Economic Watch

Türkiye | Positively surprising hike from the CBRT

Seda Guler Mert, Adem Ileri
21 March 2024

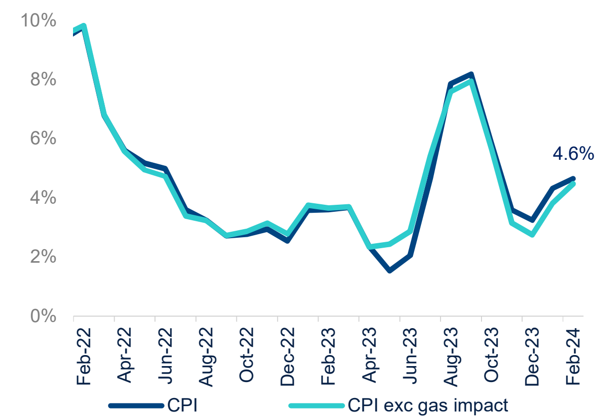
The Central Bank (CBRT) surprised the markets and hiked the policy rate by 500 bps to 50%. They also widened the interest rate corridor and set the overnight borrowing and lending rates 300 bps below and above the policy rate, respectively. The CBRT became clearer in their commitment against inflation and explained the reason to hike the policy rate as a response to the worsening in inflation outlook. Also, they promised to tighten the stance further in the case that a significant and persistent deterioration in inflation is foreseen. Widening the corridor is also a good signal to show the markets that they want to enhance the room they can adjust even on a daily basis if needed. In addition to the increasing challenges on inflation, the recent volatility in the exchange market and inadequate macro-prudential measures implemented to reduce such pressure forced the CBRT to strengthen the monetary transmission mechanism via its main tool even ahead of the local election, which finally supports to gain credibility. We expect the CBRT to maintain 50% policy rate for some time and if needed adjust the rate in the revised corridor. Today's positive surprise might result in a downside risk on our near term inflation and growth forecasts. We will assess post-election foreign currency flows and inflation trend, and revise our projections, accordingly.

On inflation, led by services inflation, the underlying trend became much higher than the level the CBRT expected. Looking ahead, the CBRT acknowledges that the sticky services inflation, inflation expectations, geopolitical risks, and food prices keep inflation pressures alive. Additionally, the resilience of domestic demand and the slow adjustment in import demand remain a concern for the CBRT. In this respect, we believe that the CBRT enhanced the commitment against inflation and promised to tighten the stance further if needed. They will also continue to support monetary transmission mechanism in case of unanticipated developments in credit growth and deposit rates.

First, in our previous reports, we were stressing the most recent acceleration in domestic demand, particularly private consumption. Second, inflation trend has started to worsen since the beginning of the year (from around 3% in Dec23 to 4.5-5% in Mar24 according to our early forecast), confirming the need for tighter financial conditions. Third, according to the March market participants' survey of the CBRT, inflation expectations for 2024 end and 2025 end rose to 44% and 26%, remaining far above the CBRT interim targets of 36% and 14%. Also, increasing FC demand of the residents in the last couple of weeks resulted in a huge depletion of the CBRT reserves. At this point, there has been the need for higher TL deposit interest rates across the board. However, the latest credit growth restrictions and forceful deposit rules have started to keep downside pressure on deposit rates. This is why an increase in the policy rate will help to have a broad-based increase in TL deposit rates. In the meantime, given the size of the FC flows, those challenging macro-prudential measures on the banking sector can be changed to further squeeze consumer lending but help commercial lending in order not to allow any financial stability problem. Last but not the least, foreign investors have been dissatisfied, again being faced by indirect measures to stabilize the most recent FC pressure. Moreover, external financial conditions will be more challenging, given lower rate cut expectations from global central banks. Therefore, foreigners wanted to see a clearer stance from the CBRT and today's surprising move will prove to support credibility with a very positive signaling effect even ahead of the election. This is also positive for additional potential upgrades in the credit rating, which can reinforce capital inflows.

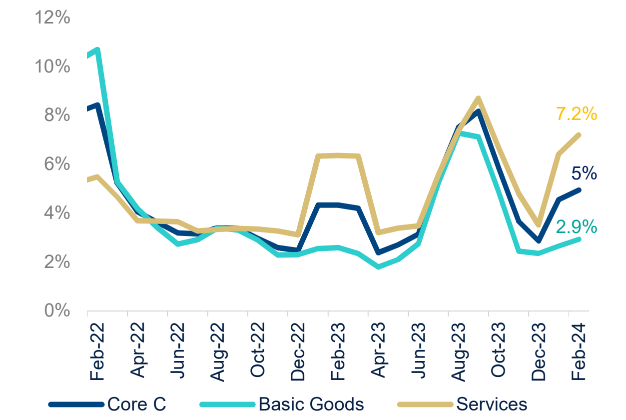
We expect the CBRT to maintain 50% policy rate for some time and, if needed, adjust the rate in the revised corridor. We also envisage additional demand restrictive policies, including a tighter fiscal stance except for the needed earthquake spending. These might generate downside risk on our near term inflation (45% by year end) and growth (3.5% for 2024) forecasts. If inflation trend can improve to a level that the year-end inflation falls below 42% -upper bound of the current CBRT forecast range-, a limited room might be opened to start cutting the rate in 4Q24. We will assess post-election foreign currency flows and inflation trend, and revise our projections, accordingly.

