

SLOWDOWN AMID FINANCIAL INSTABILITY

Turkish economic growth is slowing down. Excluding changes in inventories, final demand contracted in Q2 2025, after slowing significantly in Q1. In doing so, it rebalanced with less consumption and more investment. The contribution of foreign trade has become negative, but for the time being, the current account deficit remains contained thanks to lower energy bills and tourism revenues. Persistent inflation remains the main obstacle to growth, not only because of its detrimental effects on purchasing power and external competitiveness (through the appreciation of the real exchange rate), but also because of the constraints it imposes on monetary policy in a context of temporary but recurring financial instability. Despite the increase in the budget deficit, the public finance situation offers room for manoeuvre if needed.

GROWTH: INCOMPLETE REBALANCING

In Q2 2025, real GDP growth rebounded (+1.6% q/q) due to a very strong contribution from inventories, as companies likely anticipated the effective tightening of US customs duties. Final domestic demand (i.e. excluding inventories), which had already slowed (+0.5% q/q in Q1 compared with an average of 1.9% in Q3 and Q4 2024), contracted by 0.7%.

Household consumption declined for the second consecutive quarter. Employment has not grown since 2024 and the unemployment rate (8.5% in August) has not fallen since early 2025. Furthermore, after a period of recovery in 2023 and 2024, the purchasing power of wages slowed sharply (+3.2% in H1 2025 compared to H1 2024, compared to 21% in 2024 on average for the year); there was only one minimum wage increase on 1 January 2024 and 2025, compared with twice a year in 2022 and 2023. Finally, households made much less use of credit card purchases in Q2; At the end of 2024, outstanding credit of this type, which is very widespread, accounted for nearly half of household credit, compared with 21% at the end of 2019. Public consumption in volume terms¹ was stable in H1 2025 compared with H2 2024, reflecting the neutrality of fiscal policy (see below).

Unlike consumption, investment remained well oriented thanks to investment in construction (+4.3% in H1 2025 compared with H2 2024, which itself was up more than 4% compared with H1 2024) and, to a lesser extent, investment in equipment (+1% in H1 2025). The investment rate has remained stable at between 25% and 26% of GDP since 2022, compared with 30% between 2015 and 2019, as investment in construction has not yet returned to its pre-COVID-19 level. However, the equipment component has grown very significantly, from 4.8% of GDP in 2019 to 6.7% in Q2 2025.

The massive investment in equipment over the last five years (+83% in volume between 2019 and 2025), combined with investment in intangible assets (software and R&D, +43% over the same period), has resulted in an increase in productivity (+10% in the manufacturing sector since 2019), which has partially offset the very sharp increase in production costs (energy and wage catch-up). This is one of the reasons (along with the shift towards markets other than Euro area and UK and the dynamism of tourism) why exports of goods and services have so far held up fairly well. In volume terms, exports remained stable in H2 2025 compared with H2 2024, despite i/ weak growth in imports from the Eurozone and the United Kingdom, Türkiye's main foreign markets, and ii/ the appreciation of the real exchange rate since 2022 (+25% based on producer prices).

In H1 2025, however, the net contribution of foreign trade was negative, as restocking in Q2 pushed up imports. The trade balance excluding net energy imports turned negative between April and July.

Ultimately, on the one hand, growth has become more balanced, with

¹ The change in real terms in the total wage bill and purchases of current goods and services (i.e. excluding investments) by public administrations.

FORECASTS

	2022	2023	2024	2025e	2026e
Real GDP growth, %	5.5	5.1	3.3	3.5	3.5
Inflation, CPI, year average, %	72.3	53.9	58.5	35.0	25.8
Central gov. balance / GDP, %	-1.0	-5.1	-4.7	-3.8	-3.5
Gen. Gov. debt / GDP, % (EU standards)	29.4	28.2	23.6	23.1	23.5
Current account balance / GDP, %	-5.1	-3.7	-0.8	-1.3	-1.8
External debt / GDP, %	49.6	44.0	39.1	36.2	34.5
Forex reserves, USD bn	82.9	92.8	90.7	91.9	96.4
Forex reserves, in months of imports	2.6	2.9	2.9	2.8	2.8

e: ESTIMATES & FORECASTS

SOURCE: BNP PARIBAS ECONOMIC RESEARCH

TABLE 1

TURKIYE : ACTIVITY INDICATORS (2019=100)

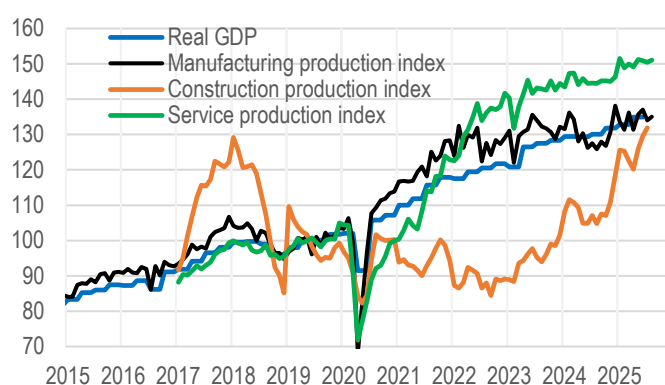


CHART 1

SOURCE: TUIK

lower consumption and higher investment, but on the other hand, foreign trade has become a negative factor. Nevertheless, the current account deficit remains contained (-1.3% of GDP over 12 months in July), thanks in particular to tourism revenues (USD 49 billion over 12 months in July, or just over 3% of GDP).



