

Economic Watch

# Türkiye | CBRT stays hold & tightens via other measures

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The Central Bank (CBRT) maintained the policy rate (50%) and the range between borrowing and lending rates (600 bps) as expected. They remain cautious about the risks on inflation outlook. On financial stability concerns, they aim to sterilize excess TL liquidity stemming from the most recent domestic and foreign demand for TL financial assets. In this respect, the CBRT raised the TL required reserve ratios, requiring much higher levels for KKM deposits. They aim to disincentivize KKM deposits and facilitate conditions to speed up an exit. Last not but the least, they imposed a monthly cap of 2% on FC credits, similar to TL commercial lending, in order to support financial stability, reduce excess TL liquidity and prevent any opportunity apart from the companies' commercial activity. Overall, the CBRT targets to eliminate the most recent downside pressure on TL deposit rates because of the decline in ON TL rates on top of excess TL liquidity in the market. This will add new pressure on TL lending rates and since FC lending growth is also capped, commercial activity will likely be put under further pressure. Since aggregate demand is still stronger than supply, we will follow how the mix of these policies will affect the inflation outlook. We maintain our view that inflation is likely to get closer to the upper bound of the CBRT forecasted range (42%) and this will provide a limited room to start easing with very gradual steps in 4Q24. Yet, lagging fiscal measures and macro-prudential policies on retailer spending availability might delay the easing cycle to later.

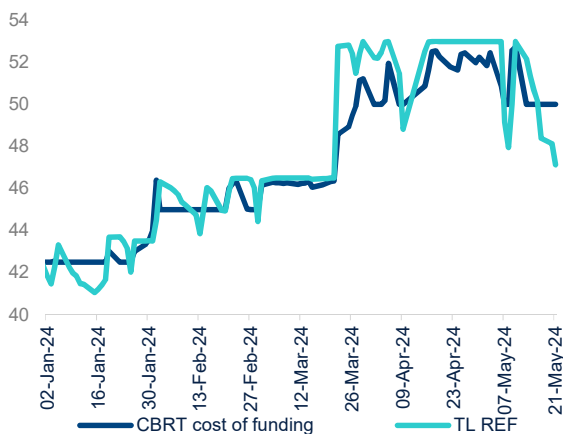
In the details of the measures on deposits, the CBRT kept the TL conversion target but reduced the maintenance ratio (roll-over + TL conversion) to 75% from 95% in FC based KKM deposits. They disregarded the commercial KKM accounts and YUVAM deposits (non-residents' FC based KKM) from the so-called maintenance rule. They decreased the maximum remuneration rate to 20% from the previous 30% for KKM accounts. All in all, the CBRT aims to disincentivize KKM deposits and facilitate conditions to speed up an exit. After the local election, there has been a significant de-dollarization trend among residents, which is also reflected to the KKM conversion rates to TL standard deposits (above 20% vs. 10-15% at most previously). Yet, since almost all of the existing KKM is the original FC savers, the CBRT would be planning to strengthen its reserves as fast as possible in order to exit from the scheme fast as well, given the more favorable TL outlook in the very short term. Therefore, it seems the CBRT will stick to heavy FC reserves purchases during high tourism season and substantial capital inflows of the foreign investors (\$55bn accumulation of reserves since election vs. \$35bn decline of swaps with local banks). This is why they prefer to absorb excess TL liquidity via a more concrete way, increasing TL required reserve ratios across-the-board. We calculate a sterilization of around TL 500bn, which will help eliminate the most recent downside pressure on TL deposit rates because of the decline in ON TL rates towards the CBRT borrowing rate (47%, Chart 1). With this, they will also attain more or less a stable lira, where they might be targeting to support tourism and exports activity.

Secondly, the CBRT imposed a monthly cap of 2% on FC credits, similar to TL commercial lending, in order to support financial stability, reduce excess TL liquidity and prevent any opportunity apart from the companies' commercial activity. Most recently, there has been a significant acceleration in FC lending since companies lack access to TL funding due to credit growth limitations and also much higher interest rates. Also, some of them have been benefiting from the advantage that they borrow in FC and invest in TL deposits with more attractive interest rates. Consequently, this resulted in a further TL liquidity in the market and the CBRT aims to regulate this, which we elaborate as sensible. Nonetheless, this will add new pressure on TL lending rates and since FC lending growth is also capped from now onwards, commercial activity will likely be put under further pressure as well. We nowcast aggregate demand remains stronger than supply and retailers' spending availability on top of wealth effects and card spending maintains a resistance against a clearer deceleration in consumption. According to our Financial Conditions Index (Chart 2), there has also been some ease, most recently, given the stronger real appreciation and stock exchange gains. Accordingly, we observe a convergence back to early April levels in card spending in real terms (Chart 3). Therefore, it will be key to suppress consumption before squeezing commercial activity further since inflation expectations stay highly

diverged to the upside (professional forecasters' 40-50%, corporates' 50-60% and households' 80-120% for year-end).

