22/11/2018

5/7 COUTRY RISK CATEGORY

COUNTRY RISK ANALYSIS

Turkey

0 1 2 3 4 5 6 7

The country risk categories are arranged on a scale from 0 to 7. The lower the figure, the better the coutry's creditworthiness.

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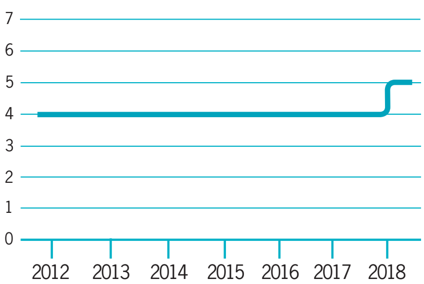
BASIC FACTS

Population	81 million (2017)
Nominal GDP	USD 852 billion (2017)
GDP/capita	USD 10,537 (2017)

COUNTRY CLASSIFICATION HISTORY



Source: EKN

Currency fall stopped

Turkey's constitutional transition to presidential rule has strengthened President Erdoğan's political power. Relations with the EU and the USA will remain strained, even though Turkey's strategic importance contributes to relations and cooperation with the West continuing to function. Fiscal stimulus in 2017 created an overheated economy with increased external imbalances as a result. When a diplomatic dispute between Turkey and the United States developed in the summer of 2018, this caused market turmoil and the currency fell dramatically. The government's and the central bank's response to the financial turbulence, coupled with reduced tension with the United States, has helped stabilise the currency temporarily. The financing of Turkey's current account deficit and private sector external debt remains the main economic vulnerability. The currency fall will lead to a reduced current account deficit, but will at the same time create a sharp slowdown in the economy. A reduced current account deficit and a tighter monetary policy suggest that Turkey will be able to avoid serious balance of payments problems.

EKN has a high guarantee exposure and business flow in Turkey. Experience s mixed, with long payment delays at times even if indemnifications have remained small.

THE COUTRY'S STRENGHTS AND WEAKNESSES

STRENGTHS

+ Middle-income country with a large and diversified economy.
+ Stable public finances with sustainable debt and budgetary control.
+ Banking system with buffers that can withstand a temporary economic downturn.

WEAKNESSES

- Domestic political instability and regional instability.
- Currency depreciation increases the risk of substantial external financing needs.
- The corporate sector is sensitive to weak growth, rising interest rates and currency depreciation.

SWEDISH EXPORT TO TURKEY, MSEK

	MSEK
2018 jan-jun	7 231
2017	14 051
2016	11 821
2015	13 164
2014	13 095

Source: National Board of Trade

EKN:S EXPOSURE

	MSEK
Garantees	5,327
Offers	1,540

EKN:S POLICY

EKN places Turkey in country risk category 5 (of 7) since 2018. This assessment is carried out in collaboration with the OECD. Turkey was downgraded to country risk category 5 from 4 June 2018 due to the turbulent political developments and increasing macroeconomic imbalances. Budgetary discipline and relatively strong public finances justify normal risk assessment for public counterparties. There are no restrictions for transactions where banks are the counterparties. The banking system is stable with profitable, well-capitalised banks. In the case of transactions with corporates as counterparties, attention is paid to the debtor's currency exposure.

EKN:S EXPOSURE AND EXPERIENCE

During the 2013-2017 period, EKN issued guarantees for 118 transactions with a total value of SEK 9.4 billion for Swedish companies exporting to Turkey. This commitment is dominated by the telecom sector, but sectors such as infrastructure, transport, construction and the power industry are also sizeable. Payment experience has been mixed. Payment delays have been high at times, but indemnifications have as a rule been limited. The majority of the problem transactions have been in sectors sensitive to economic fluctuations such as the mining and construction sectors. The recovery proceedings in these transactions have been slow.

WHAT MIGHT CAUSE A CHANGE IN THE COUTRY POLICY

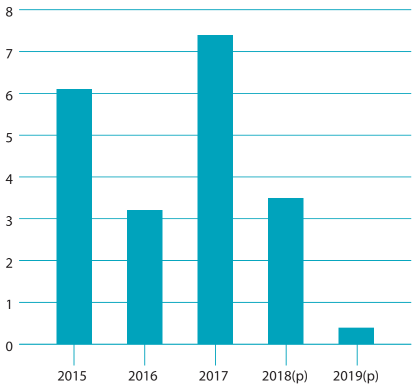
LESS RESTRICTIVE

- Increased exports and foreign investment that improve the balance of payments.
- Revived EU reforms that improve the business environment in the long term.

