

# **THE TURKISH ECONOMY: RECENT DEVELOPMENTS AND PROSPECTS**

December 13, 2011

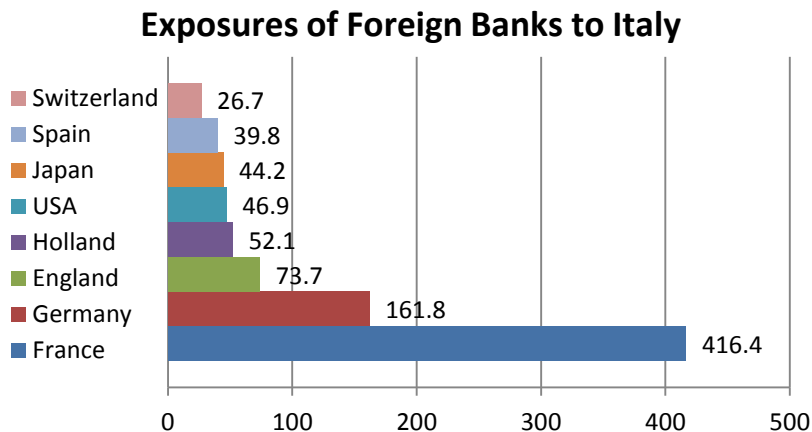
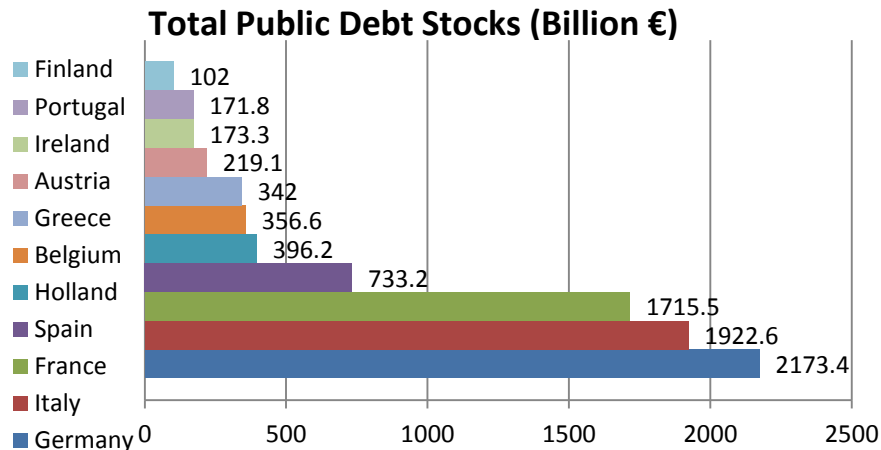


**Faik Öztrak**

Deputy Chairman, Republican People's Party (CHP)

Member of Parliament, Turkish Grand National Assembly

# Euro Area: Sovereign Debt Crisis

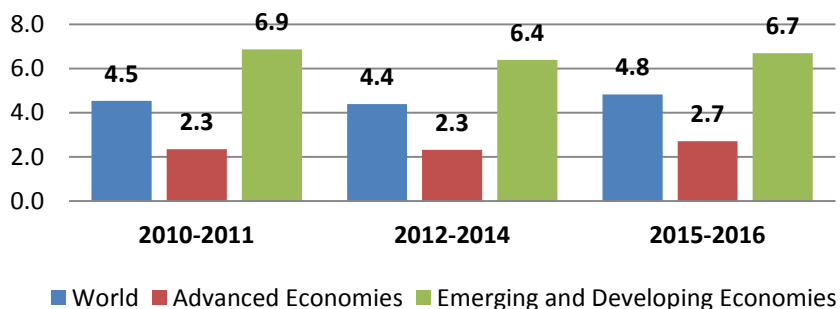


**Declining demand and confidence on the continent strongly affects Turkey, as roughly 45% of the country's exports go to Europe.**

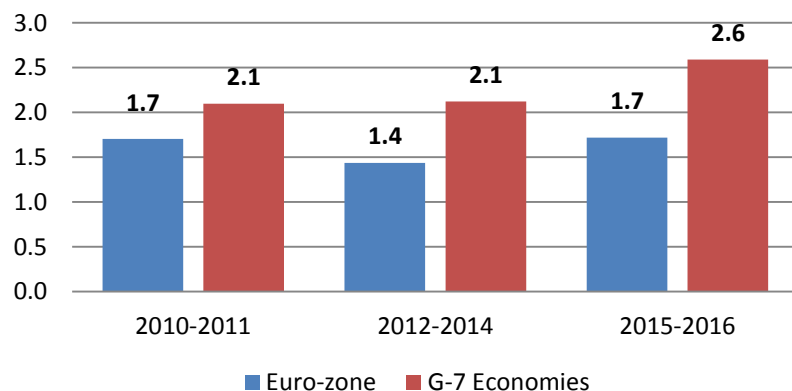
**The Turkish economy will suffer significantly if the European leaders fail to find a sustainable solution to end the crisis.**

# Prospects for the World Economy

IMF Growth Projections (%)



Growth in Advanced Economies (%)

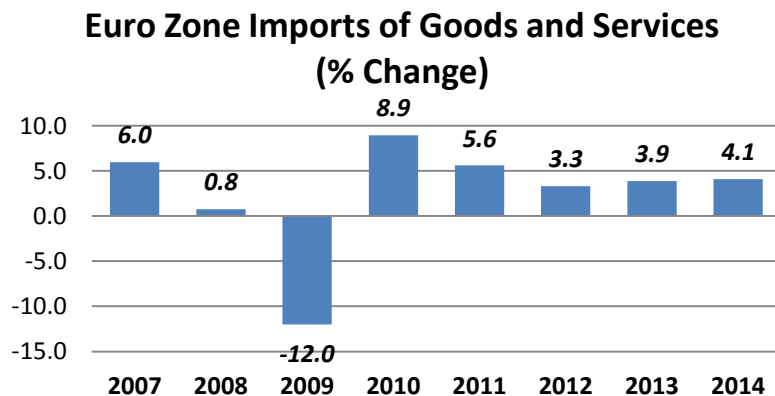
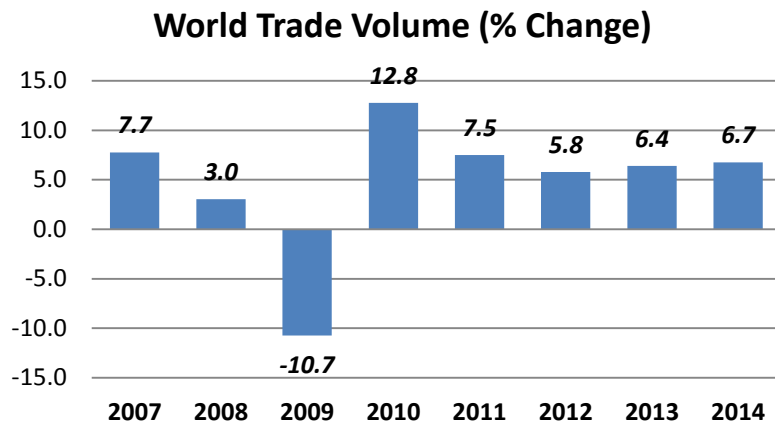


