Is 2018 a Year of Economic Crisis in Turkey?

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Abstract:

The objective of this paper is to examine the nature and extent of the negative economic developments since August 2018 against the background of different views on these developments range from those who regard them as a signal of a deep and continuous crisis to those who describe them as a financial turbulence resulting from external factors. Under those explanations, the paper will address the following question: to what extent the year 2018 in Turkey represents a crisis year. In the study, the information will be derived from newspaper and journal articles as well as from interviews conducted with observers from different sections of the Turkish economy. The paper will be organized as follows: In section 1, the immediate effects of these developments will be discussed with some suggestions about ways and means to get out of the impasse In section 2, the views of economists with different perspectives on the causes of negative developments in and around 2018 will be examined. Finally, section 3 summarizes and concludes.

Keywords: Turkey, Outlook, Recession, Crisis

JEL Codes: A11, E66, P16

Introduction

Turkey has experienced high growth rates thanks to short-term financial flows since 2008, however economic growth slowed down in recent years since Turkey as a developing country has faced problems like declining capital flows and slowing global trade. In this context, Turkish banks and large firms borrowed mainly from foreign investors in US dollars, making Turkey vulnerable to changes in the global economy. For example when the US Federal Reserve started increasing its interest rates in 2013, investors became more reluctant to invest in Turkey. In addition, investor perceptions of Turkey changed negatively since political tensions with the EU countries and US gained momentum. These factors were behind the depreciation of the Turkish lira after 2013. This culminated in the severe depreciation of the US dollar/TL parity rising sharply from 4,9223 to 6,8798 in August 2018.

On the back of growing tensions between the US and Turkey about detainment in Turkey of an American pastor whose full release President Trump requested, these developments were accompanied by rising current account deficit and inflation. This request was followed by an increase in the US tariffs on Turkish exports of iron and steel. President Erdoğan described this sequence of events as an economic attack on Turkey rather than an economic crisis. Fears were expressed in some quarters that Turkey would be unable to service its external debt and would seek help from the IMF. Markets began to settle down in September after diplomatic tensions were resolved together with the release of the pastor and the Central Bank of Turkey sharply increased interest rates. However, the vulnerabilities that caused this set of negative economic developments have not yet fully disappeared. Severely depreciated domestic currency together with continued high rates of inflation, according to some observers is leading the Turkish economy to a recession.

There are different interpretations of the recent set of economic events in Turkey by different observers of the Turkish economy which can be classified under four different perspectives. Firstly, there are academicians such as Dani Rodrik, Daron Acemoğlu, Asaf Savaş Akat, Erinç Yeldan, Galip Yalman, Ömer Faruk Çolak, Seyfettin Gürsel, Osman Aydoğuş, Murat Üçer and Ümit Akçay who describe these events as an economic crisis. However, those academicians differ from each other in their interpretation of the causes of the crisis. Some of them (Daron Acemoğlu, Erinç Yeldan, Asaf Savaş Akat, Dani Rodrik, Korkut Boratav, Ömer Faruk Çolak, and Seyfettin Gürsel) argue that economic vulnerabilities caused it, while some of them (Korkut Boratav, Mustafa Sönmez, Dani Rodrik, Daron Acemoğlu) also link the crisis with the existing political regime in Turkey. In addition, there are academicians (ÜmitAkçay, GalipYalman) who identify the cause of the crisis as the transformation of the capitalist state since the 2008 global economic crisis. As oppose to them, there are also academicians such as Nurullah Gür, MevlütTatlıyer, Şerif Dilek and Deniz İstikbal who explain the negative turn of economic indicators mainly if not solely to external factors rather than domestic economic and political factors.

The objective of this paper is to examine the nature and extent of the negative economic developments since August 2018 against the background of different views on these developments range from those who regard them as a signal of a deep and continuous crisis to those who describe them as a financial turbulence resulting from external factors. Under those explanations, the paper will address the following question: to what extent the year 2018 in Turkey represents a crisis year. In the study, the information will be derived from newspaper and journal articles as well as from interviews conducted with observers from different sections of the Turkish economy.

The paper will be organized as follows: In section 1 after this introduction, the immediate effects of these developments will be discussed with some suggestions about ways and means to get out of the impasse In section 2, the views of economists with different perspectives on the causes of negative developments in and around 2018 will be examined. Finally, section 3 summarizes and concludes.

