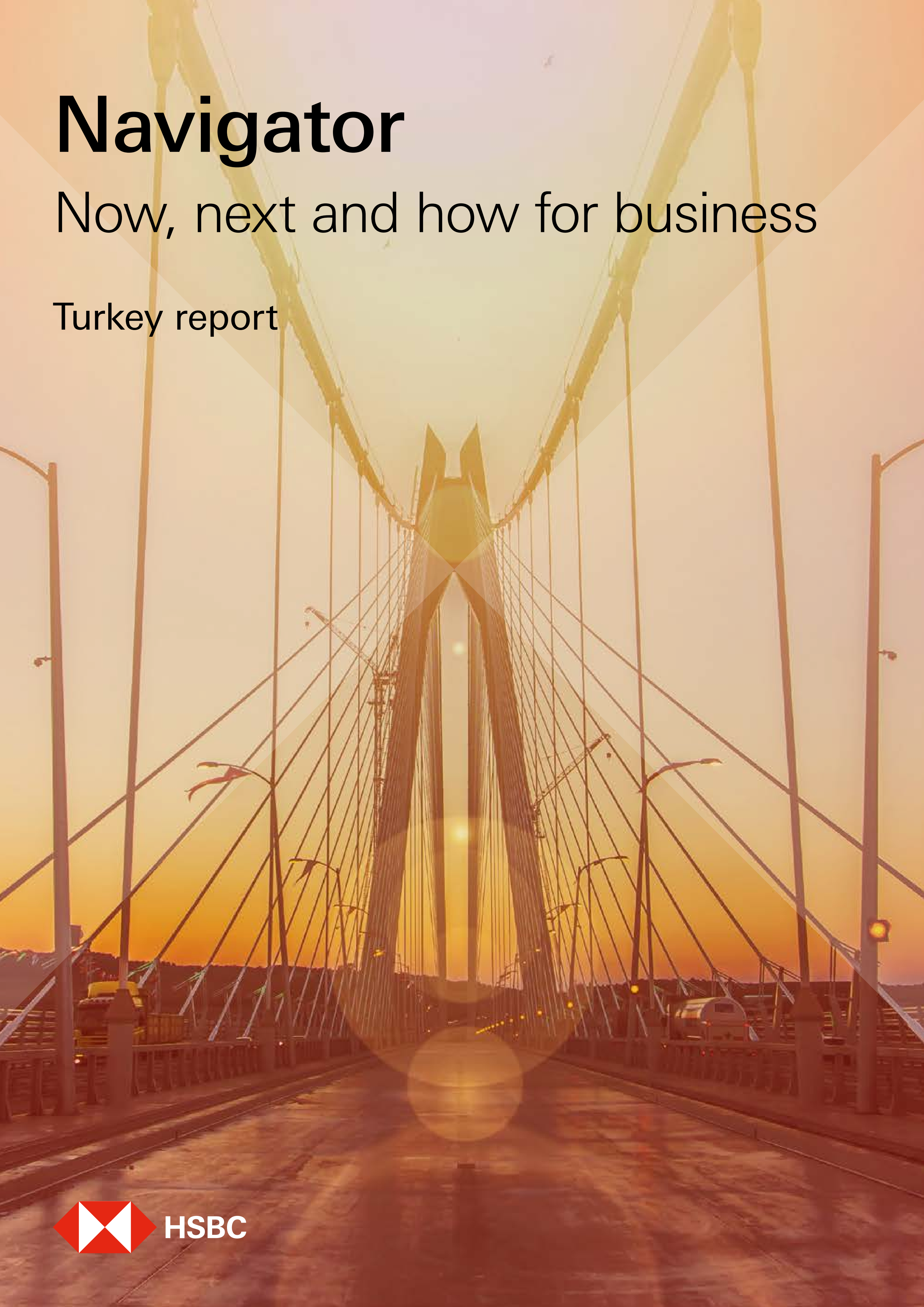
Navigator

Now, next and how for business

Turkey report



HSBC

Turkey

Europe still counts, but Turkey is increasingly looking East

Turkish exporters have been thriving in an environment of robust world trade, thanks to strong growth in key trading partners and their agility in expanding to new markets. Increasingly strong demand from other emerging markets, especially in Asia, will ensure that the outlook for Turkish exports remains bright. However, Turkey's high inflation and a reliance on foreign lending may constrain firms being able to take advantage of these opportunities.

