COUNTRY REPORT FOR TURKEY

This report begins with an analysis of the performance of the Turkish economy in the last decade, continues with recent developments in the capital market, and finally lays out the prospects for the market.

THE TURKISH ECONOMY

The Turkish economy has undergone significant changes during the past three decades. It has moved from a protected state-directed system to a market-oriented free enterprise system. Reforms initiated since 1980 have largely reduced the role of the public sector in the economy, liberalized foreign trade, removed capital transfer and exchange controls and encouraged foreign investment. A customs union with the European Union came into force in December 1995.

A new set of reforms were undertaken starting from end-1999, as a new economic stabilization program anchored in the stand-by arrangement with the IMF was initiated and the country was granted “candidate country” status by the EU. However, the overvaluation of the Turkish Lira (TL) and weak financial sector led to the abandonment of crawling peg exchange rate regime in February 2001 and the TL was left to float. The Turkish Lira devalued sharply, pushing up inflation to around 80%. Amidst the uncertain economic outlook, GDP contracted by nearly 6%, while unemployment jumped above 8% in 2001.

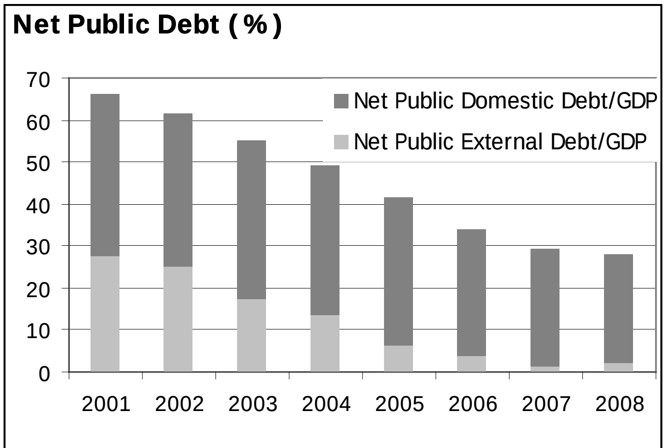
A new economic program, still backed by an IMF stand-by agreement, was launched under the free-floating exchange rate regime. The program aimed to restore confidence and stability by restructuring the public sector and further liberalising the economy. Comprehensive structural reforms were undertaken, especially in the banking sector. 22 banks, out of 80, were nationalised. The rest were recapitalised and later some merged. Currently, there are 46 banks in the market.

The new government formed by the Justice and Development Party (AKP) in the November 2002 elections pursued the IMF programme aiming at the liberalisation of the economy. Meanwhile, the European Council decided to open membership talks with Turkey in December 2004 and accession negotiations started officially in October 2005. The AKP government was re-elected in November 2007. The IMF program has ended in May 2008; however the government is still negotiating for a new program with the Fund.

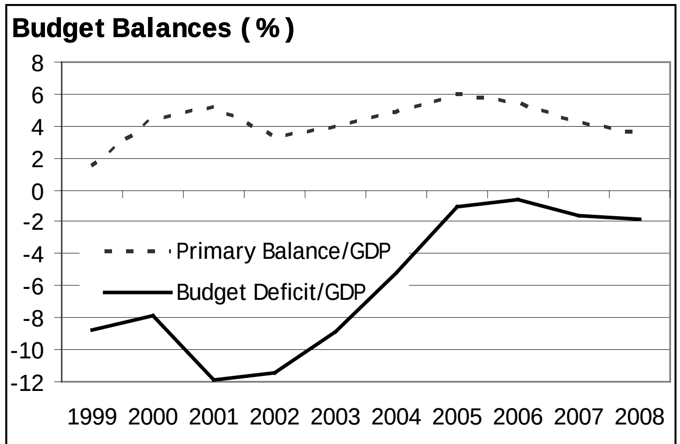
Turkey has benefited from the increased foreign investors’ interest like many emerging countries over the last few years and attracted significant capital flows, both in the form of direct investment, as well as portfolio flows. While inflation was tamed, the economy grew by an average rate of 7% during 2002-2006. However, the unemployment rate remained high during the same period, and rose further in 2009, as the economy contracted significantly amidst the global crisis. Although Turkish economy was not exposed directly to the sub-prime market, the global financial crisis affected the Turkish economy through the deterioration in external financing conditions, weakening foreign trade and destabilized confidence.

Public Finance

Strict fiscal policy was a main pillar under the macro-economic programs backed by the IMF. Fiscal discipline coupled with important privatisation efforts led to a significant improvement in the budgetary primary balance between 2001 and 2006. Reduced interest payments mirroring a decline in risk premia also helped the decline in the central government's budget balance. However, the fiscal policies were loosened in 2007, during the year of general elections. The deterioration continued in 2008 and the primary balance to GDP ratio fell to 3.5%, down from 5-6%.



Source: Treasury



Source: MoF

In the first half of 2009, the primary surplus declined considerably to US$ 3 billion from US$ 18 billion in 2008, while the budget deficit already exceeded that of the whole year of 2008 reaching US$ 15 billion.

Public sector's debt had increased sharply after the 2001 crisis when many banks were nationalised and taken over by the Savings Deposit Insurance Fund. It has declined gradually to 28% of GDP by the end of 2008, from 66% in 2001. However, there is an increase in nominal terms in the year 2009 in the public sector debt, in line with deteriorating budget balances.

Monetary and Exchange Rate Policies

It has been a general policy of the Central Bank of the Republic of Turkey (CBRT) to permit the devaluation of the Turkish Lira in line with the inflation rate until the 1999 stand-by program. The initial program consisted of a crawling exchange rate peg, coupled with limits imposed on growth of monetary aggregates.

