

# Turkey: The CBRT raises rates by 75 bps

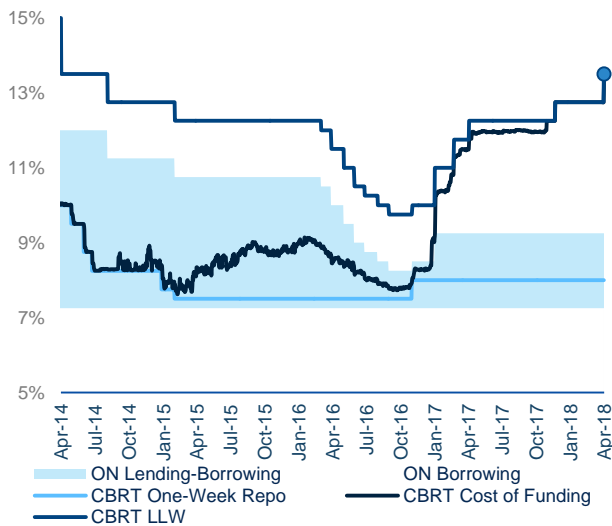
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The Central Bank (CBRT) hiked its de-facto policy rate (late liquidity window, LLW) by 75 bps to 13.50%, in line with our expectation but slightly higher than the median market call, 50 bps. The Bank emphasized that the upward movement in import prices supported upside risks on pricing behavior stemmed from the high level of inflation and the deterioration in inflation expectations. The year-to-date exchange rate depreciation, still solid domestic demand, second round price effects and high inertia (backward and forward looking) put upward pressures on inflation. Central Bank’s action is the first step in the right direction. Risks for further tightening are well alive according to the statement and market expectations. At two digits inflation (we expect the year end inflation at 10.5%), anti-inflationary policies should be at the forefront of economic strategies in a comprehensive way, including further tightening if needed.

## Rising concern on inflation expectations triggered the reaction of the CBRT

The year-to-date exchange rate depreciation, the deterioration in inflation expectations and solid domestic demand add pressures to the already high inflation inertia (which we consider is the result of both backward and forward looking mechanisms). The new round of the exchange rate depreciation (cost-push factors) could further kick in the second round effects due to relatively high level of import prices. Therefore, we expect inflation to be higher during summer and stayed at these levels until the last two months of the year, when inflation will decrease toward 10.5% on base effects. In sum, the recent deterioration in the inflation outlook has led the Central Bank to tighten the interest rate again, removing some uncertainties about the reaction. Considering the inflation outlook and potential external risks, further tightening cannot be ruled out. The important thing is to remove “reaction” doubts.

Chart 1 CBRT Interest Rate Corridor



Source: BBVA Research Turkey, CBRT, TURSKTAT

Chart 2 One year ahead expectations. & Core Inflation



Source: BBVA Research Turkey, TURKSTAT

## Fighting high inflation based on comprehensive strategy should be prior

Today’s tightening by the CBRT is a first step in the right direction, should be maintained and increased if needed. The action will also help to reduce doubts on policy inaction while the statement reminds that further action cannot be ruled out. On top of it, reducing inflation should become a top priority tackled in a comprehensive way including several economic policies.

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