COUNTRY RISK CATEGORY

5

OF 7

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Turkey

COUNTRY ANALYST

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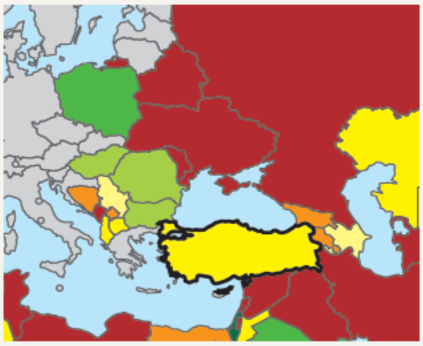
Basic facts (2023)

Population: 85 million

GDP, nominal: USD 906 billion

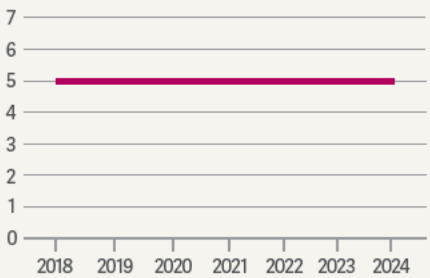
GDP/capita: USD 10 622



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

Country classification history



Source: EKN

Strengths

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

Weaknesses

– Unpredictable macroeconomic environment
– Significant external accounts imbalances
– Increasing political tensions

The economic experiment is over

Under President Erdoğan's rule, the Turkish economy has grown by an average of 5.5 per cent per year over the past 20 years. However, the ambition to achieve growth at all costs has led to a series of economic crises in recent years, with growth being achieved mainly through private credit growth rather than productivity growth or improved competitiveness. Inflation has averaged 55 per cent annualised since 2021, and Erdoğan's tightening grip on the state apparatus – the country now has its fifth central bank governor since 2019 – has been partly responsible for scaring foreign capital away from Turkey.

Following the presidential election earlier this year, in which Mr Erdoğan secured the mandate to rule the country for another five years, there has been a 180-degree shift in combined monetary and fiscal policy Previously, low interest rates were a cornerstone of economic policy, which aimed to stimulate credit-driven growth while to limit the lira's rate of depreciation the government spent tens of billions of dollars in indirect currency interventions. Strong domestic demand stimulated by the availability of credit, combined with an overvalued exchange rate, has contributed to significant current account deficits (-3.2% on average over the past decade), which have been largely financed by short-term loans in foreign currency. At the time of the May 2023 presidential elections, the country's foreign exchange reserves were at their lowest level since 2002 in gross terms and negative in net terms. Since then, the country has abandoned this unconventional monetary policy. A new economic team has been designated, including a new finance minister and central bank governor. Since May, to combat the current high-inflation environment the policy rates have been raised at a rapid pace. Existing fiscal measures aimed at limiting the pace of the lira depreciation have been phased out, contributing to a 55% depreciation of the lira so far this year.

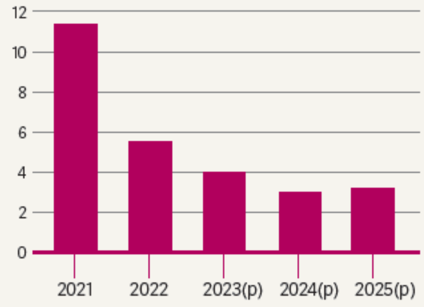
Turkey has the 17th largest economy in the world in terms of GDP and is considered to be an open and diversified economy (exports amount to over 40% of GDP). The demographics are favourable, with a median age of 33 years (compared with 44 years in the EU) and an annual population growth of 1.3 per cent (compared with 0.1% in the EU). The private sector is sophisticated, export-oriented and resilient, and benefits from Turkey's customs union with the EU, which absorbs more than 40 per cent of goods exports and a quarter of services exports. The country's government debt amounts to 34% of GDP, a low level in comparison with other emerging economies. Fiscal deficits are expected to narrow in the coming years following revenue enhancements via increases in VAT rates and fuel taxes during the summer. The risk profile is dominated by the weak external position as a result of the large external financing needs, low levels of foreign exchange reserves, and a current account deficit. The fiscal deficits are largely financed by short-term credit facilities in foreign currencies.

What comes next?

Turkey's new economic growth model relies less on domestic consumption and more on exports and investment. One prerequisite for this plan is that Turkey manages to regain the confidence of foreign investors, which is not a given after many years of a volatile regulatory environment that has made many

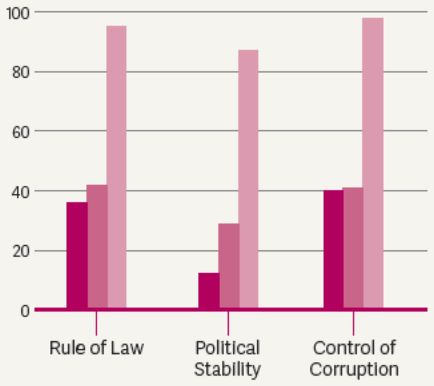
Turkey

Real GDP growth (constant prices, % per annum)



Source: IMF WEO, Macrobond

Business environment



Ranking from 0 (worst) to 100 (best)

Source: The World Bank, Macrobond

Swedish export to Turkey

	MSEK
2022	20 445
2021	15 159
2020	14 808
2019	13 142
2018	14 269

Source: SCB

EKN:s exposure

	MSEK
Guarantees	13 325
Offers	1 448

sceptical about the country from an investment perspective. On a positive note, the country continues to have access to the international capital markets and initial signs are discernible that the new policy stance is having an impact. The current account for September showed a surplus (one of two months with a surplus over the past 24 months). At the same time, according to the central bank foreign exchange reserves have increased from USD 50 billion in May to USD 74 billion. Consumption has also slowed as a consequence of increased in interest rates, which also increases the share of local currency bank holdings and limits the "dollarization" of the financial sector, which has accelerated since 2022.

