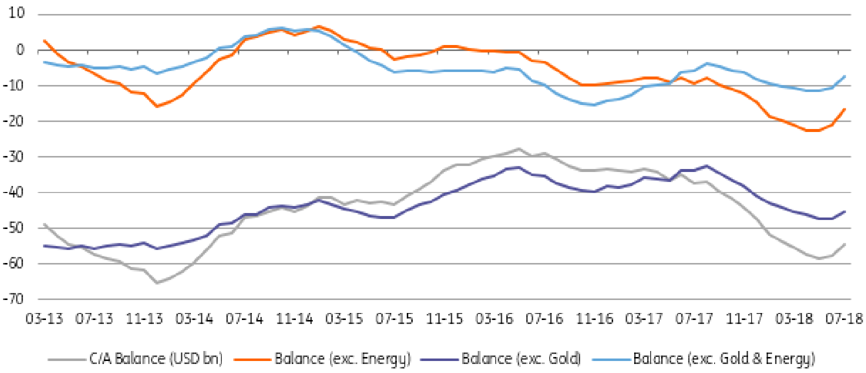
Turkey: Current account gap narrows in July

After widening for more than two years, Turkey's 12-month rolling deficit changed direction in June, a trend which continued into July. And this is just the start. With strength in exports and a sharp decline in import demand, the external deficit is set to narrow further in the months ahead

Source: Shutterstock

External Balances (USD bn, 12M rolling)



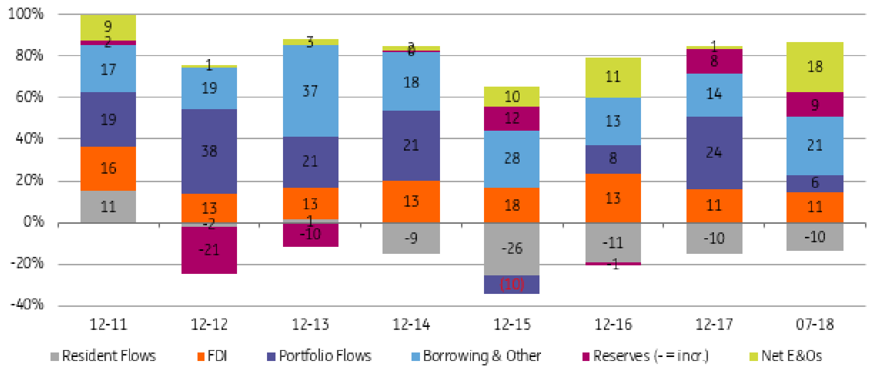
Source: CBT, ING Bank

Turkey's external deficit, which had been rising from early 2016 onwards until June this year, contracted for a second month in July to $1.8 billion, close to the consensus estimate. As such, the 12-month rolling deficit narrowed to $54.6 billion, translating into roughly 6.3% of GDP. This trend will likely remain in place going forward as signs of a significant softening in domestic demand curb imports. Meanwhile, exports should remain supported by the ongoing strength in external demand and increasing price competitiveness from the Turkish lira's depreciation, as well as healthy tourism revenues.

The improvement in the current account deficit from the same month a year ago is attributable to a declining trade deficit and strong services income, supported by an ongoing boom in tourism, despite a plunge in secondary income.

Breakdown of C/A Financing* (12M Rolling, USDbn)

(* Positive sign in reserves shows reserve accumulation)



Source: CBT, ING Bank

On the financing front, in the first month after the general election and just before the significant August volatility, capital flows turned slightly positive, though at $1.2 billion, have remained very weak given Turkey's large external financing needs. Inflows were driven by small increases in foreign banks' deposits, trade credits, borrowing and FDI despite continuing asset increases of residents abroad and portfolio outflows. Accordingly, Turkey relied on net errors and omissions at $3.0 billion (reaching $18 billion on a 12-month rolling basis), while reserves recorded a $2.4 billion increase.

Regarding borrowing, the corporate sector managed a net $0.7 billion of long-term borrowing, which translated into a rollover ratio of close to 170%. Banks, on the other hand, were net payers in the long-term, with a monthly rollover ratio of 84%. These ratios show that the Turkish banking and corporate sectors have maintained access to foreign funding despite a relatively difficult backdrop.

Given the ongoing loss of momentum in the economy and a weaker Turkish lira, the trade balance is likely to recover, indicating that we will see further improvement in the external deficit. On the other hand, the outlook for capital flows has weakened, with an increasing reliance on reserves and net errors and omissions that is likely not sustainable for long. Given this backdrop, a swift policy reaction is required to improve the flow outlook.

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