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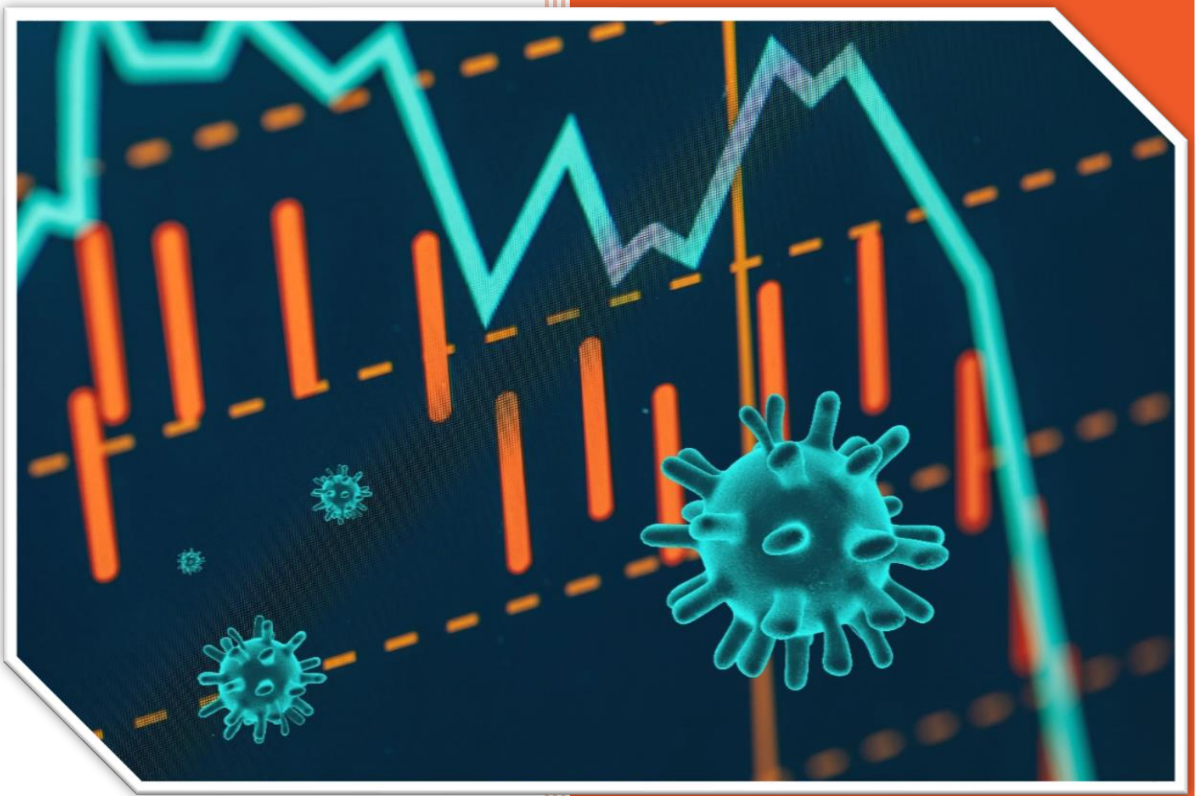

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TRENDS IN THE WORLD AND TURKISH ECONOMY AFTER THE PANDEMIC

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ABSTRACT

The COVID-19 Pandemic caused the world economy to contract sharply in 2020. While a rapid recovery process continues with the start of normalization in 2021, disruptions to global production chains and increasing inflation rates worldwide are at the top of the economic agenda. What happened in the economy and the economic policies implemented during the pandemic created the need for a widespread radical transformation in this area. For example, the direct income support measures applied during the pandemic have brought universal basic income and more egalitarian tax policy discussions up onto the agenda again. On the other hand, it can be seen that the asset purchase programs implemented by the leading central banks during the pandemic created new bubbles in many markets and financial assets. The difficulty of a "normalization" in monetary policy, especially in the USA, has clearly become apparent. The Turkish economy, on the other hand, was caught in the pandemic with high external vulnerabilities and an interest-currency bind. Preferring credit growth, mainly to keep economic activity alive during the pandemic, increased these vulnerabilities. The post-pandemic era seems to be shaping up as a period in which risks and vulnerabilities are very high on the one hand, and important policy changes will be on the agenda, both in the world and in the Turkish economy.

