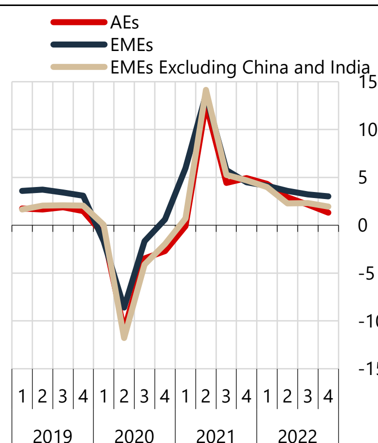
II. Macroeconomic Outlook

II.1 International Developments

The monetary policy actions taken by central banks of advanced economies and the uncertain environment that emerged following the banking failures in the US and Europe have been the main factors affecting global liquidity and economic activity.

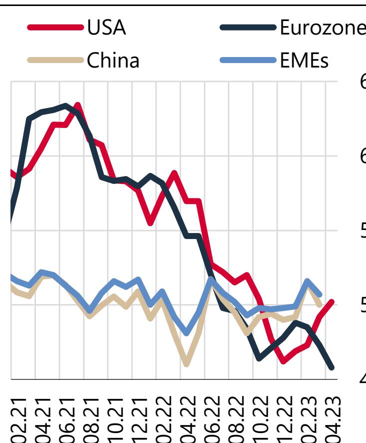
Economic growth in advanced and emerging economies (AEs and EMEs), which displayed a rapid growth after the lifting of pandemic restrictions, lost their momentum (Chart II.1.1). Monetary policies implemented in advanced economies had tightened financial conditions, thereby resulted in a negative impact on economic growth. While the bankruptcies in the banking sector adversely affected global liquidity, the liquidity support provided by central banks of advanced economies to troubled banks and their forward guidance that interest rate hikes were about to come to an end stood out as factors alleviating potential permanent financing problems in global markets. Leading indicators for growth suggest that in the USA and EMEs, the manufacturing PMI values have surpassed the reference value of 50 indicating growth, and that economic activities have started to recover in these countries. Meanwhile, manufacturing PMI values in the Euro area indicate that recovery has not started yet (Chart II.1.2). Improving global supply conditions and declining risks to energy supply are expected to support the recovery in global economic activity. In the next three-year period, the world economy is expected to grow led by India and China (Chart II.1.3).

Chart II.1.1: Countries' Growth Rates (%)



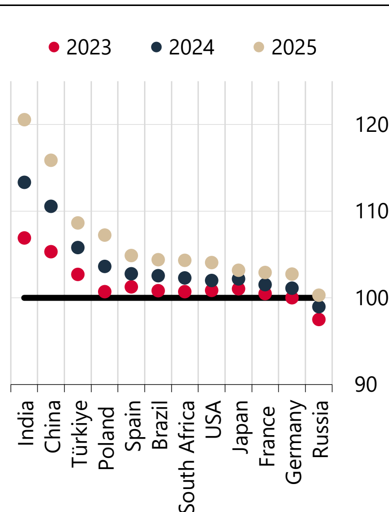
Source: Bloomberg Last Observation: 2022Q4

Chart II.1.2: Manufacturing PMI (Index)



Source: Bloomberg Last Observation: 04.23

Chart II.1.3: Real GDP and Projections (Annual, 2022=100)



Source: Bloomberg Last Observation: 2023Q1

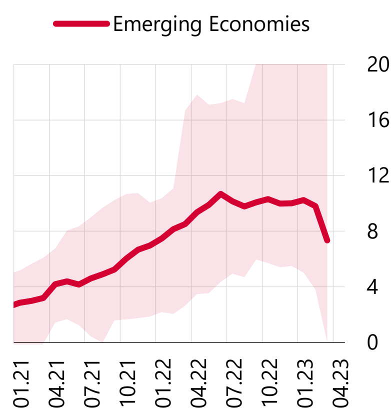
Note: AEs include the USA, the Euro area, Japan, the United Kingdom, Canada, Korea, Switzerland, Sweden, Norway, Denmark and Israel, while EMEs include China, Brazil, India, Mexico, Russia, Turkey, Poland, Indonesia, South Africa, Argentina, Thailand, Malaysia, Czechia, Colombia, Hungary, Romania, the Philippines, Ukraine, Chile, Peru, and Morocco. In Chart II.1.3, the Bloomberg data is based on the World Bank method since the Indian fiscal year has a different period than the fiscal years of other countries,

Inflation rates in advanced and emerging economies, which have been flat since the end of last year, decreased in April but are still high.

