

Investing in Turkey

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Taking its wares to the world

The country has rebalanced its economy towards exports and away from domestic demand, writes *Daniel Dombey*

In a factory on the outskirts of Istanbul, a Turkish executive is emphasising his readiness to sell golden washing machines. As yet, there have been no takers – although clients from the Gulf are a definite possibility – but a gold-painted mock-up has pride of place in a showroom crammed with some of the more than 1,000 different models that the factory already makes.

The manufacturer, Arçelik, a subsidiary of Koc, Turkey's largest company, sells to more than 100 countries across the world and has made a particular mark in the European market. Nazim Kadirzade, a plant manager, boasts that under its Beko brand, the group has, for example, become the leading supplier of washing machines and fridges to Britain.

The company has come a long way from the days, half a century ago, when it sold only one basic model to a largely captive market in Turkey alone. Arçelik's story, and the issues that the company confronts, mirror many of the changes that have taken place in Turkey's economic and corporate landscape.

In recent years, the country has been relying on surging domestic demand, fuelled by an explosion in credit, as the motor of economic growth. That has changed now as the economy rebalances. This year, domestic demand will be a drag on growth; exports have taken its place as the propulsive force behind the country's economic success.

Even so, overall growth, which last year reached 8.5 per cent, has more than halved to about 3 per cent. The shift is largely the consequence of efforts by the Turkish authorities to effect a soft landing and rein in Turkey's current account deficit



Consumer society: inside Istanbul's historic Grand Bazaar
Getty Images

by pushing banks to limit lending. "[This is] the first successful example of doing this in Turkish history," Erdem Basci, governor of the Turkish central bank, said in a recent interview. He added that he was committed to bringing down inflation to

foster the domestic capital markets that the country lacks. "Many companies would be better off if they had the opportunity to borrow in domestic currency long-term; that is simply not available at the moment," he said. Right now, Turkey is basking in the

good reviews it has garnered for righting its course from the boom years of unsustainable growth. Fitch, the rating agency, this month awarded the country investment-grade status for making the shift. Turkish officials do not disguise their hope that another rating agency will follow suit, so paving the way for large-scale institutional investment.

Yet, the true extent of rebalancing and the appropriate level of economic growth remain fierce topics of debate. Political risk is a factor at a time when Turkey has been rocked by the war next door in Syria and when Recep Tayyip Erdogan – the man who, as prime minister, has dominated the country's political life for almost a decade – is preparing to move up to become executive president, a position that does not yet exist.

Even the question of where Arçelik sells its washing machines reverberates at a higher level. Some countries are constrained by their geography. By contrast, Turkey's place on the map, on the edge of southeast Europe, bordering the Middle East, opens up a world of possibilities.

In terms of trade, the country has a new focus on the growing markets to its south and east, a push that diminishes its dependence on the often stagnant economies of the eurozone and bolsters its ties with neighbours on which it long turned its back.

And yet the sheer volume of Arçelik's trade with the EU attests to the unique advantage that Turkey enjoys as a neighbour of the bloc, with which it has a 17-year-old customs union.

Commerce with the countries of the Middle East, while booming, may be less stable than first meets the eye – not least because Turkey has

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Crucial need to retain the country's dynamism

Interview
Abdullah Gul
President

Heavyweight strikes conciliatory tone, says *Daniel Dombey*

President Abdullah Gul, one of the heavyweights of Turkish politics, does not hold back on how far he considers the country has come since his party began its stint in office 10 long years ago.

But, speaking to the Financial Times in an hour-long interview in the presidential palace last week, he does not gloss over what he says is needed to hold on to that record – structural economic reform, a consensual political approach and, above all, further effort in Turkey's bid to join the EU.

On topic after topic, Mr Gul's remarks contrast with Recep Tayyip Erdogan, his old comrade-in-arms, who, as prime minister, is the centre of power in Turkey today. Mr Gul's role is largely ceremonial, but he has the ability to veto legislation, approve appointments and set the agenda in formal addresses.

But nothing is for ever. Mr Gul has already served as prime minister once – a decade ago, when he was keeping the seat warm for Mr Erdogan – and the job is set to become vacant in 2015, by which time Mr Erdogan says he will step down.

In a move reminiscent of the Vladimir Putin-Dmitry Medvedev switch in Russia, the prime minister is widely thought to be aiming to succeed to Mr Gul's post when direct presidential elections are held for the first time in Turkey's history in 2014.

Mr Erdogan is already pushing changes that would make the presidency more powerful ahead of that date, although it is far from sure he will

get the executive style presidency he wants.

