

# Turkey: The CBRT delivers a new bold action

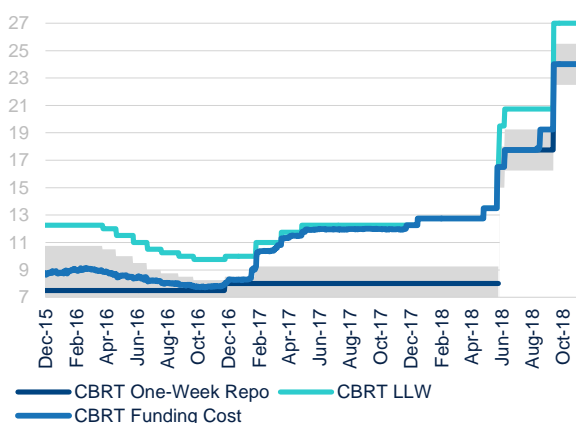
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The Central Bank (CBRT) hiked the policy interest rate (one-week repo) by 625bps to 24.0%. The hike is remarkably higher than expectations (21% Bloomberg consensus) and even ours (22.75% BBVA Research). The increase in the effective rate will now be up by 475bps as the CBRT was using the overnight lending since mid-August. Also, the CBRT stated that the funding will be done via one-week repo auctions, making it the key rate again. The decision should be welcomed as the CBRT does not only contribute to fight against inflation and inflation expectations but also supports financial stability by decreasing the pressures over the currency. Beyond this, it will help to eliminate uncertainties over monetary policy independence thus helping to reinforce credibility for the CBRT. This action should be complemented with a consistent and detailed medium term plan as we think that the strategy to fight inflation should be comprehensive.

## Worsening inflation outlook leads to a strong reaction from the CBRT

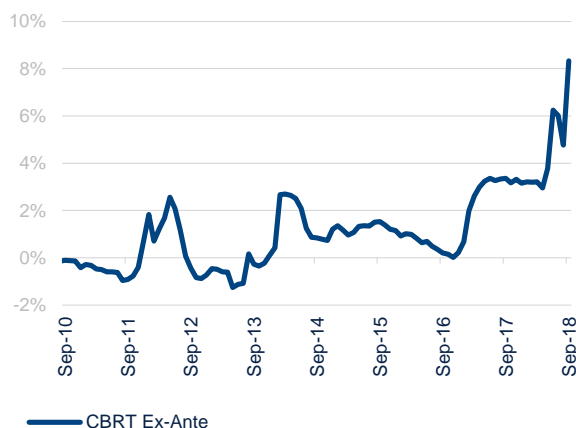
The significant worsening in pricing behavior due to the sharp exchange rate depreciation, second round price effects and increasing cost-push factors cumulated over the recent utility price hikes have led the inflation outlook to deteriorate substantially. Inflation expectations worsened rapidly not only in the short term (14.5% for 12-month ahead) but also in the long term (11.4% for 24-month ahead expectations). We expect inflation to continue to increase in the coming months and reach 21.5% at the end of the year; though the measures taken today could prevent further deterioration. We evaluate the CBRT's action as a front-loaded step (getting in front of the market expectations and leading the ex-ante real rate to 8%) and expect it to stay tight until the inflation outlook promises a disinflation path. We expect the adjustment of the economy to accelerate soon confirmed by preliminary indicators so far, facilitating to close the positive output gap faster. This could help to contain pressures over inflation stemming from the exchange rate volatility and eliminate part of the inertia.

Chart 1 CBRT Interest Rates



Source: BBVA Research Turkey, CBRT

Chart 2 Ex-ante Real Interest Rate, YoY (with 12-month ahead inf. expectation from CBRT survey)



Source: BBVA Research Turkey, CBRT, TURSKTAT

## ...And now waiting for the new Medium Term Plan (MTP)

Today's bold decision reinforcing the fight against inflation could help the CBRT to restore credibility; though it should be accompanied by a comprehensive and consistent policy mix aiming to rebalance the economy without triggering any systemic impact over financial stability. The New Medium Term Plan (MTP), expected to be announced next week, should provide the right framework accordingly.

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