Türkiye: The economy grew 5.6% in 2022

Adem Ileri / Tugce Tatoglu / Gul Yucel
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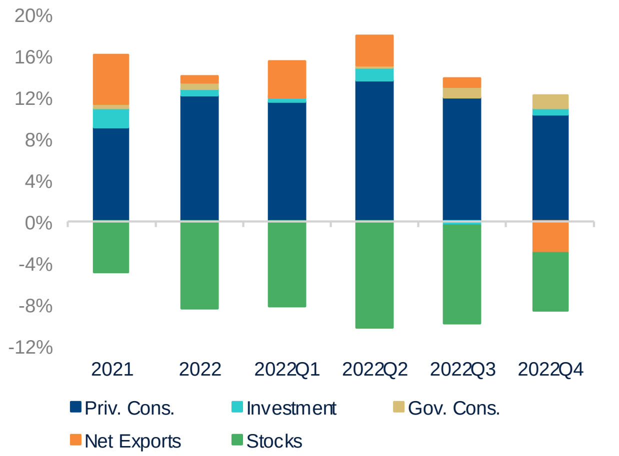
Turkish economy grew by 3.5% y/y in 4Q22 above both our expectations (3%) and market consensus (2.9%), leading to an overall GDP growth of 5.6% in 2022. Domestic demand especially private consumption was the pioneer on the expenditures side, whereas broad-based services sector was the main contributor on the production side at all. Before the latest earthquakes, economic activity was gaining pace at above 5% y/y growth rate in January, which has started to decelerate with the preliminary data as our monthly GDP indicator nowcasts 2.6% y/y GDP growth (with 27% of info.) as of February. According to our calculations, the net negative impact of the quakes on GDP might get near 1pp in 2023 by taking into account the expected rise in fiscal spending and potential production compensation of the other areas. Hence, we expect GDP to decelerate in the first half the year mainly on the direct impact of quakes but economic activity could start to be supported by fiscal expansion and better global growth outlook starting from the 2H of the year. Therefore, we maintain our 2023 GDP forecast at 3% and upgrade our 2024 GDP growth forecast to 1.5%.

Domestic demand and services were the main contributors to 2022 GDP

On the expenditures side, private consumption (16.1% y/y) and government consumption (9.0% y/y) maintained their solid pace in 4Q22 but this time investment also recovered by 2.6% y/y after declining by 0.8% in 3Q22. Exports contracted by 3.3% y/y on the back of poorer external demand and real appreciation of the currency while import (10.2% y/y) remained strong on top of robust domestic demand. Hence, contribution from net exports on annual growth turned out to be negative for the first time since 4Q20 with 3.1pp (vs 0.6pp in 3Q22), leading domestic demand to become the main driver of growth with 6.6pp contribution. Aggregate demand stayed stronger than aggregate supply so the inventories continued to be depleted driving down annual growth by 5.6pp. This is indeed ambiguous because of the continuation of depletion in the last 9 quarters, which we expect to be revised with the upcoming revision in August by incorporating the revised tourism revenues to the national accounts.

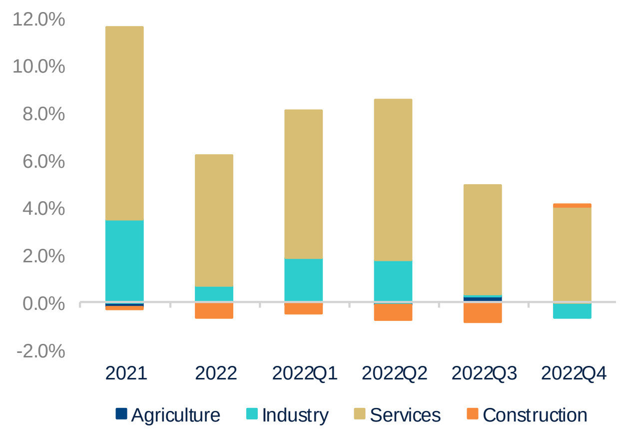
On the sectorial side, the significant contribution from broad based services (4.1pp) to annual growth was noteworthy, where trade, transportation and accommodation took the lead (2.1pp). The industry, on the other hand, drove down annual growth (-0.6pp) for the first time since 2Q20 where the negative impact of the pandemic had hindered the activity. While agricultural activity also pulled down growth only slightly (-0.02pp), improvement in construction resulted in a limited positive contribution (0.08pp) from the sector for the first time since 3Q18.

