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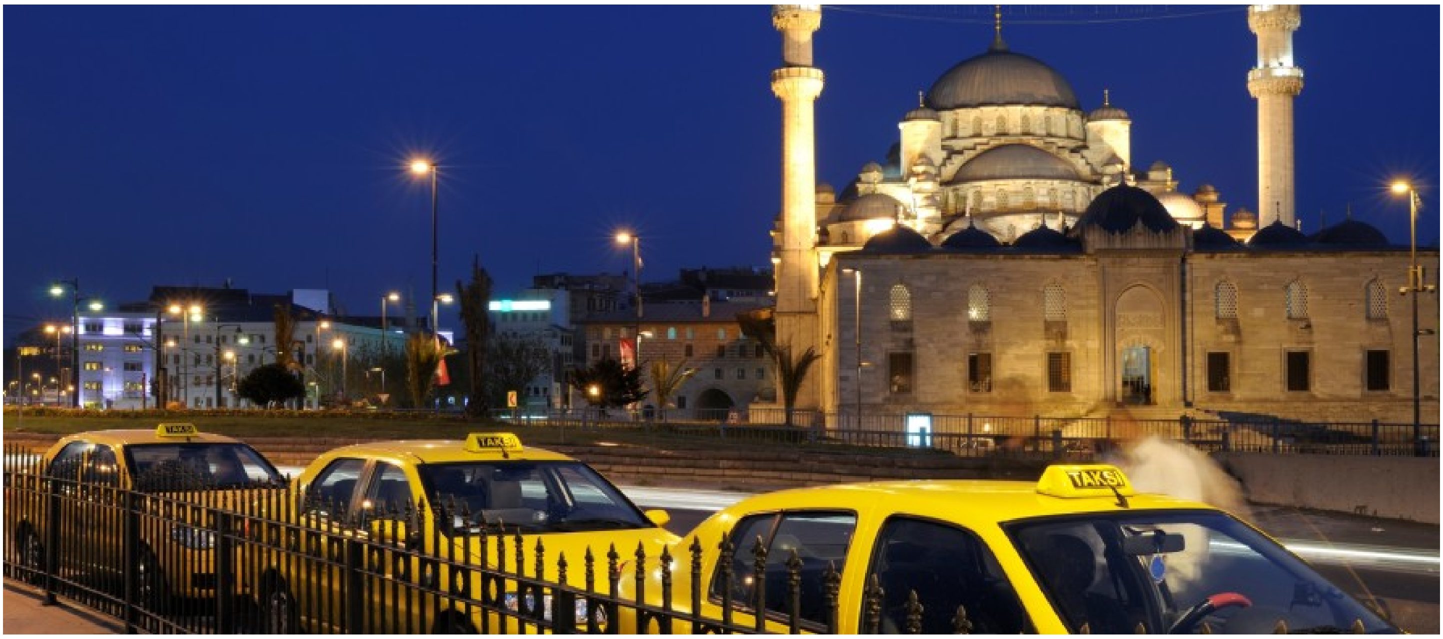
Strong Dollar and Turkey

Sevda Sarp



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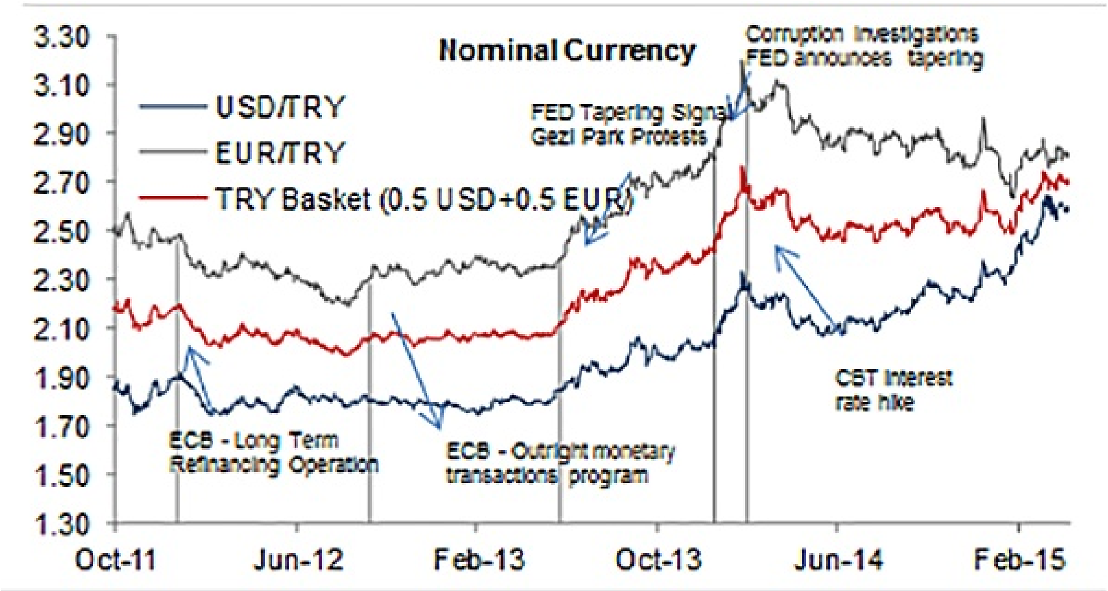
In Turkey, the impact of the currency fluctuations are being discussed and even an ordinary Turk on the street knows what it means for the currency to depreciate. For example, during a cab ride, you may have a very deep economic discussion with the taxi driver about the dollar and the Turkish lira. This is as a result of the crises Turks experienced in the past – unfortunately there was more than one! This in turn, has enabled Turks to have their guard up automatically to cope with the strong dollar and there is a dollar investment mechanism in every household immediately if they get a whiff of the depreciating Turkish lira. Corporates also got used to foreign currency fluctuations, but as an import and export oriented country, the depreciating lira has some negative implications on the corporates as well as economic indicators.

