

# TURKISH ECONOMY 2013

## Challenges and Opportunities

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# Overview

- Turkey had a «stellar» recovery post-2009
  - Fast growth, falling unemployment, financial and fiscal stability, etc.
  - Surprising many at home and abroad
- Puzzle: why such a deep recession before?
  - Political economy very interesting
  - I leave it to other occasions
- Mid-long term view – forest not trees
  - Short term policy discussion is outside my scope
  - Review historical trends
  - Emphasise structural characteristics
  - Establish challenges and opportunities
  - Obtain clues about the near future

# Warnings for Comparaisons

- Some data needs adjustment
  - Turkey has less households (19 million) compared to countries with stable population
  - Understating per capita welfare indicators (car, telephone, tv sets, etc)
  - PPP income is 50 % higher than current exchange rate income (in EU it is either at par or lower)
- High employment in low productivity agriculture
  - 40 % of the employment : self-employed, unpaid family labour and employers
- Pronounced dual structure of the economy
  - Modern, high value added, formal sector
  - Traditional, low value added, informal sector

# Brief history

- Long term growth performance: mediocre
  - Not a failure (Argentina) nor miracle (Korea)
- Four phases of post-war growth
- 1950-80: Import substitution
  - Inward looking command economy; ends in crisis
- 1980-99: Opening up - Customs Union with EU
  - Market reforms without fiscal stability; end in crisis
- 2000-10: Fiscal consolidation
  - Financial stability; high growth at the cost of large external deficits
- 2011 + : towards sustainable growth
  - Rebalancing domestic and external demand; jury still out

# Comparative political indicators

Table from Timur Kuran, 2012

## Comparative political indicators, 2011-12 (0-10, standardized and population-weighted)

Country or country group	Corruption perceptions	Rule of law	Civil liberties
Africa (non-Arab)	2.7	2.9	5.8
India	3.1	4.9	7.0
China	3.6	4.2	4.0
<b>Middle East</b>	<b>3.0</b>	<b>3.7</b>	<b>4.7</b>
<i>Arab League</i>	<i>2.8</i>	<i>3.5</i>	<i>4.4</i>
<i>Iran</i>	<i>2.7</i>	<i>2.8</i>	<i>4.0</i>
<i>Turkey</i>	<i>4.2</i>	<i>5.3</i>	<i>7.0</i>
OECD (except Turkey)	6.6	8.0	8.6

Sources: Transparency International, World Bank, Freedom House (2011-12)

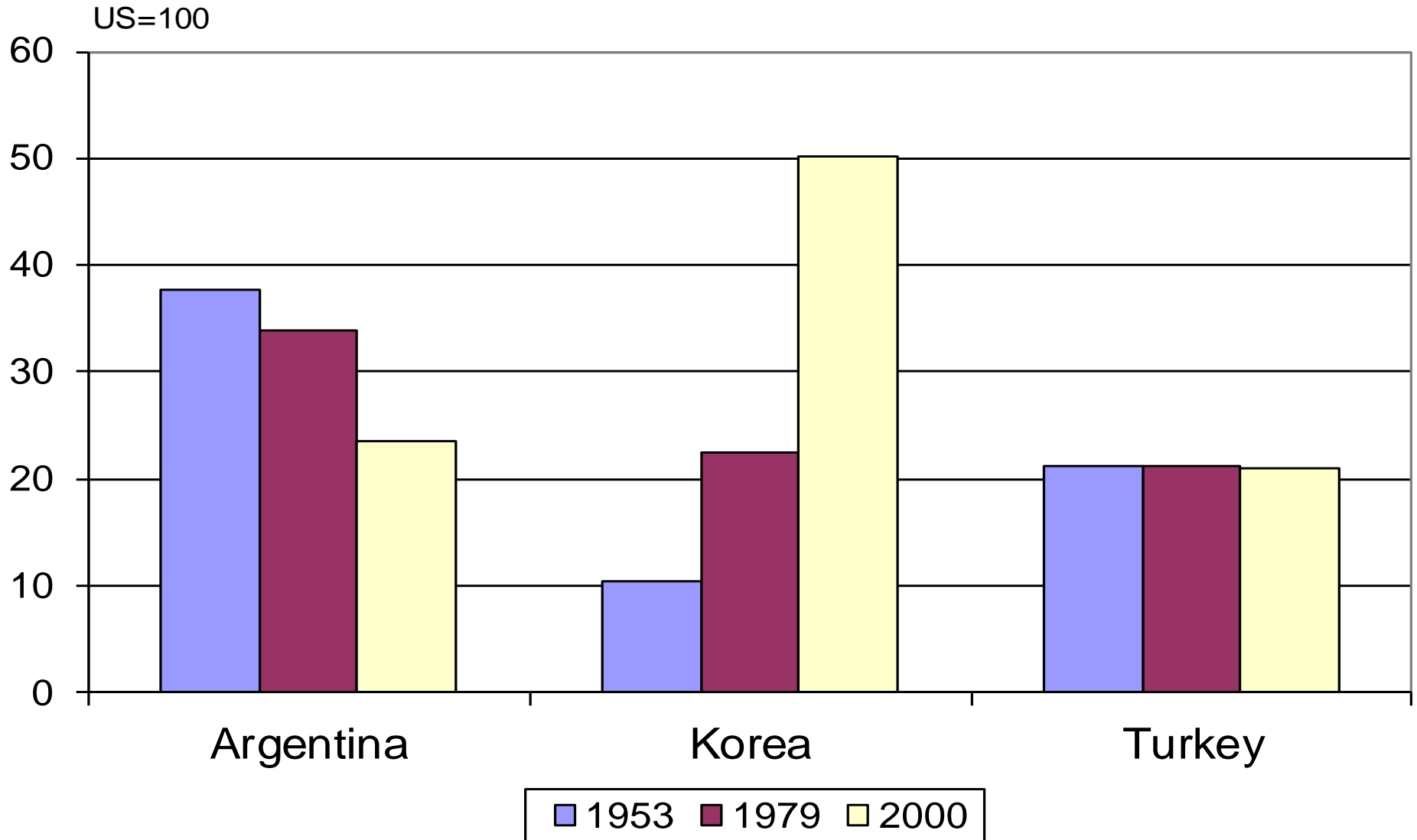
# Growth in the very long run

GDP per capita PPP, 1990=100

<b>Difference in annual growth %</b>	<b>World Economy</b>	<b>West Europe + US</b>	<b>Under-develop. Econ.</b>
<b>1500-1820</b>	<b>-0,1</b>	<b>-0,1</b>	<b>0</b>
<b>1820-1914</b>	<b>-0,3</b>	<b>-0,7</b>	<b>0,3</b>
<b>1914-1950</b>	<b>-0,1</b>	<b>-0,5</b>	<b>0,3</b>
<b>1950-1980</b>	<b>0,5</b>	<b>0,2</b>	<b>0,3</b>
<b>1980-2010</b>	<b>0,6</b>	<b>0,8</b>	<b>-0,2</b>

# GDP per capita relative to US

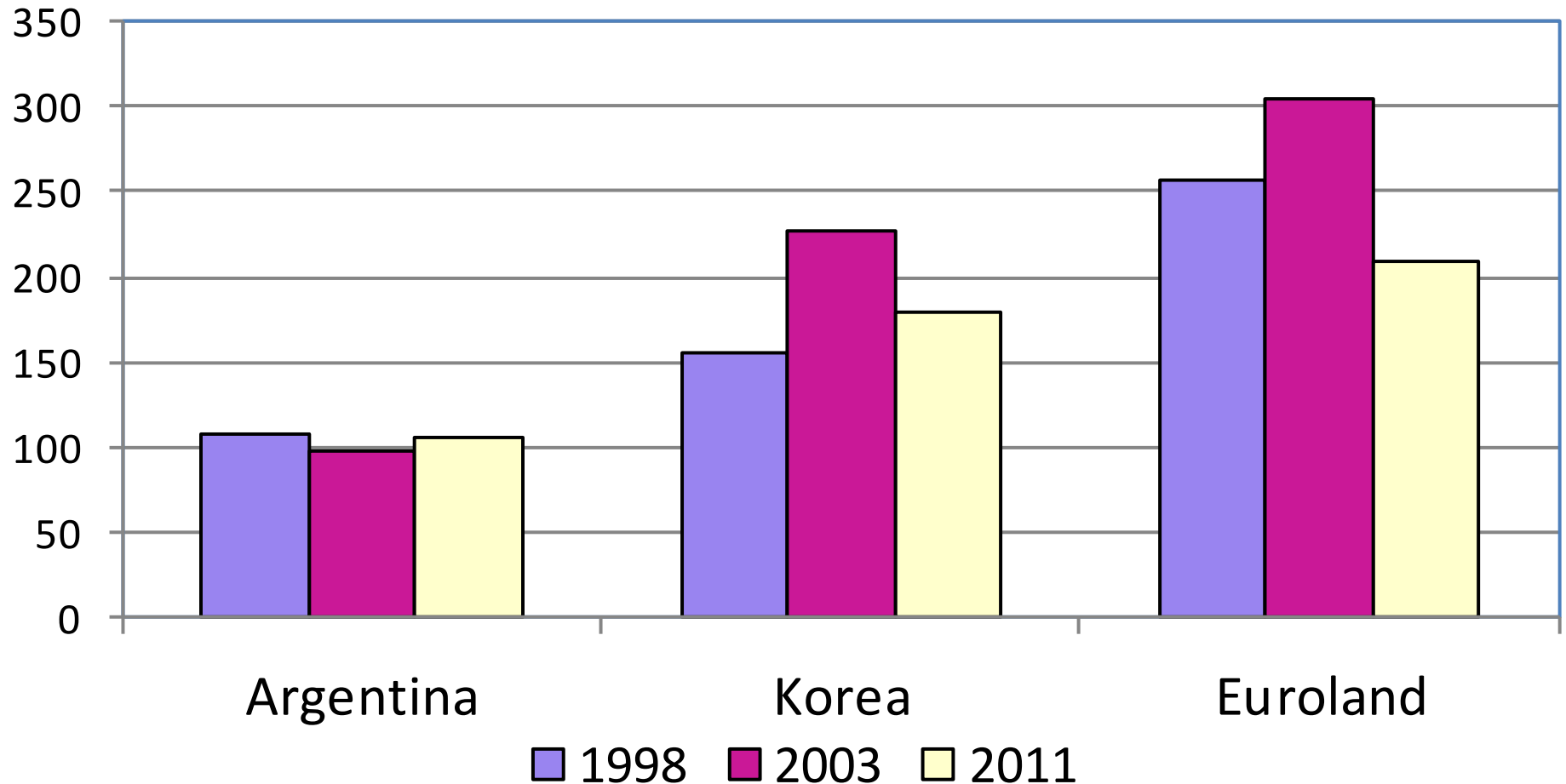
PPP; US = 100; 1953-2000 (Penn Tables)



