Economic Watch

# Türkiye | Bolder start to the easing cycle

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**The Central Bank (CBRT) lowered the policy rate by 250bps to 47.5%, beating the market expectations of 150-200bps cut (vs. our 100bps cut call), but with a narrowed down symmetric interest rate corridor of 150bps from 300bps. In the monetary policy framework of 2025, the CBRT reduced the number of meetings in 2025 to 8 from 12 and already signaled that they can start easing with a bolder move since they now gain room to have a scheduled wait & see time. Nevertheless, in today's MPC decision, the CBRT seems to feel more comfortable about the inflation outlook, most likely following the decision on the minimum wage hike of 30%. Yet, there are still uncertainties about the start of the year administrative price hikes and tax adjustments and how the monthly inflation trend will move up in early 2025. In this regard, the CBRT gives the commitment to react prudently on a meeting-by-meeting basis with a focus on the inflation outlook and to use monetary policy tools effectively in case a significant and persistent deterioration in inflation is foreseen. All in all, they started the easing cycle with a higher than expected rate cut and tried to give a balanced and cautious communication with a data-dependent approach. The distribution of the meeting dates (to be released) will be key to see how the real rates will evolve.**

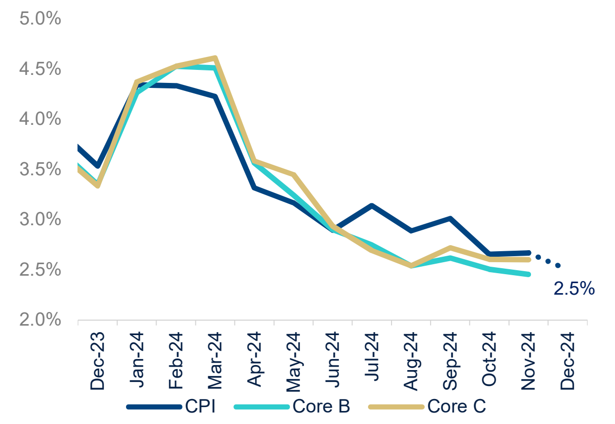
On inflation outlook, the CBRT again evaluates domestic demand conditions at disinflationary levels, most likely referring to negative output gap levels as of 4Q24. The CBRT now feels more comfortable with their assessment on the apparent improvement in services inflation while core goods inflation continuing to be low. Furthermore, they underline a more moderate unprocessed food inflation and inflation expectations tending to improve. As a result, they stress that the underlying trend of inflation will decline in December according to the early indicators. The CBRT again stressed the importance of an increased coordination with the fiscal policy on the disinflation process. The minimum wage hike of 30% could be one reason of being more relaxed on inflation outlook. Also, the Minister of Finance Şimşek had mentioned the will to break the link on some administrative prices with the realized inflation. Therefore, the CBRT might have been given the commitment on price adjustments at the start of the year, which will help contain the uptick in the monthly inflation trend in early 2025. However, it is highly uncertain about how many of those commitments will be applied and how much the pass-thru will be. Also, we still need to monitor how the non-primary fiscal cash spending will evolve in the next months.

Because of the unmanageable excess TL liquidity since September, O/N TL repo rate has been hovering around 49%. In this regard, we will see how much of the excess liquidity will die out and where the ON TL repo rate will converge (in the revised corridor of 46-49% CBRT funding rate). The CBRT also aims to simplify deposit rules and finalize the KKM deposits in 2025. Therefore, it will be essential to provide adequate real returns requiring the policy rate to remain sufficiently above the inflation to contain the dollarization tendency of residents, particularly the households.

As a result, we understand the CBRT was put in a position to prefer a bold start and they explain themselves prudently by giving the message that they will attain a data dependent approach and decide from meeting to meeting. Yet, inflation expectations stay divergent and the CBRT pays particular attention on the companies' inflation expectations as being price setters. In this respect, 2025 year-end inflation expectations of professional forecasters is 27.1%, still remaining above the upper bound of the CBRT targeted inflation range of 26%. Besides, 2025 year-end inflation expectations of corporates and households, stood at 47.6% and 63.1%, respectively, with very marginal improvements so far.

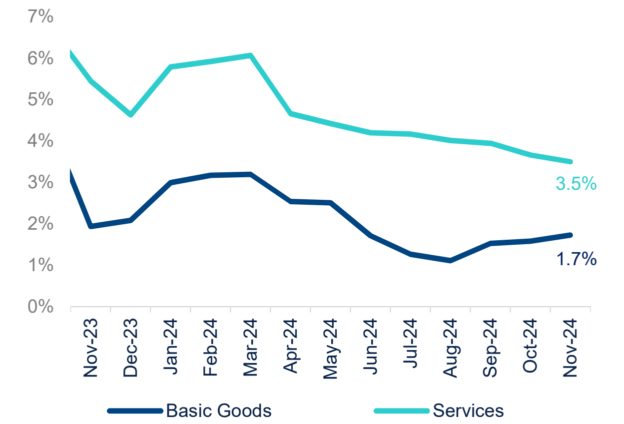
Overall, the CBRT seems to start the easing cycle with increasing comfort from the expected coordination with the fiscal policy. Nevertheless, we stay prudent in our inflation expectations and try to analyze how the monthly inflation trend will move up in the first months of the year. We nowcast 1.6% monthly December inflation, bringing the monthly inflation trend to 2.5%. Domestic demand has slowed down only limitedly so far compared to much weaker aggregate supply and financial conditions albeit tight have started to weaken since summer, keeping inflation expectations high. This is why the start of the year price adjustments could still result in an increase in the underlying inflation trend to 2.5-3% in 1Q25 with only a fall later to 2-2.5% in 2Q25 and 1.5-2% in 2H25, according to our expectations. Therefore, we stay cautious at our funding rate expectation of 31% for 2025 year end and also expect the CBRT to maintain credit growth caps especially on consumer loans as long as needed to support normalization in domestic demand. We will revise the path of our rate projections once we understand the distribution of the scheduled meetings for next year.

