“Impact of politically generated shocks on monetary performance: a cross-country comparison”

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IMPACT OF POLITICALLY GENERATED SHOCKS ON MONETARY PERFORMANCE: A CROSS-COUNTRY COMPARISON

Abstract

During the post-Great Recession period, macroeconomic stability had more often been threatened by socioeconomic shocks due to the rising of public discontent with the high unemployment rate and poverty, the activation of radical parties and movements, and the aggravation of the geopolitical confrontation in the world. Depending on the type and depth of such shocks, they become politically generated shocks and, in particular, affect the monetary sphere. The article investigates three types of politically generated shocks and their impact on the monetary sphere. It has been found out that the shocks generated by political populism are characterized by fiscal domination in the economy, the use of monetary measures in the budget deficit financing. Shocks arising after the use of international sanctions against certain countries have an external origin and primarily cause the increase in national exchange markets volatility. On the whole, macroeconomic and, especially, monetary instability is the result of the great shocks for the economy, the depth and duration of which are determined by the nature of the crisis, particularly, when country participates in the military conflict. The aforementioned types of politically generated shocks are analyzed based on the experience of countries such as Argentina, Turkey, and Ukraine, which at one time introduced the regime of inflation targeting in monetary policy, but were forced to modify it influenced by political and economic instability.

Keywords politically generated shocks, macroeconomic instability, monetary policy, inflation targeting, Argentina, Turkey, Ukraine

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INTRODUCTION

The stability of the national economy and its functional ability to balance money markets largely depend on the predictability of political processes and when there are no sharp turns in the economic policies implemented by the ruling elite.

In the post-crisis period, while the economic growth was slowly recovering, in many countries the level of the middle-class dissatisfaction with the current economic situation began to emerge. In addition, radical parties and movements started to gain popularity, whose coming to power could lead to taking the populist measures in order to obtain short-term stimulating effects that may have negative consequences for macroeconomic stability in the long term. The monetary branch of executive power is especially vulnerable to political risks, which, in the context of populist sentiment activation, is often forced to apply measures of the budget deficit monetization, manual control of the exchange rate and conduct the credit expansion. Herewith the central banks' independence declared by most countries legislation is limited

within a small segment of operational independence, which in general is not able to ensure the implementation of strategic objectives of monetary policy.

However, recently the generation of the macroeconomic stability risks does not only carried out by economic populism as a long-standing phenomenon. It was also accompanied by a sanctions policy that is applied by economically influential countries to their partners in international trade and financial relations in order to encourage them to meet certain economic and political requirements. Over the past few years Iran, Russia, and Turkey have been added to traditional sanction recipients like North Korea, but in certain institutional sectors.

The complex nature of politically generated shocks arises in the cause of hostilities that take place in a particular country's territory. Here, the budget deficit and the growth of public debt are caused by the active economy militarization, the subordination of monetary and fiscal policies to the task of the primary military-industrial complex development and the provision of military and economic advantages over the actual or probable opponent.

Different political shocks have a multiplier effect on the monetary sphere, the central banks function fulfillment and the deformation of the current monetary policy regimes. Typical countries that have not long ago experienced the impact of the aforementioned shocks on the money market and the banking system are Argentina, Turkey and Ukraine, with their nature of political instability and monetary reaction.

1. LITERATURE REVIEW

There are a lot of studies in economic literature devoted to the investigation of the impact of various political risks on the functioning of the money market and the banking system, where price stability and reflected monetary policy are sacrificed to the interests of the political situation.

Alqahtani et al. (2019) profoundly analyzed the impact of US political instability and monetary policy uncertainty on stock markets performance.

Corbet et al. (2017) studied the influence of central bank monetary policy announcements on macroeconomic stability in different countries as well as the effects of international monetary policy changes on bitcoin returns.

Yevdokimov et al. (2018) analyzed the role and influence of political shocks and economic freedom on macroeconomic and monetary stability. For this purpose, the authors used the integrated index of economic freedom, calculated by the Heritage Foundation and Democracy Index.

Dornbusch and Edwards (1990) deeply investigated the social and economic origins of political populism in Latin America. Frequent interchanges of left-wing forces with their proposals for the large businesses expropriation and right-wing radical politicians with rigid anti-democratic approaches formed an extremely unstable political and macroeconomic environment. According to the authors, the main features of the populist economic policy are the creation of favorable preconditions for the development of populism in the form of uneven income distribution and the invisible advantages of the previous macroeconomic stabilization, often done at the request of the IMF, that ignore any types of macroeconomic policy restrictions during its implementation. Political capacity is considered as freedom ensuring in order to implement expansionary measures. Previously accumulated international reserves and a strengthened exchange rate create additional motivation for stimulating policies.

Under the supervision of unprejudiced monetary policy of the pre-crisis period, there was an important subordination of the monetary institutions that acted at that time as well as the independence of central banks, which served as a guarantor of political risks counteraction. Then scientific publications tended to the necessity of ensuring a gradual monetary policy aimed at providing price stability even contrary to the desire of current economic power. However, authorities are obliged to

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put monetary policy into service for temporary interests under the pressure of a pro-populist electorate. According to Feliz (2019), for today in Latin America, the left-wing ideas show a great vitality warming up by the economic successes of socialist China in the world, the influence of political ideas of H. Chávez, and the negative attitude towards the IMF restrictive measures for many years. In this context, left-wing political forces assumed Mauricio Macri's coming to power in Argentina in 2015 as a counter-revolutionary attack on the workers' rights through the introduction of unpopular measures of fiscal and monetary recovery of the economy. Therefore, even if the government implements a deliberate budget deficit reduction program (as it was in Argentina in 2016–2017), the fiscal dominance retains when the central bank finances a budget deficit of up to 2% of GDP (Manuelli & Vizcaino, 2017). Contrary to this view, Cavallaro and Maggi (2016) think that in case of avoiding an economic collapse in Argentina, an expansionary monetary policy with reduced interest rates should be a compensator for macroeconomic imbalances and mitigate fiscal pressure.

