JENS BASTIAN

Turkish elections and economic reality

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As Turkey starts a pivotal new year characterized by the centenary of the Republic's foundation and presidential as well as parliamentary elections, some reflections are in order about the state of play of its socio-economic situation. There are reasons to be concerned about the consequences of the country's economic condition.

Let's first consider some macro-economic indicators and subsequently boil these down to their impact on day-to-day policy making. In November 2022, the Turkish Central Bank (CBRT) cut interest rates for the fourth time in as many months. The benchmark monetary policy rate now stands at nine percent. This rate cutting cycle appears in marked contrast to most other G-20 countries, with the exception of Russia and China. It stands to reason, if it is opportune for the CBRT to be seen in the company of these two countries at present. The outlier status of the CBRT is a constant feature of the institution since President Recep Tayyip Erdoğan repeatedly called for interest rate cuts over the course of the past two years.

Against this background, two developments stand out. For one, the official annual inflation rate reported by the Turkish Statistical Agency (TUIK) reached 64.3 percent in December 2022. For two successive months consumer price inflation (CPI) increased at a slower pace after reaching a record level of 85.5 percent in October. The December decline was the fastest in the past 22 years. But any suggestion of a success story unfolding would be premature. Inflation having plateaued at such an elevated level underlines how much it still has to decline before reaching levels that Turkey could share with neighbouring countries in Southeast Europe. The underlying trend of price inflation in Turkey remains far too high for any comfort to emerge among citizens and businesses. Even if CPI reaches annualized 30 percent during the first quarter of 2023, it still constitutes a mountain to climb (or come down from)!

Another macro-economic indicator also lost momentum, potentially pointing to darker clouds ahead in 2023. Third quarter GDP in 2022 fell to 3.9 percent year-on-year from a staggering level of 7.7 percent in Q2 2022. The Q3's reading may in fact be related to the CPI developments during the first half of 2022. Many private households and businesses were preoccupied with navigating the rising costs of inflation, thus putting investments on hold and curtailing consumer expenditure.

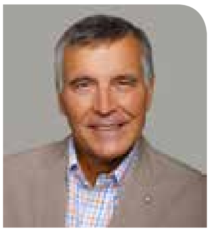
Despite the first signs of declining price pressures in the Turkish economy, the level of over 60 percent points to the risks of CPI becoming structurally entrenched in terms of expectations among consumers and businesses. To what degree this process is already under way is reflected in another macro-economic indicator, namely the dramatic, multi-year decline in the value of the Turkish lira vis-à-vis the USD. After having lost 44 percent in nominal value during 2021, the devaluation of the domestic currency against the benchmark USD continued unabated in 2022, declining a further 29 percent.

In an economy that is heavily tilted towards dollarization, the combination of currency volatility and entrenched price inflation has painful consequences. Real wage losses on a monthly basis characterized the experience of large constituencies of the Turkish population in 2022. The decline in disposal income among the citizenry can hardly be compensated by various minimum wage increases executed by the government in Ankara or auxiliary wage increases by those businesses that have the financial means available, e.g. export-oriented companies with foreign currency revenue.

Outlook 2023

Whatever the outcome of the forthcoming double elections in Turkey, a revised policy roadmap will be necessary. Domestic economic challenges and geopolitical tensions exclude the notion of business as usual. Even if Erdoğan were to be re-elected, key issues demand short- and medium-term adjustments. These include:

- There is a plausible urgency to identify measures aimed at reducing price inflation. This will require a critical decision making process inside the central bank when and by how much a policy of interest rate hikes commences. The rational for such a policy reversal will be key because it would mark the return to institutional independence of the monetary authorities.
- As a net energy importer, Turkey was directly affected by the considerable price swings we witnessed during 2022. Fossil fuel imports from Russia increased consistently. Moscow and Ankara agreed that part of the Russian bill can be paid in rouble. The outreach to Russia, including the construction of nuclear reactors and to China regarding a coal-fired power plant is viewed with alarm in Washington, Brussels and Berlin. Ankara's rejection of economic and financial sanctions against Russia adds to this widening policy cleavage.
- With regard to the region of Southeast Europe, bilateral relations between Turkey and Greece will be key. A return to dialogue and the de-escalation of rhetoric emanating from Ankara is the least that NATO members are hoping for. NATO, the U.S. administration and to a lesser degree the EU have leverage vis-à-vis Turkey, e.g. as regards arms procurement, hard currency needs and commercial trade. Repeated efforts to see a break in the clouds where none existed in 2022 are in high demand for 2023.



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