FUND LAUNCHED
2005

FUNDS UNDER MANAGEMENT
£519.4
MILLION

NET ASSET VALUE PER SHARE
435.7%
SINCE INCEPTION*

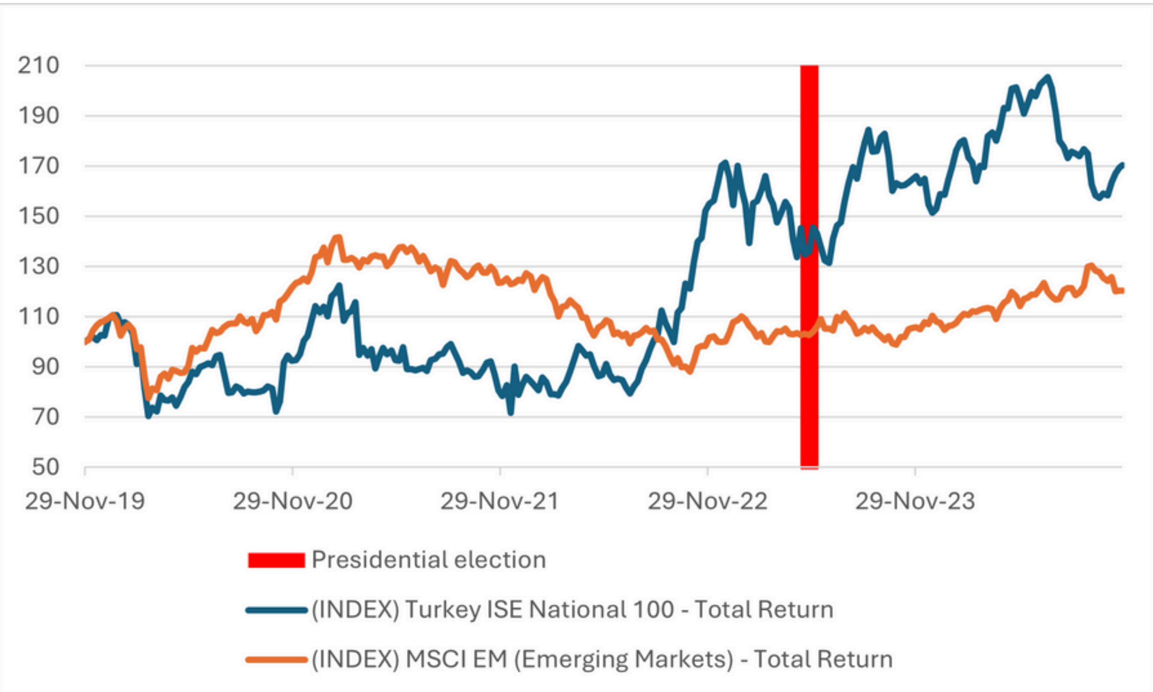
UTILICO Emerging Markets Trust plc

Türkiye – Turning the corner

December 2024

It has been 18 months since President Erdogan secured his third consecutive victory in the Turkish presidential election in May 2023, extending his rule into a third decade. Initially, the market reacted negatively, anticipating that the government's unorthodox monetary policies would perpetuate a hyperinflationary environment. However, these fears proved unfounded as Erdogan promptly shifted direction, appointing Mehmet Simsek as Finance Minister and Hafize Erkan as Central Bank Governor. Rather than cutting interest rates, the new team initiated a rate hiking cycle to tackle inflation which had stood at c.64%[1] and this strategy has started to yield positive results. Note in February, Hafize Erkan was succeeded by Fatih Karahan, who has continued the same policy's momentum.

