

Turkey Outlook 2016

January 12, 2016

Editor's Note

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Event	Possibility	Impact	Risk Level
Domestic Politics/Security			
Constitutional (presidential) referendum	3	5	
Early election	1	5	
Intensifying fight against PKK	4	4	
Opposition parties restructuring	2	2	
Islamic militancy	4	5	
Foreign Policy			
Military involvement in Syria	4	5	
Intensifying dispute with Russia	3	4	
Confrontation with Iraq	3	4	
Refugee crisis	5	4	
Friction with NATO/US	1	5	
Economy/Business Environment			
High inflation/high interest rates	2	4	
Financial crisis	1	5	
Economic stagnation	4	3	
Greater government regulation	4	3	
Labor disputes/strikes	5	4	

Possibility: 5- certain, 4-Likely, 3-Possible, 2-Unlikely, 1- Rare

Impact: 5- Highly Critical, 4-Critical 3- Moderate, 2- Marginal, 1-Negligeble

25-15: Red (High risk), 15-8: Orange (Medium risk), 8-1: Green (Low risk)

Overview

2016 will be the year where Turkey will try to manage uncertainties inherited from 2015 on various fronts.

All eyes were on the new leadership of the ruling Justice and Development Party (AKP) at the beginning of 2015, following Recep Tayyip Erdogan's election as the president in mid-2014. Erdogan himself supported his former political party in the lead-up to the parliamentary elections in June, and asked Turkish voters to boost executive powers of the presidency through a constitutional change. The result was surprise to many. Turkish voters chose to end AKP's single party rule for the first time since 2002.

A constant haggling between political parties followed the June elections, which has proven to be unsuccessful in less than few weeks. In the meantime, conflict with Kurdish separatist group PKK has escalated in southeastern Turkey, while Islamist militants staged Turkey's bloodiest attack in country's capital. The caretaker government remained in charge until Nov. 1 election. The results of the re-election were even greater surprise, where AKP made an unexpected comeback by sweeping 49.5% of the votes. Turkey's 64th Government has been formed shortly after, under the leadership of Prime Minister Ahmet Davutoglu.

Despite comfortable majority in the parliament, 2016 will not be an easy year. The new Turkish government and President Erdogan have challenging tasks on their agenda. Turkish leadership will have to tackle various issues at several fronts simultaneously. In domestic politics, Erdogan's ambition to change the constitution to establish a powerful presidency will dominate the debate, while Kurdish dispute will take on a larger scale. In foreign policy, Turkey will have to develop new skills and alliances as it repositions itself, in the face of refugee flow from Syrian civil war, confrontation with Russia, increasing dispute with Iraq and Iran. In economy and business environment, the government will have to cope with increasing expectations of Turkish voters at a time of stagnation in emerging markets, while private sector will become increasingly risk averse due to debt levels and labor demands.

Turkey has always been a confusing place for decision-makers. In 2016, it will continue to be even more so. Immense opportunities exist business leaders who can understand changing circumstances and make agile decisions when confronted with unexpected developments.

Domestic Politics & Security

Two issues will dominate Turkey's political agenda in 2016: Erdogan's ambition to change the constitution for executive presidency and Turkey's longstanding dispute with Kurdish separatists.

Even though Turkish parliamentary system gives the president ceremonial powers, Erdogan has so far enjoyed the unique conformity of having the ruling AKP (the party he founded in 2001 and led for 12 years) in government. This situation gives him more influence than his official position entails. But Erdogan has no intention to give up on his goal to change the political regime with more presidential powers.

