

ECONOMIC AND SOCIAL THOUGHT RESEARCH AND DEVELOPMENT FOUNDATION (ESAGEV)

NEWS BULLETIN

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MACROECONOMIC DEVELOPMENTS

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Turkey's 2017 IMF Article IV Consultations Report

The IMF released its Article IV Consultations Report and its selected issues papers prepared for Turkey on February 3rd. The report's main messages can be summarized as follows:

After robust growth through Q1 2016, Turkish economy's growth has slowed down. Growth is projected at 2.7 percent in 2016 and 2.9 percent in 2017 with considerable downward risks. Domestic consumption is the main growth driver, supported by a large increase in public expenditure and a hike in the minimum wage. However, political uncertainty, weakened corporate profitability, anemic credit growth, and a sharp fall in tourism have taken a toll on investment and net exports. The monetary stance and macroprudential measures were loosened, but credit growth continues to slow. Current negative output gap is widening, but sticky expectations are keeping inflation above target.

The IMF team agreed that some discretionary fiscal measures should be used in 2017 to smooth the impact of declining output. Yet, the report cautioned to

pursue a fiscal tightening in outer years as external imbalances and inflation remain high. The report encouraged Turkish authorities to continue simplifying the monetary framework. Structural reforms should focus on increasing private domestic savings, improving the business climate, and reducing informality.

Turkish Lira's Appreciation In the Aftermath of Investment Grade Credit Rating Loss

Fitch, a prominent international credit rating institution, downgraded Turkey's credit rating from the investment grade, BBB-, to speculative level, BB+. This credit evaluation had already been priced in the market as the expectations in the market had already signaled such a move. For this reason, the loss of investment grade credit rating had limited impact on the value of the Turkish lira. Another reason behind the appreciation in Turkish lira was the measures taken by the Central Bank of the Republic of Turkey. The Central Bank has been actively taking measures since mid-January. At the beginning, CB was only providing overnight lending and seeking to increase the average funding rate; yet then, the CB started to encourage banks to use late liquidity window, which is now being used as a substitute to one-week repo rate as the policy rate. On January 25th, the CB increased the overnight lending rate from 8.5 % to 9.23 and the cost of late liquidity window from 10 % to 11 %. These steps led to an increase in the CBRT's average funding rate from 8.3 % as of end-2016 to 10.4 % as of ed-February. As a outcome of all these, Turkish lira appreciated by around 8 %, compared to the level seen on the eve of the Fitch's decision.

January Inflation Exceeded Expectations

According to the data released by TURKSTAT, Consumer Price Index (CPI) increased by 2.96% and the (Domestic Producer Price Index) PPI by 3.98% in January. Thus, 12-month inflation reached 9.22% in CPI and 13.69% in PPI.

Before examining the reasons for the increase in inflation, we need to underline two crucial points:

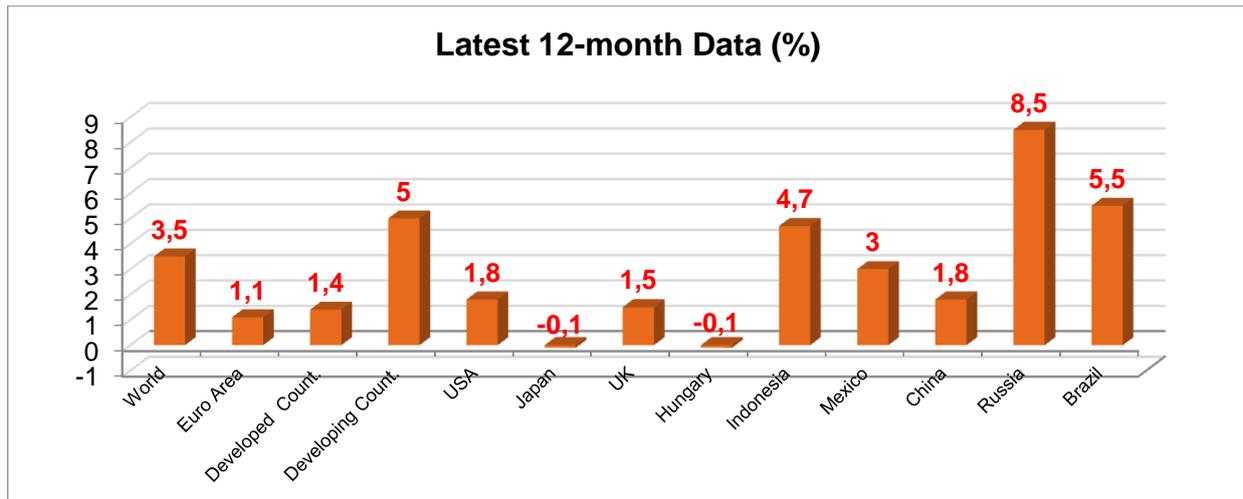
1) Turkey closely approached the 10% psychological boundary for the CPI, and has already passed this limit for the PPI. This is a negative signal for the global financial markets since this recent increase in inflation strengthens the image of stagflation while Turkey is experiencing growth problems.

