Economic Views – Adjustment in Turkey and Argentina

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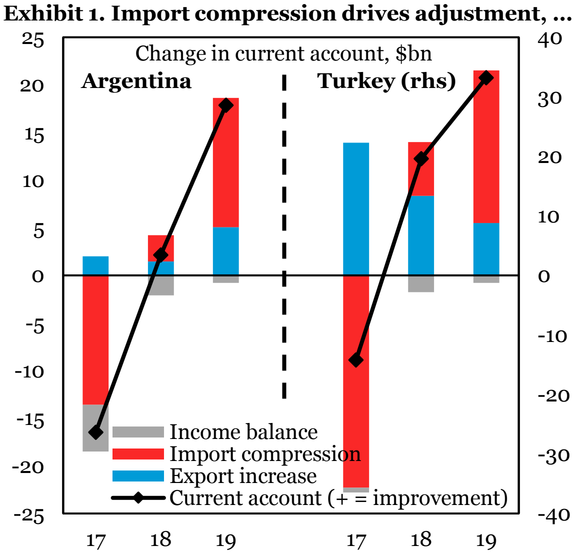
- Turkey and Argentina saw sharp depreciations in 2018, …
- that erased substantial real exchange rate overvaluations.
- We assess the BoP impact in 2019 using our Nowcast.
- Current account deficits will collapse due to lower imports.
- The flipside is low debt rollover rates for most of 2019.
- External risk is no longer the pressing issue in either case.

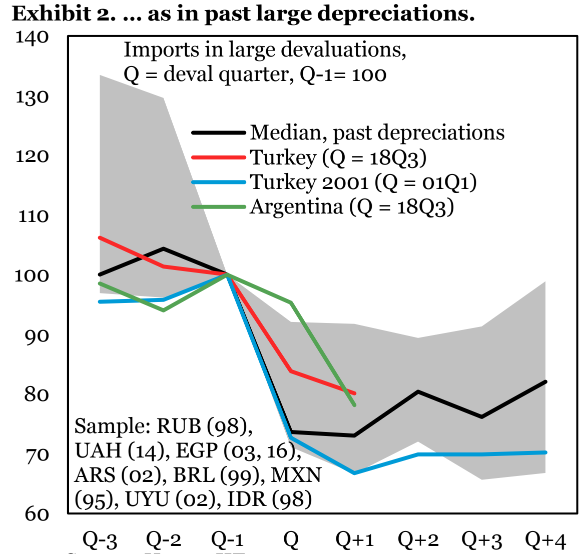
We kicked off 2018 flagging severe exchange-rate overvaluations and high external vulnerability in Turkey and Argentina. In the summer, sharp real depreciations erased overvaluations in both countries, resulting in large external adjustments. In the last few months of the year, current account deficits narrowed rapidly in both cases. We assess the implications of these sharp adjustments for the 2019 outlook through the lens of our ***BoP Nowcasts***, which provide "live" tracking of the complete balance of payments for systemic EMs. The current accounts of Turkey and Argentina will improve drastically in 2019 due to import compression—with the former going into surplus. Debt rollover rates are forecasted to remain low in the first half of the year and then pick up gradually. External imbalances will not be an issue in either country. The challenge in Argentina is ambitious fiscal adjustment in an electoral year; while in Turkey the focus will be on the credit crunch, depth of the recession, and their impact on balance sheets.

Exhibit 1. Import compression drives adjustment, …



Source: Haver, IIF

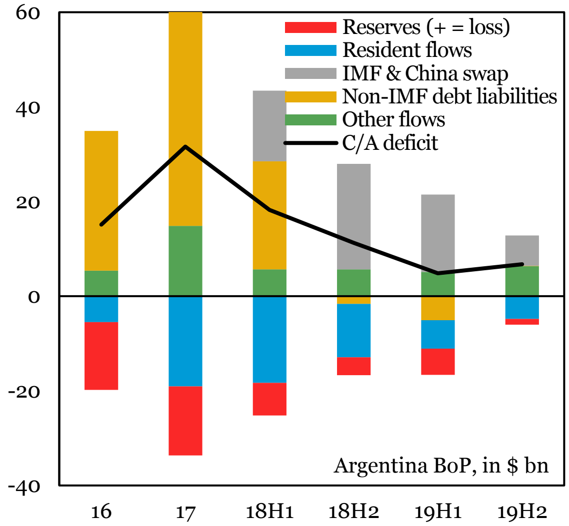
Exhibit 2. … as in past large depreciations.



