

Turkey – A Bumpy Road Ahead

Our Take on Recent Events

The recently attempted coup in Turkey came as a complete surprise to most and could suggest that much deeper divisions exist within the country than previously thought. Having said that, it's also very clear that the majority of Turks do not want a return to military rule, and this fact was made obvious by the number of people who came out onto the streets to confront the army. It's worth acknowledging too that Erdogan's supporters account for almost 50% of the population and many are passionate in their support for him, as well as the AKP party itself. However, an equally large percentage not only dislike him they detest him, and this situation has come about despite Turkey's relatively strong economic performance these past 14 years. Since the AKP were elected in 2002, inflation has been brought under control, Turkey's debt to GDP ratio was reduced sharply and poverty levels have fallen.

In considering the reasons for this atmosphere of distrust, one factor could be the events occurring just across the border in Syria, where a weakened 'Daesh' has this past year begun lashing out overseas in an attempt to stay in the news and remain relevant to its followers, this has seen terror attacks taking place most recently in Europe, but also in Turkey itself. Some of these attacks, such as the one at a peaceful anti-government rally in Ankara last year which killed over 100 people, have appeared to specifically target opponents of the ruling party, and this could well be an attempt by the militant group to exacerbate social discord within Turkey by creating the impression that the government does not care about all the country's population.

Of course there are many other factors to consider including opposition group claims that Erdogan has continued to slowly consolidate his personal grip on power even when he was forced to move from Prime Minister to President, a role that according to Turkey's constitution should be more ceremonial than functional, and that he is actively trying to marginalize secularists. This view has been given further impetus by Erdogan's "shoot from the hip" style of speaking, and in the last few days the move to arrest thousands of soldiers, police, judges and academics.

Whatever the real causes behind this political polarity, Western critics of his government's massive clampdown and purge following last Friday's failed coup attempt should also bear in mind that the action by a portion of the army and air force was not a simple bungled attempt by a few disgruntled junior officers, as suggested by some in the media. This clearly had the support of a sizeable number of senior figures within and outside of the military and could have succeeded if they had managed to shut down the internet and the few private media outlets which were instrumental in getting ordinary people out into the streets.

Therefore a strong response was inevitable if the government wanted to demonstrate it was firmly in control and to ensure that the chances of any renewed attempt to overthrow it was effectively neutralized.

