Josef Pöschl

Turkey:
Growth and inflation – mutual slowdown

Three phenomena are topical features of the Turkish economy: relatively low real GDP growth after a spectacular growth bonanza in 2010-11; relatively high, albeit decelerating, inflation; and a somewhat diminished, though still high current account deficit. This deficit, which is of a structural nature, raises concerns about the long-term sustainability of high growth. This notwithstanding, growth may re-accelerate in 2013 and 2014, if external circumstances allow for this. In recent years, Turkey's exporters have been successful in selling to non-EU countries, and this is likely to continue during the next few years. Slow growth or stagnation in the EU has an impact on Turkey, but not necessarily an overwhelming one.

Three phenomena are topical features of the Turkish economy: relatively low real GDP growth, relatively high inflation and a somewhat diminished, though still high current account deficit.

In some European countries, a real annual GDP growth rate in the current year ranging between 3 and 4 per cent would be a dream statistic. In the case of Turkey, it would represent a major slowdown after the country's having recorded growth rates of over 10% not so long ago (peaking at 11.9% in the first quarter of 2011). The deceleration is the outcome of slower growth in private consumption, whereas private investment growth has remained quite substantial. Exports continued to grow in the first quarter 2012, whereas imports, compared to the first quarter 2011, declined - at least in real terms. Households continued consuming domestic products in greater quantities, but economized on items from abroad. In contrast thereto, the share of imports in purchases of investment goods increased. Growth in the construction sector slowed down considerably. The domestic sales of motorcars and light commercial vehicles in the period January-May 2012 (some 270,000 units) was some 20% below the figure for the same period in 2011. At the same time, the number of vehicles exported increased.

The Turkish economy has created a large number of new employment opportunities in recent years. In the service sector, the increase in the number of employees was especially pronounced. As yet, the deceleration of GDP growth has not had a strong adverse impact on employment growth, but this may change during the next few months.

Inflation leapt to over 10% year-on-year in December 2011 and stood at 11.1% in April 2012. The subsequent decline to 8.3% in May 2012 came as a relief. Price increases had been highest for alcoholic beverages and tobacco. Over the past ten years, the greatest price increases have been in food and housing (rent, water and energy); these items have more weight in the budgets of poores households, and they suffered more from inflation than wealthier families. A rate of inflation in excess of 10% would offer the central bank little comfort. Inflation pressure is likely to weaken further in the course of the next few months. Austerity measures, especially in their conventional form, do not feature prominently in the Turkish political landscape. Moreover, on the fiscal side of things, austerity was not a first priority over the past few years. During the slump in 2009, the government increased the government expenditures-to-GDP ratio, but refrained from reducing it to the pre-crisis level thereafter. That notwithstanding, the budget-deficit-to-GDP ratio is better than in most of the EU 27 member states.

The main concern is over the current account deficit. It had clambered up to 10% of GDP in 2011 (rising close to 12% in the first quarter 2011). Today, given the impact of decelerated growth, it may have fallen below 9%. In that context, the good news is that initial estimates of export revenues for the first five months of 2012 point to an accrual of about EUR 45 billion: up by 10.3% year-on-year. In any event, the current account deficit is still disquieting. In the Baltic countries the deficit ratio used to be just as high (and sometimes even higher for extended periods), and most observers became quite accustomed to it. Ultimately, however, it became a source of vulnerability; clearing up the situation proved a costly undertaking for most of the parties involved. Indeed, the question is whether the protracted current account deficit could sooner or later prove a major setback for Turkey, although it is impossible to say exactly when or if this might occur.

Turkey remains attractive to foreign direct investors. FDI, however, may not reach the uppermost pre-crisis level, further to which the inflow covers only a minor portion of the current account deficit. A substantial share of that deficit is covered by categories of capital inflows (‘errors and omissions’) that have not been fully identified. Low savings are frequently suspected of being the culprit for high current account deficits, but it may well be a case of reverse causality. A high net-imports-to-GDP ratio always implies a low savings-to-GDP ratio. The best way out is to enhance the competitiveness of domestic producers. Temporarily at least, a change in the exchange rate could prove supportive. A side effect of lira depreciation would be a boost to inflation: something that the central bank would prefer not to see happen.

It is difficult to exclude the possibility of a sudden setback. Were it to occur, however, rapid recovery might be the likely response. Turkey has developed a strong business sector; its decision-makers are trained to think in dynamic terms. The sector can rely on a sound infrastructure and a well-educated labour force. There is every will to make full use of the opportunities offered by industrial modernisation. Moreover, the country disposes of labour reserves, as is visible from the low participation of females in the labour market. Assuming no sudden setback, GDP growth is likely to rise to 5% in 2013. It could climb even higher in 2014, were a global recovery to set in. Alas, nobody knows whether this will be the case.

At the technical level, preparations for Turkey’s accession to the EU continue. EU funds for Turkey will supposedly add up to EUR 5 billion by the end of 2013. In the second half of 2012, contacts between the EU and Turkey may well turn distinctly chilly when Cyprus assumes the EU presidency.