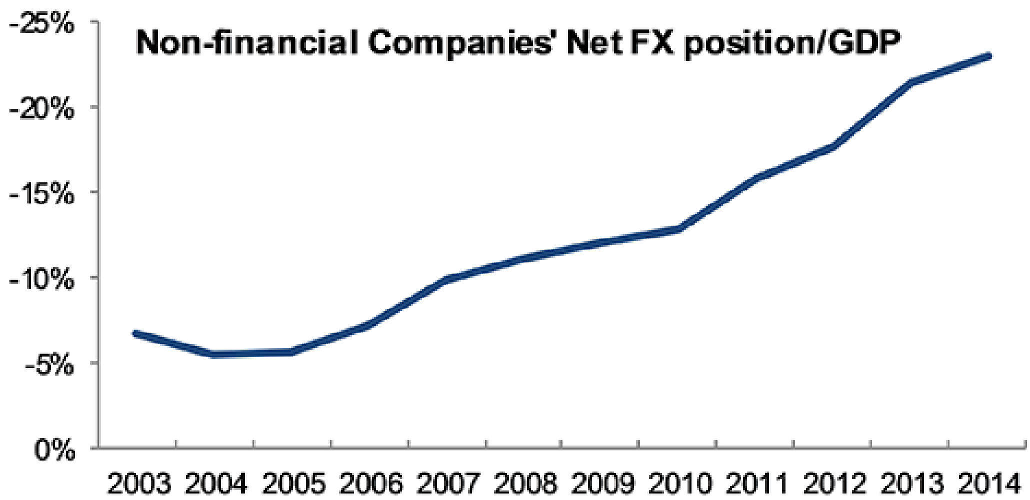
After quite a stable period the Turkish lira has started depreciating against the dollar since the final months of 2014 due to a combination of: i) President Recep Tayyip Erdogan's comments regarding the Central Bank of Turkey, ii) the ECB's quantitative easing program, iii) woes about Greece's exit from the EU and iv) the FED's rate hike expectations.



Source: CBT, Erste Asset Management

So far this year, the value of the Turkish lira slipped by 11% against the dollar and by 6% vs. the EM average. What does the strong dollar mean for the Turkish economy? The strong dollar affects households, the public sector and companies differently:

1. **Households:** In order to limit any negative impact at the micro level, regulators banned foreign currency lending on consumer loans in 2008, so the risks are limited in this area as consumers has no FX debt. Meanwhile, consumers have around USD 95bn in FC deposits (40% of the total), which actually implies that a strong dollar increases their wealth in Turkish lira terms.
2. **Financial Sector:** The Turkish Banking Sector does not have a meaning FX position and has the ability to pass on the interest rate changes to their prices. So the risk is limited in terms of currency impact, however, there is an indirect impact with the interest rates, but this is another topic for discussion.
3. **Corporates:** The corporate sector's indebtedness has increased as a result of foreign currency loans in the recent years. The currency mismatch on corporate balance sheets is around USD 180bn, but more than half of the debt is long term financial debt. That said, having an open position makes Turkish corporates vulnerable to the lira depreciation and may create some liquidity problems and also leads to a poor export performance.



Source: CBT, Erste Asset Management

At a first glance, one might think that the depreciation of the lira should be attractive for exporters. However, as a result of the changing dynamics of export driven industries and that they make around USD 180bn in intermediate goods, some producers have become dependent on imports, which in turn makes exports more expensive.

4. **Impact on macro-economic figures:** Turkey's dollar Debt to GDP hovers at around the 40% levels, which is relatively low when compared to peer group countries. However, it is the rollover of the short term debt and the current account

deficit which is hit by the strong dollar.
Around 64% of Turkish exports and 44% of imports are made in dollar terms. This means that a strong dollar makes the country’s exported goods expensive, while on the import side, companies pass on a depreciating Turkish lira to their imported goods. Meanwhile, given past experience, any default or restructuring risk is unlikely.
However, more importantly Turkey has an annual energy import bill of around USD 55bn, which is almost all of the Current Account Deficit. Plus, according to the Central Bank data, Turkey has almost a USD 184bn external financing need in 2015. Around USD 86bn of this amount belongs to private sector loans and history suggests that there shouldn’t be a major risk as it can be rolled over.

The lira may stabilize during 2Q15 with the dollar taking a breath. However, the economic data announced so far suggest that there might be some risks on inflation and growth putting pressure on the Central Bank of Turkey. This combined with election related tensions and a possible FED tightening could cause the lira to remain volatile for a little longer.

Sevda Sarp

Sevda Sarp joined Erste Asset Management in 2013, as a research analyst covering the financial sector. She worked for Erste Group since from 2011 to 2013 as a Senior Banking Analyst. Prior to that, she worked at UniCredit Istanbul and Ata Securities covering the Turkish banking and insurance sector, for a total of 6 years. Before becoming an equity analyst, she spent more than two years at Finanzbank and Deutsche Bank as a Financial Controller preparing financial reports, and was responsible for the consolidation of subsidiaries. Sevda holds an MSc degree in International Finance.