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MAY 2018

MINDING THE EXTERNAL GAP





TURKEY ECONOMIC MONITOR,
May 2018:
Minding the External Gap

WORLD BANK GROUP

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The Turkey Economic Monitor (TEM) periodically analyzes economic developments, policies and prospects in Turkey. The TEM was prepared under the guidance of Johannes Zutt (WB Country Director, Turkey) and Lalita M. Moorty (Practice Manager, Macroeconomics, Trade and Investment) by Habib Rab (Program Leader, EFI Turkey), Pinar Yasar (Country Economist, MTI GP), and Erdem Atas (Research Analyst, MTI GP). The TEM (May 2018) is based on data as of end April 2018.

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Executive summary

Taking stock

A strong policy response – on the back of fiscal buffers, a strong financial system, and favorable external conditions – enabled Turkey to recover from its shock of 2016, with growth accelerating to 7.4 percent in 2017. Countercyclical fiscal policy and private sector credit boosted demand, and helped overcome labor market and financial sector rigidities to accelerate production. Short-term fiscal and credit measures helped avert a bigger collapse in demand and production after the economy contracted in Q3 2016. They also contributed to progress on poverty reduction.

The balance of risks in the Turkish economy since Q3-Q4 2017 has shifted from growth to stability. Demand has overshot supply capacity and macroeconomic imbalances have widened. The outcome of supply constraints and demand impulse are reflected in high inflation; a large current account deficit; and currency volatility. These developments are weighing on private sector confidence despite the ongoing boost to sales, employment and profits.

Policy adjustments could help reduce the risks of a boom-bust cycle. With economic recovery, fiscal policy and private credit have turned procyclical. Policy adjustments could include an unwinding of temporary fiscal incentives; and increased alignment between monetary and macroprudential policies. The removal of fiscal incentives could help maintain fiscal buffers that in the first place helped deal with the most recent shocks. Misalignment between monetary and macroprudential policies could exacerbate macro-financial risks through a more leveraged private sector on the one hand and higher cost of financing on the other.

A renewed focus on supply side constraints will be important for medium-term growth. Recent reforms in this regard include: (i) further strengthening of the secured transactions system, which would support the financial sector's countercyclical capacity and SME growth; (ii) investment climate reforms to improve private sector competitiveness; and (iii) reforms to bankruptcy and insolvency procedures to improve efficiency and promote continuity of viable businesses.

Enabling an orderly adjustment is important for productivity and potential output. Turkey has been prone to large economic swings in the past. The greater the volatility in growth, the more pronounced is the negative impact on productive investment and efficiency of resource allocation. This hurts long term productivity and potential output, both of which have stagnated in Turkey, as in other Emerging Market and Developing Economies.

Looking ahead

Growth in Turkey is projected to moderate to 4.7 percent in 2018, though with heightened downside risks. There is high probability of continued expansionary policies driven by the desire to maintain strong growth in the run up to elections in 2018 and 2019. Inflation is projected at over 10 percent and will remain an important policy challenge in the coming year. Whilst export growth is expected to remain strong, the contribution of net exports to growth is projected to be offset by a large import bill linked to rising commodity prices.

Tighter global liquidity conditions in 2018 will affect two soft spots for the Turkish economy: access to and cost of external finance, an important lever of growth for the country. Turkey's external buffers to withstand further financial tightening have reduced relative to prior episodes of financial tightening due to rising external debt, which are subject to sustainability risks in the case of extreme currency depreciation or energy price shocks.

Despite corporate and financial sector buffers, tightening financial conditions could further increase pressures on the real sector and raise macro-financial risks. Corporate vulnerability of companies listed in the Turkish stock markets rose in 2017. Non-financial corporates face elevated interest rate and exchange rate risks due to net open foreign exchange positions. Though much of the latter has long-term maturity and is concentrated among larger firms with stronger balance sheets, increased cost of finance and a weaker Lira could affect financial sector assets. These risks may be exacerbated by the projected slowdown in economic activity.

Fiscal policy space needed to react quickly to adverse external developments remains relatively strong in Turkey, notwithstanding contingent liabilities. The government is in a good position to finance its long-term commitments and the composition of public debt does not unduly expose the authorities to a sudden change in financial market conditions. On the other hand, tightening global financial conditions together with elevated levels of external and private sector debt have the potential to rapidly erode fiscal space if the latter become contingent liabilities.

The possibility for monetary policy to respond to adverse external developments is more challenging. A combination of high inflation (due to demand pressures, exchange rate passthrough and higher production costs) on the one hand, and rising (and positive) policy rates on the other (average CBRT funding rate is currently above the last five years' average), creates challenges for a monetary stimulus in the event of an external shock. This challenge is exacerbated by the need to cool credit expansion, which has been above its long-term trend.

Taking stock

Global growth remains strong in Q1 2018 though market volatility increases[1]

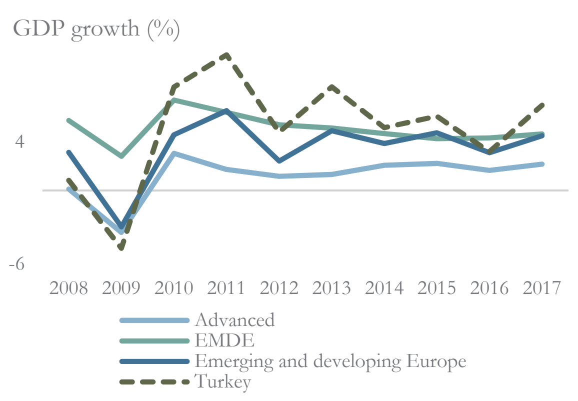
1. **The global economy continues to grow at a strong pace in early 2018.** Global growth in 2017 reached 3 percent (up from 2.4 percent in 2016) whilst Emerging Markets and Developing Economies (EMDEs) growth accelerated to 4.3 percent (from 3.7 percent in 2016) (Figure 1). Global industrial production growth posted its strongest performance since 2010. Unemployment rates in many economies reached lows not seen for a decade or more. This momentum has carried over into 2018. The composite Purchasing Managers' Index for developed and emerging markets point to continued expansion of manufacturing and services (Figure 2). Despite strong growth, global median inflation stood at 2.1 percent in January. Inflation in both advanced economies and EMDEs has been relatively flat since early 2017.

2. **All major economies and regions continue to experience simultaneous economic expansion**. In the United States, the labor market added 313,000 jobs in February (compared to an average of 200,000 since 2011) whilst the consumer confidence index was at an 18-year high. In the Euro Area, consumer confidence and the composite PMI reached decade-long highs in January. In Japan, the unemployment rate fell from 2.7 percent to 2.4 percent in January, its lowest level in 25 years. China, which grew at 6.3 percent in Q4 2017 (qoq, SAAR), saw a slight decline in the official manufacturing PMI in February. Major commodity-exporting EMDEs (Nigeria, South Africa, Indonesia, Brazil) are seeing an acceleration in growth with a recovery in investments. For commodity importing EMDEs on the other hand, early 2018 has been mixed, with some slowdown in industrial output and higher inflation.

3. **Global trade activity continues to expand in tandem with industrial production despite uncertainties related to recently announced protectionist measures**. Global trade in 2017 expanded at its highest rate since 2011. The biggest increase came from developing Europe and Central Asia, which includes Turkey and some of its largest trading partners. New manufacturing export orders in early 2018 point to positive momentum for the coming months. Protectionist measures, such as the United States' imposition of import tariffs on steel (25 percent) and on aluminum (10 percent), in addition to possible tariffs on a wide range of Chinese goods, have added to global trade uncertainty.

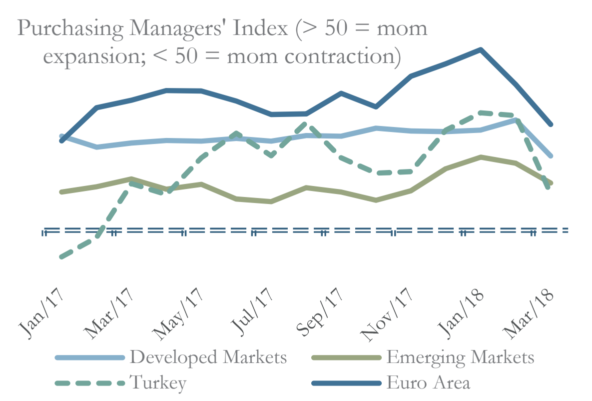
4. **Expectations around US monetary policy tightening and fears of trade protectionism caused increased volatility in financial markets in early 2018 after a prolonged period of relative stability.** This was associated with a continued rise in US long-term yields (US 10-year bond yields reached a four-year high of 2.9 percent in February), driven by rising inflation expectations and prospects of faster normalization of US monetary policy. Following the release of stronger-

Figure 1: Broad-based global recovery



Source: WB Global Economic Prospects (January 2018)

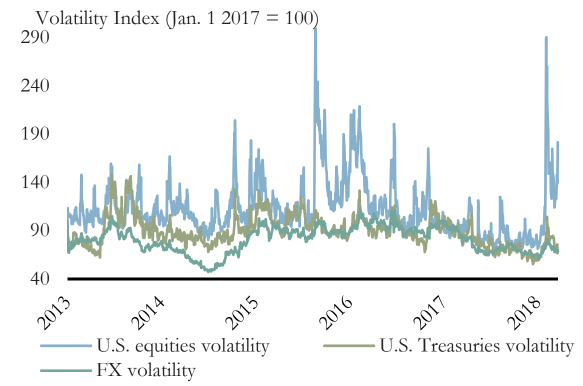
Figure 2: Output remains strong in Q1 2018



Source: IHP Markit Economics, Haver Analytics

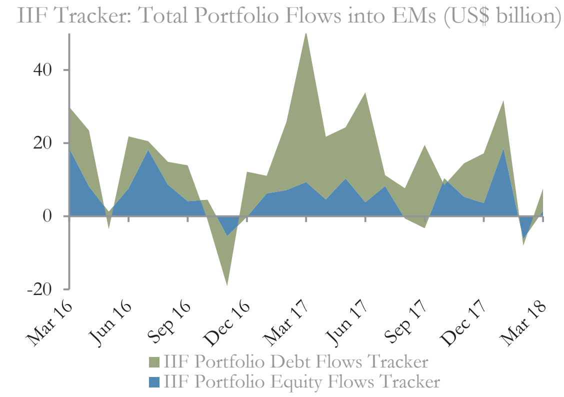
1 This section is based on WB, "Global Economic Prospects: Broad-Based Upturn, but For How Long?" (January 2018); and WB, "Global Economic Monitor (Monthly and Weekly)" (January – March 2018)

Figure 3: Increased market volatility Q1 2018



Source: WB Global Economic Monitor

Figure 4: Portfolio flows to EMDEs are resilient



Source: National Sources, Bloomberg, International Institute of Finance

than-expected US wage growth in February, US and global equity markets tumbled and stock market volatility spiked (Figure 3). After recovering from this initial jolt, financial market volatility returned in end March following news that the US administration is considering tariffs on a wide range of Chinese goods.

5. **Despite market volatility, capital flows to EMDEs in the early part of 2018 have remained relatively strong**. EMDE financial markets started the year on a strong note, with portfolio flows accelerating rapidly in January 2018 and international bond sales reaching an all-time high of US$71 billion. But EMDE markets were affected by the global sell-off in early February, resulting in equity and bond portfolio outflows over the course of February (Figure 4). In March, portfolio capital inflows to EMDE bond and equity funds rebounded following the previous month's dip. Bond spreads also narrowed after spiking in February.

Strong policy response to 2016 shock supports Turkey's sharp recovery in 2017

6. **Turkey experienced a sharp recovery in 2017 (7.4 percent growth), exceeding all expectations**. In January 2017, consensus forecasts averaged 2.3 percent growth for the year (Figure 5).[2] External demand in 2017 picked up with an acceleration in EU imports from Turkey and a quadrupling of net portfolio inflows. Private consumption drove half of the expansion in 2017, whilst investment accounted for around 30 percent of growth. Though ninety percent of this investment growth was due to construction, H2 2017 also saw a recovery in machinery and equipment investments following a contraction over four consecutive quarters. A combination of these led to a broad-based acceleration in domestic demand (Figure 6).

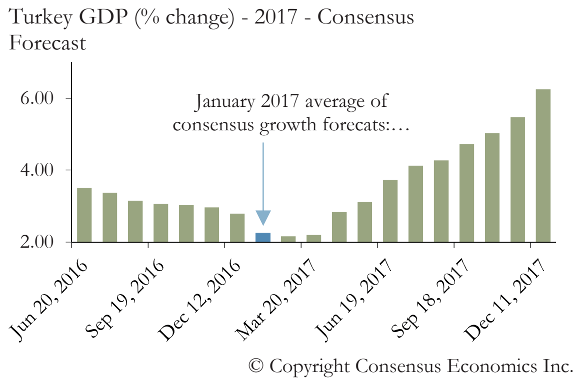
7. **Expansionary fiscal policies were a major driver of this uptick in domestic demand**. The fiscal response was possible in part thanks to buffers maintained through countercyclical fiscal policies in previous years (Figure 7). Government expenditures expanded rapidly in 2017 (16 percent in nominal terms) and had a strong multiplier effect, estimated at between 0.8 and 1.15.[3] This was offset by a recovery in customs and income tax receipts, which helped contain the fiscal deficit within 1.5 percent of GDP, though primary and recurrent surpluses have narrowed significantly over the past two years.

8. **There are indications that fiscal incentives also helped sustain supply capacity by helping address labor market rigidities**. Incentives included subsidies for minimum wage support and public transfers for employment programs. Recent research finds that whilst real wages tend to adjust to economic conditions at higher levels of income, at the lower end of the wage distribution real wages are less elastic because

2 Consensus Economics Inc.

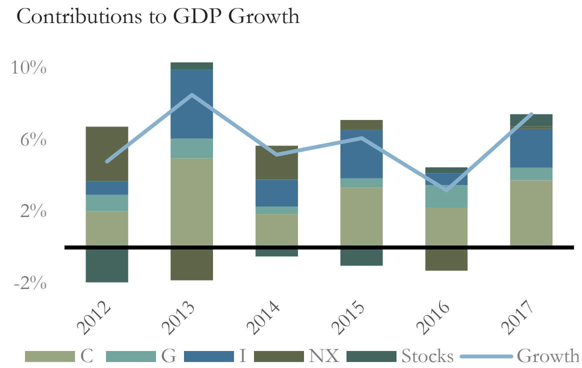
3 Assumption include a negative output gap in the past five years, low propensity to import, labor market rigidity, limited automatic stabilizers, low public debt, and effective public finance management. See also IMF (September 2014).

Figure 5: Low consensus forecast in early 2017



Source: Consensus Economics Inc.

Figure 6: Broad recovery in domestic demand



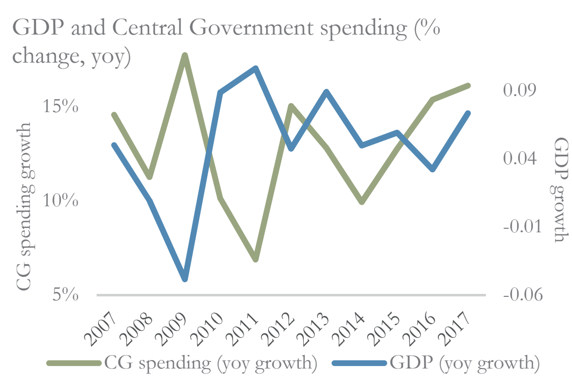
Source: Haver Analytics, WB Staff estimates

of minimum wage and other factors.[4] This creates labor market rigidity at the lower end of the income distribution. The latter account for 25 percent of workers in Turkey who are also the most vulnerable to job losses during economic downturns. Fiscal incentives likely helped to sustain employment when growth slowed down and the probability of retrenchments increased. This may also explain in part the continued progress in poverty reduction during 2017 (Box 1).

9. Rapid growth in private sector credit also helped boost demand and increase production. Money growth moderated slightly (from 18 percent in 2016 to 16 percent in 2017) though remained high in line with demand. This was driven by a 20 percent jump in credit to the private sector (Figure 8), 70 percent of which was linked to loans under the government-backed Credit Guarantee Fund (CGF) for SMEs (volume of TL 200 billion in 2017). This was helped by favorable external conditions, including a recovery in portfolio flows that boosted financial sector liquidity.

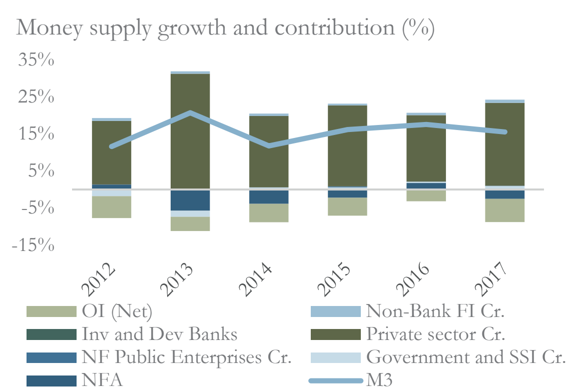
10. The CGF together with some loosening of macroprudential regulations in 2016[5] helped overcome financial market frictions. In the absence of these measures, banks are unlikely to have extended

Figure 7: Counter-cyclical fiscal policy has supported short-term recovery from shocks



Sources: Haver Analytics, WB Staff estimates.

Figure 8: Money growth in 2017 driven by private credit expansion



4 Aldan, A., and Gürcihan Yüncüler, H. B. (2016), "Real Wages and the Business Cycle in Turkey", CBRT Working Paper, No. 16/25; and Yüncüler, G., "To what extent are real wages responsive to the business cycle in Turkey?"

