

# Turkey's election: What Erdogan's victory means

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# Presenters

## ATTENDEES

**Andrew Birch**

**Jessica Leyland**

**John Raines**

**Announcer**

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# Presentation

## Announcer

You're listening to the Economics and Country Risk podcast from S&P Global Market Intelligence. In each episode, our experts will provide you with the where, how and when to make decisions that transform your business.

Your host for this episode is John Raines, Director and Principal Global Risks Adviser at S&P Global Market Intelligence.

## John Raines

On May 28, voters in Turkey went to the polls for a second time to choose their president after a vote 2 weeks earlier proved inconclusive. In this second round, current President Erdogan won a close contest, 52% to 48%, meaning his 2-decade long rule will now continue for at least another 5 years. To discuss what his victory means for the country, the region and the world, we have invited S&P Global Market Intelligence Senior Analyst, Jess Leyland; and Economist and Associate Director, Andy Birch, to discuss the election's wider political and economic implications. Jess, welcome to the show.

## Jessica Leyland

Thanks very much, John.

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# Question and Answer

**John Raines**

Jess, we've been looking at this election for quite some time, and there was a lot of debate what was going to happen here, especially in the first round where I think it was a bit of a surprise that Erdogan did as well as he did. Tell us, how is it after an earthquake, after an economic crisis, how was it that this president was able to win reelection?

**Jessica Leyland**

So Erdogan has a very strong history and started off his political career actually strengthening the Turkish economy, preventing political infighting that had plagued Turkish politics for years. And more recently, and despite the inflation, despite the earthquakes, the older voters, which do make up a big proportion of his voter base especially in rural areas, really backed him in his core constituencies.

So I think these were underrepresented in the actual voices that we heard in the hubbub surrounding the elections. But he still has strong control and strong support in wide swathes of the country. And I suppose the diversity of the opposition was just not enough to really sell themselves to people that might have voted otherwise.

**John Raines**

Is this what we saw then in the polls? I mean a lot of the polls going up in the first round -- the second round, a little bit different, but in that first round, a lot of the polls had the opposition actually winning. What you're saying there is that because they weren't able to reach those older voters or maybe they weren't reaching the rural areas, why a little bit of the discrepancy there between what we saw in the polls and then what we saw in election day?

**Jessica Leyland**

I think there was misrepresentation from the polls. They were able to engage younger demographics who have more technological prowess. So if you're doing a Twitter poll or a Facebook poll, you're probably not going to see Erdogan's core group really responding to those polls. And small, small sample sizes as well as the fact that a lot of people, especially after the earthquakes, seem to be actually embarrassed to say that they wanted to vote for Erdogan when official inflation hit over 100% and the government response was widely criticized in the aftermath of the earthquakes.

**John Raines**

In some ways, it kind of undermines that whole argument that the economy is key. That's where the voters are going to land is if the economy is doing great, you reelect the government. If it's doing poorly, you vote for the opposition. Again, are you thinking it's mainly social issues are the ones that were key here?

**Jessica Leyland**

Erdogan certainly leveraged social issues in the last 5, 6 years. He's been leveraging things such as the counterterrorism operations against the Kurdistan Workers' Party. He's also been protecting Islamic values within Turkey itself, and he's been looking at pushing Turkey onto the front lines of geopolitics as a significant mediator, all of which has increased the nationalist ideal of Turkey and really played well to his voter base.

**John Raines**

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Now this did play well, obviously. He won the election. But this always gives a situation, especially for the opposition, to say either, one, we contest the results or we don't contest the results. And it also gives reasons for division and unity within opposition to either continue or break apart.

I mean I guess the first question here really is the opposition has not contested the results. They believe the votes were counted fairly. What does that mean as far as the prospect for actual protest in Turkey going forward? Are we going to see major protests in Istanbul, in Ankara, other locations? Or are people going to be relatively happy with these results or at least feel confident that they were done correctly and therefore, protest risks are likely to be mitigated?

### **Jessica Leyland**

So there have been challenges to the results by various opposition groups against specific ballot boxes across the country for miscounting in the elections. Whether or not these are taken into account, the actual ability of the opposition to challenge these effectively through Turkey's courts is very much reduced by the fact that the judiciary and the Supreme Election Council, who authorized the vote counts, have already, as I said, authorized it and then this would need a judicial rejection, which is very unlikely to come considering Erdogan and the AKP's consolidation of the judiciary over his tenure.

So going back to the protest, Kiliçdaroglu, the leader of the opposition and opposition candidate, repeatedly called on his supporters to have their voices heard at the ballot box and not to go out and protest. There is also significant security deployment throughout main city centers. This is going to last for weeks after the election. Realistically, we don't expect to see significant antigovernment protests at this point, and we don't expect the challenges to the vote will make any material difference to the results.

