Balance of Payments - December 2012

Economic Research Division

TÜRKİYE İŞ BANKASI

Current account deficit narrowed to 48.9 billion USD in 2012.

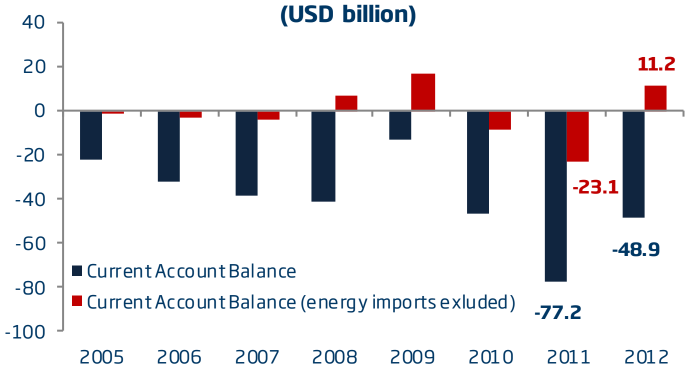
The expected recovery in economic activity during the last quarter of 2012 has not been materialized to the extent that it was anticipated. Thus, the current account deficit kept its declining trend during this period. Monthly current account deficit came in lower than market expectations both in November and December 2012 and annual current account deficit declined from 77.2 billion USD in 2011 to 48.9 billion USD in 2012. The current account deficit to GDP ratio is estimated to have declined from 9.9% at the end of 2011 to around 6% at the end of 2012. Excluding the energy imports, current account balance gave a surplus of 11.2 billion USD in 2012.

The improvement in current account deficit throughout 2012 mainly stemmed from the domestic demand which was kept under control thanks to the measures taken by the policy makers, the continued increase in exports with the help of exports diversification strategy and the increase in gold exports which was a temporary boost to exports during the last year. In fact, analysis of the sub-items of the current account deficit revealed that foreign trade deficit narrowed by 23.5 billion USD in 2012 compared to 2011 and realized as 65.6 billion USD. Besides, the surplus in services balance increased by 3.9 billion USD in 2012 compared to 2011 and reached 21.9 billion USD, further supporting the improvement in the current account deficit. The increase in services balance stemmed from the rise in the net transportation and net tourism revenues during 2012. In fact, according to the data announced by CBRT, the tourist arrivals to Turkey increased by 331 thousand persons to 31.7 million persons in 2012.

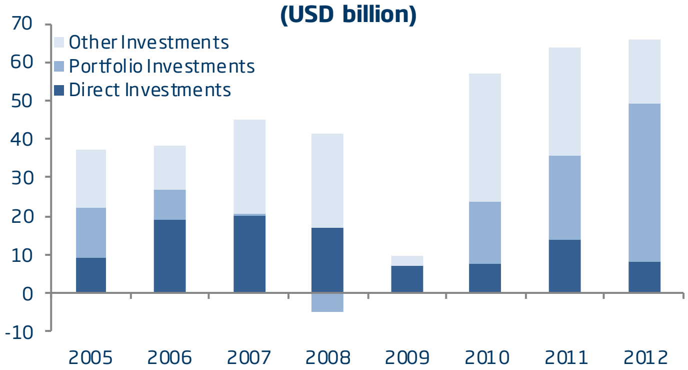
The highest amount of capital inflows was registered under the portfolio investments account in 2012.

The capital inflows towards Turkey followed a strong trend in 2012. Throughout the year, net capital inflows via portfolio investments were 40.8 billion USD, via other investments were 16.6 billion USD and via foreign direct investments were 8.3 billion USD.

Current Account Balance (USD billion)



Financing of Current Account Deficit (USD billion)



Portfolio investments, which registered the highest amount of capital inflows in 2012, increased by 18.8 billion USD compared to 2011. The increase in portfolio investments has become more evident in the second half of 2012. During 2012, non-residents' demand for government domestic debt securities continued and net capital inflows under this item increased by 13.7% compared to 2011 and reached 16.8 billion USD. The government's eurobond issues in international markets also increased significantly in 2012 and reached 4.8 billion USD, almost doubling compared to

Breakdown of Net Capital Inflows Towards Turkey (12 month cumulative, million USD)

			Breakdown of Capital Inflows (%)	
	December 2011	December 2012	December 2011	December 2012
Current Account Balance	**-77,219**	**-48,867**	-	-
Total Net Foreign Capital Inflows	**75,406**	**69,681**	**100.0**	**100.0**
-Direct Investments	13,698	8,301	18.2	11.9
-Portfolio Investments	21,986	40,773	29.2	58.5
-Other Investments	28,187	16,628	37.4	23.9
-Net Errors and Omissions	11,560	4,022	15.3	5.8
-Other	-25	-43	0.0	-0.1
Reserves(1)	**1,813**	**-20,814**	-	-

Note: The numbers may not add up to total due to rounding.
(1) (-) sign indicates an increase in reserves while (+) sign indicates a decrease.

