

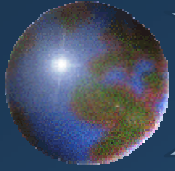
A faint, light blue world map is visible in the background of the top section of the slide, showing the outlines of continents and a grid of latitude and longitude lines.

# *Global Financial Crisis and The Turkish Economy*

*Kamil Yılmaz  
Director,*

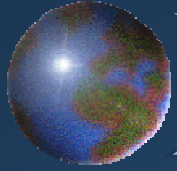
*TÜSİAD-Koç University Economic Research Forum*

*Conference on the Turkish Economy  
Paris, 14 November 2008*



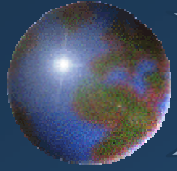
## *Heading towards a Global Recession ...*

- The U.S. and the Euro Area may have already entered into a long recessionary period
- Recession in EMs and LDCS still not certain yet, but a likely outcome in 2009



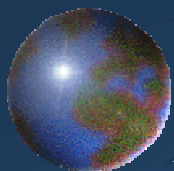
## *The Turkish Economy ...*

- Since 2001 Turkish economy experienced a dramatic recovery
- Thanks to institutional and macro reforms (e.g., banking reforms, adopting a flexible exchange rate, sticking to fiscal adjustment)
- A very pragmatic government that has stuck to EU membership goal and the IMF program
- A very benign international environment for emerging markets (the availability of large sums of international capital flows)
- However, the supply-side (micro) structural reforms did not follow through,
- The growth rate started to decline since 2006

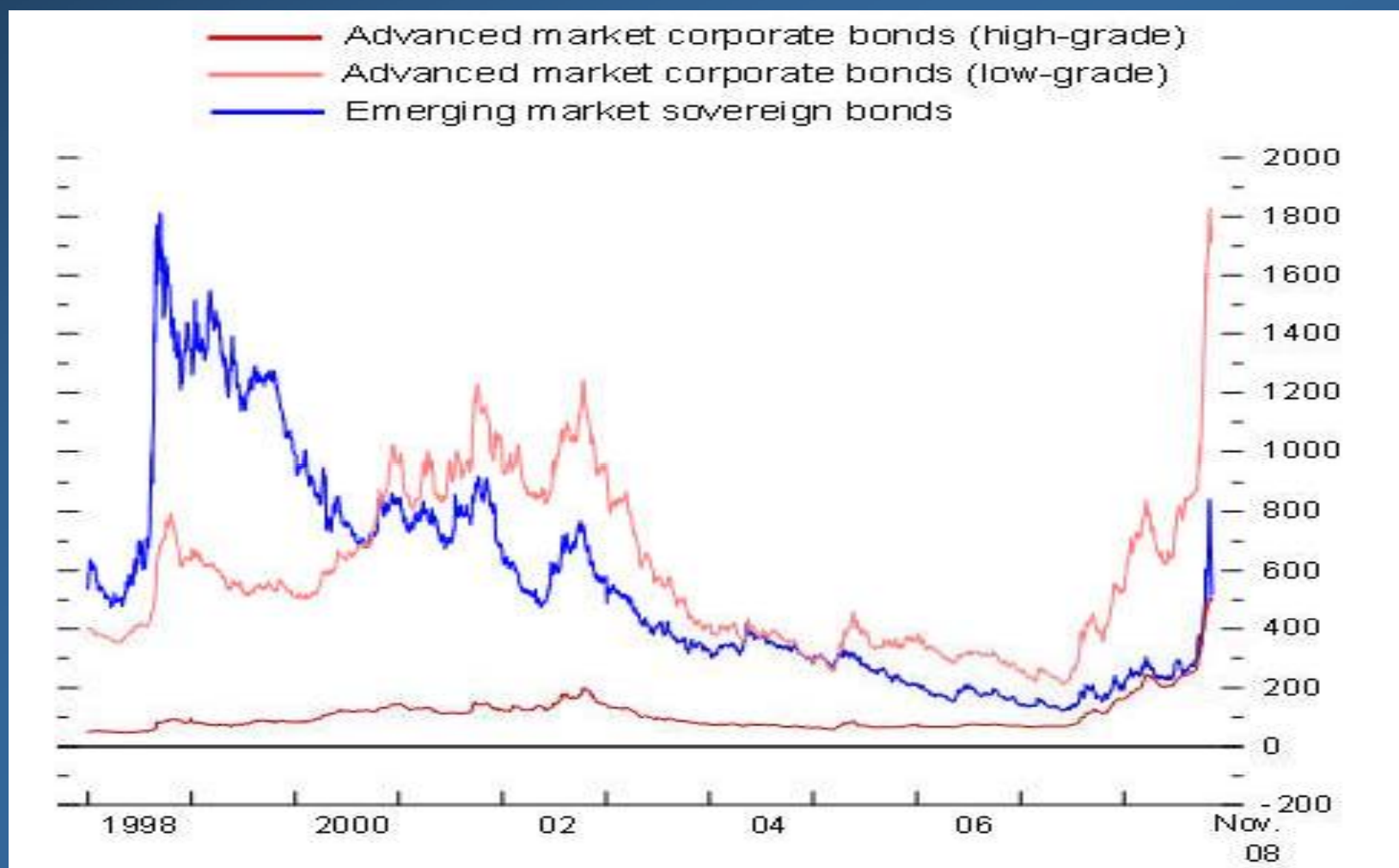


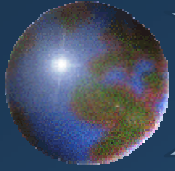
## *Crisis and the Turkish Economy ...*

- The fiscal budget is under control and public debt is within Maastricht criteria limits
- The large and chronic Current Account deficit is the most important problem
- Balance sheets of the commercial banks are in good shape,
- But the real sector debt can cause some trouble if the worst of the crisis is yet to happen
- The crisis and the ensuing recession in Europe will have its effect on Turkish economy through both the Trade and the Finance channels.
- Depreciation of the Lira will not be a cure for the CA deficit, given that the European demand is contracting simultaneously.

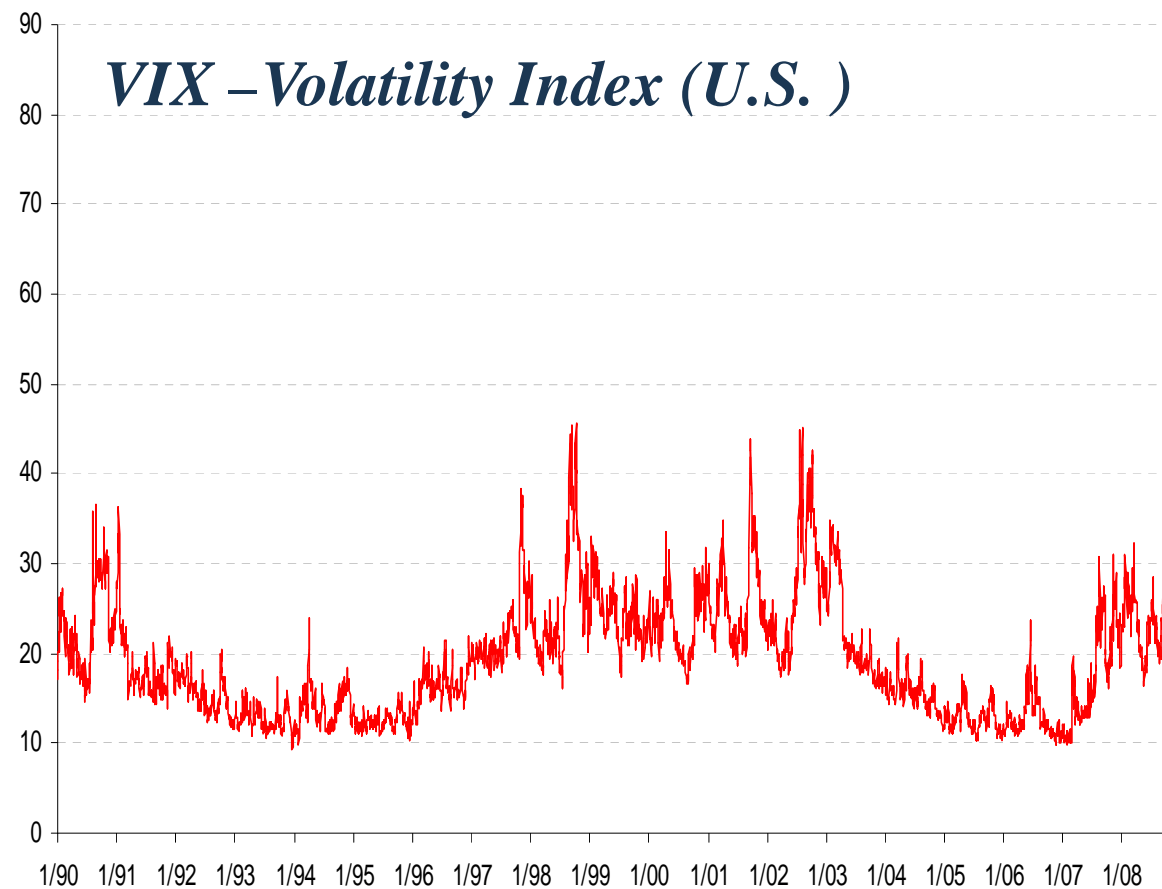


## *Sovereign and Corporate Debt Spread (1998-2008)*

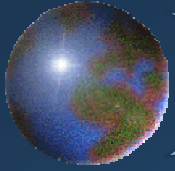




## *Volatility in the US Stock markets increased substantially*



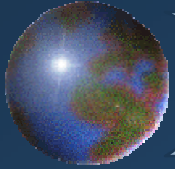
- In a matter of 15 months the sub-prime crisis originated in the U.S. turns into a Global Financial Crisis
- Volatility spills over across international financial markets



