Further Tightening from the CBRT

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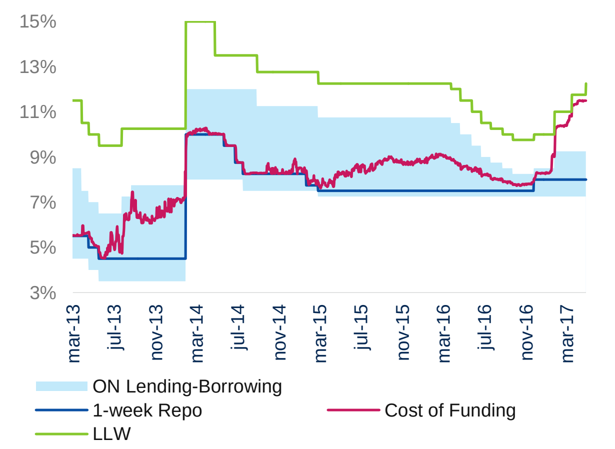
In line with our expectations, the Central Bank (CBRT) increased late liquidity window (LLW) rate to 12.25% from 11.75% and kept the rest of the interest rates unchanged. Market consensus was the CBRT to hold the entire set of rates constant. Our rate increase expectation was based on our inflation forecast where we expect to breach 12% in April and stay close to 12% in May. Considering the short term inflation outlook and no meeting scheduled until June, the CBRT made the right decision, in our view, to contain the potential market reaction and inflationary pressures to feed up the pricing behavior.

The CBRT acknowledges continuing inflationary pressures

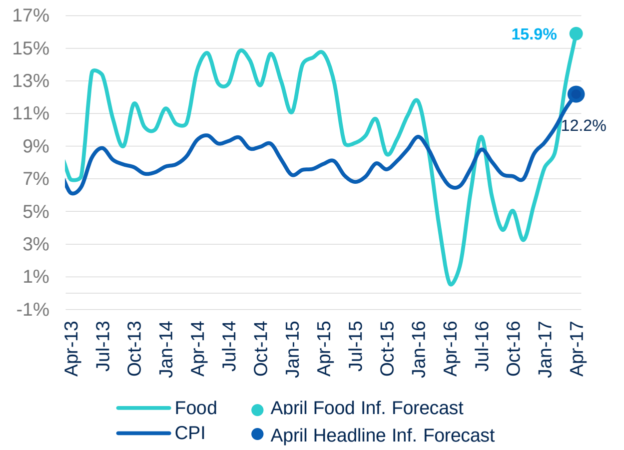
With today's decision, current funding composition of the CBRT may bring the average funding rate to 12% and the de-facto marginal funding rate in the TL money market up to 12.25% with an interest rate corridor widened to 500bps. Bearing in mind the Bank's recent policy to provide a slightly positive real interest rate, the decision acknowledges a higher path for inflation in the short-term, parallel to our expectations. We forecast inflation to keep increasing until a temporary relief in June-July period. Thus, the CBRT is likely to allocate almost entire funding from the LLW in the following weeks. Meanwhile, the Bank stated that domestic demand has been recovering gradually. This is not surprising for us. On one hand, despite the sizable monetary tightening of the CBRT, the interest rates on loans stay almost stable and credit growth continues to surge thanks to the Treasury's credit guarantee fund program. On the other hand, the intensified fiscal stimulus continues to support the overall economic activity.

Figure 1 Interest Rate Corridor (%)



Source: Garanti Research & Bloomberg

Figure 2 CPI and Food Inflation (%, annual change)



Source: Garanti Research & Turkstat

Looking Ahead

The CBRT opted to gain room with a 50bps tightening on the LLW rate in the face of further inflationary pressures. As we expect inflation to breach 12% in April and remain close to 12% in May we think the decision is the right one. After a temporary relief in June-July, inflation will remain at double digits until the last quarter in the absence of a significant currency appreciation. Hence, we expect the Bank to keep liquidity conditions tight by increasing its average funding rate further towards 12% in the short term before the next inflation release on May the 3rd.

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