Euler Hermes Economic Research

Economic Insight

Abolition of RUSF payments to boost exports to Turkey by USD20.2bn in 2015-2016

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Executive summary

- A significant import barrier, the Resource Utilisation Support Fund (RUSF) payment, 6% of the value of all imported goods, was abolished for around half of Turkish imports in April 2015. This policy change should boost the volume of imports (+2.5pps in 2015), exports (+1.7pps) and investment (+2.2pps) while the impact on GDP growth will be modest (+0.1pps), due to a worsening of net exports.
- We expect new market opportunities (USD20.2bn) for exporters to Turkey, with Russia (+2.1bn USD), China (+2.1bn USD) and Germany (+1.9bn USD) being the main beneficiaries. However, non-payment risk will also increase by an estimated +10% in Turkey in 2015.
- In turn, we also expect broad-based gains in the value of Turkish exports which should increase by USD9.5bn in 2015-2016, with the largest export gains coming from Germany (+0.9bn USD), the UK (+0.7bn USD) and the U.S. (+0.5bn USD). Textile and agrifood which account for 35% of the export gains, along with transportation which will benefit the most from rising investments are three key winners of the RUSF abolition.

Exemption from Resource Utilisation Support Fund payments for 50% of imported goods to boost exports and investment to Turkey

In Turkey, payments to the Resource Utilisation Support Fund (RUSF; Turkish: Kaynak Kullanimini Destekleme Fonu, KKDF) have been a noted cost factor in the financing of imports. According to the RUSF legislation, any import conducted on credit (i.e. if the payment related to the import is not made in advance) is subject to an obligatory payment of 6% of the value of the goods to be imported. Additionally, short-term foreign loans obtained by Turkish individuals or non-financial corporations are subject to RUSF payments.

In April 2015, the Council of Ministers decided to abolish RUSF payments for a large variety of goods (see figure 1 for a detailed overview) that are imported under acceptance credits, deferred payment letter of credit and on a cash-against-goods basis. The aim of this legislative change is to orient investment across the country towards the import of intermediate goods by decreasing the cost of imports for companies which import to re-export. Hence most of the exempted goods are either commodities, other goods predominantly used as input in industry, or goods used to improve infrastructure. However, there is an overlap as a

Figure 1: Import goods which have been exempted from RUSF payments since April 2015

Type of Products	List of products
Agricultural inputs	Animal & plant based fats, cacao, yeast, animal feed
Textile inputs	Thread, silk, cotton, natural fibers, textile materials
Metals	Iron-steel, copper, nickel, aluminium, magnesium, cobalt, titan, berilium, chrome
Basic chemicals	Mineral, organic chemicals, fuels
Transportation and vehicles materials	Railway materials, plane and helicopter parts, motor spareparts
Machinery and electronics	All types of machinery and electronics
Others	Vaccines, coatings, adhesives, plastics, crane

Sources: Council of Ministers Decision 2015/7511, Euler Hermes

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number of these exempted goods may also be used for consumption. Overall, the exempted goods account for roughly 50% of total Turkish imports.

Macroeconomic impact of the partial RUSF abolition in 2015-2016: High impact on trade, small on GDP

Euler Hermes estimations show that the partial removal of this particular trade barrier will see the targeted positive effects on both trade volumes as well as economic activity.

Euler Hermes now forecasts real imports to rise by +4.4% in 2015 and +8.3% in 2016, reflecting increases of +2.5pps and +3.8pps, respectively, compared to the forecasts prior to the partial RUSF abolition. Real exports are expected to rise as well, by +1.2% (improved by +1.7pps) in 2015 and +8.6% (+2.6pps) in 2016. There will also be a marked positive impact on fixed investment growth, projected at +3.8% (+2.2pps) in 2015 and +6% (+3.4pps) in 2016, and a marginal effect on private consumption which will achieve a +0.1pps increase in both years.

The positive effect on real GDP growth will be relatively modest in the next two years, though, amounting to +0.1pps in 2015 (to +3%) and +0.2pps in 2016 (to +4%). This is because the positive impact from domestic demand (mainly investment) is largely offset by a negative impact from net exports since the volume (real) changes resulting from the partial RUSF abolition are larger for imports than for exports.