5-year total return in USD of Türkiye ISE National 100 index vs. MSCI EM



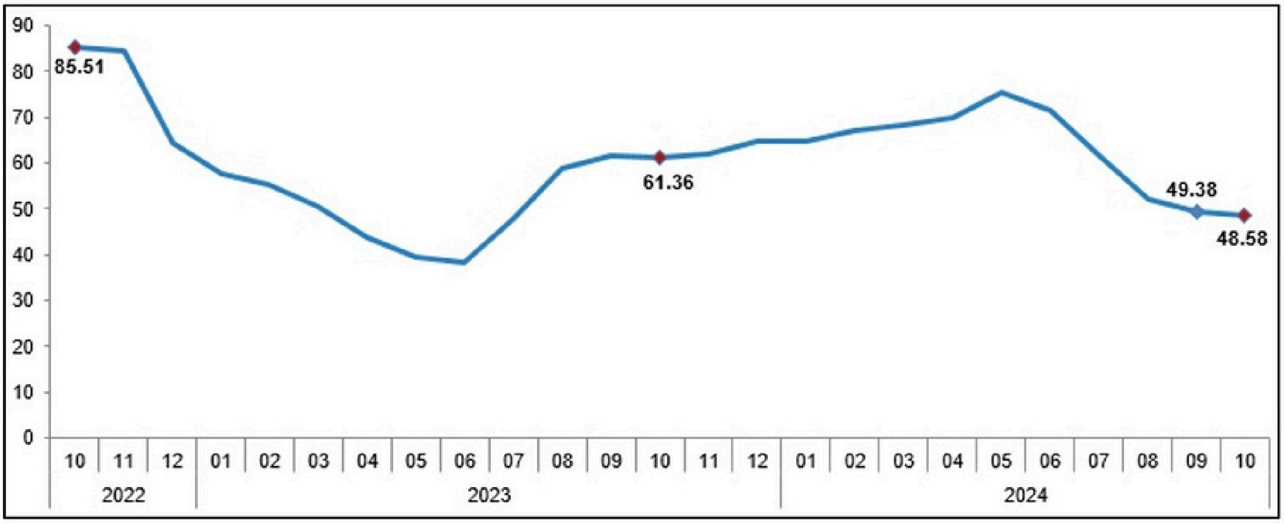
Source: Factset, 2024

MANAGED BY ICM

All eyes on the Consumer Price Index

The key question now is whether the government will stay the course or falter at the final hurdle. The latest inflation figure, at 48.6% as at October, fell short of expectations, suggesting that the battle against inflation is far from over. Tackling this challenge would likely require maintaining the current 50% interest rate—or even higher—for an extended period. However, such a tight monetary stance could weigh on economic growth next year, with corporates already voicing their concerns as they continue to have to operate in such a high interest environment. This also raises the risk that Erdogan might once again abandon his fight against inflation, opting instead to prioritize short-term economic gains and employment.

