

# VAKIFBANK TURKISH ECONOMY WEEKLY


**Souring Quality of C/A  
Financing Together With  
Increasing Uncertainty**

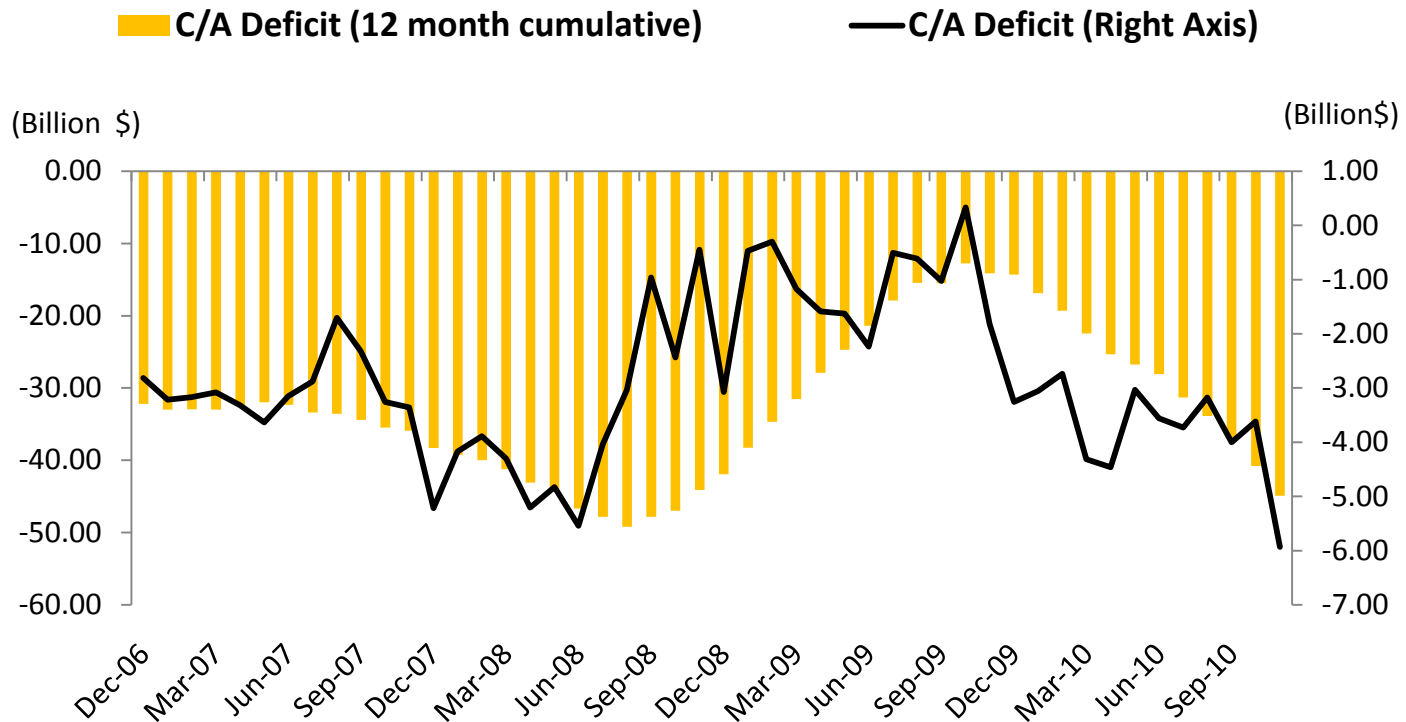


T. Vakıflar Bankası T.A.O



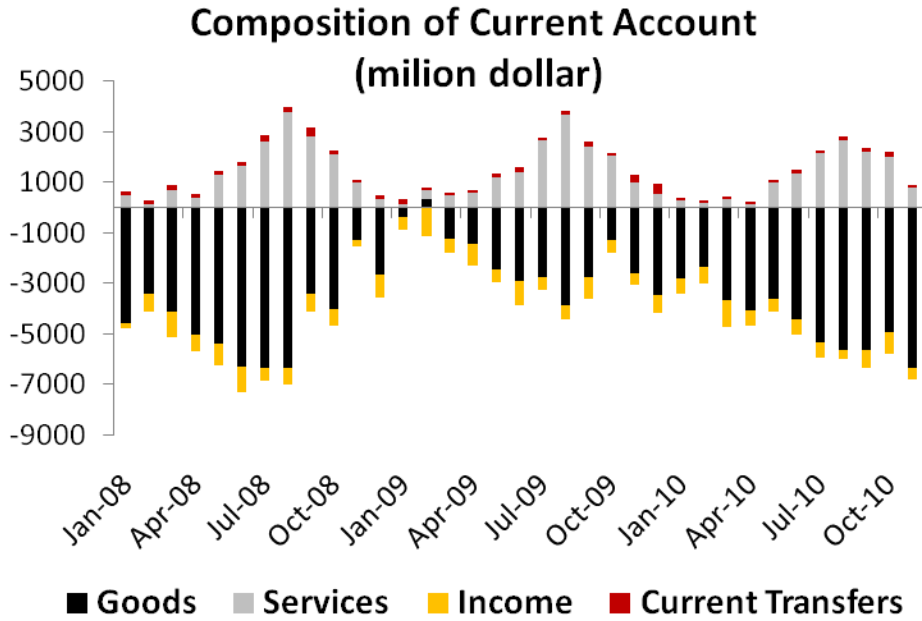
# Current Account Deficit is wider than expected in November...

 The current account (C/A) deficit came at US\$5.9 billion in November which is above market consensus of \$5.7 billion and under our forecast of \$6.3 billion. With November data the C/A deficit in the first eleven months of the year reached \$41.5 billion as compared to \$11.4 billion in the same period of 2009.



