Josef Pöschl

Turkey:
Calming-down of a growth bonanza

In the first three quarters of 2010, the GDP grew by over 8.9%. The fact that this was a swift response to an 8% GDP decline in the same period of the previous year does not spoil the positive impression: other crisis-hit countries were unable to achieve such a brilliant regain of lost terrain, and Turkey was the region's growth leader of the year 2010.

The contrast between decline in 2009 and growth in 2010 was even stronger in the first quarters of those two years (-14.6% against +11.8%). The engine of recovery was an increase in domestic demand. Household consumption started growing again soon after the slump. Later on, private gross fixed investment followed in line with substantially improved business expectations. Both the government and the central bank did their best to support these developments. The government acted on the revenue as well as on the expenditure side. This was a deliberate deviation from past years' efforts to secure substantial primary surpluses. The central bank has reduced its policy rate. The swift recovery should not be attributed to economic policy alone. In Turkey, private sector agents have a long experience with sudden crises, so they may have suffered less of a shock than was the case in other countries. At the same time, it seems that the banking sector felt less threatened than in other countries and maintained a relatively high degree of 'business as usual'. In 2001, this sector had triggered a severe crisis, and the reform steps thereafter have made commercial banking relatively crisis-resistant.

A 'meagre' 5.5% year-on-year growth in the third quarter of 2010 signalized a calming-down of a remarkable growth bonanza. The fourth quarter's rate is likely to be around 4 to 5%. This is also good news, as extremely high growth in the midst of close-to-stagnating trading partners has provoked an import expansion, which exceeded export growth by far. In euro terms, exports of goods in 2010 remained by about 6% below the pre-crisis level of 2008, whereas imports came very close to it. Consequently, the current account deficit has surpassed pre-crisis levels by climbing to about EUR 34 billion or somewhat over 6% of the GDP. At the end of 2010, the central bank's gross reserves were much higher compared to two years before, so it was inflow of capital, which covered the current account deficit. Loans rather than foreign direct or portfolio investments have closed the gap. The indebtedness of the government is moderate. However, as we have learnt in recent months from experience in other countries, in the end private sector debt can be dangerous too.

The central bank is eager to put a brake on capital inflows. To achieve this, the bank reduced its policy rate to 6.5% last December and to 6.25% last February. The exchange rate reacted, as expected, with something highly welcome – slight currency devaluation. More of the same could help to avoid an erosion of Turkish competitiveness. The country's favourable macro data tends to fuel appreciation pressure, and in view of the high current account deficit this would be dangerous. The central bank is much less scared about inflation, which has remained in a range between 5 and 10% annually for quite some time now. To prevent exaggerated credit growth, the central bank has increased the commercial banks' reserve requirements. The aim of this measure is not to fight inflation, but to contain import growth. The policy of low interest rate has positive spillover effects on the fiscal side, and the same is true for the relatively high rate of inflation. Currently, further decline of inflation is more likely than an upward trend.

From the extreme widening of the current account deficit we conclude that a growth differential against the main trading partners would not be sustainable in the longer run. For example, five percentage points above EU average could be problematic. Its tradable sector competes mainly in the low-price segment of international trade, and there competition is fierce. Turkey's revenues from exports to the EU stem mainly from clothing, transport equipment (predominantly for commercial use), textiles, electrical machinery and agri-food products. Among Turkey's competitors are Asian countries with cheap labour that are specialized on labour-intensive products and new EU-member states with specialization in capital-intensive production. In none of these product groups, Turkey surpassed the pre-crisis level (October 2009-March 2010 versus October 2007-March 2008). In this respect, Poland and China were more successful in clothing; India, Romania and South Africa did better in terms of transport equipment, and Malaysia, Korea and China were more successful in exporting electrical machinery. Some of those countries performed better than Turkey in spite of a real exchange rate appreciation. For example, real appreciation of China contrasted with Turkey's depreciation. Turkey lost shares in EU markets, but gained shares in Middle East Asia and Northern Africa. Nevertheless, Turkey's post-crisis exports grew less than the total world exports. It seems that Turkey's current account problem is of long-term nature and may turn into a major threat in the case of continuation of high growth. The central bank is aware of this and will continue its efforts to calm growth dynamics down. We expect a growth rate of at least 7.5% in 2010, 4.4% in 2011 and somewhat less than that in 2012 and 2013. Should the central bank's effort prove as not successful, so that high growth would continue to be accompanied by a widening current account deficit, Turkey could experience one more episode of sudden GDP drop, currency depreciation and swift recovery thereafter. Most likely, Turkey is part of the league of fast-growing emerging markets. Pessimists could, however, fear that there is a similarity to Spain in pre-crisis years, pointing to a level of relative prices which may prove to be not sustainable. If so, this could lead to a crisis at some point of time, with strong currency depreciation as a relief – for some time at least.

Turkey will go to the polls in June 2011. Most likely, Prime Minister Erdoğan's party will win a majority again. It will not necessarily be as strong as it has been up to now. The new government will probably start a tightening of expenditures in the second half of 2011, and continue that way in 2012-2013. This tightening could be less pronounced, should the government achieve high revenues from a privatization campaign mainly related to the energy sector, which is currently under preparation.

Challenges will be manifold. Urbanization has gone far and will progress further, and this will require high expenditures on infrastructure. The educational system will need an upgrade, and regional cohesion will remain a matter of concern.

