Turkey's central bank to remain on hold again

The Central Bank of Turkey will likely hold the policy rate steady at the 18 February MPC meeting, preferring to wait-and-see the impact of its prior moves

The Turkish Central Bank in Ankara

At the CBT's policy meeting in November, new governor Naci Agbal introduced a significant policy shift, including rapid rate hikes, policy simplification and a greater acknowledgement of the risks. Now, the question is whether the recent upside surprise in inflation is significant enough to warrant further monetary tightening. Despite high risks to price stability and the CBT's focus on credibility, the bank will likely keep the policy rate unchanged at its meeting on 18 February, allowing more time to assess the impact of its previous moves, as its concern about the inflation outlook shifts to the medium term.

According to the current policy guidance, the CBT is keen to keep a tight stance for a longer period given the risk of inflation expectations rising and pricing behaviour diverging from the medium-term target path. It has also kept the door open for additional front-loaded tightening, if needed. Another higher than expected reading in January inflation, with across the board pricing pressures, reflects continuing cost-push factors, sticky services inflation, and deteriorating expectations, highlighting the extent of the ongoing risks. Inflation will likely peak in April, and based on the

January business survey, upside risks are still high as evidenced by a further deterioration in business expectations of intermediate goods prices for the coming period. So, we still see annual inflation moving higher until April and do not rule out the possibility of a policy rate adjustment ahead, especially in case of further upside surprises.

On the flip side, there is no fundamental reason for higher rates given that the CBT is currently offering real interest rates of 2.0% in ex-post terms and 6.6% ex-ante, the highest among the major emerging market peers. On a positive note, January's sectoral PMI survey showed signs of moderation in the rates of inflation of both input costs and output prices, though they remained elevated. Also, the CBT's medium-term focus increases the possibility of some tolerance for short-term pricing developments and temporary inflation surprises.

Given this backdrop, we still expect the CBT to keep its policy rate unchanged at 17.0% this month, while strength in the Turkish lira in recent months and an improvement in the risk premium should also be supportive for such a decision. The market is not currently pricing in a hike from the CBT in the coming months, which supports our view that the next policy move will be a rate cut, likely in late 2021.

> In addition to concern about inflationary pressures, the CBT is also mindful about the level and composition of reserves, high dollarisation and the need to maintain capital flows while it waits to see the impact of previous policy moves.

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