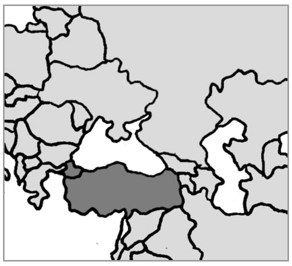

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Turkey:
Recovering and reconnecting

Confidence in the real sector, as monitored by the Central Bank, exceeded the norm level [100] throughout the first half of 2010, soaring close to 119 in April and 115 in May. Both the IMF and OECD have raised their GDP forecasts for 2010[1], while rating agencies are thinking of upgrading the country. Undeniably, Turkey contributes positively to the diversity in the economic performance of the emerging European region comprising the new EU member countries, as well as the candidate and potential candidate countries.

During the first quarter of 2010, the GDP increased by 11.7% year-on-year, in sharp contrast to the 16.5% decline one year previous. Owing to a less favourable base effect, the results of the remaining three quarters in 2010 will look less spectacular: By mid-2009, GDP recovery had already set in, as indicated in the seasonally adjusted quarter-on-quarter data.

Industrial output grew by 17% year-on-year in the first quarter of 2010. In May 2010, capacity utilization climbed close to 73%, which is not far below the level reached in the first half of 2008. Within manufacturing, transport equipment, metal industries, production of furniture, electrical machinery and refined petroleum were hit hardest by the crisis, whereas the impact was much softer in the production of food and beverages, textiles, radio and television sets. The automotive sector is now recovering. Retail sales of cars may amount to about 600,000 units in 2010. During the first four months of 2010, Otokoç (Fiat, Alfa Romeo, Lancia, Ford, Volvo), one of the major players with a market share of 8.5%, increased its vehicle sales by 24%.

In May 2010, electricity generation and consumption were up by 9% year-on-year and up by 6.5% over the period January-May: further confirmation of the ongoing economic recovery. To avoid future bottlenecks, Turkey will need to invest considerably in energy generation – some 80 billion euro over the next ten years according to spokesmen from

1 *Turkey – 2010 Article IV Consultation and Post-Program Monitoring: Preliminary Conclusions*, IMF 26 May 2010: 6.25%, *OECD Economic Outlook* No. 87, 26 May 2010: 6.8%.

within the industry. Turkey plans to build two nuclear power stations and complete the controversial Ilisu dam as part of the development plan for South-East Anatolia.

Unemployment is on the decline. Whereas it had come close to 16% in the first quarter of 2009, it was down to 14.5% a year later. Over the same period, employment grew by 7%.

For the first quarter of 2010, the central bank's balance of payment statistics in USD terms show an export growth of 7.5% year-on-year, whereas imports grew by 33.3%. The figures reflect the impact of the Turkish lira having appreciated against both the US-dollar (10.1% increase of the USD-to-TRY ratio) and the euro[2].

In 2009, Turkey's 500 largest exporters accounted for over 50% of total exports. Oyak Renault was the largest of all (EUR 2 billion export volume), followed by Vestel Foreign Trade, Turkey's largest producer of TV sets, and Ford Otomotiv (EUR 1.4 billion each). The larger exporters also included the car manufacturer Tofaş, a Fiat affiliate with a production capacity of about 400 thousand cars per year and a 27% share in automotive exports in 2009.

In the first quarter of 2010, the most important destinations for goods exported from Turkey were Germany with a volume of about EUR 2 billion, Italy, France, the United Kingdom, Iraq, Russia, Spain, the United States, the United Arab Emirates and Egypt. Iraq (EUR 1 billion export volume in the first quarter of 2010) is becoming an increasingly important market. In a meeting in early June, Massoud Barzani, the leader of northern Iraq, and Ümit Boyner, chairwoman of the Association of Turkish Industrialists and Businessmen (TÜSİAD), discussed ways and means of expanding trade cooperation. The prime ministers of the two countries have since signed protocols aimed at liberalizing trade. Other important export destinations in the vicinity of Turkey are Iran, Syria, Greece and Bulgaria. For Turkey, liberalization of ties with Syria was a positive experience.