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Introduction

At the time of writing, approximately one and a half years have passed since the COVID-19 epidemic spread rapidly all over the world and was declared as a *pandemic* by the World Health Organization. While the pandemic revealed how inadequate even the richest countries' health infrastructures are and how unprepared they are for such a shock, it also revealed how fragile the global economy is. The fact is that vaccination rates have not reached adequate levels in many countries, and the inequality and injustice in the distribution of vaccines around the world are still causing deaths in many countries due to the pandemic toward the end of 2021. The possibility has also been raised of the emergence of new vaccine-resistant virus mutations.

Restrictions and shutdown measures introduced in many countries after March 2020 to stop the spread of the virus caused a rapid and very sharp contraction in economic activity and brought global financial markets to the brink of collapse. The world economy closed in 2020 with a 3.5 percent contraction.[1] While the 2021 Trade and Development Report of the United Nations Conference on Trade and Development predicts that the world economy will grow by 5.3 percent in 2022, the global growth forecast of the OECD's 2021 Economic Outlook Interim Report is 5.7 percent.[2] Considering that the long-term growth average of the world economy has been around three percent since the 1990s, these rates appear quite high, but in fact, they are not at a level to compensate for the sharp contraction in 2020. Moreover, both UNCTAD and the OECD predict that these rates will decrease again from 2022.

The Economic Situation at the Beginning of the Pandemic

At the end of 2019, before the COVID-19 epidemic spread through the whole world, it was predicted that the growth in the world economy would slow down in 2020. Meanwhile, liquidity problems began to emerge in the financial markets of the USA.[3] At the beginning of 2020, after the disagreement between Saudi Arabia and Russia over oil supply regulation, Saudi Arabia's unexpected lowering of oil prices also caused new fluctuations in the financial markets. On the one hand, changes in the prices of derivatives based on petroleum products, and on the other hand, the anticipation that high debtor energy companies in the USA would be adversely affected by this price movement, caused sharp movements in the financial markets. While the Fed started to lower interest rates again in 2019, it stopped shrinkage on its balance sheet in the last quarter of the year, and even had to start displaying growth on its balance sheet again. In other words, the pressure of the financial markets was forcing the Fed to make a U-turn in monetary policy even before the pandemic started.

At that time, the COVID-19 Pandemic began to spread rapidly, first in Europe and then in the USA. The spread

[1] UNCTAD. 2021. *Trade and Development Report*. https://unctad.org/webflyer/trade-and-development-report-2021.

[2] OECD. 2021. Economic Outlook, Interim Report September 2021: Keeping the Recovery on Track. https://www.oecd.org/economic-outlook/.

[3] M. El-Erian. 2020. Central Banks Face a Year of Mounting Challenges https://www.project-syndicate.org/commentary/fed-ecb-captured-by-financial-markets-by-mohamed-a-el-erian-2020-01.

of the pandemic in China and some other Asian countries has already led to declines in production and trade levels, and disruptions to global production chains have begun to emerge. For example, industrial production in China decreased by 13.5 percent in January and February of 2020, sales slowed by 20.5 percent, and fixed investments by 24.5 percent. The first economic effects of the pandemic's rapid spread to the rest of the world were also revealed in the service industries, and it became clear that the world economy was facing a sharp slowdown.

However, in March 2020, the US stock markets suffered their biggest losses since 1987. The rapid decline in stock prices caused the stock markets to be closed several times. On top of that, the Fed, which also took into account the previous financial fluctuations, announced that it would launch a 1.5 trillion-dollar liquidity program. With the announcement of a series of measures against the pandemic by then US President Trump, and the US Congress bringing in a financial support package, there was a recovery in the financial markets. Despite this, the Fed, in the belief that the danger had not passed, lowered the interest rates to 0% at an extraordinary meeting in mid-March and announced a new asset purchase program of $700 billion. In order to ensure stability in the world financial markets, it aimed to prevent blockages in the global credit markets by activating swap transactions with both commercial banks in the USA and foreign banks. Despite all these measures, the decline in the US stock markets persisted for a while.

