

# Turkey Watch

Group Economics  
Emerging Markets Research

01 April 2019

## Local elections come with more uncertainty

---

**Nora Neuteboom**  
Economist Emerging Markets  
Tel. +31 20 343 77 31  
Nora.neuteboom@nl.abnamro.com

---

**Georgette Boele**  
Senior FX strategist  
Tel. +31 20 629 77 89  
Georgette.boele@nl.abnamro.com

---

- **Erdogan's alliance lost in Turkey's biggest cities in yesterday's elections**
- **Intervention by the government in the currency market last week will have negative long-term consequences**
- **We have changed our lira view, and expect the lira to slide further against the dollar (in USD/TRY is 6.0 from 5.2 previously)**
- **Local election outcome raises uncertainty over the prospect of structural reforms**

### **Erdogan's People Alliance lost major big cities in local elections...**

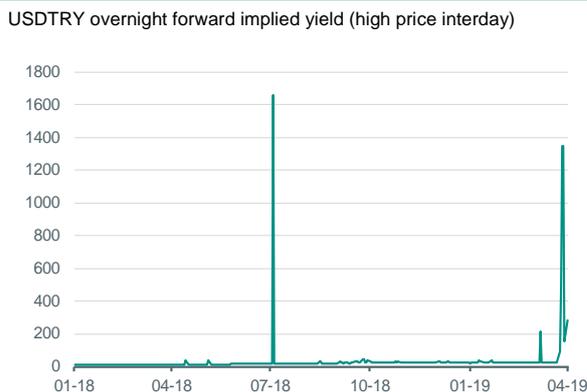
In yesterday's local elections, Erdogan's People Alliance (AKP and MHP) suffered losses in the biggest cities of Ankara, Istanbul and Izmir. The National Alliance (CHP and Iyi) got the majority of votes and thereby gained control over the large cities, as Ankara and Istanbul were previously under AKP rule. Country wide, with 99% of the votes counted, the People Alliance has gained around 51% (44.4% from AKP and 7.25% from MHP) of all votes, while the National Alliance stands around 42% of the votes. The support for the People Alliance has come down from a level of almost 54% in the general elections in 2018. The result in the local elections significantly differs from the outcome of the local elections in 2014, when the AKP and MHP alliance got almost 61% of the votes. That said, this loss is mainly due to disappointing figures for MHP, that lost over half of its votes (15.2% in 2014 versus 7.3% now). While the local elections have no effect on the leadership at a national level, the People alliance losing the control over the big cities constitutes a clear warning signal that people are not satisfied with the current economic policy of the regime.

