Türkiye

Outlook

	Average 10-14	2015	2016	2017	2018	2019	Forecasts 2020	2021	2022
GDP Growth (%)	7.6	6.1	3.2	7.5	2.8	0.9	-3.0	4.0	3.5
CPI Inflation (%)*	8.1	7.7	7.8	11.1	16.3	15.2	11.8	11.4	9.0
Fiscal balance (% of GDP)	-1.8	-1.3	-2.4	-2.2	-3.7	-5.3	-7.5	-6.7	-4.2
Public debt (% of GDP)	33.9	27.6	28.3	28.2	30.2	30.1	30.8	31.7	32.9
Reference rate (%)*	6.5	7.5	7.6	8.0	15.8	20.0	15.0	12.0	9.5
Exchange rate (TRL/USD)*	1.8	2.7	3.0	3.6	4.8	5.7	7.7	7.2	7.0
Current balance (% of GDP)	-6.0	-3.2	-3.1	-4.8	-2.7	1.1	-3.2	-2.8	-3.5
External debt (% of GDP)	37.2	44.7	44.6	48.0	59.7	52.4	60.6	55.1	52.3

Note: * Annual average.
Source: CaixaBank Research, based on data from the Turkish Statistical Institute and the IMF.

- **Türkiye is one of the emerging economies with the greatest vulnerability to the COVID-19 crisis**, affecting a country with a half-completed macroeconomic adjustment that had not been able to redress some serious macroeconomic imbalances (in particular, inflation and private debt in dollars). To this is added the delicate geopolitical situation. Finally, the strategy to alleviate the shock of the pandemic, albeit effective in the short term, has put further strain on certain economic policy failings (such as the excessive use of bank credit and an unorthodox monetary policy). All these factors put Türkiye in a very weak position with increasing risks.

- **COVID-19 economic shock.** The initial impact of the pandemic on the Turkish economy was very significant due to the high dependence on international trade, mainly with the EU and the Middle East (exports to both regions account for 70% of the total), and the great importance of the tourism sector (12% of GDP). However, the incidence in terms of cases and loss of human life was lower than in other emerging economies (although there are doubts about whether the official figures fully reflect the pandemic event). As a result, GDP fell 11.0% quarter-on-quarter in Q2 2020. The lifting of restrictions on mobility and the effects of the economic policy (see point below) are expected to enable a significant rebound in activity in Q3.

- **Increase in macro-financial vulnerabilities.** Türkiye, despite having improved its financial situation since the 2018 crisis, has continued to suffer from economic imbalances, such as excess dependence on external financing, especially in foreign currency, and high inflation (around 12% currently, the highest among comparable countries). In the context of the pandemic, the weaknesses that could trigger a new financial crisis have been exacerbated:
  - The collapse in exports and tourism revenue has returned the current account balance to a deficit position (–1.5% of GDP in Q2 2020), a variable that could fall further in the coming months in case of a worsening of the global health situation in its foreign markets.
  - Since March, foreign capital flows to Türkiye have weakened notably. Investors' lack of confidence in the monetary authorities and in their measures to give sustainability to the lira, together with the geopolitical instability that Türkiye is experiencing, have worsened net capital flows (–78% year-on-year during the first three quarters of 2020).

Outlook *(continued)*

- Türkiye has the highest external funding needs, in gross terms and for the next 12 months, among the group of the main emerging economies (they account for 25% of GDP).
- External debt to GDP, which has grown by 70% over the last decade, and with the foreseeable depreciation of the lira, will continue to increase. Furthermore, the fact that about half of Türkiye's short-term external debt is held by domestic banks increases the pressure on the banking sector.

- **Economic policy response**
  - **Monetary policy.** The central bank has focused its efforts on achieving lira exchange rate sustainability. To achieve this, it has relied on the use of foreign currency reserves (reserves have fallen by 50% in one year), on accelerating the use of currency *swaps* with other international banks and on the adoption of restrictive monetary policy measures (increase in repo rates to 15% and increase in financing costs for banks). Given the limited effectiveness of the measures on the lira exchange rate, we believe that the new governor of the bank will maintain a more restrictive and conventional monetary strategy, which could partially ease the pressure on the currency. However, it will take time for the central bank to recover its lost credibility.
  - **Growth of credit.** Nevertheless, in order to mitigate the contractionary aspects of this policy, the Government has promoted the granting of credit through public banks (credit growth has been the highest in a decade).
  - **Fiscal policy.** The fiscal response to the health crisis has been relatively more conservative (tax moratorium for companies and families, and social benefits). We expect the public deficit in 2020 to worsen significantly due to the foreseeable fall in revenues and not to improve noticeably until 2022.

