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Turkish crisis and the rupee

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Background

The Turkish crisis started as a political issue which related to the US insistence on the release of an imprisoned pastor in Turkey. The President of Turkey Tayyip Erdogan is not willing to relent and as punitive action, USA imposed sanctions against two Turkey government officials in the first week of August, followed by the decision to impose higher duties on imports from Turkey. The US decision to use trade tariffs for addressing this issue which has led to some retaliation from Turkey. However, in this process the Turkish lira has taken a major blow and fallen sharply jeopardizing its economic prospects. This can normally be addressed internally through monetary policy, which is not feasible today as the President is progressively taking control of monetary policy and is against an increase in interest rates. There are around $ 16 bn of bonds which will come up for refinancing by the end of the year which has to be addressed.

The collateral damage on global currencies is palpable as can be seen by the depreciation in various currencies as the dollar has become stronger. This background should be kept in mind when interpreting the future movement of the rupee.

The Turkish response

On August 15, Turkey announced higher tariffs on 22 types of goods imported from US, including imports of cars, alcohol and tobacco, amounting to $533 mn of extra duties. This is just after USA had done the same on Turkish steel and aluminum last week. The tariff on cars would be 120% and that on alcohol 140%. There would also be a boycott on iPhones and other goods from the USA. While the tariffs involved are not really significant in terms of the total trade between these two countries, which according to US data was $ 19 bn, it has had repercussions for currencies across the world. This response from Turkey can be seen against the pledge from Qatar to invest $15 bn in the country to bring it out of the currency crisis, which has positively aided the Turkish currency.

How is Turkey faring?

Based on data in Economist, the following is the broad picture:

- GDP is to grow by 4.3% this year and Q1 growth has been 7.4%. IIP for May is 7%. Unemployment is at 9.6%.
- Inflation in July was at a high of 15.8%.
- The latest CAD is at -5.9% of GDP which is not sustainable and will further make the currency depreciate.

The fiscal balances are on target with the deficit at 2.8% of GDP.
Interest rates are high and the 3 months rate is 20.5% and 10 years is at 19.1%.

The stock market has been down since December unlike in other countries where the indices have moved up. In local currency the Borsa Istanbul (BIST), stock exchange entity of Turkey is down by 16% and in dollar terms is down by 40%. The external debt is about 50% of the GDP and one-third of the domestic debt is in foreign currency.

Currency movement

Turkish Elections took place on 24th June this year and this has been the benchmark used here in the table below for tracking exchange rate movements of various currencies. The dialogue with USA was on but escalated towards the end of July and hence the point from whence the lira started to depreciate continuously has been chosen as the second point of reference. The lira had moved in a range of 4.58-4.88/$ during the first period and then came down to 4.82/$ on 25th July. Subsequently it rose continuously to 6.95/$ on 13th and then came down to 6.04/$ on 15th August.

How have currencies moved since June 24th(%)

Currency	June 25 to Jul 25	July 25 to Aug 15
Euro	**0.02**	**3.19**
Turkish lira	2.88	25.17
Rand	-3.00	10.79
Argentina peso	0.74	9.79
Rouble	0.33	6.92
Brazil real	-1.73	5.21
Pound sterling	0.88	3.69
Chile peso	1.21	2.87
Renminbi	3.47	2.39
Mexican peso	-6.47	2.34
Rupee	**0.91**	**1.72**
Singapore dollar	-0.08	1.39
Ringgit	0.95	1.17
Won	0.58	1.16
Taiwan dollar	0.42	1.14
Philippine peso	-0.46	0.51
Baht	0.89	0.25
Hong Kong dollar	-0.02	0.02
Yen	1.22	-0.22

Source: Pacific Exchange rate service (Positive change is depreciation)

The table shows that:

- Post 25th July, when the trade war escalated between the two countries, the euro fell by 3.2% as the dollar strengthened in the second period. The lira fell by 25.2%.
- There are 10currencies which have done worse than the rupee which includes the renminbi, pound and rouble.
- All the 4 major Latin American currencies (Argentina peso, Mexican peso, Brazil real and Chile peso)have depreciated at a higher rate than the rupee.

- The rupee has fared unsatisfactorily compared with other Asian currencies in this period.

How are Indian fundamentals?

- Trade deficit has widened this year (Apr-July) so far at $ 63 bn as against $ 54 bn in the corresponding period last year.
- FPI flows have been moving upwards. After being negative in the first three months of the year, they turned positive in July at $ 336 mn and increased further to $ 941 mn so far in August. The good news is that both equity and debt flows are positive.
- ECB registrations for first quarter of the year are higher at $ 8.0 bn compared with $ 4.4 bn last year.
- Foreign currency assets have dipped by $ 21.2 bn but are still high at $ 378 bn.
    - RBI has sold $ 14.4 bn in first quarter of the year as against a cumulative purchase of $ 8.8 bn in the corresponding quarter last year.

Therefore, prima facie, there may be little reason to suspect that the fundamentals will drive down the rupee. However factors of concern will be:

- Speculative interest in the market which can drive movements
- Exporters delaying bringing back dollars
- Importers rushing in for buying dollars
- Non Deliverable forwards market over which the RBI has little control.

Where should the rupee be valued?

While the present imbroglio in the political space will cause volatility depending on the way in which the dollar-lira value moves, it may be expected that a value of Rs 69/$ should be the equilibrium one based on expected fundamentals in the rest of the year which is predicated on the expectation of a higher trade deficit and CAD but higher invisibles, FPI, FDI and maintenance of ECBs.

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