Impacts of the Deteriorations since August 2018

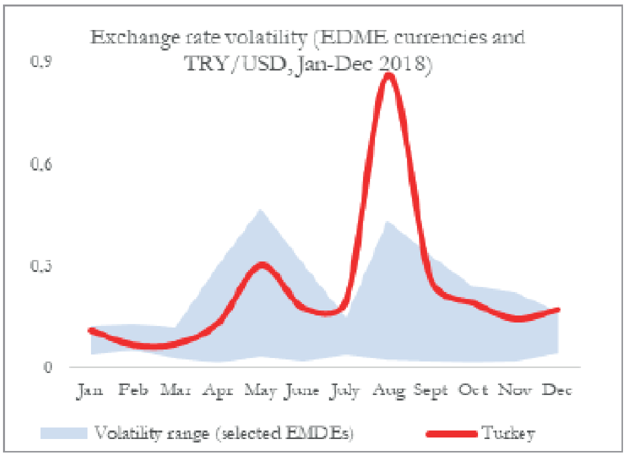
There are certain impacts of the shock increases in exchange rate on the economy since August 2018. Although economy experienced 7,3 percent economic growth in the first quarter of 2018, together with the slowdown in the foreign capital inflows in 2018, pressure on the foreign exchange rate resulted with the shock and sharp increases in foreign exchange rate on May and

August 2018. This affected economic growth is at 5,2 percent in the second quarter and 1,6 percent in the third quarter of 2018. (Ölmezoğulları, 2018).

World Bank Report in December 2018 analyses the impacts of the sharp foreign exchange increases in Turkey since August 2018. According to the report, Turkey experiences market volatility in recent years like in other developing countries and this volatility have been affected negatively by sharp increases of the exchange rate in real sector through high inflation, falling demand, and big supply side corrections like elevated corporate debt with foreign exchange exposure. On sectoral basis, non-tradable sectors are the worst affected while manufacturing sectors remain buoyant. In addition, rising corporate stress has exacerbated also banking sector vulnerabilities (World Bank, 2018). In this regard, impacts of the foreign exchange crisis can be analysed briefly under foreign exchange volatility, current account balance, change in inflation level, impacts on the corporate sector and households.

(World Bank, 2018)

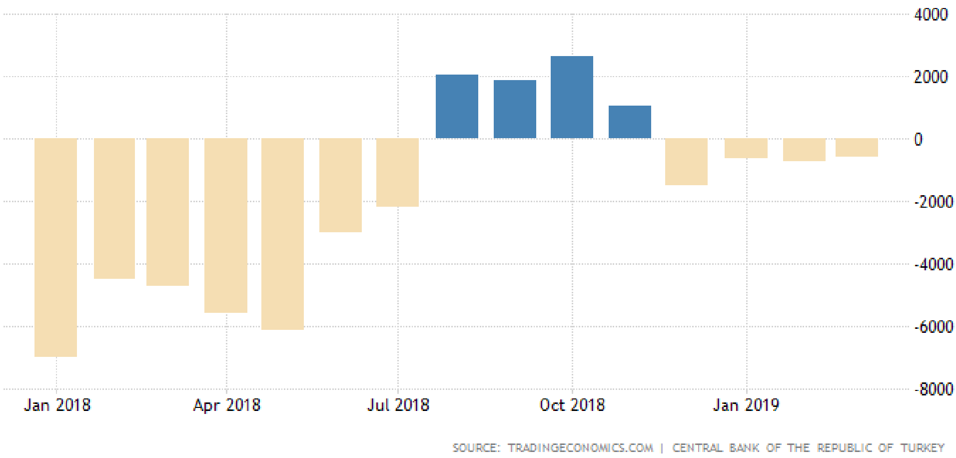
Firstly, how exchange rate changed in 2018 year is clearly shown in the graph. It is clearly seen that there is sharp increase in the exchange rate on August compared to other months. Turkish Lira depreciation in August 2018 is 7,2 TRY/USD. When it compared to the beginning of the year 2018, Turkish Lira has depreciated as 50 per cent (World Bank, 2018).



