Will the Turkish Economy Kill Erdogan's New Ottoman Empire?

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Recep Tayyip Erdoğan's Turkey in the past two years has engaged in a remarkable series of active geopolitical foreign interventions from Syria to Libya to Cyprus and most recently on the side of Azerbaijan in the territory conflict with Armenia over the status of Nagorno-Karabakh. Some have called it Erdogan's 'New Ottoman Empire' strategy. Yet a free-falling Lira and a collapsing domestic economy threaten to put an unplanned end to his grand geopolitical ambitions. How serious is the economic crisis in Turkey today and does Erdogan have a Plan B?

Lira Freefall

By the end of October, as open conflict between President Erdogan, who demands low interest rates from the central bank to stimulate growth, and financial markets who demand higher rates to "offset risk," the Turkish Lira dropped a sharp 3% in a day. To date in 2020 the Lira is down 34% against the US dollar and by 70% over the past five years. While some think it would stimulate Turkish goods exports, what it is doing is exposing the entire Turkish banking system and economy to a colossal debt blowout. The problem is that to spur Erdogan's growth agenda, Turkish banks have turned to the dollar-based low-interest rate inter-bank market to borrow funds to lend on to Turkish consumers to build houses or open hotels and other small businesses. Every time the Lira falls against the dollar, it needs that much more Lira to repay the old dollar debts, 34% more since January as of this writing.

Foreign investors, seeing the data, are rushing to liquidate Turkish stocks and bonds and exit, sending the Lira down further and hitting financial assets that back loans throughout the economy. Moreover inflation officially near 12% is adding to the crisis.

In recent years, spurred by Erdogan, the Turkish economy has expanded at an annual rate above that of China or India pre-corona. Most of that has been in the construction sector with new homes, shopping centers and tourism hotels booming. The problem is that now, with the Lira crisis showing no sign of end, and the EU states going into lockdown for coronavirus, Turkish tourism, the is being devastated. In August, peak foreign tourism season, tourism arrivals were down a huge 70% from August 2019. And with a world economic slump since the corona crisis, all exports are down.

Crisis of Foreign Debt

Erdogan's problems are compounded by the fact that Turkish businesses and banks have largely turned to foreign markets to borrow at lower interest rates, something attractive if the Lira is stable or even rising. When the Lira falls 34% this year or more, it is a catastrophe for the borrowers. To prevent that Lira fall the central bank has used much of its hard currency foreign reserves and even drawn on foreign currency swap lines to avoid rate increases. This is bringing the situation to a new potential crisis in many ways similar to the 1997 Asia Crisis. The falling Lira means construction companies are unable to repay foreign loans in dollars or Euros. Bankruptcy is next. In 2018 Turkish banks and private companies as well as government owed some $467 billion in foreign currencies. The central bank foreign currency reserves as of September, 2020 amount to $36 billion or less, after losing some $65 billion of foreign currency reserves in a fruitless defense of the Lira. Gold reserves decreased to USD 42 billion. This is not stable.

To make matters worse, in September Moodys' credit rating agency lowered the rating on Turkish government debt to 5 grades below "junk," the lowest ever. At this point, Erdogan has limited options to salvage the economy and with it, his re-election in three years. Extremely low interest rates from 2012 through until 2018 created an unprecedented economic boom, but in reality a debt-financed construction and real estate bubble dependent on foreign credits. That is now unravelling and it will have major consequences for Erdogan's "active" foreign policy.

Geopolitical Agenda Threatened

In 2010 Erdogan's then-Foreign Minister Ahmet Davutoğlu proclaimed the famous "Zero Problems Policy" with its neighbors. That has long since vanished along with the foreign minister. Today Erdogan seems intent on creating clashes with all Turkey's once-allies.

Erdogan's bold attempt to place Turkish gas exploration ships in recent months into territorial waters of EU member Cyprus and Greece, claiming sovereignty over the offshore region, has brought it into direct clash with fellow NATO member Greece which plans a gas pipeline from Israel and Cyprus to Greece and on to Italy, as well as with France. Turkey has refused to sign the UN Convention on the Law of the Sea.

To further complicate matters, some months ago Erdogan openly backed the embattled Muslim Brotherhood-led Government of National Accord in Tripoli Libya against a strong military advance by General Haftar. In June Erdogan, who supports the Muslim Brotherhood, sent Turkish troops to support Tripoli. Haftar is backed by Russia, Egypt, the UAE and France. The Turkey-Libya Special Economic Zone declared earlier this year provocatively cuts across the planned EastMed Israel-Cyprus-Greece gas pipeline path.

In Syria, France supports the Syrian Kurds, bitter foes of Erdogan who maintains a military presence in the border region of Syria to control the Kurds. As well France backs the Cyprus-Greek position on their rights to the offshore gas, against Turkey. The French Total energy group is active in the Cyprus project.

Most recently, in the wake of the gruesome beheadings in France by Jihadists, Erdogan has called for a boycott of French goods and called Macron mentally ill after Macron defended the free speech rights of a French satire magazine for reprinting a cartoon of the Prophet Mohammed.

