Macroeconomic Outlook

A challenging journey

We foresee robust growth dynamics in the first quarter, followed by a palpable contraction in domestic demand in the second half. Our 2024 GDP growth estimate remains at 3%, albeit with associated downside risks. The tightening financial conditions and escalating costs are likely to accelerate the decline in the industrial sector, presenting downward risks to our growth projections. Furthermore, the faster-than-expected erosion of real wages could precipitate a more rapid slowdown in domestic demand.

We do not anticipate the annual CPI to dip below 60% until July 2024. Our projection suggests inflation peaking around 75% in May, followed by a decline of nearly 25 percentage points during the summer months, with a year-end CPI of 43%. While we view the CBRT's year-end inflation forecast of 36% for 2024 as optimistic, we believe recent measures have fortified the Bank's position in combating inflation.

We expect the tight monetary policy stance to persist in the wake of the local elections. President Erdoğan's moderate statements and conciliatory remarks from the main opposition post-local elections indicate that political uncertainty may not be at the forefront in the near term. Hence, our focus going forward will be on whether there will be a decrease in FX demand following the elections. While we expect the individual demand for FX to settle down in the coming period, if such a cooling does not occur, we believe that the risks to the 50% policy rate could be tilted upwards.

We anticipate the ongoing decline in the CA deficit to persist on an annual basis. The impact of conventional monetary policy and tightening conditions on credit growth and domestic demand will become pronounced in the latter half. Concurrently, with tourism performance and foreign market recovery, we expect the current account deficit to further narrow this year.

We anticipate the decline in the CA deficit to persist in annual terms. We expect to see the significant effects of the traditional monetary policy and tightening conditions on credit growth and domestic demand in the second half. Alongside the performance of tourism and the recovery process in our foreign markets, we expect the current account deficit to continue decreasing this year. Our expectation for the year-end CA deficit is USD33bn.

The financing aspect remains challenging, with the external financing requirement to gross foreign exchange reserves ratio hovering at around 187%. The restoration process of FX liquidity will be pivotal in the wake of the local elections, not only for stabilizing the CBRT's reserves but also for rebuilding confidence in TL assets. It's noteworthy that the absence of the ambitioned rise in foreign demand at the beginning of this year is a cause for concern.

We expect the 2024 budget deficit to fall below the Medium-Term Economic Program (MTEP) forecast. With the bulk of earthquake expenditures absorbed in the 2023 budget, we anticipate the 2024 budget deficit to be below the MTEP forecast, with a projected budget deficit/GDP ratio of 5.2% in 2024.

Macroeconomic Aggregates

	2022	2023	2024T	2025T
GDP growth)	5.6%	4.5%	3%	3.8%
GDP (TLbn)	15,012	26,276	38,702	50,216
CAB (USDbn)	-49	45.2	33	36
CPI (eop)	64.3%	64.8%	43%	25%
USD/TRY (eop)	18.71	29.47	40	48
EUR/TRY (eop)	20.03	32.74	44	52.75

Source: CBT, TURKSTAT, Treasury, Tacirler Investment

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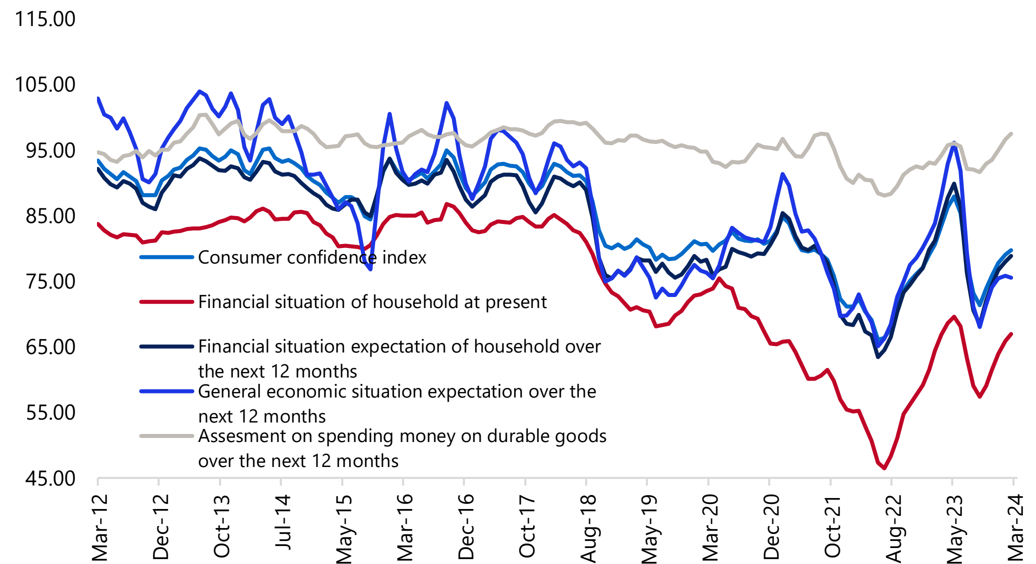
ECONOMIC GROWTH

Bumpy road ahead

While the main scenario in our 2024 year-end expectations entails a slowdown both in inflation and economic activity, we anticipate the vigor in growth dynamics to prevail throughout 1Q24, mainly on the back higher than expected minimum wage raise and vivid domestic demand. As the impact of demand – pull inflation continues to be felt, we also observe that consumer confidence indicators and credit card spending support the resilience of domestic demand. We expect the moderation in inflation and growth rate to kick in towards the second half of the year.

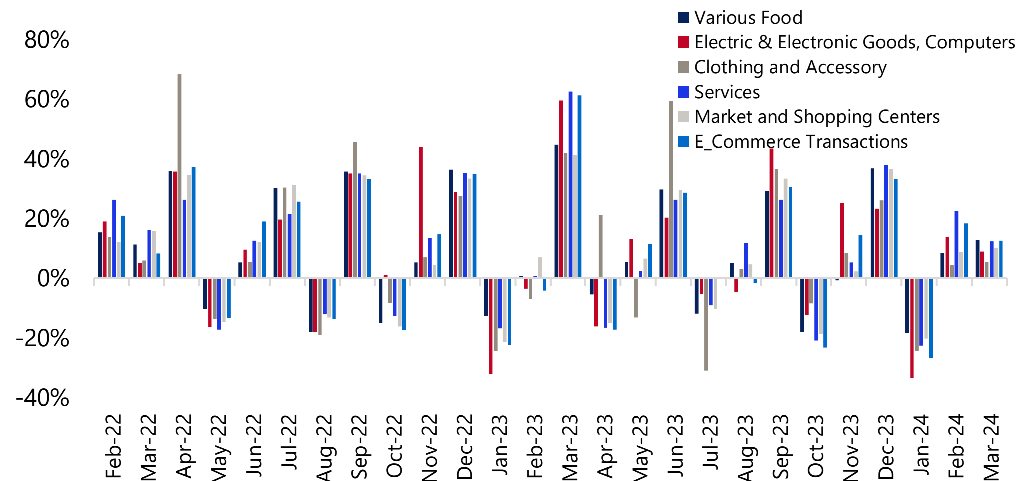
We expect strong growth dynamics in the first quarter of the year, followed by a significant contraction in domestic demand in the second half.

Consumer Confidence Index, sub-indices *(SA, 3-months MA)*



Source: TURKSTAT, Tacirler Investment

Debit Card and Credit Card Total Expenditure Amount *(monthly change, %)*



Source: CBRT, Tacirler Investment

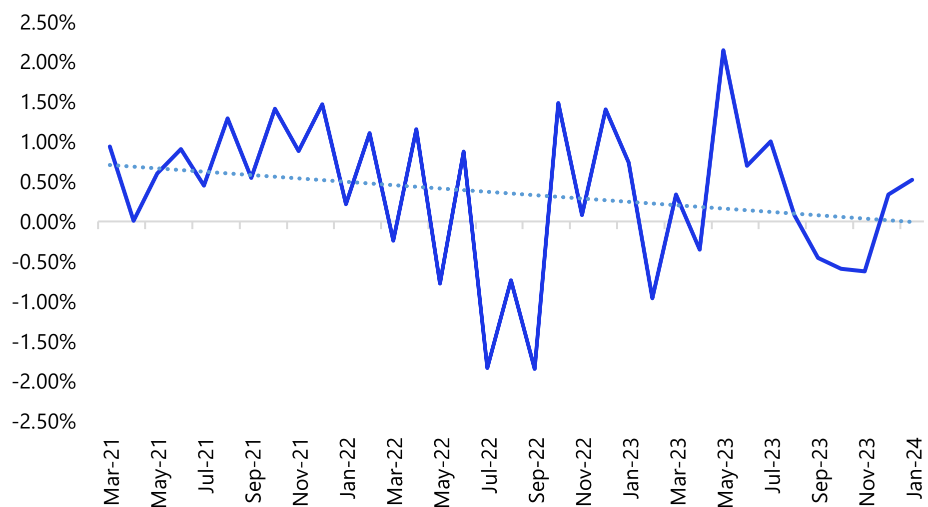
As we reach the middle of the year, with inflation expected to peak around 75% in May and the absence of mid-year price hikes, we anticipate a notable decrease in purchasing power. Hence, we foresee the vibrant domestic demand observed in the first quarter to begin losing its effect in the second half of the year, leading to a tangible slowdown in growth dynamics.

We maintain our 2024 GDP growth estimate at 3% with downside risks attached.

Our GDP growth expectation for 2024 stands at 3% with downside risks attached. We expect the driving force behind growth to be private consumption in the first quarter, with a diminishing contribution from this aspect by the end of the second quarter. Considering the anticipated moderation in public spending and investments, we maintain our growth forecast for 2024 at the 3% level. It's worth noting that there are downward risks to our growth forecast. While tightening financial conditions and cost increases may accelerate weakness in the industrial sector, faster-than-expected erosion in real wages could also result in a more rapidly decelerating domestic demand environment.