After the collapse of the exchange rate regime, Turkey adopted a free-floating exchange rate regime and moved gradually to an explicit inflation-targeting policy. Six zeros were removed from the currency at the beginning of the year 2005, with the help of the decline in inflation rates. Although declining to single-digit levels, which was an important achievement for the country, inflation remained above the targets set since 2006, due to both rising international intermediary goods' prices and buoyant domestic demand. In this context, the Central Bank revised its medium-term targets to 7.5% and 6.5% for 2009 and 2010, respectively, up from the initial 4% level.

With the growth performance being hit by the global crisis, the Central Bank of Turkey followed a countercyclical monetary policy, leading to sizeable cuts in the short-term policy interest rates starting from November 2008, as summarised in the table below.

Monetary Policy Committee (MPC) Decisions

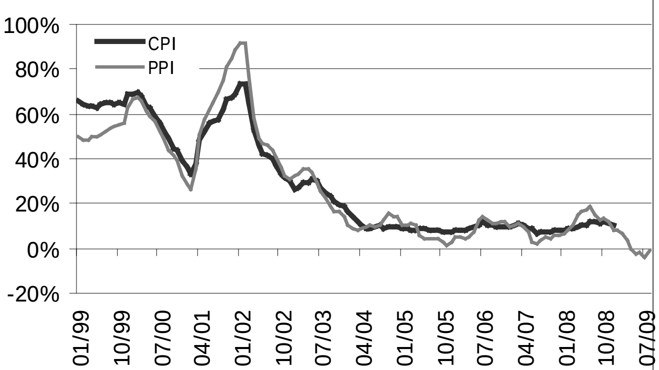
Meeting Dates	Decision on Interest Rates (% points)	Interest Rate	Meeting Dates	Decision on Interest Rates (% points)	Interest Rate
17-Jan-08	-0.25	15.50	19-Nov-08	-0.50	16.25
14-Feb-08	-0.25	15.25	18-Dec-08	-1.25	15.00
19-Mar-08	No change	15.25	15-Jan-09	-2.00	13.00
17-Apr-08	No change	15.25	19-Feb-09	-1.50	11.50
16-May-08	0.50	15.75	19-Mar-09	-1.00	10.50
17-Jun-08	0.50	16.25	16-Apr-09	-0.75	9.75
18-Jul-08	0.50	16.75	14-May-09	-0.50	9.25
14-Aug-08	No change	16.75	16-Jun-09	-0.50	8.75
18-Sep-08	No change	16.75	16-Jul-09	-0.50	8.25
22-Oct-08	No change	16.75	18-Aug-09	-0.50	7.75

Source: CBRT

The improvement in macroeconomic balances and increased foreign investors' interest towards emerging markets had led to an appreciation of the Turkish lira since 2002 until September 2008, when the global crisis peaked. A correction occurred starting from then.

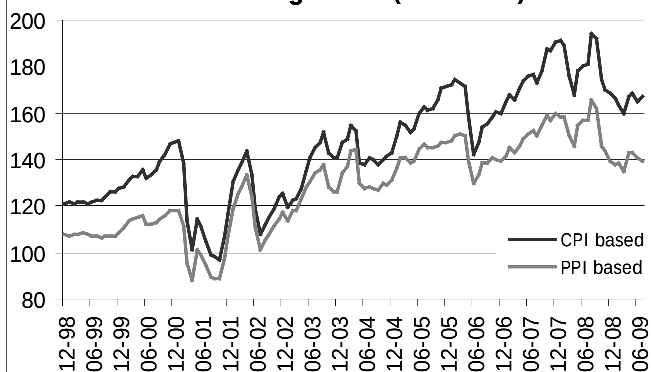
The Central Bank exchange rates for 31 August 2009 were TL 1.4956 = US$ 1, and TL 2.1358 = € 1.

Inflation (Annual, %)



Source: TurkStat

Real Effective Exchange Rate (1995=100)



Source: CBRT

Inflation

Inflation remained as one of the most serious problems faced by the Turkish economy in the 1990s. The anti-inflation programme initiated in early 2000 with the crawling peg as its main pillar, managed to pull inflation steadily down. However, the outbreak of the crisis in 2001, coupled with a sharp devaluation of the currency swept away the gains of this period, and annual inflation rose back to around 80%.

The Central Bank of Turkey started to implement an inflation targeting policy starting from the year 2002. With the help of the revaluation of the Turkish lira amidst favourable global conditions, inflation came down significantly. Although inflation realisations have been above target since 2006, single-digit rates were the lowest inflation levels recorded in the last three decades.

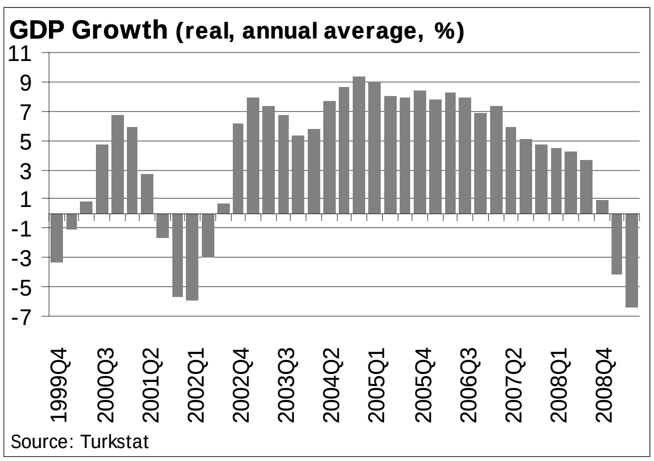
Inflation Targets and Realisations (CPI, % y-o-y change)										
	2002	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Target CPI	35.0	20.0	12.0	8.0	5.0	4.0	4.0	7.5	6.5	5.5
Realisation	29.7	18.4	9.3	7.7	9.7	8.4	10.1	-	-	-
Source: CBRT										

