

TURKISH 2018 ELECTION SPECIAL

15th June 2018

United opposition may scupper Erdogan's ultimate power plan

On Sunday 24th June, Turkey will hold snap presidential and parliamentary elections (with a runoff for the former on July 8 if needed) that could set the ball rolling for significant political changes, eighteen months after President Erdogan narrowly won public approval for a package of constitutional amendments that would move the country from its parliamentary democracy to an executive presidential system for the first time in its modern history.

Erdogan brought forward the elections from late 2019, aiming to ride a favourable wave of nationalism and cash in on a popular mandate before the dark clouds over the economy turn into a storm. Erdogan cited 'developments of historical importance' in the region as well as the cross-border operation carried out in Syria as reasons for moving elections forward from November 2019. However, concerns about the health of the economy – specifically a risk of overheating – were no doubt a key determinant, with Erdogan and the AKP wary of seeking re-election further down the line, in a potential economic downturn.

Erdogan Power Grab

The new system would change the role of the President from a primarily ceremonial office to one with wide reaching powers that include authority over the high council of judges and prosecutors, the ability to appoint and fire ministers, dissolve parliament, issue decrees with the force of law and prepare the budget subject to parliament's approval, all whilst retaining ties to a political party. Parliament would essentially continue as the legislative body, albeit with limited oversight.

Erdogan and his supporters have argued that a presidential system is necessary to bring stability and to create an efficient and strong state, after a challenging few years in which the country has been rocked by an attempted coup, terror attacks, a resurgence of the Kurdish conflict, and the Syrian civil war which rages on its border. However, for critics, this system merely underscores Erdogan's increasingly authoritarian tendencies, and would essentially eliminate the democratic checks and balances needed to contain the presidency.



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TURKISH 2018 ELECTIONS SPECIAL

Election Legitimacy

There is a cloud of doubt over the legitimacy of these election as since the Jul-2016 failed military coup, Turkey has been under a state of emergency. As a result of the crackdown, Freedom House downgraded the country from “partially free” to “not free” in January and accused the AKP government of a “growing contempt for political rights and civil liberties.” Freedom House also drew attention to “a massive purge of media outlets” since the July 2016 coup attempt in the country. The campaigns seem to be substantially biased in favour of the current leadership in terms of airtime, billboards, and public meetings. Some 144k Kurdish voters will be unable to vote in their customary ballot stations; in one southeastern province, election-related demonstrations and events have been banned; and the Kurdish HDP Party’s presidential candidate, Selahattin Demirtaş, is campaigning from his prison cell.

The Election Contenders – Parliamentary Party and Presidential Candidate, (if contending)

Eight political parties and 68 independent candidates across the country;

- The ruling Justice and Development Party (AKP) – Recep Tayyip Erdogan
- Republican People's Party (CHP) the main opposition - Muharrem Ince.
- Nationalist Movement Party (MHP)
- Peoples' Democratic Party (HDP) – Selahattin Demirtas
- Good (İYİ) Party - Meral Aksener
- Felicity (Saadet) Party (SP) – Temel Karamollaoglu
- Patriotic (Vatan) Party – Dogu Perincek
- Free Cause (Hüda-Par) Party

The AKP Party has formed an electoral pact with the MHP (People’s Alliance), for both the parliamentary vote and Presidential vote (Erdogan is their candidate). The CHP, Felicity Party and İyi Party have formed the Nation Alliance as a joint opposition in the Parliamentary elections. These opposition parties could not agree on a singular cross-party Presidential candidate and so each have nominated their own candidate.

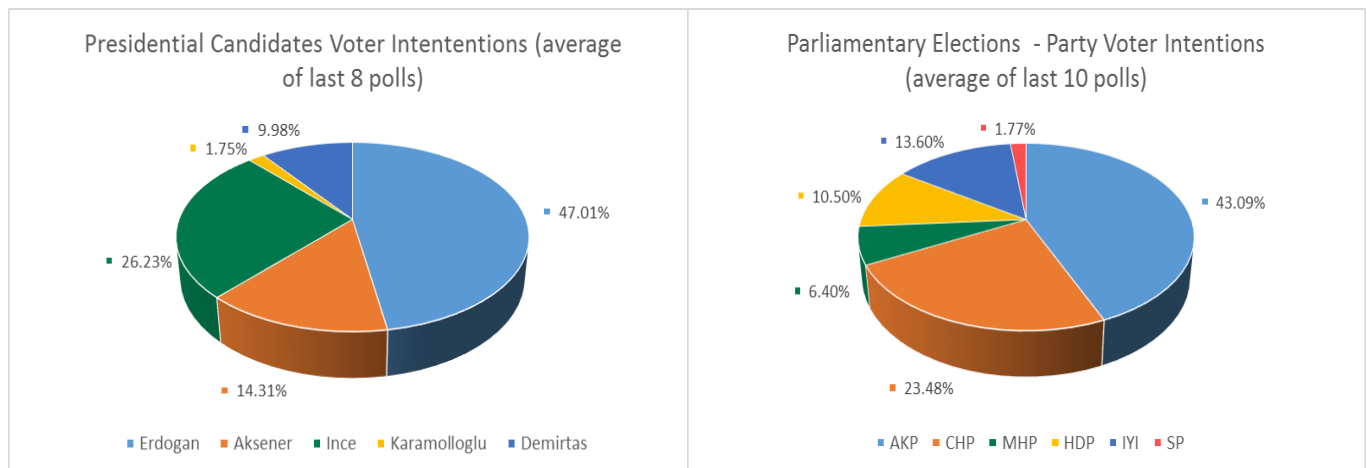
The Main Opposition in the Presidential Election

