Global Macro Views – Another Credit Expansion in Turkey

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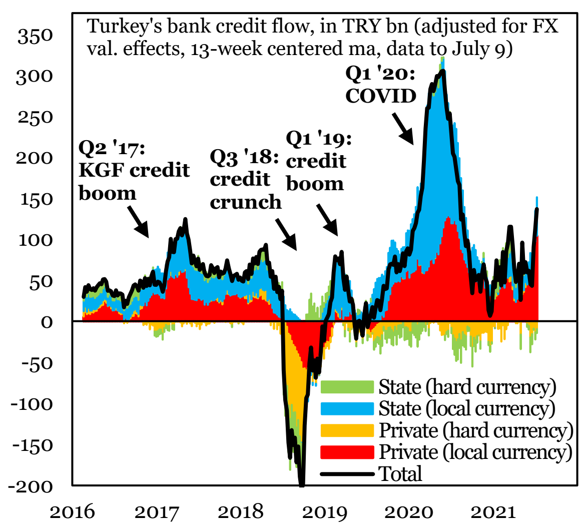
- Repeated credit expansions drove Lira depreciation in recent years.
- Credit stimulus boosts growth, but also widens the current account deficit.
- It is this current account deficit widening that weakened Lira in 2018 and 2020.
- Preliminary data now point to first signs of another substantial credit expansion.
- We revised our $/TRY fair value to 9.50 on May 2 on deteriorating sentiment.
- The latest credit data strengthen the case for that revision to our fair value.

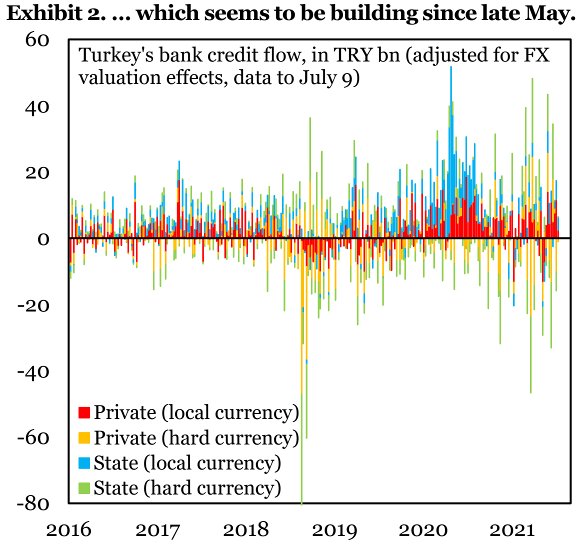
We have for many years looked at Turkish Lira through the prism of credit. Repeated credit expansions lifted growth, but at the cost of widening the current account deficit via rapid import growth. This current account deficit widening was at the root of the balance of payments sudden stop in August 2018, when the Lira depreciated very sharply, and again in 2020 when a large credit expansion meant that the Lira was among the weakest emerging market currencies that year. We are now tracking a sizable credit expansion that started in late May 2021 and is happening in Lira-denominated loans. The size of this latest credit boom has already surpassed the Q1 2019 expansion ahead of municipal elections and is about half the size of the very large 2020 expansion at the height of the COVID shock. We revised our $/TRY fair value to 9.50 from 7.50 in early May on weaker sentiment towards Turkey in global capital markets. Recent trends in credit data – if they are sustained – add to the case for that revision.

Exhibit 1. Turkey is seeing another credit expansion, ...



Source: Haver, IIF

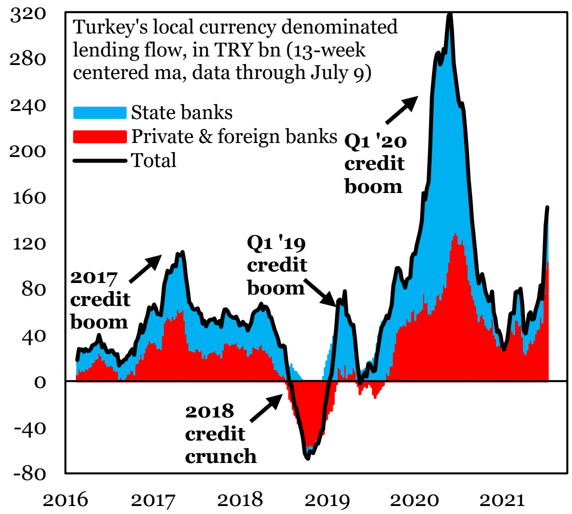
Exhibit 2. ... which seems to be building since late May.



