News Release

Japan Credit Rating Agency, Ltd.

13-I-0013
May 23, 2013

JCR Upgraded Ratings on Turkey from BB to BBB-

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

Rationale

(1) Turkey has successfully weathered challenges of highly adverse international economic environment from the Lehman Shock through the European sovereign debt crisis. Increased net export and lowered unemployment rate in 2012 suggest strength of its growth potential, despite dropped GDP growth rate itself. The level of national income has always been far greater than those of Asian emerging economies. Turkey's international presence is rising, with its historical, cultural and geopolitical importance across the regions of Europe, Asia and Middle East. As a member country of OECD and NATO it enjoys growing recognition as a reliable democracy. There remains concern over inflation, current account deficit and weak foreign exchange reserves. It is also a long way to go for planned raising of the saving rate and lowering of the import dependency of energy. JCR has been fastidious about the results thereof. However, improvement on the macroeconomic issues is significant in the latest years thanks to innovative policy measures taken. So are some concrete steps for the structural issues, albeit small. The country's foreign exchange liquidity risk itself is decreasing as the European debt crisis is finding its way out. Hence, JCR upgraded Turkey's long-term issuer ratings to BBB-. The outlook of the rating is stable.

(2) The Republic of Turkey has the largest economy among the Middle Eastern and Central Asian countries, with land area of approximately 780 thousand square kilometers and population over 74 million. Its largest city Istanbul has rich histories of cultural and religious establishment and was being a world's major hub of international trades for centuries. Its GDP per capita exceeds USD 15,000 (on PPP basis) as of 2012. With over 95% of its nationals being Muslim, Turkey' secularism has been maintained from its republic independence in 1923 through today's AKP government led by Mr. Recep Tayyip Erdoğan (since 2003). The country's polity was once characterized by occasional military intrusions and there were failures in economic policy, which have long been major impediments against its economic development. However, the former had subsided in the 1980s and, as for the latter, the persistent tendency of inflation having been largely stabilized by 2005 and IMF assistance having virtually ended in 2008, only the successful policy handling is outstanding today.

(3) Turkey's recent macroeconomic issues are: (a) abatement of current account deficit which tended to be aggravating against economic growth; (b) control of domestic credit growth and foreign exchange fluctuations against speculative international capital flows; (c) disinflation against years of inflationary pressure. Major policy constraints were the level of foreign exchanges which were hardly ample at any point of the time, as well as the import dependency of energy and materials. The government has succeeded to deliver on all of them results that are more than satisfactory, employing innovative measures, such as interest rate corridor, official reserve requirement operation utilizing Reserve Option Mechanism (ROM), and Eximbank's export rediscount credit limits changes. In the latter half of 2010, for instance, Turkey faced a mounting pressure of short-term capital inflows and resultant appreciation of TL and excessive growth of domestic credit, on the back of QE2 induced flood of cheap US dollar. Then CBRT lowered the floor rate of the interest rate corridor several times from November so as to curb the short-term carry trades on the one hand, and raised drastically the reserve requirement rates, on the other, so that it managed down the credit growth as well as the excess demand itself. At the same time CBRT conducted frequent auctions to purchase foreign currencies, making foreign exchange reserves amplified. In 2011 TL was in turn being sold in the global drop of risk appetite on top of effects of official selling, which brings the prevention of current account deficit and inflation from aggravating, together with the protection of TL itself, to become urgent issues to be tackled in the latter half of the same year. Thus, in August and November, CBRT raised the lower-end and the upper-end rates of the interest rate corridor, respectively, beside it sold US dollars totaling USD 16 billion, and at the same time raised ROM limits for holding FX and gold for TL reserve requirement step by step to 60% and 30%, respectively, and thereby achieved all the purposes. In 2012 GDP growth rate slowed in a worldwide recession to 2.2% from 8.8% in the previous year, the current account deficit/GDP improved to 6.0% from 9.7%, which is also attributable to the easing of export rediscount credit limits, as well as successful export diversification toward Middle East and African countries.