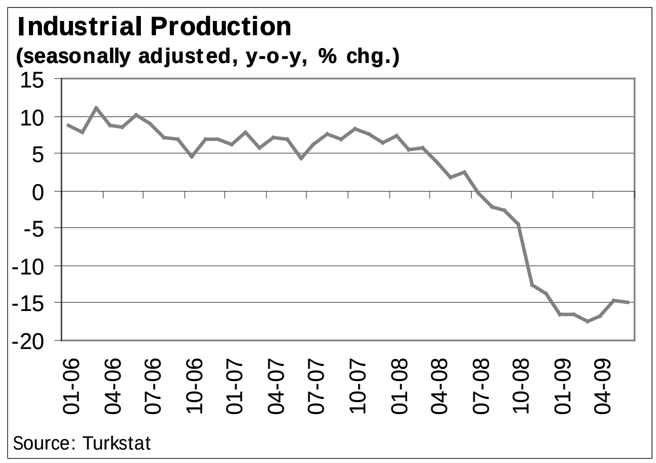
The consumer price index rose by 5.3% in the first eight months of 2009 and the year-end inflation expectation is around 6%, below the Central Bank's target.

Growth and Employment

After 5 years of robust growth averaging 7.2% during 2002-2006, GDP growth slowed down to 4.5% in 2007 with deteriorating international conditions. The growth rate further slowed down in 2008 to 1.1% as a reflection of the global financial crisis, affecting Turkey's economy through the deterioration in external financing conditions, weakening foreign trade and destabilized confidence. Nevertheless, GDP per capita reached a record-high US$ 10,436 in 2008.

The economy contracted by an unprecedented 14% in the first quarter of 2009. The contraction eased to 7% in 2Q09, thanks to tax incentives granted in various durable goods and the automotive industry. In annual terms, GDP contracted by 6.5% as of June 2009. While seasonally adjusted industrial production figures show signs of stabilisation in the second quarter of the year, the economy is expected to contract by around 5% in 2009.





Following the 2001 crisis, the unemployment level reached 10% in 2002. Despite high growth rates in GDP, it did not decline until 2007. With deteriorating domestic and external demand conditions in 2008, the unemployment level reached 11% on average in 2008. Later, the unemployment rate rose to 16% in 1Q09 and declined to 13.6% in 2Q09 due to seasonal factors. Meanwhile, it should be added that the participation rate to the workforce is quite limited at 48%.

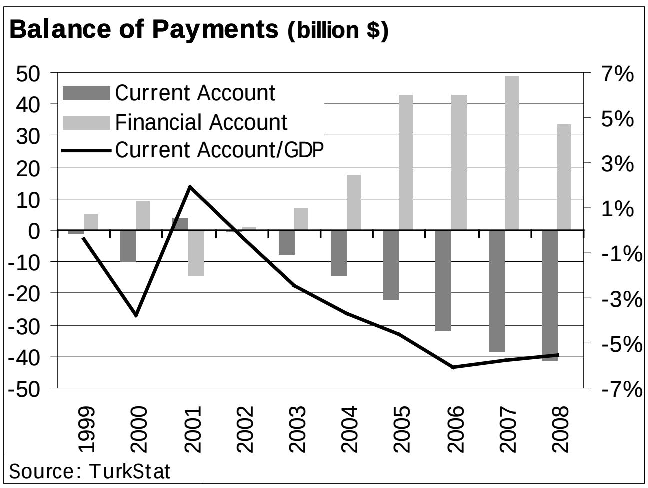
Foreign Trade and Foreign Debt

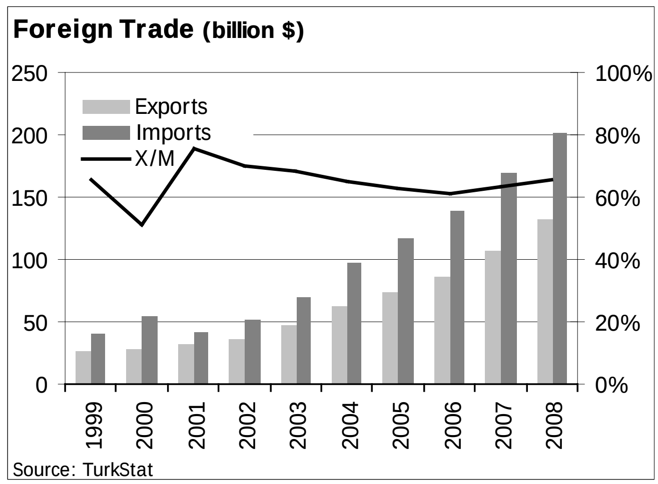
All the duties and taxes on imports to Turkey from the EU were abolished at the beginning of 1996, when Turkey became a member of the Customs Union. In addition, all customs duties and taxes applied to third countries were brought to levels imposed by the EU countries.

Favourable external and internal demand conditions led to an important rise in Turkish foreign trade in the period preceding the global crisis. The rapid expansion of the trade deficit led to a remarkable increase in the current account deficit of the country.

Turkish exports reached US$ 132 billion in 2008, up from US$ 31 billion in 2001, thanks to favourable global growth conditions and the diversification of the export markets. Nevertheless imports, 75% of which are intermediate goods, grew even faster to quadruple in 7 years, reflecting partly the rise in international commodity prices. While imports reached US$ 200 billion by the end of 2008, the current account deficit recorded US$ 41 billion.

With the contraction in global demand, exports started to decline in the last quarter of 2008. In the first seven months of 2009, Turkish exports are down by 30% year-on-year. Imports, on the other hand contracted even faster by 41%. The current account deficit went down by 76% in the first half of 2009 to US$ 7 billion.





