



BLACK SEA TRADE AND DEVELOPMENT BANK

TURKEY

Country Strategy

2019-2022

TURKEY COUNTRY STRATEGY

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Table 1: Basic Macroeconomic Indicators at a Glance for TURKEY

Key Long Term Foreign Currency Sovereign Risk Rating at October 2, 2019:

Moody's: B1 | S&P: B+ (Unsolicited) | Fitch: BB-

		2015	2016	2017	2018	Proj. 2019	Proj. 2020
1	Population (Million)	78.3	79.5	80.7	82.3	83.4	84.3
2	Avg Exch. Rate (Lira/ US\$)	2.72	3.02	3.65	4.83	5.70	5.73
3	Inflation (CPI Avg.)	7.7%	7.8%	11.1%	16.3%	15.9%	10.5%
4	Average monthly wages (US\$)						
5	GDP (Lira billion)	2,339	2,609	3,111	3,724	4,278	4,774
6	GDP US\$ billion	859.8	863.7	852.7	771.4	750.8	833.5
7	GDP per capita (US\$)	10,985	10,863	10,560	9,368	9,000	9,883
8	Real GDP growth, %	6.1%	3.2%	7.5%	2.8%	-0.2%	3.3%
9	Official Unemployment (end of period) %	10.3%	10.9%	10.9%	11.0%	14.3%	13.7%
10	Industrial Production Growth, %	3.1%	3.4%	8.7%	2.1%	-0.7%	5.0%
11	Agricultural Production Growth %						
12	Domestic Credit Growth %	17.8%	16.0%	19.4%	18.7%	17.0%	12.3%
13	Domestic Credit/ GDP	74.7%	77.6%	77.7%	77.0%	78.5%	79.0%
14	Foreign Direct Investment - \$US million	19,274	13,950	11,546	13,002	8,500	12,000
15	FDI/ GDP	2.2%	1.6%	1.4%	1.7%	1.1%	1.4%
16	Central Govt. Budget Balance/ GDP, %	-1.0%	-1.1%	-1.5%	-1.9%	-2.8%	-2.2%
17	Total External Debt- US\$ billion	400.5	409.8	455.1	444.6	448.5	478.8
18	Total External Debt/ GDP	46.6%	47.4%	53.4%	57.6%	59.7%	57.4%
19	Public External Debt/GDP	13.7%	14.4%	16.2%	19.0%	n.a.	n.a.
20	Private External Debt/ GDP	32.9%	33.0%	37.1%	38.6%	n.a.	n.a.
21	Exports- \$US million (Goods)	151,970	150,161	166,159	174,599	180,317	197,234
22	Imports- \$US million (Goods)	200,098	191,053	225,114	216,515	199,184	228,631
23	Trade Balance \$US mn (Goods)	-48,128	-40,892	-58,955	-41,916	-18,867	-31,397
24	Trade Balance/ GDP	-5.6%	-4.7%	-6.9%	-5.4%	-2.5%	-3.8%
25	Current Account Balance \$US mn	-32,145	-33,139	-47,347	-27,020	-910	-7,327
26	Current Acct. Bal./ GDP	-3.7%	-3.8%	-5.6%	-3.5%	-0.1%	-0.9%
27	Forex Reserves (eop- exc gold) US\$ mn	92,921	92,055	84,115	72,867	70,217	73,830

Sources: State Institute of Statistics, Turkey; Central Bank of the Republic of Turkey, IFS –IMF October 2019; EIU Country Data;

TURKEY COUNTRY STRATEGY 2019-2022

I. Recent Economic Developments and Outlook

Turkey's economy has been the fastest growing in the Black Sea Region since the 2008 global financial crisis. Turkey experienced a slowdown in 2008-09 as capital inflows froze, demand for exports shrank and domestic demand contracted, resulting in a -4.7% fall in real GDP for 2009. However, the economy recovered swiftly, aided by a strong resumption of capital inflows, and by end 2018 was 66% larger in real terms than it was in 2008, implying an average annual real rate of GDP growth of 5.3%. While other emerging economies, in the Black Sea Region and elsewhere, have trended away from external finance fueled growth, Turkey successfully continued with this model of growth, posting sustained high rates of investment growth.

