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INVESTING IN TURKEY

GETTY IMAGES/Ed Pritchard

A confident country leads Europe's recovery

GDP shows robust rise as exports revive; recent reforms aim to attract more investors

Presenting this year's European champion for economic growth: Turkey.

Turkey's economy has not only bounced back from the global economic crisis, it's already doing better than before.

Even though the country's banking system was one of the few healthy ones in the world, Turkey got hit hard by the crisis as exports fell and as investors lumped it with other emerging markets that they shunned during uncertain times.

"In the first quarter of 2009, the decline [in gross domestic product] was very steep, almost 14%," says Josef Pöschl, economist at the Vienna Institute for International Economic Studies. "Nevertheless, everyone is very impressed by the strong recovery." GDP rose 11.7% in the first quarter and 10.3% in the second. Total GDP "is back to the pre-crisis level and even above it," Dr. Pöschl says. Exports, too, are up, rising 13% in the January to August period, though the totals are still below pre-crisis levels.

With the economy back on track quickly — Turkey is expected to have one of the fastest-growing economies among members of the Organization for Economic Cooperation and Development, the Paris-based think tank projects in its latest report — Turkey recently has taken steps to solidify its foundation for long-term growth. It has tackled public debt, whittled the government budget deficit and taken steps to raise confidence and interest in privatizations and investment.

The global crisis squeezed Turkey as it did other countries, with rising government expenditures and falling tax revenues. Although Turkey backed away from a proposed law to limit fiscal deficits, it unveiled a three-year Medium-Term Plan, or MTP, that projects a budget deficit of 2.8% for 2011.

Tevfik Aksoy, head of economics

Continued on following page

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Continued from previous page

for Central and Eastern Europe, the Middle East and Africa for Morgan Stanley in London, says that's probably on the optimistic side for a year with general elections, although "nobody can look at the MTP numbers and call it election spending." He projects a budget deficit of 3.8% of GDP. "The thing is, 3.8% or even 4%, in today's developed markets are fairly benign numbers," he says. By contrast, the International Monetary Fund projects 2011 budget deficits of more than 5% for Spain and Greece and 6.7% for Ireland.

At the same time, Mr. Aksoy expects the debt-to-GDP ratio to keep declining as GDP continues to rise and the government maintains a primary budget surplus, which is defined as the budget balance excluding interest payments on government debt. "In the past, Turkey was a highly indebted country," he says. "There has been significant improvement." Before Turkey's 2001 banking crisis, government debt was more than 100% of GDP; today it's 45%, one of the lowest in the OECD, he notes.

Wooing investors

Turkey improved its finances through nearly a decade of reined-in spending. It also held a privatization drive from 2002 to 2007, and used the proceeds to lower general debt. Few assets remain to be privatized, but the government is wooing foreign investors in other ways.

The September referendum on the constitution should improve investor confidence, says Rizanur Meral, president of the Confederation of Businessmen and Industrialists of Turkey, or Tuskon, in Istanbul. The referendum included reforms to the judicial system, which in the past sometimes interfered with privatizations,

The Turkish government is encouraging investment in hydroelectric plants.

he says.

Meanwhile, the government is liberalizing the energy market, instituting new regulations to ensure a level playing field for foreign and Turkish investors alike, says Serdar Sayan, professor of economics at TOBB University of Economics and Technology in Ankara and director of the Entrepreneurship Institute at the Economic Policy Research Foundation of Turkey, or Tepav.

Turkey needs to expand energy production to keep pace with a growing population and a booming economy, while decreasing dependence on oil imports. The government is encouraging investment in hydroelectric plants in particular, with licenses for 1,200 new ones.

In fact, in 2009, the electricity, gas and water supply sectors brought in the most foreign direct investment, besting the financial sector, which had been the FDI leader from 2005 to 2008. Real estate and business services came in second, with finance third, according to data from the Turkish Central Bank. The largest investor was the Netherlands.

"With rapid growth and increased macroeconomic stability, there has been a quantum leap in FDI," says Dr. Sayan. FDI zoomed from $571 million in 2002 to $19 billion in 2007. The global crisis put a screeching halt to FDI world-wide in late 2008, including in Turkey,

REUTERS/Osman Orsal

Turkey is becoming wealthier, with per-capita GDP expected to rise to $10,043 by the end of this year and to $12,157 next year.

and 2009 remained quiet, with $6 billion of FDI. From January to July this year, Turkey attracted $2.5 billion of FDI, says Dr. Pöschl of WIIW.

