POPULATION

79.8 MILLION

GDP

10,817 US$

C

COUNTRY RISK ASSESSMENT

A4

BUSINESS CLIMATE

SYNTHESIS

MAJOR MACRO ECONOMIC INDICATORS

	2015	2016	2017(f)	2018(f)
GDP growth (%)	6,1	3,2	7,4	4
Inflation (yearly average, %)	7,7	7,8	10,9	9,3
Budget balance (% GDP)	-1,0	-1,1	-2,0	-1,9
Current account balance (% GDP)	-3,7	-3,8	-4,6	-4,3
Public debt (% GDP)*	27,5	28,1	28,5	28,5

*EU-defined general government's debt stock (f): forecast

STRENGTHS

- Demographic vitality
- Large population with rising middle income class
- Strategic geographic location
- Well-developed industrial base
- High capacity of creating employment

WEAKNESSES

- Domestic and geopolitical instability
- High dependence on external borrowing
- High import reliance of the industry

RISK ASSESSMENT

Hard landing risks surface after a period of very high growth

Turkey's economy recorded a solid growth rate of 7.4% year-on-year in the first quarter of 2018, mainly backed by private consumption and investments, and partly by public spending. In 2016, the Turkish economy experienced a series of shocks, such as a failed coup attempt, sharp depreciation of the lira and severe external and domestic security issues. In order to counter negative spill overs of these shocks on the economy, the authorities introduced a series of stimulation packages in 2017 that have fuelled private consumption and investment. However, the strong resulting growth performance has exacerbated existing imbalances, stirring double-digit inflation, a sharp devaluation of the Turkish lira, and a wider current account deficit. In May 2018, the central bank held an emergency meeting and hiked its late liquidity window interest rate by 300 basis points to 16.5%, and raised it again by 125 basis points to 17.75% in June 2018. This tightening will likely weigh on domestic demand, which in

turn will impact domestic-driven sectors' performances. The pace of growth could also lose momentum due currency weakness, lower purchasing power trimmed by high inflation.[IS1] .

In early 2017, the government introduced a countercyclical measure in a bid to support economic activity. It increased the size of the Credit Guarantee Fund (CGF) to ease small and medium companies' access to financing. The size of the fund was raised to TRY 250 billion. In 2018, the size of the CGF was expanded by another TRY 55 billion to further support exports and investments. In the first four months of 2018, Turkish exports rose by 8.6% from the same period a year earlier. However, as exports are dependent on imported inputs, imports jumped by 20.8% over the same period, and the trade deficit widened by 56.2% to USD 27.4 billion. The coverage rate of imports by exports declined to 66.7% in January-April 2018, down from 74.3% a year earlier. Moreover, rising energy prices also add to the country's import bill. This wider trade deficit has resulted in a larger current account deficit, which attained USD 55.4 billion on a 12-month rolling basis in March 2018. [IS2]

A continued depreciation of the lira remains the main risk for Turkey's highly import-dependent economy in the near future. Non-financial private sector's short-term foreign currency denominated debt stood at USD 50.5 billion as of the first quarter of 2018.Any additional weakness of the lira would increase both the debt burden and the costs of imported inputs for the manufacturing sector. The current inflationary environment suggests that interest rates will remain at very high levels (around 19% for both commercial and individual loans) for some time. Further rate hikes by the central bank to counter the currency weakness and inflationary pressures would again add to borrowing costs. This scenario would deteriorate the cash flow situation of Turkish companies, which suffer from structural undercapitalisation.

Twin deficits: A cause of concern

Fiscal policy has become more expansionary due to temporary tax cuts, expanded public services, and employment incentives. Off-balance sheet stimulus measures represent upside risks to debt levels if the government had to take on the liabilities mostly linked to the public guarantees given under the Public Private Partnership (PPP) projects. Although the expansionary fiscal policy is likely to be gradually scaled back in 2018, the deficit may continue to remain high ahead of the local elections[FD3] [IS4] in March 2019. Fiscal revenues are largely based on consumption, so an economic downturn and/or weaker domestic consumption would decrease government revenues accordingly. Despite all of this, the public balance sheet currently remains healthy.

While promoting banks' lending, the government CGF programme pushed the banking sector's loan-to-deposit ratio to 121% as of May 2018. However, due to the limited size of domestic savings, Turkey's economy relies heavily on external financing. While the increase in energy prices will likely widen the current account deficit, the structural lack of savings will continue to be the economy's Achilles' heel in the years ahead. The reliance on short-term capital inflows for current account deficit financing leaves the country exposed to markets' mood. Monetary tightening strategies of the major central banks and rising regional tensions may quickly reduce investors' confidence, meaning foreign direct investments may remain limited.

Lower political uncertainty after the June 2018 election

In April 2018, Turkey had presidential and parliamentary elections. The country's long-standing [FD5] [IS6] leader Recep Tayyip Erdogan (since 2002) has secured a new five-year term with nearly 53% of the votes. The country will now shift into the executive presidency system from the parliamentary system. In the parliamentary contest, the ruling AKP took 43% of the votes while its allies MHP got 11%. Political noise has decreased since the elections. However there is a possibility for the local elections initially scheduled in March 2019 to be held earlier.
In this context, international investors will pay particular attention to the ability of the new Administration to maintain economic and financial stability. A sharp depreciation of the lira due to a negative shift in investor sentiment would weigh heavily on corporate sector and extend payment terms, as the economy is dependent on imports and foreign funds. Such a situation would put under risk the financial stability and the sustainability of growth performance.

Last update : June 2018