### **John Raines**

So in that case, if we're in a situation where, at this point, the opposition is not going to impact the results, what does this mean for the opposition? Are they going to be able to hang together at this point?

### **Jessica Leyland**

The unity of the opposition is likely to be eroded in the coming year, specifically in the run-up to the municipal elections in 2024, which is the next big indicator of what we're watching out for. But given the fact that the opposition coalition ranged from center left or left to strong nationalist right, we actually don't expect them to hold together to pose a challenge to Erdogan or the AKP in the government. And we also expect potential defections towards the ruling party and backing their bills in Parliament, which will lead to a disintegration of the coalition and lead to them weakening into the run-up to the municipal elections next year.

### **John Raines**

Wow. So what we're saying here is that the opposition looks as though it's going to fall on some hard times at least initially following this election. Thank you so much, Jess. Really do appreciate it. We'll get back to you in just a minute. Andy, let's get you in to this conversation as well. We want to take an economic view here. Obviously, there was some fiscal expansion prior to this election to encourage voters to side with the government.

And oftentimes, when we think of macroeconomic or also monetary policy with Turkey, we think of some unconventional approaches. Like for example, in the past, we saw the lowering of interest rates in order to be able to decrease inflation, which isn't exactly what most economists, maybe like yourself, would advocate.

So with that in mind, what are we expecting coming out of this election? Are we expecting that monetary policies likely to continue on the path that we saw before, which has caused pretty high levels of inflation? Or are we expecting something different this time around?

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**Andrew Birch**

I think broadly, we were expecting a continuation of these policies. What we have seen in advance of the elections, there was, especially in fiscal policy, there was a more pro-growth, more aggressive expansionary policy immediately prior -- beginning late last year. And then you also saw a lot of pressure on banks to increase credit growth, again, to fill in the gaps because as you mentioned, we're in a very high inflation environment. And what the fiscal policy couldn't provide to keep up with consumer level of income, Erdogan was pressuring banks, state banks particularly, to increase their credit to kind of fill in those gaps as well.

So we will generally expect what are considered Erdoganomics of the kind of pro-growth, low interest rate environment. But what there will be is not necessarily a U-turn, and in fact, he has repledged kind of this low interest environment since the election. But there will be a shading and there will be a stepping back from the aggressive pro-growth policies.

As Erdogan has done in the past, he has allowed some, if you will, backdoor tightening both in monetary policy and in fiscal policy. And in fact, when you look back through their history, fiscal policy actually has been quite stabilizing. So it's not going to be an immediate U-turn at all, but we do expect some drifting back to allow markets to settle once again.

**John Raines**

Okay. But talk us through that a little bit because you said, okay, maybe they can restrict a little bit on the fiscal side. But on the monetary side, which a lot of folks normally look at, it's pretty obvious you would think either interest rates are going up or they're going down. Are you saying there are backdoor channels where they could impact that? And if they did, how would they do it?

**Andrew Birch**

Erdogan himself points very prominently to the 1-week refinancing rate, right? That's the main policy rate. And that is what he touts. That is what he trumpets. But what happens is, and this has happened before, is that the central bank does not always fund the market at that rate and then instead, funds the market at a mix of higher rates, such as the late liquidity window rate, the overnight rate, some of the overnight rates at higher rates.

So what we've seen just even in the past 2 weeks since the first round is the average rate at which the market is being funded by the central bank has crept up by about 50 basis points. Now that is not much when you consider the grand scheme of where inflation is still in the 40% range. And even with the backdoor financing, the interest rates as of late May are still only about 9%, but at least it shows you what can be done. Now on top of that, you've got a whole wealth of soft capital controls. You've got other restrictions on holdings that, through administrative measures, tighten the market without adjusting interest rates so that level of interest rate is held steady.

**John Raines**

You just brought up the issue of capital controls. I think capital controls, I think currency. That's where my brain just naturally goes to. When we think about the lira, lira has been setting new lows on a repeated basis. Now, again, that's not completely surprising. A lot of emerging markets go in that direction. What is your view here? When we're thinking about basket of goods and inflation, the lira, is it going to stabilize? Are we going to see a continued downward trend?

**Andrew Birch**

So the press, as you pointed out, loves to trumpet, "Oh, a new historical low," and, "Oh, the spreads have surged." All of these are true, but you have to put them in perspective exactly as you said. It's an emerging market. Currencies depreciate. That's just the nature of it. Yes, it's a historical low. But when you look at the day-to-day, the week-to-week depreciation rates, we're still seeing instability after this election that are nowhere on the levels that we saw in previous crises. So the markets are already anticipating what's happening.

