The CBRT Strengthens its Credibility

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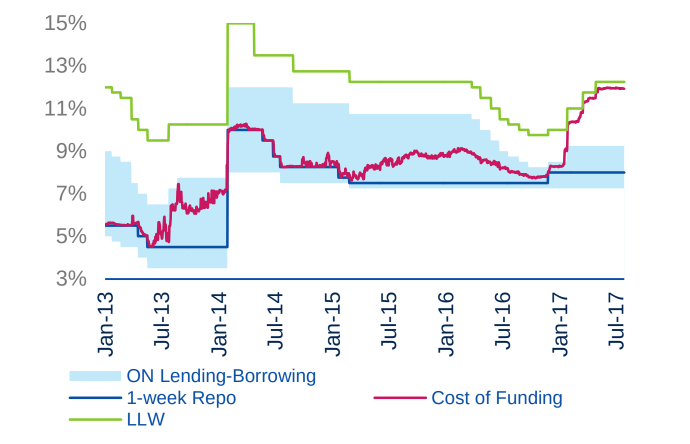
In line with our and market call, the Central Bank (CBRT) kept its interest rate corridor unchanged. The Bank continues to stick to the hawkish tone as it also envisages the disinflationary effects of recent easing in cost push factors and partial correction in food prices will be only temporary, parallel to our expectations. We expect the headline inflation to decline to slightly below 10% in July but then climb back to around 10.5% during August-November period. Bearing in mind the stickiness in inflation and the ongoing high momentum of the economic activity, we expect the Bank not to find enough room for monetary easing until the end of the year when the headline will fall toward 9% thanks to favorable base effects on food and tax hikes of last year.

Economic activity remains solid and core inflation trend needs to be monitored

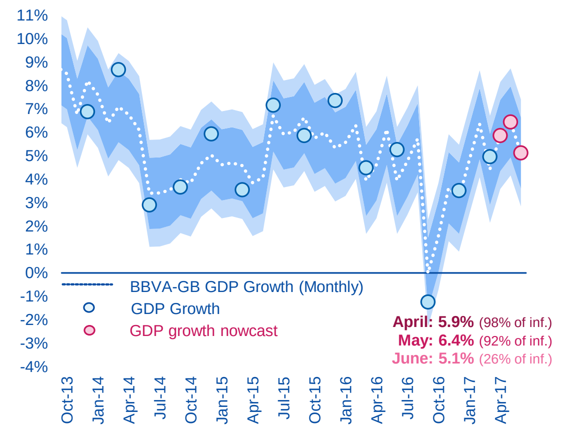
Parallel to our view, the CBRT acknowledges that the economic activity preserves its strength. Our monthly GDP indicator nowcasts a growth rate close to 5% in 2Q, similar to 5% in 1Q, on top of improving domestic demand thanks to the rapid credit growth on Credit Guarantee Fund. Even with zero quarterly growth rates during the rest of the year, the whole year growth rate may result in 5%, thus requiring the Central Bank to preserve its tight stance against the spill-overs of both Government's fiscal stimulus and the likelihood of tighter financial conditions on recent calls of global central banks for normalization. Recent work to upgrade Treasury's borrowing limit signals that either the Government will barely scale down its fiscal stimulus in the short term or revenue generation may lag behind expectations despite the solid economic performance. Additionally, the high level of services inflation on cost-push factors and second round effects should be alarming for the Bank in terms of the core inflation trend in near future.

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

Still hawkish communique of the CBRT implies that the liquidity conditions will remain tight at least until 4Q. The high momentum in economic activity and the likelihood of continuous fiscal expansion at least in the short term will require a tight monetary policy stance. We expect the Central Bank to find some room for monetary easing but only marginally (at least 1pp positive real interest rate) in 4Q, where we expect the inflation to fall towards 9%.

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