

Economic Watch

# Turkey: CBRT reacted proactively by 200bps hike

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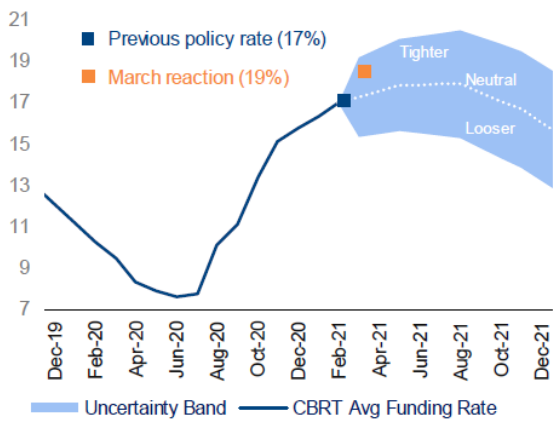
The Central Bank of Turkey (CBRT) raised the policy rate (one-week repo) by 200bps to 19% beating the expectations of a 100bps hike. The CBRT reaffirmed the upside risks on inflation expectations, pricing behavior and the medium-term inflation outlook associated with the recent volatility in global financial markets and the still continuing both demand-pull and cost-push factors. Therefore, the Bank has decided to implement a front-loaded and strong additional monetary tightening, confirming its forward-guidance in the previous communications. Market reaction was also positive, having the Turkish lira appreciating by 2% to 7.35 against US dollar and near 50bps decline in 10-year TL sovereign yield right after the decision. Although we figure out near 150bps upside risks on our current inflation forecast (10.5% by year-end), today's front-loaded reaction could be the peak of the tightening cycle. We also maintain our view to have the first rate cut of the CBRT in 4Q21, which will depend on the deviations from the projected disinflation path of the CBRT and might require to stay tight for longer, given the CBRT year-end target of 9.4%.

## The worsening inflation outlook and recent market volatility backed the decision

Improving global growth outlook and therefore rising global inflation expectations have led to sizable volatility in global financial markets and resulted in uncertainties about advanced economy monetary policies and earlier than expected monetary tightening in some emerging markets (positive surprise from BCB yesterday). Therefore, the worsening inflation outlook started to erase the real interest gains in the previous months and weigh on the exchange rate. Second, as the CBRT also shared its concerns, the recent upward trend in credit growth and the increase in import costs reinforce both demand-pull and cost-push factors on the inflation outlook, for which we also plan to revise our inflation expectations on the upside by near 150bps (10.5% by year-end). Third, the peak level we initially expected to have in April at 16% could get near 17%, given the rise in commodity prices and other supply side factors. This could have put the previous forward guidance of the CBRT at risk if they hadn't given any reaction in today's meeting. All in all, the CBRT confirmed its forward-guidance and clearly strengthened its credibility. 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".

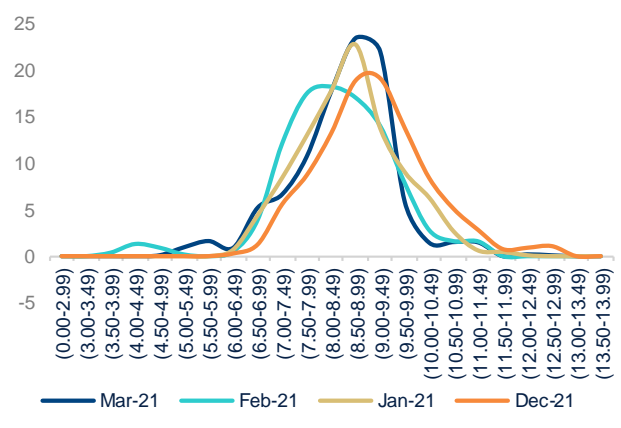
According to our Taylor rule calculations, today's decision implies a tighter bias (Chart 1), which will be crucial to anchor inflation expectations since they started to regain positive skewedness in the last few months (Chart 2). The CBRT maintains a medium-term outlook and keeps its inflation target at 9.4% for the year-end, assuming a much stronger Turkish Lira and positive gains from inflation expectations. We maintain our view to have the first rate cut in 4Q21, which will depend on the inflation dynamics and might require the CBRT to stay tight for longer.

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



Source: Garanti BBVA Research

Chart 2. **Probability Distribution of 12-Month Ahead Inflation Expectations (%)**



Source: Garanti BBVA Research

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