

VAKIFBANK TURKISH ECONOMY WEEKLY

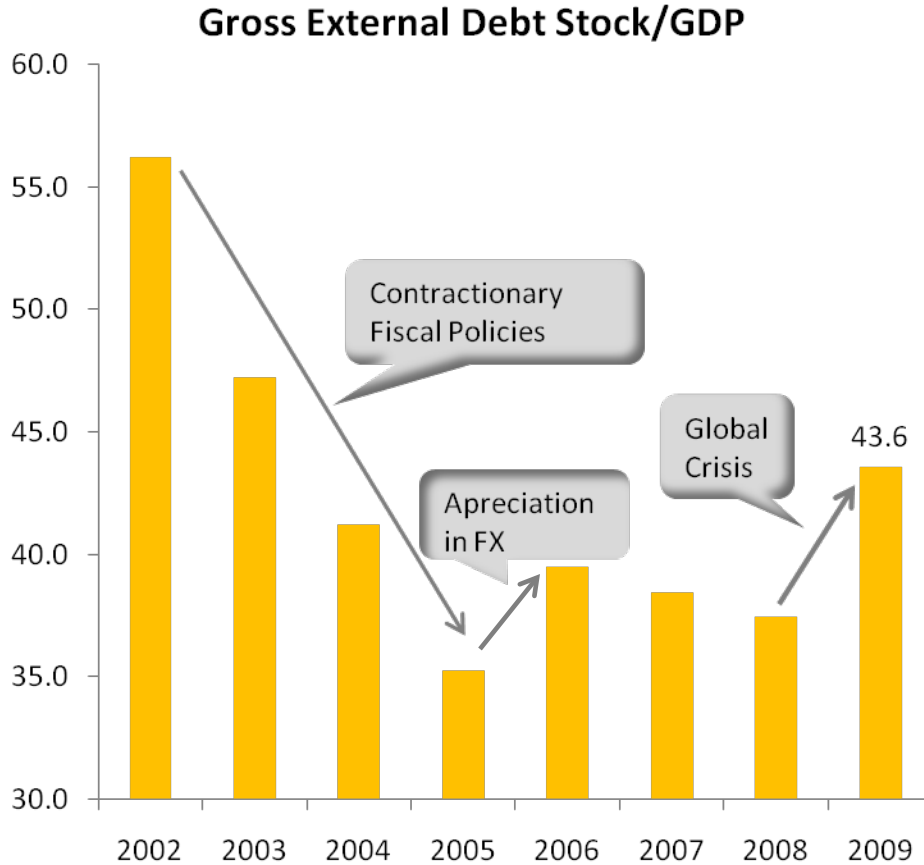
How risky external debt for
the real economy?



T. Vakıflar Bankası T.A.O



Improvement in the external debt/GDP ratio enabled strong public sector outlook...

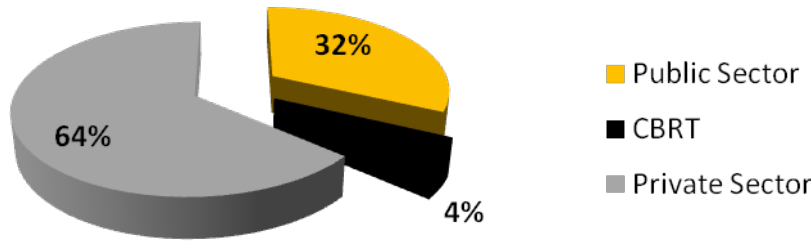


Source: Undersecretariat of Treasury

- ✔ Total external debt to GDP ratio is used for measuring the overall credibility of a country.
- ✔ In Turkey this ratio which was 56% in 2002 began to decline with the help of contractionary fiscal policies and high growth performance.
- ✔ The total external debt to GDP ratio was 37.5% and 43.6% in 2008 and 2009 respectively.
- ✔ These figures implied a relative discipline in public finance and supported the decent post crisis outlook of Turkish economy, against the serious debt problems of some Eurozone countries.

Gross external debt reached \$282.3 billion in Q3 2010...

