Turkey's Economy Slows Down: Will this Affect Spain's Burgeoning Trade and Investment?

William Chislett[*]

Theme: Turkey has engineered a soft landing for its economy, which has been roaring along like a high-speed train, but this does not look like affecting Spain's budding trade and investment provided the imbalances are brought under control.

Summary: Like Spain, the Turkish economy became overheated and growth is still high by EU standards. Spanish exports have risen by more than 30% over the last five years, making Turkey the second-largest non-EU market after the US, and in 2011 Turkey was the main destination of Spain's direct investment abroad. Per capita income trebled in dollar terms in the last decade, enhancing the attractiveness of a huge market whose infrastructure needs are high.

Analysis:

Background

The Turkish economy grew by more than 8% in 2010 and 2011 and came down with a bump in 2012 when growth was around 3%, a rate that was still the envy of euro zone countries such as Spain, which has been mired in recession for four years. Like the Spanish economy at the height of its boom in 2007, when the current account deficit reached 10% of GDP, the Turkish economy became overheated and needed to correct imbalances. Its current account deficit was close to 10% in 2011 and was still high at around 7% in 2012, while inflation was 9% last year (see Figure 1).

[*] *Associate Researcher at the Elcano Royal Institute and author of six Working Papers on Turkey.*

Figure 1. Turkey and Spain, Macroeconomic Indicators, 2009-14

	2009 Current prices	2010 (1)	2011 (1)	2012 (1)	2013 (1)	2014 (1)
GDP at market prices						
Turkey (2)	952.6	9.2	8.5	2.9	4.1	5.2
Spain (3)	1,048.1	-0.3	0.4	-1.3	-1.4	0.5
Exports goods + services						
Turkey	222.1	3.4	6.4	15.3	5.9	6.8
Spain	250.7	11.3	7.6	4.0	6.4	6.2
Imports goods + services						
Turkey	232.6	20.7	10.9	-0.7	5.5	5.8
Spain	270.2	9.2	-0.9	-4.5	-1.3	2.4
Net exports (4)						
Turkey	-10.5	-4.3	-1.5	3.9	-0.2	-0.1
Spain	-19.5	0.3	2.3	2.6	2.5	1.4
Unemployment rate (%)						
Turkey		11.7	9.6	9.0	9.3	8.7
Spain		20.1	21.6	25.0	26.9	26.8
Current account balance (5)						
Turkey		-6.3	-9.8	-7.2	-7.3	-7.5
Spain		-4.5	-3.5	-2.0	0.5	1.8

(1) Percentage changes, volume (2008 prices). (2) Turkish Lira. (3) Euros. (4) Contributions to change in real GDP, actual amount in the first column. (5) As a percentage of GDP.
Source: OECD Economic Outlook, November 2012.

The slowdown is due to lower global growth, particularly in the EU, which has dented the surge in exports, the doubling of Turkish interest rates during 2012, the impact of civil war in Syria on Middle East trade routes and the perception of political risk in Turkey itself. Turkey has been part of the EU customs union since 1995 for goods (excluding agricultural products) and has been negotiating its entry into the EU since 2005 at a snail's pace.

Turkey's central bank engineered the slowdown to some extent through interest-rate hikes and curbs on lending growth (as a euro-zone country, Spain has no control over its interest rates as they are set by the European Central Bank for all 17 zone countries).

One of the activities to slow down the most has been construction which, as in Spain, is a traditional motor of the Turkish economy, but with much less dire consequences on employment as the sector is proportionately less important than Spain's. The structure of the Turkish economy is less lopsided. Building grew by only 0.4% in the third quarter of 2012, compared with more than 10% in the same period of 2011. Turkey was a major supplier of cement to Spain during its 10-year construction frenzy which fizzled out in 2008.

Despite the slowdown in activity, Turkish employment remained, in the words of the OECD, 'exceptionally resilient',[1] with most new jobs created in service sectors. The jobless rate continued to decline in 2012 to 9%, almost three times below Spain's official rate of 26%.

Turkey's exports were boosted in 2012 by gold sales, particularly to Iran, which some analysts say cannot be sustained. Total exports grew by close to 12% year-on-year in the third quarter, compared with 21% in the second quarter. The pace of growth would have been lower but for billions worth of gold sold to Iran. The Islamic Republic, hit by sanctions, is accumulating hard currency or its equivalent.

Some of the other similarities with the Spanish economy during its boom period are striking. As well as frenetic building, Turkey's imports soared, as a result of both strong domestic demand and competiveness losses. This led to a rise in import penetration in the consumer, intermediate and capital goods markets.

Unlike Spain, however, Turkey has kept its budget deficit and public debt in check. The budget deficit in 2012 was still well under the EU's 3% of GDP threshold and public debt was below 40% of GDP. The respective figures for Spain in 2012 were around 7% and 86%.

Turkey has also enjoyed a trouble-free banking system since the country's banking crisis in 2001 when bad loans wiped out half of Turkey's banks and the financial system needed a US$50 billion government bailout. Not a single Turkish bank has had to be rescued in the past decade.

