BBVA Research

Creating Opportunities

Economic Watch

Türkiye | The CBRT stresses importance of expectations

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. On inflation, they now assess domestic demand as slowing down and reducing its inflationary impact, which they previously evaluated as inflationary. They highlight the high level and stickiness of services inflation and emphasize that the alignment of inflation expectations and pricing behavior with projections has gained relative importance for the disinflation process. They seem encouraged by the decline in goods inflation as expected via monetary tightening. Yet, they repeat inflationary risks from services inflation, inflation expectations, and geopolitics but this time eliminate risks from food inflation. Overall, 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 monthly inflation trend to remain closer to 3% in August and then decline to 1.5-2% in 4Q24 and finish the year annually at about the upper bound of the CBRT forecast range of 42%. We now evaluate risks on our limited policy rate cut expectations in 4Q24 become neutral, given the increasing likelihood of looser external financial conditions in the near term and the most recent faster than expected adjustment in economic activity. In this respect, the new Medium Term Program (MTP), to be released in early September, has become even more important to understand the political will on the pace of adjustment in the economy.

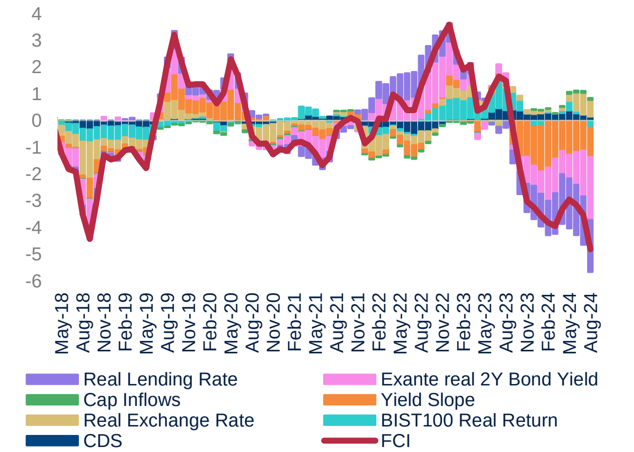
We nowcast monthly inflation to be high again at around 2.5% in August (3% if seasonal adjusted) due to the lagged effects of the adjustments in administered prices in July and the natural gas price hike in August. According to our calculations, 3-month seasonally adjusted inflation trend will decline limitedly below 3%. In this respect, the CBRT seems encouraged by the decline in goods inflation but stays cautious due to the risks from services inflation, inflation expectations, and geopolitical developments. In this regard, they highlight the high level and stickiness of services inflation and emphasize the alignment of inflation expectations and pricing behavior with projections. Following the high July inflation, 2024 and 2025 year-end inflation expectations of professional forecasters inched slightly upward to 43.31% and 25.55% in August (vs. 42.95% and 25.40%, previously) and remained well above the upper bound of the CBRT targeted inflation range (42% and 21%, respectively). Besides, 12-month ahead inflation expectations of corporates and households stood at 55% and 72%, respectively, in July. In the 3rd inflation report of the year released on August 8, the CBRT Governor also pointed that the real appreciation and the adjustment in aggregate demand are in line with their expectations so far but inflation expectations remain sticky. A study in the inflation report claims that annual inflation realizations have crucial impact on the formation of inflation expectations among different economic agents. Therefore, the CBRT believes that the faster decline in annual inflation realizations in 2H24 on base effects will eventually result in an improvement in inflation expectations.

On economic activity, we assess the bridge day effects affected economic activity much worse than we had expected and our monthly GDP indicators nowcast a quarterly contraction of 0.5-1% in 2Q. Consequently, we observe a stronger deceleration in aggregate demand in late 2Q and expect a deeper correction in 3Q, led by tighter financial conditions. The output gap will turn into negative in 3Q and reduce inflationary pressure going forward, as also highlighted by the CBRT.

On liquidity, given the high tourism season right now and the attempts of a stable lira, the CBRT faces with excess TL liquidity from time to time. O/N TL rates have again declined below 50% in the last few days and we understand the CBRT carefully monitors TL deposit rates and acts accordingly. They already started withdrawing TL liquidity from Takasbank's (Turkey's Settlement and Custody Bank) money market at the overnight borrowing rate (47%). In today's decision, the CBRT again repeated their commitment to effectively implement sterilization tools.

