TÜRKIYE

Table 1	2022
Population, million	85.3
GDP, current US$ billion	906.3
GDP per capita, current US$	10627.4
Upper middle-income poverty rate ($6.85)[a]	12.6
Gini index[a]	41.9
School enrollment, primary (% gross)[b]	96.5
Life expectancy at birth, years[b]	76.0
Total GHG emissions (mtCO2e)	525.0

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2019), 2017 PPPs.
b/ WDI for School enrollment (2020); Life expectancy (2021).

Following the May 2023 elections, the government has taken positive steps to normalize Türkiye's macroeconomic policies. After growing by 5.5 percent in 2022, Türkiye's economy is projected to initially slow to 4.2 percent in 2023 and 3.1 percent in 2024 as the economy adjusts from the previous over-accommodative and unsustainable macroeconomic stance, followed by an expected acceleration of growth in outer years. The combination of high inflation, particularly food inflation, and the earthquakes could erode prior achievements in poverty reduction.

Key conditions and challenges

The new economic team, under Finance Minister Simsek and central bank Governor Erkan, has started to normalize macrofinancial policies, and outlined more measures in the September Medium Term Program, to remedy imbalances in the economy. The central bank increased the policy rate from 8.5 percent in May 2023 to 30 percent in September (and signaled further tightening until there is significant improvement in inflation) and imposed new reserve requirements and other measures to limit loan growth. Distortive financial regulations are being unwound (including easing maintenance requirements on securities that require banks to hold government bonds and rolling back the FX-protected deposit scheme) alongside fiscal consolidation through tax increases.

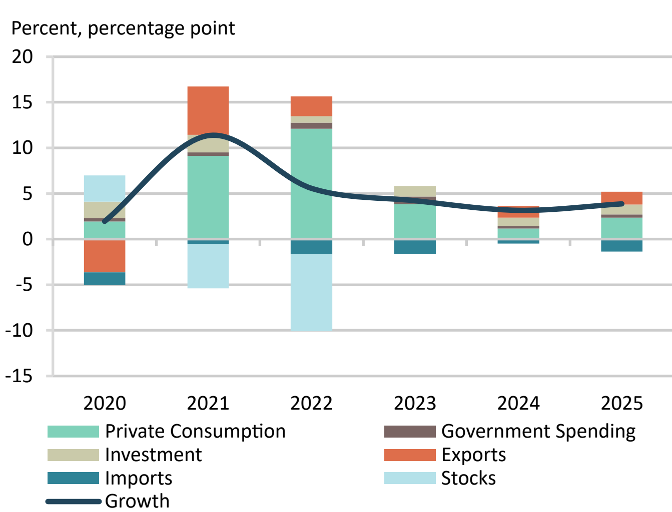
Recent macro-financial instability exacerbated longstanding structural challenges, including high private sector debt; persistent current account deficits financed by short-term portfolio flows; low productivity growth; and low labor force participation and employment levels. Nevertheless, high growth lowered the July 2023 seasonally adjusted unemployment rate to 9.4 percent, the lowest level since January 2014. However, high inflation – especially the 72.9 percent yoy food inflation in August 2023 – combined with the impact of the February 6 earthquakes, may erode prior achievements in poverty reduction.

Recent developments

After expanding 5.5 percent in 2022, real GDP grew 3.9 percent yoy in H1 2023. Responding to accommodative monetary policy, earthquake response and pre-election spending, H1 growth was driven by private and public consumption (16.4 and 5.7 percent real growth yoy, respectively) and investment (4.4 percent yoy), while merchandise exports in USD terms contracted 4.8 percent yoy as competitiveness and external demand weakened. On the production side, services grew 5.4 percent yoy in real terms in H1. On the other hand, the industry contracted 1.8 percent yoy in real terms due to early earthquake-related disruptions and a slight contraction in manufacturing. The PMI index remained above 50 since January but fell below 50 in July.

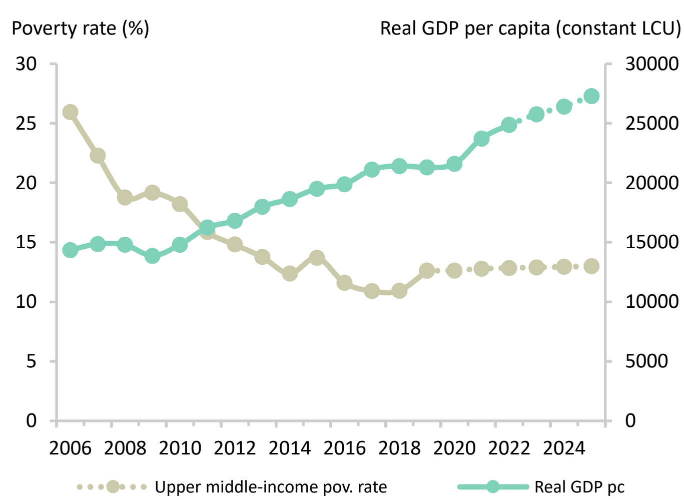
Policy normalization improved the external balance but vulnerabilities remain. The TRY continued its steady realignment, depreciating 26 percent since the May elections (and 31 percent since January) as foreign exchange interventions slowed. This helped the current account reach a surplus of USD 0.7 billion in June for the first time since October 2021 but returned to a USD 5.5 billion deficit in July. Reflecting greater investor confidence, CDS spreads have come down from 679, prior to the second round of elections in May, to under 400 in mid-September; and non-resident net portfolio inflows turned positive for 9 consecutive weeks, as of early August. As a result, central bank net reserves

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



Sources: Turkstat and World Bank staff calculations.

