Türkiye: GDP grew by 7.5% in 1H22

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Turkish economy grew by 7.6% y/y in 2Q22 parallel to expectations (7.4% market consensus, 7.8% BBVA Research). Hence, economic activity grew by 7.5% y/y in the first half of 2022. The main drivers of this strong pace remained to be private consumption and net exports, while investment demand stayed sluggish. In quarterly terms, GDP growth rate accelerated to 2.1% up from 0.7% of the first quarter. Based on high frequency indicators and our big data information, GDP growth started to slow-down significantly to slightly below 0% q/q, which corresponds to near 3.4% y/y growth as of August (with 27% of information). The downward impact on exports from expected deceleration in Eurozone and negative spill-over effects from faster than expected monetary policy tightening in advanced economies could exert downside risks on activity in the coming months. However, given the strong pace in the first half of the year and authorities' bias to maintain loose policies, we maintain our 2022 GDP growth forecast of 5%.

Aggregate demand supported by private consumption and net exports in 2Q22

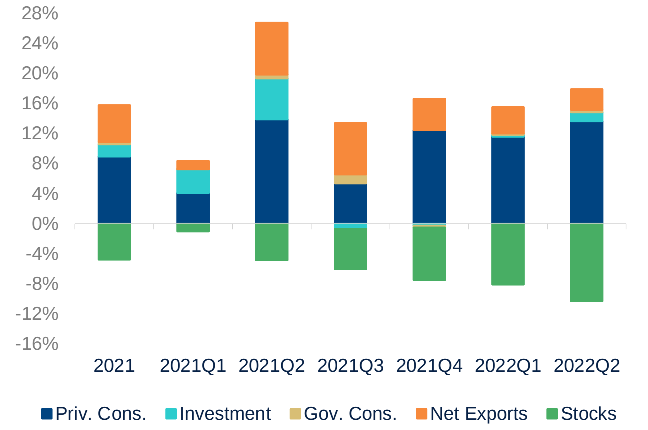
Domestic demand remained strong mainly due to private consumption (22.5% y/y), whereas contribution from investment was limited (4.7% y/y) in 2Q. The quarterly increase in consumption (3.9% q/q) was robust with the highest contribution to annual GDP growth, reflecting solid employment gains, negative real borrowing costs and high inflation expectations. In contrast, investment declined by 1.3% q/q, despite the continued growth in machinery and equipment. This could reflect hesitation to invest in longer-term projects on the back of elevated uncertainty while taking advantage of cheap borrowing. Government consumption also gained momentum on both wages and goods and services purchases, particularly in defense industry, expanding 1.1% q/q after contracting in the previous two quarters, in order to maintain countercyclical policies. On the external side, exports remained solid (16.4% y/y), whereas growth in imports also accelerated (5.8% y/y) compared to the previous quarter, resulting in a similar net exports contribution of 2.7pp (vs 3.0pp in 1Q22) to annual GDP growth. Although sharp foreign exchange rate depreciation might be supporting exports despite lower global growth, the ongoing increase in imports confirms that both exports and imports are highly interrelated and it will be impossible to reduce imports through endless exchange rate weakness, which comes at an astonishing cost in terms of near record high inflation. As a result of solid demand on consumption and exports, inventories continued to be depleted (-10.3pp from yearly growth), similar to the previous six quarters and marking the highest long-lasting depletion of all time.

On the sectorial side, the main contributors to annual GDP growth were services and industry. The contribution of overall services increased further to 6.7pp, mainly backed by trade, transportation and accommodation (4.2pp) and financial activities (1.3pp), followed by the industrial sector (1.7pp). While agriculture's downward contribution to growth was limited at -0.1pp, construction sector continued to contract (-0.7pp) slightly faster compared to the previous quarter.

