

# Research Euro area

## How vulnerable is Europe to the Turkish havoc?

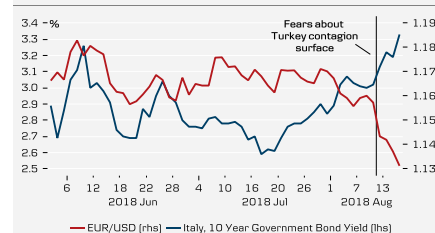
- In light of the Turkish turmoil, we take a closer look at EU-Turkey ties in this document, focusing especially on the financial, economic and political links.
- EU banks' exposure to Turkish assets is limited and we would be surprised to see the ECB reacting to the Turkey crisis with any policy measures.
- Trade and FDI links are of a relatively modest scale, limiting the possible risks to the euro area growth outlook from this channel.
- If the crisis escalates further, the EU might find itself pressured to consider support measures for Turkey, as the country has become an important puzzle in the European migration strategy.

### Financial links: limited spillover

Both the euro and periphery bond yields have recently come under increased pressure among growing fears about contagion from the Turkish turmoil to the European financial system more broadly. *Reports* that regulators at the Single Supervisory Mechanism of the ECB have growing concerns about some EU banks' exposure to Turkey further fuelled the risk-off mood.

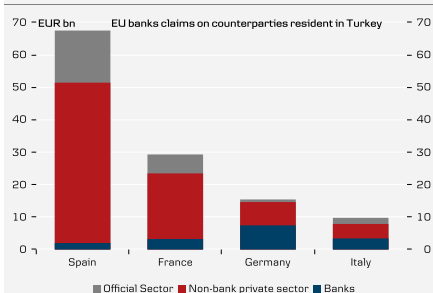
From an EU perspective, Spanish and French banks stand out as particularly exposed to Turkish assets, especially in the non-bank private sector. However, putting the absolute numbers into perspective, as a share of total banking sector assets the exposures are small (around 2.0% of total banking sector assets for Spain and less than 0.5% for France, Italy and Germany).

### Periphery yields and EUR have come under pressure



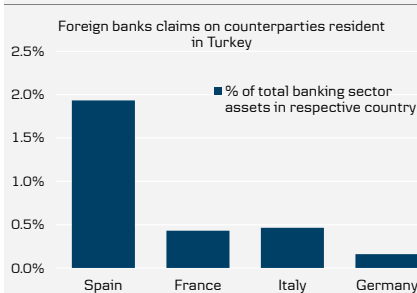
Source: Macrobond Financial, Danske Bank

### Spanish and French banks especially exposed to Turkey...



Source: BIS, Macrobond Financial, Danske Bank

### ...but in relative terms exposure remains small



Source: BIS, Danske Bank

In light of the figures above we view fears of contagion to the Italian/Spanish banking system as overblown. Indeed, for European banks, developments regarding the new Italian government's budget and deficit plans in September will be of much greater importance in our view. Despite encouraging comments from lawmakers regarding commitment to EU budget rules, we think it is too early to declare the Italian crisis over just yet.

#### Analyst

Aiila Mihr  
+45 45 12 85 35  
amih@danskebank.dk

#### Assistant Analyst

Christian Belling Sørensen  
chsr@danskebank.dk

#### Senior Analyst

Piet P. H. Christiansen  
+45 45 13 20 21  
phai@danskebank.dk

## Economic links: German interests at stake

**In terms of trade links, Germany exhibits the closest links** in absolute terms with annual exports of EUR21.5bn in 2017. Turkey is the 16th largest export market for Germany, hence ranking higher than Japan. This said, exports to Turkey still accounted for only 1.7% of total German exports in 2017 and overall this limited exposure in relative terms also holds true for the other big euro area economies (Italy 2.2% of total exports, Spain 2.1% of total exports and France 1.4% of total exports went to Turkey).

**From a foreign direct investment (FDI) perspective, Germany again dominates the picture**, with an FDI stock of EUR16.5bn in 2017, followed by Italy with EUR11.1bn. About 6,500 partly or wholly owned German companies operate in Turkey, which means the German business community is likely to be watching the current situation with concern.

