



Economic Policy Research Foundation of Turkey

Global and Domestic Developments: Prospects for the Turkish Economy

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Framework

- Where were we just six months ago?
 - Rapid economic and social transformation
 - Challenge: sustaining high growth rates
- Long term agenda vs. short term agenda
 - Many contentious issues: Need for political consensus, a mis-management case
 - Unfavorable global conditions: impact of US banking crisis
 - An unfolding political crisis, last but not least
- How to move forward?

Economic Policy Research Foundation of Turkey (TEPAV)

- Established in 2004, with the support of the Union of Chambers and Commodity Exchanges of Turkey (TOBB)
- Independent, non-partisan think tank in Ankara
- Focuses on economic policy, competitiveness, regional integration, governance and stability.

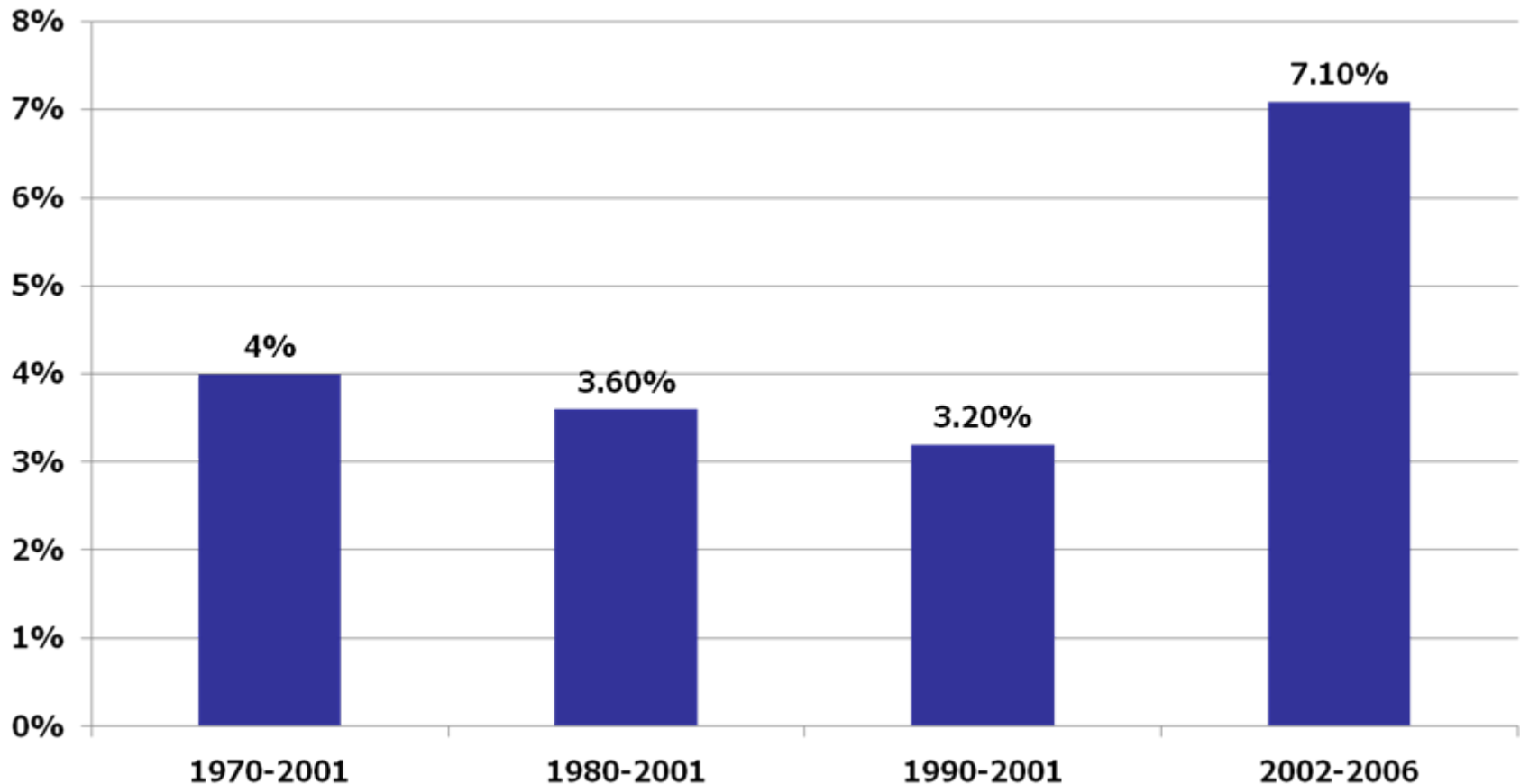
www.tepav.org.tr

A sample of TEPAV's activities

- Developing policy tools for dialogues with the government
 - Industrial Policy Document *(with State Planning Organization)*
 - Investment Climate Assessment *(with the World Bank and Treasury)*
 - Competition Environment Assessment *(with the World Bank, FIAS and Competition Authority)*
 - Higher Education Sector Project *(with the World Bank)*
- Governance of economic development
 - Decentralization studies, regional development framework *(with The Ministry of Internal Affairs and local authorities)*
 - Fiscal monitoring and transparency
- Regional Integration
 - Industry for Peace Initiative *(with TOBB)*
 - Black Sea and Central Asia Project *(with TOBB)*

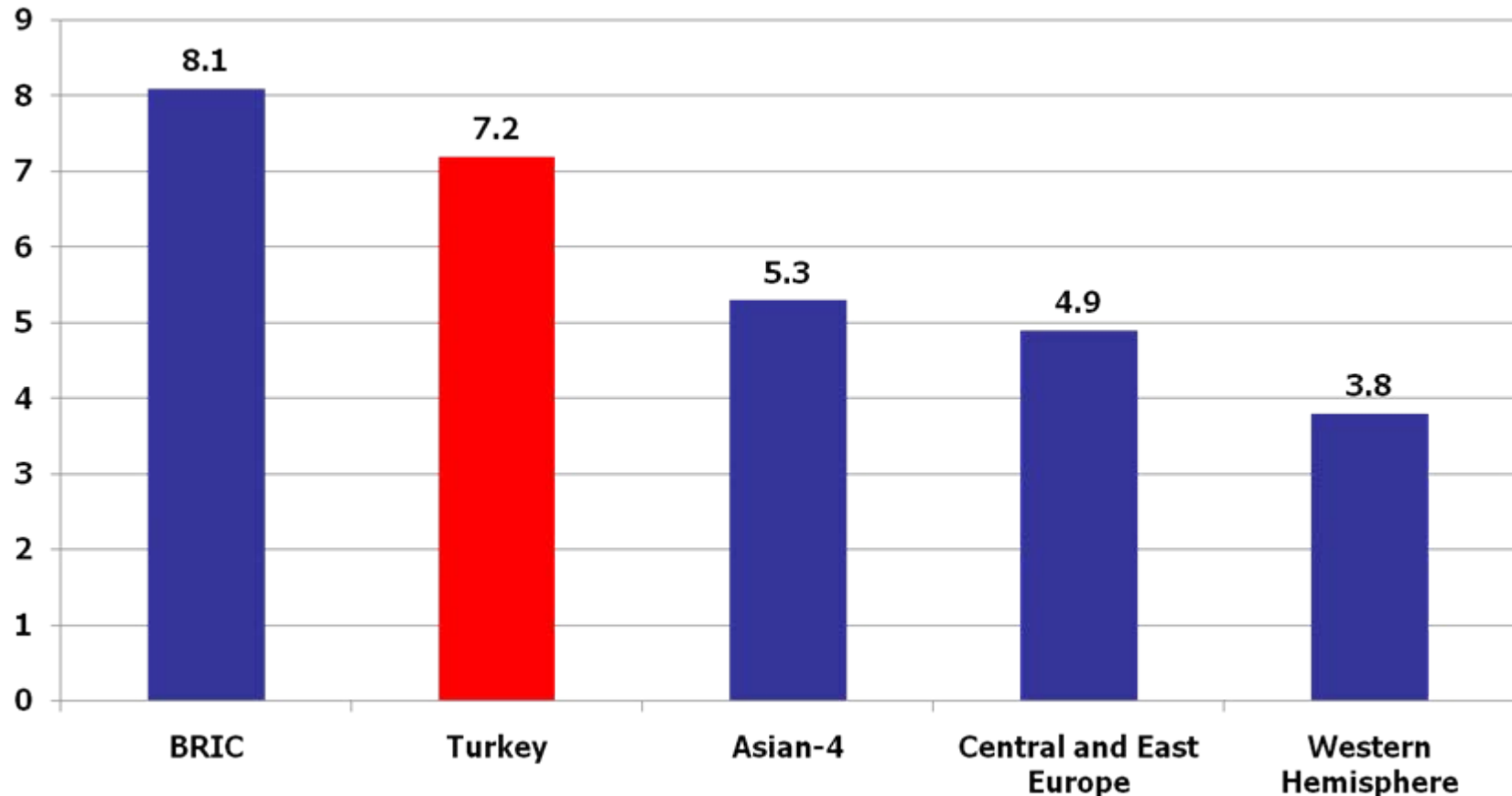
Turkish economy has jumped on a higher growth trajectory

