THE TURKISH ECONOMY

Fatih ÖZATAY

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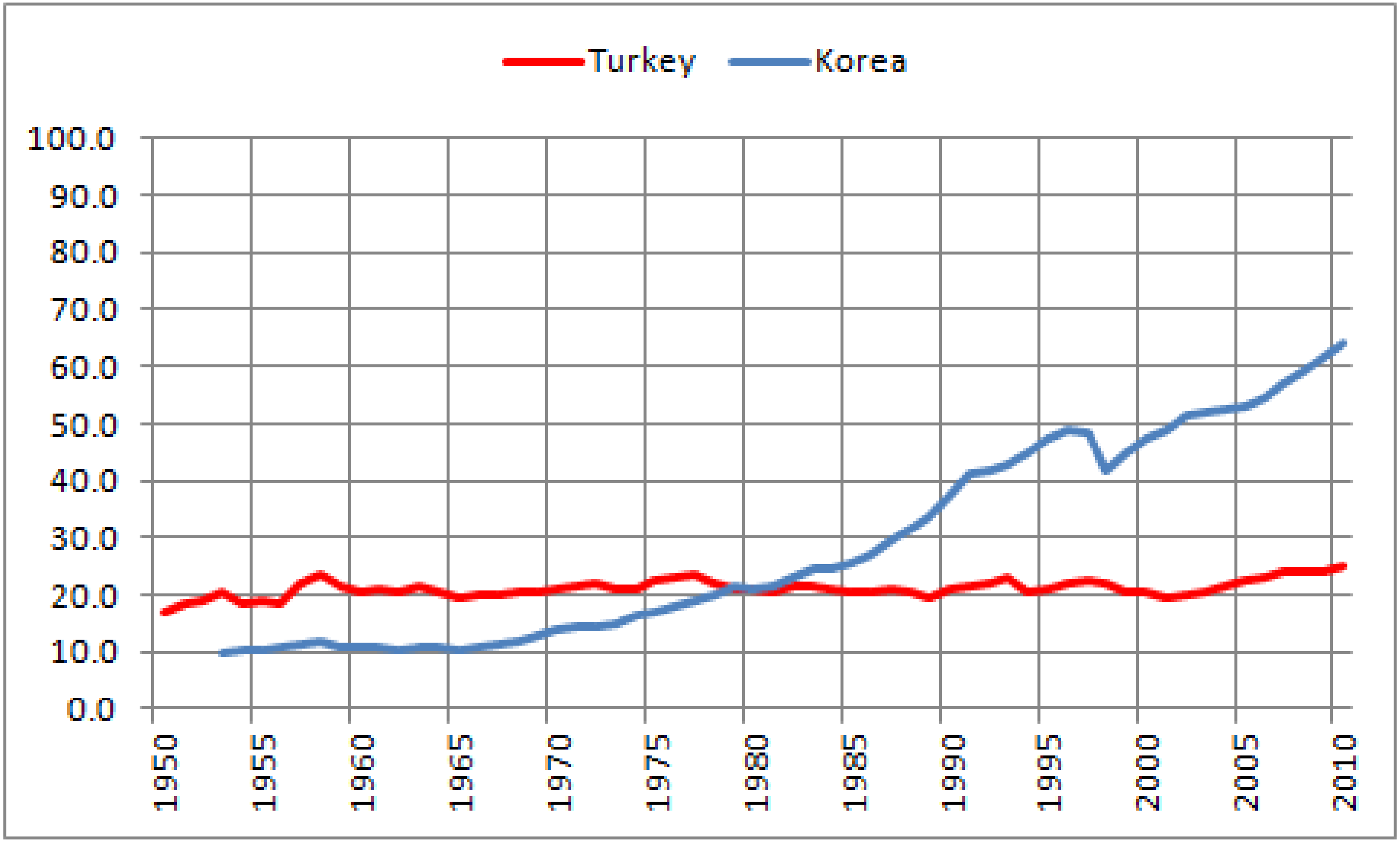
Ankara

GDP per capita relative to GDP per capita of U.S (%)



Common features of countries that succeded in converging…

- Macroeconomic stability,
- High investment (savings),
- High level of education,
- High tech exports to exports ratio: high,
- Of course… Good institutions

