Turkey: Broad-based deterioration of the economy, mounting macrofinancial risks[33]

Das Wirtschaftswachstum der Türkei hat sich im Jahr 2018 auf nur mehr 2,6% verlangsamt, nachdem es im Jahr 2017 noch 7,4% betragen hatte. Die Wachstumsraten im 3. und 4. Quartal 2018 waren gegenüber dem Vorquartal sogar negativ und die Türkei war – technisch gesehen – das erste Mal seit zehn Jahren in die Rezession geschlittert.

Fiskalische Anreize im Vorfeld der Lokalwahlen am 31. März 2019 und der Wahlwiederholung in Istanbul am 23. Juni 2019 unterstützten jedoch im 1. Quartal 2019 den Privatkonsum und konnten den zuvor starken Abschwung etwas bremsen. In der Folge stieg das BIP im ersten Quartal 2019 um 1.3% gegenüber dem Vorquartal. Die Nettoexporte profitierten zwar weiterhin von der schwachen Lira, jedoch ging das Wachstum der Exporte aufgrund hoher Kapazitätsauslastung und aufgrund von Basiseffekten im ersten Halbjahr 2019 leicht zurück, während die Importe bereits seit Ende 2018 stark rückläufig waren. Das Wachstum der Bruttoanlageinvestitionen blieb, wie im zweiten Halbjahr 2018, weiterhin im negativen Bereich.

Der Preisdruck war seit seinem Höchststand im Oktober 2018 von 25,2% im Jahresabstand etwas rückläufig, blieb jedoch aufgrund der andauernden Abwertung der türkischen Lira und der expansiven fiskalischen Maßnahmen stark. Im Juli 2019 betrug die Inflationsrate 16,7%. Im Juli 2019 hat die türkische Notenbank ihren Leitzins um 425bp auf 19,75% reduziert – die größte Senkung seit 17 Jahren, nachdem der Leitzinssatz seit September 2018 konstant gehalten wurde. Das Niveau der Bruttofremdwährungsreserven bleibt mit USD 75 Milliarden (11% des BIP) alarmierend niedrig.

Die Abwertung der türkischen Lira hat sich seit Oktober 2018 und im Laufe des ersten Halbjahres 2019 eingebremst. Somit verzeichnete die türkische Lira von Anfang Januar bis Mitte August 2019 einen Wertverlust gegenüber dem USD von 5,5% bzw. gegenüber dem EUR um 1,5% und stand auf 5,6 TRL/USD und 6,2 TRL/EUR. Das Risiko einer weiteren Abwertung bleibt hoch.

Das Budgetdefizit betrug 2018 2,6% des BIP und lag somit über dem Fiskalziel von 1,9%. Expansive fiskalische Maßnahmen im laufenden Jahr, gekoppelt mit einem niedrigen bzw. negativen BIP Wachstum machen eine weitere Erhöhung des Budgetdefizits sehr wahrscheinlich. Die Kosten der Refinanzierung der öffentlichen Schulden stiegen gleichzeitig stark an und verringern zusätzlich den fiskalischen Spielraum des Staates, wenngleich die öffentliche Verschuldung immer noch auf einem relativ niedrigen Stand ist (31,8% des BIP im März 2019).

Die Unternehmensverschuldung in Fremdwährung bleibt eines der wichtigsten makrofinanziellen Risiken. Der Anteil der Fremdwährungskredite an den Unternehmenskrediten lag im Mai 2019 bei 48,2% und belief sich auf 23,2% des BIP. Der rezente Anstieg der notleidenden Kredite, insbesondere im Unternehmenssektor, stellt ein weiteres makrofinanzielles Risiko dar.

Marked slowdown of economic growth in 2018 followed by some moderation in early 2019

The Turkish economy slid into recession as GDP growth in the final quarter 2018 dropped into negative territory for a second consecutive quarter. Compared to 2017, economic growth in 2018 more than halved on annual basis and stood a 2.6%. All domestic demand components contributed to the growth slowdown in the second half of 2018. Investment declined by 8.8% yoy on the back of discontinuation of a number of public projects among others. At the same time, private consumption growth declined by 4.1% yoy due to a marked slowdown of consumer credit along with steadily

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increasing unemployment. On the external front, unlike in the first half of 2018, net exports became supportive for economic growth for the full year 2018. On the back of continuous depreciation of the Turkish lira (TRL), the recovery of the tourism sector and robust external demand (despite enduring jitters with the USA), exports shot up by 12.1% in the second half of 2018. In contrast to 2017 and in line with stagnating investment activity, real depreciation and lower private consumption, imports contracted by 20.6% yoy in the second half of 2018.

