32. TURKEY

Turkey was one of the few countries in the world that experienced positive economic growth in 2020, at the cost of increasing vulnerabilities. The growth momentum remained strong in early 2021 and large carry-over effects are expected to lead to a rebound in 2021. However, tight economic policies and enduring vulnerabilities would curtail the strength of the recovery. Although external risks declined somewhat, policy uncertainty and inflation expectations increased following the recent dismissal of the central bank governor. The budget deficit is on a downward path but is likely to remain elevated.

A growth surprise in 2020 amid increasing vulnerabilities

Turkey was one of the few countries in the world that experienced positive economic growth in 2020. The growth performance was driven by a low base effect, strong momentum before the pandemic, and a sizeable policy stimulus that boosted domestic demand. Crisis-response measures were dominated by a large credit impulse, led by state-owned banks, and underpinned by a rapid relaxation of monetary conditions. As a result, the lira depreciated, external imbalances and dollarisation increased, foreign exchange reserves declined precipitously, and the country risk premium went up markedly. These developments triggered a sizeable tightening of the monetary policy stance since November last year.

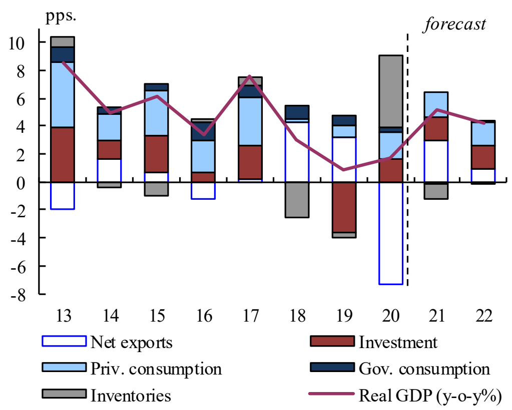
Growth momentum was strong in early 2021, but the recovery remains uneven

Manufacturing continued its good performance in the first months of the year, confirmed also by high-frequency indicators. Retail sales also went up, supported by growing economic confidence. Robust export orders and fixed investment expenditure have further sustained the ongoing recovery. However, the economy is not yet on a sustainable growth path as pandemic-related restrictions increased in April and certain high contact services remained below pre-crisis levels, while construction activity slipped back into contraction.

Strong base effects vs. elevated uncertainty and a tight policy stance

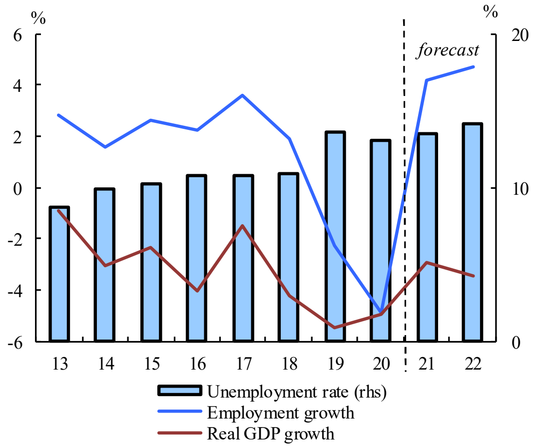
Large carry-over and base effects would be driving a strong economic rebound in particular in the first half of 2021. However, the tight monetary and fiscal policy stance and existing vulnerabilities are likely to curtail growth in the second half of the year. Overall, domestic demand is expected to remain the main driver of growth throughout the forecast horizon. Pent-up demand and improving consumer confidence are set to support the recovery of household consumption in the short term. However, consumption growth is likely to remain moderate in view of the incomplete labour market recovery, fading wealth effects originating from the dominance of gold and foreign currency savings, lower consumer lending, and higher financing costs. Budgetary saving efforts are likely to result in a negative growth contribution of public consumption. After a surprisingly good performance last year, investment growth is forecast to broadly keep its pace, although tight financing conditions and a highly leveraged corporate sector would be major constraining factors. A possible downward adjustment of the change in stocks, which had an outsized positive contribution to economic growth in 2020, remains a major source of uncertainty.

Graph II.32.1: **Turkey - Real GDP growth and contributions**



Supported by price competitiveness gains and growing external demand, exports are set to rebound strongly in 2021, continuing their upbeat performance since the second half of last year. However, the export of services is forecast to remain below its pre-crisis level even next year due to the pandemic's impact on the travel and tourism sectors. Imports growth is expected to be curbed by the depreciation of the lira and lower imports of non-monetary gold, sustaining a positive net exports contribution to growth.

