

# Turkey: The CBRT stays on hold and keeps the tone tight

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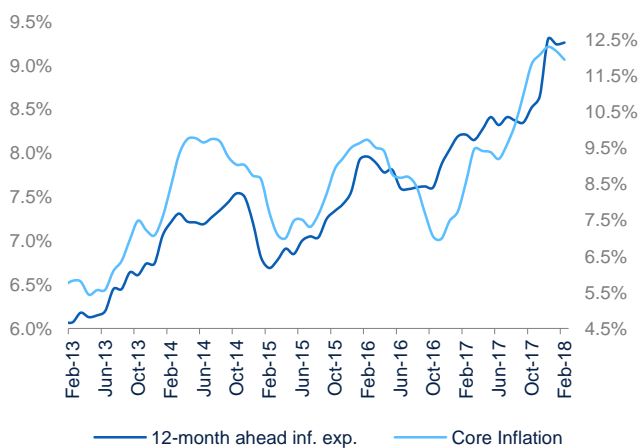
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The Central Bank (CBRT) kept its policy rates unchanged, particularly its de-facto policy rate (late liquidity window, LLW) at 12.75%, in line with expectations. The Bank maintained its policy tone but this time also stressed the inertia in inflation outlook and the high levels of core inflation. Expected decline in core inflation thanks to base effects proves to be much more limited as second round price effects continue to push especially services prices and globally appreciated euro maintains the exchange rate pass-thru at high levels. We expect headline inflation to navigate around slightly below 10% till June and deteriorate further during summer months above 10% before converging to 9% on base effects at the end of the year. In our view, the CBRT should stay tight until inflation outlook proves to contain inflation expectations and remain ready to act if inflation deviates further from their latest inflation projection path.

## Core inflation outlook remains worrying

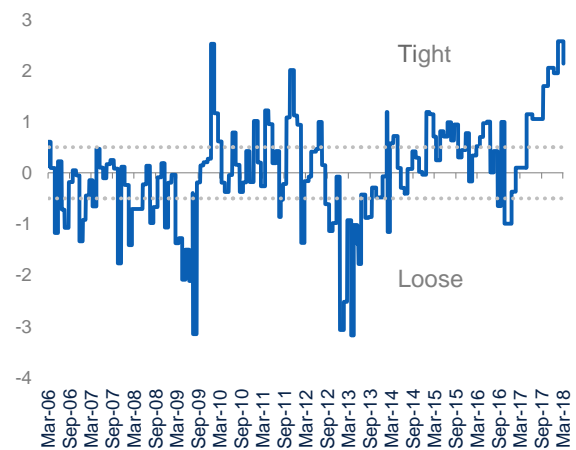
Despite relatively stable levels of Turkish Lira against US dollar, globally appreciated Euro keeps currency basket depreciating, which results in a much more limited recovery in core inflation on base effects. Still strong domestic demand, second round price effects and high levels of inflation expectations also reinforce the inertia. Hence, we expect inflation to remain high during the year close to 10% until the last two months of the year when it will converge to 9% on base effects. Though, core inflation outlook stays more worrying as it may stay above 11% in the first half of the year, before falling below 10% in the last quarter. The CBRT stresses the rigidity in inflation outlook and its potential impact on pricing behavior and the policy tone remains tight, observed in our Big-Data sentiment (Figure 2).

Figure 1 12-month Inflation Expectation & Core Inflation



Source: TURKSTAT, CBRT, Garanti Research

Figure 2 CBRT Policy Statement Sentiment



Source: BBVA Research

## Looking Ahead: Focus on core inflation dynamics

Given the high levels of inflation and inflation expectations, pricing behavior carries the risk of further inertia, which requires the CBRT to keep its tight policy stance. Recent disinflation path may help Turkish Lira volatility to be contained thanks to relatively higher positive real interest rates, though risks will likely remain alive as today's Moody's downgrade decision highlighted. We expect the CBRT to maintain the tight stance for a long period of time until inflation outlook displays a significant improvement to be consistent with the targets.

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