2) The rapid increase in the Domestic Producer Price Index is a leading indicator of the future increase of CPI.

We see that 1.39 points of the 2.46% increase in the CPI comes from the Food and Non-Alcoholic Beverages sub-group, 0.53 point comes from transportation sub-group and the 0,23 points came from the housing item. The increase in food stems from bad climate conditions in December and January; For the transportation, the increase in energy prices and the exchange rate became effective.

As a result, we can say that Turkey has re-entered a period of simultaneous increase in inflation, with the economic slowdown. We already see that exchange rate increases and energy price increases are reflected in producer prices.

In a period when low-inflation in overall developing and developed countries, the increase in inflation in Turkey is remarkable. Below we see the level of CPI in some important economies and economies similar to Turkey.



New Reductions In Value Added & Special Consumption Taxes. Can They Stimulate The Economy?

Special Consumption Tax (SCT) on white wares and on some furniture set to zero percent until the end of April.

After the negative growth of 1.8% in the third quarter of 2016, the signals of the last quarter are not very positive. Plus, exchange rates continues to increase simultaneously when economy is slowing. As an answer, the government is taking many measures to strengthen consumption channel of the economy.

In this context, special consumption taxes on white wares and on some furniture set to zero until the end of April 2017. This is an important measure.

White wares sales fell for the first time in October (-0.2%). There is a strong possibility that the tax revenue loss resulting from the SCT reset will be covered by the VAT that will be collected due to possible increases in sales.

Value Added Tax (VAT) Reductions on Construction Sector

To increase sales and production in the housing sector, which is one of the key sectors of the Turkish economy, is another effective method of accelerating the economy. The government had important tax decisions in February for supporting the housing sector.

Accordingly, the stamp tax rate (0,95%) for sales contracts set to zero. Moreover, 18% VAT for heating boilers, radiators, bathtubs in the constructed new homes set to 1%. The Ministry of Finance will return 17 per cent of the VAT that contractors pay for these items. This discount is expected to be reflected as a 1 to 1.5 percent decline in new house prices.

Thus, with a tax reset of approximately 1 point in the stamp tax and the reduction of the tax on construction materials to 1%, it will lead to a total reduction of 2.5% in housing prices.

ESAGEV will continue to monitor the contribution of the tax cuts in both White wares and furniture as well as Housing to economic growth and consumption.

Economic Recovery In Euro Area: Is It Durable Or Temporary?

Euro Zone Economies Sent Positive Signals in the Last Quarter of 2016 and January of 2017

The Euro Zone, is the most negatively affected developed economy by the 2008 Global Crisis, gave the most positive signal of the past 8 years in the last quarter of 2016. In the last quarter, the recovery in the economy was accompanied by the approach to the inflation target and the decrease in the unemployment rate.

There are currently 19 countries in the Eurozone. The growth rate of these countries in the last quarter of 2016 was 1.8%. **Thus, Euro Area growth rate for 2016 as a whole is 1.7%.** This draws attention. But for such countries as Greece and Italy, the economic crisis has not yet been overcome.

In 2016, US economy grew by 1.6%. This is near the average of developing countries (1.4%). Trump's ultimate goal is to raise this growth rate up to 4%. Nevertheless, in 2016, the Eurozone grew faster than the US economy for the first time in many years.

