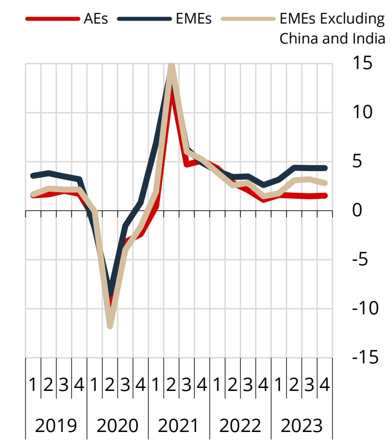
II. Macroeconomic Outlook

II.1 International Developments

Global financial conditions and ongoing tight monetary policies implemented by central banks of advanced economies continue to weigh on global growth. Key indicators of economic growth imply that the growth outlook for the US economy diverges favorably from that of the euro area.

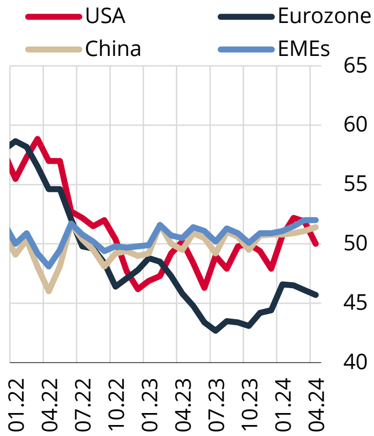
The ongoing flat course in the global growth outlook was maintained in the final quarter of 2023 (Chart II.1.1). This mainly stemmed from the tightening in financial conditions and the adverse impact on economic growth due to sustained tight monetary policies in advanced economies. Leading indicators for growth suggest that the global manufacturing PMI value surpassed the reference value of 50 across countries and recovery in economic activity started in countries other than the euro area (Chart II.1.2). Indicators for the euro area, one of Turkey's major trading partners, suggest that the slowdown in economic activity will continue and that the recovery will be delayed compared to the US (Chart II.1.2 and Chart II.1.3).

Chart II.1.1: Countries' Growth Rates (%)



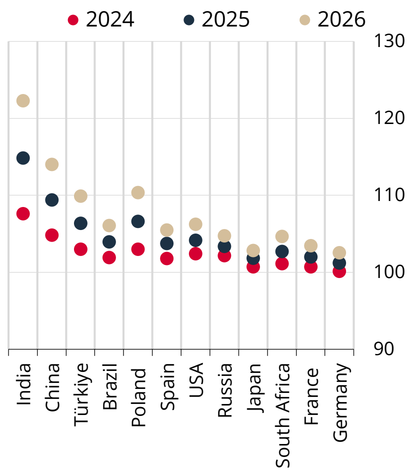
Source: Bloomberg Last Observation: 2023Q4

Chart II.1.2: Manufacturing PMI (Index)



Source: Bloomberg Last Observation: 04.24

Chart II.1.3: Real GDP and Projections (Annual, 2023=100)



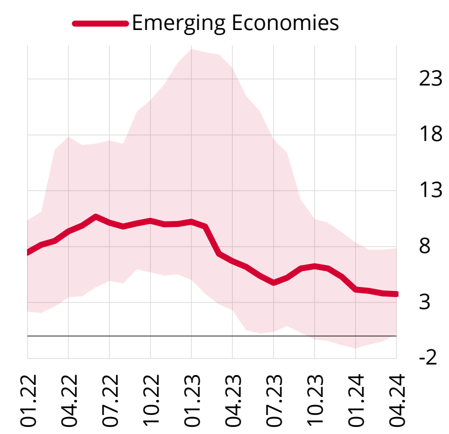
Source: Bloomberg Last Observation: 2023Q4

Note: AEs include the USA, the euro area, Japan, the United Kingdom, Canada, Korea, Switzerland, Sweden, Norway, Denmark, and Israel, while EMEs include China, Brazil, India, Mexico, Russia, Türkiye, Poland, Indonesia, South Africa, Argentina, Thailand, Malaysia, Czechia, Colombia, Hungary, Romania, the Philippines, Ukraine, Chile, Peru, and Morocco. In Chart II.1.3, the Bloomberg data is based on the World Bank method since the Indian fiscal year has a different period than the fiscal years of other countries.

The downtrend in headline inflation in advanced economies was replaced by a flat course.

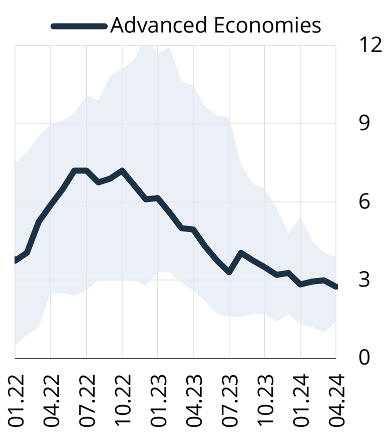
Inflation rates remained above inflation targets in many countries (generally 2% in advanced economies and 3.5% on average in emerging economies) (Chart II.1.4 and Chart II.1.5). Recently, heightened geopolitical risks, supply conditions and high energy prices stand out as risk factors that adversely affect global inflation (Chart II.1.6).

Chart II.1.4: Global Inflation-Emerging Economies (%)



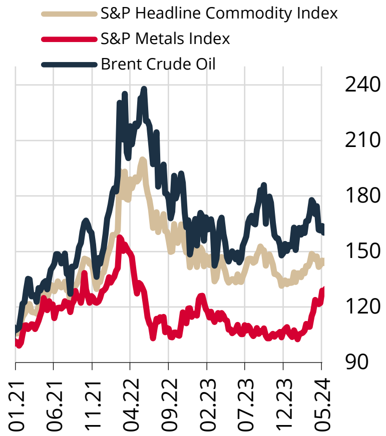
Source: Bloomberg Last Observation: 04.24

Chart II.1.5: Global Inflation-Advanced Economies (%)



Source: Bloomberg Last Observation: 04.24

Chart II.1.6: Commodity Indices (Index, 25.12.2020=100)



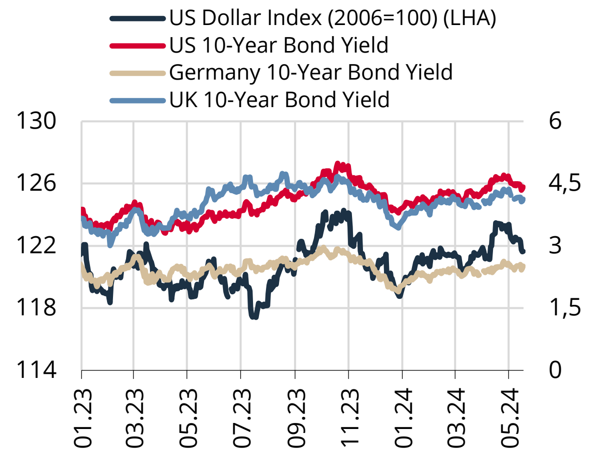
Source: Bloomberg Last Observation: 17.05.24

Note: Inflation rates refer to the annual change in CPI in respective countries. The straight line in Chart II.1.4 and Chart II.1.5 shows the median value across country groups. EMEs include Brazil, Mexico, Russia, Poland, Indonesia, S. Africa, Thailand, Czechia, Colombia, Hungary, Romania, Romania and the Philippines. AEs include the USA, the euro area, Japan, the UK, Canada, S.Korea, Switzerland, Sweden, Norway, and Israel. Shaded areas indicate the highest and lowest values observed in the respective country groups.

The US dollar index declined slightly, while long-term bond yields of advanced economies decreased slightly following the signal that the tight monetary policy of advanced economies had come to an end.

