TURKEY

Table 1	2020
Population, million	83.4
GDP, current US$ billion	720.1
GDP per capita, current US$	8635.9
Upper middle-income poverty rate ($5.5)[a]	10.2
Gini index[a]	41.9
School enrollment, primary (% gross)[b]	94.9
Life expectancy at birth, years[b]	77.4

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2019), 2011PPPs.
(b) Most recent WDI value (2018).

Turkey was the only G20 country aside from China to record an economic expansion in 2020. Real GDP growth of 1.8 percent was driven by an extensive stimulus and effective control of the COVID-19 pandemic. Turkey's economy is expected to grow by 5 percent in 2021 but reducing inflation and rebuilding external buffers—both of which suffered setbacks in 2020—will prove challenging. Poverty is projected to increase further following increases in 2019 and 2020, with informal workers and households outside the social security system being hit hardest.

Key conditions and challenges

Turkey's economy has rebounded strongly from the pandemic-related slowdown of 2020. However, this rapid recovery has raised macroeconomic and financial stability risks. Unless addressed, these vulnerabilities will expose Turkey to heightened risk and continue to limit productivity, which has stagnated in recent years. Recent market turmoil following the replacement of the Central Bank Governor illustrates the importance of a sustained and credible focus on bringing inflation down to the target rate of 5 percent and bolstering the country's international reserves. Structural reforms in labor, product, and financial markets, and to innovation systems can support productivity growth. Corporate sector vulnerabilities—further elevated by the pandemic and higher debt burden— present risks to banks. Developing local- currency, long-term finance sources would alleviate existing imbalances in the financial system and contribute to economic growth.

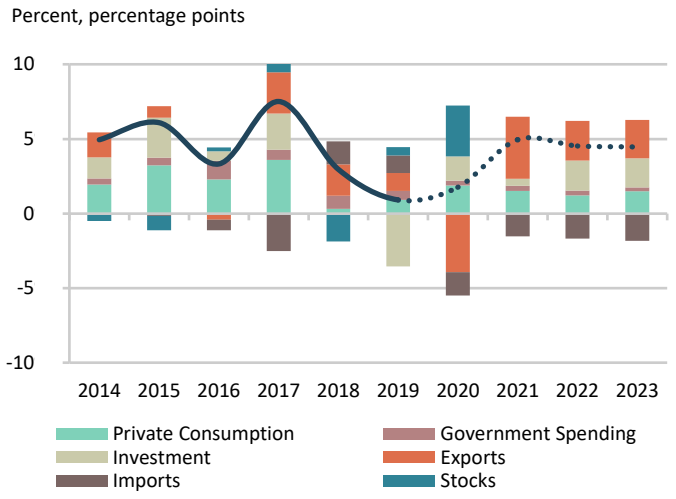
The economic recovery in the second half of 2020 helped recover most of the jobs lost during the pandemic's first wave. However, jobs for informal, lower-skilled, female, and young workers remain well below their pre-pandemic levels. Furthermore, 2.6 million more individuals were out of the labor force in 2020. The poverty rate is projected to increase to 12.2 percent in 2020, which would mark the second successive year that poverty has increased in Turkey, from 8.5 percent in 2018.

Recent developments

Real GDP grew by 5.9 percent year on year in the fourth quarter of 2020, completing a remarkable rebound in the second half and resulting in full-year growth of 1.8 percent despite the economic fallout from the coronavirus pandemic. The recovery was driven by surging domestic demand, buoyed by credit in the second and third quarter. The authorities loosened monetary policy and delivered a stimulus program totaling 13 percent of GDP, most of which was support via the banking sector in the form of partial credit guarantees and loan deferrals. Other fiscal support included social support payments to households, support for furloughed workers, tax deferrals, and other support for firms.

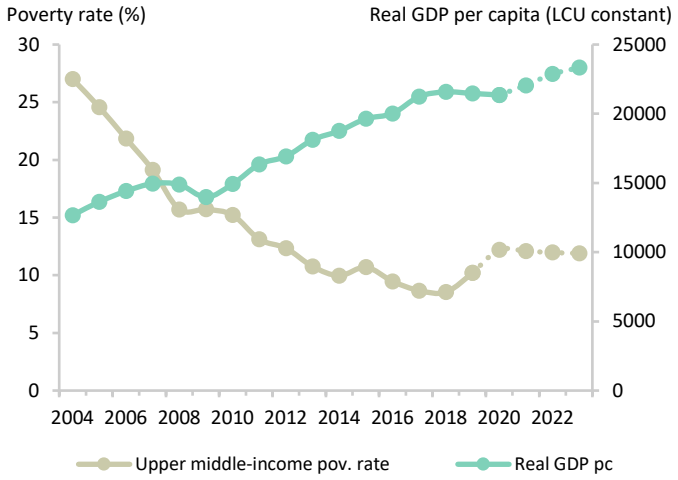
Growth from these policies came at the cost of rising prices and macro-financial vulnerabilities. Inflation trended upward, reaching 15.6 percent in February—the highest level in 18 months. The Turkish lira depreciated by 20 percent against the U.S. dollar in 2020. From a surplus in 2019, the current account moved back into deficit ($36.7 billion or 5.1 percent of GDP) as tourism income evaporated, merchandise exports fell, and gold imports increased. After the central bank stepped in to finance as much as 80 percent of the current account deficit, foreign exchange reserves fell sharply, reaching unprecedented lows on a net

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



Sources: Turkstat and World Bank staff calculations.

