



Update on Turkish Economy

December 3, 2009

Credit Rating

- **Fitch Ratings has upgraded the Republic of Turkey's long-term foreign currency Issuer Default Rating (IDR) to 'BB+' from 'BB-', its long-term local currency IDR to 'BB+' from 'BB' and its Country Ceiling to 'BBB-' from 'BB'.**
- **The rating agency's press release is as follows:**

"The upgrade reflects Turkey's relative resilience to the severe stress test of the global financial crisis and some easing in prior acute constraints related to inflation, external finances and political risk," says Edward Parker, Head of Emerging Europe in Fitch's Sovereigns team.

Turkey's relative resilience to the global financial crisis reveals that credit fundamentals and debt tolerance are stronger than previously thought. Although the global shock caused a deep recession in Turkey, it has not triggered a balance of payments or financial crisis. In contrast to previous shocks, Turkey has been able to implement counter-cyclical fiscal and monetary policies without sparking an exchange rate crisis, and interest rates have fallen to single digits for the first time in its modern history. The government has been able to step up borrowing in the domestic debt market at record low yields as well as issue USD3.75bn of eurobonds this year. It has not needed an emergency IMF bailout nor to support the banking sector, and there has been no significant pick-up in dollarisation or capital flight.

Although Fitch forecasts GDP to contract 6% in 2009, the agency expects growth of 4% in 2010. Moreover, the recession has enabled the country to attain a better macroeconomic balance. Turkey's history of relatively high and volatile inflation has been a source of macroeconomic instability and a rating weakness. But inflation has fallen to a modern low of 5.1%, from an average of 10.4% in 2008 and the floating exchange rate and inflation-targeting regime has performed well during the crisis. The exchange rate has adjusted to a more competitive level and Fitch forecasts the current account deficit (CAD) to narrow to 2.1% of GDP in 2009, from 5.7% in 2008.

Turkey's resilience also reflects its strong banking sector, which is moderate in size, well capitalised and has a low loan/deposit ratio of 80%. Debt tolerance and sovereign ratings are also supported by high GDP per capita (which is above the 'BBB' range median), high levels of human and physical capital, a favourable business climate and governance, deep local capital markets and a good modern debt service record.

However, the public finances have deteriorated. Fitch forecasts the central government budget deficit (on IMF definitions) to widen to 7.6% of GDP in 2009 and 5.6% in 2010, from 3% in 2008; and (EU defined) general government debt to increase to a peak of 48% of GDP at end-2010, from 39.5% at end-2008, compared with the 10-year 'BB' range median of 41%. Fitch estimates this will entail a fiscal financing requirement of around 19% of GDP in 2010, partly reflecting the relatively short average maturity of domestic debt. A similar amount has been readily financed so far in 2009. Encouragingly, the government has mapped out and started to implement a medium-term fiscal consolidation programme, which should be consistent with returning the debt-to-GDP ratio to a declining path.



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Although external financing risks have eased this year, helped by the narrowing in the CAD, reasonable private sector roll-over rates and large unexplained capital inflows, Turkey faces a sizeable gross external financing requirement (CAD plus medium- and long-term amortisation) which Fitch estimates at USD66bn in 2010 (plus USD48bn short-term), compared with foreign exchange reserves of USD75.4bn. Turkey's net external debt ratios and debt service ratios are somewhat higher than for rating peers.

Political risk also weighs on Turkey's sovereign ratings. But the risk of severe political instability has declined since 2007-2008, in Fitch's view.