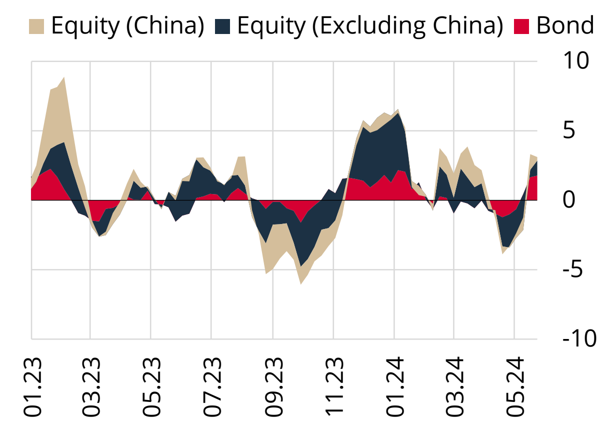
The US dollar index, which had risen in the previous reporting period, declined slightly in the final quarter of 2023, but picked up again in the first quarter of 2024. Strengthening expectations that central banks of advanced economies will cut interest rates later and more slowly compared to the previous reporting period limit the decline in 10-year bond yields (Chart II.1.7). Since the beginning of the year, uncertainties over the rate-cut processes of central banks of advanced economies, particularly of the USA, and developments in the global risk appetite have led to a volatile course in portfolio flows to EMEs (Chart II.1.8). Although there were outflows from debt and equity markets, and equity markets -excluding China-due to increased risk perception following the weakening of rate cut expectations, recent data point to some portfolio inflows.

Chart II.1.7: US Dollar Index and 10-Year Bond Yields in Advanced Economies (Index, %)



Source: FRED, Bloomberg Last Observation: 17.05.2024

Chart II.1.8: Weekly Portfolio Flows to EMEs (4-Week Moving Average, Billion USD)

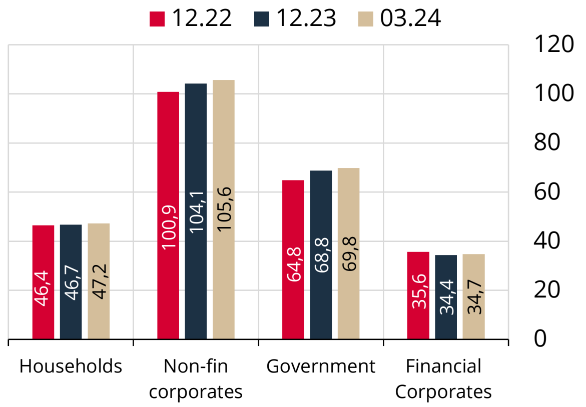


Source: IIF Last Observation: 17.05.2024

Since 2023, the financial indebtedness ratios of emerging economies have increased, while the financial indebtedness ratio of the public sector in advanced economies has remained high.

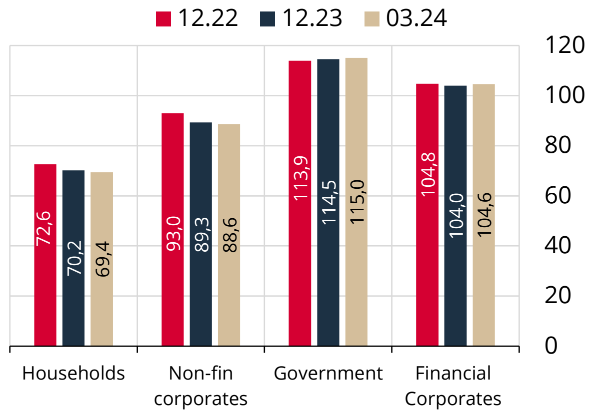
In EMEs, financial indebtedness increased across all sectors. In advanced economies, the financial indebtedness of the public and financial sectors stood out, while indebtedness in other sectors declined slightly (Chart II.1.9 and Chart II.1.10). Ongoing monetary tightening on a global scale continues to pose upside risks to sectors with high financial indebtedness.

Chart II.1.9: Financial Indebtedness in EMEs
(Debt/GDP, %)



Source: IIF Last Observation: 2024Q1

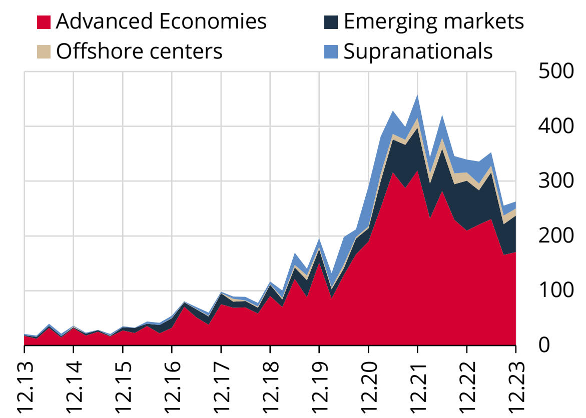
Chart II.1.10: Financial Indebtedness in AEs
(Debt/GDP, %)



Source: IIF Last Observation: 2024Q1

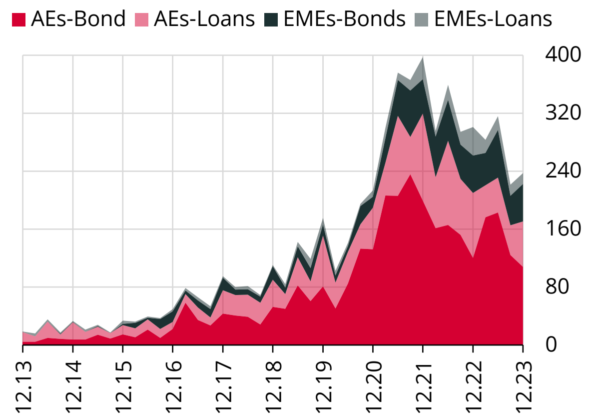
While advanced economies continued to be a major actor in sustainability-themed borrowing, sustainability-themed borrowing declined slightly on a global scale.
Since the second quarter of 2023, environmental, social and governance-themed borrowing has been decreasing moderately (Chart II.1.11). This was mainly driven by rising financial costs due to tight monetary policies and heightened geopolitical risks. Advanced and emerging economies increased the weight of bank loans in sustainability-themed borrowing and slightly reduced their bond issues (Chart II.1.12).

Chart II.1.11: : Environmental, Social, and Governance-Themed Borrowing (Billion USD)



Source: IIF Last Observation: 2023Q4

Chart II.1.12: Breakdown of Bond Issues and Bank Loans for Environmental, Social, and Governance Purposes (Billion USD)



Source: IIF Last Observation: 2023Q4

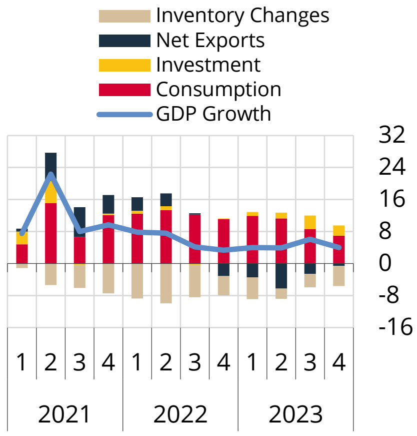
Notes: Emerging Economies (EMEs), Advanced Economies (AEs), and Offshore banking centers are the sum of 141, 35, and 24 different countries, respectively. Detailed information on country lists can be found in the sustainable debt screen on the IIF corporate website. Environmental, Social and Governance- themed borrowing can be provided in the form of both bonds and bank loans, and Chart II.1.12 analyzes this breakdown in detail for AEs and EMEs.

II.2 Main Domestic Macroeconomic Developments

Economic activity remained robust in the second half of 2023, while domestic demand rebalanced.

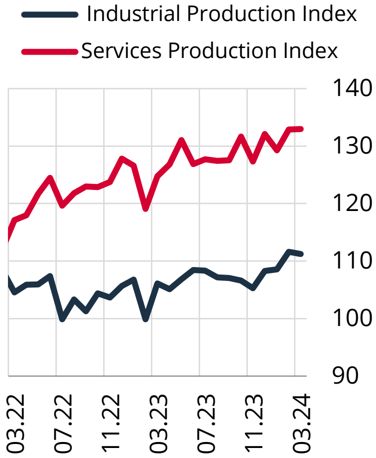
The brisk course of economic activity continued in the final quarter of 2023, while year-on-year growth stood at 4% and quarter-on-quarter growth at 1%. In the final quarter of 2023, the contribution of consumption expenditures to growth decreased, while that of net exports increased. The contribution of investment expenditures to growth is positive compared to the first half of 2023 (Chart II.2.1). In the first quarter of 2024, industrial and services production increased (Chart II.2.2). Leading indicators suggest that economic activity remained buoyant in the first quarter of 2024 as well (Chart II.2.3).

