

30. TURKEY

A solid recovery after a severe contraction

Return to positive and robust growth

The Turkish economy is recovering strongly after severely contracting in 2009. GDP tumbled 4¾% last year, a sharp contrast to the 6% average annual growth rate in 2004-08. The global financial crisis hit the economy hard, thereby reducing fixed investment and external demand dramatically. Fiscal and monetary stimuli, combined with a healthy banking sector, helped cushion the blow. In Turkey's case, the crisis had a silver lining as it highlighted the economy's enhanced resilience to external shocks.

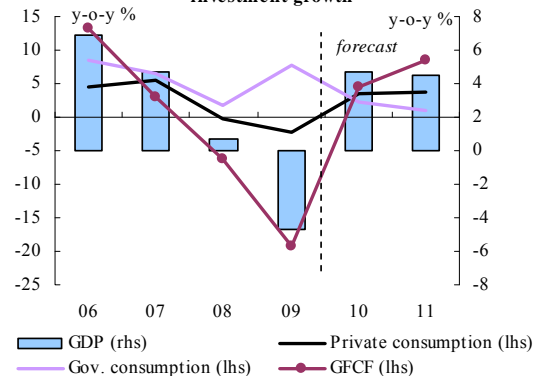
The Commission foresees a return to positive and robust annual growth in 2010. While still low levels of capacity utilisation are an obstacle to investment, and exports growth may suffer from a more gradual recovery in Turkey's chief export markets, GDP growth could be close to 5% in 2010, helped by base effects and the turn in the inventories cycle. Ultimately, a sustained upturn in growth hinges on a lasting global recovery.

Due to strong base effects, which in part reflect the severity of the 2009 downturn

The trough of the current cycle came in the first quarter of 2009 when GDP tumbled 14.5% y-o-y. The economy has since shown steady improvement, helped by stimulus measures and a solid banking sector. In contrast to emerging European peers, Turkish banks are relatively less reliant on external funding (the sector's loan-to-deposit ratio is well below 100%), and have only experienced limited asset quality deterioration. As a result, GDP in the fourth quarter of 2009 showed strong positive annual growth, amounting to 6% y-o-y and 2% q-o-q (s.a.).

Therefore, a relatively robust recovery is expected. All components of domestic demand will show positive year-on-year growth in 2010, in large part due to strong base effects, reflecting the severity of the 2009 downturn.

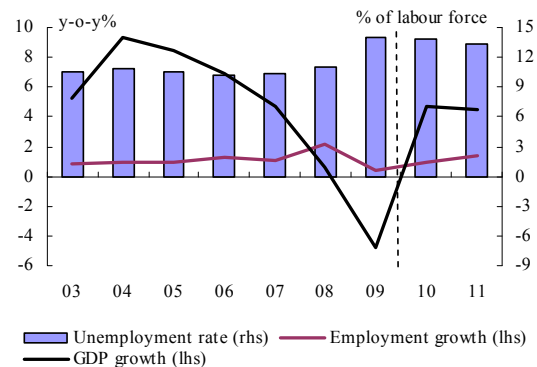
Graph II.30.1: Turkey - GDP, consumption and investment growth



And consumption and investment as the driving forces behind the recovery

Labour market developments, credit growth, and consumer and business confidence point to a gradual recovery in consumption in 2010. The jobless rate has risen to 14% in 2009 from 11% in 2008, but started decreasing slightly in the first months of 2010.

Graph II.30.2: Turkey - Labour market



Meanwhile, credit growth started to increase in the fourth quarter of 2009, albeit from very low levels, and still below the double-digit credit growth of the previous year. Both consumer and business confidence indices suggest a recovery in consumption is underway, but may take time.