Turkey was able to attract significant amounts of foreign capital flows in the last five years, both in terms of direct investment and in terms of portfolio flows.

Net foreign direct investments increased significantly, reaching a record-high US$ 20 billion in 2007, up from an average of US$ 0.6 billion in the 1990's. Net FDI went down to US$ 15 billion in 2008 with the global crisis and recorded only US$ 3.4 billion in 1H09. Sizeable portfolio flows during 2003-2006, was replaced by an outflow in 2008, as the global financial crisis deepened in the second half of 2008. This negative trend continued in the first half of 2009 as US$ 5.5 billion outflow was observed in the financial account as compared with US$ 28 billion inflow in 2008.

In line with massive foreign capital inflows, Central Bank's gross foreign exchange reserves rose from around US$ 25 billion in the early 2000s, to around US$ 75 billion in August 2008. After the collapse of Lehman Brothers in September 2008, CBRT's reserves started to erode. The Central Bank's FX reserves recovered slightly in August 2009, reaching US$ 70 billion by the end of the month.

Turkey's external debt stock recorded US$ 114 billion by end-2001. External debt expanded rapidly under favourable international liquidity conditions and reached US$ 277 billion by end-2008. With limited access to international funds in the aftermath of the global financial turmoil, it has declined to US$ 265 billion in March 2009. This figure is composed of US$ 48 billion of short-term foreign debt and US$ 217 billion of medium to long-term foreign debt, 60% of which belongs to the private sector.

KEY ECONOMIC INDICATORS	**Units**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Population											
Population (mid-year)	mn	63.4	64.3	65.1	66.0	66.9	67.7	68.6	69.4	70.3	71.1
Employment (average)	mn	22.5	21.5	21.5	21.5	21.3	21.7	22.1	21.0	20.7	21.2
Unemployment Rate	%	7.3	6.5	8.3	10.3	10.5	10.3	10.2	9.9	10.3	11.0
Underemployment	%	6.7	7.0	6.0	5.5	4.8	4.1	3.3	3.6	3.0	3.3
Output											
Gross Domestic Product	USD bn	247.5	265.4	196.7	230.5	304.9	390.4	481.5	526.4	649.0	741.8
Agriculture	%	10.5	10.1	8.8	10.3	9.9	9.5	9.4	8.3	7.7	7.6
Industry	%	24.9	23.0	22.4	21.0	20.9	20.3	20.3	20.1	19.6	19.7
Services	%	62.4	60.5	62.9	59.2	58.2	58.7	58.5	59.7	61.1	62.6
Real GDP Growth	%	-3.4	6.8	-5.7	6.2	5.3	9.4	8.4	6.9	4.7	1.1
Agriculture	%	-5.7	7.1	-7.9	8.8	-2.0	3.1	6.9	1.4	-6.7	4.1
Industry	%	-4.9	6.6	-7.3	2.7	7.8	10.8	9.1	8.3	5.8	1.1
Services	%	-1.5	6.4	-2.5	5.5	4.4	9.8	9.1	8.2	6.3	1.5
Prices											
Producers' Prices (y-o-y chg.)	%	62.9	32.7	88.6	30.8	13.9	13.8	2.7	11.6	5.9	8.1
Consumer Prices (y-o-y chg.)	%	68.8	39.0	68.5	29.7	18.4	9.3	7.7	9.7	8.4	10.1
USD Exchange Rate (y-o-y chg.)	%	72.2	24.4	115.3	13.3	-15.0	-4.1	0.4	4.8	-17.5	31.3
USD Exchange Rate (annual avg.)	TL/USD	0.4209	0.6242	1.2285	1.5071	1.4916	1.4221	1.3408	1.4314	1.3005	1.2944
External Balance											
Exports (FOB)	USD bn	26.6	27.8	31.3	36.1	47.3	63.2	73.5	85.5	107.3	132.0
Imports (CIF)	USD bn	40.7	54.5	41.4	51.6	69.3	97.5	116.8	139.6	170.1	202.0
Current Account Balance	USD bn	-0.9	-9.9	3.8	-0.6	-7.5	-14.4	-22.1	-32.1	-38.2	-41.3
Change in Reserves	USD bn	5.2	-3.0	-12.9	-0.2	4.1	4.3	23.2	10.6	12.0	-2.8
Current Account Balance/GDP	%	-0.4	-3.7	1.9	-0.3	-2.5	-3.7	-4.6	-6.1	-5.9	-5.6
Central Bank Reserves-excl. gold	USD bn	23.2	19.6	18.7	26.7	33.6	36.0	50.5	60.8	71.3	70.1
Outstanding External Debt	USD bn	103.3	116.1	115.1	129.5	144.1	161.0	169.7	207.6	249.4	277.1
Outstanding External Debt/GDP	%	41.7	43.7	58.5	56.2	47.3	41.2	35.3	39.4	38.4	37.4
Fiscal Indicators											
Non-Interest Budgetary Expenditure	USD bn	41.3	49.5	37.4	45.0	55.5	67.2	85.0	92.3	119.4	135.4
Primary Balance	USD bn	3.7	11.7	10.2	7.7	12.3	19.2	28.9	28.9	26.9	26.0
Budget Balance	USD bn	-21.7	-21.0	-23.2	-26.7	-27.0	-20.5	-5.1	-3.2	-10.5	-13.2
Primary Balance/GDP	%	1.5	4.4	5.2	3.3	4.0	4.9	6.0	5.4	4.2	3.5
Budget Deficit/GDP	%	-8.7	-7.9	-11.9	-11.5	-8.8	-5.2	-1.1	-0.6	-1.6	-1.8
Net Public External Debt/GDP	%	--	14.3	27.6	25.2	17.2	13.4	6.5	4.0	1.3	2.0
Net Public Domestic Debt/GDP	%	--	28.7	38.8	36.2	37.9	35.7	35.2	30.0	28.1	26.1
Net Public Debt/GDP	%		42.9	66.3	61.4	55.1	49.0	41.6	34.0	29.5	28.2
EU Defined Government Debt/GDP	%	--	--	77.6	73.7	67.4	59.2	52.3	46.1	39.4	39.5

