15-I-0035
August 28, 2015

Japan Credit Rating Agency, Ltd. (JCR) announces the following credit rating.

Republic of Turkey (security code: -)

<Affirmation>

Foreign Currency Long-term Issuer Rating:	BBB-
Outlook:	Stable
Local Currency Long-term Issuer Rating:	BBB-
Outlook:	Stable

Rationale

(1) The ratings are supported by (a) the largest national economy in the Middle East adjacent to the EU with nearly 80 million populations and (b) the public, banking and household sectors' buffer against shocks as underpinned by the authorities' prudent fiscal policy and strict banking supervision. The ratings are, on the other hand, constrained by (i) macroeconomic imbalances as seen in its low saving rate and chronic current account deficit, (ii) large external financing needs and dependence on the international financial markets and (iii) increasing political and social uncertainty. The outlook of the ratings is Stable. The Justice and Development Party (AKP), in power since 2002, failed to maintain a single-party majority at June 2015 general election. As no agreement was reached to form a coalition government at the post-election negotiation, the country will have another round of general election in November this year. At this moment, it is difficult to predict the result of the re-election or the political development afterward. Should the absence of administration linger, structural reforms, essential for macroeconomic rebalancing, may delay. That said, we believe that the broad direction of economic policies may unlikely be derailed given that all major political parties share more or less in common the country's economic challenges. The current account deficit, a key concern for Turkey, has improved from 7.8% of GDP in 2013 to 5.8% in 2014, thanks partly to the effect of monetary policy and macro-prudential measures. The pace of improvement has slackened recently as the US dollar-denominated export value declines due to a geopolitical factor such as Iraq and Russia and the euro's depreciation, largely offsetting the effect of the fall in import value on the lower oil prices. In 2015 to date, fueled by political factors, the lira's foreign exchange rate against the US dollar has depreciated by more than 20%. The development so far may be, given the size of Turkey's current account deficit, still within a justifiable range of corrections if viewed on a real effective basis in light of its rather stable move against the euro and the high domestic inflation rate. Steep depreciation against the US dollar may cause stress to the financial system by increasing debt burden to those who borrow in US dollar. The domestic banking sector's net open FX position remains around 2% of the capital. The household sector is not allowed to borrow in foreign currency. In the corporate sector, foreign currency borrowing is practically limited to those with foreign currency earnings or large enterprises. As such, no sign of deterioration is seen thus far in the banking sector's non-performing loans ratio. Despite uneasy economic environment such as political uncertainty, geographical factor and expectation of US interest rate hikes, the domestic financial institutions are managing to continuously roll over their external debt that amounted, as of the end of 2014, to as much as 45% and 77% of the country's annual exports and the foreign exchange reserves. In order to maintain and improve the credit standing, Turkey may need to (a) in the short term, conduct the monetary policy in a manner not to undermine the market confidence, proactively use macro-prudential measures and accumulate foreign exchange reserves further when possible and (b) in the medium- to long-term, push through structural issues such as increasing the saving rate, enhancing domestic industries' productivity, improving the investment and business climate and developing the domestic financial and capital markets. JCR will, for now, pay attention to how the political and social development could affect the broad direction of economic policy, and reflect them on the ratings.

(2) Located at the junction of Europe and Asia, Turkey is a regional power in the Middle East, having the land size of 781,000 km^2 (about twice the size of Japan) and the population of 78 million. It is a member of the Organization for Economic Cooperation and Development (OECD) and the North Atlantic Treaty Organization (NATO). Also, Turkey has a customs union with the EU. While the majority of its population is Muslim, it has been adhering to the principle of secularism cherishing

the concept of the separation of politics and religion since the founding of the Republic of Turkey in 1923. The AKP, in power since 2002, gained just 47% of the total seats at the June 2015 general election, losing majority. The post-election negotiation to form a coalition government broke down, leading to a holding of re-election in November this year. At the same time, conflicts with the Kurdish rebel group and the Islamic State (IS) surfaced lately. Political and social tension has risen, and their prospect is highly unforeseeable at the moment.

