Turkish Economy in 2012: Soft lending or a hard brake?

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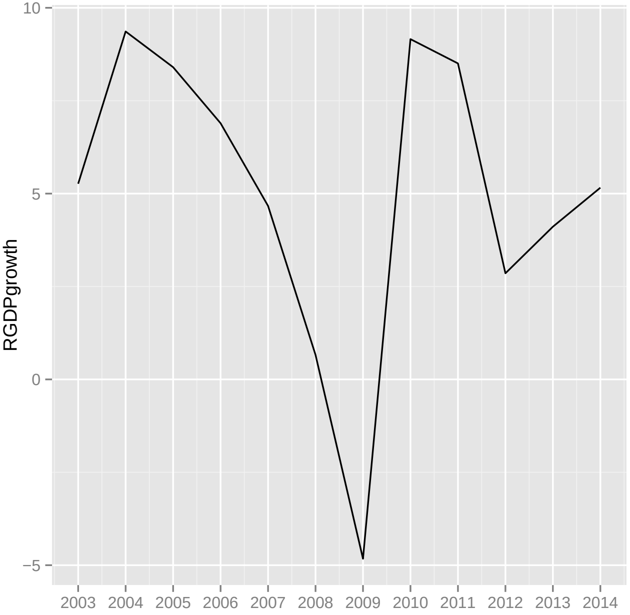
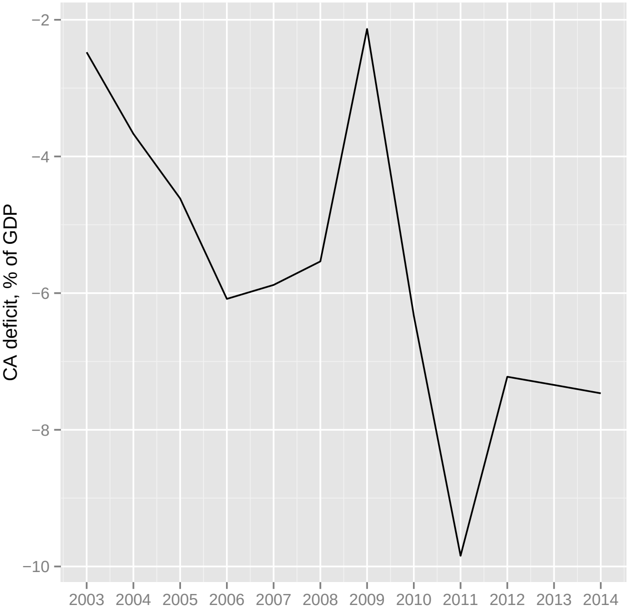
Stability of Long-term Growth

- Consumption-led growth halted in 2012; expected GDP growth would be within % 1-3 range.
- Troubles in EU and Middle East constrain external demand.
- Savings rate continued to shrink to a record low level of % 12 of GDP
- Unemployment rate steady at % 9-10 range
- Informality is resistant.


RGDPgrowth
10
5
0
−5
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014

- The growth performance is erratic
- The average growth rate is about % 5
- The forecast is based on a global recovery; about % 2-3 world output growth, % 2.5 US GDP growth
- A % 5 real GDP growth rate with a % 1 population growth rate would increase GDP per capita by about % 48 by 2023.


CA deficit, % of GDP
−2
−4
−6
−8
−10
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014

- Increasing Current Account deficits reflect "saving gaps".
- There is also an import-dependency of export-oriented industrial sectors (i.e. iron-steel, motor-vehicles, chemicals etc.)
- A substantial drag is due to energy imports
- There is a one-time questionable improvement thanks to gold exports in 2012.
- Gold and jewellery exports jumped to 16 billion dollars, which constituted little more than % 10 of total exports.

