

VAKIFBANK TURKISH ECONOMY WEEKLY

*Are There Any Risks About
Growth of Turkish Economy?*






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The effects of recent rise in oil prices on economy and financial markets become the main topic of the latest researches. This study focuses on the effects of high oil prices on growth of Turkey.

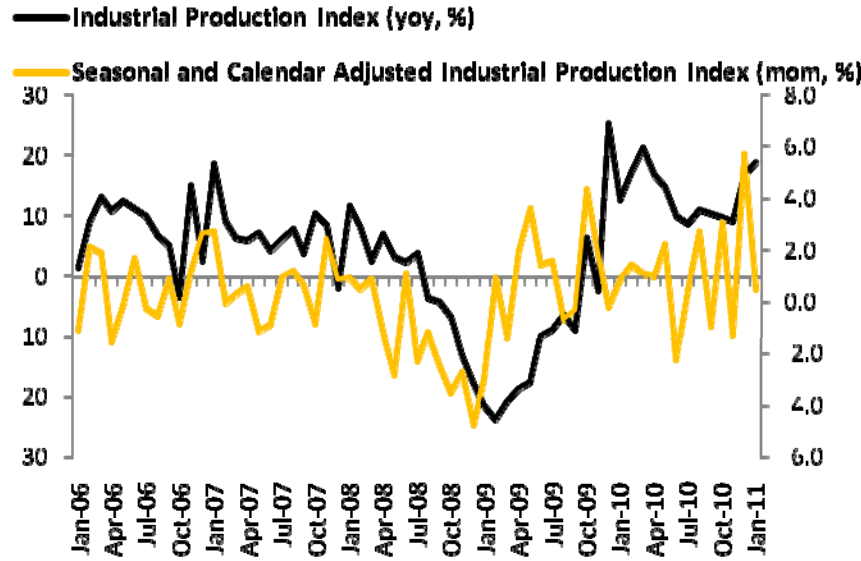
This study follows,

-  **Industrial production index (IP),**
-  **The effect of oil price shocks on the growth of Turkey,**
 - Historical Analysis,**
 - Econometric Analysis,**
-  **Conclusion.**

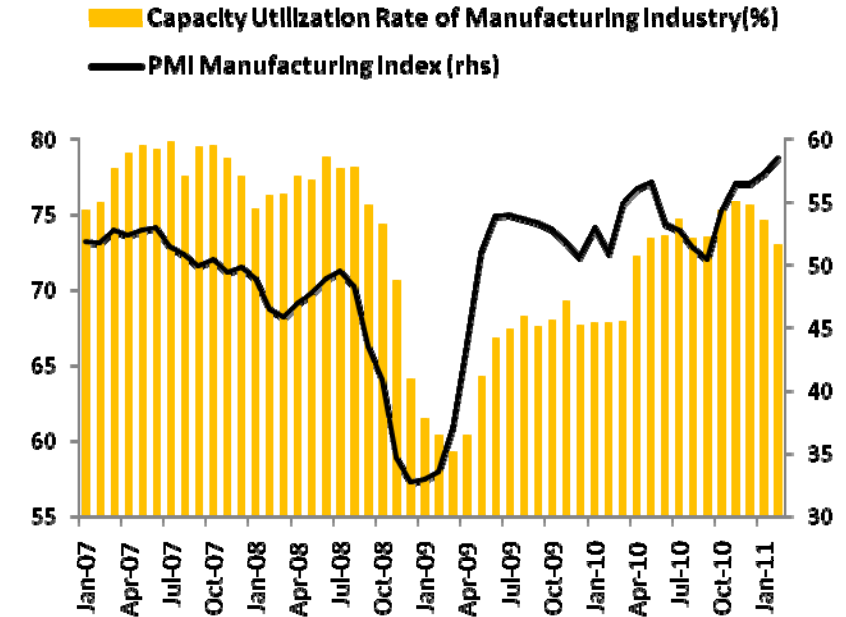
Industrial production (IP) rose by 18.9% yoy in January 2011...

- ✔ Industrial production index (IP) increased by 18.9% yoy in January with the positive base effect.
- ✔ At the same time index decreased by 13.2% mom since exports and manufacturing industrial production decreased in January.
- ✔ Seasonal and calendar adjusted IP rose by 0.5% mom.