Although Mr Gul says it is too early to discuss who will be the next prime minister, his comments, laden with English words such as "grassroots" and "checks and balances", contain glimpses of what could be an alternative agenda to the country's approach today.

"If you look at the picture of Turkey 10 years ago when I established a government as prime minister, and a picture of today, broadly speaking you would see the Turkey of 10 years ago as a negative place... very spent, living in a very uncertain environment."

Today, Mr Gul maintains, his country has conquered its once-chronic high inflation, produced rates of growth that are the envy of Europe, and is a dynamic player on the world stage.

"Now what has brought about this change in the last 10 years?" Mr Gul asks. "The key for this has been political and economic reforms," which have taken their inspiration and motivation from Turkey's EU bid, he says. "A lot has been done, but there is a lot more to do." Big problems remain.



Power play: Abdullah Gul, Turkey's president

The President is asked about one diplomat's recent observation that, while a year ago Turkey was seen as a rising economy with a growing world role, today it is perceived as a country that jails journalists – at least 61 by the count of the Committee to Protect Journalists – and has problems with its neighbour Syria.

Mr Gul does not contest this – he has expressed his concerns about freedom of expression in the past.

He adds that the political

'We still need to do some work on our economy; we still need structural changes'

instability caused by the fighting in Syria, and the unrest in the broader region have had other consequences as well. Those circumstances have led the Kurdistan Workers Party, or PKK, an organisation classified by Turkey, the EU and the US as terrorist, "to think that they have perhaps found a historical opportunity". The fighting between the PKK

and Turkish government forces has been bloodier this year than at any point for over a decade; and hundreds of Kurdish prisoners have only just ended a hunger strike.

"This is one of the most important issues in Turkey," says Mr Gul of the Kurdish question, adding the reforms introduced over the past 10 years leave no justification for violence.

He also insists on a consensus-based approach to Turkish politics, particularly with respect to replacing the country's military-era constitution.

But he returns to the importance of the economy and the EU. He compares Turkey's expectations of average annual growth of 5 per cent with the projected 1-2 per cent for other European economies. He adds, nonetheless: "We still need to do some work on our economy; we still need structural changes to ensure this continued growth."

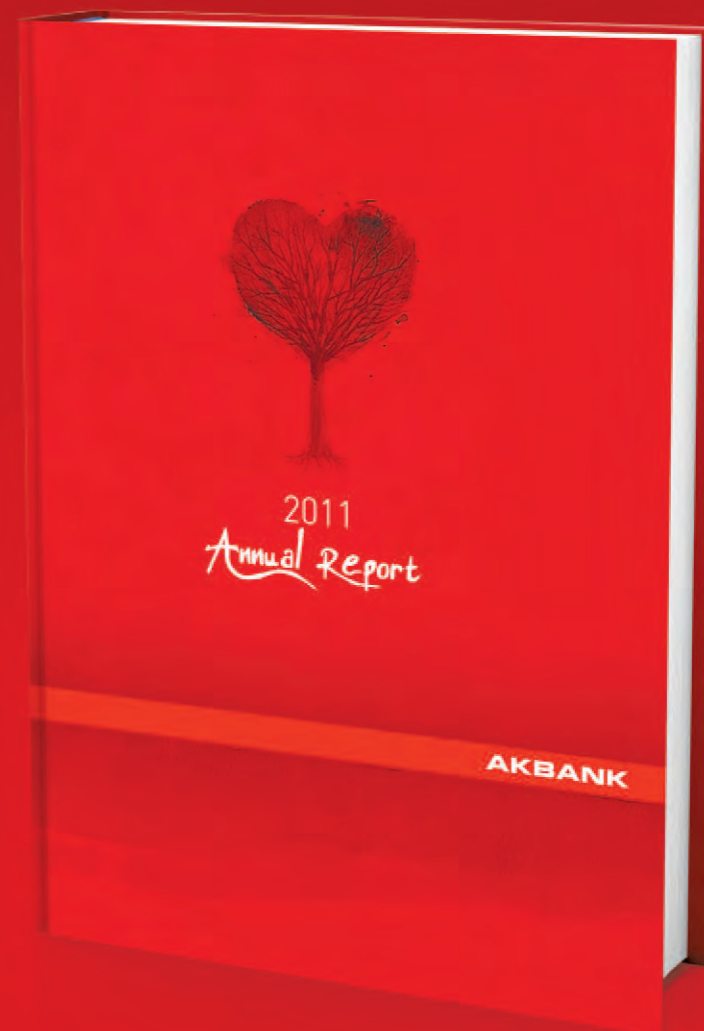
Mr Gul describes the country's current account deficit as "one of our most important soft spots", emphasising the importance of reducing it by boosting both Turkish industrial production and the country's anaemic savings rate. He praises the efforts of current economy ministers; Ali Babacan, Turkey's deputy prime minister, is often seen as a protege.

