Third 250bp rate cut from the Turkish central bank

The CBT has continued its rate-cutting cycle, reducing the policy rate to 42.5% in March, supported by improving inflation indicators. It signalled further rate cuts ahead while maintaining a cautious stance due to risks in inflation expectations and pricing behaviours

The Central Bank of Turkey (CBT) continued its rate-cutting cycle in March, following the easing trend it initiated in December, reducing the policy rate by 250 basis points (bp), bringing it to 42.5% as expected. The bank highlighted improvements in inflation indicators during February, following a temporary spike in January.

The unexpectedly low inflation in February was driven by both food and non-food categories, continuing the downward trend in annual inflation. In support of disinflation efforts, the Ministry of Treasury and Finance reversed the increase in hospital copayments, which contributed to the lower inflation reading in February. Alongside its decision, the CBT noted that core goods inflation remained relatively low, services inflation showed signs of slowing down, and there was a general decline in inflationary trends.

The CBT also commented on domestic demand. While it considered demand levels during the fourth quarter of 2024 to be supportive of disinflation, recent GDP figures showed stronger-than-expected growth. Annual GDP growth exceeded market expectations, mainly due to a recovery in private consumption and robust investments. On a quarterly basis, growth was bolstered by a reversal in household consumption from negative to positive and accelerated investment activity, despite negative impacts from changes in inventory levels and net exports.

However, the CBT still views early indicators for the first quarter of 2025 as disinflationary. Should domestic demand recover more quickly, the bank may implement additional macroprudential measures or slow the pace of rate cuts.

While the CBT did not provide specific guidance on short-term inflation expectations this time, further rate cuts may follow as realised and expected inflation continue to decline. Following this decision, the policy rate adjusted for current inflation now stands at 3.4ppt. Based on market participants' inflation expectations, the real policy rate is 17.2ppt, compared to 0.6ppt using firms' forecasts. Despite recent progress, the CBT reiterated that inflation expectations and pricing behaviour continue to pose risks to the disinflation process.

As inflation is expected to drop further in March, high real interest rates and macroprudential measures are likely to support another 250bp rate cut in April. Beyond inflation, factors such as changes in residents' foreign currency (FX) deposits, exchange rate movements, and reserve accumulation will also influence the bank's future decisions. In February, the CBT moved from heavy FX purchases in January to FX sales, driven by increased local demand for foreign currency. Prolonged FX market pressure could prompt the bank to respond with macroprudential tightening, smaller rate cuts, or a pause.

> In summary, the CBT delivered a third 250bp rate cut during its March meeting, as anticipated. The bank has maintained a meeting-by-meeting decision approach but hinted at additional rate cuts to align with expected declines in annual inflation. High real rates and tighter loan growth controls are expected to sustain the disinflation process. Inflation is forecasted at 27%, with a policy rate of 29% by the end of 2025, though risks remain tilted to the upside.

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