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MARKETS ECONOMY POLITICS

MONTHLY BULLETIN ON TÜRKİYE

JULY 2024

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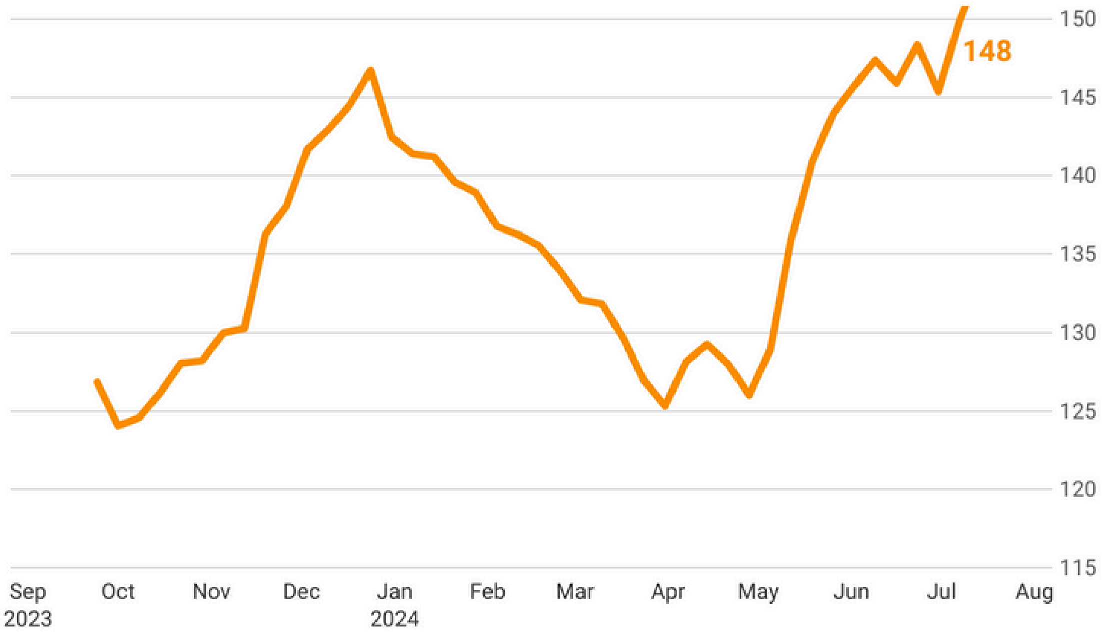
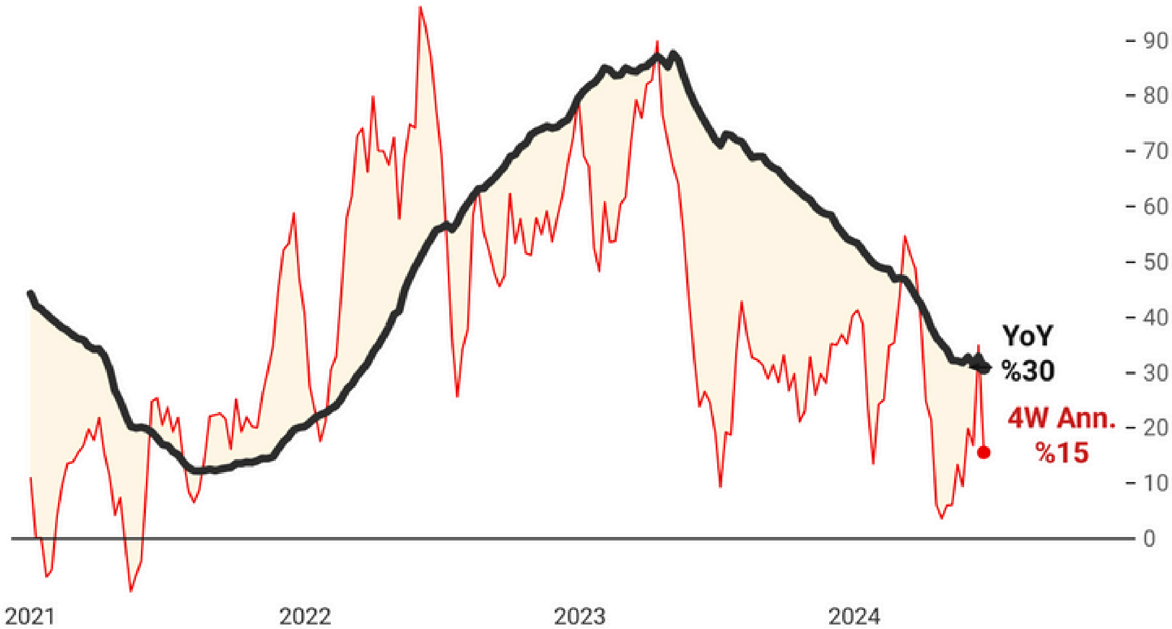


Assets (Bio USD)	29/12/23	23/06/24	YTD
Gold	47.68	58.62	+10.94
FX Banknotes	3.56	2.13	-1.43
Securities + Deposits	5.90	15.64	+9.74
Other FX Balance	87.43	69.82	-17.61
TOTAL	**144.57**	**146.21**	**+1.64**

Liabilities (Bio USD)	29/12/23	23/6/24	YTD
To Turkish Banks	74.92	73.33	-1.59
To IMF & International Insti.	29.89	28.63	-1.26
To Turkish Treasury	9.41	8.82	-0.59
To Turkish Banks in Swap Contract	48.75	7.12	-41.63
To Foreign Central Banks	23.35	23.35	-
TOTAL	**186.32**	**141.25**	**-45.07**

1.02-TL Loan Growth (as of Jun 21, YoY)



