TURKEY

Highlights

- **The economy made a robust recovery from the impact of the pandemic.** An unprecedented credit stimulus and monetary loosening helped Turkey avoid a GDP contraction in 2020, although at some cost to macroeconomic stability. Thanks to progress in vaccination and the lifting of lockdown measures since June 2021, economic activity has picked up despite a tight monetary policy and the phasing out of most stimulus measures.
- **Concerns about monetary policy effectiveness have continued as the president twice replaced the governor of the central bank.** Despite significant policy tightening and the simplification of the monetary policy framework, the removal of two governors has further undermined confidence in the central bank's ability to fight inflation, which has remained persistently in the high teens throughout 2021.
- **The authorities have renewed their commitment to certain reforms.** While managing the impact of the pandemic took precedence over reform implementation in the past year, in March 2021 the government published the Economic Reform Package, a high-level plan focusing on improvements in public finances, the financial sector, governance and employment.

Key priorities for 2022

- **Containing inflation needs to remain a priority as economic activity revives.** Inflation is facing pressures from commodity prices, rising domestic demand following the lifting of lockdowns and pass-through from currency depreciation. The authorities need to maintain tight monetary policy and avoid premature loosening.
- **Implementation of the announced Economic Reform Package needs to be prioritised.** Some of the measures in the plan, including increasing public procurement transparency, securitisation of banks' problem assets and improving the legal framework for public-private partnerships, would address long-standing problems if implemented.
- **Efforts to build back better need to focus on addressing inclusion challenges exacerbated by the pandemic.** The authorities need to prioritise efforts to improve the employment and entrepreneurship prospects of women, youth and refugees, who have experienced significant economic challenges due to the pandemic.

Main macroeconomic indicators %

	2017	2018	2019	2020	2021 proj.
GDP growth	7.5	3.0	0.9	1.8	9.0
Inflation (average)	11.1	16.3	15.2	12.3	17.4
Government balance/GDP	-1.6	-1.9	-3.0	-3.5	-4.9
Current account balance/GDP	-4.8	-2.8	0.9	-5.2	-2.4
Net FDI/GDP [neg. sign = inflows]	-1.0	-1.2	-0.8	-0.6	-0.8
External debt/GDP	52.6	53.6	54.8	60.4	n.a.
Gross reserves/GDP	12.5	12.0	13.9	13.0	n.a.
Credit to private sector/GDP	70.3	67.4	65.4	75.1	n.a.

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Covid-19: macroeconomic implications

The Turkish economy was one of the few worldwide to grow in 2020, although this came at the expense of macroeconomic instability. While the size of the on-budget fiscal stimulus was small, at 3.3 per cent of GDP, the authorities undertook significant off-budgetary measures, including monetary expansion and a major credit stimulus. Supporting a rebound in consumption and investment, the stimulus also led to an exacerbation of external imbalances and currency depreciation, giving rise to inflation, which reached 19.6 per cent in September 2021. Robust activity continued into 2021, with growth of over 14 per cent year-on-year recorded in the first half of the year.

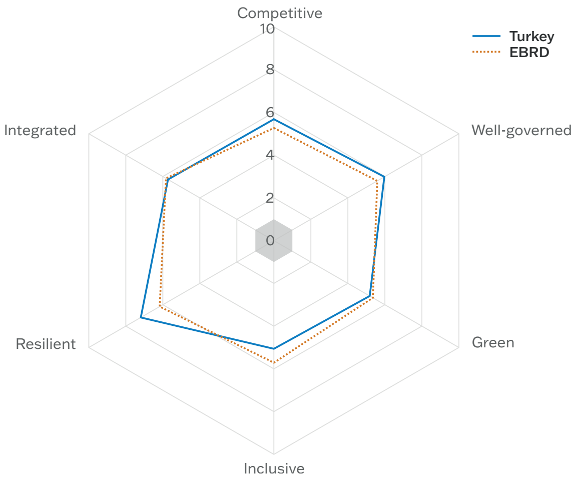
The lifting of restrictions has supported economic activity in 2021, despite tight monetary policy. Following the end of the credit stimulus in late 2020 and a cumulative policy rate hike of 10.75 basis points, pandemic support shifted to fiscal policy, including income support measures, such as the short-time work allowance. While some of these measures were phased out following the gradual reopening of the economy in June 2021, this has coincided with a rebound in tourism and services.