## Political links: Turkey as important ally in the migration crisis

**German politicians, including Chancellor Angela Merkel, have made it clear that Germany has an interest in an economically prosperous Turkey** but, at the same time, have stressed the importance of central bank independence. German and Turkish finance ministers will meet in coming weeks ahead of a state visit of  $\ddot{u}$  on 28 September.

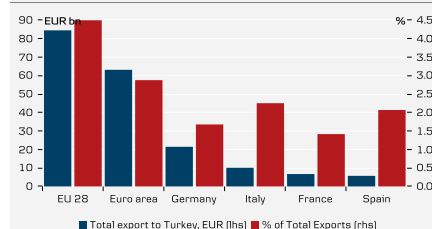
**Despite the economic ties and Germany's interest in avoiding Turkey's financial meltdown, we would be surprised to see Germany, either directly or through the EU, providing significant financial support for Turkey**, similar to Qatar, in light of the current German public mood towards bailouts and recent diplomatic clashes about human rights abuses and imprisonment of German citizens in Turkey. Instead, Germany's Finance Minister Olaf Scholz is likely to stress to his counterpart that any kind of support measures would necessitate a return to a credible and independent monetary policy regime.

**Although we view the hurdle to any kind of EU financial support measures as high, the EU might feel pressure to act not only out of economic and financial considerations but, more importantly, because Turkey has become a key piece of the puzzle in European migration strategy.** A destabilisation of Turkey could put the future of the 2016 EU-Turkey deal on the relocation of Syrian asylum seekers at stake – in 2015 (the latest information available) about 3 million refugees were stuck in Turkey. A potential influx of a large number of immigrants from Turkey would provide further ammunition for populists across the block, with European Parliament elections approaching in May 2019.

## Limited risks to EU growth but political picture remains muddy

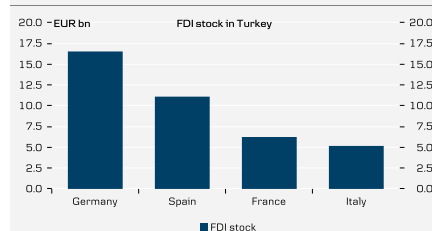
**Overall, we see the risk of a contagious crisis for the European financial system as fairly small at the current stage.** We would be surprised to see the ECB reacting to the Turkey crisis with any policy measures and instead expect it to refer to the macro-prudential toolkit of the Single Supervisory Mechanism (SSM). From an economic perspective, Germany has the strongest interest in a resolution of Turkey's troubles but total euro area trade and FDI links are of relatively modest scale, limiting possible risks to the euro area growth outlook from this channel. The diplomatic situation between the EU and Turkey remains fraught and we think it is questionable whether the EU would risk a further deterioration of its relationship with the US by openly siding with Turkey in the current conflict. However, a potential collapse of the refugee deal with Turkey is the main bargaining chip for Turkey in seeking EU support.

EU trade links to Turkey



Source: Macrobond Financial, Danske Bank

Germany has largest FDI exposure in Turkey among euro area countries



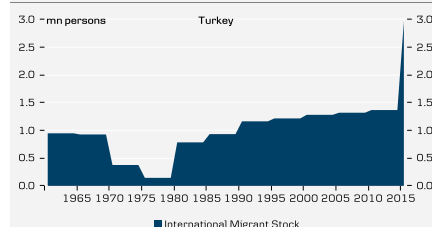
Source: Central Bank of Turkey, Macrobond Financial, Danske Bank

Turkey is the 11th largest export market for Italy

Country	Turkey export market ranking
Germany	16
France	12
Italy	11
Spain	14

Source: Macrobond Financial, Danske Bank

Turkey has been an important EU ally in stemming migration flows



Source: World Bank, Macrobond Financial, Danske Bank

## Disclosures

This research report has been prepared by Danske Bank A/S ('Danske Bank'). The authors of this research report are Aila Mihr (Analyst), Christian Belling Sørensen (Assistant Analyst) and Piet P. H. Christiansen (Senior Analyst).

### Analyst certification

Each research analyst responsible for the content of this research report certifies that the views expressed in the research report accurately reflect the research analyst's personal view about the financial instruments and issuers covered by the research report. Each responsible research analyst further certifies that no part of the compensation of the research analyst was, is or will be, directly or indirectly, related to the specific recommendations expressed in the research report.

