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TÜRKİYE ECONOMIC MONITOR

March 2024

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The Türkiye Economic Monitor (TEM) periodically analyzes economic developments, policies, and prospects in Türkiye. The TEM was prepared under the guidance of Humberto Lopez, Asad Alam, and Antonio Nucifora, by a core team led by Mustafa Utku Özmen, and including Hans Anand Beck, Claire Honore Hollweg, Etkin Ozen, Gunhild Berg, Elizaveta Perova, and Marie Sabine Lydie Albert.

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Executive Summary

Türkiye's economic policies played a crucial role in facilitating a rapid recovery from the COVID pandemic. However, the policy framework that ensured a strong economic performance during and in the aftermath of the pandemic also heightened macroeconomic risks and created vulnerabilities. The policy framework introduced during the pandemic was built on loose monetary policy, prudent fiscal policy, and boosting exports and employment. As a result, the Turkish economy grew by 11.4 percent in 2021, and 5.5 percent in 2022. Employment growth remained robust, and the unemployment rate declined steadily. However, these policies -in addition to the rise in energy prices amid geopolitical tensions and the global monetary tightening cycle- also resulted in a very rapid increase in inflation, a widening of the current account deficit, and a decline in FX reserves, which in turn contributed to a worsening of the risk perception and macrofinancial outlook in the run up to the May 2023 elections. With increased internal and external imbalances, the growth momentum also slowed down starting from the second half of 2022.

Following the May 2023 elections, the new government started a process of normalization in macroeconomic policies which can restore sustainable strong economic growth and price stability in the medium to long term. The new macroeconomic policy framework is centered on tightening monetary policy to achieve disinflation, while maintaining fiscal discipline, and a flexible exchange rate, and pursuing structural reforms to support economic growth. This transition to macroeconomic stability, however, involves a complex adjustment process, which needs to be gradually implemented. So far, the strong monetary policy rate hikes, ongoing simplification in the macroprudential policy framework, and the correction in the exchange rate since May 2023 have helped to gradually rebuild confidence in the economy, while targeted tax increases have helped reduce the fiscal deficit. The impact of the new policy framework has started to be reflected in the reduction in risk premia, realignment of interest rates, strengthening in FX reserves, the improvements in the assessment of credit rating agencies, and a significant decline in the current account deficit. Yet, in the short-term economic growth is expected to slow on the back of policy tightening, slow global growth, current account and budget deficits, and the transition period required for stabilization, while the Medium-Term Program (MTP) also outlines a shift in growth composition from private consumption to investments and exports. Therefore, maintaining this policy stance will provide the foundations for sustainable strong economic growth in the medium to long term. This strategy calls for a careful tailoring of economic policies towards maintaining stability and confidence and protecting the vulnerable and underscores the importance of tackling structural issues to strengthen economic performance.

Several risks can affect the path towards faster economic growth and poverty reduction. The government's fiscal position while strong, is vulnerable to rising borrowing costs, increasing rigidity of public expenditures, and pressing needs to support vulnerable groups during the disinflation phase. External risks were particularly elevated in the first half of 2023 with declining reserves and a rising current account deficit and high external financing requirements. While there has been a substantial increase in FX reserves along with early signs of an improvement in the current account deficit in the second half of 2023, external risks remain given the relatively low level of net FX reserves and the high external financing requirements. Further, the global economy is recovering to a low growth path on the back of tight monetary policy stance, the stagnation in global trade, and increased uncertainty due to geopolitical tensions. Also, the monetary tightening and slowing growth prospects may trigger vulnerabilities in the corporate sector which may have repercussions on the financial sector, as discussed in the special topic section of the report. Going forward there are also opportunities that can support faster economic growth induced by higher productivity, such as the greening of the economy.

I. Taking Stock

Türkiye's economic policies helped quickly recover from the COVID pandemic. The policies being implemented since late 2021 were built on loose monetary policy, prudent fiscal policy, boosting exports and employment, and managed to deliver strong GDP growth in 2022. These policies, -in addition to the rise in energy prices amid geopolitical tensions and the global monetary tightening cycle-, however also led to a very rapid increase in inflation, a widening of the current account deficit and the decline in the reserves which in turn affected investors' risk perception adversely and increased macrofinancial pressures in the run up to the May 2023 elections. As a consequence, the growth momentum also slowed down starting from the second half of 2022. Following the elections, the new government started a process of normalization in macroeconomic policies in 2023H2 with an emphasis on tightening monetary policy to achieve disinflation. The monetary policy rate hikes, ongoing simplification in the macroprudential policy framework, and the correction in the exchange rate since May 2023 have helped to gradually rebuild confidence in the economy, and the tax hikes have helped reduce the fiscal deficit. The impact of the new policy framework has started to be reflected in the reduction in risk premia, realignment of interest rates, strengthening in foreign exchange reserves, and the improvements in the assessment of credit rating agencies.

Türkiye's economic policies built on low cost of borrowing, high investment, exports and employment delivered strong growth performance initially, but had started losing steam and resulted in a widening current account deficit and very high inflation.

The economy registered strong growth performance in 2022 but the growth rate slowed down in the second half of 2022 and in 2023.

The Turkish economy grew at 5.5 percent in 2022 thanks to strong economic activity in 2022H1 (fueled by resilient exports and private consumption); yet it started to moderate since 2022H2, and the economy grew by 4.5 percent in 2023. The strong and robust contribution of private consumption continued to be the main driver of growth (Figure 1). Sizeable wage increases, the availability of low-cost credit and the front-loading of spending (to hedge against high inflation) led private consumption to grow by 18.9 percent in 2022, which moderated to 12.8 percent in 2023. Meanwhile, exports have significantly slowed down since 2022H2, as export growth came down from 18.8 percent in 2022Q2 to -9.4 percent by 2023Q2, only to recover to 1.2 percent in Q3. The loss of momentum in exports was mainly led by the slowdown in the growth of major export markets and the erosion of price competitiveness gains, which was built up due to depreciated Turkish lira, through high inflation. The robust economic activity and private consumption also pushed the import demand and imports grew by 11.7 percent yoy in 2023, despite a decline from 19.7 percent in 2023Q2. The momentum of growth in Türkiye is volatile. The seasonally and calendar adjusted qoq growth rate in the quarters of 2023 were -0.2, 3.6, 0.3 and 1.0 percent respectively (Figure 2). In Q2, both private consumption and imports grew strongly by 4.6 and 4.3 percent, respectively, while exports continued to contract. However, in Q3, private consumption of resident households contracted for the first time since 2020Q4, and exports have picked up by 5.2 percent, following the monetary policy tightening started in June. However, in Q4, private consumption increased by 3.6 percent.

On the production side, the services sector was the main driver of economic growth in 2022 and in 2023, while manufacturing slowed down. The services value added increased by 9.6 percent in 2022. The momentum of both services and industry further slowed down in 2023Q2 (Figure 3). The loss of pace in the manufacturing value added growth was linked with the weakening external demand and rising cost pressures. The manufacturing, however, recovered in second half of 2023, while services continued to lose momentum The Purchasing Managers' Index (PMI), which remained below 50 for the majority of 2022, was in positive territory in 2023H1, but fell below 50 in July 2023, only to recover to 50.2 in February 2024, and remain at the threshold level in March 2024 (Figure 4). The negative real interest rates and strong domestic demand kept the business sentiment strong in the 2023H1, but the start of the tightening cycle of monetary policy pointed to a slowdown in the economy.

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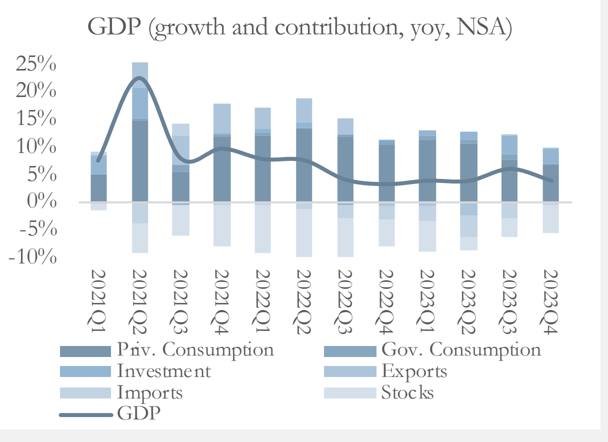
Figure 1: Economic activity remained robust in 2022H1, but slowed down since 2022H2



Sources: Haver Analytics, TURKSTAT, WB Staff estimates.

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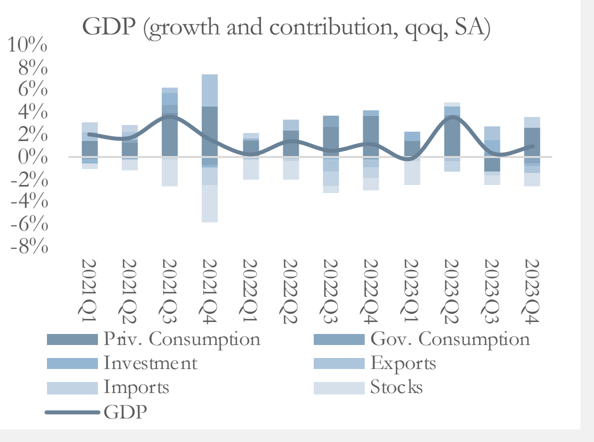
Figure 2: The momentum of growth is volatile



Sources: Haver Analytics, TURKSTAT, WB Staff estimates.

In parallel, consumer confidence followed an upward trend from the second half of 2022, peaking at 91.1 in May 2023, on the back of wage increases and the availability of cheap credit boosting private consumption. However, in the second half of 2023, the policy rate hikes, and the sizeable depreciation of the lira put a drag on consumer confidence which fell to 68.0 in August with an improvement to 79.4 in March 2024. The decline in consumer confidence from peak values also support the slowdown in economic activity in 2023H2 compared to first half.

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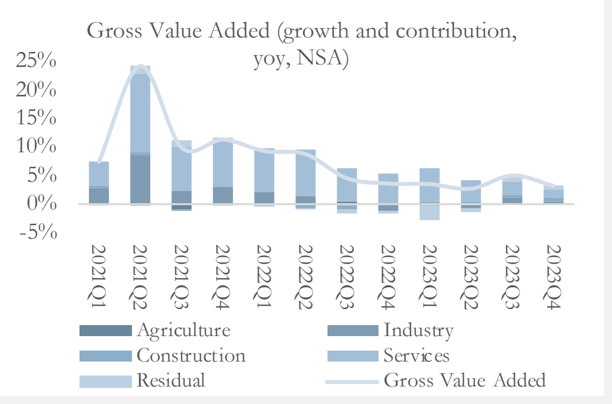
Figure 3: Services sector is the main driver of growth



Sources: Haver Analytics, TURKSTAT, WB Staff estimates.

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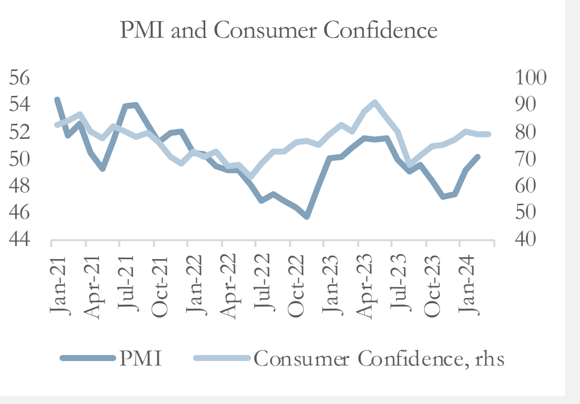
Figure 4: Economic activity has slowed in 2023H2



Sources: Istanbul Chamber of Industry Türkiye PMI, TURKSTAT

The current account deficit increased rapidly in 2022 and remained large in 2023

After reaching US$49.1 billion in 2022 (from US$7.4 billion in 2021), the current account deficit has remained large in the first five months of 2023 on the back of increasing gold imports and a worsening merchandise trade balance but narrowed in the remainder of the year due to policy shift in the economy and measures restricting gold imports to US$45.5 billion in 2023. The current account deficit narrowed by around US$4 billion in 2023 (Figure 5). However, the composition of the deficit has changed. An improving energy trade balance helped offset rising gold imports and a deteriorating non-gold-or-energy goods trade balance (Figure 6). Services balance also improved in 2023, on the back of very strong tourism revenues which increased by 12.1 percent and reached US$55.9 billion. The 12-month cumulative current account deficit further narrowed to US$31.8 billion in February 2024.

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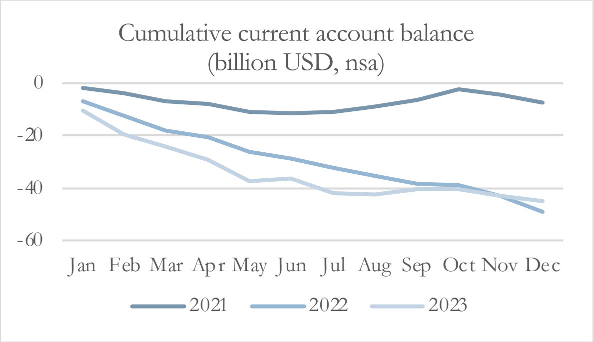
Figure 5: The current account deficit widened



Source: Authors' calculations using data from CBRT.

