

Political

Political Structure
Republic**President**
Abdullah Gül**Prime Minister**
Recip Tayyip Erdogan**National Legislative Bodies**

- Parliamentary system;
- (Meclis) National Assembly (550 seats)
- The Meclis elects the president.

Major Parties (seats in assembly)

- Justice and Development Party (AKP) – 363 seats
- Republican People's Party (CHP) – 178 seats
- Independents – 9 seats

Last Elections

Parliament: November 3, 2002

Next Elections

Parliament: October 2007

Press Freedom Survey:

- 2007 Score: 49 (partly free)
- (0: Free; 100: Not Free)
freedomhouse.org

Control of Corruption Index:

- 2006 Score: +0.06 (-2.5: Worst; +2.5: Best)
- worldbank.org

October 2007**Andrew Bennett**
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General Political Environment: Successive weak coalition governments, poor economic policies, and years of civil conflict with secessionist Kurdish forces in the 1980s and 1990s blocked many political and economic reforms in Turkey. However, this officially secular state was given a fresh start in a surprising package: an Islamist-based party led by an individual who had been banned from taking office. The Justice and Development Party's (AKP) landslide victory in the November 2002 elections created an unprecedented situation in modern Turkish politics: a government led by one party on its own. This was a very positive development for political stability.

The AKP was re-elected with a sizeable majority in legislative elections held in September 2007 and Erdogan given a second term as Prime Minister. The AKP's majority win was all the more significant in that they received support from across the country: urban centres and rural areas and in non-traditional areas such as the Kurdish southeast. The early election came as a result of the AKP's nomination of former Foreign Minister and moderate Islamist Abdullah Gül for President. This was opposed by outgoing President Sezer, the military and secular elite. The AKP's victory enabled Gül to be re-nominated and elected as President. It was a test for Erdogan's government and its desire to ease the fears of secularists which see the President as a champion of secular Turkey. The army did not react in an overtly negative way and Gül is winning some acceptance.

Since taking power, accession to the European Union (EU) has been a main goal of the AKP. Since March 2003, when PM Erdogan took his position, he has been set on convincing observers that he is the reformist that will bring Turkey into the EU. To start the negotiations, all countries that want to enter the EU must show that they meet the Copenhagen Criteria. These criteria require the countries to prove that, to begin with, they have stable institutions that guarantee democracy, the rule of law, human rights and respect for and protection of minorities. Secondly, the countries must prove that they have functioning market economies that would be able to cope with competitive pressure and market forces within the EU.

The list of reforms required to meet the criteria was long. Turkey had to confront old, thorny issues such as the role of the Kurdish minority within Turkish society and the power of the military in this Muslim-populated country. In the end, Erdogan and the AKP were successful: negotiations have begun with a large number of EU member states led by the UK supporting Turkey's eventual accession. However, progress has been slow with negotiations having stalled in December 2006 as a result of Turkey's refusal to open its ports to Greek Cypriot ships. Even though actual accession is far off (likely 2015), the reforms undertaken and the momentum built make it highly unlikely that Turkey will backslide. These changes have already begun to improve the investment environment. The Turkish lira, notorious for its sensitivity to political events, has been increasingly stable during the AKP's governance. Political events that previously could have caused the currency to depreciate have had minor, short-term effects. The resulting currency stability will likely only promote further reform. The AKP government has brought about significant improvements in service delivery and achieved a high degree of policy stability since their election in 2002. This will continue.

Investment Environment: The backbone of Turkish investment legislation remains the 1954 law on foreign investment (Law No.6224), which was modified in 1995. Since then almost all areas open to the Turkish private sector are fully open to foreign participation and investment. Turkish law guarantees the free transfer of profits, fees and royalties, as well as the repatriation of capital. There are no restrictions on convertibility for current account transactions.

Political Violence: The eastern and south-eastern areas of Turkey suffering through years of civil war in the 1980s and 1990s between the Turkish military and the secessionist Kurdistan Workers' Party (PKK), which seeks greater political and cultural rights for the Kurdish community. An estimated 30,000 people died during the conflict. The conflict in Iraq has caused concern in Turkey chiefly over the potential for stirring up Kurdish separatist tendencies in the southeastern region of the country. In mid-2004, Kurdish secessionists called off their five-year cease-fire and there have been clashes between Kurdish fighters and Turkish forces in the south-east with numerous fatalities. Late 2007 has seen a renewal of PKK violence with attacks on Turkish military units in the southeast and bombs detonating in Ankara, Istanbul and Izmir. The air force responded with targeted strikes on PKK bases in northern Iraq. Parliament has also given the army licence to enter northern Iraq to limit PKK activity.

Political Outlook

The AKP is committed to the goal of EU accession, but for now the government will focus on much needed constitutional reforms that will help facilitate eventual EU entry. With the re-election of Erdogan and the AKP it is expected that accession talks will be remain an important priority and there will be steady movement forward, even with increasing opposition from France. Likewise, the AKP's agenda of regulatory and economic reform will continue to be vigorously pursued in the medium to long-term.

