



**TURKEY**  
**Country Partnership Strategy**  
**2013-2014**

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## I. Basic Macroeconomic Indicators

**Table 1: Basic Macro-economic Indicators**

<b>Key Indicators: Turkey 2008-2012</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012*</b>
Population (mid-year; mln)	71.1	72.1	73.0	73.9	75.6
Average exchange rate (Turkish Lira, TL/ USD)	1.29	1.55	1.50	1.67	1.79
Inflation rate (CPI average; %)	10.4	6.3	8.5	6.4	8.7
GDP at current prices (local cur., bln)	951	953	1,098	1,298	1,435
GDP at current prices (USD bln)	742	617	731	774	799
GDP / capita (in cur. prices; USD)	10,438	8,559	10,067	10,469	10,582
Real GDP growth (%)	0.7	-4.7	9.2	8.5	3.2
Unemployment rate (ILO definition; eop; %)	11.0	14.0	11.9	9.8	9.0
Direct foreign investment (USD bln)	19.8	8.7	9.0	16.0	12.4
Central Gov. Budget balance /GDP (%)	-1.8	-5.5	-3.6	-1.4	-2.0
EU Defined Gen. Government Debt/GDP (%)	40.0	46.1	42.4	39.2	36.5
Export (fob, USD bln)	132	102.1	113.9	134.9	152.6
Import (fob, USD bln)	202	140.9	185.5	240.8	236.5
Trade balance (exp. fob. - imp.fob.; USD bln)	-69.9	-38.8	-71.7	-105.9	-84
Current account balance (USD bln)	-41.5	-13.5	-46.9	-77.2	-48.9
Current account / GDP (%)	-5.6	-2.2	-6.4	-10.0	-6.1
Official reserves (incl. gold; eop; USD bln)	74	74.8	86.1	88.2	120.2

\*Estimate

**Sources:**

- (1) Central Bank of Turkey
- (2) Turkish Statistical Institute
- (3) Undersecretariat of Treasury

## II. Economic Overview and Outlook

### Real Sector

The Turkish economy was performing above its potential growth rate before the global economic crisis started. Analysis of the period of 2002-2008 indicates that Turkish economic growth averaged at 6.8% during that period but came to a sudden halt in 2009. Even though the Turkish economy contracted hugely by 4.7% in 2009 as a result of the global economic crisis, it rebounded strongly as it expanded 12.4% y/y in Q1 2010 which was the highest growth rate achieved in OECD and second highest among G-20 countries.

After a Chinese-type strong growth performance in overall 2010 and 2011 with near 9% real economic growth, the Turkish economy has slowed down significantly in 2012. Turkish real GDP in Q3 2012 collapsed to the lowest annual growth recorded after the contraction ended back in Q3 2009 with 1.6% year-on-year (y/y). This compares to 3.4% y/y and 3.0% y/y respectively in Q1 and Q2 2012. As result, first nine-month growth came to 2.6% y/y. The overall year-end growth is likely to hover around 3% which is significantly below the annual average performance in the last decade.

An interesting aspect of this slowdown in the last two quarters of 2012 is that while the overall economy registered positive growth rates, domestic absorption was stealing from growth and net exports contributed positively. This is very uncharacteristic of the Turkish economy and is part of the normalization of the economy back to its long-run path.

The 2010 and 2011's high-flying real GDP growth rates were also quite uncharacteristic. The Turkish economy is estimated to require around 7% economic growth which is some 2pps above the long-run average performance in order to absorb nearly 1 million new labor market entrants every year and reduce the unemployment rate below the 9%-10% range where it was stuck since 2002. But according to the government's medium-term fiscal plan (MTP) for 2013–15, the economic performance will barely match the long-term performance which implies no improvement in the labor market front.

The country required major structural reforms to transform the economy in order to climb up the global competitiveness ladder and increase high value-added good production and export in the near future. To that end, an incentive package has been adopted in June 2012 to spur domestic and foreign investments.

The new incentives complement the existing incentive structure by encouraging additional capacity in the tradable sector, with a special emphasis on the least developed provinces. Priority sectors have been identified to receive stronger investment incentives in tourism, mining, rail and maritime transport, and pharmaceuticals. Other incentives target sectors that reduce Turkey's import dependence.

## External Sector

As a result of the strong domestic demand and successful export diversification in 2010-12, the exports and imports grew in double digits while imports outstripped exports to bring trade deficit to unprecedented high levels. Turkish exports surged by 11.5% y/y and 18.5% y/y respectively in 2010 and 2011 to reach a record USD 135 billion while imports burst by 31.7% y/y and 29.8% y/y respectively during the same period to hit another record of USD 241 billion.

The positive developments in the Euro area created both the external demand and the availability of funding for local banks in Turkey to make the economy experience its biggest trade deficit ever with USD 105.9 billion by the end of 2011.

During this period, the current account deficit also accelerated to be the second-highest in the world with USD 77 billion at the end 2011 while the 12-month rolling deficit had reached its peak in October 2011 with USD 78.7 billion. The current account deficit represented 10% of the GDP which forced authorities to expedite cooling down the economy.

The deterioration in the external sector sounded the alarm bells by mid-2011 when macroprudential measures, such as increases in risk weights and provisioning were implemented by the regulators. By the end of 2011, the Central Bank also supported the efforts and started to tighten monetary policy.

The rebalance efforts continued in 2012 when the government raised indirect taxes in several categories of imported consumer durables and introduced wide-ranging investment incentives aimed at import substitution in areas such as mining, chemicals and defense electronics that contribute to the trade deficit.

The efforts paid soon as the first positive results were observed in November 2011 when trade deficit saw its first annual contraction supported by major import slowdown. Likewise, current account deficit saw its first positive rebalancing results in late Q1 2012 albeit at a slow rate.

The rebalancing continued successfully every month throughout 2012 as trade deficit contracted around 20% y/y while the current account deficit fell close to 6% of GDP which is major improvement compared to 2011. The key macroeconomic vulnerability of the Turkish economy remains the current account deficit and its financing.

Turkey maintained its policy of the diversification of its trade partners over the past years. In 2012, the share of exports to MENA region rose to 34% in 2012 from 26% in 2011 while that of EU-27 declined to below 39% from 46% in 2011. On the other hand, Iran and Iraq became Turkey's second and third export destinations after Germany, although exports to Iran largely reflect exceptional gold exports.

In order to open new export markets, Turkey has signed a series of regional trade agreements, with Jordan, Chile, Mauritius, Lebanon, Russia, Syria and the Association of Southeast Asian Nations (ASEAN) during this period.

In the post-global crisis era, Turkey's trade with ETDB member states favored Iran more than Pakistan as seen in Table 2 and Table 3. The trade volume with Pakistan passed the USD 1 billion mark for the first time in 2011 but lost momentum quickly while trade volume of Turkey with Iran passed USD 20 billion for the first time supported by gold exports from Turkey.

**Table 2. Turkey-Pakistan Foreign Trade Figures (USD, Mln)**

	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
<b>Trade from Turkey to Pakistan</b>	157	155	163	248	214	276
<b>Trade from Pakistan to Turkey</b>	531	586	619	749	873	555

Source: Turkish Statistical Institute

**Table 3. Turkey-Iran Foreign Trade Figures (USD, Bln)**

	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
<b>Trade from Turkey to Iran</b>	1.4	2.0	2.0	3.0	3.6	9.9
<b>Trade from Iran to Turkey</b>	6.6	8.2	3.4	7.6	12.5	12.0

Source: Turkish Statistical Institute

Even though 2012 year-end projections of current account deficit are for around 6.0% of GDP which is a major improvement over 2011, the MTP foresees the ratio to remain at critical levels in the medium term which forces government to design and encourage ways to increase national savings.

Structural reforms are targeted on helping to boost domestic savings through supporting the private pension system. As a result, a combination of lower taxes for longer-term bank deposits and state contributions up to USD 125 per month to the individual's private pension account were introduced in 2012.

## **Fiscal Outlook**

The general fiscal outlook is positive as the government committed to fiscal discipline in 2011 and 2012. The budget deficit improved every year since 2009's 5.5% to GDP ratio as a result of the global economic crisis to fall to 1.4% of GDP in 2011. While the economy was cooling and the import tax revenues kept falling, the fiscal performance slowly started to deteriorate throughout 2012 and brought the budget deficit to 2% of GDP.

Overall fiscal policy is likely to be broadly neutral in 2013 but will be tightened slightly after 2014. The MTP prioritizes improvements in debt and fiscal management and debt sustainability, decreasing current account. One of the key indicators is the ratio of central government budget

deficit to GDP, which targets almost no change at 2.2% at the end of 2013 and expected to drop to 2.0%, 1.8% in 2014, and 2015, respectively.

As a result, general government debt stock to GDP (EU defined) is expected to decline from 39.2% realized in 2011 to 36.5% in 2012, 35% in 2013 and 33% in 2014. Commitment to fiscal discipline was one of the key parameters that were perceived as a support to a rating upgrade.

Despite the recent downturn in 2012, the economy managed to perform well after the global economic crisis with fiscal and monetary discipline continuing to be the main economic pillars establishing confidence among investors. Starting from mid-2010, for the first time in history, the market viewed several EU members' sovereign debt risk as higher than Turkey's. Turkish sovereign credit-default-swap (CDS) spreads are relatively lower than some other European Union member states.

