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Erdonomics

Erratic policymaking is impairing Turkey’s growth prospects.

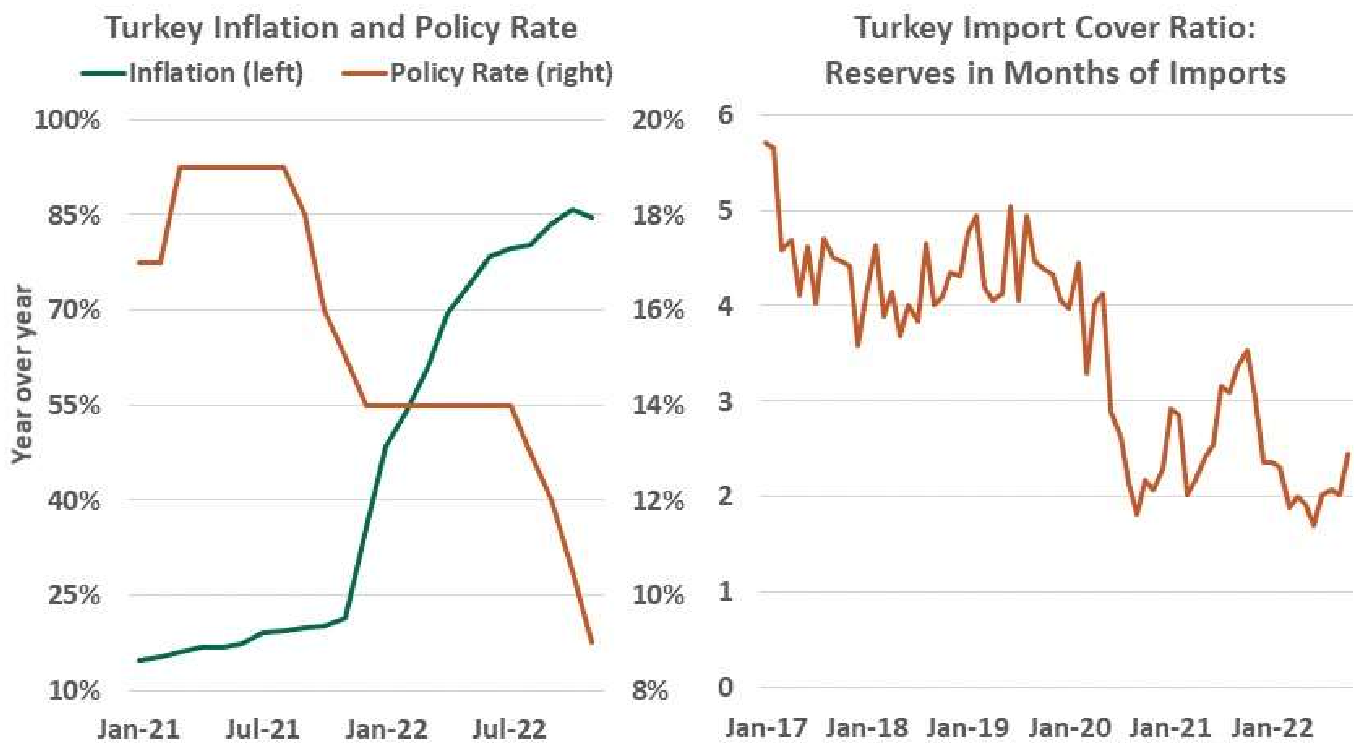
By Vaibhav Tandon

In the final episode of season 5 of the American sitcom *Seinfeld*, the hard-luck character George is convinced that if his every gut instinct is wrong, then the opposite would have to be right. So he decides to do turn his life around by doing the exact opposite of what he would normally do. Instantly, from the workplace to his romantic life, George starts getting his desired results.

Turkish policymakers may have drawn inspiration from this episode. Their recent policy actions have been the opposite of everything conventional economic theory would dictate. Unfortunately, real-life outcomes have been disappointing and certainly not entertaining.

Instead of emergency rate increases to prevent hyperinflation, the Turkish central bank has been on a rate cutting spree, under pressure from the nation's political leadership. The policy rate has been lowered by 10 percentage points to 9% since August 2021. Over the same time period, the annual inflation rate has skyrocketed to 85% (from an already-high 20%), causing the value of the Turkish lira to nose-dive from 8.3 to 18.6 against the dollar. Adjusted for inflation, the real interest rate currently stands at an astonishing negative 75%, implying Turkish banks are in effect generously paying borrowers to take out new loans.

While cheap credit and higher government spending ahead of next year's election have helped the Turkish economy continue growing, the instability is catching up with it. Many Turks are struggling to pay for daily essentials and are witnessing an erosion of prosperity. A widening current account deficit and depleted foreign reserves, along with high short-term external debt, are at the core of Turkey's economic troubles. The credit default swap premium for Turkish sovereign debt instruments is hovering around 600 basis points, signifying a high risk of default. This is a concern for several European banks that have significant exposure to Turkey.



Source: Haver Analytics

With foreign investors staying away from Turkish markets, Ankara has been relying on restrictions of capital mobility and informal FX flows to keep the economy afloat and finance its trade deficits. Aid has been sourced from abroad likely in return for greater investment avenues into Turkey: Saudi Arabia is expected to deposit $5 billion at the Turkish central bank, while Qatar is set to provide up to $10 billion of further funding.

Turkish policymakers need to go back to the drawing board to prevent an economic collapse.

Erratic policymaking over the past decade has dented Turkey's long-term prospects as well. Gross domestic product per capita has fallen from a peak of around $12,600 in 2013 to $9,600.

Foreign direct investments have not matched the levels of the mid-2000s, when Ankara followed conventional economic policies.

Turning economic dogma on its head has not produced rave reviews in Turkey. The nation's political leadership will need to flip back to the original script to make the economy a hit.

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