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The Global Economic Crisis and its Impacts on Turkey

Introduction

Turkey's recent history following the 2001 economic crisis should be divided into two sub-periods: 2002 to 2006, and 2007 to 2009. The former period was characterized by a notable average annual GDP growth of 7.2%, declining inflation (from around 70% to 10%) and relative economic and political stability under a single party government. The global environment was conducive to economic growth, with an increase in capital inflows to emerging markets, which Turkey benefitted from extensively. Fiscal discipline was maintained, bringing the budget deficit from around 12% of the GDP in 2002 to 0.6% in 2006. Along with with increased capital inflow, interest rates were falling and confidence in the economy was improving as a result of the implementation of an IMF program which set into motion a series of reforms in the banking and public sectors. Turkey became an EU member candidate in 2005, further contributing to the positive outlook of the country. During the years 2007 to 2009, however, trends in growth dynamics and the international environment changed, leading to an increasingly pessimistic outlook for Turkey's economy

Into the recession: 2007-2008

Turkey's brilliant growth performance began to stagger as early as the second quarter of 2007 for two reasons: firstly, because of local political debacles, and secondly, because of the forthcoming global economic turmoil, which surfaced in the US mortgage business in the second half of the year. Although the blow to Turkey's economy largely came from the global economic crisis of 2008, it would not be wrong to argue that Turkey's growth dynamics had started to show weaknesses long before that date, owing to local political issues and a slowdown in the reform agenda of the government. In fact, the model which was so successful from 2002 to 2006 in spurring on growth was about to complete its lifecycle, and a new model was required, backed by further economic and social reforms. In this regard, Turkey was late in re-modeling its growth strategy and thus caught up in the crisis rather unprepared.

In 2007, the infamous "turban problem"[2] and the governing Justice and Development Party's (AKP) efforts to elect Abdullah Gül as president dragged Turkey into political deadlock. The government's first attempt to elect Gul in April was strongly opposed by some secular groups as well as the Army, and Turkey was forced into early elections on July 22nd.

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Prime Minister Erdogan's ruling party (AKP) won the elections by a landslide, with 47% of the votes and more than 60% of House seats, and was able to elect Gul as president at the end of August. Against this backdrop along with increasing global fragilities, the economic growth started to decelerate, albeit at a moderate pace.

In 2008, however, in contrast to expectations of stability following the elections, politics once again took the stage beginning in March, when the Chief Prosecutor of the High Court of Appeals opened a case against the ruling AKP which demanded the closure of the party and sought to ban its leading figures from politics for five years. While U.S. subprime mortgage market concerns led to growing pessimism at the international level, local political tensions emerged as another cause for fluctuations in domestic financial markets, deteriorating consumer sentiment and decreasing investment appetite. This in turn led to a significant reduction in the GDP growth rate in the second quarter of 2008. Nevertheless, political tensions in Turkey were resolved by the end of July with the High Court's ruling against closure of the AKP.

Unfortunately, relief in local markets after the elimination of political uncertainties was short-lived. The collapse of Lehman Brothers on September 15 and the U.S. Treasury's bailout of the insurance giant A.I.G., which had been on the brink of bankruptcy, triggered a near-collapse of the ailing global financial system. Recognizing the severity of the crisis, many countries, led by the U.S., the U.K., and Euro zone members, began taking radical measures which first aimed at saving the collapsing financial system and then focused on rescuing the real economy. However, the turmoil in financial markets started to take its toll more seriously on households and non-financial companies towards the end of 2008, both locally and internationally. Therefore, even if the financial system has been saved from complete meltdown by the vigorous rescue efforts of developed countries, the impacts of the crisis will continue to be felt by the real sector for quite a long time and most likely in an increasingly worsening fashion.

Plummet in economic activity since the last quarter of 2008

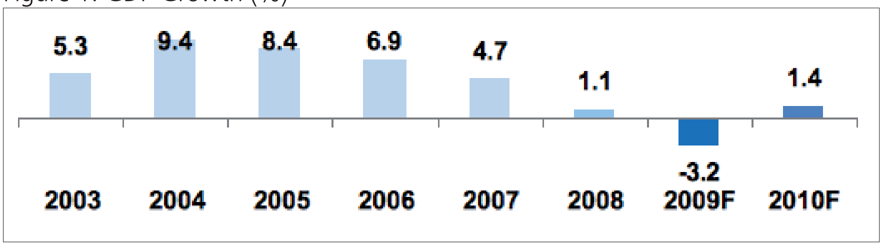
Turkey did not transmit the global crisis particularly through the financial channels, but through the foreign trade channels. Exports suddenly ground to a halt in the last quarter of 2008, when the global economy was drawn into a deep recession. Turkey's underdeveloped mortgage system, as well as limited access to international mortgage and financial derivatives markets, prevented a sharper collapse of Turkey's economy. In fact, the banking sector was quite resilient before the crisis, having already undergone a structural transformation immediately following the 2001 crisis, and this has been Turkey's major strength against deteriorating global economic conditions.