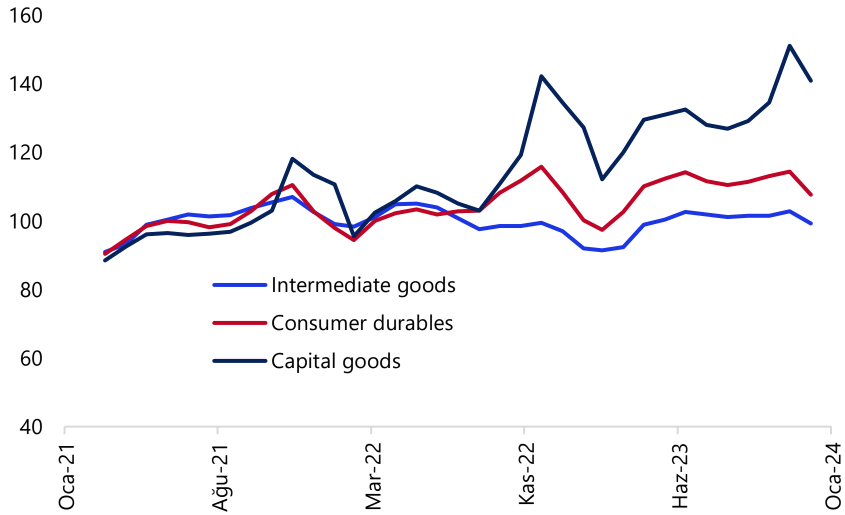
The deterioration in IP figures has been prevailing amid rising costs and tightening financial conditions, albeit resilient domestic demand dynamics. The disrupted supply-demand equilibrium fuels growth dynamics owing to resilient domestic demand, which in turn exacerbates inflationary pressures. Although February data may show temporary improvement due to the base effect of last year's earthquake disaster, we expect the weak performance in manufacturing to persist due to ongoing factors constraining production. With the anticipated moderation in domestic demand in the second half, we expect some stabilization in the imbalance of supply and demand, although we foresee the weak outlook for industrial production to persist within the framework of tight financial conditions and high costs.

Industrial Production *(SA, monthly change, %)*



Source: TURKSTAT, Tacirler Investment

Industrial Production Index *(SA, 3-month MA)*

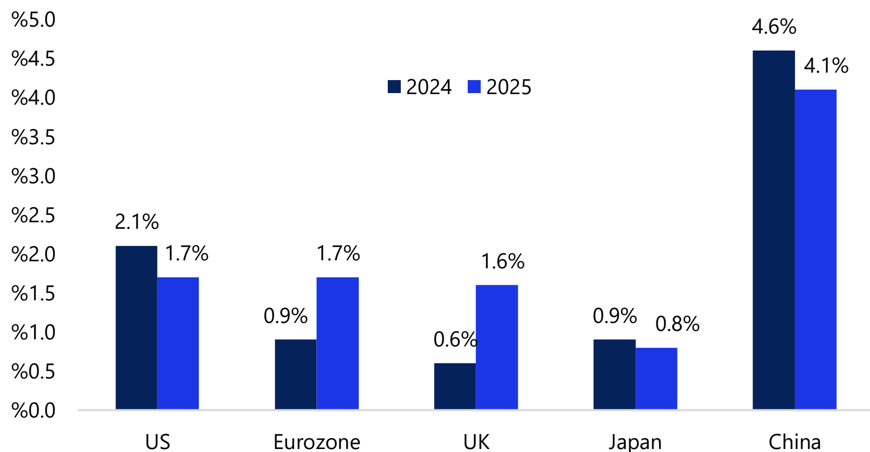


Source: TURKSTAT, Tacirler Investment

Global output forecasts indicate a relatively moderate slowdown this year than previously expected, while the slowdown in China is anticipated to indicate a much softer decline than initially projected.

Global output forecasts indicate a relatively moderate slowdown this year than previously expected. Expectations regarding the weakening of global growth have somewhat eased in the early part of this year, with slight upward revisions in the forecasts. While emerging markets are expected to remain as the main contributors of global growth, the slowdown in China is anticipated to indicate a much softer decline than initially projected. In its latest World Economic Outlook (WEO) Report published in January 2024, the IMF raised its global growth forecast for 2024 from 2.9% to 3.1%, while maintaining its forecast of 3.2% for 2025. Additionally, in the latest economic outlook report released by S&P, growth forecasts for Turkey were revised upward from 2.4% to 3% for 2024 and from 2.7% to 3% for 2025.

IMF Global Output Projections *(%)*

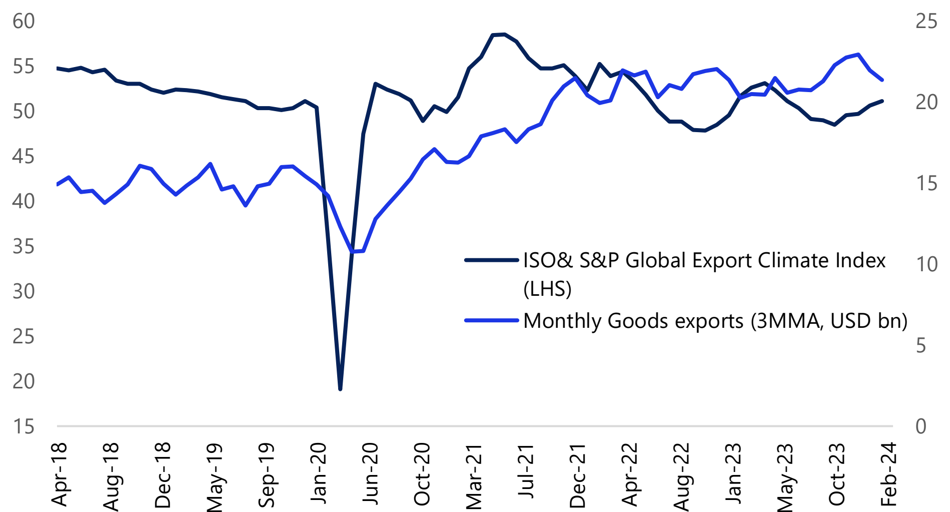


Source: IMF, Tacirler Investment

Despite noticeable signs of activity improvement in our external markets, persistent weakening growth dynamics in Germany and France pose continuous risks. Istanbul Chamber of Industry (ICI) Export Climate Index ameliorated further to 51.1 level, the highest level of the last eight months, from the previous month's 50.6 as of February, standing above the 50-threshold for the second consecutive month. As per the details, we observe that economic activity has strengthened in the United States, Turkey's second-largest export market, at the beginning of 2024. Additionally, signals of recovery persist in many significant export markets in Europe following a weak period. However, in Germany and France, economic activity continues to contract significantly, posing risks to net export contributions and growth dynamics in this region.

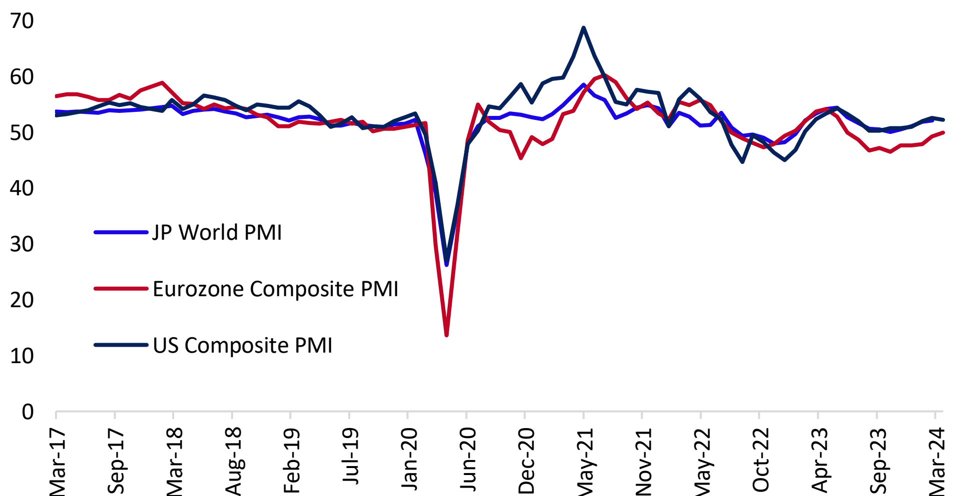
Expansion accelerated in many important export markets in Europe as of February, and signs of recovery continued after a weak period.

ICI Exports Climate Index & Exports *(3-months MA, USDbn)*



Source: ICI, S&P Global, Tacirler Investment

Global PMI



Source: Bloomberg, Tacirler Investment

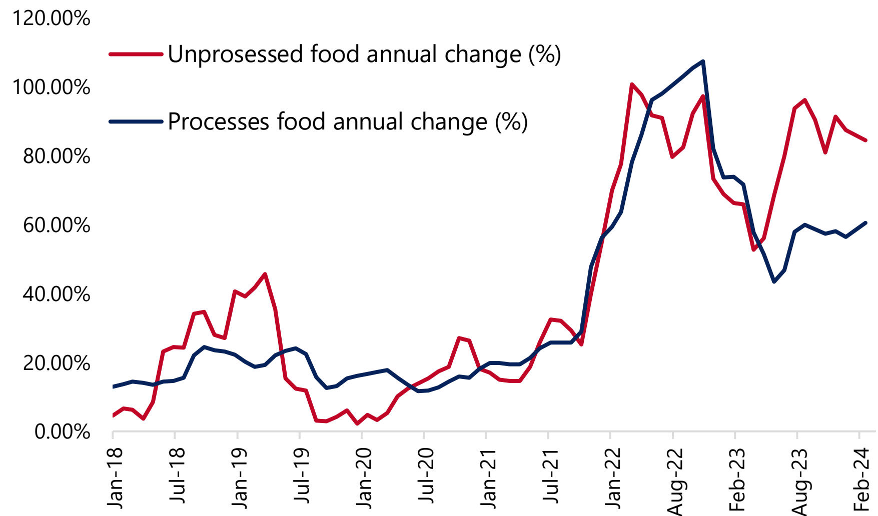
PRICE DYNAMICS

Need to go beyond the base effect

With the monthly inflation exceeding expectations in February, the annual CPI reached 67.1%. We observed a robust monthly increase of 8.3% in food prices, with food playing a significant role in the high monthly price increase in February. Additionally, the annual food inflation rose from 69.7% to 71.1%, and following the strong 7% increase in unprocessed food prices seen in January, there was again a notable rise of 9.3% in February. The monthly increase in energy prices in February dropped to 2.96%, while the annual energy price inflation climbed from 32.9% to 36% as of February.

