Economic Watch

Türkiye | No surprises: The easing cycle continues

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6 March 2025

The Central Bank of the Republic of Türkiye (CBRT) lowered the policy rate by 250 basis points in its March meeting, bringing it down to 42.5% in line with expectations. The CBRT justified the decision based on the decline in the underlying inflation trend after January and still supportive level of domestic demand on disinflation despite its stronger than expected pace as of 4Q24. The current strong momentum, the recent acceleration in loan growth and the ease in financial conditions impose upside risks on growth, while high inflation expectations and strong inertia on services inflation continue to pose challenges on inflation. Therefore, the CBRT might be required to maintain strong real appreciation similar to last year and revise credit growth caps and exceptions further in order to reinforce the monetary transmission mechanism, while continuing the easing cycle. The CBRT emphasized that policy rate decisions (not only decisions) will focus on the inflation outlook and be made on a meeting by meeting basis, implying that other macro-prudential measures may be added at any time if needed. We expect the pace of rate cuts to come down June onwards and forecast 31.5% policy rate by year end.

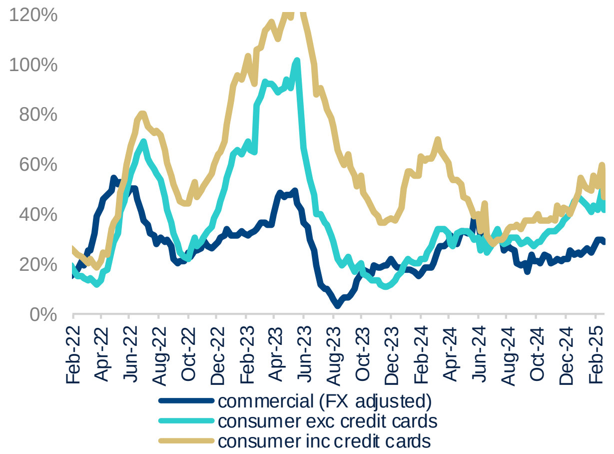
In our latest activity pulse report, we had highlighted the increasing upside risks on the near term growth outlook, led by the acceleration in domestic demand as of 4Q24, particularly private consumption. The recent easing in financial conditions and the momentum in credit growth beyond the monthly credit growth caps appear to have supported demand. Besides, fiscal policy stays expansionary with cash spending similar to last year in early months of the year, signaling lack of fiscal support to disinflation until 2H25. According to our calculations, despite high uncertainty, the output gap likely gets closer to neutral levels in 1Q25. Given strengthening demand, delayed support from fiscal policy and ongoing rate cuts of the CBRT, output gap levels may remain higher than the CBRT's projections. Therefore, while continuing the easing cycle, we believe the CBRT might revise credit caps and exceptions further to control demand-pull inflation risks. Indeed, the CBRT squeezed FC lending further most recently by also narrowing down the scope of its exceptions, aiming to support macro-financial stability with a tight monetary stance. This is why the CBRT might have emphasized that the policy rate decisions (not only decisions) will focus on the inflation outlook and be made on a meeting by meeting basis, implying that other macro-prudential measures may be added at any time if needed.

On inflation outlook, as stated by the CBRT, pricing behavior and inflation expectations remain to be key risks. Despite the positive surprise of February, the details showed the persistently high services inflation (hovering at around 62% if 3 month average annualized), particularly in items where backward-looking pricing behavior is strong, confirming solid inflation inertia. Meanwhile, despite some improvement, inflation expectations stay significantly above the CBRT's interim inflation targets (median of 24% in 2025 with a range of 19% to 29%). Market expectations for 2025 year-end inflation increased to 28.3% (vs. 27.05%, prev.), while 12 and 24 month ahead inflation expectations improved limitedly to 25.3% (vs 25.38% prev.) and 17.26% (vs 17.72% prev.), respectively, in February. The real sector's expectations for 12-month ahead inflation retreated slightly to 41.9% (vs. 43.8% prev.) but the households' expectations for 12-month ahead worsened to 59.2% from 58.8%. As a result, keeping a cautious stance with an attractive enough real rate to maintain a controlled pace of dollarization will be critical amid curbing down inflation expectations.

All in all, the CBRT did not make any surprise and did not give any signals either to start reducing the pace of cuts or any pause soon. Instead, they seemed comfortable on inflation outlook, most likely following the positive surprise of February inflation although they admitted domestic demand proves to be stronger than their expectations. We expect annual CPI to come down to 37-38% in April, which would give room for another 250bps cut in April MPC meeting to be held on 17th of April. The timing and the split of the upcoming administrative price hikes will determine the path, which we assume to materialize partially in April and later in 4Q25. If the hikes are fully postponed later to 2H25, 250bps cut in June will again be likely. If not, we expect the pace of rate cuts to decelerate June onwards (firstly 200bps in June and July and then 150bps in the last 3 meetings) before reaching 31.5% policy rate by end 2025. Under the assumptions of real appreciation, gradual easing with supported macro-prudential policies, 1-1.5pp of GDP non-primary fiscal savings, energy price hikes aligned with the inflation target and no new minimum wage hike in 2H25, we expect consumer inflation to decline to %29 at the end of the year.