Inflation showed an improvement from 10.45% at the end of 2011 to 6.16% at the end of 2012 on annual CPI basis and monthly deceleration as seen by CPI annual inflation was significant from over 10.61% in January 2012 to 6.16% in December 2012. The amount of gross foreign exchange reserves increased 28% from 78 billion to USD 100 billion in 2012 (excluding gold).

(4) Fiscal policy has consistently been contractionary since turn of the century, except in 2009 when it was forced otherwise under an international financial crisis. The fiscal position in 2012 showed a slight setback due to decreased tax revenues and increased current expenditures on economic slowdown, with the central government budget deficit/GDP being 2.0% and the public debt/GDP 36.1%, which deem to be highly sound. The primary balance is on a progressive rise in surplus after it posted 0.1% deficit in 2009. There was an improvement in the structure, and therefore its sustainability, of the central government's debt, in such ways as its extending average maturity from 35.3 months in 2009 to 60.8 months in 2012, and the increasing share of domestic currency denominated debts from 70.9% to 72.7% in the same period. The figures were 31.7 months and 66.2%, respectively, in 2008 when IMF assistance virtually ended. Medium Term Program 2013-2015 (MTP15) goals for a greater soundness, with the central government budget deficit/GDP being 1.8% and the public debt/GDP being 31.0% in 2015, is expected to be highly attainable.

(5) There is no notable vulnerability in the financial system. Its size in terms of total assets/GDP is 110.6% or, if only the banking sector is counted, 96.8% as of December 2012, which is not regarded to be too big relative to emerging economies of similar levels. Degree of concentration is not too high, either, with top 5 banks' asset holding share being mere 57% of 49 banks total. Turkey has adopted Basel II and 2.5 since the latter half of 2012, under which capital adequacy ratio and Tier I ratio stand as sound as at 17.9% and 15.1%, respectively, as of the end of 2012. The total loan/deposit ratio of 103% is comparable to those of East and Central European countries, together with loan/GDP ratio being moderate at around 56%. Turkey's banking attitude is regarded as more conservative, however, given its economy growing as fast as Asian peers. NPL ratio of 2.9% and loan loss reserve ratio of 75% are good. So is near zero exposure to EU peripheral countries. Its sources of funds, either deposit or money and capital markets, are dominantly domestic and TL denominated. The share of FX funding against total assets as of at the end of 2012 stands at 35%, and foreign shareholders against total equity at 25%, which are very low as compared to East and Central European countries. The strength of Turkey's financial system is considered to be a positive factor that supports resilience of its economy against external shocks. A risk management challenge, however, is yet to come as it is expected for the banks to expand, grossly in the long term, their lending and deposit taking, especially domestic base thereof, to support the country's sustained economic growth

(6) Turkey's external position, inter alia, the level of its foreign reserves of approximately USD 100 billion (excluding gold) as of the end of 2012, albeit improving and in stronger fashions in 2013, is desired to be augmented. Its coverage ratios over total external debt and short-term external debt are mere 30.3% and 99.2%, respectively, which suggests vulnerability, should it happen a sudden and massive capital flight. However, the concern is hardly imminent if it comes to the real economy, as the amount covers 5.1 month worth of its import and its total external debt amounts to as moderate as 42.8% of GDP. Its ultimate solution should wait for the structural improvement in the current account balance and the domestic saving rate and/or the sustained increase in FDI inflows. The MTP15 proposes a range of measures to address them, and some concrete results started being delivered, which include: the export to Middle East and African countries are steadily increasing; the first nuclear power plant construction was commissioned; and laws for the promotion of private pension schemes are enacted.

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Rating

Issuer: Republic of Turkey

<Rating Change><Outlook Change>

	Rating	Outlook
FC (Foreign Currency Long-Term Issuer Rating)	BBB- (from BB)	Stable
LC (Local Currency Long-Term Issuer Rating)	BBB- (from BB)	Stable (from Positive)

Rating Assignment Date: May 21, 2013

The aforementioned credit ratings are unsolicited. Rating definition is shown as "JCR's Rating Definitions" 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" (March 29, 2013) in Rating Policies on JCR's website (http://www.jcr.co.jp/english/).

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