Turkey: sliding into a currency crisis[36]

Die Lage in der Türkei hat sich in den letzten Wochen verschlechtert, hauptsächlich aufgrund (1) des Konflikts mit den USA und der bereits verhängten, aber auch potenziell weiteren Sanktionen in diesem Zusammenhang, (2) der längere Zeit beobachtbaren Inaktivität der Zentralbank trotz der hohen Inflationsrate und sich verschlechternder Inflationsprognose. Seit den Wahlen am 24. Juni verloren Investoren zunehmend das Vertrauen in die türkische Wirtschaftspolitik und die Verunsicherung kulminierte zwischen 8. und 13. August in einer rapiden Abwertung der Lira (-30% versus USD) und einer Verschlechterung diverser Finanzmarktindikatoren.

In der Woche vom 13. August verabschiedeten die türkischen Behörden einige Maßnahmen, die zu einer Stabilisierung der Finanzmärkte beitrugen: Zentralbank und Aufsichtsbehörde setzten einige Erleichterungen für den Bankensektor um, insbesondere bezüglich der Liquidität und Kapitalausstattung des Sektors. Zudem gab die türkische Regierung bekannt, dass Qatar der Türkei 15 Mrd USD an Direktinvestitionen zugesichert hat und der türkische Finanzminister versprach in einem Call mit Investoren, keine Kapitalkontrollen einzuführen.

Trotz der derzeitigen Stabilisierung auf den Finanzmärkten bleibt die Situation angespannt. Instabilität auf den Finanzmärkten und ein Abzug von Kapital aus dem Ausland könnten in Kombination mit den seit langem bestehenden makroökonomischen Ungleichgewichten in der Türkei zu einer tieferen Krise führen. Insbesondere die Finanzierung des hohen Leistungsbilanzdefizits der Türkei (5,6% des BIP in 2017) könnte rasch zu einem Problem werden. Die türkische Zentralbank verfügt nur über geringe Nettoreserven, um hier gegenzusteuern. Auch die strukturellen Entwicklungen der letzten Jahre im Bankensektor sind bedenklich. Die türkischen Banken haben hohe Forderungen an türkische Unternehmen, auch in Fremdwährungen. Eine Wirtschaftskrise in der Türkei oder stark ansteigende Refinanzierungskosten (für Fremdwährungskredite im In- und Ausland und variabel verzinste Lira-Kredite) könnten zu einem raschen Anstieg notleidender Kredite führen. Dies wiederum würde den Bankensektor und die Wirtschaft in Mitleidenschaft ziehen. Der hohe Anteil an Fremdwährungskrediten auf den Bilanzen der Banken führt zudem dazu, dass sich eine Abwertung der Lira in sinkenden Kapitalquoten niederschlägt.

Die türkische Regierung lehnt derzeit eine Erhöhung der Zinsen, Kapitalkontrollen und Hilfe des IMF strikt ab und fokussiert auf alternative Maßnahmen. Die Situation ist volatil; eine Entschärfung des Konflikts mit den USA wäre ein wichtiger Schritt zur Stabilisierung der Lage - angesichts des hohen USD-Finanzierungsbedarfs und der starken Handelsbeziehungen zu den USA.

Die Situation in der Türkei könnte sich auch auf andere Märkte auswirken, Ansteckungseffekte der Türkeikrise auf die Finanzmärkte anderer Schwellenländer sind bislang in moderatem Ausmaß beobachtbar. Auch die EU ist betroffen: Die konsolidierten Auslandsforderungen des Bankensektors der Eurozone an die Türkei betragen zwar nur 1,6% der gesamten Auslandsforderungen, die Forderungen variieren jedoch stark je Land. Für den österreichischen Bankensektor beträgt der Anteil der Türkeiforderungen 2,1%. Ausgewählte Länder haben zudem über ihre Handelsbeziehungen und/ oder einen relativ hohen Anteil von Direktinvestitionen starke Verflechtungen mit der Türkei. Eine Krise in der Türkei würde sich auf diese Länder negativ auswirken.