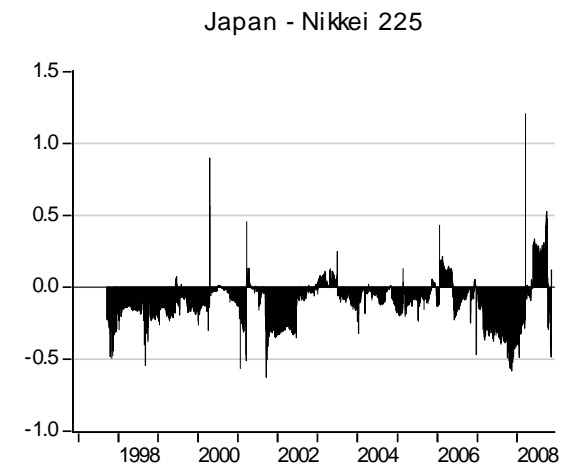
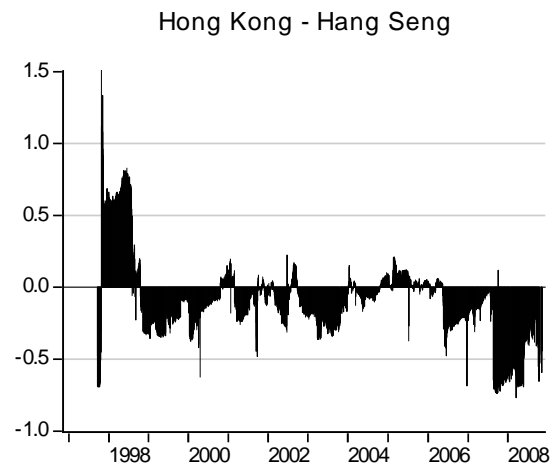
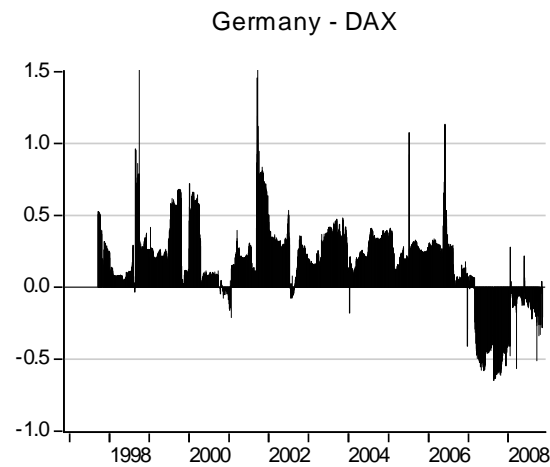
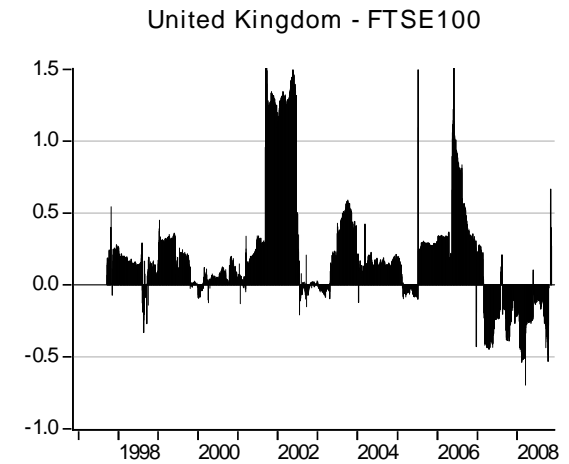
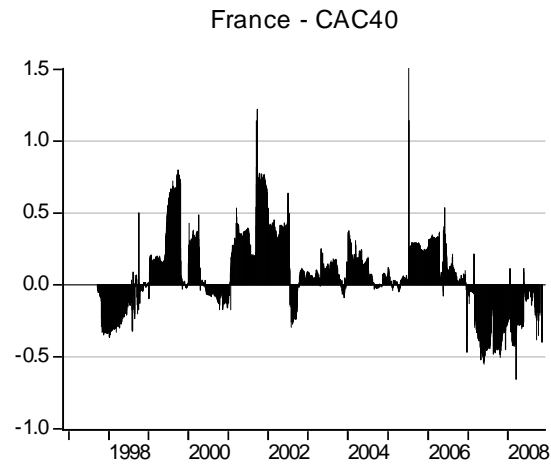
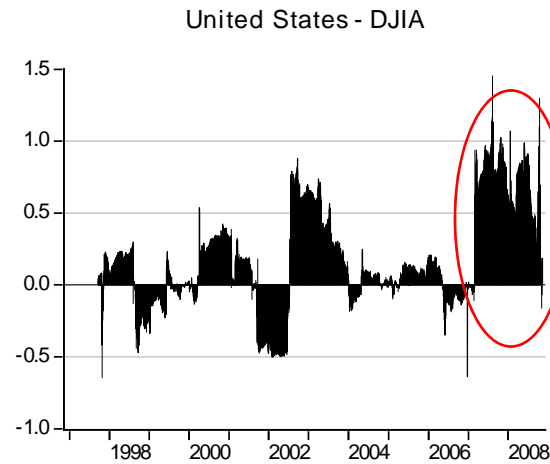
## *High Volatility in the US led to high volatility in other major stock markets*



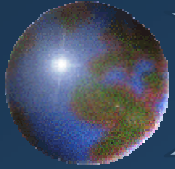
- Not only had the volatility increased in individual markets,
- but the volatility spillovers across markets reached to unprecedented levels.
- Since February 2007 volatility spillovers mostly originated in the US stock markets.



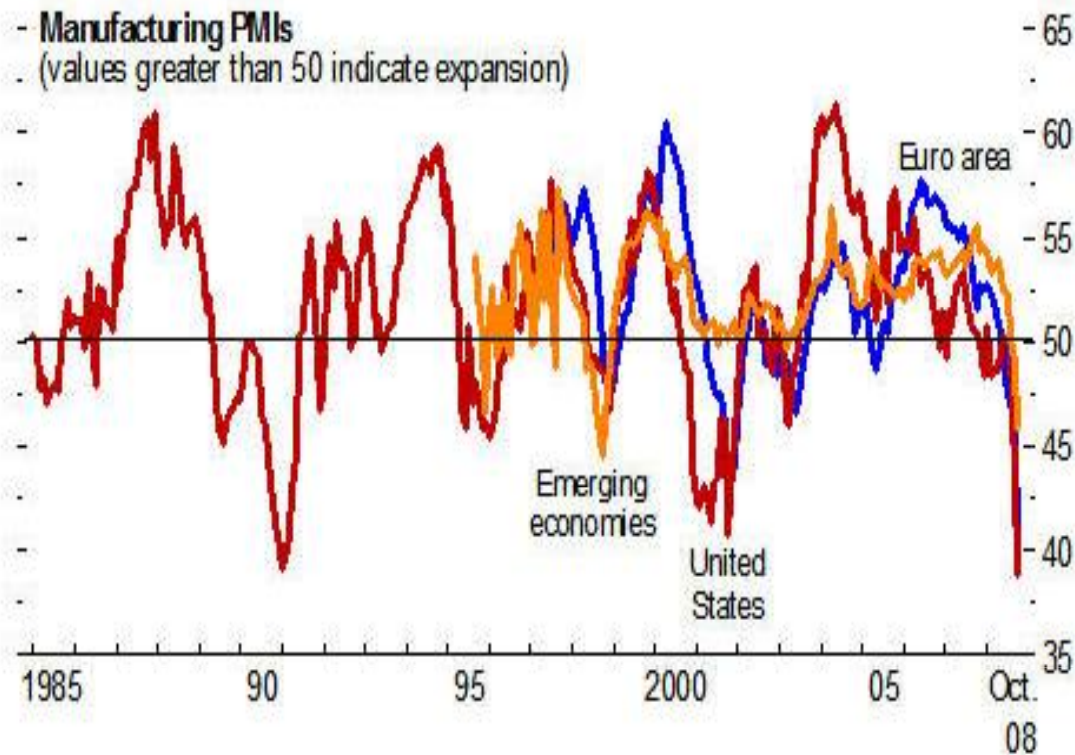
# *Direction of Volatility Spillovers*





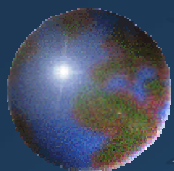


# *Business Confidence Indicators*

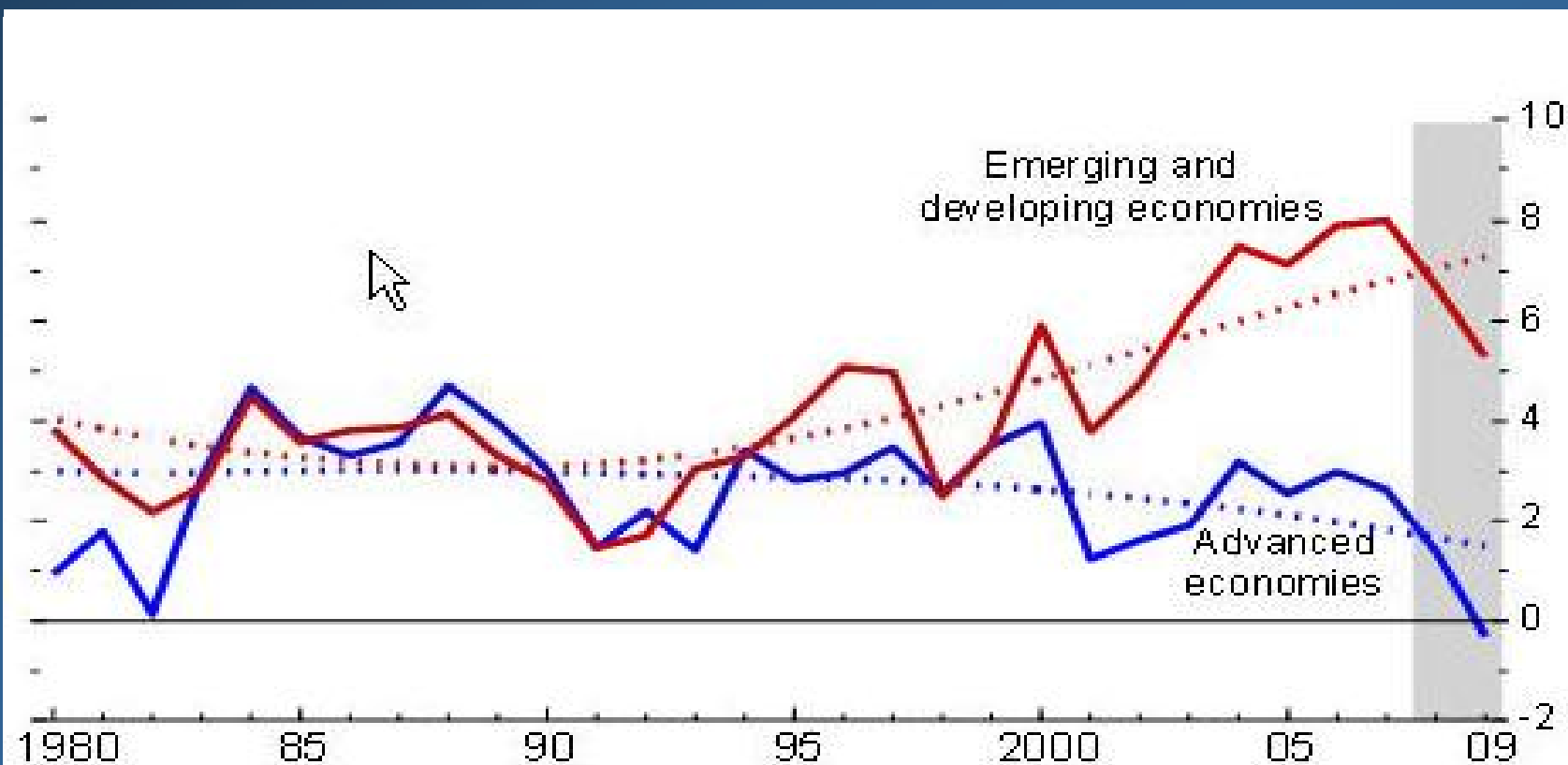


Sources: Haver Analytics; and IMF staff estimates.

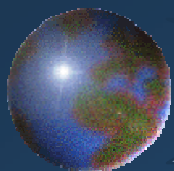
- Global financial crisis is expected to have its heavy toll on real output.
- PMIs for the U.S, Euro Area and EMs have sharply moved below 50
- Indicating that the US and the Euro area economies are already in recession



