بنك أبوظبي التجاري
ADCB

Tactical overweight on Turkey sovereign dollar bonds

- **We remain cautious on the emerging bond markets as a resilient USD and the Fed tightening cycle will keep pressure on the overall asset class**
- **For that reason we stick to those few emerging bond markets that have macro-economic fundamentals strong enough to protect them from potential global risk-off phases, such as Russia and Indonesia**
- **We are, however, introducing a tactical call on Turkish US dollar bonds on the assumption that the April 16 "yes" victory is going to bring more political stability to the country, and thus reverse the losses Turkish bonds have suffered against the overall asset class since the failed July coup**
- **Specifically, now that President Erdogan cashes in on this political victory, we think there is a good chance that the government will refrain from the most populist policy measures, and aim at more prudent fiscal policies, whilst allowing the central bank to rein in inflation**
- **Thus this call is less based on the country's current economic fundamentals, than it is on how they will work out as the country's economic policies will change**

Turkey bonds likely to witness a relief rally

Turkish assets have been under pressure since the failed coup in July last year spurred increased political uncertainty and negatively impacted the growth dynamics. However, more recently, Turkish assets have traded relatively well, despite the uncertainty regarding the outcome of the referendum. Going forward, Turkish US dollar bonds are likely to benefit from increased clarity following the "yes" victory, as the government will now focus on reducing inflation and public spending.

Below you find a short list of Turkey US dollar bonds. These bonds have not been selected based on any micro or company (issuer) analysis, but solely screened on the basis of quantitative criteria, such as maturity (3-5 years), minimum issue size of 500 million, and Fitch rating not inferior to the sovereign (BB+), if possible better.

ISIN number	Bloomberg ticker	Coupon	Maturity
USM8931TAA71	GARAN	6.25%	4/21
XS0874840688	YKBNK	4.00%	1/20
XS1571399754	YKBNK	5.75%	2/22
US900123BZ27	TURKEY	6.25%	9/22

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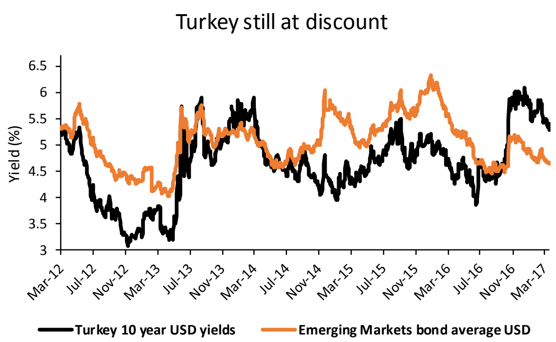
Turkish bonds too cheap relative to EM bonds

In terms of valuations, Turkey USD bonds are trading relatively cheap to the emerging market bonds. Historically, the 10-year Turkish USD sovereign bond tends to trade at a premium versus the emerging bond benchmarks as seen in the chart below. However, the failed coup in July last year coupled with deteriorating economic outlook dented investor sentiment. Political uncertainty building ahead of the constitutional referendum vote and rating downgrades by all the three rating agencies led to a sizeable sell-off in the sovereign bond market. Though there has been some recovery in demand since the Fitch downgrade in late January, the bonds are still trading at a significant discount versus the emerging market benchmark bonds. We expect some correction to take place post the "yes" vote.



Source: Bloomberg

Up and down with the US Treasuries

The recent consolidation in long-term US Treasuries is also likely to spill over to certain emerging markets. Turkey is one of such markets which is strong correlated to the movement in US Treasuries. The chart below indicates that Turkish bonds have begun to track the decline in US Treasuries. As such, this trend could continue in the near-term.

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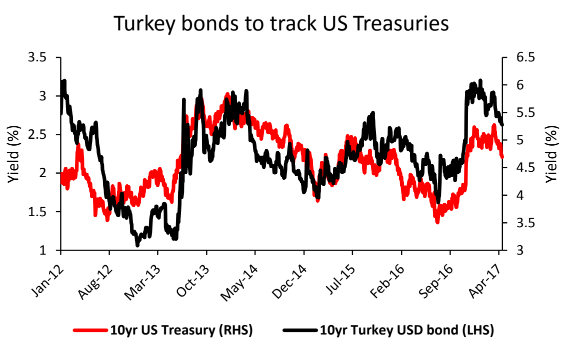


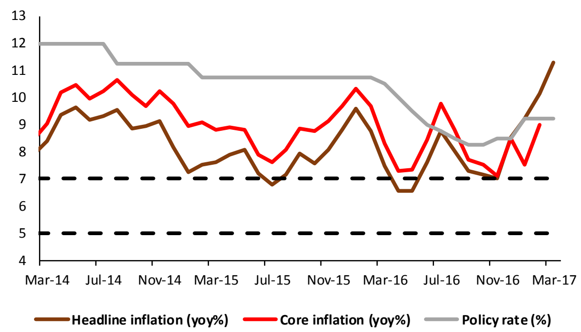
Source: Bloomberg

Stay wary of long-term political uncertainty

While "yes" outcome will somewhat clear the uncertainty before the referendum, it doesn't mean that it will lead to complete political clarity. Turkey is traditionally a divided country, and there is a good chance that President Erdogan will call new elections, rather than wait until 2019. On the other hand, he might also wait it out since, following the July coup, he is anyway governing the country on emergency powers that give him a lot of leeway to pursue his own policies, and continue to consolidate power. Either way, whilst Turkey will remain a divided country, we do expect that – through ups and downs – more stability will prevail over the months to come.

External vulnerability and negative real rate are still risks

Thus, whilst we do not see a strong case for a long-term rally in fixed income assets as underlying fundaments still point weak, we do see scope for more stability. Even though the economy has managed to escape recession, helped by the government's expansionary fiscal policies, external vulnerability still score high. Traditionally, Turkey is not precisely a market that has strong external accounts. Critically, the Turkish government has over the last years introduced increasingly loose monetary and fiscal policies, leading to a massive devaluation of the Turkish lira. Since these policies can to a large extent be attributed to the domestic political struggle between President Erdogan and his opponents, there is a good chance that after the constitutional referendum more orthodox policies might again prevailing, driving down inflation and stabilizing the economy



Source: Bloomberg

Sources

All information in this report has been obtained from the following sources except where indicated otherwise:

1. *Bloomberg*
2. *Wall Street Journal*
3. *RTTNews*
4. *Reuters*
5. *Gulfbase*
6. *Zawya*

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