Data Snapshot

Growth&Trade Balance:

The Turkish economic dilemma continues: Strong growth accompanied with weak external balances

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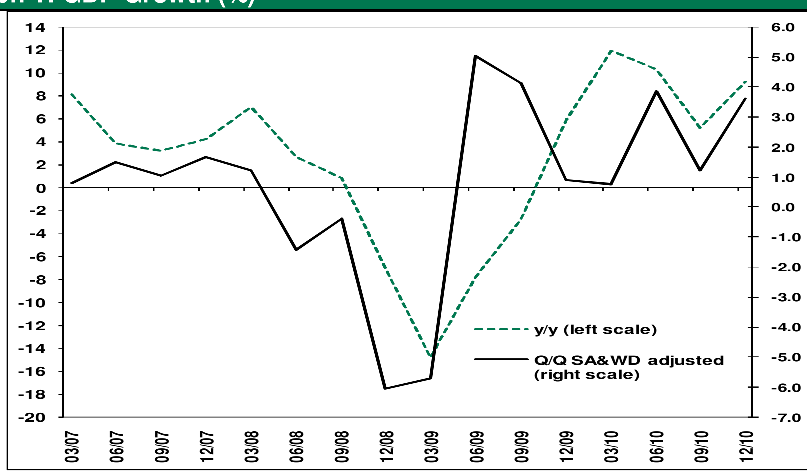
The figures released by the TurkStat once again showed the main dilemma of the Turkish economy: we are growing impressively but creating a bloated trade deficit. Real economic output expanded by 9.2% YoY in the 4th quarter, above the market consensus (7.2%) and our in-house forecast (7.1%). Our forecast error mainly stems from the fact that foreign demand erased only 5.6 points from growth figure against our calculation of 6.8 points.

Graph 1: GDP Growth (%)



Source: TurkStat

On the other hand, the seasonally and working day adjusted series shows that the economy expanded 3.6% QoQ in Q4, which is a very strong figure after 1.2% in the third quarter. In fact, the WD and SA figures imply that the economy is heading toward overheating as the WD and SA GDP for the 4th quarter is a new record high.

Powerful domestic demand was behind the growth once again in the last quarter, contributing 15.4 points to the growth rate. Private consumption and investments rose 9% YoY and 49.5% YoY, almost in line with our forecasts. On the other hand, public expenditures and investments rose by 3.2% and 17.1% YoY respectively. Meanwhile, stock changes reduced GDP by 0.7 pp in the last quarter.

Table 1: GDP Growth Rates (%)

	Q4			
	2010	2009	2010	2009
Expenditure (Demand) Side				
Domestic Demand 1/	15.4	4.8	10.9	-5.3
Private Consumption	9.0	5.0	6.6	-2.3
Public Consumption	3.2	18.2	2.0	7.8
Gross Fixed Capital Formation	42.1	-4.2	29.9	-19.0
Public	17.1	-0.8	15.1	-0.6
Private	49.5	-5.2	33.5	-22.5
Change in Stocks 1/	-0.7	2.0	2.5	-2.3
Foreign Demand 1/	-5.6	-0.9	-4.4	2.7
Exports of G&S	4.3	7.2	3.4	-5.0
Imports of G&S	25.4	11.0	20.7	-14.3
Gross Domestic Product	8.9	5.9	8.9	-4.8

1/ Contribution to GDP growth (as percentage of the preceding period's GDP).

Source: TurkStat

Looking from the production side, in Q4, agriculture (5.1% YoY), industry (10.6% YoY) and services (9.4% YoY) contributed 0.5, 2.9 and 5.9 points respectively to the quarterly growth rate.

In annual terms, the economy grew by 8.9% in 2010 after contracting 4.8% in 2009 (revised from -4.7%). It is the highest growth rate since 2004, and we expect it to slowdown to 4.5% this year mainly due to the dissipation of base effects. Domestic demand contributed 10.9 points to 2010 growth, while net foreign demand erased 4.4 points from GDP growth, and stock accumulation contributed 2.5 points. A surge in private consumption (6.6% YoY) and investments (33.5% YoY) in 2010, after respective 2.3% YoY and 22.5% contraction in 2009 also attest the fact that output gap is rapidly closing and that monetary policy should be tightened in order to cope with the risks pertaining to current account deficit.

On the other side of our dilemma stands the high trade deficit. In February, the trade balance posted a deficit of USD 7.4bn, over the market consensus of USD 7.2bn and our in-house forecast (USD 6.5bn).

