Turkey maintains easing as geopolitical risks recede

The Central Bank of Turkey cuts its policy rate by a more than expected 250 basis points to 14%. The move comes as geopolitical tensions ease and stronger than expected disinflation in the country

Central Bank of Turkey Governor, Murat Uysal

-250bp

CBT policy rate change

To 14.0%

Higher than expected

The Central Bank of Turkey (CBT) has eased by more than expected at its October rate-setting meeting, cutting its policy rate (1-week repo rate) by 250bp to 14.0% vs the market consensus (and our call) of 100bp, while forward implied yields were pricing around 250-300bp. Given the CBT's objective of "a reasonable rate of real return", the ex-post real policy rate dropped to 470bp vs the average ex-post policy rate for major EM peers close to 300bp, while the ex-ante policy rate stands slightly higher than 280bp after the decision.

As far as the inflation outlook goes, the CBT sees year-end inflation to be "notably" below (revised from "slightly" in last month's statement) the July Inflation Report (at 13.9% vs 12% in the new economic programme). It cited the large base effects as the driver of September's significant fall along with domestic demand conditions and the level of monetary tightness.

So, given the bank's increasing confidence about ongoing disinflation, it utilised the room for policy manoeuvre and over-delivered again while maintaining its previous guidance that "the current monetary policy stance, to a large part, is considered to be consistent with the projected disinflation path"; that signals a more cautious policy stance. We think inflation will probably remain in single digits in October and reverse thereafter because of unsupportive base effects, closing the year at 12.8%. In our view, the case for further monetary easing in the last MPC meeting in December has significantly weakened after today's decision, while any move should take a more gradual pace.

Regarding economic activity, the CBT sees:

1. further improvement in economic activity spreading into more sectors
2. still weak investment demand
3. a moderate pace of growth in industrial production
4. further support of improved competitiveness in goods and services' exports, despite a weakening in the global economic outlook.

This, coupled with the disinflation trend and an improvement in financial conditions, leads the CBT to believe that the gradual recovery is likely to continue.

Overall, the CBT reiterated its commitment to a sustained disinflation process that will help reduce sovereign risk, lower long-term interest rates and support a stronger economic recovery. Given the earlier signals, this commitment also includes a positive ex-post real policy rate of around 1-2% in the medium-to-long term. So, in the future, the CBT will likely be even more cautious at this level given still not well-anchored inflation expectations and high inertia, especially as far as services inflation is concerned, along with high dollarisation and the subdued capital flow outlook.

Author

Muhammet Mercan
Chief Economist, Turkey
muhammet.mercan@ingbank.com.tr

Disclaimer