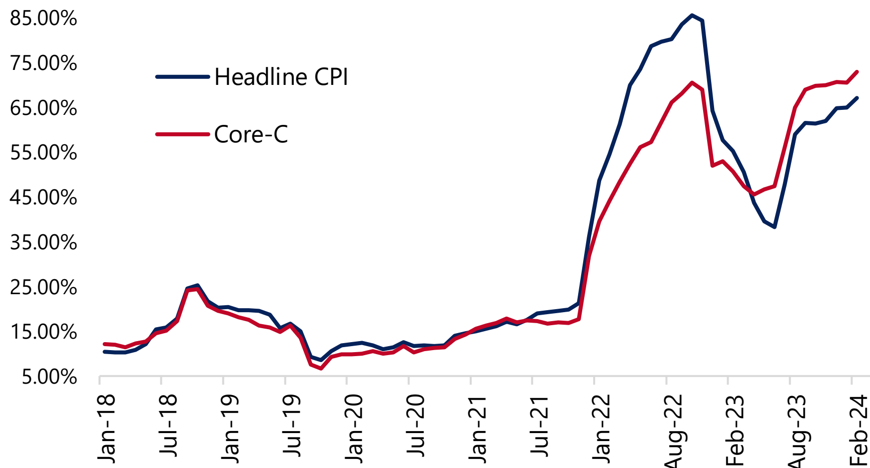
The cumulative price increase amounted to around 11% in the first two months of the year.

Food inflation *(%)*



Source: TURKSTAT, Tacirler Investment

Annual CPI & Core-C *(%)*

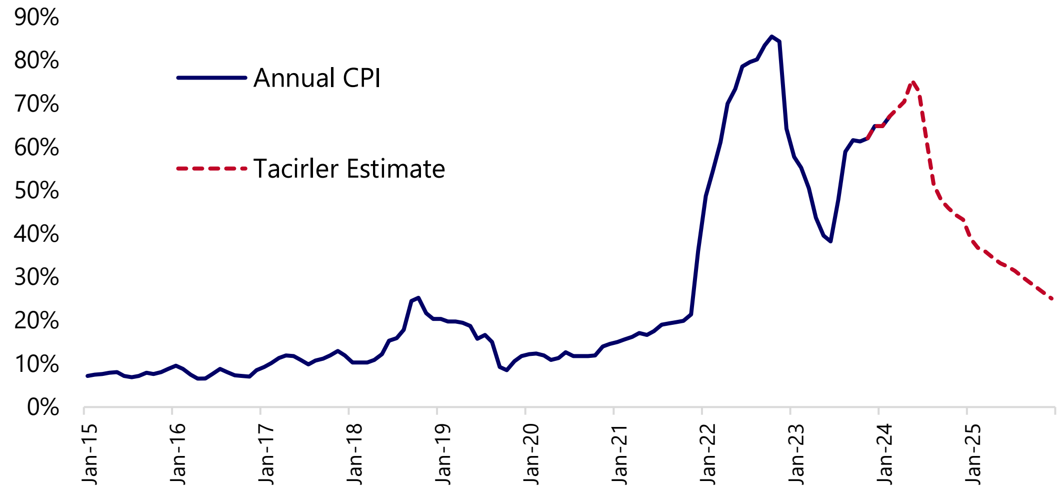


Source: TURKSTAT, Tacirler Investment

We do not foresee a decline in inflation below 60% until July 2024 as we expect 2024 year-end inflation at 43%.

We foresee the annual CPI to remain high in 1H24 with mostly the unfavorable base impact. We do not foresee a decline in inflation below 60% until July 2024, as we expect inflation to peak around 75% in May, followed by a decline of nearly 25 percentage points during the summer months and a year-end CPI of 43%. While we consider the CBRT's year-end inflation forecast of 36% for 2024 to be optimistic, we believe that the recent measures taken have strengthened the Bank's hand in the fight against inflation.

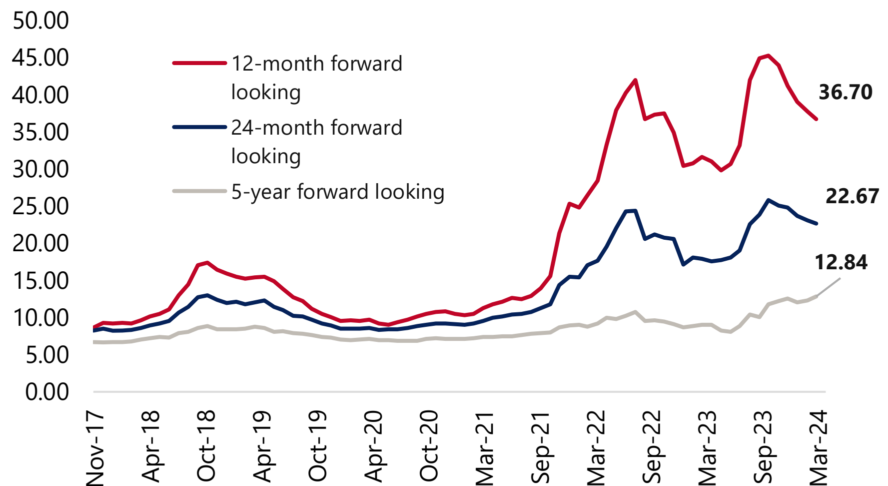
Annual CPI *(%)*



Source: TURKSTAT, Tacirler Investment

According to the results of the March Market Participants' Expectations Survey, 2024E CPI estimate revised up to 44.2% from 43%, whereas 12-month and 24-month CPI expectations revised down merely to 36.7% and 22.67% from 37.8% and 23% respectively.

Medium-Term Inflation Expectations *(%)*



Source: CBRT, Tacirler Investment

The upside risks to our inflation estimate are;

(i) **Structural risk:** Our exchange rate forecasts for 2024 do not include a real depreciation. Please note that we have recently revised our 2024YE USDTRY forecast downward to 40 level from 43. However, the continuation of weak financing conditions and the unsustainable nature of reserve management, which could further complicate inflation dynamics, are among the factors that could pose risks to the inflation outlook.

(ii) **Mid-year Wage Hikes:** Government authorities have indicated that no inflationary steps will be taken on the fiscal side, and there will be no mid-year wage hikes. Yet, given our expectation of annual CPI reaching levels around 75% by May, we are taking into account the risk of the imminent wage-increase demands exerting pressure.

(iii) **Food Prices:** We are observing that global supply problems are keeping commodity prices high in some regions. A trend of prices exceeding expectations in food prices throughout the year may increase pressure on unprocessed food.

(iv) **Increase in Oil Prices:** Along with the upward revisions in global growth expectations, we have observed that the weak growth phenomenon priced into oil in recent months has been somewhat ramped down. Additionally, we see that persistent geopolitical risks serve as a barrier to price declines. The continuation of the upward trend in oil prices would increase the burden of energy imports and also exert some pressure on inflation. In the near term, we expect a stabilization in Brent oil in the range of $80-$85 per barrel, but it's important to note that higher movements could challenge inflation dynamics.

Downside risks to our estimates would be;

(i) In addition to the positive base effect that will come into play from mid-year onwards, together with the functioning of the transmission mechanism, ensuring a healthy tightening of financial conditions and the rise in interest rates.

(ii) The acceleration of capital flows to prevent erosion in reserves and the easing of volatility in the local currency, leading to a real appreciation against the dollar.

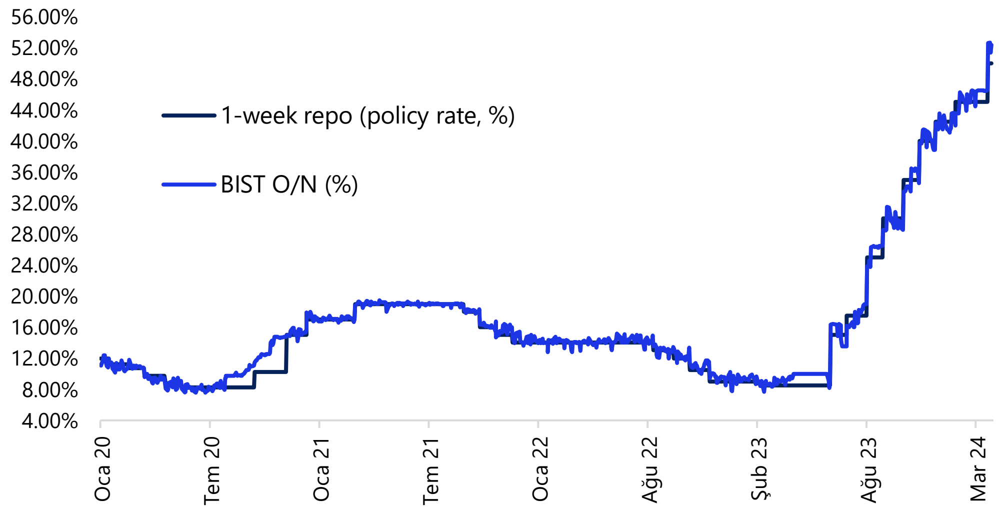
(iii) A deeper contraction in activity than our house estimates.

