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ROLL-OVER CREDITS AND THEIR APPLICATION IN TURKEY

by

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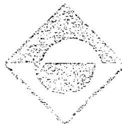

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CHAPTER ONE

INTRODUCTION

The subject of this study is the system of medium-term credits with adjustable interest rates. Instead of fixing the interest rate for the entire period of a credit, it is adjusted from time to time, at fixed intervals, to the ever-changing market rates on inter-bank deposits. This new system may also be described as credits with flexible interest rates. Because a high proportion of them are handled by a consortium of banks and are placed with a syndicate of banks, they are often referred to as consortium credits or syndicated credits.

The popular name for such credits, whether granted by single banks or by large international groups of banks or, whether they assume the form of book credits or of international note issues, is 'roll-over credits'[1], presumably because, even though they are granted for a period of years, they are renewed on specified terms.

Until very recently, most of the markets in medium-term deposits were narrow and each transaction was a matter of negotiation. These markets did not expand sufficiently to meet the rapidly increasing requirements for medium-term credits.

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(1) Foreign $ Loans in Europe, Paul Einzig, 1965 Macmillan and Co. Ltd.

The present study aims at describing a wide variety of practices, even though I can not claim to have succeeded in covering the entire field. It also attempts to deal with some of the broader implications of the system.

Chapter two deals with the relative advantages and disadvantages of flexible and fixed interest rates.

In chapter three the methods by which roll-over credits are arranged are outlined. It indicates the main forms of the contracts, but details of the terms of contracts are discussed in Chapter four.

The most important provision of the contracts, the method of the adjustment of interest rates, is discussed in detail in Chapter five. It describes the technique of determining interest rates on each interest date for the next interest period. The adjustment is usually based on the London Euro-dollar rate, while the spread, the differential between that rate and the rate actually payable by the borrower, is fixed in the contract and remains unchanged.

The factuors influencing the spread are dealt with in Chapter six. This is probably one of the important chapters in the study, both from a practical and from a theoretical point of view.

The terms of repayment are discussed in Chapter seven, which deals with the early repayment options included in many contracts, enabling borrowers to repay before maturity.

Another important option, which enables the borrower to choose between several currencies in which

to receive and repay the credit, is examined in chapter eight.

In Chapter nine, I try to examine the impact of roll-over credits on foreign exchange.

In the concluding part an attempt is made to give information about the present position of Turkey in roll-over credit market, as a country borrowing roll-over credits. Since it is, roll-over credits system, a **highly** involved system and its applications varies so widely that nobody could possibly claim to be familiar with all practices and techniques. For instance in the course of my interviews, I found that the majority of the specialists I had consulted were unware that medium-term credits on roll-over terms are granted not by Euro-markets only but by Middle East countries as well.

In essence, I have found it worthwhile to study the case as a whole and its applications in Turkey.

CHAPTER TWO
FIXED VERSUS FLEXIBLE INTEREST RATES

In the distant past interest rates were to be kept rigid by the application of severe laws which fixed the maximum permissible rates. In more recent times interference with the automatic operation of money market forces by an increasing degree of goverment intervention aimed, among other things, at reducing the range of fluctuations of interest rates and at keeping them at a level that is considered by the authorities to be in accordance with the requirements of the national economy. In such countries there was a relatively high degree of rigidity of interest rates, and their adjustment came to be considered in many situations as necessary. Nevertheless there were from time to time substantial changes in interest rates, usually as a result of monetary policy decisions, but often because the authorities were unable to prevent them.

The banks, too, played an important part in the maintenance of relatively stable interest rates. They usually readily followed the advice received from official quarters, and were willing to limit fluctuations of interest rates by the adoption of cartels restraining free competition among themselves in their capacity of lenders and borrowers. It had been a well-established practice to lend at fixed interest rates for definite periods. Changes in interest rates produce their normal effects, they encourage or discourage borrowing or lending.

The main argument in favor of the device of adjust-

able interest rates is that it enables borrowers to refrain from committing themselves for long periods to interest rates which they consider too high. As far as lenders are concerned, they are in a position to defense against losses that might result from an increase in interest rates by re-borrowing the amounts lent for the periods in question. In this way they are able to act according to their expectations of changes in interest rates.

It is the borrowers who are exposed under the system of fixed interest rates to losses caused by a decline in interest rates. They have, of course, no means for hedging by re-lending the money borrowed because they need the money. They would stand to benefit by a rise in interest rates that might occur during the period of their fixed interest bearing medium-term loans, for their rivals who had preferred roll-over credits might now have to pay higher interest rates, while they themselves would have the benefit of the lower fixed interest rates. But borrowing at a relatively high fixed interest rates for periods of years is also an act accompanied by risk of loss.

