

FORTIS BANK

Macro Scope

23 November - 6 December 2009

Weekly Economic and Strategic Review

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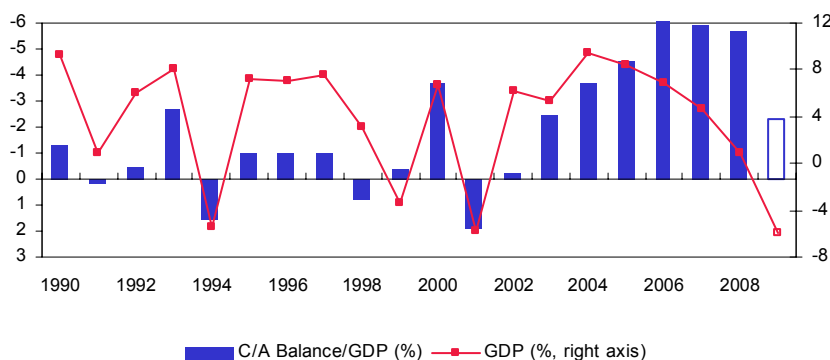
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Diagnosis Of A Chronic Case...

For a majority, the “Structural Transformation in Foreign Trade” would mean Turkey’s transformation to a net exporter, meaning that the country’s exports surpass imports. This big dream, which is also expressed as an export-led growth, often becomes a popular theme in crisis periods, where the economy contracts leading to a rapid decline in foreign trade deficit and current account (C/A) deficit. However, once the economy starts to recover, these favorable dynamics in the external balance tend to be reversed again, since the external deficit is structural and this dream ends up fading away. **There are two dimensions of the structural deficit. First of all, Turkey is an energy importing country.** This would not change unless finding rich reserves of crude oil and natural gas in Turkey. As of September 2009, the 12-month rolling C/A deficit stands at US\$14.6bn, compared to US\$12.9bn surplus excluding mineral fuel and oil (this group includes oil and natural gas). This explains how influential the first structural factor is. **The second important structural factor is the extensive dependency of exports on intermediate good imports.** Even though this seems to be a quite familiar topic, in essence the discussions are mostly grounded on a batch of researches that were conducted after 2001 crisis. To explain this dependence more clearly, the ratio of exports to intermediate good imports is higher than 1 in Turkey. That is the highest ratio among the emerging countries (China has the lowest figure). Fortunately, the new studies explain to what degree this recently strengthening tendency is related to structural factors, helping the foreign trade dynamics to be understood more clearly. These are the researches conducted by the Central Bank and presented in a conference called “The Structural Transformation in Foreign Trade: Global Dynamics and Turkish Economy”. Here in this week’s report, we will mention the key findings of these unpublished researches. The introductory speech by CBT Governor Yilmaz provided a good summary of the global tendencies.

Current Account Balance and Growth

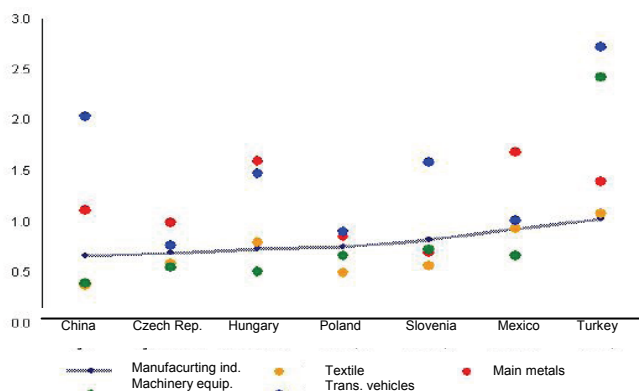


(*) 2009 values are Fortis Research forecasts

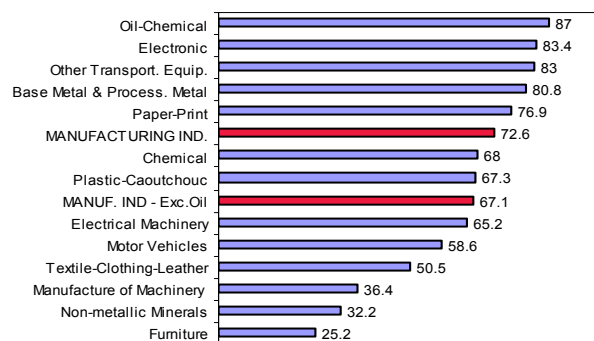
Source: CBT, TURKSTAT, Fortis Economic Research and Strategy