Source: CBRT, Treasury, TurkStat, TSPAKB calculations

OVERVIEW OF THE TURKISH CAPITAL MARKETS

The establishment of a modern securities market in Turkey dates back to the 1980's when a macro-economic approach aiming to liberalize the country's economy was adopted. A brief timeline and milestones of Turkish capital markets are presented below:

History of the Turkish Capital Markets	
1981	Capital Markets Law
1982	Capital Markets Board established.
1985	Istanbul Stock Exchange established.
1987	First mutual fund issued.
1989	Settlement and Custody Department established within ISE
	Liberalization of foreign investments.
1991	Bonds & Bills Market established within ISE.
1992	Settlement and Custody Inc. established as a separate company.
	Corporate bond market established within ISE.
1993	Repo-Reverse Repo Market established within ISE.
	Automated trading started with 50 companies.
1994	Settlement on T+2.
	Fully automated trading started.
1995	Settlement and Custody Bank (Takasbank) was formed.
	Istanbul Gold Exchange established.
	New Companies Market established within ISE.
	International Securities Market established within ISE.
1996	Securities Lending & Borrowing Market established within Takasbank
	Money Market established within Takasbank
1997	Banks are not allowed to trade equities, but may establish brokerage subsidiaries.
	First asset management company established.
1998	First credit rating agency established.
1999	Client-based custody at Takasbank.
2000	Market making system introduced for government bonds.
	First venture capital trust offered to public.
2001	TSPAKB (Association) established.
	Investors' Protection Fund established.
	Futures market established within ISE.
	Central Registry Agency established.
	Remote trading started at ISE.
2002	Pension system regulation passed.
2003	Corporate governance principles published.
	First private pension fund established.
	International Financial Reporting Standards adopted.
2004	First Exchange Traded Fund established.
2005	Turkish Derivatives Exchange established.
	Dematerialization of equities completed.
2006	Dematerialization of corporate bonds and mutual funds completed.
2007	Opening auction introduced at ISE.
	Mortgage Law passed.
	Eurobond market established within ISE.
2008	ISE's trading hours is extended by 30 minutes.
2009	Automated Disclosure Platform is introduced.
	Warrants regulations issued.
Source: CMB, TSPAKB	

Regulatory Structure of the Financial System

The Turkish financial system has a fragmented regulatory structure. Banking Regulation and Supervision Agency (BRSA) is in charge of the banking system, whereas the Capital Markets Board of Turkey (CMB) is the main regulator of the capital markets. The Central Bank of the Republic of Turkey (CBRT) regulates money and foreign exchange markets. The Undersecretariat of Treasury, on the other hand, oversees the insurance industry.

Major institutions operating in the securities industry are briefly introduced below. A detailed chart covering the whole financial system is provided on the next page with an illustration of jurisdictions.

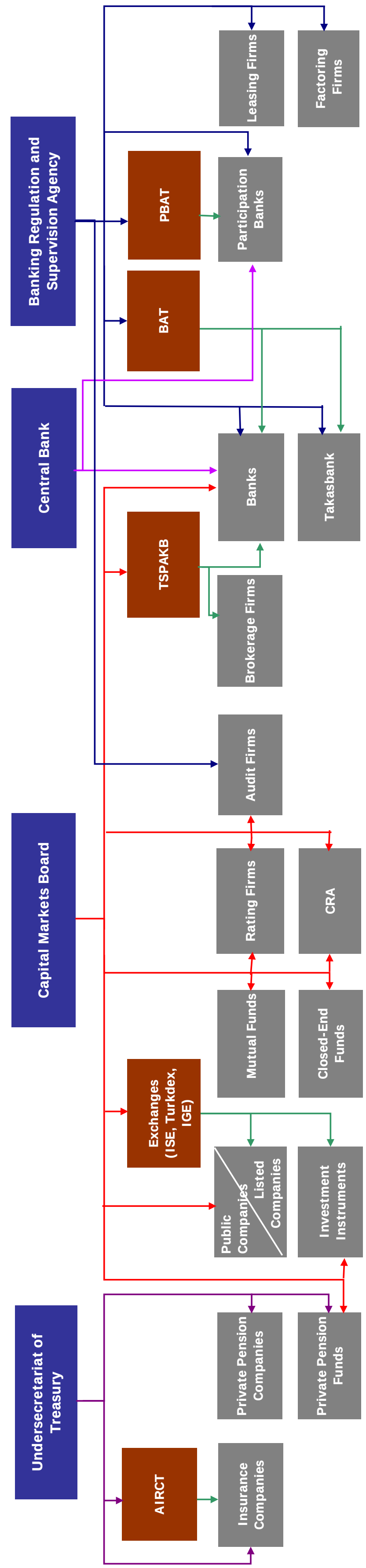
Capital Markets Board of Turkey (CMB) is the regulatory and supervisory authority for the securities markets and institutions in Turkey. The CMB determines the operational principles of the capital markets and is responsible for the protection of the rights and interests of investors. CMB regulates and supervises public companies, listed companies, financial intermediaries, exchanges, mutual, closed-end and pension funds, Settlement and Custody Bank (Takasbank), Association of Capital Market Intermediary Institutions of Turkey (TSPAKB), Central Registry Agency (CRA) and other related institutions operating in the capital markets, such as independent audit firms, rating agencies, etc.