# Per capita GDP relative to Turkey

PPP; Turkey=100; 1998-2011 (World Bank)

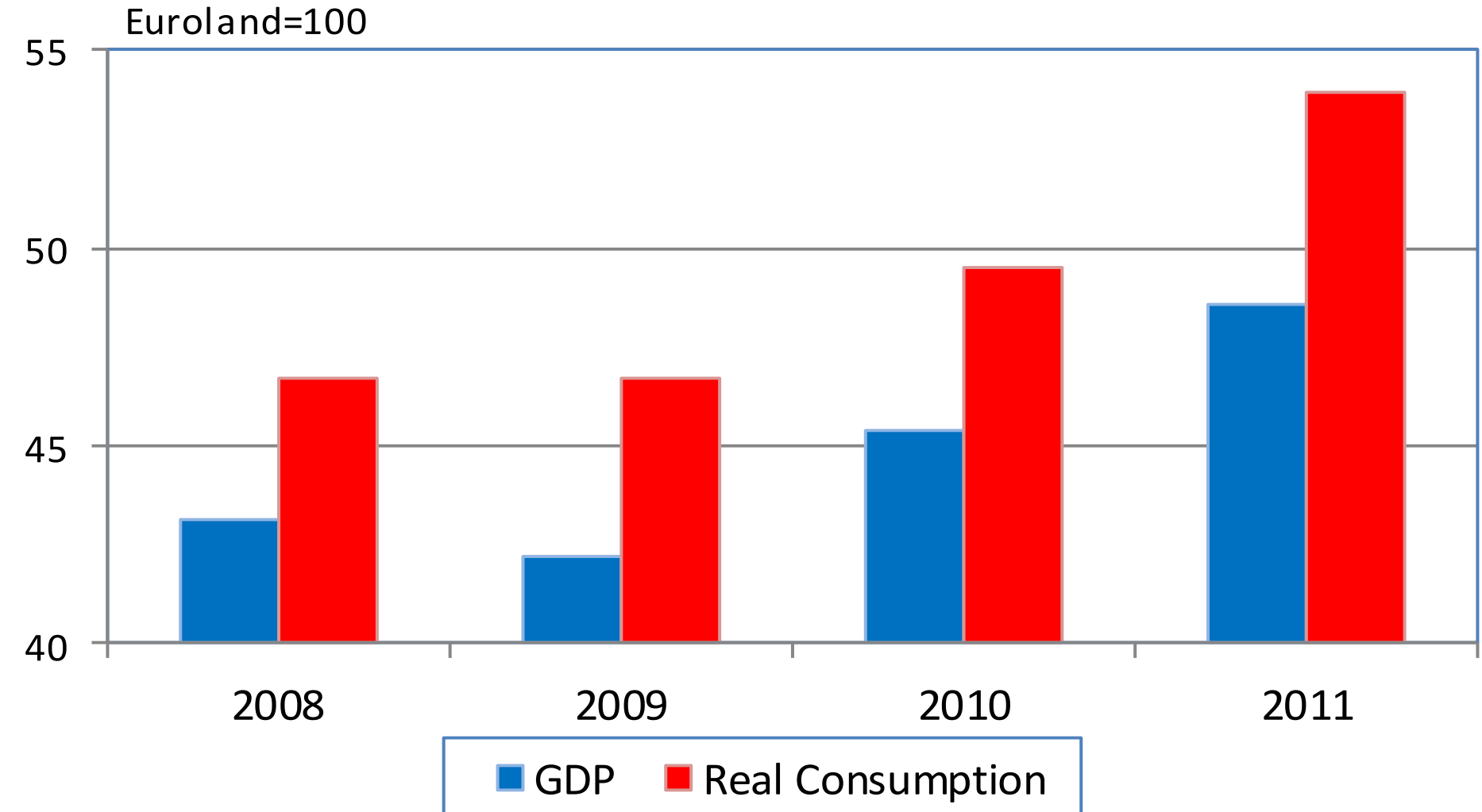
Turkey = 100





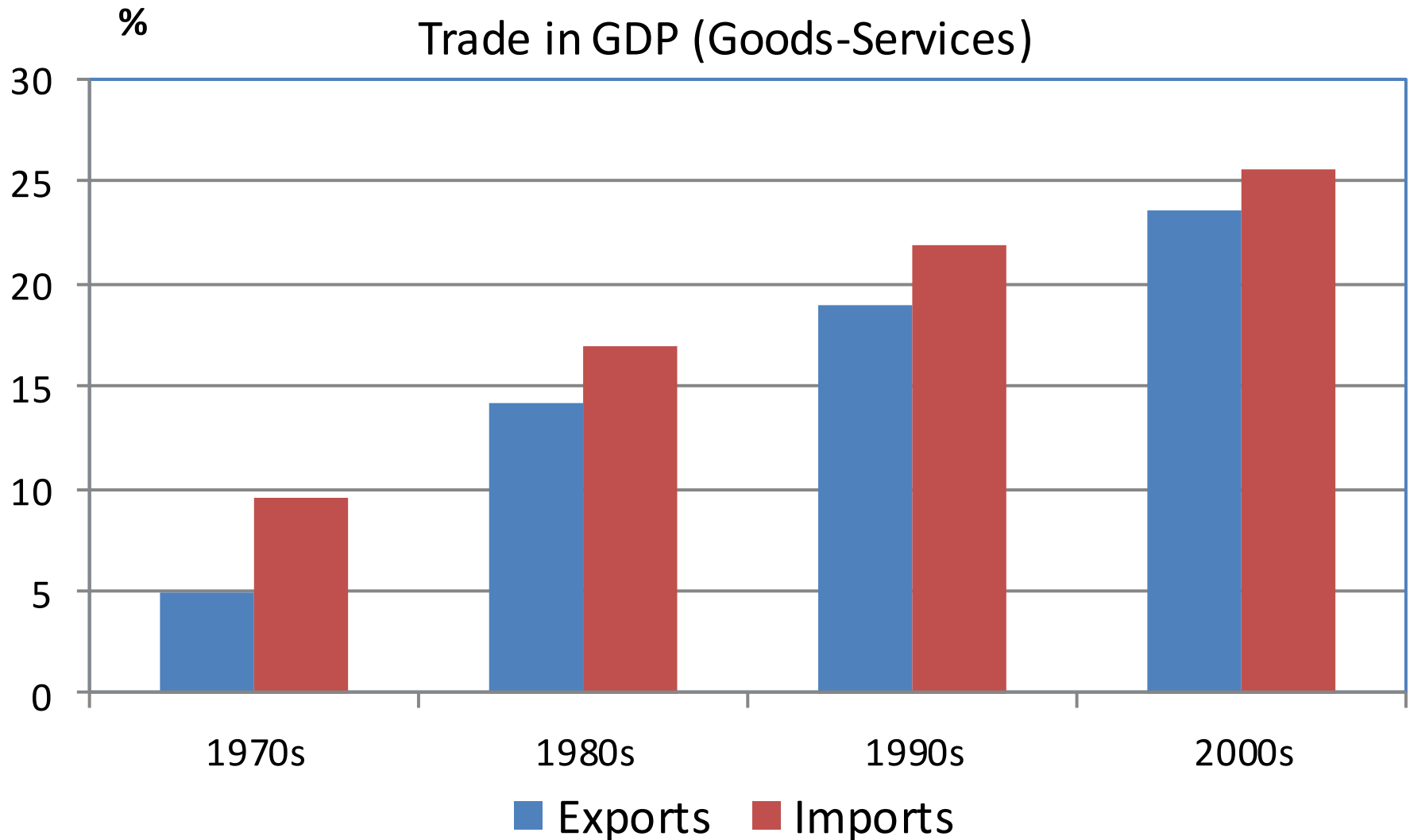
# Per capita GDP post-crisis

PPP; Euroland=100; 2008-11 (TUIK)



