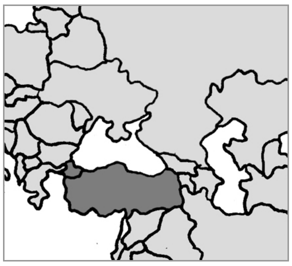

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Turkey: The return of confidence

The outlook for the real sector, as monitored by the central bank, has been fast in recovering from the deep pessimism prevailing at the end of 2008/beginning of 2009. Already in May 2009, confidence was nearly back to normal. Thereafter, the confidence index has kept fluctuating around normal level in a narrow range. International financial institutions and rating agencies share this relatively optimistic stance. The EBRD has revised its forecast for 2010 from 3% (October 2009) to 4.7% (January 2010), and a firm-level survey done by the World Bank Group[1] concludes that Turkish companies could be fast in overcoming the crisis; Standard & Poor's, Moody's and Fitch all have upgraded their ratings in their latest revisions, i.e. between September 2009 and January 2010. At least in some of the underlying assessments, the impression of financial soundness plays a role. Developments in 2009 did not confirm concerns that external and internal debt-servicing obligations of both the public and the private sector might have a major destabilizing effect. The volume of consumer loans shrank only during the final quarter of 2008 and the first quarter of 2009. The decline of corporate loans ceased in mid-2009. Loan rates reached peak values of over 20% in November 2008, but fell to about 9% in the case of commercial loans and around 14% for consumers in the second half of 2009. The so-called credit squeeze seems to be over.

Should Turkey's economy indeed be sufficiently robust to overcome so rapidly the impact of the global crisis, it is worth asking why this impact was strong enough to cause a GDP contraction of close to 6% in 2009 as a whole and as much as 13.5% in the first quarter of 2009. This may have had mainly two reasons: Those commodities that were hit most by the global crisis have a high share in Turkey's exports: transport equipment and durable consumer goods. In addition, Turkey's textile and clothing sector is exposed to strong competition from East Asia. A second reason is that after the crisis in 2001 Turkey's GDP growth became very pronounced (with rates of 9.4% in 2004 and 8.4% in 2005). At the same time, strong real appreciation of the currency set in, triggering a gradual erosion of competitiveness and thus of growth sustainability. Compared to 2001, the year with a positive current account balance, in 2008 the Turkish lira's real appreciation against EU-27 was as much as 37% if calculated from producer price indices. On foreign as well as on domestic markets, the producers of tradable goods had difficulty to remain competitive, as was reflected in the strong expansion of the current account deficit (up to about 6% of GDP in 2008). Growth had already lost momentum when the economy was hit by the crisis.

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1 Paulo Correa and Mariana Lootty, 'The Impact of the Global Economic Crisis on the Corporate Sector in Europe and Central Asia: Evidence from Firm-Level Survey', Washington DC, 16 December 2009.

Under the impact of the crisis, real appreciation not only stopped but was to some degree reversed due to nominal depreciation in late 2008[2]. This reversal was, however, much weaker than in previous crises, so that this time the preconditions for industrial recovery are less propitious. External conditions are less favourable, too. In the meantime, real appreciation is on its way again, but so far to a minor extent. In order not to deteriorate competitiveness, increases in the euro (and US dollar) prices of Turkish goods need to be backed by quality gains. Slow gradual nominal depreciation could help to avoid disproportionate real appreciation, but may not be achievable easily.

Through a policy of low interest rates, the central bank can try to put a brake on the inflow of capital and in this way keep the nominal appreciation pressure low. This, in fact, seems to be the central bank's intention since the first quarter of 2009. In the case of accelerating inflation, however, it may become difficult to stick to this policy. From November 2009 up to February 2010, the increase in the consumer price index was quite substantial. This was mainly attributable to indirect tax increases for selected consumer goods (tobacco, alcoholic beverages, fuels) and an increase in food prices. The core inflation has remained modest, but there are concerns that inflation expectations could go up again. Electricity prices are likely to become an additional source of inflation. The government will have to allow for an increase, as otherwise privatization plans related to this sector would either not materialize or produce meagre revenues. For Turkey, inflation is a sensitive issue, no matter that as a rule in emerging markets fast growth is accompanied by somewhat elevated inflation.

