Türkiye: Activity surprised to the downside

Ali Batuhan Barlas / Adem Ileri / Tugce Tatoglu / Gul Yucel
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Industrial production (IP) once again surprised to the downside and grew 0.4% y/y in September (vs. 3% expected), implying a very sharp deceleration with 2.5% y/y in 3Q (vs. 10.7% in 2Q). In seasonal and calendar adjusted series, IP shrank by 1.6% m/m and resulted in a quarterly contraction of 4.1% in 3Q. According to high frequency indicators, our monthly GDP indicator nowcasts a quarterly GDP contraction of near 0.5% for 3Q, which corresponds to a yearly growth rate of around 4%. The deceleration in global economic activity and government measures to restrict credit growth so far have been the main reasons behind the recent slow-down. However, our expectations for some ease in credit conditions, new credit packages and other potential populist measures ahead of the elections -in addition to strong performance during the first half of the year- lead us to forecast 2022 GDP growth rate at near 5.5%. We expect 2023 GDP growth to be 3%, led by the potential boost in the first half of the year before the elections.

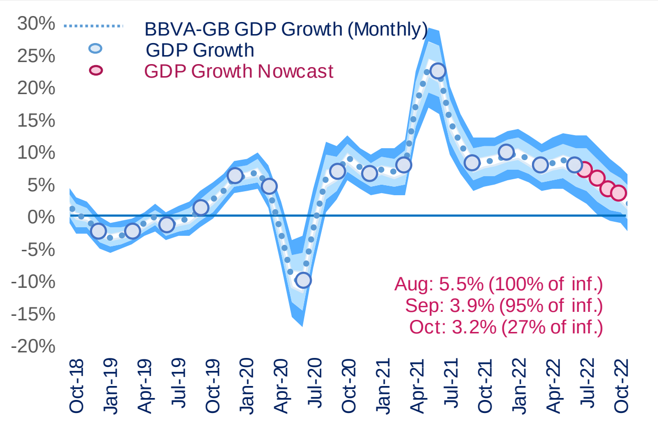
A faster than expected activity decelaration in 3Q

In seasonal and calendar adjusted series, IP declined in September (-1.6% m/m) on the back of a broad-based deterioration in subcomponents. The slowdown in industrial activity was more pronounced in quarterly terms with IP contracting by 4.1% in 3Q (vs. 0.8% in 2Q), led by the intermediate goods production contributing 2.2pp to the decline. This was followed by consumer goods (mainly non-durables), capital and energy goods, respectively.

In sectorial details, there was a widespread deterioration in manufacturing activity (-4.1% q/q) but more particularly due to worsening in basic metals (-9.7% q/q) and textiles (-7.5% q/q). There were only a few sectors in the manufacturing industry that were able to grow in 3Q (motor vehicles and other manufacturing both with 1.9% q/q), where they couldn't compensate the overall decline in industrial activity. Both domestic demand driven and export-oriented sectors experienced contractions in their productions but the former seemed to start suffering more from the recent squeeze in TL lending. On the other hand, the decline in the exports-oriented sectors' production confirms the downward pressure on exports as Europe is edging closer to recession and global financial conditions worsen.

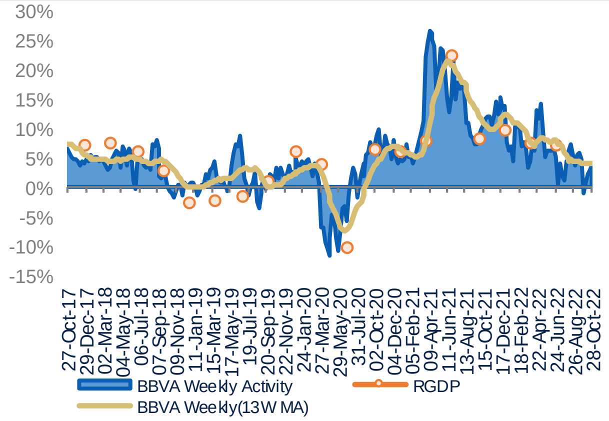
The deceleration in activity is likely to continue in 4Q as the manufacturing capacity utilization rate declined to 76.6% in October (vs. 77.3% in 3Q). The contraction in electricity production has deepened further to 7.0 y/y in Oct-Nov period compared to -4.6 y/y in 3Q. Moreover, manufacturing PMI continued to fall to 46.6 in Oct-Nov period compared to 47.5 on average in 3Q. All in all, our monthly GDP indicator nowcasts an annual GDP growth of 3.9% (with %95 of information), which can decelerate further to 3.2% in October with 25% of information. Our weekly GDP tracker also confirms a similar trend with near 4% y/y GDP growth rate by the end of October.

