# Turkey's rate of inflation is 3.2 times higher than the official rate - leading economist

Deniz Öz

June 23, 2018

Steve H. Hanke is a professor of Applied Economics and co-director of the Institute for Applied Economics at Johns Hopkins University. He is also a senior fellow and director at the Troubled Currencies Project at the Cato Institute in Washington, D.C and recently penned an article saying that Turkey's real rate of inflation was 39.9%. Hanke answered Ahval's questions.

*You remarked that Turkey's real inflation rate is 39.9 percent.This statement of yours generated much debate in Turkey. How did you reach this conclusion?*

Actually, at present, Turkey's annual inflation rate, according to my measurements, is 38.5 per cent. With the collapse of the lira, Turkey's inflation has surged. The most important price in an economy is the exchange rate between the local currency and the world's reserve currency – the U.S. dollar. Changes in the exchange rate can be reliably transformed into accurate estimates of countrywide inflation rates. The economic principle of Purchasing Power Parity (PPP) allows for this transformation. I measure the implied annual inflation rate on a daily basis by using PPP to translate changes in the TRY/USD exchange rate into an annual inflation rate. The attached chart shows the path of that annual rate. At present, Turkey's annual inflation rate is 38.5 per cent. So, my measured rate of inflation is 3.2 times higher than the official rate of 12.15 per cent.

*Is Turkey's government dissembling about the real numbers? If so, why do you think this is?*

The government's numbers are misleading. They differ from mine for a number of reasons. First, my numbers represent a much broader aggregate than do the government's. My numbers include price changes for all goods, services, and assets. The government's measurements are based on a much narrower set of prices. Second, my data are of a much higher frequency than the government's. I measure every day. The government measures each month. So, the government's measures lag behind my measures. In short, we are measuring different things. As inflation surges above 25 percent per year, my measures give a much more accurate picture of what is going in with prices in reality than the government's inflation measurements.

*Also according to government agencies, Turkey grew 7.4 per cent in 2017. Do you find it realistic? In your opinion, what was growth in 2017?*

The official 2017 GDP growth of 7.4 per cent for Turkey is a bit on the high side. I think growth in 2017 was closer to 7.0 per cent, or a bit less.

*You also have been saying that if inflation was 39.9 percent, the interest rate should be 40 percent. But Turkey's president Recep Tayyip Erdoğan says that interest is the reason and inflation is the result. What do you think?*

To stabilize the lira and control inflation, real interest rates (adjusted for inflation) should be in the 5-10 per cent range. If inflation is 38.5 percent, nominal interest rates should be between 43.5 percent and 48.5 percent. As for President Erdogan's theories about interest rates, they remind me of the ideas of Rudolf Havenstein. He was the President of the Reichsbank when Germany hyperinflated in 1923.

*What do you think about government intervention into the economy? For example, Turkey's president Erdoğan says that he can intervene into the Central Bank of the Republic of Turkey. Erdogan's invitation of Central Bank governor to his party building and meeting there was strongly criticised. What should be said instead? What would the market like to hear?*

The government's interventions have not helped. Moreover, they have set the economy up for a potential crash within the next two years. The Central Bank is not viewed as independent, and has a very poor record of creating stability in Turkey. The policies of the Central Bank have caused one currency and/or banking crisis after another. The Central Bank's policies have validated my School Boys Theory of History: 'It's just one damn thing after another." The Central Bank should have been mothballed and put in a museum long ago.

*Do you think the monetary policy in Turkey is under political pressure?*

Yes.

*You have been giving opinions about Turkish currency for a long time. How do you evaluate Turkish lira's structure? What are the reasons of swift devaluation of Turkish lira? What do you suggest about this?*

Stability might not be everything, but everything is nothing without stability. That's why I prefer currency board systems in countries, like Turkey, that have had terrible currency histories. An orthodox currency board issues notes and coins convertible on demand into a foreign anchor currency at a fixed rate of exchange. As reserves, it holds low-risk, interest-bearing bonds denominated in the anchor currency and typically some gold. The reserve levels (both floors and ceilings) are set by law and are equal to 100 per cent, or slightly more, of its monetary liabilities (notes, coins, and, if permitted, deposits). A currency board's convertibility and foreign reserve cover requirements do not extend to deposits at commercial banks or to any other financial assets. A currency board generates profits (seigniorage) from the difference between the interest it earns on its reserve assets and the expense of maintaining its liabilities.

With currency boards, the monetary authorities have no power to influence monetary policy. Therefore, the authorities are perfectly independent. You make central banks independent by making them operate under currency board laws. We adopted a currency board law in Bulgaria in 1997, and it works like a charm. My book, Gelişmekte Olan Ülkeler İçin Para Kurulları El Kitabi, which was published in Turkey in 2001, explains all this.

*President Erdoğan thinks that all this devaluation is a plot designed by Western countries. And he just said that the Turkish nation will end this play with a new national and domestic currency and rate. What should we understand from this?*

President Erdoğan's statement about the lira's weakness is nonsense, but typical. When a nation's currency collapses, the leader always blames foreigners.

*Do you think that Turkey is in an economic crisis?*

No. But, Turkey is in trouble, and might experience a crisis within the next two years.

*Do you think economic problems in Turkey can be solved in short term?*

Yes. Install a currency board, and the biggest problem facing Turkey would be eliminated immediately.

*Opposition parties point out that the main reason of this economic crisis is lack of democracy. How would you correlate the devaluation of the Turkish lira and the political atmosphere. What do you think about emergency state in Turkey? How does it seen from the outside of Turkey?*

Opposition parties have never figured out what Turkey's Achilles' heel is. It is the lira. Until that specific problem is fixed, Turkey will face economic problems.

As for the broader issue of economic and human freedoms, Turkey scores very poorly on the Cato Institute's Human Freedom Index, which measures 79 items. Out of the 159 countries covered, Turkey ranks 84th.

*What do foreign investors think about Turkey? What do they want from (or for) Turkey?*

Turkey has huge potential. If the lira became a clone of an anchor currency, such as gold or the U.S. dollar, via a currency board, investors would rush into Turkey. Foreign direct investment would soar to new record levels.

*Do you think that Turkey will knock the IMF's door once again?*

I have no idea. President Erdoğan was wise to show the IMF the door in 2008. Back then the joke was that the IMF should be renamed as the TMF, or Turkish Monetary Fund. He would be wise not to knock on the IMF's door.