Chart II.2.1: Annual GDP Growth and Contribution of Expenditures (% Points)



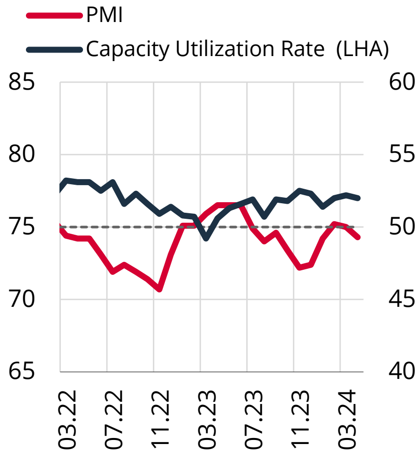
Source: TURKSTAT Last Obsv: 2023Q4

Chart II.2.2: Production Indices (Index, 2021=100)



Source: TURKSTAT Last Obsv: 03.24
Note: Industrial and services production index is adjusted for seasonal and calendar effects.

Chart II.2.3: Selected Leading Indicators of Economic Activity (Ratio, Index)

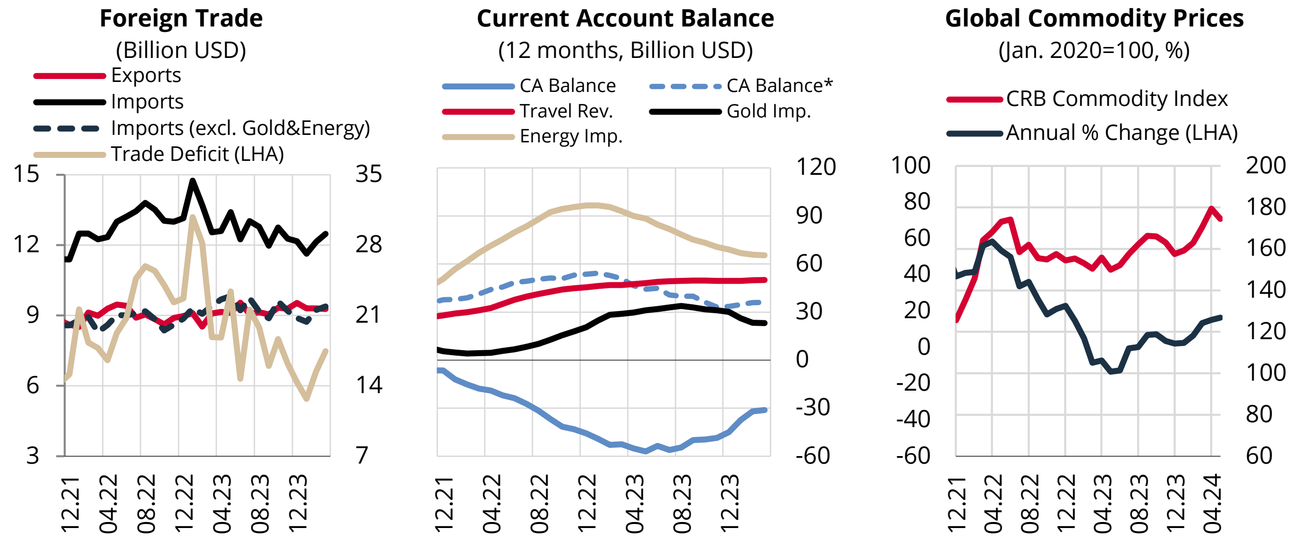


Source: CBRT, ICI Last Obsv: 04.24
Note: Manufacturing industry capacity utilization rate is adjusted for seasonal and calendar effects. The dashed line shows the stable state of Manufacturing Industry Purchasing Managers' Index (PMI).

The decline in the foreign trade deficit and the favorable outlook in the services balance helped the current account balance to improve further.

The foreign trade deficit narrowed on the back of the rise in exports excluding gold and the decline in imports. While the decrease in energy imports supported the narrowing in the current account deficit, the foreign trade deficit widened slightly due to the increase in imports excluding gold and energy in recent months. In the upcoming period, geopolitical developments, global commodity prices and the course of domestic and external demand may have an impact on the current account deficit (Chart II.2.4).

Chart II.2.4: Current Account Developments



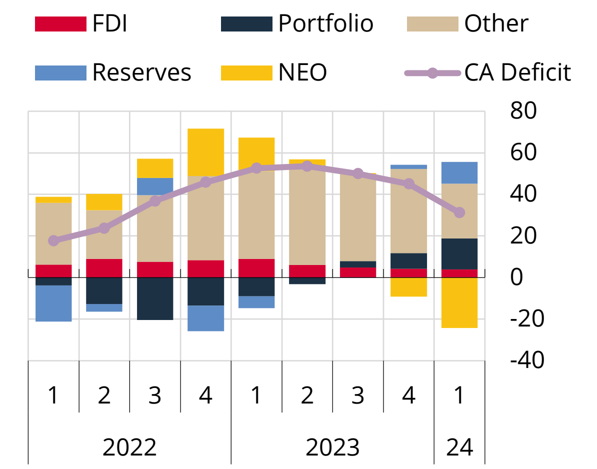
Source: CBRT, TURKSTAT, Ministry of Trade, Refinitiv Last Observation: 03.24 (Commodity Prices 16.05.2024)

Note: For foreign trade, seasonally/calendar adjusted monthly exports (fob) and imports (cif) data according to the general trade system have been used. (*) refers to the current account balance excluding energy and gold. The Commodity Index (Refinitiv/CoreCommodity CRB Index) shows the arithmetic average of futures prices of 19 commodities, such as crude oil, gold, copper, livestock, and sugar.

In financing of the current account balance, the weight of long-term items and portfolio investments increases, while that of the net errors and omissions item decreases.

In the first quarter of 2024, contribution of portfolio investments and reserves to financing of the 12-month current account deficit increased (Chart II.2.5). While banks continued to roll over their external debt by more than 100%, banks' external debt rollover ratio stood at 113% in March. The external debt rollover ratio of the non-bank sector remained above 100% and maintained its positive outlook. External borrowing by the private sector had a positive impact on the financing of the annualized current account deficit (Chart II.2.6).

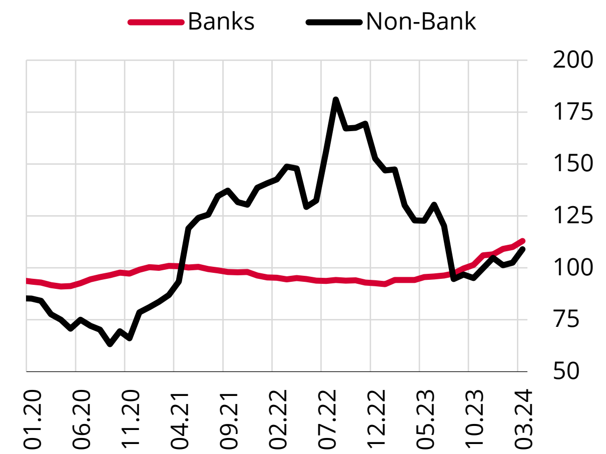
Chart II.2.5: Financing of Current Account Deficit (12-Month Cumulative, Billion USD)



Source: CBRT Last Observation: 03.24

Note: "Portfolio", "FDI", and "Other" investments items are in net terms. The (-) sign in "Reserves" implies an increase.

Chart II.2.6: External Debt Rollover Ratio (12- Month, %)



Source: CBRT Last Observation: 03.24

Note: External debt rollover ratios are calculated on short and long-term total debt in a 12-month window.