Recent macroeconomic trends

Despite major challenges over the 2015-2018 period, the Turkish economy fared relatively better than expected, although year to year growth exhibit volatility. Compared to 7.4% annual average growth in the previous four year period, GDP grew at 4.9% on average from 2015-2018. A series of domestic political events, as well as turmoil in neighboring Syria impacted Turkish economic growth negatively. Year on year fluctuations in economic activity have been particularly influenced by domestic consumption, which accounts for around 60% of GDP expenditure. GDP increased 6.1% in 2015 on the strength of domestic consumption growth, but it slowed to 3.2% in 2016 as the failed coup attempt negatively affected household consumption. A sharp rise in consumption and investment activity in 2017, supported by the Credit Guarantee Fund, helped to boost real annual GDP growth to 7.5%. However, another slow down followed in 2018 as geopolitical tensions intensified again along with the need for rebalancing. GDP growth was only 2.8%, as tight monetary policy led to household consumption remaining flat.

While investment has been much higher than the average for the Black Sea Region, and has been a key factor behind the strong growth observed after the 2008 crisis, gross fixed investment slowed markedly in 2015-2018 relative to the previous four years, and experienced an outright contraction of 0.6% in 2018. Relatively expansionary fiscal policy led to growth in public consumption, while depreciation of the local currency resulted in an increase in exports and a decline in imports, which in turn resulted in a positive contribution of net external activity to overall growth.

External sector

The current account deficit in Turkey narrowed to 3.7% and 3.8% of GDP in 2015 and 2016 (US\$ 32.1bn and US\$ 33.1bn respectively). However, as credit fueled growth took off, the deficit widened to 5.6% of GDP in 2017 (US\$ 47.3bn) before retreating to 3.4% of GDP in 2018 (US\$ 27.0bn). Compared to the previous four year period during which the deficit averaged 6.5% of GDP, the annual average for 2015-2018 was lower at 4.1% of GDP. This improvement in external balance was driven by an improvement in the trade deficit - exports were relatively flat over the four year period, but imports declined, in large part due to the lower cost of energy imports. Whereas the annual trade deficit averaged -8.4% of GDP between 2011-14, it averaged -5.6% of GDP between 2015-18. In contrast to the goods balance, the service balance worsened during this period, mainly due to weaker tourism receipts. The drop was particularly severe in 2016, but flows rebounded quickly and net inflows from tourism rose to US\$20.6bn in 2018, yet remained lower than in the pre-2016 period.

While the current account balance was in a better shape in 2015-2018 period compared to the previous four year period, the financing profile deteriorated. Net inflows increased only for foreign direct

investments, while net inflows for portfolio and other investments declined sharply. The ensuing shortfall was financed through net errors and omissions, which reached US\$ 19.1bn in 2018 (2.4% of GDP) and use of reserves.

Following two years of contraction in 2015 and 2016, Turkish exports increased 10.1% in 2017 and 7.0% in 2018. Growth was mainly driven by manufacturing, the share of which in total exports remained above 90%. A significant positive contribution came from exports of motor vehicles (+46.2% compared to 2014), basic metals (+15.7%), other machinery (+11.4%), and chemicals and chemical products (+17.6%). On the flip side, exports of coke and refined petroleum products declined -29.5% compared to 2014, and textiles and wearing apparel -6.2%.

Aside of 2017, imports declined in every year from 2015 to 2018, resulting in an annual average decline of -1.4%. This represented a contrast to the previous four year period in which imports had increased at an annual average pace of 7.7% per year. A significant portion of this decline was due to the fall oil prices. Overall, compared to 2014 imports of capital goods were down 18.6%, intermediate goods down 3.8%, and consumption goods down 21.1% in 2018.

The gross external debt stock of Turkey reached US\$ 444.6bn or 56.3% of GDP in 2018, up from US\$ 406.0bn or 43.4% of GDP in 2014. The increase was mainly driven by public external borrowing over the last two years while growth in the private sector indebtedness was moderate in nominal US\$ terms. In terms of maturity, however, short term debt was down in nominal US\$ terms to US\$ 116.8bn (14.8% of GDP), while long term external debt was up to US\$ 327.8bn (41.5% of GDP).