The trend somewhat changed in the first quarter of 2019 due to flurry supportive lending by state banks powering gains in industrial production and retail sales ahead of the local elections in March 2019. In addition, robust external demand supported the steady growth of exports (9.5% yoy). Accordingly, although GDP still declined on annual basis (-2.6%) in the first quarter, it edged up by 1.3% on a quarterly basis. Most recently, available high frequency indicators for April-June point towards a renewed deterioration of economic activity in the second quarter of 2019. Economic sentiment indicators for the next 3 months from May-July 2019 nosedived hinting that the slight recovery in the first quarter 2019 might have been only temporary. Business confidence indices show that business sentiments, in particular in the construction sector, are particularly negative with respect to the following 3 months, while only businesses in the services sector show signs of bottoming out.

GDP growth forecasts by major international organizations largely foresee a contraction of GDP for 2019 and a slight recovery in 2020 (see table below). Growth projections vary across available sources, indicating a substantial uncertainty surrounding the outlook for the Turkish economy. All GDP forecasts for 2019 significantly deviate from the projections in the medium-term program of the Turkish government from end-January 2019 (2019: 2.3%, 2020:3.5%).

Turkey: Projections of GDP growth

	2019	2020	Key risks for forecast
European Commission, May-19	-2.3	3.9	policy uncertainty, fiscal slippage, realization of contingent liabilities, deterioration of bank balance sheets to a level necessitating bail-out
IMF World Economic Outlook, April-19	-2.5	2.5	sudden shifts in capital flows, fiscal slippage, geopolitical risks
EBRD, May-19	-1	2.5	deterioration in banking sector, realization of contingent liabilities, further depreciation of TRY

Source: IMF (2019), European Commission (2019), Consensus Economics Inc., EBRD (2019)

Risks to medium-term GDP growth are tilted to the downside. Ongoing geopolitical tensions and enduring domestic political uncertainties might further worsen investor sentiments. In addition, Turkey's large gross external financing needs, high dependence on short-term capital inflows and high exposure to FX risks in the corporate sector, among others, might put additional risk to economic growth in the longer run. Further, the fiscal stance in 2019 might deteriorate due to expansionary policies, weak domestic demand and the activation of contingent liabilities.

An expansionary fiscal stance, sizable labor market deterioration

The fiscal stance remained expansionary in 2018 although some fiscal measures were discontinued as from September 2018 onwards due to, among others, high and rising inflation. On the back of temporary tax reductions, continued minimum wage subsidies, employment incentives schemes and

the Credit Guarantee Fund (CGF) loan support, the budget of the general government exceeded the budgetary target of 1.9% (as set in the New Economic Program from September 2018) and reached 2.6% of GDP. Some fiscal slippage continued to be notable also at the beginning of 2019 with nearly half of the budget target realised in the first five months of 2019. In particular, elevated subsidies for some food items, the reduction in VAT rates, the increase of the minimum wage as of 1 January 2019 by 26% ahead of the local elections on 31 March 2019 cast doubt on the feasibility of the budgetary deficit target for 2019 which was set at 2.4% of GDP.

Fiscal imbalances in 2019 are likely to deteriorate also due to planned measures announced in April. In particular, plans include the sale of Turkish government bonds predominantly to state-owned banks with the aim of strengthening their capital base. In addition, the setup and financing of two funds to take up some of the banking sector's NPLs (i.e in particular of the construction and energy sectors), although dragging longer than expected and thus putting at risk their intended financial sector stabilization function, would add on to the increase of fiscal costs. The government has announced overall costs of the planned measures to be in the tune of TRL 28 billion in 2019 (i.e USD 4.9 billion, close to 2% of 2018 GDP).

Although still on comfortable level, EU- defined gross public debt increased to 31.8% of GDP as of March 2019 and refinancing needs are close to 100%. Rising financing costs would imply also a high fiscal burden going forward. A further increase of public debt is likely as contingent liabilities are on the rise, *inter alia*, due to the expansion of state loan guarantees and heightened political uncertainty.

Since the second half of 2018, a marked deterioration of the labor market has been recorded, pushing up the overall unemployment rate (seasonally-adjusted) to 12.8% as of May 2019 – the highest reading in the past 10 years. Non-agricultural unemployment stood even higher – at 15%. The employment rate (49.3 %) remains well below the EU-28 average though (2017: 72.2%) with female employment rate slightly increasing but remaining below the alarming 35%. Youth unemployment (roughly one third of the Turkish population is below the age of 24) stood at 23.3% in May 2019 posting the largest increase on an annual basis among all categories.