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Now there is still the problem that the lira in 2022 was one of the weakest in the world; in 2021 was one of the weakest in the world among the major emerging market currencies; and now all of a sudden, in 2023 is actually trending fairly stronger before the election but now is once again moving down to one of the weaker in the world. Now there's a lot of things they are doing. Like I said, the soft capital controls, and what I mean by that is changing the requirements of how much banks, how much corporates, how much foreign currency they're allowed to hold, what they have to transition into lira.

They're going to also spend down their reserves. They've spent down tens of billions of dollars already to rescue the lira. And they're going to do this to bridge over to the summer where a strong tourism season will naturally bring in foreign currency and naturally support the lira. And at the end of the summer season, the idea -- I'm not in Erdogan's head, of course, but the idea would be that by that time, markets have stabilized. They've gotten used to the continuation of this regime and that it's back to the kind of the normal level of depreciation that we see in Turkey.

### **John Raines**

That makes sense, Andy. And I think one thing that we're seeing here is that you're talking about the bringing in of foreign capital vis-à-vis tourism or investment, and that does give a pause here because it does give a bit of a lifeline to Turkey. And then looking ahead, it seems like what you're saying is that things might not necessarily be that rosy but we're not necessarily seeing a crisis on the horizon.

### **Andrew Birch**

I think some people would be surprised. But Erdogan, even though he spouts what we view as controversial economic policies, in the end, he's a pragmatist. He has pushed these markets before to the point of breaking, and then he's allowed some restraint to come in. And even now, there's talk even in the press: Will a new economics team have more trusted names be brought back in to try to reassure markets? He has pushed the limit before and always tends to step back.

Now again, the rhetoric right now in the heat of the election, he's promising that that won't happen. We still expect that there will be some acknowledgment that markets are, ultimately, if the lira crashes, ultimately, if spreads -- yields soar, that's going to lead to an external financing crisis and that's bad for the domestic economy. So he wants to push this enough to keep growth going, to keep employment growing but yet to avoid the financial meltdown.

It's what we've seen in the past. It's what we expect. The one caveat I would say, it's like a rubber band. You keep stretching things, it doesn't continue to snap back. So while our baseline is to avoid a major crisis, the risks of a major crisis continue to grow the longer and longer he continues these kind of brinkmanship policies.

### **John Raines**

One of the things that we were looking for that could potentially cause a crisis was really the issue of energy, especially with what's going on with Russia and Ukraine, the possibility that higher fuel prices might lead to, of course, already high inflation occurring inside Turkey. Talk to us a little bit about the energy situation there and about the possibility of continuing or even increasing the level of energy that they're getting from Russia.

### **Andrew Birch**

It is important that Erdogan -- and again, as Jess was saying, he's already been this kind of mediator between Russia. He has the connections. If there would have been a change of government, there would be no necessarily guarantee that these kind of energy agreements with Russia that have been in place would continue. You've seen him walk a balance of trying to continue to gain more energy from Central Asia, from Azerbaijan, pulling in energy that way to become less dependent on Russia while still not stepping on Russia's toes to interrupt some of the deals that are critically important that they have to continue with energy from Russia.



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**John Raines**

Jess, Andy brought up a really good point there, which is that you see this kind of interesting walking line that Erdogan is doing here between Russia and the West when it comes to issues like energy, when it comes to issues like food. How is he able to pull this off? And do we expect any kind of changes now that he's been reelected?

**Jessica Leyland**

We don't necessarily see any changes to his mediatory and intermediary stance between Russia on the one side and NATO, the U.S., Europe on the other. He's been able to pull this off because he's certainly earned trust within the Russian government, with Vladimir Putin, over recent years and because he's been able to mediate the food grain deal that came in last year after Russia's invasion of Ukraine. So he has the trust there. And even despite continuing negotiations around Sweden's accession plans, Russia is already pricing in the fact that Sweden would join the NATO union.

So this -- actually, this kind of central position that he's taking is gaining him a lot of traction on the Russian side while still not being what the global West seemed to want from Turkey's position. It is also maintaining, as Andy said, energy security and gas exports from Russia, which are critical to Turkey's energy security.

**John Raines**

It's absolutely fascinating because it demonstrates the need that both sides have for Turkey. There's a realization there. You can't live with them, but you really can't live without them either because you need them in that security sphere. Is that how you're reading it? We were talking just a few months ago about aspects of where there has been a breakdown in Western and Turkish relations, but that doesn't seem to be on the cards now. And again, it's primarily due to the fact that they need each other.

**Jessica Leyland**

Exactly. And as you said, John, we've seen small incremental potential threats of sanctions against Turkey, for example, back in September when Turkey stopped using Russia's Mir system domestically and also when Turkey stopped the transfers of cargo flights to Russia. So they are taking on board that there are sanctions threats. But realistically, Turkey has become Russia's #1 trading partner, and we recently saw that Turkey has deferred on around \$600 million worth of payments to Russia for its gas supplies.