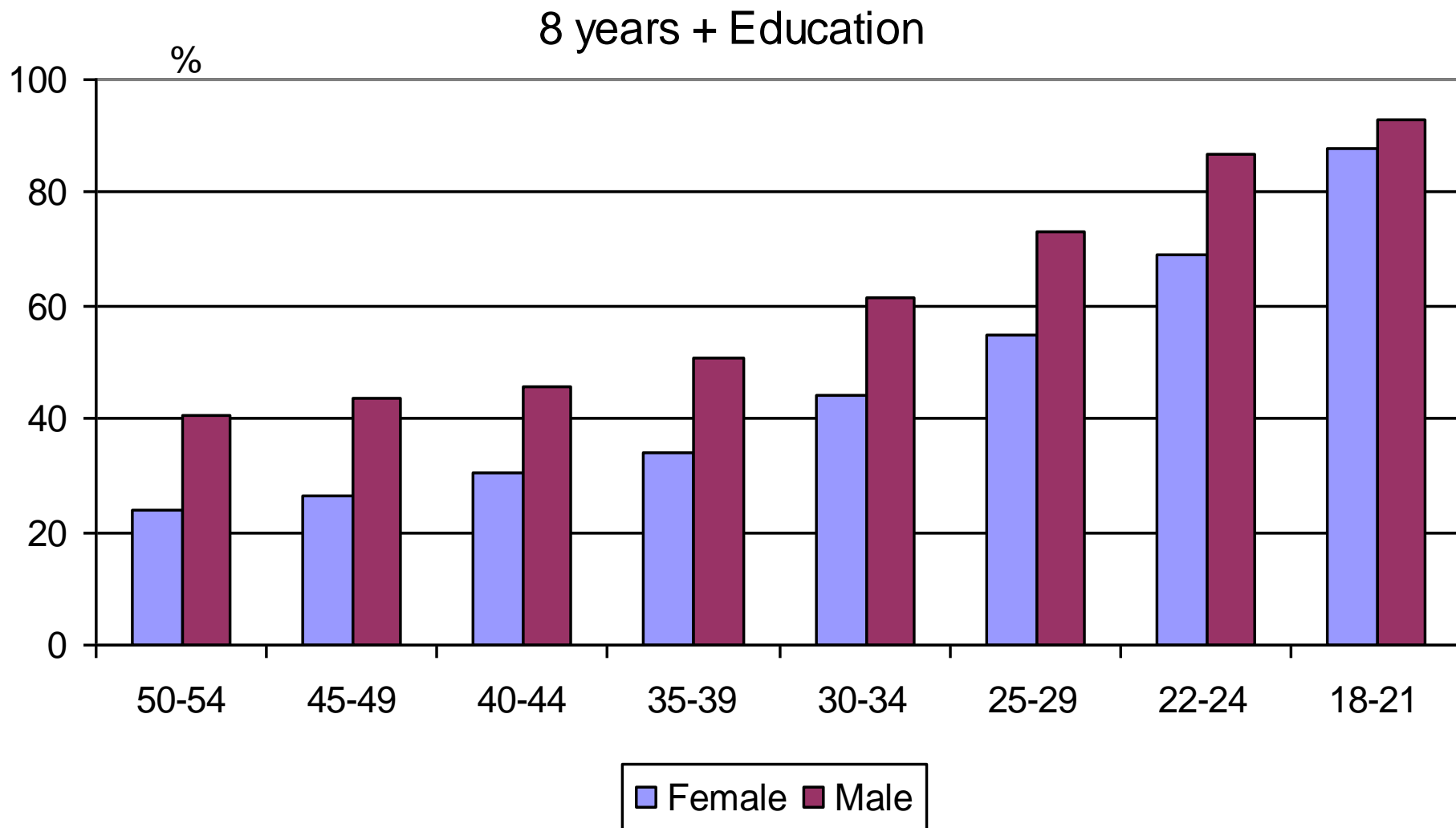
# Turkey: trade in GDP

Goods and services as % of GDP (World Bank)



# Profile of labour force (2009)

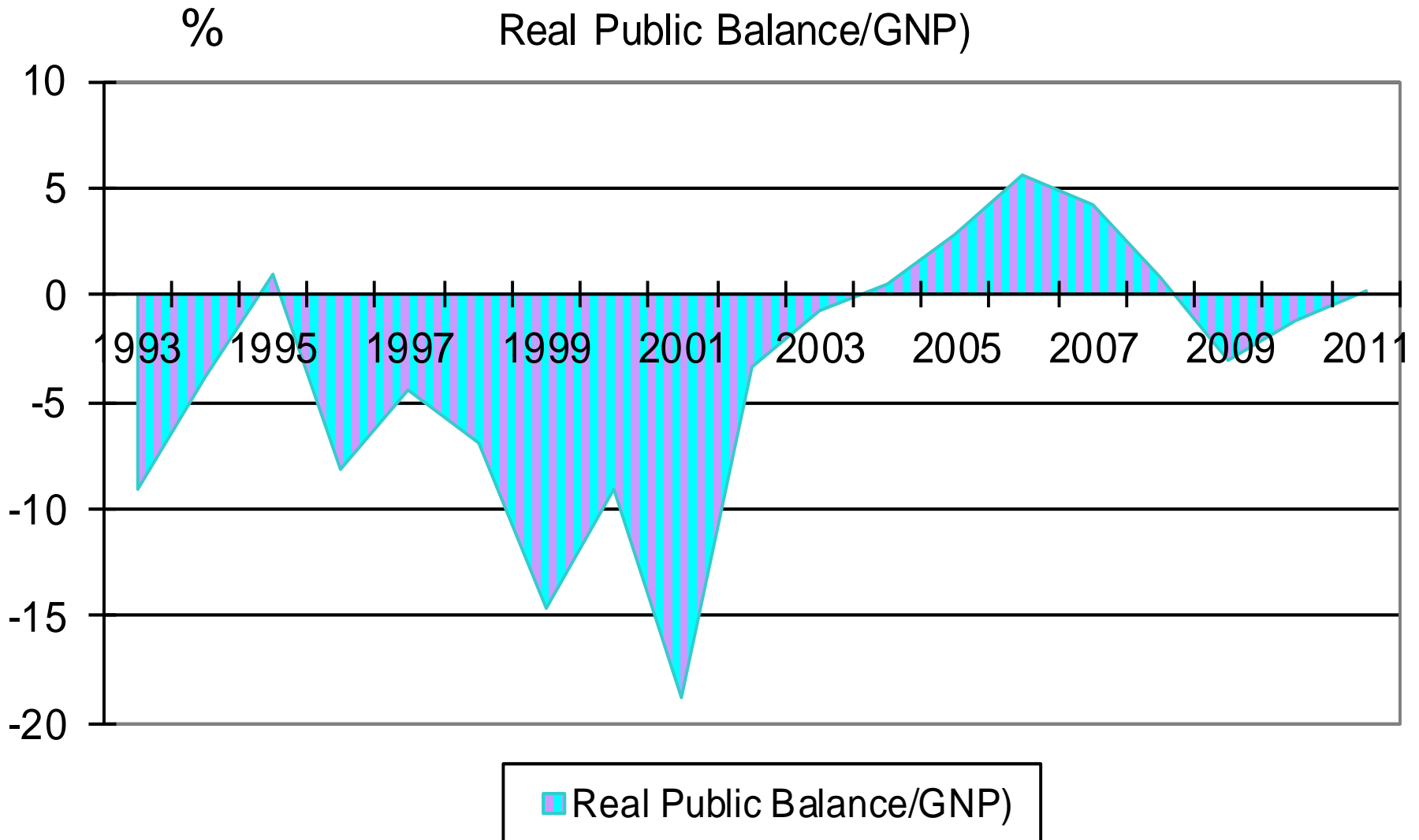
Graduates of Middle School in age groups % (TÜİK)



# «The Great Transformation»

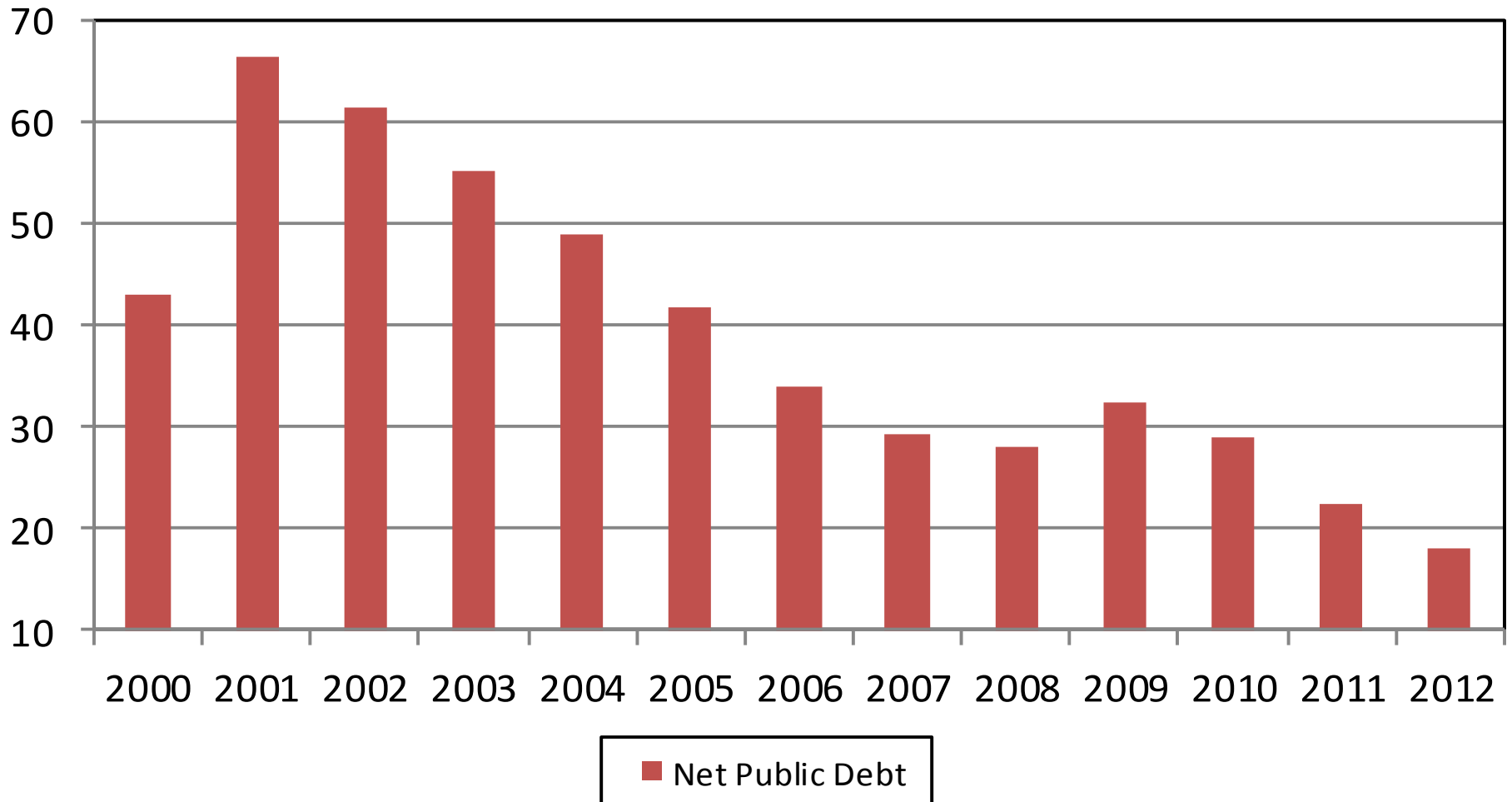
- There is no magic; «it's the budget, stupid»
  - Impressive fiscal effort on the revenue side
  - Resulting in record fiscal adjustment
  - High primary surpluses (up to 6 % of GDP)
  - Lowest debt ratio among large EU members
- The end of high inflation
  - CPI in single-digit after 30 years
  - Floating exchange rates and dedollarisation
  - Normalisation of real interest rates
- Structural reforms
  - CB independence
  - Strict regulation of banks / healthy balance sheets
  - Investment in infrastructure (roads, ports, etc)