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



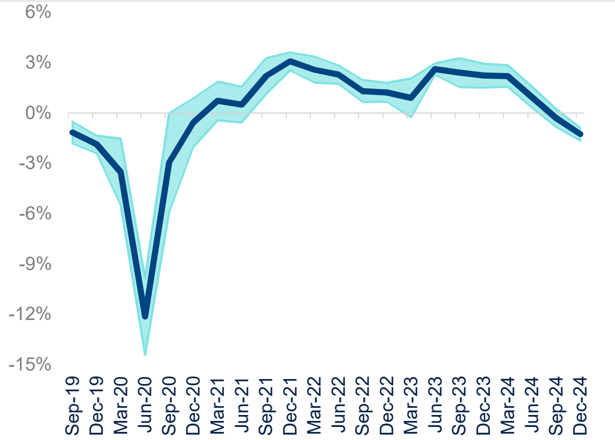

Source: CBRT, TURKSTAT

Chart 2. **CBRT Underlying Monthly Inflation Trend** (sa, m/m, 3m average)



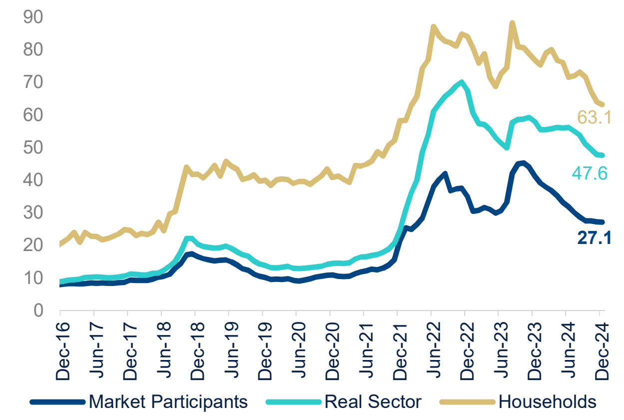

Source: CBRT, TURKSTAT

Chart 3. **Garanti BBVA Output Gap Estimate** (%, deviation from potential GDP)



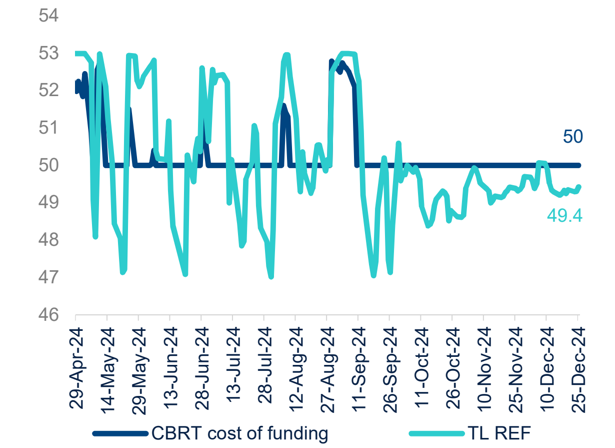

Source: TURKSTAT, CBRT and Garanti BBVA Research

Chart 4. **Sectorial Inflation Expectations** (one year-ahead, %)



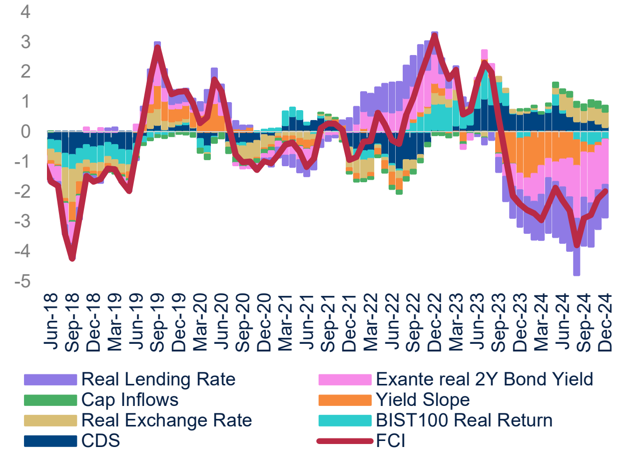

Source: CBRT and Garanti BBVA Research

Chart 5. **CBRT Funding & O/N BIST TL REF Rate** (%)




Source: CBRT and Garanti BBVA Research

Chart 6. **Garanti BBVA Financial Conditions Index** (standardized, + easing, - tightening)




Source: CBRT, Bloomberg and Garanti BBVA Research

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