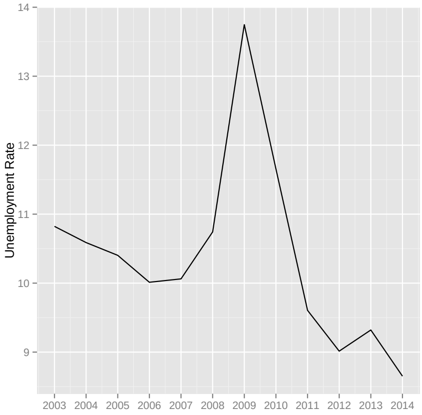
Important Prices

	2008	2009	2010	2011	2012	2013	2014
Exchange rate TL:Dollar	1.526	1.491	1.541	1.894	1.792	1.826	1.900
Exchange rate TL:Euro	2.123	2.148	2.059	2.450	2.320	2.328	2.366
Consumer prices %	10.1	6.5	6.4	10.4	6.2	6.5	6.5
Stock of money M1 %	14.9	28.2	25.1	1.8	11.5	9.4	9.1
Lending Rate %	26.5	21	19	17	19	17.5	16.5

Table : Prices, Exchange Rates and Interest Rate

- Turkish Lira appreciated against both dollar and Euro in 2012 despite more than % 6 rate of inflation
- The spread, difference between the lending and the deposit rates, remained high; supporting the profitability of banks
- There is a very little expected depreciation in the coming years; bad news for the exporters.
- Money supply will be under control.

Labor and Capital Markets

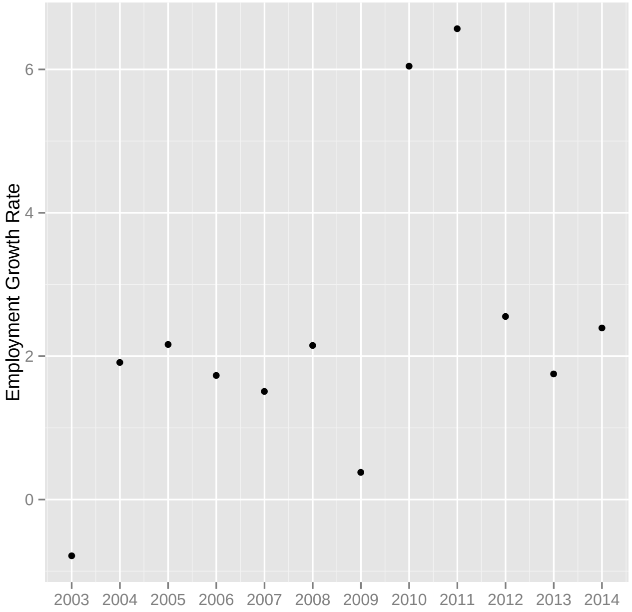


- The largest unused/wasted resource is labor
- Unemployment rate for the youth and educated is the highest.
- Although there is a certain mismatch in the labor-market, the unemployment problem largely derives from lack of investment and dismal wages.
- There is a critical 5-year period in which labor force will keep increasing at a high rate (the population growth rate in 1980-1985 period was % 2.5, twice of current rate)

	2002 Dec.	2013 Jan.	Real Growth Rate
Government Officials Average Wage	578	1958	% 35.3
Public Workers Average Wage	1012	2612	% 3.3
Pensions covered by SSK Average Wage	276	934	% 35.2
Government Pension Average Wage	502	1340	% 6.6
Net Minimum Wage	185	774	% 67.7

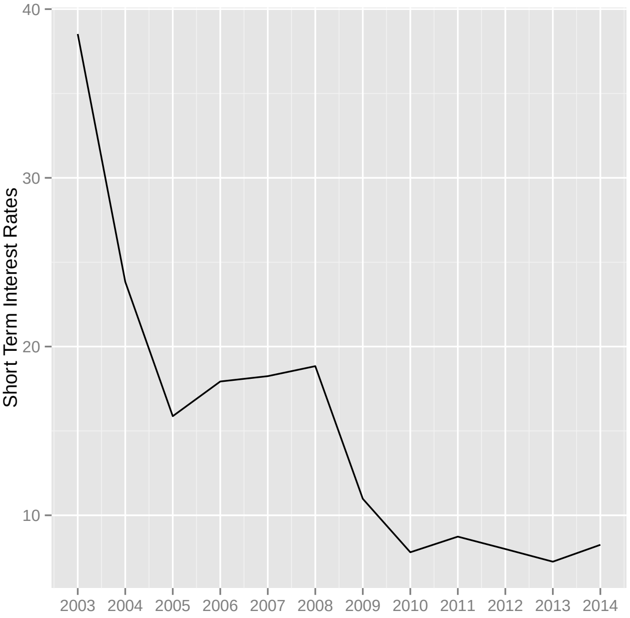
Table : Real Incomes due to Wages and Pension Income

Note that cumulative real GDP growth in the same period is % 51


Employment Growth Rate
6
4
2
0
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014

- Notice the outliers in 2010 and 2011
- Gross fixed investment (GFI) surged in these years by % 30.1 and % 19.4 respectively; that will be unlikely to happen in near future.
- In 2012 GFI is expected to decline % 3.
- Private Consumption will also grow at most % 3-4 in 2013 and in 2014.
- Thus employment creation will be a major concern.

