Turkey's central bank surprises with 150bp rate cut

The Central Bank of Turkey has cut interest rates by 150bp to 10.5% due to growth concerns and signalled that it will end its rate-cutting cycle next month at 9%

The Central Bank of Turkey

After two 100bp rate cuts in the last two months, the CBT surprised the markets by reducing the policy rate by 150bp (vs the market consensus at 100bp) to 10.5% citing growing downside risks to the growth outlook. In line with President Erdogan's earlier remarks, the bank also signalled another move next month, ending the cycle with a 9% policy rate (1-week repo rate).

The CBT's reasoning behind the extension of the easing cycle and accelerating pace of cuts in October was the need for supportive financial conditions so as to preserve the growth momentum in industrial production and the positive trend in employment. The CBT reiterated this month the importance of supportive financial conditions with an additional word, "critical", given recent signs of momentum loss in economic activity amid decreasing foreign demand, high uncertainty about the global growth outlook and escalating geopolitical risks. Accordingly, the CBT stated that it will closely monitor "pressures on the manufacturing industry due to foreign demand and their currently limited impact on domestic demand and supply capacity".

Indeed, we have seen signs of decelerating activity in the third quarter with a weak PMI, deterioration in sentiment indicators & decline in electricity consumption. Further weakness should follow due to a worsening global backdrop, which will weigh on exports, and higher FX volatility. In this environment, the CBT seems to be prioritising growth despite an acceleration in September inflation, with further pressure in services inflation and large administrative price adjustments.

The bank's signal to cut rates again next month and end its easing cycle at that point is in line with President Erdogan's recent call to bring the policy rate into single digits by year-end. The policy mix has tilted to a more supportive stance lately given i) statements about another Credit Guarantee Fund package (reportedly at least TRY50bn) that could reverse the recent momentum loss in lending, though the timing has not been specified yet ii) more expansionary stance on the fiscal side in the medium term plan (MTP) when compared with the previous MTP, and accelerating expenditures in the latest budget data releases iii) the rate cutting cycle by the CBT. However, given tighter regulations targeting banks' asset side which selectively limit loan growth, cuts are not easing financial conditions as fast.

> Further signs of a slowdown in economic activity, a recovery in FX reserves at the beginning of October (by US$6.9bn to US$114bn) and stability in the lira which has outperformed other peer currencies, are likely other factors for another rate cut this month. However, ongoing widening pressure on the current account and subdued capital flows imply the possibility of a further drawdown in reserves. Given that the current policy setting does not prioritise disinflation, inflation will likely remain elevated in the near term.

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