

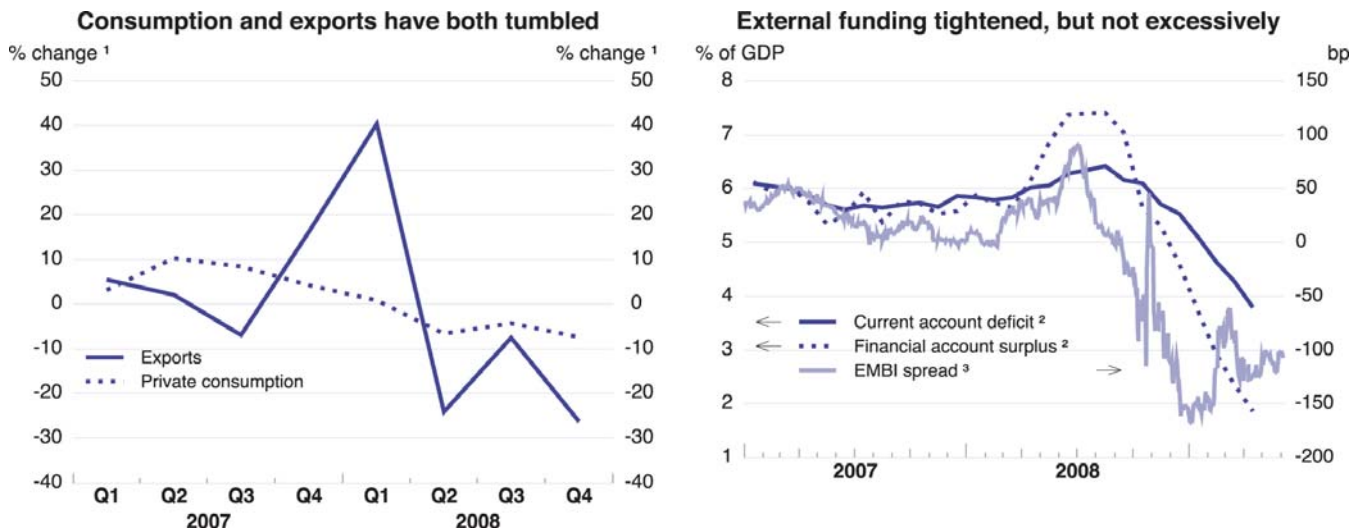
# OECD Economic Outlook: Turkey

The economy contracted beginning in early 2008 as falling domestic demand compounded the effects of the international downturn. GDP is expected to decline by nearly 6% in 2009, before recovering in 2010. The large output gap will push inflation back down to the target range.

Given global and domestic uncertainties, the credibility of economic policy is key for sustaining confidence and the recovery. A robust medium term spending framework would facilitate the operation of the automatic stabilisers and a new agreement with the International Monetary Fund would help to safeguard the confidence of domestic and international investors. Structural reforms to accelerate formalisation in the business sector would help improve longer term growth prospects.

## Domestic demand has declined sharply

GDP growth declined steadily in 2008, contracting by as much as 14% in the last quarter in seasonally adjusted annualised terms. A comparable retrenchment is expected in the first quarter of 2009. Private consumption has weakened steadily since mid 2007 and by more than in other OECD countries. Exports also fell strongly, and trade oriented industrial production followed, particularly the car and machinery equipment sectors. Falling capacity utilisation triggered a record contraction in private investment. Employment started to shrink in late 2008, and with the labour force continuing to grow steadily, the non farm unemployment rate approached 20% in early 2009.



1. Annualised quarterly rates, seasonally adjusted.
2. Last 12 months (moving sum).
3. Over emerging market averages.

Source: OECD Economic Outlook 85 database and Central Bank of the Republic of Turkey.