MONETARY POLICY

No concession from the hawkish stance

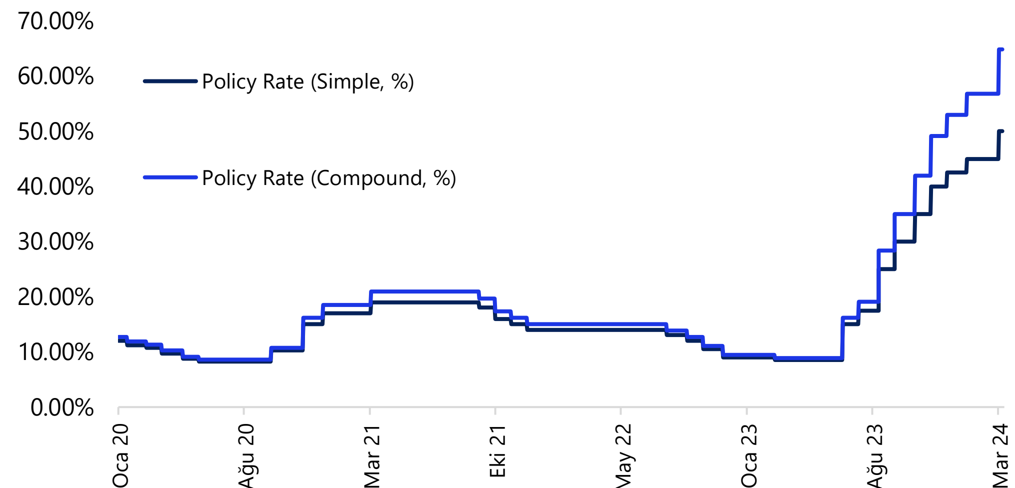
We interpret the Monetary Policy Committee's (MPC) latest 500-bps rate hike decision and the statements in the press release as quite hawkish and TL positive. Along with a 500-bps rate hike, the MPC has also decided to adjust the monetary policy operational framework by setting the overnight borrowing and lending rates 300 basis points below and above the one-week repo auction rate, respectively. Furthermore, we observe that the MPC continues to leave the door open for further hikes through quoting that "Monetary policy stance will be tightened in case a significant and persistent deterioration in inflation is foreseen." In addition to the recent sterilization and macroprudential measures, we believe that the recent 500 bps rate hike and continued inclusion of statements leaving the door open for further hikes will greatly contribute to rebuilding confidence in TL assets. Please note that the policy rate of 50% compounds to 64.8%

Policy Rate and BIST O/N Rate *(%)*



Source: CBRT, Tacirler Investment

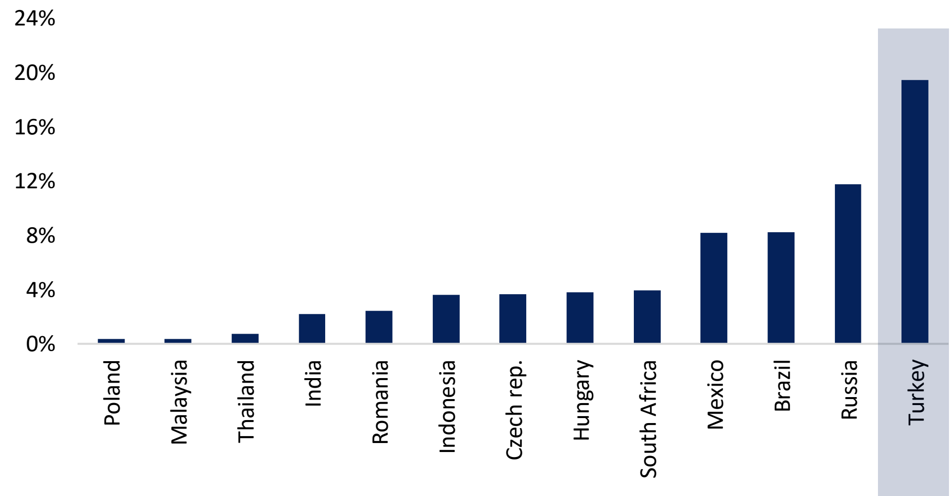
Policy Rate *(Simple & Compound, %)*



Source: CBRT, Tacirler Investment

We calculate that the ex-ante real policy rate settles around 19.5%. We have observed that the CBRT has increased macro-prudential measures lately, alongside the net OMO funding turning positive since March 1st and the Weighted Average Cost of Funding (WACF) rising above the 46% level. Recent measures such as interest on required reserves, lowering credit growth limits, establishing mandatory reserves based on credit growth exceeding these rates, restricting cash advances on credit cards, and setting the interest rate on credit deposit accounts at 5% have had an upward effect on market interest rates. In addition to sterilization and macro-prudential measures, we believe that the 500-bps interest rate hike in March and continued statements allowing for additional tightening will contribute to rebuilding confidence in Turkish assets.

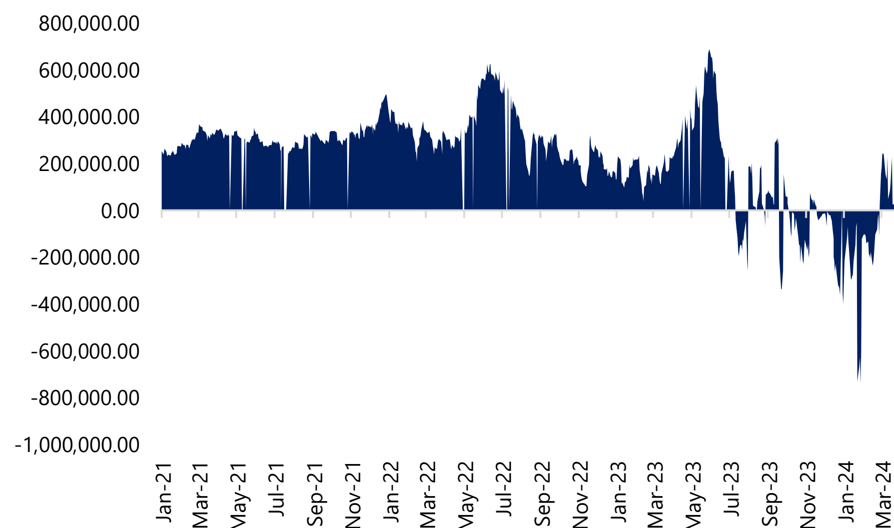
EM Real Policy Rates *(exante)*



Source: CBT, Bloomberg, IMF, Tacirler Investment

The net OMO funding of the CBRT *(TL mn)*

The net OMO funding of the Central Bank turned positive as of March 1st.



Source: CBRT, Tacirler Investment

We anticipate no change in the tight monetary policy stance following the March 31 elections.

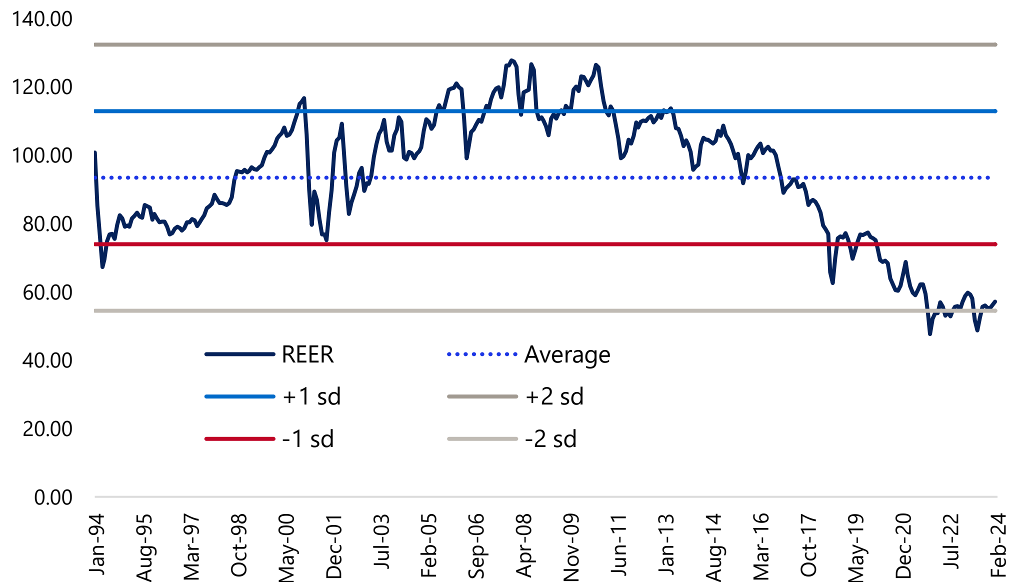
Following the intensified macro-prudential measures and the 500-bps rate hike decision, we expect the MPC not to pursue further rate hikes at its April meeting. Yet, we would like to emphasize that the inflation outcomes for March and April will be crucial for future monetary policy considerations. If the expected improvement in the monthly inflation trend does not materialize, we would expect an additional 300 basis point hike in the effective funding rate through the upper band of the corridor. It is also worth noting that the CBT's reintroduction of the interest rate corridor after the simplification of the monetary policy back in 2020 remains a point of criticism.

President Erdoğan's moderate statements and tension-reducing remarks from the opposition side in the wake of the local elections indicate that political uncertainty may not be at the forefront in the near term. Hence, we anticipate no change in the tight monetary policy stance following the March 31 elections. With the main opposition party winning the majority of votes nationwide, we expect the current administration to sustain its intensified efforts in combating inflation. On the TL front, we anticipate a gradual depreciation process in nominal terms to persist.

We recently revised our year-end USD/TRY forecast from 43 to 40.

We recently revised our year-end USD/TRY forecast from 43 to 40, implying a mere real appreciation. Hence, our focus going forward will be on whether there will be a decrease in FX demand following the elections. While we expect the individual demand for FX to settle down in the coming period, if such a cooling does not occur, we believe that the risks to the 50% policy rate could be tilted upwards. In case of the targeted downward tendency in monthly inflationary trend is achieved, we believe that the CBRT would have room to start cutting interest rates towards the last quarter of the year. Our year-end policy rate expectation is at 40%.

Reel Effective Exchange Rate *(2003=100)*

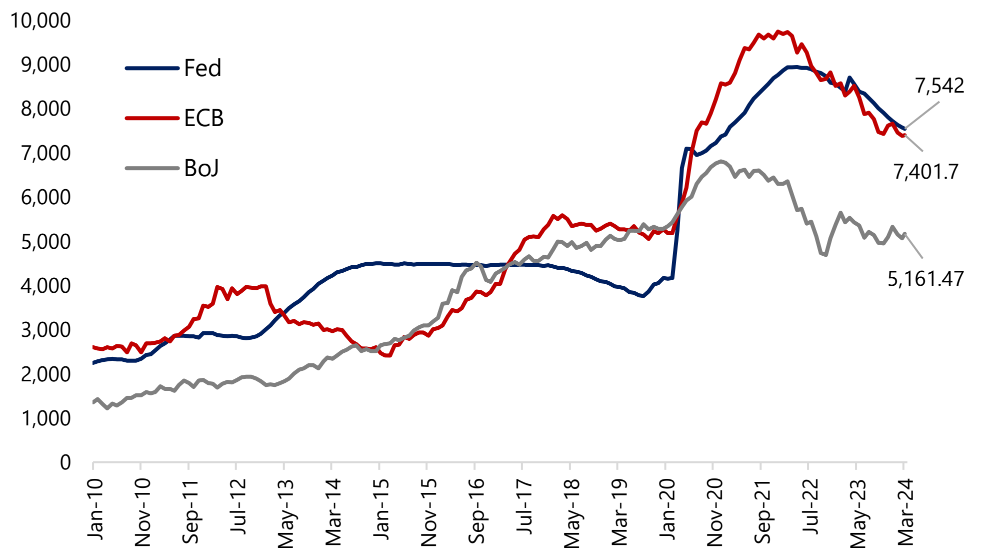


Source: CBRT, Tacirler Investment

On the global front, we expect EM universe to enjoy loosening financial conditions in the coming period as we anticipate a cycle of interest rate cuts among developing countries led by the European Central Bank's meeting on June 6th. Given Turkey's high interest rates and its conventional monetary policy framework, we expect it to remain attractive to foreign capital. Since the middle of last year, we have observed that the financing aspect of the conventional monetary policy process has not shown the previously ambitioned improvement, and foreign demand for Turkish lira assets failed to demonstrate the anticipated recovery. With the local elections behind us and Turkey entering a phase of credit rating upgrades, we expect to see an improvement in foreign demand. We believe that an improvement in FX liquidity is critical for halting the erosion of the CBRT's reserves, enhancing the effectiveness of monetary policy, and reducing domestic exchange rate volatility.

