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Managing risk, enabling trade

Turkish sector performance: a most difficult year

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Summary

- A difficult business environment due to heightened political and economic uncertainty
- Deterioration of payment behaviour across most major industries since 2015
- Many sectors continue to face problems in 2017

Economic problems have mounted

Since 2015 increased political and economic uncertainty has negatively impacted Turkey´s economic performance, markedly after the failed coup in July 2016. Economic growth has decelerated to 2.9% in 2016 (between 2012 and 2015 annual GDP growth amounted to 6.1% on average). Private consumption and investment growth have decreased, while unemployment rose to 12.7% in December 2016 – the highest rate in seven years. Inflation has steadily increased since the end of 2016, to 11.3% in March 2017.

In order to stimulate faltering domestic demand the government has stepped up fiscal spending and took measures to support credit growth. Although this has led to some improvements in economic sentiment and activity, the economic outlook for 2017 remains subdued.

The Turkish lira depreciated sharply over the last six months, while necessary foreign direct investment (down 40%), portfolio capital inflows and tourism arrivals (down 30%) declined. The current account deficit is expected to increase to almost 5% 2017. Although the exchange rate seems to have stabilised recently due to monetary tightening measures taken by the Central Bank, the Turkish economy remains susceptible to further capital outflows and currency volatility.

Political uncertainty will most probably remain an issue after the constitutional referendum, due to the high possibility of early parliamentary and presidential elections to be held in H2 of 2017, the heightened threat of terrorist attacks and the war in Syria.

The impact on industry performance

In the current difficult environment dampened consumer confidence, lower investment, rising unemployment, high inflation, increased currency volatility and more restrictive bank lending (shorter financing periods and additional collateral required) have - to varying degrees - impacted all of Turkey´s main industries. Across most major industries the general trend since 2015 has been a deterioration of

payment behaviour, with extended payment terms and an increased number payment delays, while the value of unpaid receivables has considerably increased. The same accounts for business insolvencies in Turkey. Meanwhile, 80% of newly established businesses fail in the first three years after their set-up.
That said, it must be underlined that even in industries severely affected by the current situation there are still many strong and resilient companies.

Automotive

Despite lower domestic car sales in 2016 and early 2017 the industry has kept up so far, supported by increased demand in Europe (automotive is Turkey´s second largest export sector). Lower steel and metals prices and the weaker Turkish lira have helped export-oriented Turkish car producers and suppliers. However, high import costs are having a big impact on businesses that heavily rely on imports of car parts and components.

Gearing and financial requirements of businesses are average, as supplier support, rather than bank finance, is usually sought out in this sector. Payment duration in the automotive sector usually ranges from 30 days to 60 days, and the payment behaviour is generally stable. However, foreign exchange risks, fierce competition, high taxes and the plethora of undercapitalised businesses pose downside risks.

Chemicals/Pharmaceuticals

As the Turkish chemicals sector is mostly domestic market-oriented and dependent on imports, businesses profit margins were negatively affected by increased exchange rate volatility over the last 12 months. The average payment duration in the Turkish chemicals industry amounts to 150 days. Especially the plastics subsector has faced serious troubles, due to excess capacity, low capitalisation and strong international competition. In this segment the number of payment delays and insolvency cases has been high over the last two years, with many finanancially weaker players leaving the market.

That said, the pharmaceuticals subsector is still performing well, and many foreign global players have entered the Turkish market, which has increased competition for local players. Pharmaceuticals sales prices are set by the government, and the Turkish Social Security Institution accounts for 90% of payments, making the sector heavily dependent on budget issues/public spending.

Construction

The Turkish construction sector suffers from subdued activtiy, especially in the residential building segment, which struggles with lower household confidence and supply overhead. With too many players in the market competition is fierce, leading to high pressure on businesses margins. This, together with high indebtedness and weak liquidity of many construction businesses has led to increasing insolvencies in 2016. Payment duration in the industry is 120-180 days on average, and payment experience has been rather bad over the past two years. Due to the high indebtedness in construction sector, many businesses have to provide significant collateral when lending. However, there are still businesses related to strong groups and companies without liquidity problems in the market.

Consumer durables retail

Until 2015 the Turkish retail sector strongly benefited from robust economic growth, a growing population and rising household purchasing power. However, in 2016 private consumption contracted 0.7%, and is forecast to grow only about 2% in 2017, due to higher prices for imported goods (lira depreciation), higher interest rates and consumer confidence dampened by increased political and economic uncertainty. This immedeately affects non-food/consumer durables retailers, which structurally face low profitability and thin margins due to strong competition, coupled with high inventory expenses. Leverage of many retailers is rather high, while the willingness of banks to provide credit has decreased and interest rates remain high.

