The CBRT Keeps the Hawkish Tone

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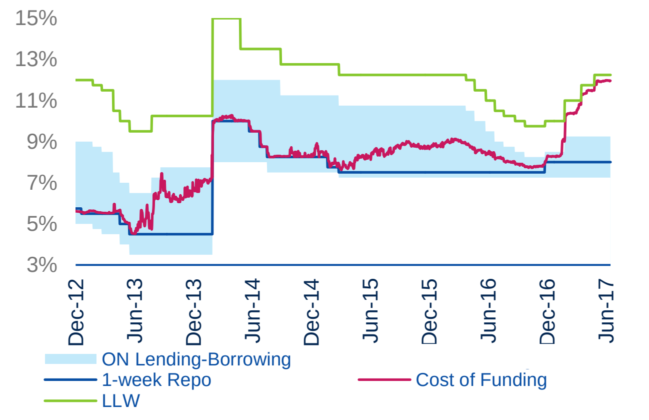
In line with our and market expectations, the Central Bank (CBRT) kept the entire set of its interest rate corridor unchanged. The Bank also preserved the hawkish tone in its cominique by over looking the expected disinflationary impacts of the fall in energy prices and partial correction in food prices. We expect a limited correction in headline inflation in June before a more significant one in July. Based on the hawkish message from the CBRT and our inflation forecasts, we expect the Bank to keep the average funding rate close to 12% until the next monetary policy meeting in July. Beyond that, the CBRT will likely keep the monetary policy tight and wait for a significant improvement in the inflation outlook before starting to ease.

Strengthening economic activity supports the tight monetary policy

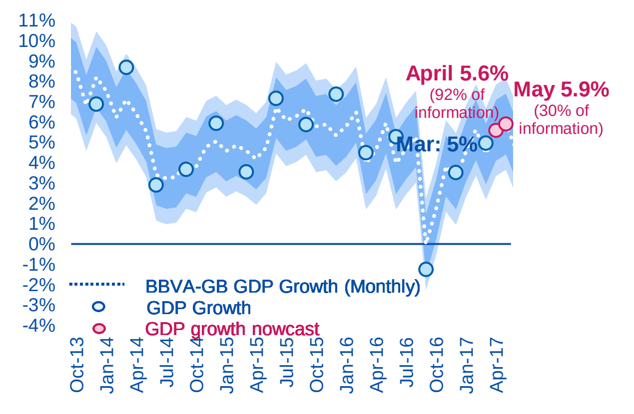
We agree with the CBRT's view that the economic activity is strengthening. Indeed, our monthly GDP indicator's nowcast suggests the growth to increase towards 6% YoY in 2Q from 5% in 1Q, mainly on the rapid credit expansion thanks to the Credit Guarantee Fund. The statistical base effects will allow even a stronger 3Q growth. Thus, the strength in economic activity will let the Central Bank preserve its tight stance during the summer and regain credibility. Meanwhile, the rapid expansion in credit growth and higher Treasury borrowing due to increased fiscal spending coupled with a tight monetary policy should bring some additional upward pressure on deposit and loan interest rates in the following months. In this respect, we think the Government may choose to scale down its fiscal stimulus as the economic activity proved to be more solid than expected. This would help ease the pressure on both the market interest rates and inflation.

Figure 1 Interest Rate Corridor (%)



Source: Garanti Research & Bloomberg

Figure 2 Garanti-BBVA Research Monthly GDP (3MA YoY)*



Source: *BBVA-Garanti monthly GDP is dynamic factor model (DFM) synthesizing high-frequency indicators to proxy monthly growth of GDP. Source: BBVA-Garanti Monthly GDP Model, Turkstat *Our indicator is also available on Bloomberg with the ticker GBTRGDPY Index

Looking Ahead

Today's hawkish cominique suggests that CBRT is likely to keep liquidity conditions tight during the summer. Further strengthening in economic activity after the strong 1Q results will allow for it. A potential scale down in Government spending during this period may be helpful in easing the upward pressure on market interest rates. We expect the Central Bank to find some room for monetary easing in 4Q, where we expect the inflaiton to fall towards 9%.

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