Box 2.1

Global Economic Prospects and External Demand Outlook

As of mid-February, when the epidemic started to spread all over the world, workplaces and factories were partially or completely closed, education was interrupted, domestic and international travel was restricted, and work-from-home and quarantine practices were introduced. The natural results of these measures, which can be summarized as social isolation, have been a large supply shock in the global economy as of March and a rapid contraction in demand.

The negative effects of the supply and demand shock caused by the pandemic on economic growth was first observed in the PMI data, which declined rapidly, particularly in developed countries. Compared to 2009, which was the peak of the Global Financial Crisis (GFC) between 2007-2009 and when the global economy contracted for the first time after the World War II, the manufacturing PMI data for March remained above the GFC period level despite some significant decline. However, in the services sector, which was most severely hit by the social isolation measures, PMI indicators declined to historic lows.

As illustrated in Chart 1, the composite PMI indicators comprised of the sum of the PMI data of two main sectors of the economy -manufacturing industry and services- and the quarterly GDP growth rates are highly interrelated. The composite PMI data for the first quarter of the year suggests that the global economy will contract in the said period, based on both developed and developing countries.[1]

Chart 1.a: Global PMI and Growth

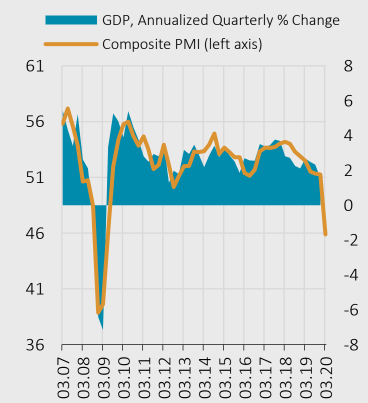


Chart 1.b: Developed Countries PMI and Growth

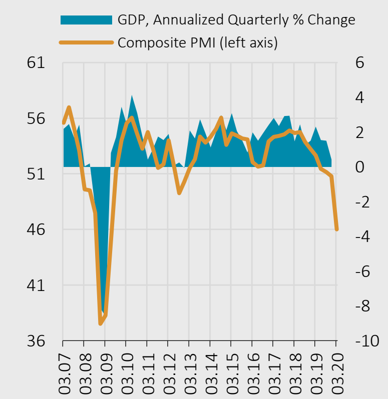
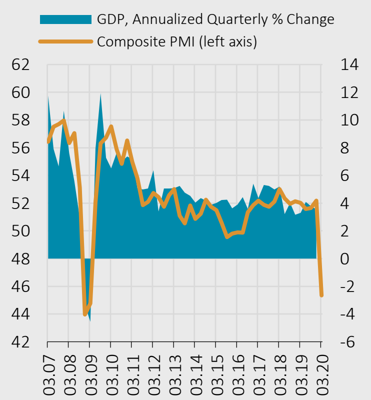


Chart 1.c: Developing Countries PMI and Growth



Source: Bloomberg, Markit.

Note: Growth data was obtained by annualizing the growth rates of seasonally adjusted GDP data compared to the previous quarter. The composite PMI indicators are derived from sum of the seasonally adjusted manufacturing PMI and services PMI data.

In light of these evaluations, it is estimated that both developed and developing countries will shrink simultaneously in 2020, and the global economic activity will decline much more sharply compared to the GFC period. Actually, many international economic organizations have drastically cut down their growth projections for 2020 as a consequence of the disease becoming a pandemic (Table 2.1.1). Although OECD stated that it was difficult to measure the exact magnitude of the impact of shutdowns imposed in the framework of quarantine