The uncertainty in relation to the populism in the monetary sphere is often worsened by the International Monetary Fund. The IMF may show inconsistent policy on making decisions about stabilizing crediting in countries such as Argentina, due to contradictions between leading member-states and the expert community that do an adequate assessment of the economic situation and the ways for its support (Van Gunten, 2017).

The first wave of populism was typical for Latin America. After the great recession, the second wave raised and had injured the central banks of other countries. According to Masciandaro and Passarelli (2018), political populism brings short-term benefits to the electorate in the form of a temporary increase in welfare, but in the long run, it reduces the potential output and the level of consumption. The central banks' activities with their conservative monetary policy are increasingly becoming the subject of criticism for populist-minded nationalists. Therefore, states need to be prepared for such central banks reforms, in which they may lose partly their independence, and monetary policy could become chronically inflationary.

Countries are given of trade and economic sanctions by international organizations or individual countries have a slightly different origin of politically generated macroeconomic shocks. Thus, in Turkey, not only the USA administration sanctions negatively affected country's real and financial sector in 2018 but also the deformation in government policy and the cyclical economy "overheating" (Matthes, 2018). The sanction measures have played a decisive role in threatening currency stability, while macroeconomic and monetary shocks having external origin from the financial markets of the USA, the Eurozone and the global raw material and energy markets have a long-term effect on the domestic market (Civcir & Varoglu, 2019). According to Binici et al. (2019), quantitative easing in the monetary policy of the post-crisis period subserved not only a significant increase in the money supply in Turkey but also led to a certain loss of the central bank' official interest rate that played regulatory role in the money market. Moreover, the short-term interbank market rate has become the indicator of the credits and deposits value flow.

The most difficult situation in the economic sphere in general and monetary in particular has occurred in recent years in Ukraine, where the aggravation of geopolitical conflicts with the Russian Federation resulted in the annexation of some part of the territory and the outbreak of hostilities in the east of the country. Under these circumstances, on the one hand, the development of military-industrial potential with parallel pressure on the expenditure part of the state budget took place, on the other hand, the Crimean regions and part of the Donbas lost the production potential, which meant a loss of significant sources of budgetary revenues. As a result, the country faced a threat of default on external liabilities. Under such circumstances, according to specialists, in order to achieve financial stability of the Ukrainian economy, it is necessary on the contrary to reduce the budget deficit to prevent a default (Shevchuk & Kopych, 2018), but there is a lack of the authorities' political will to achieve this goal. The relative economic stability was ensured by the given IMF extended credit. However, some authors argue and suggest the idea that in case of maintaining optimal growth of the Ukrainian economy,

it would be rational to provide a moderate monetary expansion with a balanced fiscal policy (Lukianenko & Dadashova, 2016).

Meanwhile, the raw material-oriented economy of Ukraine has a structure that is intense to global price shocks and tends to significant currency fluctuations, which just needs the implementation of a flexible monetary regime that is inflation targeting. Its specificity implies "anchoring" of inflationary expectations and the reaction to the expected inflation rate, which eventually implements a significant counter-cyclical component in macroeconomic policies and ensures the central bank's independence from the government's policy pressures (Koziuk, 2018). Moreover, price stability and its maintenance on the inflation targeting basis largely correspond to a democratic political regime that enables financial development, which positively affects the availability of flexible exchange rates with anti-shock goals.

2. AIMS

The purpose of the article is to identify the channels and the driving forces of political risks. Also, the effect of generated macroeconomic shocks by political risks on the national monetary sphere functioning by comparing the disclosures and results of political instability in the economies of countries such as Argentina, Turkey and Ukraine was investigated.

3. METHODS

The politically generated macroeconomic shocks influence on the monetary sphere was studied by using the methodology of systemic comparative analysis in the following directions:

1) a comparative politics: a comparative cross-country analysis by comparing the origins of political upheavals in Argentina, Turkey, and Ukraine as countries with different types of political risks;

2) a theoretical comparative analysis: a comparative analysis of monetary policy strategies and the types of inflation targeting deformation, depending on the concrete situation in one or another country;

3) a dynamic comparative analysis: a statistical comparison of macroeconomic dynamics in the period before the onset of macroeconomic shock and after it;

4) a practical comparatism: comparing the effectiveness of measures taken by the central banks of the compared countries to the political and economic instability and determining the adequacy of their reaction.

4. RESULTS

Macroeconomic shocks generated by political events have different origins, the depth of their action and, accordingly, the scale of their influence on the economy, in general, and the monetary sphere, in particular. The first of the three main shocks is a populism, connected with the coming to power of political forces giving unrealistic promises about improving the voters' welfare through fiscal and monetary easing, even threatening macroeconomic stability. The second type is sanctions that are suggested by the deterioration of foreign trade and foreign investment conditions due to imposing special restrictions by international partners. Initially, it is a signal for the growth of foreign economic threats and sharp currency market fluctuations. The third type of political shocks after the Second World War is rather unusual, especially for Europe, and involves forcible revision of present state borders through the outbreak of hostilities and a visible or invisible annexation of part of the territory. As a result, there is an inter-regional and inter-market economic imbalance, the monetary sphere suffers from monetary disordering, the banking system failures and abnormalities appear in financial markets.

