



Polina's Perspective Between Two Seas - Turkey's Orthodox Waters and Geopolitical Currents

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“Istanbul’s beauty is never-fading, however there is also a familiar paradox that often emerges in developing countries: the tension between doing what is economically orthodox and what is politically palatable.”

Have you had the good fortune to visit Istanbul? It’s a vibrant hub bridging Europe and Asia across the Bosphorus Strait. The mix of Ottoman history and modern energy is palpable, and the views are breathtaking.

Following my recent trip to Turkey, I was struck by the following:

- Istanbul’s beauty is never-fading, however there is also a familiar paradox that often emerges in developing countries: the tension between doing what is economically orthodox and what is politically palatable.
- Turkey’s current monetary policy stance presents a great case study of this dilemma, with implications that extend far beyond its borders.
- How the country is balancing its priorities, including monetary policy orthodoxy and its geopolitical & political agenda.

After a period of monetary unorthodoxy beginning in 2018, Turkey’s central bank pivoted to orthodox policies, following parliamentary and presidential elections in May 2023. Since then, it has embarked on what many would consider a textbook monetary tightening cycle, with policy rates reaching 50% in March 2024, in an attempt to combat inflation that had peaked above 80%. As inflation started to come down, the CBRT moved to a softer stance, bringing rates down to 37% in January this year, with an expectation that inflation would reach low- to mid-20s by the end of the year. Speaking with executives of the country’s top banks, a clear picture emerged: the orthodox approach is working, but at a cost.

Since mid-2024 the banking sector has been experiencing a profitability renaissance. Net interest margins (NIMs) are reaching new highs, with some institutions targeting 4.5% NIMs – a stark contrast to the compressed margins of recent years. The market expects further decline in inflation this year to the mid-20s range, and this should further boost profitability in the banking sector. Every 100 basis points of inflation translates to roughly 15 basis points of negative interest margin pressure. However, the policymakers have been keen to use macroprudential measures to complement the monetary policy toolkit, given limited appetite to keep rates at these elevated levels. This has created a delicate balancing act for financial institutions.

Select macroprudential measures could strain banks’ balance sheets and are short-lived in nature. For example, the requirement to maintain TRY deposits at a minimum of 60% of the total deposit base risks putting pressure on banks’ margins as they compete for domestic deposits, especially given Turkish people’s desire for gold deposits, its substantial increase in value over the last year, and its classification as an FX deposit.

Furthermore, the willingness to hike rates from here is also quite limited. The human cost is apparent: non-performing loans (NPLs) are rising as 4 million individuals remain in default on personal credit or credit card debt, with interest rate burdens that far exceed wage growth. While banks have been skilled at selling their NPL portfolios, public and political tolerance for higher rates is clearly low. The question that was on my mind, therefore, as I went from meeting to meeting in Istanbul was: “what happens when prudential measures stop working?”

What struck me most during conversations with government officials and business leaders was how leveraging a geopolitical position has taken precedence over delivering specific economic metrics in Turkey’s strategic calculus. The country is positioning itself as a critical energy hub between Europe and the Eastern Mediterranean, with ambitious pipeline projects connecting Qatari gas to Germany and potential hydrocarbon discoveries in Kurdish regions.

This geopolitical focus isn’t merely aspirational – it is reshaping domestic priorities. The recent resolution with Kurdish groups, aimed at bringing PKK members back without prosecution, reflects a pragmatic approach to internal stability that supports external positioning. As one senior advisor noted, “friendship with Kurds is key” to Turkey’s broader regional strategy.

The implications are profound. The Kurdish peace process is critical for ending a 40-year conflict, offering a path for stability in Turkey, Syria and Iraq by transforming the PKK from an armed group into a political actor. Turkey’s ability to project stability and also serve as a reliable energy corridor could provide economic benefits that dwarf the short-term costs of monetary orthodoxy. However, this strategy requires sustained internal cohesion and external diplomatic success – both of which remain uncertain.

Perhaps most tellingly, multiple conversations revealed that economic performance has taken a backseat to other considerations in electoral planning. As one bank executive observed, “today, the economy is not a priority for re-election, but the Kurds and the CHP are.” This suggests that the government views geopolitical success and domestic political wins as more valuable than immediate inflation reduction. The fiscal side similarly reflects this priority shift. While there has been some consolidation, with the deficit improving versus expectations, spending discipline remains selective. The government appears willing to maintain fiscal looseness in areas deemed politically essential while tightening elsewhere.



Turkey’s current approach represents a calculated gamble: loosen the focus on lowering inflation further in favour of growth and geopolitical wins in the short-term. The most concerning aspect isn’t the trend of slowly moving away from a hawkish stance per se, but rather the apparent comfort with maintaining this stance. As several bankers noted, inflation expectations remain sticky at around 20-25%, suggesting that orthodox monetary policy alone may be insufficient without complementary structural reforms.

“Hopefully, Turkey’s bold approach to balancing economic priorities and geopolitical ambitions will succeed in extending the bridge further, to achieve equally long-lasting prosperity.”

Turkey’s experience offers a cautionary tale for other emerging markets: monetary orthodoxy can stabilise currencies and strengthen financial sectors, but it cannot substitute for broader economic reform or address structural competitiveness issues. The country’s bet on geopolitical dividends may prove prescient, but it comes with the risk of prolonged economic underperformance if external conditions don’t align as expected. The coming months will test whether Turkey’s unique approach can deliver sustainable prosperity or whether the costs of this experiment ultimately exceed its benefits. Istanbul has been a capital to three empires – the Roman, the Byzantine and the Ottoman – bridging East and West through millennia of history and culture. Hopefully, Turkey’s bold approach to balancing economic priorities and geopolitical ambitions will succeed in extending the bridge further, to achieve equally long-lasting prosperity.

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