In the case of short-term financing of the production or purchase of goods with a quick turnover, the risk of changes in interest rates does not arise in an essential way. But if the financing of a transaction calls for medium-term credits, the system of roll-over credits gives the borrower the chance of a choice, which enables him to act in accordance with his expectations concerning prospects of interest rates. If he expects a rise, he borrows at a fixed rate. If he expects a

fall, he resorts to roll-over credit arrangements. His expectations might well prove to have been wrong, but, at any rate, he has a chance to act according to them.

Of course, if borrowers expect a decline in interest rates, even in the absence of the roll-over credits system they have the alternative of borrowing for short-term in the hope that they would be able to renew the credit again and again at more favourable interest rates. But that method would involve the risk of being unable to renew their credits at all in the event of an unforeseen squeeze.

Even firms which are fully provided with capital to finance their equipment may be in need of medium-term credit, for the sake of being able to adopt long-term production programmes. The advantages of planning well ahead are being increasingly realised. In order to plan ahead it is necessary to ensure in advance the availability of the financial resources required for the entire period. The entire amount is not needed immediately and under many roll-over credit contracts it is paid to the borrower in instalments fixed in advance, or it is left to the borrower to draw on the credit as and when required. Even if the cost of the future instalments of credit is uncertain, its availability is assured.

Although banks are able to hedge against the interest rate risk by re-lending the money borrowed or re-borrowing the money lent, the new system offers them an alternative device. Since they have many commitments both ways as lenders or borrowers, they are only concerned with the net balance between their grand total

of borrowing and their grand total of lending.

Borrowers of roll-over credits with an option to repay them at some relatively early date are in a position to replace their credits by credits with fixed interest if and when they should come to expect a rise in interest rates. Roll-over credits have made medium-term credits facilities more adaptable to changing requirements. These facilities may be used as an alternative to credit facilities with fixed interest rates, but they may be additional to them, in which case the total volume of borrowing, especially of medium-term borrowing, increases.

CHAPTER THREE

HOW ROLL-OVER CREDITS ARE ARRANGED

Roll-over credits may assume various form and are therefore arranged in various ways. A large number of relatively small transactions, the total of which probably represents a high percentage of the grand total of roll-over credits, are concluded simply between banks and their customers in the ordinary way in which bank credits are arranged. The main difference being that the borrower has to agree with the bank manager on the formula with which interest rates are periodically adjusted.

Since they are concluded entirely without any publicity, sufficient statistical information is not avaliable about the details of these credits, neverthe-less Euromoney, monthly journal of the world's capital and money markets, supplies some data, the amount, interest rate margin, and the term, about the loans signed.

The borrower has often the option to draw upon the credit in instalments as and when he requires the money. The interest rates are determined on the basis of the interest rates prevailing at the time of the conclusion of the credit or of the first drawing, and on sub-sequent interest dates increased by an additional percen-

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(1) Data supplied by the Euromoney Syndication Guide.

tage called spread which under most contracts remains unchanged even though the basic interest rate may move up or down with market rates.

Many contracts between banker and customer contain many more safeguarding provisions than is customary in ordinary bank credits, especially if the amount is substantial. For the sake of meeting the probable requirements for safeguards of banks which are not familiar with the borrower, they might insert in the contracts additional terms to satisfy a consortium that might take over the bulk of the credit. If such a consortium participates from the very outset then the terms have to be agreed upon in advance to the satisfaction of all participants. Such contracts are necessarily longer and more complicated, since they would have to be passed by the lawyers and accountants of several banks. All that would take time, so the negotiations would take longer.

An alternative way of arranging roll-over credits is for the borrowing firm or institution or authority to issue notes and sell them to a managing bank or a consortium of managing banks, which in turn sells them to a syndicate of banks and other financial institutions. Each one of them takes over a relatively small amount which it would be able to keep in its portfolio or would be able to place with its own customers, so that no public issue would be necessary.

Another alternative procedure is the conclusion of an agreement by the managing banks with the borrower; in this case photocopies of the contract are circulated

among potential members of the syndicate. In many cases, the managing banks issue 'Participation Certificates'[1] which are underwritten by a syndicate consisting of some dozen of banks and other dealers or institutional investors. Their number is anything up to fifty, or even higher. While in many instances the terms are negotiated by the managing banks and the potential members of the syndicate are offered participation on terms that are already fixed, in other instances members of the syndicate have some say in the negotiation of the terms. Sometimes the managing banks, knowing as they do the particular requirements of leading potential members of the syndicate, insist on the insertion of terms without which the banks concerned would not be likely to participate. Often all members of the syndicate are given a chance to state any objections or conditions they may have, and once an agreement is reached the contract is signed by all of them.

Many members of the syndicate are not big enough to assume the role of managing banks. They may not even specialise in such transactions.[2] In their case the reason why they choose to participate in not only particulary attractive transactions is that it adds to their prestige but to be associated with a number of first-class banks as well.

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(1) International Money Markets and Flexible Exchange Rates, Stanley W. Black, 1973 Princeton University.

(2) How Banks can Live with Low Spreads, Nicolas Saade Jr. Euromoney, November 1981.