Average annual growth rates of GDP (%)



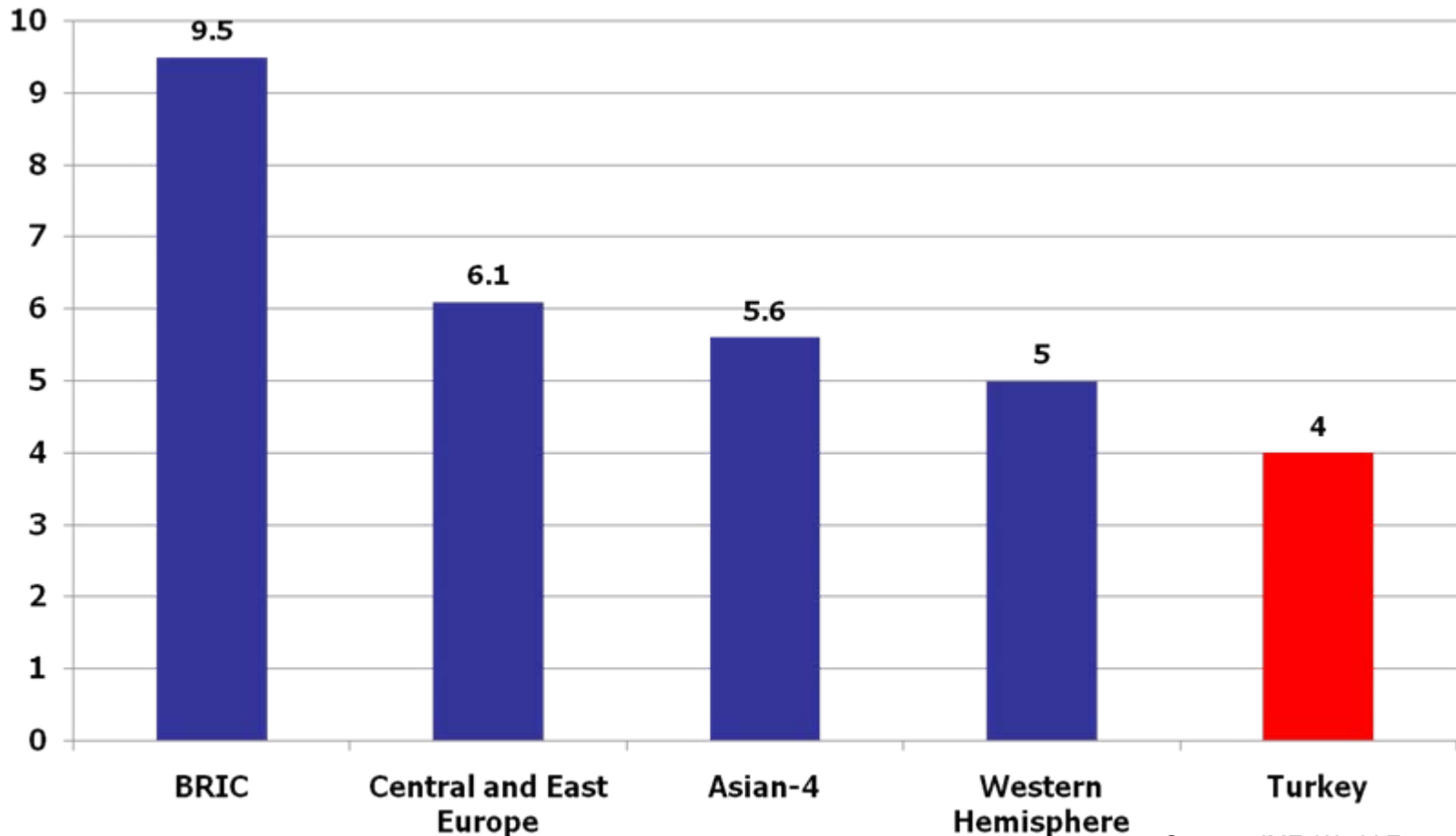
Turkey performed better than several countries between 2002-2006...