Source: Haver, IIF

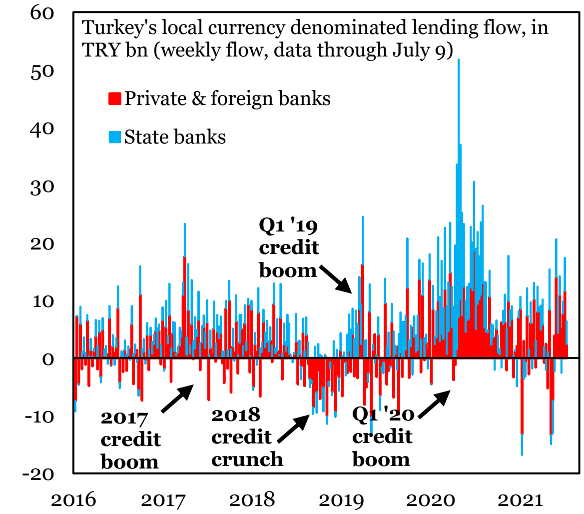
We regularly track and update the flow of credit in Turkey, given how important it has been for the balance of payments and Turkish Lira. We track weekly data on Lira- and FX-denominated lending, where we adjust FX-denominated lending for exchange rate fluctuations. We look at this flow in two ways. First, we use a 13-week centered moving average, where the last data point consists of the seven most recent weeks, grossed up to a 13-week equivalent (Exhibit 1). That perspective shows a clear rise in credit flow. Second, we look at the raw weekly flow (Exhibit 2), given that the 13-week moving average can be distorted by base effects. That perspective again shows a sizable credit expansion that began in late May. The picture becomes even clearer looking at Lira-denominated credit, which is where most of the credit expansions have occurred since 2017. This shows a much clearer acceleration of credit flow in our 13-week centered moving average (Exhibit 3) and in the weekly raw flow numbers (Exhibit 4). We think this perspective may be more authoritative, because adjusting credit flow for FX valuation changes is at best imprecise.

Exhibit 3. This expansion is in Lira-denominated loans, ...



Source: Haver, IIF

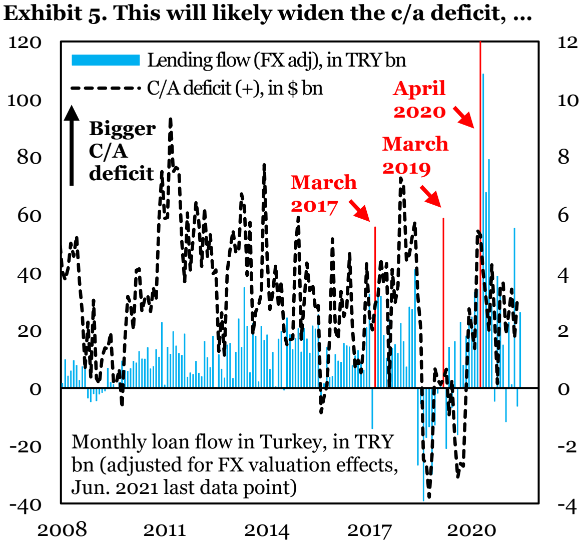
Exhibit 4. ... which already eclipsed the Q1 2019 boom.



Source: Haver, IIF

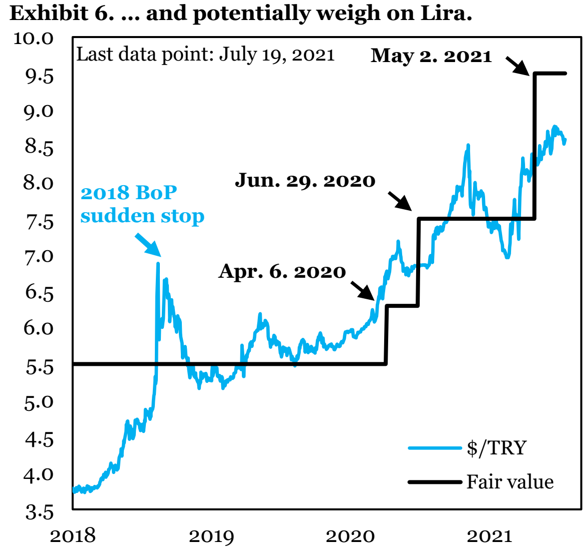
The reason we follow credit expansions so closely is because they have been a key driver of Turkey's current account deficit in recent years. Multiple credit expansions have led to repeated widening in the deficit (Exhibit 5), precipitating the balance of payments crisis in August 2018 and setting the stage for sizable Lira devaluation in 2020. We revised our Turkish Lira fair value to $/TRY 9.50 from 7.50 on May 2 of this year (Exhibit 6), on the rationale that global market sentiment towards Turkey was deteriorating, which we thought would weigh on capital inflows needed to finance the still considerable current account deficit. The latest credit expansion – if it is sustained – will tend to widen the current account deficit and increase Turkey's external financing further, strengthening the rationale for our fair value revision.

Exhibit 5. This will likely widen the c/a deficit, ...



Source: Haver, IIF

Exhibit 6. ... and potentially weigh on Lira.



Source: Haver, IIF