Sources: Haver Analytics, WB Staff estimates
Notes: Annualized volatility estimate. EDMEs in range include Argentina, Brazil, Russia, RSA, Malaysia, Indonesia, India, Mexico

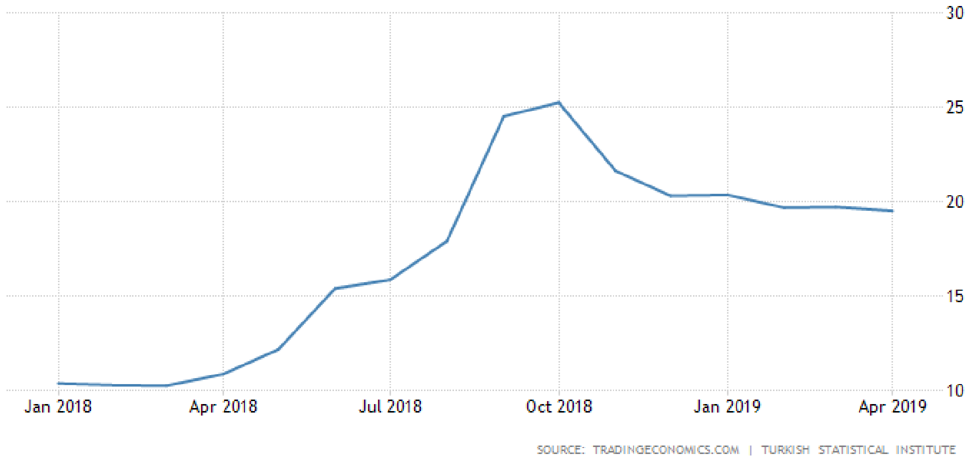
(World Bank Report, 2018)

Secondly, below graph shows how current account balance have changed with respect to depreciation of the Turkish Lira. Before August, there were large current account deficits in the economy, but it turns out to surplus in August, September, October and November 2018. For this change, World Bank report states that exchange rate depreciation and falling domestic consumption and investment have contributed to a sharp deceleration in import demand, while exports have accelerated. These developments shifted the current account deficit to surplus in August, September and October 2018, reducing to some extent pressures on external financing needs (World Bank, 2018). Then, it is also seen that current account balance turns back to deficit again since beginning of 2019, but in a small amount.



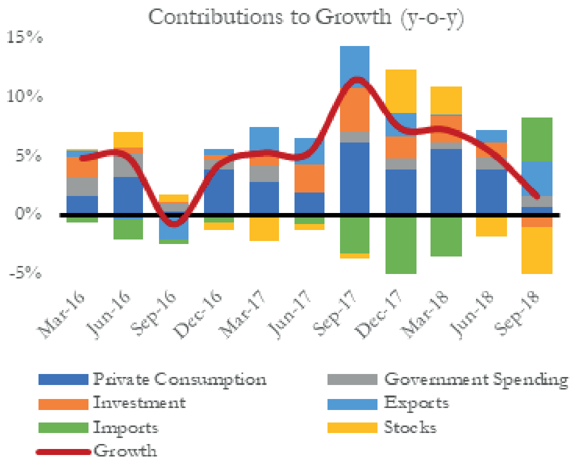
(Tradingeconomics, 2019)

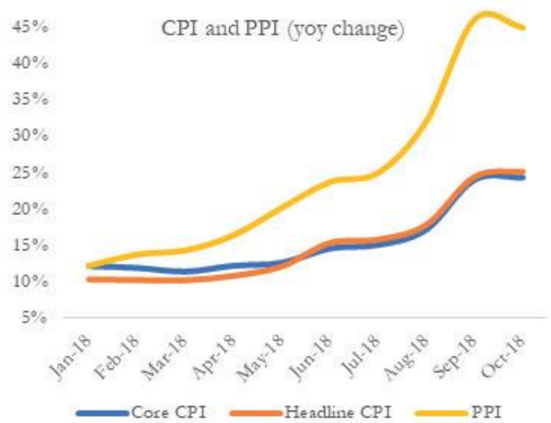
Impact of the depreciation in the Turkish Lira can also be seen in the change of inflation level. It shows that there is a sharp acceleration in inflation. Year-on-year consumer prices increased by 25 percent in September and these levels have not seen since the 2001 crisis in Turkey (WorldBank, 2018).



(Tradingeconomics, 2019).

For a detailed information, it can be seen in the below graph that the gap between consumer and producer price inflation increased significantly depreciation of TL. According to the report, this reflects suppliers' inability to pass on price increases to consumers because consumer demand also decreases in the face of exchange rate shocks. It is seen that producer price inflation peaked at 46 percent in September result of the effects of exchange rate depreciation. Private consumption decreases to 1.1 percent yoy growth and investment contracted to -3.8 percent yoy growth (World Bank, 2018).