All in all, Turkey's economic performance over the past decade has been one of the most successful among emerging markets. Per capita income has trebled to more than US$10,000 since Recep Tayyip Erdogan took office in 2003 at the head of an Islamist-rooted government. David Cameron, Britain's Prime Minister who has been courting Turkey, called the country 'Europe's Bric', the acronym for Brazil, Russia, India, China and South Africa.

Spanish Exports to Turkey

Exports to Turkey rose by more than €1 billion between 2007 and 2012 (see Figure 2) and reversed the trade deficit with the country, although this was due more to a big drop in imports as a result of Spain's recession, than to exports. As of 2008, Turkey has overtaken Mexico as the second-largest non-EU market for Spain after the US (see Figure 3), taking more than 2% of exports (half that to the US). China still accounts for less than 2% of exports. Spain's main exports to Turkey are cars, machinery, boilers, steel and iron, electrical appliances and chemicals.

[1] See OECD Economic Outlook 2012/2 at http://www.oecd.org/eco/economicoutlookanalysisandforecasts/turkeyeconomicforecastsummary.htm.

Figure 2. Trade between Spain and Turkey, 2007-12 (€ mn)

	2007	2008	2009	2010	2011	2012 (1)
Exports to Turkey	2,947	3,006	2,843	3,746	4,456	3,902
Imports from Turkey	**4,212**	**3,698**	**2,637**	**3,067**	**3,368**	**2,638**
Total trade	7,159	6,704	5,480	6,813	7,824	6,540

(1) First 10 months.
Source: Spanish Economy and Competitiveness Ministry.

Figure 3. Spanish Exports and Imports, 2012 (1) (€ bn)

	Exports	% of total	Imports	% of total	Balance
EU	116.1	62.7	106.7	50.1	+9.4
France	30.1	16.3	22.3	10.5	+7.8
Germany	19.3	10.4	22.7	10.6	-3.4
Italy	13.7	7.4	13.0	6.1	+0.7
UK	11.2	6.1	8.4	3.9	+2.8
Rest of Europe	14.6	7.9	14.8	6.9	-0.2
Russia	2.5	1.3	6.6	3.1	-4.1
Turkey	**3.9**	**2.1**	**2.6**	**1.2**	**+1.3**
US	7.5	4.1	8.1	3.8	-0.6
Latin America	11.6	6.3	16.8	7.9	-5.2
Brazil	2.4	1.3	3.0	1.4	-0.6
Mexico	2.7	1.5	4.7	2.2	-2.0
Asia	10.5	5.7	29.3	13.7	-18.8
China	3.1	1.7	14.9	7.0	-11.8
Rest of world	24.8	13.4	37.5	17.6	+7.2
Total	185.1	100.0	213.2	100.0	-28.1

(1) First 10 months and trade figures rounded to the nearest decimal point.
Source: Spanish Economy and Competitiveness Ministry.

Spanish Direct Investment

Spanish companies (see Figure 4) invested more than €7 billion in Turkey between 2007 and 2011, €4.5 billion of it in the latter year when Turkey accounted for close to 18% of total gross investment abroad, the largest share, compared with 16.6% in Poland and 16% in the UK and in Brazil, according to Spain's Registry of Foreign Investment. Gross investment in Turkey in the first half of 2012 was much lower at €117 million (3.3% of the total). The bulk of the investment in 2011 was due to BBVA's €4.2 billion purchase of a 24.9% stake in Garanti Bank, Turkey's largest by market value and one of the country's most solvent and efficient banks. Garanti has a non-performing asset ratio of just 2%, very low by Spanish standards. This move is quickly proving to be profitable for Spain's second-largest bank. Turkey accounted for 29% of BBVA's net attributable profit of €813 million generated in Eurasia in the first nine months of 2012.

Figure 4. Spanish Companies with Investments in Turkey

Sector	Company	Sector	Company
Agriculture	Eurosemillas		Simon Holding
	Semillas Fito		Essentium
	Viveros Provedo		Demol
Consumer goods	Mayoral		Colorantes Industriales
	Copreci		Cromogenia Units
	Inditex		Roca Sanitarios
	Mango	Services	Aplacats del Marbre
Raw materials, indust. products	Baley		Cala Cap Salou
	Carrocerias Ferqui		Barcelo Hotels
	Ficosa		SPTR Consult
	Asientos Esteban		Genesis Advisors
	Ormazabal		Telvent
	LPG Técnicas		Eliop
	Candemat		Mapfre
	Bamesa Aceros		Banco Sabadell
	Acerinox		BBVA

Source: Trade Office of the Spanish Embassy in Turkey.

Banco Popular, Spain's fifth-largest bank, is eyeing Turkey and according to remarks last December by Juan Echanojauregui, head of the international division, is considering applying for a banking licence or a local bank.