# Fiscal balance (real) 1993-2011



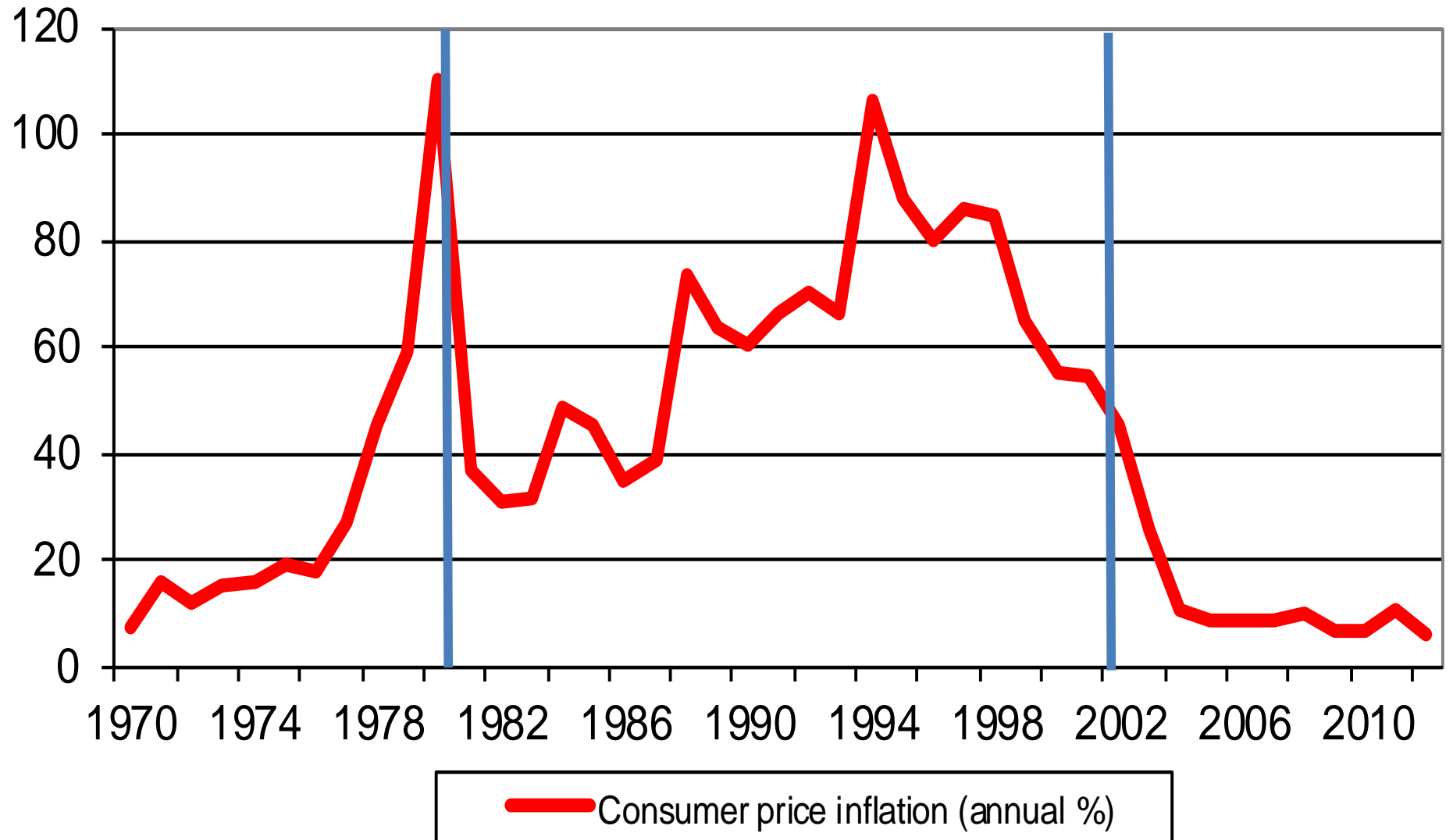
# Net public debt 2000-12

## Net Public Debt/GDP

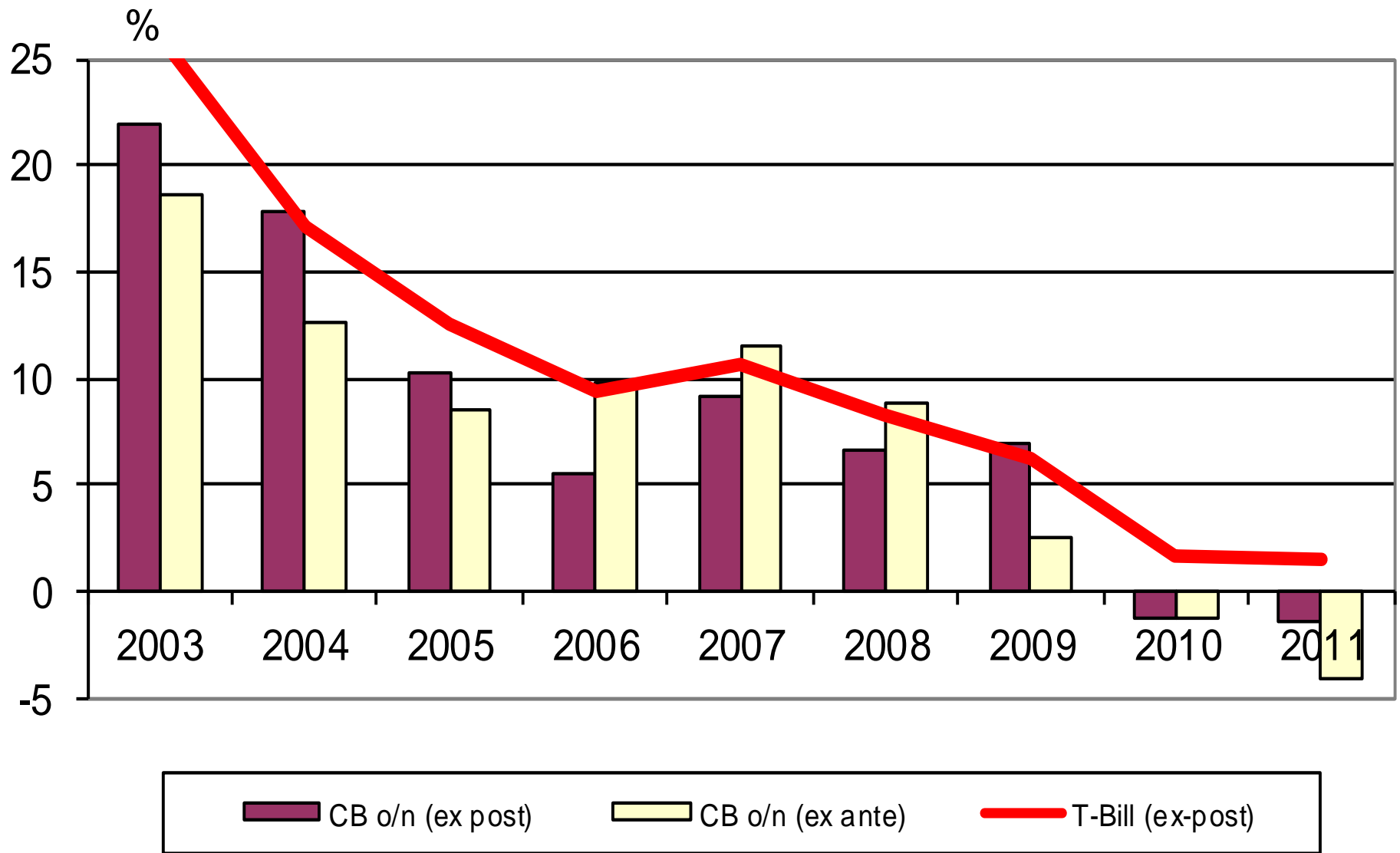


# Consumer inflation 1970-2012

Consumer price inflation (annual %)



# Real interest rates 2003-11





# Political economy of success

- IMF and the EU supplied the road maps
  - Disinflation initiated by a weak coalition government
  - Strong local constituency for reform
  - Minister Derviş defines the setting
- The role of AKP
  - Single party government – political stability
  - Pro-business, pro-market and pro-globalisation
  - By instinct fiscal conservative
  - Overall better governance
  - Sensitive to solidarity – poverty reduction
- New global image
  - Jump in inward FDI
  - Large scale privatisation

