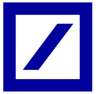
Deutsche Bank Research 

January 12, 2005

Current Issues

Turkey 2020: on course for convergence

- Turkey has in the past suffered from high levels of macroeconomic instability. Over the last ten years average economic growth has been modest. Sustained economic reform following the 2000-01 economic crisis has however improved the outlook for economic stability and higher medium-term economic growth significantly.
- The continuation of macroeconomic discipline and structural reform is likely to be driven by the prospect of EU accession. The agreement reached between the EU and Turkey regarding the start of accession negotiations in October 2005 is the first step in that direction. Risks of setbacks stem from both sides, however.
- This study is to depict plausible scenarios for the Turkish economy in the medium to long term, rather than predict at what point in time accession will actually take place.
- In our baseline scenario, medium-term real GDP growth of a good 4% on average over the next 10 to 15 years is realistic, according to DB Research's proprietary long-term growth model (*Formel-G*).
- While the continuation of economic reforms appears to be the most likely scenario, it is not, however, a foregone conclusion. Domestic political cleavages, setbacks on the IMF front and geo-political developments could yet undermine the upbeat economic outlook. We present two downside scenarios to account for this possibility.
- If Turkey realises its growth potential over the coming decade, it will be a very different country and a very different economy by the time it accedes to the EU. True, it will still be one of the poorest EU economies on a per capita basis and will have the largest agricultural sector. But Turkey's level of economic development will be comparable, in relative terms, to the levels reached by Poland in 2004.
- The political and economic impact of EU convergence will be unambiguously positive, as Turkey will benefit from continued EU-supervised reforms, increased economic stability and higher foreign investment flows.
- The banking sector in particular stands to benefit from enhanced stability and higher economic growth, and is likely to experience increased consolidation and foreign participation.

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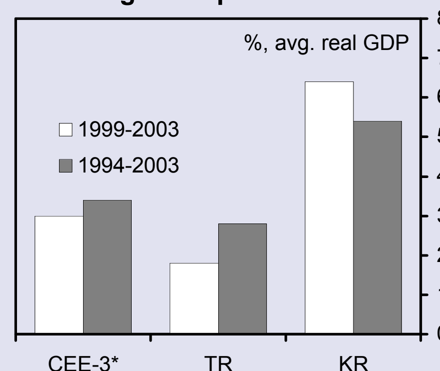
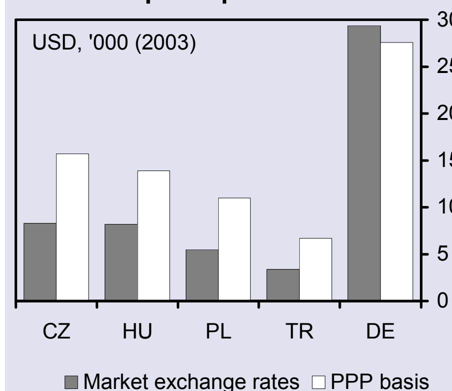
At the turn of the 19th century, the Ottoman Empire was called the "sick man of Europe". Today, modern Turkey, the state that emerged from the ruins of the Ottoman Empire in the wake of WWI, has one of Europe's most dynamic economies and societies. Reforms have led to a profound transformation of the Turkish economy since the most recent crisis in 2000-01. Thanks to a combination of favourable demographic trends, the prospect of continued economic reform and eventual EU membership, Turkey is on the verge of becoming one of Europe's most attractive markets[1]. This prediction appears to be somewhat at odds with Turkey's economic performance over the past decade. Between 1994 and 2003, Turkish economic growth averaged a mere 2.8% (see chart) and the economy experienced several severe crises. Also, Turkey is still a relatively poor economy and a large share of its population is employed in the agricultural sector.



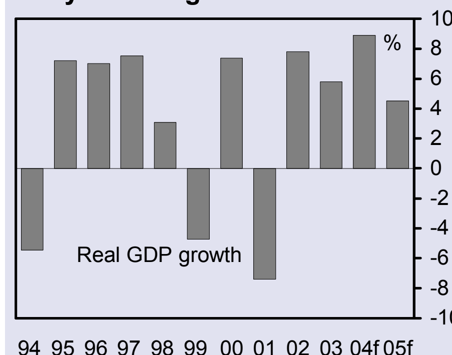
Turkey's GDP per capita income is low, but its economic catch-up potential is considerable. Measured at market prices, Turkish GDP per capita was USD 3,400 in 2003, a level comparable to the likes of Bulgaria and Romania, but far below the Czech Republic and Hungary with roughly USD 8,300 (see chart). However, a more accurate measure of per capita wealth is GDP per capita measured on purchasing power parity (PPP) basis. Here Turkey's per capita income amounts to around USD 6,700, again, comparable to the current EU accession candidates (Bulgaria, Romania), but only at around 20-25% of the biggest EU member, Germany. A low per capita income suggests substantial room for "economic catch-up", meaning considerable room to improve productivity through technological innovation and investment.



