Jesse Colombo Contributor
I'm an economic analyst who is warning of dangerous post-2009 bubbles

Πηγή: http://www.forbes.com/sites/jessecolombo/2014/03/05/why-the-worst-is-still-ahead-for-turkeys-bubble-economy/
5, March 2014

Why The Worst Is Still Ahead For Turkey's Bubble Economy?

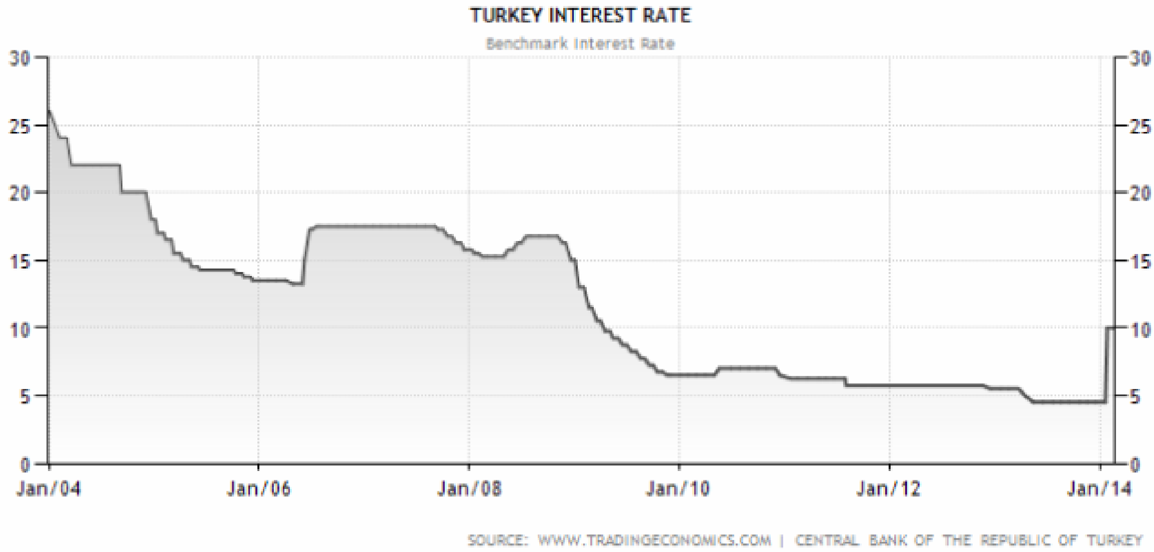
The explosive rise of Turkey's economy in the past decade is one of the most fascinating growth stories of all time. Since 2002, Turkey's economy nearly quadrupled in size on the back of an epic boom in consumption and construction that led to the building of countless malls, skyscrapers, and ambitious infrastructure projects. Like many emerging economies in the past decade, Turkey's economy continued to grow virtually unabated through the Global Financial Crisis, while most Western economies stagnated.

Unfortunately, like most emerging market nations, Turkey's economic boom has devolved into a dangerous bubble that is similar to the bubbles that caused the downfall of Western economies just six years ago. Though Turkey has received significant attention after its currency and financial markets fell sharply in the past year, there is still very little awareness of the country's economic bubble itself and its frightening implications.

The emerging markets bubble began in 2009, shortly after China pursued an aggressive credit-driven infrastructure-based growth strategy to boost its economy during the global financial crisis. China's economic growth immediately surged as construction activity increased dramatically, which drove a global raw materials boom that created a windfall for commodities exporting countries such as Australia and emerging markets. Emerging markets' improving fortunes began to attract the attention of global investors who were seeking to diversify away from Western nations that were at the epicenter of the financial crisis. As the bubble progressed, even developing countries that were not significant commodities exporters (such as Turkey) began to benefit from the growing interest in this investment theme.

Rock-bottom interest rates in the U.S., Europe, and Japan, combined with the U.S. Federal Reserve's multi-trillion dollar quantitative easing programs, encouraged a $4 trillion torrent of speculative "hot money" to flow into emerging market investments over the last several years. A global carry trade arose in which investors borrowed at low interest rates from the U.S. and Japan, invested the funds in high-yielding emerging market assets, and pocketed the interest rate differential or *spread*. Soaring demand for EM assets led to a bond bubble and ultra-low borrowing costs, which resulted in government-driven infrastructure booms, alarmingly fast credit growth, and property bubbles in numerous developing nations.

Like many other emerging nations, Turkey's economic boom since the financial crisis has been heavily predicated upon a combination of foreign "hot money" inflows, ultra-low interest rates across the yield curve, rapid credit growth, and soaring asset prices. The charts of Turkey's benchmark interest rate and three-month interbank rate show how they were cut to all-time lows in the years following the financial crisis:

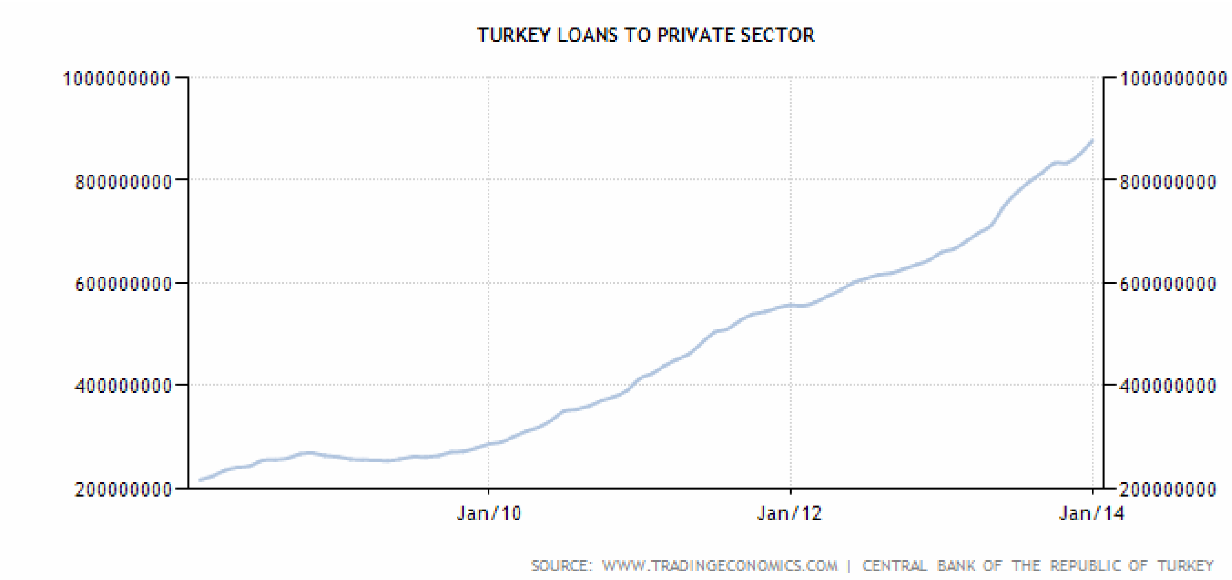


Turkey's idiosyncratic monetary policy of the past half-decade was responsible for these unusually low interest rates: Erdoğan, Turkey's Prime Minister, believes that a zero real interest rate policy is the best practical implementation of *sharia*law's ban on usury, or lending for interest, for modern Islamic societies.

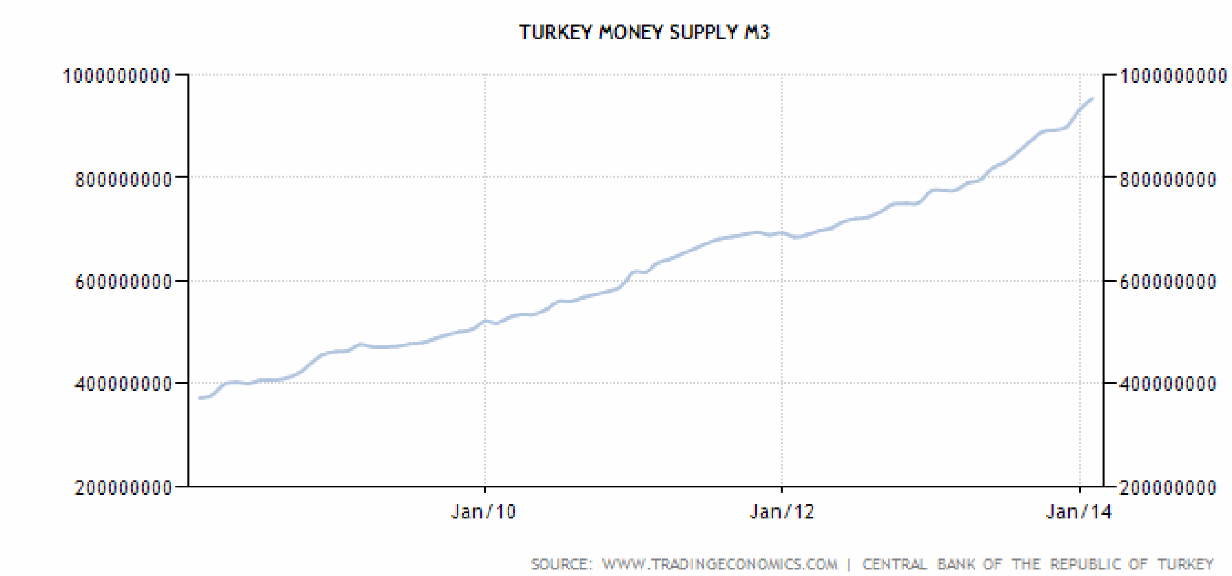
"We aim to cut the real interest rate in the long run, so people will increase their incomes through working, not through interest," he said in 2011. "Eventually we aim to equalize the interest rate and inflation rate."

Turkey's Economic "Miracle" Is Driven By A Credit Bubble

Ultra-low interest rates are, of course, notorious for creating temporary economic booms that are driven by credit and asset bubbles – a fact that likely wasn't lost on Erdoğan, who vowed to make Turkey one of the world's ten largest economies by 2023. Loans to Turkey's private sector have more than quadrupled since 2008, even though the country's real GDP only increased by approximately a third (and a good portion of that GDP increase was driven by debt):