Many banks may insist on the inclusion of particular terms for which they have preferences. If their requirements conflict with each other they have to be reconciled, and the resulting compromise has to be accepted by the borrower. The length and nature of the contracts, which are discussed in the next chapter, depend to a high degree on the nationality of the managing banks and on the countries where the notes are meant to be placed.

CHAPTER FOUR

TERMS OF THE CONTRACTS

While it would be an exaggeration to suggest that the conditions of every contract are different from those of all other contracts, there is certainly a large variety of conditions. Each managing bank has a favourite formula which differs in many respects from that of other managing banks. What is more, these formulas are subject to modifications to meet the wishes of borrowers and those of other participating banks.

The amount of individual transactions of roll-over bank credits is in many instances small compared with that of consortium credits which is usually substantial. It may be payable in one sum, or in several instalments fixed in the contract subject to notice prescribed in the contract. The borrower is usually under no obligation to use the whole amount of the credit granted.

The contract always fixes the maximum period for which the credit is granted. It also fixes the schedule of maturities if it is repayable in instalments. In some contracts the borrower, having repaid part of the credit, is entitled to draw on it again, within the limits of the maximum maturity.

The commission paid by the borrower to the managing banks, and by the managing banks to the members of the syndicate and to the agents, is fixed in the contract.

Most contracts determine the currency in which the credit is to be granted and repaid and in which interest is payable. But in a number of contracts the borrower has the choise between several currencies, or the credit is fixed in terms of a composite currency unit. If the borrower has the option to choose between various currencies, the contract prescribes the exact way in which that option may be exercised.

The borrower may be given the choise between several currencies in which to receive the whole or part of the credit. Interest and principal are always repayable in the same currency in which the credit is received.

The borrower has to provide certain information at the time of granting of the credits, and also subsequently any other information prescribed in the contract.

Appendices to the contracts contain balance sheets and other relevant information concerning the borrowing firm's business. They may contain statistical and other information dealing with the borrower's business, or the country in which it is situated together with other material enabling the lender to assess the borrower's positions and prospects.

CHAPTER FIVE

HOW INTEREST RATES ARE ADJUSTED

Interest rates on roll-over credits are subject to changes at the end of each 'interest period'[1], on the predetermined 'interest dates'[1] or 'interest determination dates'[1]. By far the most frequently applied interest period is six months, but three months and twelve months are also quite common. In some contracts provision is made for changing the interest period. There may be broken interest periods if borrowers avail themselves of their right to repay the credit before the next interest date.

The interest dates are usually taken as occuring two clear days before the concluding dates of the interest periods.

A large number of contracts contain provisions under which the managing bank or banks must ask neutral banks, referred to as reference banks, for the current quatation of interest rates for the maturity corresponding to the next interest period. There may be more than one reference bank, they are also called 'rate setting banks'[1]. in which case the rate will be the average of their quatations. If some of them are

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(1) Foreign Dollar Loans in Europe, Paul Einzig, 1965 Macmillan and Co. Ltd.

unable to quote rates the avarage of the rates quoted by the remaining banks will be used. To be on the safe side some contracts provide for six reference banks. If the rates are fixed by the managing banks themselves it is the average of their rates that counts.

In many contracts the parties safeguard themselves against the use of a distorted rate that is likely to be quoted in any one day, on days before or after week-ends, holidays, or through the coincidence of several distorting influences. To do that the rate is to be based not on the quotation on one single day but on the average of the quotation of several consecutive business days, usually of three days.

In many contracts the changes in interest rates are not left unlimited. A maximum limit or a minimum limit for the interest rates may be fixed. There are contracts which fix both a maximum limit and minimum limit. Such limits are usually very wide. e.i. from 6.5% to 13%.[1]

The rates used for adjusting the interest rates on roll-over credits are always those quoted for banks of first rate standing. In some contracts the borrower has the option of changing the next interest period from one standard period to another. Such a change of period is subject to a notice, usually of five days.

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(1) Syndicated Loan Rankings, Euromoney, September 1981.

CHAPTER SIX

WHAT DETERMINES THE SPREAD?

Spread is the difference between the current quotation of the Euro-dollar, or, as the case may be, of some other Euro-currency in terms of which the credit is granted, and the actual interest rate payable by the borrower.[1] On the date when the contract becomes operative and on each interest date the spread is added to the current Euro-dollar rate, and the resulting figure represents the interest payable for the next interest period.

The cost of a credit to the borrower is determined by the current Euro-dollar rate for inter-bank time deposits the maturity of which corresponds to the interest period fixed in the contract, plus the spread. The base rate is subject to fluctuations, but the spread is usually fixed for the duration of the contract, unless arrangement is made for its change after a certain number of years. The profit margin of the lender is determined by the spread plus the additional fees that banks earn by participating in credits are participation fees and commitment fees. The former, which is typically a flat fee paid at the onset of the credit, can vary considerably between credits and is not necessarily a function of term. It can easily vary from as little as 1/16% to

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(1) The Management of the Dollar in International Finance, Robert Z. Aliber, 1964 Princeton University.

