Creating Opportunities

Turkey: Growth slowing but keeping a solid pace

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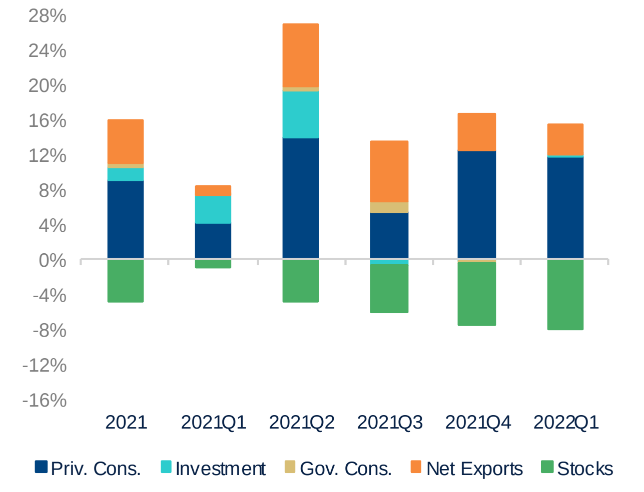
Turkish economy grew by 7.3% y/y in 1Q22 parallel to market expectation (7.2%) but slightly lower than our forecast (7.7%). Strong private consumption and exports remained to be the main drivers on the yearly growth rate. The quarterly growth rate indeed decelerated to 1.2%, the lowest level in the last 5 quarters. Based on high frequency indicators and our big data information, GDP growth continues to decelerate but to a much lower extent with near 1% q/q growth rate in 2Q22, which corresponds to near 6.5-7% y/y. Looking ahead, negative effects of Russia's invasion in Ukraine and its spill-over effects from sanctions are yet to be seen much more clearly on the external demand. However, given recent high momentum in activity and clear commitment of authorities to maintain loose policies, risks become tilted significantly to the upside on our prudent 2022 GDP growth forecast of 2.5%.

Growth mainly supported by consumption and exports

In 1Q22, domestic demand remained solid mainly due to private consumption (19.5% y/y), whereas contribution from investment was limited (1.1% y/y) in 1Q22. The quarterly contraction in consumption (-2.8% q/q) was not strong to offset its continuing high momentum so its contribution to annual growth remained high. On the investment side, the quarterly contraction of the previous two quarters gave way to a positive growth rate (2% q/q). However, the contraction in construction (-9.8% y/y) resulted in a much lower overall investment growth despite the fact that machinery and equipment investment still grew 10.5% y/y. Also, government consumption remained weak by increasing only 0.9% y/y. All in all, the main driver on domestic demand stayed as private consumption. On the external side, exports proved to be solid (16.8% yoy), whereas imports also grew moderately by 2.3% y/y. Hence, the contribution from net exports to annual GDP growth slightly slowed down to 3.5pp (vs 4.2pp in 4Q21). Led by strong consumption and exports, inventories continued to be depleted (-8.1pp from yearly growth) similar to the previous five quarters, the longest period in the current series.

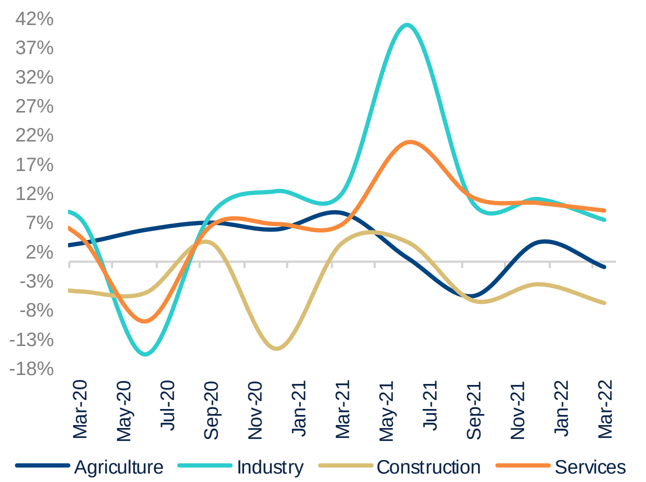
On the sectorial side, main contributors were services and industry since the contribution of services in general terms increased further to 6.1pp, mainly backed by trade, transportation and accommodation (3.3pp) and financial activities (1.2pp), which was followed by industry (1.6pp). On the other hand, agriculture contribution was almost negligible and the construction sector continued to contract (-0.4pp).

