

Economic Watch

Turkey: The last bold cut... now time for fine tuning

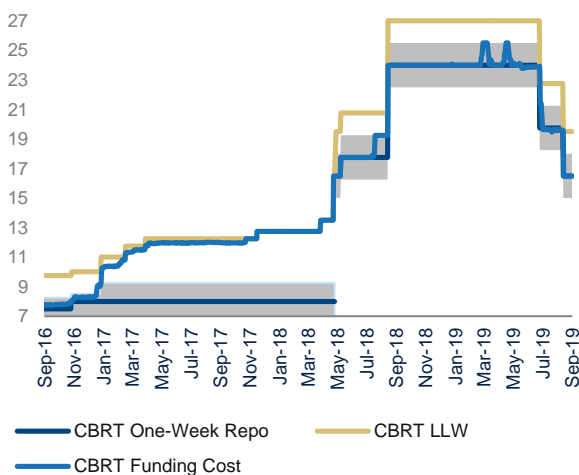
Ali Batuhan Barlas / Serkan Kocabas / Alvaro Ortiz
12 September 2019

The Central Bank of Turkey (CBRT) reduced the policy rate by 325 bps from 19.75% to 16.50%. The movement was higher than expected (Consensus 275 bps) but the reaction of financial markets to today's decision was positive as the CBRT justified the movement with a faster than expected disinflation in the statement. In line with the statement and the new Inflation Forecast Targeting, that means that the CBRT expects that inflation will be lower than the 13.9% projected for December 2019 in its last inflation report. This leaves the one quarter ex-ante real interest rate near 3% which given the lower natural rate of the US and the situation in the Eurozone looks reasonable. We assume that after the second bold decision (750 bps in two meetings) the CBRT will move to fine tuning and will continue to decide according to inflation projections and realizations. In our opinion, and given global uncertainties, the CBRT should enhance prudence from now onwards and signal to the market that they will be ready to go in any direction if needed.

The second bold move by the CBRT ...

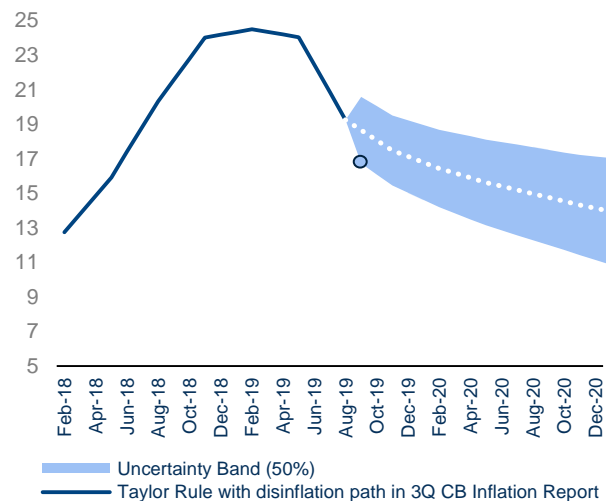
The CBRT delivered the second bold movement and justified this with the faster than expected disinflation path. This is partly the result of better than expected data in August (15%), the inflation falling below two digits in temporarily September and October and last, but not least, a likely revision in the expected inflation in the short & medium term in the Central Bank Projection models. In chart 2, we introduced the latest inflation report projections in our model and produced Taylor rule style interest rate projections. Today's decision is in the lower part of the uncertainty band and should imply that the CBRT has changed the inflation path to the downside again. Besides, we think that the CBRT could be considering a lower one quarter ahead ex-ante real interest rate of near 2.5%-3.0%. Although this entails some risks, it is now more supported by lower natural rates in US and the Eurozone.

Chart 1. **CBRT Official interest rates** (%)



Source: BBVA Research Turkey, CBRT Statements

Chart 2. **Interest rate according CBRT disinflation** (Projection from BBVA-MPM SOE model with CB inflation path)



Source: BBVA Research & CBRT

... should be followed by fine tuning based on inflation projections & data

In sum, once they catch up with the disinflation path, the CBRT should return to maintain the fine tuning and monitoring closely the inflation data & financial stability. At the same time, the Central Bank should be prepared for changes in any direction if needed. We expect rates to close this year in the 15%-16% area.

DISCLAIMER

This document has been prepared by BBVA Research Department. It is provided for information purposes only and expresses data, opinions or estimations regarding the date of issue of the report, prepared by BBVA or obtained from or based on sources we consider to be reliable, and have not been independently verified by BBVA. Therefore, BBVA offers no warranty, either express or implicit, regarding its accuracy, integrity or correctness.

Any estimations this document may contain have been undertaken according to generally accepted methodologies and should be considered as forecasts or projections. Results obtained in the past, either positive or negative, are no guarantee of future performance.

This document and its contents are subject to changes without prior notice depending on variables such as the economic context or market fluctuations. BBVA is not responsible for updating these contents or for giving notice of such changes.

BBVA accepts no liability for any loss, direct or indirect, that may result from the use of this document or its contents.

This document and its contents do not constitute an offer, invitation or solicitation to purchase, divest or enter into any interest in financial assets or instruments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

With regard to investment in financial assets related to economic variables this document may cover, readers should be aware that under no circumstances should they base their investment decisions on the information contained in this document. Those persons or entities offering investment products to these potential investors are legally required to provide the information needed for them to take an appropriate investment decision.

The content of this document is protected by intellectual property laws. Reproduction, transformation, distribution, public communication, making available, extraction, reuse, forwarding or use of any nature by any means or process is prohibited, except in cases where it is legally permitted or expressly authorised by BBVA.

ENQUIRIES TO:

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

