

Decoupling of the U.S. and World Economy: The Turkish Perspective

Murat Üçer

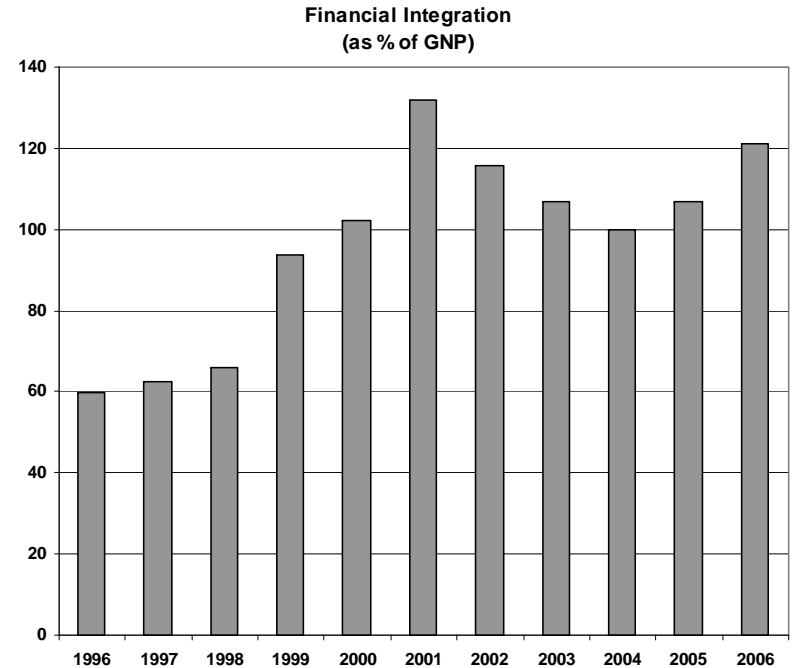
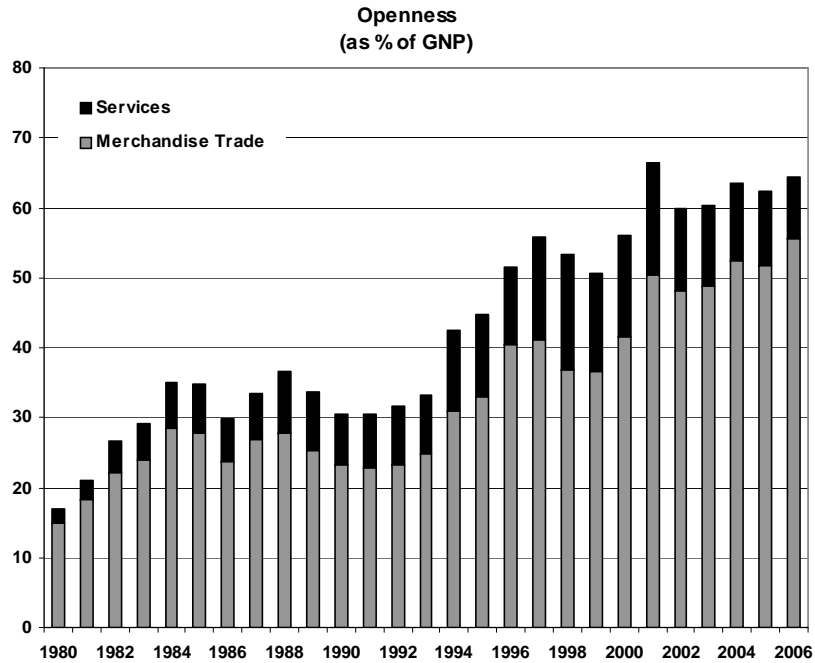
November 2, 2007

