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UPDATE ON TURKEY'S ECONOMY WITH FINANCE MINISTER MEHMET ŞIMŞEK

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WELCOME:

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REMARKS AND Q&A:

MEHMET ŞIMŞEK: Minister of Treasury and Finance, Republic of Turkey

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WESSEL: Good morning and welcome. I'm David Wessel, director of the Hutchins Center on Fiscal and Monetary Policy here at Brookings. And I'm very pleased to welcome you, Minister Şimşek and the Turkish ambassador this morning. As I'm sure all of you know Turkey is a big economy, 86 million people somewhere around 18th, not only in GDP ranking around the world, but by PPP in the top dozen. And 2023, after a few years of unorthodox monetary policy and a devastating earthquake. Turkey was in economic trouble. Runaway inflation, a weakening currency was on the precipice of a balance of payment crisis. Then they then President Erdoğan appointed Mehmet Şimşek as finance minister. And everything's been perfect ever since. Right. Well, maybe not. The central bank has raised interest rates from 8.5% to 50%. The government has tightened fiscal policy and inflation is down, although it's still a very stiff 50% and inflation expectations remain unanchored. The lira has stabilized, as you'll hear, I'm sure. International reserves have increased. Credit rating agencies have upgraded Turkey's sovereign risk ratings and market spreads on its bonds have declined. As you'd expect, though, from tight monetary policy, the pace of economic growth is slowing substantially. Today, we're going to get an update on Turkey's progress towards the goals it set a year ago. From Mehmet Şimşek, he served as deputy prime minister from 2015 until the office was abolished in 2018. He previously served as finance minister of Turkey from 2009 to 2015. Before working in government he had worked in the private sector at Merrill Lynch, Deutsche Bank, UBS, and early in his career. He spent four years as an economist at the US economy, US embassy in Ankara. Mr. Şimşek has a brief presentation, after which I'll join him on stage. Ask him a few questions, and I'll welcome questions from the audience. Thank you very much.