Global inflation increased due to the resurfacing of demand that was deferred during the pandemic and by disruptions in the supply chain. Although global inflation rates partially declined as of the last quarter of 2022 on the back of the fall in energy prices, they remain high (Chart II.1.4, Chart II.1.5). Commodity prices, which accelerated in the previous period due to the impact of the pandemic and the Russia-Ukraine conflict on production and supply chains, slightly declined due to the weakening in global economic activity, particularly in China, and the expectation of a recession (Chart II.1.6). The weakened demand, amid tighter global financial conditions, is believed to have an effect on the decline in commodity prices. On the other hand, Brent oil prices, which declined significantly due to the bankruptcies in the banking sector, recovered in the following period. In addition, oil prices increased significantly in early April due to oil-exporting countries' announcements that oil

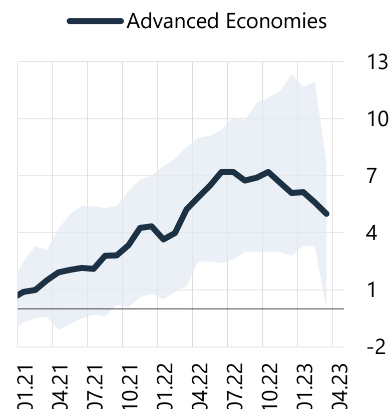
production would be cut as of May, but this increase was followed by a slight decline towards the end of the month.

Chart II.1.4: Global Inflation-Emerging Economies (%)



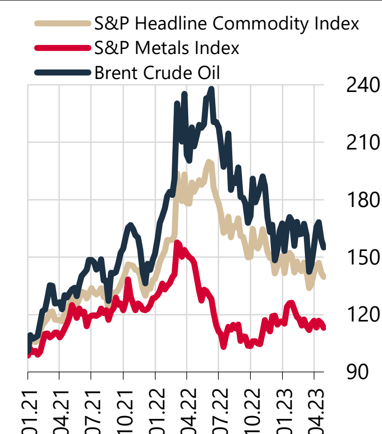
Source: Bloomberg Last Observation: 04.23

Chart II.1.5: Global Inflation-Advanced Economies (%)



Source: Bloomberg Last Observation: 04.23

Chart II.1.6: Commodity Indices (Index, 25.12.2020=100)



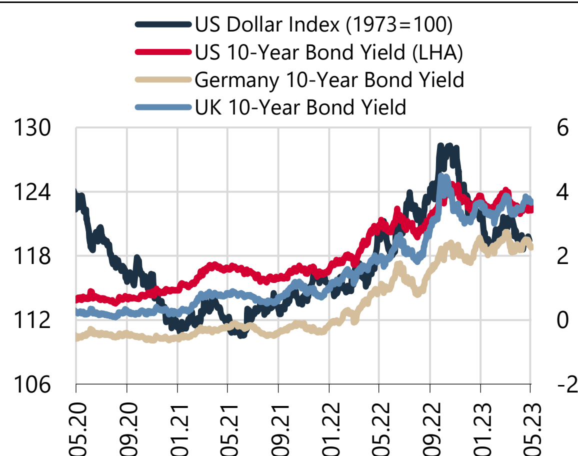
Source: Bloomberg Last Observation: 28.04.23

Note: Inflation rates refer to the annual change in CPI in the respective countries. The continuous line in Chart II.1.4 and Chart II.1.5 shows the median value across country groups. EMEs include Brazil, Mexico, Russia, Poland, Indonesia, South Africa, Czechia, Colombia, Hungary, Romania and the Philippines. AEs include the USA, the Euro area, Japan, the UK, Canada, Korea, Switzerland, Sweden, Norway, and Israel. Shaded areas indicate the highest and lowest values observed in the respective country groups.

The uptrend in long-term bond yields of advanced economies was replaced by a flat course, while the recent ongoing rise in the US dollar index was also reversed.

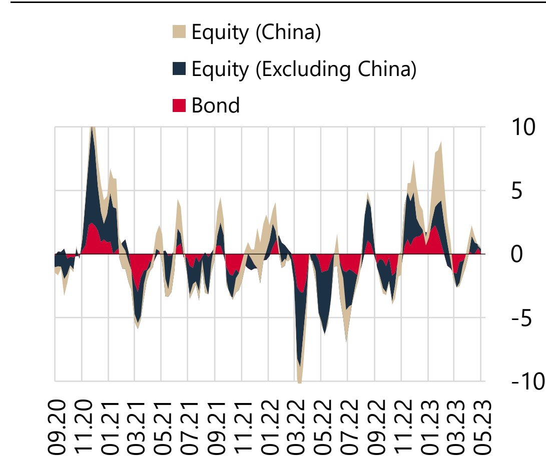
The uptrend in bond yields of AEs observed after the policy steps taken by their central banks turned flat in this period, while the US dollar index started to decline after marking the highest value since 2001 (Chart II.1.7). Due to expectations for a slowdown in the tightening in global financial conditions, EMEs received portfolio inflows both into equity securities and bonds and bills in the first quarter (Chart II.1.8). Portfolio flows to these countries remained seasonal as was the case in previous years and there have been portfolio outflows from EMEs as of March. Nevertheless, as of early April, EMEs started to receive portfolio flows both into bonds and equity securities. In this period, it was noteworthy that portfolio flows to equity securities to China continued.

