Inflation Surge in Turkey: Navigating Through this Economic Turmoil

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Abstract:- This paper examines the economic shifts in Turkey during Recep Tayyip Erdogan's presidency (2014-present). Initially marked by stability and growth through AKP-led reforms, Erdogan's tenure took a controversial turn after a failed 2016 coup, resulting in strained international relations and economic repercussions. Erdogan's constitutional changes in 2017 concentrated presidential power, with his unorthodox economic approach causing severe instability in 2022, including an 80% inflation rate. The paper analyzes the economic consequences, emphasizing Erdogan's decision to decrease interest rates during inflation. It also explores Turkey's recent policy reversal, where a dramatic interest rate hike, the first since March 2021, aims to address the soaring inflation. The research provides insights into Erdogan's economic legacy and the challenges facing Turkey's future stability.

Keywords:- *Inflation, Interest Rates, Fx Rate, Sectors, Lira, Monetary.*

I. INTRODUCTION

Turkey, officially the Republic of Turkey, is a transcontinental country connecting Europe and Asia on the Anatolian Peninsula. It is surrounded by the Black Sea, Mediterranean Sea, and Aegean Sea, with Istanbul as its largest city. Boasting a population of 85.8 million and a GDP of 819 billion USD, Turkey is a global leader in agriculture, textiles, and electronics. As a member of the G20, it plays a pivotal role in the world economy. Germany, the UK, the United States, Iraq, and Italy are its major export partners, while China, Germany, Russia, and the United States are key import partners. Recep Tayyip Erdogan, Turkey's 12th president since 2014, previously served as the 25th prime minister and was re-elected in July 2018.

- Average inflation rate from 1960 to 2022 - 32.6%
- Fx rate compared to dollar - 1302.07% increase since 2013

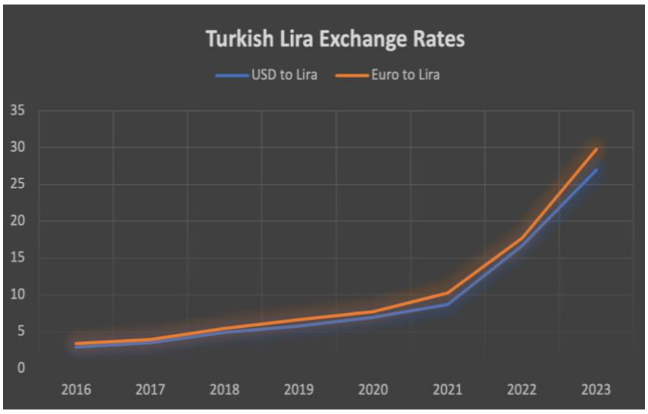

Fig 1: Turkish Lira Exchange Rates – USD to Lira & Euro to Lira (2016 – 2023)

II. BRIEF SUMMARY OF THE TURKSH ECONOMY

Before Erdogan got elected as president in 2014, Turkey's economy was experiencing significant growth and transformation. A number of reforms had been introduced by the Justice and Development Party (AKP), which was led by Erdogan. However, these reforms actually stabilized the Turkish economy, brought millions out of poverty, ended discrimination of students in religious high schools etc. The economy of Turkey seemed to be growing at a rapid pace during Erdogan's tenure as Prime Minister, however, his election as president was marked with controversy and criticism. In 2016, a faction of the Turkish military launched a coup to topple Erdogan's government. The failure of this coup attempt resulted in the arrest of American pastor Andrew Benson. This resulted in the Trump administration imposing further sanctions on Turkey, and stopped buying steel from Turkey. Erdogan introduced a constitutional referendum in 2017, which proposed changes to the Turkish constitution and converted Turkey's current parliamentary system into a presidential one, increasing Erdogan's authorities as president. Erdogan's most significant impact as President was his unorthodox approach to the economy, leading to large scale inflation in Turkey. When Turkey began to experience inflation and currency devaluation, Erdogan made the economically incorrect decision of decreasing interest rates instead of increasing them. This led to extreme financial instability in Turkey in 2022, with inflation rates soaring up to around 79%. Turkey is currently hiking inflation rates (currently at 61%) in an effort to reduce inflation. This is the nation's first hike in interest rates since March 2021.

