Türkiye, Between Economic Vulnerabilities and Political Ambitions as a Regional Power

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Abstract: T*he Turkish economy continued its strong post-pandemic recovery trend in 2022, with a growth rate of 5.6%, which exceeded authorities' expectations, with private consumption contributing significantly to economic growth, amid wage increases and the support provided for households with regard to energy costs. The earthquakes in Turkey earlier this year had a devastating impact on the population and on the economy in the southern country. The reconstruction effort will cover the losses incurred, so GDP will continue to grow over the next two years, but at a slower pace than in recent years. Exports will moderate, while imports will accelerate. Under the post-election effect, the new administration led by President Erdogan seems inclined to adopt radically different policies from those of recent years, returning to conventional methods of targeting inflation and restoring macroeconomic balance.*

Key words: Economic outlook, Türkiye, inflation rate, natural disasters, economic nationalism

JEL classification: E00, E60, F52, O53

1. Introduction

Türkiye is one of the global emerging powers, given the size of its economy, the growth rate, its strategic geographical position that mediates trade on the East-West route and its productivity factors. Türkiye is located in Southeast Europe and Southwest Asia, having control of the Bosporus and Dardanelles straits on the Black Sea, but also it widens to the Middle East. Türkiye has a large and expanding population with a low median age of the active population. Türkiye's population reached 85.27 million in 2022, 0.6 million up from the previous year, ranking 17th in the top countries by population size in the world and the 2-nd in Europe (Turkstat, 2023). Türkiye has been a NATO member state since 1952 and is the Alliance's second-largest military power. The state is a candidate for membership in the European Union, a process that has been dragged on for a long time due to political differences and security and justice issues raised by Western partners. With a nominal GDP expressed in US dollars at current prices of 906 billion, in 2022, Türkiye ranks 19th in the world, being part of the G20, the group of the world's top 20 countries by economy size (The World Bank, 2023). In terms of GDP / capita, with a value of USD 10,616 / capita, Türkiye falls into the category of emerging economies, with upper-medium incomes (CIA, 2023).

On February 6, 2023, starting at 4.17 a.m., southern Türkiye was hit by a series of devastating earthquakes, with a magnitude of 7.8 on the Richter scale recorded in the epicenter area near the city of Gaziantep, followed about 9 hours later by another, equally powerful, 7.5 degrees, located in the Kahramanmaras county, as well as by numerous smaller aftershocks. On February 20, a 6.4 magnitude earthquake struck Hatay county, located in the same region (SBB, 2023). The quakes affected a total of 11 counties in Türkiye and 4 in Syria, making them the strongest in 20 years and as strong as the 1939 earthquake, the largest recorded in that region. They were the most devastating earthquakes recorded in Türkiye in modern times and the deadliest globally since the 2011 earthquake in Japan.

Türkiye's economic prospects for the current year, but also for the following years, are therefore under the impact of earthquakes. The damage produced by these hazards was estimated at 2,000 billion Turkish lira (103.6 billion USD, respectively 9% of GDP), with losses distributed as follows: housing (55%); public infrastructure and administrative buildings (12%); private sector, excluding housing (11%); insurance and macroeconomic impact (22%) (SBB, 2023).

This article presents **Türkiye's economic outlook for 2020-2024** based on the main macroeconomic indicators, **and provides** a qualitative analysis of the factors that have the greatest impact on the evolution of the economy during the reference period.

The tense regional geopolitical context, the late and seamless modernization of the Turkish state, with major historical reminiscences and influences since the Ottoman Empire, the natural disasters it faced just this year, all these make Türkiye's analysis from the perspective of its economic performance a difficult study. A study that is marked by many risk factors and uncertainty. The relevance of the study is, at the same time, indisputable, both for the decision-makers in Romania, given the common neighborhood of the two countries, as well as for the intense traditional relations. Nevertheless, the economic research of this country is of general relevance, regarding Türkiye's particular economic growth model and the unorthodox economic and monetary policies it applied in recent years.