TÜSİAD-KOÇ UNIVERSITY ECONOMIC RESEARCH FORUM
CONFERENCE

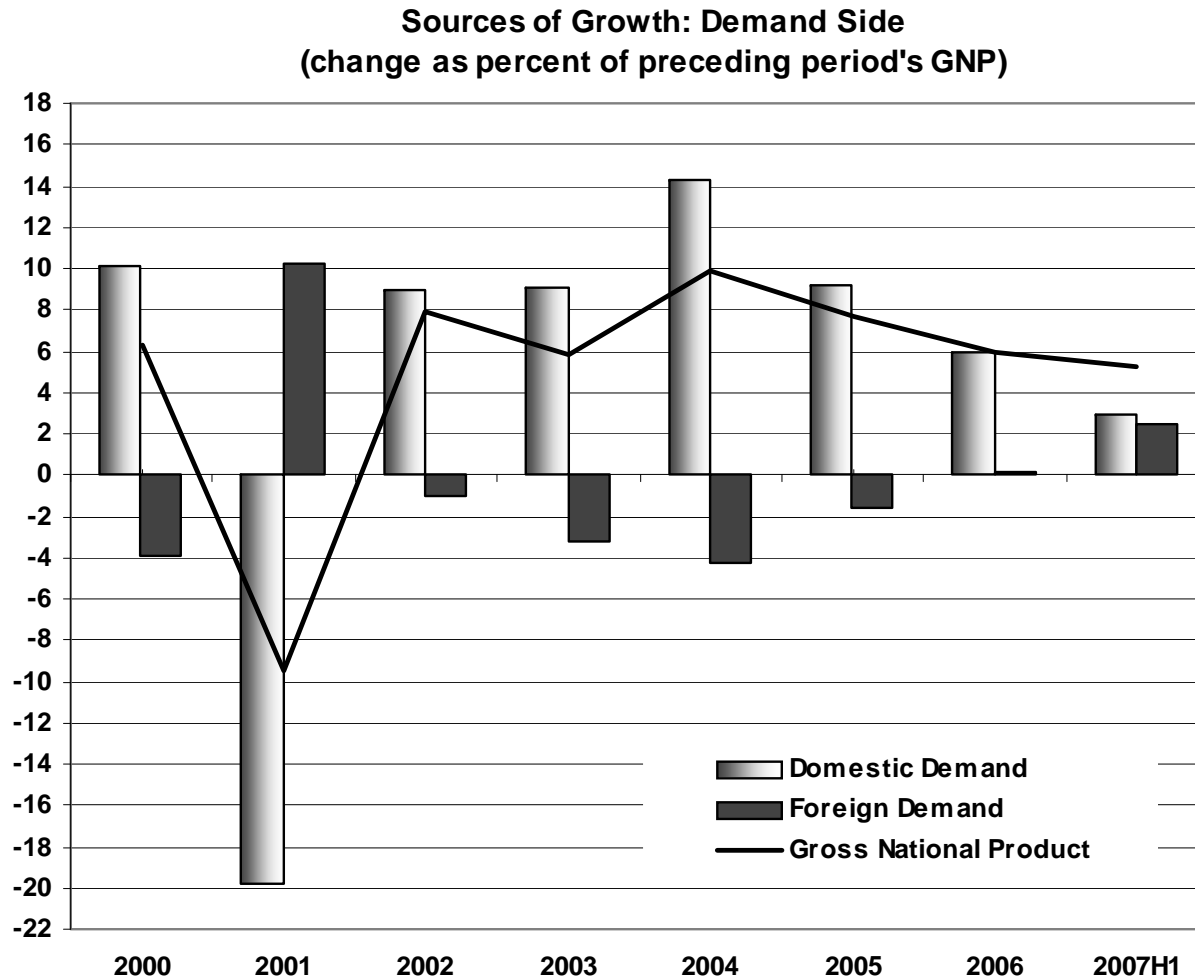
Before we decouple...

- How is the Turkish economy wired to the outside world?
 - External trade vs. external finance
 - Sources of growth and its financing
- How vulnerable is it?
 - Recent developments in selected vulnerability indicators
 - Before the storm and after: Observations on May 2006/Summer 2007 turbulences
 - Policy response: Tight monetary/loose fiscal policy mix => Lira appreciation?
- Concluding thoughts

Turkey is a highly open and financially integrated economy.

