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Turkey:
Slowdown? Or even recession?

The growth of Turkey's economy was over 10% year-on-year in some quarters of the period 2010-2011. It may have decelerated recently, but it is not yet certain that this will lead to a more or less soft type of ‘landing’; a swift resumption of growth is feasible. In 2011, thanks to high real growth and a rate of inflation between 5% and 10%, growing budget revenues offered a nice opportunity to increase expenditures and decrease the budget deficit at the same time. This 'pro-active' fiscal policy will continue. The central bank, too, supports GDP expansion by keeping the policy rate low. However, this job is a bit tricky. The rate of inflation should not climb over 10%, and the exchange rate should remain rather stable. The high deficit in the current account is a main source of vulnerability. In the case of no major adverse external shock, growth is likely to accelerate again in 2013-2014.

Economists have predicted a sharp deceleration of Turkey’s GDP growth for quite some time. Throughout 2011 however, each quarter’s performance was surprisingly strong. Fourth-quarter data are not on the table yet, but growth is likely to be above 5% year-on-year once again. Were the Cassandras wrong when trying to paint a rather black picture?

In more recent weeks, signs of a slowdown have become more visible. The growth rates of industrial output, exports and imports all have decelerated. The Consumer Confidence Index has been on the pessimistic side all the time; only in mid-2011 it had come close to a neutral stance. The Real Sector Confidence Index, in its seasonally adjusted version, was on the positive side throughout 2011; it declined somewhat, but not substantially, towards the end of the year and beginning of 2012.

In many respects, Turkey’s economic performance is in sharp contrast to what we have seen in recent years in large parts of Europe. Turkey’s recovery from the shock in late 2008 was fast and strong, and in the 2010-2011 period, in three quarters out of eight GDP growth was above 10%. Domestic demand was the driving force – not only gross fixed investment, but increasingly also private consumption. Obviously, the mentioned pessimism did not prevent households from increasing their spending. Fiscal and monetary policy helped to bring this boom about starting from 2009; later on, monetary policy tried to fight overheating through not purely conventional measures.

High real GDP growth combined with a rate of inflation between 5% and 10% provoked a nice swelling of government revenues, and over large parts of the year they exceeded expenditures. Growing revenues are a comfortable background for a fiscal policy which is more growth- than stability-oriented. Central and local governments are running a large number of construction projects. Monetary policy felt a bit more challenge, as it would be a bad signal if inflation climbed over 10% year-on-year for a longer period. The central bank leadership rejected the standard recommendation, an increase in the policy rate. In fact, such a policy might have provoked a currency appreciation. This would have dealt a blow to the competitiveness of locally produced products. In Turkey, in several product categories European or Japanese products have a better quality reputation than local products, so that wealthier people in particular tend to buy foreign products in spite of their higher prices. In addition, Turkish producers do not cover the whole range of products demanded by consumers and investors. This is why the trade deficit and the gap in the current account have widened dramatically in the context of extreme GDP growth and high imports of investment goods. The deficit in the current account almost doubled from 2010 to 2011. It went up to approximately 10% of GDP. More saving as the cure against high deficit is not popular in Turkey; and it is hard to see how more saving might increase the quality and therefore competitiveness of Turkish brands.

The explosive expansion of the current account deficit has scared financial investors. Turkey absorbs much more goods and services than are produced within the country. The gap is financed from external sources, credits predominantly. The lesson learnt in more recent years all over the globe is that a high degree of indebtedness can be dangerous even if it is accumulated mainly by the private sector. In mid-2011 the Turkish currency started depreciating, and for some time the central bank let it go that way. In more recent months, however, it has intervened in support of the Turkish lira. The lira has stabilized and to some degree even re-appreciated. It is not likely that this will last forever. Renewed depreciation would support the competitiveness of domestic production, but the problem is how to keep it within limits, so that inflation will not exceed the magic mark of 10%.

Prime Minister Erdogan has launched a fight against the ‘high interest rate lobby’. He dislikes austerity measures as tools to lower inflation and the imbalance in the current account. This may also be one motive for keeping distance from the IMF. So far, this policy has been a success, also in terms of election results of his party. The central bank has an independent status but supports this policy, for example by keeping the policy rate low. To cope with the need of restricting the growth of bank loans, the central bank has introduced high reserve requirements for commercial banks. For quite some time it seemed as if that measure would not have the expected impact. In more recent months, however, credit growth has decelerated, for whatever reason. The central bank's survey of bank loans points to a tightening in the course of the last quarter of 2011, and especially in last December.

There is no sign so far that Turkish commercial banks might have been severely infected by the 'European disease'. As it seems, up to now Turkey is benefiting from the reforms implemented under the authorship of Kemal Dervis after the crisis in 2001. It is unclear how much Turkey's GDP growth will decelerate in 2012. Analysts' forecasts differ over a wide range. Unless circumstances are very exceptional, Turkey is likely to return to relatively high growth after 2012.

Politically, it proved difficult to maintain the 'no problems' policy with the neighbourhood in the longer run. Relations with Syria have worsened; Iraq is an important trading partner, but for Turkey Iraq's severe internal conflict is a problem. A Cyprus compromise is not in sight. Iran is a problem too, of course. The Turkish government and public would not appreciate military action against Iran, but may also not like the idea of Iran becoming a nuclear power. Turkey is just planning its nuclear power future, by building two nuclear power plants. The politically much less troublesome neighbourhood lies in the west, north and northeast of Turkey. Turkish business has been active there for a long time.