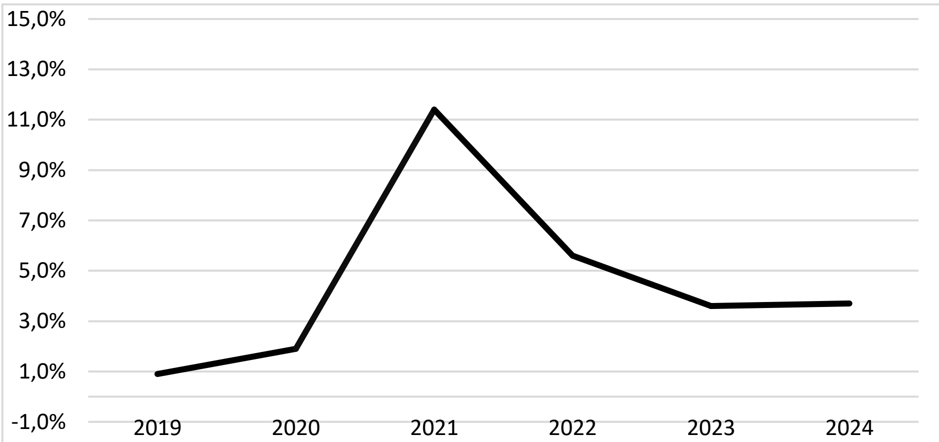
2. Türkiye's economic outlook

The Turkish economy continued its strong post-pandemic recovery trend in 2022, with a real GDP growth rate of 5.6%, which exceeded authorities' expectations (Figure 1). The start of the year was clearly favorable for exports, but they soon moderated in the second half of the year, while imports continued to grow. The foreign demand, due to the post-pandemic recovery, but also the development of technology-intensive sectors drove to a record volume of industrial production this year (European Commission, 2023).

The volume of exports of goods and services increased by 9.1% yoy, while imports also increased by 7.9%, with net exports contributing 0.4% to GDP growth (Turkstat, 2023).

The Turkish government has remained consistent in implementing the "Turkish economic model" which began in autumn 2021. This plan aimed to "achieve a positive current account balance, reduce dependence on external financing (in the short term) and increase the role of Lira in the economy (de-dollarization), while keeping the interest rates low and directing credit to productive and high value-added sectors. The plan also involves prolonging macroprudential measures and other complex and sometimes disruptive regulatory measures, such as in the case of financial markets" (European Commission, 2023).

Figure 1. Türkiye's economic growth rate, 2019-2024[*] (%)

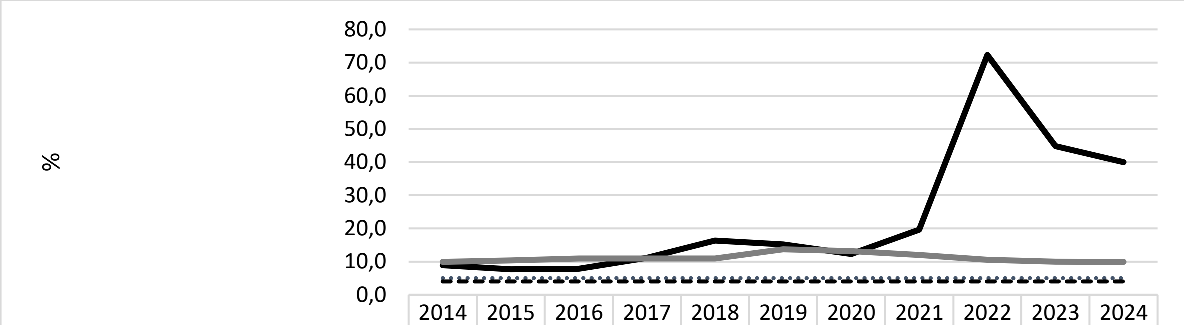


Source: OECD (2023), *2023-2024 – forecast.

Despite the performance in the economic activity, Türkiye's macroeconomic instability has deepened. The energy price crisis, aggravated by the war in Ukraine, which has affected the entire European continent, has also left its deep mark on the evolution of prices in Türkiye, both for industrial products and for consumer goods and services. The escalation of energy prices has reflected Türkiye's vulnerability linked to its dependence on imports of energy products, especially imports from Russia: Türkiye imports 99% of its natural gas needs, of which about 40% from Russia and also imports 89% of its crude oil and petroleum products demand, of which over 25% from Russia. Russia is Türkiye's main source of natural gas imports and its second largest source of crude oil, after Iraq.

Against this background, inflation has escalated to record levels, with the Harmonized Index of Consumer Prices peaking at 85.4% in October 2022. The annual average inflation rate was 72.3%, well above the central bank's target of 5%. This progression had a negative impact on the purchasing power of households, especially for low-income households.

