Central Bank of Turkey keeps rates on hold but softens its tightening bias

As widely expected, Turkey's central bank has kept rates on hold (50%) at the September rate-setting meeting, reiterating its attentiveness to inflation risks. The interest rate corridor also remained unchanged, with the upper and lower bounds at 53% and 47% respectively

Fatih Karahan, Turkey's central bank governor

In the assessment of the inflation outlook:

1. The Central Bank of Turkey (CBT) concluded that the monthly inflation trend in August was yet to improve towards its target for the last quarter of this year (1.5% month-on-month on a seasonally adjusted basis). It also pointed out that core goods inflation remained low (despite a slight increase) given that annual inflation in this group stood at 29% year-on-year as of August
2. For services inflation, the CBT dropped its statement that “improvement in services inflation is expected to lag”, and instead announced that “the improvement in services inflation is expected to occur in the last quarter”.
3. Accordingly, the CBT only mentioned inflation expectations and pricing behaviour as factors that continue to pose risks to the inflation outlook, while dropping its reference to

"stickiness in services inflation" and "geopolitical developments".

The central bank also slightly revised its statement and noted that "monetary policy tools will be used effectively" in the case where a significant and persistent deterioration in inflation is foreseen. This has been adapted from the previous statement which cited that "monetary policy stance will be tightened". This softening in tone indicates that the bank now holds a preference for relying on the effective use of policy tools, dropping its direct references to policy tightening. However, strong policy guidance from the MPC related to the timing of rate cuts remains unchanged, with a continuing pledge to keep rates higher for longer until we see a significant and sustained decline in the underlying trend of monthly inflation and a convergence between inflation expectations and the CBT's projected forecast range.

Inflation expectations have remained a key area of focus for the CBT. Market participants' expectations for this year and end-2025 have been sticky in recent months, standing at 43.1% (34-42% CBT forecast band) and 25.3% (14-21%YoY forecast band) respectively. Meanwhile, households and corporates see inflation at around 73% and 54% respectively in the next 12 months. Given this backdrop – as well as risks related to inflation outlook and foreigners' and locals' portfolio preferences – the CBT has maintained its cautious approach, as continuously signalled by officials.

On the other hand, private consumption (the main driver of growth in recent quarters), grew in the second quarter on a sequential basis and reached a new historical high, while leading indicators for the third quarter a gradual slowdown from the high base. Given this environment, the CBT has not changed its assessment and the September MPC noted the diminishing impact of domestic demand on inflation once again.

Finally, the bank repeated its pledge to use additional macroprudential steps in case of unexpected moves in credit and deposit markets, and to effectively implement sterilisation tools. Accordingly, sterilisation efforts are likely to continue with the aim of supporting short-term interest rates kept close to the 50% policy rate.

Overall, the CBT reiterated that its tight monetary stance would lead to a) a decline in the underlying trend of monthly inflation by moderating domestic demand, b) real appreciation in TRY, and c) an improvement in inflation expectations. While the statement implies a resumption of the underlying trend improvement and a more concrete drop in services inflation in the last quarter, a toned down reaction in the case of a deterioration in the inflation outlook hints at a move to cautiously set the scene for rate cuts.

Given that the relatively stable currency and normalisation in domestic demand should support a decline in the underlying inflation trend in the remainder of this year, we continue to see room for the central bank to cut in November or December, depending on the data.

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