Türkiye

Highlights

- **The economy bounced back strongly following the pandemic, but the currency has come under severe pressure.** Growth momentum in the past year has been supported by the introduction of the New Economic Model in September 2021, but the unorthodox approach of significant policy rate cuts amid high inflation has led to real interest rates turning deeply negative and further pressure on the lira, necessitating heavy intervention by the central bank.
- **External imbalances have widened.** Significant increases in energy and food prices, particularly following Russia's invasion of Ukraine, saw the current account deficit rise, increasing the fragility of external balances and bringing Türkiye's risk premium to its highest level in 18 years.
- **Reforms have advanced hesitantly.** The severity of dealing with macroeconomic challenges has meant that progress in implementing the Economic Reform Package, a high-level plan introduced in the middle of 2021 that focuses on improvements in public finances, the financial sector, governance and employment, has been slow.

Key priorities for 2023

- **A return to a more orthodox policy approach is needed to prevent current high inflation rates becoming entrenched.** Overly-loose monetary policy and a lack of policy credibility have contributed to inflation reaching a two-decade high in excess of 80 per cent. Higher policy rates are needed, rather than relying on regulatory measures to limit credit growth and running down reserves at the central bank.
- **Priority should be given to helping the employment and entrepreneurship opportunities of vulnerable groups.** Inclusion challenges were exacerbated by the pandemic, and deep-seated structural challenges remain. Women, the youth and refugees are in particular need of assistance in the post-pandemic period.
- **Türkiye needs to strengthen its institutional and regulatory environment.** Elements of this agenda are included in the Economic Reform Package, including improving the efficiency of public spending via public procurement transparency and investment management, and these reforms should proceed without delay.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	3.0	0.8	1.9	11.4	4.5
Inflation (average)	16.3	15.2	12.3	19.6	72.0
Government balance/GDP	-1.9	-2.9	-3.5	-2.8	-3.4
Current account balance/GDP	-2.8	0.7	-4.9	-1.7	-6.0
Net FDI/GDP [neg. sign = inflows]	-1.6	-1.3	-1.1	-1.6	-1.0
External debt/GDP	53.5	54.8	60.4	54.8	n.a.
Gross reserves/GDP	11.7	13.9	13.0	13.4	n.a.
Credit to private sector/GDP	67.5	65.5	75.2	60.1	n.a.

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Macroeconomic developments and policy response

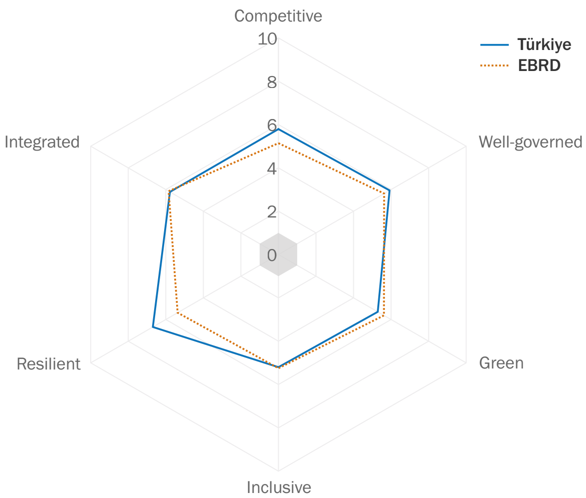
Strong growth in the past year has been accompanied by unstable price and currency developments. In September 2021 the government introduced the New Economic Model, which aimed to increase export competitiveness and private investment, and which foresaw price stability being achieved via a rebalancing of the current account. The economy grew by 11.4 per cent in 2021 and this momentum carried over into 2022, with gross domestic product (GDP) growing by 7.5 per cent year on year in the first half of the year. However, leading indicators point to a slowdown in the second half of the year, not least given the weakening global outlook. Policy rates were cut by 500 basis points (bps) to 14 per cent, and held at this level for seven months until further cuts of 100 bps were introduced in both August and September 2022. This was despite inflation increasing rapidly over this period to reach a two-decade high of 83 per cent in September 2022. Deeply negative real interest rates resulted in a steep depreciation of the lira, by around 30 per cent in 2022 to date, which in turn spurred significant dollarisation.

