Türkiye: Fast deceleration in economic activity

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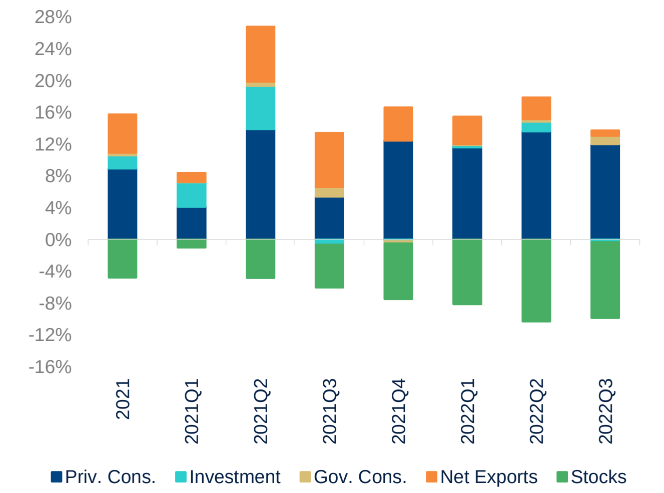
Turkish economy grew by 3.9% y/y in 3Q22 in line with our expectations (4%) but slightly lower than the consensus (4.4%). On quarterly terms, GDP contracted for the first time since the pandemic (-0.1%). The main drivers of the slow-down were much weaker net exports and contracting investment demand. Looking forward, we nowcast an annual GDP growth rate of 2.8% as of November (with 27% of information). The downward pressure on exports from poorer external demand and too much sterilization of TL liquidity led by the recent regulations have resulted in much faster than expected deceleration in economic activity so far. Given the Government's priority to boost growth and employment, we expect more counter-cyclical policies ahead of the elections, including some ease in credit conditions, potential new credit packages or other campaigns in order to reverse the recent deceleration in activity. The current weaker momentum puts very slight downward risk on our 2022 GDP growth forecast of 5.5%. We forecast 2023 GDP growth to be 3% with the expected boost in the first half of the year.

Services sector was the main driver of growth while industry decelerated sharply

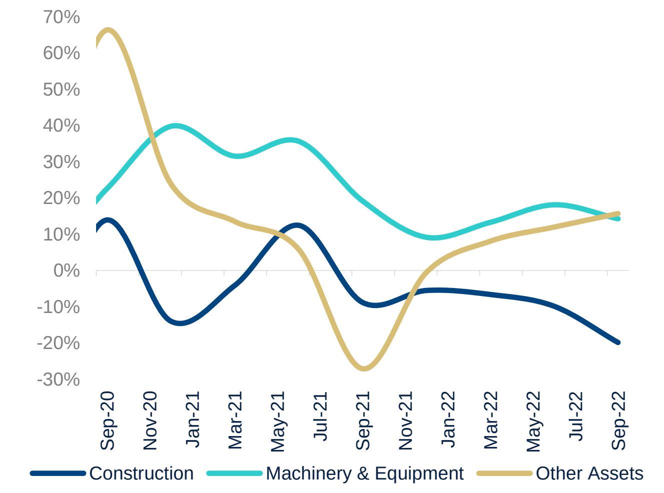
On the sectorial side, broad based services remained as the main driver of annual GDP growth (with 4.5pp contribution to annual GDP), which was supported by trade, transportation and accommodation (1.7pp) and financial activities (0.9pp). After expanding in the last 8 quarters, industrial sector, on the other hand, decelerated sharply by contracting 2.2% qoq especially on the back of manufacturing. Therefore, contributions from agriculture and industry to annual growth were limited (0.12pp and 0.1pp respectively), while construction sector contracted much faster compared to the previous quarter (-0.8pp vs. -0.62pp in 2Q).

