The Times They Are A-Changin’
Some Observations
on the Global Environment and the Turkish Economy

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Global Source Partners/Koc University
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Global Economy

- Some background
  - Global crisis and its legacy…
  - Current growth environment…
- What are markets, analysts, financial media most busy with?
  - Another “Emerging Market Crisis”? Probably not, but…
  - Chinese slowdown: Hard or soft?
  - Fed “liftoff”: Timing and the pace…
  - Euro Zone and Greece: Contained, but not quite over…
Healing from a devastating crisis...

- The global crisis of 2008-09 was the defining economic event of our times... Why did it happen?
- In a world of ‘global savings glut’ + ‘great moderation’ + easy monetary policy + poor regulation and poor incentives, advanced economies have taken on too much debt...
- The crisis is not over... Thanks to massive monetary and (some) fiscal stimulus the worst was avoided, but the recovery/healing is rather slow because of, among other factors, the legacies of the crisis (e.g., high debt, high unemployment)...
- Growth is weak, with frequent downward revisions (e.g., IMF)...
- Advanced country recovery is proceeding slowly – the U.S. economy is looking better than most, but it has yet to regain full strength – while emerging markets are slowing very sharply...
Legacy: High public sector debt...

General government gross debt (as % of GDP)
Advanced, 2014
Legacy: ...and high debt, all over

Since the Great Recession, global debt has increased by $57 trillion, outpacing world GDP growth.

Global stock of debt outstanding, $ trillion, constant 2013 exchange rates

<table>
<thead>
<tr>
<th></th>
<th>Q4 2000</th>
<th>Q4 2007¹</th>
<th>Q2 2014²</th>
<th>Total</th>
<th>Compound annual growth rate, %</th>
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<td></td>
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<td>2000–07</td>
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<tr>
<td>Household</td>
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<tr>
<td>Total</td>
<td>87</td>
<td>142</td>
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<td>199</td>
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246% 269% 286% Total debt as a share of GDP

¹ Figures do not sum to total, because of rounding.
² Q2 2014 data for advanced economies and China; Q4 2013 data for other developing countries.

http://www.mckinsey.com/insights/economic_studies/debt_and_not_much_deleveraging
Legacy: High unemployment...

Unemployment rate (percent of total labor force)
Advanced, 2014

[Bar chart showing unemployment rates for various countries, with Greece having the highest rate.]
Legacy: Huge balance sheets...
Legacy: ...and Zero Lower Bounds...
Growth moderated, so did ‘convergence'...
EM convergence, in perspective…

GDP based on PPP share of world total: 1990
- United States: 31.9%
- Japan: 22.5%
- European Union: 8.9%
- China: 4.1%
- Other Advanced Economies: 5.3%
- Other Emerging market and developing economies: 27.2%

GDP based on PPP share of world total: 2014
- United States: 40.5%
- Japan: 16.3%
- European Union: 5.3%
- China: 16.9%
- Other Advanced Economies: 4.5%
- Other Emerging market and developing economies: 16.5%
Growth environment and forecasts...

### Overview of the WEO Projections

(annual % change)

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<td>3.3</td>
<td>3.4</td>
<td>3.1</td>
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<td>2.2</td>
<td>-0.1</td>
<td>-0.2</td>
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<td>US</td>
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<td>2.4</td>
<td>2.6</td>
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<td>-0.2</td>
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<td>Consumer prices (average)</td>
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<td>5.1</td>
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<td>0.3</td>
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Source: IMF WEO, October 2015
Growth environment and forecasts...

**IMF October 2015 WEO: GDP Growth by Selected Countries and Country Groups**

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<td>Japan</td>
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<td>Emerging and Developing Asia</td>
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<td>India</td>
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<td>6.9</td>
<td>7.3</td>
<td>7.6</td>
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<td>Russia</td>
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<td>South Africa</td>
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<td>5.2</td>
<td>3.3</td>
<td>3.0</td>
<td>3.4</td>
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</table>
Advanced countries are struggling for legacy and structural reasons...

- Some say, West – specifically the U.S. -- cannot grow as fast – like 3% per annum…
- The reasons include:
  - High indebtedness…
  - High inequality…
  - Poor demographics…
  - Poor education…
- Is the West in “secular stagnation”?

Versus…
- The ‘techno-optimists’…
This environment is keeping long-term benchmark rates low…

Selected Advanced Countries -- Bond Rates
EMs are slowing sharply as well...