# FDI & privatisation

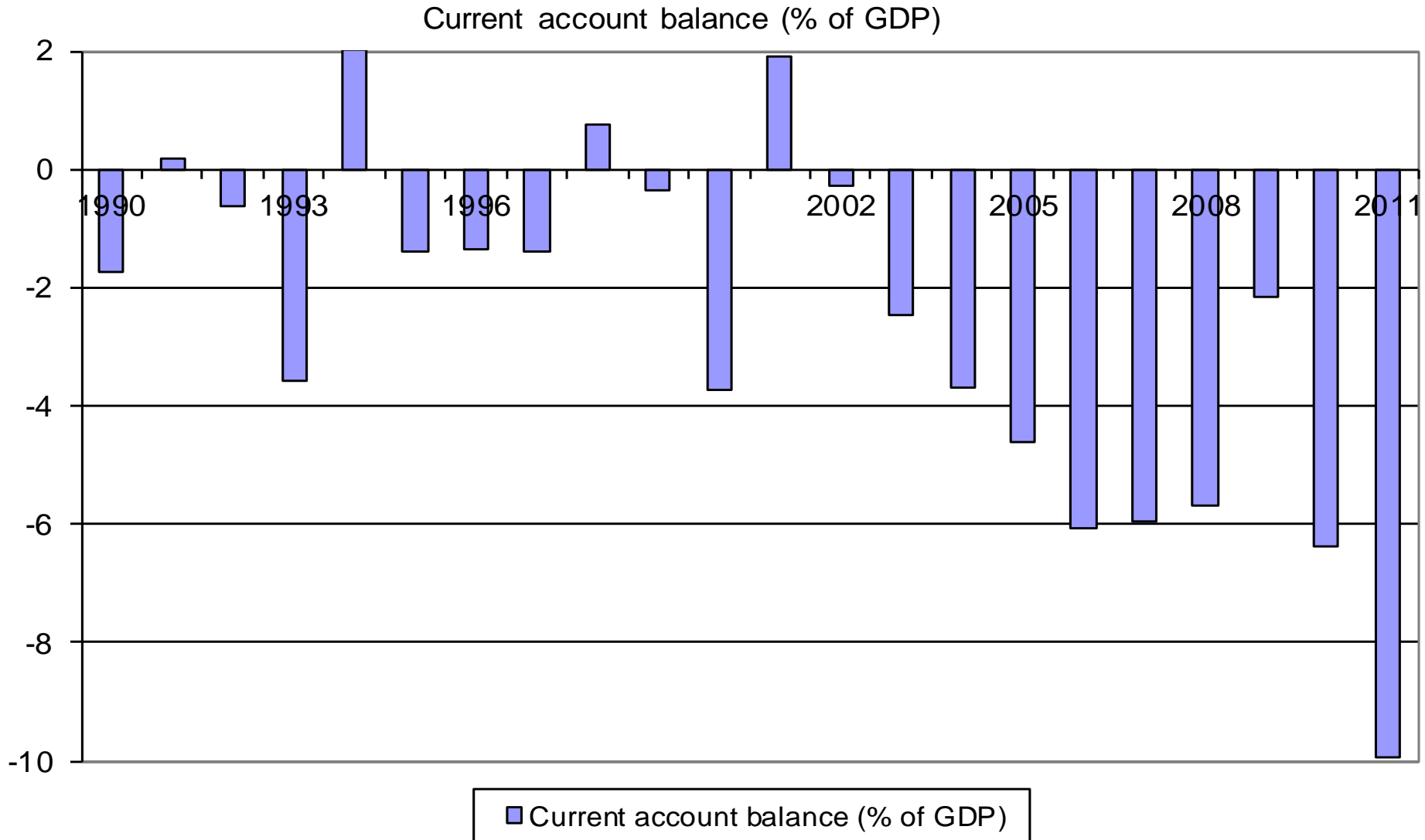
FDI inflows	US\$ bill.	% of GDP
1980s	2,4	0,3
1990s	8,1	0,4
2000s	98,4	2,0
2003-07	55,1	2,3

Privatisation Revenue	US\$ bill.	% of GDP
1986-02	6,1	0,2
2003-07	22,0	0,9
2008-10	14,0	0,7
Total	42,1	0,6

# The curse of success

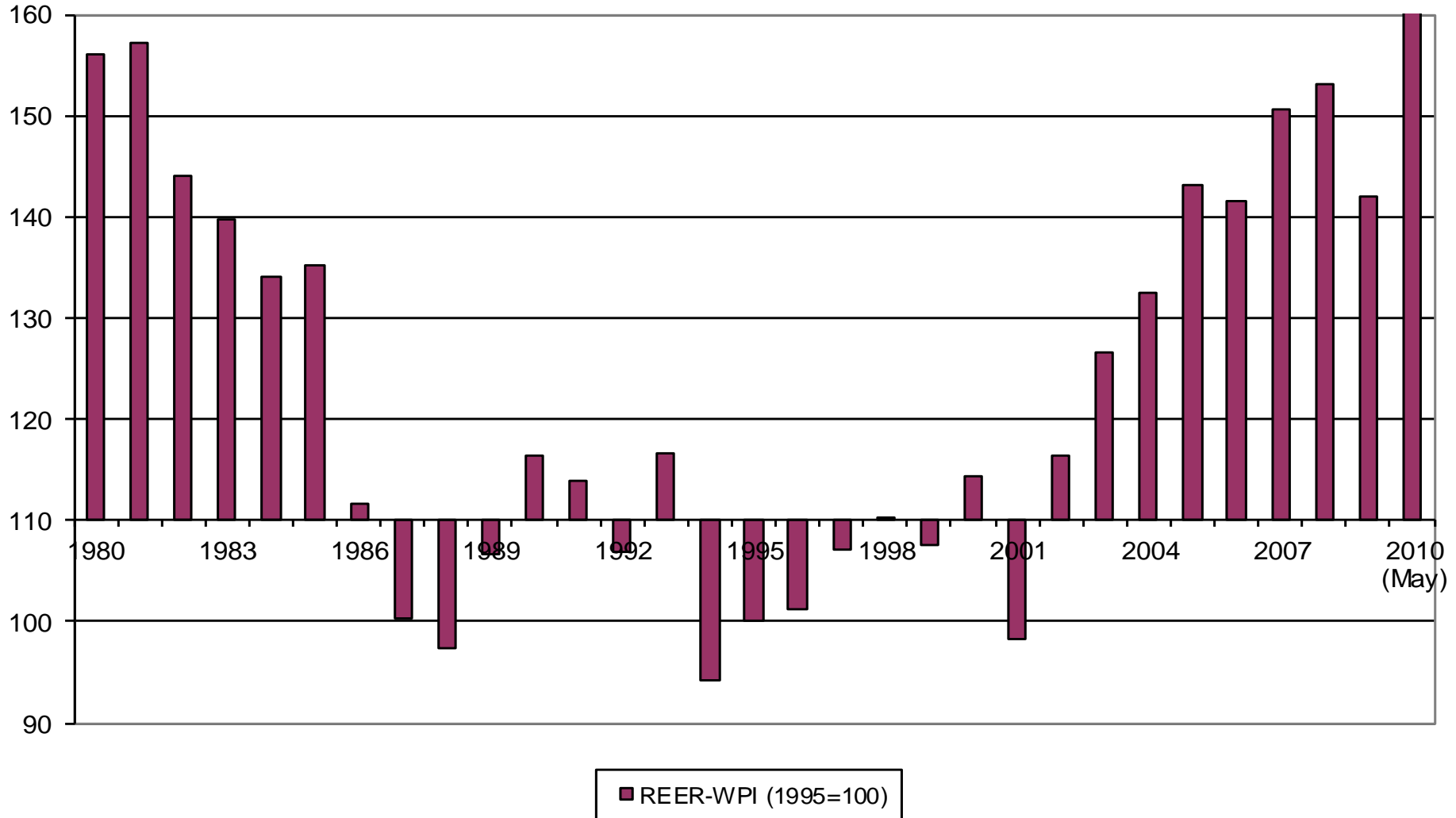
- The failures of the last decade are well known
- Ever larger external deficits
  - Remember the «Dutch syndrome»?
  - Overvalued currency: high demand for TL assets
  - Role of monetary policy
- Collapsing private savings
  - Rapid credit expansion
  - Cheap tradable goods
  - High non-tradable income
- Low employment rates
  - Structural issues dominate the debate
  - Growth created payroll employment
  - But employment rates remain low (women)