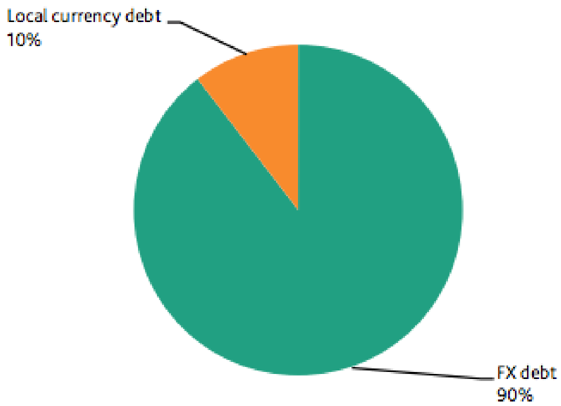
Turkey's M3 money supply – a broad measure of total money and credit in the economy – shows a similar ominous increase:



The emerging markets bond bubble enabled a corporate borrowing spree that caused Turkey's external debt, or debt owed to foreign creditors, to surge to a record high of U.S.$372.6 billion or nearly 47 percent of the country's GDP:

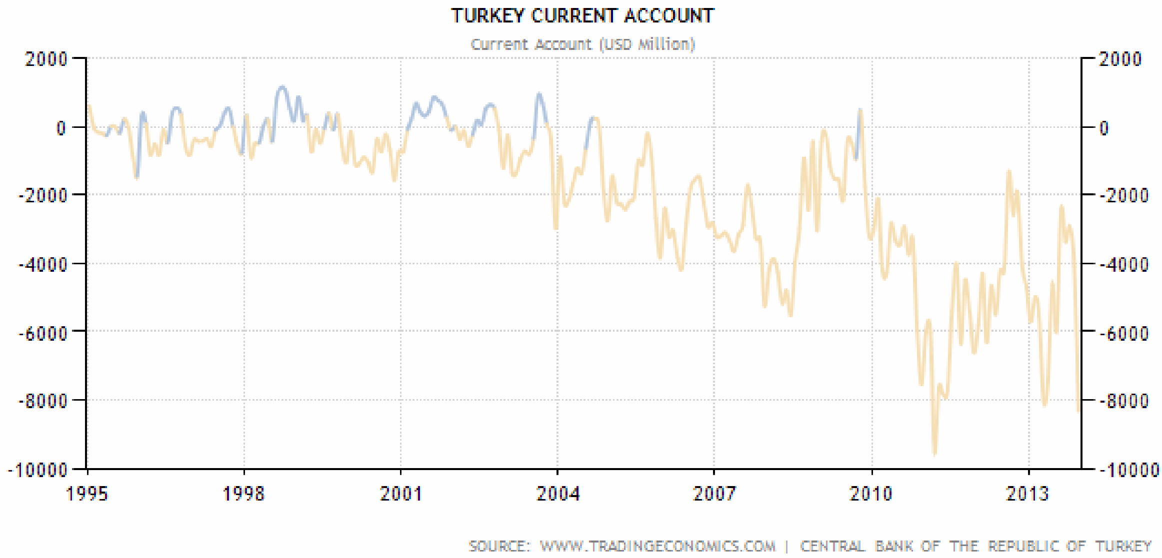
90 percent of Turkish corporate debt is denominated in foreign currencies, which dangerously exposes the country's corporate borrowers to weakness in the Turkish lira currency, which is down by over 18 percent against the U.S. dollar in the past year:

EXHIBIT 3
Majority of debt held by rated Turkish corporates is denominated in foreign currency