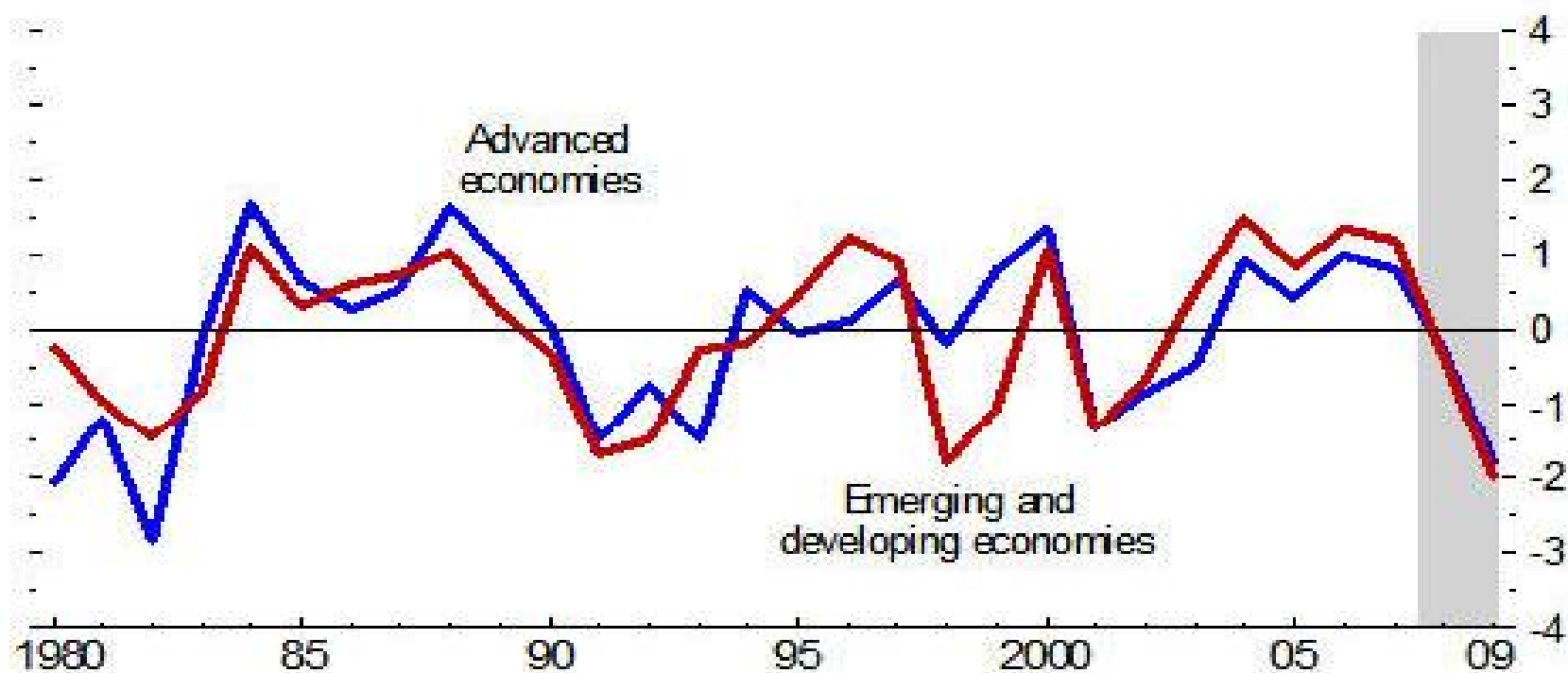
## *Real GDP Growth Rate and Trend*



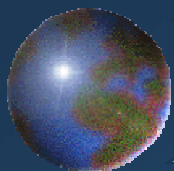
Source: IMF staff estimates.



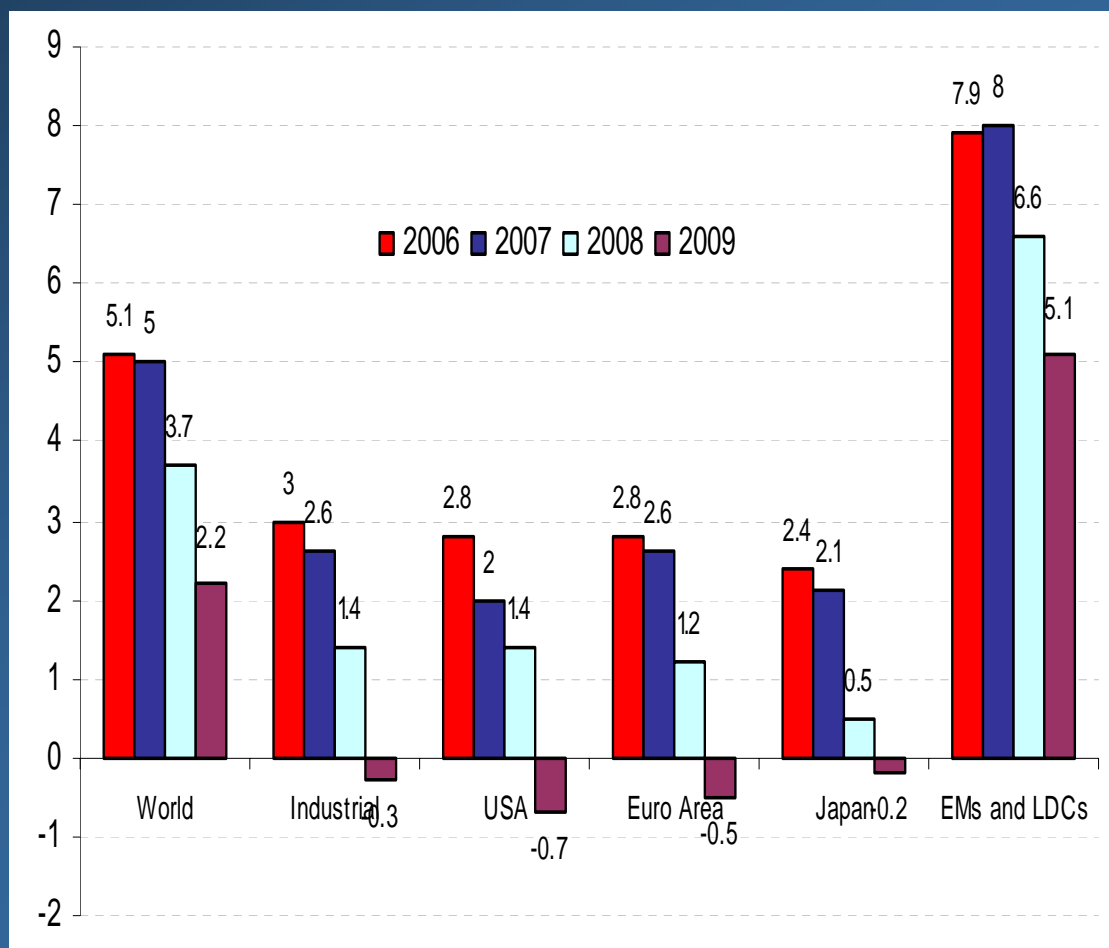
## *Real GDP Growth - Deviation from Trend*



Source: IMF staff estimates.

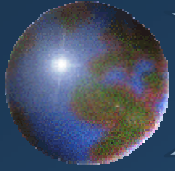


## IMF Growth Forecasts

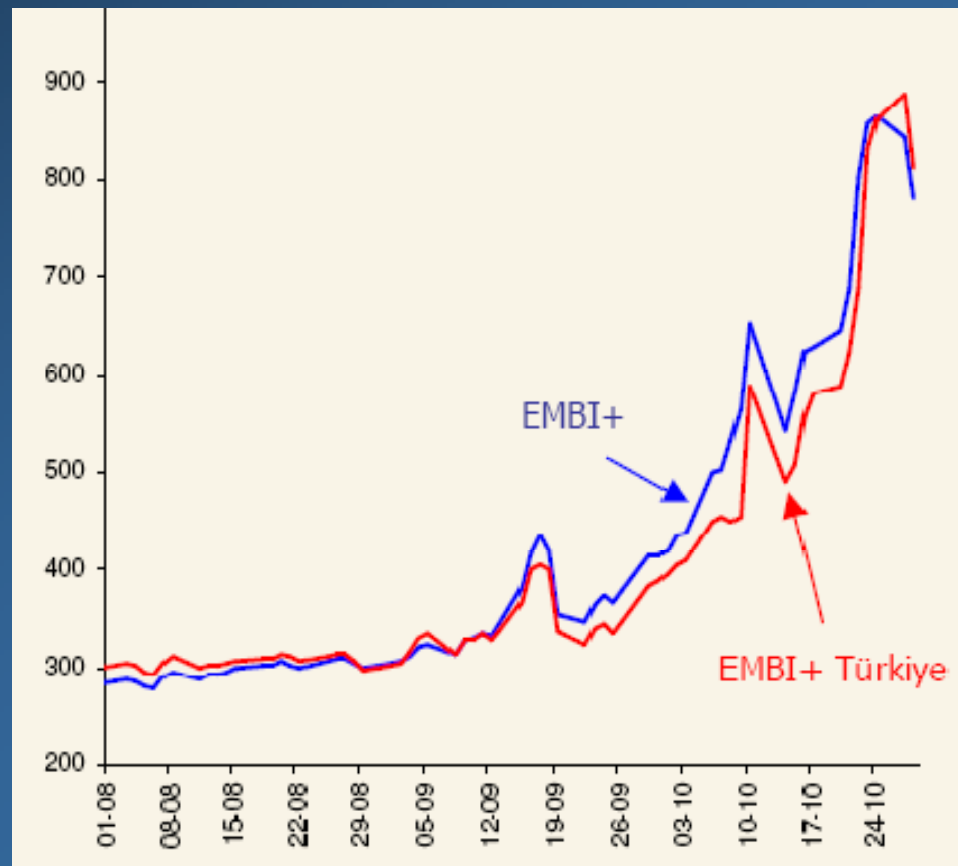


Source: IMF

- IMF lowered its forecasts throughout the year
- Industrial countries will be in recession in 2009 if not in 2008
- Growth in EMs and LDCs decline significantly
- According to IMF, the likelihood of the world economy experiencing a recession in 2009 has increased substantially recently

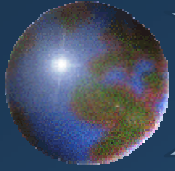


## *The Impact on Turkish Economy*

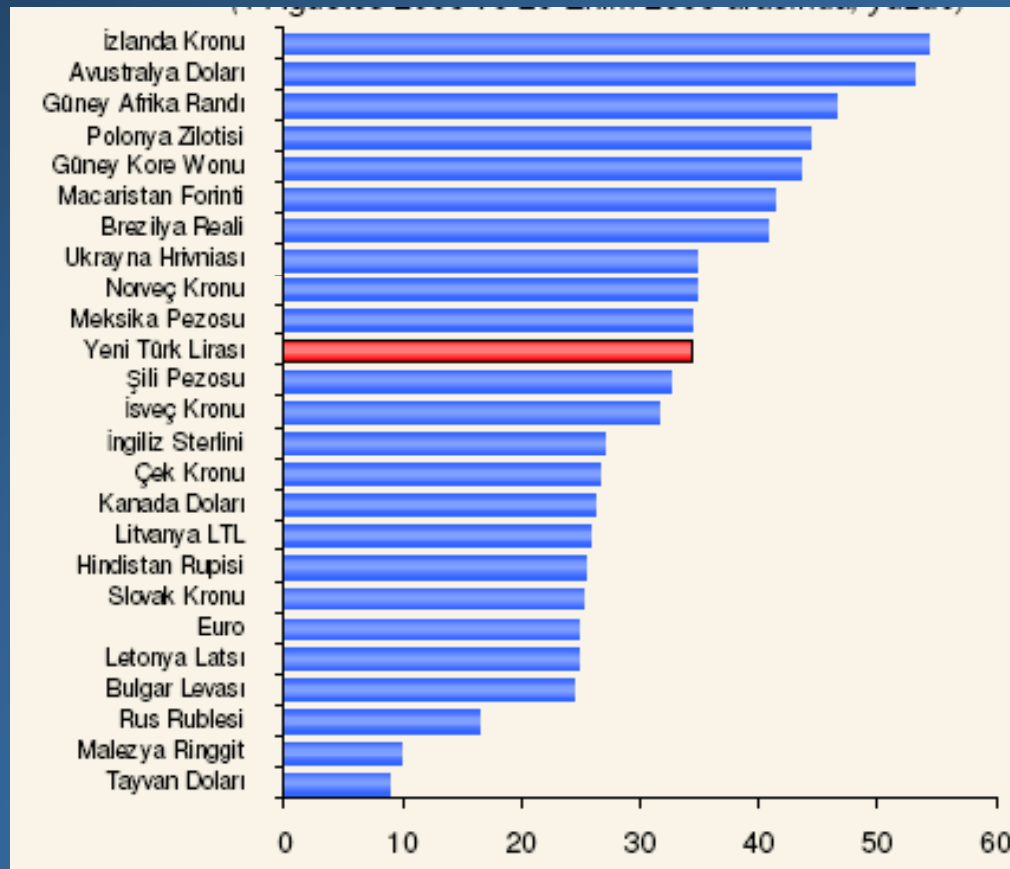


Source: CBRT

- The global crisis has its impact on Turkish financial markets recently
- However, Turkey does not fare any worse than many emerging and industrial countries so far.
- As EMBI+ and EMBI+ Türkiye indices clearly show