Short-Term Snapshot

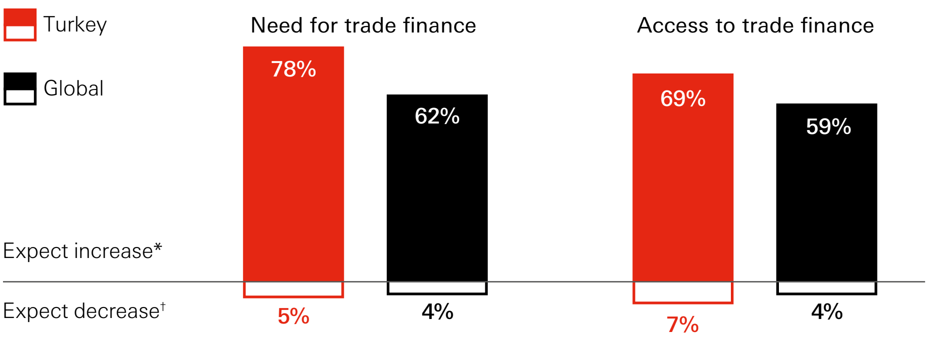
The Turkish economy looks set to have grown by close to 7% in 2017, making it one of the fastest-growing emerging markets. This was driven by easier access to credit, faster government spending, and low real interest rates. But external trade has also played a key role, as Turkey has enjoyed strong export growth, with the tourism sector rebounding nicely. However, sustaining the current rate of economic growth may be a challenge due to high inflation and a widening current account making Turkey more exposed to changing global conditions than other major emerging markets.

More than 80% of Turkish respondents to our survey expect an increase in trade volume this year (compared to 77% globally), suggesting plenty of potential for Turkey to continue to benefit from the pickup in world economic growth. But it also is a testament to the diversity of Turkey's trading partners. Turkish firms have benefitted from the strong economic recovery in Europe (Turkey's largest trading partner), but have also demonstrate agility in expanding to new markets such as in Asia, which offers the most positive outlook for export growth. And they have proved adept at taking advantage of opportunities created by geopolitical tensions: normalisation of relations with Russia has boosted tourism, while the Gulf Cooperation Council's (GCC) embargo of Qatar has enabled Turkish firms to ramp up exports to the wealthy Gulf state.

Action points for business

- Turkish firms should continue seeking new markets in Asia and the Middle East, but that shouldn't distract from the need to increase productivity and enhance technological adoption.
- Businesses should position themselves against the headwinds that may arise from high domestic inflation and exchange rate volatility.

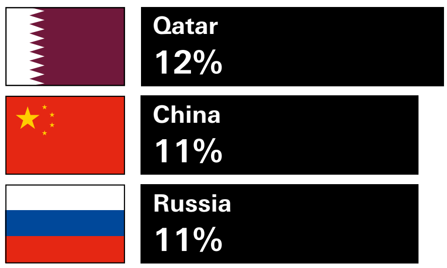
Outlook for trade finance need and access in the next 12 months



*Expect increase = Increase significantly + Increase slightly
†Expect decrease = Decrease significantly + Decrease slightly

Source: TNS Kantar

Which are the top 3 markets where your business will look to expand in the next 3-5 years?



