POLICY PULSE

Turkey: A Modest Move as Expected

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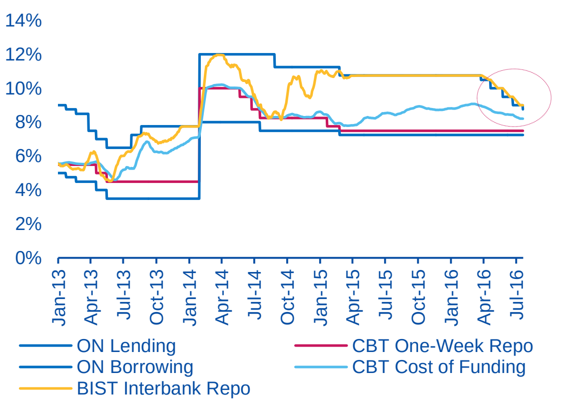
The Central Bank (CBRT) reduced the upper bound of its interest rate corridor (marginal funding rate) 25bps further to 8.75%, and kept the lower bound of the interest rate corridor and the one-week repo rate constant at 7.25% and 7.50%, respectively. The decision was in line with the analyst expectations, which reduced the magnitude expectations from the previous 50bps to a 25bps reduction following the heightened political volatility.

The benefits of simplification allowed a modest cut despite increased volatility

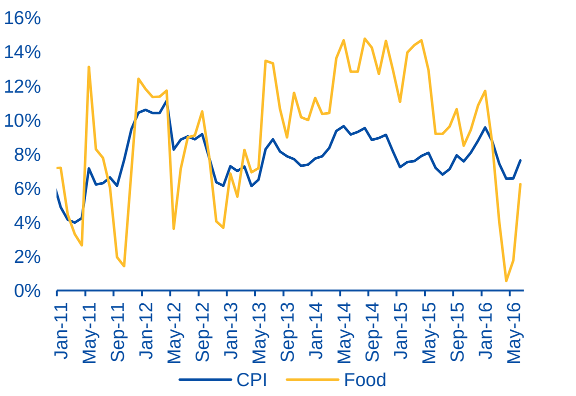
The CBRT expects a marked increase in inflation due to tobacco and unprocessed food prices and only a gradual fall in core inflation. Combining these with a sharp depreciation in currency due to political developments, the Bank decided to take a cautious step and slowed down its simplification process by narrowing the corridor by a modest 25bps. With this, the cumulative decrease on the upper bound became 200bps since March, placing the corridor at its narrowest since its introduction back in 2011. The CBRT is satisfied with the simplification process as it believes a narrower corridor increases the effectiveness of monetary policy. Although the improvement in core inflation indicators is not yet satisfactory, the scarce signs of recovery in credit growth and the weakness in tourism sector might have also supported the decision.

Figure 1
Turkey: Interest Rate Corridor



Source: Garanti Research, Bloomberg

Figure 2
Turkey: Headline and Food Inflation (YoY)



Source: Garanti Research, TURKSTAT

Looking Ahead…

Today´s decision will have a marginal effect on the average funding rate (near 10bp from current 8.2% towards 8.1%), keeping the current funding composition constant. We think the margin for maneuver has narrowed as the closing output gap, the sticky services inflation and surging unit labor costs will prevent a remarkable deceleration in core inflation. Thus, we think that the CBRT will continue to manage the monetary policy prudently, either through reducing the average funding rate with another modest 25bps upper bound interest rate reduction or stop to wait core inflation data to give a further respite. The risks are also present, as rating potential rating reductions by credit rating agencies could heighten volatility and affect to the stance of monetary policy.

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