But his words sometimes sound like a prospectus for government at a time when Mr Erdogan's plans to leave his post have increased political uncertainty.

At the end of the interview, the president recalls his long history with Mr Erdogan, with whom he set up both the Islamist-rooted Justice and Development party, as well as the current government.

But, asked if Turkey needs a stronger opposition in the face of such a powerful prime minister, he doesn't hesitate for a moment in saying yes.

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Investing in Turkey

Pipeline offers security with demand for energy growing

TANAP Joint venture with Azerbaijan will secure supplies for EU, writes *David O'Byrne*

In the world of natural gas, geography is everything. And for Turkey, located between the rich gas fields of the Caspian and north Middle East and the gas hungry markets of the EU, geography is about to become destiny with the construction of the planned Trans-Anatolian gas pipeline (TANAP).

A joint venture between Turkey and Azerbaijan, its eastern neighbour, TANAP is expected to begin by carrying gas from the Azeri sector of the Caspian Sea with a possible later expansion to carry gas from Turkmenistan and other Caspian states.

Planned to be commissioned in 2018, TANAP will initially supply 6bn cu m/yr of gas from Azerbaijan's Shah Deniz field to Turkey, with a further 10bn cu m/yr crossing Turkey on its way to Europe.

Good news for Turkey, where demand is expected to exceed its existing import portfolio within two to three years, but even better news for the EU which has long been looking to secure access to new supplies to reduce reliance on existing sources. Chief among those is Russia's Gazprom, which meets about 25 per cent of EU gas demand, and in September became the subject of an antitrust case by the EU.

Since the late 1990s, EU hopes have been set on the creation of the "Southern Gas Corridor", a bespoke pipeline to carry gas from the ample reserves of the Caspian and north Middle East through Turkey to markets in Europe. Until a year ago, EU hopes were pinned on the Nabucco pipeline being developed by a consortium of Austria's OMV, Germany's RWE,

Hungary's MOL and the state gas companies of Romania, Bulgaria and Turkey, to carry gas from Eastern Turkey all the way to Europe's main gas hub at Baumgarten in Austria.

But, with questions over whether it could succeed in persuading the BP-led consortium developing the Shah Deniz field to favour the project over two rival pipeline projects, Azerbaijan and Turkey stepped in with TANAP.

TANAP's first phase is expected to cost in the region of \$8bn. It will be scalable to 30bn cu m/yr, with the extra capacity expected to be used to carry gas from other gasfields currently being prospected in the Azeri sector of the Caspian.

Hakan Turker, BP's head of external affairs and security for Turkey, says the Shafaq-Asiman block it is prospecting in partnership with Socar, the state-owned oil and natural gas corporation of Azerbaijan, could alone hold as much as 1tn cu m of gas.

However, such are the reserves available in the region that a second parallel line is already being planned.

Gulmira Rzayeva, an analyst at Azerbaijan's official strategy research centre, says: "There is the possibility of adding a second parallel line to double throughput to 60bn cu m/yr."

That extra capacity could be used to carry gas from Turkmenistan, Kazakhstan or any other country in the Caspian region with gas reserves available for export westwards.

With the delivery of 10bn cu m/yr of Azeri gas to Turkey's western borders now all but guaranteed for 2018, and with the promise of more to follow, two projects are competing to carry the gas on to European markets



Supply lines: routine checks are carried out at a natural gas control centre west of Ankara. A new gas pipeline is planned for 2018

Getty Images

starting at Turkey's western borders.

A truncated Nabucco West project aims to carry 31 billion cu m/yr of gas to Baumgarten, while the Trans-Adriatic Pipeline, backed by the US group EGL, Norway's Statoil, and Germany's Eon, is expected to carry up to 20bn cu m/yr of gas through Greece and Albania and across the Adriatic to markets in Italy.

A decision on which line will carry the gas is expected from the consortium developing the Shah Deniz field by the middle of next year, with consortium members BP, Statoil and Total considering an offer to take a combined 29 per cent stake in TANAP, alongside Socar (51 per cent) and Turkey's state pipeline company Botas (20 per cent).

As well as further enhancing European energy security, TANAP offers the same for Turkey, whose gas

demand is expected to exceed its current 51.8bn cu m/yr import portfolio within the next two years.

