Turkey – Russia Standoff

Much Ado about "Something"

Turkey - Russia │ Economy
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The confrontation between Russia and Turkey is raising concerns about its potential negative impact on the region's economic development. However, detailed analysis indicates that the interdependence between Turkey and Russia is limited, with even fewer possible implications for Georgia. The main ways Turkey depends on Russia are imports of Russian natural gas and revenues from Russian tourists. While we do not expect Russia to cut gas deliveries, we think that fewer tourists will travel to Turkey. Turkish exports of agricultural goods and textiles to Russia are likely to fall, albeit their share of total exports is low. Some of the loss will be compensated by the newly signed EUR 3.0bn deal between Turkey and the EU for managing Middle East migrant inflows. As for the region as a whole, heightened tensions will probably lead to a temporary increase in risk perception, resulting in a higher cost of external financing, particularly for current account deficit economies.

Russia accounts for a minor share of total Turkish exports. Russia's share of total Turkish exports in 2014 was 3.8% (US$ 5.9bn out of a total of US$ 157.6bn), which fell further to 2.5% in 10M15, as the economic contraction in Russia depressed demand for foreign goods. Turkish exports to Russia are dominated by textiles and clothing (19.1% of total exports in 2014), fruits and vegetables (17.9%), machinery and electronics (15.3%), and transport (10.9%). While the overall dependence is limited, the Turkish agricultural sector exhibits high vulnerability, with Russia accounting for 12.7% (US$ 1.1bn) of total Turkish fruit and vegetables exports in 2014 (US$ 8.4bn). Dependence in textiles and machinery is relatively insignificant, as Russia accounted for just 3.9% of total exports in these sectors. On the other hand, Turkey's dependence on imports is relatively substantial, with Russian goods accounting for 10.4% of total 2014 imports (US$ 25.3bn out of a total of US$ 242.2bn). Key imports from Russia are oil and gas (65.6% of the total in 2014) and metals (16.5%).

Banned products accounted for 0.5% of total Turkish exports. Russia banned the import of 18 items from Turkey starting January 1, 2016. Exports of these items totaled US$ 0.8bn in 2014 (12.9% of total exports to Russia) and have been declining in 2015, falling by 2.3% y/y in 10M15. This fall will accelerate in 2016 once the ban takes effect. However, given the low share in total exports, its impact should be minor.

Contrary to exports, Turkey is highly dependent on Russia for natural gas imports. Overall, Turkey imported 49.3bcm of natural gas in 2014, including 7.3bcm of LNG. Slightly more than half of this gas demand (27.0bcm, 54.8% of total) was met by Russian gas, with the rest being imported from Iran (8.9bcm), Azerbaijan (6.1bcm), and others (7.3bcm). Turkey used the largest share (48.1%) of its natural gas consumption for electricity generation, followed by industry (25.4%), residential (19.3%), and other purposes (7.1%). Therefore, any disruption in natural gas supplies from Russia could have a serious negative impact on electricity generation in Turkey. The country is expected to partially lessen its dependence on Russian gas starting in 2018, as an additional 6bcm of gas will be imported from Azerbaijan (already contracted).

Turkey versus Russia, 2014

	Turkey	Russia
GDP, US$ bn	798.3	1,860.6
GDP per capita, US$	10,381	12,718
CAB, % of GDP	-5.8%	3.1%
CAB, US$ bn	-46.5	58.4
Trade balance	-63.6	189.7
Service balance	25.2	-55.3
Others	-8.1	-76.0
Fiscal balance, % of GDP	-1.0%	-1.2%
Reserves, US$ bn	141.8	385.5

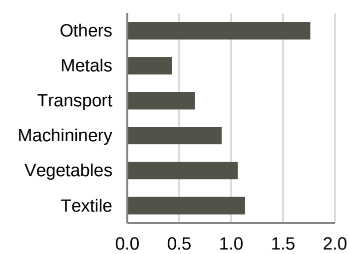
Source: IMF and official data

Georgia dependence on Turkey and Russia, 2014

	Turkey	Russia	Total
Exports, US$ bn	0.2	0.3	2.9
Imports, US$ bn	1.7	0.6	8.6
FDI, US$ bn	0.1	0.1	1.8
Arrivals, mn	1.4	0.8	5.5

