Turkey: Central Bank of Turkey likely to step in again...

We expect the CBT to react to upside risks on the inflation front and to higher commodity prices. We look for a 100bp rate hike this month to 18%. Reviving curreny volatility and motivation to strengthen reserves should be other factors behind such a decision.

Following the recent upside surprises on the inflation outlook against a backdrop of rising cost-push pressures, whether the CBT will step in this month and hike the policy rate again after two months of silence is the question. We think that the bank will tighten, with a 100bp hike to 18% at the March MPC meeting to be held on 18 March, on the back of a shift in global risk appetite, the uptrend in commodity prices and a weakening currency adding to already elevated inflation risks.

After the February MPC, citing the decline in loan and deposit rates, the CBT revised the reserve requirement framework and hiked all liability types and maturity brackets by 200bp with the intention to improve the effectiveness of monetary transmission mechanism. The change that is effective as of 5 March is calculated to increase TL-denominated required reserves by TRY25 bn, though the perceived impact on lending and deposit rates is relatively low if we consider the rise in the remuneration rate applied. However, the decision is also an indicative of the CBT's sensitivity to deposit rates and TRY attractiveness, particularly given its importance in reserve replenishment -

something that may also be a factor behind further rate adjustment.

In the investor meeting held after the inflation release in early March, the CBT:

- flagged some positive developments in the February data, with a partial improvement in the core goods trend and some alternative indicators of underlying inflation, so keeping the headline figure within the uncertainty band envisaged in the latest inflation report
- expected to achieve its interim target for this year at 9.4%, on the back of a slowdown in credit growth likely to ease pricing pressures and dissipation of cumulative exchange rate pass-through effects

The CBT seemed concerned about the continuing adverse impact of domestic demand conditions, rising commodity prices and elevated inflation expectations on the outlook.

Growing inflation expectations owing to the loose monetary stance of central banks globally, coupled with large fiscal stimuli, support the broader commodities complex. Accordingly, we have seen strong uptrends in agricultural, energy and basic metal prices in recent months, adding to already high cost-push factors for Turkish inflation. Given that the CBT's assumptions in the January inflation report for oil, food, and import prices seem to be relatively optimistic, the possibility of a rate hike to contain inflation has also increased.

Finally, the recent rise in US rates weighing on the TRY along with other EM peers can add to the already challenging inflation outlook. So, any deterioration in global risk appetite should be a factor for the CBT to deliver a hike given that we have not seen a concrete improvement in short term dynamics for financial markets.

All in all, we expect the CBT to react to upside risks on the inflation front with higher commodity prices via a 100bp rate hike this month, while reviving curreny volatility and its aim to strengthen reserves and support demand for TRY should be other factors behind such a decision.

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