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Press Release: Rating Action

JCR affirms BB ratings (FC/LC) on Turkey; Outlook Stable

Issuer: Republic of Turkey

<Description of Debts>

Issues	*Rating*	*Outlook*
FC (Foreign Currency Long-Term Senior Debts)	BB	Stable
LC (Local Currency Long-Term Senior Debts)	BB	Stable

JCR has affirmed its BB ratings on the Republic of Turkey's foreign and local currency long-term senior debts. The outlook of the ratings is stable.

The ratings primarily reflect the country's significantly improving fiscal position as compared with the one during its economic crisis in 2001 thanks to the structural reforms implemented by the Turkish government under its standby arrangement with the IMF as well as prudential fiscal and monetary policies carried out by the government, and the stability of the country's financial system which has similarly improved through the IMF-supported reforms. Backed by these factors, the Turkish economy displayed resilience to external shocks caused by the global financial crisis from late 2008 to early 2009, attaining a self-sustained recovery without relying on supports of the IMF. Meanwhile, the ratings are constrained by the structural instability of Turkey's external balance and resultant weakness in its foreign currency liquidity position.

The rating outlook is stable. The Turkish economy bottomed out in the first quarter of 2009, posting a double-digit growth in the first half of 2010 on recovery of consumer spending and corporate investment on top of recoupment of inventory investment which had substantially fallen in the previous year. The growth apparently decelerated in the second half of 2010 as exports slowed down and inventory investment returned to normal. On a full-year basis, the growth rate well exceeded an estimated 7% due in part to the high expansion in the first half. In 2011, the growth rate is expected to decelerate to the 4% level, given the tapering base effect and the continuing sluggishness of European economies, Turkey's major export destinations. The current account deficit decreased markedly in 2009 on a reduced trade deficit mainly brought by slower import and lower oil prices. However, it widened again as the economy picked up in 2010. Hence the foreign currency liquidity position deteriorated. Its future trends need to be watched.

On the political front, the referendum carried out in September 2010 resulted in a 58% voter support for the government's proposed constitutional amendment for reform of the judicial system. It is crucial for the government to materialize the favorable result of referendum to a greater political stability. JCR holds that in order for Turkey to make a sustainable economic development in the medium to long term the country needs to steadfastly implement its medium-term economic programs, inter alia a further improvement of the fiscal position, and its reforms aiming at EU membership and thereby maintain its political and social stability as well as international confidence on her.

(1) Macroeconomic trends

The Turkish economy had grown an average 6.9% per year in real GDP terms for five years until 2007. However, it decelerated sharply in 2008 as the impact of the global financial crisis rapidly spread to its real economy, being forced to contract 4.7% in 2009. The economy hit a rock bottom in the first quarter of 2009. On a quarterly basis, it posted double-digit growth rates in the first and second quarter of 2010 on recovery of consumer spending and corporate investment on top of recoupment of inventory investment which had substantially fallen in the previous year. The growth decelerated in the second half of 2010 as exports slowed down and inventory investment came back to normal. In fact, the growth rate slowed to 5.5% in the third quarter of the year. Nonetheless, the economy grew an estimated 7% or higher on a full-year basis due partly to a high expansion in the first half. JCR expects the growth rate to slow to the 4% level in 2011, when there will be no base effect and the European economies, Turkey's major export markets, will remain weak.

(2) Public finance and financial system

The government's fiscal position has significantly improved to this day as compared with the country's economic crisis in 2001. Much of the improvement came from the structural reforms and other efforts the government made under its standby arrangement with the IMF as well as prudential fiscal and monetary policies carried out by the government. The inflation rate which had exceeded 100% in 1994 fell to a single digit in 2004. This helped to slash the interest expenses/revenue ratio from 79.7% in 2001 to an estimated 19.6% in 2010. In 2009, the fiscal deficit to GDP ratio surged to 5.5% from 1.8% in the previous year due to the stimulus measures. As a result, the public debt/GDP ratio also rose to 45.5% in 2009 from 39.5% the year before. However, the ratio turned declining again to 41.5% in 2010 against the background of the high economic growth and the government's measures. The government should be able to keep its public debt position at a manageable level in the future, presuming the country's economic recovery.

The stability of the financial system has also been enhanced through the IMF-supported reforms. Banks that had run into management difficulties have been rebuilt or liquidated under the State Deposit Insurance Fund (SDIF). Twenty banks were initially placed under the SDIF, but only two out of those twenty banks remained placed as of the end of January 2011. The banking sector's nonperforming loan ratio declined to 3.7% at the end of 2010 from 12.1% at the end of 2001 right after the global financial crisis. The stability of the banking system has been strengthened, with its capital adequacy ratio kept high at 18.9%. Meanwhile, the privatization of state-owned banks which hold a substantial share in the banking sector remains to be seen. The banking sector is required to promote a greater deposit mobilization and financial intermediation to expedite the country's corporate investments, thereby bolstering sustainable economic development in the future.

(3) External balance

A concern on the Turkish economy in the recent years is the widening current account deficit due mainly to bigger trade deficits stemming from an expanded savings-investment gap. In 2009, the current account deficit narrowed substantially on a sharply reduced trade deficit brought by slower imports amid the plunge of oil prices and a steep economic downturn in the second half of 2008. However, in 2010 it was inevitable for the deficit to widen again as the trade deficit started to increase amid the economic recovery. The foreign exchange reserves swelled on increased capital inflows in 2010, but the short-term external debt grew at a faster pace. As a result, the foreign exchange reserves/short-term external debt coverage ratio further decreased in 2010 from 1.4 times at the end of 2009. With the current account deficit expected to keep increasing, the country needs to ensure a stable inflow of international capital centering on foreign direct investment (FDI). Its future developments need to be closely followed.

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The primary rating methods applied to the ratings are posted on JCR's website (http://www.jcr.co.jp) "Sovereign, Public Sector Entities and Multilateral Development Bank Rating Methodology." The rating methods are subject to change or addition. However, the changes and additions including those that have been made in the past are posted in chronological order. Please refer to the rating methods above after checking by comparing the date of press release about the ratings with the release date of the rating methods (effective date of each of such rating methods).