## GROWTH:

**Poor in the advanced world,  
falling in emerging markets.**

**Downside risks are rising.**

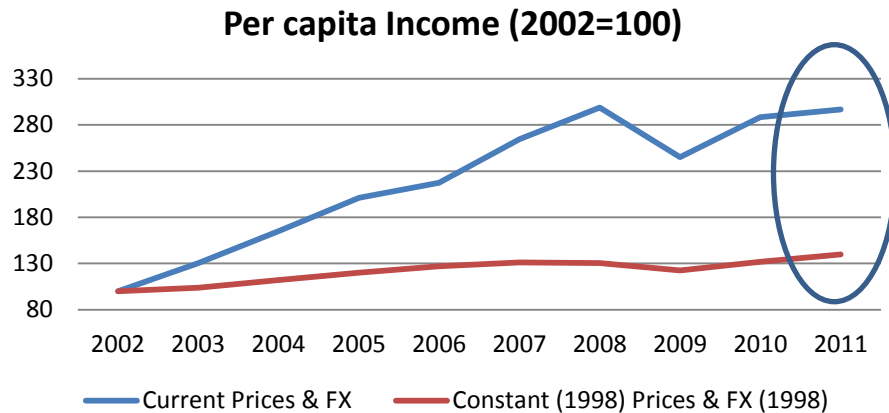
# Prospects for the World Economy



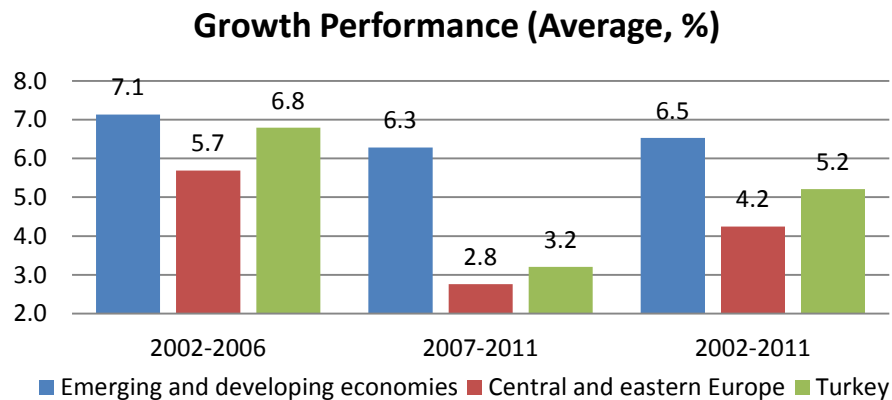
**There is a slowing trend in overall global trade.**

**Imports of Turkey's main trading partners are falling significantly.**

# Turkey: Perception vs Truth



**Vice President Joe Biden:**  
"Turkey's economy has tripled its GDP over the last 10 years. Per capita income has remarkably increased. Now, family living standards are much better."



**BUT WHAT IS MISSING?**

# Turkey: Perception vs Truth

**Turkey's economic performance over the last couple of years has led many to overlook insufficient policy mix and underlying structural problems;**

- High unemployment creating social tension and frustration among young people.
- Unsustainable current account deficit
- Skyrocketing Inflation
- Widening Income equality

Credit rating agency Fitch's downgrade of Turkey's outlook from positive to stable in November highlighted the country's increasing vulnerability to the deterioration in global outlook.

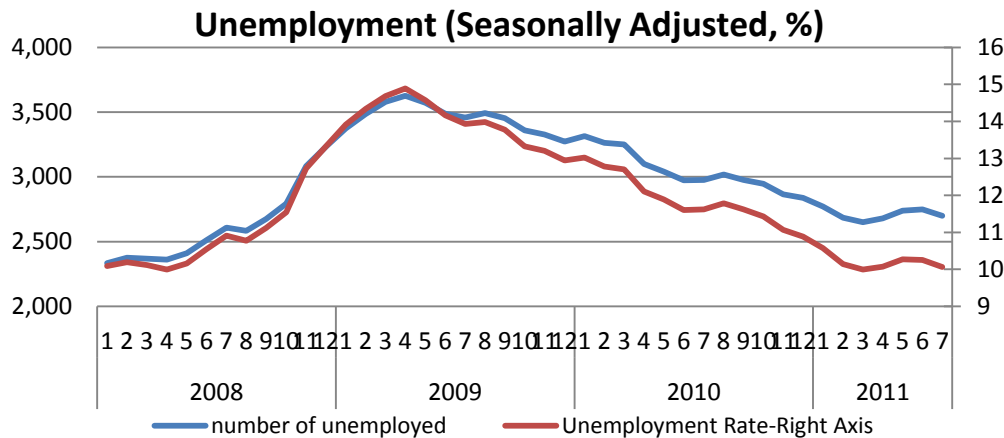
# Turkey: Perception vs Truth

| Unemployment rate<br>Percent of total labor force |             |                 |             |                 |             |
|---|-------------|-----------------|-------------|-----------------|-------------|
|   | 2002        |                 | 2007        |                 | 2011        |
| 1 South Africa                                    | 30.4        | 1 South Africa  | 22.2        | 1 South Afri    | 24.5        |
| 2 Argentina                                       | 22.5        | 2 Colombia      | 11.2        | 2 Colombia      | 11.5        |
| 3 Poland  | 19.9        | 3 Saudi Arabia  | 11.0        | 3 Hungary       | 11.3        |
| 4 Venezuela                                       | 16.0        | <b>4 Turkey</b> | <b>10.2</b> | <b>4 Turkey</b> | <b>10.5</b> |
| 5 Colombia  | 15.7        | 5 Morocco       | 9.8         | 5 Egypt         | 10.4        |
| 8 Morocco   | 11.3        | 8 Egypt         | 9.2         | 8 Venezueli     | 8.1         |
| <b>9 Turkey</b>                                   | <b>10.3</b> | 9 Indonesia     | 9.1         | 9 Ukraine       | 7.8         |
| 10 Egypt  | 10.1        | 10 Ecuador      | 8.8         | 10 Peru         | 7.5         |
| 25 Thailand                                       | 2.4         | 25 Thailand     | 1.4         | 24 Thailand     | 1.2         |

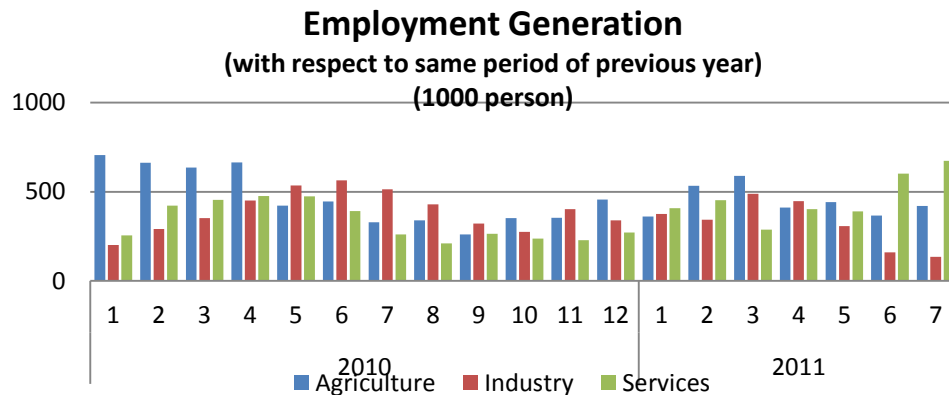
## UNEMPLOYMENT

- Why is the purported economic success not generating employment?
- Turkey's unemployment rate is still above 10%.
- Among 25 emerging economies, Turkey had the ninth highest unemployment rate in 2002, and the fourth highest in 2007 and 2011.

# Turkey: Perception vs Truth



- Unemployment figures returned to pre-crisis levels.
- But job growth is largely generated by agriculture and services sectors.