As a matter of fact, the US stock markets had been continuing to rise and breaking historical records since 2009, aside from minor pullbacks. The US economy, on the other hand, was experiencing the longest expansionary period in its history after the 2008 financial crisis. Behind these two situations lay the "quantitative easing" programs implemented by all major central banks, especially the Fed, after the 2008 financial crash. Policies implemented after 2008 would be reintroduced in 2020 during the pandemic. After 2008, the Fed,

> “(…) In order to prevent the depression, it not only reduced interest rates to 0 percent but also announced a new monetary easing program, which has never been seen before. Within the framework of this quantitative easing program, (I do not normally alter direct quotations. However, “the” is necessary every time before “Fed”. It is your own quote, and your own paper. So: Your call! Editor) the Fed started to buy the troubled debts and bonds held by the banks. Thus, on the one hand, it aimed to strengthen the banking sector by freeing banks from risky debts and financial assets that could not be repaid, and on the other hand, to revive consumption and investment expenditures through a new credit expansion with the assistance of 0% interest. When we monitor the Fed's balance sheet from 2008 to 2017, we see that monetary expansion has reached 3.5 trillion dollars.
>
> As part of its initial quantitative easing program, known as QE1, between December 2008 and July 2010, the Fed purchased $800 billion of Treasury securities and derivatives based on mortgaged home loans. Despite this, after no signs of recovery were seen in the economy, The Fed made similar

purchases of 600 billion dollars in the QE2 period from November 2010 to July 2011. This time, long-term assets were also included in the program. As the purchase of 400 billion in September 2011 did not stimulate the economy much, QE3 was activated in September 2012, exactly 4 years after the crisis erupted. Under this program, the Fed announced monthly purchases of $40 billion and then $85 billion. Moreover, the Fed announced that interest rates would be kept at 0 percent until at least 2015 and that quantitative easing operations would continue until the economy seriously recovered. In other words, by declaring that it would not allow a new economic contraction, the Fed aimed to build confidence and increase investment and consumption expenditures.

In the same period, the central banks of England and Europe and the Japanese central bank introduced similar policies. Thus, the amount of money-driven to world markets by central banks exceeded 10 trillion dollars. When the 2008 crisis began, all these economies were already in high indebtedness. The path chosen by the central banks in this situation was aimed at reducing the long-term interest rates and stimulating investment and consumption by the abundance of money they created by purchasing debt products in the market through monetary expansion. As this revival got delayed, they released more and more money. However, a very small part of this money, which was released as a result of the largest monetary expansion in history, was directed to real investments. Most of it started to flow to the stock markets and high-yielding countries, including Turkey."[4]

As a result of these developments, going into 2020, bubbles emerged in many financial markets and the indebtedness ratios worldwide reached very high levels. It was estimated that the total amount of debt in the world was around 260 trillion dollars, exceeding three times the total figures for production in the world. Thinking that the US economy was recovering, and worried that the bubbles in the markets would cause a new crisis, the Fed first put an end to "quantitative easing", and then started to slow down the financial expansion by increasing the interest rates. However, this time the Fed was faced with a stalemate:

> "After the Fed's rate hikes in 2018, significant losses were experienced in many stock markets, especially the US stock market. Unable to afford a sharp fall in the stock markets, the Fed feared that high indebtedness levels in both the US and the rest of the world would lead to a new financial crisis if it continued to raise interest rates. In the USA, the debt of both companies and the public exceeded the levels before the 2008 crisis, so the US economy became very sensitive to interest rates. The slowdown in the US, as well as in China and Europe, caused the Fed to postpone interest rate hikes by announcing that they would be 'patient' with interest rate hikes in early 2019. In fact, the Fed was faced with a major stalemate. Unless it

[4] Orhangazi, Özgür. 2020. *The Structure of the Turkish Economy: Problems, Vulnerabilities, Crisis Dynamics*, Ankara: İmge. (pp. 53-56).

> raises interest rates, the abundance of available liquidity would contribute to further inflating financial asset bubbles and raising the danger of a financial crisis. When it increased interest rates, there was a possibility that financial asset bubbles would burst and cause a new financial crisis."[5]

At the beginning of 2020, the indebtedness and leverage ratios in the US economy reached very high levels, and financial asset bubbles were inflated as a result of the abundance of liquidity. For example, it was estimated that at least one-sixth of publicly-traded companies in the United States did not have enough income even to make the interest payments. These companies, which began to be called "zombie companies", were able to survive thanks to cheap borrowing opportunities. While there was already concern that any negative development would trigger a crisis in the financial markets in 2020, the global pandemic of COVID-19 has added both supply- and demand-side shocks to this picture. Therefore, the Fed's interventions will not solve the fundamental problems, and the supply and demand shocks caused by COVID-19, together with the sharp contraction of production and incomes, led to the introduction of large-scale fiscal policies, as will be discussed below.

Will There Be a New Post-pandemic Macroeconomic Consensus?