External demand and base effects will drive growth in 2021. Driven by the recovery in tourism, the declining real exchange rate and a favourable shift in global value chains, net exports will make a strong contribution to growth over the next year, enhanced further in growth terms by base effects. The persistent inflation needs to be contained in order for the central bank to rebuild its credibility, but there is a risk of the authorities relaxing policy prematurely due to the approaching electoral cycle in 2023. Subject to pandemic-related and policy risks, the economy is expected to grow 9.0 per cent in 2021, followed by 3.5 per cent in 2022. Downside risks include further waves of the pandemic and associated containment measures, and macroeconomic instabilities linked to external imbalances.

Policy response to Covid-19

The authorities' stimulus response to the pandemic has shifted from monetary policy and credit towards fiscal measures in 2021 and is being gradually withdrawn. Tight monetary and macro-prudential policies adopted to contain inflation since late-2020 have left fiscal policy as the main tool to support the economy. However, most of these measures, which included income support to workers on unpaid leave due to a temporary layoff ban, short-time work allowances and grants to artisans and small businesses, are being phased out as the pandemic-related restrictions started being lifted in June 2021.

Assessment of transition qualities (1-10)



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Structural reform developments

The government unveiled a high-level reform plan focusing on the public, employment and financial sectors. The Economic Reform Package announced in March 2021 includes steps to improve fiscal and public sector governance, such as the reform of state-owned enterprises, a framework law for public-private partnerships and the simplification of public procurement processes. Regarding the financial sector, the package contains actions to improve the capacity of asset management companies, facilitate the securitisation and sale of problem loans and promote the issuance of green bonds. With the aim of promoting the development of domestic capital markets, the package also contains plans to lower the barriers for initial public offerings and to establish a bond guarantee fund for private sector debt securities.

The government has released the National EU Green Deal Action Plan. Published in July 2021, the plan contains 32 actions in nine areas, including carbon border adjustment and pricing, circular economy, green finance (including green bonds) and Islamic finance, clean energy, sustainable agriculture and transportation. The plan also contains a clause on reassessing Turkey's stance on the Paris Agreement; this was subsequently ratified in October 2021. The action plan is in line with the government's existing green strategy documents in areas such as energy efficiency, the circular economy and decarbonisation of industry, with its implementation monitored by an official working group. The authorities expect the implementation of the action plan to support Turkey's efforts to deepen the EU-Turkey Customs Union agreement, currently under discussion by both parties.

The authorities took steps to promote energy efficiency and the circular economy. A mandatory deposit scheme for drinks bottles is slated to be rolled out in 2022, while the Environment Agency was established in December 2020 to manage the scheme and promote the circular economy. A directive for energy performance contracting in public buildings was adopted, which will facilitate the financing of energy saving investments by funding them through the cost savings they generate.

The Capital Markets Board has introduced new regulations enabling the financing of public sector projects through capital markets. The regulations, which entered into force in July 2021, allow for the establishment of funds linked to one or more public projects in areas such as infrastructure, health and energy. These funds will be able to issue securities linked to the income and debt of these projects, which is expected to improve their financing prospects.

The government is increasing financial support for apprenticeships for youth in vocational education. The wages of students studying at vocational training centres will be covered by the government, meaning that the cost of labour will also be eliminated for employers.

The scope of e-government has increased. According to the Online Service Index computed by the United Nations Department of Economic and Social Affairs (UNDESA), a composite indicator on the use of information and communications technology (ICT) by governments and the quality of the online services provided, with values between 0 and 1, Turkey scores 0.86, significantly above the EBRD regional average of 0.68. In the past year, 600 new services have been added and use of these services has increased substantially.