One third of recovery process is completed; but there remains a problem

Sarp Kalkan
Economic Policy Analyst

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The starting point of a research is the pattern. In Edward Leamer's words "Human beings are pattern seeking, story telling animals."[1] Human beings, looking at the phenomena and figures, search for a certain regularity; that is pattern. At the second stage, they try to explain why the certain regularity takes place. The aim here is to be able to write a story in harmony with the pattern. In fact, pattern and story refers to developing a hypothesis based on the pattern and the phenomena. Then, it is time to analyze the hypothesis at the third stage. The analysis of the year 2010 with reference to up-to-date data would better follow this organization. In this sense, the objective of this note is not to attempt to conduct a full-fledged analysis on the performance of the economy in 2010 but to show the existing pattern. It will be useful to identify the questions that will guide the future research.

This policy note examines the performance of Turkey's economy in 2010 on the basis of key macroeconomic indicators. In a nutshell, production and consumption indicators for 2010 indicate that the economy has regained the pace before the crisis. Nonetheless, unemployment could not be reduced to the pre-crisis levels and export performance remains weak, raising concerns about Turkey's economy. Besides, recovery in the absence of export dynamism turns current account problem into a more dangerous and substantial one.

Three key indicators: one-third of the recovery completed

It is possible to analyze the economic recovery process on the basis of three key indicators: recovery in production, recovery in unemployment and recovery in export performance. Here, recovery refers to the situation where the loss faced during the crisis is offset. Therefore, in the analysis of the figures the first quarter of 2008 was considered the period before the crisis since each analysis requires a point of bearing. First quarter of 2008 was assumed to be 100, and the movement of the relevant indicator in comparison to this index was examined. Figure 1 shows the movements in production, unemployment and export indicators.

As of the end of the third quarter of 2010, recovery in production level was completed in nine quarters whereas unemployment rate stood 17.5 percent above and exports stood 12 percent below the starting level.

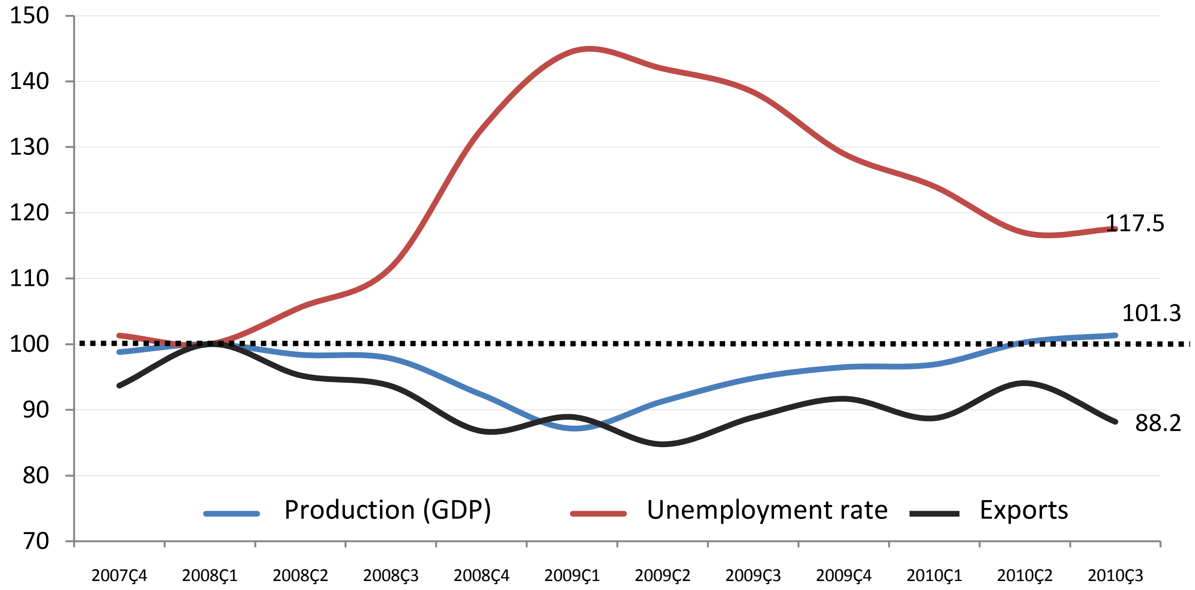
As figure 1 also suggests, level of production in the period before the crisis (the first quarter of 2008) was regained. Production volume that faced a 13 percent contraction during the crisis period has completed the recovery process: current level of production is slightly above 100 – the index level at the pre-crisis period. Unlike the 2001 crisis, the

- *Sarp Kalkan, TEPAV Economic Policy Analyst, http://www.tepav.org.tr/en/ekibimiz/s/1034/Sarp+Kalkan*

[1] Edward Leamer (2009), Macroeconomic Patterns and Stories, Springer-Verlag.

locomotive of recovery in the 2008 crisis was domestic demand (consumption and investment expenditures) rather than exports.

Figure 1. Production, exports and unemployment rate (Net of seasonal effects, 2008Q1=100)



Source: Turkish Statistical Institute and TEPAV's calculations

Unemployment rates were affected to the largest extent by the crisis and this impact of the crisis on unemployment rate still continues. Along with the crisis, unemployment rate increased by 32 percent. Despite the signs of rapid recovery in 2010, unemployment rate was fixed slightly below 12 percent in the last two quarters reinforcing the risk that the problem will turn into a medium-term challenge. In fact, that unemployment rate could not be reduced to desired levels despite the fact that over the last one year of the recovery employment increased by 1 million people is also a result of the increase in labor force participation along with the crisis. Labor force participation rate that stood at 46 percent before the crisis reached to 49 percent with the crisis and currently varies around 48.5 percent. But the fact is apparent. Unemployment rate that was 100 before the eruption of the crisis did not fall back to 100. The rate currently stands at 17.5 percent.