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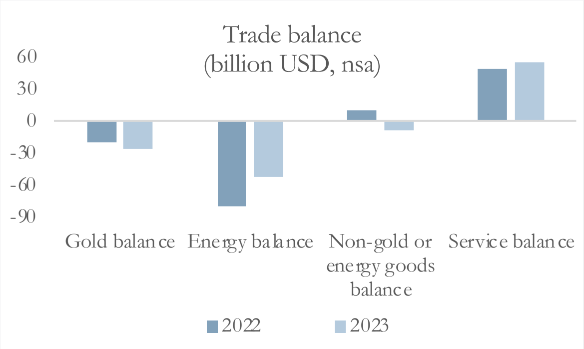
Figure 6: …on the back of higher gold imports and contracting merchandise exports



Source: Authors' calculations using data from CBRT.

Monetary policy remained loose in 2022 and in the first half of 2023, despite high inflation and continuing lira depreciation, only to be tightened starting from June 2023.

The CBRT started a long easing cycle of monetary policy in late 2021. The CBRT initially cut the policy rate from 19 percent to 14 percent from September 2021 to December 2021, and from 14 percent to 8.5 percent from August 2022 to February 2023. The rate cuts, which started when inflation was already high (19.25 in August 2021), had a significant impact on exchange rate, inflation, and inflation expectations. They were accompanied by measures under the 'Liraization Strategy', including the introduction of the 'FX protected deposit scheme' to reduce the demand for FX and stabilize the currency.[1] However, a widening current account deficit and global monetary tightening continued to put pressure on the lira. In the first months of 2023 the pressure on the lira reached very high levels, and the central bank's net reserves fell to US$-5.7billion in the first week of June.

The macroeconomic policy mix shifted after the May 2023 elections, as the CBRT started an aggressive tightening of monetary policy. The CBRT has increased the policy rate in nine meetings from 8.5 percent in May to 50 percent in March 2024 (Figure 7). Moreover, in the July and November 2023 Inflation Reports, the CBRT has increased the 2023 year-end inflation forecast to 58 and 65 percent, respectively, from 22 percent in its April Report. The end-2024 inflation forecast is kept at 36 percent in November 2023 and February 2024 reports. The MPC has put forward a clear message indicating that the level of the policy tightness will be maintained until there is a significant decline in the underlying trend of monthly inflation and until inflation expectations converge to the projected forecast range. CBRT also initiated a process to gradually remove the restrictions that have been in place either to lower the cost of borrowing or to curb the demand for FX (including the FX protected scheme).

1. For additional information on liraization strategy: https://tcmbblog.org/wps/wcm/connect/blog/en/main+menu/analyses/liraization+strategy; on macroprudential measures: https://www.tcmb.gov.tr/wps/wcm/connect/EN/TCMB+EN/Main+Menu/Announcements/Press+Releases/2022/ANO2022-36 ; on FX-protected scheme: https://tcmbblog.org/wps/wcm/connect/blog/en/main+menu/analyses/a+glance+at+fx-protected+and+standard+deposits+from+an+investor+perspective

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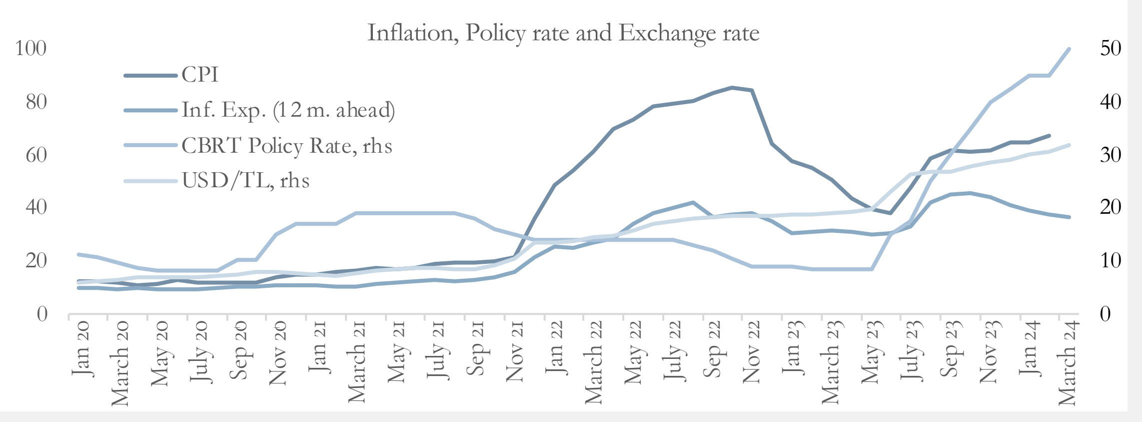
Figure 7: The Central Bank started increasing the policy rate in 2023 June after a long-lasted easing cycle causing a rapid increase in inflation and a significant decline in real rates



Sources: CBRT, TURKSTAT, Haver Analytics.

Base effects and policy measures helped inflation ease from its peak in October 2022 until June 2023, but inflation has recently rebounded

Inflation rose to very high levels in 2022, peaking at 85.5 percent in October 2022, on the back of loose monetary policy, depreciation of the lira, rising international commodity prices, and strong domestic demand. Consumer price index (CPI) inflation exceeded 80 percent, reaching 85.5 percent in October 2022, and domestic producer price inflation hit 158 percent (Figure 8). Following that, with the help of the base effects and relative stability in the exchange rate consumer inflation came down to 38.2 in June 2023. However, the new round of depreciation of the lira post-elections, the significant tax hikes as part of the efforts to finance reconstruction of the earthquake-affected areas, minimum wage adjustments, and the surge of international oil prices, all put extra pressure on inflation, putting headline inflation to 64.8 percent in December 2023, and 67.1 in February 2024.[2]

2. The increase in Value Added Tax rates (by 2 percentage points for most goods and services), coupled with a significant increase the Special Consumption Tax on fuel, also had direct and indirect effects on inflation., which together with the depreciation of the lira explain about half of the surge in inflation since June 2023. The central bank's Inflation Report 2023-III provides a detailed analysis of the impact of tax and administered prices on inflation.

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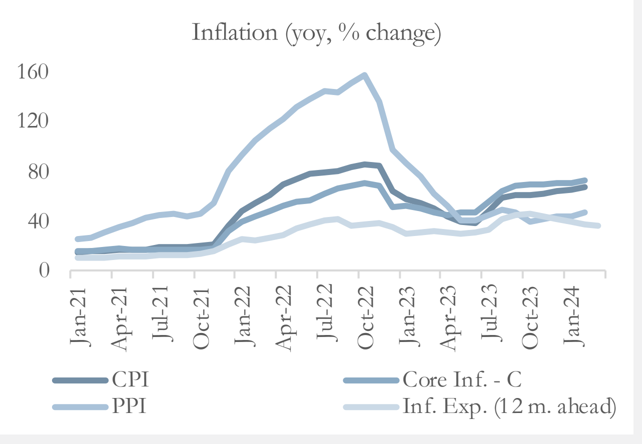
Figure 8: CPI inflation peaked in October 2022, eased until June 2023, but started to increase again



Sources: TURKSTAT, CBRT.

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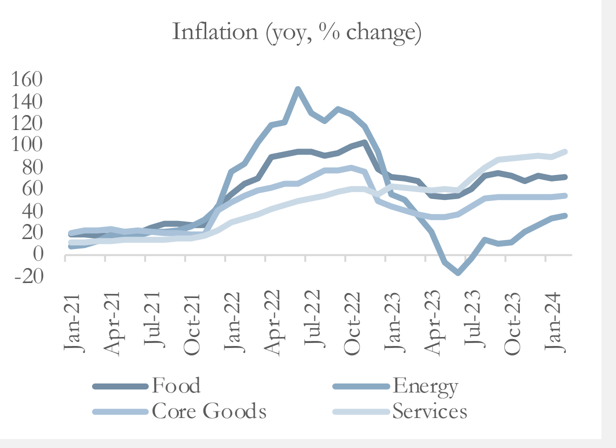
Figure 9: The food and services inflation are particularly high



Sources: TURKSTAT.

Despite recent monetary tightening inflationary pressures are still alive, driven by the persistence of services inflation, the existing level of domestic demand and geopolitical risks; and medium-term inflation expectations remain above the CBRT forecasts. As of March 2024, the 12-month-ahead inflation expectation is at 36.7 percent, while the year-end inflation expectation is 44.2 percent, above the CBRT's forecast for end-2024 of 36 percent. Similarly, 24-month ahead inflation expectation came down from 25.8 percent in October 2023 to 22.7 percent in March 2024, being higher than CBRT's end-2025 forecast of 14 percent. Moreover, the slowdown in inflation observed from October 2022 to June 2023 has been limited to goods inflation, while over the same period services inflation stuck around 60 percent and further increased to 94.4 percent, currently being the main subgroup with the highest level of inflation as of February 2024 (Figure 9). Services prices are sensitive to wage developments, food and energy inputs, and exchange rate shocks, and constitute the stickiest portion of the CPI where shocks to prices occur slowly but persist longer compared to other components. Therefore, services inflation presents an important challenge for disinflation. Furthermore, the rapid increase in inflation also distorts the pricing behavior of economic agents as increased backward looking pricing further strengthens the persistence of inflation, and as high inflation and inflation uncertainty boosts the pass-through of shocks to inflation (Box 1).

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Box 1: Pass-through of shocks to inflation

Inflation in Türkiye has been subject to sizable shocks recently: Inflation has been fueled by the significant depreciation of the Turkish lira, the increase in import prices following the post-COVID global recovery, Russia's invasion of Ukraine, and the strong domestic demand fueled by loose credit policy and minimum wage increases. In addition, inflation expectations have increased, and pricing behavior has been distorted, adversely affecting the pass-through of shocks to consumer inflation. A VAR analysis conducted with monthly data and including import unit value index in USD, USD/TL exchange rate, minimum wage, industrial production, inflation, policy rate and inflation expectations, has been estimated for January 2005 to June 2023. The results suggest that the pass-through of an exchange rate shock on headline inflation is around 30 percent (Figure 10). One striking observation is the speed of pass-through of an exchange rate shock: About half (two thirds) of the pass-through happens in two (three) months, and the pass-through of the exchange rate shock is completed in around one year.

The sensitivity of inflation to shocks and the speed of transmission has considerably increased in recent years making the disinflation foreseen by the authorities even more challenging. Comparing the pass-through estimates (cumulative responses after 24 months) for 2005-2023 with those for 2005-2020 suggests that the exchange rate, import price and minimum wage pass-through has increased in the recent period for almost all subcomponents of the CPI (Figure 11). For instance, the exchange rate pass-through to core goods (services) has increased from 32 percent (6 percent) to 35 percent (20 percent); and the pass-through of minimum wage on food prices has increased from 14 percent to 30 percent in the latest estimation sample. Especially, the notable increase in the sensitivity of services inflation to shocks makes the disinflation period ahead more difficult than previous episodes of disinflation.

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Figure 10: Exchange rate pass-through to CPI inflation

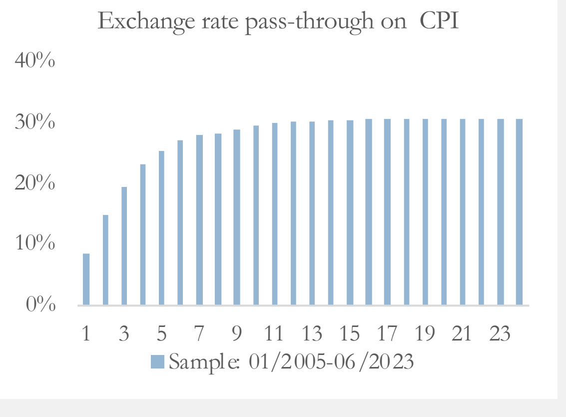

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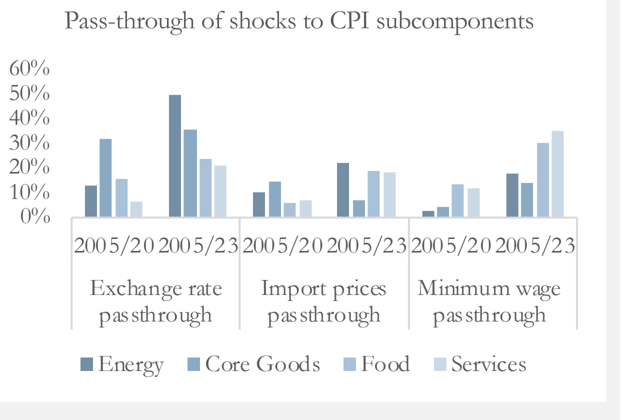
Figure 11: Pass-through of shock to CPI subcomponents



Sources: TURKSTAT, CBRT, WB staff estimations. In left panel, the horizontal axis represents months following the shock and cumulative responses are reported. In the right panel, cumulative responses at the end of 24 months are used to calculate the pass-through coefficients.

Corporates faced rising production costs and working capital needs while enjoying lower cost of borrowing in 2022 and in the first half of 2023

Average cost of production increased significantly through 2022 on the back of lira depreciation and high inflation but eased in 2023H1 before accelerating again in 2023Q3. The significant depreciation of the lira caused a surge in cost of imported inputs and the wage adjustments increased the cost of labor contributing to rising cost of production (Figure 12). Meanwhile, corporates enjoyed low cost of borrowing (with negative real interest rates), which helped them finance their increased working capital needs (Figure 13). Overall, despite cost increases, corporates enjoyed a significant increase in their sales and profits given the strong domestic demand. The recent increase in interest rates, however, has pushed the real interest rates into positive territory resulting in more stringent financing conditions for corporates which might increase corporate vulnerability (as will be discussed in section III).[3]

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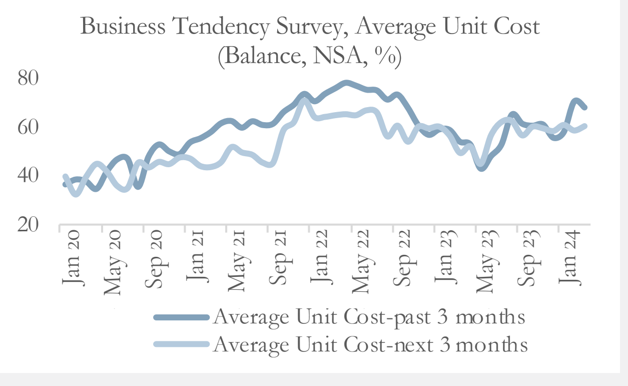
Figure 12: Corporates faced higher cost of production...