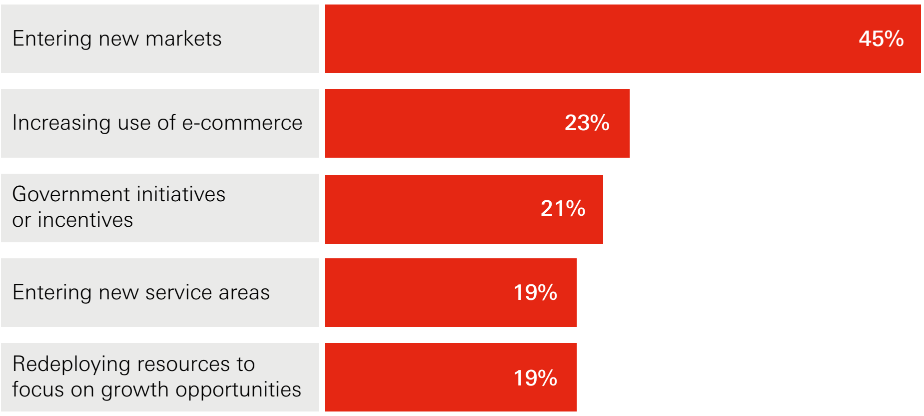
Source: TNS Kantar

Nevertheless, Turkish firms face a dilemma of sorts with regards to trade financing. According to our survey, the share of firms expecting an increase in both their need for trade finance, and their ability to access it, are larger than the global average. But nevertheless, meeting financing needs could be challenged by exchange rate volatility, high inflation, and domestic conditions during the 2019 election period.

Turkey's services exports, which accounted for just over a fifth of total exports in 2017, are dominated by two industries – tourism and transportation/distribution – which together account for 84% of the total. Both have suffered in recent years due to geopolitical and domestic events, dampening overall export performance. But according to our survey, 61% of respondents in Turkey expect services exports to increase in the next year, in line with the global average. Given the dominance of transport and tourism, the survey suggests that entering new markets will be the most important business strategy adopted.

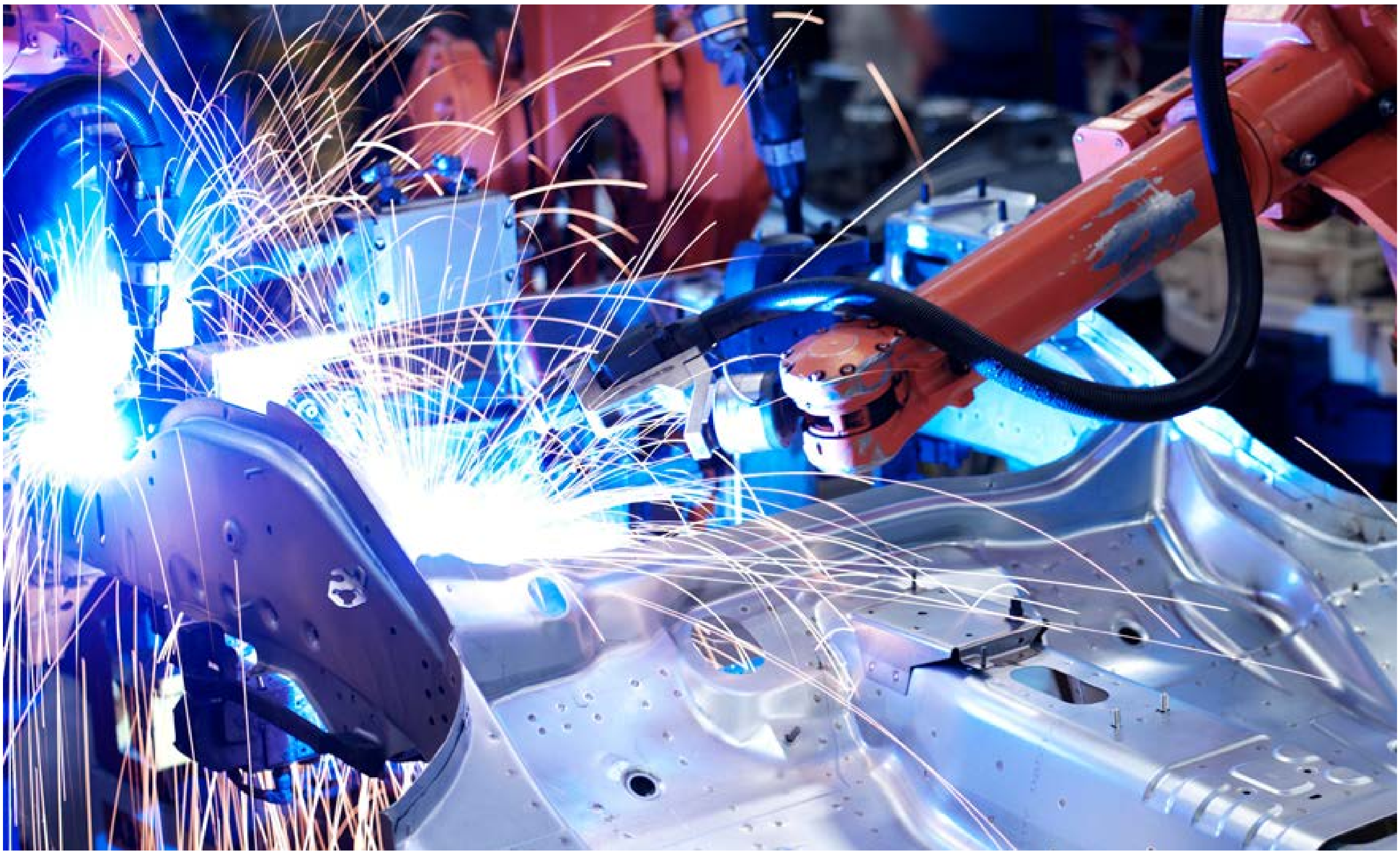
Strong external demand bodes well for exports, but macro-imbalances need to be addressed to maximise potential.