The aim of this paper is to assess what the Turkish economy will look like in 10 to 15 years. Combining a qualitative scenario analysis framework with a proprietary quantitative forecasting model, we examine the political factors likely to affect economic policy and stability, analyse the structural factors underpinning Turkey's growth potential and estimate economic growth under different political scenarios. We then study the impact of our baseline scenario on production patterns and analyse likely implications for the banking sector.

I. The political economy of economic growth and stability

Turkey is at a crossroads and in a position to put the economy on the path to sustainable growth. Structural factors point towards a considerable medium-term economic growth potential. Whether this potential can be realised will crucially depend on economic and political stability and continued reform. Over the past decade, Turkey has experienced several economic and financial crises (1994, 1999, 2001). The crises were primarily due to political instability, weak regulation, poor macro-management or a combination of the above.



What makes us believe that Turkey can break with this volatile past? First of all, despite Turkey's chronic political instability, its political system is not necessarily ill-suited to the successful implementation of macro-policies. The centralised structure of the Turkish political system (unicameral parliamentary system, centralised bureaucracy) should make it possible to pursue

[1] For the current status of Turkey-EU negotiations and related reports check http://www.eu.int/comm/enlargement/turkey/docs.htm

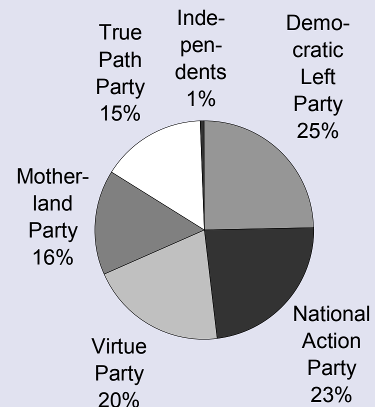
disciplined economic policies and even push through wide-ranging reforms. The problem is that, in the past, Turkey suffered from a high degree of political fragmentation despite institutional centralisation. Although political parties need to win more than 10% of the national vote to gain representation in the Grand Assembly, parliament was often very fragmented (see chart), which more often than not resulted in weak and incoherent macro-policies and slow structural reform. Empirical analyses show that the more fragmented – numerically and ideologically – a coalition government, the less stability-oriented economic policies will be[2]. *Ceteris paribus* single-party governments are more conducive to stability-oriented economic policies. This is largely what differentiates the current Justice and Development Party (AKP) government from previous government coalitions.

The current single-party government emerged from the failure of ideologically split and numerically fragmented coalition governments of the 1990s. Following the Ozal governments of the 1980s, a succession of weak and divided coalition governments resulted in poor macro-management, financial volatility and repeated economic crises. By contrast, given its 2/3 majority in the Grand Assembly, the AKP government has so far proven that it is both able and willing to push through important reforms and stabilise the macro-economy. The reason is simple. A single-party government cannot avoid responsibility if it fails to stabilise the economy or meet EU accession requirements. This means that even though the AKP government may be tempted to switch to more redistributive policies, which could potentially undermine the on-going process of macro-stabilisation, it is less likely to do so. Equally important, it also has the ability to stay the course due to its control over a disciplined parliamentary majority. Moreover, with the economy growing at record rates, the pressure to switch to redistributive, destabilising policies is low.

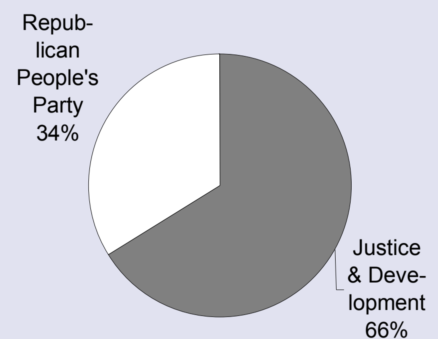
Widespread political support for EU accession and considerable consensus with regard to economic consolidation create major incentives for the AKP to continue with its economic reform programme. It is important to note, though, that the AKP has so far enjoyed favourable tailwinds. The rebound post-2001 crisis and favourable global political and economic conditions have created a virtuous cycle of higher growth, improving debt dynamics and lower domestic interest rates. This favourable constellation has greatly facilitated economic reform, particularly the achievement of a sizeable primary surplus (i.e. fiscal surplus before interest payments) to stabilise a precarious public debt position. The government still needs to prove its willingness to implement macro and structural reforms when circumstances are less favourable. But again, the government has limited incentives to reverse policies at this point.

Stability-oriented policies are likely to continue after the election year 2007. Given the AKP's popularity, it is not inconceivable that it will stay in power for another term. However, should a different, fragmented coalition government emerge in 2007, Turkey's ability to push forward with reforms could be weakened. But even then, we believe that the constraint of EU accession negotiations may go a long way to compensating domestic political fragmentation and weakness.