Inventories to be depleted on much higher demand than supply

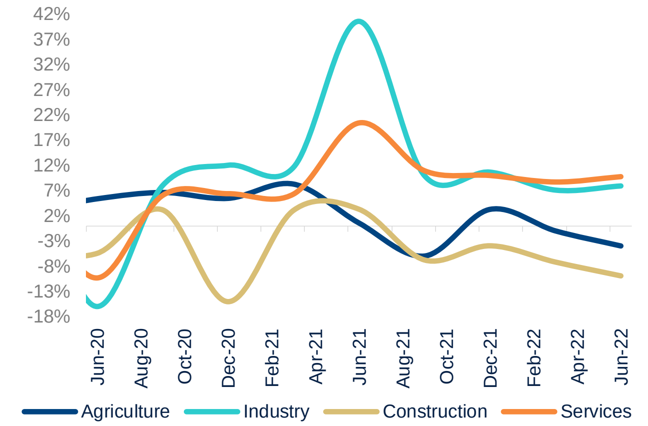
Stocks continued to decline in the last 7 quarters, reaching the historically highest negative contribution to GDP in 2Q22, as demand remained stronger than supply (Figure 3). According to our August nowcasts on GDP sub-components, private consumption stayed robust by growing 15.7% y/y, while investment continued weakening to 1.8% y/y contraction. Meanwhile, the contribution of net exports to GDP growth started to retreat compared to previous quarters, despite a strong tourism season with 1.8pp. All in all, we estimate that aggregate demand will remain stronger than supply, implying further depletion of inventories in 3Q22 as well (Figure 4 and Figure 5).

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



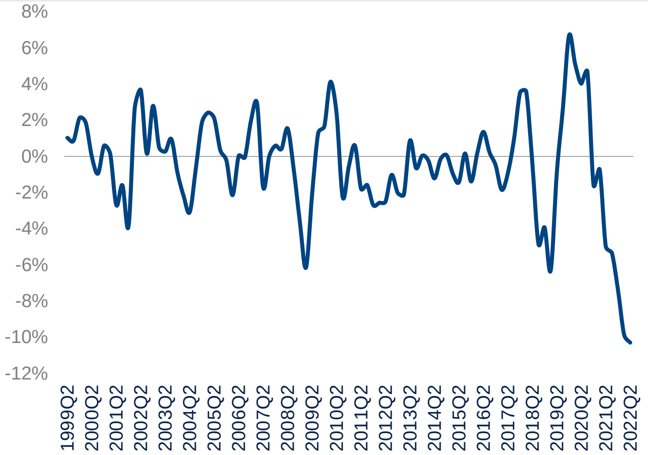
Source: Garanti BBVA Research, Turkstat

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



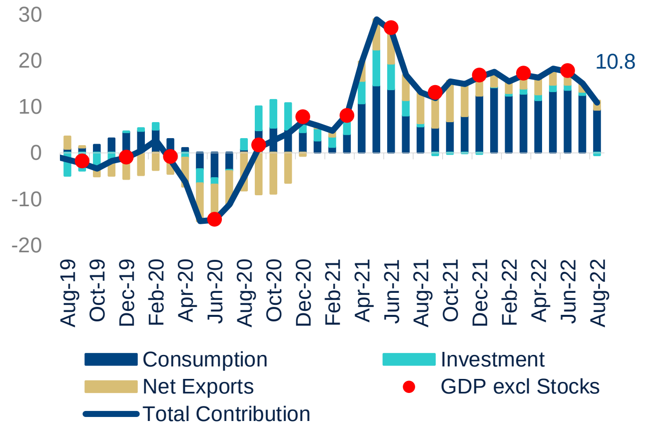
Source: Garanti BBVA Research, Turkstat

Figure 3. **Annual Contribution of Stocks to GDP**



Source: Garanti BBVA Research, Turkstat

Figure 4. **Nowcast Contributions to GDP (pp)**

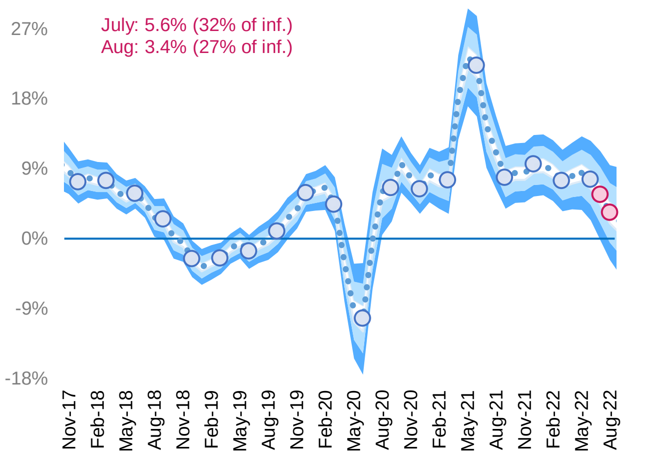


Source: Garanti BBVA Research, Turkstat

Despite robust demand and supportive economic policies, aggregate supply has been lagging behind demand for a long time. The rapid correction on the production side (-0.5% qoq in 3Q22) may point to increased uncertainties and higher costs of inputs, due to both high inflation and deterioration of companies' cash flows. These trends could reflect the negative impact of restrictive commercial credit policies for certain sectors. In any case, these trends confirm that loose economic policies have not only failed to achieve the objective of boosting supply to reduce inflation but that it has boosted demand significantly above potential. Therefore, this framework cannot be sustained indefinitely without further pressures on prices and the exchange rate and implies that a much faster adjustment in aggregate demand will be finally needed.

