GOLDERA

MANAGEMENT | INVESTMENT | BUSINESS DEVELOPMENT

MARKETS ECONOMY POLITICS

MONTHLY BULLETIN ON TÜRKİYE

JUNE 2024

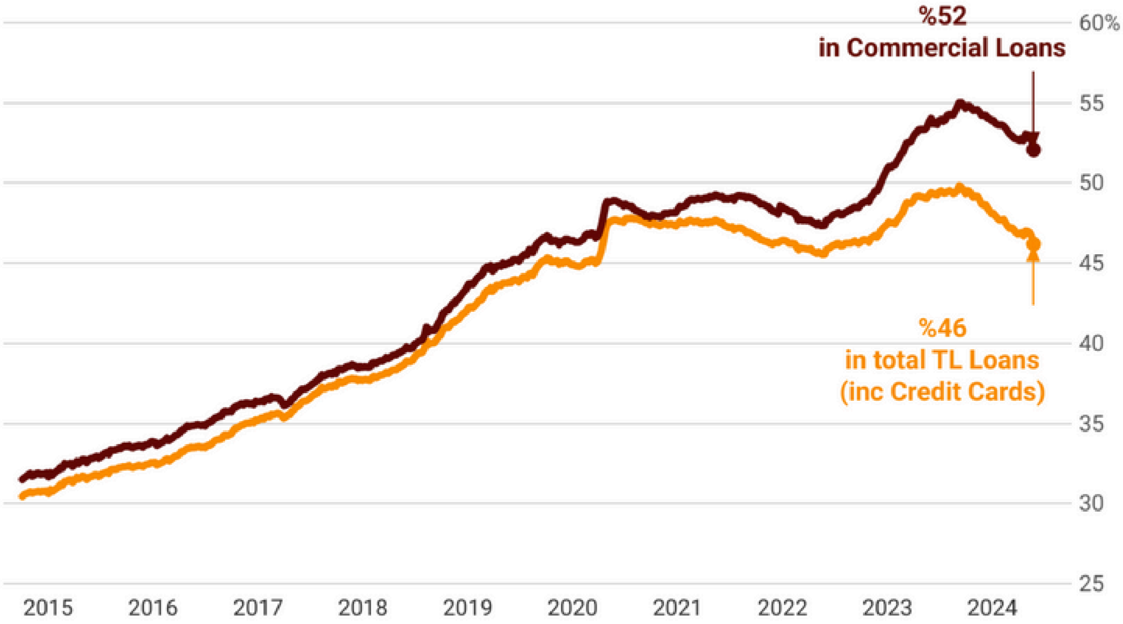
CONTENTS

Central Bank Gross FX Reserves (Bio USD, May 31, Daily)

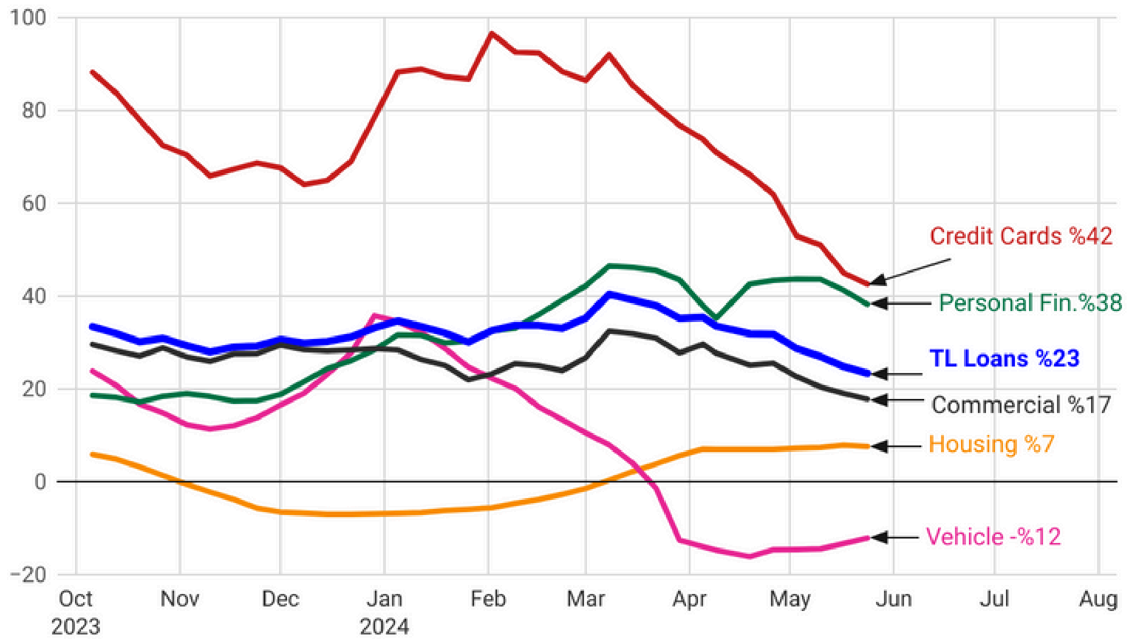
Assets (Bio USD)	29/12/23	24/05/24	YTD
Gold	47.68	59.32	+11.64
FX Banknotes	3.56	2.88	-0.68
Securities + Deposits	5.90	14.44	+8.54
Other FX Balance	87.43	65.06	-22.37
TOTAL	144.57	141.7	-2.87

Liabilities (Bio USD)	29/12/23	24/5/24	YTD
To Turkish Banks	74.92	72.84	-2.08
To IMF & International Insti.	29.89	28.83	-0.06
To Turkish Treasury	9.41	9.01	-0.4
To Turkish Banks in Swap Contract	48.75	21.56	-27.19
To Foreign Central Banks	23.35	23.35	-
TOTAL	186.32	155.59	-30.73