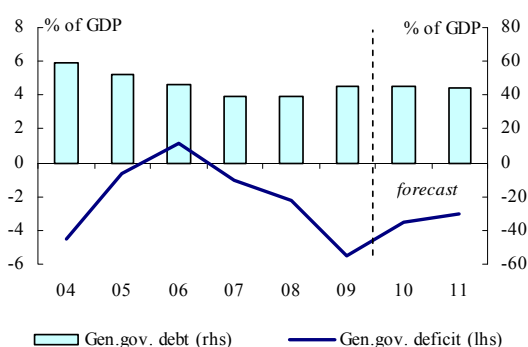
A recovery in investment is expected to be somewhat stronger. The low capacity utilization rate (70% in early 2010) suggests considerable excess capacity. Meanwhile, industrial production trends and Turkey's Purchasing Managers' Index

(PMI) present a more positive picture. Industrial production surprised on the upside in the first two months of 2010 as it rose at double digit rates. The most recent PMI increases indicate a marked improvement of business conditions and significant growth of new orders in the Turkish manufacturing sector.

Fiscal rebalancing may be challenging...

Compared to the fiscal consolidation that took place in 2001-08, the budgetary performance has deteriorated markedly in 2009, and the general government budget deficit increased to 5½% of GDP from 2% in 2008. The main contributors were the acceleration of public spending, in particular of transfers to social security institutions, which recorded a deficit of 3% of GDP, and the impact of the various stimulus packages, which amounted to about 2% of GDP. Some of these stimulus measures have already been withdrawn. In addition, the strengthening economy may positively affect budget revenues. It is therefore forecast that the budget deficit will narrow to around 3½% of GDP in 2010 and 3% of GDP in 2011. However, only a credible, strong and binding fiscal rule may lead to the forecast fiscal outcome.

Graph II.30.3: Turkey - Public finances



In the past, the IMF programme, in addition to the EU-accession process, supported the economy in Turkey by providing a strong policy anchor. Turkey's last Stand-By Agreement expired in May 2008, and in mid-March 2010 both the government and the IMF announced that there is no successor arrangement to be expected anytime soon. The government plans to announce the details of a fiscal rule sometime in the first half of 2010, which is expected to serve as a potential fiscal anchor. Yet such a rule won't be put into effect until 2011.

Indeed, in terms of downside risks, the spectre of fiscal deterioration is of paramount importance. In tandem with the rising budget deficit, the public debt level has increased rapidly. The public debt stock rose to 45½% of GDP at the end of 2009, a jump from 39½% of GDP level a year earlier. While fiscal deterioration occurred around the world due to the sharp downturn in 2009, the danger in Turkey is that the deterioration trend might continue.

The government's Pre-accession Economic Programme for 2010-12 shows real expenditures remaining high even as growth returns. The specific concern is that the government will ramp up spending ahead of 2011 parliamentary elections in a bid to shore up support. Such a ramp-up would likely pressure interest rates and dent investor confidence, thereby slowing or even undermining the recovery.

... while monetary policy may affect the recovery prospects

In addition, the country's dramatic economic contraction in the fourth quarter of 2008 and the first half of 2009 year spurred the central bank to cut the total overnight rates by 1025 bps to an all-time-low of 6½% in the first quarter of 2010. The near doubling in inflation between October 2008 and March 2010 – from 5% to 10% – now urges the bank to back away from overly relaxed monetary policies.

Inflation is expected to remain at elevated levels in 2010 owing to base effects, higher commodity prices and the pass-through from administrative price adjustments as well as excise tax hikes. Food-price inflation constitutes an additional risk factor. Against this backdrop, inflation is expected to be close to 8½% by December 2010, exceeding the central bank's inflationary end-year target of 6½%. A key question, which poses both upsides and downside risks to the forecast, is now how the new economic and inflationary developments will be reflected in monetary policy.

The other major downside risk to the baseline scenario would be a renewed bout of global risk aversion. Any major cutback in investors' appetite for emerging market assets would negatively affect Turkey's recovery prospects. Meanwhile, political risks continue to lurk in the background. Any potentially escalating political tensions, which are

not a part of the baseline scenario, pose a downside risk to the growth outlook.

