

Turkey: Easing cycle continues at full steam

The Central Bank of Turkey continued the rate cuts in October with another larger-than-expected 200bp move to 16%, likely attributable to an objective of providing support to the real sector



The Central Bank of Turkey

In the October rate setting meeting held with the participation of two newly appointed members, the CBT decided to cut the policy rate by a surprising 200bp to 16% vs consensus at 100bp, market pricing at around 50bp and our call for an on-hold decision. The central bank also pointed out that there is limited room for further rate cuts after a cumulative 300bp reduction in two months.

Ahead of the meeting, i) five out of six core inflation indicators were above the policy rate after the focus shifted to a relatively benign core inflation, ii) the recent sharp moves in commodity prices already impacted headline inflation despite efforts to absorb the pricing shock via tax adjustments and iii) significant TRY weakness since early September created further cost-led pressures and added to already high inflation challenges, were the key reasons for expectations that a CBT move would be cautious with either a limited cut or no move.

However, the CBT continued policy easing, reiterating the same line of reasoning in the rate setting statement in comparison to the one released last month, citing:

- transitory supply side factors: The CBT saw the ongoing uptrend in inflation attributable to

pressures from food and import prices, supply constraints and effects of the reopening as “transitory” and hence downplayed impact of ongoing inflationary forces. Also, the CBT remained vocal about the current account, implying that a recovery should support the TRY outlook, hence expecting a contribution to disinflation. There is a revision in assessment related to current account balance. Since July, the CBT had projected “a surplus in the remainder of this year”, implying a significant contraction in the deficit in comparison to the market consensus. This month, the CBT wording was revised as it now expects a continuation of the improvement in the current account deficit for the rest of the year.

- “higher than envisaged contractionary effect” (of) “the tightness in monetary stance” on commercial loans: Growth of this group of loans (excluding currency effects) is relatively low at mid-single digits, though this is attributable to FX commercial lending that has been sluggish since the August 2018 shock with strong deleveraging in the corporate sector in recent years. TL commercial loans, on the other hand, have relatively strong momentum (as evidenced by the 13-week moving average, annualised, year-on-year growth rate) higher for private banks in comparison to that for state banks, while the annual growth rate is currently slightly below 13%, implying a relatively mild real contraction.

One addition to the statement is related to the policy stance in the near term as the bank foresees that “supply-side transitory factors leave limited room for the downward adjustment to the policy rate”. In our view, this guidance implies that the bank preemptively cut the policy rate ahead of tapering, though more than envisaged initially by the market consensus, and it is likely to come up with either a measured cut, ie, 50bp or an on-hold decision next month, closing the current easing cycle at least for the short term until the year-end.

All in all, rate cuts that continued at full steam with another surprise move in October likely attributable to an objective of providing support to the real sector though weighing on the exchange rate is likely to further deteriorate expectations, adding to already high inflationary pressures. The decision should also support the views that disinflation is not a policy priority currently.

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