



International Commentary — May 11, 2023

Turkey 2023 Presidential Election Scenario Analysis Update

Summary

General elections in Turkey are set to take place on May 14, and with the first round of elections this weekend, we updated election our scenario analysis. Typically, we would note that the outcome of the presidential election is not as important as parliament/ congressional elections; however, with President Erdogan controlling the overarching policy direction for Turkey—especially economic and monetary policy—the presidential election is more consequential than Turkish parliamentary elections. As far as our views, we continue to believe President Erdogan will retain office, and our base case forecast for the Turkish lira includes President Erdogan winning the election via second round runoff. Despite the challenges associated with Turkey's economy and the new challenges associated with the earthquakes, we believe Erdogan is still popular enough to receive a sufficient amount of votes, or is able to influence voting intentions or challenge results as a way to win re-election. We place a 50%-55% probability Erdogan retains office. However, the likelihood of this scenario unfolding has fallen since we published our original scenario analysis, and the probability of regime change has increased. At the heart of the regime change scenario are unsustainable economic conditions, although an underwhelming and inadequate response to the earthquakes is contributing meaningfully to the opposition Nation Alliance gathering momentum over the last few months. In addition, the Nation Alliance has demonstrated further unity by putting forward a common candidate in Kemal Kilicdaroglu and rallying around technocratic policy frameworks. We now assign a 45%-50% likelihood of regime change materializing.

Figure 1 outlines the Erdogan retaining office and regime change scenarios in more detail, and provides the local financial market implications in both situations. In our view, should President Erdogan retain office, the Turkish lira is likely to experience another large depreciation on expectations of policy continuity. Longer-term, as economic trends and monetary policy frameworks go unchanged, additional large lira depreciations could materialize, but at a minimum we expect lira depreciation through the middle of 2024. In our regime change scenario, the lira could experience one of the most sizable rallies in modern history as an independent central bank gets restored and an orthodox monetary policy framework is implemented. Should Nation Alliance take office, we would adjust our USD/TRY exchange rate forecasts to show material and prolonged lira strength as a policy sea change results in foreign investor capital returning to TRY and lira-denominated assets.

Economist(s)

Brendan McKenna

International Economist | Wells Fargo Economics Brendan.McKenna@wellsfargo.com | 212-214-5637 International Commentary Economics

Figure 1

Turkey 2023 Presidential Election Scenario Analysis



Scenario Description

- We have lowered our probability of President Erdogan retaining office in the
 upcoming election. In our view, Erdogan still has the better chance of winning;
 however, this likelihood has fallen as the opposition alliance has gathered additional
 momentum and as Erdogan's popularity has slipped amid an underwhelming
 earthquake response, reduced household purchasing power and broader economic
 malaise.
- Our base case scenario is still for President Erdogan to secure re-election via second round runoff; however, we cannot rule out the possibility that Erdogan influences voter intentions or challenges results as a way to win re-election in the first round.
 In past election cycles, most notably local elections in 2019, controversy surrounded the Erdogan administration's alleged attempts to overturn outcomes in key cities such as Istanbul and Ankara. Similar tactics could be used in 2023 to retain office.
- Erdogan's influence over monetary and economic policy remains intact. The
 unorthodox view that "higher interest rates leads to higher inflation" remains the
 underlying ideology of Turkish monetary policy decisions and a lack of central bank
 independence is unchanged. Progress towards Erdogan's new economic model, a
 Turkish economy driven by exports and cheap credit, is made and economic
 stagnation continues going forward.

Local Financial Market Implications:

- In the short-term, an Erdogan victory, in the first round or runoff, is likely to lead to
 an outsized lira depreciation on reduced FX intervention efforts and expectations
 for policy continuity. In this scenario, we believe the USD/TRY exchange rate can
 reach TRY22.00 by the end of Q2-2023, with risks tilted toward an even sharper lira
 depreciation.
- Longer-term, as FX reserves remain depleted and the direction of monetary policy
 does not change, we expect lira depreciation to continue. While additional one-off
 depreciations could materialize, we believe the USD/TRY exchange rate can reach
 TRY23.00 by Q4-2023 and trend to TRY24.50 by mid-2024. Risks still tilted toward
 greater lira weakness.

Scenario Description

- The probability of regime change has risen further. We felt an opposition victory
 was a strong possibility before the earthquakes, but the likelihood of regime change
 has increased amid a backdrop of economic and social crisis conditions. As the
 government's response to the natural disasters has underwhelmed, Erdogan's
 approval ratings have trended lower and the opposition alliance is currently leading
 opinion polls.
- Using history as an indicator, a slow and underwhelming government response to natural disasters has not inspired confidence in incumbent leadership. President Erdogan rose to prominence following the 1999 Izmit earthquake and the perceived insufficient response of the Turkish government at the time. "Regime change" has gathered momentum as the current administration's response continues to be perceived as inadequate and confidence around President Erdogan wanes in the same way that brought him into the political spotlight.
- At the same time, the Nation Alliance, the bloc of political parties challenging President Erdogan, have put forward and rallied around a common candidate in Kemal Kilicdaroglu. Nation Alliance parties are committed to implementing technocratic and pragmatic policies, particularly related to orthodox monetary policy. Opposition candidates outside of Nation Alliance have dropped from contention, potentially aligning most opposition voters to support Nation Alliance.

Local Financial Market Implications:

- We believe regime change sparks a sharp lira rally on expectations for a more credible and orthodox monetary policy framework. Foreign investors are likely to return to Turkish financial markets and significantly tighter monetary policy likely acts as a catalyst for sustained long-term lira strength.
- FX intervention efforts may cease; however, positive real interest rate dynamics, credible forward guidance, and a newly independent central bank attracts capital flows toward TRY to the point where intervening in FX markets may not be necessary. In our view, the USD/TRY exchange rate could end 2023 at TRY15.00 and TRY14.00 by mid-2024.

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Economics Group

Jay H. Bryson, Ph.D.	Chief Economist	704-410-3274	Jay.Bryson@wellsfargo.com
Sam Bullard	Senior Economist	704-410-3280	Sam.Bullard@wellsfargo.com
Nick Bennenbroek	International Economist	212-214-5636	Nicholas.Bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	704-410-3283	Tim.Quinlan@wellsfargo.com
Sarah House	Senior Economist	704-410-3282	Sarah.House@wellsfargo.com
Azhar Iqbal	Econometrician	212-214-2029	Azhar.Iqbal@wellsfargo.com
Charlie Dougherty	Senior Economist	212-214-8984	Charles.Dougherty@wellsfargo.com
Michael Pugliese	Senior Economist	212-214-5058	Michael.D.Pugliese@wellsfargo.com
Brendan McKenna	International Economist	212-214-5637	Brendan.Mckenna@wellsfargo.com
Jackie Benson	Economist	704-410-4468	Jackie.Benson@wellsfargo.com
Shannon Seery	Economist	332-204-0693	Shannon.Seery@wellsfargo.com
Nicole Cervi	Economic Analyst	704-410-3059	Nicole.Cervi@wellsfargo.com
Jessica Guo	Economic Analyst	212-214-1063	Jessica.Guo@wellsfargo.com
Karl Vesely	Economic Analyst	704-410-2911	Karl.Vesely@wellsfargo.com
Patrick Barley	Economic Analyst	704-410-1232	Patrick.Barley@wellsfargo.com
Jeremiah Kohl	Economic Analyst	704-410-1437	Jeremiah.J.Kohl@wellsfargo.com
Coren Burton	Administrative Assistant	704-410-6010	Coren.Burton@wellsfargo.com

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