Republic of Türkiye
Rating Report

B- NEGATIVE OUTLOOK

Credit strengths

- Moderate levels of public debt
- Resilient banking system
- Large and diversified economy
- Comparatively high potential growth

Credit challenges

- Record of unorthodox policies, persistently high inflation
- Elevated external-sector vulnerabilities
- Institutional challenges, high geopolitical risks

Rating rationale:

Moderate levels of public debt: General government debt follows a rising trend but remains below that of most peers, affording the government fiscal space and time to cushion accommodative fiscal policies.

Resilient banking system: Local banks remain adequately capitalised and the non-performing loan ratio is low. The resilience of the banking system, however, is challenged by the sovereign drawing on its resources via unorthodox policies, which weaken private sector balance sheets.

Large and diversified economy with comparatively high potential growth: Türkiye's diversified economy has a solid medium-run growth potential, supported by its customs union with the European Union, a diversification of trading partners, and favourable demographic trends.

Rating challenges include: i) central bank and structural economic policies that are inconsistent with the economy's long-run sustainability, including still too loose monetary policy, persistently high inflation, negative net foreign assets of the central bank, and elevated foreign-currency exposure; ii) elevated external-sector vulnerabilities, including current-account deficits, significant exposures to lira depreciation, periods of capital outflows, and inadequate international reserves; and iii) institutional challenges amid municipal elections in March 2024 and high geopolitical risks.

Türkiye's sovereign rating drivers

Risk pillars		Quantitative		Reserve currency	Qualitative*	Final rating (foreign currency)	Final rating (local currency)
		Weight	Indicative rating	Notches	Notches		
Domestic Economic Risk		35%	bbb	TRY [+0]	-2/3	B-	B
Public Finance Risk		20%	a-		-3/3		
External Economic Risk		10%	ccc		-3/3		
Financial Stability Risk		10%	aaa		-2/3		
ESG Risk	Environmental Factors	5%	b		-1/3		
	Social Factors	7.5%	a-		0		
	Governance Factors	12.5%	c		-1/3		
Indicative outcome			bbb-		-3		
Additional considerations						-3	-2

Note: *The qualitative scorecard adjustments, capped at one notch per rating pillar, are weighted equally with an aggregate adjustment rounded to the nearest integer. The reserve-currency adjustment applies to currencies in the IMF's SDR basket. For details, please see Scope's 'Sovereign Ratings' methodology. The rating committee approved an implied CVS rating of 'bbb-'. Source: Scope Ratings. *For Türkiye, an extraordinary two-notch downside adjustment is applied across of foreign- and local-currency long-term ratings to account for significant weaknesses in macro-financial management and high economic imbalances. A further one-notch downside adjustment is applied for foreign-currency issuer and senior unsecured long-term ratings to account for high balance of payment risks.

Outlook and rating triggers

The Negative Outlook represents our view that risks to the ratings are tilted to the downside over the next 12-18 months.

Positive rating-change drivers

- Continuity in policy normalisation, enhancing durably predictability and effectiveness of public policies
- Significant reduction of external vulnerabilities, for example via sustained improvement in net reserves

Negative rating-change drivers

- Macroeconomic instability due to deterioration in external accounts and curtailed resilience of the banking sector
- Further decline in policy predictability and effectiveness
- Severe stress in political, security conditions, and/or international relations

Ratings and Outlook

Foreign currency

Long-term issuer rating	B-/Negative
Senior unsecured debt	B-/Negative
Short-term issuer rating	S-4/Stable

Local currency

Long-term issuer rating	B/Negative
Senior unsecured debt	B/Negative
Short-term issuer rating	S-4/Stable

