

## Turkey: No change in policy rate or guidance

The Central Bank of Turkey has remained on hold and kept the policy guidance unchanged despite an upside surprise in inflation in July amid buoyant demand conditions, high services inflation and easing pandemic restrictions



In line with the market consensus, the CBT has remained on hold at the August rate setting meeting once again despite headline inflation recording an upside surprise in July, which was almost aligned with the policy rate of 19%.

Despite challenging inflation dynamics, the CBT did not make any changes to its policy guidance as the bank:

- reiterated that “the current stance would be maintained decisively until the significant fall in the Inflation Report’s forecast path is achieved”, pointing to the fourth quarter
- again underlined its commitment to “use all available instruments in pursuit of the primary objective of price stability.”

On the inflation side, driven by food prices and administrative price adjustments which impacted housing, annual CPI continued to rise last month with the highest July reading in the

current inflation series, while the underlying trend of core inflation on a seasonally-adjusted basis (3m-ma, annualised) showed some improvement. According to the CBT, the rise in food inflation was driven by “supply-side effects in some products led by climate conditions, the high level of international agricultural commodity and food prices, as well as the effects of the reopening”. However, the bank also noted “the decelerating impact of monetary tightening on credit and domestic demand”.

Regarding other key takeaways from the rate setting statement:

- The CBT continues to point to global inflationary risks driven by improving demand, supply constraints and commodity prices while global food prices are also under pressure with the “unfavourable effects of weather conditions in major agricultural commodities”.
- The bank acknowledges that “that domestic economic activity remains strong in the third quarter, with the help of robust external demand” as evidenced by leading indicators. Given this backdrop, second quarter GDP growth will likely be better than envisaged earlier with an increasing vaccination pace and full reopening supporting the recovery in services and tourism.
- The CBT projects a surplus for the remainder of this year and states that “the improvement in the current account balance is important for the price stability objective”. However, according to a survey of market participants, the market expects a higher deficit due to the current uptrend in energy imports and there is no concrete sign of improvement in the core trade deficit (excluding gold and energy) yet.

All in all, the CBT has remained on hold this month, and maintained its cautious stance. Going forward, while the market will closely watch the level of real rates, the bank will likely remain on hold in the coming few months. Given the guidance that the current stance will be maintained until there is a significant fall in inflation, and the expectations that this decline will take place in the fourth quarter, we think the bank will cut rates by 100bp in the last two months of the year. However, challenging inflation dynamics, fragile capital flows and the exchange rate outlook as well as Turkey's vulnerability to a stronger US dollar and rising US real yields could encourage the CBT to wait longer.

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