

Economic Watch

# Turkey: The CBRT reinforces its hawkish stance

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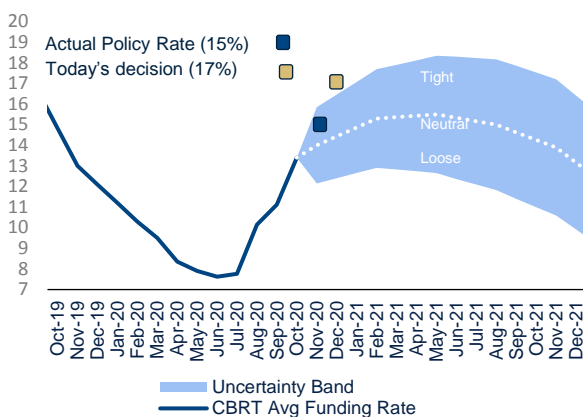
The Central Bank of Turkey (CBRT) raised the policy rate (one-week repo) by 200bps to 17%, higher than the expectations (100bps BBVA Research, 150bps Consensus). The decision proved to be a strong commitment of the CBRT to fight against inflation and restore credibility as soon as possible. Continuing pressures over current account deficit on top of still high domestic demand also seemed to require a tighter stance. The forward guidance in terms of taking into account the end-2021 forecast target (9.4%) and adopting a framework with a medium term perspective should also be welcomed in order to eliminate risks on the inflation outlook. Given the upside surprise in November inflation release, lagged effects of the exchange rate pass-thru, and increasing supply side factors, inflation will be increasing above 15% till May 2021 even under a stabilized currency. Therefore, we evaluate today's decision as a front-loaded action to contain inflation expectations and restore disinflation process in a decisive manner and forecast that the CBRT will follow a wait-and-see mode from now onwards until a permanent fall in inflation is achieved.

## The CBRT adopts a medium term perspective

Today's decision was an important credibility test for the CBRT and the Bank succeeded in this by giving priority to price stability and restoring credibility by means of a bolder reaction. Adopting a medium term perspective in fight against inflation and taking the end-2021 forecast target (9.4%) as a forward guidance all confirm the decisiveness of the CBRT to initiate a disinflation process as soon as possible.

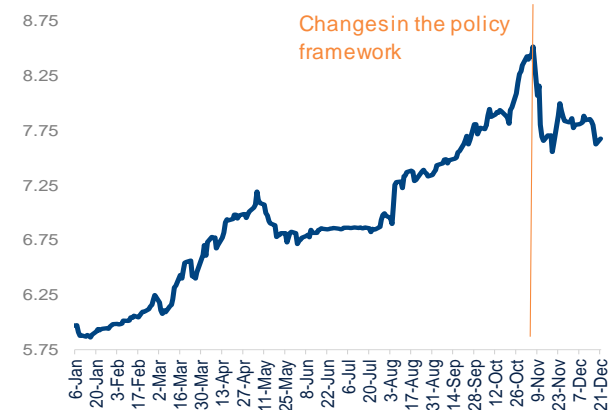
As seen in our Taylor rule calculations (Chart 1), we evaluate today's decision as a front-loaded action to contain still deteriorating inflation expectations and continuing dollarization tendency of the residents. Even though our Taylor rule still foresees additional tightening till 2Q, we forecast that the CBRT will follow a wait-and-see mode from now onwards given the uncertainties attached to the pandemic in the very short term. Also, we expect a comprehensive policy-mix targeting a rebalancing in the economy by eliminating disequilibria in a context that would be complementary to the already tightened monetary policy in order to reduce country risk premium, initiate reverse currency substitution and accumulate foreign exchange reserves.

Chart 1. **Garanti BBVA Taylor Rule Implied CBRT Funding Rate (%)**



Source: Garanti BBVA Research

Chart 2. **Exchange Rate (Level, USDTRY)**



Source: Garanti BBVA Research

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