Chart II.1.7: US Dollar Index and 10-Year Bond Yields in Advanced Economies (Index, %)



Source: FRED Last Observation: 28.04.23

Chart II.1.8: Weekly Capital Flows to EMEs (4-Week Cumulative, USD Billion)

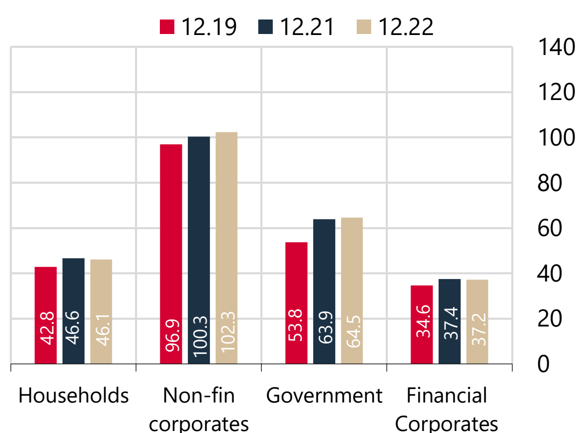


Source: IIF Last Observation: 05.05.23

While there has been no significant change in indebtedness ratios of emerging economies, those of advanced economies have decreased.

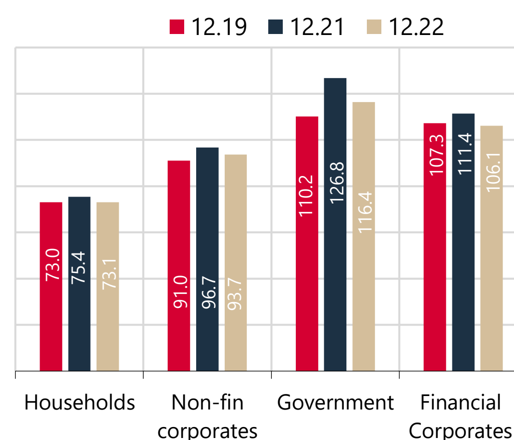
In advanced economies, the rise in the financial indebtedness ratio, particularly of the public sector, displayed a significant decrease last year. Meanwhile, the discrepancy in the compositions of financial indebtedness ratios of AEs and EMEs was maintained in this period as well. Accordingly, in EMEs, compared to 2021, real sector firms continued to stand out as the main borrowers from financial markets and institutions, while the indebtedness ratio of the financial sector particularly, was considerably lower than in AEs. On the other hand, it is noteworthy that the public sector and the financial sector are the most indebted sectors in advanced economies (Chart II.1.9 and Chart II.1.10).

Chart II.1.9: Financial Indebtedness in EMEs (Debt/GDP, %)



Source: IIF Last Observation: 2022Q4

Chart II.1.10: Financial Indebtedness Level of AEs (Debt/GDP, %)



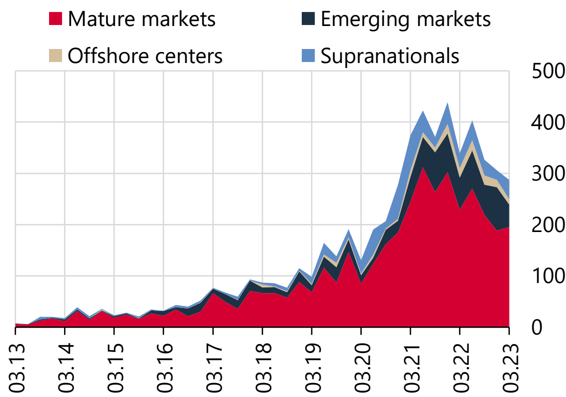
Source: IIF Last Observation: 2022Q4

Note: The average is calculated based on GDP weights of countries. Data for the third and fourth quarters are estimations of the IFF.

In 2023, environmental, social and governance themed borrowing declined compared to the previous period. This development is also attributed to the tightening in credit conditions following the bank failures in the USA and Europe.

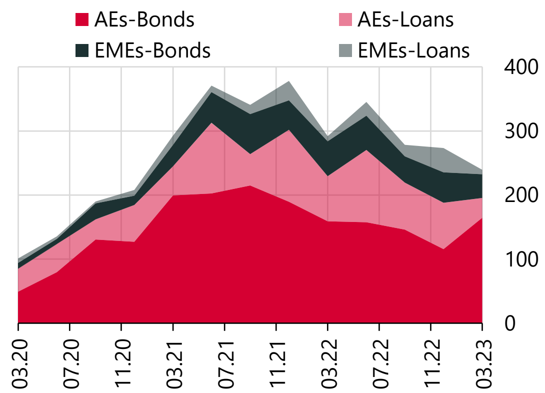
Sustainable financing activities accelerated as a reflection of the climate change issue that became a top global financial agenda item after the pandemic. Sustainability-themed bond issues and bank loans, which increased rapidly in the post-pandemic period led by AEs, posted a significant growth (Chart II.1.11). However, due to rising financing costs as a result of tightening monetary policies and the energy problems for Europe caused by the Russia-Ukraine conflict, sustainability-themed borrowing activities lost momentum as of the second half of last year. The tightening in credit conditions as a result of bank failures in the USA and Europe is also believed to have played a role in this development. Actually, as of the first quarter of 2023, sustainability-themed borrowing in both AEs and EMEs was mostly carried out via bond issues, whereas bank loans with the same theme decreased significantly (Chart II.1.12). In the first quarter of 2023, the amount of sustainability-themed bonds and loans reached approximately USD 5.1 trillion, and this corresponds to approximately 5.5% of total financing on a global basis.

