Economic Outlook

July 2022

Coincident Economic and Financial Conditions Indexes Current Estimates

Cem Çakmaklı, PhD
Koç University, College of Administrative Sciences and Economics
Department of Economics
Email: ccakmakli@ku.edu.tr
Twitter: @Cem_Cakmakli

This report publishes the current estimates of the coincident economic (CEI) and financial conditions indexes (FCI) we have designed for the Turkish economy using advanced econometric methods. We used a rich dataset including many macroeconomic and financial indicators available with different timing and frequencies.

As financial stability is one of the main conditions for economic growth, FCI is considered a primary leading indicator for CEI. Therefore, based on the joint behavior of these two indexes, we computed the probability of entering an economic recession within the same model framework. This report also publishes these probabilities' current estimates as a numerical reflection of our expectations of the economy's direction in addition to the current estimates of these indices.

The model that we use in this report has been published in one of the internationally respected journals in the field. For details, our article can be found at https://onlinelibrary.wiley.com/doi/full/10.1111/obes.12413 .

Coincident Economic Index (CEI)

According to the most recent model estimates, CEI decreased by -1,09% in July compared to the previous month. The changes in May and June were -0.92% and 0.11%, respectively. Considering the quarterly predictions, we expect a change of 0.67% in real GDP in the second quarter of 2022 compared to the previous quarter. On the other hand, when the second quarter of 2022 is compared to the second quarter of 2021, this rate corresponds to a 6.1% growth. **Consequently, based on the data available as of July, we expect stagnation in the economy in the third quarter.**

Considering the constituents of CEI, on the production side, a mild increase of 0.5% was observed in May compared to the previous month in the latest industrial production index data. On the demand side, retail sales volume slightly improved by 1.9% in May. Finally, considering the developments in the labor market, a 1.2% mild increase was observed in total employment in May. From the data published timelier, the PMI was announced as 48.1 for June, the fourth consecutive month with a value lower than the critical value of 50. Based on all these components, we see a volatile pattern of CEI in the first and second quarters of 2022. Nevertheless, since the trend is not affected by these changes, the indicator points to stagnation in the following months.
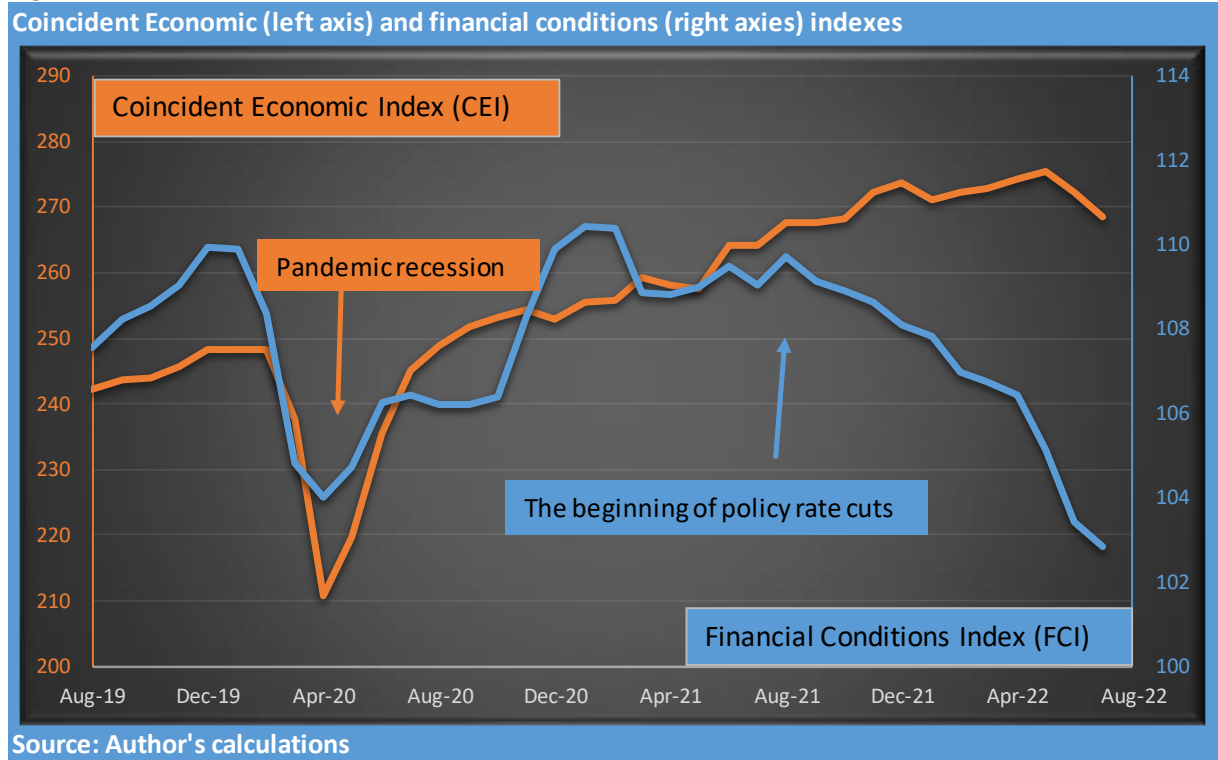
Financial Conditions Index (FCI)

According to the most recent model estimates, FCI decreased by -0.61% in July compared to the previous month. The changes in June and May were -1.63% and -1.26%, respectively. Therefore, the contraction in financial conditions for many months also continues this month.

Considering the constituents of FCI, gross FX reserves experienced a decline in July. On the other hand, the volatility of many sub-components is at high levels. The realized volatility of the BIST-100 market index, one of the leading risk indicators, exhibits a mild decrease. Crucially, Turkey's 5-year CDS premium is above 800 basis points. These figures indicate that Turkey's risk perception deterioration is very high. One of the underlying reasons for the high CDS rate is the high course of inflation and inflation expectations. Finally, we see a decline in total credit volume in real terms due to high inflation.

Figure 1 shows the evolution of FCI and CEI starting from 2019. In the first half of 2020, the sharp economic contraction caused by the Covid-19 pandemic and the subsequent rapid rebound is observed in CEI's evolution. Similar drops and rapid rises can be detected for FCI, especially during the term of former Central Bank Governor Naci Ağbal. On the other hand, the contraction in FCI since September 2021 continues at full speed. In CEI, with the start of 2022, the sharp decline in January is followed by stagnation.

Figure 1. Coincident Economic and Financial Conditions Indexes Estimates as of July 2022

Coincident Economic (left axis) and financial conditions (right axes) indexes

Coincident Economic Index (CEI)

Pandemic recession

The beginning of policy rate cuts

Financial Conditions Index (FCI)

Source: Author's calculations

Probability of Economic Recession

We compute the probability of the economy entering a recession in the short term based on the joint behavior of CEI and FCI. **We calculate this probability as 84% as of July.** Figure 2 shows these probabilities' evolution from 2007 to the present.

Figure 2. Recession probabilities computed using available data as of July 2022

The periods with two consecutive quarters of economic decline (+ Covid-19)   Recession probability

Source: Author's calculations