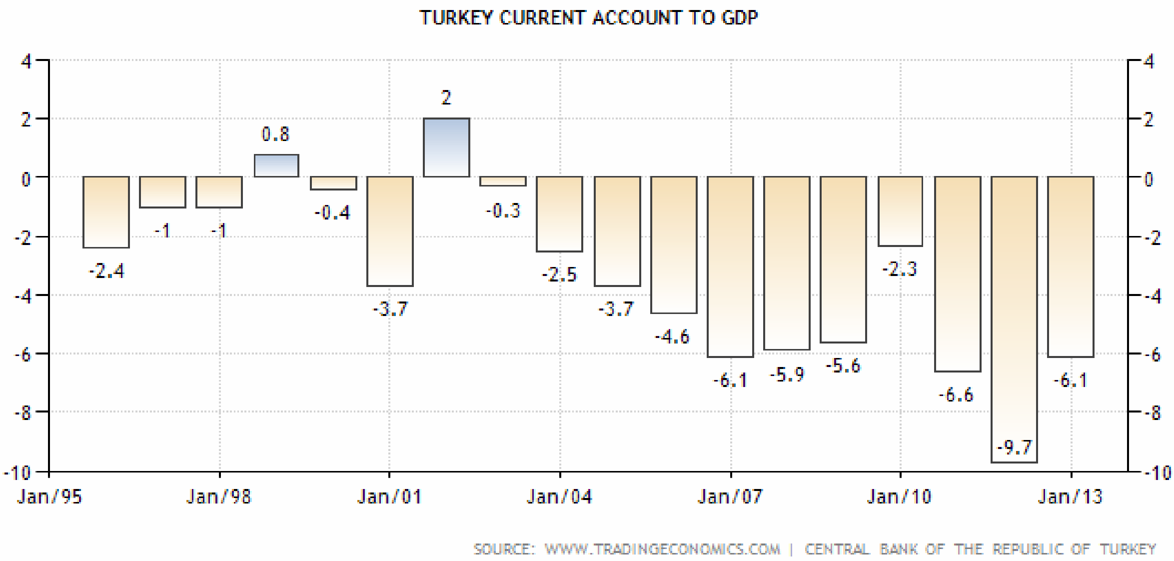


Source: Issuers' financial statements and Moody's

Even more worrisome is the fact that U.S. $129.1 billion, or just over a third, of Turkey's external debt is short-term debt that will come due in the next year, which is a sharp increase from the country's short-term external debt of U.S. $100.6 billion at the end of 2012, and U.S. $52.52 billion external debt in 2008. Turkey's short-term and long-term external debt have both increased at a faster rate than economic growth in the past half-decade. Having a large stock of short-term external debt makes economies more vulnerable to rising interest rates, as many emerging market nations have experienced in the past year after the U.S. Federal Reserve's QE taper plans surfaced. Turkey's short-term external debt burden exceeds 100 percent of its currency reserves, making it one of the highest risk emerging economies based on this metric.
One of the reasons for Turkey's rapid accumulation of external debt in the past decade has been the need to finance its growing current account deficit, which the country's economy has become increasingly reliant upon to continue growing:



Turkey's current account deficit to GDP ratio has swelled to over 6 percent – a level that has led to currency crises in the past:



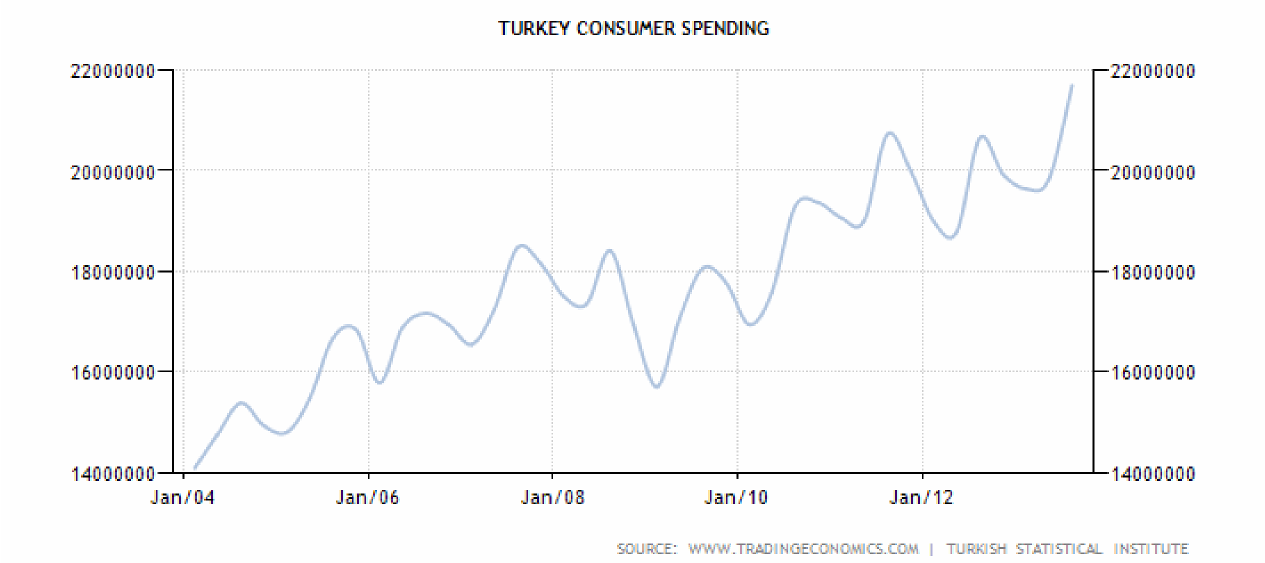
Turkey's Consumption Boom Is Actually A Bubble

Accounting for 70 percent of Turkey's GDP, consumer spending has been the country's primary engine of economic growth in the past decade. Unfortunately, much of this consumer spending has been financed by debt, as with many other areas of Turkey's economy. Personal loans grew at a scorching 61 percent average annual rate from 2005 to 2008 and barely slowed down after the financial crisis, while loans to households were increasing at a 28 percent annual rate in 2013. Credit is so free-flowing in Turkey that consumers are even able to receive approvals for personal loans via text message and ATM machines.

In addition to personal loans, credit card debt has played a significant role in enabling Turkey's consumption boom, with credit card loans from the country's leading banks having risen by 77 percent from 2010 to mid-2013. Turkey's 74 million citizens now own 57 million credit cards and carry approximately $45 billion in outstanding credit card debt – nearly a third of which is considered to be nonperforming. Turkish consumers' embrace of debt-driven consumption has caused household debt as a proportion of disposable income to rocket from 4.7 percent in 2002 to 50.4 percent in 2012.

As is common in low interest rate and credit bubble environments, Turkey's consumption boom has been abetted by a savings rate that has fallen to its lowest level in at least three decades, which places Turkey dead last among fourteen other developing countries for this metric. An IMF study found that the average developing country has a savings rate of 33.5 percent, which is nearly triple Turkey's 12.6 percent savings rate.

