Texto para Discussão

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The Turkish Currency Crisis - More of the same

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Antony P. Mueller[2]

Introduction

The current Turkish currency crisis has implications beyond Turkey and the Middle East. Under President Erdogan, the country pursues a policy of becoming the major regional power in its area of influence and - while being still a member of NATO - is forming new alliances that may include Russia, Iran, and maybe even China.

President Erdogan has taken center stage in this development whose geopolitical implications are enormous. The Middle East is a powder keg and Turkey had been an important economic and political partner of the West. If the current crisis should deepen, and the split with the West should widen, a new geopolitical structure will emerge in the Middle East. It is not rare that currency crises work as the catalyst for momentous political changes.

Currency crisis

From March 19 to March 21 in 2021, the Turkish lira experienced a new crash after the President of Turkey fired the head of the national central bank because of a dispute about the interest rate. The national currency devalued from a rate of 7.2 to the US-dollar to a rate of over eight liras to the US-dollar on March 26, 2021 (figure 1).

[1] Part of this article is based on an earlier analysis of the Turkish currency crisis of 2018, available on https://www.aier.org/article/the-turkish-currency-crisis-and-what-it-can-teach-us/

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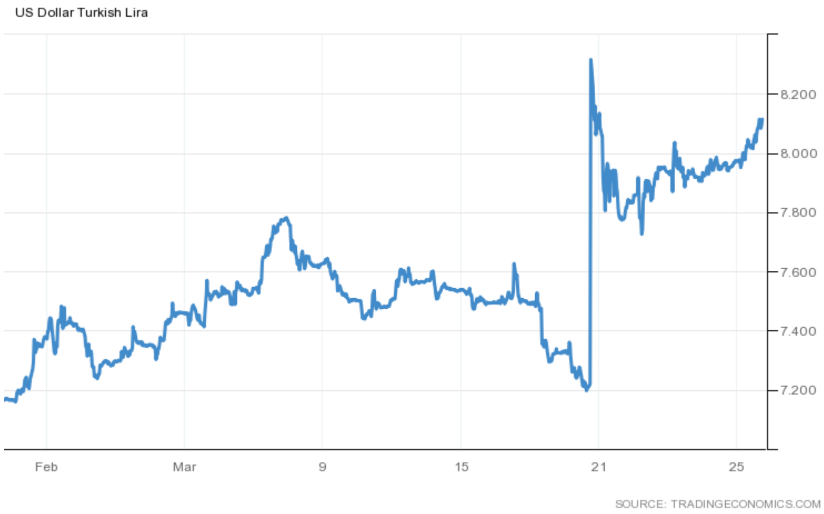
Figure 1
Exchange rate of the Turkish Lira to the US-dollar
February 24 to March 26, 2021



The recent collapse is consistent with the long-term weakening of the Turkish lira which has accelerated over the past five years (fig 2).

Figure 2:
Exchange rate of the Turkish currency (Turkish Lira per US-dollar) 1995-2021

The deterioration of the exchange rate reflects the monetary expansion as shown by the balance sheet of the Turkish central bank and the consequent acceleration of price inflation that began with Erdogan’s rule.

Extreme monetary expansion came as the result of putting an end to the independence of the Turkish central bank by Turkey's President. He was democratically elected in 2014 and re-elected in 2018. Over the years since he took power, he has become increasingly authoritarian to the dismay of his Western allies, including the United States.

Foreign debt

Turkey is just one more example of the many emerging economies whose leaderships have put their countries on a splurge of debt. Over the past ten years, emerging market dollar debt has more than doubled. The extremely low interest rates of the dollar, the euro, and the yen attracted many governments in the emerging economies to borrow in foreign currencies. There are many candidates which will have to confront external debt problems when interest rates in the United States and Europe should continue to rise.