Source: Haver, IIF

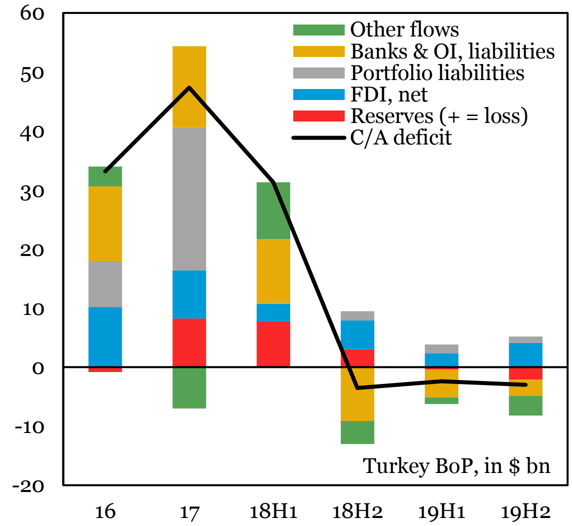
The defining theme in the external accounts of Turkey and Argentina is import compression in the aftermath of sudden stops in capital flows (Exhibit 1). The current accounts of both countries are estimated to have improved sharply in the second half of 2018—a trend we think will carry into the first half of 2019. The rapid import and domestic demand compression we are seeing in Turkey and Argentina mirrors the pattern of other EMs that experienced sharp real depreciations (Exhibit 2). In past cases, import and current account adjustments were all but completed in just two quarters—a pattern we think will also emerge in the cases of Turkey and Argentina. The flipside of current account adjustment is continued nonresident capital outflows. In Argentina, the augmented IMF package should be enough to finance continued outflows from government debt and smaller, but persistent, domestic capital flight (Exhibit 3). In Turkey, the ongoing domestic credit crunch will translate into repayment of foreign liabilities by banks (Exhibit 4). Capital flows will be an order of magnitude smaller than in past years as the current account is projected to post a modest surplus. Key debt rollover rates (public in Argentina, banks in Turkey) fell well below 100% mid-last year and will remain low through 2019 (Exhibits 5 and 6).

Exhibit 3. Argentina's current account will shrink.



Source: Haver, IIF

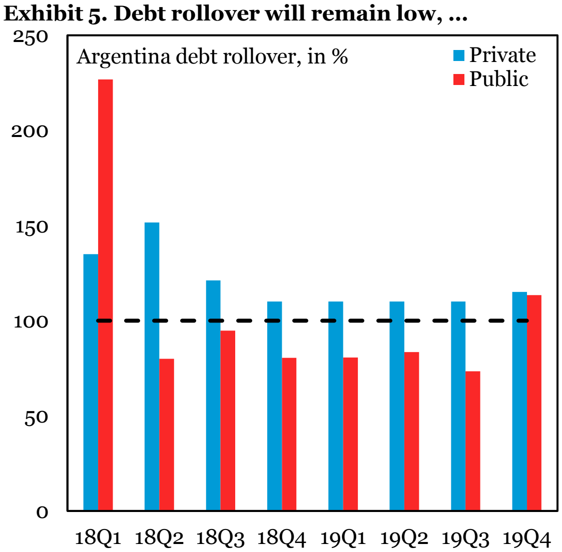
Exhibit 4. Turkey's will swing into surplus.



Source: Haver, IIF

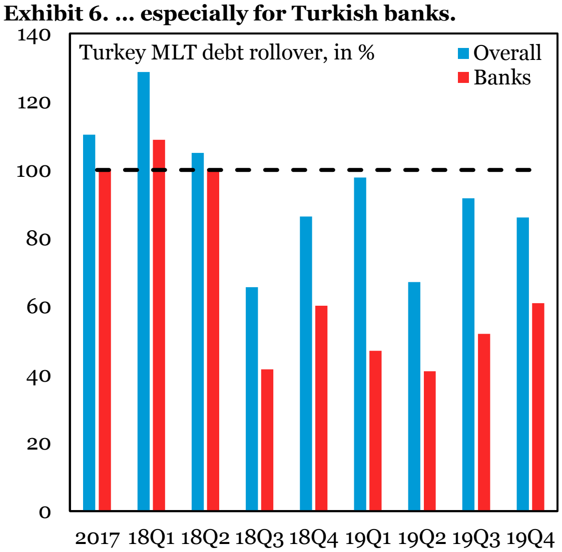
External imbalances in Turkey and Argentina grew large in 2017, setting the stage for sharp adjustments last year. Our BoP Nowcast framework indicates import compression will persist through 2019 in both countries, translating into low debt rollover rates (Exhibit 7). Current account imbalances and overvaluation are water under the bridge. The focus will now shift to the output cost of sharp external adjustment and, in the case of Argentina, the feasibility of the fiscal adjustment required to prevent imbalances from re-emerging. In forthcoming ***Economic Views***, we will continue to analyze BoP developments in major EMs.

Exhibit 5. Debt rollover will remain low, ...



Source: Haver, IIF

Exhibit 6. ... especially for Turkish banks.



Source: Haver, IIF

Exhibit 7. Balance of Payments Nowcast, in $ bn.

	Argentina		Turkey	
	2018	2019	2018	2019
Current account	-29	-12	-28	5
Exports (G&S)	75	80	223	232
Imports (G&S)	86	73	240	214
Non-IMF liabilities	21	-5	6	-5
IMF	28	23	0	0
Net capital flows	-9	1	32	-3
Reserves (+ = loss)	-11	-7	-11	2

Source: Haver, IIF