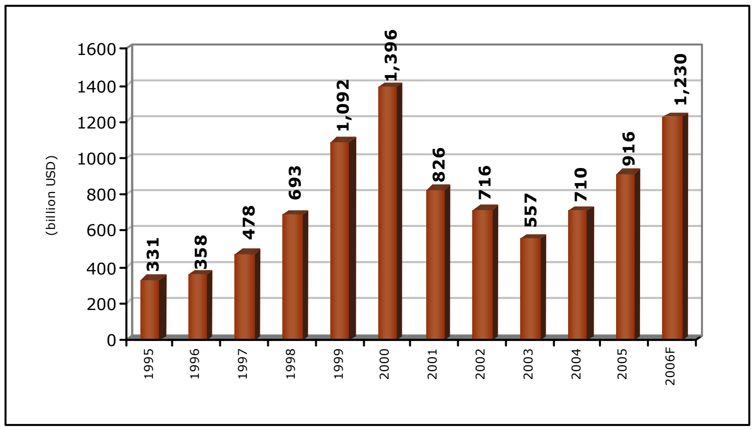
FOREIGN DIRECT INVESTMENTS REPORT

July 2007

RECENT TRENDS IN FOREIGN DIRECT INVESTMENTS AND AN EVALUATION OF 2006 IN THE WORLD AND IN TURKEY

The level of **international direct investments in 2006** was closest to the record level in 2000. Among the main characteristics were the rising trend for developing countries as the source country for international direct investments and the increasing role for collective funds such as private equity funds in cross-border mergers and acquisitions (M&As).



Source: UNCTAD

Ongoing global economic growth, increasing level of corporate profits, generally low level of interest rates, high stock and real estate prices and the rise in the cross-border M&A activities are reinforcing the predictions that **upward trend for international direct investments** will be maintained. On the other hand, imbalances in the current accounts of several developed countries, high energy costs and a possible tightening of financial markets are the **risk factors that create uncertainties** for the future of direct investments.

Rising Protectionism

Another note-worthy observation regarding international investments is the rise in the protectionist policies climbing up on the agendas mainly as a result of the uneasiness in the public opinion in many countries against globalization in general and furthermore foreign investments and especially mergers and acquisitions. France and Germany have introduced closed lists of sectors and activities which restrict access for foreign investors on "security" grounds. In USA, Congress is considering the tightening of procedures. China has introduced new screening requirements on mergers and acquisitions by foreign investors in major investors having an impact on national economic security. Russian and Indian authorities are reassessing their positions on foreign control of "sensitive" enterprises and a resurgence of expropriation in some South American countries has been seen. OECD Roundtable on the issue, held on March 30 in Paris, has drawn attention to the subject and to protectionist measures through both new regulations and existing regulations like anti-trust laws which are not directly related to investment policy but used in different ways in an attempt to protect "strategic" areas. Declaration of the G8 Summit held in Heilingendamm in June has also emphasized that the possible effects and the implications of protectionist measures especially for the global economic activity should be well calculated.

According to UNCTAD preliminary data for **2006**, **global FDI inflows** have reached the highest level after the peak in 2000 (1.4 trillion USD) and is estimated to be **1.23 trillion USD**. FDI inflows have increased by 48% over 2005 in **developed countries** to reach 800 billion USD and by 10% to 368 billion USD in **developing countries**. In 2006, USA was the top-ranking country in terms of attracting FDI with an inflow at 177 billion USD and UK followed as the second most FDI attracting country.

Looking **by regions, EU-25** countries have attracted 45% of global FDI inflows. It is interesting to note that the growth in FDI inflows to **10 new EU member countries** was below the growth in the whole of Europe. There is little evidence that the investment locations are moving from West to East in Europe. While reduction in risk ratings, trade liberalization, adoption of Euro and structural funds created advantages for the new members; membership removed the reform anchor and also upward pressure on currencies and labour costs, elimination of special FDI incentives and additional costs on business created disadvantages in terms of attracting FDI.

Asian countries reinforced their attractiveness and increased their share from 59% to 63% in FDI inflows to developing countries; China, Hong Kong and Singapore being the major recipients. Turkey and the oil exporting Middle East countries were other locations in the region attracting high levels of FDI. Asian countries maintain their position as the most preferred destinations for FDI according to surveys on multinationals and the reason is not only low labour costs but also qualified labor force especially for R&D investments. In the other regions, there has been an upward trend in oil-rich **Africa**n countries while the inflows to **Latin America** slowed down slightly, Mexico and Brazil still being the major recipients.

