Ecognosis Advsiroy Ltd afreris@ecognosisadvisory.com

ECOGNOSIS ADVISORY LTD

From the Greek:
ΟΙΚΟΝΟΜΙΚΗ ΓΝΩΣΙΣ, (Ekonomiki Gnosis, Knowledge of economics)

A global financial and economics advisory service covering economic and financial developments, equities, fixed income, forex, commodities and other assets

Dr. Andrew Freris, CEO, ECOGNOSIS ADVISORY LTD,
Level 20, 1 International Finance Centre, 1 Harbour Street, Central, Hong Kong
Tel.: (852) 3167 4591 Mobile: (852) 9738 0944 Email: afreris@ecognosisadvisory.com
Website: www.ecognosisadvisory.com Facebook: www.facebook.com/ecognosisadvisory

ECOSNAP No.1 The Turkish crisis in a nutshell, 26 August 2018

This is the first of a new series,Ecosnaps, of very short reports by Ecognosis Advisory, sticking to our benchmark principle that "If you can not explain it in very few words then perhaps you do not understand it ! " It might sound cocky but we will stick to it.The monthly, and longer (two sidess of A4 !) Econotes will, of course, continue to be published.

The Turkish crisis, which unfolded from early 2018, and then blew up in July-August 2018, had several simple and common factors of any financial crisis plus an unnecessary complication of a spat with the US over an imprisoned US citizen, which degenerated into a tariff war.

Common factors included:

1.A current account deficit (see chart below), which, after a brief improvement, started widening, and, hence, added foreign borrowing pressures.

2.A fiscal deficit, currently at 5.7% of GDP, also likely to widen and also partially dependent on foreign funding.

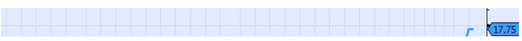
3.A banking system extensively dependent on foreign flows with about 47% of bank deposits and 36% of bank loans all in foreign currencies. These exposures make borrowers very sensitive to the Lira forex movements and, hence, expose the capital base of the banks to pressures from defaults. Depositors would also seek to remove their forex deposits from Turkey fearing the usual capital controls, which include the freezing or even confiscation of forex deposits.

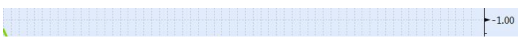
4.A currency, the Lira (USD/TYR), which had come under pressure before, especially in 2001, and whose defence by the central bank has been doubted by foreign investors.(See chart above)

5.Politics: The re-election with increased powers of president Erdogan on 24 June 2018 spooked, again, foreign investors with his talk of refusing to hike interest rates,(see chart below), threats to the independence of the central bank, the appointment of his son-in-law as finance minister and, finally, the open war of words with president Trump over the imprisonment in Turkey of a US pastor under accusations of conspiracy and treason which led to Trump imposing tariffs on Turkey only to be countered by Turkey doing likewise on US imports.

What happens next?

The Lira has stabilised but its recent 40% depreciation (see chart above) had immediate impact on inflation, while the hikes of a benchmark rate since May by 575 bps to 17.75% did not reassure the markets. Expect more volatility of the Lira but, possibly, the worse has passed now and the cheaper Lira will support the tourist sector for the rest of the season. However the central bank will not avoid further hikes in rates as inflation accelerates, Erdogan’s objections notwithstanding





Interest rates

As indicated the central bank of Turkey, under political pressure, has been reluctant to hike rates sufficiently to stave off further sales of Lira. Inflation has accelerated and will stay under pressure, especially in the energy sector where imported energy prices have risen by as much as 60% because of the depreciation of the Lira. Inflation rates moved from10.3% yoy in January 2018 to 15.8% yoy in July.

Current account deficit

This stands now at 5.4% of GDP, reflecting also a large trade deficit. This deficit was funded by the highest nonfinancial private sector borrowing in foreign currency than any other major emerging market. (IIF). The overall external debt, including sovereign debt, of Turkey stood in 2017 at 53.4% of GDPa higher percentage than those of S.Africa, Mexico, Argentina, Russia, Brazil, India and China! All these factors make Turkey very vulnerable to forex crises and steep depreciations.

Our mailing address is:
afreris@ecognosisadvisory.com