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Bosnia-Herzegovina Economy briefing:

US-Turkey tariff war and implications on Bosnian economy

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US-Turkey tariff war and implications on Bosnian economy

Turkish lira plunge

An escalation of the diplomatic crisis between the United States and Turkey triggered tariff war that caused an apparent plunge of Turkish lira in August. Economic crisis that hit one of the world's fastest growing economies and freefall of its currency – losing one fifth against the US dollar in one week alone and hitting new record high 40% inflation - had also some implications for the Western Balkans and Bosnia and Herzegovina where Turkish investment has mainly been present in banking, agriculture and infrastructure sector.

From the beginning of August, European financial institutions started to worry on the implications of sharp depreciation of Turkish lira for the common European market. In the SEE, a region with currencies tightly pegged with euro, the central banks and leading financial institutions responded to the inflation hike in Turkey by issuing appeasing statements on the impact it could have on their national markets. In the report of Erste Bank, a bank with significant share on the SEE market, it is assessed that the regional financial market is well protected against any credit defaults caused by lira fluctuations.

Following suite, Central Bank of Bosnia and Herzegovina (CBBH) declared the impact as minimal and indirect. According to CBBH`s press office, trade exchanges between Bosnia and Herzegovina and Turkey in this year represent only 4.6% of country`s total. Also, due to low credit rating, Turkish lira is not included in CBBH`s foreign reserve basket, therefore there should be no impacts on its investment portfolio and no negative effects on stability of country`s currency, BH mark. Similarly, central Foreign Trade Ministry expects no big downturns in current trade exchange with Turkey, citing that the most of the export contracts Bosnian companies have with Turkey are denominated in EUR or USD. Lastly, independent economic analysts mollified the worries by saying that direct consequences of Turkish lira plunge will be avoided.

Yet, these statements were all projected for short-term period, predicting that Turkish currency will recover within the month. The bounce back of lira happened in mid-August and again in September, but consequences for local markets are waiting to be calculated. The main concern for Bosnian economy is possible spillover effect from the European markets, decreased rate of investment from Turkey and mid-term drop of exports to Turkey. By September, the first Bosnian 'victim' of depreciated lira was Bimal Group from Brcko. This producer of edible oil that have relied on export to Turkey already registered significant loss in 2018. The profit from export has slushed to 500 000 BAM in the first half of 2018, comparing with 5 million BAM in the first half of 2017, signifying that Turkey`s economic problems were long time in the making, at least long before the American sanctions.

Turkish investment in BIH

Turkey is believed to be a major political player in Bosnia and Herzegovina, a strategic partner and one of the top trading partners and foreign investors. However, despite special bond with Sarajevo, trade and investment links between the two countries are still lagging behind the political friendship and are hampered by the internal problems in Bosnian economy. The words allegedly said by some Turkish investors, "our heart goes to Bosnia, but investment goes to Serbia" best describe high regard for maintaining close political and social relations with Bosnia and Herzegovina but sheer pragmatism in doing business.

According to BH Foreign Investment Promotion Agency, Turkey was 11th trading partner and investor in Bosnia and Herzegovina with investment at €15.4 million in 2016. In contrast to some neighboring countries, Turkey is not even in top 10 largest foreign investors in the country. Although there are no comprehensive official data for number of Turkish companies registered in the BH Federation and ROS, government mouthpieces usually brag with a few catchy names. These are Ziraat Banka, Bosnian branch of Ziraat Bankasi, Soda Sanayi Group in Soda Lukavac (Tuzla) and Natron-Hayat in Maglaj. The website of Bosnian Foreign Trade Association also mentions other 15 companies engaged in textile industry, trade and construction, apparently generating small FDI amount.

Ziraat Bank, which hold less than 10% of assets in BH's banking, has only modest exposure to Turkish government lira-denominated securities. Other spillover impacts on Turkish subsidiaries in Bosnia and Herzegovina are also insignificant due to low exposure and small share. Turkey's investment in Bosnia and Herzegovina managed to grow 2-4% in the first half of this year, but some independent analysts say this expansion was fueled by capital injections into existing companies operating in BH and is uncorrelated with country`s performance in attracting FDI, which is still regarded as generally thwarted by administrative incapacities and political conflicts.