The latter is also the reason for larger projected current account deficits in 2015 (5.6% of GDP; +0.4pps) and 2016 (5.8%; +0.9pps) resulting from the trade liberalisation. While external shortfalls of this magnitude have always been a source of concern in Turkey and repeatedly contributed to currency volatility, the projected increases should not add further to the already high level of perceived external liquidity risk.

An opportunity for trade partners: USD20.2bn to capture for exporters to Turkey in 2015-2016

The partial RUSF abolition will lead to an estimated rise in total imports of goods by USD20.2bn over 2015-2016 (USD5.5bn in 2015 and USD15.7bn in 2016). Russia, China and Germany who account for 20% of Turkish imports will benefit the most from these new opportunities: (i) Russia will see its exports to Turkey rise by USD2.1bn thanks mainly to fuel products; (ii) China will see similar exports gains driven by electronic devices; and (iii) German exports will be up by USD1.9bn driven by engines and machineries. To a lesser extent, the U.S., Italy and France will also benefit with respective potential gains of USD1.1bn, USD1bn and USD0.7 bn. Eventually, Iran should be a major winner of the RUSF abolition as Turkey accounts for about 10% of the country's exports.

In 2014 and in Q1 2015, about half of total Turkish imports was conducted by advance payment. Many companies obviously chose this method of payment in order to avoid RUSF payments. The other half of imports was done by payment methods that were subject to RUSF payments. This therefore creates an opportunity for companies who have established credit management practices to trade on open account with Turkey without an additional cost.

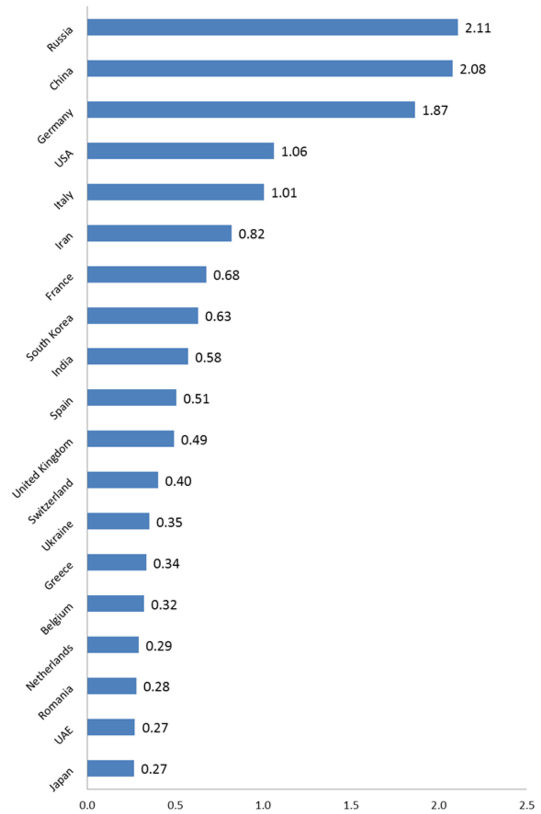
Figure 2: Key economic forecasts

Turkey		2014	2015	2016	2015	2016
			before partial RUSF abolition		after partial RUSF abolition	
GDP		2.9	2.9	3.8	3.0	4.0
Consumer Spending		1.3	4.0	4.0	4.1	4.1
Public Spending		4.6	3.2	2.0	3.2	2.0
Investment		-1.3	1.6	2.6	3.8	6.0
Stocks	*	-0.4	0.0	0.0	0.0	0.0
Exports		6.8	-0.5	6.0	1.2	8.6
Imports		-0.2	2.0	4.5	4.4	8.3
Net exports	*	2.0	-0.8	0.2	-1.1	-0.3
Current account (USD bn)		-45.8	-37.6	-36.8	-40.3	-44.2
Current account (% of GDP)		-5.7	-5.2	-4.8	-5.6	-5.8

NB: Change over the period, unless otherwise indicated.
* Contribution to GDP growth.

