Macro: No surprise from CBRT, rate cut continues in line with expectations

The CBRT cut the policy rate from 45.0% to 42.5%, in line with the expectations. There were no significant changes in the Statement regarding the policy stance and the overall framework. However, the shift in emphasis from all policy instruments to only the policy rate in the sentence "*The Committee will ~~make its decisions~~ adjust the policy rate prudently on a meeting-by-meeting basis with a focus on the inflation outlook*" conveys the message that the appropriate degree of monetary tightness will be achieved not only through macroprudential tools but also through the policy rate. This answers the recent controversial question of whether it is a contradiction for policy tools to move in opposite directions (macroprudential tightening while the policy rate is lowered). In other words, given the supportive tools, the CBRT is committed to achieving appropriate monetary tightening through the policy rate (through the "pass" or "smaller steps" options).

We maintain our previous view that the February inflation reading and the underlying trend implied by the expected disinflation path leave room for a 250 bps cut at both meetings in the second quarter of the year. On the other hand, despite the recent additional macroprudential measures, we believe that the current trend in credit growth points to a stronger GDP growth (>4.0%) than the CBRT's projections for 2025 (2.5%). As a result, we believe that the CBRT may reduce the pace of rate cuts starting from July and take additional macroprudential tightening steps by monitoring developments.

Other key messages and our evaluations are as follows:

- ***"Following the increase in January, the underlying trend of inflation decreased in February. Over this period, core goods inflation remained relatively low, while services inflation slowed down after the idiosyncratic increase in January."***
  - In February, monthly inflation was 2.27% and annual inflation was 39.05%, below the expectations (3.0% mom; 40.0% yoy).
  - The decline in monthly services inflation in February was mainly due to the re-adjustment of co-payments in health services. Excluding this effect, we think that the services inflation remains strong. (Macro: Inflation Developments – February 2025). Services, especially rents, continue to be the factor holding back the rapid disinflation.
- ***"Although domestic demand was above projections in the fourth quarter, it remained at disinflationary levels. Leading indicators suggest that domestic demand remains disinflationary in the first quarter. The effects of monetary policy stance on credit and deposit markets as well as on domestic demand are closely monitored."***
  - In the last quarter of 2024, GDP increased by 3.0% yoy and 1.7% qoq in seasonally and calendar-adjusted terms. The output gap forecast in the CBRT's Inflation Report was flat in the last quarter. In other words, it was assumed that the quarterly growth in the last quarter would be around potential (≈1.2%).
  - In the current conjuncture, where unemployment is quite low and sectoral divergences are evident, we think that it is not easy to make inferences about the level of the output gap. The output gap indicator, which we construct by aggregating information from goods/services, credit and labor markets, suggests that demand conditions may not be at disinflationary levels (Macro: GDP Developments – 2024Q4).
  - On the other hand, the CBRT has stated that it will closely monitor credit and domestic demand conditions, signaling that it will remain cautious in interest rate cuts.
  - The significant acceleration in loans in February supports growth. If we take into account the external demand conditions, which are expected to recover slightly compared to last year, and if there is no significant improvement in the cash-based budget balance, we assess that the current credit impulse could push 2025 growth well above the MTP target (4.0%). According to the output gap path of the CBRT Inflation Report, the year-end inflation forecast of 24% seems compatible with a moderate, sub-potential growth of around 2.5% (Macro: 2025-I Inflation Report).

- **There was no change in the following statements regarding the policy stance.**
    - *"The decisiveness regarding tight monetary stance is strengthening the disinflation process through moderation in domestic demand, real appreciation in Turkish lira, and improvement in inflation expectations."*
    - *"Going forward, increased coordination of fiscal policy will also contribute significantly to this process."*
    - *"The tight monetary stance will be maintained until price stability is achieved via a sustained decline in inflation. Accordingly, the policy rate will be determined in a way to ensure the tightness required by the projected disinflation path taking into account realized and expected inflation, and the underlying trend."*
    - *"Monetary policy tools will be used effectively in case a significant and persistent deterioration in inflation is foreseen."*
- ***"Considering the recent developments in credit growth, additional measures were taken to preserve macro financial stability and to support the tight monetary policy stance."***
    - With the announcement dated 1 March 2025 (link), the CBRT made the following changes in the loan growth-based reserve requirement practice in order to support the tight monetary stance by taking into account the developments in foreign currency loans. Accordingly, the monthly growth limit for foreign currency loans has been reduced from 1% to 0.5%, while the scope of foreign currency loans exempted from the growth limit has been narrowed.
- **"Liquidity conditions will continue to be closely monitored and sterilization tools will continue to be used effectively ~~with additional measures~~"**
    - Most recently, the CBRT started to hold 4-week deposit buying auctions as of January 24, 2025. It is understood that no further steps will be taken to strengthen sterilization in the near future.

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