Setting Sail for a Greener World in the Pandemic Storm

TSKB Economic Research

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Outline

Climbing the Long Ascent

It was little longer than a year ago, when I wrote "Time to Act: Broad Thinking, Smart Financing" to describe the path ahead for increasing Turkey's resilience under the Covid-19 pandemic.[1] Today, after a compelling period of global fight with the pandemic, green shootings are underway. Yet there is a Long Ascent ahead, with an uneven and uncertain global recovery.[2]

Multilayered challenges facing humanity show that measures to "save the day" will not be enough. On one hand, problems such as uneven distribution of vaccines, disruption in the global supply chain point at the importance of multinational cooperation. On the other hand, each country has to write its own policy receipt based on country-specific damage assessment report. While each country's recovery will help to improve the global economic outlook, the pace of improvement in the global economy will be a leverage for countries.

Within this interdependent framework, Turkey's openness to the world is an important asset. Investing in the trade competitiveness will be a major item in the short to medium term agenda. Now is the time to transform and improve Turkey's doing business environment with a climate-responsible approach. This is critical considering the need to attract external savings, support growth and raise employment. Covid-19 pandemic hit female and youth employment disproportionately around the world, Turkey being no exception. Hence in the period ahead, policy priorities should be determined to support responsible growth with enhanced inclusion especially in the job market.

It takes time to reap the fruits of structural measures in an economy. Therefore, today is always the best day to start. Reminded of our strengths and weaknesses during the pandemic and seeing that global recovery is vulnerable, no time to look back. Let's help each other to climb the Long Ascent, with the motivation of having a better view for everyone when we make it to the top of the hill.

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[1]https://www.tskb.com.tr/i/assets/document/pdf/Increasing%20the%20resilience%20of%20Turkey%20under%20the%20Covid-19%20pandemic.pdf

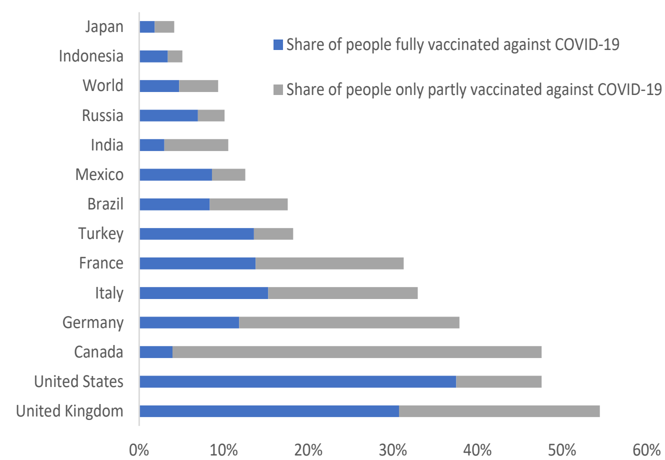
[2]https://www.imf.org/en/News/Articles/2020/10/06/sp100620-the-long-ascent-overcoming-the-crisis-and-building-a-more-resilient-economy

A Diversed and Still Fragile Recovery across the Globe

As the COVID-19 has left behind its the first anniversary, world economy has still got challenging outlook. There has been a considerable recovery in global economy thanks to supportive economic policies and recent acceleration in vaccinations. However, there have been significant doubts over the resilience of economies.

While the pandemic and containment measures have had varied impacts on each economy, governments' policy responses against the economic damage and vaccination programs have decoupled. More than half of the US and the UK residents were vaccinated in the last six months, reaching significant levels. But, despite the recent acceleration, one third of the European residents were vaccinated in the same period. While only 10% of world population is vaccinated as of mid-May, it is expected that vaccination for reaching herd immunity level in most emerging market economies may take more time. Given the high mutant cases, it is difficult to say that the global health crisis is well-contained.