Average annual growth rates of selected regions and Turkey (% , 2002-2006)



... however something started to change in 2007

GDP growth rate forecasts for Turkey and selected regions (%)

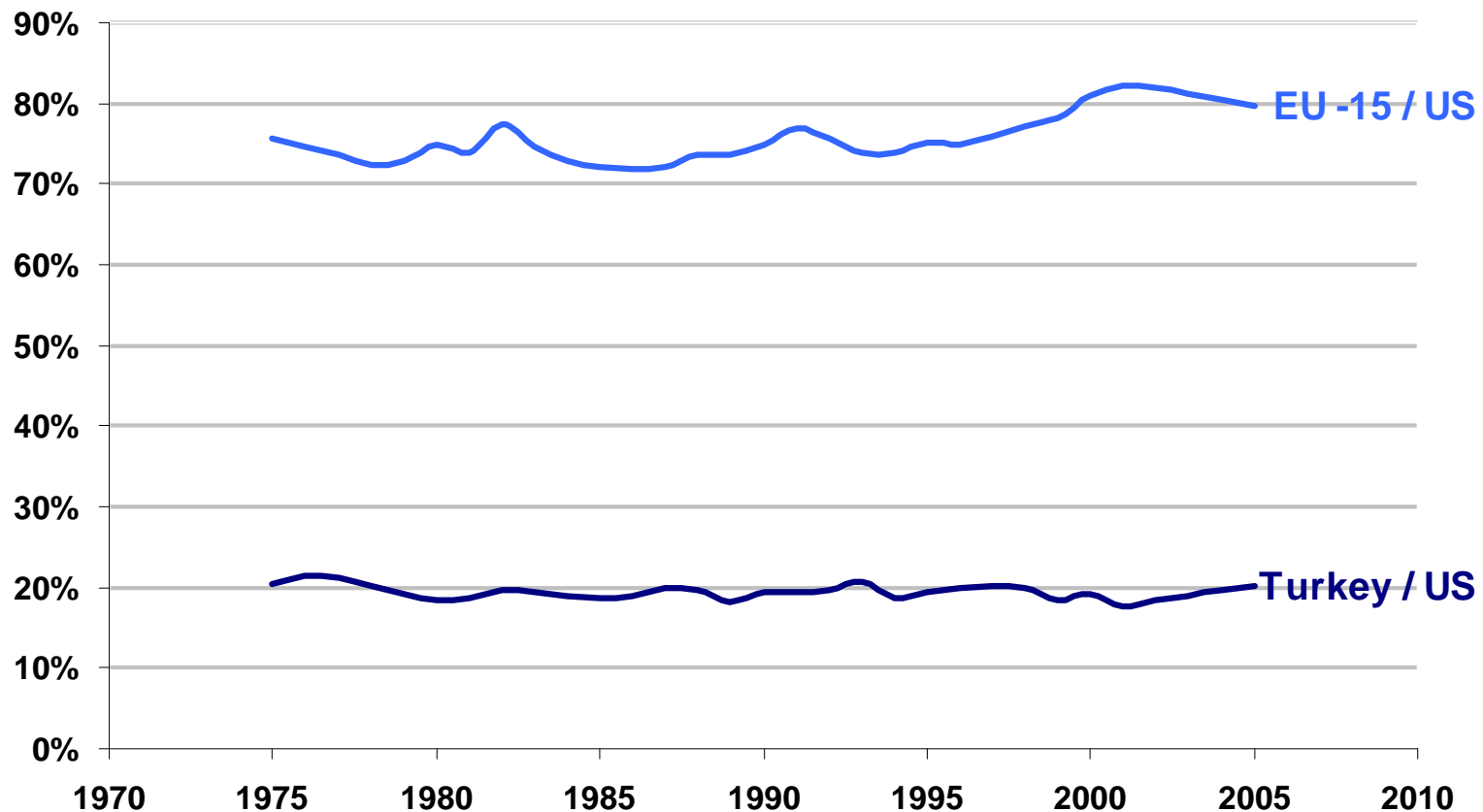


A rapidly growing middle class

	1999	2003	2006
Automobile sales (in thousands)	-	359	622