Source: CBRT

2011. On the other hand, the most notable development in portfolio investments was the increase in banking sector's bond issues in international markets. Banks benefited from the favorable market conditions in international capital markets and their total bond issues during 2012 reached 8.6 billion USD. Majority of these issues were completed during the second half of 2012. As a comparison, banks' bond issues in international markets were only 2.8 billion USD in 2011. Another noteworthy development in portfolio investments was the high amount of net capital inflows into the equity market. Net capital inflows into this market reached 6.3 billion USD in 2012. In contrast, there was a net capital outflow of 1 billion USD from the equity market in 2011. Fitch's upgrade of Turkey's credit rating to investment grade in the beginning of November 2012 has also been influential for the steep rise in capital inflows into the equity market.

Decline in foreign direct investments...

Despite the strong portfolio inflows in 2012, foreign direct investments towards Turkey have lost pace. Net foreign direct investments declined from 13.7 billion USD in 2011 to 8.3 billion USD in 2012. The decline in foreign direct investments inflows into Turkey as well as the Turkish investors' increasing foreign direct investments abroad have been effective in the lower net foreign direct investments figure in 2012. Turkish investors' foreign direct investments abroad increased from 2.3 billion USD in 2011 to 4.1 billion USD in 2012.

Slowdown in other investments...

Analyzing the other investments, it was seen that net loans raised from abroad by the banking sector decreased by 8.3 billion USD in 2012 compared to 2011 and realized as 4.3 billion USD. Banks' tendency to issue bonds in international markets instead of raising loans from abroad was the main reason behind this decline. Net borrowing of the non-bank sectors by raising loans from abroad, on the other hand, was 6.4 billion USD in 2012. Long-term debt roll-over ratio of the banking sector was 95% and that of non-bank sectors was 115% in 2012.

CBRT increased its FX reserves by 20.8 billion USD in 2012.

The continuing strong capital inflows towards Turkey and the reserve option mechanism implementation enabled the CBRT to increase its FX reserves by 20.8 billion in 2012. The rise in CBRT's FX reserves makes the Turkish economy resilient against the possible financial turbulences that may occur in international markets.

Improvement in current account deficit might lose pace.

The domestic consumption and investment expenditures are expected to increase in 2013 as a result of the pent-up

Current Account Balance (USD million)

	December	January-December		%
	2012	2011	2012	Change
Current Account Balance	**-4,658**	**-77,219**	**-48,867**	**-36.7**
Foreign Trade Balance	-5,403	-89,139	-65,602	-26.4
Services Balance	804	18,003	21,932	21.8
Tourism Revenues (net)	897	18,044	19,389	7.5
Income Balance	-321	-7,841	-6,594	-15.9
Current Transfers	262	1,758	1,397	-20.5
Capital and Financial Accounts	**6,531**	**65,659**	**44,845**	**-31.7**
Direct Investments (net)	599	13,698	8,301	-39.4
Portfolio Investments (net)	5,560	21,986	40,773	85.4
Equity Securities	852	-986	6,274	-
Debt Securities	4,356	20,284	31,858	57.1
Other Investments (net)	-390	28,187	16,628	-41.0
Assets	-2,193	11,136	-1,152	-
Currency and Deposits	-2,535	12,852	657	-94.9
Liabilities	1,803	17,051	17,780	4.3
Loans	2,173	18,866	8,495	-55.0
Banking Sector	1,230	12,527	4,267	-65.9
Non-bank Sectors	944	7,121	6,373	-10.5
Deposits	-222	-4,309	7,783	-
Foreign Banks	-308	-5,841	7,113	-
Foreign Exchange	-686	1,759	5,229	197.3
Turkish Lira	378	-7,600	1,884	-
Non-residents	207	3,447	2,914	-15.5
Reserve Assets (net)	762	1,813	-20,814	-
Net Errors and Omissions	**-1,873**	**11,560**	**4,022**	**-65.2**

Source: CBRT

demand and the economic activity is expected to accelerate compared to 2012. As a consequence of this expectation, the current account deficit is expected to widen in 2013 after having contracted significantly in 2012. Besides, further pressure might be built up on the current account balance should the gold exports return to their normal levels in 2013. On the other hand, leading indicators point out that the recovery in economic activity has been weak recently. In addition, CBRT highlighted the importance of financial stability several times recently and announced that further macroprudential measures might be implemented if excessive credit growth leads to a significant widening in the current account deficit. These indicate that the current account will be kept under control also in 2013. Besides, the continuation of the exports diversification strategy and the expectations that the oil prices will not increase rapidly in 2013 also point out that a possible deterioration in current account deficit would be limited. In this context, we estimate a current account deficit of 63 billion USD at the end of 2013 and a slight increase in the current account deficit to GDP ratio. Regarding the financing of the current account deficit, we do not expect a significant problem considering the favorable global liquidity conditions and strong macroeconomic fundamentals of Turkish economy .

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