29 May 2023

Research Turkey

Time to fasten seatbelts as Erdogan secures another term

- **Recep Tayyip Erdoğan, has sealed his iron grip on Turkey. In the absence of a u-turn in his economic policies, the risk of an acute currency crisis looms.**
- **In a scenario where Turkey ran out of foreign currency, lira's value would likely collapse, inflation would explode and goods shortages could occur. Turkish corporates with large foreign liabilities would face rising rollover risk.**

Recep Tayyip Erdoğan, a long-standing Turkish leader also known for his unorthodox economic doctrines, has secured a victory in the country's presidential election yesterday. When almost all ballots have been counted, 52.5% of the votes went to Erdoğan and 47.8% to his challenger Kemal Kılıçdaroğlu. While the opposition leader Kılıçdaroğlu has not explicitly conceded victory, the country's Supreme Electoral Council has confirmed the result and there is no doubt Erdoğan has secured a grip on power for the next five years.

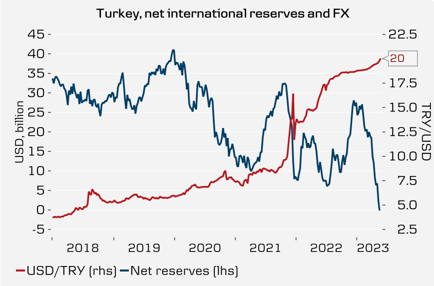
In a country that is becoming increasingly polarised, one of Erdoğan's biggest appeals is his strong man image. Over the coming years, he will likely continue to undermine the country's democracy. Since a failed military coup in 2016, Erdoğan has responded with an intensifying crackdown on opposition and an abolishment of prime minister's post. He has persistently accused the opposition for siding with terrorists and insisted that e.g. the former co-leader of Turkey's pro-Kurdish HDP party, Selahattin Demirtas stays in prison. Going forward, Erdoğan will likely only increase the level of repression towards dissidents, hereby exacerbating what already constitutes to a brain drain out of the country.

President Erdoğan has given no signals that would lead us to expect he is planning a u-turn in economic policies. Erdoğan has acknowledged the pain from high inflation to Turkish households but he has not admitted a link between his low rate policy and high inflation. Inflation has fallen from the highs above 80% to 44% in April but will likely stay elevated, particularly as recent fall in lira will again add to imported inflation.

The recent increase in current account deficit is mostly due to imports rising faster than exports, illustrating how Erdoğan's doctrine of exports-driven growth has not worked. Some of Turkey's vulnerabilities are structural in nature (e.g. reliance on energy imports), but the recent rise in imports is not due to energy. In fact, the energy bill as a share of total imports has fallen from above 30% in Jan-2022, to below 20% in Mar-2023.

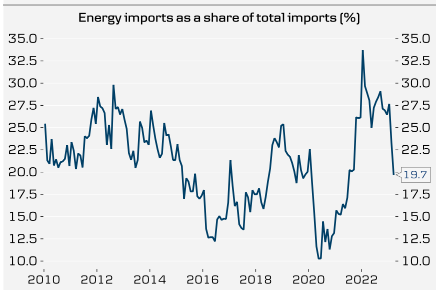
While Turkey does not have a public debt problem, its corporate sector has substantial foreign liabilities, and going forward, maintaining investor confidence is key. Net foreign reserves are already negative and the only thing keeping the CBRT's nose above the water (as they are forced to intervene on lira) is their access to foreign currency from Turkish banks and Gulf states. Turkish businesses are already obliged to convert a part of their export revenues into liras and FX-protected lira deposit scheme is a way for the central bank to vacuum dollars from the public. In any case, an artificially strong currency, record CA deficit and a central bank with no credibility left is an unsustainable combination, implying that eventually something will break. Predicting the exact timing is the hard part as capital controls can always be tightened. For sure, Turkish corporates have large maturities in June and they cannot afford a stumbling investor confidence.

Chart 1. Turkey's net FX reserves are negative



Source: CBRT, Macrobond Financial

Chart 2. Turkey's energy bill has fallen



Source: CBRT, Macrobond Financial

Chief Analyst
Minna Kuusisto
minna.kuusisto@danskebank.com

Disclosures

This research report has been prepared by Danske Bank A/S ('Danske Bank'). The authors of this research report is Minna Kuusisto, Director.

Analyst certification

Each research analyst responsible for the content of this research report certifies that the views expressed in the research report accurately reflect the research analyst's personal view about the financial instruments and issuers covered by the research report. Each responsible research analyst further certifies that no part of the compensation of the research analyst was, is or will be, directly or indirectly, related to the specific recommendations expressed in the research report.

Regulation

Danske Bank is authorised and regulated by the Danish Financial Services Authority (Finanstilsynet). Danske Bank is authorised by the Prudential Regulation Authority in the UK. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request.

Danske Bank's research reports are prepared in accordance with the recommendations of Capital Market Denmark.