Elections 1999



Elections 2002



History of governments

Akbulut	1989-91
Yilmaz	1991
Demirel	1991-93
Ciller	1993-95
Ciller	1995
Ciller	1995-96
Yilmaz	1996
Erbakan	1996-97
Yilmaz	1997-99
Ecevit	1999
Ecevit	1999-2002
Gul	2002-03
Erdogan	2003-today

[2] Volkerink, B. and J. de Haan (2001): "Fragmented Government Effects on Fiscal Policy: New evidence", Public Choice, Vol. 109, Dec 2001.

Recent institutional changes have facilitated the pursuit of disciplined macro-policies. Considerable structural reforms have improved the macroeconomic policy framework. Under the IMF programme, extra-budgetary funds have been closed and budgeting procedures have been improved and made more transparent, making the executive more accountable. A much-enhanced monetary framework has also improved the outlook for monetary stability. In April 2001, the central bank law was amended, making price stability the primary objective of central bank policy. Moreover, the adoption of a floating exchange rate regime also reduces the likelihood of a renewed currency crisis. Renewed macroeconomic instability, however, remains possible. But the EU convergence process and an already much higher degree of stability should help prevent renewed economic-financial volatility of the type seen in the 1990s. The continuation of reforms is set to be effectively locked in with the help of a new three-year IMF programme (see table) and the EU accession process.

Repeated IMF bail-outs

Date	Type of arrange-ment	Dura-tion	Amount committed (USD bn)
Dec 1999	SBA	3 years	3.7
Dec 2000	SRF		7.3
May 2001	augmen-tation of SBA		8
Feb 2002	SBA	3 years	19
Feb 2005	SBA	3 years	10

Despite this upbeat outlook, downside risks remain. The government may become over-confident regarding its ability to manage the economy, overlooking the fact that part of the improvement in economic conditions is due to a very favourable macro-environment. For example, should the economy slow substantially, the government's appetite for politically costly reforms might diminish. Even if the AKP wins a second term, it might be tempted to reward its electoral base through more redistributive policies which, if implemented via fiscal relaxation, could jeopardise economic stabilisation and undermine market confidence. Similarly, greater emphasis of religious issues during a second term could strain relations with the military and the secular establishment and upset markets. Finally, relations with Washington could sour over Iraq. So there are plenty of potential pitfalls.

On balance, however, we see a 60% chance that these pitfalls will be avoided and Turkey will make good progress with regard to EU convergence until 2007 and beyond. This expectation is based on a combination of a more coherent party system and a powerful external constraint reinforced by strong support from the Turkish public and elite for EU membership.

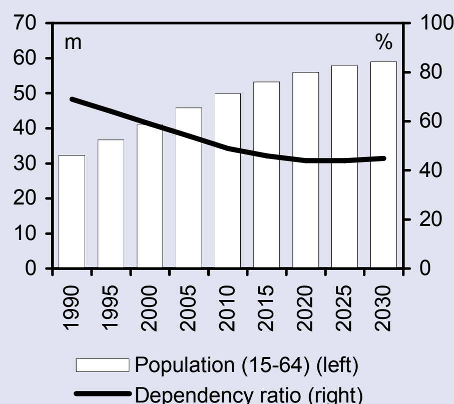
II. Structural underpinnings of economic growth

In addition to a favourable political outlook, structural variables like labour force growth, falling dependency ratios[3], increasing savings and investment, an improving human capital stock and an increasingly open economy bode well for future economic growth, as predicted by standard economic growth theory.

Demographic trends conducive to higher GDP growth

Overall, the demographic developments in Turkey are conducive to higher economic growth. The population will continue to increase, though the rate of population growth will slow over time. The UN projects an average population growth rate of 1.1% a year in its medium-variant scenario (see chart). More importantly, the population is fairly young and around 70% (and rising) of the population is of working age (15-65 years old). A more