Sources: Haver Analytics, TURKSTAT, CBRT.
Notes: Balance: Difference between percentage of "increase" and "decrease" responses

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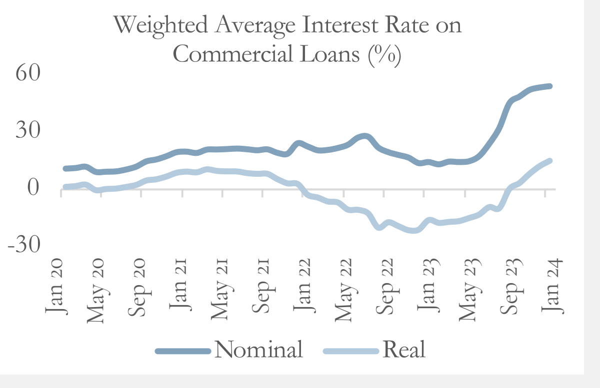
Figure 13: ...while enjoying negative real cost of borrowing



Sources: Haver Analytics, CBRT, WB Staff calculations.
Notes: For calculating real rates, 12-month ahead inflation expectations are used.

The financial sector, supported by the gradual simplification of macroprudential policies, remained resilient amid challenges

The financial landscape in Türkiye has undergone significant changes, driven primarily by policy interventions, macroeconomic challenges, and market dynamics. Under the 'Liraization Strategy', the CBRT introduced measures aimed at stabilizing the lira, and guiding selective credit growth, and reducing FX demand. Notable interventions include the 'FX-protected TL deposit scheme' and adjustments to reserve ratios. This regulatory approach impaired banks' lending practices, and indirectly supported the domestic government bond market. Real credit growth declined mainly in private banks, while state banks continued to push their loan offerings at the expense of straining their capital buffers. As a result of lower credit growth compared to deposit increase, the loan to deposit ratio decreased significantly since the high of 121 percent at end-2017 to 88 percent at end-2022 (108 percent end-2020). The uncertainties combined with tight credit conditions increased corporate funding challenges,

3. The MPC argues that selective credit tightening may also lead to the improvement in the distribution of financing sources, which will have positive effects factor productivity.
https://www.tcmb.gov.tr/wps/wcm/connect/EN/TCMB+EN/Main+Menu/Announcements/Press+Releases/2023/ANO2023-37

particularly for SMEs, and depreciation also increased banks and corporates' FX risks. In addition, high inflation eroded the savings of households, pushing them towards FX, gold, real estate, and other assets for genuine returns, which led to a significant real increase in asset prices.

The new economic team has started to gradually unwind the complex network of macroprudential regulations of the financial sector in Türkiye. Recently introduced monetary policy normalization and gradual easing of macroprudential policies to improve the functioning of transmission mechanisms will provide buffers for banks' profitability and capital adequacy. Banks have already started to ease their commercial lending conditions amid high demand for corporate finance despite rising loan costs. However, higher policy rates and still very high inflation keep the loan growth contained. Despite the very high nominal rates, the real loan growth (yoy, adjusted by the annual CPI inflation) as of 2023Q3 for state banks, domestic private banks and foreign banks was 5.1 percent, -16.8 percent and -9.5 percent, respectively.

The net FX position of the banking sector has improved significantly following the monetary policy normalization. Despite the slowdown in FX loan growth, the FX protected deposit scheme and TL supportive required reserve policies supported the net FX positions of banks with the FX net position/regulatory capital increasing from -1.1 percent in February 2023 to 4 percent in February 2024. Despite episodes of increased uncertainty and volatility in the past years, banks were able to roll over their external debt at above 100 percent during postelection period, albeit at higher costs. Turkish banks' short-term external debt stood at US$69.9 billion as of January 2024. Banks continue to show maturity mismatches along their historical averages with a maturity mismatch of 9.3 months for TL assets and liabilities, and a mismatch for foreign currency assets and liabilities of 5.8 months as of 2023Q3.[4] FX liquid assets over FX short-term debt ratio stood at 259% as of February 2024.

Banks' reported capitalization is supported by solid free provisions for reserve coverage of distressed loans. The capital adequacy ratio (CAR) across the banking sector increased from 18.7 percent in 2020 to 19.5 percent in 2022. State banks' CAR stood at 15.7 percent in 2022 compared to 23.1 percent for domestic private commercial banks, reflecting their stronger lending activity, intensified by sticky inflation and lira depreciation. As of 2023Q3 CARs stood at 15.9 percent, 21.2 percent and 19.9 percent for state banks, domestic private banks and foreign banks respectively (Figure 14). Private banks saw soaring profits thanks to wide net interest margins and inflation-indexed government bond holdings, which allowed them to boost their capital reserves. Returns on Equity increased from 11.4 percent to 49.9 percent between 2020 and 2022 for the whole banking system, with private banks enjoying higher returns than state banks (50.1 percent versus 27 percent in 2022). Additionally, banks are still using regulatory forbearance, allowing them to use a more favorable exchange rate to calculate risk-weighted assets, though this relaxation is gradually being phased out. Removing or quickly tightening forbearance without a consistent decrease in macroeconomic and financial stability risks, along with stabilizing FX rate, might cause the capital ratios of some banks to approach the minimum thresholds of 12% target ratio set by BRSA for Turkish banks.

Gradual monetary policy normalization will limit the potential risks to asset quality. Nominal loan growth, largely driven by inflation, improved the NPL ratio (1.5 percent as of 2023Q3 compared to 4.1 percent in end-2020). Besides the credit growth, slow-down in new NPL inflows and increase in NPL collections also helped the decrease in NPL ratio. There remain concerns related to the high credit growth during the pandemic, the effect of depreciation on FX-exposed firms, the high but declining stock of Stage 2 loans (8.0 percent, as of September 2023), and the rise of loan restructurings since 2018 (Figure 15). Corporate vulnerability has decreased, mainly driven by lower cost of borrowing and strong domestic demand. However, the recent tightening in the policy rate is translating into higher borrowing costs amid a slowing economy, which could negatively affect corporates financial soundness and lead to asset quality risks for banks (see Section III). Since 2018 banks have restructured their distressed assets[5] (as 55% of Stage 2 loans) and have built significant low NPL and free provisions to cover potential risks which can be further limited by the balanced and gradual policy normalization.

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4. Financial Stability Report, November 2023, https://www.tcmb.gov.tr/wps/wcm/connect/EN/TCMB+EN/Main+Menu/Publications/Reports/Financial+Stability+Report/2023/Volume+37
5. Banks Association of Türkiye (https://www.tbb.org.tr/en/Content/Upload/Dokuman/1222/Classification_Of_Loans_September_2023.pdf)

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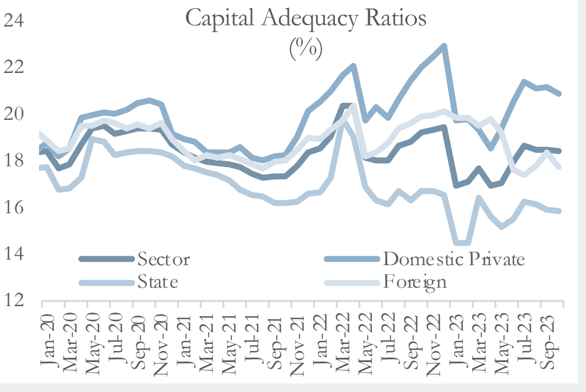
Figure 14: CARs have improved recently



Sources: Haver Analytics, BRSA

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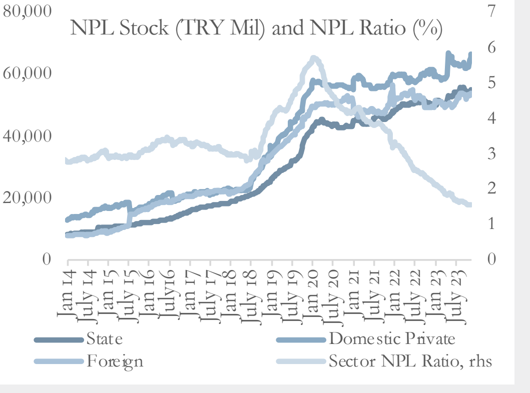
Figure 15: Sector level NPL ratio is low



Sources: Haver Analytics, BRSA.

The rising expenditures and earthquake related investment needs have implications on overall fiscal balances

The budget deficit remained manageable in 2022 with a positive primary balance over the year. However, in 2023 the budget deficit significantly widened with a primary deficit (Figure 16). The significant increase in expenditures stemmed from significant increases in personnel expenditures, current transfers primarily to compensate for high inflation and current and capital transfers to support earthquake recovery. In July, a supplementary budget was issued, around one fourth of the size of the 2023 budget. In this framework, significant tax increases were introduced, including a 2-percentage point increase in VAT and a significant hike in fuel Special Consumption Tax (SCT). In spite of these tax increases, however the 12-month cumulative primary balance as of December remains in deficit, around 2.7 percent of GDP (Figure 17). The budget deficit was largely financed with domestic borrowing in 2023.

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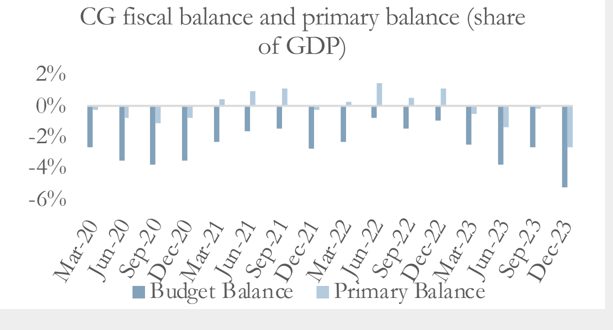
Figure 16: Strong fiscal balance has been deteriorating



Sources: MOTF. Notes: 2023Q4 value is WB staff estimate.

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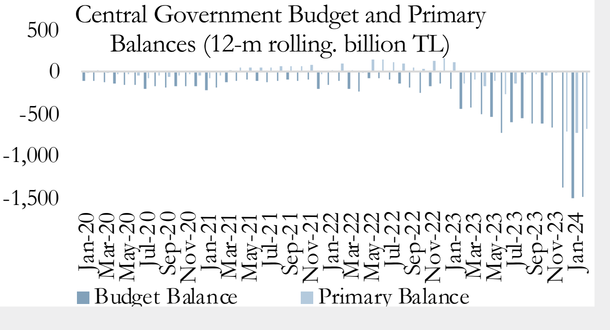
Figure 17: …and primary surplus turned into deficit

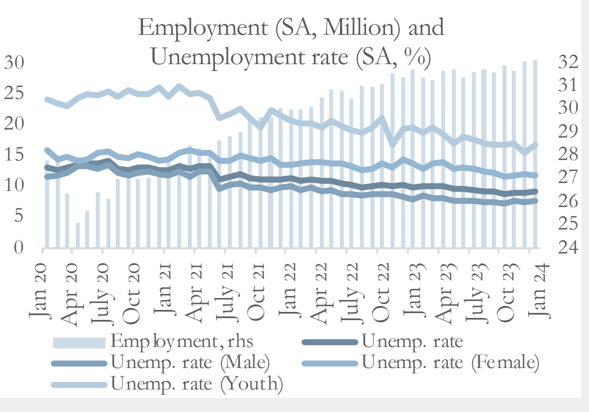


Sources: MOTF

Robust employment and wage growth continue in 2023 with unemployment declining

The number of people employed reached an all-time high in 2022 and continued to increase in 2023 along with buoyant economic activity. As of January 2024, the seasonally adjusted number of employed people reached 32.2 million (Figure 18). Meanwhile, the strong employment growth also led to a decline in unemployment rates, as the total unemployment rate came down to 8.6 percent in October 2023, the lowest reading since mid-2013, before edging to 9.1 percent in January 2024. The reduction in unemployment was more pronounced for men and for the youth. Yet, the youth unemployment remains high at 16.6 percent as of January 2024. Wages also continued to grow, with gross wages and salaries index surpassing annual CPI inflation in 2023Q3 (Figure 19).

> > >
Figure 18: Total employment is at record levels, while unemployment rates fell to lowest levels since mid-2013



Sources: TURKSTAT.

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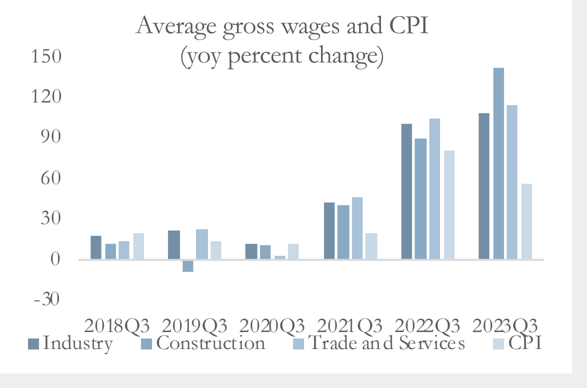
Figure 19: Gross wages have increased more than CPI in yoy terms



Sources: TURKSTAT. Note: Quarter averages are used.