The Exchanges; Istanbul Stock Exchange (ISE), Turkish Derivatives Exchange (TurkDex), and Istanbul Gold Exchange (IGE) have the authority to regulate their own markets, listed companies and products in these markets, and member intermediaries. Istanbul Stock Exchange and Istanbul Gold Exchange are mutual organisations, while the Turkish Derivatives Exchange is a for-profit company.

The Association of Capital Market Intermediary Institutions of Turkey (TSPAKB) is a self-regulatory organization. All brokerage firms and banks, authorized for capital market operations have to be members of the Association. In Turkey, only brokerage firms are allowed to operate in the equity market; whereas in other markets, banks may also operate. TSPAKB sets professional rules and monitors them to provide a fair and disciplined capital market. TSPAKB establishes and enforces regulations on subjects assigned by legislation or CMB.

Banks' Association of Turkey (BAT), Participation (Islamic) Banks' Association of Turkey (PBAT) and Association of the Insurance and Reinsurance Companies of Turkey (AIRCT) are the other self-regulatory organisations in the financial system.

REGULATORY STRUCTURE OF THE TURKISH FINANCIAL SYSTEM



AIRCT: The Association of the Insurance and Reinsurance Companies of Turkey
BAT: Banks' Association of Turkey
CRA: Central Registry Agency
IGE: Istanbul Gold Exchange
ISE: Istanbul Stock Exchange
PBAT: Participation Banks' Association of Turkey
Takasbank: Settlement and Custody Bank
TSPAKB: The Association of Capital Market Intermediary Institutions of Turkey
Turkdex: Turkish Derivatives Exchange

Recent Developments in Capital Markets

In the wake of the deterioration in expectations of global liquidity and the contagious effect of the financial crisis, the Central Bank cut O/N interest rates to 7.75% by August 2009, from 16.75%. In line with declining O/N rates, T-bill rates in the secondary markets also went down to below 10%, from around 25% in November 2008. Secondary market activity recovered mainly starting from the second quarter of the year; however in US$ there is a decline in the trading volume, due to the depreciation of the Turkish Lira.

After a 50% decline in the ISE-100 index in 2008, the Istanbul Stock Exchange recovered in 2009 as the index rose by 73% until end-August. Secondary market activity recovered mainly starting from the second quarter of the year; however the number of IPOs is still very limited. The trading volume recovered in 2009 after a decline in 2008.

1. *Equity Market*

As of August 2009, there are 324 listed companies in the Istanbul Stock Exchange. The number of listed companies increased by 10% in three years until 2007. However, a decline was observed starting from 2008, as the number of IPOs remained limited in the aftermath of the global crisis.

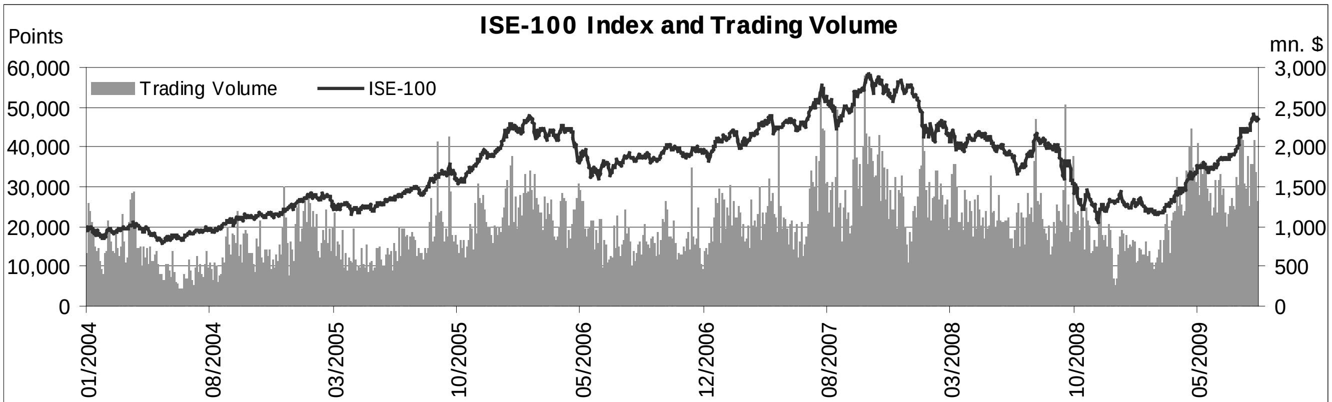
Equity Market at a Glance	No. of Companies[1]	No. of IPOs[1]	Delistings[1]	IPO Size (mn. $)	Market Cap. (mn. $)	Trading Volume (mn. $)	No. of Brokerage Firms
2004	297	12	-	482	98,073	147,755	112
2005	306	11	-	1,790	162,814	201,763	108
2006	322	19	-	949	163,775	229,642	105
2007	327	11	2	3,389	289,986	300,842	104
2008	326	2	2	1,895	119,698	261,274	104
08/2009	324	1	-	69	209,607	193,429	103

Source: ISE
1: Numbers may not add up due to relistings and mergers.

After the 2001 crisis, the IPO market revived only in 2003, averaging 13 new listings per year until 2008. Average IPO size was US$ 125 million in the same period. In 2008, there were 3 public offerings in the market, amounting to US$ 1.9 billion in total. Almost the entire amount of total IPOs was raised by the Turk Telekom, which has been the largest IPO ever in Turkey. It should be noted that, 58% of the IPO proceeds between 2003 and 2008 is raised by privatization activities. In 2009, the only new IPO belonged to an exchange traded fund. However, thanks to a recent regulation, public companies can become listed after fulfilling certain conditions, without having to go through a formal IPO procedure.

