Turkey
Country Partnership Strategy
2017-2018

TABLE OF CONTENTS

I. Main Economic Indicators

	2012	2013	2014	2015	2016
Population (mid-year; mln)	74.855	76.055	76.903	77.738	79.278
Average exchange rate (Turkish Lira,TL/ USD)	1.79	1.90	2.19	2.7	3.02
Inflation rate (CPI average; %)	8.89	7.49	8.85	7.6	7.7
GDP at current prices (local cur.,bln)	1,570	1,810	2,045	2,339	2,609
GDP at current prices (USD bln)	871	950	935	862	863
GDP / capita (in cur. prices; USD)	11,588	12,480	12,112	11,019	10,883
Real GDP growth (%)	4.8	8.5	5.2	6.05	3.2
Unemployment rate (ILO definition; eop; %)	8.4	9.04	9.9	10.30	10.9
Direct foreign investment (USD bln)	13.6	12.9	12.8	17.6	12.3
Central Gov. Budget balance /GDP (%)	-1.87	-1.02	-1.14	-1.0	-1.10
Gross Gen. Government Debt/GDP (%)	32.6	31.3	28.6	27.50	29.10
Export (fob, USD bln)	152.4	151.8	157.6	143.8	142.5
Import (fob, USD bln)	236.5	251.7	242.2	207.2	198.6
Trade balance (exp. fob. - imp.fob.; USD bln)	-84.1	-99.9	-84.6	-63.4	-56.1
Current account balance (USD bln)	-48.0	-63.6	-43.6	-32.1	-32.6
Current account / GDP (%)	-5.5	-6.7	-4.7	-3.7	-3.8
Official reserves (incl. gold; eop; USD bln)	119.1	131.0	127.3	110.5	106.3

Sources: IMF, CBRT & TUIK

II. Economic Overview and Outlook

Real Sector

Economic growth rebounded in Turkey in 2016 underpinned by supportive macro prudential measures and introduction of various incentives and fiscal stimulus packages. Despite the economic contraction observed in third quarter (-0.8%) economic activity partially recovered in the fourth quarter (4.2%) with full year GDP growth standing at 3.2%. Economic growth was mainly driven by rise in private consumption and robust growth witnessed in exports.

Value added in agriculture whose share in GDP was estimated to be 7.9% in 2016 contracted by 4.1%. Industry with share in GDP standing at 21.5% expanded by 4.5% whereas services sector with share in GDP at 70.6% grew by 3% in fourth quarter of 2016.

Private consumption expenditures grew by 2.3% for the full year and rebounded in fourth quarter recording a growth of 5.7% versus 1.7% contraction observed in third quarter. Government consumption expenditure slowed down in fourth quarter to 0.8% with overall yearly growth standing at 7.3%.

External Sector

Turkish exports experienced their longest and strongest growth track during 2000-2012 with an average growth of 15.3% and surged by 18.5% y/y and 13% y/y respectively in 2011 and 2012. But this performance slowed down in the recent years with the exports growth losing momentum in 2015 and 2016 due to weak external demand arising from the economic slowdown and contractions in the major trade destinations of Turkey. Exports in 2013 contracted slightly for the first time since 2009 as Turkey's main export markets in Europe experienced a severe recession. Turkey's exports decreased by 8.7% y/y in 2015 and were realized at USD 143.8 billion while imports decreased by 14.4% y/y and stood at USD 207.2 billion.

A similar pattern was observed in 2016 wherein exports and imports fell but the pace of decline pared to 0.9% and 4.15% respectively, with exports and imports standing a USD 142.5 billion and USD 198.6 billion, respectively. Imports decreased owing to the weak domestic demand conditions and the sharp decline in oil prices recorded in the second half of the year. As a result foreign trade deficit of Turkey which has declined in the previous two years shrank further in 2016 by 11.5% and was realized as USD 56.1 billion.

Current account deficit declined to USD 32.6 billion in 2016 from high of USD 74.4 billion realized in 2011 mainly on account declining oil prices. In terms of GDP current account deficit in 2016 stood at 3.8% of GDP compared to a high of 8.9% recorded in 2011.

Fiscal Outlook

Turkey has over the past five years adhered to fiscal discipline as reflected by the surplus in primary balance and budget deficit that has stabilized in the range of 1.0-1.5% of GDP. Government's commitment to fiscal discipline was evident in 2016 wherein central government budget deficit was realized at 1.1% of GDP against Medium Term Program (MTP) target of 1.6%. Growth in revenues was realized at 14.8% and expenditures posted a growth of 15.3%. Government fiscal stimulus measures announced in latter part of 2016 were the main reason for the uptick in overall expenditures. Primary surplus to GDP ratio was realized at 0.8%.

According to the MTP 2018-2020 projections budget deficit to GDP ratio is expected to reach 2% of GDP in 2017. The MTP supports the view that the government will not derail from fiscal consolidation during this period.