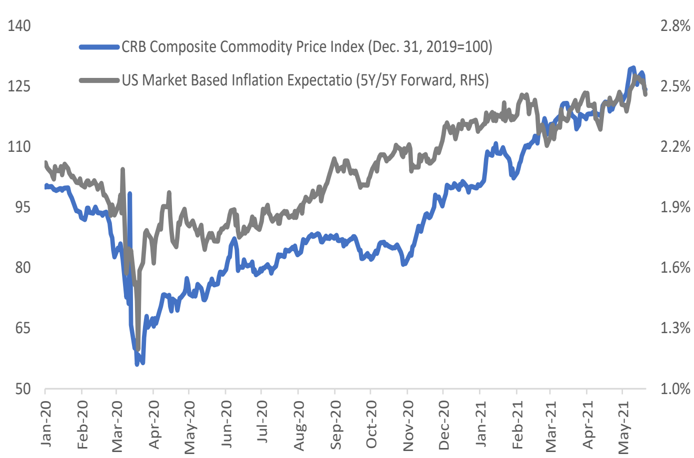
Vaccination Rates (as of May 20th)



Sources: OurWorld In Data, TSKB Economic Research

Although the manufacturing purchasing managers indices (PMI) have stayed above expansion territory for 10 months in major economies, the fragilities in the service sectors have been persisting. While this picture caused an asymmetrical and fragmented structure in global recovery, it intensified the challenges in the world economy.

Commodity Prices & US Inflation Expectations



Sources: Reuters, TSKB Economic Research

While demand for manufacturing goods remained strong, there were temporary setbacks in some intermediate goods due to country-wise and sector specific problems. Meanwhile, logistic costs increased as a result of this asymmetry. The shipment costs from China to Europe increased by %250 in the second half of 2020, while there was an additional 60% increase in the rest of 2021. Lengthening delivery times and the inclination of companies to stock up on some products increased the pressure on commodity prices. Hence, commodity prices increased by 24% year-to-date, in addition to 26% rise in the second half of 2020. Consequently, inflation concerns reinforced and triggered the rise in advanced economies bond yields and repricing in risky assets in February-March 2021.

Policy makers eased the tension in financial markets to some extent, pledging to keep interest rates lower for longer period. But, divergences between the market participants and policy makers over the persistence of inflation have heightened the uncertainties and kept the downside risks on outlook important.

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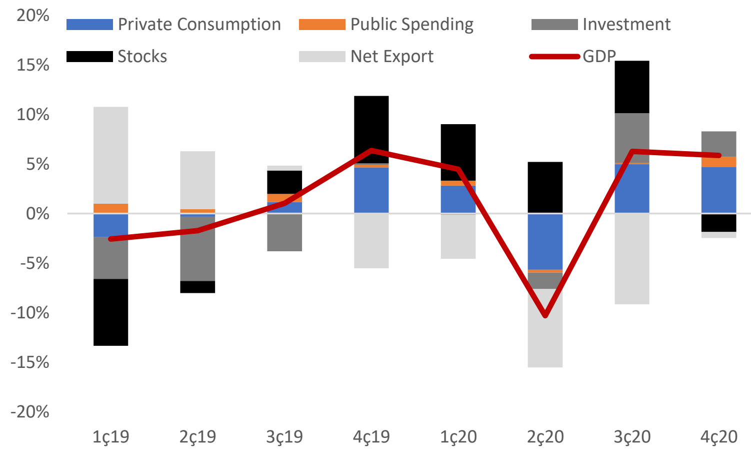
The Current Outlook for the Turkish Economy

While the Turkish economy rebounded sharply in the second half of 2020, the slowdown in activity was limited despite the recent pandemic related restrictions. While global inflationary trends have had adverse impact on Turkish economy, the elevated uncertainties limit the room for maneuver in economic policies.

Although foreign demand remained weak in the second half of 2020, domestic demand contributed 10.9 percentage points to gross domestic product (GDP). Thus, GDP grew throughout the year. In addition to interest rate hikes in the last quarter of 2020 and March 2021, COVID-19 containment measures led to a limited slowdown in domestic demand in the remainder of 2021. Fortunately, foreign demand supported the economic activity thanks to strong performance in the global manufacturing. Going forward, deceleration in domestic demand is expected to continue due to the tight financial conditions. While recent global trends may support the exports, the tourism sector outlook will be vulnerable to pandemic related developments.