The third important indicator determinant for recovery analysis is the volume of exports. Along with the crisis exports contracted by 15 percent and did not demonstrate a strong recovery performance in the following period. Exports still vary around the 90 percent interval. Data for the last quarter of 2010 announced the day before reveal that this trend continues. Exports that corresponded to 88.2 percent of the pre-crisis level as of the third quarter of 2010 stood at 88.1 percent at the end of the fourth quarter. Unfavorable outlook of the export performance stems mainly from the recession and financial problems in EU countries which receive almost 50 percent of Turkey's exports. Forecasts that the crisis in Europe will continue also in 2011 indicate that Turkey's exports will be under pressure for a long period. This challenge also perpetuates the current account deficit problem.

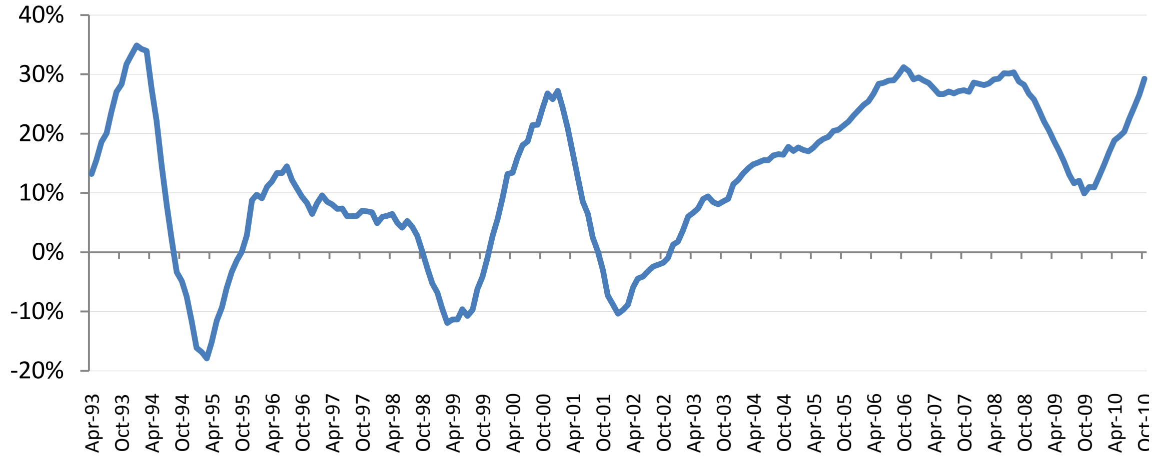
The analysis of the three key macroeconomic indicators reveal that as of the third quarter of 2010 production level recovered whereas unemployment and export performance did not complete the recovery process. To put it differently, one third of the recovery process has been completed. Although this is a considerable achievement, it is striking that the recovery in production is not yet translated into the unemployment and export performance.

Current account deficit turned into a severer problem

Problems about the export performance in spite of the recovery in production turned current account deficit into a severer problem. This is another dimension of the economic performance of Turkey in 2010. The policy change introduced by the Central Bank must be assessed in this frame. For the first time in Turkey domestic demand played the major role in production recovery after crisis. Under these circumstances, the ratio of current account deficit to FX generating transactions – that is to export and tourism revenues – reached the pre-crisis levels only in one year. At this point it should also be emphasized that the said level was already risky.

Figure 2 shows the ratio of current account deficit to FX generating transactions. In periods preceding crises in Turkey, the ratio had reached as high as 30 percent and shown a sudden rupture with the emergence of the crisis. This trend was observed both in 1994 crisis and in 2001 crisis and re-gaining the pre-crisis levels took 5-6 years. In the case of the 2008 crisis, however, not only the contraction was more limited but also was pre-crisis levels achieved more quickly. The answer to the question why Turkey's sovereign rating is not improved shall better be sought in association with this fact.

Figure 2. The ratio of current account deficit of FX generating transactions (exports and tourism revenues)



Source: CBRT, Balance of Payments

Growth process should be managed to avoid trouble

In the light of the above analysis, which story fits into this pattern? To what direction must the analysis move on? If the above findings are summarized; Turkey achieved an impressive growth performance driven by the buoyant domestic market. Nevertheless, the recovery process in unemployment and exports could not be completed yet. This turned the current account deficit problem into a severer challenge. As in the old saying "new taste in old mount" the crisis has put a new face in the old problem. This should be considered as an important risk item for 2011 and the following years. TEPAV study on the method of current account deficit finance indicates that there exists an apparent and near risk[2].

The question the analysis of the recovery performance in 2010 must raise is: If the economy grows by 7.5-8 percent, in spite of the fact that the Medium Term Program estimates 4.5 percent growth and that all macroeconomic balances are built upon this estimation, would this be an indicator of successful economic management? The answer would be no. This is exactly where the source of the current account deficit problem with the new face lies. It appears that this will be the research subject of the period ahead.

[2] Sarp Kalkan (2010), Short Term Fund Inflows are Dangerous for Banks, TEPAV Policy Note.