On the other hand, the European Central Bank is targeting an inflation rate of 2% for the euro area. In a significant part of developed countries inflation continues at near zero levels. This is a factor that negatively affects the economy's consumption channel and growth. **The optimum inflation rate agreed on most central banks is 2%. An the Euro Zone inflation has reached 1.8% in January.** This increase is largely due to an increase in energy prices, but it is also an important indicator for the strengthening of the economy.

In the same way, Euro Zone also gives positive signals in the employment field. In December, unemployment rate fell to 9.6%. This is the best level since May 2009. In December of 2015, the unemployment rate was 10.5%. The unemployment rate in Germany is 3.9% at historic lows. This is Merkel's most important card for this year's elections.

Despite all these positive developments in the Eurozone, it is too early to say that, this situation is permanent. The rate of non-refundable loans in Italy is at the historic peak of 17.7%. This raises doubts about the banking sector in Italy. A negative development in the Italian banking sector is strong enough to shake up the whole Euro Economy.

Amendments In the Public Procurement Law

With the Decree Law No 68, which was published on Official Gazette on January 23, 2017, Turkish Public Procurement Law was amended. Following this amendment which comprised 43 important revisions in the law, secondary legislation was also amended via revisions on 108 articles on January 25, 2017. These changes were mainly in the below mentioned fields:

- The change in the documents to be represented during the tender process and the lift of the obligation to provide eligibility documents depending on the type and the nature of the tender
- Features of the documents organized abroad and to be represented by the applicants
- Inability of people who faced public prosecutions to participate in tenders
- Identification of the type and quantity of work experience documents
- The terms of use of the work experience documents to be obtained from the business with private sector.
- Limit value identification and extremely low bidding calculations
- Not demanding bank reference letters in every public tender process
- Business turnover volume
- Allowing trade consulate to organize work completion documents for the overseas construction business
- Reducing contractor's profit share in the approximate cost calculations of the service procurements
- Allowing provision of temporary letter of guarantee via the use of electronic signature
- Announcement of price advantage application for the applicants that offer the use of domestic goods
- Conditions for the presentation of the documents which are electronically prepared and could be electronically verified.

Wealth Fund

In August 2016, Turkey Wealth Fund was established with the Law Nr. 6741 with the task of managing some corporations operating under the Prime Ministry, and establishing and managing funds with the purpose of contributing to instrument diversity and depth of the capital markets, mobilizing domestic public resources and directing them to the economy, attracting foreign capital, participating in large scale investment, and Turkey Wealth Fund Incorporated Company was founded to establish and manage sub-funds of the Turkey Wealth Fund.

With the 9th Article of the Statutory Decree Nr. 684, which was published in the Official Gazette dated 23.01.2017 Nr. 29957, all of the Turkish Treasury's shares at the Ziraat Bank, Petroleum Pipeline Corporation (BOTAS), Turkish Petroleum Incorporated Company (TPAO), Post and Telegraph Administration (PTT), Borsa Istanbul, Turksat Satellite Communications and Cable Tv Operations Company, 6,68 % of the Treasury's share in Türk Telekom, EtiMaden, Çaykur, 49.12 % of the Turkish Airlines and 51.11 % of Halkbank was transferred to the Turkey Wealth Fund. In addition, some immovables in Antalya, Aydın, İstanbul, Isparta, İzmir, Kayseri and Muğla which belonged to Turkish Treasury was also transferred to the Wealth Fund with the abrogation of their allocation.

It is expected that the Turkish Wealth Fund will establish an asset basket and knock the doors of foreign investors in the couple of months for securitization following the completion of the efforts to valuation and auditing of the transferred assets.

City Hospitals

Yozgat City Hospital, with 325 m. TL investment value and 475 beds, and Mersin City Hospital, with 725 m. TL investment value and 1250 beds, were inaugurated on January 16, 2017 and on February 3, 2017 respectively. Until 2019, it is expected to see operationalization of 26 new hospital projects with total 35.000 beds that were approved by the High Planning Council.

