Macro: CBRT seems determined and target-oriented, policy rate 50.0%

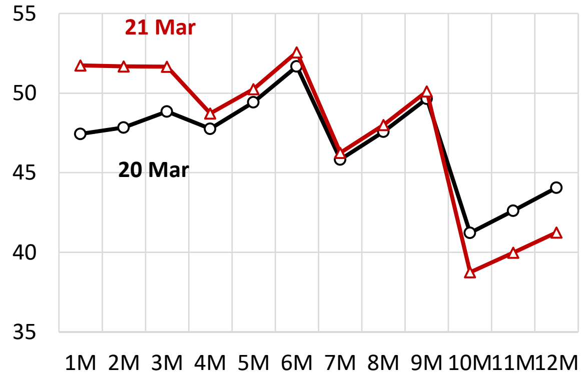
CBRT raised the policy rate by 500 basis points to 50% in March. The market expectation was that the policy rate would remain unchanged, but could increase within three months**.** The highlights and our evaluations are as follows:

- ***The Committee changed the operational framework and widened the interest rate corridor.***
  - The interest rate corridor (the spread that determines the overnight borrowing and lending rates), which was previously -/+ 150 basis points around the policy rate, was widened to -/+ 300 basis points.
  - Thus, CBRT switched to a framework that allows for an additional tightening of 3 percentage points above the policy rate of 50%.
- ***"In February, led by services inflation, the underlying trend of monthly inflation was higher than expected."***
  - In February, monthly inflation (4.5%) realized well above the projection (3.4%) in the Inflation Report. We understand that this figure is also above the CBRT forecasts.
- ***"While imports of consumption goods and gold slowed down and contributed to the improvement in the current account balance, other recent indicators imply that domestic demand remains resilient."***
  - High-frequency indicators point that economic activity gained strength in the first quarter of the year with an annual growth rate of around 5%, largely driven by domestic demand.
  - Our view that domestic demand is stronger than the CBRT's previous projections was confirmed.
- ***"Stickiness in services inflation, inflation expectations, geopolitical risks, and food prices keep inflation pressures alive."***
  - The addition of "inflation expectations" to last month's statement indicates that the deterioration in expectations was also influential in the decision. The year-end inflation expectation for 2024 increased to 44.2% in March and continued to move away from the CBRT's forecast band (December: 41.2%, January: 42.0%, February: 43.0%) (Macro: Expectations for further tightening against deteriorating CPI outlook). Thus, after the minimum wage hike and other fiscal expansion steps, the revision in year-end inflation expectations reached 3 points.
- ***"In response to the deterioration in the inflation outlook, the Committee decided to raise the policy rate."***
  - We assess the decision to be fully linked to the inflation outlook positively in terms of the clarity of the monetary policy reaction function and policy communication.
- ***"Tight monetary stance will be maintained until a significant and sustained decline in the underlying trend of monthly inflation is observed, and inflation expectations converge to the projected forecast range."***
  - At the Inflation Report press conference, CBRT stated that seasonally adjusted monthly average inflation was expected to be 2.5% in the third quarter and 1.5% in the fourth quarter (Macro: Inflation forecasts were maintained with the change in the forward guidance on the monetary stance).
  - The course of the fiscal stance and the development of inflation expectations will be influential on the timing of interest rate cuts. In this context, we will be monitoring the administered price adjustments postponed until after the elections and the incomes policy. In the scenario that no additional minimum wage adjustment is made in the middle of the year, it is possible that interest rate cuts will be put on the agenda at the beginning of the fourth quarter.

- After the decision, pricing in the OIS (overnight indexed swap) market rose and flattened in the short term, but did not imply an additional rate hike (Chart 1). On the other hand, the implied interest rates in the forward exchange rate market also moved down significantly after the decision (Chart 2).

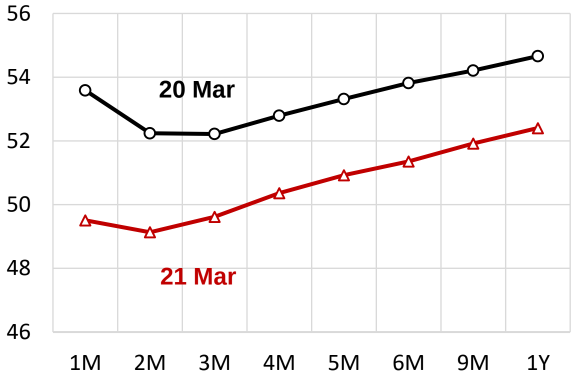
- ***"Monetary transmission mechanism will continue to be supported in case of unanticipated developments in credit growth and deposit rates. Market liquidity will be closely monitored and sterilization tools will continue to be effectively used whenever needed."***
    - With the widening of the interest rate corridor, the message is given that if additional tightening is needed, it will be done through the corridor and through regulations.
    - In case there is a need for an additional increase in the deposit rate for the continuation of de-dollarization, it is possible that existing regulations, especially commission rates, may be tightened.

Chart 1. Policy Rate: OIS Curve (%)



Source: Bloomberg

Chart 2. Forward USD/TRY Implied Rate (%)



Source: Bloomberg

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