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Global Emerging Markets

Türkiye in Focus

We recently returned from a trip to Türkiye, on paper a country that looks like a classic EM opportunity with great demographics and a range of well managed companies to invest in. We saw evidence of improved policy orthodoxy supporting more stable markets, even as inflation remains elevated. However, a weaker institutional and political backdrop has worsened the risk/reward potential. Türkiye therefore remains one our 'Least Preferred' sovereigns across EM, with a very high required return to invest in Turkish equities.

In February the Northcape EM team travelled to Türkiye. This month we review and update the political and economic developments of the country since our last visit to the sovereign in November 2024. We ask the question: has the situation improved or deteriorated?

Prior to 2023, Türkiye had experienced persistent and very high inflation which had a perverse and negative impact on the economy. This was a direct result of the unorthodox low-interest rate monetary policy enacted by the Turkish Central Bank at the direction of President Erdoğan.

With the Turkish Lira depreciating 85% against the US dollar, depleted foreign reserves, household savings evaporating, and foreign investors fleeing, even for Erdoğan it must have been obvious that his low interest-rate policy had failed, and hence the 2023 election proved a turning point for the government's economic management.

On 4 June 2023 Erdoğan appointed Mehmet Şimşek to be the new Finance Minister. Şimşek was highly regarded by capital markets when he served as Finance Minister between 2009 and 2015. It was quite a change of fortune for Şimşek given in 2018 he was dismissed from the government by Erdoğan and replaced by Erdoğan's son in law.

Under Şimşek, and his choice of Central Bank Governor, Fatih Karahan (a former economist at the Federal Reserve Bank of New York), the Turkish official reference rate tightened to 50% by mid-2024, well above the inflation rate (see Exhibit 1 below). The government also limited hikes in the minimum wages to bring down inflation, with the last increase of 25% set for 2025 again well below inflation, and a significant real wage shock for many Turkish workers.

Despite this improvement in the economic environment, capture of the institutions of state by President Erdoğan, including the judiciary, free press, police and parliament, created limited checks and balances on his power. This ultimately heightens risks to all shareholders (particularly foreign) given the lack of legal protection and unpredictability of economic policy.

Politics in Türkiye since 2024

Since 2024, we have seen Erdoğan increasingly use his control of the courts to intimidate and imprison his political adversaries. Following the constitutional changes in 2017, Erdoğan has taken control of two critical parts of the judicial system which effectively give him complete control of the presidency:

1. Selecting the majority of members of the High Council of Judges and Prosecutors (which appoints all judges and prosecutors and oversees promotions to higher courts).

2. Appointing 12 of the 14 members of the constitutional court.

Erdoğan has used this control with ruthless efficiency in dealing with the highest profile opposition leader and likely challenger in the 2028 presidential election, Istanbul's Mayor Ekrem İmamoğlu, and the opposition party he leads, the Republican People's Party (CHP).

İmamoğlu was arrested in March 2025, and there has been an escalation of legal challenges against him in the past six months, including:

- İmamoğlu's university diploma was revoked by his university over what the school described as an "irregular" transfer from a Turkish Cypriot institution. A university diploma is required to qualify to run as a presidential candidate.
- In October 2025, Turkish prosecutors brought new "political espionage" charges against İmamoğlu.
- In November 2025, Istanbul's Chief Public Prosecutor filed a 4,000-page indictment against İmamoğlu. The indictment accused İmamoğlu of leading a criminal organisation and committing 142 offenses, charges that could carry a combined sentence of up to 2,430 years in prison. The allegations include bribery, embezzlement, money laundering, extortion and bid rigging.

The legal assault on İmamoğlu is part of a wider campaign against the CHP. In September 2025, a Turkish court annulled the leadership of the CHP's Istanbul branch, citing procedural irregularities in the party's internal congress. This was widely viewed as judicial intervention in opposition politics and triggered a sharp sell-off on the Turkish stock market.

Türkiye's Interior Ministry has also begun investigations into Ankara Mayor Mansur Yavaş also of the Republican People's Party (CHP) over allegations linked to violations of municipal zoning laws. This was a clear message to Yavaş, warning him not to run as a candidate in the 2028 Presidential elections or he may face the same fate as İmamoğlu.

On 10 February 2026, Erdoğan appointed Akın Gürlek – previously Istanbul's Chief Public Prosecutor – as Türkiye's new Justice Minister. By elevating the prosecutor who led the legal campaign against his main political rival to the position of Justice Minister, Erdoğan has effectively placed the architect of the opposition crackdown in charge of Türkiye 's entire judicial system. Thus, legal pressure on the opposition is likely to intensify heading into the 2028 election.

