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EVALUATION NOTE

LESSONS FROM TÜRKİYE AND INDIA FOR THE US FEDERAL RESERVE

Central Bank Autonomy is Critical for Ensuring Healthy Economies and Financial Markets

A recent study published in the Harvard Business Review by Roberto Stefan Foa and Rachel Kleinfeld states that "far from growing private-sector wealth, we find that equity returns under right-wing populists often prove dismal." More specifically they "underperform benchmarks by around a quarter during a first term in office, and by half after a decade." This is because right-wing populists typically undermine the rule of law and meddle in markets (e.g. Trump's tariffs). Nobel Prize winning economists Acemoglu, Johnson and Robinson also demonstrated in "Why Nations Fail," that authoritarian assaults on institutions are associated with lower growth.

President Donald Trump visited the Washington DC headquarters of the US Federal Reserve (the US' central bank, known as the Fed) on July 25 as tensions continued to escalate between his Administration and the independent overseer of the US' monetary policy. The US Fed's conduct has significant implications for the rest of the world as well as the US dollar's (USD's) future as the world's reserve currency. This visit came in a context where Trump has repeatedly demanded that Fed Chair Jerome Powell cut US interest rates to close to zero. He has also insisted in the face of contrary data in June that US inflation will not rise. He has also frequently raised the possibility of firing the Fed Chair although he then rolls this threat back. He has also repeatedly used highly objectionable language against him. One of the latest slurs directly aimed at Powell by the US President was "numbskull" for Powell's unwillingness to cut the Fed's interest

[1] https://www.tepav.org.tr/en/ekibimiz/s/1489

rates while, after threatening to fire him recently, the latest timeframe he has given Powell to stay at the Fed is eight months. This is even though the Fed Chair's current four-year term does not end till May 2026, and his Fed Board term does not expire till 2028.

Unsurprisingly, President Trump sparred with Federal Reserve Chair Powell on July 25 during his Fed visit not just about the costs of the ongoing renovation to the historical building which he has said are tantamount to a "fraud", wrongly alleging that their cost was about $3.1 billion when it is $2.5 billion. While he backed away from earlier recent statements in which he had suggested he would fire Powell, he demanded that the Fed lower its interest rates by three percentage points to between 1.25-1.5 per cent.

This rare Presidential visit to the Fed took place a week before the Fed Board of Governors were to meet for a two day interest rate setting meeting at which they expectedly decided to ignore President Trump's demands for lowering the interest rate. Instead, they decided to leave the Fed's benchmark interest rate in the 4.25-4.5 per cent range, where it has been since December 2024, as they sensibly wait to see how the US economy, inflation and employment perform in the face of both the US Administration's new global tariffs expected to come into effect from August 7, as well as his other economic policies, some of which were just approved in the One Big Beautiful Bill Act (OBBBA). While two of President Trump's appointees at the meeting voted to cut interest rates at the meeting as President Trump had demanded, and he applauded that, they did so because they saw the economy and employment weakening, not because inflation was reducing, which were not the reasons he wanted to hear. Instead, he followed his tirade on the Fed Chair in late July by firing Erika McEntarfar, the Commissioner of the Federal Bureau of Labour Statistics a few days later in early August, because he did not like the low employment numbers announced for July by her in her official role, less still the significant downward revisions to the employment numbers for May and June which she also announced.

The US economy contracted (-0.5%) in the first quarter of 2025. Despite a 3% economic growth rate in the second quarter, significantly because of reduced consumer and producer demand for imports (not the healthiest of reasons), the US' economic growth rate for the first half of 2025 was around only 1.5% and is expected to remain in that range for the rest of 2025. This is the lowest on record since 2020 at the height of the Covid-19 pandemic.