One reason for the low FDI is that Turkish companies scooped up some of the electrical generation privatizations, says Dr. Aksoy of Morgan Stanley. "The glass is half full. Yes, FDI is down, but the Turkish companies will be borrowing funds from abroad. They're going to bring a lot of quality financing."

Turkey's interest rates are higher than in other countries, because the central bank is focused on reining in inflation, and that pulls in financial investors. The stock exchange main index is up 40% for the year. The next phase for FDI would be to attract more manufacturing and greenfield investment.

Such a shift would help ease unemployment, which was about 10% before the crisis and about 11.7% today, according to the OECD. The unemployment rate grew despite the economic recovery because Turkey's work force grew — through population growth but also because previously inactive women in urban areas started to look for jobs in big numbers, says Rauf Gonenc, head of the Turkey desk in the OECD's economics department. Turkey needs to create at least 500,000 jobs a year in the next few years to start to bring the employment rate in line with OECD averages, he says.

Despite the uptick in unemployment, Turkey's economy rebounded mostly thanks to domestic demand. First, it's a big market, with a population of 72

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million. Second, Turkey is becoming wealthier: the government expects per-capita GDP to rise to $10,043 by the end of this year and to $12,157 next year, says Mr. Meral of Tuskon.

A slew of strengths

"Turkey has a number of strengths that have emerged since 2001 and since the global downturn," says Susan Schadler, former deputy director of the International Monetary Fund's European department, where she led surveillance missions to Turkey, among other countries, and senior fellow at the Atlantic Council in Washington. The healthy financial system, a decade of stable governments, strong links to the European Union and a convergence to EU living standards and "a pretty good and growing record on inflation. They've managed to keep it in a 7% to 9% range for several years now."

Mr. Aksoy of Morgan Stanley also sees improvement. "I'm fairly optimistic about Turkey's economy," he says. "It's one of the high-growth stories. With the size of its GDP and population and the upside that it can offer, it's impossible not to be invested in Turkey."

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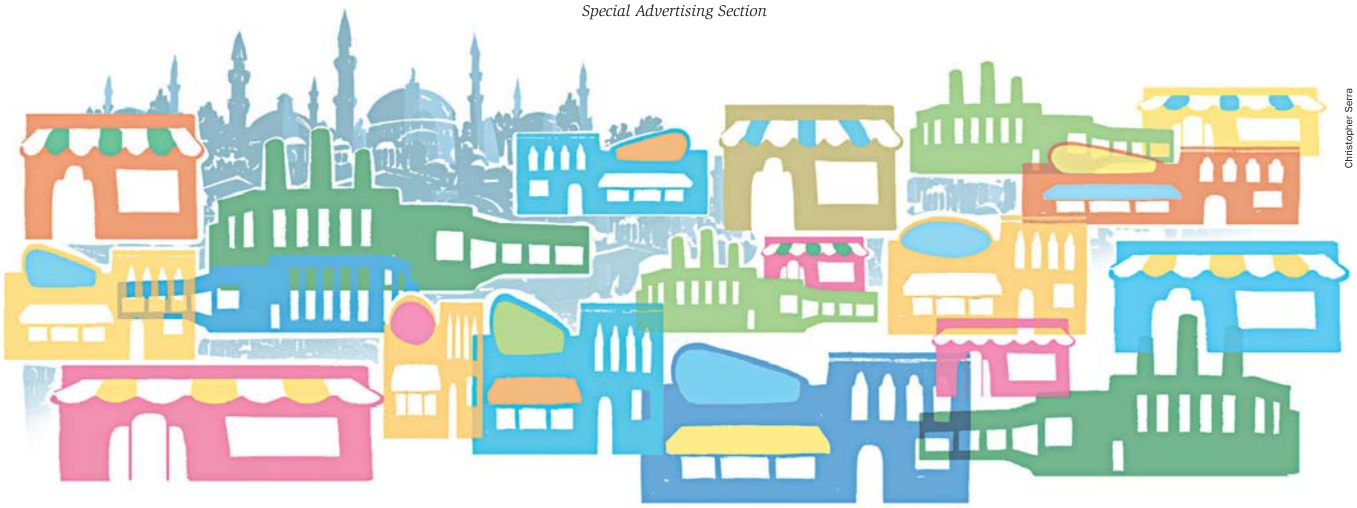

Christopher Serra

Big successes can come in small packages too

In Turkey, small companies do big things.