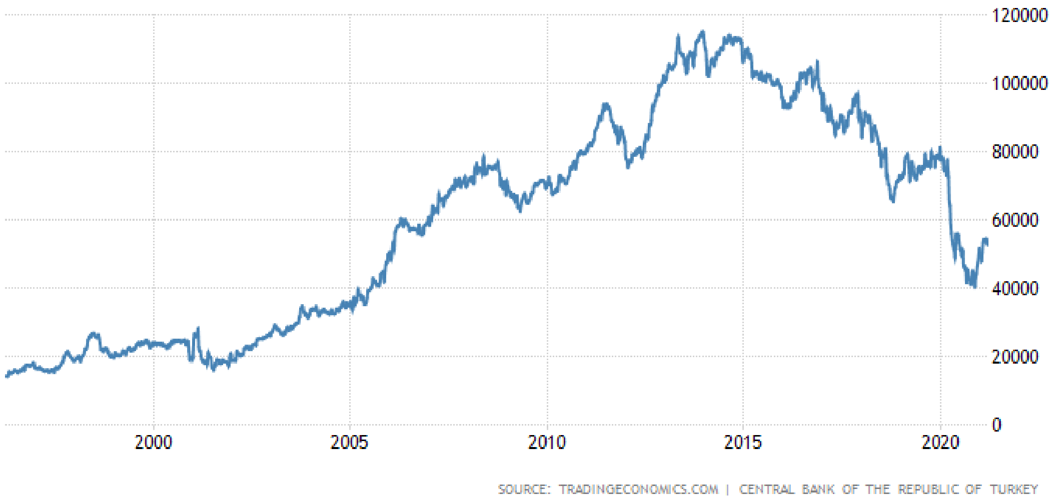
As a response to the currency crisis of 2018, the Turkish president did not come up with a solid economic policy plan, which would include a cut in government spending and curbing the money supply. He rather accused 'foreign powers' for the mess, with the American President as the prime culprit of his accusations. Instead of signaling economic policies which could stabilize the currency, President Erdogan denounced the fall of the Turkish currency as an 'enemy attack' on his country. This reaction of the Turkish president has contributed to a further loss of the value of the Turkish currency.

In this sense, the current crisis was the "accident waiting to happen".

The devaluation of the currency means that Turkey's external debt burden that stood at USD 435.12 billion in the third quarter of 2020 has quadrupled over the past decade although the overall amount of debt has come down slightly from its peak in the past couple of years.

While the overall ratio of public debt to the gross domestic product is relatively low, half of the public debt is in foreign currency, which makes the budget vulnerable to a currency devaluation and the stoppages of international capital inflows (fig. 3)

Figure 3
Turkey. Foreign exchange reserves, 1995-2021

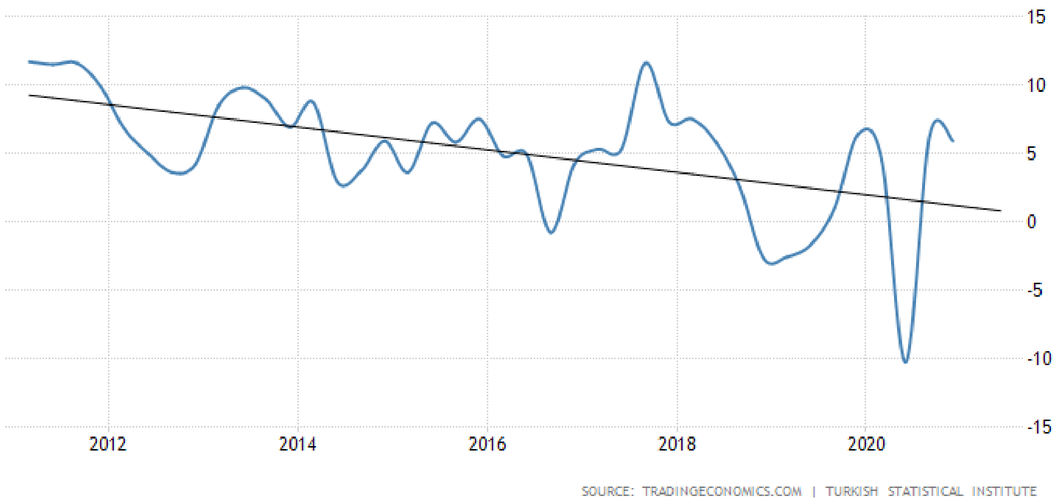


Economic performance

The reduction of the relative burden of the overall public debt was mainly due to a good growth performance over the past decade. After a swift recovery from the international debt crisis of 2008, the annual real growth rate of Turkey's gross domestic product averaged around seven percent. In the first quarter of 2018, the annual growth rate reached 7.4 percent after 7.3 percent in the quarter before.