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Bloomberg: RESP SCOP

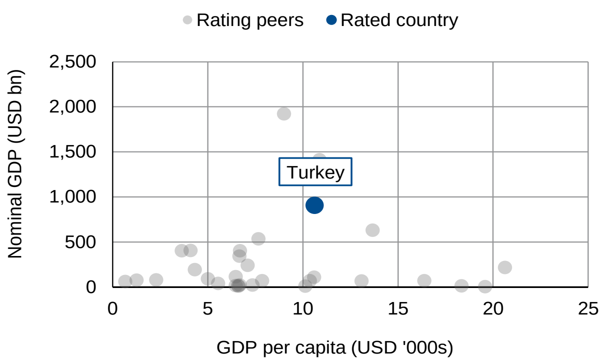
Domestic Economic Risks

- **Growth outlook:** Real GDP growth is expected to decline to 3.0% in 2023, from 5.6% in 2022, despite credit and fiscal stimulus introduced ahead of general elections, with lira lending growing by 82% YoY on average in H1 2023. Lower growth reflects the adverse consequences of the February earthquake in a region generating around 10% of GDP, structural constraints given the record of unorthodox economic policies, and widening long-run imbalances in the economy including persistently high inflation. Moreover, policy normalisation initiated post-elections, in the form of monetary tightening, lira depreciation, and simplification of prudential framework, is expected to weigh on domestic demand. But the reconstruction efforts in the earthquake region will boost domestic economic activity thanks to foreign aid and large multiplier effects. GDP growth may pick up modestly to 3.3% in 2024 and then hover around a below-potential growth rate of 3.5%.
- **Inflation and monetary policy:** Following the elections in May, the central bank has raised its one-week repo auction rate by 900 basis points, from 8.5% to 17.5%, its highest level since September 2021. Still, real policy rates remain negative around minus 20% given persistently high inflation. Although inflation declined to 38.1% YoY in June 2023, from 85.9% in October 2022, thanks to base effects and lower energy prices, price pressure will remain severe given the revalorisation of the minimum wages and pensions; the rise in tax and regulated prices; the lira depreciation feeding-through domestic prices via a higher import bill; and a potential unsterilised compensation by the central bank for losses related to foreign-currency protected deposit accounts. Over the medium term, a significant reduction in inflation towards the central-bank target of 5% is challenged by President Erdoğan's stated preference for low interest rates.
- **Labour markets:** Comparatively low rate of labour force participation (53.6% in May 2023) and employment (48.5%) remain important constraints on the medium-run economic outlook. The unemployment rate declined to 8.8% as of May 2023, from more than 11% as of end-2021, although it remains significantly higher, at 17%, for people aged 15-24. Moreover, the near-term economic slowdown and structural vulnerabilities constraint a further material reduction in unemployment. Still, Türkiye displays favourable demographic trends compared to peers, with growing population and moderate albeit rising old-age dependency ratio.

Overview of Scope's qualitative assessments for Türkiye's *Domestic Economic Risks*

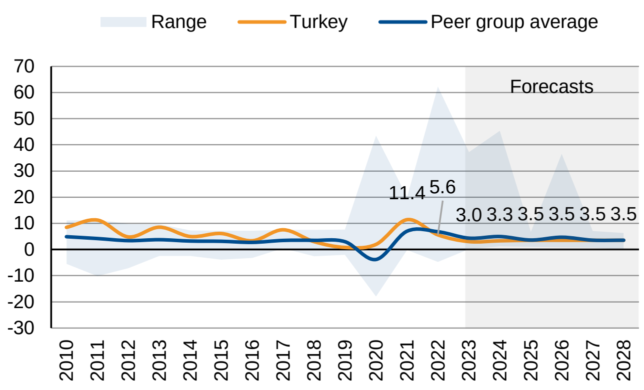
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bbb	Growth potential of the economy	Neutral	0	Robust growth potential, but constraints given large economic imbalances; record of unorthodox policies
	Monetary policy framework	Weak	-1/3	Monetary-policy undermined by frequent changes in central-bank governance; weak policy credibility, independence, and effectiveness
	Macro-economic stability and sustainability	Weak	-1/3	Large and diversified economy; however, significant macroeconomic imbalances including high inflation and low labour-force participation

