Turkey – as a potential eurozone candidate?

András Málnássy
Introduction

• 2009-2011: Economic Analyst – Prime Minister Office (Think-tank - Ecostat)

• 2011-2013: EU Analyst – Ministry for National Economy

• Present: International Taxation Analyst – Hungarian Tax Office
My hypothesis:

Whether the euro zone is an optimal environment for a less developed country like Turkey to catch up?
Turkey is One of the Eight Growth Markets of Future

Source: Goldman Sachs
Real GDP Growth of Turkey compare to Selected Countries/Country Groups (2012)

Source: TURKSTAT, IMF
# Growth Forecasts for Selected Countries/Country Groups (%)

<table>
<thead>
<tr>
<th>Year</th>
<th>Turkey</th>
<th>Euro Area</th>
<th>US</th>
<th>Brazil</th>
<th>Russia</th>
<th>India</th>
<th>China</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>3.4</td>
<td>-0.6</td>
<td>1.7</td>
<td>2.5</td>
<td>2.5</td>
<td>5.6</td>
<td>7.8</td>
</tr>
<tr>
<td>2014</td>
<td>3.7</td>
<td>0.9</td>
<td>2.7</td>
<td>3.2</td>
<td>3.3</td>
<td>6.3</td>
<td>7.7</td>
</tr>
<tr>
<td>2013</td>
<td>3.1</td>
<td>-0.6</td>
<td>1.9</td>
<td>2.9</td>
<td>2.3</td>
<td>5.3</td>
<td>7.8</td>
</tr>
<tr>
<td>2014</td>
<td>4.6</td>
<td>1.1</td>
<td>2.8</td>
<td>3.5</td>
<td>3.6</td>
<td>6.4</td>
<td>8.4</td>
</tr>
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<td>3.6</td>
<td>-0.6</td>
<td>2.0</td>
<td>2.9</td>
<td>2.3</td>
<td>5.7</td>
<td>7.7</td>
</tr>
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<td>4.5</td>
<td>0.9</td>
<td>2.8</td>
<td>4.0</td>
<td>3.5</td>
<td>6.5</td>
<td>8.0</td>
</tr>
<tr>
<td>2013</td>
<td>3.2</td>
<td>-0.3</td>
<td>2.1</td>
<td>3.3</td>
<td>4.4</td>
<td>6.7</td>
<td>8.3</td>
</tr>
<tr>
<td>2014</td>
<td>5.4</td>
<td>0.9</td>
<td>2.3</td>
<td>4.5</td>
<td>4.4</td>
<td>7.2</td>
<td>8.5</td>
</tr>
</tbody>
</table>

Source: IMF, OECD, UN, WB
Maastricht Criteria (1)

Inflation rate of no more than 1.5 percentage points above the average of the three countries with the lowest inflation rates

<table>
<thead>
<tr>
<th></th>
<th>Reference value</th>
<th>Eurozone</th>
<th>Turkey</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>2.8</td>
<td>2.1</td>
<td>8.78</td>
</tr>
<tr>
<td>2008</td>
<td>4.2</td>
<td>3.3</td>
<td>10.43</td>
</tr>
<tr>
<td>2009</td>
<td>0.6</td>
<td>0.3</td>
<td>6.26</td>
</tr>
<tr>
<td>2010</td>
<td>1.5</td>
<td>1.6</td>
<td>8.58</td>
</tr>
<tr>
<td>2011</td>
<td>3.4</td>
<td>2.7</td>
<td>6.45</td>
</tr>
<tr>
<td>2012</td>
<td>3.2</td>
<td>2.5</td>
<td>8.94</td>
</tr>
<tr>
<td>2013*</td>
<td>-</td>
<td>1.4</td>
<td>6.2</td>
</tr>
<tr>
<td>2014*</td>
<td>-</td>
<td>1.3</td>
<td>5</td>
</tr>
</tbody>
</table>

Source: Worldwide Inflation Database
Maastricht Criteria (2)
Nominal long term interest rates not exceeding by more than 2 percentage points those for the three countries with the lowest inflation rates.

