

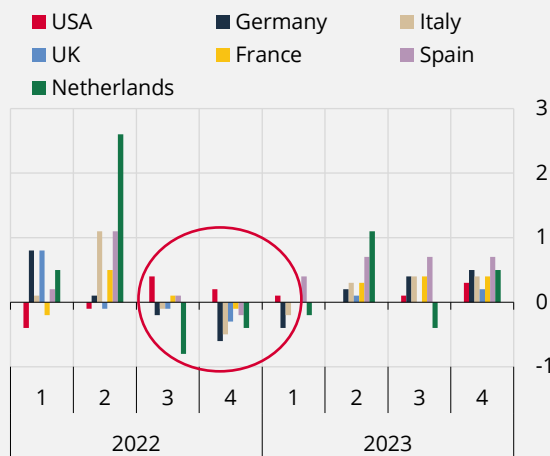
Box 2.3

Slowdown in Foreign Demand and Its Effects on Economic Activity

The slowdown in global growth after the Russia-Ukraine war was driven by persistent geopolitical risks and the energy crisis that emerged in the European Union due to the sanctions imposed on Russia. In addition, the tightening trend in the monetary policies of developed countries has also strengthened due to rising inflation, which has led to a downward revision of the 2023 growth forecasts, especially for the US, European Union and UK economies. This box examines the possible implications of these developments for the Turkish economy.

The national income of a significant portion of Türkiye's main trading partners is expected to decline from the second half of 2022 to the first quarter of 2023 (Chart 1). Annual growth forecasts and PMI indices also indicate that the global growth outlook deteriorated significantly compared to the July Report period (Table 1). In addition, the risks to growth have gained downward weight and the probability of recession in 2023 in particular in the European Union and UK economies has increased (Table 2). This negative outlook, especially originating from the Eurozone, which constitutes nearly half of Türkiye's export market, indicates that foreign demand may weaken in the rest of the year.

Chart 1: Quarterly Growth Forecasts for Türkiye's Major Trading Partners* (%)



Source: Consensus Economics.

* Prepared according to the September Consensus Bulletin.

Table 1: PMI Indices for Türkiye's Major Trading Partners

	Manufacturing PMI		
	Q2	Q3	Difference
Euro Area	54.1	49.3	-4.8
USA	56.3	51.8	-4.5
Germany	53.8	48.8	-5.1
Italy	52.4	48.3	-4.1
UK	54.4	49.3	-5.2
France	53.9	49.3	-4.6
Spain	53.2	49.2	-4.0
Netherlands	57.9	52.0	-5.9

Source: CBRT, S&P Global.

Table 2: Annual Growth Forecasts* for Türkiye's Major Trading Partners (2022-2023 Cumulative Growth)

