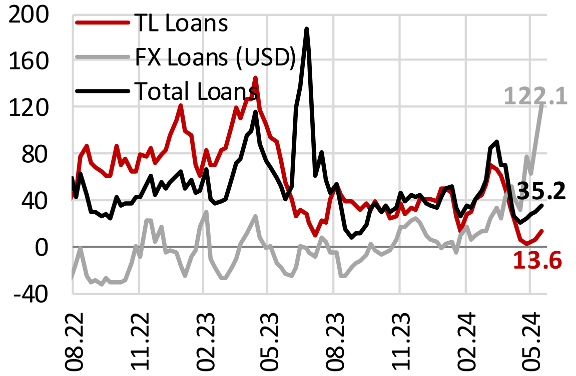
Macro: Policy rate unchanged; steps taken to accelerate the exit from KKM, support monetary transmission and tighten credit conditions

CBRT kept the policy rate unchanged at 50% in May, in line with expectations. However, CBRT announced in a press release after the decision that it took additional steps to maintain macro financial stability, support the monetary transmission mechanism and sterilize excess liquidity. The main messages and our evaluations are as follows:

Outlook Before the Decision:

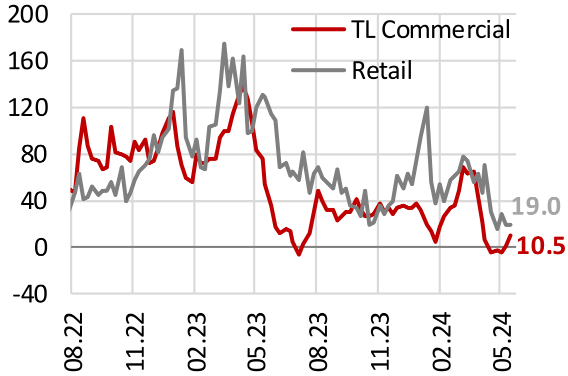
- Monetary tightening steps led to a significant slowdown in TL loan growth, while the recent acceleration in FX loans strengthened the total credit impulse and eased financial conditions (Chart 1). The impact of the tightening in financial conditions was more evident in TL commercial loans, while retail loan growth also slowed down (Chart 2).

Chart 1. Loan Growth (4 week avg., annualized, %)



Source: BRSA, Akbank

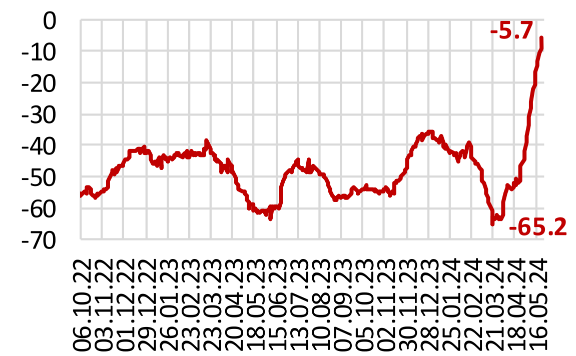
Chart 2. TL Loan Growth (4 week avg., annualized, %)



Source: BRSA, Akbank

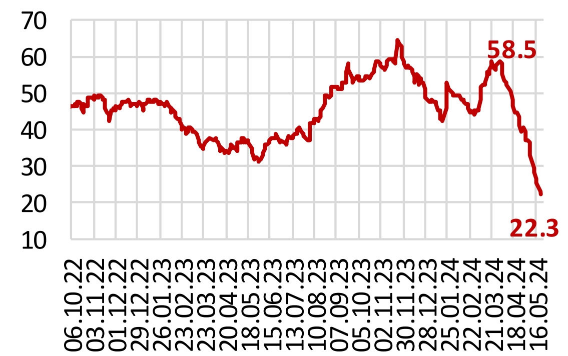
- Recently, foreign inflows and de-dollarization led to a rapid improvement in net reserves. In this period, while net foreign assets increased rapidly, CBRT swaps with domestic banks declined significantly (Charts 3 and 4). We calculate that the CBRT made net FX purchases of $58.2 billion between April 1 and May 22. March 2020 was the last time net foreign assets were positive.

Chart 3. Net Foreign Assets (excl. swaps, billion $)



Source: BRSA, Akbank
Last observation: 22 May 2024

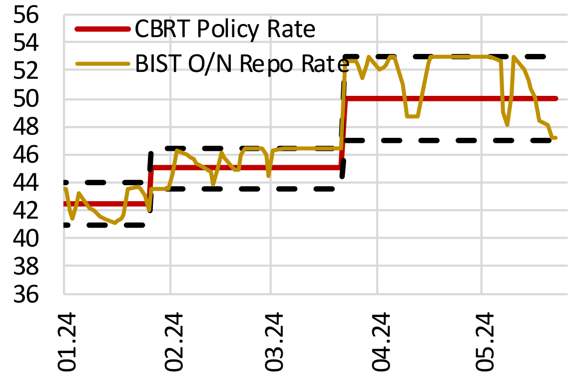
Grafik 4. CBRT SWAPs (billion $)