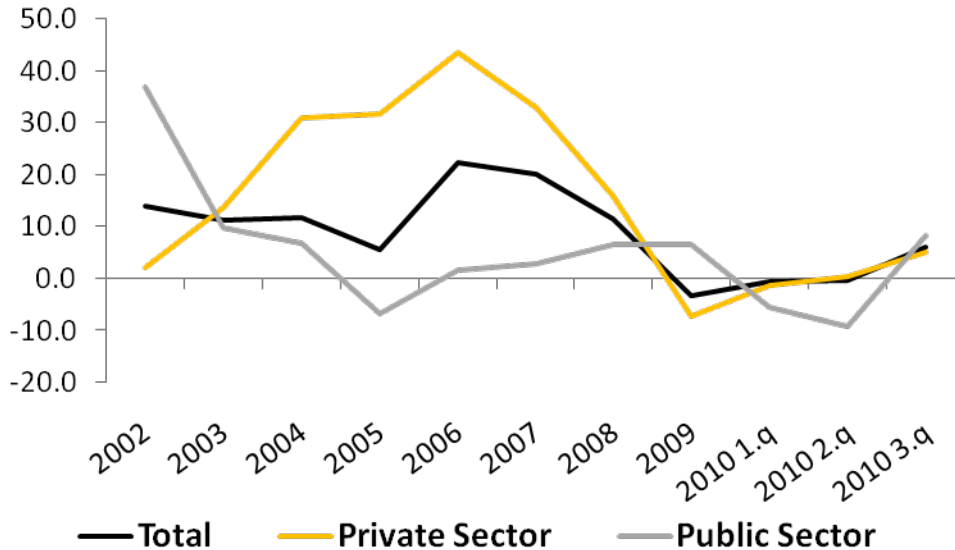
Gross External Debt of Turkey - by Borrowers (%)



Source: Undersecretariat of Treasury

V Public sector share in gross external debt is 32% and CBRT share is 4%, while the private sector has the highest share with 64%.

% Change in Gross External Debt

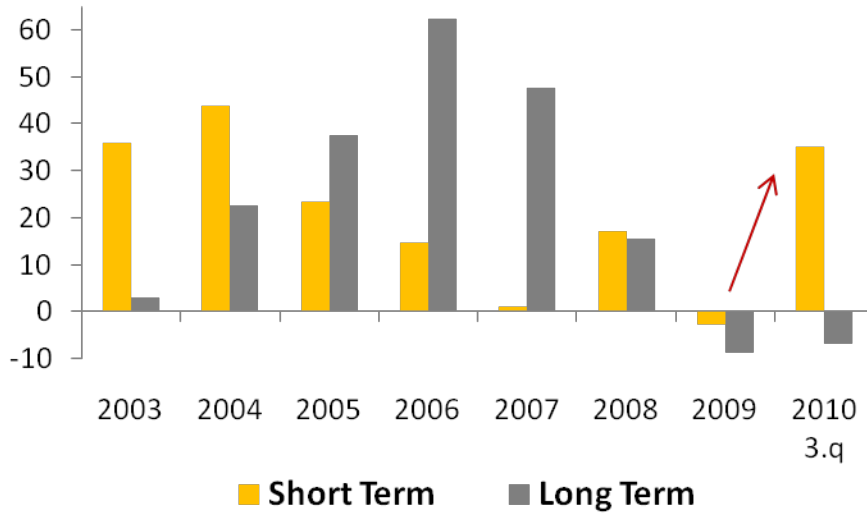


Source: Undersecretariat of Treasury

V Private sector external debt which decreased since 2006 began to rise after 2009 and public sector external debt sharply increased in the third quarter of 2010.

Short term private sector debt stock increased in 2010 ...

