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Developing Markets Insight

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TURKEY: UNCERTAINTY AMID NEGOTIATIONS

Turkey had an unexpected result in its June 6th Parliamentary elections with the AKP loosing single party rule for the first time in 12 years and signalling a significant change in the Turkish political landscape in the years to come. The root cause of the fall in AKP support lies in the several missteps of President Erdogan and his AKP government in the last 24 months:

1. Mismanagement of the Gezi park protests which alienated some of the Istanbul secular Turks as well as pushing some of the nationalist votes from AKP to MHP.

2. Fethullah Gulen and “tapes” scandal in December 2014 revealing corruption among Erdogan, his family members as well as government officials and a “cleaning up” of police, intelligence and judge forces by President Erdogan post scandal to consolidate his power.

3. Rumours of Turkey’s arms shipments to Islamic State and Erdogan’s inaction in support to Syria’s Kobani Kurds during January-February 2015 leading to a significant shift of votes from the AKP to the Kurdish HDP opposition party.

As a result the AKP fell short of the 276 MP seats necessary to form a single party majority government at the June 6th elections and it now faces the necessity of forming a coalition with one of the two largest opposition parties – CHP (Socialists) or MHP (Nationalists). The fourth opposition party, the Kurdish HDP, announced that it will not be entering into coalition with AKP.

While in the aftermath of the election the Turkish stock market experienced significant volatility (-9%/+10% moves), it closed June almost flat as the market currently perceives the chance of a coalition as quite high. The probability of second parliamentary elections if the AKP fails to reach a coalition agreement is currently perceived by the market as quite low, but will significantly increase volatility if it turns out to be the case.

Following the election of AKP candidate Ismet Yilmas as a Speaker of the Parliament on July 1st, the coalition scenarios remain ambiguous. Turkish medium-term performance will be based on the longevity of this new structure. The three main scenarios from here are:

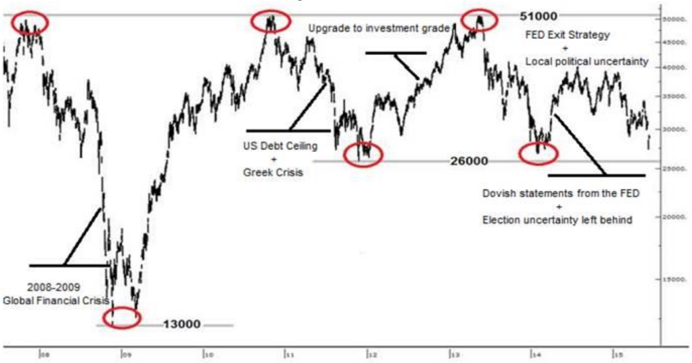
1. AKP-CHP coalition (40% probability) - probably the easiest to achieve given the minimum number of concessions and ministerial positions that the AKP needs to give up to the CHP. At least initially, the market will be optimistic about this coalition and will price in normalisation of Turkish politics with no hard line comments against the Kurds. The mid-longer term success of this coalition will depend a) on the consistency of reforms on the removal of the red tape, b) the stability of the exchange rate and interest rates and c) ensuring continuation of the AKP’s policies of infrastructure spend and support for businesses.

2. AKP–MHP coalition (40% probability) - while neutral on the economic front, this is likely to significantly increase risks of the government putting breaks on the Kurdish peace process and taking more of a hard-line against the Kurds. This is very likely to result in Kurdish violence across the country and might increase Turkey’s country risk premium.

3. Second elections by November 2015 (20% probability) – this would be the most negative outcome in the case of the AKP failing to reach agreement with the opposition parties. This might result in another hung parliament (as the political landscape would not have changed dramatically in the last month) or an AKP victory due to additional votes gained from HDP and CHP (which will be perceived by the stock market as positive).

Our base case scenario is that the Turkish political landscape will normalise by September 2015 (even in the case of increasing Turkish–Kurdish confrontation if a coalition with the MHP materialises), just in time for Turkey to have a government in place and face potential global headwinds as the Federal Reserve may inch closer to hiking the rates in the US. The market is likely to have a small “optimistic” rally if a coalition is announced but we do not expect significant re-rating until further clarity on USA policy rates and continuity of reforms.

Turkish market performance 2008-2015



Source: Bloomberg, BGC

GREECE: FROM TRAGEDY TO FARCE

Developments in Greece added volatility not only to regional but also to global markets in the second half of June and especially post the unexpected June 28th announcement by PM Tsipras of a Greek referendum on July 5th on the EU/IMF/ECB bailout package. The Greek banking and financial sector is closed until July 7th. Still “Greek drama” is quickly becoming “Greek farce” as PM Tsipras continues to issue contradictory statements on the possibilities of acceptance of the previously discussed bailout package, while campaigning for a “NO” vote. Recent polls suggest a marginal increase in “Yes” votes and the ECB has decided not to pull the plug on ELA immediately. Europe (including Chancellor Angela Merkel) clearly wants to let the people of Greece have their say but it is now obvious that there will be no U-turns or any negotiations before the referendum and its outcome is still as uncertain as the result of tossing a coin. The biggest unknown is how and when the Greek banking system will re-open if the vote is “No”. It’s not totally clear that it can be re-opened with the Euro as base currency without additional capital and liquidity injections that Europe may not be willing to provide. The range of outcome scenarios is quite wide, but despite its hard stance, the EU base scenario is skewed to attempt to keep Greece in the monetary union, even if the cost of this is re-starting negotiations with Greece’s new or old Government. We have no exposure to Greece in our GEM Core strategy.

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