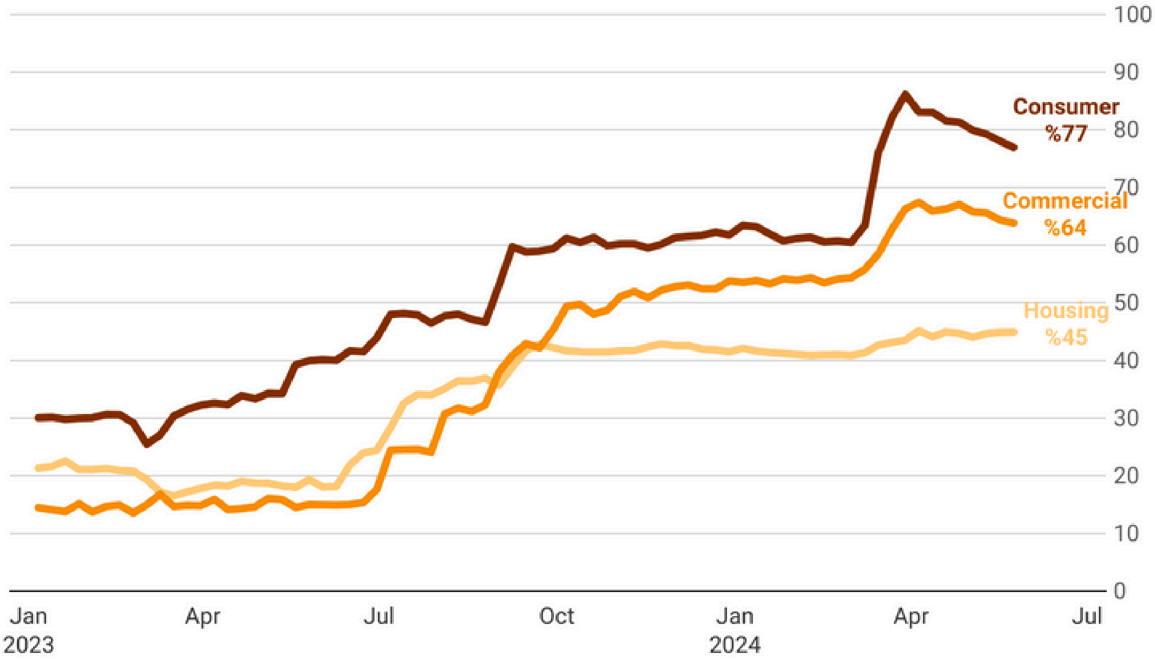
Share of Public Banks in Loans (%)



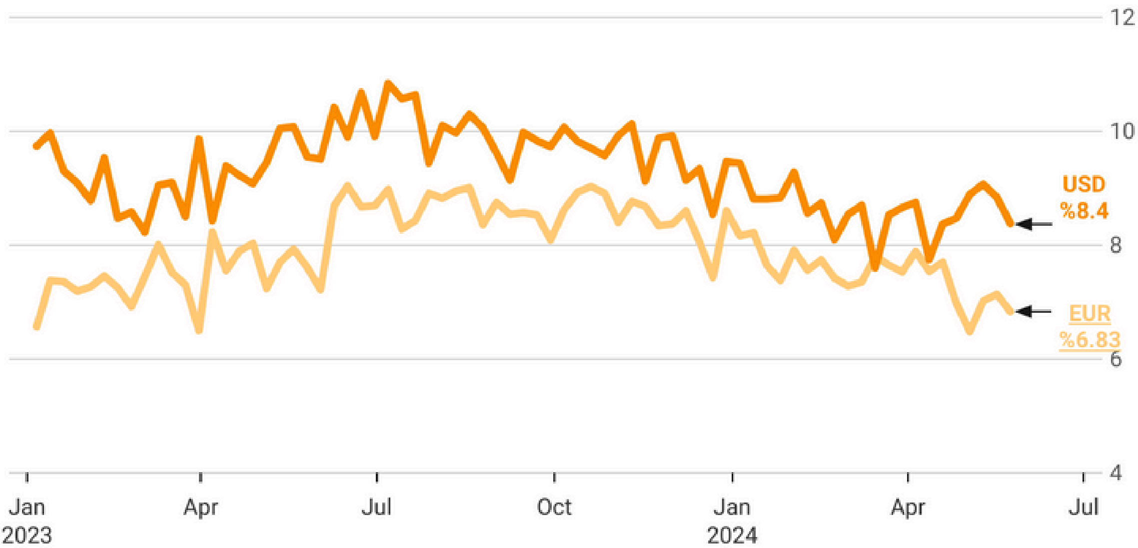
TL Loan Growth Momentum(May 24, 13 Week. Ann., YoY %)



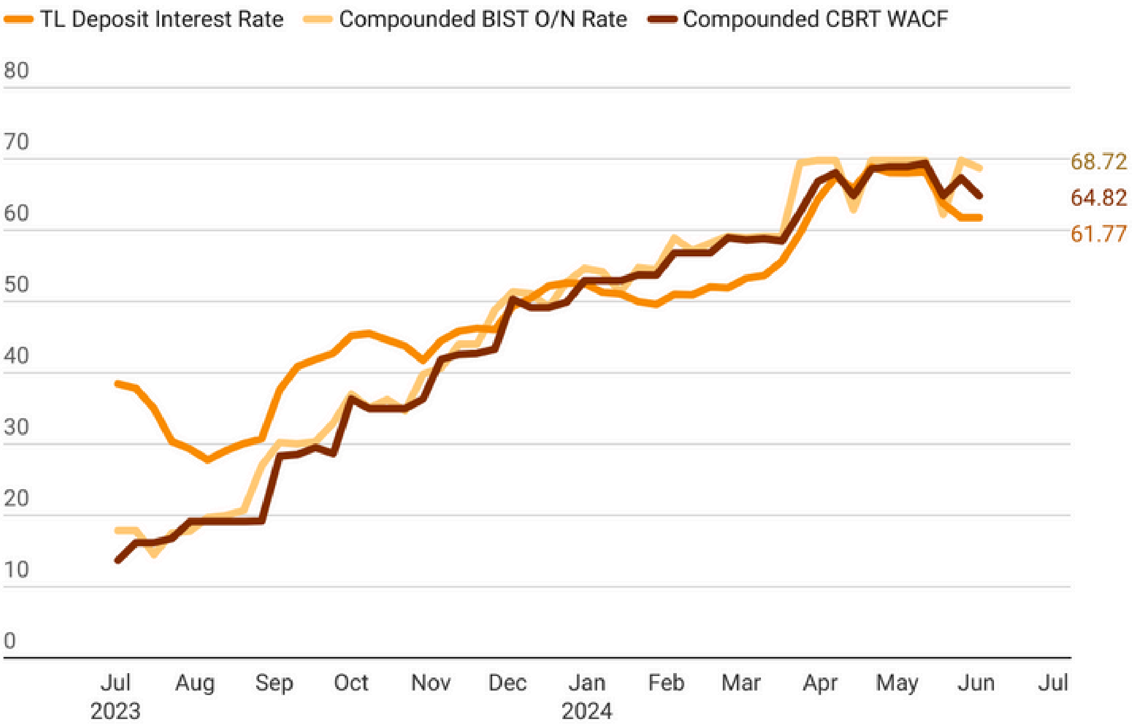
TL Loan Interest Rates (May 24)