According to the IMF, the ongoing rebalancing of the economy is expected to lead to a slowdown in economic growth from 5.5% in 2022 to 3,0% in 2024, while by the end of 2024 the inflation rate will decline to 46% (from 72% at the end of 2022). It is difficult to assess the sustainability of the current policy direction, partly because the increased concentration of power in the Office of the Presidency makes decision-making more unpredictable. The planned municipal elections in both Ankara and Istanbul in March 2024 will therefore be a litmus test for the ruling AKP party, which seeks to win back power in both cities. But the question is how much patience voters will have with weaker economic growth, especially in an election year.

In the longer term, the country faces several challenges, in addition to the risks related to its balance of payments. Political unrest with a government that is perceived as increasingly authoritarian has led to a rise in public discontent, which also contributes to hesitation among foreign investors about new investments. These tensions risk exacerbating economic problems in the form of sudden new capital outflows and a falling exchange rate. Only through long-term structural reforms can this vulnerability be reduced. In terms of fiscal policy, there is currently scope, however, the Government's commitment to reform has been temporary and erratic in the past.

Business environment

The World Bank ranks Turkey's business environment at 33 out of 190 countries, in line with the Balkan and Eastern European countries, but better than its Middle Eastern neighbours (2020). Strengths include access to credit information, low trade barriers and the possibility to enforce contracts. Reforms in the judiciary began in the early 2000s and have made some progress. New courts for commercial disputes have been established, but difficulties in the form of protracted judicial processes remain. Political interventions affect individual sectors and businesses. According to several analysts, the economy is now less rule-based than before. Transparency International's Corruption Perceptions Index shows a negative trend in recent years and Turkey is ranked 101 out of 180 countries. The World Bank's Worldwide Governance Indicators (WGI) rank Turkey around the average for the region on all measurements of the quality of public institutions and the regulatory environment. However, in all of the measures, a negative trend can be seen in the country over the past decade. The Turkish corporate and banking sectors are accustomed to crises and have previously proven to be resilient to the country's weak external position and domestic financial turmoil. The private sector is particularly vulnerable to a weaker lira, due to the fact that companies account for a large share of total external debt.

Turkish banks are profitable, well-capitalised, and relatively well run. High profitability, despite a difficult macroeconomic environment, is explained by the fact that, thanks to the current interest rate policy, the banks are currently able to use an element of interest rate arbitrage. Capital adequacy is on average 18 per cent. On paper, asset quality remains good. The average level of non-performing loans (NPLs) is low, at slightly under two per cent, and has been declining for several years. However, the share of non-performing loans is masked by expansionary credit growth above 50 per cent per year since 2022. Non-performing loans are mainly made up of credits to the construction, manufacturing, power generation, and tourism sectors. Over time, the banks' asset quality is expected to deteriorate as a result of the slowdown in economic growth from 2024 and lower credit growth. The principal systemic risks are the banks' dependence on external funding, which will leave the sector exposed to global funding conditions and risk appetite, as well as currency volatility in the coming years.

EKN:s policy

Since 2018, EKN has classified Turkey in country risk category 5 (out of 7). This assessment is carried out in collaboration with the OECD. Turkey was down-graded to country risk category 5 (from 4) due to increased economic imbalances. Normal risk assessment applies to all buyer categories. Fiscal discipline and relatively strong public finances justify normal risk assessment for governmental counterparties. No restrictions exist for transactions where banks are the counterparties.

EKN:s commitment and experience

During the period 2018-2022, EKN issued guarantees for 414 transactions for Swedish companies exporting to Turkey with a total value approaching SEK 19 billion. The exposure is dominated by the infrastructure and transport sectors, however there is also a large exposure in the telecom sector. The demand for EKN's guarantees has increased since 2018 following the economic turbulence in 2021 and due to the deteriorating risk environment. Letter of credit guarantees, where EKN shares the risk with banks that confirm letters of credit on behalf of Swedish exporters and where the counterparties are Turkish banks, have increased during the current financial turbulence, and constitute a large proportion of the guarantees issued.

EKN's payment experience is good. Arrears occur; however indemnifications have remained minimal. Since 2018, indemnifications have been paid out on only a few small transactions. The majority of the troubled transactions have been in cyclical sectors such as mining and construction. The recovery proceedings have been protracted. EKN's experience in bankruptcies is that according to Turkish bankruptcy legislation, the claim is converted into lira.