Turkey's central bank ends hiking cycle, keeps the door open to further tightening

In line with its guidance last month and the market consensus, the Central Bank of Turkey (CBT) raised the policy rate by 250bp to 45%. With this move, the bank completed its tightening cycle and switched to a wait-and-see approach

The building of Turkey's central bank in Ankara

Following large rate hikes totalling 34pp since June, the Central Bank of Turkey has signalled an end to its tightening cycle as soon as possible. Given that current policy is considered tight enough, the disinflation objective has been achieved and the latest inflation increase is in line with the outlook presented in the last inflation report, the CBT has opted to end hikes with its latest 250bp move.

While the bank switched to a wait-and-see approach, it has remained cautious and ready to act "if notable and persistent risks to inflation outlook emerge". On the inflation side, the annual figure rose as expected in December. We see further increases in the near term given a higher-than-expected minimum wage rise and increases in administrative prices due to special consumption tax and revaluation rate related adjustments. Accordingly, we see inflation remaining elevated until mid-2024, with further increases above 70% on seasonal effects in January and unfavourable base effects in May. The second half the this year, on the other hand, will likely see a sharp downtrend – though upside risks to the CBT's forecasts are still significant in the second half of the year. On the fiscal side, while the end-2023 budget recorded a large deficit close to 5.5% of GDP on the back of earthquake-related spending, the 2024 budget also projects another wide deficit at 6.4% of GDP. This implies that budget performance will also be key for the disinflation path. Accordingly, the CBT leaves the door open for further rate hikes if required by the inflation outlook.

Additionally, a comparison between the CBT's projections and market participants' expectations still shows a meaningful gap. While the CBT sees inflation at 36% at the end of this year and 14% in 2025, the survey reveals market expectations at 42% for 2024 and 24% for 24 months ahead. Continuing its hawkish stance, the central bank reiterated that it wouldn't start cutting any earlier and that it needs to "ensure sustained price stability". For now, it remains committed to maintaining its tight stance until i) a significant decline in the underlying trend of monthly inflation, and ii) inflation expectations converge to the CBT's forecast range. The inflation report release on 8 February will be key to watch.

Finally, since the elections, the CBT has taken a number of measures aiming to simplify macro-prudential policy framework with the purpose of increasing the functionality of market mechanism and strengthen macro financial stability. In the statement, the CBT pledges further moves "in the face of any potential excess volatility in credit supply and deposit rates". This does not imply any imminent action, in our view – though we have seen some acceleration in retail lending momentum driven by credit cards and slight moderation in deposit rates recently.

All in all, the CBT delivered an expected hike and reached the terminal rate at 45% while calling it the end of the tightening cycle. The bank also repeated its pledge to maintain a tight monetary policy stance for longer, and kept the door open for further rate hikes. Given this backdrop, we expect the first cut in the last quarter of this year and for the policy rate to reach 40% by the end of 2024.

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