Activity Pulse
Türkiye | Activity led by prevailing strong demand
Adem Ileri / Ali Batuhan Barlas / Tugce Tatoglu / Gul Yucel
13 July 2023

Industrial production (IP) decreased by 0.2% year over year in calendar adjusted series while unadjusted one increased by 11.3% in May. Seasonal and calendar adjusted (sca) IP slightly recovered by 1.1% m/m, which led the cumulative growth to materialize as 1.4% during April-May compared to 1Q (vs. 0.5% q/q in 1Q). Domestic demand remained strong as signalled by robust trend in retail sales, while turnover indices showed that services and construction sectors would maintain contribution to activity in 2Q. Strong calendar effects in addition to bridge day impact—since religious holidays shift in yearly comparisons for 2Q and 3Q—create uncertainty to evaluate clearly the trend in economic activity. Our monthly GDP indicator nowcasts an annual growth of 4.4% for 2Q with 27% of information. As the recent communication of the economy management signals efforts to achieve a soft landing scenario, we expect the positive output gap to close only slowly. We forecast GDP growth to be 4.5% in 2023, led by the expected gradual normalization steps in monetary policy and still resistant global activity. The growth outlook next year will depend on the stance of fiscal and monetary policies against inflation, especially after the local election in March 2024.

Uncertainty on activity trend due calendar effects, domestic demand stays robust

In seasonal and calendar adjusted series, monthly IP slightly recovered by 1.1% in May and reached limitedly above its March figure, eliminating the negative impact from April. In main subcomponents, capital (5.9%), durable consumer (1.8%) and energy goods production (1.9%) supported IP in April-May, while intermediate goods production (0.2%) remained weak and nondurable consumer goods production contracted (-0.4%). On sectors, motor vehicles, other transportation and fabricated metal production were the main supportive items. However, particularly, export-oriented sectors such as computer-electronics and optics, electrical equipment, chemicals and clothing production remained weak due to the real appreciation of the currency and low foreign demand.

Figure 1. Garanti BBVA Monthly GDP Indicator (3-month average YoY)

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 2. Sectorial Turnover Indices (real, seasonal and cal. adj., Jan 2022=100)

Source: Garanti BBVA Research, TURKSTAT
2Q of the year includes strong negative calendar day impact as the religious holidays moved from May to April for Ramadan and from July to June for Eid al-adha. Economic activity has negatively been affected by calendar and bridge day effects in April and June, while May and July show the opposite. Bridge day impact results from the extended holidays which is not well captured by regular seasonal and calendar adjusted methods. Therefore, even though Turkstat also releases calendar and seasonal adjusted statistics, to understand a clear trend in economic activity becomes harder in such periods.

Turnover indices signal that after the negative impact of the quakes in February, all sectors have recovered. Construction, services and trade sectors could have contributed to activity in 2Q more than the industry did, which will be similar to what we observed in 1Q. On the other hand, domestic demand has remained much stronger, which we can confirm with our big data indicators and official retail sales data. Looking ahead, leading indicators such as PMI (51.3 in the last 3 months), manufacturing capacity utilization rate (76.6% in June), our big data indicators and confidence indices signal that economic activity remained robust in 2Q, corresponding to near 3% quarterly GDP growth (after 0.3% in 1Q). Our annual GDP nowcasts show 4.4% growth in June (with 27% of information) and 6.5% in July (particularly boosted by positive calendar day impact).

High aggregate demand needs more efforts than gradual normalization steps

Aggregate demand excluding stocks has maintained a strong trend in recent years, especially on top of strong private consumption. According to GDP subcomponents nowcasts, private consumption remains solid on particularly goods consumption, while investment expenditures improve further. On the other hand, even if the contribution of exports is recovering, the real appreciation of the exchange rate and credit growth (especially led by consumer loans) resulted in the continuation of strong imports. Therefore, the contribution of net exports to growth remains negative despite the latest slight improvement. The composition of aggregate demand in favor of domestic demand (Figure 3) maintain upside pressure on currency, inflation and current account deficit.

The lower than consensus interest hike of the Central Bank (CBRT) in June signaled that the monetary policy normalization will be very gradual to achieve a soft landing scenario before the local elections scheduled in March 2024. In addition, Vice-President Yılmaz recently stated that the government will avoid a recession while fighting against inflation. Therefore, the Government might target weak but positive quarterly growth rates in the near future. However, this will lead domestic demand to remain strong if other macro prudential policies would not be introduced
while increasing the policy rate below inflation. Hence, we expect credit policies to be selective in order to squeeze consumption and ease the pressure over inflation and current account balance. According to our VAR analysis (Figure 4), consumer loans and real exchange rate explain most of the variation in real imports. On the other hand, commercial lending can still be supported but to a lower extent to achieve a soft landing in activity, whose impact over imports will die out in two years horizon.

**We expect 4.5% GDP growth in 2023 on gradual steps toward normalization**

Inflation report of the CBRT scheduled to be released on July 27 will provide a clear picture on their output gap assumptions and the future path of the monetary policy. Additionally, recent tax hikes revealed that economy management prefers to generate revenues with higher tax rates including indirect ones rather than introducing fiscal savings in order to reduce the pressure on budget deficit. In this regard, the need to reduce consumption in order to rebalance the economy will also require efforts of the government to reduce fiscal spending. Hence, Medium Term Program (MTP) will be key to check growth objectives and budget deficit targets of the Government and the stance of the fiscal policy against imbalances.

Based on our assumptions that the Government will target a soft landing in economic activity and therefore normalization in economic policies will be quite slow, we expect 2023 GDP growth to be 4.5%. We maintain our view that the adjustment in activity might be more clearly observed after the local election and GDP growth might decelerate to 2% in 2024. The magnitude of the correction will be determined by the stance of both fiscal and monetary policies against inflation.
Activity led by prevailing strong demand / July 13, 2023
DISCLAIMER

This document has been prepared by BBVA Research Department. It is provided for information purposes only and expresses data, opinions or estimations regarding the date of issue of the report, prepared by BBVA or obtained from or based on sources we consider to be reliable, and have not been independently verified by BBVA. Therefore, BBVA offers no warranty, either express or implicit, regarding its accuracy, integrity or correctness.

Any estimations this document may contain have been undertaken according to generally accepted methodologies and should be considered as forecasts or projections. Results obtained in the past, either positive or negative, are no guarantee of future performance.

This document and its contents are subject to changes without prior notice depending on variables such as the economic context or market fluctuations. BBVA is not responsible for updating these contents or for giving notice of such changes.

BBVA accepts no liability for any loss, direct or indirect, that may result from the use of this document or its contents.

This document and its contents do not constitute an offer, invitation or solicitation to purchase, divest or enter into any interest in financial assets or instruments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

With regard to investment in financial assets related to economic variables this document may cover, readers should be aware that under no circumstances should they base their investment decisions on the information contained in this document. Those persons or entities offering investment products to these potential investors are legally required to provide the information needed for them to take an appropriate investment decision.

The content of this document is protected by intellectual property laws. Reproduction, transformation, distribution, public communication, making available, extraction, reuse, forwarding or use of any nature by any means or process is prohibited, except in cases where it is legally permitted or expressly authorised by BBVA on its website www.bbvaresearch.com.