Macroeconomic Review Of The Turkish Economy

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Several times before, I had the chance of introducing the structure of the Turkish economy and of analyzing economic problems we have to face. Today I want to start my address to you by giving a comparative analysis of the Turkish economy with some other countries. Then I want to show you the changing trends in our economy. I want to conclude with my comments on what we can do, particularly what the Central Bank can do with these changing trends.

I like to point out four main issues. First, Turkey is the fifth largest country in OECD both in terms of population and of total area. This also implies that Turkey is the largest country in European Union comparing total area and second largest after Germany comparing population. In addition to that, population density is much lower than that of many European countries. More than half of our population is in age between 15 and 64, indicating young, productive and active population.

Second, for the last couple of years our economy grows quite fast. The average growth rate for the last couple of year is above 7 percent. In 1997 our GNP was around 192 billion US dollars while our per capita GNP at current prices and exchange rates is expected as 3015 US dollars. Average per capita GNP growth for the last couple of years was 5.5 percent. If I compare our GNP and per capita GNP figure with other OECD countries' figures, I can conclude that Turkey has the eighteenth biggest GNP in OECD countries.

Third, the sectoral breakdown of GDP indicates a shift from agricultural products to industrial products in gross domestic products. Over last twenty years the share of industrial production in GDP rose from 16 its percent to 28 percent in 1997. Industrial production has grown by 8.2 percent, which faster than the growth in Hong Kong, G-7 countries, Korea and Thailand.

Fourth, our unemployment rate, set at about a level of 6 percent for the last couple of years, is the fifteenth highest figure among OECD countries.

On the other hand, distribution of income in Turkey shows a pattern similar to other countries facing structural change and high inflation. The share of income the top quintiles received has increased to 54.9 percent while the bottom quintiles received 4.9 percent of income in 1994 down 0.3 points from 1987. In addition to that, Gini coefficient estimates which are higher than many developed economies, rose from 44 to 49 percent for the same period. These estimates might reveal higher level of inequality.

Another characteristic of the Turkish economy is that Turkey has the highest inflation among OECD countries.

The well known reasons of high inflation in Turkey are budget deficits and entrenched inflationary expectations.

The picture from the external side of our economy looks more shiny. Turkey, beside having high inflation and large budget deficits have favourable balance of payments and international reserve position than for example some South Asian countries. The figures of foreign trade indicate that Turkey took the highest 20th place among OECD countries. During the last twenty years the commodity composition of exports changed dramatically in favour of manufacturing goods. The share of industrial goods in our total exports is 84 percent, which is higher than that of some OECD countries like Australia, Canada, Denmark, Greece and Norway. The average annual increase in exports is around 13 percent while the rise in imports is around 11 percent, during the last ten years.

According to the results of a study conducted by the Research Department of the Central Bank, even if there is no big differences in growth rates, the ratio of current account deficits to GNP is lower for the period of greater economic openness. In other words, during 1950-83, when inward oriented import substitution economic policies were followed the current account deficit to GNP ratio is 1.7 percent which is higher than the ratio during 1984-96 when economic policies are outward oriented. The current account balances as percentage of GDP is estimated to be 1.3 percent in 1997 and it was 0.8 percent in 1996. This ratio is lower than that of some OECD countries.

From the macroeconomic point of view our external debt position has also reveal interesting developments. Turkey has been a net debt payer for the last couple of years. In other words there has not been any net inflow of foreign resources. On the contrary, since 1994 taking into account Turkey's total principal and interest payments minus the total disbursements we can say that Turkish Economy's net cash outflow was 13 billion US dollars.

External debt - GNP ratio which indicates indebtedness of our economy dropped down during the last three years from 50 percent in 1994 to 43 percent in 1997. This development shows a manageable external debt position especially if we consider the fact that Turkey paid all its external obligations on time without rescheduling. Our external debt structure has also been changing. The share of borrowing from international markets, increased to 47 percent from a 28 percent level in 1984.

Our capacity to pay back our external obligations can be best reflected debt service and debt to export ratios. With only 25 percent of the current account revenues we can finance almost all debt, principal and interest payments.

Our reserve position is strong. Today Central Bank's international reserves is 25 billion US dollars. The gross reserves of the system is 33 billion. In other words the official reserves can finance eight month import of goods. Our ratio of reserves to average monthly imports of goods is within the top ten among OECD countries.

One of the structural problem of the Turkish economy is the high public sector deficits and borrowing requirements. The government debt structure and high real interest it commands beg the question of sustainability of public sector financing requirements. Debt dynamics of the government are dominated by the cash debt. Two essential problems explain the unsustainability of the deficit financing; namely high interest rates in real term and short maturity structure of domestic debt.

I want to make a brief explanation about Turkish capital markets and ,İstanbul Stock Exchange. There is no restrictions on foreign portfolio investments in Turkey. Repatriation of proceeds is free. Trading system is fully automated and computerized. Clearing and settlement system is in accordance with international standards. In addition to this technical background I can say that İstanbul Stock Exchange is a fast growing market with an average daily stock trading volume of 300 million US dollars. This value is higher than the average daily value of stock trading in other emerging markets like Thailand, Argentina and Singapore. Market capitalization of shares in İstanbul Stock Exchange is 61 billion US dollars, higher than the market capitalization in some of the markets like Korea and Philippine. Those indicators show the potential of İstanbul Stock Exchange as an emerging market.