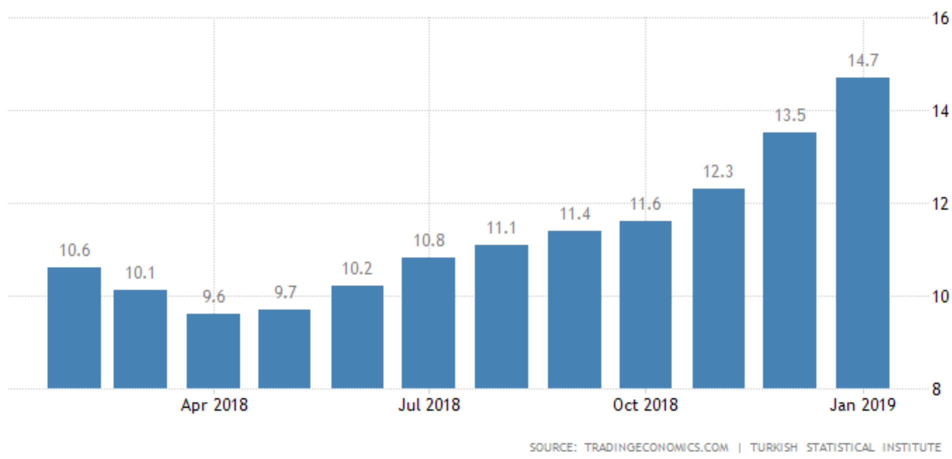
The report also analyses how corporate sector has affected since August 2018. Corporate debt in Turkey has risen sharply since the Global Financial Crisis in 2008. It is argued that severe depreciation on TL led to high increase in corporate debt and thus, it has raised corporate solvency and liquidity concerns in Turkey and non-tradable sectors with mostly foreign exchange debt are vulnerable to the recent currency shock. The situation is exacerbated by credit rationing, that is, it became more difficult for corporate to access finance for rising working capital needs. This has resulted in a rapid rise in corporate debt restructuring demands in the past months, including under the newly established Concordat process.

Currently, Turkey’s external debt stock is 444.878 Million Dollar. Private sector has 298.393 Million dollar and public sector has 140,562 Million dollar in this debt stock (Hazine ve Maliye Bakanlığı, 2019). The World Bank report shows that Turkey has one of the highest corporate debt to GDP ratios, rising from 56 percent of GDP at the end of 2014 to 77 percent in quarter three of 2018. In addition, around 90 percent of the increase in Turkey’s corporate debt for this period resulted from the increase in the foreign exchange debt and around 65 percent of corporate debt to GDP is foreign exchange denominated by 2018. In the public sector, it is noted that government lending is expanding rapidly year-on-year, standing at 60 percent higher than previous year (World Bank, 2018).

The sectors concentrated on foreign exchange (FX) debt are also analysed in the report. According to it, the highest concentration of foreign exchange loans is in the manufacturing sector as 29 percent of total FX loans, there is also high concentration in the energy sector as 12 percent of external FX loans and 7 percent of domestic FX loans, and the transportation and storage sector. It is also notated that FX lending to the construction sector has risen sharply in recent years as 10 percent of external FX loans and 13 percent of domestic FX loans (World Bank, 2018).

For the analysis of the impacts in the banking sector, the report states that cracks are beginning to appear on the asset quality side due to rising corporate stress in the banking sector. Banks’ capital adequacy ratio – available capital as a share of banks’ risk weighted assets, which provides a measure of banks’ ability to absorb losses – is high at 18.19; At the same time, Non-Performing Loans have been on an upward trend in recent months, reaching 3.47 percent as of October 2018, Loan growth has decelerated sharply in recent months due to the phase out of the credit guarantee scheme.

While analysing the impacts of deteriorations on the real sector, it is also notable that there is an increasing unemployment rate in the economy and currently, and now it is 14,7 percent n April 2019.



(Tradingeconomics, 2019)

Causes of Sharp Economic Deterioration in 2018

In this section, the causes of economic deteriorations which started as an exchange rate crisis in August 2018 in Turkey will be analyzed as put forward by economists with different perspectives. These causes will be classified under four perspectives as external factors, economic factors, political factors and deteriorations stemming from the accumulation regime.