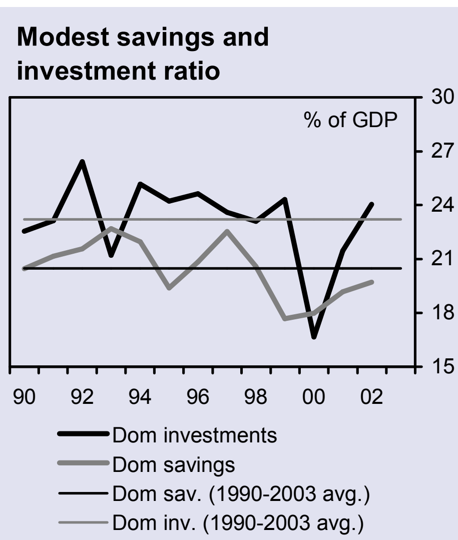
Favourable population dynamics



Source: UN

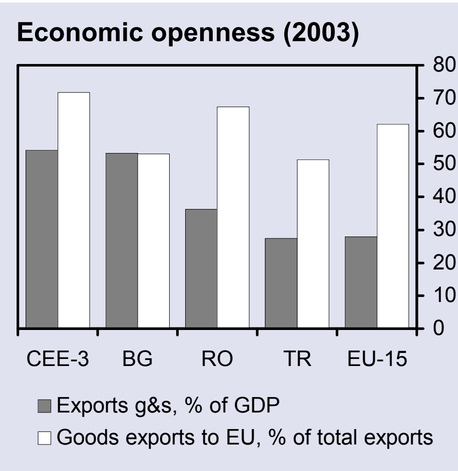
[3] The dependency ratio is a measure of the portion of a population which is composed of dependents (people who are too young or too old to work). It is equal to the number of individuals aged below 15 or above 64 divided by the number of individuals aged 15 to 64, expressed as a percentage.

rapid increase in the population of working age compared with the dependent population should help boost savings and investment from their currently modest levels (see chart). Labour force growth is expected to average around 1-2% over the next decade. As was the case in Asia in 1970-90[4], this "demographic gift" will be a considerable factor in boosting Turkish GDP growth in the next few decades.



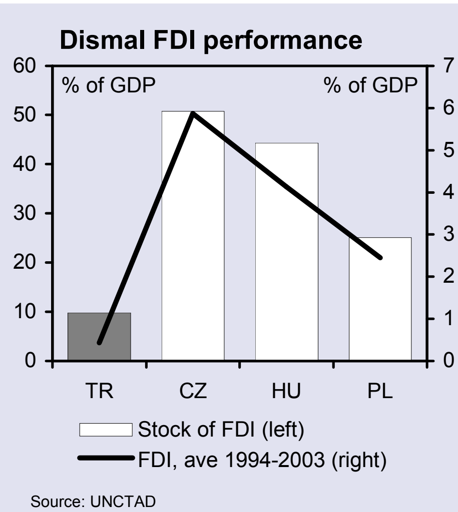
High potential for increased trade and FDI

Turkey is already a fairly open economy, both in terms of trade in goods & services and portfolio flows, especially when adjusted for the size of the economy. Imports and exports combined represent more than 60% of GDP (and rising). Export growth has been phenomenal over the past decade with exports of goods rising from around 20% of GDP in 1994 to 30% in 2003 (see chart). With continued economic reform and closer economic integration with the EU, the Turkish economy will become even more open in trade terms, which should benefit efficiency and growth. We expect exports to reach 40% of GDP by the end of the decade.



The major problem is Turkey's limited openness in terms of foreign direct investment. FDI averaged less than 1% of GDP over the past decade, a dismal performance by any standard (see chart). However, EU convergence, increased macroeconomic stability and privatisation could help attract substantial FDI over the next few years. Increased FDI inflows would help increase macroeconomic stability by providing a less volatile source of financing for the current account deficits. This would help prevent Turkish growth being hampered by a shortage of foreign-currency financing, the so-called balance of payments constraint. Equally important, FDI inflows will boost the investment ratios and bring technology and management skills Turkey badly needs.

The potential for attracting FDI is considerable. A large domestic market, a stable macro-environment and effective domestic institutions are generally conducive to FDI. Turkey has the first, has advanced with regard to the second and is likely to improve the third as convergence to EU standards progresses. Turkey's large internal market with a population of 70 m and considerable growth potential should make the country attractive to investors. Turkey's strategic location between Europe, Central Asia and the Middle East is another advantage. Both the new FDI law (June 2003) and the creation of the Investment Advisory Council (March 2004) will also make Turkey more attractive to foreign direct investment. The privatisation of public sector companies could also help boost FDI inflows. The government seems more determined than in the past to sell a number of major companies in 2005. But if the past is anything to go by, caution is justified here. Currently, however, the Czech Republic, Hungary and Poland rank 13th, 33th and 68th on the UNCTAD 2001-2003 FDI performance index, respectively, while Turkey ranks 110th!



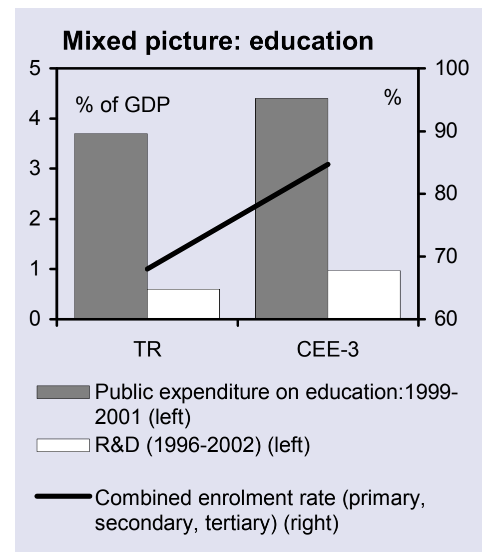
Source: UNCTAD

For the time being, however, FDI inflows remain at very low levels. As a USD 240 bn economy, Turkey would need to attract annual FDI of USD 6-9 bn to boost investment by 2-3% of GDP. Poland, an economy of USD 210 bn, benefited from annual FDI inflows of around USD 5 bn over the past decade, even though progress on privatisation has been less than stellar.