5 Baziki, S.B. (2017): "Impact of macroprudential policies on loan utilization," CBRT Blog

Box 1: Poverty and inequality trends in Turkey

Poverty in Turkey continues to decline. The share of the population with per capita expenditure below the poverty line (US$5.5 a day in 2011 PPP) is estimated to have fallen from 9.9 percent to 9.1 percent in 2017. Compared to other Upper Middle Income, or recently acceded to High Income, Turkey has achieved one of the fastest progress in poverty reduction over the past 15 years (Figure 9). On average, inequality over this period has also been relatively low, although in more recent years has started to increase (Figure 10).

Figure 9: Declining poverty

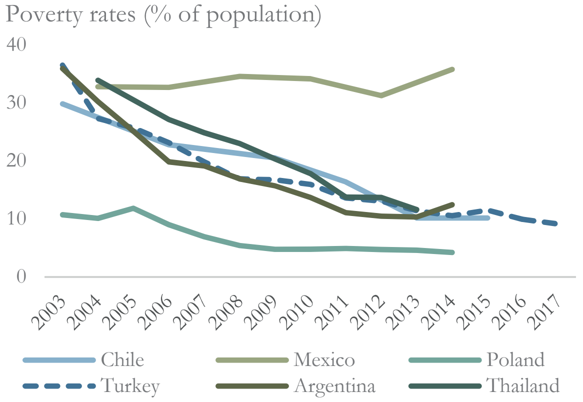
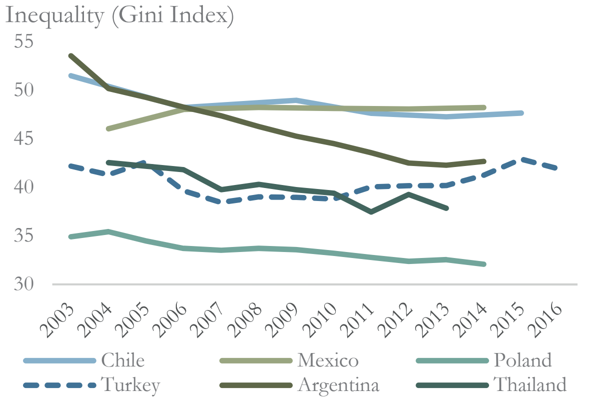


Figure 10: Slight decrease in inequality



Source: Household Budget Survey 2003 – 2016, TUIK. The World Bank, PovcalNet for other countries.
Note: Poverty measured using the absolute poverty line of US$5.50-a-day in 2011 PPP, the World Bank's internationally comparable methodology for upper middle-income countries

The progress in 2017 was supported by increased employment and a higher minimum wage. The unemployment rate declined from 12.7 percent in 2016 to 10.4 percent in 2017. An estimated 1.6 million jobs were created over this period, half of which were in services and a fifth in industry. Labor force participation rates for women increased from 32.2 to 33.5 percent. Fiscal support to disadvantaged groups and areas may have contributed to some of these outcomes, but their actual impact is yet to be assessed.

Figure 11: Higher lending rates during downturns

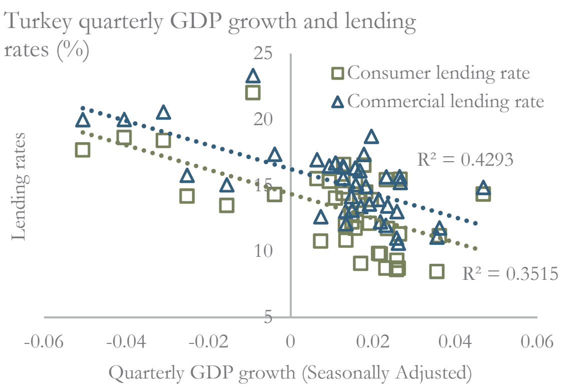
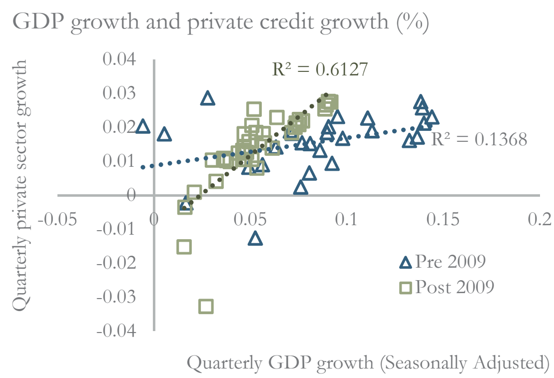


Figure 12: Credit is increasingly pro-cyclical



Sources: Haver Analytics, WB Staff estimates

countercyclical financing. Private credit in Turkey is pro-cyclical (Figure 11) and has become increasingly so after 2009 (Figure 12). The countercyclical capacity of the financial sector in Turkey is limited by its depth. This includes the relatively small non-bank financial sector (e.g. capital markets, private equity, insurance). These short-term measures – on the back of a strong financial system and favorable external conditions – therefore helped avert a more sustained collapse in demand and production after the contraction in Q3 2016.

The balance of risks has shifted from growth to stability

11. Monthly data point to sustained growth in Q1 2018, though economic confidence indices have started to decline with increased macroeconomic imbalances. Industrial production continued to rise by over 10 percent per month in early 2018. This is consistent with the latest Purchasing Managers' Index (PMI) survey results (March 2018), which point to a fourteenth consecutive month of expansion in the manufacturing sector.[6] Despite the boost to sales, employment and profits over the past 12 months, inflation, currency volatility, and policy predictability have started to weigh on private sector confidence.

12. Demand has overshot supply capacity and macroeconomic imbalances have widened. Headline inflation (CPI) accelerated from 7 percent in 2016 to 12 percent in 2017, exceeding the Central Bank's target of 5 percent. Inflationary expectations have risen, creating upward inertia in price pressures (Figure 13). The CPI diffusion index, which measures the fraction of CPI components rising (or falling) in total components, followed an upward trend in 2017 (Figure 14). Almost 80 percent of CPI components rose above the inflation target, exceeding historical averages.

Figure 13: Rising inflation expectations

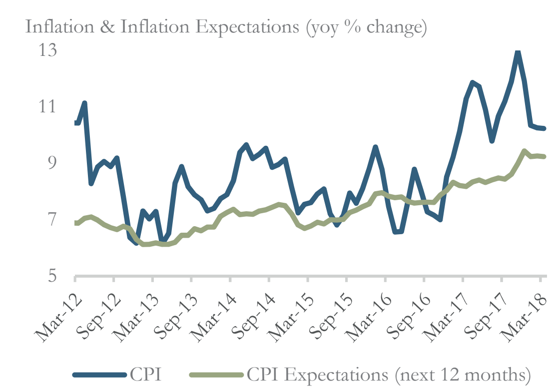
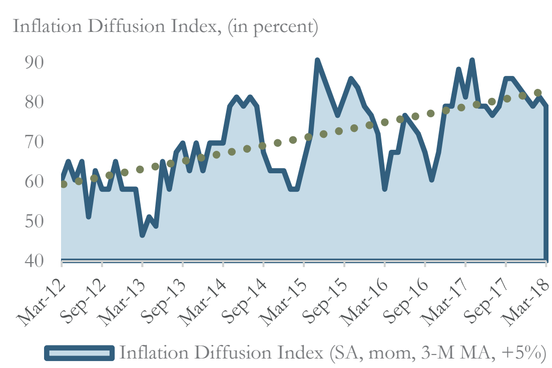


Figure 14: Broad-based increase in prices



Sources: Haver Analytics, WB Staff estimates

6 IHS Markit and Istanbul Chamber of Industry PMI, "Turkish manufacturing sector continues to grow," (March 2018)

Figure 15: Demand-side factors, cost-push and currency contributed to price pressures

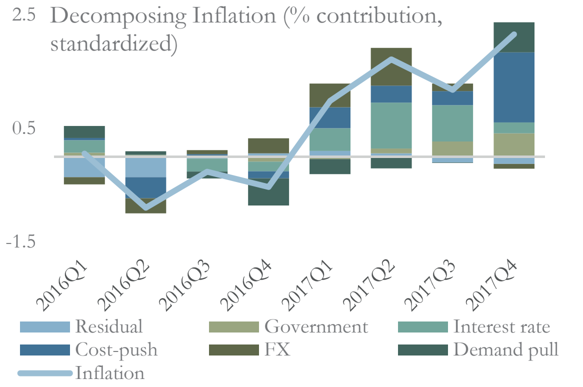
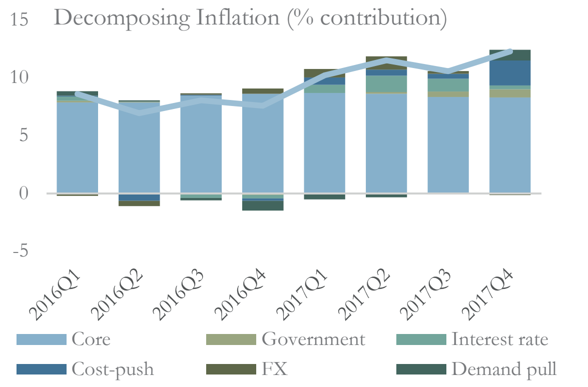


Figure 16: Higher implicit inflation target than the legislated one



Sources: Haver Analytics, WB Staff estimates

13. Demand-side factors, cost-push and Lira depreciation all contributed to inflation (Figure 15). Exchange rate depreciation (proxied by terms of trade) accounted for almost half of the increase in consumer prices in 2017. Inflation dynamics were also significantly driven by cost push factors (wage, rental cost of capital etc.) and expansionary fiscal policy, particularly in the last quarter of 2017. Along with a strong cyclical recovery, the slack in demand has vanished, which has started to exert higher pressure on inflation, signaling a risk for inflation outlook. Subtracting the shocks off inflation leaves core inflation at around 8.5 percent in 2017, suggesting that the implicit inflation target is higher than the legislated one (Figure 16).

14. Strong demand and rising commodity prices contributed to a widening current account deficit in 2017 and the early part of 2018 (Figure 17). The current account deficit increased from 3.8 percent of GDP in 2016 to 5.6 percent in 2017 (US$47 billion rising to US$53 billion in February 2018 on a 12-month rolling basis) (Figure 17). Rising energy prices and gold imports were important drivers of this increase. The value of energy imports rose by 37 percent in 2017, whilst its share in merchandise imports increased from 14 to 16 percent between 2016 and 2017. The net trade in gold went from a surplus of US$1.8 billion in 2016 to a deficit of US$9.9 billion in 2017 (rising to over US$12 billion in January), with imports accelerating rapidly in the second half of the year and in January 2018. At the same time, gold and energy adjusted current account figures indicate sustained domestic consumption. Net portfolio flows recovered sharply (from 0.7 to 2.9 percent of GDP between 2016 and 2017) (Figure 18), though net FDI flows declined by 19.2 percent.

Figure 17: Rising current account deficit

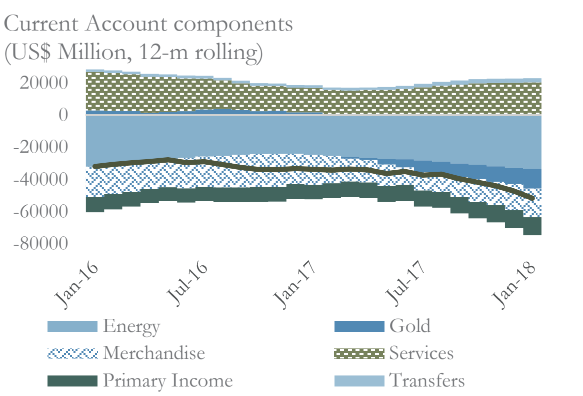
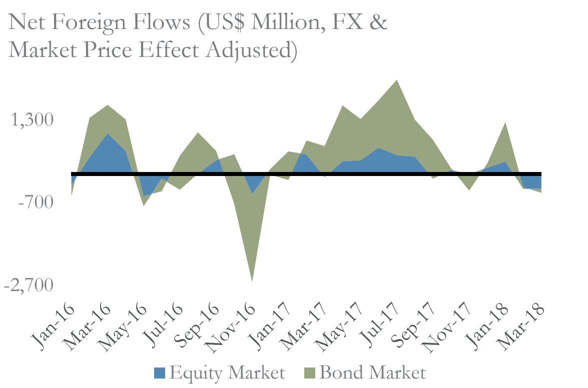


Figure 18: Strong recovery in portfolio flows



Sources: Haver Analytics, WB Staff estimates

15. These developments have contributed to a sharp depreciation in the Lira (Figure 19). A depreciating free float has been an important shock absorber for the economy. It has contributed to the recovery in exports and should help moderate import demand (particularly for consumables). It also helped accelerate customs receipts to contain the budget deficit. Accordingly, the Real Effective Exchange Rate has dropped by close to 20 percent since 2015, the sharpest among a selected group of EMDEs, whilst the Lira rate against the US dollar and the Euro also depreciated by close to 20 percent in the past two years. Currency depreciation accelerated in most recent weeks due to a combination of global liquidity tightening and investor sentiments, which led to a net outflow of portfolio debt and equity flows in February and March.

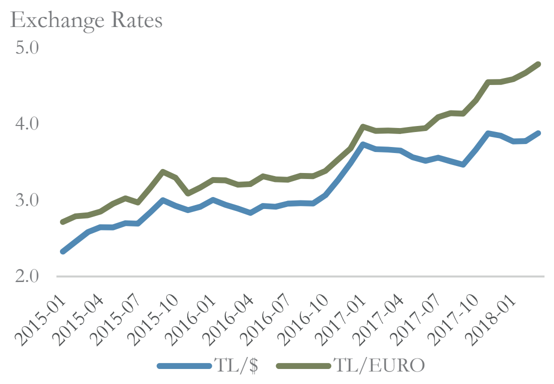
Policy adjustments could help reduce the risks of a boom-bust cycle

16. Policy adjustments could help mitigate risks of macroeconomic imbalances from unraveling into a sharp cyclical downurn. Despite strong growth, there are signs that fiscal policy remains accomodative. This is reflected in the continued expansion of public transfers in the 2018 Budget, including in the form of direct subsidies for private sector employers (Box 3). These may be supplemented by additional stimulus measures proposed to Parliament in the past two months. Given the positive output gap, however, the fiscal multiplier is expected to decline in 2017.

17. Financial sector stability and lower inflation, both key to avoiding a boom-bust cycle, are likely to require greater alignment of monetary and macroprudential policies. Monetary tightening, with a 450 basis points increase in the average cost of funding in 2017, has not reigned in monetary expansion because of sustained credit growth. With the uptick in economic growth, credit has turned procyclical, despite the slight deceleration in recent weeks. Whilst countercyclical credit expansion was important, it is now worth revisiting the policy mix. Recent Central Bank research highlights that "monetary policy alone is not as effective as when it used with macroprudential instruments to limit credit growth and stabilize credit volatility."[7] Misalignment between the two could exacerbate a deterioration in banking sector asset quality through a more leveraged private sector on the one hand and higher cost of financing on the other.

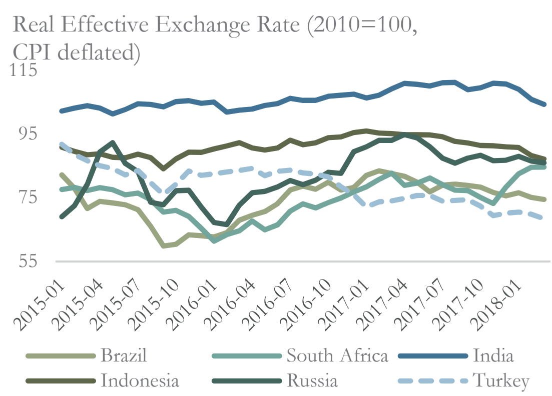
18. This could be a concern in Turkey where volatility in private sector credit is associated with volatility in growth. Turkey's extensive macroprudential toolkit[8] has helped to contain risks in the financial sector, including those transmitted through highly volatile capital flows from abroad. The literature finds that increased credit is associated with less growth volatility up to a certain point, but too much credit can increase volatility (Figure 21).[9] This is both because of the size of credit in GDP (and associated leverage), and a lack of diversification in financial instruments. This could be exacerbated if growth is concentrated

Figure 19: Sharp Lira depreciation against US dollar and Euro



Sources: Haver Analytics, WB Staff estimates

Figure 20: Currency adjustment supports REER depreciation despite high inflation



7 Chadwick, M.G. (2018): "Effectiveness of monetary and macroprudential shocks on consumer credit growth and volatility in Turkey," Central Bank Review

8 Kara, H. (2016): "A brief assessment of Turkey's macroprudential policy approach: 2011-2015", Central Bank Review 16 (2016).

