INTERNATIONAL

Turkey's economic odyssey: inflation, lira decline and strategic shifts

Marcello Minenna delves into the damage of 20 years of 'Erdoganomics'

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Twenty years of 'Erdoganomics', with double-digit inflation – averaging over 15% and peaking at 80% based on Turkstat figures – have undermined not only the autonomy of the Central Bank of the Republic of Turkey (CBRT), but also its room for manoeuvre and its influence over economic policy.

The lira is no longer the *de facto* reference currency in Turkey, since more than 70% of deposits in the Turkish banking system are denominated in US dollars or euros or otherwise tied to these currencies.

The CBRT has only recently abandoned its unorthodox approach over the past few years based on the independence of the interest rate level from inflation (but it can be said that its discontinuation of the policy in favour of traditional policies has been limited and came too late) changing structurally the landscape of Turks' financial preferences.

In fact, the Turkish central bank has now resorted to bilateral currency swaps with central banks that are similar in total size to the level of its foreign exchange reserve to maintain its balance-of-payments equilibrium; swaps that increasingly have as counterparts its Middle Eastern neighbours, China and Russia (the CBRT, for example, has swap lines with Qatar, the United Arab Emirates, China and South Korea, totalling $57.5 billion). These are financial dynamics of no small magnitude that are moving Turkey away from the European Union and closer to the Brics (Brazil, Russia, India, China and South Africa).

Apart from a few geopolitical factors at play, there are two crucial financial elements that ensure this economic mix does not become explosive: the confidence of the Turkish people in their own country-system and the resilience of exports.

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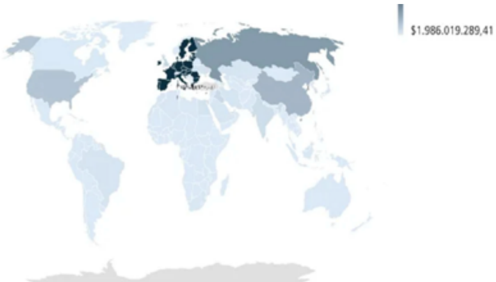
Trade balance vs World (merged data for EU and USA countries)



Source: Trading Economics. Data elaborated by the author

Citizens' confidence can be measured clearly by the fact that both households and companies keep their operations firmly in the domestic financial system. In doing so, they become an important support for the country's foreign exchange and gold reserves, not just in times of emergency. In fact, it is precisely the purchase of gold that, together with energy, is driving Turkey's trade balance into the deep 'red'.

And it is precisely the awareness of the energy limit and its contribution to systemic instability that led Turkey to 'ally' with Russia for the construction of its first nuclear power plant.

Inflation has resumed its growth and is now close to the highest level seen in the last two decades of Erdoganomics. However, there is a decoupling between consumer inflation and output inflation. In fact, the exchange rate-weighted figure shows a very interesting picture. While on the consumption side there is indeed a collapse in international purchasing power, indicating a trend decline in imports; on the production side the figure is instead trending moderately upwards.

This means foreign investors still think the Turkish economic system is capable of stabilising many of the elements of domestic instability. An effectiveness that is particularly aimed at the EU, considering the trade exchange with the EU is equal to the sum of those with Russia and China.

If, on the trade front then, systemic stability comes from the European partners, on the financial front it is provided by the economically stronger partners of the Brics alliance.

Erdogan's geopolitical balancing act, supported by Turkey's powerful military, as evidenced by its 11th place ranking in *Global Firepower*'s list of the world's most powerful armies, is likely no accident.

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