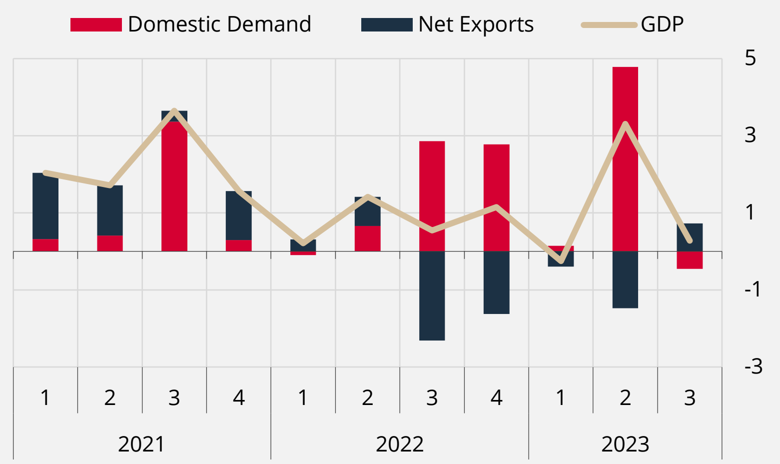
Box 2.1

Rebalancing Process in Domestic Demand

Strong domestic demand driven by high credit growth in the first half of 2023, was one of the main determinants of the rise in inflation and the deterioration in expectations. The tightening in financial conditions that started in June supported the normalization in credit growth and composition. Thus, it contributed to a gradual rebalancing of domestic demand and an improvement in inflation expectations. The course of demand conditions will also play a critical role in ensuring a permanent fall in inflation in the upcoming period. Accordingly, this box examines the impact of the monetary tightening process on demand conditions in sectoral detail with various high-frequency indicators.

Economic activity remained strong in the first half of the year, driven by domestic demand. Strong private consumption and domestic demand were the main drivers of growth, while net exports had a dampening effect on quarterly growth (Chart 1). In the third quarter, GDP growth decelerated on a quarterly basis, signaling the start of the rebalancing in domestic demand following the monetary tightening. With the tightening in financial conditions, the contribution of final domestic demand to quarterly growth declined significantly, led by the contraction in private consumption, while net exports made a positive contribution to quarterly growth for the first time in four quarters. While imports remained high in the first half of the year, mainly driven by imports of consumption and investment goods as well as gold imports, the monetary tightening in the second half of the year, which was reflected on financial conditions and the rebalancing in domestic demand, started to have a dampening effect on imports. In this period, in addition to the slowdown in gold imports, imports of consumption goods also lost momentum (Chart 2).

Chart 1: Gross Domestic Product and Its Components
(Contributions to Quarterly Growth, % Points)

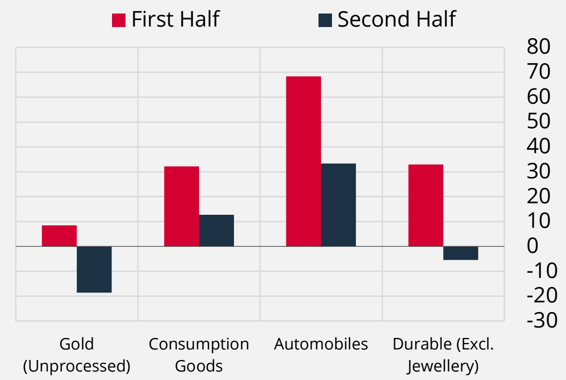


Source: CBRT, TURKSTAT.

Among the leading indicators of consumption, the retail sales volume index and data on card expenditures also point to a loss of momentum in domestic demand since the start of the monetary tightening (Chart 3). The retail sales volume index, which increased by 6.7% and 5.1%, respectively in the first two quarters of the year, decelerated to 0.6% in the third quarter, while the index pointed to a quarter-on-quarter contraction of 0.1% in the last quarter as of November. Recent tendency of the retail sales volume index, which is broadly in line with the private consumption trend, suggests that the loss of momentum in the second half of the year was more pronounced in non-food groups including computers, electronics, housing-related expenditure items, household appliances and furniture. As these groups typically include durable goods that are more sensitive to financing conditions, retail sales volume index data provide signs of the impact of monetary tightening.

