

COUNTRY FOCUS

Turkey business update

ECONOMY | Rebalancing act

The fruits of a decade of reform: More growth and greater ambitions

The watchword of the Turkish economy over the past year has been "rebalancing." After two years of high growth, however, the landing has proved less soft than expected, with growth declining to 2.2 percent in 2012 from a high of 8.8 percent the year before. The sharp decline is likely to spark a new debate between the Central Bank, which advocates caution and curbs on loans, and government ministers, who seek higher growth.

Lower domestic demand, engineered by Central Bank policies, has widely been seen as positive, since an imbalance between exports and imports had caused the current-account deficit to reach an unsustainable 10 percent of Turkey's gross domestic product. In 2012, the deficit dropped to 6 percent of GDP, but it is likely to rise again as domestic economic activity resumes.

"In this low-interest-rate environment," says Nergis Kasabali, executive vice president of research at Burgan Securities, "we expect to see a strong recovery, although the signs are not there yet." Growth is expected to reach 4 percent this year.

In November, Fitch Ratings gave Turkey a long-awaited investment-grade rating

The imbalance is structural, however, and cannot be resolved overnight. Thus Turkey remains dependent on portfolio investments, which have been flowing in, to finance the gap.

"The key problem is a lack of savings," explains Burcu Ünüvar, senior economist and deputy manager of research at Is Investment, "and it will take time to build them up."

To encourage more people to set money aside, the government is offering a contribution to a pension plan. Incentives have also been introduced to drive investment into specific sectors in order to boost exports on the one hand and to reduce dependence on imports of intermediate goods on the other. In the meantime, policy makers will continue their balancing act, aiming for 5 percent growth, a 5 percent current-account deficit and 5 percent inflation.

The government's attempt to put an end to the Kurdish conflict, which has placed a heavy human and financial burden on Turkey over the past three decades, could give the economy a significant boost if it succeeds. The renowned economist Nouriel Roubini, speaking at the Uludag Economic Summit in Turkey in March, pointed out that if a peace settlement is reached, "military spending would go down and more investments would take place in all regions." He also pointed out that peace would have a positive impact on domestic trade: "Turkey could enter the world of greatest success stories."

In November, Fitch Ratings gave Turkey a



By 2023, when the Republic of Turkey celebrates its 100th anniversary, it hopes to be one of the world's top 10 economies.

long-awaited investment-grade rating. In March, Standard & Poor's signaled that it might soon follow suit, as when it raised its rating on Turkey to BB+, one notch below investment grade. Meanwhile, the Istanbul Stock Exchange rose by 56 percent in 2012, to become one of the world's best-performing bourses of the year. With more initial public offerings and privatizations planned this year, foreign capital inflows are likely to be sustained.

But important challenges still remain.

Although unemployment, at 9.4 percent, is well below the average of the European Union — which Turkey seeks to join — the country needs to generate more jobs for its young population; the national median age is 28.8. Women's low participation in the labor force, at 30 percent, also deprives the country of valuable human capital.

Presidential elections, scheduled for next year, are introducing an element of political uncertainty, as Prime Minister Recep Tayyip Erdogan is known to want the position; this

would force the ruling Justice and Development Party (AKP) to seek a new leader.

Nevertheless, at a time when more E.U. member states are in need of bailouts, Turkey is about to make its final loan repayment to the International Monetary Fund, which came to its rescue after the 2001 financial crisis. This illustrates the transformation that has taken place over the past decade. The reforms were initiated by the former minister of the economy, Kemal Dervis, but the AKP, now in its third term in

office, has won praise for its careful economic management. The government has set itself the lofty target of propelling Turkey into the world's top 10 economies by the time the republic celebrates its 100th anniversary in 2023. Now in 17th place, Turkey still needs to improve its competitiveness and productivity. But with positive demographics, a solid banking sector to support economic growth and a public-debt-to-GDP ratio now below 40 percent, the country has strong assets to support its ambitions. ■

2.2%

growth in 2012 followed 8.8 percent growth the year before

INFRASTRUCTURE | Transport and energy

Domestic and foreign investors vie for airport, railroad and power projects

With the centenary of the Turkish Republic now a decade away, the government has embarked on a vast program of infrastructure projects designed to spur economic growth and push Turkey, already a member of the Group of 20, higher in the ranking of world economies.

Both local and foreign companies are

expected to submit bids in early April for the construction of a third Istanbul airport, expected to take four years to build. The airport will become the world's largest, able to handle 150 million passengers annually, and will cost up to \$8.7 billion, according to Minister of Transport Binali Yıldırım. The project is attracting interest from local compa-

nies such as TAV Airports Holding, Alarko, Koç and Sabancı. In addition, foreign groups like BAA of the United Kingdom and Changi of Singapore are said to be seeking joint ventures with domestic partners.

