Global Economics commentary

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Türkiye's current account registered a $3.1 billion deficit in August, the country's central bank said on Tuesday, as the soaring global energy prices weighed on the trade balance.

The deficit came in below forecasts and the nearly $4.1 billion gap in July. The balance had posted $1.1 billion in August of 2021.

The shortfall in the first eight months of the year widened to $39.7 billion, the Central Bank of the Republic of Türkiye (CBRT) said.

The gap was mainly driven by the trade deficit, a major component of the current account balance, which rose to $9.7 billion in August, mainly due to the country's energy import bill, up from $6.8 billion in the same period of the previous year, the data showed.

Excluding gold and energy trade, the current account balance saw a surplus of $6.3 billion.

The services sector posted a surplus of $7.24 billion, while the travel item, under services, recorded net inflows of $5.1 billion in the month.

Direct investments saw net inflows of $573 million.

The Turkish government sees the deficit at $47.3 billion this year, according to official forecasts. In 2021 the shortfall stood at nearly $14.9 billion.

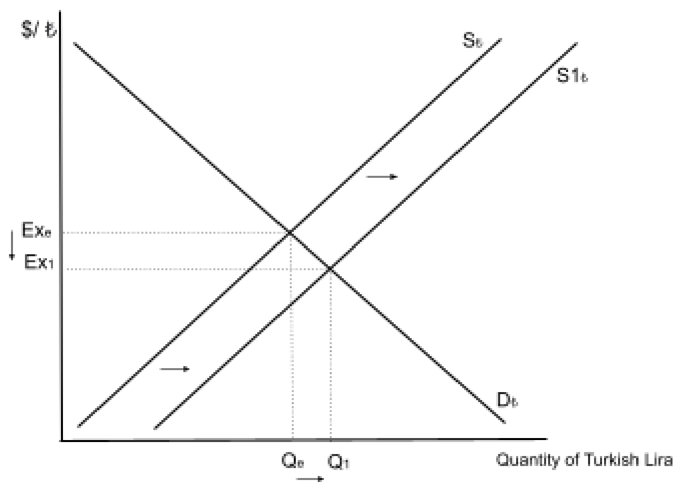
The government says Türkiye's chronic current account deficit will turn into a surplus under its new economic program, which prioritizes low-interest rates to boost exports, production and investments.

Commentary

Türkiye'scurrent account deficit narrows to $3.1B in August

The article is about The Central Bank of the Republic of Türkiye(CBRT) announcement in August, in which they stated their current account was at a $3.1 billion deficit as a result of the value of Turkish imports exceeding the value of exports. This trade deficit has been linked to the rise in global energy prices, and since Turkey is a heavy importer of energy, there is a negative outflow of money in the Turkish current account. This is because the deficit in the trade of goods and services section, which is the biggest component of the current account, outweighs the potential surpluses in other sections of the current account. In order to fix the deficit the CBRT has prioritized low-interest to depreciate their currency in order to boost exports. The key concept of**change**will therefore be covered as thelowered interest rates will change the exchange rate of the Turkish lira, and possibly affect Turkey's current account in the balance of payments, which is the difference between all the money entering and leaving a country over a defined period.

Diagram A

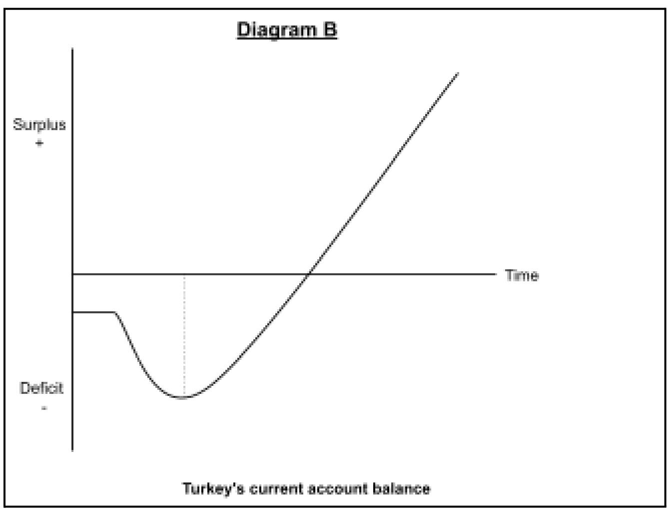


Effects of a decrease in interest rates on the Turkish Lira

Turkey uses a floating exchange rate system where the forces of supply and demand determine the value of the Turkish Lira. Therefore, by decreasing interest rates through expansionary monetary policy, ceteris paribus, the exchange rates of the lira**changes**. Holding the lira becomes less attractive since the return is reduced, and as a result, people sell the Turkish lira to look for better returns i.e higher interest rates, thus increasing the supply of the lira. This is shown in Diagram A, where low-interest rates in Turkey shift S₺→S1₺, which increases the quantity of the Turkish lira on the forex market from Qe→Q1, and causes the currency to depreciate shown by the drop in the exchange rate from EXe→EX1.

A depreciated lira makes Turkish imports more attractive on foreign markets as importing goods from Turkey becomes cheaper. This**changes**the demandfor Turkish exports as they become more attractive for foreigners, and as a result there is an increased flow of credit items into their balance of payments. Furthermore, it would reduce demand for imports as the lira now has less purchasing power when buying foreign goods and services on the international market, therefore reducing spending on imports. By depreciating the lira the CBRT aims to achieve a surplus in the current account as more money flows into the economy from exports and less flows out through spending on imports.

However, in order for the depreciated lira to have a positive impact on the Turkish current account trade deficit the Marshall Lerner condition needs to hold true. The condition states that PEDm+ PEDx> 1 in order for the depreciation of acurrency to have a positive effect on the current account. If the condition does not hold true the Turkish trade deficit would worsen.



In addition, although the Marshall Lerner condition holds true, the current account deficit will worsen in the short-run due to PED for net exports being inelastic in the short-run. This is because as a currency depreciates,**changes**in demanddo not occur instantaneously as consumers need time to adjust to changes in price due toprevious contracts and consumer preferences. It is only over the long-run that there is a positive impact on the deficit, as PED for net exports becomes elastic when consumers adapt to the price changes. This isshown in Diagram B, where the change from a straight line to a curve on the J-curve represents the point in which the lira depreciates. Initially, the current account deficit worsens because PED of net exports is inelastic in the short-run, shown by the downward sloping section of the curve. However, in the long-run PED for net exports turns elastic and consequently the current account deficit is positively affected, shown by the upward sloping section after the turning point.

Clearly this is relevant when considering the CBRT stated “the chronic current account deficit will turn into a surplus” asthey are certain thelower interest rates will turn the deficit into a surplus. This means the CBRT believes that the total sum of PEDmand PEDxwill be greater than 1.

To conclude, Turkey's decision to lower interest will**change**the value of the Turkish lira by depreciating it, and as a result there will be a positive flow of money into the current account. Although, for this to occur the Marshall Lerner condition needs to hold true. In addition, Turkey's currency account deficit would worsen in the short-run. Turkey's approach to fixing the deficit is therefore a long-term solution that involves increasing exports by depreciating the lira. However, when considering the global energy crisis, the ability for other countries to import from Turkey might not be as great as the CBRT anticipates.

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