Turkey: The CBRT strengthens the stance

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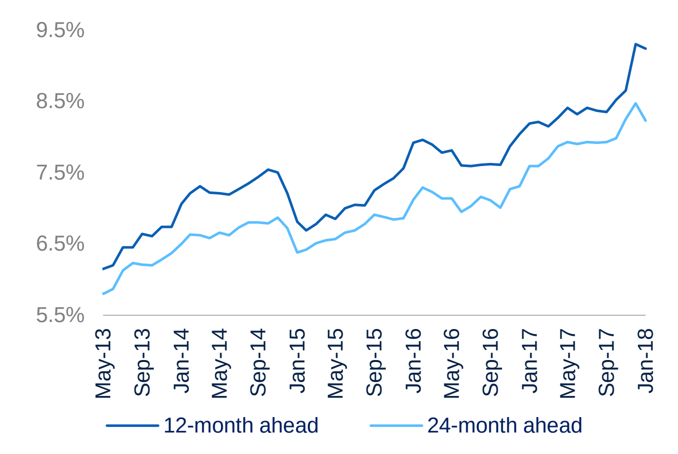
The Central Bank (CBRT) maintained policy rates unchanged, including the late liquidity window (LLW) at 12.75%, in line with expectations. The Bank reinforced the tight sentiment by repeating "until the inflation outlook becomes consistent with the targets" and also adding "independent of base effects and temporary factors" given the expected base effects during the first monts of the year. This strengthens the stance of the CBRT as we understand that monetary policy will remain tight until inflation outlook proves to contain inflation expectations. We expect inflation to converge to 10% in January thanks to favorable base impact on food but it will navigate around 10% until 4Q before decreasing to 9% at the end of the year. Considering the high difference between market's inflation expectations and CBRT's inflation projection (which could be revised upwards in the next inflation report on the 30th of January), we envisage that the tightening will be maintained for a long time.

Inflation to remain high with a transitory reduction in the short term

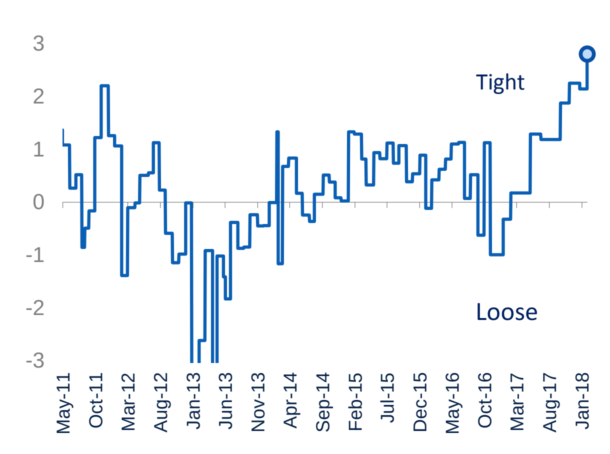
While global factors remained supporting since the last meeting and the exchange rate has appreciated, there are still factors supporting high inflation dynamics. The lagged-effects of the sharp depreciation of the Lira since last summer (particularly vs the euro), still robust domestic demand (we expect the GDP to growth near 7% in 2017) and the deterioration in inflation expectations could reinforce inertia further. As a consequence, we expect inflation to remain high during the year, after a transitory period in the 1Q when base effects will support a rapid but temporary reduction in inflation. We maintain our 9.0% forecast for the end of the year with a neutral balance of risks. Although expected, the decision today adds some "verbal tightening" as observed in our Big-Data sentiment of the statement (see Figure 2) and we expect the CBRT to maintain this stance for a long period of time.

Figure 1 Inflation Expectation (12-month ahead)



Source: CBRT, Garanti Research

Figure 2 CBRT Policy Statement Sentiment



Source: Garanti Research

Looking Ahead: Tight for a Long Period

One year ahead inflation expectation (9.2%) remains far from the CBRT's inflation target and inflation projection (7%) in the last inflation report. This is enough to justify a "tighter" tone and to remain monitoring the incoming data and news to react if necessary. We expect the CBRT to maintain high rates for a long period of time at least until inflation data and expectations show a marked reduction.

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