At the same time, these shocks have a number of common features inherent to unstable economies, where the money market and the banking system react sharply to the least political turbulence, reinforcing it with "herd" reaction. These features are the following:

- initially, sharp fluctuations of the national foreign exchange rate with its, mainly, further

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devaluation. Its depth depends on specific monetary conditions and the level of the devaluation expectations;

- generation of inflationary expectations and subsequent increase in actual inflation;
- slowing down of growth rates or even falling of real GDP, first of all, in import-dependent economies with an inelastic decline in import;
- reduction of central bank official reserves, the rate of which depends on the depth of the foreign exchange market imbalance, the national monetary authorities activity in ensuring exchange rate stability and financial support of the international monetary institutions;
- increase of the debt burden on the economy both in the part of the public and private external debt due to its rise in the national currency owing to the national currency devaluation. The debt devaluation increase is often supplemented by its quantitative growth in consequence of additional borrowings on the domestic and foreign financial markets.

In general, the influence chain of politically generated shocks on the monetary sphere and the real sector can be represented as follows (Figure 1).

The peculiarity of the transmission of the disturbing impulses is that the first and last links in the shocking course of events concern the political sphere, where the economic development risks occur at first, and eventually, after injuring the financial and real sectors, the crisis situation of the political community itself breaks down.

Let us consider the specifics of the monetary policy establishment in the context of intensification of each of these political shocks by illustrating examples of events happened in countries close to the monetary policy structure. The authors chose Argentina, Turkey, and Ukraine. Despite the fact that each of them has its own type of politically generated risks, the common features in the structure of the real sector, the monetary sphere and the political environment allow for a comparative analysis of the political shocks impact on macroeconomic stability in these countries. The common features are as follows:

1) The industrial and agrarian kind of the real sector with a significant share of agricultural production in GDP (5-10%) and exports, which makes the economic situation greatly dependent on environmental and weather conditions, and the subsequent drought and crop failures generate a shock of the commodity market supply.

2) The mainly negative balance of payments over a long time and the high dependence of foreign economic equilibrium on world market conditions, the reliability of foreign financing sources and the continuity of their functioning in order to stabilize the balance of payments. As a result, significant foreign exchange market volatility appears.

3) The political instability, roughly equal chances of political forces with different socio-economic development vectors in the parliamentary and presidential elections victory, the prevalence of liberal-conservative or social priorities pronounced by them, which often force them to use populist promises in the political struggle.

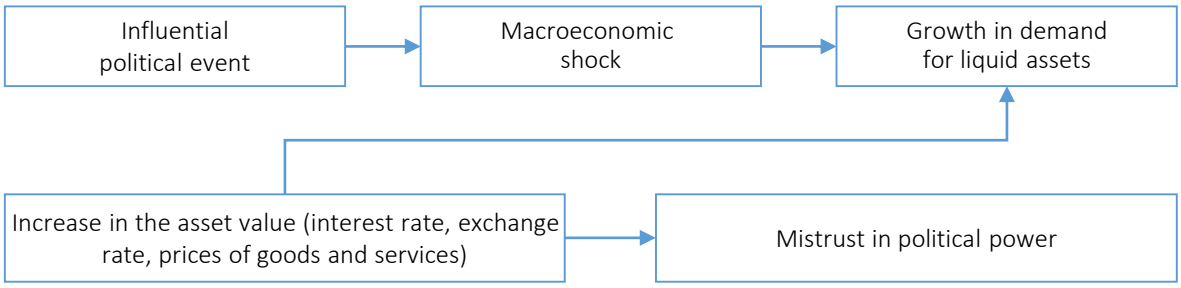

Figure 1. Transmission mechanism links of the politically generated shocks affecting the economy

Table 1. National features of the structure of monetary policy in Argentina, Turkey, and Ukraine

Source: Based on data from the official websites of the central banks of Argentina, Turkey, and Ukraine.

	Country		
	Argentina	**Turkey**	**Ukraine**
National regulator	Banco Central de la Republica Argentina	Central Bank of the Republic of Turkey	National Bank of Ukraine
The current monetary policy regime	Monetary targeting	Inflation targeting	Inflation targeting
Year of implementation	2018Q4	2006	2016
Target indicator	Monetary base	Consumer price index	Consumer price index
Unit of measurement	Monthly growth of monetary base	Annual CPI	Annual CPI (±) deviation
The characteristic of the monetary regime	Hard	Soft	Soft
The main monetary transmission channel	Monetary	Interest rate	Interest rate
The declared current regime duration	Three quarters	Three years	Three years
Period of inflation targeting actions	2016Q2–2018Q3	2006–present	2016–present
Preparatory period to the IT implementation	2015–2016Q1	2002–2005	2014–2015
Target inflation rate	2018: 8-12% 2019: 3.5-6.5%	2020: 5%	2020: 5 ± 1%

4) A similar structure of the monetary sphere with a commonly accepted paradigm of the central bank role in the economic system and the modern monetary policy mechanism aimed at inflation control through traditional and newest monetary instruments.

5) Use of the monetary regime of inflation targeting (IT), introduced at different times but aimed at achieving the disinflation effect in the medium term.

However, the similarity of the structure of the monetary sphere does not mean its full identity in all three countries, because there is certain specificity in the IT implementation by each of them (Table 1) that influences the formation of politically generated shocks as well.

Thus, all this makes a legitimate comparative analysis of the politically generated risks mechanisms and the country specificities of their overcoming by monetary measures.

4.1. Populist shocks and their monetary neutralization (the example of Argentina)

Traditionally, the populist political programs are widely used in Latin American countries, where the right-wing reactionary regimes being in power are often replaced by radical left-wing.

Political and economic instability due to periodic populism revelation has forced international monetary and financial institutions to develop a special stabilization plan called the Washington Consensus for such countries. This type of macroeconomic policy, introduced at the end of the 20th century, was recommended by IMF and World Bank leadership for implementation in countries with financial and economic instability that could get macro-stabilization credits.

