

Economic Watch

Turkey: The easing cycle starts with a bold action

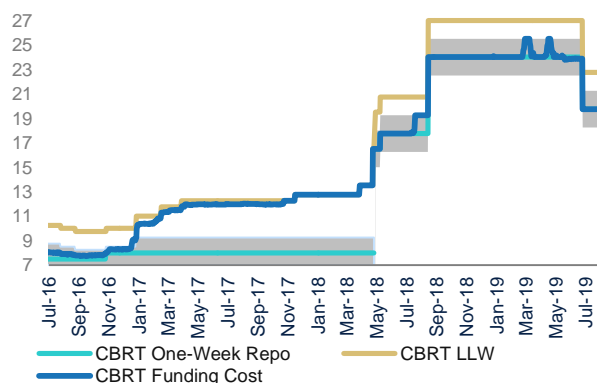
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The Central Bank of Turkey (CBRT) reduced the policy rate by 425 bps from 24% to 19.75%. The movement was bolder than expected by market expectation and ours (Consensus 250 bps, BBVA 200 bps). The reaction of financial assets to today’s decision was relatively calm as the CBRT justified the movement with a faster than expected disinflation projections (to be released next week) and market’s reaction was somehow front loaded. In absence of new shocks, inflation will start to come down fast, given the favorable base effects, still weak internal demand and stabilization in currency. However, some factors as the high inertia in services prices, high inflation expectations and still unsolved geopolitical uncertainties will require the CBRT to be prudent to avoid policy mistakes. Aside risks, the easing cycle will contribute to support the ongoing recovery providing some room for fiscal consolidation effort from now onwards.

Bold action from CBRT on the back of rapid disinflation...

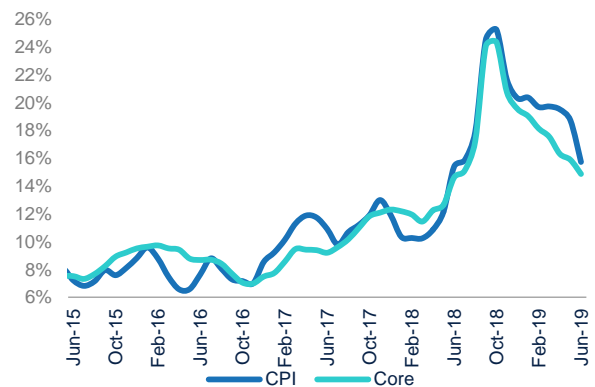
Inflation decreased faster than both market expectation and CBRT projection as declining from 15.7% in June thanks to the sharp normalization in food prices, easing in core prices on the diminishing pass thru and lower energy prices. Despite the increased currency volatility during April and May, 12 and 24 month ahead inflation expectations also retreated from 15.5% and 12.3% in May to 13.9% and 11% in July stemmed from the tight monetary policy stance, the end of some uncertainties and the recent inflation realizations. We expect that after the temporary jump up in inflation in July on the end of tax incentives and recent electricity price hike, recent faster than expected correction in inflation and favorable base effects from now onwards till November will help inflation to get around 10% levels in September and October before having a reversal to near 15% by the end of the year. Hence, CBRT took a bold action today based on the expected easing in external financial conditions, inflation realization and expectations. On the other hand, high inertia, remained political and geopolitical uncertainties, cost push factors, still double digit inflation expectations and credibility concern required to be met with cautious steps in the coming meetings.

Chart 1. CBRT Interest Rates (%)



Source: BBVA Research Turkey, CBRT Statements

Chart 2. Headline (CPI) & Core Inflation



Source: TURKSTAT

... the easing cycle should be welcomed ... but monitored gradually

The CBRT has started the easing cycle with a bold action. According to the statement, the CBRT is including inflation projections (to be released next week) more benign than market expectation and ours. If inflation data materialize in line with the CBRT projections, the ex-ante real interest rate will continue to be attractive but also will support the economic recovery. However, still some risks remains on both economic and geopolitical sides which should be met with a gradual and cautious approach on the economic policy front.

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