Turkey is also becoming increasingly important for the insurance group Mapfre, which acquired a majority stake in Sigorta, the 10th-largest non-life insurer, in 2007. Antonio Huertas, Mapfre's Chairman, announced last October that Turkey holds strategic significance for the company in its plans to expand into Eastern Europe and the Middle East.

Other significant Spanish investments are the acquisition in 2006 by La Seda –the textiles and chemicals group and one of Europe's largest producers of artificial and synthetic fabrics and yarns– of the textiles group Advansa, and Grupo Essentium's acquisition in 2008 of 88% of Universal Cimento –one of Turkey's biggest cement producers– for around €400 million. Essentium has an option to fully own Universal Cimento. Técnicas Reunidas has won contracts to modernise refineries and Indra in air-traffic surveillance.

The largest completed infrastructure project involving Spanish companies is the high-speed train line between Ankara and Eskisehir (245km). Construcciones y Auxiliar de Ferrocarriles (CAF) supplied 12 trains with six carriages for €220 million and OHL carried out the railway work. CAF was also awarded the contract to supply the Mediterranean coastal city of Antalya with 14 trams and 33 suburban trains for Izmir, the country's largest port, after Istanbul, on the Aegean coast.

In 2011, a consortium led by OHL won the €933 million contract to connect the railway lines that will unite the European and Asian sides of Istanbul, through two tunnels passing under the Bosphorus Strait. This will be the first line that connects the two continents, and will carry commuter, high speed and freight trains.

Inditex, the world's largest fashion retailer, has 146 stores in Turkey. Mango also has stores in the country.

The economic slowdown is unlikely to have any significant impact on direct investment in Turkey. The country won investment-grade status from the ratings agency Fitch last November for the first time since 1994, giving a confidence boost to the economy. The upgrading of a country's foreign-currency ranking (in this case to BBB- from BB+), which is expected to be followed by other agencies, usually accelerates the inflow of foreign investments. Fitch said it believed the economy was 'on track to return to a sustainable growth rate, having narrowed the current account deficit and lowered inflation after overheating in 2011'. It forecast growth in close to 4% in 2013.

It warned, however, that 'at some point, an external financing shock and a recession are likely. However, the agency believes the country's strong sovereign, bank and household balance sheets, and economic and exchange rate flexibility provide important buffers against shocks spreading into a wider financial crisis'.

If other rating agencies grant Turkey investment grade status then this would allow institutions, such as pension funds, to start investing in the country.

Turkey's level of foreign direct investment has grown in recent years but is still low. Even in a recession year, such as 2011, Spain attracted US$29.4 billion of inward FDI, almost double that of Turkey (see Figure 5) and the inward stock of FDI was only 18% of GDP at the end of that year compared with Spain's 42% (see Figure 6). According to Ilker Ayci, head of the Investment Support and Promotion Agency of Turkey (ISPAT), Turkey can set its sights on annual foreign direct investment inflows of 4% of GDP instead of the current 2.5%.

Figure 5. Foreign Direct Investment Inflows in Turkey and Spain, 2004-11 (US$ mn)

	2004	2005	2006	2007	2008	2009	2010	2011
Turkey	2,785	10,031	20,185	22,047	19,504	8,411	9,038	15,876
Spain	24,760	25,020	30,802	64,264	76,993	10,407	40,761	29,476

Source: World Investment Report 2012, UNCTAD.

Figure 6. Foreign Direct Investment Inward Stock 2004-11, (% of GDP)

	2004	2005	2006	2007	2008	2009	2010	2011
Turkey	9.8	14.8	17.9	23.8	11.0	23.4	25.3	18.0
Spain	39.0	34.0	37.4	40.6	36.9	43.2	45.5	42.1

Source: World Investment Report 2012, UNCTAD.

Among the big infrastructure works planned for the future are more high-speed train lines, for which Spanish companies are well positioned. These lines are expected to account for 10,000 of Turkey's total 25,000kms of railway by 2023. Spain's high-speed rail network of more than 2,600km is the most extensive in Europe and the second in the world after China. A third airport is scheduled for Istanbul.

Conclusion: Turkey is clearly bound to become a richer country, whether it becomes a member of the EU or not, and continue to climb up the global GDP league. It also has a very large population (at 73 million, 26 million more than Spain's) and hence a budding market for goods and services. Since 2009, the country has been one of seven countries with which the Spanish government has an annual summit, a framework that is proving useful for identifying each countries' economic priorities. The political relation is also good: support for Turkey's EU membership cuts across the political divide between the conservative Popular Party, currently in power, and the Socialists, the main opposition.

According to a report by PwC, Turkey's per capita income will exceed US$35,000 over the next 30 years, roughly what Spain's is today.[2] Five industries –food & beverage processing, agricultural R&D and services, alternative energy, car production and tourism– have the potential to become regional centres of excellence, several of which are areas where Spain has expertise.

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[2] 'Turkey in 2041: Looking to the future' at http://www.pwc.com.tr/tr_TR/tr/publications/arastirmalar/pdf/turkey-in-2041-eng.pdf.