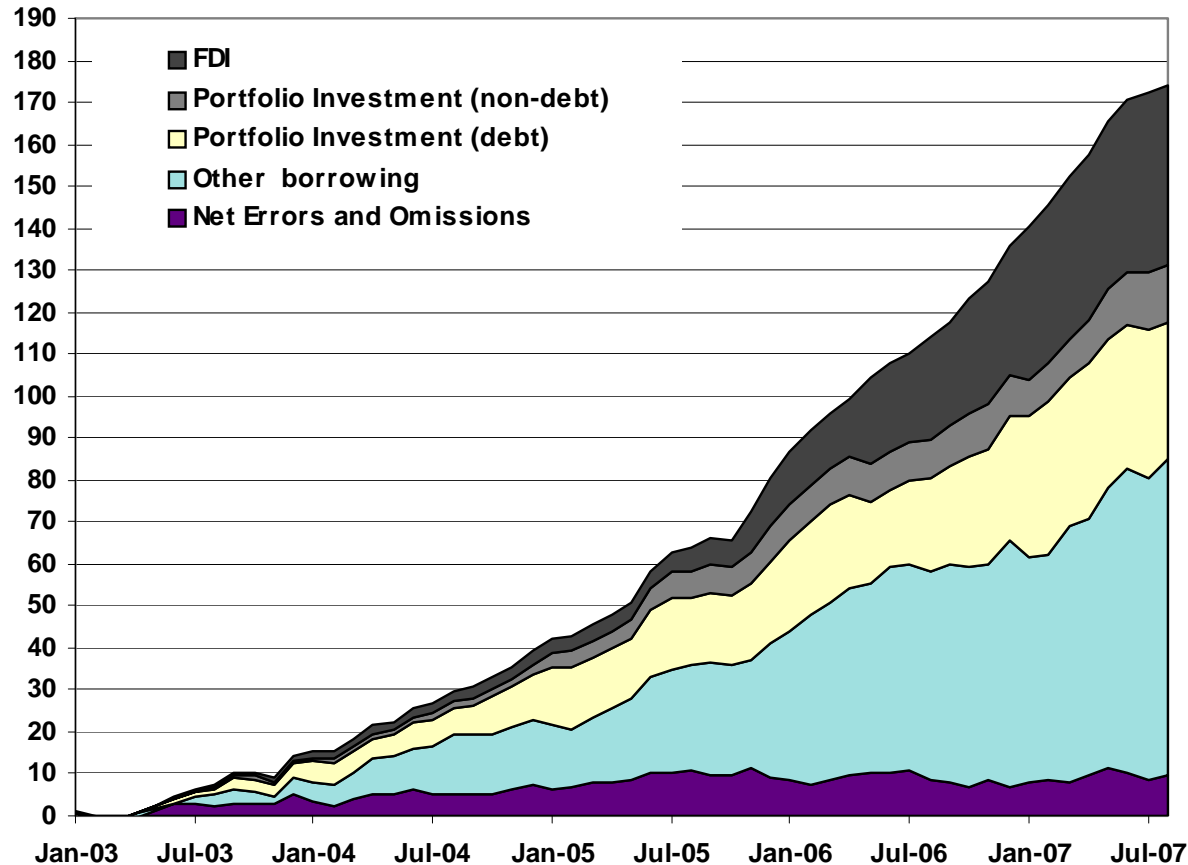


Arguably, the external finance linkage is more important than the trade linkage...



