MNI CBRT Preview: October 2021

Details:

Monetary policy decision: 1400 local time / 1200BST / 0700ET, Thursday 21st October 2021.

MNI Point of View

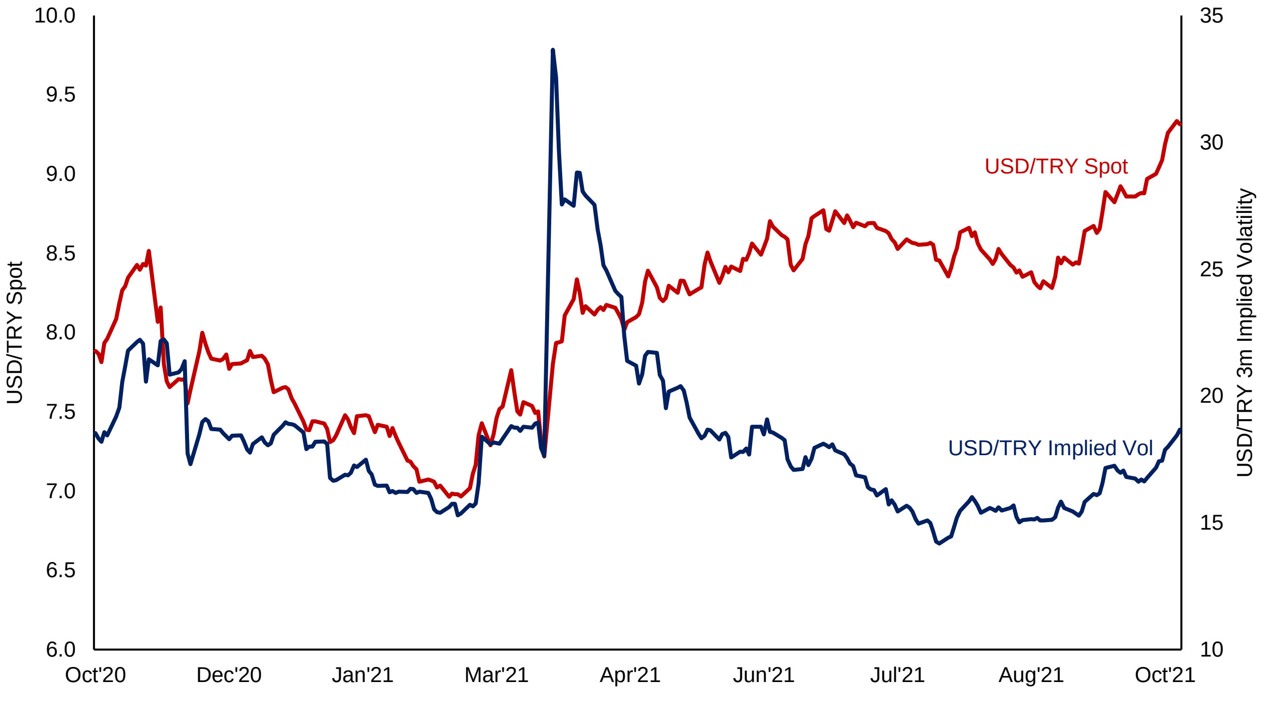
CBRT Seen Cutting 100bps, Visible Erdogan Frustration Drives Dovish Policy Revision

The CBRT are broadly expected to reduce its one-week repo rate by 50-100bps this week with visible signs of frustration from Erdogan bolstering the political influence component of the bank's 'revisionist' stance on policy. This comes against a backdrop of rising inflationary pressures on a global scale as the CBRT loosens its policy setting into oncoming CPI tailwinds.

Both headline and core CPI rose in September, printing y/y at 19.58% & 16.98% respectively (vs 19.25% & 16.62% prior), while PPI dipped slightly to 43.96% vs 45.52% prior. Food prices and supply-induced factors were highlighted as the key drivers of the higher print but were labelled as transitory in numerous statements by CBRT governor Kavcioglu. Here, we see pricing data being a less dominant driver in the decision-making process under the bank's new 'revisionist' framework, with rising core metrics doing little to deter policymakers from easing directly into more pronounced domestic and global inflationary headwinds.

Inflation expectations remained elevated in September and likely accelerated over and above the rise in global expectations with higher energy prices exerting pressure on both PPI and CPI. Moreover, with TRY trading close to 8.0% weaker vs the USD since the prior meeting, both FX passthrough to inflation and higher dollarisation will likely filter through into upside price pressures in the October inflation data and temper the more positive base-effects driven moderation expected in November - exacerbating the CBRT's woes and making the dovish pivot all the more pronounced.

