Euler Hermes Economic Research

Country Risk Analysis

Turkey

Improved short-term economic risk undermined by social unrest

General Information

GDP	USD775bn (World ranking 18, World Bank 2011)
Population	73.64 millions (World ranking 18, World Bank 2011)
Form of state	Republican Parliamentary Democracy
Head of government	Recep Tayyip ERDOGAN (AKP)
Next elections	2015, legislative

Strengths

- Important geostrategic position that has historically always ensured aid when needed
- Public finances
- Adequate business environment
- Well-educated workforce and competitive economy
- Mostly financially solid banking sector
- Increasingly important role as regional hub between Europe, MENA and Asia

Weaknesses

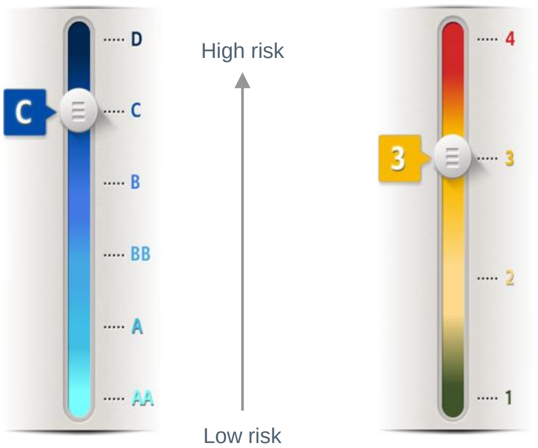
- Continued rapid private sector credit growth
- Exchange rate vulnerability to domestic and external shocks
- Persistently large current account deficits, largely financed through short-term external debt which is consequently rapidly rising
- Commercial risk (insolvency risk) stemming from high business cycle volatility
- (External) debt refinancing risk of weaker companies and banks
- Deep-rooted division in society between secularists and religious conservatives

Country Rating

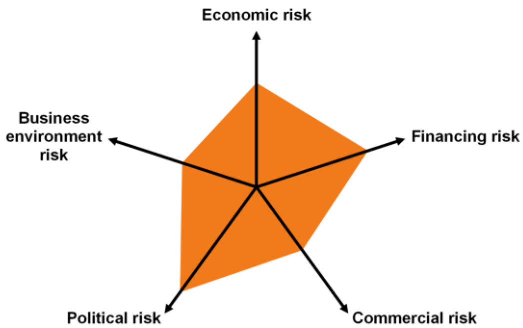
C3

Country Grade

Country Risk Level

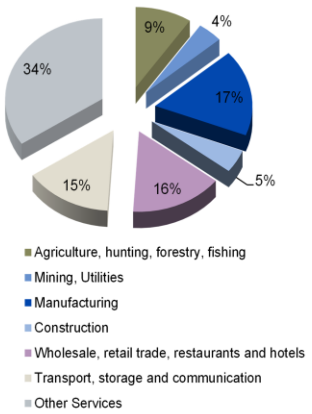


Risk Dimensions



Economic Structure

GDP breakdown (% of total, 2010)



Trade structure (% of total, 2012)

By destination/origin

Exports		Rank		Imports
Germany	9%	1	11%	Russia
Iraq	7%	2	9%	Germany
Iran	7%	3	9%	China
United Kingdom	6%	4	6%	USA
UAE	5%	5	6%	Italy

By product

Exports		Rank		Imports
Machinery, appliances etc.	14%	1	25%	Mineral fuels and oils
Textiles and clothing	12%	2	18%	Machinery, appliances etc.
Iron and steel	11%	3	9%	Iron and steel
Precious stones and metals	11%	4	7%	Plastic and rubber products
Road vehicles and parts	10%	5	6%	Road vehicles and parts