Figure 1. **Contributions to GDP Growth (pp, annual)**



Source: Garanti BBVA Research, Turkstat

Figure 2. **Sectorial GDP Growth** (YoY)

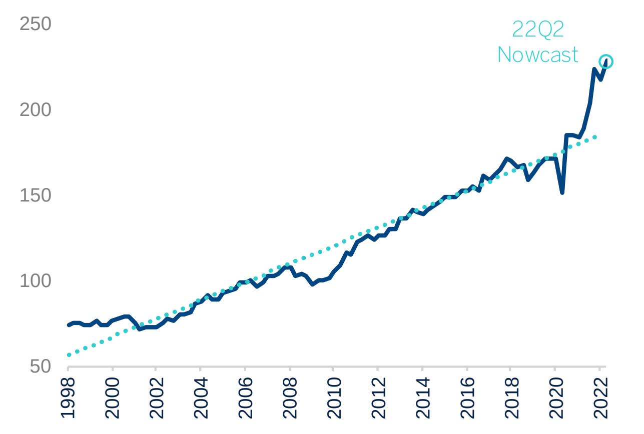


Source: Garanti BBVA Research, Turkstat

No clear correction in consumption while investment remains sluggish

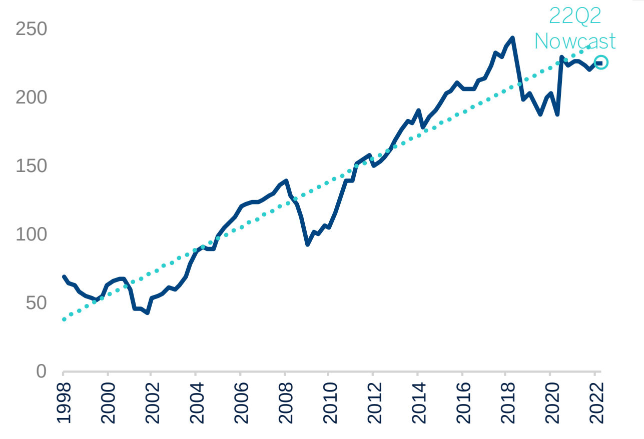
Leading indicators such as our high-frequency proxies, electricity production, confidence indices, manufacturing capacity utilization and PMI still signal solid activity in 2Q22 as our monthly GDP indicator nowcasts an annual GDP growth rate of 6.8% (37% of info) in May. On the expenditure side, our demand subcomponents signal that investment remains sluggish in 2Q22 after a very slight pick-up in the previous quarter, while private consumption stays much stronger. On the consumption side, larger negative real interest rates maintain the brought forward demand due to deteriorating inflation expectations and continue to support the significant positive gap in consumption (Figure 3). Strong consumption strengthens the pass-thru impact on already elevated consumer prices due to exchange rate depreciation and stronger cost-push factors. Since inventories have still been depleted, the pass thru from PPI to CPI should be expected to push up prices further. So, this finally creates a negative loop. In the case of investment, the correction we have been observing with the help of the pandemic has been short-lived and the negative gap relative to its trend could not be recovered despite loose economic policies in recent years (Figure 4). Although the current strong momentum in commercial loans is supportive, increased uncertainty stemming from both internal and external conditions put downside risks on investment and might prevent it from reaching the pre-crisis trend level of 2018. Therefore, this slow pace of capital accumulation may reduce long-term potential growth going forward. Net exports, on the other hand, seem to have increased their contribution to growth on the back of solid exports and some normalization in imports. Better than expected tourism revenues and flexibly differentiated nature of Turkish exports help to absorb negative pressure so far from the war.

