Atradius Country Report

Turkey – October 2012

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$ 10,520 in 2012)

Most important sectors (2011, % of GDP)

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

Main import sources (2011, % of total)

Russia:	9.9 %
Germany:	9.5 %
China:	9.0 %
USA:	6.7 %
Italy:	5.6 %

Main export markets (2011, % of total)

Germany:	10.3 %
UK:	6.0 %
Italy:	5.8 %
France:	5.3 %
Russia:	4.4 %

Main expenses of foreign exchange

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

Main sources of foreign exchange

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

Key indicators

	2009	2010	2011	2012*	2013*
GDP (US$ million)	614,554	731,168	773,070	783,757	919,326
Real GDP growth (%)	-4.8	9.1	8.5	3.5	4.0
GDP per capita (US$)	8,553	10,050	10,498	10,520	12,177
Inflation p.a. (%)	6.3	8.6	6.5	9.3	7.6
Fiscal balance (% of GDP)	-5.5	-3.6	-1.4	-1.9	-1.8
Total foreign debt (US$ million)	271,225	293,872	306,600	318,800	326,300
Foreign debt/GDP (%)	44	40	40	41	35
Foreign debt/XGS (%)	182	183	164	162	159
Short-term debt/inter. reserves (%)	71	97	n/a	n/a	n/a
Debt service ratio (%)	42	37	23	18	16
Current account balance (US$ m.)	-13,370	-46,643	-77,238	-64,200	-66,100
Current account/GDP (%)	-2.2	-6.4	-10.0	-8.2	-7.2
Nom. exchange rate to US$ (average)	1.55	1.50	1.68	1.81	1.78
International reserves (US$ million)	69,914	80,162	80,885	85,755	n/a
In months of merchandise imports	6.0	5.2	4.4	4.1	n/a

*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 large 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 smaller parliamentary majority (327 of the 550 seats). As a result, the AKP can rule with an absolute majority for the third consecutive term. However, the AKP has failed to reach a two thirds majority in parliament - the threshold for constitutional amendments. The nationalist 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.

A shift in foreign policy priorities away from EU membership

Accession talks between Turkey and the EU have been effectively on hold since 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. Other major obstacles to EU entry are the Kurdish issue, the need for reform and the covert resistance of some of the EU's major states to Turkish entry.

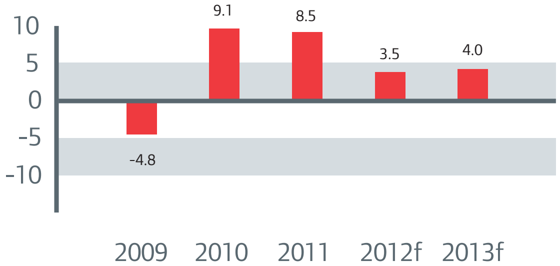
Because of this slow progress, the formerly widespread popular support for EU accession has declined considerably. While the AKP under Erdogan at first pressed hard to begin negotiations, it has since then partially shifted its foreign policy, and now focuses more on relationships with the Middle East and Central Asia: aiming to strengthen political and economical ties with the countries in those regions.

Heightened conflict in the region

Relations with Israel have deteriorated rapidly since 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.
Meanwhile 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). Together with 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.

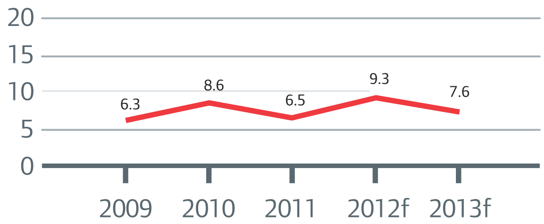
Internal economic situation: A more balanced growth

Real GDP growth (%)



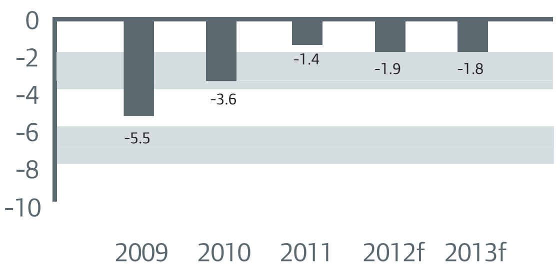
Source: EIU/IMF

Inflation p.a. (%)



Source: EIU/IMF

Fiscal balance (% of GDP)



Source: EIU/IMF

Growth has weakened in H1 of 2012

After two years of high domestic demand-led GDP growth (9.1 % year-on-year in 2010 and 8.5 % in 2011), the Turkish economy has recently begun to lose momentum: growing just 3.3% in Q1 of 2012 and 2.9 % in Q2. Manufacturing and construction output growth has fallen markedly, with sales to the Eurozone declining and domestic demand becoming less buoyant than in 2011. Industrial production growth slowed to 4 % year-on-year in the first half of 2012. However, capacity utilisation remained fairly stable at 74.2 % between January and August, compared to 74.9 % in the same period last year.