9 Easterly et al (2000); Dabusinskas et al (2012)

Figure 21: Financial sector development matters for growth volatility

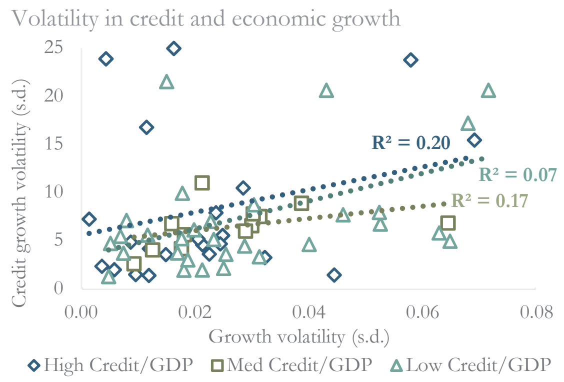
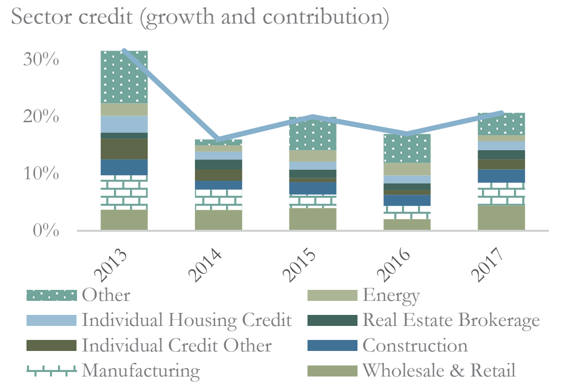


Figure 22: Manufacturing, trade and construction fueling private credit



Sources: Haver Analytics, WB Staff estimates

in sectors that have relatively higher levels of troubled assets and higher outstanding credits (Figure 22). This requires strong macroprudential regulations focused on financial sector stability rather than short-term demand management.[10]

19. The recently imposed restrictions on foreign currency borrowing to contain real and financial risks arising from currency mismatch could in part support alignment of monetary and macroprudential policies.[11] Accommodative monetary policies in developed markets has led to a sharp rise in foreign currency borrowing by corporates, not just in Turkey but among other EMDEs also. Recent bouts of depreciation therefore negatively affect profitability and debt service capacity for non-financial corporates, which can spill over into the financial sector. In response to this, effective from May this year, Turkish residents will only be able to borrow in foreign currency if they have foreign currency income or outstanding foreign currency loans of US$15 million or more at the time of borrowing.

20. This should help contain the demand for foreign currency loans and associated risks, though a few points need to be considered: (i) companies without US$15 million in foreign exchange debt may be borrowing up to the threshold thereby having the opposite effect on forex demand, at least till May; (ii) some sectors have a natural hedge (e.g. energy, which has a large net open position because of dollar imports and Lira sales, but where Lira denominated sales in the domestic market are indexed to the US dollar price of imported fuel); and (iii) foreign currency loans have been a major source of long-term finance, which cannot be substituted quickly by Lira denominated loans, therefore complementary measures to increase Lira deposits (which are mostly short-term maturity) are needed to avoid maturity mismatch.

21. Recent reforms to the secured transactions system could contribute to the financial sector's counter-cyclical capacity and improve supply response. During cyclical downturns, SMEs' access to finance becomes even more restricted than usual due to high collateral requirements in terms of fixed assets. Downturns depress collateral value – for those that have it in the first place – making it difficult to obtain funding even for profitable or innovative projects. The Law on Moveable Collateral in Commercial Operations[12] (January 2017) enables SMEs to use tangible and intangible moveable assets including receivables, stocks, machinery and equipment as security to generate capital. This can help tackle market failures that prevent SMEs from innovating. This is particularly the case during downturns when companies cannot expand short-term production, but should be able to access cheaper finance for longer-term productive investments.[13]

10 IMF (2017): "Turkey – 2017 Article IV Consultation – Staff Report," IMF Country Report No.17/32

11 Official Gazette No. 30312, January 25, 2018: (i) Decree No. 2018/11185 amending the Decree No. 32 on the Protection of the Value of the Turkish Currency; (ii) Communiqué No. 2018-32/46 amending the Communiqué on the Decree No. 32 on the Protection of the Value of the Turkish Currency

12 Law No. 6750 on Moveable Collateral in Commercial Operations, January 1, 2017

13 Dabusinskas et. al (2012)

22. This important reform was further deepened in recent months as part of an Omnibus Law[14] aimed at improving the overall investment climate. The legislative package expanded the use of collateral to future or after-acquired assets as well as to proceeds and replacements of the original assets, which will allow a wider selection of goods to be used as collateral for businesses. Banks will be able to expand loans to riskier borrowers at more affordable rates, whilst SMEs can scale up and improve productivity. This can be an important enabler for higher growth through deeper supply side capacity. In the future, the collateral amendment could be further aligned with global best practices by establishing a single center for monitoring and reviewing the collateral registries of companies by creditors and developing new products for asset-based lending to increase the utilization of movable collaterals.

23. The Omnibus Law adopts several other measures to improve the investment climate. Firstly, to simplify business registration, ID verification and certification of company books by notaries are now moved to the Trade Registry Office, and 25 percent paid-in minimum capital requirement is removed. Moreover, inspection from the tax office requirement was eliminated and entrepreneurs are now able to complete their social security system registration process electronically. Secondly, to improve the system for construction permitting, an online application process will be introduced for more transparency on guidelines, fees, documents and pre-approvals via municipalities' webpages. Thirdly, land registration and transfers will be simplified and done through a web registry system, which allows for online verification of non-encumbrance information. In addition, an independent complaints mechanism related to land-specific disputes has been established. Lastly, contract enforcement reforms were adopted through introduction of a small claims procedure for cases below TL 100,000 and number limit to adjournments, provision of electronic publication of judgments and incentives for using Alternative Dispute Resolution. This is expected to play a key role on the acceleration of conflict resolution, especially among SMEs.

24. Further measures to improve the investment climate were introduced relating to bankruptcy and insolvency procedures.[15] The existing procedures were costly and inefficient, and a major hurdle in the business environment. Since the introduction of the Bankruptcy Law in 2003, only 2 percent of the 3524 enterprises that filed for this procedure recovered from insolvency. In practice, this means that most insolvent businesses are terminated informally and that viable businesses that could stay in the market end up being liquidated. On the other hand, resolution of insolvency procedures last around 5 years on average, which is more than twice the average across Europe and Central Asia (ECA). Recent reforms aim to address these issues. A new 'concordat' procedure has been introduced, which enables authorities to set timelines for the procedure, and puts a heavy focus on business continuation rather than its liquidation through new financing, confirmation of contracts and sale of essential assets in bankruptcy. These reforms should help businesses to go through a more efficient and faster insolvency procedure focused on saving the business.

25. Ongoing discussions to reform the tax system are also geared to improving private sector competitiveness. The draft Law on Value Added Tax submitted to Parliament in February 2018 has several features in this regard.[16] They include measures to improve the availability of VAT refunds and limit the possibility that the VAT acts as a tax on investment. This is in addition to administrative proposals to clear the existing backlog of VAT refunds, which will need to be sequenced carefully to avoid fiscal pressures. The draft Law also aims to simplify the VAT regime for small businesses. The latter will need to be complemented with reforms to simplify VAT accounting and reporting for small businesses. On the other hand, the current draft also sees the proliferation of VAT exemptions and concessions, which reduces the overall efficiency of the VAT and may be worth considering further.

14 Law No: 7099 on Amending Various Laws for Improving Investment Climate, March 10, 2018.

15 Law No: 7101: on Amending the Bankruptcy and enforcement, March 15, 2018.

16 Law No. 7104 on amending the Value Added Tax Law and Certain Laws was published in the Office Gazette dated April 6, 2018.

Figure 23: Growth in Turkey is volatile

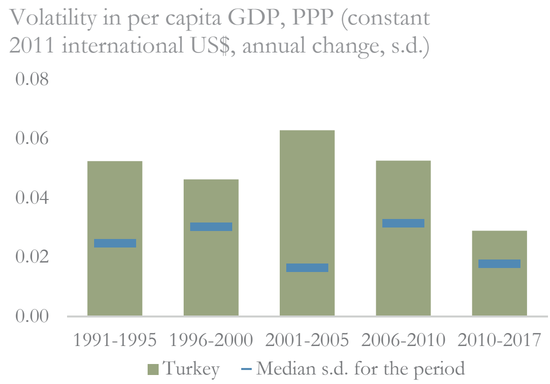
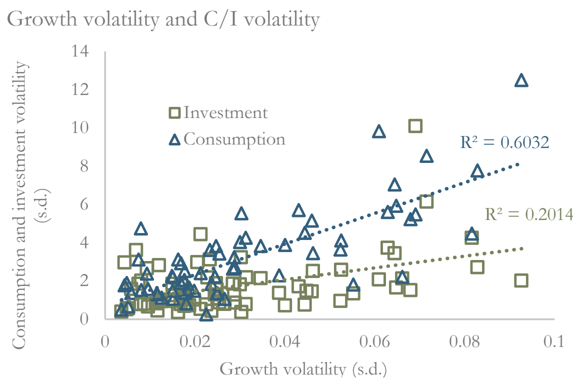


Figure 24: Consumption and investment volatility



Sources: World Development Indicators, WB Staff estimates
Note: Countries in the sample include Argentina, Brazil, Chile, China, Hungary, India, Indonesia, Korea (Rep.), Malaysia, Mexico, Poland, Romania, Russian Federation, South Africa, Thailand, Turkey.

Containing growth volatility is key to higher productivity and potential output

26. Policy adjustments as noted above are necessary to contain large economic swings, which Turkey has been prone to in the past. Growth volatility in Turkey has historically been high relative to other Upper Middle-Income Countries, or countries that have (recently) crossed the High-Income threshold (Figure 23). This is a challenge because it is associated with volatility in consumption, which hurts household welfare (particularly poorer households with lower savings); consumption is usually the most stable component so volatility could arise from shocks to permanent income or a breakdown in financial and/or jobs market intermediation. Growth volatility is also associated with volatility in investment, which can translate into lower per capita GDP growth over the long-term (Figure 24).[17] The degree of volatility can depend on the type of exogenous shock (e.g. commodity prices, capital flows), structural rigidities, economic buffers, and policy responses. Pro-cyclical policies can amplify economic swings through overshooting and the erosion of fiscal, financial sector and external buffers.

27. Macroeconomic and structural policy responses to shocks that help reduce growth volatility can help improve productivity, which has stagnated in Turkey as in other EMDEs (Box 2).[18] The need to manage short-term demand diverts resources away from longer-term investment in structural reforms, skills, technology and innovation. The greater the swings in demand, the more pronounced is the negative impact on productive investment and efficiency of resource allocation. In Turkey, this is reflected in labor shifting increasingly into less productive sub-sectors within manufacturing and services.[19] A growing share of value addition is accounted for by those less productive sub-sectors, pointing to a misallocation of resources and slow uptake of technology and innovation. A combination of these has dampened overall productivity.

28. The shift from deepening supply capacity to managing short-term demand spurred by recent shocks has contributed to a stagnation in Turkey's potential growth rate (Figure 25). With declining contributions from Total Factor Productivity (TFP – efficiency in harnessing human and physical capital for growth), the potential growth rate for Turkey in 2017 is estimated at 5 percent (Figure 26). Capital accumulation has been the main driver of potential growth, while TFP has made a negligible contribution. Although continued strong growth in the working-age population supports a positive outlook for potential growth, greater rebalancing towards deepening supply side capacity could lift both potential and actual growth.

17 Ramey, G. and V.A. Ramey (1995): "Cross-country evidence on the link between volatility and growth", American Economic Review, No. 85 (5); Easterly, W., R. Islam, J.E. Stiglitz (2000): "Explaining growth volatility," The World Bank; Loayza, N.V., R. Ranciere, L. Serven, J. Ventura (2007): "Macroeconomic Volatility and Welfare in Developing Countries: An Introduction," The World Bank Economic Review (V. 21, No. 3); Dabusinskas, A., D. Kulikov, M. Randveer (2012): "The Impact of Volatility on Economic Growth," Bank of Estonia Working Paper Series

18 WBG (2016), "Turkey's Future Transitions: Towards Sustainable Poverty Reduction and Shared Prosperity."

19 WBG (2018), "Turkey Country Economic Memorandum on Productivity," (Forthcoming)

Figure 25: Decline in potential growth rate

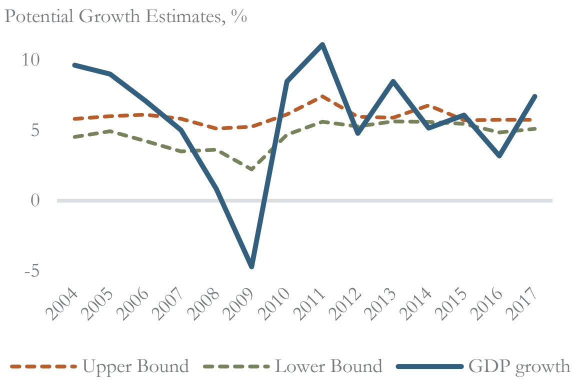
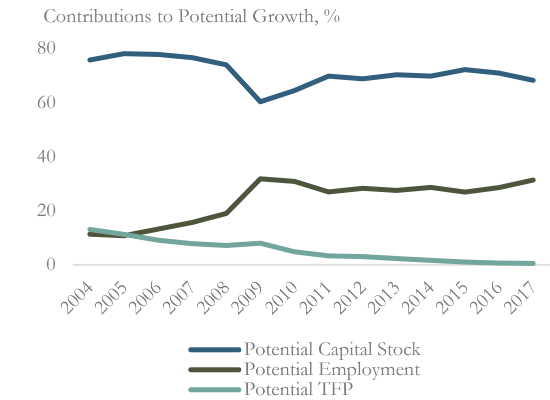


Figure 26: Decline in potential TFP contribution

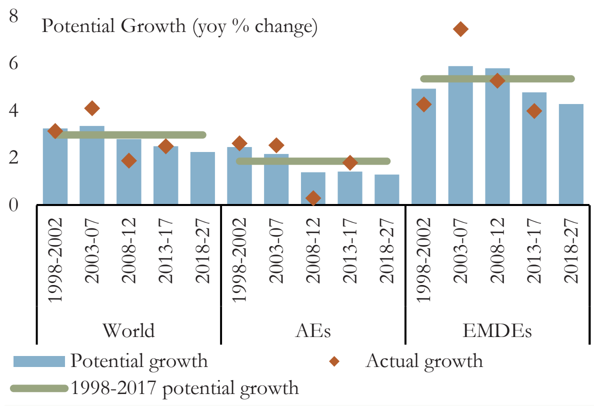


Sources: World Development Indicators, WB Staff estimates
Note: Countries in the sample include Argentina, Brazil, Chile, China, Hungary, India, Indonesia, Korea (Rep.), Malaysia, Mexico, Poland, Romania, Russian Federation, South Africa, Thailand, Turkey.

Box 2: Global trends in potential growth

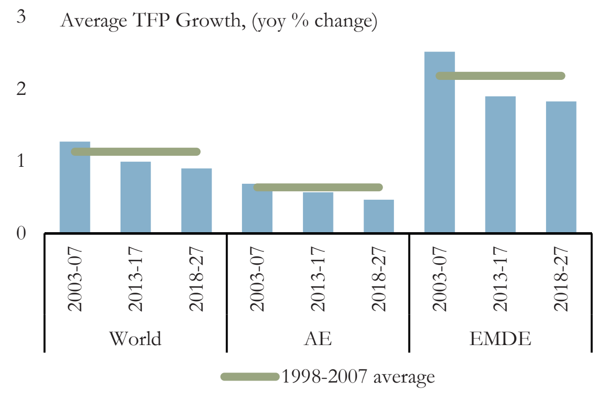
Global potential growth is well below its pre-crisis average in both advanced economies and emerging market and developing economies (EMDEs). Despite a recent acceleration of global economic activity, slowdown in potential output growth continues (Figure 27). This broad-based slowdown mainly reflects weaker capital accumulation, slowing productivity growth and demographic trends (Figure 28).

Figure 27: Drop in global potential growth rate



Source: WBG, Global Economic Prospects (January 2018)

Figure 28: Decline in global TFP growth



Source: WBG, Global Economic Prospects (January 2018)

Following the GFC, a sharp slowdown in productivity growth below its longer-term average and pre-crisis levels was accompanied by slower productivity enhancing investment growth. The slowdown in productivity started well before the GFC in advanced economies and spread to emerging market developing economies after the crisis. Unless focus is shifted from cyclical policy options to productivity enhancing reforms, the ongoing trend is likely to continue.

Source: Global Economic Prospects (January 2018)

Looking ahead

Growth is projected to moderate in 2018 with downside risks

29. Growth is projected to moderate in 2018 with downside risks. Private consumption is expected to be weighed down by rising costs and declining real wages (Figure 29), though employment growth continues. There are also signs of a slowdown in credit growth. Leading indicators suggest that the recent pick up in machinery and equipment investment in the second half of 2017 is likely to continue in the first half of 2018 (Figure 30), particularly as capacity utilization rates have already hit high levels and imports of capital goods have been rising. On the other hand, producer price pressures, slowing demand, and oversupply is projected to moderate construction sector growth.

30. There is high probability of continued expansionary policies driven by the desire to maintain strong growth in the run up to elections in 2018 and 2019. Two sets of elections are scheduled: simultaneous Presidential and Parliamentary elections in June 2018; and local elections in March 2019. Several incentive measures have already been announced. This includes supplementary fiscal measures proposed to Parliament in February to accelerate investment and employment (TL 17 billion); a new super incentive scheme targeted at 23 projects designed to reduce import dependence (US$33 billion); and a further extension to the Credit Guarantee Fund for lending in 2018 (TL 55 billion). In line with these announcements, public consumption is expected to accelerate and the budget deficit is projected to widen to just above 2 percent of GDP.

31. Inflation is projected at over 10 percent and will remain an important policy challenge in the coming year. Core inflation has remained high and for the first time in a decade rose to double digits. Inflationary expectations remain elevated at close to 10 percent for 2018. A lack of policy adjustment as discussed above could leave inflationary expectations unanchored with associated wage-price spiral. The burden of adjustment rests on monetary and macroprudential policies. Recalibrating policy with a credible inflation target, supported by a transparent and predictable adjustment to policy rates and macroprudential regulations to focus on financial sector stability, could help better anchor economic expectations.

