Economic Outlook

June 2023

Coincident Economic and Financial Conditions Indexes
Current Estimates

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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 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 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 .

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Coincident Economic Index (CEI)

According to the most recent model estimates, CEI decreased by -0.55% in June compared to the previous month.[1] The changes in May and April were 0.84% and 0.79%, respectively. Considering the quarterly predictions, we expect a change of 1.04% in the second quarter of 2023 compared to the previous quarter. On the other hand, when the second quarter of 2023 is compared to the second quarter of 2022, this rate corresponds to a 2.9% growth. **Consequently, based on the data available as of May, we expect a slow growth in the economy in the second quarter.**

Considering the constituents of CEI, on the production side, a decrease of 0.9% was observed in April compared to the previous month in the latest industrial production index data. This drop indicates that the slowdown in the industrial production continues despite the reversal in March that succeeded the February earthquake. From the data published timelier, the manufacturing PMI was announced as 51.5 for June, continuing to exceed the critical value. We observe opposing trends in the industrial production index and manufacturing PMI.

Considering the developments in the labor market, a 1.7% increase was observed in total employment in April. While the outlook is negative in many indicators, this relatively strong stance in the labor market is behind the relatively high quarterly growth in CEI. Based on all these components, we see a volatile pattern of CEI throughout the year. We expect a slow growth pattern in the second quarter of 2023.

Financial Conditions Index (FCI)

According to the most recent model estimates, FCI increased by 0.1% in June compared to the previous month. The changes in May and April were -1.18% and -0.46%, respectively. The momentum in the financial conditions index, led by loosening global financial conditions, lost its pace totally and reversed.

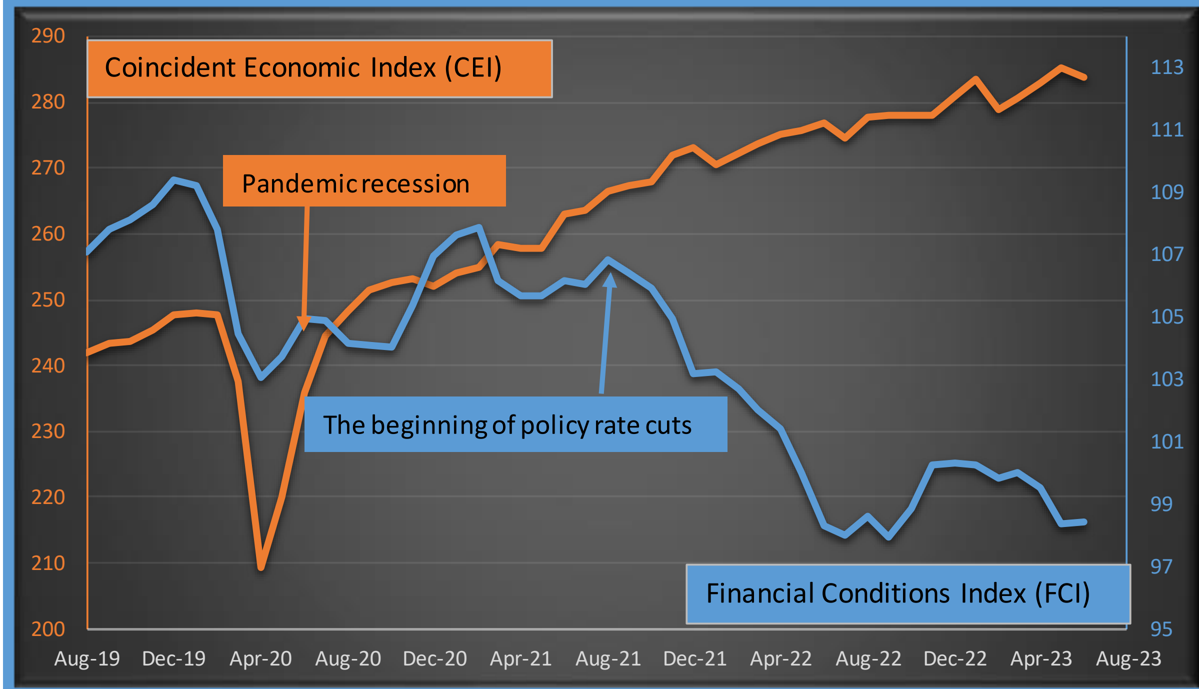
Considering the constituents of FCI, gross FX reserves experienced a strong increase in June. Turkey's 5-year CDS premium is 482 basis points below 500 basis points after many months. These figures indicate that Turkey's risk perception deterioration is still very high despite the resolving uncertainty of the elections. One of the underlying reasons for the high CDS rate is the high course of inflation and inflation expectations. Finally, we see an 1%increase in total credit volume in real terms despite the 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 has ceased in the last months. While it increased rapidly in the last months, thanks to soaring global risk appetite, the rapid increase has been replaced with secular stagnation starting the previous months which is followed by a significant drop. In CEI, the slow growth in the first quarter of 2023 seems to be replaced by a reduction.