The combination of Turkey's falling savings rate and credit binge has helped to propel the country's consumer spending to an all-time high in the past decade:



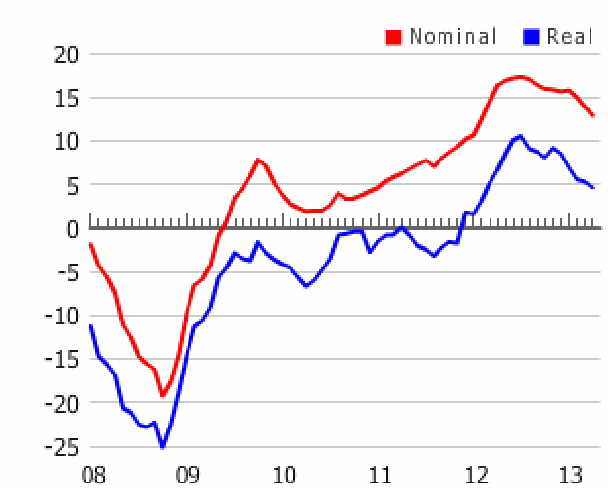
Turkish consumers have focused much of their discretionary spending on goods such as automobiles, consumer electronics and household appliances. Numerous foreign multinational corporations have flocked to Turkey to profit from the country's spending boom.

Turkey Has A Property Bubble

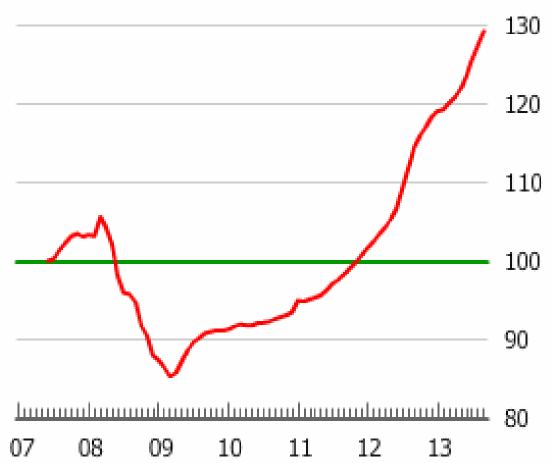
Like many other emerging market nations, Turkey's frothy, low interest rate environment of the past half-decade has led to the inflation of property bubbles in major urban centers. Turkish housing prices have soared by nearly 53 percent since 2009:

House price change

% change over a year earlier

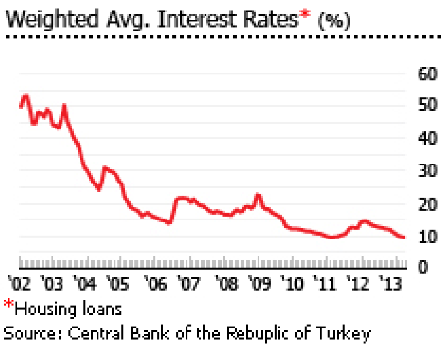


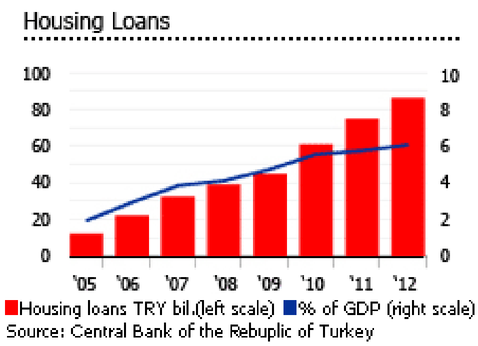
Composite House Sales Price Index (June 2007=100)



Source: GlobalPropertyGuide.com

Turkey's property bubble was driven by mortgage interest rates that have plunged from nearly 50 percent in 2002 to under 10 percent in 2013, which led to a more than sixfold increase in the country's total outstanding mortgage loans since 2005:





Turkey's ballooning mortgage bubble – which expanded by 28 percent last year alone – helped to finance a 78.7 percent increase in property sales in 2013, which has led to a bubble in residential construction activity in turn.

Construction Plays A Key Role In Turkey's Bubble

Construction is one of the most common drivers of economic activity during bubbles, and Turkey's bubble economy is no exception to this pattern. Now accounting for $170 billion or approximately 20 percent of Turkey's $789.3 billion economy (when including related activities), construction of all types have been booming, particularly construction of residential buildings, malls, hotels, skyscrapers, airports and other massive infrastructure projects. Growing by 42.9 percent in 2013, construction-related loans are a major component of Turkey's overall credit bubble.

Since 2008, 39 new skyscrapers have been completed in Turkey, and there are 42 more skyscrapers currently under construction. After its completion in 2011, the 856-foot tall Istanbul Sapphire became both Turkey and Europe's tallest building outside of Russian territory. Turkey's skyscraper construction frenzy is a reason for alarm according to the Skyscraper Index, which posits that many of history's worst economic crises – including the Great Depression and 1997 Asian financial crisis – were preceded by the building of record-breaking skyscrapers.

Skyscraper booms and economic bubbles go hand-in-hand because excessive optimism combined with the availability of cheap credit leads to wildly ambitious, "pie in the sky" business decisions that are later regretted when the boom inevitably turns into a bust. Turkey's skyscraper mania is funded in large part by the risky short-term U.S. dollar-denominated loans that were discussed earlier. Property development conglomerate Kiler Group – which owns the Istanbul Sapphire – had 164 million liras worth of debt in 2013, 154 million liras of which are U.S. dollar-denominated loans. Property development firms that have large amounts of dollar-denominated loans are dangerously exposed to adverse moves in the Turkish lira's exchange rate against the U.S. dollar.