Table TR

Turkey: Selected Economic Indicators

	2008	2009	2010	2011 1)	2011 1st quarter	2012 1st quarter	2012 Forecast	2013 Forecast	2014 Forecast
Population, th pers., average	71095	72050	73003	73950	.	.	75200	76100	77000
Gross domestic product, TRY bn, nom.	950.5	952.6	1098.8	1294.9	288.0	323.0	1460	1670	1890
annual change in % (real)	0.7	-4.8	9.0	8.5	11.9	3.0	3.5	5.0	5.0
GDP/capita (EUR at exchange rate)	7000	6100	7500	7500	.	.	7800	7800	8200
GDP/capita (EUR at PPP - wiiw)	11700	10900	11900	13000	.	.	15400	18300	20500
Consumption of households,TRY bn, nom.	663.9	680.8	787.8	920.8	217.4	.	.	.	.
annual change in % (real)	-0.3	-2.3	6.7	7.7	11.9	.	4	4	5
Gross fixed capital form., TRY bn, nom.	189.1	160.7	207.8	283.2	64.1	.	.	.	.
annual change in % (real)	-6.2	-19.0	29.9	18.3	33.9	.	-1	10	10
Gross industrial production									
annual change in % (real)	-0.6	-9.7	13.1	8.9	14.4	2.8	4	7	8
Gross agricultural production									
annual change in % (real)	.	.	.	.	.	.	.	.	.
Construction industry									
annual change in % (real)	-7.6	-16.3	17.5	11.8	16.3	.	5	7	9
Employed persons - LFS, th, avg.	21193	21271	22593	24099	22802	23700	24100	24650	25800
annual change in %	2.1	0.4	6.2	6.7	7.2	3.9	0.0	2.3	4.7
Unemployed persons - LFS, th, average	2279	3053	2696	2324	2637	2500	2700	2800	2850
Unemployment rate - LFS, in %, average	9.8	12.6	10.7	8.8	10.4	9.5	10.1	10.2	9.9
Reg. unemployment rate, in %, average	.	.	.	.			.	.	.
Average gross monthly wages, manuf.ind., TRY	1590	.	.	.	.	.	.	.	.
annual change in % (real)	0	.	.	.	.	.	.	.	.
Consumer prices (HICP), % p.a.	10.4	6.3	8.6	6.5	4.3	10.5	9.1	9.0	8.0
Producer prices in industry, % p.a. 2)	13.0	1.0	6.2	12.4	10.1	9.9	8	7	7
General governm. budget, EU-def., % GDP 3)									
Revenues	32.0	33.5	36.7	38.0	.	.	.	.	.
Expenditures	34.8	40.4	39.4	39.4	.	.	.	.	.
Deficit (-) / surplus (+)	-2.8	-6.9	-2.7	-1.4	.	.	-1.6	-1.8	-2.5
Public debt, EU-def., in % of GDP 3)	39.5	45.5	39.4	37.9	.	.	35	33	31
Central bank policy rate, %, p.a., end of period 4)	17.50	9.00	6.50	5.75	6.25	5.75	5.75	5.75	5.75
Current account, EUR mn	-28108	-9551	-35135	-55375	-15810	-12341	-52000	-54000	-56000
Current account in % of GDP	-5.6	-2.2	-6.4	-10.0	-11.8	-9.0	-8.9	-9.1	-8.9
Exports of goods, BOP, EUR mn	95484	78616	91292	103154	24289	28642	112000	128000	147000
annual change in %	13.7	-17.7	16.1	13.0	20.7	17.9	9	14	15
Imports of goods, BOP, EUR mn	131095	96145	133986	167238	39376	41327	177000	191000	210000
annual change in %	11.0	-26.7	39.4	24.8	48.2	5.0	6	8	10
Exports of services, BOP, EUR mn	23928	24251	26604	28221	4598	4952	30000	33000	36000
annual growth rate in %	13.3	1.3	9.7	6.1	25.7	7.7	8	9	9
Imports of services, BOP, EUR mn	12186	12024	14759	15201	3542	3386	15000	16000	18000
annual growth rate in %	6.8	-1.3	22.7	3.0	21.2	-4.4	0	6	12
FDI inflow, EUR mn	13217	6085	6805	11476	3089	3483	10000	8000	112000
FDI outflow, EUR mn	1707	1110	1108	1789	689	1744	1500	1500	1600
Gross reserves of CB, excl. gold, EUR mn	51022	49088	60411	60637	61094	60010	.	.	.
Gross external debt, EUR mn	202201	187157	218740	236920	236920	.	.	.	.
Gross external debt in % of GDP	40.6	42.5	39.7	42.8	42.8	.	.	.	.
Average exchange rate TRY/EUR	1.9064	2.1631	1.9965	2.3378	2.1576	2.3551	2.50	2.80	3.00
Purchasing power parity TRY/EUR	1.1385	1.2171	1.2605	1.3496	.	.	1.26	1.2	1.2

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

1) Preliminary. - 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.