PRESS RELEASE **8 May 2023**

Turkey's economy at a crossroads

- *In 2023, GDP growth will halve to 2.6% (2022: 5.6%)*
- *The effects of the recent earthquake are slowing growth*
- *There is a looming currency crisis, due to current monetary policy*
- *Political and macroeconomic stability is needed*

Economically, Turkey is facing more difficult times ahead of the presidential election on 14 May. This is revealed by a new economic forecast from the Vienna Institute for International Economic Studies (wiiw). While the country still grew by 5.6% in 2022 (after 11.4% in 2021), growth is expected to halve to 2.6% this year. Private consumption, which has been the most important pillar so far, will lose momentum in 2023. The reasons for this are weakening demand following the catch-up effects witnessed in the course of the recovery from the COVID-19 pandemic and the dwindling purchasing power of the population, due to the record-high inflation.

Last year, inflation was a whopping 72%. And for this year, wiiw expects inflation to be slightly below 50%. The question of what will happen to the country after the presidential election is causing uncertainty. The damage wrought by February's devastating earthquake and the effects of the restrictive monetary policy of the US Federal Reserve and the ECB in Frankfurt are also weighing on the economy. Turkey, which is heavily indebted in US dollars and euros, feels every rise in interest rates acutely. The country's already high current account deficit – i.e. the balance between exports and imports of goods, services and capital – also widened by 54% from January to February, compared to the previous year. How much longer this deficit can be financed is open to question. The Ukraine war is also having an adverse impact. While Turkey initially benefited from the influx of Russian capital and from its role as a hub for trade with Moscow, the partial ban on the export of sanctioned Western products to Russia is now creating tensions with the Kremlin.

There is a looming currency crisis

'If the ultra-expansive monetary policy continues, the country risks a further sharp depreciation of the lira and greater risks for the financial sector, especially if the Fed continues to raise interest rates,' says Richard Grieveson, Deputy Director and Turkey expert at wiiw. *'In 2018, we clearly saw the problems this monetary policy can cause, especially in combination with adverse external conditions,'* points out Grieveson.

But even in the event of an opposition victory and a new administration in Ankara, inflation is only likely to be brought under control in the medium term. *'Although the opposition, with its presidential candidate Kemal Kılıçdaroğlu, promises an end to Erdoğan's unconventional economic policy and an independent central bank, the latter would only be able to raise interest rates slowly, in order to avoid a shock to the financial system,'* points out Meryem Gökten, also a Turkey expert at wiiw and author of the new forecast for the country.

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The effects of the earthquake are slowing growth

The effects of this February's devastating earthquake will pose a major challenge to any new government. More than 50,000 people were killed in the disaster and about 13 million have been affected, across ten provinces of the country. Those regions devastated by the earthquake used to account for 9.3% of Turkey's GDP, as well as 8.5% of its exports and 15% of agricultural production. The Turkish government estimates the total damage at around USD 104bn. *'Even though reconstruction spending should support the economy, growth will still suffer from the destruction of infrastructure and machinery, disrupted supply chains and the loss of labour and investment overall,'* says Gökten. Largely for this reason, wiiw has revised its growth forecast for Turkey for the current year downwards by 0.4 percentage points, compared to the winter (to 2.6%).

Political and macroeconomic stability is needed

In principle, Turkey has enormous growth potential, according to the wiiw analysis. However, this can only be raised through greater political and macroeconomic stability. Above all, a prudent, stability-oriented monetary policy is needed to curb the high inflation and the currency's slide. Tackling the chronically high current account deficit, which has become more difficult to finance in recent years and has made Turkey dependent on the volatile mood of foreign investors and US monetary policy, should be another priority for any new government. To this end, domestic industrial production also needs to be boosted, in order to reduce the dependence of economic growth on credit-financed household spending.

'Only through greater political and macroeconomic stability will more foreign direct investment be attracted. It is absolutely essential for the necessary structural change in Turkey, but also for the post-earthquake reconstruction,' stresses Meryem Gökten.

The new Turkey analysis by wiiw is available for download here.

About the Vienna Institute for International Economic Studies (wiiw)

For 50 years, wiiw has been an economic think tank that produces economic analyses and forecasts for currently 23 countries in Central, Eastern and South-Eastern Europe. In addition, wiiw conducts research in the areas of macroeconomics, trade, competitiveness, investment, the European integration process, regional development, labour markets, migration and income distribution. www.wiiw.ac.at

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