The US also witnessed very modest employment growth in May, June and July 2025. These two critical indicators, if taken together with core inflation which advanced by 2.8% in the twelve months to June, with higher inflation expected in the coming months, suggest that the US is headed for what economists call stagflation i.e. low, declining economic growth coupled with escalating inflation. This was last seen in the US in the 1970s at the time of the Organization for Petroleum Exporting Countries (OPEC) oil price shock.

While the US economy's inflation rate thus far has been manageable, having reduced significantly during the Biden Administration's last year in office, the rise in the US Consumer Price Index (CPI) in June by close to 3% over the previous year is ominous, especially since the impact of President Trump's global tariffs have not even started to bite because they were largely paused between April 2 and August 7.

As a result, the June inflationary figures likely represent only the beginning, with much higher US inflation, lower economic growth and unemployment almost inevitable before the end of the year. These will result not only because of the tariffs which will come into effect from August 7 but because of the high inflationary and negative employment impacts in the agricultural, health and other sectors caused by both President Trump's escalating deportation drive and the Elon Musk led federal Department of Government Efficiency (DoGE) slash and burn policies which have led to huge staff cuts which will negatively impact the delivery of vital health, social security, education and other services.

While the full impacts of the combined effect of all these factors may only be felt later in 2005 and into 2026, a mid-term election year, the Fed has its hands full. It faces major dilemmas about what to do next on interest rates at its forthcoming September meeting and in its subsequent meetings over the next 12-month period. This is because its twin objectives of ensuring price stability (low inflation) while optimizing economic growth and ensuring high employment are likely to be in conflict. The pressure from President Trump and his loyalists in the Administration and Wall Street is only likely to mount over the next few days and weeks. There will likely be a crescendo of voices asking Fed Chair Powell to cut interest rates in September, despite rising inflation which could compromise the US' mid to long-term economic stability.

Central banks, in both economically advanced and developing countries, play a crucial role in maintaining economic stability and promoting economic growth, even though their specific roles and priorities may differ, depending on a country's stage of economic development. They manage monetary policy, oversee the banking system and act as a lender of last resort. They must balance price stability, economic growth and employment objectives in all countries.

The independence and integrity of any central bank is vital for the effective performance of all these functions. In the case of the US, the Fed's independence and integrity is also vital for the health of both the global economy and global financial markets given the US economy's still dominating influence in both. Its periodic interest rate announcements serve as particularly important signals for Wall Street and the Treasury bond market and directly impact the value of the US dollar and its role as the world's reserve currency.

What is particularly perturbing at this time is not just Trump's attacks on Fed Chair Powell, whom ironically, he appointed during Trump 1.0 expecting loyalty, but, as Gillian Tett pointed out in a recent opinion piece in London's Financial Times, Trump and some of his loyalists want to "smash" the Fed's independence. The recent surprise resignation of Dr. Adriana Kugler from the Federal Reserve Board on 8 August, well before the end of her term on 31 January 2026. She was the first Hispanic to serve on the Board, having been appointed by President Biden in September 2023.

Her premature departure allows President Trump to appoint a blind loyalist to this position at a critical time, to try and shape Fed policy before Fed Chair Powell exits his current role in May 2026. This will be repeat of what he thought he had done with the US Supreme Court during Trump 1.0.

Once marginal, but now increasingly influential US right-wingers like Curtis Yarvin, the "self-styled populist authoritarian" want him to go much further. They are advising Trump and his relevant loyalist senior colleagues to merge the Fed with the US Treasury, effectively placing the former under the latter. They also want the Treasury to restructure the US' current $37 trillion debt and "unplug" it from the rest of the world's financial system. Yarvin wants a revaluation of US debt and other assets and says, "it is very incorrect to regard Treasury obligations as debt---they are restricted stock."

Most economists rightly consider this crazy, but many senior Trump 2.0 officials now follow Yarvin whose ideas are apparently also being cited approvingly by US Vice President JD Vance. There is also speculation that if Trump does, indeed, fire Fed Chair Powell, he will appoint Scott Bessent, his Treasury Secretary, to oversee both institutions.