Nominal GDP and GDP per capita



Source: IMF, Scope Ratings

Real GDP growth, %



Source: IMF, Scope Ratings

Public Finance Risks

- **Fiscal outlook:** The general government deficit is forecasted at 5.7% of GDP in 2023, below the 3.2% deficit in 2022. The budgetary outlook is negatively impacted by lower GDP growth, sizeable support measures to the earthquake-hit areas, and pre-elections accommodative fiscal stance, notably through the early retirement plan and the revalorisation of wage and pension payments. As of end-June 2023, the cumulative deficit reached a record high of TRY 500bn or around 2.6% of GDP, against a surplus of TRY 97bn last year. Although the authorities announced a return to a more prudent fiscal policy post-elections, by raising and introducing new taxes, including the VAT on certain products, a more accommodative stance, easing the near-term cost of policy normalisation, as well as additional spending to mitigate the consequences of the February earthquake, cloud the fiscal outlook.

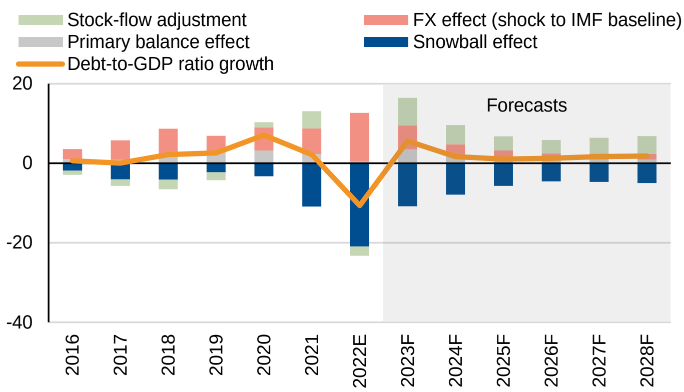
- **Debt trajectory:** Moderate levels of government debt represent a credit strength and provide comfortable fiscal space to the government. General government debt-to-GDP is projected at 37% of GDP in 2023 as the positive impact of high inflation is reduced by the devaluation of the lira amid high dollarisation of government liabilities. The government debt trajectory is exposed to exchange rate movements and valuation effects, with around half of total debt denominated in foreign-currency, mostly USD and EUR, up from 28% as of mid-2013. In the long run, we expect a slightly rising debt trajectory to 44% of GDP by 2028, driven by moderate GDP growth, sustained fiscal deficits, and a steady weakening of the lira amid upward pressure on interest rates.

- **Debt profile and market access:** The central government debt had an average time to maturity of 5.4 years as of May 2023, up from 5.1 years in 2020. This is, however, below pre-crisis values, which averaged 6.2 years over 2016-2019. More than 99% of the government's USD 100bn domestic debt is held by the resident sector, a sharp rise from around 80% as of late 2017, following successive exits of international investors from local debt capital markets. The banking system alone holds about 76% of the government domestic debt with a further 6.5% held by the central bank. The government's increasing reliance on domestic banks for funding represents a contingent liability risk if, in the event of a loss of depositor confidence or banks facing restricted access to external funding, it is called upon to inject significant amounts of capital into the banking system.

Overview of Scope's qualitative assessments for Türkiye's *Public Finance Risks*

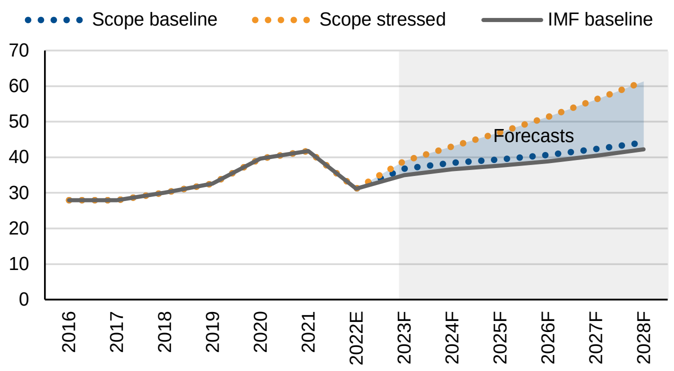
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a-	Fiscal policy framework	Weak	-1/3	Spillovers from unconventional policies, persistent accommodative stance, including wage and pension revalorisation
	Debt sustainability	Weak	-1/3	Public-debt trajectory highly exposed to lira depreciation under adverse scenarios
	Debt profile and market access	Weak	-1/3	Developed domestic capital markets but elevated FX exposure in liabilities, high financing costs, constrained access to bilateral, multilateral sources