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



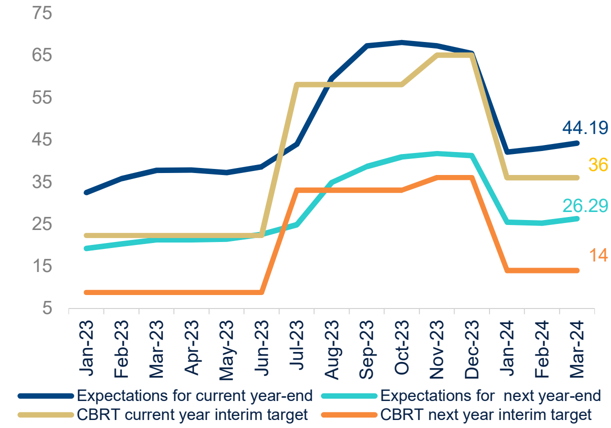
Source: Garanti BBVA Research, TURKSTAT

Chart 2. **Trend CPI Indicators (SA MoM, 3M avg)**



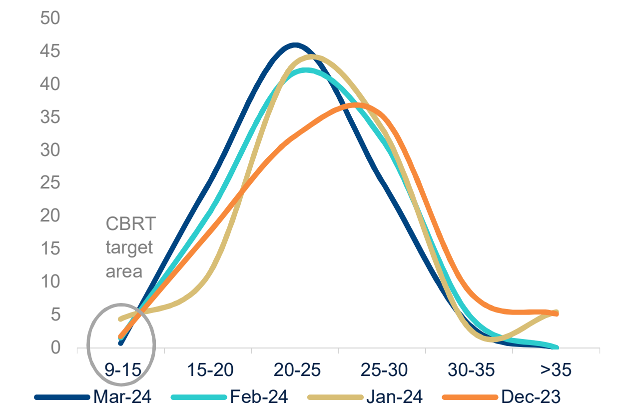
Source: Garanti BBVA Research, TURKSTAT

Chart 3. **CBRT Market Participants Survey Inflation Expectations (%)**



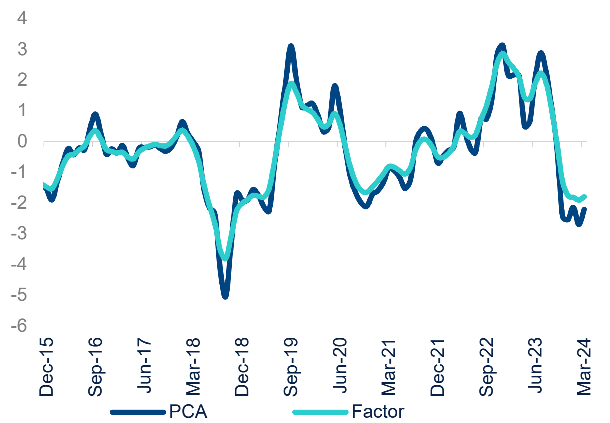
Source: Garanti BBVA Research, CBRT

Chart 4. **CBRT Market Participants Survey Inflation Expectations (24M ahead, probability distribution)**



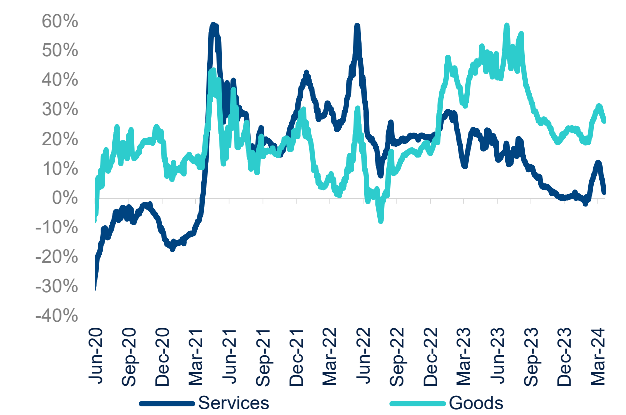
Source: Garanti BBVA Research, CBRT

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

DISCLAIMER

This document has been prepared by BBVA Research Department. It is provided for information purposes only and expresses data, opinions or estimations regarding the date of issue of the report, prepared by BBVA or obtained from or based on sources we consider to be reliable, and have not been independently verified by BBVA. Therefore, BBVA offers no warranty, either express or implicit, regarding its accuracy, integrity or correctness.

Any estimations this document may contain have been undertaken according to generally accepted methodologies and should be considered as forecasts or projections. Results obtained in the past, either positive or negative, are no guarantee of future performance.

This document and its contents are subject to changes without prior notice depending on variables such as the economic context or market fluctuations. BBVA is not responsible for updating these contents or for giving notice of such changes.

BBVA accepts no liability for any loss, direct or indirect, that may result from the use of this document or its contents.

This document and its contents do not constitute an offer, invitation or solicitation to purchase, divest or enter into any interest in financial assets or instruments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

With regard to investment in financial assets related to economic variables this document may cover, readers should be aware that under no circumstances should they base their investment decisions on the information contained in this document. Those persons or entities offering investment products to these potential investors are legally required to provide the information needed for them to take an appropriate investment decision.

The content of this document is protected by intellectual property laws. Reproduction, transformation, distribution, public communication, making available, extraction, reuse, forwarding or use of any nature by any means or process is prohibited, except in cases where it is legally permitted or expressly authorised by BBVA.