TURKEY: Outperforming the region – for now

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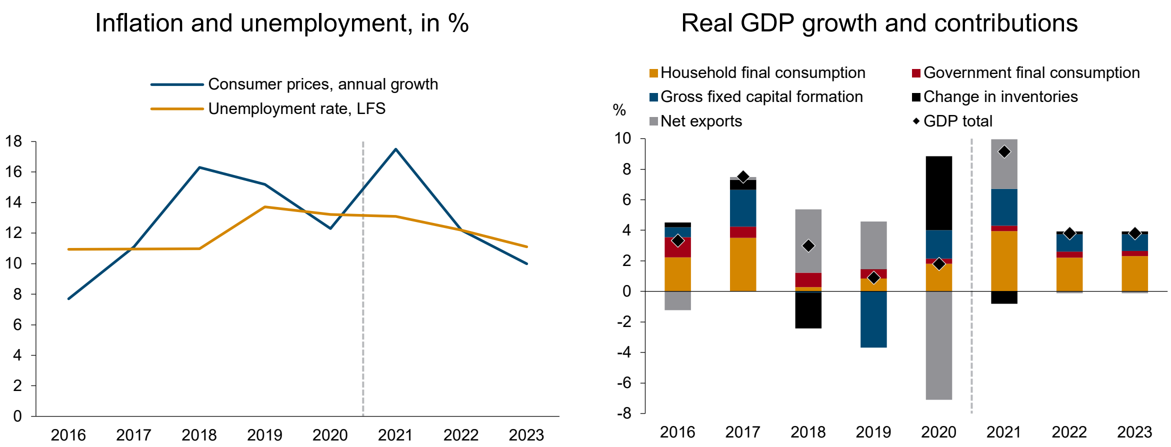
The economy is currently booming, underpinned by strong credit growth, robust domestic consumption, and the impact of the global recovery on export demand and tourism. Ultra-loose monetary policy by the major economies is supporting capital inflows; but as the US, in particular, starts to taper its asset purchases, the risks for Turkey's external financing will rise. While the short-term outlook is good, the usual vulnerabilities remain – not least high inflation and uncertainty over the direction of monetary policy.

Figure 4.22 / Turkey: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

The Turkish economy has built on its relatively good performance in 2020 with – so far – a very strong 2021. Turkey's economy grew by 1.8% in 2020, making it the only country in CESEE to post full-year growth last year. Growth this year has surged even higher, with the economy expanding by 7.2% year on year in Q1 2021, and by 21.7% in Q2. This particularly strong growth in Q2, however, was significantly influenced by the low base period, with the economy having contracted by 10.4% in the same period of last year. In quarterly terms, the economy expanded by 0.9% in Q2, a significant slowdown from the 2.2% expansion in the first three months of the year.

The improved external environment has significantly helped the Turkish economy. Exports of goods and services increased by 59.9% year on year in Q2 in real terms, easily outpacing the 19.2% increase in imports over the same period. The weaker lira (as well as Turkish exporters' proven track record of adjusting to and finding new markets amid volatility in the global economy) certainly helped this export performance. However, it is also worth noting that the base effects were quite different: exports fell by 36.4% in Q2 of last year, whereas imports declined by just 8%. Household consumption and investment also contributed very strongly to growth in Q2 2021, rising by 22.9% and 20.3%, respectively, year on year. Government spending played a less significant (though still clearly positive) role, rising by 4.2%.

Credit growth has slowed from its peak in 2020, but remains strong and has been a further key driver of economic expansion so far in 2021. In August 2021, credit extended by banks to households rose by 15.4% year on year, according to the central bank. Although still strong, this is down from a peak of around 50% growth in the second half of last year, reflecting the tighter monetary policy that began in the latter half of 2020 and the phasing out of some supportive lending measures ('credit campaigns'). With the central bank having apparently now embarked on a new cycle of monetary easing (see below), credit growth could again pick up in the remainder of 2021 and into 2022.

Fiscal policy, by contrast, has remained relatively conservative, in line with historical trends. Although the pandemic has led to higher spending, this has generally been offset by an increase in revenues on the back of the strong performance of the economy. Public debt as a share of GDP remains low (particularly compared to the country's main regional peers and other major emerging markets around the world), and is unlikely to present a problem during the forecast period.

As a result of the very strong Q2 performance, we have revised our forecasts upwards for 2021. For this year, we now expect the economy to expand by 9.1% – a major upgrade on our previous forecast of 5.8%, reflecting the extremely strong performance of the first two quarters of the year. This forecast implies more or less a continuation of the quarterly momentum of April-June for the remainder of the year (something that high-frequency indicators suggest was the case at least through most of Q3). For 2022, we expect growth of a bit below 4%, similar to that projected during our last forecasting round. This implies a slight decrease in quarterly growth rates next year, but not a huge slowdown relative to current momentum.

