

# Macronote

## MPC Decision:

Not bit of a surprise as the CBRT treads carefully...

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**Monetary Policy Committee (the Committee) kept the short term interest rates constant at the following levels as widely expected.**

- Overnight Interest Rates: Marginal Funding Rate at 9.25% and borrowing rate at 7.25%,
- One-week repo rate at 8.00%,
- Late Liquidity Window Interest Rates (between 4:00 p.m. – 5:00 p.m.): Borrowing rate at 0%, and lending rate at 12.25%.

Important takeaways

- Recently released data indicate that the recovery in the economic activity has gained pace.
- Although recent improvements in cost factors and expected partial correction in food prices will contribute to disinflation, current elevated levels of inflation pose risks on the pricing behavior. Accordingly, the Committee decided to maintain the tight stance of monetary policy.

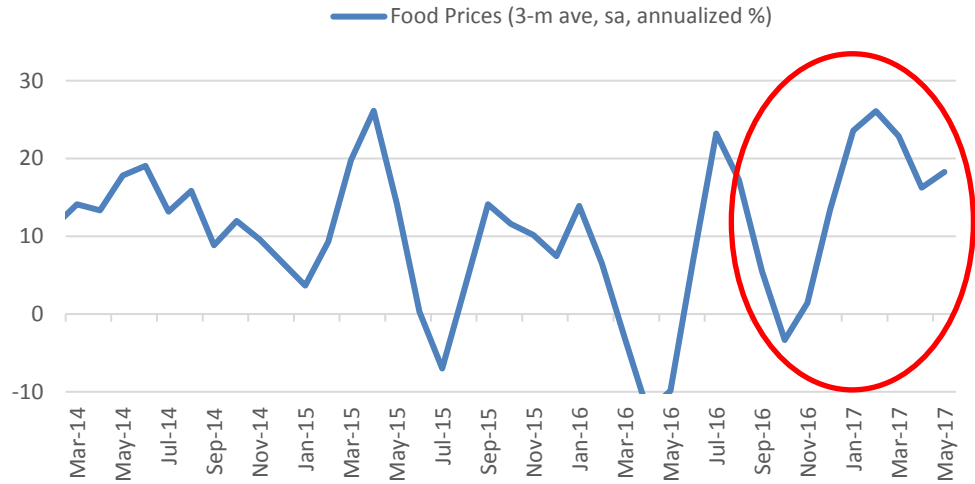
CBRT did not rush to ease policy despite improving core inflation momentum, given currently high level of inflation threatening pricing behaviour.

Given faster than expected growth, CBRT will seem to be threading carefully, as we believe the Bank aims to win market's approval/credibility and hope to influence long term interest rates lower while keeping liquidity tight to the banking system.

**Monetary Policy Going Forward?**

- Given that the core inflation outlook is the one CBRT takes more into account in monetary policy decisions as stated repeatedly, and acted upon in the past by the CBRT, there could have been ample room for easing.
- However, deterioration in inflation expectations led by high annual food inflation limits the bank's easing of monetary policy as we expected. Deterioration in the pricing behavior since mid-2013 is a real thing, which reversed the significant improvement hitherto, threatening official's effort to reining in interest rates. CBRT has a tough job ahead reining in inflation while not disturbing growth momentum.
- In the short-term, food inflation is the main pressure point (see chart

- **below**) on inflation as core momentum has weakened significantly.
- Unseasonably cold weather throughout the spring and higher tourism arrivals could will continue to pressure food prices. The very low base in food prices for the rest of the year is another factor that will keep annual food inflation higher.
- **However, the respite due to global backdrop has been providing a tailwind to the Bank.** Given the flattening of global bond yields, downward pressure on the USD and significant easing by inflationary EM economies, the TL may overperform the rest of the EM if the CBRT eases monetary policy more cautiously (evidence so far is in this direction). **Still high inflation expectations&improving growth outlook could lead the Bank stay on the cautious side, despite the positive trajectory of core inflation. So far, average cost of funding stood firmly near 12% (late liquidity window rate) despite weaker USD and UST yields.**
- **Given a high food/core inflation base for next year, and improving CA Dynamics, inflation could behave positively (more than currently priced) leading to front-loaded rate cuts by the CBRT towards 4Q17.**



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