managing risk, enabling trade

Atradius Country Report

Turkey – December 2013

Turkey: Atradius STAR Political Risk Rating*:

5 (Adequate) – Stable

* The STAR rating runs on a scale from 1 to 10, where 1 represents the lowest risk and 10 the highest risk.

The 10 rating steps are aggregated into five broad categories to facilitate their interpretation in terms of credit quality. Starting from the most benign part of the quality spectrum, these categories range from 'High Quality', 'Good', 'Adequate', 'Impaired' to 'Prohibitive Conditions', with a separate grade reserved for 'Off Cover.'

In addition to the 10-point scale, there are rating modifiers associated with each scale step: 'Positive', 'Stable', and 'Negative'. These rating modifiers allow further granularity and differentiate more finely between countries in terms of risk.

For further information about the Atradius STAR rating, please click here

Overview

General information

Capital:	Ankara
Government type:	Republic
Currency:	Turkish lira (TRY)
Population:	74.0 million
Status:	Lower middle income country (GDP/capita: US$ 10,823 in 2013)

Most important sectors (2013, % of GDP)

Services:	65 %
Industry:	26 %
Agriculture:	9 %

Main import sources (2012, % of total)

Russia:	11.3 %
Germany:	9.0 %
China:	9.0 %
USA:	6.0 %
Italy:	5.6 %

Main export markets (2012, % of total)

Germany:	8.6 %
Iran:	6.5 %
UK:	5.7 %
UAE:	5.4 %
Russia:	4.4 %

Main expenses of foreign exchange

Import of chemicals (15 %), oil/gas (12 %), cars (9 %).

Main sources of foreign exchange

Export of textiles/clothing (19 %), cars (13 %), base metals (13 %), agricultural goods (10 %), tourism, private transfers.

Key indicators

	2010	2011	2012	2013*	2014**
GDP (US$ million)	731,168	774,754	788,874	817,135	867,940
Real GDP growth (%)	9.1	8.8	2.2	3.4	4.7
GDP per capita (US$)	10,135	10,604	10,660	10,823	11,390
Inflation p.a. (%)	8.6	6.5	8.9	6.6	7.1
Fiscal balance (% of GDP)	-3.6	-1.4	-2.1	-2.5	-2.7
Total foreign debt (US$ million)	299,859	307,007	336,900	362,300	378,800
Foreign debt/GDP (%)	41	40	43	44	44
Foreign debt/XGS (%)	185	163	159	167	165
Short-term debt/inter. reserves (%)	97	104	n/a	n/a	n/a
Debt service ratio (%)	37	30	24	17	16
Current account balance (US$ million)	-45,447	-75,092	-47,750	-55,000	-63,600
Current account/GDP (%)	-6.2	-9.7	-6.1	-6.7	-7.3
Nom. exchange rate to US$ (average)	1.50	1.68	1.80	1.92	1.99
International reserves (US$ million)	80,162	80,885	100,518	111,947	n/a
In months of merchandise imports	5.2	4.0	5.1	5.3	n/a

* estimate **forecast   Source: Economist Intelligence Unit (EIU), International Monetary Fund (IMF)

Political situation: Stable

Head of state: President Abdullah Gül (since August 2007)
Head of government: Prime Minister Recep Tayyip Erdogan (since March 2003)
Nature of regime: Republican parliamentary democracy and secular state. The armed forces still have some political influence.

AKP rules for the 3rd consecutive term

The general elections of June 2011 delivered a clear victory for the religiously conservative Justice and Development Party (AKP) of Prime Minister Recep Tayyip Erdogan, although with a reduced parliamentary majority (327 of the 550 seats). As a result, the AKP can rule with an absolute majority for the third consecutive term. However, it failed to reach a two thirds majority in parliament - the threshold for constitutional amendments. The social democratic Republican People's Party CHP and the pro-Kurdish Peace and Democracy Party gained additional seats but remain in opposition, as does the far-right National Movement party MHP.

In recent years, the AKP government has been successful in gradually curbing the army's political powers and increasing democratic control over the courts. A comprehensive reshuffle of the top military leadership has further strengthened the position of civilian rule: and especially that of Prime Minister Erdogan.

However, what some see as Prime Minister Erdogan pressing his own pro-Islamic ideology has annoyed a growing part of the population, especially in the cities. The protests sparked in Istanbul this summer were a reflection of such opposition and, if they resurface, could finally split AKP between hardliners and more reform-minded politicians.

