Bahçeşehir Üniversitesi Ekonomik ve Toplumsal Araştırmalar Merkezi
Betam

Economic Outlook and Forecasts: July 2014

BAHÇEŞEHİR ÜNİVERSİTESİ

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RAPID DECLINE IN THE CURRENT ACCOUNT DEFICIT

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Executive Summary

In May, seasonally adjusted Industrial Production Index (IPI) declined by 1.0 percent from the previous month. Export volume index increased by 0.1 percent, and the import volume index increased by 2.6 percent. Indicators show that the revival in consumer and investment remained weak in the second quarter. Gold-excluded exports and imports increased almost at the same pace, therefore, contribution of net exports remains limited. Due to the fall in the IPI, we revise down our forecast for the second quarter. We reduce our quarter on quarter (QoQ) growth forecast from 0.8 percent to 0.4 percent, and the corresponding year on year (YoY) forecast from 3.8 percent to 3.4 percent.

The current account deficit continues to fall rapidly due to fall in gold imports. The current account deficit in May was $3.4 billion. 12-month rolling current account deficit declined by $4.2 billion in May, and fell to $52.6 billion. We expect the current account deficit to GDP ratio to fall to 6.4 percent at the end of the second quarter, and the gold-excluded current account deficit to be 5.8 percent.

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Table 1.Betam's quarterly and annual growth rate forecasts

	2014 2. Quarter (%)
Real GDP growth, % (quarter on quarter, sa*)	0.4
Real GDP growth, % (year on year, ca**)	3.4
Current account deficit (% of GDP, annual)	6.4
Gold Excluded current account deficit (% of GDP, annual)	5.8

Source: Betam.*sa: seasonally and calendar day adjusted **ca: calendar day adjusted.

Domestic demand is weak

In May, industrial production declined by 1 percent and returned to its March level. The two-month average IPI increased only marginally, by 0.1 percent, from the previous quarter. The main cause of the fall in May was the decline in investment goods production. Both the investment goods imports and the capacity utilization rate of investment goods production declined, weakening the investment outlook. The deceleration in consumer and intermediate goods imports and declines in durable goods production for two consecutive months indicate that private consumption is not strong either.

Exports continue to increase, but slowing European economy curbs the increase in exports. Imports, on the other hand, increased mildly. Weaker exports data and stronger imports in the second quarter compared to the previous quarter will reduce the contribution of net exports to growth.

Data released so far show that the revival in the domestic demand is weak in the second quarter and the contribution of net exports is not as strong as the previous quarter. Therefore, we revise down our forecast for the second quarter. We reduce our quarter on quarter (QoQ) growth forecast from 0.8 percent to 0.4 percent, and the corresponding year on year (YoY) forecast from 3.8 percent to 3.4 percent.

The current account deficit is declining rapidly. One of the major reasons for this rapid decline is the normalization in gold imports which last year had increased to all time high levels. However, gold-excluded current account deficit also declined significantly, and this was caused by the ongoing weak domestic demand. We expect the current account deficit to GDP ratio, which was 7.5 percent at the end of the first quarter, to fall to 6.4 percent at the end of the second quarter. Moreover, we expect the gold-excluded current account deficit to GDP ratio, which was 6.4 percent at the end of the first quarter, to fall to 5.8 percent at the end of the second quarter.

Risks continue for growth outlook

The turmoil in Iraq continues to pose a threat to the Turkish economy. Trade between Turkey and Iraq is affected heavily, Turkish exporter's council data shows about 20 percent decline in exports to Iraq in June. Oil prices increased slightly due to Iraq related concerns, but remains limited since the conflict has not spread to southern Iraq.

Unemployment rate and inflation in the US, two important indicators that FED follow closely, show signs of improvement. Monthly asset purchasing is expected to end in October. If positive outlook continues, discussions on timing of interest rate hikes in the US will dominate markets and will probably cause capital outflows from emerging markets. On the European front, following interest rate cuts and targeted long-term loan program, ECB will not be looking into an asset purchasing program in the near future. Therefore, it's not likely that the ECB will make a move that can revive capital inflows to emerging markets.