External Factors

Firstly, there are views that blame the economic deterioration on external factors, describing them as an economic war rather than a crisis. For example, Berat Albayrak ,the Treasury and Finance Minister, has said "This is clearly an attack against the Turkish economy," (Daily Sabah, 12 August 2018). Likewise, President Recep Tayyip Erdoğan, after U.S. President Donald Trump raised U.S. tariffs on Turkish aluminium and steel imports from 20 to 50 percent" said that "Turkey is under siege in the economy, as in other areas," but "Turkey's economic dynamics are solid, strong and intact, and they will continue to be intact ". (Daily Sabah, 13 August 2018). Similarly, Mevlüt Tatlıyer argued that Turkey has one of the best economic indicators such as the public debt/ national income ratio. He further argued that there was no real reason for the sharp increase in the dollar/Turkish Lira parity. He blamed the US-based financial centres trying to discredit the existing Turkish government and using dissentive votes against it. (Güneş, 23 May 2018).

Airing views close to those expressed by government circles, observers such as Nurullah Gür, Mevlüt Tatlıyer, Şerif Dilek, Deniz İstikbal and Merve Yanartaş have in a publication titled *Economy in 2018*, argued that Turkey was faced with two serious financial attacks in May and August 2018. They challenge the view of some economists attributing the exchange rate shock to deteriorations in inflation and current account. Instead, they argue that serious speculative attacks led to the sharp increase in the exchange rate and that there were political factors behind it which stemmed from political tensions between US and Turkey. They identify the US demands for the release of pastor Andrew Brunson and threats to introduce sanctions against Turkey as major factors in this context. At the same time, in explaining the sharp depreciation of the Turkish Lira, they draw attention to the importance of additional factors such as the increase in US interest rates, trade wars started by the US and the increase in the geopolitical risks leading to a decrease in the foreign capital inflow to developing countries. Together with those global developments and tension between US and manipulative news gains Turkey in the West led to apprehension by foreign investors. According to these observers, speculators made attacks on the exchange rate under conditions of increased uncertainty and uneasiness and so they tried to increase their gains (Gür, Tatlıyer, Dilek, İstikbal, Yanartaş, 2018).

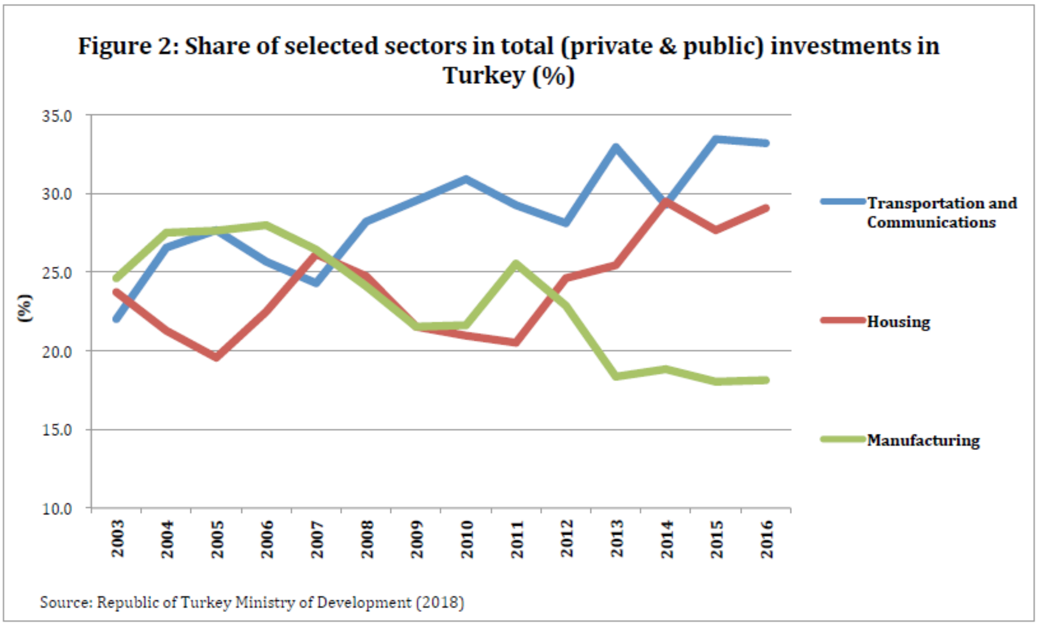
Economic Factors

As opposed to those interpretations, there are many commentators who view the negative economic developments as an economic crisis while having a common point of view in this economic crisis in Turkey being different from previous crises. However, they differ from each other in identifying the causes of this crisis.

