**Turkey at the threshold of a new age**

**World economy truly entering Industry 4.0 age, QE ends**

* In 2017, world economy finally recovered from the deep wounds of the Great Financial Crisis, reaching take-off speed.
* In 2018-2020, global growth is expected to set root across the world, leading to full capacity utilization, firming inflation and tighter monetary policies.
* I call this period the dawn of a new age, because the fixed investment needed to boost capacity will incorporate Industry 4.0, boosting productivity and accelerating the process of labor shedding.
* The implications of the juxtaposition of new fixed investment and tighter monetary policy are profound. In this speech, I examine them for Turkey.

**Recession and crisis risks very low**

* Predicting the future in a chaotic world is inherently risky business, but the nature of the current global recovery precludes severe down-turns.
* The recovery is world-wide, driven by capital investment and rising global trade, which enhance its self-sustaining nature.
* There is marked increases in consumer and business sentiment, which suggest the psychological wounds of the Great Financial Crisis are finally healed and animal spirits are taking over.
* Fears of protectionism and a new cold war are exaggerated, the global economy is too interlinked for economic nationalism to prosper. Challengers to American supremacy, i.e. Russia and China can’t afford open confrontation.
* Changes in labor markets (lower inflation) and expectations (higher capex) prolong the recovery phase of the current business cycle, moderating the required monetary response.
* Despite years of growth, there is still a savings surplus to feed further growth with low real rates and modest CB rate hikes.

**Fed and ECB will tighten, forcing deleveraging**

* The deflation scare is over.
* Current monetary policy settings by Fed and ECB are too loose according to well-known “policy criteria” such as Taylor Rule. Further stimulus risks financial instability or soaring inflation.
* Nominal interest rates across the yield curve in Developed Countries will rise gradually but steadily through 2018-2020.
* Emerging Countries have accumulated an extraordinary amount of F/X debt after the Great Financial Crisis, benefiting from cheap finance. It is hard to argue that EM companies put these funds to productive uses.
* Higher interest rates possibly accompanied by stronger Euro and dollar will squeeze profit margins, rendering fixed investment difficult for certain countries, and sectors.

**A fixed investment boom is in the making**

* According to World Bank 60% of growth in 2017 was contributed by gross fixed investment. After years of hesitation, companies are rushing in to renew machinery, equipment and factories to meet rising global demand.
* As world reaches full capacity utilization, the rate of capital accumulation must accelerate to expand the supply base.
* While technological innovations summarized as Industry 4.0 are marvels, their incorporation into workplace has been very slow. This is one reason why labor productivity has declined vis-à-vis 1990s.
* New capex will bring in Industry 4.0, accentuating productivity and competitiveness differentials among companies sectors and countries. How does Turkey fare in the new race?

**Turkey’s Achilles heel: Financial fragility**

* Turkey’s low savings rate, which manifests itself as a very high current account deficit is its major disadvantage at the start of the race.
* Turkey must roll-over and borrow $220 billion per annum to make ends meet (balance BoP). New investment will require additional borrowing.
* High inflation and rising budget deficits keep monetary policy tight and demand for funds high, reducing domestic funds available for private sector investment.
* Rising loan rates and cost of capital are inevitable.

**Capital stock is aged and outdated**

* With capacity utilization reaching 80%, and years of underinvestment in equipment and machinery, Turkey has a second disadvantage in the race.
* The government’s misfortunate emphasis on construction and housing has led to a severe misallocation of resources and talent for almost a decade.
* The need for capex and new technology is very urgent.
* So far, efforts to create home-spun tech centers and incentivize companies to invest into R&D have largely failed

**Education system is bankrupt**

* An unqualified labor force is the third disadvantage.
* Turkey scores very low in PITA aptitude tests. The average schooling is only 9 years. The curriculum is heavily weighted towards rote memorization and religion-ethics, offering little in the way of skills needed in the Industry 4.0 work force.
* Since the coup a relentless purge and political cronyism has depleted the ranks of educators.

**Business environment is not conducive to innovation & investment**

* The State of Emergency has a chilling effect on FDI.
* Presidential system promises more discretion, fewer rules, and bureaucratic paralysis.
* The judicial purge has reduced resources dedicated to commerce cases.
* There has been no orthodox micro-reforms since zest for accession petered off.

**Predictions for macro-policy**

* It is essential for Erdogan and AKP to win the next elections, or the opposition to sweep both. A divided legislative could spell economic demise.
* In case of the more likely scenario of Erdogan and AKP-MHP victory, a more moderate regime at home and better relations with the West are possible. These changes will increase FDI and business morale.
* Micro-reform and a more orthodox policy mix will only be considered if global financial conditions force Ankara to do so.
* Many mega-projects will have to be ditched, a tighter monetary and fiscal policy framework will have to be adopted.
* A rather prolonged economic slowdown led by a collapse in housing, energy and retail industries cannot be ruled out.

**What will the private sector do?**

* Business models will have to change; greater emphasis on core businesses, cash generation and financial risk management.
* A massive wave of consolidation, restructuring and downsizing cannot be avoided.
* Companies will have to raise equity to pay off leverage, which will become very expensive to obtain. Some of that is lodged in off-shore accounts, but a rule-based economic management and lifting of SoE is required for repatriation.
* Cross-border M&A will accelerate, company valuations will drop, owners will become more open to the idea of relinquishing control.
* Turkey’s two-track economy will become even more pronounced. Companies which are part of global supply chains, have foreign partners and access to financing will invest to incorporate Industry 4.0 and retain competiveness. Others will have to downsize.
* University-business joint ventures will have to become more prevalent. On the job training will become the norm. Salary differentials will increase.

Author: Atilla Yesilada,

CEO Yesilada Consulting, [www.istanbulanalytics.com](http://www.istanbulanalytics.com)

Consultant to GlobalSourcePartners [www.globalsourcepartners.com](http://www.globalsourcepartners.com)

GSM: 533 216 9795

Business e-mail: Istanbulanalytics@gmail.com