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



Source: Garanti BBVA Research, Turkstat

Figure 2. **Gross Capital Formation** (YoY)

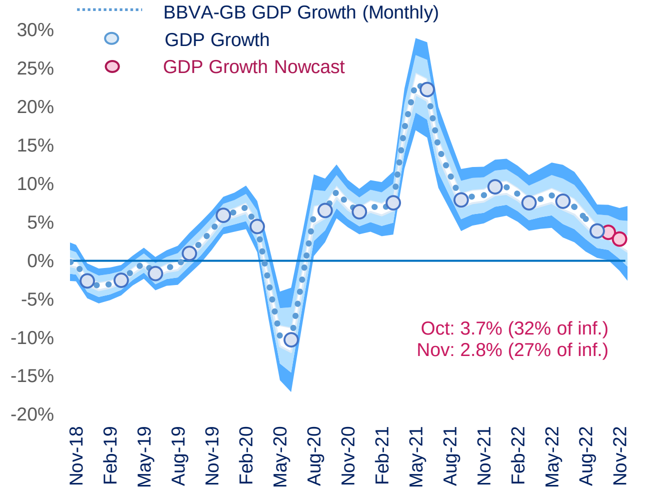


Source: Garanti BBVA Research, Turkstat

On the expenditure side, private consumption remained solid (19.9% y/y) with only a very limited moderation. Government consumption accelerated significantly and became one of the main drivers of growth (8.5% y/y). On the other hand, investment contracted (-1.3% y/y) for the first time since 2021Q4 on the back of a deeper fall in construction investment (-19.9% y/y). Net exports' contribution to GDP has declined to 0.7pp (down from 2.7pp in 2Q), led by strong import growth on robust consumption while exports weakened further on the ease in global activity. Nonetheless, both domestic demand and external demand's contributions to growth were positive (3.2pp and 0.7pp, respectively) but geared down in 3Q. Still, aggregate demand remained stronger than aggregate supply so inventories continued to be depleted (-9.5pp impact on annual growth).

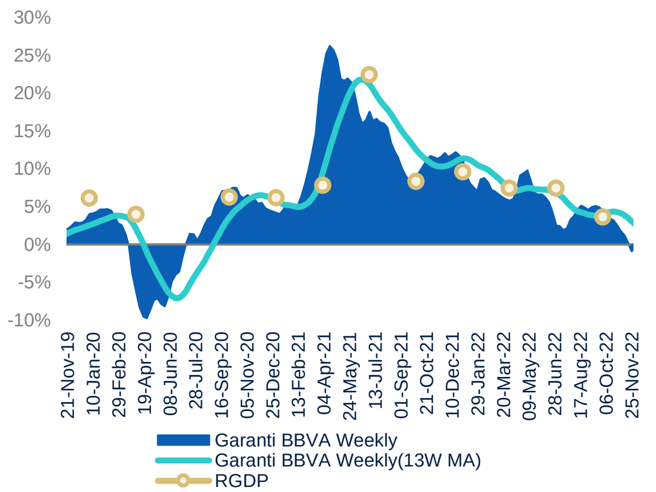
Leading indicators on activity including PMI, capacity utilization, electricity production and confidence indices signal that the deceleration in GDP growth is likely to continue in the last quarter of 2022. Our monthly GDP tracker also confirms the deceleration by nowcasting 2.8% annual GDP growth rate as of November (Figure 3). Besides, our weekly activity tracker shows a yearly growth rate of near 3% at the end of November (13-week moving average) by signaling a slight contraction in activity on a weekly basis in the last week of the month (Figure 4).