A shift in foreign policy priorities away from EU membership

Accession talks between Turkey and the EU were put on hold in December 2006, when the EU suspended further negotiations for eight of the 35 chapters until Ankara opens its ports and airports to Greek Cypriot traffic. Talks resumed in early November this year on a new chapter on regional policy but many obstacles remain, including the Kurdish issue, the need for reform and the covert resistance to Turkish entry of some of the EU's major states. Therefore, Turkey's EU entry is unlikely before 2020.

Because of the slow progress, earlier widespread popular support in Turkey for EU accession has faded. While the AKP under Erdogan at first pressed hard for negotiations, it has since then partially shifted its foreign policy and is now focused on relationships with the Middle East and Central Asia: aiming to strengthen political and economical ties and enlarging its influence in those regions.

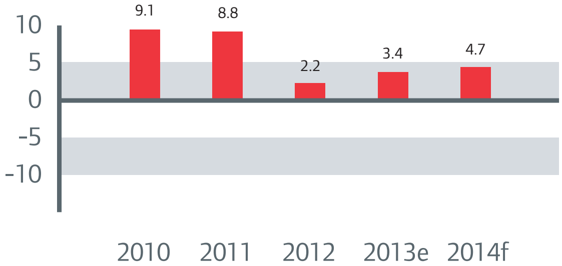
Heightened conflict in the region

Relations with Israel deteriorated rapidly in May 2010, when Israeli soldiers raided a Turkish-led aid flotilla to the Gaza strip. Ankara demanded an official apology and compensation for the families of the victims, but Israel refused. Turkey consequently stopped its long-standing security cooperation with Israel. Mediated by US President Obama, in March Israel's Prime Minister Netanjahu finally apologised to Erdogan, but relations are still strained due to differences over the Palestinian conflict and Egypt, as the Turkish government has repeatedly voiced its support for toppled former President Mursi.

Turkey has taken a clear anti-Assad stance in the Syrian civil war and firmly supports the opposition forces. This is no doubt why the Syrian government has resumed its tacit support of the Kurdistan Workers´ Party (PKK). Compounded by Ankara's tougher stance on the Kurdish question, this has led to renewed violent clashes between the PKK and Turkish forces since July 2012. Turkey's anti-Assad stance has also damaged its relations with neighbouring Iran.

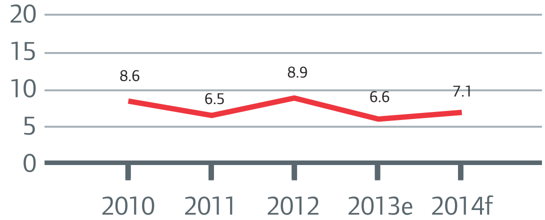
Internal economic situation: more balanced growth

Real GDP growth (%)



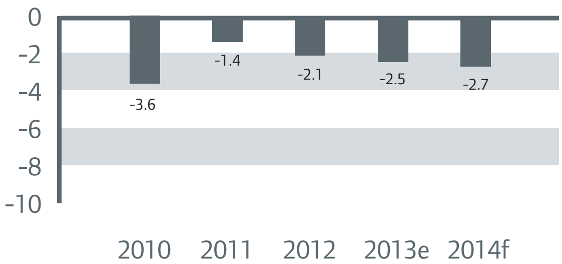
Source: EIU/IMF

Inflation p.a. (%)



Source: EIU/IMF

Fiscal balance (% of GDP)



Source: EIU/IMF

Growth revived in early 2013

In the last decade, Turkey has made impressive economic progress. With political stability since 2002, when the AKP came to power, the country has experienced GDP growth exceeding the European average, while real income per capita has increased substantially. A fast growing population of 75 million and rising prosperity have turned Turkey into one of the most prominent of emerging markets.

After two years of high domestic demand-led GDP growth (9.1 % year-on-year in 2010 and 8.8 % in 2011), the Turkish economy began to lose momentum in 2012, but has nonetheless entered a period of more stable and balanced growth. The economic boom had led to a high current account deficit - nearly 10 % of GDP – while inflation reached 9 % in 2011. Therefore, in 2012 the government acted to cool the economy by urging the Central Bank to tighten monetary policy and advising commercial banks not to grow their loan books by more than 25 %. As a result, domestic demand decreased and, together with lower demand from the Eurozone, this resulted in a reduced growth rate of 2.2 % in 2012.

Led by a modest rebound in domestic demand and exports, GDP grew again in the first half of 2013 (up 3.7 %) and overall this year economic growth of 3.4 % is expected. Industrial production increased 4.2 % in the first half of the year and capacity utilisation increased slightly - to 76.4 % - between January and October, compared to 74.9 % in the same period last year.