Contributions to changes in debt levels, pps of GDP



Source: IMF WEO, Scope Ratings forecasts

Debt-to-GDP forecasts, % of GDP



Source: IMF WEO, Scope Ratings forecasts

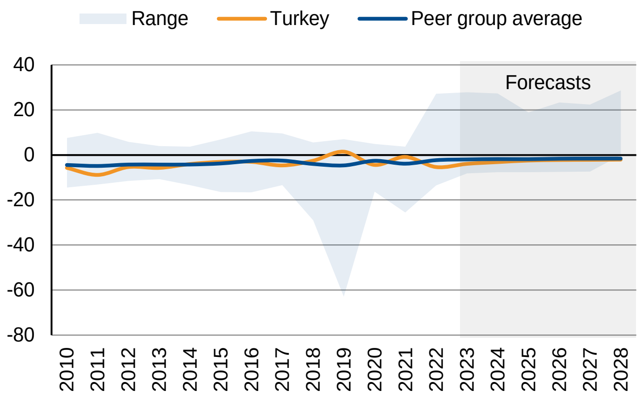
External Economic Risks

- **Current account:** The current account deficit is projected to widen to USD 55bn this year, or 5.7% of GDP, compared to USD 48bn or 5.4% of GDP in 2022. The deficit remains large relative to historical performance, around USD 26bn on average since 2000, reflecting a higher energy-import bill and expansionary economic policies. Energy imports are projected at around USD 60-70bn in 2023, down from USD 97bn last year, while the trade balance also benefits from the rebound in tourism receipts. However, the import bill will be negatively impacted by the lira depreciation and the surge in net gold imports, to an estimated USD 25-30bn this year, up from USD 20bn last year, acting as a hedge against inflation and policy uncertainty. Financial inflows from unknown origins, in the form of net errors and omissions, funded almost 30% of the current account deficit in 2022, underscoring risk of pressure on international reserves.
- **External position:** Türkiye's external position is a credit weakness. External debt repayments amount to around USD 221bn in 2023, including USD 166bn for short-term debt, which is 153% of the central bank gross official reserves as of end-June. As central government debt is exclusively long-term, short-term external payments are mostly owed by non-financial institutions (33% of total) and local banks (39%). Turkish banks and corporates managed to secure foreign financing in the past and rolled over most of their external debt even during the 2018 lira crisis. Nonetheless, refinancing risks have increased due to strong sovereign-banking nexus, tighter funding conditions, and lira depreciation.
- **Resilience to shocks:** Türkiye's net international reserves remain inadequate, highlighting the volatility of the lira losing around 30% of its value against the US dollar since end-2022. Gross official reserves including gold stand at USD 108.6bn as of end-June 2023 (USD 113.6bn as of mid-July), below the 2022 peak of USD 128.7bn as of December 2022. While these reserves cover about 68% of short-term external debt, it remains below international adequacy thresholds. The central bank runs a significant net foreign liability position, at minus USD 60bn in June 2023, against a record-low of minus USD 73bn in May. More than half of banks' USD 74bn foreign-currency liquid assets is parked at the central bank, mostly through foreign-currency swaps. The central bank's reliance on domestic banks for foreign-currency and vice versa is a risk should banks need to access this liquidity to repay significant amounts of FX debt or deposits in a stressed scenario.