Argentina is the third-largest economy in Latin America, whose gross national income per capita in 2017 indicated its affiliation with high-income countries (although after the shock, the figure was somewhat lower) (Table 2).

However, macroeconomic instability was obvious in Argentina and begun much earlier than the Great Recession. Starting from the 1990s, the economy stagnated from time to time due to political contradictions, when populist democratic regimes were replaced by military dictatorships, and attempts to liberalize the economy ended with populist revenge. After losing support from the IMF, Argentina was forced to declare a default in 2001. The political cause for the macro-shock was

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Table 2. Indicators of Argentina's macroeconomic development in the post-crisis period

Source: World bank, IMF.

	2011	2012	2013	2014	2015	2016	2017	2018
GDP annual growth (%)	6.0	–1.0	2.4	–2.5	2.7	–1.8	2.9	–2.5
GNI, Atlas method (current USD)	10,610	11,790	12,770	12,260	12,300	11,940	13,040	...
Foreign direct investment, net outflows (% of GDP)	0.3	0.2	0.2	0.4	0.2	0.3	0.2	...
Inflation, end of period consumer prices (%)	9.5	10.8	10.9	23.9	...**	...**	24.8	47.6
Current account balance (% of GDP)	–1.0	–0.4	–2.1	–1.6	–2.7	–2.7	–4.9	–5.4
General government structural balance (% of potential GDP)	–3.8	–3.6	–4.2	–4.1	–6.5	–6.9	–6.8	–3.7
General government gross debt (% of GDP)	38.9	40.4	43.5	44.7	52.6	53.1	57.1	86.3
Broad money growth (annual %)	26.0	34.8	27.1	29.8	39.6	41.5	30.1	...
Interest rate spread (lending rate minus deposit rate, %)	3.4	2.0	4.8	4.3	3.7	7.0	9.7	...

Note: ** Data is not available due to the change in the CPI calculation methodology.

the change of presidential power when, during one week, four presidents were changed. Currency and financial turbulence significantly affected the real sector, negatively influenced the population welfare, and inevitably radicalized the political situation in the country.

Later, a strict populist policy was carried out by President Cristina Kirchner. During her 2007–2015 cadence, she was accusing the establishment of the country's economic problems, the USA big business, and the activities of pro-Western institutions. As part of economic reform, there were nationalized large enterprises, and export-import operations were assessed by high taxes. Subsidization of gas, electricity and fuel tariffs has changed Argentina from an exporter to an importer of energy resources. Inflation has risen dramatically too. Longstanding significant government budget deficits, reaching 6% in 2015–2016 (Table 2) with the absence of external financing sources, resulted in a big increase in gross public debt, which grew from 37.5 to 55.1% of GDP in 2011–2015. Contrary to the common economic laws there was an attempt to repay the state debt by central bank's gold and currency reserves, but it was ended with the impeachment and subsequent change of the presidential power.

Mauricio Macri was elected as the new president of Argentina, who promised to implement swift and painful reforms in order to liberalize the economy, attract investors, reduce inflation rate and fight against poverty.

The new government quickly softened the restrictions on capital movements, got back the country to international financial markets and removed some restrictions on foreign trade. However, the attempt to drastically cut state subsidies for gas and electricity was unsuccessful due to the judiciary opposition. As a result, macroeconomic growth had ascending dynamics, but did not become irreversible (Figure 2). Due to the political opposition and, consequently, an inappropriate implementation of the restrictive measures there was a cut of production instead of economic growth from 2017 to the beginning of 2018. The reason for this was the deterioration of the macroeconomic conditions through the peso devaluation, the complicated international financing of the national economy and crop failure in crop production.

A major factor in the maintaining instability was the increased inflation, which showed a tendency to decrease from December 2016 to August 2017, and since September 2017 began to leap rapidly, reaching 48.5% per year in December 2018 (Figure 3).

The inflation targeting regime with a target rate of 17%, initiated in 2016, was quite achievable in the long run, but the CPI growth since September 2017, due to peso exchange rate fluctuations and an increase in regulated prices and tariffs, caused the inflationary expectations of business entities with a cumulative rise in prices within the next months. This forced the CBA to change the monetary policy regime from October 2018 to the side of harder measures of monetary targeting.

During the macroeconomic instability, the most volatile object is the exchange rate of the national currency. The Argentine peso demonstrated

Source: CBA.

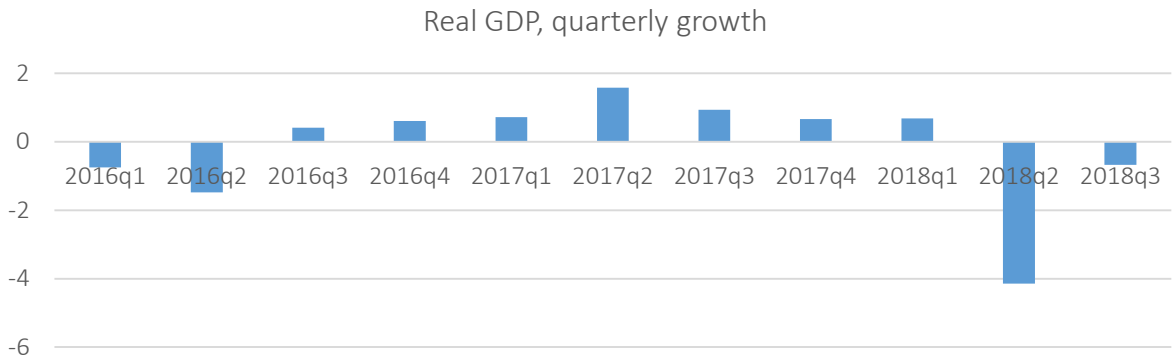

Figure 2. Quarterly growth rates of Argentina's real GDP in 2016–2018

significant fluctuations in 2018 (Figure 4). At first, the central bank caused it by itself, having raised the inflation target from 10% to 15% on the eve of 2018. Therefore, the CBA generated inflation and exchange rate expectations that emerged immediately on the currency market in an attempt to consistently adhere to the short-term inflation targeting regime. In addition, the idea of inflation targeting was mistaken, because the goal given away by the central bank was unchanged during the medium-term period.