Figure 3. **Private Consumption (SCA vs. Trend)**



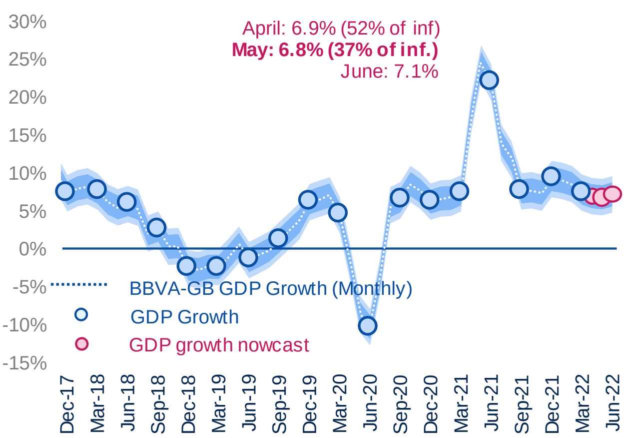
Source: Garanti BBVA Research, Turkstat

Figure 4. **Investment (SCA vs. Trend)**



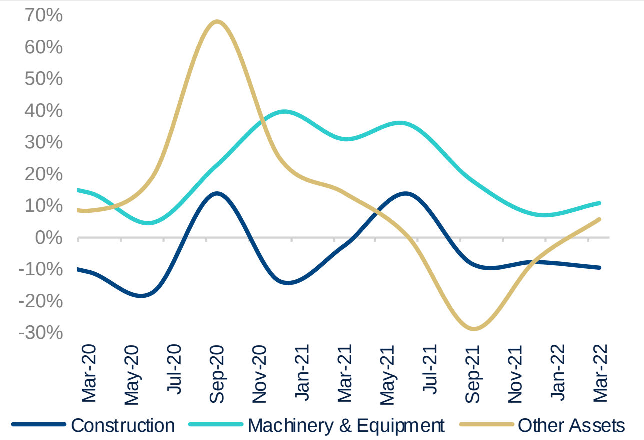
Source: Garanti BBVA Research, Turkstat

Figure 5. **Garanti BBVA Research Monthly GDP Indicator** (% yoy, 3-month moving avg.)



Source: Garanti BBVA Research, Turkstat (GBTRGDPY Index in BBG)

Figure 6. **Gross Fixed Capital Formation** (YoY)