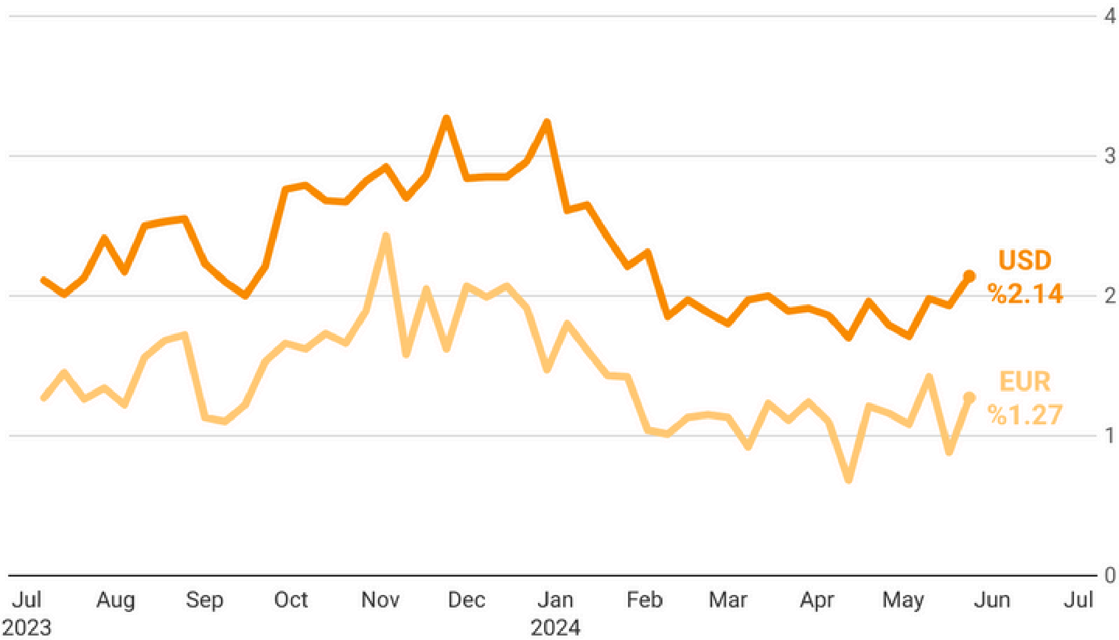
FX Loan Interest Rates (May 24)



TL Deposit Rate (Upto 3M, %, May 24)



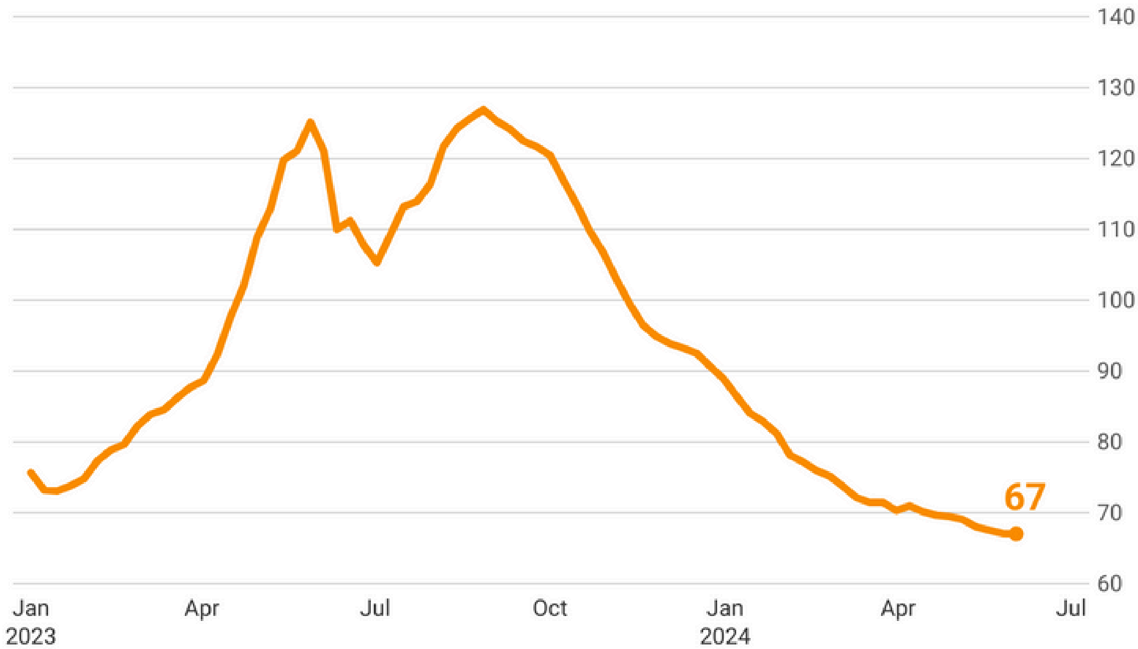
FX Deposit Interest Rates - 3M Maturity (May 24)