FDI Inflows	**2004**	**2005**	**Change (2004/2005)**	**2006**	**Change (2005/2006)**
Developed Countries	396.1	542.3	36.9	800.7	47.6
EU-25	213.7	421.9	97.4	549	30.1
EU-10	28.5	34.0	19.3	38.4	12.9
USA	122.4	99.4	-18.8	177.3	78.4
Developing Countries	275.0	334.3	21.6	367.7	10.0
Africa	17.2	30.7	78.5	38.8	26.4
Latin America	100.5	103.7	3.2	99	-4.5
Asia ve Oceania	157.3	200	27.1	229.9	15.0
Transition Economies (South-East Europe and the CIS)	39.6	39.7	0.3	62	56.2
World – Total	710.8	916.3	28.9	1230.4	34.3

Source: UNCTAD

Cross-border mergers and acquisitions (M&A) have played a significant role in this high level of FDI inflows. **716 billion USD** of cross-border M&A deals have been made in 2005 and had a share of 78% in total FDI inflows of 916 billion USD. In **2006**, cross-border M&A deals **surpassed 1 trillion USD** and have been around **400 billion USD** in the **first half of 2007**. Low level of interest rates especially in developed countries and enhanced financial integration have prompted a surge in M&A activity by investment funds. Having a sectoral look at cross-border M&As, one can see that **share of services sector** has been **55% in 2005** and mounted to **70% in 2006**. Also, energy has recently stood out as a sector where M&A deals intensively took place.

Cross-Border Mergers and Acquisitions (Deals over 1 billion USD)				
Year	**Number of deals**	**Share in total number of M&As (%)**	**Value (billion USD)**	**Share in total value (%)**
1990	33	1.3	60.9	40.4
1995	36	0.8	80.4	43.1
2000	175	2.2	866.2	75.7
2001	113	1.9	378.1	63.7
2002	81	1.8	213.9	57.8
2003	56	1.2	141.1	47.5
2004	75	1.5	199.8	52.5
2005	141	2.3	454.2	63.4

Source: UNCTAD

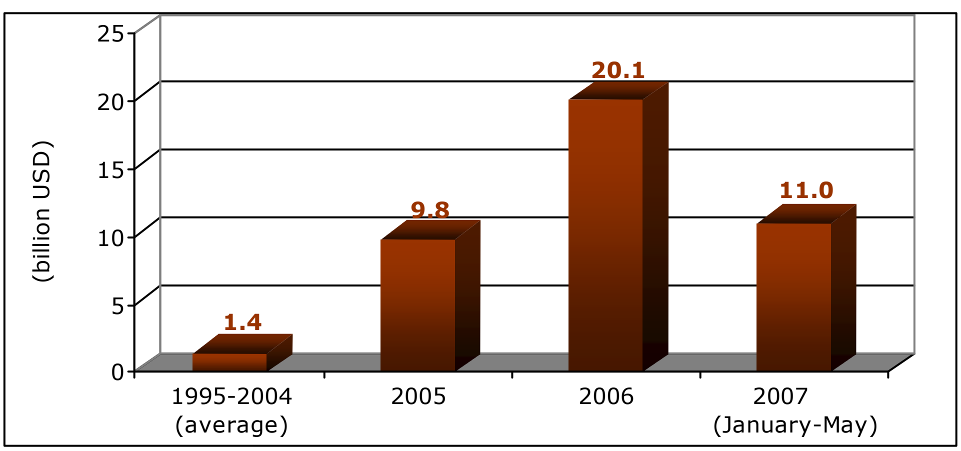
Turkey has climbed to 22nd place among top FDI attracting countries in 2005, up from 53rd place in 2003 and 37th place in 2004. According to the preliminary data for **2006**, Turkey will be **among top 10** FDI attracting countries. Thanks to macroeconomic stability, implications of EU membership process and efforts for the improvement of the investment environment; level of FDI inflows to Turkey has increased from an average of **853 million USD** in the **1995-2000** period to **9.8 billion USD in 2005** and to **20.1 billion USD in 2006.** Out of 20.1 billion USD of FDI, 2.9 billion was real estate purchases by foreigners. Top 5 FDI deals accounted for the 13.2 billion USD of the remaining 17.2 billion USD. Mergers and acquisitions amounting to 15.4 billion USD constituted an important part of FDI inflows.

Top 10 FDI Attracting Countries (billion USD, 2006)	
1. USA	177.3
2. UK	169.8
3. China (+Hong Kong)	111.4
4. France	88.4
5. Singapore	31.9
6. Italy	30.0
7. Russia	28.4
8. Mexico	18.9
9. Turkey	**17.1**
10. Poland	16.2

Source: UNCTAD

As of first five months of 2007, FDI inflows reached 11 billion USD, reinforcing the predictions for FDI inflows of 25 billion USD and plus for the year-end.

FDI Inflows to Turkey



Source: Central Bank of Turkey

In 2006, **financial services** had the highest level of FDI inflows with a share of **39%**. **Telecommunications, transportation and warehousing** came second with a share of **37%**.

