Some Thoughts on Turkey’s 2022 Macroeconomic Outlook

As of the first quarter of this year, we are at the precipice of a new period in which the global economic and political outlook has completely changed. After the Covid-19 crisis of the past 2.5-3 years, the global economy is facing a new supply shock, the Ukraine-Russia war, and its ramifications. This turn of events has the potential to trigger both short-term and long-term changes. It is probable that for **the rest of the year, geopolitical developments will be a greater determinant for global financial markets than the macroeconomic outlook.**

The preliminary effect that we will witness will be sustained global inflation. The possible supply shortages in commodities, energy, and various food products will continue to put upwards pressure on prices. That being said, economies will try to adapt to the global supply chain shift. The war in Ukraine has added an important element of uncertainty to the already changing conjuncture with global supply chain bottlenecks, sudden increases in energy prices and inflationary pressure.

This new period may lead to quicker and more pronounced polarization for global economies. On the one pole, the U.S. and European economies will come together and likewise economies such as China, India, Russia, and Iran may align with each other. They may even form their own payment systems and implement their own trade agreements in the future. At this conjuncture, the change in the growth dynamics of the European, U.S and Chinese economies, and the new path on which they eventually settle will also gain importance. For example, while the U.S. economy is expected to grow by 3.5-4% in 2022, on top of its 5.7% growth in 2021, it will have to combat high inflation. Therefore, it is possible that the FED will continue to increase interest rates and monetary tightening aggressively, one after the other. In addition, it starts to implement monetary tightening measures, such as a balance sheet reduction. Meanwhile, its fiscal policy will be expansionary to support the economy with infrastructure investments. Its policy mix of choice will most likely be loose fiscal policy and a tight monetary policy design. The shrinking of the FED’s balance sheet, which started in 2008, saw an increase from USD1trn to USD4trn in the first stage and to USD9trn with the 2020 Covid-19 crisis, indicating that **the expansionary monetary policy that we have witnessed in the last 14 years has completely changed. This change will have different effects on all economies going forward.**

For Europe, the growth trajectory may be different from that of the U.S. economy. Therefore, the European Central Bank may not have the comfort of saying “let's tighten the monetary policy and control inflation, but loosen the fiscal policy,” like the FED. The war in Ukraine poses a huge risk to Europe due to its proximity to the war zone, a refugee inflow of 6 million people in the first stage and its commercial ties to the region. There is a risk of recession in the region, so in 2022, it is possible that the European Central Bank could make a policy error when it comes to tightening like the FED. Any mistake in monetary policy has the potential to drag Europe into a recession. Inflation is high and growth is under pressure. It should be noted that the inflation dynamics in the European economies are also different from that of the U.S. demand is strong in the U.S. economy, which is inflationary. However, the war broke out while Europe was just reaching its pre-pandemic production levels. Therefore, rather than inflationary demand, there is more supply-side inflation imported from the global markets. If the European Central Bank tightens its monetary policy rapidly, it may have to make a U-turn as the economy will be under greater pressure than expected soon.

This could possibly hurt regions like Turkey, where 50% of its exports are linked to Europe. In 2021, Turkey exported goods and services that totaled USD93bn to Europe. In 2022, we were working with an annual export increase of 20%. However, it is possible that Turkey’s exports will slow down significantly after the latest developments. European demand is the most important factor for Turkey’s exports to Europe and the effect of the depreciation in the Lira is very limited in terms of offering a competitive advantage. Therefore, a possible slowdown/stagnation in Europe will also negatively affect Turkey's export revenues.

On the flip side, Russia is Europe’s largest gas supplier, so there is also the risk of an energy-related slowdown in Europe. In addition, Russia and Ukraine are the two most important global grain suppliers. In general, there is likely to be a continuing problem in the global supply chain, especially on the agricultural commodities side, which inevitably indicates that global food inflation will not be a temporary phenomenon.

The Russia-Ukraine war might affect the Turkish economy through inflation and expectations, foreign trade, finance, and the tourism channels. Delving into the economic effects for Turkey, at first, we estimate a cost of approximately USD30-40bn. In our short-term figures, we are working with a possible cost of USD10bn from exports, USD5-6bn from tourism and minimum additional USD15bn from energy costs.