Under these conditions, outlook for the Turkish economy is weak and we believe it is hard to achieve 4 percent growth in the second half of the year.

Private consumption will contribute positively in the second quarter

In May from the previous month, consumption goods imports and non-durable goods production increased by 1.0 percent and 0.6 percent, respectively. However, durable goods production fell by 0.4 percent in the same period. After consumer confidence index fell by 3.3 percent in May, it further declined by 2.3 percent in June. We believe that contribution of private consumption expenditure to growth was positive but weak in the second quarter.

Private investment declined in May

In May, from the previous month, investment goods imports and investment goods production declined by 6.1 percent and 5.7 percent, respectively. The IPI fell by 1.0 percent in the same period. The capacity utilization rate (CUR) continues its volatile course. It had declined 0.6 percent in May, however, increased by 0.5 percent in June. After a long upward trend, real sector confidence index declined by 0.6 percent in June, but it is still above the previous quarter level on average. Even though investment indicators are negative in May, the QoQ increase in investment imports remains high. Therefore, we expect private investment to contribute positively to growth.

The contribution of net exports is weakening in the second quarter

Figure 2 shows monthly changes of seasonally adjusted import and export volume indices. In May from the previous month, export volume index and import volume index increased by 0.1 and 2.6 percent, respectively. In the same period, gold-excluded real exports did not change, while gold-excluded real imports declined by 3.8 percent. Due to the fall in gold exports in April, export volume index seems to decline sharply, QoQ. However, gold-excluded real exports continue to increase. We expect the contribution of net exports in the second quarter to be positive but weaker than the previous quarter.

Sharp decline in the current account deficit

In May, the current account deficit was $3.4 billion. In the same month of the previous year, the current account deficit was $7.6 billion. The 12-month rolling current account deficit declined from $56.8 billion to $52.6 billion, and gold-excluded current account deficit fell from $49.8 billion to $46.8 billion.

The significant part of the fall in the current account deficit was caused by the decline in gold imports. In the last year during April-May period, net gold imports was $3.9 billion. In the same period of this year, it was $0.9 billion. Due to the normalization of gold trade, we expect sharp declines in the current account deficit to continue through July.

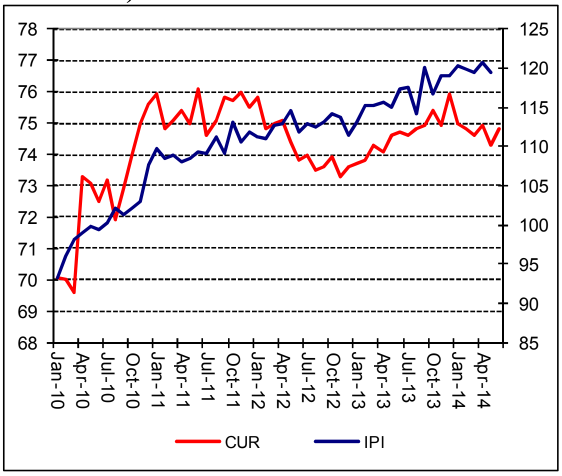
At the end of the first quarter, the current account deficit to GDP ratio fell to 7.5 percent from the 7.9 percent (Figure 3), and we expect this ratio to be 6.4 percent at the end of the second quarter. We expect the gold-excluded current account deficit to GDP ratio fell to 5.8 percent from 6.4 percent at the end of the second quarter.

Table 2: Monthly and quarterly changes of Betam's selected indicators (real and sa)