1 1/2%.[1] The commitment fee is usually applied on the undrawn portion of the credit during the drawdown period. A typical rate is 3/8%.[1]

The spread is liable to follow certain basic trends, in addition to being subject to certain influences. There is an economic explanation for low spreads in the Eurocredit markets. It is the economic theory of perfect competition. It says that excess profits will diminish as financial markets become more competitive.

The number of lenders and the number of borrowers in the Euromarkets have increased significantly. International barriers to entering these markets have been broken into. For example, between 1976 and 1980, the number of banks lending in the syndicated loan market increased from about 400 to more than 700.[1] Over the same period, the number of loans syndicated increased from about 350 to 1,100.[1] Moreover, the number of countries that contained the borrowers increased from about 65 to around 100. A borrower or a lender alone is too small to affect the market. A bank becomes a price-taker as opposed to a price-maker, and if it offers to lend at higher margins, it will be driven out of the market. The direct result is the decline in spreads. In the past few months, spreads were below 1/2% and these have gone down to as low as 1/4%.[1] And maturities are longer. In 1976, the average maturity would have been less than 5 years. In 1979 it exceeded 8 years.[1]

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(1) <u>How Banks can Live with Low Spreads</u>, Nicolas Saade, Euromoney, November 1981.

The fundamental reasons for participating may well be less tangible ones. A bank that has had a long-standing relationship with a particular client would find it hard to refuse a participation in a credit. A refusal or a few consecutive refusals, could lose the account. And a bank that wants to gain a borrower as a client would want to take the opportunity to enter a credit for that borrower, despite the fact that a participation would be unprofitable. In essence, the bank would hope to gain in the future some benefits from the borrower.

CHAPTER SEVEN

TERMS OF REPAYMENT

The repayment of roll-over credits, as determined by the contract, may take place in one lump sum at the maturity date; or it may take place in several instalments at maturity dates fixed in the contracts; or the borrower may have the option to repay the whole or part of the loan on any interest date after the passing of a minimum period on giving notice as specified in the contract.

Many contracts determine a minimum limit and a maximum limit for the period during which the debtor has to repay the credit, but within those limits the actual date or dates may be determined by the debtor, subject to such notice as is specified in the contract. This option of early repayments is a great advantage to the borrower, not only because he need not to continue to pay interest on the loan when the money is no longer required, but also because it provides him with an opportunity for taking advantage of any cheaper facilities that might become available before the date of maturity, or dates of maturities, fixed in the contract.

Durig a period of rising interest rates, when under the terms of a roll-over credit the borrower has to pay higher and higher interest rates in accordance with the higher rates quoted in the market on interest dates, an

early repayment option enables him to terminate the loan if it ceases to be profitable for him to continue to use the money at such a high cost. Some contracts contain a provision under which the borrower is given the right to repay the credit if and when the interest rate rises to a certain level. But many more contracts grant him an option of early repayment which is independent of the level of interest rates.

During a period of declining interest rates roll-over credits give borrowers the full benefits derived from the decline of interest rates in the market of the Euro-currency in terms of which the credit is fixed.

As a general rule lenders have no option to demand early repayment except in special circumstances (to be discussed below). If the lenders had the right to demand early repayment borrowers would lose the advantage derived from medium-term borrowing. Debtors might be called upon to repay their debts at a time when they might find it difficult or impossible to raise the necessary cash, or when they might only be able to do so on less favourable terms. If debtors exercise their options of early repayment it is true that lenders might find it difficult to re-employ the money on equally profitable terms. But banks are always able to find a market in which they could employ the funds, even though during periods of declining interest rates and increasing liquidity they might have to do so on less advantageous terms than those obtained even after the downward adjustment of the interest rates on roll-over credits. It is for this reason that the spread on roll-

over credits with a one-way option to the borrower's benefit is wider than on credits without such options.

If the practice of giving lenders the option to recall their credits were widespread it would discourage borrowers against roll-over credit facilities. On the other hand one-sided options in favour of borrower are widely practiced without discouraging participation in such operations by lenders, because lenders are in a better position than borrowers to cope with the situation arising from an early termination of a medium-term contract.

Most contracts specify that if borrowers make use of their early repayment options then repayment must take place at interest date, though some lenders have no objections to broken interest periods that would occur if repayment was made on other dates. Early repayments usually have to be made in round amounts. In many contracts it is specified that the repayments must be a minimum amount or its multiples[1]. Frequent repayments of variying amounts would involve everyone corcerned in much additional clerical work.