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



Source: Garanti BBVA Research, TURKSTAT

Figure 2. **Contributions to GDP Growth via Production (annual, pp)**



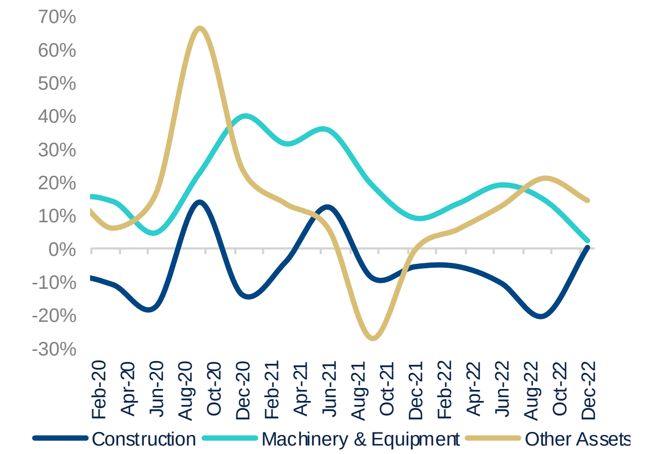
Source: Garanti BBVA Research, TURKSTAT

When the overall 2022 is considered, domestic demand supported growth with 5pp contribution on the back of accelerating private consumption (12.1pp) while investment remained very limited (0.7pp) despite the government ambition. On the external demand, net exports showed a weaker contribution to annual growth with 0.6pp due to both slow-down in exports (9.1% y/y in 2022 vs. 24.9% y/y in 2021) and acceleration in imports (7.9% y/y in 2022 vs. 2.4% y/y in 2021). All in all, the economy grew above potential in 2022 thanks to government's pro-growth policies on extremely loose monetary policy and expansionary fiscal measures despite the downward pressures from the tighter external financial conditions and the war in Ukraine. Consequently, as a result of stronger trend in aggregate demand than aggregate supply, inventories posted the highest depletion of all time (-8.5pp).

On the production side, the total contribution from industry (0.7pp), construction (-0.6pp) and agriculture (0pp) corresponds to almost zero, while broad-based services contribution especially from trade, transportation and accommodation (2.7pp) thanks to strong tourism season, and financial services (0.9pp) became prominent.

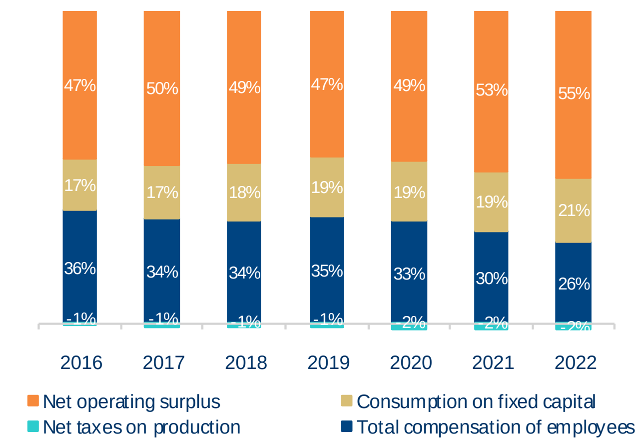
On the income levels, the share of wages in value added maintained a decreasing trend as it fell further to 26.5% in 2022 down from around 35% levels before the pandemic, signaling further deterioration in inequality in favor of the capital owners (Figure 4). In this regard, the fact that GDP per capita in US dollars rose to 10,655 in 2022 up from 9,539 in 2021 is not implying an increase in welfare. Instead, it reflects the government's efforts to keep the exchange rate stable despite the very high levels of inflation.