After March 2020, many observers and commentators began to anticipate that the pandemic would create lasting effects and significant transformations in the global economy. Meanwhile, restrictions and lockdown measures brought economic activities to a standstill and financial markets to the brink of collapse, causing governments in major countries to provide unprecedented amounts of income support. This led the central banks to start implementing financial asset purchase programs similar to the "quantitative easing" policies implemented after the 2008 global financial crisis, in order to support these government policies and prevent the collapse of financial markets. While small businesses and large multinationals that lost their income were kept alive with the direct support of governments, the financial markets were not only saved from collapse with the liquidity expansion of the central banks, but a new wave of rises began in these markets. During the pandemic, it was the direct income support to members of the public that kept the economies alive, especially in the major countries. The total intervention reached 10.6 percent of the national income in the USA, 16.3 percent in the United Kingdom, and 15.5 percent in Japan. In this period, it is estimated that the total economic support provided in Turkey remained at around 1 percent of the national income.[6]

The mainline of neoliberal economic thought, which started to dominate the whole world in the 1980s, was based on the fact that free markets would give the most optimum results in every field, and therefore the state should both withdraw from economic activities and minimize regulation of the markets. Public expenditures had to be reduced in such a way that the budget would not have a deficit, and taxes had to be reduced as well. In

[5] Orhangazi, Özgür. 2020. *The Structure of the Turkish Economy: Problems, Vulnerabilities, Crisis Dynamics*, Ankara: İmge. (p. 22).

[6] UNCTAD. 2021. *Trade and Development Report*. https://unctad.org/webflyer/trade-and-development-report-2021.

this framework, central banks were given the target of keeping inflation low with a predictable interest rate policy. This consensus was shaken by the 2008 global financial crisis when governments in major countries introduced large bailout packages, and central banks began to implement "quantitative easing" policies, to save financial markets and institutions. During this period, many began to think that the age of neoliberal policies had come to an end, and with the election of Barack Obama as president in the USA, a radical change in economic policies emerged. However, by the mid-2010s, it was seen that the Obama administration had not made any changes in general economic policy, except for a few regulations in the financial markets. Similarly, although the financial crisis in Europe raised expectations for structural change, there was no significant change in economic policies there either.

With the economic policies implemented during and after the pandemic, the idea arose that a radical transformation was needed in economic policies, and expectations in this direction became much more widespread. As a result of the direct income support applied during the pandemic, discussions of a universal basic income and a more egalitarian tax policy were brought to the agenda again. Moreover, the role of public investment in stabilizing economies against shocks began to be widely debated.[7]

In fact, signs of this consensus change even began to appear in the *Financial Times* newspaper, which generally advocates global neoliberal policies, at the very beginning of the pandemic. For example, an article published on April 3, 2020, recommended that redistribution policies, a universal basic income, and high wealth taxes that would reverse the economic policies of the last forty years should be reconsidered. The article emphasized the need to increase public investment and reduce insecurity in the labor markets.[8]

Joe Biden, who took over the presidency of the USA at the beginning of 2021, quickly introduced a series of economic packages. The Biden administration took up the idea of increasing social security expenditures and making tax policies more egalitarian. The state's infrastructural investments, and in this context, "green energy" investments, have also reinforced these expectations. A report prepared by Biden's council of economic advisers draws attention to the view that policies such as low taxes, low public expenditures, and that deregulation is necessary for economic growth has dominated economic policies in the USA for the past four decades. According to the report, during this period there was not enough investment in infrastructure, public goods, and innovation in the US. And much of that period's economic growth benefited those at the top of the income and wealth distribution charts. The report emphasizes that initiatives such as the *American Jobs Plan* and the *American Families Plan*, proposed by the Biden administration, will prioritize public investments

[7] See: Haughwout A (2019). Infrastructure investment as an automatic stabilizer. In: Boushey H, Nunn R and Shambaugh J eds. *Recession Ready: Fiscal Policies to Stabilize the American economy*. Brookings. Washington, D.C: 129–152; and Orszag PR, Rubin RE and Stiglitz JE (2021). Fiscal resiliency in a deeply uncertain world: The role of semiautonomous discretion. Policy Brief No. 21-2. Peterson Institute for International Economics.