- **Evolution of the exchange rate.** The combination of the economic *shock*, the tension in capital flows and the reduction in foreign currency reserves have resulted in the lira being one of the worst affected emerging currencies so far this year. Looking ahead, we do not rule out an increase in the weakness of the lira in the current context of high financial and geopolitical vulnerabilities.

Main risks

The balance of risks is clearly weighted to the downside. Specifically, there are several types of risk:

- **Macrofinancial risk.** The worsening of the global health crisis would mean a further deterioration in the current account balance, mainly due to the stagnation of tourism, an aspect which, together with Türkiye's high short-term external debt (half of which is in the hands of domestic banking), would further weaken the lira and increase the aversion of foreign investors to assets in local currency.
- **Monetary policy risk.** The decline in foreign currency reserves and the high dependence on external financing would require further tightening of monetary policy to halt the depreciation of the lira and to regain some investor confidence. However, the rate hike would slow down the credit expansion announced by the Government to support private spending.
- **Geopolitical risk.** The current government seeks to establish Türkiye's economic and military power in the region. However, this quest for regional hegemony has strained Türkiye's diplomatic relations, which have worsened in recent months with EU countries (especially Greece and France), the US, Russia and Saudi Arabia, among others.

	Rating	Last changed	Outlook	Last changed
STANDARD & POOR'S	B	17/08/18	Stable	17/08/18
MOODY'S	B2	11/09/20	Negative	11/09/20
FitchRatings	BB-	12/07/20	Negative	21/08/20

■ Indicates that the country has "investment grade".
□ Indicates that the country does not have "investment grade".

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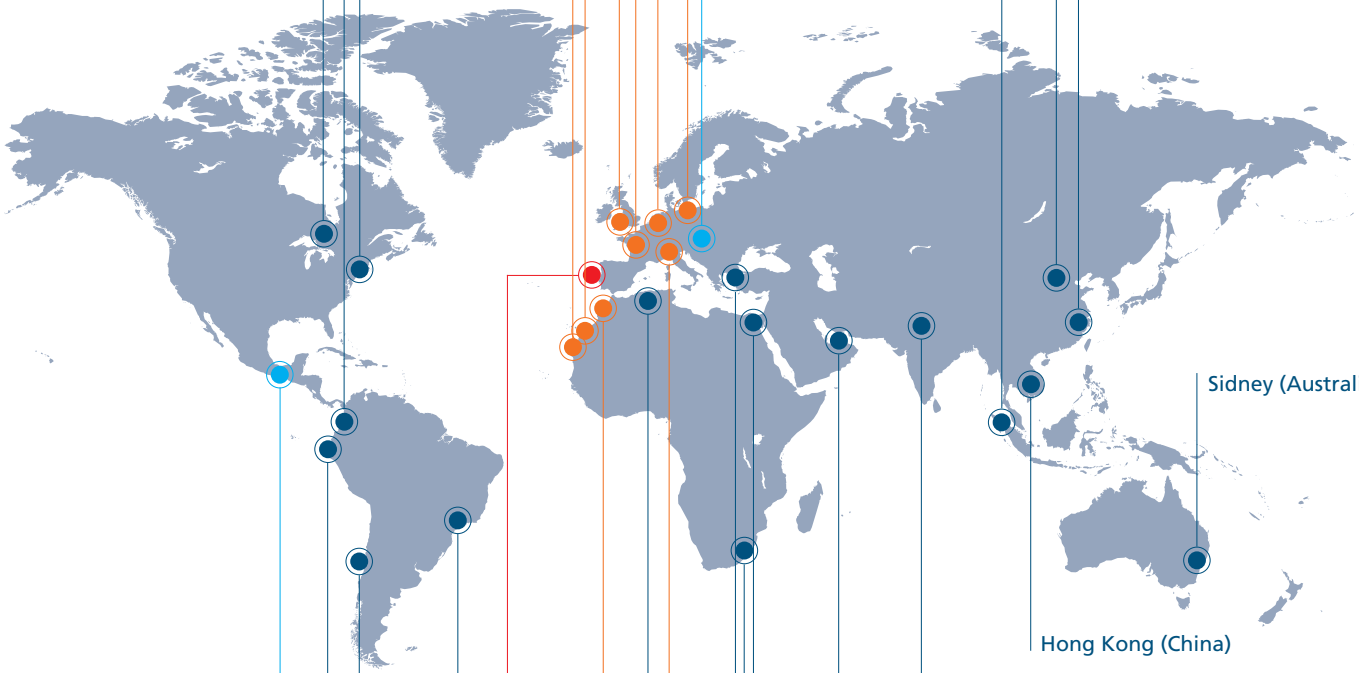

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