Despite robust labor market performance and wage increases, the poorest appear to have been hurt the most by inflation in a similar pattern observed across many countries. Inflation weighs more on the consumption of poorer households because most of their income is spent on necessities. For instance, the share of food and non-alcoholic beverages in consumption basket went up to 35.8 percent in 2022, from 30.7 percent in 2019 for the bottom quintile, while it only increased by 1.3 percentage points to 16.6 percent for the top quintile. Coupled with the rapid increase in food prices (food inflation being higher than headline inflation), it forced poorer households to spend a much higher proportion of their income on food items, cutting back spending on other goods and services. The prior loose monetary policy stance may also have been benefitting the wealthier segments of the population. First, with higher credit scores, they might have disproportionately benefited from effectively negative interest rates on consumer loans. Second, imported goods might constitute a higher share of consumption of the wealthier households, thus they may have also benefitted more from the relatively stable lira (resulting from interventions to limit pace of depreciation) until the May 2023 elections, which effectively subsidized prices of imports.

The poverty rate continued to decline while inequality has increased in 2021 in Türkiye. The latest available micro data reveals that the poverty rate declined from 9.8 percent in 2020 to 7.6 percent in 2021, mainly driven by changes in labor earnings affected by the minimum wage hike in 2021 (Figure 20).[6] At the

6. In 2021, 55% of observed decline in poverty is due to labor earnings. The second largest contributor is pensions (19%), followed by business income (14%) – as per decompositions using Shapley value.

same time, income inequality widened. The Gini coefficient increased from 43.2 to 46.0 (Figure 20). This dynamic of simultaneous reduction in poverty and increase in inequality is explained by two facts: first, the high growth rate in 2021 (11.4 percent) which more than offset the increase in inequality; and second, the fact that the bottom and, particularly, the top deciles were the ones that benefitted the most from growth between 2020 and 2021 (Figure 21). Growth in incomes among the top decile significantly exceeded growth in all other income deciles, -a deviation from recent historical trends- further strengthening the income inequality. The macroeconomic indicators suggest that the income of the top deciles may have been growing at disproportionally high rates due to the surge in asset prices such as housing, and rents, and from the transfers of the FX-protected deposit scheme. Overall, income growth -rather than redistribution- continued to be the main source of poverty reduction between 2020 and 2021 (Figure 22). While the bottom decile experienced the highest increase in labor income (26 percent), the top decile benefitted the most from increase in business income. Some of the increase in labor income among the bottom decile may be attributed to improvements in the quality of jobs, potentially associated with the rebounding from the COVID-19 pandemic in 2021 as the share of those working in casual employment declined and the share of full-time employees increased the most among the bottom decile (Figure 23).

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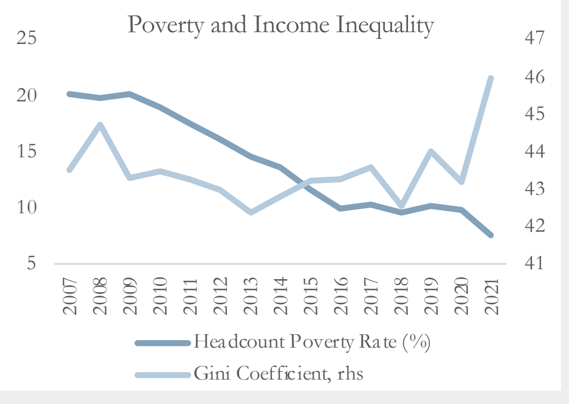
Figure 20: Poverty continued to decline in 2021, income inequality has increased



Source: WB staff calculations using SILC 2008-SILC 2022 data from the TURKSTAT. Notes: Income reference periods are the previous calendar year. Per capita income is used as welfare aggregate. Absolute poverty line of US$6.85/day at 2017 PPP.

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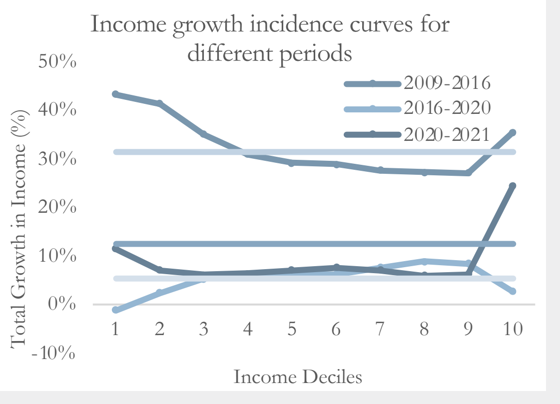
Figure 21: The income growth of top 10 decile was relatively higher in 2021



Sources: TURKSTAT SILC Data, WB staff calculations

Notes: Using per capita income in PPP terms as welfare aggregate

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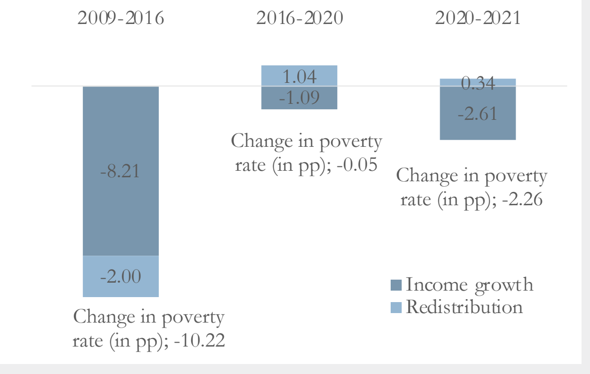
Figure 22: Datt-Ravallion decomposition of poverty reduction (2020-2021)



Source: WB staff calculations using SILC data from the TURKSTAT.

Notes: Decomposition based on Ravallion et al. (1991).

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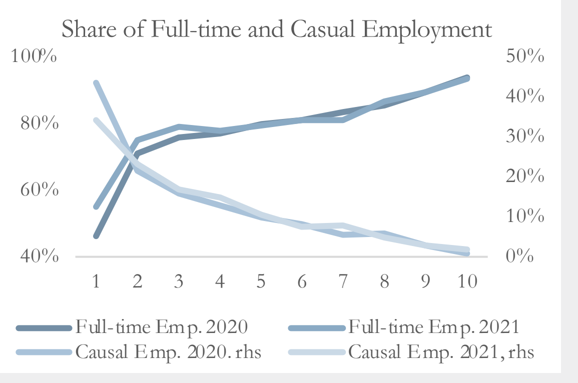
Figure 23: The share of casual employment is declining



Sources: TURKSTAT SILC 2021-2022 Data, WB staff calculations.
Notes: Full time employment: worked in a full-time job at least 9 months.

Taking a long term perspective, the reduction in poverty rate is remarkable. The headcount poverty rate declined from 20 percent in 2007 to 7.6 percent in 2021. Moreover, the downward trend, which stagnated over 2016-2020, remerged with the latest available data. However, income inequality -measured by the Gini coefficient- has followed a U shape over the last two decades, declining until 2013, before picking up afterwards. Significant decrease in informality, increased participation of women in the labor force, and declining spatial inequalities since the mid-2010s should have contributed to lower inequality. Yet, inequality increased over this period. One potential explanation for the rebound of income inequality might be linked with sectoral shifts in the economy and demand for different skills.[7] The declining share of employment in agriculture (from around 20 percent in the mid-2010s to around 15 percent now), and in construction (from around 7 percent in the mid-2010s to around 6 percent now) could signal a lower demand for low skilled workers, which could then have implications on income inequality.

7. Other factors such as wealth concentration, tax policies, wage gaps, automatization, shrinking income share of the middle class and the disproportionate income increase of the top decile could also play a role. Regarding the sectoral shifts, the move from labor-intensive sectors towards more technology-driven industries might leave low-skilled workers behind, leading to stagnant wages and widening income gaps.

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II. Looking Ahead

Türkiye's normalization of macroeconomic policies after the elections introduces both opportunities and challenges. The reorientation of monetary policy to restore price stability, the adoption of disinflation as a main policy target by the entire administration, and the strong support for the Medium-Term Program, all contribute to stabilize the markets and build confidence in the economy. Yet, in the near-term economic growth is expected to slow on the back of policy tightening and slow global growth, while domestic (budget) and external (current account) imbalances persist with high inflation. The current outlook therefore calls for a careful calibration of policies aimed at maintaining stability and confidence and protecting the vulnerable and underscores the importance of tackling structural issues to strengthen the economic performance.

A. A period of the normalization of macroeconomic policies

The recent steps taken towards normalization of macroeconomic policies are expected to boost confidence, mitigate macrofinancial risks, and support the vulnerable

After the May elections, the government started implementing a new policy mix centered on reducing inflation while maintaining financial stability and keeping the economy growing. The policy mix includes tight monetary policy and selective fiscal tightening accompanied with income policies and a reform agenda. Given multiple challenges built up over the past few years, a gradual process of policy normalization that allows for corrections appears appropriate, though this means that it will take time for the results to be evident. The strategy of the government, which was outlined in the Medium-Term Program announced in September 2023, prioritizes (i) anchoring inflation expectations relying on a credible (and tight) monetary policy and on forward policy guidance, (ii) building back external reserves to comfortably withstand external volatility, and (iii) keeping fiscal policy prudent and well targeted to protect the poor. The task is not easy given the complexity of the adjustment needed to achieve macroeconomic stability. Adjusting the policy rate, assuring the flexibility of the exchange rate, and simplifying the macroprudential measures require a cautious and calibrated approach. For instance, a rapid exchange rate depreciation would feed into inflation; very strong rate hikes might hit corporates and the financial sector; or a fast unwinding the complex web of macroprudential measures might threaten financial stability.

New settings for monetary, fiscal, and income policies have introduced a relative stability in the markets, boosted confidence and reduced uncertainties. The current tightening of the monetary policy and measures taken to improve fiscal outlook helped improve the risk perceptions in the economy. Reflecting greater investor confidence, CDS spreads have come down from 679 in mid-May, to under 300 in December, their lowest level in two years; and three major rating agencies have upgraded the outlook for the Turkish economy recently, with one of them increasing the rating as well, raising the prospects for further upgrades in Türkiye's sovereign ratings.

The policy normalization will likely initially result in a period of depreciated lira and slower economic growth, as the economy corrects the imbalances of the recent past

The current policy framework aims at correcting domestic and external imbalances to secure macroeconomic stability. Such a correction is expected to be gradual and to lead to a moderate growth path over the coming years in the baseline scenario.

Key Macroeconomic Indicators

	2022	2023	2024	2025	2026
Real GDP Growth	5.5	4.5	3.0	3.6	4.3
Inflation (%, year average)	72.3	53.9	57.8	28.9	16.4
Inflation (%, end of period)	64.3	64.8	43.1	23.1	12.2
Current account balance (% of GDP)	-5.4	-4.1	-2.8	-2.4	-2.5
General government balance (% of GDP)	-1.0	-5.4	-5.4	-3.7	-2.4

Notes: 2023 general government balance and all 2024-2026 values are WB staff estimations.

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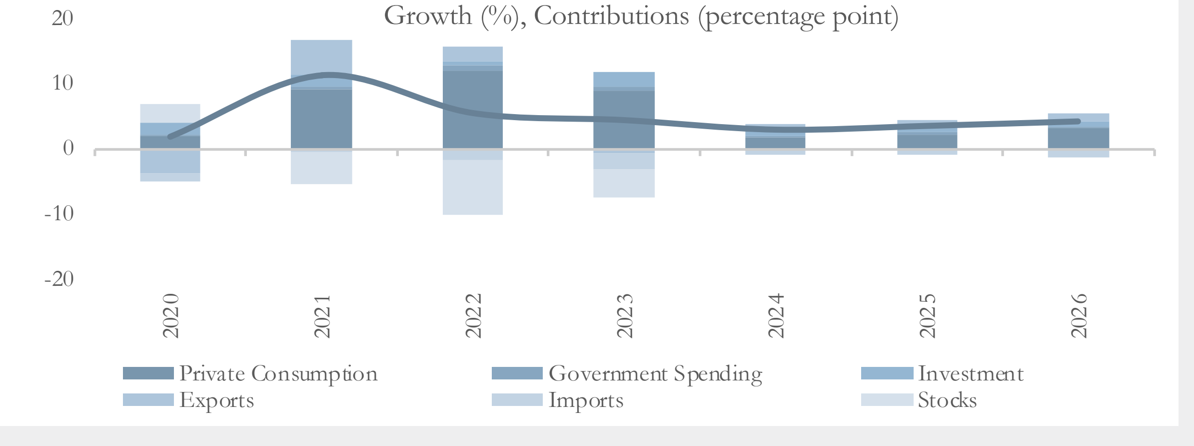
Figure 24: Domestic demand has been the main driver of growth, and to a lesser extent in upcoming years



Source: TURKSTAT and WB staff calculations.

Economic growth is expected to moderate in 2024 and pick up in 2025 and 2026. After expanding 11.4 percent in 2021, 5.5 percent in 2022, and 4.5 percent in 2023, the economy is expected to grow at 3.0 percent in 2024 according to our estimates (Figure 24). Economic activity has started to weaken in the second half of 2023, as inflation eroded the purchasing power of households, slower consumer credit growth hampered the frontloading of consumption by households, and external demand weakened. Private consumption, which grew strongly in 2023H1 with the help of sizeable wage increases and availability of cheap credit, was the main driver of growth in 2023. Nonetheless, the pace of private consumption appears to have moderated starting in the second half of 2023 due to the monetary policy tightening and the slowdown in credit growth, and it is projected to further slowdown in 2024, and to recover moderately in later years. The increased welfare effect felt by those who have benefitted from the recent rapid increase in asset prices (i.e., house prices, rents, stock market, FX-protected deposit scheme) may contain the expected slowdown in private consumption. Government consumption also had a significant contribution to growth in 2023 due to the stimulus measures and earthquake reconstruction related expenditures. However, going ahead the growth of government consumption is expected to be much lower in line with the expected fiscal consolidation. Meanwhile, investment growth was strong in 2023 primarily due to negative real interest rates on credits which was observed in the first half of the year. However, with the impact of monetary tightening, investment growth is expected to slowdown in 2024 before gradually improving in 2025 and beyond. The contribution of net exports has been negative in 2023. The loss of competitiveness from the appreciation of the lira and the slowdown in the major trade partners have put a strain on exports in the first half of 2023, and despite the recent depreciation of the lira since May. Meanwhile, with a strong domestic demand, imports grew rapidly in 2023 as well. In 2024 and onwards, however, the composition of growth is expected to be more balanced with lower contribution of private consumption, and a positive contribution of net exports.