# Turkey: Perception vs Truth

| Ranking |                            | 2000         | Ranking |                            | 2011         |
|---------|----------------------------|--------------|---------|----------------------------|--------------|
| 1       | Norway                     | 0.913        | 1       | Norway                     | 0.943        |
| 2       | Australia                  | 0.906        | 2       | Australia                  | 0.929        |
| 3       | United States              | 0.897        | 3       | Netherlands                | 0.910        |
| 4       | Sweden                     | 0.894        | 4       | United States              | 0.910        |
| 5       | Netherlands                | 0.882        | 5       | New Zealand                | 0.908        |
| 77      | Armenia                    | 0.643        | 88      | Iran (Islamic Republic of) | 0.707        |
| 78      | Dominican Republic         | 0.640        | 89      | Oman                       | 0.705        |
| 79      | Iran (Islamic Republic of) | 0.636        | 90      | Tonga                      | 0.704        |
| 80      | <b>Turkey</b>              | <b>0.634</b> | 91      | Azerbaijan                 | 0.700        |
| 81      | Sri Lanka                  | 0.633        | 92      | <b>Turkey</b>              | <b>0.699</b> |
| 82      | Tunisia                    | 0.630        | 93      | Belize                     | 0.699        |
| 83      | Thailand                   | 0.626        | 94      | Tunisia                    | 0.698        |
| 151     | Afghanistan                | 0.230        | 185     | Burundi                    | 0.316        |
| 152     | Niger                      | 0.229        | 186     | Niger                      | 0.295        |
| 153     | Congo                      | 0.224        | 187     | Congo                      | 0.286        |

## DEVELOPMENT AND INCOME EQUALITY

- According to the UNDP Human Development Report's ranking;
- In 2000, Turkey ranked 80th among 153 countries. In 2011, Turkey ranked 92nd among 187 countries.
- According to the latest OECD report released last week, Turkey ranks in the top 3 of the 34 OECD countries in terms of income inequality.
- The richest 10% in Turkey earn 14 times more than the poorest 10%. This situation needs to be fixed before the gap grows even bigger.

# Turkey: Perception vs Truth

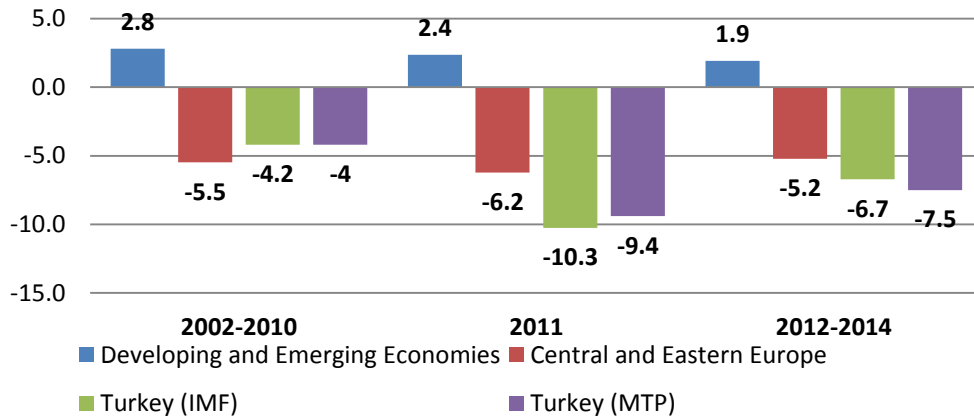
| Current account balance |         |                 |         |                  |         |
|-------------------------|---------|-----------------|---------|------------------|---------|
| Percent of GDP          |         |                 |         |                  |         |
|                         | 2002    |                 | 2007    |                  | 2011    |
| 1 Lebanon               | -13.912 | 1 Romania       | -13.426 | 1 Lebanon        | -14.682 |
| 2 Nigeria               | -13.031 | 2 South Africa  | -6.971  | 2 Turkey         | -10.258 |
| 3 Hungary               | -6.947  | 3 Hungary       | -6.923  | 3 Morocco        | -5.239  |
| 5 Ecuador               | -3.947  | 5 Poland        | -6.231  | 5 Romania        | -4.491  |
| 6 Romania               | -3.333  | 6 Turkey        | -5.902  | 6 Ukraine        | -3.893  |
| 7 Poland                | -2.797  | 7 Ukraine       | -3.694  | 7 Czech Republic | -3.289  |
| 13 Philippines          | -0.343  | 13 Brazil       | 0.113   | 13 India         | -2.185  |
| 14 Turkey               | -0.27   | 14 Peru         | 1.362   | 14 Egypt         | -1.9    |
| 15 Egypt                | 0.702   | 15 Egypt        | 2.068   | 15 Mexico        | -0.951  |
| 28 Argentina            | 8.535   | 28 Saudi Arabia | 24.261  | 28 Saudi Arabia  | 20.58   |

## WHAT ABOUT THE EXTERNAL DEFICIT?

- Worsening situation:** In 2002, Turkey had the 14th-highest external deficit among 28 emerging economies. In 2007, it had the sixth-highest. In 2011, it had the second-highest.
- Increasing Vulnerability:** With a current account deficit bordering on 10% of 2011 estimated GDP, and another \$110-125 billion in foreign debt maturing in the next 12 months, Turkey is the prime target for contagion from the crisis-stricken European banking system.

# Falling Short on CA Deficit

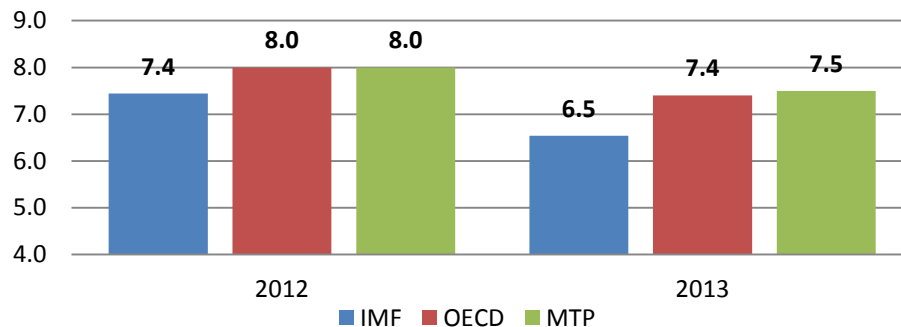
Current Account Deficit in Peers (Ratio to GDP)



**In best-case scenarios, the 2012 current account deficit will not drop below \$70 billion.**

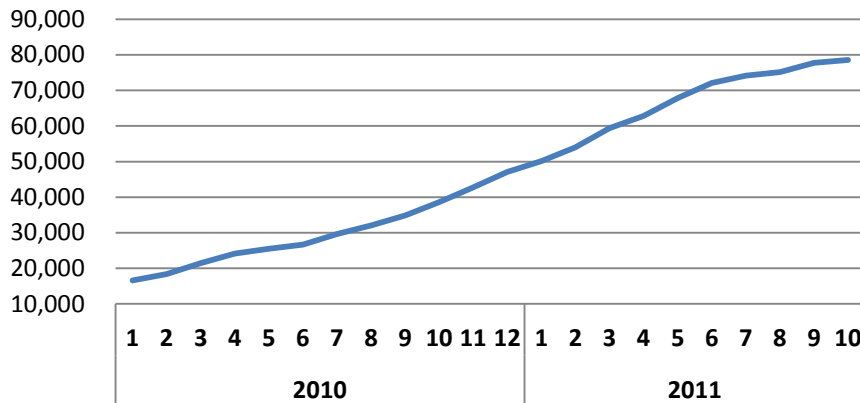
**Turkey's rating outlook is largely conditional on the Government's success in reducing the current account deficit.**

Current Account Deficit (Percent of GDP)



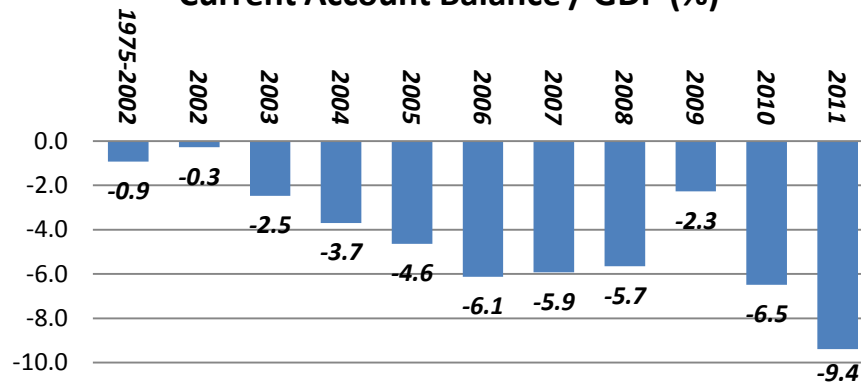
# Recent Developments in Turkey's Economy

Current Account Deficit (Million \$)



**The October current account deficit was around \$79 billion per annum, largely financed by net errors and omissions and hot money.**