Deterioration of financial market indicators and policy actions in August

Events in Turkey have taken a turn for the worse since the elections on June 24 and particularly since early August. In particular, the deterioration of relations with the United States and the inaction of the central bank have worried investors. Regarding the former, relations between the United States and Turkey have suffered, allegedly because Turkey has refused to release a U.S.

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pastor detained in Turkey. The United States have increased tariffs on aluminum imports to 20% and on steel imports to 50%, a measure with limited economic impact, but a strong signaling effect. Turkey has retaliated by increasing 22 tariffs on U.S. products, including cars, alcoholic beverages, cosmetics and tobacco. In addition to the deterioration of trade relations, markets became worried by the inaction of government authorities in response to accelerating inflation. The Turkish central bank failed to deliver a widely expected interest rate rise on June 24 despite the fact that it raised its inflation forecast sharply to 13.4% from 8.4% for 2018 and 9.3% from 6.5% for 2019 a week later. Inflation for July was reported at 15.9% (up from 15.4% in June). The deterioration in trade relations paired with the limited policy actions by the authorities led to strong financial market turmoil between August 9 and 13. Within this period the lira depreciated by 30% vs the USD, and 10-year government bond yields increased by 2.8 percentage points to 21.2%. The lira peaked at 7.24 versus the USD on August 13, but has recovered since. Table 1 shows the evolution of some important financial market indicators since August 1, 2018, and since the beginning of the year. It should be noted that there is still considerable volatility in the markets and these indicators could change rapidly.

Table 1

Latest developments of Turkish financial market indicators

	TRY vs USD	10y-government bond yield	10y-CDS-spread	EMBI+ stripped spread	Stock market index ISE30
	exchange rate	*in percent*	*in basis points*	*in basis points*	*Index value*
Value on 16 August 2018	5.8	20.3	488.5	518	107,372
1 August 2018	4.9	17.9	414	426	119,908
1 January 2018	3.8	11.4	198	288	142,112
%-change since 1 August	*17.9*	*13.5*	*18.1*	*21.6*	*−10.5*
% change year-to-date	*53.1*	*77.4*	*146.7*	*79.9*	*−24.4*

Source: Macrobond.

The authorities reacted late to the market turbulences with a first set of measures being announced only on August 13. As of August 16, the measures seemed to have halted the downward spiral of the lira and led to an appreciation to 5.8 versus the USD (-53% year-to-date). Given uncertainties around the financing of the high current account deficit, the government secured USD 15 billion in foreign direct investments from Qatar.

On August 13, the central bank reduced the reserve requirement ratios by 250 basis points for all reserve requirements in lira and by 400 basis points in selected maturity brackets for foreign currency (FX) requirements. The central bank stated that this should free liquidity for the banking sector amounting to TRY 10 billion, USD 6 billion and USD 3 billion-equivalent of gold liquidity. On August 6 the central bank had already lowered the upper limit of the FX maintenance facility within the reserve options mechanism to 40% from 45%.

The central bank also announced a number of measures in terms of TRY and FX liquidity management, aimed largely at improving the liquidity situation of Turkish banks.

On August 15, the Banking Regulation and Supervision Agency undertook several measures: Firstly, it increased the cost of borrowing lira to prevent increased short-selling, by cutting the value of currency swaps banks may hold on their books to 25% of their regulatory capital, from the previous limit of 50%. This effectively doubled the cost of borrowing lira, prompted short-sellers to retreat and alleviated the pressure on the lira. However, according to analysts the policy measure is contentious as it implies that banks are now restricted in using currency swaps as

hedges, as a result of which certain positions will remain unprotected. Secondly, regulators allowed banks to use the end-June exchange rate to calculate capital ratios given the rapid deterioration of capital ratios driven by the rise of (partially FX-denominated) asset prices relative to lira-based equity. Finally, the regulator also loosened the rules around loan restructurings.

