Turkey's Unprotected Inflation Reaches a 24-year High

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Introduction

The failure of Turkey's economic development paradigm in 2018 triggered the country's economic crisis. The strategy called for maintaining high levels of investment while supporting them with ever-increasing amounts of foreign debt. Despite the economy briefly recovering in 2019, as a result of favorable global trends and the Central Bank of Turkiye (CBRT) significantly boosting interest rates, needed changes were not executed (Kubilay, 2021).

Today in Turkiye inflation is the most serious economic and social concern for the working classes. It even averted widespread unemployment, which had existed for a long period. Minimum-wage earners who are no longer employed are also unhappy. Because their pay money is continually evaporating due to growing inflation. While this condition rapidly impoverishes people and degrades their living standards, it also contributes to the existing economic inequality.

To begin with, Turkey's official inflation rate (CPI) is 36.08 percent per year, which is 5 times higher than in the United States, 7 times higher than in the European Union, 11 times higher than in India, 20 times higher than in Japan, and more than 39 times higher than in China. The official PPI of 79.9 percent suggests that the true inflation level is at least twice as high as the official one and that inflation estimates are still manipulated (Daily Sabah, 2022).

In fact, while the housing price index (which accounts for 15.4 percent of the inflation basket) increased by 50.5 percent in nominal terms in November of last year (compared to the same month the previous year), according to Central Bank data (TCMB, 2021) TURKSTAT reported a 23.8 percent increase for the same month (TÜİK, 2021)

The Climate Catastrophe is Fueling Inflation

Furthermore, concerns relating to the climate catastrophe contribute to inflationary pressure. Natural gas demand has surged since one of the quickest methods to minimize greenhouse gas emissions is to replace coal in power generation with a "greener" fossil fuel. The increased frequency of extreme weather events has also resulted in significant decreases in agricultural productivity, resulting in fast increases in global food costs (Granville, 2022) According to the FAO, global food prices would rise by 28% in 2021, hitting their greatest level in ten years. Food price increases contributed to overall inflation (Reuters, 2022)

Food price increases are caused by a variety of factors, some of which are systemic. Following COVID-19, difficulties in the global supply chain (particularly those connected to transportation) have been a major factor in causing price hikes for a wide range of goods. Energy prices (especially the large increases in oil prices in 2021) have also significantly boosted agricultural production and transportation expenses. Other explanations for the increase in food costs last year included overstocking due to the expectation of future food price increases, large-scale financial speculation in food markets, and extreme weather events related by climate change, such as floods, storms, forest fires, and droughts (Ghosh, 2022)

The Causes of Turkiye 's High Inflation

Turkiye's inflation dynamics are one-of-a-kind. Understanding these mechanisms is crucial for managing inflation and determining whether the current inflation is temporary or permanent.

First, mainstream economic theory states that when a country with a capitalist system has an economy that is already at full employment and the government attempts to spend more, price increases are unavoidable because the resources required to meet the induced increase in demand will not be available (Danninger et al., 2022). This illustrates how this condition leads to inflation when the increases continue.

At Full Employment, There is no Abrupt Spike in Demand.

However, while this circumstance is theoretically very unusual even in sophisticated economies (with the exception of the war economy during WWII), it has never occurred in Turkiye. For example, the country's employment rate is at 46.6 percent, while the unemployment rate is around 11.3% (TUIK, 2022). As a result, it is impossible to speak of "inflation induced by a sudden surge in demand that cannot be supplied because there is insufficient labor force to be deployed in production."

When analyzing whether excessive growth in consumer spending increased aggregate demand, a similar scenario emerges. When compared to other economies, the average income level of the population is relatively low and the degree of borrowing in the form of loans is low undermines the Notion (Hudson, 2022) that "there is demand inflation emanating from consumer spending."

In this context, the issue of "whether the government subsidies provided during Covid-19 lead to an increase in consumer expenditures" may emerge. However, in Turkiye, unlike in many other countries, such public assistance in the form of direct income support has remained exceedingly limited. Some of the money was used to pay off previous debts. As a result, it is doubtful that Turkiye's inflation was driven by a failure of manufacturing to keep up with strong increases in consumer spending.

The Other Side of the Coin... In June, an Export Record Was Broken.

Mr. Muş, the Trade Minister, said that an export record was broken in June. Stating that exports increased by 18.5 percent compared to June of 2021, exports in June reached a monthly record of 23.4 billion dollars.

Turkiye has long struggled with the problems caused by disruptions in global supply chains and supply-demand imbalances that began with the pandemic in the global economy, and the war in Ukraine caused significant increases in the prices of both energy and agricultural products, exacerbating market fluctuations (Dünya, 2022).

As a result of all of this, unprecedented inflation in many affluent countries has become a huge issue for humanity. He added that inflation, which has hit a 40-year high in the United States and England, is smashing records in the Eurozone by reaching double digits. While the OECD has decreased its global growth prediction to 3%, the World Bank has revised it to 2.9 percent. Turkiye is receiving signs that it has entered a period of reverse globalization, with increased protectionist measures and shifts in global value networks. However, every attempt is taken to address global issues (OECD, 2022). The United Nations warns that rising food costs might lead to a food crisis in 2023, especially when combined with drought in Africa caused by climate change.