A series of inconsistent steps made by the CBA and the government gave the market a wrong signal for a change in the stabilization policy course and increased inflationary expectations. An additional challenge for the economy was the crop failure of the export crops that had worsened the country's balance of payments. Eventually, on September 4, 2018, the Argentine authority in the economic sphere was obligated to meet with the IMF leadership and to take the crucial decision about the beginning of technical negotiations to provide Argentina with macro-financial assistance because of the market destabilization.

On account of the crisis, the CBA was forced to temporarily defeat the inflation targeting regime and implement from October 2018 a new monetary policy framework with a hard peg to the size of the monetary base, which means a reappearance to the monetary targeting regime, although it was introduced for 9 months. According to the new scheme, the CBA is due not to raise the monetary base until June 2019, which will be difficult to do, since in recent months the monetary base was growing by more than 2% per month. As a result, it is expected that the money supply will be significantly reduced owing to the decrease in the value of the money multiplier, as well as the money supply and the monetary base in the current calculation. The CBA has chosen the monetary base as the nominal anchor since its components (the banking system reserves and money in circulation) are

Source: CBA.

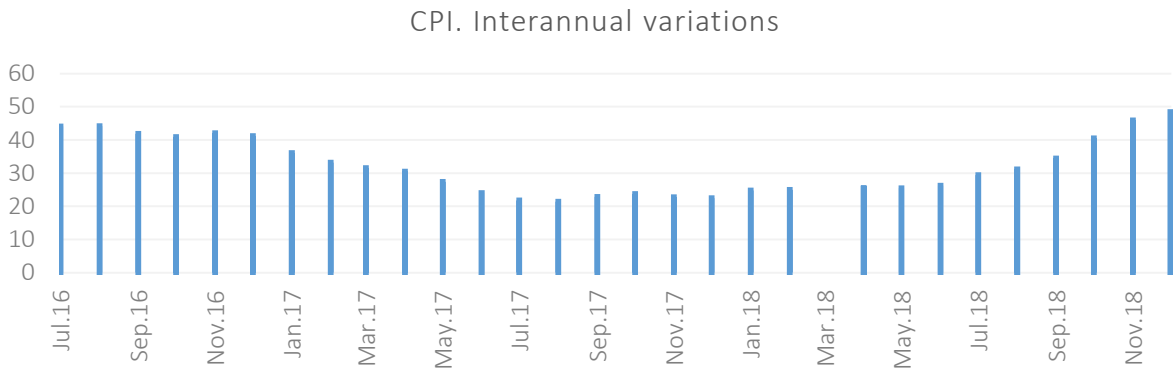

Figure 3. Annual inflation rate in Argentina during 2016–2018

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Source: CBA.

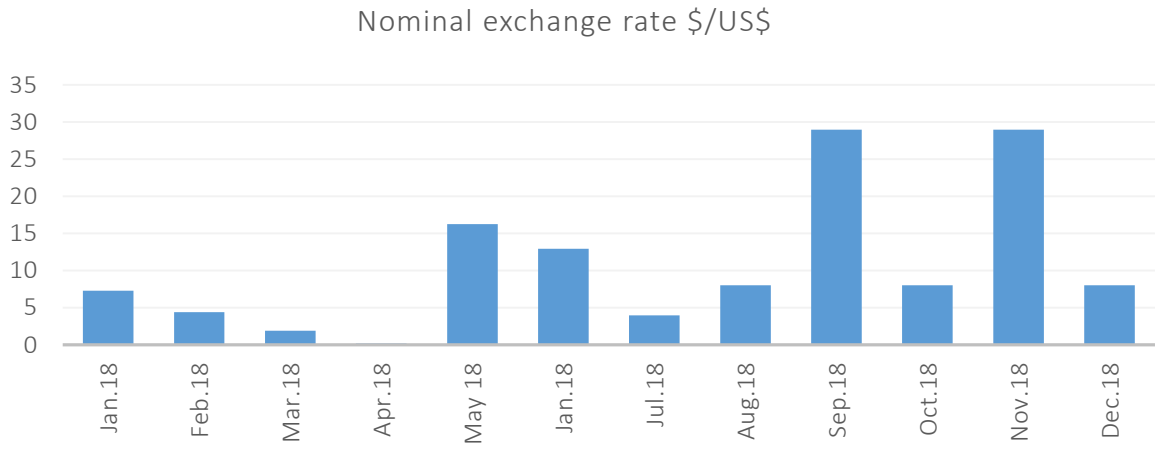

Figure 4. USA/ARS nominal exchange rates in 2018

fully under central bank control. Monetary target is reached by conducting daily operations on liquidity accounts in the interbank market. Besides, this goal can be achieved by adjusting the minimum reserve requirements for liquidity.

Also, the termination of inflation targeting takes place in the foreign exchange market regulation. While the exchange rate of peso is floating, the CBA has the right to carry out currency interventions if the price of the dollar goes beyond 34-44 pesos. The currency band is adjusted monthly by 3%, and if there are exchange rate fluctuations beyond the band, the regulator conducts daily currency interventions in the amount of USD 150 million, which helps to absorb excess liquidity and achieve a zero growth of the monetary base.