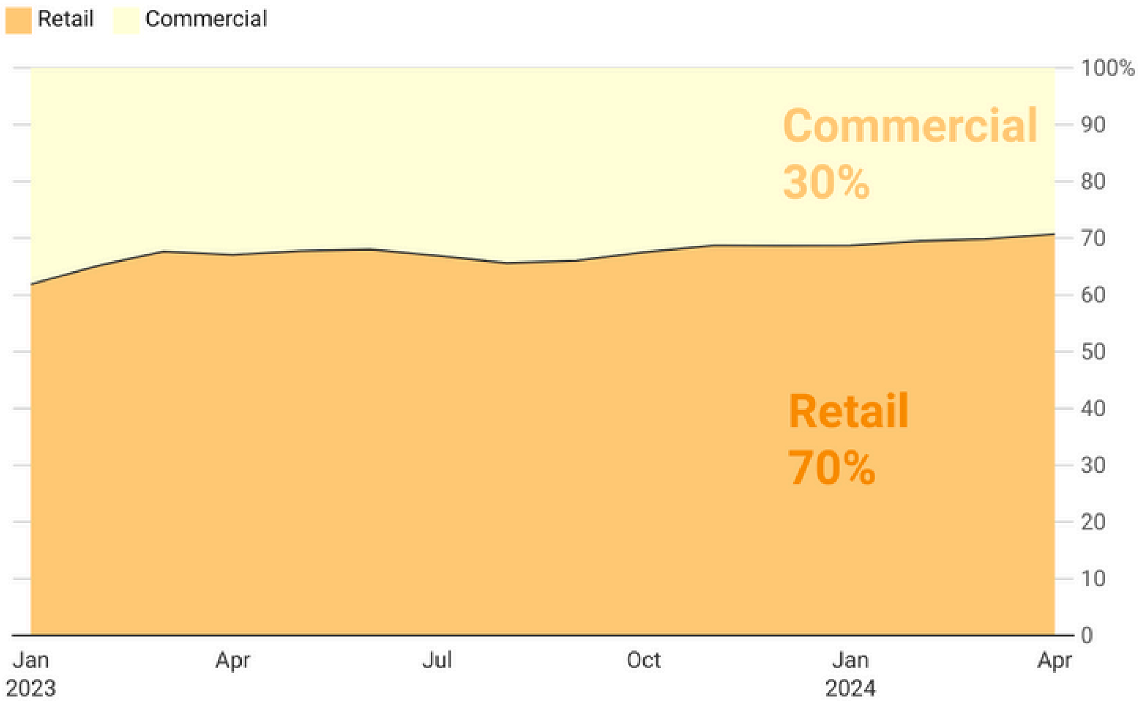
Retail FX Deposits (Bio USD, May 24)

Commercial FX Deposits (Bio USD, May 24)

FX Protected TL Deposits (Bio USD, May 24)



Breakdown of FX Protected Deposits (as of Apr 2024)



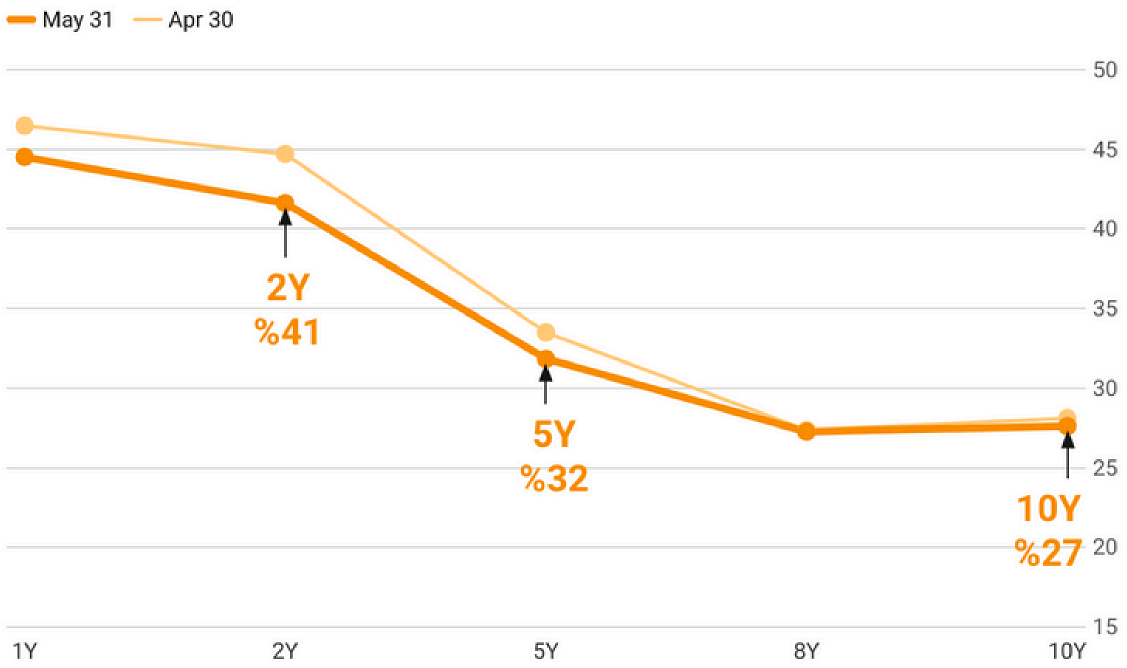
Sovereign Credit Risk (bps, May 31)

Ishares TUR ETF (AUM, Mio USD, May 31)

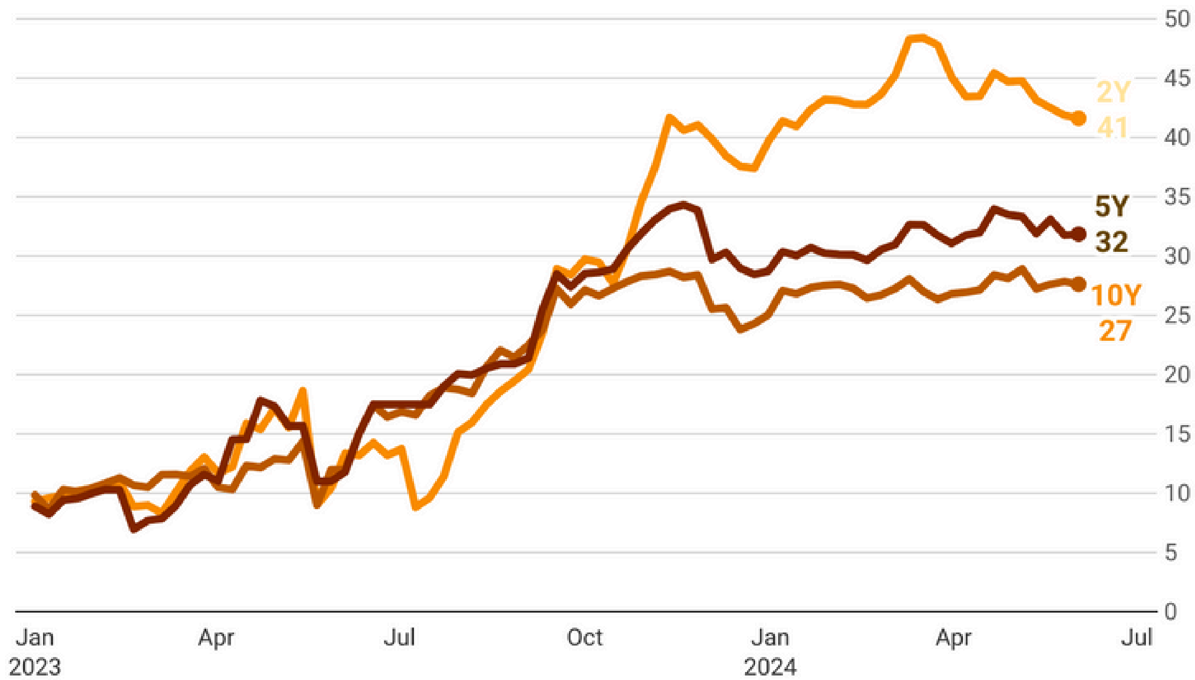
TL Treasury Bonds - For. Ownersh. (Bio USD, May 24, Mcap.)

