الوكالة الإسلامية الدولية للتصنيف
Islamic International Rating Agency

IIRA Maintains Sovereign Ratings of Türkiye

Manama, August 18, 2023 – The Islamic International Rating Agency (IIRA) has reaffirmed the long-term and short-term foreign currency ratings of Republic of Türkiye ('Türkiye' or 'the Country') at 'BB+/A3' (Double B Plus / Single A Three) and local currency ratings at 'BB+/A3' (Double B Plus / Single A Three) on the international scale, and 'AAA (tr)/ A1+ (tr)' (Triple A/ Single A One Plus) on the national scale. The outlook on the ratings is 'Stable'.

Credit ratings of Türkiye derive strength from historically strong fiscal discipline, relatively low levels of government debt, and a resilient economy. However current account deficit is high in relation to GDP, even though likely to moderate in the remainder of the year. Inflation is expected to accelerate in the coming months until Q2'24 on account of depreciation of Turkish Lira, recent tax hikes, and persistently strong domestic demand. Recent normalization of monetary policy direction is considered positive towards gradually addressing inflationary pressures and alleviating the strong demand-push. The coverage of international reserves to short-term external debt is on an improving trend when viewed in a long-term perspective, but still well below 100%. Following the elections, the political environment is conducive for the government to institute a structural reform agenda foreseeing sustainable growth, a lower current account deficit and a more balanced fiscal profile, with reducing reliance on indirect taxes in fiscal receipts.

IIRA foresees around 4% GDP growth for Türkiye driven by domestic demand in turn fuelled by gains in employment, wage hikes and high inflation expectations. Recent monetary tightening as well as measures to curb retail credit growth could have a dampening effect on domestic demand. Despite the weakening momentum in external trade partners, strong tourist inflows support growth prospects. For the next year, growth momentum is expected to slow down modestly. However, the contribution of growth drivers is expected to be more balanced, with moderated impetus from domestic consumption and propelled more by investments and external demand.

After peaking at 85.5% in October 2022, the annual headline inflation tapered lower to 38.2% as of June 2023, supported by a relatively stable Turkish Lira and base effects. However, since July of this year, inflation has been rising again due to sharp depreciation of Turkish Lira after May elections, increase in taxes and prices of administered items, and relatively steep wage hikes. The Central Bank of the Republic of Türkiye (CBRT) forecast inflation to close the current year at 58% and 2024 at 33% after peaking around mid-60%'s in Q2'24.

The policy rate was hiked 650 bps in June and another 250bps in July 2023, to 17.5%. This marked reversal of the unorthodox policies in effect previously, with the monetary tightening processes instituted to establish the disinflation course as soon as possible, to anchor inflation expectations, and to control the deterioration in pricing behavior. Despite the recent monetary policy actions and associated prudential measures for credit growth, pricing behaviors may continue to be rigid, given the elevated inflation levels for extended periods.

Strong domestic economic activity and higher import related taxes on account of weaker TL, as well as increased corporate income tax due to strong profitability, supported overall fiscal dynamics in 2022 with total deficit contracting to 0.9% of GDP and primary surplus of 1.2% of GDP. For 2023, the government has announced tax measures after the May'23 elections to cover for the earthquake related spending needs and wage hikes to state employees and retirees, to ease the burden of very high inflation. Overall, Türkiye has demonstrated commitment to maintaining fiscal discipline, with the aim of actualizing earthquake adjusted fiscal deficit to GDP ratio in line with the Maastricht criteria of 3% in 2023. IIRA is cognizant of government efforts to contain the deficit and undertake potential tax reform in 2024 towards a more balanced taxation system and reduced reliance on indirect taxes.

Even though IIRA foresees significant improvement in current account dynamics in H2'23 compared to the first half, with expectations of a lower energy bill, decline in gold imports, strong tourism receipts, and decline in consumption goods imports, the full year CAD could converge to around 4.5% of GDP, well above the last 10-year average of 3.2%. In 2024, the deficit is expected to reduce relative to its long-term average, in tandem with further improvement in tourism receipts, further modest decline in energy bill, and softening of consumption goods imports as targeted by prudential measures taken by the government. On the financing front, the quality of deficit financing is expected to improve with shift away from deposit and reserve financing towards portfolio flows and FDI, the latter mainly reflecting recent deals inked with United Arab Emirates.

Strong GDP growth surpassed growth in external debt, with the ratio softening to 50.7% in 2022 (2021: 54.2%) and further to 49.0% in Q1'23. Meanwhile, shortened average maturity of debt and international reserves coverage of short-term external debt at 60.2% as of March 2023 vis-a-vis 67.7% in 2022 (2021: 64.8%) indicates vulnerability, even as coverage levels indicate improvement in the longer-term perspective, and are likely to recover from March'23 by current year end.

Turkish banking sector posted significant gains in profitability in 2022 supported by surging yields on CPI-linkers and wider loan-deposit spreads, as well as the Liraization of balance sheets. Aggregate capital adequacy ratio remained comfortably above regulatory thresholds and increasing as of YE2022, owing to strong internal capital accretion. As of June 2023, around 56.5% of total deposits are denominated in Turkish Lira whereas FCY protected deposits accounted for about 23.5% of total deposit with FCY and FCY-indexed deposits still corresponding to around 67% of total deposits.

BRSA's Sustainable Banking Strategic Plan (2022-2025), which is crucial for the improvement of green finance ecosystem, aims to ensure the banking sector's adaptation before 2026, when the carbon border adjustment will begin to create financial obligations in accordance with the EU Green Deal. The main pillars of this plan are to manage climate-related financial risks effectively, to develop sustainable finance flows, and to improve cooperation between relevant parties on sustainable finance. Recent initiatives within this scope included the creation of interim green taxonomy with banking sector participants, implementation of Basel climate risks draft regulations, and comprehensive sector wide survey regarding green finance. Progress on this front will be monitored and ratings have not been impacted by any concerns on this front.

Indicators for Future Change in Ratings

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

- Fiscal deficit exceeding the expectations by a wide margin,
- Realization on the consumer price inflation notably deviating from the CBRT's forecast path,

Ratings maybe upgraded in case of:

- Notable improvement in fiscal performance into the year 2024, with the recent and prospective revenue mobilization measures as well as cost savings, reflecting on to a clearly improving trajectory vis-a-vis long-term average of 1.8% deficit to GDP,
- Improvement in external debt dynamics with continuation of decline in external debt to GDP, as well as notable increase in coverage of short-term external debt by international reserves.

For further information on this rating announcement, please contact IIRA at iira@iirating.com.