- Why?
  - Key cyclical reasons…
    - U.S. monetary normalization/strong dollar…
    - Advanced country slow growth…
    - End of the commodity boom…
  - Key secular/longer-term reason…
    - Lack of structural reform, productivity slowdown…
- Is an emerging market crisis around the corner?
  - Different circumstances now, but possible -- China, Brazil need to be watched very closely…
  - Lot of external (dollar) debt in the system, sharp increase in corporate debt…
  - But looking more like a “growth crisis” – so far…
Dollar strength: A pause or the end?

ICE Dollar Index and Eur/Usd Parity

Slide # 16
Growth and policy divergences drove USD...
EMs suffer from dollar strength…

Selected Emerging Markets Exchange Rates (April 2013=100)

Index

2013-04-02 to 2015-10-09

Real (Brazil)
Rupee (India)
Rupiah (Indonesia)
Ruble (Russia)
Rand (South Africa)
TL (Turkey)
...and from the collapsing commodity prices...

IMF Commodity Price Indices (2005=100)
Growth prospects and capital flows are linked in EMs...
From U.S., to EZ, to EMs?

CBOE Volatility Index (VIX)
Turkish Economy

- A perspective on the past decade+
- Recent developments, gathering clouds+
- Quo Vadis Turkish economy?
Last decade+, in a nutshell…

- The economy has had a generally good performance after the 2001 financial crisis...

- Drivers:
  - Reforms/Institutions:
    - Clean up of the banking sector and public sector balance sheets (and institutions), shift toward a rule-based policy environment (autonomous bodies, CBRT independence etc.), flexible exchange rates, and so on…
  - Politics/Anchors
    - Pragmatism of a single-party government sticking to EU-IMF anchors; an end to the political malaise of the 1990s; building of much infrastructure, more ‘inclusiveness’ and ‘shared prosperity’…
  - Global Backdrop:
    - Very supportive, arguably even more so after the Lehman crisis; some $0.5 trillion net inflows came Turkey’s way since 2003…
Last decade+, in a nutshell…

But better to divide this period into 3 sub-periods…

- **The Good** -- 2002-2007: Strong growth phase (≈7%); lots of things were done right in the background…

- **The Bad** -- 2008-2011: Global crisis and the rebound, thanks to very expansionary policies; growth was already slowing beforehand, the economy became overheated, extra-leveraged…

- **The Ugly** -- 2012-present: Low growth (≈2.5%-3%), but relatively high inflation (≈7%-8%) and current account deficit (≈5%-6% of GDP), stalling of reforms, institutional regress, no productivity growth, little private investment…
Caveat on Data: While it is not entirely correct to use nominal market exchange rates in historic comparisons, the developments during 2002-2007 are similar in real or purchasing power parity terms. Moreover, nominal figures allow a direct comparison to 2023 per capita target of $25K, which has also been set in nominal market exchange rates.
Growth has been visibly slowing…

GDP Growth (yoy, %)
Inflation systematically above-target…
Current account deficit unsustainable…

Long View: Current Account Balance (as % of GDP)
Both are high by international standards...

Inflation, end of period consumer prices / Current account balance (as % of GDP)
Selected Comparator Countries, 2014
Foreign direct investment has slowed...
Institutional progress has also stalled...

Figure 8.8: Institutional reforms have slowed since the mid-2000s

Source: WGI, Doing Business, OECD
Doing Business indicators are calculated based on the 2014 release. From the 2015 release onwards, a change has been introduced in the methodology and “distance to the frontier” measures for 2015 are not comparable across time.

What’s the problem now? Where are we?

- We are in a “perfect storm” environment… **Global backdrop** is shifting rapidly against emerging markets (EM) because of upcoming Fed normalization, declining commodity prices, growth slowdown, particularly in China…

- Elections heightened **political uncertainties**, created a political gridlock, leading to new elections. The parliament composition was right, but the opportunity missed, terror is back… What will happen on November 1st? Will it happen?

- Little hope or capacity for developing a **productivity-focused reform narrative** in the short-run while the **institutional environment** has worsened dramatically…

- We have a large **external financing requirement** and a **dovish central bank** under enormous political pressure… Fiscal side not bad, but risks exist there as well… So IG is also at risk…
Turkey has been suffering more than the average EM...

MSCI: Turkey and EM (August 2008=100)
Concluding thoughts…

- The world has become a very edgy place. Key macro question (or anxiety) is (how to accelerate) growth…
- Markets keep looking to Fed – or central banks, more generally – but monetary policy has reached its limits, which is a risk in itself…
- As for Turkey, after a good run, it has come to a very critical juncture. Raising trend growth and developing a new investment narrative are a major challenge…
- But it is extremely difficult to do that in the current polarized environment; could a coalition be the cure?