Overview of Scope's qualitative assessments for Türkiye's *External Economic Risks*

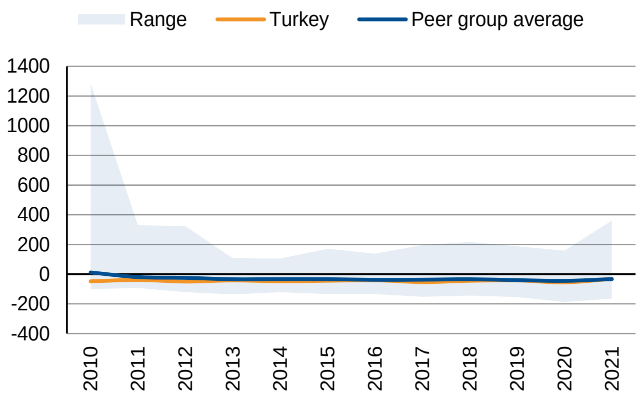
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
ccc	Current account resilience	Weak	-1/3	Diversified exports; however, high current-account deficit amid exposure to volatile energy and commodity import prices
	External debt structure	Weak	-1/3	Substantial short-term external debt; improving but highly negative net international investment position
	Resilience to short-term external shocks	Weak	-1/3	Inadequate reserve coverage; significant net foreign liabilities of the central bank excluding foreign-currency swaps

Current account balance, % of GDP



Source: IMF WEO, Scope Ratings

Net international investment position, % of GDP



Source: IMF, Scope Ratings

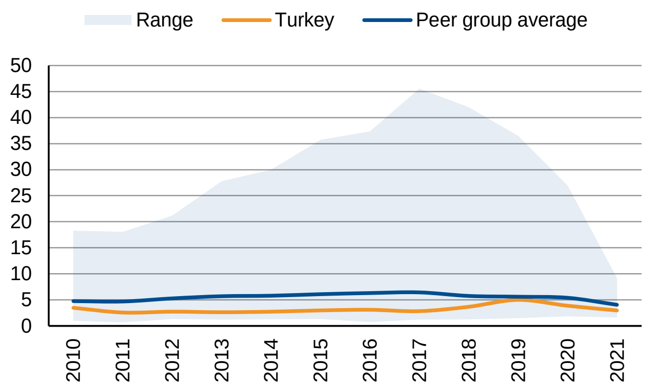
Financial Stability Risks

- **Banking sector:** Tier 1 capital adequacy stood at 15.4% of risk-weighted assets as of Q2 2023, which is higher than 15.2% ratio as of Q2 2022 and the 2010-2019 average. Moreover, public banks rely on the regular support of Türkiye's sovereign wealth fund that injected TRY 111.7bn (around USD 5.8bn) into three state-owned banks in March 2023. Robust asset quality also supports the resilience of local banks with non-performing loans declining to 1.6% of aggregate loans as of June 2023, after reaching highs of 5.4% as of end-2019. However, banks are exposed to periods of foreign-currency sell-off that disproportionately affects financial-system liabilities and capital cushions due to the lower albeit persistent discrepancy between the share of banking deposits and funding in foreign-currency (43%) and that of loans in foreign-currency (33%). Finally, banks are exposed to financial market distortions resulting from several years of unconventional monetary policy.
- **Private debt:** Risks from household indebtedness remain manageable, with household debt of 11% of GDP as of Q1 2023. Non-financial corporates experienced an increase in indebtedness levels during the pandemic crisis, on the back of low-cost funding opportunities. However, their debt as a share of GDP continuously fell to 52% as of Q1 2023, from 74.9% as of Q4 2021. Non-financial corporates' net foreign-currency position was reduced to minus USD 86bn as of April 2023, from a 2018 peak of minus USD 195bn, related to sovereign crowding out of private-sector access to foreign-currency lending.
- **Financial imbalances:** As the central bank imposed regulations requiring local banks to buy government debt securities, monetary policy tightening could generate sizeable losses for banks' security portfolios because of their exposure to fixed-rate local currency government bonds, with average time to maturity of 5 years. Moreover, the housing market was severely impaired during the 2018 currency crisis, although lower funding costs introduced since 2020 reversed this trend and brought a strong recovery. Residential property prices posted an annual growth rate of almost 190% YoY in Q3 2022 but fell around 104% as of May 2023.