Monetary policy is expected to remain tight, and inflation is expected to gradually decline after May 2024. The central bank projects inflation to fall to 36 percent by the end of 2024 and to continue its downward trend, receding to 14 percent by the end of 2025. The monetary policy is expected to remain tight for a long period to achieve a sustained disinflation path. In this perspective, inflation is expected to peak in May 2024, followed by a sizable decline in 2024H2 on the basis of policy impact and the base effects. Inflation will however remain high, with end-2024 inflation of slightly above 40 percent and with annual average inflation staying above 50 percent in 2024. In our baseline scenario of a period of moderate growth, the disinflation is expected to be gradual with average inflation staying in double digits in 2026 as well, while getting closer to single digit levels.

The current account balance is expected to further improve starting from 2024, on the back of the change in growth composition, relying less on domestic demand with a higher contribution of net exports. In this perspective, the current account deficit, which remained relatively high in 2023 (4.1 percent of GDP), is expected to further narrow down in 2024 (2.8 percent) and onwards. Moreover, the exchange rate is expected to continue its gradual depreciation pattern over the medium term; increased net financial inflows are expected starting from 2024H2 with increased confidence in the normalization policies and central bank reserves increasing accordingly.

The general government deficit is expected to be 5.4 percent of GDP in 2024, as the earthquake reconstruction adds to pressures from a rising public wage bill and pensions, before a stronger fiscal consolidation is observed in 2025 and 2026. Given the expected slowdown in the economy, the revenue generation will be more constrained, and the tax revenues to GDP ratio is expected to remain modest, despite an uptick due to tax rate hikes in 2023. Accordingly, the deficit is expected to be covered by additional borrowing and the debt to GDP ratio is expected to gradually increase in our baseline scenario.

Commitment to tight monetary policy until inflation expectations are anchored will support confidence, but the disinflation will be challenging.

Disinflation has been set as the main target of the macro policy mix by the new economic team in the government and the CBRT. The MPC of the central bank have started a cycle of aggressive increases in the policy rate, unquestionably reversing the earlier policy approach. The firm commitment of the government to disinflation has also been declared in the MTP. Nonetheless, the disinflation process will be challenging. First, the persistency of inflation, measured as the dependence of current inflation to lagged inflation, has increased considerably recently (Figure 25). Second, despite a decline in medium term inflation expectations -primarily for 12 and 24-months ahead-, even the 5-year ahead inflation expectations are not yet in single digits (Figure 26). Third, the pass-through of shocks to inflation has strengthened (Box 1). Therefore, the commitment to tight monetary policy until expectations are anchored to the inflation path forecasted by the authorities is needed for disinflation to be successful, as also highlighted by the CBRT. The CBRT also conducts liquidity measures to complement policy rate hikes. While these measures may help lower inflation in the short term, continuation of a tight monetary stance with clear forward guidance will be essential to help avoid excessive volatility in the capital markets, address dollarization, ease pressure on the lira, anchor inflation expectations, and reduce inflation.

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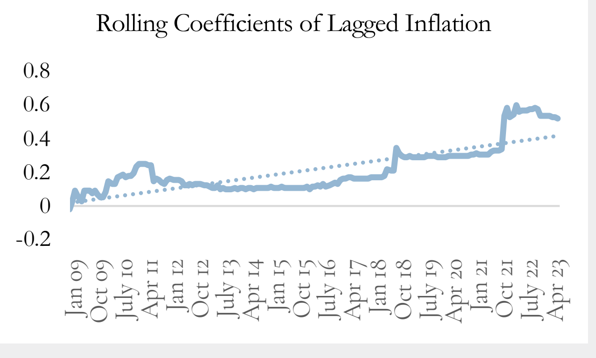
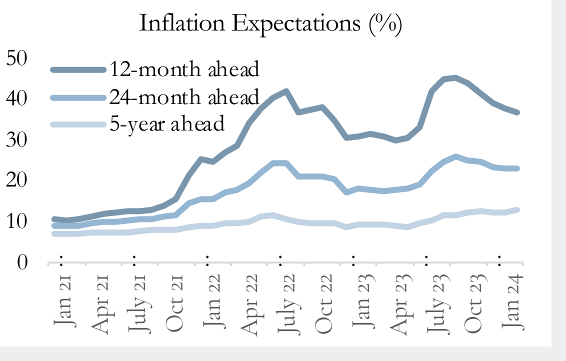
Figure 25: Persistency of inflation has increased



Sources: TURKSTAT, WB staff estimates.
Notes: The coefficient of past inflation in a regression where seasonally adjusted CPI inflation is regressed on its own lag, controlling for exchange rate, oil price, industrial production, and minimum wage changes, is reported for rolling samples of 48 months. Last sample ends in July 2023.

> > >
Figure 26: Even 5-year ahead inflation expectations are not in single digits



Sources: CBRT.

The growth-inflation tradeoff will likely kick-off starting in the last quarter of 2024. After peaking in 2024Q2, inflation is expected to start falling in the second half of the year with the impact of monetary policy tightening and with the help of base effects. However, reducing inflation over the medium term (along path outlined by the authorities) will entail a period of slower economic activity (reflecting the tradeoff between growth and inflation). The gradual approach considered in our baseline scenario outlined above, contains a moderate growth scenario in the medium term and therefore a gradual disinflation path. This approach of very gradual disinflation runs the risk of not effectively controlling the inflation expectations, which could further extend the duration of the disinflation process. An alternative scenario would be a frontloaded monetary tightening, which is more effective in anchoring inflation expectations and securing a faster disinflation. Moreover, a frontloaded tightening also helps prevent inflation from becoming stickier and costly to reduce to targeted levels in terms of forgone growth. On the other hand, a strong frontloaded tightening has initial contractionary impacts on the economy and may raise financial stability concerns as it may increase risks on corporate vulnerability, specifically for small businesses, (see section III). The central bank's latest Inflation Report alludes to another intermediate scenario where inflation reaches single digits in 2026, which comes at the cost of a sizeable output gap over the disinflation process pointing to a slower growth (but not a contraction) than in the baseline scenario discussed above. Overall, all alternative policy choices have pros and cons, and therefore a clear communication strategy is needed to bring the support of all the economic agents to achieve a sustained disinflation.[8]

The gradual adjustment of financial sector policies to reconverge to international standards will strengthen financial stability

The government and the central bank have already taken steps to improve the macro financial regulatory environment and continue converging with international norms. Policy efforts have been aligned with the FSAP recommendations.[9] The CBRT's efforts to increase the Lira's share in banking system and streamline access to credit and export loans are part of a broader strategy to enhance the monetary transmission mechanism. Simultaneously, the Banking Regulation and Supervision Agency (BRSA) should enhance its ongoing process of realigning regulatory standards with international norms to improve banking sector transparency. A significant focus is on managing systemic foreign exchange (FX) risks, exacerbated by the close relationship between the CBRT and domestic banks, with a substantial portion of the CBRT's FX liabilities tied to these banks. This necessitates a more assertive supervisory approach, including contingency plans for FX shocks and enhanced liquidity risk monitoring. Clear policy communication, effective corporate insolvency, and debt resolution frameworks, coupled with a financial policy framework aligned with international standards, are vital for de-risking the corporate and financial sectors.

The policies follow a balanced approach to maintain financial stability while addressing existing challenges. The recent tightening in the policy rate is translating into higher borrowing costs amid a slowing economy, which could negatively affect corporates financial soundness and lead to asset quality risks for banks. Removing or quickly tightening forbearance and faster monetary tightening without a consistent decrease in macroeconomic and financial stability risks, along with stabilizing FX rate, amid high stock of FX deposits and the FX-protected deposit scheme might cause potential stress for the financial sector. Carefully planned and well-communicated approach to normalizing policies will help to reduce overall financial risk.

Türkiye can benefit from the accelerating global trend of investors seeking green investment opportunities. Türkiye's vulnerability to climate change necessitates significant investment in climate mitigation, adaptation, and resilience, as highlighted in the World Bank's Türkiye Country Climate and Development Report (CCDR).[10] A projected investment of US$165 billion is required from 2022 to 2040, in addition to the US$482 billion baseline in sectors like power, residential, and transport. Accessible and affordable long-term finance will be needed for sustainable economic growth, the green transition, and job creation. This underscores the financial sector's critical role in mobilizing capital for Türkiye's green transition, going beyond the capacities of the public sector and banks, and necessitating the involvement of private capital.

8. As also alluded by the CBRT, the current policy rate tightening cycle is approaching to its limits. Our estimations based on Taylor rule type of analysis suggests that the current level of the policy rate is close to the levels consistent with reaching the disinflation path envisaged by the CBRT in 2024. Meanwhile, the tightness of the monetary policy should be maintained until the inflation expectations are in line with the targeted disinflation path for later years.
9. The Financial Sector Assessment Program helps countries identify financial system vulnerabilities and appropriate policy responses. The most recent report for Turliye is found here: https://www.imf.org/en/Publications/CR/Issues/2023/08/17/Republic-of-Trkiye-Financial-System-Stability-Assessment-538281
10. https://www.worldbank.org/en/country/turkey/brief/key-highlights-country-climate-and-development-report-for-turkiye

The development of a conducive environment for green finance is essential, particularly in anticipation of the growing financing demands due to the increasing frequency and severity of natural disasters. Regulators are at the forefront of greening the financial sector. The BRSA's Sustainable Banking Strategic Plan marked an early step in this direction, followed by the collaborative effort with the Banking Association to develop the Green and Sustainable Banking Guideline, aligning with international best practices. Subsequently, the Green Asset Ratio Communique and Climate Risk Management Guidelines were introduced last year. A Draft Guideline on Effective Management of Climate-Related Risks by Banks has been prepared for the identification, measurement, monitoring and control of climate-related risks to which the banking sector may be exposed, and this guideline is planned to be put into practice by the end of 2024. In the capital markets, the Capital Markets Board (CMB) issued the "Guidelines on Green Debt Instruments, Sustainable Debt Instruments, Green Lease Certificates, and Sustainable Lease Certificates" in 2022, promoting green capital market instruments and enhancing their capacity in sustainable and green finance analytics. This comprehensive approach aims to foster a robust, inclusive, diversified, and sustainable financial system in Türkiye, aligning with macroeconomic fundamentals and international banking standards, clarifying regulatory roles, and bolstering the central bank and financial regulators' operational independence.

Elevated investment needs and high inflation warrant a cautious and well targeted fiscal policy

Securing the disinflation requires support from fiscal policy as well. The previous loose monetary policy stance had put much pressure on fiscal policy measures to compensate for the widening external imbalances and to help ease the pressures on the lira (such as with the introduction of FX-protected deposit scheme). With the normalization of the monetary policy stance, fiscal policy can now concentrate on the earthquake recovery related investments needs, and on supporting vulnerable groups against high inflation, while keeping a prudent fiscal stance. To support the disinflation, changes in administered price and public wage adjustments should be benchmarked against the predicted inflation path, rather than historical inflation, as already been indicated in the MTP.

Effective use of available fiscal space whilst maintaining fiscal sustainability will be important going forward. In the MTP, the government announced projections for the fiscal balance with and without expenditures related to earthquake recovery. For 2023, the budget deficit was predicted to be 6.4 percent of GDP including earthquake related expenditures (current and capital), and a lower 3.4 percent of GDP when earthquake related expenditures are excluded. Meanwhile, the realization was 5.2 percent of GDP including earthquake related expenditures, 1.6 percent of GDP when earthquake related expenditures are excluded. This suggests a deterioration in the fiscal performance compared to previous years. Moreover, according to the MTP, the budget is expected to yield a primary surplus only in 2026. This very gradual return to primary surplus may reduce the effectiveness of the polices for disinflation.

A new window of opportunity to consider structural reforms

The period ahead also provides opportunities for tackling structural issues. In the 2024-2026 MTP, the government has expressed its commitment to advance structural reforms over the next three years on areas including growth and trade, human capital and employment, price and financial stability, public finance, disaster management, green and digital transformation, business and investment environment. For instance, reforms addressing structural issues related to price stability (such as backward-looking wage indexation), and to financial stability (such as improving the macro financial regulatory environment), will make the transmission mechanism work better and thus help achieve macroeconomic stability faster. Reforms aimed at ensuring flexibility in the labor market, improving the business and investment environment, enabling digital transformation, and deepening trade opportunities, will all help to increase the resilience of the economy and competition, and to boost productivity, which in return will ease the output cost of achieving disinflation.