How do you plan to grow your services business?



Source: TNS Kantar

Upgrading the customs union with the EU is key for the exports outlook, but what happens in Asia is becoming increasingly important.



Trade Policy Developments

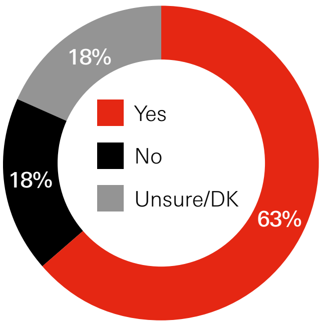
Turkish firms should push for engagement in major Asian initiatives such as Belt and Road and ASEAN 2025 at an official level, especially to take advantage of infrastructure opportunities and diversify their services exports.

The key issue on the trade policy agenda for Turkey is upgrading the 1995 Customs Union with the EU, to include trade in services, public procurement, e-commerce, and agricultural goods (in addition to the current scope with focusses mainly on industrial goods). The EU as a bloc is Turkey's single largest trading partner, but progress on the agreement could be slow due to political relations between Turkey and key EU members such as Germany and the Netherlands.

Action points for business

- Regardless of the outcome of any negotiations to upgrade the Customs Union with the EU, Turkish firms should continue to support the adoption of efficiency-enhancing measures and harmonised standards to ensure seamless integration in value chains.

Are governments becoming more protective of their domestic business?