The jump in imports (48.7% YoY to USD 17.5bn) was behind the rise in the trade deficit, as exports showed a weaker performance compared to imports. Exports rose 22.2% YoY to USD 10.1bn in February.

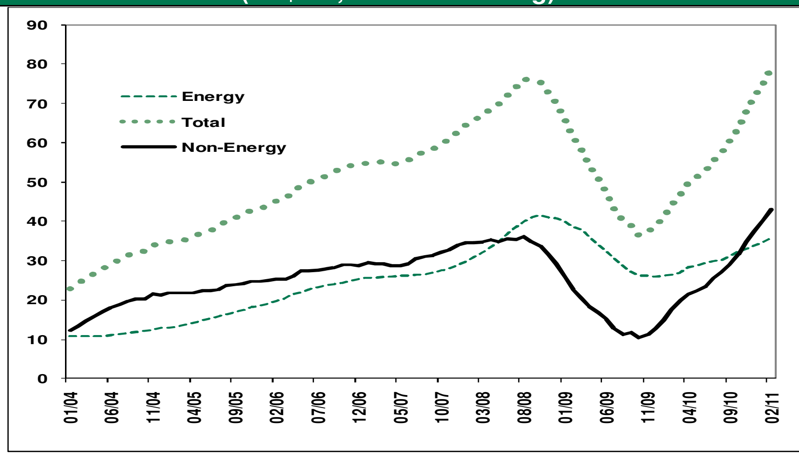
Table 2: Foreign Trade (US$ bn)

	February	
	2011	2010
Trade Deficit	7.4	3.5
Energy	3.3	2.2
Non-Energy	4.1	1.3
Exports	10.1	8.3
12-month; %	22.2	-2.0
Imports	17.5	11.8
12-month; %	48.7	29.8
o/w: Energy	3.7	2.4
12-month; %	56.1	16.0
Non-Energy	13.8	9.4
12-month; %	46.8	33.9

Source: TurkStat

The trade deficit for January-February rose to USD 14.8bn, twice as much compared to January-February 2010. On the other hand, the 12-month rolling trade deficit rose to a new record (USD 78.9bn) in February, widening USD 2.9bn from January.

Figure 1: Trade Balance (US$ bn; 12-month rolling)



Source: TurkStat

Non-energy trade deficit rose to USD 4.1bn in February from USD 1.3bn in February 2010, which supports the fact that the share of non-energy component in the widening of the trade deficit is more than the effect of higher oil prices. In fact, intermediate goods imports rose 51.8% YoY to USD 12.7bn in February, topping the list. On the other hand, capital goods imports rose 41.3% to USD 2.4bn, which reflects the high investment appetite of the private sector in the second quarter after the last quarter of 2010.

We forecast the current account deficit to reach USD 62 bn (7.9% of GDP) from USD 48.6bn (6.6% of GDP) in 2009. The figures increase our concerns over financing in an environment where the ECB will likely start rate hikes in April and the Fed may not continue quantitative easing after June. Because, Turkey financed the majority of its current account deficit with short-term funding instead of FDI and medium to long term debt in 2010.

The Monetary Policy Committee, sharing our concerns, said in its meeting summary that the reserve requirement is only one of the tools for containing credit growth and domestic demand, and emphasized the importance of supplementary macro-prudent measures by other related institutions. In this respect, it was stated that **direct measures targeting credit supply** would enhance the effectiveness and efficiency of the policies implemented by the CBRT.

This statement implies that new measures by other authorities may be in the pipeline, in our view. While the economic administration will not likely bring a legal limit to credit growth, the BRSA (banking watchdog) may change the capital adequacy ratio calculations in accordance with the type of credits (consumer or corporate credits) to restrain loan growth - even the banking sector's capital adequacy ratio is high compared to its peers. The BRSA may increase risk weighting rates for personal loans. In addition, the ratio of resource utilization support funds may be increased further. All in all, the probability of the introduction of new measures by other institutions is not insignificant, which may further weigh on the profitability of the banking sector.

As for the market outlook, while strong growth is desirable, it may impact market sentiment negatively, as the figures may be interpreted as causing the CBRT and other economic institutions to potentially take more aggressive steps to maintain financial stability. Therefore, as we have stated in our daily note, the initial reactions to the data releases may be temporary, and change direction in our opinion.

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