The greening of the economy stands out as an important opportunity that could lead to both higher growth and increased productivity. For example, the European Union's Carbon Border Adjustment Mechanism (CBAM), which will come into full force in 2026, is an opportunity for the Turkish industry. With geographical advantage, strong trade links with the EU and having started decarbonizing the power sector, Türkiye can be a first mover and use the comparative advantage by decarbonizing its industry, to secure competitiveness gains and boost productivity. Also, in a broader context, addressing climate change challenges constitutes an important opportunity for Türkiye in achieving a sustainable and resilient future.[11]

11. Transatlantic Policy Quarterly, Addressing Climate Change in Türkiye: An Opportunity for a More Sustainable and Resilient Future - Vol. 22 · No. 3 · Fall 2023; http://transatlanticpolicy.com/issue/90/addressing-climate-change-in-turkiye-an-opportunity-for-a-more-sustainable-and-resilient-future

B. Several risks can affect the path of economic growth and poverty reduction

While the new macroeconomic policy mix represents a significant change in a positive direction, it is important to remain committed to pursuing these policies. The new direction in macroeconomic policies following the May 2023 elections has been welcomed by domestic and foreign investors, as reflected in the significant reduction in CDSs and the change in the outlook by credit rating agencies, with one rating upgrade, which are important initial achievements. However, the authorities' commitment to these policies, which will determine the nature and duration of the necessary macroeconomic adjustment will be crucial. Staying the course with the policy normalization would further strengthen the confidence in the economy.

Moreover, there are several downside risks in the near term. While the new macroeconomic policy mix will return the economy to a macro sustainable path, vulnerabilities to domestic and external shocks remain elevated. The government's fiscal position while strong, is vulnerable to rising borrowing costs, the high share of FX-denominated debt, growing current and capital expenditures related to earthquake recovery, increasing rigidity of public expenditures, and pressing needs to support vulnerable groups during the disinflation phase. Moreover, despite an increase in FX reserves and a decline in the current account deficit in the second half of 2023, external risks still remain given the relatively high current account deficit and the high external financing requirements. Further, in a global context where the global growth is expected to further decelerate in 2024, the external demand will contribute to a domestic slow down due to the projected stagnation in global trade and the increased overall uncertainty associated with geopolitical tensions (GEP January 2024). Also, the period ahead distinguished by monetary tightening and slowing growth prospects may trigger vulnerabilities in the corporate sector which may have repercussions on financial sector (see Section III). Each of these areas of risk are elaborated below.

Fiscal risks accumulate on earthquake related expenditures, contingent liabilities, wages

Rising contingent liabilities and rigid expenditures may increase fiscal risks going forward. The main priorities of Türkiye's debt management policies are the sustainability and reduced sensitivity of the debt stock to macroeconomic variables. Nonetheless, the high share of FX-denominated debt (64 percent as of December 2023) makes further depreciation of the lira a major risk to the public debt burden (Figure 27). Rapid exchange rate movements can also adversely affect the fiscal position through lending to SOEs to cover import bills (primarily energy), PPP debt assumption commitments, and PPP guarantees, for which the allocated appropriations in the central budget law may fall short if the depreciation exceeds the projected level. The transfer of the FX-protected deposits originating from TL deposits to the central bank helped reduce the burden of the scheme on the fiscal side. Also, steps taken by the central bank helped the initiation of destocking of the scheme, with the value of FX protected deposits falling to around US$90 billion at the end of 2023, from its peak of around US$140 billion in August. Additional risks relate to wages of public servants and retirees, and to the changes in the retirement system. The wage adjustments were expected to be in line with the expected disinflation path as mentioned in the MTP, however, together with the inflation differences, the wages increased by 49.3 percent in January 2024. Moreover, in addition to the approval of the early retirement scheme in 2023, the recent plans to shorten the retirement eligibility criteria for self-employed will further increase the risks fiscal expenditures. Meanwhile, the expected slowdown in economic activity will highlight the risks on fiscal revenues.

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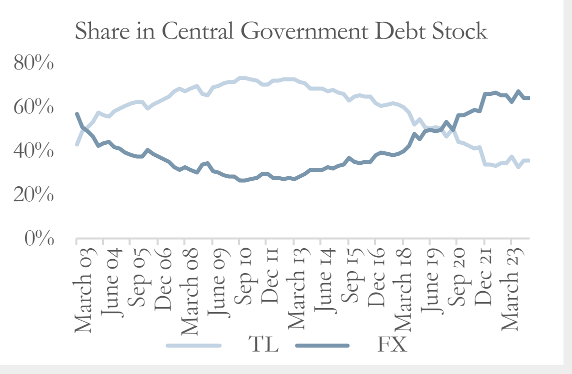
Figure 27: Currency composition of government debt poses risks



Sources: Ministry of Treasury and Finance.

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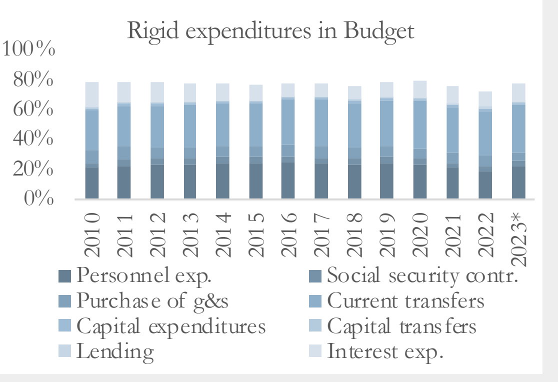
Figure 28: The share of rigid expenditures in the budget is high



Sources: MTOF, WB Staff estimates.

**2023 first 9 months.*

Moreover, the increase in the share of rigid expenditures in the budget significantly reduces the flexibility of fiscal spending. Recent estimates suggest that, despite being close to historical averages, the rigidity of the budget expenditures has increased in 2023, primarily due to heightened personnel expenditures and interest payments (Figure 28).[12] Accordingly, around three-fourths of budget expenditures are considered as rigid, significantly leaving a smaller room for reprioritizing expenditures. In addition, capital expenditures, a large proportion of which is considered as flexible, will also exhibit additional rigidity in the near term due to earthquake related investments.

External imbalances continue despite a recovery in reserves

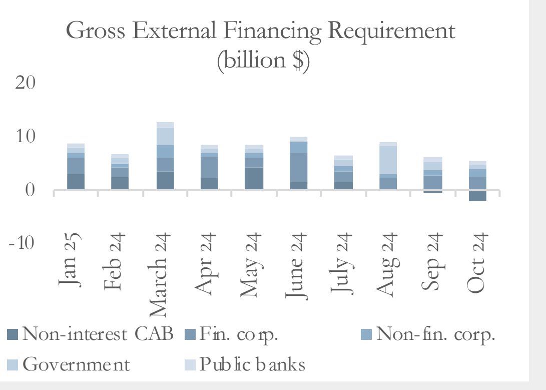
Despite a modest return of capital inflows and recovering reserves, Türkiye's external balance sheet remains vulnerable amid high external financing needs and continued lira depreciation. Non-resident net portfolio inflows turned positive for nine consecutive weeks following the May 28 elections after a net outflow of US$1.6 billion between January and the elections, and have been volatile since, with net inflows totaling US$5.5 billion since the elections (as of February 9 2024). As a result, central bank net reserves have started to recover, albeit slowly, reaching US$28.8 billion in early-February 2024 from US$–5.7 billion in early June 2023. But swaps with other central banks and domestic banks continue to make up a significant portion of foreign currency reserves[13], as well as commercial banks' FX-denominated required reserves held at the central bank (Figure 29). There could be a risk of competing demand for FX between the Central Bank and commercial banks in the event of a future shock. Moreover, gross external financing requirements (GEFR) are expected to increase in the coming months. Excluding foreign exchange currency, the deposits of non-residents, and trade credits, the monthly GEFR is estimated at around US$8.9bn between up to October 2024 (Figure 30). A large proportion of debt maturing is expected to be rolled over, resulting in a much lower net external financing requirement. However, continued depreciation of the lira would put additional pressure on external balances, as according to the Central Bank's March Survey of Market Participants, the lira is expected to continue to depreciate over the next 12 months, reaching 42.8 TL/USD.

12. An approach to classify the rigid expenditures in Türkiye is proposed by Çebi (2015). Instead of classifying the expenditures by entire categories, the study determines the share of flexibility of each major spending item in the budget. Using this approach, the rigidity in the budget has been calculated for the recent period.
13. As well as other aggregate short and long positions in forwards and futures in currency markets.

> > >
Figure 29: Swaps and FX required reserves make up a significant portion of foreign currency reserves

Source: CBRT
Notes: Other assets includes IMF reserve position and SDRs. Swaps include aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the domestic currency (including the forward leg of currency swaps). FX required reserves include other contingent liabilities. Other short-term drains include collateral guarantees on debt falling due within one year and other accounts payable and receivable.

> > >
Figure 30: External financing needs are increasing in the coming months



Source: CBRT, Ministry of Treasury and Finance, WB staff estimates and calculations.
Notes: Does not assume any changes in foreign exchange deposits and excludes trade credits.

> > >
Box 2: Measuring the international reserve position of the CBRT

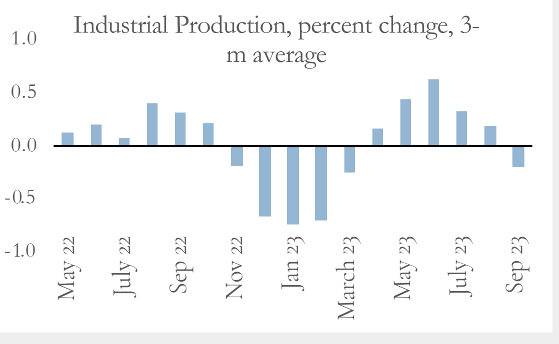
When assessing a central bank's reserves, several terms are used to describe the nature and composition of the reserves. These include:

- Gross reserves – Gross reserves represent the total holdings of foreign currency and gold (or other precious metals) by a central bank as well as IMF reserve position and SDRs. Gross reserves are used to manage the value of the domestic currency and to cover international debt obligations, among other purposes. In early-February 2024, gross reserves of CBRT amounted to US$134.9 billion.
- Net reserves – Net reserves are gross reserves minus short-term foreign currency liabilities and forward commitments. In other words, net reserves show the amount of reserves that are readily available without any impending liabilities, and thus is a more accurate measure of the ability to deal with external economic shocks. In early-February 2024, net reserves amounted to US$28.8 billion.
- Liquid reserves – Liquid reserves, which refer to those assets that can be quickly and easily converted into cash or other liquid assets without significant loss of value, usually consist of cash, Treasury bills, and other highly liquid assets. These are crucial for countries and institutions to meet their short-term obligations and to intervene in the foreign exchange markets if needed. In early-February 2024, liquid reserves are estimated by World Bank staff to be US$41.1 billion.

Global economy is on a low-growth trajectory with amplified geopolitical tensions

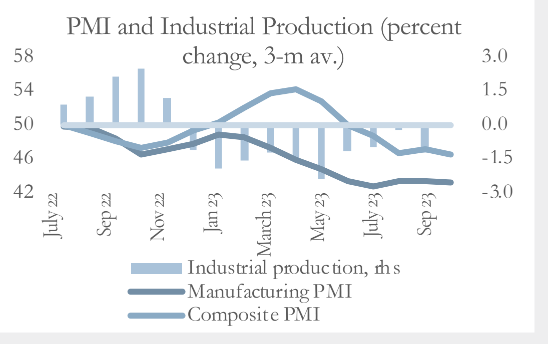
Global growth is expected to experience a significant decline in 2023, with a further slight downturn in 2024. The impact of tight monetary policy and weakened trade persists, alongside the long-lasting damages from the COVID-19 crisis and the shock from the Russia's invasion of Ukraine. Over the past months, global activity has continued to slow with global industrial production (excluding China) decreasing slightly at the end of 2023 Q3 (Figure 31). The manufacturing sector remains weak, with elevated financing costs and decelerating global goods demand. PMIs for services sectors continue to signal expansion but have deteriorated notably, reflecting weaker indicators for employment growth and order backlogs. While the United States experienced robust growth due to strong domestic demand, the euro area growth remains sluggish, and economic momentum weakened in emerging and developing economies (EMDEs). Growth is expected to decelerate in advanced economies in 2024, while EMDEs aggregate (excluding China) is projected to rebound modestly from a cyclical low. However, the outlook remains challenging in many countries facing elevated financing costs, high debt, and geopolitical conflicts.

> > >
Figure 31: Global IP slightly decreased in Q3



Sources: Haver Analytics; World Bank.

> > >
Figure 32: Euro area activity is still weak



Sources: Haver Analytics; World Bank.

Sluggish euro area growth may restrain Türkiye's export performance. Growth decreased slightly by 0.1 percent (q/q sa) in 2023Q3, and to the same extent in Germany, Türkiye's main export destination. Manufacturing activity in particular remains lackluster, with manufacturing PMI in contractionary territory-below 50- as of November (Figure 32). The subdued growth outlook in the euro area puts risks on Turkish exports and economic activity since the EU is the main trading partner of Türkiye and the income elasticity of exports to EU is higher than other main export regions.[14]

Despite the monetary policy tightening cycle approaching to an end, global interest rates are likely to remain high for a longer period. Global headline and core inflation are decelerating, reaching both 4.3 percent in October, in the context of a slow decline in commodities prices–but with levels still above the 2015-2019 average. Inflation remains above the targets in many countries. Higher-for-longer path of policy rates than was expected in June 2023 and lagged effects of the tight monetary policy will continue to prevent a more dynamic recovery, most of the advanced countries continue to tighten (Figure 33). The tight monetary stance in advanced countries both increases the cost of external borrowing for Türkiye and limits the inflow of financial funds putting pressure on Turkish lira.

14. Culha and Kalafatcilar (2014) find that the income elasticity of Türkiye's exports to Euro area is higher than to other regions.