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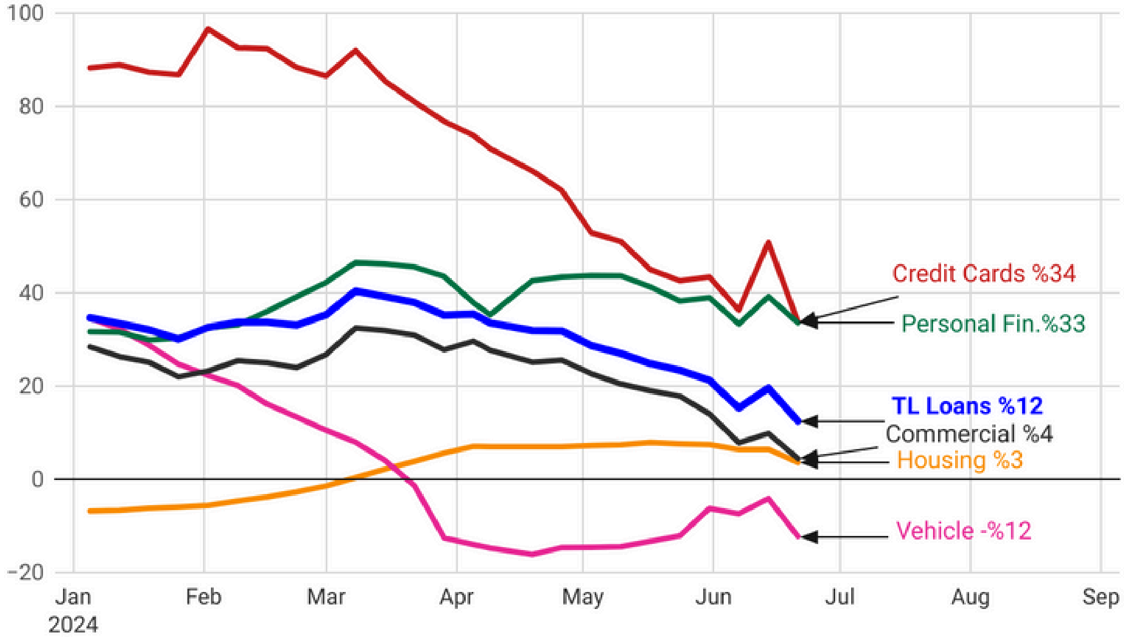

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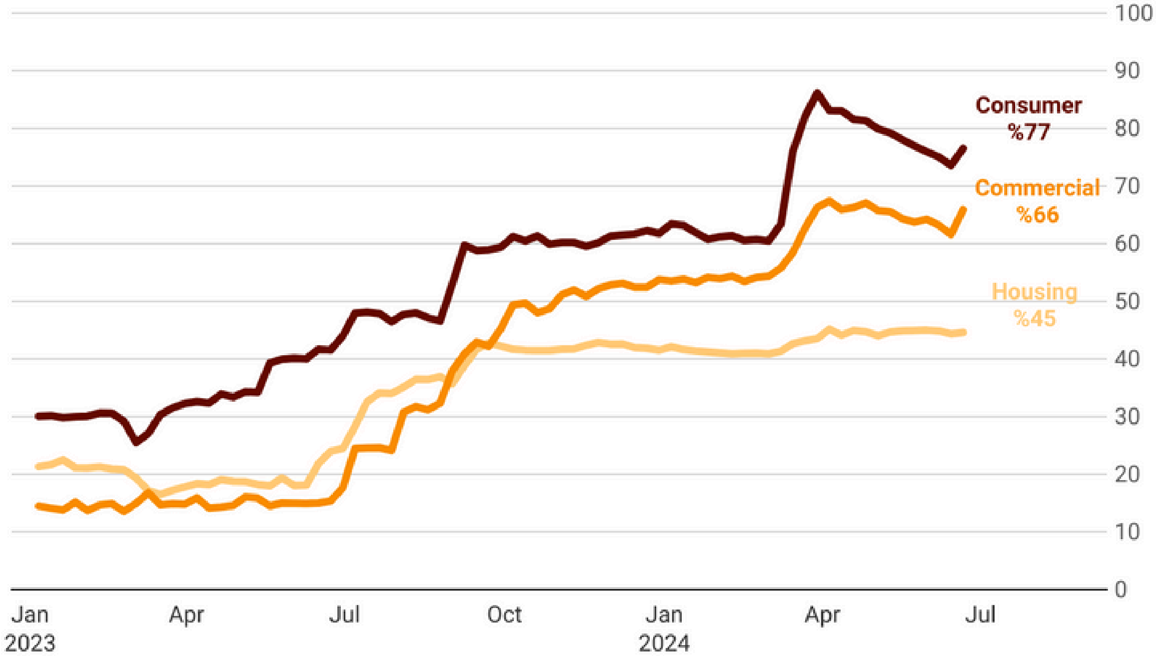

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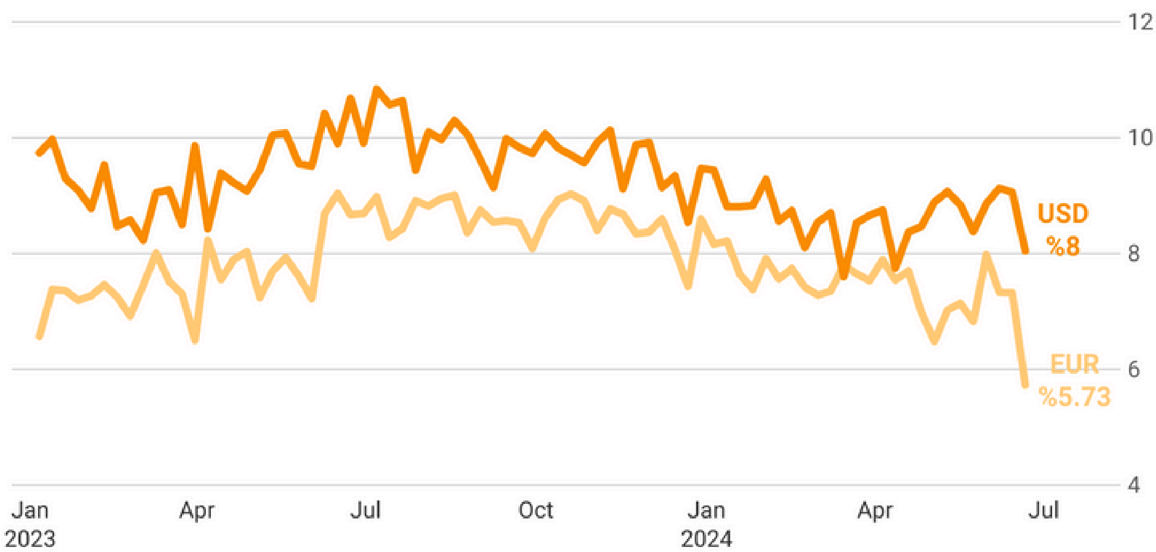

