CareEdge Global assigns Long Term Foreign Currency Rating of B+ (Unsolicited) to Republic of Turkiye

Credit Profile

Turkiye's credit profile is characterized by its weak fiscal position, very high inflation levels, large external financing needs, and weak institutional framework. Moreover, there are material macro risks emancipating from widening twin deficits. Despite these negatives, Turkiye benefits from having a moderate economic profile and favorable demographic dynamics.

Post his re-election in 2023, President Erdogan returned to conventional monetary policy in order to address the prevailing macro-economic imbalances. This is demonstrated by an increase in interest rates to 50% from 8.5% in a span of a year and half and steps to tighten credit availability by the central bank. The government has also increased taxes on fuel and standard vat rates to bring down fiscal deficits. Going forward, the impact of such monetary and fiscal tightening on Turkiye's growth will be a key monitorable. Rising geo-political tensions too remain a concern.

Strengths

- Large size of the economy coupled with moderate economic growth
- Relatively high GDP per capita
- Customs union with the European Union, provides access to large market

Weaknesses

- Macroeconomic imbalances with high inflation, high dollarization of economy and external imbalances
- Low usable FX reserves
- High levels of contingent liabilities of the government
- High oil import dependency
- Centralised decision making leading to policy unpredictability

Key Monitorables

- Impact of monetary and fiscal tightening on Turkiye's growth
- The economy's ability to adapt to new economic policies
- Rising geopolitical tensions

Key Rating Drivers

Economic Structure & Resilience

Turkiye's economy economic structure reflects its large size (Nominal GDP of USD 1.1 trillion in 2023), high GDP per capita (USD 34,401 constant PPP in 2023), and moderate past economic growth (average of 4.8% between 2019-23). Unlike most of its European counterparts, Turkiye benefits from a young and growing population (median age-33 years). Additionally, the economy's geographical location and business culture adds add to its strengths.

Despite these positives, Turkiye's inflation rate has been very high (CPI average of 34.6% between 2019-23, with 72% in 2022 alone) due to past unorthodox monetary policy of keeping the interest rates artificially low. The resulting macro imbalance led to a lira depreciation of more than 300% in the last 5 years. Considering a recent switch back to conventional monetary policy and fiscal consolidation, the medium-term growth is expected to be lower at ~3% levels. Also, Turkiye receives almost 40% of its gas from Russia, thus making it more vulnerable to current geo-political tensions.

Turkiye also faces structural challenges from high deposit dollarization in the economy, at 45% in H1 2024, albeit lower than the highs of 2022 of more than 60%. Slowing demand from the European Region, a major trading partner, could also pose a risk.

Fiscal Strength

Turkiye's fiscal profile is characterized by wide fiscal deficits, a large share of inflation-indexed bonds, and significant risks from contingent liabilities. The fiscal deficit widened to 5.5% in 2023 due to stimulus packages, subsidies for high energy prices, and increase in public wages and pensions. Additionally, inflation-indexed bonds account for 22% of public debt, adding to the burden on fiscal position in a high inflationary environment.

Though government debt to GDP is low (at 28.9% of GDP in 2023), there are material risks arising from contingent liabilities. First, Turkiye as the largest Public-private partnerships (PPP) market in Europe, has extended guarantees to the foreign currency debt of PPPs. With the sharp depreciation of the Turkish lira, the guaranteed payments have risen. Secondly, to reduce the dollarization of the economy, the government introduced foreign exchange protected exchange-protected deposits (KKMs) in 2021, where the government committed to compensate lira depositors against exchange rate depreciation exceeding interest rates. While the government has initiated phasing out of these deposits in 2024, the risks are still substantial. Government interest payments to revenue remain elevated due to high credit risk premia.

External Assessment

Turkiye has large external financing needs. The current account deficit narrowed to 4.1% of GDP in 2023 primarily due to moderating energy prices. Turkiye imports the majority of its fuel requirements, increasing its vulnerability to commodity price shocks. Also,net foreign direct investment inflows have been declining amid uncertain economic conditions.

Additionally, not all of Turkiye's reserves are immediately usable as gross reserves also include foreign currency deposits from banks and swap lines from Qatar and other Gulf Corporation Countries (GCC). Thus, though gross forex reserves stood at USD 85 billion in 2023, usable reserves are estimated to be less than half. However, the central bank has been continuously adding to its gross forex reserves with reserves reaching USD 149 billion in August 2024. External debt to GDP stood at 45% of GDP in 2023, of which about a third (or 21% of GDP) is short-term, implying significant near-term funding needs.