25 July 2016**Glenn Wepener**Executive Director, Markets & Geo-
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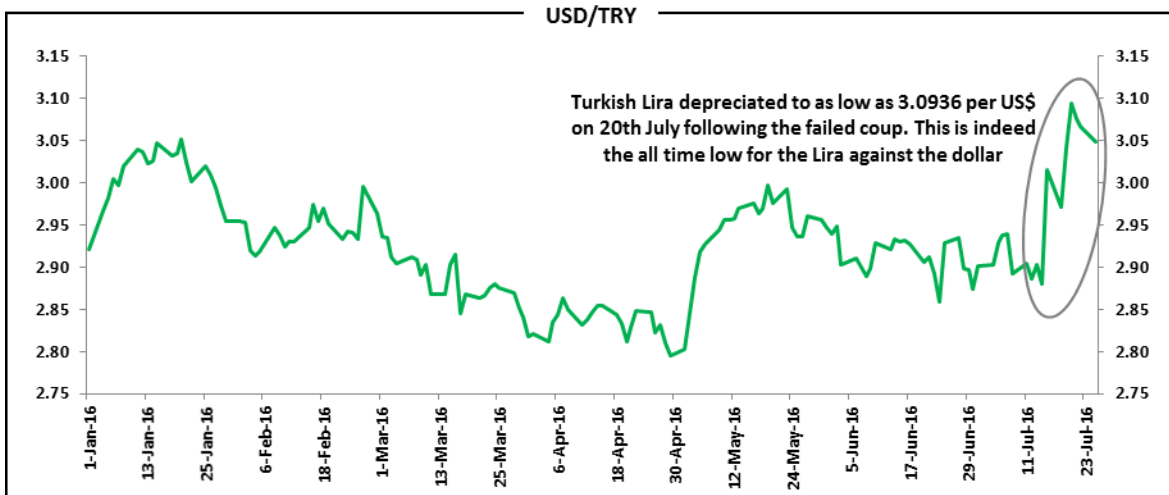
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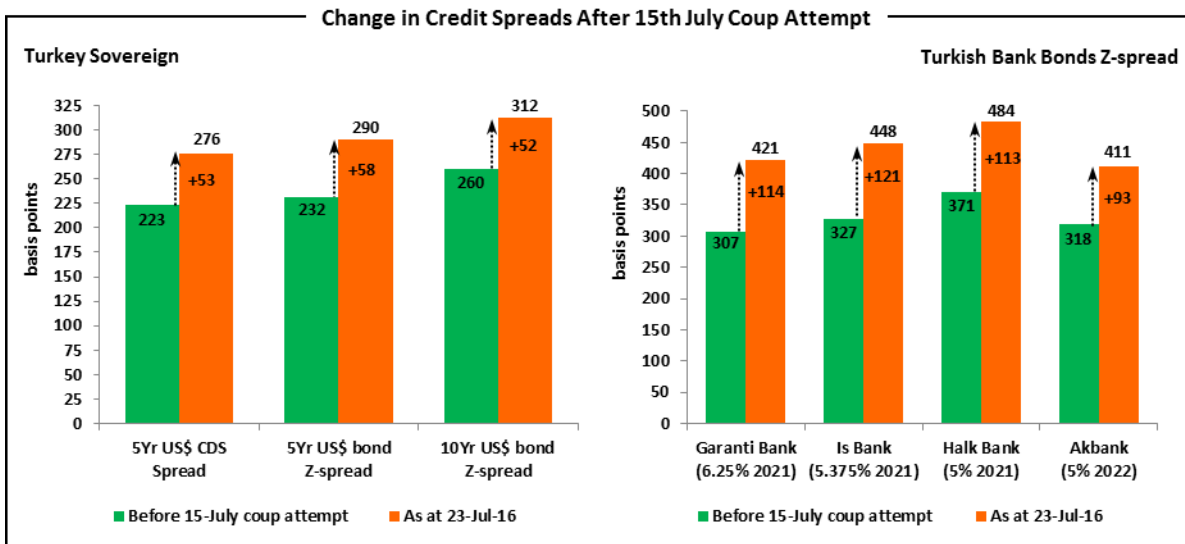
Analyst

The question now is what the government will do in the medium to longer term. If President Erdogan uses this situation to increase his own powers by amending the constitution, and not make a genuine attempt to try and remove some of the understandable fears felt by those within Turkish society who feel threatened by his rule, then the risk of further political divisions will rise. Unfortunately the signs are not very encouraging so far, but it's also too early to judge so investors will likely remain cautious in the weeks to come.

The local currency and bond markets have been battered over the past few days (as shown by the charts below). On the ratings front S&P downgraded Turkey further into junk status, and although Moodys & Fitch each continue to maintain an investment grade rating on the country they have placed these under review. This is another important concern as the country relies heavily on overseas buyers of its debt to fund its current account deficit (Turkey has US\$170 bio of external debt maturing over the next 12 months). In a statement S&P justified its downgrade decision by saying: "Following the attempted coup in the Republic of Turkey on July 15, we believe the polarization of Turkey's political landscape has further eroded its institutional checks and balances. In addition, we expect a period of heightened unpredictability that could constrain capital inflows into Turkey's externally leveraged economy."