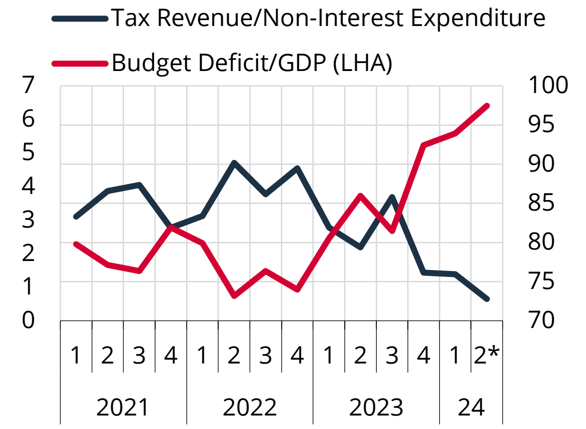
In public finance, the impact of earthquake-related expenditures continues and these expenditures will be the key determinant of the public finance outlook throughout 2024.

The effects of the earthquake disaster on public finance continued in the first quarter of 2024. The ratio of budget deficit to GDP, which was 5.2% at the end of 2023 due to earthquake expenditures, is projected to be 6.4% as of April. This increase was mainly driven by personnel expenditures and current transfers (Chart II.2.7).

Consumer inflation rose to 69.8% in April 2024, mainly due to the high course of services inflation.

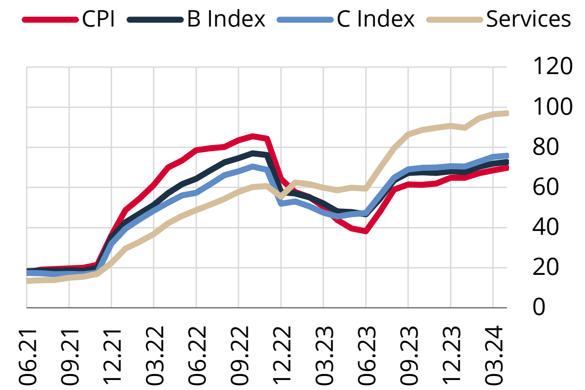
Annual inflation continued to rise on the back of time-dependent price adjustments and revision in administered prices by indexation to past inflation, as well as wage adjustments. While B and C indices continued to rise, the main driver of inflation was the services sector due to the strong inertia in the pricing behavior (Chart II.2.8). Geopolitical developments also played an important role in the elevated levels of inflation. In the first quarter of 2024, global commodity prices rose, led by the energy group, due to geopolitical developments and production disruptions. Geopolitical developments necessitated using alternative trade routes and led to longer delivery times pushing up freight rates.

Chart II.2.7: Central Government Budget Indicators (12-Month Cumulative, %)



Source: CBRT, MTF Last Observation: 04.24
Note: Estimated value for 2024 GDP.
*Data for Q2 includes only April.

Chart II.2.8: Inflation Developments
(Annual % Change)



Source: CBRT, TURKSTAT Last Observation: 04.24
Note: The B index is obtained by excluding unprocessed food products, energy, alcoholic beverages, tobacco and gold items from the CPI, and the C index is obtained by excluding food and non-alcoholic beverages from the B index.

Box II.2.I: Policy Framework Supporting Monetary Transmission and Macro Financial Stability

The monetary policy transmission mechanism is defined as the effect of changes in policy interest rates, the main instrument of monetary policy, on economic activity, inflation and other macroeconomic variables through market interest rates led by loan and deposit rates, exchange rates, expectations, credit, and asset prices. The effectiveness of monetary policy on macro variables through the transmission mechanism depends on dollarization, liquidity conditions, confidence in central bank policies, the exchange rate regime in place and the depth of financial markets. Recent studies suggest that monetary transmission is stronger when economic uncertainty is low, financial conditions are tight and monetary policy is coordinated with fiscal and macroprudential policies (Vollmer, 2022 and Deb et al., 2023).

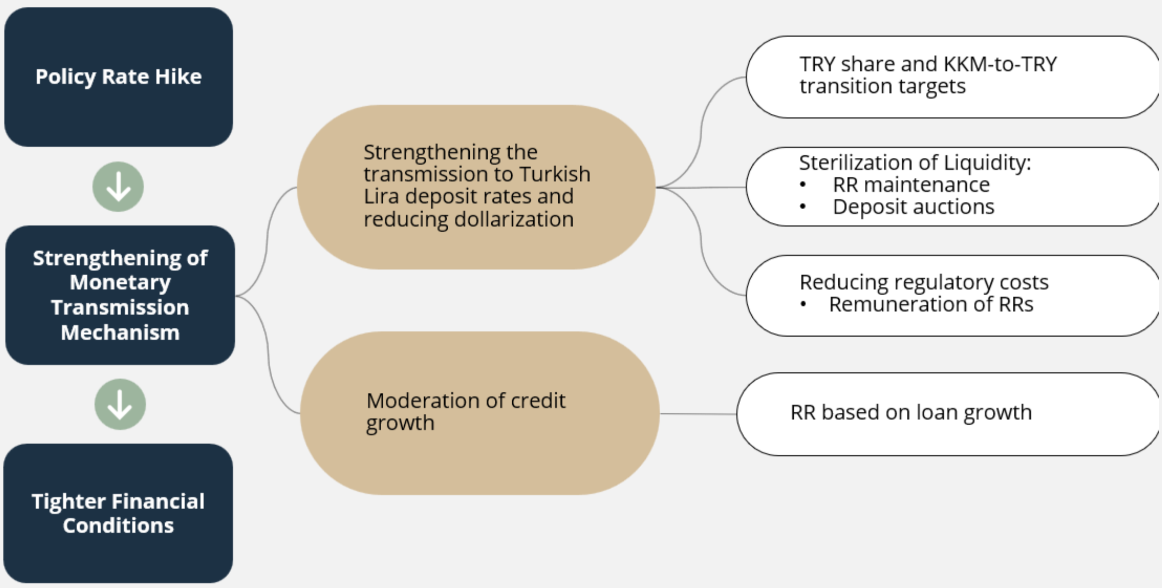
The CBRT has embarked on a strong monetary tightening since June 2023 by raising the policy rate from 8.5% to 50%. In this period, the CBRT continued to implement macroprudential policies with the aim of enhancing the functionality of the market mechanism and establishing macro financial stability. Although these developments supported the monetary transmission mechanism, dollarization and liquidity conditions limited effectiveness of transmission. Although the policy interest rate is formed in tightening territory consistent with inflation target, financial conditions should be supported by complementary and effective macroprudential tools in order for them to remain tight to ensure stronger transmission. This box elaborates on the objectives of the macroprudential policy framework that aims to enhance the effectiveness of the monetary policy stance, the channels through which the monetary policy stance supports the transmission mechanism, and the effects of policies on financial conditions.

The transmission of the changes in the policy rate to financial conditions are strengthened mainly if the following two conditions are met: (Diagram II.2.I.1).

- Strong transmission from policy rate to Turkish lira deposit rates and reduced dollarization.
- Balancing of loan growth and loan composition.

The following section summarizes the steps to ensure these conditions.

Diagram II.2.I.1: Enhancing Effectiveness of the Monetary Transmission Mechanism



Objective 1: Strengthening the Transmission to Turkish Lira Deposit Rates and Reducing Dollarization

The bulk of deposits in the banking system is composed of FX deposits or FX-protected accounts, which is one of the main factors that undermine the monetary policy transmission channel. The CBRT, aiming to affect TL interest rates and money supply/demand in the market through the short-term policy rate, is unable to use the policy rate effectively when the share of FX in the system increases. At the same time, high dollarization weakens the monetary transmission mechanism by increasing the dependence of pricing decisions on exchange rates (and expectations).

The rise in exchange rates and gold prices expands the TL equivalent of FX deposits and KKM accounts, which are important components of the broadly-defined money supply, and this leads to nominal growth in the money supply. The increase in the money supply creates demand inflation, drives asset prices higher and makes it more difficult to achieve price stability. Exchange rate difference payments on KKM deposits also cause excess liquidity in the system and reduce the tightening effect of monetary policy.