This is an important consideration given that Turkey has few energy reserves of its own beyond low grade lignite and some unexploited hydro potential and that power demand is expected to continue rising at about 8 per cent a year. Imported gas has long been earmarked to meet much of Turkey's baseload.

Already 21 new gas-fired plant totaling 21.3GW have been issued with generating licenses despite no new gas being available to supply them.

Applications for a further 60 totaling 29.2GW are on hold, with Turkish officials warning private sector developers will need to arrange their own gas imports if the plant are to be constructed. An impasse that TANAP should go some way to resolving.

Erdogan dash for growth will need backers

Infrastructure

Turkey may struggle to raise the billions of dollars it needs, says *Shawn Donnan*

Drill down at all into the ambition laid out by Prime Minister Recep Tayyip Erdogan to turn Turkey's economy into one of the 10 largest in the world by 2023 and you quickly discover just how much the government is depending on transforming the country's infrastructure to get there.

By 2023, the centenary of the fall of the Ottoman Empire and birth of the Turkish republic, the government has set the goal of having in place 10,000km of high-speed rail track, one of the world's top 10 ports and an electricity grid that draws a third of its power from renewable sources.

It may, for now, have put a hold on plans to build a canal alongside the Bosphorus to ferry goods to and from the Black Sea, but Turkey is not wasting time in rolling out other large-scale projects.

Work is under way on a \$2.5bn third bridge across the Bosphorus and a pair of tunnels where the strait flows into the Sea of Marmara. New motorways are being built across the country and airports planned. The country's power infrastructure is being privatised. All in the name of Turkey achieving what Mr Erdogan this year dubbed its "bright future" as "one of the greatest powers of its region and the world."

There is certainly more than a tinge of hubris to Mr Erdogan's grandiose vision. In 2011, the prime minister proclaimed as "crazy and magnificent" his plans for Canal Istanbul, the 50km, 150-metre wide man-made waterway he wants to build alongside the Bosphorus to draw tanker and other freight traffic away from the busy strait.

"We are building the canal of the century, a project of such immense size that it can't be compared to the Panama or Suez canals," he declared. There are, therefore, those who question the government's ambition, be it ever so gently.

"What is more important than the sheer quantity of [infrastructure] investment is the quality of that investment," says one western diplomat. But there are signs that foreign investors are buying into Mr Erdogan's vision, something they haven't always done before.

Private equity groups have been paying more and more attention to Turkey and people in the industry say they see a promising future in the country's infrastructure plans. Turkey projects now

form a significant portion of the €385m deployed by InfraMed, a Paris-based infrastructure fund backed by the European Investment Bank, says Marian Bocek, associate director.

And, as it looks to expand – it has a target of having €1bn under management – he expects many of its new investments to be Turkish.

Its economic growth and transformation into an emerging market champion are the main reasons. The country, says Mr Bocek, "is just China next to Europe".

"Just looking at the macro fundamentals it is one of the most attractive markets we have," he says. "We see a huge pipeline of new opportunities."

Chief among those is the power sector which the government is aggressively privatising in order to attract investment to keep up with surging demand.

Turkey has already had some luck doing so. In 2005 it attracted just \$4m in foreign direct investment in electricity, gas, and water supply projects, according to central bank data.

In the first nine months of 2011 electricity, gas and water projects drew in \$2.6bn in FDI, the bulk of the \$3.7bn in investments that went into the infrastructure sector during that period.

There are . . . those who question the government's ambition, be it ever so gently

But that still falls well short of what the government says it needs. Over the next decade it estimates it will require more than \$100bn in investment in the energy sector to keep up with growing demand.

There are certainly practical challenges facing Mr Erdogan's ambitious vision. Chief among them, in the short term, may be a difficult financing market for the flood of new projects hitting it.

According to Martin Spicer, head of the International Finance Corporation's southern Europe infrastructure practice, European banks have traditionally dominated Turkey's project finance market and they are still reeling from the effects of the Eurozone crisis.

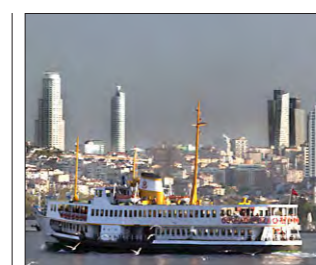
That means Turkey may struggle to raise the \$10bn-15bn that it needs to keep up with its bold ambitions for the next three years. "The financing market today is difficult and will be a constraint to meeting this aspiration of building all this infrastructure," says Mr Spicer.

"All these projects take money from the same source."