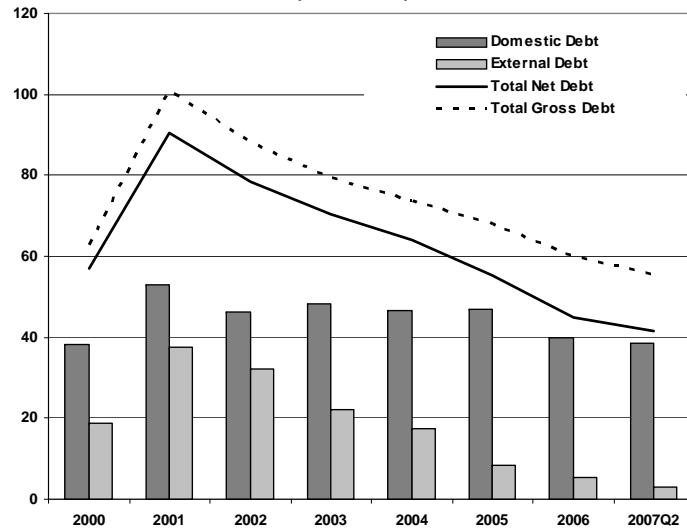
But global liquidity matters! Growth is home-grown, but with other people's savings

Sources of Finance
(Jan 2003-Aug 2007, cumulative)

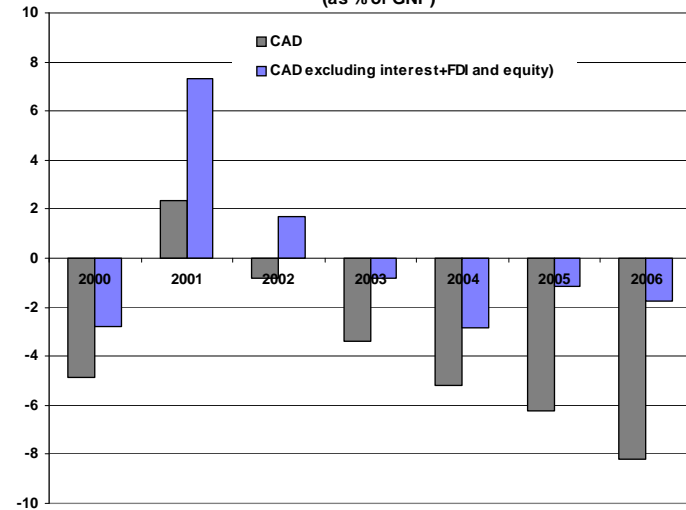


Vulnerability indicators: Good, but good enough?

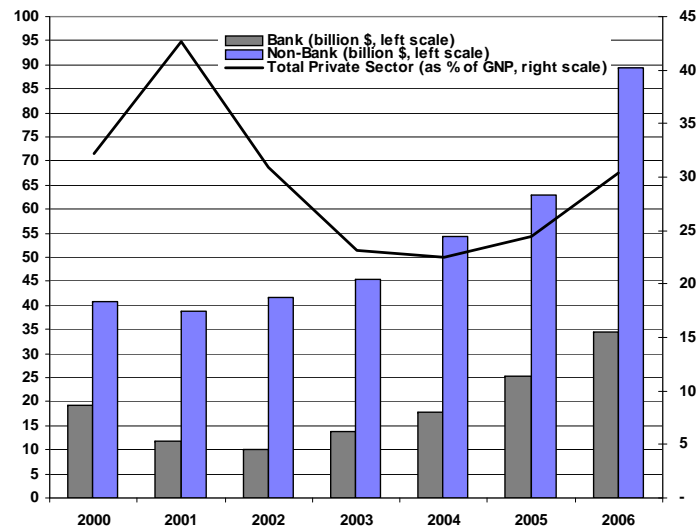
Public Sector Net Debt Stock
(as % of GNP)