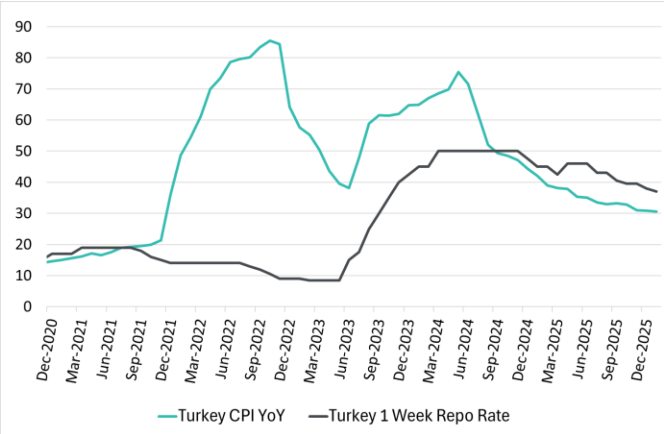
Amongst the discussions we had in Türkiye there was wide agreement that the political situation within the sovereign has deteriorated over the past two years, including continued harassment of journalists. This has been associated with high-level corruption, impairing economic growth.

Despite this assault on civil liberties, Erdoğan appears to remain relatively popular with those being drawn to his strong "macho" style. Türkiye is also a deeply socially conservative country, so his conservativism attracts voters, even those that are secular. Finally, the creeping Islamisation of Türkiye's population is helping him given his strong Islamist image. In the past decade acts such as wearing of a headscarf have become widespread and there is a growing tendency for people to display their Islamic faith (even if they don't practice). Our discussion with the main Coca-Cola bottler in Türkiye highlighted this trend: anti-American sentiment from the conflict in Gaza has impacted Coke's sales much more significantly in Türkiye than other markets including Pakistan and Iraq.

Türkiye's Current Economic Situation

The key economic issue facing Türkiye has been the high and persistent inflation rate (see Exhibit 1). Since 2023 when Erdoğan reinstated Mehmet Şimşek as Finance Minister, bringing inflation back under control has been the key goal of the government's finance team.

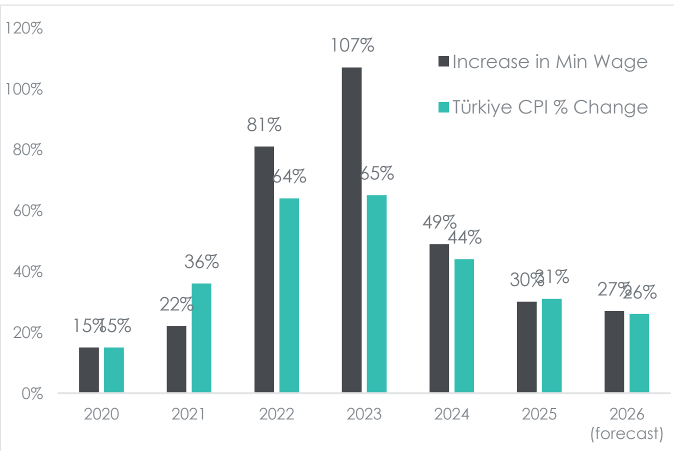
Exhibit 1: Türkiye CPI versus Central Bank 1-Week Repo Reference Rate (Source: Bloomberg)



As Exhibit 1 shows, despite the Turkish Central Bank setting the policy rate (1-Week Repo rate) above 45% from late 2023 to early 2025, inflation has proven 'sticky' and only reduced slowly over 2024 and 2025 such that it is running at approximately 30% in early 2026. This has meant that the Central Bank has only reduced rates slowly to ensure continued real interest rates and tight monetary policy.

One key reason for this sticky inflation is continued significant increases in the minimum wage rate in Türkiye. In 2026 the minimum wage increase has been set at 27%, this compares to inflation which is expected to increase by 26% to 30% (see Exhibit 2). It is no coincidence that the inflation rate closely mirrors the increase in minimum wages.

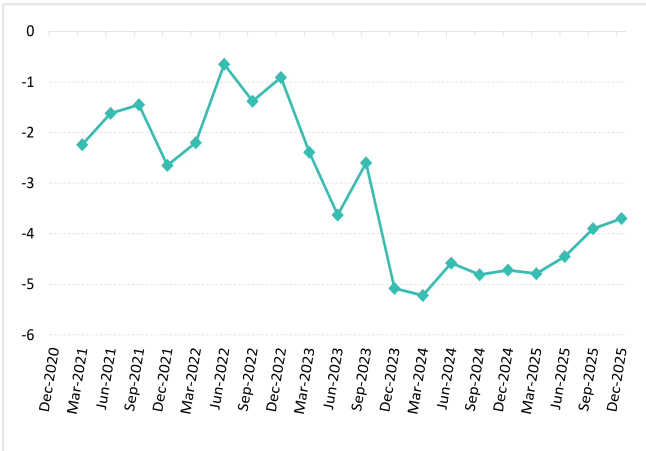
Exhibit 2: Türkiye CPI versus minimum Wage Increases (Source: Bloomberg)



The other key issue that has been acting against tight monetary policy is the fiscal situation. As shown in Exhibit 3, Türkiye's fiscal deficit has expanded since 2023. However, this has been impacted by expenditures focused on rebuilding the southeastern region of Türkiye that was devastated by the early 2023 earthquakes (more than 48,000 people were killed in Türkiye which led to rebuilding costs of some $100 billion). Going forward these expenditures will be reduced. Türkiye's central government budget deficit is therefore expected to narrow to 3.6% of GDP in 2026, from 4.3% in 2025.