Construction of a third bridge across the Bosphorus, which will also include a rail link, is expected to start in May, after a Turkish-

Italian joint venture won the tender last year. The government has announced that it intends to extend Turkey's railroad network, creating new high-speed connections to 14 cities. A new rail link between the Black Sea and Turkey's southeast is also planned to facilitate the transfer of goods both within the area and to countries south of the border — Iraq is the second-largest importer of Turkish goods. The Turkish authorities have also announced that the country's railroad network will be opened to private operators, although details are still unclear.

Turkish officials are confident that foreign groups will want to be involved in these major projects, which also include a vast urban-regeneration plan that could see millions of homes shored up or rebuilt in earthquake-prone regions. In 2012, Turkey attracted \$12.4 billion in foreign direct investment.

"We have been observing intense interest in urban transformation and Istanbul's third airport project by foreign investors," says Ilker Ayçi, president of the Investment Support and Promotion Agency of Turkey. "Japanese investors are particularly interested in urban transformation, while the Chinese are interested in any infrastructure project taking place in Turkey. Sovereign funds from the Gulf and Far Eastern countries are expected to invest in Turkish infrastructure projects."

Presenting his country's plans to investors in London in late March, Ayçi pointed out that Turkey's privatization program — of ports such as Izmir and Derince, for instance — also offered deals that could attract foreign investors. In fact, Prime Minister Recep Tayyip Erdogan recently canceled a privatization agreement for several bridges and highways because he found the winning bid, at \$5.7 billion, too low. The sale is likely to be realized through a public offering.

To fuel economic expansion, Turkey will need to boost its power output; thus energy is another sector that is expected to draw foreign involvement in the coming years. In spite of popular concerns about nuclear energy, the government has invited bids for the

construction of a second nuclear power plant in the Black Sea region. Japanese, South Korean and Chinese companies, as well as France's GDF Suez, are said to be among the contenders. Rosatom from Russia won the right to build a first nuclear power plant, which should be operational by 2019.

The major items on Turkey's to-do list, which require significant amounts of capital,

will present opportunities not just for foreign investors but also for the Turkish banking sector.

"For some projects, Turkey has already found the money," says Burcu Ünüvar, senior economist and deputy manager of research at Is Investment. "There will be a natural selection, of course. But if the banks are involved, we know that the risk awareness is very high because of the regulators." ■



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Planned infrastructure projects include the construction of a third bridge across the Bosphorus.

EVENTS | Olympics 2020

Istanbul is shortlisted for the 2020 Summer Games

Fifth time lucky? Istanbul is, together with Madrid and Tokyo, among the three cities shortlisted to hold the 2020 Summer Olympic Games. Turkey's most vibrant metropolis has unsuccessfully sought to host the Olympics several times in the past, but after a decade of economic growth — which has transformed the country and drawn significant investment into the city — Istanbul is now in a position to submit a strong bid.

Local support for the Olympics project is always an important criterion, and an International Olympic Committee survey revealed that 83 percent of the city's residents would welcome the Games, while national support stands at 76 percent. Turkey's top private-sector companies have already pledged some \$20 million in sponsorship.

Under the slogan "Bridge Together," the city has submitted plans for Olympic and Paralympic Games that would span two continents — Europe and Asia — starting with a spectacular opening ceremony on the Bosphorus Strait. A Games Route Network

would connect seven clusters of venues in four zones, ensuring that athletes staying at the Olympic Village would never have to travel far to events.

A crowded and busy metropolis, Istanbul is often congested, but the city has been spending an average of \$1.2 billion annually to expand its public-transport network. An additional \$6.8 billion will be invested before 2020. In November 2012, the Turkish government also announced that \$1.77 billion in new investment would be spent on 415 community sports facilities and 24 stadiums. More than 200 projects are already under construction.

Many of the major infrastructure projects envisaged for the coming decade would boost Istanbul's ability to organize successful games. The city, which welcomed 9 million foreign visitors in 2012, already has a

strong hospitality sector, and hotel capacity keeps increasing.

Prime Minister Recep Tayyip Erdogan, a native of Istanbul and former mayor of the city, has put his political weight behind the project. "Nobody should doubt that we will meet the requirements to host the Olympic Games in the most ideal way," he told the visiting IOC representatives, stressing that by the time the 2020 Olympics are held, Turkey will be stronger, more prosperous and close to meeting its 2023 development targets.

After discussing "Istanbul 2020" plans with the authorities and visiting the city in March, members of the IOC left with "an excellent impression," according to the organization's vice president, Craig Reedie. Turkey's growing influence on the international scene — and the fact that the Games have never been held in a Muslim country — might help swing the vote next September in favor of the Bosphorus city. ■

Turkey business update was produced by the International Herald Tribune Creative Solutions department and did not involve the newspaper's reporting or editorial departments. Text by NICOLE POPE.