TURKEY

Table 1	2021
Population, million	84.1
GDP, current US$ billion	810.0
GDP per capita, current US$	9626.1
Upper middle-income poverty rate ($5.5)[a]	10.2
Gini index[a]	41.9
School enrollment, primary (% gross)[b]	97.1
Life expectancy at birth, years[b]	77.7
Total GHG Emissions (mtCO2e)	518.0

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2019), 2011 PPPs.
b/ Most recent WDI value (2019).

Turkey's economy grew 11 percent in 2021, the fastest among G-20 countries, as COVID-19 related measures were gradually relaxed in Turkey and abroad. While Turkey's interest rate cuts from September supported demand, they also amplified macro-financial instability, which, combined with spillovers from the Ukraine-Russia war, will lower 2022 growth to 1.4 percent. Rising energy and food price inflation will hurt the poor the most, compromising a gradual employment-driven, post-pandemic poverty recovery.

Key conditions and challenges

Turkey enjoyed high growth rates between 2002-17, which propelled the country to the higher reaches of upper-middle-income status. But productivity growth slowed as reform momentum waned over the past decade and efforts turned to supporting growth with credit booms and demand stimulus, exacerbating internal and external vulnerabilities. High private sector debt, persistent current account deficits financed by short-term portfolio flows, high inflation, and high unemployment have been exacerbated by macro-financial instability since August 2018. Moreover, the economy's high energy and carbon intensity make it vulnerable to global energy supply and price volatility and pose a challenge for Turkey's exporters in the context of global and regional decarbonization policies.

Turkey's growth accelerated to the highest rate among G20 countries in 2021 as COVID-19 related measures were gradually relaxed in Turkey and abroad and authorities loosened monetary policy. However, monetary stimulus also caused deteriorating macro-finance conditions. The Lira depreciated to record lows and inflation rose to record highs. External and fiscal buffers deteriorated as the central bank supported the Lira, and the government deployed tax rate reductions and fuel subsidies to dampen headline inflation.

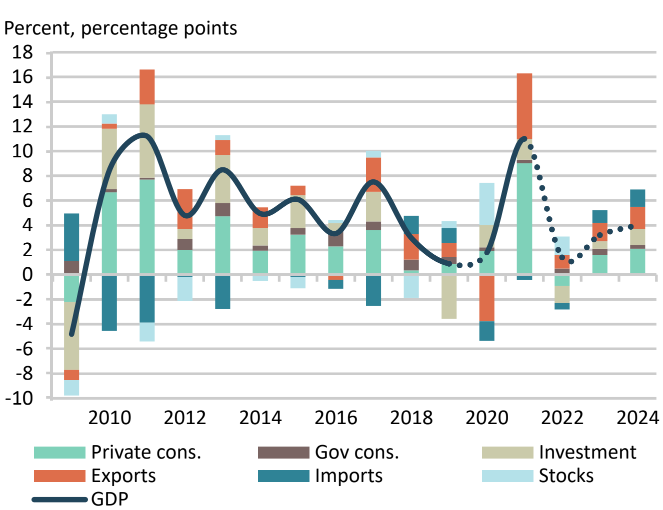
The Russian invasion of Ukraine is amplifying the headwinds facing the Turkish economy. Given Turkey's close economic ties to both Russia and Ukraine, the war is expected to disrupt Turkey's energy and agricultural trade, tourist arrivals, and overseas construction activities. Price spikes of essential commodity imports will directly affect households and industry and adversely impact the current account balance and inflation. Low-income households in Turkey are especially affected as they spend nearly twice as much of their budgets as the wealthiest on necessities such as food and housing.

Recent developments

Turkey's economy grew by 11 percent in 2021, supported by exports and accelerated domestic private consumption as COVID-19 measures were relaxed and people brought forward some consumption expenditures in fear of continued price rises. Turkey's goods and services exports were supported by buoyant external demand, sharp nominal depreciation of the Lira, and global supply chain disruptions that diverted global demand to Turkey.

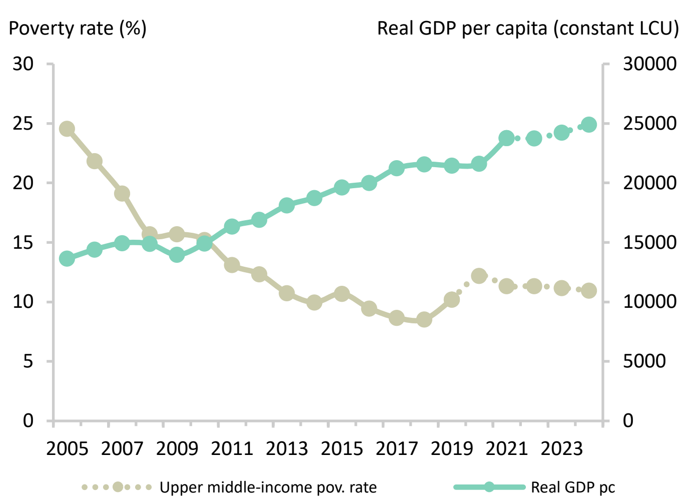
Total employment and labor force participation surpassed pre-pandemic levels in 2021. However, the recovery has been uneven, with those with informal work arrangements still lagging. On the other hand, the recovery was faster for women than men. Between December 2020 and December 2021, female labor

FIGURE 1 Turkey / Real GDP growth and contributions to real GDP growth



Sources: Turkstat and World Bank staff calculations.