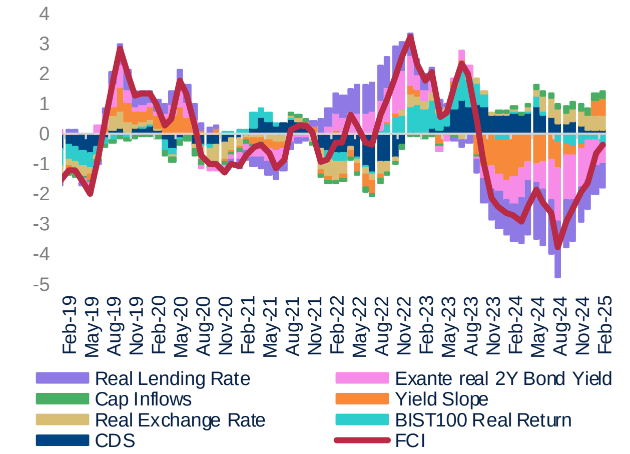
Creating Opportunities

Chart 1. **Credit Growth by Segments** (13week avg, annualized, %)



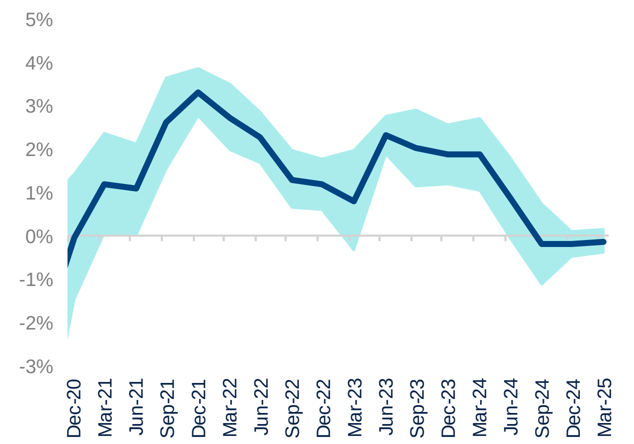
Source: BRSA and Garanti BBVA Research

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



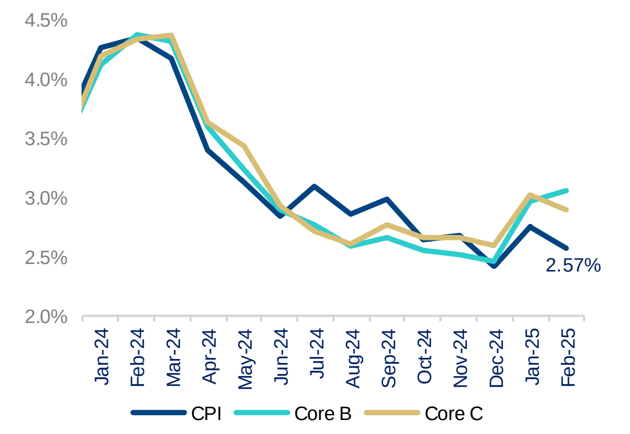
Source: CBRT, Bloomberg and Garanti BBVA Research

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



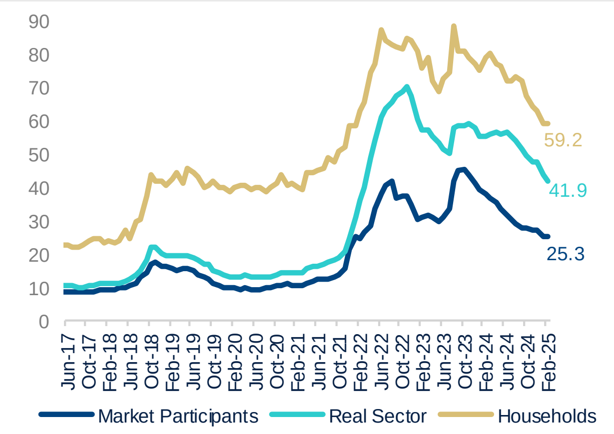
Source: TURKSTAT and Garanti BBVA Research

Chart 4. **Trend CPI Indicators** (sa, m/m, 3m average)



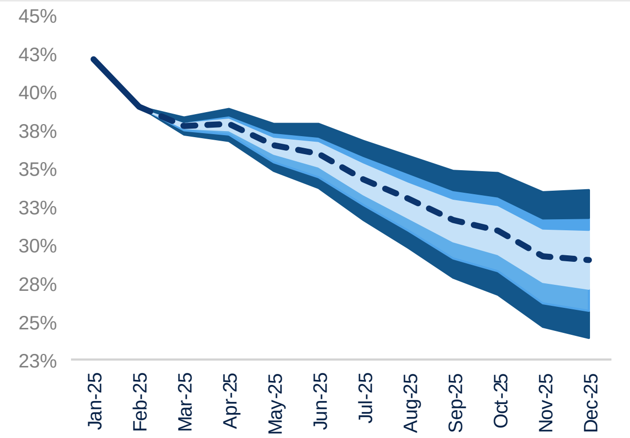
Source: TURKSTAT and Garanti BBVA Research

Chart 5. **Sectorial Inflation Expectations** (one year-ahead, %)



Source: CBRT and Garanti BBVA Research

Chart 6. **Garanti BBVA CPI Forecasts** (YoY, 30%- 50%- 70% Confidence Bands)



Source: TURKSTAT and Garanti BBVA Research

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