Turkey's total exports of goods reached record high in 2018, yet exports to BSTDB member countries during the 2014-2018 period were lower than those, in nominal dollars, compared to the previous four year period. Total exports to BSTDB members reached to US\$ 17.8bn in 2018, resulting in annual average US\$15.3bn exports from 2015 to 2018, which is 20.2% lower than the annual average US\$ 19.2bn from 2011-2014. Similarly, imports from BSTDB countries were down, averaging US\$29.8bn annually during 2015-2018 period, compared to an annual average of US\$40.6bn in the previous period. As a result, trade turnover between Turkey and other BSTDB members was down 26.4% in 2015-2018 period compared to the 2011-2014 period.

Foreign direct investment to and from other BSTDB members (excluding Moldova and Armenia due to lack of data) shows an even sharper downturn. FDI to Turkey was down 30.3% in 2015-2018 period compared to 2011-2014, while FDI from Turkey to other BSTDB countries was down 64.1% compared to the previous four year period.

Public finances

Sound public finances with persistent primary surpluses have been a key characteristic of Turkey for more than a decade, and have provided the basis of macroeconomic stability which has underpinned the strong economic growth observed. In recent years, however, this surplus has narrowed and fell to 0.0% of GDP in 2018. The primary surplus, which averaged 1.5% of GDP annually between 2011- 2014, declined to 0.6% of GDP in the period 2015- 2018, and is trending downward. On the revenue side, consolidated budget revenues declined from 21.2% of GDP during 2011-2014 to 20.6% of GDP in the 2014-2018 period, while the composition of revenues remained broadly stable. Expenditures were also down from 22.5% of GDP to 22.1% of GDP over the respective periods, thanks to declining interest expenses. Non-interest expenses, on the other hand increased from 19.7% of GDP to 20.1% of GDP, driven by an increase in current transfers. Interest expenses were down thanks to lower debt servicing costs of the domestic debt, while that of foreign debt increased slightly.

Persistent primary surpluses have led to a decline in public debt from 40.9% of GDP in 2010 to 30.0% of GDP in 2014 and further down to 28.2% of GDP in 2017. However, this trend was reversed in 2018 as the nominal debt stock increased with the depreciation of the local currency. As a result, public debt was marginally up to 28.7% of GDP in 2018. As of end of 2018, foreign debt accounted for 45.1% of total public debt, up from 32.3% in 2014, in large part due to the local currency depreciation.

Inflation, exchange rate, and monetary policy

Inflation, which has remained high in Turkey, re-accelerated in early 2018 and reached 25.2% y/y in October 2018, levels not seen since late 2003. In annual average terms, prices were up 16.3% in 2018, up from 11.1% in the previous year. Over 2015-2018, inflation averaged 10.7% per annum, compared to 7.9% in the previous four year period.

Inflation in domestic producer prices was far more pronounced, reaching 27.0% in 2018, up from 15.8% in 2017 and 4.3% in 2016. Over the four year period from 2015 to 2018, annual average inflation in producer prices was 13.0% compared to 8.0% in the previous four year period.

A principal factor pushing up inflation was the rapid depreciation of the local currency. Turkish Lira (TRY) was relatively stable from 2011 to 2014, with the TRY/ USD rate averaging 1.89 while the rate moved in the range of 1.50-2.37. However, since early 2015, there has been a steady depreciation, with the TRY/ USD exchange rate slipping from 2.3 to 5.26 as of end of 2018, and touching 6.88 at its lowest in August 2018.

As depreciation fed inflation and led to concerns regarding the ability to service foreign exchange debt (especially for firms with high external debt), the monetary authority addressed the issue by raising the monetary policy rate. The benchmark one week REPO rate was raised in several stages from 7.8% in early 2015 to 24.0% in late 2018.

Banking sector

The banking sector in Turkey continued to expand over the 2015-2018 period with total assets as a share of GDP in the banking sector increasing from 97.5% in 2014 to 103.8% in 2018. Depreciation appears to have played an important role in the balance sheet expansion, as evidenced by an increase in the share of foreign exchange assets compared to total assets from 34.8% in 2014 to 43.7% in 2018, mainly due to an increase in the Lira equivalent of FX. The rise in dollarization ratios was more evident in 2018 because of currency depreciation, with loan dollarization jumping from 32.6% in 2017 to 39.9% in 2018, the highest level since 2003. Similarly, deposit dollarization also increased, reaching 48.8% by the end of 2018, the highest level since 2002.