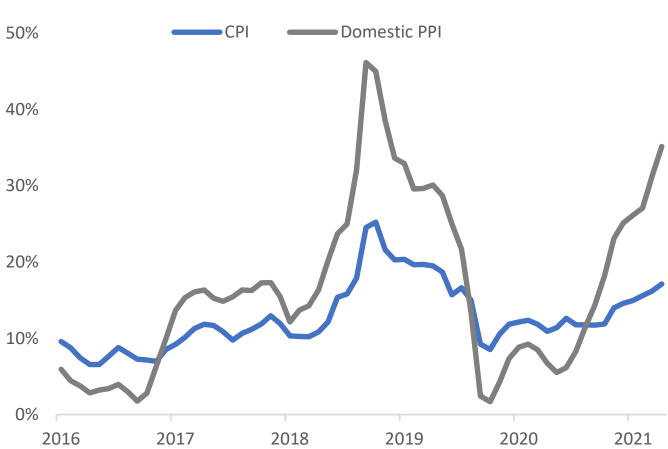
Contributions to Annual Growth



Sources: Turkstat, TSKB Economic Research

In addition to cost factors, increases in expectations and credit induced the acceleration in domestic demand during 2020 deteriorated inflation dynamics. Therefore, exchange rate developments and the extent of slowdown in domestic demand will determine the course of inflation going forward.

Annual Changes



Sources: Turkstat, TSKB Economic Research

The consumer price index (CPI) inflation, which remained at low double-digit levels in the first half of 2020, rose to 14.6% at the end of 2020. While slowdown in domestic demand was limited, CPI annual inflation surpassed 17% in April 2021 due to accumulated costs. Meanwhile, underlying dynamics and higher domestic producer prices index (D-PPI) indicate that the peak in CPI may not have been seen yet. In addition, the rise in commodity prices, especially in global agricultural prices, put further upward pressure. Ongoing deceleration in domestic demand and lower volatility in exchange rates in the short term may limit the cost pass-through. However, in the medium term, structural policies, especially climate-friendly agricultural production and food security, should be considered to implement in order to sustain price stability.

The recent experiments confirm that, in addition to growth and employment policies, instruments to be used in decreasing inflation and reducing external imbalances should be strengthened by development policies within a comprehensive approach.

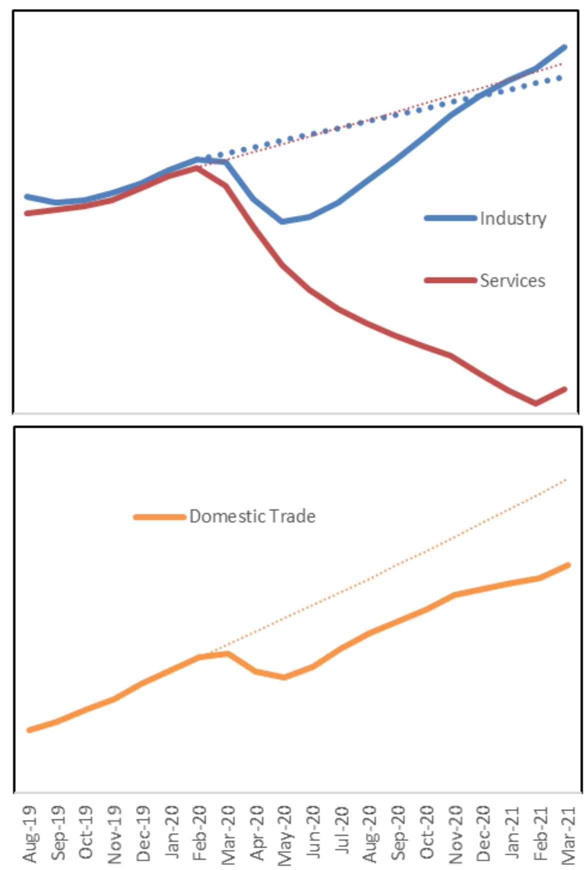
K Shaped Recovery

The extent of post-crisis recovery varies widely among countries, between activities within the country and between segments of society. For this reason, the discussions about which letter the recovery would look like ended by making a decision on the letter "K". An important reason for the long recovery journey is that this situation creates an uneven and uncertain recovery.