Marked narrowing of the current account deficit, but external indebtedness on the increase

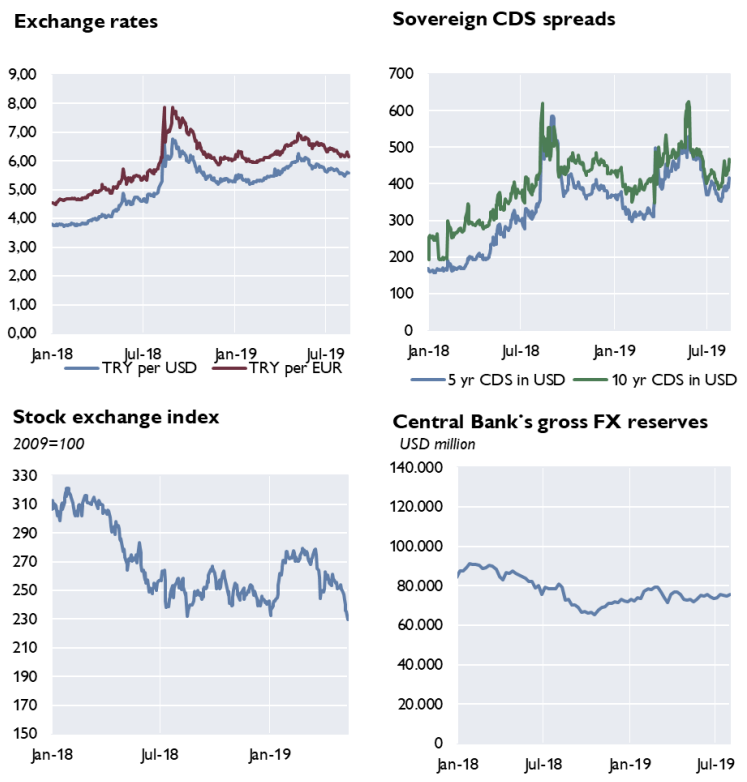
External imbalances as measured by the current account developments have been on the decline since mid-2018. The current account balance turned into a small surplus in the second half of 2018 (1.1% of GDP) – the first time in the past 15 years – narrowing the full-year deficit to 3.4% of GDP in 2018 from 5.6% of GDP a year ago. What is more, the balance of the moving four quarter current account average turned into a surplus in June 2019 – also the first time in the past one and half decades. This was due to a higher services surplus and the improvement of the trade deficit on the back of the strong depreciation of the TRL and the contraction of domestic demand which weighed on imports. Risks to further trade developments are tilted to the downside.

On the financing side, net FDI inflows amounted to 1.2% of GDP in 2018, thus covering 33% of the current account deficit in that year and remained flat in the first quarter of 2019. The economy is traditionally highly reliant on more volatile capital inflows – such as portfolio inflows and loans. Although immediate financing pressures have relaxed during 2018, financing difficulties are still elevated as portfolio and other investments that mainly represent bank flows experienced net outflows in the second and third quarter in 2018. However, latest data for 2019 show an increased interest from investors with portfolio investment climbing up to 5% of GDP in the first quarter of 2019 – the highest value since 2012.

Gross external debt soared in 2018 coming up to 62% of GDP as of March 2019 (i.e. EUR 393 billion). Gross external financing needs (i.e the sum of short-term debt, amortization of medium- and long-term debt and the current account deficit) remain among the highest in emerging markets and came close to 25% of GDP in 2018. Debt rollover needs for 2019 are substantial and the ratio of short-term debt to foreign exchange reserves came close to alarming 300% in the fourth quarter of 2018, with the non-financial corporate sector accounting for the larger share of it.

In June 2019, Moody's downgraded Turkey's long-term rating from Ba3 to B1 (outlook: negative) citing risks related to the effectiveness of monetary policy, further delays in implementing core structural economic reforms and the sizable external financing needs. In July also Fitch cut Turkey's outlook to negative (BB), three notches below investment grade, reflecting the possible implications of the current jitters in the Central Bank of the Republic of Turkey (CBRT) for the effectiveness of the monetary policy, among others[34].

Financial market developments since January 2018



Source: Macrobond, CBRT.

Monetary policy easing despite elevated inflationary pressures

Following a peak of 25.4% in October 2018, consumer inflation (CPI) came gradually down to 16.7% in July 2019 – clearly above the monetary policy target of 5%. The decrease of CPI was due to eased food prices and subdued domestic demand along with continued depreciation of the Turkish lira (TRL). Producer prices also started to slowly ease up on an annual basis compared to the peak of 46.2% in September 2018 and came down to still high 21.7% in July 2019. Despite enduring depreciation pressures, the Central Bank of the Republic of Turkey (CBRT) held back the increase of the key policy rate and kept the one-week repo rate at 24% unchanged since mid-September 2018 until recently. Surpassing market expectations, for the first time since 2016, the CBRT sharply reduced the policy rate in one step by 425bp to 19.75% on the Monetary Policy Committee meeting on 25 July, thus bringing in the biggest interest rate reduction in at least 17 years. In addition, at the end of July the CBRT cut its inflation forecast for 2019 to 13.9% from 14.6% but left next year's outlook unchanged at 8.2%. CBRT's scope of manoeuvre continued to narrow due to a rapid decrease