This trend peaked in November 2012 when after almost two years of waiting time, Fitch finally upgraded Turkey. The country's performance in public finances, sound banking system was justifying this upgrade since 2010. Fitch improved Turkey to investment grade by raising its Long-term foreign currency Issuer Default Rating (IDR) to 'BBB-' from 'BB+'. The upgrade reflected easing macro financial risks as well as underlying credit strengths, declining government debt burden and sound banking system.

Maintaining fiscal discipline will be a real test for the government in order to secure its investment grade status as the country will experience three elections till mid-2015. The MTP, if followed, supports the view that the government will not derail from fiscal consolidation during this period which will strengthen rating outlook.

### **Inflation Dynamics**

CPI inflation surged to double digits at 10% on an annual basis by the end of 2011, up from 6.4% a year ago as the boost in bank lending supported domestic demand while energy prices made huge comebacks. The inflationary pressures subdued in 2012 as the central bank together with the banking regulator cooled down domestic demand.

Turkey's CPI inflation by the end of 2012 stood at 6.16%, below the government's 7.4% revised estimate, but still above the initial goal of 5.2% set at the beginning of 2012. This is the lowest CPI reading for year-end since 1968. Core CPI which excludes food, energy, alcohol, tobacco and gold reached 5.81% at the end of 2012 while PPI inflation came at 2.45% which is the lowest seen in more than three years.

The favorable annual performance in inflation is not expected to keep up in the medium-term. Inflation is likely to return in 2013 amid expectations of renewed domestic consumer demand and recent central bank cuts in borrowing rates. December 2012's cut in the policy rate followed three months of consecutive cuts in the upper rate of the interest corridor and is expected to help

spur an economic growth rate higher than 4% in 2013. Thus, an inflation rate target of 5% by the central bank looks hard to achieve.

## **Monetary Policy**

The Turkish Central Bank is operating as an inflation-targeting central bank since 2006, but it became also concerned about financial stability by the second half of 2010 due to rapid expansion of domestic credit, increase in external borrowing by corporates and banks, and real appreciation of the Turkish lira which widened current account deficit.

As a result, Central Bank increased the number of instruments it is relying on in order to achieve the increased targets. Instead of relying on one interest rate, the Central Bank is using an interest rate corridor, delineated by overnight borrowing and lending rates. Similarly, a set of repo facilities were introduced (i.e. quantity and price auctions), through which liquidity is injected to the market. In order to cap banking sector credit growth, reserve requirement (RR) ratios were differentiated by currency and by maturity while the Reserve Option Coefficient (ROC) system requires a higher equivalent amount of FX or gold to meet a given portion of TL reserve requirement for capital flows and financial stability purposes.

The result of this new framework is a mixed success story. In 2012, inflation was slowly declining from its double digit heights of end-2011. By the end of 2012, the CPI inflation fell to a forty-four year low. Central Bank cut its lending rate for the first time in seven months in September 2012 and increased ROC in order to manage currency pressures associated with potential capital inflows. Thus, it can be said that the central bank succeeded in lowering bank credit growth in 2012 from as high as 40% in 2010. Finally, the current account deficit fell significantly in levels and its ratio to GDP but it is hard to judge how much of the correction in external imbalance is attributed to central bank policy.

Having multiple goals on the agenda, central bank announced that it will utilize from RRs varying according to maturity, Reserve Option Mechanism and Lender of Last Resort tools as well as the policy rate, policy corridor, TRY liquidity management and FX liquidity management in the medium-term to achieve the 5% CPI target.

## **Labor market**

Due to exceptionally high growth rates, the unemployment rates recovered back to its pre-crisis levels in 2012. The unemployment rate dropped to a historic low of 8.0% in June 2012 while number of people employed reached another record of 25.5 million in October 2012. Annual labor force growth topped the 1 million mark in October 2012 for the first time in a year pushing the labor force to a record high of 28.1 million. As the economy is cooling down, the unemployment rates are prone to increase starting from the final months of 2012 and according to MTP the labor markets will remain stable around 9% till 2015.

Jobless growth was the term describing Turkey's mid-2000 labor market performance. The economy seems to be stuck at the elevated unemployment levels for the last decade thus efforts to tackle unemployment and improve labor market efficiency are under way. The government



has started to implement a number of measures to reform existing labor market regulations, including reduction in severance payments and more flexible working hours.

In April 2012 a new incentive scheme was introduced to minimize the cost of labor, whereby new employees hired in the least advanced eastern regions are exempt from employer social contributions and from employee contributions and income taxes.

## **Future Outlook**

Turkey's medium-term economic growth and reform prospects are good, notwithstanding certain vulnerabilities to further global financial turmoil. Recent reforms in the energy sector – especially to promote private sector participation, energy savings and renewables – as well as in the areas of competition law, labor market efficiency, improvements in the business environment and promotion of regional trade reinforce the prospects for sustainable growth and development.

The Turkish economy is likely to continue to grow but at sub-par rates together with the general slowdown in global economic activities. While the current account deficit has fallen almost 4 percentage points, the pace of re-balancing is not likely to continue at this rate in the coming years and there are risks that it will lose momentum in 2013 as domestic demand picks up and the lira appreciates. Thus, policy action is required to break the strong relationship between growth and current account deficit. The Turkish economy needs to slowly adjust its economy where growth is maintained with shrinking current account deficit levels.

Looking forward, the average economic growth for the Turkish economy in the medium-term stands at 4% which is around 2-3% below the nominal economic growth rate required by the country to reduce its unemployment rate and maintain its favorable debt stock to GDP ratio. As a result of the economic recovery, the current account deficit levels will not get back to its pre-crisis levels soon which necessitate sustaining the external funding of the economy.

The government is looking to change the economic parameters of the country in the medium-term. The economic growth model pursued since the last IMF deal was signed in 2005 resulted in import dependency of Turkish exports. The Turkish economic growth relies heavily on foreign funding as well as on the consumption of foreign goods and services. Such a growth model has major drawbacks for the Turkish economy.

The low savings rate, around 14% of GDP, results in a sharp pro-cyclicality of investment linked to the availability of external financing, with major consequences for the volatility of output. Better integrating monetary, fiscal, and macro-prudential frameworks would help smooth the cycles through future episodes of capital inflows and maintain financial stability.

Despite the 2012 rating upgrade, the Turkish economy might have to wait several quarters to see more pronounced effects of the upgrade since the financial markets are already treating Turkish economy as an investment grade country since summer 2010 due to its resiliency to economic shocks. The country needs an “investment grade” rating from one of the remaining two major rating agencies in order to ensure attracting higher quality capital flows in to the economy.

### **III. Review Bank's Operations**

The Bank continued to participate in the sustainable development efforts of Turkey through its well established programs which have been implemented through project and corporate finance operations and credit lines to financial institutions (FIs). From the beginning of operations in 2008, the total disbursement of the Bank to various operations in Turkey amounted to USD 285.2 million by the end of 2012. Bank's total outstanding portfolio in Turkey was USD 95.3 million at the end of December 2012.

In intermediated loans, as an integral part of its lending and non-cash (guarantee) services, the Bank is cooperating with an increasing number of financial institutions in Turkey in order support a targeted market segment more efficiently and effectively. In this respect, the Bank has a dedicated guarantee and trade finance program and continues to provide SME focused credit lines to financial institutions. The cash and non-cash (guarantees) credit limits approved to 11 FIs amounted to USD 475 million as of December 2012. The Bank is disbursing loans to public and private financial institutions which in turn pass on (or on-lend) to SMEs. Similarly through these intermediaries trade finance operations are conducted with an aim to support the intra-regional trade. The use of financial intermediaries is part of the policy of the Bank in transforming development finance that is oriented towards supporting the real sector and financial institutions as key drivers for sustainable economic development. The Bank is paying utmost attention in selecting trusted and experienced partners for such operations. At least once each year during implementation, the Bank conducts a formal review of the condition and performance of participating FIs, including a review of their audited financial statements, to determine their continued performance and compliance with objectives of such lending.

The financial sector in Turkey is attracting a significant interest from international investors due to strong recovery in the economy and solid performance of banks particularly in view of global financial crisis. Meanwhile, in November 2012, the Fitch Ratings handed Turkey its first investment-grade ranking since 1994, citing a sound banking system and favorable growth prospects. The borrowing costs of top Turkish banks are expected to come down even more, especially with expectations of an investment-grade ranking from a second rating agency. Within this perspective, Turkish banks would find borrowing abroad at more attractive rates while taking advantage of falling yields. Although the Bank's FIs operations in Turkey have been the most successful within its portfolio, however, the rates have come to such a level that the Bank's pricing could become unattractive to leading financial institutions. Therefore, the strategy within the coming years would be extending the partner FIs network in Turkey through cooperating with mid-tier commercial and participation banks which have effective distribution services and channels for SMEs loans and trade finance portfolio, particularly in cross-country operations. The Bank would also enhance its guarantee facilities as one of the most complementary instruments to its credit operations in order to stimulate trade finance and investment in Turkey.

Most of the SMEs use external financing sources like debt and equity capital to finance their activities. Bank loans and overdrafts are the most widespread debt financing methods for SMEs, but alternative sources like leasing and factoring have also a high relevance. In view of this fact, the Bank has started to cooperate with leasing companies as integral part of its SME finance strategy. Accordingly, there are four leasing companies in Turkey which have been included in the SMEs development facility network.