The first point in Yilmaz's speech was that the inter-industry trade which formed the basis of international trade in the first half of the last century has been replaced by intra-industry trade in today's World. The international trade depends on the exchange of products in similar groups rather than different group of products. The developments in the automotive sector can be good example to this. As a second point which is also related to the first one was that the share of industrial goods in the emerging markets' exports has been increasing, while the developed countries' exports have been shifting towards the services sector from the industrial goods. The developed countries introduce new products and technologies to the market by taking advantage of their research and development activities, qualified workforce, as well as technological know-how. Through time, these products turn to be producible by the standard technologies and unskilled workforce, with the industry centers start being shifted to emerging countries from the developed universe. The third point was about the "vertical specialization" that has been another evolving trend in the global trade. Technological developments allow the companies to segregate their production process into sub-processes, which necessitate different factor orientations. Therefore, each sub-process can be carried out in different countries. Accordingly, the companies can choose the most advantageous region for each process and reduce their cost. The fourth point was about the dominance of multinational companies on directing the global production chains and the role of direct investments in this process. While these investments boost the exports of emerging countries, they, at the same time, urge the need for new capital and technology. On the other hand, this new trade system, where vertical specialization is needed, makes the economies more import-dependent. With the global production chains becoming more widespread, the firms in the emerging countries that produce for the multinational companies become obliged to import the intermediate and investment goods from the other countries commercially related with the multinational company in order to meet the required quality level.

Intermediate Goods Imports Per Unit Exports



Share of Imports in Raw Materials, 2007 (%)



Source: CBT, Fortis Economic Research and Strategy

The other research that was also presented in the conference under the title of "The Structure of Imports in the Turkish Manufacturing Sector" was based on a comprehensive survey conducted with 145 companies from different sectors. The study analyzes the impacts of the global tendencies to the Turkish economy and aims to find the reasons of the increase in especially the share of imported inputs. Based on the companies' statements, there are two different factors behind this development: 1) The firms are more inclined to use imported intermediate and investment goods, 2) The change in the economy's structure of specialization in foreign trade. For the 1st factor, the firms stated that the most important reason that pushed them to import is the insufficient domestic production of basic intermediate and investment goods (this factor explains approximately 60% of total intermediate and investment goods imports). The other important reason was stated to be the need for using high quality intermediate and investment goods (this factor explains approximately 20% of total intermediate and investment goods import). Coming to the 2nd factor, the

sectors which have become more dominant in the new specialization structure are more import-dependent than the traditional labor-intensive sectors. Automotive, durable goods and base metal sectors, which directly or indirectly use more imports of raw material, expanded fast in the period behind, contributing to the increase in the share of imported inputs. The remarks in the conclusion part of this study were very much similar to the assessment that we have been stressing for a long time and which are repeated in the beginning of this weekly. *“It can be said that the import-dependence in the Turkish economy has a structural characteristic. In other words, we think that Turkey’s natural resources, insufficient allocation of resources to the production of raw materials and intermediate goods, difficulties in procurement of high quality intermediate goods, lack of specialization in high value-added levels of production, a limited ability of investment goods production are the reasons behind the high level of import-dependence, which is lifted further by the change in the structure of specialization in the foreign trade. Since the import-dependence has a structural characteristic, the decline in the import-dependence and the contracting foreign trade deficit would ascend back to pre-crisis levels in parallel to the strengthening domestic and external demand. Accordingly, for a permanent solution, medium-long term policies that reduce the import-dependence should be launched. In the meantime, the export performance has an important role in limiting the foreign trade deficit. Under this context, in addition to increasing the export volume, the companies should specialize on the production of high value-added goods and/or transforming their current production facilities in a way that would generate greater value-added.”*

Factors That Push Firms To Import More (%)

Sectors	Cheaper Supplies	Continues and Better Quality Supplies	Insufficient Domestic Production	Relations With Other Firms	External Loans	Total
<u>Raw Materials</u>						
Simple Average	20.1	18.8	53.8	4.2	3.1	100.0
Firm Size Weighted Avg.	12.6	15.1	61.4	9.6	1.3	100.0
Firm Size Weighted Avg. – Excl. Oil	15.9	19.1	51.2	12.2	1.6	100.0
Sector Weighted Avg.	21.1	20.2	51.8	3.9	3.1	100.0
Sector Weighted Avg. - Excl. Oil	21.4	21.0	50.8	3.9	3.0	100.0

All in all, in the recent global tendency, the import-dependence is rising due to the vertical specialization that is urged by the global production chains directed by the multinational companies. Besides the structural transformation, the impact of this tendency is felt more in Turkey due to the insufficient domestic production and inadequate quality of the intermediate good produced at home. The survey data compiled from companies showed that the prices (F/X rates) are not as influential as thought in increasing the import-dependence. Rather than the F/X rates that may affect the profitability in the short term, other factors, such as the quality of technology and infrastructure investments, increasing the skilled workforce, encouraging the research and development investments are certainly more important in the medium-long term.