Sources: Chelem, Turkstat, IHS Global Insight, Euler Hermes

Economic Forecasts

	Average 2000-08	2009	2010	2011	2012	2013f	2014f
GDP grow th (% change)	4.7	-4.8	9.2	8.8	2.2	4.0	4.0
Inflation (%, end-year)	22.3	6.5	6.4	10.4	6.2	6.0	5.8
Fiscal balance (% of GDP)	-5.8	-5.6	-2.3	-0.4	-2.0	-1.8	-1.8
Public debt (% of GDP)	56.7	46.1	42.4	39.2	36.4	35.5	35.4
Current account (% of GDP)	-3.3	-2.0	-6.2	-9.7	-6.0	-6.4	-6.5
External debt (% of GDP)	44.4	43.9	40.1	39.5	42.8	44.1	43.5

Source: IHS Global Insight, national sources, Euler Hermes

Economic Growth

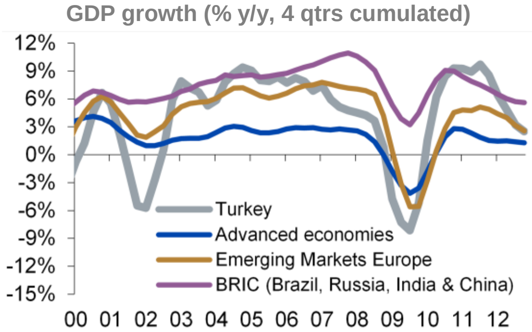
After a soft landing in 2012, growth will pick up in 2013

Turkey experienced rapid economic growth during 2002-2007 (average annual +6.8%)—largely in line with the average of Emerging Europe though somewhat below the BRIC average—before it fell into a deep recession in the wake of the global economic and financial crisis in 2008-2009. A strong recovery thereafter with average annual real GDP growth of +9% in 2010-2011 reflected, at least in part, economic overheating, but it appears that Turkey has managed a soft landing of its economy in 2012 as growth decelerated to +2.2%. Tight monetary policy curtailed private consumption (-0.7%) and private investment (-4.5%) in 2012. Counteracting fiscal policy—reflected in robust growth of public consumption (+5.7%) and public investment (+8.9%)—as well as a surge in gold exports to Iran kept the economy growing in 2012. Exports increased by +17.2% in 2012 while imports were flat as a result of the weak domestic demand. Early indicators and sentiment indices suggest an improving outlook for 2013. We expect full year growth to pick up to about +4%.

Insolvencies will continue to rise

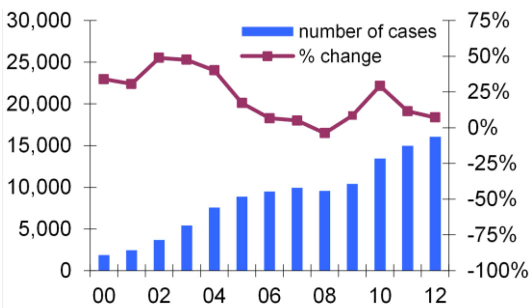
The number of corporate bankruptcies has risen steadily over the past 12 years, even in years of strong economic growth, reaching 16,063 cases in 2012. In Q1 2013, the number surged further by +23% y/y.

GDP growth (% y/y, 4 qtrs cumulated)



Sources: IHS Global Insight, Euler Hermes

Insolvencies



Sources: TOBB, Euler Hermes

Unorthodox monetary policy appears to be eventually successful

To tackle excessive credit growth and large speculative foreign capital inflows—seen as main sources of rising macroeconomic imbalances and economic overheating—the central bank embarked on an unorthodox monetary policy strategy in late 2010: lower interest rates to curb short-term foreign capital inflows and ease upward pressure on the TRY and sharply higher bank reserve requirements to tighten monetary policy at home in order to reduce credit growth in spite of lower interest rates. After considerable doubts about this strategy in 2011, it eventually appears to be successful in facilitating a soft landing, including a narrowing of the external imbalance and a reduction of private sector credit growth to a more reasonable level of around 18% y/y at end-2012 (down from a temporary peak of 44% y/y in August 2011).

Inflation is forecast to remain moderate

Average annual inflation has been fairly moderate within the 6-9% range since 2009, and we expect it to remain in that range in 2013-2014. On a monthly basis, however, annual inflation has been relatively volatile: Following a record low of 4% y/y in March 2011, it accelerated to 11.1% in April 2012, before moderating to 6.2% at end-2012. After picking up again in Q1 2013, inflation eased to 6.1% y/y in April. This volatility reflects a high vulnerability to food and energy price shocks as well as to sudden exchange rate movements.