Figure 29: Declining real wages

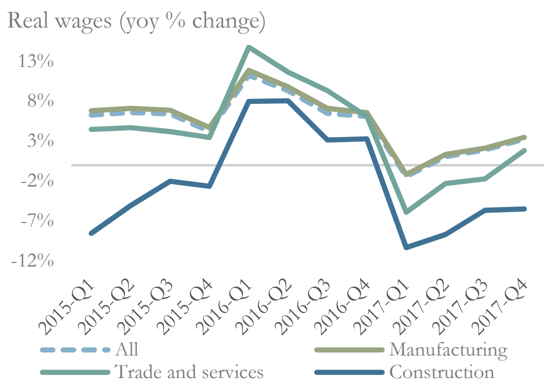
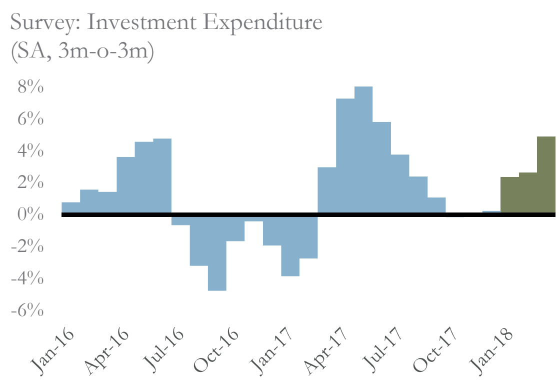


Figure 30: Sustained investment spending



Sources: Haver Analytics, WB Staff estimates

Box 3: Turkey's 2018 Budget and Medium-Term Program

Turkey's 2018 Budget was approved by Parliament on December 22, 2017. The Budget is based on a Medium-Term Program (MTP) released by the Ministry of Development on September 27 last year.

Macroeconomic assumptions: The Budget and MTP assume an optimistic 5.5 percent real growth per year 2018-2020, with unemployment falling to just below 10 percent by 2020. Inflation is projected to abate quickly to 7 percent in 2018, dropping further to 5 percent by the end of the program period.

Budget aggregates: Overall fiscal conditions are expected to deteriorate slightly in 2018, including narrower primary and current surpluses. The MTP projects a budget deficit close to 2 percent of GDP in 2018 and 2019, before falling to 1.3 percent in 2020. Yet general government revenue as a share of GDP is projected to decline slightly over the program period, despite tax reforms, large tax gaps, and a growing economy. As a result, expenditures adjust down from 34.8 to 32.7 percent of GDP.

Budget policy priorities: (i) Maintain macroeconomic stability; (ii) Increase human capital and labor quality; (iii) enhance high value-added production; (iv) Improve business and investment environment; (v) Increase employment and improve income distribution.

Revenue: Tax reforms approved by Parliament in December include: (i) increasing the CIT rate (20 to 22 percent), (ii) reduced corporation tax exemption for immovable property (from 75 to 50 percent – previously sale of shares and immovable property benefited from 75 percent exemption rate); (iii) introduction of VAT liability for non-residents engaged in e-commerce; (iv) removal of tax breaks on durable goods and furniture; and (v) hike in motor vehicle tax.

Expenditure: Spending growth of ministries is planned to moderate slightly to 12.7 percent, compared to an estimated 16.7 percent growth in 2017. Finance and Treasury budgets drive close to half of overall spending growth. Other big contributors are the Defense Ministry (30 percent increase in budget allocation, contributing 12 percent of overall growth), and the Labor and Social Security Ministry (contributing 8 percent to planned spending growth).

Supplementary fiscal stimulus: On February 22, the Parliament's Plan and Budget Commission approved an Omnibus Bill for Parliament's consideration with fiscal stimulus to boost employment and investment. The package is estimated to cost TL 17.3 billion (likely over 3 years). Measures include: (i) subsidies to private companies for "minimum wage support" and payment of social security premia for workers employed between 2018 and 2020; (ii) additional income tax and revenue stamp duty exemptions; (iii) VAT exemption on purchase of new machinery and equipment.

Source: MOF, WB Staff estimates

Figure 31: Slight deterioration in fiscal conditions in 2018…

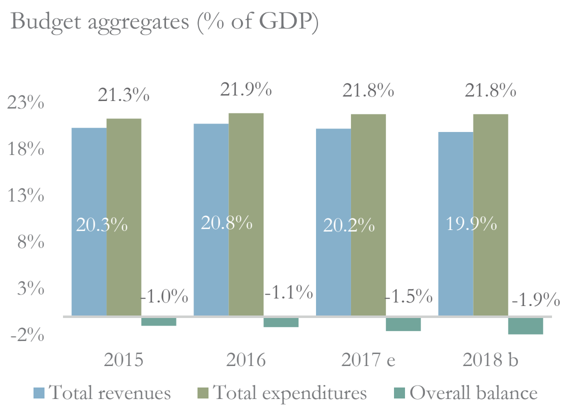


Figure 32: …with smaller primary and recurrent surpluses

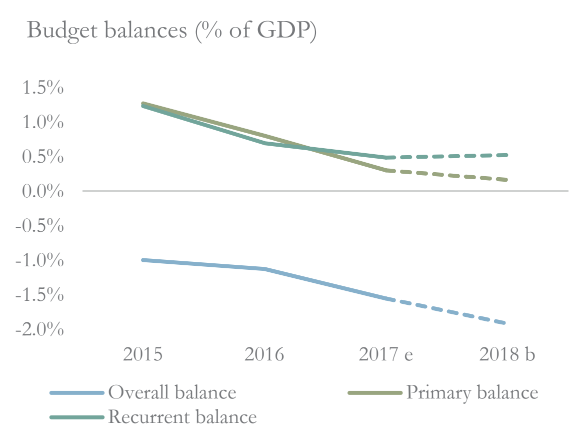


Figure 33: Revenue estimate for 2018 are relatively flat…

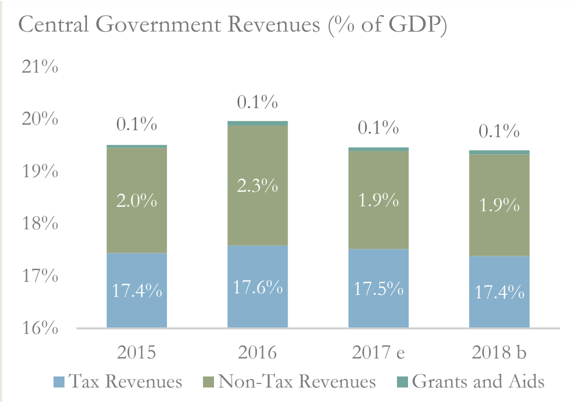


Figure 34…with slow growth in tax collections.

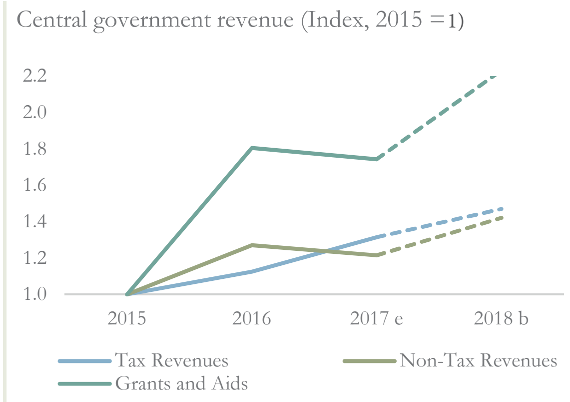


Figure 35: Spending adjustments on investment side…

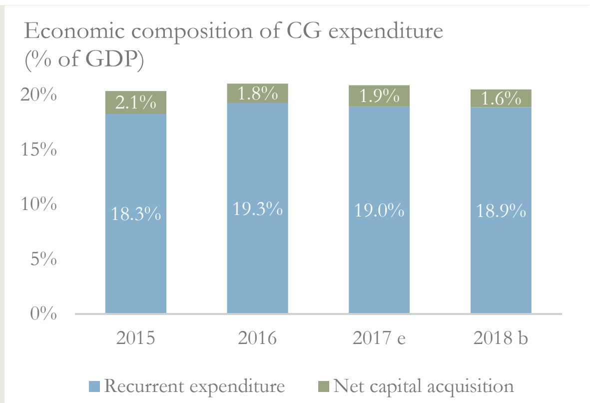


Figure 36: …to enable large increase in public transfers…

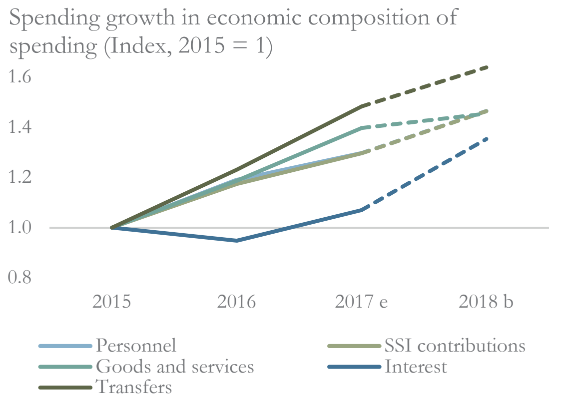


Figure 37: …particularly for Labor and Social Security. [20]

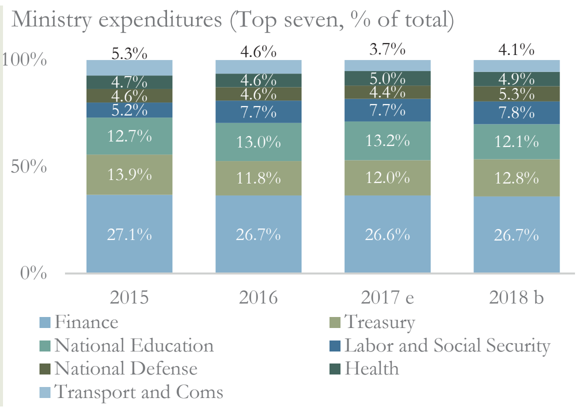
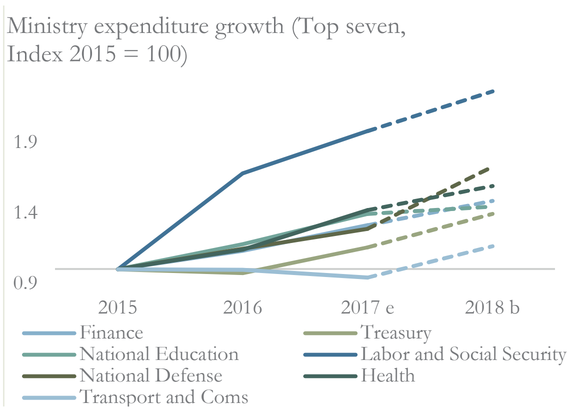


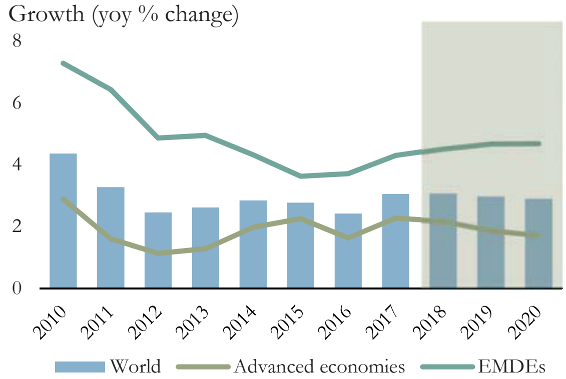
Figure 38: Defense ministry has also seen a big jump.



Source: MOF, WB Staff estimates

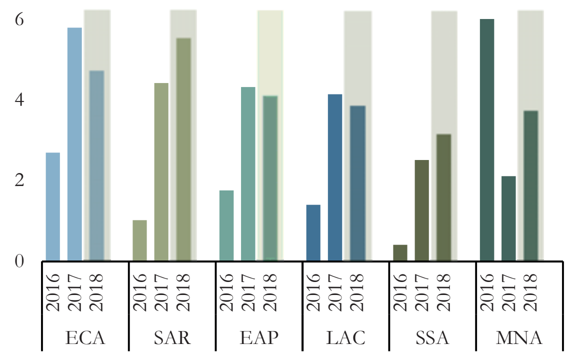
20 Note: this is ministry rather than functional general government, or public sector spending. This therefore does not reflect full sector spending in education, health, defense, and others.

Figure 39: Global growth projected to rise in 2018



Source: WB Global Economic Prospects (January 2018)

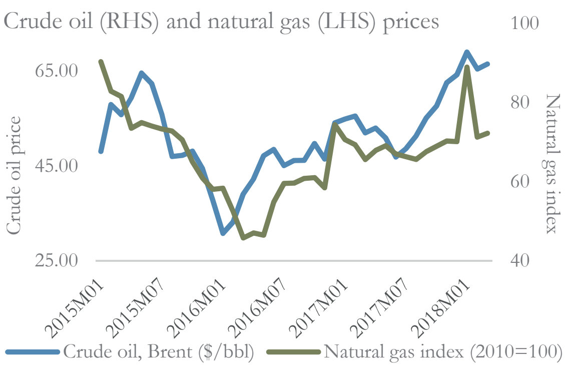
Figure 40: Continued export growth in EMDEs



32. Global growth in 2018 is expected to remain supportive of Turkey's strong export performance from the past year, though risks to global trade have increased. Growth in EMDEs is projected to accelerate further thanks to a rebound among commodity exporters (Figure 39 and Figure 40). Recent protectionist measures however pose concerns for global trade. US tariffs on steel (25 percent) and aluminum (10 percent) will affect Turkey.[21] The overall impact on the trade balance may not be that significant; indirect impacts through turbulence in financial markets and flows, protectionism and currency volatility may be more severe.

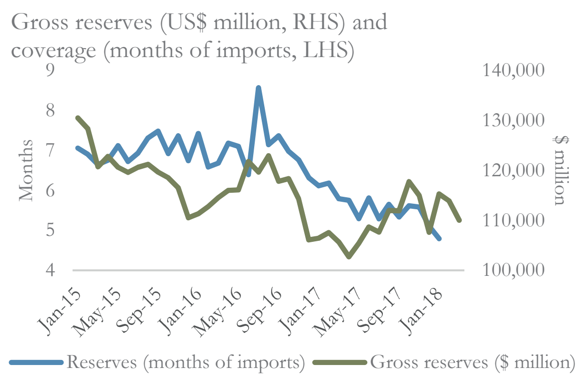
33. Turkey's current account deficit in 2018 is expected to remain over 5 percent of GDP. This is largely due to energy imports, which account for around 15-20 percent of total imports. Brent oil averaged US$65 per barrel in February – a 5 percent (mom) drop from January – ending seven months of gains (Figure 41).[22] Prices rose again in late March amid concerns of sanctions against Iran. This points to sustained pressure on the Lira given more the recent decline in foreign exchange reserve coverage (Figure 42) and a slowdown in capital inflows.

Figure 41: Commodity prices increasing



Source: World Bank Commodity Prices

Figure 42: Decline in forex reserve coverage



Source: Haver Analytics, WB Global Economic Monitor

21 Around 15 percent of total iron and steel exports from Turkey in 2016 were bound for the US (and 2 percent of aluminum exports). Around 4-5 percent of total iron and steel imports by the US comes from Turkey, making it the sixth largest seller of iron and steel to the US.

22 WB, "Global Economic Monitor" (March 2018)

Figure 43: External flows vulnerable to monetary tightening in the US

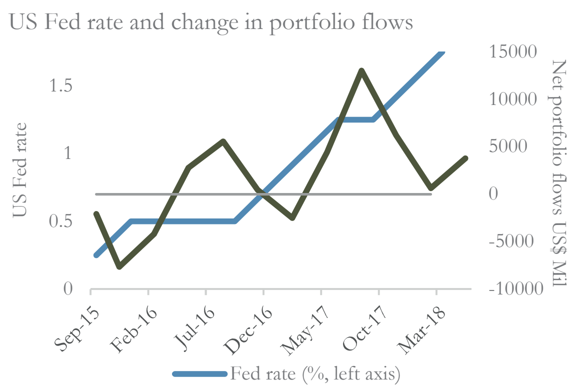
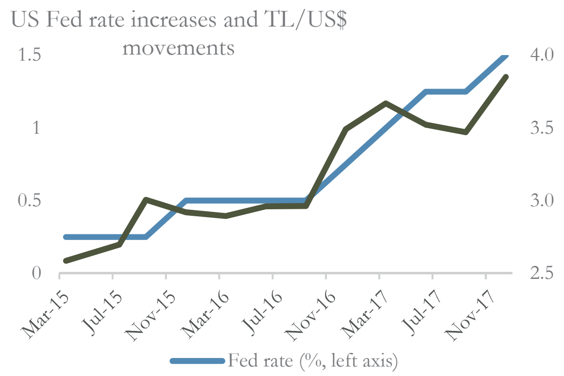


Figure 44: Exchange rate developments also closely linked



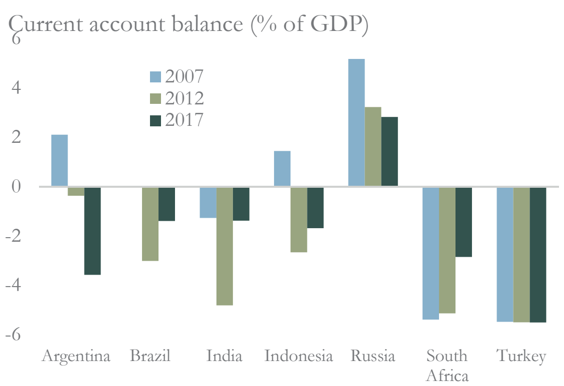
Sources: Haver Analytics, US Federal Reserve, WB Staff estimates

Turkey's external buffers against tightening financial conditions have declined

34. Tighter global liquidity conditions in 2018 affects Turkey's access to and cost of external finance, an important lever of growth for the country. Following the US Federal Reserve's decision to raise policy rates by 25 basis points (from 1.5 percent to 1.75 percent) on March 21, and the Chairman's assessment of the US economy, markets raised the probability that the policy rate will be hiked four times in 2018.[23] Past episodes of US monetary tightening were associated with sharp slowdowns, and occasional reversals, of net portfolio flows to Turkey (Figure 43), and currency depreciation (Figure 44).