ŞIMŞEK: Thank you, David. You've covered all the grounds so I can leave. Good morning, everyone. I'm delighted to be with you today, and I'm very grateful for this opportunity. Yes, I do have a presentation, but it's not a classic one. I try to second guess your questions on the speakers macroeconomic outlook. And so we have something called top ten questions on Turkey. So if I may, I'll go through some slides and then hopefully we can do the Q&A sessions. Yeah. Got this one. Is inflation likely to fall beyond, you know, the base effect? The easy part is behind us. No, it is the tough bit. We think, of course, the answer is yes. First of all, this is the path we we think inflation will follow. The band suggest widening uncertainty as we go beyond one year. It's understandable. But we do see inflation coming back down to high single digits sometimes at the end of 2026. Is inflation responding to the program? It does. It is simply if you look at core goods, inflation is down to 28% year on year. Overall goods about 40% headline inflation at 49%. So still pretty high. But what's holding us back from, you know, obviously a faster decline in headline inflation is the stickiness or the inertia in services inflation. As you can see, we had capsule rents as soon as we lifted. Rents have gone through the roof, of course. So as you can see, services, inflation across the board is way above the headline inflation. That's not unusual. Even though there are some peculiarities, some unique aspects to do with Turkey, such as caps, abolishing those caps and of course, that leading to a significant adjustment in the immediate term. This is typical, I guess, even in the US relative to the core relative to headline inflation. US services inflation is still stuck at well over 4%. So as you can see, it's not really unique to Turkey. It does take time. We'll get that. What makes me think what makes us think that we can reduce inflation meaningfully in 2025? Well, first of all, there's a strong commitment. It's real. We believe that if we can reduce inflation, it will serve the country well. But also, I think it's politically also quite favorable, simply because inflation tends to be the most regressive form of taxation. It spoils income distribution. So income inequalities, of course, becomes a major issue, and that gets reflected in the ballot box. So that's why reducing inflation is key also to political fortunes. So the ownership is that. Secondly, we've had a fair bit of monetary tightening, quantitative conventional tightening, quantitative tightening, selective credit tightening and inflation cannot defy gravity will fall, but it does fall with lax. Monetary policy works, but usually it works with variable and long lags. So we're not unique here either. So we're going to get that done. This next 12 months. There's going to be also fiscal support because we're going to reduce fiscal deficit meaningfully from around 5% of GDP to about 3%. So the negative fiscal impulse is going to help bring inflation down. We noticed that the pricing behavior of corporates is also changing in a positive way. When domestic demand was very strong to have strong pricing power, they no longer have that. So margins are under pressure. They can no longer, you know, raise prices the way they want. And on that basis, I think pricing behavior is going to be is going to also improve. We think that there will also be more supportive incomes policies in terms of administrative prices will obviously do our homework. So as you can see, all stars seems aligned for lower inflation in 2025. Just to give you a perspective, monetary tightening, if you take the compounded version of the policy rate, we offer substantially higher, obviously. I mean, the monetary policy stance is pretty solid. Let's put it this way. Keep it short. Fiscal deficit, as I said, is going to come down and pricing behavior is improving. This is percent of firms planning to increase their prices. You know, and clearly, as you can see, it's is coming down. Inflation expectations are improving. So 12 month forward inflation is now at 27% and 24 months is about 18%. These are ahead of our targets. But that's typical, again, because as we deliver expectations, likely to converge. So the second question is, okay, so much of the disinflation is likely on the back of fiscal adjustment. How are we going to deliver this fiscal adjustment, fiscal consolidation? So that's the spending to GDP. If you take long term, it was about 23% expenditures to GDP. It picked up on the back of earthquake spending and early retirement scheme last year. We think we can bring the spending back down to long term averages by the end of this program. And therefore, it's largely driven by spending controls or spending cuts as a percent of GDP. Our job is going to be relatively easy because earthquake spending is going to peter out. As you can see, earthquake spending has been very high last year this year, but is going to obviously not be sustained at the current levels. We've also instituted really strong spending controls. If you take a decade to deviation between what was appropriated by the parliament versus what government spent. I know you're puzzled. Normally, government should not be able to spend more than what was appropriated. But we have some loopholes in our legal system where you could do it to concession. Court canceled it. So it's like it's going to serve as a fiscal rule anyway to keep it short. Over the past decade, the slippage in spending was 9.1% of total spending. Now, the fact that we've reduced it to 0.8% in amaz to almost 2% of GDP are equivalent of spending cuts as a percentage. So it's quite dramatic. Revenues, of course, we would like to also boost revenues, get back to long term averages. Why are we obsessed with fiscal adjustment? It's really nothing to do with debt sustainability. Government debt, including external and domestic debt, you know, as a percent of GDP is only 26% compared to our emerging market peers. Average of 70%. So Turkey doesn't have sustainability issues. The issue at heart this time around is to help central bank disinflate. So that's really the summary of what we're trying to do. Is it a tradeoff between growth and inflation? The perception is that there is a short term debt, maybe. But if you take long term to get to cause real GDP growth rates for past century is about 4.8% past 20 plus years, it's about 5.5%, but is now softening. This year is likely to be about 3 to 3.5%. So there is some softening, which suggests maybe there is a tradeoff. The reality is if you take a longer term perspective, you know, ten years, there are no tradeoffs. In fact, if anything, when to bring inflation down, it tends to actually boost growth. Look at 1990s, a decade inflation over 70% growth around 3%. Look at the beginning of this millennium for ten years. Inflation is down to single digits, high single digits, of course, and growth goes up by almost, you know, substantially by almost 2%, more than two percentage points. And then last ten years, inflation goes back up. Growth performance deteriorate. So as you can see, Turkey needs to achieve price stability to sustain strong growth. So there are no tradeoffs. An unemployment rate by Turkey standards is at a decade low. And there has been rebalancing of growth. So in terms of contribution to growth, net exports have become positive and domestic demand contribution has softened meaningfully. So the program is really delivering. It's working. How about external balance? Because David was talking about prior to this program, Turkey being on the verge of balance of payment difficulties. Well, it's true that we had a massive current account deficit prior to the program, and at that time it seemed like it was close to five and a half, 6% of GDP, not sustainable. Well, we've reduced that to less than 1% of GDP. So there's been a substantial correction in current account balance how that came about. Well, part of it is cyclical policy induced. Part of it is structural. Structural takes time, but it's underway. Let me talk about cyclical component. On the topic of obviously domestic demand softening. We've also had moderation in gold imports. Why did Turks, if you exclude some small countries last year, per capita gold input, we were almost number one into autumn. Why? Because there was financial repression, massive negative, real interest rates. So Turkish citizens were seeking cover in gold and they benefited. Of course, gold prices have gone through the roof. But that's, you know, it's a part of their portfolio. So to keep it short, as you can see, gold imports have moderated and will continue to moderate because now lira is attractive. Our oil and gas output is rising. We've we used to think that we were not blessed with natural resources, unlike our neighbors. But it turns out that Brexit did include some natural gas and that we do have oil in south eastern part of Turkey and now we're ramping up the output. And this is going to make a big difference. The reason is simple. Over the past 20 plus years, we've paid over 900 billion U.S. dollars for imports of oil and gas. Think about it if we can. Make a small dent in this bill that gets translated into quite a bit of improvement in current account balance because, you know, oil imports annually has been one and a half times of Turkey's current account deficit. So there's a compelling case for Turkey to do what we call energy transition. And that's exactly what we're doing. We're boosting renewables, and that's reducing our natural gas imports and oil imports. This is likely to accelerate going forward. And finally, we copy well, let's put it this way. Inflation Reduction Act served as a source of inspiration for us. And now we are back in the club of, you know, industrial policy initiatives. So, yes, we are supporting investment in certain areas, and it's not unique to these chapters. We also have identified 284 products that are medium, high, high tech stuff. And we give them preferential credit to get into nations to invest. So can't