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Direct operations elsewhere in the corporate and project finance loans are focused to identify medium sized enterprises and structured with a high degree of flexibility to match client and project needs. The Bank will also continue to seek opportunities for co-operation with a variety of other lenders including multilateral development banks, bilateral financial institutions, export-credit agencies, official lenders or guarantors, commercial banks, and other financial intermediaries.

### **Small and Medium Sized Enterprises (SMEs) Development Facility**

Under this facility, the Bank provides loans to local banks and other financial intermediaries which subsequently on-lend to the SMEs. The Bank is seeking co-funding from the participating financial institution in each on-lending, in order to strengthen the relationship between the intermediary and its clients, and to increase the intermediaries' interest in the good performance of the credit line. The main goal of these intermediated loans is to support growth and employment potential of the SMEs. Promoting the knowledge economy/skills and innovation capacity of vibrant SMEs in Turkey remains a priority for the Bank. The Bank has been able to enlarge the network of its partner FIs in Turkey participating in the said program. By the end of 2012 a total of USD 140 million credit limits have been activated for the use of partner FIs in Turkey. So far, the operations of the Bank supported the availability and lengthen the maturity of funding for SMEs in Turkey, underpinning job creation and growth. Firm-level survey data have shown that SMEs benefiting from this facility come from a diverse group of sectors which includes agribusiness and farming, manufacturing, healthcare, tourism, and trading. The total disbursements amounted to USD 84.5 million by the end of December 2012.

Furthermore, through intermediated financing the Bank will continue to increase the availability of long term funding to SMEs and look for opportunities on how SME financing can be supported via venture capital initiatives and credit enhancement techniques such as securitization, loan guarantee or structured portfolio guarantee.

### **Short Term Trade Finance (STTF) Program**

Trade finance is a distinct core business of the Bank. The program has been designed to strengthen the ability of local banks to provide trade financing to entrepreneurs throughout the country to expand their import and export. Within the STTF facility, the FIs participating in the program have been using this facility and have helped a number of businessmen in Turkey in trade transactions within and outside of the region. The Bank approved credit limits amounting to USD 140 million to six banks in Turkey as of December 2012. The Bank has been successful in extending loans to support trading operations of businessmen in the country. The total disbursements amounted to USD 115.7 million by the end of 2012. The Bank will continue to seek new opportunities to provide short and medium term trade financing to eligible partner banks for trade finance purpose and to the companies for trade transactions under its Trade Finance Program.

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## **Corporate and Project Finance**

In line with its overall objective of fostering economic development and social progress, the Bank provides medium to long term finance to development projects. The process of selecting projects is based on the assessment of additionality and development impact. Contribution to national priorities and promoting complementarities among member states, in particular, tends to preclude a preferential factor in allocation funds towards projects with the optimum risk/return ratio. The corporate loans are provided to firms and public sector entities in order to cater their needs such as acquisition of equipment, modernization of plant and structures, trade transactions and other related expenditures.

At the end of 2012, Bank's active portfolio under these operations in Turkey consisted of one operation with an investment amount of USD 35 million. The nine years (including three years grace period) loan extended to the Istanbul Metropolitan Municipality under the guarantee of the Undersecretariat of Treasury in October 2010 has been utilized for the purchase of subway rolling stock for Taksim–Yenikapi Metro Line. The project has helped the Bank to contribute to the efforts of Turkey to build attractive, high-capacity and effective public transportation system.

In March 2011, the Bank also supported the Turkish Refining and Petrochemical Company and extended an 18-month loan amounting to USD 30 million for the purpose of financing import of raw material. This loan was repaid and the facility had contributed to development of intra-regional trade.

Major challenges being faced with regard to Turkish operations is that strong economic growth and favorable forecasts for the future have made the country an attractive investment destination with considerable foreign capital coming in search of profitable investment opportunities. This has made the market very competitive adding pressure on the Bank in terms of its loan pricing and terms and conditions related to collaterals and security. Limited capital base of the Bank also puts a constraint on the Bank to finance just a few projects. It is hoped that in near future the Bank would be able to raise money in the capital markets thus augmenting its resources to serve the growing needs of Turkish industry and commerce.

The Bank intends to work more closely with related government agencies and private sector clients in order to keep on exploring further opportunities for investment in growing Turkish sectors. Under these operations, the strategy of the Bank would be supporting transport and energy related infrastructure projects and growth of medium sized enterprises through direct lending and investment operations.

## **IV. Review of Key Sectors and Investment Opportunities**

Turkey is an upper middle income developing country with a population of 75.6 million. Its economy has recorded high growth performances in 2010 and 2011 while diminishing uncertainties, achieving healthy macroeconomic fundamentals, continuing capital inflows, low

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interest rates and credit expansion. The country has set an ambitious target to become one of the ten largest economies (16th largest economy in the world in 2011) in the world by 2023. In order to achieve the subject target the country plans to triple the annual economic output to more than USD 2 trillion, increase annual exports to USD 500 billion and make significant upgrades in its energy, information technology, finance, and physical infrastructures. In this connection, adoption of new laws such as Turkish Commercial Code and capital markets' law in 2012 and steady implementation of privatization program, new investment and employment incentives, structural reforms in education, judicial, tax systems are all expected to contribute significantly in creating a more efficient production structure, increase competitiveness, accelerate foreign direct investments and support R&D activities. Furthermore, increasing domestic savings, reducing dependency on energy imports, innovation, high value added production, further improving investment environment and making Istanbul a leading global financial centre are going to be very important agenda items of Turkey in the coming years.

In view of these priorities, the main purpose of the Bank in its new strategy during 2013-2014 is to contribute to Turkey's sustainable development and objectives established in the Vision 2023 document, Ninth Development Plan 2007- 2013 (the tenth development plan 2014-2018 is under preparation) and the 2013-2015 Medium-Term Program (MTP). The Bank will also consider and contribute to the priorities set in the sectoral strategies prepared by the relevant ministries/public administrations. In the forthcoming period, efforts in project identification and implementation will be intensified decisively. In terms of sectors, energy, transport/ infrastructure, manufacturing, and agriculture will remain the top priority sectors for the Bank. However, the Bank would also explore appropriate investment opportunities in other sectors such as petrochemical, tourism, logistics, and retail sectors. Meanwhile the Bank will put efforts to support exports of the country which is expected to reach USD 185 billion in 2014. In line with the objective of its SMEs development facility, the Bank will also continue to support their access to finance in order to enhance productivity, competitiveness and job creation.

### **i) Energy**

Energy has a strategic importance in sustainable development of Turkey. The population increase, robust economic growth, industrialization and urbanization across the country elevate the energy demand. In this context, securing sustainable energy supply through diversified sources, routes and technologies, identifying and utilizing domestic and renewable resource potentials, restructuring energy market and making use of energy efficiency and new technologies remains essential components of energy strategy of Turkey in the coming years. In 2011, the total primary energy demand reached to 115 million Ton Equivalent Petroleum (TEP) which increased by 6.4 percent compared to previous year. The demand was about 119 TEP in 2012 and estimated to surge further to 218 TEP by the end of 2023. Based on this long-term projection, the share of coal in total energy supply will be increased from 31% to 37%. The nuclear energy planned to have 5 percent share and shares of oil (26%), hydroelectric (4%) and renewable energy resources (6%) will be sustained. On the other hand, the share of gas which is about 32 percent will be reduced to 23 percent. Accordingly, entire coal/lignite and hydroelectric

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potential of the country will be integrated to the economy, wind energy installed capacity is expected to reach to 20,000 MW and geothermal energy installed capacity is expected to reach to 600 MW.

The domestic primary energy generation which was 32.2 million TEP in 2011 only meets the 28 percent of consumption. This makes the country dependent on imports for its primary energy needs at a high rate. Within this dependency, the oil import rate is 93 percent, while gas import dependency is even higher, at 98 percent. The total energy import (mostly oil and gas) of the country which amounted to USD 38.5 billion in 2010 had surged to USD 54 bln in 2011. This figure was about USD 60.1 billion by the end of 2012. Energy import account for over 22 percent of Turkey's total import and about 50 percent of the current account deficit. Therefore, diversification of energy supply, particularly developing domestic and renewable resources is a major agenda in reducing import dependence and current account deficit over time.

The total installed electric power generation capacity, which was 44,758 Mega Watts (MW) in 2009 increased to 57,058 MW by the end of 2012. In 2011, the total electricity generation of Turkey increased by 8.6 percent compared to previous year and amounted to 229.395 Giga Watt Hours (GWh). The electricity generation was 239.800 GWh in 2012. While the electricity consumption in 2011 increased by 9.4 percent compared to 2010 and amounted to 230.306 GWh. The electricity consumption has further increased and amounted to 241.947 GWh by the end of 2012.

