

# Flash Comment

## Turkey: Erdogan shaken, not stirred – political uncertainty returns

### Street protests increase political uncertainty and weigh on markets

This morning the Turkish markets are under serious selling pressure after tens of thousands of people took to the streets in the largest protests ever against the AKP government under the leadership of Tayyip Erdogan. The AKP has been in power for a decade.

The protests were sparked by plans to redevelop Istanbul's well-known Taskim square and demolish a nearby park. Originally the protests had attracted only few demonstrators - primarily environmentalists - but over the weekend they have grown into a large-scale manifestation against the government and its policies and the demonstrations have spread across Turkey to other large cities.

This is a major blow to the Turkish government as it clearly shows that the government is increasingly becoming unpopular after having ruled Turkey for a decade and the scale of the unrest has clearly surprised the authorities. In that regard it should be noted that Turkey will hold presidential elections next year. Until now it had been assumed that Prime Minister Erdogan would run for president next year but given the size and scale of the weekend's demonstrations the presidential elections could effectively be turned into a referendum on the continued rule of AKP.

The popularity of Prime Minister Erdogan and his AKP has been declining. Furthermore, it is clear that a rising number of Turks think of the AKP government as increasingly authoritarian and over the weekend many opposition commentators have again and again stressed that free speech is under threat in Turkey. The police's hard-handed handling of the demonstrations has also been criticized - both inside and outside of Turkey.

### Erdogan remains popular but his grip on power will not last forever

The AKP government has been seriously shaken by the weekend's events but we stress that particularly Erdogan remains quite popular, particularly in the rural parts of Turkey. In that sense Turkey can be compared to Russia - an Emerging Market country with an increasingly monopolistic govern party and a leader, who is unpopular among the urban middleclass, but remains popular in the country side.

Turkey therefore - like Russia - is becoming more and more polarised and sooner or later this will have negative consequences for political stability. However, in the case of Turkey, markets should certainly not be surprised by these risks. So even though the Turkish markets are selling off today, investors are not necessarily waking up to a 'new reality'.

For now Erdogan's grip on power remains intact but it is clear that after a decade the Turkish population will not just automatically vote for the AKP, so we might be seeing the beginning of the end of AKP's monopoly.

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### **There is no unified opposition to AKP**

While Turks over the weekend demonstrated *together* against the government, one can hardly call it a unified opposition.

Demonstrators consist of numerous groups ranging from environmentalists, nationalists and extreme leftists to liberals. The main opposition party, the Social Democratic CHP, over the weekend said its supporters had also joined the demonstrators.

This is also similar to the situation in Russia. There might be general discontent with the government but there is no united opposition.

However, it is notable that a lot of opposition seems to be coming from young people in the major cities, who are reacting to what they view as an increasing Islamist government and we might be witnessing the development of a new force in Turkish politics united by Western liberal values. However, so far Western-style liberal parties have had little political success in Turkey.

It is also notable that the opposition to the AKP is primarily an urban phenomenon at this stage but we would not rule out the possibility of the demonstrations spreading to rural areas. If that happens, it would clearly be a sign that the AKP is losing its grip on power. In that sense it is more important what happens in rural Turkey than what is happening in major cities such as Istanbul, Ankara and Izmir.

### **A weakened military is unlikely to intervene**

One or two decades ago widespread street demonstrations and growing popular discontent with the government would have led to speculations that the Turkish military would step in to 're-set' the situation. However, in this day and age such speculation is much less common and rightly so. Hence, we view military intervention as very unlikely.

### **Market reaction justified but no reason to panic**

Given the increased political uncertainties the sell-off in the Turkish markets is fully justified in our view. Furthermore, given that this is weakening the AKP's grip on power, it is increasing the likelihood of a 'regime change' - hence, a new party or a coalition of power coming into power in the coming years.

From a market perspective the weakening of the AKP is not positive as there is uncertainty about what the alternative would be. The most likely party to come into power would be the Social Democratic CHP, which does not have a good economic political track record and which in many ways has a more interventionist economic policy agenda than the AKP. That said, a CHP government would in reality likely continue the overall centrist economic policies that we have seen from the AKP in the past couple of years.

Furthermore, while the AKP has a strong track record of economic reforms, the pace has clearly slowed in recent years and arguably the reforms have actually been reversed in some areas. Hence, while the AKP started out as economically liberal, it is harder to argue that it will be so in the future. AKP's economic reforms have never been ideologically driven, so investors should probably not fear the day the AKP is no longer in power – at least not from a reform perspective.

Concluding, the political disconnect in Turkey has very little to do with economic policy but a lot more with the polarising issue - the role of religion in public life. The popular opposition is united by what it views as the AKP's increasingly Islamist tendencies.

So, while the demonstrations are a political uncertainty and while we expect elevated political uncertainty about next year's presidential election, we for now see little reason to panic.

We have for long been somewhat cautious about the outlook for the Turkish lira - particularly because of the continued fairly large Turkish current account deficit and the demonstrations clearly are not helping. However, it should be noted that the recent drop in the oil price helps the Turkish economy and is likely to significantly reduce the current account deficit. To some extent this is counteracting the increased political uncertainty.

Concluding, while we do not see the sell-off in the Turkish markets as a buying opportunity at present, we do not see a reason to panic. Furthermore, we do not see a reason to significantly change our forecast for the lira at this stage. We will, however, publish a new forecast for the lira in connection with our next Emerging Market Briefer, which will be published in about two weeks. That forecast will obviously take into account recent events in Turkey.

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