Borrowers have to give the agents due notice of their decision to exercise their early repayment option. The most frequently fixed period is thirty days[1], though the contracts may fix longer or shorter periods. There are cases of contracts that fix a longer notice during the early period of loan and shorter notice during a later period. In given circumstances the borrower may

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(1) Foreign Dollar Loans in Europe, Paul Einzig, 1965 Macmillan and Co. Ltd.

approach the lender with the request to give up part of the notice. Since banks are anxious to ensure the goodwill of the borrower and are anxious to acquire a reputation for being obliging to borrowers, early repayment without the full contractual notice is usually accepted.

Under some contracts which do not have a repayment option clause the borrower is entitled to repay the loan if adjusted interest rate exceeds a certain figure.

But both from the point of view of lenders and from that of borrowers it is always inconvenient to have to negotiate another loan contract because the other party has exercised its early repayment option. Such negotiations always involve delays and expense. Under some contracts the party that makes use of his option has to pay a fixed sum to cover expenses, or he has to pay a penalty of 1/8 per cent or such other penalty as may be fixed in the contract[1].

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(1) <u>How Banks can Live with Low Spreads</u>, Nicolas Saade, Euromoney, November 1981.

CHAPTER EIGHT

CURRENCY OPTIONS

Most roll-over credits are in dollars, but similar credits may also be fixed in other leading currencies. Some contracts give the borrower the option to borrow in one of several currencies.

Many contracts are drawn up which entitle the borrowers to choose from among several currencies the one in which they require the first or a later instalment of the loan to be paid, or in which they may draw the entire credit. The borrower must inform the agent of his choise of currency and must give him notice the length of which is prescribed in the contract. The minimum notice is often five days. Since all participating banks have to decide whether the borrower's choice of currency is acceptable to them, a five days' notice is not unreasonable.

Contracts usually contain a reservation under which the lender banks are entitled to refuse to accept the borrower's choice of the denomination of the loan or of any of its instalments if the currency chosen by him is not easily available at a reasonable price. Of course in theory all major currencies are supposed to be available in a good market at a reasonable price. In practice exchange rates might make it difficult for the lenders

to satisfy the borrower's wish. Or it might become costly to acquire the currency as a result of a squeeze in the market or of other changes that may have occured since the conclusion of the credit.

Repayment is always due to be made in the same currency in which the credit, or any of its instalments, was made available to the borrower; interest, too, is due in the same currency. If in spite of this condition borrowers prefer to choose a particular currency to depreciate before the credit is repaid, the reason is usually because they expect the currency to depreciate.

Some contracts contain provisions to safeguard lenders against consequences of changes in parities between the conclusion of the contract and its implementation. Some contracts contain provisions authorising the borrower to convert the loan into some other currency on any interest date.

If the currency chosen by the borrower isnot acceptable to the lenders then they, the lenders, are entitled to lend dollars under many contracts. Sometimes contracts rule that unless all participating banks agree to the curremcy chosen by the borrower the contract will be cancelled. But usually the borrower is given the option to accept the credit in dollars.

If the amount of the credit is fixed in dollars and the borrower exercises his option to be paid in some other currency, the equivalent amount is calculated on the basis of the mean rate of the non-dollar currency in terms of dollars quoted by the IMF on the relevant

date. Under some contracts, if no mean rate is quoted in that currency by the IMF on the relevant date, the amount is then calculated on the basis of the offered rate of that currency in the London foreign exchange market.

If the borrower chooses payment in dollars then under mast contracts or in the absence of any provision to the contrary, the lenders have to accept his choise of currency. Like, if the lenders notify the borrowers through their agent that they intend to pay in dollars, then, in the absence of a provision in the contract to the contrary, the borrower has to accept it, although under some contracts he would have the option of cancelling the deal.

Under some contracts, the lenders may notify the borrower not later than at 10a.m., two business days[1] before the date of payment, that they wish to change the currency. The borrower will then notify the agents as to whether he is willing to accept the lenders' decision or prefers to cancel the deal.

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(1) Euromoney Syndication Guide, Euromonay, November 1981.

BOĞAZİÇİ ÜNİVERSİTESİ KÜTÜPHANESİ

CHAPTER NINE

IMPACT ON FOREIGN EXCHANGES

All credits granted in terms of a foreign currency, that is, in a currency that is not the local currency either of the lender or a borrower, are liable to affect the foreign exchange market. A similar effect is liable to be produced if the lender lends in terms of the borrower's currency, or if the borrower borrows in terms of the lender's currency.

All this effect may be produced by any form of international credit transaction. Roll-over credits actually increase the volume of foreign exchange operations. So that it is reasonable to say that the adoption and expansion of roll-over credits system tend to cause an expansion of activity in the foreign exchange market, in addition to causing an expansion of activity in the Euro-currency market.

Roll-over credits are liable to affect forward exchanges to a higher degree than spot exchanges. Since the interest period in most contracts is six months, both lenders and borrowers may want to secure themselves against a loss for that period, not only against the interest risk rate, but also against the exchange risk. Of course, they now have facilities at their disposal to cover the exchange risk right up to maturity, it is

possible to negotiate forward transactions for anything up to five years or more. But the exchange risk for long periods can be covered with the help of a medium-term Euro-currency transaction, always provided that the parties concerned expect interest rates to move in their favour.