Turkey's small and medium-size enterprises, or SMEs, account for 99.9% of all businesses, 81% of total employment and 56% of exports. SMEs present opportunities for foreign investors, especially with recent changes in laws on mergers and acquisitions and increased assistance from the government.

"Today, SMEs are both the source and the driving force behind the entrepreneurship and innovation. This characteristic gives them the chance of growing fast," says Mustafa Kaplan, president of Turkey's Small and Medium Enterprises Development Organization, or Kosgeb, based in Ankara.

While some Turkish SMEs are tiny, many are innovative in technology and business practices. A survey of SMEs by the Turkish Statistical Institute from 2006-2008 found that 52% reported that innovation improved the quality of their goods or services, and 30% were active in technological innovation.

"Turkish SMEs are not in the inefficient, traditional model of small, technologically backward enterprises," Mr. Kaplan adds.

Textiles and automotive parts and accessories are among the biggest sectors for Turkish SMEs, says Serdar Sayan, professor of economics at TOBB University of Economics and Technology in Ankara and director of the Entrepreneurship Institute at the Economic Policy Research Foundation of Turkey, or Tepav.

In textiles, as cheap Asian competitors threatened to squelch Turkey's market share, some Turkish mills responded with research and development to create new, high-tech fabrics.

Ekoten A.S., a textile company in Izmir, develops smart fabrics, whose special qualities range from waterproof, nonflammable, stain-resistant and thermal properties to unlimited washing without shrinkage or fading. Customers include Nike, Topshop, Marks & Spencer, Decathlon and Benetton. Though it's one of Turkey's top 500 companies, Ekoten is technically an SME, with just 350 employees. Proof of its resilience: Revenue rose 15% in 2009 — the depths of the global downturn — to €45 million.

Technology is another strong sector for SMEs, Dr. Sayan says. "Software companies are mushrooming all over Turkey. Some employ just a few people. Computer game production also has become a very popular area.

When the global economic crisis hit Turkey's big export markets in Europe, SMEs nimbly won openings in new markets, particularly in Central Asia, the Middle East and Africa.

"Because Turkey is based in middle of East and West, Turkish managers can establish very good relations with Western people as well as with Eastern people," says Rizanur Meral, president of the Confederation of Businessmen and Industrialists of Turkey, or Tuskon, in Istanbul.

> *"Today, SMEs are both the source and the driving force behind the entrepreneurship and innovation. This characteristic gives them the chance of growing fast."*

In some ways, entrepreneurship is steeped in Turkey since ancient times. The global success of today's SMEs, however, dates to the opening of Turkey's economy in the 1980s, says Susan Schadler, former deputy director of the International Monetary Fund's European department, where she led surveillance missions to Turkey, among other countries, and senior fellow at the Atlantic Council in Washington.

"There's been an enormous change in Turkey's growth model from a domestic market focus to the opening of the economy and promotion of exports as an engine of growth," she says. "We actually see ongoing effects of profound shifts in policy over a long period of time. The strength of SMEs in Anatolia is a lagged effect of the change from the 1980s." SMEs in Anatolia, or the Asian part of Turkey, were extremely dynamic when Turkey opened its economy, earning the name "Anatolian Tigers."

The government is stepping up help to SMEs to keep the growth story going. During the economic crisis, Kosgeb provided €4 billion of support to 180,000 SMEs, says Mr. Kaplan of Kosgeb.

Financing is typically difficult for SMEs in any country. Turkey's government is running programs to provide credit guarantees for SMEs and other programs to monitor which companies repay their loans on time, to assuage banks' wariness about lending, says Josef Pöschl, economist at the Vienna Institute for International Economic Studies.

The financing picture has eased this year, says Dr. Sayan of Tepav. When the economic crisis hit in late 2008, Turkish banks panicked, even though they were among the healthiest in the world. Fearing a credit crunch, they stopped making new loans. "It put SMEs in a difficult position," he says.

However, since the first quarter of this year, loans to SMEs have marked a steady increase."It indicates things are looking bright for SMEs," says Dr. Sayan.

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