

What Happened to Turkish Lira in 2021?

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Introduction

There are evidence of Turkey's catastrophic economy all over the place. Outside the reduced bread booths, long lineups snake around the block. Medicine, milk, and toilet paper are all increasing in price. Some petrol stations have closed due to a lack of supply. On the streets, angry outbursts have occurred. In December, yearly inflation soared to 36 percent, up from 21 percent the month before. The Confederation of Progressive Trade Unions stated, "Unemployment, exorbitant living costs, price rises, and bills are breaking our backs" (Disk, 2021). Turkey was seeking to avoid a recession even before the coronavirus epidemic and supply chain bottlenecks hit the world's economy about two years ago, as it grappled with mountainous debt, significant losses in the value of the Turkish lira, and growing inflation. However, in recent weeks, that slow-moving train catastrophe has picked up speed and severity.

Turkey says farewell to 2021 in the midst of economic reforms, contentious interest rate choices, and the resulting unprecedented jumps in the dollar/TL, as well as the country's high inflation rate. While the economy was a top priority for Turkey in 2021, the depreciation of the Turkish Lira was definitely the most significant factor. Since January, the Turkish lira has lost 44% of its purchasing power versus the US dollar.

The devaluation in question, on the other hand, was mostly caused by local market movements and governmental actions and pronouncements. In this scenario, the dollar, which began the year at 7.44 lira, hit an all-time high of 18.37 lira on December 20, 2021, when the date was shown. With President Recep Tayyip Erdoan's announcement of the exchange-protected TL time deposit application, the dollar, which had been in free decline, was retracted to 10.25 liras in the evening of the same day.

How did the Economy Start 2021?

Former Central Bank President Naci Abal and former Treasury and Finance Minister Lütfi Elvan were in charge of the economy when 2021 began. Abal took office in November 2020,

and at the last two Monetary Policy Committee (MPC) meetings of the year, he decided to tighten monetary policy in order to control the dollar and high inflation, which was above 8 lira at the time of his arrival, by raising interest rates by a total of 675 basis points. Interest rates increased from 10.25% in November to 17% in December 2020 as a result of these hikes (Bloomberg, 2021). As a result, the dollar/TL rate, which had previously exceeded 8 liras, was cut to below 7 liras, and the year 2021 began at 7.44 liras.

In his remarks, President Erdoğan, on the other hand, repeatedly emphasized his displeasure with excessive interest rates and upheld the notion that *"interest is the source, inflation is the outcome."* The public was often informed about the rise of tensions between the administration of the economy and Erdogan.

While Erdoğan was said to be pressuring Ağbal for low interest rates, the Central Bank under Ağbal's leadership held interest rates steady in the two Monetary Policy Committee (MPC) sessions on January 21 and February 18, 2021, but lifted the rate to 19 percent with a 200-basis-point rise at the meeting on March 18. Ağbal was fired two days after the decision was reached, on March 20, and Şahap Kavcıoğlu was appointed in his place. With the belief that Kavcıoğlu is close to Erdoğan and his views, and therefore interest rate reduction would commence, market tensions mounted, and with the appointment in March 2021, the dollar/TL surged above 8 liras again in a short period (Cnbc, 2021).

Period of Kavcıoğlu

The dollar/TL, which had risen beyond 8 Liras after Kavcıoğlu entered office, fell again on March 30, when Kavcıoğlu spoke at the Central Bank of the Republic of Turkey (CBRT) General Assembly, emphasizing the fight against inflation and announcing that the interest rate will be greater than inflation. The dollar/TL steadied slightly at 8 liras after the news, after briefly falling below it. The dollar ranged between 7.42 and 8.62 liras throughout the spring months, notwithstanding the substantial volatility in exchange rates. The dollar / TL exchange rate ranged between 8.48 and 8.68 liras over the summer months, with occasional surges. During the MPC sessions between April and August, the Central Bank, under Kavcıoğlu's leadership, kept the interest rate at 19 percent (Statista, 2021).

The Turkish lira has been in free collapse.

The process and actions that will bring the dollar/TL to the level of 18.37 lira began in September, according to some estimates. With the shift in the Central Bank's rhetoric and subsequent interest rate reduction, the dollar rose to 9.30 liras in September.

The Central Bank's rhetoric that *"interest will be formed above inflation"* was refuted by the August inflation numbers, which were released in conjunction with the arrival of September 2021. The Turkish Statistical Institute (TUIK) released inflation figures on September 3 that indicated a monthly increase of 1.12 percent but an annual increase of 19.25 percent, which was higher than the Central Bank's target rate of 19 percent (Qantara, 2022). The markets were focused in on the Central Bank's signals following the aforementioned developments. At the German-Turkish Chamber of Commerce and Industry meeting on September 8, CBRT President Kavcıoğlu sent out the expected signals (Qantara, 2022).

Kavcıoğlu modified the wording in his speech here, stating that the interest rate would be higher than *"core inflation."* As a result of this remark, the dollar/TL exchange rose from roughly 8.35 lira to 8.48 lira on the day it was made. In September, the MPC meeting on September 23 was another watershed moment. Following August's inflation rate exceeding the existing policy rate, the market consensus was that the Central Bank would maintain its current interest rate. The CBRT, on the other hand, lowered interest rates by 100 basis points on September 23, lowering the policy rate from 19 percent to 18 percent in a surprise decision.