Annual rate of changes in CPI (%), October 2024

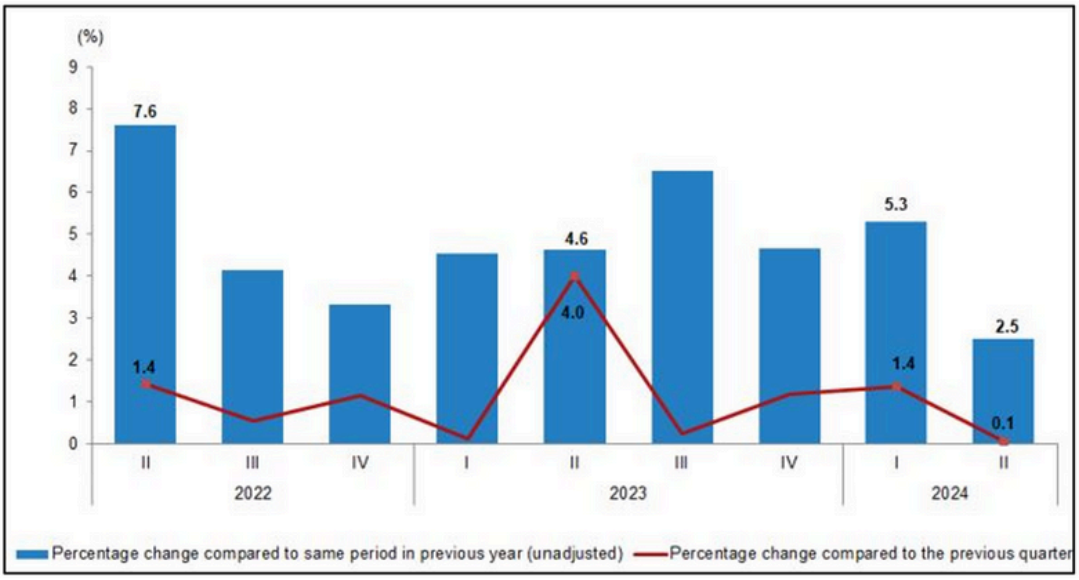


Source: Turkish Statistical Institute, 2024

Economy continues to grow but challenges ahead

While much of Europe continues to grapple with an industrial slowdown or outright decline, despite the high inflationary environment, Türkiye's economy is still managing to deliver positive GDP growth, though its manufacturing sector faces significant pressure. Unlike other major regional economies, Türkiye benefits from strong demographics, which shield its corporates from labour shortages. Notably, 44.9% of the population is under the age of 30 years,[2] and the overall population continues to grow. Meanwhile, demand for Turkish exports showed some growth year-on-year, and the environment of negative real interest rates[3] has, until recently, been positive for the earnings of exporters. The shift to real interest rates as well as the economic difficulties that Europe is experiencing poses a challenge to Türkiye's industrial outlook in 2025. Note that 40.8% of Türkiye's exports are to the EU.[4]

GDP Percentage Rate, Quarter II: April-June 2024

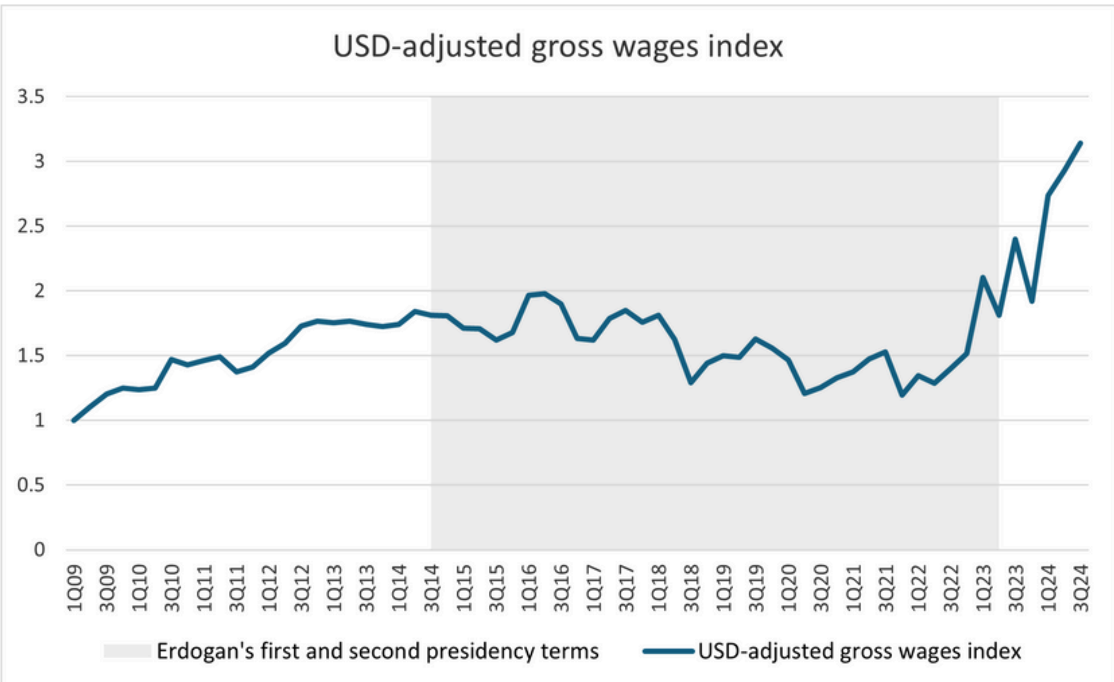


Source: Turkish Statistical Institute, 2024

Turkish consumer most affected

The biggest victim of inflation was the domestic consumer rather than large corporates. This is why Erdogan had insisted on minimum wage increases that tracked inflation, but which have also reinforced the vicious inflationary cycle. Over 40% of the Turkish working population is officially paid the minimum wage and most private and public sector wages are in some way linked to it. To crush inflation expectations and accelerate a return to normalcy, Erdogan needs to also limit the mandatory minimum wage increases that are typically scheduled once a year. Positively, real wages appear to be quickly recovering after a period of stagnation between 2016-2023. It is not a surprise that the trend accelerated after the switch to an orthodox monetary policy.