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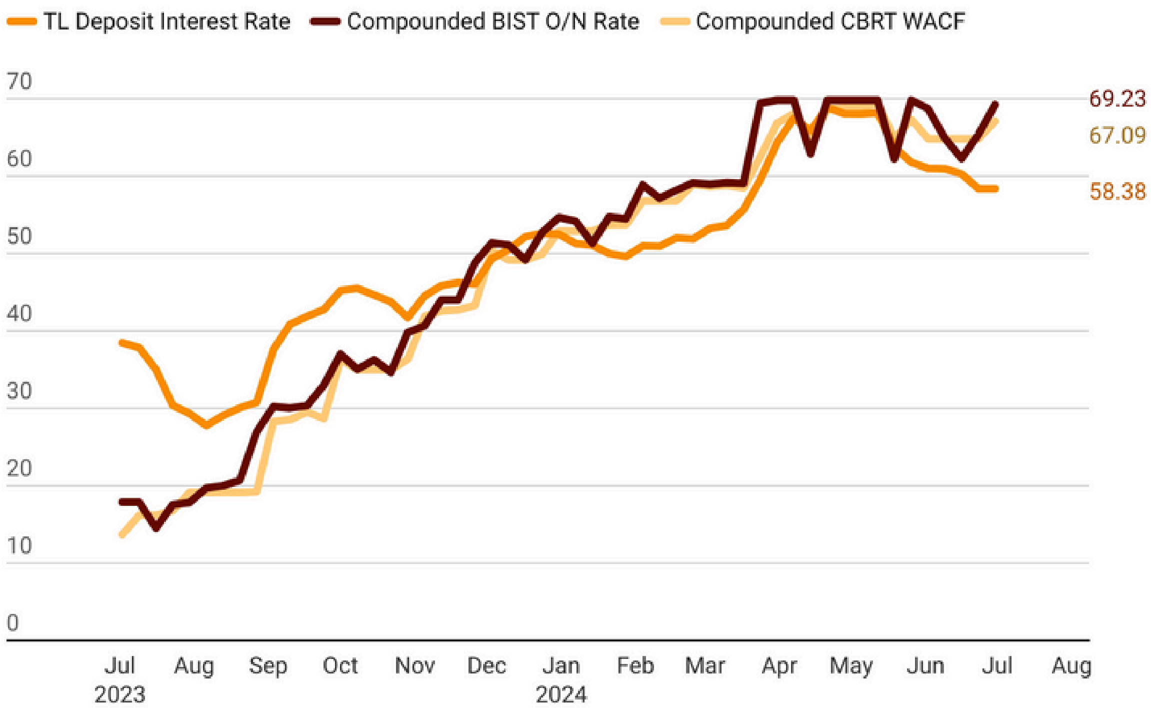

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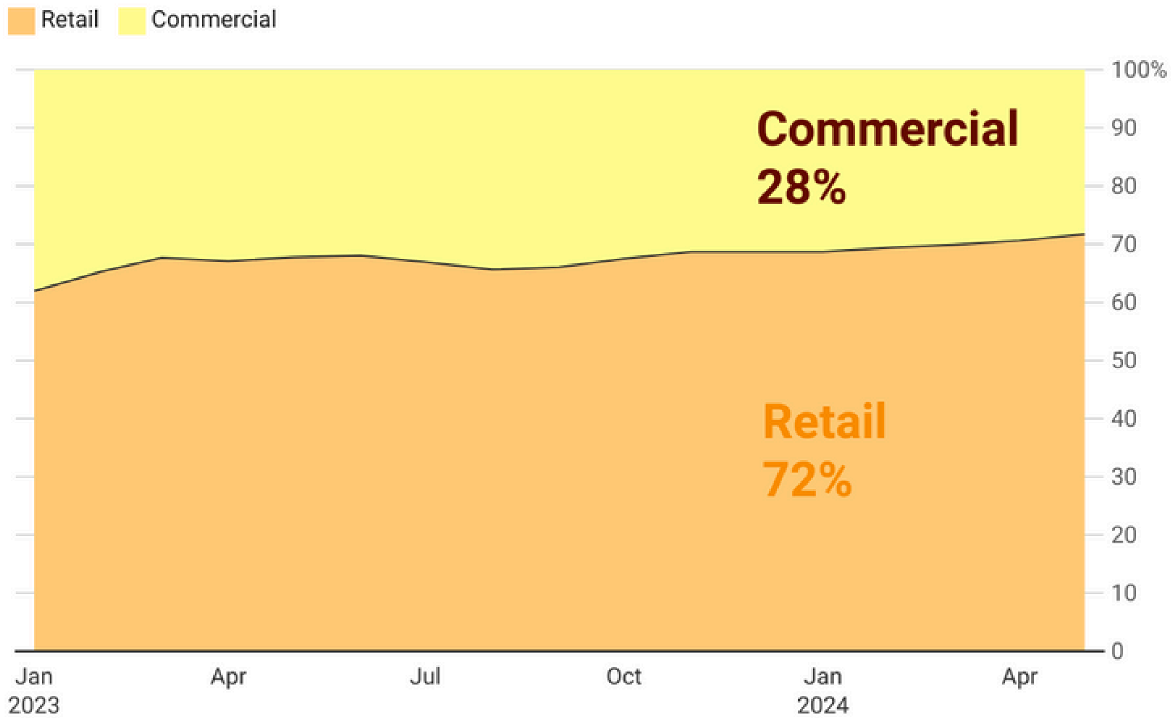

