

## 33. TURKEY

### Resilience is wearing thin

*The economy recovered faster than expected from last year's currency crisis, supported by a large fiscal stimulus and strong growth contribution of net exports. The recovery, however, is likely to be shallower than after previous recessions. A weak labour market, the need to repair corporate balance sheets, and persistent uncertainty are expected to weigh on consumption and investment. Policy buffers appear constrained by low reserves and a shrinking fiscal space following recent stimulus measures, and resilience is likely to be tested further in view of geopolitical and regional tensions.*

#### Tradables behind the recent rebound

The twin effects of a steep decline in domestic demand, in particular investment, and strong depreciation of the lira led to a significant drop in imports. Combined with robust export performance, this resulted in a large contribution of net exports to growth in the first half of the year, justifying, *inter alia*, a marked upward revision of the 2019 growth forecast compared to the spring, which is now in positive territory.

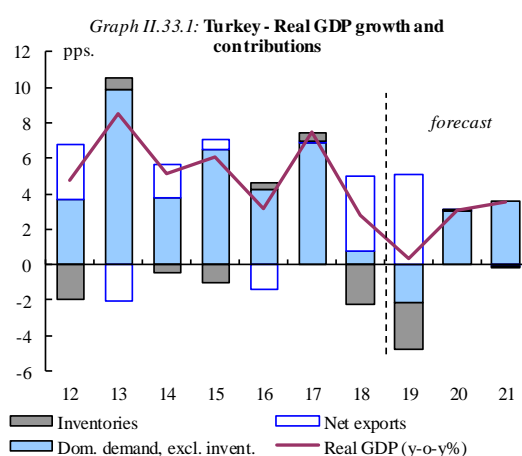
Agriculture and services have in general held their ground in the first half of the year. However, construction and to a lesser extent industry continued to be a drag on growth. High frequency indicators point to a still feeble bottoming out in the third quarter. Manufacturing industry capacity utilisation and the PMI increased, signalling a revival in industrial activity. General economic confidence improved as well across a number of sectors. However, reflecting the weak labour market situation, consumer confidence remained gloomy, extending its decline to a historic low in the third quarter.

#### Base effects to drive the momentum in the short term but medium-term growth prospects appear subdued

By the end of 2019 and early next year, strong base effects would determine a more vibrant economic performance. Rising domestic demand is forecast to sustain the growth momentum. However, over the forecast period, economic growth is unlikely to return to its pre-crisis averages, remaining below the government's ambitious 5% growth target.

Pent-up demand and expanding consumer lending should support private consumption but the weak labour market might turn out to be a major constraint to higher households spending. In addition, further real wage increases, which helped soften the impact of the crisis, are less probable in

view of already elevated wage levels and recent changes in the wage setting mechanism, adjusting wages with targeted instead of past inflation.



Investment's share of GDP remained elevated even after the steep fall during the crisis. The magnitude and speed of investment recovery will likely be constrained by the limited fiscal space, financial market bottlenecks, in particular the rising NPLs in some investment-driven sectors like construction and energy, and the need to repair companies' balance sheets. Although financial conditions have improved from the heights of the crisis, they remain inherently volatile and may represent an additional challenge to investment performance. Heightened uncertainty, stemming from geopolitical tensions is also expected to sap the strength of investment recovery.

Net exports' contribution to growth is expected to remain largely neutral in the next two years. Export growth is likely to slow down because of spill-overs from global trade tensions, sanctions, and the waning effects of the lira's depreciation. The slow recovery of domestic demand is forecast to still pull imports up but, external imbalances are set to remain low as compared to the excesses seen in the pre-crisis years.

### Risks are looming large

The forecast assumes a gradual return to exchange rate stability and, in view of a slow recovery in domestic demand, subdued inflationary pressures. However, this scenario could easily be challenged in case of domestic policy decisions aiming to materially boost growth and employment, swings in investors' preferences, or aggravation of geopolitical and regional tensions leading to the imposition of more powerful sanctions. External financing needs remain large, which in view of the need to rebuild foreign reserves and the high country risk premium could pose an additional risk.