Sources: National sources, IMF, IHS, Euler Hermes

Figure 3: 2015-2016 potential export gains in Turkey for its main trading parterns (USDbn)



Sources: National sources, Euler Hermes

Rising non-payments are the price to pay for new opportunities

With regards to the partial RUSF abolition, (future) overall Turkish imports and the importing firms concerned and the evolution of their payment behaviour can be broadly classified into four categories:

(i) Imports of goods that remain subject to RUSF payments (50% of total imports): Nothing changes for these imports and the firms concerned, including their payment behaviour.

(ii) Imports of goods that have been exempted from RUSF payments and were previously done by advance payment (25% of total imports): These importing firms appear to be solvent. There could be a one-off push to imports and investment if a significant number of these firms shift to importing on credit. However, the rise in the risk of non-payment will be almost insignificant.

(iii) Imports that have been exempted from RUSF payments and were previously done on credit and thus subject to the 6% RUSF payments (25% of total imports): Although these importing firms may have (had) liquidity problems, their profitability will initially rise, as they get imported goods 6% cheaper now, and any prior financing problems should decline. However, it is likely that at least some of these firms will import and invest more (on credit) in future. Due to the RUSF abolition, non-payment risk is estimated to rise by +10% in this cluster which represents about 25% of Turkish firms.

(iv) Imports that were previously retarded by the RUSF legislation (estimated at 5% of total imports) but will be conducted in future because lower import costs will make additional production profitable: Nonetheless, these firms appear to be more subject to liquidity and financing problems with non-payment risk in this cluster considered to be approximately 50% higher than the average in Turkey.

Overall, Euler Hermes estimates that the risk of non-payment for the companies importing goods exempted from the RUSF payment will increase by about +10%, in line with our insolvency forecasts. This is the price to pay for exporters to Turkey – as well as for local suppliers – for new business opportunities in the country.

Turkish exports to increase in value by USD9.5bn in 2015-2016

Nominal exports of goods dropped by -7.5% y/y in Q1 2015, reflecting the nascent recovery in Europe (-7% y/y for Q1 exports to the EU) and geopolitical tensions in other important export markets such as Iraq (-23% y/y) and Russia (-35% y/y). As a result, prior to the partial RUSF abolition, goods exports in USD terms were forecast to decline by -1.9 bn in 2015-2016 (-7.2 bn in 2015 and +5.3 bn in 2016). Following the trade liberalisation move, Euler Hermes expects exports in USD to increase by +7.6 bn in 2015-2016 (-3.6 bn in 2015 and +11.2 bn in 2016). Hence the net effect of the legislative change is an increase of USD9.5 bn in 2015-2016.

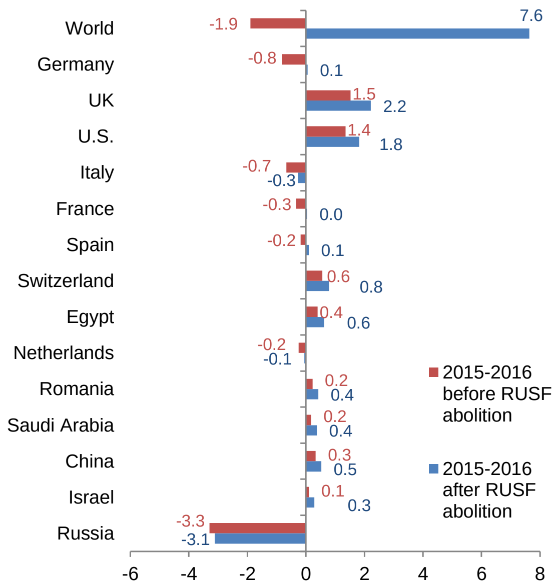
Among Turkey's main trading partners, the largest export gains thanks to the new policy should come from Germany (+0.9bn USD), the UK (+0.7bn USD) and the U.S. (+0.5bn USD).

Regarding Turkey's main export sectors, textiles &

Figure 4: Change in insolvencies in Turkey (USD bn)

Sources: TOBB, Euler Hermes

Figure 5: 2015-2016 potential export gains and losses in key export markets before and after the partial RUSF abolition (USD bn)



Sources: Chelem, IMF, Euler Hermes

clothing (+2bn USD) will benefit the most from the partial RUSF abolition, followed by chemicals (+1.4bn USD), agrifood (+1.2bn USD), automotive (+1.2bn USD), machinery & equipment (+1.1bn USD) and metals (+0.8bn USD).