Although in theory roll-over credits are only supposed to affect the Euro-currency rates concerned, in practice interest rates in other currencies and in other centres are also liable to be affected. This again tends to react on exchange rates, both spot and especially forward.

The development of roll-over credits depends to some extent on the stability of exchanges. This would both simplify the transactions and would in given circumstances reduce the cost of the credits to the borrower or increase the yield to the lender.

The prospect of favorable interest rates is not the only consideration by which borrowers and lenders decide whether to fix the interest rate for the entire period of the credit or whether to adjust it to the market rate at fixed intervals. Variations in the rate of exchange and the premium or discount on the forward exchanges have also be taken into consideration. On the basis of the borrower's view taken on prospects of interest rates alone, or on Euro-dollar rates if the transaction is in terms of Euro-dollars, it might appear advantegous to return to roll-over credits.

CHAPTER TEN

TURKEY IN ROLL-OVER CREDIT MARKET

Over the past years a great deal of time and energy have been devoted to the problems of rescheduling Turkey's external debt and Turkey being a 'developing country' is striving to solve the problems of industrialization.

During the period in question, international purchasing power of the country has decreased and economic expansion was handicapped to no slight degree by an inadequacy of medium-term facilities, besides Ankara's problems were immense and included a total foreign debt that exceeded $ 16 billion, a current-account deficit of $ 4 billion, 90% annual inflation, and 20% to 30% unemployment in the late 1979s.[1] Until a military coup in September 1980 put an end to it, the country was wracked by political violence and terrorism that was claiming as many as 30 lives a day. Turkey's industrial base was also seriously damaged by extensive sabotage and labor unrest. Added to these problems are foreign reserves, an oil bill that

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(1) Dünya Gazetesi, 23 November 1979.

has exploded because Ankara has had to buy from the higher-priced spot market since its two major suppliers Iran and Iraq, went to war.

Trying to minimize the problems or at least to decrease the number of them down to a certain level, Turkey followed a set of policies which is prepared by considering all the economic aspects and their probable effects. As it is experted by the majority of us, among these policies set, borrowing policies play a vital role in the course of economic development. Since the various alternatives of efficient usages of the money lent is not within the limits of this study, the application of an alternative borrowing mechanism, the roll-over credits, will be outlined.

How Risk Factor Effects the Borrowing?

There exists a risk factor in granting roll-over credits to countries the political stability of which is uncertain. There are a great many of them in Latin America, in Africa and in Southern Asia. Since violent changes of regime are subject to be followed by default on external liabilities, it is reasonable for lenders to expect compensation for such risk in the form of wider spreads. Even in the absence of political uncertainties, their probable anticipation is led to non-renewals of credits.

The extent of general risk also influences the spread. In addition to risks involved in lending to

borrowers with low credit rating or to those who are borrowing too much, there is a more general risk arising from the possibility of a deterioration of general business conditions. In a general depression, for example, a series of crises can not be prevented and practically no debtors are considered absolutely safe. The anticipation of some such crises causes lenders to demand for wider spreads, and to insist on legal guarantees of roll-over credits by goverments or goverment-controlled institutions if the borrowers themselves have not a sufficiently high credit rating.

Among various existing risk-factor rating tables, "Euromoney Country Risk Factor Table" will be given as a guide to represent Turkey's position since the table is prepared by taking only the public sector syndicated loans granted and their average weighted spreads, into consideration.

How the Euromoney Rating Works

Country Rating	Value of Country Risk Factor	Number of Countries
EM-I	Under 5.4	24
EM-II	5.5 to 6.2	7
EM-III	6.3 to 7.4	5
EM-IV	7.5 to 8.3	8
EM-V	8.4 to 10.8	6
EM-VI	10.9 to 20.8	12
EM-VII	20.9 and over	

SOURCE: Euromoney Syndication Guide

Among 69 countries Turkey is the 68th with a country risk factor of 21 with February 1982 figures.[1]

Prospects for Roll-over Credits Granted:

Since risk rating factor of Turkey is very low it has to depend on loans from the World Bank and credits guaranteed by the Goverments by the lending countries. Until most recemt years because of the political instability there is no guarantee that the lenders will be negotiating with the same people a second time around. After the military coup in September 1980, a short-run political stability is obtained and the immediate changes of goverments are avoided.

Until recently, Turkey was not in a position to use syndicated loans, nevertheless, after the procurement of stability both in terms politics and economics, roll-over credits become obtainable.

In November 1981,[2]

Borrower: The Central Bank of Republic of Turkey
Lead Management Group: Libyan Arab Foreign Bank
Amount in Millions: $ 100
Interest Rate Margin: 1 for the first 6 months
1.25 for the last 6 months

Term 1 year

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(1) See Appendix-II for further information.
(2) See Appendix-I for further information.

and, in March 1982,
Borrower: The Central Bank of Republic of Turkey
Lead Management Group: National Bank Kuwait
Amount in Millions: $ 70
Interest Rate Margin: 1
Term: 6 months

are used. As it can be observed easily from the above mentioned credits the spreads are following a decreasing pattern which may be an indication of a decrease in the existing risk-factor.