Figure 3. **Gross Capital Formation (%, y/y)**



Source: Garanti BBVA Research, TURKSTAT

Figure 4. **Shares in Gross Value Added (%)**



Source: Garanti BBVA Research, TURKSTAT

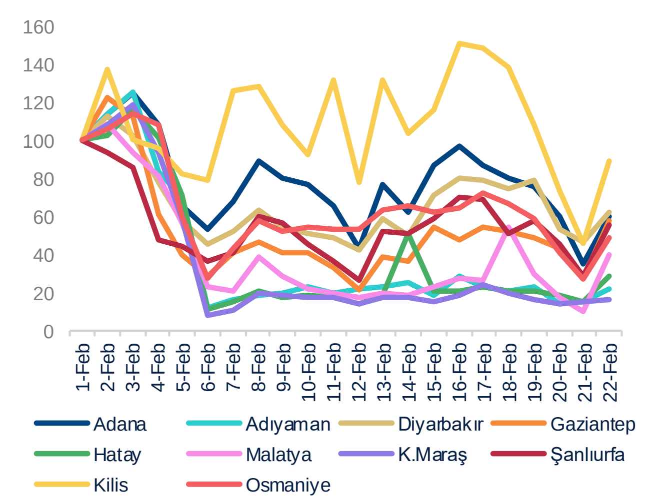
The negative impact of the quakes could be contained by stimulative policies

Although it is still early to calculate the impact of the latest devastating earthquakes as there is still no clear information regarding the total damage on production capacity. Hence, we calculate indirect costs on the value-added by incorporating information from our Big Data (Figure 5) and merging it with the capacity assumptions of the World Bank in the assessment of the 1999 earthquakes. Also, we assume one third of the disruptions in the first two quarters are offset by increased activity in other areas. And finally, we multiply net disruption by the weight of the region in the overall output (see table below). Consequently, the first two quarters show the most damaged effects, which starts to reverse therafter and the average direct impact on GDP reaches 1.5-2% of GDP. However, we also need to incorporate the expected signficant increase in the fiscal spending. By assuming the same ratio of the fiscal cost to the estimated physical damage in the 1999 earthquakes, we end up with an assumption of near 5.4% GDP fiscal cost, which we expect to reflect a certain share of fiscal expenditures to be spent in a 2-3 years horizon (reaching 3.6% of GDP as reconstruction activities). Therefore, the net impact from the quakes on the value-added would diminish with the support from fiscal spending, which turns out to be at most 1% of GDP in 2023. Next years, on the other hand, would be positively affected given the lagged impact on GDP, considering the most of the fiscal spending will be in the form of construction investment.

Following the earthquakes, the Central Bank (CRBT) reduced the policy rate by 50 bps to 8.5% and made the political intention clear that they will prioritize the creation of supportive financial conditions in order to minimize the effects of the latest earthquakes and support the necessary recovery. However, according to our calculations, the elevated uncertainty and other regulations to contain liquidity in order to finally achieve some stabilization in the currency limit the expected high impact of the extremely loose monetary policy on economic activity in a historical relation. Based on our SVAR and Large Bayesian VAR models[1], we try to estimate policy rate paths starting from 1Q20, which the country's macroeconomic conditions and realized growth figures would imply (Figure 6). Our results show that our policy rate estimates were close to the official figures till the last quarter of 2021 but a high deviation from the official rate has begun and increased further thereafter. As a result, our research indicates that decreasing policy rate to even one-digit levels despite very high inflation levels did not reflect the expected positive impact on economic activity well together with the squeezed liquidity (in order to contain the pressure on the exchange rate). Instead, its created the potential to deteriorate inflation expectations further including a longer horizon.

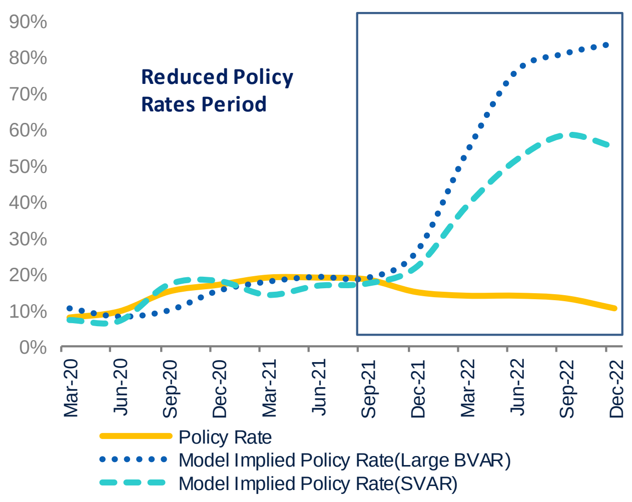
Impact on GDP[2]	1Q23	2Q23	3Q23	4Q23	2023 avg.
Direct	-3.0%	-3.0%	-2.1%	-1.2%	-2.3%
w/ Compensation From Other Regions	-2.0%	-2.0%	-2.1%	-1.2%	-1.8%
w/ Fiscal Support**	**-2.0%**	**-2.0%**	**-0.5%**	**0.5%**	**-1.0%**

