CENTRAL BANKS: TURKEY BITES THE BULLET, BOE WAITS FOR BREXIT, ECB ON TRACK

Berenberg Macro Flash

After three widely watched central bank decisions, the overall news today is modestly encouraging. Most importantly, the Turkish central bank dared to raise rates a lot. While the BoE sprang no major surprise today, the ECB did not deviate much from its prior line in its policy statement today. We will send out a more detailed comment on the ECB press conference later on.

TURKEY: DARING TO DEFY ERDOGAN’S RHETORIC

We do not dare to speculate whether or not Turkey’s all-powerful president Erdogan gave his central bank the green light to go ahead. But that the central bank raised rates, and did so by more than expected by hiking the benchmark one-night repo rate by 625bp to 24%, sends a strong signal to markets and to Turkey’s citizens: Turkey is swallowing the bitter medicine that most economists including us believe to be necessary to cure the malaise of a country suffering from the aftermath of prior credit excesses. Higher interest rates will not prevent a serious economic downturn in Turkey. The cleansing of excesses and the correction of a current account deficit that markets are no longer willing to finance does entail pain. But by re-establishing some confidence in Turkey’s capacity to take the right steps, it limits the downside. If the Turkish lira now recovers somewhat, the socially and economically disruptive spike in inflation that the prior plunge of the currency had put into the pipeline could be less pronounced than otherwise.

Turkey’s trading partners will still have to contend with a likely significant drop in their exports to Turkey. For example, a possible 25% fall in Eurozone exports to Turkey could shave about 0.1%ppt off Eurozone annual GDP growth. However, as Turkish policy becomes less unorthodox, the risk that an ever-escalating Turkish crisis could trigger even more contagion across emerging markets and have a more significant impact on confidence in the Eurozone next door has probably receded a bit with the big Turkish rate hike today.

That Turkey had to raise rates massively today partly reflects Erdogan’s misguided rhetoric before. After Erdogan had publicly railed against rate hikes and announced that he is de facto in control of monetary policy, the central bank had to demonstrate that it can nonetheless do the right thing even more visibly than otherwise. If — very big if — Erdogan could also make another U-turn and take the necessary step to mend relations with the US, the outlook for Turkey could improve noticeably. That remains a very big if, though. Erdogan plans to visit the US 23-27 September to attend the UN General Assembly.

BoE: WAITING FOR THE BREXIT DECISION

For once, it is probably not worth parsing through the BoE statement in great detail. It all depends on Brexit anyway. Upon voting unanimously to hold rates steady today after the August rate hike, the BoE noted an increase in uncertainty around Brexit. No surprise as the key decisions whether or not the UK can accept any of the post-Brexit arrangements offered by the EU27 are drawing closer. The BoE also pointed to increased risks from trade tensions and emerging markets. But examining the recent data, the BoE raised its projection for Q3 GDP growth from 0.4% to 0.5% qoq nonetheless.

As long as the UK avoids a no-deal hard Brexit (20% risk in our view), receding Brexit-uncertainty and improving real wage growth should drive slightly stronger gains in UK domestic demand next year. We con-
continue to look for two 25bp BoE rate hikes each in 2019 and in 2020, with the first move likely in May 2019 after the formal Brexit on 29 March of that year.

ECB: ON TRACK
No surprise in the ECB’s monetary policy decision. The bank will cut its net monthly asset purchases from €30bn to €15bn in October, anticipates to end these purchases at the end of December and expects to keep interest rates at their current levels through the summer of 2019. As the only change, the ECB has now firmed up its decision to reduce asset purchases in October, announcing that it “will reduce” the purchases instead of saying that it “anticipates” that it will do so as stated in the ECB’s policy decisions before.

We look for the ECB to shave its growth projection for 2018 slightly (from 2.1% to 2.0% or 1.9% upon presenting new staff estimates at the press conference) without changing its overall tone very much. The ECB will likely note increased risks from emerging markets. We expect the ECB to raise rates in two steps late next year, in September and December 2019, to bring the refi rate from 0.0% to 0.25% and the deposit rate from -0.4% to 0.0% by December 2019.