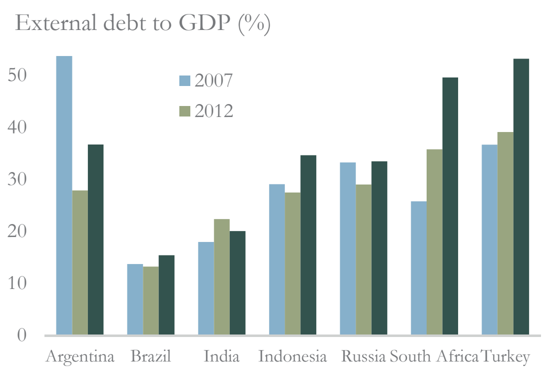
35. Turkey's external buffers to withstand further financial tightening have reduced relative to prior episodes of financial tightening. Compared to 2007 (before onset of the GFC) and 2012 (before "Taper Tantrum that followed the announcement of US monetary policy normalization), Turkey's external position has deteriorated. External financing needs remain large (Figure 45), whilst external debt stock has risen sharply from 37 percent of GDP in 2007, to 39 percent in 2012, and to around 53 percent in 2017 (Figure 46). Other than South Africa, selected EMDEs' external financial requirements and debt are lower than Turkey's.

Figure 45: Large external financing needs



Source: IMF World Economic Outlook

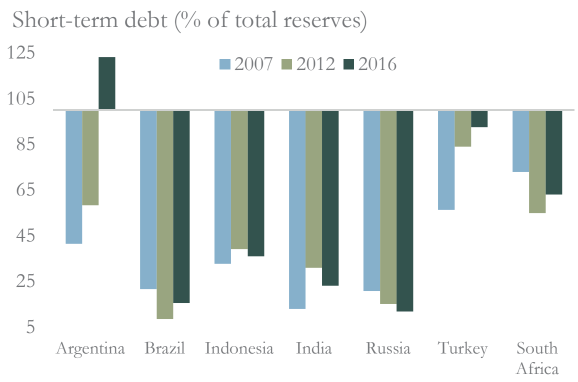
Figure 46: Increased external debt stock



Source: WB International Debt Statistics

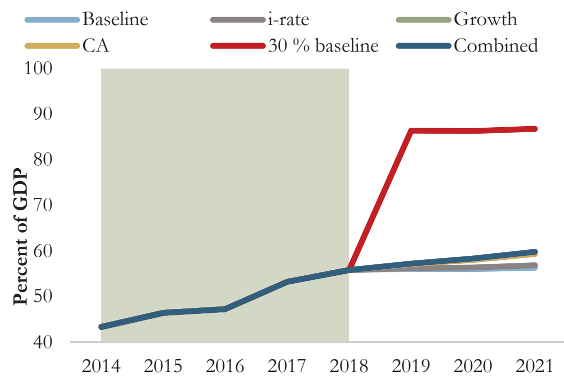
23 WB, "Global Economic Monitor (Monthly)" (March 2018)

Figure 47: Short-term debt vulnerability low



Source: WB International Debt Statistics

Figure 48: Increased debt sustainability concerns



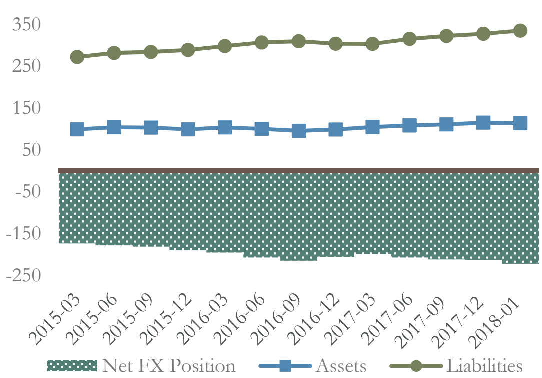
Source: WB Staff estimates

36. Whilst Turkey's total external debt trajectory remains sustainable, vulnerability to adverse shocks has increased with the recent rise in external debt. Despite the drop in international reserves, there are no immediate concerns over external liquidity – the ratio of short-term debt to reserves has declined though remains below 100 percent (Figure 47). In terms of solvency, total external debt is projected to increase to 56.3 percent by 2021, which does not pose significant sustainability risks. But external shocks can quickly change this scenario: (i) A steeper rise in energy prices could push the external debt ratio to 59.4 percent of GDP in 2021; (ii) a permanent 30 percent real depreciation shock could increase external debt to GDP to 86.8 percent in 2021. This puts external debt sustainability at risk (Figure 48).

Pressures on corporates and macro-financial risks have risen

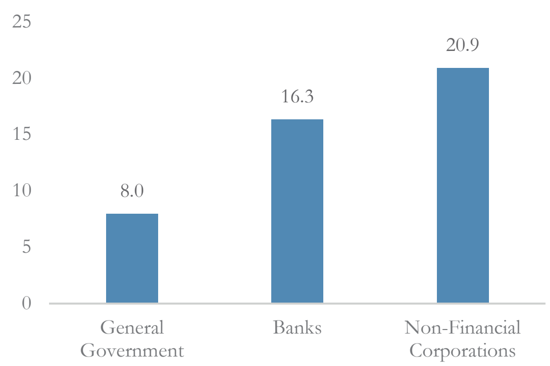
37. A large portion of Turkey's external financing needs belongs to corporates, which have a sizeable and rising net open foreign exchange positions. Almost half of the total external debt increase stemmed from the corporate debt in 2017 (Figure 49). The net FX open position of corporates reached US$221.5 billion dollars in January 2018 (Figure 50). The share of FX corporate loans with maturities of 5 years and longer make up more than half of the total FX loans of the banking sector. In an adverse scenario of significant tightening of global liquidity, and persistent lira depreciation corporate balance sheets would be strained. Although banks are not allowed to hold net open currency positions, defaults in the corporate sector could also have an adverse impact on the banking sector through credit risk channels.

Figure 49: Net Open FX Position of Corporates increasing



Sources: CBRT, Treasury.

Figure 50: Contribution to Increase in External Debt in 2017 comes mostly from corporates

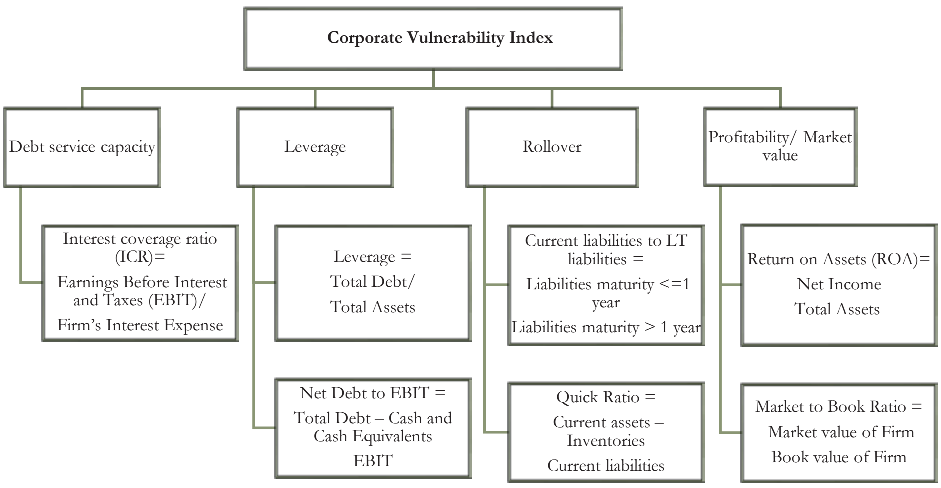


Box 4: Corporate Vulnerability Index

The Corporate Vulnerability Index (CVI) is calculated to track financial conditions of non-financial corporate sector in EMDEs by using balance-sheet information of listed nonfinancial firms (Feyen et al. 2017). Based on corporates' balance-sheet information, the CVI measures four key aspects of financial vulnerability that have been identified by the literature as leading indicators of corporate financial distress: (i) Debt Service Capacity; (ii) Leverage (iii) Rollover Risk; and (iv) Profitability/Market value.

These four aspects of corporate vulnerability are measured using seven indicators for which data are readily and sufficiently available across a broad range of EMDEs: (i) Interest Coverage Ratio (ICR); (ii) Leverage Ratio; (iii) Net Debt to EBIT (Earnings before Interest and Tax) Ratio; (iv) Current Liabilities to Long-term Liabilities Ratio; (v) Quick Ratio; (vi) Return on Assets (ROA); and (vii) Market to Book Ratio (Figure 51).

Figure 51: Structure of Corporate Vulnerability Index



The CVI is based on the concept of "Debt at Risk" (DaR), the total amount of outstanding debt in a country (or industry) associated with firms that are deemed financially vulnerable. DaR is defined as the share of corporate debt in a country that is considered vulnerable according to indicator Y at time t and country c where Y denotes one of seven indicators. For each of the indicators, firms are classified as financially vulnerable if an indicator breaches an industry-specific threshold at time t (Table 1).

$$(\mathrm{DaR_Y})_{ct} = \frac{\text{Total debt firms financially vulnerable in indicator Y, country c time t}}{\text{Total debt of all firms, in country c and time t}}$$

- 1 is used as a threshold for ICR, since firms with profits less than interest expenses are immediately highly vulnerable.
- For Leverage Ratio, Net Debt to EBIT Ratio, and Current to Long-Term Liabilities, the vulnerability thresholds correspond to the 90th percentile value of the respective indicators for all firms within the same industry and across countries.
- For Quick Ratio, Return on Assets, and Market to Book Ratio, the respective thresholds are equal to the 10th percentile value of the indicator by industry.

Table 1: Thresholds to classify a firm as financially vulnerable

Indicator	"At risk" Thresholds
• Interest Coverage Ratio	<1 (profits less than interest expenses)
• Leverage	>90th percentile value of **all firms** within the same industry, for the **whole sample 2006Q4-2017Q3**. One number per industry
• Net Debt/EBIT	
• Current Liabilities / Long-term Liabilities	
• Quick Ratio	<10th percentile value of all firms within the same industry, for the **whole sample 2006Q4-2017Q3**. One number per industry
• Return on Assets (ROA)	
• Market-to-Book Ratio	

$\mathbf{DaR}_Y$ is extended to multiple indicators to measure the "intensity" of debt at risk. The underlying assumption is that debt that is associated with firms that are contemporaneously vulnerable according to multiple indicators is more risky. It provides a stronger signal-to-noise ratio. In this regard, $\mathbf{DaR}_{\geq X}$, which captures the proportion of total corporate debt in a country that is held by firms that are vulnerable according to X or more indicators at the same time, where $X \in [0,7]$:

$$(\mathbf{DaR}_{\geq X})_{ct} = \frac{\text{Total debt firms financially vulnerable according to X or more indicators, country c time t}}{\text{Total debt of all firms, in country c and time t}}$$

Finally, CVI is calculated as the average of $\mathbf{DaR}_{\geq X}$ for country c and time t:

$$\mathbf{CVI}_{ct} = \frac{1}{7}\sum_{X=1}^{7}(\mathbf{DaR}_{\geq X})_{ct}$$

where $0 \leq CVI_{ct} \leq 1$.

The Corporate Vulnerability Index (CVI) shows how vulnerable are firms across 7 financial indicators. The index goes from 0 to 1, where 0 represents that firms are not vulnerable in any indicator, and 1 represents that all firms are vulnerable in all 7 indicators.

38. Corporate vulnerability of companies listed on the stock exchange in Turkey has increased in 2017. A recently developed Corporate Vulnerability Index (CVI – see Box 4 for methodology)[24] suggests that corporate vulnerability in most EMDEs has risen since 2013 (Figure 52). The increase has been particularly sharp for Turkey. The debt in firms that are financially vulnerable in 2 or more indicators increased significantly from 14 percent to 37 percent of total reported debt of listed Turkish firms between 2015 and 2017Q3[25] (Figure 53). Firms' vulnerability is mostly driven by high levels of leverage ratios (Figure 54), deterioration of interest coverage ratio (i.e., more firms with ICR < 1) (Figure 55). As a result, rollover risk is increasingly becoming a problem as debt at risk (DaR) for Quick Ratio and Current Liabilities to Long-term liabilities are rising from low levels (Figure 56). These challenges have been compounded by an overall decline in earnings (Figure 57).

24 Feyen, E., N. Fiess, I.Z. Huertas, L. Lambert, "Which Emerging Markets and Developing Economies Face Corporate Balance Sheet Vulnerabilities? A Novel Monitoring Framework," World Bank Group Policy Research Working Paper 8198

25 The sample covers 274 listed non-financial Turkish firms.

Figure 52: CVI in Turkey deteriorates

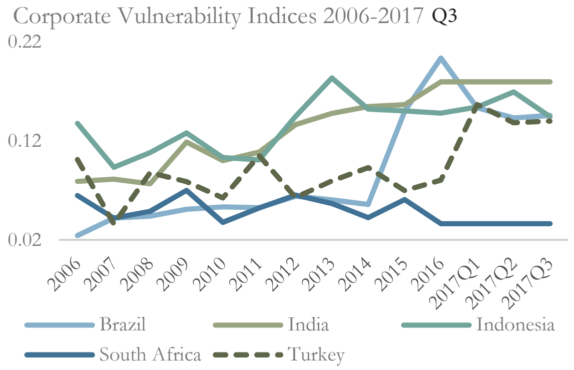


Figure 53: Firms with DAR > 2 more than doubles

Figure 54: Sharp rise in leverage ratios

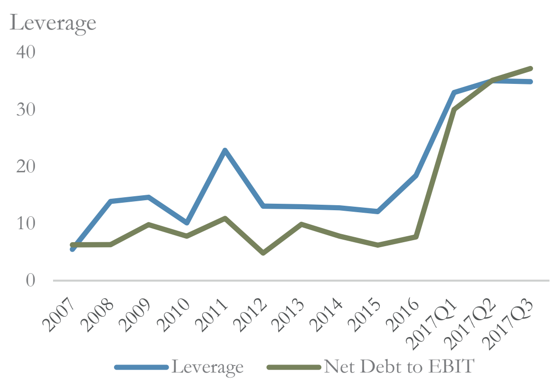


Figure 55: Deterioration in debt service capacity

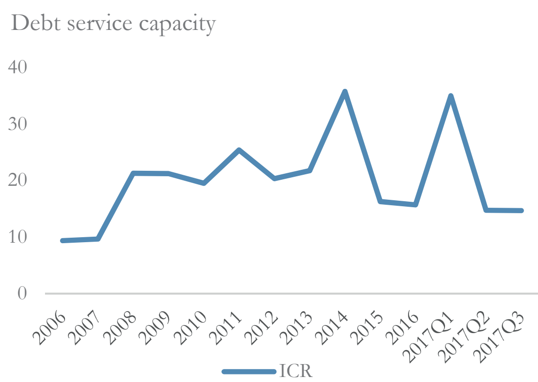


Figure 56: Rollover risk becoming a problem

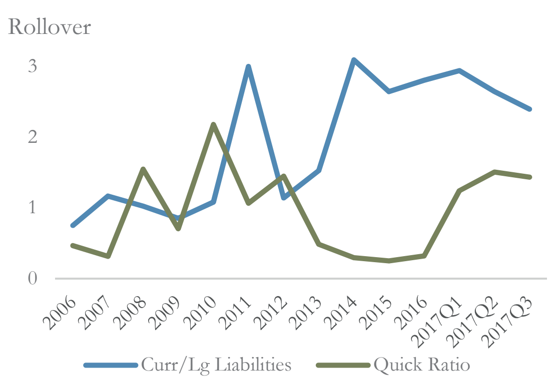
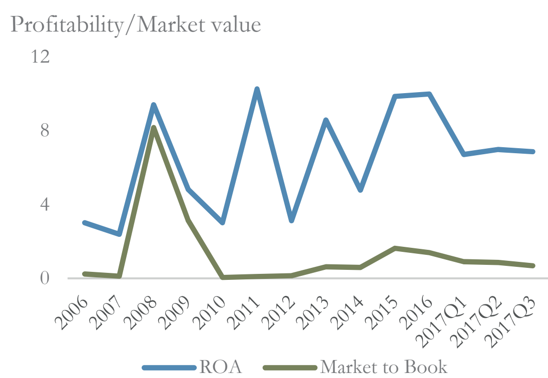


Figure 57: Compounded by falling earnings



Sources: Bloomberg, WB Staff estimates

Policy space to respond to tighter external financial conditions[26]

39. Fiscal policy space needed to react quickly to adverse external developments remains relatively strong in Turkey. As noted above, countercyclical fiscal policy has helped maintain fiscal discipline (Figure 58), and protect fiscal buffers (Figure 59). Solid fiscal positions in other EMDEs prior to the GFC, enabled them to implement strong stimulus programs. This more recently has led to a deterioration in fiscal positions, exacerbated for some by declining commodity prices. In Turkey, a broader set of fiscal space indicators (Table 2)[27] confirms that the government is in a strong position to finance its long-term commitments (Table 2: Government debt sustainability indicators), and that the composition of public debt does not unduly expose the authorities to a sudden change in financial market conditions (Table 2: Balance sheet composition).

