Turkey: New central bank governor likely to maintain orthodox monetary policy for now | Credendo

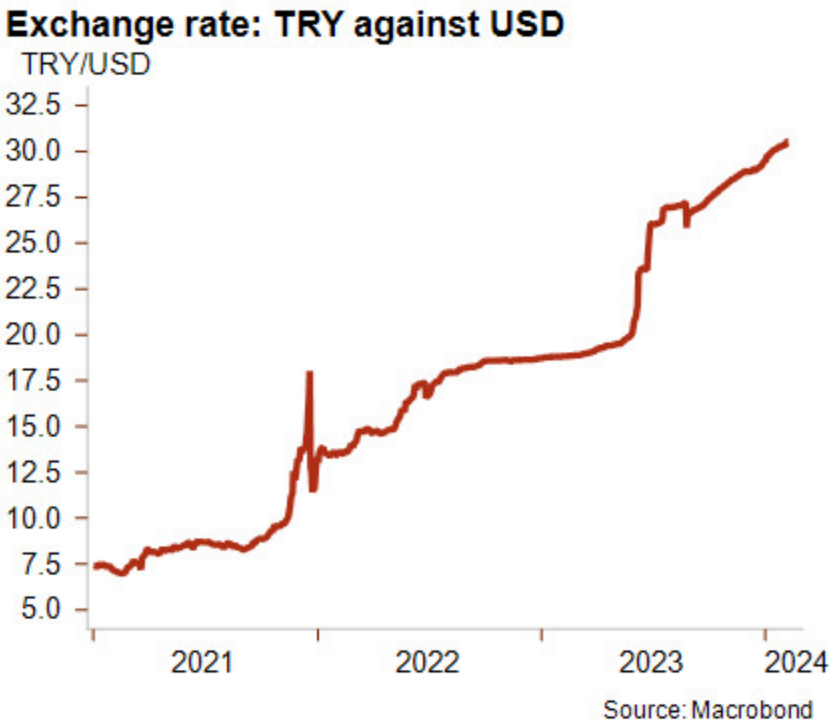
Event

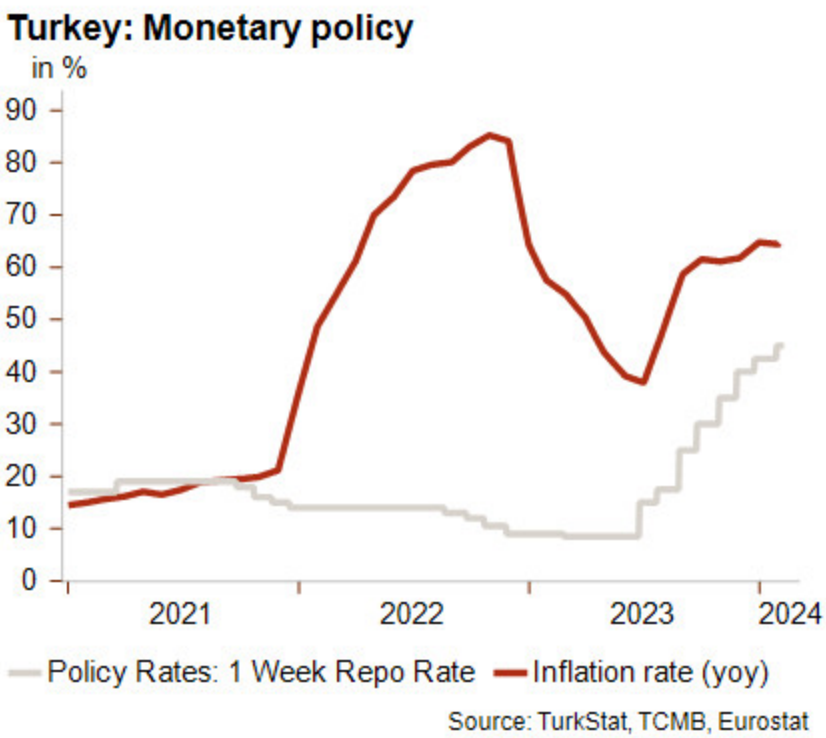
Central bank governor, Hafize Gaye Erkan, resigned after eight months in office. Former deputy governor, Fatih Karahan, becomes the new central bank governor.