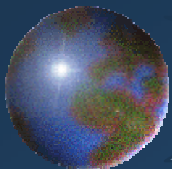


## *Depreciation of Currencies (Aug 1 – Oct 29)*



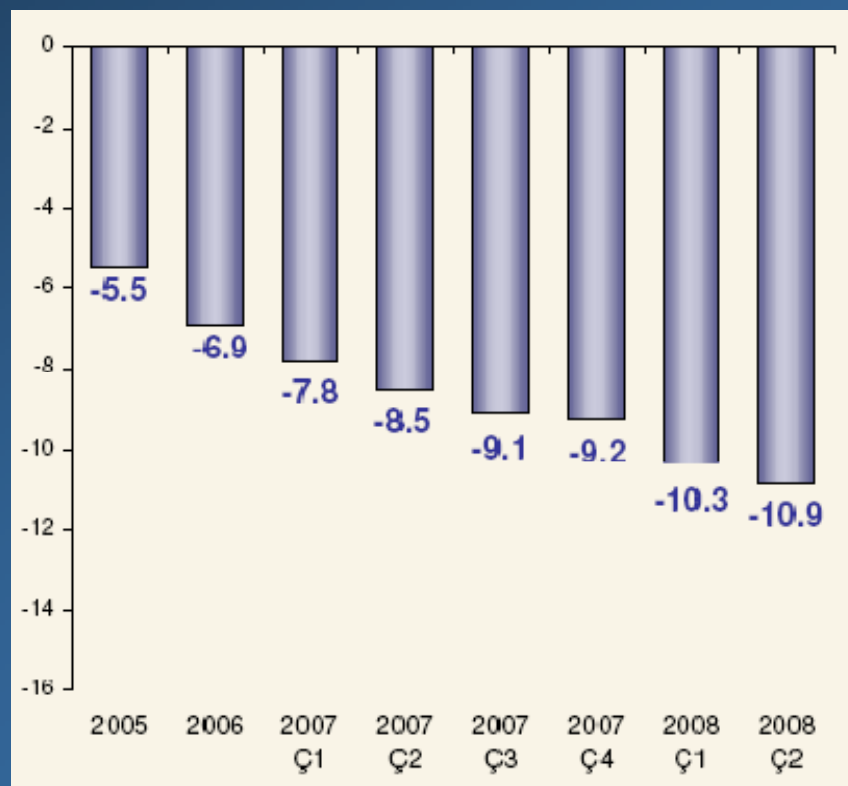
■ With a depreciation of 34% (between Aug 1, and the end of October) YTL is ranked 11th among a group of 25 countries

Source: CBRT

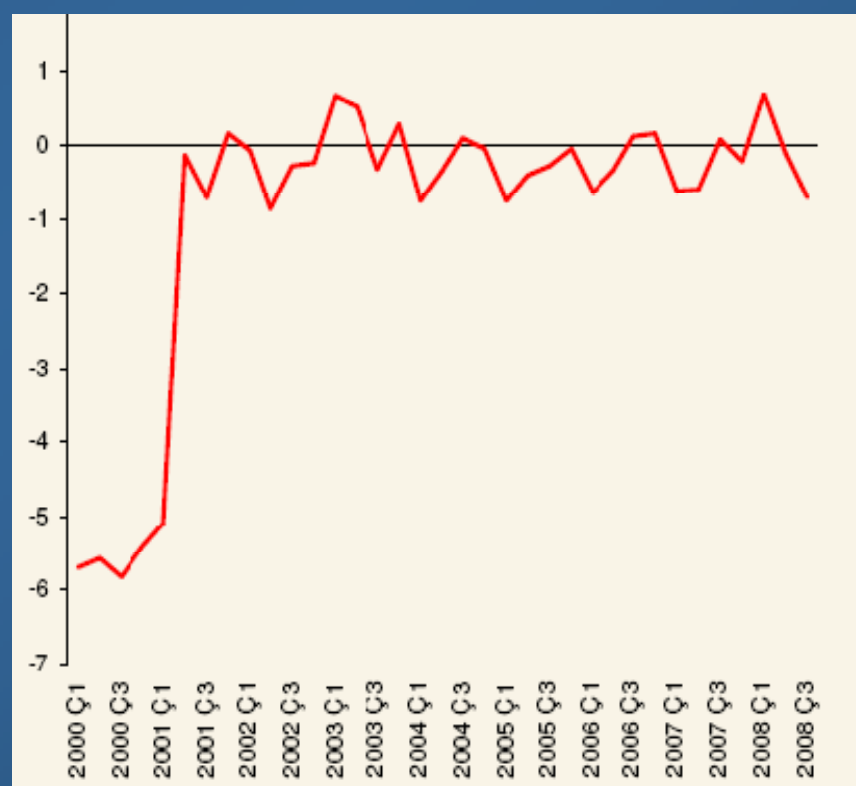


## *FX Open Position – Private Sector*

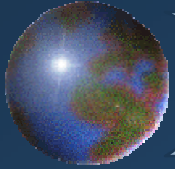
Real Sector (percent of GDP)



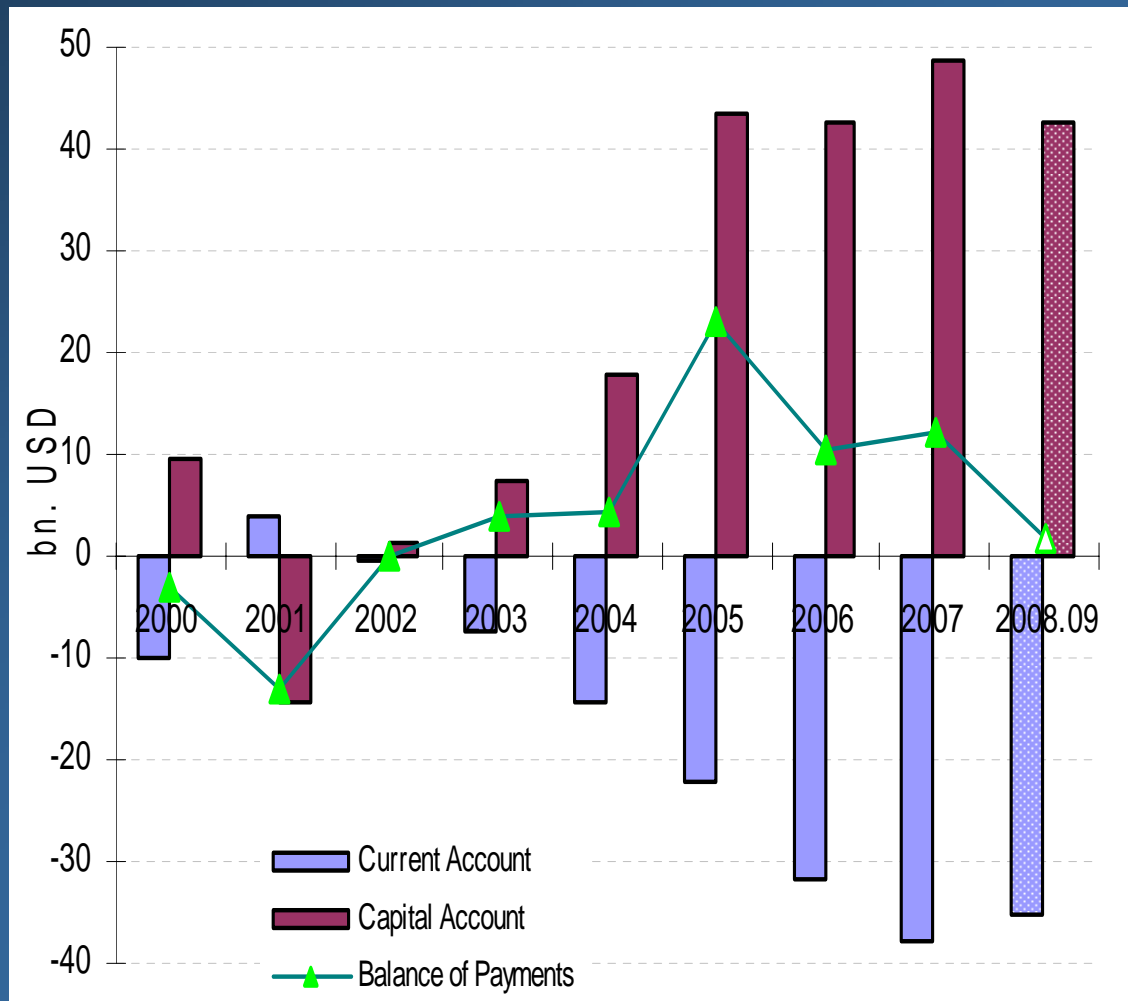
Banks (bn USD)



Source: CBRT

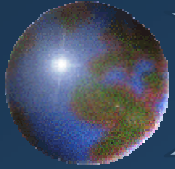


## *Balance of Payments*

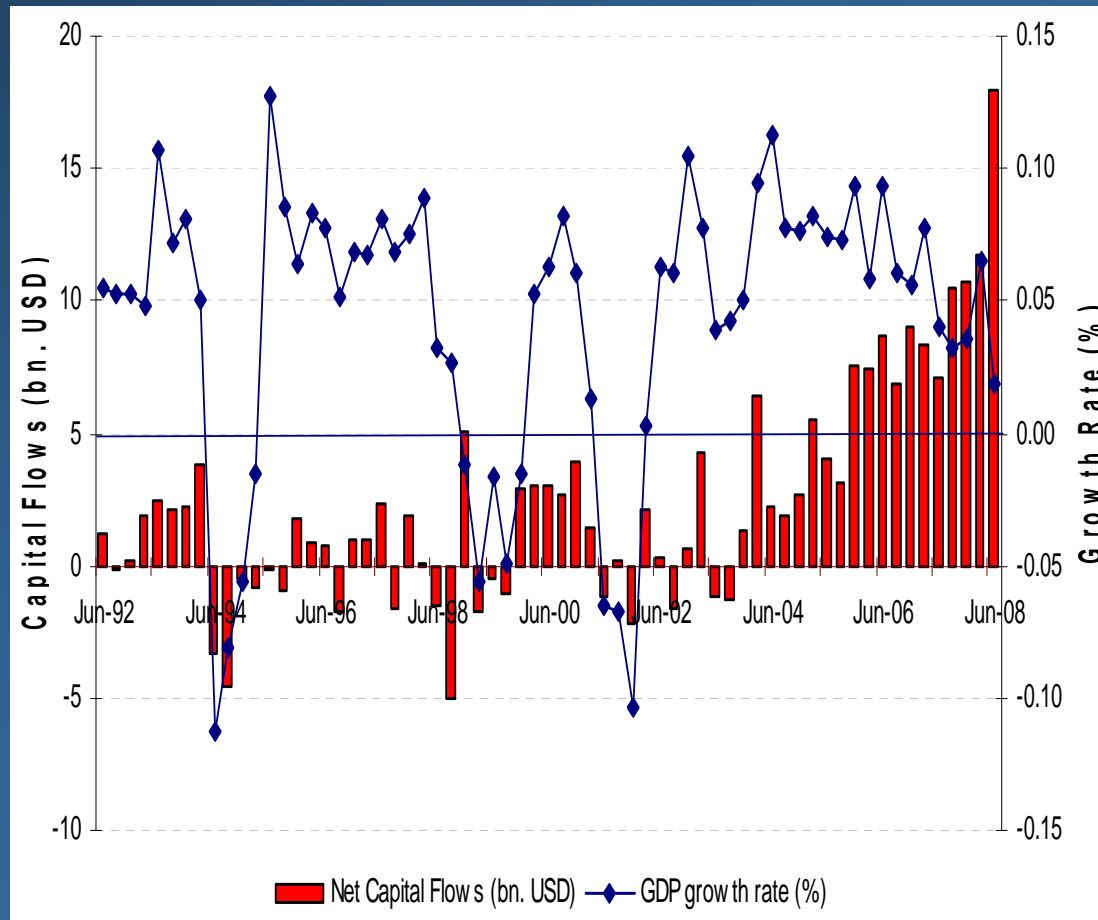


- 2000-2007: Capital account surplus in excess of current account deficits led to more than \$10 bn surplus in Balance of Payments
- That is why YTL appreciated significantly over the last four years
- Jan-Sep 2008 figures show the decline in balance of payments surplus to less than \$2 bnç