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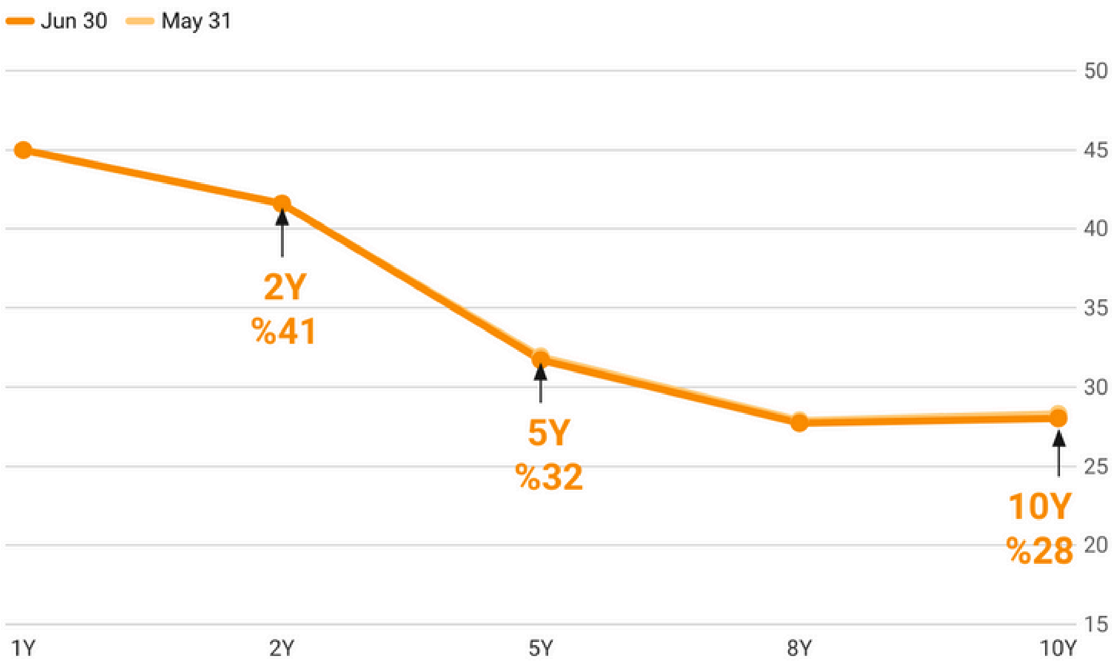

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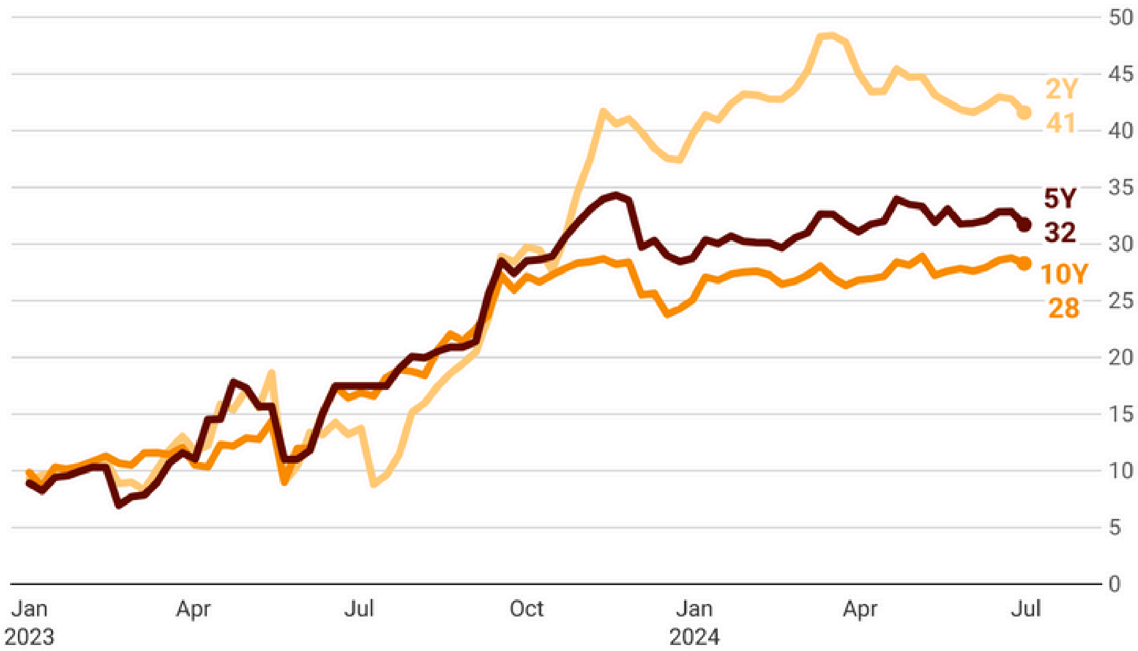

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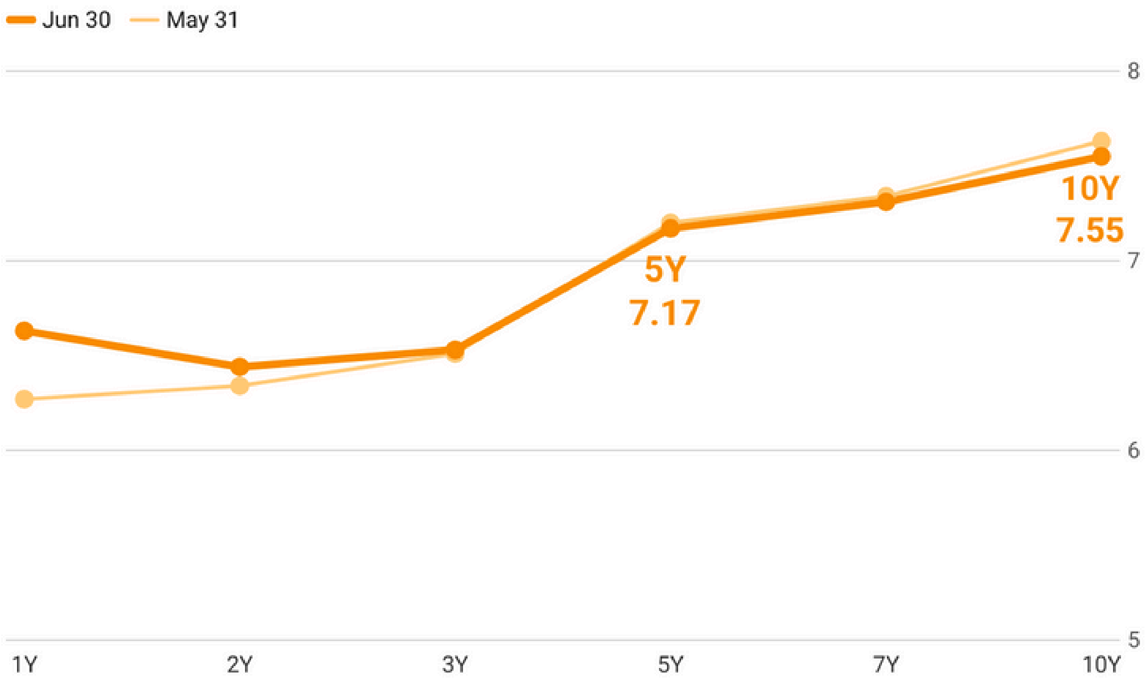