The policy response to high inflation has been unorthodox. Instead of tightening monetary policy the authorities have spent the past months attempting to introduce new policy instruments and regulatory measures to support the lira. The central bank (CBRT) has intervened heavily using its extremely limited reserves, and has introduced several schemes to encourage "liraisation" by compensating lira deposit holders for foreign exchange losses. At the same time, the authorities have sought to dampen the overly rapid commercial credit expansion associated with low policy rates, which had contributed to the widening current account deficit, through various regulatory measures.

Fiscal and external pressures have increased. Public finances remain one of the anchors of the economy, with the debt-to-GDP ratio standing at a relatively modest 38 per cent. However, some of the policy measures introduced (notably the new FX-linked deposit schemes) have shifted the burden of adjustment to fiscal policy, creating a potentially sizeable contingent liability. Meanwhile, the hoped-for rebalancing of the current account has failed to materialise, as higher commodity prices linked to the war on Ukraine have increased Türkiye's commodity import bill. Türkiye's large short-term external debt stock also remains a concern, particularly as the cost of servicing it has increased dramatically following the lira depreciation.

The short-term outlook is highly uncertain. We expect GDP to grow by 4.5 per cent in 2022 and 3.5 per cent in 2023, but there are significant risks to the outlook as current policy settings have rendered the macroeconomic situation extremely fragile. Furthermore, there are risks of spillovers to the Turkish economy from aggressive policy tightening in developed economies.

CHART Assessment of transition qualities (1-10)



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Structural reform developments

Türkiye ratified the Paris Agreement in October 2021. The authorities also announced a net zero target year of 2053, although they have not yet submitted an updated nationally determined contribution (NDC) reflecting the more ambitious emissions reduction target that is in line with this commitment. Over the past year the authorities have taken steps to strengthen institutional arrangements for climate change issues by updating important policy documents, such as the National Climate Change Action Plan. And, to reflect the importance of climate change, the Ministry of Environment and Urbanisation has been rebranded the Ministry of Environment, Urbanisation and Climate Change (MoEUCC).

New instruments for green projects are being facilitated. In February 2022 the Capital Markets Board of Türkiye produced guidelines on Green and Sustainable Debt Instruments and Lease Certificates. These guidelines aim to ensure that such instruments and certificates are issued in compliance with best international practice and to increase transparency, integrity and comparability in the context of financing green projects.

Legislation to strengthen asset management companies (AMCs) has been adopted. To boost the capacity of AMCs, in October 2021 new regulations were brought in to allow all banks and non-bank financial institutions to sell problem (stage 1 and 2) loans in addition to non-performing loans (NPLs) to AMCs. Furthermore, the Capital Markets Board enabled the establishment of AMC funds to issue asset-backed securities, allowing for the securitisation of loan portfolios, including NPL portfolios.

To shield low-income families from rising energy prices the authorities introduced graduated tariffs based on consumption. From the start of 2022 the Energy Market Regulatory Authority moved away from a fixed electricity tariff system and began implementing a new system based on the level of consumption. The Authority also set up a tariff for vulnerable consumers in advance of some subsidies being lifted, which will adversely affect lower-income households.

Vocational training is being promoted. In the last year, the government has continued to implement its “Vision 2023” for the education system, improving the provision of technical and vocational education and training (TVET) by setting up formal cooperation agreements with local chambers of commerce. This cooperation is expected to strengthen the link between employers and training institutions, with positive effects on young people’s school-to-work transition. The attractiveness of TVET in the country has been strengthened thanks to recently established diploma equivalency between vocational training centres (VTCs) and high schools and a new law introducing financial incentives for VTC students (Law No. 7346 from December 2021), resulting in a 57 per cent increase in VTC enrolment.