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Turkey Pivots To Economic Orthodoxy

A change in Turkey's economic policies was long overdue.

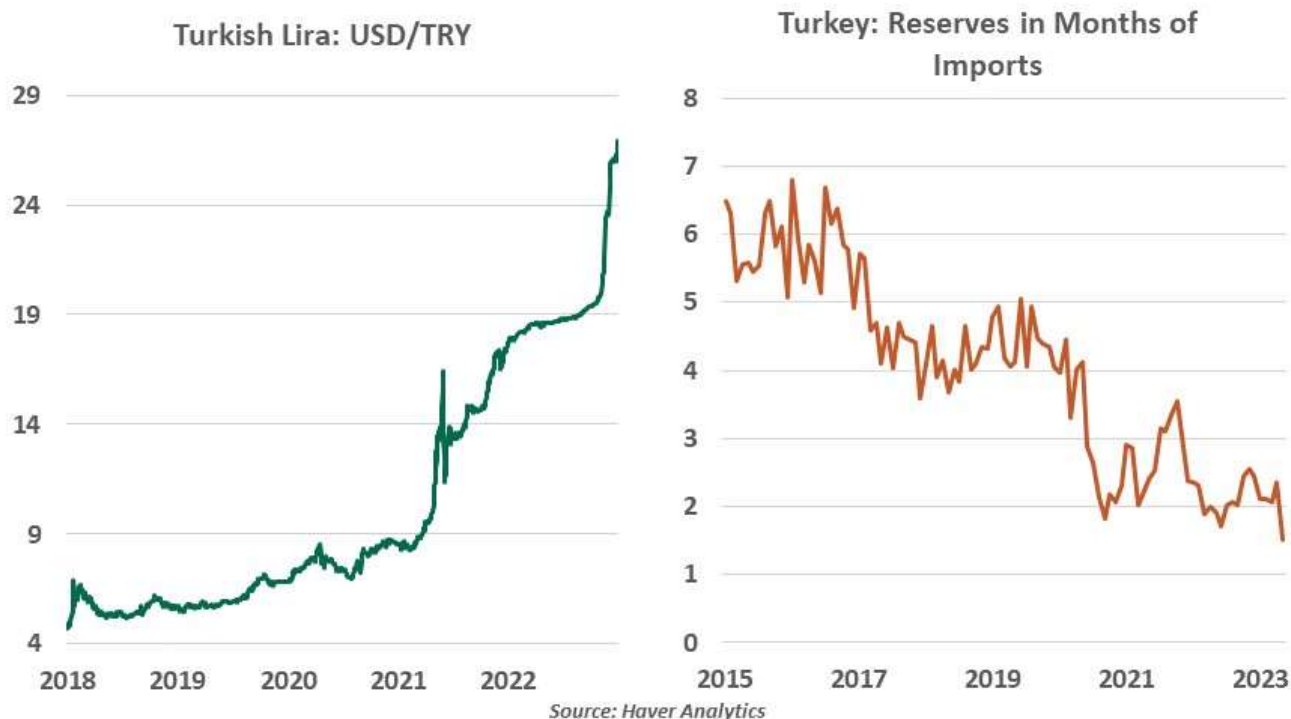


In the wake of the Turkish elections in May, many wondered what changes President Recep Erdogan would make. To the surprise of many, his largest shift has been in economic strategy. The appointment of Mehmet Simsek to the finance and treasury ministry, coupled with increases in policy rates by the central bank under the newly appointed governor Hafize Gaye Erkan, are the clearest signs of a return to conventional economic policies.

The U-turn comes as the Turkish economy is in tatters, owing to unorthodox economic approaches pushed by President Erdogan in recent years. The Turkish central bank has been on a rate cutting spree since mid-2021, even as inflation was rising. Billions of dollars of new

spending, including energy subsidies, were announced in the run-up to elections to insulate voters from rising prices.

The result was runaway inflation and a collapsing lira that is pushing many Turkish families to the brink of bankruptcy. The annual inflation rate, after peaking above 80% last year, still stands at around 40%. Foreign reserves have been depleted rapidly to defend the lira, leaving them at a dangerously low level.



Reversing course will not be pain free. The central bank will have to tighten aggressively to bring inflation down and stabilize the currency. Turkey is a deeply indebted country, and rising debt interest will bring discomfort across economic sectors.

Despite the two recent hikes, the lira's value has continued to decline, falling to a record low of 27 against the dollar. This reflects the lack of confidence among investors that the president will really give up his hold over the actions of the central bank. We don't blame the markets, as Erdogan has a record of backtracking after making investor-friendly propositions. Erkan is the fifth new central bank governor in just four years.

By appointing a respected economist as the central bank governor and a former economy chief as energy and treasury minister, President Erdogan has re-opened the door to economic orthodoxy. Turkey cannot afford to close that door again.

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