Economic Indicators	March	April	May	June	2014 1st Quarter	2014 2nd Quarter
Exports	**1.5**	**-8.3**	**0.1**	**	**4.6**	**-6.4**
Imports	**-1.5**	**0.7**	**2.6**	**	**-4.1**	**-0.5**
Intermediate goods import	-1.0	3.2	1.5	**	-4.2	1.8
Consumer goods import	-4.8	5.1	1.0	**	-7.8	0.8
Investment goods import	3.5	5.8	-6.1	**	3.7	3.0
Exports excluding gold* **	**0.4**	**2.5**	**0.0**	**	**2.3**	**2.4**
Imports excluding gold* **	**-2.4**	**8.1**	**-3.8**	**	**-1.9**	**2.4**
Industrial Production Index	**-0.3**	**0.9**	**-1.0**	**	**1.4**	**0.1**
Nondurable consumer goods	1.2	0.1	0.6	**	2.4	0.4
Durable consumer goods	2.0	-0.3	-0.4	**	-0.4	1.8
Intermediate goods	-0.4	0.7	0.1	**	2.4	0.2
Investment goods	-3.6	2.0	-5.7	**	-2.0	-2.7
Capacity Utilization Rate	**-0.2**	**0.3**	**-0.6**	**0.5**	**-0.6**	**-0.1**
Nondurable consumer goods	-0.5	0.4	0.1	-0.3	0.8	0.3
Durable consumer goods	-0.1	3.3	-1.3	1.4	-0.6	3.1
Intermediate goods	-0.1	-1.2	0.0	0.4	-0.1	-1.0
Investment goods	-0.2	0.6	-1.8	0.5	-1.2	-1.5
Soft Data						
Consumer confidence index (Turkstat)	5.6	6.9	-3.3	-2.3	-7.2	5.8
Real sector confidence index	0.5	1.3	1.0	-0.6	-5.0	2.3
Financial Data						
IMKB 100 (Stock Exchange)	1.4	5.8	4.7	7.1	-13.6	11.8
Other						
Special consumption tax* (SCT)	-12.2	9.2	-3.4	**	-1.9	-0.7
Passenger Cars	2.7	7.4	-4.1	**	1.4	5.2
Commercial Vehicles	1.6	4.2	-1.1	**	-4.3	5.3

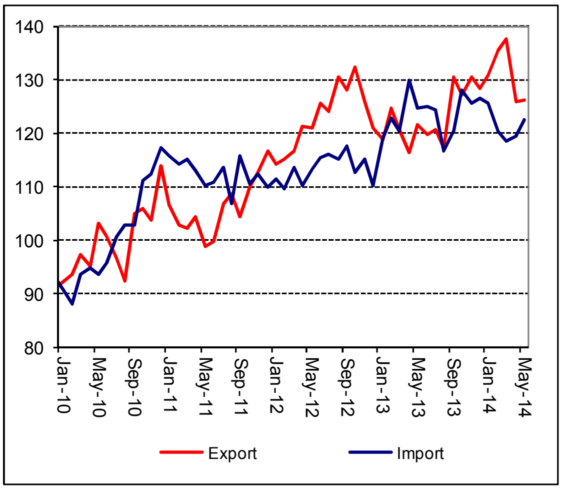
Source: TurkStat, CBRT, Treasury, ISE, Betam. All series are real (or inflation adjusted) wherever necessary and seasonally adjusted.
*This tax is collected on sales of goods such as gas, fuel oils, alcohol, tobacco products and automobiles.
**Data not yet released.
***Betam's calculations: Nominal exports (imports) minus non-monetary gold, deflated using the export (import) unit value index.

Figure 1: Capacity utilization rate and industrial production index (sa, left axis for CUR and right axis for IPI)



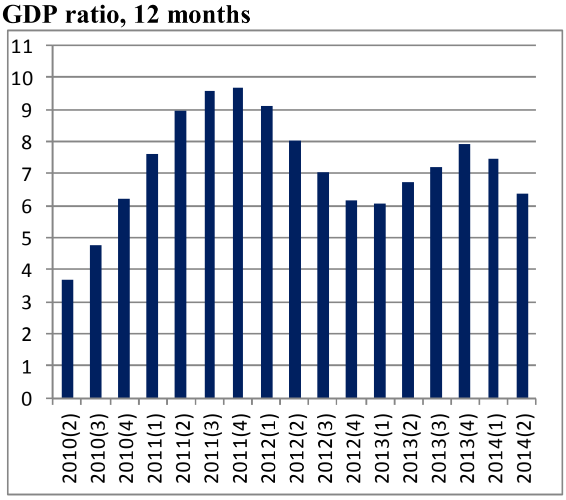
Source: TurkStat, Betam.

