Snap | 19 February 2020

Turkish Central Bank maintains easing with a smaller cut

The CBT extends its easing cycle further but with a more measured move this time. It's in line with its ongoing priorities and a relatively supportive global backdrop and comes despite higher headline inflation and a less favourable FX environment

The Turkish Central Bank in Ankara

-50bp

CBT policy rate change

to 10.75%

The decision

At its February rate-setting meeting, the Central Bank of Turkey (CBT) maintained its easing cycle but this time at a slower pace, reducing the key rate by 50bp to 10.75% from 11.25%. Calls were split between 'no change' on the back of a still recovering growth performance and a continuing supportive global backdrop, and a 50bp reduction attributable to a rise in market volatility with growing geopolitical risks and a risk-off mode towards EM assets given the coronavirus fears. We were not expecting a move this month given the recent pressure on TRY assets.

Policy guidance

In its statement, the CBT kept key guidance sentences unchanged: it sees the current monetary stance to be consistent with "the projected disinflation path" and that "the continuation of a cautious monetary stance" is still required to keep the disinflation process on the "targeted" track. The Bank also reiterated that it would continue to determine monetary policy by considering "the indicators of the underlying inflation trend to ensure the continuation of the disinflation process".

All in all, the February statement does not show a meaningful change in policy guidance over the past month. This can be an indicator that depending on the performance of the TRY, further measured easing cannot be ruled out.

Details of the statement

Differing from the last month, the CBT sees "signs of recovery" in investment and employment though it still remains weak. Additionally, the Bank adds that it closely monitors the likely impact of credit expansion on external balance and inflation, while pointing out "a moderate course in current account balance" as "a crucial element of the macroeconomic policy mix." These add to the signals that policymakers are ready to take action to curb current significant consumer lending appetite in the banking sector. The remaining part was unchanged as the CBT stated that:

1. the recovery continues,
2. the sectoral diffusion of economy activity improves,
3. the recovery will be driven by the disinflation process and an improvement in financial conditions given that the contribution from net exports to economic growth declines.

The CBT does not mention the improvement in the inflation outlook this month, though it sees the continuation of a mild trend in core inflation driven by inflation expectations, demand conditions and producer prices. The CBT envisages annual inflation to remain elevated in 1Q at slightly above 12% and adopting a downtrend thereafter towards 8.2% by the end of this year.

With this latest move, the ex-post real policy rate went down further, close to the lows realised since 2013. However, the CBT continues to focus on the ex-ante real rate calculated by using expected inflation to guide its policy decisions. Given that the 12M and 24M inflation expectations, according to the CBT's latest survey, stand at 9.6% and 8.5%, respectively, the CBT will not likely overrule further easing as long as the currency remains stable.

Overall, given its ongoing growth priority along with a relatively supportive global backdrop, the CBT extended its easing cycle further, though with a more measured move this time despite higher headline inflation and less favourable FX dynamics. The Bank will remain cautious in the near term on the back of likely stickier inflation readings with a less supportive base and a low real rate buffer while maintaining its easing bias and delivering if it sees room to manoeuvre.

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