Creating Opportunities

Economic Watch

Turkey: The CBRT maintains the current stance

Adem Ileri, Seda Guler Mert

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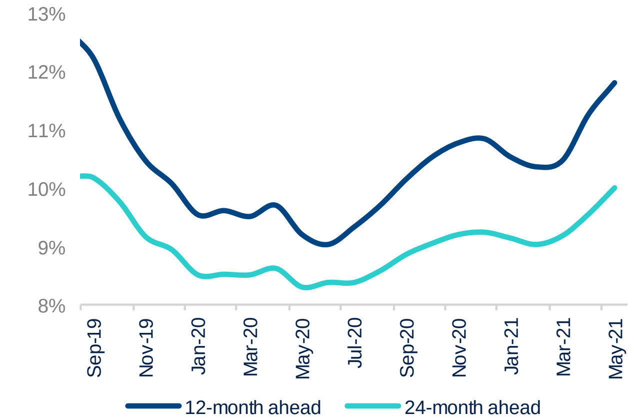
The Central Bank of Turkey (CBRT) kept the policy rate (one-week repo) at 19% in line with the expectations. The CBRT acknowledges that the decelerating impact of the monetary tightening on credit and domestic demand has begun to be observed. Yet, given the high levels of inflation and inflation expectations, the CBRT underlines the need to keep the current monetary policy stance until the significant fall in the April Inflation Report's forecast path is achieved. In its revised projections, the CBRT foresees the peak in CPI in April, and forecasts a clearer decline in inflation only starting from 3Q and a year-end inflation level of 12.2% (vs. 13.8% in May expectations survey). Therefore, the CBRT once again tries to eliminate any early rate cut expectations. Led by strengthening cost push factors, supply side constraints on pandemic, decelerating but still effective domestic demand and continuing pass-thru impact, we expect consumer inflation to fluctuate around 17% till November before declining to 15% at the end of the year. Also, rising global inflation expectations on both higher commodity prices and positively revised growth forecasts and its potential effects on the markets remain significant, as the CBRT also highlighted. So, we expect the CBRT to start an easing cycle only very gradually in late 3Q and end the year with 16% policy rate.

Still strong activity, worsening inflation expectations gain importance

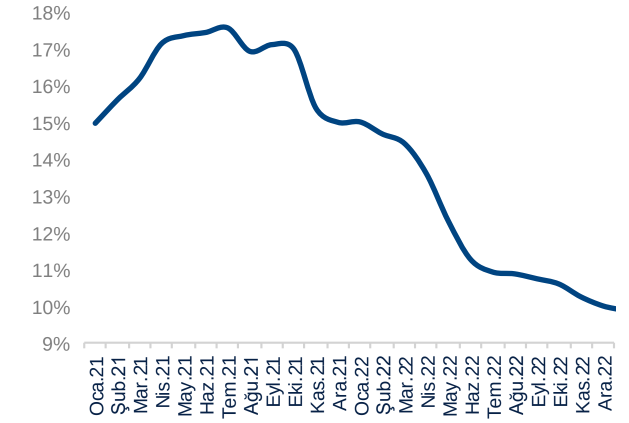
One of the important changes in the decision is about the assessment on credits. The CBRT acknowledges the decelerating impact of the monetary tightening on credit and domestic demand has begun to be observed, but this time eliminates its expectation from the tightening to become more significant in the upcoming period. Its assessment as "consumer loans, along with commercial loans, exhibiting a milder course", also shows some softening bias on credit growth, which could be linked to the recent faster moderation in activity especially after the stricter lock-down measures. Second, the CBRT justifies its decision to keep the current stance with the high levels of inflation and inflation expectations, which makes it harder to achieve the April Inflation Report's forecast path. In May, inflation expectations deteriorated further as year-end expectation increased to 13.8% from 13.1%, while the 12-month and 24-month ahead expectations also rose to 11.8% and 10%, respectively (Chart 1). Services prices inflation jumped to 13.1% in March, implying strengthening inertia. Besides, cost push factors accelerated further as domestic PPI upsurged to 35% in annual terms. All in all, even in a gradual currency depreciation pattern, the peak in CPI could still be experienced in the coming period depending on the price adjustments once the economy is reopened in late May (Chart 2). Therefore, worsened inflation outlook requires the CBRT to be more cautious, which the CBRT tries to manage right now by eliminating any early rate cut expectations.

Chart 1. **12-Month and 24-Month Ahead Inflation Expectations** (%, yoy)



Source: Garanti BBVA Research, CBRT

Chart 2. **Garanti BBVA CPI Expectations** (%, yoy)



Source: Garanti BBVA Research

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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