Turkey, promising an economic expansion, should be prepared to change the assessment of country condition and outlook and not be locked into accustomed views.

APPENDIX I

SYNDICATED LOANS

September 1981: Loans signed[1]

Data supplied by the Euromoney Syndication Guide

Borrower: Anambra State of Nigeria
Lead Management Group: American Express Bank, Citicorp International Group, European American Bank, Long-Term Credit Bank of Japan, Sumitomo Bank
Amount in Millions: DM 150
Interest Rate Margin: 7.5 (fixed rate)
Term : 7 years

Borrower: Ansett Aviation Equipment Pty
Lead Management Group: Hambros Bank, Bank of Montreal, Bank of Nova Scotia, Chemical Bank, Tokai Bank, Rural Bank of New South Wales
Amount in Millions: $ 195.85
Interest Rate Margin: 1/4 % for the first 3 years
3/8 % for the last 6 years
Term: 9 years

Borrower: Atlantic Richfield (ARCO)
Lead Management Group: Bank of Montreal, Citibank, Chemical Bank, Chase Manhattan Bank, Morgan Guaranty
Amount in Millions: $ 950
Interest Rate Margin: 1/2 % for the first 4 years
5/8 % for the last 8 years
Term: 12 years

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(1) Only loans above $100 million, DM100 million, £100 mil are taken into consideration.

Borrower: Banco de la Nacion Argentina
Lead Management Group: Citicorp International Group, Mitsui Trust and Finance, Sumitoma Finance International, Takugin International, Sumitomo Trust Finance
Amount in Millions: $ 100
Interest Rate Margin: 1/4
Term : 5 years

Borrower: Castle Peak Power Co Ltd (CAPCO)
Lead Management Group: Schroder Wagg
Amount in Millions: £ 357
Interest Rate Margin: 8.5 (fixed rate)
Term: 12

Borrower: Castle Peak Power Co Ltd (CAPCO)
Lead Management Group: Schroder Wagg
Amount in Million: £ 285
Interest Rate Margin: 8.5 (fixed rate)
Term: 12

Borrower: Castle Peak Power Co Ltd (CAPCO)
Lead Management Group: Citicorp International Group, Schroder Wagg
Amount in Million: $ 300
Interest Rate Margin: 3/8 for the first 5 years
1/2 for the following 5 years
5/8 for the last 2 years

Term: 12 years

Borrower: Cia Financiamenti e Refinanciamenti SpA (COFIRI)
Lead Management Group: Arab Banking Corporation, Fuji Bank, Istituto Bancario San Paolo di Torino
Amount in Million: $ 175
Interest Rate Margin: 1/2 for the first 4 years
5/8 for the last 3 years
Term: 7 years

Borrower: Comision Federal de Electricidad (CFE)
Lead Management Group: Chase Merchant Banking Group, Credit Commercial de France, European American Bank, First Chicago Panama, Industrial Bank of Japan, International Mexican Bank, Long-Term Credit Bank of Japan
Amount in Million: $ 425
Interest Rate Margin: 1/2
Term: 8 years

Borrower: Dow Chemical Company
Lead Management Group: European Banking Company, Citibank
Amount in Million: $ 1,000
Interest Rate Margin: 3/8 for the first 3 years
1/2 for the last 2 years
Term: 5 years

Borrower: Empresa Nacional del Gas SA (ENAGAS)
Lead Management Group: Arap Banking Corporation, Banco Espanol de Credito, Banco Exterior de Espana, Banco Hispano Americano, Barclays Bank Group, Fuji Bank, Sumitomo Bank
Amount in Million: $ 100
Interest Rate Margin: 1/2
Term: 8 years

Borrower: Gaz de France
Lead Management Group: Credit Lyonnais, Credit Agricole, Tokai Bank, Toronto Dominion Int Bank
Amount in Million: $ 250
Interest Rate Margin: .45 for the first 4 years
.35 for the following 4 years
.25 for the last 2 years
Term: 10 years

Borrower: Industria Minera Mexico SA (IMMSA)
Lead Management Group: Manufacturers Hanover Ltd, Bank America International Group
Amount in Million: $ 250
Interest Rate Margin: 7/8 for the first 5 years
1 for the last 5 years
Term: 10 years

Borrower: Itaipu Binacional
Lead Management Group: Arab Banking Corporation, CIBC Ltd, Citicorp Intenational Group, Banco Central, Bank of Nova Scotia Group, Continental Illinois, Fuji Bank, Mitsubishi Bank, Morgan Guaranty, Sanwa Bank
Amount in Million: $ 100
Interest Rate Margin: 2 1/4
Term: 10 years