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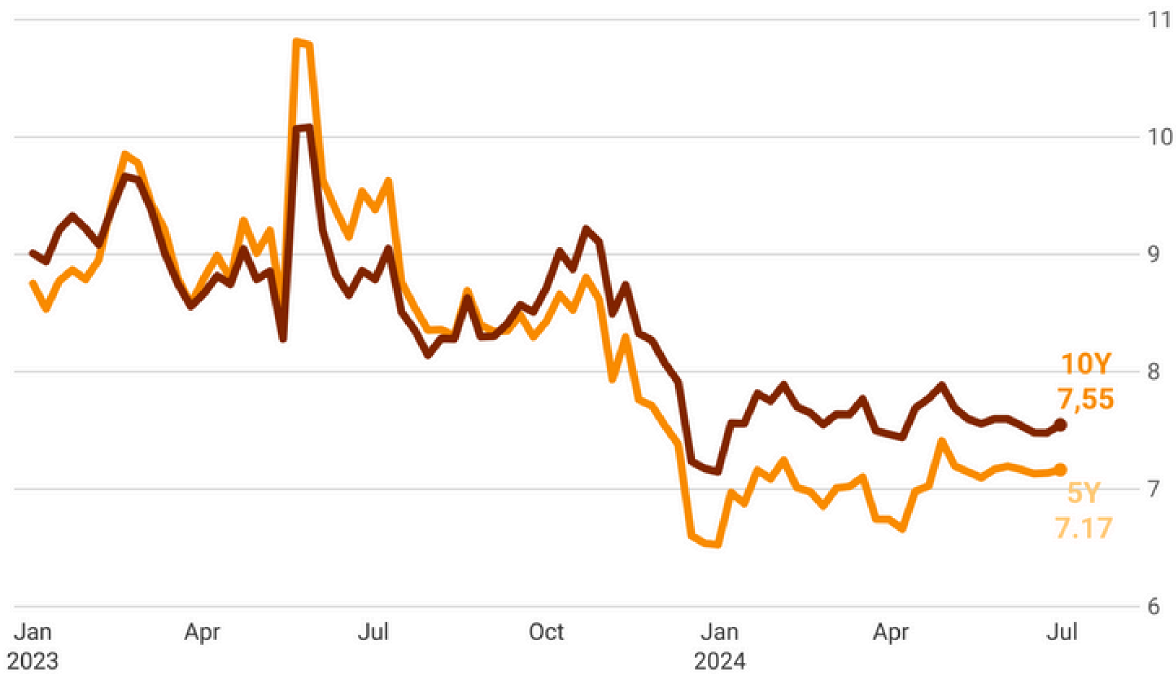

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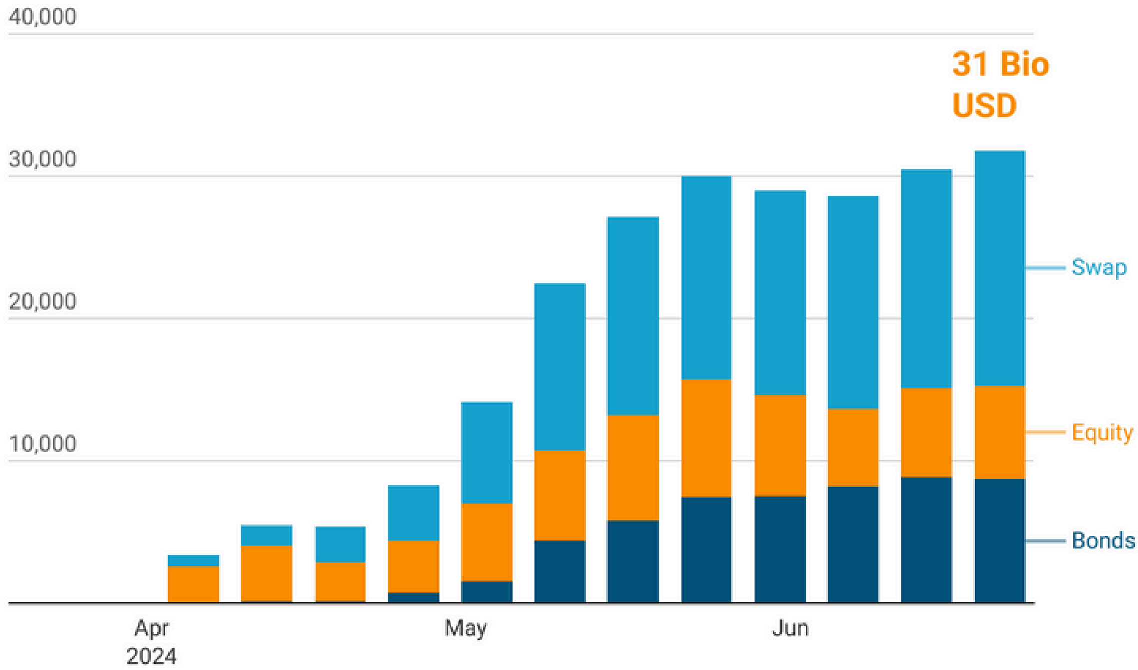