- ✔ 3 months average of IP reached 15% and manufacturing PMI became 58.7 in February. These draw a positive outlook about the economic growth in the first quarter of 2011.
- ✔ Although manufacturing PMI reached the highest level of its history, capacity utilization rate continue to decrease in February and declined to 73%.
- ✔ Hence, decline in capacity utilization rate constitute a risk on the continuation of the IP growth.



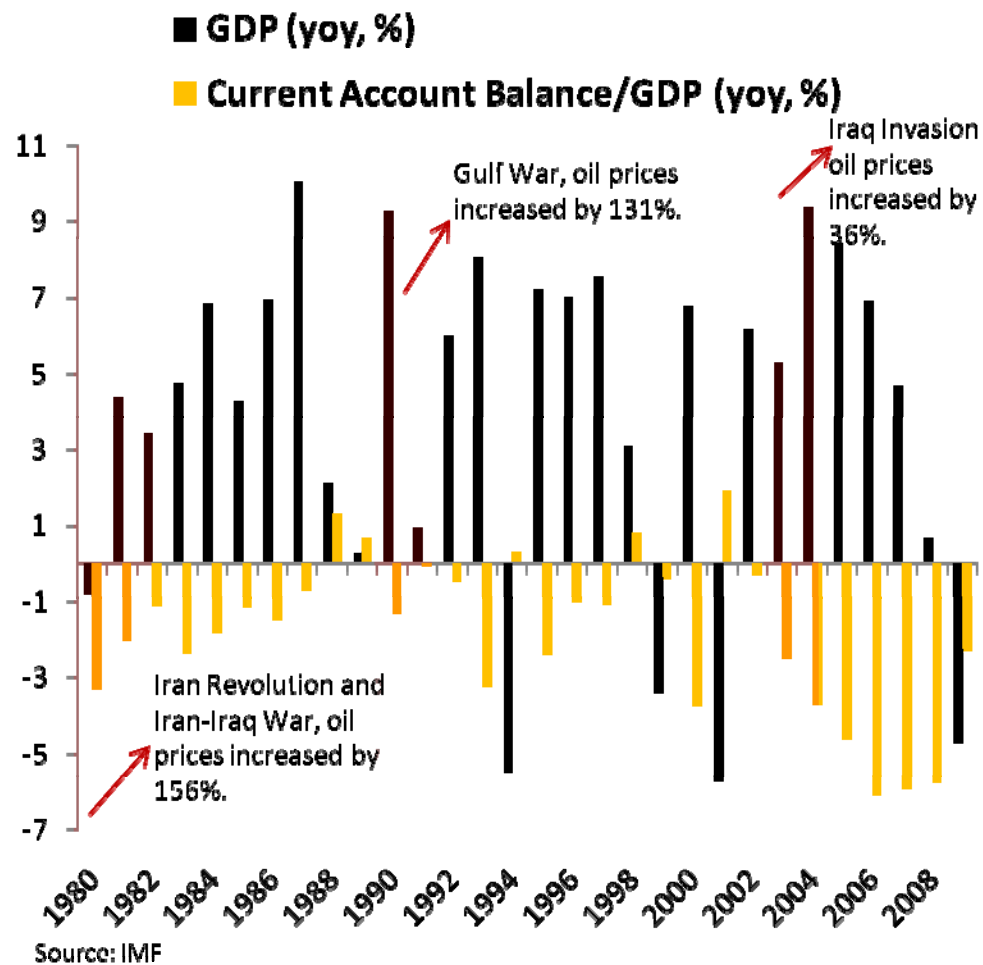
Source: Turkstat



Source: CBRT, Reuters





The effect of oil price shocks on the growth of Turkey...

Historical Analysis:



- After the 2nd World War, oil prices increased 4 times because of oil supply shocks.
- 1973-1974, Arab-Israel War
- 1979-81, Iran Revolution and Iran-Iraq War: In 1980 Turkish economy contracted and current account deficit increased. After 1980, growth rate turned positive.
- 1990, Gulf War: Growth rate was high with 9% but current account deficit increased by contrast to previous year.
- 2003, Iraq Invasion: Growth rate decreased and current account deficit increased.
- To conclude, in general during the oil supply shocks, economic growth rate of Turkey was not negatively affected but current account deficit increased sharply.