In Turkey, economic agents tend to expect a continuation of the positive economic development in 2012 and thereafter: Growth slowdown, temporarily, yes; recession unlikely.

Table TR

Turkey: Selected Economic Indicators

	2006	2007	2008	2009	2010	2011 1)	2012	2013 Forecast	2014
Population, th pers., average	69395	70215	71095	72050	73003	73950	75200	76100	77000
Gross domestic product, TRY bn, nom.	768.9	856.1	950.5	952.6	1103.7	1270	1430	1640	1860
annual change in % (real)	6.9	4.7	0.7	-4.8	9.0	8.4	3.0	5.0	5.0
GDP/capita (EUR at exchange rate)	6100	6800	7000	6100	7600	7300	7600	7700	8100
GDP/capita (EUR at PPP - wiiw)	10600	11500	11700	10900	12000	12900	15100	18000	20100
Consumption of households, TRY bn, nom.	534.8	601.2	663.9	680.8	787.3	910	.	.	.
annual change in % (real)	4.6	5.5	-0.3	-2.3	6.7	9	4	4	5
Gross fixed capital form., TRY bn, nom.	169.0	180.6	189.1	160.7	206.9	270	.	.	.
annual change in % (real)	13.3	3.1	-6.2	-19.0	29.9	22	-2	10	10
Gross industrial production									
annual change in % (real)	7.3	7.0	-0.6	-9.7	13.1	8.7	4	7	8
Gross agricultural production									
annual change in % (real)	1.3	-7.3	.	.	.	.	.	.	.
Construction industry									
annual change in % (real)	18.4	5.5	-7.6	-16.3	17.5	12.0	5	7	9
Employed persons - LFS, th, avg.	20433	20750	21193	21271	22593	24000	24100	24650	25800
annual change in %	1.8	1.5	2.1	0.4	6.2	6.2	0.4	2.3	4.7
Unemployed persons - LFS, th, average	1950	2019	2279	3053	2696	2400	2700	2800	2850
Unemployment rate - LFS, in %, average	8.8	8.9	9.8	12.7	10.7	9.2	10.1	10.2	9.9
Reg. unemployment rate, in %, average	.	.	.	.	.	.	.	.	.
Average gross monthly wages, manuf.ind., TRY	1301	1437	1590	.	.	.	.	.	.
annual change in % (real)	2.1	1.6	0	.	.	.	.	.	.
Consumer prices (HICP), % p.a.	9.3	8.8	10.4	6.3	8.6	6.5	9.1	9.0	8.0
Producer prices in industry, % p.a. 2)	9.7	6.0	13.0	1.0	6.2	12.4	12	8	7
General governm. budget, EU-def., % GDP 3)									
Revenues	34.0	33.4	32.0	32.7	33.1	33.5	32.9	33.0	33.5
Expenditures	33.2	34.5	34.2	39.4	36.6	36.0	36.2	35.4	36.0
Deficit (-) / surplus (+)	0.8	-1.1	-2.2	-6.7	-3.5	-2.5	-3.3	-2.4	-2.5
Public debt, EU-def., in % of GDP 3)	46.1	39.4	39.5	45.5	43.2	42.5	41	38	36
Central bank policy rate, %, p.a., end of period 4)	22.50	20.00	17.50	9.00	6.50	5.75	6.25	6.25	6.25
Current account, EUR mn	-25595	-27915	-28108	-9995	-35930	-57000	-52000	-54000	-56000
Current account in % of GDP	-6.0	-5.8	-5.6	-2.3	-6.5	-10.5	-9.1	-9.2	-9.0
Exports of goods, BOP, EUR mn	74397	84001	95484	78616	91292	103000	112000	128000	147000
annual change in %	17.8	12.9	13.7	-17.7	16.1	12.8	9	14	15
Imports of goods, BOP, EUR mn	106996	118053	131095	96145	133986	169000	179000	193000	212000
annual change in %	19.1	10.3	11.0	-26.7	39.4	26.1	6	8	10
Exports of services, BOP, EUR mn	20165	21116	23928	23923	26176	28600	31000	34000	37000
annual growth rate in %	-7.0	4.7	13.3	0.0	9.4	9.3	8	9	9
Imports of services, BOP, EUR mn	9352	11408	12186	12105	14897	15300	16000	17000	19000
annual growth rate in %	1.4	22.0	6.8	-0.7	23.1	2.7	0	6	12
FDI inflow, EUR mn	15916	16238	13217	6085	6986	9000	10000	8000	112000
FDI outflow, EUR mn	713	1568	1707	1110	1108	1450	1500	1500	1600
Gross reserves of CB, excl. gold, EUR mn	46251	49804	51022	49088	60411	60538	.	.	.
Gross external debt, EUR mn	157710	169471	201449	186351	216669	229000	.	.	.
Gross external debt in % of GDP	37.1	35.4	40.4	42.3	39.2	42.2	.	.	.
Average exchange rate TRY/EUR	1.8090	1.7865	1.9064	2.1631	1.9965	2.3378	2.50	2.80	3.00
Purchasing power parity TRY/EUR	1.0405	1.0643	1.1385	1.2171	1.2605	1.3362	1.26	1.2	1.2

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

1) Preliminary and wiiw estimates. - 2) Domestic output prices. - 3) According to ESA'95 excessive deficit procedure. - 4) From 2010 one-week repo rate, overnight lending rate before.

Source: National statistics (Central Bank, Turkish Statistical Institute – TSI, etc.), Eurostat. Forecasts by wiiw.