First of all, among those observers who view Turkey's vulnerable economic structure has led to the crisis will be analyzed on the focus how economic deteriorations caused the crisis. According to European Economic Forecast, there were increasing signs that the Turkish economy fell into recession as a result of the rapid deteriorations in economic conditions. There were vulnerabilities in the economy such as the high current account deficit, increasing foreign liabilities, high and increasing inflation, high unemployment and deteriorating business environment. These factors as well as the change in investor sentiment towards emerging market economies following the rise in interest rates in developed countries became end point for recent crisis (European Economic Forecast, 2018).

Dani Rodrik has argued that the causes of negative economic developments arose from Turkey's unhealthy growth model. Since this model depends on external capital, especially short term capital inflows, current account deficit leads to a sudden brake in when markets become insecure (Durak, 2018). Korkut Boratav defines this crisis as a balance of payments crisis. He criticizes the dependence of developing countries on foreign capital inflows and argues that a slowdown or exit of capital from these economies leads to severe shocks and then to a crisis. He gives the examples of the 1997 Asian crisis, 1994, 1998-99, 2001 Turkish crises and 2008 global economic crisis for it. He shows that international capital flows to Turkey began to slow down after March 2018. Foreign capital inflows between March and May decreased 66 per cent compared to same period in 2017. Foreign capital inflow which stood at 16,3 billion dollars in March 2018 decreased to 5,6 billion dollars in May 2018 These developments were inevitably reflected in foreign exchange markets (Birgün, 30 December 2018).

According to CemOyvat (2018), the first reason of the downturn in Turkish economy is the chronic current account deficit problem in Turkey since the 2000s. He states that between 2010 and 2017, the current account deficit as a share of GDP was on average 5.6%, which is the highest amongst OECD and G-20 countries and this ratio increased to 6.7% in the first quarter of 2018. Congressional Research Service also argues that the easy access to foreign financing of Turkish banks and firms led to a large current account deficit between 2000 and 2017and this dependence also made the economy vulnerable to changes internally and externally (Congressional Research Service, 2018). In addition, Oyvat asserts that the large share of investments have not led to a structural technological change in industry that would have reduced the current account deficit problem since AKP governments did not develop efficient industrial policies. Instead it implemented policies that would boost growth through construction projects. According to him, after 2009, the government enacted a new urban development law introduced in 2012, and supported public housing investments of Mass Housing Administration. For example, capital was directed to massive infrastructure projects such as the construction of $10.2 billion new airport in Istanbul. Thus, the composition of investments shifted from industry to construction for him. Between 2005 and 2016, the share of manufacturing in total investment declined from 27.6% to 18.1%, while the share of housing increased percentage points from 19.8 percent to 28.5 percent(Oyvat, 2018).



Source: (Oyvat, 2018).

Another important factor behind the negative turn of events in the economy is related to the accumulation of gross external debt. According to Korkut Boratav, the Turkish economy has a fragile structure because of the increase in the firms' and banks' external debts and the need of foreign capital for financing the current account deficit (Birgün, 30 December 2018). Cem Oyvat argues that the gross external debt as a proportion of GDP increased from 36.7% in 2011 to 52.9% in the first quarter of 2018. He also emphasizes that this increase came from mainly from external indebtedness of the private sector. He also draws attention to the fact that the gross foreign currency reserves of the Central Bank was depleted from $112.0 billion in December 2013 to $78,3 billion in July 2018 and to $70,4 billion in August 2018, when Turkey's foreign currency needs were rising (Oyvat, 2018).

Daron Acemoğlu (2018) also draws attention to structural problems in the economy. According to him, the crisis does not come from the withdraw decisions of foreign investors or the tweets of the American president. He defines the problems as low productivity in the corporate sector, unsustainable credit growth, and corporate overextension. He defines these problems as:
"Where politics led, economics followed. The government started clawing back the independence that had been granted to the public agencies. The central bank dutifully started doing the government's bidding. The reforms in the procurement process were rolled back, with corruption and backroom deals increasing. In the private sector, the good graces of the governing party once again became the most valuable asset of any company.

