

Economic Watch

Türkiye | The CBRT gives more hawkish messages

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The Central Bank (CBRT) maintained the policy rate at 45% as expected. Compared to the previous messages, the CBRT now seems more concerned about the inflation outlook since they observe lower than projected consumption expenditures in some items and signal potential pressure from inflation expectations and pricing behavior due to wage increases. In order to strengthen monetary transmission mechanism, they will still primarily use credit policies and try to keep deposit rates as high as needed through macro-prudential measures in addition to quantitative tightening. Nonetheless, hiking above 45% policy rate becomes more likely after today's decision in our view, since they explicitly say that if notable and persistent risks to inflation outlook emerge, "monetary policy stance will be tightened", rather than "be reassessed".

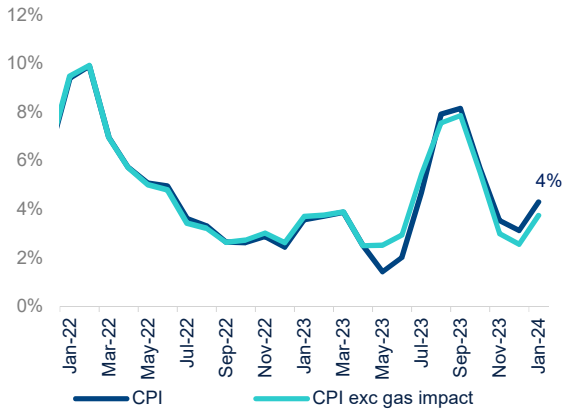
On inflation, the CBRT drew a more concerning picture. They stressed that the increase in January monthly inflation trend was in line with their projections. However, compared to their previous assessment of existing level of domestic demand parallel to their projections, this time they acknowledged slower than projected consumption expenditures in some items. Second, they added food prices to the risk factors, which they had previously mentioned on inflation as stickiness in services inflation and geopolitical risks. Third, they point out potential inflationary pressure from inflation expectations and pricing behavior due to wage increases. In this respect, it is not clear which trend indicators and inflation expectations they follow in order to assess the impact on inflation. In their latest forward guidance, they referred to the 3-month average seasonal adjusted inflation moving at around 4% in January and mentioned about the target of reducing it to 1.5% in 4Q24 (1-1.5% sa m/m in Dec24). Metrics on inflation expectations and pricing behavior are rather blurred. According to the February market participants' survey of the CBRT, inflation expectations for the next 12 month and 24 month improved limitedly to 37.8% and 23.1%, respectively. Though, the expectations for 2024 end and 2025 end stood at 43% and 25%, far above the CBRT interim targets of 36% and 14%.

For the first time, the CBRT referred to the real appreciation of Turkish lira being a key element of disinflation, from which we understand they want to give the message that they will not allow a fast depreciation of the currency and try to eliminate those expectations of a significant depreciation after the election in March.

On the future course of the monetary stance, they repeat their commitment to keep the current level until there is a significant and sustained decline in the monthly inflation trend and until inflation expectations converge to the projected forecast range (30-42% for 2024 end, 7-21% for 2025 end). In this regard, we still believe macro-prudential measures and quantitative tightening tools will be primarily preferred. Nevertheless, we also assess the likelihood of an additional rate hike has increased after today's more hawkish messages. According to our calculations, financial conditions started to ease since December and consumption expenditures do not decelerate further since November, which increase challenges on anchoring inflation expectations toward the targeted levels. Also, if we decompose factors on core inflation, we still observe the contribution from aggregate demand and monetary policy, confirming the need to tighten the monetary stance further. Moreover, since there has been renewed tendency toward dollarization and the pressure on the CBRT reserves continues, a broad-based increase in TL deposit rates via the increase in the policy rate will be more effective to help de-dollarization, instead of adding new deposit rules. Last not but least, we value the signaling effect of hiking policy rate beyond expectations to enhance credibility.

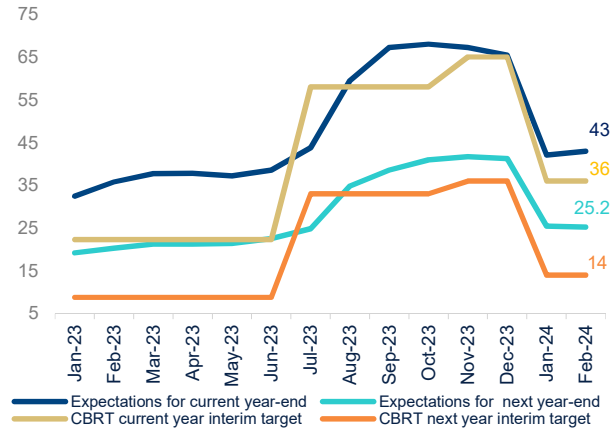
Given the recent challenges on inflation outlook and expectations of significant energy prices hikes for households after the election, we maintain our year-end inflation expectation of 45%. We will closely watch how the monthly inflation trend will move and try to see whether the trend will start coming down as targeted by the CBRT. Therefore, we maintain our call of keeping 45% policy rate throughout the year with a bias tilted to the upside. If post-election policies become more clearly restrictive, we will revise our forecasts, accordingly.

