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Turkey Watch

Group Economics
Emerging Markets Research

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300bp rate cut: On the way to 'single-digits'

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- **We expect a 300bp rate cut on Thursday September 12**
- **We are slightly more dovish than the market (consensus: 275bp)**

We expect a 300bp rate cut on September 12

This Thursday, 12 September, the Turkish Central Bank (CBRT) will almost certainly ease monetary policy. Bloomberg consensus expects a 275bp cut, from 19.75% to 17%. In line with our previous Turkey Watch (Rate cut, recovery and rivalry), we expect a more aggressive 300bp cut, taking rates to 16.75%. As such, we are slightly more dovish than the market. We base our view on the following:

1. Inflation has come down more than expected

Inflation yoy fell to 15% in August, from 16.7% in July (15.6% consensus). These rather favourable inflation figures were driven by the stability of the lira, and as we had flagged, largely due to base effects. While inflation may temporarily decelerate to around 12% in September and October, we expect it to increase again by end-2019. Despite the fall being short-lived, it nonetheless enables the CBRT to 'front-load' some of the easing. Therefore, we expect a 300bp this coming Thursday, and a more modest 125bp cut, in October this year.

2. The lira barely reacted to the other two – larger than expected – rate cuts

Another element at play is that the market reacted quite modestly to the latest rate cuts. In July, the CBRT eased more than expected, but the Turkish lira barely reacted. This bolsters the case for the CBRT to cut rates further. With that said, recent volatility in the currency will keep the central bank from cutting *too* much more than the market expects. In August, the gradual appreciation trend that started since May this year came to an end as the lira weakened sharply. The weakening was caused by a combination of general EM woes as well as policy implementations by the CBRT such as lowering the required reserves limits, and boosting returns for lenders with more than 10% loans growth. Since then the currency has rebounded somewhat, also on the back of a more favourable external environment (see point 3), but not to the levels that we saw in the beginning of August. This volatility will give the CBRT pause for thought.

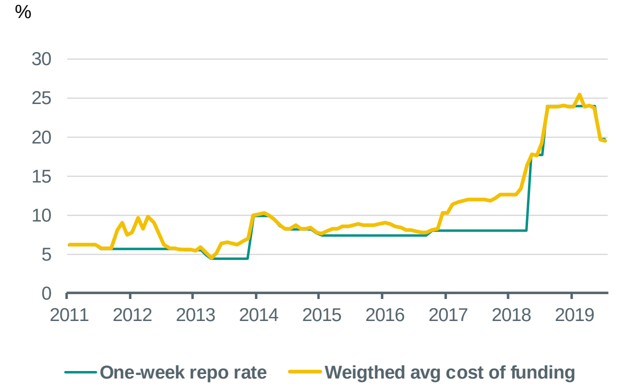
3. Relatively favourable external environment

Further easing by both the Fed and the ECB is generally supportive for capital flows to EMs, including Turkey. Moreover, the tensions between Turkey and the US have eased. The US imposed no sanctions over the purchase of the S-400 missile system from Russia, and both US and Turkish troops conducted their first joint ground patrols in recent days. We also concluded in our Emerging Europe Watch (Resilience to a global slowdown) that Turkey is relatively shielded for an escalating trade war.

4. The 'single-digit' target

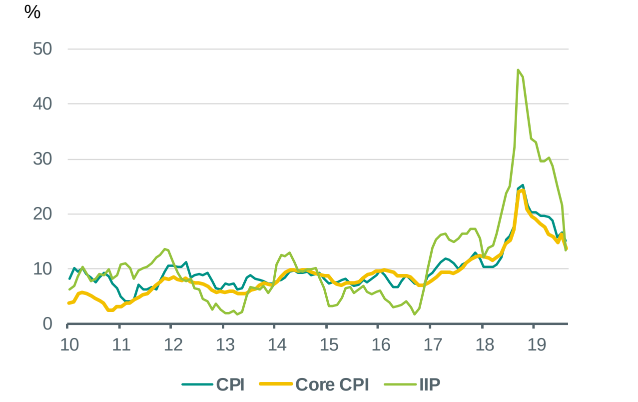
Over the last couple of days, President Erdogan has increased pressure on the CBRT to lower rates by saying that he wants rates to be back in single digits in the shortest period possible. Given that President Erdogan has a good relationship with the central bank governor, Mr. Uysal, we think such a message will not fall on deaf ears.

Sharp drop in interest rates



Source: Bloomberg

Inflation is coming down rapidly



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