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Economic ties Business looks to Gulf states

Oil-rich region is a key source of funds, says Camilla Hall



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Taking its wares to the world

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significant political problems with two of its biggest trading partners, Iran and Iraq. The fighting in Syria has also reduced access to other markets in the Gulf.

"It is important for Turkey to diversify the markets it is trading with, but I still can't see any other market by itself replacing Europe," says Umit Boyner, the head of Tusiad, Turkey's biggest business confederation.

Adding that the country only accounts for less than 3 per cent of total EU imports, she argues there is still space both to increase Turkey's market share and achieve higher value-added. "People felt the Middle East region was a low hanging fruit; we are seeing that that is not the case," she adds. "In terms of political stability we see that they are not such easy markets."

Meanwhile, Ms Boyner urges Turkey to keep up with economic reforms and infrastructure investment, to boost its capacity to grow. In the short term, the news is likely to be good. It

is not just investment-grade status and the demographics of the country's young population that draw portfolio funds to Turkey; like other emerging markets, the country attracts capital let loose in the US and elsewhere by continued quantitative easing.

Public debt of about 38 per cent of GDP shines in comparison with European levels of 80 per cent or more. Nor do traditional exports such as white goods, televisions and cars represent all of Turkey's international economic dynamism – Turkish companies now take second place after their Chinese equivalents in the international construction sector.

But the longer-term challenges remain. One underlying dilemma is that, after a decade in which Turkish per capita income tripled in dollar terms, the country is facing the same scenario as other upper-middle-income states: a lower, though still substantial, rate of growth. While growth of 4.5 per cent is attractive to multinationals and investors of

many stripes, for politicians it may not be enough.

Mr Erdogan, who has built his rule on the mutually reinforcing accomplishments of political stability and economic growth, has set out the much more ambitious goals of making Turkey into one of the 10 biggest economies in the world by 2023 and of bringing per capita income up to \$25,000 by that point.

A recent Organisation for Economic Co-operation and Development paper argued that the country's growth over the past decade had two causes: productivity growth in the export-oriented west – the greater Istanbul region around the Sea of Marmara accounts for 45 per cent of GDP – and employment growth in the Anatolian hinterland.

For Turkey to grow more in the coming decades – by closer to 6 per cent a year rather than 4 per cent – the paper argues that the country should loosen the labour restrictions that inhibit employment in the formal sector and push ahead with educational reforms, includ-

ing vocational training. It remarks that "Turkey still has the human capital characteristic of a developing country."

Kemal Dervis, the architect of many of the economic reforms that pulled Turkey away from crisis a decade ago, highlights the country's low savings rate – recently at about 14 per cent of GDP or less – as a constraint on its ability to achieve the growth goals that it wants.

Pointing out that the lower a country's savings rate, the higher its current account deficit, the former minister of economic affairs adds that Turkey's deficit remains largely financed by relatively fickle portfolio investment, and that it has attracted markedly less foreign direct investment over the past two decades than countries such as Mexico and Brazil.

"There are no miracles in economics," he says. "If the savings rate does not go up to at least 17, 18, 19 per cent, the Turkish growth rate will be mediocre, not spectacular."

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Investing in Turkey

Near neighbours can still become good friends



David Gardner

Egemen Bagis, the Turkish minister for Europe, is in the habit of describing Turkey as the most eastern part of the west and the most western part of the east. In that sense Turkey should be an invaluable ally to an EU fumbling for answers on its periphery – a Middle East and north Africa in upheaval.

Instead, Turkey is fast losing interest in a European club that appears to spurn its once enthusiastic drive for membership, at the same time that its ambitious plans to help reshape its neighbourhood in light of the Arab Spring are in danger of being unravelled by the bloody conflict in Syria, which has set alight its southern border.

Just as importantly, the paralysis in negotiations on accession to the EU, now in their seventh year, has shut down what for Turkey had been a formidable engine of democratic renewal, at a time when the authoritarian tendencies of Recep Tayyip Erdogan, the prime minister, are beginning to worry not just his opponents but some of his supporters.

Mr Erdogan, who triumphantly won his third election last year on a rising share of the popular vote, can look back on a decade of China-style economic growth, the sidelining of the army as the final arbiter of Turkish politics, and the re-emergence of Turkey as an admired



Recep Tayyip Erdogan, Turkey's prime minister, and Angela Merkel, German chancellor

Reuters

and influential regional power.