Chart II.1.11: Environmental, Social and Governance-Themed Borrowing (USD Billion)



Source: IIF Last Observation: 2023Q1

Chart II.1.12: Breakdown of Bond Issues and Bank Loans for Environmental, Social and Governance Purposes (USD Billion)



Source: IIF Last Observation: 2023Q1

Notes: Emerging Economies (EMEs), Advanced Economies (AEs), and offshore banking centers are composed of 141, 35, and 24 countries, respectively. Detailed information on country lists can be obtained from the sustainable debt screen on the IIF corporate website. Environmental, Social and Governance themed borrowing can be provided in the form of both bonds and bank loans, and Chart II.1.14 shows this breakdown in detail for AEs and EMEs.

Box II.1.I: Recent Developments in the Global Banking Sector

The failures of two US banks based in California and New York, whose depositors overwhelmingly composed of large technology firms, followed by the takeover of a globally systemically important bank, the second largest bank in Switzerland, and then the failure of another California-based bank in the US have fueled concerns over the resilience of the global financial system against shocks and the potential for these developments to create a systemic risk.

Silicon Valley Bank (SVB), which served nearly half of technology and science companies, which were funded by venture capital in the USA, as well as more than 2,500 venture capital firms, announced failure on 10 March 2023. It was announced that SVB's depositors with insured deposit accounts would be able to access their accounts within the same week and depositors with uninsured deposit accounts would be able to access their accounts the following week, nevertheless this announcement fell short of calming down the market. Some similar medium-sized banks experienced deposit runs and another US-based bank, Signature Bank, announced failure on 12 March 2023.

After the SVB's failure, the largest bank failure in the US since the Global Financial Crisis, the US Treasury Department, the Fed and the Federal Deposit Insurance Corporation (FDIC) took steps to protect the depositors.[1] On 12 March 2023, the Fed launched a new program (Bank Term Funding Program) to provide additional funding to eligible depository institutions, and the aim of the program was to offer loans to banks at the face value of their collateral and make them more resilient against deposit runs. The FDIC compensated the losses of depositors by making a systemic risk exception in the Deposit Insurance Fund and covered not only the insured deposit accounts but also the uninsured deposits of the two banks, which were acquired by other banks later on.[2]

In March, the shares of another bank, First Republic Bank, started to fall due to concerns felt by depositors at regional banks during the failures of SVB and Signature Bank. First Republic Bank's financial report for the first quarter of 2023 published on 24 April 2023 showed a 41% outflow in deposits during the first quarter of 2023.[3] The bank had provided cheap mortgages to qualified customers, and as a result of rising interest rates, was faced with large losses on its mortgage portfolio. On 1 May 2023, the bank was announced failure and most of its assets were sold to JP Morgan Chase, the largest bank in the USA by asset size. First Republic Bank became the second largest bank to fail in the USA, after the failure of Washington Mutual Inc. in 2008. In terms of bank asset size, bank failures in the USA converged levels seen during the Global Financial Crisis (Chart II.1.I.1). Despite the measures taken by authorities, banks' CDS spreads increased and their market value decreased (Chart II.1.I.2).

The bank failures and deposit runs in the US revealed that banks, which had been operating in a low interest rate environment for a long time, had failed to properly address the interest rate risk in their risk management practices and had taken on additional risks by investing in long-term securities. In this context, an analysis of the SVB' balance sheet reveals some remarkable features on the assets and liabilities sides. The liabilities side is dominated by deposits and there is a sectoral concentration of venture capital firms in terms of bank customers. The asset side is dominated by securities purchased by using customer deposits when interest rates were low, investments were not diversified and the bank was exposed to risks that exceeded its loss-absorbing capacity.

Commercial customers, whose funding needs increased due to rising interest rates, started to withdraw deposits to meet their liquidity needs. In order to meet the increasing demands of its customers, SVB had to sell its assets, including those to be kept until maturity, and incurred losses.

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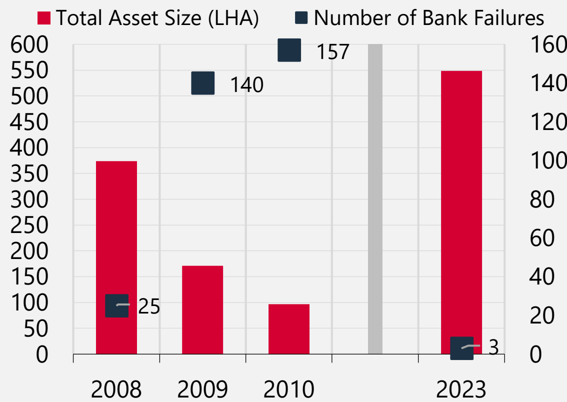
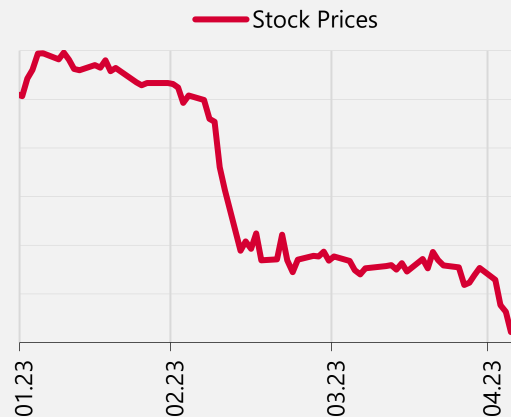
[1] https://www.fdic.gov/news/press-releases/2023/pr23029.html
[2] https://www.fdic.gov/news/press-releases/2023/pr23022.html
https://www.fdic.gov/news/press-releases/2023/pr23026.html
[3] https://ir.firstrepublic.com/static-files/013f57fb-b980-4353-bbb3-0e7a3b27f20a