[8] Virus lays bare the frailty of the social contract https://www.ft.com/content/7eff769a-74dd-11ea-95fe-fcd274e920ca.

and aim to improve the welfare of wider groups, contrary to this trend.[9]

Although all these developments encourage the claims that we will be at the dawn of a new economic era[10] after the pandemic and that a new type of capitalism is about to emerge[11], some think that neoliberal policies have been declared dead since the 2008 global financial crisis, so these changes should be approached cautiously today.[12]

On the other hand, leading central banks, especially the Fed, resorted to the "quantitative expansion" policies that they put into effect after the 2008 global financial crisis, yet again, and on a much larger scale during the pandemic. For example, a significant portion of the Fed's financial asset purchases consisted of public debt securities issued to finance public expenditures. This has started to be shown to prove that states can engage in large expenditure projects with the support of their central bank, even after the pandemic. In this context, the idea that large green investment projects could be funded in a similar way against the climate crisis has become stronger. It is generally accepted that the most urgent measures to be taken against the climate crisis are huge investments in renewable energy and reducing carbon emissions. These green investments also have job creation, employment, and income-generating aspects. Calls for a transformation led by public green investments were already growing before the pandemic. During the pandemic, both the expenditures of the states and the massive interventions of the central banks showed that green investments can be funded in this way.

However, the Trump administration did not take any steps in this direction between 2017 and 2020; on the contrary, it weakened some regulations. The US even withdrew from the Paris Climate Agreement in 2017. One of the first acts of the Biden administration was to rejoin the Paris Accords. With the 8-year, $2.7 trillion *American Jobs Plan*, it is planned to direct approximately $130 billion annually into investments that will reduce carbon emissions, support R&D activities on climate, and support employees in the fossil fuel industries. Regardless of whether these will receive political support or whether they will ever be implemented, it is certain that even if they are fully carried out, they will not be sufficient to reach the net zero emissions target in 2050 (UNCTAD 2021: 26). It seems that the kind of progress that will be made in this regard will mainly depend on the policies of the USA, EU, and China.

Inflation Threat and Financialization Trends

This enormous liquidity expansion, which went beyond the 2008 crisis, not only enabled public expenditures and kept economies alive but also gave a lifeline to financial markets and contributed to the continuation of financialization processes. However, the idea that such a monetary expansion will cause inflation to get out of control is also widely supported. The initial impact of the pandemic was a sharp contraction in economies and an

9 See: Council of Economic Advisors (2021). Building Back Better: The American Jobs Plan and the American Families Plan. *Issues Brief*. May.

10 Tooze A (2021). Biden's stimulus is the dawn of a new economic era. *Foreign Policy*. 5 March.

11 Elliot L (2021). During the pandemic, a new variant of capitalism has emerged. *The Guardian*. 30 July.

12 Galbraith JK (2021). The death of neoliberalism is greatly exaggerated. *Foreign Policy*. 6 April.

accompanying fall in inflation rates. However, especially since the second half of 2020, the rapid recovery in supply and demand problems due to disruptions in global production chains caused price levels to rise rapidly. Food inflation was added to the rise in oil prices and the prices of metals, which are the main production expenditures of many industries. According to the calculations of the World Agriculture Organization, food prices have reached their highest level in the last 10 years. The surge in inflation was faster in countries with high inflation before the pandemic, such as Turkey and Argentina. In countries such as Brazil and Mexico, the devaluation of their currencies also contributed to inflation.

The question of whether inflation is temporary or permanent remains particularly important for the US economy, although the Fed is of the opinion that the increase in inflation is temporary and therefore there is no need to raise interest rates immediately when the inflation target is exceeded, as has happened before. By mid-2021, the surge in the consumer price index in the USA had reached 5.4 percent. The main problem here is that if inflation is considered to be permanent and structural, it is expected that the Fed will prefer to slow down the economy by increasing interest rates. However, this will both negatively affect the post-pandemic recovery and, perhaps more importantly, cause problems in the financial markets.

The biggest fear is that inflation will trigger a successive cycle of price and wage increases. In the 1970s, the slowdown in productivity due to the rise in oil prices triggered cost inflation, inflation led to wage increases, and wage increases to price increases above costs. However, the very low bargaining power of the working class today supports the idea that such a cycle will not occur. Still, real wages, which have been stagnant for 30-35 years, have started to rise in the USA. Whether this will translate into price increases depends on labor productivity. If the increase in labor productivity is above the increase in real wages, such a cycle is not expected to occur.

