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Turkey Overtaking Germany No Wishful Thinking on Paradigm Shift  
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By Steve Bryant and Ben Holland

April 7 (Bloomberg) -- Erda Gercek spent 20 years outside Turkey, identifying stock market winners as a fund manager at Citigroup Inc. and Legg Mason Inc. Now he has moved back to his homeland, saying it's a buy.

"In the time I was away, Turkey went from a highly volatile, boom-and-bust economy to one that's relatively stable as inflation and interest rates came down," Gercek, 44, said in an interview from Izmir, south of Istanbul. He said he's "nurturing future talent," teaching courses in fund management at Istanbul's Bilgi University and Izmir Economy University.

The paradigm shift, as market strategist John Lomax of HSBC Holdings Plc calls it, was engineered by a government that the military and prosecutors say is trying to turn Turkey into an Islamic state. As Prime Minister Recep Tayyip Erdogan fought off pressure from secularist generals who ousted four governments since 1960 and also a lawsuit to shut his party, he reined in government spending, sold state-owned companies and crisscrossed the region to open trade doors for Turkish business.

The payoff has been average economic growth of 4.4 percent since he was first elected in 2002. Gross domestic product increased at an annual rate of 6 percent in the fourth quarter of 2009, lagging behind only China among the Group of 20 nations, the government said last week. Deputy Prime Minister Ali Babacan said April 2 the economy may have expanded by more than 10 percent in the first quarter.

Turkey's \$620-billion economy could move ahead of Germany's to become the third-biggest in Europe by 2050, behind Russia and the U.K., Goldman Sachs Group Inc. economist Ahmet Akarli wrote in a report published in 2008.

#### 11 Countries

It was a follow-up to research by Jim O'Neill, Goldman Sachs's chief global economist, that listed Turkey among emerging markets that could become world leaders. O'Neill's study was published in 2005, the year Turkey started talks to join the European Union.

It's the youth of Turkey's 73 million people that drives much of the optimism. More than a quarter are under 15 years old and 6.3 percent are over 65, according to the 2009 census. In the U.S., 19 percent are under 15 and over-65s make up 13 percent of the 316 million population, data compiled by Bloomberg show.

Turkey is also younger than China, where 19 percent of 1.4 billion people are under 15 and 8.4 percent over 65. In countries that share the euro, 17.5 percent are over 65 and 16 percent are under 15.

Turkey's demographics "can sustain very high levels of growth," and there's "ample potential" to put more young people to work in industries that are more productive, Gercek said. Sustaining 6 percent growth "seems to me to be perfectly achievable," he said.

## IMF 'Walking Stick'

Erdogan, 56, has cast aside what he calls "walking stick" loans from the International Monetary Fund, which sustained Turkey through most of the past two decades.

The premier announced March 10 that Turkey was breaking off almost two years of loan renewal talks with the IMF and turning its back on a credit line worth as much as \$40 billion. Turkey survived the global economic crisis on its own, without bailing out a single bank, and doesn't need the money, the premier said.

In the past, any glitch in Turkey-IMF talks would prompt investors to sell. The lira shed 2.6 percent of its value against the dollar in two days in March 2005 as legislative delays threatened a \$10 billion IMF loan. The benchmark ISE 100 stock index slumped 20 percent in two weeks in July 2001 amid a dispute with the IMF over selling state companies.

Now, investors are betting Erdogan is right. The ISE-100 has climbed about 130 percent in dollar terms in the past 12 months, almost double the gain of Morgan Stanley Capital International's benchmark emerging market index. The Turkish index is up more than 10 percent since the March 10 break with the IMF.

## Lira Steady

Lower inflation has reduced bond yields, above 50 percent for much of the pre-Erdogan decade, to about 9 percent. And the lira has held close to 1.50 per dollar since October 2008, even as the central bank slashed interest rates by more than half to a record low of 6.5 percent. The cost of insuring against a default on Turkish debt plunged in the past 12 months to 165 basis points from 360 a year ago.

Investors now reckon six EU member countries, including Turkey's neighbors Greece and Bulgaria, are more likely to default. Greece's ratio of debt to GDP will rise to 96.3 percent this year, according to a January government forecast. Turkey's official target is 49 percent.

Greece, Turkey's longtime rival, has profited from its neighbor's rise: National Bank of Greece SA, the nation's biggest lender, generated 46 percent of net income last year from its Turkish unit Finansbank AS in Istanbul.