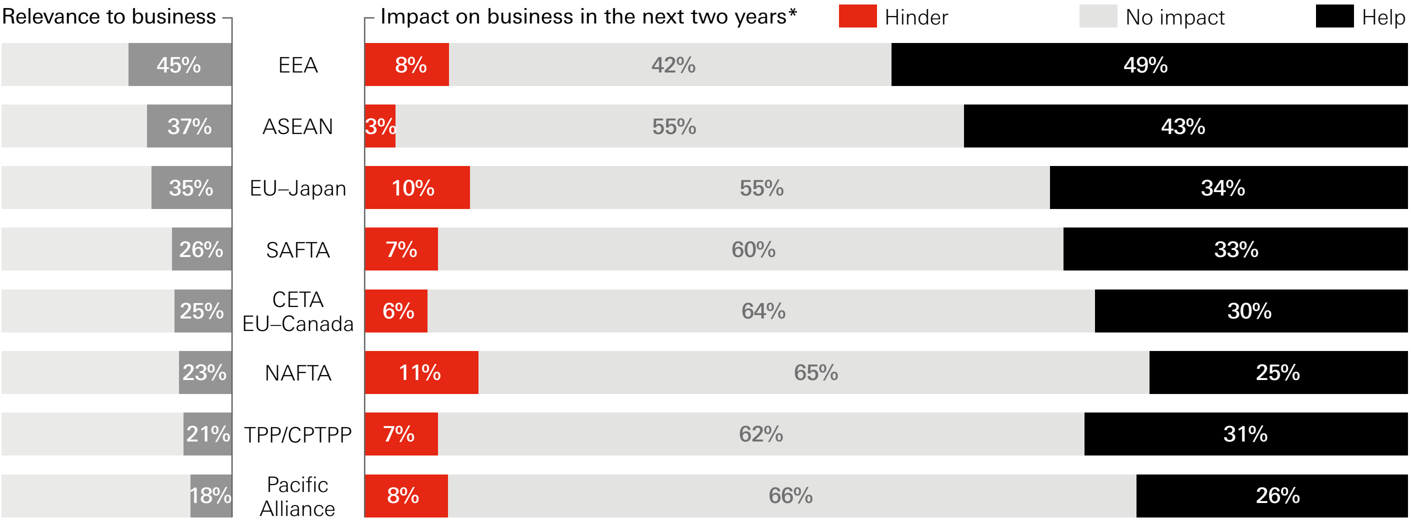
Note: may not total 100% due to rounding

Source: TNS Kantar

Top 3 impacts of protective policies on my business

Source: TNS Kantar

Relevance and impact of trade agreements



Source: TNS Kantar

*May not total 100% due to rounding

The future trade relationship with Europe is consistently cited as the most important trade policy issue in survey data. 45% of companies cited trade with the EEA as being relevant to their business, and almost half expect the EEA to benefit their business in the next two years. However, the opinion on the EU regulatory environment is split, underlying the risk that expanding trade ties could be affected by the political relationship between Turkey and some of its key trading partners. Turkish firms also continue to set their sights further east, with over a third of respondents expecting the Belt & Road Initiative and ASEAN 2025 to benefit their businesses.

Long-Term Outlook for Trade

Educational reforms that improve quality and skills of the workforce will help Turkey diversify its services exports away from the dominance of tourism and transport. Turkey's long-term trade prospects are at a cross roads. Turkish firms have historically proved very agile in expanding to new markets (Middle East, Africa, and, and other fast-growing emerging markets in Asia), and are in a position to benefit from geopolitical developments in their neighbourhoods. Brexit could open up the opportunity for a free-trade agreement between Turkey and the UK. Turkey would also need to play a key role in reconstruction efforts in Syria, and has already expanded trade ties with Iran, Iraq, UAE, and Qatar. However, for Turkey to maximise its potential, it needs to address its macroeconomic risks. Due to the large import content of Turkish exports, Turkish industry is exposed to swings in its exchange rate, which itself is more volatile than is the case for other emerging markets where inflation is lower.

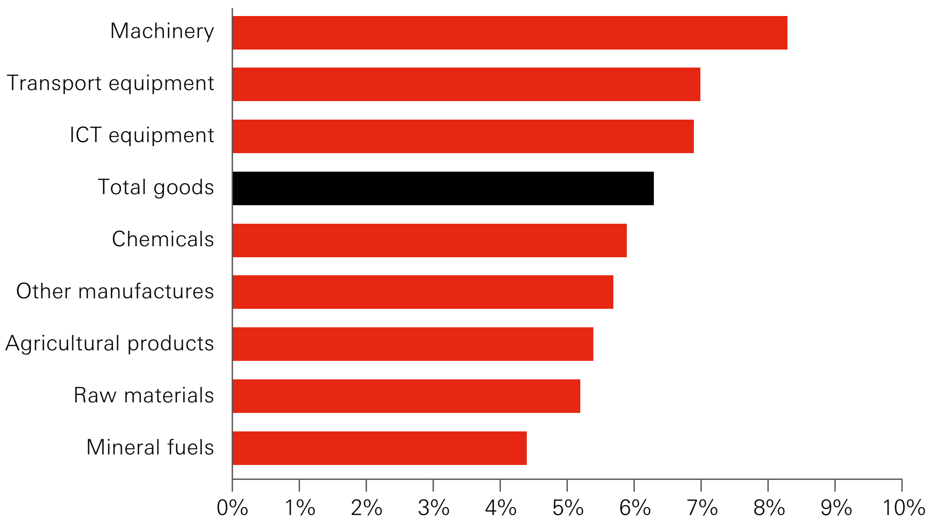
Europe still dominates goods exports, but pivot to East is happening
Turkey's exports are dominated by transport equipment (mostly in the automobile sector) and industrial machinery, mostly to Europe (Germany, France, and the UK in particular). Both sectors have benefited from the customs union with the EU, which removed tariffs on Turkish industrial goods. Turkey's competitiveness in these sectors is based largely on its geographical proximity to Europe, lower relative labour costs, and harmonised standards with Europe. But to remain competitive, Turkey will need to move up the value-added production chain, and adopt more technologically-intensive processes, which will require further investment in research and development. As a bloc, Europe (Germany, the UK, and France in particular) continues to be Turkey's main trading partner, but Turkish exports – not just of machinery and transport equipment, but also clothing and apparel and textiles – are increasing their market share in other countries, notably the US and the Middle East.

