

POLICY PULSE

Turkey: More than Expected Hike by the CBRT

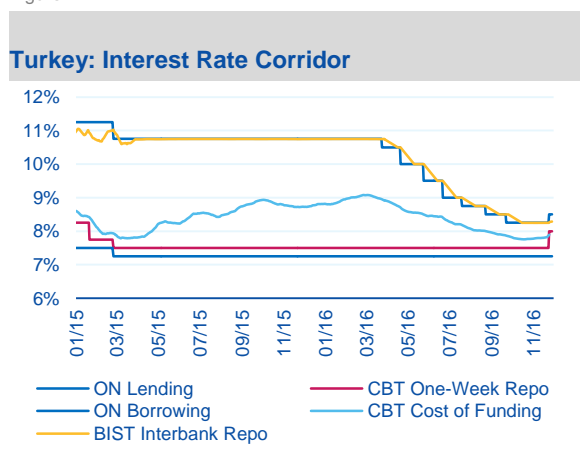
Ugur N. Küçük / Seda Güler / Asuman Kemiksiz

In today's monetary policy meeting, the Central Bank (CBRT) increased the O/N lending rate by 25 bps to 8.5% and one-week repo rate by 50 bps to 8.0%, and kept the O/N lending rate constant at 7.25%. The decision surprised the markets as the general market expectation was only a 25bps hike on the one-week repo rate. Market reaction was positive sending Turkish lira and stock exchange up by circa 0.75%. Separately, the CBRT reduced the reserve requirement ratio (RRR) on FX liabilities by 50bps, as to counterbalance partly the tightening in terms of higher interest rates.

A rate hike due to the exchange rate depreciation and heightened volatility

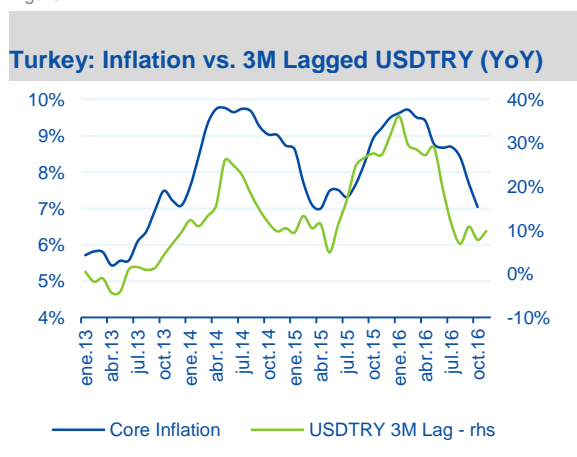
The accompanying statement clearly shows the rate hike was due to the recent depreciation pressure on Turkish lira and its potential impact on inflation outlook and financial stability. The Bank seems also concerned about the economic growth by acknowledging the deceleration in the economic activity in 3Q, and expects a recovery to start in the final quarter of this year on the back of the supportive measures. Thus, the CBRT accompanied its interest rate hike by a reduction in the FX reserve requirements to somehow mitigate the tightening impact. The RRR reduction will release some USD 1.5bn in the market, by reducing the same amount from the CBRT reserves. There was no reference to the "simplification process" in the statement, which means that the average funding rate can go as high as 8.5% in the short run, if exchange rate depreciation pressure continues.

Figure 1



Source: Garanti Research, Bloomberg

Figure 2



Source: Garanti Research, TURKSTAT

Looking Ahead

Keeping the current decomposition constant, the average funding rate will rise close to 8.4% from the current 7.9%. Going forward, the CBRT will monitor closely the developments in the global markets and US dollar's move to decide on the interest rates. However, we expect the bank to continue its macro prudential easing, as the economic activity continues to show weakness in demand.

DISCLAIMER

This document has been prepared by BBVA Research Department, it is provided for information purposes only and expresses data, opinions or estimations regarding the date of issue of the report, prepared by BBVA or obtained from or based on sources we consider to be reliable, and have not been independently verified by BBVA. Therefore, BBVA offers no warranty, either express or implicit, regarding its accuracy, integrity or correctness.

Estimations this document may contain have been undertaken according to generally accepted methodologies and should be considered as forecasts or projections. Results obtained in the past, either positive or negative, are no guarantee of future performance.

This document and its contents are subject to changes without prior notice depending on variables such as the economic context or market fluctuations. BBVA is not responsible for updating these contents or for giving notice of such changes.

BBVA accepts no liability for any loss, direct or indirect, that may result from the use of this document or its contents.

This document and its contents do not constitute an offer, invitation or solicitation to purchase, divest or enter into any interest in financial assets or instruments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

In regard to investment in financial assets related to economic variables this document may cover, readers should be aware that under no circumstances should they base their investment decisions in the information contained in this document. Those persons or entities offering investment products to these potential investors are legally required to provide the information needed for them to take an appropriate investment decision.

The content of this document is protected by intellectual property laws. It is forbidden its reproduction, transformation, distribution, public communication, making available, extraction, reuse, forwarding or use of any nature by any means or process, except in cases where it is legally permitted or expressly authorized by BBVA.