

Flash Comment

18 December, 2008

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Turkey: TCMB cuts by 200bp

The Turkish central bank (TCMB) yesterday night once again surprised the markets when it cut its key policy rate by 200 basis points to 13% from 15%. We had expected a rate cut of 100bp and the consensus expectation was for a 75bp cut. Despite the aggressive rate cut the lira has remained relatively stable. We expect more rate cuts going forward, but the likelihood of further lira weakness is a key challenge.

Commenting on the rate cut it was reflected that "the slowdown in the domestic economic activity has further intensified" and the "latest forecasts suggest that ongoing problems in international credit markets and the global economy will last longer than previously envisaged. Therefore, downward pressures on both domestic and external demand and inflation will continue. Moreover, significant drops in oil and other commodity prices are having a favourable impact on disinflation. The Committee predicts that inflation will be close to the target by mid-2009 and that the probability of undershooting the target by the end of the year has increased".

We in general agree with this assessment of the Turkish economy even though we are slightly less optimistic on the outlook for inflation. That said inflation has surprised on the downside in recent months and the sell-off in the lira that we have seen has not been translated into higher inflation as commodity prices have plummeted and the economy has slowed down sharply.

The TCMB also said that it judged that "moving forward a sizeable portion of the rate cuts envisaged for the coming months would help offset the tightening in financial conditions". Hence, even though the TCMB cut more than expected the aggressive cut is an indication of "frontloading" of the monetary easing and hence we should expect less rate cuts down the road than we otherwise might have expected.

However, we continue to expect the TCMB to cut rates going forward, but the coming steps will be smaller than 200bp at the time. We now expect the TCMB to cut rates by an additional 150bp over the coming 12 months to 11.5%.

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