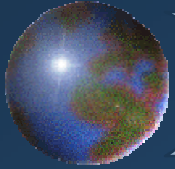




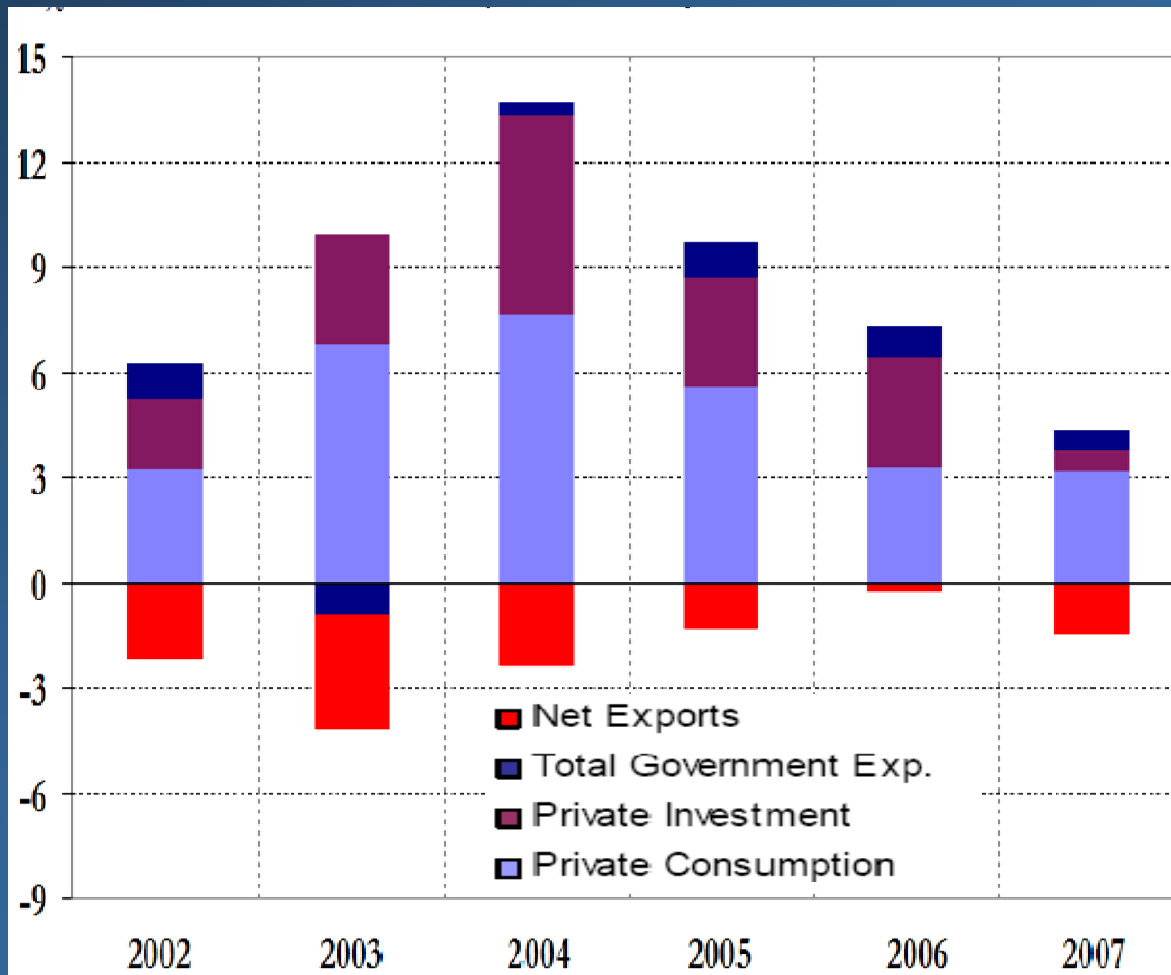
## *Turkey - Capital Flows and Growth*



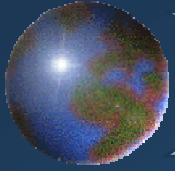
- Growth in Turkey is very much financed by external funds
- Which is provided through net capital flows
- As capital inflows are expected to decline sharply Turkey will feel the punch



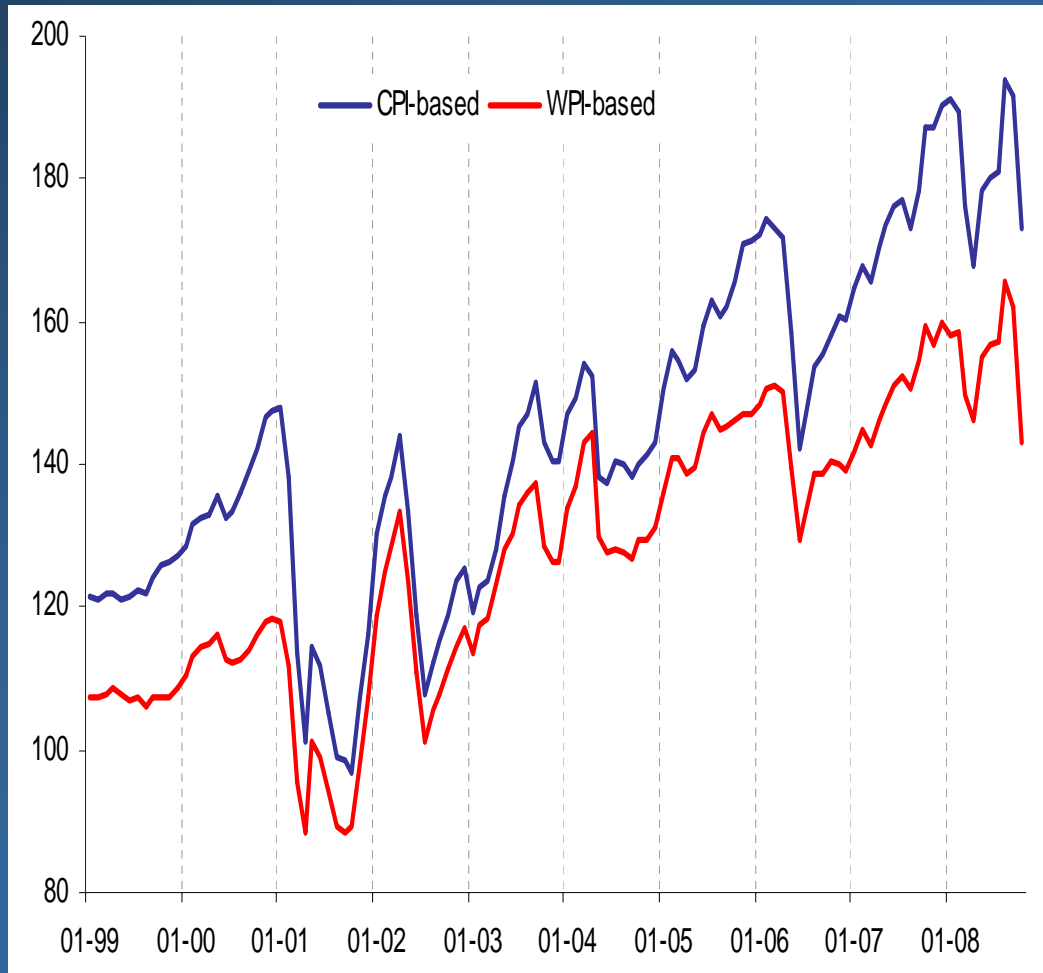
## *Drivers of Growth on the Demand Side*



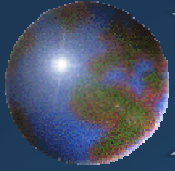
- Growth is driven by the domestic demand
- Private Consumption contributes the bulk of the growth, followed by the private investment
- The contribution of Net Exports always negative
- In Summary:
- Turkey grows with external funds not with external demand



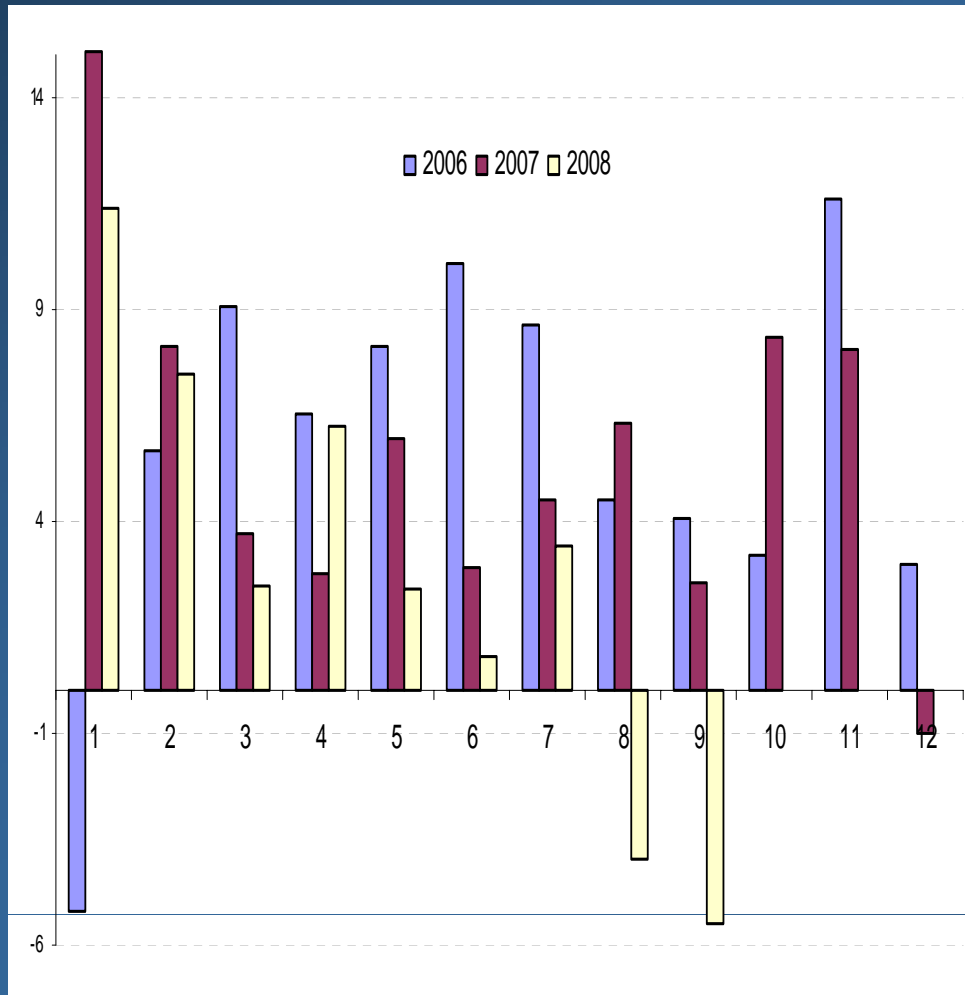
## *Net Capital Inflows contributed to the real appreciation of the Lira since 2002*



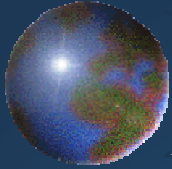
- So far, correction in the real exchange rate in September-October is not larger than the one in June-July 2006.
- More depreciation should be expected in the coming months as the global crisis deepens
- That is why the government should not waste any more time to sign a stand-by agreement with the IMF