Action points for business

- Given high inflation and exchange rate volatility, firms should increase investments into local production processes that can reduce the import content of Turkish exports.
- Firms should strive to improve the sustainability of their supply chains and enhance the uptake of digitisation, which still remain low by global standards.

> In the next decade, the fastest-growing destinations for Turkish exports will be in Asia, not in Western Europe.

Exports of goods by sector, 2017-30 (average annual growth)



Source: Oxford Economics

Top 5 Hotlist destinations of goods exports

Rank	2016	2030
1	Germany	UAE
2	UK	Germany
3	USA	USA
4	France	UK
5	UAE	France

Note: Ranking among the 24 trade partners covered in the forecast

Source: Oxford Economics

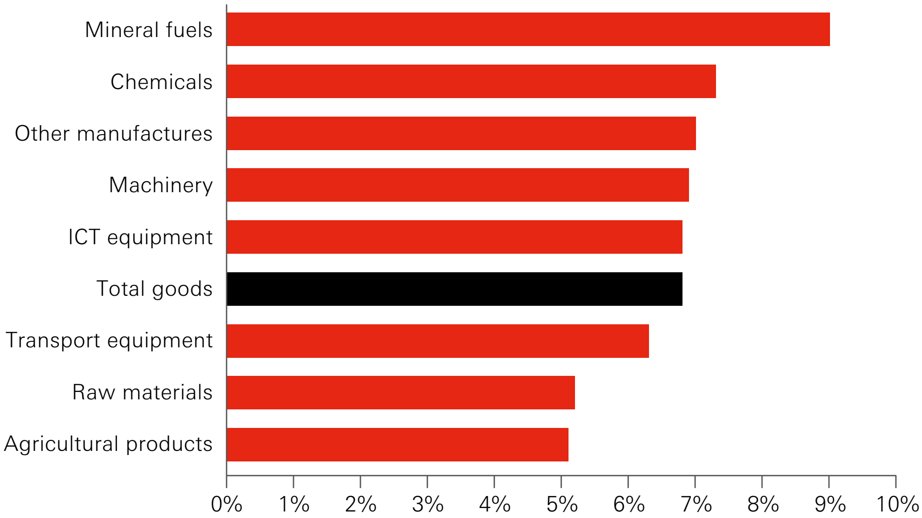
However, with the upgrade of the Customs Union with the EU still hanging in the balance, and with conflict in the Middle East increasing transport and trade costs, Turkey has been increasingly turning eastwards to seek new export markets. In fact, between 2021 and 2030, the fastest-growing export destinations will not be Western Europe nor the US, but India and China, which confirms the views expressed in the survey that the countries towards with Turkish firms have the most favourable outlook are in Asia. However, the Middle East will remain an important part of Turkey's export strategy, with Saudi Arabia, UAE, and Egypt taking up the remaining of the top five fastest-growing export destinations. That strategy, however, faces some risks given the geopolitical fault lines in the Middle East and Turkey's increasing trade links with Qatar.