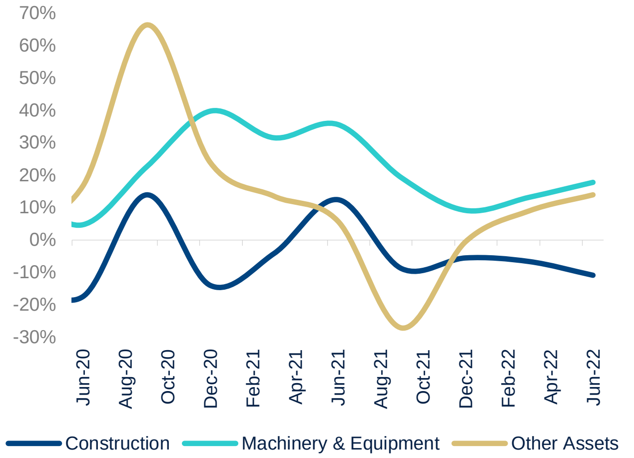
Recent policies to curb down commercial lending and expected deceleration in exports on the back of the slow-down in external demand, particularly European economies, might reduce aggregate demand in the near future. However, the slow adjustment so far stemming from extremely low real interest rates and deteriorated expectations would still keep inflationary pressures on the upside. On top of that, slower adjustment in domestic demand accompanied with tightening external financial conditions and the expected decline in export revenues would increase the pressure on exchange rate, which might eventually worsen the inflation outlook, thereby strengthening the negative loop in terms of expectations.

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



Source: Garanti BBVA Research, Turkstat

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

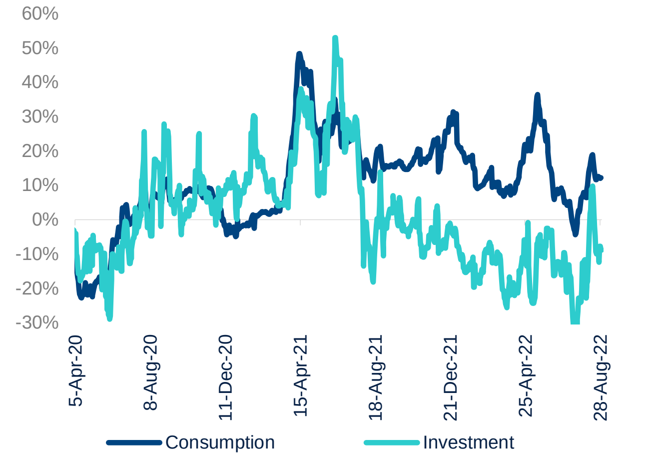


Source: Garanti BBVA Research, Turkstat

Short-term risks remained balanced but tilted to the downside for 2023

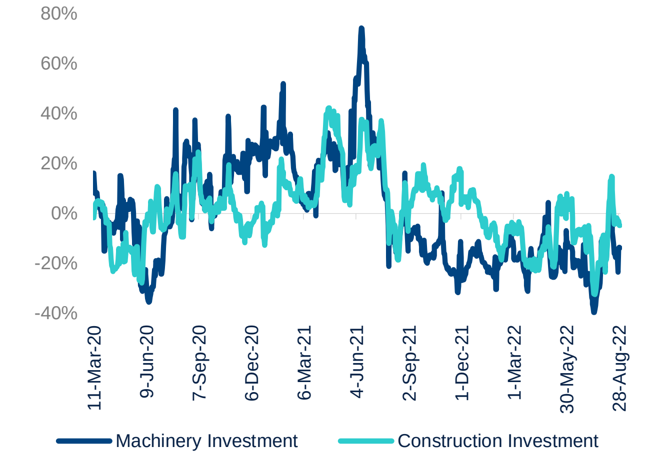
Tighter external financial conditions and negative impacts of the regional conflict with Russia might reinforce downside risks on growth in the coming period. However, strong momentum, an expansionary bias ahead of the elections, and still extremely low real interest rates could offset the downside factors in the short term. Hence, we maintain our 5% growth for 2022. However, the downside risks on growth in 2023 are increasing since the expected correction, which is being delayed, will be larger the longer the current expansion continues.

