

Turkey: CBRT surprised markets on the upside

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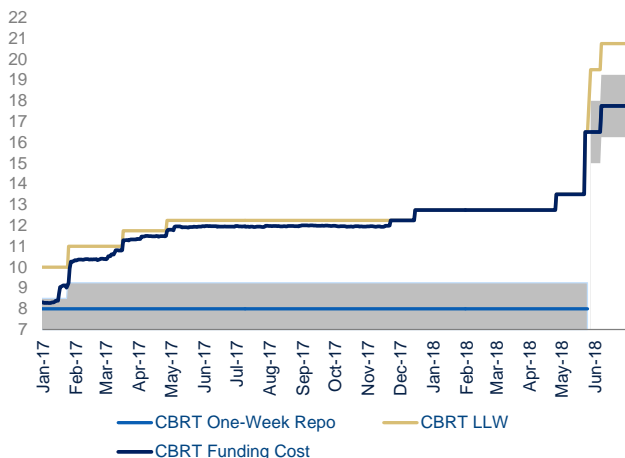
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The Central Bank (CBRT) hiked the one-week repo rate by 125 bps to 17.75%, clearly above market expectations (BBVA Research 50bps). With the decision, the CBRT reinforces its stance on inflation worries in the short term and takes a solid step to restore credibility against rapidly worsening inflation expectations. Since April, the CBRT has increased the rates by 500 bps, simplified its policy framework and provided some supporting liquidity measures. The ex ante real interest rate (discounting our one year ahead inflation expectation) is now slightly above 7%, a real tight stance in the anti-inflation strategy. The CBRT has shown a pro-active movement which will help to restore credibility faster. We welcome CBRT's decision and commitment to "additional tightening if needed" and "the tight stance will be preserved decisively until inflation outlook improves significantly". Today's decision is a step in the right direction which should be accompanied by fiscal restraint to "rebalance" the economy to a healthier path.

Worsening inflation outlook, exchange rate volatility and credibility woes behind the bold move

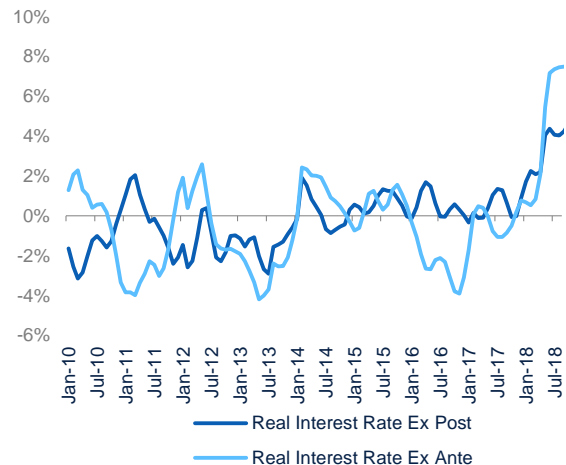
We appreciate today's CBRT decision to hike rates clearly above expectations for several reasons. First, after a protracted period of time it decided to go ahead of the curve surprising the market expectations. Second, it's a big step forward in the anti-inflation strategy. The ex ante real interest rate now moves above 7% (according to our inflation expectations) which will help to contain demand pressures. Third, it will reinforce the recent positive trend in the lira, initiated by the previous decisions. Fourth, it will restore credibility rapidly with this bold movement as the sensation that the CBRT will control the situation has increased. We believe that today's tightening will reduce the differentiation among the Emerging Markets, which already initiated with the previous tightening and will help the beta to return the normal levels of the rest of the Emerging Markets. Still there is the question of whether more action is needed. This will depend on global conditions in Emerging Markets, the evolution of inflation in the short term and the new disinflation path which the economy management could introduce potentially in the new Medium Term Program, to be known after the elections.

Figure 1 CBRT Interest Rate, %



Source: TURKSTAT, CBRT, Garanti Research

Figure 2 Real Interest Rates, YoY



Source: BBVA Research

A good step in the right direction which should be complemented with fiscal restraint

Today's decision by the CBRT should be welcome as it will help to correct the imbalances and restore credibility. The commitment on the tight stance to be preserved decisively until inflation outlook improves significantly is also a good step and should be reinforced with fiscal restraint.

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