## Buying Balkans

Now it's Turkish companies that are potential buyers outside their home market. Turkiye Is Bankasi AS, the country's biggest publicly traded bank, may buy assets in Balkan countries should they come up for sale as Greek competitors feel the pinch of the government's budget cuts.

"We keep looking for opportunities, and I think the problems in Greece will trigger some interest by Turkish banks in the Balkans," Is Bankasi Chief Executive Officer Ersin Ozince said at an Istanbul press conference on March 31. He declined to give details and said the bank has "no immediate plan" for investments in the region.

Greece is trying to cut its deficit to 8.7 percent of GDP this year from 12.7 percent in 2009, the biggest any euro member nation has reported in the currency's 11-year history. Turkey is on course to beat its deficit goal of 4.9 percent of GDP in 2010.

## Mexican Food

Turkey's prosperity is visible in the villas and new apartments in the Cayyolu suburb west of Ankara, where in the evenings Turks gather at Mexican or Chinese restaurants and drink specialty beers. Fifteen years ago it was wheat fields.

Chosen as the capital by Turkey's founder Mustafa Kemal Ataturk in 1923, Ankara was at the heart of his efforts to emancipate women, restrict the social role of Islam and develop the economy through state planning. It's still the headquarters of state companies such as agricultural lender TC Ziraat Bankasi AS, Turkey's biggest bank.

Erdogan, who hails from the business capital, Istanbul, has dismantled the state-dominated economy, selling more than \$30 billion of government assets since coming to power in 2002.

While the premier has promised to win EU membership for Turkey, the bloc's cold shoulder in recent years, driven by French President Nicolas Sarkozy and German Chancellor Angela Merkel, has pushed him to seek friends elsewhere.

In the past seven years, while total annual exports tripled to \$102 billion, sales to the Middle East grew twice as fast. Erdogan has worked to build political ties in the region that will help companies expand. He flew to Syria in December with more than 200 company executives on his plane.

## Government Listens

Erdogan's government has paid attention to the needs of business, said Bulent Celebi, who returned to Turkey in 2004 after more than a decade working in California's Silicon Valley. Celebi has set up AirTies, an Istanbul-based maker of wireless routers and Internet television technology.

"I used to come to all these conferences and do all these great speeches and think that nobody ever listens, but maybe they listened," Celebi said. "They took tangible action. They said OK, every school in Turkey is going to have ADSL."

Turk Telekomunikasyon AS in Ankara has extended broadband networks throughout the country, said Celebi, whose company had \$36 million of sales last year. He also cited laws that encourage research by granting tax incentives and measures that require technology investors to use local products.

## Cheapest in a Generation

Credit is the cheapest in a generation for Turkish companies as banks, including Isbank and Istanbul-based Akbank TAS, in which New York-based Citigroup holds a 20 percent stake, followed Central Bank Governor Durmus Yilmaz in lowering interest rates. Consumer prices rose 5.1 percent in the 12 months through October, the lowest in almost four decades.

The inflation rate has since increased to 9.6 percent, prompting some economists to question whether Turkey has solved its long-term problems.

"In the most disinflationary environment you can imagine, inflation bottomed out at 5 percent and, in the blink of an eye, ping, it was back at 10 percent," said Akarli, the author of Goldman Sachs's 2008 report on Turkey's prospects of pulling ahead of Germany.

Surpassing Germany is a long way off. The German economy was about \$3.6 trillion in 2009, more than five times the size of Turkey's. Germany's jobless rate is 8 percent, almost half the rate in Turkey, where about 1 million young people enter the workforce every year.

#### Judicial Appointments

Erdogan's political battles aren't over, either. He proposed constitutional changes last month that would make it harder to ban political parties -- a fate the premier himself narrowly escaped in 2008 when the Constitutional Court rejected a lawsuit to close his party by a single vote -- and increase parliament's role in judicial appointments.

Opposition leaders and top judges lined up to denounce Erdogan, who could become Turkey's longest-serving premier for more than 60 years if he wins re-election in 2011, for politicizing the courts. Secular opposition leader Deniz Baykal called the proposals a "fiasco."

Investors haven't been fazed. The main share index rose 14 percent in March. That's partly because Turkey's economy has matured to a level where it's increasingly insulated from political upheaval, said Murat Koprulu, the Turkish-born chairman of Multilateral Funding International in New York, which manages about \$120 million of emerging-market assets.

"It's not an agrarian economy, it's not a desert economy, it's an economy with a deep manufacturing base and a large middle class," Koprulu said. Turkey "is going to pick itself up again after a political crisis and show some growth again."

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