TL Equity - For. Ownership (Bio USD, May 24, Mcap.)

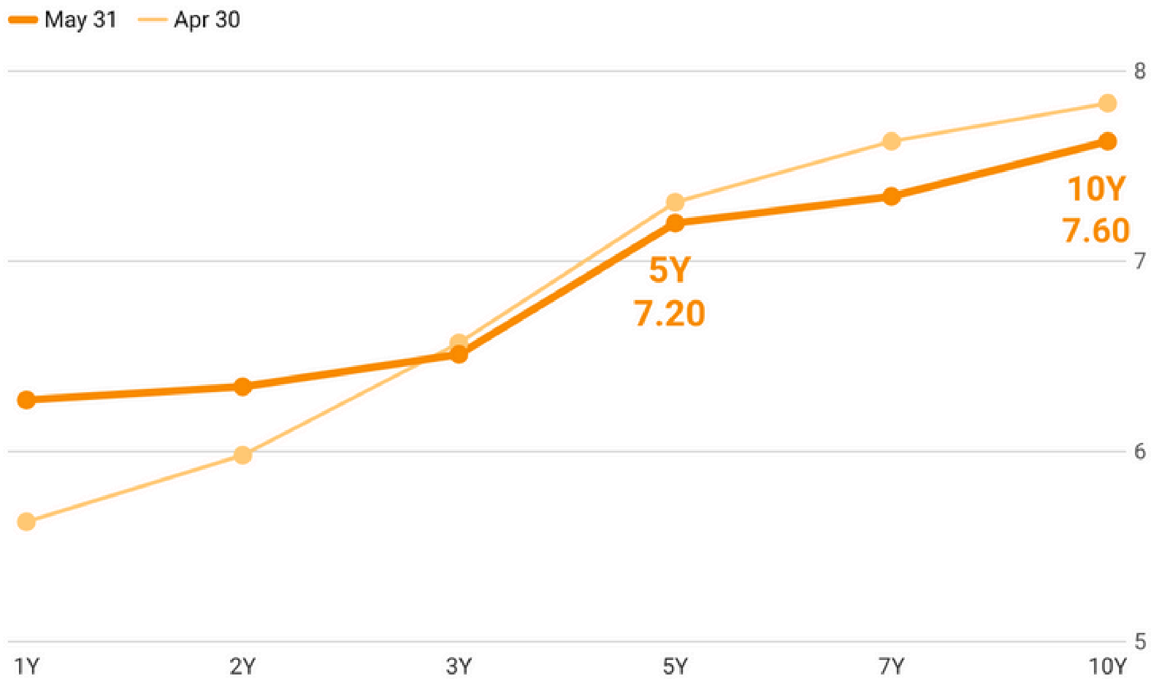
TL Sovereign Yield Curve



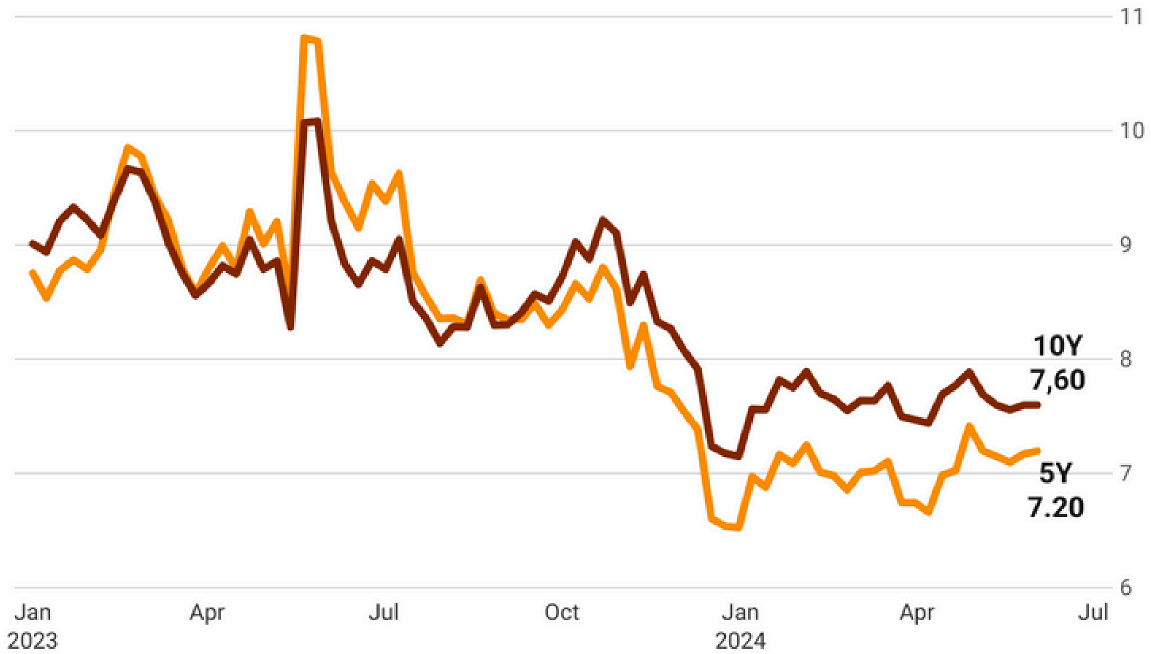
Turkish Lira Sovereign Bonds (%, May 31)