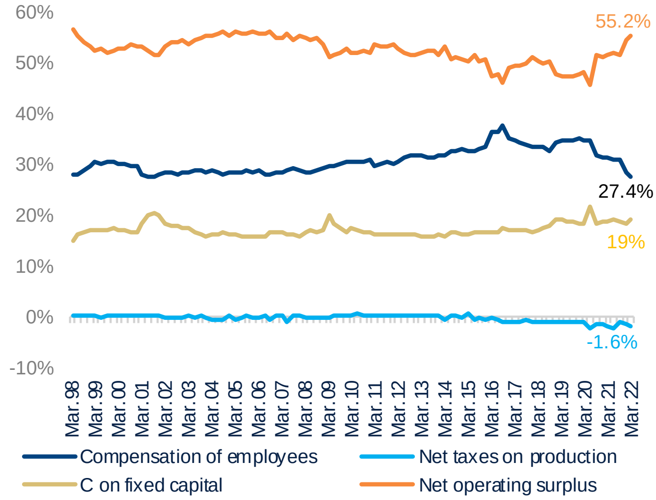


Source: Garanti BBVA Research, Turkstat

Worst compensation of employees since 2001 financial crisis

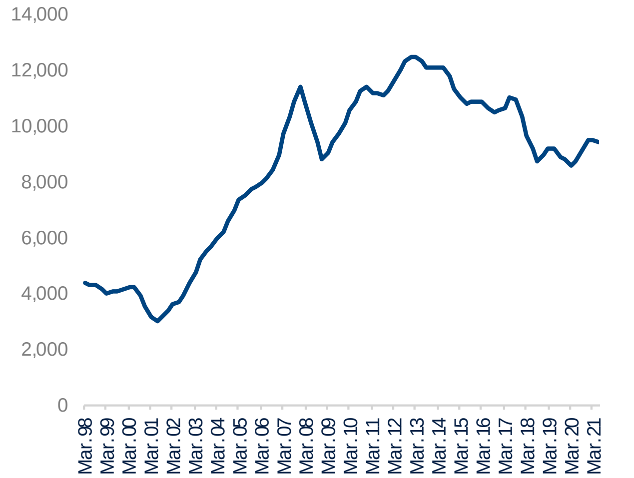
In order to assess the quality of the recent high momentum in activity, it is also important to check how the welfare is distributed by means of the income channel. As seen in figure 7, the share of wages in gross value added (GVA) continued to decline significantly to 27% in the seasonal adjusted series, the lowest level since 2001 financial crisis, which had experienced a peak of 37.5% in 3Q16. In contrast, the share of net operating surplus (net profit from capital) rose to 55%. Besides, per capita income stood at US$ 9,363 (figure 8), which has not been changing much since 2018 currency shock despite the positive differentiation of the Turkish economy pandemic onwards. So, although Turkey remains to keep one of the highest growth rates in G20, the welfare is not evenly distributed instead the recent jump benefited more the companies in relative terms, as a reaction to increasing cost-push factors. Income transfer in favor of the corporate sector becomes much clearer since 3Q20.

Figure 7. **Shares in SA Gross Value Added (%)**



Source: Garanti BBVA Research, Turkstat

Figure 8. **Per Capita Income (US$)**

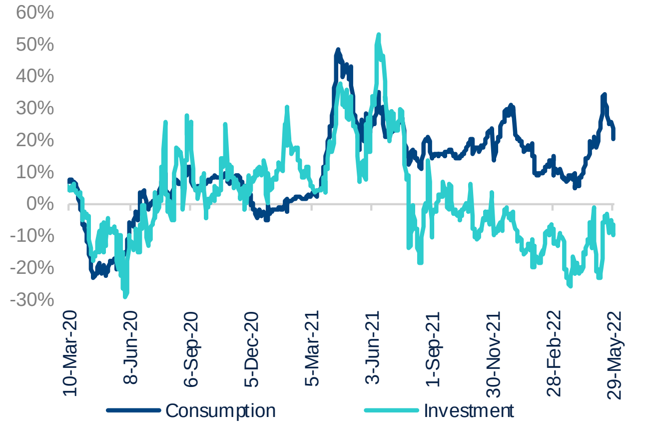


Source: Garanti BBVA Research, Turkstat

Risks on growth tilted to the upside

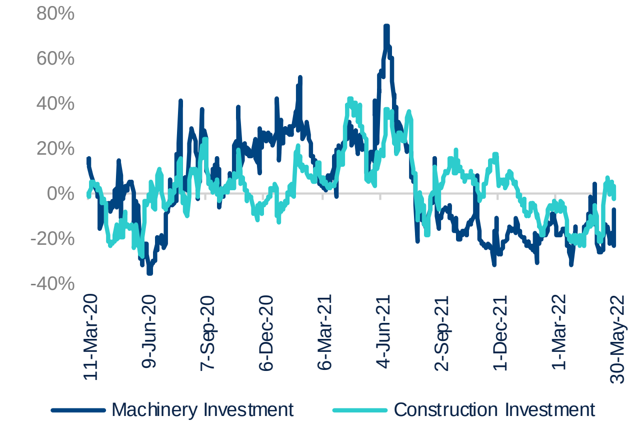
Current stress and uncertainty in financial markets and their potential impact on global demand are clear downside risks on the near term growth outlook. Nonetheless, the expansionary bias of the government, recent stimulus in credits and post-pandemic positive effects help absorb those negative factors and maintain relatively a solid pace as our GDP nowcasts already figure out. Therefore, risks become tilted significantly to the upside on our prudent 2022 GDP growth forecast of 2.5%. Though, its welfare impact continues to be unevenly distributed, particularly in favor of the corporate sector, which will keep threatening both price and financial stability, in our view.