Chart II.1.I.1: Bank Failures in the USA with Respect to Asset Size (Billion US dollars, Annual)



Source: FDIC Last Observation: 04.23

Chart II.1.I.2: Market Value of Regional Banks in the USA (US dollars)



Source: Bloomberg Last Observation: 05.05.23

Note: Based on shares of the SPDR S&P Regional Banking ETF.

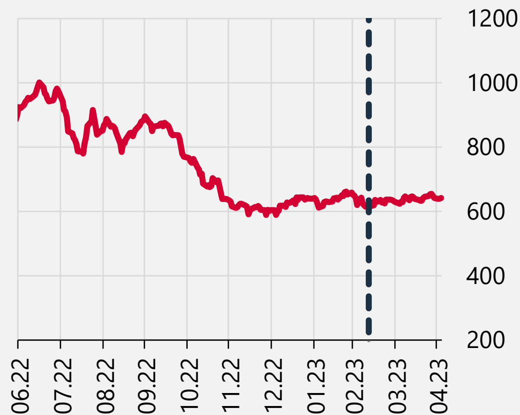
On 28 April 2023, the Fed published a report on the failure of SVB and regulatory and supervisory conditions, and the FDIC published a report on the failure of Signature Bank and both stated that mismanagement was the main cause of bank failures. [4] Meanwhile, in accordance with the Economic Growth, Regulatory Relief and Consumer Protection Act approved on 24 May 2018 in the USA, the Fed differentiated banks' regulatory and reporting obligations pertaining to liquidity and capital based on banks' asset size. Accordingly, the three failed banks were included in groups where regulatory and reporting requirements were less strict than larger banks. The Fed and the FDIC mentioned this issue in their reports, and stated that the authorities were not fast enough to identify and respond to risks and that there was room for improvement in regulation and supervision.

Following the bank failures in the USA in march, the CDS of Credit Suisse, a Swiss-based global systemically important bank, increased by approximately a thousand basis points and the bank's shares were transferred to UBS. The Swiss Financial Market Supervisory Authority (FINMA) approved this share transfer with an announcement dated 19 March 2023.[5] Moreover, the nominal value of all capital instruments issued to raise core equity base (AT1) of Credit Suisse in the amount of around CHF 16 billion was written down and the core capital was increased. FINMA issued an announcement regarding the write-down of AT1s, which was criticized in international markets for not complying with the creditor hierarchy and caused concerns in financial markets, emphasizing that the actions taken relied on the applicable bond prospectuses and the Federal Council's Emergency Ordinance, that the hierarchy of investors was not changed, and that the authorities had not made any changes in this regard.[6] European Union (EU) regulatory authorities also issued a joint statement to allay concerns in the bond markets, stating that there was a creditor hierarchy in the EU in accordance with the Financial Stability Board (FSB) resolution framework, and that common equity instruments are the first ones to absorb losses, and only after their full use would Additional Tier 1 be required to be written down.[7]

The uncertain environment induced by developments in the US and Swiss banking sectors did not have any negative impacts on the Turkish banking sector. Banks' 5-year CDS spreads remained flat (Chart II.1.I.3). Moreover, the fact that the Turkish banks have adopted an active risk management approach and hold the required liquidity and capital buffers against risks reduces the likelihood of systemic problems. Banks in Türkiye are considered to have sufficient loss-absorbing capacity for times of stress. Deposit and participation banks operating in Türkiye have been subject to liquidity coverage ratios since 2016. Banks' total and FX liquidity coverage ratios hover above the standard ratios and the share of FX liquid assets on their balance sheets has been on an uptrend since mid-2020 (Chart II.1.I.4).