Nevertheless, due to contraction in trade volumes and domestic demand, the full-scale deceleration in economic activity was felt in the second half of 2008 with 1.2% GDP growth in the third quarter, followed by a drastic 6.2% contraction in the next quarter. This brought the cumulative growth of Turkey's GDP in 2008 to a dismal 1.1%. The contraction in the last quarter was the first drop in output since 2001, driven mainly by the collapse in private consumption (-4.6%) and private investment (-23.5%), while public sector expenditures ahead of local elections limited the decline to some extent.

Throughout the year, private consumption growth stalled at a mere 0.3%, while private investments contracted by 7.3%. The public sector's consumption and investment expenditures nevertheless contributed 0.6 percentage points to overall growth, while the contribution of exports (net of imports) was more remarkable, with 1.6 percentage points. In this sense, a sharp deceleration in imports and an increase in the public sector's spending prevented a collapse of total GDP growth in 2008. The public sector's contribution is expected to continue in 2009, because of increased expenditures ahead of local elections in the first quarter and possible increase in expenses to stimulate stagnant domestic demand in the rest of the year.

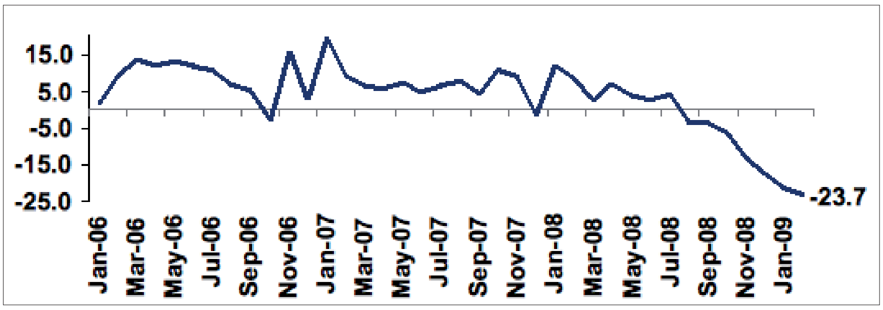
In terms of production, a collapse in industrial production in the last quarter (-9.6%) was accompanied by a contraction in the output of the services sector (-6.2%). For the whole year, industrial output growth decelerated to 1.1% and services to 0.6%. The agricultural sector had a prosperous year with a growth rate of 4.1%, reining in the slowdown in Turkey's economy to some extent. The construction sector was hit the hardest throughout 2008, with a 7.6% contraction in output.

Figure 1: GDP Growth (%)



Source: Turkstat. 2009 and 2010 are Yapı Kredi Bank's projections.

Figure 2: Industrial Production Growth (y/y, %)



Source: Turkstat.

Data regarding the first quarter of 2009 was not encouraging, either. A free fall in industrial output continued in the first months of 2009, with contraction reaching 22.5% in the first two months. Export-oriented sectors were hit the first due to a recession in major export markets, namely the Euro zone. The textile and clothing sectors, Turkey's strongest export group, were already struggling before the global crisis, which compounded contraction. The automotive industry, Turkey's second largest export sector, slumped 37% in the period from August 2008 to February 2009. The chemical, metal goods, machinery, equipment and construction sectors were particularly hit due to weakening foreign and domestic demand.

Table 1 below outlines industrial production growth and decline from January 2008 to February 2009. A comparison of growth before and following August illustrates the dismal picture of industrial sector. The first two columns show each sector's growth rate for the period in question, while the third shows the contribution of each sector to the overall 12.8 point contraction from August 2008 to February 2009, when the effects of the global crisis were felt most acutely. Accordingly, the nine sectors, mostly export-oriented, constitute 11 percentage points (88%) of the whole contraction in the total industry. The automotive and textile sectors reflect the largest decline, followed by basic metals.

