CURRENT ACCOUNT SUSTAINABILITY IN THE TURKISH ECONOMY

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УСТОЙЧИВОСТ НА ТЕКУЩАТА СМЕТКА НА ТУРСКАТА ИКОНОМИКА

Фатма Джесур

ABSTRACT: The current account deficit now has become one of the major problems facing the national economies. The point of discussion is the sustainability rather than the existence of this situation which is caused by the fact that a country spends more than its revenues or a country invests more than its savings. Turkish economy in her historical periods frequently faced with these current deficits problems. Considering that current accounts exceeds the 5% of the GNP and it is seen as a sign of a crisis, and also thinking that crisis unfolded in the past with deficits of current accounts, the question whether deficits of current accounts will be lasted became an important discussion point. The main variables on the sustainability of the current deficits are various as the export, import, reel effective foreign exchange, interest rates, short term capital movements, long term capital movements, structure of debts, exchange reserves and the sustainability of investing environments. As the Turkish economy is analysed in terms of these factors, it is found out that the economy is far from the balance at exchange and interest rates, although significant improvements are seen regarding other variables. This paper analyzes these inconveniences of the balance of current accounts developing countries economies, especially by focusing on Turkish economy. Indeed, the current account has deteriorated due to capital inflows for years while the national currency has appreciated in Turkish economy. As a result, the effects of current account deficit on macroeconomic variables and current account sustainability of Turkey are the main subject of this study.

Key Words: Capital Flows, Current Account Deficit, Sustainability Current Account Deficits, Macroeconomics

Introduction

One of the main issues which have frequently been on the agenda in recent years and have been disputed widely in the Turkish economy is current account deficit problem. Main reason of this situation is that current account balance is the most important and sensitive problem of the economy. In other words, balance of payments is the mirror of the economy of a country. Analysis of the dynamics determining the current account balance is directly related to the discussions on current account deficit, external debt sustainability and capital movements particularly including short term capital movements which are frequently emphasized as hot money flow. We can summarize certain developments which led to the breakthrough of current account deficit problem by 2000s as follows: overvaluation of Turkish lira with inflation targeting, increasing dependence on foreign sources in energy and belated impacts of Customs Union which entered into force in 1996. As a result of these developments, dependence of production and export on import acquired a structural quality. Sources from which the current account deficit is financed and continuity of these sources have gained importance. While low current account deficit/GDP rate leads to economic crisis in some countries, countries with higher current account deficit/GDP rates maintain sustainability without a negative impact on macroeconomic stability. Sustainability of current account deficits is also affected by global macroeconomic conjuncture and accordingly, the type and continuity of sources of financing significantly.

Provided that different opinions on sustainability of current account deficit are set aside, the fact that current account deficit is accepted as one of the most important reasons of foreign exchange and/or finance-based crises experienced especially in the economies of developing countries increase the actuality and importance of the issue.

Balance of Payments and Current Account Deficit

Balance of payments is a systematic record of all financial transactions that residents of a
specific country make to the residents of another country in a specific period.

Current account constitutes the most important account group of the balance of payments. Covering all the goods and services produced in a country in a specific period, this account constitutes a great majority of the balance of payments in terms of economic transaction. Thus, current account has a really crucial role in the national income of the country. Current account provides data to the domestic and foreign economy units and decision takers about the economic performance of the country. Current account consists of real sources including goods, services and income as well as unilateral transfers. Current account demonstrates whether a country gains foreign currency in return for its normal economic transactions. If outflow of foreign currency is more than the inflow of foreign currency, this points out to a current account deficit. Otherwise, there will be current account surplus. As current account deficit is financed through debt, the increase of this debt jeopardizes the future of the economy of the country.

The first reason leading to the arousal of current account deficit is the deficiency of domestic savings in relation to new investments. Provided that the necessary savings are not made for economic growth, current account deficit also increases. Another factor influential on this increase is the overvaluation of Turkish lira. Overvalued national currency leads to more increase in import when compared to export as well as growing foreign trade deficit (Yeldan, 2005:57).