Non-performing loans have also been on a rising trend, increasing from 3.0% in 2017 to 3.9% in 2018. The increase was more pronounced in local currency loans, where the NPL ratio reached 6.0%, the highest level since May 2010. Despite the rise in NPLs, the banks' capital adequacy remains within prudential thresholds and capital adequacy ratio was 17.3% in 2018 which is above the regulatory requirement.

Outlook

According to Turkey's New Economy Program announced in September 2019, GDP growth in 2019 will be subdued at 0.5% before picking up to 5.0% in 2020 and remaining at that level until 2022. The slowing economy will lead to a 0.1% of GDP surplus in the current account balance in 2019, which will return to deficit of 1.2% in 2020, before balancing once again in 2022. The Government forecasts that inflation will decline from 20.3% in 2018 to 12.0% in 2019 and further down to 8.5% and 6.0% in 2020 and 2021

respectively. Authorities stress that the upper limit of the budget deficit at 3.0% of GDP will be observed, with the central government budget deficit projected at 2.9% of GDP from 2019 to 2021 and retreating marginally to 2.6% of GDP in 2022.

II. Overview of Current BSTDB Portfolio

As at 30 September 2019, the active BSTDB portfolio in Turkey amounted to 21 operations approved by the Board of Directors (BoD), involving an investment of € 723.5 million. Out of this total amount, 19 operations were signed for € 573.4 million and the outstanding disbursements were at € 409.0. Turkey ranks first in the BSTDB portfolio, with 23.7% of BoD approved operations, 22.0% of signed operations, and 21.7% of amounts outstanding. Relative to the Bank's active portfolio at the end of 2014, Board approvals increased by 89.1%, signings by 98.5%, and amounts outstanding by 137.6%.

Table 2: Active BSTDB Portfolio in Turkey as at end September 2019

All Figures in Euros Million	BoD Approval Date	Approved Amount	Signed Amount	Amount Outstanding
Emerging Europe Accession Fund	25-Sep-09	1.2	1.2	1.0
Balkan Accession Fund	10-Aug-06	0.5	0.5	0.1
Equity to ADM CEECAT Recovery Fund	21-Jul-11	6.2	6.2	2.3
TAV Izmir EGE Airport	12-Nov-12	40.0	40.0	38.1
Ekspo Faktoring	1-Dec-12 11-Apr-14	9.2	9.2	5.6
Hayat Kimya Sanayi A.S.	11-Nov-14	16.5	16.5	9.4
Ankara Etlik Integrated Health	28-Nov-14	60.0	60.0	45.8
Gurmat Geothermal Power Plant	24-Apr-15	59.7	59.7	39.7
Konya Karatay Integrated Health	27-Nov-15	50.0	50.0	35.0
SOCAR	12-Feb-16	27.6	27.6	27.6
Is leasing SME II	12-Feb-16	27.6	27.6	15.7
Garanti Leasing Turkey	26-May-17	20.0	20.0	17.1
AKLease	12-Jun-17	20.0	20.0	17.1
Turk Eximbank	4-Oct-18	50.0	50.0	50.0
Development & Invest/t Bank Turkey	23-Nov-18	50.0	50.0	50.0
Is Leasing SME III	23-Nov-18	30.0	30.0	30.0
Istanbul Metropolitan Municipality	15-Mar-19	77.5	77.5	-
SOCAR Turkey II*	22-Mar-19	19.3	9.2	9.2
Istanbul Metropolitan Municipality	1-Apr-19	40.0	-	-
Gurmat Geothermal Power Plant II*	27-Jun-19	18.4	18.4	15.2
Halkbank	8-Jul-19	100.0	-	-
Total		723.5	573.4	409.0

III. Review of Country Strategy 2015-2018: Post-Evaluation

The evaluation was performed by the Bank's Evaluation Office as per the respective Evaluation Policy. It reveals the performance of the Bank's 2015-2018 Country Strategies, to provide accountability and facilitate the decision-making regarding future strategies.

