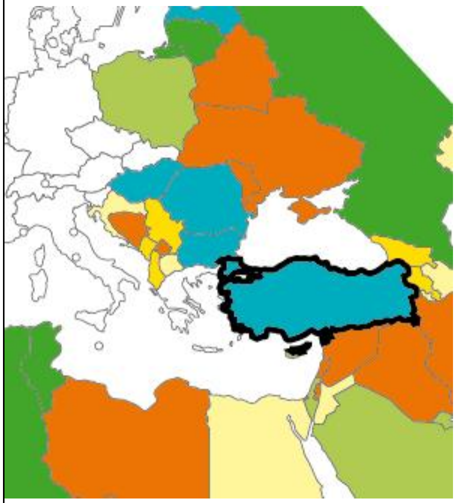
COUNTRY RISK ANALYSIS

Turkey

CREATING CONFIDENCE IN YOUR EXPORTS



COUNTRY RISK CATEGORY

4/7

The country risk categories range from 0 to 7. The lower the number the better the credit rating the country has.

0 1 2 3 4 5 6 7

EKN'S OUTSTANDING GUARANTEES IN THE COUNTRY

Short-term transactions: SEK 730 million

Medium and long-term transactions: SEK 7,791 million

EKN'S POLICY

Sovereign risks: Normal risk assessment

Other public risks: Restrictive risk assessment

Bank risks: Normal risk assessment

Corporate risks: Restrictive risk assessment

See “EKN'S POLICY” section

DATE

20/03/2013

Safe haven in troubled surroundings

Turkey's political and economic situation has stabilised over the last decade with the dominance of the AK Party and its successful economic policies. The political conditions and public finances that previously generated uncertainty and economic crises have in recent years promoted stability and predictability. However, divisions remain within the society between Islamist and secular forces, but the AK Party has the upper hand in this power struggle with the military, and the likelihood of a new political intervention by the military is limited. External needs for financing continue to cause vulnerability in the economy. Confidence in the economy among foreign investors is still high, which means a balance of payments crisis is unlikely. Payment risks in the banking sector are expected to be insignificant, while funding difficulties and currency exposure is restricting creditworthiness in Turkish companies.

STRENGTHS

- Increased political stability and continuity
- Strong public finances
- Stable banking system

WEAKNESSES

- Large current account deficit and high debt service ratio
- The corporate sector is hampered by financial and currency risks
- EKN's negative experience of debt recovery among smaller Turkish buyers

POLITICS

From destabilising to stabilising factors

Turkey's political conditions have historically been a source of economic and social tensions in the country. Military coups and weak coalition governments have contributed to irresponsible economic policies that have led to high inflation and sharp fluctuations between upturns and downturns in the economy. The election of 2002 was a turning point with the victory of the moderate Islamist and socially conservative AK Party. Electoral success gave the government a mandate to implement a number of necessary political and economic reforms, which have brought the country closer to the EU. Meanwhile, Turkey has come to play an increasingly more pronounced political role in the Middle East and North Africa. There have been tensions between the AK Party and the secular and military factions since the election 2002. Several controversial trials against the military, business leaders, journalists and civilians indicate divisions within Turkish society and have brought the independence of the legal system into question. In terms of Turkey's past, greater civilian control over the military is strengthening the country's political institutions.

There is a risk of a deterioration of political stability in the coming years. The civil war in Syria shows no sign of abating in the near future, which is creating tensions in the countries where refugees are looking to move, including Turkey. The war is not a national security threat in view of Turkey's cautious attitude and military superiority, but it has aggravated the military conflict with the Kurdish organisation PKK, as many Kurds live in Syria. The renewed talks with the PKK, which began in late 2012 are therefore a step forward. The negotiations are supported by both the opposition and Kurdish opinion leaders and represent a genuine opportunity for resolving the conflict.

The upcoming presidential and parliamentary elections could have negative domestic political consequences. The prelude to the elections would likely lead to a temporary fiscal deterioration, although this does not pose a threat to public finances. Prime Minister Erdoğan's ambitions to become president with expanded powers will also explicate the conflict with his secular opponents.