Figure 1: Implied Vols rising as TRY weakens



Source: MNI/Bloomberg

Business Address – MNI Market News, 5th Floor, 69 Leadenhall Street, London, EC3M 2DB

New MPC appointments reinforce dovish tilt

In addition to the recent dovish pivot to core CPI as the benchmark for the CBRT's reaction function, Erdogan has recently installed two new MPC members after dismissing three rate cut dissenters late last week. Research shows at least one of the new additions, Yusuf Tuna, favours ultra-dovish policy and a synchronous approach to government alignment on monetary policy. In 2014, Tuna said Turkey had been "drowning in the grip of high interest rates for years" with big hikes being fine in theory, but incorrect in practice. He also noted that the CBRT must act in line with the government's wishes - taking on a subordinate role. In 2014 he also asserted that a 200-300bp rate cut would not hurt the lira, given Turkey's high degree of political stability. This leaves the CBRT with a relatively inexperienced MPC with little capacity/inclination to temper Erdogan's dovish policy ambitions.

From here, the question becomes less about interpreting rational markets-based assumptions/inputs in the bank's reaction function, and more about how much Erdogan would like policy rates to fall by to support his 2023 election campaign going forward - a concerning dynamic to say the least.

Consensus of 100bps cut misrepresents number of different choices CBRT could make

Going into this meeting, uncertainty is especially high - resulting in a variety of potential scenarios and different inferences markets can draw from the outcome.

The base case is for a 50-100bps cut at this meeting, leaning more closely towards 100bp in keeping with the bank's revisionist stance. Additionally, Kavcioglu's precarious position within the bank should see him giving little pushback on Erdogan's demands - which are unlikely to be less aggressively dovish than the prior meeting. This reflects a CBRT under the heavy political influence of Erdogan against a backdrop of rising inflation.

A second possible scenario envisages a hold, followed by a 100bps or greater cut in November on more favourable base effects. Contrary to the first scenario, this reflects a CBRT Governor with more influence on the decision-making framework than previously anticipated and is a broadly encouraging sign against a very concerning longer-term outlook.

Markets leaning into CBRT easing cycle

TRY has weakened materially against all other global currencies in the weeks headed into the October decision – a clear indication that markets expect the CBRT to follow through with policy easing despite blooming inflationary pressures. This keeps USDTRY bulls firmly in charge, with the 9.20 handle giving way in recent weeks and scope is seen for a move towards 9.3803, 2.382 projection of the Sep 10 - 20 - 22 price swing. The 2.50 projection is at 9.4185.

The unorthodox approach to policy is blending into other financial market indicators, with the front-end of the implied vol curve rallying sharply to accommodate the increased uncertainty. Similarly, CDS spreads are nearing the late March highs of 482bps, levels inspired by Erdogan's surprise removal of former CBRT governor Agbal.

Business Address – MNI Market News, 5th Floor, 69 Leadenhall Street, London, EC3M 2DB

Central Bank Data Watch

MNI CBRT Data Watch List												
Inflation		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
CPI YoY	% y/y	19.58	17.53	↑	16.19	↑					1.85
Core CPI YoY	% y/y	16.98	17.47	↓	16.88	↑					-0.12
PPI YoY	% y/y	44.0	42.9	↑	31.2	↑					0.77
Expected CPI	%	12.94	12.12	↑	10.47	↑					1.21
Economic Activity		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Industrial Production YoY	% y/y	13.8	40.9	↓	9.0	↑					0.23
Trade Balance	$bn	-4.26	-4.17	↓	-3.35	↓					-0.76
Markit PMI Mfg	Index	52.5	51.3	↑	52.6	↓					0.31
Capacity Utilization	%	78.1	76.6	↑	74.7	↑					1.65
Monetary Analysis		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
M3 Money Supply	TRYbn	4100.0	3889.64	↑	3559.0	↑					1.65
Foreign Transactions of Equities	%	36.0	-3.00	↑	-814.0	↑					0.50
Foreign Transactions of Govt bonds	$m	114.0	69.00	↑	83.0	↑					0.22
Home Sales YoY	% y/y	7.6	-29.10	↑	2.4	↑					0.09
Consumer / Labour Market		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Retail Sales YoY	% y/y	15.02	27.66	↓	4.78	↑					0.47
Consumer Confidence	Index	61.8	62.60	↓	58.2	↑					0.97
Unemployment rate	%	12.00	12.40	↓	14.10	↓					-0.49
Foreign Tourist Arrivals	% y/y	119.4	3038.80	↓	-69.0	↑					-0.59
Markets		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Equity Market (BIST 100)	Index	1406	1356	↑	1392	↑					0.95
TR 10-Year Yield	%	6.79	6.25	↑	7.31	↓					0.69
TR Yield Curve (2s-10s)	bps	362	338	↑	539	↓					1.25
Effective Exchange Rate	Index	63.09	59.68	↑	65.65	↓					0.00

Note: For quarterly data the 3m ago column will display the previous data point and the 6m ago column will display the data point prior to that.
Source: MNI, Bloomberg

Summary of Analyst Views

- Consensus looks for a cut of 100bps at this meeting to 17.00%. No analysts surveyed forecast a larger cut, but a number of outfits see a strong possibility of a smaller cut of 50 or 75bps.
- The majority of sell-side analysts see further cuts beyond one in October, with some seeing the main policy rate as low as 15.00% by the end of the year.