To an ever-increasing degree, Turkey is discovering the major export potential offered by its neighbours. Producers of tradable goods and services are pleased with the government's effort to liberalize trade flows through bilateral agreements. Some of these agreements also support Turkish investment abroad. Turkey signed a deal of historical dimensions with Russia in May 2010. Russia will build one of the two nuclear power plants that the government is planning. (South Korea will build the other one.) The deal is not

[2] The EUR-to-TRY ratio increased by 3.6% (av. Q1 2010/av. Q1 2009). In EUR terms, exports grew by 1.1%, imports by 25.4%. In TRY terms, exports fell by somewhat over 2%, whereas imports increased by over 20%. In April 2010, the year-on-year increase was 24% in exports and 46% in imports (in USD terms).

limited to trade. The two countries will drop their respective visa requirements and Turkey's tourism expects – in the context of a forthcoming economic recovery and rise in incomes – a palpable increase in the number of Russian visitors to the country (up from 2.6 million in 2009). Turkish hopes that within a few years Russian tourists could outstrip the number of German tourists (4 million in 2009) may well be exaggerated. Cooperation between the two countries' airlines, Turkey's Hava Yollari and Russia's Aeroflot, will underpin these tourism and business ties. Services provided by Turkey's construction industry were not part of the agreement, yet the sector expects new avenues to open up in the new spirit of cooperation: for example in the context of the Winter Olympics to take place in 2014 in Sochi on the Russian shores of the Black Sea. Turkish hopes of a large increase in turkey and other poultry exports may not be realized in the near future, as Russia will not relax its quotas for poultry imports.

Turkish companies are also interested in investing abroad. Members of President Dimitry Medvedev's entourage expressed the hope that Turkish companies would invest in Russia's special economic zones (industrial, innovation, tourism-recreation and port-development zones). A few Turkish companies have already adopted an active pioneering role in the Russian manufacturing sector. In Iraq, the Turkish oil company TPAO has won two oil-production tenders. Central Asian countries are proving attractive to Turkish companies, with linguistic or religious proximity proving supportive in some cases. For example, some 600 Turkish companies have established business ties with Turkmenistan, and according to Turkish estimates, Turkish investment in that country amounts to a total of some EUR 5 billion.

The fiscal and monetary policy fit was perfect both before and during the crisis. Up to mid-2008, fiscal austerity offered scope for a gradual reduction of the policy rate. During the crisis months, the government let automatic stabilizers do their job; furthermore, it introduced business stimulus packages. At the same time, the central bank kept the policy rate low and started preparing an exit strategy for the period after economic recovery. The government introduced new fiscal regulations that are envisaged to enter into effect on 1 January 2011. Tax revenues rose steeply in the first quarter of 2010, thus making it easier to avoid a massive increase in government debt. Larger cuts in expenditure are unlikely, given that Turkey is going to the polls in 2011.

All this looks very fine – fine enough to make it difficult to avert real appreciation. This may not necessarily occur only on account of high inflation, which hit the 10% mark in May 2010, but is likely to fall in the second half of the year. A change is more likely to come about through nominal appreciation against the euro or the euro and the dollar. Strong real appreciation could bring about an erosion of the Turkish producers' international competitiveness and thus lead to instability in the longer term. Danger of this actually happening is evident, given that the current account is rapidly reverting to former high deficit levels under the impact of recovery. First quarter exports covered 95% of imports in 2009, but only 77% in 2010; the latter figure is not much above the full-year average for the period 2005-2009 (73%).

For 2010 we expect GDP growth to hover between 6% and 6.5% – thanks primarily to an expansion of domestic demand. The GDP will thus reach and slightly surpass the pre-crisis level. The average rate of inflation will remain significantly below 10%. In all likelihood, the economy will grow less in 2011 and 2012, since the government will have to economize after the 2011 elections at the latest, while real appreciation will slow down exports and speed up imports. In political terms, Turkey remains a fairly inhomogeneous society in many respects. The government will secure a comfortable majority in the forthcoming referendum about the reform of the judiciary system; however in the elections in 2011 the ruling AK Party will have to struggle hard, if it is to achieve as large a parliamentary majority as it has had to date. Relations with Israel have worsened, and in some respects – but not necessarily all –- the rupture may be beyond repair. Within Turkish political and economic circles, the relative weight of EU is likely to decline.

