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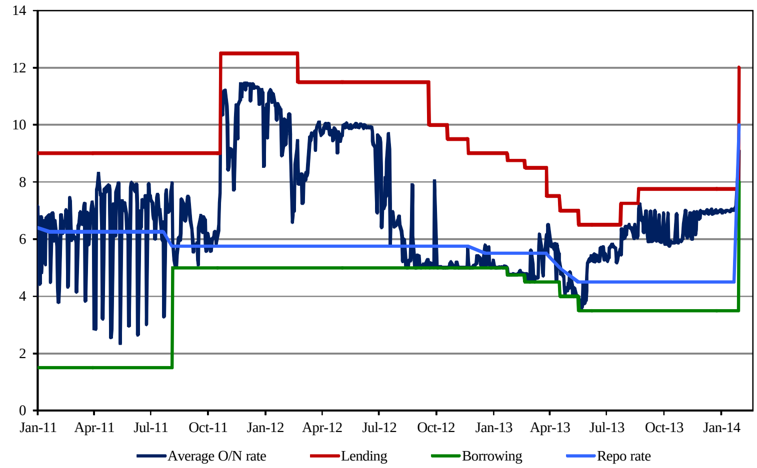
Turkey: Politics, Monetary Policy and Growth

by Francisco Larios*

The governing party's victory in municipal elections continues to reverberate in Turkey: emboldened by the official interpretation of results, according to which voters have validated the Erdogan administration's contention that recent turmoil is the result of a conspiracy, and that Turkish public opinion does not view the government as corrupt, prime minister Erdogan has gone on the offensive again, demanding that the Turkish Central Bank (TCB) ease monetary policy right away.

Chart 1
Turkey: Interest Rates
(Percent)



Sources: Decision Economics, Inc. and Bloomberg.

The bank tightened rather abruptly at the end of January, in a move that was at least partly predicated on the need to adjust to worsening domestic and global risks. Those risks, the government now argues, have been reduced by the outcome of the election, as demonstrated by the appreciation of the lira since then.

The pressure is apparently strong enough to force the TCB's hand: although Governor Erdem Basci has stated that the central bank will not hold an "*extraordinary meeting at the moment*," to reduce rates, he has added that "*one shouldn't expect too big a rate decline*", which obviously point to a partial undoing of January's tightening, as early as April 24, the next scheduled policy meeting.

Given the potential for continuing political turmoil, plus the upward trajectory of inflation in recent months, another change in the bank's policy stance appears premature and possibly more adverse to markets in the near term than beneficial to the real economy over the next few quarters.

As pointed out in an earlier note, near-term optimism regarding the economy is risky, given the complex political situation, and despite some positive signs coming from manufacturing, including a better-than-anticipated industrial production figure for February (4.9% Y/Y versus Consensus of 4.6%). These figures might be a near-term peak, given the rapid deterioration of conditions: higher borrowing costs, the political crisis, and signs that the global economy's recovery lacks stamina. Regardless of the next TCB move, we reiterate our forecast of real GDP growth near 2.4% Y/Y for Q1 (Consensus estimates are close to 2.9% Y/Y). The range of outcomes for 2014 is 1.5%-to-2.5%. We still see Turkey as a high recession risk.

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