Economic and Political Agenda

▪ In the upcoming two weeks, the Financial Stability Report (November 24th), Treasury's Borrowing Program (November 26th), summary of MPC meeting (December 3rd), foreign trade and inflation will be among the key developments. The domestic markets will be closed on 27th and 30th November. Coming to the external arena, Eurozone and U.S. PMIs, as well as the housing and labor market data will top the agenda.

Data issuances at Home

Importance	Indicator	Unit	Date of issuance	Fortis (Consensus)
High	Real Sector Confidence Index, Nov.		Nov. 24 th , 15:00 GMT	-
Medium	ICC Price Index, Nov.	% m/m	Dec. 1 st , 10:00 GMT	-
High	CPI & PPI, Dec.	%m/m	Dec. 3 rd , 15:00 GMT	-
High	Imports & Exports, Oct.	US\$ bn	Dec. 4 th , 15:00 GMT	12.9 & 10.1

Importance	Country	Indicator	Unit	Date of Issuance	Consensus
High	Eurozone	Services & Manuf. Flash PMI, Nov.	-	Nov. 23 rd , 8:58 GMT	52.9 & 51.1
High	U.S.	Existing Home Sales, Oct.	mn	Nov. 23 rd , 15:00 GMT	5.65
High	U.S.	GDP (1 st revision), 3Q	% q/q	Nov. 24 th , 13:30 GMT	3.3
Medium	U.S.	Consumer Confidence Index, Nov.	-	Nov. 24 th , 15:00 GMT	49.0
High	U.S.	Core PCE, Oct.	% m/m	Nov. 25 th , 13:30 GMT	0.1
High	U.S.	Durable Orders, Oct.	% m/m	Nov. 25 th , 13:30 GMT	0.5
Medium	U.S.	Michigan Sentiment Ind., Nov.	-	Nov. 25 th , 14:55 GMT	66.0
High	U.S.	New Home Sales, Oct.	Mn	Nov. 25 th , 15:00 GMT	0.41
Medium	Eurozone	Manufacturing PMI, Nov.	-	Dec. 1 st , 8:00 GMT	-
Medium	U.S.	Manufacturing ISM, Nov.	-	Dec. 1 st , 15:00 GMT	-
Medium	U.S.	Pending Home Sales, Oct.	% m/m	Dec. 1 st , 15:00 GMT	-
Medium	U.S.	ADP Employment, Nov.	K	Dec. 2 nd , 13:15 GMT	-
High	Eurozone	Services PMI, Nov.	-	Dec. 3 rd , 8:58 GMT	-
High	Eurozone	ECB Rate Decision	bps	Dec. 3 rd , 12:45 GMT	no change
High	U.S.	Non-manufacturing ISM, Nov.	-	Dec. 3 rd , 15:00 GMT	-
High	U.S.	Non-farm Payrolls & Unemp., Nov.	K & %	Dec. 4 th , 13:30 GMT	-

Macro-Economic and Financial Forecasts

Macro Economic Outlook of 2007-2010

	2008	2009f	2010f	2011f
GDP (TRY - bn)	950.1	973.5	1,066.7	1,179.7
GDP (US\$ - bn)	734.9	628.0	688.2	718.8
GDP Growth (y/y % chg)	0.9	-6.0	4.0	5.0
PPI (y/y % chg)	8.1	4.0	5.0	4.0
CPI (y/y % chg)	10.1	5.5	6.5	5.5
Trade Balance (US\$ - bn)	-69.8	-37.6	-58.0	-63.8
Exports (FOB, excl. luggage trade)	132.0	101.3	126.2	122.9
Imports (CIF, incl. gold)	201.7	138.8	184.2	186.7
Current Account Balance (US\$ - bn)	-41.7	-14.4	-30.6	-33.9
Current Account Balance / GDP (%)	-5.7	-2.3	-4.4	-4.7

Financial Indicators Forecasts

	Nov. 20 th	1M	3M	6M	12M	2009	2010
US\$/TRY	1.4831	1.4800	1.5200	1.5800	1.5600	1.4800	1.5600
EUR/TRY	2.2046	2.1850	2.2300	2.2900	2.2500	2.1800	2.2500
FX Basket	3.6877	3.6650	3.7500	3.8700	3.8100	3.6600	3.8100
EUR/US\$	1.4865	1.4750	1.4700	1.4500	1.4400	1.4750	1.4400
O/N	6.50%	6.25%	6.25%	6.25%	7.25%	6.25%	7.75%
Benchmark Bond	8.70%	8.70%	8.50%	8.50%	10.50%	8.70%	10.50%

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