The latest high-frequency indicators give little indication that the economy is slowing. Retail sales volumes continued to increase in July (latest data available), by 0.7% month on month and 12.3% year on year, pointing to robust momentum in consumer spending (unsurprisingly, retail sales volume online and via mail order rose by 46.1% year on year, underlining the shift towards online retail driven by the pandemic). Consumer confidence increased in September, relative to August. Meanwhile, the latest Istanbul Chamber of Industry purchasing managers' index (PMI) for manufacturing was 54.1 in August – well above the level of 50 that separates expansion from contraction. Although industrial production declined fairly sharply in July (by 4.2% month on month), the annual growth rate was still very robust, at 8.7%. The PMI survey indicated that Turkish manufacturers are facing similar challenges to those across Europe, with increased pressures on the supply side leading to sharply rising input costs (and with the weakness of the lira compounding this in Turkey's case). One positive from the September survey was that firms reported an easing of delays caused by supply-chain disruptions, with import delays and raw material shortages said to be the 'least marked for a year'.

The effect of robust economic growth has been increased labour demand, which is supporting a decline in the headline unemployment rate. Joblessness was recorded at 12% in July 2021, 2.4 percentage points lower than a year earlier. Headline employment has risen this year: in July 2021, the total number of people in employment was almost 2.4m greater than a year earlier. While labour market data have been affected by the pandemic and may not be fully comparable with pre-pandemic times, the available figures suggest that the labour market in Turkey has been much less badly affected over the last 18 months than is the case in most of the rest of CESEE.

Despite the fairly positive current backdrop, however, there are growing signs of difficulties facing the economy. One key challenge (which is not new to Turkish firms or consumers) is inflation, which rose by 19.3% year on year in August. Even by Turkish standards, inflation is currently very high, and is eating into real income gains. As everywhere in the world, domestic prices are being heavily influenced by the cost of commodities. In Turkey in August, the costs of food and transport increased by over 20% year on year, above the level of headline inflation. However, Turkey is also affected by the weaker lira, which is increasing imported inflation. Even a measure of 'core' inflation that excludes volatile items, such as energy and unprocessed food, rose by 18.5% year on year in August.

As we predicted in the summer, the central bank cut interest rates, despite the very high inflation. This suggests another period of uncertainty ahead for monetary policy. The bank cut its target interest rate by 100 basis points to 18% in September, putting real rates firmly into negative territory. Governor Şahap Kavcıoğlu, who was appointed to the position in March, had previously kept rates unchanged, but now looks to have embarked on a new easing cycle. The risks are clear: the central bank is cutting rates with inflation close to 20%, with the US Federal Reserve about to start tapering its asset purchases, and with the lira hitting new all-time lows against the dollar. It is likely that even the best-case scenario will see a weaker lira and more imported inflation. Although looser policy will support economic growth in the short term, there is a chance that a period of loosening will have to be followed by a sharp rise in rates further down the line, in order to support the currency and bring inflation back under partial control (a pattern that is now very familiar in Turkey).

Turkey's current account deficit has so far narrowed during 2021, but it is likely to remain fairly large as a share of GDP throughout the forecast period. The current account deficit totalled USD 13.7bn in January-July 2021 – quite significantly less than the shortfall of USD 23.2bn (5.3% of GDP) over the same period last year. This reflected strong year-on-year growth in exports of merchandise goods (in US dollar terms) and a recovery in tourism (total arrivals from abroad rose 52% year on year in January-July). However, given the very unusual base period, year-on-year comparisons could paint a false picture. A notable development is the 25% year-on-year expansion of goods imports in January-July (in US dollar terms), driven by credit-financed import demand and higher prices, especially for energy. If these trends on the import side continue, the current account deficit will remain elevated. We expect a shortfall of around 3% of GDP in 2021-2023 (down from last year). Short-term external-debt rollover needs remain substantial, totalling USD 125bn as of July 2021 and equivalent to about 17% of GDP (one of the highest ratios among the CESEE countries for which comparable data are available). Some 41% of this is in US dollars and another 26% in euros, underlining both how problematic the persistent depreciation of the lira is, and Turkey's high level of vulnerability to US interest rate rises.

The risks to the outlook are certainly on the downside, and stem from the usual sources: US monetary policy tightening, high short-term external debt refinancing needs, the blowback from geopolitics, erratic monetary policy, persistently high inflation and the weakness of the lira. These factors interact with (and in many ways reinforce) each other, and the pressure is likely to grow, rather than diminish in the coming years. This is certainly true of US monetary policy, with tapering set to begin by the end of 2021, and with higher US rates from 2022 or 2023. In the past –most notably during the taper tantrum of 2013 – even the possibility of tighter US policy caused huge volatility on Turkish markets. Given that this looks set to coincide with a cycle of monetary loosening in Turkey, the risks are even higher.