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eurozone</td>
<td>4,31</td>
<td>3,82</td>
<td>3,61</td>
<td>4,35</td>
<td>3,88</td>
</tr>
<tr>
<td>Reference value</td>
<td>6,17</td>
<td>5,52</td>
<td>4,91</td>
<td>4,84</td>
<td>3,94</td>
</tr>
<tr>
<td>Turkey</td>
<td>19,16</td>
<td>11,66</td>
<td>8,89</td>
<td>9,8</td>
<td>10,43</td>
</tr>
</tbody>
</table>

Source: Eurostat, TURKSTAT

Maastricht Criteria (3)
No exchange rate alignment for at least two years.

Not relevant at the moment.
Maastricht Criteria (4)
Government budget deficit not in excess of 3 (%) of each country’s GDP.

Source: Eurostat, TURKSTAT
Maastricht Criteria (5)
Gross debt to GDP ratio that does not exceed 60(%).
Convergence criteria for a hypothetical entry test for Turkey (SUMMARY)

<table>
<thead>
<tr>
<th>Inflation (1)</th>
<th>Interest rates (2)</th>
<th>Fiscal balance (3)</th>
<th>Public debt (4)</th>
<th>Exchange rate regime (5)</th>
<th>Number of criteria fulfilled</th>
</tr>
</thead>
<tbody>
<tr>
<td>NO</td>
<td>NO</td>
<td>YES</td>
<td>YES</td>
<td>(YES)</td>
<td>3</td>
</tr>
</tbody>
</table>
Advantages of the Eurozone accession for a less developed country

1. Stability (0.08-0.13%)
2. Lower exchange rate risk
3. Trade expansion (0.55-0.76%)
4. Higher investment rate
5. Price transparency
6. Lower transaction costs (0.18-0.3%)
7. Lower monetary reserves needed

Result in additional GDP growth by 0.6 to 0.9 percentage points
Significant decrease in nominal and real interest rates

Source: Eurostat, National Bank of Poland
Increased creditworthiness induced high capital inflow

Source: Eurostat, National Bank of Poland
Large investment in housing started a boom-bust cycle in the periphery

Source: Eurostat, National Bank of Poland
Decreasing competitiveness

Unit labour costs, Q1 2000=100

* Ireland – business sector, rest – total economy

Source: ECB, IMF, National Bank of Poland
Decreasing competitiveness

ULC deflated REER, Jan. 2002=100

Source: ECB, IMF, National Bank of Poland
Faster convergence but at a cost of growing external imbalances

Current account balance in the peripheral countries, in % of GDP

Source: ECB, IMF, National Bank of Poland
Growing external imbalances

External debt, in % of GDP

Source: ECB, IMF, National Bank of Poland
Summary

**ADVANTAGES**
1. Monetary Stability
2. Lower exchange rate risk
3. Trade expansion
4. Higher investment rate
5. Price transparency
6. Lower transaction costs
7. Lower monetary reserves needed

**DISADVANTAGES**
1. Risk of bubbles
2. Losing the chance of countercyclical policy response
3. Risk of losing monetary independence
4. Faster economic growth may be more difficult
5. Problem of the EUR exchange rate

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Can result in additional GDP growth by 0.6 to 0.9 percentage points

Can cause a two-digit output decline and a debt trap
Thank you for your kind attention!
Summary
The Euro – good project for good times

10Y spreads against German Bunds

Source: ECB, IMF, National Bank of Poland
Summary
Global crisis revealed euro area weaknesses

Why?
Because euro is an incompleted project:

+ COMMON MONETARY POLICY;
- MULTIPLE FISCAL AND STRUCTURAL POLICIES;

+ FINANCIAL MARKET INTEGRATION.
- WEAK AND FRAGMENTED SUPERVISION, LACK OF CROSS-BORDER BANK RESOLUTION REGIME.

- NO FLEXIBLE, MOBILE LABOR MARKET (like in the US);
Summary
Greece – a perfect example of weak supervision over national fiscal policies in the euro area

General government balance in Greece, in % of GDP

Source: ECB, IMF, National Bank of Poland
Growing external imbalances

Current account balance, Germany vs. rest of the euro area, EUR mn

Source: ECB, IMF, National Bank of Poland
Real GDP growth (core vs periphery+Turkey)

Poor correlation between business cycles

Source: Eurostat