Erdogan looks set to be run hard by two secular candidates:

- **Meral Aksener** – İYİ Party - seen as an energetic and unique challenger to Erdogan from Turkey's political right. She recently broke away from the Nationalist Movement Party (MHP) and created her own party, the İYİ. Her supporters, come from the nationalist, conservative and religious communities, but she rejects the move to a presidential regime. CHP leader Kilicdaraulo “donated” 15 lawmakers who quit his party to join Aksener's, letting her contend in the elections.
- **Muharrem Ince** – CHP Party - is known in Turkish politics as one of the fiercest voices of the main opposition since 2002

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What Do the Polls Predict?



Both Erdogan and the AKP are favourites to win the elections, although they may struggle to secure the votes needed for an outright first round victory and a parliamentary majority. According to a handful of polls over the course of the last 2-months through to 11 Jun, Erdogan's support was averaging around 47%, while the AKP averaged 43% and even fall short of 50% with the support of the MHP, with whom it has formed an electoral pact.

To form this pact, Erdogan had to change the law to allow parties to band together which means that opposition parties could prove a hindrance if they pass the 10% threshold. Recall, the pro-Kurdish HDP managed to deny the AKP its parliamentary majority at the June 2015 elections (although this was regained five months later in re-run elections called by Erdogan after attempts to form a coalition government failed).

For the first time, Erdogan is facing a significantly united opposition, seemingly willing to back each other in a second round run-off contest. The above mentioned Nation Alliance is averaging 38.85% across the polls, which together with the Kurdish backed HDP (av 10.5%) would push the opposition also to just below 45.0%. So all depends on the success of the HDP and the Felicity Party – which if they go well means a parliamentary majority could well go to the opposition parties, very much like the June 2015 election. It seems that the HDP and the Felicity Party could therefore be the new kingmakers.

Election Outcome Possibilities and Market Impact

- The **first possibility** is that incumbent President Recep Tayyip Erdoğan as well as his alliance between the Justice and Development Party (AKP) and the Nationalist Movement Party (MHP) emerge victorious.
- The **second possibility** is that Erdoğan succeeds in his re-election bid but the parliamentary majority goes to the alliance of the main opposition Republican People's Party (CHP), the İYİ (Good) Party and the Felicity Party, plus the Kurdish issued-focused Peoples' Democratic Party (HDP).
- The **third possibility** is that the presidency goes to either CHP candidate Muharrem İnce or İYİ Party candidate Meral Akşener over two rounds, while parliament is held by the AKP-MHP alliance.
- The **fourth possibility** is a double victory of the opposition: Winning both the presidency and parliament.

Many fear that scenario one, an Erdogan and AK Party victory, will mark the beginning of the end for a secular, democratic republic. The judiciary, media, and civil society will remain under tight control, and the purge of the