FIGURE 2 Turkey / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see Table 2.

force participation (FLFP) increased by 14 percent, compared to 6 percent for males– although this leaves Turkey's FLFP still as the lowest among OECD countries. Youth employment also recovered, but 20.1 percent of youth are still unemployed. Poverty is expected to retreat due to the employment recovery, but will be partially offset owing to high inflation, keeping the poverty rate at 11.3 percent in 2021.

Despite rising domestic inflation and tightening global monetary conditions, Turkey's Central Bank lowered interest rates five times, by a total of 500 basis points, between September 2021 and the year-end. The move rapidly worsened macro-financial conditions and dented investor confidence. The Lira depreciated by roughly 120 percent in 2021 – the worst performance among emerging markets. This, coupled with rising global commodity prices, pushed year-on-year CPI and PPI inflation to 54.4 percent and 123.8 percent, respectively, in February 2022 – a two-decade high for both indices. Real interest rates moved deep into negative territory and dollarization accelerated. In response, the authorities launched several fiscal measures to stabilize the currency and dampen the impact of inflation, including a FX-protected deposit scheme that offers an exchange rate guarantee from the state budget.

The fiscal balance deteriorated in 2021 despite rising revenues, as the Lira depreciation raised FX-denominated debt service costs and PPP outlays, and as government provided capital injections to shore up SOE balance sheets. The FX-protected deposit scheme also created a sizable contingent fiscal liability. General government debt stock is estimated to have risen to 42.4 percent of GDP by end-2021. However, due to strong export growth, the current account deficit narrowed to 1.8 percent of GDP in 2021, from 5 percent in 2020. Gross FX reserves declined from $120bn to $111bn in 2021 amid FX interventions.

Outlook

Economic growth is expected to moderate to 1.4 percent in 2022 as macro-financial volatility intensifies and the impacts of Russia-Ukraine materialize, before returning to 3.2 percent and 4.0 percent in 2023 and 2024, respectively. Net exports are expected to drive growth in 2022, offsetting the drag from contractions in investment and private consumption. Inflation is projected to accelerate further to 61 percent in 2022, assuming no change in the monetary policy stance and high global commodity prices. In 2022 lower export growth and rising import prices are expected to widen the current account deficit to 6.4 percent of GDP. The general government deficit is projected to widen to 5.2 percent and 5.1 percent in 2022 and 2023, respectively, driven by rising public consumption, interest expenses, and current transfers.

Both external and domestic risks are tilted significantly to the downside. The Russia-Ukraine war has raised considerable uncertainty around the outlook. The war could: continue to increase commodity prices and exacerbate inflation, disproportionately impacting the poorest households; undermine Turkey's nascent tourism recovery; and spill over into Turkey's financial sector by raising NPLs in affected corporate sectors. Turkey is also vulnerable to tightening global liquidity conditions, given its high external financing requirements. The banking sector remains highly capitalized and with adequate FX buffers. However, removing forbearance measures is likely to pressure banks' balance sheets. The slowdown in the economy and job creation in 2022, and persistently high inflation mean that the poverty rate is projected to reach 11 percent by 2024.

TABLE 2 Turkey / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2019	2020	2021e	2022f	2023f	2024f
Real GDP growth, at constant market prices	0.9	1.8	11.0	1.4	3.2	4.0
Private Consumption	1.5	3.2	15.1	-1.5	2.6	3.5
Government Consumption	4.1	2.2	2.1	3.6	3.9	2.0
Gross Fixed Capital Investment	-12.4	7.2	6.4	-5.6	2.4	5.8
Exports, Goods and Services	4.6	-14.8	24.9	4.7	6.0	7.0
Imports, Goods and Services	-5.4	7.6	2.0	-2.5	5.0	7.3
Real GDP growth, at constant factor prices	1.0	1.1	11.5	1.4	3.2	4.0
Agriculture	3.3	5.9	-2.2	1.0	2.0	2.0
Industry	-2.9	1.0	12.5	2.0	3.5	4.8
Services	2.7	0.6	12.7	1.1	3.2	3.8
Inflation (Consumer Price Index)	15.2	12.3	19.6	61.0	27.0	20.0
Current Account Balance (% of GDP)	0.7	-4.9	-1.8	-6.4	-5.0	-3.4
Net Foreign Direct Investment (% of GDP)	0.9	0.6	1.0	1.0	1.0	1.2
Fiscal Balance (% of GDP)	-3.0	-3.9	-3.1	-5.2	-5.1	-3.7
Debt (% of GDP)	32.7	39.8	42.4	44.5	43.0	40.3
Primary Balance (% of GDP)	-0.5	-1.1	-0.1	-1.4	-1.2	-0.1
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	10.2	12.2	11.3	11.3	11.2	11.0
GHG emissions growth (mtCO2e)	1.8	0.3	7.1	0.4	1.9	2.5
Energy related GHG emissions (% of total)	80.3	79.6	78.8	78.6	78.7	78.7

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
a/ Calculations based on ECAPOV harmonization, using 2011-HICES and 2019-HICES. Actual data: 2019. Nowcast: 2020-2021. Forecasts are from 2022 to 2024.
b/ Projection using point-to-point elasticity (2011-2019) with pass-through = 1 based on GDP per capita in constant LCU.