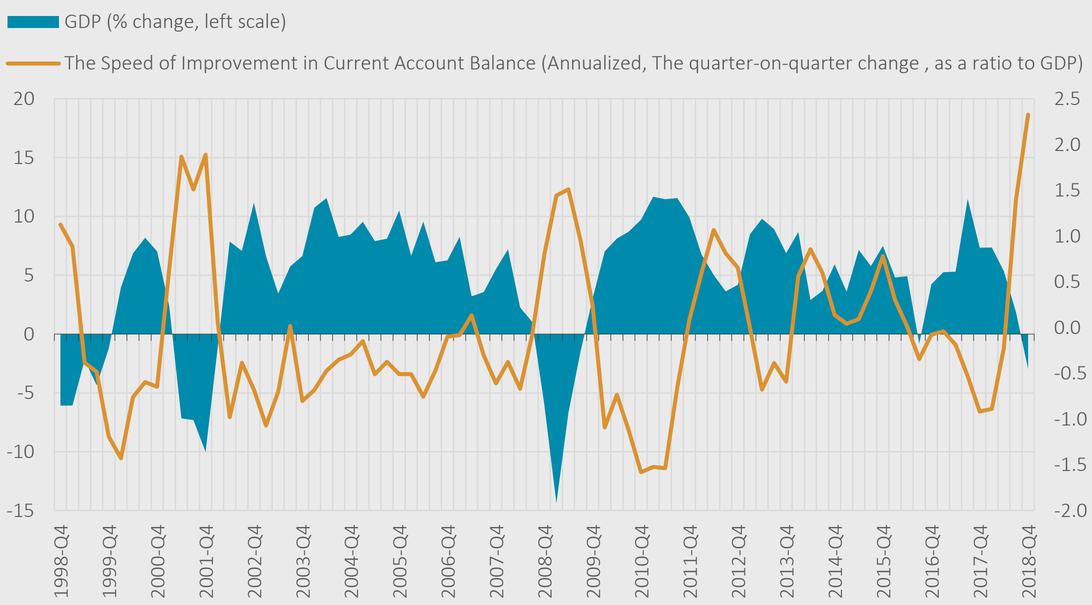
# Box 4.1

## Sources of the Rapid Improvement in the Current Account Balance

The improvement trend in the current account balance, which started in the third quarter of 2018, continued in the first quarter of 2019 thanks to the strong performance in exports of goods and services as well as the contraction in domestic economic activity. Indeed, the ratio of current account deficit to GDP, which had reached 6.6% in the second quarter of 2018, is estimated to have fallen below 2% in the first quarter of 2019. Historically, improvement in current account deficit in Turkey is usually observed in periods of significant contraction in economic activity. However; the recent improvement in current account deficit has different features compared to the previous periods. First of all, the improvement has the highest pace and magnitude among all the previous periods. Secondly, the rapid improvement occurred in a period in which economic activity was about to balance out and the decline in national income was gradual levels (Chart 1).

**Chart 1: The Speed of Improvement in Current Account Deficit and GDP**



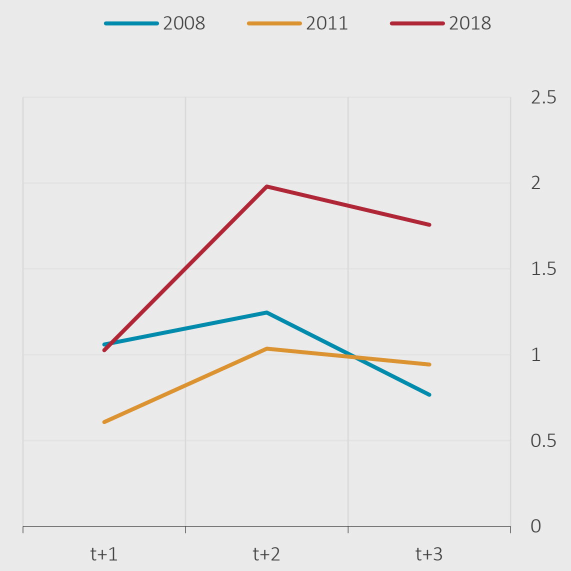

Source: TCMB calculations.