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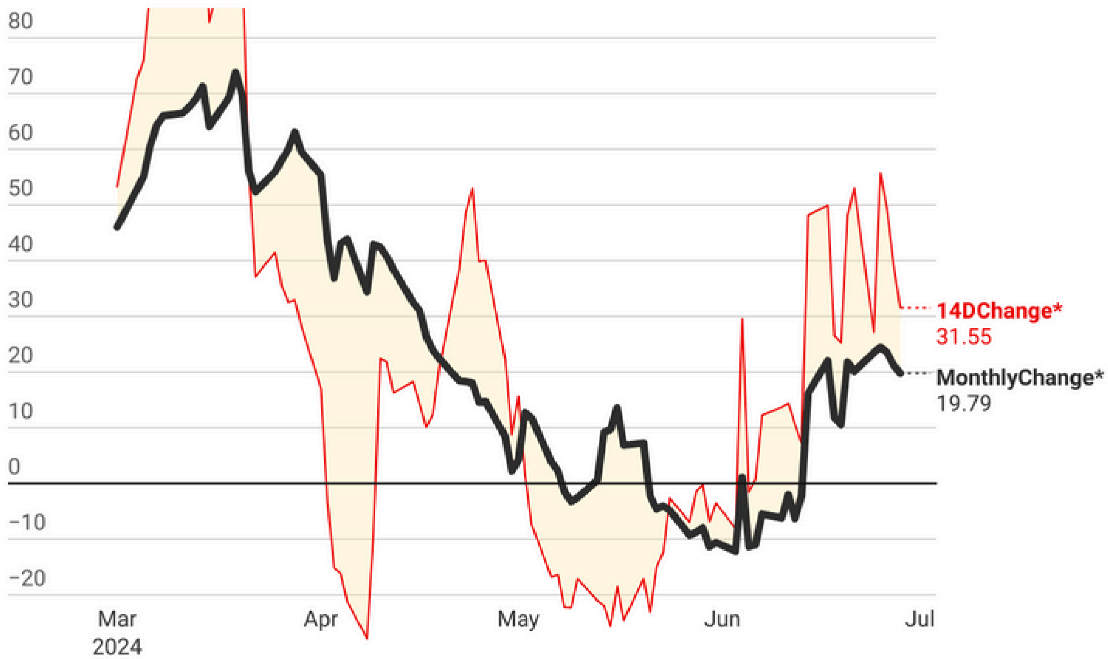


TURKEY REACT: Rates on Hold Means Ramp Up in Alternative Tools By Selva Bahar Baziki (Economist)

(Bloomberg Economics) --

OUR TAKE: The Central Bank of the Republic of Turkey's rates may have peaked but its tightening cycle is far from over. The central bank will further restrict financial conditions via its alternative tools - a position we expect it to maintain through the third quarter of this year.

The central bank kept its one-week repo rate on hold at 50% for the third consecutive time - having reached that peak for the cycle back in March. The move matched our call and the median consensus expectation in a Bloomberg survey.

We expect the hold in the key lever to be accompanied by tightening in alternative tools such as credit growth caps and banking regulation to reverse the recent easing in lending and deposit rates. The central bank can also lift the reference rate for lenders by shifting funds away from its repo window to its overnight lending rate - for which the associated rate sits at a higher 53%.

Should the needle tilt toward lira oversupply in the market again, as it did recently, the central bank may also deploy its liquidity tools such as higher reserve requirements or opt for an asymmetric interest rate corridor by lifting the lower bound.

We expect inflation to start easing from the June reading onwards. This means the worst of the price gains is now likely in the rearview mirror after the annual rate reached 75.5% in May. The slide will probably feature large steps down in the summer months due to favorable base effects.

Even so, we expect the year-end prints for this year and next to remain at multiples of the central bank's 5% target - 43% in 2024 and 24% in 2025. Risks to this outlook are tilted to the upside and include an escalation in the Middle East war as well as a sizable mid-year update to the government's tax and fee schedule. Our baseline rates call sees the key rate on hold at 50% before the CBRT cuts borrowing costs by a total of 500 bps in 4Q24 to 45% by year-end. Should the risks to inflation materialize, we think the central bank would remain tight for longer by delaying cuts.

TURKEY INSIGHT: Pro-lira Interventions Hit $300 Billion - So Far By Selva Bahar Baziki (Economist)

(Bloomberg Economics) -- We estimate the Central Bank of the Republic of Turkey's stealth interventions to support the lira reached $300 billion between December 2021 and the end of March 2024 – that's nearly one-third of GDP. The central bank has subsequently switched strategies so that it is now accumulating FX reserves and we expect this to be maintained in the near term as foreign and domestic investors continue their switch to lira assets.

The CBRT's net reserves fell by $8.5 billion in March 2024 compared to December 2021, our calculations show. That stands in contrast to the $292 billion we estimate for net inflows into reserves during that time. We take the $300 billion difference as being CBRT FX interventions to support the lira.

That puts the total pro-lira interventions under Mehmet Simsek' stewardship at the Ministry of Finance at $85 billion. Monthly interventions for the period averaged $11 billion per month.

The central bank has flipped its approach to accumulating reserves following the March 31 local elections, as both local and foreign investors moved to lira assets. That saw the net reserves balance improve from -$74 billion in March to -$5.7 billion at the end of May. The difference of $68 billion far exceeds the $17 billion we estimate for inflows and suggests the central bank moves have added $51 billion into reserves over the past two months.

If the CBRT keeps up this pace, net reserves are likely to flip into positive territory this week. According to the definition used by the International Monetary Fund, though, that switch to surplus happened in May – our calculations show net international reserves net of swaps reached $1.5 billion net of swap obligations at that time.

However, the CBRT's recent decision to ease the rules governing exporters' mandatory FX conversion to 30% of revenue – which becomes effective this week and is down from 40%, previously – means gains ahead may be slightly slower. We calculate that, after adding $203 billion to reserves from December 2021 through end of May, the rule means an average $2 billion less inflows per month this year.

Methodology

To calculate the CBRT's net reserves we subtract total foreign liabilities and all swaps from the central bank's foreign assets. We divide the time since December 2021 into two periods of analysis as follows.

First, we focus on calculating the central bank's pro-lira interventions since December 2021 through March 2024. To arrive at the estimated $310 billion of inflows, we used the following:

A $189 billion inflow may have come from exporters' mandatory revenue conversion. We build this estimate based on TurkStat trade data and assume full compliance (25% of revenue conversion until mid-April 2022 and 40% since) after allowing for destination-based exemptions.

FX-protected deposits of non-lira origin may have added $91 billion. We use data from a newly released monthly CBRT database as well as the MoF and assume similar retention rates across different types of deposit origins. Our earlier approach used data from the Banking Regulation and Supervision Agency and the MoF, as well as our own assumptions on the lira and non-lira origin accounts splits. If we continued to use this older method, inflows from this item would have been $90 billion – with the $1 billion difference resulting from inflows in October and November 2023 shown in the new data source.