Source: CBRT

## Foreign trade deficit has the highest impact on C/A deficit...



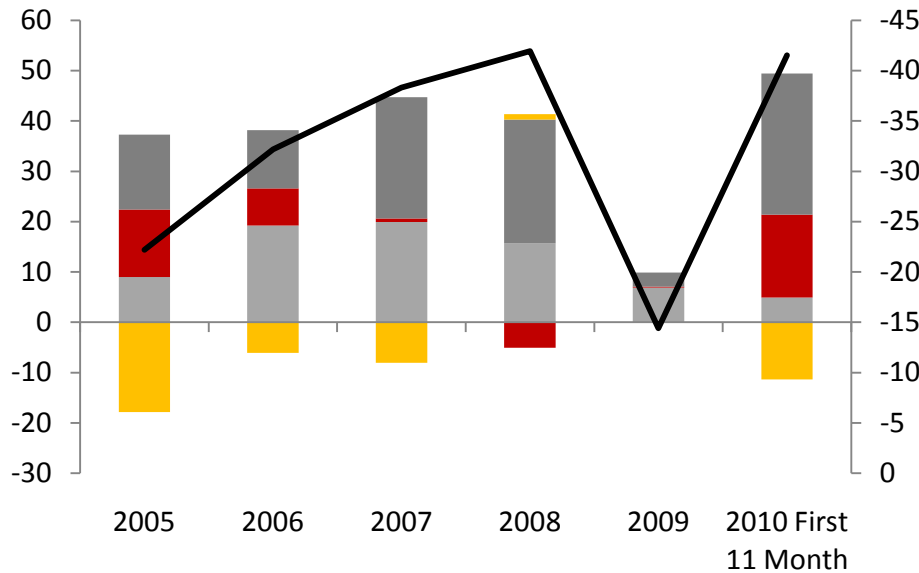
Source: CBRT

- Foreign trade deficit increased by 144.5% to \$6.37 billion in November 2010 compared to the same month of 2009. Increase in imports is the main reason of the rise in foreign trade deficit.
- Import/export ratio declined to 55.1% which is the lowest level of the last 5 years, due to weak foreign demand together with strong domestic demand conditions.