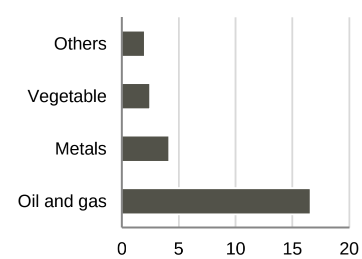
Source: GeoStat, GNTA

Figure 1: Turkish exports to Russia, 2014 (US$ bn)



Source: TurkStat

Figure 2: Turkish imports from Russia, 2014 (US$ bn)



Source: TurkStat

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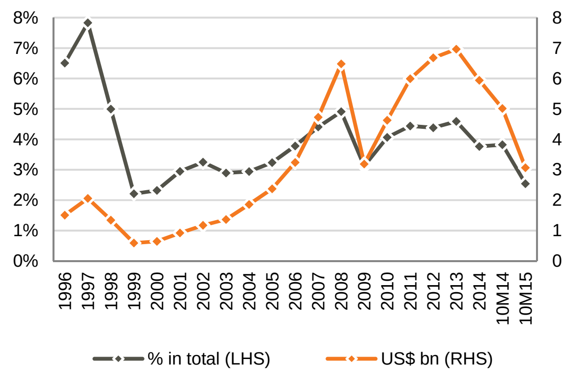
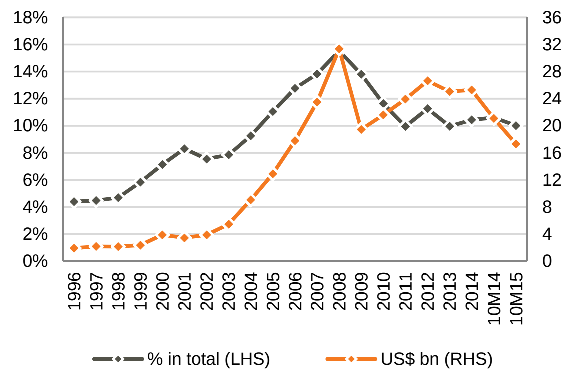
We don't expect Russia to cut gas supplies to Turkey. Natural gas exports are a major source of Russia's export revenues and Turkey is its second biggest customer after Germany. Cutting gas supplies to Turkey would mean loss of revenues, which are already suffering from the US-EU sanctions. Russia's weak external position due to the low oil prices reinforces this argument. In addition, looking back at history, Russia (and the Soviet Union) never resorted to cutting oil and gas supplies to the West, as they always were and remain Russia's main source of hard currency revenues.

Figure 3: Turkish exports to Russia



Source: TurkStat

Figure 4: Turkish imports from Russia



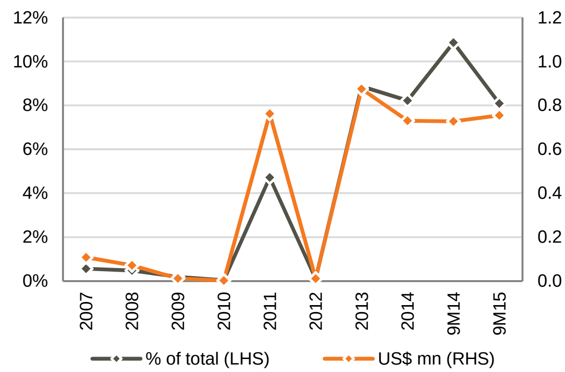
Source: TurkStat

FDI from Russia in Turkey has generally been low. According to the Turkish central bank, of the US$ 101.4bn in FDI into Turkey from 2007 to September 2015, only US$ 3.3bn (3.3%) came from Russia. It is highly unlikely that Russia will constrain operations of Russian businesses in Turkey. Turkish investments in Russia are not expected to be hurt directly by sanctions either, as Russia does not intend to limit operations of Turkish subsidiaries registered as separate entities in Russia. However, an indirect impact on these companies cannot be ruled out, as they might run into problems procuring Turkish inputs and/or hiring Turkish personnel.

