The strong 2021 economic recovery decelerated in early 2022 and is expected to weaken further before rebounding somewhat in 2023. Private consumption is forecast to stagnate, while the high country risk premium and growing uncertainty, coupled with tighter global financing conditions, are expected to sap investment performance.

The disruption of global supply chains and the lower external demand because of Russia’s war against Ukraine is forecast to significantly curb export growth. However, exports are likely to continue expanding, supported by previous price competitiveness gains and the further lifting of pandemic-related restrictions. Service exports may even benefit from the conflict in certain sectors, as international transport corridors have been re-routed through Turkey and the country remains open to Russian tourists. Turkey may also benefit from a possible relocation of some companies out of Russia and from the shortening of global supply chains. Despite a continuation of a relatively robust net exports contribution to growth, external imbalances are forecast to worsen significantly. The negative terms of trade shock from the higher global commodity prices, energy in particular due to the strong rise in food and energy prices. Without a budget revision, inflation would also take the edge off public consumption. The high country risk premium and growing uncertainty, coupled with tighter global financing conditions, are expected to sap investment performance.

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Following a strong recovery in 2021, the labour market is forecast to stagnate, with limited gains in employment and a broadly unchanged unemployment rate.

Real interest rates have been deeply negative since late 2021, triggering a steep drop in the lira and a resulting multiyear record spike in inflation. In an environment of persistent global inflationary pressures, the continuation of an excessively loose monetary policy stance is expected to keep domestic inflation very high and to further entrench the rising inflationary expectations.

Higher budget deficits but stable debt

The budget execution outperformed the 2021 target and the good performance continued in the first quarter of 2022. The 2022 budget, however, is outdated, as it is based on an unrealistic macroeconomic scenario and does not include a number of measures on the revenue and expenditure side to lower inflation and support the lira. Therefore, the annual deficit is expected to increase above plans and its previous-year levels and to remain elevated next year. Despite the bigger deficit and significant valuation effects, high inflation is forecast to keep the government debt-to-GDP ratio broadly stable through the denominator effect. Fiscal challenges loom large in view of growing contingent liabilities and the political cycle, with executive and parliamentary elections due in 2023.

Risks are elevated

Turkey’s high exposure to Russia makes it vulnerable to a drawn-out war in Ukraine. The global monetary policy tightening cycle is another challenge for the economy, which relies on sizeable short-term external financing. The unorthodox monetary policy and lack of credibility remain key sources of domestic risk.