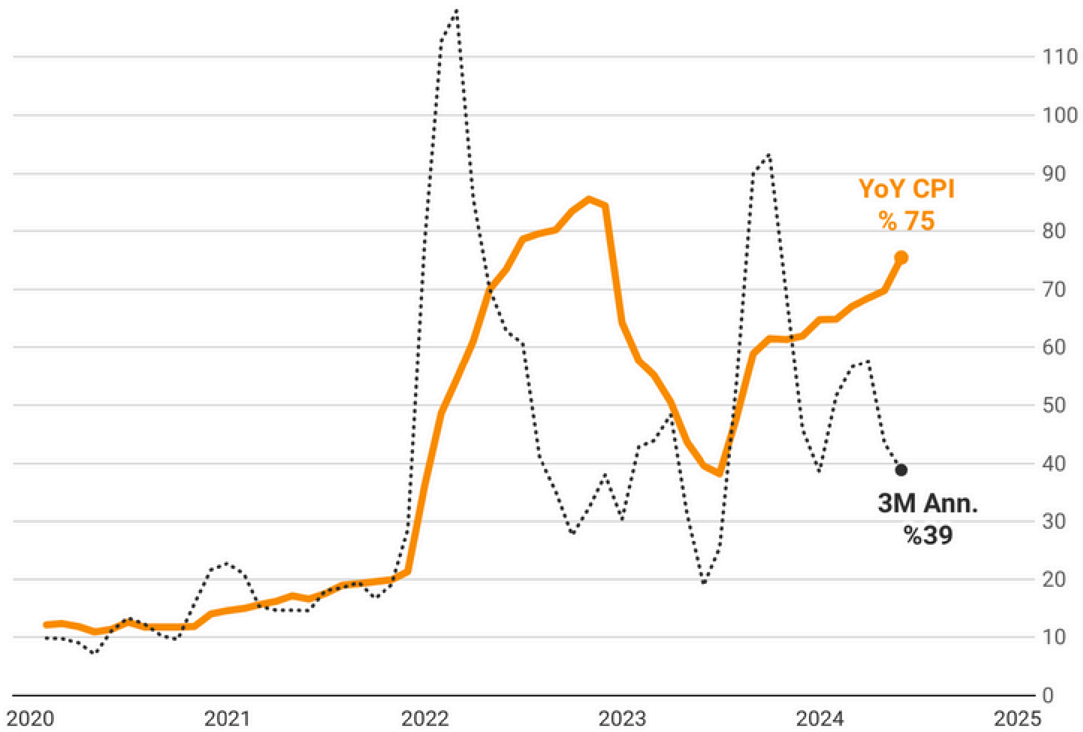
Turkey Sovereign Yield Curve (%, USD)



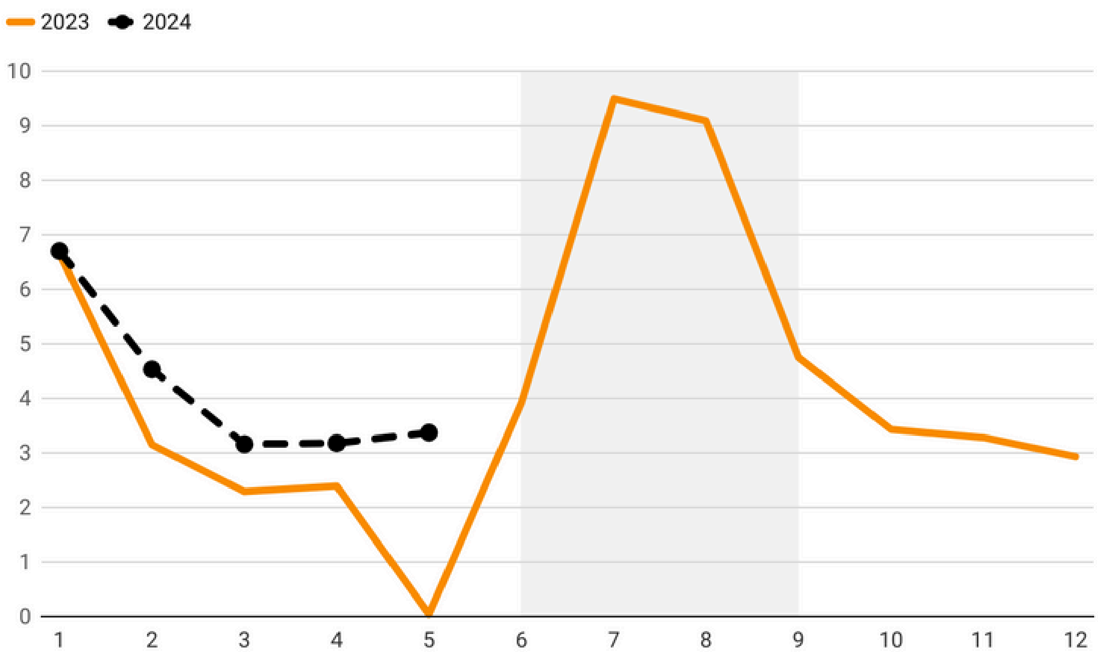
Turkey USD Sovereign Bonds (%, May 31)



Headline Türkiye CPI



Monthly Headline CPI Türkiye



TURKEY REACT: 1Q GDP Underwhelms, Signals Softer Growth Ahead By Selva Bahar Baziki (Economist)

(Bloomberg Economics) -- OUR TAKE: Turkey's underwhelming first quarter growth reading is a sign of things to come. Going forward, the central bank's tighter monetary policy is set to weigh further on activity. We expect 2024 annual growth to slip to 3.2%, well short of the economy's above-5% performance before the pandemic.

Turkey's GDP grew by 5.7% in 1Q24, up from 4Q23's 4%. The reading was lower than the median consensus call of 5.8% and our projection of 6%.

Despite undercutting expectations, the growth rate climbing above 5% at a time of aggressive central bank tightening is surprising. We explain the elevated rate as being mainly due to a surge in household consumption, which was up by 7.3% year-on-year in the reporting period.

Expectations of a currency slide following the March 31 local elections likely played a key role in households front-loading spending in 1Q24. Pre-election transfers ahead of the local elections and households' higher propensity to spend during Ramadan (which started in March) may have added further support.

Investment also expanded, rising by 10.3% year-on-year in 1Q24. This was also likely due to expectations of lira depreciation, even as borrowing costs remained high. It is worth noting the lira lost more than 20% against the dollar in the month following May 2023 elections, which drove sentiment for a similar outcome following the March vote.

We expect the economy to feel the burn from the tighter policy cycle starting in the current quarter and carrying through to 2025. We expect high borrowing costs (with the policy rate rising from 8.5% in May 2023 to 50% in March), coupled with a tighter fiscal stance, to reduce the 2024 annual growth rate to 3.2%. Our current estimate reflects a technical update from an earlier call of 3.1% due to underlying trends in the 1Q24 data – even as the overall print fell short of our estimate.

