POLICY PULSE

Turkey: The CBRT Opts a Wait and-See Mode

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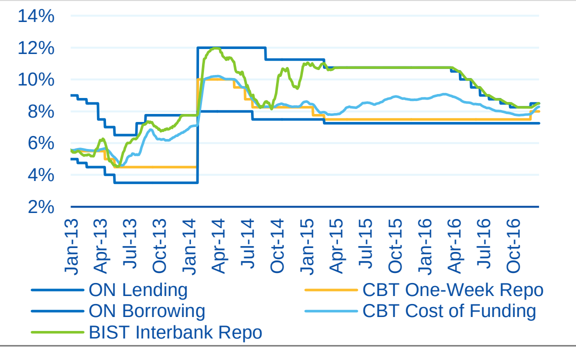
The Central Bank (CBRT) maintained the entire set of its monetary policy rates constant at the following levels; O/N lending rate at 8.5%, one-week repo rate at 8.0%, and O/N borrowing rate at 7.25%. Turkish lira was sold-off slightly by 0.3% following the decision as the markets had already priced in a 25bps hike in the lending rates. The Bank referred to the necessity of additional time for a clear assessment of the net inflationary impact of higher exchange rate and energy prices as opposed to modest aggregate demand conditions.

The Bank needs more time to weigh the counteracting inflationary pressures

In the accompanying statement, the CBRT acknowledges the upward risks on inflation outlook due to the recent exchange rate depreciation and increase in oil prices. Yet, 12-m ahead inflation expectations rose some 40bps in two months to slightly over 8% despite the favourable current CPI realizations thanks to low food prices. Nevertheless, the Bank opted a wait-and-see approach to weigh to what extent the poor demand conditions and therefore lower demand pressures will offset the pass-through from recent surge in import prices. Analysis of the recent years show that the ex-post real interest rates on the CBRT's policy rate hover around zero percent. The current real interest rate levels are at positive rates, but it is also true that zero real interest rates policy has not brought inflation to the target either.

Figure 1

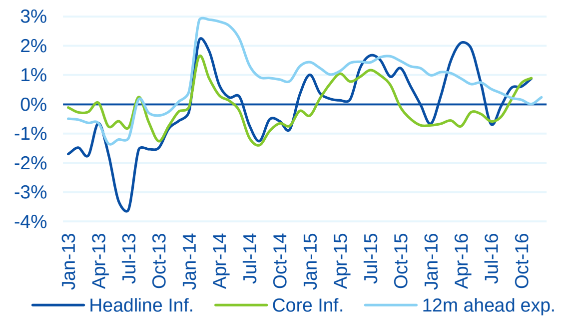
Turkey: Interest Rate Corridor %



Source: Garanti Research, Bloomberg

Figure 2

Turkey: Real Interest Rates (Differential against the CBRT Funding Rate %)



Source: Garanti Research, CBT, Turkstat

Looking Ahead

We expect the CBRT to continue monitoring closely the developments in the global markets and US dollar. According to our forecasts, the current low food prices and favorable base impact in January should provide some relief in the short term. However, rising energy prices and some other negative shocks clearly pose some risks for inflation expectations to overshoot. This risk scenario may require a tighter monetary policy thereafter so the CBRT should clarify its view rapidly to limit the inflationary risks. In the meantime, we expect the CBRT to manage the daily average funding rate between the current 8.3% mark and the upper bound of the interest rate corridor to tackle the currency volatility.

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