Economic Watch

Turkey: CBRT keeps the stance but adds inflation worries

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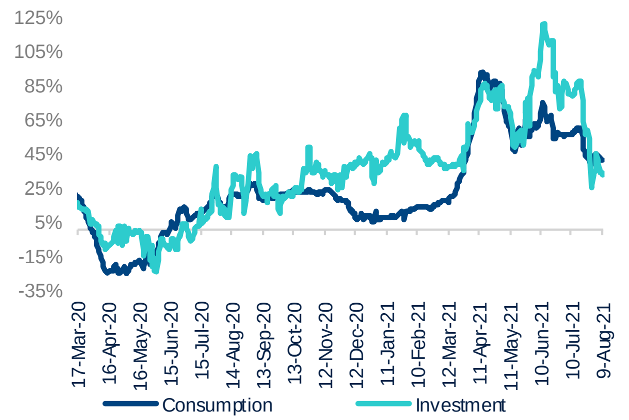
12 August 2021

The Central Bank of Turkey (CBRT) maintained the policy rate (one-week repo) at 19% in line with the expectations. The decision statement remained almost the same apart from strong 3Q activity on strengthening external demand and concerns about the food inflation linked to higher global commodity prices and climate change effects. Given the high levels of inflation and inflation expectations, the CBRT repeated the need to decisively keep the current "tight" monetary policy stance until a significant fall in the Inflation Report's forecast path is achieved, referring to a timing of late 3Q or start of 4Q. Given the increased upside risks, we expect consumer inflation to hover near 19% till November before declining to 16% at the end of the year. Rising global inflation and inflation expectations and their potential effects on the markets remain important for especially the EMs. Besides, risks on food inflation might reduce the expected fast correction in inflation in 4Q. Given the CBRT communication so far, we expect the CBRT to start an easing cycle very gradually in 4Q and end the year with 17.5% policy rate. However, depending on the market volatility and potential upside surprises of inflation, the first rate cut might be delayed further.

Consumption still remains strong, inflation expectations worsen further

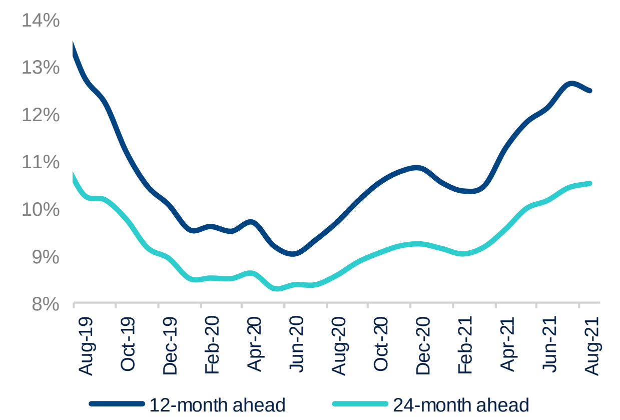
According to our Big Data proxies and other high frequency indicators, the economy has shown a fast recovery following the reopening since mid-May, and our monthly GDP indicator still nowcasts a yearly growth rate of near 13% in early August. The CBRT will monitor the adequacy of the implemented macroprudential measures to curb personal loan growth, but it still doesn't signal any further tightening bias. Indeed, as our big data indicators show, consumption stabilizes at only strong levels and investment maintains an adjustment since June (Figure 1). Deepening cost-push factors and still strong consumption levels reinforce upside risks on the inflation outlook in a period of reopening and supply-side problems. Also, inflation expectations keep deteriorating as year-end expectation increased to 16.3%, while the 12-month and 24-month ahead expectations remain high at 12.5% and 10.5%, respectively (Chart 2). Last but not least, food inflation might result in additional upside risks due to this year's drought and losses on wildfires. On the positive side, the current account balance is still expected to post a surplus in the rest of the year, which is stated as important for the price stability objective. All in all, worsening inflation outlook and potentially increasing global yields when getting close to the FED tapering will require the CBRT to be more cautious, which the CBRT tries to manage right now by keeping the current monetary stance.

Chart 1. **BBVA Big Data Domestic Demand Indicators** (28-day sum, nominal, YoY)



Source: Garanti BBVA Research

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



Source: Garanti BBVA Research, CBRT

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