

Economic Watch

Turkey: The CBRT stays on hold

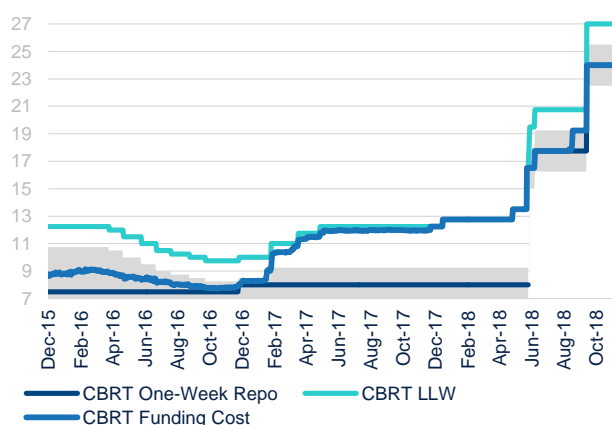
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The Central Bank (CBRT) left its policy rate (one-week repo, 24%) unchanged in line with the consensus (vs. our expectation of 100bps hike). The press release after the decision is almost the same with the previous one, except for the stress over the slow-down in economic activity “partly due to tighter financial conditions”. Hence, the Bank might have wanted to observe the lagged impact of recent monetary policy decisions to build up a new reaction despite the upside surprise of September inflation and sharp divergence in inflation expectations in the medium term. The recent stabilization in the currency and voluntary discount campaigns could provide some buffers to curb inflationary pressures till the end of this year. However, we think the discounts could reverse at the start of next year on top of still high pass thru and climbing cost-push factors (September annual domestic PPI at 46%). Besides, inflation expectations remain far from anchored. All in all, the inflation problem is still alive and may require a tight or even tighter monetary policy stance.

Higher inflation expectations should be the main concern for the CBRT...

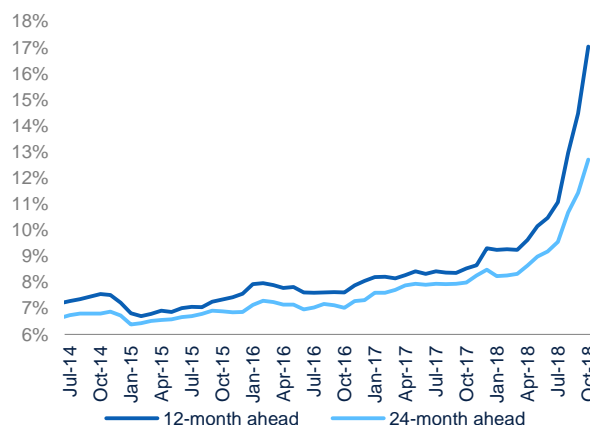
September inflation data surprised on the upside with monthly 6.3% figure vs. 3.5% of the consensus. The significant worsening in pricing behavior due to sharp exchange rate depreciation, second round price effects and increasing cost-push factors cumulated over the recent utility price hikes have led the inflation outlook to deteriorate substantially. Inflation expectations in October continued to worsen rapidly not only in the short term (17% for 12-month ahead, up from 14.5%) but also in the long term (12.7% for 24-month ahead, up from 11.4%). Although the sizably worsening inflation outlook requires the CBRT to react today, expected stabilization in inflation till the end of the year on current discount campaigns and recent stabilization in currency could have provided some relief for the CBRT not to widen the negative output gap further since the adjustment in activity becomes faster on tighter financial conditions both domestically and externally. In line with the consensus, we also expect some stabilization in inflation until the end of this year; however, starting from 2019, we expect inflation to accelerate on base effects and likely reversal of the current discounts before starting to ease slightly by June 2019.

Chart 1 CBRT Interest Rates



Source: BBVA Research Turkey, CBRT

Chart 2 Inflation expectations, YoY



Source: BBVA Research Turkey, CBRT, TURSKTAT

It is important to remain focus on the inflation problem

The recent appreciation of exchange rate has provided some relief for the Central Bank. However, we maintain our view that anchoring inflation expectations should be a priority target for the CBRT. It would be crucial not to lose the focus on expectations and the CBRT should remain vigilant on inflation evolution.

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