Borrower: Joseph E. Seagram and Sons
Lead Management Group: Citibank
Amount in Million: $ 100
Interest Rate Margin: 3/8
Term: 3 years

Borrower: Joseph E. Seagram and Sons
Lead Management Group: Manufacturers Hanover
Amount in Millions: $ 100
Interest Rate Margin: 3/8
Term: 3 years

Borrower: Matthey Finance Limited
Lead Management Group: SG Wargburg
Amount in Millions: $ 175
Interest rate Margin: 5/8 for the first 5 years
1/2 for the last 3 years
Term: 8 years

Borrower: Nike Inc
Lead Management Group: Seattle-First National Bank, First National Bank of Boston, Security Pacific Bank, First State Bank of Oregon
Amount in Millions: $ 110
Interest Rate Margin: 1/2
Term: 1 year

Borrower: Occidental Petroleum
Lead Management Group: Swiss Bank Corporation(International Algemene Bank Nederland, Bank of Scotland, Banque National de Paris, Banque Bruxelles Lambert, Banco Urquijo Hispano Americano, Dresdner Bank Int, Midland Bank, Morgan Grenfel National Westminister Bank, Royal Bank of Scotland, WestLB
Amount in Millions: $ 305
Interest Rate Margin: 1/2 for the first 5 years
5/8 for the last 2 years
Term: 7 years

Borrower: Petroleos Mexicanos (PEMEX)
Lead Management Group: Baring Brothers, N M Rothschild, Samuel Montagu
Amount in Millions: £ 365
Interest Rate Margin: 1/2
Term: 2 years

Borrower: Public Power Corporation (Dimosia Epihirisis Elektrismou)
Lead Management Group: Banque Nationale de Paris, Chase Manhattan Ltd, Continental Illinois Ltd, Mitsubishi Trust and Banking, National Bank of Canada, National Commercial Bank (Saudi Arabia), National Westminister Bank, Nippon Credit Bank, Orion Royal Bank, Sanwa Bank
Amount in Millions: $ 220
Interest Rate Margin: 7/16 for the first 2 years
1/2 for the last 8 years
Term: 10 years

Borrower: Sears Roebuck Acceptance Corporation
Lead Management Group: Morgan Guaranty
Amount in Millions: $ 2,000
Interest Rate Margin: 1/2 for the first 5 years
5/8 for the last 3 years
Term: 8 years

Borrower: Societa per Azioni Finanziaria Industria Manifatturiera (SAFIM)

Lead Management Group: SG Warburg, Soditic, Long-Term Credit Bank of Japan, Gulf International Bank, Banca Nazionale del Lavoro (London branch), Hokkaido Takushoku Bank, Kyowa Bank, Sumitomo Trust and Banking Co, Die Erste Österreichische Spar-Casse, Genossenschaftliche Zentralbank, Norddeutsche Landesbank, Svenska Handelbanken

Amount in Millions: $ 135

Interest Rate Margin: 5/8

Term: 5 years

Borrower: Türkiye Cumhuriyet Merkez Bankası (The Central Bank of the Republic of Turkey)

Lead Management Group: Libyan Arab Foreign Bank

Amount in Millions: $ 100

Interest Rate Margin: 1 for the first 6 months
1 1/4 for the last 6 months

Term: 1 year

APPENDIX II[1]

COUNTRY RISK FACTORS
FOR COUNTRIES IN EM-VI AND EM-VII

Countries in EM-VI

	Ranking for 1981	Ranking for 1980	Number of public loans	Total volume of all loans $ mil.	Average weighted spread %
Bahamas	51	-	2	165.0	1.13
Ivory Coast	52	54	9	595.0	1.42
Morocco	53	43	7	922.8	1.06
Zimbabwe	54	59	4	357.4	1.34
Congo	55	-	1	50.0	1.13
Panama	56	52	4	629.0	1.25
Honduras	57	-	2	24.2	1.39
Yugoslavia	58	49	14	1,371.3	1.22
Angola	59	-	2	80.0	1.74
Senegal	60	-	1	7.5	2.00
Venezuela	61	51	25	6,149.3	.57
Brazil	62	53	44	6,883.6	2.05

(1) Euromoney Syndication Guide , Euromoney Rating (EM) for February 1982.

Countries in EM-VII

	Ranking for 1981	Ranking for 1980	Number of public loans	Total volume of all loans $ mil.	Average weighted spread %
Bolivia	63	-	4	424.0	2.22
Jamaica	64	-	2	182.0	2.12
Pakistan	65	67	2	355.5	0.88
Zambia	66	66	4	211.8	1.30
Sharjah	67	40	1	63.0	1.00
Turkey	68	-	1	100.0	1.13
Niger	69	50	1	25.0	1.25

Euromoney risk rating is calculated by the following formula:

$$\frac{\sum \frac{\text{Volume x spread}}{\text{Euromoney Index}}}{\sum (\text{Volume x maturity})}$$

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