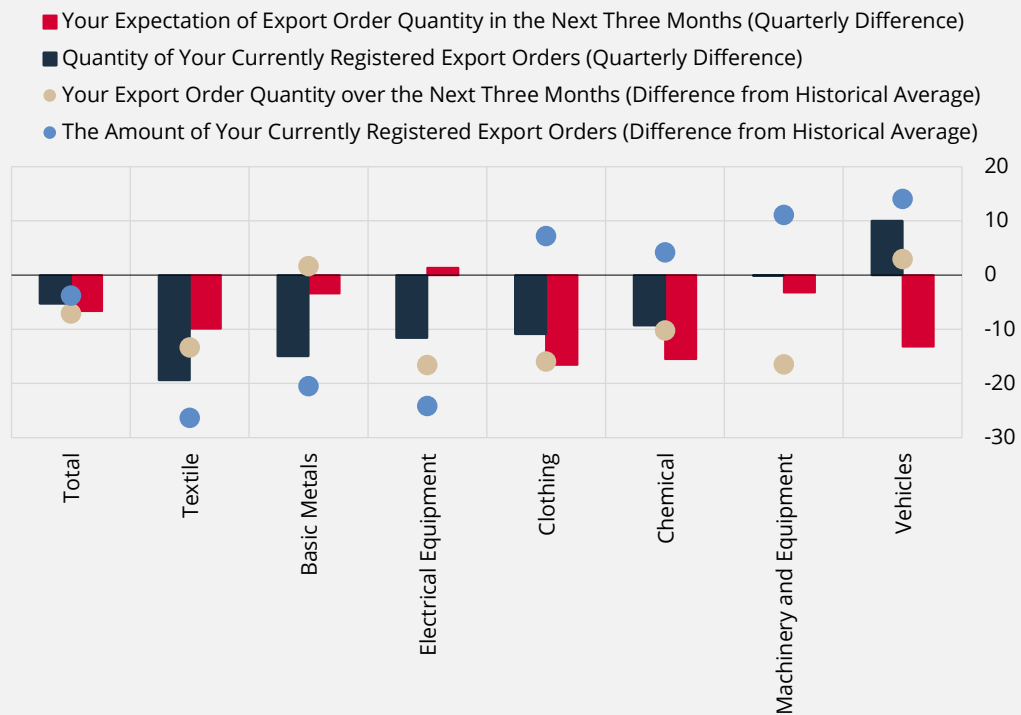
	Consensus			IMF			OECD		
	July IR	October IR	Difference	July	October	Difference	June	September	Difference
Euro Area	4.8	3.0	-1.8	3.8	3.6	-0.2	4.2	3.4	-0.8
USA	4.4	1.9	-2.5	3.3	2.6	-0.7	3.7	2.0	-1.7
Germany	3.9	0.5	-3.4	2.0	1.2	-0.8	3.6	0.5	-3.1
Italy	4.3	3.2	-1.1	3.7	3.0	-0.7	3.7	3.8	0.1
UK	4.3	3.8	-0.5	3.7	3.9	0.2	3.6	3.4	-0.2
France	4.1	2.8	-1.3	3.3	3.2	-0.1	4.0	3.2	-0.8
Spain	7.3	5.7	-1.6	6.1	5.6	-0.5	6.4	6.0	-0.4
Netherlands	4.2	5.3	1.1	3.5	5.3	1.8	-	-	-
Iraq	16.4	14.6	-1.8	-	13.7	-	-	-	-

Source: Consensus Economics.

* The Iraq estimate is created by the CBRT based on the S&P Global estimates.

It is anticipated that the developments summarized above will adversely affect the export performance in particular. Considering that industrial products account for 94.4 percent of Türkiye's exports in the last five years, a negative shock on the foreign demand side will affect the manufacturing industry the most. There are two questions regarding the export outlook in the Business Tendency Survey (BTS), which is the leading indicator for the industry sector. The first of these questions includes information on the current status of registered export orders, while the second reflects the expectations for the next three months. The sectoral changes in these questions in the third quarter compared to the previous quarter shows that the current situation for export orders weakened in the main sectors excluding the vehicle sector (Chart 2). For the next three months, a significant decrease is expected in export orders in the vehicle sector, while the expectation that the decrease in demand will continue in other sub-sectors excluding electrical equipment is maintained.

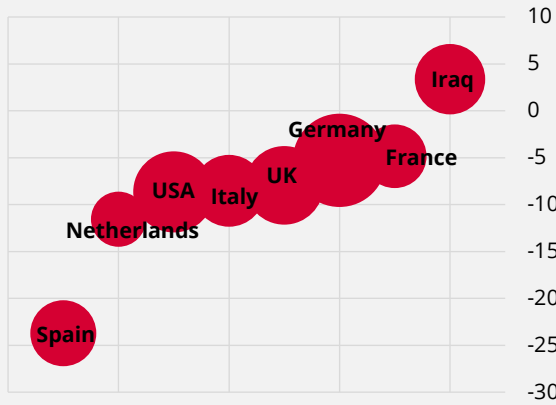
Chart 2: Current Situation and Expectations of Export Orders in the Third Quarter of 2022 (Increase-Decrease, Seasonally Adjusted)



Source: CBRT BTS.

