

Turkey Macro Flash

February C/A corroborates external adjustment story

- At US\$3.2bn, the current account deficit in February came in somewhat wider than the consensus (US\$3.0bn) and our forecast (US\$3.1bn). A closer look at the data lends support to our view that an external adjustment is underway. Specifically, the current account gap in the first two months of the year is about US\$2.8bn narrower than the deficit seen in the same period of 2013. The magnitude of the correction during the same period still remains significant (around US\$2.1bn) in the case of the underlying deficit excluding energy and gold.
- A quick glance at the seasonally adjusted data also confirms that an adjustment is underway, as the current account gap in February is about US\$0.8bn narrower than the previous month. We expect the current account gap to narrow on the back of a weaker lira and a sub-par growth from 7.9% of GDP in 2013 to about 5% this year ([Turkey Macro View - Will the external adjustment beat the consensus estimate?](#)).
- On the capital account front, standing at US\$1.8bn in the first two months of the year, FDI inflows turned out to be somewhat stronger than they were in the same period of 2013 (US\$1.3bn). During the same period, we see a sharp reversal in errors and omissions (to US\$4.5bn from -US\$2.0bn), as portfolio inflows (equity net) remain weak. All in all, external financing continues to be highly tilted toward shorter term inflows and more stable sources of funding like FDI remain rather unimpressive.
- We look for a more aggressive external adjustment than the consensus view. While this is encouraging and bodes well for Turkish assets, we argue that, projected at about 5% of GDP, Turkey's current account deficit remains too wide for comfort. This, coupled with the country's large external financing needs, will continue to leave Turkish assets at the mercy of global financial markets. In this respect, we believe that Moody's recent decision to change the outlook on Turkey's Baa3 rating to "negative" from "stable" demonstrates that there is little room for policy slippages.

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Figure 1. Current Account, Actual and as Forecast, February 2014 (US Dollars in Billions)

February 2014	Actual	Citi Forecast	Market Forecast	Previous Release
Current account (US\$ billion)	-3.2	-3.1	-3.0	-4.9
Merchandise trade	-3.5	-3.4		-5.3
Services	0.9	0.8		0.9
Income	-0.6	-0.6		-0.5
Transfers	0.1	0.1		0.0

Source: Bloomberg and Citi Investment Research and Analysis

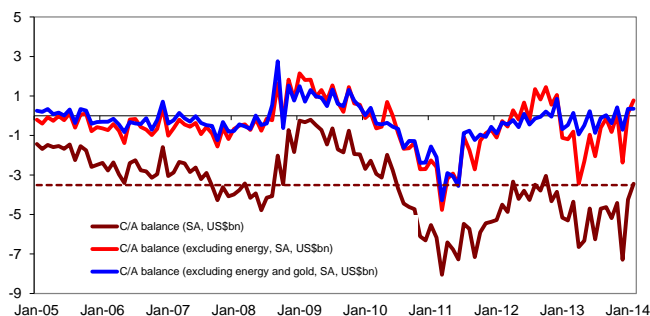
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Forecast Implications

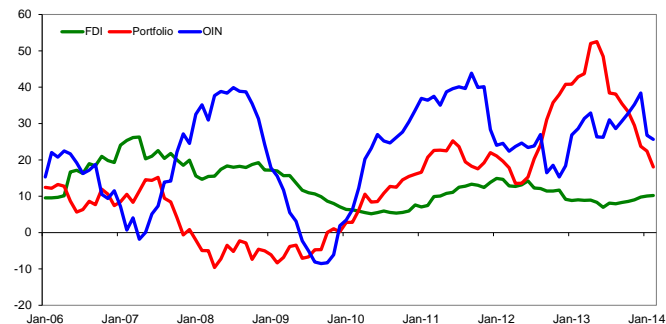
We expect the current account deficit to narrow this year to about 5.0% of GDP from 7.9% in 2013 thanks to the lira depreciation and weaker domestic demand. A quick look at the seasonally adjusted monthly growth rate of imports excluding gold and energy suggests that domestic demand remains soft. In our view, the possibility of a narrower deficit than we envision cannot be ruled out given downside risks associated with our 2014 GDP growth forecast.

Figure 2. Current Account Balance (SA, US Dollars in Billions)



Source: Citi Research and Haver Note: Tramo-Seats is used for seasonal adjustment

Figure 3. Capital Account Developments (12-month rolling, US\$bn)



Source: Citi Research and Haver

Policy Implications

As we discussed earlier ([Turkey Macro View - Will the external adjustment beat the consensus estimate?](#)), we look for a more aggressive external adjustment than the consensus view. Our forecast is underpinned by a reversal in net gold exports, an improvement in the underlying current account balance, which excludes energy and gold, and softer oil prices. It is worth noting that the likely reversal in net gold exports and exports to the Euro zone can be stronger than expected, thereby leading to a narrower current account gap than we foresee. By contrast, pre-mature monetary policy easing and stronger domestic demand could lead to a wider current account gap than we envisage.

It is true that the envisaged external adjustment is encouraging and bodes well for Turkish assets. However, we argue that, projected at about 5% of GDP, Turkey's current account deficit remains too wide for comfort. This, coupled with the country's large external financing needs, will continue to leave Turkish assets at the mercy of global financial markets. In this respect, we believe that Moody's decision to change the outlook of Turkey's Baa3 rating to "negative" from "stable" demonstrates that there is little room for policy slippages ahead of the upcoming presidential and general elections.

Appendix A-1

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