Economic Watch

Türkiye | Surprising rate hike with a narrowed corridor

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17 April 2025

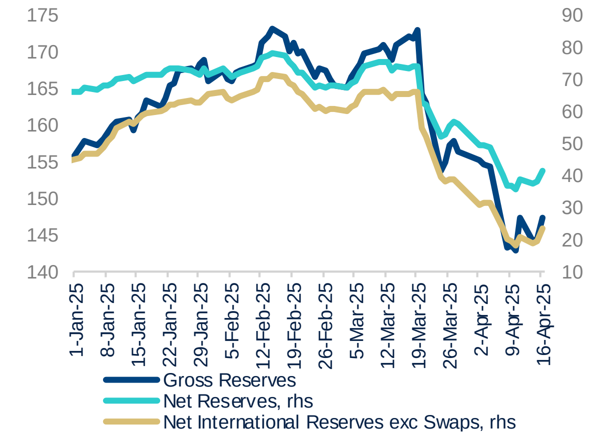
The Central Bank of the Republic of Türkiye (CBRT) hiked the policy rate (one-week repo) by 350bps to 46%, surprising the market expectations of a no change. The CBRT also raised the overnight (ON) lending rate by 300bps to 49% and the ON borrowing rate by 350bps to 44.5%, resulting in a narrowed down interest rate corridor compared to the previous 41%-46%. After the domestic political shock, the CBRT had already hiked the ON lending rate to 46% on March 20th in an interim meeting and started to fund the markets via 46%. They also sterilized the excess TL liquidity completely via an extension of tools and squeezed the TL liquidity even further pushing up the ON TL rates even more. Contrary to their previous assessments on the recent shocks as transitory, it seems the CBRT now becomes more prudent and gives a strong message by making a hike in its main tool and reaching an availability of raising the cost of funding even up to 49%. We think, given the uncertainties on the macro outlook and continuing foreign currency demand of the residents, the CBRT might increase the average funding rate towards 49% if needed and try to accumulate reserves as much as possible. Once the stress gets over also with the help of the upcoming tourism season and the CBRT can start easing the policy rate in June but this time with a much higher magnitude of cut as long as the inflation outlook would allow. If the stress continues, they also opened a clearer door to additional monetary tightening in today's decision, instead of their previous expression of an effective use of monetary policy tools.

Although decelerating, the depletion from the CBRT reserves has continued after the recent shocks. The net international reserves excluding swaps declined by 45bn$ between April 11 and March 18 and fell to 20.8bn$. If the gold and parity price effects, and the FC purchases from the exporter revenues are excluded, the intervention amount has been much higher, reaching above 50bn$. Even though the CBRT reacted in a timely and market-friendly manner, growing uncertainty due to both domestic and external developments has kept the stress to some extent. Therefore, today's decision became even more critical to regain confidence and to make TL assets again attractive by giving a stronger message instead of assessing the shocks transitory. Additionally, since the next MPC meeting will be held on June 19, they enlarge their flexibility and reach an availability of raising the cost of funding even up to 49%, if needed.

On inflation outlook, despite a more favorable outlook for disinflation led by much tighter financial conditions and positive commodity price shock, the CBRT shows a higher degree of prudence by acknowledging the uncertainties ahead and the strength of domestic demand in 1Q25 (please see our latest activity report for details). Despite being absorbed to some extent, the currency shock on March 19th and appreciating euro-dollar parity result in roughly 4% monthly depreciation in the currency basket separately in March and April so far. Meanwhile, the electricity price hike of 25% for households and 10-15% for producers as of April will weigh on inflation to the upside. On the other hand, the latest domestic and external shocks led to tightening financial conditions, resulting in a potentially stronger domestic demand moderation going forward. Moreover, the recent positive oil price shock will help to contain partially the impact from the exchange rate pass-thru and the latest worsening in inflation expectations. In this respect, the CBRT highlights a slight increase in monthly core goods inflation in April with a relatively flat services inflation. We expect monthly consumer inflation to be 3-3.5%, in line with CBRT's expectation, but food inflation could generate upside risks. According to the market participants survey of the CBRT for April, inflation expectations for 12 and 24 month ahead deteriorated to 25.56% from 24.55% and to 17.69% from 17.06%, respectively, while 2025 year end expectation rose to 29.98%, higher than the upper band forecast of CBRT (29%). Therefore, high inflation expectations, recent global tariff shock, still expansionary fiscal policy and uncertainties on food prices keep the challenges on inflation outlook, while the recent decline in commodity prices and expected moderation in domestic demand could be disinflationary. We will closely monitor the CBRT's second inflation report of the year to be released on May 22, in order to get their forward guidance on inflation outlook and monetary stance.