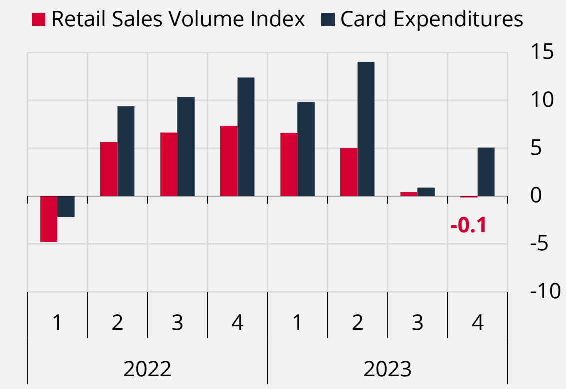
Similarly, data on card expenditures, which provide more timely information about the private consumption tendency, also indicate that domestic demand has started to rebalance. An analysis of card expenditures by sub-sectors deflated by the relevant CPI indices reveals that there were strong increases across sectors in the first half of the year compared to the last quarter of 2022. In fact, in real terms, total card expenditures increased by 9.7% and 14% quarter-on-quarter in the first two quarters of the year, respectively. On the other hand, in the third quarter, the rate of increase in card expenditures slowed down across sectors to 1.1% compared to the strong momentum in the first half of the year. Meanwhile, factors such as the year-end campaigns in the last quarter of the year and the demand incentive, which was brought forward, limited the loss of momentum in demand to some extent. In this period, card expenditures increased by 5.1% quarter-on-quarter but still implied a lower increase compared to the first half of the year.

Chart 2: Imports* (2023, Seasonally Adjusted, Nominal, Six-Month % Change)



Source: CBRT, TURKSTAT.
* Percentage change of imports in consecutive six-month periods.

Chart 3: Retail Sales Volume Index and Card Expenditures* (Seasonally Adjusted, Real, Quarterly % Change)

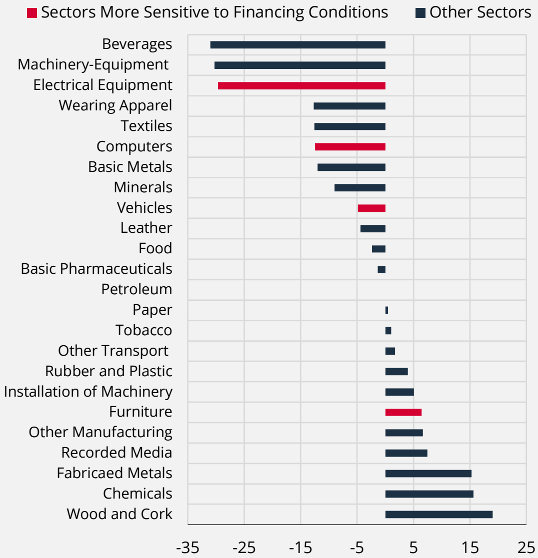


Source: CBRT, TURKSTAT.
* Retail sales volume index is as of November.

In addition to the data on retail sales volume and card expenditures, the BTS, which includes information obtained from interviews with manufacturing industry firms, also enables the current demand conditions to be monitored in sectoral detail. The survey question on the change in the quantity of registered domestic market orders provides leading information on the course of domestic demand. This indicator for domestic market orders is analyzed in the context of the impact of the monetary tightening launched in June on sectoral demand. Accordingly, an analysis of the change in registered domestic market orders in January-June period reveals that 12 out of 24 sectors recorded a decline, while 11 sectors posted an increase (Chart 4). Considering that durable consumption good sectors such as vehicles, electrical equipment, computers and furniture are more sensitive to financing conditions, survey data suggest that domestic demand in these sectors weakened, except for furniture.