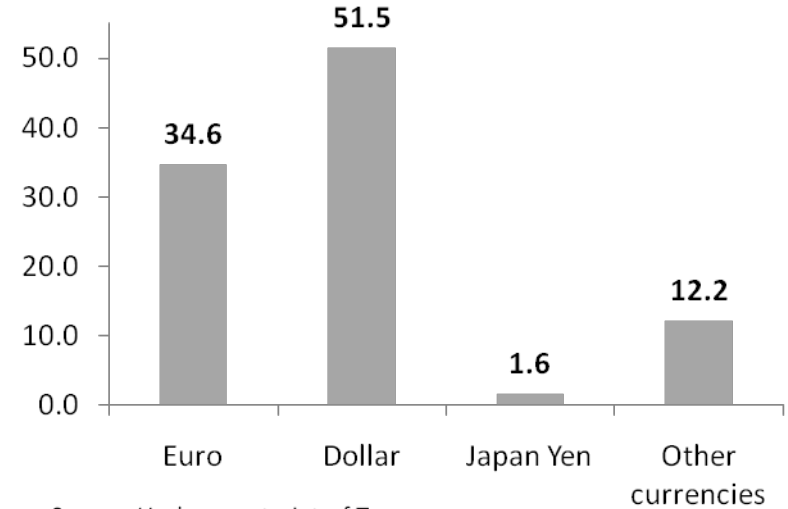
Yearly % Change in Private Sector External Debt by Maturity



Source: Undersecretariat of Treasury

- Long term debts constitute 75% of private sector external debts and increase since 2005. However, long term debt share declined to 66% with the increase in the short term external sources of funds.
- Private sector short term debt rose 35% in 2010.

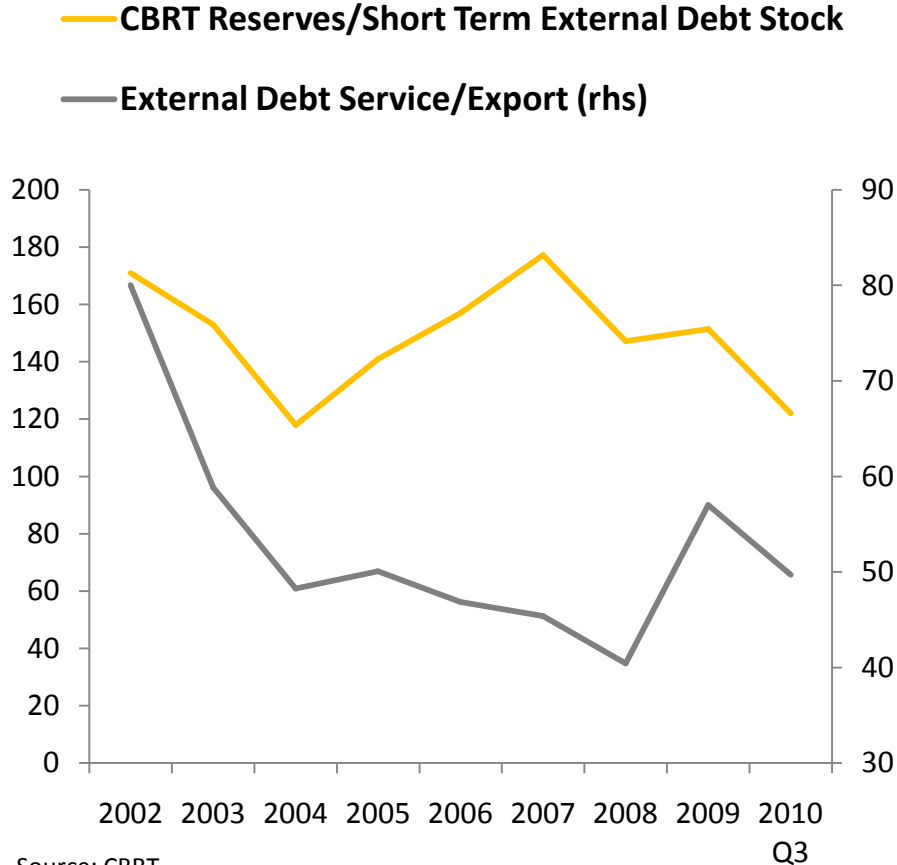
Currency Composition of External Debt (%)



Source: Undersecretariat of Treasury

- Share of dollar, euro and yen debts are 51%, 35% and 2% respectively.
- In Q3 2010, while euro debts decreased 1%, dollar denominated debts increased 2.5% and Japanese yen debts rose 16.5% compared to Q3 2009.