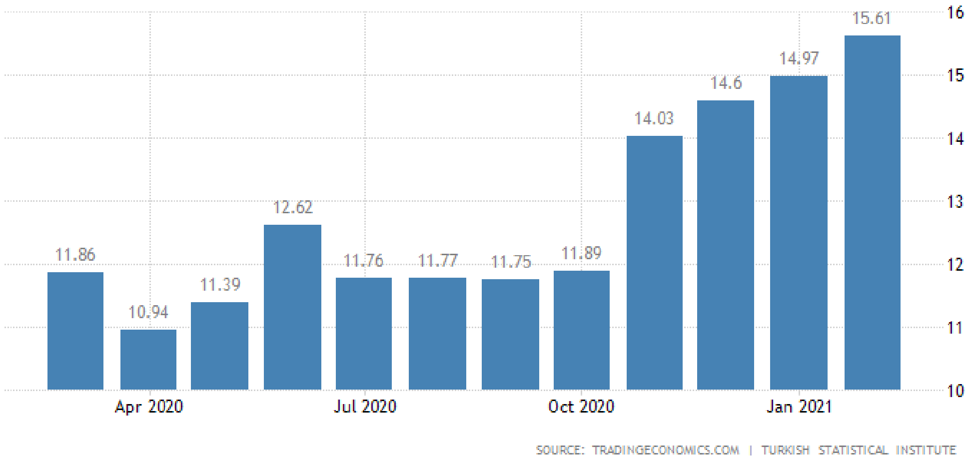
Yet since then, the economic growth rate has been faltering and over the past decade, economic growth shows a clear trend downwards (fig. 4)

Figure 4
Annual economic growth rates of real gross domestic product, 2010-2020



Even if Turkey can avoid an outright default, the economic impact of the sharp currency devaluation with the consequent rise of the interest rate will reduce investments and squeeze profits. The Turkish consumers face rising prices (figure 5) and higher unemployment (which currently stands at 12 percent) is about to follow.

Figure 5
Monthly price inflation rates, March 2020 to February 2021



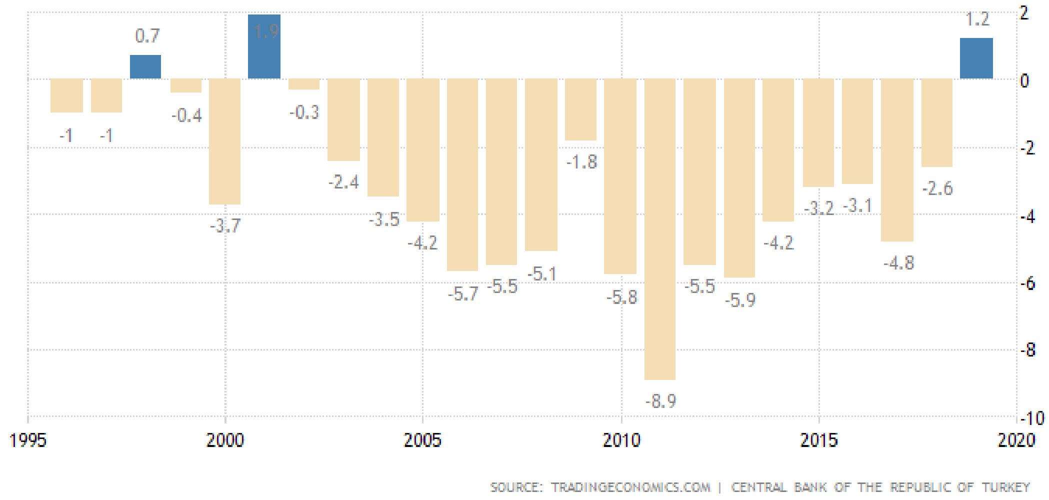
President Erdogan’s government has lost the confidence of the international investors when the president undermined the formal independence of the Turkish central bank after he took office. At the beginning of his new term, president Erdogan practiced outright nepotism when he appointed his son-in-law as treasury and finance minister in June 2018 right after his re-election.

In March 2021, the Turkish President triggered a new shock wave when he fired for the third time the incumbent head of the central bank within two years.

Turkey’s foreign debt exposure results from the country’s persistent current account deficits as these require the import of capital. With the decline of the Turkish lira, it will become harder to finance these deficits.

