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FOCUS ON TURKEY

IAN WHADCOCK

ALL ROUTES LEAD TO GROWTH

INFRASTRUCTURE PLAN PAVES WAY FOR JOINING WORLD'S TOP 10 BIGGEST ECONOMIES

Turkey's big investment in infrastructure has put the country's economic path into a virtuous circle. Better infrastructure enhances economic growth, which allows for more spending to improve infrastructure and further economic growth.

"A lot has happened in the infrastructure space in the past 10 years," says Dimitris Tsitsiragos, vice president, Europe, Central Asia, Middle East and North Africa for the International Finance Corp., who is based in Istanbul. "With roads, power, telecoms and good logistics, you can enhance economic activity. You can increase growth, increase productivity and lower transaction costs."

IN JANUARY, TURKEY ANNOUNCED PLANS TO BUILD THE WORLD'S LARGEST AIRPORT.

Turkey's economic growth illustrates the story, rising 5.15% between 2002 and 2012 according to the Ministry of the Economy. Turkey's economy slowed to a 2.2% growth rate last year—still far better than the European Union. The International Monetary Fund forecasts 3.5% growth for Turkey this year, compared with a 0.2% contraction in the euro zone.

Turkey's exports rose to a record $152 billion in 2012, up 12.6% from a year earlier and continuing their double-digit growth since the global economic crisis squeezed exports in 2009, according to the Turkish Statistical Institute. As a result, freight traffic has surged, according to Turkstat data from 2007-2011.

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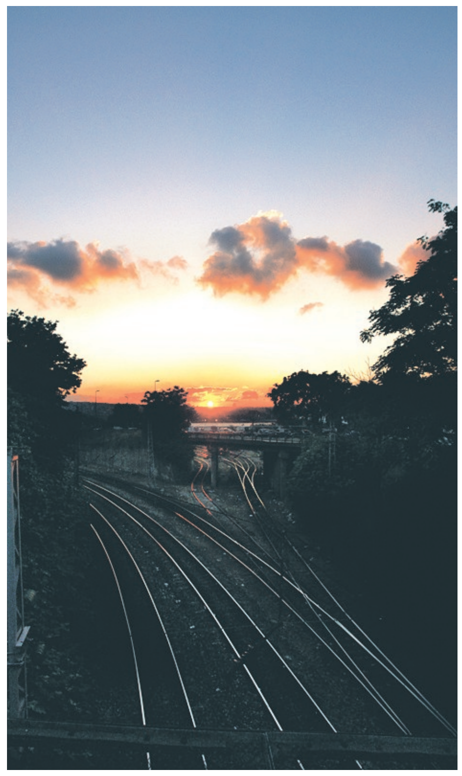

Turkey's freight traffic has surged due to double-digit export growth. According to the Turkish Statistical Institute, the country's exports rose to a record $152 billion in 2012. Airlines have also grown rapidly—Turkish Airlines will nearly double its fleet with recent deals to buy up to 117 aircraft from Airbus (top right) and 95 from Boeing.

All routes lead to growth

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Ships carried 67% more ton-miles of cargo, rail 18% more ton-kilometers of freight and roads 12% more ton-kilometers of goods.

Turkey's central location between Asia, the Middle East and Europe has historically made it a crossroads for trade. Modern improvements in infrastructure have increased its importance as a logistics center. Turkey has Europe's biggest truck fleet, and the length of divided highways is nearing 20,000 kilometers, nearly tripling in length in the decade since 2003. It now has 48 airports with scheduled flights, as well as 76 ports.

It isn't over: Turkey's 2013 budget includes 13.6 billion lira ($7.5 billion) for transportation investment and 4.3 billion lira ($2.3 billion) for energy investment.

POSITIVE IMPACT

"There's no question the impact was positive. It's across all the measures—communication, transportation, energy," says Johannes Fedderke, professor of economics and international affairs at Pennsylvania State University and co-author of the paper "The Productivity Impact of Infrastructure in Turkey, 1987-2006," published in March 2013.

The economic benefits are "more noticeable where Turkey has gone for less privatization and has gone for less state provision," Dr. Fedderke says. However, "where the government relied more on partnerships with the private sector, the impact on growth was greater than where it did not."

Turkey spent more than Sweden, Poland or Canada on rail infrastructure in 2010, according to the United Nations Economic Commission for Europe. It has yet to privatize its railways, though, and "one struggles to find an impact of railway infrastructure on growth," Dr. Fedderke says.

