BBVA Research

Economic Watch

Turkey: The CBRT reinforces credibility

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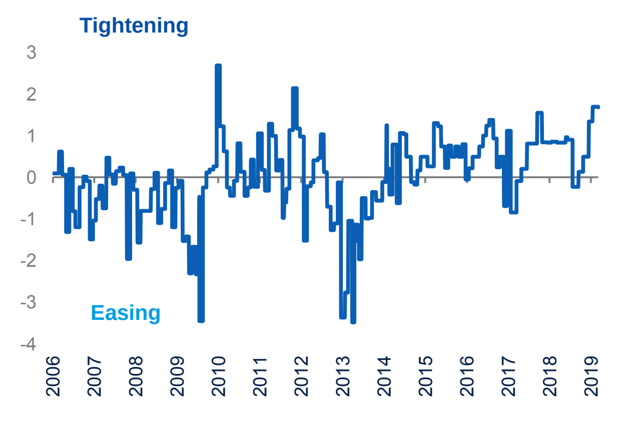
The Central Bank (CBRT) kept its policy rate (one-week repo, 24%) unchanged in line with expectations. The policy statement is almost the same with the latest one and maintains the tight tone (as seen in our Big Data CBRT sentiment index) by being prudent on inflation outlook and keeping the door open for further tightening if needed. Despite the recent better than expected inflation figures, the permanent component of inflation (when adjusted from cyclical, seasonal and irregular factors) continues to remain high and doesn't imply a clear disinflation trend yet. Also, cost-push factors and volatile food inflation remain to be the main upside risks on inflation, keeping inflation expectations still far from anchored. Hence, the message "to maintain the tight monetary policy stance until inflation outlook displays a significant improvement" is preserved, which signals the prudence on inflation outlook and pays way to restore further credibility. In our view, the CBRT should wait for June (when the recovery in inflation becomes more obvious) to start a gradual easing cycle.

Inflation outlook will require more patience…

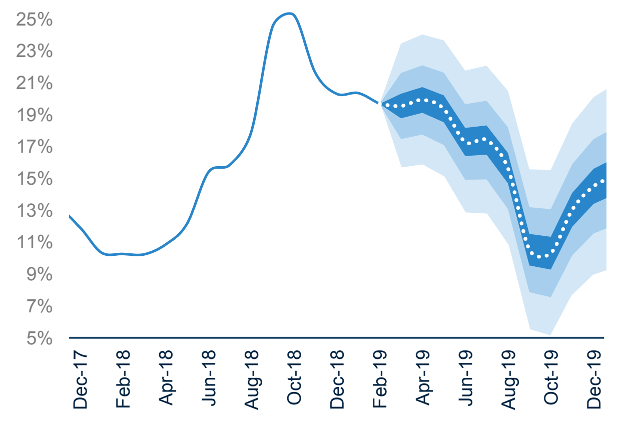
In contrast to our initial expectations, the appreciation in the currency, utility price reductions and the extension of tax incentives all led to a downward shift in our expected inflation path in the short term. Though, despite the Government's municipality stalls selling food with subsidized prices, cost-push factors and some structural problems continue to weigh on food inflation, creating additional volatility in the headline figure. Besides, the sticky services inflation implying the high inertia on backward pricing, minimum wage hike beyond expectations and tighter financial conditions makes it harder to anchor expectations. Despite some easing, medium term inflation expectations stay high, where one-year ahead inflation expectation is near 16% and two-year ahead at 12%. All in all, according to our estimates, the trend (permanent) factor that eliminates the temporary effects in inflation starts to show some stabilization but still remains at an unfavorable level of near 14.5%, which is early to introduce any imminent rate cut, in our view. Hence, the CBRT carries the need to maintain its tight stance (as seen in our Big Data CBRT sentiment index in Chart 1), which will help to restore credibility and make it easier to manage medium term inflation expectations with more clarity and predictability in time.

Chart 1 CBRT Big Data Monetary Policy Sentiment Index



Source: BBVA Research Turkey, CBRT

Chart 2 Inflation Expectations (YoY)



Source: BBVA Research Turkey

…not to start an easing cycle at least before June

As also confirmed by the CRBT, despite the recovery in recent inflation figures and sharper adjustment in activity, uncertainties over the pricing behavior still prevail. We maintain our view that the CBRT should wait for June, when the improvement in inflation outlook will become more promising on wider negative output gap and easing exchange rate pass-thru, to start a gradual easing cycle. Depending on the attained disinflationary path, the CBRT could deliver a total of 500bps cuts till the end of the year according to our year-end inflation estimate at 14.5%.

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