Comparisons of Election Results

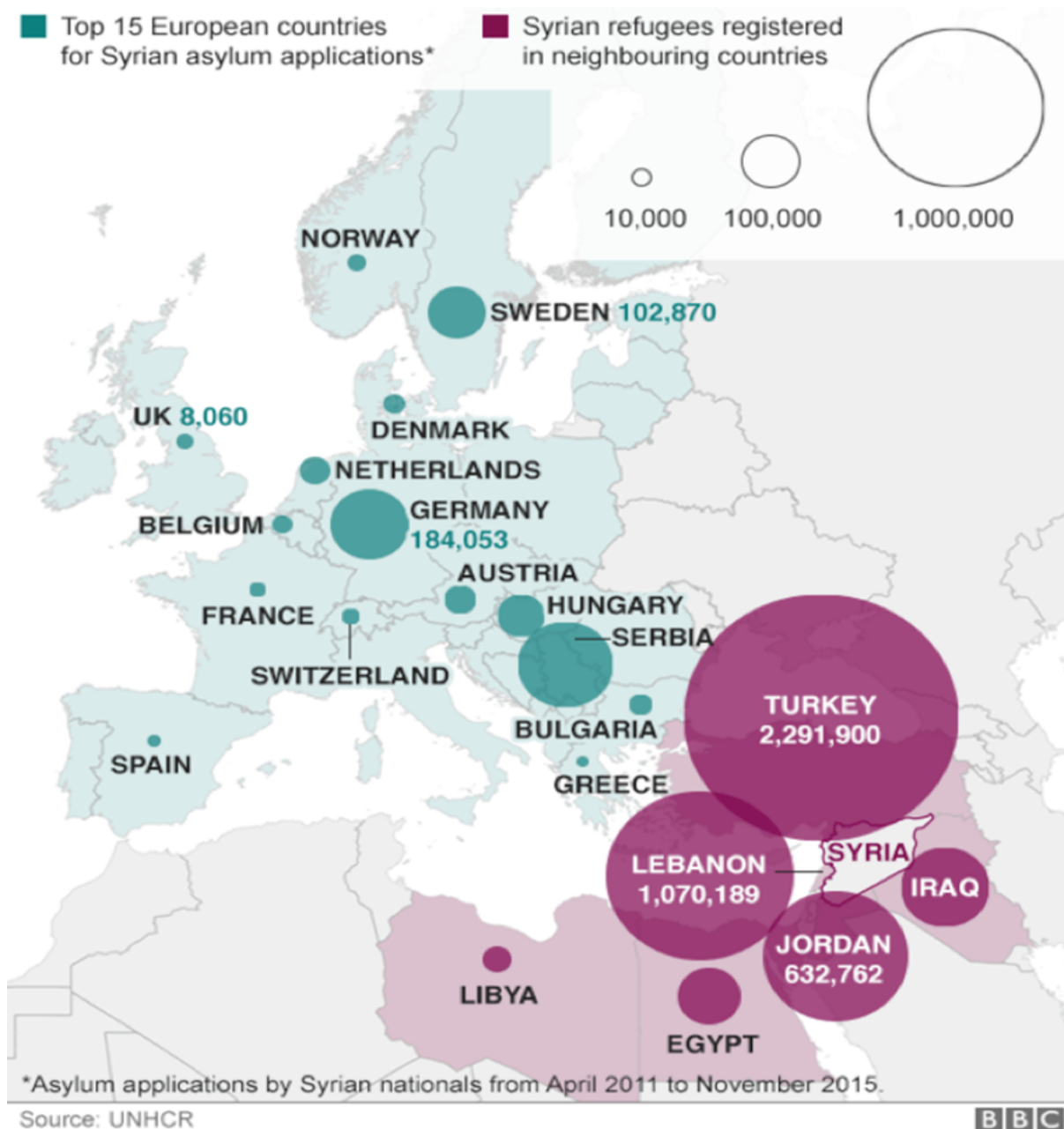
	2011	June 2015	November 2015
 AKP	% 49  332	% 40.87  258	% 49.34  315
 CHP	% 25  138	% 24.95  132	% 25.42  134
 MHP	% 12  50	% 16.29  80	% 11.96  41
 HDP	% 0  0	% 13.12  80	% 10.77  60

The current parliamentary distribution, however, makes it impossible for the AKP to amend the constitution on its own, for which at least 330 seats required to hold a referendum. Therefore, it remains to be seen how the AKP leadership will try to forge a coalition to this end. Opposition parties (People's Republican Party – CHP and Nationalist Movement Party – MHP) will go through internal debates, where leadership changes are possible. However, it is unlikely that they will pose serious challenge to AKP's rule in the short-term, for which a deep fissure within the AKP leadership will have to emerge.