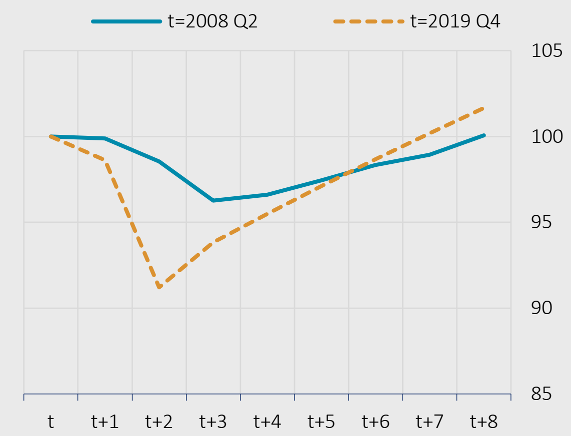
[1] GFC caused an economic contraction mainly in developed countries, and developing countries displayed a more positive growth outlook, relatively. Economic growth declined simultaneously in developed and developing countries in the last quarter of 2008, the peak of the GFC, and in the first quarter of 2009.

measures on the global economic activity, it estimated that the shutdowns would cause a decline between 20-25% in production and 30% in consumer expenditures, and its reflection on annual growth will depend on the implementation period of these measures.[2] These estimates indicate that contraction in the global economy and global commodity trade will be much higher in 2020 compared to the GFC.

According to expert opinion and the experience of China that was first hit by the pandemic, the outbreak is expected to be taken under control in the third quarter of the year, and more effective treatment methods will be available as of October. Therefore, it is estimated that the global economy will gradually return to normal in the second half of the year, and the growth rate will be positive in the last quarter after the contraction in the first three quarters. However, it should be borne in mind that uncertainty about these estimates is high due to many factors such as the size and duration of business shutdowns, the decrease in demand for sectoral goods and services, and the timing and effectiveness of the fiscal and monetary policy measures taken.

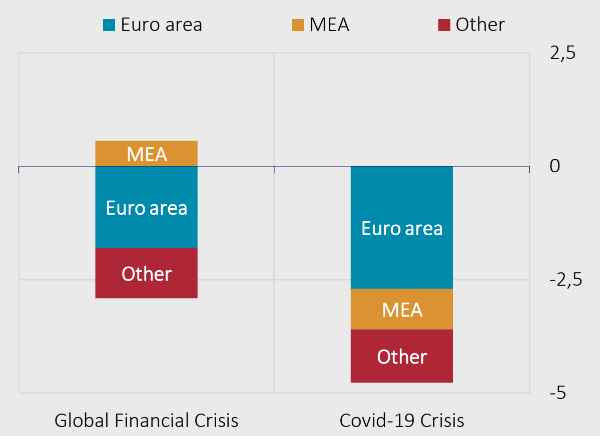
In 2020, the expected slowdown in global economic growth and global trade will also be determinant on Turkey's external demand (Chart 2.a). The countries that have been most severely affected by the epidemic have been the euro area countries, which are Turkey's largest trading partners. According to the April estimates of the IMF, in 2020, economic contraction in the euro area is expected to be much deeper than the average of the developed countries (Table 2.1.1). In 2020, the annual growth rate of the export-weighted global production index, which has been updated with these estimates, suggests that external demand will contract by 4.8%. Hence, forecasts of international organizations imply a slowdown in Turkey's external demand more severe than the 3% decline projected for the global economy. When the impact area of the epidemic and the current levels in oil prices are evaluated, it is projected that our export markets such as the Middle East, Africa and Russia will also remain far from being compensatory in the upcoming period (Chart 2.b). When all these evaluations are taken into account, it can be suggested that the adverse impact of the epidemic disease on Turkey's external demand may be deeper than the global growth outlook implies. Nevertheless, the deteriorated external demand is expected to improve rapidly once the pandemic is taken under control and the global economy starts growing again.

Chart 2.a: Export-Weighted Global Production Index (t=100)



Source: Bloomberg, CBRT.
Note: t, t+1, ..., t+8 indicate trimesters.

Chart 2.b: Contributions to External Demand Contraction (% Point)



Source: Bloomberg, CBRT.
Note: MEA group represents Middle Eastern and African countries.

[2] OECD (2020), "Evaluating the initial impact of COVID-19 containment measures on economic activity," Paris, Updated April 14, 2020. https://read.oecd-ilibrary.org/view/?ref=126_126496-evgsi2gmqj&title=Evaluating_the_initial_impact_of_COVID-19_containment_measures _on_ economic_activity.