Conflicts of interest

Danske Bank has established procedures to prevent conflicts of interest and to ensure the provision of high-quality research based on research objectivity and independence. These procedures are documented in Danske Bank's research policies. Employees within Danske Bank's Research Departments have been instructed that any request that might impair the objectivity and independence of research shall be referred to Research Management and the Compliance Department. Danske Bank's Research Departments are organised independently from, and do not report to, other business areas within Danske Bank.

Research analysts are remunerated in part based on the overall profitability of Danske Bank, which includes investment banking revenues, but do not receive bonuses or other remuneration linked to specific corporate finance or debt capital transactions.

Financial models and/or methodology used in this research report

Calculations and presentations in this research report are based on standard econometric tools and methodology as well as publicly available statistics for each individual security, issuer and/or country. Documentation can be obtained from the authors on request.

Risk warning

Major risks connected with recommendations or opinions in this research report, including as sensitivity analysis of relevant assumptions, are stated throughout the text.

Expected updates

Monthly

Date of first publication

See the front page of this research report for the date of first publication.

General disclaimer

This research has been prepared by Danske Bank A/S. It is provided for informational purposes only and should not be considered investment, legal or tax advice. It does not constitute or form part of, and shall under no circumstances be considered as, an offer to sell or a solicitation of an offer to purchase or sell any relevant financial instruments (i.e. financial instruments mentioned herein or other financial instruments of any issuer mentioned herein and/or options, warrants, rights or other interests with respect to any such financial instruments) ('Relevant Financial Instruments').

This research report has been prepared independently and solely on the basis of publicly available information that Danske Bank A/S considers to be reliable but Danske Bank A/S has not independently verified the contents hereof. While reasonable care has been taken to ensure that its contents are not untrue or misleading, no representation or warranty, express or implied, is made as to, and no reliance should be placed on, the fairness, accuracy, completeness or reasonableness of the information, opinions and projections contained in this research report and Danske Bank A/S, its affiliates and subsidiaries accept no liability whatsoever for any direct or consequential loss, including without limitation any loss of profits, arising from reliance on this research report.

The opinions expressed herein are the opinions of the research analysts and reflect their opinion as of the date hereof. These opinions are subject to change and Danske Bank A/S does not undertake to notify any recipient of this research report of any such change nor of any other changes related to the information provided in this research report.

This research report is not intended for, and may not be redistributed to, retail customers in the United Kingdom (see separate disclaimer below) and retail customers in the European Economic Area as defined by Directive 2014/65/EU.

Disclaimer related to distribution in the United States

This research report was created by Danske Bank A/S and is distributed in the United States by Danske Markets Inc., a U.S. registered broker-dealer and subsidiary of Danske Bank A/S, pursuant to SEC Rule 15a-6 and related interpretations issued by the U.S. Securities and Exchange Commission. The research report is intended for distribution in the United States solely to ‘U.S. institutional investors’ as defined in SEC Rule 15a-6. Danske Markets Inc. accepts responsibility for this research report in connection with distribution in the United States solely to ‘U.S. institutional investors’.

Danske Bank A/S is not subject to U.S. rules with regard to the preparation of research reports and the independence of research analysts. In addition, the research analysts of Danske Bank A/S who have prepared this research report are not registered or qualified as research analysts with the New York Stock Exchange or Financial Industry Regulatory Authority but satisfy the applicable requirements of a non-U.S. jurisdiction.

Any U.S. investor recipient of this research report who wishes to purchase or sell any Relevant Financial Instrument may do so only by contacting Danske Markets Inc. directly and should be aware that investing in non-U.S. financial instruments may entail certain risks. Financial instruments of non-U.S. issuers may not be registered with the U.S. Securities and Exchange Commission and may not be subject to the reporting and auditing standards of the U.S. Securities and Exchange Commission.

Disclaimer related to distribution in the United Kingdom

In the United Kingdom, this document is for distribution only to (I) persons who have professional experience in matters relating to investments falling within article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the ‘Order’); (II) high net worth entities falling within article 49(2)(a) to (d) of the Order; or (III) persons who are an elective professional client or a per se professional client under Chapter 3 of the FCA Conduct of Business Sourcebook (all such persons together being referred to as ‘Relevant Persons’). In the United Kingdom, this document is directed only at Relevant Persons, and other persons should not act or rely on this document or any of its contents.

Disclaimer related to distribution in the European Economic Area

This document is being distributed to and is directed only at persons in member states of the European Economic Area (‘EEA’) who are ‘Qualified Investors’ within the meaning of Article 2(e) of the Prospectus Regulation (Regulation (EU) 2017/1129) (‘Qualified Investors’). Any person in the EEA who receives this document will be deemed to have represented and agreed that it is a Qualified Investor. Any such recipient will also be deemed to have represented and agreed that it has not received this document on behalf of persons in the EEA other than Qualified Investors or persons in the UK and member states (where equivalent legislation exists) for whom the investor has authority to make decisions on a wholly discretionary basis. Danske Bank A/S will rely on the truth and accuracy of the foregoing representations and agreements. Any person in the EEA who is not a Qualified Investor should not act or rely on this document or any of its contents.

Report completed: 29/05/2023, 13:30 CET

Report first disseminated: 29/05/2023, 14:00 CET