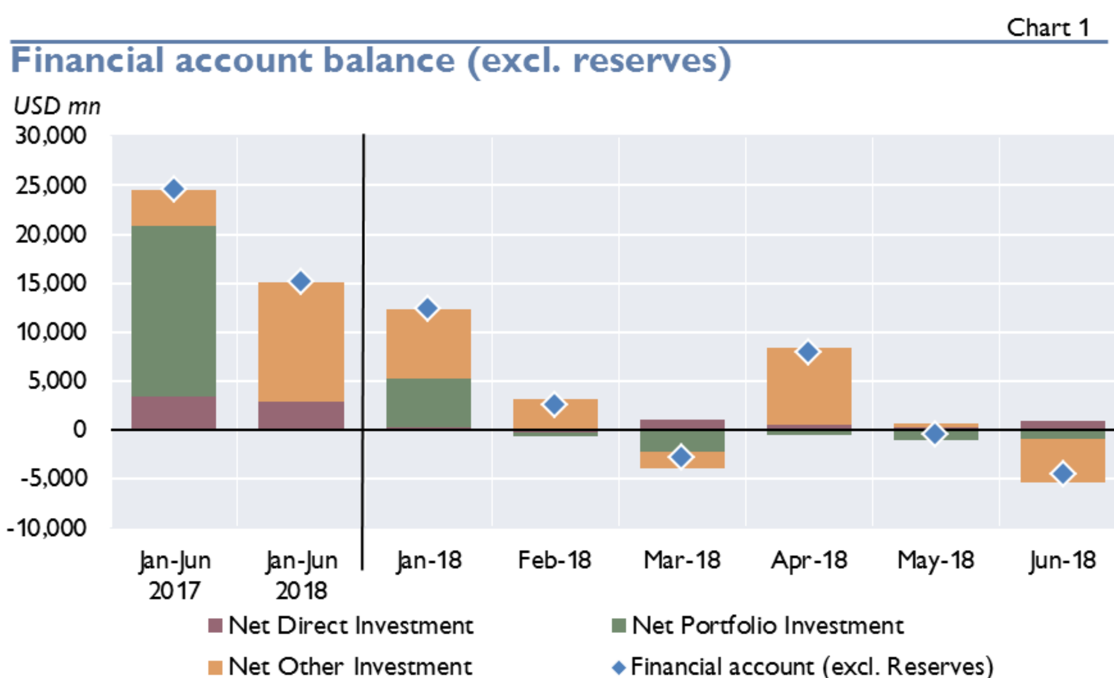
Underlying weaknesses in the balance of payments and banking sector remain

While the policy actions have halted the deterioration of financial market indicators, underlying weaknesses remain:

Balance of payments: Turkey's current account deficit stood at USD 31.2 billion for the first six months of 2018, sharply higher than USD 21.3 billion in the same period of 2017. On a positive note, the 12-month rolling deficit decreased mildly in June, to USD 57 billion (roughly 6.5% of 2017 GDP). This means that the deterioration of the Turkish current account has so far continued in 2018 – between 2016 and 2017 the deficit widened from 3.8% of GDP to 5.6% of GDP. Over the past years, Turkey's current account deficits were largely financed by portfolio inflows, which have however been negligible this year and have been largely replaced by net inflows from other investments, largely in the banking sector. Chart 1 shows this development for the first six months of 2017 and 2018. It also shows net financial outflows in May and June 2018. Given the current situation of severe uncertainty, it is likely that these outflows have increased since then.

Chart 1

Financial account balance (excl. reserves)



Note: Positive values are inflows, meaning net borrowing from abroad.
Source: Turkish Central Bank.

The situation is worsened by the fact that Turkey has a fairly low level of international reserves. Official reserve assets stood at USD 98 billion at the end of June, having decreased by 8% versus the previous month. It should be noted that reserves banks are required to hold account for more than half of these reserves, namely around USD 58 billion. Net of required reserves, the central bank's reserves amount to only roughly 2 months of Turkish imports, leaving very limited space to counteract balance of payments turbulences. This means that to avoid financing problems, Turkey needs to improve its current account balance or secure financial inflows.

