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COUNTRY ANALYSIS

Alive and Kicking

Turkey's economic rise has been stunning. But is the boom over? No way, thinks guest columnist Murat Yülek. Turkey will be back.

By Murat Yülek

Turkey's international standing has risen steadily over the past years. Last year, Turkey was elected a member of the UN's Security Council by the UN General Assembly with the highest possible number of votes. A Turkish diplomat was elected Chairman of the Organization of the Islamic Conference (OIC), an international political organization comprising 57 member countries. In the last few years, it has been difficult to book rooms at five star hotels in Istanbul where new hotels are being opened every day and, because of hundreds of international business, political and science meetings.

Much of this had to do with Turkey's stellar economic success. Prior to the global crisis, the Turkish economy registered remarkable growth rates. Between 2002 and 2006 average GDP growth

was 7.2 percent. Inflation, which earlier could reach levels of 100 per cent, was nonetheless kept in check by sustainable monetary and fiscal policies.

Massive inflows

Perhaps the most impressive macroeconomic development of the last few years in Turkey was the massive capital inflow. From lower than USD 1 billion (EUR 720m) prior to 2001, foreign direct investment (FDI) reached USD 22 billion in 2007. Exports more than tripled from USD 40 billion in 2002 to USD 141 billion in 2008. However, the Turkish lira, driven up in value by rising capital inflows, helped boost imports just as much, from USD 47 billion in 2003 to USD 194 billion in 2008 driving current account deficit to USD 44 billion in 2008 (5.9 per cent of GDP).

A significant part of this inflow was in the form of investment in privatized entities and acquisitions of Turkey corporations. Notable examples include the privatisations of the Turkish Telecom (USD 6.5 billion), Erdemir steelworks (USD 2.8 billion) and TUPRAS and PETKIM refineries (USD 4.2 and 2.0 billion, respectively). Turkish Telecom's landmark privatisation also paved the way for a major entry of Gulf investors into Turkey. Their other major acquisition was Cevahir, a large mall in Istanbul.

High vulnerability

The Turkish economy has always been vulnerable to contagion from outside crises. Recent examples include the 1997-8 Asian and Russian crises. On top of that, Turkey has also produced a



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number of crises on its own such as the major financial dislocation in 2001 when a number of banks went bust, costing Turkey the equivalent of more than USD 45 billion.

But this time the situation is different. Although Turkey has not been able to uncouple from the world recession – the stock market has plummeted –, the economy is less likely to suffer as badly as it did during other crises. Most importantly, the country has not seen the eruption of a financial crisis – not in the banking and financial sector, not in the forex markets and not in private and public debt repayments. Turkish banks have proven relatively resilient

thanks to reforms introduced in the wake of the 2001 financial crisis, including the establishment of an independent bank regulator. At the moment Turkish banks are in fact quite liquid. The average adequacy ratio for the 48 banks operating in Turkey is around 18 per cent and non-performing loans constitute only around 4 per cent of cash credits.

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Painful on three fronts

Yet there is no denying that the global crisis has been a painful bruising for the Turkish economy, hurting it on three separate fronts. Firstly, exports, which have become a

central economic pillar, have crashed, driving many Turkish manufacturers and, consequently, their employees into misery. Secondly, domestic demand has also slowed down due to eroding confidence among households and businesses.

This weakens demand for bank credits. It has to be underlined that the slowdown affects different sectors differently; while demand in the automotive and construction sectors, which boomed in the last few years, has shrunk precipitously, the telecommunications sector is relatively unaffected. Thirdly, the government budget has been brutally damaged by slowing revenues and increasing outlays occasioned by the expansionary fiscal policies, some of which owe themselves to the March 2009 local elections. In mid-April, the budget deficit target for 2009 was raised to 4.6 per cent of GDP from 1.2 per cent in October 2008. But given the tremendous worldwide economic fault lines, it can be said that the Turkish economy has weathered the storm quite successfully. More recently, economic activity has been showing signs of a mild recovery hinting that the worst may be over. In March, import contraction be-

gan to decelerate, and capacity utilization increased by more than 10 percentage points compared to February. In April, the Istanbul Stock Exchange (ISE) index posted a 40 per cent gain in US dollar terms – quite a return during a financial crisis of historical proportions.

Supported by the economic and political stability re-established in Turkey during the last years, M&A activity reached historic heights in the past two years. M&A volume stood at USD 16.3 billion for transactions whose value have been disclosed. Adding the transactions with undisclosed values, total activity was estimated by Ernst&Young at close to USD 19 billion. While this was lower than in 2007, it was still a respectable figure when considering that a global crisis erupted last year. Landmark deals included the privatisation of cigarette producer Tekel, the sale of Turkey's largest retailer Migros to private-equity firm BC as well as the privatisation of the gas and electricity distribution company of Ankara.