The slowdown in domestic demand also owes much to government and Central Bank initiatives to prevent the economy from overheating. After a period of monetary easing to discourage the strong capital inflow in lira-dominated assets, since October 2011 the Central Bank has tightened its policy (e.g. by increasing the overnight lending rate) to cool down the economy. Moreover, banks have been asked not to grow their loan books by more than 25 % this year: a target that is likely to be achieved.

High inflation remains an issue

After falling to 6.5 % in 2011, inflation increased to 10.4 % in Q1 of 2012. While consumer price increases have tailed off a little in recent months, they remain structurally above the regional average. Turkey is a net energy/commodity importer and very vulnerable to higher world market prices, and this is exacerbated by the volatility of the Turkish lira. In August 2012 inflation was still high at 8.9 % after 9.1 % in July.

Moderate budget deficits

Public finances deteriorated sharply in 2009 with a deficit of 5.5 % of GDP: the result of a combination of lower tax income and subsidies and public expenditure aimed at boosting economic activity. While fiscal consolidation reduced the budget deficit to 1.4 % of GDP in 2011, it is expected to increase slightly: to 1.9 % in 2012 and 1.8 % in 2013.

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

Fewer non-performing loans, but a steep increase of 'bounced' cheques

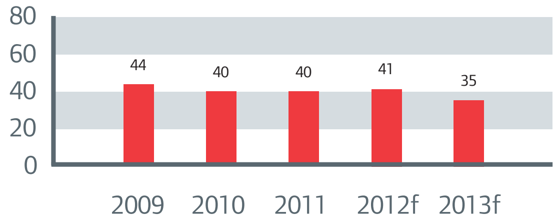
The banking sector is still strong, with a high capital adequacy ratio of over 16 %, robust profitability and a transparent loan portfolio that does not involve mortgage products. In line with the continued economic growth non-performing loans decreased to 2.7 % in July 2012 from 2.9 % in July 2011. 'Bounced' cheques, usually an excellent indicator of payment behaviour because of the common use of cheques in Turkey, increased by 56 % in the first eight months of the year. This sharp increase is mainly explained by the fact that the regulations for cheques have been amended at the beginning of 2012, i.e. the penalties for bounced cheques having been lowered. However, the slower economic growth this year also had an impact.

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.

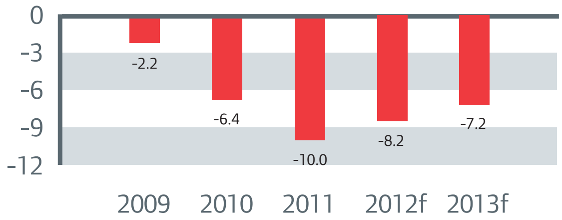
External economic situation: Lower external imbalances

Foreign debt/GDP (%)



Source: EIU/IMF

Current account/GDP (%)



Source: EIU/IMF

Foreign debt

Level:	Quite high: US$ 318 billion in 2012 (41 % of GDP and 162 % of exports of goods and services)
Structure:	Good, high long-term share
Debt service ratio:	In 2012 quite high at around 20 %

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

Balance of payments

Trade balance:	Very large deficits
Current account:	Still large deficits, but slowly decreasing: to around 7 % of GDP in 2011
Capital account:	Large surpluses
Total account:	Positive

Remarks:
Between 2009 and 2011, imports (including oil) increased much more than exports, because of strong domestic demand, and this has led 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 the weaker lira exchange rate that increased import prices. However, since the end of 2011 the current account deficit has improved slowly (US$ 31 billion in the first half of 2012 compared to US$ 44.7 billion in the same period of 2011) as import growth declines.