Conflict between Turkish security forces and Kurdish militants of PKK has escalated in July 2015, after a two-year peace process that involved negotiations with PKK's jailed leader Abdullah Ocalan. The current form of clashes, however, is different from the past incidents, as they take place in urban areas of southeastern Turkey. Many civilians flee their towns due to long-lasting curfews. Pro-Kurdish and socialist HDP (People's Democratic Party) declared that they would seek political autonomy in Kurdish populated areas. In 2016, an increase in tension – both politically and militarily – is expected, but restart of negotiations cannot be ruled out.

Foreign Policy

Turkey has been repositioning itself as a regional power over the past several years, but 2015 has been a test of its capabilities at many fronts. Syria has become the main battlefield of Turkish foreign policy, whose main interest is to oust Assad, prevent a Kurdish region in the north and stop refugee flow. Turkey is likely to benefit from US backing in 2016 in its quest to create a foothold in the region. For this reason, Ankara will ally with other regional players such as Saudi Arabia and Qatar in containing ISIS militancy. However, this also means that it will make some significant rivals, such as Russia and Iran. This may create a greater possibility for Turkey and Israel to mend their ties after five years.

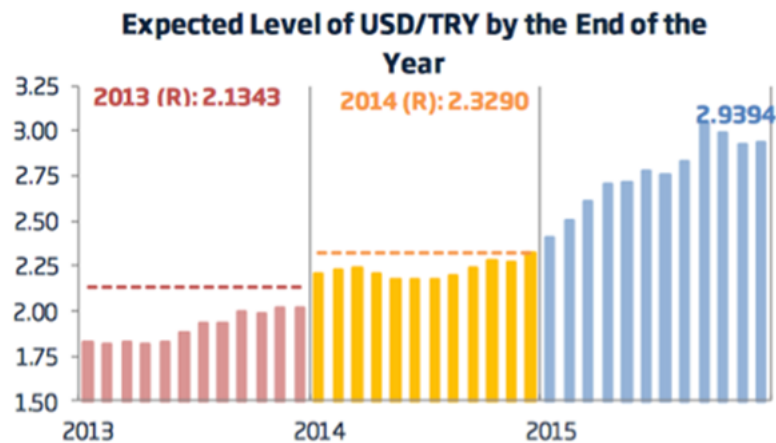
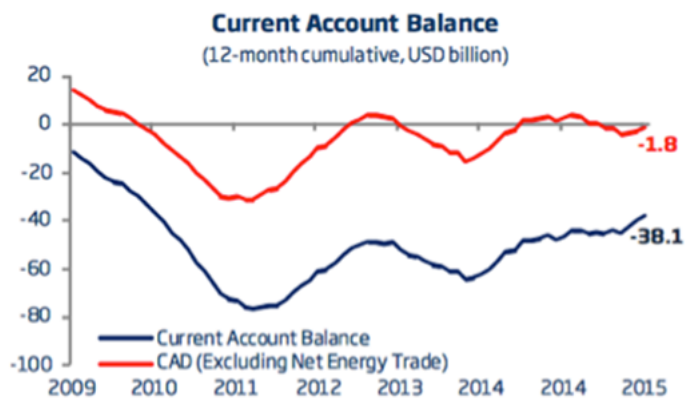


Turkey will also get increasingly involved in Iraq, by using its special relations with the Kurdistan Regional Government. Ankara – Baghdad relations are likely to deteriorate in 2016. The downing of the Russian jet in late November 2015 will continue to have implications in bilateral relations. Even though neither side have an interest in cutting the relations completely, trade and mutual investments will suffer in the short-term.

Macro Economy & Business Environment

Turkish will face some tough choices in economy and business environment in 2016, caused by external and internal factors.

At the external front, the most significant development is FED's decision to raise interest rates in December 2015, for the first time since nine years. Though the hike will be slow and gradual in 2016, it still means less appetite by foreign investors to remain in emerging markets. Turkey is considered among the most vulnerable ones among them, due to its high dependence on external financing sources. Thus, 2016 will witness increasing value of foreign currencies against Turkish Lira, which is particularly troubling for foreign-indebted private sector.



Source: [CBRT](#), [TurkStat](#)

Another external impact, however, made positive contribution to Turkey's balance sheet. Steep decline in oil prices helped Turkey narrow trade imbalance, which decreased one third of the gap. However, increasing geopolitical risks and declining exports will have a negative impact on Turkey's exports in 2016.

