Central Bank of Turkey cuts rates and commits to supportive financial conditions

While the Central Bank of Turkey (CBT) cut the policy rate to 8.5%, it also signalled that interest rate cuts will not continue as a series

Skyscrapers and modern office buildings in the financial districts of Levent and Besiktas, Turkey

At today's rate-setting meeting, the CBT slashed the policy rate (1-week repo rate) by 50bp to 8.5%. There was not a clear consensus for the CBT move this month as the market expectations were split between a 100bp cut and no change. The CBT guidance does not indicate further cuts at the upcoming monetary policy committee (MPC) meetings, though it has remained vocal about the growth outlook.

Regarding the two large earthquakes in Southeast Turkey and their economic implications, the CBT seemed to prioritise the impact on economic activity over inflation. Accordingly, like the reasons given during the previous rate-cutting cycle, the bank once again cited the need for supportive financial conditions in order to preserve the growth momentum in industrial production and the positive trend in employment. As per the policy guidance, the CBT concluded that “the current monetary policy is adequate to support the necessary recovery in the aftermath of the earthquake”, while pointing out that “the effects of the earthquake in the first half of 2023 will be closely monitored”. This line of thinking implies, in our view, that after the “measured cut” it will not make any rate move and remain in wait-and-see mode in the near term.

Additionally, while the bank also repeated its emphasis on alternative policy instruments and the alignment of all policy instruments with “Liraisation” targets, it said it prioritised the creation of supportive financial conditions in order to minimise the effects of the disaster and support the necessary recovery. This implies that the CBT will continue to use macro-prudential tools and regulations to reduce the secondary effects of the earthquakes on macroeconomic stability. In this regard, in addition to the rate cut, we can see further steps being taken to ease the costs of additional government borrowing related to the disaster (ie increasing direct purchases and higher security maintenance requirements).

For inflation, on the other hand, the bank doesn't seem concerned, but is cautious, stating that “the effect of earthquake-driven supply-demand imbalances on inflation is closely monitored”. However, the extra fiscal burden of reconstruction costs and the CBT’s supportive stance will, in our view, likely create further pressure on the already elevated headline inflation.

> Overall, the CBT has hinted that interest rate cuts will not continue as a series, while we can expect further macro-prudential measures to maintain favourable financial conditions with the objective of minimising the effects of the earthquakes. Given this backdrop, the CBT remains on the policy path of keeping interest rates low, maintaining a selective credit policy, and pursuing a ‘Liraisation’ strategy.

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