[4] https://www.federalreserve.gov/publications/files/svb-review-20230428.pdf
[5] https://www.finma.ch/en/news/2023/03/20230319-mm-cs-ubs/
[6] https://www.finma.ch/en/news/2023/03/20230323-mm-at1-kapitalinstrumente/
[7] https://www.bankingsupervision.europa.eu/press/pr/date/2023/html/ssm.pr230320~9f0ae34dc5.en.html

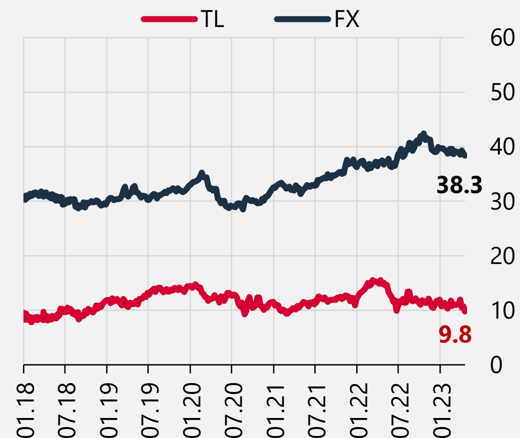
Chart II.1.I.3: 5-Year CDS Premiums of Selected Banks* (Average)



Source: Bloomberg Last Observation: 03.05.23

Note: Dashed line indicates the date on which SVB was taken over by the Federal Deposit Insurance Corporation (FDIC).

Chart II.1.I.4: Ratio of Liquid Assets to Total Assets (%)



Source: TCMB, BRSA Last Observation: 20.04.23

Note: Liquid assets are the sum of cash, CBRT, RR, foreign banks (Free), free DBS and other liquid assets.

Due to developments in international markets, the global financial agenda was dominated by issues related to the soundness of financial institutions and the "too-big-to-fail" problem framed by the Basel III standards, which are important parts of the post-Global Financial Crisis reform efforts, as well as the concepts of spillover effects and systemic risk. Systemic risk is defined as a risk that causes serious adverse consequences for the real economy and leads to widespread disruption in the provision of financial services and it is a key element of the macroprudential policy framework. [8] Systemically important financial institutions are those institutions that can create significant disruption in the financial system and economic activity due to their weaknesses or disorderly insolvencies, size, complexity and interconnectedness. From the banking sector standpoint, the Global Financial Crisis clearly revealed that rescuing systemically important banks with government interventions is very costly, and that the expectation that these banks will be rescued by the government causes banks to take more risks, and provides implicit support to banks with funding advantages and creates the risk of moral hazard.

In this context, within the framework of the methodology determined by the Basel Committee on Banking Supervision (BCBS) and in consultation with the BCBS and national authorities, the Financial Stability Board (FSB) announces the global systemically important banks each year and these banks become subjected to different regulations than other banks. Some of these regulations include increasing the loss-absorbing capacity of these banks in order to reduce the risk of failures, imposing additional obligations, subjecting them to stricter supervision, establishing resolution frameworks on a global scale in order to mitigate the effects in case of their failure, and making cross-border cooperation agreements. In addition, the Basel III framework has introduced additional capital and leverage requirements.

Recent developments in the banking sector have provided an opportunity to test the G20 financial reforms prepared in the aftermath of the Global Financial Crisis. It is crucial to accurately assess the impact of these developments. The global financial system has been exposed to significant shocks over the last three years. The pandemic and the conflict between Russia and Ukraine, which were exogenous shocks, had a significant impact on the global economy. Unlike these two exogenous shocks, the recent international developments in the banking sector have originated from within the financial system and have had a limited impact on the global economy. These developments have once again emphasized the importance of effective corporate governance and risk management in banking, the effects of technological advancements on the speed of bank failures, non-bank financial institutions' interconnectedness to banks, banking regulations and resolution framework for the

[8] https://www.fsb.org/2011/10/r_111027b/

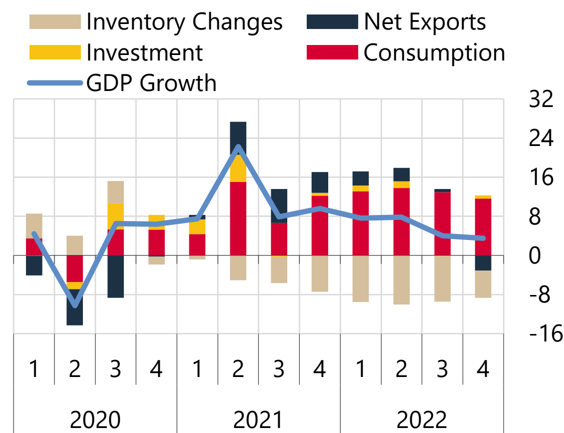
resilience of the global banking system against shocks. Although post-Global Financial Crisis reforms have increased the resilience of the global financial system to shocks, it has been observed that banks with weaker business models and inadequate risk management practices may fail in the face of tightening financial conditions and liquidity challenges. Against this backdrop, international financial institutions and standard-setting bodies closely monitor the issues that cause significant vulnerabilities to financial stability together with regulatory and supervisory authorities in order to preserve the gains from reforms and work on possible measures based on the lessons learned from experiences.

II.2 Main Domestic Macroeconomic Developments

Economic activity decelerated somewhat on an annual basis in the last quarter of 2022 due to weakening external demand, but domestic demand remained brisk.