The evaluation compares the stated targets with actual results as of end of 2018, and provides an evaluation rating. The 2015-2018 Country Strategy is aligned with the objectives of the Bank's Business Plan 2015-2018 and was therefore evaluated in that context.

The implementation of the Country Strategy is in line with the Medium Term Strategy and exceeded the targeted volumes at a very high level of 219%. Both the investment volume objectives and the intended sector coverage were fulfilled substantially. Further details are outlined in the following table.

Table 3: Post Evaluation of 2015-2018 Country Strategy for Turkey

Post Evaluation of 2015-2018 Country Strategies				
TARGETS (signed Operations)			RESULTS (Signed Operations)	
Country Strategy	Sectors / Priorities	Target: Number / EUR million	Actual: Number / EUR million	Evaluation Summary
Turkey	<p>1. Financial sector – priority: Trade Finance, SME.</p> <p>2. Energy/Infrastructure: energy (efficiency and renewable), transport, municipal, mining, utilities, PPP, etc.</p> <p>3. Manufacturing and agri-business</p> <p>4. Health / PPP</p>	16/197	11/433	<p>1. Signed volume: 219%</p> <p>2. Sector coverage: Hayat Kimya (consumer staples) Ankara Etlik Health Campus (PPP) Gurmat Geothermal Power Konya Health campus (PPP) SOCAR Energy IS Leasing SMEL 2 CCN Research Center Garanti Leasing Aklease Turk Eximbank TKB (SME)</p> <p>2. Conclusion: Targets exceeded twofold; very balanced sector coverage. The Bank addressed the respective priorities, products and sectors exceptionally well. This includes a substantial share of Public Private Partnerships (health sector in particular).</p>

IV. BSTDB Operational Priorities for 2019-2022

The Bank's role and priorities for Turkey during the 2019-2022 period are outlined in accordance with (i) the priorities and targets laid out in its *Medium-term Strategy and Business Plan 2019-2022*¹; (ii) updates to the MTSBP 2019-2022, (iii) country needs and objectives, and taking due consideration of (iv) available resources, strategies and policies of BSTDB. BSTDB will seek viable opportunities for operational activity

¹ Approved by the Bank's Board of Governors in February 2019.

and will closely monitor developments in the Turkish economy in order to stand prepared to support bankable projects. Where possible, the Bank will seek to leverage its presence by co-financing with international financial institutions (IFIs), public sector institutions and private partners, per its mandate.

The intention of the Bank is to provide support for the implementation of Government economic priorities, while being responsive to market demand. The Bank will consider undertaking activities and providing services as may advance its purpose, paying special attention to activities that promote regional cooperation, development of infrastructure, increased and diversified export of goods and services, and new employment creation. The Bank will seek to maintain consistency with the UN's Sustainable Development Goals in the context of Turkey and its priorities and needs. In this respect, the Bank will also pay due attention to the New Economy Program for the 2019-2021 period announced in September 2019, in particular the intention to realize mega-infrastructure projects through foreign investment and international financing.

The Bank has historically had a robust portfolio in Turkey and one that has been diverse in terms of sectors of coverage. In particular, the Bank has had a high proportion of its public sector operations in Turkey, and has had the opportunity to finance different areas such as the health sector and research in which it typically has not had much of a presence. Based on the updated 2019-2022 BSTDB Medium Term Strategy and Business Plan, the Bank would expect on average to sign around three new operations each year, for approximately € 95-105 million. Over the four year period, this implies twelve to thirteen new commitments (signed operations) for approximately € 400 million (a range of € 380-420 million). The Bank will insist that all operations meet criteria of sound banking principles on the one hand, and financial viability/ economic sustainability on the other hand.

These indicative targets are based on the Base Case Scenario of Growth of the updated MTSBP 2019-2022², and given appropriate circumstances and sufficient operational opportunities, the Bank would seek to exceed this level in order to continue meeting client needs. In case of higher regional economic growth rates, an improved situation in financial markets, and above all, increased demand for Bank funding coming from private and/ or public entities active in the Turkish market, the Bank will welcome the prospect to exceed the projected scenario and achieve higher operational results.