(3) The country's GDP totaled USD0.8 trillion, the largest in the Middle East, and its GDP per capita was USD10,404 in 2014. The population expanded 1.3% per year (2010-14 average) and real GDP annually grew an average 4.3% for the last 10 years (2005-14). Exports sized 28% of GDP in 2014, relatively low as compared to European countries. The gross national saving rate remained low at 14.9% in 2014, way below its gross domestic investment rate at 20.3%, causing its chronic current account deficit (CAD). The CAD has been financed by capital inflows from abroad. Both nonresident portfolio investment in bonds and domestic financial institutions' external borrowing swelled amid the global monetary ease in the post-Lehman shock period. At the end of 2014, the outstanding balance of external debt was equivalent to 183% of annual goods & services exports and 316% of the foreign exchange reserves, respectively. Also, the annual external financing needs loom large. In 2014, the combined total of the CAD, principal and interest payments on external debt and the outstanding short-term external debt at the end of the previous year reached 103% of exports and 178% of foreign exchange reserves.

(4) In recent years, the Turkish banking sector accelerated lending amid the monetary ease both at home and abroad in the post-Lehman shock period. The banking sector's loan outstanding soared from 41% of GDP at the end of 2009 to 71% at the end of 2014. During the same period, the deposit outstanding rose only from 54% of GDP to 60%, resulting in higher dependence on external borrowing. The banking sector's loan-to-deposit ratio climbed from 76% at the end of 2009 to 118% at the end of 2014. That said, the banking system is under the authorities' rigorous supervision and remains sound. At the end of 2014, its capital adequacy ratio (CAR) stood at 16.1%, nonperforming loan ratio at 2.9% and 0.8% in gross and net terms and liquidity ratio (liquid assets up to three months divided by liquid liabilities up to three months) at 107%. While the domestic banking sector increased the foreign currency borrowing, their net open FX position is contained at around 2% of the capital by active use of currency swaps. Household debt stood at as low as over 20% of GDP. Households are not allowed to borrow in foreign currency. Corporate lending in foreign currency is practically limited to large enterprises given the regulatory floor set at more than USD5 million. As such, the impact of foreign exchange fluctuations on the banking system is limited. In fact, despite more than 20% depreciation of the lira against the US dollar in 2015 to date, its CAR and nonperforming loan ratio (gross) stood solid at 15.4% and 2.9% at the end of June 2015.

(5) The country's public finance is managed with discipline under the 2003 Public Financial Management and Control Law. The government increased its expenditures in 2009-10 to underpin the flagging economy after the Lehman shock while keeping the primary balance in surplus. Between 2011 and 2013, it improved the primary balance significantly. The year 2014 registered a central government primary surplus equivalent to 1.6% of GDP and an overall budget deficit equivalent to 1.3% of GDP. The sustained primary surplus put the public debt (EU defined general government debt) in a gradually declining path to reach 33% of GDP at the end of 2014. The government's medium-term fiscal plan for 2015-17 aims to cut the public debt further to 29% of GDP by the end of 2017 by retaining an annual primary surplus equivalent to 1.2-1.8% of GDP.

Toshihiko Naito, Satoshi Nakagawa

Rating

Issuer: Republic of Turkey

<Affirmation>

	Rating	Outlook
Foreign Currency Long-term Issuer Rating	BBB-	Stable
Local Currency Long-term Issuer Rating	BBB-	Stable

Rating Assignment Date: August 25, 2015

The criteria used for identifying matters which serve as assumptions for the assessment of the credit status, and the criteria used for setting of grades indicating the results of the assessments of the credit status are published as "Types of Credit Ratings and Definitions of Rating Symbols" (January 6, 2014) in Rating Policies on JCR's website (http://www.jcr.co.jp/english/).

Outline of methodology for determination of the credit rating is shown as "Sovereign and Public Sector Entities" (November 7, 2014) in Rating Policies on JCR's website (http://www.jcr.co.jp/english/).

The aforementioned credit ratings are unsolicited. Except in cases of a credit rating for a sovereign, JCR indicates affix "p" after a rating symbol to distinguish it from a rating with solicitation. The undisclosed information, which has material influence on the credit rating, was obtained from the rating stakeholder.

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