An improvement in FX liquidity is critical for halting the erosion of Central Bank reserves, enhancing the effectiveness of monetary policy, and reducing domestic exchange rate volatility.

G3 Central Banks' Balance Sheets *(USDbn)*



Source: Bloomberg, Tacirler Investment

EXTERNAL BALANCE

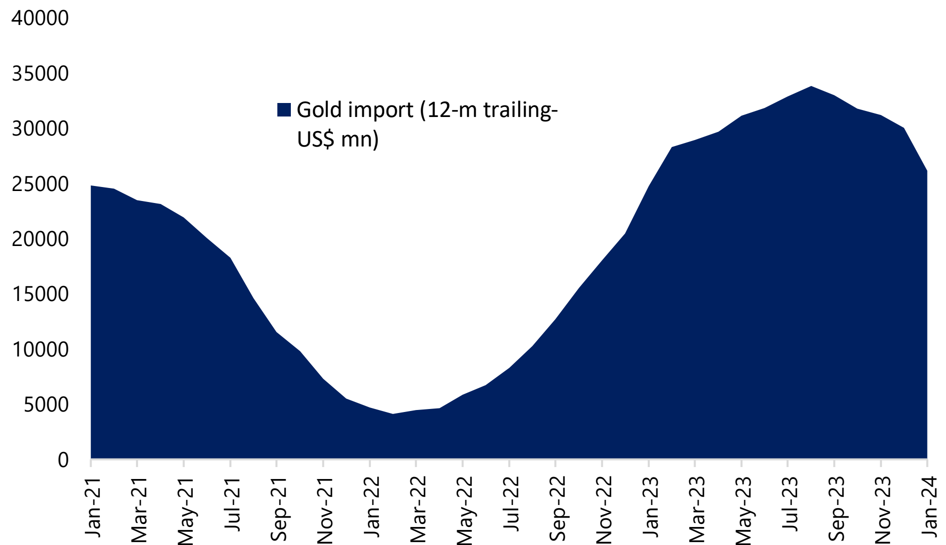
Anticipating further progress

In 2023, the current account deficit amounted to USD45.2bn, in line with our house estimate. Excluding gold and energy, the core balance of the current account recorded a monthly surplus of USD4.2bn, increasing the 12-month surplus from USD32.5bn to USD33.2bn.

As of January 2024, the annual current account deficit has fallen below USD40bn. With the latest monthly current account deficit announced for January standing at USD2.55bn, the annual deficit decreased from USD45bn to USD37.3bn. Excluding gold and energy, the core balance of the current account recorded a monthly surplus of USD3.6bn, increasing the annual surplus from USD33.2bn to USD34.8bn.

We observe that the decline in gold imports has played a crucial role in reducing the pressure on the current account deficit. After showing an increase of over 200% in the first half of 2023, gold imports have significantly retreated in the second half of 2023 due to measures taken to restrict imports. According to January 2024 data, gold imports decreased by USD500mn compared to December, reaching the lowest level since April 2022, standing at USD1bn. We expect the increase in individual gold demand observed ahead of the elections to settle down in the second quarter. While we believe that the story of the rise in gold prices is not yet complete, we anticipate that the strong demand seen in the last weeks of March will stabilize once the elections are over.

Gold import *(12-m trailing, USD mn)*



Source: CBT, Tacirler Investment

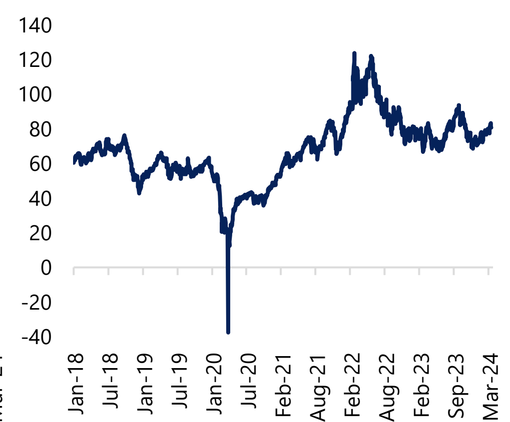
We expect the performance of the tourism sector to remain supportive for the current account balance throughout 2024. According to the latest border statistics, there was a 22.7% year-on-year increase in foreign visitors to Turkey in February 2024. Looking at their share among total foreign visitors, Iran ranks first with 9.8%, followed by Russia at 8.9%. Germany's share of total visitors stands at 8.2%.

We have recently observed Brent crude oil prices settling above $85 per barrel, exceeding global oil forecasts for 2024 converging around $80 per barrel. Prevailing geopolitical risks have been influential in the recent spike of oil prices, yet we expect the current appetite to diminish in the coming period. Additionally, alongside the expectation that the slowdown in global growth will not be as severe as feared, steps taken by the People's Bank of China to improve economic activity also emerge as factors supporting prices. Analyzing global growth dynamics and supply conditions, we have set our average Brent oil assumption for 2024 at $82 per barrel. We observe that our house estimate aligns with forecasts from international energy organizations. Within this framework, we do not anticipate a significant trend change in the terms of trade compared to 2023 during this year.

We expect no palpable change in the term of trade gains compared to 2023 during this year.

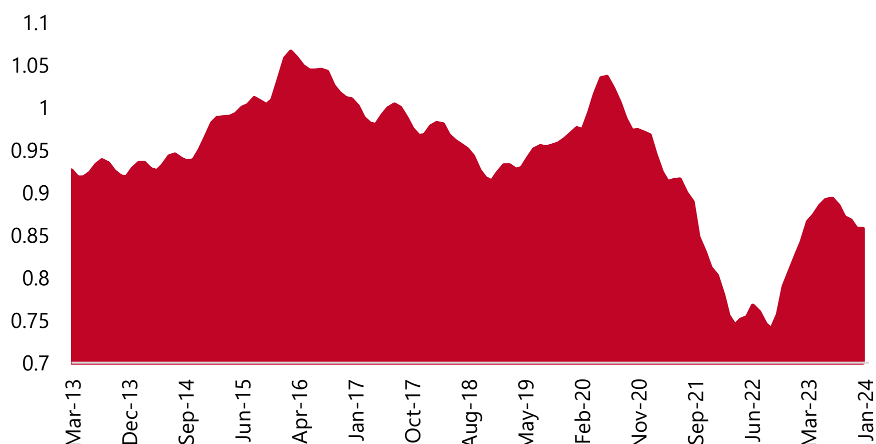
Brent Oil *(per barrel, $)*

Crude Oil *(per barrel, $)*



Source: Bloomberg, Tacirler Investment

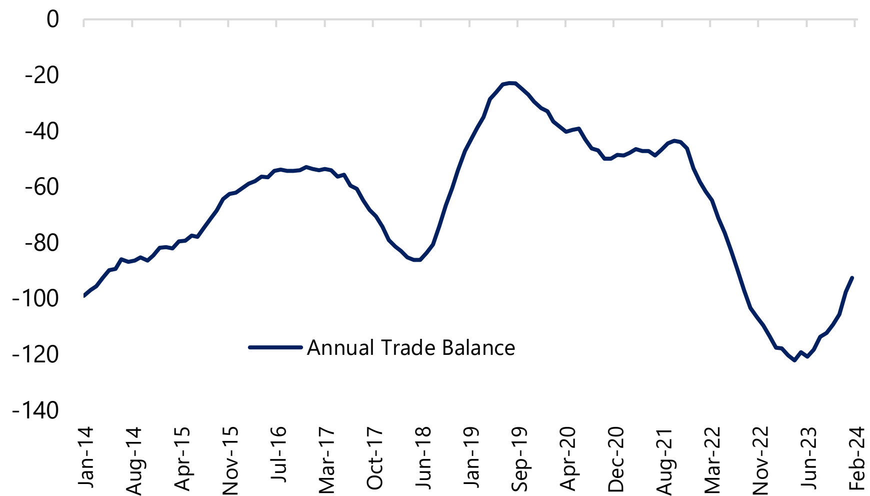
Terms of Trade *(Export Prices / Import prices, 3MMA))*



Source: CBRT, Tacirler Investment

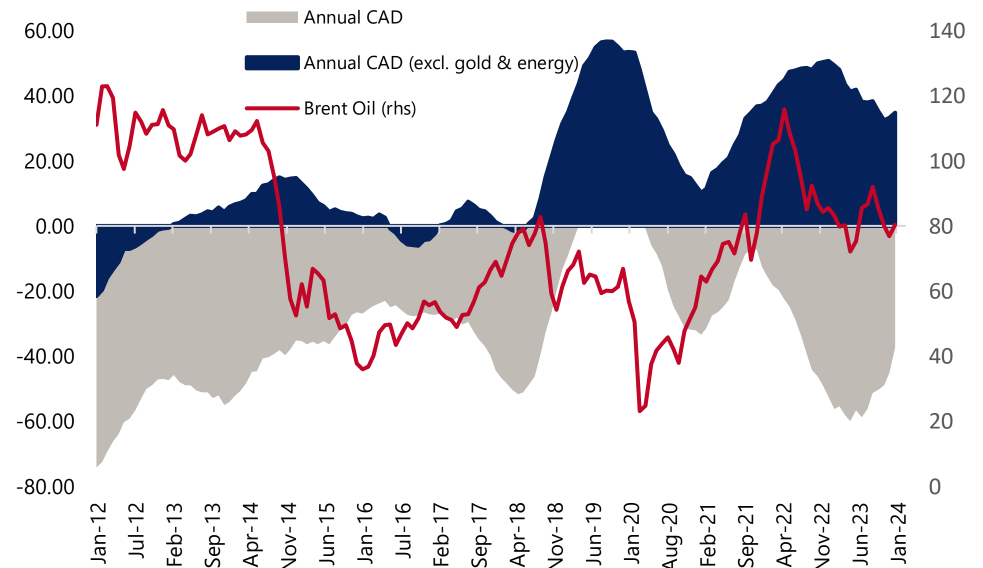
We project an annual current account deficit of USD33bn for 2024. The amelioration in the economic activity in Turkey's major export markets after a prolonged stagnation indicate that external dynamics will provide a more supportive environment. We anticipate seeing the significant effects of the conventional monetary policy and tightening conditions on credit growth and consumption demand in the second half on the domestic side. Additionally, with the performance of tourism and the recovery process in our foreign markets, we expect the annual current account deficit to narrow further this year. However, it's worth noting that the continuation of geopolitical risks remains a significant factor that could limit the improvement in the current account deficit. Global energy prices and the magnitude of an imminent slowdown in domestic demand in the upcoming period will be the main determinants of the current account balance.