In the medium term, the RUSF abolition also provides an opportunity for Turkish firms to move up the value chain. Since intermediate goods have become relatively cheaper now, it may be beneficial to some extent to replace the domestic production of such goods by imports and instead focus on the production of higher value added goods.

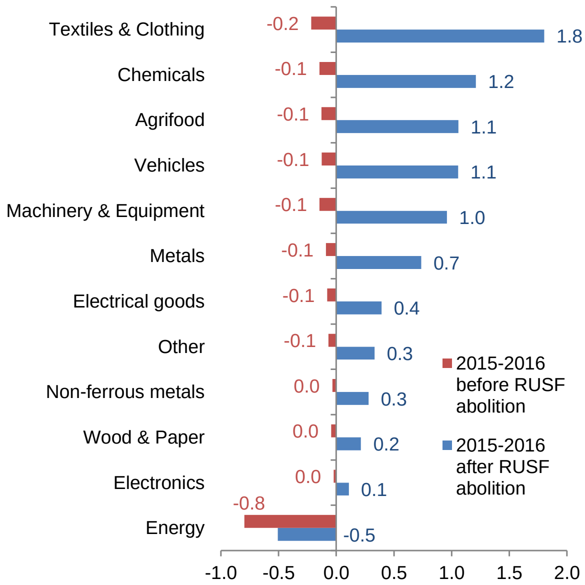
Textile, agrifood and transport are three domestic winners of the RUSF abolition

(i) The Turkish textiles & clothing industry accounts for about 18% of total exports, ranking Turkey as a top ten textile exporter worldwide. However, the sector currently faces major challenges which led Euler Hermes to downgrade it from medium to sensitive risk in Q2 2015. The myriad of Turkish companies (more than 50,000) act as a key supplier to European brands, with the EU accounting for 65% of Turkish apparel exports. They now face increasingly sharp competition from the Balkan states, mainly Bulgaria. Thus, manufacturers face the risk of contract cancellation by luxury brands in Italy, Spain and France. The RUSF abolition on thread, silk, cotton, natural fibres and textile materials should boost the price competitiveness of Turkey. This should support this key industry as it fights to retain market share.

(ii) Agrifood is a cornerstone of the Turkish economy, accounting for nearly 17% of total exports and 12% of GDP. The RUSF abolition on animal & plant based fats, cacao, yeast and animal feed, which is expected to boost the sectors' exports, is part of a larger government plan for 2023. The latter has set very ambitious targets for agrifood in Turkey: becoming one of the top five global producers and doubling agricultural exports to USD40 bn, compared to USD18 bn in 2014.

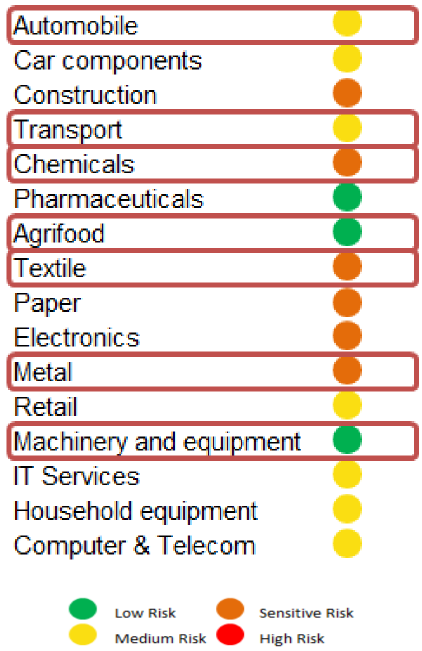
(iii) As export industries highly rely on transport and logistics, increasing investment in this sector will be critical for the RUSF abolition trade benefits to materialize. The zero RUSF tax on railway materials, plane and helicopter parts and motor spare parts imports will contribute to strengthen that investment and should allow the transport sector to fully benefit from the Turkey's hub position and its competitive and low cost workforce.

Figure 6: 2015-2016 potential export gains and losses in key export sectors before and after the partial RUSF abolition (USD bn)



Sources: Chelem, IMF, Euler Hermes

Figure 7: Turkish sector grades



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