Monetary & Financial Stability

The exchange rate regime de jure is free-floating, de facto it is floating. In response to the depreciation of 20% in the Turkish lira between 2021-23, the central bank continued to intervene in the markets, causing depletion in forex reserves. Further, due to energy price shocks and spillover effects of past ultra-loose monetary policy, CPI inflation was high at 54% in 2023, against the central bank's target of 5%, and is likely to remain high in the medium-term too.

Going forward, high-interest rates are expected to weigh on banks' profitability and non-performing loans ratio. Balance sheet mismatches across corporate and banking sector due to tenure and currency structure of assets and liabilities could pose a risk to financial stability.

Institutions & Quality of Governance

President Erdogan's centralized power has led to low transparency and a lack of predictability in policy making. Since 2016, about 4 central bank governors have been replaced by the President, indicating limited central bank independence. The President appointed new cabinet ministers, finance minister, and central bank governor in 2023 signaling change in economic policies, however, long-term effectiveness and independence in policy making remain key monitorable.

Turkiye – Select Indicators									
	Unit	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024 F**	**2025 F**
Economic Indicators									
Nominal GDP	USD Billion	780	761	720	818	906	1108	1114	1107
GDP Per Capita (Constant-PPP)	USD	28670	28505	28876	31774	33296	34401	35074	35801
Real GDP Growth	%	3.0	0.8	1.9	11.4	5.5	4.5	3.1	3.2
GFCF/GDP	%	29.8	26.0	27.5	28.2	29.2	32.4	-	-
Gross Domestic Savings/GDP	%	29.3	27.8	28.2	31.8	31.0	27.0	-	-
Exports (G&S)/GDP	%	31.2	33.1	29.1	35.7	38.6	32.3	-	-
Working-Age (15-64) Population (% Share in Total)	%	68.3	68.1	68.1	68.1	68.1	68.1	68.0	68.0
Old-Age (65+) Population (% Share in Total)	%	7.6	8.0	8.2	8.4	8.6	8.9	9.2	9.6
Fiscal Indicators – General Government									
Fiscal Balance/GDP	%	-3.2	-4.8	-4.7	-3.0	-1.1	-5.5	-5.4	-3.7
Revenue/GDP	%	30.8	30.1	29.4	27.8	26.6	28.4	29.9	29.7
Expenditure/GDP	%	34.0	34.9	34.1	30.8	27.7	33.9	35.4	33.4
GG Gross Debt/GDP	%	29.9	32.4	39.4	40.4	30.8	28.9	30.9	31.0
GG External Debt (by Creditor)/GG Gross Debt	%	40.6	40.5	37.5	34.4	42.1	38.8	-	-
Interest/Revenue	%	9.1	8.3	10.3	10.5	18.2	-	-	-
External Indicators									
Current Account Balance/GDP	%	-2.6	1.4	-4.4	-0.9	-5.4	-4.1	-2.8	-2.2
FDI, Net Inflows/GDP	%	1.6	1.2	1.1	1.6	1.5	0.9	-	-
Outstanding FII Liabilities/GDP	%	18.0	17.6	15.7	11.7	10.3	8.6	-	-
NIIP/GDP	%	-43.1	-40.6	-53.1	-30.4	-36.5	-24.9	-	-
Foreign Exchange Reserves	USD Billion	93.0	105.7	93.6	111.2	128.7	140.9	-	-
Import Cover	Months	4.5	5.6	4.9	4.7	4.0	4.4	-	-
External Debt/GDP	%	54.7	54.5	59.5	53.3	50.6	45.1	-	-
Monetary and Financial Indicators									
CPI Inflation	%	16.3	15.2	12.3	19.6	72.3	53.9	59.5	38.4
Exchange Rate (Average)	LC per USD	4.8	5.6	7.0	8.9	16.6	23.8	-	-
Non-Performing Loans/Total Gross Loans	%	3.7	5.0	3.9	3.0	2.0	-	-	-
Private debt, loans and debt securities/GDP	%	82.4	79.6	88.9	89.0	65.6	-	-	-

Sources: International Monetary Fund, World Bank, Bank for International Settlements, National Sources, CareEdge Global

Note: F - Forecast; PPP – Purchasing Power Parity; GFCF – Gross Fixed Capital Formation; Exports (G&S) – Exports of Goods and Services; GG – General Government; FDI – Foreign Direct Investment; FII – Foreign Institutional Investment; NIIP – Net International Investment Position; Data refers to fiscal/calendar year and actual/estimate as reported by the source; Where general government data is unavailable, central government data is used; Latest available data for 2023

Rating History

Instrument	Type	Rating	Date
Issuer Rating	Long Term Foreign Currency (Unsolicited)	B+	October 3, 2024

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Criteria Applied

CareEdge Sovereign Rating Methodology

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