FIGURE 2 Türkiye / Actual and projected poverty rate and real GDP per capita



Source: World Bank. Notes: see Table 2.

have started to recover, reaching USD 17.6 billion in mid-September from an all-time low of USD –5.7 billion in early June.

Financial market conditions tightened in response to monetary policy. Credit growth continued to slow and commercial and consumer loan interest rates increased, with the latter nearly positive in real terms. But TRY depreciation, a 34 percent minimum wage increase in July, and the impact of higher taxes reignited inflationary pressures. Annual inflation rose for the first time in nine months in July and August to 58.9 percent, after reaching an 18-month low in June, and year-end inflation expectations rose to 67.8 percent in September despite monetary policy tightening. Domestic asset prices continued to soar well above CPI inflation; across Türkiye, house prices increased 95 percent yoy in July and the stock market was up 140 percent yoy in mid-September. TRY depreciation led to declining CARs from 20.4 percent in March to 18.7 percent in August in private banks, and from 19.8 percent to 15.9 percent in state banks. Importers and non-traders are most exposed to TRY depreciation and SMEs to interest rate increases. While the official NPL ratio fell to 1.7 percent in mid-August despite phased-out forbearance measures, asset quality risks remain high from FX-exposed companies, past rapid credit growth, and remaining high loan exposures.

The authorities have also targeted fiscal imbalances. Parliament passed a supplementary budget in July to counter pressures from the February earthquakes and election-related pension and civil service wage increases, which resulted in a record high 12-month fiscal deficit in June of 4.8 percent of 2022 GDP. Increases in the VAT rate and a special consumption tax on fuels supported a central government budget surplus of TRY 49 billion in July and 51 billion in August, and a reduction in the 12-month deficit to 3.7 percent of 2022 GDP. Government debt remained manageable at 31.7 percent of GDP in 2022, but the FX-share was high at 66 percent.

Outlook

The economy is projected to grow 4.2 percent in 2023 and 3.1 percent in 2024 as it adjusts from the previous over-accommodative and unsustainable policy stance, followed by an expected acceleration in growth in outer years. Private consumption is the largest component of GDP and 12-month consumer confidence indicators fell sharply in August 2023, to the lowest level over 12 months due to expectations of a slowdown in income growth, the possibility of unemployment, and persistent inflation. Gradual fiscal consolidation is expected to continue supporting fiscal balances, and the macro-financial stabilization alongside lira depreciation and policy support to exporters is expected to further narrow the current account deficit.

Well-implemented and timely social protection programs, targeted expressly at vulnerable populations in earthquake-affected areas, can mitigate the earthquakes' impacts and economic slowdown on poverty. The government has already supported earthquake survivors by activating established social protection and labor schemes. Poverty is projected to stay at 12.9 percent in the next few years.

The outlook faces considerable uncertainty related to the macroeconomic policy stance in the run up to the March 2024 municipal elections and the phasing out of the FX-protected deposit scheme and heterodox regulations distorting the financial sector. Despite recent prioritizing of policy tightening and disinflation, a pre-election stimulus could increase short-term growth, while aggravating already-elevated external risks. The FX-protected deposit scheme, which accounts for 26 percent of total banking sector deposits and is sensitive to TRY depreciation, remains a source of fiscal risk. Some rating agencies have recently revised Türkiye's outlook from negative to stable with the return to a more consistent policy mix.

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

	2020	2021	2022	2023e	2024f	2025f
Real GDP growth, at constant market prices	1.9	11.4	5.5	4.2	3.1	3.9
Private consumption	3.2	15.4	18.9	6.1	1.7	3.4
Government consumption	2.2	3.0	4.2	7.2	2.1	2.4
Gross fixed capital investment	7.3	7.2	1.3	5.7	3.5	4.4
Exports, goods and services	-14.6	25.1	9.9	-2.2	5.4	5.8
Imports, goods and services	6.8	1.7	8.6	7.4	2.4	6.4
Real GDP growth, at constant factor prices	0.9	12.7	6.2	4.2	3.1	3.9
Agriculture	5.8	-3.0	1.3	0.4	1.5	1.6
Industry	0.8	13.0	-0.6	5.5	3.5	4.9
Services	1.1	13.2	10.1	3.5	3.1	3.6
Inflation (consumer price index)	12.3	19.6	72.3	53.4	57.2	27.5
Current account balance (% of GDP)	-4.4	-0.9	-5.3	-5.0	-3.3	-2.6
Net foreign direct investment inflow (% of GDP)	0.6	0.8	0.9	1.1	1.3	1.4
Fiscal balance (% of GDP)	-3.9	-2.6	-2.9	-5.3	-5.3	-3.8
Revenues (% of GDP)	32.4	30.9	26.4	26.9	27.8	27.5
Debt (% of GDP)	39.6	41.8	31.7	33.0	34.4	34.7
Primary balance (% of GDP)	-1.1	0.0	-0.6	-2.2	-1.7	0.0
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	12.6	12.8	12.8	12.9	12.9	13.0
GHG emissions growth (mtCO2e)	1.5	9.7	2.5	1.4	2.1	2.6
Energy related GHG emissions (% of total)	77.9	78.7	78.8	78.2	77.7	77.6

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.
a/ Calculations based on ECAPOV harmonization, using 2014-HICES and 2019-HICES. Actual data: 2019. Nowcast: 2020-2022. Forecasts are from 2023 to 2025.
b/ Projection using annualized elasticity (2014-2019) with pass-through = 0.85 based on GDP per capita in constant LCU.