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Turkey Outlook 2017 – Light at the end of the tunnel

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Turkey faced a lot of difficulties in 2016 – both on the economic and political side. On the economic front, the first half of the year was a recovery period where most of the macro data showed improvement, political turmoil had diminished and equity market was pretty much on hold while the market participants had positive views in general. A new Prime Minister and a new Governor for the Central Bank was appointed, who started his term with a positive tone with respect to Monetary Policy. On the other hand, in the second half of the year Turkey had to cope with a lot of turmoil.

Coup attempt ensured turbulences

In the midst of July, 2016 the country faced a coup attempt which had been failed. Afterwards, Turkey started State of Emergency and extended another three months which will end by the end of the year. After the coup attempt more than 90,000 people were laid off from various levels of government institutions. The political agenda was very heavy and some of the economic reforms were on hold during this period.

Moody's cut Turkey's unsolicited foreign currency sovereign credit ratings to Ba1 from Baa3, with a negative outlook. S&P revised up Turkey's outlook from negative to stable while keeping Turkey's sovereign rating at 'BB', which are two notches below investment grade.

2017: referendum to implement a presidential system

Despite the fact that economic reforms were a little bit on hold, we guess, that the reforms that have been planned, will remain in place. However, this time the implementation will be more important, as the new government's main priority will be switching to a presidential system as soon as possible. With this regards, the government is working on a referendum, which will most possibly be conducted in the first half of 2017.

EU negotiations

Another crucial topic for the near future will be EU membership talks. In late November, 2016 the European Parliament has voted to suspend Turkey's EU membership talks because of the Turkish government's crackdown since a coup attempt. Afterwards, some government officials gave negative statements, which created more tension. While there are various uncertain items, please note that the suspension of accession talks is a complex procedure. Although, the European Council will decide whether to suspend the negotiations, we expect EU leaders will decide to maintain negotiations talks with Turkey. However, no new chapters are likely to be considered for opening with Turkey under the current circumstances.

Central Bank moving interest rates

With respect to the Monetary Policy: after his appointment the new governor of the Central Bank of Turkey (CBT) cut its interest rates by 250 bps from 10.75% to 8.25% through March-September period and kept its interest rates unchanged in October. However, during the meeting held in November the CBT made a 50bps rate hike which surprised the market – the move was stronger than what the market was looking for. Given the continuous depreciation of Turkish Lira, the action was very positive where the Central Bank also provided the message that it can hike its interest rates when it is needed. With this, the CBT sounded one notch more cautious on its inflation outlook where it referred mainly to recent TRY depreciation and gave a clear message that the next step in the simplification process will depend on the upcoming data.

