



R&R Weekly Column
By Brunello Rosa



Turkey Caught Between Risks of a Financial Crisis and Hopes For a More Orthodox Economic Policy

We have often written about Turkey in the last few weeks. The catalyst for this has been the [presidential and parliamentary elections that took place in May](#), the first round held on the 14th and the second round on the 28th. [In our initial preview](#), we asserted that a period of change, and potentially instability, could emerge during the election period. That would have been exacerbated by a potential victory for the leader of the wide-ranging coalition that opposed incumbent president Recep Tayyip Erdoğan, which was led by Kemal Kılıçdaroğlu.

In [our review](#), we discussed how Erdoğan managed to win his third mandate, and his third decade in power, with a narrow (52%-48%) victory over his opponent in the presidential race. Erdoğan maintained a comfortable majority with his nationalistic allies of the MHP, further indicating what might be lying ahead for Turkey, in terms of the country's policies. Finally, [in our column for last week's ViewsLetter](#), we discussed the appointment of [Mehmet Şimşek as the new finance minister](#). Turkey is again in the news this week, for the appointment by Erdoğan [of the new central bank governor](#).

Turkey is an important country to watch, for a number of reasons. *First*, from a geopolitical perspective, Turkey has long tried to become the intermediary to broker a Russia-Ukraine conflict. Being a NATO country, Turkey can reassure Ukraine that Russia will be opposed in its most outrageous territorial requests. At the same time, Erdoğan has attempted to keep an open relationship with Vladimir Putin, even after the beginning of the war. Long gone are the days in which the two leaders were at loggerheads over the issue of the Russian fighter jet downed by a Turkish warplane, back in 2015. [Erdoğan instead brokered a U.N-backed deal on grain exports from Ukraine](#) when the risk existed of a devastating food crisis in emerging markets, especially in Africa.

Second, Turkey sits at the boarder of several political fault-lines. It is the gateway between Europe and the Middle East and Asia, being an Islamic country but with secular institutions established by Mustafa Kemal Atatürk – the first Turkish president. At the same time, it is also a primary example of the ongoing phenomenon of the [“autocratization” of democracies](#), with Erdoğan having also brought back the respect for Islamic rules in public affairs, though short of re-establishing the Shari'a.

Finally, Turkey is at the centre of attention of financial markets, given the sharp depreciation of the Turkish lira observed in the last few years. The [USD/TRY exchange rate moved from 1.18 to 23.4](#) between 2008 and 2023. This is the end result of the un-orthodox economic policies introduced by Erdoğan over the last few years, which have [been branded “Erdonomics.”](#) The most notorious and controversial of these has been the reduction of interest rates carried out in the last few months, which have led to a sharp increase in inflation, which has reached 85.5% y/y recently (before “easing” back to 40%). Erdoğan was in fact convinced that an increase in interest rates would lead to an *increase* in inflation rather than a *reduction*, as economics textbooks would traditionally say. (Erdoğan's rationale being that, when the inflation basket is dominated by administered prices, an increase in rates would lead to an increase in these administered prices).

During his years as president, Erdoğan has appointed several central bank governors, [including five in the last four years](#), until he found someone willing to follow his lead on these policies. At the same time, in the past he appointed his son-in-law Berat Albayrak as Finance Minister, to replace the well-respected Mehmet Şimşek. The result of this has been fiddling economic growth, rampant inflation, a large current account deficit (4.5% of GDP) and a collapsing currency. The failed attempts to prop up the currency have resulted in [the depletion of foreign exchange reserves](#), and the explosion of bank [deposits protected against TRY devaluation](#) (which reached USD 92bn in April 2023), which is a clever way to mask foreign currency debt. This is the recipe for a financial crisis to occur sooner rather than later.

Facing that, Erdoğan has decided to change tack, at least on economic policies, soon after his re-election as president at the end of May. As we discussed last week, he re-appointed Mehmet Şimşek as Finance Minister, who promised transparency and accountability. Last week, he appointed Hafize Gaye Erkan as the new central bank governor. Ms Erkan is a well-respected figure in financial circles, having worked for several years at Goldman Sachs after graduating from Princeton, and recently as Deputy CEO in charge of risk management (her specialisation) at First Republic, the now-disgraced American bank that was once considered innovative. Her last stint at First Republic, which failed because – among other reasons – of inadequate risk-management practices and a poor business model, clearly makes her appointment controversial. At first sight investors are likely to approve of the move, however.

