Economic Watch

Türkiye | The CBRT remains cautious but eases its tone

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The Central Bank (CBRT) kept the policy rate at 50% in line with the expectations. The bank eased its tone by changing the statement that monetary policy will be tightened when necessary to that monetary policy tools will be used effectively. Still, they emphasize inflation expectations and pricing behavior as risks to the disinflation. Restrictive monetary policy and the tight financial conditions lead output gap to turn into negative in 3Q24 and domestic demand to moderate further, especially driven by private consumption. We expect the monthly inflation trend down to slightly below 2% in the last quarter of the year, bringing annual inflation to 43% by end 2024, which could create room for the CBRT to consider to start a gradual easing cycle. However, high inflation expectations and uncertainties stemming from wage and price adjustments at the beginning of 2025 require a cautious stance. Therefore, we have shifted our first rate cut expectation from November to December with a 250 bps cut, while anticipating credit growth caps especially on consumer loans to continue for a while.

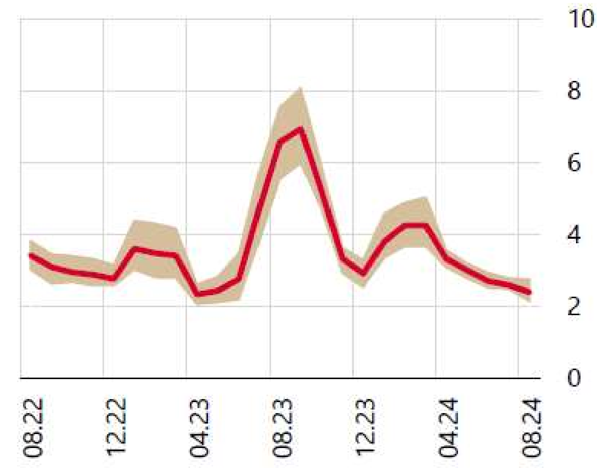
There are four important changes as reference points in the MPC decision, in our view. First, the CBRT does not highlight services prices as a risk factor and underline their expectations for an improvement in services inflation in the last quarter of the year. Second, the CBRT seems to have started to observe lagged effects of the monetary tightening, most likely referring to the negative output gap as of 3Q24, and stresses a further moderation in domestic demand with a diminishing inflationary impact. Third, they eliminate geopolitical factors from risks on inflation, which they could have implied the upcoming US elections and its potential impact on the commodity prices. Surprisingly, they did not put any emphasis on potentially more favorable external financing conditions after the surprising 50 bps rate cut decision of the Federal Reserve on Wednesday, which confirms the CBRT's prudence in the near future. Lastly, may be most importantly, the CBRT has started to ease its tone by eliminating "the likelihood of any additional tightening if needed". Instead, they changed their statement with using monetary policy tools effectively in case a significant and persistent deterioration in inflation is foreseen. Therefore, we understand the CBRT now feels more comfortable about the potential risks on inflation and begins to change its communication for a gradual easing cycle. There are two KPIs for the CBRT to reach that point, one is a significant and sustained decline in the underlying trend of monthly inflation and the other is a convergence of inflation expectations to the projected forecast range, but not to the point targets.

We nowcast monthly consumer inflation to decelerate to nearly 2% in September (also closer to 2% if seasonal adjusted) after the temporary rises in July and August. Yet, according to our calculations, 3-month seasonally adjusted inflation trend might remain almost the same, at slightly below 3%. We expect the monthly inflation trend go down to slightly below 2% in the last quarter of the year, bringing its annual level to 43% by end 2024. The CBRT is calculating six different trend indicators and communicating via those of already closer to 2% in their monthly price developments (Figure 1). On expectations, 2024 and 2025 year-end inflation expectations of professional forecasters inched only slightly downward to 43.14% and 25.26% in September (vs. 43.31% and 25.55%, previously) and remained well above the upper bound of the CBRT targeted inflation range (42% and 21%, respectively). Besides, 12-month ahead inflation expectations of corporates and households in August, stood at 53.8% and 73.1%, respectively, with a deterioration in the later in the last two months (Figure 2). In this regard, we will closely watch how the CBRT will revise its forecast range after the new Medium Term Program (MTP) in its next inflation report to be released on the 8th of November. We expect the CBRT to update the end-2025 point inflation target to closer to the 17.5% stated in the MTP and the new inflation forecast range to be updated to 10-25%. Thereafter the CBRT can also revise its communication, via the changes in the ranges.