From 1980 to 2017, the current account balance was on average at -2.5 percent. Since 2001, the country has experienced a sharp deterioration, and the deficit hit nine percent in 2011. Since then, there has been an ongoing reduction of the deficit and in 2019 the country achieved a surplus of 1.9 % after almost twenty years of current account deficits (figure 6)

Figure 6:
Turkey. Current account balance in percent of the gross domestic product



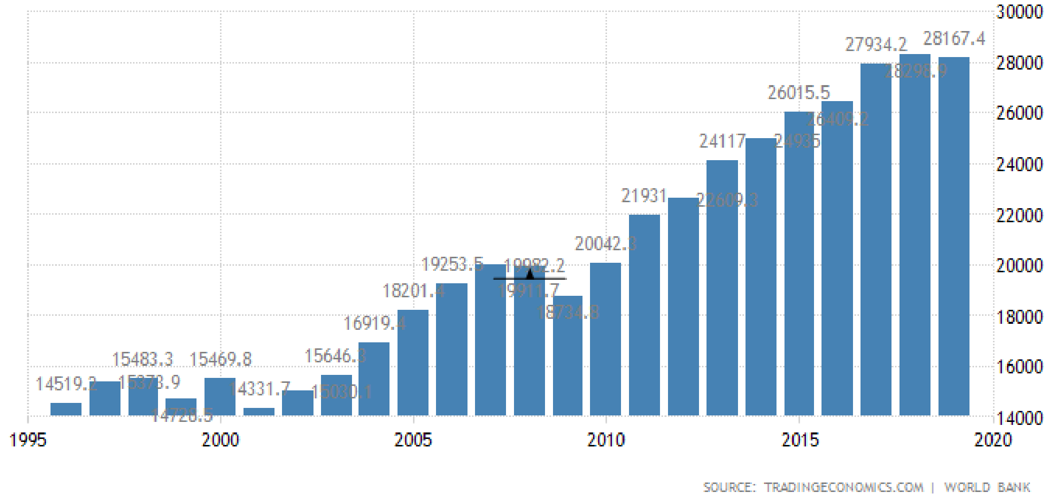
Politics

Since 2002, first as prime minister and since 2014 as president, Erdogan has intensified his grip on the country and abolished civil liberties. The failed 2016 coup has given him a free hand to intensify the authoritarian style of his rule. Erdogan challenges what has defined modern Turkey since the end of the sultanate. As president, Erdogan has moved to authoritarianism driven by religious zeal. He thus represents a break with Turkey's modern history.

Erdogan's new mandate extends until 2023. He can act freely based on the new institutional framework of an 'Executive Presidency', which gives him broad legal authority over almost all governmental activities, a privilege he won after winning the referendum to his favor of a new presidential system for Turkey.

With a better economic management, Turkey would have the chances to become a wealthy country. It has a diversified economic structure. Turkey's domestic financial system is flexible and resilient. Over the past decades, Turkey has experienced remarkable economic progress. Since the beginning of the new millennium, the economy has registered high growth rates with a moderate price inflation. Over the past two decades, the purchasing power per capita has almost doubled (figure 7).

Figure 7:
Turkey. Gross domestic product per capita in purchasing power parity (in US-dollar)



President Erdogan's aspirations to establish an Islam-based authoritarianism and his erratic, incoherent, and nepotistic economic policy puts Turkey's progress at risk. The crucial reforms of the Turkish economy were made before he came to power. Erdogan could enjoy the favorable economic situation prepared by his predecessors and gain the laurels while in fact he has been on the path to destroy not only what was accomplished in the decade before his rule but since the 1920s.

After the end of the Ottoman Empire, Turkey became a republic in 1923. Since then, the country has become one of the most secular countries in the Middle East. Under the leadership of Mustafa Kemal Pasha, later called Atatürk (father of the Turkish people), Turkey experienced a profound and broad transformation.

After Atatürk's death in 1938, the subsequent leaders continued Turkey's path to modernization. In 1952, Turkey joined the NATO, became a founding member of the OECD in 1961, and an associate member of the European Economic Community in 1961. Yet the path to a modern economy and a democratic political system became stony thereafter. There were military coups d'état in 1960, 1971, and 1980, and a 'military memorandum' in 1997, which forced the ruling prime minister to resign.

With this intervention of 1997, the role of the military as a guardian of secularism has ended. Since then, Turkey has been exposed to a rising tide of re-Islamization.