ECONOMY

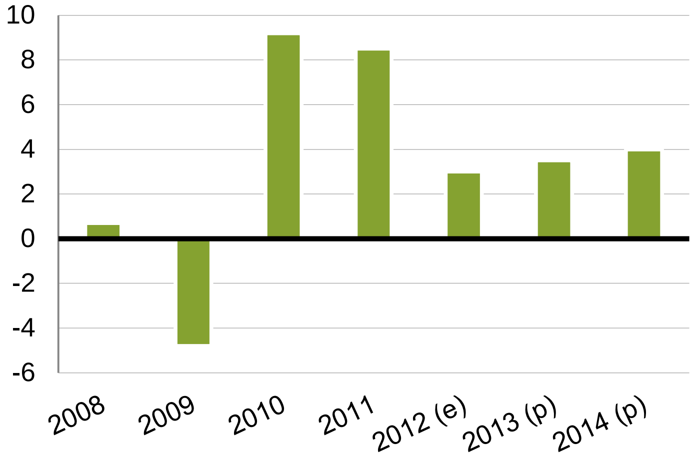
Balanced growth and strengthened public finances

Over the past decade, Turkey has enjoyed economic growth, development and stability without historical precedent. In 2010 and 2011, Turkey had an economic growth of over eight percent. Such growth rates are unsustainable in the long run. The rate fell in 2012 after a tighter economic policy and interest rate hikes in 2011. Economic activity is likely to rise in the future and forecasts point to a GDP growth of between three and four percent over the next two years.

Private manufacturing in the textile, automotive and electronics industries have evolved into the most dynamic sectors. However, Turkey has no high-tech production that can compete with the advanced industrial countries and large family-owned conglomerates continue to play an important role in the business community. A degree of diversification in foreign trade has taken place in recent years. Trade with the Arab world has risen during the term of the

AK government and the economic downturn in Europe, but it is still insignificant compared to trade with the EU.

GDP GROWTH (% PER YEAR)



The growth rate has slowed to more sustainable levels of around three to four percent per year going forward. Source: IMF

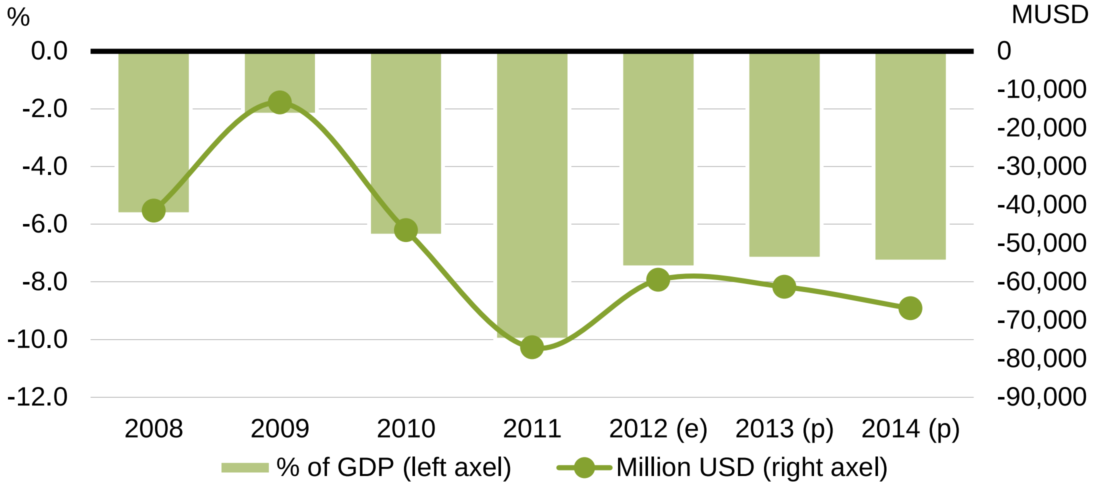
Turkey's public finances have been historically weak and contributed to the economic crises in the country. Public finances have strengthened considerably over the past decade. The improvement has taken place on both the revenue and expenditure sides. The national debt relative to government revenue has more than halved since 2001, and there is the same trend in the ratio of government interest payments and income. The relatively small and short-term deterioration of public finances following the global financial crisis of 2008/2009 was a sign of strength. The budget deficit declined during 2010, while the primary balance (balance before interest expenses) showed a surplus after having been in deficit for just one year. The relatively short duration of the national debt has been extended due to increased confidence in the state and the refinancing risk has thereby been reduced. Public finances have been a stabilising factor that is expected to reduce the fluctuations in the economy going forward.

BALANCE OF PAYMENTS AND DEBT ISSUES

The current account deficit continues to burden the economy

Several structural weaknesses continue to impact the economy. Turkey's external liquidity is weak in terms of the major financing needs caused by the current account deficit and foreign debt. The financial crisis broke the trend of declining external debt, which Turkey has had since the country's banking crisis in the early 2000s. The economy is relatively closed, with exports accounting for only 20 percent of GDP, making it difficult to generate export revenues as a way of reducing the current account deficit and paying off the debt. Since the extreme year of 2011, the deficit has declined substantially, but a structural deficit of the equivalent of six to eight percent of GDP will continue for the next five years. The country is dependent on foreign investment to finance deficits and is vulnerable to changes in the risk appetite of investors and reduced global liquidity.