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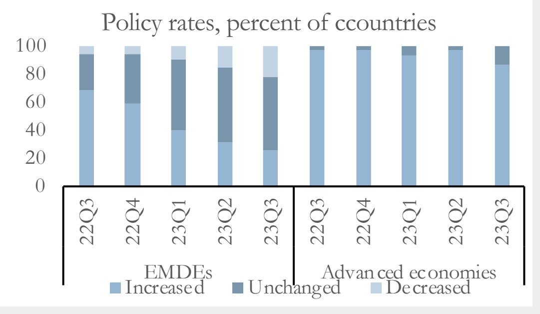
Figure 33: Policy rates are rising in advanced economies



Sources: Haver Analytics; World Bank.

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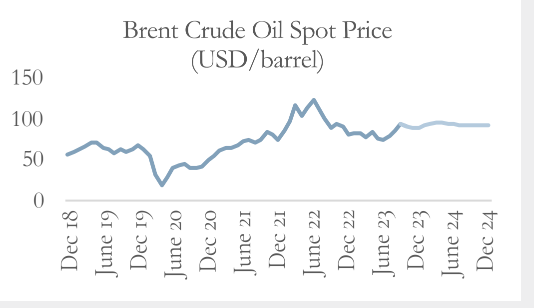
Figure 34: Oil price remain high



Sources: Energy Information Agency forecast, November 2023.

Overall, risks to the global economy are still tilted to the downside. Stickier-than-expected inflation could trigger a further tightening of monetary policies and a potential reversal in risk sentiment in financial markets. The recent conflict in the Middle East, coupled with Russia's invasion of Ukraine, has significantly heightened geopolitical risks, with potential adverse global impacts on financial markets, trade, confidence, and commodity -primarily energy- prices (Figure 34). Other risks include financial stress related to sharp increases in long-term yields, lower-than-expected activity in China, trade fragmentation, and climate-related disasters.

Slowing economic growth poses risks to poverty reduction in the medium term

Türkiye has made considerable progress in reducing poverty, but recent developments pose challenges to continuing sustained poverty reduction. First, economic growth is slowing down. There will be less growth in incomes, which has been a primary driver of poverty reduction until now (Figure 22). Second, increase in income inequality poses a risk to sustained poverty reduction. International evidence suggests that inequality deters poverty reduction.[15] The recent policy changes – such as increase in minimum wages in 2022 and 2023 - may sustain poverty reduction in the short run, as in 2021. However, such a reduction may not be sustainable, especially considering that slowing growth may limit the government's ability to protect the poorest due to lower fiscal revenues. More equitable growth and prioritizing income inequality reducing policies are needed to ensure sustained poverty reduction over the long run. The protective capacity of the fiscal policies in Türkiye are mainly channeled to protecting the vulnerable -through current transfers- rather than directly targeting redistribution.[16] Social assistance programs and pensions are well targeted, but should be scaled up to mitigate income inequality. Also, the significant role of indirect taxes -which are regressive in nature- limits the potential benefits of taxation in correcting income inequality.

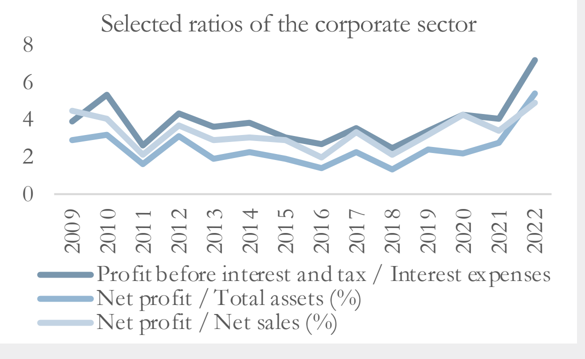
15. For instance, Lakner et al. (2019) find that reducing each country's Gini index by 1 percent per year has a larger impact on global poverty than increasing each country's annual growth by 1 percentage point above forecasts.
16. According to OECD, redistribution plays a limited role in Türkiye compared to OECD averages. https://www.oecd-ilibrary.org/economics/income-redistribution-across-oecd-countries_3b63e61c-en

III. Special Topic

Corporate vulnerability in Türkiye and linkages to financial sector

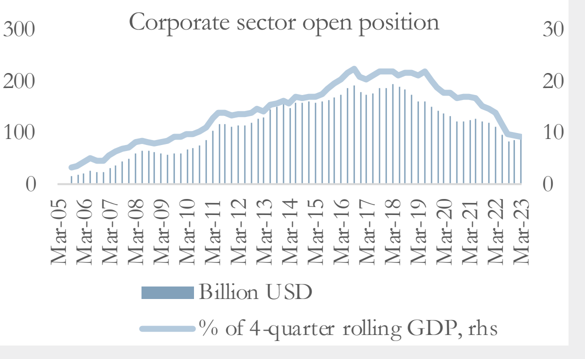
The corporate sector represents the dynamic part of the economy which has proved its resilience against various shocks over the years. Since the currency shock in 2018, the corporate sector has enjoyed an improvement in its profitability and capacity to cover interest payments, partly due to loosened monetary policy and selective credit policies which lowered borrowing costs, and partly due to buoyant domestic demand helping the corporates improve their profitability (Figure 35). Concurrently, the corporate sector has significantly lowered its open position to reduce the exchange rate risk in their balance sheets (Figure 36).[17] These have helped strengthen the resilience of the corporate sector.

Figure 35: Interest coverage and profitability of corporate sector increased



Sources: CBRT Sectoral Accounts

Figure 36: Corporate sector has lowered its open position



Sources: CBRT

A closer look at the soundness of corporates can be traced with corporate vulnerability indicators. Using the detailed sectoral balance sheets provided by the CBRT, a corporate vulnerability indicator comprising of five subcomponents has been generated.[18] The indicators are generated both for sectoral balance sheets containing all firms, and for different firm sizes.[19] Accordingly, the corporate vulnerability for all firms, after declining in 2010 increased in 2016 and peaked in 2018, both years featured an exchange rate shock and a contraction in the economy (Figure 37). Afterwards, the corporate vulnerability has declined, more significantly in 2022 amid strong economic activity and falling cost of borrowing, potentially enabling firms to act countercyclically and to rebuild some financial buffers.

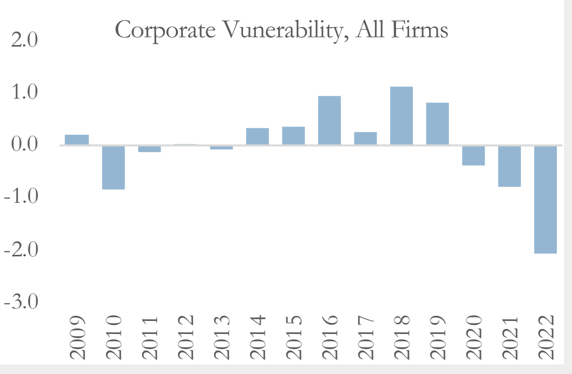
17. In a recent study, Pienkowski (2023), investigating the exposure and interconnectedness of the FX balance sheets of sectors in Türkiye, argues that despite considerable deleveraging pursued by non-financial corporations, they still play an important role in the FX network.

18. The corporate vulnerability indicator builds on the methodology used in the ECB Financial Stability Report, November 2020 by Gardó et al. (2020). The indicator aims to track the time-varying impact of several driving factors of the financial soundness of the corporates. The indicator combines relevant factors under five different components with the following sub indicators: Debt service capacity (interest coverage ratio and revenue generation); leverage/indebtedness (debt-to-equity and net debt-to-EBIT ratios); financing/rollover (short-term debt-to-long-term debt ratio, quick ratio -defined as current financial assets/current liabilities-, overall cost of debt financing and credit impulse -defined as the change in new credit issued as a percentage of GDP); profitability (return on assets and profit margin); activity (sales growth, trade creditors ratio and change in accounts receivable turnover). The sub indicators are standardized with mean zero and standard deviation of one. Then, for each component, the average of standardized indices is calculated for each sector. All the subcomponents are then equally weighted and summed to produce the corporate vulnerability indicator for the sector. For the aggregate measures, sectoral level vulnerability indicators are aggregated by weighting with the size of total assets. For the indicators, positive/negative values refer to an increase/decrease in the corporate vulnerability.

19. The sectoral accounts data provides an aggregate measure for sectors at different levels of disaggregation. For the sector total, three-digit NACE classification is used. For the size disaggregation, sectoral classification at two-digit level is used. In the size breakdown, different aggregates for large, medium, small and micro firms in each sector are available. The classification of firms into categories are as follows: Micro, small and medium firms have less than 10, 50 and 250 employees respectively. Meanwhile large firms have more than 250 employees.

The evolution of the corporate vulnerability differed across firm sizes. Large firms have the least volatile corporate volatility; large, medium and small firms have enjoyed a similar reduction in corporate volatility in the last two years; meanwhile micro firms' vulnerability has declined significantly only in 2022 (Figure 38).[20]

> > >
Figure 37: Corporate vulnerability has declined...



Sources: CBRT Sectoral Accounts, WB Staff calculations.

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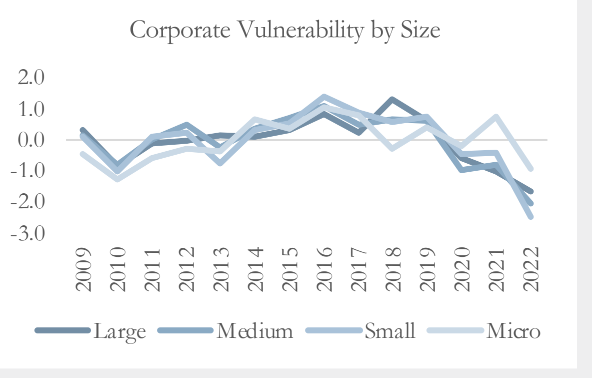
Figure 38: ...but to a different extent by size



Sources: CBRT Sectoral Accounts, WB Staff calculations.

By the construction of the indicator, it is possible to follow the sources of the changes in corporate volatility for different firm size groups. Large firms have enjoyed a steady decline in corporate vulnerability backed by all subcomponents in 2021 and 2022, while improved activity, debt service capacity and profitability played a big role (Figure 39). Medium and small firms benefited from higher profitability only in 2022, where they have enjoyed the largest reduction in corporate vulnerability. Overall, the widespread reduction in corporate vulnerability in 2022 was mainly driven by lower cost of borrowing backed by loose monetary policy and the strong domestic demand boosting activity and profitability of the corporate sector. Meanwhile, the corporate vulnerability in micro firms has increased in 2021 before declining in 2022 to a lesser extent than other firms. The micro firms' debt service capacity has improved over the recent years despite their leverage/indebtedness remaining as a constraint. Also, over the covid period of 2020-21, these firms have experienced a significant drop in their profitability, contributing to the vulnerability. Looking at the earlier episodes, while the corporate vulnerability peaked in 2016 in medium and small firms, large firms' vulnerability has peaked in 2018, when the open positions of the corporates reached a very high level (Figure 36).

20. This methodology enables a comparison over time, detecting the episodes of vulnerability above or below the mean value for the time period considered. Accordingly, the figure suggests that corporate vulnerability was 1.1 standard deviations higher than the sample mean in 2018, while 2.1 standard deviations lower in 2022. A recent similar analysis for the Euro area shows that vulnerability was around 1.3 and 1.5 standard deviations higher than the sample average in 2009 and 2020, respectively, while around 0.8 standard deviations lower in 2022 (ECB Economic Bulletin, Issue 2/2022).

> > >

Figure 39: The evolution of vulnerability differs by firm size

Sources: CBRT Sectoral Accounts, WB Staff calculations.

However, the upcoming period characterized by higher cost of borrowing, a depreciated Turkish lira and growth slowing down may pose challenges to the soundness of the corporate sector. Recent changes in the macroeconomic policy framework following the May elections, with the new economy team prioritizing disinflation and reducing external imbalances, have been changing the rules of the game for the corporates. The monetary policy is now on the tightening cycle, the interest rate of commercial loans has been increasing in parallel, and the depreciation of around 50 percent observed since the elections has further increased the cost of imported inputs. In the meantime, economic growth is slowing down, and the macroeconomic stabilization policies envisage a change in the growth composition by lowering the contribution of domestic demand, limiting the possibility of passing through of cost increases onto consumers.[21]

Specifically, to investigate the sensitivity of corporate vulnerability to exchange rate and commercial loan interest rate panel VAR models are estimated.[22] In this setting, the impact of exchange rate and commercial loan rate shocks are analyzed through the impulse response functions, which suggest that both exchange rate and loan rate shocks significantly increase the corporate vulnerability across all sizes (Figure 40).

21. The recent targeted credit policies supporting the exporting firms' access to finance, and incentivizing companies to export, and availability of companies' liquid foreign currency assets and their ability to hedge themselves might alleviate some of the impact of the exchange rate shocks on corporate vulnerability.

22. The panel VAR includes USD/TL exchange rate, average commercial loan interest rates, corporate vulnerability, and controls for GDP growth, inflation, and oil prices in USD, with all variables in stationary forms. The panel VAR allows for controlling for sector specific unobserved fixed effects. Moreover, lags of the variables are used as instruments to alleviate endogeneity concerns, and the models are estimated with one lag, covering the period 2009-2022. The sectoral accounts are available at yearly frequency. Separate models are estimated for sectoral information covering all, large, medium, small, and micro firms. When sectoral data for different sizes are considered, the panel VAR models are estimated with two-digit level disaggregation.