### Regulation

Danske Bank is authorised and subject to regulation by the Danish Financial Supervisory Authority and is subject to the rules and regulation of the relevant regulators in all other jurisdictions where it conducts business. Danske Bank is subject to limited regulation by the Financial Conduct Authority and the Prudential Regulation Authority (UK). Details on the extent of the regulation by the Financial Conduct Authority and the Prudential Regulation Authority are available from Danske Bank on request.

Danske Bank's research reports are prepared in accordance with the recommendations of the Danish Securities Dealers Association.

### Conflicts of interest

Danske Bank has established procedures to prevent conflicts of interest and to ensure the provision of high-quality research based on research objectivity and independence. These procedures are documented in Danske Bank's research policies. Employees within Danske Bank's Research Departments have been instructed that any request that might impair the objectivity and independence of research shall be referred to Research Management and the Compliance Department. Danske Bank's Research Departments are organised independently from, and do not report to, other business areas within Danske Bank.

Research analysts are remunerated in part based on the overall profitability of Danske Bank, which includes investment banking revenues, but do not receive bonuses or other remuneration linked to specific corporate finance or debt capital transactions.

### Financial models and/or methodology used in this research report

Calculations and presentations in this research report are based on standard econometric tools and methodology as well as publicly available statistics for each individual security, issuer and/or country. Documentation can be obtained from the authors on request.

### Risk warning

Major risks connected with recommendations or opinions in this research report, including as sensitivity analysis of relevant assumptions, are stated throughout the text.

### Expected updates

None.

### Date of first publication

See the front page of this research report for the date of first publication.

## General disclaimer

This research report has been prepared by Danske Bank (a division of Danske Bank A/S). It is provided for informational purposes only. It does not constitute or form part of, and shall under no circumstances be considered as, an offer to sell or a solicitation of an offer to purchase or sell any relevant financial instruments (i.e. financial instruments mentioned herein or other financial instruments of any issuer mentioned herein and/or options, warrants, rights or other interests with respect to any such financial instruments) ('Relevant Financial Instruments').

The research report has been prepared independently and solely on the basis of publicly available information that Danske Bank considers to be reliable. While reasonable care has been taken to ensure that its contents are not untrue or misleading, no representation is made as to its accuracy or completeness and Danske Bank, its affiliates and subsidiaries accept no liability whatsoever for any direct or consequential loss, including without limitation any loss of profits, arising from reliance on this research report.

The opinions expressed herein are the opinions of the research analysts responsible for the research report and reflect their judgement as of the date hereof. These opinions are subject to change and Danske Bank does not undertake to notify any recipient of this research report of any such change nor of any other changes related to the information provided herein.

This research report is not intended for, and may not be redistributed to, retail customers in the United Kingdom or the United States.

This research report is protected by copyright and is intended solely for the designated addressee. It may not be reproduced or distributed, in whole or in part, by any recipient for any purpose without Danske Bank's prior written consent.

## Disclaimer related to distribution in the United States

This research report was created by Danske Bank A/S and is distributed in the United States by Danske Markets Inc., a U.S. registered broker-dealer and subsidiary of Danske Bank A/A, pursuant to SEC Rule 15a-6 and related interpretations issued by the U.S. Securities and Exchange Commission. The research report is intended for distribution in the United States solely to 'U.S. institutional investors' as defined in SEC Rule 15a-6. Danske Markets Inc. accepts responsibility for this research report in connection with distribution in the United States solely to 'U.S. institutional investors'.

Danske Bank is not subject to U.S. rules with regard to the preparation of research reports and the independence of research analysts. In addition, the research analysts of Danske Bank who have prepared this research report are not registered or qualified as research analysts with the NYSE or FINRA but satisfy the applicable requirements of a non-U.S. jurisdiction.

Any U.S. investor recipient of this research report who wishes to purchase or sell any Relevant Financial Instrument may do so only by contacting Danske Markets Inc. directly and should be aware that investing in non-U.S. financial instruments may entail certain risks. Financial instruments of non-U.S. issuers may not be registered with the U.S. Securities and Exchange Commission and may not be subject to the reporting and auditing standards of the U.S. Securities and Exchange Commission.

**Report completed:** 16 August 2018, 17:22 CEST

**Report first disseminated:** 16 August 2018, 07:00 CEST