[4] Bloom, D. and J. Williamson (1998): Demographic Transitions and Economic Miracles in East Asia, World Bank Economic Review, Vol. 12, no. 3, Sep. 1998.

Improving human capital stock and skills profile

The quality and level of education in Turkey is modest compared to other top-tier emerging markets. However, Turkey has made sizeable progress in recent years, especially as regards basic and intermediary skills. Primary school enrolment is close to 100%, which puts Turkey at a level comparable to Central and Eastern European countries. But at 55-60%, secondary enrolment ratios are comparatively low. An only gradual increase in the secondary school enrolment ratio is the most likely scenario given the government's limited fiscal resources. But while overall literacy levels are low, youth literacy levels are fair. This is more indicative of future growth than overall literacy levels. After all, it is teenagers that will enter the job market, replacing their on average less well-educated parents and grand-parents in the labour market. Overall, Turkey's human capital endowment still compares unfavourably to other emerging markets (see World Bank Education Index table) but continues to improve gradually. Additionally, Turkey has a very well-educated, often foreign-trained elite and a number of first-class universities churning out highly-skilled graduates. Most importantly, the human capital endowment is set to improve, as less skilled workers retire and younger better educated workers enter the workforce.



Institutional and regulatory environment below average

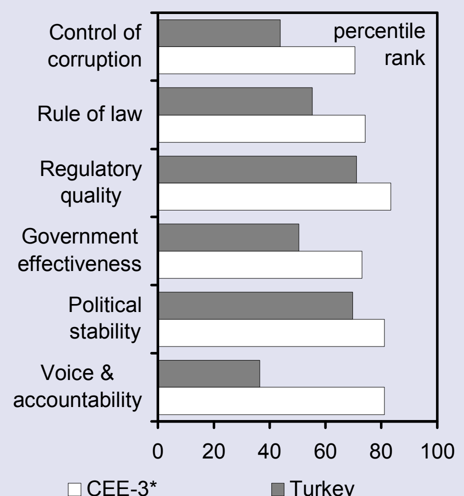
The institutional and regulatory environment does not compare favourably with the more advanced CEE-3 countries. The EU Commission attests Turkey a "functioning market economy". But "institutional quality", broadly defined, has considerable room for improvement. According to the Transparency International Corruption Perceptions Index, Turkey ranks 77, behind the CEE-3 countries Poland, Czech Republic and Hungary, which ranked 67, 51 and 42, respectively. Another well-known index, the Fraser Economic Freedom Index, ranks Turkey 100. By comparison, Poland is ranked 61, while Hungary is ranked 22 and Czech Republic 41. The World Economic Forum Growth Competitiveness Index and the World Bank Governance Indicators also show Turkey underperforming the CEE-3 countries.

World Bank Education Index*

Country	Index
Korea	0.98
CEE-3	0.94
Bulgaria	0.91
Romania	0.88
Turkey	0.80

*) 1 = best

But continued reform in the context of EU accession negotiations makes improvement of the institutional environment very likely. If the experience of the Central and Eastern European economies is anything to go by, then institutional improvement will be forthcoming and Turkish institutions will gradually converge to the new EU-10 average over the next decade. Higher quality institutions should help attract investment and boost economic growth.



*) Czech Rep., Hungary, Poland

Source: World Bank

III. Estimating Turkey's growth potential: DB Research's foresight model for growth[5]

Population growth, fixed capital investment, human capital and openness are the four drivers in our proprietary model for long-term GDP forecasts. Using this model and computing assumptions for these variables along the lines described above leads to an **average growth rate of total GDP of 4.1% per year for the period 2006-20**. Our analytical framework is theoretically based on the

[5] This section was contributed by Stefan Bergheim (stefan.bergheim@db.com). Details and background of the long-term growth analysis will be published separately in February (Current Issues: "Global growth centres 2020: *Formel-G* for 34 economies").

neoclassical production function, which is extended by using human capital as a measure of the quality of labour input and trade openness to capture institutional efficiency. By taking human capital and openness on board, our analytical model describes technological progress explicitly and comprehensively. This contrasts with growth accounting calculations, which arbitrarily assume convergence of per capita income levels without providing a fundamental explanation for technological progress.

Considering Turkey's history of highly volatile GDP growth, it would be difficult to estimate a reliable country-specific model. Taking the experience of other countries into account while still allowing for country-specific business cycles can generate a more reliable model[6]. It quantifies the linkages between real per capita GDP and the four fundamental drivers of growth, taking account of the information in the time series. We estimated the model for 12 emerging markets and generated similar common long-run coefficients as the companion model for 21 OECD countries: a 10% rise in the investment rate raises GDP by 13% over the long run. A 10% increase in human capital (average years of education of the working age population) leads to a long-term gain in GDP of 9% in emerging markets. A half-point gain in openness (trade share adjusted for population size and differences in price levels) raises GDP by 7% in the long run. Country-specific constants capture other influences on growth.