Especially retailers with debt denominated in foreign currency are highly exposed to default risk due to the on-going currency volatility. Therefore the Turkish Ministry of Finance has cut certain consumption taxes on a number of electronic home appliances, and extended VAT cuts on property acquisitions in order to soften the impact of the fluctuating exchange rate on retailers. Nevertheless payment delays and insolvencies have increased in this segment, with retailers selling mainly imported and therefore more expensive ICT and consumer electronics products facing above average risks.

Machines

Machinery businesses dependent on exports to Russia, Iraq or Azerbaijan have faced some problems due to the political and economic problems in those countries. Domestically, political uncertainty has lead to less capital expenditure, while high interest rates and the weakness of some buyer sectors (e.g textile) have a negative effect on the industry. Competition in the Turkish machinery market is high due to overcapacity, leading to price wars. Dependence on bank loans for financing is high. Currency volatility (foreign exchange inflow and outflow) is a major issue for the sector.

However, the decrease in commodity prices, like metals, have helped to sustain machinery businesses profit margins, and compared to many developed markets the Turkish machinery industry still benefits from lower labour costs. Payment duration in the machines/engineering sector is usually between 90 days and 120 days and the level of protracted payments is elevated.

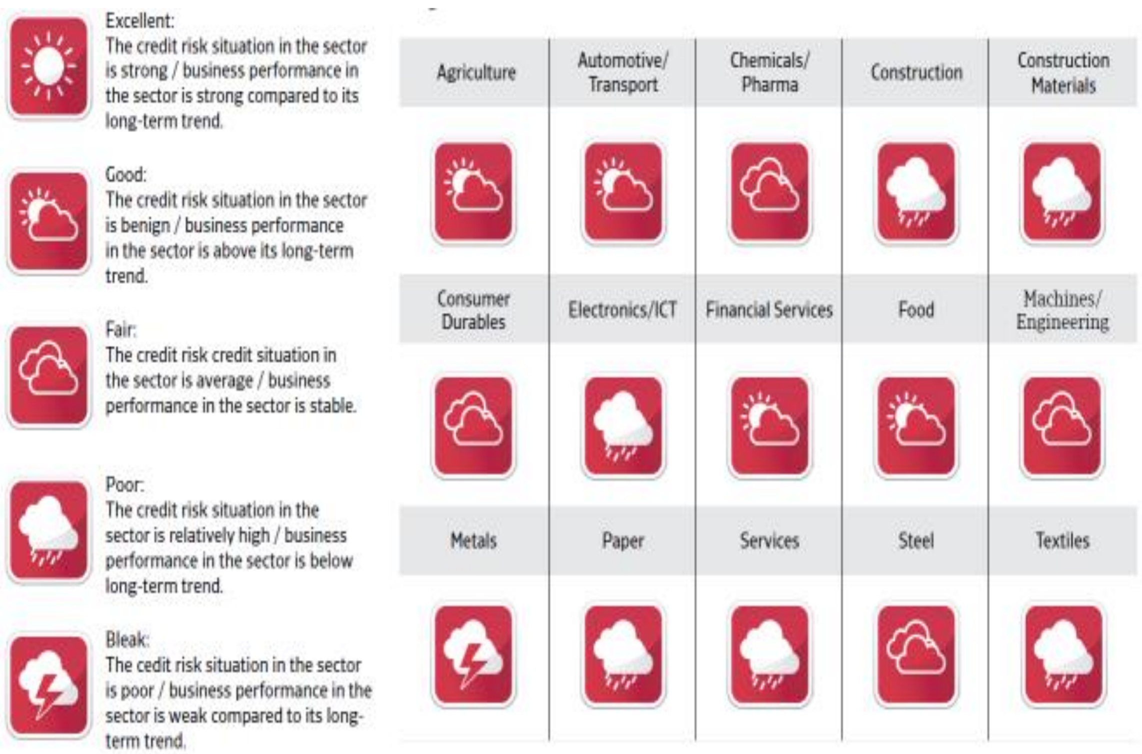
Metals

The metals segment suffers from major structural problems, such as overcapacities and fierce competition from China, high dependence on (more restrictive) bank lending and exposure to currency volatility. Business insolvencies and payment delays have sharply increased over the past two years, due to deteriorating margins and high indebtedness of businesses.

Textiles

The Turkish textiles industry has shown a deteriorating trend in recent years due to a combination of excess capacity, lack of branded production, low capitalisation, decreasing domestic and export demand and fierce competition from Asia. Many businesses suffer from high indebtedness and weak liquidity, and non-performing bank loans amount to around 6%.

Turkey industries performance outlook



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