Economic Watch

Turkey: CBRT made changes for the future stance

Adem Ileri, Seda Guler Mert
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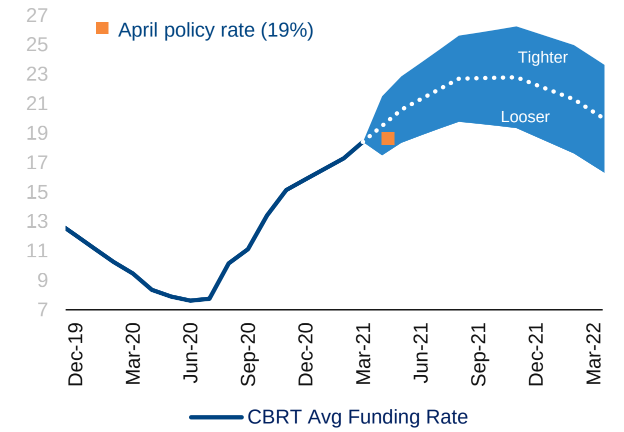
The Central Bank of Turkey (CBRT) kept the policy rate (one-week repo) at 19%, in line with expectations. Though, the MPC decision carried important changes by removing the two forward guidance remarks on the tight stance: (i) additional monetary tightening will be delivered if needed, (ii) the continuation of the decisive tight stance for a long period of time. Instead, they referred to the tight stance by means of keeping the policy rate unchanged and promised to keep the policy rate at a level above inflation. Therefore, the monetary stance turns out to be gaining a dovish background since the inflation outlook has worsened further, given the latest developments. The initial market reaction was also negative as the TL depreciated above 8.15 against the US dollar and the equity market has been sold mainly from banks. Due to ongoing cost push factors, stronger global commodity prices, supply side constraints on pandemic, still robust demand and accelerating pass-thru impact from the recent currency depreciation, we expect consumer inflation to remain near 18% in 2Q and fluctuate around 17% till October before declining to 15% at the end of the year on the back of favorable base effects in the last two months. So, relying on the other constraints as well, we expect the CBRT to start an easing cycle only very gradually in late 3Q.

Still strong activity, worsening inflation expectations gain importance

Despite tighter financial conditions and weak services sector, economic activity remained strong in 1Q. Although February IP data signaled a clearer deceleration, our monthly GDP indicator still nowcasts a yearly GDP growth rate of near 5.5% in 1Q. Also, the recent upward trend in credit growth especially on the consumer side might delay the expected impact of the current tightening, which is also highlighted by the CBRT. Nevertheless, the CBRT still assumed the decelerating impact of the current policy stance on credit and domestic demand to become more evident in the coming period. On the other hand, inflation expectations have deteriorated further as year-end expectation increased to 13.1% from 11.5%, while the 12-month and 24-month ahead expectations also rose to 11.3% and 9.6%, respectively (Chart 2). Services prices increased to 12.6% in March, the highest figure in the last 19 months, implying strengthening inertia. Besides, cost push factors have accelerated further as domestic producer prices inflation upsurged to 31% in annual terms in March. Although our Taylor rule implies a need for further tightening (Chart 1) given the worsened inflation outlook, we expect the CBRT to stay on hold till September and start an easing cycle only very gradually thereafter. The reference in the MPC decision to a viable foundation to investment, production and employment might require a longer than expected higher interest rates, in our view.

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



Source: Garanti BBVA Research

Chart 2. **12-Month and 24-Month Ahead Inflation Expectations** (%)

Source: Garanti BBVA Research, CBRT

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ENQUIRIES TO:
Garanti BANKASI A.Ş. Nispetiye Mah. Aytar Cad. No:2 34340 Levent Beşiktaş İstanbul.
Tel.: +90 212 318 18 18 (ext 1064)
bbvaresearch@bbva.com www.bbvaresearch.com