

Economic Watch

Türkiye | CBRT kept policy rate at %50

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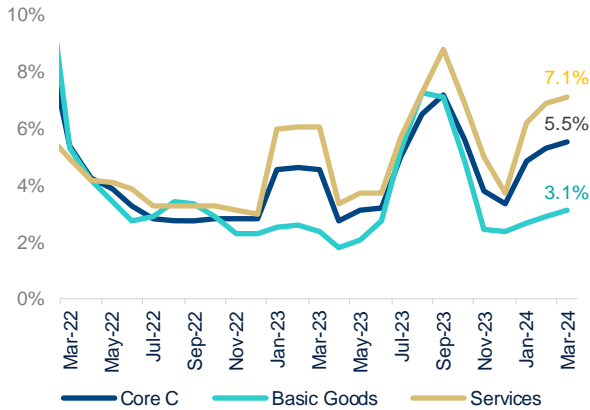
The Central Bank (CBRT) kept the policy rate on hold, in line with ours and market expectations. They stated the inertia in high service prices, inflation expectations, food prices and geopolitical risks keep the pressures on the inflation alive. The CBRT rationalized the decision by emphasizing the recent significant tightening in financial conditions and the lagged impact of the monetary policy. Nevertheless, they will maintain cautious stance based on the upside risks on inflation. Also, the CBRT increased the upper limit of the remuneration to TL required reserves in order to accelerate the conversion from FC protected to standard TL deposits, while enhancing the financial stability to reduce the average cost of deposit. Despite the surprising rate hike in March, year-end inflation expectations in April remained unchanged. We expect the CBRT to maintain tight monetary stance for longer, on top of the likelihood of additional demand restrictive measures, while easing current regulations in the coming period to support the monetary policy transmission mechanism. We assess that the downward risk on our inflation (45%) and growth forecasts (3.5%) for 2024 has increased.

High service prices, the deterioration in basic goods prices due to the currency depreciation and still solid demand led inflation to remain high in March (Chart-1). Despite the CBRT's positive surprise rate hike in March, market participants' inflation expectations for the end of 2024 and 2025 remained unchanged with 44.2% and 26.3%, respectively, well above the CBRT's targets of 36% and 14% (Chart-2/3). Based on our forecasts, the cumulative inflation in the first 4 months could reach 19%. Hence, the faster adjustment in inflation trend (3 month moving average), currently hovering around 3.5%, should be carefully observed in order to assess the possibility of hitting the CBRT target of 36% by year end. Another negative factor is the recent surge in oil prices stemming from the increase in the geopolitical tensions between Iran and Israel. To sum up, the risks on the inflation outlook are still alive in the short run. Therefore, we deduce from the CBRT's signal that the bank would maintain its cautious stance.

The Central Bank emphasized that the financial conditions have become significantly tighter recently. The latest rate hike and the rise in required reserve ratio for FX deposits put upward pressure on TL deposit rates in all maturities. In particular, the 3-month deposit interest reached 66%. This caused lending rates to surge on the upside notably (Chart-4). We calculate that financial conditions (Chart-5) remained tight in April with higher lending rates, but the rise in real return in the stock market and the real currency appreciation were supportive factors to prevent further tightening. We envisage that the financial conditions will remain tight in the coming period to support the expected rebalancing in the economy. Our big data (Chart-6) indicates that consumption has lost momentum on both the goods and services in April, but it is early to call faster normalization considering the negative calendar effect due to the long holiday. The CBRT also revised required reserves in such a way that the maximum remuneration on the required reserves to FC protected TL deposits interest rate could be 60% of the policy rate while the remuneration to standard TL deposits could reach up to 80% of the policy rate. Hence, the Bank aims to accelerate the conversion from FX protected TL deposits to standard TL deposits. We observed that the dollarization tendency has stopped in April and we believe de-dollarization may accelerate in the coming months. Lastly, the securities maintenance ratio applied to the liabilities is reduced from 4% to 1%, led 5- and 10-year government bond yields adjusted on the upside. The increase in yields and other policy measures to fight against inflation may support investors' appetite.

