Many Sides to the Coin in Turkey's Lira Crash

These days the Turkish lira is very much an embattled currency. The past week alone saw it lose 25% of its value, priced 0.20 per $1USD in 1 week. This on top of the fact in the past year the lira has been the worst performing currency in global markets, ultimately dropping by over half its value in the last 12 months.

To understand what has happened here, it's essential to recognize the long-term factors at play, alongside recent events.

Turkey's Domestic Challenges

Despite Turkey's strategic geopolitical influence, given its location between Europe and the Middle East, as well as its population size of 80million, it is also a nation that suffers a number of systemic challenges.

Markets are concerned that the wave of construction of the last years is coming to a halt and that high levels of debt in the private sector together with a rampant inflation rate of over 15% in the last year, are all placing pressure on Turkey's economy.

The political tensions surrounding President Erdogan, who after the failed coup of 2016 has aggressively consolidated his leadership by decreeing a State of Emergency in the country have only increased. The end of the State of Emergency on July 18th has fundamentally not improved investor confidence. Instability in government is rarely a recipe for strong economic growth.

Turkey Tariffs

The precipitation of the lira's crash in recent days is a result of the announcement via the White House that the U.S. would double its tariffs on Turkish steel and aluminum, ultimately rising to 50% and 20% respectively.

Similar to Erdogan, U.S president Donald Trump is a controversial figure at home and abroad.
This is undoubtedly the most immediate and fundamental reaction seen to date of President Trump's controversial policy of raising trade tariffs.

The clear takeaway from the events of the most recent days, is that tariffs have shown how vulnerable nations like Turkey are.

Paradigm Shifts

We are witnessing a shift in global trends away from globalization and a worldwide open mercantile economy. Since WWII, the Western world has strongly evolved towards consensus on the Liberal International Order, with free trade at its heart. The fall of the USSR in the early 1990’s has only accelerated the spread of this single triumphant economic model.

Since the 90s, we’ve had the luxury of living in relative political stability, where our main concern was the state the economy and financial markets.

More recently however, we are facing new and material threats to the established world order. Brexit, China’s aggressively expanding sphere of influence, Russia’s rekindled military ambitions and Donald Trump’s aggressive foreign and trade policies are all clear signs of a new threat to the aforementioned stability. This developing economic crisis in Turkey is more than just a financial crisis.

Irrespective of Turkey’s clear economic challenges, the political arm-wrestling with the United States on many levels, including the release of Pastor Andrew Brunson and its purchase of a missile defense system from Russia, are exasperating this crisis.

President Erdogan may yet have to consider options he fundamentally doesn’t like such as allowing the Turkish Central Bank to raise interest rates, adopt austerity measures or decrease his demagoguery. Whatever he chooses, unfortunately at this late stage, a recession of the Turkish economy seems unavoidable.

The Ripple Effect

Beyond Turkey, there could be wider global implications. It would not be misplaced to fear a ripple effect of the Turkish currency crisis on other emerging markets. We shouldn’t be surprised if heads of Central Banks in countries such as India, South Africa or Brazil are watching the developing situation in Turkey very closely with their own vulnerabilities in mind.

Similarly, the Turkish crisis will be on the forefront of the agenda of the executives at the IMF, World Bank and EBRD.