03/12/2020

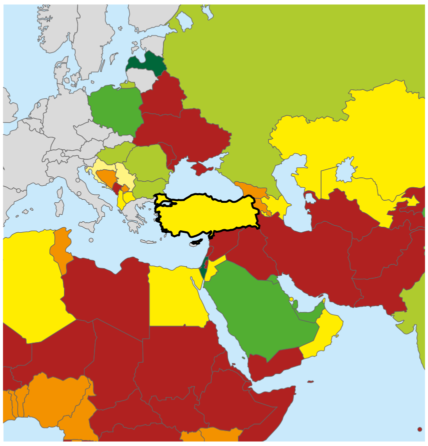
5/7 COUNTRY RISK CATEGORY

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 country's creditworthiness.



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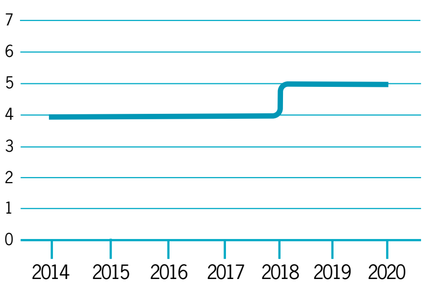
BASIC FACTS

Population:	83 million (2019)
GDP, nominal:	USD 761 billion (2019)
GDP/capita:	USD 9,151 (2019)

Source: IMF WEO

COUNTRY CLASSIFICATION HISTORY



Source: EKN

Pandemic hits already fragile economy

The Turkish economy is large and well diversified, but the dependence on foreign funding poses a significant risk. Turkey's vulnerable economic situation has worsened during the pandemic. Rapid weakening of the currency, large capital outflows and a fall in international reserves have once again put the focus on Turkey's balance of payments. Political risks are also high. Deteriorating relations with the USA and the EU, as well as tensions in the eastern Mediterranean, could exacerbate the economic problems.

Only through long-term reforms can the vulnerability be reduced. In terms of government finances, there is room for such reforms, but the government's willingness to reform appears to be limited. Instead, economic policy focuses on solving the most acute problems and quickly returning to the usual economic model of credit and consumption-led growth. The Turkish government and the economy are used to crises, but the risk of balance of payments problems has increased.

EKN has large exposure and business flow in Turkey. The payment experience is good. Payment delays occur, but indemnifications have remained small.

THE COUNTRY'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

- Regional instability and tense international relations.
- Weakening of the currency and reduced international reserves increase the risk because of large external financing needs.
- Expansionary economic policy that creates economic imbalances.

SWEDISH GOODS EXPORTS TO TURKEY, MSEK

	MSEK
2019	13 142
2018	14 269
2017	14 051
2016	11 821
2015	13 164

Source: Kommerskollegium

EKN:S EXPOSURE

	MSEK
Guarantees	SEK 4,517 million
Offers	SEK 958 million

EKN:S POLICY

Since 2018, EKN has classified Turkey in country risk category 5 (of 7). This assessment is carried out in collaboration with the OECD. Turkey was downgraded to country risk category 5 from 4 in 2018 due to increased economic imbalances. Budgetary discipline and relatively strong government finances justify normal risk assessment for public counterparties. No restrictions exist for transactions where banks are the counterparties. In the case of transactions with corporates as counterparties, particular attention is paid to the debtor's currency exposure.

EKN:S EXPOSURE AND EXPERIENCE

During the period 2015 to 2019, EKN issued guarantees for 214 transactions with a total value of SEK 11.8 billion for Swedish companies exporting to Turkey. This commitment is dominated by the telecom sector, but sectors such as metals, infrastructure, transport, construction and the power industry are also sizeable. Demand for EKN's guarantees has increased since 2018 due to the deteriorating risk situation and the increased need for Swedish banks to share letters of credit risk.

Payment delays have been large at times but indemnifications have remained small. Only a couple of small transactions have been indemnified since 2018. The majority of the problem transactions have been in sectors sensitive to economic fluctuations such as the mining and construction sectors. The recovery proceedings have been slow.

