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The CBRT displays a more hawkish tone

Seda Guler / Asuman Kemiksiz

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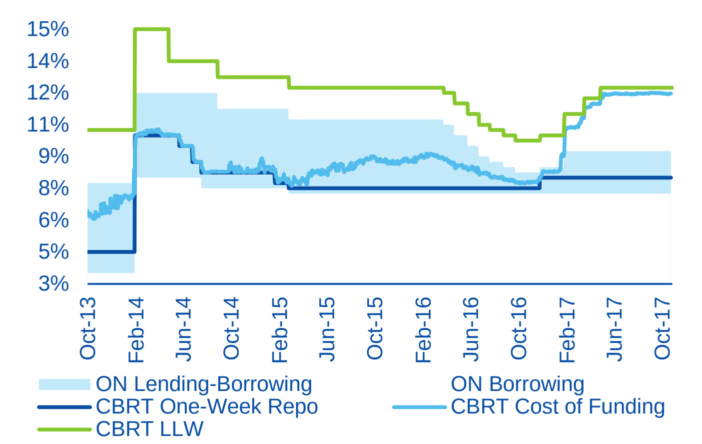
The Central Bank (CBRT) keeps its interest rate corridor (with de-facto marginal funding rate in the TL money market up to 12.25%) once again parallel to our call and market consensus. The hawkish tone is preserved as the Bank continues to find both headline and core inflation outlook alarming over pricing behavior and tries to clarify its roadmap by inserting a new message ("until inflation outlook becomes consistent with the targets") over the maintenance of the tight stance. We expect the headline to touch at least 11.5% in October and remain at those levels in November at best. Core inflation will likely hit the highest level (close to 12%) in October and end the year with a rate over 11%, which increases the possibility to have the headline at two-digits at the end of 2017. Considering the stickiness in inflation, ongoing high momentum of the economic activity and the recent depreciation pressures over TL, we expect the Bank to stay tight for longer even though the headline will fall towards 8.5% at the end of 1Q18 thanks to favorable base effects.

Inflation will end the year at two-digits

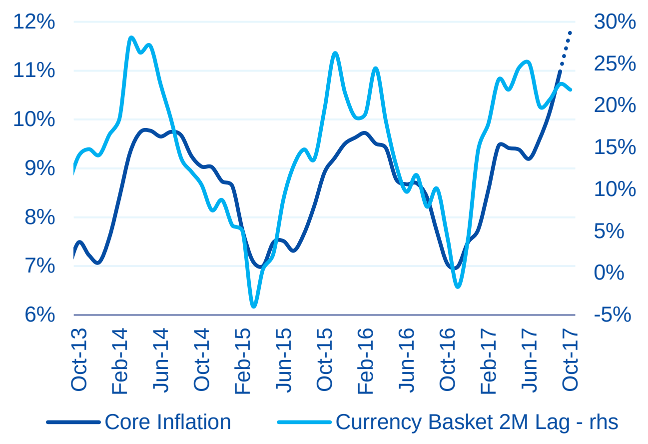
The worsening inflation outlook on top of mainly core prices in the last couple of months is one of the reasons that requires the CBRT to be more hawkish. Second round price effects on cost push factors and spillovers from narrowing output gap thanks to the Credit Guarantee Fund (CGF) may keep core inflation close to 10% at the end of 1Q18. Secondly, parallel to the CBRT's acknowledgement, we expect economic activity to stay strong even though we bear in mind the dying out impact of the CGF in 4Q. After a robust growth rate in 2017 (our expectation is 6%), we forecast that the continuation of stimulus policies could maintain the high performance in economic activity next year ahead of the election cycle in 2019. Additionally, recent tighter financial conditions on both global and local factors could limit the expected fall in core inflation over easing exchange rate pass through thanks to favorable base effects in 1Q18, which would require the Central Bank to preserve its tight stance longer than we had initially expected.

Figure 1 CBRT Interest Rate Corridor



Source: CBRT, Garanti Research

Figure 2 Core Inflation and Currency Basket (2M lag, YoY)



Source: TURKSTAT, Garanti Research

Looking Ahead: Trying to build a more hawkish stance and restore credibility

Upward risks on inflation on both core inflation dynamics and the Government's efforts to keep growth rate at high levels would require a longer period of tight monetary policy stance. We expect the CBRT to wait for some more room for monetary easing, although the headline will fall towards 8.5% at the end of 1Q18 thanks to favorable base effects.

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