Monetary Policy and Inflation

CPI remained elevated at an average 8% after the post-global crisis era. The trend continued in 2013 and 2014, as well, with annual inflation averaging 7.5% in 2013 which was a moderate deceleration compared to 2012's 8.9%. Starting in 2015 price pressures subdued slightly and a 2016 average CPI was realized at 7.7%. Year- end CPI stood at 8.5% which surpassed Central Bank of Republic of Turkey (CBRT)'s 5.0% year-end forecast.

CPI inflation was primarily driven by volatility in unprocessed food prices due to adverse weather conditions, tax adjustments and depreciation of Turkish Lira. Prices remained elevated in latter part of 2016 as exchange rate pass-through led to rise in service sector inflation and import prices. On the other hand, due to the base effect related to macro-prudential measures there was an increase credit growth which also contributed to build up of price pressures.

In early 2016 with a backdrop of easing global financial conditions and a relatively stable domestic currency, inflationary pressure subsided which led CBRT to embark on a course of normalizing the monetary policy by delivering a series of measured cuts in overnight lending rate. Specifically, between March and September, overnight late liquidity rate was reduced from a high of 10.75% to 8.25%, and overnight borrowing rate and one-week repo rate was held unchanged at 7.25% and 7.5%, respectively.

During the summer of 2016 with the rise in political uncertainty after the failed coup and the resultant financial volatility led CBRT to introduce liquidity measures to mitigate the risks to financial stability. In late 2016 with the shift to a more tight monetary policy stance of developed country central banks and the increased financial volatility witnessed after the US presidential elections, CBRT decided to tighten the monetary policy stance and late liquidity window was increased by 25 basis point to stand at 8.5% and the weekly repo rate raised by 50 basis point to 8%.

Future Outlook

Supportive measures in the form of macro-prudential relaxations, interest rate developments, credit guarantee scheme and other incentives provided a strong momentum to credit growth which propelled the economy to rebound towards the latter part of 2016. Exports rebounded in the latter part of 2016 and the recovery continued through the first quarter of 2017. It is projected that exports will maintain the growth momentum for the rest of the year on the back of strengthening of external demand in EU.

It is expected that Turkish economy will perform moderately well in the short term and real GDP is projected to grow by 5.5% in 2017 and the next three years as per the MTP (2018-2020). Realization of strong first quarter 2017 real GDP growth at 5.2% coupled with strong readings from the various leading indicators and recovery in tourism and exports point to continued solid growth in the near future.

III. Review of 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 596 million by the end of September 2017. Bank's total outstanding portfolio including short-term trade finance operations in Turkey was USD 172.4 million at the end of September 2017.

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 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 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 has also initiated provision of medium-long term sub-ordinated loans which are extended on case by cases basis with a specific condition to improve the SMEs portfolio of the FIs in Turkey. 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. 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 in view of this fact, the Bank has started to cooperate with leasing companies as integral part of its SME finance strategy.

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.

(i) Micro, Small and Medium Sized Enterprises (M-SMEs) Development Facility

In SME development loans, the Bank is cooperating with an increasing number of financial institutions in Turkey in order to support SME segment more efficiently and effectively. The Bank is disbursing loans to public and private financial institutions which in turn pass on (or on-lend) to 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. SME Development Facility Program plays a vital role in creating jobs and generating income for low income people. It also serves the ETDB mandate in an optimal manner.

As of September 2017, the Bank has been able to enlarge the network of its partner FIs to 12 financial institutions in Turkey participating in the said SME program. 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. Supportive measure in the form of macro prudential relaxations, interest rate developments and other incentives provided a strong momentum to credit growth and sector’s bottom line. The sector is well capitalized and is well regulated by two regulatory authorities namely Banking Regulation and Supervision Agency (BRSA) and Central Bank of Turkey (CBT). Nevertheless, Turkish banking remains well capitalized and meets the Basel III requirements, with the capital adequacy ratio (CAR) at 15.5% in 2016. Core Tier 1 (CET 1) ratio stood at 13.2% against the regulatory minimum of 5.6%.

Although the Bank’s FIs operations in Turkey have been the most successful within its portfolio, still, for better efficacy and efficient outreach, the strategy has been to expand 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. The Bank added 4 new mid-size conventional banks and 3 new Islamic banks into its portfolio in Turkey since 2013 as financial intermediaries to the SME Development Facility Program.

Most of the SMEs use external financing sources 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 3 new leasing companies in Turkey which have been included in the SMEs development facility network since 2012.

Since 2013, ETDB initiated co-finance and parallel-finance transactions in SME Development program with other MDBs such as IFC, EBRD and EFSE. During 2013-2014, ETDB executed the first sub-ordinated (tier II) SME lending program, the first Murabaha and the first Wakala transactions since establishment. In 2016, ETDB executed its first SME facility to finance sustainable energy consumption. From the beginning of operations in 2008, the total SME development facility disbursement of the Bank to various operations in Turkey amounted to USD 246.5 million by the end of September 2017.

The Bank has specific eligibility criteria which are defined to the selected Financial Institution in order to assure that funds are moving to the Bank’s target market. Funds will be allocated to SMEs according to following amounts and requirements.