Though Turkey did weather the global recession reasonably well, the growth that followed has been low in quality. Productivity has declined for most of the past decade. Growth during this era relied on a construction boom and rampant credit expansion. It is these unsustainable engines of growth that have also created the persistent current-account deficits and inflationary pressures that have become harder to contain" (Acemoğlu,2018).

Political Factors

Apart from the economic factors briefly outlined above, there are observers who argue that the crisis has stemmed from political factors under AKP governments. Dani Rodrik draws attention to this point as starting causes of negative economic developments and rejects the view that the causes could be attributed to external factors like the role of the US and CIA. Instead, they are caused by the Turkey's political regime under Erdoğan as well as the unsustainable growth model. (Durak, 2018). Ziya Öniş also emphasizes the importance of political behind the crisis. According to him; there was a sign of an economic crisis in the shape of currency volatility before the presidential elections in June 2018 since there were continuing doubts and uncertainties on how to land the economy after the June 2018 elections According to him, transferring the management of the economy from Mehmet Şimşek to Berat Albayrak, former Energy Minister and Erdoğan's son-in-law, was received negatively by market actors. Thus, Turkey found itself in the midst of a serious currency crisis during the summer of 2018 as a reaction of t financial markets (Öniş, 2019). Korkut Boratav also draws attention to this point and states that the challenge against international financial domains by the AKP government and appointment of Berat Albayrak to head of economy led to insecurity in financial markets (Birgün, 30 December 2018). In addition, Mustafa Sönmez interprets the recent economic developments as the political, economic and ideological crisis of the AKP regime. Thus, he regards it as a regime crisis rather than economic crisis. According to him, AKP government has tried to build its own regime that can be described as "islamofaşist" for the past fifteen years. He argues that the AKP regime polarises the society, eliminates rule of law, restricts the media freedom and independent judiciary and adds political risks to the economic risks. Therefore, this crisis is a regime crisis (Sönmez, 2018).

Neoliberal Accumulation Regime

In addition to the explanations briefly summarized above, there are also commentators who regard all of them as insufficient. Observers like Galip Yalman and Ümit Akçay link the negative economic developments to the transformation of the capitalist state and describe them as crisis of neoliberal accumulation regime. Galip Yalman defines this crisis as "crisis of management strategy". For him, this can be interpreted as crisis of neo-liberalism for critical political economists, but it is also a crisis of the authoritarian structure of the capitalist state in specifically in Turkey (Yalman, 2018).

According to Ümit Akçay, these negative economic developments do not start and end in Turkey. Politics and economy have been shaped by the 2008 global financial crisis and its effects have continued for the past ten years. He divides the global crisis into three stages. According to him, the first stage of the global crisis started with the financial downturn in US. The second stage was seen in the European Region crisis which peaked between 2010 and 2012. The third stage of the global crisis came as the slowdown of emerging market economies after 2013. Here, he defines the five years period between 2013 and 2018 as period of instability. He argues that while the crisis of neoliberal populism was deepening in this period, no alternative model emerged to cope with. Thus, this crisis cannot be defined as the transformation from one accumulation crisis to another. He defines it as an "interim regime" happening within the same accumulation regime. The third stage of the global crisis and the crisis of neoliberal populism are related to each other. Neoliberal populism is an accumulation regime based on low interest rates. Therefore, for countries like Turkey which depends on imports and international capital flows for growth, .keeping interest rates low depends on developments in the global conjuncture Thus, the global conjuncture after 2013 has removed the necessary framework for sustaining the neoliberal populism model (Akçay, 2018).

After all of these analysis and interpretations, the research question "Is 2018 a year of crisis in Turkey?" can be answered. In the first section, how sharp increase in the foreign exchange rate affected economy is displayed and it is seen that these negative consequences still continues in the economy. In this regard, the first interpretation that financial turbulence resulted from external factors like political tensions between US and Turkey is no longer valid since how Turkey has economic vulnerabilities before the crisis has been displayed as its dependency on the capital flows, large current account deficits, and increase in the debt level in foreign exchange.

