Turkey: Policy rate to stay flat this week

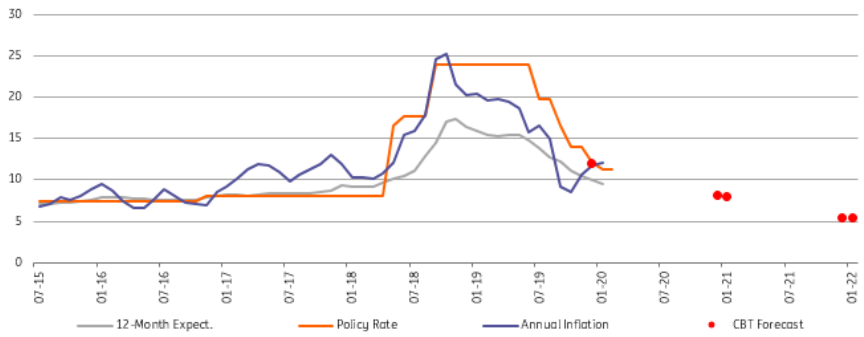
Given the relatively higher volatility in the currency amid renewed geopolitical concerns, we think the Central Bank of Turkey will be cautious and opt not to make a move on Wednesday, keeping the policy rate flat at 11.25%

Governor of Central Bank of Turkey Murat Uysal

Source: Shutterstock

The Central Bank of Turkey (CBT) reduced the pace of rate cuts in January and maintained its easing bias based on forward inflation (ex-ante real interest rates). Given higher volatility in the currency amid renewed geopolitical concerns, we think the CBT will be cautious and opt not to make a move this week, keeping the policy rate flat at 11.25%.

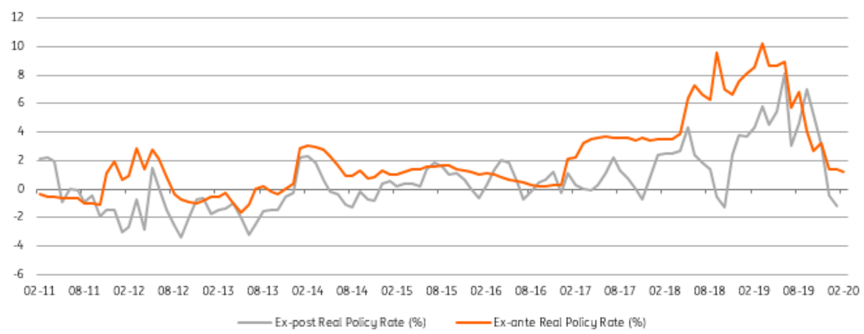
On the inflation side, despite a range of administrative price and tax decisions, January's reading surprised on the upside, pulling the annual figure up to 12.15%. Housing inflation was higher-than-expected while services inflation has remained elevated. Going forward, key risk factors include changes to the exchange rate and any possible reversal in unprocessed food inflation, which was one of the major drivers of the disinflation process last year. The CBT expects annual inflation to remain elevated in the first quarter at slightly above 12% before falling to 8.2% by the end of 2020. The market consensus based on the CBT survey stands at 10.1%.



Source: TurkStat, CBT, ING

With the latest inflation data, the *ex-post* real policy rate (based on the effective cost of funding rate) has gone down further to -1.2%, close to the lows realised since 2013. However, the CBT continues to focus on *ex-ante* real rates to guide its policy decisions. In the inflation report briefing, CBT Governor Murat Uysal highlighted the ex-ante real policy rate, which is in positive territory, while pointing out the continued improvement in inflation expectations. The language and forecasts have remained broadly unchanged, hinting at no meaningful change in the policy stance. So the CBT does not rule out further easing as long as the currency remains stable, which has been the case since the start of the easing cycle in mid-2018.

Real Policy Rate



Source: TurkStat, CBT, ING

It should be noted that increased geopolitical vulnerability has started to weigh on the Turkish lira in recent days. The Banking Regulation and Supervision Authority cut the derivative limits (with forward TRY receivables) to 10% of capital from 25% with the objective of easing pressure on the currency by making TRY borrowing expensive.

This backdrop, with renewed geopolitical risk, as well as likely flat annual inflation in the near term and real rate buffer close to the long-term average, will make the CBT more cautious at the February meeting. However, if geopolitical risks subside in a sustained way, supporting the lira, further (measured) easing cannot be ruled out.

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