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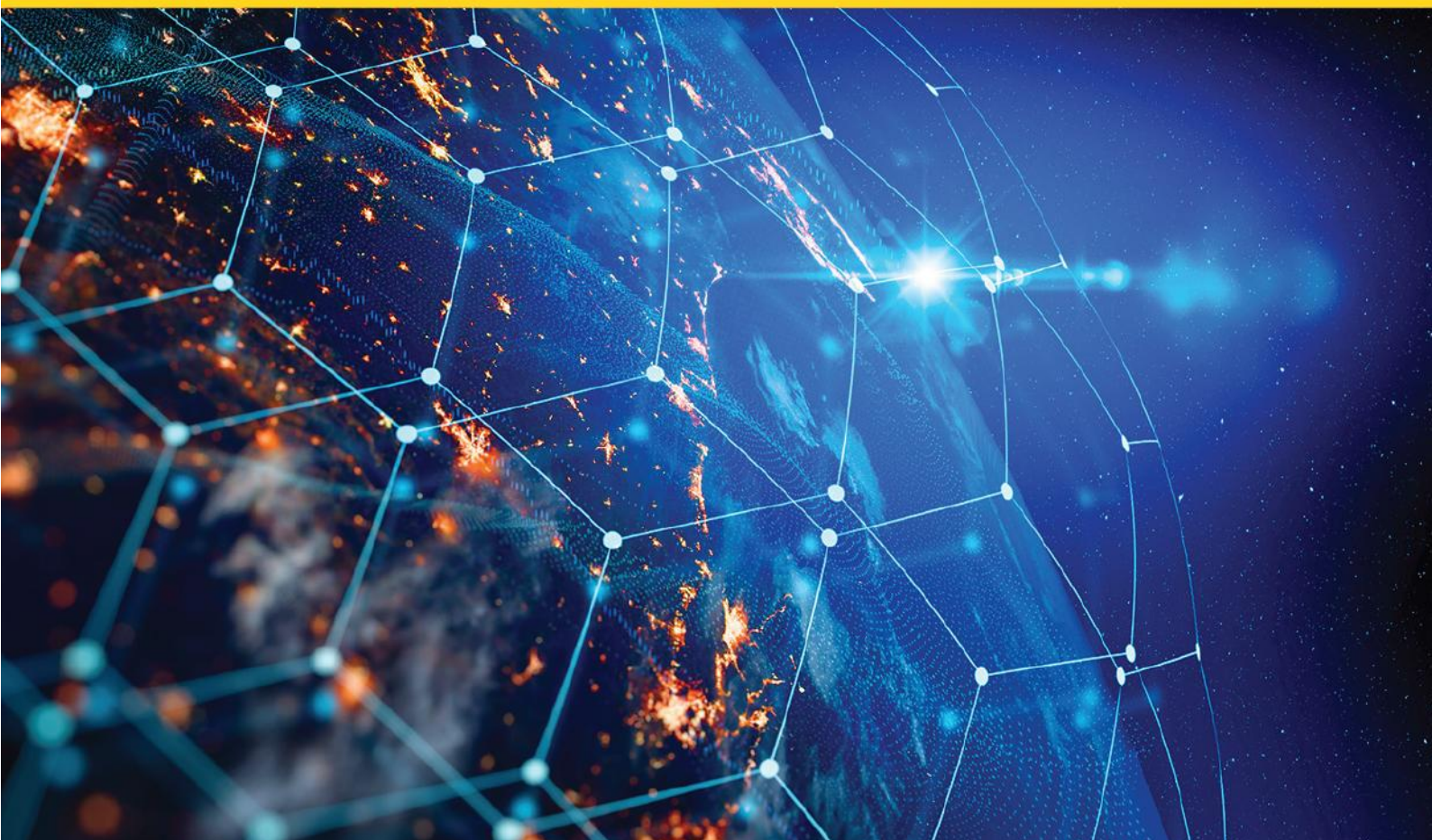