Figure 5. **Consumption Activity in the Quakes Region (1 Feb=100, via Garanti BBVA cards)**



Source: Garanti BBVA Research

Figure 6. **Implied CBRT Policy Rate Paths (%)**



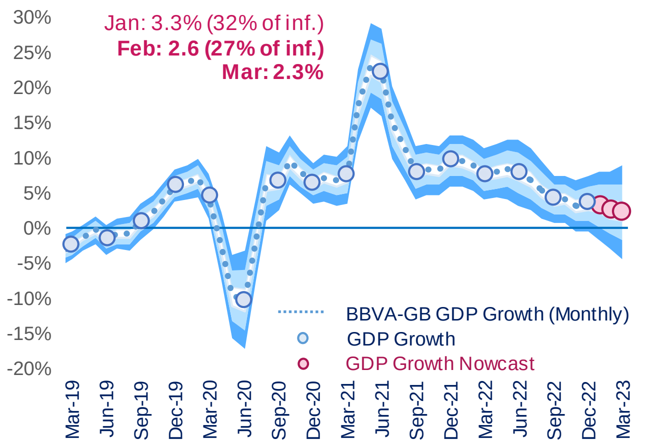
Source: Garanti BBVA Research

Fiscal spending and gradual normalization will be decisive on growth outlook

As our calculations have showed, the negative indirect impact from the quakes on value-added might be 1.5-2% and the monetary policy could be less effective in terms of economic stimulation. Hence, expected fiscal expansion and multiplier effects will be the important drivers on economic growth in the near term. In order to contain negative side effects of the ultra loose monetary policy, the government has implemented too many different regulations particularly on the banking sector. Therefore, expected policy normalization after the elections should be very gradual to prevent any financial instability. We maintain our GDP growth forecast at 3% in 2023 by assuming expansionary fiscal policy and better global growth outlook will compensate the negative direct impact from the quakes. Also, we have upgraded our 2024 GDP growth forecast to 1.5% based on more gradual policy normalization and lagged impact from the expected fiscal spending.

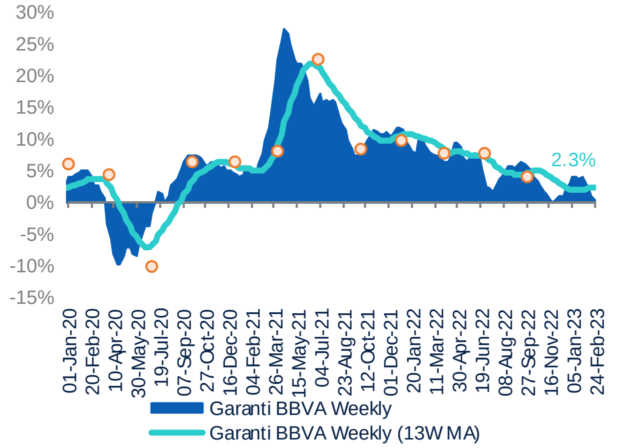
[1] We will elaborate our results in a sperate upcoming research note
[2] WB assumptions in the assessment of 1999 earthquakes: a) value added lost due to disruptions in industry and services in the most severely affected regions is 50%, 30%, 15% and 8% in the first 4 quarters, b) one third of the disruptions in the first 2 quarters are offset by increased activity in other areas, c) multiplying net disruption by the weight of the región. Cyclical fiscal multipliers are assumed, 2.2 in one-year, 0.9 in two-year cumulative impact starting from 3Q23

Figure 7. **Garanti BBVA Monthly GDP Indicator*** (yoy, 3-month moving avg.)