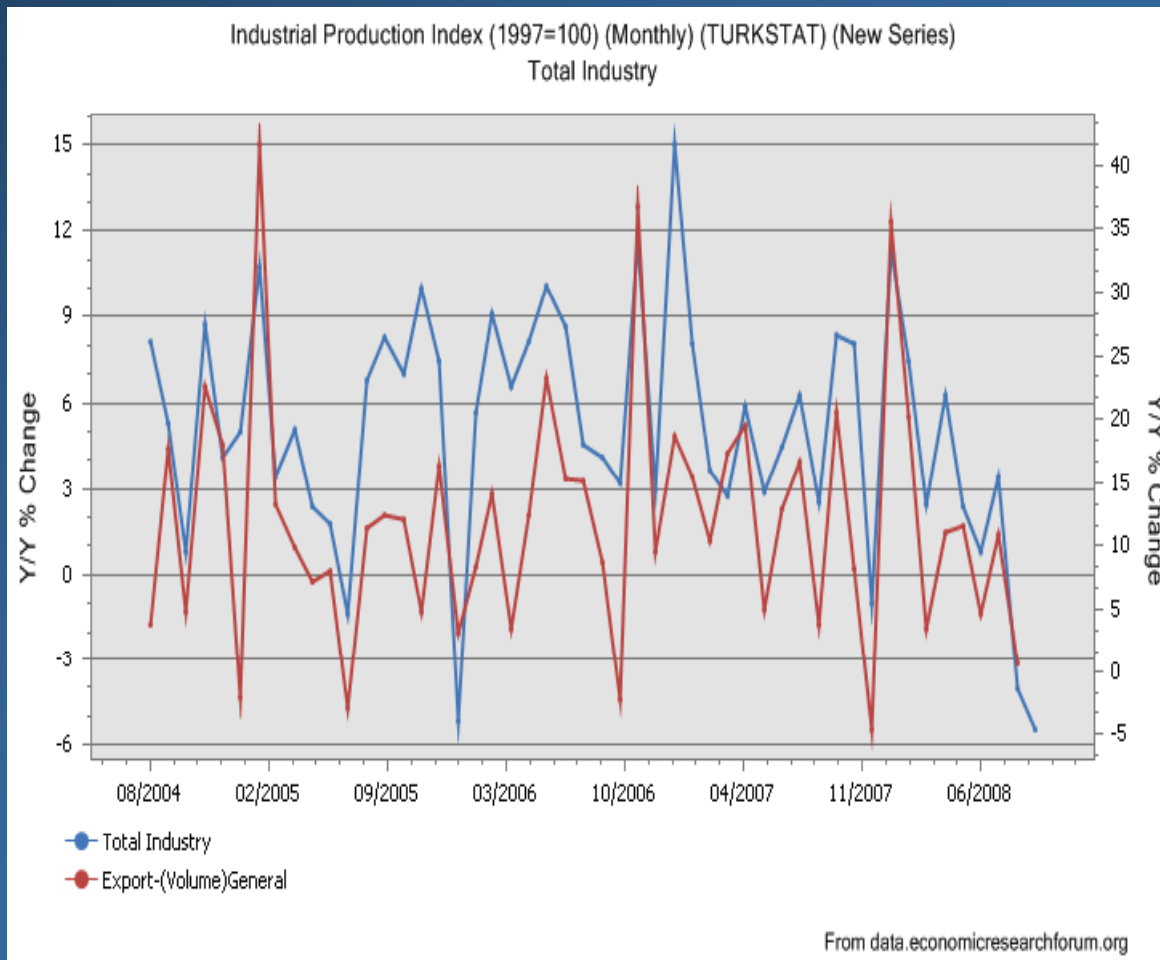
# *Industrial Production*



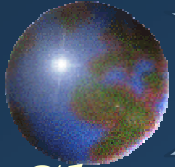
- Recent industrial production figures depict a bleak picture
- Continued decline in industrial production in the last three months of the year can move the annual growth rate for the industrial sector below 2%



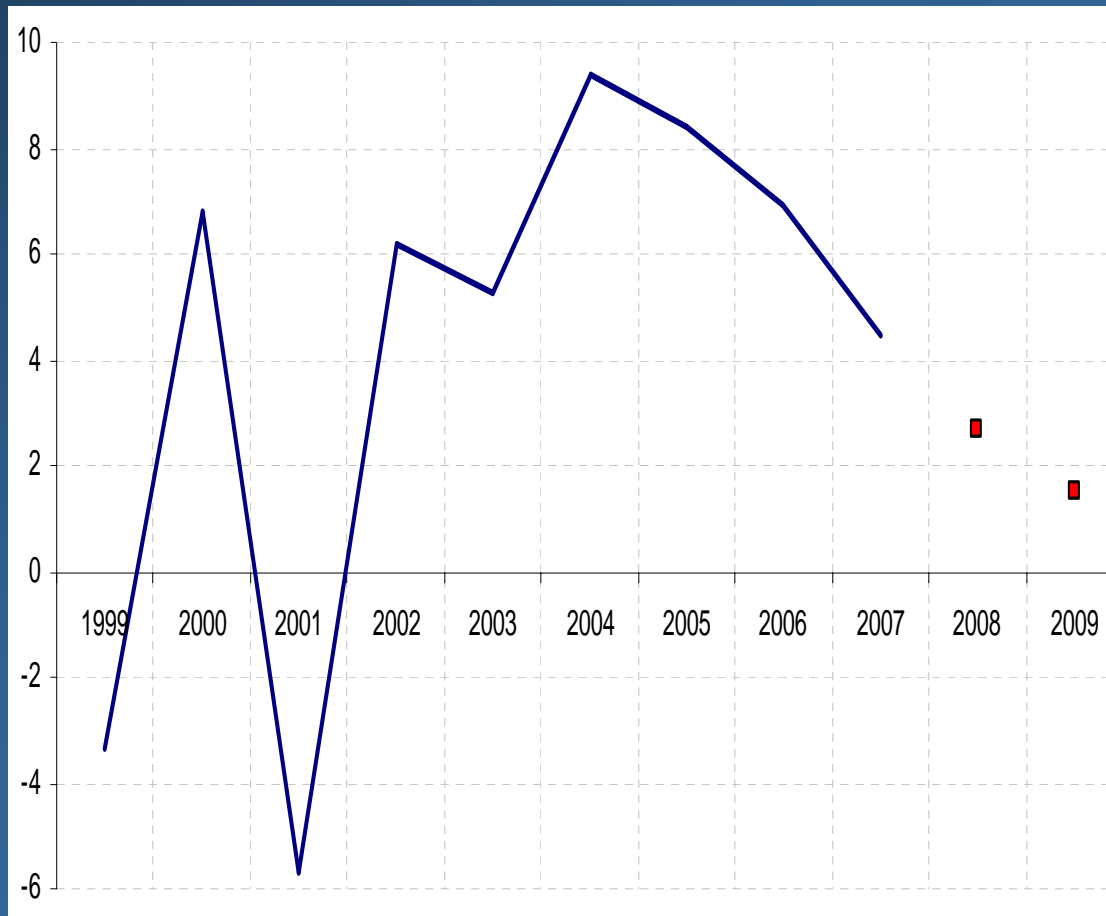
## *Industrial Production and Exports (YoY % change)*



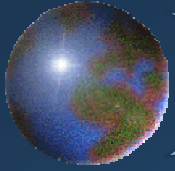
- Decline in August and September closely linked with the decline in manufacturing exports (Automotive, Basic Metals, Textiles, Consumer Electronics)
- There is a close association between exports and the industrial production.



## *Slowdown in growth has already started in 2006 ..*

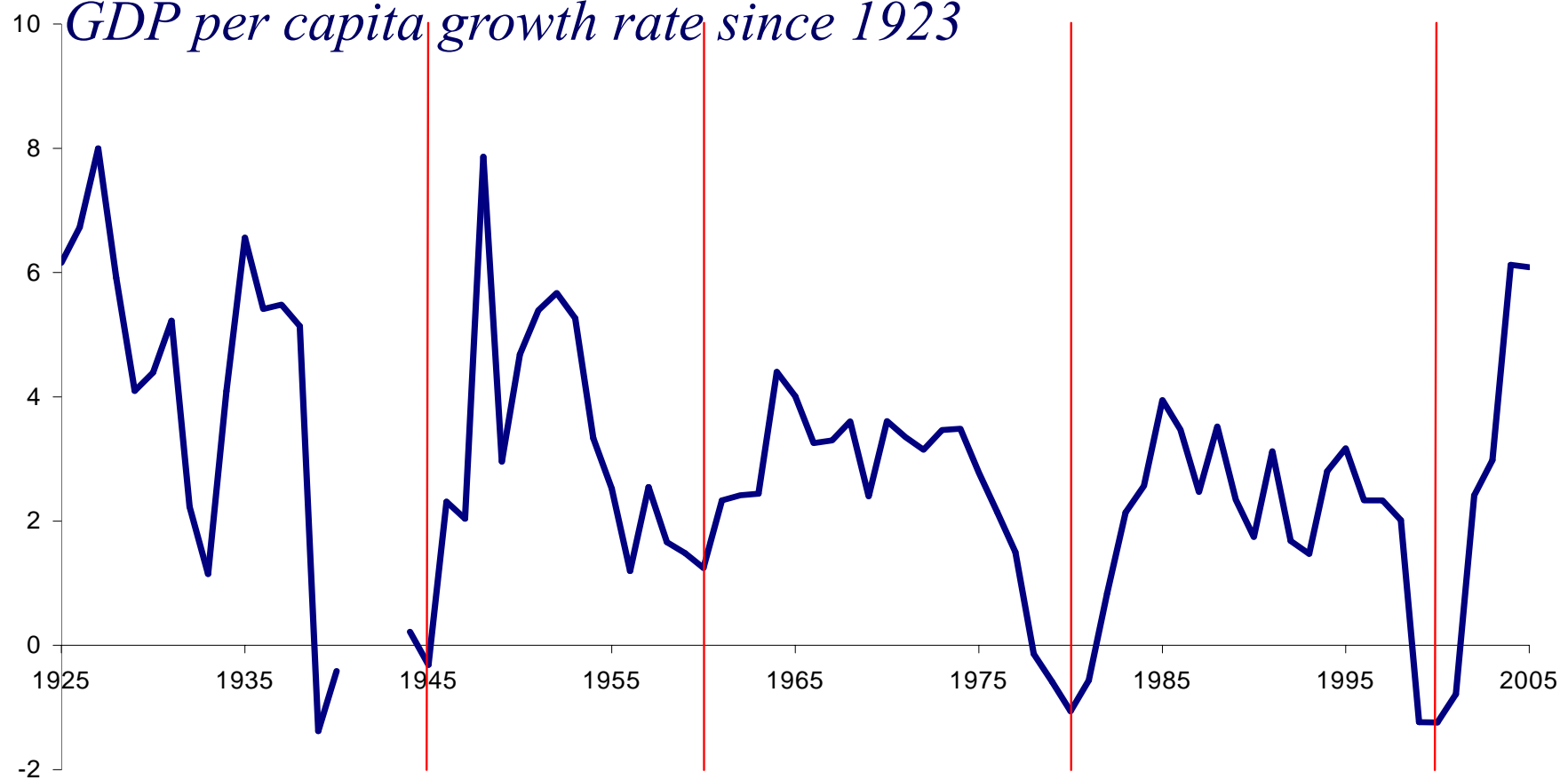


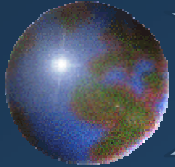
- An impressive growth record between 2002-2006
- However, a downward trend becomes more and more visible since 2005
- Recession in Europe has already started hurting Turkey
- Growth in 2008 below 3%, and 2009 below 2 %, can go down further.



