

Economic Watch

Turkey: The CBRT gives a stronger message

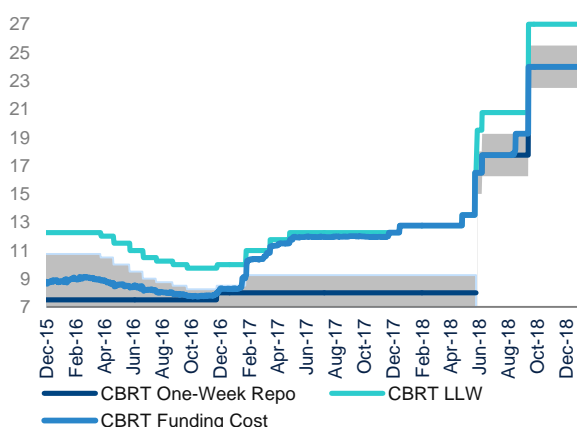
Adem Ileri / Serkan Kocabas / Seda Guler Mert / Alvaro Ortiz
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The Central Bank (CBRT) kept its policy rate (one-week repo, 24%) unchanged parallel to the expectations. The Bank strengthens its message against the easing expectations of the market, saying that risks on price stability continue to prevail despite the recent improvement in inflation outlook due to the developments in import prices and domestic demand conditions. The downside surprise of November inflation also shifted the expected inflation path downwards for 2019; though the likely reversal of recent tax reductions and discount campaigns at the start of next year will still bring a temporary pick-up in the headline by around 2-3pp. Also, uncertainties over the wage adjustments and volatility in financial markets still make the CBRT vigilant and leads the Bank to repeat its message as “if needed, further monetary tightening will be delivered”. We maintain our view that the CBRT could wait to deliver the first rate cut around the summer, when inflation starts to come down more obviously on base effects, easing exchange rate pass-thru, deeper negative output gap and declining cost push factors.

Uncertainties on inflation outlook makes the CBRT vigilant...

Recent stabilization in financial markets also supported by the supportive external conditions provides some relief for inflation especially in a period of poor demand conditions. Though, still the uncertainties over the pricing behavior and cost push factors especially at the start of next year when the current price reductions on tax cuts and discount campaigns will be reversed and most of the wages will be adjusted with this year’s high inflation will keep the inflation increasing in the first quarter of next year. Also, local elections in March will likely keep the volatility high in the markets. Hence, we envisage that the CBRT should stay alert and even tighter to achieve a sizable improvement in inflation outlook as inflation expectations are still well above the CBRT’s interim targets. Despite the recent limited decline in medium term expectations, 12-month ahead inflation expectation stays near 16.5% and 24-month ahead at 12.4%, in contrast to the CBRT’s own targets of 15.2% and 9.3%. Besides, as the CBRT also mentions, contribution of fiscal policy to rebalancing process will also be crucial to restore credibility in order to anchor inflation expectations.

Chart 1 CBRT Interest Rates, %



Source: BBVA Research Turkey, CBRT

Chart 2 Inflation expectations, YoY



Source: BBVA Research Turkey, CBRT, TURSKTAT

...there is a long way to anchor inflation expectations

Despite both the recent stabilization in financial markets and higher than expected retreatment in inflation, the CBRT should wait for a sizable improvement in inflation outlook to start an easing cycle as inflation expectations remain far from the CBRT’s interim targets. The stance of the fiscal policy will also be critical to assure a manageable rebalancing process as in the promised fiscal consolidation plan in New Economic Program (NEP).

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BBVA Research Turkey Unit

Chief Economist for Turkey, China and Big Data Unit

Álvaro Ortiz
alvaro.ortiz@bbva.com

Pelin Ayrancı
pelin.ayranci@bbva.com

Ali Batuhan Barlas
albari@bbva.com

Yigit Engin
yigite@bbva.com

Deniz Ergun
denizer@bbva.com

Seda Guler Mert
sedagul@bbva.com

Adem İleri
ademil@bbva.com

Serkan Kocabas
serkankoc@bbva.com

BBVA Research

Chief Economist BBVA Group Jorge Sicilia Serrano

Macroeconomic Analysis

Rafael Doménech
r.domenech@bbva.com

Digital Economy
Alejandro Neut
robertoalejandro.neut@bbva.com

Global Macroeconomic
Scenarios
Miguel Jiménez
mjimenezg@bbva.com

Global Financial Markets
Sonsoles Castillo
s.castillo@bbva.com

Long-Term Global Modelling and
Analysis
Julián Cubero
juan.cubero@bbva.com

Innovation and Processes
Oscar de las Peñas
oscar.delaspenas@bbva.com

Financial Systems and Regulation

Santiago Fernández de Lis
sfernandezdelis@bbva.com

Digital Regulation and Trends
Álvaro Martín
alvaro.martin@bbva.com

Regulation
Ana Rubio
arubiog@bbva.com

Financial Systems
Olga Cerqueira
olga.gouveia@bbva.com

Spain and Portugal

Miguel Cardoso
miguel.cardoso@bbva.com

United States
Nathaniel Karp
nathaniel.Karp@bbva.com

Mexico
Carlos Serrano
carlos.serranoh@bbva.com

Middle East, Asia and
Big Data
Álvaro Ortiz
alvaro.ortiz@bbva.com

Turkey
Álvaro Ortiz
alvaro.ortiz@bbva.com

Asia
Le Xia
le.xia@bbva.com

South America

Juan Manuel Ruiz
juan.ruiz@bbva.com

Argentina
Gloria Sorensen
gsorensen@bbva.com

Colombia
Juana Téllez
juana.tellez@bbva.com

Peru
Francisco Grippa
fgrippa@bbva.com

Venezuela
Julio Pineda
juliocesarpineda@bbva.com

CONTACT DETAILS:

BBVA Research: Azul Street. 4. La Vela Building – 4th and 5th floor. 28050 Madrid (Spain). Tel.: +34 91 374 60 00 and +34 91 537 70 00 / Fax: +34 91 374 30 25 - bbvaresearch@bbva.com www.bbvaresearch.com