Creating Opportunities

## Economic Watch

# Turkey: CBRT raises rates and sends the right signal

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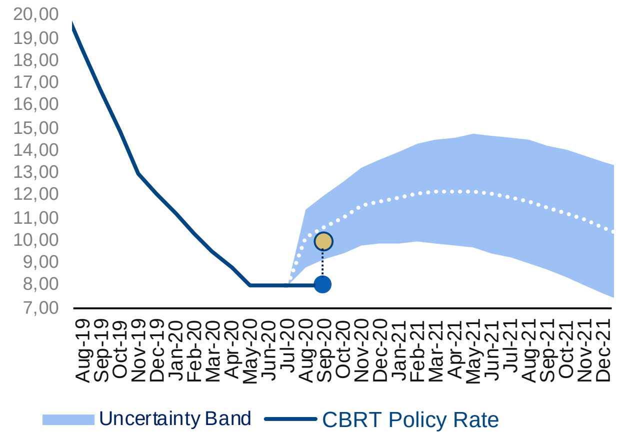
**The Central Bank of Turkey (CBRT) raised the policy rate by 200bps to 10.25% surprising the markets (vs. no change expectations). The decision is the correct one, not only by size (our Taylor rule is in line with the decision, suggesting near 10.5%) but also in terms of the "signaling" effect. The official rate hike of the CBRT will likely make the policy rate the main funding tool and will support the commitment to contain the inflation pressures. The CBRT justifies the decision with the inflationary pressures coming from a strong path of the economic recovery (in line with our view) and supply-side effects due to the recent exchange rate depreciation: "as a result of fast economic recovery with strong credit momentum, and financial market developments, inflation followed a higher-than-envisaged path". The last part of the statement is also preserved by recognizing the importance of "maintaining a sustained disinflation process as a key factor for achieving lower sovereign risk, lower long-term interest rates, and stronger economic recovery". The message is clear but should be reinforced by actions if needed. Time to rebalance.**

## The right signal

The combination of the rapid economic recovery and recent depreciation of the exchange rate made inflationary pressures inconsistent with the CBRT's year-end inflation projection at 8.9%. The CBRT acknowledges a fast recovery pattern in economic activity and the role of the recent credit boost. While the magnitude of the hike is slightly below the level of our Taylor rule suggests, it is very close to the central path and also depends on different inflation expectations considering the recent depreciation (our year-end inflation forecast to 11%). The economic activity remains strong and our Big data and nowcasting model suggest near 6% yoy GDP at the end of 3Q (still need to be confirmed by hard data). While we expect some moderation ahead, due to base effects and the monetary tightening, we believe that the GDP growth in Turkey will outperform the rest of the peers (in a very challenging year) and today´s decision makes this more likely. We expect a growth rate close to -1% but with clear risks on the upside. With the right decisions and other policy rebalancing efforts, growth would be closer to 0%.

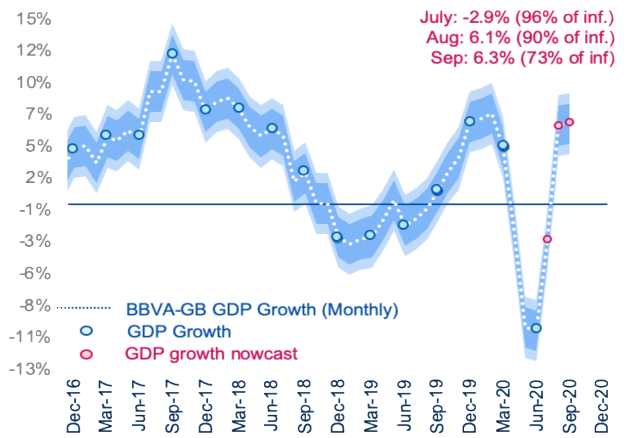
In sum, we welcome the decision as it is clearly in the right direction and stress that lagging reactions would imply higher rates (The later… the tighter). Volatility in the international markets will remain present and it is important not to lose the focus on the right policies, specially in countries with high sensitivity to financial market events.

Chart 1. **GB-BBVA Taylor Rule Implied Policy Rates** (%)




Source: BBVA Research Turkey

Chart 2. **Garanti BBVA Monthly GDP Indicator** (% YOY, 3-month moving average)




Source: BBVA Research Turkey

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