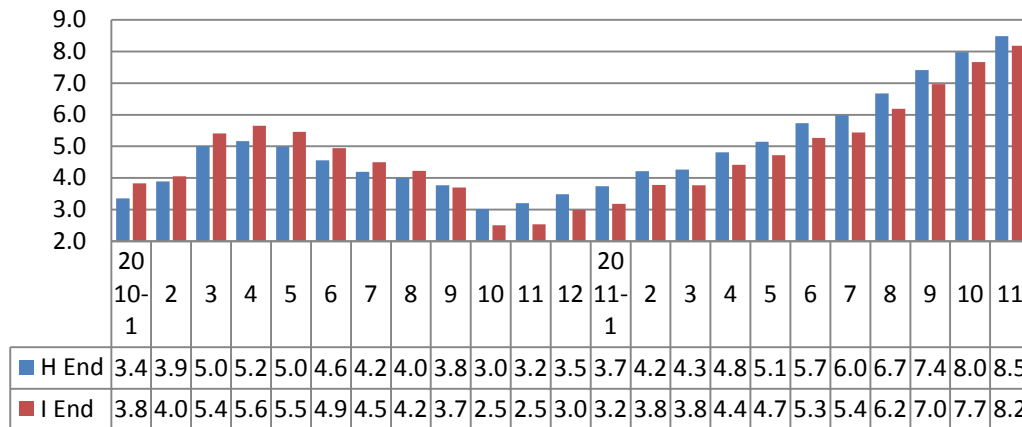
Current Account Balance / GDP (%)



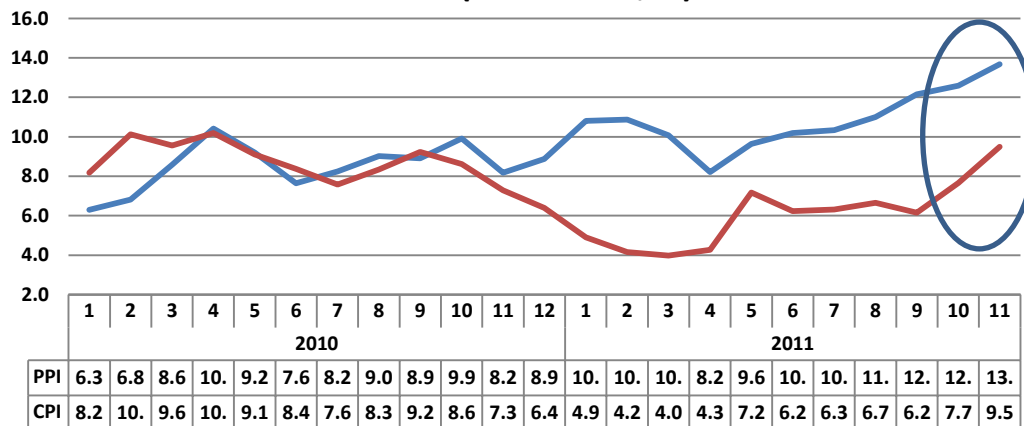
**Turkey will continue to be the current account deficit "champion" over the next three years.**

# Inflation

Developments in Core Inflation (12 Months,%)



Inflation (12 Months, %)



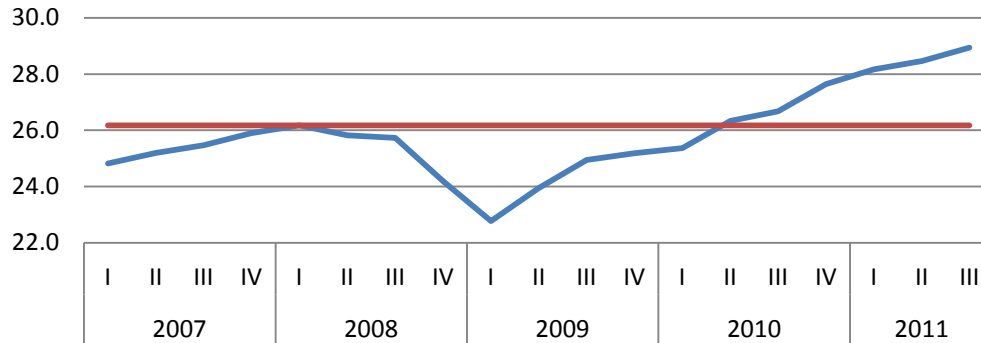
**November CPI came in at 1.73%, much higher than the 1.2% consensus, pushing the annual number to 9.48. It is a clear indication of Turkey's overheating economy.**

**Not only headline inflation, but also core inflation figures are sharply rising.**

**The central bank had expected the economy to level off more quickly and head for a soft landing. However, it is clear that these expectations were wrong.**

# Recent Developments in Turkey's Economy

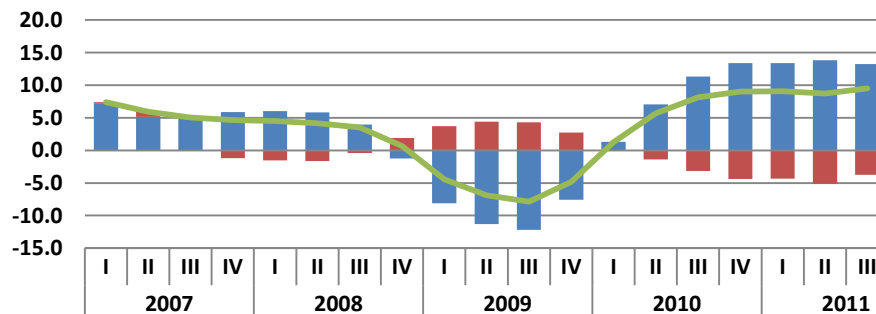
**GDP (Seasonally and Calendar Adjusted, Billion TL)**



**GDP is increasing at a very rapid pace, driven by domestic demand fueled by credit expansion.**

**Turkey's growth performance seems to be stealing the headlines in foreign media—but questions about fundamentals are largely being ignored.**

**Contributions to GDP Growth (Annualized, %)**



**We believe Turkey should focus on a path of economic and financial sustainability while strengthening its free market economy.**

|                 | I    | II  | III | IV   | I    | II   | III  | IV   | I    | II    | III   | IV   | I    | II   | III  | IV   | I    | II   | III  |  |
|-----------------|------|-----|-----|------|------|------|------|------|------|-------|-------|------|------|------|------|------|------|------|------|--|
|                 | 2007 |     |     |      | 2008 |      |      |      | 2009 |       |       |      | 2010 |      |      |      | 2011 |      |      |  |
| Net Export      | 0.2  | 0.8 | 0.1 | -1.2 | -1.6 | -1.6 | -0.4 | 1.9  | 3.7  | 4.4   | 4.3   | 2.7  | -0.1 | -1.4 | -3.2 | -4.4 | -4.3 | -5.1 | -3.7 |  |
| Domestic Demand | 7.1  | 5.1 | 5.0 | 5.9  | 6.0  | 5.8  | 3.9  | -1.2 | -8.1 | -11.1 | -12.1 | -7.6 | 1.3  | 7.0  | 11.3 | 13.4 | 13.4 | 13.8 | 13.2 |  |
| GDP             | 7.4  | 5.9 | 5.1 | 4.7  | 4.5  | 4.2  | 3.5  | 0.7  | -4.4 | -6.9  | -7.9  | -4.8 | 1.3  | 5.7  | 8.1  | 9.0  | 9.0  | 8.7  | 9.5  |  |

# Turkey: Perception vs Truth

| Gross domestic product, constant prices |      |                         |      |
|---|------|-------------------------|------|
| 2002=100                                | 2007 | 2007=100                | 2011 |
| 1 China                                 | 173  | 1 China                 | 145  |
| 2 United Arab Emirates                  | 161  | 2 India                 | 135  |
| 3 Argentina                             | 153  | 3 Nigeria               | 132  |
| 8 Russia                                | 144  | 8 Morocco               | 120  |
| 9 Turkey                                | 140  | 9 Egypt                 | 119  |
| 10 Peru                                 | 137  | 10 Philippines          | 119  |
| 18 Poland                               | 129  | 18 Thailand             | 112  |
| 19 Egypt                                | 128  | 19 Turkey               | 111  |
| 20 Chile                                | 127  | 20 United Arab Emirates | 109  |
| 28 Hungary                              | 117  | 28 Ukraine              | 95   |