Navigating economic challenges: Türkiye's economy in 2025

Szabolcs Veres

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Csaba Moldicz

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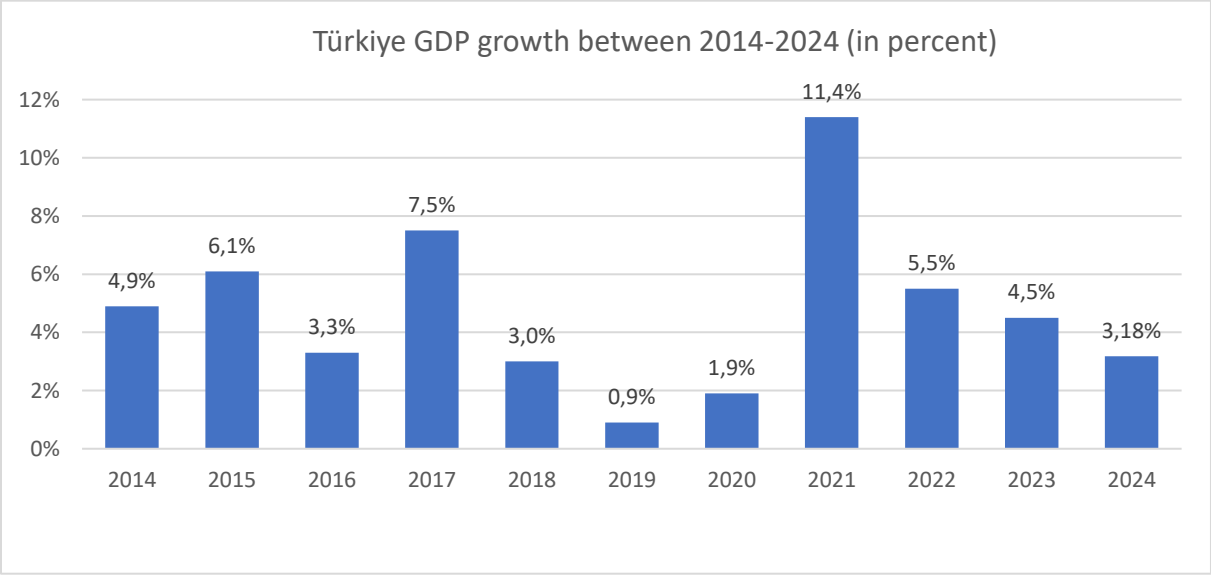
Abstract

Türkiye, a country connecting Asia and Europe, boasts a population of over 85.5 million and a GDP of over USD 1 trillion. Notwithstanding the challenges posed by elevated inflation rates, a depreciating currency, and political turbulence, the government is implementing proactive measures to restore economic stability. Türkiye's economy is currently undergoing a period of slower growth, with a decline in GDP growth from 5.1 percent in 2023 to 3.2 percent in 2024. The observed deceleration can be attributed primarily to the implementation of monetary policy measures intended to curtail inflation, which surged to 75 percent in May 2024 before declining to 38 percent in March 2025. While private consumption continues to support growth, net exports have weakened. The labor market continues to demonstrate resilience, with an unemployment rate of 8.2 percent in February. However, broader measures of unemployment suggest the presence of more substantial challenges. The most salient factors influencing Türkiye's economic outlook encompass monetary policy, the foreign investment environment, and structural reforms. A prudent monetary policy, structural reforms designed to bolster investor confidence, and strategic planning for long-term growth represent a path for Türkiye to achieve economic transformation and stability within the global economy.

Keywords: Türkiye, economy, growth, GDP, inflation

Introduction

Türkiye forming a bridge between Asia and Europe has a GDP of over USD 1 trillion and a population of over 85.5 million people. Until 2022, GDP growth was rapid at above 5 percent annually and Türkiye was one of the few major economies in the world that continued to expand in 2020 despite the COVID-19 pandemic.