POST 2001 CRISIS: TOWARDS MACROECONOMIC STABILITY

Since 2001:
towards macroeconomic stability

- Important steps towards macroeconomic stability
- Fiscal discipline:
  - Low public debt and budget deficit
  - Low real borrowing rates
- Stronger banking sector:
  - Low non-performing loans
  - Upward trend in credit-to-GDP ratio
  - Satisfactory capital-to-asset ratio
- Independent central bank and banking regulation and supervision agency
- Favorable external conditions…

As a result: high growth in the 2002-2007 period

	1960-2013	2002-2007
Average growth rate (%)	4.4	6.8
Average per capita growth rate (%)	2.4	5.5

SHARP DIFFERENCE BETWEEN THE 2002-2007 PERIOD AND AFTERWARDS

Low growth and investment but high foreign financing

	Private investment growth (%)	GDP growth rate (%)	Current ac. bal. (% GDP)	Net capital inflows (% GDP)	Required net capital inflows as % GDP for 1% growth
2002Q1-14Q3	10.7	5.0	5.1	5.8	1.2
2002Q1-07Q4	19.1	6.8	3.9	5.3	0.8
2008Q1-14Q3	3.2	3.4	6.1	6.0	1.8
2012Q1-14Q3	-2.0	3.1	6.6	7.5	2.4

Post 2007 is radically different than 2002-2007

- Growth in 2002-2007 was rather high.
- However, despite strong fiscal and financial position, high growth performance did not continue afterwards.
- Turkey is one of the economies that contracted most in 2009.
- Growth in the 2012-2014 period is low, private investment contracted, reliance on foreign financing increased.
- WHY?

Importance of external financing:
mediocre level of investment (% GDP)

	2002-2006	2007-2011	2012	2013
Argentina	16.8	19.7	17.3	18.3
Brazil	16.4	19.4	17.5	18.1
China	41.0	45.8	47.7	47.8
India	30.9	36.2	34.7	31.4
Indonesia	24.3	29.8	34.7	33.6
Korea	32.0	31.8	31.0	29.0
Mexico	22.1	23.0	23.1	21.5
Russia	20.2	22.5	23.6	22.6
Saudi Arabia	20.9	28.6	26.3	28.2
South Africa	17.6	20.3	19.4	19.4
Turkey	19.3	20.2	20.1	20.6
Developing countries	26.2	30.3	31.5	31.6

Importance of external financing:
strikingly low level of savings (% GDP)

	2002-2006	2007-2011	2012	2013
Argentina	20.7	20.6	17.1	17.5
Brazil	17.2	17.9	15.1	14.5
China	45.5	51.8	50.3	49.7
India	31.1	33.5	30.0	29.7
Indonesia	26.8	30.7	32.0	30.3
Korea	33.6	33.7	35.2	35.1
Mexico	21.4	21.9	21.9	19.5
Russia	29.6	27.6	27.1	24.2
Saudi Arabia	39.5	46.4	48.8	45.9
South Africa	15.3	15.8	14.2	13.5
Turkey	16.0	14.3	14.0	12.6
Developing countries	29.4	32.7	32.9	32.4