account deficit, which average to about 4% of GDP in the long run, it's already down to less than 1% this year. By the way, these are medium term official targets. So that's why I put here. No need to get confused. We'll probably do better than these numbers. But anyway, so current account deficit has narrowed and is narrowed in a way that enables us to build our reserves as well as reducing external debt to GDP ratio. So that sustainability is no longer a cause for concern. And also reserve inadequacy is something of the past. So let me cover that ground. Our gross reserves are up by 61 billion U.S. dollars. Our net reserves are up by over 100 billion US dollars. This is since the start of the program. This is quite a turnaround. And according to IMF definition, which is we take reserves, as you know, over your certain liabilities. We have just achieved the reserve adequacy. So clearly, we've addressed one of the major vulnerability. How did we do that? Well, we convinced that, you know, that we mean business. So devaluation is happening, high external debt rollover ratios and of course, strong portfolio inflows. This is the dollarization. So the currency substitution rate fell from near 70% to just under 50%, which is quite a good for a year. Quite an adjustment. And secondly, our rollover ratio as compared to the first half of last year has gone up dramatically. And that also enables us to accumulate reserves. And portfolio inflows relative to the beginning of the last year is up significantly, a swing of about 30 billion US dollars. When will Turkey exit exit what we call a protected Lira deposit scheme? I don't know if you're familiar with it. I'm sure Turkish citizens are familiar with it. We call it KKM. This was one of the scheme that was introduced to avoid course correction in the interim period. But of course, it's a source of uncertainty, significant conditional liability, but also a barrier to disinflation. That's why we would like to exit. So it peaked at $44 billion roughly last year. It's down by over $100 billion US dollars. So we are reducing Turkish vulnerabilities. We'll exit at some point soon, probably because the reserves are strong. Now we can afford to pull the plug at some point on this scheme. How about unwinding some of the macroprudential measures that gets in the way of properly functioning market economy? So to return to a fully functioning market economy, clearly we need to continue to unwind some of these measures that were introduced again as a substitute to monetary policy in the interim period. Well, we've done a lot. I'm not going to go through the details. We're still looking at, you know, additional steps. No need to go into details. Has there been any fallout from relaxing your depreciation so far? Rate exchange rate has appreciated depending on which metric used. Is a CPI based? Is PPI based still? Doesn't point to meaningful overvaluation. But, you know, there's a debate out there with respect that debate. Exports have continued to edge up. These are you know, this does that's despite Eurozone weakness. Eurozone is our key trading partner. So Germany is still stuck in recession. So the fact that we're doing well, that means there hasn't been really meaningful fallout yet. And imports, if you take energy out, which you know you should, again, imports are down. So despite the real exchange rate appreciation, imports are down. Exports are up. Current account deficit has narrowed. How come? Well, very simple. Number one, our exports are driven by external demand. Even though there hasn't been a meaningful improvement, it hasn't been a meaningful deterioration. Second, our inputs are driven by domestic credit growth, which has been under check. So that's really simple exchange rate matters. It does, but not to the extent that people think. The key to long term. Of course, strength of lira is productivity growth. I don't really have time to go to details, but we do have a program that foresees improvement in productivity. How vulnerable is to get to trade fragmentation? After all, you know, geopolitical competition or geo economic fragmentation is now a reality. Well, let's look at it. We have 54 free trade agreements. EU is accounts for half of that. And other countries account for the rest. 60% of our exports goes to countries that we have free trade agreements. So that's insulated unless there's a reversal that our trade with the EU is balanced. You know, it demands trade volume amounts to just goods. Trade amounts to about 215 billion USD. So it's sizable. They can't afford to let us go and we can't afford to drift away. So even though we have disagreements on certain political issues, we tend to do well when it comes to trading with each other. So I don't think that's going to change. And Europe is not talking about becoming more protectionist. How about the rest of the world? Well, one thing I can say comfortably, I don't think will be one of the target countries if things change in the United States because we don't have a trade surplus with the United States. We have a trade gap. So technically speaking, we shouldn't be really out, you know, being singled out. So as you can see, we do have a relatively open economy and we do have access to $30 trillion GDP through free trade agreements. So I think that gives us a little bit of room. We're not immune, but certainly it will be less we are less vulnerable. The other thing is we do benefit from near shoring and shoring. We qualify as friends for Central Asia, Middle East, North Africa and Europe to a customs union. And of course, we're near. So technically speaking, if those two trends were to be sustained, you know, hopefully Tokyo would be more resilient. How about the impact of rising geopolitical tensions and conflicts in the Middle East? We live in a rough neighborhood. And clearly there are implications of living in that neighborhood. Well, typically, there are two channels in which we get affected. Typically, one is energy prices, because our region is energy rich. When there's a conflict and as you prices tend to respond, but our vulnerability to energy prices is really not manageable. So if oil prices go up from, let's just say around 70 to $80 right now to let's say $100, the impact will be current account deficit will be half a percentage points higher. And inflation will be two percentage points higher. Well, in the grand scheme of things, we can live with that. Not desirable. But Turkey can live with that. Can cope with that. How about trade? Well, if there is a retaliation, if things really deteriorate, our net exports to Iran accounts for only 0.4%. So it's no big deal. Trade with Israel has been suspended since May. And even if you take a broader region, Middle East, North Africa, if you really even that, I think while the fallout will be significant, we could still manage it. So why would you invest in Turkey? I know probably there's no entrepreneurs in here. I mean, you know, among you. But still, I would like to make a case for that. After all, you invited me. So you need to give me a few minutes to pitch, you know? Otherwise, it wouldn't be fair. Anyway, why would you invest in Turkey? Well, first of all, it's a large economy. How many countries can you can't with a population of 90 million people, if you include refugees and a per capita GDP of $15,000. Simple question. There are only four countries. Yeah. I'm not exaggerating. Of course those are convenient, difficult conditions for Turkey. But let's reduce the threshold to 80 million people and per capita GDP of $10,000. Still, you get only eight countries. So it is a sizable market. Now, if you don't want to take my word for it, let me give you a table. Turkish, Turkish economy or population or industry value, whatever is as big as 12 to 17 EU member states. So when you are in Turkey, it's like covering a dozen or more than a dozen EU kind of like. So this is quite big. So it's a sizable economy. Okay. You may have a sizable economy, but are you performing? Are you growing? Well, if you look at real GDP growth, you take 22 as your base year equaling 100. Turkey is the dotted red line. It's up. You know, to 302 from 100. Well, you may say we are at par with the emerging market, which is 291 two. But if you exclude China, India. So similar, Piers, you know, similar sized countries. Then, of course, you need to look at the yellow line and relative to the yellow line. Turkey has massively outperformed emerging market peers when it comes to growth. So not only where big market, big economy, but also we are growing fast and you don't have the labor market impediments. You know, every year we get university graduates of 900,000 university graduates. And also we have vocational schools, you know, essentially delivering 430,000 qualified people. So this is quite sizable. In that sense, we've invested very heavily in infrastructure. So infrastructure is good according to the World Bank. We are among some of the best EMS back in the top four in terms of the infrastructure from energy to road network, airports, ports. You know, so across the board manufacturing value add. We have a strong culture of manufacturing relative to our per capita GDP. We are almost at par with Asian, you know, tigers. And so that clearly tells you that we have a strong manufacturing base. So why aren't we as rich as some developed economies? Because we still haven't move up the value chain. So that's something we need to work on. So that's part of our structural reform agenda to make to this economy more complex, you know, produce more medium, high and high value added stuff. We seem to be on the right track. They just released the Global Innovation League. Of course, we need to compare ourself with our peers. Our peers are upper middle income countries. We're still an upper middle income country. So on that basis, we're number three in the Global Innovation League. China is number one. Malaysia is ahead of us. We are number three. So that's my presentation. I hope, if I cover all the grounds. So no need for any questions.