- Surplus in services decreased by 18% to \$13.1 billion in the first 11 months of 2010 while it was \$15.96 billion in the same period of 2009 as a result of the 8% fall in net travel revenues and 87% decline in net transportation revenues.
- Income deficit decreased by 7% to \$6.9 billion in the first 11 months of 2010.
- Current transfers decreased by 35%. Especially the 49% decline in general government sub item has been effective in this fall.

## Main financing source for C/A deficit is portfolio investments...

**Capital And Financial Account (billion \$)**



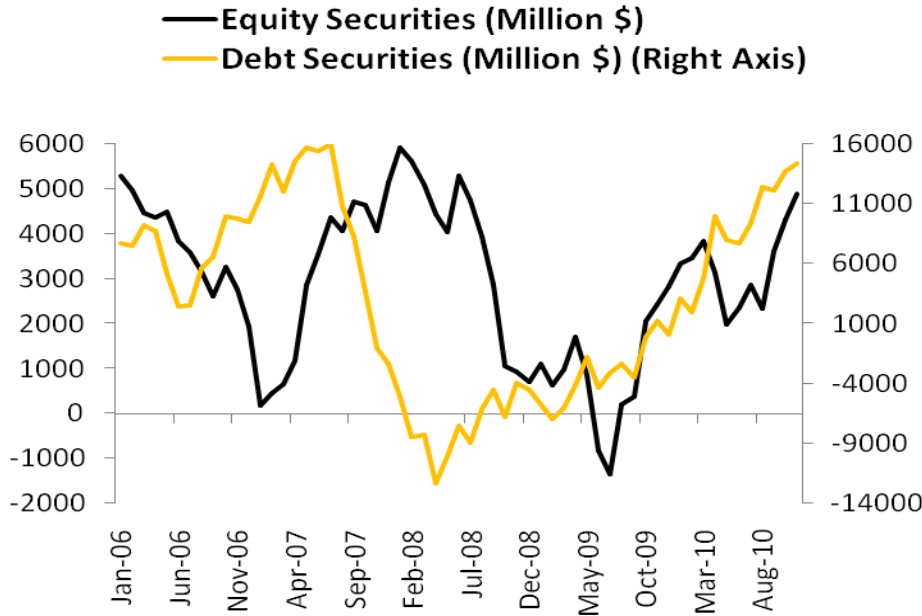
Direct Investment  
 Other Investment  
 Current Account (Right Axis)

Portfolio Investment  
 Reserve Assets

Source: CBRT

- In January-November 2010 period, the capital and financial account cumulative total reached to \$38.1 billion compared to \$7.26 billion dollar in the same period of 2009.
- FDI inflows were lower (\$4.9 billion) compared to the same period of 2009.
- Portfolio investment was \$16.51 billion in Jan-Nov 2010 compared to \$851 million in the same period of 2009.
- With \$28 billion, other investment had the largest share in financing of the current account deficit in Jan-Nov 2010.