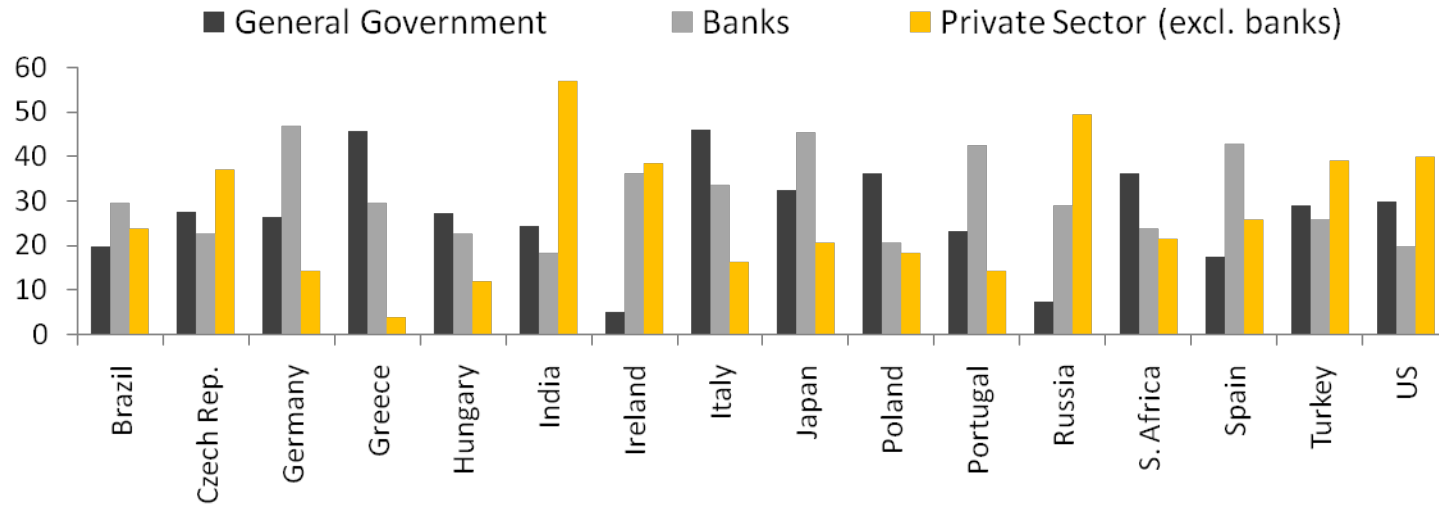
Measuring risk and borrowing structure are important for external debt sustainability framework...



- External debt service/export ratio is an important indicator about a country's external debt payment strength.
- Latest data (Q3 2010) which is 49.7% implies that about half of the export revenues is spent on foreign debt and interest payments.
- A rapid increase in this ratio might have a significant negative effect on investments, capital accumulation and growth performance.
- In addition a rapid rise is seen in private sector debt recently. Private sector debt to export ratio which is 161.3% by Q3 2010 is signaling rising short term risks.
- Moreover, CBRT reserves/short term external debt stock ratio which declined to 122% in Q3 2010 supports this scenario.

On a global scale there isn't a significant increase in private external debt...

Gross External Debt Shares of Sectors (2010 Q3, %)