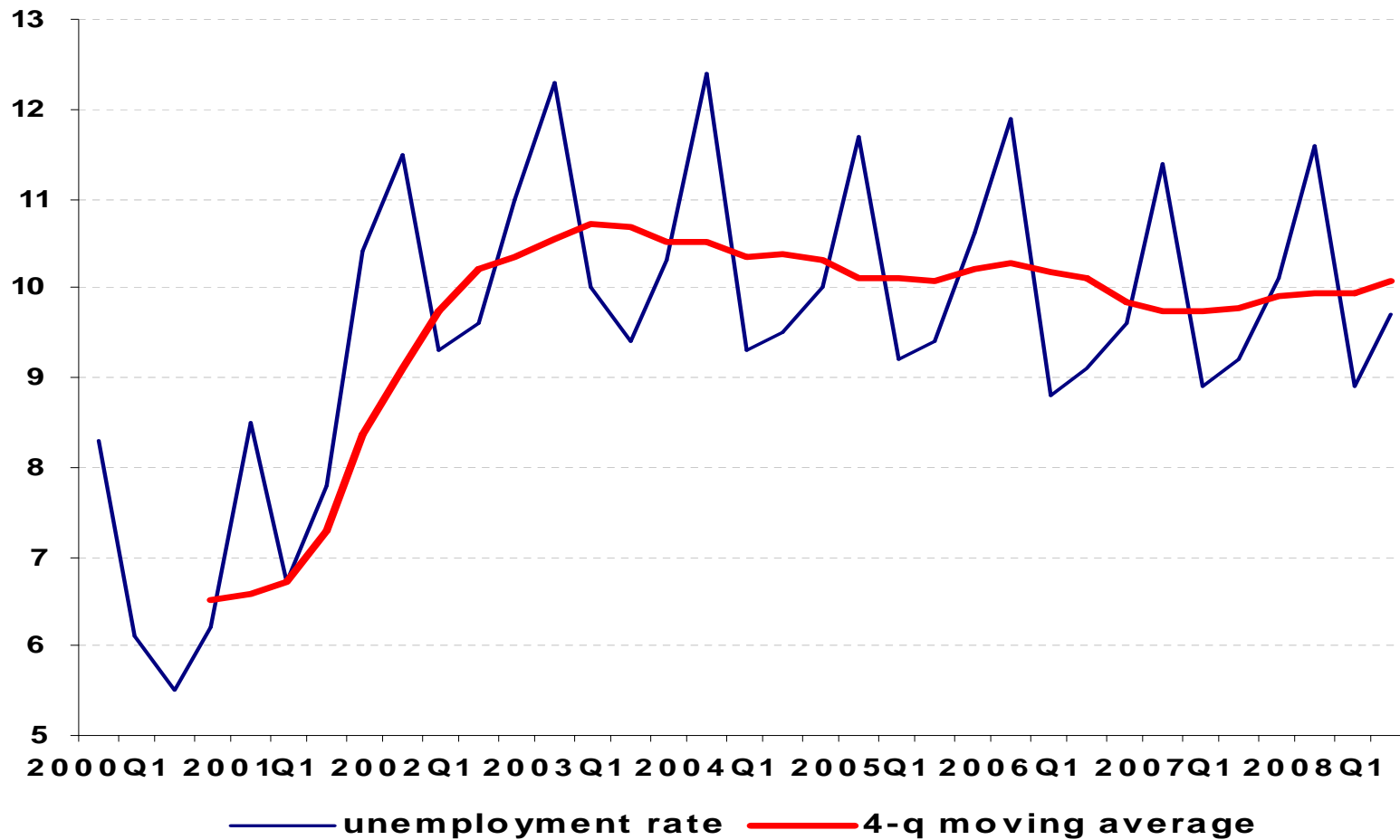
## *From A Long-run Perspective Turkey is not successful in sustaining high growth rates*

*GDP per capita growth rate since 1923*

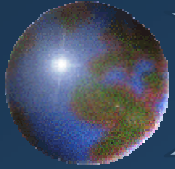




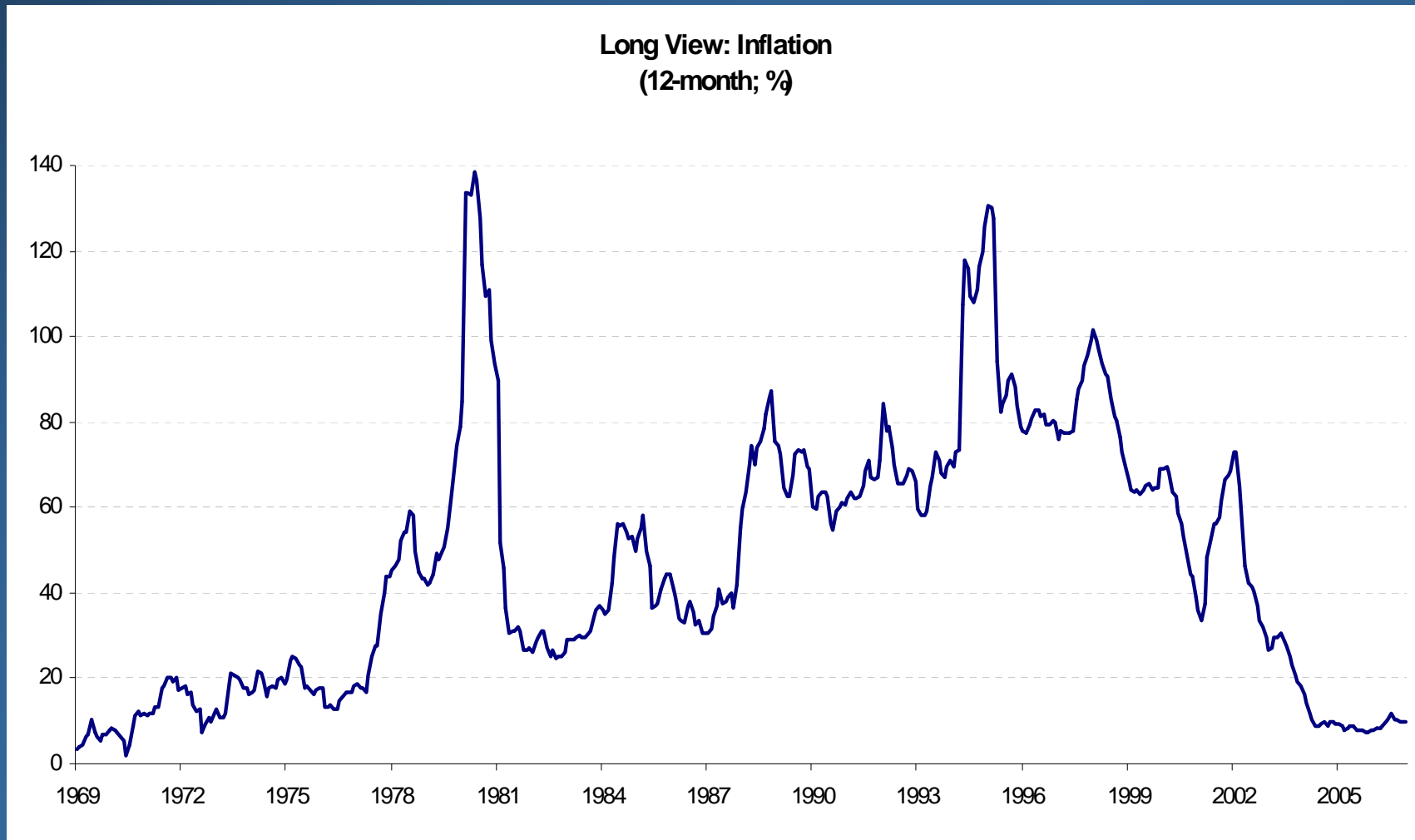
*Unemployment is still high...and likely to increase further..*