Trade Balance *(annual, USDbn)*



Source: TURKSTAT, Tacirler Investment

CAD – excluding net energy & imports *(annual, USDbn)*



Source: CBRT, Tacirler Investment

EXTERNAL FINANCING

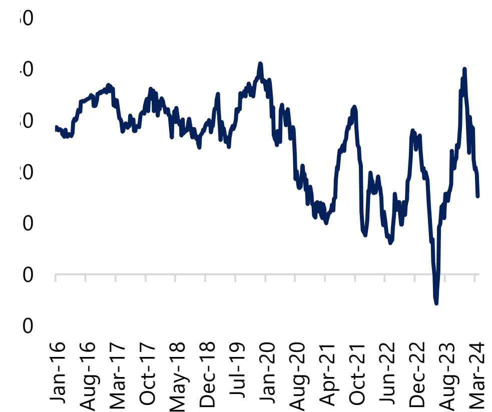
The core vulnerability

Turkey's annual external financing need remains high due to the absence of the ambitioned foreign demand. We have observed an acceleration in the depletion of foreign exchange reserves alongside the increase in individual FX demand ahead of the March 31 elections. In fact, the ratio of external financing requirement to gross foreign exchange reserves stands at a high level of 187.

The ratio of external financing requirement to gross foreign exchange reserves stands at a high level of 187.

CBT's Gross FX reserves *(USDbn)*

CBT's Net Int. Reserves *(USDbn)*



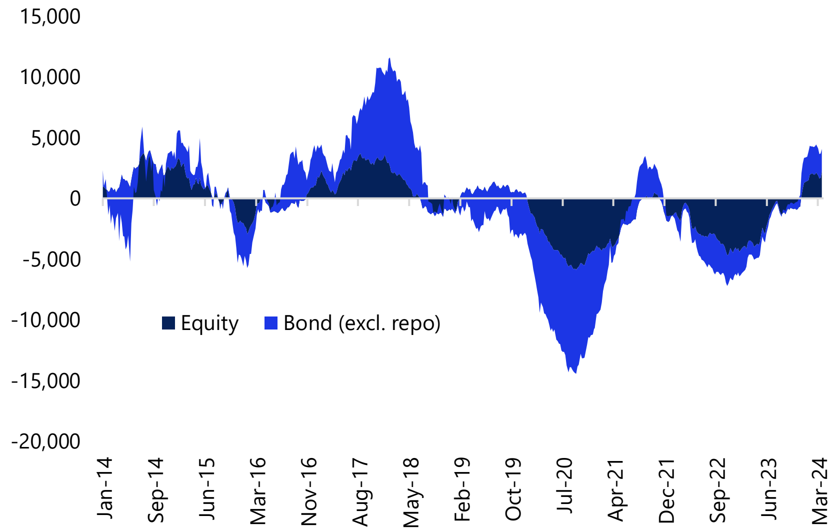
Source: CBRT, Tacirler Investment

We calculate that the downfall in CBRT's net FX reserves came to a halt in the week of March 22 – 29, while the gross FX reserves continued to dwindle. Accordingly, based on our calculations upon the CBRT's analytical balance sheet, we estimate that during the week of March 22 – 29 the gross FX reserves decreased by a mere USD45.3mn to USD123.50bn, while net international reserves increased by USD1.04bn to USD16.2bn. Net FX reserves have fallen USD20bn since the beginning of the year, while net reserves excluding swaps were -65.1bn in the week of May 15 – 22.

The short-term external debt stock in January decreased by 0.2% compared to the end of 2023, reaching USD174.9bn. In terms of short-term debt statistics, we believe that "debt stock on a remaining maturity basis," calculated based on the external debt maturing within one year or less regarding the original maturity, is rather critical, which is at USD225.4bn as of January 2024. Out of this figure, USD19.6bn is debt to the resident banks and private sectors to the banks' branches and affiliates abroad. Stripping this amount from the total results in USD205.8bn. We also add 12-month forward-looking CAD expectations on this amount so as to reach Turkey's annual external financing need (EFN). Accordingly, we calculate EFN as of January 2024 around USD240bn.

Furthermore, there has been observed a weak foreign demand in the equity and bond markets. Since the beginning of the year, there has been a total foreign outflow of USD410mn in the stock market and USD8.6mn in the bond market, excluding repo transactions. Looking at the cumulative data over the past year, there has been a total foreign inflow of USD1.7bn in the stock market and USD1.97bn in the bond market, excluding repo transactions.

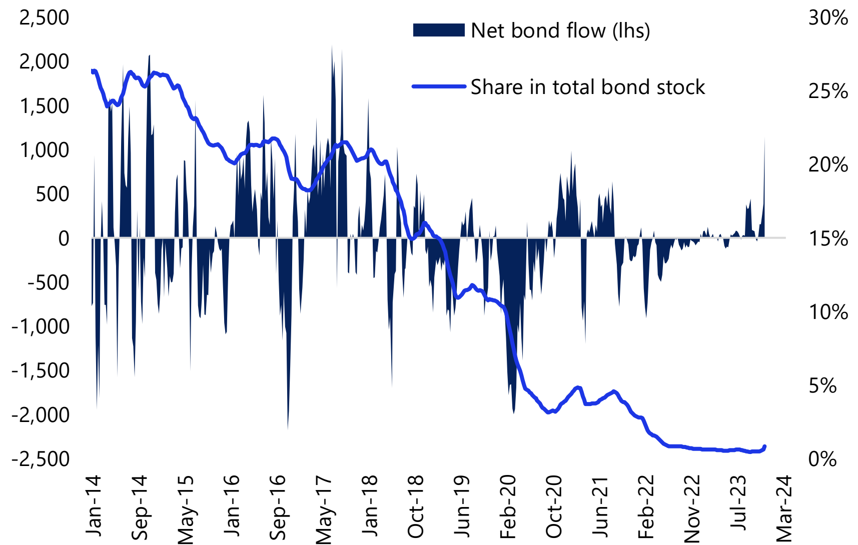
Net Foreign portfolio flows
(12m cumulative, equity + bond (excl. repo transc.),USDmn)



Source: CBRT, Tacirler Investment

The absence of the ambitioned foreign demand in the first quarter of this year is a cause of concern.

Foreigners' Government Bond flows & Share in bond stock
(4-week cum., USUSDmn)



Source: CBRT, Tacirler Investment

The restoration process of FX liquidity will be pivotal in the wake of the local elections, not only for stabilizing the CBRT's reserves but also for rebuilding confidence in TL assets. It's noteworthy that the absence of the ambitioned rise in foreign demand at the beginning of this year is a cause for concern. Accompanied by the conventional monetary policy stance, the local currency has considerably fortified its position, attracting renewed interest from foreign institutions in Turkey in recent times. Nonetheless, the absence of the ambitioned foreign demand in the first quarter of this year is a cause of concern.

Turkey's position well below the investment-grade level poses a continued risk of weak portfolio movements.

Credit rating agency Fitch upgraded Turkey's long-term foreign-currency issuer default rating (IDR) to 'B+' from 'B' back in early March, while also revised the outlook to 'positive' from 'stable'. The Agency stated that the upgrade reflects increased confidence in the durability and effectiveness of policies implemented since the pivot in June 2023, including greater-than-expected frontloading of monetary policy tightening, in reducing macroeconomic and external vulnerabilities. Fitch added that the positive outlook reflects their expectation that Turkey's overall macroeconomic policy stance should be consistent with a significant decline in inflation (albeit inflation will likely remain significantly higher than rating peers), as well as a continued reduction in external vulnerabilities in terms of lower current account deficits and stronger liquidity buffers. According to the statement, Fitch forecast inflation to average 58% in 2024 and finish the year at 40%. The agency cited that the growth was resilient at 4.5% in 2023, yet they expect that a tighter policy mix weighing more forcefully on domestic demand and private consumption after 1Q24, combined with relatively weak external demand, will result in growth slowing to 2.8% in 2024.

We expect at least two rating upgrades for Turkey this year. However, Turkey's position well below the investment-grade level within the assessment scale poses a continued risk of weak portfolio movements. Turkey's upcoming sovereign rating review will be conducted by S&P on Mar 3rd. Given S&P's tendency to lag behind in the credit rating upgrade cycle among rating agencies, we do not attribute much likelihood for a rating upgrade in May. We rather anticipate a rating upgrade on Moody's assessment slated for July 19. Yet, in case of S&P to upgrade Turkey's credit rating in May, it would play a significant role in improving the perception of TL assets.