Turkey's capability of returning to significant GDP growth depends on success in exports. For achieving this, the absence of strong real appreciation is a necessary precondition. In this respect, the central bank will face a challenge. The European Union continues to be the main trading partner, but hopes for fast trade expansion concentrate on other parts of the globe. The EU share in Turkey's exports is shrinking. Turkey has signed free trade agreements with a large number of non-EU countries. Their shares in Turkish exports are still low, but expanding overproportionately. This regional trade diversification has a positive impact on Turkey's overall export performance.

Gross fixed capital formation experienced a deep decline in late 2008/early 2009. Some recovery is likely, but it will gain momentum only later on, after the economy's return to higher degrees of capacity utilization. In the first months of 2010, the latter was still very low, around 60%. Currently, a considerable part of gross fixed capital formation is attributable to the government. As soon as GDP growth has returned, the government's focus will switch from growth stimulation towards budget consolidation. Public investment may expand less or even shrink.

Finally, household consumption is not likely to start growing fast in the near future. Unemployment is high, close to 17% in the non-agricultural sector, and GDP growth may be 'jobless' for quite some time, as was the case after 2001. Most likely, real wages will remain stagnant at best during the next few months and perhaps even years.

[2] At the end of 2008, the Turkish lira (TRY)-USD parity was 1.51 compared to 1.16 one year before (+30%), whereas the TRY-EUR parity was up to 2.14 from 1.71 (+25%). At the end of 2009, the parities were similar to end-2008: 1.49 vis-à-vis the US dollar and 2.14 vis-à-vis the euro.

Our new, substantially revised GDP forecast is 4% growth in 2010 thanks to export expansion, 3% in 2011, again because of export expansion but accompanied by restrictive government policies, and 5% in 2012 due to strong growth in gross capital formation. It is based on optimistic assumptions, namely the ability of the central bank to keep real appreciation low, and viable conditions prevailing for export expansion. In such a scenario, the widening of the current account deficit should remain moderate. We also assume that there will be no skyrocketing of energy prices, so that Turkey's consumer and producer price inflation may remain in the range between 5% and 8% (annual average). We are not very optimistic regarding a rise in employment starting anytime soon.

The government was very determined in fighting the impact of the global crisis with fiscal policy tools. Its deficit climbed from 2.2% of GDP in 2008 to 6.6% in 2009 due to nearly unchanged revenues, but much higher expenditures. The EU-defined public debt increased from 39.5% of GDP in 2008 to 47.3% in 2009. In per cent of GDP, government revenues and expenditures are still low (roughly between 20% and 25%). Privatization revenues will not continue to flow in forever, so the government will need to push through a tax reform. The tax authorities tend to feel free to choose between merciful and merciless treatment of individual taxpayers. The IMF proposal of establishing an independent fiscal supervisory body would make sense, but has so far failed to produce a positive echo.

Turkey has cultivated a number of political taboos for many decades, and the current government has touched upon them all. It was in a position to do so thanks to a sound majority in the parliament and the backing of the European Union. Internal tensions are strong and have been close to eruption at some points of time – such as in February 2010. The assumed homogeneity of the Turkish society has turned out to be a fiction, and it has become clear that the political system needs to create structures supportive of compromise and cooperation. The odds are good that this will happen. In this case, Turkey's position as a regional political and economic power, and as an EU candidate country as well, will strengthen.