Client Category	**Micro**	**SME**
Headcount	**<50**	**51-250**
Annual Turnover	**<EUR 50,000.-**	**EUR 51,000-EUR 15,000,000**

a. Only be applied to SMEs which are bankable, financially sound and will be able to use the funds economically.
b. Only be applied to finance of SMEs domiciled in the territory of the ECO Bank member states.
c. Only be used by SMEs which comply with ECO Trade and Development Bank rules on sector eligibility and restrictions as defined in this document.

In addition to above final beneficiaries of the SME Development Loan will be filtered according to the negative list of products and sectors and the environmental policy of the Bank. Going forward, 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 credit enhancement techniques such as securitizations or structured asset backed lending programs.

(ii) 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 trade activities. The FIs participating in the program have been making use of relevant products offered under the STTF and have helped a number of businesspersons in their trade transactions within and outside of the region. Each and every transaction is filtered according to the negative list of products and the environmental policy of the Bank.

Under this facility, the cumulative disbursements since 2008 amounted to USD 241.6 million by the end of September 2017. 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.

(iii) Corporate and Project Finance

The Bank provides medium to long term finance to corporates and development projects in line with its overall objective of fostering economic development and social progress in its member states and trade finance loans to promote export/import among the region. The Bank provides medium to long term finance to corporates and development projects, where the process of selecting projects is based on the assessment of incremental 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. From the beginning of operations in 2008, the total disbursement of the Bank to various operations in Turkey under this section amounted to USD 107.8 million by the end of September 2017.

At the end of 2016, Bank's active portfolio under these operations in Turkey consisted of two operations. One project finance loan with an amount of USD 35 million and nine years (including three years grace period) tenor was extended to the Istanbul Metropolitan Municipality in October 2010 which 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 August 2015, the Bank also supported the Vestel Elektonik San. Ve Tic.AŞ and extended a 24-month loan amounting to EUR 20 million for the purpose of financing exports of the company to about 150 countries.

Limited capital base of the Bank also puts a constraint on the Bank to finance large scale/mega projects. Nevertheless, the country specific focus is ensured vigorously to tap new avenues of operations in the country, where the right kind of match be accorded between bank's mandate and lending appetite vis-a-vis the beneficiary's business and financial aspirations. The Bank intends to work more closely with other MDBs on exploring further opportunities for co-financing in the Turkish market. The strategy of the Bank would be supporting transport, trade, manufacturing and infrastructure projects and growth of medium sized enterprises through direct lending and investment operations.

IV. Conclusion

Turkey has undergone profound economic transformation over the last decade and its economic fundamentals are quite solid. Turkey's main assets include a young, dynamic population, a large domestic market, and a strategic location, combined with strong infrastructure and much improved public services. It is among the 20 largest economies in the world and the 6th largest economy in Europe with a current GDP amounting to USD 862.7 billion by the end of 2016. It has also established the aim of growing the economy in order to be among the top ten by 2023. Despite the current global challenge and weak progress in global economies, Turkey managed to preserve its growth performance at 3.2 percent in 2016.

While Turkey has greatly improved broad range of industrial and service sectors, it remains essential to deepen the structural transformation for more high-value added output and move towards upper end of the global value chain. Increase in business investment and innovation as well as in education and skills would further strengthen the private sector-led, open, competitive and productivity growth. Investing in infrastructure, human capital, R&D, innovation and entrepreneurship would further support sustainable growth.

The Bank would aim to contribute to Turkey's sustainable development and objectives established in the Vision 2023 document, the Tenth Development Plan 2014-2018, Medium-Term Program (MTP, 2018-2020) and respective Annual Plans. The main objectives of the current MTP are to decrease inflation and increase employment by maintaining macroeconomic stability and fiscal discipline, to build stable, inclusive and sustainable growth path without increasing current account deficit. The program is prepared with an approach to promote investment and high value-added production. During the program period, main priorities are to increase domestic savings, to ensure private investment and export-driven growth, to accelerate structural transformation in industry, to become more competitive in the international markets by increasing technology and productivity level.

Within the current MTP, the GDP growth is forecasted to be 5.5 percent in 2017. On the other hand, the GDP growth rates in 2018 and 2019 under the current MTP are targeted as 5.5 percent along with the growth strategy which is supported by investments to productive areas. Having positive contribution from total factor productivity to growth and developing the export-oriented, private sector-led competitive production structure are of utmost importance for Turkey in the coming years.

To this end, this country strategy document is the primary analytical and planning tool that would enable ETDB to design, execute, monitor, review, and evaluate its operations in Turkey. The Bank's role and priorities are defined according to (i) country development priorities and (ii) available resources, strategies and policies of ETDB. The Bank will also consider and contribute to the priorities set in the above mentioned plans/programs. 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 logistics, health, petrochemical, ICT, automotive, and tourism sectors.

Meanwhile the Bank will put efforts to support enhancement of total exports (particularly high value-added products) of the country. 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. 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. 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 and facilitate trade with an aim to contribute the target of Turkey to boost exports.
Financial sector. Support improving capacity and competitiveness of the financial institutions. Increase providing long-term funds aimed to improve competitiveness of SMEs.