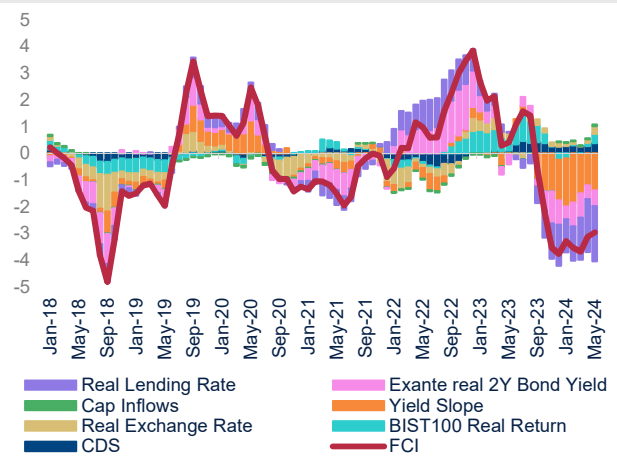
We know that the complementary side policies imply a higher level than the current average cost of funding, which serves for additional tightening. According to our new study, we calculate an implied policy rate (Chart 4), driven by the market dynamics, as high as 5pp<sup>1</sup>. Credit growth caps since early March are also important in the final reflection, which can be around 2pp at minimum. Therefore, the monetary stance is already much tighter but the monetary transmission has not been effective enough to decelerate domestic demand more clearly. We understand one of the main obstacles to strengthen the transmission mechanism is the KKM accounts and differentiated TL deposit rates in the market. We will follow how the speeding up process to exit from the scheme with today's additional measures will be helpful on the inflation outlook.

Chart 1. **CBRT Cost of Funding & ON TL REF**



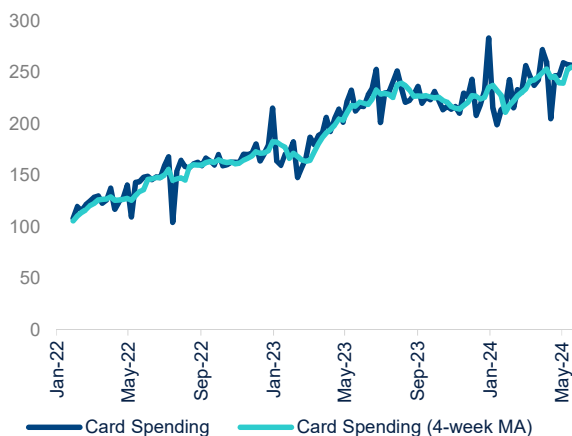
Source: Garanti BBVA Research, CBRT

Chart 2. **Garanti BBVA Financial Conditions Index (standardized, + easing, - tightening)**



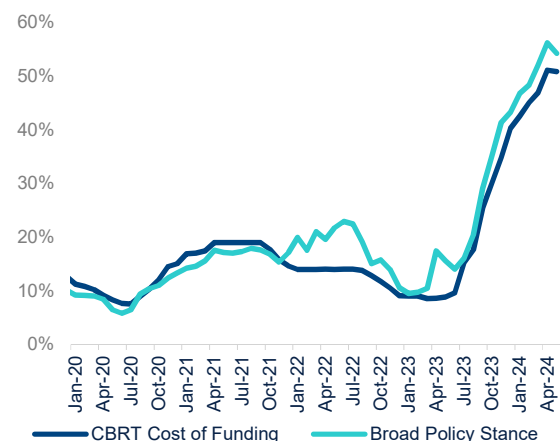
Source: Garanti BBVA Research, TURKSTAT, CBRT, Bloomberg

Chart 3. **Card Spending (real, Jan22=100)**



Source: Garanti BBVA Research, CBRT

Chart 4. **CBRT Broad Policy Stance (w/o credit growth caps, driven by market dynamics)**

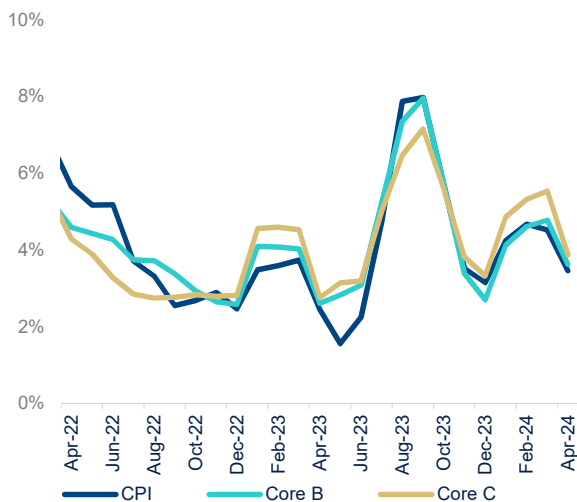


Source: Garanti BBVA Research, CBRT

<sup>1</sup> We use average TL deposit rate, 1-month currency swap rate, 3-month and 2-year government TL bond yields, real money supply (M2), interbank TL overnight lending rate, commercial and consumer loans spreads and yield slope. We use principal component and partial least squares methods. The principal component is mapped to the average cost of funding for the period between 2011-2019 on a weekly frequency. In partial least squares method, a model is fitted between the funding cost and other explanatory variables. In both methods, based on the obtained coefficients, a broad policy stance starting from 2020 are estimated where the results obviously show a clear divergence from the CBRT policy rate especially starting from the end of 3Q21.