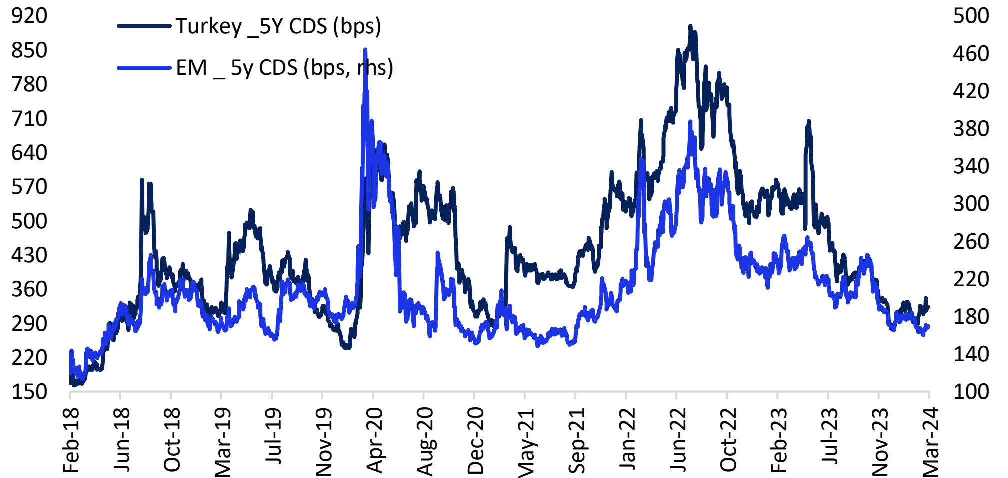
Rating Agencies' 2024 Review Calendar

S&P	May 3, 2024
Moody's	July 19, 2024
Fitch	Sept. 6, 2024
S&P	Nov. 1, 2024

Source: S&P Ratings, Fitch, Moody's, Tacirler Investment

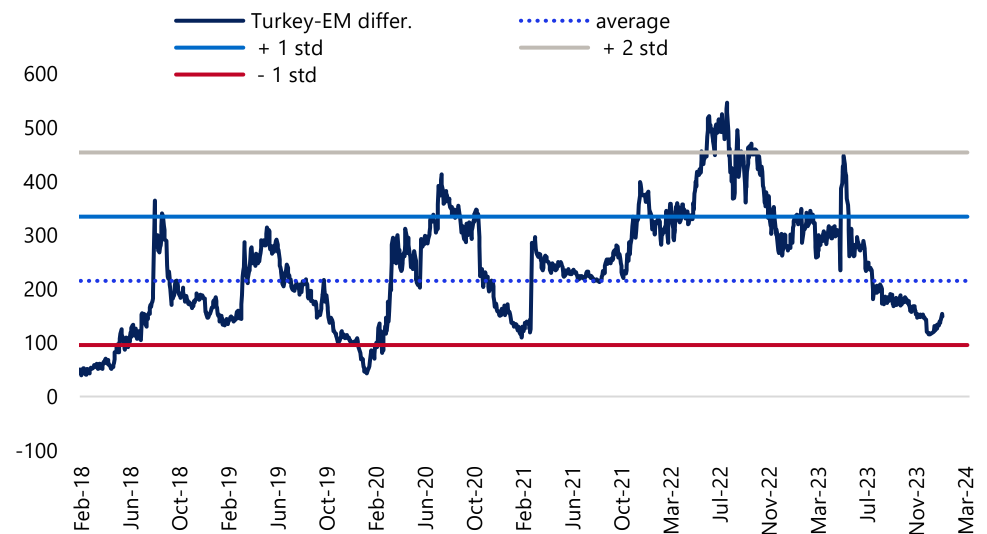
On the risk premium side, we have been observing a movement of over 300 bps in Turkey's 5-year CDS spread since the beginning of March. Despite dropping to 288 basis points in February, the risk premium has been on the rise recently, particularly accelerated by the change in maturity, leading to a widening gap between Turkey's CDS spread and the EM average. Before the maturity change on March 20, while the EM CDS averages remained relatively stable, Turkey's risk premium showed a gradual upward trend. Consequently, the increase in the risk premium appears to be Turkey-specific, and as a result, we've seen the Turkey - EM CDS spread widening from 115-bps levels to over 150-bps in March.

Turkey & EM_ 5y CDS comparison *(bps)*



Source: Bloomberg, Tacirler Investment

Turkey - EM CDS difference *(bps)*



Source: Bloomberg, Tacirler Investment

In the wake of the local elections, foreign capital inflows will be at the forefront of market participants' focuses. We believe that the following steps are crucial for increasing the country's FX liquidity:

i) Opening up the London swap market.

ii) Achieving a decrease in inflation beyond the base effect.

iii) Reaching a stabilization process below 300 bps in CDS spreads.

In the event of any delay or disruption in these steps, we emphasize the risk that foreign investor interest in Tl assets may be postponed until the end of this year.

FISCAL DYNAMICS

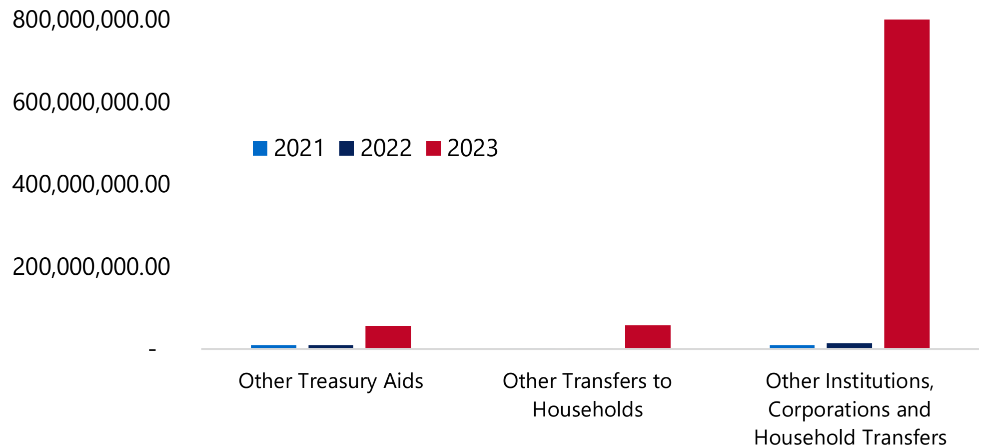
Anticipating a budget deficit below the MTEP forecast

Following the earthquake disaster in February 2023, the budget dynamics have significantly changed. The cumulative budget deficit for 2023 amounted to TL1.37tn, indicating a significant deterioration compared to the budget deficit of TL142.6bn recorded in 2022. Additionally, the cumulative primary budget deficit for 2023 reached TL700.35bn, showing a substantial worsening compared to the primary surplus of 168.3bn TL recorded in 2022. According to the Medium-Term Economic Program (MTEP) estimates, the budget deficit for 2023 was projected to be high at TL1.63tn, with expenditures of TL6.56tn and revenues of TL4.93tn. The actual budget deficit for 2023 was slightly below the MTEP estimate.

The cumulative budget deficit for 2023 amounted to TL1.37tn, indicating a significant deterioration compared to the budget deficit of TL142.6bn recorded in 2022.

The alterations witnessed in the three primary categories where earthquake expenditures have been accounted for in recent years underscore the pronounced burden on the budget. Under the Central Government Budget Expenditures Ecode4 classification, "Other Transfers to Unclassified Institutions, Businesses, and Households" category increased to TL56.2bn in 2023 from TL9.4bn in 2022, while the "Other Transfers to Unclassified Institutions, Businesses, and Households" category rose to TL57.7bn from TL1.5bn during the same period. The most significant surge was observed in the "Other Transfers to Unspecified Institutions, Businesses, and Households" category, which soared to TL800.7bn in 2023 from TL14.5bn in 2022.

Budget Items Covering Earthquake Expenditures *(TL thousand)*

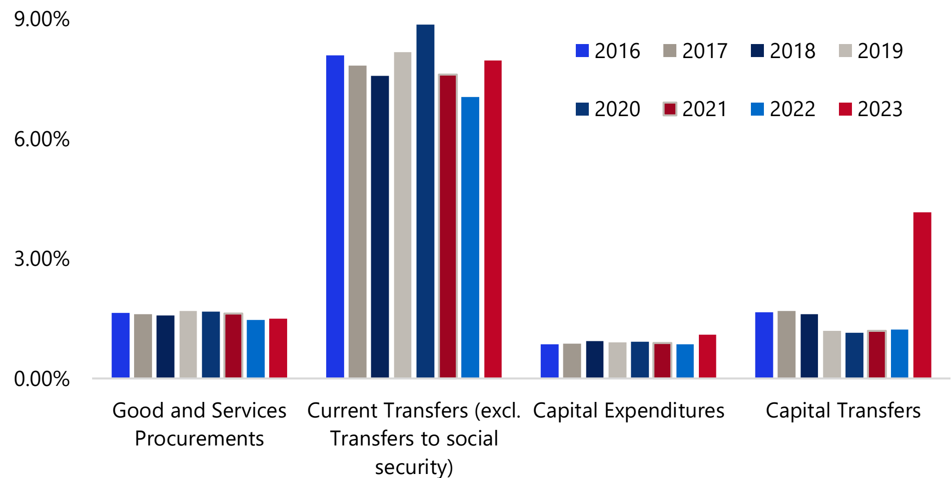


Source: The Treasury and Finance Ministry, Tacirler Investment

The substance of the expenditures matters in regards how much the fiscal stance provides further room for the economy. We have classified goods and services procurement expenditures, current transfers (excl. transfers to the social security institutions), capital expenditures and capital transfers under the shelter of "flexible expenditure items). The "rigid expenditures items", on the other hand, includes interest expenditures, personnel expenditures and transfers to the social security institutions.

