# The Central Bank of Turkey remains tight

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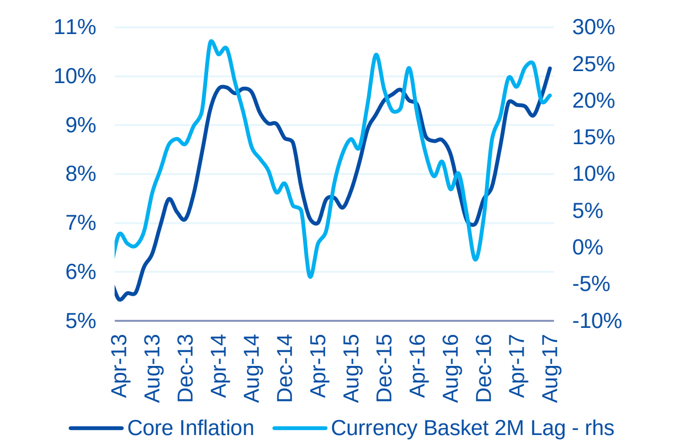
**The Central Bank (CBRT) maintained its interest rate corridor once again parallel to our call and market consensus. The Bank keeps its hawkish tone as it also finds the high levels of both the headline and core inflation alarming over pricing behavior. We expect the headline to breach 11% in September and stay close to those levels till December. The recent pick-up in core inflation increases the risks over the headline not to be able to fall below 10% at the end of this year. Bearing in mind the high inertia in inflation and the ongoing high momentum of the economic activity, we expect the Bank not to find room for monetary easing until the end of 1Q18, when the headline will fall towards 8-8.5% thanks to favorable base effects on food and the declining core inflation over the easing exchange rate pass through.**

## Economic activity will accelerate further and inflation will stay above 11% till December

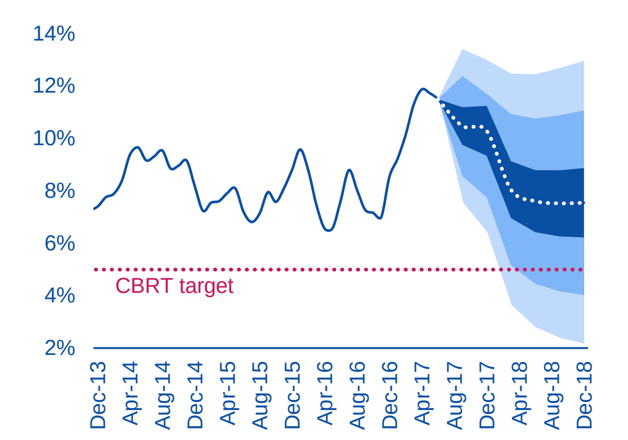
In line with our expectations, the CBRT acknowledges that the economic activity will gain additional strength in 3Q. Our monthly GDP indicator nowcasts a growth rate close to 7% (26% of information at hand) as of August, on top of both the recent high momentum thanks to the policy stimulus and favorable base and calendar effects. Although we envisage the dying out impact of the Credit Guarantee Fund in 4Q, we forecast at least 5.5% growth rate is likely for the whole 2017 and what we expect for the next year is the continuation of stimulus policies before the election cycle in 2019. Secondly, despite the positive global mood with more dovish monetary policy stance, the likelihood of tighter financial conditions which has taken the stage in the last couple of days would require the Central Bank to preserve its tight stance longer than we initially expected. Moreover, acknowledging our previous calls, high levels of core inflation seem to be disturbing for the Bank as the rigidity on cost-push factors, second round price effects and recent appreciation of Euro continue to be the risk factors on core inflation outlook in the near future.

**Figure 1** Core Inflation and Currency Basket (2M lag, YoY)




Source: Garanti Research, CBT, TURKSTAT

**Figure 2** Inflation Forecasts (Quarterly Avg, YoY)




Source: Garanti Research & Turkstat

## Looking Ahead: Restoring credibility and waiting for some room to ease in 2018

The positive momentum in economic activity and the high levels of inflation would require a longer period of tight monetary policy stance. We expect the Central Bank to maintain restoring credibility and waiting for some room for monetary easing, starting from 1Q next year, where we expect the headline to fall towards 8-8.5%.

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