Source: Turkish Statistical Institute data, https://www.tuik.gov.tr/

While services make up the largest part of the economy, with tourism services being particularly

important, Türkiye has a substantial manufacturing sector accounting for over 20 percent of GDP. Automobiles, textiles, refined oil and jewelry are important export items. Agriculture accounts for about 6 percent of GDP. The most important products include cereals, fruit and vegetables.

The country has formed a customs union with the European Union since 1995, but the customs union does not include trade with agricultural products. Accession negotiations stalled in 2016 due to fears in Western countries over migration and rule of law, which situation is unlikely to change in the near future.

In recent years, monetary policy has been extremely loose because of the need for more investment and low interest rates. This in the short term has translated into a strongly weakening lira. Weak currency and extremely highest inflation rates weighed heavily on purchasing power and investors' sentiment.

In addition to high inflation, interest rates and weak currency; rule of law concerns put Türkiye in a tough spot on the international markets in 2024. While the country has undergone a power centralization phase in recent years, the country had large and persistent current account deficits, low international reserves, and large foreign currency liabilities posing a risk of a balance of payments crisis.

Türkiye is now going through one of its most challenging times. Facing increasing external pressures and continuous attempts to bring about political destabilization to the country, the government had acted promptly which is a useful approach for restoring economic stability and social order. ed.

Recent domestic political events in Türkiye and regional developments in the Middle East have shown that the Turkish authorities have a clear understanding of the threat and the ability to react promptly. Türkiye's central bank on Thursday unveiled a raft of measures to counter the economic crisis, including a drastic hike in its one-day interest rate to 46 percent to avoid a run on the lira. At the same time, they sold 50 billion (USD 1.3 billion) lira-worth of short-term bonds that allowed the control of liquidity in the financial markets.

But also, must recognize the capability of the Turkish economy to cope with crises. Despite the lira exchange rate fluctuation and the drop in stock market indices, all the most important figures — exports, industrial production and tourism — are still signaling positive trends in Türkiye.

Political and economic background and its impact

The next analysis will investigate the role of political and economic influence on price behavior. In the spring there were nationwide protests after Ekrem Imamoglu, an opposition figure, was arrested on corruption and public procurement fraud charges.

The number of those arrested protesting the decision has reached 1,100 as per official figures released by the Turkish Ministry of the Interior, which shows social unrest.

With a political crisis boiling over, the Turkish central bank resorted to its emergency toolbox to strengthen the macroeconomy . The bank raised the interest rate on overnight loans to 46 percent, action designed to quickly divert speculative attacks on the lira and minimize short-term volatility.

Also, it held its first auction of 91-day treasuries in 20 years, designed to increase liquidity in the banking system. It also cut the tax on lira deposits in the bank system as well as extending a ban on short sales of Turkish equities and loosening the requirements for lender's reserves. The actions represent the government's efforts to stop capital from leaving the country and to prevent further falls in the stock market.

The political scandal was met with an immediate response by the markets- with large enough volume of selling of assets. The BIST 100 index[1] plunged while prices of government securities in the secondary market moved lower, raising yields. Amid the selling spree of the Turkish lira against maincurrencies, driven primarily by currency speculators, the currency weakened rapidly. This comes on top of Turkish reputation as a high political risk country, and in consequence the additional panic has escalated in Turkish sovereign debt. The risk premium in investments in Turkish assets rose dramatically, limiting inflow of foreign capital.

There is a gradual systemic devaluation of the Turkish lira, and this is due to a number of essential reasons:

- The implementation of an aggressive monetary policy is a key factor in this dynamic. In recent years, Türkiye has pursued an economic policy that deviates from conventional practices by implementing measures intended to stimulate economic growth, despite the occurrence of rising inflation. This policy has involved a significant reduction in key interest rates. This has exacerbated the inflationary spiral and triggered massive capital flight.
- The nation is experiencing a chronic current account deficit. The Turkish economy continues to exhibit a high trade deficit, exerting pressure on the currency market. The