Source: NBAD, Bloomberg



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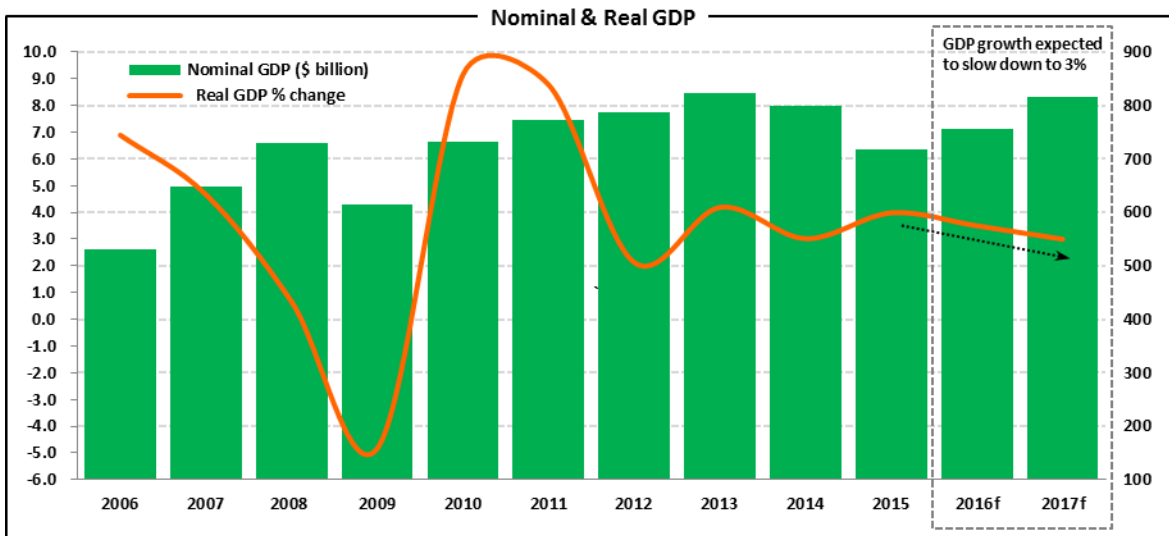
Meanwhile the recent turmoil combined with a series of high profile terror attacks, like last month's bombing at Istanbul's main international airport, is having an impact on the economy, with the important tourism sector probably the worst affected especially after relations between Ankara and Moscow deteriorated. This is reflected in hotel occupancy rates which were down by 40% in the first half of this year according to recent data published by the GRI strategy group.

However, some stability does appear to be returning to the local financial markets and the recent sharp falls are probably overdone for now, meanwhile the Central Bank and Finance Ministry have also been active in trying to calm concerns and reiterated that the government remains committed to maintaining its current economic policies. Added to this, and before the attempted coup took place, Ankara was making progress in mending its ties with Russia, this move is likely to continue although on the flip side Turkey's relations with both Washington and Cairo have worsened.

In conclusion we recommend a "wait-and-see" approach until there is more clarity on the political road ahead for Turkey, without doubt it's likely to be a pretty bumpy one.

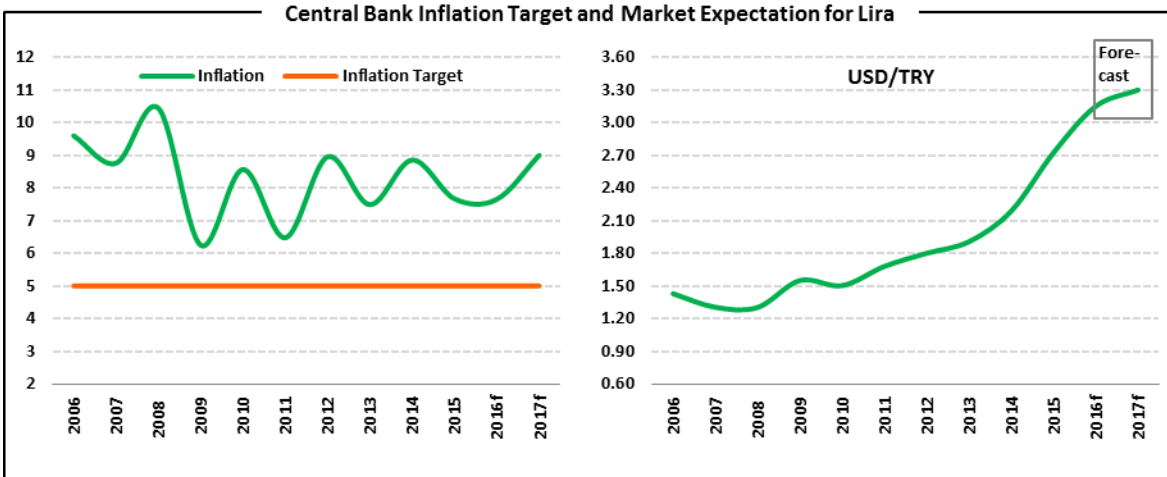
Economic Snapshot

- Turkey is currently the 19th largest economy within the G20 (US\$ 730bn), with a population of approximately 77 million.
- Tourist arrivals and industrial production data indicates that 2016 & 2017 will be challenging. Economic growth for 2016 is expected to be around 3.5% dipping further to 3% next year, against government forecasts of 4.50 & 5.00%.
- The spike in growth late last year was primarily driven by a sharp increase in government spending ahead of the elections.