Econometric analysis:

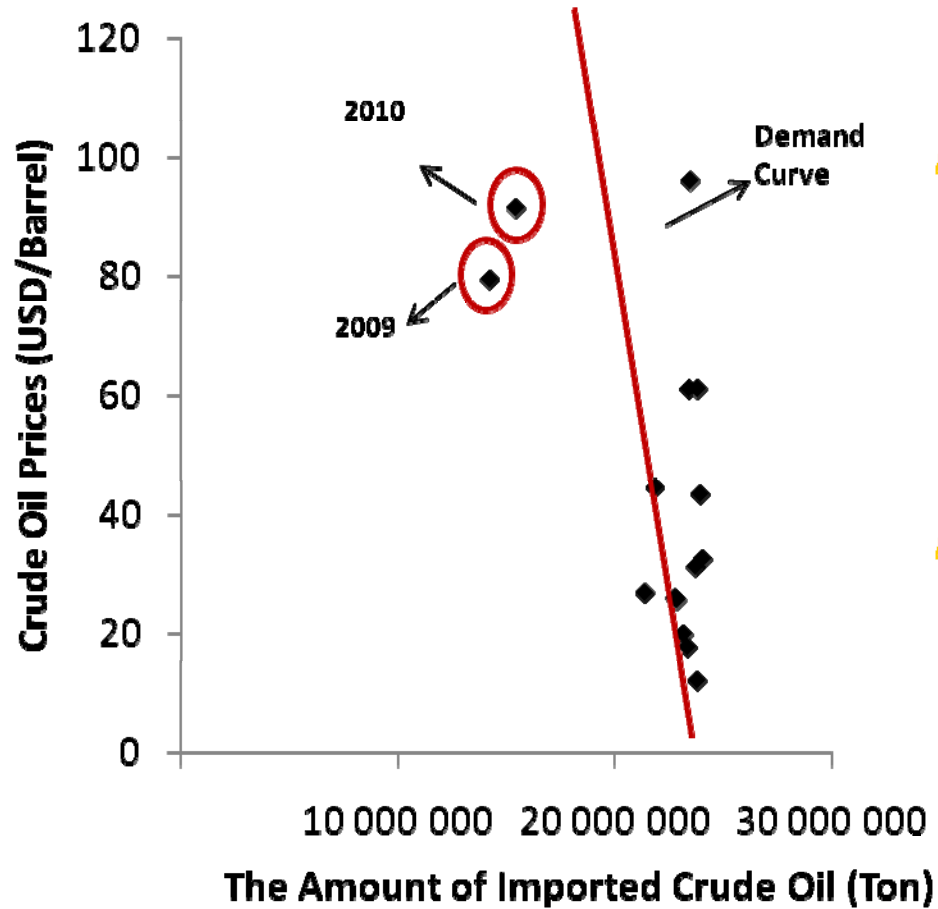
-  Historically, the effect of oil price shocks on the growth of Turkey are founded weak. It seems important to examine the accuracy of this hypothesis in statistical base.
-  The presence of long-term cointegrating relationship between oil prices and growth in Turkey are tested by using a Johansen Cointegration Test.
-  As shown in the table below, there is no statistically significant long-term relationship between GDP and oil prices.
-  This result is a surprise for Turkey which heavily depends on oil import. Therefore , the causes of this result will be discussed under two main headings.

Johansen Cointegration Test

Hypothesis	<i>There is no long-run cointegrating relationship between oil prices and GDP in Turkey.</i>	<i>Do not reject hypothesis at 99% confidence level</i>
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Source: VakifBank

1-Low price elasticity of oil demand in Turkey...



Source: TurkStat, Reuters, VakifBank



The main reason of the weak sensitivity of economic growth to changes in oil prices is the low price elasticity of oil demand.



As seen in graph, demand curve showing the relationship between the amount of imported crude oil and oil prices is steep. This indicates that oil prices have limited impact on oil demand in Turkey. In other words, the effect of oil price increases on reducing oil demand is weak.