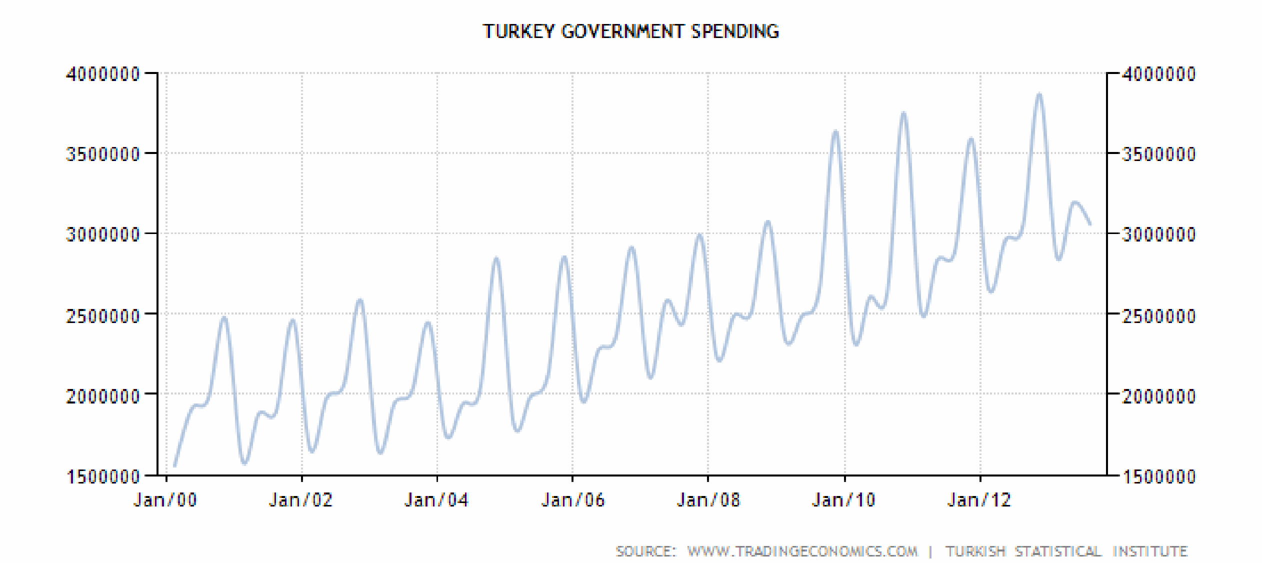
Shopping mall development is another important facet of Turkey's construction bubble: Turkey had only 46 malls in 2000, but now has over 300, and there are plans to build at least 300 more in the next decade. 1.5 million square meters of shopping space is expected to come online in 2014, representing an 18 percent increase in Turkey's total shopping mall space. Turkey's mall construction bubble is being encouraged by the country's unsustainable credit-driven consumer spending boom that was discussed earlier.

As with malls, there has been an explosion of new hotels built in Turkey in the past decade, and many more are in the pipeline. In the next three years, 65 new four and five star hotels with a total number of 38,853 beds are expected to be completed. Western hotel companies have been clamoring to get a piece of the hotel bubble action: Hilton Worldwide had 20 hotels under construction in 2013, Radisson has 15 Park Inn properties planned, while Wyndham has 9 more Ramadas, an additional Wyndham, and 20 Super 8 hotels planned, to name just a few examples. According to Mehmet Onkal of BDO Hospitality Consulting, 95 percent of Turkey's hotel projects are funded by local investors.

Ambitious government-led infrastructure projects have been a significant driver of Turkey's construction activity and economic growth as well. Prime Minister Erdoğan is the mastermind behind Turkey's decade-long, $200 billion construction plan that includes mega projects such as:

- A third airport in Istanbul that is expected to be one of the world's largest when it opens in 2019. Costing an estimated $29 billion, this is currently Turkey's most expensive mega project
- A 26-mile shipping canal to link the Marmara and the Black Sea, which is expected to cost $15 billion
- A 24-tower public-private real estate development that will contain approximately 5,000 luxury apartments, at a cost of $8.4 billion
- A $5 billion rail tunnel that will run under the Bosporus
- A third bridge across the Bosporus that will cost $4.4 billion
- A $2.6 billion financial center complex for the central bank, financial regulators, and private financial firms
- A $2.5 billion luxury high-rise that includes a hotel, a new mall, office space, and a spacious performing arts center
- A large new tunnel under the Bosporus that will cost $1.4 billion
- A $1.35 billion development with two marinas, two five-star hotels, a massive mall, and a 1,000-capacity mosque
- A $700 million ship port, along with luxury hotels and offices
- A $180 million luxury hotel and office skyscraper called the Diamond of Istanbul that will replace the Istanbul Sapphire as Turkey's tallest building when completed