Table TR

Turkey: Selected Economic Indicators

	2006	2007	2008	2009 [1)]	2009	2010	2010	2011	2012
					1st quarter			Forecast	
Population, th pers., average [2)]	69421	70256	71079	71897	.	.	72700	73500	74300
Gross domestic product, TRY bn, nom.	758.4	843.2	950.5	954.0	209.7	243.3	1100	1240	1380
annual change in % (real)	6.9	4.7	0.7	-4.7	-14.5	11.7	6.3	4.5	4.0
GDP/capita (EUR at exchange rate)	6000	6700	7000	6100	.	.	8000	8900	9300
GDP/capita (EUR at PPP - wiiw)	10500	11100	11400	10700	.	.	.	.	.
Consumption of households,TRY bn, nom.	534.8	601.2	663.9	683.3	155.5	181.3	.	.	.
annual change in % (real)	4.6	5.5	-0.3	-2.3	-10.1	9.9	4.0	3.0	3.0
Gross fixed capital form., TRY bn, nom.	169.0	180.6	189.1	160.6	39.7	42.9	.	.	.
annual change in % (real)	13.3	3.1	-6.2	-19.2	-27.6	14.4	10.5	13	10
Gross industrial production									
annual change in % (real)	5.8	4.5	-0.8	-5.7	-19.0	17.1	15	10	7
Gross agricultural production									
annual change in % (real)	1.3	-7.3	.	.	.	.	.	.	.
Construction industry									
annual change in % (real)	18.4	5.5	-7.5	-16.6	-18.4	.	.	.	.
Employed persons - LFS, th, avg. [3)]	22330	20738	21191	21288	19826	21215 [I-II]	22000	22300	22500
annual change in %	1.3	1.5	2.2	0.5	0.0	7.0	3	1	1
Unemployed persons - LFS, th, average [3)]	2446	2376	2605	3460	3276	3578 [I-II]	.	.	.
Unemployment rate - LFS, in %, average	9.9	10.3	11.0	14.0	15.8	14.5 [I-II]	13	12	12
Reg. unemployment rate, in %, average	.	.	.				.	.	.
Average gross monthly wages, manuf.ind., TRY [4)]	1301	1437	1590	.	.	.	.	.	.
annual change in % (real) [4)]	2.1	1.6	0	.	.	.	.	.	.
Consumer prices, % p.a.	9.3	8.8	10.4	6.3	8.4	9.3	8.5	7.5	7.0
Producer prices in industry, % p.a.	9.7	6.0	13.0	1.0	7.8	4.6	6.5	6.5	6.0
General governm. budget, EU-def., % GDP [5)]									
Revenues	.	19.6	21.6	22.5	.	.	22	22.5	22.5
Expenditures	.	20.6	23.9	28.0	.	.	28	27	26
Deficit (-) / surplus (+)	1.2	-1.0	-2.3	-5.5	.	.	-6.0	-4.5	-3.5
Public debt, EU-def., in % of GDP [5)]	46.1	39.4	39.4	45.5	.	.	48	50	51
Discount rate of NB % p.a., end of period [6)]	22.5	20.0	17.5	9.0	13.0	9.0	.	.	.
Current account, EUR mn	-25640	-27954	-28520	-9944	-1519	-7189	-26000	-30000	-32000
Current account in % of GDP	-6.1	-5.9	-5.7	-2.3	-1.6	-6.2	-4.5	-4.6	-4.6
Exports of goods, BOP, EUR mn	74556	84174	95730	78716	20062	20286	91000	102000	112000
annual change in %	18.4	12.9	13.7	-17.8	-14.5	1.1	15	12	10
Imports of goods, BOP, EUR mn	107255	118319	131779	96464	21034	26386	121000	136000	150000
annual change in %	19.7	10.3	11.4	-26.8	-33	25.4	25	12	10
Exports of services, BOP, EUR mn	20348	21109	23677	23507	3614	3244	22000	24000	26000
annual growth rate in %	-5.4	3.7	12.2	-0.7	2.4	-10.2	-5	10	10
Imports of services, BOP, EUR mn	9507	11372	12036	11866	2914	2909	13000	14000	15000
annual growth rate in %	2.9	19.6	5.8	-1.4	8.4	-0.2	9	6	6
FDI inflow, EUR mn	16076	16087	12421	5453	1857	1066	8000	10000	10000
FDI outflow, EUR mn	736	1537	1733	1128	273	324	1500	1500	1700
Gross reserves of CB, excl. gold, EUR mn	46251	49804	51022	49088	50436	51520	48000	49000	50000
Gross external debt, EUR mn	157626	169436	199973	188213	200476	.	185000	190000	200000
Gross external debt in % of GDP	38.7	34.5	45.2	42.5	45.3	.			
Average exchange rate TRY/EUR	1.8090	1.7865	1.9064	2.1631	2.1618	2.0868	1.9	1.9	2.0
Purchasing power parity TRY/EUR	1.0403	1.0804	1.1711	1.24557	.	.	.	.	.

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

1) Preliminary. - 2) TSI projections. - 3) From 2007 according to new census. - 4) Including overtime payment. - 5) According to ESA'95 excessive deficit procedure. - 6) Overnight lending rate.

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