Türkiye

Highlights

- **Economic policies have taken a more orthodox turn.** A new economic management team appointed in the wake of the presidential and parliamentary elections of May 2023 has started to unwind the highly unorthodox monetary and financial policies adopted over the past two years.
- **Fiscal and external pressures are declining from peak levels.** Expansionary policies and major earthquakes in the first half of 2023 have resulted in twin deficits, which the authorities are seeking to address through a combination of fiscal and monetary tightening.
- **There has been limited progress on reforms in the past year, but long-term plans are being developed.** While the national elections took priority over structural reforms, the authorities have advanced efforts to lay out long-term strategies and action plans for climate change, energy transition and electric mobility.

Key priorities for 2024

- **The shift towards orthodox economic policy needs to be sustained.** Strengthening the monetary transmission mechanism and improving the regulatory environment of the banking sector remain key priorities for achieving macroeconomic stability and sustainable growth.
- **The authorities need to reinvigorate the structural reform agenda, which has been overshadowed by election campaigning.** This means addressing systemic issues affecting Türkiye's long-term growth potential, including low levels of innovation, the weak corporate governance of small and medium-sized enterprises (SMEs), and low levels of global value-chain participation.
- **Social protection policies need to be enhanced to address the negative impacts of recent developments on vulnerable groups.** Although the national minimum wage has increased substantially over the past year, high and sticky inflation means hunger and poverty thresholds exceed the monthly minimum wage. Among other things, this highlights the need to address high rates of informality, skills mismatches in the labour market and low rates of employment among women.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	0.8	1.9	11.4	5.5	3.5
Inflation (average)	15.2	12.3	19.6	72.3	53.0
Government balance/GDP	-4.8	-5.1	-4.0	-1.7	-5.4
Current account balance/GDP	1.4	-4.4	-0.9	-5.3	-4.1
Net FDI/GDP [neg. sign = inflows]	-0.9	-0.6	-0.8	-0.9	-0.7
External debt/GDP	54.7	60.1	54.4	52.0	n.a.
Gross reserves/GDP	13.9	13.0	13.6	14.2	n.a.
Credit to private sector/GDP	61.9	70.9	66.1	48.4	n.a.

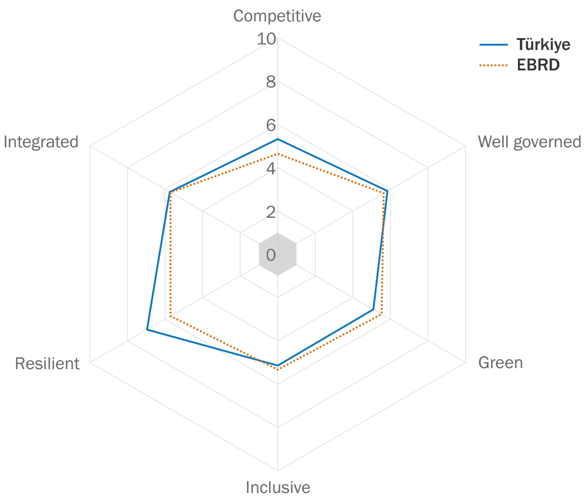
Macroeconomic developments and policy response

The economy grew rapidly in the first half of 2023, but so did the fiscal and current account deficits. Following a gross domestic product (GDP) growth rate of 5.5 per cent in 2022, the authorities enacted a series of stimulus measures in the first half of 2023, including hikes in wages and pensions, the introduction of an early retirement scheme, and government-backed guarantees and lending targets for banks, which spurred a credit boom. These policies contributed to a growth rate of 3.9 per cent year on year in the first half of 2023, although this came at a significant cost. Short-term external debt liabilities now exceed US$ 200 billion (€186.3 billion), while the cumulative 12-month current account deficit peaked at US$ 60 billion (€55.9 billion or 6.5 per cent of GDP) in May 2023, implying external financing needs in excess of 25 per cent of GDP. The authorities sought to prevent the strong depreciation of the currency by tapping into foreign-exchange reserves, with net reserves at one point down more than US$ 35 billion (€32.6 billion) since the start of 2023. Meanwhile, the government posted record fiscal deficits due to increases in personnel and social spending, as well as temporary expenditures related to the earthquakes of February 2023.

