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Turkey and the feeling of summer time sadness

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We are almost approaching the end of the summer but it looks like we are back to April 2015 in Turkey. The election outcome and aftermath did not work as politicians had desired and the efforts to form a government have failed so far.

June elections and its consequences

As a reminder: on 7 June 2015, Turkish parliamentary elections generated 40.9% votes for the Justice and Development (AKP), followed by the Republican People's Party's (CHP) with 25.0%, the Nationalistic Movement Party's (MHP) with 16.3% and the People's Democratic Party's (HDP) with 13.1%. This indicated that AKP had lost its single party government and there will be four parties represented in the parliament. Turkey had two major options with this election outcome: a coalition government or early elections. Turkish politicians had a series of coalition meetings throughout the summer, but have failed to produce a coalition government, leaving the second option to be on the table. This is happening for the first time in Turkish politics, and it looks like we are back to April 2015. Very recently it is officially announced that Turkey will go for an early election on 1 November 2015. This means that we have a couple of uncertain months ahead. Reliable opinion polls will be followed closely once again. According to the current polls the increase in AKP support is only between 1 and 2.5%, which is not enough for AKP to form a single party government.

Turkey and terrorist attacks

Meanwhile, apart from politics, there were clashes between Turkish armed forces and PKK, where terrorist attacks killed more than 50 army and police officials in the last month. In late July, there was an emergency NATO meeting called by Turkey in which the NATO statement condemned terrorist attacks and expressed solidarity with Turkey. The country's Southern region is in chaos due to Islamic State and Turkey was unable to form a government during this time period. Therefore; the terrorist attacks and Turkey's response will continue to play a big role in the coming period as these attacks in turn affect political parties' popular support. Meanwhile, Turkey and the US have completed an agreement for allowing Turkey to strike Islamic State targets in Iraq and Syria. However, they don't expect the airstrikes to begin immediately.

How does this impact the economy?

The real impact of early elections on Turkish economy will be felt in the last quarter of 2015. In its last meeting the Central

Bank of Turkey (CBT) did not change the rates. However, it hinted at a more tight fiscal policy – a rate hike. In their meeting with the economists, CBT underlined that they would wait for the FED decision, and they now (for the first time) consider local risks as possible. CBT also announced the roadmap aiming to simplify its monetary policy and decided further tightening TRY (Turkish New Lira) liquidity.

In addition, CBT expects a slight improvement in inflation. It highlighted that despite the correction in fruit and vegetable prices, rising red meat prices limited the decline in food inflation. The Bank also stated that it observes – albeit limited – improved inflation and core inflation indicators. Currently, the inflation forecast for the end of 2015 remains at 6.8%, while GDP is expected to grow by 3%. Depending on the political turmoil, there might be some downward revisions in the forecasts.

Conclusion

Despite the strong financial results for the first half of 2015, we see declining commodity prices and attractive valuation. The period of uncertainty before the elections is likely to impact investments and portfolio flows negatively during the coming months. We might see downgrades by rating agencies during this period. As politics continue to weigh on local markets, slowdown in the economy and as Fed gets ready to hike rates in late 2015; challenging months are ahead for us.

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