Turkey: Risks and Opportunities in the New Global Economy
Active Academy, 25 February 2010, Istanbul

Slide 1. **Title Slide**

Günaydin. **<u>Thank you</u>** for inviting me to Active Academy's Risk Summit again.

When we met here in Istanbul at the same time last year, the world economy was in the deepest recession most of us can remember.

I am going to suggest that there are three kinds of risks to the recovery or, put differently, three opportunities to make the recovery stronger and more sustainable

- ***In the short term, continued strong macroeconomic management***.
- ***The key for the medium term is a competitive business climate and job creation***.
- ***The key long term risk is climate change***.

Slide 2. **Sir Winston**

Sir Winston Churchill said: "The pessimist sees difficulty in every opportunity. The optimist sees the opportunity in every difficulty." So the question is: are we are optimists or pessimists?

A year ago, many people were pessimistic. Today, I believe, some or even many of us can be more optimistic and talk of risks being opportunities.

Slide 3. **Quarterly Growth**

<u>The global crisis hit Turkey's real economy</u>. The bars in this graph show GDP growth since 2000, the line shows industrial production.

- On the left hand side you can see the effects of the 2001 banking crisis.
- On the right you can see the effects of the global financial crisis.
- The two look quite similar, but you can see that, although the shock in 2008-2009 was not a financial one—that's the big difference from 2001—the ***real*** economic decline was if anything steeper, more sudden, more severe.

Why did GDP fall by more in Turkey than in many other emerging markets? In the Bank we have looked at this and we think that there are several reasons:

Cause Number 1.	Turkish growth was already slowing down since 2006-07
Cause Number 2.	In 2007 Turkish producers had built up inventories and invested much, so in 2008 when the crisis hit they then cut production and investment quickly
Cause Number 3.	Turkish firms had high external financing needs to roll over their foreign borrowing. This increased uncertainty about how the Turkish economy would fare.
Cause Number 4.	Turkey specializes in some sectors that were particularly hard hit, like automobiles and durable goods.
Cause Number 5.	Finally, banks here were cautious – a good thing in the long run but a cause of the slowdown in early 2009.

Slide 4. **Manufacturing Confidence**

That last point—the caution of banks—is important because the crisis has also proved Turkey's strength. This graph shows the level of confidence in Turkish manufacturing and you can see that by the end of the second quarter – that's quick! – Turkish firms were feeling pretty good again.

Why had confidence recovered already in the summer of 2009?

- One reason is that most Turkish companies, despite that external borrowing, did not over-borrow.
- Also the financial system was and is fundamentally in good shape, and so are public finances.
- So by the middle of 2009 many firms anticipated that the complete seizing-up of credit would be temporary and banks would start lending again, even if slowly. This is indeed what happened.

Slide 5. **Unemployment**

But the recession has left its mark. This graphs shows how unemployment rose significantly and persists at high levels. It went up to 16 percent. Now it's 13 percent. **Reducing unemployment is a top priority and probably Turkey's most important challenge over the medium term.**

Slide 6. **Strengths and Challenges**

<u>What are these challenges</u> and difficulties and, to stay with Winston Churchill, **what are the corresponding opportunities and the strengths that Turkey can draw on to turn the challenges into opportunities**?

Some of Turkey's long-term strengths are:

1. **… its entrepreneurship**. Survey after survey finds that Turkish entrepreneurs are dynamic, well-educated, and globally competitive.
2. **… its location**! Turkey is strategically important, and it is well situated to serve the major markets of the EU as well as the Middle East.
3. **… its large domestic market**. This is especially important now, because in the short term export markets may be slow to recover.

The key challenges are:

1. Higher unemployment, lower families incomes, some increase in poverty, greater social needs—and a greater need for government policies to respond.
2. This will happen with **lower growth rates**, because **global growth will remain slow for some time**, and because global deleveraging will mean that **there will be less foreign capital** for investment in Turkey, as elsewhere.
3. **And Turkey's public debt has risen** from – in approximate terms – about 40 percent of national income to about 50 percent. Servicing that debt – and bringing it back down – means fewer resources for other things.