Table TR

Turkey: Selected Economic Indicators

	2005	2006	2007	2008	2009	2010 1)	2011	2012 Forecast	2013
Population, th pers., average 2)	68582	69421	70256	71079	71861	72500	73200	73900	74600
Gross domestic product, TRY bn, nom.	648.9	758.4	843.2	950.5	952.6	1110	1230	1350	1480
annual change in % (real)	8.4	6.9	4.7	0.4	-4.5	7.5	4.4	4.0	3.7
GDP/capita (EUR at exchange rate)	5600	6000	6700	7000	6100	7700	8400	9100	9400
GDP/capita (EUR at PPP - wiiw)	9500	10500	11300	11700	10700	11500	12200	13000	14100
Consumption of households,TRY bn, nom.	465.4	534.8	601.2	663.9	681.5	790	.	.	.
annual change in % (real)	7.9	4.6	5.5	-0.3	-2.3	6.5	3.7	3.0	2.8
Gross fixed capital form., TRY bn, nom.	136.5	169.0	180.6	189.1	160.7	210	.	.	.
annual change in % (real)	17.4	13.3	3.1	-6.2	-19.2	23.9	14.9	10.4	10.0
Gross industrial production									
annual change in % (real)	5.6	7.3	7.0	-0.6	-9.7	12.7	10.0	7.0	7.0
Gross agricultural production									
annual change in % (real)	6.6	1.3	-7.3	.	.	.	.	.	.
Construction industry									
annual change in % (real)	21.5	18.4	5.5	-7.6	-16.3	14.0	12.0	9.0	9.0
Employed persons - LFS, th, avg.	20074	20433	20750	21193	21271	22600	23000	23450	23800
annual change in %	.	1.8	1.5	2.1	0.4	6.2	1.8	2.0	1.5
Unemployed persons - LFS, th, average	.	1950	2016	2278	3053	2760	2520	2600	2700
Unemployment rate - LFS, in %, average	.	8.8	8.9	9.8	12.7	10.9	9.9	10.0	10.2
Reg. unemployment rate, in %, average	.	.	.	.	.				
Average gross monthly wages, manuf.ind., TRY	1162	1301	1437	1590	.	.	.	.	.
annual change in % (real)	4.3	2.1	1.6	0	.	.	.	.	.
Consumer prices, % p.a.	8.1	9.3	8.8	10.4	6.3	8.6	6.0	5.5	5.5
Producer prices in industry, % p.a.	7.1	9.7	6.0	13.0	1.0	6.2	5.5	4.5	4.5
General governm. budget, EU-def., % GDP 3)									
Revenues	.	.	.	32.3	33.8	34	34	34	34
Expenditures	.	.	.	34.5	40.5	38	37	36	36
Deficit (-) / surplus (+)	.	0.8	-1.0	-2.2	-6.7	-4	-3	-2	-2
Public debt, EU-def., in % of GDP 3)	52.3	46.1	39.4	39.5	45.4	48	49	48	47
Central bank policy rate, %, p.a., end of period 4)	17.5	22.5	20.0	17.5	9.0	6.5	6.0	6.0	6.0
Current account, EUR mn	-17843	-25640	-27954	-28520	-10261	-34400	-37900	-38300	-38500
Current account in % of GDP	-4.6	-6.1	-5.9	-5.7	-2.3	-6.2	-6.2	-5.7	-5.5
Exports of goods, BOP, EUR mn	62989	74556	84174	95730	78697	89900	98900	108800	119500
annual change in %	14.3	18.4	12.9	13.7	-17.8	14.2	10.0	10.0	9.8
Imports of goods, BOP, EUR mn	89579	107255	118319	131779	96564	130500	143500	155000	167000
annual change in %	22.1	19.7	10.3	11.4	-26.7	35.1	10.0	8.0	7.7
Exports of services, BOP, EUR mn	21512	20348	21109	23677	18250	24500	26600	29500	32100
annual growth rate in %	16.6	-5.4	3.7	12.2	-22.9	34.2	8.6	10.9	8.8
Imports of services, BOP, EUR mn	9240	9507	11372	12036	8713	13800	15200	16400	17700
annual growth rate in %	13.3	2.9	19.6	5.8	-27.6	58.4	10.1	7.9	7.9
FDI inflow, EUR mn	8063	16076	16087	12421	5927	5000	8000	9000	7000
FDI outflow, EUR mn	855	736	1537	1733	1115	1100	1500	1500	1500
Gross reserves of CB, excl. gold, EUR mn	42820	46251	49804	51022	49088	61000	65000	68000	65000
Gross external debt, EUR mn	143994	157774	169452	199662	186482	209000	.	.	.
Gross external debt in % of GDP	35.3	38.8	34.5	45.1	42.2	39.0	.	.	.
Average exchange rate TRY/EUR	1.6800	1.8100	1.7900	1.9100	2.1600	2.0000	2.0000	2.0000	2.1000
Purchasing power parity TRY/EUR	0.9919	1.0402	1.0641	1.1454	1.2363	1.3293	1.38	1.41	1.41

Note: Gross industrial production and construction output refer to NACE Rev. 2.

1) Preliminary and wiiw estimates. - 2) TSI projections. - 3) According to ESA'95 excessive deficit procedure. - 4) From 2010 one-week repo rate, overnight lending rate before.

Source: National statistics (Central Bank, Turkish Statistical Institute - TSI, etc), Eurostat. Forecasts by wiiw.