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



Source: World Bank. Notes: see Table 2.

basis. Deposit dollarization rose to 55 percent. Buoyant tax revenues resulted in a central government deficit of 3.4 percent of GDP in 2020, better than the planned deficit of 4.9 percent of GDP.

Toward the end of 2020, a second wave of COVID-19 peaked, with cases reaching 30,000 a day in November. Following the reimposition of containment measures (including masking, weekend curfews, and restaurant closures), new cases declined to around 10,000 a day by February 2021, following which, the government began easing restrictions again, based on a province-level risk assessment.

By late 2020, the authorities had also moved to address economic vulnerabilities, more than doubling interest rates between August and December, repealing exceptional regulations aimed at stimulating credit growth, and increasing transparency. This policy shift helped spur portfolio inflows, stabilize the lira, and strengthen market confidence. Credit growth decelerated sharply to near zero (13-week average) by February, and the banking sector reduced its net open foreign exchange position.

Outlook

The economy is expected to grow by 5.0 percent in 2021 and 4.5 percent in 2022 and 2023. Despite slow quarterly growth expected in 2021—as monetary policy remains tight and external demand weak—GDP in the second quarter will be higher than the year-earlier period when COVID-19 brought Turkey's economy to a near-standstill. These projections assume that cautious reopening continues and that there is no uncontrolled outbreak in Turkey or its major export markets, which could undermine growth.

Recent sharp depreciation of the Lira in response to the replacement of the Central Bank Governor will impact inflation. Average inflation is projected to increase in 2021 to 15.5 percent. The current account deficit is expected to narrow to 3.7 percent of GDP in 2021. The 2021 general government deficit is projected at 3.5 percent of GDP as the need for additional support to cushion the economic and social impact of the pandemic continues, before narrowing to 3.1 percent in 2022 and 2.6 percent in 2023 as temporary tax reductions and other government support is withdrawn.

Regulatory forbearance (especially on nonperforming loan definitions and capital adequacy ratio calculations) is expected to be phased out in mid-2021, after which there may be an increase in nonperforming and distressed loans. Strengthening bad loan resolution, insolvency, and out-of-court corporate debt restructuring frameworks with an effective corporate viability assessment will be critical to shield corporates and the banks from spillovers.

Turkey's external risk profile is high due to its still-low level of international reserves and sizeable external financing needs. The country has limited space to manage exchange rate volatility in the event of new external shocks. The banking sector has adequate foreign exchange buffers, most of which form part of central bank international reserves.

Simulation analysis suggests that poverty may have increased by as much as 2.1 percentage points in 2020—equivalent to 1.6 million new poor. The crisis pushed a similar number of people into poverty as the 2018/19 recession. Had the government not acted swiftly to stem the social effects of COVID-19 the increase in poverty would have been three times greater. Turkey is projected to enter 2021 with the highest poverty rate since 2012. Successful poverty reduction will require ensuring that the recovery benefits informal and unskilled workers and other vulnerable groups through a policy mix of social transfers, inclusive job creation, and labor activation strategies.

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

	2018	2019	2020 e	2021 f	2022 f	2023 f
Real GDP growth, at constant market prices	3.0	0.9	1.8	5.0	4.5	4.5
Private Consumption	0.5	1.6	3.2	2.5	2.6	2.9
Government Consumption	6.6	4.4	2.3	2.3	2.2	1.8
Gross Fixed Capital Investment	-0.3	-12.4	6.5	1.8	8.0	7.2
Exports, Goods and Services	9.0	4.9	-15.4	19.5	9.0	8.5
Imports, Goods and Services	-6.4	-5.3	7.4	7.0	6.5	6.0
Real GDP growth, at constant factor prices	3.2	1.1	1.2	5.0	4.5	4.5
Agriculture	2.1	3.7	4.8	1.5	2.0	2.0
Industry	0.5	-3.0	0.6	5.7	5.0	4.2
Services	4.8	2.8	1.1	5.0	4.6	4.9
Inflation (Consumer Price Index)	16.3	15.2	12.3	15.5	12.0	10.0
Current Account Balance (% of GDP)	-2.8	0.9	-5.1	-3.7	-4.0	-4.0
Net Foreign Direct Investment (% of GDP)	1.2	0.8	0.6	0.9	1.0	1.0
Fiscal Balance (% of GDP)	-2.4	-3.0	-3.9	-3.5	-3.1	-2.6
Debt (% of GDP)	30.2	32.5	39.6	40.6	39.6	38.4
Primary Balance (% of GDP)	-0.2	-0.5	-1.0	-0.4	0.0	0.1
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	8.5	10.2	12.2	12.1	12.0	11.9

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.

(a) Calculations based on ECAPOV harmonization, using 2013-HICES and 2019-HICES. Actual data: 2019. Nowcast: 2020. Forecast are from 2021 to 2023.

(b) Projection using point-to-point elasticity (2013-2019) with pass-through = 1based on GDP per capita in constant LCU.