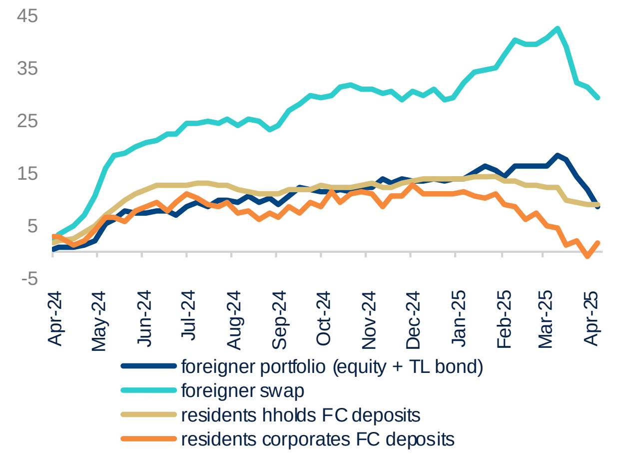
All in all, we assess today's decision as a very strong message of the CBRT to regain confidence and to make TL assets again perceived as relatively attractive in order to contain the pressure on the reserves, instead of assessing the shocks transitory. After April, we expect an improving inflation trend, supported by moderating private consumption, tighter financial conditions and lower commodity prices, and forecast 31% year end inflation. Given the potentially higher risk premium levels, going forward, the CBRT might keep slightly higher than previously expected real rates of at least 4pp.

Chart 1. **CBRT International Reserves** (bn$)



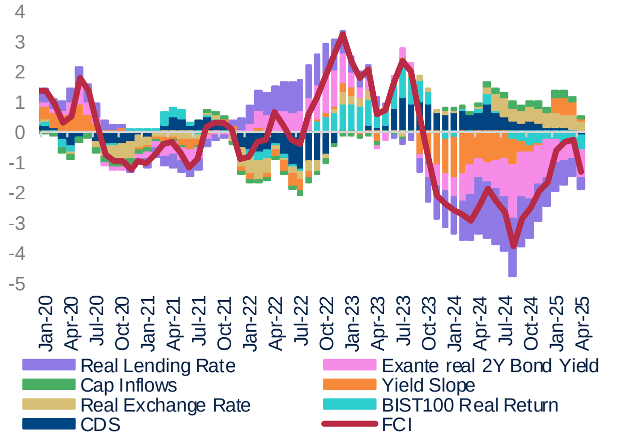
Source: CBRT and Garanti BBVA Research

Chart 2. **Foreign Currency Flows** (bn$, cumulative as of the end of March 2024)



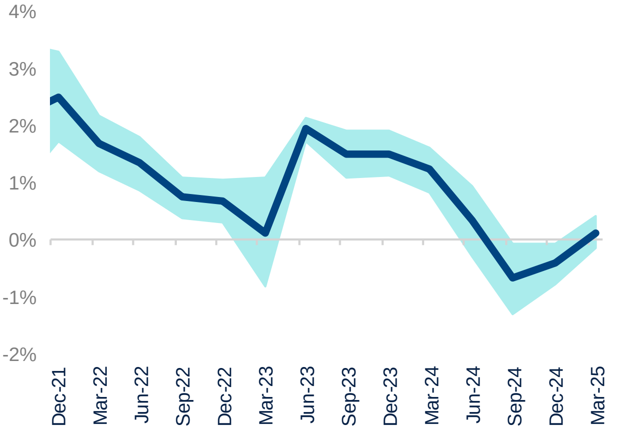
Source: CBRT and Garanti BBVA Research

Chart 3. **Garanti BBVA Financial Conditions Index** (standardized, + easing, - tightening)



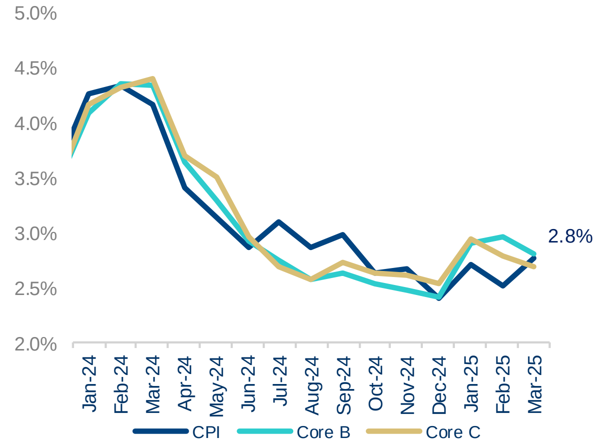
Source: CBRT, Bloomberg and Garanti BBVA Research

Chart 4. **Garanti BBVA Output Gap Estimate** (%, deviation from potential GDP)



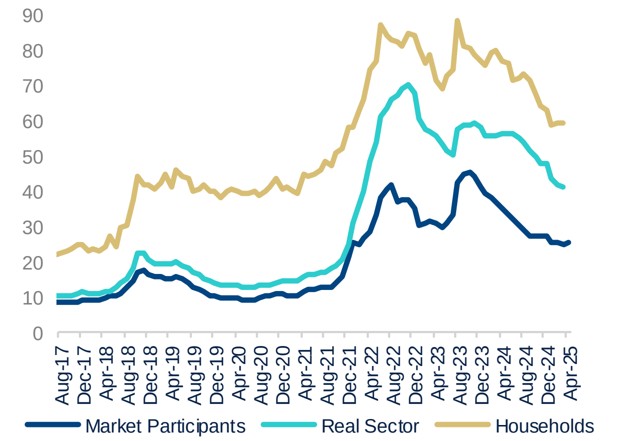
Source: TURKSTAT and Garanti BBVA Research

Chart 5. **Trend CPI Indicators** (sa, m/m, 3m average)



Source: TURKSTAT and Garanti BBVA Research

Chart 6. **Sectorial Inflation Expectations** (one year-ahead, %)



Source: CBRT and Garanti BBVA Research

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