The top panel of the figure on the right shows how the letter K corresponds in recovery. While the industry in Turkey has recorded a strong recovery after the first months of the crisis, it is seen that the decline in services continued for a long time. As the industry has surpassed the pre-pandemic trend, it can be said that widespread vaccination is needed both at home and abroad to see a strong recovery in services.

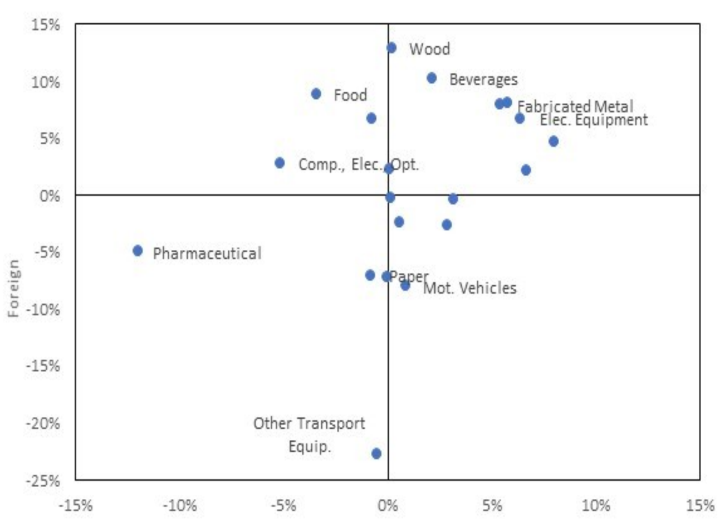
The bottom panel in the right group shows that there has been a structural break in domestic trade and that it is still far from returning to the levels implied by the pre-pandemic trend. In this channel, domestic vaccination will be followed for normalization.

Turnover Indexes (real, 12 month mov. avg.)



Sources: TurkStat, TSKB Economic Research

Turnover (real, q-o-q, sa, 2021 Q1)



Sources: TurkStat, TSKB Economic Research

The sales made both domestically and abroad are deemed important for the strong development of the industry. As of the January-March period of 2021, it is seen that real domestic turnover in 20 of the 23 sub-branches of the manufacturing industry and real foreign turnover in 17 of them exceeded the pre-pandemic level.

The chart on the left shows how domestic and foreign turnovers have progressed compared to the previous quarter.

In the computer, electronics, optics and food business branches in the upper left region, it is noteworthy that the international turnover continues to increase despite the decrease in domestic turnover.

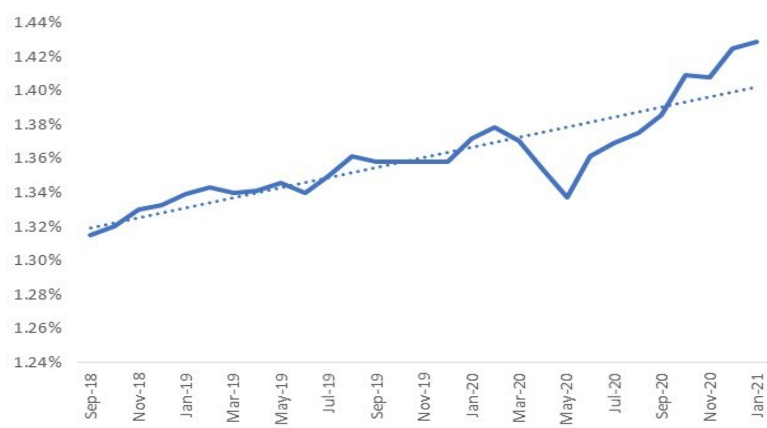
The Search for a Resilient Supply Chain

The pandemic process has shown how fragile global production networks interconnected with supply chains are. The failure in one of the rings caused the entire value chain to be disrupted and the chain to be broken. Although more than a year has passed since the beginning of the pandemic, as a reflection of the asymmetric recovery, disruptions in supply chains continue, especially in some commodities and semiconductors used in automotive.

