The Currency Crisis in Turkey and its Implications

Oyadeyi, Olajide

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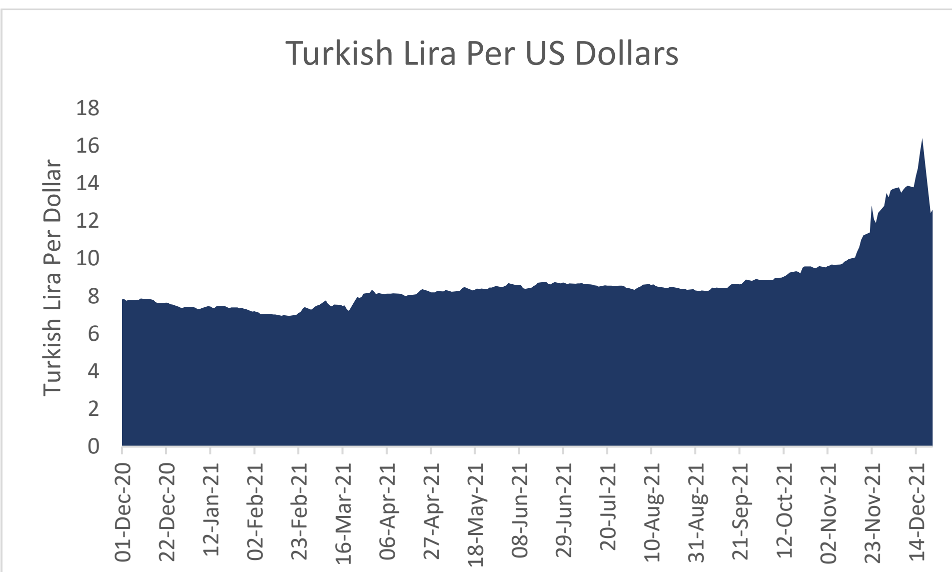
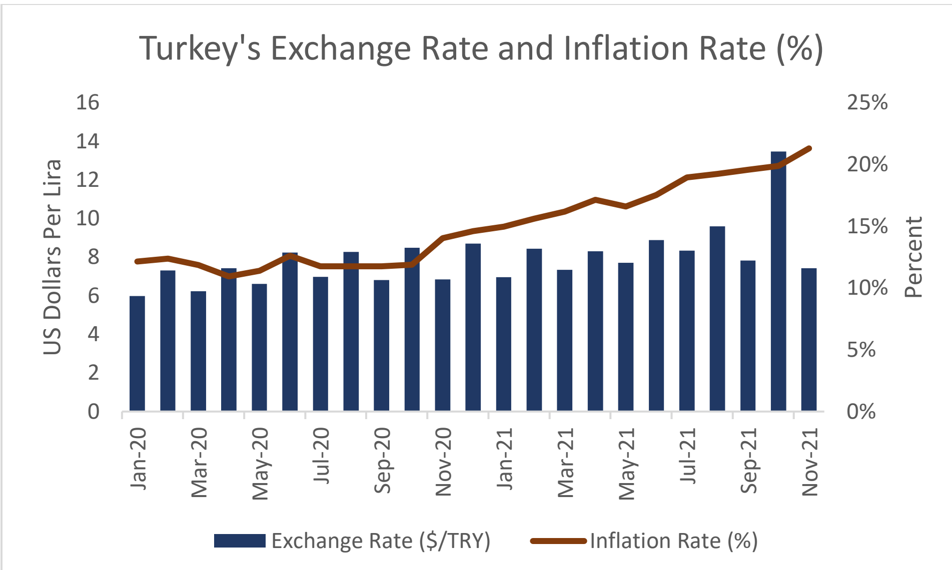
Turkish Lira in Crisis

The Turkish Lira is in the midst of a currency crisis, there's no other way to phrase it. USD/TRY rates have surged almost 42 percent and EUR/TRY rates have risen over 37 percent since the Central Bank of the Republic of Turkey (CBRT) made a surprise 100-bps rate decrease at the end of September. Under Governor Sahap Kavcioglu's tenure, the CBRT has lost all appearance of independence, owing to heavy-handed pressure from Turkish President Recep Tayyip Erdogan.

The currency crisis that has bedeviled the Turkish Lira in recent months has already taken a negative turn, and another negative shift could be on the way, with the CBRT expected to maintain its rate cuts in the near future. Turkey's short-term external debt stock has risen to $124.4 billion, a growth of +8.8% since the end of 2020, according to news released today. The rise in the USD/TRY and EUR/TRY exchange rates will only exacerbate Turkey's financial woes in the coming months. According to CBRT data, approximately 43 percent of the country's debt is denominated in US dollars, with just over 25 percent pegged in Euros.



President Erdogan recently announced methods to ensure continued lira savings, stating that if the value of the lira against international currencies falls below the interest rates provided by banks, the government will step in and make up the difference. It is an unusual strategy selected by a president who holds unconventional economic beliefs: Erdogan has long decried interest rates, referring to them as the "mother of all evils" and claiming that raising rates causes inflation rather than lowering it. His extended failure to raise rates, as well as his apparent control over central bank monetary policy, have contributed significantly to the lira's unprecedented depreciation, which has seen it fall from less than 4 to the dollar in 2018 to 18 to the dollar this week. Turkey's inflation rate is now around 21%. Finally, the remedies do not appear to address the root causes of excessive inflation and currency devaluation.



