Economic Watch

Türkiye | The CBRT remains cautious on inflation outlook

Adem Ileri, Seda Guler Mert

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The Central Bank (CBRT) kept the policy rate at 50% in line with the expectations. They repeat their commitment to support monetary transmission mechanism via additional macro-prudential measures if needed. Given the most recent excess TL liquidity and the downside pressure on O/N TL rates, in a separate note sent to the banks, it is said that the CBRT might hold FC and gold swap auction to sterilize TL liquidity. Last Friday, the CBRT had also reduced the monthly credit growth cap to 1.5% (from 2%) in foreign currency lending. On inflation, they highlight a potential temporary increase in monthly inflation in July due to the adjustments in administered prices and taxes as well as supply-side factors in unprocessed food prices. However, they expect the rise in the underlying inflation trend to be relatively limited. They repeat their assessment on domestic demand as slowing down but still remaining at inflationary levels. Considering the lagged effects of the monetary tightening, they maintain a wait and see approach with their hawkish message on a potential tightening in case a significant and persistent deterioration in inflation trend is observed. We forecast inflation trend to keep improving after July's temporary effects and finish the year with 43% annual inflation. Since unanchored medium term inflation expectations maintain upside risk on inflation outlook, we keep an upward bias on our short term policy rate expectations which involve limited rate cuts in 4Q24.

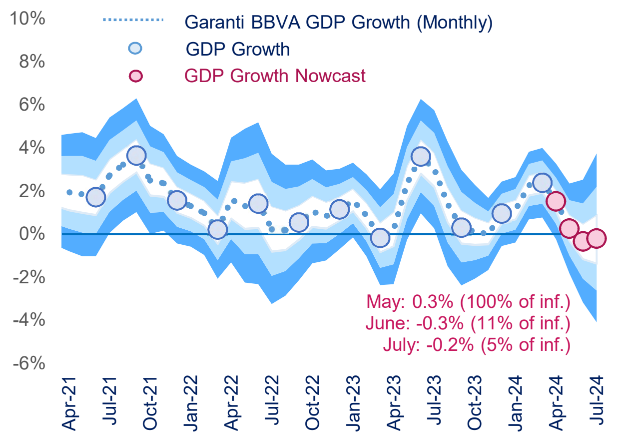
After June's exceptionally low inflation figure, we nowcast monthly inflation to be around 3.5% due to the one-off effects of the adjustments in administered prices and taxes together with indirect effects on food inflation. According to our calculations, 3-month seasonally adjusted inflation trend will move upward limitedly (to 3.1% from the previous 2.9%), which has also been highlighted by the CBRT. Yet, if those one-off effects are excluded, the underlying trend would still be able to improve. This is why the CBRT prefers to wait and see how the trend will move in the next months. In this respect, the CBRT remains cautious and remains highly attentive to inflation risks as underlined by stickiness in services inflation, inflation expectations, geopolitical risks and food prices. Despite much weaker than expected June inflation, inflation expectations have only limitedly improved in July and remained far from the CBRT targets with 43% for 2024 end and 25.4% for 2025 end (vs. 38% and 14% targets of the CBRT respectively).

On the economic activity, we nowcast a mild negative quarterly growth as of early July (-0.3% in 2Q24 and 2.4% in 1Q24). The targeted rebalancing in the economy has been slowly taking place due to the counter effects over the monetary transmission mechanism and still supportive fiscal stance. High inflation expectations, wealth effects and retailers' spending availability prevent a faster adjustment in private consumption. On one hand, since the adjustment of wages in 2H24 are much more limited compared to 1H24, a more restrictive monetary stance on top of easing inflation trend will result in a more obvious demand deceleration. On the other hand, a clear fiscal consolidation with effective savings measures might be missing in the short term to support monetary policy in fight against inflation.

On liquidity, given the current account surplus on high tourism season right now and slower but continuing capital inflows and de-dollarization of residents, the CBRT keeps accumulating reserves and ends up with excess TL liquidity. O/N TL rates have again declined below 50% and the CBRT has started to open TL depo auctions to sterilize the excess TL liquidity. Last Friday, they also reduced the monthly credit growth cap to 1.5% (from 2%) in foreign currency lending. After today's decision, it is said that the CBRT might also hold FC and gold swap auctions to sterilize TL liquidity. Therefore, we understand they will carefully monitor TL deposit rates and act accordingly.

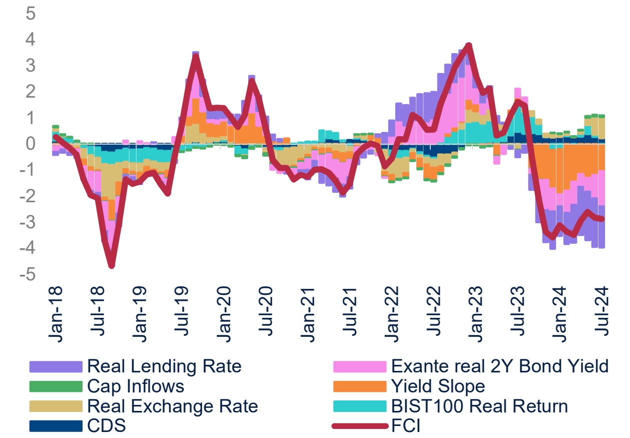
All in all, there will be some one-off effects on July inflation, which would also weigh on August reading. Under the assumption of a clearer rebalancing in the economy in 2H24, a steady depreciation of the currency and 38% natural gas hike in August, we forecast inflation trend to keep improving after July's temporary effects and finish the year with 43% annual inflation. Since unanchored medium term inflation expectations maintain upside risk on inflation outlook, we keep an upward bias on our short term policy rate expectations which include limited rate cuts in 4Q24.