# Current account: 1990-2011



# Real exchange rate: 1980-2010

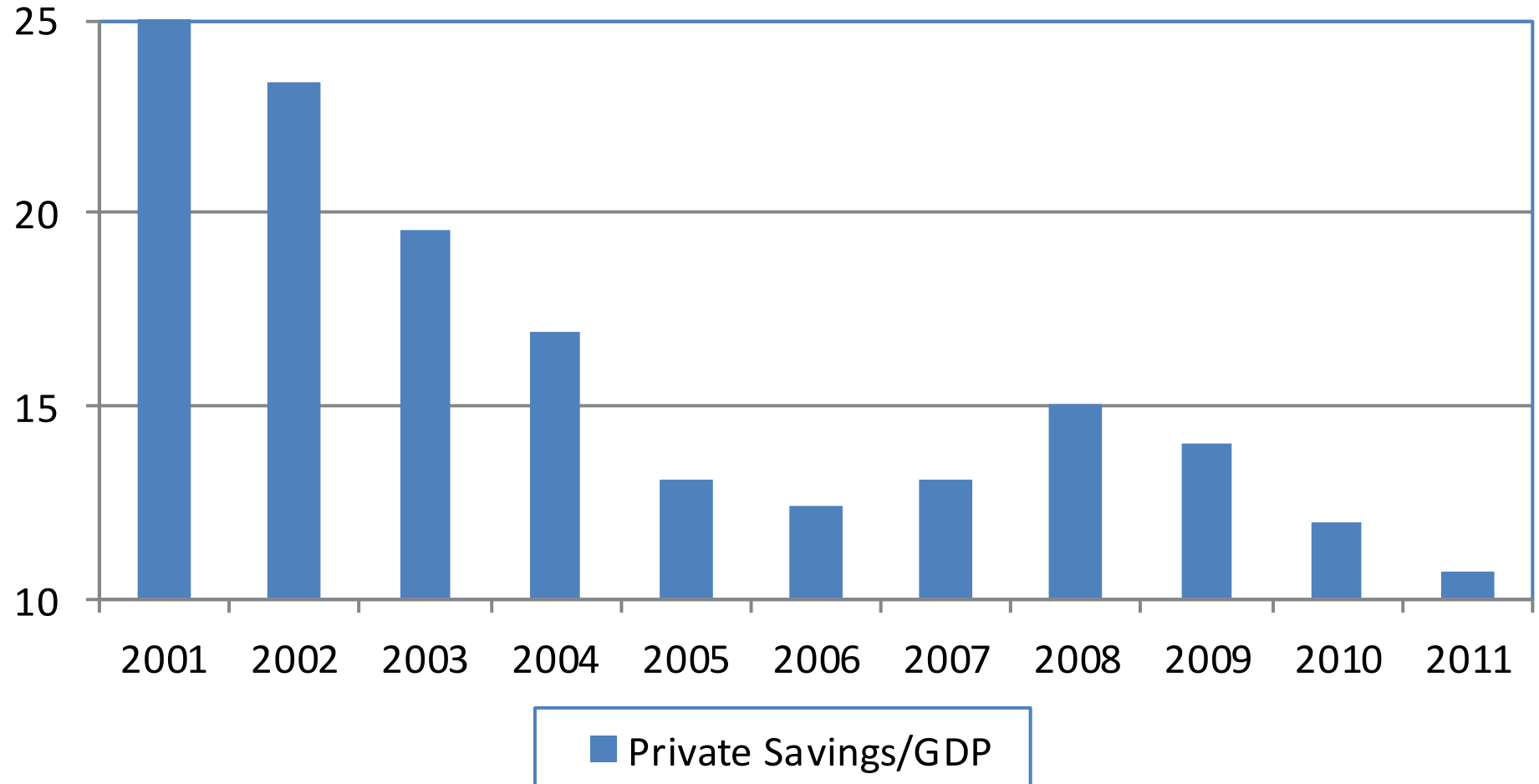
REER-WPI (1995=100)



# Private savings 2001-12

Current prices (1998 series)