One important consequence of the "quantitative expansion" policies of central banks and the increase in global liquidity was the increase in financial asset prices. The financial markets, which came to the brink of collapse in March 2020, then began to break records after records. It is a common belief that new bubbles are forming in many markets and financial assets.[13] This situation ties the Fed's hands in deciding when to end "quantitative expansion". As in the last phase of the "quantitative expansion" policies implemented after the 2008 global financial crisis, the Fed's termination of this policy creates a stalemate. The Fed's attempts to shrink its balance sheet and increase interest rates may cause significant depreciation and even sharp collapses in the financial markets. This worry has begun to drag the Fed into the kind of stalemate we described above. For example, when the Fed increased interest rates in 2018, there were great losses on many stock markets, especially in the US. Thus, the Fed is faced with a similar dilemma: as long as "quantitative easing" continues, and interest rates stay around 0%, financial asset bubbles will continue to inflate and the danger of a financial crisis

[13] Skidelsky, Robert. 2021. "Where Has All the Money Gone?" Project Syndicate, September 15, https://www.project-syndicate.org/commentary/quantitative-easing-has-fueled-financial-instability-by-robert-skidelsky-2021-09.

will continue to grow. With the reversal of these policies and the increase in interest rates, there is a high probability that asset bubbles will burst and a financial crisis will emerge immediately.

Considering the increasing trend in inflation, according to Bloomberg's estimates, as of December 31, 2020, debt securities worth 17.8 trillion dollars worldwide offer negative real returns. This process increases inequalities. While the owners of financial assets are getting richer, the groups with lower income and wealth distribution are getting poorer as a result of the pandemic. According to Bloomberg's estimates, the total wealth of the world's 500 richest people increased by $1.8 trillion last year, reaching $7.6 trillion. Of course, this has also increased discussions about income and wealth inequalities, as mentioned above.[14]

Trends in the Turkish Economy

The Turkish economy, on the other hand, was caught in a situation where economic growth slowed down and vulnerabilities became more evident. In addition to the direct effects of the pandemic, the Turkish economy had already started 2020 with many problems and vulnerabilities. In the 2000s, the growth model of the Turkish economy was dependent on foreign capital inflows, based on debt growth, and was construction-oriented. After the 2018 currency crisis caused by this model, economic growth came to a standstill in 2019.[15] The relatively favorable course of global liquidity conditions ensured that foreign capital inflows continued, albeit at a very low level. In 2019, the Fed re-starting to lower interest rates and issue money to the market in the face of the liquidity crunch in US financial markets played an important role in this regard. This gave the Central Bank room to lower interest rates and reinvigorate expansion, driven by debt growth. In addition, a deeper recession was averted with the decline in imports and the increase in public expenditures. When the COVID-19 Pandemic broke out in China, the vast majority did not expect it to spread to the rest of the world and bring almost the entire world economy to a standstill. In fact, the expectation that Turkish companies could take over the export markets that China would lose due to the pandemic, and that this pandemic would benefit the Turkish economy, began to be expressed. Calculations were being made that the strong decline in oil prices would also benefit the Turkish economy, due to its position as an oil importer. However, the rapid spread of the pandemic in Europe and the USA and then to Turkey turned all these calculations upside down.

The Turkish economy, which took on an increasingly unstable and fragile appearance after the currency crisis in the summer of 2018, shrank in the last quarter of 2018 and the first half of 2019. It has been showing signs of slow recovery since the second half of 2019. In 2020, with the economic effects of the COVID-19 Pandemic, there was a rapid foreign capital outflow, as in similar countries. While the economy started to shrink again with the effects of the pandemic, it was on the

[14] Curran, Enda & Chris Anstey. 2021. "Pandemic-era Central Banking is Creating Bubbles Everywhere" Bloomberg Market January 25 https://www.bloomberg.com/news/features/2021-01-24/central-banks-are-creating-bubbles-everywhere-in-the-pandemic.

[15] Orhangazi, Ö. and E. Yeldan. 2021. Re-making of the Turkish Crisis. *Development and Change*, 10.1111/dech.12644.

verge of a currency crisis. Especially in the major countries, there was a desire to reduce the economic effects of the pandemic, with large-scale public expenditure and income support programs. In Turkey, on the other hand, the government has chosen to keep public support at a very limited level. A significant part of the support was funded through the resources of the Unemployment Insurance Fund. From mid-2020, interest rates were lowered, banking regulations were also changed, and there was an attempt to support the economy through a credit expansion. The Turkish economy, whose growth rate remained at 0.9% in 2019 with the support of rapid credit growth, closed 2020 with a growth of 1.8%.

