DEVELOPMENT ECONOMICS REPORT

Advantages and disadvantages of the Covid-19 crisis

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A quick overview of Turkish economy in the last two decades

For a period, Turkey had the macro-economic stability that now seems so unreachable. After the 2001 crisis, the central bank was granted more independence since the aim was to lower inflation and then keep it at the desired level. When President Erdoğan came to power in 2003, he kept following these policies, inflation dropped significantly, and GDP growth took off. However, in a few years, the central bank started losing its independence and gradually became more and more subject to political pressure. It lowered the interest rates more and more, even if inflation kept growing.

Despite the fact that the macro-economic situation of Turkey isn't flourishing , it is worth noticing that the economy keeps going well as it used to do in the past two decades. It has a large domestic market of mostly young consumers and has long been a staging post for trade between east and west. In addition as a country it has a solid business culture. Turkish entrepreneurs have, by now, become used to economic volatility and high inflation, hence they have learnt how to adjust to a weak lira.

The consequences of the pandemics

As a result of the Covid-19 crisis, Turkey has experienced an acceleration in economic activity, with sped up the economic recovery of the country, however this positive note is counterbalanced by a negative consequence: micro-financial volatility has risen, and this phenomenon has mostly impacted households.

During the first three quarters of 2021, after a year of restrictions, quarantines and closures, the Turkish economy started recovering and experienced an 11.7% growth, which has been triggered by both domestic and foreign demand. As a result of this increase in demand, the external and fiscal balance improved while unemployment fell significantly.

Nevertheless, this quick and apparently miraculous recovery has also had a number of downsides. The first negative consequence that we can observe is the depreciation of the Turkish currency, the Lira, to record low levels in the last quarter of 2021 and has lost half of its previous value by the beginning of December of the same year. (It subsequently started appreciating again, even if its value has remained volatile). The Covid-19 pandemic has also exacerbated the already existing income and labor disparities. The inequalities that have been amplified by the insurgence of the pandemics also include gender inequality, especially regarding workplaces. The regional inequalities of the crisis also manifested in larger impacts for women from Eastern regions, widening the existing gender gaps.

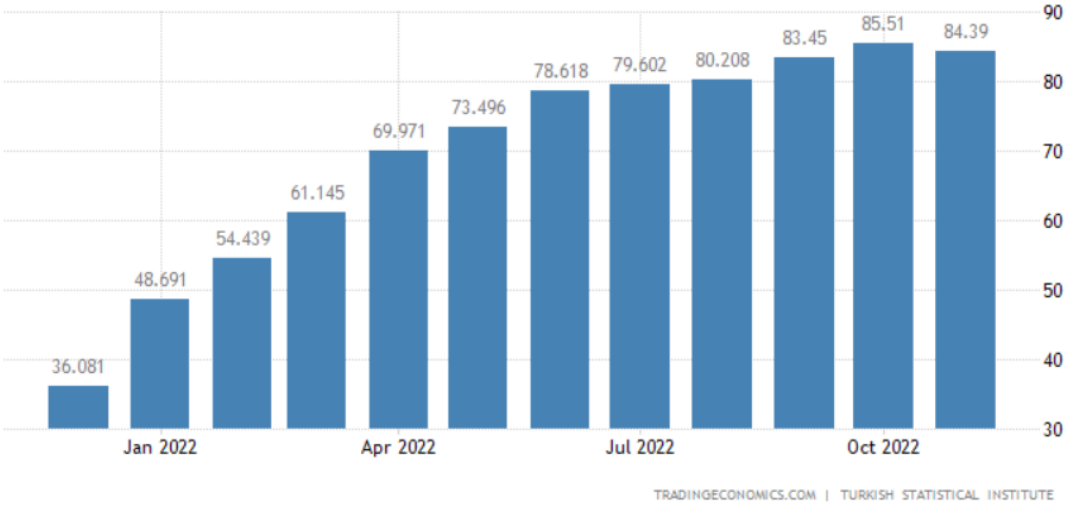
The threat to Turkey's development: High Inflation

High inflation may further exacerbate macro financial vulnerabilities, erode real incomes and disrupt production and supply channels. High inflation also represents a threat for Turkey's progress on poverty and inequality reduction.

After expanding 11% in 2021, Turkish economy is expected to grow 4.7% in 2022 and 2.7% in 2023, economic activity is expected to weaken in the second half of 2022 and this is due to the fact that as macroeconomic volatility intensifies, inflation keeps decreasing the purchasing power of households, that are no longer able to maintain the previous level of consumption.

Another consequence of high inflation concerns the poverty rate. In fact, despite the labor market and economic recovery that took place in 2021, the poverty rate is expected to remain above the level that could be observed before the pandemics. As anticipated, this is due to persistently high inflation that affects the lowest-income households the most since they spend a far bigger share of their income on items like food and basic needs in general, which face higher than average inflation.

TURKISH INFLATION LEVEL IN 2022



What can policies do?

Macroeconomics policy settings should adjust to boost confidence and mitigate macro financial risks. Further monetary policy loosening will continue widening both internal and external imbalances. Policies should also focus on supporting the most vulnerable groups and improving labor market outcomes.

A focus on improving Turkey's long-term global competitiveness is also necessary since the country has not been attracting as much foreign investment as in the past or compared to other emerging markets. Good quality foreign direct investment (FDI) which is more productive, is important for countries like Turkey whose aim is too catch-up to high income levels. It is essential that Turkey attracts foreign capital since it is a low-saving country, which means it needs investments from outside to cover the persistent deficit on its current account.

Right after the Covid-19 crisis, while many countries have raised interest rates to keep prices in check, Turkish government has repeatedly cut them. In November the International Monetary Fund has recommended that Turkey raise the interest rate to start driving inflation down and grant more independence to its central bank. But there has been no intention on behalf of the government to modify the current strategy, instead, at the end of November, the central bank lowered interest rates again.

There is an urgent need to stimulate the demand for labor and increase the inclusion of vulnerable youth and women. A study conducted by the United Nations Development Program (UNDP) in 2019, in fact, it shows that labor force participation rates were just 34% for women, against 72.6% for men. Additionally, more recent data show that the pandemic has made the situation even worse, pushing the rate for women to just 30%.

What does future hold for Turkey?

As it has happened in 2021, in 2022, growth is expected to be for a large part driven by the persistent rise in exports and consequently the composition of growth is expected to continue shifting towards foreign demand, to the point that net exports could drive more than two thirds of growth in 2022.

On the production side, the services sector is projected to increase its contribution to growth in 2023, it is especially the strong recovery of the tourism sector that will lead this advancement.

However, even though Turkish economy kept growing in the last years, high inflation and consumer prices together with widespread poverty and disparities, prevent Turkey from being a developed country at 360 degrees. There exist fundamental issues that on the macro-economic level that require a trend inversion to be resolved. To start, the central bank has to reacquire the independence it used to have in the past, as a consequence, it would be able to modify interest rates so as to balance inflation levels and avoid further devaluations of the Lira.

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