Economic Watch

The Central Bank of Turkey relies on Macro-Prudential and Communication policies

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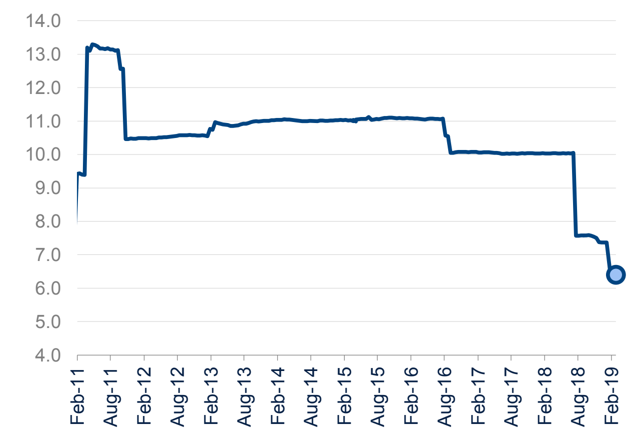
The Central Bank of Turkey (CBRT) decided last Saturday to reduce the Reserve Requirement Ratios (RRR) in Turkish Lira (by around 100 bps on average) and increase the upper limit of the ROM facility for holding standard gold converted from wrought or scrap gold to support credit growth and maintain the tightening stance intact until disinflation signs become more evident. As the "real" digestion of the crisis deepens, the CBRT remains increasingly reliant on Macro-prudential and Communication policies while they will wait for some months to begin with the standard easing cycle. So far, the CBRT has maintained the tightening stance after the bold rise in interest rates last September (625 bps to 24%) in order to gradually restore credibility and trust. This, and a more orthodox fiscal policy, have clearly paid off as the exchange rate has regained near 25% of its value since then. Rather than considering the reduction of RRR as an early sign of an interest rate cut before the elections, we perceive the decision as the logical response to stimulate credit but avoid a premature rate cut which could put credibility (and the exchange rate) at risk. We believe that the CBRT will expect to observe clear signs of disinflation maybe in summer when the Monetary Policy Committee can start the easing cycle and even implement more aggressive cuts if the outlook allows, and credibility and inflation expectations are clearly anchored.

Macro-prudential and Communication Policies at play…

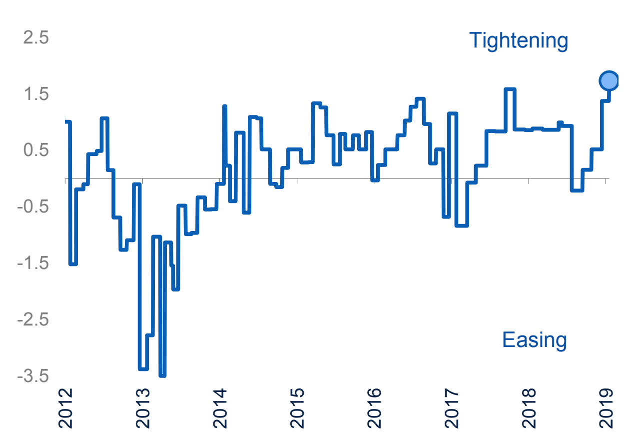
The CBRT decision to reduce the TL RRRs (Chart 1) and ease the ROM facility in gold should be considered as a movement to support credit rather than an early indicator of an imminent cut. The quarterly annual growth rate in FX-adjusted loans slumped during the last quarter of 2018 as the financial shock deteriorated the confidence. Although credit growth is already bottoming out (the 13-week avg. annualized growth rate is already at -1.6% after reaching near -15% in November), the decision will help to sustain the recovery in credits. Still, inflation remains high and the credibility gains of the monetary policy since September could be vanished if the CBRT decides to start the easing cycle prematurely. The tighter verbal stance on the latest MPC statements (see our Big Data sentiment index in Chart 2) and enhancing communication policy (i.e. recent speeches and interviews by the CBRT Governor) have helped to maintain the anti-inflation alert, avoiding any unnecessary volatility in the exchange rate.

Chart 1 CBRT TL Reserve Requirement Ratio, % Avg.



Source: CBRT

Chart 2 CBRT Monetary Policy Statement Index



Source: BBVA Research Turkey

…before starting the easing cycle in summer

In Sum, we believe that the CBRT will wait to start the easing cycle when the negative output gap and diminishing exchange rate pass-thru lead to a faster decline in the headline inflation, which will be clearer during summer. Meanwhile the combination of tight stance, verbal guidance and easing macro-prudential policies will help to maintain the tight monetary policy stance and provide some support to the recovery of credit.

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