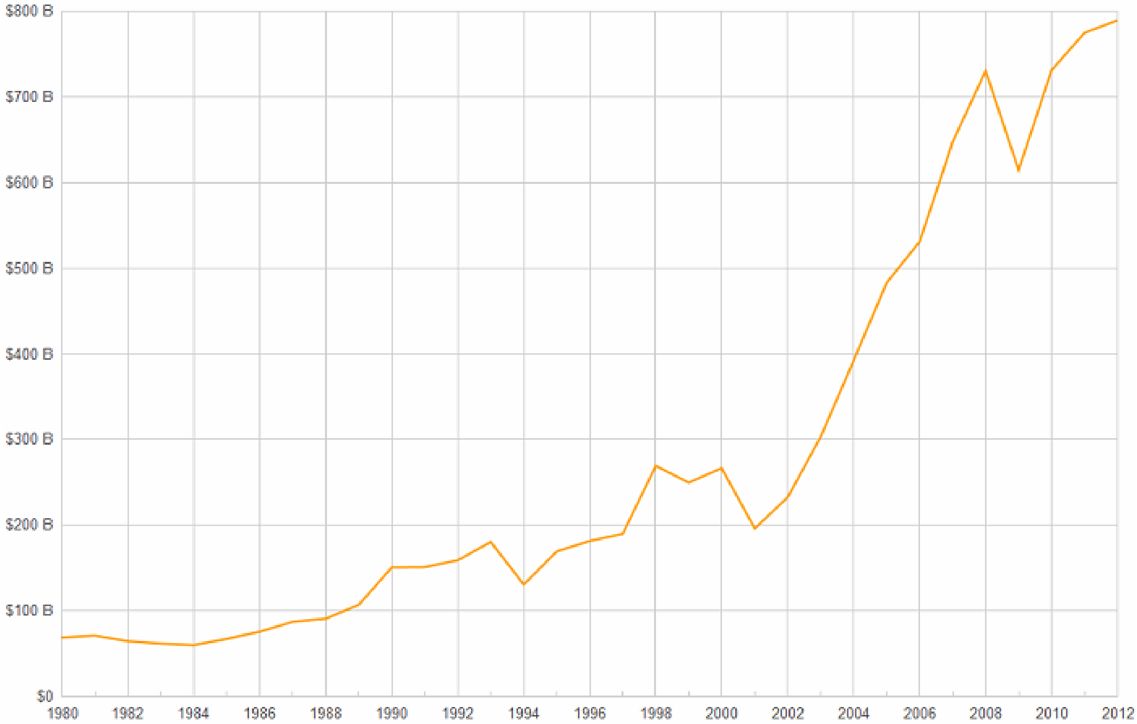
Public construction projects are the primary reason why Turkey's government spending has increased by nearly two-thirds in the past decade:



Turkey's construction boom has been rife with corruption and scandals involving allies of Prime Minister Erdoğan. On December 17th 2013, news of a 15-month secret investigation broke that led to the arrest or questioning of over 100 people. Among those people were sons of three of Erdogan's cabinet ministers, the CEO of a state-run bank, and a construction tycoon who has become one of the wealthiest men in Turkey thanks to the country's bubble economy of the past decade. The allegations against those arrested range from taking bribes to bid rigging. Millions of dollars in cash have been found in some of the homes of the accused. Erdoğan dismissed the criminal investigations of his allies as a plot by foreign interests to hamper and detract from Turkey's economic boom.

Turkey's Bubble Has Created An Illusion Of Prosperity

Turkey's inflating bubble economy has helped the country's GDP to nearly quadruple in a little over a decade:



Source: World Bank

Turkey's stock market soared by ninefold from 2003 to its peak in early 2013, and is still up by sixfold despite the recent market rout:

Booming stock and property prices have led to a surge in the number of wealthy Turks since 2002, including a 10.5 percent increase in the number of ultra-wealthy individuals with net assets of $30 million and above in 2013. Turkey now has the world's seventh highest number of billionaires according to Forbes' billionaire list. Many of Turkey's new billionaires hail from the finance and construction sectors, which are typical epicenters of wealth generation during credit-driven economic bubbles.

Though traditionally an emerging market, Turkey's frothy economic boom has recently led to its reclassification as a newly industrialized country by economists and is considered to be a developed country by the CIA. Turkey is a member of the MINT, CIVET, and Next Eleven groups of emerging economies that are being touted as the next BRICs, which is an acronym for Brazil, Russia, India, and China. Many of the countries in the aforementioned groups are experiencing economic bubbles of their own and are part of the overall emerging markets bubble.

Cracks Are Beginning To Show

Turkey's economy and financial markets were sailing fairly smoothly until a perfect storm of events in late-May 2013 caused a change of sentiment virtually overnight. From late-2012 until May 2013, Turkey's financial markets had levitated on a new wave of liquidity that was provided by the U.S. Federal Reserve's $85 billion per month QE3 program and Japan's new Abenomics stimulus program. In the spring of 2013, rumors of an upcoming tapering or downsizing of the Fed's QE3 program began to put global financial markets on edge – particularly those that were the greatest beneficiaries of the Fed's liquidity such as emerging markets and bonds.

With markets already uneasy over QE3 taper rumors, one catalyst was all that was needed to send Turkey, and soon the rest of emerging markets, reeling: a wave of protests and riots began in Turkey on May 28th 2013 over a slew of discontent that had built up despite the country's booming economy. Often compared to the Occupy protests and movement, Turkish protesters expressed their dismay over numerous environmental issues that resulted from the country's construction boom, excessive use of police force, the lack of freedom of speech and right to assembly, government encroachment of the country's secularism, and Prime Minister Erdoğan's authoritarianism. 3.5 million of Turkey's 80 million people took part in the protests, which resulted in 11 deaths, over 8,000 injuries, and more than 3,000 arrests.

The combination of QE3 taper speculation, the persistent current account deficit, and civil unrest, led to a sharp loss of confidence that caused Turkey's stock market to plunge by over 25 percent in just one month, sparked a sell off in the Turkish lira currency, and caused 10 year Turkish government bond yields to spike from 6 percent to 10 percent.

