TURKEY

GDP growth is projected to increase from 3% in 2015 to above 4% in 2017, as political uncertainties are assumed to fade, employment continues to rise, and the exchange rate depreciation and the gradual strengthening of global markets support export growth. The geopolitical crisis at the southern border and the associated influx of refugees pose challenges. Currency depreciation until October has strengthened price competitiveness, but has also weakened household confidence, created pressures on corporate balance sheets and added to already high inflation.

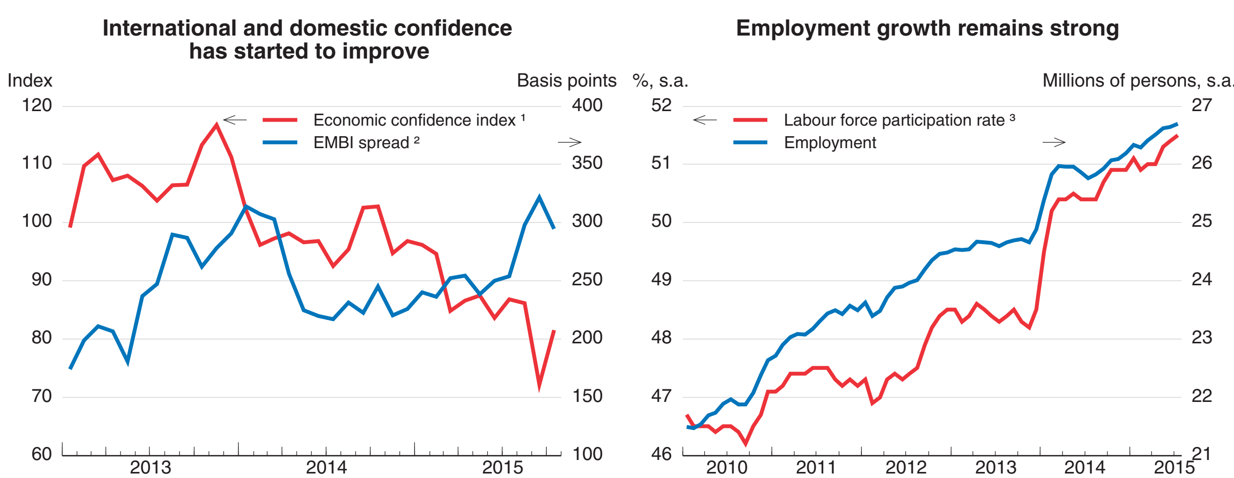
Large external funding needs and volatile international capital market conditions warrant cautious macroeconomic policies. Monetary policy should remain tight to ensure inflation is controlled, and it may have to be tightened if inflation remains persistently above target. Room is probably available for fiscal support, although shortcomings in fiscal transparency at the general government level make judgments in this area difficult. Progress in implementing programmed structural reforms will be crucial to rebalance demand and strengthen growth.

Turkey's carbon footprint per capita is lower than in the more advanced economies, but is growing at one of the fastest rates in the OECD area. The government's recent announcement of a quantitative emission path for the period 2020-30 should help to set concrete energy efficiency measures, such as stronger harmonisation of tax rates on fuels in different uses, and will promote investment in renewable energy.

Growth has been below potential

Job creation and private demand have remained robust on the back of falling oil prices. On the external side, regional turmoil has escalated and total exports have continued to contract, notably reflecting rapidly declining trade with Russia and Iraq. Over 2 million

Turkey



1. Türkstat composite index combining consumer, business, retail trade, construction and service sector indexes.
2. Stripped spread in basis points of the JP Morgan Emerging market bond index (EMBI), global index for Turkey.
3. In percentage of the population aged 15 and older.

Source: Thomson Reuters (2015), Datastream database; and Turkish Statistical Institute.