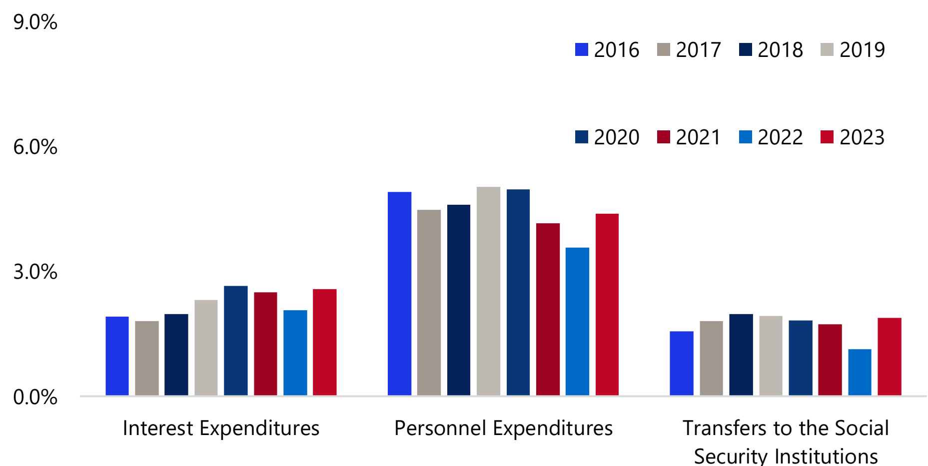
Accordingly, the share of flexible expenditure items in GDP increased from 12% in 2016 to 15% in 2023. The primary factor playing a part in the deterioration was the increase in capital transfers. On the other hand, a relatively smooth rise is salient at the share of rigid expenditures in GDP. Accordingly, there has been an increase from 8.4% in 2016 to 8.8% in 2023. We observe that the rise in interest expenditures and personnel costs within the rigid expenditure group has been the driving forces behind the rising ratio of rigid expenditures in GDP.

Flexible budget expenditure items *(as % of GDP)*



Source: The Treasury and Finance Ministry, Tacirler Investment

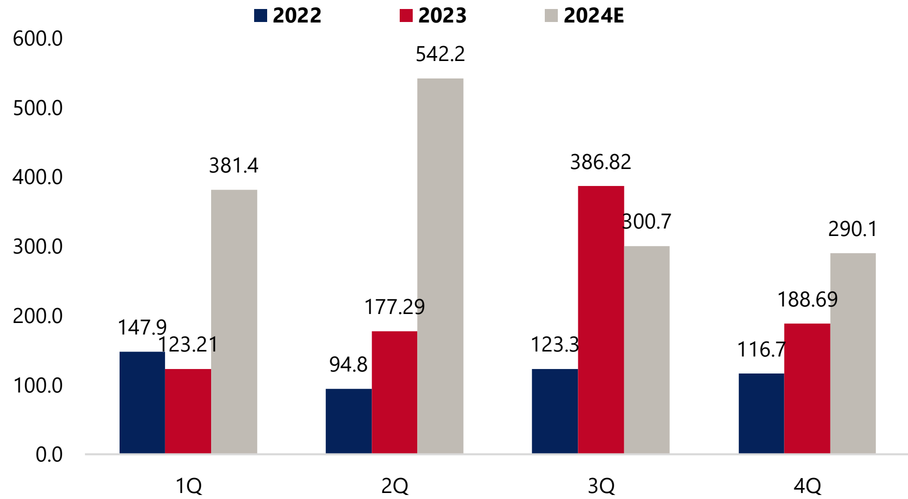
Rigid budget expenditure items *(as % of GDP)*



Source: The Treasury and Finance Ministry, Tacirler Investment

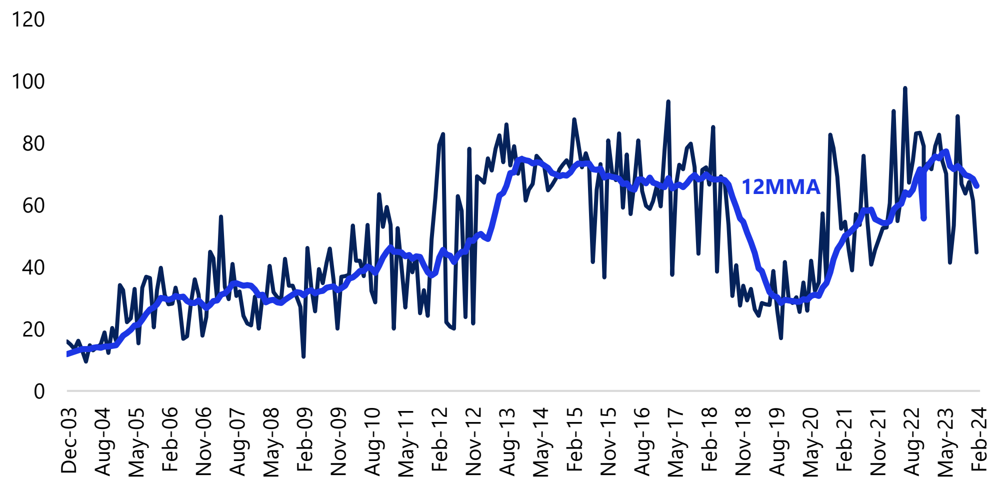
As per the domestic borrowing dynamics, the Treasury plans to borrow TL2.14tn in total from the domestic markets during 2024 against a domestic debt service of TL1.56tn, indicating a roll-over ratio of 136%.

Treasury's Domestic Debt Service *(TLbn)*



Source: The Treasury and Finance Ministry, Tacirler Investment

Weighted Average Maturity of the Domestic Borrowing *(months)*

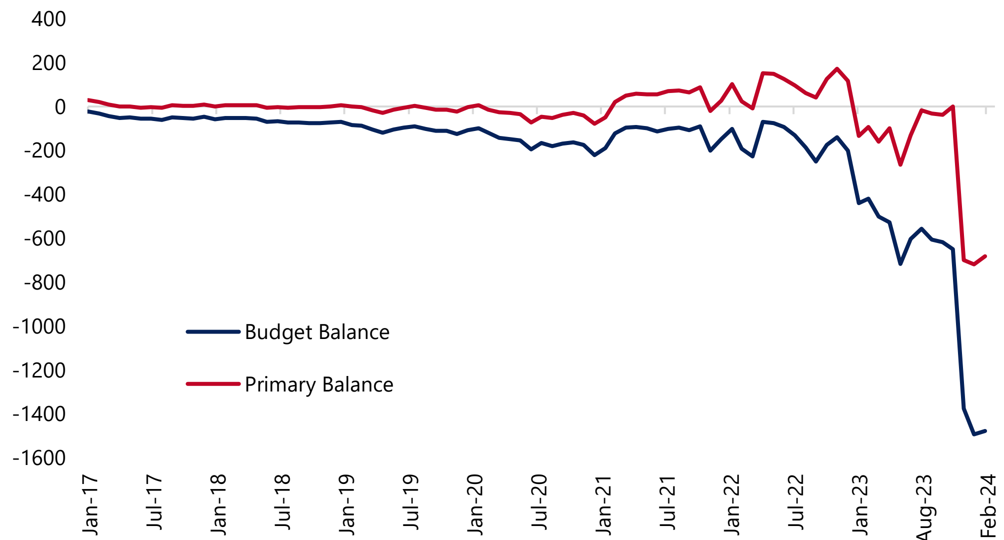


Source: The Treasury and Finance Ministry, Tacirler Investment

The latest budget data for February revealed a central government budget deficit of TL153.8bn, with a primary deficit of TL99bn. Thus, the budget deficit in February was TL44.5bn lower than the Treasury cash deficit of TL198.3bn recorded in the same period. There was a partial improvement compared to the budget deficit of TL170.6bn and the primary deficit of TL136.3bn recorded in the same month of the previous year. According to the February data, the 12-month budget deficit decreased from TL1.5tn to TL1.47tn, while the 12-month primary deficit decreased from TL719bn to TL681bn. In the second month of 2024, a yearly increase of 145% was observed in budget revenues, while on the expenditure side, there was an annual rise of 77%.

Our expectation for the budget deficit/GDP ratio for 2024 stands at 5.2%.

Budget Indicators *(12-months trailing, TLbn)*



Source: The Treasury and Finance Ministry, Tacirler Investment

A high budget deficit estimate of TL2.65tn is foreseen for 2024 according to the MTEP. We expect earthquake and interest expenditures to continue to play a decisive role in the 2024 budget realization, albeit modestly compared to 2023. We anticipate the 2024 budget deficit to fall below the MTEP estimate as the overwhelming majority of earthquake expenditures has already been absorbed in the 2023 realizations. Accordingly, our expectation for the budget deficit/GDP ratio for 2024 stands at 5.2%. In 2025, amidst the gradual easing process expected in monetary policy, we anticipate a rather contractionary fiscal policy to balance the accommodative policy stance leading to a decline in the budget deficit/GDP ratio compared to 2024, with our expectation for the budget deficit/GDP ratio for 2025 being at 4%.

We believe that aligning fiscal policies with the current tightening monetary environment is crucial for the CBRT to achieve its target of a disinflationary path. The persistence of expansionary fiscal policy post-elections will emerge as a risk factor limiting gains in inflation.

MACRO AGGREGATES AND FORECASTS

	2021	2022	2023	2024T	2025T
Economic Activity					
Nominal GDP (TL bn)	7,256	15,012	26,276	38,702	50,216
Nominal GDP (USD bn)	807	906	1,104	1,101	1,128
GDP real growth	11.4%	5.6%	4.5%	3%	3.8%
Unemployment rate	12%	10%	9%	10%	11%
External Balance					
Current Account Balance (USD bn)	-7.2	-49	-45.2	-33	-38
Current Account Balance / GDP	-0.9%	-5.4%	-4.1%	-3.0%	-3.4%
Fiscal Dynamics					
Central Gov. Budget Revenues (TL bn)	1,402	2,800	5,200	8,288	10,591
as of GDP	19.3%	18.7%	20%	20.7%	20.9%
Central Gov. Budget Expenditures (TL bn)	1,604	2,942	6,580	10,300	12,600
as of GDP	22.1%	19.6%	25.0%	26.6%	25.1%
Budget Balance (TL bn)	-202	-143	-1,375	-2,012	-2,009
as of GDP	2.8%	1.0%	5.2%	5.2%	4.0%
Prices					
CPI (eop)	36.1%	64.25%	64.77%	43%	25%
CPI (average)	19.60%	72%	53.44%	59.30%	32.20%
CBRT's one-week repo rate (simple, eop)	14%	9%	42.50%	40%	25%
10-year bond yield (eop)	24.30%	10.80%	26.75%	20%	18%
USD/TRY (eop)	13.40	18.71	29.47	40	48
USD/TRY (average)	8.9	16.59	23.80	35.16	44.50
EUR/TRY (eop)	15.1	20.03	32.74	44	52.75
EUR/TRY (average)	10.5	17.38	25.76	38.92	48.47
Brent oil (average, per barrel $)	69.6	97.78	81.92	82	80

Source: CBT, Treasury, TURKSTAT, Bloomberg, Tacirler Investment

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