The problems that emerged in the US financial markets at about the same time as the COVID-19 Pandemic prompted the Fed to take extraordinary measures once again. The Fed had to pour trillions of dollars into the markets to avoid any liquidity crisis. Similar quantitative easing policies implemented after 2008 had increased foreign capital inflows to Turkey and similar countries to unprecedented levels. However, the uncertainties experienced this time round prompted international financial investors to quickly return to safe-havens. As a result, capital outflows from "emerging markets" accelerated. The Turkish economy, which is dependent on foreign capital inflows for economic growth, entered a recession even when these inflows slowed down, as they did in 2018 and 2019. In conditions where the appetite for global risk and confidence hit rock bottom, the exodus of international financial investors from Turkey further aggravated the situation.

One of the most important elements of the growth model that dominated the Turkish economy in the 2000s was the increase in debt. After the 2018 crisis, many companies were unable to pay their debts and declared concordat one after another. The debt crisis was postponed with the intensive introduction of the Credit Guarantee Fund, changes in banking regulations, and similar measures. However, there was also the possibility that the COVID-19 shock would cause serious problems in debt payments again. The Central Bank brought the interest rates down further and took measures to increase the amount of credit the banking sector would open to the real sector. Despite all this, it can be said that in an environment where the expectations are quite negative and the global recession has become certain, rather than going toward new investments, these loans help companies in distress to surviving at the expense of worsening their balance sheets.

Pushed by low-interest rates and massive credit expansion in 2017, the economy faced a currency crisis in the summer of 2018. While low-interest rates and credit expansion supported economic growth, high current account deficits increased the need for foreign capital inflows. The global conditions that would keep both the interest rates and the exchange rate low had disappeared. However, chronic and very high current account deficits and the high amount of foreign debt accumulated in the previous periods led to an increase in the demand for foreign exchange. The crisis could only be brought under control when the Central Bank pulled the overnight interest rates up to 25.5 percent. The Turkish economy shrank at the end of 2018 and the beginning of 2019. The depreciation of the Turkish Lira was rapidly reflected in inflationary terms, and the inflation rate soared up to 25 percent.

In 2019, the Fed suspended interest rate hikes. Foreign capital inflows into Turkey continued, albeit not at the same level as in previous periods. In addition, the fact that the inflation rates came down due to a base effect created some room for the Central Bank to start cutting interest rates again in the second half of the year. However, as the interest rates decreased, the lira continued to depreciate. This was a period in which interest rates were lowered to stimulate economic growth, and the foreign exchange reserves of the Central Bank were used with back-door interventions to prevent the exchange rate from rising too much. Thus, a "creative" solution to the interest-currency clinch was found. Interest rates could be lowered, but the lira did not lose much value. In fact, in some periods of 2019-2020, the exchange rate was kept almost constant with these backdoor interventions.

Meanwhile, the interest rate, which reached 25.5 percent in September 2018, was reduced to 9.75 percent in May 2020. In the pandemic period, economic growth was supported through credit expansion with a low-interest rate instead of providing direct income support through the budget. However, 2020 was also a time when hot money escaped rapidly from Turkey and similar countries. As a result, the attempt to control the exchange rate while keeping interest rates low caused the Central Bank to deplete all its foreign exchange reserves. Not only that, it turned out that the Central Bank was selling more foreign currency than it actually had, using a protocol with the Treasury, through public banks, and the reserves fell to negative figures. The dollar rate, which was around 5.9 to the lira at the beginning of January 2020, exceeded 7 in May. Although this was kept under control for a while with the back door reserve sales, it broke a new record by exceeding 8.5 in the fall.

Growth, supported by low-interest rates and rapid credit expansion, led to an increase in imports. On the other hand, tourism revenues were falling rapidly due to the effect of the pandemic, and foreign capital outflows continued. This increased the pressure on the Turkish Lira. There was an attempt to avoid this pressure by using foreign exchange reserves with the covert interventions of the Central Bank. But the rapid depletion of foreign currency reserves put the Central Bank in a position of net foreign currency debtor, and in the autumn of 2020, the economy was on the brink of a new currency crisis. At this point, with the policy change, both the head of the Central Bank and the Minister of Treasury and Finance were replaced. Interest rates were raised sharply and the Turkish lira started to appreciate again, as some of the short-term financial capital seeking high returns in an environment of abundant global liquidity turned to Turkey during this period.