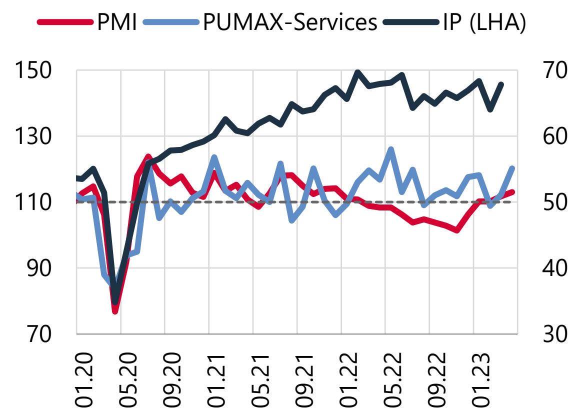
In the last quarter of 2022, GDP grew annually by 3.5%, and quarterly by 0.9% in seasonally and calendar adjusted terms. In this period, final domestic demand, led by private consumption, was the main driver of growth in terms of expenditures, while the positive contribution of machinery-equipment investments to growth continued (Chart II.2.1). Annual growth was recorded as 5.6% throughout 2022. The industrial production index, which contracted in February due to the earthquake, grew slightly in quarterly terms thanks to strong performances in January and March. Leading indicators for April point to an increase in production in the industrial and services sectors (Chart II.2.2).

Chart II.2.1: Annual GDP Growth and Contribution of Expenditures (% Points)



Source: TURKSTAT Last Observation: 2022 Q4

Chart II.2.2: Selected Leading Indicators of Economic Activity (Index)

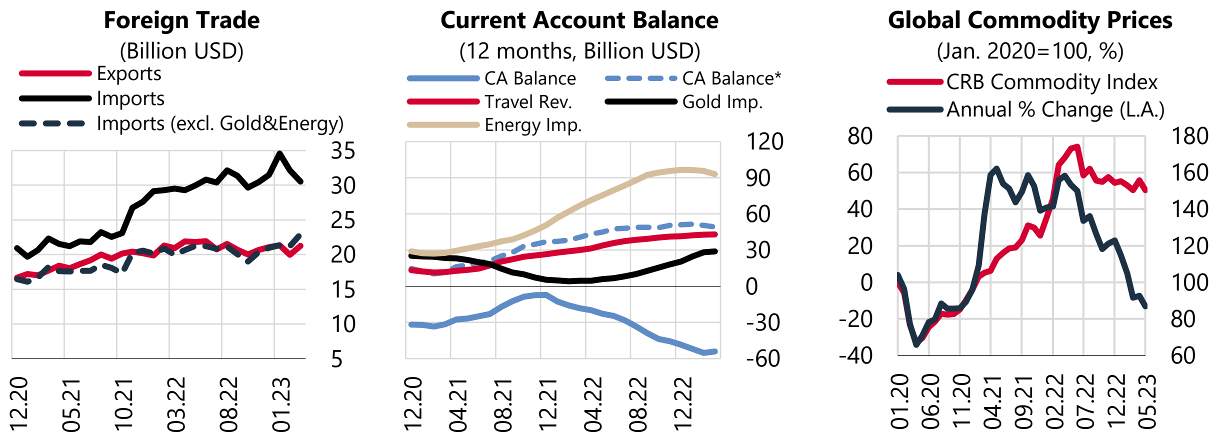


Sources: TURKSTAT, ICI, MUSIAD Last Observation: 04.23 (IPI 03.23)
Source: Industrial Production Index (IPI, 2015=100) and the Services Sector Purchasing Managers' Index (PUMAX-Services) are adjusted for seasonal and calendar effects. The dashed line shows the stable state compared to the previous month in the Manufacturing Industry Purchasing Managers' Index (PMI) and PUMAX.

Exports have trended up despite disaster-related effects, while the foreign trade deficit has widened due to the acceleration in gold imports and the increase in imports of consumption goods. Meanwhile, strong services revenues continue to support the current account balance.

The ongoing increase in services revenues backed by strong contribution from tourism continue to support the current account balance. Excluding gold and energy, imports exhibit a trend similar to exports. As of March 2023, the annual current account deficit was USD 54.2 billion, while the current account excluding energy and gold remained favorable and posted a surplus of USD 49.3 billion in the same period. (Chart II.2.3).

Chart II.2.3: Current Account Developments

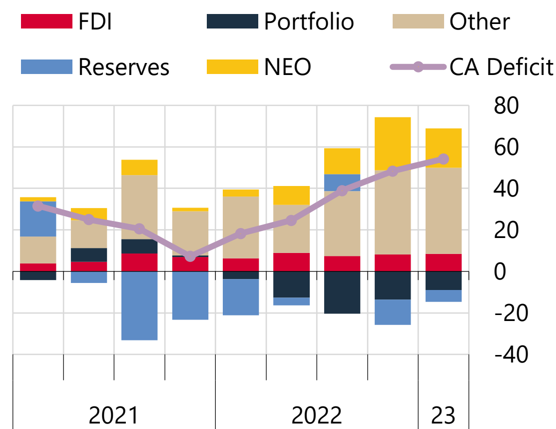


Sources: CBRT, TURKSTAT, Ministry of Trade, Refinitiv Last Observation: 03.23 (Commodity prices 10.05.2023)
Note: For foreign trade, seasonally/calendar adjusted monthly exports (fob) and imports (cif) data according to the general trade system have been used. (*) refers to the current account balance excluding energy and gold. Commodity Index (Refinitiv/CoreCommodity CRB Index) shows the arithmetic average of futures prices of 19 commodities such as crude oil, gold, copper, livestock, and sugar.