What matters now are his intentions in drawing up a new constitution to replace the army-dictated charter of 1982. The question is whether he wants to use this opportunity to strengthen individual rights – and craft a consensus giving Turkey's large Kurdish minority cultural and self-government gains – or to mould a new order in his own image, stepping up from the premiership to an executive presidency on the French model, thereby to claim a mantle to rival that of Mustafa Kemal Atatürk, the secularist founder of modern Turkey.

Abdullah Gul, the current president and Mr Erdogan's only rival on the national stage, who might take over the premiership in 2014, has told the Financial Times that, for its own reasons, Turkey

needs to keep to the path of reform traced by its bid for EU membership. "We should not stop here; it's not sufficient", he said.

Very much in contrast to Mr Erdogan's belligerent attitude towards his critics, Mr Gul acknowledges the need for a strong opposition to counterbalance the dominance of the neo-Islamist ruling Justice and Development party (AKP) he and the premier founded.

Turkey's political drama is not the secularists' spectre of creeping theocracy but that the opposition has proved unelectable, trapped in the past and hitherto reliant on generals and judges to win back what it keeps losing at the ballot box.

The paradox is that Mr Erdogan and the AKP, although now lords of all they survey, behave as though they were still in opposition.

The prime minister exemplifies Turkey's winner-takes-all political culture in which the AKP has resorted to the same methods its enemies used to try to deny it power. As Mustafa Akyol, a Muslim liberal writer says, "it is not that the AKP is too Islamist, it's that it's too Turkish".

This sense of entitlement, as a new elite rooted in the dynamic capitalism of the Anatolian bourgeoisie elbows aside the secularist establishment of Kemalist and metropolitan Turkey, now comes with more than a tinge of disdain towards an EU mired in crisis.

Turkey, with the long conditioning of its NATO membership and vestiges of dirigisme, does not see itself easily reflected in a European landscape peopled by what one former minister derides as

'It's getting harder and harder to defend the EU in Turkey, let alone defend Turkey inside the EU'

"market fundamentalists and defence pygmies".

At this year's AKP conference, Mr Erdogan managed to speak for more than two hours without mentioning the EU, to an audience that included Arab Islamist leaders such as President Mohamed Morsi of Egypt and Khaled Meshal of Hamas but no front-rank European figures.

"It's getting harder and harder to defend the EU in Turkey, let alone defend Turkey inside the EU," where Germany and France have kept raising the barriers to Turkish accession, one official says.

Yet, there are ties that bind.

The economic integration of Turkey and the EU, to the benefit of both, proceeds apace. There are now more than 14,000 European companies in Turkey, giving them an extra competitive edge as well as access to Turkish engineering skills. EU officials say there are nearly 60,000 Turkish students currently studying in Europe with EU funding. The European Investment Bank has become an important source of infrastructure funding. Turkey's large army plays a full part in international peacekeeping, from Afghanistan to Lebanon.

If President Gul, who drove EU policy in his previous role as foreign minister, gets his way, Turkey may just swivel back westwards – especially since its ambitions in the neighbourhood have been hit badly by the intractable and bloody reality of the Syrian civil war on its doorstep. Some Turkish officials believe the EU's apparent move towards a multi-tier Europe – with the eurozone at its core and a British and Scandinavian outer ring – may make it easier for Turkey eventually to slot in.

"If we're in the same room as, say, the UK or Sweden, that is something I can explain to Turkish public opinion", one says.

Gold deposits could meet credit demand

Banking

The central bank's policy is also a way to boost savings, writes David O'Byrne



Stock pile: Grand Bazaar's gold souk in Istanbul

Although much criticised for its use of "unconventional measures", few would argue that the decision last year by Turkey's Central Bank to allow the country's banks to buy gold was anything less than a roaring success.

Beginning in October 2011, the CBT has allowed banks to hold part of their reserve requirements in gold, while at the same time allowing them to collect the gold themselves.

The rationale is straightforward. With many Turks historically preferring to invest their wealth in physical gold rather than more traditional banking instruments, analysts estimate there may be as much as 5,000 tonnes of gold being held "under the pillow" in the country.

These investments, which are effectively held outside the economy, could be converted to bank deposits while simultaneously allowing banks some leeway on their reserve requirements.

Initially set at 10 per cent of reserve requirements, the level has been successively raised to its current 30 per cent as the policy has succeeded in attracting gold back into the economy with high street banks initiating open "gold days" – when anyone holding gold can trade it in for a replacement investment in a "gold deposit account".

The effect has been dramatic, with Turkey's banking regulator reporting an increase in the banking sector's collective precious metal account rising from TRY1.8bn in September 2010 to TRY15bn by September 2012 and individual banks reporting gold collections measured in tonnes.