External imbalances widening again

The correction in external accounts represented the silver lining of the recession. The positive terms-of-trade shock resulting from the collapsing oil prices combined with the decline in domestic demand and imports led to a major contraction of the trade and current-account deficits, from 5¾% in 2008 to 2¼% in 2009.

The forecast expects an increase of the current-account deficit to 4½% of GDP in 2010

due to stronger domestic demand and higher energy prices. With the recovery underway, the current-account deficit is likely to widen further in 2011.

However, the outlook for exports remains somewhat mixed. Exports declined by 5½% y-o-y in 2009 and are forecasted to increase by 5½% y-o-y in 2010. Of particular concern is the impact on the automotive sector, Turkey's top export earner. Roughly three-quarters of autos manufactured in Turkey are exported to Europe. Special schemes supporting car sales in EU markets, which have now expired, brought forward future sales.

Table II.30.1:

Main features of country forecast - TURKEY

	2008			92-05	Annual percentage change					
	bn TRY	Curr. prices	% GDP		2006	2007	2008	2009	2010	2011
GDP	948.7	100.0	4.2	4.2	6.9	4.7	0.9	-4.7	4.7	4.5
Private consumption	663.0	69.9	4.3	4.3	4.6	5.5	-0.1	-2.3	3.5	3.7
Public consumption	121.9	12.8	3.8	3.8	8.4	6.5	1.9	7.8	2.2	1.0
Gross fixed capital formation	188.8	19.9	5.5	5.5	13.3	3.1	-5.0	-19.2	4.6	8.4
of which : equipment	98.4	10.4	-	-	10.2	1.2	-3.4	-21.4	5.0	10.0
Exports (goods and services)	227.7	24.0	9.5	9.5	6.6	7.3	2.3	-5.4	5.7	7.2
Imports (goods and services)	275.3	29.0	10.6	10.6	6.9	10.7	-3.8	-14.4	9.5	9.6
GNI (GDP deflator)	938.6	98.9	4.2	4.2	6.8	4.8	0.9	-4.7	4.7	4.5
Contribution to GDP growth :										
Domestic demand			4.7	4.7	7.4	5.4	-1.1	-5.0	3.7	4.3
Inventories			0.0	0.0	-0.1	0.6	0.3	-2.4	2.1	1.0
Net exports			-0.4	-0.4	-0.4	-1.3	1.7	2.8	-1.1	-0.9
Employment			0.8	0.8	1.3	1.1	2.2	0.4	0.9	1.4
Unemployment rate (a)			7.8	7.8	10.2	10.3	11.0	14.0	13.9	13.4
Compensation of employees/head			55.3	55.3	12.7	12.7	8.6	-0.8	6.4	7.2
Unit labour costs whole economy			50.2	50.2	6.8	8.9	10.0	4.6	2.5	4.0
Real unit labour costs			-2.6	-2.6	-2.3	2.5	-1.5	-0.2	-3.5	-2.0
Savings rate of households (b)			-	-	-	-	-	-	-	-
GDP deflator			54.3	54.3	9.3	6.2	11.7	4.7	6.3	6.2
Harmonised index of consumer prices			-	-	9.3	8.8	10.4	6.3	9.0	7.8
Terms of trade of goods			-0.1	-0.1	-4.9	3.3	-2.7	-0.5	-1.0	-1.0
Trade balance (c)			-4.8	-4.8	-7.5	-7.3	-7.0	-4.5	-5.4	-6.1
Current account balance (c)			-0.5	-0.5	-6.1	-5.9	-5.7	-2.2	-4.5	-5.4
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-	-	-	-	-	-	-	-
General government balance (c)			-	-	-1.2	-1.0	-2.2	-5.5	-3.5	-3.0
Cyclically-adjusted budget balance (c)			-	-	-	-	-	-	-	-
Structural budget balance (c)			-	-	-	-	-	-	-	-
General government gross debt (c)			-	-	46.1	39.4	39.4	45.5	45.1	44.5

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.