Reasons of Current Account Deficit

In Turkey, the underlying factors of high current account deficit are as follows:
1. Dependence of Turkey on foreign sources in energy. Most of the basic energy consumption items such as oil and natural gas are imported. This situation results in a high current account deficit.
2. Import of intermediate products in the industry sector. One of the main reasons of current account deficit is the dependence of industry on import.
3. Value of Turkish currency in face of dollar and euro.
4. Continuous increase of domestic consumption. As the demand on foreign products increases, the current account deficit also increases.
5. Low tourism income. The number of tourists coming to Turkey is increasing rapidly but foreign tourists spend only a little amount of money in Turkey. Thus, we should create attraction centres which will increase the consumption of tourists.

Macroeconomic Variables

We can write the equation of macroeconomic balance as follows: 
\[(S-1) + (T-G) = (X-M)\]. This equation means that total of saving (S) and investment (I) balance of private sector and income (T) and expense (G) balance of public sector is equal to current account balance (X-M). Total of two balances at the left of the equation shows the internal economic balance of a country while the right part of the equation shows the external economic balance. In other words, internal economic balance and external economic balance of a country are equal to one another. As it is understood from the equation, the more the internal economic balance of a country has deficit, the more deficit the external economic balance of that country has. This is because of the fact that deficit of internal economic balance is financed through the deficit of external economic balance.

The global crisis which broke out in 2008 affected the whole economies in the world deeply and greatly. Turkish Economy has displayed a considerable recovery after the global crisis. We can address three important factors effective on this recovery. The first one of them is a series of measures taken by the Central Bank of the Republic of Turkey (CBRT) in order to alleviate the effects of global crisis. CBRT increased its liquidity support and decreased its political interests by 1025 base in a one-year period to mitigate the devastating effects of global crisis. With reduction in loan interests, significant increases were observed in the loans and domestic demand (Başçı and Kara, 2011:10). The second one of them is the free fiscal policy. Government also took measures in order to mitigate the negative impacts of global crisis. The majority of these measures are related to the fiscal policy (Üçer, 2011:47). These measures are taken by the government in order to increase consumption and revive domestic demand. The third factor is the intensive foreign source input. In this period, the increase in the foreign source input in exchange for the low interest rates of CBRT resulted from the fact that developed countries increased the money supply and the interest rates were low (Özatay, 2011:29). As a result, domestic demand
revived depending on these three factors and Turkish economy displayed a positive growth performance.

As stated by Balçılar and Tuna (2009), Yıldırım (2011) and Üçer (2011), low inflation levels in the recovery period of an economy where domestic demand is so dynamic resulted from the fact that a great majority of the increasing domestic demand was met through import. In the period in question, valuation of the Turkish currency (TL) depending on the intensive foreign source input facilitated meeting the increasing domestic demand through import. Following the global crisis, sharp increase seen in the import volume originated from the burst in the domestic demand. Import rates of both consumption products and intermediate products increased significantly in this period. However, increase of export volume could not catch up with the import volume and thus, current account deficit increased considerably.

Recovery period of Turkish economy following the global crisis bears numerous similarities to the period of 2002-2006. Some of them are intensive foreign source input, valuable Turkish currency, and expansion in credits, dynamic domestic demand, strong economic growth and increasing current account deficit. Despite these similarities, there is rather important difference between two periods. This is the monetary policy of CBRT. While CBRT did not consider credit expansion and expanding current account deficit as risks for macroeconomic and financial stability in the period of 2002-2006 and directly focused on price stability, it regarded credit expansion and expanding current account deficit observed following the global crisis as macro financial instability and adopted an alternative policy (Başçi and Karar, 2011:11). The main reason of the adoption of this alternative policy is allegedly to prevent the financial instabilities that may occur in the medium or long term to affect the price stability target negatively. As implied by Başçi and Kara, CBRT addressed the financial stability target along with the price stability target. Besides, recent publications and announcements of CBRT reveal that the financial stability target is more prominent (Özatay, 2011:28). In these publications and announcements, CBRT obviously expresses that expansion in the current account deficit is the basic factor threatening the macroeconomic and financial stability in the post-crisis period. In this respect, the emphasis was put on the deterioration of financing of the current account deficit. CBRT reports that increasing share of short-term capital inputs and portfolio investments in the financing of current account deficit will increase the fragility of the economy against sudden changes in the global risk appetite (Başçi and Kara, 2011:10).