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



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

Figure 4. **Garanti BBVA Research Weekly GDP Indicator** (% yoy)



Source: Garanti BBVA Research, Turkstat

Aggregate demand remains stronger than supply

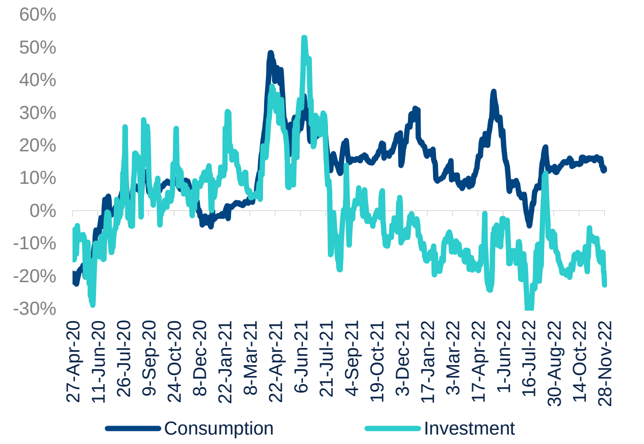
According to our nowcasts on GDP sub-components, private consumption stays robust by growing 15.9% y/y, while the contraction in investment deepens to 4.1% y/y as of November (Figure 7-8). Meanwhile, the contribution from net exports has turned into negative since exports decelerate much faster and imports keep increasing on mainly continuing consumption (Figure 9-10). All in all, aggregate demand remains stronger than supply, implying further depletion of inventories but with a slower pace. Stocks have been declining since the recovery from pandemic starting from 3Q20, implying historically longest period of depletion with again historically largest negative contribution, keeping inflationary risks alive led by the deteriorating cost push factors.

We expect upward pressure on inflation and current account deficit in the near future on top of envisaged populist policies ahead of the elections. More rapid correction on the production side may point to increased uncertainties and higher costs of inputs, due to both high inflation and deterioration of companies' cash flows. These trends might show the negative impact from current restrictive credit policies and too much sterilization of TL liquidity. 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.

Further expansionary policies expected ahead of the elections

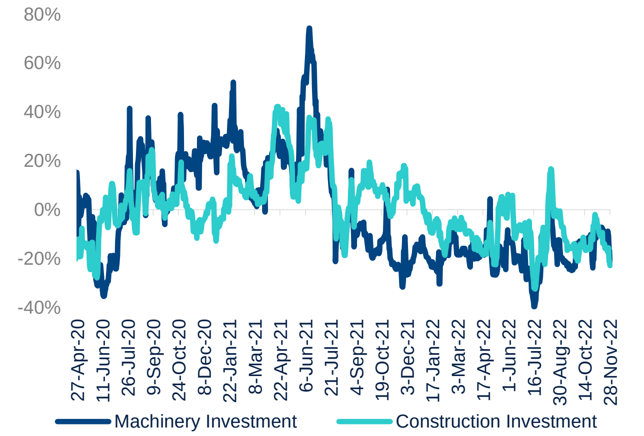
The current weaker momentum puts very slight downward risk on our 2022 GDP growth forecast of 5.5%. Looking ahead, foreign demand will decelerate further on the back of tighter external financial conditions and some regional specific downside risks. Hence, in order to stimulate activity as we get closer to the elections, potential ease in credit conditions, new credit packages and further expansionary fiscal policy on top of loose monetary policy cannot be ruled out. Therefore, economic activity would be boosted in the first half of next year, while the expected adjustment in the economy might take place after the elections. We expect 2023 GDP growth to be 3%.

Figure 5. **Garanti BBVA Big Data Domestic Demand Indicators** (28-day yoy real changes)



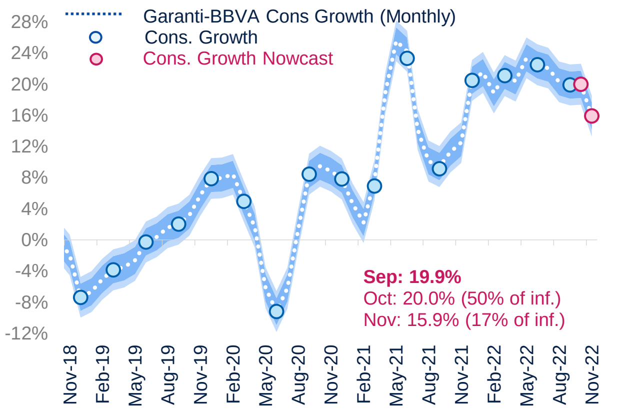
Source: Garanti BBVA Research, Turkstat

Figure 6. **Garanti BBVA Big Data Investment Indicators** (28-day yoy real changes)