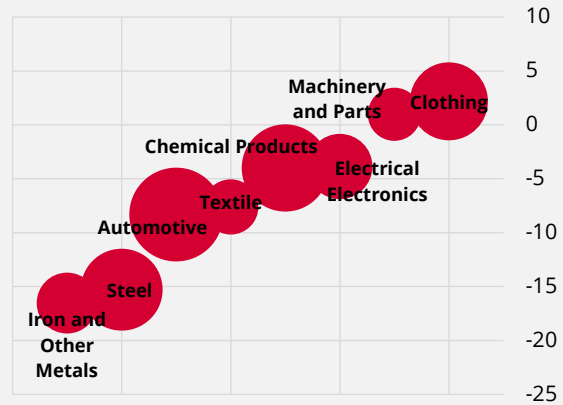
Recent foreign trade developments are in line with the survey data. Seasonally adjusted exports, which had increased steadily in the post-pandemic period, decreased in the third quarter of the year, which was driven by the slowdown in European countries and the USA. It is observed that exports to the eight main trading partners, which constitute 42.5 percent of Türkiye's exports, declined except Iraq (Chart 3). On the other hand, the increase in exports to Russia and Ukraine in this period limited the decrease in total exports. On a sectoral basis, exports decreased in the third quarter in the main exporting sectors, primarily iron, steel, automotive and textile, while exports in the clothing and machinery and accessories sectors increased, albeit slightly (Chart 4).

Chart 3: Change in Exports to Türkiye's Major Trading Partners in the Third Quarter of 2022* (Seasonally Adjusted, Quarterly, %)



Source: Ministry of Trade, TURKSTAT.
 * Ministry of Trade data for September 2022 is provisional. The size of the balloon is proportional to the share of the relevant country in exports.

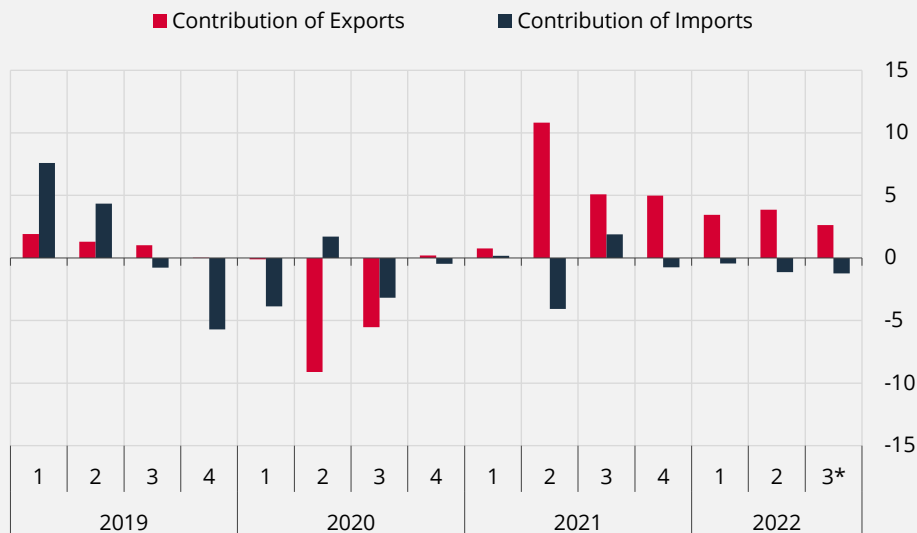
Chart 4: Change in Exports by Sectors in the Third Quarter of 2022* (Seasonally Adjusted, Quarterly, %)



Source: Turkish Exporters Assembly.
 * The size of the balloon is proportional to the share of the relevant sector in exports.

Considering the channels through which the slowdown in foreign demand is reflected on the domestic market, the loss of momentum in exports is expected to limit the strong growth performance in the first half of the year by directly slowing economic activity. As a matter of fact, the positive contribution of net exports, an important driver of growth, to annual growth in the third quarter is expected to decline due to the slowdown in exports (Chart 5).

