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## IIRA Improves Outlook on Sovereign Ratings of Republic of Turkey

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**Manama, February 28, 2020**—The Islamic International Rating Agency (IIRA) has reaffirmed the long term and short term foreign currency ratings of Republic of Turkey ('Turkey' or 'the Country') at 'BBB- /A3' (Triple B Minus / Single A Three) and local currency ratings at 'BBB/A3' (Triple B/ Single A Three), on the international scale. National Scale ratings remain outstanding at 'AAA (tr)/ A1+ (tr)' (Triple A/Single A One Plus). Outlook on the ratings has been improved to 'Stable'.

The assigned ratings are reflective of Turkey's demonstrated economic resilience, sustained fiscal discipline and a well-developed social and physical infrastructure. Turkey has just emerged from a phase of contraction in the economy, marked by high inflation and following sharp depreciation of the local currency in mid August '18. In recent months, inflation has been reined in, and interest rates have normalized providing impetus to economic growth. The economy is on the path of recovery with a 0.9% GDP growth during 2019 and IIRA's expectation of 4% growth in 2020; however, unemployment remains a challenge as well as headwinds in terms of a dimmer global growth outlook arising from rising trade protectionism, fallout from shifting geopolitical dynamics and unpredictable disruptions to global business. A health emergency outbreak in early 2020, may also have implications, given the indirect effects of expected slowdown in international trade and tourism.

Against the backdrop of slackened economic activity, a significant reversal in current account balance emerged during the first three quarters of 2019, with mild growth in exports and a sharp reduction in imports. The current account is expected to post a full year balance of 0.1% of GDP, which is likely to move into a gold adjusted deficit of under 3% of GDP during 2020, as per IIRA's forecast, and as economic growth picks up, driving up imports. Tourism revenues remain substantial in relation to current account receipts and have been gaining strength since 2017, reaching their highest level in 2019 in more than a decade. While targeted to increase further over the next few years as per national strategy, tourism revenues may be faced with headwinds during the current year, with global health risks looming.

To prop up receding growth levels, the government had increased its spending during 2019, which is expected to continue in 2020. The cost of the fiscal stimulus in addition to lower growth in tax revenues and the higher cost of indebtedness has pushed the fiscal deficit to -2.9% of GDP during 2019, against a budgeted deficit of -2.0%. The deficit is budgeted to remain in similar range in 2020 with continued higher spending and moderate revenue growth, despite the expected off-take in economic activity. The upside from reduced interest rates may neutralize potential pressures on revenue growth.

Turkey's EU defined general government debt stock level increased to TL 1,329b by end 2019 (end-2018:TL 1,067b). While external debt has remained range bound since 2017, its share in terms of GDP has increased during the first three quarters of 2019. We see some deleveraging in the private sector, starting from 2018 and continuing for the larger part of 2019. Nevertheless, the high level of foreign currency indebtedness in the private, non-financial sector, remains a concern.

While pressures on the banking sector are heightened in the face of rising non-performance, the extent of asset losses is expected to remain range bound and neutralize over the next few years as loan growth resumes. Stability indicators including capitalization and liquidity continue to suggest the presence of

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adequate safeguards. The risk of further escalation in the banking sector risks is considered limited at present with recent policy response having been sufficient to reinforce buffers to withstand recent losses.

### **Outlook**

IIRA has improved the outlook on the outstanding ratings to 'Stable' based on the above mentioned factors. Ratings may be upgraded if:

- a. Turkey achieves long term potential growth of 5% as forecasted, while maintaining current account deficit below 2.5% of GDP,
- b. Unemployment falls to below 10%.
- c. Disinflation continues in line with targets set, with no material volatility in interim periods,

Ratings may be viewed to be under downward pressure in case of:

- a. Significant deviation from inflation targets
- b. Any external shock adversely affecting economic recovery
- c. Material deterioration in banking sector stability indicators

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