Macro note – MPC Rate Decision

CBRT cuts policy rate by 250 basis points to 42.5% in line with expectations. Emphasis placed on goods and services inflation, credit growth rate, and macro-prudential policies.

Abdulkadir DOGAN
Chief Economist
adogan@sekeryatirim.com.tr
(+90) 212 334 33 33/313

The CBRT's Monetary Policy Committee (MPC) cut the policy rate by 250 basis points to 42.5% at this month's meeting, in line with expectations. The rhetoric, which was in line with the MPC text in the January rate decision, also included some additional emphases. Firstly, retrospective indexation was removed from the text, while it was emphasized that services inflation remained calm after the temporary increase in January. Core goods inflation remains relatively low compared to services inflation. The second important point is that although domestic demand was higher than projected in the last quarter, it is at levels consistent with disinflation. The policy text includes a close monitoring of the effects of the monetary policy stance on credit and deposit markets as well as domestic demand. Finally, it was stated that some additional measures have been taken in view of the developments in the credit growth rate and that these measures may be expanded if necessary. In a period when the interest rate cut cycle in monetary policy will continue, we believe that tightening steps will be implemented through complementary macro-prudential tools instead of the main policy instrument (policy rate). Apart from these fundamental changes, the policy text contains similar emphases to the previous text. The importance of fiscal policy coordination is reiterated and the contribution of fiscal discipline to price stability is underlined. It is reemphasized that the policy rate will be adjusted in a way to ensure that inflation realizations, the underlying trend, and expectations support disinflation. Although inflation expectations have improved, they remain a risk factor. In case of a deterioration in the inflation outlook, it was reemphasized that monetary policy tools would be used effectively instead of monetary tightening. Despite the rate cut, it was declared in a general tone throughout the text that the tight stance would be maintained and price stability would not be compromised. Considering the statement that real interest rate developments will be closely monitored, we see that economic activity is supported, albeit implicitly. When the discount cycle started in December, the 12-month-ahead inflation expectation was 27.07%. While inflation expectations fell by only 2 points (25.26%), the policy rate was cut by 7.5 points in total. Hence, we see that economic activity has been supported. As a risk factor, we think that inflation expectations have not been managed effectively, while current inflation levels have declined significantly compared to the previous year. Anchoring the inflation expectations of market participants will increase the effectiveness of monetary policy and ease the Committee's hand.

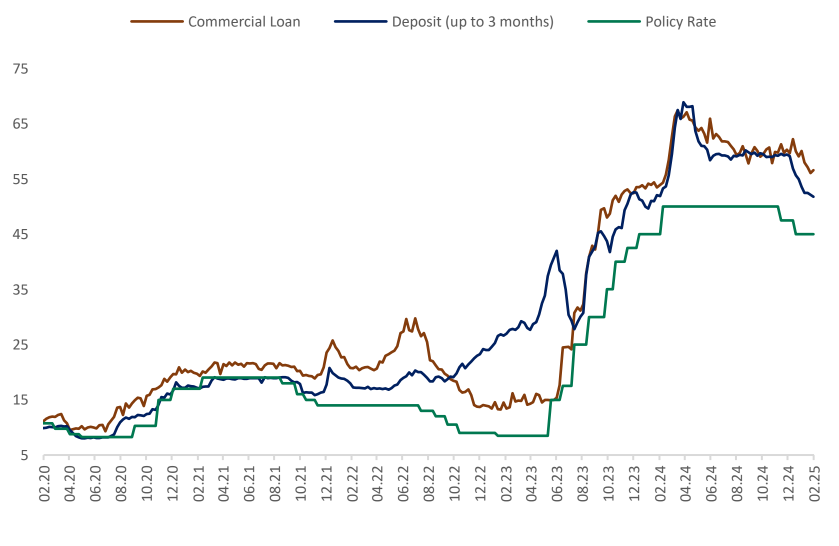
The decision text details the rationale for the tight stance and current developments. Accordingly, “The underlying trend of inflation declined in February following the increase in January. In this period, core goods inflation remained relatively low, while services inflation decelerated after the January-specific increase. Although domestic demand was higher than projected in the fourth quarter, it remained supportive of disinflation. Leading indicators suggest that this supportive outlook continued in the first quarter of the year. The effects of the monetary policy stance on credit and deposit markets and domestic demand are closely monitored. Although inflation expectations and pricing behavior have been improving, they remain a risk factor for the disinflation process.” The high course of services inflation, at 59.78%, reveals the significant difference from headline inflation. We have entered a period in which the fight against inflation in core goods has been effective and disinflation can be achieved with the decline in services inflation.