FINANCIAL INSTABILITY: A CONSTRAINT ON MONETARY POLICY

Persistent inflation remains the main obstacle to growth, not only because of its detrimental effects on purchasing power and external competitiveness (through the appreciation of the real exchange rate), but also because of the constraints it imposes on monetary policy in a context of financial instability.

Inflation remains high. The monthly change in the consumer price index has even accelerated since May, rising from 1.4% to 2.6% on average over the August-October period, with the result that the year-on-year decline in inflation has come to a halt since July, stabilising at around 33%. The main reason for this is exchange rate volatility.

During the second half of March, the country experienced a new episode of financial tensions triggered by the domestic political situation. Significant outflows of non-resident portfolio investments led the Central Bank to halt its monetary easing policy, forcing it to raise its key interest rates in April.

Ultimately, tensions over yields and risk premiums on government bonds quickly subsided during the second quarter. Five-year CDS premiums even reached a low point during the summer, at just 215 basis points (the historical average is around 200 basis points). The Central Bank was able to lower its main policy interest rate (the one-week repo rate) again in July and September, bringing it down from 46% in April to 39.5% currently.

However, government bond yields did not follow this easing of policy rates and remained at a higher level than before the stress episode.

The impact of this period of stress should be limited in principle. The government's interest burden will only increase marginally if bond yields stabilise at current levels (30% for 10-year bonds). For households and businesses, lending rates follow the Central Bank's key interest rates (Chart 2) and have therefore already eased. Furthermore, household and corporate debt ratios remain moderate.

However, in a context of ongoing political risk, which is a source of exchange rate and interest rate volatility, the monetary authorities may be forced to reverse course at any time. Even if temporary, episodes of volatility weigh on business confidence. Under these conditions, the Turkish economy can only recover gradually, as monetary policy remains very restrictive² and fiscal policy is unlikely to provide much support.

PUBLIC FINANCES: ROOM FOR MANOEUVRE IF NEEDED

Public finance metrics continued to improve. However, the budget deficit increased significantly in 2023 and 2024, but this deterioration was largely due to budgeted expenditure related to the 2023 earthquake. Excluding this expenditure, the deficit was only 3% of GDP in 2024. Excluding interest payments, it was only 0.2%.

This year, the primary balance (i.e. excluding interest charges) fell from -2.2% in December 2024 to -0.5% in August 2025, thanks to both an increase in revenue (+1 percentage point of GDP) and control of non-interest expenditure (-0.7 percentage points of GDP). However, interest expenditure increased from 2.8% of GDP in Q4 2024 to 3.4% in Q2 2025, as i) the negative gap between real bond yields and real GDP growth (negative snowball effect) narrowed with pressure on bond yields, and ii) the debt-to-GDP ratio increased slightly in the first half of 2025.

² The central bank's real repo rate is 8% based on observed inflation and 19% based on expected inflation.

³ The debt ratio for the general government sector is only slightly higher (24.1% of GDP).

TURKIYE : INTEREST RATES AND DOMESTIC CREDIT

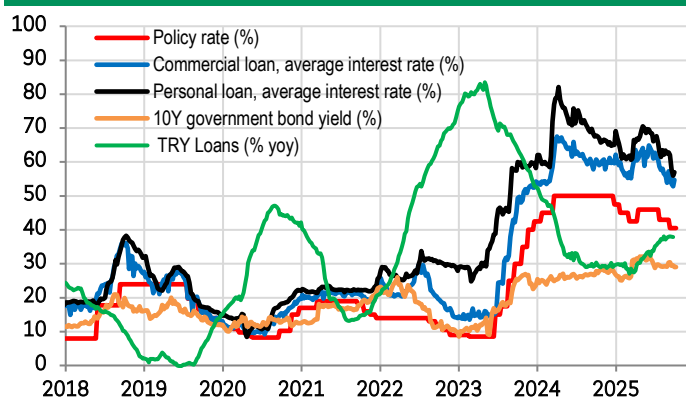


CHART 2

SOURCE: BDDK - TCMB - MACROBOND

However, the debt trend remains very favourable; the central government debt ratio has been reduced by 15 percentage points of GDP since the end of 2020. It stood at only 21.9% in June 2025³. This is due to moderate primary deficits and, above all, a strong negative snowball effect and, since 2022, the real appreciation of the pound. The structure of debt remains risky because a significant portion is denominated in foreign currency (53%) and the maturity of domestic debt is short (3.4 years at the end of 2024, compared with an average of 7.9 years for Eurozone countries).

In its medium-term programme (MTP) for 2026-2028 published in September, the Ministry of Finance revised the budget deficit for this year upwards to 3.6% of GDP. However, excluding earthquake-related expenditure, it should remain moderate at -2.8% despite the increase in interest charges. Excluding exceptional expenditure and interest charges, the budget is even expected to show a slight surplus (0.2% of GDP), based on growth assumptions that are more realistic than those in last year's MTP. Fiscal policy will *a priori* be neutral for economic growth in the short term, even if there is some room for manoeuvre.

The Treasury is not experiencing any financing difficulties, although occasional financial tensions sometimes force it to postpone international bond issues, as was the case in the first part of the year. Since January, however, it has issued the equivalent of USD 8.75 billion in global bonds in USD or euros and Sukuk bonds in USD.

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François Faure

francois.faure@bnpparibas.com



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