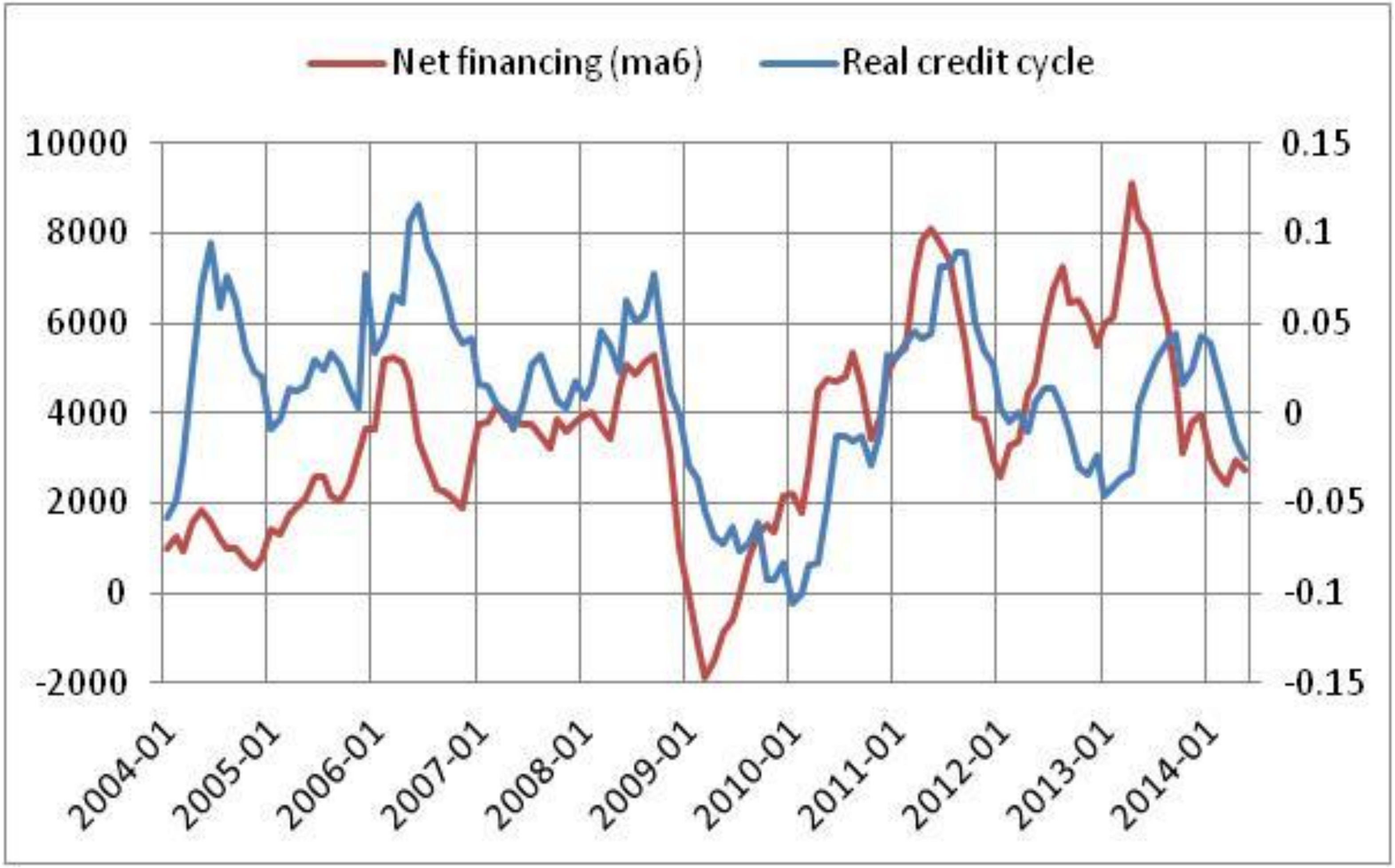
Importance of external financing:
high savings-investment gap (current account deficit)

	2002-2006	2007-2011	2012	2013
Investment (% GDP)	19.3	20.2	20.1	20.6
Savings (% GDP)	16.0	14.3	14.0	12.6