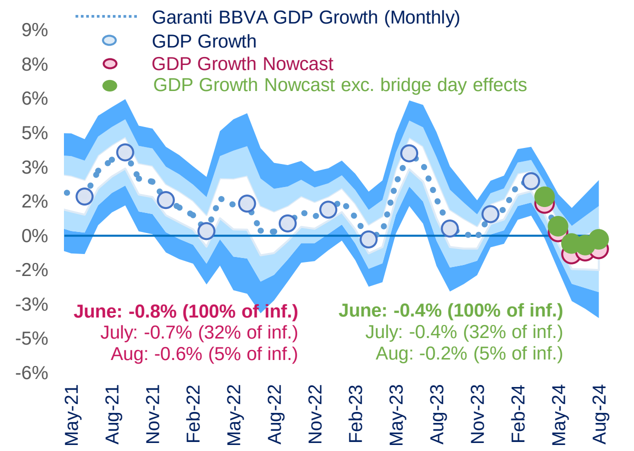
Overall, lagged effects of the monetary tightening have started to be clearly seen in 3Q and financial conditions have become much tighter. We forecast inflation trend to keep improving to 1.5-2% in 4Q and finish the year annually at about the upper bound of the CBRT forecast range of 42%, where the range becomes the reference for the CBRT rather than the point target. We now evaluate risks on our limited policy rate cut expectations in 4Q24 become neutral, given the increasing likelihood of looser external financial conditions and the most recent faster than expected adjustment in economic activity. We will closely watch the MTP to understand the political will on the pace of adjustment in the economy.

Chart 1. **Garanti BBVA Financial Conditions Index** (standardized, + easing, - tightening)



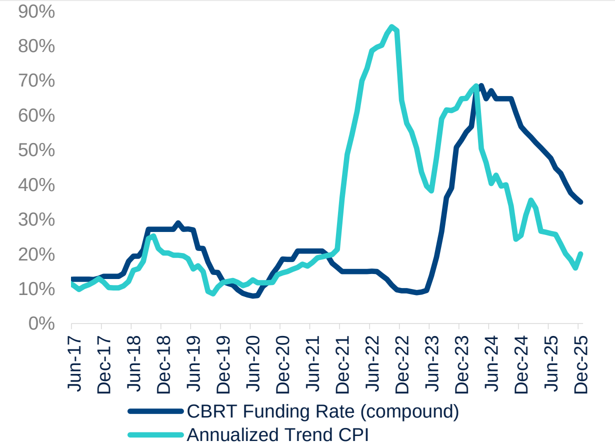
Source: CBRT, Bloomberg and Garanti BBVA Research

Chart 2. **Garanti BBVA Monthly GDP Nowcast** (3-month average QoQ)



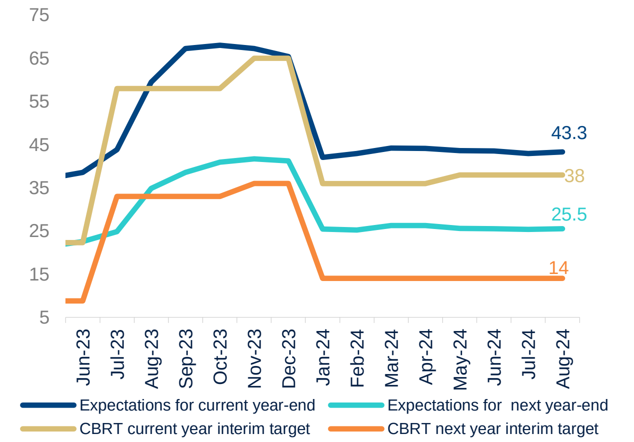
Source: CBRT, Garanti BBVA Research

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



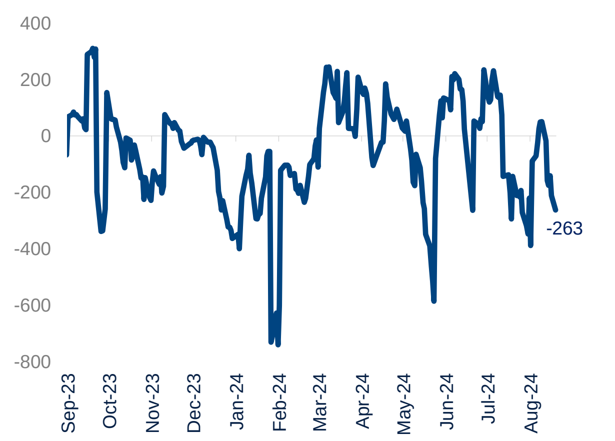
Source: Garanti BBVA Research, CBRT, TURKSTAT

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



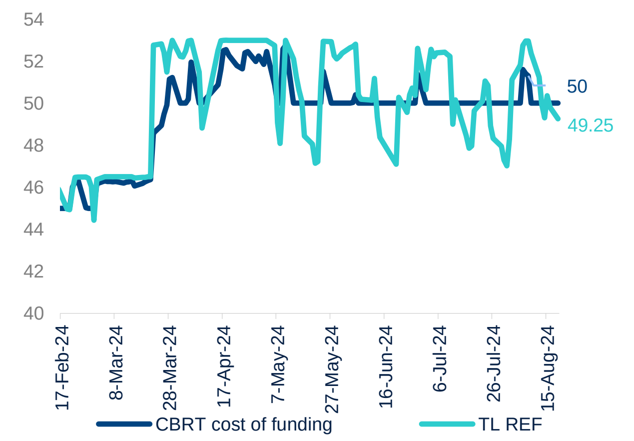
Source: Garanti BBVA Research, CBRT

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