**Between 2002 and 2007, Turkey had the ninth highest growth rate among 28 emerging economies.**

**Within the same group, Turkey's ranking declined to 19th for the period of 2007-2011.**

**Why?**

# Turkey: Perception vs Truth

Table: GDP Rankings (PPP, Billion Int. Dollar)

| Country                     | 1987  | Country                     | 2002   | Country                     | 2011   |
|-----------------------------|-------|-----------------------------|--------|-----------------------------|--------|
| 1 United States             | 4,736 | 1 United States             | 10,642 | 1 United States             | 15,065 |
| 2 Japan                     | 1,752 | 2 China                     | 3,702  | 2 China                     | 11,316 |
| 3 Germany                   | 1,139 | 3 Japan                     | 3,355  | 3 India                     | 4,470  |
| 4 France                    | 827   | 4 Germany                   | 2,265  | 4 Japan                     | 4,396  |
| 5 United Kingdom            | 797   | 5 India                     | 1,774  | 5 Germany                   | 3,089  |
| 6 Italy                     | 794   | 6 United Kingdom            | 1,648  | 6 Russia                    | 2,376  |
| 7 Brazil                    | 708   | 7 France                    | 1,638  | 7 Brazil                    | 2,309  |
| 8 China                     | 679   | 8 Italy                     | 1,485  | 8 United Kingdom            | 2,254  |
| 9 India                     | 547   | 9 Brazil                    | 1,334  | 9 France                    | 2,217  |
| 10 Mexico                   | 495   | 10 Russia                   | 1,282  | 10 Italy                    | 1,829  |
| 11 Canada                   | 451   | 11 Mexico                   | 1,098  | 11 Mexico                   | 1,659  |
| 12 Spain                    | 431   | 12 Spain                    | 996    | 12 Korea                    | 1,556  |
| 13 Australia                | 248   | 13 Canada                   | 967    | 13 Spain                    | 1,413  |
| 14 Turkey                   | 234   | 14 Korea                    | 898    | 14 Canada                   | 1,391  |
| 15 Korea                    | 231   | 15 Australia                | 585    | 15 Indonesia                | 1,123  |
| 16 Netherlands              | 226   | 16 Indonesia                | 564    | 16 Turkey                   | 1,055  |
| 17 Indonesia                | 204   | 17 Turkey                   | 534    | 17 Islamic Republic of Iran | 930    |
| 18 Poland                   | 201   | 18 Netherlands              | 503    | 18 Australia                | 919    |
| 19 Islamic Republic of Iran | 201   | 19 Islamic Republic of Iran | 501    | 19 Taiwan Province of China | 886    |
| 20 Argentina                | 182   | 20 Taiwan Province of China | 486    | 20 Poland                   | 767    |

**Since 1980s, Turkey has always been in the club of the biggest 20 economies.**

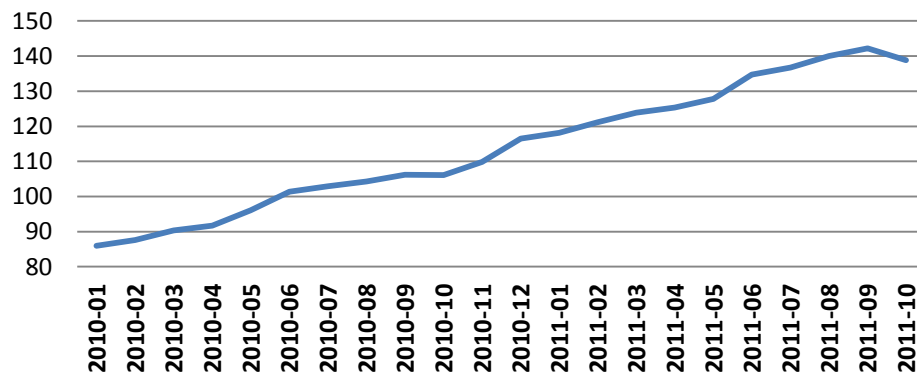
**When the G-20 was announced in 1999, the Turkish economy ranked 16th in the world.**

**It has not moved up the ranks since.**



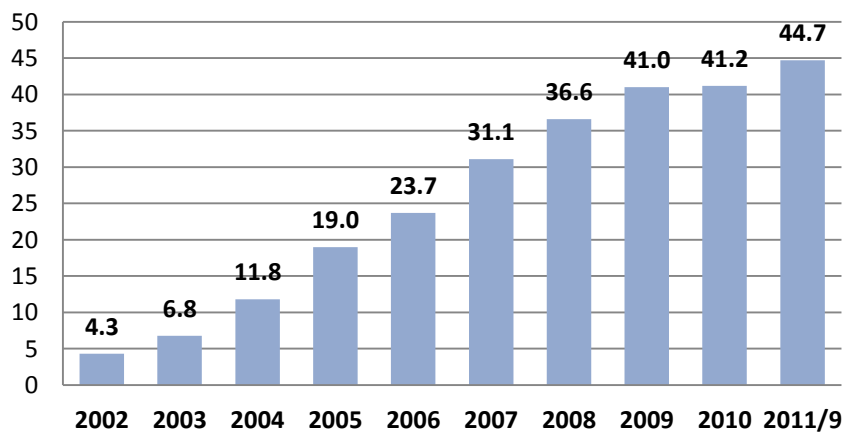
# Recent Developments in Turkey's Economy

Real Credit Volume in Banking Sector  
(2010 =100)



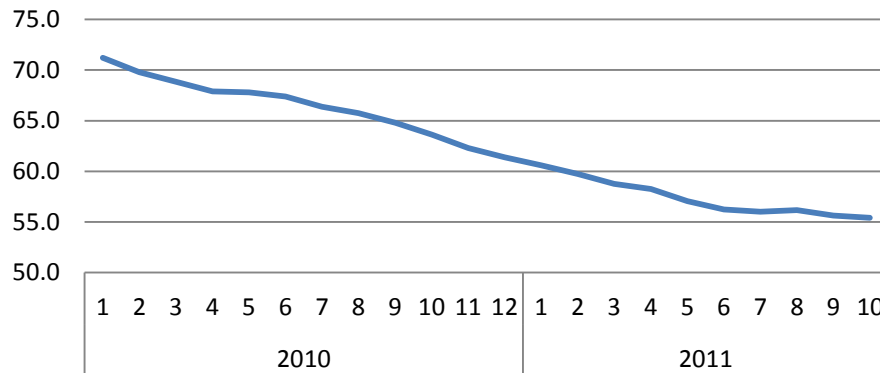
**The remarkable increase in household indebtedness since 2009 continues.**

Household Debt/Disposable Income (%)

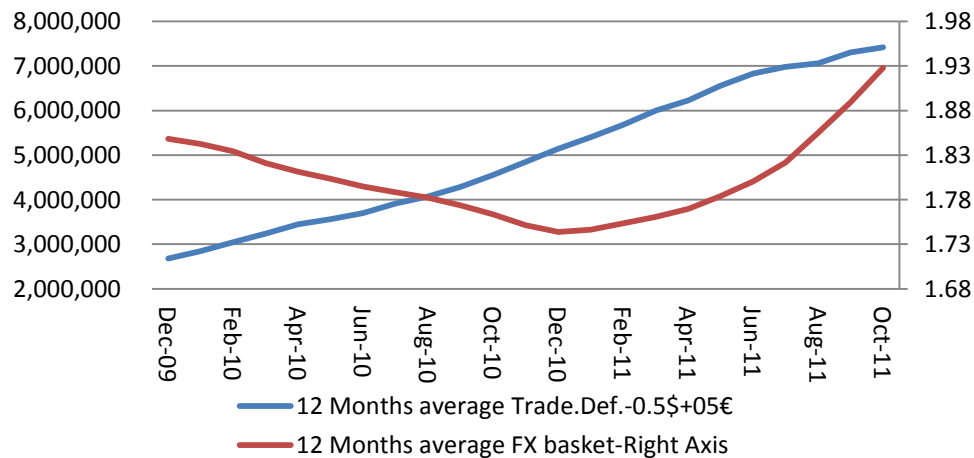


# Recent Developments in Turkey's Economy

Export/Import Ratio (Annualized, %)