WESSEL: Well, thank you very much, Minister, I. I already knew that people respect your ability to steer a troubled economy, but I didn't anticipate what a good salesman you are. And I also want to compliment you and your staff. We have lots of slides in this auditorium, and most people use font this big and try and fit as many words as possible. So we're going to use your slides as a model of how to tell a clear story. I do think, you know, like, okay, you took about six of my questions and answered them already. So it's a challenge. But I know we're going to focus on the economy, but I really don't think we can ignore what's been going on in the past few days. So five people were killed, more than 20 injured in an attack which the PKK has taken responsibility for in Turkish airspace outside of Ankara. The Turkish government has responded by bombing Iraq and Syria for a couple of days. But this comes at a moment when there were some signs of olive branch. Devlin partially has made a headline Making Peace Offering, inviting Abdullah Ocalan to make an appearance in parliament and so forth. And I wonder what what is the state of play here? Is this the beginning of a big change or it has have these terrorist attacks successfully disrupted what's look like a real promising start? How do you how do you read this?

ŞIMŞEK: Well, thank you. First of all, I think it shows the nature of Peacock as a terrorist organization. Clearly, certain circles do not want reconciliation. They do not want a resolution of issues. Look, ethnically, I'm a code. I'm a proud Turkish citizen all the way to the age of 67. I couldn't speak a word in Turkish. And my parents were subsistence farmers. They couldn't speak a word in Turkish because during that time they childhood there were no schools because we were in a remote mountainous region. So you can see I'm not I'm not trying to tell you. I come from a very humble background, which I do. But that's not my point. The point is. You know, Turkey has diverse ethnic groups and sectarian groups and Turkey you know, generally in recent years, under President Erdoğan's leadership, there was a genuine effort. To address any issues at that time to two outstanding, including the Kurdish issue. But sadly, PKK walked away. And chose the path of destruction. Now. A couple of days ago, there was this extraordinary outreach by the leader of NHP. Which is seen by many as a nationalist party. Our junior coalition partner. Partner at the parliament. That was amazing. And I don't think it's coincidence that immediately, less than 24 hours later, there was this act of terror. But we will not allow that to get in the way because we will continue to do what is right for the country. And what is right for the country is to continue to boost fundamental rights and freedoms, enhance standards of our democracy, because this is key to our long term prosperity. And so I, I am always optimistic. I have to be by definition, but I am optimistic that such an outreach, such a call for reconciliation hopefully won't be left in the cold. Hopefully there will be follow up. We cannot afford violence to get in the way because then of course they would win or we cannot allow them to it. So for Turkey to win, we need to continue to move on. Now, I did my best. We as a team, we are doing our best to return to rule based policymaking in line with international norms. And Turkey has benefited from that. I'm optimistic that we will also make progress on other areas. A number of traumas got in the way of our story at the beginning of this millennium where we had a very progressive platform. It's very unfortunate, but it is what it is. No point of looking back. Looking ahead, I think the only way forward is to continue to work and do reforms that will serve Turkish people well.

