

TURKEY

Recent developments

Table 1 **2018**

Population, million	814
GDP, current US\$ billion	768.9
GDP per capita, current US\$	9445
International poverty rate (\$ 19) ^a	0.2
Upper middle-income poverty rate (\$5.5) ^a	9.9
Gini index ^a	419
School enrollment, primary (% gross) ^b	1013
Life expectancy at birth, years ^b	75.8

Source: WDI, Macro Poverty Outlook, and official data.

Notes:

(a) Most recent value (2016), 2011 PPPs.

(b) Most recent WDI value (2016)

The sharp external adjustment that Turkey experienced in mid-2018 is now feeding through to the real sector. The economy is contracting, and unemployment is rising. The livelihoods of low-income households and the incidence of poverty are at risk of deterioration. The downturn has so far been tempered by a strong, positive contribution of net exports. The outlook hinges on how early a recovery takes root, with well-targeted policy responses and clear communication of macroeconomic risks likely to be key.

Growth in 2018 fell to 2.6 percent, with the last two quarters seeing a contraction in economic activity. A slowdown in the real sector began in the second half of 2018. Private consumption declined by 1.6 and 2.4 percent in Q3 and Q4 respectively, while investment fell by 6.7 and 3.6 percent in the same quarters (seasonally-adjusted, quarter on quarter). Over the last year, Turkey has experienced intense market turbulence, ending 2018 with its nominal effective exchange rate 25 percent lower, consumer inflation above 20 percent, and policy interest rates tripling to 24 percent. Since the end of September, the exchange rate has become more stable, and gross international reserves have risen nearly 20 percent to \$99 billion although market risk perception remains elevated.

The impact on growth would have been more severe were it not for a strong external adjustment, with import volumes contracting sharply and exports rising during the year. The current account moved from a deficit of \$3.4 billion per month in the first three quarters of 2018 to a surplus of \$900 million per month in the fourth quarter.

With a large proportion of domestic credit extended in foreign currency or FX-indexed loans and weakening domestic demand, part of the corporate sector is under stress. While the nonperforming loan ratio has only risen to 4.1 percent so far, a much larger fraction of domestic credit may be unable to be collected soon. Banks are undergoing a process of balance

sheet repair, with their liabilities to foreign banks falling by 16 percent from their peak in August, and domestic credit has contracted since end-September.

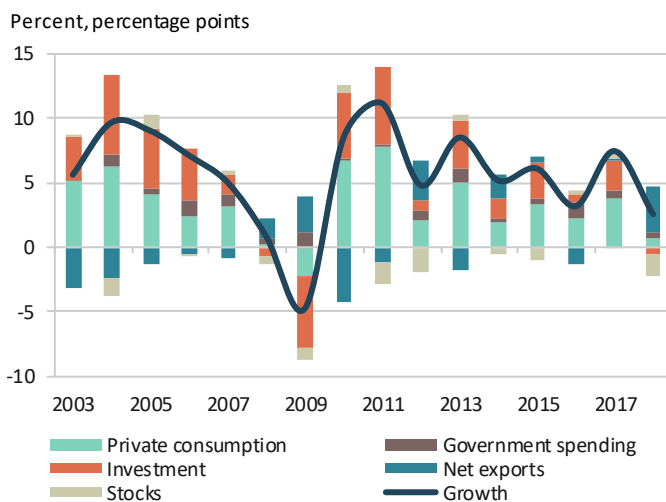
Unemployment is steadily rising, and food price inflation has spiked, adding further to economic difficulties for low-income households. The sharp fall in demand has begun to feed through into business cut-backs: The economy experienced a net loss of 200,000 jobs in 2018 and unemployment rose from 10 to 13 percent in the last year. Meanwhile, the youth unemployment rate peaked at 22.2 percent, having risen by three percentage points in a year. Annual inflation accelerated to 19.7 percent in February 2019; the rate of food price inflation rose even faster at 29.3 percent. While poverty had been declining until 2016, the latest available data point, recent inflation, and unemployment evolution put poverty trends at risk of stagnation and reversal.

The government raised the minimum wage by 26 percent in January to stem low-income households' eroding purchasing power. In addition, benefit levels of certain government transfers increased since they are indexed to the minimum wage, but the target population of those transfers is limited and composed mainly of the elderly and disabled.

Outlook

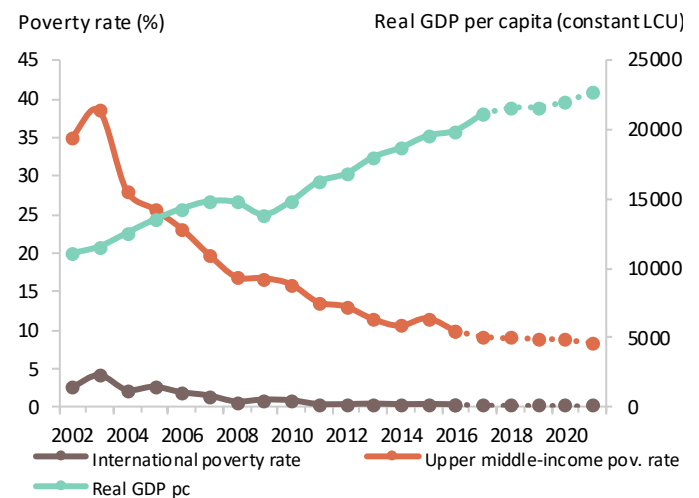
Growth in 2019 is projected to decelerate to 1 percent, reflecting three consecutive quarters of contraction from the fourth