## The external balance and inflation have improved

The current account deficit narrowed sharply in the first quarter of 2009 owing to slowing domestic demand and falling oil prices. Exchange rate depreciation between August 2008 and April 2009 (by 35% against the US dollar) improved Turkey's competitiveness, but this was not enough to offset the effect of depressed international markets. There has been no major strain in external funding to date despite the ongoing decline in capital inflows. Consumer price inflation fell from 11.9% in October to 6.1% in April, reflecting the fall of the full range of raw material, manufacturing and service prices. With inflation declining, and inflation expectations staying in line with the year end target of 7.5%, the Central Bank was able to reduce its policy rate in several steps from 19.75% in October 2008 to 11.75% in April 2009. Commercial lending rates have not fallen proportionally so far, and credit standards remain tight, but further cuts in policy rates and a stronger pass through to lending rates are expected given the broadly robust banking sector.

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## Demand, output and prices

	2005	2006	2007	2008	2009	2010
	Current prices TRL billion	Percentage changes, volume (1998 prices)				
Private consumption	465.4	4.6	4.6	0.3	-4.4	1.7
Government consumption	76.5	8.4	6.5	1.8	3.0	2.2
Gross fixed capital formation	136.5	13.3	5.4	-4.6	-18.3	8.6
Final domestic demand	678.4	6.8	5.0	-0.5	-6.2	3.0
Stockbuilding <sup>1</sup>	-6.8	-0.1	0.6	0.3	-2.8	0.3
Total domestic demand	671.6	6.7	5.6	-0.3	-8.8	3.3
Exports of goods and services	141.8	6.6	7.3	2.6	-12.0	2.8
Imports of goods and services	164.5	6.9	10.7	-3.1	-21.8	5.1
Net exports <sup>1</sup>	-22.7	-0.3	-1.3	1.4	3.4	-0.6
GDP at market prices	648.9	6.9	4.7	1.1	-5.9	2.7
GDP deflator	-	9.3	6.2	11.5	6.5	6.3
<i>Memorandum items</i>						
Consumer price index	-	9.6	8.8	10.4	6.4	5.9
Private consumption deflator	-	9.8	6.8	10.5	6.5	6.2
Unemployment rate	-	9.7	9.6	10.4	15.2	16.4
Current account balance <sup>2</sup>	-	-6.0	-4.2	-5.5	-2.1	-2.6

*Note:* National accounts are based on official chain-linked data. This introduces a discrepancy in the identity between real demand components and GDP. For further details see *OECD Economic Outlook Sources and Methods* (<http://www.oecd.org/eco/sources-and-methods>).

- Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column
- As a percentage of GDP.

Source: OECD Economic Outlook 85 database.

### Monetary and fiscal conditions will be more supportive...

The spending plans of the 2009 budget, adopted in December 2008, were based on a GDP growth assumption of 4%, well above OECD projections. The authorities are not expected to fully adjust spending despite a sharp shortfall in revenues in the course of the year, as the automatic stabilisers are allowed to play their role on the revenue side. At the same time they have a limited role on the side of social spending, as only about 300 000 of Turkey's 3 million unemployed are covered by unemployment insurance, due to the high rate of informality. Family and other social networks nonetheless play a central role in income maintenance. Additional discretionary stimulus of some 3% GDP was introduced in early 2009. It included substantial cuts in consumption and value added taxes for selected consumer and capital goods, applicable between March and June, which resulted in an immediate, but probably temporary, acceleration in private consumption and investment. Interest rate subsidies and guarantees have also been offered to enterprises, and new government guarantees on outstanding and new corporate debt are considered. Infrastructure investment is also being increased.

### ... if confidence is maintained

Supportive monetary and fiscal conditions will be effective only if markets remain confident in the long term sustainability of public finances. Turkey's risk premia relative to other emerging markets declined since late 2008 and were 120 basis points below the emerging market average in April 2009. Strengthening the medium term fiscal framework by introducing timely general government accounts and credible multiyear spending ceilings would reinforce confidence. Finalising a new Stand By Agreement with the International Monetary Fund would also help by providing a reliable funding source and credible monitoring.

### Growth will contract before strengthening in 2010

GDP growth is projected to fall by nearly 6% in 2009 and to start growing again in 2010 due to the international recovery and fiscal and monetary easing. Short and medium term risks appear relatively balanced. A swifter than projected international recovery and sustained competitiveness by Turkish exporters could boost growth. On the other hand, if international conditions worsen, or if confidence in the sustainability of Turkey's macroeconomic framework weakens, the recovery could be delayed.