The country is planning to reach an installed electric power generation capacity of 100,000 MW in order to meet the estimated electricity consumption of 500.000 GWh in 2023. Accordingly, 30 percent will be produced from natural gas, 35 percent will come from coal, another 30 percent will come from renewable sources and 5 percent will be nuclear. Turkey places priority on the development of its lignite and coal deposits in an attempt to reduce its dependence on imported natural gas as a fuel for power plants. The electricity energy generation potential from lignite reserves is about 120 billion kWh/year and 44 percent of the potential has been actualized. Approximately 40 percent of Turkey's lignite reserve which is about 12.8 billion tons is located in the Afşin-Elbistan basin in southern Turkey will be put to use for electricity generation and provide opportunity for investment. Total lignite reserve of EUAŞ is 7 billion 800 million tons, and total lignite Afşin-Elbistan basin is 4,856 million tons. As with the coal, which has a potential of 11 billion kWh/year, 21 percent of the potential has been evaluated. The hard coal is mostly located in the Zonguldak basin which has more than 700 million metric tons of proven reserves. Turkey aimed to raise power generation capacity from coal to 17,000 MW and investment opportunities are provided for private sector in development of potential fields. In plants using lignite and coal importance is given to installation of new technologies and the utilization of the cycle technologies to provide low emission and high efficiency. Meanwhile, Turkey is interested in developing clean energy opportunities for use of methane captured from its large coal reserves. Efforts have been intensified to start producing syngas from coal at Soma region. The hydroelectric power potential is 140 bln kwh per year and about 37 percent of it has been utilized with around 15 percent of the potential is currently under construction as of 2010. Efforts are being made to fully utilize this potential through promotion of private investment in new hydroelectric energy projects including small hydro power plants.

In addition, the country has launched comprehensive incentive programmes to tap massive renewable energy sources including wind, solar, bio-mass and geothermal sources. The target is to generate at least 30 percent of total electricity generation from renewable sources by 2023. The installed capacity in wind energy which has reached to 2.338 MW in March 2013 is planned to be 20.000 MW by 2023. The installed geothermal energy capacity has reached to 162,2 MW by the end of 2012 and the Government plans to increase the capacity to 600 MW by the end of 2023. For the purposes of creating robust resource diversity and enhancing the security in electricity supply, Turkey has accelerated efforts for full functioning of two nuclear power plants. Turkey and the Russian Federation signed an agreement for the construction and operation of the first nuclear power plant (estimated investment cost is USD 20 bln) at the Mersin-Akkuyu (4800 MW) site in southern Turkey. The first unit of this plant will start electricity generation in 2019 and will reach to full capacity in 2022. The second nuclear power plant which will be built at the Sinop site on the Black Sea is under tender process, while the third project is still under discussion.

Turkey has great growth dynamics and is keen to attract foreign direct investment to develop its indigenous energy resources. The foreign direct investment in electricity, gas and water sector amounted to USD 4.3 bln in 2011. However, the total amount of investments to be made to meet the energy demand in Turkey until 2023 is estimated to be around USD 130 billion. Within this framework, the government is implementing necessary measures and regulations in order to increase role of private sector in energy generation and distribution. The process for the privatization of the electricity generation facilities and distribution/transmission networks are continued for bringing private investments and competitiveness into the electricity energy market. Turkey also continues the policy of privatization of the gas distribution sector. The share of the private sector in the installed electric power generation capacity and production has reached to 56 percent and 61 percent respectively by the end of 2012. Significant achievement was made privatization of electricity distribution companies and out of 21 regional electricity distribution companies 13 were privatized as of 2012. Privatization processes of publicly owned thermal power plants such as Hamitabat, Seyitömer and Kangal have been initiated. Meanwhile, support mechanism has been provided for domestic manufacturing of machinery and equipment used in energy generation. Additional price support is provided for plants using domestically manufactured machinery. Therefore, there is huge investment opportunity for manufacturing machinery and spare parts for electricity generation purposes.

The improvement of the efficiency, prevention of loss and the reduction of energy intensity are of vital importance for Turkey. In this context, the primary energy density is planned to be reduced by 2023 at the rate of 20 percent compared to the amount in 2011. The maintenance, rehabilitation and modernization programs being implemented in the state owned electricity generation plants and since 2005 about 7.8 bln kwh increase in the production has been realized by the end of October 2012. Another program which started in 2008 for rationalizing illumination in the public sector has provided saving of about USD 30 million every year. Activities for enhancing energy efficiency in the residential and commercial buildings and projects of industrial bodies for increasing the efficiency is regarded as the most promising and attractive field of investment.

The development of Turkey's domestic oil and gas resources is a priority because it enables the nation to reduce its dependence on import of hydrocarbon resources. As of November 2012, the crude oil reserve is 43,3 million tons and the natural gas reserve is 6,9 billion m<sup>3</sup>. The natural gas consumption which was 500 mln m<sup>3</sup> in 1987 increased to 45.2 billion m<sup>3</sup> by the end of 2012. It is expected to reach 47.6 billion m<sup>3</sup> in 2013. About 54 percent of gas consumption is used for electricity generation. The oil and natural gas exploration operations both at home and abroad have been intensified and investment in exploration projects for oil and natural gas in Black Sea, Mediterranean Sea and Southeast regions is being pursued. The total investment in domestic oil and natural gas exploration works amounted to USD 610 mln by the end of 2012. On the other hand, Kuzey Marmara and Değirmenköy Natural Gas Storage Facility is the first in Turkey which was put into service by TPAO, working with the capacity of 1,6 billion sm<sup>3</sup> in 2007 and 2,6 billion sm<sup>3</sup> in 2012. Studies are ongoing to increase the storage capacity to 2,84 billion sm<sup>3</sup> for at the end of 2014 . Particularly, the Salt Lake Natural Gas Storage Project with a capacity of 1 bln m<sup>3</sup> will be implemented during 2015-2019. Turkey aims to secure sustainable investments in the area of exploration, production and storage of oil and gas.

Turkey is positioned in a geography that holds about 72 percent of the world's proven oil and natural gas reserves. Building on this geographical and geostrategic position, the country aims to be an important player in energy transit corridors and terminals. In this regard, Baku–Tbilisi–Ceyhan, Samsun-Ceyhan, Iraq-Turkey oil pipelines and Bakü-Tiflis-Erzurum, Turkey-Greece-Italy, Nabucco and Trans Anatolia (TANAP) gas pipelines are among the important projects being pursued by Turkey. Turkey plans to make the Ceyhan region an integrated energy terminal where various quality and feature of crude oil may be offered for international markets, and where a refinery, petrochemicals facilities and liquefied natural gas (LNG) exportation terminal will be available.

The Bank's main objective in this sector is to contribute in improving supply of reliable and efficient energy while increasing use of renewable energy resources. Exploring opportunities in energy efficiency projects will continue to feature prominently the operations in the coming years. The Bank will concentrate on mid-size projects that will increase the share of indigenous and renewable energy resources. Special attention will be devoted to development of geothermal, wind and small hydropower stations. In this regard, local manufacturing of renewable energy equipment will be supported. The Bank will also aim to support projects minimizing the losses in electricity generation, transmission and distribution, increasing the energy efficiency in buildings, transportation and industry. The Bank would also aim to play a role to improve gas/oil transportation and storage facilities. The Bank would look for partnership that may provide new opportunities for closer cooperation to support efforts in making Turkey a transit country and a hub for the transportation of energy resources in the region.

There remains solid optimism that energy consumption growth will continue, providing tremendous opportunity for the future of energy and for power project development in Turkey. In the coming decade, primary energy consumption is estimated to increase by around 4 percent per annum. Electricity consumption to 2020 is estimated to increase in the range of 6.7 percent (low) to 7.5 percent (high). In order to meet this growth in energy consumption, it is intrinsically important to develop domestic resources and renewable energy, which would also reduce the soaring dependence on imported energy, predominantly in the form of oil and natural gas. There



are economically viable options for increasing the capacity of power generation fuelled by domestic lignite. However, adoption of efficient coal power plants and of carbon capture and storage (CCS) technology would secure the position of coal in the energy mix and make an important contribution to tackling climate change. There is material opportunity for the hydraulic, wind, solar, geothermal energy potentials to be harnessed. In summary, the Bank will provide support to projects which utilize domestic resources and enable Turkey to meet a large proportion of its increasing energy demand with a reduced reliance on imported oil and natural gas. The Bank will also assist efforts of Turkey to reduce its high energy intensity, which presents a further dilemma of energy utilization.

## **ii) Transportation**

The country's natural bridge position between Europe to Asia makes transportation infrastructure an attractive investment area. The main objective of Turkey in the transportation sector is to build the relevant infrastructure which will secure a complementary balance among transportation modes and widespread use of combined transport; is compatible with modern technological and international standards; is sensitive to the environment and where transportation is conducted safely, economically and rapidly. During 2012, the amount of investment in transport and communication sectors totaled around TL 12.6 bln (about USD 7 bln) and the figure is planned to further increase to TL 13.8 bln (about USD 7.5 bln) in 2013. Most of these investments were realized through BOT (Build Operate and Transfer) and PPP (Public Private Partnership) arrangements. The total cost of transport and related infrastructure projects to be implemented until 2023 is estimated to be around USD 175 bln and share of the BOT and PPP arrangements is planned to be around 28 percent. The sector has about 15 percent share in the GDP and provides employment to about 1.3 million people.