In fact, more than the presence of these two figureheads that can reassure markets, the real question is whether they will be left with the freedom to adopt the orthodox policies the country needs to avert a financial crisis in short order. If so, we should soon observe a re-appreciation of the TRY. But if instead they are asked to continue following unorthodox policies, a financial crisis appearing on the horizon will be more likely than not.

Our Recent Publications

📖 [Spanish Elections: Uncertainty and Polarization - Analysing Spanish Politics After The Regional And Local Elections](#), by London Politica, 7 June 2023



📖 [Assad's Visit to Jeddah Marks The Return Of Syria To The Arab League](#), by Gulf State Analytics, 2 June 2023

Looking Ahead

The Week Ahead: EZ And US Headline And Core Inflation To Decrease; UK Unemployment Rate To Rise; CBs To Remain Hawkish

In the US, in May, headline and core inflation are expected to fall to 4.1% y-o-y (*p*: 4.9%) and 5.3% y-o-y (*p*: 5.5%). In May, retail sales are seen contracting by 0.1% m-o-m (*p*: 0.4%).

In the EZ, in May, headline inflation is seen easing off to 6.1% y-o-y (*p*: 7.0%). Core inflation is likely to fall to 5.3% y-o-y (*p*: 5.6%). April's IP is seen increasing by 0.8% y-o-y (*p*: -1.4%).

In the UK, in April, the unemployment rate is expected to edge up to 4.0% (*p*: 3.9%). IP is likely to shrink by 1.7% y-o-y (*p*: -2.0%).

CBs are expected to remain hawkish. In the US, the Fed is expected to maintain its target Fed funds range at 5.0% - 5.25%. In the EZ, ECB is expected to raise its main policy rates by 25 bps, with the deposit rate reaching 3.50%.

The Quarter Ahead: The Collapse Of Kakhovka Dam; War In Ukraine; Trump Indicted In the "Classified Documents" Case

The collapse of Kakhovka dam in Ukraine triggers an emergency. According to the senior administration official, U.S. intelligence agencies remain unable to present concrete evidence identifying the perpetrator behind the destruction. Meanwhile, Kyiv and Moscow both blame each other for the attack. Ukraine's security service says it has proof Russia blew up the dam.

War in Ukraine. According to U.S. intelligence officials, Iran is assisting Russia in establishing a drone manufacturing facility, indicating an ongoing enhancement of military cooperation and weapons support between the two countries. Putin says Ukraine's counteroffensive has begun but is failing so far.

Former President Trump has been charged with mishandling classified documents. Classified documents, which contained sensitive information about the covert U.S. nuclear program and possible domestic vulnerabilities in case of an attack, were mishandled by Trump. Trump is said to be engaged in actions to preserve classified documents that had been subpoenaed by the DOJ.

Boris Johnson quits parliament, reigniting profound divisions within the governing Conservative Party just ahead of a general election expected to take place next year. He claims he was "forced out of Parliament" over Partygate.

Last Week's Review

Real Economy: EZ Economy Entered Recession; Retail Sales Contracted In EZ; Composite PMIs Rose In US, While Fell In EZ And UK

In the US, in May, HCOB Services and Composite PMI edged up to 54.9 (*c*: 55.1; *p*: 53.6) and 54.3 (*c*: 54.5; *p*: 53.4) respectively.

In the EZ, in Q1, according to the third estimate, on a quarterly basis, GDP growth shrank by 0.1% (*c*: 0.0%; *p*: -0.1%). The economy decelerated by 1.0% y-o-y (*c*: 1.2%; *p*: 1.8%). In April, retail sales shrank by 2.6% y-o-y (*c*: -3.0%; *p*: -3.3%). In May, HCOB Services and Composite PMI edged off to 55.1 (*c*: 55.9; *p*: 56.2) and 52.8 (*c*: 53.3; *p*: 54.1) respectively.

In the UK, in May, S&P Global Services and Composite PMI decreased to 55.2 (*c*: 55.2; *p*: 55.9) and 54 (*c*: 53.9; *p*: 54.9) respectively.

Financial Markets: Stock Prices And Bond Yields Increased; Dollar Index Fell; Oil Prices Decreased, While Gold Prices Increased

Market Drivers: Investors turned their attention towards the imminent inflation data and the latest policy announcement from the Fed, resulting in a rise in stocks. Following the Bank of Canada's decision to increase interest rates, there was a sell-off of U.S. Treasuries. In response to the latest week's data revealing higher-than-anticipated U.S. jobless claims, the dollar experienced a decline.