As stated by Özatay (2011), CBRT has two alternatives to reduce the current account deficit. One of them is to increase the policy interest. The other one is to use other monetary policy instruments in addition to the policy interest. The first choice affects current account deficit through two different channels. These channels are shown in the Figure 1. Upper part of the figure shows the currency channel while lower part shows the credit channel. An increase in the policy interest affects current account deficit in this manner: Increase of the policy interest leads to the valuation of Turkish currency and expansion of the current account deficit by increasing the foreign source inflow. On the other hand, increase in the policy interest affects current account deficit through credit channel in this way: Increase in the policy interest shrinks the credit demand and domestic demand. As domestic demand in Turkey is largely based on import, import volume decreases and thus, current account deficit reduces. CBRT is of the conviction that the first alternative will not decrease the current account deficit and instead, it will expand the current account deficit. This is because of the fact that it envisages that the currency channel in the first alternative has a greater impact on the current accounts when compared to the credit channel. Thus, CBRT preferred using other policy instruments in addition to the policy interest (Özatay, 2011:30). Three steps of the alternative policy that the CBRT put into practice are indicated below:

Channels through which policy interest affects current account deficit (Currency and Credit Channels):

- Increase of policy interest
  - Foreign source inflow increases
  - Turkish currency gains values
  - Import increases
  - Current account deficit increases
  - Credit domestic demand decreases
  - Import volume decreases
  - Current account deficit decreases

Alternative monetary policy approach of CBRT:

- Maintaining price stability and financial stability;
- Policy interest rate
- Required reverse ratio
• Interest rate corridor

It is seen that the first step of the alternative policy is the policy interest rate. This policy instrument is used to keep capital movements under control. The second step, the required reverse ratio, aims at reducing the credit volume. The third and last step is the interest rate corridor. This step intends to reduce short term capital inflows and credit expansion.

Table:1 Economic indicators (%)

<table>
<thead>
<tr>
<th>Various indicators</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inflation (year-end)</td>
<td>7.7</td>
<td>9.6</td>
<td>8.4</td>
<td>10.1</td>
<td>6.5</td>
<td>6.4</td>
<td>10.5</td>
<td>6.5</td>
</tr>
<tr>
<td>GDSs Interest rate (year-end)</td>
<td>16.2</td>
<td>18.0</td>
<td>18.4</td>
<td>19.1</td>
<td>11.5</td>
<td>8.2</td>
<td>8.7</td>
<td>6.5</td>
</tr>
<tr>
<td>Growth</td>
<td>8.4</td>
<td>6.9</td>
<td>4.7</td>
<td>0.7</td>
<td>-4.7</td>
<td>9.2</td>
<td>8.5</td>
<td>3.5</td>
</tr>
<tr>
<td>Unemployment</td>
<td>10.6</td>
<td>10.2</td>
<td>10.3</td>
<td>11.0</td>
<td>14.0</td>
<td>11.9</td>
<td>9.8</td>
<td>9.0</td>
</tr>
<tr>
<td>Budget Balance / GDP</td>
<td>-1.5</td>
<td>-0.5</td>
<td>-1.6</td>
<td>-1.8</td>
<td>-5.5</td>
<td>-3.6</td>
<td>-1.3</td>
<td>-2.7</td>
</tr>
<tr>
<td>Current Account Balance</td>
<td>-4.6</td>
<td>-6.1</td>
<td>-5.9</td>
<td>-5.7</td>
<td>-2.2</td>
<td>-6.3</td>
<td>-10.0</td>
<td>-7.0</td>
</tr>
</tbody>
</table>