High import content of exports means Europe still highly relevant
Turkey's manufacturing firms rely heavily on imports of intermediate inputs and machinery. This is reflected in Turkey's import mix, where transport equipment and industrial machinery form the two largest categories. Turkey is highly integrated in the supply chains of the main European automakers providing a relatively low-cost "workshop" for the assembly of vehicles. Germany, France, and the UK accounted for 72% of its imports of transport equipment in 2017. But the sources of its industrial imports are more varied. Whereas Germany and the UK together make up around 40% of Turkey's machinery imports, 23% come from China, which is rapidly gaining market share.

This may reflect the weakening of the lira against the euro in particular, which renders imports from Europe more expensive, but also, increasing trade and investment linkages with China. Other important trading partners are Vietnam and China (for ICT equipment); UAE (for commodities, iron and steel, and other manufactured products); Saudi Arabia and South Korea (for plastics); and southeast Asia (for textiles).

Being highly integrated in European supply chains means a high share of industrial imports from Europe; but China and other emerging Asian countries are gaining market share.

Imports of goods by sector, 2017-30 (average annual growth)



Source: Oxford Economics

Top 5 Hotlist origins of goods imports

Rank	2016	2030
1	Germany	China
2	China	Germany
3	USA	UK
4	France	UAE
5	UK	USA

Note: Ranking among the 24 trade partners covered in the forecast

Source: Oxford Economics

The growing role of China in producing inputs and machinery for use in Turkish factories means that China will displace Germany by 2030 as Turkey's top source of imports. Emerging markets elsewhere in Asia will also see rapid growth in exports to Turkey. Vietnam, which supplies much of Turkey's ICT equipment, is set to become Turkey's fastest-growing import source in the next decade. India takes second place, providing Turkey's economy with refined petroleum products, as well as chemicals, and textiles. Turkey will continue to import textiles from many Asian countries (including for use in its own clothing and apparel exports). Egypt is also set to become one of the fastest-growing import origins for Turkey, increasingly supplying it with plastics, refined petroleum, textiles, and fertilisers.

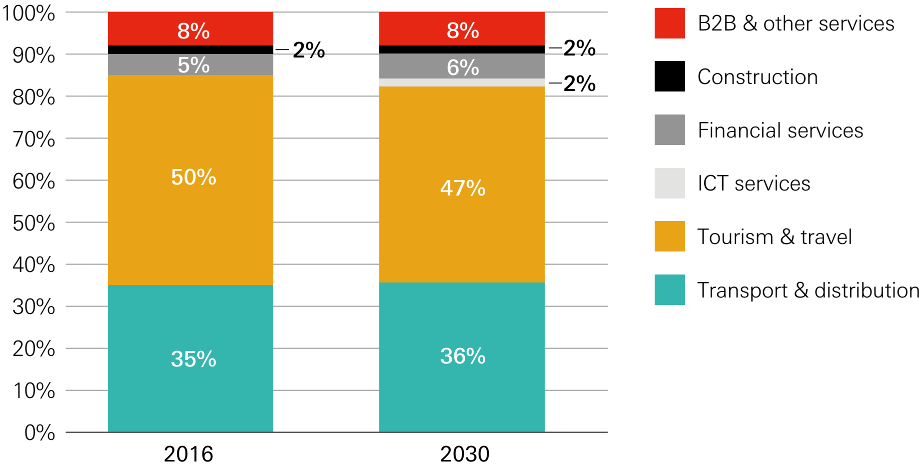
See Turkey, think transport and tourism

Turkey's services exports are, and will continue to be, dominated by travel and tourism, with its share of the total dipping slightly from 50% in 2016 to 47% by 2030. Tourism is an important source of foreign exchange for Turkey's economy, but it is also sensitive to domestic and regional developments.