Figure 1. **Garanti BBVA Monthly GDP Indicator*** (yoy, 3-month moving avg.)



*Garanti BBVA monthly GDP is an average of different model results synthesizing high-frequency indicators to proxy monthly GDP (GBTRGDPY Index in BBG)

Figure 2. **Garanti BBVA Weekly GDP Tracker*** (YoY)



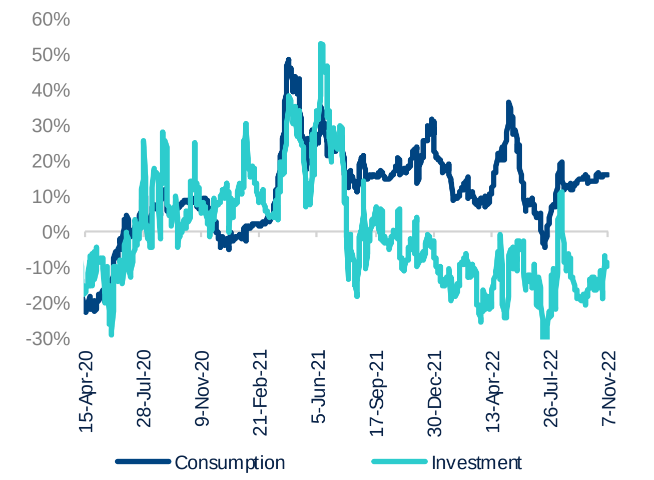
Source: Garanti BBVA Research, Turkstat, for methodology please check *our research*

Consumption becomes the main driver of activity

In terms of demand sub-components, relatively solid levels of consumption help to avoid a much stronger deceleration in economic activity. The high inflation environment, very large negative interest rates and continuaton of employment lead private consumption to remain as the main driver of GDP growth. Since we get closer to the elections, it can still be the low hanging fruit to boost activity by means of more counter-cyclical fiscal policies. Meanwhile, deceleration is more evident in investment expenditures as our investment nowcast model shows a yearly contraction as of November. Therefore, domestic demand decelerates but consumption still remains the main buffer.

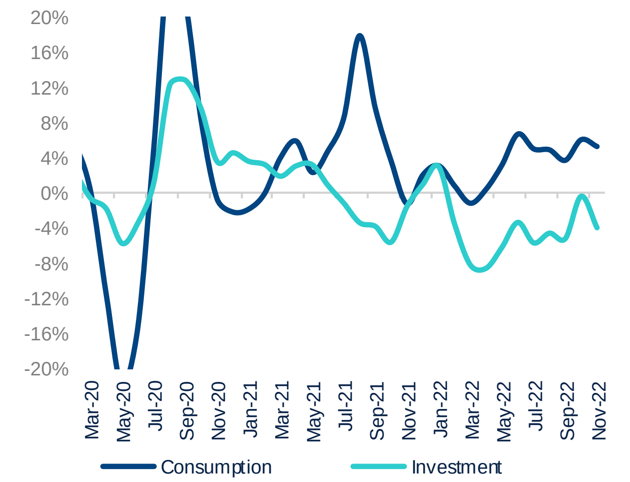
On the external side, imports accelerate more clearly on growing consumption and exports weaken further on top of poorer global demand, resulting in almost no contribution from net exports as of October. All in all, economic activity can decelerate further in 4Q, which we would expect to reverse in the first half of the year just before the elections with much looser fiscal and credit policies. Since the demand side of the economy -particularly consumption- will likely remain much stronger supported by the continuing employment gains, the need of renewing inventories and the additional pressure on the exchange rate will keep inflationary risks alive.