High inflation remains an issue

Despite its more balanced economic performance, Turkey suffers from structural economic bottlenecks. It is a net energy/commodity importer and therefore very vulnerable to higher world market prices: a situation exacerbated by the volatility of the Turkish lira. This is contributing to structurally high inflation rates, which reached 9 % in 2012. Although inflation has decreased since then – to 6.6 % for 2013 - it remains well above the regional average.

Moderate budget deficits

Public finances deteriorated sharply in 2009, creating a deficit of 5.5 % of GDP: the result of lower tax income combined with public expenditure aimed at boosting economic activity. Although fiscal consolidation reduced the budget deficit to 1.4 % of GDP in 2011, the trend is now upwards: from 2.1 % of GDP in 2012 to 2.5 % in 2013 and a forecast 2.7 % in 2014. Public sector debt remains moderate at 40 % of GDP.

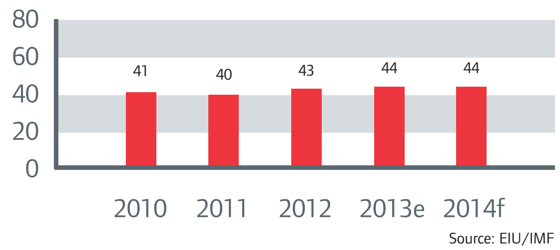
In general, the pace of reform of the labour market, social security and tax administration is still too slow to tackle structural unemployment and widespread 'informal' economic activities. Moves to privatise state banks and the power sector are also proceeding too slowly.

Energy situation

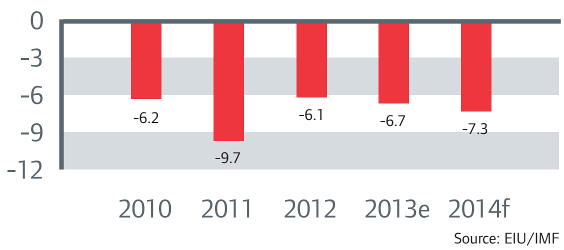
Quite bad, as 95 % of oil has to be imported. Turkey has large lignite reserves. Hydro-electricity has a 28 % share of electricity production.

External economic situation: high external imbalances

Foreign debt/GDP (%)



Current account/GDP (%)



Foreign debt

Level:	Quite high: US$ 360 billion in 2013 (44 % of GDP and 167 % of exports of goods and services)
Structure:	Good, high long-term share
Debt service ratio:	In 2013 quite high at 17 %.

Remarks:
Around two thirds of foreign debt has been incurred by the private sector.

Balance of payments

Trade balance:	Very large deficits
Current account:	Structurally large deficits of more than 6 % of GDP
Capital Account:	Large surpluses
Total Account:	Negative in 2013

International reserves - in months of imports (cif)
Sufficient, ca. US$ 110 billion / more than 5 months of import cover in 2013

Exposing the bottlenecks in the economy

Between 2009 and 2011, imports (including oil) increased much more than exports because of high domestic demand, leading to large trade and current account deficits. Turkey's current account deficit deteriorated substantially in 2011 - to 10 % of GDP - compared to 2 % of GDP in 2009 and 6.4 % in 2010 - compounded by increased import prices resulting from the unfavourable lira exchange rate.

Since the end of 2011, the current account deficit has improved slowly but still remains high, at 6.7 % in 2013. It is expected to increase again in 2014, to 7.3 % of GDP, as the savings ratio remains low.

The Turkish economy remains vulnerable, as substantial capital imports (foreign direct investment and portfolio capital) are needed to cover its high current account deficit. However, as much of that deficit is financed from volatile short-term portfolio investment, any shake-up of financial markets could trigger a massive withdrawal, making the economy even more vulnerable. This was evident earlier this year, when rumours that the US Federal Reserve would end its expansionary monetary policy led to investors withdrawing short-term capital from Turkey and other emerging markets. The result was additional pressure on Turkey's international reserves and exchange rate, with the lira depreciating by around 10 % against the US$.

Despite this, international reserves were not greatly affected, and remain stable at around five months of import cover. But the Central Bank has had to take this market sentiment into account in its monetary policy decisions: to prop-up the exchange rate and stave off any erosion of reserves it had to raise official interest rates more than is justified by the current state of the domestic economy.

