

Economic Watch

# Turkey: The CBRT stays on hold but reinforces its tight stance

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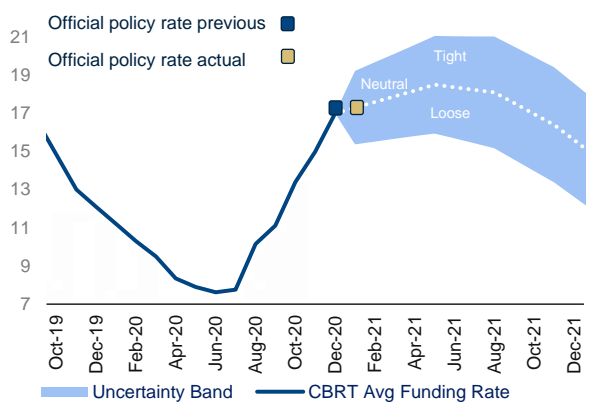
The Central Bank of Turkey (CBRT) maintained the policy rate (one-week repo) at 17% in line with the expectations. Though, the Bank reinforced its hawkish stance by providing a commitment for additional monetary tightening if needed. It also underlined the decisive maintenance of the tight stance “for an extended period of time” until strong indicators point to a permanent fall in inflation and price stability. In this context, the CBRT admits the risks on the inflation outlook and the adverse effects of the still strong domestic demand on the current account balance. Therefore, it provides a clearer forward guidance as it indicates a preference to wait-and-see the impact of the recent tight stance on credits and domestic demand and hints additional tightening if needed. Also, stressing a longer duration of the tight stance aims to eliminate expectations of an early rate cut which was as early as 2Q21 in some expectations. Therefore, we maintain our expectations having the first rate cut of the CBRT in 4Q21 only in a very gradual manner. We expect the policy rate to be 14% at the end of 2021.

## The CBRT stresses the end-2021 forecast target but with no level this time

The CBRT will present its next inflation report on January 28, which will show its latest inflation projections. The expected path will be important to understand when and in which level the Bank sees the peak in inflation. Today’s decision showed that the CBRT admits the uncertainties in the inflation outlook (domestic demand conditions, cost-push factors, exchange rate effects, increasing international food and other commodity prices, high levels of inflation expectations, recent supply constraints intensifying in some sectors, and the adjustments in wage and administered prices) and tries to guard itself by providing a forward guidance in a much clearer way. The CBRT expects the impact of the recent strong monetary tightening to be much more effective on domestic demand and accordingly contain demand-pull and cost-push factors on inflation gradually.

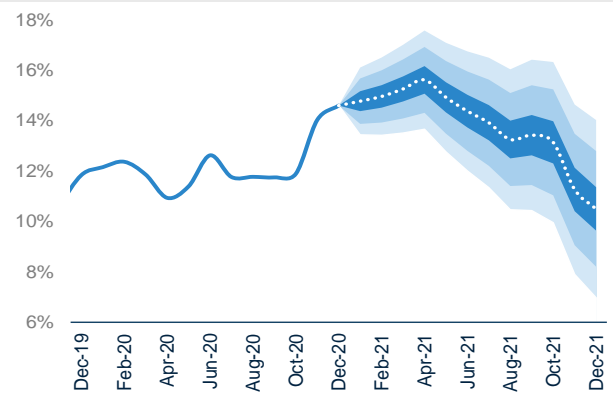
Even though our Taylor rule still foresees additional tightening till 2Q (Chart 1), we forecast that the CBRT will maintain a wait-and-see mode unless a negative surprise on inflation happens. We expect consumer inflation to realize a peak at 15-16% in April before starting to decline very gradually till 4Q21 and end the year at 10.5% (Chart 2). Therefore, we forecast the CBRT to start a gradual easing cycle in October and reduce to policy rate to 14% at the end of 2021. Also, we expect a comprehensive policy-mix targeting a rebalancing in the economy by eliminating disequilibria 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. **Garanti BBVA Inflation Projections (% annual)**



Source: Garanti BBVA Research

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