Continued development in the railway sector enabled the country to reach 12,000 km network by the end of 2012. The network is owned and operated by the state railways company, TCDD. Main strategy is to increase the role and competitiveness of the sector. In this context, reorganization of TCDD, modernization of train sets and construction/rehabilitation of railway lines across the country is being pursued. The target is to have by 2023, a 25,940 km long railway network with an investment of USD 60 bln. The high-speed train operations are being conducted between Ankara-Eskişehir and Ankara-Konya since March 2009 and August 2011 respectively. Construction of other lines such as Eskişehir-Istanbul, Ankara-Sivas, Ankara-İzmir, Bursa-Bilecik, and Halkalı- Kapıkule are under implementation. Investments in this sector are expected to improve the share of the railway sector in passenger transport from 2% to 10% and in freight from 5% to 20%. By completion of Marmaray underwater tunnel project (Istanbul Strait) in 2013, the railway network will be connected to the Europe without any interruption.

Turkey is implementing major PPP projects particularly to increase and improve its transport infrastructure capacity. The planned and ongoing projects across the country represent credible business alternatives to operators and investors. The projects in Istanbul such as Marmaray (the Rail Tube Tunnel under Bosphorus in Istanbul) Project, third Bridge on Bosphorus, Ankara-Istanbul high-speed rail line, Eurasia Tunnel (Istanbul Strait Road Tube Crossing), third airport, Canal Istanbul (linking the Black Sea with the Marmara Sea) and Istanbul-Izmir highway estimated to have a total investment cost of USD 36 billion. These projects would make it easier to travel to and in Turkey and strengthen Istanbul's position as an international business hub.

Compared to other modes of transport the road network is the most developed sector in Turkey. Turkish international highway transportation sector has the largest and the most modern fleet in Europe, which carries about 43% of Turkey's exports to the world markets. Turkey ranks third in the international land transport business after Russia and Germany. The road surfaces have been improved and total length of dual carriageways has been increased to 22.100 km over the past decade. The dual carriageways is planned to increase to 36.825 km by 2023. Turkey has completed the legal infrastructure regarding privatization of highways and bridges under the privatization program and pursuing relevant tendering process. Within the framework of development of international land transport corridors such as Trans Turkey Highway (TTH) and Trans European South-North Motorway Project (TEM), Gebze-Orhangazi-Izmir motorway has been contracted in 2010 and expected to be finalized within 5 year. The 3,000-meter-long suspension bridge to be built as a part of this project on the Izmit Gulf would be the second longest suspension bridge in the world.

The number of airlines in Turkey has risen to 15 during the last five years. However, the Turkish Airlines is the major national carrier which dominates domestic air transport in Turkey. As the passenger and freight traffic is increasing, the government puts utmost importance to build new airports and improve the infrastructure capacities of the airports under operation. The Turkish aviation market saw a 137 percent increase in the passenger capacity since 2003 and have been able to build a passenger capacity of 65.573 by 2013. There are 48 airports in the country and there are plans for constructing new ones as BOT project. Private sector has been inducted in operations of main airports e.g. Istanbul, Ankara and Izmir and it is expected to be extended to new airports as well. The government plans to realize an increase in current passenger carrying volume from 130 million to 350 million and fleet numbers from 373 to 750 planes by 2023.

Although Turkey is surrounded by seas on its three fronts but this advantage has not been fully exploited. The government is now placing great emphasis on sea transport including port development. The concessions for the management of state-owned ports and establishment of private ports has reduced overcrowding and inefficiencies in this area. Samsun, Bandirma and Mersin ports have been privatized. The privatization process of other major port is still continuing. As regards maritime safety, Turkish flag has been moved to the white list of the Paris MoU since 2008. The trade fleet of Turkey having a capacity of about 22.5 Million Deadweight Ton (DWT) ranks 15th in the world.

In shipbuilding, with 71 shipyards operational the current capacity of the country is about 3.6 Million Deadweight Ton (DWT). With the completion of 54 shipyard projects the capacity is expected to reach 7.3 million DWT. Turkey ranks fifth place in world in terms of yacht building. The export volume of the sector in 2011 was USD 1.27 bln. More than 60 percent of Turkey's logistics activity is operated from Istanbul but other cities are also emerging to be among main logistic centers of Turkey.

The Bank would support projects that contribute to development of transportation and communication networks. This includes development and modernization of relevant infrastructure including shipyards, marinas, custom points, ports and logistics centers preferably

through the participation of the private sector. The Bank shall also support road and railway projects aimed at revitalization of Silk Road and running of block trains within the ECO region.

### **iii) Agri-business**

With its favorable climate and geographical conditions, rich soil sources and biological diversity, agriculture is one of the leading sectors in the Turkish economy. The cultivated land is around 23.6 million hectares and about 22 percent of this land is irrigated. Despite global crisis and drought, the agricultural sector grew by 5.8 percent in 2011 compared to previous year and registered an output of USD 61.8 bln. This robust output puts Turkey in seventh place worldwide in terms of agriculture production. Turkey is a world leader in the production of a number of crops such as dried figs, hazelnuts, sultanas/raisins and dried apricots, forth in fresh vegetables, grape and tobacco production and seventh in wheat and cotton production. It has the largest milk and dairy production in its region. Turkey's share in the fishery and organic farm products market is rapidly increasing. The country made substantial progress in fishery products and was the third-largest fishery products producer of Europe in 2010. The share of agriculture in GDP was 9 percent in 2011. The agriculture sector accounts about 25.5 percent (6.1 million people) of employment in Turkey and during the last eight years significant legislative arrangements in agriculture sector have been introduced (13 fundamental laws including agriculture law were published and 21 laws were amended) in order to enhance productivity and efficiency in the sector. The main objective of the country is to develop a well-organized and highly competitive agriculture structure by taking into account the food security and safety concerns along with the sustainable use of natural resources.

The ample agricultural potential offers a large range of products such as grains, pulses, oil seeds, fruits and vegetables, cut flowers, poultry, milk and dairy products, fishery, honey and tobacco. Crop production, livestock and fishery/forestry account for 67 percent, 26 percent and 7 percent of the total agricultural production respectively. The export of agricultural products including processed food rose from USD 4 billion in 2002 to USD 15.3 billion in 2011. The export of the sector is expected to be about USD 16.2 bln by the end of 2012. The Government is allocating significant support for increasing efficiency, productivity and quality in which cash assistance amounted to USD 4.6 bln in 2011 and estimated be about 4.3 bln by the end of 2012. Within this framework, production of 17 items have strategic value such as cotton seed, sunflower, soybean, canola, safflower, corn, grain, olive oil, tea premium, wheat, rice, etc. The total agricultural support amounted to 1.09 percent of the GDP in 2011. The country is also benefitting from European Union funds under the Instrument for Pre-Accession Assistance. Within the rural development (IPARD) component of this assistance, the sector will benefit about 23 percent of the Euro 2.6 bln allocated to pre-accession funds for the years 2011- 2013.

The aim of Turkey is to become one of the five biggest countries in terms of agricultural production by 2023 with a USD 150 bln gross agricultural domestic product. The main areas of agriculture development program include modernizing agri-food processing, improving phytosanitary, animal health and food safety measures, rationalization of land consolidation (There are about 3.1 million agricultural holdings in the country and average size of operated land is 6 hectares which is also structurally fragmented on average 7 parcels. The average size of operated land in EU which are usually integrated is about 17.5 hectares), integrated approaches

to water basin management and strategic regional development. The export of the sector is targeted to be USD 40 bln by the end of 2023.

Productivity and competitiveness have been rising in the sector. The country is making important transformation in mechanization process and use of modern equipment, irrigation and cultivation techniques. The number of tractors which is the basic equipment that enables the use of other agricultural equipment, increased by 18.6 percent during last decade and reached to 1.1 mln units by the end of 2011. Similarly, during last ten years the number of dropped irrigation plants surged by 4.5 times and accounted 264,639 as of 2011. The subsidy scheme developed under rural development program enables farmers to claim reimbursement of up to 50 percent of their mechanization investment, including harvesting and processing equipment. Industrialization of agriculture products is an important objective of the sector. The SMEs in agriculture based industry reached to 4,057 and employ about 42,000 individuals. Significant opportunities exist for joint ventures and developing or manufacturing innovative food products under license as well as in production of specialist machinery and equipment in Turkey. Moreover, investment opportunities are available in biodiversity, protection and remediation of soil quality, environment-enhancing management practices, developing parental plant breeding material and food supply chain technologies.

The Bank's activities will remain focused on operations aimed to support realizing country's full agricultural potential. In this regard, particularly, the Bank would support investments in modernizing agri-food processing as well as branding, meat and dairy production, packing, certification, establishment of food safety laboratories, fertilizers, storage, organic farming, aquaculture production, seed production, R&D and human resources to boost production, competitiveness and exports. Turkey is rapidly developing in seed production and organic agriculture. In 2011, the total area of organic farm lands has reached to 614,618 hectares and the number of registered producers was about 42,460. Meanwhile, compared to previous year the total production increased by 116 percent to 2,905,755 tons in 2011. Accordingly, domestic consumption and export of organic agricultural products has increased. The export of organic agricultural products which was USD 15.5 million in 2011 is planned to be USD 2.5 bln by 2023. Possible support shall be extended for integrated approaches to irrigation, water basin management and strategic regional development projects as well. Another possible intervention of the Bank shall be allocated for export/import financing transactions in agricultural and food sectors. Projects in other similar area development schemes would also be considered for financing.