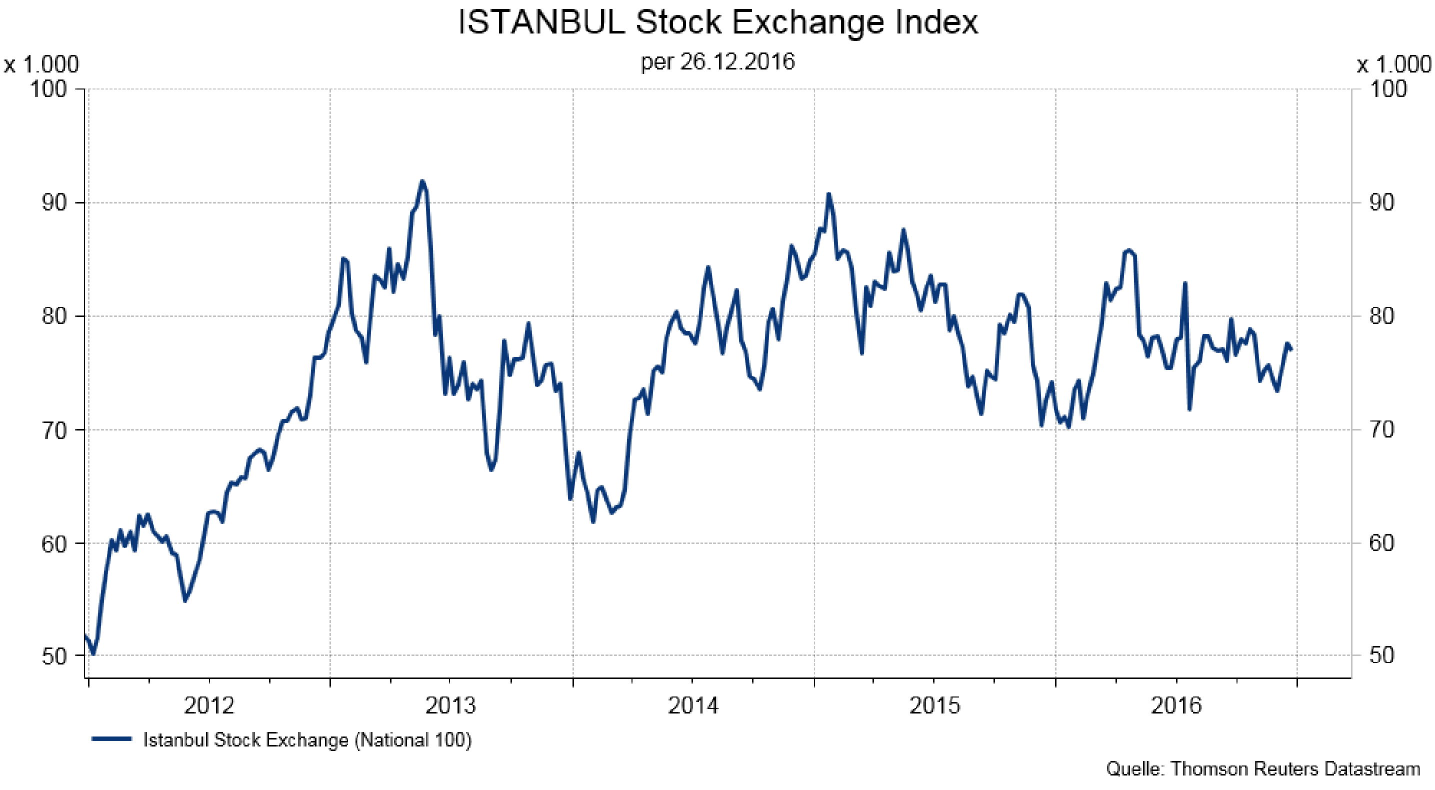
Meanwhile, within the scope of medium term economic program, Turkey revised 2016 GDP (Gross domestic product) growth forecast to 3.2% from 4%. The government now expects inflation to end this year at 7.5% which might be the case should food prices continue to behave as planned.

It should be also noted that Fitch maintained the rating for now, but, it is scheduled to make its new assessment in the early months of 2017.

Comeback of tourism?

Another important topic for 2017 will be the tourism revenues. Tourism sector declined by 40% in 2016 which was due to a combination of terrorist attacks, worsening relations with Russia and the failed coup attempt which led Turkey to be less attractive for tourists. However, given the improved relations with Russia and absence of political turmoil unlike 2016; the market expects a pick up in the number of tourist arrivals.

Performance Istanbul Stock Exchange (12/2011 – 12/2016)



Source: Thomson Financial Datastream; data per 27.12.2016; the chart represents an index and does not include any fees; Please note that past performance is not a reliable indicator of the future performance

Equity valuations are getting more attractive

Looking at the equity market, Turkish equities are down by 15% year-to-date in US-Dollar terms underperforming Emerging stock markets by 23%. Meanwhile since the end of 3Q16, Turkish market is down by 18% in Dollar terms which implies an underperformance of 14% relative to Emerging markets pointing Turkey as the second-worst performer in the global Emerging Markets benchmark index (MSCI-EM) after Brazil. The Turkish equity market now trades at 8x Price-to-Earnings (P/E-ratio), with plus 20% expected Earnings-per-share growth, which is significantly lower than the historical P/E-average of 10x. The banking sector on the other hand trades with 0.7x Price-to-Bookvalue with 14% Return-on-equity for 2016 (expected), which makes the sector attractive compared to its peers. More importantly – according to Bloomberg – consensus estimates a 7% increase in earnings-per-share for banks and a 30% boost in bottom line profits for industrials in 2017.

Turkey attractive for long term investors

All in all, after being dominated heavily by local politics, the Turkish market has now reached a turning point and considering the Earnings-per-share-growth and positive macro-economic growth outlook Turkey offers upside potential in the longer term – unless we see jittery on the political side. Turkey's structural problems coupled with the global financial conditions may lead Turkey to grow less than its potential growth rate of 4.5%. The failed coup attempt and Moody's rate cut decision has put additional pressure on Turkish assets in the short term. However, structural reforms and the easing of domestic politics will be much more important for Turkey's growth prospects in the medium term. Considering the equity valuations, Turkey still trades at very attractive levels for longer term investors.

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