40. Tightening global financial conditions together with elevated levels of external and private sector debt have the potential to rapidly erode fiscal space. Turkey's dependence on external finance remains high relative to other EMDEs, with some exceptions (Table 2: External and Private Sector Debt). Therefore, if downside risks associated with the banking sector, non-financial corporates, and Public Private Partnerships – all of which are exposed to currency risks – materialize, this may create contingent liabilities for the government. This may explain partly why, despite strong fiscal buffers, market perceptions of risk towards Turkey remain relatively high (Table 2: Market Perception).

41. The possibility for monetary policy to respond to adverse external developments is more challenging. This is because the positive deviation of inflation from its target is already high in Turkey (Figure 60),[28] whilst the Central Bank's average cost of funding is already at 13.5 percent and positive in real terms (Figure 61). Therefore, if a tightening of external liquidity conditions leads to slower growth, the possibility of a monetary stimulus will be challenging given high inflation.

42. In Turkey, this challenge is exacerbated by a need to cool credit expansion. The credit-to-GDP gap in Turkey has been high in recent years, meaning that credit growth has been above its long-term trend pointing to potential erosion of countercyclical buffers (Figure 62).[29] Further evidence of excessive credit expansion (credit boom) is evident when computing the threshold for credit growth that determines whether the observed growth in credit can be associated with a boom or a bust (Figure 63).[30] If international financial tightening exposes financial (and real sector) fragilities as discussed above, then high inflation constrains the ability to reduce interest rates and/or expand credit to boost demand.

43. These developments point to heightened macro-financial risks. The banking sector is stable with capital adequacy and NPL at 17 percent and 3 percent respectively but total troubled assets, which includes restructured and written-off loans, are almost three times higher than NPL levels. A combination of these factors together with high corporate hard-currency indebtedness, external financing constraints, and a slowing economy point to a deterioration in banking sector asset quality and heightened macro-financial risks.

26 Parts of this section draws on the approach in Rojas-Suarez, L., 2015. "Emerging Market Macroeconomic Resilience to External Shocks: Today versus Pre–Global Crisis", Center for Global Development

27 The data in this section is taken from: Kose, M. Ayhan, Sergio Kurlat, Franziska Ohnsorge, and Naotaka Sugawara (2017). "A Cross-Country Database of Fiscal Space." Policy Research Working Paper 8157, World Bank, Washington, DC. Not all countries' data for 2017 has been updated, therefore 2016 data is used to illustrate developments compared to 2007 (prior to GFC onset) and 2012 (prior to "Taper Tantrum" and collapse in commodity prices in 2014.

28 Rojas-Suarez, L., 2015: "Deviation of inflation from its announced target captures the constraints imposed on the implementation of countercyclical monetary policy when the economy is facing inflationary or deflationary pressures at the time of the shock."

29 Bank for International Settlements: "The credit-to-GDP gap is defined as the difference between the credit-to-GDP ratio and its long run trend. The credit-to-GDP ratio as published in the BIS database of total credit to the private non-financial sector, capturing total borrowing from all domestic and foreign sources, is used as input data…The gap indicator was adopted as a common reference point under Basel III to guide the build-up of countercyclical capital buffers."

30 Rojas-Suarez, L., 2015: $Financial\ Fragility = (\Delta RC^{boom} - \Delta RC_t) * (\Delta RC_t - \Delta RC^{bust})$ where ΔRC^{boom} is the threshold for credit boom and ΔRC^{bust} the threshold for credit bust. The thresholds are determined by using the Hodrick-Presscot (HP) filter to calculate the cyclical component of credit growth, then multiplying the standard deviation for the sample period by 1.5 and -1.5 to obtain the boom and bust thresholds respectively.

Table 2: Cross-country indicators of fiscal space

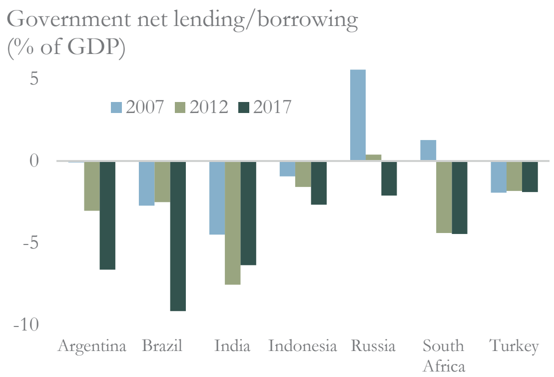
	Argentina 2007	Argentina 2012	Argentina 2016	Brazil 2007	Brazil 2012	Brazil 2016	India 2007	India 2012	India 2016	Indonesia 2007	Indonesia 2012	Indonesia 2016	Russian Federation 2007	Russian Federation 2012	Russian Federation 2016	South Africa 2007	South Africa 2012	South Africa 2016	Turkey 2007	Turkey 2012	Turkey 2016
Government debt sustainability																					
General government gross debt, % of GDP	61.0	38.9	54.2	63.7	62.2	78.3	74.0	69.1	69.6	32.3	23.0	27.9	8.0	11.5	15.6	27.1	41.0	51.7	38.3	32.7	28.1
Primary balance, % of GDP	1.7	-1.7	-4.8	3.2	1.9	-2.5	0.3	-3.2	-1.8	0.9	-0.4	-1.0	5.6	0.7	-3.1	3.7	-1.7	-0.6	2.7	0.7	-0.9
Cyclically-adjusted balance, % of potential GDP	-2.0	-3.8	-4.2	-3.2	-3.8	-7.4	-5.2	-7.3	-6.3	-1.1	-1.7	-2.4	3.0	-0.5	-2.8	0.2	-4.6	-3.7	-3.1	-1.7	-2.8
Fiscal balance, % of GDP	-0.1	-3.0	-5.8	-2.7	-2.5	-9.0	-4.5	-7.6	-6.6	-0.9	-1.6	-2.5	5.6	0.4	-3.7	1.3	-4.4	-4.0	-1.9	-1.8	-2.3
General government gross debt, % of average tax revenues	288.6	184.3	256.7	231.7	226.0	284.6	490.4	457.9	460.9	286.2	203.2	246.6	30.7	44.2	59.9	104.5	158.3	199.6	212.1	181.1	155.9
Fiscal balance, % of average tax revenues	-0.5	-14.4	-27.5	-9.9	-9.2	-32.8	-29.8	-50.0	-43.5	-8.4	-14.0	-22.0	21.3	1.5	-14.0	4.9	-17.0	-15.4	-10.8	-10.1	-12.8
Balance sheet composition																					
Debt securities held by nonresidents, % of total	0.2	0.1	0.4										0.7	0.1	0.1				1.0	1.1	0.8
General government debt held by nonresidents, % of total	42.0	30.8	37.7	10.1	13.9	14.4	5.9	6.4	5.7	53.2	58.1	60.0	29.7	20.2	17.9	20.5	34.4	36.0	29.5	41.2	41.8
Concessional external debt stocks, % of general government gross debt	1.0	1.5	1.2	0.3	0.8	0.7	4.9	4.0	2.9	25.2	19.2	10.0	3.2	0.8	0.7	0.0	0.0	0.0	2.3	4.0	4.8
Sovereign debt average maturity, years	24.6	18.1	13.3	15.8	13.9	10.7		4.7	4.5	16.4	12.3	14.1	10.4	7.9	6.9	6.3	9.0	8.7	13.3	11.9	12.3
Central government debt maturing in 12 months or less, % of GDP		2.7	12.9		5.0	7.4		3.9	8.7		0.9	3.0		0.7	1.3		5.4	8.1		9.2	2.3
External and private sector debt																					
Total external debt stocks, % of GDP	43.2	25.0	33.3	17.3	17.9	37.6	16.7	21.6	20.1	30.1	27.5	34.1	33.3	28.8	40.1	25.8	35.9	48.4	37.0	38.9	46.8
External debt in foreign currency, % of total	89.7	93.8	92.3			74.5	83.3	78.0	68.8					72.1	78.5	60.4	42.9	49.5	94.5	93.2	94.1
Private external debt stocks, % of GDP	18.5	12.1	10.9	12.5	15.1	26.6	12.2	17.1	16.2	12.9	13.7	17.1	30.4	25.6	36.1	19.3	21.8	29.4	24.5	28.3	36.8
Domestic credit to private sector, % of GDP	13.1	15.2	14.0	51.5	69.0	66.2	44.8	51.9	49.8	23.1	29.9	33.1	35.2	43.9		78.3	68.6	66.9	28.2	49.1	65.7
Short-term external debt stocks, % of total	22.2	26.1	20.0	16.1	7.4	8.3	18.9	23.7	18.4	13.2	17.5	12.8	21.1	12.8	8.8	31.2	19.6	20.9	17.3	29.5	24.2
Short-term external debt stocks, % of reserves	59.8	87.4	94.3	21.6	8.7	15.4	14.1	31.1	23.2	32.8	39.2	34.9	20.4	15.2	12.0	73.0	55.0	63.1	56.4	83.9	92.4
Total external debt stocks, % of reserves	269.8	335.5	471.6	133.7	118.1	185.4	74.6	131.2	126.1	248.6	223.7	273.1	97.0	118.3	136.4	234.3	280.8	302.7	326.7	284.9	381.8
Total external debt stocks, % of reserves excluding gold	278.6	363.2	498.8	134.3	119.2	186.7	77.3	145.6	133.7	257.5	231.9	280.0	99.5	130.8	161.9	260.7	323.5	335.6	340.6	339.8	439.4
Market perception																					
5-year sovereign CDS spreads, basis points	315.0	1228.6	5244.0	89.1	129.8	325.1				136.0	166.4	180.2	61.9	183.1	244.4	46.1	159.4	274.0	169.3	204.7	260.0
Foreign currency long-term sovereign debt ratings, index from 1-21	5.0	6.4	5.0	10.5	13.0	10.3	12.0	12.0	12.0	8.7	11.7	11.7	13.7	13.3	11.3	14.0	14.2	12.3	9.0	10.6	11.4

Sources: The full database can be downloaded from: http://www.worldbank.org/en/research/brief/fiscal-space. The database is compiled from a range of sources including: World Development Indicators (WB); International Debt Statistics (WB); Quarterly External Debt Statistics (WB); Quarterly Public Sector Debt (WB); World Economic Outlook (IMF); International Finance Statistics (IMF); World Revenue Longitudinal Dataset (IMF); Government Finance Statistics (IMF); Joint External Data Hub (WB, BIS, IMF, OECD); and databases provided by BIS, OECD, Bloomberg, J.P. Morgan, and Arslanap and Tsuda. 31,32

31 Arslanap, S., and T. Tsuda. 2014a. "Tracking Global Demand for Advanced Economy Sovereign Debt." IMF Economic Review 62 (3): 430-464

32 Arslanap, S., and T. Tsuda. 2014b. "Tracking Global Demand for Emerging Market Sovereign Debt." IMF Working Paper 14/39, International Monetary Fund, Washington DC

Figure 58: Fiscal discipline maintained



Source: IMF World Economic Outlook

Figure 59: Fiscal buffers relatively strong

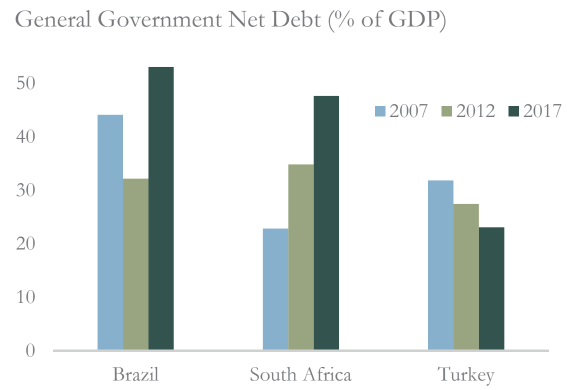
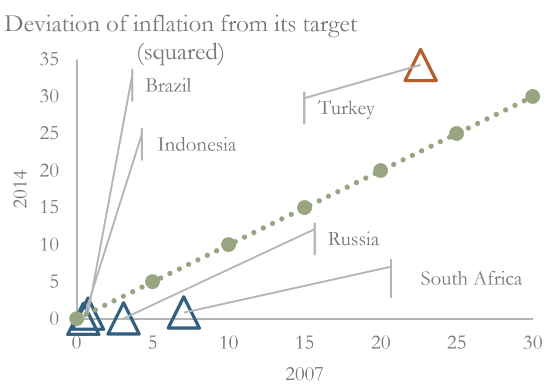
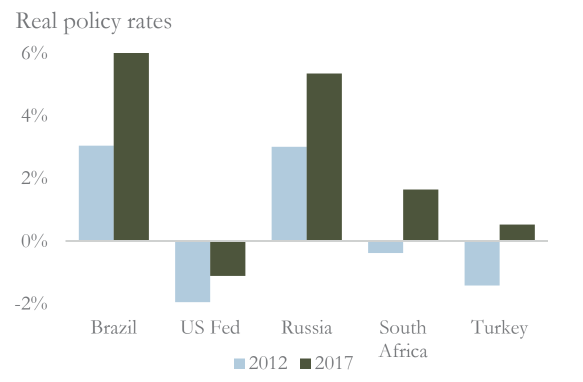


Figure 60: Deviation of inflation from target



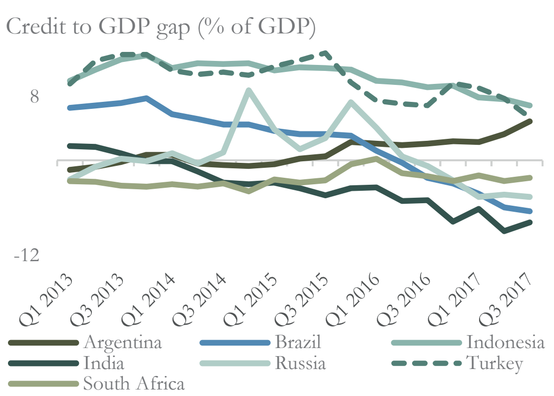
Sources: IMF WEO, National Central Banks, WB Staff estimates

Figure 61: Real policy rates are positive



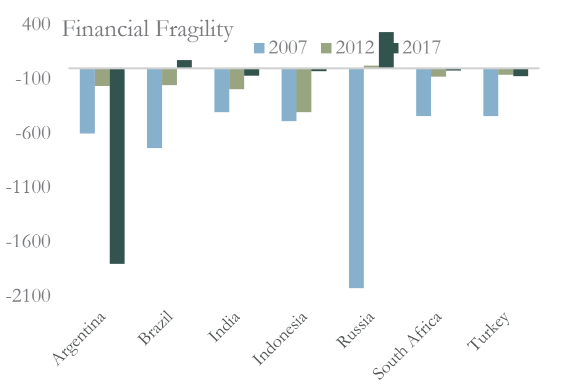
Source: Haver Analytics, WB Staff estimates

Figure 62: High credit to GDP gap



Sources: Bank for International Settlements

Figure 63: Indications of credit boom



Sources: Haver Analytics, WB Staff estimates

Annex 1: Medium-Term Outlook

Key Macroeconomic Indicators

	2015	2016	2017	2018	2019	2020
Population (mid-year, million)	78.2	79.3	80.3	81.3	82.4	83.4
GDP (current US$, billion)	861.9	862.7	851.1	875.5	937.1	1007.7
GDP per capita (current US$)	11019	10883	10597	10763	11372	12082
Upper middle-income Poverty Rate (US$5.5 in 2011 PPP)	11.5	9.9	9.1	8.8	8.4	8.2
CPI (annual average, in percent)	7.7	7.8	11.1	10.4	9.0	8.2
Real Economy	TL Billion, unless otherwise indicated					
Real GDP	1527.7	1576.4	1693.3	1773.1	1850.5	1924.5
Private Consumption	930.7	964.8	1023.8	1064.7	1105.2	1144.9
Government Consumption	200.4	219.5	230.5	241.9	254.8	266.4
Gross Fixed Capital Formation	455.5	465.8	499.8	526.5	551.0	573.3
Net Exports	-14.2	-33.9	-31.6	-30.8	-31.3	-31.0
Fiscal Accounts	TL Billion, unless otherwise indicated					
Total Revenues	799.2	904.3	1030.0	1146.5	1292.9	1458.5
Total Expenditures	801.6	939.5	1090.8	1222.0	1376.0	1534.7
General Government Balance	-2	-35	-60	-76	-83	-76
Government Debt Stock	646.5	738.5	877.8	1008.6	1144.9	1271.4
Primary Balance	52.4	17.6	0.2	-1.1	0.6	27.2
Monetary Policy	TL Billion, unless otherwise indicated					
Broad Money (M3)	1232.3	1451.8	1686.4	-	-	-
Credit Growth (FX-adjusted, eop, y-o-y)	11.8	10.9	20.3	-	-	-
Average Funding Rate (annual average, in percent)	8.4	8.4	11.5	-	-	-
Gross Reserves (in US$ Billion)	110.5	106.1	107.6	-	-	-
o/w Gold Reserves	17.6	14.1	23.5	-	-	-
o/w Net Reserves	28.3	34.1	36.1	-	-	-
External Sector	US$ Billion, unless otherwise indicated					
Current Account balance	-32.1	-33.1	-47.4	-49.9	-52.5	-55.6
Trade Balance	-48.1	-40.9	-58.9	-66.4	-75.2	-83.9
Exports	152.0	150.2	166.2	180.7	196.0	211.7
Imports	200.1	191.1	225.1	247.0	271.2	295.6
Net Foreign Direct Investment	12.9	10.2	8.2	9.8	11.2	12.1