Table 1: Sectors most impacted by the crisis:

	January 2008 – July 2008	August 2008 - February 2009	Percentage points contribution to growth in Aug 2008-Jan 2009 period
	% growth wrt same period in prev. year	% growth wrt same period in prev. year	
TOTAL INDUSTRY	**5.4**	**-12.8**	**-12.8**
1. Textiles	-7.4	-18.6	-1.8
2. Wearing apparel	-11.3	-14.6	-0.8
3. Chemicals and chemical products	6.4	-12.6	-1.0
4. Rubber and plastic products	2.5	-15.4	-0.6
5. Other non-metallic minerals	2.7	-11.3	-0.6
6. Manufacture of basic metals	7.3	-17.7	-1.5
7. Manufacture of fabricated metal products	1.6	-21.8	-0.7
8. Manufacture of machinery and equipment	-1.2	-13.8	-0.8
9. Motor vehicles and trailers	30.5	-37.0	-3.4
Total of 1-9 industries			**-11.2**

Source: Turkstat

Automotive and domestic appliance sales also illustrate a continuing decline in consumer demand in the first two months of 2009, reflecting an escalation in the crisis. Automobile and domestic appliance sales were below levels recorded in the previous three years by a wide margin, down by 31% and 30%, respectively, in the first two months of 2009 compared to the same period last year. As a positive signal, consumer and real sector confidence indices have been steadily rising, starting from 2009 – despite being still far below 2007 levels – increasing hopes for a possible recovery in domestic spending and economic activity. Moreover, the government's reduction in the VAT for automobiles for three months seems to have boosted sales and imports in March and April of 2009. We are far, however, from contending that recovery has finally begun.

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Trade deficit decline in 2009 along with the sudden stop in the economy

The contraction in exports that began in the last quarter of 2008 continued unabated in 2009. More specifically, exports shrank further 26% in the first three months over 13.3% in the last quarter of 2008, while the reduction in imports was even sharper, with 41.8% in the first quarter of the year compared to 20.6% in the last quarter of 2008. These trends are expected to prevail throughout 2009, when, according to the IMF, advanced economies are expected to contract by 3.8% and the Euro area in particular is expected to shrink by 4.2%.[3] Turkey's exports may contract by at least 25% owing to the worldwide recession and imports will shrink by not less than 30%, due to the limping domestic economy and depressed international commodity prices.

In fact, Turkey has responded to the global crisis by diversifying some export markets since 2007, which obviously helped for dealing with the crisis. The most notable changes occurred in Euro zone and Middle Eastern export market shares; the former dropped by 4 percentage points, declining to 48% at the end of 2008 (Figures 3 and 4). Turkish exporters compensated for the decline by substituting Middle Eastern markets, whose share in total exports rose from 14% in 2006 to 19% in 2008. Interestingly, the United Arab Emirates became the third largest export market following Germany and United Kingdom, while Iraq rose to tenth. Unfortunately, in the middle of a worldwide collapse when developed as well as developing countries are faced with a prolonged crisis, contraction in trade volumes was inevitable and penetration of new markets no longer seemed sustainable. January to February figures support this trend, with nine of the ten largest export markets displaying sharp decline.

Figure 3: Major export markets (2006)

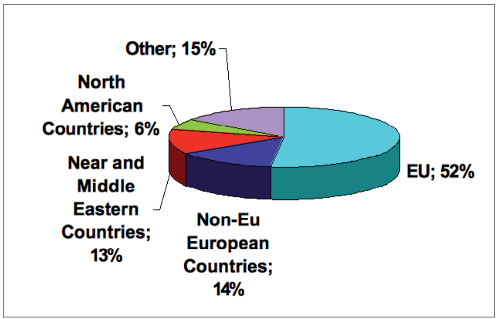
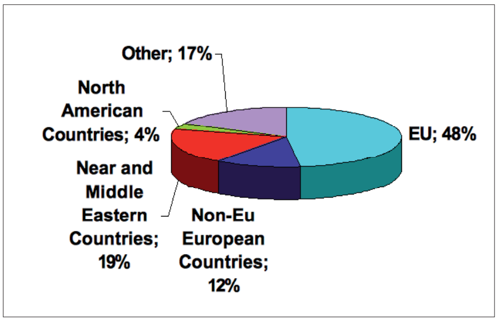


Figure 4: Major export markets (2008)



Another challenging issue ahead of Turkey is the foreign financing constraint most likely to arise in 2009. The financing difficulties were first felt with capital outflows starting from October onwards, especially in the securities markets. Nevertheless, despite global credit crunch towards the end of the year, Turkey managed to secure net FDI inflows for the amount of USD 15.4 billion and USD 30 billion in net borrowing through the private sector in 2008.

