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Analysis of today
Assessment of tomorrow

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Strong Country, Strong Currency?!

Preserving the value of their currencies is a big obsession of developing countries. Thinking that “strong countries have to have strong currencies”, they tend to do things in reverse, which leads them to make one mistake after another.

Recently, Egypt has quit its pointless efforts to try to protect the value of its national currency. Instead, it hiked interest rates and let exchange rates float freely. This action resulted in an upgrade in its credit rating, with a nice bonus of IMF aid.

The need for foreign money, the fate of countries dependent on imported goods for production, is a factor that fuels inflation. This dependence does not end with production alone; everything from government tenders to tuition fee installments is adjusted according to the dollar exchange rate.

And the rises in the exchange rate, along with the pass-through effect, inevitably cause prices to climb further.

This is the reason why the devaluation efforts of the import-dependent countries aimed at being more competitive in exports always fail. Because when costs go up, inflation goes up too and you are back to square one.

The economic theory around this refers to the phenomenon as the "Marshall-Lerner Condition", which gives us an idea about the cause of devaluation-inflation spiral.

The "crawling peg" method

The bottom line is that governments of countries that are dependent on imported raw materials try to control exchange rates while ignoring the fact that the reason for the depreciation of their national currency is their own policies.

Such ignorance often ends up in negative outcomes yet governments always choose to deal with the outcomes rather than addressing the real causes of the problems.

> The correct policy should have been for the Turkish government to avoid intervening in the value of the national currency

Even the IMF itself had supported the "crawling peg" method to bring inflation under control, consequently becoming the architect of the 2001 financial crisis in Turkey.

In an article he would write years later, Stanley Fischer, former First Deputy Managing Director of the International Monetary Fund, expressed the fallacy of this suggestion.

The correct policy should have been for the Turkish government to avoid intervening in the value of the national currency and let the free market be the judge of that.

People do not like their money to lose its value

The cause of inflation is often defined as "deterioration in pricing behaviour", yet the cause of this deterioration is ignored. The real reason behind it is the behaviour of the monetary authority and economic agencies that disrupt the relative price balance.

For example, as long as these 2 continue to keep exchange rates and policy rates under control so that prices do not rise, people continue to buy strong currencies, gold, real estate, raw materials or all kinds of goods. Rightly so, people do not like their money to losef its value.

The wrong monetary and exchange rate policies aimed at preventing consumers from purchasing goods or services that are likely to be more expensive tomorrow, such as limitations or constraints imposed on credit card limits and the borrowing and lending of loans, do not only fail to yield the intended results but also bring about many side effects, including stagnation.

The true solution that can protect the value of the national currency is to give the impression of being a strong country rather than controlling exchange rates

If a country's economy is perceived negatively by its citizens as well as other people living in foreign countries, both naturally would want to avoid the currency of that country.

And the reasons leading them to do this are: - A general state of uncertainty - Complications in domestic politics - Diplomatic deficit - Independent decision-makers no longer independent - Unreliable investment climate - Weakening competitive environment and market economy - arbitrary decision-making If such problems often occur in a country, the value of its currency would decline rapidly.

The true solution that can protect the value of the national currency is to give the impression of being a strong country rather than controlling exchange rates.

High GDP or a big populations are not enough to make a country powerful

A country will never be considered strong if it acts against its founding principles, treats its citizens unequally, takes questionable actions, especially with regard to the country's future, and most importantly, if it gradually moves away from science and reality.

High GDP or a big population are not enough to make a country powerful. A country will never be regarded as a strong country unless it thrives on science, technology, arts and sports.

For example, the GDP of Austria and Belgium are smaller than that of Indonesia, India and Russia. Yet, the former two do not use armaments and military readiness to prove that they are powerful.

If a government lets political preferences or ideologies affect its decision-making - which should be based on science and reality - economic rationality begins to fade away.

When the society comprehends this, it will see that the value of the national currency does not depreciate due to changes in the economy, but due to turbulence in social and political life.

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When foreign exchange and interest rates are kept under control, people, in light of their bitter experiences, assume that dollar exchange rate will rise in the future and take precautions accordingly.

Sellers would price their goods and services according to the future level of the dollar, not according to the exchange rate forced by the government.

In other words, pushing the foreign exchange rates down when they increase with the purpose of keeping the prices low results in the same outcome: inflation.

There are two ways to control inflation: - To switch to a free market economy, just like Egypt did, and offer depositors a satisfactory interest rate in national currency.

This can also be done with a superbond with a less than one-year term to maturity. - To implement a strict control not only of the money market but also of all goods and services markets.

The truth is that it is quite difficult to implement the second option in import-dependent economies.

However, if it is an autocratic country, this option could be deliverable. But this time the country could face growth and welfare problems, eventually leading to social unrest.

So, the most rational solution is to liberalise all markets, from goods and services to money, labour to real estate, while preventing corruption through effective supervision. Only the countries that can achieve this most successfully are likely to stay strong and keep their money strong.