Figure 3. **Garanti BBVA Big Data Domestic Demand Indicators** (28-day sum, adjusted by CPI and PPI, YoY)



Source: Garanti BBVA Research, Turkstat

Figure 4. **Garanti BBVA Big Data Domestic Demand Indicators** (3-month qoq, adjusted by CPI and PPI)



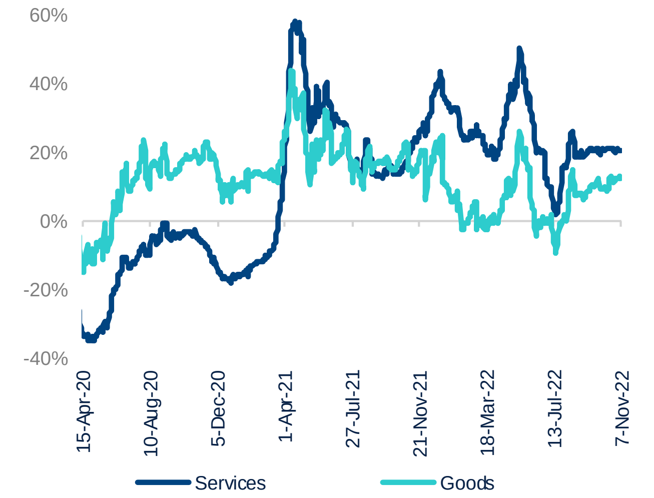
Source: Garanti BBVA Research, Turkstat

2022 GDP growth expected to reach above 5%

Much tighter global financial conditions and clear downside risks to external demand -particularly recession in Europe- create uncertainty on the near term growth outlook. Moroever, recent macro-prudential measures to sterilize TL liquidity and therefore manage FC demand of the residents add pressure on domestic activity since companies have difficulties in terms of keeping their cash-flow management effective.

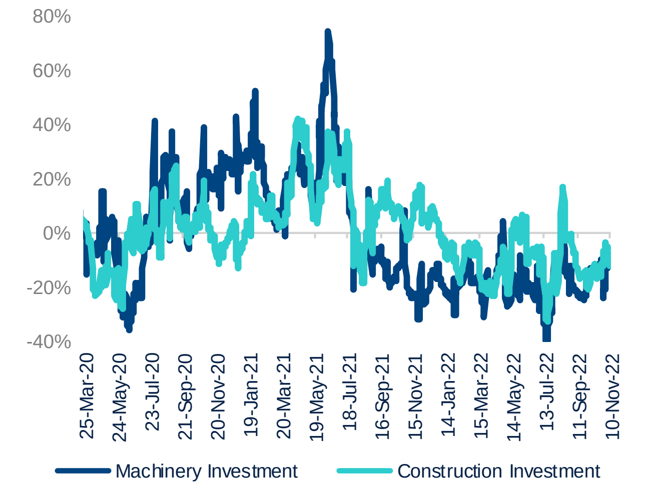
According to our nowcasts, GDP growth has started to decelerate more clearly as of 3Q and the slow-down has started to become much faster than expected with 4Q early indicators. The political priority to maintain pro-growth policies at all costs leads us to expect more countercyclical fiscal measures ahead of the elections in addition to the continuation of ultra-loose monetary policy. Therefore, we expect 2022 GDP growth to reach near 5.5%, which would be followed by a strong pace in the first half of the year with around 5%. Led by this boost at the beginning of the year, 2023 GDP growth might be close to 3% despite our expectation of an adjustment in the economic policies towards normalization in the second half of the year. Since this would mean delaying the expected adjustment, elevated current account deficit, substantial financial stability risks and high inflation will continue for some time.

Figure 5. **Garanti BBVA Big Data Consumption Indicators** (28-day sum, adjusted by CPI, YoY)



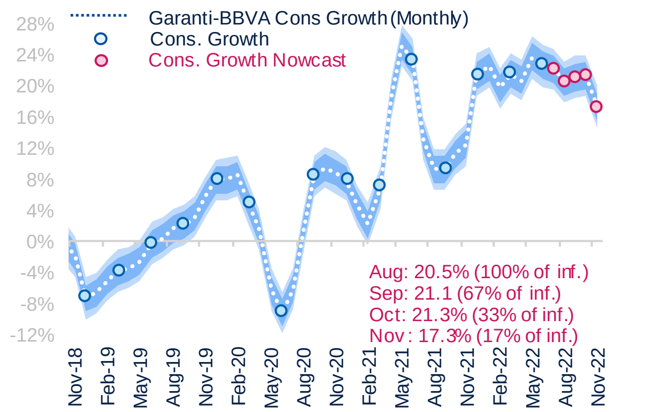
Source: Garanti BBVA Research, Turkstat

Figure 6. **Garanti BBVA Big Data Investment Indicators** (28-day sum, adjusted by PPI, YoY)