Overview of Scope's qualitative assessments for Türkiye's *Financial Stability Risks*

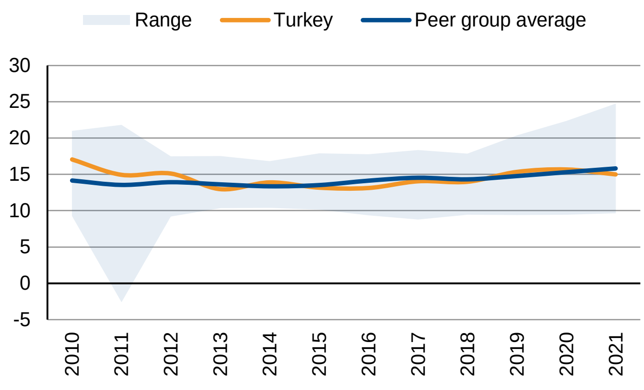
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Banking sector performance	Neutral	0	Resilient banking system able to provide significant liquidity to the sovereign, low NPLs, but lira depreciation weakens capitalisation ratios
	Banking sector oversight	Weak	-1/3	Banking system supervisory policies have exacerbated macroeconomic imbalances, state-coerced banking system interventions in exchange rate and in credit conditions
	Financial imbalances	Weak	-1/3	Moderate private-sector debt, but large sovereign-bank nexus, high FX exposure, significant (although declining) net FX liabilities of corporates

Non-performing loans, % of total loans



Source: IMF, Scope Ratings

Tier 1 capital, % of risk-weighted assets



Source: IMF, Scope Ratings

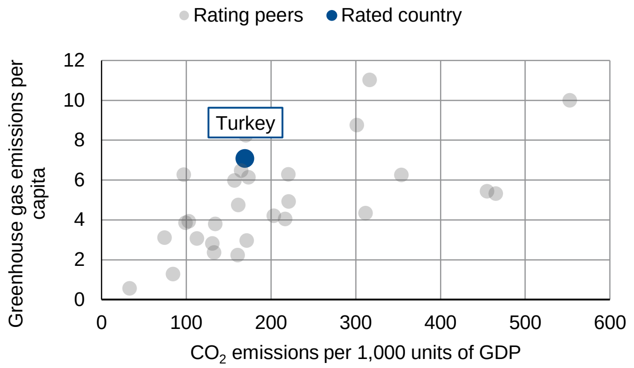
ESG Risks

- **Environment:** Türkiye is exposed to a broad range of natural risks, including earthquakes, landslides, and wildfires. Due to its geographic diversity, floods, and droughts are also common. Annual CO_2 emissions per capita are close to EU-27 and UK levels, and Türkiye plans to reduce total emissions by 41% by 2030 compared to business-as-usual levels. Commitments to effectively tackling climate change have further been strengthened with the ratification of the Paris Agreement in 2021 and the setting of a net zero emissions target by 2053. To achieve this, however, decarbonisation of the power sector as well as energy efficiency in the economy are challenges. Primary energy consumption is heavily dominated by fossil fuels (about 85% of total), with almost all gas and oil imported, while only 15% of energy is sourced from renewables. Türkiye has prioritised an expansion of domestic energy production to reduce its dependency on oil and gas imports. The newly published National Energy Plan 2022-2035 sees the renewable energy share increasing to nearly 24% by 2035. Investment into nuclear energy has been accelerated, with the first nuclear power plant expected to begin production in 2025.
- **Social:** The economy displays comparatively high unemployment rates, low rate of labour force participation, especially among women and youth, as well as high levels of income inequality. Türkiye has a favourable old-age dependency ratio and retains positive demographic growth, expected of 0.4% annually by 2030 for the working-age population supporting economic prospects. Progress has also been made in reducing poverty levels and improving educational outcomes.
- **Governance:** President Erdoğan was re-elected for a four-year term in May 2023 and secured a majority in parliament. Notwithstanding ongoing policy normalisation, his re-election makes the persistence of macroeconomic imbalances more likely given recent track record of loose and unorthodox policies. General elections did not trigger heightened domestic political tensions, but the exposure to geopolitical risk is high, including sanctions over economic cooperation with Russia, adverse spillovers from conflicts in Syria and Libya, as well as tensions around gas exploration in the eastern Mediterranean. Still, Türkiye is likely to continue playing a leading role in international negotiations related to the Russia-Ukraine conflict as a key regional power and NATO member.