- Informality both in terms of firms and employment is a major obstacle.
- As of October 2012, % 39.7 of total employment is without a social security coverage, thus informal.
- Similarly, the majority of the micro enterprises and a big chunk of SMEs are informal one way or another.
- As of 2011, there had been almost 50 billlion TL tax debt which could not be collected.
- Probably the amount of taxes evaded/avoided would be much more than the uncollectable taxes.


Short Term Interest Rates
40
30
20
10
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014

- The real success story has been the decline of borrowing costs, for the government and the banks/corporations.
- Interest payments on the accumulated debt have been constrained at about 50 billion TL per year.
- As the budget revenues increased steadily interest burden as a share of budget (and GDP) went down drastically (from %15 of GDP in 2002 to % 3 in 2012)
- As the cost of borrowing decreased for the financial/non-financial corporations, the credit boom materialized.

- Household debt sky-rocketed; reached more than % 50 of the disposable income.
- Bounced checks and unpaid IOUs more than doubled in 2012.
- Cash withdrawals from credit cards surpassed consumer credit flows in 2012.
- Debt service flows reached 25 billion TL in 2012; that is almost equivalent to income of bottom % 30 of the households.

- CBRT has recognized the double danger of unsustainability of current account deficits and high indebtedness of households, and constrained the credit growth under % 15 per year.
- CBRT also implemented prudential monetary policy instruments such as incremental reserve requirement ratios in different asset forms.
- There are also new attempts to change incentive structures for private savings, i.e. individual pension plans (BES), changing the tax rates on interest incomes from deposits with varying maturity terms..
- However, there is an internal debate among the ministers on the issue of monetary policy; i.e. trade minister criticising the head of CBRT

	2008	2009	2010	2011	2012	2013	2014
Debt stock	284.080	271.225	293.872	306.747	334.094	343.843	353.606
Debt service paid	55.527	62.027	58.700	55.371	57.904	62.489	64.820
Principal repayments	42.077	49.801	47.198	44.723	46.134	49.800	52.615
Interest	13.450	12.226	11.502	10.648	11.770	12.689	12.205

Table : External Debt Dynamics

Note that FX requirements cover both the debt service to be paid and the current account deficit. On top of that financial and non-financial corporations will be in need of new financing!

	2003	2008	2012
Assets	30.2	80.5	85.7
Liabilities	-48.7	-152.8	-218.8
Net FX Deficit	-18.5	-72.3	-133.2

Table : FX Position of Non-financial Corporations

Apart from the fragility due to the current account deficit, the FX position of the non-financial corporations also poses a risk!

Back to the Future

- Foreign sources of savings/credit will be available but in limited quantities; Turkey has to depend on its own resources.
- The phenomenal growth of foreign credit in the 2002-2008 period is so over (from annual average of % 50 to less than % 5 in 2012)
- EU and Middle East/North Africa will keep conflictual
- İmralı Process and an eventual solution to the "Kurdish Problem" including a soft-federation with the North Iraqi Kurds are promising but yet to be persuasive.
- Gold exports (!) to Iran will come to a full-stop probably as US will strengthen the sanctions against Iran.

- There may exist a bubble in real estate; unfortunately we do not have reliable and comprehensive statistics on real estate.
- However, the gap between the cumulated number of construction and residency permits implies an excess supply in the order of several thousands
- Since construction sector is pivotal in both fixed capital investment and GDP growth, a burst would be disastrous.
- Nevertheless, "urban transformation" process, if carried out successfully, will create new demand for real estate.

- Non-tax revenues may have peaked
- Gigantic projects such as the third airport and the channel İstanbul may be risky.
- 2B sales may not bring about as much money as it was expected
- Education and health will need more funds as the population ages.

- Both 2013 and 2014 are election years; worsening of public finances is likely.
- There are a few opportunities and sectors to be privatized; energy, infrastructure, railways and couple of banks.
- Growing social security deficits will be a major concern
- Without a radical tax reform, growth in state revenues will be limited.
- Military conflict may destabilize public finance dynamics