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## Turkey Economics | Europe

## CBT Review: Next Stop Terminal

The CBT delivered a 250bp hike to 42.5% in line with our forecast and consensus, and signalled completion of the tightening cycle as soon as possible, which gives support to our call for an additional 250bp to a 45% terminal rate in January. New steps on macroprudential and liquidity policies should support policy effectiveness.

**The CBT continued tightening with a smaller 250bp hike, in line with the forward guidance from last month:** The MPC sees the current level of the policy rate significantly close to the level compatible with the CBT's projected disinflation path (mid-point 36%Y, upper band 42%Y). According to the [statement](#), the MPC expects to complete the tightening cycle as soon as possible, which we think signals a final 250bp hike to a 45% terminal rate, in line with [our earlier call](#). The MPC repeated its pledge to maintain tight monetary policy for as long as is needed to ensure sustained price stability.

**Communication continued to be inflation focused:** The MPC's assessment of the outlook for inflation and domestic demand was mostly unchanged, with a repeated reference to domestic demand, stickiness in services inflation and geopolitical risks as factors that keep inflationary pressures alive. The MPC noted continued moderation in domestic demand, a decline in inflation expectations and an "accelerated" increase in domestic and foreign demand for Turkish lira assets as supporting the ongoing decline in the underlying trend of monthly inflation.

#### New decisions to extend sterilisation tools to support quantitative tightening...

As the CBT's reserve accumulation gained pace on the back of increased foreign inflows to Turkish lira assets, its net funding through open market operations (OMO) has turned negative, standing at -TRY 218 billion as of December 20 ([Exhibit 2](#) and [Exhibit 4](#)). This, in turn, has put downside pressure on the interbank rate, moving it towards the lower band of the interest corridor, which stands 150bp lower than the one-week repo rate ([Exhibit 5](#)). As a response, the MPC announced today that it will start [Turkish lira depo purchase auctions](#) to diversify its sterilisation tools. Currently, the CBT sterilisation is done by overnight borrowing by the CBT at the lower band of the interest rate corridor. Turkish lira depo purchase auctions will likely have a longer tenor, at two weeks or one month, with an interest rate above the lower band, but we are yet to receive specific information on the terms of these TRY depo auctions.

**...and to ease TURKGB holding requirements on banks' FX liabilities:** While the MPC repeated its signal for continued simplification steps in the macroprudential framework, [a separate press release](#) announced that the TURKGB holding requirement, which previously applied as 5% of banks' total FX liabilities, is now reduced to 4%. This implies lower regulatory pressure on banks to buy TURKGBs, supporting market-based pricing of TURKGBs, which have already started to move

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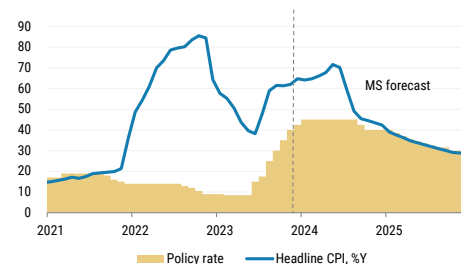
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**Exhibit 1 :** We keep our forecast for an additional 250bp hike to a terminal rate of 45% and see the first rate cut in 3Q24



Source: Haver Analytics, Morgan Stanley Research forecasts

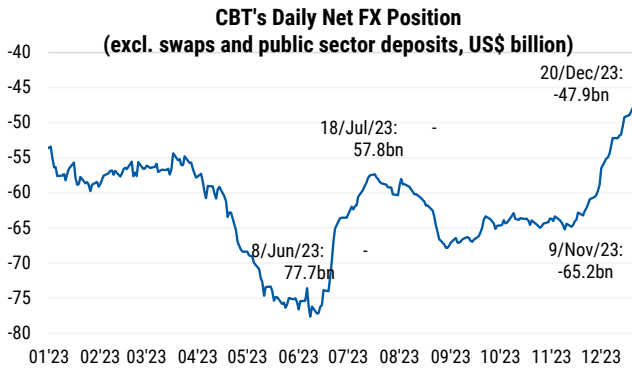
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with market dynamics. Meanwhile, the TURKGB holding requirements related to monthly credit growth caps were extended for another six months. While these requirements are no longer that penalising (due to the upward adjustment in TURKGB yields), it is supportive of monetary tightening as it signals that the CBT is determined to keep credit conditions tight.

**Today's rate hike and its communication should support a gradual improvement in inflation expectations:** Today's hike, the seventh in a row since June, has brought the policy rate up by a total 34pp to 42.5%, which equals 52.7% when compounded, significantly higher than 12-month ahead inflation expectations, which currently stand at 41%Y. The tightening in rates, along with the introduction of more effective tools for sterilisation, should keep TRY deposit rates at elevated levels, supporting domestic demand rebalancing and de-dollarisation. The decisive tightening steps should also support foreign inflows and reserve accumulation ([Exhibit 2](#) and [Exhibit 3](#)), containing upside risks to the currency. As we highlighted in our [CBT preview](#), the size of the upcoming minimum wage hike and the trajectory for fiscal policy (including the pending increase in earthquake spending and a potential correction in administered energy prices) will be key for the inflation profile. In light of these factors, we currently see headline inflation declining to 42.3%Y in December 2024, after peaking at 71.6%Y in May ([Exhibit 1](#)).