A key consideration for the Bank is to increase its relevance in each Member State. Achievement of such greater prominence has both quantitative and qualitative aspects- how much the Bank plans to do, but also where it plans to do so. In line with the MTSBP 2019-2022, the Bank intends to increase its presence in key infrastructure sectors since on the one hand regional investment rates are low while country needs are high, and on the other hand such operations usually have high cooperation and development impact, and positive economic and social returns that exceed the financial returns of the particular operation. The willingness to provide sovereign guarantees (or equivalent undertakings) for such operations would greatly increase the ability of BSTDB to provide support in these high priority areas.

Areas for BSTDB Financing:

Energy and Infrastructure (E&I)

The Bank will continue offering its support for “bankable” project opportunities in the areas of energy and infrastructure, where investment opportunities are materializing due to Turkey’s growing demand for energy, electricity and upgrade and rehabilitation of all kinds of national infrastructure. This applies

² Any revisions to the MTSBP 2019-2022 may affect the indicative targets, as country specific figures might need to be revised accordingly with the overall figures

to all key infrastructure sectors, including energy and electricity, oil and natural gas upstream, midstream and downstream, transport infrastructure, telecommunications, information technology, and municipal and social infrastructure. In particular, the Bank will be looking forward for more “renewable energy” opportunities. The existence of an appropriate competitive environment and regulatory framework will be an important consideration in ascertaining ‘bankability’ alongside development impact.

The Bank will continue to ensure that all BSTDB E&I operations in Turkey meet sound banking principles, comply with the Bank’s Environmental Rules and Procedures, and incorporate, where appropriate, Environmental and Social Action Plans.

Turkey has enjoyed close historical economic ties with neighboring countries. In this respect BSTDB will be prepared to support bankable investments and business opportunities promoting regional economic cooperation as well as involving investments of Turkish companies in E&I projects in other BSTDB Member Countries.

The Bank will also work in cooperation with international financial institutions (IFIs), commercial banks and export credit agencies (ECAs) as an important source of the project co-financing as well as the institutional knowledge transfer.

Areas of particular focus include:

Natural resources

- Projects involving the development and rehabilitation of natural resource facilities upstream, midstream and downstream;
- Projects involving exploration and production of hydrocarbons both onshore and offshore, including any technical applications to increase recovery;
- Projects involving construction of new or rehabilitation of existing energy transportation infrastructure (pipelines, railways, river/maritime transportation facilities, etc). The Bank will also support projects designed to improve local and regional energy and handling infrastructure, such as rehabilitation of gas/oil processing and storage facilities;
- Provision of financing for ‘downstream’ operations, particularly the expansion of retail networks, and upgrading of oil refineries and petrochemical facilities to increase production and improve the quality and environmental acceptability of refined products;

Energy and electricity

- Projects envisaging construction, upgrading, modernization, expansion, operation and maintenance of all kinds of conventional and renewable energy and electricity capacities; facilities and infrastructure which facilitates generation, production, distribution, transmission and sale of energy and electricity;
- Projects, which lead to improved energy efficiency and energy conservation

The Bank will work in cooperation with other IFIs and commercial banks in joint energy and infrastructure sector projects as an important source of institutional knowledge transfer.

Municipal and Social Infrastructure

- Municipal projects with or without sovereign or municipal undertakings or guarantees where municipalities, local regional governments or companies linked to municipalities or local regional governments are in the role of the borrower or ultimate guarantor;
- Projects supporting Public-Private Partnerships, with a special focus on the health care sector, and in various sectors of Municipal Infrastructure, in particular waste/water management
- Projects involving waste water, solid waste, hazardous waste treatment and sewage.

Mining

- Projects in the mining sector including, among others, import/export of equipment and production for further processing;

Transportation and Transport Infrastructure

- Support for the development and rehabilitation of key transportation and transport infrastructure.

Telecommunications and IT Services

- Projects involving upgrade, development and modernization of telecommunications infrastructure.