Source: TSI, CBRT

Inflation: Inflation which has been the biggest problem of Turkey for a long time is currently around the levels of 2009 and 2010. Interest rate: Interest rate of the Government Debt Securities (GDSs or Treasury Bonds) is in parallel to the inflation rate. Growth: While the growth rate was around zero (0) in 2008 and plunged to below zero in 2009. Following the subsequent high growth rates seen in 2010 and 2011, a low growth rate was recorded in 2012 once more. Unemployment: Unemployment rate varies between 8 % and 10 %. When compared to the developed countries, similar rates are seen. Budget Deficit: The most positive development marking the last ten years of Turkey is the reduction of budget deficit to the level prescribed by the international standards. The budget deficit which displayed a significant increase with the effect of global crisis in 2009 and 2010 has been taken under control once more as of 2011. Current account deficit: Substituting current account deficit instead of budget deficit which it managed to eliminate has become a fiscal policy for Turkey. While budget deficit has reduced, the current account deficit has increased in the last ten years. However, current account deficit reduced to 7 % from 10 % in 2012. Unfortunately, in today’s conditions, the growth of Turkey is only possible with deficit of either public sector or private sector due to the current economic structure. The underlying reason of this situation is the deficiency of domestic savings.

In summary, 2012 can be defined as a year when positive developments outnumbered negative ones. In a period when so many problems came out in Europe with which we have the highest trade volume, this is real success. It seems that there are two scenarios for Europe in 2013: the first one is recovery while the second one is the continuity of negative economic situation. If the second scenario comes true, economic situation of Europe can deteriorate. Turkey should put into practice the structural reforms without delay so as to improve and maintain its economic situation. The most crucial structural reforms for the economy are tax reform, partial and temporary import substitution, transition to a model relying on local sources instead of over-dependence on natural gas in energy.

Current Account Sustainability Problem In Turkey

If incomes that the country gains in exchange for current accounts are higher than the expenses made for current accounts, this refers to a current account surplus. However, if incomes are lower than the expenses, then the current account deficit occurs. In other words, if the incomes obtained from goods and service trade and net transfers cannot meet the relevant expenses, the country faces current account deficit (Peker and Hotunluoğlu, 2009:222). When the current account displays deficit, this means that the country has sent more money to foreign countries than the money that it received from foreign countries. In this case, this deficit is met through either external barrowing or the sale of domestic
assets. In the contrary case, when the country faces current account surplus, residents of the country make capital transfer to foreign countries (Obstfeld and Rogoff, 1996:5).

As a current account deficit exceeding 5% of the GDP is interpreted as a sign of crisis and Turkey faced economic crises in the periods when the current account deficits were high in the past, sustainability of current account deficits has become an issue of curiosity.

Fundamental variables discussed in relation to the sustainability of current account deficits include export, import, real effective foreign currency, interest rates, short term capital movements, long term capital movements, and structure of debts, currency reserves and the stability of investment environment. When Turkish economy is considered in terms these variables, it is seen that there has been significant recoveries in all the variables except for foreign currency and interest rates which are far from balance.

By the end of 2005, different explanations had been made about the current account deficit in Turkey. Some economists stated that this deficit resulted from the high interest rates leading to overvaluation of Turkish currency (Cansen, 2006) while some claimed that it resulted from the saving deficit of the country or investment and consumption amounts exceeding savings (kumcu, 2005). While Akat (2006) reported that the wrong monetary policy led to overvaluation of TL and resulted in a domestic demand burst, Gökçe (2005) argued that the effect of foreign currency and real growth rates on the increasing current account deficit was obvious. Whereas Aysan (2005) stated that it resulted from the increasing short term capital movement inflow and high interest rates, Özttrak (2005) attributed it to the consumption expenses of private sector to exceed the private sector savings or to the deficiency of private sector savings. Uras (2005) specified that current account deficit resulted from the increasing import volume triggered by the cheapness of foreign currency while Yeldan stated that it relied on the short term speculative movement inflows resulting from high real interest rates. According to IMF, however, the dominant factors were private sector borrowing and demand increases (2005). Lastly, Yıldırım (2005a) put the emphasis on valuation of currency, increase in oil prices and growth increase.