However, total capital inflows (net) in the amount of USD 34.3 billion in 2008 fell significantly short of the current account deficit recorded at USD 41.6 billion, signaling forthcoming financing pressures ahead. According to the Institute of International Finance (IIF), total external financing for emerging markets is projected to fall to USD 165 billion, less than half of 2008 and almost one fifth of 2007 inflows.[4] This projection reflects the squeeze in the pool of funds available to emerging markets as the global financial crisis worsens, among which Turkey has been one of the major receivers with more than annual USD 40 billion net inflows between 2005 and 2007. Even in 2008, 79% of net capital inflows stemmed from corporate sector loans in the amount of USD 27 billion (net). Turkey's Treasury estimates that the outstanding debt payments of the private sector (corporate sector and banks) in 2009 amount to a sizeable USD 51.5 billion. Therefore, in an environment where foreign financing conditions are no longer supportive, Turkey's private sector, which heavily borrowed during the 2004 to 2008 period, will be hard-pressed to locate new means of financing. Most likely the private sector will be re-paying foreign debt in 2009, which is likely to put pressure on exchange rates throughout the year.

Aggravated unemployment

The collapse in production beginning in late 2008 resulted in a sharp increase in unemployment in Turkey: from 11.6% in January 2008 to 15.5% in the same month in 2009. However, Turkey's employment dynamics had already been problematic, even during the 2002 to 2007 period, when the average GDP growth was as spectacular as 6.8%. Economic growth in this period neither reduced unemployment rates, nor increased labor force participation. Large numbers of people from the agricultural sector were dislocated because of the post-2001 economic transformation, many of whom were small scale farmers who lived on government subsidies and could no longer make a living from agriculture following the reduction of subsidies to minimal levels. Employment generated in the service and industrial sectors during the buoyant growth period did not sufficiently absorb the masses who left the agricultural sector.

In the aftermath of the 2001 crisis, unemployment rose from around 7.7% in the 1989 to 2000 period, to around 10% on average until 2006, while labor force participation declined from an average of 54% to 48.9%. Falling labor force participation rates suggest that the number of people who gave up looking for a job increased, and it was disproportionately women returning to their homes without a hope of finding a job in labor markets.

Women's low rates of employment and labor force participation

Women's vulnerable and disadvantaged position in labor markets in Turkey is particularly worthy of mention. Not only Turkey's economic structure but also patriarchal values jointly determine women's position in labor markets. As of January 2009, women's labor force participation was at 23.5%, meaning that only one out of four women are in the labor market either with or without a job, and the remaining women (more than 20 million) are

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considered "economically inactive." Women's low level of employment is one of the biggest challenges for Turkey, and examining the issue in more detail reveals further complexities reflecting the gendered structure of the labor market.

Virtually 5.2 million women are employed, as opposed to 14.7 million men; and 36% of all employed women work in the agricultural sector, where norm employment is non-wage family business with almost no social security (98% of all women in the agricultural sector are not protected by any social security plan). Considering the weakening agricultural sector mentioned above, women's vulnerability in the agricultural sector is compounded.

Another gendered aspect of the labor market is the increasing feminization of the informal sector. 54% of women employed (as opposed to 36% of men) are deprived of proper social security protection. These employment figures altogether show that women are not only under-employed but most of those who are employed are obliged to work unofficially for low wages and insufficient, and possibly non-existent, social security. Discrimination based on gender can be seen in the wage gap between men and women as well, which has been estimated to be 22% in urban areas.[5]

Given these structural issues in employment, the current crisis is bound to affect women and men differently. The first impact of the crisis has been observed as a sharp increase in unemployment rates for both men and women. The number of unemployed men surpassed unemployed women by a wide margin because of the contraction in the manufacturing and construction sectors, which women have only limited access to. Hence, 1 million 59 thousand people became unemployed in one year in 2008, of which 780 thousand were men and 280 thousand were women. In the same period, 239 thousand men lost their existing jobs, while 314 thousand women found new jobs. These new jobs, however, are mostly in the informal sector, as may be expected since women often seek employment desperately when male providers in the household lose their jobs. Turkstat figures show that 38% of these new jobs for women are low-skill positions. To survive the crisis, women have been more readily accepting any type of job to secure an income.

We do not have enough evidence right now to assess the total impact of the current crisis on women and men separately. However, two trends may prevail in the coming period regarding women; women's unemployment may rise, especially in the financial sector where women's participation in the labor force is high, and women may be laid off on the grounds that they are complementary earners to the "male bread winner" and as such the first to be eliminated. Or, on the contrary, as mentioned above, women's labor force participation and employment may increase because more women might be substituted for relatively high-wage earning male positions and/or may be given low-salary, informal positions without social security benefits. Which of the two trends will be dominant is unforeseeable for now.

