

Turkey's 300bps Hike: The later, the tighter

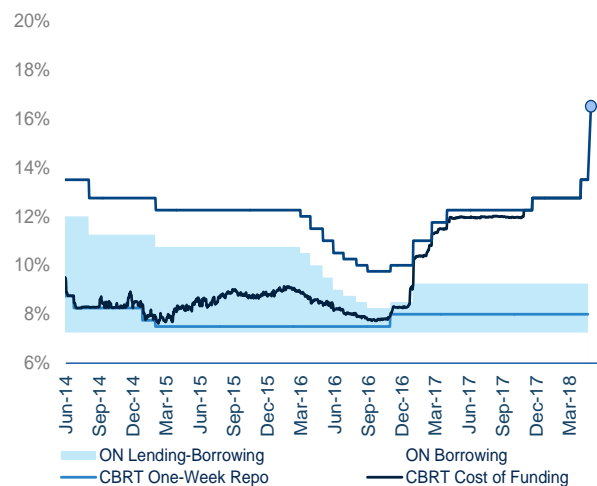
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The Central Bank of Turkey (CBRT) finally decided to “step in” an emergency meeting yesterday to correct the significant depreciation of the Turkish Lira (21% against US dollar from the April’s meeting). There are also other reasons for the action including the huge deviation of inflation from the target and expectations, financial stability motives and rapid loss of credibility during the last two weeks. In this sense, yesterday’s interest rate hike and the potential for more in the official meeting is a step in the right direction and should be welcomed. The action should be reinforced in a comprehensive way as we continue to believe that the fight against inflation should be prioritized on the top of the agenda with coordinated efforts in all fronts: Monetary policy should be maintained tight and independent for further reactions, fiscal policy should be tightened, the distortions in monetary transmission mechanism should be eliminated to enhance the power of monetary policy as soon as possible and accept a lower but healthier growth rate. Besides, the legislation for corporates indebted in foreign currency should be extended to the big ones.

CBRT delivers 300bps hike to fight inflation and enhance financial stability

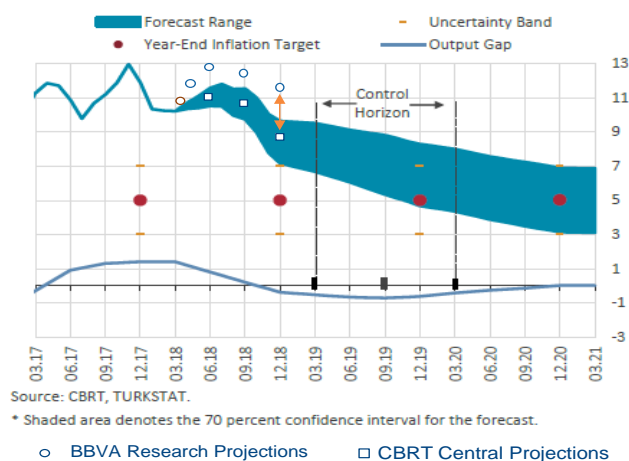
The Monetary Policy Committee decided yesterday to raise the “de facto” policy interest rate (Late Liquidity Window) by 300bps to 16.5%. The CBRT gave the rationale of the decision as “current elevated levels of inflation and inflation expectations”. The CBRT added that tight stance in monetary policy will be maintained decisively until inflation outlook displays a significant improvement and “any new data or information” may lead to revise its stance thus opening the door for more actions if needed. We think that the CBRT took the decision on both deviations of inflation and inflation expectations (at current exchange rates, our year-end forecast is already 3pp higher than the CBRT’s projection (see chart 2)) and the risk in both financial stability and policy credibility. Yesterday’s comments from top politicians after the decision should be welcomed and maintained.

Chart 1 CBRT Interest Rates



Source: BBVA Research Turkey & Turkstat

Chart 2 Central Bank Inflation Projections



Source: CBRT, TURKSTAT.

* Shaded area denotes the 70 percent confidence interval for the forecast.

○ BBVA Research Projections □ CBRT Central Projections

Source: BBVA Research Turkey & Turkstat

A national and comprehensive anti-inflation policy is urgently needed

The action of the CBRT is an important step to normalize the situation. Yesterday’s action (and more if needed) should be reinforced in a “comprehensive” way and elevated on the top of the agenda including: monetary policy and fiscal policy tightening, the removal of distortions in the monetary transmission mechanism, completing the FX hedge legislation and last but not least, accept a lower but healthier growth target.

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