The CBA communication policy and transparency of decision-making procedures play a key role in improving the situation on the money market.

Thus, macroeconomic imbalances are the result of the long-term policy of social and economic populism that could not be overcome immediately and require government' decisive action to carry out consolidated financial statements and monetary restrictions. In this case, the transition from the medium strategy of inflation targeting to the monetary base targeting since the end of 2018 to mid-2019 seems to be logical. Then it is advisable to restore the IT regime with the gradual return to annual CPI in the limit of previous currency band value. However, it is important not to allow a sharp disinflation, as it may reduce the real GDP, due to the braking restrictive policy. Therefore, the CBA should postpone the achievement of the stated inflation target for 2-3 years and return to the strategy of inflation targeting.

4.2. The threat of authoritarianism and sanction political shocks (the example of Turkey)

Unlike Argentina, in Turkey in recent years the political elite has demonstrated signs of large-scale power expansion, a disturbance in the balance of "checks and balances" in favor of the presidential branch of government. The political confrontation between the Justice and Development Party (AKP) headed by current President Recep Tayyip Erdogan, on the one hand, and the opposition on the other, leads to revealing the authoritarian tendencies from the establishment, the collapse of the liberal democracy system, and sometimes coup d'état (the attempt of such a coup took place on July 15, 2016, and went into a phase of strict repression with further ruthless cleansing of military personnel and state apparatus). Political instability formed a negative macroeconomic shock, which resulted in a decrease of real GDP growth in half in 2016, although Turkey still showed steady growth, and inflation was limited to unequivocal numbers in the post-crisis period (Table 3).

Instead of the instability caused by the repressions among opposition activists and the government violent reaction that stood after the unsuccessful

Table 3. Turkey's macroeconomic development indicators in the post-crisis period

Source: World bank, IMF.

	2011	2012	2013	2014	2015	2016	2017	2018
GDP annual growth (%)	11.1	4.8	8.5	5.2	6.1	3.2	7.4	2.6
GNI per capita, Atlas method (current USD)	11,230	11,880	12,530	12,590	12,000	11,230	10,940	...
Foreign direct investment, net outflows (% of GDP)	0.3	0.5	0.4	0.8	0.6	0.4	0.3	...
Inflation, end of period consumer prices (%)	10.4	6.2	7.4	8.2	8.8	8.5	11.9	20.3
Current account balance (% of GDP)	–8.9	–5.5	–6.7	–4.7	–3.7	–3.8	–5.6	–3.6
General government structural balance (% of potential GDP)	–2.7	–2.5	–3.0	–2.1	–3.5	–3.3	–5.0	...
General government gross debt (% of GDP)	36.5	32.7	31.4	28.8	27.6	28.3	28.3	...
Broad money growth (annual %)	15.2	10.4	21.2	11.2	16.5	17.6	16.4	...

coup, there was a negative economic shock added by the USA government sanctions and the threat of their spread to the domestic Turkish and foreign financial markets.

On August 3, 2018, sanctions were imposed against Abdullah Gül, the Ministry of Justice of Turkey, and Süleyman Soylu, the Minister of the Interior. They were banned from entering the United States, and their assets were frozen. It was the Washington reaction to the house arrest of American pastor Andrew Brunson, whose imprisonment was organized by officials. The situation worsened on August 10, when the US President Donald Trump doubled the import duty on steel and aluminum imported from Turkey.

After that, the major stock exchanges of the Asia-Pacific region, in the face of fears related to the financial crisis in Turkey, closed trades with a decline in quoted price within 2%. European markets reacted to the possibility of Turkish turbulence in the same way. Initially, the financial crisis in Turkey threatened emerging markets. Next, the economic risks associated with the fall of the exchange rate of Turkish lira led to an appreciation of the yen, the dollar, and the Swiss franc, which are alternatives and more secure assets for investors.

Instead, the Central Bank of the Republic of Turkey (CBRT) proclaimed that it was ready to take all necessary measures for financial stabilization. Under those circumstances, the regulator has promised to provide banks with all the necessary liquidity of about USD 10 billion. At the same time, it was planned to increase the limits of bank guarantees in foreign currency for operations with Turkish lira from 7.2 billion to 20 billion euro.

In addition to weekly overnight loans, private banks received foreign exchange credits for one month. If there was a necessity, tenders were announced for long-term repo rates and currency placements with a maturity of 91 days. Also, banks were given the room for maneuver to manage guarantees on operations in Turkish lira, depending on the types and timing of interest rates.

However, currency disturbances immediately reflected in the inflation dynamics. In August 2018, consumer prices grew by 17.9% compared to the same month of the previous year. This increase was the largest since the end of 2003 when inflation reached 15.85% (Figure 5).

CBRT has sharply raised the key interest rate due to the results of exchange rate fluctuations and the rise of inflation. The bank management decided to change the rate from 17.75 to 24 percent. CBRT also announced a decision to intensify monetary policy in order to limit the inflation threat for price stability. Market entities predicted an increase of approximately 3 percentage points. In their opinion, the growth which was higher than expected would prevent the fall of the lira. After the taken measures, the exchange rate of Lira began to recover.

However, in September 2018, inflation was even higher than in the previous month. The inflation rate in September was 25% compared to the same period in 2017 (Figure 5) and 6.3% compared to August of the current year. It was the highest figure for the last 15 years.

Despite the fact that personal sanctions were abolished in October, the market stabilization is going slowly, as there were not only the political

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Source: CBRT.