The inflation crisis in Turkey, therefore, instead of spillover concerns revealed a gap between real and expected investment figures and switched the concern to structural problems in attracting FDI; especially, it defied political messages claiming the high increase of Turkish FDI.

Bosnian export to Turkey

Plunging lira surely had a sharp negative effect on Bosnian economy through decreased level of remittance and trade flows. Turkey hosts significant number of Bosniak people and people of Bosniak descent who have established trade connections with BH. In the aftermath of the 2008-2009 global financial crisis, Turkey was also in the pool of the remittance sending countries, so a certain downturn in remittance flow to BH is likewise expected after this crisis.

However, the biggest impact from economic crisis in Turkey is expected to occur in trade export where it could affect Turkey-bound exporting companies and planned bilateral trade arrangements. B. Simic, an economic analyst from Indikator.ba believes only prolonged crisis in Turkey can affect Bosnian companies. But, it is hard to say how long Bosnian companies (and banks that credited their business with Turkey) can sustain higher export costs to Turkey.

In the first 6 months of current year, Bosnia and Herzegovina run trade deficit with Turkey, export (191 million BAM) was covering only about 52% of current import (365 million BAM) and deficit is expected to rapidly increase in the second half of the year. Main goods exported to Turkey are edible oil, meat, steel, furniture and finished wood products, ammunition and paper products. BH Foreign Trade Minister Sarovic raised concerns for companies with export contracts set in Turkish lira without collateral clauses or without sister companies in Turkey. As of August 2018, only state regulated exports, such as the export of meat and agriculture products were euro-denominated, while only big companies, such as Bimal, had parent company in Turkey to cover the losses. Other companies were on their own.

Hence, the problem that could possibly appear with prolonged crisis is twofold. First, Turkish market could soon turn to free market for more affordable suppliers and change supply chain for good. Small-sized Bosnian companies will have little leverage to recapture niches previously held on Turkish market. Second, industries directly relying on bilateral agreements with Turkey are usually state-subsidized companies with strong rent-seeking business culture that will require state help to pull through the crisis. Comparing with other regional companies affected by depreciation of Turkish lira, BH companies are less market diversified, thus more exposed to sudden changes in demand. Therefore, it is highly unpredictable to how the Bosnian exporters will adapt in case if the crisis in Turkey prolongs indefinitely. For now, with all eggs in one basket, they can only bet on quick recovery of Turkish economy.

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Demand side and other (political) implications

The advantages of decreased value of Turkish lira can hardly be overestimated for importers and average consumers of garments, food, machinery as well as culture& entertainment products from Turkey. Popularity of Turkish economic and cultural exports is related to traditional social affinity due to a special bond Turkey acquired in Bosnia and Herzegovina as predominantly Muslim country with historical links and political attachments. Turkish soap-operas are currently aired on several TV stations in Bosnia, affordable casual wear from Turkey became a staple for "off-broadway fashion" and Turkey-made confectionery is ubiquitous in every retail store. Turkey is one of the top travel destinations for BH citizens for its affordable all-inclusive package holidays. Several tour companies in the region have already advertised special break deals which compete with much closer destination like Croatia or Montenegro. In a word, Turkey has established the market in Bosnia and the demand for its products can only thrive in financial hiccups like this one.

However, not all political actors in BH are happy with the current level and deepening of economic ties with Turkey. Impotent in preventing Turkish soft power coming through the back door (cheap economic and cultural products for mass consumption), some politicians in ROS and Croat areas of the Federation are adamant to stop high-end projects financed by Turkish companies, or at least publicly voice out largely unsubstantiated concerns about Turkey`s expanding influence in the Western Balkans. After the current crisis, their voice will even be better heard internationally.

Following the diplomatic spat between the US and Turkey over extradition of Fethullah Gulen, a leader of FETO movement whom President Erdogan accuses as the mastermind behind the failed July 2016 coup, which, among other things, was a cause for a tariff war; Turkey`s economic clout came on the radar of the Western countries. The US and the EU have also expressed concern over Turkey's rising influence in the Western Balkans. European officials have been repeatedly voicing out approved mantra of Turkish politically motivated investments in the region and Bosnia and Herzegovina particularly. Without checking facts, local politicians will use this opportunity to further exaggerate Turkish economic influence in the country. It would be surprise when the next possible crisis in Turkey reveals probable reason for avoiding any serious spillover effects was in fact the lack of any significant Turkish investments at the first place.