Apart from tourism, Turkey has benefited from its geographic proximity to large markets both in the West and the East to build up and strengthen its position as a leading exporter of transportation and distribution services (both in passengers and cargo). These now account for 35% of total. Turkey's flag-carrier airline flies to more countries than any other in the world, and Istanbul's international airport is among the top five busiest airports in Europe based on passenger traffic. Exports of B2B, construction, financial, and ICT services make up 16% of the total, with this share projected to remain small over the next decade. This reflects Turkey's relatively weak position in these sectors versus higher-skilled economies in Europe and Asia.

Tourism and transport and distribution services make up the lion's share of Turkey's services exports, accounting for almost 90% of the total.

Sectoral shares in total services exports



Source: Oxford Economics

Top 5 Hotlist destinations of services exports

Rank	2016	2030
1	Germany	Germany
2	China	China
3	UK	India
4	USA	UK
5	France	UAE

Note: Ranking among the 23 trade partners covered in the forecast

Source: Oxford Economics

Adverse security conditions and Russian sanctions led to a slump in tourism in 2015-16, but the ensuing rebound has highlighted an important trend, which is Turkey's ability to increasingly attract tourists from other countries than Western Europe and Russia on which it has traditionally relied. Germany and the UK will still be on the list of top five export destination for Turkish services, but Asia is becoming increasingly important to the outlook. To that effect, the top two fastest-growing export markets for Turkish services in 2021-30 are projected to be China and India, driven by visitors from the strengthening middle classes in these countries. But ties with the Middle East are also expanding, with exports to Saudi Arabia and UAE also projected to grow strongly – supported by Turkey's provision of construction, financial, and B2B services.

About the HSBC Navigator

The HSBC Navigator presents a blend of survey evidence, policy analysis, and economic modelling to generate unique and timely insights into the changing landscape for global trade.

The business survey is a quantitative indicator of the short-term outlook for global trade. The survey, which is the largest of its kind, is conducted on behalf of HSBC by Kantar TNS. It is compiled from responses by decision-makers at over 6,000 businesses – from small and mid-market to large corporations – across a broad range of industry sectors in 26 markets. Interviewees were polled on a range of questions including expectations around future growth in trade, trade finance needs, attitudes toward trade policy developments and strategic business plans.

The survey represents a timely source of information on the fast-evolving trade environment. And it can provide a useful contextual setting for interpreting developments in official data. In this way, economists at Oxford Economics are able to blend insights from the survey with their own analysis and modelling of developments in trade.

Oxford Economics has tailored a unique service for HSBC which forecasts bilateral trade in goods and services, in part based on HSBC's own analysis and forecasts of the world economy. A top-down approach is employed, with Oxford Economics' suite of models used to ensure consistency between HSBC's forecasts for economic growth and exchange rates in key countries and the more granular projections for bilateral trade flows presented here.

Oxford Economics employs a global modelling framework, with headline bilateral trade forecasts constructed as a function of demand in the destination market and the exporter's competitiveness (as measured by unit labour costs in nominal USD terms). Exports, imports and trade balances are identified, with both historical estimates and forecasts for the periods 2017-20 and 2021-30.

These headline bilateral trade forecasts for goods and services are also disaggregated by sector, using Oxford Economics' Industry forecasts to inform future production trends and taking into account the historic relationship between output and exports in each sector, by market:

- For trade in goods, sectors are classified according to the UN's Standard International Trade Classifications (SITC) system at the two-digit level and grouped into 30 sector headings.
- For trade in services, we identify five broad sectors: B2B and other services, tourism & travel, transport & distribution, financial services, ICT services and construction.

Drawing on the Kantar TNS survey results and Oxford Economics' long-term forecasts, Oxford Economics produces in consultation with HSBC a global report and specific reports on the following 23 markets: Argentina, Australia, Bangladesh, Canada, China, Egypt, France, Germany, Hong Kong, India, Indonesia, Ireland, Japan, Malaysia, Mexico, Poland, Saudi Arabia, Singapore, Turkey, UAE, UK, USA and Vietnam. The analysis of trade in goods also includes trade with Brazil and Korea for a total sample of 25 key trading markets; for trade in services the analysis also includes Korea for a total sample of 24 key trading markets.

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