Selected Indicators

(In this part, brief information on the important indicators released by Turkstat in February is shared)

Labor Force Statistics, November 2016

In November 2016, total number of unemployed who are at 15 or older increase by 590.000 compared to the same month of the last year and reached 3 million 715 thousand. With 1.6 % increase, unemployment rate was realized at 12.1 %. In the same period non-agricultural unemployment was estimated to be at 14.3 %, after a 1.9 % increase. While unemployment among young population (aged 15-24) was realized as 22.6 % with 3.5 % increase, unemployment among the 15-64 age group was realized at 12.3 %, with 1.6 % increase.

Total number of the employed in November 2016 period increased by 391 thousand compared to the same period of last year and reached 27 million 67 thousand. Employment level remained the same at 45.8 %. Sectoral composition of the employment was as follows: 18.7 % agriculture, 19.6 % industry, 7.4 % construction, 54.2 % services. The share of the informal employment was realized as 33.3 %.

Industrial Production Index, December 2016

When the seasonal and calendar adjusted sub-industrial sectors were analyzed (2010=100 as the basis year), in December of 2016, while mining and quarrying sector index declined by 3.4 % compared to the last month, manufacturing sector index remained the same. Production and distribution of the electric, gas, steam and air-conditioning sector index declined by 0.2 %. In total, industrial production declined by 0.2 % since last month.

Calendar adjusted industrial production rose by 1.3 % compared to the same month of last year.

Economic Confidence Index, February 2017

Economic confidence index rose by 6.8 % in February compared to January and increased from 85.7 % to 91.5 %. The increase in the economic confidence index was supported by the rises in services sector, real sector (manufacturing industry), construction sector and retail industry confidence indexes. In February, services sector confidence index increased to 92.9 % level, real sector confidence index rose to 106.5 %, construction sector confidence index reached 76.4 % and retail trade sector confidence index increased to 97.9 % level.

In February, consumer confidence index declined to 65.7 % level.

Life Satisfaction Research, 2016

The share of individuals who declared that they are happy was in 56.6 % in 2015. This figure was found to be 61.3 % in 2016. The share of people who declared that they are unhappy declined from 11.4 % to 10.4 %.

When we take a look at the happiness level at different age groups, in 2016 highest level of happiness was seen in the 18-24 age group with 65.1 % and the lowest level was observed in the 35-44 age group with 58.2 %.

When we have a look at the individuals' general satisfaction level from the public services, the highest increase was observed in the Social Security Institution with 9.2 % points. The highest satisfaction level was realized in the transportation services with 78.4 % share. This performance was followed by security with 75.7 % share, health at 75.4 %, Social Security Institution at 67.9 %, education at 65.1 % and judicial services at 57.9 %.

DEVELOPMENTS IN FOREIGN POLICY

Long-Lasting Issues Again Come To The Fore: The Enosis And Kardak Crises

Negotiations between the Turkish Republic of Northern Cyprus and Greek populated southern part of Cyprus broke up over the Enosis decision of the Greek Cypriot Parliament on February 12. The law permitting the annual commemorate of 1950 referendum for union with Greece in schools caused reaction from Turkish Cypriots. On February 16, during the first negotiation meeting after the Enosis decision between Turkish Cypriot leader Mustafa Akıncı and Greek Cypriot leader Nicos Anastasiadis, Akıncı demanded from Anastasiadis to publicly condemn the Enosis decision and to take necessary steps to denounce the law. Anastasiadis left the meeting room by shutting the door and by saying 'I have nothing to say'. Then, Turkish Cypriot leader Akıncı declared not to attend the next meeting on February 22, due the fact that Greek side did not take any step to reverse the Enosis decision.

Before the February 22 meeting, Anastasiadis said that he is ready to continue the negotiations. He admitted that the Enosis decision of the Parliament was wrong and timeless, but he also said that the overreaction of the Turkish side is unfair. Although the Greek Cypriot leader stated that the Enosis decision was wrong, his party DISY had supported the passing of the draft law in the parliamentary committee and abstained in the vote allowing the bill to be passed. It seems that Anastasiadis seeks to represent Turkish Cypriots as the side who leave the negotiation table.