WESSEL: Thank you for that. You mentioned, Minister, that in the long run you argued there is not a tradeoff between reducing inflation and growth, but you acknowledged that there is a tradeoff in the short run. Growth is slowing in Turkey and industrial production has been down, industrial company sales have been off and inflation is always very sticky. There's a lot of inertia. So are you. How do we how will the program be able to be sustained as the economy weakens? Will you be able to maintain political and popular support for something which, as you pointed out, is going to be, well, painful for the near term, tightening the fiscal deficit and so forth?

ŞIMŞEK: Admittedly, there are always side effects of any treatment. You know, we've had years of relatively high inflation. Pricing behavior is unruly. Expectations are still put into high inflation. Look, you had an inflation episode. The advantage you had is that long term inflation expectations did not deteriorate.

WESSEL: Exactly.

ŞIMŞEK: We have I'm speaking in general as an emerging market. We have more of a credibility gap. So that raises the cost of, you know, achieving price stability. But look, I'm not naive, but let me tell you this. By the time. Before. There are spillovers. I'm trying to get my words right before there are spillovers to the labor market. As I've shown, you know, unemployment is at a decade low. So before there are meaningful spillovers where it becomes politically obviously difficult, I'm optimistic that the policy response will be there. Worst case scenario will deploy what we call active labor market policies, which we did, by the way, back in the past 2829. You know, on the back of the global financial crisis. So will provide support if needed at that point to SMEs to keep people on the job or, you know, deploy some maybe Keynesian, you know, programs to get some temporary public sector employment. So, again, I mean, it's too early. We have not seen an evidence yet. The manufacturing recession that you've alluded to. It's more to do with two factors. Number one, it's not unique to Turkey. It's really across the board. If you look at global manufacturing, PMI, it's well into negative territory. So it's global. Secondly, unfortunately, much of our manufacturing is destined to Europe and Eurozone recovery has been dismal. So that is not healthy. And finally, because the cost of funding is high now, the cost of maintaining stocks is high. So retailers, warehouse owners or whatever vendor are no longer withdrawing. I mean, buying the stuff and stocking it. They used to during high inflation episodes where the expectation was that the price will go up. They would stop now. So instead, in the last few months, what we see, there's evidence of depleting stocks. But as you deplete your stock, you don't really I mean, factories cannot sell. So what I'm trying to say is this. Some of it is transitionary, some of it to do with external demand conditions. But some of it is to do, of course, with softening of domestic demand. But if you look at the overall economy, manufacturing accounts for only 23%, construction for about 6%, agriculture for about 6%. So 65% of the economy is actually services and services remains pretty strong, remember. So this services inflation that needs to have the pricing power. So tourism is doing well. Education is doing the health care is doing well across the board. Services are still strong. So it's too early to talk about a generalized, you know, faltering of of the economic activity.

WESSEL: But your story is that if demand falters and it becomes too painful, monetary will continue to be tight and you'll compensate with fiscal policy, targeted fiscal policy if you need to. Is that basically.

ŞIMŞEK: Because, you know, I'm finance minister, if I say anything about monetary policy direction, I'll get crucified by the lot. So. So, look, I have to be sensible. I can only talk about the fiscal aspects of policy response. Otherwise, you know, I would be stepping into the wrong direction.

WESSEL: I'm tempted to make some comments about the United States here, but I'll I'll let them be linger in there. I think you mentioned that the real exchange rate has been rising. That's what happens when you have inflation like you have and in your way of manage the currency. And you said not a problem yet. But as you just pointed out, tourism is a big part of Turkey's economy. At what point do you begin to see some effects of real change rate appreciation and what do you do if it starts to bite?

ŞIMŞEK: Well, there are there are dislocations in certain sectors. Admittedly, Radware laser shoemaker is, you know, the ones that are labor intensive are showing signs of, you know, some stress and probably some structural issues, meaning competitiveness issues on top of of course, exchange rate appreciation doesn't help. By the way, we're talking about real appreciation here. Not so. And we cannot be we cannot ignore those. But what I'm trying to say is this Our exports are driven by external demand. We've done a lot of analysis. In my good old days, I used to be on the sell side. You know, I used to have. Different hats.

WESSEL: It shows yeah.

ŞIMŞEK: We've done we've done quite a bit of analysis. And I can tell you the main driver is external demand. We are optimistic. Of course, we cannot bank on it, but we are optimistic based on the IMF World Economic Outlook, that Eurozone will show a little bit more recovery next year, but who knows? And our domestic demand is driven by credit growth and incomes policies, and that affects imports. So. It's premature to talking about implications for external battles. But of course, we have to be also attentive to sectoral dislocations. So we looking to see what we can do. To be honest with you. So I can't give you a timeline. But, you know, I think to afford further real appreciation, we have to be convinced that productivity, total sector productivity is going to follow in a meaningful way. Total factor productivity tends to be associated with these type of programs. You can't talk your way into making companies productive. You just make them productive. You know that. So we've got a good evidence of the past disinflation. I can tell you, if you go back to 1990s, if you look at GDP growth, you know, only 9% is attributable to total factor productivity. If you come to the first decade of this millennium where disinflation was the it was the game in town and real exchange depreciation was quite strong. That's when total factory productivity accounted for 40% of growth. So again, I can't sell this point yet, but I'm optimistic that the combination of productivity growth will help. But then again, this is a very controversial in Turkey, and that's why I need to pick my words. Right. Exporters, you know, clearly do have a strong voice. We respect them. We hear them out.