Table TR

Turkey: Selected Economic Indicators

	2004	2005	2006	2007	2008	2009 1)	2010	2011 Forecast	2012
Population, th pers., average 2)	71152	72065	72971	73436	74414	75200	76000	76700	77500
Gross domestic product, TRY bn, nom.	559.0	648.9	758.4	843.2	950.1	950	1060	1160	1280
annual change in % (real)	9.4	8.4	6.9	4.7	0.9	-6	4	3	5
GDP/capita (EUR at exchange rate)	4400	5400	5700	6400	6700	5800	6600	6900	7200
GDP/capita (EUR at PPP - wiiw)	8200	9100	10000	10600	10900	10400	.	.	.
Consumption of households,TRY bn, nom.	398.6	465.4	534.8	601.2	663.0	680	.	.	.
annual change in % (real)	11.0	7.9	4.6	5.5	-0.1	-4	1	2	3
Gross fixed capital form., TRY bn, nom.	113.7	136.5	169.0	180.6	188.8	170	.	.	.
annual change in % (real)	28.4	17.4	13.3	3.1	-5.0	-15	7	7	10
Gross industrial production									
annual change in % (real)	9.7	5.6	5.8	4.5	-0.8	-5.7	8	8	10
Gross agricultural production									
annual change in % (real)	2.7	6.6	1.3	-7.3	.	.	.	.	.
Construction industry									
annual change in % (real)	4.6	21.5	18.4	5.5	-7.5	-20	.	.	.
Employed persons - LFS, th, avg. 3)	21791	22046	22330	20738	21194	21200	21200	21500	22000
annual change in %	3.0	1.2	1.3	1.5	2.2	0.0	0	1	2
Unemployed persons - LFS, th, average 3)	2498	2520	2446	2376	2611	3500	.	.	.
Unemployment rate - LFS, in %, average	10.3	10.3	9.9	10.3	11.0	14	14	14	12
Reg. unemployment rate, in %, average	.	.	.	.	.		.	.	.
Average gross monthly wages, manuf.ind., TRY 4)	1030	1162	1301	1437	1590	.	.	.	.
annual change in % (real) 4)	.	4.3	2.1	1.6	0	.	.	.	.
Consumer prices, % p.a.	10.1	8.1	9.3	8.8	10.4	6.3	7	6	5
Producer prices in industry, % p.a.	12.2	7.1	9.7	6.0	13.0	1.0	.	.	.
General governm. budget, EU-def., % GDP 5)									
Revenues	.	.	.	19.6	19.3	18.5	19	20	21
Expenditures	.	.	.	20.6	21.5	25.1	25	24	24
Deficit (-) / surplus (+)	.	-0.6	1.2	-1.0	-2.2	-6.6	-6	-4	-3
Public debt, EU-def., in % of GDP 5)	59.2	52.3	46.1	39.4	39.5	47.3	49	49	48
Discount rate of NB % p.a., end of period 6)	22.0	17.5	22.5	20.0	17.5	9.0	.	.	.
Current account, EUR mn	-11601	-17843	-25640	-27954	-28520	-9944	-13000	-14000	-16000
Current account in % of GDP	-3.7	-4.6	-6.1	-5.9	-5.7	-2.3	-2.6	-2.7	-2.9
Exports of goods, BOP, EUR mn	55097	62989	74556	84174	95730	78716	91000	100000	114000
annual change in %	19.2	14.3	18.4	12.9	13.7	-17.8	15	10	14
Imports of goods, BOP, EUR mn	73375	89579	107255	118319	131779	96464	113000	123000	141000
annual change in %	26.3	22.1	19.7	10.3	11.4	-26.8	17	9	15
Exports of services, BOP, EUR mn	18443	21512	20348	21109	23677	23507	25000	26000	29000
annual growth rate in %	16.1	16.6	-5.4	3.7	12.2	-0.7	5	5	10
Imports of services, BOP, EUR mn	8155	9240	9507	11372	12036	11866	12000	13000	14000
annual growth rate in %	23.2	13.3	2.9	19.6	5.8	-1.4	5	6	10
FDI inflow, EUR mn	2239	8063	16076	16087	12421	5453	8000	10000	10000
FDI outflow, EUR mn	627	855	736	1537	1733	1128	1500	1500	1700
Gross reserves of CB, excl. gold, EUR mn	26436	42820	46251	49804	51022	48000	48000	49000	50000
Gross external debt, EUR mn	118184	143860	157626	169436	199973	186000	185000	190000	200000
Gross external debt in % of GDP	38.8	35.3	38.7	34.5	45.2	42			
Average exchange rate TRY/EUR	1.7771	1.6771	1.8090	1.7865	1.9064	2.1631	2.1	2.2	2.3
Purchasing power parity TRY/EUR	0.9637	0.9917	1.0403	1.0804	1.1711	1.2184	.	.	.

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

1) Preliminary and wiiw estimates. - 2) SIS projections. 2008 figure: Eurostat. SIS figure 2009 (end of year): 72561 th. persons based on new census methodology. - 3) From 2007 according to census 2006. - 4) Including overtime payment. - 5) According to ESA'95 excessive deficit procedure. - 6) Overnight lending rate.

Source: National statistics (Central Bank, State Institute for Statistics etc). Forecasts by wiiw.