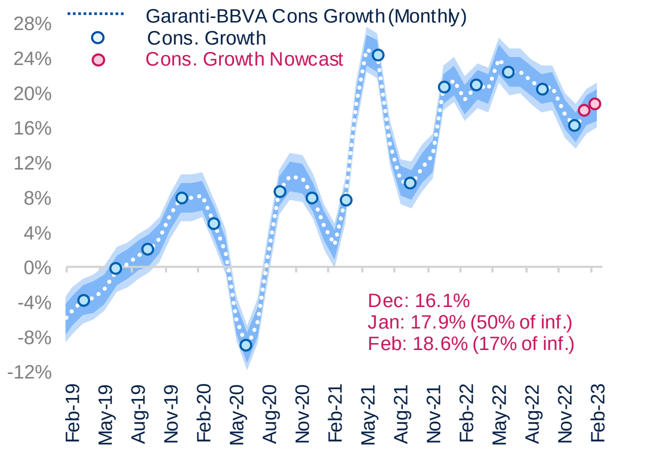
Source: Garanti BBVA Research, *Garanti BBVA monthly GDP indicator is an average of different model results synthesizing high-frequency indicators to proxy monthly GDP (GBTRGDPY Index in BBG)

Figure 8. **Garanti BBVA Weekly GDP Tracker*** (YoY Growth)



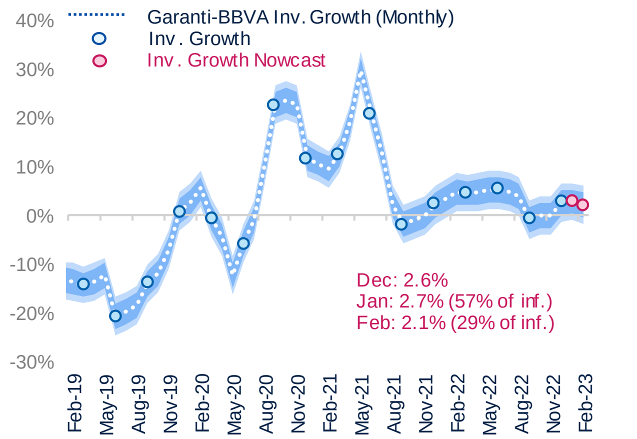
Source: Garanti BBVA Research, Turkstat, for methodology please check the following link

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



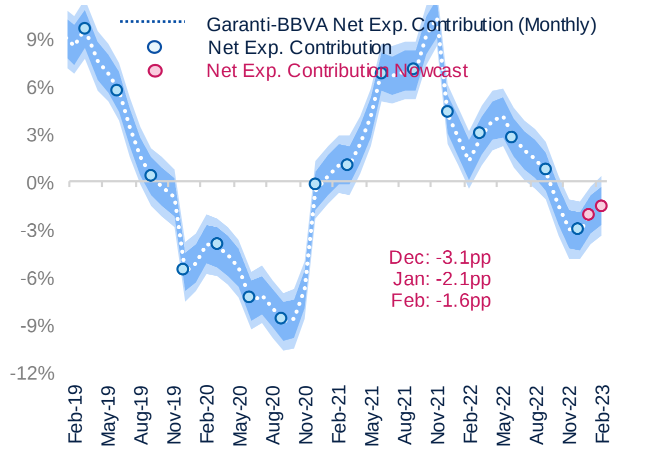
Source: Garanti BBVA Research, GBTRGDPC Index in Bloomberg

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



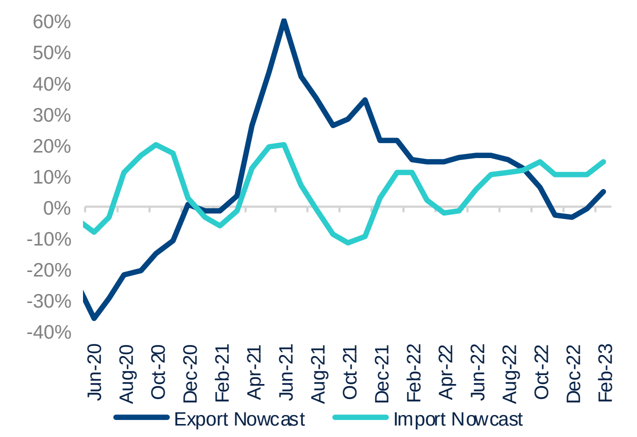
Source: Garanti BBVA Research, GBTRGDPI Index in Bloomberg

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



Source: Garanti BBVA Research, GBTRGDPX and GBTRGDPM in Bloomberg

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



Source: Garanti BBVA Research, GBTRGDPX and GBTRGDPM 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