After June 2023, when the monetary policy tightening process started, the rise in exchange rates along with the exchange rate difference payments to FX-protected deposits led to excess Turkish lira liquidity in the system. In this period, Turkish lira interest rates in the interbank market were formed at a level lower than the policy rate due to excess liquidity, which resulted in weaker transmission from monetary policy to deposit rates. To counter these challenges to the monetary transmission, the CBRT aims to strengthen the transmission from the policy rate to Turkish lira deposit rates, reduce FX deposits and KKM accounts, and accelerate transition to Turkish lira deposits.

Instrument 1.1: TL Deposit Share Growth and KKM-to-TL Transition Targets

Foreign currency deposits and FX-protected deposit accounts lead to an expansion in the money supply in times of appreciation in exchange rates, thereby having an inflationary effect. As the share of the Turkish lira in the system increases and dollarization is reduced, the monetary policy's potential to affect money supply and savings/consumption preferences increases.

The growth target for the Turkish lira share refers to an increase in the share of Turkish lira deposits in total deposits at a rate set as a monthly minimum. In the calculation of the Turkish lira share, Turkish lira deposits are included in the numerator and total deposits including KKMs are included in the denominator. Transitions from FX deposits and KKM accounts to Turkish lira deposits increase the share and help achieve the target. Besides, new deposits arising from loan growth are also kept in Turkish lira, which contributes to increase in this ratio. The target value for the growth of the Turkish lira share is actively managed based on data and impact analyses in line with market conditions.

$$\text{TL Share} = \frac{\text{TL Deposits}}{\text{TL Deposits} + \text{FX Protected Deposits} + \text{FX Deposits}}$$

To increase the weight of the Turkish lira in the deposit composition, the CBRT also sets targets for banks to switch from the KKM to Turkish lira deposits. Additionally, the CBRT specified targets for renewal of the portion of the conversion KKM[1] accounts that was not switched to Turkish lira deposits, thus aimed to gradually reduce KKM deposits before they are converted into FX deposits. At the end of 2023, the TL-driven KKM[2] account openings and renewals ended. As the improvement in expectations and the decrease in exchange rate volatility have recently downplayed FX deposits, reserves strengthened and Turkish lira deposits became more preferable, the target of switching from KKMs to Turkish lira was maintained, but the total target for renewal and switching to Turkish lira was reduced to 75% on 23 May 2024 to ensure a faster decline in KKMs. As is the case with the Turkish lira share target, the targets for switching to Turkish lira and renewal are managed dynamically taking into account market developments.

Banks that fail to achieve the conversion-to-TL, renewal and TL share targets pay commission on required reserves maintained for FX deposits. On the other hand, banks that fulfill the targets of transition to TL and renewal are remunerated on their required reserves maintained for TL deposits and/or KKM deposits. The targets are set taking into account banks' business models, size and balance sheet structures, and decisions are taken based on impact analyses.

Instrument 1.2: Increasing Reserve Requirement Ratios

The increase in Turkish lira reserve requirement ratios sterilizes excess liquidity in the system, reduces banks' excess Turkish lira liquidity and supports the transmission of the CBRT funding rate to loan and deposit rates.

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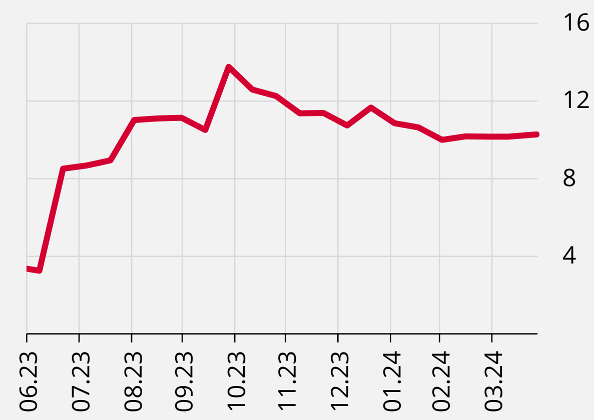
[1] Conversion KKMs are accounts opened by converting foreign currency and gold deposits into Turkish lira.
[2] TL-based KKMs are accounts opened using Turkish lira deposit accounts.

The CBRT made use of reserve requirements to sterilize the permanent excess liquidity in the financial system caused by the exchange rate difference payments to KKM deposits, and held Turkish lira deposit auctions to manage the temporary excess liquidity. In this context, the CBRT first ordered banks to maintain RRs for KKMs, and significantly raised the ratios of Turkish lira-denominated RRs maintained for KKMs. As another step taken in liquidity management, the Bank introduced the maintenance of additional Turkish lira-denominated RRs for FX deposits.

Although the withdrawal of excess liquidity from the system through the increase in RR ratios is expected to have a tightening effect on deposit rates via the liquidity channel, the increase in RR ratios also pulls deposit rates down as it creates costs for bank balance sheets. At the end of 2023, the share of the total RR amount in interest-bearing assets rose to 12% (Chart II.2.I.1). As the RR amounts to be maintained and borrowing costs increase, the RR cost also increases, driving banks to raise loan rates or reduce deposit rates to bear this cost. In fact, although the funding cost of RRs increased, banks did not yield interest income on these RRs. This pushed the regulation-driven costs on banks' balance sheets up and exerted downward pressure on deposit rates in early 2024 (Chart II.2.I.2). Finally, the revision of the KKM facility and the increase in RR ratios for KKM and TL deposits on May 23 are expected to increase the share of RR volume in interest-bearing assets in the recent period. Meanwhile, on the back of the decline in the KKM balance in line with the target renewal rates, the volume of RRs maintained for KKM accounts is expected to decline in the coming period.

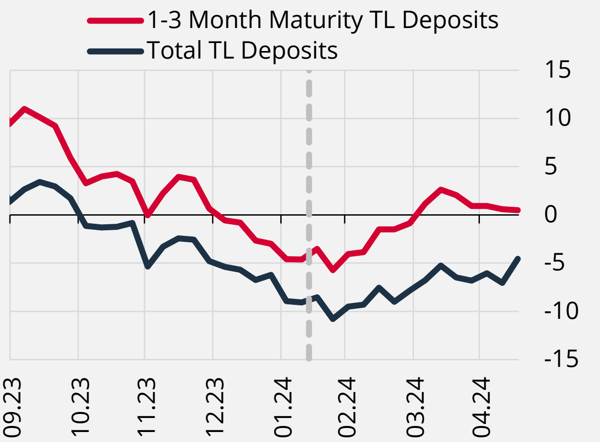
Chart II.2.I.1: Share of TL Required Reserves in Interest-Bearing Assets (%)



Source: CBRT Last Observation: April 2024

Note: Amounts that need to be maintained are taken into account.

Chart II.2.I.2: Spread Between TL Deposit Rate and Weighted Average Funding Cost (WAFC) (%)



Source: CBRT Last Observation: 17.05.2024

Note: Interest rate spreads are calculated with the annual compounded level of the WAFC. Participation banks are excluded. The dashed line indicates the effective date of the RR remuneration for banks that achieve the targets.

Instrument 1.3: Remuneration of Required Reserves

The remuneration of required reserves by the CBRT aims to offset the cost of the regulations and has an upward effect on deposit rates by supporting bank interest margins.

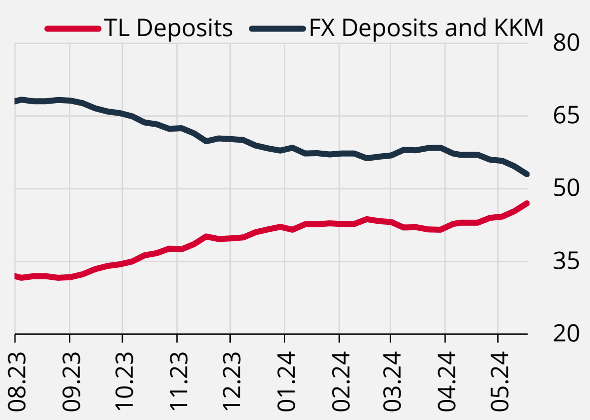
Banks generally need deposits along with other funding sources to finance their lending operations steadily and at affordable costs, to secure an equilibrium on their balance sheets and to cover the requirements arising from regulatory ratios. On the other hand, the maturity of deposits is generally short, while that of loans is longer. As a result, banks may tend to act slowly while reflecting policy rate increases on deposit rates.