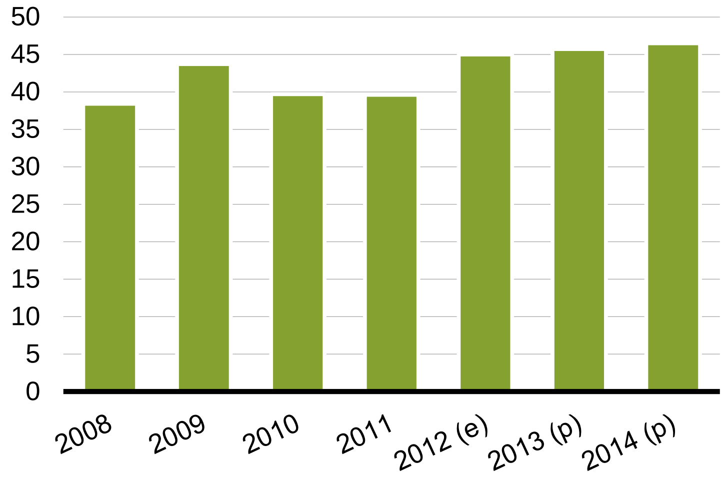
BALANCE OF PAYMENTS



In 2011 Turkey had the second largest current account deficit in absolute terms, only the United States deficit was larger. Source: IMF.

Although external debt will continue to grow in the future, the debt service ratio will drop due to lower interest rates. Financing of the current account deficit has also improved in recent years, but short-term loans and portfolio investment still represent the largest share. Short-term liabilities are equivalent to the total foreign exchange reserve which is at a high level. Nevertheless, Turkey has historically been able to finance its debt and even demonstrate a net inflow of capital, despite challenging economic conditions abroad. International reserves rose sharply in 2012 to the equivalent of five months of import coverage thanks to the current glut of global liquidity, creating a larger buffer against future capital outflows.

EXTERNAL DEBT (% OF GDP)



External debt in relation to GDP will remain stable over the coming years. Source: IMF.

The large external financing needs will continue to make the economy vulnerable. But economic confidence among investors together with larger international reserves will make a balance of payments crisis unlikely in the medium term.

CURRENCY POLICY

Continued currency fluctuations are to be expected

Turkey's floating exchange rate has given the economy, flexibility and enhanced competitiveness over the recent years of turbulence. The deterioration in the global financial markets during the global financial crisis and then the euro crisis, along with Turkey's vulnerable external balance led to a sharp depreciation of the lira in both 2008 and 2011. The central bank's various targets for inflation, credit growth, capital inflows and the exchange rate have also led to uncertainty among market participants, which has had a weakening effect.

However, the lira was more stable in 2012. The financial markets have only been marginally affected by the political turmoil in the Middle East. Contributing factors are more stable external economic and financial conditions, particularly in the US and EU, as well as the perceived predictability of the AK Party's economic policies. Given that the external refinancing risk is still prevalent, and the current account deficit will not decrease dramatically, the currency will continue to fluctuate and the risk of depreciation remains. The lira has a high degree of convertibility and may be considered by EKN in local currency financing transactions.

FINANCIAL SECTOR

Consolidation will strengthen the banking sector further

The banking sector is well capitalised and profitable with a low proportion of non-performing loans. Sector assets correspond to a modest 90 percent of GDP, but lending has grown strongly in recent years. Credit losses could therefore rise in the future, especially following the next significant economic downturn. Household debt is low and mainly in local currency, which is positive. The banking sector as a whole has a balanced foreign currency exposure with equal assets and liabilities denominated in foreign currencies.

Concentration in the banking sector is high for an emerging market. The country's seven largest banks account for 80 percent of deposits and foreign ownership in these banks is minimal. Foreign acquisitions have at the same time increased among medium-sized banks over the last two years. The financial soundness of the banking sector, the large market and the broadly favourable outlook for the Turkish economy make the country's banks appealing. Further consolidation of the sector is likely, particularly among smaller banks. Although these banks are robust enough to survive in the short term, this consolidation process will help them develop and maintain their profitability in a highly competitive sector. Acquisitions of this type could eventually improve the credit ratings of the banks as the buyers, mostly from Europe and the Arabian Gulf, are usually financially strong.

