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Crisis in Turkey: Consequences for Germany

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From Germany's perspective, Turkey's economic problems primarily mean risks in the sphere of security and migration control, as well as uncertainty about the stability of the international economic situation. Germany will try to prevent an escalation of the crisis and simultaneously consider the situation as a chance to improve bilateral relations with Turkey, intensify that country's ties with Europe, and persuade its government to reform.

There are many indications that after the recent currency crash, Turkey will be in the doldrums for longer. Its authorities can either continue the policy of low interest rates, which will result in further investor flight and pressure on the lira's course, or raise interest rates, which will stabilise the rate but at the same time lead to recession and rising unemployment. Neither is optimal.

The situation is closely observed in Germany, where Turkey is important from the point of view of security policy, control of migration, and economic relations. The risk assessment in these areas will determine whether and in what way Germany will be involved in possible assistance to Turkey.

International Risks. The political repercussions of a collapse of the Turkish economy are particularly worrisome to the authorities in Berlin. The first is the durability of the immigration control agreement concluded between Turkey and the EU in 2016. The authorities in Ankara, if faced with a lack of public finances, they cannot, for example, afford to meet the conditions of the agreement or will demand the EU increase financial transfers. Meanwhile, for Germany, the continuation of this agreement is key to managing the effects of the mass-migration crisis. The deal's importance was heightened after recent events in Chemnitz, Germany, which have sharpened the intra-German dispute over policy on refugees.

Another risk is related to the security sphere. Turkey plays an important role in NATO as the second-largest conventional power in the Alliance. It is also an important player in the Middle East and is involved in the war in Syria. The Germans fear that a deep economic slump could lead Turkish President Recep Tayyip Erdoğan to take actions that divert public attention from the crisis, including greater involvement in military operations in the region or pursuing a policy of obstruction in NATO, especially with deteriorating U.S. relations.

From the German point of view, there are many imponderables related to the impact of the Turkish economy on the global economy, which in turn determines the condition of German exports. The concerns are primarily related to the deterioration of investor mood and crisis "contagion" to other emerging markets. Analysts are divided: some believe that most emerging markets do not show problems similar to Turkey; others warn that with the chaos in Venezuela, the increasingly worrying crisis in Argentina, and the prospect of trade wars, the Turkish problems may lead to another outbreak of a global economic crisis.

The threats resulting from the situation in Turkey also have a European dimension: the involvement of banks from EU Member States. In the case of Spain, their exposure is €82 billion; France, €42 billion; Germany, €14 billion; Italy, €10 billion. The most exposed to risk are the financial sectors of the Southern European economies, which have just started regaining stability after the last global crisis. Costs may also arise in connection with possible bankruptcies of Turkish banks with subsidiaries in EU countries, such as Ziraat, Garanti, Yapi Kredi, and

Credit Europe, whose deposits are covered by EU guarantees. However, there are also strong arguments for a calmer view, one that the Turkish crash will not “infect” the European banking system. The amounts, although billions of U.S. dollars, are too small to have systemic significance. In addition, after the crisis in the euro area, both banks and supervisors have much more experience in responding to such situations.

Direct Risk for Germany. Less apprehension is connected with the expected effects on the German economy itself. The Turkish market, worth €21.4 billion euros, is a distant 17th place in the export statistics, behind the much smaller Hungarian market (data from 2017). It is not enough to seriously harm the German economy.

Slightly more concerning is direct investment data. Up to 7,000 Germany-based companies are engaged in Turkey, employing more than 100,000 employees. Among them are the potentates: VW, Daimler, EON, BASF, Siemens, Puma, Allianz, Axel Springer, MAN, and Hugo Boss. For many of them, the lira’s collapse is primarily tied to losses related to the growing costs of imported supplies and declining internal demand.

That is why it is not surprising that, for example, Oldenburg, Germany-based EWE, which distributes gas to 900,000 customers, plans to withdraw from the Turkish market. The company has to buy gas for dollars and constantly sells it for the cheaper lira. Also, around EON, another player on the energy market, speculation is growing that it may leave the Turkish market after it decreased its share in a joint company with local partner Sabanci. The problems may also affect Puma, whose activity may be hindered by the introduction of barriers to imports from China planned by the Turkish government (the company imports half-finished products). However, devaluation has also made winners: this includes companies that produce for export and can increase their margins, or Deutsche Bank, which earned €35 million in exchange on the falling lira.

Among the potential consequences of the crisis for the German economy, the potential for an increase in immigration should be considered. The impulse would be rising unemployment and declining income in Turkey, with a facilitating factor the presence of the large Turkish diaspora in Germany (2.8 million people). From a purely economic point of view, it does not have to be a negative phenomenon because Germany has been recording record low unemployment for several years and needs employees. The question remains whether the qualification profile of the immigrants meets the needs of German employers.

Conclusions. Faced with a variety of threats, the German authorities are considering whether and in what form to help Turkey. There is potential for destabilisation of security and loss of migration control, as well as some threat to the stability of the international economy. However, there are also reasons for restraint. Turkey has a relatively low direct impact on the economic situation in Germany and one can also expect a lack of public support for assistance to a state criticized for its authoritarian tendencies and with which relations have deteriorated in recent years (e.g., due to arrests of German citizens).

An option preferred by the majority of politicians in the ruling coalition is the involvement of the International Monetary Fund, an institution established to respond in such situations. The problem is that President Erdoğan will not want to accept assistance from the IMF both out of pride and because it will require his country to carry out political and economic reforms. This is why SPD Chairwoman Andrea Nahles said that Germany should be ready to assist Turkey bilaterally, despite political differences and doubts about President Erdoğan’s political course.

Direct financial support would, however, be the ultimate option. It is more likely that the IMF option will be complemented with proposals for economic and political cooperation aimed at improving mutual relations. There are indeed many signals that Germany has chosen this path. It is worth noting, for example, the abolition of restrictions on export credit insurance in trade with Turkey that had been introduced as a sanction for the arrests of German citizens, and signals of involvement in the renovation of railway lines in Turkey. The meetings calendar also makes an impression. At the beginning of September, Germany’s Minister of Foreign Affairs Heiko Maas paid a visit to Turkey, his first in this capacity, and at the end of the month, President Erdoğan is planned to visit Berlin. With these measures, Germany wants to achieve several goals: stabilise Turkey, induce it to reform, strengthen its relations with Europe, and, at the same time, end the deadlock in bilateral relations.

From Poland’s perspective and that of other countries in Central Europe, the possibility of an economic meltdown in Turkey must be alarming—even more than in Germany. They are treated by financial markets also as emerging economies and often put in the same risk group as Turkey. In the event of a worsening situation, they too—especially those not in the euro area—could experience exchange rate volatility and higher debt servicing costs. Another risk for them is the potential for a new flow of refugees, as well as the possible weakening of NATO. Therefore, it is in their interest to quench the crisis in Turkey as quickly as possible.