Manufacturing

In line with its medium term strategy, the Bank will give priority to public projects in Turkey. With the relatively large size of the economy, and with comparatively higher population growth and urbanization rates, Turkey presents various financing opportunities in sectors such as transportation, health, education and municipal infrastructure. In addition, Turkey has developed an advanced legal framework and accumulated considerable experience for implementation of projects under public private partnership (PPP) structure. In view of the priority to attracting private financing expressed in the New Economy Program for 2019-21, the Bank will continue to look for financing possibilities for such PPP projects and public projects, mainly in the transport sector for activities such as motorway, port and railway projects. The Bank will give priority to those projects that have already been realized to a considerable extent, that are linked to and implemented simultaneously with other projects, and that have strategic importance for the future of the country.

Municipal projects will continue to be a priority for the Bank, especially those in urban mass transportation systems like metro and light rail lines, waste treatment facilities, potable water and sewerage infrastructure projects.

Other sectors will be considered but will comprise lower priority. Private manufacturing firms will have to deal with the impact of recent devaluations and the consequent challenges. It is expected that there will be greater need to focus on restructuring existing loans rather than to grow and expand capacities during the program period. BSTDB will be very selective in financing private sector companies with priority given to export oriented companies and companies with international operations, especially in the greater Black Sea region and involving other BSEC countries.

Turkey has a rather diversified economy and is an exporter in a number of sectors. However, the share of imported inputs for those exports remains relatively high. Due to the recent volatility of the exchange rate, many companies plan to make vertical integration investments that reduce their dependence on imported goods and that increase the domestic value added of their production. As a result, the Bank will explore investment in companies that target import substitution and vertical integration.

Although Turkey traditionally produces and exports a wide range of agricultural products, there has been a decline in agricultural productivity during last years. New investment is required to maintain Turkey's position as an exporter of agricultural products. The Bank will consider opportunities for new agribusiness investments as well as renewal and modernization projects that (i) create employment, (ii) generate exports, and (iii) reduce bottlenecks and increase competitiveness.

The geographic location of Turkey makes it important for logistics investments. This sector has significant potential to grow and may provide benefits to the economy. Thus the Bank will look for possibilities to finance projects in this sector that will contribute to the country's strategic vision to serve as a link between Europe and Asia.

BSTDB will be very selective in the real estate and tourism sectors. After several years of fast growth, the real estate sector is in a contraction phase, while the need for additional supply in tourism sector is rather limited.

BSTDB Trade Finance and Financial Sector Strategy for Turkey

BSTDB's Trade Finance and Financial Sector Strategy was created in order to develop a network of financial intermediaries, through which to deliver trade finance and SME finance products. Since BSTDB began its operations, the following products have been introduced through selected financial intermediaries in Turkey for the purpose of Trade Finance, and SME development:

- Short and medium-term Pre-export Finance product;
- Combined Trade Finance (export/import) product;
- Medium-term SME Finance products;
- Subordinated loan for SME financing;
- Leasing Facility for SMEs

The financing of trade, particularly the export of manufactured goods and equipment from Turkey to other BSEC countries, was successfully implemented in previous years through the export credit agency Turk Eximbank. In addition, the Bank invested in two equity funds in the region that also covered Turkey, and small scale investments have been made. Furthermore, the first subordinated loan to a bank for SME financing was successfully co-financed under a Master Co-operation Agreement signed with other IFIs. The bank also increased its leasing sector coverage.

While the Bank will remain present in the financial sector in the coming program period in Turkey, it will likely reduce its exposure relative to the past. Where the Bank does get involved, priority would be given to public sector banks with a special mandate such as development and export promotion given by their establishing agreements, or to other majority state owned bank whose exposures will be covered by a sovereign guarantee, thus increasing the sovereign exposure of the BSTDB portfolio. Given the importance of export promotion, short term trade financing facilities will also be considered.

The Bank will continue to provide financial support to SMEs which undertake modernization programs of their production facilities, corporate development or investment programs, but it will not increase the number of financial intermediary partners.

To a lesser degree, special focus activities will also be considered. For example, energy efficiency needs to be raised, particularly through reduction of heating losses and improvements of existing systems. Thus, the Bank will consider offering targeted credit facilities through financial intermediaries in order to finance energy efficiency investments of SMEs and households. The Bank will also maintain contact with complementary development finance institutions such as EBRD, IFC, EIB, DEG and KfW to seek ways to coordinate activities and share experiences, given the opportunities which exist for joint involvement.