ISE's market capitalization reached a record level of US$ 301 billion in 2007. However in 2008, the ISE-100 index posted a 50% decline in TL terms and reached 26,864 points. Accordingly, total MCap dropped to US$ 120 billion at the end of the year. MCap declined further to US$ 100 billion in February 2009. However it has recovered since, reaching US$ 210 billion by August. The average free float is 33% (US$70 billion).

The equity trading volume doubled in US$ terms between 2004 and 2007, reaching US$ 300 billion. Although having declined in 2008 and in early 2009, trading volume recovered in the second quarter of 2009. In January-August 2009, trading volume in equities reached US$ 193 billion, the same level recorded in the same period of last year.



Source: TurkStat

Coupled with the rising equity prices, the share of foreign investors in the equity trading volume also increased from 13% in 2004 to 26% in 2008. Although trading volumes recovered in 2009, the share of foreign investors has declined significantly amidst the global crisis, to record 15% in 1H09.

2. Bonds & Bills Market

Interest rates in the secondary markets entered a downward path in recent years, in line with declining inflation and increased confidence in the Turkish economy. T-bill rates, which were around 70% by the end of 2001, dropped gradually to around 20% in 2008. After the collapse of Lehman Brothers, interest rates rose up 25% in November 2008. However, in line with Central Bank's interest rate cuts, rates went down below 10% as of August 2009.

Banks and brokerage firms compete in the fixed income market. 89% of T-bill trading volume, and 81% of repo trading volume has been generated by banks in the first eight months of 2009. These figures indicate the total amount of OTC and organised market volumes.

Fixed Income Trading Volume

	ISE Markets		OTC Market		Total	
(bn.$)	T-Bill Trading	Repo	T-Bill Trading	Repo	T-Bill Trading	Repo
2004	263	1,090	158	281	420	1,372
2005	359	1,387	172	251	531	1,638
2006	270	1,770	140	351	410	2,122
2007	279	1,993	184	375	463	2,369
2008	239	2,274	164	366	404	2,640
08/2009	186	1,284	90	222	276	1,507

Source: ISE

Repo trading volume increased significantly since 2004 to reach US$ 2.6 trillion in 2008. In the first eight months of 2009 it has reached US$ 1.5 trillion, which implies a 17% drop compared to last year. In fact, trading volume in TL terms has increased by 7%, but the depreciation of the TL led to a decline in US$ terms.

Trading volume in T-bills was quite stable in recent years, recording an average of around US$ 450 billion. In January-August 2009, T-bill trading volume rose by 17% in TL terms, which turns into a decline of 10% in US$ basis. Note that Turkish bonds and bills market is dominated by Treasury bills. Outstanding corporate bonds represent less than 1% of the government debt.

3. Futures Market

The futures market TurkDex has been growing steadily since its launch in 2005. In 2008, the growth of the futures market started to slow down and the trading volume increased by 77% reaching US$ 161 billion. In the first eight months of 2009, US$ 134 billion of trading volume was recorded, up by 13% as compared to last year.

Contrary to the fixed income market, brokerage firms get the lion's share in futures trading. Brokerage firms' share of trading volume increased to 87% in January-August 2009.

There are 6 groups of contracts, as shown in the table. Trading is concentrated mainly in equity index contracts. Currency contracts based on US$/TL and €/TL exchange rates come in second place.

Futures Market Main Indicators

	No. of Contracts Traded				Trading Volume (mn. $)			
	2006	2007	2008	08/2009	2006	2007	2008	08/2009
Index	2,194,245	17,016,913	40,334,968	45,895,839	7,411	82,740	145,425	121,071
Currency	4,429,502	7,849,609	14,110,292	11,791,014	4,714	8,017	15,165	12,294
Interest Rate	1	401	420	456	0	3	3	2
Benchmark T-Bill	3,317	0	0	0	18	0	0	0
Commodity	13	110	27,155	87,757	0	0	77	273
Gold	1,425	0	0	0	3	0	0	0
Total	**6,628,503**	**24,867,033**	**54,472,835**	**57,775,066**	**12,147**	**90,759**	**160,669**	**133,640**

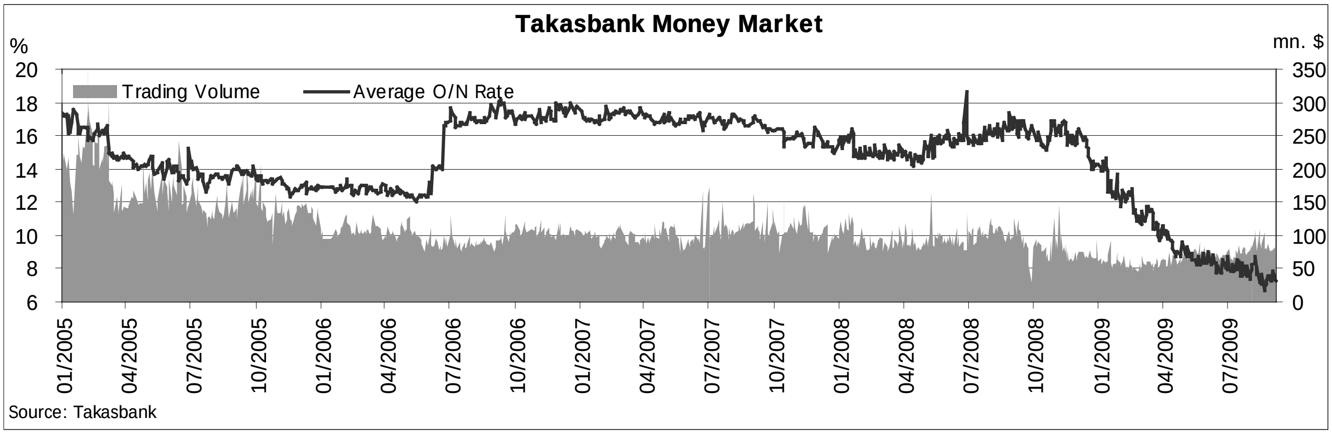
Source: TurkDex

4. Money Market

As stated above, Turkish Central Bank pursues an inflation-targeting policy. After two rate cuts totalling 50 basis points in the first months of 2008, the Central Bank adopted a tighter stance due to mounting inflationary pressures, raising O/N rates up to 16.75% in July from 15.25% in February.