[1] The BIST 100 is widely regarded as the most significant Turkish stock index. The acronym BIST is an abbreviation for Borsa Istanbul, which is the Turkish term for the Istanbul Stock Exchange. The BIST 100 index is a valuable tool for analyzing the share prices of the 100 largest Turkish companies that are listed on the Istanbul Stock Exchange. The index's base value was initially set at 100 points. Subsequently, on December 27, 1996, the index underwent a recalibration, with the 1986 base value being divided by 100, thereby establishing a new baseline of 1 point. A subsequent recalibration occurred on July 27, 2020, when the index was once again divided by 100, resulting in a new baseline of 0.01 points. The index is calculated in Turkish lira.

demand for energy and other imports has led to an increase in the demand for foreign currency, thereby weakening the lira.

- Waning confidence of Western investors is making headache for Turkish politicians. This dynamic shift was precipitated by a series of political decisions, notably the authorities' intervention in the operations of the central bank and mounting pressure on autonomous institutions. Consequently, Western investors initiated a substantial withdrawal of their capital from Türkiye. The downgrading of sovereign bonds by leading credit rating agencies further exacerbated the situation.

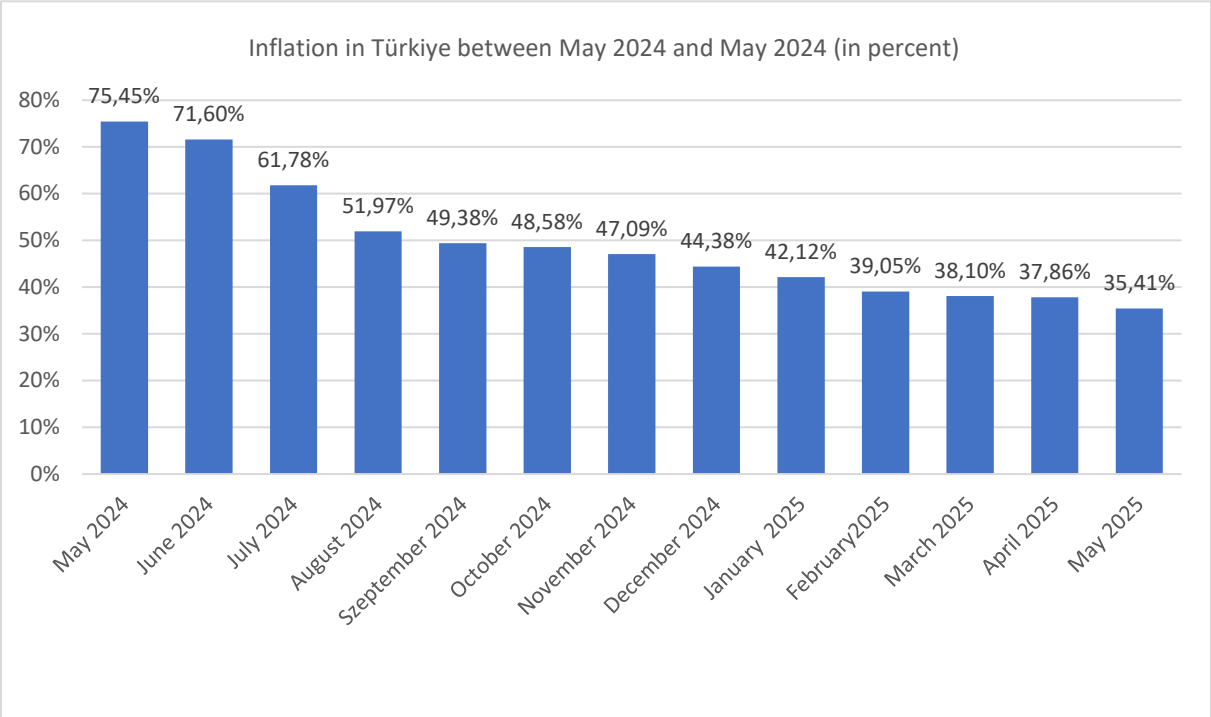
Meanwhile, economists have warned that over-tightening of monetary policy may lead to a stall in domestic consumption and lead to economic deceleration. The Turkish economy is highly prone to quick "dollarization" as the struggles of the lira has been going on for a long time already and consumers and companies accustomed themselves to this situation. The gradual use of the U.S. dollar by the population and business community as the official currency held for savings and exchanged for goods and services increases the country's dependence on the U.S. dollar.