The concept that comes to the fore in these discussions that accelerated during the pandemic is the resilience of the supply chain. One way to increase resilience is seen as the realization of procurement processes from regions closer to the end user, that is, the establishment of regional supply chains. This trend, which implies a change in the structure of the production chains, has the potential for Turkey to further strengthen the already strong commodity trade flows with the EU.

The data indicate that this potential provides an improvement in Turkey-EU trade relations for some product groups.

Turkey's Market Share in European Union (annualized)



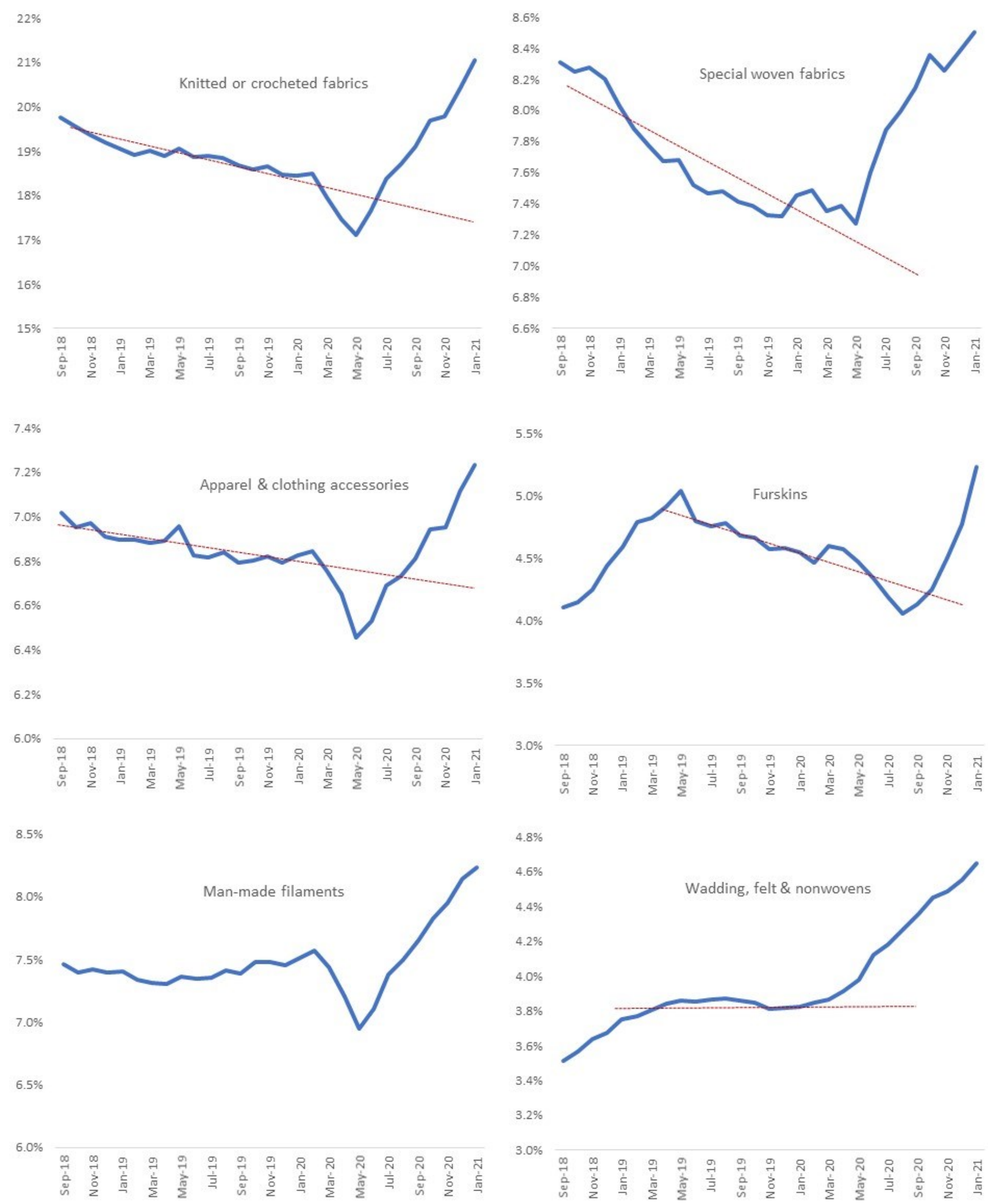
Sources: TradeMap, TSKB Economic Research