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Measures to cope with the crisis in Turkey: The later, the worse

Following the global financial market crash in September, Turkish leaders confidently stated that Turkey would not be affected by the global crisis and they asserted that the country's macroeconomic infrastructure was sturdy. When deceleration in the domestic economy reached alarming proportions, a series of measures to stimulate domestic demand were announced in March of 2009. Until that point, a limited number of measures had been announced to curb domestic economic deceleration, such as erasing debtors' records at the Central Bank and increasing short period working allowances allotted to workers. Those measures were insufficient to stimulate domestic demand, let alone restore confidence in the economy.

In March, the government reduced the value added tax for three months on residential property, automobiles, domestic appliances, electronic equipment, office equipment and furniture. These measures were responded to quickly, leading to an increase in domestic sales, particularly in the automotive and domestic appliance markets. The question is whether these measures will translate into a recovery in production and a re-functioning of the credit mechanism. The abovementioned increase in sales is bound to remain a one-off change unless the re-functioning of the credit system is restored. To complement these measures, government spokespersons have signaled that a credit guarantee fund is being prepared to facilitate the flow of loans between banks and the real sector.

The Central Bank (CBRT), on the other hand, began easing policy rates in November 2008 in response to stagnating domestic demand. Just like everywhere else, inflation lost its relative importance on Turkey's agenda starting from the second half of the year, when international commodity prices began slipping and the slowdown in domestic demand became apparent. In Turkey, annual inflation in consumer prices (CPI) ended the year at 10.1% and declined to 7.9% by March. A further decline in inflation, to 6%, is expected at the end of 2009, to a level below the CBRT's official 7.5% target. Disinflationary trends and weak demand have allowed the CBRT to reduce rates, and since November ON borrowing rates were reduced 750 basis points to 9.25% (9.7% annual compounded) by May. Bond rates also followed suit, declining to 12% in May, whereas bank loan rates were slow to adjust owing to increased lending standards and banks' increased risk perceptions.

A deal with the IMF, if could be finalized, would more than improve the picture. A new realistic budget supported with a stand-by loan, expected to be at least USD 20 billion, is already on the agenda of most market players. In the G20 meeting held on April 1-2, the IMF was backed by USD 750 billion of funds, expected to be directed mostly at emerging markets. If Turkey completes the deal and receives a loan from the IMF, this would obviously help improve expectations for the near future.

Closing words

Turkey began feeling the impacts of the global crisis in the last quarter of last year, and the impacts were further aggravated in the first quarter of 2009. Production and employment have been shrinking drastically, while the global recession and the drying up of global trade have brought exports to a halt. The government, after a notable delay, began announcing incentives to stimulate domestic demand, which found rapid response in the automotive and domestic appliance industries, resulting in rallying sales. So far five packages have been implemented, amounting to TL 36 billion, and government spokespersons have stated that further initiatives will be undertaken to support the real sector, to establish a credit guarantee fund and to increase employment.

Unemployment, which has soared to record levels in the first quarter of 2009, is one of the major perils ahead of Turkey. Depressed domestic demand, resulting from massive unemployment, weakens the impact of stimulus packages and keeps the wheels from turning. We cannot safely say we have reached the bottom yet; however, the IMF deal which authorities claim will be signed may act as a brake preventing further decline in economic activity. For consumer and producer confidence to increase, fiscal recovery measures need to be visibly operative and the global economy needs to show signs of relative stability. Once these occur, Turkey may recover more quickly than expected.

1) **Yelda Yücel,** Bilgi University, Business Administration, Member of the Initiative For Women's Labor and Employment (KEIG)
2) Turban is the headscarf of women and strictly banned in schools in Turkey, including the universities. The government attempted to free the headscarf in universities by changing the constitution in 2007. This prompted the prolonged tensions between the secular forces and the government.
3) IMF World Economic Outlook, April 2009, "Global Economic Policies and Prospects." Note by the Staff of the International Monetary Fund, presented at the Meeting of the Ministers and Central Bank Governors March 13–14, 2009, London, U.K..
4) IIF, Capital Flows to Emerging Economies, January 27, 2009.
5) "Türkiye'de Kadın Emeği ve İstihdamı: Sorun Alanları ve Politika Önerileri, Kadın Emeği ve İstihdamı Girişimi Platformu (KEIG), 17 Nisan 2009.

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