Macro Projections

		2022E		
	2021	TUSIAD	Bloomberg*	World Bank
GDP (bln USD)	802.6	690.0	829.1	566.1
Growth (%, real, yoy)	11.0	3.0	3.3	2.0
Inflation (%, End Of Period)	38.1	45.0	44.3	47.0**
Current Account Balance (bln USD)	-14.9	-30.0	-20.7	-14.6
Current Account Balance (% GDP)	-1.8	-4.4	-2.5	-2.6
Budget Balance (bln TRY)	-192.2	-551.5		-446.4
Budget Balance (% GDP)	-2.7	-5.0	-4.1	-4.6

Source: TDM, TUSIAD Calculations
* Consensus
**Year Average
E: Expected

Economic Costs of War	Economic Volume	Details and Costs
Foreign Trade (Russia)	US$34bn.	Turkey's exports to Russia account for US$6bn (3% of the total). The largest items are fruits, vegetables, textiles and automotive parts. Turkey's imports from Russia account for US$23bn (10% of the total). The largest items include energy/commodities and cereals.
Foreign Trade (Ukraine)	US$7.5bn.	US$3bn exports, US$4.5bn imports
Tourism	US$35bn for 2022 (TUSIAD calculations) US$22bn for 2021	Russia's share in tourism is 20% and Ukraine's is 8%. The total share of the two countries in tourism income is between 15-20%. From this item, we calculate a cost of approximately US$5bn in the first phase.
Oil	US$10-14bn. (additional cost)	Estimated cost for a 90-100 usd/bbl oil price is US$10-14 bn (average is 70 usd/bbl for 2021). (Oil prices fell to 40 usd/bbl just 1 year after the annexation of Crimea which pushed the prices up to 110 usd/bbl.)
Foreign Trade (Europe)	US$95 bn.	A severe slowdown caused by the expectations channel would create a cost that is difficult to calculate on exports. Turkey's total exports to Europe account for US$95bn. Our forecast was a 20% increase, so a 10% slowdown in our exports points to a cost of US$10bn.
Total	**US$35-40bn.**	
Inflation	On the global front, it is possible that commodity prices, which have increased sharply, will make a significant transition to inflation, together with the exchange rate, which is headed upwards. The year-end forecasts for 2022 are also being revised upwards.	The price increase in commodities and wheat prices since the beginning of the year is 40%. A similar increase is also valid for oil prices, which are hovering above 100 usd/bbl.

A stagnant story: Inflation, an increasing current account deficit and the Turkish economy's high external financing needs

Rising inflation and the need for external financing are still Turkey's Achilles' heel. Inflation, which was at c. 8.4% annually from 2006-2017, surpassed 15% yoy on average from 2018-2021. Inflation has averaged 25% over the last year. At the end of March22, CPI inflation came in at 62% yoy and PPI at 115% yoy. For the long view, as for monetary policy, there is a process time inconsistency like early interest rate cuts from time to time and delayed rate hikes in some periods. In addition, the inadequate economic framework adopted as of September 2021 is deepening the "inflation-currency-interest" spiral that is plaguing the country's economy.

Some Thoughts on Turkey’s 2022 Macroeconomic Outlook

As the global front is facing war-like supply shock and price increases, there is a risk of 70% annual inflation, especially in the second quarter of the year. Although annual inflation of around 45-50% yoy is calculated at the end of the year due to the base effect, our primary question is at what level inflation will stop and start to retreat? We are moving forward in a global environment where risks have become augmented even when compared to the beginning of the year and it will only become more difficult for Turkey to control inflation going forward.

The need for foreign financing in the economy, that is, the total need for foreign currency in 2022, is close to USD190-200bn. USD170bn of this is the foreign debt payment corresponding to this year and the remainder is the current account deficit. The foreign trade deficit, which has widened recently, indicates that the current account deficit will result in an increase, not a decrease, contrary to expectations. Especially on the global front, the tightening of financial conditions led by the FED’s tightening makes it both difficult to access foreign exchange and increases its cost. Furthermore, when Turkey's own vulnerabilities are added, access to the needed foreign currency becomes expensive both in terms of quantity and price. This inevitably creates pressure on the Lira and once again inflation with depreciation. Moreover, there appears a question of funding of growth for the rest of the year as well.

For Turkey to free itself from this vicious spiral, it needs to adopt a comprehensive economic policy design consisting of the right monetary policy, fiscal policy, and necessary sectoral structural changes. As we foresee the continuation of the existing monetary policy in the rest of the year, we anticipate the continuation of risks on both inflation and external financing. In this context, it may be somewhat difficult for economic growth to be supported significantly by the investment and export channels in 2022.

Macro Indicators (Period Average)

	2004-2012	2013-2015	2016-2020	2021
GDP (USD, End Of Period)	877.7	867.1	717.0	802.6
GDP (yoy, %)	5.7	6.5	3.3	11.0
CPI	8.9	8.1	12.9	36.1
CBRT Funds Rate	12.8	7.8	13.9	14.0
Budget Balance (%GDP)	-2.4	-1.1	-2.2	-2.7
Current Account Balance (%GDP)	-5.1	-4.4	-3.0	-1.8
External Debt (End Of Period, %GDP)	37.5	43.5	53.1	57*
Private Sector (%GDP)	22.5	30.2	35.5	30.1*
Public Sector (%GDP)	12.7	12.9	17.1	23.7*
USD/TRY (End Of Period, %)	33.0	37.0	110.8	79.7

Source: TDM, TUSIAD Calculations

*As of 3Q21