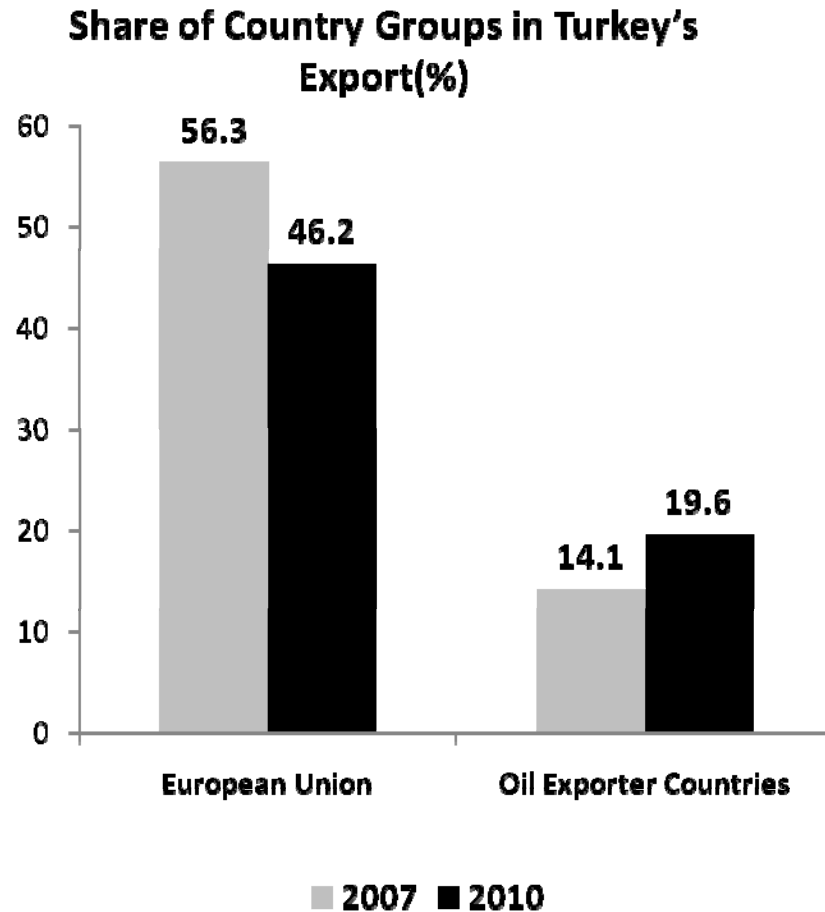


Since crude oil is the important input for the production and Turkey's export mainly depends on oil import, when oil price increases, the producers tend to compensate this increase by borrowing or reflecting this price increases to consumers rather than reducing oil demand.



Although this increases the current account deficit and inflationary pressures, does not pose a risk for growth.

2- Increasing the Share of Oil Producing Countries in Total Export of Turkey...










Source: TurkStat

- ✓ Another reason is the increase in the share of oil exporter countries in total export of Turkey.
- ✓ After the crisis, Turkey's export to oil-producer countries increase as seen in the graph.
- ✓ Rising oil prices may lead to a wealth transfer from oil-consuming countries to oil-producing countries.
- ✓ If oil-producing countries earn more they spend more and exports from Turkey to oil-producing countries may increase.
- ✓ Since the oil-producing countries will spend more with the increase in revenues thanks to the rise in oil prices, it may be possible to make a positive contribution to the growth of Turkey through exports.

We do not revise our 2011 GDP forecast...



-  In the light of recent developments, since there may be no negative impact of the rise in oil prices on growth, we do not revise our 2011 GDP forecast which is 4.0%.
-  CBRT's recent policy actions may pose a risk on the our forecast .
-  The implementation of policy mix (a low policy rate, a wide interest corridor and high reserve requirement ratios) does not affect total loan and current account deficit at a considerable extent.
-  CBRT remaining behind the other developing countries with the policy action may hike policy rate sharper than expected and that may pose a risk for growth.
-  In general, \$ 120per barrel level is the critic that may undermine global growth and oil demand.
-  If tension in Libya spread to Saudi Arabia and Iran, oil prices may exceed the critic level \$ 120 per barrel.
-  In this case, permanent increases in oil prices may negatively affect Turkish economy.

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