A sign of maturing markets

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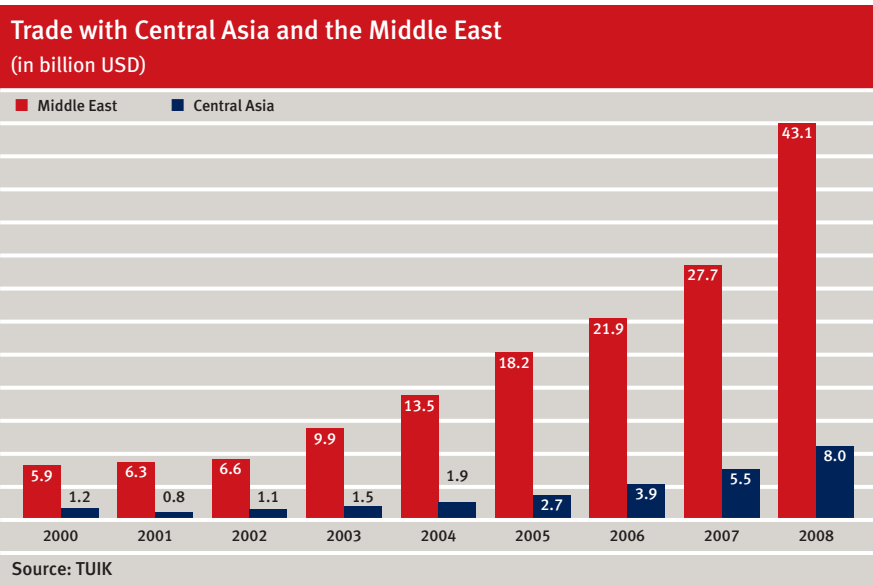
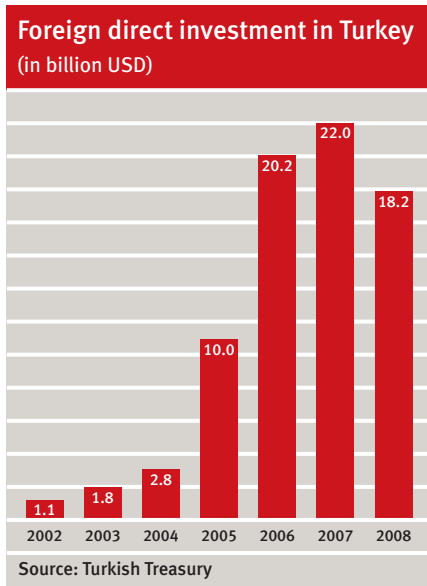
Source: IMF, per cent GDP growth in 2004 and 2009 (est'd)



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The M&A activity of 2008 was also a sign of maturing M&A and corporate finance market in Turkey. Unlike in the previous years, the deals involved a large number of smaller transactions, with about half of all transactions below USD 50 million and only five transactions above USD 900 million. Buyers were also fairly well diversified. Most came from within Turkey (25 per cent of total transaction value), most others from the UK (20 per cent), Russia (10 per cent), France, the Netherlands and Greece (6 per cent each), Germany and Czech Republic (4 per cent each).

Investments were also directed at many different sectors, mainly energy, financial services, retail, manufacturing, media, cement, health and real estate & construction, and owners, with 45 per cent of companies bought from the state and 55 per cent from private hands. Sovereign wealth funds from the gulf region have been looking at Turkish targets for a long time now, with one landmark deal so far, the partial acquisition of Sabah, the second largest media group in Turkey.

Smaller deals continue

Like everywhere else, M&A activity in Turkey is bound to fall in 2009. Nevertheless, activity has not come to a complete stop though no landmark transaction has been announced as yet. But some smaller deals have been publi-

cized and some have already been closed. Corio, a Dutch real estate investor, announced the acquisition of a mall for EUR 67.6 million euros in May. Food giant Ulker bought Rotopas, a PVC packaging producer, for an undisclosed price. Moreover, a number of large Turkish and international corporations including Boeing and Italian energy company Edison have announced investment plans worth EUR 1 billion over the next five years. Turkish Telecom revealed plans to spend somewhere close to EUR 1 billion on acquisitions in 2009.

Turkey's rising international status was also noticeable in Central Asia and the Middle East, where inherited cultural, economic, ethnical and religious ties have been strengthened. Turkey's total trading with Central Asia increased a stunning sevenfold between 2000 and 2008 to over USD 43 billion. High-ranking politicians and business people from the Gulf region, Russia and the Turk states have become regular sights in the main industrial centres Istanbul, Antalya and Bodrum. In addition to large Turkish contractors, many other Turkish corporations are present in these regions such as Turkcell, which operates a GSM network in Azerbaijan, and candy producer Ulker, which has production facilities in Saudi Arabia as well as distribution networks in many countries.

At a recent international meeting hosted by the Syrian International Academy, a private institution based in Damascus, former Syrian Minister of Information Dr. Mahdi Dahlala defined Turkey's role as "Syria's gate to the west" and Syria as "Turkey's gate to the Arab world." Turkey's foreign policy based on the 'zero problems with our neighbours' principle has made Turkey the only country that engages in an open dialogue with all countries in the region, from Egypt to Afghanistan and from Iran to Israel.

Still strong

How much has Turkey's gateway function to the Middle East and Central Asia changed through the crisis? While the rich countries of the Gulf region and Central Asia are muddling through the crisis, the Turkish government, banks and business people are intensifying their relations with the regions, and Istanbul is strengthening its position as a business hub for both regions. With Turkey's further strengthened position in the region following the Davos meeting, Gulf investors and statesmen show signs of increasing interest in Turkey. A recent elite real-estate conference in Istanbul, for example, boasted a lot of high-level participants from the Gulf region. Turkey may become a prime country of investment when the risk appetite of the Gulf investors revitalizes. ←