Turkey's exports to the EU started to rise in June after a sharp decline in the period of March-May 2020. After May, it is seen that Turkey's exports to the EU increased in 82 of the 98 lines of activity. As can be seen from the graph, this performance brings along a strong increase in Turkey's market share in the EU, which is above the previous trend. It is also seen that the increase in market share shows a tendency to span across most of activities.

Textile and clothing related activities stand out among those with the highest market share increase. In these activities where Turkey has a comparative advantage, the country faced a stress to lose its market share in EU due to the competitive pressure from East Asia in recent years. The data indicates that market share losses in pre-pandemic era were replaced by strong increases in the post-pandemic period, which can be seen as a sign that European companies are shifting their suppliers in favor of Turkey. This situation positively affects the export performance of Turkish exporters by increasing their market share in the EU. On the other hand, it should not be ignored that this rapid increase may cause possible disruptions in domestic supply chains, difficulties in product supply and price pressures.

Turkey's Market Share in EU

(Selected product groups, annualized)



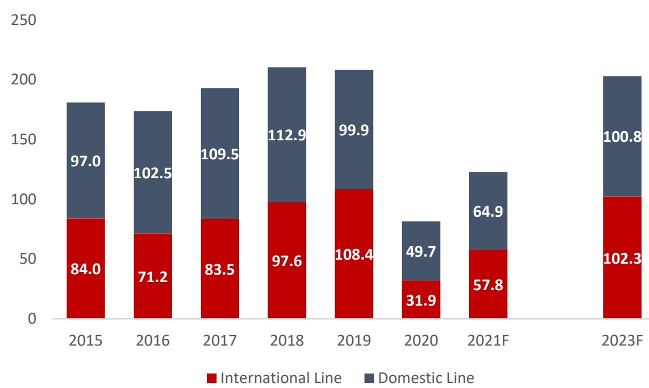
Source: Trademap, TSKB Economic Research

Transportation and Tourism

Globally, tourism has been one of hardest hit sectors during the COVID-19 pandemic. Despite easing travel restrictions worldwide (aside from few destinations), negative economic conditions brought by the pandemic and ongoing health concerns of the consumers remain to be the obstacles preventing the full recovery of tourism sector.

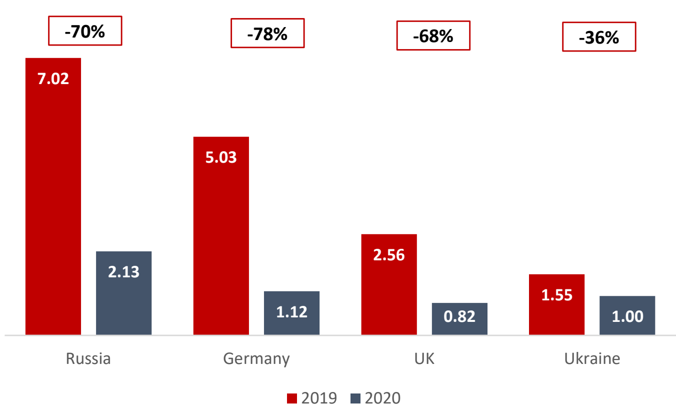
Recent forecasts reflect expectations of a slow, but gradual improvement in Turkey as well as other tourist destinations around the world. According to the forecasts published by General Directorate of State Airports Authority (DHMI) at the end of April, air passenger traffic in Turkey will approach 2019 levels in 2023. These forecasts are in line with the studies conducted by international organizations such as the International Air Transport Association (IATA). DHMI forecasts an 81% y-o-y increase in international traffic for 2021, while still remaining 47% behind 2019 levels.