The political turmoil that has followed Imamoğlu's detention has also damaged Türkiye's attempts to improve ties with the European Union. The European partners have deemed in the past the principles of rule of law and political stability as fundamental prerequisites for starting the dialogue on integration. Recent developments have intensified Western partners' worries about the transparency of the Turkish judiciary and democratic institutions.

As the political front in Türkiye inches toward the edge of economic importance, analysts have raised the alarm over the potential for further escalation in a rolling political crisis to create larger systemic risk. In the long-run, the corruption crisis and erosion of the investment atmosphere and the trust in the national currency may be a serious threat to the Turkish economy and financial system's stability.

Inflation

The worst is over for the Turkish economy, said earlier Mehmet Şimşek, the country's minister of finance and treasury. But analysts say these upbeat words conceal a more complicated and nuanced reality. May 2025 inflation rate amounted to 35.4 percent in Türkiye on official figures, the lowest figure of the past year. Besides, the Turkish Ministry of Finance says that inflation may drop to 24 percent by the end of 2025, in line with the target of the Turkish Central Bank.



Source: https://tradingeconomics.com/

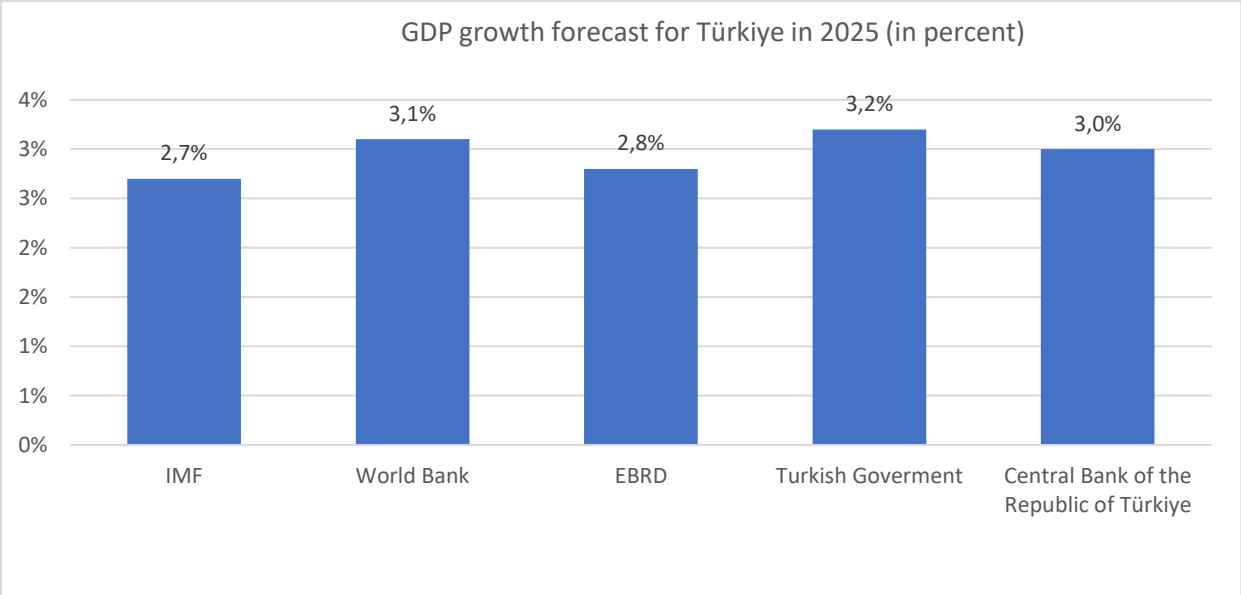
The decrease in inflation can largely be explained by a contractionary monetary policy being conducted since mid-2023. The Turkish Central Bank in the framework of a stabilization policy, raised the basic rate to 50 percent, reduced the money supply and limited public spending. This has led to a drop in demand, a reduction in excess demand and, as a result, some moderation in price rises.