The dollar/TL rose to 8,80 lira after the ruling, having been at 8.60 earlier in the day. The dollar touched 8.95 liras at the end of September and now stands at 9. The dollar/TL exchange rate was extremely volatile in October, fluctuating between 8.89 and 9.85, as the Turkish lira strengthened by almost 8% versus the dollar (Reuters, 2021). Despite the market's 100 basis point decrease, the Central Bank maintained its low interest policy, lowering the policy rate to 16.5% during the MPC meeting on October 21. As a result of the decision, the dollar / TL exchange rate jumped to 9.48 lira on the same day, up from 9.21 as the first reaction (TRCB, 2022). While these moves led the Turkish lira to plummet, the dollar continued to set new highs practically every day during the process. In addition to the Central Bank's interest rate decision in 2021, political pronouncements have occasionally fueled the dollar's fire.

President Erdoğan's stance on interest rates, particularly remarks like *"Interest is the source, inflation is the effect"*, *"We will not crush our countrymen with excessive interest rates"*, and *"We will not have to say anything against the interest rate"* heightened the dollar's volatility by the second. TL depreciated the most against the Chinese yuan in the previous year. The Yuan/TL exchange rate climbed by 92.2 percent in a year, compared to 86.3 percent for the dollar/TL.

	December 15, 2020	December 15, 2021	Δ%
US Dollar	7,85	14,66	86,83%
Euro	9,54	16,52	73,29%
Pound	10,48	19,48	85,85%
Swiss Francs	8,87	15,9	79,19%
Swedish Krona	0,94	1,61	71,95%
Canadian Dollar	6,16	11,41	85,27%
Kuwaiti Dinar	25,83	48,64	88,32%
Norwegian Krone	0,9	1,61	79,34%
Saudi Arabian riyal	2,09	3,91	86,82%
100 Japanese Yen	7,56	12,92	70,88%
BGL	4,9	8,5	73,29%
Ron	1,97	3,36	70,45%
Russian Rouble	0,11	0,2	85,95%
100 Iranian Rial	0,02	0,04	86,80%
Chinese Yuan	1,21	2,32	92,21%
Pakistani Rupees	0,05	0,08	68,31%
Qatari riyal	2,17	4,05	86,85%
Australian Dollar	5,92	10,47	76,95%
Danish Krone	1,28	2,23	73,43%

Source: TRCB, 2022.

In dollars, the '*psychological limit*' is ten liras.

For the Turkish lira, November was a watershed moment. When the dates changed to November 12, 2021, the dollar/TL, which had been rising in the overnight hours and was close to 10 lira, saw 10 liras and broke beyond the market's '*psychological limit*.' While the Turkish Lira's wild decline intensified once the psychological limit was breached, the dollar/TL exchange rate climbed to 13.74 from 9.60 in November. Interest rates were cut by 100 basis points to 15% at the MPC meeting on November 18, matching market forecasts (Euronews, 2021).

A new economic paradigm has emerged

Following the extraordinary volatility in the dollar, the government issued a new economic model statement in response to comments from nearly every sector of society, business, and politics. According to the model, a high exchange rate and a low TL would provide Turkish exporters a competitive advantage in the international market, boosting exports and balancing exchange rates with the large quantity of foreign cash entering the country as a result of higher exports. The government emphasized that the model in question is the "*Turkish Model*" in contrast to many economists who refer to it as the "*Chinese Model*".

18.37 USD/TL is a historical high

In December of 2021, the dollar rate reached its highest point. With the effect of the government's statement that it was clearly implementing a high exchange rate policy and the interest rate decisions from the CBRT, the dollar/TL increased by around 1-2 liras in a very short time, starting at 13.50 levels with the inevitable losses in the Turkish Lira. earnings exceeded 10% (Reuters, 2021).

In addition, during the MPC meeting on December 16, the Central Bank decreased the interest rate by 100 basis points to 14%. Dollar/TL touched 18.37 lira on December 20, smashing yet another record. On the same day, the euro hit a high of 20.80 liras. Following the Cabinet Meeting, President Erdoan declared that the 'currency-protected TL time deposit' application had been put into use. Those who move money from foreign currency to TL deposits will be compensated for the difference if the dollar rises. The dollar dropped substantially as a result of this speech, with losses of 13%. The dollar, which had reached a high of 18.37 liras before Erdogan's remark, has now fallen to 10.25 liras (Fortune, 2021).

The dollar's trajectory in 2021 vs. the Turkish lira

The Turkish Lira fell by 44% versus the dollar in 2021, starting at 7.44 in the year. In January, the TL lost 1.63 percent of its value. The Turkish lira lost about 10% of its value in the first quarter of 2021. The Turkish currency lost 5.61 percent of its value versus the dollar in the second quarter, but just 2.5 percent in the third.

Conclusion and Future Expectations

Contrary to expectations, currency protected TL deposits (a new definition that has just entered the Turkish financial sector after the Turkish lira depreciated) did not decrease dollarization and this new instrument created a risk on public finances. Although there is no return to orthodox policies before the elections in 2023, it is expected that expansionary monetary policy will continue to be implemented. If the possibility of a surprise early election in 2022 may be one of the factors affecting TL negatively.

Inflation in Turkey is expected to be 52.6 percent on average in 2022, and to reach 40 percent at the end of the year. For the end of 2022, the dollar/TL forecast is expected to reach 20 from 12, and the dollar rate is expected to reach 28 at the end of 2023. Although the financing need of the real sector has increased significantly due to the increasing exchange rate and inflation, the interest rates in the banks are increasing despite the decrease in the policy rate. Therefore, 2022 will perhaps be Turkey's worst financial year in the last 20 years.

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