Explained: Turkey's currency is crashing. What's the impact?

Why in news?

Inflation has soared by more than 21% in Turkey and many people in this country are struggling make both the ends meet.

What is the present situation in Turkey?

- Turkey's currency (Lira) has been plunging to all-time lows against the U.S. dollar and the euro in recent months.
- Turkish lira has lost around 40% of its value since the start of the year, becoming one of the world's worst-performing currencies.
- As a result, families are struggling to buy food and other goods.
- However, President Erdogan presses ahead with a widely criticized effort to cut interest rates despite surging consumer prices.

How interest rate affects economic growth and inflation?

- Money is a commodity. Its value changes as per demand supply equation.
- The government of the day is generally responsible for promoting economic growth. On the other hand the central bank is responsible for controlling the inflation.
- **Interest rate and economic growth -** To boost economic growth money should be made available to the people.
- To achieve this interest rate has to be reduced.
- Now people can borrow more from the bank and invest the borrowed money in business to make profit.
- This promotes economic growth due to job creation, increased production and importantly more purchasing power with the people.
- **Interest rate and Inflation -** When people borrow more there is a tendency to spend more. Purchasing power of people increases.
- When supply of goods remains constant and money supply increases demand supply equilibrium alters it leads to inflation.
- Now interest rate has to be increased so that more money goes into the hands of bank rather being available with the general public.
- So interest rate has to optimised so that there is a stable economic growth

and a manageable level of inflation.

What led to the present situation in Turkey?

- **Erdogan's Policy –** Erdogan, the long standing president, is of the religious view that interest rates as "evil."
- He had argued that high interest rates cause inflation contrary to what economists generally say.
- He has been pushing for low borrowing costs to stimulate the economy, boost growth and exports, and create jobs.
- **Banks response -** Turkey's Central Bank has repeatedly cut borrowing costs in line with Erdogan's wishes.
- As a result, the Turkish lira, which had barely recovered from a currency crisis in 2018, has been weakening to record lows against the dollar and the euro.
- Inflation is especially acute in Turkey because of the government's unorthodox policies.
- Lira plummeted to an all-time low of 14 Lira against one US dollar.

What are the impacts of current crisis?

- The inflation rate stands at a stunning 58%.
- Turkey relies on imported raw material.
- The devalued lira is driving prices higher. It is making imports, fuel and everyday goods more expensive in Turkey.
- Every morning, long lines form outside kiosks selling bread a lira cheaper than in bakeries and shops.
- The economic crisis has also led to brain drain making experts moving out of the country.
- The rate cuts have raised concerns over the bank's independence
- The country's unconventional monetary policy has spooked foreign investors, who are dumping Turkish assets.
- Turkish citizens are rushing to convert their savings to foreign currencies and gold to protect them from inflation.
- Turkey is focused on growing the economy rather than controlling inflation
- But now even growth is highly questionable at this point because we are going to see more contraction coming as a result of the panic and uncertainty and escalating costs coming from this crisis.

Reference

1. https://indianexpress.com/article/explained/turkey-currency-crashing-us-dollar-turkish-lira-7658461/