Graph II.32.2: **Turkey- Labour market**



Risks remain elevated

Geopolitical risks are still high and weigh heavily on the country risk premium and economic developments. However, recent steps to lower tension in the Eastern Mediterranean have opened the way to developing a positive agenda with the EU, which could potentially boost Turkey's medium-term investment and trade prospects. Domestically, the recent dismissal of the central bank governor, after just four months in office, has increased again the uncertainty about the course of monetary policy. It also triggered exchange rate depreciation, a rise in inflation expectations and a spike in the country risk premium, largely reversing the gains made since the start of the tightening cycle last November.

A tight fiscal policy

The fiscal policy response to the crisis involved a rather limited increase in budget expenditure. Together with a strong revenue performance, this led to a significant fiscal tightening last year and a much better than anticipated budgetary outcome. The authorities have signalled their intention to maintain the tight fiscal stance in 2021 and use any additional fiscal space to lower the deficit beyond the budget plans. Although declining, the headline budget deficit is forecast to nevertheless remain elevated due to rising interest payments and lower one-off revenue. The deficit dynamics and the expected weakness of the lira are projected to contribute to a further rise in the government debt ratio to above 40% of GDP.

Table II.32.1:

Main features of country forecast - TURKEY

	2019		Annual percentage change						
bn TRY	Curr. prices	% GDP	01-16	2017	2018	2019	2020	2021	2022
GDP	4320.2	100.0	4.9	7.5	3.0	0.9	**1.8**	**5.2**	**4.2**
Private Consumption	2457.0	56.9	4.4	5.9	0.5	1.6	**3.2**	**3.1**	**3.0**
Public Consumption	670.8	15.5	4.9	5.0	6.6	4.4	**2.3**	**-1.0**	**0.0**
Gross fixed capital formation	1117.6	25.9	7.5	8.3	-0.3	-12.4	**6.5**	**6.3**	**5.8**
of which: equipment	:	:	:	:	:	:	**:**	**:**	**:**
Exports (goods and services)	1414.5	32.7	5.4	12.4	9.0	4.9	**-15.4**	**14.7**	**9.6**
Imports (goods and services)	1293.5	29.9	5.5	10.6	-6.4	-5.3	**7.4**	**4.0**	**6.4**
GNI (GDP deflator)	4233.4	98.0	4.9	7.3	1.7	1.6	**2.3**	**4.4**	**4.1**
Contribution to GDP growth: Domestic demand			5.5	6.7	1.2	-2.2	**3.9**	**3.3**	**3.3**
Inventories			-0.1	0.7	-2.4	-0.3	**5.2**	**-1.0**	**0.0**
Net exports			-0.3	0.2	4.2	3.2	**-7.3**	**2.9**	**0.9**
Employment			:	3.6	1.9	-2.3	**-4.8**	**4.2**	**4.7**
Unemployment rate (a)			9.8	10.8	10.9	13.7	**13.1**	**13.5**	**14.1**
Compensation of employees / head			:	8.8	17.0	22.7	**15.1**	**14.6**	**17.0**
Unit labour costs whole economy			:	4.8	15.8	18.9	**7.7**	**13.6**	**17.6**
Real unit labour cost			:	-5.5	-0.6	4.4	**-6.2**	**-1.5**	**3.8**
Saving rate of households (b)			:	:	:	:	**:**	**:**	**:**
GDP deflator			13.0	11.0	16.5	13.9	**14.8**	**15.3**	**13.2**
Harmonised index of consumer prices			13.8	11.2	16.4	15.2	**12.3**	**15.7**	**12.5**
Terms of trade goods			0.0	-8.5	-3.1	0.5	**11.7**	**-3.6**	**0.0**
Trade balance (goods) (c)			-6.1	-7.6	-5.4	-2.9	**-6.2**	**-5.6**	**-6.0**
Current-account balance (c)			-3.5	-4.7	-2.7	0.9	**-5.2**	**-3.9**	**-3.1**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			:	:	:	:	**:**	**:**	**:**
General government balance (c)			-0.6	-2.8	-2.8	-4.5	**-4.5**	**-4.0**	**-3.6**
Cyclically-adjusted budget balance (d)			:	:	:	:	**:**	**:**	**:**
Structural budget balance (d)			:	:	:	:	**:**	**:**	**:**
General government gross debt (c)			44.2	28.1	30.4	32.6	**39.5**	**41.3**	**42.0**

(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.