Source: BRSA, Akbank

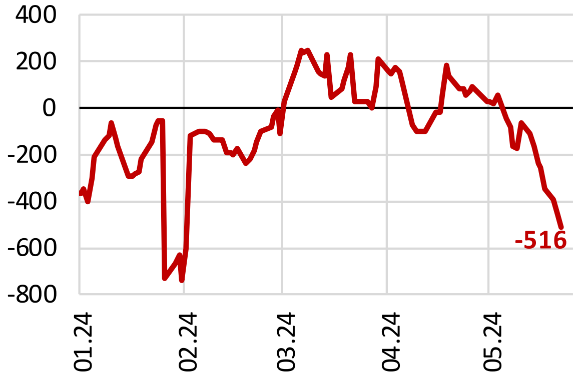
- However, the excess TL liquidity that emerged in the market after these developments eased monetary conditions in terms of loan and deposit pricing. While the BIST overnight repo rate fell to 47%, the CBRT borrowing rate, net OMO reached -516 billion TRY (Charts 5 and 6).

Chart 5. Interest Rates (%)



Source: CBRT, Bloomberg
Last observation: 22 May 2024

Chart 6. CBRT Net OMO Funding (billion TL)



Source: CBRT

MPC Decision:

- **CBRT reiterated its hawkish stance regarding potential policy actions ahead and the possibility of taking further tightening steps, by keeping the following statements about the policy stance.**
  - *"Considering the lagged effects of the monetary tightening, the Committee decided to keep the policy rate unchanged, but reiterated that it remains highly attentive to inflation risks"*
  - *"The 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"*
  - *"Monetary policy stance will be tightened in case a significant and persistent deterioration in inflation is foreseen"*
  - *"The effects of monetary tightening on credit conditions and domestic demand are closely monitored"*
- ***"Considering the recent developments in credit growth and deposits, additional steps will be taken to preserve the macro financial stability and to support the monetary transmission mechanism. The excess liquidity stemming from the surging domestic and foreign demand for Turkish lira financial assets will be sterilized through additional measures."*** In line with this statement, the CBRT announced that it decided to take the following steps in order to maintain macro financial stability, support the monetary transmission mechanism and sterilize excess liquidity:
  - Reserve requirement ratios (RRR) for Turkish lira deposits and FX-protected deposits (KKM accounts) have been increased. RRR were increased i) from 8% to 12% for demand deposits and TL deposits with maturities up to 3 months, ii) from 0% to 8% for TL deposits with maturities up to 6 months and longer, iii) from 25% to 33% for KKM deposits with maturities up to 6 months, iv) from 10% to 22% for KKM deposits with maturities up to 1 year and longer than 1 year.
    - Required reserves shall be maintained as of 24 May 2024. Therefore, the calculation date will be May 10, 2024.
    - We estimate that the RR increases will raise the effective average RRR on TL deposits (including KKM) from around 10% to slightly above 16%. Therefore, we **calculate the liquidity that will be withdrawn from the market in this way to be around TRY 600 billion.**
  - Remuneration and commission practices for reserve requirements have changed in the following way:
    - The target for transition from KKM to Turkish lira has been retained, and the total target including renewal has been reduced to 75%.
    - As of the next calculation date, legal persons' KKM accounts, as well as legal and real persons' YUVAM (Deposit and Participation Scheme for Non-Resident Turkish Citizens) accounts will be excluded from calculation of the total target.

- The remuneration rate applied to reserve requirements maintained for KKM accounts when the total target is achieved has been decreased to 40% of the policy rate.

- A monthly growth limit of 2% has been introduced for foreign currency loans, and it has been decided that Turkish lira required reserves amounting to loans exceeding the limit will be blocked for one year.
  - Limiting FX loan growth in line with TL loan growth will push total loan growth to levels in line with macro targets. We expect a momentum where total loan growth remains below 30% to slow down domestic demand in the second half if the fiscal stance is also tightened.

Our Evaluations:

- The current conjuncture, in which foreign capital inflows and residents' preference for TL had strengthened, provided a favorable backdrop for steps to accelerate the exit from KKM.
- In the wake of the strong reserve accumulation since early April, we consider the limitation of KKM conversion targets to real persons (excluding legal persons from target calculations) and the easing of existing targets as timely policy steps. The previous set of regulations, which further incentivized KKM rollover under external resource constraints, created a rather rigid burden on the financial system that had to be largely rolled over in the three-month maturity at a cost above the average deposit rate, as well as making it difficult to assess the true picture of TL/FX preference due to fragmented deposit pricing (FX share: 40%, KKM share: 14%, TL share: 46%).
- Since it is critical that the net FX position, which can be considered as the sum of the CBRT's net foreign assets and the CBRT's net foreign exchange position, continues to improve in order to fully establish the flexibility and effectiveness of monetary policy in the medium term, it seems appropriate to utilize the space created here. In this context, the new rules make it more important that monetary policy actions are supported by a tighter fiscal stance in the upcoming period.

This report is prepared by Akbank Economic Research

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