The model forecasts for the four growth drivers stem from a three-stage approach. Extrapolation of the trajectories of the last 20 years or so is the starting point, with the exception of population growth, where we use the UN's forecasts. The second stage takes information from levels and changes in other countries into account to dampen excessive movements in these variables that were generated at the first stage. The third and most important stage captures structural breaks through a broad-based country-specific assessment of six clusters of trends in politics, society and business – based on the country expert's assessment.[7] For example, DBR expects trends in the area of work and society to have a greater influence in Turkey in the future than in the past, partly because women are expected to gain more importance in employment. Major one-off events like increasing prospects of EU entry and the resulting significant changes to domestic institutions are added here as well. Depending on our assessment of these trends, we adjust the forecasts of all four growth drivers.

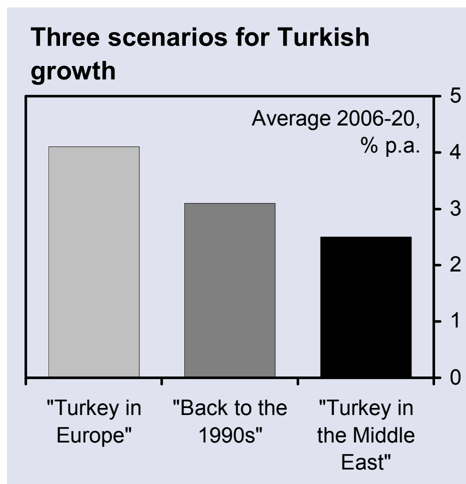
This leads to annual per capita GDP growth of 2.8% on average in 2006-20 and total GDP growth of 4.1% p.a. in the baseline outlook.

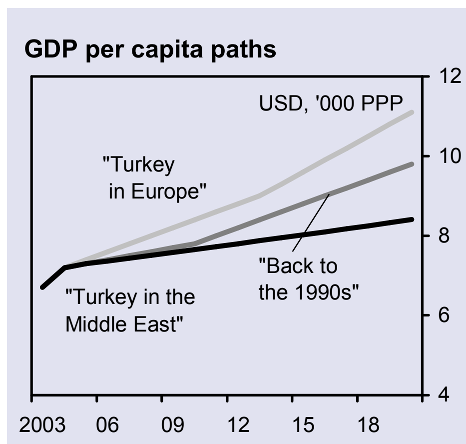
IV. Alternative scenarios

We attach the "EU convergence" scenario discussed above a probability of 60%. Two other scenarios are conceivable, although less likely.

Alternative scenario I: "Back to the 1990s" (p = 30%)

Continued, though manageable, tensions characterise the geo-political situation and domestic politics. A less coherent coalition government emerges from the 2007 elections. Turkey will continue to work towards EU integration, though the process is more gradual





6 This is what our empirical analysis does by using a panel estimation with the "pooled mean group estimation" technique.

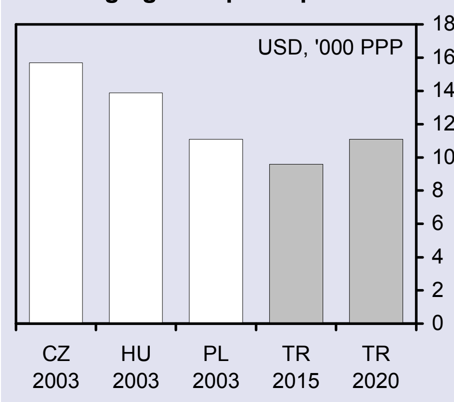
7 See the trend map "The trends that will shape future growth" at www.dbresearch.com.

and more difficult than expected. The economy remains vulnerable to shocks, but volatility will be lower than in the 1990s. Structural reforms only advance very gradually, but government commitment to disciplined macro-policies is tenuous at times, leading to occasional volatility. The regulatory environment improves slightly but not significantly. Combined with the failure to implement the large-scale privatisation of state assets, this will keep FDI inflows at low, and total investment at historical, levels. In this scenario, GDP growth would average 3.1%, in line with Turkey's GDP growth in the past decade or so.

Alternative scenario II: "Turkey in the Middle East" (p = 10%):

Increased geopolitical uncertainty and increased tensions between the Islamic government and the secular-oriented establishment produce recurrent political and economic instability. Turkey continues to be held at arm's length by the EU. The economy will remain as volatile as in the 1990s, leading to erratic GDP growth, significant monetary and exchange rate volatility and recurring economic crises. Structural reforms stall. No significant FDI inflows. No improvement in institutional quality and regulatory environment. GDP growth would on average be only 1.9%.