Table 4.22 / Turkey: Selected economic indicators

	2018	2019	2020 1)	2020	2021	2021	2022	2023
				January-June			Forecast	
Population, th pers., average	81,407	82,579	83,385	.	.	84,385	85,398	86,423
Gross domestic product, TRY bn, nom.	3,759	4,318	5,047	2,109	2,970	6,500	7,600	8,700
annual change in % (real)	3.0	0.9	1.8	-3.5	14.4	9.1	3.8	3.8
GDP/capita (EUR at PPP)	19,170	18,530	19,000	.	.	.	.	.
Consumption of households, TRY bn, nom.	2,099	2,441	2,845	1,204	1,620	.	.	.
annual change in % (real)	0.5	1.5	3.2	-2.6	14.8	7.0	3.9	4.1
Gross fixed capital form., TRY bn, nom.	1,115	1,117	1,382	568	852	.	.	.
annual change in % (real)	-0.2	-12.4	7.2	-3.3	16.4	8.8	4.1	4.0
Gross industrial production 2)								
annual change in % (real)	1.1	-0.6	2.2	-5.8	24.5	8.0	3.1	2.8
Gross agricultural production 3)								
annual change in % (real)	-0.9	4.1	3.0	.	.	.	.	.
Construction industry 2)								
annual change in % (real)	-5.0	-8.0	-3.0	.	.	.	.	.
Employed persons, LFS, th, average 4)	28,734	28,081	26,808	26,306	27,920	28,100	28,800	29,500
annual change in %	1.9	-2.3	-4.5	-5.4	6.3	5.0	2.5	2.5
Unemployed persons, LFS, th, average 4)	3,535	4,461	4,063	4,027	4,036	4,240	4,000	3,680
Unemployment rate, LFS, in %, average 4)	11.0	13.7	13.2	13.3	12.7	13.1	12.2	11.1
Reg. unemployment rate, in %, eop	.	.		.	.	.	.	.
Average monthly gross wages, TRY 5)	3,597	4,470	4,595	.	.	5530	6360	7170
annual change in % (real, gross)	-0.7	7.9	-8.5	.	.	2.5	2.5	2.5
Consumer prices (HICP), % p.a.	16.3	15.2	12.3	11.9	16.3	17.5	12.2	10.0
Producer prices in industry, % p.a. 5)	27.0	17.6	12.1	7.5	33.6	18.8	13.5	11.3
General governm.budget, nat.def., % of GDP								
Revenues	29.8	29.8	29.7	.	.	30.0	31.0	32.0
Expenditures	32.5	32.9	32.5	.	.	33.5	33.5	33.5
Deficit (-) / surplus (+)	-2.8	-3.2	-2.8	.	.	-3.5	-2.5	-1.5
General gov.gross debt, nat.def., % of GDP	30.2	32.7	39.5	.	.	40.4	43.5	46.4
Stock of loans of non-fin.private sector, % p.a.	9.6	10.2	35.3	28.4	18.7	.	.	.
Non-performing loans (NPL), in %, eop	3.9	5.4	4.1	4.4	3.7	.	.	.
Central bank policy rate, % p.a., eop 6)	24.00	12.00	17.00	8.3	19.0	18.00	12.00	10.00
Current account, EUR m	-17,579	6,106	-32,886	-19,255	-10,836	-22,300	-22,400	-22,500
Current account, % of GDP	-2.7	0.9	-5.2	-6.5	-3.5	-3.1	-2.9	-2.7
Exports of goods, BOP, EUR m	151,681	162,818	147,064	67,748	86,158	171,000	180,000	189,000
annual change in %	1.2	7.3	-9.7	-14.3	27.2	16.0	5.0	5.0
Imports of goods, BOP, EUR m	185,543	177,819	180,271	84,322	97,303	196,000	206,000	216,000
annual change in %	-7.8	-4.2	1.4	-1.1	15.4	9.0	5.0	5.0
Exports of services, BOP, EUR m	49,928	56,908	30,412	13,379	16,237	36,000	38,000	40,000
annual change in %	6.4	14.0	-46.6	-41.3	21.4	20.0	5.0	5.0
Imports of services, BOP, EUR m	24,154	25,082	22,501	11,019	11,063	24,000	25,000	26,000
annual change in %	0.8	3.8	-10.3	-5.6	0.4	7.0	5.0	5.0
FDI liabilities, EUR m	10,931	8,274	6,814	2,881	3,656	7,155	.	.
FDI assets, EUR m	3,019	2,630	2,799	855.8	1,536.7	2,939	.	.
Gross reserves of CB excl. gold, EUR m 7)	63,666	69,975	40,776	42,219	48,100	.	.	.
Gross external debt, EUR m 7)	373,278	370,674	352,944	365,337	375,664	418,900	427,000	439,200
Gross external debt, % of GDP	56.7	54.6	56.3	53.8	60.0	58.0	54.5	52.0
Average exchange rate TRY/EUR	5.7077	6.3578	8.0547	7.1521	9.5126	9.00	9.70	10.30

1) Preliminary. - 2) Enterprises with 20 and more employees; for construction wiiw estimate. - 3) Based on UN-FAO data, wiiw estimate in 2020. - 4) From 2021 new methodology in line with the Integrated European Social Statistics Regulation (IESS). - 5) Personnel costs. Data based on Annual Industry and Service Statistics excluding NACE activities agriculture and fishing, finance and insurance, public administration, defence and social security. - 5) Domestic output prices. - 6) One-week repo rate. - 7) Converted from USD.

Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.