Real losses will occur if Russia decides to suspend the planned multi-billion dollar projects. While no official statement has been made, Russia may opt to suspend construction of the US$ 20bn nuclear plant in Akkuyu (Turkey), which it is to finance fully, and Turkish Stream – another multi-billion dollar project that is intended to expand the natural gas pipeline connecting Russia and Turkey. The medium- to long-term repercussions of the suspension of these projects would probably be felt in Turkey's electricity market.

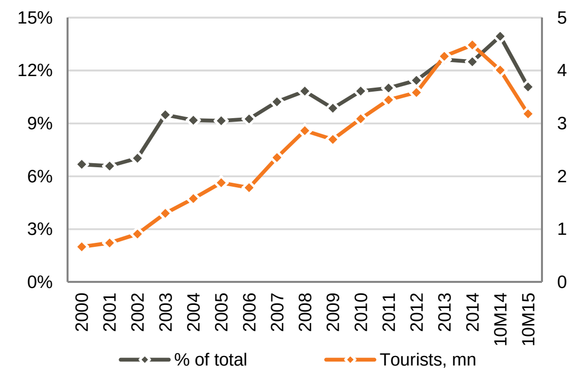
Turkish tourism exports to take the biggest toll from the strained Turkey-Russia relations. According to the Central Bank of Turkey, 4.5mn (12.5% of total) Russian tourists visited Turkey in 2014 (+5.0% y/y) and based on our calculations, Turkey received about US$ 3.7bn from them. With the economic contraction in Russia, however, the number of visitors to Turkey has already fallen 20.7% y/y in 10M15 to 3.2mn (11.1% of total). Unless the problems are resolved by spring 2016, we expect the full impact of the drop in tourist arrivals to be felt in mid-2016, as October-April is the low season in the tourism industry in Turkey (in 2014, 83.1% of Russian tourists visited Turkey from May to September).

Figure 5: Russian FDI in Turkey



Source: Turkish Central Bank

Figure 6: Russian tourists in Turkey



Source: Turkish Central Bank

EU pledge to support Turkey and the low oil price will help the country withstand pressure on its currency. Loss of inflows from Russia could put pressure on Turkey's current account balance and thereby, on the exchange rate. Our calculations indicate that annual losses from the standoff could amount to a maximum of 0.5% of GDP. However, this loss should be partially compensated by the EUR 3.0bn pledge by the EU to Turkey and a lower import bill due to sustained low oil prices, mitigating pressure on the exchange rate.

Expected Impact on Georgia

Transit of goods from Turkey to Russia through Georgia seems to be the only area that will suffer directly from the strained Russia-Turkey relations. Georgia has benefitted from the transit of Turkish goods through its territory, not only to Russia but also through Russia to Central Asia. With Russia banning certain imports from Turkey and limiting transit to Central Asia, Georgia could lose some revenue due to the drop in transit. However, the volume of trade through Georgia was probably not significant enough to have a major impact. Moreover, Azerbaijan recently offered its territory to Turkey to use for transit to Central Asia, which, if implemented, will redirect some transit to Georgia.

In some respects, Georgia could benefit from the new reality. Georgia can (i) partially substitute Turkish fruits and vegetables on the Russian market and (ii) attract some of the tourists who would normally go to Turkey. However, the benefits from these channels would only be realized by the middle of next year, as Turkey is a summer destination for Russian tourists, and redirecting vegetable and fruit exports could take a few months. Additionally, Georgia could increase electricity exports to Turkey.

The Turkey-Russia standoff may have a negative impact on regional stability, leading to an increase in the risk premium for the region. Georgia may face challenges, given that it is a current account deficit economy with persistent external financing needs. Foreign direct investment, IPOs, and access to other forms of financing have been vital in financing growth in Georgia in recent years. A heightened risk perception could temporarily inflate the cost of financing. However, we believe that prudent economic policies, along with strong and independent institutions, will ensure that Georgia remains attractive for foreign investors.

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