POLICY PULSE

Ongoing easing despite the worsened financial conditions

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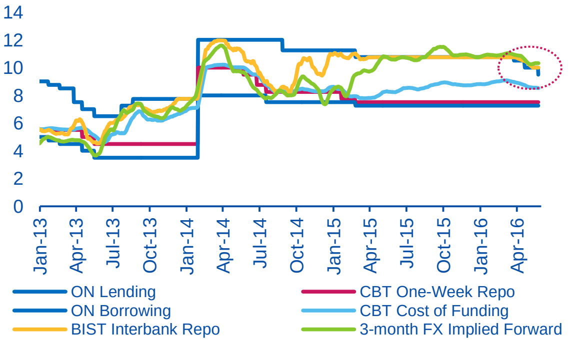
In today's Monetary Policy Committee (MPC) meeting, the Central Bank of Turkey (CBT) reduced the upper bound of its interest rate corridor (marginal funding rate) 50bps further to 9.5%, and kept the lower bound of the interest rate corridor and the one-week repo rate constant at 7.25% and 7.50%, respectively. Despite the recent increase in global volatility, the CBT decided that "narrowing down the interest rate corridor and easing the monetary policy help the resilience of the economy against shocks". Thus, CBT considers its action as a step towards simplification for the third month in a row. Despite this, the CBT avoided a more aggressive movement as suggested for some policy advisors.

Unprocessed food prices will support the CBT maneuver

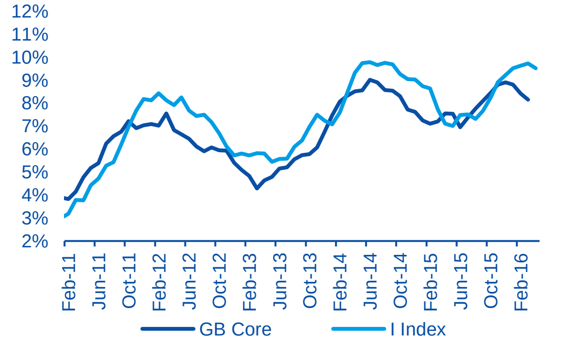
Despite the recent Emerging Markets volatility, triggered by the data and speeches by FOMC members on the US economy, and the rising uncertainties on domestic politics, the CBT decided to reduce again the upper bound of the corridor of the monetary policy. Supporting this, exceptionally favorable unprocessed food prices will still continue to subdue the inflation in May (we expect a below 7% inflation in May) which leads the ex-post real interest rate on the CBT's average funding rate over 1%. We were waiting for a "wait and see" attitude given the EM volatility and political uncertainty but the CBT real rate is still positive and given that the upper bound rates pass-through to the average funding costs is only partial, the movement is consistent with our gradual loosening of monetary policy estimates for the coming months. Fortunately, the CBT keeps a cautious stance as its average funding rate fell by only 40bps since the start of its simplification steps in March against a total of 125bps decline in the marginal funding rate. Furthermore, today's decision will not result in a sizable decline in the short term rates. This and the reluctance to implement more aggressive movements as suggested by some policy makers have led the lira to appreciate further after the decision (the movement was initiated after the new Government announcement).

Figure 1
Turkey: Interest Rate Corridor and Market Rates (%)



Source: Garanti Research, Bloomberg, CBT

Figure 2
Turkey: CBT's I Index & Garanti Bank Core Index (yoy,%)



Source: Garanti Research, Bloomberg, CBT

What is next?

The sizable fall in the inflation headline figure since February was mainly due to the extraordinarily low food prices. However, core inflation should maintain still high as the output gap closes and the favorable base effects on energy and food are reversed. We believe that the CBT will continue to manage the monetary policy gradually, therefore narrowing the interest rate corridor by reducing the upper bound .Yet, the decline in the average funding rate will be much more modest as the underlying inflation dynamics continue to call for a prudent stance.

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