Roubini and Watchel stated that capital movements play a crucial role in terms of the sustainability of current account deficit. Although these types of movements increase sustainability in the short term, they actually affect sustainability negatively in the course of time due to two reasons. As these movements typically refer to portfolio investment or hot money, the changes in the market conditions can lead to sudden withdrawals. Another negative impact is that they will lead to the valuation of the currency of the country, decrease the competitiveness of the country and reduce the export incomes which will be necessary to cover the current account deficit in the future. To prevent such a valuation, Central Banks buy foreign currencies from the market and make a positive impact on the sustainability by increasing the foreign currency reserves. However, if these capital movements are not sterilized, they lead to high inflation and real valuation by resulting in monetary growth (Roubini and Watchel, 1998:7-9).

According to Milesi-Ferretti, the definition of sustainability is closely associated with a country’s ability to pay. If the current value of the future foreign trade surplus of a country is equal to the current value of that country’s external borrowing, it has the ability to pay and the current account deficit is sustainable. However, in case of imbalances which may necessitate a change in the existing monetary policy or lead to the breakout of a crisis, the current account deficit becomes unsustainable (Milesi-Ferretti, 1996:2).

Current account deficit financing is maintained through continuous hot money and/or direct foreign capital inflow. Thus, economy bears a dependent, risky and fragile nature for a long time. The fact that the economic growth achieved following the 2001 crisis heavily depended on hot money and the recent economic growth largely depends on foreign capital shows that the economy is under risk. High interest rate policy and incomes obtained through sale of property to foreign individuals are emphasized (Özbek, 2008:10). Speculative growth trends are never long-lasting and each one of the expansion periods (1990-93; 1995-98; 2000) resulted in an economic crisis (1994, 1999 and 2001), respectively (Yeldan, 2005:59).

**Conclusion**

Economic events are heavily influenced by the expectations. Thus, economic relations can display different appearances at different times and places. When the expectations of people about the future come into question, a complicated appearance is inevitable. When we target
growth, unemployment rate can decrease but current account deficit is encountered. The increase of current account deficit, however, reduces budget deficit. While current account deficit is reduced, the growth rate also decreases and budget deficit and unemployment rate start to increase. If it is intended to reduce the interest rates, then the savings also decrease. When savings are reduced, current account deficit occurs. Macroeconomic objectives are contradictory. Thus, macroeconomic instruments to be used in an economy also contradict one another.

Current account deficit financed through long term capital inflows does not constitute a problem. However, a current account deficit financed through short term capital inflows as in the case of Turkey bears a really high risk. This is because of the fact that short term capital inflows can increase suddenly. Therefore, this kind of current account deficit is unsustainable under any circumstances. Instead of hot money, attracting stable foreign investments to Turkey in order to cover the deficit is a more sound and reliable method. We should create an environment of confidence for investors to attract direct foreign investments to our country, political and economic stability should be maintained and a suitable environment for investment should be provided. With the aim of decreasing the dependence of domestic production on the import, policies should be developed to produce imported intermediate products used in the industry within the country under competition conditions. We should make a fundamental change in our production structure while struggling with the current account deficit. We should become a country having the knowledge and technology to manufacture products with high added value. Attempts should be made to eliminate the current account deficit resulting from a high growth rate and overvalued TL depending on the domestic demand through new structural policies based on solid growth principles. Increasing the amount of savings will significantly contribute to the elimination of current account deficit problem in the long run. In case that domestic savings increase, there will be no need for external borrowing for investment.

Standard & Poor’s upgraded the credit note of Turkey in its own currency and put our country into the category of “investible countries”. This is another important development which will make the direct foreign investors to head towards Turkey in the long run.

A particular importance should be placed on the sectors which bring foreign currency to the country. In order to increase the contribution of tourism sector as the leading sector providing foreign currency for our country, types of tourism with high added values should be encouraged. In summary, it is of crucial importance to take steps to increase savings and put an economy model based on production and export into action with the aim of keeping the growth of current account deficit under control and reaching a sustainable current account deficit.

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