Figure 2. Inflation versus unemployment rate, 2014-2024* (%)



	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
inflation rate	8,9	7,7	7,8	11,1	16,3	15,2	12,3	19,6	72,3	44,8	40,0
unemployment rate	9,9	10,3	10,9	10,9	10,9	13,7	13,1	12,0	10,5	10,0	9,9
inflation rate target	5,0	5,0	5,0	5,0	5,0	5,0	5,0	5,0	5,0	5,0	5,0
natural unemployment rate	4,0	4,0	4,0	4,0	4,0	4,0	4,0	4,0	4,0	4,0	4,0

Source: OECD (2023), * 2023-2024 – forecast.

In order to ease the burden of **general price increase** on the population, the authorities have adopted several measures to support incomes, including the accelerated increase of the minimum wage (by 50.6% in January 2022, by 29.3% in July 2022, by 54.6% in January 2023 and by 34% in July 2023). Thus, the net monthly minimum wage increased from 2,825 Turkish lira to 11,402, a nominal increase of 300%. The pro-cyclical measure was aimed to maintain the purchasing power of low-income households and support private consumption, the main component of GDP and the main driver of economic growth. Therefore, the private consumption raised by 19.3% in 2022 compared to the previous year. In addition, the authorities have adopted measures regarding energy costs, reducing or cancelling some energy taxes, compensating with subsidies the natural gas and electricity bills for different categories of population.

As regards the monetary policy, the central bank has maintained its unconventional approach, in line with the "Turkish economic model". Thus, despite price escalation, monetary policy has been expansionary, with benchmark interest rates successively reduced from 14% in 2021 to 9% in 2022 and 8.5% in March 2023. This fundamental contradiction with classical economic theory required a series of stimulus or, as the case may be, restriction measures in the sphere of financial economy and the banking system, including: imposing the obligation to maintain deposits denominated in lira, protecting deposits in lira from massive depreciation of the exchange rate, tax exemptions, obligations regarding foreign exchange reserves, establishing the obligation to sell to the central bank 40% of the currency obtained from sales by exporters, the obligation to maintain a 10% rate of assets consisting of government securities denominated in lira by banks, respectively 20% of the value of loans granted if the interest rate on loans exceeds 1.4 times the reference interest rate, setting capital safety rates and strict rules for granting loans for commercial purposes, etc. (European Commission, 2023). These measures distorted market price signals and aggravated financial risks, especially in the banking system. Despite all risks, the banking system remained resilient (OECD, 2023).

The lira's exchange rate depreciated by 40% against the US dollar in the first three quarters of 2022, before stabilizing at the end of the year. The depreciation of 80% against the dollar, cumulated over the last 5 years, weighs heavily on the cost of living of Turkish citizens. Efforts to prop up the lira have significantly weakened the country's foreign exchange reserves and lowered confidence among international financiers.

In terms of fiscal and budgetary policy, the Turkish government has managed to achieve the budget deficit target. In fact, the budgetary exercise was above expectations due to windfall revenues amid high inflation and additional profits of companies. The budget deficit was only 0.9% of GDP at the end of the year, below the authorities' forecast of 3.2% of GDP in September 2022 and below the 2021 level of 2.8% of GDP. This result was also positively reflected in the exercise of public debt. Thus, if at the beginning of the year the public debt-to-GDP ratio stood at 42.3%, the denomination effect of the lira, in the context of high inflation, reduced the public debt ratio to 31.7% of GDP at the end of the year. Under the effect of inflation, international experts anticipate a low ratio of public debt to GDP in the coming years, as well (European Commission, 2023).

The labor market remained vulnerable, with a persistent unemployment rate of 10.4% of the active population, but declining after the COVID-19 pandemic, when it reached 13%. The post-pandemic recovery trend is noted: the number of employees increased by 7.8% in 2022, especially in construction, trade and manufacturing. The employment rate was 47.5% of the active population, compared to 42.7% in 2020. In contrast, large differences remain between men (65%) and women (30.4%). The youth unemployment rate also remains at an alarming 19.4%, down from 22.6% in 2021 (Turkstat, 2023).

In terms of the foreign trade balance, the indicators worsened, despite the exceptional performance of exports in recent years. Thus, the current account deficit widened to 5.4% of GDP, compared to 0.9% of GDP in 2021. It is also expected that the current account deficit will widen in the current year, due to reconstruction efforts in the region affected by natural disasters.