Analyst Views (Alphabetical Order)

Barclays: Expects three consecutive 75bps cuts at next three meetings

- Until recently, our policy rate call of 15.75% for the end of 2021 was the most aggressive call in the market. But following a surprising 100bp cut in September and the CBT's ongoing focus on anaemic commercial lending growth, market expectations have started to converge towards ours.
- Markets have also started to expect a bigger cut after the recent replacements in the MPC.
- We expect CBRT to continue the easing cycle in the last quarter of 2021 but with smaller cuts. We expect the CBT to deliver three 75bp cuts in the last three meetings of the year, with the policy rate at 15.75% at the end of 2021.
- Alternatively, the CBT might consider pausing its easing cycle in October and continue delivering 100bp cuts in the November and December meetings. The MTP was already assuming USDTRY at about 9 at the end of 2021. Therefore, we do not expect current TRY levels to impact the CBT's easing cycle decisions.

Goldman Sachs: CBRT to cut rates by 50bps to 17.50%

- We expect the Bank to cut its policy rate by 50bp to +17.5% against a consensus of 17.25% and forecast that inflation will remain elevated in the next few months and only fall to 16.7% at the end of the year with the help of base effects, with risks significantly skewed towards a higher figure. Given this high growth, high inflation backdrop, we think that policy should be tighter rather than easier.
  Nevertheless, GS still expect a 50bp cut given the previous cut and the authorities' preferences.

- We have not observed a change in the TCMB's communication as it still emphasises the transitory nature of inflation and the TCMB has not indicated that the cut in September was a one-off. Hence, we think that they are likely to continue reducing the policy rate.
- However, we have little conviction on the size and the timing of the rate cuts, as we think that both will depend on the Bank's assessment of what can be done without creating excessive volatility in the Lira. The OIS curve is pricing a strong likelihood of a 50bp cut and hence that cut should to some extent already be priced in.
- Going forward, we think that inflation will remain elevated, and we do not expect the TCMB to have the room to lower rates below +15% in the medium term, with risks skewed to the upside. As financial conditions tighten globally, the CBRT may have long pauses in its cutting cycle and may even need to hike its policy rate again.

JP Morgan: Sees 200bps cumulative rate cuts before year-end

- Turkey's unexpected rate cut in September had clearly shown the difficulty of making rate forecasts based on fundamentals. Moreover, some recent appointments at the CBRT have introduced fresh uncertainties to the policy outlook.
- We remain confident on our view that the CBRT likely will deliver further monetary easing although the fundamentals all point in the opposite direction. Recent data show further strengthening of price pressures, robust domestic demand, and ailing monetary policy credibility, as evidenced by continually rising in inflation.
- However, following recent domestic developments we now fear that this easing cycle could be even more front-loaded than we previously expected.
- Given the dovish stance of the CBRT and new staffing developments, we now think it is likely that the CBRT will not pause in October as we initially expected. We thus project a 100bp cut this month followed by two 50bp cuts in the last two months of the year. We still see the cyclical trough of the policy rate at 15%, but the risk is for a deeper easing cycle and much higher inflation.

Morgan Stanley: Uncertainty remains over size of rate cut

- USD/TRY broke above 9.00 and continued to depreciate versus USD, which makes monetary policy decision-making more challenging. We continue to expect weakness in the currency as expectations build that more rate cuts will be delivered. Risk/reward continues to be on the downside in case the CBT surprises again with a cut larger than 100bp.
- Expectations are for a cut but the uncertainty is around the size: The current episode might not be that different but risks do remain to the downside for TRY, mainly due to recent events at the central bank, which have shifted expectations towards more aggressive easing.
- Relative to the previous meeting, the current consensus is that the central bank will ease policy but the uncertainty is about the size. In that regard, we see a similar response by the lira. In case of another 100bp cut or a smaller, such as 50bp, the currency can continue to depreciate gradually. The risk is if the CBT delivers a cut larger than 100bp, which will be more than consensus and likely market expectations.

UniCredit: Expects another 100bps cut and easing could carry on beyond October

- In Turkey, we expect the CBRT to deliver another 1pp rate cut. We should acknowledge that the risk of an even larger cut has increased following the sacking of the MPC members, which were said to be against the latest rate cut.
- That said, the recent acceleration of the TRY selloff could discourage the central bank from opting for a larger cut. The CBRT has argued that the recent rise in inflation stemmed from transitory factors while the improvement in the current account balance was important for price stability. We are taking both arguments with more than a pinch of salt.
- The CBRT could carry on with rate cuts beyond October. We maintain our forecast for the policy rate at 15% by the end of this year although the pace and size of the easing cycle remains dependent on the TRY's performance.