Over the last weeks, the other thing that attracted our attention on the Mediterranean Sea was the Ageanislets of Kardak, which brought Turkey and Greece on the brink of an armed conflict in 1996. Turkish Military Chief of Staff Hulusi Akar paid a visit to the Aegean's disputed Kardak islets to conduct inspections on the twenty-first anniversary of Kardak incident. This visit took place soon after the Greece's refusal to extradite eight pro-coup soldiers to Turkey. It was reported that during the visit, one Greek military vessel attempted to prevent the Akar's ship from getting close to the islets. Also, one Turkish and Greek warship came face to face near Kardak islets on February 22. It seems that the Greek Supreme Court's refusal to extradite pro-coup soldiers to Turkey escalates the tension between Turkey and Greece over the disputed islets of the Aegean Sea.

New Era In Syrian Conflict and The Search of New Balance In Turkish Foreign Policy

Since the onset of the domestic conflict in Syria, Turkey's foreign policy faced a number of turning points. The downing of the Russian fighter jet in November 2015 and developments in its aftermath showed how deeply the Syria problem affects Turkey's foreign policy. After the relationship breakdown with Russia, the impression of ineffectiveness on the field in Syria strengthened and the state institutions commenced the search of an exit from the situation faced in Syria. While after the initiation of the resettlement of relations with Russia and the Operation Euphrates Shield somewhat broke that impression, the fall of Aleppo and the USA's closer relations with The Democratic Union Party (PYD) through transfer of new armored vehicles posed burden in front of fully alleviating the existing impressions.

With the inauguration of Trump administration on January 20, authorities of Turkish foreign policy accelerated exchange of views of with the new administration to put highly tense Turkish-American relations back on track and bringing a new balance to the relations with Russia, which were being often seen as highly imbalanced. In this context, ongoing consultations both at the Military Chief of Staff and Prime Minister / Vice President levels can be seen as search for new

pathways for a new period. In the meantime, cleaning of the field from the ISIS by the Free Syrian Army supported by the Turkish Army brought questions and rumors both at the local and international level on where will be the next target. While having talks on targets such as Afrin, Tel Abyad, Raqqa, President Erdoğan's speech claiming that a joint operation with the US forces in Raqqa to clean this area from the ISIS murderer herds turned the focus of the agenda once again to the hints of the new era on the Turkish-American relations.

While Turkish foreign policy's search for balance is focusing on both joint interest with the USA and alleviating the threat from PYD and ISIS, Foreign Minister Çavuşoğlu's comments on Iran in his visit to Bahrain took its place as a point to be noted for the new era of Turkish-American relations. We will see in the future what kind of a reaction the emphasis of discomfort from the expansion of Iranian influence in the region expressed at the Prime Minister level will receive from the Trump administration.

Main foreign policy agenda item of the forthcoming days will be concentrated on whether relations between Turkey and the USA could be put back on track and how this probable partnership will be executed on the field (PYD, Iran etc). Domestic public opinion seems to getting ready to discuss the level of casualty that a probable Raqqa operation by the Turkish Armed Forces may cause. Despite the fact that the constitution referendum to be held on April 16th seems to put these foreign policy discussions in the shadows, until international diplomatic policy ceases, these soul-hurting issues appear to continue to come to the fore.

USA Looking For A New Adventure on Iran and North Korea

Tension between the US and North Korea-Iran axis which had already ups and downs through different US administrations is now accelerating after Trump administration's inauguration. Having prioritized the fight against radicalism in its foreign policy, Trump administration declared to initiate a missile defence system against Iran and North Korea's nuclear antagonism. It is expected to increase the tension because those two countries started their nuclear tests which is seen as a violation of 2231 UN Council Resolution on the one hand and moderates in the administration are at the bottom of the pile on the other. New administration seems to widen the sanctions to Russian and Chinese companies which are regarded as the supporters of Iran and North Korea's nuclear tests.

First Position Change in Trump Administration: Flynn Resigned

Trump's Security Advisor Michael Flynn was asked to resign due to misinforming the Vice President Mike Pence on his conversations with Russian Ambassador. Less than a month in the administration, Flynn, who was supporting moderate relations with Russia, resigned last Monday and passed his position to Joseph Kellogg. When considered together with Trump's declaration that Russia should get Crimea back to Ukraine, this resignation can be seen as a signal for an anti-Russian strategy of Trump administration who already criticized Obama administration for being too soft on policy towards Russia.