Converging GDP per capita



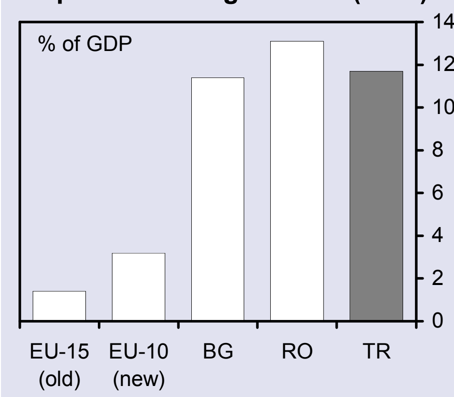
V. Some implications of the EU-convergence scenario

Turkey would in 2015-2020 reach an income level of over USD 11,000 in purchasing-power-parity terms, which would put it at the level of Poland in 2003 (also measured in PPP terms).

This narrowing of income differentials might reduce the incentives for large-scale migration from Turkey to the EU. In fact, a higher growth rate in Turkey relative to the EU as a whole might make it more attractive for Turkish workers to remain in Turkey, thus supporting Turkish growth. This view is supported by the experiences of previous enlargement rounds. In addition, the EU will apply transition rules in the area of free movement of workers.

The share of agriculture in GDP is expected to decline significantly, with manufacturing increasing slightly and services expanding more strongly. While the scarcity of data makes detailed projections difficult, it seems safe to assume that rising prosperity will bring increased demand (and therefore rising output) for consumer durables, real estate and residential services, education and health care.

Importance of agriculture (2003)



Increased macro-stability and steady growth will lead to transformation of the banking and financial system

The Turkish banking sector is relatively underdeveloped. Assets and loans represent a mere 70% and 20% of GDP, respectively. Increased macroeconomic stability, improving sovereign creditworthiness, high growth, increasing domestic savings and EU-related institutional reforms will help improve systemic stability and boost the development of the sector over the coming decade.

The government-led bank restructuring in the wake of the 2000-01 crisis has helped improve the stability of the banking sector, though from a very low level. In 2000-01, the Turkish banking system suffered a major crisis due to currency mismatches, maturity mismatches, "duty losses" of politicised public sector banks and related-party lending gone bad. Supported by a large-scale IMF programme, the government intervened in order to prevent the total

collapse of the banking system, spending around USD 44 bn (or 30% of GDP) on the restructuring of the sector. Since then, weak and insolvent banks have been eliminated, merged or taken over by the Savings and Deposit Insurance Fund (SDIF). State banks have been restructured and recapitalised, though not yet privatised. (State banks still represent one-third of total assets and deposits, respectively, and more than 20% of total loans.) But overall asset quality remains poor despite progress made under the debt restructuring framework known as the “Istanbul approach”. NPLs still represent more than 10% of total loans, though this figure is substantially lower for top private-sector banks. Sovereign risk remains a major risk driver, as high-yielding government securities make up a large share of total banking assets (roughly 40% of total assets). At the same time, capitalisation and profitability are high.

The regulatory environment has been strengthened. Substantial improvement has been made in terms of banking system regulation and supervision. The establishment of an independent central bank (CBT) and the creation of an independent banking sector regulator (BRSA) have created a more favourable institutional environment. Limits for related-party lending and open FX positions have been introduced. The government currently seeks to bring regulation in line with EU standards through the so-called Banking Act.

Although progress has been made in stabilising the banking sector, it remains vulnerable in the event of a macroeconomic shock, especially given the limited capacity of the Turkish state to financially support the banking sector. The system remains highly exposed to crisis-of-confidence shocks. According to Moody’s, Turkey’s financial strength compares poorly with the financial strength of the banking sectors of the CEE-3 countries (see table).

Continued reforms and macro-stability are necessary if the banking sector is to realise its potential. A high degree of dollarisation on both the liability and asset side of banks’ balance sheets still reflects a lack of confidence in the domestic currency, the government’s macroeconomic management and unfavourable taxation. Over the past few years, the share of foreign currency deposits and loans as a share of the total has decreased, though this is partly due to currency appreciation effects. However, substantial improvements like a reduction in inflation have helped to build confidence. The cutting out of 6 zeros in the Turkish lira may be evidence for the new stability orientation. But the chances are that improving monetary stability and increasing confidence in the government’s macroeconomic management will lend a boost to the development of domestic financial markets more generally.

Provided macroeconomic stabilisation proves permanent, many of the smaller banks that have so far largely invested customer deposits in high-yielding government securities will have to adapt to a low-inflation and low-interest-rate environment and re-orient their activities towards private sector lending and/or fee-generating services. With lower interest rate margins, banks will be forced to offer new products. (Currently many banks are focussing on consumer credit.) The large, relatively sophisticated private banks will be best placed to cope with the changing environment.