Trade Deficit and FX Movement



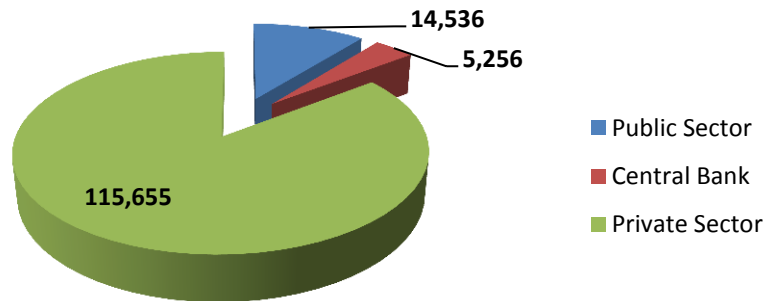
**Loss of competitiveness.**

**Export-import coverage ratio is the lowest since 2001 crisis.**

**Despite the high depreciation of the lira, no recovery in trade deficit**

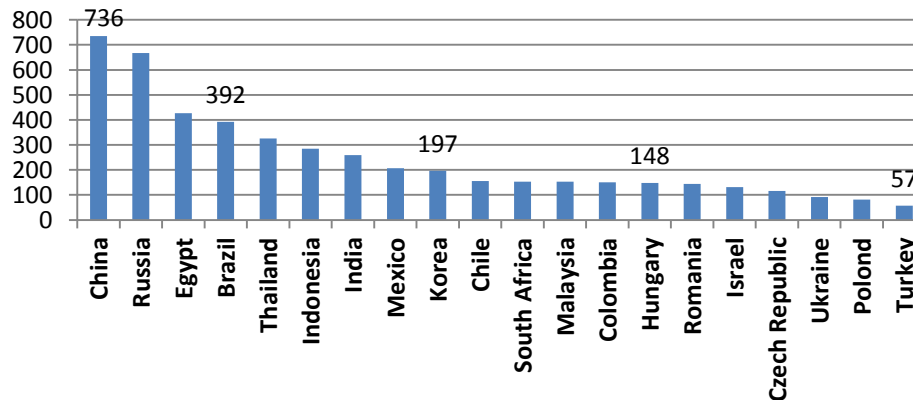
# Recent Developments in Turkey's Economy

**Short Term Debt Stock**  
(according to maturity, million \$)



Turkey does not have enough reserves to support the lira: according to import coverage and reserves to short-term debt ratios, the country is one of the most vulnerable among the emerging markets.

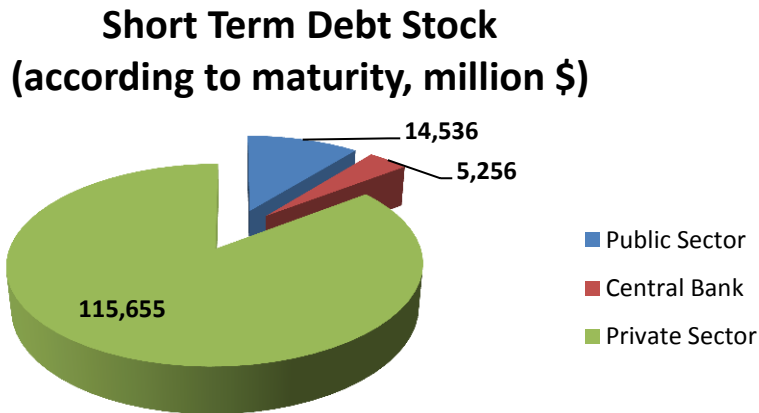
**Foreign Reserves as a ratio of Current Account Deficit+ Short Term Debt (%)**



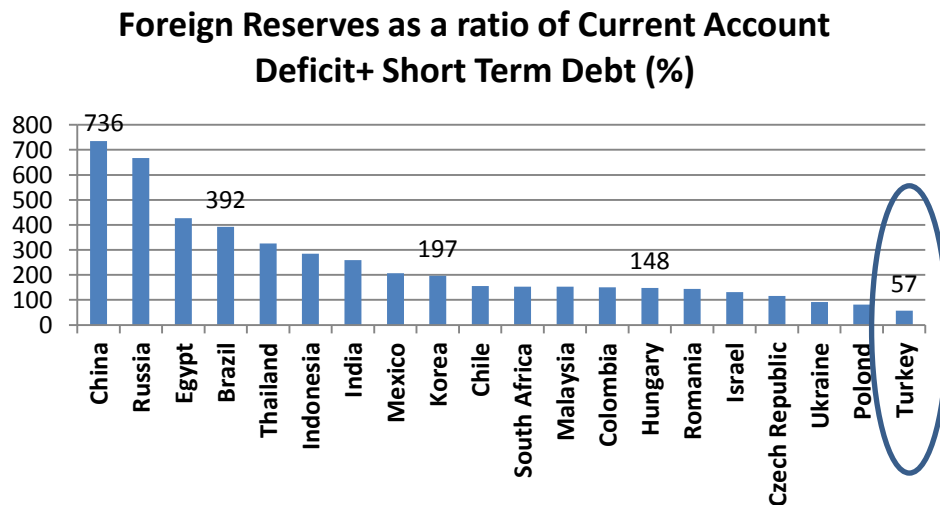
Central Bank's foreign exchange reserves are only around \$90 billion.

Combined with the \$79 billion current account deficit, this signals a big problem.

# Recent Developments in Turkey's Economy



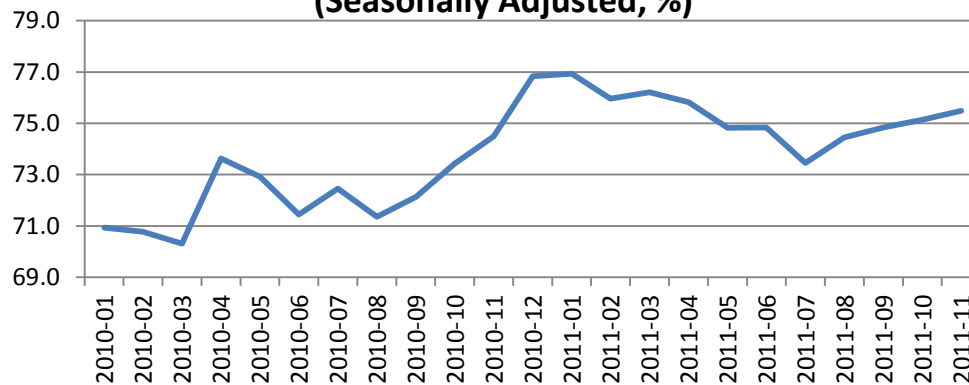
Turkey's import coverage ratio—that is, the number of months of imports that can be covered by the country's reserves—stands at a mere 5 months, compared to 19 months for Brazil, 23 for Russia, and 24 for China.



Similarly, Turkey's reserves/short-term external debt ratio is also about four times worse than Brazil's and right times worse than China's.