The pass-through of the increase in the policy rate to deposit rates may be slower in an environment where credit growth is capped and RR ratios are high. To achieve its policy objective of prioritizing Turkish lira deposits more effectively and to ensure that the tighter monetary policy is reflected in the macroeconomy through deposit rates, the CBRT decided to remunerate banks' RRs depending on their transition-to-Turkish lira and renewal rates.

This practice helped support the balance sheets of banks that achieved the targets and mitigate the RR cost, thereby preventing an easing in deposit rates. Moreover, the banks that failed to reach the desired level of transition were motivated to meet the targets so as to benefit from this advantage, and Turkish lira deposit rates increased to the extent that allowed attaining targets. The RR remunerations are paid quarterly, based on the achievement of the target to limit the impact of the remuneration on liquidity.

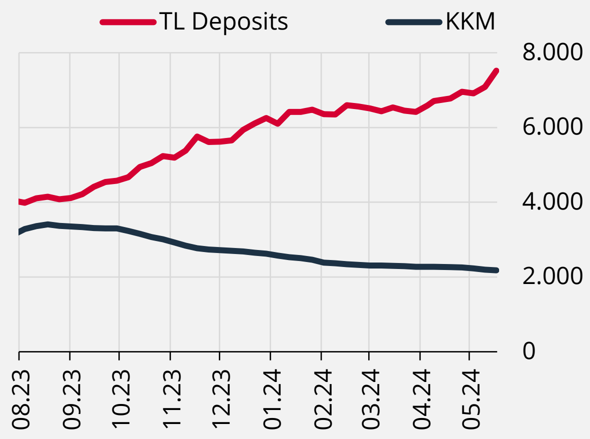
As a result of the steps taken, the share of FX deposits and KKMs in total deposits decreased, while the share of Turkish lira deposits increased. Since August 2023, the share of Turkish lira deposits has increased by 15 percentage points (Chart II.2.I.3). The transition in the related period was mainly driven by KKM accounts. In that period, KKM accounts declined by approximately TL 1.2 trillion (Chart II.2.I.4). There has recently been a shift from FX deposits to TL deposits thanks to the improvement in expectations. This trend is expected to continue as real TL deposit rates move into positive territory and as inflation declines steadily and permanently.

Chart II.2.I.3: Composition of Deposits (%)



Sources: CBRT, BRSA Last Observation:17.05.2024

Chart II.2.I.4: Deposit Volume (TL Billion)

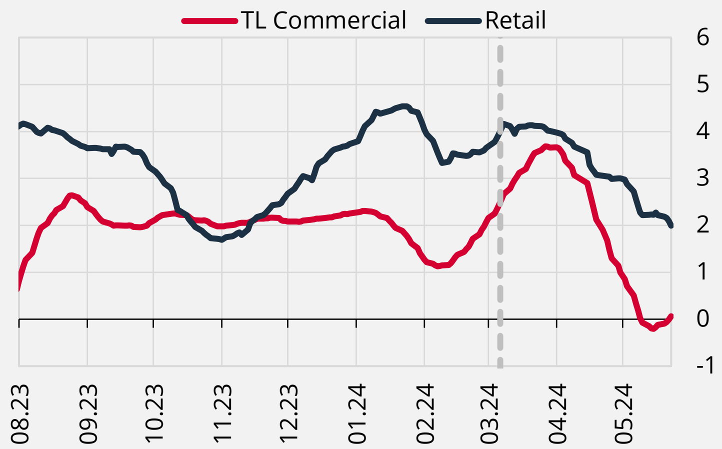


Sources: CBRT, BRSA Last Observation: 17.05.2024

Objective 2: A Balanced Course Between Loan Growth and Loan Composition

With the monetary policy rate hikes and the simplification of the regulatory framework, bond yields rose across all maturities and the yield curve became negatively sloped, reflecting the improvement in inflation expectations. With this normalization, holding long-term securities became less of a deterrent for banks and the tendency of banks to extend loans above the loan growth limits defined in the securities maintenance practice increased, and Turkish lira commercial loans recorded an above-the-limit loan growth across the sector except for January.

Chart II.2.I.5: Monthly Loan Growth Trends (%)



Sources: CBRT, BRSA Last Observation: 23.05.2024

Note: Calculated by taking the average of 20 business days of the growth rates pertaining to 20 business days. The dashed line denotes the announcement date of the loan growth-based RR maintenance.

Instrument 2.1: Loan Growth-Based RR Maintenance and Loan Growth Limits

Since the loan growth-based RR practice imposes a significant RR cost on banks' balance sheets when loan growth limits caps are exceeded, banks tend not to exceed the caps. This practice stabilizes loan growth by tightening financial conditions and supports the transmission of monetary policy.

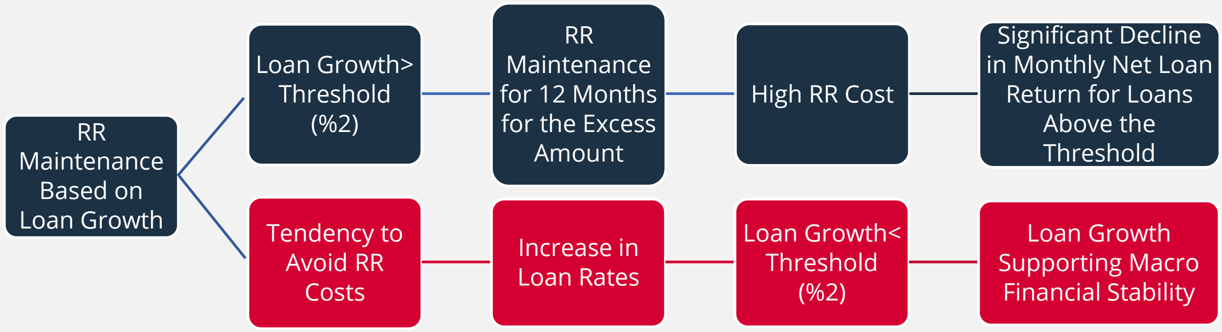
In March 2024, credit growth strengthened in a short period of time due to a higher-than-expected demand for loans driven by the volatility in expectations. Accordingly, in addition to the monetary policy rate hike in March 2024, financial conditions were tightened through regulations to support the transmission of the monetary policy. The monthly growth limits for Turkish lira commercial and general-purpose loans were reduced to 2%, making financial conditions tighter, and an obligation to maintain RRs was introduced if growth limits were exceeded, to increase the effectiveness of the practice.

The loan growth-based RR requires banks to maintain reserve requirements equal to the amount exceeding the monthly growth of 2% for general-purpose loans, vehicle loans and Turkish lira commercial loans[3] for 12 months. Since this amount maintained is not remunerated, exceeding the loan limits significantly increases banks' RR costs. Thus, the RR cost arising from exceeding this limit has supported the steps taken to tighten financial conditions. The aim of the RR maintenance practice is to induce banks that do not want to bear this cost to keep their loan growth rates within specified limits by increasing the interest rates on loans, and to moderate loan growth through higher loan rates (Diagram II.2.I.2).

Following the implementation of the loan growth-based RR maintenance, Turkish lira commercial loan rates and general-purpose loan rates increased by approximately 10 percentage points and 18 percentage points, respectively, compared to their levels in the first week of March. After the implementation, commercial and retail loan growth rates slowed down significantly (Chart II.2.I.5). Thus, the loan growth-based RR maintenance loan growth is judged to support monetary policy transmission by tightening financial conditions.

On the other hand, Turkish lira loans declined in response to the measures taken regarding TL loans, while foreign currency loans have increased recently. Accordingly, in May 2024, a 2% monthly loan growth limit was imposed on FX loans[4] as well as TL loans. This practice requires that banks should maintain Turkish lira denominated RRs equal to an amount exceeding the 2% loan growth limit in blocked accounts for one year. This step that tightens the FX loan growth incurs high RR costs for banks exceeding the threshold, and inhibits FX loan supply, and thereby contributes to maintaining macro financial stability and supporting the monetary transmission. Therefore, with this latest measure, the CBRT continued to strengthen macro financial stability and at the same time showed its sensitivity to this issue and commitment to monitoring the related developments.