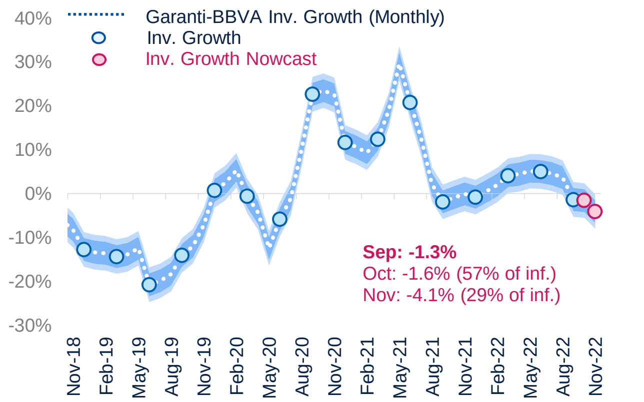
Source: Garanti BBVA Research, Turkstat

Figure 7. **Garanti BBVA Monthly Consumption Nowcast** (3m yoy)



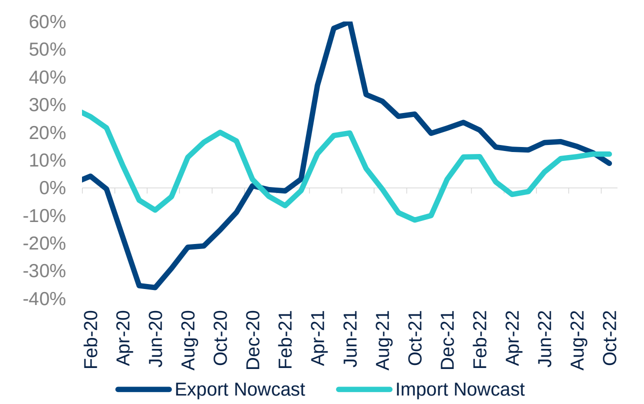
Source: Garanti BBVA Research, Turkstat, GBTRGDPC Index in Bloomberg

Figure 8. **Garanti BBVA Monthly Investment Nowcast** (3m yoy)



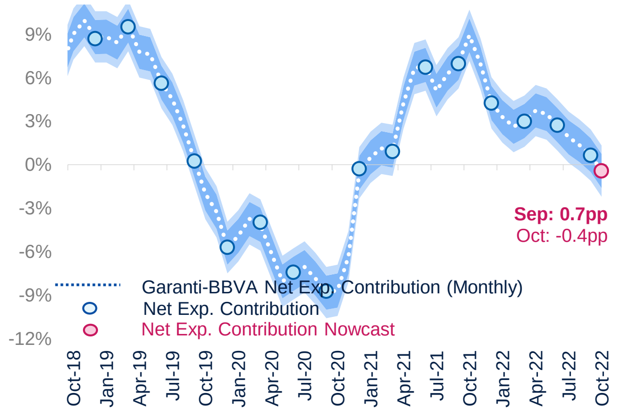
Source: Garanti BBVA Research, GBTRGDPI Index in Bloomberg

Figure 9. **Garanti BBVA Monthly Exports & Imports Nowcast** (3m yoy)



Source: Garanti BBVA Research, GBTRGDPX Index and GBTRGDPM Index in Bloomberg

Figure 10. **Garanti BBVA Monthly Net Exports Nowcast** (cont. pp)



Source: Garanti BBVA Research, GBTRGDPX Index and GBTRGDPM Index in Bloomberg

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