Mr. Erdogan's Use of Unorthodox Economic Policies in Managing the Economy

The Turkish lira's depreciation is due to his unconventional economic policy of keeping interest rates low to increase Turkey's economic growth and export potential with a competitive currency. Inflation is on the rise all around the world, and central banks are considering raising interest rates. But not in Turkey, where the president believes inflation will eventually fall. He has fired three central bank presidents in the last two years and has recently changed his finance minister. If inflation rises, economists believe that raising interest rates is the best way to control it. Interest rates, on the other hand, are seen by Mr. Erdogan as "an evil that makes the rich richer and the poor poorer."

Erdogan has forged ahead with his economic program, which prioritizes exports and lending, despite widespread criticism and the rapid economic fallout – including Turks' rapidly eroding incomes and savings. Under President Trump's urging, the central bank reduced rates by another 100 basis points last week, pushing real rates even lower into negative territory, raising concerns among investors and savers. To some extent, the rate cuts have resulted in positive real economic growth, with the economy growing 7.4% in Q3 2021, mostly due to exports. However, other economists predict that the economy would collapse in the fourth quarter, owing in part to the President's unconventional policies and a decline in purchasing power due to growing inflation.

In reaction to the aforesaid rate decreases, Mr. Erdogan promised a 50% increase in the minimum salary next year, to 4,250 lira ($275). However, overall consumer price inflation is likely to rise as a result of this. Turkey's economy is also heavily reliant on foreign capital, which means that enterprises that took out debts in dollars would face higher payback expenses if the lira depreciates against the dollar. Despite recent significant increases in December, the Turkish lira has lost over half of its value against the US dollar this year, making it the poorest performer among emerging market currencies, owing to a lack of monetary confidence. Turkey is embarking on a difficult journey; they no longer play by the rules.

Implications for Turkey

Mr. Erdogan's freshly announced initiatives have so far deviated dramatically from market norms. The longer the currency crisis lasts, the more entrenched he appears to be in his anti-interest rate attitude, as the lira is already becoming divorced from fundamentals. This means that if the rate cuts continue, currency volatility is likely to rise in the future, and many investors may move their money out of Turkey. Furthermore, as Turks watch their savings and wages evaporate due to increasing inflation and a sinking currency, the knock-on impacts of continued rate reduction have been swift and unpleasant. According to IHS Markit, Turkey's five-year credit default swaps, the cost of insuring against sovereign default, have lately risen to 622 basis points.

Implications for Nigeria

1. **Trade Policy**

More recently, Turkish President Recep Tayyip Erdogan has declared that he intends to raise current trade volumes of $25 billion to over $60 billion in a short period, with Africa playing a key role in this expansion. Though the quota may appear inflated, the African market, particularly Nigeria, provides Turkish enterprises with numerous chances. Turkish goods (such as calcium sulphate or gypsum) have a strong reputation in Nigeria and across the African continent since they are of European quality but at Asian pricing. However, Turkey's negative economic outlook, owing in part to currency and inflation crises, is the main source of anxiety about the country's future, which could harm demand for Nigerian sesamum seeds (who they have been actively trading with).

2. **Security and Defense**

Because of the power vacuums created by the US and China, Turkey's impact in the growth of many African economies has grown. Even though Turkey's connection with many African countries, such as Nigeria, is still relatively new, their capacity as an emergent mid-level power has increased their influence on the continent and helped obtain crucial business accords. Furthermore, the recent summit in Istanbul is expected to usher in a new era marked by greater cooperation on international governance concerns as well as stronger security and defense cooperation. After successfully training various units inside Somalia's military machinery, Turkey recently struck security agreements with Nigeria and Burkina Faso, demonstrating their ability to confront terrorist organizations such as the PKK (Partîya Karkerén Kurdîstan - Kurdistan Workers' Party).

3. **Vaccination**

Because of the low levels of support received from Western countries in Africa during the ongoing pandemic crisis, Turkey has a new window of opportunity to improve its reputation on the continent. Turkey has agreed to delivering 15 million Turkovac vaccine doses in the coming months once trials are completed.

4. **Foreign Policy**

Finally, Turkey's dire financial situation may have unavoidable ramifications for its foreign policy. Turkey's African strategy, on the other hand, is less affected by the country's economic fortunes. Turkish people have become less reliant on financial resources as a result of their strategy to building relationships based on partnerships and people-to-people ties. As a result, Turkish-African relations can weather economic downturns. In the short run, trade growth with Nigeria and other African countries is unlikely to aid the Turkish economy's recovery. Turkey, on the other hand, has laid the groundwork for long-term relations with Nigeria and Africa, which are set to continue increasing despite the current crisis.

Conclusion

Inflation has soared above 21% as a result of Erdogan's determination to push through 500 basis points of monetary easing since September, including another substantial decrease in December.

According to FocusEconomics researchers, it is projected to exceed 30% next year due to rising import prices and an emergency increase in the minimum wage. The longer the currency crisis continues, the more Erdogan appears to be entrenched in his anti-interest rate stance. Turkey may be past the point of no return.