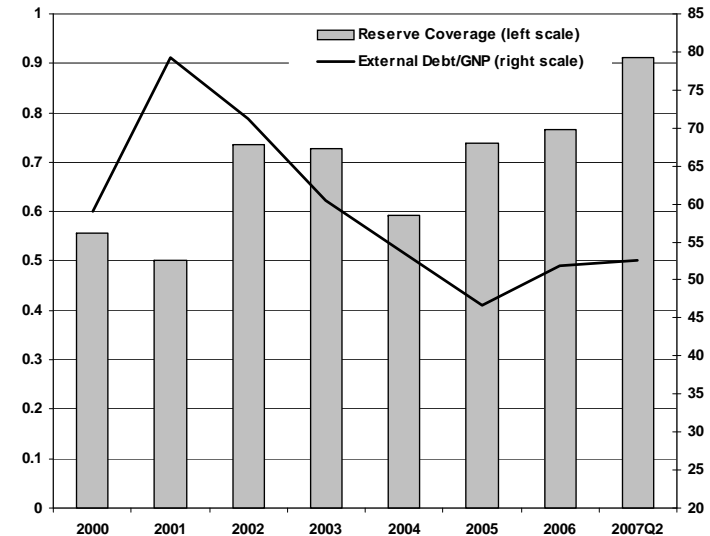
Current Account Deficit
(as % of GNP)