[34] With a decree published in Official Gazette on 6 July 2019, President Erdogan appointed with an immediate effect the new CBRT Governor to be Murat Uysal – previously a deputy governor of CBRT – thus effectively dismissing Murat Cetinkaya, who had occupied this position since April 2016. In addition, on 8 August at least nine senior managers of the CBRT were removed, including the CBRT chief economist: https://www.bloomberg.com/news/articles/2019-08-08/turkey-central-bank-removes-chief-economist-other-officials-jz34v7c6.

of the level of net reserves (excluding gold and deposits of commercial banks) in May to close to USD 30 bn (2 months of imports). Gross FX reserves (excluding gold) increased slightly recently and hover around USD 75 bn in August 2019 but are also very low (see chart below)[35,36].The pace of depreciation of the TRL slowed down in the course of 2019 despite several spikes of depreciation mostly related to the local election cycle in March and June, accordingly. Overall, TRL lost between the beginning of January and mid-August 5.5% vis-à-vis the USD and 1.5% and against the EUR, to reach 5.6 TRL/USD and 6.2 TRL/EUR (see chart). Risks for a further depreciation remain elevated[37].

Mounting financial stability risks

On the back of a pre-election fiscal stimulus, relaxation of lending standards for some segments and despite high inflation pressures, financial conditions have eased somewhat since the beginning of 2019. Nevertheless, overall credit growth (fx-adjusted) of the private sector started to slow down in the first half of 2019 and stagnated in June 2019 (-1.3% yoy). Domestic credit to the private sector still exceeds deposits by a sizable margin (24.2% of GDP as of mid-2019), implying a loan-to-deposit ratio of 131% as of June 2019, down from 142% as of end-2017.

While TRL-denominated loans increased since 2017 due to the loan guarantees through the CGF, the still elevated high share of foreign currency loans to the non-financial corporate sector constitutes a major risk for financial stability. The indebtedness in foreign currency of the corporate sector reached almost 50.4% of GDP in the first quarter of 2019. As of June 2019, the share of foreign currency loans in total loans amounted to the high 48.2% - thus broadly unchanged on both monthly and annual basis.

Credit risk to the private sector has been on the rise since August 2018. As of end-March 2019, the officially published NPL ratio amounted to 4% of total loans and thus edged up on quarterly basis by 1 percentage point. The NPL ratio of the non-financial corporate sector stood at 7% of total loans in the first quarter 2019. However, there are several reasons why this figure most likely does not capture the true asset quality of the Turkish banking system. In August and September, the Turkish Banking Regulation and Supervision Agency (BRSA) introduced several legislative amendments regarding the commercial code and restructuring arrangements aimed at alleviating the repayment pressure on Turkish corporate and subsequently on the banking system. In addition, BRSA undertook an asset quality review in December 2018 announcing that the NPL ratio might increase to 6% of total loans.

Overall, although the banking sector appears to have some capital buffers, there has been a declining trend in capitalization. The overall Capital Adequacy Ratio (CAR) stood at 16% as of March 2019, compared to 16.9% in the third quarter of 2018. The Tier 1 CAR declined as well and was at 12.6% as of March 2019, which is slightly above the regulatory minimum of 12%. Noteworthy, from June to December 2018 BRSA has passed supportive regulations for the CAR calculation. While these measures have helped lower the stress on Turkish banks, they have also reduced the transparency regarding the true condition of the banking sector. The profitability of the banking sector took up one

[35]According to back of the envelope estimations by Financial Times, net FX reserves of the CBRT (i.e after subtracting swap agreements) even dipped into negative territory at the end of April 2019 due to the extensive use of currency swaps by the CBRT: https://www.ft.com/content/9718e75e-611d-11e9-b285-3acd5d43599e.

[36] The increase was mainly due to a currency swap in the tune of USD 1 billion between the CBRT and the Central Bank of China in June 2019.

[37] The Turkish lira depreciated again strongly following the cut-off date of this publication (16.08) losing 4% vis-à-vis the USD and 4.8% against the EUR by 26 August.

of the lowest levels in the past three years mainly due to a surge of operating expenditures reflecting the increase of funding costs. The Return on Assets (ROA) of the banking sector was 1.2% and the return on equity (ROE) stood at 12.5% as of March 2019. According to an analysis by the CBRT, net interest income and non-interest income had a positive impact on the profitability development, while non-interest expenses had a large negative impact, driven by higher general provisions related to the implementation of a new accounting standard (IFRS 9).