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Turkey´s astonishing rush to early elections

Gast-AutorIn / Guest Author

Amalia Ripfl, Senior Fundmanager

Last week Turkey's political class managed to surprise investors again by calling early elections for 24th of June. After last year's constitutional referendum in April 2017, which offered the newly elected president numerously executive powers, a lot of voices speculated that presidential elections would follow suit, as Erdogan's wish to strengthen his political position had been obvious in previous years. But those thoughts/rumours were soon forgotten in view of Erdogan's persistent speeches on elections to be held "on time" in November 2019.

Last week, the situation changed. In a perfectly timed move, the new elections programme was proposed on Tuesday by Mr. Bahceli, leader of the MHP Nationalist Movement Party and alliance partner of AKP, accepted on Wednesday by President Erdogan, discussed on Thursday by the parliament's constitutional committee, and approved on Friday by the parliament's general assembly. Mr. Erdogan stated as a reason for early elections the cross-border operations in Iraq and Syria and the crisis in neighbouring countries – a reason as good as any. The fact is that the elections which are about to happen less than two months from now represent the final stage of a process started a long time ago.

Who benefits from early elections?

The present assumption is that Mr. Erdogan, the ruling AKP party and their partner, the Nationalist party MHP, are obviously convinced that the economic and popularity momentum is better now than it could one year from now. Indeed, the majority of analysts agree that, at this point, the Erdogan alliance has the upper hand in the coming votes.

There are numerous reasons for rushing the election calendar.

1) Economic situation:

The economy has always played an important part in AKP's success over the past 16 years. As long as AKP managed to achieve the real growth targets, they would win elections. The hurry reflects the degree of uneasiness about the possible deterioration of the economy. Over the past years Turkey has experienced amazing growth rates (above 7% in 2017), which have been supported by a set of ultra-expansionary policies (huge infrastructure programmes, tax incentives in different sectors, credit growth).

The negative aspect of this expansionist programme has been a constantly high level of inflation (over 10%) as well as a persistent current account deficit (ca. USD 50bn expected for 2018), which has to be financed. And this is the weak point in the actual economic policy of Turkey, in an environment where the interest rates have started to change on an international scale, global liquidity keeps declining, and the cost of external borrowing is on the rise. The operational environment for the companies will be also more difficult taking into consideration that the current corporate sector currency mismatch is of a magnitude of about USD 200bn and the FX losses and financing cost will keep increasing.

2) Political situation:

The opposition is weak (since the coup in 2016 Erdogan has used his power to defeat all his political opponents). Now the opposition has no time left to form strong alliances which could represent any real danger for Mr. Erdogan. Additionally, the Turkish military action in Syria has stirred nationalistic and populist feelings, giving a boost of approval rates to the AKP-MHP alliance.

What to expect after the election?

Most analysts think that these early elections could bring stabilisation at the political level. Given that the political direction (growing authoritarianism and an erosion of the rule of law) in Turkey is now clear and will be cemented after the June elections, investors will just have to focus on the economic measures and their success. Deputy Prime Minister Mehmet Simsek declared that early polls would improve expectations regarding Turkey's economy…. "A new five-year period is set to open where we can focus on the second and third generation of economic reforms, which we will start after the elections".

How is the equity market reacting?

Over the past months the market has experienced high levels of volatility, switching between risk-on/risk-off constantly. The sentiment has generally been poor, and the effect from the weakness of the Turkish lira has been a significant one. The Turkish equity market has underperformed the MSCI EM index and is currently trading at more than a 30% discount vs. emerging markets.

Last week we saw a short-term rally, with almost all sectors putting in a good performance. Investors have begun to think the uncertainty is likely to disappear after the June elections. The banking sector and state-affiliated companies, which had underperformed strongly over previous months, managed to outperform the rest of the market by a particular sizeable degree.

On the other hand, the long term picture has not changed. Turkey will continue to hold a strategically important position for Europe and for European companies. Turkish companies will continue to be operated by professional management which will continue to be efficient, flexible, and business/client/profit-oriented, offering the investor strong returns. The macro issues will continue to hover over the market development (high leverage, high inflation, volatile exchange rate/ weakening currency) but now the expectations of measures aimed at economic stabilisation by the policy makers are higher.

The Turkish political class is expected to show awareness of current economic imbalances, to start reforms and to implement economic programmes in order to bring about more macro stability and to reduce the current account deficit. A higher rate hike to contain both inflation and the slide of the lira and thus a slower GDP growth rate could be the main themes for 2019. In our portfolios we strongly focus on quality companies with good fundamentals, high export capabilities, and good connection to the political class. We think that those companies will be the ones to benefit the most from the further government incentives.

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