Chart 1. Trend CPI Indicators (SA MoM, 3M avg)



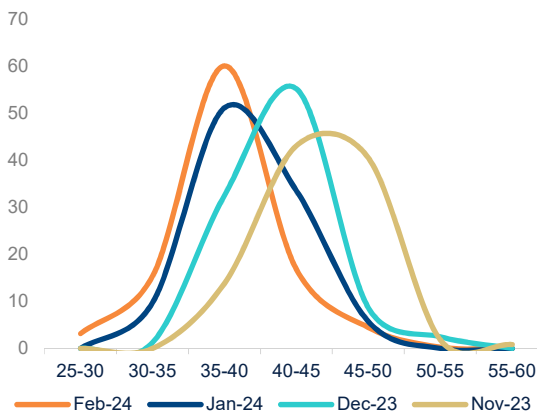
Source: Garanti BBVA Research, TURKSTAT

Chart 2. CBRT Market Participants Survey Inflation Expectations (%)



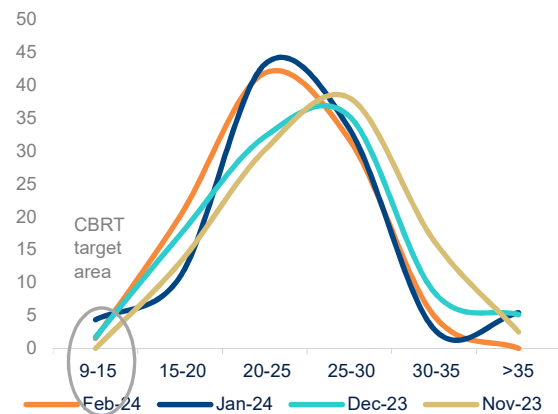
Source: Garanti BBVA Research, CBRT

Chart 3. CBRT Market Participants Survey Inflation Expectations (12M ahead, probability distribution)



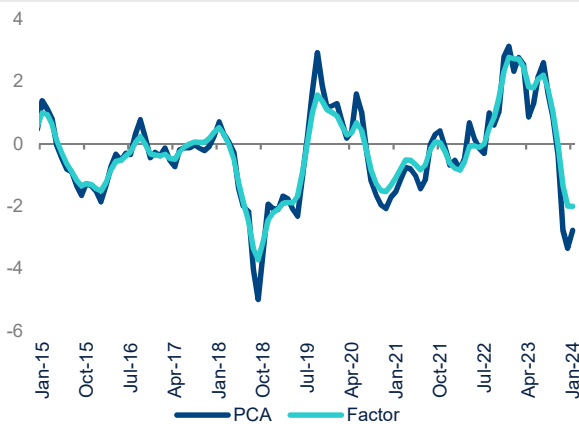
Source: Garanti BBVA Research, TURKSTAT

Chart 4. CBRT Market Participants Survey Inflation Expectations (24M ahead, probability distribution)



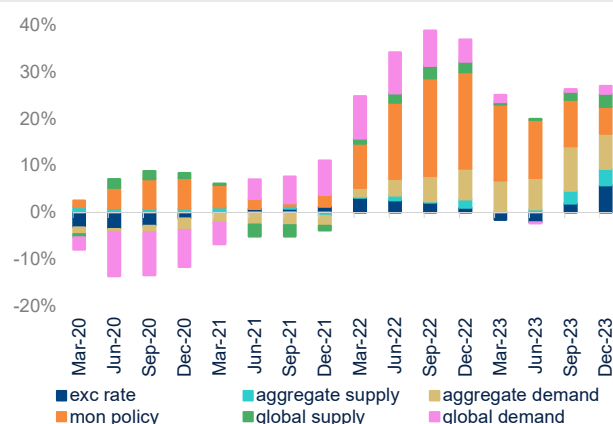
Source: Garanti BBVA Research, CBRT

Chart 5. Garanti BBVA Financial Conditions Index (standardized, + easing, - tightening)



Source: Garanti BBVA Research, TURKSTAT

Chart 6. Historical Contribution of Shocks on Core D (pp)



Source: Garanti BBVA Research, TURKSTAT

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