WESSEL: But just tell them you have to be more productive, right? Yes.

ŞIMŞEK: Yes. Thank you. You did it.

WESSEL: Happy to help. Let me ask you about Russia. Turkey has, of course, been a member of NATO's for since the early 50s, aspires to join the European Union someday. But, of course, Turkey has also applied or joining the BRICS. And President Erdoğan was recently got a lot of attention from joining Vladimir Putin and the BRICS summit in Kazan, Russia. So I'm curious how you how is this going to work? Can you really expect fuller integration into Western Europe? Can you expect Western foreign direct investment if people are worried that Turkey is playing the West off of Russia and might end up more in the Russia bloc than in the Western bloc?

ŞIMŞEK: Thank you. Well, two points. First of all. BRIC is currently in the current format is barely a dialog platform. G20 includes BRICS and most of them anyway, and it's a dialog platform, so we cannot really equal that to something like European Union or any other more structural or structured platform. So number one. So this is a dialog platform. Number two. Please hear me out. I mean, and our friends in the West in general, including geographic west, which is the EU and the non geographic was which includes the United States. There's a lot of frustration. Even I could go as far as to say there's a lot of anger and resentment for keeping Turkey in the entry room for 40 years. On what ground? They used to say, you're not. You're poor. So you've become a liability. Actually Turkey has proven to be an asset rather than a liability. We can actually help EU. You know, I looked at Draghi's report. I couldn't read the 400 page version. But we looked at the.

WESSEL: We'll see if we can get you some good slides like yours.

ŞIMŞEK: I looked at the executive summary and I can tell you. You know, if they really want deeper, bigger market, deeper integration, they need turkey. But politics gets in the way. Lack of strategic perspective gets in the way. And that's frustrating for us. You know, I know President Erdoğan, you know, clearly is frustrated. We are frustrated. So we need to be treated with respect because we're not a pushover. This is a, you know, a proud country with a proud history. And Europe has not treated us that way. Lack of strategic perspective? Now, they always blame us for not satisfying all the conditions. But go back to 2007. Paris essentially was saying if you read between the lines, that regardless of what you do, even if you do whatever it takes to become an EU member, that they will let you in. How that would make you feel that you're told that you're not loved, you're not wanted. So clearly, that's really not. So my I've always argued that it's hard to understand European Union perspective other than domestic politics, because imagine Europe having a free put option. After all, these are sophisticated people. So I assume what that option is so you have a free put option. If you allow Turkey to use European Union as an engine for wholesale change. Wholesale. Peer pressure, you know, that way the worst case that could happen to Europe, you have a stable, strong, prosperous. Neighbor. It's good for you. It enhances the value of your property. Neighborhood goes up and they fail to see that. And so I don't think you can assess the search for alternative platforms independent of the treatment we are getting from our Western friends. So it takes two to tango and I genuinely see benefit. Of, you know, anchoring to get back to you. I do. I see that. It's good for us. It's good for you. But sadly, we don't see that strategic depth and perspective among our European political circles.

WESSEL: You mentioned in your remarks I think you were being slightly humorous that you don't have to worry about the US sanctioning Turkey because of your trade deficit, because we run a trade deficit. But there has been a lot of tension about Turkey's and Turkey's financial institutions and other dealing with Russia. And to what extent do you are those sanctions an issue for you and where is Turkey on in terms of cooperating with the US and Ukraine and its allies in pursuing sanctions in that attempt to restrain Russia?

ŞIMŞEK: Well, first of all, we have a principled stance. We have been strongly opposed to occupation of Ukraine territory, full stop. And that's not something new. It goes back all the way to 2014 when Crimea was annexed. So we've had a very strong principles stance. That's number one. That has not changed. Number two. Unlike our European friends or distant friends in this geography, we can't decouple with our neighbors. It's not easy. There's a lot of interdependencies.

WESSEL: Russia being one of your neighbors.

ŞIMŞEK: Of course. Of course. Big neighbor, an important one. And so, therefore, I think it would be naive. However, let me make it very clear. We've been working with our allies and friends to make sure that the military industrial establishment doesn't get the support to Turkey. That's also very clear. Our financial system have gone actually over compliance, not because of fear of sanctions. They have de-risked and even for non sanction products or entities, they are wary of doing business facilitating transactions. I can tell you that it's quite clear because wherever I go there are complaints that complaints internationally by the Russian counterparts that are complaints domestically by Turkish corporates who sell food, staff ready wear and all this sort of stuff. So I can tell you that we've also made it sure, we're making sure that U.S. or West originated potential dual use stuff don't make it. So we're doing our best in that sense. And I don't really see the merit in occasionally Turkey being singled out on these type of issues. I wish if I knew that that question might come. I can show you slides, exports and tie European Union members to this town, to Kazakhstan, to Tajikistan, to Georgia, Azerbaijan. You know, all of them literally like is done gone through the roof like that. So it's not unique. You know, so the fact that I understand, you know, press coverage and stuff like that, but know there's a genuine effort on our side. But I think expecting us to just walk away, decouple. You know, much of our industry lives off Russian natural gas. You can't just substitute it. Even though we are diversifying. So you can't just do that. And that's why we cannot, you know, entertain the the more extreme version of what is expected of us.