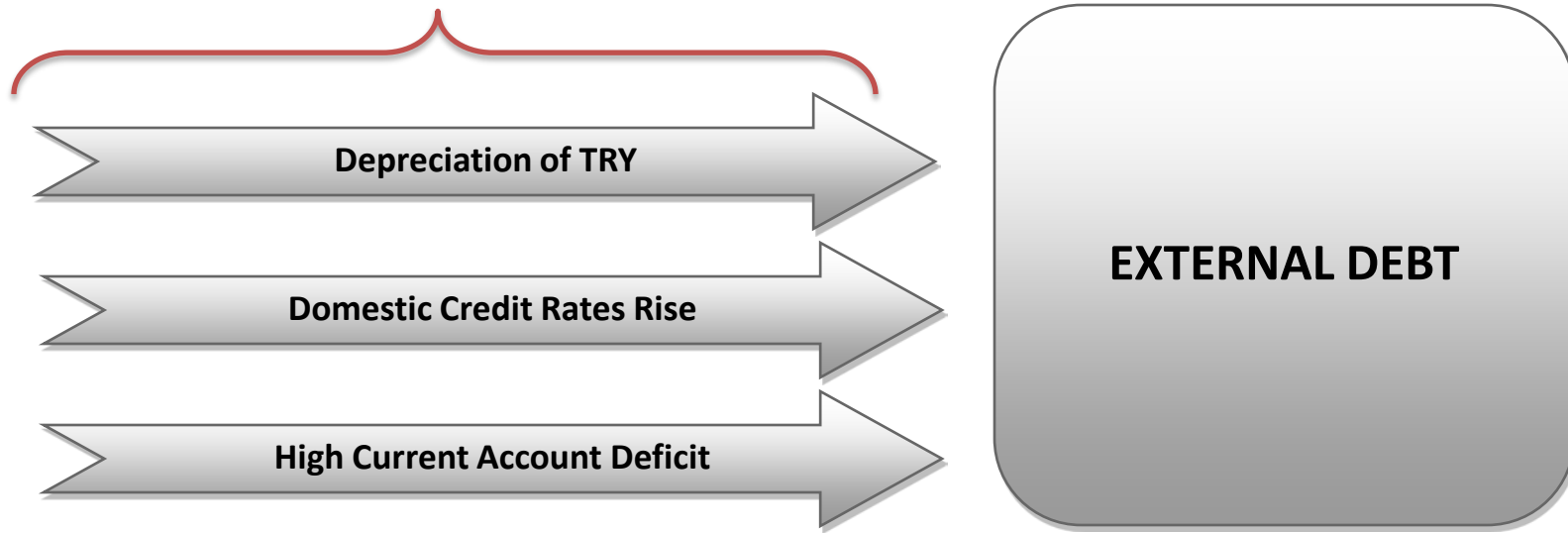





Source: World Bank

- ✔ In advanced economies the share of the private sector external debt in total external debt has decreased to a certain extent by Q3 2010 compared to 2007, but still close to the pre crisis levels as a result of the high private sector leverage ratios.
- ✔ In emerging economies the increase in the share of private sector external debt in total external debt was much evident due to the higher growth performance.
- ✔ The share of the external debt of the banking sector has also increased in both country groups: in advanced economies as a result of higher financing needs induced by the financial sector vulnerabilities and in emerging economies as a result of strong economic activity and increasing net capital inflows.
- ✔ The increase in private external debt doesn't bode too much risk for the moment but the current trend might cause higher vulnerabilities in the coming periods.

The correlation between exchange rate and external debt is high...

Risks on Private Sector External Debt



-  *CBRT cut policy rate with the hope of reducing short term capital inflows, and weakening the TRY. Possible depreciation in TRY may increase debt burden.*
-  *We modeled the relationship between exchange rate and external debt. According to our estimates, %1 increase in exchange rate rises private sector external debt by 0.8% after three periods. Also we find high correlation (%72) between these two variables.*
-  *The credit rate increases due to recent reserve requirement hikes might encourage Turkish companies to seek more external debt.*

Conclusion...

- ✔ The strong growth performance of Turkish economy notwithstanding the interruption of global crisis and the discipline in the public finances has considerably diminished the risks arising from the external debt.*
- ✔ The external debt to GDP ratio declined below the EU criteria drawing a much stronger outlook than many advanced economies.*
- ✔ In the mean time a number of structural changes appeared in Turkish economy. The increasing saving propensity of public sector decreased its contribution to C/A deficit while the import oriented growth performance of the corporate sector with a wide savings gap accelerated C/A deficit.*
- ✔ CBT's recent rate cuts intending to decrease the C/A deficit might induce further depreciation of TL renders the level of external debt stock more important.*
- ✔ In line with our expectation, our analysis demonstrated that the correlation of the exchange rate and the external debt stock is high and that the probable sharp rises in the exchange rate might increase the debt stock further.*
- ✔ Depreciation of TL is expected to have a positive effect on exports, but in the face of the prevailing dependence of exports to imports in Turkey, this positive effect might take a long time.*
- ✔ However the negative effects of the exchange rate depreciation on the debt stock might appear sooner.*
- ✔ Specifically, companies which have incomes in TL might have difficulty in external debt servicing.*

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