International reserves - in months of imports (cif)

Sufficient, ca. US$ 85 billion / more than 4 months of import cover in 2012

Outlook: Improving, but with large finance gaps still to be covered

The AKP retains it firm grip on power

Since the constitution does 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.

Turkey's entry to the EU is unlikely before 2020 at the earliest. While progress on the Cyprus issue is possible in the medium term, many other hurdles remain: such as human rights, freedom of religion, and the Kurdish question. What's more, EU members remain divided over Turkey's membership, and in Turkey itself doubts about the benefits of EU entry (particularly the costs) are rising, while its foreign policy has shifted focus away from the EU and towards the Middle East and Asia.

Lower growth is helping to mitigate structural problems…

Economic growth is expected to slow to 3.5 % this year, followed by a slight increase to 4 % in 2013. Inflation is forecast to decrease to 7.6 % in 2013 - still structurally high. Much depends on future developments in the Eurozone, which accounts for nearly 50 % of Turkey's exports and is the main source of capital investments.

The cooling economy is helping to mitigate the effects of Turkey's structural problems, i.e. persistent high inflation rates and current account deficits, the latter expected to decrease to 7 % of GDP in 2013 after peaking 10 % of GDP in 2011. The current account reacts quite swiftly to changes in the domestic business climate: this year's economic slowdown has already contributed to an improvement in the trade deficit, with growth in exports exceeding that of imports.

This is a positive development, given Turkey's weak external financial position in the last couple of years. Capital imports (foreign direct investment and portfolio capital) have had to be substantial to cover Turkey's high current account deficit. However, as much of that deficit is financed from volatile short-term portfolio investment, any shake-up of financial markets may trigger a massive withdrawal, making the economy more vulnerable.

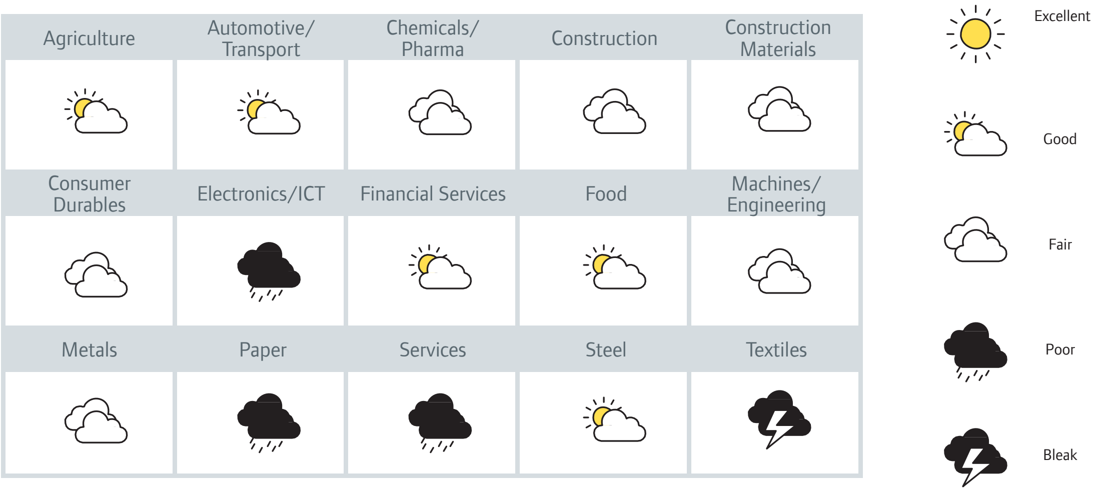
Fortunately, so far there has been a healthy inflow of capital – although sometimes too much, with short-term capital flooding the Turkish capital markets and its banking sector. This has regularly created a dilemma for the Central Bank: while in times of economic overheating its normal practice would be to raise the official interest rate, it has to lower the rate to control capital inflow.

..but potential risks persist

Turkey's international solvency and liquidity position will remain reasonably good. Because of its high debt service, Turkey will continue to have considerable borrowing requirements on the financial markets and, while covering the finance gaps is not a problem at the moment, they remain a potential risk. As said above, much of the required capital investment is short-term and therefore volatile, which can also lead to more fluctuations in the lira exchange-rate.

Turkey industries’ performance forecast

October 2012



Sector performance: general upswing, but textiles and plastics are still suffering

Automotive is 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 are 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.

managing risk, enabling trade

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