	25.1	23.0	25.9
Foreign direct investment (net)	3.1	2.3	1.1	1.0	1.7	1.8	2.1
Gross external debt 2/	38.4	38.4	43.7	39.7	39.6	45.0	45.7
Net external debt	21.0	21.5	24.7	24.1	24.2	27.5	29.7
Short-term external debt (by remaining maturity)	11.7	16.0	15.2	16.7	17.9	20.4	20.3
Monetary aggregates							
Nominal growth of M2 broad money (percent)	15.7	26.7	13.0	19.1	14.8	...	...
GDP (billions of U.S. dollars) 3/	649	730	614	731	774	...	...
GDP (billions of Turkish lira)	843	951	953	1,099	1,298	1,419	1,585

Sources: Turkish authorities; and IMF staff estimates and projections.
1/ The structural balance is estimated using the absorption gap method and excludes one-off operations.
2/ The external debt ratio is calculated by dividing external debt numbers in U.S. dollars based on official Treasury figures by GDP in U.S. dollars calculated by staff using the average exchange rate (consolidated from daily data published by the CBRT).
3/ GDP in U.S. dollars is derived using the average exchange rate (consolidated from daily data published by the CBRT).

Statement by Mr. Prader and Mr. Yalvac on Turkey - 2012 Article IV Consultation
November 16, 2012

We thank staff for the comprehensive set of papers. Our authorities appreciate the dialogue with staff.

After the strong growth performance in 2010 and 2011, the authorities targeted a rebalancing of the economy in 2012. With prudent monetary, fiscal and macro prudential policies, Turkey has managed to slow down the economy and reduce imbalances without risking the favorable medium term outlook. In addition to the positive reaction in the equity markets, CDS levels and spreads, the latest rating upgrade by Fitch to investment grade reflects the authorities' success in rebalancing the economy.

As an important policy anchor, the Medium-Term Program (MTP) for the period 2013—2015 was announced on October 9, 2012. The program was prepared under a gloomy global economic and financial outlook despite all the commendable measures taken by the major key players in the world economy. The authorities have continued their cautious stance for this program period, taking the downside risks for the global economy into consideration.

The MTP aims at gradually converging to potential output growth, further reducing the current account deficit, achieving inflation targets, maintaining a strong fiscal balance, and strengthening financial stability. In addition to the favorable fiscal position, a strong financial sector, household and corporate sector balance sheets will be critical to achieve the targets put forward in the MTP.

Growth Outlook

Following the high growth of 9.2 percent in 2010 and 8.5 percent in 2011, the authorities decided on a policy induced economic slowdown to contain the imbalances which could jeopardize macroeconomic and financial stability. Since strong private sector consumption and the appreciation of the Turkish Lira (TL) were the underlying reasons for imbalances, the authorities designed a framework that would curb private credit growth and reverse the real appreciation trend of the TL. However, the weaker than expected global growth outlook and higher than forecasted energy prices have negatively affected the planned growth path. The Turkish economy is expected to grow by 3.2 percent in 2012. Towards the end of the MTP period, the economy is expected to gradually reach the medium-term growth target of 5 percent, which is higher than staff's estimates.

The economy has adequate resources to reach the targeted growth levels. Since 2009, 4.2 million jobs have been created and the unemployment rate has declined to its lowest level in the last decade. The young population with positive employment prospects and a strong banking sector will be critical for achieving sustainable growth targets in the medium term. Additionally, a favorable fiscal stance in terms of a low debt-to-GDP ratio and budget deficit is important to eliminate the bottlenecks in infrastructure, human capital and public administration.

Monetary Policy

Faced with excessive cross-border capital inflows, rapid credit growth, and a deterioration in the current account deficit in the second half of 2010, the Central Bank has enhanced the conventional inflation targeting regime. They adopted financial stability as a complementary objective and added a set of policy instruments with a particular emphasis on credit growth. Accordingly, since the end of 2010, the Central Bank has been implementing a new framework supported by a mix of credit, liquidity and interest rate policies.

The new framework has supported a healthier outlook in the composition of growth as well as improvements in the current account balance. The annual rate of credit growth has declined from 35 percent to around 14 percent. The current account deficit to GDP ratio is expected to come down from 10 percent in 2011 to 7.3 percent at the end of 2012. More importantly, this adjustment has been achieved without a contraction in the aggregate demand, thanks to a marked improvement in the contribution of net exports. Despite the slower growth in the Euro area, exports have increased with the support of a successful market and product diversification.

Although the adjustments in energy prices in September have led to a revision of headline inflation forecasts for end-2012 from 6.2 percent to 7.4 percent, inflation has recently been on a declining trend. Core inflation has been easing since the beginning of the year and is expected at around 6 percent at the end of the year. The risks are on the downside due to the favorable outlook of unprocessed food prices. Moreover, existing output gap and the tapering-off of last year's exchange rate pass- through effects are expected to bring inflation down to the target of around 5 percent at the end of 2013.

So far, the new policy framework has been successful in rebalancing the economy without hampering the price stability objective. Moreover, exchange rate volatility in Turkey has been lower than in peer emerging economies with current account deficits. Overall, the last two years have illustrated well the importance of establishing a flexible policy framework with a broad range of instruments in order to cope with the variety of shocks arising from global factors. The asymmetric interest rate corridor and the reserve option mechanism, which are important tools developed by the Central Bank, are likely to support the flexibility of the policy framework going ahead. Should the new framework continue to function well, it could be a good alternative to the standard inflation-targeting framework with sterilized interventions under a floating exchange rate regime. Nevertheless, the authorities are thankful for staff's valuable contribution to the policy discussion and they will closely follow the developments under the new framework.