The main stimulus of Türkiye's exports was the depreciation of the lira's exchange rate against the currencies of trading partners. The value of imports increased in two directions: escalating energy prices in regional markets and the gold imports. Thus, the value of energy imports doubled compared to the previous year, having registered the main "contribution" to the current account deficit. At the same time, Türkiye achieved a surplus in trade in goods other than gold and energy (European Commission, 2023).

The foreign trade situation by destination countries and import sources is presented in Table 1.. The European Union consolidated its position as Türkiye's main trading partner, in particular as an export market for goods.

Table 1. Türkiye's main foreign trade partner countries by value of exports and imports, respectively, 2022

Rank	Country of destination of exports	Share in exports (% of total value)	Source country of imports	Share in imports (% of total value)
1	Germany	8.4	Russia	18.0
2	USA	6.7	China	13.0
3	Iraq	5.4	Germany	7.4
4	United Kingdom	5.1	Switzerland	4.7
5	Italy	4.9	USA	4.7
6	Spain	3.8	Italy	4.3
7	France	3.8	India	3.3
8	Russia	3.7	France	2.9
9	Others	58.2	Others	41.7

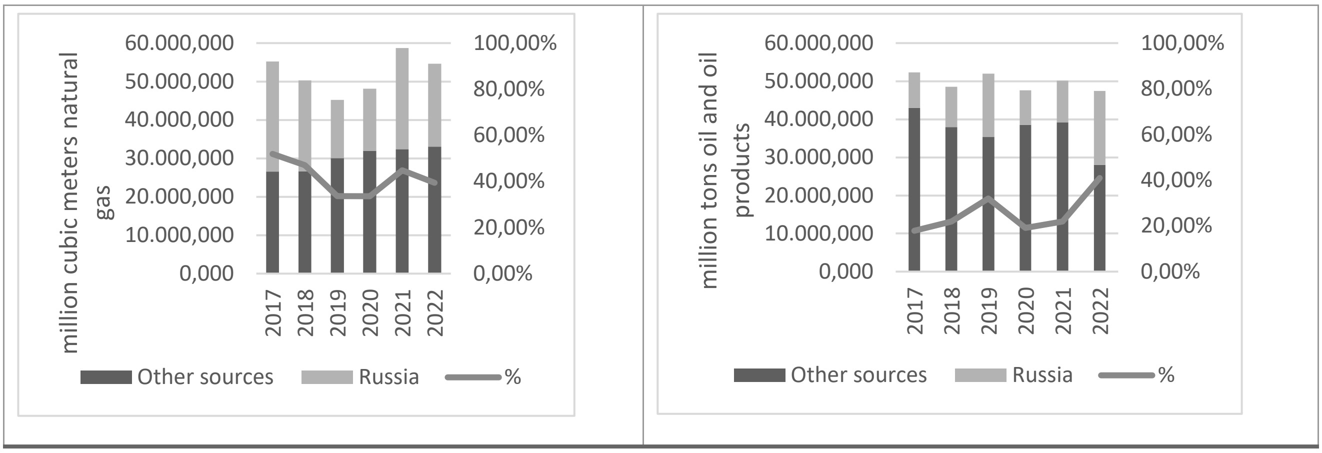
Source: compiled by author, based on data (Trading Economics, 2023)

With the reconfirmation of Mr. Recep Tayyip Erdogan as president after winning the presidential elections in May 2023, doubled by ensuring the government by the president's party, the Justice and Development Party (AKP), the Turkish government has entered a new stage, with a radically different approach than in recent years: under the pressure of a necessary infusion of external funds to finance reconstruction in the earthquake zone, amid rampant inflation, the Turkish administration has abandoned loose monetary policy and is trying to target inflation using conventional methods. The changes at the top of the central bank and the finance minister have brought a more inclined approach a more inclined approach toward a monetarist policy of macro-financial stabilization. Therefore, the first decisions aimed to increase the reference interest rate from 8.5% to 15%, in an attempt to temper inflation. Fiscal measures are also expected to restore macroeconomic stability, aimed at alleviating the current account deficit and restoring foreign exchange reserves.