Turkiye would never abandon its firm stance on the regulated free market, stating that domestic and international capital in Turkiye is in an economic climate where it may invest securely and legally. Mr. Muş goes on to say that the Turkiye economy maintained its 11 percent growth rate in 2021 in the first quarter of 2022, growing by 7.3 percent. Net exports accounted for over half of the rise in GDP throughout the 15-month period. Furthermore, he claims that the Industrial Output Index climbed by 10.8 percent year on year, indicating that the economy's production momentum is continuing. As a result, despite all of the global challenges, the Turkiye economy continues to grow in a balanced and sustainable manner.

Inflationary Pressures Will Make Exporting Tough

Rising expenses owing to exchange rate increases, on the other side, raise the costs in the export industry, making exports harder. One reason for this is that freight is computed fully in foreign currency, which raises transportation expenses (TCMB, 2022).

While small-scale transportation companies were unable to cope with cost increases of up to 50% in just a few months due to price increases on almost everything, particularly fuel, they closed their contracts, large companies that were unable to make pricing due to uncertainty turned to the spotlight instead of annual contracts. In other words, exporters are increasingly losing the benefit of securing transportation costs through an annual contract. This year, on the other hand, a rise of 20-40% is projected (Yücel, 2022)

Furthermore, rising inflation increases the tendency to import goods, which are sold relatively cheaper because they are produced on a larger scale, because domestic production has become more expensive, and it results in the disappearance of the competitive exchange advantage provided by the high exchange rate.

Based on a 78.62 percent Inflation Rate

TÜİK's December inflation (CPI) reached a 19-year high in 2021, reaching 13.58 percent on a monthly basis and 36.08 percent on an annual basis. (5) However, TURKSTAT reported monthly Producer Price Inflation (PPI) of 19.08 percent and yearly PPI of 79.89 percent

(TÜİK, 2022) The Inflation Research Group (ENAG) calculates December inflation (CPI) to be 82.8 percent (ENAG, 2022)

High Inflation Reduces the Advantage of Competitive Exchange Rate

The effect of inflation on exports is; it happens in the form of eliminating the competitive exchange advantage provided by the rising exchange rate due to increased production costs. Because while the basket exchange rate (consisting of 1/2 dollar, 1/2 euro) increased by 69,97 percent in the last year, PPI increased by 79.9 percent in the same period, and this difference is due to developments such as energy hikes, labor costs, and revaluation rates in taxes in the new year. It is expected to open more and more. This situation causes the exporter to lose the competitive exchange rate advantage. In addition, the very low exchange rate as well as the sudden fluctuation harms the competitiveness and negatively affects the export, the representatives of the sector said that in today's conjuncture, the dollar/TL rate should not fall below 14 (or even around 16), otherwise the momentum gained in exports will be lost. They argue that both production and investments will be endangered (Karadeniz, 2022; TCMB, 2022).

Beside mentioned factors, the correspondence business saw the most minimal yearly development rate, at 23.74 percent. It was trailed by the material and footwear area (26.99%), instruction (27.76%), and wellbeing (39.34%). Transportation (123.37 percent), food and non-cocktails (93.93 percent), and furniture and home hardware had the most elevated yearly increments (81.14 percent). Expansion has ascended since last harvest time, when the lira dove following the national bank's consistent decrease of its strategy rate by 500 premise focuses to 14 percent (TÜK, 2022).

This year has been bothered by Russia's invasion of Ukraine, as well as the lira's proceeding with debasement. Last year, the money fell 44% versus the dollar and was down 24% this year until recovering a portion of its misfortunes lately. The earlier month, May 2022, yearly expansion arrived at a 24-year high of 73.5 percent (TÜK, 2022).

Conclusion

After completing last year with 500 basis points of cumulative easing, the central bank has refrained from hiking rates for the time being. Instead, it has advocated policies targeted at increasing the usage of the local currency and making long-term investment financing available.

When adjusted for inflation, Turkiye now has the world's deepest negative rates. It's also one of the main reasons why the Turkiye lira has been the weakest performer in developing markets this year against the US dollar. On June 23, Turkiye's central bank kept its benchmark policy rate constant for the sixth month in a row, reiterating its belief that a disinflationary process was imminent. The Monetary Policy Committee (MPC) retained the one-week repo rate at 14 percent, as most analysts predicted. Following that, yearly inflation in Turkiye reached 79 percent in June, the highest level since 1998. The Board anticipates that the disinflationary process will begin with the restoration of world peace and the removal of base effects in inflation. At the same time, authorities lowered their growth forecasts and indicated that the possibility of a recession has grown.

Turkiye needs external borrowing for both industrial output and family spending. The country's savings rate is low. Savers invest in real estate rather than banks since banks cannot provide a genuine financial return. As a result, rather of investing in productive areas, their funds are invested in non-productive sectors such as real estate or automobiles. As a result, banks are unable to collect sufficient deposits from households. As a result, the government is forced to finance the banks by printing additional money. As a result of the increased circulation of lira in the market, inflation rises. To summarize, Turkiye has lost its battle against inflation owing to a mix of factors such as delayed interest rate rises, delayed savings efforts, and deteriorating state finances. The economic policy promises to reduce Turkey's persistent current account deficits through increased exports, although higher energy import costs have already done so.

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