#### **iv) Manufacturing**

The main objective in manufacturing industry is to accelerate the structural transformation by increasing the production of high value-added goods to increase the competitiveness and the share in the world trade. The manufacturing industry was among the sectors in Turkey which were hit hard by the global economic crisis. Since December 2009 significant improvements in terms of production and employment were observed in the sector. Industrial production index which measures the output of businesses integrated in industrial sector of the economy such as manufacturing, mining, and utilities increased by 13.1 percent in 2010 compared to previous year. The index increased by 8.9 percent 2011. During 2010-2011, the sectors such as textile, leather, chemical products, rubber and plastic, metal goods, computer-electronics and optical

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products, transport equipment, electrical equipment, machinery and automotive recorded the highest production increase. However, due to soft landing of Turkish economy, the industrial production index in 2012 increased only by 2.3 percent compared to previous year. The capacity utilization rate of manufacturing industry which was 75.6 percent in December 2011 slightly decreased to 73.6 percent in December 2012. Overall the share of manufacturing industry in GDP was 24.4 percent in 2011. The manufacturing sector has registered a growth of 9.6 percent in 2011 compared to previous year. The sector growth was slowed to 2.8 percent during the first 9 months of 2012 compared to same period of last year.

The automotive, iron and steel, textile, food, beverages, chemicals, electronics, home appliances and tobacco are among the leading sectors in the manufacturing industry. After a record high production (1,189,131 units) in 2011, the Turkish automotive industry with a total of 1,072,978 units of production showed a 10 percent decrease in 2012 compared to previous year. The motor vehicles, parts, and accessories sector was the leader of export with 19.3 bln USD and had 13.7 percent share in the country's overall exports in 2012. In 2012, total automotive exports comprised 729,923 units showing a decrease of 8 percent. Domestic sales attained a figure of 817,620 units in 2012, posted an annual contraction of 10 percent compared to previous year. According to figures of World Steel Association, Turkey raised two ranks to the 8th row in steel production. The steel production rose by 5.2 percent to 35.9 million tons in 2012.

Majority (about 89%) of companies in the sector are small and medium sized enterprises (SMEs) with up to 10 employees. The SMEs employ 76.7 percent of the available workforce and produce 37.7% of the total added value of the overall economy. The strategy for development of SMEs includes measures to increase value-addition, promote competitiveness, create brands and support export-oriented production. The government intends to accelerate the structural transformation process of the manufacturing industry in order to improve competitiveness and share in the world trade with production of high value-added goods. Turkey has started to implement industrial strategy and sectoral strategies to become a manufacturing center for specific sectors. The Industry Strategy Document announced by Turkey in January 2011 covers the period from 2011 to 2014 and describes 72 actions to improve industry, trade and service sectors. The basic goal of the document is to increase the country's competitive position and productivity as well as add momentum to Turkey's transformation into an industrial center where high-technology products are manufactured by a qualified labor force. This would include improving cooperation between public and the private sectors; supporting high value and well-known Turkish brands; and improving access to finance for SMEs looking for new international markets. In this context, loan mechanisms and procedures for accessing Credit Guarantee Fund (KGF) and 'Istanbul Venture Capital Fund' would be improved. Improvement of skills and human resources would also be given priority. The private sector would be supported in establishing vocational schools and technical training courses. The Industry-University Project (SAN-TEZ), which aims to support cooperation between universities and sectors, would be strengthened. This document would be complemented by Sector Specific Strategy Papers such as automotive sector, iron and steel sector, machinery, etc. to be prepared in future. Meanwhile, greater emphasis would be laid in reducing the greenhouse effect.

In order to improve the investment and business environment of Turkey, a new Turkish Trade Act has been enacted in July 2012. On the other hand, the new incentive system introduced by

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Turkey in June 2012 aimed at economic growth has four different areas such as general investment incentives, regional investment incentives, large-scale investment incentives and strategic investment incentives. The major support instruments for investments with an incentive certificate are included as exemption from customs duties, tax benefits, social security premium support, interest payment support and land allocation. Specific priority is given for investment in the sectors namely tourism, mining, railroad, maritime, pharmaceuticals, defense, test facilities, education, R&D. Accordingly, until December 2012 about 2,526 investment certificates with amount of TL 37.6 billion (about USD 20.8 bln) of fixed investments were issued. This represented 37 percent increase in the number of investment certificates and 87 percent increase in terms of fixed investments.

Turkey spent about USD 6.6 billion in research and development (R&D) investment in 2011, indicating a 20.4 percent recovery from a year ago. R&D spending as a percentage of GDP climbed from 0.5 percent in 2002 to 0.86 percent in 2011. R&D expenditure in Turkey is expected to take up 3 percent of the country's GDP by 2023. The government, in particular, offers special incentives to companies planning to invest in the development of new technologies. Meanwhile the number of personnel employed in R&D increased by 13.5 percent in 2011 over a year ago to reach 92,801. The continued growing interest in R&D incentives is expected to decrease Turkey's dependency on foreign sources in the field of advanced technology.

The rapid growth rates in manufacturing sector offers wide financing opportunities for the Bank. As a priority, funding for SMEs would be supported. The Bank would give due consideration to the priorities determined in the Industry Strategy Document and would look on opportunities to provide financial support for development of industrial zones, small industrial sites, technoparks, innovation transfer centers and enterprise incubators.

#### **v) Municipal Infrastructure**

Municipalities are responsible for transportation and the delivery of civil services in urban areas. Urbanization rates in Turkey are relatively high. With the new metropolitan municipalities law adopted on 6 December 2012 the number of metropolitan municipalities in Turkey will increase from 16 to 29 at the time of next municipal election. The main objectives of the Bank in supporting municipal services are to improve urban services and implement infrastructure projects including water supply networks, waste management systems, environmental and public health programs. Migration from rural to urban areas has further increased the pressure on municipalities to provide safe and reliable municipal services. Municipalities and their utilities have depended on the central government to subsidize investment and operations. Municipalities receive nearly 9 % share in the state's budget. Municipalities receive some portion of the central budget tax revenues, depending on their Greater City Municipality Status, population and tax revenues generated in their territory. The main revenues of the municipalities in Turkey are central budget tax revenues and hence Municipalities lack then ability to generate their own revenues. For water, wastewater, and solid waste services, small municipalities with limited resources struggle to cover on-going asset maintenance and investment projects. In urban

transport services, it is necessary to enhance the efficiency of private sector operators. Greater use of Public-Private Partnerships (PPPs) to operate publicly owned systems (with appropriate fiscal monitoring and risk management) and improvement of governance at the municipal and central government levels could be considered as key objectives. Government provides significant support for the inner-city mass transportation projects like metro and light rail transit systems of municipalities. Several municipalities have built or are building metro and light rail transit systems. Given such support, the Bank participated in the financing of metro infrastructure of the city of Istanbul. The Bank would put further efforts to raise resources for municipal infrastructure projects. Development of municipal water/wastewater treatment systems would also be supported. Possible cooperation areas with İller Bankası, which is the biggest domestic financial source for municipalities, may also be explored.

#### **vi) Tourism**

Tourism is one of the major drivers of growth and sources of foreign exchange revenue for Turkey. The tourism market share of Turkey has actually increased markedly over the past two decades. The country is the 6th most popular tourist destination according to the United Nations World Tourism Organization's (UNWTO) Tourism Highlights 2012 Edition. In terms of world tourism market the country attracts about 3.6 percent of tourist inflows and has a share of about 2.7 percent in tourism revenues. Availability of excellent coastlines, suitable infrastructure, wide range of natural attractions, unique historical and archaeological sites and a suitable climate make country most popular global tourist destinations. In the recent years, Turkey has also become a popular destination for culture, congress, spa and health care tourism. In tourism sector, the main objective of the country is to increase the number of tourist arrivals and receipts per tourist through increasing the quality of services, diversifying marketing channels, developing tourism products where Turkey has relative competitive advantage. Meanwhile, in order to expand the tourism activities to the entire year Turkey pursue an investment strategy to exploit potentials of other regions. Transportation and technical infrastructure deficiencies in these regions need to be rapidly resolved.

The total number of visitors reached to 36.7 million in 2012, an increase of 1.7 percent compared to previous year. Accordingly, the total tourism revenues in 2012 compared to previous year increased by 4.3 percent and amounted to USD 29.3 bln. Average expenditure was USD 798 per capita in 2012. Foreign tourists mainly come from Germany, France, Netherlands, United Kingdom, Iran, Russia, Georgia and Bulgaria. Antalya, Muğla, Izmir and Istanbul were the most visited tourist destinations in Turkey. In order to increase the share from global tourism market, Turkey shall give importance on promotion activities particularly in target markets and cooperation with international tourism organizations.

The 2023 target of Turkey in this sector is to be among the top five countries in the world in terms number of visitors and revenue. Within this framework, various forms of support are being provided to investors. The main strategy of the country is to improve products, facilities, service quality and marketing channels while preserving the natural capital and comparative advantage. In addition the government plans to develop the cities having cultural, social and natural potentials and make them brand cities for tourism across the world. By implementation of

several projects in different tourism models, including coastal, health, winter, thermal, cultural, congress and sportive tourism the country is expected to increase tourism revenues. The tourism industry cuts across many sectors, such as retail, housing construction, hotels, restaurants, telecom and transportation. Therefore, considering the strong potentials of the sector, the Bank shall look in supporting relevant projects which would eventually have impact on creating new jobs and improving the country's balance of payments.