Average Inflation Rates in Turkey – Year by Year Analysis

2018	-	16%
2019	-	20%
2020	-	11%
2021	-	18%
2022	-	79%
2023	-	38%

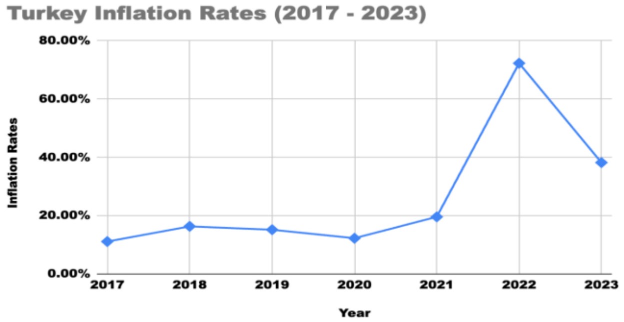

Fig 2: Line chart depicting average inflation rates in Turkey (2017-2023)

III. ERDOGAN'S UNORTHODOX INTEREST RATE POLICY

Since the beginning of 2021, Turkey has experienced a severe currency crisis, which many people attribute to Erdogan's unconventional belief that lowering interest rates will decrease inflation. Traditional economic thinking calls for quite the opposite - a rise in interest rates will aid in reducing inflation and controlling price increases. Turkey's central bank cut inflation rates for the third consecutive month in October 2022, resulting in extremely high inflation that continues to pinch people's finances. In September 2022, Turkey's inflation rate had reached a startling 83.45%, making it extremely challenging for people to purchase basic necessities. Erdogan asserts that he will continue to lower interest rates every day for as long as he is president, disregarding the opinions of his fellow citizens and other economists. Erdogan believes that the economy will only develop and grow when single digit interest rates are in effect. Households and businesses continue to struggle financially as rising grocery prices and utility bills continue to squeeze their finances. A weaker currency will mean that Turkey will have to pay more for imported raw materials, which it is heavily dependent on.

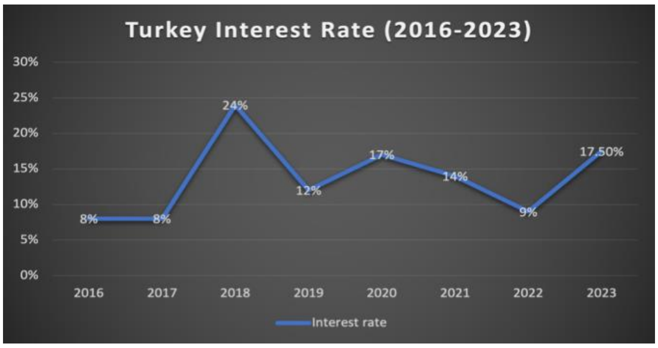

Fig 3: Line chart depicting average interest rates in Turkey (2016-2023)

IV. MONETARY POLICIES

Monetary policy involves decisions aimed at shaping the availability and cost of money to achieve goals like economic growth, employment expansion, and price stability. In Turkey, the Monetary Policy Committee (MPC) makes these decisions during scheduled meetings.

After the crash and collapse of the Lira in 2001, Turkey implemented a floating exchange rate regime in early 2001. This change from the pegged currency regime to a floating exchange rate regime was decided by Turkey's Central Bank and government. Under this regime, the value of the Lira is dependent by supply and demand and can openly fluctuate depending on the condition of the market.

In 2006, the CBRT (Central Bank of the Republic of Turkey) implemented a full fledged inflation targeting regime which revolves around adjusting monetary policies to achieve a specified annual rate of inflation.

Following the implementation of these two major reforms, from 2002 to mid 2008, the Turkish economy grew by over 5% and inflation declined dramatically. However during the Global Financial Crisis in 2008, Turkey's economy and exports were severely hit. In the end, there was a collapse in foreign demand for Turkish products and services, turmoil in global financial markets and increased unpredictability.

Over the past few years, the CBRT's unorthodox monetary policies influenced by Erdogan have continued to depreciate the Lira and squeeze people's finances. In the first few months of 2023, the CBRT has doubled down on its unorthodox monetary policy stance, with further decrease in interest rates and new macroprudential measures which aim to increase the economy's resilience to financial shocks.