Overview of Scope's qualitative assessments for Türkiye's *ESG Risks*

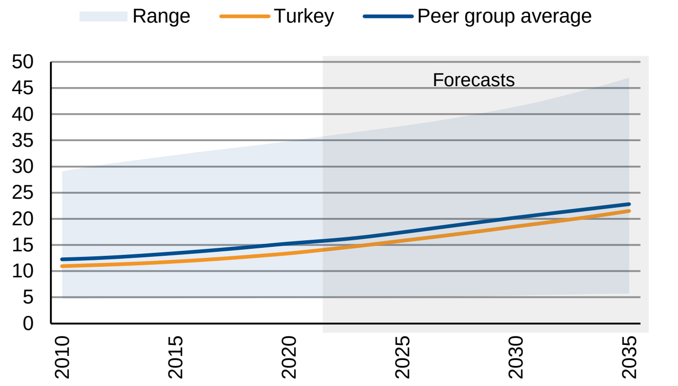
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
ccc	Environmental factors	Weak	-1/3	Significant exposure to a broad range of natural risks; high economic reliance on fossil fuels; weaker preparedness for climate change
	Social factors	Neutral	0	Relatively favourable demographics, high income inequality, progress in reducing poverty levels and improving educational outcomes
	Governance factors	Weak	-1/3	Significant institutional challenges, geopolitical tensions; limited policy predictability and effectiveness likely to remain after this year elections

Emissions per GDP and per capita, $mtCO_2e$



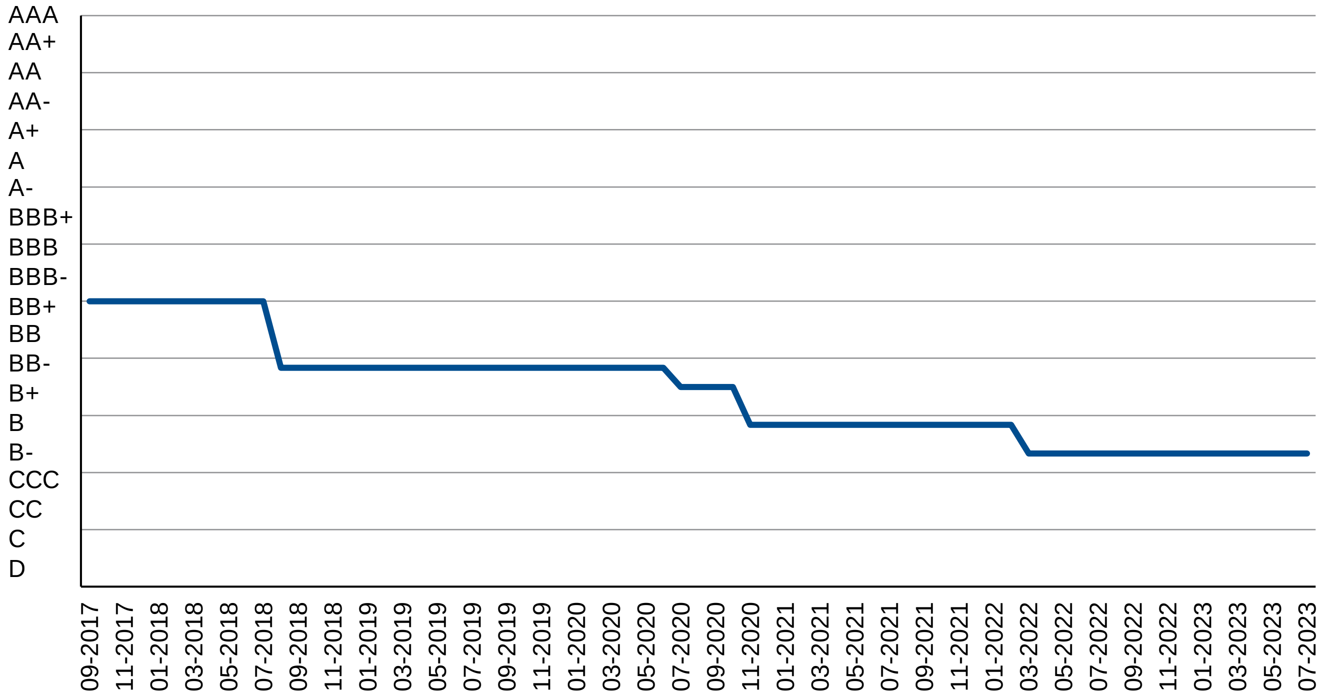
Source: European Commission, Scope Ratings