StatLink http://dx.doi.org/10.1787/888933296541

Turkey: **Demand, output and prices**

	2012	2013	2014	2015	2016	2017
	Current prices TRY billion	Percentage changes, volume (1998 prices)				
GDP at market prices	1 416.8	4.2	2.9	3.1	3.4	4.1
Private consumption	994.4	5.1	1.4	3.3	2.8	3.8
Government consumption	210.3	6.5	4.7	8.1	5.2	3.6
Gross fixed capital formation	287.1	4.4	-1.3	5.7	4.7	5.0
Final domestic demand	1 491.8	5.1	1.3	4.5	3.5	4.0
Stockbuilding[1]	- 1.9	1.4	0.0	-0.7	-0.3	0.0
Total domestic demand	1 489.9	6.5	1.4	3.9	3.3	4.1
Exports of goods and services	372.6	-0.2	6.8	-0.7	2.5	5.7
Imports of goods and services	445.7	9.0	-0.2	1.5	2.4	5.6
Net exports[1]	- 73.1	-2.9	1.8	-0.7	-0.1	-0.1
Memorandum items						
GDP deflator	_	6.2	8.3	7.3	6.8	5.0
Consumer price index	_	7.5	8.9	7.4	6.9	6.5
Private consumption deflator	_	6.2	7.0	7.3	6.5	5.9
Unemployment rate	_	9.0	10.0	10.5	10.8	10.3
Current account balance[2]	_	-7.9	-5.8	-5.3	-4.9	-4.9

1. Contributions to changes in real GDP, actual amount in the first column.
2. As a percentage of GDP at market value.
Source: OECD Economic Outlook 98 database.

StatLink http://dx.doi.org/10.1787/888933297268

refugees from Syria are adding to Turkey's strains. In contrast, export prospects in European markets have been improving and domestic and international confidence turned up in October, while the outcome of the legislative elections in November reduced political uncertainty.

The sharp exchange rate depreciation improved price competitiveness for exporters, but has also pushed up consumer price inflation and end-of-year inflation expectations, which are now both running at around 8%, well above the 5% target of the central bank. The current account deficit is projected to remain above 5% of GDP in 2015, as growth continues to rely disproportionately on domestic demand. Foreign funding needs are projected to reach 25% of GDP in 2016, including the refinancing of external debt. Bank and other corporate liabilities are being rolled over smoothly, but high dependence on global capital market conditions remains a source of vulnerability.

Prudent macroeconomic management and ambitious structural reforms are needed

Monetary policy should stay cautious despite significant economic slack, as the priority is to maintain confidence by containing inflation. This may require tightening if inflation remains persistently above target. There might be room for countercyclical fiscal stimulus, but weak fiscal transparency at the general government level makes judgments about the stance and sustainability of the fiscal position difficult. The consolidated balances, on an accrual basis, of the social security system and local governments, government guarantees to public-private partnerships and the quasi-fiscal activities of state-owned entities should all be reported more systematically. Macro-prudential measures have helped contain loan growth since mid-2014 and should remain in place.

Enhancing competitiveness is key to make the most of the ongoing recovery of Turkey's main European export markets. The sharp exchange rate depreciation has helped exports, but the competitiveness gains will be dissipated if inflation stays high or, worse, rises. Progress with the structural reforms programmed in the National Development Plan 2014-18, notably in the labour market, would help shift employment to formal firms, improve productivity and help rebalance growth. The creation of higher-quality and better-paid jobs in the formal sector, notably for low-skilled women, many of whom currently work in the informal sector, would improve social inclusion.

Greenhouse gas emissions per capita are lower than in the more advanced economies but increased by 110% between 1990 and 2013, one of the fastest rates among OECD countries. This calls for effective energy efficiency measures, such as stronger harmonisation of the implicit carbon tax rates on fuels, including coal, used across sectors, and investment in renewable energy.

Growth is set to pick up gradually

Growth is projected to increase to 3½ per cent in 2016 and to over 4% in 2017, assuming that political normalisation after the November elections will foster a recovery in private consumption and investment. The main downside risks relate to the escalation of regional geopolitical conflicts and to a weakening of activity in Europe and China. Any further deterioration in international and domestic confidence may worsen financial strains, and hold back growth more than projected. In contrast, improved governance conditions and tangible progress with reforms could lift competitiveness and confidence and stimulate additional investment and job creation.