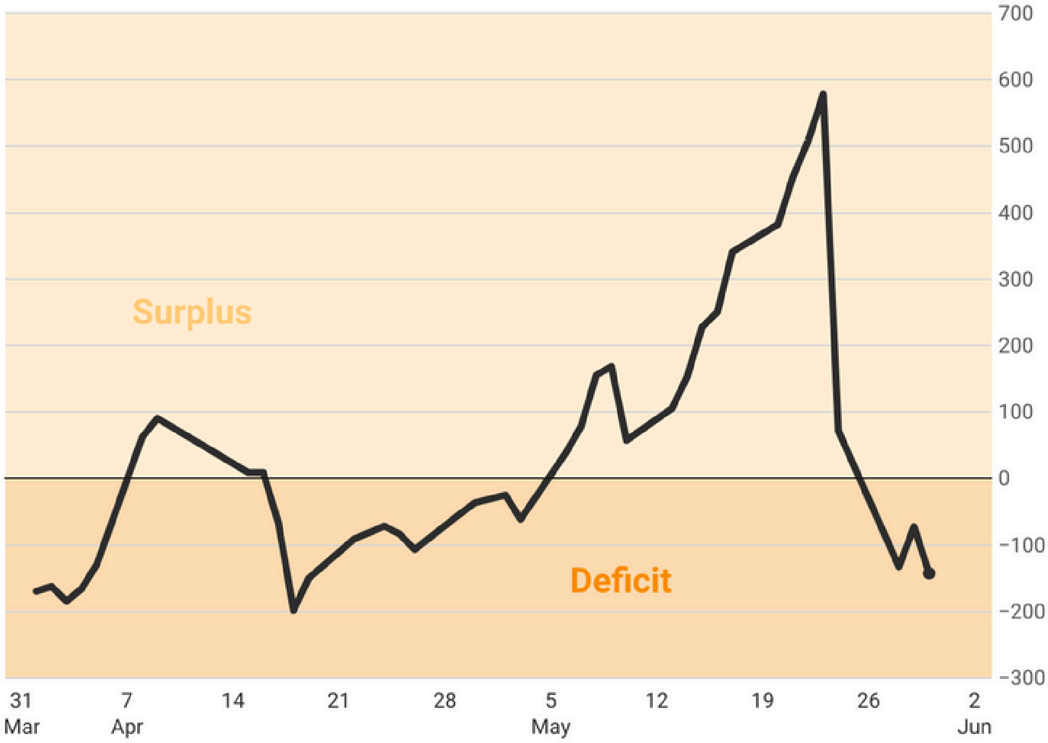
TURKEY INSIGHT: Central Bank Liquidity Action Risks Looser Rates By Selva Bahar Baziki (Economist)

(Bloomberg Economics) -- The Central Bank of the Republic of Turkey's latest reserve requirement moves will swiftly solve its lira abundance problem. The CBRT's choice of weapon to tackle the issue suggests policymakers may consider the oversupply a short term concern, but they also risk easing financial conditions by making lira deposits more expensive for commercial banks to hold.

The problem: The central bank's recent efforts to accumulate FX reserves has contributed to an oversupply of lira in the market. This is an issue for the CBRT, as it means commercial banks take the interbank or CBRT borrowing rates as their reference rate, rather than the higher CBRT policy rate. The solution: Lifting reserve requirements for deposits is a fast and effective remedy for the lira oversupply problem, as we previously highlighted. We estimate the central bank's action will remove 636 billion lira from the market - more than the oversupply value on the day of the decision.

The (potential) new problem: The move makes lira deposits costlier for commercial banks to hold. Lenders may be unable to shift that cost onto lira loans given they already face waning growth amid higher borrowing costs and a weaker economic outlook. That could lead to lower deposit rates, resulting in an easing of financial conditions. Back in 2007, the central bank issued liquidity bills – securities with maturities of up to 91 days – to drain lira oversupply caused by its FX-purchase auctions. We interpret the central bank approaching a similar problem stemming from a similar cause with a different solution as a signal it may be viewing the current issue as more temporary than the prior case. That could suggest the central bank doesn't expect its efforts to support FX reserves to extend beyond the summer.

Turkish Lira liquidity will be in deficit again after the recent change in required reserves.



TURKEY INSIGHT: Carry Trade Adds $16 Billion With More to Come By Selva Bahar Baziki (Economist)

(Bloomberg Economics) -- Our calculations show Turkey's carry trade inflows are up by $16 billion since the March local elections. The lira's muted second quarter, coupled with interest rate differentials that are likely to widen further in its favor, suggests a relatively stable currency outlook. As such, we expect Turkey's carry trade inflows to continue to grow in the near term.

We estimate about $16 billion of potential inflows related to carry trade between the March vote and May 17. That's small when compared with the size of Turkey's trillion-dollar economy, but relatively high given portfolio inflows of about $9.5 billion across the first quarter. It also comes as no surprise given Bloomberg calculations show the lira's 7.5% carry returns against the dollar so far in this quarter. That's the second highest globally, coming a close second to the Chilean peso's 7.7% return.

·Two factors make us think the high volume of flows will continue in the short-term.

Borrowing costs in hard currencies are likely to ease as central banks in major economies start to trim rates from mid-year. In contrast, we expect Turkey's central bank to maintain its policy rate at 50% through 3Q24 - suggesting increasingly higher relative returns, especially as inflation is set to ease in the second half.

Turkey's policymakers are targeting a real appreciation in the currency, indicating low currency-related risks on potential earnings. The current year-end pricing in dollar-lira forward markets implies a 2.6% lira depreciation in each of the months ahead. For the administration's goal to materialize, the lira needs to remain stronger given our year-end inflation call suggesting an average monthly inflation gain of 2.4% starting in May. The central bank's forecast implies an even lower 1.9%.

TURKEY REACT: Brakes on Rates, Full Throttle on Alt-Tools By Selva Bahar Baziki (Economist)

(Bloomberg Economics) -- OUR TAKE: The Central Bank of the Republic of Turkey's decision to complement a policy rate pause with liquidity steps lends support to our view that policymakers will further restrict financial conditions through revisions to its alternative measures and an active use of the interest rate corridor. The rate pause comes even as underlying inflation dynamics suggest a further increase is warranted.

The CBRT kept its one-week repo rate unchanged at 50% at its May gathering, which we expect to be the peak of the current rate cycle. The move matched our call and the median consensus expectation from a Bloomberg survey and extends the rate pause to a second consecutive policy meeting.

Following the decision, the central bank also announced changes to reserve requirements that will mainly help drain extra liquidity in the market and favor a faster switch to regular lira deposits from FX-protected accounts.