Exchange rate risk remains a concern

The exchange rate of the Turkish lira (TRY) has shown considerable volatility and vulnerability to external and domestic shocks in recent years. Periods of gradual appreciation and real overvaluation of the TRY resulting from large speculative foreign capital inflows have often been followed by a sudden, sharp depreciation as these foreign capital inflows were withdrawn in the wake of a "shock" event.

During the period 2008-2011 the TRY depreciated by a total 62% against the USD and by 42% against the EUR. Since 2012 the currency has stabilised. Moreover, the real effective exchange rate does currently not indicate a significant overvaluation of the TRY.

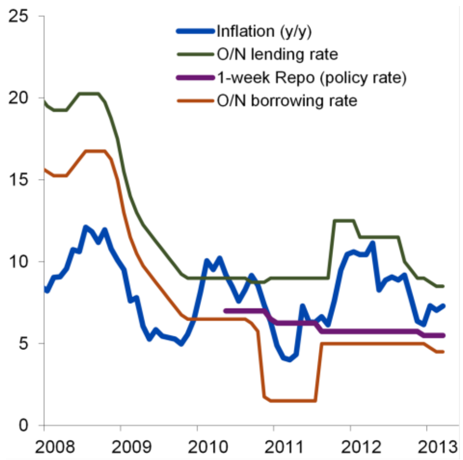
Nevertheless, exchange rate risk remains a concern in the medium term, especially since short-term foreign capital inflows have remained substantial to date.

Adequate fiscal position

Turkey's fiscal position has markedly improved since the domestic economic crisis in 2001. The fiscal deficit has been below 3% of GDP since 2010 and should remain so in 2013-2014. Total public debt in relation to GDP has halved from almost 80% in 2001 to around 38% in 2012. Fitch Ratings agency upgraded Turkey to investment grade in November 2012, followed by Moody's in May 2013. S&P has kept the country one notch below that level, for now.

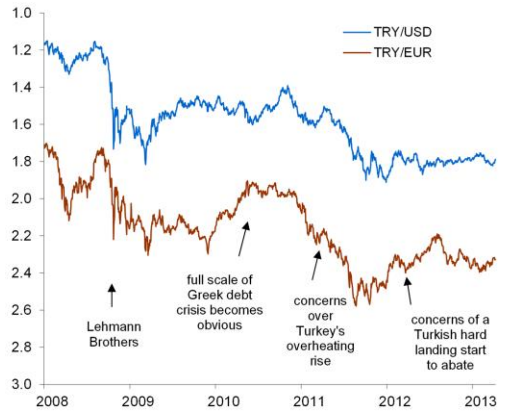
It should be noted, however, that much of the improvement of Turkey's fiscal position in recent years is owed to strong tax revenues thanks to the sound economic performance and markedly lower interest payments rather than spending restraint. Indeed, public spending has often been higher-than-targeted, indicating a reluctance to fiscal consolidation. This could undermine market confidence in the event of lower future growth, domestic or external shocks.

Inflation and interest rates (%)



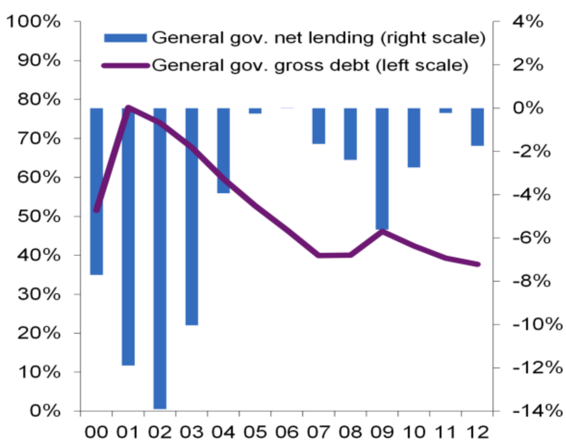
Sources: IHS Global Insight, national sources, Euler Hermes

Exchange rate



Sources: ECB, Euler Hermes

Fiscal balance and general government debt (% of GDP)



Sources: IHS Global Insight, Euler Hermes

Current account deficit is narrowing ...

