TURKEY: Looking good, for now

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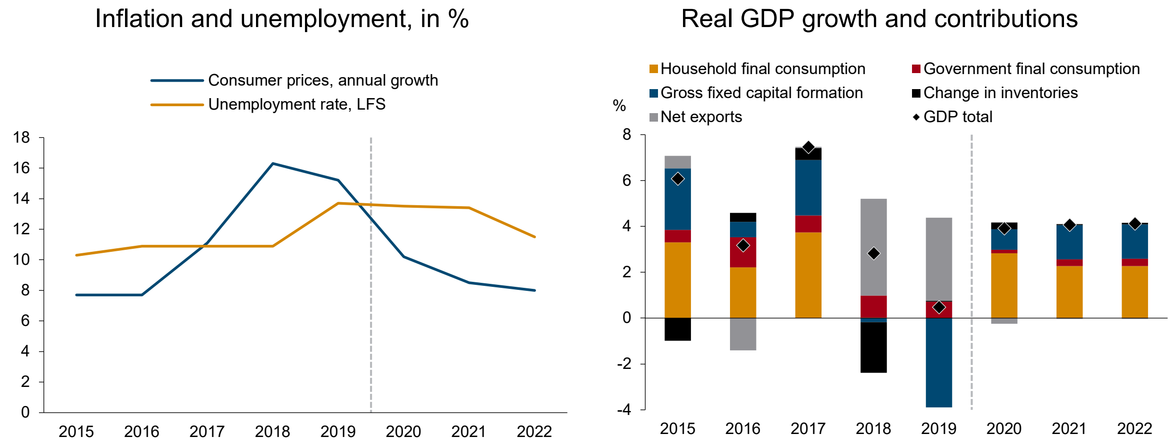
Turkey has again confirmed its status as the most high-beta economy in CESEE, with a host of indicators suggesting that a 'V-shaped' recovery is in progress. The currency crisis and sharp economic downturn of 2018–2019 now seem a long time ago, following a sharp bounce-back in the second half of last year. Growth could be around 4% this year, but that will mean a return to reliance on credit growth and external imbalances, and the old familiar vulnerabilities of the Turkish economy.

Figure 6.22 / Turkey: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

The recovery in Turkey has been even stronger than our (relatively optimistic) expectations. For 2019 as a whole, we estimate full-year expansion of 0.5%, which if confirmed would mark an impressive outturn after the sharp contraction in the first half of 2019. Real GDP grew by 0.9% year on year in Q3 (latest data available at the time of writing), the first positive outturn since the same quarter of 2018. This was driven by private consumption (+1.5%), exports (+5.1%) and especially government spending (+7%). Investment continued to collapse in year-on-year terms (-12.6%), but quarterly data suggest a stabilisation (-0.1% relative to the previous three months) after a very tough 12 months for this component of GDP.

More recent high-frequency data suggest that economic activity firmed in the final months of 2019 and the start of 2020, and we have therefore revised upward our 2020 forecast. We now predict economic growth this year to reach almost 4%, and at present the risks to this are to the upside. The most important driver of growth has been the massive monetary easing over the past 12 months, and its impact on credit growth and private consumption more generally. The central bank cut its benchmark rate by a cumulative 1,200 basis points in the second half of 2019. The real policy rate (CPIadjusted) is now back into negative territory, having been 7.2% as recently as June 2019. This is a huge amount of monetary easing over a short period, and has had a clear impact on economic activity – an impact that will continue in 2020.

The new credit boom is pushing up short-term growth rates, but also signals new risks for the economy. Consumer credit, in particular, has risen strongly, with loans to households rising by 11.9% year on year in November 2019. Credit to corporates has reacted more slowly, but was also growing by 5.6% as of November. The government appears determined to push this trend further, and in February 2020 cut the amount of commission that banks can charge on loans. This follows various other measures already announced to increase lending growth. We expect credit growth this year to be higher than in 2019. Although non-performing loans are at a low level (a bit above 5% at end-2019), rapid credit growth creates overheating risks and could contribute to another build-up of dangerous imbalances. The strong increase in credit has already had an impact on market sentiment, with the lira having weakened since November 2019.

Inflation is still very high, but is well down from peak levels, and we expect a further moderate decline in the headline rate over the forecast period. Full-year inflation was 15.2% in 2019, and fell as low as 8.6% in October, before rising again to 12.2% as of January. Part of the reason for this was higher imported inflation on the back of the weaker lira. We expect inflation to trend downward for the rest of the year, and to average 10.2% in 2020 as a whole.