MORE RESTRICTIVE

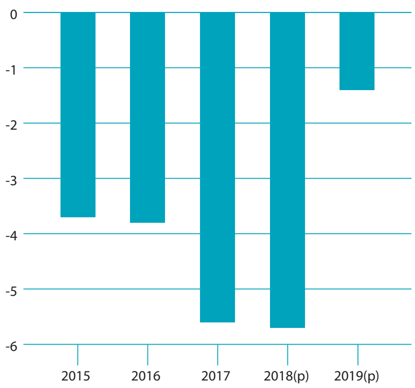
- Domestic political turbulence and more interventions against the opposition.
- Reduced capital inflow that creates problems with the balance of payments.

GDP-GROWTH (% PER ANNUM)



Source: IMF WEO 2018

CURRENT ACCOUNT (% OF GDP)



Source: IMF WEO 2018

COUNTRY ANALYSIS

BACKGROUND

Since the attempted coup in 2016, the political landscape in Turkey has been polarised. The government has carried out mass arrests of military personnel, dissidents and civil servants. Relations with the West, which criticised Turkey's hard-line response to the attempted coup, have deteriorated, increasing Turkey's isolation. With his victory in the presidential election in June 2018, President Erdoğan has tightened his hold over Turkish politics. The presidential election was the first under the new constitution and Turkey has completed its transition to presidential rule. Erdoğan now holds the role of both head of government and head of state.

The Turkish economy is large and diversified with a well-developed private sector and relatively high level of income. Public finances are strong with a low government debt of slightly less than 30 per cent of GDP. Economic growth was seven per cent in 2017. Growth was driven by fiscal stimulus, state-subsidised loans to the private sector and some recovery in tourism. The increasingly weak lira, rising oil prices and strong domestic consumption also contribute to rising inflation. The economy showed clear signs of overheating.

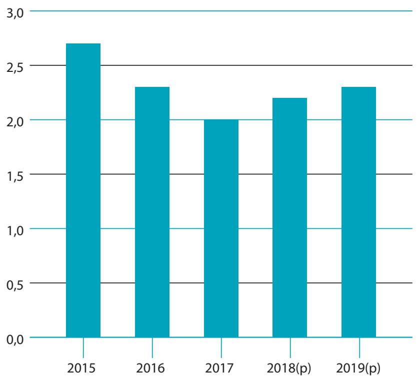
The strong growth contributed to a growing current account deficit in 2017. A weak currency and increased tourism could not compensate for the more expensive energy imports. The current account deficit and dependence on foreign financing have long been a risk factor for the Turkish economy. The external debt has risen to over 50 per cent of GDP. The country's limited exports and unbalanced growth, driven by domestic consumption, have contributed to these developments. Foreign direct investment as a share of GDP has been relatively low. The reason is political uncertainty, but also a fickle business environment where some sectors and investors have been discriminated against.

RECENT DEVELOPMENTS

In August 2018, a dispute arose between Turkey and the United States concerning the imprisoned pastor Andrew Brunson. Turkey accused the pastor of having links with the Gülen movement and being involved in the attempted coup of 2016, which the United States dismissed. The United States imposed sanctions against Turkish ministers and increased import duties on Turkish steel and aluminium. The dispute caused concern in the foreign exchange market and the Turkish lira weakened dramatically over a few weeks. The uncertainty concerning the economic policy's credibility and the independence of the central bank contributed to the market turbulence.

The government's and the central bank's response to the monetary crisis was a relatively forceful one. A tighter monetary and fiscal policy is necessary to stabilise the currency and bring down inflation, which has risen to over 20 per cent due to the currency fall. The central bank raised the key interest rate by 6.25 percentage points to 24 per cent in

EXTERNAL DEBT (% of GDP)



Source: IMF Article IV 2018

September, stabilising the lira. Following pastor Brunson's release in October 2018, the lira has to some degree recovered.

The new fiscal programme is more realistic than in the past and in the short term implies austerity. To achieve the 2019 budgetary target, public investment projects will be postponed. At the same time, the government has announced some tax cuts to alleviate the coming economic downturn. The government wants to both demonstrate its ability to act after the currency fall and, as before, to support growth in all situations. The contradictory behaviour raises doubts about the objective of the economic policy and risks leading to new crises of confidence and hampering efforts to bring inflation down.