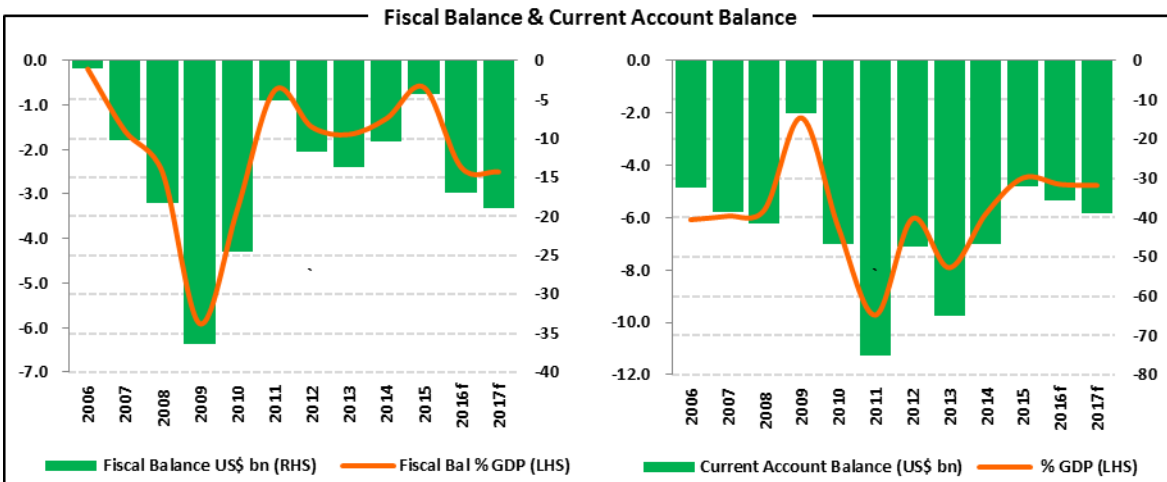


Source: IIF, IMF

- The Central Bank will likely continue to follow an accommodative monetary policy and had already reduced its benchmark lending rate by 175bps in June. Inflation meanwhile remains under control at around 7.6%.
- The local currency is expected to depreciate further due to twin deficits (Current and Budget) although this in turn could help to boost exports.

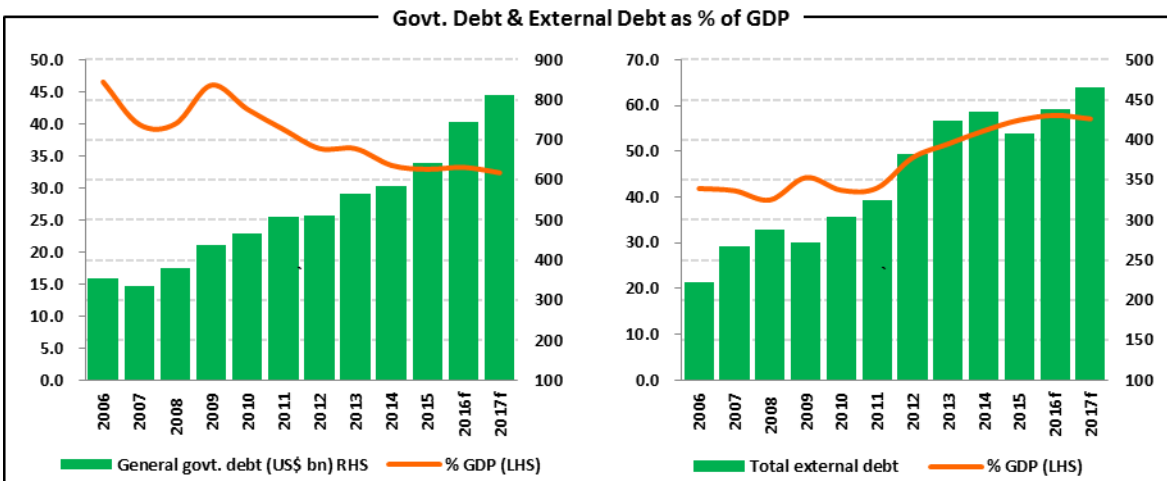


Source: IIF, IMF



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- Despite the deficits Turkey has a proven track record of paying its debts during difficult times such as in 2001 when the country's debt-to-gdp ratio was around 90%. Currently the ratio is around 35%. Low energy prices will also help relieve the pressure.



Source: IIF, IMF

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