### **vii) Financial Sector**

Turkey's financial sector and banking system weathered the 2009 global financial crisis and did not suffer significant declines due to banking reforms implemented during the country's own financial crisis in 2001. By the end of 2012, there were 49 banks in Turkey comprising 32 commercial banks, 13 development and investment banks and 4 participation banks with a total employment of about 201,474 people and 11,061 branches. There are 7 state-owned banks (3 commercial banks and 4 development and investment banks), 16 privately-owned investment and commercial banks and 24 foreign commercial and investment banks including branches of foreign banks. There are 2 banks under the management of Savings Deposit Insurance Fund of Turkey. The performance of 4 participation banks (Islamic banking) is overwhelming and as funds collected is growing on average close to 30 percent annually while the asset share in total banking system is continuously increasing from 2 percent pre-2000 rates to 5.1 percent as of 2012.

In 2012, alternative distribution channels used by financial institutions kept increasing in parallel with technologic developments. The number of ATMs which has increased by 9.6 percent comparing to previous year reached to 34.709 units by the end of 2012. The harmonization of solutions implemented by operators with the finance sector has provided the growth of the transaction volume made on mobile banking. Financial sector overcoming its technologic infrastructure problems and continuing to renovate its online applications contributes positively to the increase of financial transactions realized on the internet.

The asset size of the banking sector has reached to TL 1.371 billion (about USD 770 bln) as of December 2012. Total assets of the sector have increased by TL 153 million (12.6%) comparing to end- 2011. As of December 2012, loans which are the biggest placement item are composing 58 percent of total assets with TL 794.8 billion (about USD 447 bln). The gross loans have increased by 16.4 percent in 2012 compared to previous year. As of December 2012, the sector's profit was TL 23.6 billion (USD 13.2 bln); it has increased by TL 3.7 billion (18.8%) comparing to the same period of previous year. The sector's return on assets and return on equities are realized respectively as 1.8% and 15.7%, which are remarkably high. The implementation of Basel II norms has started as of July 2012 and the sector's capital adequacy standard ratio was increased to 17.9 percent as of December 2012. This is safely above most European countries and the recommended minimum level under Basel II norms. Nonperforming loans ratio which was realized as 2.7% as of December 2011 has increased to 2.9% as of December 2012.

The project "Istanbul International Financial Center" is accorded top priority and importance by the government. In the framework of the relevant strategy and action plan efforts will be accelerated during 2012-2014 to implement this project. The headquarters of Central Bank, state-owned banks (Ziraat, Vakıf, Kalkınma Bank, Turk Eximbank and Halk Bank) and other public

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financial institutions are planned to move to Istanbul. It's a long term project with significant benefits for Turkey and the region. Meanwhile, the Istanbul Stock Exchange and the Istanbul Gold Exchange are set to be merged under one umbrella called the "Borsa İstanbul" in 2013. It is aimed to make it a dynamic organization and to put an end to the fragmented nature. This is an important step in the government's bit to privatize the bourse and turn Istanbul into a regional finance center. With the new capital markets law adopted in 2012 and improvements in technological infrastructure of stock exchange as well as the newly established single stock options market, Turkey has begun to demonstrate to the rest of the world its capabilities and investment potentials.

Deposits remain the main funding source for the banking industry. The total volume of deposits grew by 11% in 2012 compared to last year and reached TL 771.884 bln (USD 434 bln). The analyses show that domestic savings in Turkey need to be increased from current levels (14.3 % of GDP in 2012) and support the sustainability of growth. Efforts in the context of further informing the investors about capital markets, capital market entities and instruments, investor protection systems, risks and similar matters are important. The private pension schemes and support provided by the government is expected to have significant positive effect on domestic saving rate. More generally, in Turkey the level of financial development would play an important role in channeling savings to growth-enhancing activities.

Demand for lending is expected to continue increasing due to a recovery in GDP growth, declining interest rates and inflation. These assumptions lead to an expected compound annual growth rate of 15% from 2012 to 2014. The increase in personal loans and housing credits are expected to be an important factor for future growth. Turkey has become the third largest credit card market in Europe. The SME loans increased by 22% in 2012 compared to 2011 and amounted TL 204.9 bln (USD 115.1 bln). The SME loans which stood around 13% of the GDP in 2010 improved to 14.5% by the end of 2012. In addition, the law regarding the promotion of angel investments was enacted in 2012. It is a crucial mechanism to ease access to finance for entrepreneurs, increase professionalism and improve business culture and ethics in this market through licensing business angels, who are asking for tax and other incentives for their investments and willing to participate in economic development of Turkey. This licensing mechanism presents a new instrument for those companies at their early venture development stages and having funding difficulties, makes angel investments an institutionalized and trustworthy financial market and make angel investments attractive by state supports. Banking regulation and supervision have greatly improved since the 2001 crisis with the establishment of the Banking Regulation and Supervision Agency (BRSA). The BRSA aligned Turkish banking regulations with international regulations on transparency of balance sheets and compliance with international financial reporting standards.

There are 31 financial leasing companies operating in Turkey with 1,251 employees as of June 2012. The net profits of financial leasing companies decreased by 15% in 2012 compared to last year to reach TL 434 million (USD 244 mln), while factoring firms posted TL 623 million (USD 350 mln) in total net profits by the end of 2012, registering an 26.4% increase over the same period of the previous year. The asset size of the financial leasing sector increased in the same period increased by 8.8% from TL 18.6 bln (USD 9.9 bln) to TL 20.2 bln (USD 11.3 bln). During the last five years there has been a major FDI inflow into the Turkish finance industry,

largely in banks. This inflow is expected to continue in other fields of the industry, such as leasing, factoring, asset management, etc. In addition, privatization of the three state banks Vakifbank, Halkbank and Ziraat Bank is on the medium and long-term agenda.

The Banks operations in the financial institutions sector will focus on improving the role of banking and non-banking financial services in supporting economic growth. This would include improving access to long-term funding for SMEs especially those active in specific regions/sectors and possessing strong export potential. The trade finance and guarantee programs of the Bank shall complement such efforts by extending facilities to reputable local banks. In addition, support for energy efficiency initiatives may be advanced through tailored financial intermediary support. The Bank shall continue to provide support to leasing industry which is a good conduit for SME finance and holds significant potential for helping agribusiness activities.

### **viii) Telecom and IT**

The young, well-educated and IT-familiar population of Turkey provides a strong foundation for the development of Information and Communication Technologies (ICT) sector. The main objective is to have widespread and efficient use of ICT and to accelerate the process of transformation into an information society. The telecommunications sector in Turkey has grown rapidly in recent years as a result of increase in the disposable income level and government support for liberalization and privatization of telecommunications sector. The ICT Authority exercises regulatory functions in the telecommunications sector. Turkey's ICT market size reached to USD 44 billion in 2012, with a breakdown of USD 33 billion in telecommunications and USD 11 billion in information technologies. The Turkish ICT sector continues to be one of the key growth sectors in Turkey with an estimated growth of 8-10% for 2013.

A significant increase is expected in PC usage as the Ministry of Education plans to increase the number of computers and internet connections. The National Fatih Project is one such development project to provide schools with 2 million tablets, thousands of smart boards and high speed internet connection, project is worth an estimated USD 5 billion. Schools in remote areas are to be connected to the net via satellite with the cooperation of the Turkish satellite company Turksat. Turkey's computer hardware sales are projected at USD 6.1 bn in 2013 and are forecasted to reach around USD 10.6 billion in 2016. Computer penetration is expected to pass 50% by 2016. The market is forecasted to remain in positive growth territory in 2012, with revenue forecast to grow at a 17% CAGR in 2012-2016. The software market in Turkey is projected at USD 933 million in 2012 and is forecast to reach USD 1.5 billion in 2016, with an expected growth rate of 13%. The software developers are benefiting from significant tax and investment incentives provided by the government in The Technology Development Zones ("TDZ"). The Government has also implemented new legal frameworks to encourage R&D and IT spending, which supports the growth of the sector. Income earned as a result of R&D activities by companies located in TDZs is exempt from tax. Additional incentives include contributions to the social security premiums of R&D staff.

Having executed a share sale agreement for the sale of a 55% stake corresponding to USD 6.5 billion to Oger Telecoms Joint Venture Group in August 2005, Türk Telekomünikasyon A.Ş. (Türk Telekom) was organized as Turkey's sole landline operator based on its historic structure and mission, with its infrastructure established accordingly. Having 13.8 million landline

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subscribers as of September 2012, the penetration rate in Turkey decreased to around 18.7% and is not expected to increase due to hard competition from GSM cellular operators. With the introduction of 3G, IPTV, online services, content and media services, E-business, personalized services, music download, games, multi-play, video services, other mobile entertainment and soon 4G, the services segment has been developing rapidly, creating new business areas and revenues.