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.

quarter of 2018 to the second quarter of 2019. This marks a downward revision, as a deeper-than-expected fall in consumption in the last quarter of 2018 is expected to continue in the first half of 2019. Private consumption growth is expected to resume in the third quarter aided by the substantial minimum wage hike in January and recently-announced employment support programs. A larger primary deficit and higher interest costs are forecast to drive a widening of the overall fiscal deficit in 2019. Robust government consumption growth is also expected to contribute to growth in 2019 while investment—both public and private—is projected to contract substantially. Import volumes are forecast to fall slightly, reflecting slowing consumption growth and declining investment. Despite lower growth expectations in Europe, improved price competitiveness is expected to boost exports in 2019.

In 2020, growth is expected to recover momentum to 3 percent, led by recovering private consumption and investment, and further to 4 percent in 2021.

Inflation is forecasted to decline steadily beginning in mid-2019; aided by a continued tight monetary stance, inflation should fall to 15 percent by year-end. However, with inflation beginning the year high, average annual inflation for the

year is expected to peak at around 18 percent. In later years, inflation is expected to fall towards the high single digits.

Credit markets will remain muted as banks go through a process of deleveraging in 2019. Many firms will be effectively under bankruptcy protection in 2019, so the full extent of balance sheet losses is unlikely to be realized until 2020.

Despite the increased minimum wage, higher social assistance transfers will be needed to protect unemployed people and informal workers from potential shocks. Poverty is projected to stagnate around 9 percent from 2018 to 2020, measured with the upper-middle-income country poverty line of \$5.5/day in 2011 PPP. The total number of poor is forecasted to rise from 7.37 million people in 2018 to 7.42 million in 2020.

Risks and challenges

The outlook for 2019 hinges on how early a recovery takes root. At present, the authorities are in a position to support a recovery, by providing more transparent information to the market about the health of the banking sector and measures to support a recovery, such as a corporate debt restructuring program and well-targeted counter-cyclical fiscal policy.

However, market actors are increasingly concerned about poorly planned, interventionist policies targeted to artificially lower market prices and boost credit growth in the short run, and in the absence of an adequate policy response, the economy may experience a prolonged period of recession.

A recovery in mid-2019 will depend on an improving environment for both consumption and investment. Further shocks from the external sector, domestic supply shocks, or materialized risks in the financial system could lead to a delayed, or weaker, recovery.

The most significant known risk is the rising level of uncollectable debts in the private sector (especially in the non-tradeable sectors) which, if not well managed, could lead to severe problems in the financial sector.

High inflation and unemployment stand out as the major risks to Turkey's prospects for poverty reduction in 2019. Rising food prices should be monitored carefully and addressed with adequate policies to ensure continued poverty reduction. Poor households are particularly vulnerable to high food price inflation since food comprises a larger share of their budgets. The continuation of adverse trends in 2019 would put the poverty reduction gains of the last decade at risk.

TABLE 2 Turkey / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	3.2	7.4	2.6	1.0	3.0	4.0
Private Consumption	3.7	6.1	1.1	0.6	2.2	2.7
Government Consumption	9.5	5.0	3.6	5.4	2.0	2.6
Gross Fixed Capital Investment	2.2	7.8	-1.7	-5.9	4.8	9.0
Exports, Goods and Services	-1.9	11.9	7.5	5.5	5.7	4.8
Imports, Goods and Services	3.7	10.3	-7.9	-1.5	6.0	7.5
Real GDP growth, at constant factor prices	3.1	7.9	2.9	1.0	3.0	4.0
Agriculture	-2.6	4.9	1.3	0.9	2.0	2.0
Industry	4.6	9.1	0.2	1.0	3.3	3.8
Services	3.2	7.6	4.4	1.1	2.9	4.2
Inflation (Consumer Price Index)	7.8	11.1	16.3	18.0	11.0	9.5
Current Account Balance (% of GDP)	-3.8	-5.6	-3.6	-2.7	-4.0	-4.5
Net Foreign Direct Investment (% of GDP)	1.3	1.0	1.2	1.0	1.1	1.1
Fiscal Balance (% of GDP)	-1.4	-1.8	-2.7	-3.8	-2.7	-2.0
Debt (% of GDP)	28.3	28.3	32.7	33.6	33.9	32.8
Primary Balance (% of GDP)	0.6	0.1	-0.4	-1.2	0.3	0.5
International poverty rate (\$1.9 in 2011 PPP)^{a,b}	0.2	0.2	0.2	0.2	0.2	0.2
Upper middle-income poverty rate (\$5.5 in 2011 PPP)^{a,b}	9.9	9.2	9.1	9.1	8.9	8.6

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.

Notes: e = estimate, f = forecast.

(a) Calculations based on ECAPOV harmonization, using 2011-HICES, 2017- and 2016-HICES. Actual data: 2016. Nowcast: 2017-2018. Forecast are from 2019 to 2021.

(b) Projection using point-to-point elasticity (2011-2017) with pass-through = 1 based on GDP per capita in constant LCU.