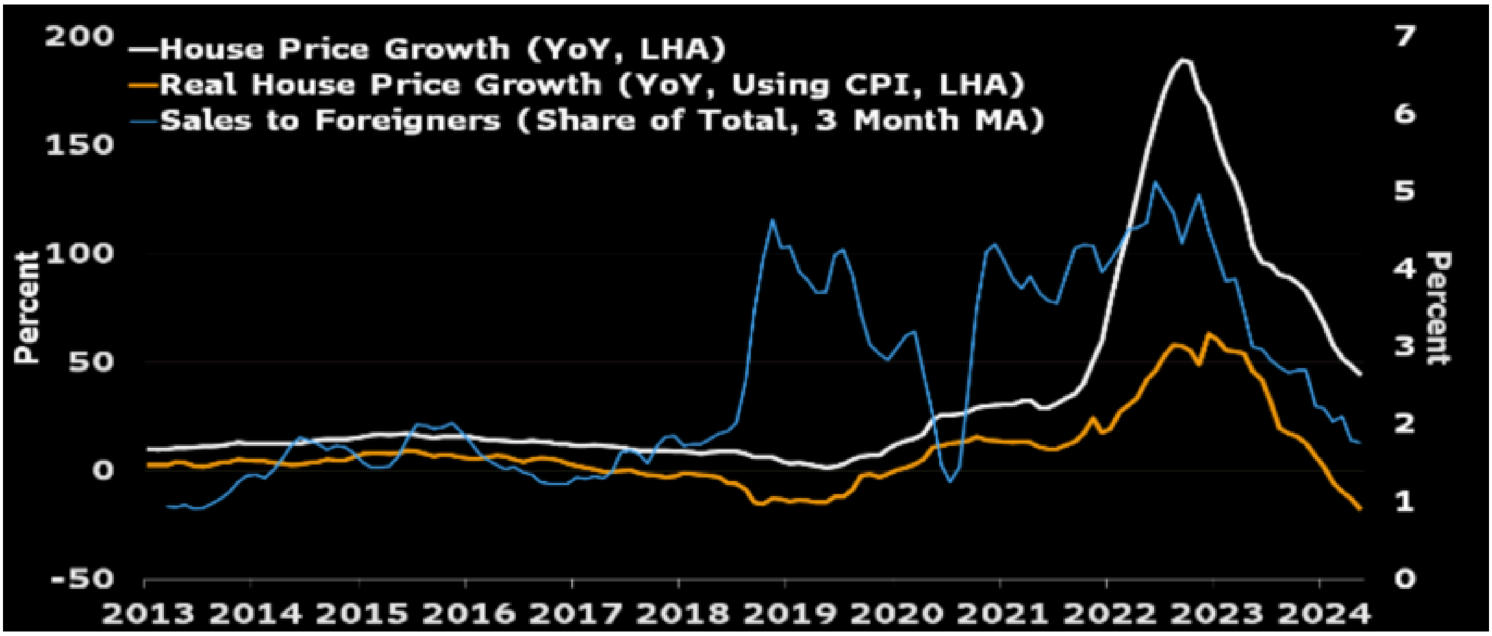
Contributions from rediscount credits totaled $23 billion, according to actual CBRT data through January and the central bank's estimates for February onward. Changes in gold prices may have added $7 billion. We base this calculation on the CBRT's monthly net gold volume data.

The central bank's foreign currency sales to state-owned enterprises, such as BOTAS, constitute our outflows. That number stands at $18 billion, based on CBRT data, and is unchanged from mid-2022. We take the difference of our estimated inflows ($310 billion) and outflows ($18 billion) to arrive at a net inflow figure of $292 billion. The difference between these inflows and the actual change in net reserves (-$8.5 billion) gives the central bank's estimated stealth intervention to support the lira as $300 billion.

Turkey House Prices Slipping, No Relief In Sight

Turkey's once-hot property market is cooling fast - so much so that price growth is lagging behind inflation. House prices were up 48% in April over the year - down from 52% in March. Adjusted for inflation of 69.8% in April, that's actually a negative annual growth rate of nearly 13%. If recent trends continue, we estimate real growth may dip further to -17% for the May print.

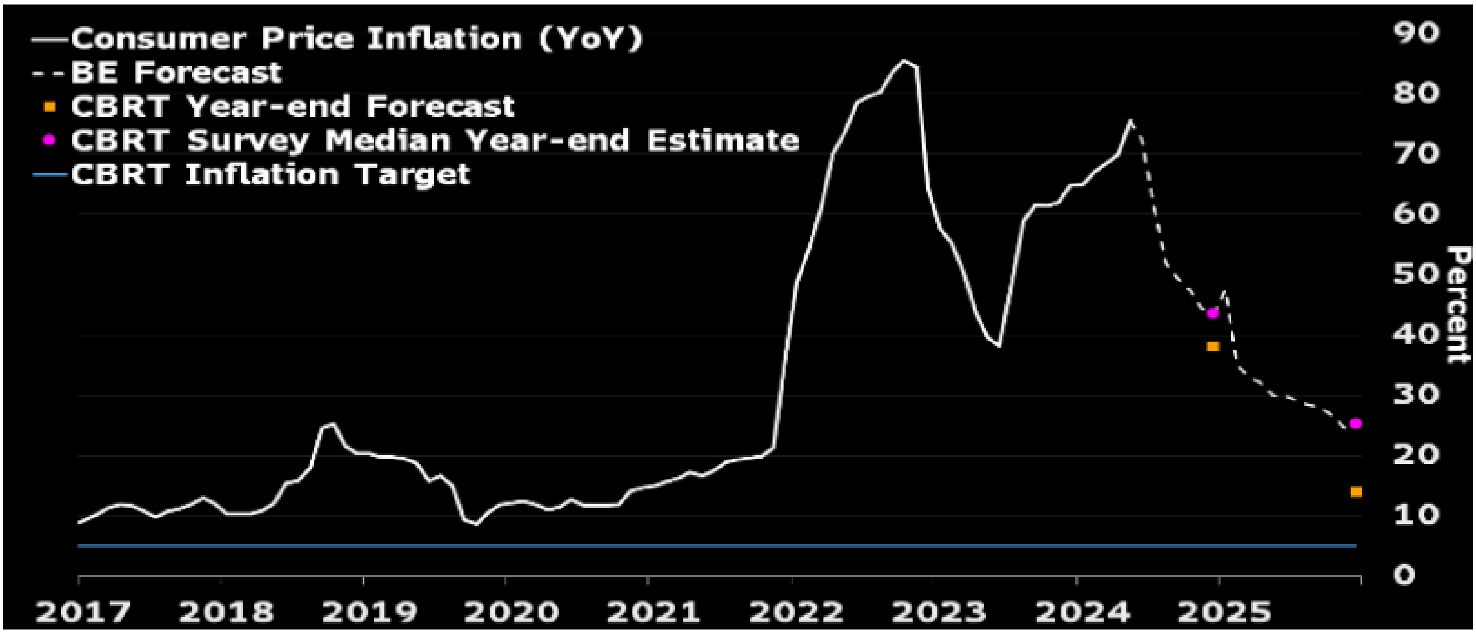
Beyond May, waning interest from foreign nationals and high borrowing costs will likely see nominal price gains easing. High potential returns in other lira denominated assets will also dampen investment demand for property, further cooling prices. Deceleration in price gains starting in June could mean the worst may be over in real terms - but it will likely take time for real returns to become positive. (06/28/24)