On liquidity, given the most recent FC purchases of the CBRT after the global sell-off in August, the CBRT is again faced with excess TL liquidity and O/N TL rates have declined below 50% in the last few days. In today's decision, the CBRT again repeated their commitment to effectively implement sterilization tools. In this respect, we expect the CBRT to carefully monitor TL deposit rates and act accordingly. The maintenance of deposit rules for longer will be key to well manage any dollarization tendency of the residents.

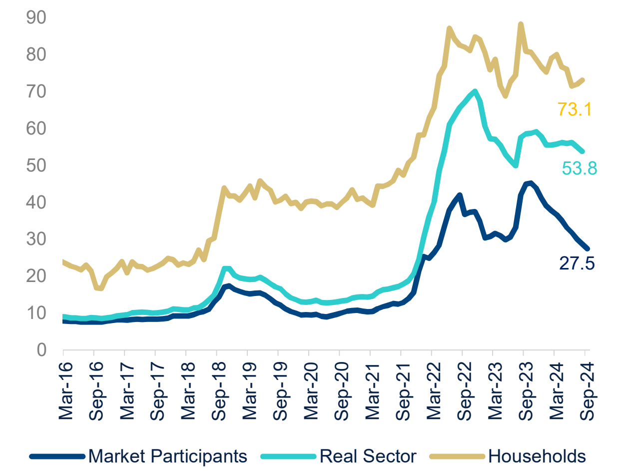
Overall, lagged effects of the monetary tightening have started to be clearly seen in 3Q24 and financial conditions remain tight (Figure 3). The MTP has confirmed the political will aiming at a gradual soft landing of the economy. MTP targets also imply that a significant fiscal consolidation is projected for 2025 (0% primary balance vs. 2% of GDP in 2024). Under a smooth transition assumption, the expected tight fiscal stance 2025 onwards would be accompanied by some easing in monetary stance, given the expected improvement in monthly inflation trend towards the end of the year (Figure 4). However, high inflation expectations and uncertainties stemming from wage and price adjustments at the beginning of 2025 require a cautious stance. Therefore, we have shifted our first rate cut expectation from November to December, with a 250 bps cut, while anticipating credit growth caps especially on consumer loans to continue for a while.

Chart 1. **CBRT Underlying Monthly Inflation Trend** (sa, m/m, 3m average)



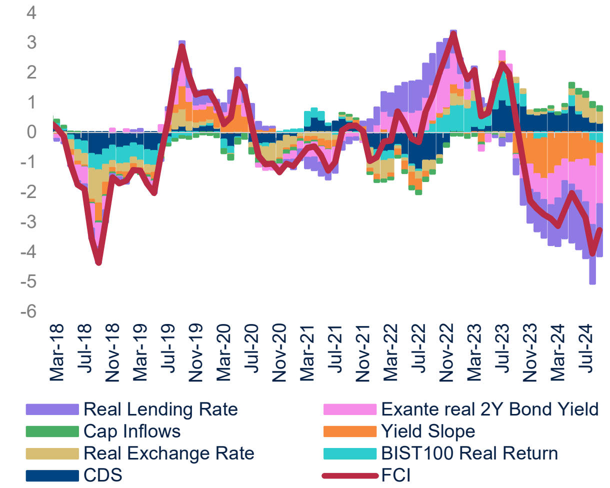
Source: CBRT

Chart 2. **Sectorial Inflation Expectations** (one year-ahead, %)



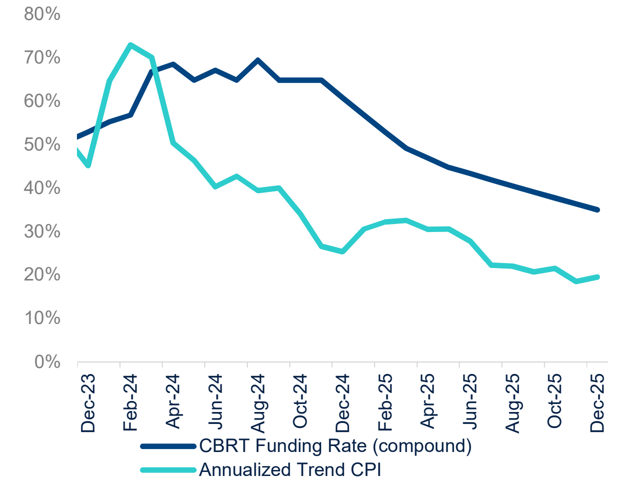
Source: CBRT, Garanti BBVA Research

Chart 3. **Garanti BBVA Financial Conditions Index** (standardized, + easing, - tightening)



Source: CBRT, Bloomberg and Garanti BBVA Research

Chart 4. **Garanti BBVA CBRT Funding Rate & CPI Forecasts** (%)



Source: CBRT and Garanti BBVA Research

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