Economic Outlook

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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, EDE increased by 0.6% compared to the previous month in July.[1] The changes in June and May were -0.2% and 0.9%, respectively. Focusing on the quarterly predictions, we expect a 1.4% change in the second quarter of 2023 compared to the previous quarter. When compared to the second quarter of 2022, the second quarter of 2023 translates into a growth rate of 3.9%. Based on the data available as of July, we anticipate an average growth in the economy for the second quarter.

Elaborating the changes in EDE's components on the production side, according to the latest industrial production index data, there was a 1.1% increase in May compared to the previous month. After the correction in March following the February earthquake, it had remained low. This relatively strong rise in May after the decline in April indicates a correction. PMI, which is published timelier, continued to be above the critical threshold of 50 with a value of 51.5 in June. The PMI data has been above 50 for the past four months. The PMI data and the industrial production index, which showed opposite movements, have aligned considerably this month. However, despite the increase in domestic consumption, the seasonally adjusted real export data shows a very mediocre increase in June, while there is a sharp decrease in real imports. Considering that intermediate goods for production are vastly imported, our expectations are negative for the coming months.

Looking at the labor market, total employment increased by 0.2% in May. Considering all these components, we see that EDE has been quite volatile throughout the year. Based on the available data, we expect an secular growth in the second quarter of the year.

Financial Conditions Index (FCI)

According to the most recent model estimates, FDE decreased by -0.1% in July compared to the previous month. The changes in June and May were 1.0% and -1.0%, respectively. The upward momentum resulting from the easing of international financial conditions in the Financial Conditions Index has come to a complete halt and changed direction. The index's volatility has increased significantly in recent months due to the uncertainties surrounding the elections in May. Despite the efforts to recover in financial conditions, there is currently no clear trend of improvement or deterioration.

Focusing on the sub-components of FDE, there was a strong surge in gross reserves in June. Turkey's 5-year Credit Default Swap (CDS) premium decreased to 437 basis points and thereby approached 400 basis points after several months. The decline from 600 to the levels of 400 basis points can be attributed to efforts to close the budget deficit and the Central Bank's actions to increase reserves. However, these levels are still relatively high compared to similar countries. This indicates that despite resolved uncertainty after the elections, Turkey's risk perception remains at elevated levels. One of the main reasons for this is the persistently high inflation and inflation expectations. The likelihood of this picture worsening is high, especially with the expected increase in inflation in the coming months. Finally, there has been a decline in credit momentum, leading to a sharp decrease of 2.5% in real credit volume. Despite contractions in real credit volume and many similar indicators, the improvement in Turkey's risk perception compared to previous months led to divergent movements of the sub-components of the index. Consequently, a clear trend has not yet formed in financial conditions.

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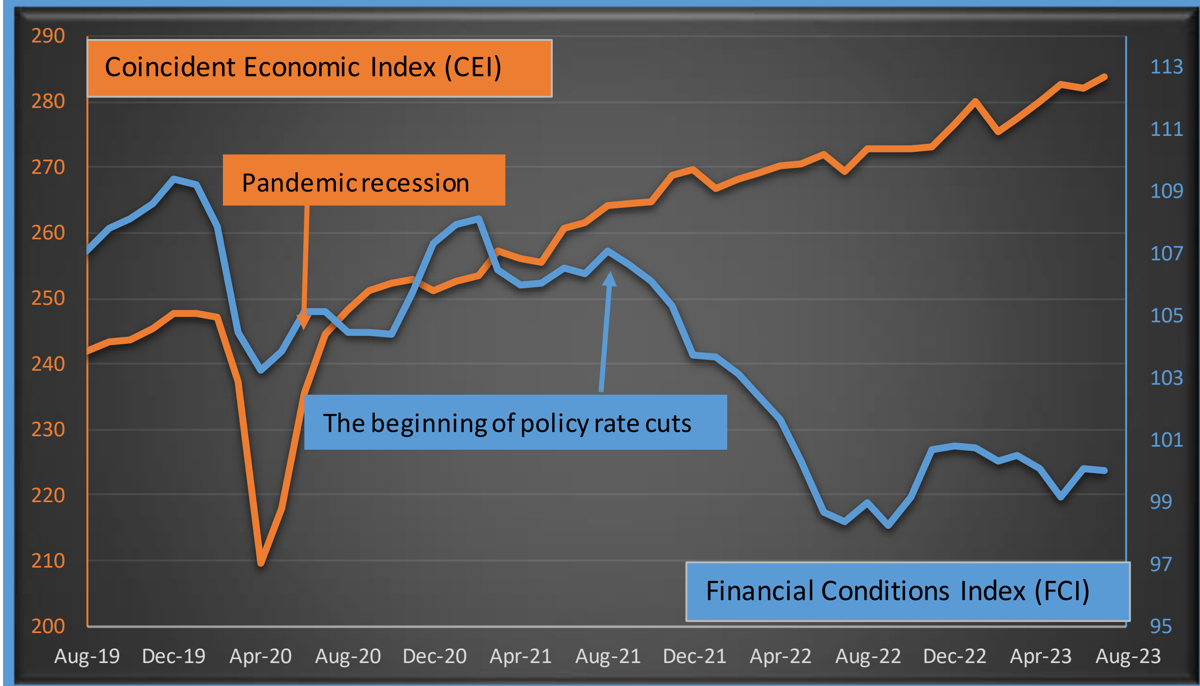
[1] As a result of the standardization of the data we imposed for the sake of interpretation of the outcomes, the rate of change in both economic and financial condition indices is expected to be between 2% and +2%. Values less than -2% or higher than +2% can be interpreted as low probability extreme 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 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 stagnation.