The image of stability obtained with these changes did not last long. This time, high-interest rates, combined with the effects of the pandemic, began to complicate the internal debt cycle and increase the financing costs of companies. Toward the end of March 2021, the signal that a policy change would be made again, and interest rates would be lowered, came with the replacement of the head of the Central Bank once again, and the appointment of a low-interest rate proponent. However, this appointment resulted in a very rapid outflow of foreign capital from Turkish Lira-denominated assets, and the lira promptly depreciated. The result was that a rate cut became impossible in the short run, and the economy eventually entered a period of high interest and exchange rates.

One of the direct effects of the pandemic was seen in unemployment and employment statistics. The official unemployment rate reached 13.1 percent, the youth unemployment rate reached 25.3 percent, and the broad unemployment rate, which TURKSTAT defines as "idle workforce", reached 27.8 percent. When we look at the distribution of GDP, it was seen that the share of employees in total income decreased from 39 percent in the same period of 2020 to 35.5 percent in the first three months of 2021. The fact that this ratio, which normally changes very slowly over long periods, slumped so sharply in one year was an indicator of how fast inequalities were increasing. On the other hand, while the direct and indirect effects of the pandemic are felt by many, there are increasing signs that severe impoverishment is spreading. According to the Turkish Economic Monitoring Report published by the World Bank in April 2021, the absolute poverty rate in Turkey, which was 8.5 percent in 2018, increased to 10.2 percent in 2019 and 12.2 percent in 2020. In other words, by the end of 2020, the absolute number of poor in Turkey, as defined by the World Bank, had reached 8.4 million people.

In the second half of 2021, a recovery in economic activity began with the removal of almost all restrictions, the provision of vaccines, and the rapid introduction of vaccination. However, when the Central Bank cut interest rates by one percent in September 2021, the exchange rate started to rise rapidly again. With this, it was seen that the Turkish economy could not get rid of the interest-currency clinch that it had been dragged into since 2018. However, this time, global liquidity conditions were not at all suitable for a rate cut. Interest rates on US Treasury bonds were increasing, and the US dollar was relatively valuable against other currencies. And at any moment, the Fed was expected to announce that it would begin to reduce its asset purchases. This time, the reaction of the financial markets to the interest rate cut was quite harsh, and the depreciation of the lira accelerated. Despite this, interest rate cuts continued in October, and signals were given that the rates would fall further in November.

The high dependency of production on imports causes every exchange rate shock to be reflected as a price increase, and the Turkish economy has entered a period in which high unemployment and high inflation are observed together. The increase in inflation observed both in the USA and in the rest of the world also poses a great danger, it being already high in a country like Turkey that is highly dependent on imports for production.

It is understood that the motives behind the low-interest policy are twofold: keeping the economic growth high regardless of the cost and supporting the construction capital, which is especially close to the government's heart. The 'developmentalist' motifs sprinkled around this policy are far from being part of a coherent program. In this context, rising inflation is seen as a cost that must be endured. Before a possible early election, it is also possible to try to compensate for the effects of inflation, even for the short term, at least for some segments of society, by using public budget facilities.

It is seen that the hope for the exchange rate is stabilization, albeit at a high place. However, at a time when the Fed has started to reduce its asset purchases, it would not be surprising to see the continuation of the increase in the deterioration of the exchange rate without this stabilization bringing the country to the brink of a balance of payments crisis and a U-turn in interest policy again. As a result, the Turkish economy is being dragged into an environment where both the exchange rate and interest rates are quite high.

On the other hand, as mentioned above, while it is feared that the Fed's ending of "quantitative expansion" policies at some point will cause a crisis in worldwide financial markets, this policy change is also expected to affect Turkey and similar countries through capital movements. In an environment where both global uncertainties and fragilities in the Turkish economy are at high levels, it does not seem possible for Turkey to attract much foreign capital. This keeps on the agenda the possibility of problems in the rollover of external debts. Up to now, private sector banks and companies have not had any problems with debt rollover, but foreign debt rollovers are becoming more and more expensive. While the private sector is trying to reduce risks by reducing its FX short position, the public's FX debts, and thus FX short position, continue to increase.

In short, the post-pandemic period seems to be shaping up as a period in which risks and vulnerabilities are very high on the one hand, and important policy changes will be on the agenda, both in the world economy and in the Turkish economy. It is expected that the negative economic effects of the pandemic will be overcome in 2022. Despite this, the Fed has announced that it will begin to reduce its bond purchases, which reached record levels during the pandemic, in late 2021. The effects of the reduction in asset purchases on global financial markets will be the main determinant in this course.

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