A Protracted Assault on Turkiye's Central Bank: Implications and Impact

It is worthwhile, in this context, to consider Turkiye's central bank experience over the last decade, after President Erdogan more stridently and repeatedly increased his similar long-standing assertions about lowering the central bank's interest rates despite high inflation, thereby seeking to invert the standard economic textbook relationship between inflation and interest rates. This has had serious continuing political economy consequences for both Turkiye's domestic economy and its role in West Asia and globally.

There are many differences between the political economies of the US and Turkiye. For one, the US economy's influence is global while Turkiye's is now barely regional, while the US dollar is the world's reserve currency and the Turkish Lira (TL) clearly is not. Nevertheless, there are important lessons to be learnt by both the US and other emerging BRICS economies such as India from the Turkish government's repeated and prolonged political interferences in the functioning of the country's central bank.

Even as recently as 2013, when the Turkish Central Bank Governor was Erdem Basci, before he started to come under severe political pressure from President Erdogan, facing similar slurs and pressures which President Trump is currently hurling at Fed Chair Powell, Turkiye's Central Bank was regarded as one of the best in the advanced economy 38-member Organization for Economic Cooperation and Development (OECD). It clearly became amongst its worst performers in the decade since, simultaneously also losing its hard-won earlier reputation. It has been struggling to regain its credibility over the last two years since when President Erdogan was forced to return to economic orthodoxy. It is likely that both its effectiveness and reputation will continue to suffer for a long time to come.

In Turkiye, economic lunacy has created an unnecessarily huge economic burden for the country for at least a decade. Erdogan's stubborn insistence on populist economic policies kept Central Bank interest rates very low for years despite high inflation, declining foreign exchange reserves and significant declines in the value of the Turkish Lira (TL).

Erdogan insisted, against economic orthodoxy, that high interest rates were "the mother of all evil" and the cause of high inflation. He pushed the Central Bank Governor to lower rates as the way to cool inflation, similarly to what President Trump is currently trying to push Fed Chair Powell to do, to spur economic growth whilst denying that US inflation has risen and is likely to do so even more significantly over the coming months.

The cumulative results of hyperinflation and its nosediving currency forced Türkiye to the economic wall for close to a decade, finally forcing President Erdogan to agree to an embarrassing U-turn on the country's central bank interest rates in June 2023. The Turkish Central Bank has returned to economic orthodoxy since then when it was forced to hike interest rates by 40%, from 10% to 50%.

In late July 2025, more than two years later, interest rates remained stubbornly high at 43%, despite a rate cut on 24 July of three percentage points from 46%. This was the first rate cut since April, when the Central Bank was forced to increase its interest rate after the politically motivated arrest of Istanbul Mayor Imamoglu which sent the TL tumbling to a record low against the USD (40.96 to the USD). It had recovered only slightly to 40.55 between then and July 25, 2025.

The 2023 interest rate increases did not make a dent on price and wage inflation which remained at 67% over the next twelve months, only slightly lower than its peak of 85.5% in October 2022. While inflation in Turkiye has been steadily declining since then, it still sat at 35.05% on July 25, 2025.

High interest rates have clearly failed to stabilize the currency. The TL at 40.55 to the US dollar in late July 2025 has fallen more than 50% since the start of 2024 when it was slightly under 30 TL to the US dollar (it was slightly more than 35 TL to the USD on December 31, 2024) having depreciated significantly from 10 TL to the US dollar in September 2021 and a little over 3.5 TL to the US dollar at the end of 2016, down from around 0.78 to the USD in April 2013.

As a result of inflation, minimum wages had to be increased by 49% before the March 2024 local elections, threatening a wage price spiral. The sad state of the economy was clearly a major reason for the defeat of President Erdogan and his ruling Adalet ve Kalkinma Partisi (AKP) in the March 31, 2024, local municipal elections.

