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Is Turkey's Economy on the Brink of Collapse?

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In recent months, much has been written about Turkey's economic prospects. Some commentators claim that the economy is on the brink of collapse, or at least that there is high risk of collapse, while others believe that it is stable. The optimists predict that Turkey's economy will continue to develop at a fast pace and that by 2017, its growth rate will surpass that of China, while the pessimists predict a collapse as a result of an inability to finance the growing debt. Is such a collapse likely to happen?

Turkish economic data can be misleading, and that is the reason for the contradictory commentaries. On the one hand, Turkey presents very impressive growth rates (8.2 percent in 2010 and about 8 percent in 2011). In 2012, a year of slow economic growth worldwide, economic growth is forecast at between 0.5 and 4 percent. On the other hand, some claim that growth in Turkey is artificial and has been caused by excessive spending financed by cheap credit.

Economic growth in the recent years has also been encouraged by foreign investment. Between 2003 and 2008, foreign investment was estimated at about $75 billion (an average of $15 billion a year). Since then the level has fallen to about $8 billion in 2009, $9 billion in 2010, and $11 billion in 2011. Because of the expected weaknesses in the global economy in 2012, the level of foreign investments in Turkey is expected to fall.

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Turkish stock exchange data indicate high volatility, which might discourage foreign investors, although many see an opportunity in these declines. Those who invested in the stock market in 2011 lost a lot of money (as the stock market index fell about 23 percent). Although in 2011 many stock exchanges experienced declines, Turkey's decline was particularly steep. Since the beginning of 2012, a recovery has been underway, but has yet to make up for the 2011 losses.

Turkish industry has greatly developed in recent years, especially in the manufacture of cars, buses, textiles and building materials. Exports, many of which go to Europe, are expected to suffer in 2012 as a result of the Eurozone crisis. Furthermore, the economic consequences of the Arab Spring might also cause a slowdown in Turkish exports, as many Arab countries are experiencing economic crisis and political instability. From 2002 to 2009, Turkish exports to Arab countries increased fourfold. In 2010, they totaled $27 billion, almost double their 2009 level, but in 2011, they fell by 13 percent. In 2011, Turkey made up for this by exporting more to other countries, thus increasing its exports to an all-time high of $135 billion. In January 2012 total exports were 10 percent higher than in January 2011. The Turks are not resting on their laurels and are encouraging exports to different countries, especially the rich Gulf States that have not been affected by the Arab Spring and may be the source for investment in the Turkish economy. At the same time, they have not lost hope in the markets that have experienced the Arab Spring: in October 2011, anticipating new opportunities, Prime Minister Erdoğan, along with 200 Turkish businessmen, visited Egypt, Tunisia, and Libya in an effort to promote business in those countries. The recent increase in tension between Turkey and Iran may also negatively affect Turkish exports to Iran that increased considerably in the last few years. A dramatic rise in oil prices due to the widening of sanctions on Iran might also cause an increase in the price of oil imported to Turkey (about a third of Turkish oil imports come from Iran), with adverse effects on its economy. Turkey is considering importing oil from other sources, mainly Saudi Arabia, but such a move might increase costs, and may damage trade between Turkey and Iran.

Many commentators consider Turkey's credit problem to be the economy's main problem. Turkey is very dependent on external borrowing: from 2009 to 2011, Turkish banks flooded the economy with credit. Prime Minister Erdoğan was accused of using credit to buy votes in the last elections. The danger of relying on credit is the risk of default. The situation might be similar to the one experienced by Argentina in 2000 and Mexico in 1994. Greece has already reached a cessation of payment, but the Eurozone, especially Germany, came to the rescue. Dubai also experienced a crisis in 2009 when its national debt rose to $60 billion, but received aid from Abu Dhabi, its fellow Emirate, and debt rescheduling was organized. Turkey, however, is not a member of the Eurozone or of a political-economic union such as the GCC. No one will necessarily come to the rescue if it reaches a credit crisis and threatens to default.

Because of Turkey’s large private sector debt, the world’s main credit rating agencies have lowered the country's credit rating, from “positive” to “stable”/“stable with a warning.” The external debt reached 43 percent of GDP in 2010 and 40 percent of GDP in 2011. In comparison, Greece’s total debt (mostly external) reached 137 percent of GDP at the height of its crisis. However, countries can reach a crisis at a much earlier stage; for example, Argentina went bankrupt with a national debt to GDP ratio of 50 percent.

The inflation rate in Turkey, which increased to approximately 10 percent in 2011, is another problem. In 2012, inflation is expected to stay high. As a preventative measure, the Central Bank has sold dollars, and thus early this year stabilized the Turkish lira, whose value greatly eroded in 2011. If the government does not act, high inflation will continue, which may in turn force it to raise interest rates. This would increase the cost of debt servicing in a way that could lead to bankruptcy. Many economists claim that the policy of low interest rates when inflation is rapid is not sustainable. When the day arrives that Turkey has to raise interest rates, its economy might suffer a major blow, since it will be even harder to repay debts. The government is worried that raising interest rates will cause another increase in inflation and a slowdown in growth.

During 2011, the exchange rate of the Turkish lira fell by 22 percent against the US dollar, and in 2012 it may continue to decline. In 2001, during one of the most serious crises in the Turkish economy, the lira depreciated by 50 percent overnight. There are no guarantees that this will not happen again.

In conclusion, Turkey’s credit problem, accompanied by high inflation and a depreciated currency, creates difficulties for its economy. If Turkey does not continue selling dollars and does not implement a more cautious credit policy, its economy might collapse. Trends in early 2012 indicate that the government is aware of the risks and is trying to reduce them. However, it has not yet raised interest rates, and as long as inflation remains high and interest rates are low, the economy is exposed. It should be noted that the development of Middle Eastern economies greatly depend on the regional politics, and Turkey’s promotion of a more Islamic agenda may turn foreign investors away and reduce the demand for Turkish products abroad. An economic crisis will have implications on the internal stability and the government might lose support. In such a situation, unrest is possible, especially in the east of the country, where the Kurdish population, which along with national aspirations has a dire economic situation, is concentrated. The benefits of economic growth in Turkey have not been equally distributed. A small number of industrialists and merchants have earned huge incomes from the massive industrialization and growing trade, while the majority of the population has become poorer as a result of inflation. One of Turkey's comparative advantages is its cheap labor force, and once workers' wages are linked to inflation, labor costs will rise, possibly damaging production and trade.