Source: TURKSTAT, CBRT, Ministry of Development, WB Staff Calculations

Annex 2: Medium-Term Outlook

Key Macroeconomic Indicators

	2015	2016	2017	2018	2019	2020
Real Economy	Annual percentage change, unless otherwise indicated					
Real GDP	6.1	3.2	7.4	4.7	4.4	4.0
Private Consumption	5.4	3.7	6.1	4.0	3.8	3.6
Government Consumption	3.9	9.5	5.0	5.0	5.3	4.6
Gross Fixed Capital Formation	9.3	2.2	7.3	5.3	4.7	4.0
Exports	4.3	-1.9	12.0	6.7	5.5	5.0
Imports	1.7	3.7	10.3	6.0	5.2	4.6
Fiscal Accounts	Percent of GDP, unless otherwise indicated					
Total Revenues	34.2	34.7	32.6	32.3	32.1	32.1
Total Expenditures	34.3	36.0	35.0	34.5	34.2	33.8
General Government Balance	-0.1	-1.3	-2.4	-2.1	-2.1	-1.7
Government Debt Stock	27.6	28.3	28.3	28.4	28.4	28.0
Primary Balance	2.2	0.7	0.0	0.0	0.0	0.6
Monetary Policy	Percent of GDP, unless otherwise indicated					
CPI (annual average, in percent)	7.7	7.8	11.1	10.4	9.0	8.2
Broad Money (M3)	52.7	55.7	54.3	-	-	-
Gross Reserves	12.9	12.3	12.7	-	-	-
In months of merchandise imports c.i.f.	6.4	6.4	5.5	-	-	-
Percent of short-term external debt	104.9	104.6	91.4	-	-	-
External Sector	Percent of GDP, unless otherwise indicated					
Current Account balance	-3.7	-3.8	-5.6	-5.7	-5.6	-5.5
Trade Balance	-5.6	-4.7	-6.9	-7.6	-8.0	-8.3
Exports	17.6	17.4	19.5	20.6	20.9	21.0
Imports	23.2	22.1	26.5	28.2	28.9	29.3
Net Foreign Direct Investment	1.5	1.2	1.0	1.1	1.2	1.2

Source: TURKSTAT, CBRT, Ministry of Development, WB Staff Calculations

Annex 3: Gross Domestic Product

Gross Domestic Product: Production Approach

	2013	2014	2015	2016	2017
GDP (current, TL billion)	1809.7	2044.5	2338.6	2608.5	3104.9
Agriculture	121.7	134.7	161.4	161.3	188.7
Industry	355.3	410.8	462.0	511.8	640.6
Construction	145.9	165.7	190.6	223.4	265.7
Services	962.4	1097.0	1246.7	1402.4	1655.4
GDP (constant prices, TL billion)	1369.3	1440.1	1527.7	1576.4	1693.3
Agriculture	94.6	95.2	104.1	101.4	106.1
Industry	268.9	284.0	298.4	311.0	339.7
Construction	101.3	106.4	111.6	117.6	128.1
Services	743.4	790.4	834.8	861.2	925.8
Real GDP Growth (%)	8.5	5.2	6.1	3.2	7.4
Agriculture	2.3	0.6	9.4	-2.6	4.7
Industry	9.0	5.6	5.1	4.2	9.2
Construction	14.0	5.0	4.9	5.4	8.9
Services	7.7	6.3	5.6	3.2	7.5
GDP (constant prices, % share)					
Agriculture	6.9	6.6	6.8	6.4	6.3
Industry	19.6	19.7	19.5	19.7	20.1
Construction	7.4	7.4	7.3	7.5	7.6
Services	54.3	54.9	54.6	54.6	54.7

Source: TURKSTAT, WB Staff Calculations

Annex 4: Gross Domestic Product

Gross Domestic Product: Expenditure Approach

	2013	2014	2015	2016	2017
GDP (current, TL billion)	1809.7	2044.5	2338.6	2608.5	3104.9
Private Consumption	1120.4	1242.2	1411.8	1560.5	1836.0
Government Consumption	255.6	288.1	324.6	387.0	450.2
Gross Fixed Capital Formation	516.2	590.7	694.8	764.7	925.5
o/w Construction	291.4	338.4	380.2	424.5	533.8
o/w Machinery and Equipment	182.3	206.4	263.1	283.9	326.9
Net Exports	-105.1	-79.4	-61.0	-75.3	-139.5
Change in Inventories	22.6	2.8	-31.5	-28.4	32.7
GDP (constant prices, TL billion)	1369.3	1440.1	1527.7	1576.4	1693.3
Private Consumption	857.2	882.8	930.7	964.8	1023.8
Government Consumption	187.0	192.8	200.4	219.5	230.5
Gross Fixed Capital Formation	396.6	416.8	455.5	465.8	499.8
o/w Construction	217.1	231.2	242.1	248.8	278.6
o/w Machinery and Equipment	148.2	153.9	182.4	184.5	185.8
Net Exports	-48.1	-22.3	-14.2	-33.9	-31.6
Change in Inventories	-23.4	-30.1	-44.7	-39.8	-29.1
Real GDP Growth (%)	8.5	5.2	6.1	3.2	7.4
Private Consumption	7.9	3.0	5.4	3.7	6.1
Government Consumption	8.0	3.1	3.9	9.5	5.0
Gross Fixed Capital Formation	13.8	5.1	9.3	2.2	7.3
o/w Construction	21.1	6.5	4.7	2.8	12.0
o/w Machinery and Equipment	8.1	3.9	18.5	1.2	0.7
Exports	1.1	8.2	4.3	-1.9	12.0
Imports	8.0	-0.4	1.7	3.7	10.3
Change in Inventories	-18.5	28.8	48.4	-11.0	-26.8
GDP (constant prices, % share)					
Private Consumption	62.6	61.3	60.9	61.2	60.5
Government Consumption	13.7	13.4	13.1	13.9	13.6
Gross Fixed Capital Formation	29.0	28.9	29.8	29.5	29.5
o/w Construction	15.9	16.1	15.8	15.8	16.5
o/w Machinery and Equipment	10.8	10.7	11.9	11.7	11.0
Exports	22.1	22.7	22.3	21.2	22.1
Imports	25.6	24.2	23.2	23.4	24.0
Change in Inventories	-1.7	-2.1	-2.9	-2.5	-1.7

Source: TURKSTAT, WB Staff Calculations

Annex 5: Prices

Consumer and Producer Prices: End of period y-o-y, percentage change

	2013	2014	2015	2016	2017
CPI (All items)	7.4	8.2	8.8	8.5	11.9
CPI (Food and non-alc. Beverages)	9.7	12.7	10.9	5.7	13.8
CPI (Core C)	7.1	8.7	9.5	7.5	12.3
Alcoholic beverages, tobacco	10.5	7.7	5.7	31.6	2.9
Clothing and footwear	4.9	8.4	9.0	4.0	11.5
Housing & Energy	4.8	6.8	6.7	6.4	9.6
Furnishings	9.7	7.7	11.0	7.9	10.6
Health	4.8	8.6	7.2	9.7	11.9
Transport	9.8	2.1	6.4	12.4	18.2
Communication	1.2	1.6	3.6	3.2	1.4
Recreation and culture	5.2	5.7	11.6	5.9	8.4
Education	10.1	8.3	6.4	9.5	10.5
Restaurants and Hotels	9.9	14.0	13.2	8.6	11.5
Miscellaneous goods and services	2.2	9.7	11.0	11.1	12.8
PPI (All items)	7.0	6.4	5.7	9.9	15.5

Consumer and Producer Prices: Annual average, percentage change

	2013	2014	2015	2016	2017
CPI (All items)	7.5	8.9	7.7	7.8	11.1
CPI (Food and non-alc. Beverages)	9.1	12.6	11.1	5.8	12.7
CPI (Core C)	6.3	9.2	8.0	8.5	10.1
Alcoholic beverages, tobacco	15.2	4.1	4.5	18.1	15.4
Clothing and footwear	6.4	8.0	6.2	7.4	7.1
Housing & Energy	7.2	5.7	7.6	6.6	8.0
Furnishings	7.8	9.5	8.7	10.6	4.4
Health	2.7	8.4	7.3	9.6	12.4
Transport	6.8	9.8	1.5	7.4	16.8
Communication	5.1	1.0	3.1	2.8	2.7
Recreation and culture	2.5	7.3	9.0	7.1	9.8
Education	7.1	9.1	7.0	8.2	10.0
Restaurants and Hotels	9.3	13.3	13.5	10.2	10.3
Miscellaneous goods and services	4.9	7.2	10.1	11.3	12.3
PPI (All items)	4.5	10.2	5.3	4.3	15.8

Source: TURKSTAT, WB Staff Calculations

Annex 6: Balance of Payments

Balance of Payments Statistics

	2013	2014	2015	2016	2017	2018-Mar
	US$ Billion, unless otherwise indicated					
Current Account	-63.6	-43.6	-32.1	-33.1	-47.4	-55.4
Trade Balance	-79.9	-63.6	-48.1	-40.9	-58.9	-67.6
Exports	161.8	168.9	152.0	150.2	166.2	169.0
Imports	241.7	232.5	200.1	191.1	225.1	236.6
Services Balance	23.6	26.7	24.2	15.3	20.0	21.2
Primary Income Balance	-8.6	-8.2	-9.7	-9.2	-11.1	-11.3
Secondary Income Balance	1.3	1.5	1.4	1.7	2.7	2.3
Capital Account	-0.1	-0.1	0.0	0.0	0.0	0.1
Financial Account	-63.0	-42.6	-22.4	-22.1	-46.7	-47.4
Direct Investment	-9.9	-6.1	-12.9	-10.2	-8.2	-7.1
Portfolio Investment	-24.0	-20.2	15.7	-6.3	-24.4	-22.3
Other Investment	-38.7	-15.9	-13.3	-6.5	-5.8	-13.1
Net Errors & Omissions	1.0	1.1	9.8	11.0	0.7	7.9
Reserve Assets	9.9	-0.5	-11.8	0.8	-8.2	-4.9
Overall Balance	9.9	-0.5	-11.8	0.8	-8.2	-4.9
memo item:						
Energy Balance	-49.2	-48.8	-33.3	-24.0	-32.9	-34.5
Gold Balance	-11.8	-3.9	4.0	1.8	-10.0	-13.5
	Percent of GDP, unless otherwise indicated					
Current Account	-6.7	-4.7	-3.7	-3.8	-5.6	-6.5
Trade Balance	-8.4	-6.8	-5.6	-4.7	-6.9	-7.9
Exports	17.0	18.1	17.6	17.4	19.5	19.9
Imports	25.4	24.9	23.2	22.1	26.5	27.8
Services Balance	2.5	2.9	2.8	1.8	2.3	2.5
Primary Income Balance	-0.9	-0.9	-1.1	-1.1	-1.3	-1.3
Secondary Income Balance	0.1	0.2	0.2	0.2	0.3	0.3
Capital Account	0.0	0.0	0.0	0.0	0.0	0.0
Financial Account	-6.6	-4.6	-2.6	-2.6	-5.5	-5.6
Direct Investment	-1.0	-0.7	-1.5	-1.2	-1.0	-0.8
Portfolio Investment	-2.5	-2.2	1.8	-0.7	-2.9	-2.6
Other Investment	-4.1	-1.7	-1.5	-0.8	-0.6	-1.5
Net Errors & Omissions	0.1	0.1	1.1	1.3	0.1	0.9
Reserve Assets	1.0	-0.1	-1.4	0.1	-1.0	-0.6
Overall Balance	1.0	-0.1	-1.4	0.1	-1.0	-0.6
memo item:						
Energy Balance	-5.2	-5.2	-3.9	-2.8	-3.9	-4.1
Gold Balance	-1.2	-0.4	0.5	0.2	-1.2	-1.6

Source: CBRT, WB Staff Calculations

Annex 7: Monetary Policy

Monetary Survey

	2013	2014	2015	2016	2017	2018-Mar
Total Assets (TL Billion)	1228.4	1394.3	1627.4	1894.4	2224.6	2325.3
Net Foreign Assets	-3.8	-41.5	-65.7	-42.4	-80.0	-100.7
Foreign Assets	364.6	385.8	443.6	561.8	631.2	659.6
Monetary Authorities	283.5	299.4	326.7	380.3	417.1	447.0
Deposit Money Banks	75.2	80.3	107.3	167.4	201.2	199.8
Participation Banks	4.4	4.6	7.1	6.7	7.3	7.5
Investment & Development Banks	1.4	1.6	2.6	7.4	5.6	5.3
Foreign Liabilities	368.4	427.4	509.3	604.2	711.2	760.4
Monetary Authorities	16.2	11.0	9.7	10.5	12.0	21.0
Deposit Money Banks	313.2	372.0	441.6	514.8	607.5	644.5
Participation Banks	17.8	18.4	20.0	22.2	22.4	22.7
Investment & Development Banks	21.3	26.1	38.0	56.7	69.3	72.2
Domestic Credits	1232.3	1435.8	1693.0	1936.8	2304.5	2426.0
Net Claims on Central Government	165.7	170.5	175.2	174.5	178.1	204.0
Claims on private sector	1023.2	1214.3	1456.3	1687.0	2025.9	2116.5
Total Liabilities	1228.4	1394.3	1627.4	1894.4	2224.6	2325.3
Money	165.9	185.5	217.1	270.1	297.4	300.9
Currency in Circulation	66.2	75.4	91.9	111.3	118.5	120.0
Demand Deposits	99.7	110.1	125.3	158.8	178.9	180.9
Quasi Money	826.3	923.5	1071.6	1245.5	1453.9	1514.5
Time and saving deposits	496.2	550.8	589.7	682.4	764.1	789.6
Residents' foreign exchange deposits	289.4	328.5	439.2	517.6	631.4	658.4
Securities Issued	0.0	0.0	0.0	0.0	0.0	0.0
Restricted Deposits	0.0	0.0	0.0	0.0	0.0	0.0
Other Items (Net)	236.2	285.3	338.6	378.9	473.3	509.8

Source: CBRT

Annex 8: Monetary Policy

Central Bank of Turkey Balance Sheet (TL Billion)

	2013	2014	2015	2016	2017	2018-Apr
CBRT Assets	265.9	281.9	293.2	345.4	396.2	442.5
Foreign Assets	283.5	299.4	326.7	381.0	436.8	478.9
Domestic Assets	4.6	5.3	-0.8	18.2	16.4	12.5
Treasury Debt: Securities	8.9	9.2	9.0	13.9	14.5	14.7
Cash credits to Public Sector	8.9	9.1	8.9	13.8	14.4	14.6
Cash credits to Banking Sector	13.3	19.3	22.7	37.6	48.1	52.5
Credits to SDIF	0.0	0.0	0.0	0.0	0.0	0.0
Other Items	-17.6	-23.1	-32.4	-33.1	-46.1	-54.6
FX Revaluation Account	-22.2	-22.9	-32.7	-53.8	-57.0	-48.9
CBRT Liabilities	265.9	281.9	293.2	345.4	396.2	442.5
Total FX Liabilities	199.8	207.7	244.1	260.9	299.7	344.6
Foreign Liabilities	16.1	10.8	9.7	10.0	9.1	10.6
Domestic Liabilities	183.7	197.0	234.4	251.0	290.6	333.9
Central Bank Money	66.1	74.2	49.1	84.5	96.5	97.9
Reserve Money	91.2	107.2	122.3	168.0	174.1	158.5
Other Central Bank Money	-25.1	-33.1	-73.3	-83.5	-77.6	-60.6

Source: CBRT

Annex 9: Fiscal Operations

General Government Budget

	2013	2014	2015	2016	2017	2018
	TL Billion, unless otherwise indicated					
Revenues	625.3	691.2	799.2	904.3	1030.0	1146.5
Tax Revenues	334.4	361.9	418.7	470.4	534.6	613.8
o/w Indirect	231.1	243.7	285.7	315.1	363.8	411.3
o/w Direct	92.6	106.0	118.9	138.1	162.3	184.4
Non-Tax Revenues	29.5	38.9	42.8	46.3	60.7	66.3
Factor Incomes	90.8	99.4	112.7	129.6	138.3	136.5
Social Funds	158.0	178.9	212.9	248.4	282.0	305.0
Privatization Revenues	12.6	12.1	12.1	9.6	6.0	10.0
Expenditures	637.0	701.9	801.6	939.5	1090.8	1222.0
Current Expenditures	281.6	314.6	357.7	426.6	484.2	548.8
Investment Expenditures	65.8	66.9	81.1	91.4	108.4	120.1
Transfer Expenditures	289.6	320.4	362.8	421.4	498.1	553.1
o/w Current Transfers	272.0	295.8	339.4	399.9	471.8	525.6
o/w Capital Transfers	17.6	24.6	23.4	21.6	26.3	27.5
Balance	-11.7	-10.6	-2.4	-35.1	-60.4	-75.5
Interest Expenditures	51.7	51.7	54.9	52.7	60.6	74.4
Government Debt Stock	567.9	588.2	646.5	738.5	877.8	1008.6
Primary Balance	39.9	41.1	52.4	17.6	0.2	-1.1
	Percent of GDP, unless otherwise indicated					
Revenues	34.6	33.8	34.2	34.7	33.2	32.3
Tax Revenues	18.5	17.7	17.9	18.0	17.2	17.3
o/w Indirect	12.8	11.9	12.2	12.1	11.7	11.6
o/w Direct	5.1	5.2	5.1	5.3	5.2	5.2
Non-Tax Revenues	1.6	1.9	1.8	1.8	2.0	1.9
Factor Incomes	5.0	4.9	4.8	5.0	4.5	3.9
Social Funds	8.7	8.8	9.1	9.5	9.1	8.6
Privatization Revenues	0.7	0.6	0.5	0.4	0.2	0.3
Expenditures	35.2	34.3	34.3	36.0	35.1	34.5
Current Expenditures	15.6	15.4	15.3	16.4	15.6	15.5
Investment Expenditures	3.6	3.3	3.5	3.5	3.5	3.4
Transfer Expenditures	16.0	15.7	15.5	16.2	16.0	15.6
o/w Current Transfers	15.0	14.5	14.5	15.3	15.2	14.8
o/w Capital Transfers	1.0	1.2	1.0	0.8	0.8	0.8
Balance	-0.6	-0.5	-0.1	-1.3	-1.9	-2.1
Interest Expenditures	2.9	2.5	2.3	2.0	2.0	2.1
Government Debt Stock	31.4	28.8	27.6	28.3	28.3	28.4
Primary Balance	2.2	2.0	2.2	0.7	0.0	0.0

