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Analysis

Can Turkey's new economic plan restore foreign investor confidence?

Eager to regain Istanbul and other major cities from the opposition, Erdogan is expected to turn to populist policies again ahead of local elections next spring.

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ISTANBUL — Turkey's government has unveiled a new economic program to bring inflation down to single digits by 2026, but questions linger on whether it can attract much-needed foreign investments.

The so-called Medium-Term Program, which covers the next three years, is Ankara's first comprehensive economic plan since a new economic leadership took office in June and pledged to return Turkey to "rational ground" in replaced the central bank's governor and senior managers, signaling a turnaround from his unorthodox policies that were largely blamed for rampant inflation. February's devastating earthquakes in southern Turkey have further deepened the country's financial woes.

Since similar programs have failed to meet their objectives in the past five years, the new targets are being closely analyzed by pundits. Presenting the plan on Wednesday, Vice President Cevdet Yilmaz said the main objectives are to recover from the earthquakes, achieve macroeconomic and financial stability, reduce inflation to single digits and maintain growth and employment.

Rebuilding the 650,000 homes and business places destroyed by the quakes is a massive task down the road. The cost of reconstruction alone is estimated to start at $100 billion, with further investments required to minimize the damage of a big tremor that scientists expect to hit Istanbul, Turkey's most populous city and economic hub, in the near future. Quake-related spending was the main reason for the 1.1 trillion lira ($41 billion) supplementary budget that Ankara sought in July, and such financing needs will continue in the coming years.

The populist policies that Erdogan followed from 2021 until the May elections resulted in runaway inflation, which hit an annual rate of 59% in August. The new program projects that the rate will reach 65% by year-end, but many observers believe it is likely to jump past 70%. The program's forecast is 33% for next year, 15% in 2025 and an ambitious 8.5% by the end of 2026.

Fighting inflation requires countries to forego growth, to cool the economy and rein in domestic demand. Yet the program aspires to do so without a major revision of growth targets. Gross domestic product growth is projected at 4.4% this year and 4% in 2024, down from 5% and 5.5% previously. For 2025 and 2026, the forecasts stand at 4.5% and 5%, respectively. Such ambitions could impede the goal of reducing inflation. Yet given Erdogan's passion for growth, the authors of the program might have knowingly kept the growth forecasts high to avoid friction with the president.

Meanwhile, the program forecasts that the country's current account deficit will fall to $30 billion over three years. This, too, is ambitious, not least because this year's gap could hardly be limited to $42.5 billion as the program projects. Having reached $37 billion in the first half of the year, the current account deficit is estimated to have widened to $43 billion in August and is unlikely to fight inflation with budget deficits amounting to 6.4% of the GDP in two consecutive years remains a big question mark.

Another key forecast pertains to the value of the lira. Hakan Kara, a former chief economist at the central bank, notes that the figures imply the lira would fall to 29.9 versus the dollar by year-end from around 26.8 at present. "The dollar rate implied for the end of 2024 is roughly 43 liras, meaning a 44% annual increase in the dollar-lira rate. And here comes the question: How is inflation going to fall to 33% next year while the exchange rate increases 44% and growth does not slow significantly?" Kara wrote on Twitter.

Ali Babacan, Erdogan's former economy czar who now leads a small opposition party, was also critical. "One cannot ensure trust and predictability with a program that makes no mention of the past mistakes, is weak in terms of internal consistency and contains abstract and general expressions rather than concrete steps," he wrote.

Moreover, key indicators such as inflation and the current account gap are expected to overshoot the program's forecasts this year as the country heads to local elections on March 31. Eager to regain Istanbul and other major cities from the opposition, Erdogan remains reluctant to tackle inflation and is expected to turn to populism again ahead of the polls.

An economy without price stability will not be appealing to foreign investors. Thus, Turkey's inflation requires a real tightening in monetary and fiscal policies, as well as measures to increase the agricultural output to rein in food inflation in particular.

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