**TRY volatility went up in the previous week**



Source: Bloomberg

**Swap rates went through the roof in the last week**

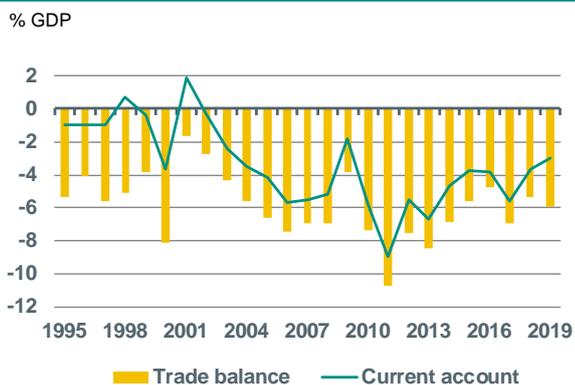


Source: Bloomberg

**... and the losses came at a high cost**

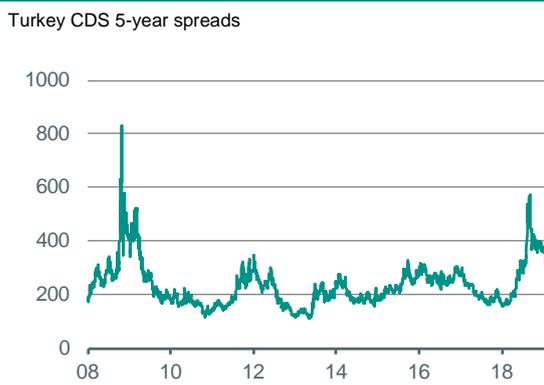
Last week in order to avert a currency crisis before the elections, the authorities intervened by suspending the one-week repo auctions for an unspecified period, which basically means that banks can lend at the CBRT for the overnight lending and the late liquidity window which stand at 25.5 percent and 27 percent (this represents a monetary tightening from the one-week repo, which stands at 24%). Moreover, last week the lira overnight swap rate rose to over 1350%, as investors with long lira exposure were not able to off-load their positions, and lira shorts were discouraged. Local banks were pressured by authorities to not provide liquidity to foreign investors. Investors dumped Turkish bonds and stocks, sending banking stocks lower by 10%. CDS spreads (5y) increased from an average level of 312 in February to a peak of 457 on March 27.

**Current account in deficit since 2002**



Source: EIU

**5y CDS spreads up**



Source: Bloomberg

As Turkey is highly vulnerable to a shift in investor sentiment, and depends on foreign investors to fund its current account deficit, the long-term negative implications from the measures taken last week outweigh any short-term gains. The actions of the authorities decreased volatility on the lira in the short-term, but is unlikely to provide support to the lira in the longer run. Foreign investors are able to anticipate market volatility, but not erratic action by the authorities that result in the drying up of liquidity in currency and interest rate markets. Moreover, the refusal of Turkey to stop the purchase of the Russian missile

defence system S-400 could potentially lead to another stand-off between Turkey and the US. These Turkey-specific factors come against the backdrop of cooling global economic growth, affecting general risk sentiment. We think investors will shy away from Turkey going forward, resulting in a weaker lira against the dollar.

As a result, we have downgraded our outlook for the lira versus the US dollar. Our new year-end forecast for USD/TRY is 6.0 (5.2 previously). We continue to foresee a recovery of the lira in 2020, mainly because we expect a generally weaker US dollar. Our end-2020 forecast in USD/TRY is 5.5 (5.0 previously). We keep our GDP growth forecasts at -1.5% in 2019 and 2.5% in 2020 (we are already on the bearish side).

#### **Local election outcome creates uncertainty over the prospect of structural reforms**

Last month, Minister Albayrak has announced that Turkey will embark on a round of reforms after the elections, and presented a roadmap for the coming years. Given the results of the elections, however, we think momentum behind structural reforms is likely to fall somewhat.

After losing the major cities in the local elections, it will be crucial for the Erdogan's AKP to win back the confidence of the voters in the coming years, which can only be done by improving the current economic situation. Structural reforms often take years before they bear fruit, while often coming with short-term costs. As such, the current government is likely to have limited appetite for reforms, and may instead focus more on quick fixes, such as flooding the economy with more cheap credit.

*This document has been prepared by ABN AMRO. It is solely intended to provide financial and general information on economics. The information in this document is strictly proprietary and is being supplied to you solely for your information. It may not (in whole or in part) be reproduced, distributed or passed to a third party or used for any other purposes than stated above. This document is informative in nature and does not constitute an offer of securities to the public, nor a solicitation to make such an offer.*

*No reliance may be placed for any purposes whatsoever on the information, opinions, forecasts and assumptions contained in the document or on its completeness, accuracy or fairness. No representation or warranty, express or implied, is given by or on behalf of ABN AMRO, or any of its directors, officers, agents, affiliates, group companies, or employees as to the accuracy or completeness of the information contained in this document and no liability is accepted for any loss, arising, directly or indirectly, from any use of such information. The views and opinions expressed herein may be subject to change at any given time and ABN AMRO is under no obligation to update the information contained in this document after the date thereof.*

*Before investing in any product of ABN AMRO Bank N.V., you should obtain information on various financial and other risks and any possible restrictions that you and your investments activities may encounter under applicable laws and regulations. If, after reading this document, you consider investing in a product, you are advised to discuss such an investment with your relationship manager or personal advisor and check whether the relevant product—considering the risks involved—is appropriate within your investment activities. The value of your investments may fluctuate. Past performance is no guarantee for future returns. ABN AMRO reserves the right to make amendments to this material.*

© Copyright 2017 ABN AMRO Bank N.V. and affiliated companies ("ABN AMRO").