BUSINESS ENVIRONMENT

Credit risks due to financing difficulties and currency mismatches

The lack of cheap medium-term financing in local currency is restricting the room for manoeuvre for Turkish companies. Companies are being forced to seek finance overseas which is creating currency mismatches. Meanwhile, lending in foreign currency is regulated and the recent growth in credit to households and small and medium-sized companies has mainly been in local currency. Both deposits and loans in foreign currencies are significantly lower today than at the beginning of the 2000s, which indicates greater confidence in the lira and a more developed domestic capital market. Lending in foreign currencies makes up a quarter of the loan portfolio, although only 10 percent are short term liabilities. The trend for local borrowing is therefore positive but individual companies may have currency mismatches, and consideration should therefore be taken in the credit assessment of companies.

The growing economy and lack of financing has stimulated the development of the domestic capital market. 2012 was an important year in this respect with the revision of the trade and capital market law. The reforms include modernisation of the stock market and the forcing of listed companies to become more financially transparent, to allow market operators to better understand credit risks. These improvements will likely further stimulate the development of a local investor base and capital market.

Political intervention is still influencing individual sectors, companies and projects. High consumption taxes and frequent tax changes are affecting companies that sell to consumers, such as in the automotive and telecom sectors. Public procurement legislation, regional development and investment support, employment and exports are under constant review, as well as barriers to trade in agriculture, textiles and other sectors. Unpredictability also surrounds the authority and independence of supervisory bodies. Competition from public companies with competitive advantages continues to be a problem in areas such as the banking and energy sectors. The World Bank places Turkey in 71st place in terms of the business environment, in line with the countries in the Balkans and Eastern Europe, but better than its neighbours in the Middle East.

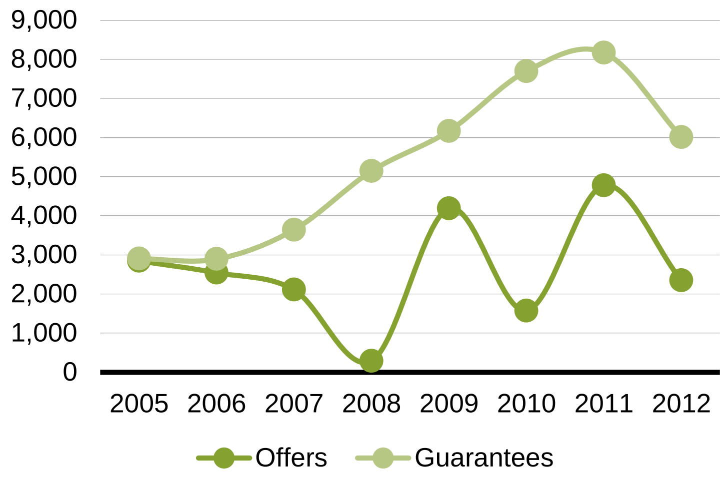
EKN'S EXPOSURE

Large exposure but decline in 2012

In the period 2008-2012, EKN has issued guarantees for 146 transactions totalling SEK 16.2 billion for Swedish companies exporting to Turkey. Both the flow of guarantees and outstanding exposure have gradually increased over the years and at the end of 2011 outstanding guarantees totalled SEK 8.2 billion. However, in 2012 both the flow and stock of guarantees decreased. Contributing to this trend is the fact that Swedish exports to Turkey declined by 19 percent in 2012 compared to 2011. The improvement in international financial and capital markets, and the fact that Turkey is increasingly seen as a mature market where risk coverage is not needed to the same extent as previously, may have contributed to the lower demand at EKN.

Exposure has a certain concentration in the telecom sector but sectors such as infrastructure, transportation, construction and power also have major exposure. In several guarantees, the payment risk rests on the Turkish state, municipalities and banks.

EXPOSURE PER 31 DECEMBER 2012 (MSEK)



The stock of guarantees has been on a downward trend since its peak in 2011.

PAYMENT EXPERIENCE

Payment experience has been good in Turkey, even during the recent financial crisis. The rate of arrears has been periodically high, but actual indemnifications have remained small. Over the past five years, transactions totalling SEK 18 million have been settled. The majority of the problem transactions have been with smaller buyers in the quarrying and transport sectors. The recovery processes in these transactions have been sluggish. Ownership licences have not always been able to be utilised and auctions of recovered assets have been manipulated. The lesson for EKN is that small buyers in cyclically sensitive industries should be assessed carefully, even if the buyer looks financially acceptable on paper.