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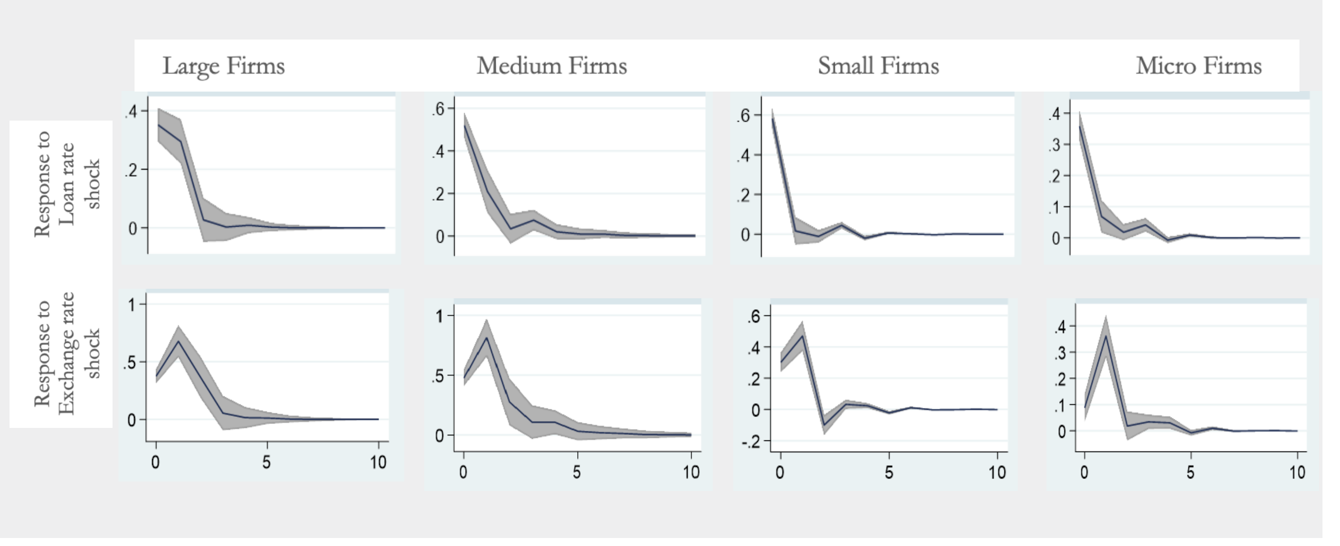
Figure 40: Exchange rate and loan rate shocks and corporate vulnerability



Sources: CBRT Sectoral Accounts, WB Staff estimations. Notes: The figures show the response of corporate vulnerability to exchange rate and interest rate shocks for different firm sizes using panel VAR estimated at sectoral level estimated for 2009-2022.

The pass-through coefficients calculated from the impulse responses help gauge the impacts more easily. A 10-percentage point shock to credit loan rates increase the vulnerability of large and medium corporates by 1.9 standard deviation, and that of small and micro corporates by 1.6 standard deviations. Meanwhile, a 10 percent depreciation of the lira increases the corporate vulnerability by 2.2, 2.6, 1.5, and 1.2 standard deviations (Figure 41).[23] What is striking is that for large and medium firms, the impact of an exchange rate shock (10 percent depreciation) is higher than 10 percentage point increase in the average loan rate.[24] Meanwhile, especially for micro firms, the impact of the interest rate shock overweighs the impact of exchange rate shock, suggesting that micro firms are relatively more vulnerable to interest rate shocks. Similarly, large and medium firms are more vulnerable to exchange rate shock.

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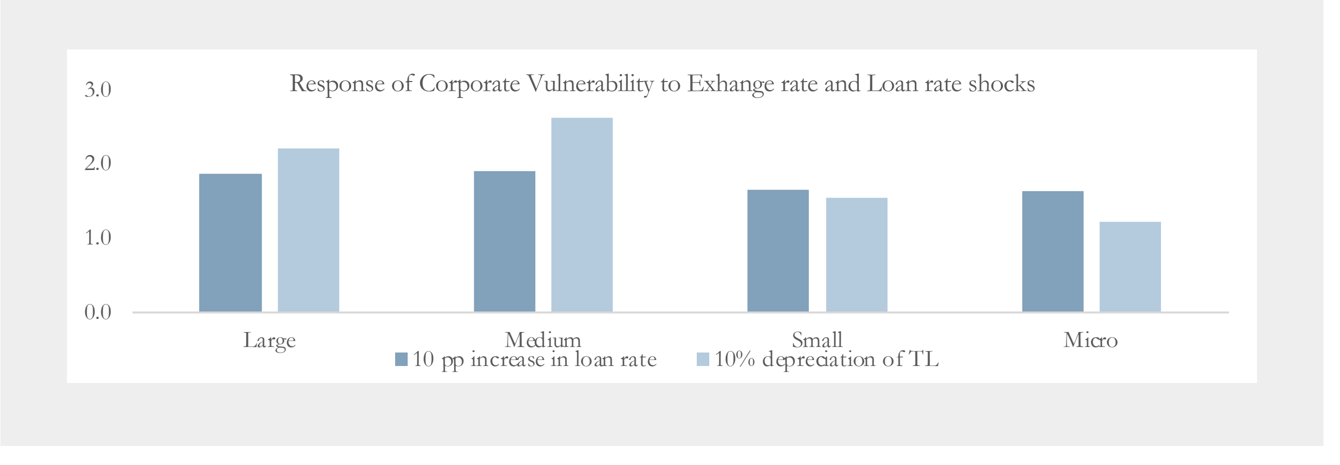
Figure 41: Cumulative response of corporate vulnerability to exchange rate and loan rate shocks by firm size



Sources: CBRT Sectoral Accounts, WB Staff estimations.
Notes: The columns show the cumulative response of corporate volatility (in standard deviation units) to 10 percentage point increase in commercial loan rates and to 10 percent depreciation in the USD/TL exchange rate, which are calculated by using the impulse response functions from the panel VAR estimation described above.

23. Considering that the levels of corporate vulnerability range between -2.5 and 1.5, according to Figure 39, the estimated effects of these shocks are sizeable.
24. The finding that large firms are less vulnerable than medium firms to exchange rate shock could point to better ability of large firms to hedge themselves and to reduce their open positions.

The changes in corporate vulnerability reflect the changes in the financial soundness of the firms which is directly related with their ability to pay back their loans. Therefore, an increase in corporate vulnerability is expected to have impact on non-performing loans of the banking sector. To investigate this link, another set of panel VARs are estimated.[25] The results suggest that one standard deviation increase in corporate vulnerability increases the share of bad loans in total by 0.4 percentage points in the services sector and 0.9 percentage point in manufacturing sector.

In the manufacturing sector, a corporate vulnerability shock has different impacts by firm size. Specifically, one standard deviation increase in corporate vulnerability increases the share of bad loans in total loans by 2.5, 2.7, and 7.5 percentage points for medium, small and micro firms respectively (Figure 42).[26] Therefore, the corporate vulnerability shocks in manufacturing industry more adversely affect the bad loans for micro firms.

With the tightening cycle of the monetary policy, a depreciated Turkish lira and slowing down growth perspective, corporate vulnerability is expected to be higher in 2023 and 2024 compared to 2022 figures. Furthermore, micro firms are relatively more affected by changes in the interest rates, standing out as the most vulnerable portion of the corporates.[27] In addition, the increase in corporate vulnerability is likely to impact the non-performing loans of the banking system. Therefore, the fiscal policy measures in support of vulnerable businesses will be crucial in the upcoming period.

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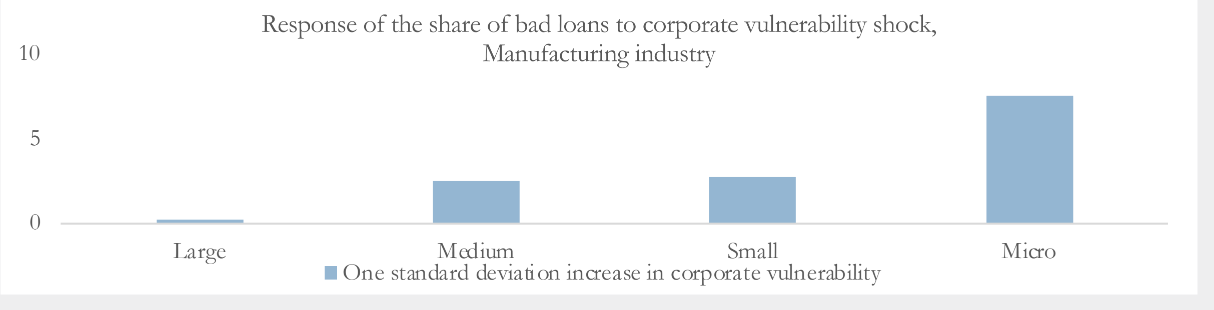
Figure 42: Cumulative response of the share of bad loans in total loans to corporate vulnerability shock by firm size in manufacturing industry



Sources: CBRT Sectoral Accounts, WB Staff estimations.

Notes: The columns show the cumulative response of the share of bad loans in total loans to a shock to corporate volatility (in standard deviation units).

25. This set of panel VARs include the non-performing loans calculated at the sectoral level (as the share of bad loans in total cash loans) and the corporate vulnerability, controlling for the growth rate, inflation, and oil price as a proxy for external conditions. The models are separetely estimated for different sizes, and for services and manufacturing sectors.
26. Assuming a normal distribution, estimation of the impact of one standard deviation increase in corporate vulnerability would be the impact for a sector with average vulnerability being as vulnerable as a sector at the 84th percentile.
27. For instance, the average net debt to EBIT ratio -weighted by total assets- for the entire sample of micro firms is 22.3; meanwhile this ratio is 2.7, 6.2, and 12.4 respectively for the samples of large, medium, and small firms, over the analysis period. In manufacturing sector only, this ratio for the sample of large, medium, small, and micro firms are 2.4, 5.1, 10.2, and 27.5 respectively.

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Annex 1: Medium-Term Outlook, Nominal

Key Macroeconomic Indicators						
	2020	2021	2022	2023	2024	2025
Population (mid-year, million)	83.4	84.1	85.0	85.8	86.3	86.7
GDP (current US$, billion)	717.1	807.9	905.8	1024.5	1188.9	1216.3
GDP per capita (current US$)	8600.4	9601.3	10659.1	13110.0	13782.7	14028.8
CPI (annual average, in percent)	12.3	19.6	72.3	53.9	57.8	28.9
Real Economy						
Real GDP	1804.4	2010.8	2122.1	2217.9	2284.3	2366.6
Private Consumption	1076.0	1241.4	1476.1	1664.3	1702.6	1754.5
Government Consumption	259.0	266.9	278.2	292.7	300.0	306.4
Gross Fixed Capital Formation	473.2	507.4	513.9	559.5	575.9	592.8
Net Exports	-6.6	84.2	98.1	32.4	37.7	44.8
Fiscal Accounts	**TL Billion, unless otherwise indicated**					
Total Revenues	1637.2	2239.5	4180.7	6429.3	10543.2	13808.3
Total Expenditures	1835.4	2430.8	4300.8	7751.9	12705.6	15740.4
General Government Balance	-198.7	-191.4	-120.1	-1325.5	-2162.4	-1932.1
Primary Balance	-56.7	-0.6	204.6	-607.2	-309.8	310.7
Monetary Policy	**TL Billion, unless otherwise indicated**					
Base Money (M2)	3325.0	5061.7	8218.2	13665.1	-	-
Average Funding Rate (annual average, in percent)	10.5	17.8	13.0	20.7	-	-
Gross Reserves (in US$ Billion)	93.6	111.2	128.7	140.9	-	-
o/w Gold Reserves	43.6	38.5	45.8	48.2	-	-
External Sector	**US$ Billion, unless otherwise indicated**					
Current Account Balance	-31.9	-7.4	-49.1	-45.5	-33.9	-29.0
Net Foreign Direct Investment	4.4	6.5	8.7	4.7	10.5	13.4

Source: TURKSTAT, CBRT, Strategy and Budget Presidency, WB Staff calculations.

Annex 2: Medium-Term Outlook, Percent of GDP

Key Macroeconomic Indicators						
	2020	2021	2022	2023	2024	2025
Real Economy	**Annual percentage change, unless otherwise indicated**					
Real GDP	1.9	11.4	5.5	4.5	3.0	3.6
Private Consumption	3.2	15.4	18.9	12.8	2.3	3.1
Government Consumption	2.2	3.0	4.2	5.2	2.5	2.1
Gross Fixed Capital Formation	7.3	7.2	1.3	8.9	2.9	2.9
Exports	-14.6	25.1	9.9	-2.7	4.5	5.2
Imports	6.8	1.7	8.6	11.7	3.7	4.2
Fiscal Accounts	**Percent of GDP, unless otherwise indicated**					
Total Revenues	32.4	30.9	27.8	26.4	26.2	26.2
Total Expenditures	36.4	33.5	28.6	31.8	31.5	29.9
General Government Balance	-3.9	-2.6	-0.8	-5.4	-5.4	-3.7
Government Debt Stock	39.4	40.4	30.8	29.5	29.9	30.5
Primary Balance	-1.1	0.0	1.4	-2.7	-0.8	0.6
Monetary Policy	**Percent of GDP, unless otherwise indicated**					
CPI (annual average, in percent)	12.3	19.6	72.3	53.9	57.2	28.9
Base Money (M2)	65.9	69.8	54.7	-	-	-
Gross Reserves	13.1	13.6	14.4	-	-	-
In months of merchandise imports	5.4	5.2	4.5	-	-	-
Percent of short-term external debt	83.4	93.6	86.4	-	-	-
External Sector	**Percent of GDP, unless otherwise indicated**					
Current Account balance	-4.4	-0.9	-5.4	-4.1	-2.8	-2.4
Net Foreign Direct Investment	0.6	0.8	1.0	0.4	0.9	1.1

Source: TURKSTAT, CBRT, Strategy and Budget Presidency, WB Staff calculations.