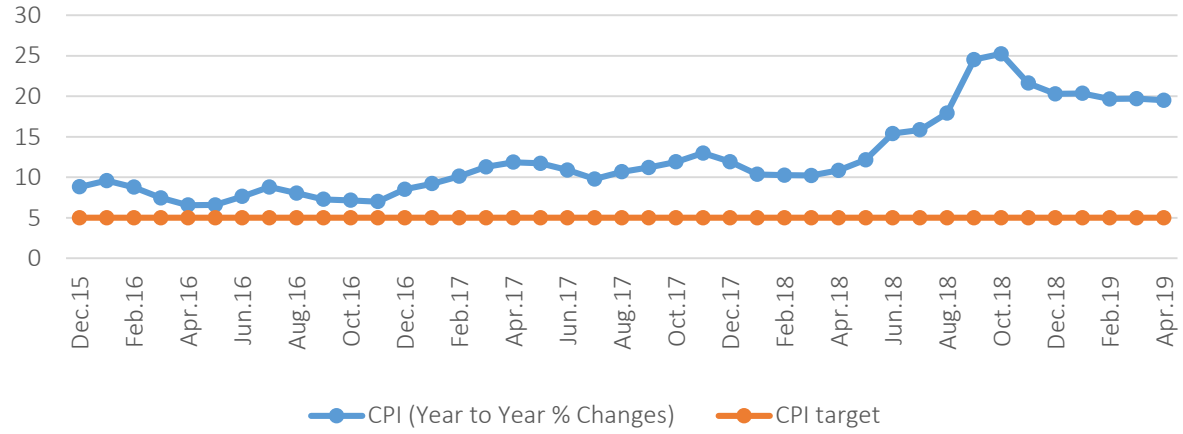

Figure 5. Factual and target annual inflation rate in Turkey

negative effects but also the inexplicable building boom, which was credited by the banks of Spain, Italy and other European countries. An outstanding example of the unreasonable gigantomania of the Turkish government is the new Istanbul Airport, the full capacity of which remains to be quite doubtful.

Altogether, the monetary sphere of Turkey was a hostage of political instability. On the one hand, there was the internal confrontation between political forces, military actions in neighboring Syria, and the dissatisfaction of the middle class with the betray of democratic principles, and, on the other hand, external factors such as the escalated contradictions between the Turkish authorities and the establishment of the European Union, the United States and NATO. Political instability has overwhelmed the financial markets and raised inflationary expectations, which resulted in maintaining annual inflation rate at 5% that was far beyond of target at the end of the decade. It seems that reaching the inflation target under further political stability will also have to be postponed for 2-3 years.

4.3. Political shocks in terms of the hybrid war (the example of Ukraine)

In contradiction to the two abovementioned countries, Ukraine is in the most difficult situation, for not only the change in the political situation but also the military conflict in the east that has a significant impact on the economy. Among the post-Soviet republics, it experienced the deepest decline in the 1990s under the transformation process. At the same time, the economic recovery since 2000 was also hard. During the great recession, the economy lost 14.8% of its GDP, while during the military-political aggravation in 2014–2015 it was 16.4% (Table 4).

The military-political shock had a significant impact on annual inflation, which rose to 48.7% in 2015, and the exchange rate of the dollar against the national currency, hryvnia, had climbed more than two times.

In the process of getting over the macroeconomic shock generated by geopolitical factors, the National Bank of Ukraine set up the inflation targeting regime as a new monetary policy strategy. The IT in Ukraine was officially installed in 2016, after the critical phase of the macroeconomic shock that threatened the economic system by the military conflict in the East, the imbalanced banking cleansing, poorly managed devaluation of the hryvnia and the recession of the real sector. By that time, the methodological, technical and organizational preconditions for such a transition were formed and consisted of creating the analytical and forecast system of the National Bank, launching a quarterly publication of inflation reports, introducing a system of business and bank surveys on inflation expectations, and developing a model for testing financial stability in the country. In addition, the NBU initially supported the transition to the floating exchange rate regime and provided the growth of the dis-

Table 4. Macroeconomic development indicators of Ukraine in the post-crisis period

Source: World bank, IMF.

	2011	2012	2013	2014	2015	2016	2017	2018
GDP annual growth (%)	5.5	0.2	–0.03	–6.6	–9.8	2.4	2.5	3.3
GNI per capita, Atlas method (current US$)	3,120	3,500	3,800	3,560	2,650	2,310	2,390	...
Foreign direct investment, net outflows (% of GDP)	0.1	0.6	0.2	0.4	0.04	0.2	0.2	...
Inflation, end of period consumer prices (%)	4.6	–0.2	0.5	24.9	43.3	12.4	13.7	9.7
Current account balance (% of GDP)	–6.3	–8.1	–9.2	–3.9	1.7	–1.5	–2.2	...
General government structural balance (% of potential GDP)	–3.2	–4.5	–4.8	–3.0	–0.4	–2.0	–2.0	...
General government gross debt (% of GDP)	36.9	37.5	40.5	70.3	79.5	81.2	71.9	...
Broad money growth (annual %)	14.7	12.8	17.6	5.3	3.9	10.9	9.6	...
Interest rate spread (lending rate minus deposit rate, %)	8.1	5.4	5.9	5.6	8.8	7.8	7.3	...

count rate as the main instrument of monetary policy. It should be mentioned that the creation of the Monetary Policy Committee (MPC) and strengthening communication with the public about the future actions of the National Bank of Ukraine leadership was another prerequisite for the IT implementation.

When the IT was launching, the macroeconomic environment had been stabilized somewhat, however, a clear disinflationary trend and a monotonous downward price dynamics occurred only in 2018–2019 (Figure 6). The inflation with a rate of 43.3% in 2015 changed and was 12.4% and 13.7% in 2016 and 2017, respectively. And only in 2018, the inflation rate fell below 10%, remaining still above the long-term target with an upper limit of 6.5%. However, besides return inflation to the targeted band of 5 ± 1.5%, the following are needed: the further reduction of inflation expectations, stabilization of the foreign exchange market through cooperation with international monetary institutions, targeted reform of market institutions to improve the investment environment.