Now that continuation of the relationship is necessary for Turkey, and I think that Western nations know that they don't want to specifically jeopardize Turkey. As one of the major or the biggest military in the Middle East region, it does sit in this nexus of Syria, Iraq, Iran and on the Mediterranean. So it is very geopolitically significant.

**John Raines**

Speaking about that, when we're thinking about being key and actually strategic not only within this military sphere but also when we're thinking about the food grain deal where we're talking about large populations not only in Turkey but really throughout the region and elsewhere really dependent upon these grains being able to make it to market, Turkey has been instrumental there. Any type of implication that we could have on this election or Erdogan staying into power, how could that impact this food grain deal? Or do we think it pretty much stays as it is?

**Jessica Leyland**

Turkey will continue to seek extensions to the grain deal for as long as possible. And exactly like you said, had there been a change in the presidency, the trust that was built and the mediatory position of Turkey in this situation would have been significantly reduced. Turkey is one of the largest exporters of processed wheat in the world, and it is highly dependent on wheat imports and exports for its security. So the continuation of this is a significant priority.

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**John Raines**

Then finally, I wanted to end on, Jess, this is what it means for Turkey. This is what we see for the food grain deal, but also just from a wider regional politics. Obviously, Turkey is involved in a lot of different locations. We've seen it in Syria. We've seen it in Iraq in the past. We've seen it elsewhere. What does this mean for the region now that Erdogan has been reelected?

**Jessica Leyland**

So Turkey's approach and Erdogan's approach to regional relations has very much softened over recent years in tandem with the deterioration of the lira value over the last couple of years, as Andy said. So we're seeing this realignment of Turkey with regional countries, such as Saudi Arabia, such as the UAE, but also attempting to create a mediatory position within Syria specifically for its fight against the Kurdistan Workers' Party, yes, but also to return Syrian refugees to the northwest of the country. This is the same in Libya.

It's not seeking to reengage or to enable the Western-based Tripoli government to reengage with its opposition. Instead, it is talking to backers of the opposition, such as Egypt and the UAE. And we expect this diplomacy, if you will, to continue. And that also goes back to seeking investment from the Arab Gulf, seeking deposits at the central bank and seeking increased trade.

**John Raines**

And then finally, I wanted to end on this, which is when we're looking ahead, let's say, in the next year to 2 years, what is your forecast for Turkey? Is there one thing that keeps you up at night? Or is there one change that you're going to see now that you believe from this election could transpire to Turkey? Are we going to see a little bit more of a ray of light? Or are there still quite a few clouds on the horizon?

**Jessica Leyland**

As I said earlier, we're looking forward to the 2024 municipal elections. In that time, we expect that Erdogan is going to seek to polarize Turkish politics even further and erode the kind of opposition stronghold of the left. So that's the CHP and Kiliçdaroglu's party.

What this will mean is that if Istanbul goes to Erdogan and the AKP in the next election, we're probably going to see a tightening of the cultural aspects, the Western-leaning aspects of Turkish society in and around the Aegean. And what that will probably mean is that where you have educated left-leaning people, they're going to be looking to leave more so than they were before. We are looking forward to the 2024 elections, but we see policy continuity. We do think that there's going to be some brain drain, if you will, from Turkey probably towards Europe.

**John Raines**

Thanks, Jess. And Andy, turning to you. Jess mentioned brain drain, quite a bit of focus on social issues. Looking at the economy, again, looking a year, 2 years out, you talked a little bit about this before about the prospect of a crisis. But is there anything on the horizon that you're looking out for maybe in the next few months to signal that maybe that crisis is on the way? Or actually, maybe take it the other way and think about things that might be positive. Anything positive that you're seeing over the next year or 2?

**Andrew Birch**

As I said before, Erdogan has proven adept at bridging crises and then riding the wave when global economies recover. And if he can get by through the next several months through some mix of soft capital controls from foreign capital inflows, from lending from the Gulf countries or Russia, then he does have pro-growth policies. So when the global economy is

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recovering, capital can flow into Turkey. It is a dynamic market. It's a large market. Investors tend to forgive the ups and downs of the Turkish market. So Turkey is in a position to grow when the global economy is doing well.

The flip side of that is because of its unorthodox policies, Turkey is typically the emerging market that is the most vulnerable. So when you look across what is hurting most emerging markets, it's hurting Turkey usually at a higher degree.

### **John Raines**

Thank you so much. Thank you, Andy. Thank you, Jess. Really do appreciate your insights. And thanks again to our listeners for tuning in. We encourage you to join us next week when we'll dive even deeper into the forces at work in 2023. Thank you much.

### **Announcer**

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