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Depreciation in exchange rates and sluggish domestic demand affect corporate payment performance

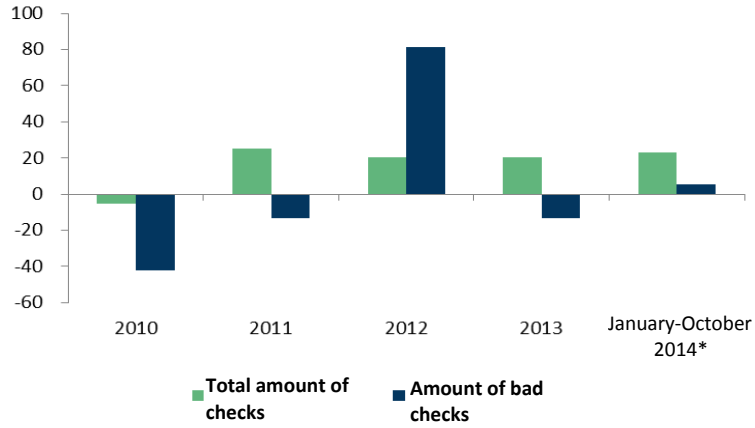
- **Payment performance of Turkish companies depends on domestic demand and exchange rates**
- **The sharp depreciation in exchange rates at the beginning of 2014 reflected negatively on the profitability of companies**
- **Slowing domestic demand due to rises in interest rates and macroprudential measures reflected negatively on payment performance.**
- **Coface notes the risks in housing segment of the construction and non-iron& steel metals sector in particular**

Disclosure of the exit strategy by FED Chairman Ben Bernanke in May 2013 triggered a new period marked by a change in the risk perception towards developing economies in financial markets. Turkey entered this period with a high current accounts deficit, a production sector substantially dependent on imports and three successive elections.

The sharp depreciation in exchange rates, which started in December 2013, stabilized only after the Central Bank sharply reduced interest rates at the end of January. However, this depreciation in lira continues negatively affecting company balance sheets. On the other hand, the credit restriction measures introduced by Banking Regulation and Supervision Agency (BRSA) at the beginning of the year to contain the current accounts deficit have slowed down domestic demand, which was among the factors that made it difficult for companies to collect their receivables.

In line with these developments, impairments were started to be observed in the payment capacities of sectors with production and sales concentrated predominantly on the domestic market. The rises in both protested bills and bad checks confirm this impairment.

Annual change in total and bad check amounts* (%)



Source: Ministry of Industry, Entrepreneur Information System

*Checks used by corporates

Bad checks amounted to 15.9 billion TL in the first 10 months of 2014, up by 5.4 percent. The amount of protested bills also rose by 9.1 percent y-o-y in the first ten months of 2014, due to rising interests and slowing domestic demand.

Coface forecasts Turkish economy to growth by 3,1 percent in 2014 and by 3,5 percent in 2015. In November 2014, Coface downgraded Turkey's country risk assessments from A4 to B, due to lower growth perspective, higher private sector indebtedness and volatility in exchange rates.

The exchange rate loss of 2 million 973 thousand companies include in the Entrepreneur Information System of Ministry of Industry seems to have grown significantly due to the surge in exchange rates at the end of 2013. As a matter of fact, exchange rates losses amounted to 118.8 billion TL as of end-2013, up from 45.1 billion TL as of end-2012. This is a key indicator reflecting the vulnerability of companies to volatility in exchange rates.

“Given that the level of exchange rates and domestic demand are two key factors affecting the profitability of companies in Turkey, a moderate recovery in domestic demand in the first quarter of 2015 may positively affect profitability of companies. However, developments in the global economy, geopolitical risks, the expected process of interest rate hike by FED and the upcoming general elections in Turkey signal the persistence of exchange rate risk. This suggests that we are entering a period when companies must manage their cash flows and borrowing much more consciously,” says Seltem İYİGÜN, Coface MENA economist.

The main sectoral risks highlighted by Coface are as follows:

Metal sector (non-iron & steel): Import-dependence in raw material supply, declines in raw material prices, and the negative impacts of changes in exchange rates on borrowing costs are the main risks facing companies.

Automotive sector: The tax rates increased at the beginning of the year, rising interest rates, the macroprudential measures introduced by BRSA to contain consumer loans and the surge in exchange rates, among other factors, have resulted in a significant decline in domestic sales. However, positive outlook continues for exports.

Food sector: The greatest risk for food producers is the rise of production costs due to drought experienced during the year.

Chemical sector: Almost 70 percent dependence on imports in raw material supply and the slowdown in the construction sector, which is among the key clients of the sector, are the main risks facing the sector.

Construction sector: On the housing side, the uncertainty raised by the increase in interest rates and slowdown in the economy seems to have caused a regression in consumer confidence, which reflects negatively on the housing demand. The widening gap between supply and demand is viewed as another risk factor.

Retail sector: Private sector consumption accounts for approximately two thirds of GDP in Turkey. According to recent data, retail sales continue rising and the risk level of the sector does not seem to be high.

Textile and apparel: This sector, which has a high production and sales capacity towards both the domestic and external markets, features a medium level risk. The recovery trend in European markets and the exports supported by higher exchange rates are positively affecting the sector's performance.

Pharmaceuticals: The pressure caused on prices by reference drug system and high level of competition is negatively affecting the profitability of companies.

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P R E S S R E L E A S E

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