WESSEL: We've run some of those charts that you refer to on our website. If you're looking like this. I want to take some questions. So here's the deal. The minister came here to give a speech. You came here to ask questions. I'm going to cut you off if you make a speech. I'm going to take, say, maybe 2 or 3 questions, and then I'll give you a chance to decide which one you want to answer. Is the woman here?

ŞIMŞEK: Can I have a notepad so that you take notes? Because I'm not that smart?

AUDIENCE QUESTION: So the Minister, thank you so much for you.

WESSEL: Tell us who you are before you ask a question.

AUDIENCE QUESTION: Of course. The Minister, thanks so much for your presentation. My name is Shalala Shalala. So I am from Azerbaijan and currently I am doctoral at American University in Judicial Science. And my research is on and conducted in the state. So basically it's about trade law, export controls and supply chain. So you mentioned about. And Turkey is one of them, a leader in electronics industry. I would like to learn what's Turkey's plan on semiconductor industry in this regard when it comes to national security and the economic stability. Thank you.

ŞIMŞEK: Thank you.

WESSEL: Over here. Wait for the mic, please.

AUDIENCE QUESTION: Sure. I wanted to ask you about post US elections.

WESSEL: Can you introduce yourself?

AUDIENCE QUESTION: Aslı Aydıntaşbaş , Visiting fellow at Brookings Institution. Thank you for coming and thank you for this interesting presentation. I wanted to ask you about the impact of US elections. We don't know, of course, what will happen in November, but one of the candidates, former President Donald Trump, is talking about wide ranging tariffs on China. But across the board, how what is the impact on Turkey? How do you prepare for something like this, especially since there is an expectation that there would be also be tariffs on Europe and that EU might retaliate? And maybe as a follow up, is there a silver lining here for Turkey or is that too much of a Pollyanna thinking? You have talked about Europe, you know, wanting to re anchor with Europe. Is this an opportunity for that or not?

WESSEL: Gentlemen. Over here. Sara, raise your hand so she can see you.

AUDIENCE QUESTION: So I have my name is [inaudible] I have basic questions and micro. I guess Turkey is expensive. Like literally when you go to Turkey and the service industry is like 60%. But Turkey is expensive. So is this the new reality of being low or stagnant? Is this a new reality or is it going to go back to, I guess, normal times? That's the I have another question. And Turks are usually missing gold. You mentioned the thing and I think that another area becoming like a lot of Turks are investing in housing in US and housing in other countries. I'm a real estate investor in Baltimore. Last year, around like 700 of them got scammed actually by other Turks. So but I mean, they are always coming forward to get rent like dollar rent and stuff. So is that like, Yeah. And is that a worry for Turkey? It's kind of like seems like a growing area.

WESSEL: Thank you. All right. So the first question was about semiconductors.

ŞIMŞEK: Thank you. Thank you. Look at the the search for having some semiconductor chips produced in Turkey is very simple. We're number two in the world in manufacturing of what we call white goods, like fridges, washing machines, dishwashers and things. So we have a massive manufacturing base. We're only second to China, so we need chips for that. Number two, we have. A rising defense industry is getting really big. Last year, the 11th largest exporter in the world. And much of that requires, again, chips. So machinery equipment is again, it's a big industry now. We're not yet at par with Germany, but we're almost getting there. So there are a number of sectors, car. Annually, our car exports are about $35 billion. So there's a significant auto manufacturing and mobility now becomes really a big issue, self-driving cars. So a number of our manufacturing sectors have huge appetite for chips and these are not top end. So we're not talking four, nine or whatever. So we're talking about more like more basic stuff. So, yes, ideally we would like to have some manufacturing capabilities. I don't know if there's going to be a global interest, but certainly there is a program if somebody would provide them with incentive. Regarding US elections, I think you won't be appropriate for me to comment on individuals. But one scenario is where apparently based on public statements, is that U.S. will have a larger fiscal deficit on the back of tax cuts. That's what it seems like it. A larger deficit means growing debt growing. That means higher long term rates. And that may mean also strong U.S. dollars. Now, typically. Hi. Long term interest rates in the US and strong dollar doesn't serve em as well. Emerging markets well. And Turkey is one of them. Why? Because, you know, we we have significant external liabilities. Plus, of course, we still have gross financing requirements, you know, external financing. So purely on that basis, clearly that wouldn't be a good news for EMS. And we're not immune to that. Now, when it comes to trade fragmentation, which your question was about, again, I tend to think that probably we're not high up there. But as part of EU, we could be affected. Whether that brings us closer leads to upgrading of customs union. It's hard to make that argument because the European political backdrop, unfortunately, it's not very conducive of progress. I'm talking about Germany here. I've told my friends here I think it's no brainer to upgrade the customs union with Turkey to include services, public procurement and agriculture. It would possibly, in the long run, double trade volume. By the way, trade volume is massive, is over 200 billion U.S. dollars, if you include services, is actually around 300 billion U.S. dollars. So clearly, everybody would benefit. But that's politics gets in the way. So, again, I mean, we'll see. Regarding Turkey being expensive. This is a general perception and possibly a reality. How do we cut back? Well, either we're going to have to boost incomes to justify the current level of relative prices or relative prices have to adjust downward. So one of them will work its way through I don't know which one, but hopefully second one is more likely in the short run. It seems like it. Now, regarding are we worried about Turks investing abroad in property or in gold? Clearly we wouldn't want that. But we obviously our citizens are free in their portfolio preferences. We have to respect them. So we need to go to the root causes. One of the root cause of why Turkish citizens are buying property abroad is because for three years, while inflation rate was in high double digits, government had a rent cap of 25%. So essentially you're forced to accept a substandard return post substandard return on your assets. And so the portfolio preference has shifted. So we now we've begun addressing that root cause. So as of July this year. And that's why inflation is a bit stickier than what we had forecasted. So we've abolished that rent cap. Hopefully that will reduce the need. But of course, there are other incentives. There are other reasons why people invest abroad that is will take longer time to change. But as far as returns are concerned, we could change.