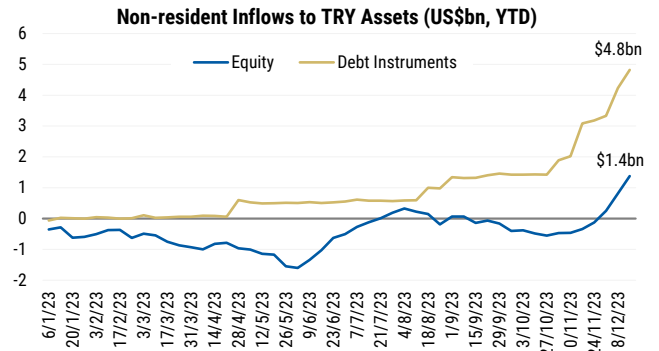
# Chart Gallery

**Exhibit 2:** The CBT's net reserve accumulation has gained pace since mid-November...



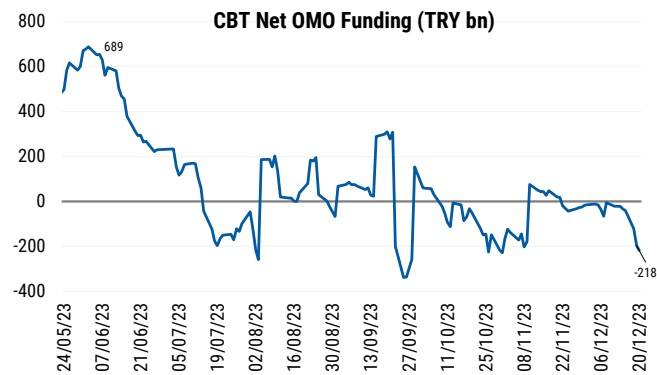
Source: Haver Analytics, Morgan Stanley Research

**Exhibit 3:** ...supported by an increase in portfolio flows to Turkish lira assets, among other inflows



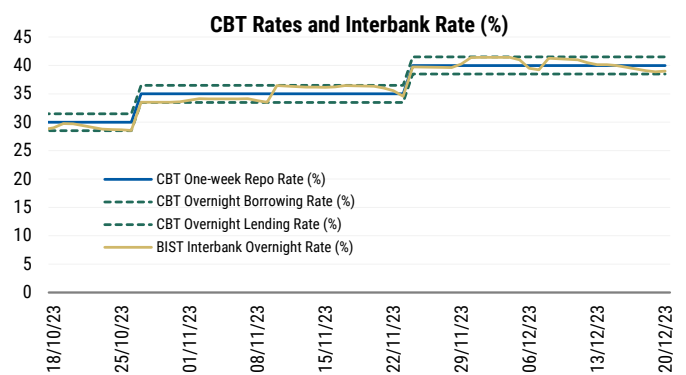
Source: Haver Analytics, Morgan Stanley Research

**Exhibit 4:** The CBT announced TRY depo auctions for sterilisation as net OMO funding turned negative...



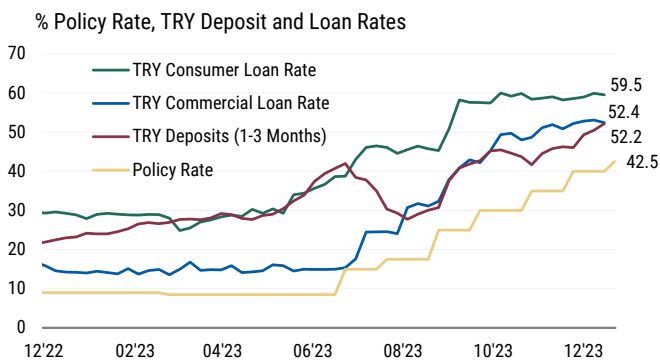
Source: Haver Analytics, Morgan Stanley Research

**Exhibit 5:** ...which has pushed the interbank rate down to the lower band of the interest rate corridor



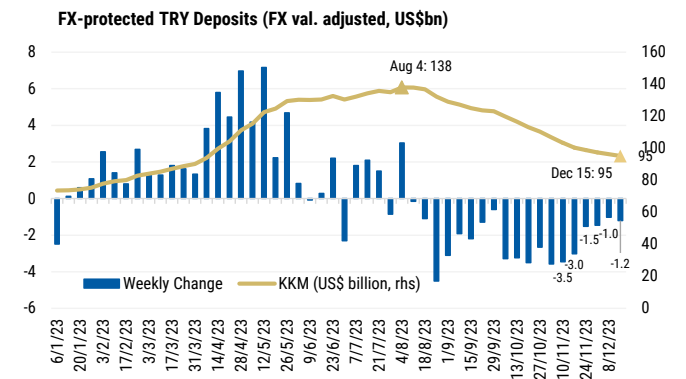
Source: Haver Analytics, Morgan Stanley Research

**Exhibit 6:** Today's decisions on rates and liquidity should keep TRY deposit rates at elevated levels...



Source: Haver Analytics, Morgan Stanley Research; Note: Deposits and loan rates as of December 15.

**Exhibit 7:** ...supporting the ongoing decline in KKM



Source: Haver Analytics, Morgan Stanley Research

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