White good sales (in millions)	4	3	5,5
Airline passengers (in millions)	30	34	59
Mobile Phone Network subscribers (in millions)	-	26,6	51,4
# of people getting House Loans (thousands)	14	43	460
Consumer credit + credit cards (billion YTL)	-	12,8	67,7

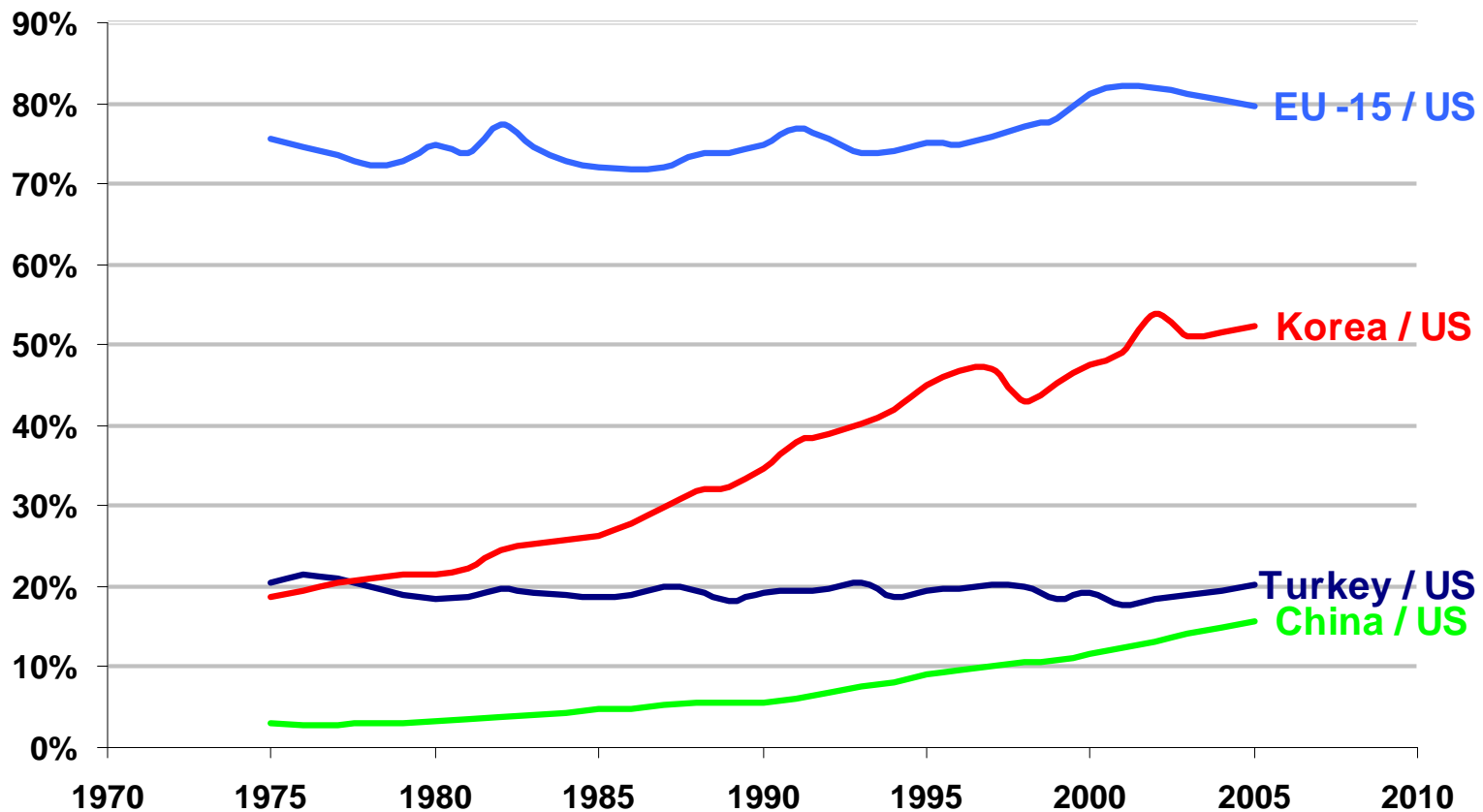
Challenge of convergence relative to the US per capita income