We think the inflation dynamics warrant a further tightening in the policy stance. Inflation has exceeded the central bank's expectations so far this year and annual price gains haven't peaked yet. We expect the annual rate to top out in May with a reading in the mid-70s, up from 69.8% in April.

The deceleration we forecast for the second half is likely to see the annual inflation rate retreat to 43% at year-end. That's still more than eight times the CBRT's 5% target. The median year-end reading in the central banks own survey points to 43.5%. Both are well above the CBRT forecast for 38% and outside its 34%-42% projection.

The central bank's statement following the May meeting offers a hawkish message regarding further tightening in the case of the inflation outlook worsening. We think the decision makes it likelier the central bank will deliver necessary tightening through additional revisions to its alternative tools rather than via rate hikes.

In this regard, the CBRT is likely to prioritize pro-lira policies within its alternative tools, such as lowering the regulatory costs for banks with higher transitions from non-lira to lira deposits. That would supplement the steps taken at this meeting, such as reducing the remuneration paid to the reserve requirements for FX-protected deposits.

The central bank could also choose to shut its repo window. That would mean all liquidity is provided through its overnight lending facility, where the associated rate sits at a higher 53%, directly raising the reference rate for lenders

CBRT Policy Outlook

Our baseline call has the key rate on hold at 50% through the third quarter, with the CBRT then delivering 500-basis points of cuts in 4Q24 – taking the policy rate to 45% by year end. That view is dovish when compared to the median consensus expectation for 250- bps of cuts.

The risks to our inflation outlook are skewed to the upside on potential pressures from outsized increases to the government's tax and fee schedule, as well as a further escalation in the Middle East war. Should these risks materialize, we would reduce our rate cut expectations for this year, moving closer to the current the consensus view.

CBRT's Policy Steps Since Mid-2023 Pivot

After pivoting away from accommodative policies following the May 2023 elections, the CBRT has hiked its one-week repo rate by a cumulative 4,150 bps to 50%, with the last increase coming in March. But that's not the full extent of its policy tightening. We estimate the central bank added another 380 bps to the policy stance through revisions to its alternative tools, including:

· 40 bps from tighter reserve requirements announced in July 2023,

· 230 bps from lower credit growth caps introduced in March,

· 50 bps from raising the cap on credit card transaction rates in April,

· as much as 60 bps from the hike to reserve requirement remuneration caps in April.

In addition, the central bank has actively used its interest rate corridor to partially shift funding away from the repo window and into its overnight lending facility.

TURKEY INSIGHT: Central Bank to Argue Expectations Favor a Hold By Selva Bahar Baziki (Economist)

(Bloomberg Economics) -- Turkey's inflation data and outlook suggest an interest rate hike is needed at the May 23 central bank meeting, but we don't see that happening. Instead, we expect policymakers to argue the improvement in inflation expectations supports interest rates remaining on hold.

The Central Bank of the Republic of Turkey has listed inflation expectations moving into line with its own forecasts as a policy target for this year. The reality, though, is the median year-end expectation from its own survey is 43.5%, which is still well above its forecast of 38% and outside its 34%-42% projection band. In other words, the central bank is yet to deliver on its objective. However, we think the CBRT is looking elsewhere to find support for a likely policy rate hold. The positive link between current inflation outcomes and inflation expectations seems to have flipped, with year-ahead expectations recently falling despite still rising inflation.

Turkey's Inflation Outcomes and Expectations Decoupling

We see two reasons for the break in trend.

First, strong favorable base effects are expected to dampen annual gains in the summer months. We estimate a large impact in July and August, taking annual inflation from around 70% in June to 50% in August – a total of 20 percentage points in just two months.

Second, the central bank's tight stance and guidance. The decoupling between the two series followed the central bank surprising with a 500 basis point increase in borrowing costs in November – double the median expectation – and then a 500-bp hike to the policy rate in March – against expectations for a hold.

The CBRT has lifted its key rate by a cumulative 4,150 bps to 50% since the policy pivot that followed the May 2023 elections. Further central bank rate hikes are warranted, in our view, given the elevated price gains and sticky underlying inflation dynamics. Such a move would also speed up the improvement in expectations, helping keep future price gains under wraps.

We expect the inflation rate to still be in double digits (13%) at end-2026 – more than three years after the CBRT started its aggressive tightening cycle. The CBRT's own forecast is 9% – which is almost double its 5% target.

With the policy rate remaining on hold, we expect the central bank to further lean on its alternative tools. In this regard, revisions to its reserve requirements tool, credit growth caps and banking regulations are all in play to help keep financial conditions restrictive.

Turkish Inflation Tops 75% But Worst of Crisis Likely Over
By Beril Akman

- Inflation in May accelerated to 75.5% in likely peak
- Officials aim to get inflation to slow to 38% by year-end

(Bloomberg) -- Turkey's inflation accelerated more than forecast last month, in what officials hope marks the worst of a yearslong cost-of-living crisis.

Data on Monday showed inflation reached an annual 75.5% in May, from just under 70% a month earlier. Monthly price growth, the central bank's preferred gauge, also quickened and hit 3.4%. Both readings exceeded the median economist predictions.

The trajectory of prices with a peak in May follows the path mapped out by the central bank as it embraced more conventional economics since President Recep Tayyip Erdogan's reelection a year ago. The question now is whether inflation will also hew closely to forecasts on the way down and prepare the ground for interest rates to fall after an aggressive cycle of monetary tightening.

Policymakers anticipate Turkey's inflation will end the year at 38%, which would still leave it as the world's sixth-fastest, according to the International Monetary Fund. "The worst is behind us," Turkish Finance Minister Mehmet Simsek said on X shortly after the data release. Permanent declines in inflation would begin in June, bringing it "probably under 50%" by the end of the third quarter, he said.

Signs of easing inflationary pressures are starting to emerge.

A measure of Turkish manufacturing activity compiled by the Istanbul Chamber of Industry and S&P Global has dropped below the 50-mark that separates expansion from contraction. Input costs and output prices both increased "at much weaker rates" in May than in the previous month, according to a report published on Monday.

Official borrowing costs have been kept on pause at the last two meetings, though policymakers introduced measures to restrain loan growth and remove excess liquidity from the market to ensure financial conditions stay restrictive.

The central bank says a significant deviation from the projected outlook and expectations could prompt another rate hike, after a cumulative tightening of over 40 percentage points in less than a year brought its benchmark to 50% in March.

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