WHAT MIGHT CAUSE A CHANGE IN THE COUTRY POLICY

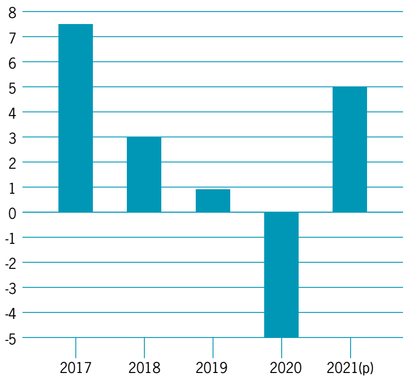
THE EASING OF RESTRICTIONS, IN THE EVENT OF:

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

THE TIGHTENING OF RESTRICTIONS, IN THE EVENT OF:

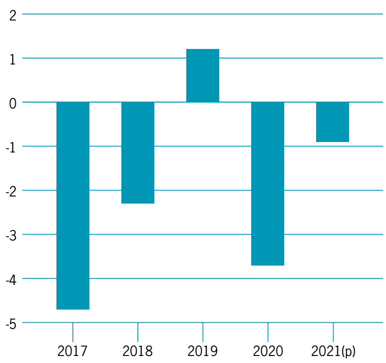
- International conflicts that lead to new capital outflows and a falling exchange rate.
- Continued decline in international reserves that creates balance of payments problems.

GDP-GROWTH (% PER ANNUM)



Source: IMF WEO october 2020

CURRENT ACCOUNT (% OF GDP)



Source: IMF WEO october 2020

COUNTRY ANALYSIS

BACKGROUND

Fiscal policy stimuli and strong credit growth led to an overheated economy in 2017 and the first half of 2018. When Turkey became involved in a diplomatic dispute with the USA later in 2018, this caused great market turmoil and the currency fell sharply. The economy entered a short-term recession in 2018. Growth returned in 2019 thanks to fiscal policy stimuli and credit growth. A lessening of tension with the USA also helped to stabilise the economy. Nevertheless, the structural problems remained unresolved. Inflation remained high. The current account was positive in 2019 for the first time in a long time, but only due to weakening of the currency and weak domestic demand.

Public finances are sound and have remained a stabilising factor for the economy as a whole. Government debt is low at around 40 per cent of GDP, despite budgetary targets being exceeded in recent years. Turkey has had many elections in recent years (local, parliamentary, presidential and a referendum on a new constitution), which has meant more political initiatives and a more expansionary financial policy.

Turkey's accession process to the EU is at a standstill. Erdoğan's increased power as president, the pressure on the media and journalists, the disputed regional elections in 2019 and Turkey's gas exploration off Cyprus are contributing causes. Turkey's willingness to move closer to the EU has also diminished. The plan to review the EU-Turkey customs union, which currently covers only industrial goods and processed goods, has been halted. Relations with the USA and NATO are strained and Turkey is threatened with American sanctions following the purchase of a Russian missile defence system.

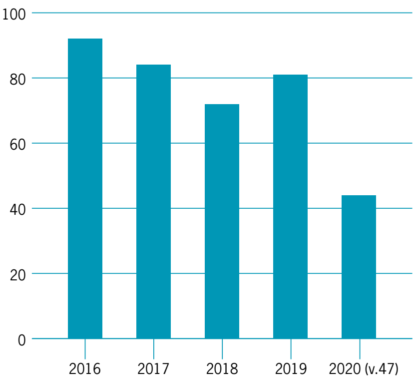
RECENT DEVELOPMENTS

Turkey entered a recession in 2020. Closing down parts of the economy to reduce the spread of Covid-19 is expected to reduce GDP by five per cent in 2020. President Erdoğan has opposed a larger and longer closing down of society for economic reasons. The spread of infection subsided after May, after which restrictions were gradually eased. Since August, the spread of infection has increased again and restrictions have been reinstated, including restrictions on restaurants and shops.

Turkey is vulnerable to the effects of the pandemic. The current account deficit and external debt create a large dependence on foreign financing. The Turkish lira has weakened sharply against the US dollar in 2020. The private sector is particularly exposed to a weaker lira because companies owns a large part of the external debt. International reserves have fallen by over 40 per cent since the beginning of the year, to the lowest level since 2005, in the central bank's attempt to defend the value of the currency. The tourism sector, which accounts for just over ten per cent of GDP and is an important foreign exchange earner, has collapsed. Liquidity risk is partly limited by Turkey's gold reserves, which are almost as large as the international reserves.

Most emerging economies have improved their current account balance during the pandemic because of reduced imports. The exception is Turkey,

INTERNATIONAL RESERVE (MRD USD)



Source: Turkish Central Bank

where the government's credit stimuli have kept up imports. The current account deficit has grown sharply so far in 2020, compared with a surplus in the same period in 2019.

Reduced international reserves, a growing current account deficit and a large external debt pose major risks. Only through long-term structural reforms can the vulnerability be reduced. Turkey needs to move up the economic value chain. High-tech products account for only 3 per cent of exports of manufactured goods. In terms of financial policy, there is room for such initiatives, but the government's willingness to reform appears to be limited. Instead, the fear is that the government's economic policy is creating a new overheating by pushing banks to increase their lending. The government is stimulating lending to kick-start the economy and the central bank provides incentives to banks that meet lending targets. Economic policy focuses on a rapid return to the usual model of credit and consumption-led growth.