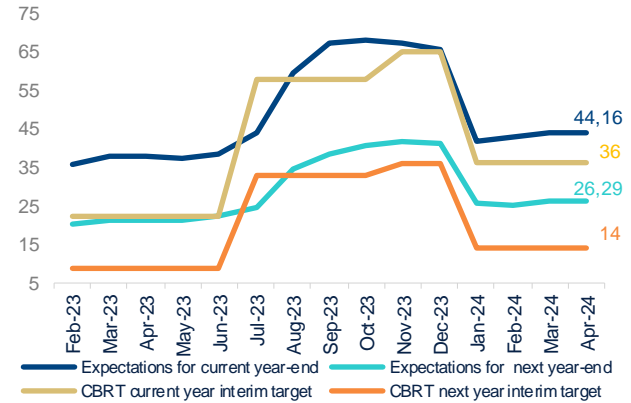
We expect that the Central Bank will remain tight for longer based on the upside risks on the inflation outlook. Also, we expect fiscal policy excluding earthquake expenditures to be tight. We could not rule out possible new macroprudential measures, especially on the credit cards, to balance domestic demand faster. We expect annual inflation, after peaking in May, to fall in the 2H2024 on the assumption of the expected normalization in the economy, real currency appreciation, gradual utility price hikes and no additional minimum wage increase. However, downside risk on our year inflation forecast of %45 has increased. If the year-end inflation could retreat below the upper band of the central bank's target (42%), the CBRT could start easing cycle very gradually in the 4Q24.

Chart 1. Trend CPI Indicators (SA MoM, 3M avg)



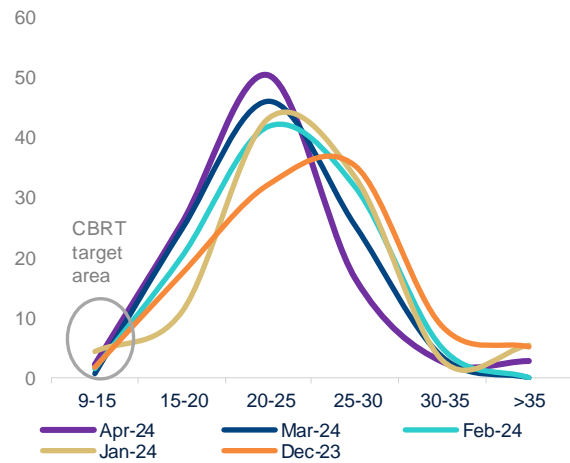
Source: Garanti BBVA Research, TURKSTAT

Chart 2. CBRT Market Participants Survey Inflation Expectations (%)



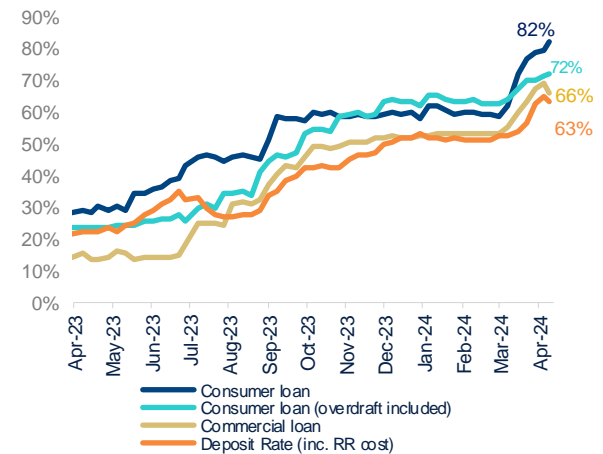
Source: Garanti BBVA Research, TURKSTAT

Chart 3. CBRT Market Participants Survey Inflation Expectations (24M ahead, probability distribution)



Source: Garanti BBVA Research, CBRT

Chart 4. Loans & TL Deposit Rates(%, flow, sector)



Source: Garanti BBVA Research, CBRT

Chart 5. Garanti BBVA Financial Conditions Index (standardized, + easing, - tightening)



Source: Garanti BBVA Research, TURKSTAT

Chart 6. Garanti BBVA Big Data Consumption Indicators (28-day sum, real, YoY)



Source: Garanti BBVA Research, TURKSTAT

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