[1] As a result of the standardization of the data we imposed for the sake of interpretation of the outcomes, the rate of change in both economic and financial condition indices is expected to be between 2% and +2%. Values less than -2% or higher than +2% can be interpreted as low probability extreme values. For example, in the past, these values were observed as -2.08% in November 2008, the trough of the 2008 recession, and -2.17% in July 2016. Therefore, the proximity of these values to 2% will also inform us about the severity of the contraction.

Figure 1. Coincident Economic and Financial Conditions Indexes Estimates as of June, 2023

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

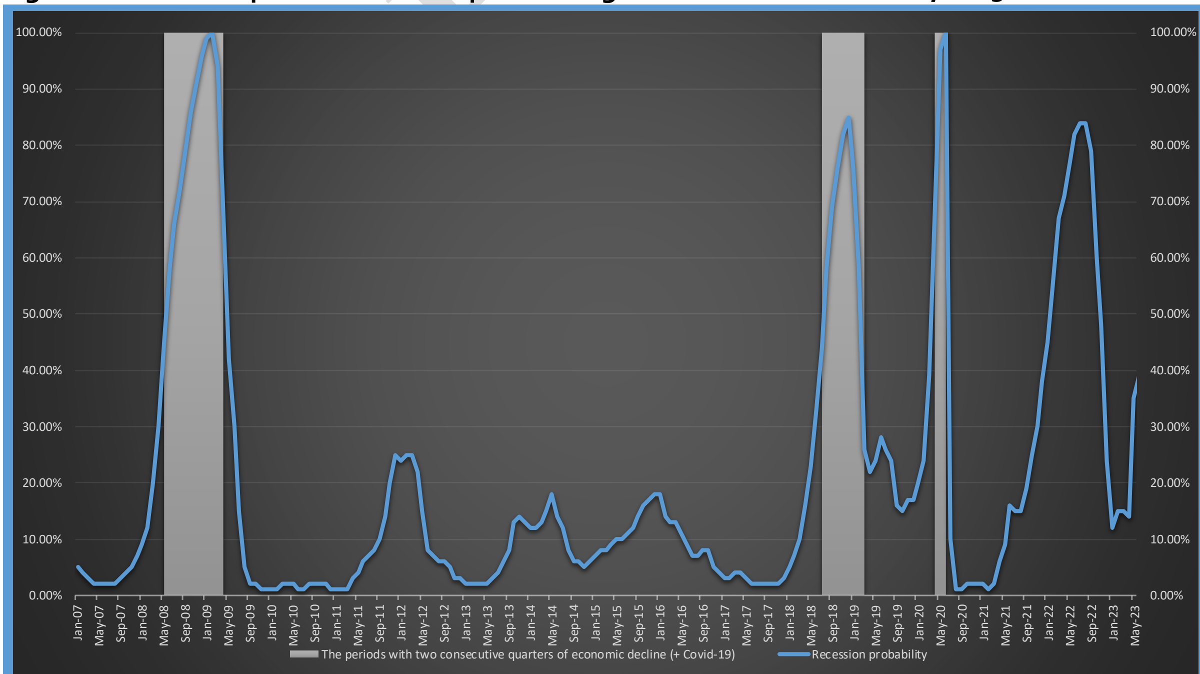


Source: Author's calculations

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. Figure 2 shows these probabilities' evolution from 2007 to the present. **We calculate this probability as 39% as of June. Past experience shows that economic contraction followed almost every month in which probabilities were predicted around this level. Therefore, we anticipate a contraction in the economy in the third quarter of the year.**

Figure 2. Recession probabilities computed using available data as of June, 2023



Source: Author's calculations