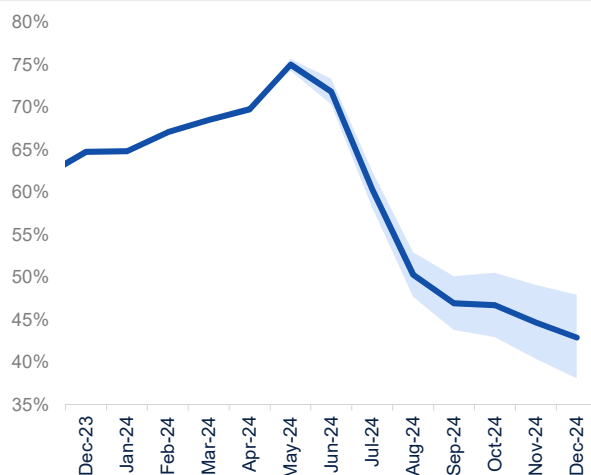
Overall, we believe other complementary macro-prudential measures aiming to suppress consumption by reducing the availability of spending via cards and to squeeze wealth effects become essential in order not to lose time to anchor inflation expectations. Besides, keeping financial conditions tight for longer will be needed to start a sustained path to unwind current regulations (firstly credit growth caps, later deposit rules) in order to strengthen the monetary transmission mechanism. We maintain our view that inflation (Chart 7) is likely to get closer to the upper bound of the CBRT forecasted range (42%) and this will provide a limited room to start easing with very gradual steps in 4Q24. Yet, lagged effects of most recently announced fiscal measures and lacking macro-prudential policies on retailer spending availability might delay the easing cycle to later.

Chart 5. **Trend CPI Indicators (SA MoM, 3M avg)**



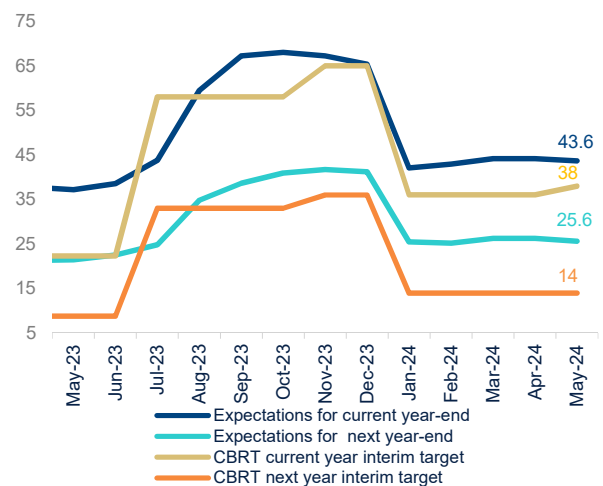
Source: Garanti BBVA Research, CBRT

Chart 7. **Garanti BBVA CPI Simulation (YoY, 70% confidence band)**



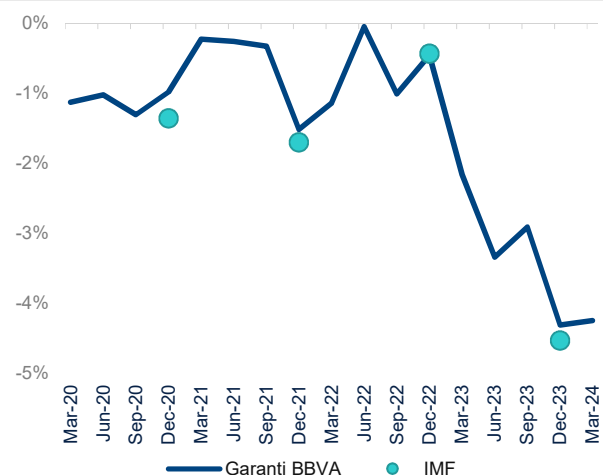
Source: Garanti BBVA Research, TurkStat

Chart 6. **CBRT Market Participants Survey Inflation Expectations (%)**



Source: Garanti BBVA Research, CBRT

Chart 8. **Fiscal Impulse Indicator (cyclically adj primary balance / potential GDP, annualized sum)**



Source: Garanti BBVA Research, Treasury and Finance Ministry, IMF

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