While doing so, it is necessary to realize that Türkiye's inflation rate remains one of the highest among OECD countries. Also, the 35 percent rate can be no more than a success when contrasted to the trauma before it, during which inflation was upwards of 60-80 percent. Still, inflation stabilization has begun in Türkiye, albeit remains incomplete.

GDP and growth structure

According to Turkish government data, the country's economy exhibited growth of 2 percent in the first quarter of 2025 and 3.2 percent in 2025 as a whole. These indicators, while moderate in nature, are indicative of a positive trend. The International Monetary Fund (IMF) forecasts growth of 2.7 percent, while experts at the Turkish Central Bank predict approximately 3 percent.

But the Turkish economy is forecast to grow by 3.1 percent in 2025, according to the World Bank. Other forecasts range from 2.8 percent to 3.5 percent. The European Bank for Reconstruction and Development (EBRD) has revised its forecast down to 2.8 percent due to lower domestic and external demand and tighter monetary policy. The World Bank has also raised its forecast from 2.6 percent to 3.1 percent.



Source: own compilation based on the IMF, Moody's, World Bank, EBRD, Turkish Government and Central Bank of the Republic of Türkiye data

The primary challenge confronting the Turkish economy pertains to the quality of growth. In recent years, the economy has relied primarily on domestic consumption, which has been stimulated by inexpensive loans and one-time social payments. However, following the change of direction in 2023, the focus has shifted to investment and exports. This shift is predicated on the conditions of time and investor confidence, both of which are not yet fully in place.

Concurrently, forecasts indicate that the Turkish economy is expected to experience a slowdown in the second quarter of 2025, due to global and domestic factors. These factors include global uncertainty (declining demand from the European Union, instability in energy markets, and tensions in the Middle East, among others), as well as tight Turkish fiscal and monetary policy and a decline in the real income of the Turkish population.

Internal problems and the reaction of financial markets

The political uncertainty in Türkiye in the spring of 2025 had an immediate impact on the value of the Turkish lira, which slumped 2 percent against the dollar, indicating an escalation of devaluation trends. The gigantic othering of Turkish state bonds, which put the country's financial system under intense pressure, required an emergency corporate action by both the Central Bank of Republic Türkiye and the Turkish Capital Markets Board and to inhibit that panic.

The National Bank raised the one-day rate from 44 percent to 46 percent, which allowed stabilizing speculative pressure on the national currency. The Central Bank of Republic Türkiye, meanwhile, took the decision to stop holding weekly credit auctions, by which the Central Bank of Republic Türkiye usually manages the amount of cash in the economy. This

created a short-term liquidity squeeze in the system and thus contained inflationary perils.

Macroeconomic stability is beginning to reveal itself amidst the worsening of the investment climate and the rise in political risks. While the current account deficit has steadied at below 4 percent of GDP in the past three months, according to JPMorgan data, it is a silver lining among this volatility.

The goal: stability similar to the “golden years”

The objective of the Turkish government at present is to get the economy back to the model of the "Golden Years" of 2003-2012, in which the country brought major changes. During that period Türkiye’s average GDP growth was 5.7 percent, and inflation stood at around 9 percent. Türkiye was known as the "rising star" of emerging markets at the time, and investors had poured money into its economy in sectors such as industry, tourism, and real estate.

But today it's a lot more complicated. The geopolitical situation in the region is volatile, some period of unpredictability of actions of the Turkish authorities has affected to a certain extend the confidence of the investors, the internal political system is centralized in one decision-making center, which also brings instability concerns for the future.

Stabilization, but not definitive

The Turkish economy has started to normalize with a decrease in inflation, stability in the lira and an end to capital flows. At the same time, 57 percent of the Turkish people is in debt. The top sources of debt are credit cards (43 percent), bank loans (14 percent) and other debts (10 percent). In the Turkish citizens personal debt via loans and credit cards hit a historical peak of 4.28 trillion Turkish lira (some USD 110 billion) in the end of February 2025.

