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Executive Summary.

This paper provides an insight into the Turkish 2015 economic situation, the stance of the monetary, fiscal policy in the short-run and the medium-run prospects. Different estimates were used, and they all gave the same conclusion about the economic situation of Turkey. The results show that Turkey is in a recession in the business cycle as of 2015 even though there is loose fiscal policy which is sustainable in the medium-run and a loose monetary policy.

- **Supply and Aggregate Demand.**

According to figure 1, the Turkish real Gross Domestic Product (GDP) is below potential output in 2015 and the economy is in a recession in the business cycle. This is illustrated by the negative output gap of -1.1%, -0.3% and -0.1% using the linear trend, HP filter and the Cobb-Douglas production function approach respectively. According to figure 2, the key drivers of economic growth in Turkey from 2011-2015 were capital then labor and the least contributor is total factor productivity (TFP), and it was ranked the 55th country easy to do business with in 2015 (PowerPoint, Reference 1) which reveals that Turkey is not considered business-friendly and that may be one of the reasons that Turkey has slow economic growth. The factors that are favorable to growth include a high TFP which leads to a higher GDP growth. A high TFP increases the standard of living through the growth of output per worker. An increase in capital accumulation is favorable but it is not enough as it will increase growth of output per worker by less than 1-for-1. However, from 1999 to 2014, the average GDP growth of Turkey was 3.4% which was higher than that of South Africa (3.1%) and Brazil (3.1%) but lower than that of Poland (3.6%) and Indonesia (4.9%) as per figure 3. This shows that Turkey is doing relatively well compared to other Emerging Market Economies. Furthermore, it is forecasted that in 2016/7, Turkey will not be able to reach the growth rate target of 5%, on the contrary, it is estimated that it will have a negative growth rate as shown by figure 4.

- **Monetary Policy Stance.**

The 2015 inflation rate in Turkey is 7.7% as shown by figure 5 and that is above the central bank's inflation rate target. The top three key drivers of the inflation rate are housing and non-alcoholic beverages (30%), housing/water/electricity/gas & other fuels (12.1%), and transport (11.4%) as per figure 6. The high inflation rate shows that the cost of living and unemployment rate is increasing, and the real wages are decreasing. Furthermore, on the 4th quarter of 2015, the Central Bank's policy rate (3.1%) (PowerPoint, Reference 2) is lower than the neutral nominal interest rate (10.5%) (PowerPoint, Reference 3) and this indicates that the monetary policy stance is loose. The yield curve on figure 8 is relatively flatter which shows that there is no substantial change in the interest rate across the spectrum of maturities and there is little growth for the year of 2015. Furthermore, with reference to figure 9, by 2016/7, it is estimated that the inflation rate will be 7.2% which is above the 5% inflation rate target. In addition to this, given that the central bank's inflation rate target, setting the nominal policy rate at 10.8% at the end of 2015 (PowerPoint, Reference 4) is not appropriate as this will further increase the inflation through demand-pull inflation as consumers spend more (Öner, 2018).

- **Fiscal Policy Stance.**

According to figure 9, the fiscal impulse is 0.06 and the fiscal stance from the cyclically adjusted primary balance is 1.0 which indicates that the fiscal policy was too loose in 2015. The risks associated with this fiscal policy stance is that it can create a large budget deficit that the government won't be able to sustain, and it will increase the opportunity cost of holding money and will slow down demand. The fiscal impulse over time shows that the fiscal policy was consistent with the business cycle stabilization and is likely to be counter-cyclical. Furthermore, given the trends in expenditure and revenue, it makes economic sense to assume that the government will not meet its primary balance (PB) target of 2.1% in 2016. Being a pessimistic, it seems like the government will achieve a forecasted PB of 1.04 as a percentage of GDP as shown in figure 10. The increasing expenditure as per figure 11 could be difficult to sustain in the medium-run and the government should consider investing in infrastructure for sustainable growth.

- **Fiscal Sustainability.**

The baseline scenario in figure 12 indicates that the general government gross debt to GDP will initially increase and after a few years it is likely to stabilize. The public debt to GDP ratio of 39.4% is acceptable according to the World Bank Standards (Caner et al., 2010) and it makes Turkey less vulnerable to small economic shocks. The level of debt does not appear to be detrimental to economic growth. The decrease in the interest rate differential indicates that less effort is needed to put the public debt ratio on a downward path. In summary, the public debt of the Turkish government is currently considered sustainable and it will be sustainable even in the medium run. Furthermore, as per figure 13, applying stress testing on the assumptions of the baseline scenario indicate that a decrease in the GDP growth rate in 2016/7 is likely to increase the debt to GDP ratio and which will later stabilize from 2018. Furthermore, a notable increase in the domestic and foreign interest rates from 2016-2019 which later remain high will increase the debt to GDP ratio throughout to 2025. A decrease in the primary balance from 2016-2018 is going to increase the debt to GDP ratio but it will later stabilize after the primary balance return to its baseline. The depreciation of the Turkish Lira over three years will also increase the debt to GDP ratio from 2016-9 before it stabilizes.

Risk-Assessment.

The inflation rate expectation which is above the target is an economic risk that may put pressure in the exchange rate to depreciate. Moreover, the debt to GDP ratio will rise if there is negative output growth or an increase in domestic interest rate and that may mean a rise in the cost of servicing the government debt (Blanchard and Johnson, 2014).