WESSEL: So, you know, it was good to catch a couple more questions for almost the time this gentleman here. And then one over here and then we'll have to let it go at that.

AUDIENCE QUESTION: Thank you. Thanks for coming. My name is [inaudible]I'm from the Council on Foreign Relations. I want to go back to what you said earlier about it Takes two to tango. Maybe you are dancing, but not very well. And the reason I said there's another way of looking at this. When you look at Turkish trade, especially manufacturing, I mean, 70% is with Europe, United States and the advanced economies. Same thing is when you look at direct foreign investment, most of the guy for investment comes again from Switzerland, five other European countries, the United States. So by contrast, when you look at your relationship with China, you have a huge deficit. The Chinese buy nothing from Turkey. And but that pattern is also true for Russia and other parts of the world. So, yes, you may be angry at Europeans, but at the same time, they are the ones who support you, especially your manufacturing base. So I want to see why is it that you can't deepen your relation export relationship with other countries? Why are you stuck only in Europe?

WESSEL: Thank you.

AUDIENCE QUESTION: [Inaudible name] I'm the CEO of Tundra Capital Partners, a London based investment manager investing in energy and infrastructure. So good to see you again, Mr. Şimşek. And my question is regarding the carbon border adjustment mechanism, CBAM that is going to become live in 2026.

And given Turkey's propensity of exports towards the European Union, I would love again comment on how that will impact the Turkish economy going forward. Thank you.

ŞIMŞEK: Thank you. First of all, we. That's why I said it's in our interest. To keep Turkey firmly anchored. To the west. And I met because I'm quite familiar with these, you know, these dependencies or interlinkages. I think, you know, why can't we diversify? There has been some diversification. A couple of decades ago. Europe accounted for well over 55% of our exports. Today it's down to around 40%. Just just over 40%. So there has been some diversification in particular to minerals successfully. So. So the share of MENA region has gone up. I think in the future, the share of Africa will go up because we have got a very strong presence in Africa. Of course we're not China, you know. But so there is strong connectivity through Turkish Airlines, strong diplomatic presence. And our Turkish entrepreneurs are pretty adventurous, meaning they do venture out. So I think it's highly likely, as the demographic boom in Africa has translated into purchasing power and, you know, infrastructure needs and stuff. Chances are you're going to see increasingly more visible Turkish presence and success there and therefore diversification. So I'm not where we had a difficulty in penetrating is Asia, China, India, Southeast Asia. Partly it's probably because of distance, partly because we've always been west oriented, meaning it's easy to to to do trade with familiar, you know, in regions where you have more, we have more affinity. It just. So I don't know what will change that. But we've had a difficulty in that. China, as far as I can remember the numbers, about 85% of our imports are considered to be either capital goods or raw materials or intermediate goods. The same applies to Russia, probably more so largely energy. You're right, we have substantial gap. Trade gap vis a vis two countries and they buy very little from us, even though Russia does a little bit more balance compared to China. But you're right, It's you know, we can't compete. But also maybe language, maybe other factors gets in the way. And in Europe, we feel more comfortable in Middle East with a few more companies, Central Asia with more.

WESSEL: So make your answer quick or your staff is going to shoot me.

ŞIMŞEK: Okay. CBAM. We are acutely aware of what's coming is going to initially cover seven sectors. We have a roadmap. That's why the energy transition is an important angle in our program. Plus, of course, we're going to push through hopefully sometimes, maybe in the latter part of this year, early next year, a new climate law that would also facilitate the trading of emissions. So we're getting ready. We're getting ready. And I think, you know, it's something we can't ignore. And Europe means business. And will push some of these changes too quickly.

WESSEL: Thank you very much, Minister. We. Please stay in your seats until the Minister can leave and take your coffee cups and put them in the recycling back. Thank you very much for your time. We look forward to welcome you back here in a year or 18 months and we hope your charts will continue to go in the right direction and maybe even inaugurating a period of peace in Turkey with the Kurds.

ŞIMŞEK: Thank you.