Turkey and the Highwayman Politicians

Rating agencies are independent bodies, whose analysts assess companies and countries, issuing ratings based on what they perceive to be the risk rating of that company or country.

There are 3 main rating agencies internationally - Moody's, Standard & Poors, and Fitch. All are over 100 years old, and between them, provide ratings for the vast majority of the worlds debt (mainly bonds).

The ratings of these bonds can change during the lifespan of the bond, and a downgrade may result in some holders, particularly investment funds, selling off the downgraded (and therefore riskier) debts.

Fitch has just released its latest Report on Turkey and has downgraded the Rating to JUNK BOND STATUS.

The Official Rating is now just one level above DEFAULT and Fitch have stated that the Outlook is NEGATIVE.

They say;

“The policy-driven financial stress episodes of higher frequency and intensity have increased Turkey’s vulnerabilities in terms of inflation, low external liquidity and weak policy credibility. Fitch does not expect the authorities’ policy response to reduce inflation, including FX- protected deposits, targeted credit and capital flow measures, will substantially ease macroeconomic and financial stability risks.”

In very simple terms, it is difficult to justify lowering interest rates, as Turkey did, when inflation is around 50%!

Fitch do not believe there is any sign of lowering inflation in Turkey in the near future, so it is reasonable to assume the country’s economic future is in a downwards spiral, at least in the medium term.

Against this sort of backdrop, along with Turkey’s almost empty foreign currency reserves, Recep Tayyip Erdoğan, the country’s president, has already asked Turkish nationals to hand over their foreign currency in exchange for Turkish Lira.

At the current exchange rate of about 13, and half what it was a year ago, I guess most people resisted the temptation, as there is now a new scheme, persuading people to swap family gold for Lira.

This really sounds like a desperation measure.

People in Turkey see gold as a secure store of value, with a culture of collecting gold jewellery, and giving gold as wedding presents, as in many other countries.

The Turkish government is now asking its citizens to hand over all personal gold in exchange for lira, and the government is hoping to collect 5,000 tonnes of gold. They are not focusing on large corporates for the gold bars in the safe (although it would be gratefully received), but individuals and families for earrings, necklaces and items of family gold.

Five Turkish gold refineries have been commissioned to melt down all the family jewellery received to make gold bullion to add to Central Bank reserves.

The finance minister, Nureddin Nebati has arranged for some 30,000 gold shops to act as collection points and expects that about 10% of the estimated US$250 billion worth of gold in the country will be surrendered sold to the government.

Even if this expectation is accurate, $25 billion is not likely to last long. Turkey spent $10.5 billion in December 2021 alone, simply trying to support the Lira and import gas!

With inflation in Turkey at almost 50%, it is not surprising that healthcare workers were on strike this week, demanding pay increases in line with this inflation rate, and more workers are likely to do the same.

President Erdoğan announced a reduction from 8% to 1% on food tax to ease the effect of inflation but went on to demand food producers reduce prices by 7% too. Most of us are well aware that the food production industry typically works on fairly narrow margins, so a sudden loss of 7% when costs have increased at 50% probably puts most food producers into a loss, with, as a consequence, the resultant job losses.

A 7% drop in food prices is also likely to be almost irrelevant, against a backdrop of 50% inflation anyway.

Finance minister Nebati was in London last week, talking to 'potential investors'. Following the meetings, he was in buoyant mood, and suggested the only problem facing his country was the current high rate of inflation.

With more than 50% of all transactions on the ground in Turkey done in US Dollars, it is reasonable to suppose that the population has lost confidence in the Lira. It therefore follows those large international investors are equally likely to see the problems in the country, and ultimately find a better home for their investment funds.

How the long-term economic future develops for Turkey and its 85 million citizens is well beyond the scope of my knowledge.

For now, it looks unpleasant at best, and things are unlikely to be improved by a government behaving like highwaymen, relieving families of their gold and hard currency, which is their only protection against the hard times to come.