Impact

Ms Erkan was appointed in May 2023 following President Erdogan's re-election. At the same moment, President Erdogan appointed Mehmet Simsek as Minister of Finance. The new team represented a return to more orthodox fiscal and monetary policies.

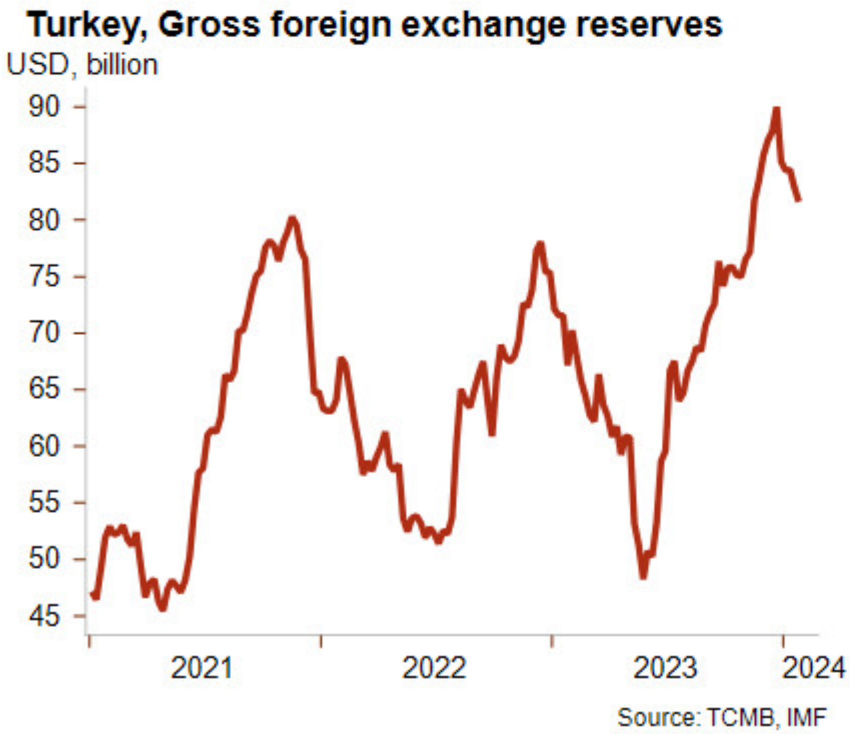
During her time in office, Ms Erkan implemented a more orthodox monetary policy by gradually increasing benchmark interest rates up to 45% (from 8.5% in early June 2023) – allowing the Turkish lira to depreciate – but also by gradually removing some unorthodox financial instruments (such as an FX-protected deposit scheme). The return to a more orthodox monetary policy is putting heavy pressure on the Turkish lira, which depreciated sharply just after the election and followed a depreciation trend afterwards (see graph – TRY against USD). As a result, inflation (see graph – Monetary policy) rose and reached 64.9% in January 2024.





The key question following Ms Erkan's resignation is whether the more orthodox monetary policy will be pursued. A priori, the new central bank governor, Mr Karahan, who is a respected economist, is expected to continue on the same line. However, it remains to be seen whether President Erdogan – who is opposed to high interest rates – would ultimately agree to a more orthodox monetary policy being implemented for an extended period. Indeed, in recent years, President Erdogan already nominated a more orthodox central bank governor, Naci Agbal, and sacked him later.

Amid continuation of orthodox policies, the outlook for the short-term political risk rating (in category 5/7) remains positive. Indeed, despite a recent decrease, foreign exchange reserves have increased sharply since mid-2023 (see graph – Gross foreign exchange reserves), which, along with other factors, improves Turkey's liquidity.



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