Ratio of GDP per capita of EU-15, China, Korea and Turkey to GDP per capita of the US (PPP, 1975-2005)



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Does the transformation process come to a halt?

- Capacity constraints threatens the transformation process
- Current capacity of industry and services is not enough to employ the people, who ran out of agriculture
 - Percentage change from 2002 to 2007
 - Total employment: Agriculture (-20%), Industry (13%), Services (20,7%)
 - Registered employment increased by 30%
 - Unemployment rate stuck at 11%
- Transformation itself is productivity enhancing
 - Productivity growth was the source of expansion after 2001 crisis
- An unmanaged transformation process with capacity constraints
 - Importance of **“second generation reforms”** (Is this timely?)

Where were we before when the focus shifted?

Agenda of three months ago:

First generation reforms

Second generation reforms

Objectives

- ✓ Restoring growth
- ✓ Reducing inflation

- Sustaining growth
- Maintaining macroeconomic stability
- Increasing international competitiveness
- Fostering social development

Reform strategies

- ✓ Changing macroeconomic rules
- ✓ Reducing the scale and scope of the state
- ✓ Reducing protectionism and statism

- Strengthening the institutional infrastructure of a market economy
- Reforming education, health, social security and other public services
- Building strategic coordination mechanisms for competitiveness of the private sector

Now: three crises juxtaposed

- Reforms to increase the growth capacity of Turkey could not be started (DOMESTIC)
 - Second generation reform agenda with priorities still absent
 - A deeply polarized Turkey is not good for the agenda
- Favorable international liquidity conditions are not going to be available for a while (EXTERNAL)
 - Financing corporate activities will be difficult
 - Major finding of ICA: Turkish companies do not grow
 - Bad for growth capacity again
- Political crisis has led to economic policy uncertainty (DOMESTIC)
 - Policy uncertainty will be bad for growth