Despite a fair degree of market concentration (8 largest banks representing 80% of assets, loans and deposits), **further consolidation appears inevitable given that many of the smaller banks are unlikely to be successful at diversifying their activities.** The phasing-out of the full government guarantee on bank deposits will likely also increase consolidation pressure. Further regulatory and supervisory improvements and changes to the tax regime for financial transactions, which currently favours

Sovereign foreign currency ratings

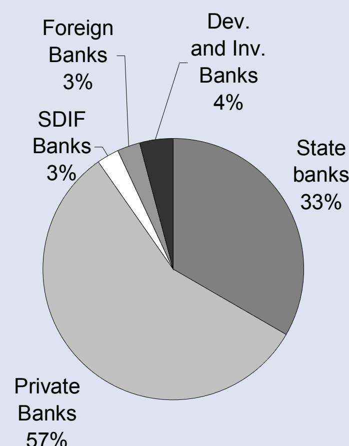
	S&P	Moody's
Turkey	BB-	B1
Czech Rep.	A-	A1
Hungary	A-	A1
Poland	BBB+	A2

Banking Financial Strength Rating

UK	B+
Czech Rep.	C-
Hungary	C-
Poland	D+
Turkey	D-

Source: Moody's

Turkish banking sector (by assets)



channelling savings into government securities, will help boost deposit and loan growth. A combination of increased macro-stability and a more favourable tax regime would reduce bank spreads and increase loan demand.

Rising prosperity due to higher economic growth will require more developed financial markets. Demographic developments and the "life-cycle hypothesis" point towards rising savings, certainly in the later phase of the forecast period, while declining sovereign borrowing requirements will make it more difficult to recycle these savings by simply channelling them into government securities. Increasing wealth and rising savings should therefore lead to demand for more sophisticated financial products. Social security reform might over time lead to the emergence of insurance and pension funds and thus for demand for long-term financial products, as it was the case in other emerging markets like Mexico or Chile. Improved, EU-inspired corporate governance and financial market regulation could lead to the development of a more liquid and deeper domestic bond and better developed equity market. The issuance of longer-dated government securities, facilitated by increasing sovereign creditworthiness, could allow the development of a mortgage market. Needless to say, this can only happen if the government manages to maintain macroeconomic stability.

The Turkish banking sector will see increased foreign participation if the Central and Eastern European experience is anything to go by. The combination of macro-stability and institutional reform will attract foreign banks, which in turn will enhance the stability and performance of the banking system thanks to improved management and financial support from foreign investors. A number of key international banks have already entered the Turkish market in recent years. However, the market share of foreign banks is still very low (3% of total assets), especially if compared to the CEE-3 banking sectors, which are largely influenced by foreign banks.

Conclusion

The Turkish EU convergence process and eventual Turkish membership will be overwhelmingly positive. Turkey will need to implement wide-ranging economic reforms which will make it a more stable and more productive economy. The accession process will strengthen the hand of reform-minded groups in Turkey and help push through further growth-enhancing reforms, as wide-ranging reforms have to overcome entrenched interests and structures. A new reform impetus will substantially increase Turkey's medium-term economic growth and per capita income level. By the time of EU accession, as our analysis has shown, Turkey's economic standing is likely to be comparable to some of the new EU members, a development that is to be unambiguously welcomed.

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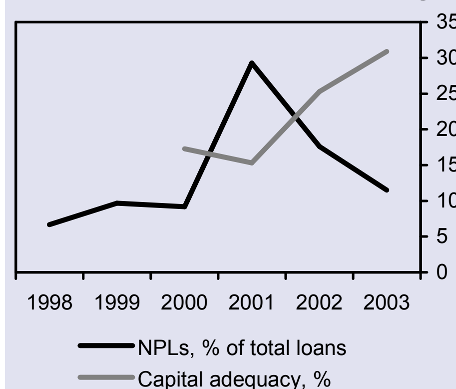
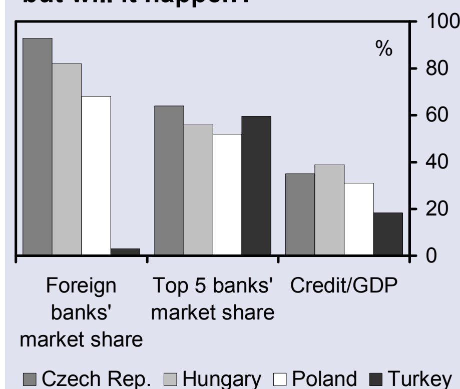
Substantial loan growth potential

% GDP	Bank deposits	Bank loans
Czech Rep.	65.5	41.3
Hungary	38.7	28.9
Poland	34.4	25.2
Turkey	50.0	17.8

NPL's & capitalisation improving



Plenty of room to catch up: but will it happen?



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Printed by: Druck- und Verlagshaus Zarbock GmbH & Co. KG

Print ISSN: 1612-314X / Internet and e-mail ISSN: 1612-3158