Turkey: MTP sees improvement in macro imbalances

The MTP programme is a step in the right direction with a rebalancing on growth and a commitment to fiscal prudence. The inflation path, however, is to remain elevated longer while after a recovery in the external balance next year, as expected, the programme foresees it to remain low in the following years

Source: Flickr

The Medium-Term Programme (MTP) for the 2019-21 period that was announced by Economy and Finance Minister Berat Albayrak made substantial revisions to targets given the recent volatility and its reflections on the Turkish economy. The programme, which specifies key priorities as rebalancing, discipline and change, in our view presents a more realistic scenario than the previous MTP. The Ministry will closely follow implementation and evaluate the performance in 3-month periods.

Key Economic Forecasts

	NEW MTP				PREVIOUS MTP		
MACRO ASSUMPTIONS	2018F	2019F	2020F	2021F	2018F	2019F	2020F
GDP growth (%)	3.8	2.3	3.5	5.0	5.5	5.5	5.5
Unemployment Rate (%)	11.3	12.1	11.9	10.8	10.5	9.9	9.6
Inflation (%)	20.8	15.9	9.8	6.0	7.0	6.0	5.0
C/A Balance (% GDP)	-4.7	-3.3	-2.7	-2.6	-4.3	-4.1	-3.9
Cent. Adm. Budget Bal. (as % of GDP)	-1.9	-1.8	-1.9	-1.7	-1.9	-1.9	-1.6
Cent. Adm. Primary Bal. (as % of GDP)	0.1	0.8	1.0	1.3	0.2	0.3	0.6
EU Defined Public Debt Stock	31.1	28.5	28.2	27.2	28.5	28.0	27.5

Source: Economy and Finance Ministry, ING Bank

Government sees soft landing

On the growth side, the government's projection for 2018 is closer to market expectations after a revision from 5.5% to 3.8%. Given the repercussions of the last years' above-potential growth rate with substantial stimulus measures on inflation, external balances and fiscal indicators, the GDP growth projection for the period of 2019-21 now looks modest at 2.3% (down significantly from 5.5% in the previous MTP). So the government foresees a soft landing following the increased financial volatility weighing on sentiment, ongoing uptrend in inflation and sharp monetary tightening since early 2018. Additionally, continuing tightening signals from global central banks with likely implications on the capital flow outlook to EM countries and geopolitical developments are expected to keep the macro performance in check.

Fiscal prudence with large spending cuts

Since 2016, accelerated primary spending to elevate growth along with rising interest expenditures on the back of the uptrend in yields have weighed on fiscal performance. Additionally, the government has increasingly relied on quasi-fiscal spending channels in recent years. The MTP envisages the central administration budget balance-to-GDP ratio to remain under control with floating under 2% threshold until 2021, while the size of the primary surplus-to-GDP is to gradually improve and return to the pre-2016 level at 1.3% in 2021. To this end, Minister Albayrak pledges significant spending cuts of close to TRY60bn next year as well as revenue-boosting measures amounting to TRY16bn.

In the upcoming years, an acceleration in privatisation revenues is also expected from TRY8bn this year to TRY22bn in 2020, likely reflecting the currency impact along with another boost to privatisation efforts. So, the government sees the EU Defined Public Debt Stock-to-GDP returning to below 30% after 2018 with a marked drop in public sector borrowing requirement-to-GDP to below the level realized in 2017. Regarding investment projects, those not auctioned or not started yet would be suspended while upcoming large infrastructure projects would be financed by either FDI or other types of international financing, in an effort to ease concerns about the Treasury's contingent liabilities. All in all, the government anticipates a relatively ambitious fiscal performance, showing return to fiscal discipline.

External deficit to remain low after 2019

In terms of the external balance, the MTP envisaged the C/A deficit to gradually improve to 2.6% of GDP in 2021 from 4.7% in 2018. Improvement in external imbalances, already started in recent months, has accelerated according to the latest trade data with the ongoing slowdown in economic activity weighing on imports and significant real TRY depreciation contributing to exports growth. What is noteworthy in the MTP is that after a strong recovery, as expected, it would remain below 3% in 2020 and 2021 despite a gradual recovery in growth, while the energy bill will remain roughly flat impacted by a gradual decline in oil prices. Accordingly, the government expects the non-energy external balance to turn to a USD10bn surplus (at close to USD13bn deficit as of Jul-18 on a 12M rolling basis) this year and from this level to more than doubled until 2021. To this end, the Economy and Finance Minister announced a large set of actions aiming to curb Turkey's import dependency.

Inflation to remain in double digits until late 2020

On the inflation side, the government has raised this year's inflation forecast to 20.8% vs the CBT's 13.4% estimate in the July inflation report, while envisaging lowering annual inflation to 15.9% next year and 9.8% in 2020. Given the weakening domestic demand, flat energy prices forecast in 2019 as well as an implicit USD/TRY assumption in the MTP in the 5.6-5.7 range, which is a significant strengthening from current levels, the MTP still has a high inflation estimate in 2019. This likely reflects a further impact of the rising trend inflation, deteriorating pricing behaviour and risks from the food group. The CBT is likely to come up with the same forecasts in the last inflation report release of the year, scheduled for 31 October as the current estimates released on 31 July are lower.

Firm to stand-by banks

Finally, some recent news that non-performing loans could be transferred to another entity to be formed by the government was ruled out in the MTP meeting. However, the policymakers pledge to evaluate banks to determine asset quality issues and updated financial strength to employ a comprehensive policy set in line with global practices and Turkey's prior experience so as to strengthen the sector, if needed.

Overall, we think the MTP programme is a step in the right direction with rebalancing on growth and reviving a commitment to fiscal prudence, though the inflation path is to remain elevated longer while after a recovery in external balances next year, as expected, the programme foresees it to remain low in the following years. Also, implicitly assumed is a significant improvement in the currency outlook, likely with a material turn in non-resident inflows next year, though it may take more time than expected in the programme.

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