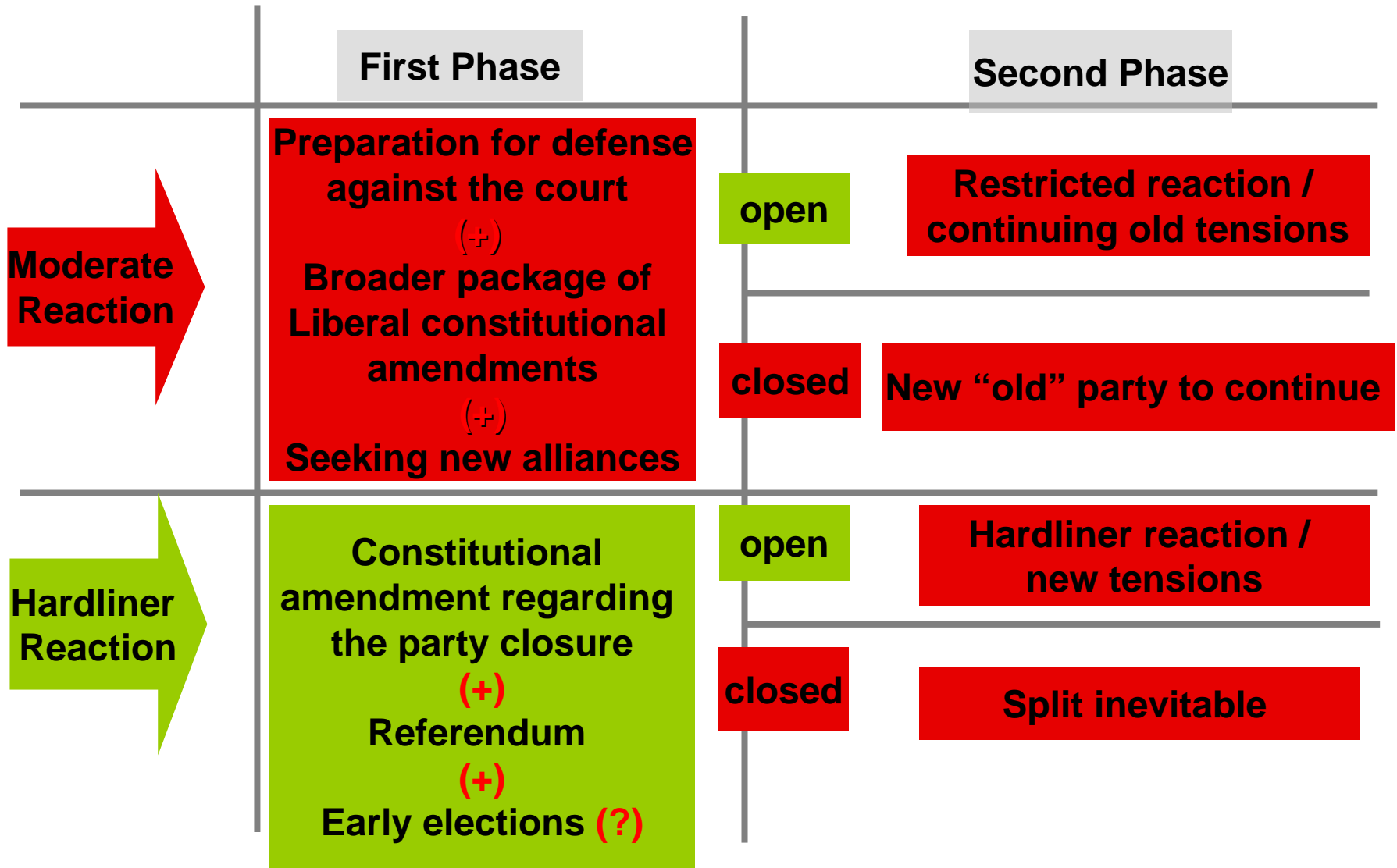
Impact of triple crises on economy

- No measures against the international banking crisis, it will continue to unfold. Waiting to see the impact.
- Domestic issues should in principle be more easily manageable
 - Currently we have a paralysis at the governmental level: **Bad for policy certainty hence growth.**
 - Government could not prioritize a policy agenda that can create positive expectations: **Bad for consumer sentiment hence growth**
- Strengthening the EU anchor would be good for both policy uncertainty and consumer sentiment

How will recent global credit crisis affect the Turkish economy?

- May 2006 turmoil is like the dress rehearsal for the current one
 - Less FX rate more interest rate adjustment
 - Highest rate of return after Iceland now.
- The impact will be long term
 - Turkey will be affected due to its CA deficit financing
 - The impact will be on growth
- Political uncertainty costs higher interest rates especially during credit crisis
- Policy uncertainty is the worst case scenario, look for the court case unfolding

Turbulent times in Turkish politics after the closure case: Transformation in danger?



What should be today's priorities?

- Re-financing needs of corporate sector
 - FX indebted corporate sector
- Focus should be on sustaining fund inflows
 - Uncertainty in the regulatory framework is not good
- Adherence to fiscal discipline is key for stability
 - Tough choice: Primary surplus vs. public investments
 - Is it possible to boost public investments w/o sacrificing fiscal discipline? Case of Brazil
- Credibility of the central bank is important
 - From explicit targeting to forecast targeting
 - Need for realignment is obvious

Conclusions

- Completing the economic and social transformation of Turkey is of regional importance
- Transformation process needs to be managed more properly
 - Bad political decisions are the new binding constraint nowadays
- Nature of the reform process requires broad based consensus
 - Polarization is not good for transformation
 - Role for Grand National Assembly-
Constitutional Convention