

Turkish economy in recovery but risks remain

Euromonitor International

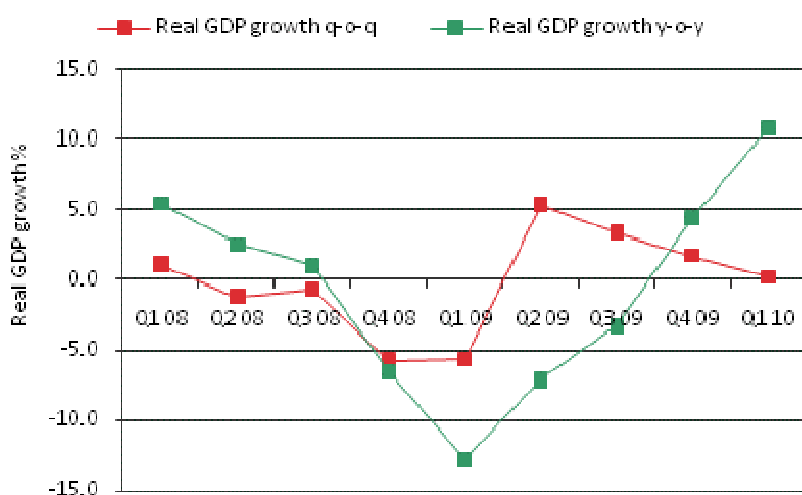
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Turkey's annual Q1 2010 GDP demonstrated exceptional growth but this was partly due to the base effect following a severe contraction in 2009. Quarter-on-quarter growth slowed illustrating that Turkey is vulnerable to global economic headwinds, particularly the European Union's (EU) financial woes. Domestic demand has been a major contributor to economic growth but unemployment remains high.

- Turkey posted a 10.9% increase in real GDP growth in Q1 2010 (seasonally adjusted) versus a year ago (second only to China's Q1 2010 real growth amongst the G-20) compared to a real contraction of 12.8% in Q1 2009. The rise is due to the “base effect”, i.e. a comparison with the previous year's figure coming from a very low base. However, the quarter-on-quarter figures reveal that the economy slowed for the third consecutive quarter with seasonally adjusted real growth of 0.2% in Q1 2010. Growth has been affected by the European debt crisis and lower public spending;

Chart 1 Turkey's seasonally adjusted real GDP growth: Q1 2008 – Q1 2010

Quarter-on-quarter and year-on-year growth %



Source: *Euromonitor International from national statistics*

- The apparent strength in the recovery is important given the severity of the contraction in 2009, owing to the global financial crisis and an acute slowdown in EU trade;
- However, lower interest rates have resulted in upward pressure on domestic demand. Q1 2010 figures show that household spending rose by 9.9% year-on-year in constant terms according to national statistics.

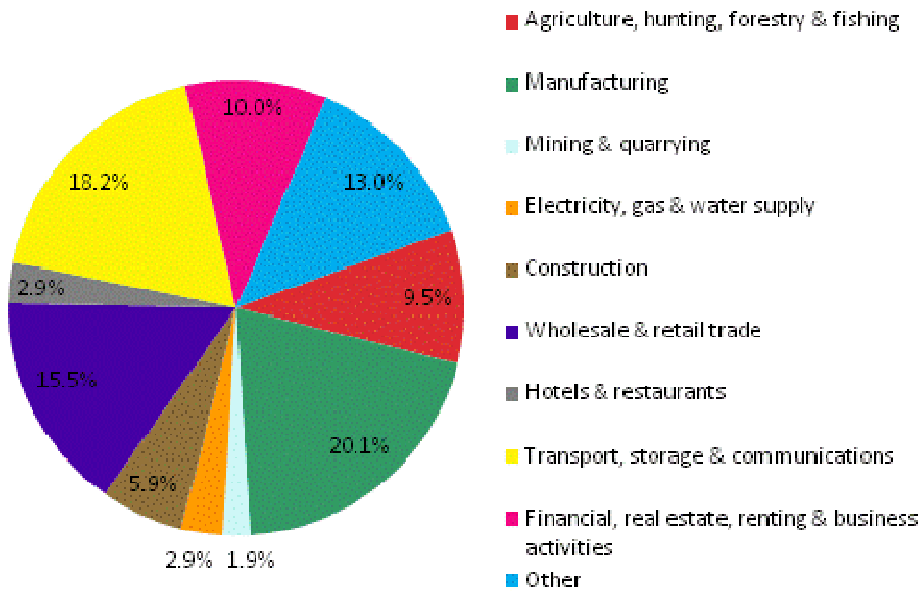
Implications

Turkey's domestic demand holds the key to economic recovery with consumers at the forefront, given that consumption accounted for 70.0% of GDP in 2009. However, Turkey remains vulnerable:

- The lacklustre nature of Turkey's quarter-on-quarter figures could underline the central bank's decision to maintain interest rates at 6.5% and 9.0% for borrowing and lending respectively in June 2010 (unchanged since November 2009), suggesting that the central bank does not believe that the economy is in danger of overheating and could face external challenges. Inflation for June 2010 showed CPI at 8.4% (a decrease of 0.7 percentage points on the previous month). Lower inflation will allow the central bank to keep interest rates depressed, which will boost consumer spending and allow business investment and employment;
- Two of the economy's largest sectors expanded in Q1 2010. Manufacturing and retail increased their activity by 20.6% and 22.4% year-on-year respectively in real terms (albeit from a low base). The agricultural sector, which employed 24.3% of workers and accounted for 9.5% of GDP in 2009, showed a real decline of 3.8% in Q1 2010 year-on-year;

Chart 2 Turkey's GDP by origin: 2009

% of GDP



Source: *Euromonitor International from national statistics*

- Unemployment, whilst a lagging indicator, is high at 12.0% in April 2010, which will weigh on consumer spending power, and will result in more pressure to redirect growth towards business development;
- The troubled debt-ridden EU could also dampen Turkey's economic recovery, particularly given that the EU is Turkey's main trading partner. Exports to the EU-27 amounted to 38.2% of Turkish exports in 2009;
- Government expenditure has begun to decline following the stimulus since the global financial crisis. The slowdown in public spending could place pressure on the private sector and consumers to find growth.

Prospects

Real Turkish GDP will grow by 5.2% and 3.4% in 2010 and 2011 respectively. However, the IMF expects the economy to grow more robustly by 6.3% in 2010 but slowing to 4.0% in 2011. Concerns remain about over-reliance on consumption and weak external factors.

The government has been working on the “National Employment Strategy” aimed at boosting labour through reforming employment practices, which is expected to debut in the second half of 2010. Policies could be met with trade union opposition if they attempt to address areas such as severance pay and a regional minimum wage.

Turkey has started to ease fiscal stimulus and has raised taxes on tobacco and fuel (2009) as well as reining in healthcare costs. Any monetary tightening could weigh on economic growth prospects.