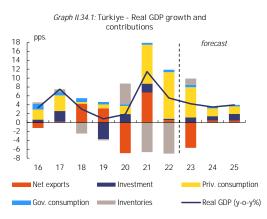
34 TÜRKİYE

Economic activity rebounded strongly in the second quarter as sizeable pre-election stimulus further boosted domestic demand. After the May elections, the authorities have tightened the policy stance when starting to pursue more conventional economic policies. Despite a rebalancing of growth towards net exports, softening domestic demand is projected to still make a positive contribution to economic growth. Inflation is forecast to remain high in the near term and external imbalances to decline only slowly. The budget deficit is expected to increase significantly in 2023 and to remain high next year. Geopolitical risks are acute and policy uncertainty has not dissipated completely, also in view of local elections next year.

Domestic demand driving economic growth in the first half of 2023

Economic activity rebounded strongly in the second quarter as sizeable pre-election stimulus further boosted domestic demand. Household consumption remained the main engine of growth, which was also supported by government consumption and upbeat investment in machinery and equipment. Inventories and import growth increased strongly. As a result of weaker external demand, the decline in Türkiye's exports steepened, leading to a large negative contribution of net exports to GDP growth in the first half of 2023.



Tighter fiscal and monetary policy stances to slow down domestic demand and growth

After the May general and presidential elections, the authorities have progressively tightened the monetary policy stance, doubling the policy rate between June and September to 30%. They also signalled a gradual further tightening of monetary conditions and a simplification of the existing micro- and macro-prudential framework. In addition, the government has adopted multiple and sizeable tax increases with a view to reducing the bulging budget deficit and financing earthquake reconstruction expenditure.

High frequency indicators have captured a slowdown in economic sentiment after the elections, with consumer confidence plummeting from a multiyear high to very low levels. The manufacturing PMI has been under 50 since July and weak manufacturing activity brought down industrial production. However, confidence indicators remained relatively upbeat in services, retail trade and the real sector, showing resilience and still robust demand, employment, exports and investment expectations.

Thus, despite an expected further slowdown, domestic demand is projected to preserve its positive contribution to economic growth and to facilitate a 'soft landing', with real GDP growth projected to decline to 3.5-4.0% in the next two years. As external demand recovers, exports are forecast to regain momentum in 2024. Still, the expected rebalancing of growth and the shift to a slightly positive contribution of net exports to growth is seen as mostly driven by the expected sharp moderation in import growth. Tighter financing conditions are set to sap private investments, but earthquake reconstruction efforts are projected to keep total investment up.

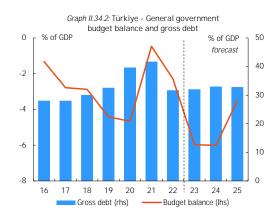
The labour market has been relatively upbeat since the beginning of the year, with robust job creation in services and construction, while the unemployment rate fell to its lowest level in nearly a decade. Employment gains are forecast to continue but at a slower pace, with a further decline in the unemployment rate expected in 2025.

Imbalances abating slowly

Despite the tighter policy stance, inflation is forecast to remain high in the near term due to inflation inertia, high inflation expectations, and the impact of the recent lira depreciation and tax hikes. The gradual correction of excess domestic demand will contribute to the projected moderate inflation reduction and the slow decline of external imbalances.

Backloading fiscal adjustment

The significant pre-election increases in non-discretionary budgetary expenditure and post-earthquake reconstruction spending have been only partially offset by the tax hikes in the summer. Therefore, the 2023 budget deficit is still expected to increase significantly. The deficit is expected to remain large and broadly unchanged in 2024 and to decline only in 2025. Nevertheless, due to the significant snowball effect from high inflation, the government debt-to-GDP ratio is forecast to remain close to its 2022 level, despite the impact of the lira depreciation.



Acute geopolitical risks

Geopolitical risks are particularly acute for Türkiye and could derail the forecast scenario via multiple channels. Although domestic policy uncertainty declined, partial policy reversals remain a material risk, also in view of local elections next year. In addition, risks from the unwinding of an overly complex set of regulatory measures are also non-negligible. Tighter global financial conditions continue to be highly relevant in view of Türkiye's reliance on short-term external financing and the still low level of disposable foreign exchange reserves.

Table II.34.1:

Main features of country forecast - TÜRKIYE

	2022				Annual percentage change					
	bn TRY	Curr. prices	% GDP	04-19	2020	2021	2022	2023	2024	2025
GDP		15011.8	100.0	5.3	1.9	11.4	5.5	4.2	3.5	4.0
Private Consumption		8603.0	57.3	4.6	3.2	15.4	18.9	11.8	3.0	3.0
Public Consumption		1749.4	11.7	5.5	2.2	3.0	4.2	5.0	3.0	3.0
Gross fixed capital formation		4377.9	29.2	6.9	7.3	7.2	1.3	4.0	2.8	3.6
Exports (goods and services)		5792.2	38.6	6.3	-14.6	25.1	9.9	-0.4	3.6	4.3
Imports (goods and services)		6392.9	42.6	4.7	6.8	1.7	8.6	13.0	2.0	2.6
GNI (GDP deflator)		14808.8	98.6	5.3	2.2	11.3	5.7	4.2	3.3	3.9
Contribution to GDP growth:	ļ	Domestic demand	t	5.5	4.1	11.2	11.3	8.5	3.1	3.5
	I	nventories		-0.4	4.7	-6.6	-7.0	1.4	0.0	0.0
	ļ	Net exports		0.5	-6.9	6.8	0.5	-5.7	0.5	0.5
Employment				1.8	-4.5	7.5	6.6	3.0	2.4	2.7
Unemployment rate (a)				10.0	13.2	12.0	10.5	10.0	10.2	9.8
Compensation of employees / head				12.7	14.7	22.4	70.5	81.6	59.6	29.1
Unit labour costs whole economy				9.0	7.5	18.1	72.2	79.5	58.0	27.5
Saving rate of households (b)				:	:	:	:	:	:	:
GDP deflator				9.1	14.8	29.0	96.0	63.7	58.6	24.3
Consumer price index				9.4	12.3	19.6	72.3	55.4	53.6	22.9
Terms of trade goods				:	:	:	:	:	:	:
Trade balance (goods) (c)				-1.3	-1.8	-3.6	-9.9	-8.8	-7.1	-6.0
Current-account balance (c)				-4.0	-4.8	-1.6	-5.4	-4.0	-2.9	-2.7
General government balance (c)				-1.9	-4.7	-0.5	-2.3	-6.0	-6.0	-3.5
Structural budget balance (d)				:	:	:	:	:	:	:
General government gross debt (c)				36.6	39.6	41.7	31.7	32.0	33.0	32.8

(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