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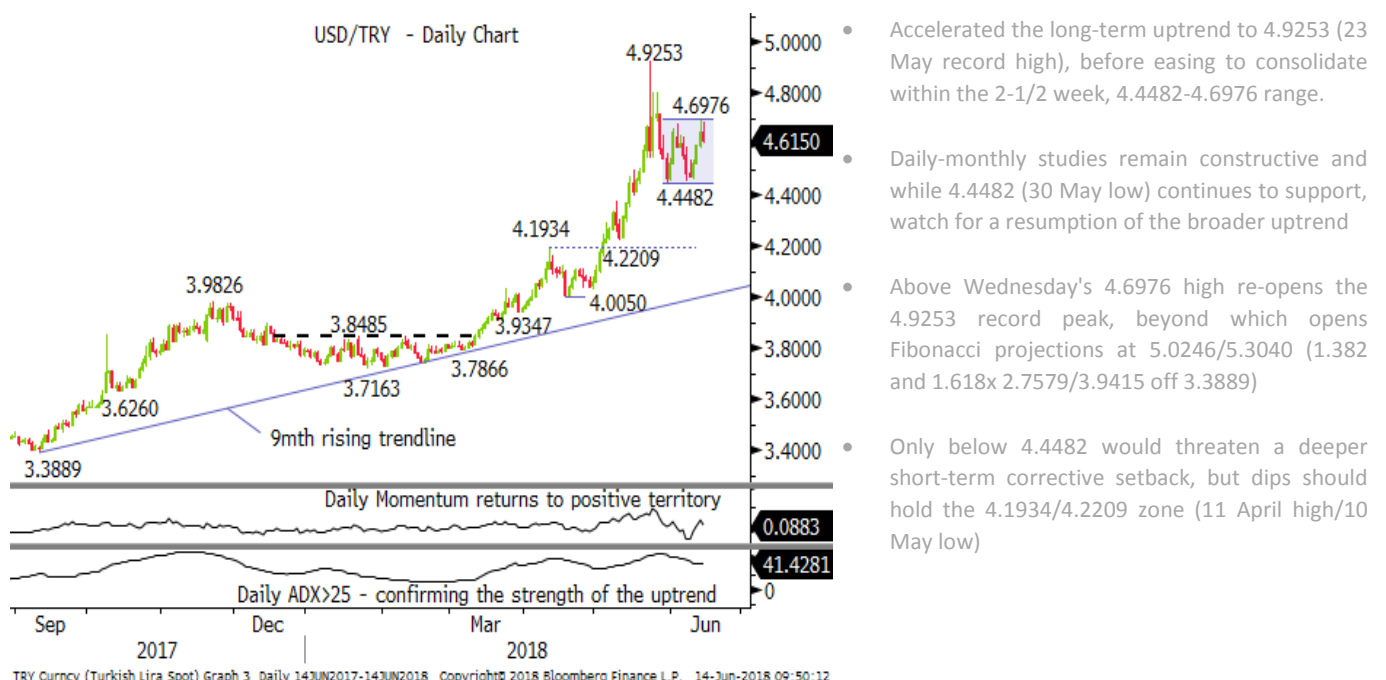
'enemies of the state' will likely continue. This could result in a significant capital flight over the long-term. However, we expect that markets will trade up in the short term should Erdogan and the AKP win, given that this is the least uncertain scenario for investors. This may not last long as investors will not be reassured by Erdogan's uncommon economic and monetary views (promised to take active role in policy). Local elections in March 2019 mean that, even if he wins both polls, Erdogan is unlikely to be able to shift out of election mode for the best part of a year, and this means that there may not be a tightening of fiscal policy to gradually slow the economy, that many hope will occur after the elections. Thus fears of an economic hard-landing and non-independent CBRT monetary policy may end-up intensifying after the election.

An opposition win for the Nation's Alliance in the parliamentary and either Ince or Arkenser in the Presidential votes is the most unlikely outcome, but would mean massive political change is likely to occur. It should be taken as a positive by markets, as the new President is expected to restore policy orthodoxy, constitutional order and democracy, and pivot Turkey back towards Europe, but it is unlikely that Erdogan will retreat quietly.

A likely and worst-case outcome would be where Erdogan secures the presidency, and the opposition alliance the parliamentary majority. Erdogan has made it clear that if this occurs then he will call for snap, repeat legislative elections, as was done in 2015. At the moment the constitution says that in the event of a parliamentary dissolution, both votes would need to be held again, therefore putting Erdogan's presidential mandate in jeopardy. All of this would usher in a period of increased uncertainty for the Turkish economy. International investors would probably adopt a wait-and-see attitude, pending indications of the economy's direction, and the resulting prolonged uncertainty will inevitably damage the country's fragile economy.

Trade Idea – Negatives whatever the outcome

From the above we recommend **a long USD/TRY position targeting a return to the 4.9523 record peak** and then 5.0250, given that, in our opinion, whatever the elections outcomes there will remain plenty of uncertainty over policy direction, and expansionary economic policies are unlikely to be reversed quickly if at all. This is supported by a still constructive technical picture (see chart and bullets below).



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As the effects of the recent CBRT policy action fade and investor focus shifts onto the post-election fallout, we see Usd/Try upside risks into year-end, even if there is a dip in the pair during the immediate election aftermath that could occur if Pres Erdogan emerges victorious from both votes. In a close run race there are likely to be accusations of vote fraud, which could lead to social unrest, although emergency rule could deter the electorate from such actions. Still, as witnessed during 2013 and the Gezi Park protests, there is a risk of mass protests that would throw the legitimacy of the election results into question and the country into instability.

Post-election, even if Pres Erdogan does decide he needs to put the brakes on the economy and tighten fiscal policy, this re-balancing, whilst welcomed by investors, would naturally lead to higher rates, lower growth and a weaker currency.

Thus we see few scenarios that do not lead to further Lira weakness.

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