At the same time, Morgan Stanley investment bank released a new report of analysis that shed light at the positive prospects of Turkish economy in the second half of 2025. Turkish central bank's rate hike boosts investor confidence, signaling towards more predictable economic policy, report says Another positive factor is that the euro has been appreciating vs the U.S. dollar, which improves the competitiveness of Turkish exports in the European markets.

Forecasts and scenarios

Türkiye, for its part, has huge economic potential — but that potential can only be realized by following consistent, well-thought-out policy. Restoring investor confidence, stabilizing the exchange rate of the Turkish lira and reestablishing fiscal discipline among priorities of Turkish authorities.

Continued public unrest would prompt further depreciation of the lira. Unfortunately, an acceleration of the downward spiral in the value of the peso, new waves of capital flight, a worsening trade balance or mounting social discontent could exacerbate the devaluation process. On the other hand, the pull of active investment in the real economy, the realization of

export potential, and the implementation of the structural visions of the future could provide the foundations for Türkiye to revert to the path of sustainable growth.

As a result, Turkish policy makers face the key challenge of balancing the need to stabilize the market with the need to support economic activity. The impact of an all-encompassing anti-crisis program in this respect, will be decisive for the economic future of the country.

Although the possibility of recent unrest remains, Türkiye has everything it needs to recover from the crisis. By implementing an adaptive economic system and utilizing the accumulated experience from anti-crisis measures taken in the past, the country has not changed its development direction and continued improvement.

The recent management of the current account deficit at less than 4 percent of GDP is a positive sign, signifying that the national economy still has the space for growth and development. But the impacts of these policies depend to a great extent on the calibration of other policies to address some of the structural imbalances.

The Turkish lira fell 2 percent after Istanbul's mayor Ekrem Imamoglu was detained, a sign that investor pressure is back on the currency. Very rapidly the deteriorating exchange rate is due to two, interconnected reasons: political instability and the lack of investment climate.

The return of confidence in the lira, experts say, requires a return to the basic tenets of classical monetary policy. The institutional independence of the Turkish Central Bank needs to be a critical pillar of the country's overall economic strategy. We should understand that what we need are decisions made on the basis of macroeconomic indicators (and not political reasons), if we do not want the currency market to be chaotic and we want inflation to be in check.

One of the primary problems facing the Turkish economy is the flight of capital. In 2024, the portfolio investments fell by 38 percent, and the foreign direct investment – by 26 percent. This dynamic carries a double risk not only does it threaten growth but also the stability of the banking system.

To breathe new life into investment activity Türkiye must offer direct advantages to the foreign investor by:

- A stable rate of exchange of the domestic currency is essential to the prosperity of a country.
- Long-term investment programs in priority areas are an important tool of a comprehensive development policy.

Türkiye on the road to economic transformation?

A crucial choice between short term stabilization policy and full structural reform is now facing Türkiye. The second course, while more difficult, will enable the country to not only overcome today's problems, but would create conditions for sustainable economic development.

Türkiye in particular has proved itself capable to tackle difficult situations. Following the 2001 economic crisis the country restructured its entire banking system, putting it back on a path to prosperity that earned it the title of the world's fastest growing economy. Türkiye is at a crossroad again and its success will still depend on how willing the authorities are to its implementing calmer reforms.

The lira's fall may not mean an economic round the corner, but instead, that the current economic policy approach needs adjusting. Türkiye is industrially strong, in a strategically favorable position, and has a steady social net. These are solid prerequisites for an economic recovery.

A complex solution is required to effectively address the crisis. Such an approach should be built around an independent monetary policy, as well as structural reforms and social strengthening support for the citizens. For Türkiye, the only way out of the current crisis is not only overcoming the hassle, but stabilizing its place in the global economy by constantly taking calculated steps to ensure that long growth is essential.