Outlook: large finance gaps still to be covered

The AKP retains its firm grip on power

Despite the Taksim Square protest that escalated into national unrest, a fundamental change in the political situation is not expected in the short term. Since the AKP party statutes do not permit a third term, it is likely that Prime Minister Erdogan will instead run for the presidency in 2014. In the next parliamentary elections, scheduled for 2015, the AKP has a good chance of again prevailing as the opposition parties remain weak and divided, and provided that the different factions within the AKP (hardliners and more reform-minded members) stay together.

However, the sign of popular dissatisfaction with the administration's rather autocratic rule has to be addressed more seriously in a society that is heading for diverse democracy and religious tolerance. If realised, Turkey can look forward to an even more promising future and set an example to the region.

Higher growth, but persisting structural problems

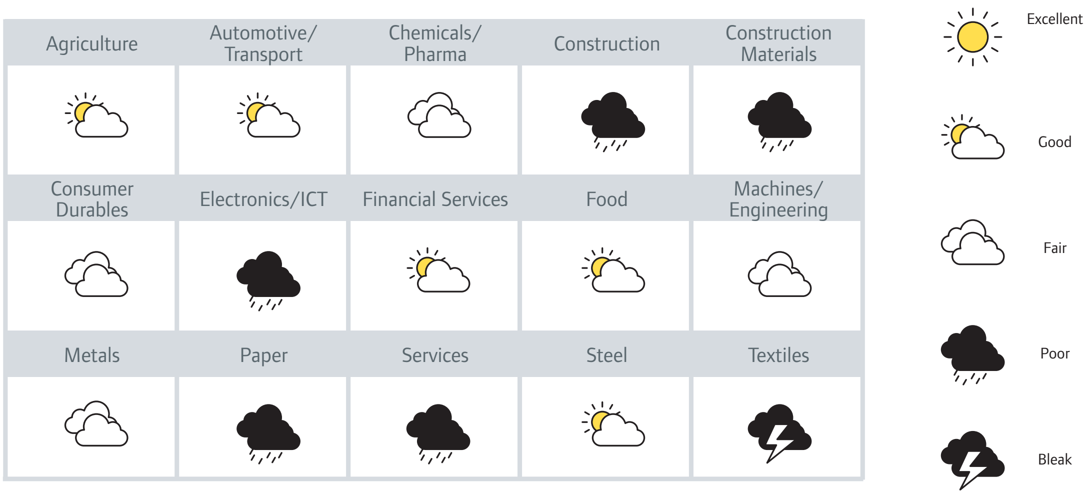
Economic growth is expected to increase to 4.7 % in 2014. Much depends on future developments in the Eurozone, which accounts for nearly 50 % of Turkey's exports and is the main source of capital investment.

Despite this higher growth forecast, Turkey's structural problems will persist: inflation is expected to rise further next year - to 7 % - and the current account deficit will also increase again. As a consequence of this and the high debt service on foreign debt totalling 44 % of GDP, the country remains very reliant on financial markets to cover its large finance gaps – and is therefore vulnerable to adverse market sentiment. As mentioned, much of the required capital investment is short-term and therefore volatile, which could also lead to more fluctuations in the lira exchange rate.

However, if capital inflow continues and there is no major shake-up in financial markets, we expect Turkey's international liquidity and solvency to remain reasonably good: guaranteeing a solid payments position.

Turkey industries performance outlook

December 2013



Better payment behaviour: fewer 'bounced' cheques

The banking sector is still robust, with a high capital adequacy ratio of about 16 %, healthy profitability and a transparent loan portfolio.

In line with the positive development of the economy, non-performing loans remained stable at 2.8 % in August 2013. 'Bounced' cheques, usually an excellent indicator of payment behaviour because of the common use of cheques in Turkey, decreased by 9.4 % in the first ten months of 2013 after a sharp increase in 2012.

Sector performance: textiles and plastics continue to suffer

Automotive: Turkey's second largest export sector and an important customer of several other industries. Production in both the vehicle and spare parts segments has increased significantly since 2010, due mainly to foreign demand.

Steel/metals: Increased demand from the automotive, machinery and construction industries, together with the overall economic growth, has helped the sector.

Textiles: Still particularly vulnerable, due to a combination of excess capacity, lack of branded production, low capitalisation, decreasing domestic and export demand, competition from the Far East, and a non-performing bank loans ratio of around 10 %.

Chemicals/pharmaceuticals: While pharmaceuticals production and distribution remain stable and strong subsectors, the plastics subsector faces similar structural problems to the textile sector.

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