Based on above indicators, it is shown that Turkish economy experiences a deep recession currently. The perspective that economic factors have led to the current economic crisis can be analysed under similar example from the world. In this regard, Paul Krugman (2018) makes an analysis just after the sharp depreciation of Turkish Lira in August 2018. He views that Turkey started to experience similar economic crisis like in the Asian Crises in 1997. Since there is fixed exchange rate, dependence on capital flows, high current account deficit and high private sector debt in foreign exchange rate. Thus, Asian economy had severe vulnerabilities in its economy and experienced severe crisis as a balance of payment crisis (Krugman, 2018). Now, is it possible to say that Turkey also experiences a balance of payment crisis but under flexible exchange rate similar to Asian Crisis? In section 2, Turkey's vulnerabilities in the economic structure is analysed with its dependency on the capital flows, large current account deficits, high indebtedness of the private sector and low investments in the production sector. These deteriorations have shown that Turkey has similarities with the Asian crisis in its fundamental points as in mentioned economic vulnerabilities. However, his analysis predicts that financial crisis and real sector crisis will process simultaneously while these crises have entered differently in Turkey. Foreign exchange crisis has entered in March 2018 and peaked in the August 2018 while crisis in real sector has started in September when the foreign exchange crisis has ended (Boratav, 2019).

In the third interpretation, reasons of the economic crisis in Turkey are explained under political regime of the AKP government since it implements irrational policies. However, this also cannot be only answer of the economic crisis. As in the last under interpretation, the causes of the economic crisis can be explained under neoliberal accumulation regime

Conclusion

Turkey has experienced vulnerabilities in its economy because of the declining capital flows and slowing global trade among developing countries in recent years. Together with these, it was faced with severe depreciation on Turkish Lira in August 2018 as losing its value approximately 50 percent since the beginning of the year 2018. Together with this depreciation, there have been negative reflections in the real sector and the economy has become more

vulnerable. Firstly, these impacts can be seen in current account imbalances since capital inflows declined with regards to tensions between US and Turkey, increase in the inflation rate, increase in the unemployment rate, decline in the domestic demand, increase in the private sector debt and public deficit. All of these results show that Turkey'
Experienced economic vulnerabilities with TL depreciation lead to a deep recession in the Turkish economy.

These economic deteriorations have wakened the question whether Turkey goes into a new economic crisis after this severe depreciation on the Turkish Lira and its impacts on the economy. In literature, some of the academicians (Nurullah Gür, MevlütTatlıyer, Şerif Dilek and Deniz İstikbal) argue that these economic deteriorations resulted from external factors stemming from tensions encouraged with US and Turkey because of the detaining of the American pastor and speculative attacks made to the economy with respect to these negative developments. They do not see any economic problem in the economy and views in the same pattern with the government. However, many of the observers analyse these negative consequences as a different type of economic crisis in Turkey since its impacts experiences gradually on the real sector and according to them, recovery of the economy will not be easier compared to previous crises in Turkey. Some of these observers (Daron Acemoğlu, Erinç Yeldan, Asaf Savaş Akat, Dani Rodrik, Korkut Boratav, Ömer Faruk Çolak, and Seyfettin Gürsel) argue that Turkish economy has vulnerabilities and unsustainable growth because of depending on short term capital flows, increasing chronic current account deficit, government's increasing unsustainable investment policies in construction sector rather than production sector and increase in the private sector debt significantly since 2008. Some of them (Korkut Boratav, Mustafa Sönmez, Dani Rodrik, Daron Acemoğlu) analyse that political factors under AKP government caused the economic crisis and this factor is political regime of the AKP government itself like change in ministry of economy as Berat Albayrak, Erdoğan's son-in law, after the presidential elections, implementing policies that polarizes the country and restrict the state institutions' independence and media freedom. In addition to these, there are also academicians (Ümit Akçay, GalipYalman) analyse the crisis as transformation of the neoliberal capitalist state and for them, this economic crisis does not stem from only economic vulnerabilities or the political factors, rather it appears as the accumulation regime crisis since impacts of the global economic crisis have continued since 2008.

All of the perspectives have shown that economic deteriorations experienced in 2018 since severe depreciation on the Turkish Lira in August 2018 cannot be explained only by external factors such as political tensions between US and Turkey and speculative attacks to economy by stating that Turkish economy has not any problems. Economic indicators in the first section showed that Turkish economy has affected worse combined with its fragile structure and currently the economy still experiences the recession and thus; the year 2018 became a year that starts a new type of crisis in Turkey compared to previous crises since there are deteriorations in the institutions and high increase in the private and household debts. The recovery from the crisis cannot be easy.

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