Diagram II.2.I.2: Reserve Requirements Maintenance Based on Loan Growth

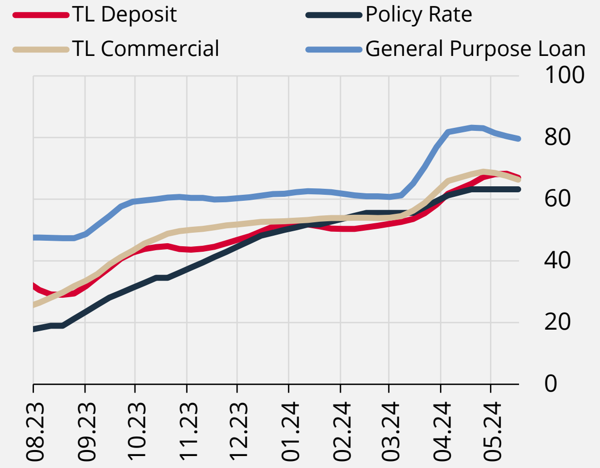


[3] Export, investment, agriculture, tradesmen and earthquake loans, and loans to public institutions and agencies are excluded.
[4] Investment loans, and loans extended to the earthquake region, public institutions-agencies and domestic banks are excluded.

Conclusion:

The CBRT aimed to increase the effectiveness of the policy rate, the main instrument, by implementing measures to manage Turkish lira liquidity and strengthen monetary transmission. As a result of these measures supporting the tight monetary policy, the transmission from the policy rate to loan and deposit rates strengthened and the degree of tightness in financial conditions increased (Chart II.2.I.6). Moreover, the elevated level of deposit rates compared to ex-ante and ex-post inflation increased the attractiveness of Turkish lira financial assets (Chart II.2.I.7). The tightening in financial conditions is expected to contribute to the decline in dollarization and has a positive impact on inflation and inflation expectations by promoting savings instead of consumption.

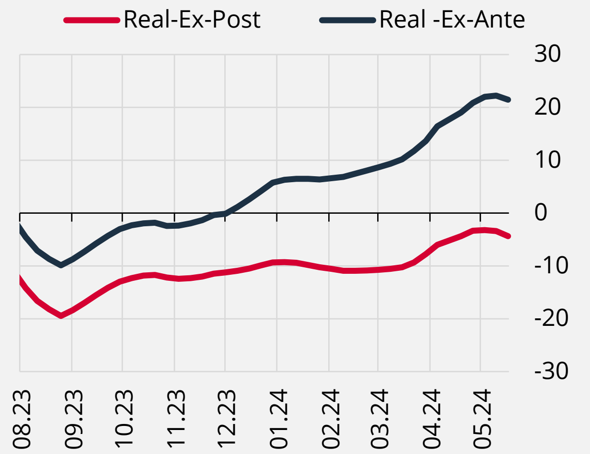
Chart II.2.I.6: Interest Rates (%, 4 WMA)



Source: CBRT Last Observation:17.05.2024

Note: TL deposit interest rate represents the interest rate on TL deposits with 1 to 3-month maturity and is calculated excluding participation banks. TL commercial loan rate is calculated excluding credit cards, overdraft accounts and zero interest loans. General-purpose loan interest rate is calculated excluding overdraft accounts. Policy rate is converted to compound interest rate.

Chart II.2.I.7: Real TL Deposit Rates (%, 4 WMA)



Source: CBRT Last Observation: 17.05.2024

Note: TL deposit interest rate represents the interest rate on TL deposits with 1 to 3-month maturity and is calculated excluding participation banks. Real deposit rate is calculated by Fisher method, and deflated by expected and actual CPI inflation. The expected inflation is the 12-month-ahead CPI inflation expectation (modified mean) of the Survey of Market Participants. The chart shows the net return with withholding tax deduction applied.

References

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Box II.2.II: Steps for Effective Functioning of Financial Markets

This box presents, under main headings, a summary of measures and policy steps implemented in the current reporting period to strengthen macro financial stability and contribute to the functioning of market mechanisms.

Table II.2.II.1: Major Measures and Regulations for Financial Markets

1. Policy Rate and the CBRT's Liquidity Management

Announcement / Issue Date	Measure / Regulation
24.11.2023	The one-week repo auction rate was raised from 35% to 40%.
22.12.2023	The one-week repo auction rate was raised from 40% to 42.5%.
26.01.2024	The one-week repo auction rate was raised from 42.5% to 45%.
26.02.2023	The one-week repo auction rate was kept unchanged at 45%.
22.03.2024	The one-week repo auction rate was raised from 45% to 50%. The CBRT decided to set the Central Bank overnight borrowing and lending rates 300 basis points below and above the one-week repo auction rate, respectively.
25.04.2024	The one-week repo auction rate was kept unchanged at 50%.
23.05.2024	The one-week repo auction rate was kept unchanged at 50%.

2. Reserve Requirements and Securities Maintenance

Announcement / Issue Date	Measure / Regulation
21.12.2023	The CBRT decided that the securities maintenance ratio applied to liabilities would be reduced from 5% to 4% to be effective from the calculation date of 24 November 2023, and temporary implementation regarding securities maintenance based on loan growth, which was to be terminated on 29 December 2023, would be extended for six months until the calculation date of 28 June 2024.
27.12.2023	Regarding the commission implementation on reserve requirements, the CBRT decided to - adjust the monthly Turkish lira share growth target for real persons based on their Turkish lira share levels, - increase the target for the Rate of Transition to Turkish Lira Deposits from KKM Accounts from 10% to 15% and introduce changes in the calculation of this rate, - finalize the 75% KKM renewal rate target, - extend the calculation period of the Rate of Renewal and Transition to Turkish Lira to four weeks, as in the implementation regarding the Turkish lira share, effective after 22 December 2023; and - reduce the target for the Rate of Renewal and Transition to Turkish Lira from 100% to 95%, effective from 19 January 2024.
30.01.2024	Effective from the calculation date of 19 January 2024, the CBRT decided that the reserve requirement ratios for KKM accounts with maturities up to six months would be reduced from 30% to 25%, and the additional reserve requirement ratio for FX-denominated deposits/participation funds (excluding deposits/participation funds in foreign banks and precious metal deposit accounts) maintained in Turkish lira would be increased from 4% to 8% across all maturities.
04.02.2024	Based on the Rate of Renewal and Transition to Turkish Lira and the Rate of Transition to Turkish Lira for KKM accounts, the CBRT decided that - a set amount of Turkish lira reserve requirements of deposit banks would be subject to remuneration, and - participation banks would be provided with a discount on the set amount of their Turkish lira reserve requirements.
05.03.2024	Effective from the calculation date of 26 January 2024, the monthly growth limit for Turkish lira commercial loans excluding exempt loans, previously set at 2.5%, was reduced to 2%; the monthly growth limit for general-purpose loans, previously set at 3%, was revised down to 2%; and the 2% limit for vehicle loans remained unchanged within the scope of the loan growth-based securities maintenance practice.
08.03.2024	Effective from the calculation period of 29 March 2024, banks were required to keep the required reserves up to the loan amount exceeding the 2% growth limit for Turkish lira commercial loans (excluding exempt loans), general-purpose loans (excluding overdraft