Despite all this turmoil over the last decade, the Turkish President still refuses to turn to the International Monetary Fund (IMF) for an economic stabilization program since this would be politically very difficult for him, given his past vocal oppositions to dealings with the Fund. The population, therefore, will continue to suffer and deal with a greater degree of pain over a protracted time frame as the Minister of Treasury and Finance, Mehmet Simsek, tries to stabilize and grow the economy without IMF support, than may have otherwise been the case.

Despite its return to economic orthodoxy since mid-2023, Turkiye's Central Bank remains anything but independent as evidenced by Erdogan's firing of numerous Central Bank Governors since 2013 from when there have been six. Naci Agbal lasted less than five months (November 7, 2020-March 20,2021). The current Governor, Fatih Karahan, has been in office less than 18 months, starting February 2024.

Government Pressures on the Reserve Bank of India

Tensions between the inflation stabilization and longer-term economic stability priorities of the Reserve Bank of India (RBI—India's central bank) and the Government's economic growth priorities are not new and continue. D Subbarao, the then Governor of the Reserve Bank of India, frequently clashed with two Finance Ministers of the Congress led United Progressive Alliance (UPA) during his 2008-13 term over the RBIs anti-inflation stance, which was perceived by the Government of India then as a barrier to economic growth.

This has been normal and understandable, and to the credit of most RBI Governors and Governments, the independence of the RBI on interest rate policy has been able to prevail. Even as recently as December 2024, barely a week before his retirement, and despite pressure from the ruling Bharatiya Janata Party (BJP) to address GDP slowdown, their own closely allied RBI Governor, Shaktikanta Das (2018-2024) who oversaw and implemented many other government induced policies like demonetisation (for which he was subsequently rewarded with the position of Principal Secretary II in the Prime Minister's Office, his current position from February 2025), resisted cutting the RBI repo rate from 6.5% to control high inflation at that time.

What has been most undermining of the RBIs authority and autonomy in the last decade and most striking in India's case, however, was when the government ignored the

advice of the then Reserve Bank of India Governor, the world-renowned economist who had also been a previous IMF Chief Economist and Research Director (2003-2006), Dr Raghuram Rajan. He advised the Government of India against demonetization in 2016. Ignoring him, Prime Minister Modi went ahead with it, with now well documented serious negative consequences for Indian society, the country's economic growth and its most vulnerable population groups.

Dr. Rajan, former RBI Governor (2013-16), when consulted while still in that position, had emphasized the significant short-term economic costs associated with demonetization, particularly the slowdown of Gross Domestic Product (GDP) growth. He had also pointed out that the proposed demonetization exercise was not adequately planned, especially in terms of ensuring a smooth and timely replacement of the demonetized currency. He had also felt that its full potential impacts had not been adequately assessed and measured by its key proponents and the BJP Government and that there were other means to achieve the proposed policy's avowed objectives of rooting out illegal "black" money.

Dr Rajan not only strongly resisted the government's proposed demonetization, but he also strongly defended the RBI's autonomy, (he famously emphasized the RBIs ability to say "No") and also resisted the government's move to shift money market regulation to the Securities and Exchange Board of India (SEBI). Governor Subbarao, under the Congress Party led government, had also similarly opposed the formation of the Financial Stability and Development Council (FSDC), arguing it undermined the RBIs role in maintaining financial stability. Their recommendations on both SEBI and the FSDC were not accepted by either government.

Much more damagingly, however, the Modi government ignored Dr Rajan's professional judgement on the risks and perils of the proposed demonetization, and he was pushed out, with his term ending shortly before demonetization began. Tellingly and inappropriately, it was overseen not by the RBI but by Shaktikanta Das, then Economic Affairs Secretary, Ministry of Finance (a non-economist, later rewarded and made RBI Governor from 2018-2024 just after the relationship between the Government and the RBI was at an all-time low after the resignation of RBI Governor, Dr Patel (2016-18) who had succeeded Dr Rajan after he left, having been effectively pushed out.