The section on the rationale for the interest rate decision is summarized as follows. “The decisive stance in monetary policy strengthens the disinflation process through stabilization in domestic demand, real appreciation in the Turkish lira and improvement in inflation expectations. Increased coordination of fiscal policy will also contribute significantly to this process. The tight monetary policy stance will be maintained until inflation falls permanently and price stability is achieved. Accordingly, the policy rate will be set in a way to ensure the tightness required by the envisaged disinflation process, taking into account inflation realizations, underlying trend and expectations. The Committee will determine the steps to be taken regarding the policy rate with an inflation outlook-oriented, prudent and meeting-based approach. In case of a significant and persistent deterioration in inflation, monetary policy tools will be used effectively.” Evaluating inflation realization and expectation together with the underlying trend implies that disinflation will be achieved through more comprehensive and longer-term indicators. The inflation-focused and meeting-based assessment of the policy rate indicates that the monetary policy stance and the level of tightness will be reconsidered based on monthly developments.

The paragraph on macro financial stability was amended as follows. “Considering the recent credit growth developments, additional steps were taken to maintain macro financial stability and support the tight monetary stance. In case of unanticipated developments in credit and deposit markets, the monetary transmission mechanism will be supported by additional macro-prudential steps. Liquidity conditions will continue to be closely monitored and sterilization tools will continue to be used effectively.” Levels of credit growth that are detrimental to financial stability pose a risk to price stability through lagged effects. In this context, some adjustments have been made to support price stability, especially in foreign currency credit growth. The introduction of additional measures for sterilization indicates that complementary tools (such as reserve requirements, liquidity management) will be used effectively in addition to the main tool (policy rate).

In summary, with today's interest rate decision the Central Bank cut the policy rate by 250 basis points to 42.5% in line with expectations. The message was that both inflation and expectations will be closely monitored until, and reviewed at, the April meeting. In addition, it was re-emphasized that meeting-based and inflation-focused decisions would be taken. It was underlined that caution should be exercised regarding interest rate cuts. The rigidity in services inflation seems to be the primary obstacle to the pace of the CBRT's rate cuts. We underline here that improvements in this area may bring interest rate cuts above expectations. The CBRT maintains its resolute stance in the fight against inflation, both by effectively using its main policy tool and by adjusting liquidity through complementary macro-prudential measures. In this context, we expect that gradual rate cuts will continue in 2025 depending on the course of inflation. We stress that the policy rate stance may be revised in case of new supply or demand shocks.

Graph 1: Policy, Loan, and Deposit Rates (%)



***Source:** CBRT, SEKER Invest*

ŞEKER INVEST RESEARCH

Şeker Yatırım Menkul Değerler A.Ş.
Buyukdere Cad. No: 171 Metrocity
A Blok Kat 4-5 34330 SİSLİ /IST
TURKEY

TEL: +90 (212) 334 33 33
Fax: +90 (212) 334 33 34
E-mail: research@sekeryatirim.com
Web: http://www.sekeryatirim.com/english/index.aspx

For additional information, please contact:

Research

Kadir Tezeller	**Head**	**+90 (212) 334 33 81**	ktezeller@sekeryatirim.com
Burak Demirbilek	**Utilities, Defense Industry**	**+90 (212) 334 33 33-128**	bdemirbilek@sekeryatirim.com
Sevgi Onur	**Banks**	**+90 (212) 334 33 33-150**	sonur@sekeryatirim.com
Engin Değirmenci	**Cement**	**+90 (212) 334 33 33-201**	edegirmenci@sekeryatirim.com
A. Can Tuğlu	**Food & Bev., Retail, Auto, Aviation, Oil&Gas**	**+90 (212) 334 33 33-334**	atuglu@sekeryatirim.com
Esra Uzun Özbaskın	**Telcos, Iron & Steel, Cons. Dur.**	**+90 (212) 334 33 33-245**	euzun@sekeryatirim.com
Başak Kamber	**Glass**	**+90 (212) 334 33 33-251**	bkamber@sekeryatirim.com

Economy & Politics

Abdulkadir Doğan	**Chief Economist**	**+90 (212) 334 91 04**	adogan@sekeryatirim.com

Institutional Sales

Batuhan Alpman	**Head**	**+90 (212) 334 33 70**	balpman@sekeryatirim.com
Deniz Keskin	**Trader**	**+90 (212) 334 33 36**	dkeskin@sekeryatirim.com
M.Kerim Culum	**Trader**	**+90 (212) 334 33 33-316**	kculum@sekeryatirim.com.tr

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