In contrast, in electricity generation there is "strong impact" on the economy, he says. The share of private-sector power companies has increased to 51% in 2010, from 19% in 2000. The private companies notably have improved efficiency in generating power and, his paper points out, each percent of efficiency improvement raises productivity growth 2.06%.

Turkey has privatized five energy companies since December, reaping $122 billion. It has 134 public-private partnership projects worth about $35 billion.

"WHERE THE GOVERNMENT RELIED MORE ON PARTNERSHIPS WITH THE PRIVATE SECTOR, THE IMPACT ON GROWTH WAS GREATER THAN WHERE IT DID NOT."

Airlines are another area of fast growth, thanks to privatization and big investment. Turkish Airlines, which was privatized a decade ago, has doubled its fleet to 215 in five years and will nearly double it again, with recent deals to buy up to 117 aircraft from Airbus and 95 from Boeing.

Turkey's geography makes air links crucial. With far more land mass than any EU member, complicated by mountain ranges, travel by land is time-consuming, and building roads and rails is difficult.

The growth in airline passenger and cargo capacity "helps enlarge the domestic market," says Serdar Sayan, professor of economics at the TOBB University of Economics and Technology in Ankara. "It enables Turkish businesses, especially small and medium-size enterprises, to serve a larger market. And when you can serve a larger market, your costs go down because you can then take advantage of economies of scale."

In January, Turkey announced plans to build the world's largest airport outside Istanbul, with six runways and annual capacity of 150 million passengers a year. The $9 billion project would be privately run in a build-operate-transfer model and would replace Ataturk Airport. Turkey also plans to complete five more new airports by 2014.

For more budget-minded travelers, a high-speed rail line between Istanbul and Ankara should cut travel time to two or three hours—down from six or more—when it opens late this year. Turkey plans nearly 10,000 kilometers of new high-speed rail lines through 29 cities and nearly 5,000 kilometers of new conventional rail lines by 2023. Other major infrastructure projects include the $7.5 billion Gebze-Istanbul motorway with the Izmit Bay Crossing; the $3.3 billion Marmaray tunnel below the Bosphorus Strait; a third $2.7 billion bridge over the Bosphorus, and the $1.4 billion Euroasia tunnel between the European and Asian parts of Istanbul.

FORGING AHEAD

The World Economic Forum's 2012-2013 Global Competitiveness Index ranks Turkey No. 43 out of 144 overall, a big jump from No. 59 the year before and No. 61 two years earlier. That puts Turkey ahead of Brazil (48), Russia (67), India (59) and South Africa (52). It's also ahead of 11 of the 27 European Union members—Lithuania (45), Malta (47), Portugal (49), Latvia (55) Slovenia (56), Cyprus (58), Hungary (60), Bulgaria (62), Slovakia (71), Romania (78) and Greece (96).

On the index's infrastructure measure Turkey ranks No. 51, but it punches above its weight on air transport, where it's No. 36 for quality and No. 19 for available airline seat kilometers per week, with 1.8 million.

Turkey ranks better than most Southeastern European countries, but not quite as high as those in Central Europe or the Baltics in the European Bank for Reconstruction and Development's 2012 Transition Report. On a scale from 1 (conditions of a rigid, centrally planned economy) to 4-plus (conditions of an industrialized market economy), Turkey gets marks between 3-minus and 3-plus for natural resources, sustainable energy, electric power, water and wastewater, urban transport, roads, railways and telecommunications.

"They are catching up," says Mr. Tsitsiragos of the IFC. "They are not there with Europe yet, but they are catching up. It's important for them." Turkey, currently the world's 17th biggest economy according to the IMF, wants to be in the top 10 by the country's centennial in 2023. "To do that requires infrastructure investment," he says.

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FOCUS ON TURKEY

The nation's banking boom continues

BY MAKING JUDICIOUS CUTS AND SCALING BACK ON LOANS THE FINANCIAL SECTOR HAS MAINTAINED GOOD HEALTH

A healthy financial sector has been a key driver of economic growth in Turkey over the past decade—something few other countries around the world can claim.

When the global financial crisis began in 2008, "Turkish banks were well-capitalized. Their open positions were at relatively sound levels and non-performing loans were at low levels," says Caner Bakir, associate professor of international political economy at Koç University in Istanbul.

Turkey's bank-capital-to-assets ratio was 12% last year, a level that's held steady since 2008, according to the World Bank. By contrast, Germany's ratio was 4.4% last year. Under the Basel II international banking rules the core capital ratio must be 7%, with certain exceptions.