V. REFUGEES IN TURKEY

Turkey accommodates four million refugees and has held the title of the world's largest host of refugees for the past nine years. The majority of these refugees are Syrian refugees fleeing from the Syrian Civil War. More than a third of these Syrian refugees are hosted in Southeastern Turkey near the Syria-Turkey border. Turkey shelters a significant number of refugees from Russia, Iraq, Venezuela, and Iran due to reasons such as armed conflict, ethnic intolerance, religious fundamentalism, and political tensions in their respective home countries.

Turkey thus incurs high expenses to take care of the refugees. This includes expenses on housing, education, employment and health. These major expenses have had a pretty significant impact on Turkey's economy, resulting in an increase in prices of property and food, and an increase in the employment rate due to lack of jobs for refugees.

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VI. IMPACT ON MAJOR SECTORS

➢ *Financial Sector:*

- Traditionally, inflation has a drastic impact on the financial sector due to an increase in inflation rates, subsequently tightening the monetary policies. The borrowing costs would also increase, affecting a company's lending power. However, since Erdogan made the unorthodox decision of decreasing interest rates rather than increasing them, the financial sector has not been affected as adversely as one would expect.
- Lower interest rates means that consumers will have a greater amount of spending money in their pockets rather than stored in the bank. This also means that there will be more consumers willing to spend money, leading to an increase in demand. Lower interest rate means lower borrowing costs businesses, encouraging economic activity and boosting the demand for funding and loans from financial institutions.
- With an increase in the number of refugees, the demand for loans and funding from financial institutions in Turkey has never been greater. Thus, it is fair to say that the ongoing hyperinflation in Turkey has been quite beneficial to the financial sector.

➢ *Pharmaceutical Sector:*

- Due to rising inflation, major pharma companies are seeing higher costs for raw materials and are expecting a decline in profit margins. They are also facing increased pressure on drug pricing and higher energy costs.
- Some of the biggest pharma companies in Turkey by sales are Ibrahim ($420 million), Novartis ($350 million) and Pfizer ($300 million).
- The Turkish Government has launched numerous reforms to promote the growth of the pharma industry during such times of inflation, such as tax incentives and establishment of trade free zones. The government has also increased people's access to healthcare services by increasing the number of clinics and hospitals in the country.

➢ *Insurance Sector:*

- Some of the top insurance companies in Turkey are - Alianz Sigorta, Acıbadem Sağlık ve Hayat Sigorta and Aksigorta.
- This period of heavy inflation in Turkey will result in insurance companies experiencing higher claims payouts and higher operating costs. This would result in more expensive coverage prices for consumers, causing numerous consumers to drop their coverage or switch their insurance to cut down on costs.

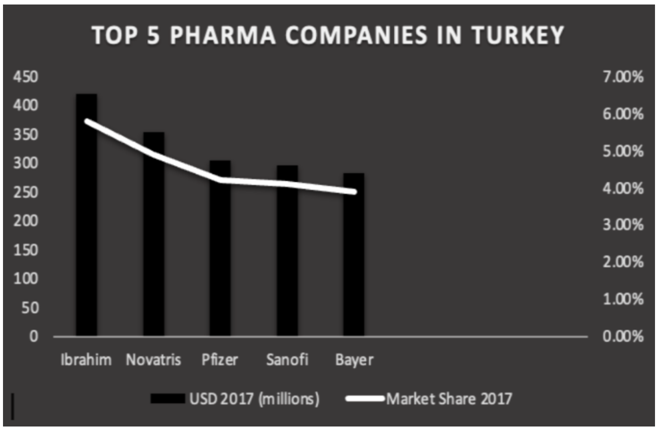

Fig 4: Revenues and market shares of top 5 pharmaceutical companies in Turkey (2017)

VII. CONCLUSION

Inflation has persisted in Turkey for several years, yielding widespread repercussions. President Erdogan's unconventional economic strategies have induced rapid fluctuations in inflation rates, putting a strain on individuals' finances. Tackling this issue necessitates a comprehensive approach and a reversal in Erdogan's economic stance. Currently, Turkey's foreign exchange reserves are nearly depleted. In 2023, the central bank expended approximately $25 billion to offset a substantial account deficit and stabilize the fluctuating lira. Loans are now predominantly sourced from Gulf countries like the UAE. In recent months, there has been a discernible shift in President Erdogan's monetary policy as he incrementally raises interest rates. Consequently, the crisis-ridden nation may be on the path to a financial recovery sooner than anticipated.

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