

Economic Watch

Turkey: The CBRT easing cycle continues

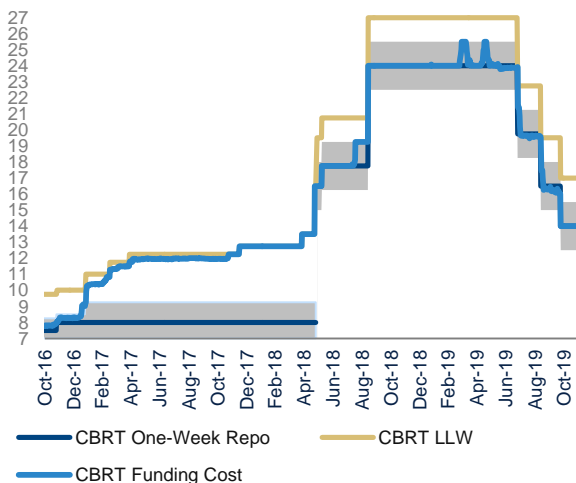
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The Central Bank of Turkey (CBRT) reduced the policy rate by 250 bps to 14% from 16.50%. Though the rate cut was much higher than the median market expectation (consensus 100 bps), the market reaction was calm as the recent ease in geopolitical risks and global central banks dovishness have supported the financial assets. The CBRT has justified its decision as its expectation on year end inflation stated as “...inflation is likely to materialize notably below the projections of the July Inflation Report by the end of the year”. Besides, CBRT is also more confident on gradual recovery in economic activity as they stated that recent high volatility in industrial production stemmed from working day effects and trend still revealed moderate growth path. While the easing cycle has been supported so far by the rapid disinflation, the high interest rate at the peak of the tightening cycle and a supportive “Global Dovishness”, we think that the CBRT should start to increase caution in the magnitude of the policy rate cuts as global uncertainty remains well alive and the CBRT should be ready to react at any moment if needed.

More confidence on inflation outlook by CBRT..

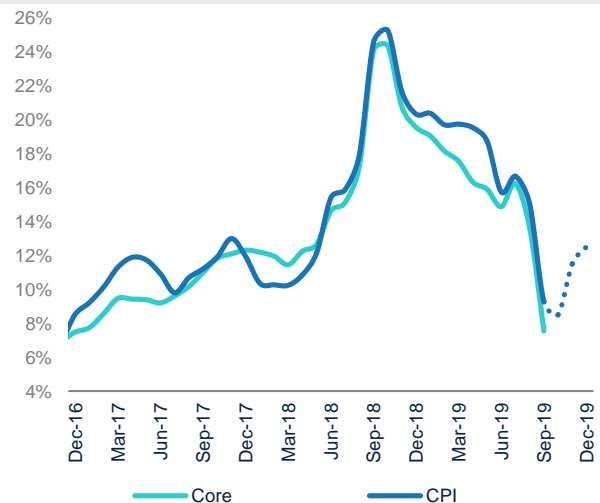
Annual inflation decreased to one digit level of 9.3% in September on substantial base effect, ongoing normalization in food prices and the ease in core inflation. Also, we expect that inflation could decrease further below 9% in October (8.5%) on still favorable base effect. Faster than expected disinflation path has also led inflation expectations to retreat further but still not anchored well as 24 month ahead inflation expectation in October CBRT Survey materialized as 9.8%. Today’s decision will probably be justified with a significant correction on the inflation projections in the next inflation report. We still think that CBRT should hold ex-ante real interest rate close to 2.5%-3% to cope with potential volatility stemming from global and geopolitical factors.

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



Source: BBVA Research Turkey, CBRT Statements

Chart 2. **Headline (CPI) & Core Inflation**



Source: BBVA Research & CBRT

...but prudent stance should be preserved to cope with uncertainty

Despite the global central bank dovishness and better than inflation realizations, uncertainties on global activity and geopolitical side continued to pose some risks. Hence, the CBRT should preserve prudent stance to reinforce credibility in order to encounter those risks. We believe that a real interest rate of near 2.5%-3.0% should prevail to cope with the actual high uncertainty in the Global Financial Markets.

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