Turkey Air Passenger Traffic Outlook (million)



Source: DHMI, TSKB Economic Research

Number of Tourists from Selected Source Markets (million)



Source: Ministry of Culture and Tourism, TSKB Economic Research

Turkey faced some source countries' decisions on travel activities due to high COVID-19 figures registered. Recently, Russia suspended air traffic between two countries and UK put Turkey on travel "red list" associated with high health risk. In 2019, Russia and UK respectively formed 15.6% and 5.7% of the 45 million foreign tourists Turkey hosted. Furthermore, in May, UEFA Champions League final which was set to be played in Istanbul was moved to Portugal and Turkey was removed from Formula 1 2021 schedule.

Turkey adopted a three-week "full closure" at the end of April and succeeded a rapid decline in number of new cases despite missing expectations. Yet, in order to avoid further actions limiting travel activity and strengthen its "safe destination" image, Turkey has to speed up the domestic vaccination process.

Developments on vaccine procurement and bilateral talks with source countries enforcing travel restrictions will be closely watched by the tourism sector in the short term.

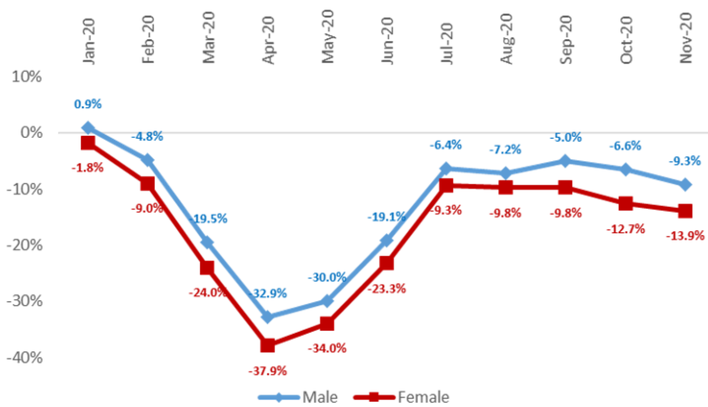
Asymmetric Reflections in Employment

The COVID-19 pandemic has widened the gender gap in labour markets

Women have borne the brunt of the pandemic's impact on employment, as the pandemic has led to more job losses globally for women than it has for men. While the loss of employment for men, relative to the ILO's calculations for the years 2018 and 2021 stood at 3.9% in 2020, this figure was 5% for women.[3]

The COVID-19 pandemic has piled an additional burden on women in Turkey. Both the number of people in employment and the total hours spent in work have decreased during the pandemic period, and the consequences of COVID-19 are likely to affect women and men differently with a stark drop in production and unprecedented job losses. Monthly labour force figures published by TurkStat indicate that the decline in the number of total hours spent in work during COVID-19 pandemic was considerably greater than the fall in the number of people in employment alone. Total working-hour losses were higher for female workers as the gender gap in working hours has constantly widened since before the COVID19 outbreak became widespread. The reduction in working hours for female workers had reached 37.9% as of April 2020, while the decline in the total hours worked for men had declined by 32.9%.