Policies have tightened markedly following the appointment of a new economic management team in the wake of May's elections. Starting in June 2023, the central bank has undertaken a series of policy rate hikes, which, although insufficient to achieve positive real interest rates, have helped improve investor confidence, as witnessed by the significant decline in Türkiye's credit default swap (CDS) premium since its peak in May 2023. Fiscal policies have also been tightened, with the government increasing the value-added tax (VAT) rate from 18 per cent to 20 per cent, hiking taxes on fuels and enacting cost-cutting measures in the public sector. The central bank has also cut back on interventions to defend the lira, which has lost over 30 per cent of its value since the start of 2023, driving another surge in inflation to 61.5 per cent year on year in September. While these measures have led to a lower current account deficit and improvements in reserves and the fiscal balance, leading indicators suggest that consumers and businesses are becoming more pessimistic and spending less, meaning that enhanced stability is coming at the expense of growth.

Short-term growth prospects are relatively subdued. In light of recent macroeconomic developments and policy changes, a growth rate of 3.5 per cent is expected in 2023, followed by 3 per cent growth in 2024. In the short term, the authorities will continue to face the difficult task of balancing growth and macroeconomic stability in the run-up to local elections in March 2024. Consequently, a key risk is the possibility of a sudden reversal of the current turn towards orthodox economic policy, which would damage investor confidence.

Assessment of transition qualities (1-10)



Structural reform developments

Restrictive regulations affecting the financial sector are being relaxed. The new economic management team has loosened a series of restrictive financial regulations adopted prior to the 2023 elections, including punitive security maintenance requirements for banks not meeting certain lending and de-dollarisation targets. While the process has been gradual and many rules adopted prior to the elections remain in place, the authorities have committed to pursuing normalisation steps in a holistic and data-driven manner in order to maintain financial stability.

The government is working to develop strategies and action plans to achieve long-term climate targets. In November 2022 the government updated Türkiye's Nationally Determined Contribution (NDC), increasing its emission reduction target from 21 per cent to 41 per cent by 2030. The authorities have also published the National Energy Plan (2020-35), which is aligned with the country's 2053 net-zero emission target, setting out actions for increasing the share of renewables, upgrading the electricity grid and reducing fossil-fuel consumption. Meanwhile, legislators are working on a new climate law, which is expected to incorporate the announced climate targets and policies and establish a national emissions trading scheme, with a pilot phase scheduled to start in 2024.

Efforts to promote electric mobility have been stepped up. In November 2022 the government reduced taxes on the purchase of electric cars, while at the same time raising import duties on electric cars built in China. Meanwhile, in July 2022 the Energy Market Regulatory Authority issued licences for 124 companies with plans to build over 1,000 new fast charging stations, in a move that is expected to help double the number of public charging stations by the end of 2023.

Social protection policies seek to contain the negative inclusion impacts of recent developments, but fall short of addressing fundamental shortcomings. The national minimum wage increased by a further 34 per cent in June 2023, after doubling over the course of last year. The hunger and poverty thresholds, however, continue to exceed the monthly minimum wage in light of persistent inflation. Economic hardship also risks increasing violence against women, with the government adopting new Provincial Action Plans to address the issue and facilitate access to justice across its 81 provinces. Whether such efforts can effectively mitigate the fallout from Türkiye's 2021 withdrawal from the Istanbul Convention on human rights remains to be seen.

The new Law on Retirement Age Victims (EYT, Law No: 7438) has the potential to reduce available human capital significantly. The 2023 law removed the age requirement for individuals who started working prior to September 1999 and have contributed a minimum 20 or 25 years to social security, enabling them to retire with immediate effect. Data suggest that in the areas affected by February's earthquakes, current and future beneficiaries of EYT make up around 7 per cent of the workforce, putting additional pressure on the already-stretched labour market. Meanwhile, efforts to improve the school-to-work transition for young people are ongoing, but have suffered from shifting priorities and frequent changes at national and regional level. So far, no announcements on a new stage of Türkiye's Education Vision 2023 or its National Youth Employment Strategy and Action Plan (2021-23) have been made.