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

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



Source: Author's calculations

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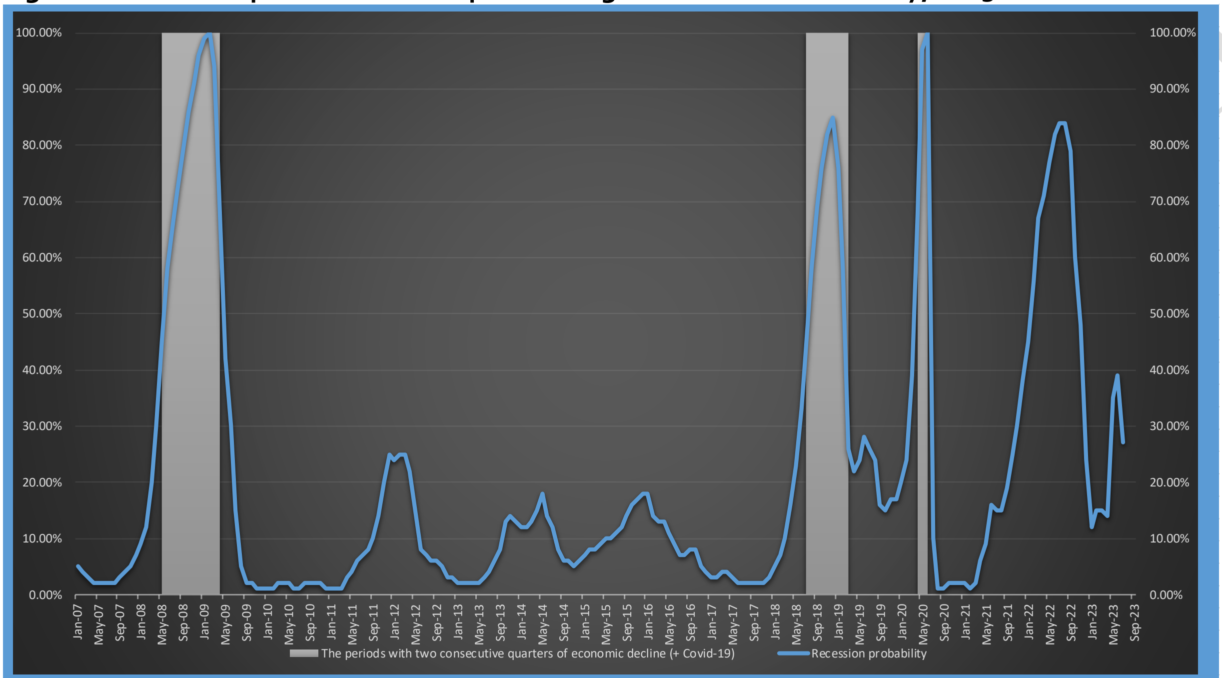
Probability of Economic Recession

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 illustrates these probabilities' evolution from 2007 to the present. In June, we had calculated this probability to be 39%. However, this month, due to the increase in industrial production in May and the relatively improved risk perception of Turkey, this probability has decreased to 27%. Despite the decrease in probability based on our past experiences, historically, economic contractions have followed almost every month when probabilities were at similar levels. **Therefore, we maintain our forecast of an economic contraction in the third quarter of the year.**

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



Source: Author's calculations