The current account deficit declined from USD77.2bn (10% of GDP) in 2011 to USD48.9bn (6% of GDP) in 2012, as weak domestic demand curbed imports. We forecast the annual deficit to remain relatively large at around 6.5% of GDP in 2013-2014.

... but the financing of the deficit remains a cause of concern

Net foreign direct investment (FDI) inflows have been modest in recent years (USD8.3bn or 0.9% of GDP in 2012), covering just 17% of the annual current account deficits in 2010-2012. The large remainder of the short-falls was financed through new short-term external debt: In 2012, net portfolio investment inflows, which have a more speculative nature, amounted to USD40.8bn (4.6% of GDP) and net external bank borrowing added up to USD16.4bn (1.9% of GDP).

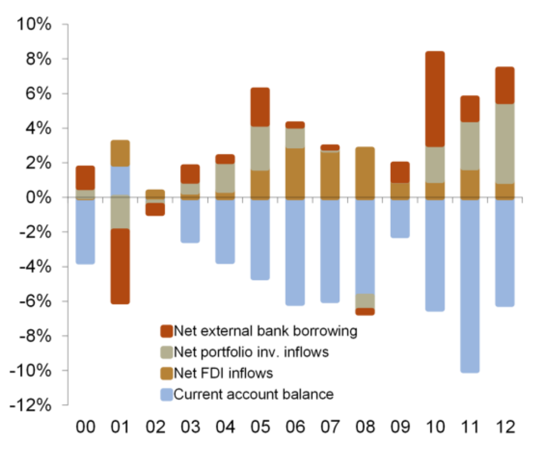
Rapidly rising short-term external debt poses risks and requires close monitoring

As a result, total external debt has risen to a record USD337bn in 2012, equivalent to about 43% of GDP or 163% of export earnings. These ratios appear manage-able at first sight. However, short-term external debt has risen faster than the total, hitting a worrisome, new record high of USD109bn in February 2013 and increas-ing to about 33% of the total from 17% at end-2007. The debt-service ratio is falling but will remain large at about 25% in 2013.

Foreign exchange reserves appear adequate

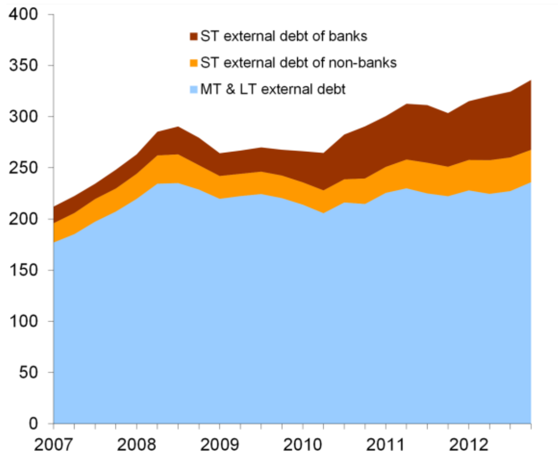
Largely as a result of the above mentioned substantial short-term capital inflows in recent years, foreign exchange reserves have continued to rise and reached a record USD104bn in March 2013. The uptrend has been volatile though, owing to occasional central bank intervention to stabilise the TRY and/or a temporary reversal in capital inflows at times of globally deteriorat-ing investor sentiment. This reflects once again Turkey's vulnerability to external events. Positively, the current level of foreign exchange reserves is comfortable with regard to import cover (around five months). In other terms, however, reserves cover just about 70% of the estimated external debt payments falling due in the next 12 months, which is well below an adequate level of at least 100%.

Current account balance and financing of deficits (% of GDP)



Sources: IHS Global Insight, national sources, Euler Hermes

External debt (USDbn)



Sources: Central Bank of Turkey, Euler Hermes

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