Source: Ministry of Development, WB Staff Calculations

Annex 10: Banking Sector Balance Sheet

Money and Banking Statistics of Financial Institutions

	2013	2014	2015	2016	2017	2018-Feb
Assets	Billion TL, unless otherwise indicated					
Total assets	1708.0	1972.4	2338.3	2732.6	3263.0	3329.7
Net foreign assets	-279.3	-342.1	-397.5	-433.2	-521.4	-549.9
Claims on nonresidents	81.2	86.7	117.3	182.2	214.9	206.6
Liabilities to nonresidents	360.4	428.8	514.8	615.4	736.3	756.5
Claims on Central Bank	198.0	221.4	260.3	295.8	355.3	367.2
Currency	9.8	11.2	12.9	13.6	15.2	12.9
Reserve deposits and securities	188.2	210.2	247.3	282.2	339.7	354.0
Other claims	0.0	0.1	0.1	0.0	0.3	0.3
Net claims on central government	211.3	217.7	231.0	242.9	279.5	276.5
Claims on central government	249.0	261.6	287.8	307.1	353.8	366.3
Liabilities to central government	37.7	44.0	56.8	64.2	74.3	89.8
Claims on other sectors	1078.0	1276.9	1533.7	1790.7	2168.0	2215.4
Claims on other financial corporations	28.9	35.2	40.8	48.8	61.8	61.7
Claims on state & local governments	14.0	15.3	17.6	23.4	34.4	35.6
Claims on public nonfinancial corporations	0.9	0.9	3.7	3.8	5.5	5.4
Claims on private sector	1034.3	1225.5	1471.6	1714.7	2066.3	2112.6
Liabilities	Billion TL, unless otherwise indicated					
Liabilities to Central Bank	50.8	65.6	112.9	106.8	99.2	97.5
Transfer deposits included in broad money	173.3	194.3	230.4	282.3	343.9	333.0
Other deposits included in broad money	687.5	761.0	881.7	1028.7	1184.3	1205.2
Securities other than shares included in broad money	24.5	26.5	27.4	26.3	38.9	43.1
Deposits excluded from broad money	0.0	0.0	0.0	0.0	0.0	0.0
Securities other than shares excluded from broad money	1.3	2.5	1.2	1.5	2.3	1.6
Loans	2.6	12.2	12.3	17.4	30.4	30.8
Financial derivatives	1.3	1.2	1.6	2.7	2.7	2.4
Insurance technical reserves	0.0	0.0	0.0	0.0	0.0	0.0
Shares & other equity	194.0	237.5	269.0	308.3	366.2	386.5
Other items (Net)	72.8	73.1	91.1	122.2	213.5	209.1

Source: CBRT, BRSA, IFS

Annex 11: Banking Sector Ratios

Selected Ratios for Banking Sector

	2013	2014	2015	2016	2017	2018-Mar
Liquidity Position	in percent, unless otherwise indicated					
Liquidity Requirement Ratio	146.5	144.3	143.5	135.6	144.5	143.7
Loan-to-Deposit Ratio	107.4	113.9	117.2	117.4	121.3	121.7
Capital Adequacy	in percent, unless otherwise indicated					
Core Capital Adequacy Ratio	-	14.0	13.3	13.2	14.1	13.9
Capital Adequacy Standard Ratio	15.3	16.3	15.6	15.6	16.9	16.6
Total Risk Weighted Assets (Net) / Total Risk Weighted Assets (Gross)	69.6	68.8	68.6	43.3	42.1	65.1
Regulatory Capital / Total Risk Weighted Assets	15.3	16.3	15.6	15.6	16.9	16.6
Profitability	in percent, unless otherwise indicated					
Profit (Loss) Before Tax / Average Total Assets	2.0	1.7	1.5	1.9	2.0	0.5
Net Income / Average Total Assets	1.6	1.3	1.2	1.5	1.6	0.4
Net Income / Average Shareholder's Equity	14.2	12.3	11.3	14.3	16.0	3.8
Net Interest (Profit) Revenues (Expenses) / Average Total Assets	3.7	3.5	3.5	3.6	3.8	1.0
Asset Quality	in percent, unless otherwise indicated					
Non-Performing Loans (Gross) / Total Cash Loans	2.7	2.8	3.1	3.2	2.9	2.9
Provision for Non-Performing Loans / Gross Non-Performing Loans	76.3	73.9	74.6	77.4	79.4	75.1
Credit Growth (FX-adjusted, eop, y-o-y)	29.5	15.5	11.8	10.9	20.3	18.5
Interest Rates (end-of-period)	in percent, unless otherwise indicated					
Weighted average of Central Bank Cost of Funding	6.8	8.5	8.8	8.3	12.5	12.8
Weighted average Interest Rate for Deposits	8.0	9.5	11.0	9.6	12.8	12.7
Consumer Loans Rate	12.6	13.1	16.4	14.7	17.7	18.7
Commercial Loans Rate	10.6	11.1	15.7	14.3	17.1	17.7

Source: CBRT, BRSA, IMF

Annex 12: Doing Business Index (2018)

Doing Business Indicators	UMC	HIC	Turkey	Poland	Argentina	S. Africa	Hungary	Malaysia
Global Rank	93	47	60	27	117	82	48	24
Starting a business								
Rank	100	59	80	120	157	136	79	111
Procedures - Men (number)	8	5	7	5	13	7	6	8
Time - Men (days)	27	11	7	37	24	45	7	18
Cost - Men (% of income per capita)	21	4	13	12	10	0	5	5
Procedures - Women (number)	8	6	7	5	13	7	6	9
Time - Women (days)	27	11	7	37	24	45	7	19
Cost - Women (% of income per capita)	21	4	13	12	10	0	5	5
Minimum capital (% of income per capita)	4	6	8	11	0	0	44	0
Dealing with construction permits								
Rank	93	56	96	41	171	94	90	11
Procedures (number)	16	14	18	12	22	20	20	14
Time (days)	162	158	103	153	347	149	206	78
Cost (% of Warehouse value)	3	2	4	0	3	2	1	1
Building quality control index (0-15)	10	11	10	10	11	11	13	13
Quality of building regulations index (0-2)	2	2	1	1	2	2	2	2
Quality control before construction index (0-1)	1	1	1	1	1	0	1	1
Quality control during construction index (0-3)	1	2	2	2	2	2	2	2
Quality control after construction index (0-3)	3	3	3	2	3	3	3	3
Liability and insurance regimes index (0-2)	1	1	1	2	1	0	1	1
Professional certifications index (0-4)	2	3	2	2	2	4	4	4

Getting electricity

Rank	91	49	55	54	95	112	110	8
Procedures (number)	5	5	4	4	6	4	5	4
Time (days)	89	73	55	122	92	84	257	31
Cost (% of income per capita)	705	77	458	19	25	147	90	28
Reliability of supply and transparency of tariff index (0-8)	4	7	5	7	5	0	7	8
Total duration and frequency of outages per customer a year (0-3)	1	2	0	2	0	0	2	3
System average interruption duration index (SAIDI)			16	1.2	4.5		3.1	.5
System average interruption frequency index (SAIFI)			8.6	1	16.2		1.4	.6
Minimum outage time (in minutes)			5	3	3	1	3	1
Mechanisms for monitoring outages (0-1)	1	1	1	1	1	1	1	1
Mechanisms for restoring service (0-1)	1	1	1	1	1	1	1	1
Regulatory monitoring (0-1)	1	1	1	1	1	1	1	1
Financial deterrents aimed at limiting outages (0-1)	0	1	1	1	1	0	1	1
Communication of tariffs and tariff changes (0-1)	1	1	1	1	1	1	1	1

Registering property

Rank	95	60	46	38	117	107	29	42
Procedures (number)	6	5	7	6	7	7	4	8
Time (days)	34	38	7	33	52	23	18	13
Cost (% of property value)	6	4	3	0	7	8	5	4
Quality of land administration index (0-30)	15	21	22	20	14	14	26	28
Quality of land administration index (0-30)	15	21	22	20	14	14	26	28
Reliability of infrastructure index (0-8)	4	6	8	7	5	4	8	7
Transparency of information index (0-6)	3	3	3	3	3	3	4	6
Geographic coverage index (0-8)	2	5	4	4	2	2	8	8
Land dispute resolution index (0-8)	5	6	7	6	4	5	7	7
Equal access to property rights index (-2-0)	0	0	0	0	0	0	0	0

Getting credit								
Rank	86	76	77	29	77	68	29	20
Strength of legal rights index (0-12)	5	6	4	7	3	5	10	8
Depth of credit information index (0-8)	5	6	7	8	8	7	5	8
Credit registry coverage (% of adults)	21	18	80	0	45	0	0	64
Credit bureau coverage (% of adults)	36	53	0	86	80	64	90	83
Getting Credit total score	10	11	11	15	11	12	15	16
Protecting minority investors								
Rank	86	63	20	51	43	24	108	4
Extent of disclosure index (0-10)	6	6	9	7	7	8	2	10
Extent of director liability index (0-10)	5	6	5	2	2	8	4	9
Ease of shareholder suits index (0-10)	6	7	6	9	6	8	6	7
Extent of shareholder rights index (0-10)	6	6	8	6	9	8	6	8
Extent of ownership and control index (0-10)	4	5	7	5	7	6	5	6
Extent of corporate transparency index (0-10)	5	7	8	8	7	4	7	8
Extent of shareholder governance index (0-10)	5	6	8	6	8	6	6	7
Strength of minority investor protection index (0-10)	5	6	7	6	6	7	5	8
Paying taxes								
Rank	104	49	88	51	169	46	93	73
Payments (number per year)	22	14	11	7	9	7	11	8
Time (hours per year)	309	144	216	260	312	210	277	188
Total tax rate (% of profit)	40	37	41	41	106	29	47	39
Profit tax (% of profit)	17	15	18	15	4	22	10	22
Labor tax and contributions (% of profit)	17	19	20	25	29	4	34	16
Other taxes (% of profit)	7	3	3	1	73	3	2	1
Time to comply with VAT refund (hours)				8		8.5	15	22
Time to obtain VAT refund (weeks)				8.2		26.6	15.2	17.5
Time to comply with corporate income tax audit (hours)			1.5	6	6	11	12	11.3
Time to complete a corporate income tax audit (weeks)			0	18.1	0	31.6	23	33.5
Post filing index (0-100)	56	75	50	77	48	55	64	53

Trading across borders								
Rank	95	51	71	1	116	147	1	61
Trading across borders	70	86	80	100	65	58	100	83
Time to export: Documentary compliance (hours)	60	14	5	1	30	68	1	10
Time to import: Documentary compliance (hours)	73	19	11	1	192	36	1	10
Time to export: Border compliance (hours)	58	27	16	0	21	100	0	45
Time to import: Border compliance (hours)	65	28	41	0	60	144	0	69
Cost to export: Documentary compliance (US$)	145	72	87	0	60	170	0	45
Cost to import: Documentary compliance (US$)	109	79	142	0	120	213	0	60
Cost to export: Border compliance (US$)	494	238	376	0	150	428	0	321
Cost to import: Border compliance (US$)	536	268	655	0	1200	657	0	321

Enforcing contracts								
Rank	83	60	30	55	102	115	13	44
Time (days)	619	606	580	685	995	600	605	425
Filing and service (days)	44	34	30	60	90	30	60	35
Trial and judgment (days)	390	441	450	480	540	490	365	270
Enforcement of judgment (days)	185	131	100	145	365	80	180	120
Cost (% of claim)	29	22	25	19	23	33	15	37
Attorney fees (% of claim)	19	15	12	12	15	23	5	30
Court fees (% of claim)	5	4	3	5	7	8	8	1
Enforcement fees (% of claim)	5	3	10	2	1	3	2	6
Quality of the judicial processes index (0-18)	9	10	13	11	12	7	14	12
Quality of the judicial administration index (0-18)	9	10	13	11	12	7	14	12
Court structure and proceedings (0-5)	3	4	4	5	5	2	5	4
Case management (0-6)	2	2	4	2	4	2	4	3
Court automation (0-4)	1	2	4	2	1	1	3	3
Alternative dispute resolution (0-3)	2	2	2	3	2	3	3	3

Resolving insolvency								
Rank	97	48	139	22	101	55	62	46
Outcome (0 as piecemeal sale and 1 as going concern)	0	1	0	1	0	0	0	1
Time (years)	3	2	5	3	2	2	2	1
Cost (% of estate)	17	10	15	15	17	18	15	10
Recovery rate (cents on the dollar)	33	61	15	63	22	34	44	81
Strength of insolvency framework index (0-16)	8	10	8	14	10	13	10	6
Commencement of proceedings index (0-3)	2	3	3	3	3	3	3	2
Management of debtor's assets index (0-6)	4	5	2	6	4	6	5	2
Reorganization proceedings index (0-3)	1	1	1	3	2	2	1	0
Creditor participation index (0-4)	2	2	2	2	1	2	2	2

Source: WB, Doing Business

Annex 13: Logistics Performance Index (2016)

Logistics Performance Indicators	UMC	HIC	Turkey	Poland	Argentina	S. Africa	Hungary	Malaysia
Logistics performance index: Overall	2.7	3.6	3.4	3.4	3.0	3.8	3.4	3.4
Lead time to export, median case (days)	4.1	2.3	2.0	1.0	2.0	3.0	-	3.0
Lead time to import, median case (days)	3.7	2.7	2.0	1.0	4.0	3.0	-	7.0
Ability to track and trace consignments	2.7	3.6	3.4	3.5	3.3	3.9	3.4	3.5
Competence and quality of logistics services	2.7	3.5	3.3	3.4	2.8	3.7	3.4	3.3
Ease of arranging competitively priced shipments	2.7	3.5	3.4	3.4	2.8	3.6	3.4	3.5
Efficiency of customs clearance process	2.5	3.4	3.2	3.3	2.6	3.6	3.0	3.2
Frequency with which shipments reach consignee within scheduled or expected time	3.1	3.9	3.7	3.8	3.5	4.0	3.9	3.7
Quality of trade and transport-related infrastructure	2.6	3.6	3.5	3.2	2.9	3.8	3.5	3.4

Score, 1=low to 5=high

Source: WB, Logistics Performance Index

Annex 14: Health Statistics (2015)

Health Statistics Indicators	UMC	HIC	Turkey	Poland	Argentina	S. Africa	Hungary	Malaysia
Life expectancy at birth, total (years)	75.1	80.7	75.4	78.2	76.3	61.9	76.0	75.2
Life expectancy at birth, male (years)	72.9	78.2	72.2	74.4	72.6	58.5	72.4	73.0
Life expectancy at birth, female (years)	77.5	83.5	78.7	82.2	80.2	65.6	79.7	77.5
Mortality rate, infant (per 1,000 live births)	12.6	4.6	11.7	4.2	10.3	35.5	4.6	7.0

Source: WB, World Development Indicators

Annex 15: Education Statistics (2015)

Education Statistics Indicators	UMC	HIC	Turkey	Poland	Argentina	S. Africa	Hungary	Malaysia
Educational attainment, at least completed primary, population 25+ years, total (%) (cumulative)	-	-	88.3	98.9	-	82.4	99.6	-
Primary completion rate, total (% of relevant age group)	94.7	98.8	91.8	97.9	101.8	-	96.9	101.2
Educational attainment, at least Master's or equivalent, population 25+, total (%) (cumulative)	-	-	1.8	18.7	-	1.2	8.9	-
Educational attainment, Doctoral or equivalent, population 25+, total (%) (cumulative)	-	-	0.3	0.6	-	-	0.8	-
School enrollment, secondary (% net)	79.1	92.2	86.4	92.5	88.2	-	91.0	68.5
Educational attainment, at least completed upper secondary, population 25+, total (%) (cumulative)	-	-	37.1	83.5	-	64.6	75.1	-
Educational attainment, at least completed lower secondary, population 25+, total (%) (cumulative)	-	-	56.4	83.9	-	77.2	96.8	-
Adjusted net enrollment rate, primary (% of primary school age children)	95.7	97.2	94.2	96.5	99.7	-	95.7	98.1
School enrollment, primary (% net)	94.8	96.5	94.1	96.4	99.3	-	90.6	98.1

*Scores for Poland and Argentina represent 2014 figures.

Source: WB, World Development Indicators

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