Economic

Credit Agencies

Moody's: Ba3
S&P: BB-
Fitch: BB-

Nominal GDP (2006)

USD 395.4

Population (2005):

74.3 m

Total Trade / GDP:

55.6%

Currency:

Turkish New Lira

Exchange regime:

Managed float.

Merchandise imports from Canada (Domestic 2006):

CAD 520.3 m

Merchandise imports from the world:

US130.119 billion

Main sources of Foreign Exchange (excl. FDI):

Equity inflows; government bonds; remittances.

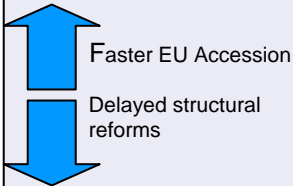
Largest Merchandise Trading Partner (2005):

Germany (13%)
United States (8%)

Main imports (2005):

Machinery (18%)
Transport equipment (11%)
Chemicals (10%)

Risks to the Outlook



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Market Spotlight: A confluence of domestic issues and global economic headwinds in 2006 resulted in reversals for Turkish markets and stoked fresh doubts on the durability of Turkey's recovery from its last financial crisis in 2000-01. But decisive actions by Turkish authorities, especially as pertains to interest rate hikes, forex interventions, and recent completion of scheduled IMF program reviews, have restored the confidence of the investment community and stabilized the markets. The negotiations with the EU may have hit a few speed bumps, but overall the basic view of Turkey bearing a steady path toward EU markets and institutions – along with steadily rising living standards – remains valid.

Recent economic Developments: The Turkish economy slowed 3.4% y/y in Q3/06 (the most recent at time of writing) down from 7.8% in Q2 and 6.5% in Q1. Industrial production declined to 2.5% (y/y) in December 2006, compared to 11.6% in November 2006 and 7.5% in December 2005. The decline was caused by weak growth in manufacturing (which accounts for 70% of the industrial production). Much of Turkey's exports to the EU consists of manufacturing, which may explain the decline.

Monetary Policy: A protracted period of declining inflation abruptly ended in April, forcing the government to reverse its monetary loosening and shifting its focus from controlling growth to dampening inflation. The most recent data (end-January) shows inflationary pressures accelerating, with y/y inflation at 9.93 versus 9.65 in December. The key overnight borrowing rate is now 17.5%, up from 13.25% in April 2006. The Central Bank has all but abandoned its inflation target of 5% for 2006 and 4% for 2007-08 (plus/minus 1%).

Fiscal Policy: Fiscal reforms have been highly successful in reducing the country's debt burden. Higher than expected tax receipts have widened the primary surplus beyond the 6.5% of GNP required for debt sustainability. Within the context of successive IMF programs, the authorities have considerably strengthened both tax administration and policy, particularly in areas of personal and corporate income tax, boosting receipts and enhancing debt sustainability.

External Accounts and Debt: While booming imports have fed both the merchandise trade and current account deficit for most of 2006 save in December, where the merchandise trade deficit contracted 30% y/y -- the first decline since 2003. This result was thanks to both higher exports to Europe (which takes half of Turkey's exports), and lower imports as a result of slowing domestic demand and lower petroleum import prices. The current account deficit in 2006 may have exceeded 7% of GDP this year, although it is expected to narrow somewhat this year to around 5% on account of the slowing economy and lower currency. While the financing of the external deficit is made possible by strong FDI inflows of over \$10 billion/year, a substantial part of non-investment inflows also remain short-term and debt-creating, thus instilling a degree of uncertainty regarding the durability of these flows. Foreign debt has declined considerably in the past four years, from nearly 80% of GDP in 2001 to its current level of less than half of GDP, thanks to a combination of Lira appreciation, as well as debt drawdowns.

Outlook: Turkey has successfully weathered the recent bout of financial uncertainty, and fundamentals appear stable. Market confidence is likely to remain lukewarm in view of the continuing global slowdown. Still, the policy mix underpinning of the IMF program, combined with the continuing EU accession process, will likely support and enhance Turkey's long-term convergence with the EU.

Economic Indicators				
	01-05 avg.	2006	2007(f)	2008(f)
GDP (% growth, real)	4.3	4.9	4.7	5.6
Inflation (%chg, pa avg.)	26.9	9.6	8.4	5.1
Fiscal Balance (% of GDP)	-10.3	-1.9	-2.6	-2.4
Exports (% comp. annual growth)	20.2	16.8	10.5	6.8
Imports (% comp. annual growth)	15.8	18.4	3.9	3.1
Current Account (% of GDP)	-2.7	-8.3	-6.5	-5.5
Reserves (months of curr. debits)	4.7	2.7	4.4	4.4
External Debt (% of GDP)	62.1	50.5	46.8	44.1
Debt Service Ratio (due)	39.4	34.7	37.1	30.5
Exchange Rate (to USD; eoy)	1.4	1.4		

Source: EIU, EDC Economics