Turkey's sole weakness was its reliance on foreign short-term capital inflows, which shrank dramatically when the crisis hit. "Offshore funding opportunities were limited and the cost was high," Dr. Bakir says. "That was a big challenge for Turkish companies and the banking sector."

FOREIGN EXCHANGE MATTERS

Foreign exchange dried up. "Short-term foreign exchange inflows are very important for economic growth in Turkey," Dr. Bakir says. Turkey's central bank responded by injecting liquidity into the market through several avenues. It suspended foreign-exchange buying auctions and launched foreign-exchange buying options; it increased transaction limits for commercial banks in the foreign-exchange deposit market; it reduced lending rates; it lowered the foreign-exchange reserve requirement to 9% from 11% and it increased export limits. In addition, it increased export rediscount credit limits and relevant legislation was reconfigured to make it easier for exporters to access credit, Dr. Bakir says.

Meanwhile, the global economic crisis was reducing demand for Turkish exports, especially to the European Union. The central bank responded by lowering "its policy rates more than any other central bank in emerging markets operating in an inflation-targeting framework in 2009," Dr. Bakir says. "The cuts were vital in affecting economic activity."

At the same time, banks—wanting to avoid risk—scaled back new loans. Loans to small and medium-size enterprises (SMEs) declined sharply in the economic downturn, though consumer, commercial and corporate loans shrank as well, he says.

ECONOMY HAS BLOOMED

Since 2010, Turkey has observed increased foreign capital inflows, bank loans have grown about 11% a year and as much as 16% at the end of last year, and the economy has bloomed, with 9.2% growth in gross domestic product in 2010, 8.5% in 2011 and 2.2% in 2012. Profits in the banking sector rose 19% last year to 23.6 billion lira ($13 billion), according to the Turkish Banking Regulation and Supervision Agency.

The boom in banking is likely to continue in 2013, thanks to low interest rates. Turkish banks expected a rise in demand for retail and commercial loans this year, according to a central bank survey.

Demand for credit is particularly strong from SMEs, which account for about 70% of jobs in Turkey. The biggest constraint for SMEs to grow is a lack of access to financing, says Dimitris Tsitsiragos, vice president,

> "IT'S ONE OF THE FEW MARKETS FOR INVESTMENT INTO THE BANKING SECTOR—RUSSIAN BANKS AND SOME MIDDLE EASTERN BANKS ARE ACQUIRING TURKISH ASSETS."

Europe, Central Asia, Middle East and North Africa for the International Finance Corp., who is based in Istanbul.

Almost 65% of bank loans go to commercial and corporate enterprises, including SMEs, says Dr. Bakir. "The banking community these days are keen to make loans to these enterprises. SME profit margins are

Profits in Turkey's banking sector rose 19% last year, according to the Turkish Banking Regulation and Supervision Agency.

relatively high."

However, SMEs also present problems for Turkey's compliance with Basel II, because SMEs often lack proper accounting systems and don't have credit ratings, he says.

Access to financing is the top complaint about doing business in Turkey, cited by 14.1% of respondents in the World Economic Forum's Global Competitiveness Report for 2012-2013. Turkey ranks No. 44 out of 144 countries for financial market development in the report.

In the European Bank for Reconstruction and Development's 2012 Transition Report, Turkey scores between 3-minus and 4-minus on a scale from 1 (standards of a centrally planned economy) to 4-plus (standards of an industrialized market economy) for the development of its banking, insurance, private equity, capital markets and micro, small and medium enterprises finance.

Turkey offers opportunities to develop capital markets, Mr. Tsitsiragos says. "The financial sector has done well and is well managed. The banks are competitive. It's one of the few markets for investment into the banking sector—Russian banks and some Middle Eastern banks are acquiring Turkish assets. But it will be good for Turkey to focus more on capital markets to finance infrastructure," he says.

FURTHER OPPORTUNITIES

Long-term corporate bonds are starting to be issued in capital markets, Dr. Bakir says, though it still doesn't constitute a large portion of external funding for companies.

Other opportunities in the financial sector include retirement and insurance, both underdeveloped to date. A government program subsidizes savings set aside for retirement funds, and Turks are taking advantage, he says. Just as more Turks are adopting personal retirement savings, they also are buying insurance. "A lot of people didn't have property insurance for their homes or cars, or health insurance, so the potential is huge," he says.

The text of this Special Advertising Section was written by Catherine Bolgar.