25th Anniversary of Hocalı (Khojaly) Massacre

After the dissolution of the Soviet Union, Caucasus Regions witnessed series of bloodshed. Tensions and armed conflict between Azerbaijan and Armenia was one of those. During the armed conflict between Azerbaijan and Armenia, Armenian Army attacked Hocalı Town at night from 3 different sides with the support from its shooting of artillery and tanks. The damage caused by the Armenian Army's massacre was observed at the dawn of February 26, 1992. Civilians were mass murdered, innocent people's were heavily tortured and their corps turned out to be beyond recognition as a consequence of the inhuman acts of the Armenian Army. That night, in total 613 Azeri were slaughtered. Out of 613, 106 were women and 83 were children.

Azerbaijan is claiming that the inhuman and cruel massacre of the Armenian Army in Hocalı is against 1949 Geneva Convention and the UN Convention on the Prevention and Punishment the Crime of Genocide, and strive for the recognition of Hocalı Massacre as a genocide.

During the armed conflagrations of last year, Azerbaijan gained small amount of land; yet, Armenian land-grab comprising around 20 % of Karabakh that belong to Azerbaijan is still ongoing. Taking account of infiltration efforts of Armenian Army and small-scale armed conflicts between two sides observed over the last weeks, it seems that Karabakh conflict will be occupying an important part of the foreign-policy agenda.

3rd National Culture Council

On March 3-5, 2017, 3rd National Culture Council will be organized at the İstanbul Lütüfi Kırdar International Congress and Exhibition Center. After approximately a quarter century since the last council gathering of whose first held in 1982 and second in 1989, organization of a new national culture council event serves as an important opportunity for reviewing and updating the policies of the Ministry of Culture and Tourism.

Because, at the intersection of the 2 centuries, the elapse of times accelerates, the advances achieved in technology and communications tools downscales the world, systems and countries encounter creative destruction processes and dominant ideologies face changes. Hence, the understanding of the context we call culture by the individuals, states and international organizations changes and this change in certain ways have impact on our lives.

Today, we are experiencing an era in which we are pushed to new attitudes, evaluations and reviewing the sorting of our priorities maybe by the movements that occur around the globe yet we think that are peculiar to our neighborhood since we deeply feel their tension. In such a period, consultations on culture is likely to create an opportunity to take stock of the 30-year history and to take a position for the future.

In the first day of the Council, at the first 2 sessions that will be moderated by Mr. Nabi Avcı, Minister of Culture and Tourism, esteemed academicians such as Alev Alatlı, İlber Ortaylı, İbrahim Kalın and Mehmet Genç will deliver their speeches. We hope that the 3rd National Culture Council, with the participation of reputable names to the event in the following days at the 17 different topics from culture economy to cultural diplomacy will bring a new breath to culture policy.

History of Science

We have started to share series of articles on the history of science by Osman Kocabaş, ESAGEV History Desk coordinator on our website. The list of articles on history of science published is as follows: i. Education in Christian West, ii. Education in Muslim East, iii. House of Wisdom in Baghdad, iv. Scientific Movement in Early Years of Turkish Republic.

NEWS FROM ESAGEV

- ESAGEV seminars are ongoing in Hamamönü Kabakçı Konağı on every 3rd Friday of each month starting from January.
- The first seminar took place on January 20, 2017 with the participation of Associated Professor M.Serdar Palabıyık (TOBB Uni) under the topic of "Thoughts on Civilization by Ottoman Intellectuals".
- The second ESAGEV Hamamönü seminar was held on February 17, 2017 with the Prof. Dr. Mustafa Öztürk on the theological background of the FETO.
- **The next seminar will be organized on March 17, 2017 in Hamamönü Kabakçı Konağı. The guest speaker and theme of this event will be announced in the coming days.**
- ESAGEV website (www.esagev.org) has been updated. Your inputs and views regarding the content will be highly appreciated.
- For receiving the news bulletin and stay tuned to our activities you may contact us through iletisim@esagev.org or through our twitter account ([@esagev_org](https://twitter.com/esagev_org)).

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