The remission of inflation at the end of 2018 forced the NBU to lengthen the term of achieving a medium-term inflation target. In addition, a floating inflation targeting regime supported the NBU and the planned inflation rates at the level of 5 ± 1 percentage point of annual inflation will not be reached in 2019 (as it was provided by The Main Principles of the Monetary Policy for 2018), and, obviously, in 2020 (according to a new assessment of the inflation situation by the National Bank).

It is not worth disapproving the National Bank of Ukraine for allowing the excessive elastici-

Source: NBU.

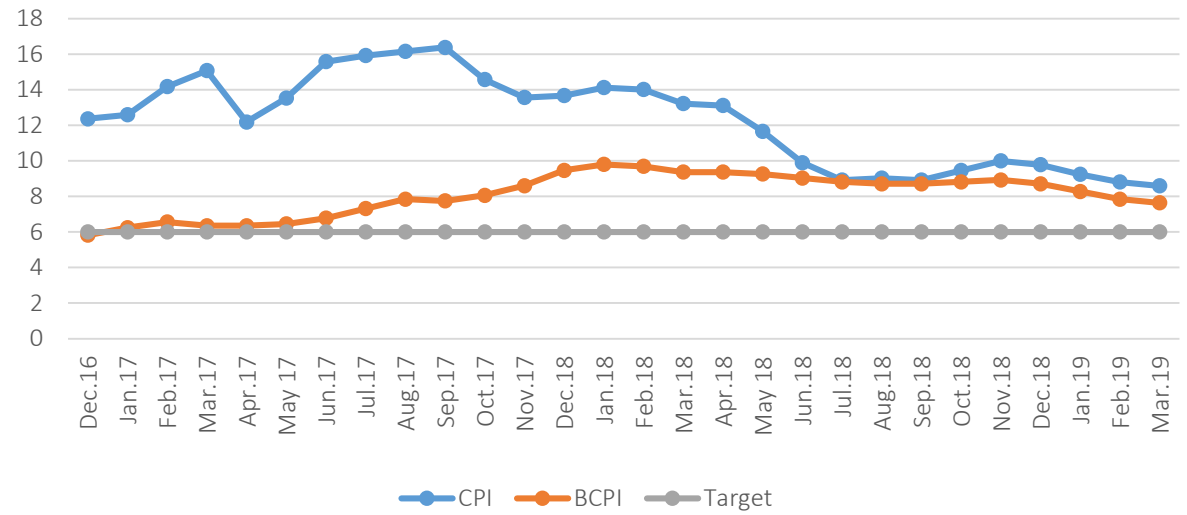

Figure 6. Annual consumer and basic inflation rates in comparison with the inflation target in Ukraine

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ty of IT, because there are too many factors of unexpected changes in the macroeconomic situation. In addition, the National Bank does not fully control inflation processes, as they are strongly influenced by non-monetary factors that include significant openness of the economy and dependence on global risks of domestic development, monopolization of some markets with the monopolists ability to upward prices, dollarization of the money market, state regulation of prices and tariffs, which recently served as a significant point of the growth of the general level of prices in the country. In view of this, it is extremely necessary to coordinate the National Bank's activities with other executive branches.

However, the current NBU policy and the practical plane of the IT regime implementation are still in question. Firstly, whether a discount interest rate is a fairly effective monetary policy instrument and whether the interest rate channel of the monetary transmission works reliably since the repeated increase of the discount rate during 2018 did not appreciably affect inflation rates. Secondly, whether inflation is out of control regarding the hryvnia exchange rate fluctuations, which, after the proclamation of the floating regime, has a powerful influence on prices through the mechanism of imported inflation. And, finally, which should be the limits of the flexibility of inflation targeting, so that economic entities trust in it will not be completely lost due to the excessive inflation targets volatility, as it has happened in Argentina. Besides, monetary challenges may become a macroeconomic shock in case of the new political forces that came to power after the 2019 presidential election get away the principles of stabilization policy and suggest weaknesses or errors in its implementation.

CONCLUSION

Thus, politically generated shocks undermine the country's macroeconomic stability, disturb financial markets and, eventually, prevent the growth of the real sector. Their influence on the monetary sphere relates to a number of political and economic processes and can be summarized in the context of comparative analysis as follows.

The most powerful political impact is observed in the long-term military and political events, which disturb inter-sectoral and interregional proportions and greatly destabilize market processes. Populist and sanction political risks have a smaller multiplier effect on the economy. The difference between the politically generated macroeconomic shocks is that the populist policy causes, first of all, the shock of aggregate demand, activated by heightened expectations of economic entities regarding future incomes and prices. The market reaction to previous events is characterized by the homogeneity in all three cases: an increase in prices for goods and services, financial and real assets, and for labor. Foreign exchange markets are the most volatile in the monetary sphere, especially in the case of politically generated sanction shocks, closely related to a foreign economic imbalance.

In all three types of political instability, the regulatory effect of central banks is the increasing flexibility of the inflation targeting regime.

The leveling of the root causes of the political instability generation is based on the international and national coordination of the opposing sides, mainly in the long run. The political risks of populist origin in Argentina can be neutralized by mobilizing sufficient political will of the authorities and the public willingness to improve prosperity in the long term; cancelling international sanctions for political stabilization by the negotiation process and fulfilling the requirements of the partner countries, which was mainly done in Turkey; solving the military-political confrontation from the point of Ukraine force seems unlikely due to the threat of open external interference, and negotiations on reconciliation are still impossible owing to the parties antagonism, which threatens in the future the emergence of the conflict into a permanent political instability with the prospect of freezing the conflict for many years.

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