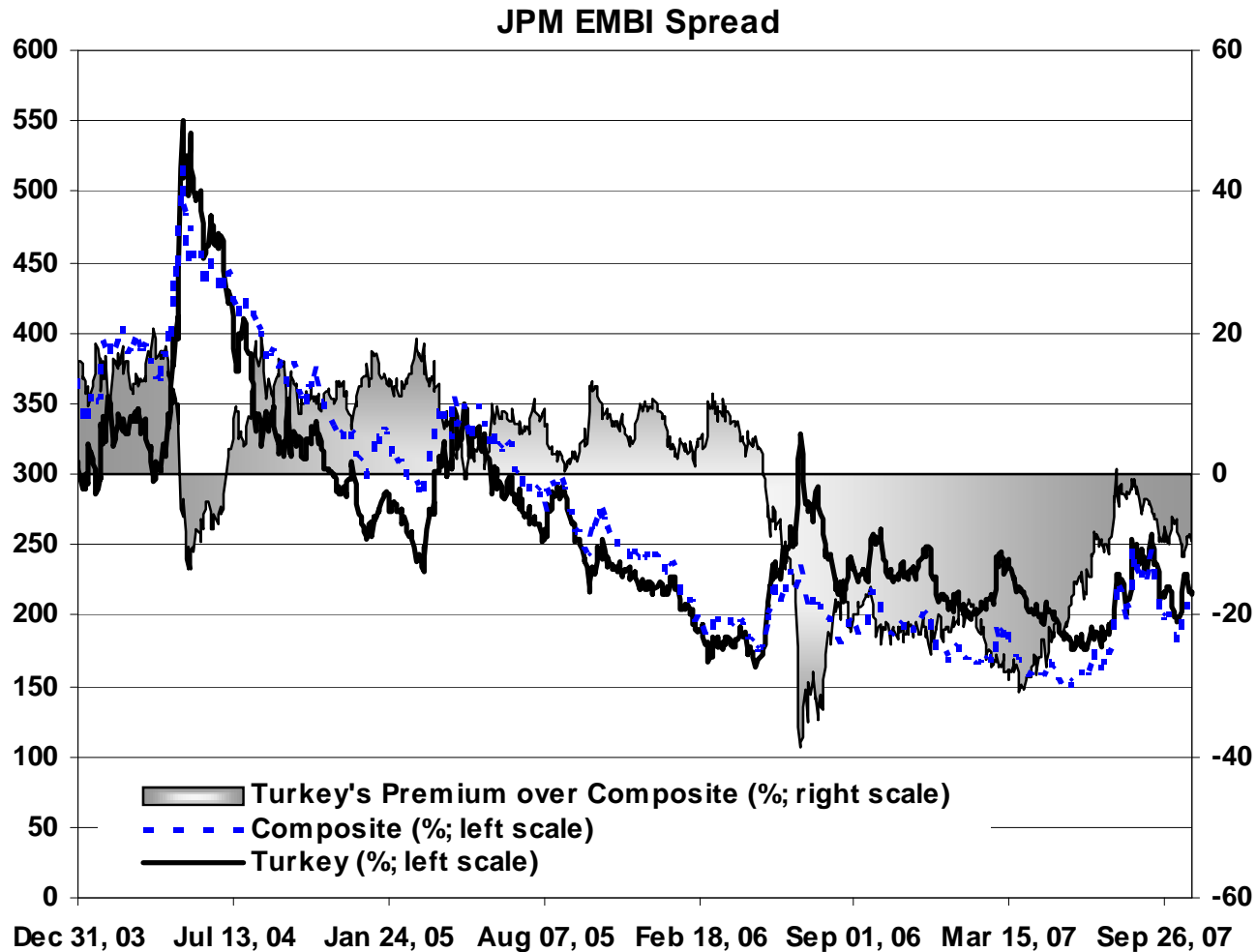
Private Sector Indebtedness



External Debt / Reserve Coverage



May 2006/Summer 2007: And they know it!

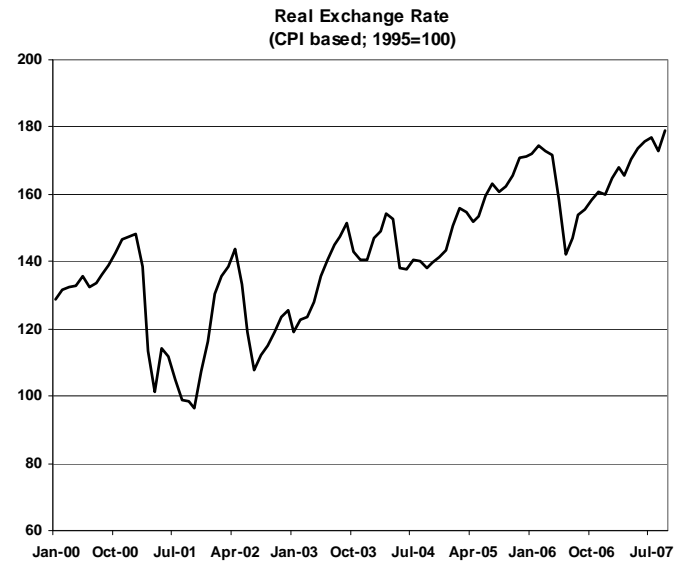
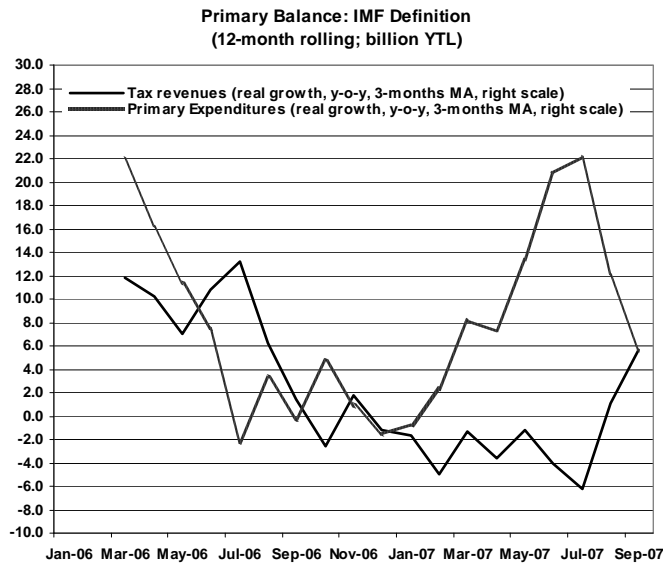
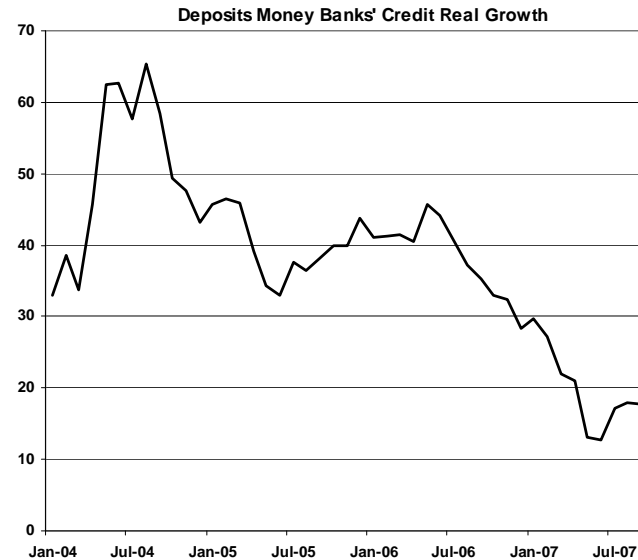
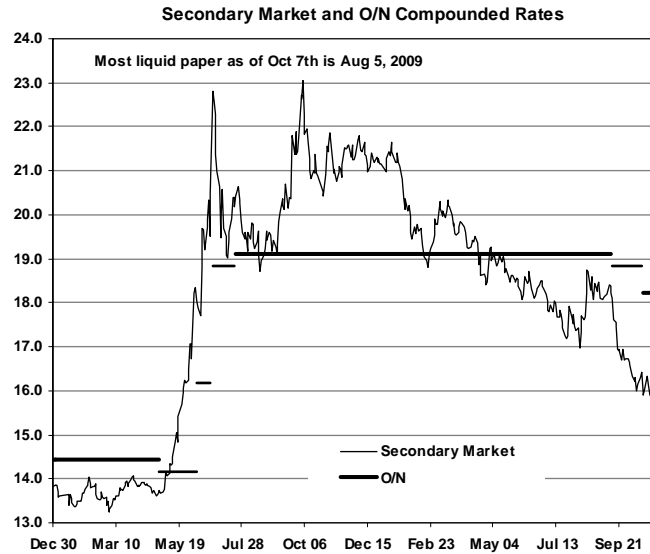