Slide 7. **Three Horizons**

Let's look, in turn, at the short term (1 to 2 years), the medium term (3 to 5 years, or even a bit longer), and the long term, 10 years and more.

Slide 8. **Risk Premia**

Today and for the near term emerging markets are once more in a race to differentiate themselves from one another. Financial markets are less liquid and are more discerning.

This graph shows the difference between the JP Morgan's Emerging Market Bond Index – the EMBI plus – and Turkey's own spread over US Treasury Bonds.

By this measure, Turkey is doing quite well so far. The line is now below the axis, so Turkey is seen as less risky and more attractive than the average**. There is a risk that this may change—but also an opportunity to do even better**.

Slide 9. **Primary Surplus**

How *can* Turkey do even better? The short answer to that question is hitting the targets Turkey has set for itself, especially the fiscal targets. — This graph shows how Turkey's primary public sector surplus fell steeply during the recession, and how the government's medium-term plan aims to re-establish balance.

This rebalancing is Turkey's opportunity. As the primary public sector surplus rises again, public debt will stabilize and eventually fall again, and over time this will help make room for *private sector* borrowing. And this rebalancing is important ***now***—both as a policy signal, and financially while interest rates remain low, indeed, so that interest rates can remain low.

Slide 10. **Doing Business**

In the medium term, the challenge is to sustain robust growth—with improved competitiveness, and with jobs! This chart shows how ***The World Bank's Doing Business Indicators*** have ranked Turkey since 2006. Turkey's investment climate improved in relative terms in 2008 but since then it has slipped back, from a rank of 57 (out of about 180 countries) to 73.

This is a challenge! It is also a huge opportunity. A major market like Turkey will benefit enormously if it can get itself, say, into the top 20 or 30 places in the world to do business. And this is not impossible. There are clear steps Turkey can take: increasing labor markets flexibility, the new Commercial Code currently before Parliament, improved capital market regulation, to name just three.

Slide 11. **Youth Unemployment**

An improved business environment is critical for jobs. And increasing the scope and the flexibility for firms to create jobs, especially jobs for young people and for women, will be particularly important.

This graph shows what you all know—that unemployment among young people is much higher than in the general workforce. **It must become easier and more advantageous for firms to hire youth …**

Slide 12. **Inequality of Opportunity**

… **and young people deserve the opportunity to acquire the skills the labor market needs**—through more and better education, including vocational training.

This slide shows just how important education is in the medium to long run.

- In recent work in the Bank here in Turkey, we looked at the causes of inequalities in opportunity among people in Turkey.
- **We found that parents' education determines half of children's opportunities in life**. So more and better education of young people today will help *them*. But in addition it will help their children and future generations of Turkish people have more opportunities and better jobs.

Slide 13. **Preschool Enrolment**

Turkey *is* working to improve its education system. And Turkey is now also working to improve *early* childhood education—where the challenge *and* the opportunity are the greatest.

Indeed, the challenge *and* the opportunity Turkey faces is major by international standards.

- This graph shows Turkey well below the line in the enrolment of 5-year olds in a pre-school or early childhood development program, compared with many other countries, relative to countries' per capita income.
- Turkey is now working hard to move up, in the direction of the arrow. This is an important objective—and we in the Bank enthusiastically support it!

Slide 14. **Climate Change Exposure**

Finally, in the long run, the whole world faces the climate change challenge. So does Turkey! This slides illustrates quite how much of a challenge this.

- The graph shows an index of "exposure" to climate change, in other words the extent of likely adverse impacts.
- Turkey is one of the most affected countries in the Europe and Central Asia region, and one of the most important effects will be on water scarcity.

But climate change is also an opportunity for Turkey. The country is already a producer of energy using renewable sources such as wind and geothermal power. In tomorrow's lower carbon economy these comparative advantages will be at a higher premium than they are today.

Slide 15. **JFK**

Our World Bank office in Ankara is near a street named after *this* man, President John F. Kennedy. I would like to leave you with his call for action:

"There are risks and costs to a program of action. But they are far less than the long-range risks and costs of comfortable inaction."

Slide 16. **Teşekkürler.** Thank you very much.