EKN'S POLICY

Positive outlook but unchanged policy

EKN has classified Turkey in country risk category four since 2008, an assessment undertaken in collaboration with the OECD. EKN's policy prescribes standard risk assessment for government and banking risks. Here the transactions are assessed on their own merits without any special requirements or conditions. For other public risks, such as municipalities, payment securities are to be pursued and for corporate risks special attention should be paid to the buyer's currency exposure.

OFFICIAL COUNTRY DATA AND CREDIT RATINGS

OFFICIAL COUNTRY DATA

Area: 783,562 km² (1.7 times Sweden)

Population: 79.7 million (2012 est.)

Population growth: 1.2 % (2012 est.)

GDP: USD 774 billion in 2011 est. (Sweden USD 545 billion in 2011)

GDP/capita: USD 10,363 in 2011 est. (Sweden USD 57,638 in 2011)

CREDIT RATING

	COUNTRY CEILING	SOVEREIGN RATING
Moody's:	Baa2	Ba1/positive
S&P:	BBB-	BB/stable
Fitch:	BBB	BBB-/stable

COUNTRY ANALYST

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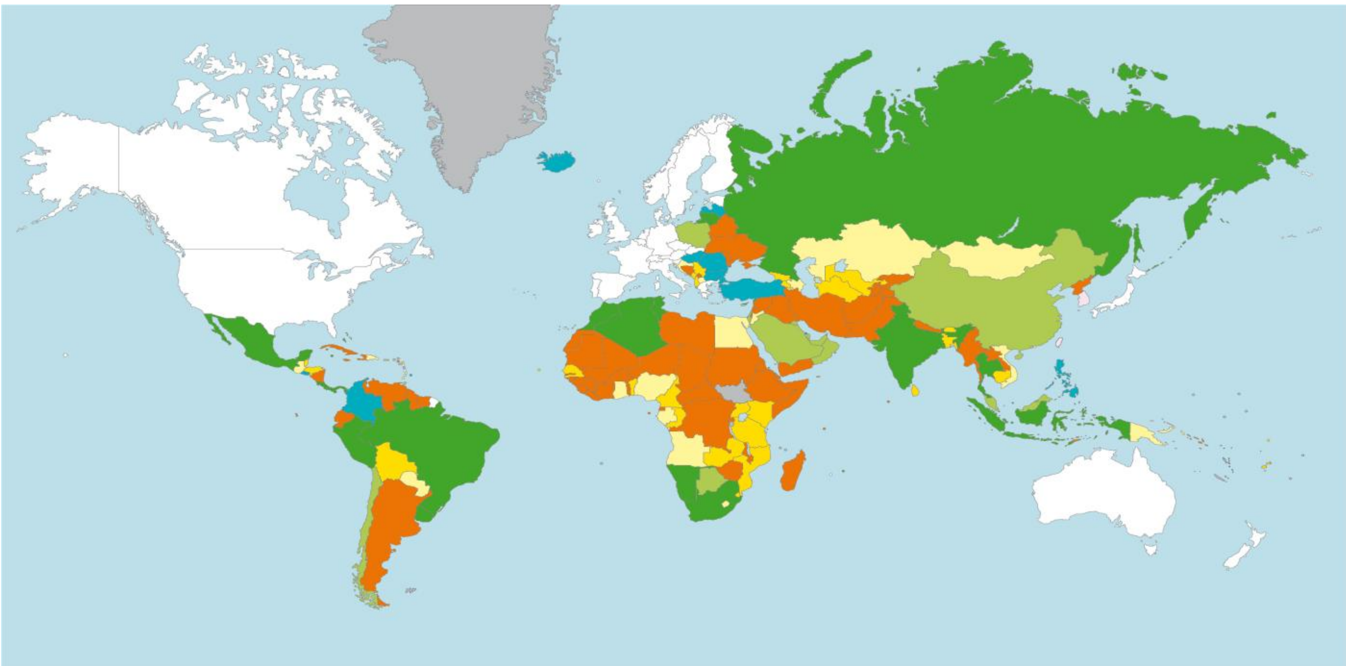
EKN'S VIEW OF THE WORLD



The country risk categories range from 0 to 7.
The lower the number the better the credit rating the country has.

0 1 2 3 4 5 6 7 No Policy Fixed

EKN – CREATING CONFIDENCE IN YOUR EXPORTS

EKN is a government agency that supports Swedish exports and the internationalisation of Swedish industry. This we do by offering exporting companies and banks guarantees for payment and financing, together with advice on business structure and risk management. Our services provide an extra level of confidence, increased competitiveness and more opportunities for successful export transactions.

The Swedish Export Credits Guarantee Board

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