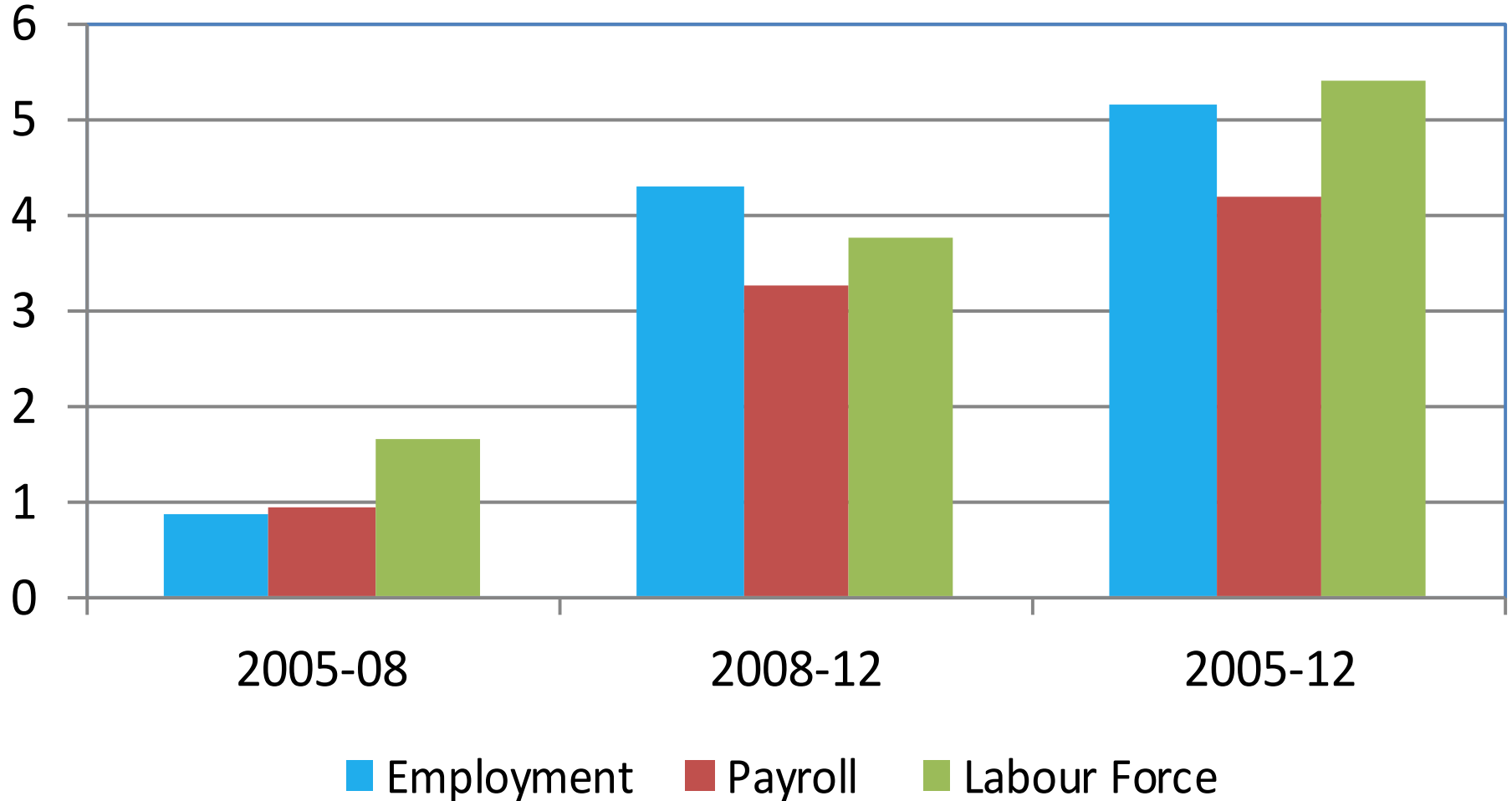
## Private Savings/GDP



# Employment 2005-12

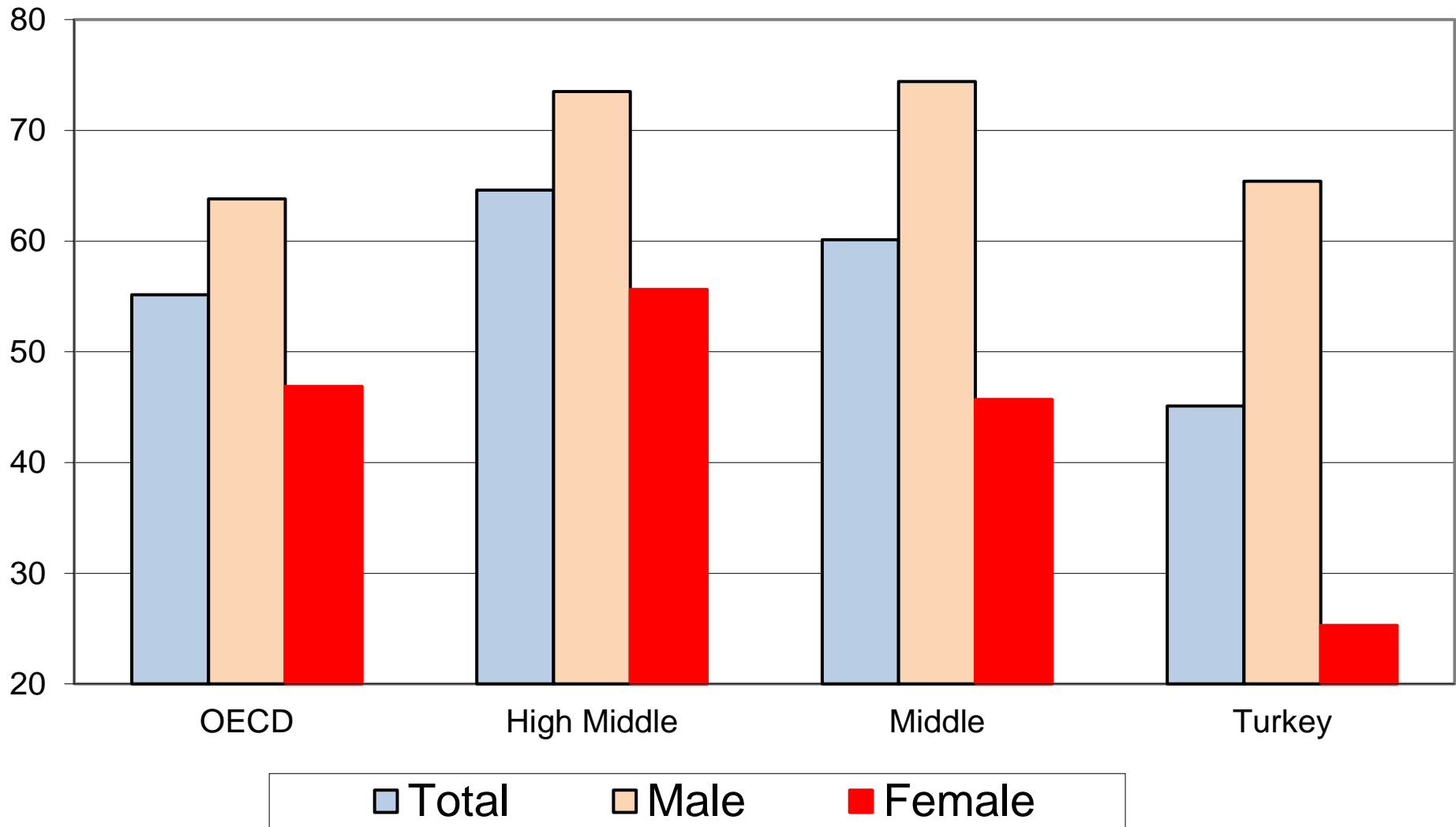
Million

Increasing employment



# Employment rates 2011

Employed to 15+ population (%); WDI





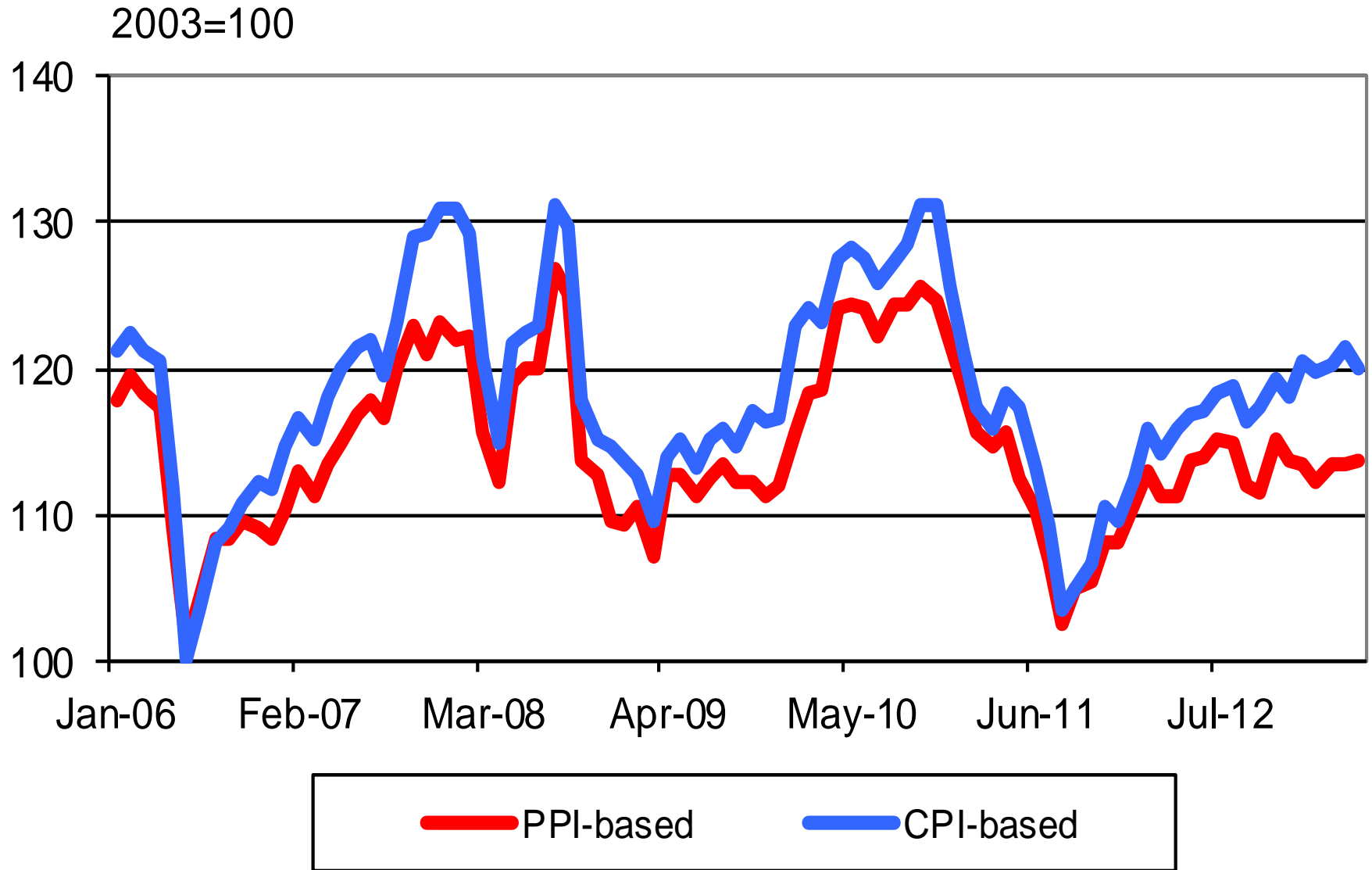
# Rebalancing the economy

- Large external deficits despite fiscal discipline
  - Vulnerabilities in private balance sheets
  - As in Spain, not Greece
- Change in policy position since Fall 2010
  - To balance domestic and external demand
  - «Orderly correction» is difficult; first time for Turkey
- Definition of sustainable external deficit
  - Captive capital: FDI; BIST; project finance
  - Is 5 % of GDP sustainable?
  - Puzzles: Net Errors Omissions; Gold
- No free lunch: hard choices
  - Inflation and growth trade-off
  - Sudden versus gradual correction

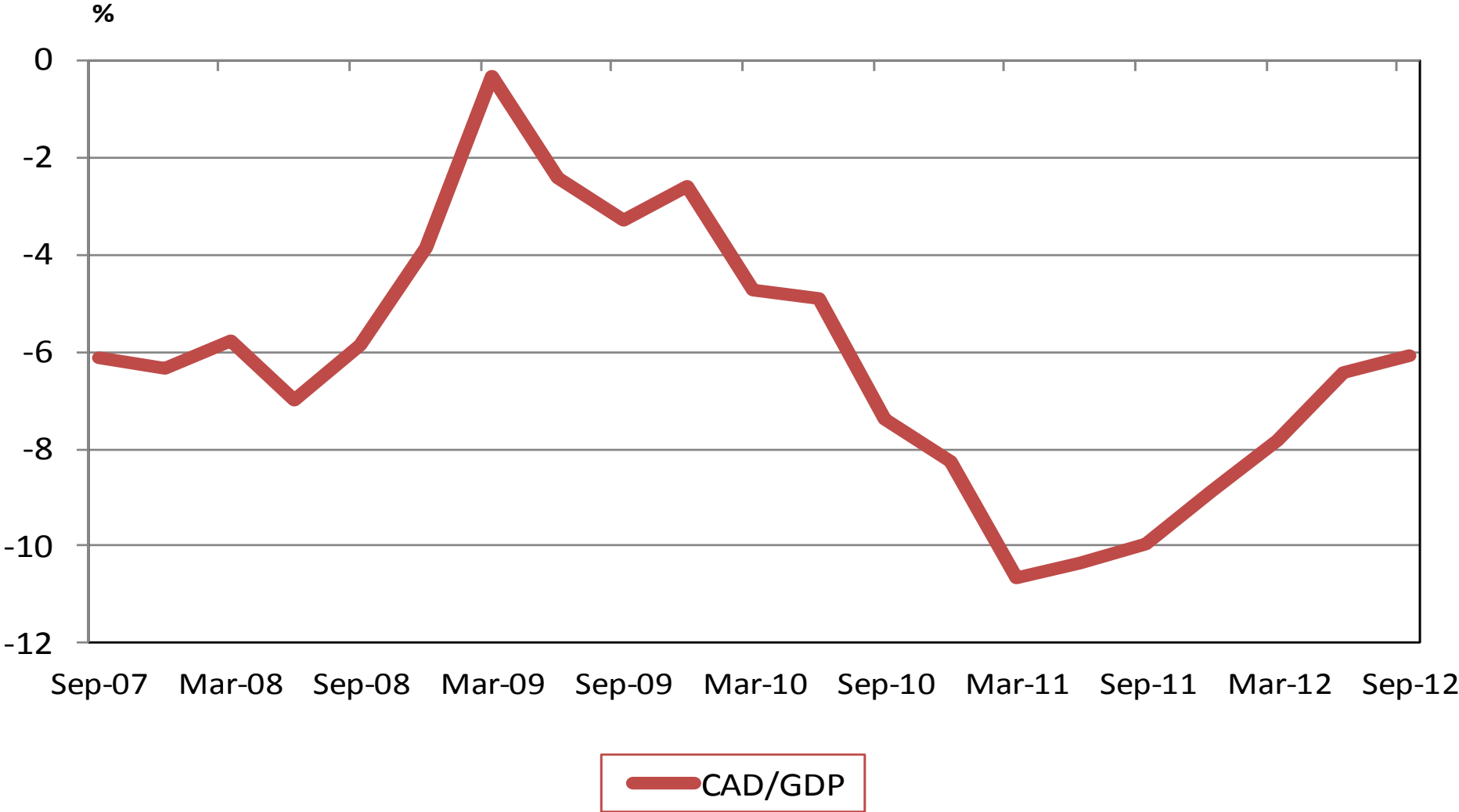
# Global headwinds

- Global economic conditions are not favourable for an orderly correction
- Euro crisis and recession in EU
  - Real economy: half Turkey's exports go to EU
  - Finance: risk of contagion and sudden stop
- Oil and commodity prices
  - Turkey is resource poor country
  - Worsening terms of trade requires larger exchange rate correction
  - Pass through effects to higher inflation
- Risks on both sides
  - Lower growth with tighter policy to fight cost inflation