Figure 9. **BBVA Big Data Domestic Demand Indicators** (28-day yoy real changes)



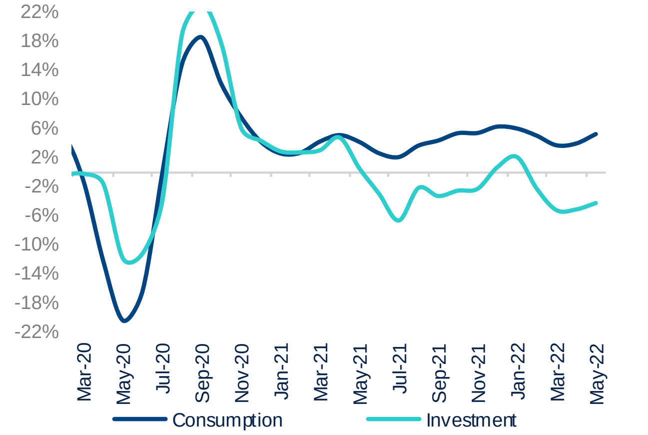
Source: Garanti BBVA Research, Turkstat

Figure 10. **BBVA Big Data Investment Demand Indicators** (28-day yoy real changes)



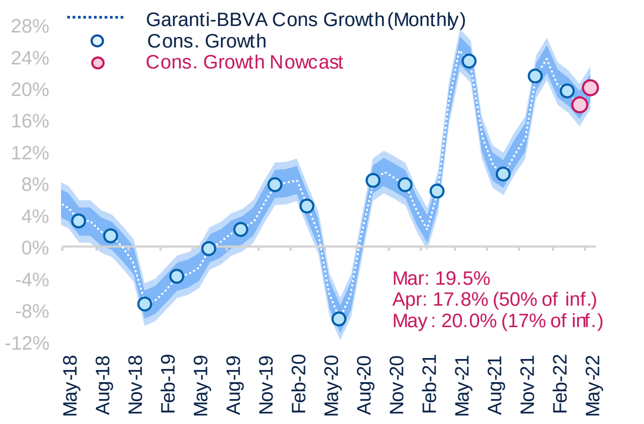
Source: Garanti BBVA Research, Turkstat

Figure 11. **BBVA Big Data Domestic Demand Indicators** (3m q/q changes)



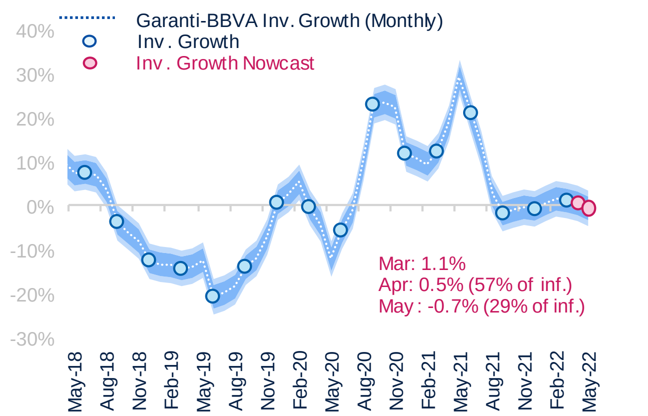
Source: Garanti BBVA Research, Turkstat

Figure 12. **BBVA Monthly Consumption Nowcast** (3m yoy)



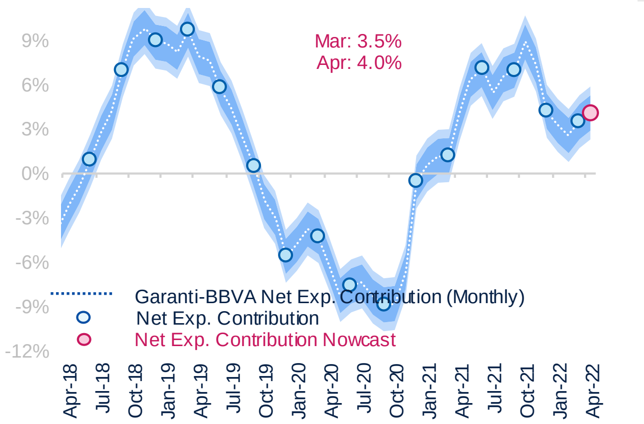
Source: Garanti BBVA Research, GBTRCGDPY Index in Bloomberg

Figure 13. **BBVA Monthly Investment Nowcast** (3m yoy)



Source: Garanti BBVA Research, GBTRIGDPY Index in Bloomberg

Figure 14. **BBVA Monthly Net Exports Nowcast** (cont. pp)



Source: Garanti BBVA Research, GBTRXGDPY and GBTRMGDPY in Bloomberg

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