Tourism is an increasingly important part of the Turkish economy (accounting for over 10% of GDP) and significantly helped the recovery last year. Arrivals from abroad rose strongly in 2019, including a particularly robust increase of 17% from Europe. Within this, Germans make up the single biggest group, but especially strong increases in tourists were recorded for Spain, Italy and France. The fact that tourism growth from Western European sources was so strong is particularly important, as these tourists tend to spend more money than for example Russians.

Turkish industry has had a tough time, but started to recover at the end of last year. Industrial production growth averaged almost 4% year on year in September-November. Survey data – for example, the purchasing managers' index (PMI) released by the Istanbul Chamber of Commerce – suggest that the industrial recovery is fairly broad-based. New orders growth was positive as of January 2020, including from abroad. This implies some degree of resilience to the weak external environment.

For now, the major volatility in Turkish growth rates appears to be over, but there is no guarantee that this will last. Turkey has been through extreme volatility in the last few years, with real GDP year-on-year growth rates ranging from +10.6% to -7.7% since the middle of 2017. Our baseline forecast is that growth will be around 4% during the forecast period. However, given the unbalanced nature of the Turkish growth model, in particular the reliance on (often external) credit, a return to heightened volatility cannot be excluded.

The government is aware that the old economic growth model leaves Turkey exposed to external volatility and changes in investor sentiment, and is seeking to pursue a new strategy. Treasury and Finance Minister Berat Albayrak has outlined a plan to make the economy more resilient, and is targeting growth of 5% per year in 2020-2022. The government wants to grow the manufacturing sector and exports, thereby reducing the large current account deficit and reliance on foreign capital inflows.

The government's plans will produce some results, but we are sceptical that it can really engineer a fundamental change in the way that the economy operates. We expect Turkey to return to gradually expanding external deficits in the forecast period, financed to a large extent by hot money inflows. Although the scale of the external imbalances may not be as high as in the past, the fundamental exposure to the whims of foreign investors will still be there. The lira will continue to depreciate (albeit not at the same rate as in 2017-2018), and inflation will remain relatively high.

Turkish foreign policy has become more active and assertive, most notably with interventions in Syria and Libya. There is a risk that these will bring Turkey into conflict with other regional or global actors. From an economic perspective, this could have damaging repercussions. The 2018 currency crisis – which was heavily influenced by a spat with the US – demonstrated the linking of geopolitical, financial and economic developments. Turkey's large external borrowing needs leave it particularly exposed to this. There are also signs that the alliance with Russia could be fraying, especially following the killing of Turkish soldiers by Russian-backed Syrian forces at the start of February.

The massive expansion of global liquidity since the global financial crisis will act as a partial factor of stability for Turkey's external accounts. This wall of money created by the Fed, ECB and Bank of Japan has to go somewhere. As long as foreign investors do not get too spooked by political developments, we think that a large amount of this money will continue to end up in Turkey. This is hardly a stable growth model. However, we view significant monetary tightening by the Fed or ECB (which would be highly destabilising for countries like Turkey, reliant as it is on hot money inflows) as highly unlikely during the forecast period.