# Real exchange rates 2006-13



# Current account deficit 2007-12

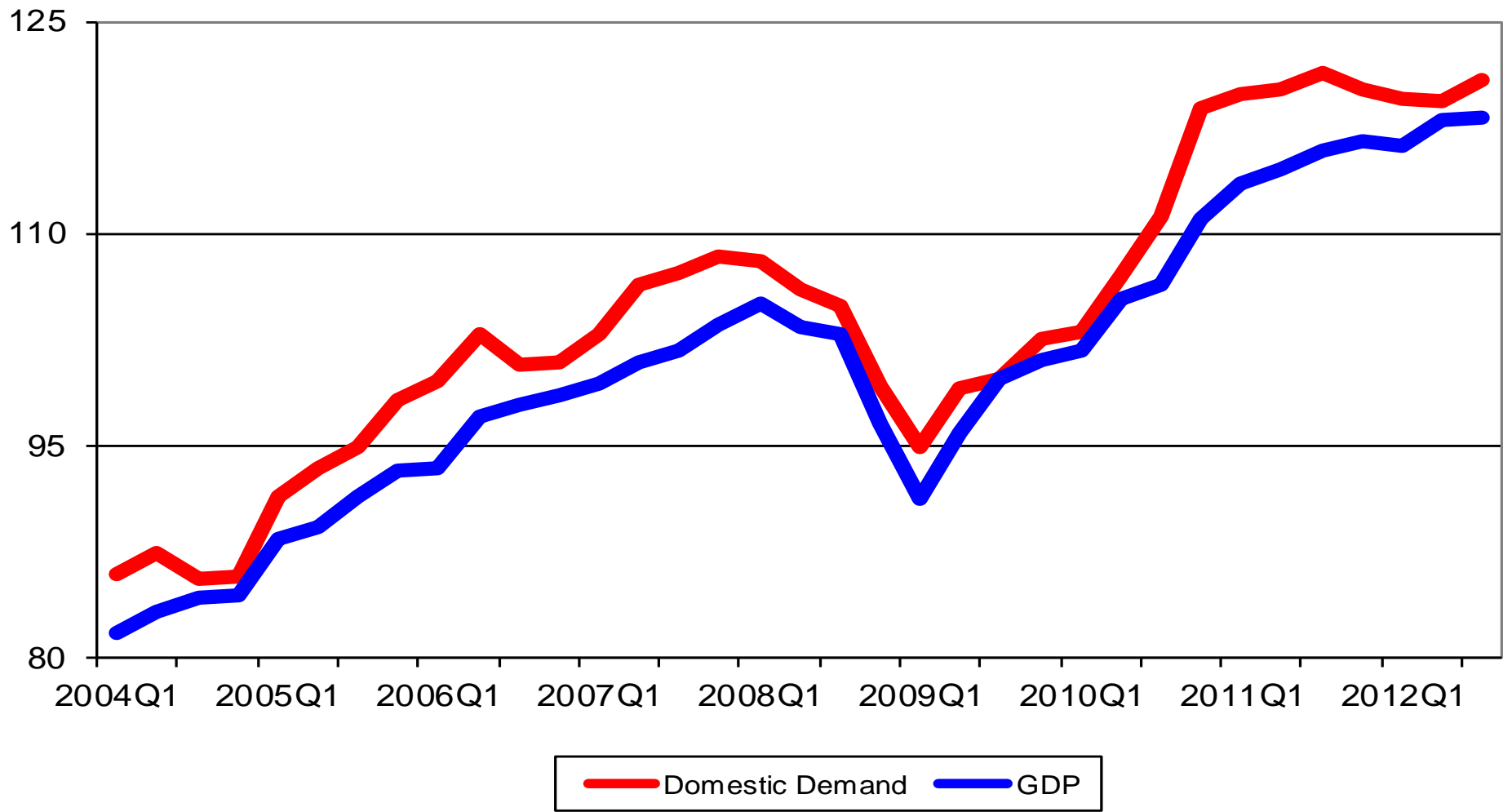




# Domestic demand 2004-12

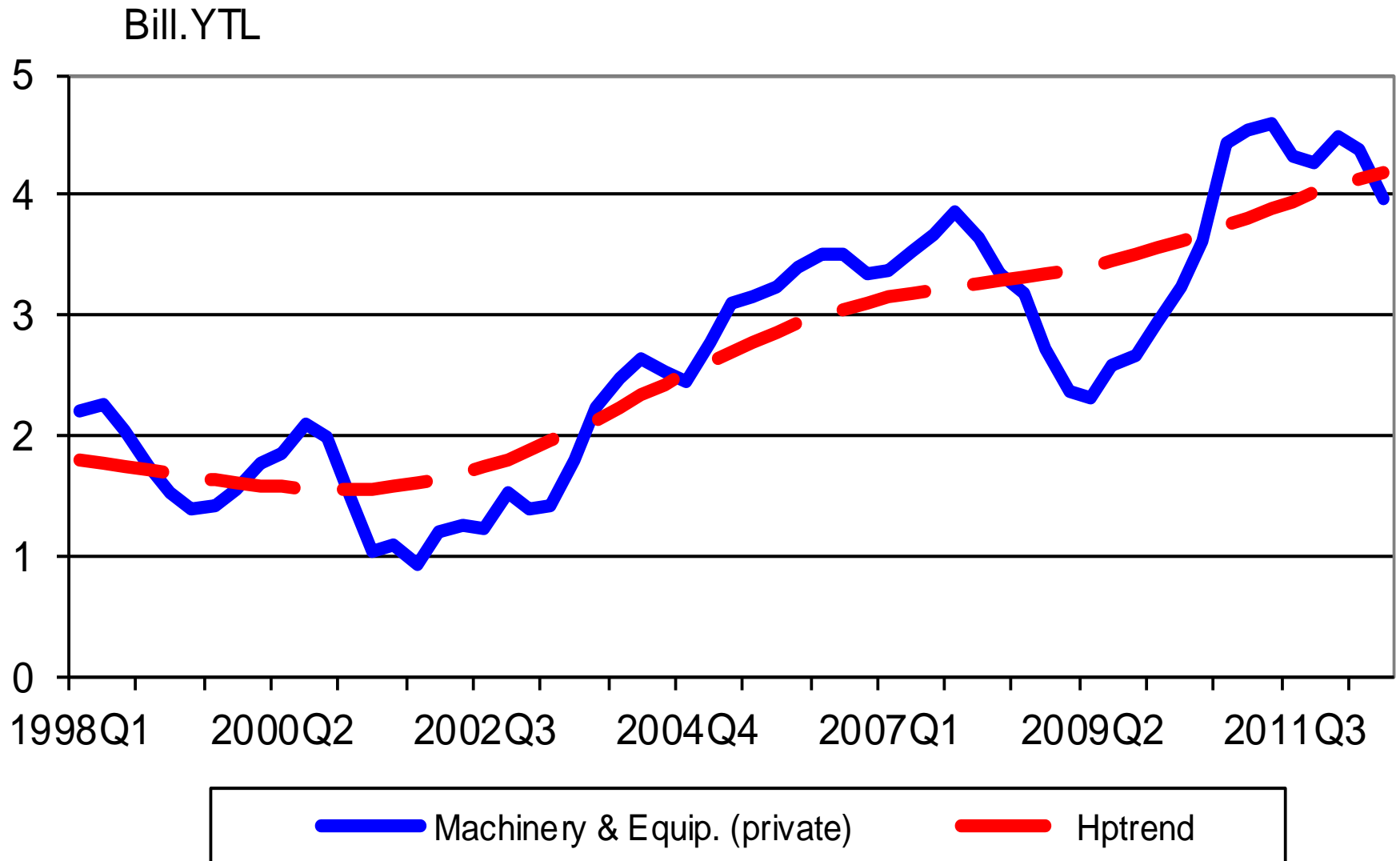
Seasonally adjusted, annualised (1998 prices)

TL bill.



# Private investment 1998-12

Constant price (1998); seasonally adjusted



# Political economy of rebalancing

- Risks of gradualism
  - Rough times ahead for the global economy
  - Markets have a tendency to overshoot
- Impact of changing relative prices
  - Non-tradable sectors face austerity
- Sensitivity to exchange rate movements
  - Legacy of dollarisation period
- Construction and real estate
  - Is there a bubble in real estate? Will it burst?
- The virtuous cycle of growth is crucial
  - Pains of adjustment are eased by fast growth
  - How to sustain growth during correction
  - Difficult policy (political) choices ahead



# Structural challenges

- Turkey lacks global champions
  - Critical sectors dominated by foreign firms
  - Successful firms are usually small
  - Industrial policy very low on policy agenda
- Large informal economy
  - Tax evasion distorts efficiency and equity
  - Formal sector labour markets lack flexibility
- Human capital problems
  - Education is not just years in school
  - Major quality issues need to be attended
- Political risks persist
  - Civil war in Syria
  - Recent demonstrations in big cities

# Structural assets

- Half of the glass is full
- Interesting geography
  - Largest economy in the region
  - Valuable strategic position (NATO, EU)
  - Young and relatively well educated population
- Relatively developed institutions
  - Muslim country with a working democracy
  - Established property rights
  - Customs Union with EU
- Experienced policy team
  - Babacan is the longest serving minister
  - CBT, Treasury technically very competent
  - Excellent policy coordination

# Opportunities of the crisis

- Global conditions could be turned to advantage
  - Bright star in the dark sky ; growth premium
  - Fast growth attracts the attention of others
  - Supports «animal spirits» at home
- Regional growth is strong
  - Turkish firms enjoy distance & culture advantage.
  - Diversified and flexible economy also helps
  - Rapid expansion of trade, tourism & financial flows
- Falling commodity prices
  - Offsets loss of EU export markets
- Istanbul: the Megapolis
  - Already a regional hub for many activities
  - Only metropolis between London and Mumbai

# Conclusion

- Turkey's economic and political transformation is finally turning into a success story
  - Integration with the global economy
  - Financial and fiscal stability
- To consolidate the gains a difficult adjustment lays ahead
  - Reducing the external deficit to sustainable levels
  - Increasing domestic saving rate
  - Without breaking the growth virtuous circle
  - «An orderly correction»
- The glass is half full
  - Despite big risks, it has a fair chance of success
  - I remain in the optimist camp