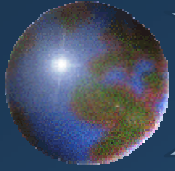




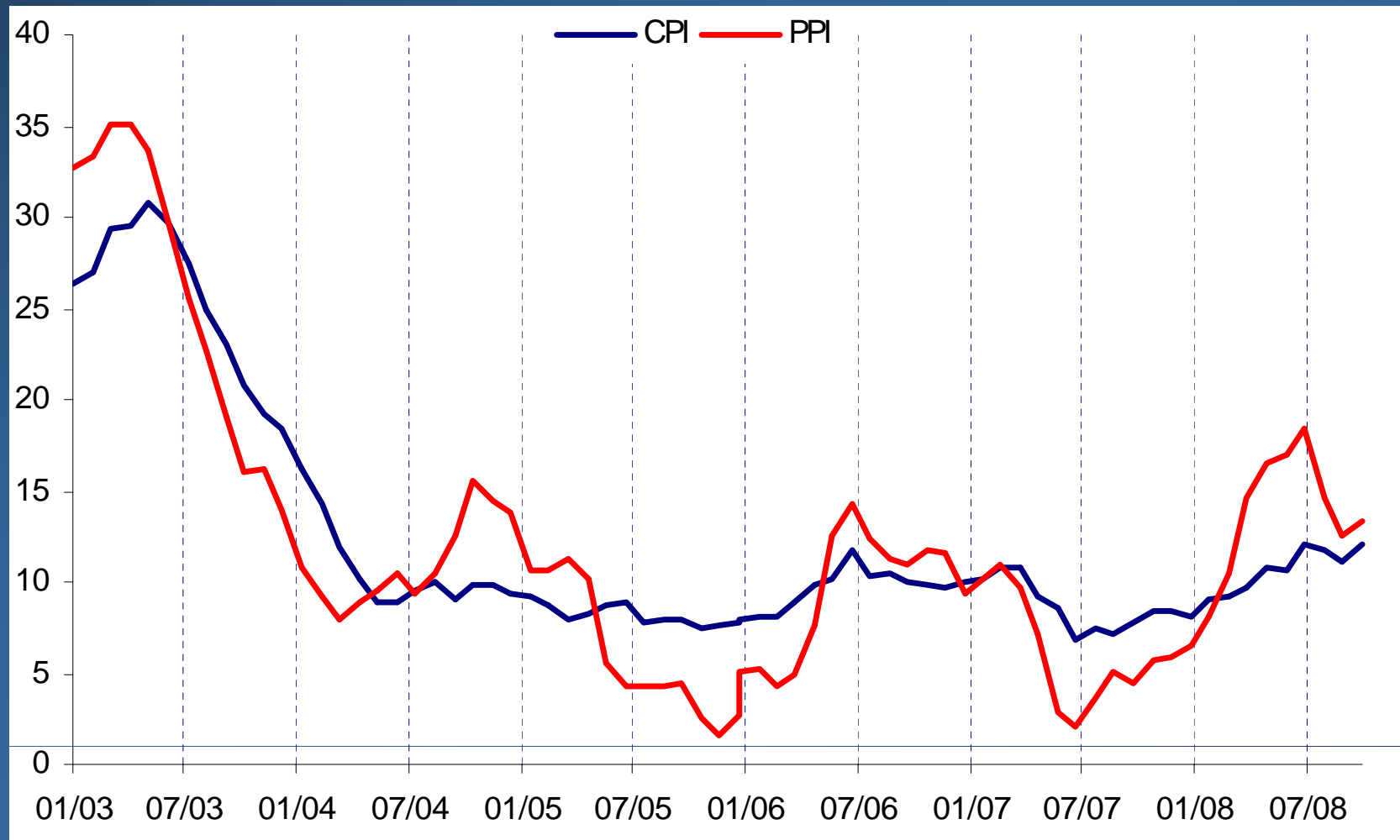


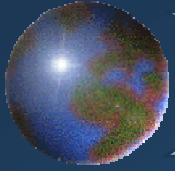
# *Conquest of inflation*



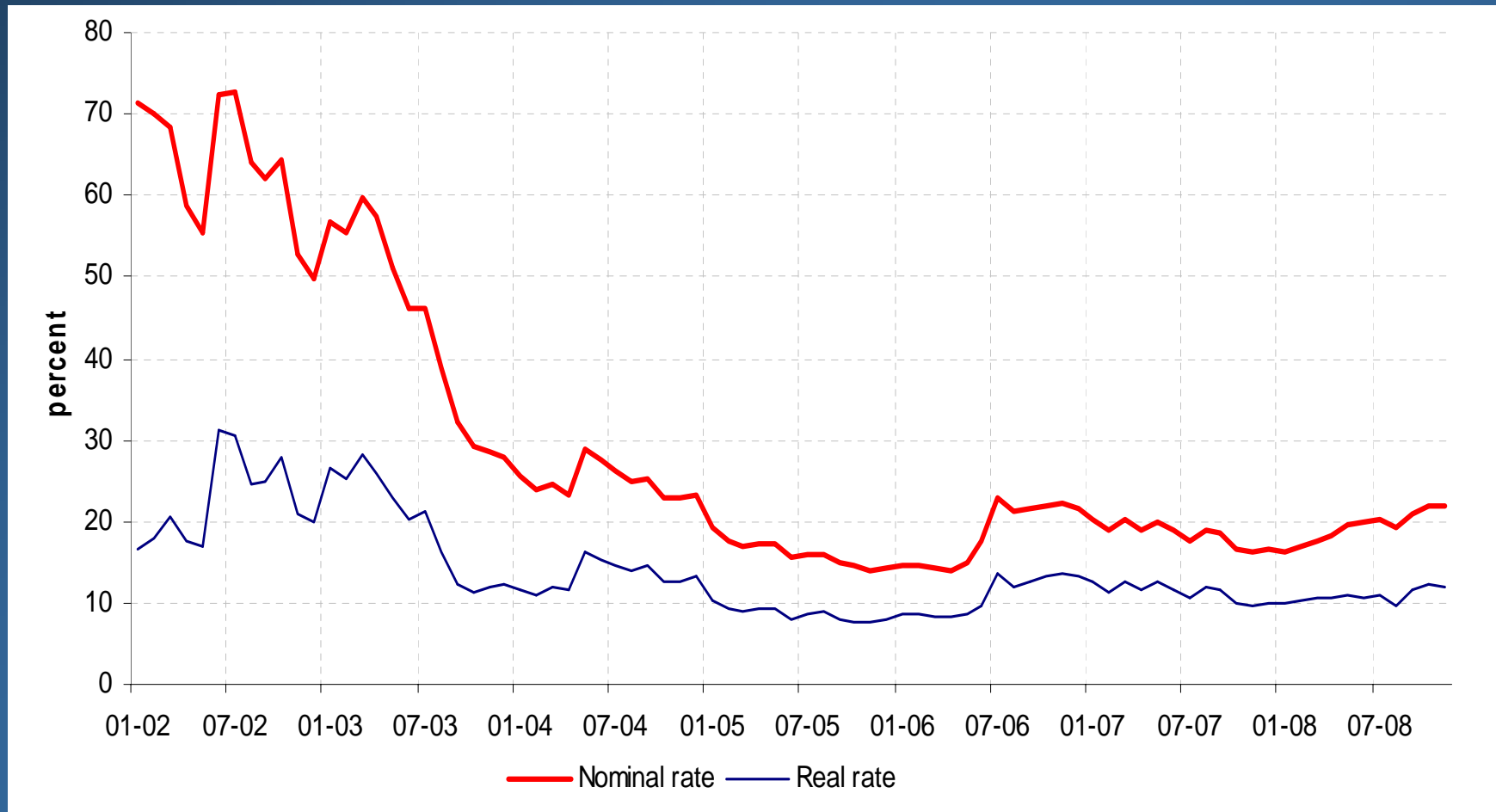


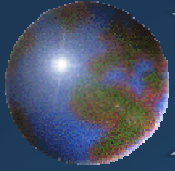
## *Conquest of inflation (...sort of)*





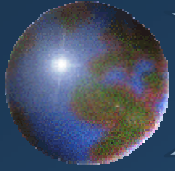
## *After the Sharp decline comes a level-up*



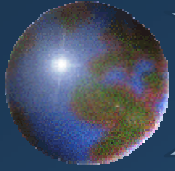


## *Vulnerability and the Challenge ...*

- Turkish economy is vulnerable to the current global financial crisis,
  - With a large current account deficit.
  - And a relatively high external debt of the real sector
- With the global recession,
  - Growth will definitely decline further
  - Inflation seems to stuck above 10%
  - Unemployment and the resulting social consequences will be the most important problem to tackle in 2009



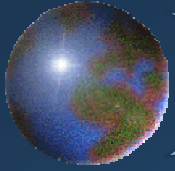
*Thank You*



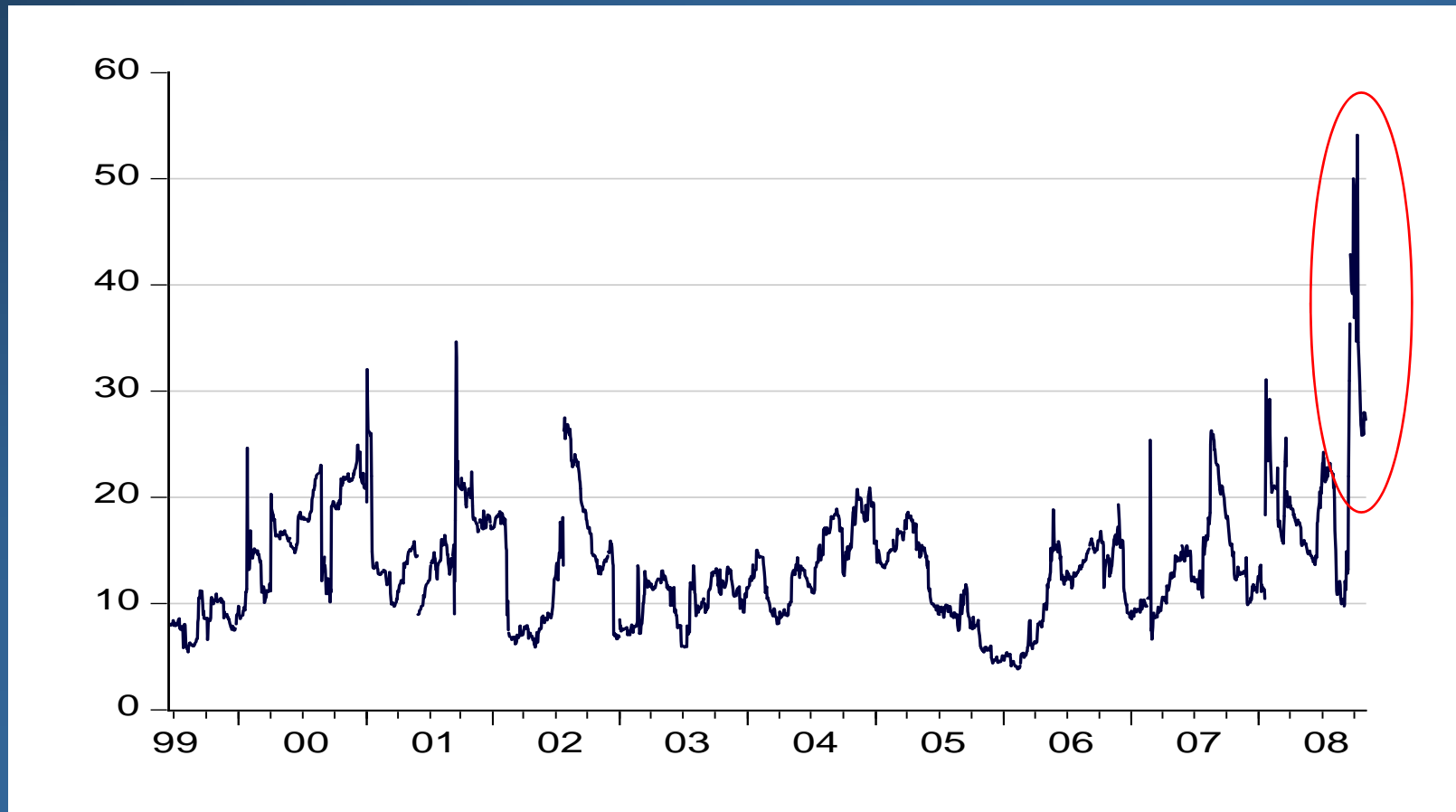
## *TED Spread*



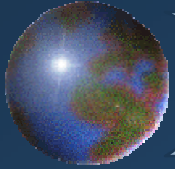
- 2001 February: A dramatic collapse of the program, because of a confluence of factors: Fragile design, adverse shocks, unstable politics, etc.
- 2001-2002: Post-crisis recovery efforts and coming of AKP government
  - A big IMF bail-out package, importing Mr. Dervis from Washington D.C.



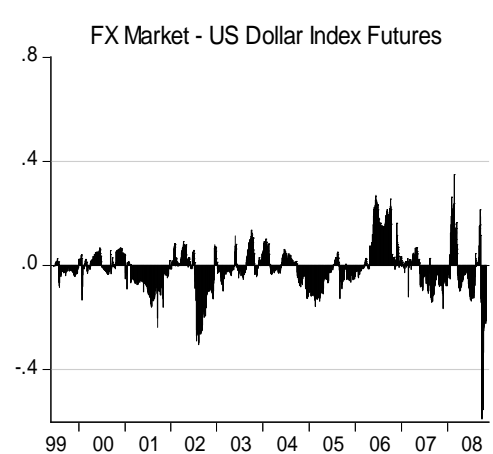
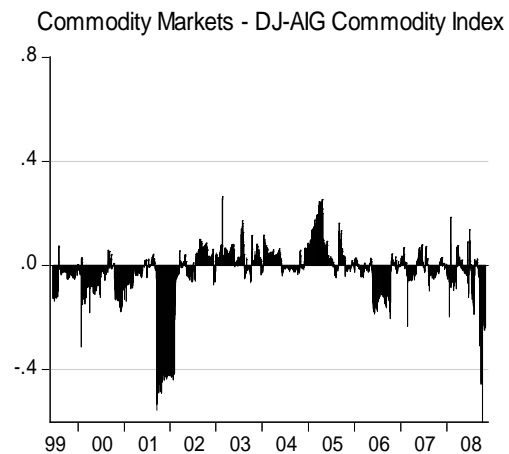
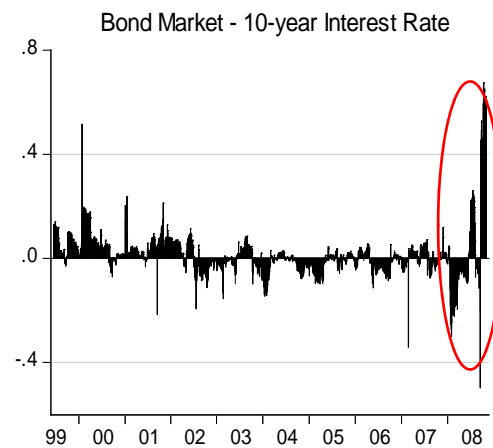
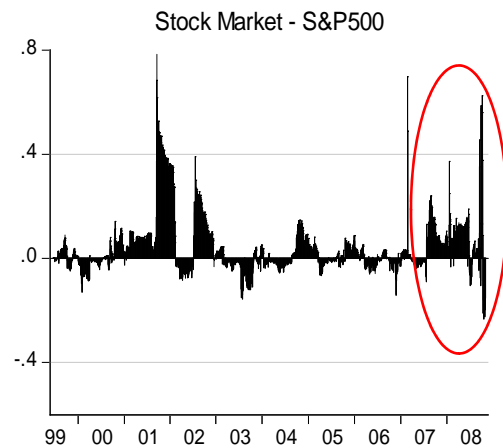
## *Volatility Spillovers Among Four Asset Classes (U.S.)*



Source: Diebold and Yilmaz, 2008



# *Volatility Spillovers Among Major Asset Classes*



- When focused on domestic US asset classes, until recently the volatility spread from the stock market to the others
- Since the collapse of the Lehman Brothers, however, it is the bond/credit markets from which the volatility spreads to others