Table 6.22 / Turkey: Selected economic indicators

	2015	2016	2017	2018	2019 1)	2020	2021 Forecast	2022
Population, th pers., average	78,218	79,278	80,313	81,407	82,579	82,700	83,600	84,400
Gross domestic product, TRY bn, nom.	2,339	2,609	3,111	3,724	4,300	4,900	5,500	6,200
annual change in % (real)	6.1	3.2	7.5	2.8	0.5	3.9	4.1	4.1
GDP/capita (EUR at PPP)	19,300	18,900	19,600	19,700	19,900	.	.	.
Consumption of households, TRY bn, nom.	1,412	1,561	1,836	2,111	2,430	.	.	.
annual change in % (real)	5.4	3.7	6.2	0.0	0.0	5.0	4.0	4.0
Gross fixed capital form., TRY bn, nom.	695	765	936	1,114	1,120	.	.	.
annual change in % (real)	9.3	2.2	8.2	-0.6	-13.0	3.0	5.0	5.0
Gross industrial production 2)								
annual change in % (real)	6.2	3.4	9.1	1.1	-0.6	3.0	3.0	3.0
Gross agricultural production 3)								
annual change in % (real)	5.2	0.5	2.0	0.5	0.5	.	.	.
Construction industry 2)								
annual change in % (real)	1.7	2.9	3.8	-5.0	-8.0	.	.	.
Employed persons, LFS, th, average	26,619	27,216	28,197	28,734	28,081	27,400	28,100	28,800
annual change in %	2.7	2.2	3.6	1.9	-2.3	-2.5	2.5	2.5
Unemployed persons, LFS, th, average	3,050	3,332	3,451	3,535	4,461	4,280	4,350	3,740
Unemployment rate, LFS, in %, average	10.3	10.9	10.9	10.9	13.7	13.5	13.4	11.5
Reg. unemployment rate, in %, eop	.	.	.	.	.	.	.	.
Average monthly gross wages, TRY 4)	2,014	2,280	2,470	2,820	3,250	3680	4130	4620
annual change in % (real, gross)	2.8	5.2	-2.5	-2.0	0.0	2.8	3.5	3.5
Consumer prices (HICP), % p.a.	7.7	7.7	11.1	16.3	15.2	10.2	8.5	8.0
Producer prices in industry, % p.a. 5)	5.3	4.3	15.8	27.0	17.6	15.0	13.0	11.0
General governm. budget, nat.def., % of GDP								
Revenues	31.9	33.0	30.1	30.0	31.0	32.2	33.5	33.8
Expenditures	32.9	34.7	32.1	32.8	34.0	35.0	36.2	36.6
Deficit (-) / surplus (+)	-1.0	-1.7	-2.0	-2.8	-3.0	-2.8	-2.7	-2.8
General gov.gross debt, nat.def., % of GDP	27.6	28.3	28.2	30.2	32.0	32.0	31.2	31.0
Stock of loans of non-fin.private sector, % p.a.	19.4	15.2	19.9	9.6	10.5	.	.	.
Non-performing loans (NPL), in %, eop	3.1	3.2	2.9	3.9	5.4	.	.	.
Central bank policy rate, % p.a., eop 6)	7.50	8.00	8.00	24.00	12.00	10.00	9.00	9.00
Current account, EUR mn	-28,986	-29,981	-41,679	-22,119	1,576	-9,100	-15,300	-20,400
Current account, % of GDP	-3.7	-3.8	-5.5	-3.4	0.2	-1.3	-2.1	-2.6
Exports of goods, BOP, EUR mn	136,978	135,795	147,218	148,024	162,699	167,000	175,000	184,000
annual change in %	7.7	-0.9	8.4	0.5	9.9	2.5	5.0	5.0
Imports of goods, BOP, EUR mn	180,353	172,701	198,906	182,938	179,380	194,000	208,000	223,000
annual change in %	2.9	-4.2	15.2	-8.0	-1.9	8.0	7.0	7.0
Exports of services, BOP, EUR mn	42,419	34,125	38,691	41,552	48,117	49,000	51,000	54,000
annual change in %	8.3	-19.6	13.4	7.4	15.8	2.0	5.0	5.0
Imports of services, BOP, EUR mn	20,563	20,366	21,250	19,496	19,856	21,000	23,000	25,000
annual change in %	7.9	-1.0	4.3	-8.3	1.8	7.5	8.0	8.0
FDI liabilities, EUR mn	17,376	12,627	10,201	11,128	7,476	9,000	.	.
FDI assets, EUR mn	4,595	2,837	2,419	3,069	2,575	1,820	.	.
Gross reserves of NB excl. gold, EUR mn 7)	85,356	87,334	70,202	63,666	69,974	.	.	.
Gross external debt, EUR mn 7)	367,819	388,626	378,969	384,872	399,000	404,800	416,200	427,700
Gross external debt, % of GDP	47.6	49.8	50.2	59.0	59.0	57.0	56.0	54.5
Average exchange rate TRY/EUR	3.0255	3.3433	4.1206	5.7077	6.3578	6.90	7.40	7.90

1) Preliminary and wiiw estimates. - 2) Enterprises with 20 and more employees; for construction wiiw estimate from 2017. - 3) Based on UN-FAO data, wiiw estimate from 2017. - 4) Data based on Annual Industry and Service Statistics excluding NACE activities agriculture and fishing, finance and insurance, public administration, defence and social security. wiiw estimate from 2016. - 5) Domestic output prices. - 6) One-week repo rate. - 7) Converted from USD.

Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.