What does the IMF think?

“Staff analysis suggests that three factors—current account deficit, real currency overvaluation (as measured by deviations of the REER from long-run trend), and past credit growth—can largely explain why financial markets in some countries were more affected than others during the May-June market turbulence. ...From this perspective, it is hardly surprising that the lira came under heavy pressure, as Turkey’s current account deficit, real overvaluation, and credit growth were among the highest in large emerging markets. Other less favorable fundamentals (low reserve cover, high public debt, uncertain inflation outlook, high degree of dollarization) and political risks also leave Turkey susceptible to abrupt changes in investor sentiment”

IMF Staff Report, November 2006, p.15.

Policy response: The wrong mix?



What does IMF research suggest?

“...greater restraint on expenditure growth has three benefits. First, by dampening aggregate demand during the period of high inflows, it allows lower interest rates and may therefore reduce incentives for inflows. Second, it alleviates the appreciating pressures on the exchange rate directly, given the bias of public spending toward nontraded goods. Third, to the extent that it helps address or forestall debt sustainability concerns, it may provide greater scope for a countercyclical fiscal response to cushion economic activity when the inflows stop. Although discretionary fiscal tightening during a period of capital inflows may be problematic because of political constraints and implementation lags, avoiding fiscal excesses—holding the line on spending—could nonetheless play an important stabilization role in this context.”

From IMF WEO, Managing Large Capital Inflows, October 2007, p.8

Conclusions

- Turkey has come a long way in reducing vulnerabilities
- Latest turbulences showed that we are starting to operate like normal economies!
- But we are still vulnerable, and policy response to May 2006 turbulence was not ideal: Tight monetary policy was not supported by tight fiscal policy, which possibly contributed to the exchange rate appreciation that followed
- Staying vulnerable means heightened volatility/low growth (4%-5%?) -- this is our new definition of “crisis”
- If any, Turkey’s next crisis has to be a “payments crisis”, i.e. a sovereign and/or corporate default. Take two extremes: Asia 1997 and Argentina 2001. But rest assured, we are not quite there yet!
- Ratings upgrade is what we need, it is the best insurance.

*Global*SOURCE

All information copyright of EuroSource and/or Murat Ucer. All rights reserved. No reproduction by any form or by any means without the express consent of EuroSource and Murat Ucer.