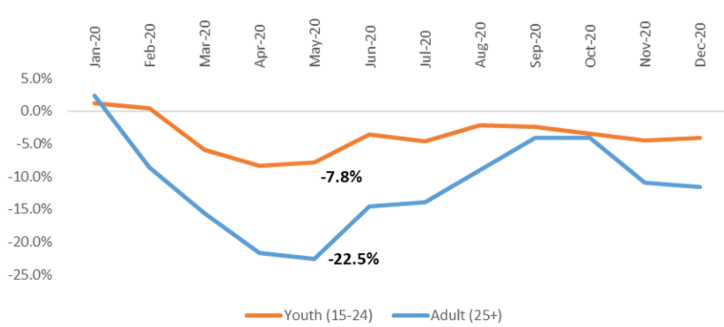
Change in Total Actual Hours of Work, Turkey, y-o-y (%) by Gender



Source: TurkStat, TSKB Economic Research

Young labour force also faces a challenging outlook in the wake of the COVID-19 crisis

Change in no. of People Employed, by ages, Turkey (y-o-y)



Source: TurkStat, TSKB Economic Research

According to the ILO estimates, job losses for young people in 2020 hit 8.7% compared to 3.7% for adults due to the pandemic.[4] Also, simply because of the fact that young people also are often overrepresented in the informal sector, they are facing a higher risk of job and income loss during the COVID-19 pandemic.

More than half of young workers in Turkey are employed in accommodation and food services, manufacturing, and wholesale and retail trade activities, where 293,000 youth aged 15 to 24 lost their positions in a year. Figures prove that employment among young workers has decreased more sharply than adult workers (older than 25 years old) in the COVID-19 recession.

[3,4] ILO (2021), ILO Monitor: COVID-19 and the World of Work. 7th edition

Climate Policies can Accelerate Structural Transformation

Although the world economy is in the recovery phase, the recovery process seems asymmetrical, involves inter-country and intra-country inequalities and great uncertainties. This unequal structure of the effects of the recovery phase is felt both in the world and in Turkey. The climate crisis occupied an important place on the economic policy agenda throughout 2020, including the period when there were great uncertainties regarding the course of the pandemic, both to ensure recovery on the axis of sustainability and to mitigate the unequal impact.

We have seen that "green" is used abundantly in recovery packages announced in order to limit the economic effects of the pandemic. Although phrases such as "green recovery", "green jobs", "green reboot" express the intention of the recovery packages, we do not know if the intention is reflected in the actual expenditures or not. While the IISD's (Internatonal Institute for Sustainable Development) study highlighted that clean energy is behind fossil fuels in pandemic economic support, United Nations (UN) Secretary General António Guterres noted only about a quarter of pandemic recovery spending was expected to contribute to mitigating emissions, reducing air pollution or improving biodiversity. However, the return of the USA to the Paris Agreement with President Biden and the green infrastructure investments package, the progress made under the European Green Deal, the more ambitious commitments on cutting emissions pledged by many countries for 2030 and the announcement of a net zero target for 2050, the steps taken by the IMF to include climate in its field of study, the IMF's proposal to establish a global carbon market and to set a floor price and all related developments clearly highlight that climate is now permanently on the policy agenda.

Undoubtedly, the global climate agenda has the potential to affect Turkey in many areas. Areas such as transformation in energy production, R&D processes focusing on the pursuit of resource efficiency, agriculture and food systems, a circular economy and border carbon taxes are the first to come to mind. It could be said that the steps to be taken in these areas may bring about a transformation in the overall structure of the country. In other words, climate policies can be considered as an accelerator of structural transformation in the country.

This transformation, which is vital to achieve a greener world, will contribute to both the global climate agenda and Turkey's structural change. Such a transformation move will only reach a concrete result with the steps to be taken by all stakeholders in this direction and the responsibilities to be taken. The targeted funding to be provided by international development finance institutions will contribute to accelerating Turkey's green transformation.

[5] https://www.tskb.com.tr/blog/ekonomik-desteklerde-temiz-enerji-fosil-yakitlarin-gerisinde

[6] https://www.ft.com/content/3ea3e9f6-1c18-42c7-9912-c51efed3f721

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