Global Equities: Increased w-o-w (MSCI ACWI, +1.6%, to 667.08). The US S&P 500 index edged up (+0.4% w-o-w, to 4,298.86). In the EZ, share prices were up (Eurostoxx 50, +0.6% w-o-w, to 4,289.79). In EMs, equity prices moved up (MSCI EMs, +1.8%, to 1002.33). Volatility declined to 15.2 (VIX S&P 500, 52w avg.: 24.6; 10y avg.: 18.5).

Fixed Income: w-o-w, the 10-year US treasury yields were up (+5 bps to 3.74%). The 2-year US Treasury yields also increased (+9 bps to 4.60%). The German 10-year bund yield edged up (+7 bps to 2.37%).

FX: w-o-w, the US Dollar Index fell (DXY, -0.4%, to 103.53; EUR/USD +0.4%, to 1.07). In EMs, currencies increased (MSCI EM Currency Index, +0.2% w-o-w, to 1,688.39).

Commodities: w-o-w, oil prices decreased (Brent, -1.4% to 75.04 USD/b). Gold prices rose w-o-w (+0.3% to 1,975.90 USD/Oz).



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The picture in the front page comes from [this website](https://www.rosa-roubini-associates.com)



Abbreviations, Acronyms and Definitions

a	Actual	LN	Northern League, Italy
AKP	Justice and Development Party, Turkey	MSS	Five Star Movement, Italy
ann.	annualized	m-o-m	Month-on-month
ARS	Argentinian Peso	mb	Million barrels
avg.	Average	mb/d	Million barrels per day
bn	Billion	MENA	Middle East and North Africa
BoC	Bank of Canada	MHP	Nationalist Movement Party, Turkey
BoE	Bank of England	mn	Million
BoJ	Bank of Japan	MPC	Monetary Policy Committee
bpd	Barrels per day	NAFTA	North-American Free Trade Agreement
bps	Basis points	NATO	North Atlantic Treaty Organization
BS	Balance sheet	OECD	Organization for Economic Cooperation and Development
c	Consensus	Opec	Organization of Petroleum Exporting Countries
C/A	Current account	p	Previous
CB	Central bank	P2P	Peer-to-peer
CBB	Central Bank of Bahrain	PBoC	People's Bank of China
CBK	Central Bank of Kuwait	PCE	Personal Consumption Expenditures
CBT	Central Bank of Turkey	PE	Price to earnings ratio
CDU	Christian Democratic Union, Germany	PM	Prime minister
CNY	Chinese Yuan	PMI	Purchasing managers' index
CPI	Consumer Price Index	pps	Percentage points
DJIA	Dow Jones Industrial Average Index	pw	Previous week
DJEM	Dow Jones Emerging Markets Index	QCB	Qatar Central Bank
d-o-d	Day-on-day	QAR	Qatari Riyal
DXY	US Dollar Index	QE	Quantitative easing
EC	European Commission	q-o-q	Quarter-on-quarter
ECB	European Central Bank	RE	Real estate
ECJ	European Court of Justice	RBA	Reserve Bank of Australia
EIA	US Energy Information Agency	RRR	Reserve Requirement Ratio
EM	Emerging Markets	RUB	Russian Rouble
EP	European Parliament	SWF	Sovereign Wealth Fund
EPS	Earnings per share	tn	Trillion
EU	European Union	TRY	Turkish Lira
EUR	Euro	UAE	United Arab Emirates
EZ	Eurozone	UK	United Kingdom
Fed	US Federal Reserve	US	United States
FOMC	US Federal Open Market Committee	USD	United States Dollar
FRB	US Federal Reserve Board	USD/b	USD per barrel
FX	Foreign exchange	UST	US Treasury bills/bonds
FY	Fiscal Year	VAT	Value added tax
GCC	Gulf Cooperation Council	VIX	Chicago Board Options Exchange Volatility Index
GBP	British pound	WTI	West Texas Intermediate
GDP	Gross domestic product	WTO	World Trade Organisation
IMF	International Monetary Fund	w	Week
INR	Indian Rupee	w-o-w	Week-on-week
IPO	Initial public offering	y	Year
IRR	Iranian Rial	y-o-y	Year-on-year
JPY	Japanese yen	y-t-d	Year-to-date
k	thousand	ZAR	South African Rand
KSA	Kingdom of Saudi Arabia	2y; 10y	2-year; 10-year