Chart 5: Contribution of Exports and Imports to Annual Growth (%)

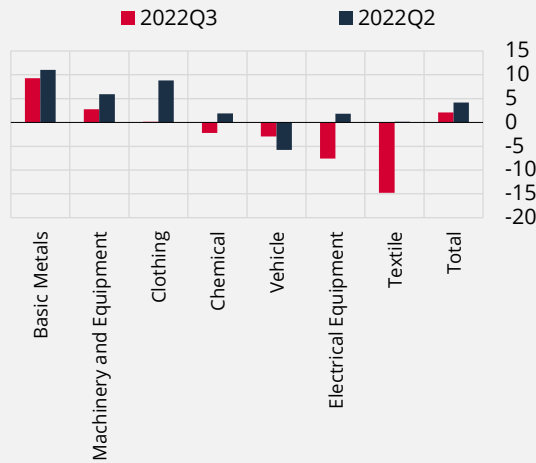


Source: CBRT, TURKSTAT.
 * Forecast for 2022Q3.

The decline in exports may also hit the current positive trend in employment and bring about a slowdown in employment growth, especially in the industrial sector. The employment tendency data in the BTS shows that the employment expectation for the next three months in the third quarter decreased compared to the previous quarter in many sectors, especially in the clothing, textile and electrical equipment sectors (Chart 6).

The slowdown in foreign demand may also put a drag on fixed capital investments, which have maintained their strong course for a long time despite the pandemic. When the fixed capital investment expectations in the BTS are analyzed, it is seen that the investment expectations remained above the long-term average in the third quarter, but there was a decline compared to the second quarter (Chart 7).

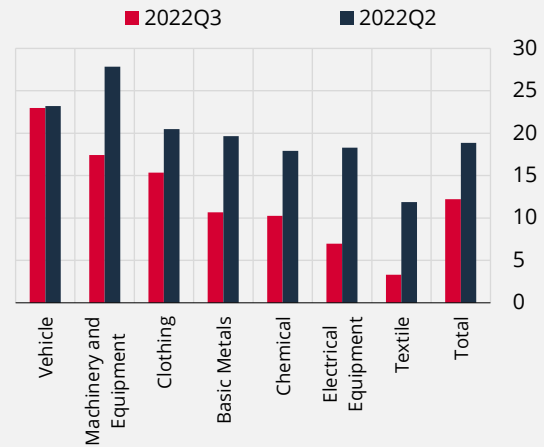
Chart 6: Expectations of Total Employment in the Next Three Months
(Increase-Decrease, Seasonally Adjusted, Difference from Long-Term Average*)



Source: CBRT BTS.

* The average for the period of 2011-2019 was taken as the long-term average.

Chart 7: Fixed Capital Investment Expenditure in the Next Twelve Months Compared to the Past Twelve Months
(Increase-Decrease, Seasonally Adjusted, Difference from Long-Term Average*)



Source: CBRT BTS.

* The average for the period of 2011-2019 was taken as the long-term average.

In the period since the pandemic, the structural transformation in Turkish exports took place alongside (i) the preservation of the production potential as a result of the continuity of investments in the economy and (ii) the decrease in the supply capacities of some other economies in the face of supply-side shocks. The role of exporter firms' dynamic capacity and flexibility in product and market diversification in reducing vulnerabilities to external shocks has been clearly observed. The energy-related risks faced by the European economies will have downward effects on the economic activity in Türkiye through the external demand channel and upwards from the possible substitution of production channel. On the other hand, the increasing trend in exports to countries in the Middle East region (such as Iraq, Qatar, the UAE) whose income increased as a result of the rise in energy prices in the post-pandemic period, and the recent acceleration of exports to markets such as Saudi Arabia, are likely to mitigate the potential risks arising from foreign demand on total exports. In addition to the Middle East countries, the recent increase in exports to Asian countries such as India, Japan and Malaysia also supports this expectation. Therefore, it is considered that the effects on exports and economic activity will occur in the form of a pause in the growth momentum rather than a large-scale and sudden decline, and the export targets announced in the MTP are achievable. On the other hand, financing costs, which are reduced by policy rate decisions and macroprudential measures, will reduce the general repercussions of this effect on the economy in the upcoming period, and contribute to the temporary nature of the expected effects.