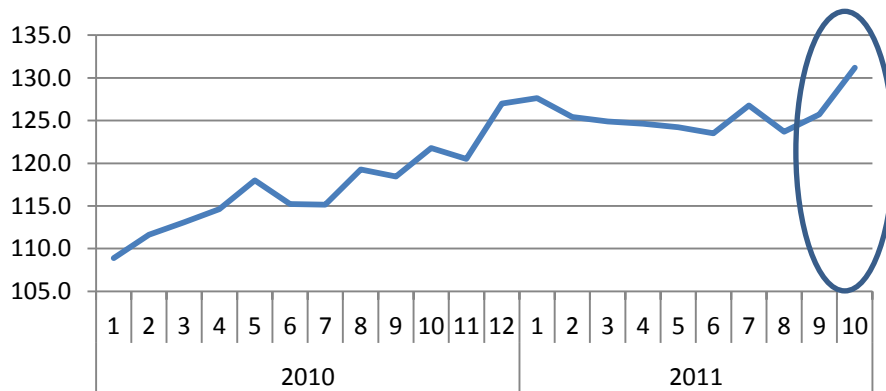
# Any Indication of a Soft Landing?

Capacity Utilization in Manufacturing Sector  
(Seasonally Adjusted, %)



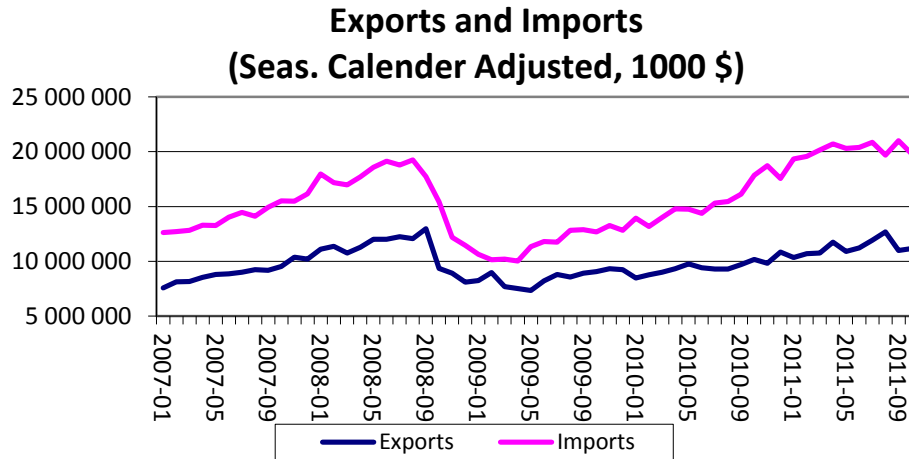
**Capacity utilization and industrial production are increasing.**

Industrial Production (Seas., calendar adjusted)



**In October, seasonally- and calendar-adjusted industrial production increased 4.4%, the highest figure for 2011.**

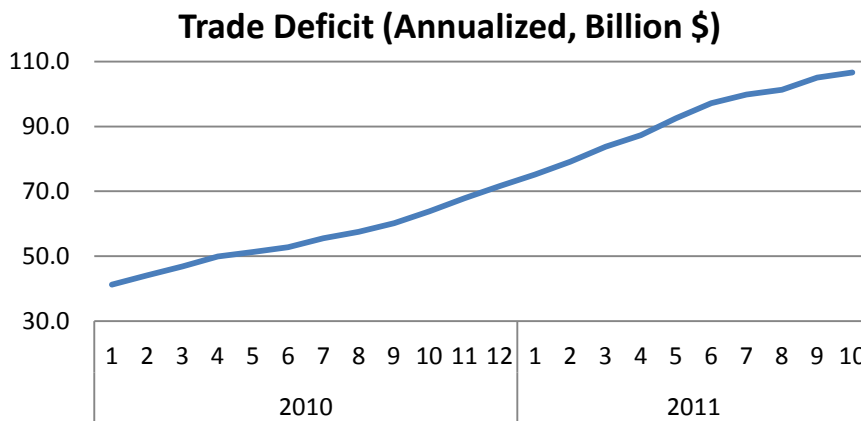
# Any Indication of a Soft Landing?



The trade deficit widened to \$8 billion in October, underlining the economic problems in Turkey's main trading partners.

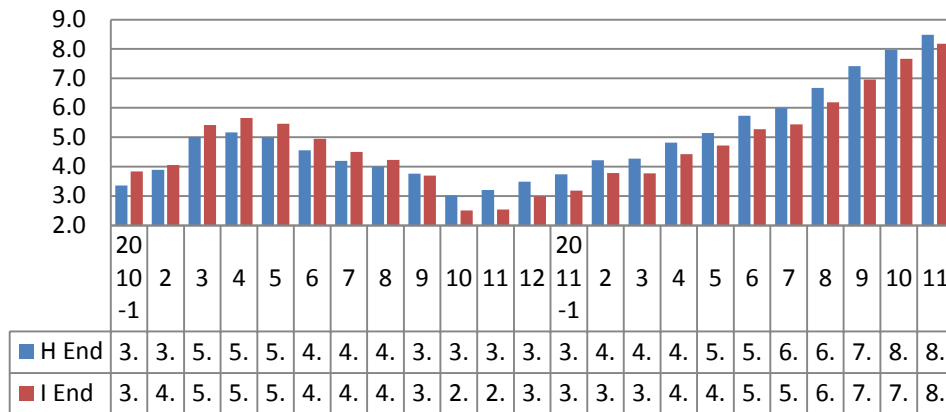
Though imports are losing momentum, exports got stuck.

The key factor driving the trade deficit is the country's loss of competitiveness, which should be addressed through policies to boost domestic industries by focusing on new sectors, and increasing R&D activities.



# Any Indication of a Soft Landing?

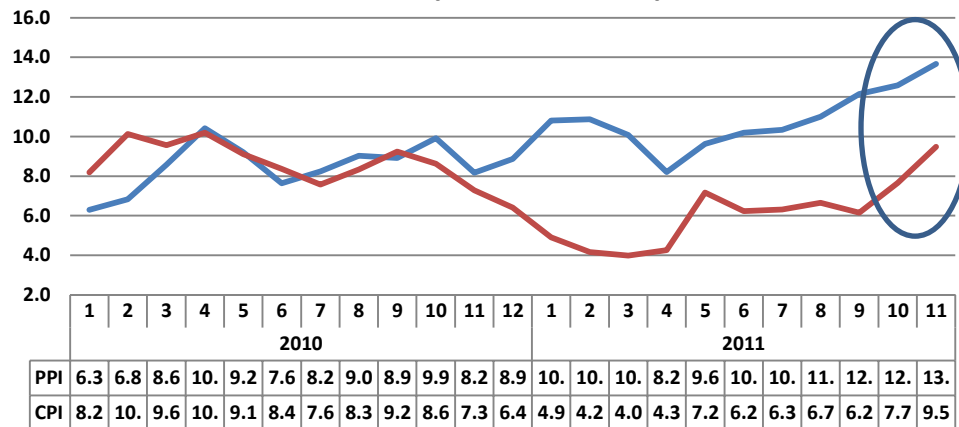
Developments in Core Inflation (12 Months,%)



Not only headline inflation, but also core inflation figures are sharply rising.

The November consumer price inflation figure was a clear indication of Turkey's overheating economy.

Inflation (12 Months, %)



The central bank had expected the economy to level off more quickly and head for a soft landing. However, it is clear that these expectations were wrong.