I predicted the turmoil in Turkey and other emerging markets just a few months before it started in a report that I wrote when I was a contributor to Business Insider called "All The Money We're Pouring Into Emerging Markets Has Created a Massive Bubble."

Turkey's financial markets stabilized after their spring rout until December 2013, when the country's corruption scandal came to light and the Fed's imminent QE taper caused the Turkish lira to crash by over 12 percent to a record low against the U.S. dollar, bringing the currency's total loss for the year to nearly 22 percent:

Turkey's latest turmoil led to its categorization as one of the "Fragile Five" emerging economies, which also includes South Africa, Brazil, Indonesia, and India. The Fragile Five experienced the most pain among emerging markets since the spring 2013 because of their large current account and trade deficits, high inflation, significant dependence on foreign capital inflows, and slowing economic growth.

To shore up Turkey's currency after its sharp decline, Erdoğan was finally forced to give in to the demands of a group of Turkish leaders that he called the "interest rate lobby" that he had long battled against due to their calls for higher interest rates. On January 28th 2014, Turkish Central Bank Governor Erdem Basci – a member of the so-called "interest rate lobby" – surprised the world when he ordered dramatic hikes of the overnight lending rate from 7.75 to 12.5 percent, the overnight borrowing rate from 3.5 percent to 8 percent, and the benchmark one-week repurchase rate from 4.5 percent to 10 percent:

The World Is Still Unaware Of Turkey's Economic Bubble

Though Turkish and international financial markets initially cheered January's surprise rate hikes, I view this as evidence that the world is *still unaware* that Turkey's economic boom is actually a credit-driven bubble that is predicated on ultra-low interest rates, both foreign and domestic. Falling interest rates helped to inflate Turkey's bubble economy, and rising interest rates will put an end to it. This is a very simple concept, yet so few people understand it – even after the events of 2008.

I see even more evidence that the world is largely unaware of Turkey's economic bubble in the fact that the vast majority of the recent discourse about Turkey's problems is myopically focused on the country's current account deficit and currency weakness, while virtually ignoring the risks posed by the eventual popping of Turkey's credit bubble. I believe that this myopia is caused by denial of the existence of Turkey's economic bubble in the first place, along with a mental block that is causing economists and commentators to focus too much on a 1997-style currency crisis, as if that is the only possible template for emerging market crises to follow.

It is important to remember that history doesn't repeat itself, but it does rhyme. The popping of the overall emerging markets bubble will cause a very severe global economic crisis, but it is wrong to expect this crisis to play out identically to the 1997 Asian financial crisis. Like snowflakes, no two economic crises are the same.

Contrary to popular belief, Turkey's currency weakness is not a new phenomenon, as it has been a consistent trend for the last six years:

Despite the Turkish lira's downtrend of the past six years, Turkey's credit and asset bubble has continued to inflate to dizzying new heights, as it has also done since the spring 2013 panic. I am certainly not denying the risks posed by the Turkish lira's rout, but I do not believe that Turkey's economic bubble has truly popped yet. The lira's weakness is the precursor to Turkey's coming economic bust, but it is not "The Crisis" in and of itself.

Lack of awareness and understanding of the implications of Turkey's credit-driven bubble economy is the reason why most mainstream economists and commentators are still relatively optimistic on the country's long-term economic prospects, even if they concede that growth will slow. Unfortunately, credit bubbles of the magnitude of Turkey's do not end in a mere economic slowdown, but in a crisis.

How Turkey's Economic Bubble Will Pop

Turkey's economic bubble is likely to pop as a result of rising short and long-term interest rates, and may coincide with the popping of the overall emerging markets bubble. As the U.S. Federal Reserve follows through with its QE taper – which is expected to be completed this year – the flow of "hot money" to emerging markets will reverse, which will cause those countries' currencies to decline and bond yields to climb. Turkey's $129.1 billion short-term external debt that will come due over the next year is an additional related catalyst that will likely contribute to the popping of the country's bubble.

Here is what to expect when Turkey's economic bubble truly pops:

- The country's runaway credit boom will turn into a bust
- Countless construction and property development projects will turn sour
- Many banks and property developers will go under
- Many corporations that have large foreign currency debts will default
- Over-leveraged consumers will default on their debts
- Economic growth will go into reverse
- Unemployment will surge
- Government and corporate debt downgrades by rating agencies
- Property, the lira currency, stock, and bond prices will fall significantly, leading to higher interest rates
- Political backlash against the current leaders and more public protests

Credit-driven construction and consumption have been Turkey's two main engines of economic growth in the past decade, and the inevitable ending of those unsustainable booms will leave the country without a viable source of growth. The popping of the overall emerging markets bubble will likely lead to a crisis that is worse than the 1997 Asian financial crisis because more countries are involved (Latin America, China, and Africa) this time, and because the global economy is in a much weaker state now than it was during the booming late-1990s.

I will end this report with my favorite quote from economist Ludwig Von Mises:

> "There is no means of avoiding the final collapse of a boom brought about by credit expansion. The alternative is only whether the crisis should come sooner as a result of a voluntary abandonment of further credit expansion, or later as a final and total catastrophe of the currency system involved."

I will be publishing many more reports about dangerous bubbles that are currently developing around the entire world – most of which you probably *never even knew existed*.

Please join my 70,000 person community by following me on Twitter, Google+ and liking my Facebook page so that you can stay informed about the most important bubble news and my related commentary.