LONG-TERM TREND

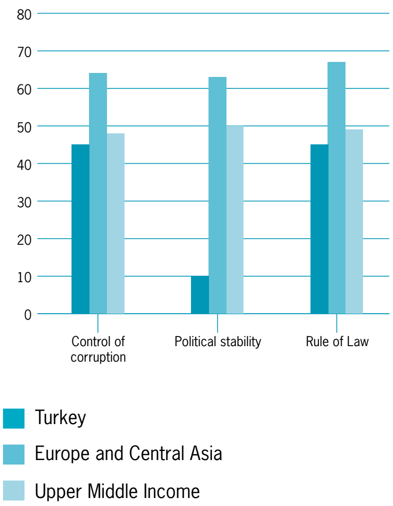
Erdoğan's and the government's target is a rapid recovery with 0.3 per cent growth as early as 2020. An annual growth rate of around five per cent is then forecasted. The government's forecast is far more optimistic than that of other analysts. In order to achieve these objectives, economic policy is expected to continue to consist of an expansionary monetary policy, cheap loans and government consumption. Such a development risks recreating a large current account deficit, high inflation and falling currency. With each crisis, the level of indebtedness in the corporate sector becomes higher. Sooner or later, the debt burden risks becoming unsustainable. The bill will end up with the banks and ultimately with the government, the two remaining strengths in the economy.

The appointment of a new finance minister and governor of the central bank in November 2020 ensures a more restrained economic policy in the short term. Given Erdoğan's opposition to high interest rates, and the need for growth-building measures during the pandemic, there are major questions about the sustainability of such a policy shift.

Periods of high growth in Turkey have always brought external imbalances in the form of a large current account deficit. The country's future growth depends on a large inflow of capital that can finance the deficits. In recent years, the inflow of capital has mainly consisted of volatile portfolio investments, instead of more stable foreign direct investment. Turkey is unlikely to have the funding to deal with large current account deficits, which means that long-term growth will remain at a modest level. The IMF forecasts annual growth in the medium term of around 3.5 per cent.

Politically, Turkey is facing increased international isolation on several fronts. The country is involved in risky and costly military operations in Syria and Iraq, which have led to conflicts with previously friendly countries in the Middle East. At the same time, the hunt for gas deposits in the Mediterranean has created tensions with Greece and France. There is increasing hostility towards Erdoğan among politicians in the EU and the USA. These tensions risk exacerbating economic problems in the form of sudden news capital outflows and a falling exchange rate.

BUSINESS ENVIRONMENT



Ranking from 0 (worst) to 100 (best)

Source: The World Bank

BUSINESS ENVIRONMENT

The World Bank ranks Turkey's business climate in 33rd place out of 190 countries, on a par with the Balkans and Eastern Europe, but better than its neighbours in the Middle East. Turkey's ranking has improved since last year. Strengths include access to credit information, low trade barriers and the possibility to enforce contracts. EU reforms in the judiciary began in the early 2000s and have come a a long way. New courts for commercial disputes have been set up, but problems in the form of time-consuming litigation persist.

Political interventions affect individual sectors and businesses. According to several analysts, the economy is now less rule-driven than before. Political contacts are said to be important in large projects and public-private partnerships. 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.

The lockdown during the pandemic is worsening conditions for Turkish companies. Government budget support amounting to almost three per cent of GDP is intended to help companies through the crisis. The support includes subsidised loans, deferment of loan payments, wage subsidies and exemptions from certain taxes and charges. Total public crisis aid is reported to represent almost 13 per cent of GDP, half of which is loan guarantees to companies and households. These measures will to some extent mitigate the effects and help businesses to survive the crisis.

The banking sector is relatively strong and ensures that capital flows into Turkey. However, the capital inflow to the banks is short-term. Long-term capital has mainly gone to the corporate sector and project financing. Bank supervision follows international standards and is based on the reforms implemented under the IMF programme in the early 2000s. Banks must hedge their borrowing in hard currency, and have to meet capital adequacy requirements above international requirements. Lending in foreign currency is not allowed to households, and is limited to companies and project financing.

The proportion of non-performing loans in the banks' lending has risen from three per cent in 2017 to almost five per cent at the end of 2019. This proportion is expected to rise further in the wake of the pandemic. The problem loans that are emerging now are mainly loans to the construction, manufacturing and power sectors and derive from the strong lending during 2017. At the request of the banking supervisory authority, the government has capitalized state banks. Private banks were asked to do the same, but have increased funding more through loans.

The main systemic risks are the banks' dependence on external financing, a low level of saving in the economy and the exposure of some banks to individual borrowers and projects. The banks' risk management is considered to be good overall, even if the complexity varies. Foreign-owned banks are generally better in this regard.