But the initial rush of interest appears to be slowing, with Is Bank, Turkey's biggest high street bank, telling the Financial Times that it expects to collect only \$50m in gold deposits by the end of 2012.

Similarly, doubts have surfaced over just how much gold is likely to be available for deposit.

Speaking earlier this month, Erdem Basci, governor of the CBT, estimated Turkey's "under the pillow" reserves at being about

2,200 tonnes or about \$12.2bn at current prices.

With the figure apparently based on recorded gold sales over the past three decades, analysts point out that it fails to account for "heirloom gold" already in circulation and passed down through families, suggesting the true figure could be as much as 5,000 tonnes.

Whatever the true figure, opinions differ as to how much of that gold might be available for deposit in the banking system.

Can Demir, banking analyst at Renaissance Capital, says much of the "under the pillow gold" is jewellery with cultural traditions mitigating against it being banked to be melted down for bullion. A better measure of how much gold is

'The ratio of assets in the financial system to GDP is a quarter of that of the EU average'

available for banking would be the weight of Turkish gold coins in circulation, he explains. "They are produced only for saving, they have no other use," he says.

But, with the state Darphane mint having already produced 39 tonnes of gold coin in the first nine months of this year, the same as it produced in the whole of 2010, questions remain over how much of this gold is likely to be banked. And over what banks will do with the gold they collect, with utilisation of the Central Bank facility for swapping bullion for lira reserves approaching capacity.

"Unless the cap is raised it's difficult to see what else banks can do with the additional gold, because the current gold deposits can be

utilised at the CBT anyway," says Mr Demir. Raising that cap and attracting further gold into the banking system would free up a tranche of lira liquidity.

"It will open up a sizeable savings pool which the banks would be able to extend as credit," says Inan Demir (no relation), chief economist at Turkey's Finansbank.

With loan growth in Turkey static extra liquidity is not an issue, but with analysts predicting the Turkish economy growing faster in 2013, many are anticipating increased demand for credit, which could be met by increased gold deposits.

But the benefits for the banking system of buying up Turkey's "under the pillow" gold, are not confined to reserve requirements and credit pools. It also serves to increase the level of bank savings in Turkey which, according to World Bank figures, fell from 23.5 per cent of GDP in the mid '90s to 12.7 per cent by 2010.

"The ratio of assets in the financial system to GDP is only a quarter of that of the EU average," says Suzan Sabanci Dincer, chairman of Akbank, adding that with 19m Turks without bank accounts, there is still plenty of room for the sector to grow.

But, with the easing of Basel II capital adequacy ratios and the scarcity of capital since 2009, banks are trying to generate non-capital consuming business opportunities through cross marketing rather than be restricted to savings accounts, explains Can Demir, pointing out that buying gold is a way of reaching out to Turks who have never set foot inside a bank.

"If you have a good gold deposit product, then once you initiate the relationship with the customer, you have the opportunity to sell them credit cards, mortgages and other products."

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Investing in Turkey

Erdogan and Gul differ on country's EU aspirations

Europe The president hopes that joining will complete the country's transformation but hurdles abound, writes *Daniel Dombey*

It is a matter, President Abdullah Gul tells the Financial Times, of completing the country's transformation – and yet Turkey's bid to join the EU could hardly be more tortuous, or its outcome more uncertain.

Recep Tayyip Erdogan, prime minister, once put membership at the heart of his project of government, but as EU states' reservations about Turkish membership have hardened into formal blocks on talks, so Ankara's ardour has cooled into indifference.

On a recent trip to Berlin Mr Erdogan said the bloc would have to admit Ankara by 2023 or "lose Turkey" and has floated the idea of reintroducing the death penalty, which would sound the death-knell for his country's bid.

And yet Turkey's EU talks, troubled though they are, are still vital for the country's orientation. Three-quarters of foreign direct investment comes from the EU, even though sales to the bloc are now little more than a third of total Turkish exports.

The loss of EU influence, as talks have stalled, has coincided with

increased complaints within Turkey about such issues as media freedom and the rule of law.

"There should be no doubt with respect to the determination of Turkey to successfully complete negotiations," says Mr Gul, who talks about Turkey's EU aspirations in a markedly different way from Mr Erdogan. "This is what is going to complete the transformation of Turkey."

Mr Gul concedes Turkey may finally decide not to proceed with membership and that a country such as France or Austria could veto its accession at the last gasp. But he argues that the mere fact that it will have completed the talks will have brought Ankara up to EU standards.

He also insinuates that Turkish entry, as potentially the biggest member state, may be less threatening to other Europeans at a time of flux in the EU, when the bloc may be reshaping along the lines of a eurozone inner core and an outer periphery.