Straining ties with Russia in addition to Libyan adventures, has been the open backing from Erdogan, including reportedly of military supplies and possible troops, in Azerbaijan's clash with Russian ally Armenia over Nogorno-Karabakh. A new factor in Turk-Azeri relations is the Trans Anatolian Natural Gas Pipeline from Arerbaijan to Turkey where Turkey imported for the first time 5.44 bcm Azrei gas in the first half of this year, a 23 percent increase compared to the same period of 2019.

Yet Erdogan has gone to great lengths to cultivate good relations with Russia's Putin among other things to buy the advanced Russian S-400 Russian anti-missile defense system, earning the condemnation of NATO and Washington.

At this point the hyper-active foreign interventions by Erdogan's Turkey have met little serious sanction or opposition by the EU. One obvious reason is the large exposure of EU banks to Turkish loans. According to a September 17 report in the German Die Welt newspaper, Spanish, French, British and German banks have over a hundred billion dollars invested in Turkey. Spain is most exposed with $62 billion, followed by France with $29 billion. That means the EU is walking on eggshells, not eager to sink more money into Turkey but leery of precipitating a full clash of economic sanctions.

As Erdogan for many reasons refuses to go hat in hand to the IMF, his options at present are to drastically reduce his foreign geopolitical operations to concentrate on stabilizing the domestic economy, or find a Plan B. At this point, the only possible contender for a Plan B financial rescue would be China.

Can China Fill the Gap?

In recent years Erdogan has taken remarkable steps to better relations with Xi Jinping and China. In 2019 during a visit to Beijing Erdogan shocked many by refusing to condemn China's reported harsh treatment of the large Muslim Uyghur population in Xinjiang region. For decades, Turkey, which calls the Uyghur region "East Turkestan," accepted Uyghur Muslim refugees and condemned what Erdogan once called China's "genocide" in Xinjiang. In July 2019 during a visit in Beijing, Erdogan buried all mention of the Uyghurs and praised Turkey cooperation with China. Cynics might suggest hopes of huge China financial largesse influnced Erdogan's shift.

During the previous Lira crisis in 2018 when the Lira plunged by 40%, China's state-owned Industrial and Commercial Bank of China loaned the Turkish government $3.6 billion for energy and transportation projects. In June 2019, in the wake of Istanbul municipal elections that indicated crumbling support for Erdogan, China's central bank transferred $1 billion—the largest cash inflow, under a swap agreement. The July, 2019 Beijing meeting with Xi Jinping came just after that election setback at a time Erdogan was vulnerable as never before on the economy. Chinese Uyghurs might be fellow Muslims, but they don't vote in Turkish elections.

Beijing has responded. Under the umbrella of China's Belt and Road Initiative (BRI), earlier this year China's Export and Credit Insurance Corp. committed up to $5 billion for Turkey's Sovereign Wealth Fund, to be used for BRI projects. Previously China has invested in a railroad from Kars in eastern Turkey via Tbilisi, Georgia, to Baku, Azerbaijan, on the Caspian Sea, where it links to transportation networks to China. In 2015, a Chinese consortium bought 65 percent of Turkey's third-largest container terminal, Kumport, in Istanbul. Chinese investors this January saved an Erdogan prestige project buying 51 percent of the Yavuz Sultan Selim Bridge connecting Europe and Asia across the Bosporus when an Italian-Turkish consortium controlling the bridge opted out. And Beijing is now allowing Turkish companies to use the Chinese yuan to make trade payments, allowing them easier access to Chinese liquidity.

While the Chinese involvement clearly gives Erdogan some aid, it has not been able to stop the latest free-fall of the Lira or to be enough to replace the $100 billion EU and related borrowings to revive the Turkish economy. China yuan-Lira trade and swap agreements help Turkey import more Chinese goods, but she needs dollars to repay the EU and other dollar loans. China, despite optimistic headlines in media, has been severely hit by the global lockdowns and trade collapse from the coronavirus this year. Exports from China have by no means recovered to 2019 levels and domestic food problems from severe flooding and locust plague this year have put added strains on the world's second largest economy.

With Beijing beefing up its military responses in the East China Sea and around Taiwan as well as being forced to renegotiate many debt deals with BRI countries in Africa and elsewhere that have been unable to pay, it is questionable whether Xi Jinping regards his recent alliance with the unpredictable Erdogan as his highest priority during China's present redirection of its economy inward.

2023, the year of next elections was to be the glory year for Erdogan's AKP as Turkey celebrated 100 years since founding. The party's "2023 Vision" program calls for Turkey to become a Top Ten economy with autos, steel and defense industries of world class and a GDP of some $2.6 trillion.

That all now looks very implausible. The next months for Erdogan and the Turkish economy look to be quite turbulent and far from clear. The shrewd Erdogan is rapidly running out of winning cards to play.

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This skilfully researched book focuses on how a small socio-political American elite seeks to establish control over the very basis of human survival: the provision of our daily bread. "Control the food and you control the people."

This is no ordinary book about the perils of GMO. Engdahl takes the reader inside the corridors of power, into the backrooms of the science labs, behind closed doors in the corporate boardrooms.

The author cogently reveals a diabolical world of profit-driven political intrigue, government corruption and coercion, where genetic manipulation and the patenting of life forms are used to gain worldwide control over food production. If the book often reads as a crime story, that should come as no surprise. For that is what it is.

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