Sectors (Million USD)	2002	2003	2004	2005	2006	2002-2006	% Share in cumulative inflows
Agriculture, forestry,fishing	--	1	6	5	6	18	0.1
Industry	**180**	**548**	**358**	**832**	**1,756**	**3,675**	**12.7**
Mining and quarrying	2	14	75	40	125	256	0.9
Manufacturing	110	448	214	788	1,520	3,080	10.6
Chemicals	*9*	*9*	*39*	*174*	*600*	*831*	*2.9*
Food, beverages, tobacco	*14*	*249*	*78*	*68*	*252*	*661*	*2.3*
Basic metals and products	*25*	*1*	*8*	*139*	*161*	*334*	*1.2*
Electricity, gas and water supply	68	86	69	4	112	339	1.2
Services	**442**	**196**	**927**	**7,697**	**16,054**	**25,316**	**87.3**
Financial sector	260	51	69	4,016	7,002	11,398	39.8
Transport, warehousing and telecommunications	1	2	639	3,285	6,303	10,230	35.7
Wholesale and retail trade	89	92	103	68	1,496	1,848	6.5
Total	**612**	**745**	**1,291**	**8,534**	**17,817**	**29,009**	**100**

Source: Central Bank of Turkey

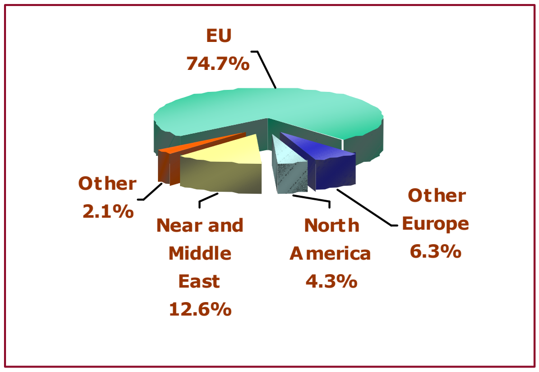
Netherlands due to **Vodafone – Telsim** deal payment, **Belgium** due to DexiaBank **- Denizbank** deal, **Greece** due to **NBG** (National Bank of Greece) - **Finansbank** deal, United Arab Emirates (**UAE**) due to **Turk Telekom** privatization (**Oger Telecom**) and **Austria** due to **OMV – Petrol Ofisi** deal were the top source countries of FDI inflows into Turkey.

	2005	FDI Inflows (million USD)	Share (%)
1	France	2,107	24.8
2	UAE	1,625	19.2
3	Russia	1,605	18.9
4	Belgium	1,088	12.8
5	Italy	692	8.2
6	Germany	391	4.6
7	Netherlands	381	4.5
8	UK	165	1.9
9	USA	88	1.0
10	Spain	66	0.8
	Other	**272**	**3.2**
	Total	**8,480**	**100.0**

	2006	FDI Inflows (million USD)	Share (%)
1	Netherlands	5,171	29.0
2	Belgium	3,456	19.4
3	Greece	2,787	15.6
4	UAE	1,548	8.7
5	Austria	1,108	6.2
6	UK	883	5.0
7	USA	693	3.9
8	France	444	2.5
9	Germany	366	2.1
10	Luxemburg	246	1.4
	Other	**1,115**	**6.3**
	Total	**17,817**	**100.0**

Source: Central Bank of Turkey

Looking at the major countries investing in Turkey in the **last five years**, Netherlands and Belgium are on the top of the list again. As well as large international investor countries like **Netherlands, Belgium, France, UK, Italy and Germany**; there are countries ranking high due mainly to one big deal like **UAE (Turk Telekom), Greece (Finansbank), Russia (Turkcell) and Austuria (Petrol Ofisi)**. Looking at the regional breakdown of inflows, again in the 5-year 2002-2006 period, EU countries has a share of 75% and Middle and Near East countries has 12% share as the source for FDI inflows.



Source: Central Bank of Turkey

The value of FDI inflows that entered **through privatization** deals has amounted to **1.5 billion USD in 2005** (15% of total 9.8 billion USD) and **1.8 billion USD in 2006** (9% of total 20.1 billion USD). FDI through privatization for 2006 is composed of 1.5 billion USD payment of Turk Telekom privatization by Oger Teelcom and Groupama's (France) payment of 270 million USD for Başak Insurance.

	Total FDI Inflows	Privatization Revenues	FDI Inflows through Privatization	Share of FDI Inflows in Privatization (%)	Share of Privatization in FDI Inflows (%)
2000	982	3,302	585	17.7	59.6
2001	3,352	2,579	2,369	91.9	70.7
2002	1,137	537	-	-	-
2003	1,752	187	-	-	-
2004	2,883	1,283	49	3.8	1.7
2005	9,801	8,222	1,500	18.2	15.3
2006	20,125	8,095	1,768	21.8	8.8
Total	**40,032**	**24,205**	**6,271**	**25.9**	**15.7**

Source: Undersecretariat of Treasury

M&A deals, on the other hand, had a share of 75-80% in 2006. Out of 19.2 billion USD of 154 M&A deals, international investors were involved in deals worth 17.2 billion USD and the actual inflow realized as 15.4 billion USD during 2006. Major areas for M&A deals were financial services (44%) and telecommunications (41%).

According to **investment incentive statistics**, **151 investment projects** planned by international investors, having a value of **1.8 billion USD**, have receieved investment incentives in 2006. 82 of them were for new investments, amounting to 557 million USD. In the last five years, more than a thousand projects were planned by international investors accumulating to an investment amount of 12.3 billion USD. 40% of them were planned to be in Marmara region and 15% in Agean region.

The cumulative number of **companies with foreign capital** has reached **14,955** by the end of 2006, together with 3,350 companies established in 2006.

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