Figure 2: Volume indices of exports and imports (sa)



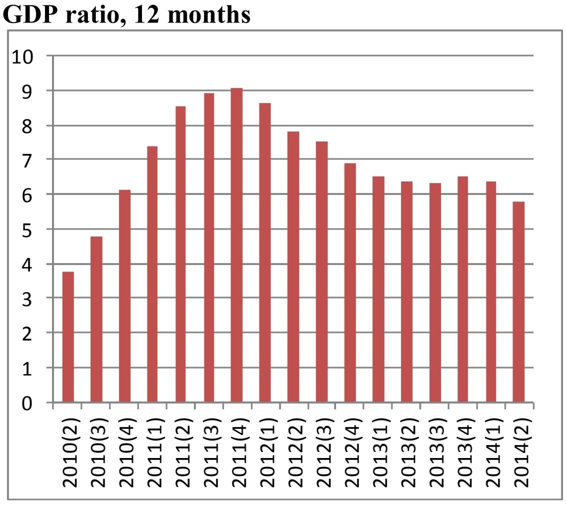
Source: Turkstat, Betam.

Figure 3: Gold included current account deficit to GDP ratio, 12 months



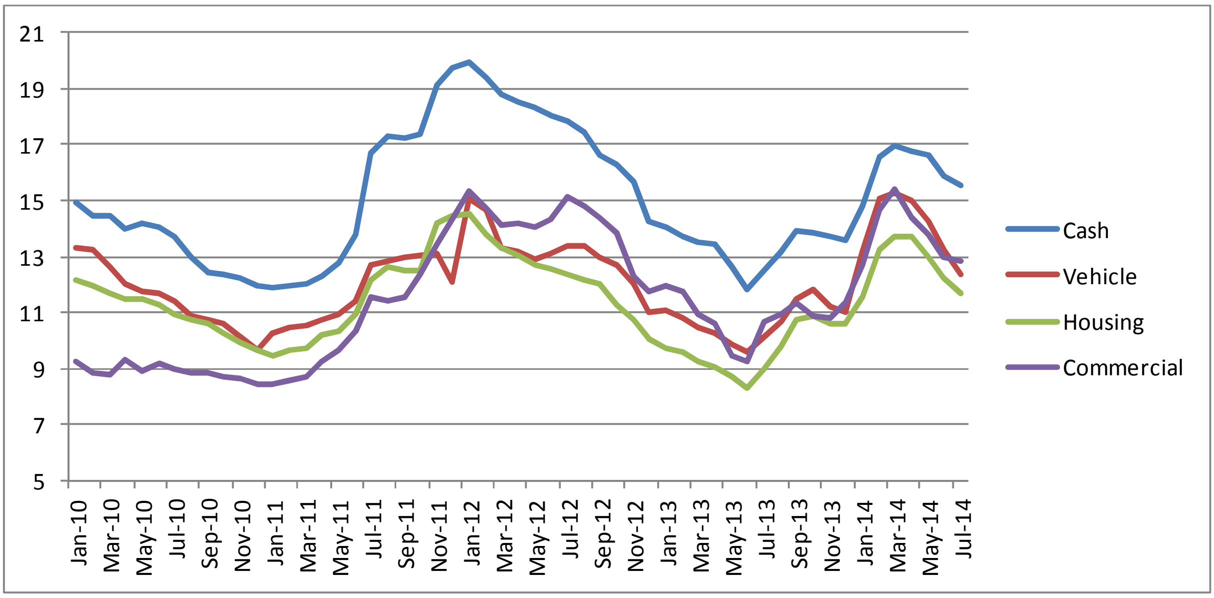
Source:TurkStat, TCMB,Betam.

Figure 4: Gold excluded current account deficit to GDP ratio, 12 months



Source: Turkstat, TCMB,Betam.

Figure 5: Weighted Average Interest Rates for Turkish Lira Banks' Loans (%)



Source: CBRT.