In the electronic communications sector, a very rapid increase in the number of mobile subscribers has been observed since the concession agreements executed with GSM operators in 1998. There were 67.2 million mobile subscribers corresponding to an 89.9% penetration rate as of September 2012. While the number of mobile subscribers and penetration rate have indicated a continuously rising in previous periods, this upward trend had slowed. The said slowdown results from the cancellation of users secondary subscriptions due to mobile number portability, as well as the “all directions” tariffs offered by operators. On the other hand, the 3G service commenced in July 2009, with the number of 3G subscribers reached 40.3 million as of September 2012. With the 3G service, the number of users obtaining mobile internet services increased to 11.5 million. The total telecom equipment and services market grew to USD 20 billion and is expected to expand in 2012 as the GSM sector remains the driving force as subscribers are expected to use more and more 3G services.

There were about 35 million internet users in Turkey (representing 46% of the population) as of June 2012. Broadband, which as yet has a small base, is also growing rapidly. Total fixed and mobile broadband subscribers have reached to 19.2 million as of September 2012. The government's E-Government projects still continue to move forward, although most of the projects have been completed. The Turkish ICT market is far from being saturated and still has significant growth potential as the technology driven young population continues to invest in computers, consumer electronics, software and ICT services. The ICT market has grown every year and even in times of global crisis the growth has only dropped slightly, a good indicator that the ICT industry remains an attractive industry in Turkey. The Bank may consider opportunities to support up-gradation and extension of communications infrastructure. Projects involving IT, software development and hardware assembly, and development of technology parks would also be explored by the Bank.

## **ix) Real Estate & Construction**

Construction sector plays a crucial role in Turkey's economic development. It is one of the main drivers of economic growth, employment, exports and private and public investments. The share of construction sector in GDP was 5.8 percent in 2011. Employment in the construction sector was at an all-time high in September 2012 with 1.89 million people. Its share in overall employment rose to 7.4 percent by the third quarter of 2012. Although the sector suffered a 16.3 percent contraction in 2009 but a significant boom was recorded in 2010 and 2011. The sector enjoyed a greater jump than other major sectors in 2010, recording an increase of 18.3%. Overall a growth rate of 11.3% was recorded in the sector for 2011 as well. However, parallel to slow down in the economy, the construction sector also expected to register a meager growth between 1.0 and 1.5 percent in 2012.

The housing sector's performance throughout 2012 remained weak. The number of construction permits given by the municipalities for buildings during January-September 2012 increased by 5.6% compared to the same period of 2011. The total area of construction permits for residential buildings reached 106,556 meter square in January-September 2012 period, an increase of 28.7% compared to the same period of the previous year. Ambiguity relating to VAT rates of housing and increase of title-fee fees within the year also had a negative effect. Control of expansion of housing loans and other tightening measures led to weak housing sales. Together with the new incentive law, industrial and logistics areas within organized industrial zones attract gradually more interest and demand in commercial real estate sector.

Population growth, increasing urbanization, renewal of existing housing, disposable income growth and affordable financing services are the main factors that escalate the housing sector in Turkey. Meanwhile the country has adopted important regulatory arrangements such as easing foreign nationals purchase, amendment to the pre-forested areas (2B) law and ownership law modification enabling a 2/3s majority of condominium owners to decide whether to demolish and reconstruct which are expected to unleash considerable housing demand. It is estimated that the annual housing demand is approximately 650.000 dwellings.

The urban transformation project introduced by the Ministry of Environment and Urban Affairs is expected to be the locomotive of construction sector in Turkey. Within the framework of this project out of the total 19 million total housing stock in Turkey about 6,5 million houses will be reconstructed. The project is expected to increase supply as well as the quality of housing in compliance with green housing (energy efficiency & water saving) and earthquake regulations. All these developments provide signals that construction sector will experience a better growth in the coming years. In 2013, about 5-6 percent growth in the construction sector is expected.

Advanced technology, on time delivery, quick response, high quality, use of reasonably priced Turkish labour and goods, equipment and building materials at international standards have enabled the Turkish construction and building materials sectors to compete throughout the world. The Turkish construction companies were active in about 100 countries and secured 433 projects in overseas during 2012. The total value of these projects amounted USD 26.1 billion which showed a 31 percent increase over 2011. This figure was USD 1 billion in 2000. In terms of number of contracting companies recorded in the International Contractors list, Turkey ranked second in the world, after China. Turkmenistan (18 percent) and Iraq (16.9 percent) were the major markets in terms of value of the projects. Major projects that stood out for companies in 2012 include a railroad project in Ethiopia, second-phase work on an Olympic Village in Turkmenistan, the northern St. Petersburg highway project in Russia and the expansion of the Abu Dhabi airport. These operations also contributes significantly to Turkey's export of construction materials, which rose in the first 11 months of 2012 to USD 20.5 billion, representing a 7.4 percent increase over the same period of the previous year. The total value of projects in abroad by the industry targeted to be USD 100 billion by the end of 2023.

Increase in population, migration from rural to urban areas, renewal of existing housing units as well as development of housing finance triggered rapid growth in construction of residential complexes, business centers and shopping malls. Considering the recent developments in housing market and the potential of the sector, it can be expected that the Turkish property

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market will enter another growth phase after the full recovery of the economy. The Bank shall consider opportunities where it may provide financing to local companies in executing housing, commercial and infrastructure projects having development impact. The Bank shall consider opportunities to support development of financial products in the sector and may provide financing to the private sector in implementing sustainable & environment friendly housing, commercial and infrastructure projects.

**x) Retail Business**

Turkey is continuing to be an appealing market with increasing investments in development of modern and organized retailing. Final consumption expenditure of households in Turkey makes about 71 percent of the total output. The annual private consumption per capita has increased by 12.5 percent in last four years and reached to USD 7,450 in 2011. Recent economic performance supported by young population that likes to spend, the per capita consumption is expected to exceed USD 10,000 by 2015. The robust consumer demand and rapid urbanization triggered large scale investments including foreign private equity firms, global supermarket chains, fashion retailers and several other retail concepts. The number of shopping malls in Turkey increased by more than 20% in the last two years and reached to 314 as of December 2012. This number is expected to be 347 by the end of 2014. In 2011, an average of 108 million people visited shopping malls in Turkey per month. The gross leasable area (GLA) of the shopping center market which was 8.1 million square meters in 2012 is expected to reach 9.7 million square meters by the end of 2013.

The total size of the retail sector which was USD 248 billion in 2009 is expected to reach USD 313 billion by the end of 2012. The food and beverage, which has the largest share (52.3 percent) in the Turkish retail sector as of 2011 is a highly promising segment.

On the other hand e-commerce is expanding considerably in Turkey. Initiatives and foreign investments also grow in parallel to the increase in Internet use and consumer's confidence in shopping online. The total value of e-commerce transactions was about USD 13.7 billion in 2011 which has increased by 37 percent compared to 2010. This volume is expected to reach to USD 17 billion by the end of 2012. According to the Interbank Card Center, there are nearly 7,400 "3D Secure" registered virtual shops in Turkey as of 2011. Increasing activity of private equity investors and venture capitalists with a focus on e-commerce the total value of e-commerce transactions are expected to double by 2015.

Institutional investors with access to financial and management capacities are expected to make use of emerging opportunities in this sector in the coming years. Other than Istanbul, Ankara, and Izmir other urban centers like cities in the tourism region and near to border area are emerging as attractive centers for retail business and development of shopping malls. The Bank shall support enterprises to expand operations in the retail sector particularly for e-commerce activities.

## V. Conclusion

From the above, it could be concluded that Turkey has rebounded in a very short time from the economic down turn brought about by global recession. Its strong growth in the post-crisis period demonstrates the strength of key sectors that include manufacturing and services. Lower than expected inflation also depicts strong productivity profile of key segments of the economy. These indicators add to the expectations that Turkish economy would enjoy healthy growth rates in the medium term. However, these growth expectations also bring challenges that the country need to focus on upgrading production and moving up in the value chain. Investing in infrastructure, human capital, R&D, innovation and entrepreneurship would support stronger growth over an extended period. The current country program document has been developed in alignment with the 2013-2015 Medium-Term Program (MTP) and Vision-2023. In the coming years, the major components of the country program would include:

**Energy.** Contribute in reliable energy supply and improvement of energy efficiency across the economic sectors. The Bank would concentrate on mid-size projects that will increase the share of indigenous and renewable energy resources in total energy production. Development of storage and transport facilities including emphasis on cross-country networks.

**Infrastructure.** Infrastructure investments in education, health, technological research, transportation, drinking water and improvement of information and communication technologies will be given priority. Support will be provided to development of relevant projects including modernization of shipyards, marinas, custom points, ports and logistics centers. Engage in development of trade related infrastructure projects particularly enhancing regional connectivity.

**Manufacturing.** The Bank will seek to support development and competitiveness of the enterprise sector with a particular focus on supporting innovation, R&D and high value-added products. Highly competitive cluster formations that increase innovation capacity, productivity and exports and improve entrepreneurship will be supported.

**Agriculture.** Agricultural supports will be restructured for increasing efficiency, productivity and quality in production. Support investments in modernizing agri-food processing as well as branding, meat and dairy production, packing, certification, etc. to boost production, competitiveness and exports.

**Trade.** Support expansion & diversification of trade in terms of markets and products with an aim to contribute the target of Turkey to boost exports to USD 500 billion by 2023.

**Financial sector.** Support improving capacity and competitiveness of the financial institutions. Increase providing long-term funds aimed to improve competitiveness of SMEs.