Economic Watch

Turkey: The CBRT keeps the policy rate unchanged

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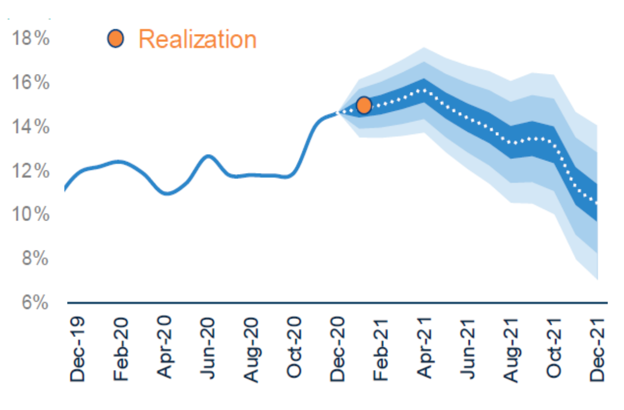
The Central Bank of Turkey (CBRT) maintained the policy rate (one-week repo) at 17% in line with the expectations. The two forward guidance remarks have also been kept the same: (i) the commitment for additional monetary tightening if needed, (ii) the decisive maintenance of the tight stance "for an extended period of time" until strong indicators point to a permanent fall in inflation. Additionally, the point that clarifies the policy goal in the medium term has also been added to this MPC decision by means of the commitment of a real interest rate level between the realized/expected inflation and the monetary policy rate until 5% target is reached. In this context, the CBRT repeats the upside risks on the inflation outlook and the adverse effects of the still strong domestic demand on the current account balance. Therefore, it preserves the wait-and-see mode to observe the expected lagged impact of the recent tight stance on credits and domestic demand. But, at the same time, it repeats the decisive maintenance of the tight stance in order to anchor expectations. We maintain our expectations having the first rate cut of the CBRT in 4Q21 and expect the policy rate to be 14% at the end of 2021.

The CBRT stresses the medium term target in its forward guidance

According to the latest inflation projections of the CBRT (where the path itself is now the target), the Bank expects the peak in inflation at near 16% in April (as mid-point) and foresees a much more rapid decline in inflation in the second half of the year (to have 9.4% by year end), assuming a much stronger Turkish Lira and positive gains from inflation expectations. In contrast, even though we expect a similar peak level in April, we remain prudent on the expected disinflation process (Chart 1) due to the stickiness in inflation led by high inertia and supply side factors (Chart 2). Therefore, we expect consumer inflation to end the year at 10.5% and forecast the CBRT to start only a gradual easing cycle in 4Q21 and reduce to policy rate to 14% at the end of the year.

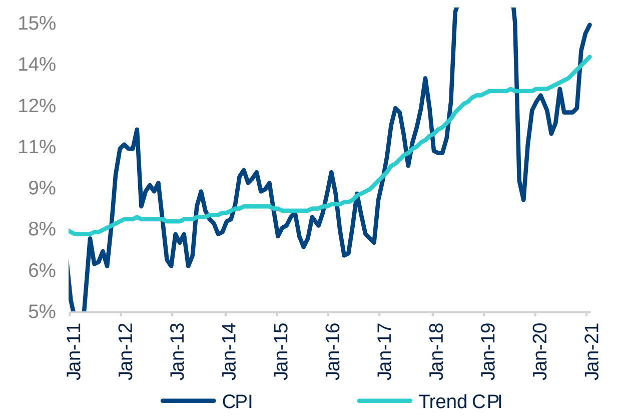
The increasing risks on the inflation outlook or any other factor that could disturb the global portfolio flows (reflation risks) might result in an additional rate hike or a delay of the rate cut to preserve a desired real interest rate that would reduce country risk premium, strengthen reverse currency substitution and accumulate foreign exchange reserves.

Chart 1. **Garanti BBVA Inflation Projections**
(%, annual)



Source: Garanti BBVA Research

Chart 2. **CPI and Trend Inflation, YoY**
(%, annual)



Source: Garanti BBVA Research

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