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Turkish Elections Round Two

Sevda Sarp

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Turkish early elections to be held on 1 November, 2015; and once more, the market is waiting for a positive outcome. Neither the country nor the market has more tolerance to absorb any further political uncertainty; however, the election outcome may not be too different from the results back in June 2015. Nevertheless, this time Turkey is closer to a coalition government.

As a reminder: on 7 June 2015, Turkish parliamentary elections generated 40.9% of votes for AKP (governing party Justice and Development), followed by CHP (Republican People's Party) with 25.0%, MHP (Nationalistic Movement Party) with 16.3%, and HDP (People's Democratic Party) with 13.1%. Meanwhile, the average of the recent polls conducted indicates some minor changes for AKP at 42%, CHP at 27.3%, and HDP at 12.4%. But this outcome would still not be enough for AKP to form a single party government. That being said, this time the likelihood of the successful formation of a new government is bigger than before, given that the uncertain political environment affects all parties equally across the board. In this scenario, a coalition of AKP with the main opposition party CHP is highly probable. We think it would be very hard for AKP to form a coalition with HDP or MHP after consecutive terrorist attacks which killed almost 200 people in a couple of months. Besides, the head of MHP has stated at several occasions that the party is not willing to be part of any coalition, especially after the terrorist attacks.

Worst-case scenario: no coalition and again a repeat of the election

If the parties failed to form a coalition government, Turkey would have to repeat the election again – but from our point of view, this is an unlikely scenario. However, if it were to materialise, it would come with high economic costs, and it would be detrimental to the markets. It is also important to note that Turkey did not have a coalition government since 2001, as AKP was the only ruling party. The coalition of course may lead to another period of uncertainty, with the capital markets concerned over who is going to replace the existing MPs and economy officials.

The formation of a coalition would have a positive impact

If a coalition government were successfully formed, the “2.5 years election cycle” would have come to an end, which would reduce the political risk in the country. The election period and related uncertainties have cost Turkish assets a lot: the MSCI Turkey index currently trades at 9.2 x 12M forward earnings estimate, which is 18% below the Price/Earnings-ratio of 11.3x of the MSCI EM index.

Of course, even after the formation of a possible coalition government, we will have to wait at least until February 2016 to see some structural reforms and a new budget as the current temporary government has limited power when it comes to introducing economic reforms or passing a budget. However, a new government based on a coalition would remove uncertainty which currently puts weigh on the Turkish capital markets.

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Sevda Sarp

Research Analyst, Erste Asset Management