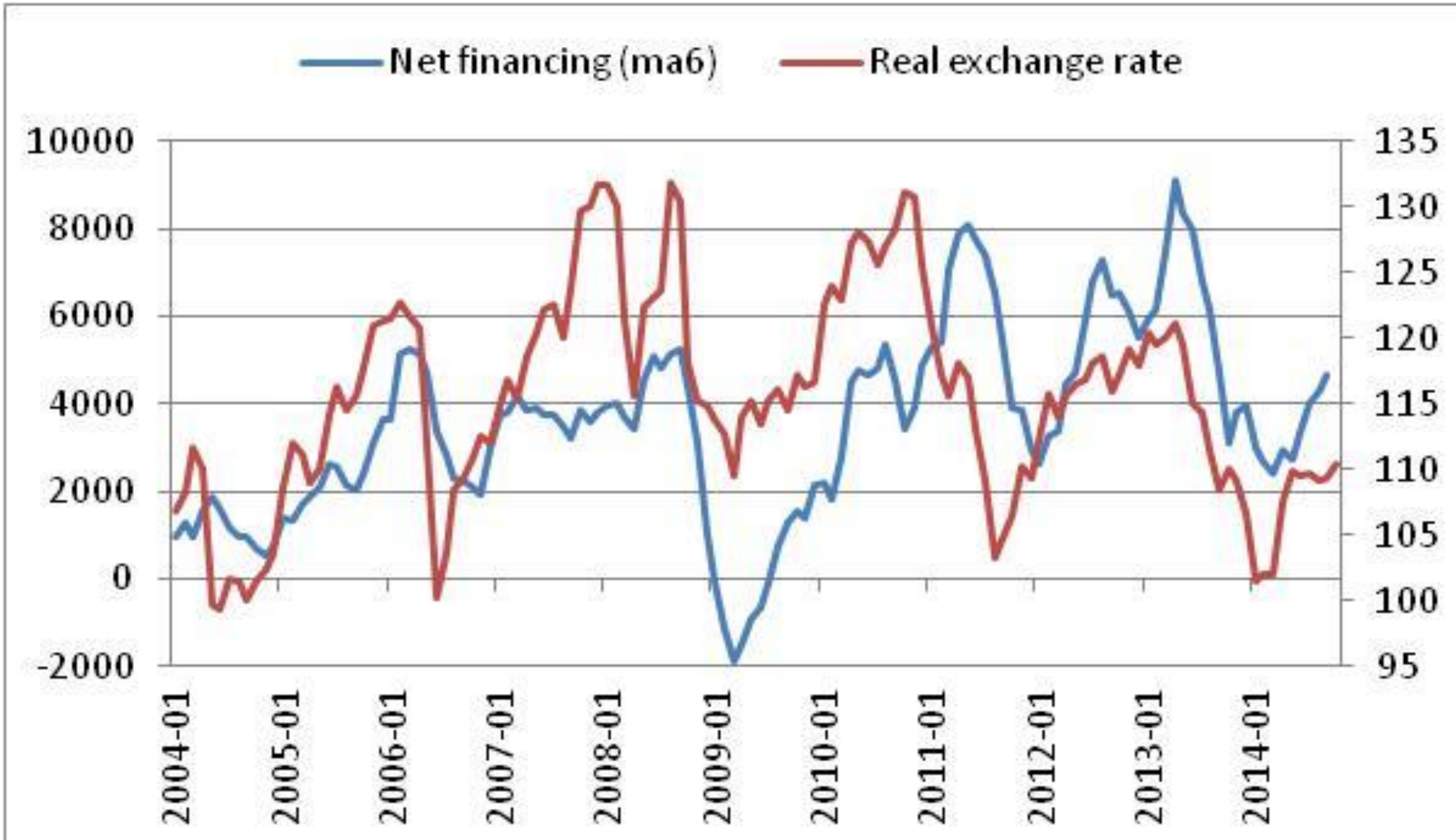
Importance of external financing:

- Episodes of surge in capital inflows:
  - Increase in asset prices, appreciation of the lira, decrease in interest rates, rise in confidence
  - Rapid domestic credit growth
- Episodes of capital outflows or 'sudden stops':
  - Decrease in asset prices, depreciation of the lira, and increase in interest rates, reduction in confidence
  - Low domestic credit growth or credit crunch

Net external financing and real domestic credit cycle



Net external financing and real value of the lira



In summary…

- Despite all those efforts in the aftermath of the 2001 crisis, macroeconomic stability is still in the mercy of international risk appetite.
- This assertion could seem a bit strong.
- Nonetheless, it is the mere reality…

Educational attainment

	Average year of total schooling (years)		
	Age: 20-24	Age: 25-29	Age: over 15
Argentina	10.55	10.34	9.51
Brazil	9.94	9.81	7.89
China	9.17	8.87	7.51
India	9.02	7.76	6.24
Indonesia	9.47	9.22	7.61
Korea	13.93	14.70	12.05
Mexico	10.48	10.14	8.79
Russia	11.75	11.85	11.53
Saudi Arabia	11.28	9.64	8.53
South Africa	11.08	11.03	9.69
Turkey	9.12	8.50	7.05

Share of high tech exports in total exports (%)

	2007-2011	2012
Argentina	7.9	7.7
Brazil	11.5	10.5
China	26.6	26.3
India	10.6	7.3
Indonesia	7.3	6.6
Korea	28.4	26.2
Mexico	16.9	16.3
Russia	7.9	8.4
Saudi Arabia	0.5	na
South Africa	5.1	5.5
Turkey	1.8	1.8

Nothing new, nothing unknown…

- I said nothing unknown… nothing new…
- But, this is what exactly the problem is.
- This is the status-quo and it was the same status-quo back in let's say 12 years ago…
- It is not pleasant…
- How to change the status-quo?
- It seems that the binding constraints are the low savings rate, low level and low quality of education…

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