External debt of the economy: In 2017 Turkish gross external debt continued to increase to 51.5% of GDP – the private sector accounts for roughly 80% of outstanding external debt, split

roughly equally between banks and nonfinancial corporations (NFCs). Thus, unlike during the banking crisis in 2000/2001, the main source of vulnerability is the private and not the public sector. A quarter of external debt is short-term debt, which points to considerable rollover needs.

According to Turkish central bank data, NFCs had a shortage of external assets over liabilities amounting to USD 223 billion in the first quarter of 2018, even though short-term positions seem to be largely covered. Unhedged borrowers are the most exposed to sudden defaults if the fall of the lira continues. But also borrowers with hedged positions will likely see the costs of the hedging increase if the high levels of uncertainty in financial markets continue to prevail. The combination of high rollover needs with increasing domestic and international borrowing costs could put additional pressure on some NFCs.

Banking sector: The banking sector looks much sounder today than before the banking crisis in 2000/2001. In 2017 the Turkish banking system had a return on assets of 1.6% in 2017, a relatively low cost-to-income ratio of 38%, a capital adequacy ratio (tier 1) of 13.6% and a nonperforming loans ratio of around 3%. However, there are some underlying weaknesses: Despite the seemingly high return on equity exceeding 11% over the past years, the IMF reported that the structure of returns had deteriorated and Turkish banks were on average not able to earn their cost of equity. In addition, over the past years banks substituted securities with loans to NFCs in foreign currency (FX). The loan-to-deposit ratio in the banking sector stood above 130% at end-2017. Funding for the very high credit growth in the domestic economy was raised at shorter maturities and also increasingly in FX. The replacement of longer-term bank debt securities with short-term funding has increased the maturity mismatch and liquidity risk in the sector.

A further sharp depreciation of the lira or other sources of increased refinancing risks for NFCs could lead to issues for the banking sector. If companies became unable to roll over their debt in FX or otherwise, nonperforming loans could increase sharply. A number of rating agencies have put Turkish banks and corporates on the watch-list. Analysts have also noted that the lira depreciation is having negative effects on banks' capital adequacy ratios. The move of the regulator to allow banks to calculate their capital ratios with end-June 2018 exchange rates therefore provides some temporary relief for the sector.

The outlook is highly uncertain

The measures announced in the week of August 13 seem to have calmed financial markets as of August 16, but the underlying weaknesses of the economy remain. President Erdogan remains firmly opposed to a domestic interest rate raise, which would most likely lead to repayment issues for some households and corporates and slow down economic growth. In addition, Finance Minister Albayrak stated in a call with investors that no capital controls would be imposed. He also stated that Turkey would not ask for an IMF bailout. Currently, it seems that the authorities are therefore using alternative measures: calming institutional investors, promising fiscal consolidation, attracting funding from allies such as Qatar and alleviating pressures on the banking sector. Resolving the dispute with the United States would be an important step in the current situation, given that the United States are one of Turkey's main trade partners (but not vice-versa) and Turkey's large USD financing needs.

Spillover effects could affect a variety of markets

Spillover effects from the Turkish economic woes could extend to a variety of geographic areas and industries depending on the degree of exposure towards Turkey. So far, spillover effects, e.g.

to emerging markets and some EU peripheral countries have been observed but they remained muted. While some countries, most notably Italy, Greece, Russia and Hungary showed certain increases in bond yields, these were to a large extent also affected by idiosyncratic factors of the specific countries. "Save" assets such as German long-term bonds recorded inflows and a fall in yields.

Table 2

10-year government bond yields

in percent	Portugal	Spain	Greece	Italy	Czech Republic	Poland	Hungary	Russia
Value on 16 August 2018	1.9	1.4	4.3	3.3	2.1	3.1	3.5	8.5
1 August 2018	1.8	1.5	4.0	2.9	2.2	3.2	3.3	7.7
Change in percentage points	0.1	−0.0	0.3	0.4	−0.0	−0.0	0.2	0.8

Source: Macrobond, National Central Banks.