The current account deficit was predominantly financed by non-residents' deposits in domestic banks, and partly by loans and direct investments.

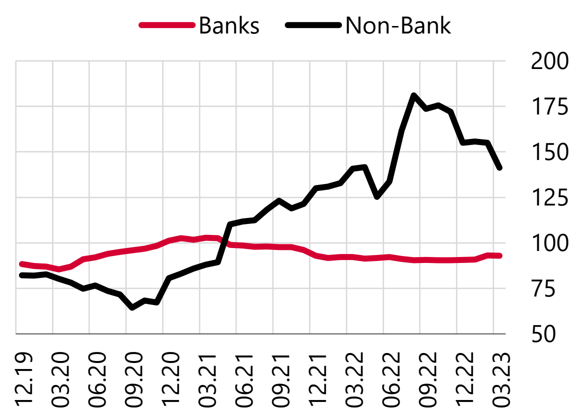
In the last quarter of 2022, the financing need driven by the current account deficit was predominantly covered by non-residents' deposits at banks and direct investments, which are monitored under other investments, whereas in the first quarter of 2023, the contribution of reserves to the current account deficit financing increased (Chart II.2.4). In March, banks remained net payers of external debt, which had been the case in the last couple of years, and thus, have continued to lower indebtedness. In the meantime, the non-bank private sector has renewed its external debt at a high rate despite a slight decline in recent months, and continued to contribute to the financing of the current account deficit (Chart II.2.5).

Chart II.2.4: Financing of Current Account Deficit (12-Month Cumulative, USD Billion)



Source: CBRT Last Observation: 03.23
Note: "Portfolio", "FDI", and "Other" investments items are in net terms. The (-) sign in "Reserves" implies an increase.

Chart II.2.5: External Debt Rollover Ratio (12-Month, %)



Source: CBRT Last Observation: 03.23
Note: External debt rollover ratios are calculated on short and long-term total debt in a 12-month window.

Public finance remains robust on the back of tax revenues.

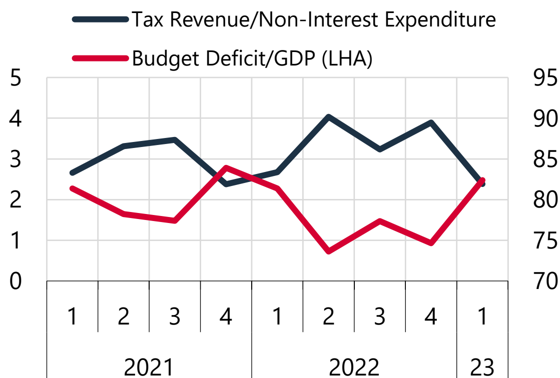
The proportion of primary expenditures covered by tax revenues, which fell in the third quarter of 2022, had an upward trend in the last quarter of the year, but decreased somewhat in the first quarter of 2023 due to the rise in expenditures driven by the disaster. The periodic rate of increase in budget revenues remained lower in the first quarter of the year, due to the shifting of the temporary corporate tax collection from February to May. Thus, the

ratio of budget deficit to national income, which had been 0.9% at end-2022, increased to 2.5% in March (Chart II.2.6).

The favorable effects of the policy mix implemented as part of the Liraization Strategy initiated an improvement in the level and trend of inflation.

Consumer price inflation declined to 43.7% in April from 64.3% at end-2022. Annual inflation fell compared to the previous year across all groups, more visibly in energy. However, annual price increases remained relatively high in food and non-alcoholic beverages and to some extent in services. In April, producer prices continued to decline on an annual basis amid falling energy prices. Against this background, annual rates of change in core CPI indices decreased in both B and C indices (Chart II.2.7).

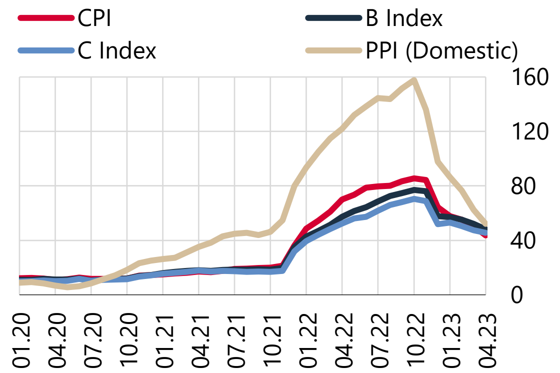
Chart II.2.6: Central Government Budget Indicators (12-Month Cumulative, %)



Sources: CBRT, MTF Last Observation: 03.23

Note: Estimated value for 2023Q1 GDP.

Chart II.2.7: Inflation Developments
(Annual % Change)



Sources: CBRT, TURKSTAT Last Observation: 04.23

Note: The B index is obtained by subtracting unprocessed food products, energy, alcoholic beverages, tobacco and gold items from the CPI, and the C index is obtained by subtracting food and non-alcoholic beverages from the B index.