When compared to the 2008 global financial crisis and the 2011 eurozone debt crisis, there are substantial differences with respect to the magnitude and the sources of the improvement observed in the current account balance in 2018 (Chart 2 and 3). Chart 2 compares the improvement in current account balance, in 2008, 2011 and 2018, as a ratio of GDP for three successive quarters. Accordingly, the improvement in 2018 exceeded the improvement in other episodes, with respect to both the pace and the magnitude of the decline in current account balance. Chart 3 shows the magnitude and components of the improvement in the current account deficit for each of these three periods. The equation used for the comparison is shown below:

$$cab_t - cab_{t-1} = (x_t - x_{t-1}) - (m_t - m_{t-1}) + (r_t - r_{t-1}) \quad (1)$$

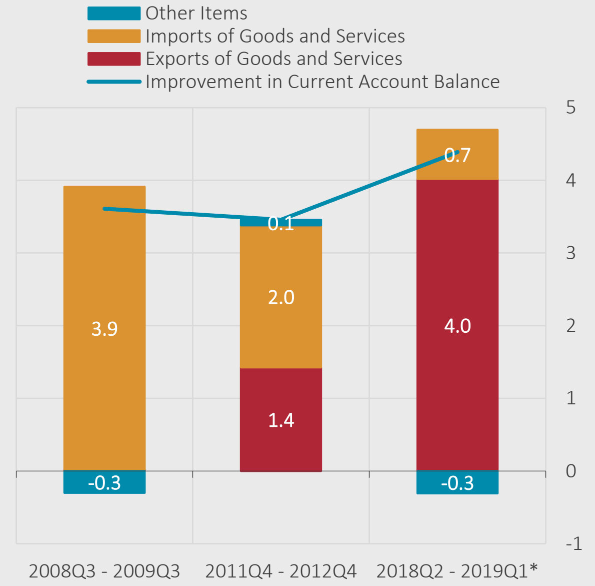
In equation (1), cab stands for current account balance, x and m denote the export and import of goods and services, respectively and finally r is the other components of current account balance. All of the variables are shown as a ratio to GDP, in terms of US Dollars.

**Chart 2: The Speed of Improvement in Current Account Balance**
(The Quarter-on-Quarter Change in the Ratio of Annual Current Account Deficit to GDP




Source: TCMB calculations.

**Chart 3: The Contributions to Improvement in Current Account Balance**
(Annualized, as a Ratio to GDP)




* The values for May and February are used for 2018 Q2 and 2019 Q1, respectively. The end of the year value in 2018 is used to compute the ratio to GDP for February 2019.

While the ratio of the current account balance to GDP improved by approximately 3.5 percentage points in 2008 and 2011; the improvement in the period covering the second quarter of 2018 and the first quarter of 2019 was around 4.5 percentage points. Meanwhile, there are significant discrepancies between the compositions of improvement in these periods. During the 2008 global crisis and the 2011 Eurozone debt crisis, when foreign demand was low and the lira was above its historical averages in real terms, the improvement in current account deficit was mainly attributed to the fall in imports of goods and services and there was no positive contribution from exports of goods and services to the current account balance particularly during the global crisis period. Unlike these episodes, the positive contribution from exports of goods and services became a main source of improvement in the current account balance in the latest episode.

To sum up, currently, unlike the 2008 and 2011 periods, the relatively robust foreign demand conditions and the historically low levels of real exchange rates support exports of goods and services. This support provides steady and solid contribution to the recent bulk improvement in current account deficit. In this respect, the improvement in current account deficit is expected to continue in the first half of 2019 and to provide more positive contribution to the economic rebalancing process.