Despite this improving fiscal situation, the minimum wage increase locked in for 2026 (and limited willingness by the government to enact large real wage declines) means it is unlikely that the high real rates will push inflation down at a rapid rate. Whilst the hyperinflation (70%+) experienced in 2021 and 2022 has passed, consensus forecasts are for inflation to still be very elevated at 26-30% in 2026.

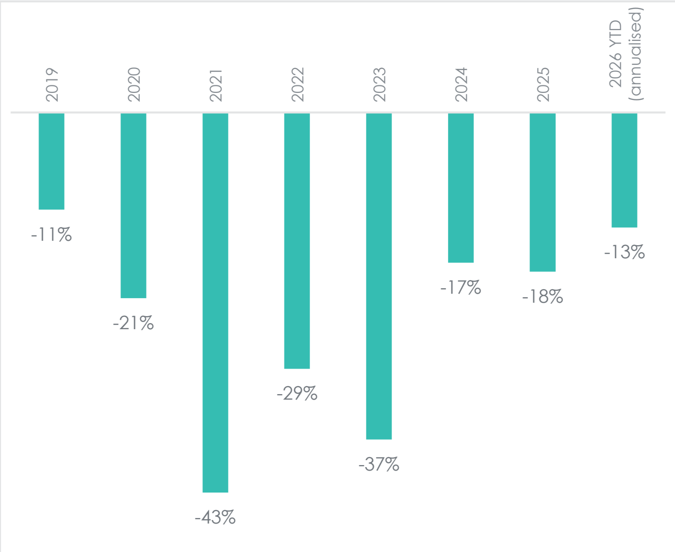
Exhibit 3: Türkiye Fiscal Deficit to GDP (Source: Bloomberg)



Key Investment Risks in Türkiye

We note that since Mehmet Şimşek was reappointed Finance Minister we have witnessed a substantial reduction in USD 10-year yields on Turkish Government bonds, falling from a peak of 11.83% in August 2023 to 6.75% today. The Turkish Lira has also seen the large devaluations of 30-40% per annum stop, and a more manageable 10-20% per annum decline has been experienced in the past 2 years (see Exhibit 4). In 2026 to date the Lira has depreciated at a rate of 13% per annum (if the experience over January and February continued for the rest of the year).

Exhibit 4: Türkiye Lira Depreciation versus USD YoY (Source: Bloomberg)



Conclusion

The aforementioned macroeconomic trends potentially support a lower cost of capital and a more stable currency for Türkiye, suggesting the sovereign is becoming a more attractive investment destination, particularly given the country's many well managed, high quality, listed companies on Istanbul's stock exchange.

This analysis however ignores the political reality of Türkiye, with all power increasingly concentrated in the hands of President Erdoğan. This makes the situation highly volatile and subject to unexpected events and shocks that could materialise at any time.

In many ways the Turkish authoritarian government looks a lot like Putin's regime in Russia. We saw what happened to foreign investors in Russia when it invaded Ukraine (100% capital loss). Whilst we do not see Türkiye undertaking a foreign military adventure, Erdoğan could undertake other misguided actions that severely undermine its credibility, capital markets, and currency. Sacking the finance minister, Şimşek, is an obvious potential event in Türkiye that would see confidence rapidly drain from the market. As the Presidential election approaches in 2028, and if inflation remains elevated, the chance of something like this occurring is rising.

The high reliance of Türkiye on imported oil, and trade links to Iran are other systemic risks that need to be considered.

The longer Erdoğan clings to power, the higher the risk of a popular uprising, like we have seen in some Middle Eastern countries (e.g. Syria, Egypt, Iran). This would be an extremely disruptive event for its capital markets, as it would likely follow a violent crackdown of dissidents by Erdoğan, which brings the spectre of EU and US sanctions on Türkiye into question.

So, to answer the initial question posed, the situation has not improved, rather on balance, Türkiye has deteriorated further over the past two years.

We therefore continue to see Türkiye as one of our "Least Preferred" sovereigns post our visit in 2026, despite the headline improvements in economic policy. We currently use a very high Cost of Equity at 38% as our hurdle rate in valuing Turkish companies, which completely disqualifies this capital market. As such, we will continue to avoid placing any of our client's capital in front of the Türkiye investment proposition.

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