## Foreign investors remained more inclined to government debt securities...

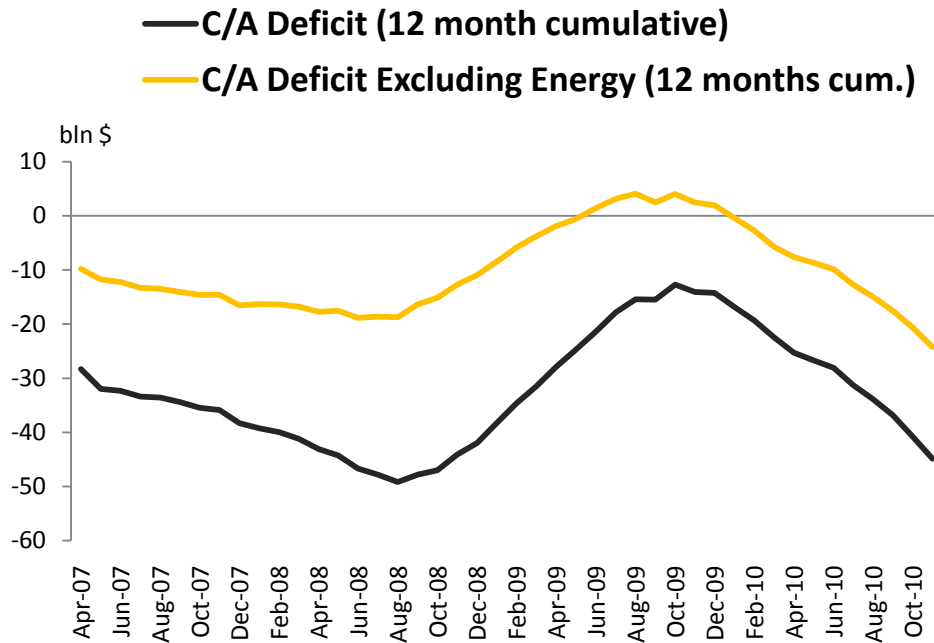


Source: CBRT

- Overall purchases of government debt securities was higher than equity purchases in November. In Jan – Nov 2010 period, total equity purchases amounted to just \$4.3 billion.
- On the other hand, foreign investors bought \$10.3 billion government debt securities in local markets.

- Reserve assets recorded an increase of \$11.4 billion in Jan – Nov 2010, contrary to \$1.1 billion decrease in the same period of 2009.
- Net errors and omissions also decreased to \$3.53 billion in the 11 months of 2010 while it was \$3.77 billion in the same period of 2009

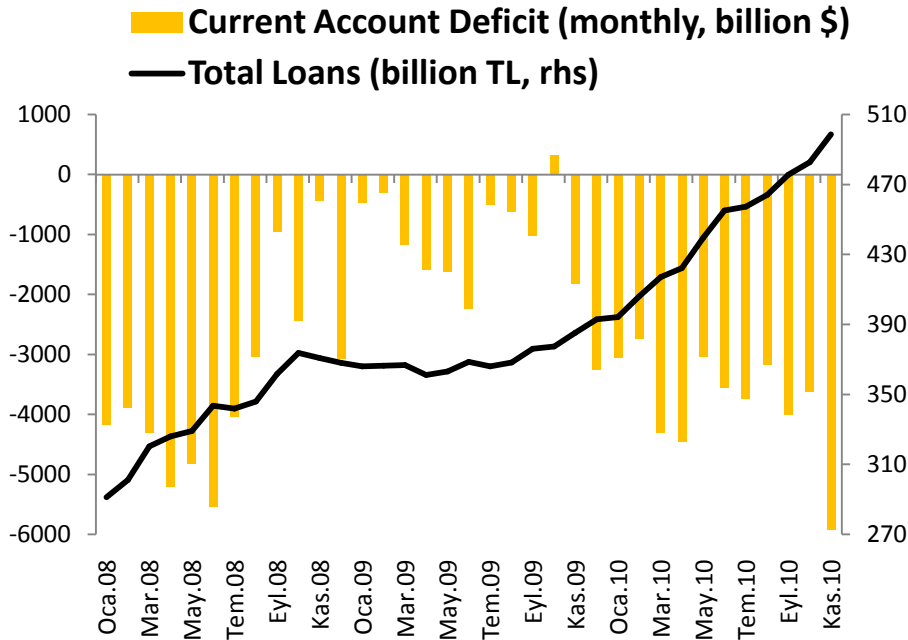
## Another reason of the increase in C/A deficit is energy prices...



Source: CBRT, Turkstat

- ▣ The gap between C/A deficit and C/A deficit excluding energy continued to expand in November.
- ▣ The main reason of expanding C/A deficit in November is increasing imports due to strong domestic demand conditions rather than increasing energy costs.
- ▣ In the next period, there may be a risk of increase in Turkey's energy import cost due to increasing prices of oil and other production inputs.

# Total credits of the banking sector remains high, while the quality of the C/A deficit financing is still weak...



Kaynak: CBRT, BRSA

Main reasons of the increase in C/A deficit in Jan-Nov 2010 period can be summarized as:

- Difference between the pace of domestic and foreign demand,
- Domestic credit expansion,
- Increase in commodity prices.