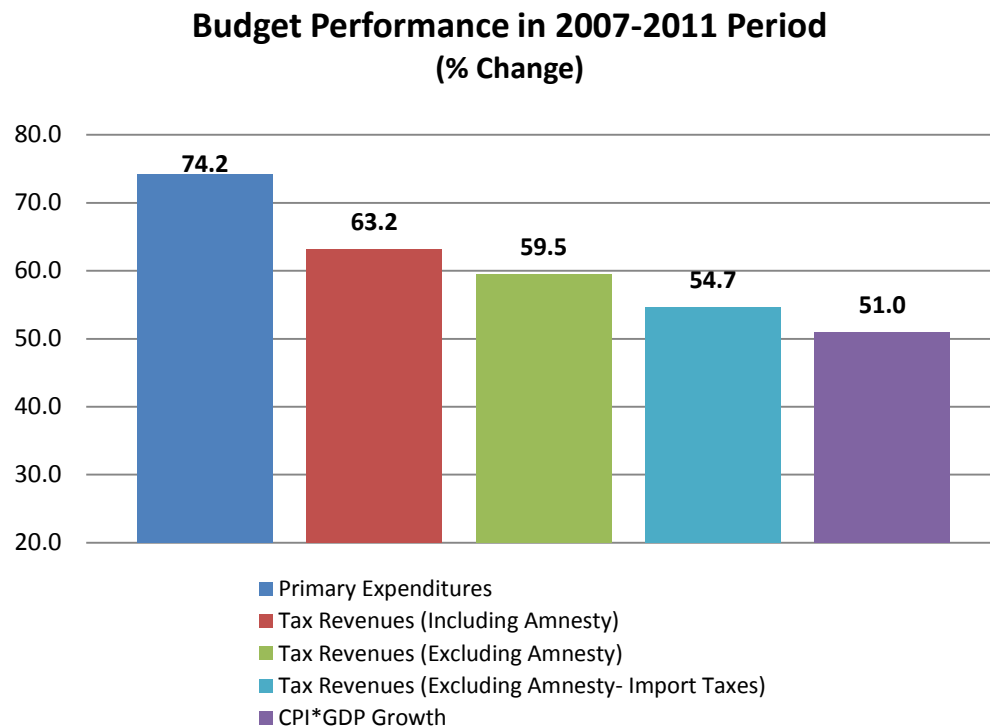
# Unorthodox Central Bank Experience

*Monetary policy: too many targets, too much noise*

- Turkey`s Central bank`s policies have been more confusing than effective. The unorthodox policy of keeping interest rates low but increasing reserve requirement ratios to fight hot money inflows has not been successful.
- The Turkish lira has been one of the worst-performing emerging market currencies, putting Turkey in the middle of a complicated situation: It needs a stronger lira to suppress inflation, but a weaker one to solve its current account problem.
- Central Bank`s independence is also getting questionable in Turkey.



# Any Indication of a Soft Landing?



*"The primary balance of the nonfinancial public sector continued to improve, largely reflecting buoyant-but transient-tax revenue from the boom in output and imports and proceeds from a tax restructuring scheme, which masked a relaxed fiscal stance."*

**Article IV Consultation  
Assessment , IMF**

## Medium Term Programs (MTP): Reliable Anchor?

|                                      | 2011 Targets     | 2011 Official Estimate | Deviation (Times) |
|--------------------------------------|------------------|------------------------|-------------------|
|                                      | October 11, 2010 | October 17, 2011       |                   |
| Growth Rate (%)                      | 4.5              | 7.5                    | 1.7               |
| CPI (%)                              | 5.3              | 7.8                    | 1.5               |
| GDP Deflator(%)                      | 5.8              | 8                      | 1.4               |
| Cur. Ac. Deficit/GDP (%)             | 5.4              | 9.4                    | 1.7               |
| Current Account Deficit (Billion \$) | 42.2             | 71.7                   | 1.7               |

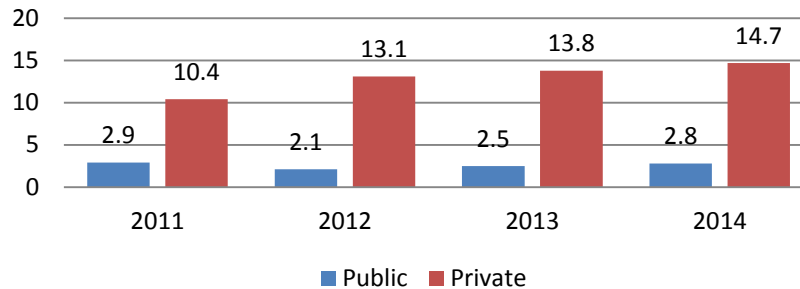
**In November, CPI increased by 9.5%. Number came much higher than the consensus.**

**For 2011, double-digit inflation is unavoidable. Returning to double-digit figures will create a psychological negative impact.**

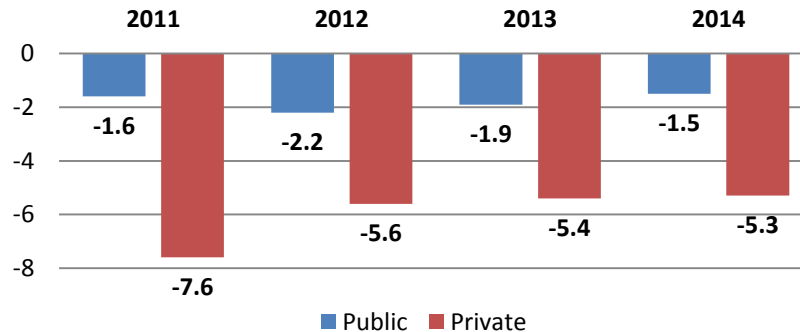
**The October current account deficit was around \$79 billion per annum, largely financed by bank loans and net errors and omissions. (covering 20% of the deficit in the first ten months)**

# MTP Falling Short of Aims

Public and Private Sector Savings  
(Ratio of GDP, current)



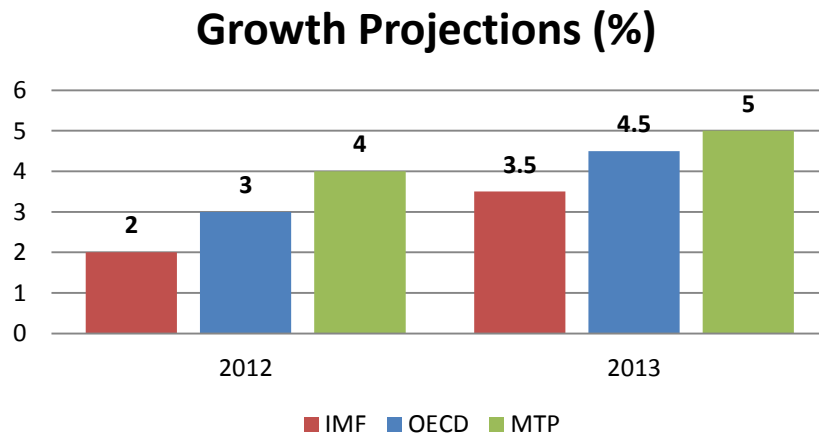
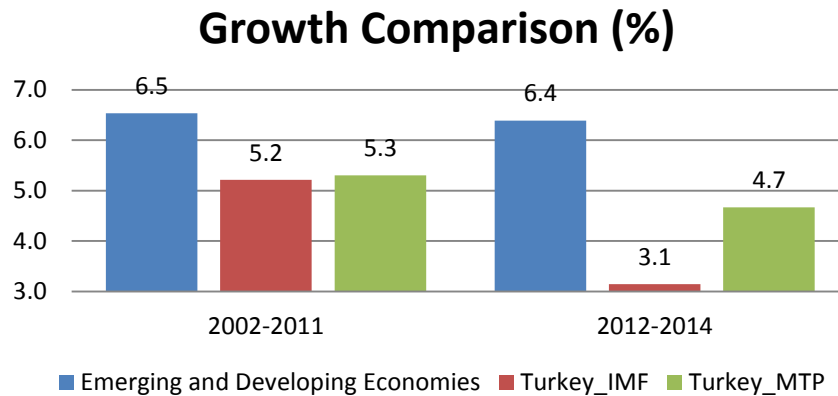
Saving - Investment (Ratio of GDP)



**The MTP's main goals are to increase domestic saving and reduce the current account deficit.**

**Yet public sector saving investment gap is projected to increase in 2012.**

# A "Stable Growth Process"?



**Turkey's growth rate is anticipated to stay behind other emerging and developing countries over the next several years.**

**The recently published Bank of America Merrill Lynch report suggest zero percent growth for Turkey in 2012.**

# Conclusion

- Turkey's economic performance over the last couple of years has led many to overlook underlying structural problems.
- We believe Turkey should focus on a path of economic and financial sustainability while strengthening its open market economy.
- We have a strong economic team that follows global and regional developments very closely, constantly devising new strategies and policies to take Turkey to a more sustainable tomorrow.

# THANK YOU!



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