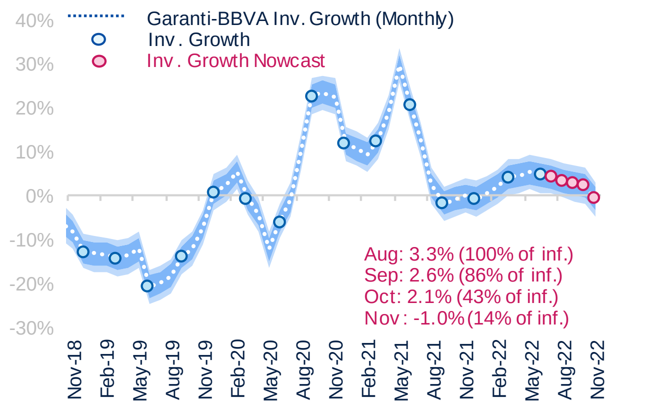
Source: Garanti BBVA Research, Turkstat

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



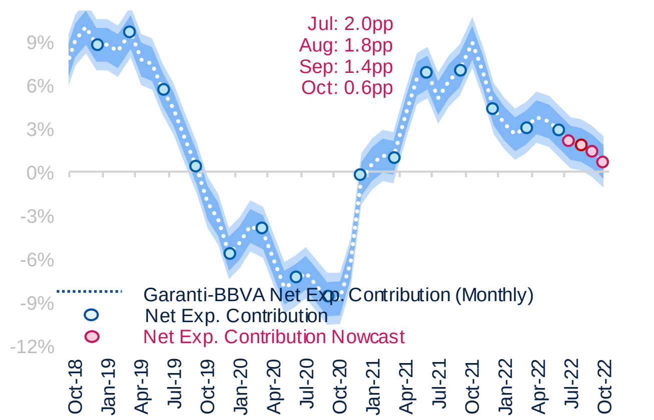
Source: Garanti BBVA Research, GBTRCGDPY Index in Bloomberg

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



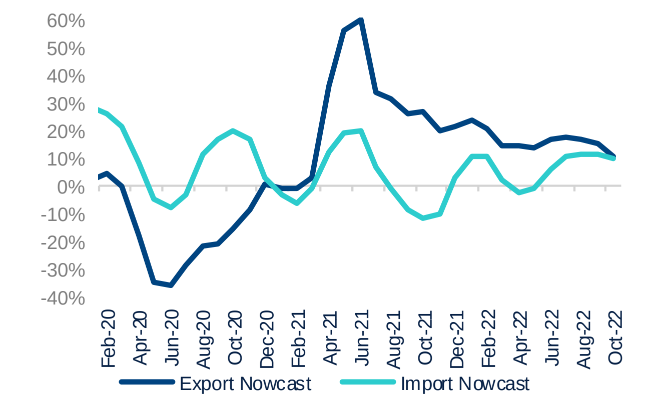
Source: Garanti BBVA Research, GBTRIGDPY Index in Bloomberg

Figure 9. **Garanti BBVA Monthly Net Exports Nowcast** (contribution, pp)



Source: Garanti BBVA Research, GBTRXGDPY and GBTRMGDPY in Bloomberg

Figure 10. **Garanti BBVA Monthly Foreign Trade Nowcasts** (3m yoy)



Source: Garanti BBVA Research, GBTRXGDPY and GBTRMGDPY in Bloomberg

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ENQUIRIES TO:
Garanti BANKASI A.Ş. Nispetiye Mah. Aytar Cad. No:2 34340 Levent Beşiktaş İstanbul.
Tel.: +90 212 318 18 18 (ext 1064)
bbvaresearch@bbva.com www.bbvaresearch.com