3. Türkiye – Russia trade relations

Following the invasion of Ukraine by the Russian Federation, trade relations between Türkiye and Russia intensified, despite economic sanctions imposed by NATO and the European Union, which Türkiye did not submit to. Thus, the volume of trade between the two countries increased from $ 34.73 billion in 2021 to $ 68.19 billion in the year of analysis, practically doubling. In particular, Türkiye's imports increased from $28.95 billion to $58.85 billion. Türkiye was among the first countries to take advantage of the EU's imposition of sanctions, after China and India. Since April 2022, Türkiye 's oil import volume from Russia has doubled, benefiting from a very advantageous price (USD 37.8/barrel, compared to USD 60.12/barrel at the beginning of the invasion) (Nordic Monitor, 2023). As shown in Figure 1, imports of crude oil and petroleum products from Russia increased in particular, reaching a share of 41% of the total import volume, compared to 22% in 2021. For natural gas, although the volume of imports from Russia decreased by about 19% compared to the previous year, it accounted for 40% of the total volume of Türkiye's imports.

Figure 3. Evolution of Türkiye's import volume of natural gas and oil respectively and dependence on imports from Russia, 2017-2022 (%)



Source: compiled by the author, based on corroborated data taken from (S&P Global, 2023), (Statista, 2023), (Trading Economics, 2023) and (Nordic Monitor, 2023)

The cooperation between the two states was not limited to energy products. Türkiye also imported from Russia the equipment needed to build this year the first nuclear reactor of the Akkuyu plant, located in the south of the country. The plant, comprising four VVER-1200 reactors designed, owned and operated by Rosatom, Russia's state-owned energy company, will be fully operational in 2026 with a total capacity of 4,500 MW. The plant will produce about 10% of Türkiye's electricity needs.

Amid the war in Ukraine and the rupture of relations between the European Union and the Russian Federation, Türkiye steps forward to become the winner in the energy sector. Already, part of the natural gas and crude oil flows, flowing in the East-West direction, from the Russian Federation, have been redirected through Türkiye. Türkiye could become a regional energy hub in the medium term, especially as it seeks long-term partnerships with producer countries in Central Asia, such as Turkmenistan and Azerbaijan or the in Middle East, including Iran and Libya, thus facilitating energy transit to Central and Western Europe. In addition, Türkiye has made new discoveries of natural gas deposits in the Black Sea, in the Sakarya perimeter, exploitable since this year, which will reduce its dependence on imports.

4. Conclusions

In conclusion, one-off factors have a predominantly negative impact on Türkiye's economy, which has been experiencing major macroeconomic imbalances in recent years, despite sustained economic growth and relatively rapid recovery from the COVID-19 pandemic.

The factors that influenced Türkiye's economic evolution in 2022-2023 were the following: the revival of the external demand after the pandemic and the strengthening of Türkiye's position as one of the main regional producers and exporters of industrial and consumer goods; the persistence of macroeconomic risks and instability amid the implementation of the Turkish economic model and the adoption of non-standard monetary measures; the devastating earthquakes in the south of the country in early 2023, with major impacts on the local population and the region's economy; the energy price crisis and huge dependence on energy imports; the war in Ukraine and the persistence of regional geopolitical tensions; strengthening Türkiye 's trade relationship with the Russian Federation; the holding of general and presidential elections in May this year.

The earthquakes in Türkiye earlier this year had a devastating impact on the population, causing human and material losses unprecedented in the modern era of this country. The reconstruction effort will compensate for the losses suffered, so GDP will continue to grow over the next two years, but at a slower pace than in recent years.

The earthquakes caused damage estimated by the government at about $103 billion (9% of GDP), consisting mainly of collapsed or majorly damaged housing, followed by losses caused to the private sector, through affected commercial and industrial buildings, public infrastructure and macroeconomic impact. The industrial production sector is the most affected in the short term, followed by agriculture, trade and tourism.

Also, the macroeconomic impact is relevant, earthquakes having an effect of increasing prices this year, after Türkiye experienced a massive escalation of inflation rate in the previous year. The inflation rate will remain very high this year as well. In addition, the government's rescue and reconstruction efforts require additional budget spending allocations, which will deepen the budget deficit to 5% of GDP this year. At the same time, demand for imported raw materials and materials for reconstruction is increasing, while impact on exports remains negligible. As a result, the trade deficit is deepening, putting pressure on the external debt and, implicitly, on the exchange rate of the Turkish lira.

Under the post-election effect, the new administration led by President Erdogan seems inclined to adopt radically different policies from those of recent years, returning to conventional methods of targeting inflation and restoring macroeconomic balances.

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