Turkey has grown by 3.4% in the first nine months of 2015 (mostly driven by domestic consumption), compared with the same period last year. However, the prospects of further growth in 2016 looks dim. It should be noted that [IMF](#) slashed its [GDP growth forecast for Turkey](#) in 2016 from 3.6% to 2.9% in October.

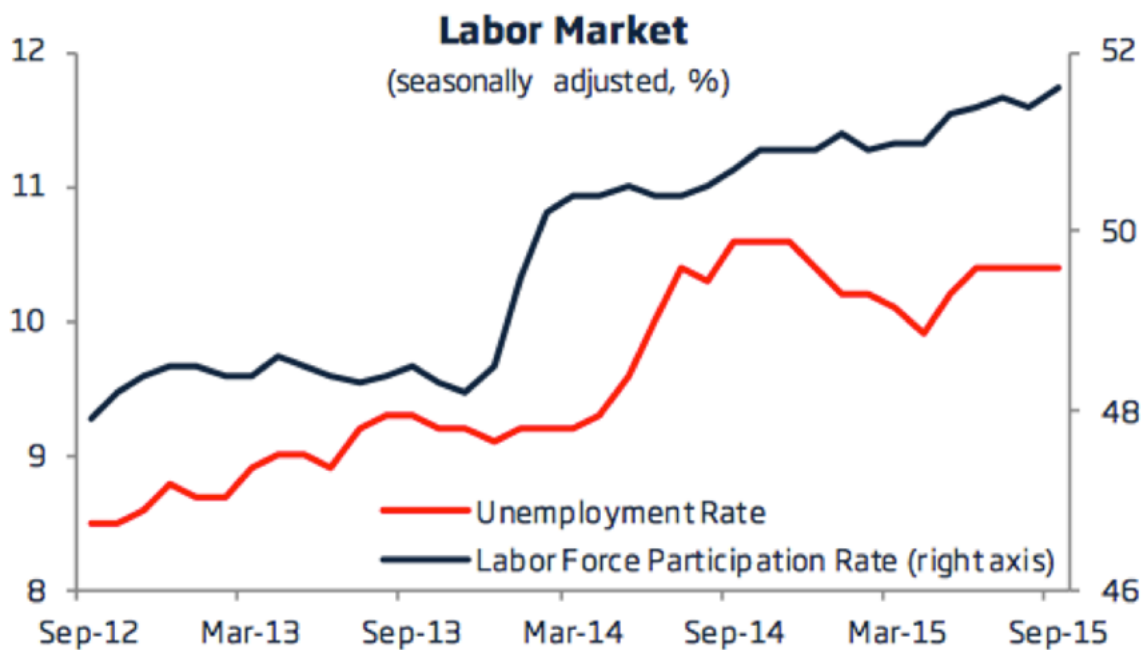
GDP Growth



At home, Turkish Central Bank has kept the rates on hold in December contrary to the market expectations. The decision increased doubts about Bank's independence. However, the Bank is expected to increase the rates in January 2016. In the meantime, inflation shows signs of increase. Deputy Prime Minister Mehmet Simsek declared in early January that maintaining the inflation target will be the main challenge in 2016 (Consumer prices index was realized 8.81% in December 2015). Turkey will use all means not to go back to high inflation/high interest rate vicious cycle it experienced in 1990s.

A potentially turbulent period will be experienced in labor relations. As a result of the rapid economic growth over the past decade, expectations of the newly emerging middle class have increased. Turkish government had to respond to these demands by increasing the minimum wage by 30% (approx. 400 Euro) as of January 2016. This means Turkey will cease to be a low-labor cost country soon, and businesses will need to find solutions remain competitive, such as increasing productivity, quality and high value products.

However, the situation will cause serious challenges in the short-term, as firms will be struggling to adjust to the new conditions. Employee movements and strikes are highly expected, organized by slowly emboldening labor unions. Conditions of new collective bargaining agreements as well as sub-contracting system will be under the spotlight and will put additional burden on Turkish private sector.



About StratejiCo.

StratejiCo. is a strategic consultancy company headquartered in Istanbul. Since 1987, StratejiCo. serves multinational companies that operate in Turkey and in the region by providing knowledge, relations and communication. We use an engagement-based approach to develop and execute corporate and public affairs strategies.

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