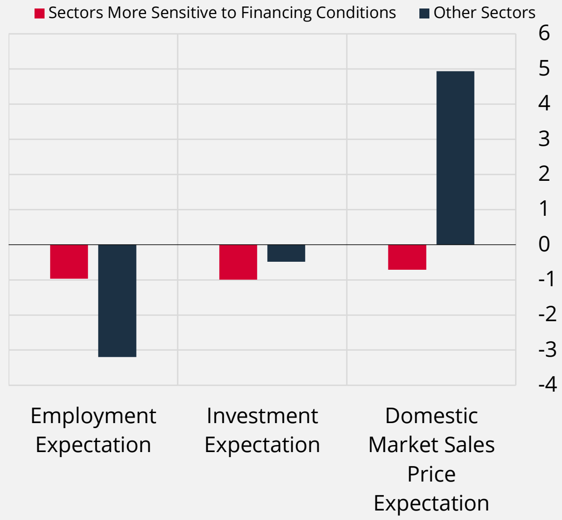
The questions in the BTS also allow examination of employment, investment and price expectation developments at the sectoral level. The sectoral analysis of these developments in terms of sensitivity to financing conditions reveals that employment expectations have decreased in sectors such as computers, vehicles and electrical equipment, which are more sensitive to financing conditions, whereas there has been a limited increase in the furniture sector. When these sectors are aggregated by their weights in the manufacturing industry, employment expectations imply a decrease compared to June but present a more positive outlook compared to other sectors (Chart 5). As for investment expectations, investment expectations decreased in the furniture, vehicle and electrical equipment sectors that are sensitive to financing conditions, while there was an increase in the computer sector. Despite this increase, investment expectations in sectors that are more sensitive to financing conditions decreased more than other sectors. On the price expectations side, domestic market sales price expectations increased in the electrical equipment sector during this period, while price expectations decreased in all other financing-sensitive sectors. When aggregated by their weight in the manufacturing industry, domestic market sales price expectations decreased in sectors that are more sensitive to financing, whereas there was an increase in other sectors.

Chart 4: Quanity of Currently Registered Domestic Market Orders (Increase-Decrease, Seasonally Adjusted, January 2024 – June 2023 Difference)



Source: CBRT.

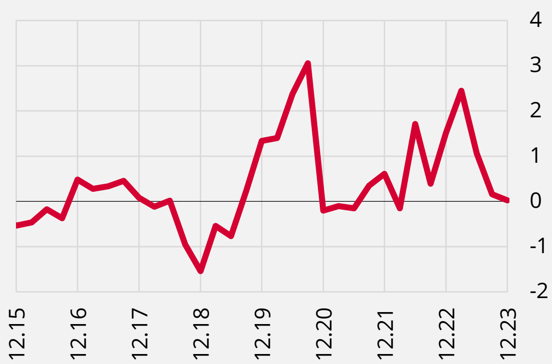
Chart 5: BTS Price, Employment and Investment Expectations* (Increase-Decrease, Seasonally Adjusted, January 2024 – June 2023 Difference)



Source: CBRT.
* Excluding petroleum products sector due to high volatility.

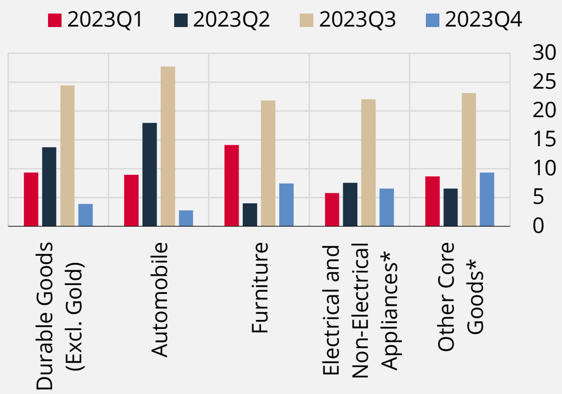
A closer look at how the domestic demand outlook is reflected in consumer prices highlights developments in the durable goods group, where prices are highly sensitive to financing conditions. As implied by sectoral demand data, inflation in durable goods (excluding gold) remained high in the first half of the year due to strong demand and strengthened significantly in the third quarter due to combination of multiple shocks. In the fourth quarter, price increases slowed down significantly in this group due to the completion of the transmission of the shocks to a large extent and campaigns to deplete stocks as well as the loss of momentum in consumer loan growth (Charts 6 and 7). The analysis on a sub-group basis shows that the weakening in price increases in the last quarter of the year spread across sub-groups, with the slowdown in automobiles being more pronounced.

Chart 6: Consumer Loan Growth* (Quarterly, Real, Standardized Value)



Source: CBRT.
* Deflated by CPI. The mean and standard deviations of the series are calculated based on the 2006-2019 period. The quarterly average is taken after weekly real changes are standardized.

Chart 7: Prices of Durable Goods and Its Sub-Items (Seasonally Adjusted, Quarterly % Change)



Source: CBRT, TURKSTAT.
* No seasonality detected.

In sum, with the reflection of the monetary tightening process that started in June on financial conditions, domestic demand started to balance, and accordingly, the import tendency weakened while an improvement in pricing behavior and expectations was observed. On the other hand, it should be noted that domestic demand remains resilient due to the wage updates in January, and despite this balancing tendency, the current level of domestic demand may be a risk factor on inflation.