Turkish wage index adjusted for TRY/USD



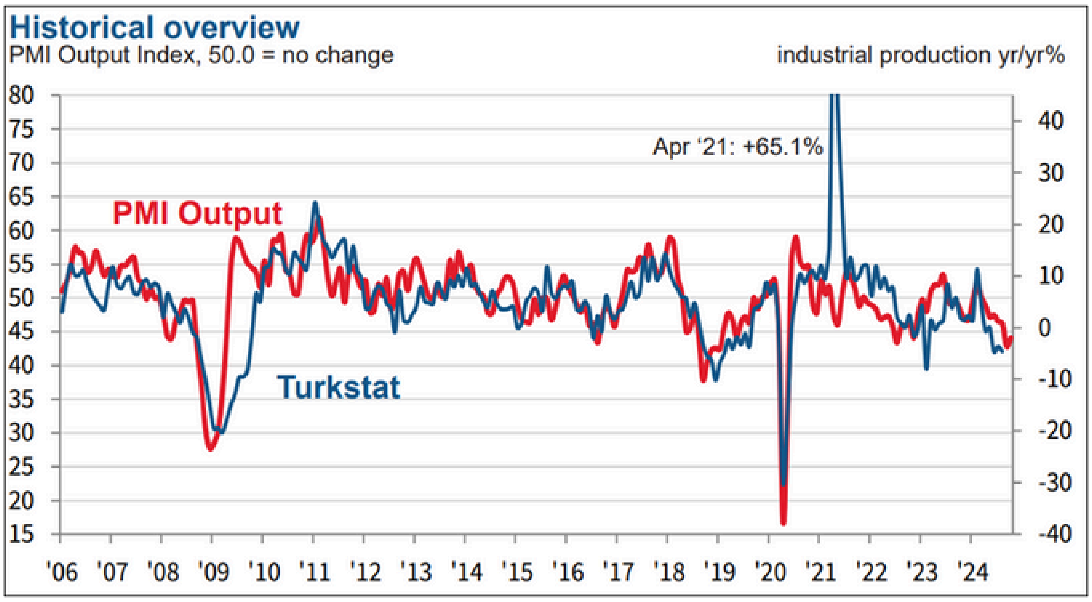
Source: Turkish Statistical Institute, 2024; Factset 2024; ICM

Turkish corporates are resilient
Overall, as noted, the Turkish corporate sector has adapted remarkably well to the challenging macroeconomic environment. Financial leverage remains low, and negative real interest rates (which lasted until recently) had allowed export-oriented businesses earning hard currency (i.e. dollars or euros), as well as those operating under regulated asset-based tariff models (such as power utilities), to generate supernormal profits in recent years.

An exception has been the Turkish telecom sector, where mobile and internet tariffs have remained significantly lower than those in Europe, as price adjustments lagged behind inflation. However, with inflation now easing, telecom companies are seeing tariffs align more closely in real terms.

The challenge ahead will be for those corporates that have thrived in this high-interest rate high inflationary environment. Despite their low leverage, they must now navigate a tighter funding landscape and a strengthening lira.

ICI Türkiye Manufacturing PMI



Source: Istanbul Chamber of Industry, 2024

Cheapest EM market
Despite their rally in recent years, Turkish equities remain one of the cheapest among emerging markets. This reflects investors' lingering doubts about the administration's commitment to monetary normalisation, as well as a potential risk premium tied to the future presidential elections in 2028. According to the Turkish constitution, Erdogan cannot run again as President and he has indicated that this will be his final term. In time, the question of his successor will become increasingly important for the markets.

Additionally, part of the market discount reflects expectations of a profit slowdown in 2025, driven by the continuation of this tighter monetary policy that is now starting to bite. The Justice and Development Party's (AKP) losses in this year's regional elections further heighten the risk of a shift toward more populist policies as the next election cycle approaches.

Price-to-earnings ratio of emerging markets

Source: Istanbul Chamber of Industry, 2024

UEM investments in Türkiye

Our outlook on Turkish equities is positive due to their attractive valuations and Türkiye's long term positioning. The Turkish market is relatively large and there is a significant opportunity set in terms of investable companies that fit our investment criteria. Currently, Utilico Emerging Markets has an investment in TAV Airports, which represents 3.1% of the portfolio. The company has been a stronger contributor to our performance since 2021. Moreover, we are actively evaluating further investment opportunities in companies with more defensive business models that allow them to operate well even in more challenging macroeconomic circumstances, but still capture the key megatrends in the country.

George Velikov

27 November, 2024

Source Data: ICM Limited

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