After this brief macroeconomic review of the Turkish economy I want to indicate you the changing trends in some economic variables. Therefore first, I want to summarize recent developments in the Turkish economy.

- In 1997, the Turkish economy maintained its growth trend of the preceding two years. GNP for 1997 increased by 8 percent over 1996 in real terms. Turkey is one of the high growing country in the world.

- Major source of growth in the last three years has been the rise in investment and consumption expenditures as well as contribution of external sector. A surge in investments aimed at increasing the capacity of the economy is the main factor explaining the growth cycle in the economy.

- On the production side, agricultural production shows a recession around 2 percent while industrial sector expansion is again astonishing with an average 8 percent real growth rate.

- On the other hand, inflation continued to be the major problem of the Turkish economy in 1997. The increase in the wholesale price index turned out to be 91 percent by the end of 1997.

- The budget deficit continued to increase in 1997. The ratio of the consolidated budget deficit to GNP is estimated at around 8 percent. However reasonable operational deficit and primary surplus have continued over four years. For 1998, primary surplus is expecting 4-5 percent of GNP while operational deficit would be around 1 percent.

- Turkey's continuing inadequate access to foreign borrowing constrains the financing of the budget deficit and increases the pressure on domestic borrowing and interest rates.

Now I want to explain what I mean by the changing trends in early 1998. I can point out mainly three developments indicating changing trends: decreasing trend in inflation despite an acceleration in industrial production and improvement in the public sector accounts.

Annual industrial production growth in the first two month of 1998 has accelerated to an average of 9.5 percent. This rate is high above the last year's growth figure.

During the first four months of this year inflation rate reveals a decreasing trend. Wholesale price index rose by 20.5 percent during the first four month of this year. This rate of increase is the lowest inflation rate for the first four month since 1994. This trend is also expected continue during May too. High increase in agricultural prices prevent further fall in inflation rate during the first four month of this year. The fall in non agricultural price inflation which we may call "core" inflation is a kind of reflection of our fight against inflation.

Another positive development of this year is the improvement in budget performance. This improvement contributed to the fall in inflation rate during the first three month of this year. In addition to that the increase in the primary surplus during the first three months of the year was remarkable. Primary surplus realization by the end of March is estimated 372 trillion Turkish Lira, which is above the programmed level. Furthermore, Treasury follows its domestic borrowing strategy in a programmed manner. All of these developments helped in reducing the pressure on the markets coming from the public sector financing requirements.

Following these developments interbank interest rates was lowered and a slight downward trend in domestic interest rates is observed. These reflects a positive movements in inflationary expectations. Slowing in the rate of increase in exchange rates followed these developments. The stable movements of the exchange rates indicates less uncertainty in the financial markets and support the increase in the international reserve position of the Central Bank despite the political tension we experienced in this region, between Iraq and USA and the economic crises in South Asia.

Now let me turn to monetary policy. The implementation of 1998's monetary policy is based on financial programming. The balance of payments and budgetary aggregates are among the key variables that will influence the Central Bank's determination of aggregates of 1998. We are in favour of monetary targeting accompanied with inflation forecast.

The main goal of the Central Bank's monetary policy is to support the implementation of measures aimed at decreasing the annual inflation rate to the range of 70 percent during the first half of 1998. This figure is consistent with the macroeconomic targets for 1998. All the monetary policy tools available to the Central Bank will be employed for this purpose. Basically, the Central Bank will continue to limit the increase in domestic assets to create money only against increases in foreign assets. The tool of short-term interest rates will be used more effectively to achieve this target.

The exchange rate policy will be conducted in accordance with the inflation rate estimated for the first half of 1998. Accordingly, beginning in January, the monthly rate of exchange rate increase is tied to the estimated inflation rate.

I would like to emphasize that the control of monetary aggregates is very important at a time when a fight against inflation is planned. In this connection, the rate of increase of reserve money was set to be consistent with the growth rate of the economy and the inflation target.

While conducting an exchange rate policy aimed at reducing inflation to a desired level, inflationary expectations must rapidly be decreased. The rate of change in inflationary expectations basically depends on the credibility of policies. This credibility can only be established with the support of government. The government has to show its commitment to the fight against inflation by putting into effect, on a definite timetable, the structural reforms that are crucial for creating a durably sound and balanced economy. In point of fact, the necessary structural measures should be completed by mid-year if the forecast inflation rate is to be achieved by year's end. There is no doubt that progress in this area will motivate us to carry out our monetary policies more effectively and to succeed in the fight against inflation.

I want to make a final comment on our monetary policy. Central Bank of Turkey for the last couple of years has concentrated mainly on establishing and maintaining financial stability. This was not and cannot be a target for the Central Bank. But financial stability is a prerequisite for the fight against inflation. In other words financial stability is the desired situation for a central banker who wants to reach price stability. As a matter of fact, even if we had to concentrated on financial stability, Central Bank has never quitted the anti-inflationary monetary policy.

Lastly, I would like to comment on the possible election in 1999. One of the important reasons for not achieving a low inflation in Turkey is unfortunately ongoing political instability for a decade. Expectations have been shaped mainly by political developments such as in Turkey. Political uncertainties also create instability and inability to fight with inflation. It is not easy to convince people in a chronic inflation regime together with political uncertainties that inflation will stay low.

If we are able to establish a stable government after 1999 election, in one year or one and a half year, we would be able to reduce inflation at reasonable levels.

Thank you for your kind attention.