### Fiscal anchor increasingly unhinged

In the aftermath of the failed coup attempt in 2016, the fiscal anchor weakened significantly and fiscal buffers have worn increasingly thin. Expansionary fiscal policy was also a key element of the authorities' response to the crisis last year. As a result, the 2019 budget deficit, net of one-off receipts of close to 1% of GDP from a super-dividend from the central bank, is set to

widen further to levels not seen in a decade. Fiscal space is thus severely limited to further support growth and, absent new measures, the headline government deficit is likely to remain elevated in the next two years. Government debt is now firmly in the zone above 30% of GDP and growing, with rising interest payments. Contingent liability risks from public-private partnerships and concerns about asset quality in majority state-owned banks persist.

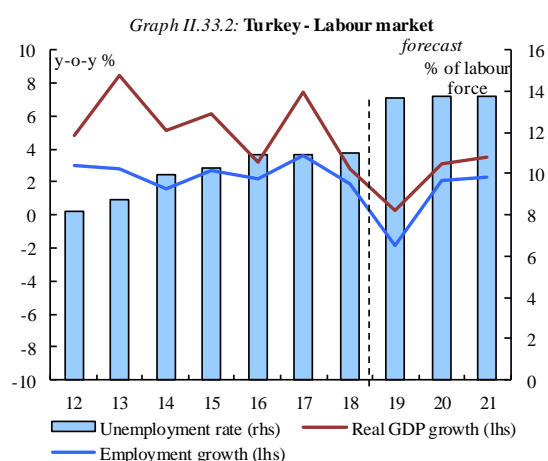


Table II.33.1:

### Main features of country forecast - TURKEY

	2018			Annual percentage change						
	bn TRY	Curr. prices	% GDP	00-15	2016	2017	2018	2019	2020	2021
GDP	3724.4	3724.4	100.0	5.1	3.2	7.5	2.8	0.3	3.1	3.5
Private Consumption	2111.3	2111.3	56.7	4.5	3.7	6.2	0.0	0.0	2.9	3.0
Public Consumption	552.4	552.4	14.8	4.6	9.5	5.0	6.6	3.3	2.9	2.8
Gross fixed capital formation	1114.1	1114.1	29.9	8.7	2.2	8.2	-0.6	-9.0	3.3	5.1
of which: equipment	357.0	357.0	9.6	7.7	1.2	-0.2	-7.8	-4.2	5.1	5.7
Exports (goods and services)	1099.8	1099.8	29.5	7.0	-1.9	12.0	7.8	6.2	3.1	3.5
Imports (goods and services)	1140.7	1140.7	30.6	6.6	3.7	10.3	-7.8	-10.8	3.2	3.9
GNI (GDP deflator)	3623.4	3623.4	97.3	5.1	3.4	7.2	1.4	0.4	3.1	3.5
Contribution to GDP growth:										
Domestic demand				5.7	4.2	6.9	0.8	-2.2	3.0	3.6
Inventories				-0.2	0.4	0.5	-2.2	-2.6	0.0	0.0
Net exports				-0.2	-1.4	0.1	4.2	5.1	0.0	0.0
Employment				1.2	2.2	3.6	1.9	-1.8	2.6	2.8
Unemployment rate (a)				9.2	10.9	10.9	11.0	13.7	13.3	12.9
Compensation of employees / head				17.6	20.2	8.8	17.0	17.5	10.8	10.0
Unit labour costs whole economy				13.2	19.1	4.9	15.9	15.0	10.3	9.2
Real unit labour cost				-1.8	10.2	-5.5	-0.4	1.2	-0.6	-0.5
Saving rate of households (b)				-	-	-	-	-	-	-
GDP deflator				15.3	8.1	11.0	16.4	13.6	10.9	9.8
Consumer-price index				16.6	7.8	11.1	16.3	15.3	10.3	9.3
Terms of trade goods				-	9.4	-6.9	-4.7	-9.1	-0.6	-0.6
Trade balance (goods) (c)				-	-4.8	-6.9	-4.9	-3.0	-3.2	-3.3
Current-account balance (c)				-4.1	-3.8	-5.6	-3.6	-0.6	-0.7	-1.0
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-	-3.8	-5.6	-3.6	-0.6	-0.7	-1.0
General government balance (c)				-	-1.1	-2.8	-3.2	-3.0	-3.5	-3.3
Cyclically-adjusted budget balance (d)				-	-	-	-	-	-	-
Structural budget balance (d)				-	-	-	-	-	-	-
General government gross debt (c)				46.0	28.3	28.2	30.1	31.4	33.0	34.3

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.