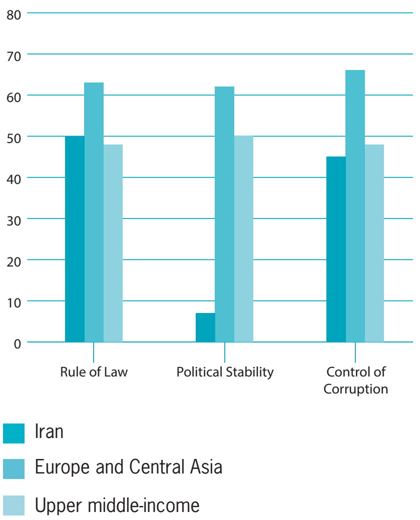
LONG-TERM TREND

The introduction of presidential rule limits Parliament's and the judiciary's control of the government and the president. President Erdoğan is expected to continue his offensive against the Gülen movement and Kurdish nationalists, both inside and outside the country. Relations with the US will remain strained, with unsolved issues such as Turkey's purchases of Russian defence equipment and the countries' positions on the war in Syria and sanctions against Iran. Turkey's strategic importance for the US on a number of issues, including membership of NATO and geopolitical influence in the Middle East, will nonetheless contribute to relations with the US continuing to function. There are particular interests between Turkey and the EU in several key areas, not least economic relations and the refugee agreement, which will ensure that cooperation continues.

The lira's fall will lead to lower growth and a reduced current account deficit. Growth is expected to slow significantly from 2018 due to lower lending to businesses and consumers, reduced imports and tighter fiscal and monetary policies. Growth, which has exceeded five per cent per annum over the last three years, is expected to fall to around zero for 2019, and then recover to around two per cent the following year. In the short term, Turkey's economy will benefit from more modest growth, as this will lead to a reduced current account deficit and a more stable currency. The inflation rate will nonetheless remain above ten per cent over the next few years despite the tighter monetary policy. A weakened currency and Turkey's dependence on imports of energy and food make it difficult to bring inflation down.

The expected global monetary tightening policies, together with Turkey's political and economic uncertainties, risks the financing of the country's current account deficit and private external debt. Banks and businesses will need to amortise parts of their hard currency loans and foreign currency reserves are therefore expected to decrease. On the positive side, the current account deficit will come down as domestic demand declines, while exports and tourism continue to be strong. The central bank is likely to raise the interest rate further to strengthen the lira, which will benefit the inflow of capital. A reduced current account deficit and a tighter monetary policy suggest that Turkey is able to avoid serious balance of payments problems. Introduction of capital controls or a request for an IMF programme is unlikely.

BUSINESS ENVIRONMENT



Ranking from 0 (worst) to 100 (best)

Source: The World Bank

BUSINESS ENVIRONMENT

Reforms and foreign investment following the Turkish banking crisis in the early 2000s have created a banking sector on a fairly stable foundation. Bank supervision follows international standards, banks must hedge their borrowing in hard currency, and have to satisfy capital adequacy requirements far above international requirements. The banking sector is now facing its most difficult test since the banking crisis. The weakening of the lira, higher interest rates and lower growth lead to risks to the banks' profitability, capitalisation and liquidity. The earlier high credit growth has already ended. The risk of banks failing or forcing the state into bailouts is limited, but the central bank may need to provide liquidity.

The banking sector's main weakness is its large external debt and dependency on foreign financing. Lending in foreign currency to Turkish businesses accounts for one third of the banks' total lending. The lack of medium-term financing in local currency has attracted many businesses to borrow in US dollars or euros at lower interest rates. It will be a challenge for businesses with debts in hard currency and earnings in local currency to pay their debts when the lira decreases in value. The market conditions for businesses have also deteriorated due to higher inflation and interest rates and subdued growth. The weakening of the lira and lower growth will lead to higher credit losses for the banks and risks putting their capitalisation and profitability under pressure.

The World Bank ranks Turkey's business climate in place 43 of 190 countries, on a par with the Balkans and Eastern Europe, but better than its neighbours in the Middle East. Turkey's ranking is an improvement from last year. Strengths include access to credit information, low trade barriers and the possibility to enforce contracts. Political interventions nonetheless affect individual sectors and businesses. Frequent changes in taxation affect businesses that sell to consumers. Legislation on public procurement, regional development aid and employment is under constant review. The powers and independence of supervisory authorities are often unclear. EU reforms in the judiciary started in the 2000s and have come a long way. New courts for commercial disputes have been set up, but problems in the form of time-consuming litigation persist. After the attempted coup of 2016, businesses with links to the Gülen movement, considered by Turkey to be a terrorist organisation, have been closed down.