Old age dependency ratio, %



Source: United Nations, Scope Ratings

Appendix I. Rating history (foreign-currency long-term ratings)



NB. Positive/Negative Outlooks are treated with a +/-0.33-notch adjustment. Credit Watch positive/negative with a +/-0.67-notch adjustment.

Appendix II. Rating peers

Rating peers are related to sovereigns with an indicative rating in the same rating category or in adjacent categories per Scope's Core Variable Scorecard, including a methodological reserve-currency adjustment.

Peer group*
Georgia
Greece

*Publicly rated sovereigns only; the full sample may be larger.

Appendix III. Statistical table for selected CVS indicators

This table presents a selection of the indicators (24 out of 30 – with the governance indicator reflecting a composite of six indicators) used in Scope's quantitative model, the Core Variable Scorecard, in line with Scope's Sovereign Rating Methodology. The metrics and sources for the data presented here ensure comparability across global peers and may therefore differ from national and other selective international statistics.

Pillar	Core variable	Source	2018	2019	2020	2021	2022E
Domestic Economic Risk	GDP per capita, USD '000s	IMF	9.5	9.1	8.6	9.7	10.6
	Nominal GDP, USD bn	IMF	779.7	759.5	720.1	817.5	905.5
	Real growth, %	IMF	3.0	0.8	1.9	11.4	5.6
	CPI inflation, %	IMF	16.3	15.2	12.3	19.6	72.3
	Unemployment rate, %	WB/TurkStat	10.9	13.7	13.1	12.0	10.0
Public Finance Risk	Public debt, % of GDP	IMF	30.1	32.6	39.7	41.8	31.2
	Net interest payment, % of revenue	IMF	4.9	6.1	6.7	6.1	4.7
	Primary balance, % of GDP	IMF	-2.3	-2.9	-3.2	-2.3	-0.4
External Economic Risk	Current account balance, % of GDP	IMF/TCMB	-2.6	1.4	-4.4	-0.9	-5.4
	Total reserves, months of imports	IMF/TCMB	4.2	5.2	4.6	4.3	3.7
	NIIP, % of GDP	IMF	-43.1	-40.7	-53.3	-30.9	-30.8
Financial Stability Risk	NPL ratio, % of total loans	IMF	3.7	5.0	3.9	3.0	2.0
	Tier 1 ratio, % of risk-weighted assets	IMF	13.9	13.3	14.9	15.0	17.2
	Credit to private sector, % of GDP	WB	67.5	65.6	75.2	-	54.5
ESG Risk	CO_2 per USD 1,000 of GDP, $mtCO_2e$	EC	185.2	177.2	173.9	169.2	-
	Income share of bottom 50%, %	WID	11.8	11.9	11.9	11.9	-
	Labour-force participation rate, %	WB/OECD	58.1	58.1	54.0	56.3	-
	Old-age dependency ratio, %	UN	12.7	13.0	13.4	13.8	14.3
	Composite governance indicators*	WB	-0.5	-0.5	-0.5	-0.5	-

* Average of the six World Bank Worldwide Governance Indicators.

Appendix IV. Economic development and default indicators

IMF Development Classification	Emerging market and developing economy
5y USD CDS spread (bps) as of 31 July 2023	377

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