	accounts), and vehicle loans separately, as blocked, within the scope of the loan growth-based reserve requirement implementation.
13.03.2024	Within the scope of the reserve requirement implementation, institutions with an asset size of more than TL 500 billion and institutions with an asset size of more than TL 100 billion were required to keep 25% and 15% of the required reserves to be maintained as average for Turkish lira liabilities, respectively, as blocked.
16.03.2024	Regarding the commission implementation, the CBRT decided to - introduce a monthly Turkish lira share growth target for legal persons, as for real persons, and - revise the monthly Turkish lira share growth target for real persons and increase the commission rate applied upon failure to achieve the target from 2% to 3%.
06.04.2024	The CBRT decided that the securities maintenance ratio applied to liabilities would be reduced from 4% to 1% to be effective from the calculation date of 29 March 2024, and that temporary implementation regarding securities maintenance based on loan growth, which was to expire on 28 June 2024 (including), would be terminated as of the calculation date of 23 February 2024 (including).
29.04.2024	Within the scope of the reserve requirement implementation, - effective from 26 April 2024, the upper limit of the remuneration rate applied to the amount of required reserves that should be maintained for KKM accounts based on the renewal and transition to Turkish lira was set at 60% of the policy rate, the upper limit of the remuneration rate applied to the amount of required reserves that should be maintained for Turkish lira deposits based on the Turkish lira conversion rate was set at 80% of the policy rate, and - the cumulative discount application for participation banks on the set amount of their Turkish lira reserve requirements was terminated and replaced with remuneration.
09.05.2024	The securities maintenance regulation was repealed.
23.05.2024	To be effective as of 24 May 2024, - the required reserve ratio for Turkish lira deposits/participation funds (excluding deposits/participation funds obtained from banks abroad) – demand, notice, with maturities up to one month and up to (and including) three months- was raised from 8% to 12%, - the required reserve ratio for Turkish lira deposits/participation funds (excluding deposits/participation funds obtained from banks abroad) with maturities up to (and including) six months, up to one year, of one year, and longer than one year was set at 8%, - the required reserve ratio for KKM accounts with maturities up to (and including) six months was raised from 25% to 33%, and - the required reserve ratio for KKM accounts with maturities up to one year, of one year, and longer than one year was raised from 10% to 22%.
23.05.2024	Regarding reserve requirement and commission implementations, - the total target rate including renewal and transition to Turkish lira was reduced to 75%, effective from the calculation period of 7 June 2024, - Legal persons' KKM accounts, as well as legal and real persons' YUVAM accounts were excluded from calculation of the total target, effective from the calculation period of 5 July 2024 (including), - the remuneration rate applied to reserve requirements maintained for KKM accounts when the total target is achieved was decreased to 40% of the policy rate, effective as of 24 May 2024 (including).
23.05.2024	Effective from the calculation period of 21 June 2024 (including), a monthly growth limit of 2% was introduced for foreign currency loans (excluding those extended to the earthquake zone), and Turkish lira required reserves amounting to loans exceeding the limit were decided to be blocked for one year.

3. Rediscount Credits and Advance Loans

Announcement / Issue Date	Measure / Regulation
23.11.2023	The maximum discount rate for rediscount credits for export and foreign exchange earning services was kept constant at 25.93%, and a cap was set for the total interest cost of these credits.
23.11.2023	According to the new implementation framework for ALAIC, it was decided that eligible firms would be allocated ALAIC via intermediary banks for their investment projects with a

	minimum total investment amount of TL 1 billion by taking into account their Technology/Strategy score, and the interest rate for loans, which would be extended with a maximum maturity of ten years, would be set between 15% and 30%, depending on the Technology/Strategy score, the ratio of external financing for the investment, and the financial soundness assessment.

4. Deposits/ Participation Funds and Payment Systems

Announcement / Issue Date	Measure / Regulation
25.11.2023	An amendment was introduced to enable participation accounts to be opened with maturities up to (and including) one month.
31.01.2024	The CBRT decided that the minimum interest rate on KKM accounts cannot be lower than 80% of the one-week repo auction rate set by the CBRT.
05.02.2024	The cut-off date for real residents' KKM accounts was extended from 30 November 2023 to 31 January 2024.
06.04.2024	The cut-off date for real residents' KKM accounts was extended from 31 January 2024 to 31 March 2024.

5. Regulations Regarding Credit Extension, Installments, and Debt Repayments

Announcement / Issue Date	Measure / Regulation
14.12.2023	As per the decision taken by the SDIF, the amount of deposits and participation funds covered by insurance, which is currently TL 400 thousand, was set at TL 650 thousand, effective from the beginning of the calendar year 2024.
21.12.2023	An upper limit was introduced for the reference rate not to exceed current levels of maximum interest rates for credit cards and maximum commission rates for merchants. The upper limit was set at 3.11%, which was the current level of the reference rate, and the calculation method was kept unchanged for rates below this level. No increase was thus introduced to the most recently announced rates for maximum interest rates for credit cards and maximum commission rates for merchants.
16.03.2024	It was decided that the monthly maximum contractual interest rate to be applied in cash withdrawal or usage transactions made through credit cards was determined by adding 189 basis points to the monthly reference rate in place of 131 basis points, and that the revised rates would be announced and implemented from 16 March 2024.
21.03.2024	As per the decision taken by the BRSA, the maturity limits for loans only for electric vehicles manufactured by taxpayers falling within the scope of Provisional Article 12 of Corporate Tax Law No. 5520 dated 13 June 2006, were set as - forty-eight months for loans extended for the purchase of vehicles with a final invoice value of TL 1.6 million or less, - thirty-six months for loans extended for the purchase of vehicles with a final invoice value above TL 1.6 million and below TL 3 million, - twenty-four months for loans extended for the purchase of vehicles with a final invoice value above TL 3 million and below TL 4 million, and - twelve months for loans extended for the purchase of vehicles with a final invoice value above TL 4 million and below TL 5 million. The loan-to-value ratios were set - to not exceed 70% for vehicles with a final invoice value of TL 1.6 million or less, - to not exceed 50% for vehicles with a final invoice value above TL 1.6 million and below TL 3 million, - to not exceed 30% for vehicles with a final invoice value above TL 3 million and below TL 4 million - to not exceed 20% for vehicles with a final invoice value above TL 4 million and below TL 5 million, and - as 0% for vehicles with a final invoice value above TL 5 million.
06.04.2024	It was decided that the monthly maximum contractual interest rate on credit card transactions in TL (excluding cash withdrawal or usage transactions) was determined by adding 114 basis points to the monthly reference rate in place of 55 basis points, and that the revised rates would be announced and implemented from 6 April 2024.

6. Classification of Loans and Receivables, and Legal Ratio Limitations

Announcement / Issue Date	Measure / Regulation
27.01.2024	Pursuant to the Communiqué, the amount that the drawee banks should be legally obliged to pay to the bearer (holder) of the bad checks on or after 31 January 2024 was increased from TL 6,000 to TL 9,270.

7. Other Regulations

Announcement / Issue Date	Measure / Regulation
21.12.2023	The CBRT decided to hold Turkish lira deposit buying auctions to enhance the monetary transmission mechanism and contribute to the diversification of the sterilization instruments.
01.05.2024	As per Presidential Decree No. 8434, the withholding tax rate for deposits was set at - 7.5% for demand and notice accounts and accounts with maturities up to (and including) six months, - 5% for time deposits up to (and including) one year, - 2.5% for accounts with maturities longer than one year, - 0% for accounts with maturities longer than one year and an inflation-based variable interest rate, - 0% for KKM accounts.
01.05.2024	As per Presidential Decree No. 8434, the withholding tax rate for income and earnings from bonds and bills issued by banks and from lease certificates issued by asset leasing companies with these banks as the fund users was set as - 7.5% of the income provided to those with maturities up to (and including) six months, - 5% of the income provided to those with maturities up to (and including) one year, - 2.5 % of the income provided to those with maturities longer than one year, - 7.5% of earnings derived from the disposal of those held for less than (and including) six months, - 5% of earnings derived from the disposal of those held for less than (and including) one year, and - 2.5% of earnings derived from the disposal of those held for more than one year.
01.05.2024	As per Presidential Decree No. 8434, the withholding tax rate applied to income and earnings from asset-based securities, mortgage-based securities, mortgage-backed securities, and asset-backed securities issued by mortgage finance institutions (including asset finance funds and housing finance funds founded by these companies) established under Law No. 6362 was raised from 5% to 7.5%.
21.05.2024	With the Presidential Decree, the monthly late fee determined in Article 51 of Law No. 6183 on the Procedure for Collection of Public Claims was increased from 4% to 4.5%.
21.05.2024	With the Presidential Decree, the legal interest rate was increased from 12% to 24% per annum, effective from 1 June 2024 (With the Decree of the Council of Ministers No. 2005/9831 dated 19 December 2005, the legal interest rate had been reduced from 12% to 9% per annum, effective from 1 October 2006).