While economic linkages to Turkey are moderate for the EU-28 overall, the exposures vary by countries. Bank stocks across Europe have fallen sharply by roughly 8% between July 31 and August 15 (as measured by the Stoxx Europe 600 Banks index).[37] According to data from the Bank for International Settlements (BIS) the banks of euro area reporting countries had a total exposure of EUR 137.6 billion to Turkey in Q1 2018 (1.6% of total consolidated foreign claims).[38]

Table 3

Foreign banking claims (consolidated data, outstanding at the end of Q1/2018)

	Vis-à-vis Turkey	Total	
Banking sector in	EUR billion	EUR billion	*% of total foreign claims*
AT[1)]	7,5	351,4	*2,1*
DE	11,1	1.785,4	*0,6*
ES	70,8	1.564,2	*4,5*
FR	30,8	2.698,0	*1,1*
IT[2)]	16,2	788,7	*2,1*
Euro area[3)]	137,6	8.863,2	*1,6*

Source: BIS, OeNB. With one exception (see footnote 1), the data on foreign claims reflect the ultimate risk of the respective "domestic banks" (i.e. domestically owned banks).

[1)] AT claims against Turkey: Claims of "all banks resident in Austria"; i.e. including Deniz Bank in particular (Therefore, these claims are included in the sum total of all foreign AT claims as well as in the sum total of all euro area banks.)

[2)] IT: The data on the exposures of Italian banks do not include the pro rata exposure resulting from the 40% minority interest of UniCredit in Yapi-Kredi (totaling at least EUR 30 billion).

[3)] Euro area: The data for the euro area include data for AT, BE, DE, ES, FI, FR, GR, IE, IT, NL and PT. The exposure of Greek banks to Turkey has been rather low since the National Bank of Greece (NBG) sold the Turkish subsidiary Finansbank to the Qatar National Bank in early 2016.

[37] It should be noted that the index has been falling gradually over the entire year and is overall down by 17% year-to-date.

[38] See Table 3. Foreign claims are defined as the sum of cross-border claims plus foreign offices' local claims in all currencies. In the euro area reporting countries include only Austria, Belgium, Germany, Spain, Finland, France, Greece, Ireland, Italy, Netherlands and Portugal.

EU countries with highest trade exposures

Country	Exports to Turkey in percent of total exports	Imports from Turkey in percent of total imports
Bulgaria	8.0	6.2
Greece	5.4	3.2
Romania	3.2	3.8
Italy	2.3	2.0
Spain	2.0	1.9
Hungary	1.9	0.9
Germany	1.9	1.6
Poland	1.6	1.6
France	1.6	1.4
Austria	1.0	1.1
United States	0.6	0.4

Source: OECD.

Turkey has strong linkages to the EU-28 in terms of trade. In 2017, the share of the EU-28 in Turkey's total imports and exports was 36% and 47%, respectively. The value of imports from the EU-28 was USD 85.2 billion in 2017 and the value of exports USD 73.9 billion. Turkey's top five trading partners in terms of imports were China (10% of total imports), Germany (9%), Russia (8%), U.S.A. (5%) and Italy (5%) and in terms of exports Germany (10%), U.K. (6%), UAE (6%), Iraq (6%) and USA (6%).

For the EU-28 the exposures towards Turkey are overall limited: Turkey's export and import volumes made up around 4% to 5% of total extra-EU trade in 2017. However, some EU countries have more significant exposures and could be affected more severely by a downturn in Turkey. Table 4 (top rows) shows the EU countries with the highest trade exposure vis-à-vis Turkey in 2016, led by Bulgaria, Greece and Romania. Austria (at the bottom of the table) has a rather low exposure of around 1%. Austria and Turkey are not among each other's top 20 trading partners in terms of imports or exports. For the United States, trade volumes with Turkey are rather small, but the U.S. are among Turkey's top five trading partners. U.S. sanctions therefore have the potential to damage the Turkish economy much more severely than the other way around.

Europe also accounts for roughly 75% of the entire foreign direct investment (equity capital) stock in Turkey. The exposures are highest in absolute terms for the Netherlands (a popular location for holding companies and special purpose vehicles), Germany, Russia, Spain, UK and Luxemburg. Outside of Europe, the countries with the highest FDI stocks are the United States, Azerbaijan, Qatar and United Arab Emirates.