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# Turkey in turmoil

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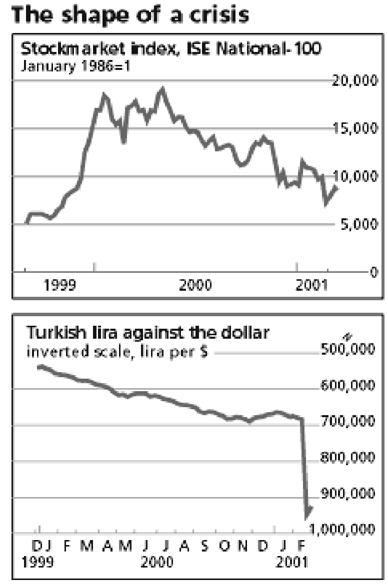
**Soaring interest rates and fleeing capital have forced Turkey to float its currency, the lira. Now the fallout begins, in the shape of rising inflation, collapsing banks and redundant central bankers**




Sources: Thomson Financial Datastream; Central Bank of Turkey

THE crisis is beginning to take its toll. The day after the devaluation of the Turkish lira threw the country's whole IMF-inspired economic stabilisation programme into doubt, Gazi Ercel, the governor of the central bank, offered his resignation. On February 26th, Selcuk Demiralp, the undersecretary of the treasury, followed suit. Then on February 28th, Ulusal, a middling bank failed, prompting Turkey's banking regulator to take it over. At the same time, the government admitted that it was looking for someone to lend it $25 billion. Although the headless central bank has succeeded in bringing down interest rates and stabilising the exchange rate for the time being, Turkey's hopes of taming inflation, and with them its dream of a speedy entry into the European Union, have taken a drubbing.

In fact, it was Turkey's politicians, not its financial bureaucrats, who caused the latest *kriz*, or crisis. On February 19th, Bulent Ecevit, the prime minister, stormed out of a meeting with Ahmet Necdet Sezer, the president. Mr Sezer had apparently chided Mr Ecevit for his half-hearted pursuit of corrupt politicians. But Mr Ecevit seems to have taken more umbrage at Mr Sezer's bad manners than at the substance of his comments. (The president is rumoured to have shoved a copy of the constitution at the bristling prime minister, only to see it flung back.) The markets, naturally enough, took the news badly, fearing that infighting might distract or even topple the government, and hence bring Turkey's much-needed economic and political overhaul to an untimely end.

Jittery investors started pulling billions out of the country, seriously denting the central bank's reserves of foreign exchange. Overnight interest rates soared to thousands of percentage points. The stockmarket tumbled, losing 18% of its value on February 21st alone. In the end, the government had no choice but to abandon the lira's "crawling peg", under which the currency was to be allowed to slide down by about 15% this year against a currency basket comprising the dollar and the euro. The move led to an immediate slide of more than 30% against the dollar, although by February 26th the currency had recovered slightly. Since the predetermined crawling peg was the government's chief device to dampen inflationary expectations, analysts now fear that inflation will jump. The government's credibility, and hence the rates at which it can borrow, will also suffer, further undermining the IMF scheme. In the wake of the devaluation, the IMF sent a team to Turkey to discuss what sort of programme it can salvage from the crisis.

## Lurching from *kriz* to *kriz*

This is Turkey's second financial crisis in three months, and the IMF's second salvage mission. The last time Turkey reached such a pass, in November, a timely dollop of cash from the IMF bailed the government out. At that stage, Turkish officials could boast that, for all the upheaval, the programme had been working well. Inflation had fallen from almost 100% a year to a third of that rate.

Debt-servicing aside, the government was running a healthy and growing budget surplus. If anything, the disinflation programme was a victim of its own success: inflation and interest rates fell so sharply last year that the economy boomed.

**Un-bullish Bulent Ecevit**

That encouraged Turks to start splurging on imports, and investors began to worry that inflows of foreign capital might not be big enough to finance the deficits caused by spendthrift consumers and the perennially penurious government. The cost of borrowing began to creep up again, a big bank failed, foreign capital took flight and Turkey found itself in a vicious circle of wobbling banks and spiralling interest rates. As a condition of its life-saving loan, the IMF insisted that the government clean up the banking sector and speed up privatisation to lure foreign investment once more.

It is the government's slow progress on both these fronts since November, rather than the tiff between Messrs Ecevit and Sezer, that gave investors pause once more. A row in parliament delayed procedural changes that would have speeded the passage of critical legislation. The sale of a 33.5% stake in Turk Telecom, the state-owned fixed-line monopoly, has not drawn a single foreign bid. The disposal of a 51% stake in Turkish Airlines, a state-owned airline, looks likely to fizzle too, although in the wake of the devaluation, the government said it would do everything necessary to complete both privatisations quickly.

The banking sector looks gloomier still. Since its creation at the IMF's behest last year, Turkey's banking watchdog has gradually revealed pervasive corruption and incompetence in many of the country's 80-odd banks. It was forced to take over 11 others before Ulusal's collapse, including another bank owned by the same conglomerate. One financier was caught on a security camera leaving the vaults of his bank with a cash-stuffed suitcase. What with four huge state-owned banks and 12 private ones under administration, over half the assets of the sector now lie in the government's hands. That figure will doubtless swell, as the sudden increase in the cost of servicing foreign-currency debts pushes other banks under. Those that survive will be tempted to revert to a steady diet of high-interest government debt, starving the private sector of funding and risking similar fiascos in the future.

Sorting out this mess is likely to take several years. Although the IMF remains supportive, both to save its own reputation and to prevent the crisis from spreading to other emerging markets, it must be exasperated by the extent to which this economic wound has been self-inflicted. Investors and analysts could write off one financial crisis as bad luck, but two in four months looks like downright carelessness.