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Economic Watch

Turkey: CBRT remains “tight” but closer to “ease”

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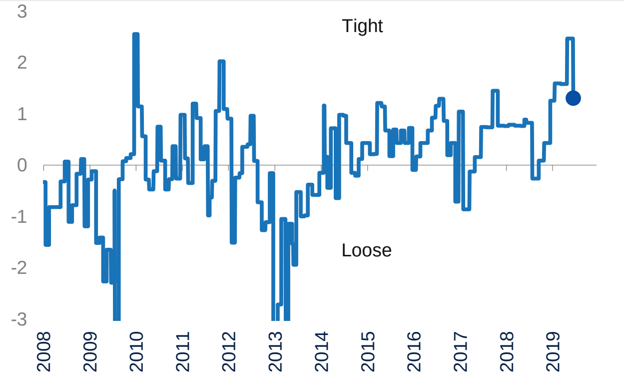
The Central Bank of Turkey (CBRT) maintained its policy rate unchanged (one-week repo, 24%). Today´s decision has justified the tight stance in terms of “reinforcing the disinflation process”. As shown in our Big Data Sentiment indicator (Chart 1), the “tone” of the statement is softer as the conditions to ease the monetary policy stance in the new “Inflation Forecast Targeting framework” are already present. In absence of new shocks, inflation will start to come down fast, given the favorable base effects, the recent improvement in core inflation and some ease in energy and food prices. The CBRT has opted to gain some credibility by “reinforcing the disinflation process” and cope with the political and geopolitical uncertainties in the short term. We maintain our view that the CBRT will start the gradual easing cycle towards the end of the year, but the expected disinflation path could bring it forward. On the other hand, important uncertainties remain to be solved so today’s decision is a prudent one and will help in terms of financial stability and credibility. In the medium term, the need for a comprehensive policy mix (monetary and fiscal) to complete the rebalancing of the economy and to anchor inflation expectations is still present.

Increasing room of maneuver for the CBRT… but prudence should prevail

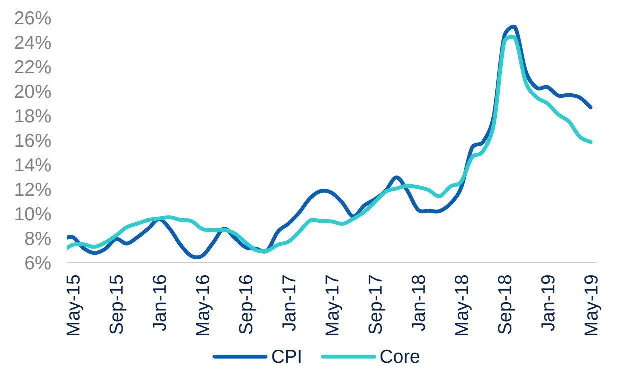
Lower than expected inflation realizations in the last two months (even below the lower bound of the CBRT’s inflation projections), rapid improvement in core inflation, negative output gap, relatively lower exchange rate pass-thru and lower international energy prices suggest that the disinflation path could accelerate in the short term. In absence of new exchange rate shocks, the current conditions improve the room of maneuver for the CBRT to initiate a gradual easing cycle. Still, the political and geopolitical uncertainties require careful monitoring and inflation expectations remain far from anchored (one and two year ahead inflation expectations stay above 15% and 12%, respectively). Although the base effects will also facilitate a rapid decline in inflation till November, the CBRT should remain prudent to reinforce confidence in order to anchor inflation expectations, in our view.

Chart 1. **BBVA RESEARCH BIG DATA CBRT MONETARY POLICY SENTIMENT INDEX**



Source: BBVA Research Turkey, CBRT Statements

Chart 2. **HEADLINE (CPI) & CORE INFLATION**



Source: TURKSTAT

We are getting closer to the beginning of the easing cycle

Starting from June, inflation will also be supported by base effects apart from its recent improvement. The current high levels of ex post (5.3pp) and ex ante (8.5pp) real interest rates provide room for the CBRT to initiate rate cuts. However, as important uncertainties on markets, politics and geopolitics remain, today´s decision to keep the tight stance should be welcomed. In absence of new shocks, the CBRT could start the easing cycle earlier than expected.

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