Demonetization was implemented on 8 November 2016 (86% of India's currency was nullified overnight to clean out "black money and counterfeit notes, objectives which are far from being achieved today, almost a decade later. If anything, the problem has become worse. The short-term consequences of the demonetization policy were horrendous, for both economic growth and in human terms.

In India, the surprise demonetization of large Rupee banknotes with no advance notice and no alternatives literally shortchanged approximately 90% of the population, may without bank accounts, as well as many micro, small and medium enterprises (MSMEs) largely reliant on the cash economy. It has certainly done long-term structural damage to the Indian economy as well from which it is yet to fully recover.

Demonetization was probably the worst among the BJP government's attempts to interfere with the autonomy and integrity of the RBI. There have been many more, even if they have failed on pressuring a reduction in interest rates more recently.

Urjit Patel (2016-2018), Dr Rajan's successor resisted the government's attempt to tap into the RBIs excess reserves, leading to escalating tensions. The government wanted to use foreign exchange reserves to finance its fiscal deficits and use them for loan write-offs which he resisted, fearing this could undermine financial stability and lending norms and weaken the Rupee, leading to disagreement with the Government about reserves management.

Dr. Patel resigned amid increasing pressure and escalating tensions between him and the Government, particularly regarding the latter's attempts to access the RBIs capital reserves, notably after the Government invoked Section 7 of the RBI Act of 1934 which gives it the power to direct the RBI on matters which it regards as in the "public interest."

Recurrent themes and continuing source of tension between the RBI and the Government in India, especially over the last 11 years since Mr. Modi became Prime Minister have included but are not limited to the following: the autonomy of the central bank; government interference in RBI appointments (how the Governor and other senior RBI staff are appointed and the independence of this process); interest rate policies; regulatory jurisdiction (e.g., RBI role vis-à-vis SEBI); use of foreign exchange reserves and surpluses (e.g., disputes over how foreign exchange reserves should be used, government demands for higher dividends surpluses from RBI income earned from bonds. The RBI partially retains such surpluses for buffers like the Contingency Fund and Asset Reserve which it is reluctant to deplete because of inflation risks and threats to macroeconomic stability); divergent priorities (the Government's short-term political considerations versus the RBIs priority of ensuring long-term economic stability).

The RBIs role is and remains to vigilantly guard its autonomy and key priorities, and to say "No" as Dr Rajan did, when both were in danger. It is still too early to tell whether the relatively new RBI Governor, appointed earlier this year, will guard these as fiercely as Dr Rajan did. The reduction of RBI interest rates as the government had pressured, so soon after he joined as RBI Governor, was not a good omen. It appeared to ignore or downplay the huge uncertainty caused by geopolitical and geo-economic trends under Trump 2.0, despite declining food inflation in India. As such, it appeared premature. However, today's August 6, 2025 decision of the RBI Monetary Policy Committee led by him not to lower the repo interest rate further despite a reduced forecast of 3% inflation in 2025 is reassuring, given that 25% tariffs on Indian exports to the US will come into effect from 7 August with these now threatened (on August 6, hot off the press today) to double to 50% from sometime later this month as a result of India's oil and defence purchases from Russia. President Trump has also repeatedly promised high US import tariffs on pharmaceuticals and 25% tariffs on Apple IPhones made overseas, both of which figure significantly, in both quantity and value terms, among Indian exports to the US.

Some Key Overall Lessons for Both Economically Advanced and Developing Countries

Populist leaders do more long-term structural damage to the economy the longer they stay in power. This has certainly been the case in Turkiye over Erdogan's 23 years in power and has also increasingly been the case in India over Modi's 11 years as Prime Minister.

Will something similar, if not identical, be the fate of the US economy and financial markets under Trump 2.0 given his repeated and continuing assaults on the Fed's independence and integrity? Only time will tell. We must hope President Trump fails in such efforts, not just for the sake of the US domestic economy, but for the economic health and integrity of the global economy.