Figure 7. **BBVA Big Data Domestic Demand Indicators** (28-day yoy real changes)



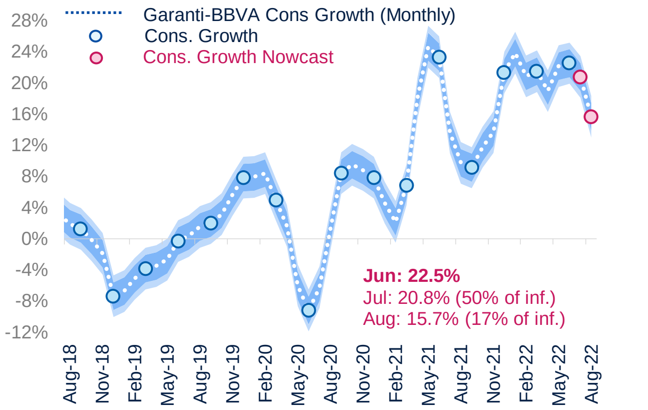
Source: Garanti BBVA Research, Turkstat

Figure 8. **BBVA Big Data Investment Demand Indicators** (28-day yoy real changes)



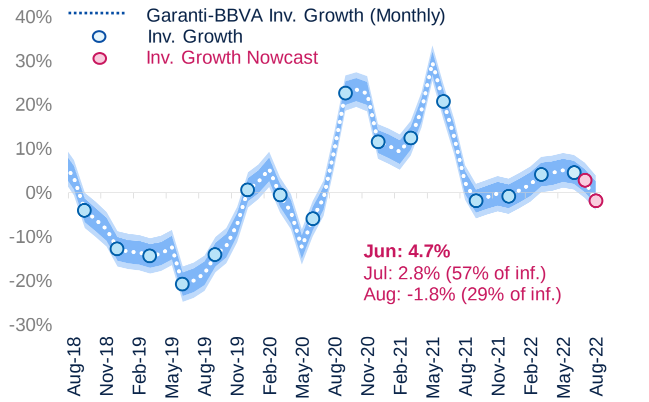
Source: Garanti BBVA Research, Turkstat

Figure 9. **Garanti BBVA Monthly Consumption Nowcast** (3m yoy)



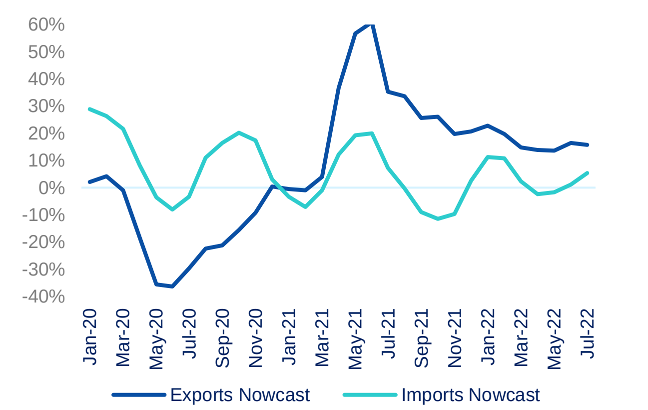
Source: Garanti BBVA Research, Turkstat, GBTRCGDPY Index in Bloomberg

Figure 10. **Garanti BBVA Monthly Investment Nowcast** (3m yoy)



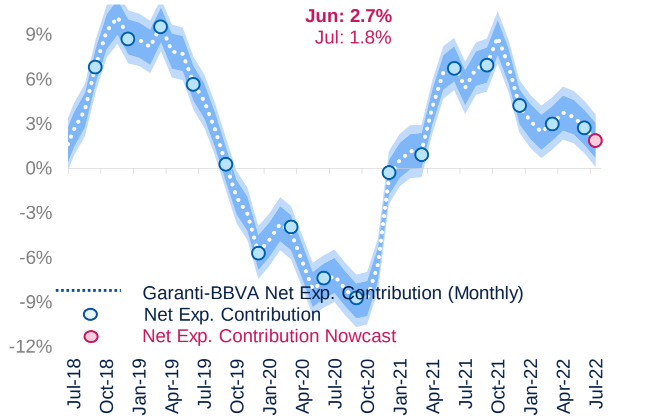
Source: Garanti BBVA Research, GBTRIGDPY Index in Bloomberg

Figure 11. **Garanti BBVA Monthly Exports & Imports Nowcast** (3m yoy)



Source: Garanti BBVA Research, GBTRXGDPY and GBTRMGDPY in Bloomberg

Figure 12. **Garanti BBVA Monthly Net Exports Nowcast** (cont. pp)



Source: Garanti BBVA Research, GBTRXGDPY and GBTRMGDPY in Bloomberg

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