"We are very closely following the difficulties that the EU is facing at the moment – the ongoing political and economic restructuring," he says.



Abdullah Gul, president (right) and Recep Tayyip Erdogan, prime minister Getty Images

"There may be new mechanisms that emerge in the EU, and Turkey should take its rightful place within this overall picture."

In a likely reference to Turkey's ambitions as a rising power on the world and regional stage, he adds: "The EU countries should also appreciate the fact that there is no substitute for Turkey; they have to recognise the contribution that Turkey can add to the EU."

But while Mr Gul speaks of a virtuous cycle in which the possibility of EU entry serves to speed Turkey along the path of reform, today a vicious cycle applies: the EU censures Ankara for its failings, yet those very failings make it more difficult to revive the negotiations.

The EU's most recent report on Turkey, issued last month, was its most critical yet, raising serious concerns over the country's jailing of journalists, the legitimacy of high-profile court cases and internet censorship.

"The progress report was basically raising one question: 'Where is this country going?'" says Jean-Maurice Ripert, EU Ambassador to Ankara.

He adds that the dynamic could yet be changed with the opening of new negotiating chapters, something that can be achieved if, as European diplomats hope and expect, France lifts reservations put in place during the presidency of Nicolas Sarkozy.

"The EU has to give signs that we still care, this is really important," Mr Ripert says.

But even that hope depends on the government of Francois Hollande detaching Turkey's EU aspirations from the vexed issue of whether massacres of Armenians in Anatolia almost a century ago constituted genocide, a controversy that has put Ankara at loggerheads with Paris.

Marc Pierini, Mr Ripert's predecessor, is worried Mr Erdogan's government may have decided for religious and ideological reasons that it does not want to be too close to Europe.

And yet he, too, thinks greater EU attention could still change the country's course, for economic reasons among others. "Look at Gulf investment in Turkey; it is shopping malls," he says. "The future of Turkey as a Bric is with Europe."

High society does lunch in Istanbul

Lifestyle

Confidence aplenty in a changing city, says *Andrew Finkel*

Tucked into a busy Istanbul side street, beside the city's Spice Bazaar, is one of the masterpieces of the classical Ottoman age. The Rustem Pasha Mosque, with panel after panel of decorative Iznik tiles, is a happy marriage of aesthetics and faith, as well as a mid-16th century expression of bling.

"It displays great wealth with great confidence," says Lucien Thys-Senocak, an architectural historian at Istanbul's Koc University. The mosque is a peaceful sanctuary above the shops – which gave it an income – a literal attempt to move religion into the marketplace.

The current generation's nostalgia for the Ottoman period, reflected in the Disneyland-style office blocks or Ottoman-themed housing estates, appears symptomatic of a longing to show off Turkey's new-won prosperity with a time-proven yardstick of good taste.

After years of running to catch up to Europe, the Turkish haut monde now feel they may be even ahead in the race. The rivalry is now less with the outside world than between home-grown rival elites.

A new, more conservative haute bourgeoisie is on an accelerated learning curve. "They may be even overconfident, but they feel that Turkey has a status. The newly affluent look at a Europe in crisis and think to themselves: 'We're not a failure after all,'" says Alan

Duben, an anthropologist at Bilgi University in Istanbul.

In the comfortable seaside neighbourhood of Florya is the famed meat restaurant, Beyti. Its owner, Beyti Guler, began with a simple roadside grilled meat restaurant, which has evolved into a palatial, gilded emporium, with its Ottoman tiles and stained-glass windows.

Among the photos of celebrity diners is one of Turgut Ozal, former prime minister, who battled Turkey's way into the global economy. But it was Beyti who tutored Turkey's post-war citizens in the pleasures of Sunday lunch. Very much an institution, it is as much a clubroom as a restaurant, with a bar and drawing rooms to linger before and after a meal.

That disappearing world – in particular its polite envy for the instant coffee, Marlboro cigarettes and department stores of western consumerism – is captured in the display cabinets of Istanbul's new Museum of Innocence, a shrine by the writer Orhan Pamuk to his novel of the same name.

The novel's centrepiece is an engagement party in the Hilton Hotel, a place where "so many Western innovations made their first appearance... that the leading newspapers even posted reporters there."

The novel begins in the 1970s, but the Hilton was finished in 1955 in the nick of time to cosset the delegates to that year's IMF meeting. Its week-long opening warranted its own commemorative stamp.

The writer is the author of 'Turkey: What Everyone Needs to Know', published by Oxford University Press



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