However, amidst the global financial crisis in the last quarter of the year, the Central Bank has taken measures to support the liquidity of the financial system, and reduced O/N rates to 15% by the end of the year. Central Bank reduced its O/N rate further to 7.75% in August 2009, amidst contracting domestic demand.

The trading volume in the money market increased by 10% to US$ 23 billion in 2008, with an average daily transaction volume of US$ 91 million.



Source: Takasbank

5. Asset Management

There are two major classes of mutual funds in Turkey; equity and fixed income. Fixed income funds are the leading group. Institutional investors' total portfolio declined by 29% to US$ 21 billion in 2008, in line with a rise in interest rates and a decline in the equity index. Although fixed income mutual funds' assets fell by 30%, they continued to be the leading investor group with a 73% share in this breakdown. While there was a decrease in the number of equity funds, the number of fixed income funds increased from 173 to 200.

Private pension system was introduced towards the end of 2003 and has been growing exponentially. Pension funds' assets continued to increase even in 2008, and reached US$ 5.5 billion as of end-August 2009. Their share in total managed assets reached 20%, up from 10% in 2006.

Institutional Investors (mn. $)	2004	2005	2006	2007	2008	08/2009
Mutual Funds–Fixed Income	17,708	20,977	15,701	21,670	15,253	19,363
Mutual Funds–Equity	583	786	599	762	365	581
Private Pension Funds	222	913	2,048	3,813	4,193	5,515
Real Estate Inv. Trusts	752	1,864	1,487	2,723	776	1,686
Investment Trusts	220	360	280	317	152	297
Exchange Traded Funds	-	40	88	226	128	154
Venture Capital Inv. Trusts	64	69	68	63	27	47
Total	**19,548**	**25,010**	**20,271**	**29,574**	**20,895**	**27,642**

Source: CMB

Investment trusts have to be listed on the ISE and there is no significant growth in this segment. Although real estate investment trusts (REITs) were becoming more popular in recent years, they were hit by the global financial crisis to decline by 71% in 2008, followed by a recovery in 2009.

Exchange traded funds (ETFs) were introduced to the market in 2005 and they reached US$ 154 million as of August 2009, after peaking at US$ 226 million in 2007.

PROSPECTS FOR THE TURKISH CAPITAL MARKETS

Turkish capital markets currently depend on a few products; namely equities, government bonds and bills, mutual funds and recently futures. However, the market is expanding and new products are being introduced and developed. The increased diversification of products will lead to the diversification of brokerage services and investors.

In a long-term perspective, the financial sector offers significant opportunities, given the favourable demographics and low penetration levels. According to recent statistics, total population measures as 72 million people, and half of this population is under 30 years of age. This young and dynamic consumer base is expected to be the catalyst for economic growth. Another important factor in foreign interest is Turkey's European Union accession prospects.

The expected development areas for the near future are briefly summarized below.

Introduction of New Products

Currently the size of the corporate bonds market is limited in the Turkish capital markets. However, as interest rates went down to historically low levels, the issuance of corporate bonds is expected to revive in the near future, helped by the recently revised regulations.

On the other hand, new regulation regarding the issuance of company and covered warrants has been passed in 2009, although there has not been any issue yet.

On the other hand, the ISE recently established the Emerging Companies Market in order to create a transparent and organized floor for companies with high growth potential. A sponsor-based system was put in place for SMEs.

The amazing growth of TurkDex indicates the appetite of Turkish investors for derivatives. Currently, the market is discussing the introduction of single-stock futures.

Harmonisation with the EU Regulations

Currently, the Turkish capital market's regulatory structure is in line with the global standards. As part of the adoption of the European Union acquis, several regulations are being revised. The Turkish Commercial Law draft, being discussed in the parliament, is expected to introduce buy-backs which are not currently allowed. On the other hand, the Capital Markets Board initiated a twinning project with the German BaFIN in 2006-2007. In that study, Turkish regulations were reviewed and their conformity to European Union regulations was analyzed. It has been concluded that Turkish regulatory structure is in line with the EU standards to a great extent. However, minor changes requested are being implemented gradually.

Istanbul as a Financial Centre

The government has recently undertaken a project in order to make Istanbul a regional financial center. Indeed, in the last few years, Turkey has been taking on an increasingly important role as a regional financial centre.

Turkey has a well-developed regulatory structure and institutions in line with global standards. Moreover, Istanbul is close to major financial markets and located at the heart of the region. It is believed that Istanbul has the potential to become a financial centre for the Eurasia region, covering

Eastern Europe, Middle East and Central Asia, since Turkey is the largest country in terms of GDP, population, market capitalization, market liquidity, etc. in the targeted region.

Studies have started under the coordination of the government and working groups have been formed in early 2009, with the contribution of 81 public and private institutions, non-governmental organisations and universities. These studies propose revisions and reforms in a wide range of areas including the justice system, regulatory and supervisory framework, diversification of financial services, taxation policies, human resources and infrastructure. The Strategy Document has been launched in the beginning of October 2009, during the IMF-World Bank Annual Meetings in Istanbul.