Why bets are rising on a December rate cut in Turkey

The Central Bank of Turkey kept rates on hold at 50% at its November rate-setting meeting, in line with consensus. The latest MPC statement includes changes that provide additional support to expectations of an easing cycle beginning in December

A few highlights to note from the accompanying statement to the CBT's decision to keep rates on hold:

The CBT has issued a more positive inflation assessment, citing a) a decline in the underlying trend in October, adding that the pressure in unprocessed food inflation is deemed temporary, b) a further slowdown in domestic demand “reaching” disinflationary levels, revised from “approaching” in October, c) signs of improvement in services inflation becoming more apparent, which was expected to occur in the last quarter in the previous statement, d) an acknowledgement that “inflation expectations and pricing behaviour tend to improve” (upside risks to inflation posed by these factors are also pointed out), and e) a removal of the warning about increasing uncertainty related to the pace of improvement in inflation.

Turkey's central bank has maintained its strong policy guidance related to the timing of rate cuts in recent MPCs. It continues to pledge keeping rates higher for longer until a significant and sustained decline is seen in the underlying trend of monthly inflation, as well as maintaining its focus on the convergence of inflation expectations to its projected forecast range.

The key change, however, was not in the guidance but in our view in the bank's inflation forecasts, which function as intermediate targets. Introduced in early November, the bank now sees headline inflation at 21% year-on-year (with an upper band at 26% YoY) by end-2025, and 12% YoY (with an upper band at 17% YoY) by end-2026. Accordingly, market participants' end-2025 inflation expectation of 26.2% in the latest survey is now slightly above that of the CBT's forecast range. Given this backdrop, the CBT added a new sentence and pledged to determine the policy rate "in a way to ensure the tightness by the projected disinflation path" which now shows a slower-than-expected adjustment in headline inflation in comparison to the previous inflation report.

Finally, the CBT expects significant contributions from increased coordination between fiscal policy and the disinflation process. The October budget saw a slight deterioration due to a rapid pace continuing in primary spending, and interest expenditures attracted attention despite ongoing strength in revenue collection. The ratio of budget deficit to GDP stood at 4.8% (with the primary balance at a 2.0% deficit). However, according to its medium-term plan, the government aims to narrow the central government budget deficit from c.4.9% this year to 3.1% in 2025, while Minister of Finance Mehmet Şimşek recently signalled additional fiscal measures to support the CBT in its disinflation efforts.

All in all, the central bank's recent communication suggested that we are nearing a gradual rate-cutting cycle, implying that a December move could now be a real possibility. Uncertainty surrounding a new year wage hike has been a contributing factor to expectations that the CBT would prefer to wait until the January MPC. However, a statement from President Tayyip Erdogan's hinted that the minimum wage adjustment will be based on expected inflation (likely with an additional buffer to support wage earners), and this should provide a clarity on this front in our view. Accordingly, we continue to expect the bank to start cutting rates with a measured move in December, unless we see a negative surprise in November's inflation data (released 3 December).

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