The increase in domestic loans carried C/A deficit to pre-crisis levels.

Increasing C/A deficit depends on not only domestic commercial loans but also appreciation in exchange rate, commodity prices and low rates in developed countries.

■ The widening of the C/A deficit has serious macroeconomic and financial risks.










■ Financing the deficit with short term capital inflows is at the top of the list.

## ***Inflationary pressures may create vulnerability...***







-  Strong growth performance, low price pressures, sustainable budget deficit and strong banking sector are drawing a bright outlook for Turkish economy.
-  However, rising C/A deficit stays as an important weakness.
-  Inflation may also turn into an additional cause of fragility.
-  World economy finished 2010 under subdued inflationary pressures.
-  It is generally expected that the inflationary pressures become stronger in specifically EM economies on a broad extent .
-  The loose monetary policies of developed countries especially the QE2 steps of the FED are expected to have inflationary effects in EM economies via capital inflows.
-  The probability of such an effect to arise in Turkey must not be overlooked.











## ***Recent change in the CBT policy may cause inflationary pressures...***

-  There's not a marked improvement in US growth outlook recently and the inflationary pressures seem to be subdued.
-  Problems of the Eurozone countries are still prevailing.
-  On the other hand, Germany has a strong growth performance with the record low unemployment rate, which may trigger inflation and as a result necessitate an earlier tightening of monetary policy.
-  CBT's rate cut decision in December has been taken in an environment in which the EM central banks are preparing for rate hikes and received cautious reactions.
-  It is claimed that CBT decision which was intended to limit portfolio capital inflows, might increase inflation under strong demand conditions.
-  However, CBT's concerns about potential inflationary pressures lies behind the rate cut decision.
-  Main risk about the CBT's unconventional policy is the failure in preventing the overheating of the economy.
-  Due to the low costs of borrowing, CBT's arrangements on reserve requirements may cause banks to increase their foreign liabilities and try to expand their credit portfolios further.
-  The decline in interest rates may also induce banks foreign liabilities as a result of the fall in the propensity to save.

## ***The relationship between financial stability and overvaluation of TL...***

-  The appreciation of the TL in real terms since the beginning of 2010 is an important factor on the C/A deficit expansion.
-  The rise in the exchange rate which resulted in some portfolio outflows from the equity market since December may limit the rise in C/A deficit.
-  Today, the world and Turkish economy is in a different conjuncture than May 2006.
-  If new policy of CBRT can't help prevent capital inflows and credit expansion, overheating in the economy may cause a rapid increase in inflation.
-  It is claimed that in this situation, even if CBRT begin to increase interest rates, loss of confidence as in May 2006 may cause capital outflows and a rapid increase in exchange rate.
-  But, due to the different conjuncture, the probability of a volatility effecting only Turkish economy is thought to be relatively low for the moment.

## ***Turkey's credit rating is widely expected to increase...***

-  If CBT fails to attain its policy goals, the possible loss of confidence may be prevented as a result of a possible increase in Turkey's credit rating.
-  The fact that the markets didn't overreact CBT's unconventional policy, indicate that a possible loss of confidence may be limited compared to the pre-crisis period.
-  On the other hand, it is a fact that the global financial crisis made the investors very sensitive to potential losses.
-  Due to the fact that Turkey's production is highly dependant on imports, depreciation of TL would increase import costs besides its positive effect on exports.
-  Eurozone countries problems are the main global threats which may trigger capital outflows in Turkey.
-  Inflation and strong capital inflows are the threats coming from EM countries.
-  Relative interest rate gaps are strongly related to the widening of the C/A deficit in Turkey.
-  A probable increase in Turkey's credit rating might induce foreign direct investments in Turkey.

## ***CBT's unconventional policy increased uncertainty...***

- EM central banks are signaling rate hikes emphasizing expected inflationary pressures.*
- CBT's rate cut in Turkey, brings out the widening of the gap between Turkish and EM interest rates.*
- As a result of this expectation, the fear of a sudden and serious depreciation of TL has recently increased uncertainty in Turkey.*

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