Chart 1. **Garanti BBVA Monthly GDP Nowcast** (3-month average QoQ)



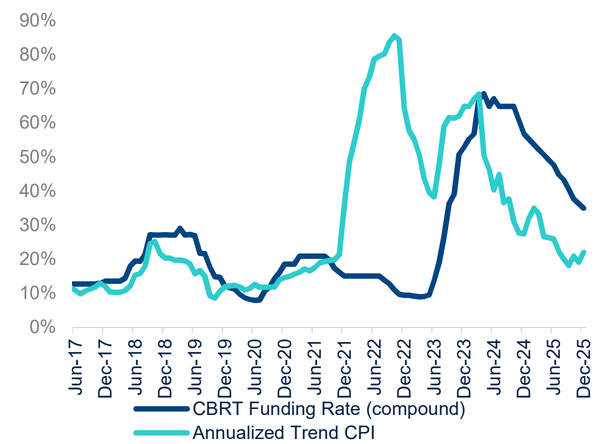
Source: Garanti BBVA Research, TURKSTAT

Chart 2. **Garanti BBVA Financial Conditions Index** (standardized, + easing, - tightening)



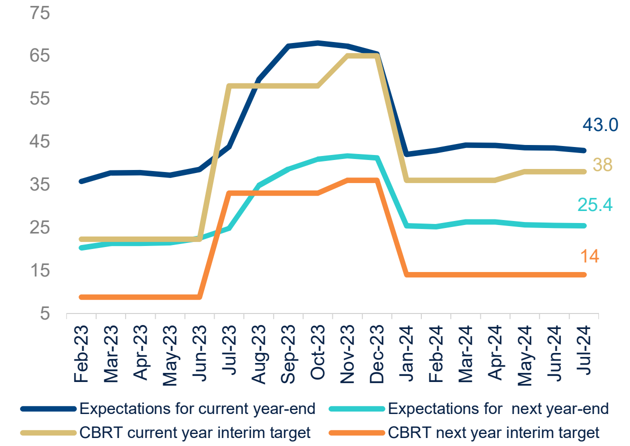
Source: CBRT, Garanti BBVA Research

Chart 3. **Garanti BBVA CBRT Funding Rate & CPI Forecasts** (%)



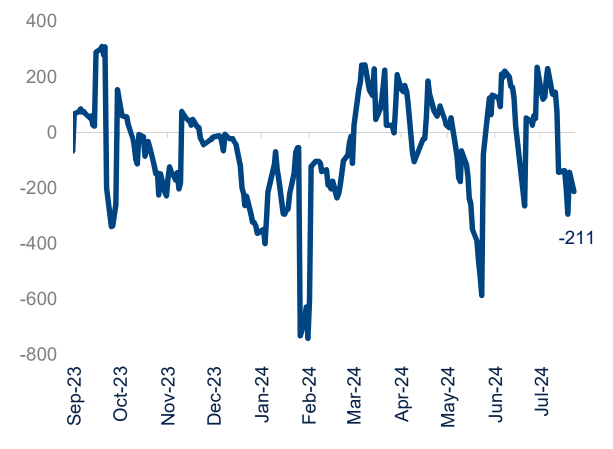
Source: Garanti BBVA Research, CBRT, TURKSTAT

Chart 4. **CBRT Market Participants Survey Inflation Expectations** (%)



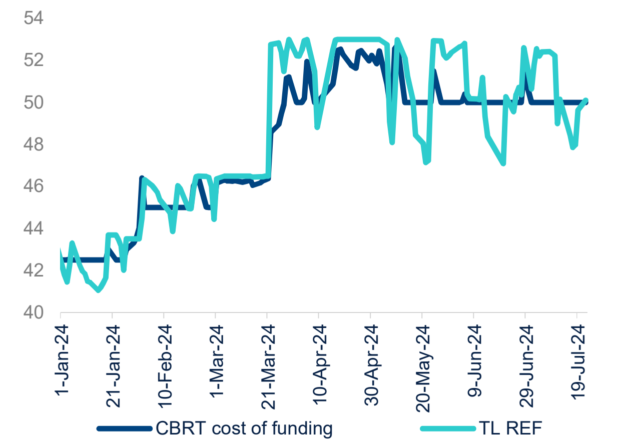
Source: Garanti BBVA Research, CBRT

Chart 5. **CBRT Net Funding** (TL bn)



Source: Garanti BBVA Research, CBRT

Chart 6. **CBRT Cost of Funding & BIST TL REF** (%)



Source: Garanti BBVA Research, CBRT, TURKSTAT

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ENQUIRIES TO:
Garanti BANKASI A.Ş. Nispetiye Mah. Aytar Cad. No:2 34340 Levent Beşiktaş İstanbul.
Tel.: +90 212 318 18 18 (ext 1064)
bbvaresearch@bbva.com www.bbvaresearch.com