Turkey Inflation Puts the Worst Behind, Heads for a Summer Dive

The worst of Turkey's price gains will soon be in the rearview mirror. We see the year-on-year CPI reading falling to 72.4% in June from 75.5% in May. Our call is for faster disinflation through summer, with the annual rate tumbling by 10 percentage points in July and August each - aided by favorable base effects.

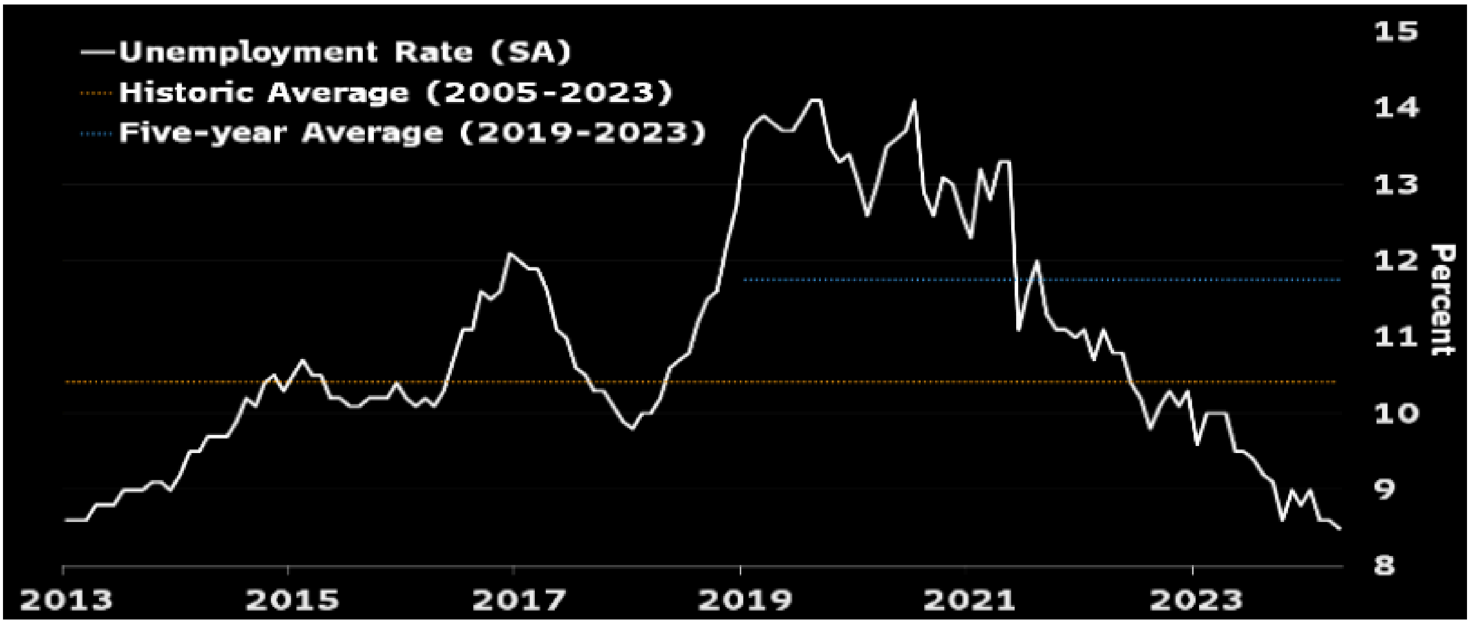
The deceleration in price gains will continue in the fall, albeit at a moderating pace, with the headline rate closing out the year at 43%. That's well above the central bank's latest forecast for 38% and outside its 34%-42% projection band. The median reading in CBRT's own expectations survey points to a print of 43.5%, broadly matching our call.



Turkey Unemployment Still Sliding, Will Reverse in 2H24

Tight monetary policy has yet to hit Turkey's labor market. The unemployment rate inched down to 8.5% in the seasonally adjusted series in April, from 8.6% prior. Religious festivities and good weather contributed to an earlier start to the holiday season this year, boosting services employment. That said, pockets of stress are arising as a composite measure of labor underutilization that factors in time related underemployment, as well as the potential labor force into calculations, shot up to 27.2% in April from 24.1% in March.

We see the central bank’s tight stance taking a toll on activity already - likely to show in the data for 2Q24. Given the high tourism season ahead, however, the related rise in the main unemployment rate may arrive with a slight delay after the summer.



FATF Exit Marks Policy-Shift Anniversary

The removal of Turkey from the Financial Action Task Force's grey list on June 28 comes about a year after the country's economic policy pivot began and underscores policymakers' commitment to combating illicit financial activity. Enhanced trust in the financial system could drive more foreign-capital inflows (including foreign direct investment), with overseas investors holdings of Turkey equities and bonds at about $51 billion vs. a $150 billion peak in 2013.

An IMF study from 2021 shows that capital inflows decline sharply during grey listings (late 2021 for Turkey), with gross inflows worth 6% of GDP on average, which are lower than historical norms.

The exit also means a reduced cost of compliance and anti-money laundering checks for domestic banks, with restored credibility possibly leading to lower borrowing costs.

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