Turkey’s central bank cuts rates by a full point as easing continues

Turkey's easing cycle continues as the central bank slashes interest rates by 100 basis points. We were expecting it, despite elevated price and financial stability risks. It follows calls by the country's president for the bank to keep on cutting to stimulate growth

The Central Bank of Turkey has cut its policy rate by 100bp to 15%, in line with consensus and close to market pricing. It signalled, however, that it would consider ending the easing cycle in December after a cumulative 400bp reduction in the last three months.

In its rate-setting note, the CBT once again reiterated that it relied on analysis showing “the impact of demand factors that monetary policy can have on effect, core inflation developments and supply shocks” on its decision. The bank points out an ongoing uptrend in inflation that is mainly due to supply-side factors including pressures from food and import prices and supply constraints, in addition to administrative price adjustments and demand developments. However, what's different from last month is that the CBT sees a continuation of the “transitory” supply-side factors into the first half of 2022.

Regarding the “higher than envisaged contractionary effect” [of] “the tightness in monetary stance” on commercial loans that the CBT pointed to as another factor to cut the policy rate in

September and October, it sees recovery in the pace of lending. It stated that 'The revision in the monetary policy stance began to affect commercial loans positively". Indeed, with support of the CBT's shifting stance, there are signals of an acceleration in Turkish lira corporate lending lately. While non-state banks with an already strong appetite show further momentum gains, it's worth mentioning state banks' participation in this trend in recent weeks. Annual growth of this asset class is around 14% as of 5 November, but the pace of expansion as measured by the 13-week MA, FX adjusted annualised, YoY growth has reached around 20% vs 35% in non-state banks.

One revision to the statement is related to the policy stance in the near term as the bank signals to complete "the use of limited room" implied by "transitory" supply-side factors impacting the inflation outlook. This guidance does not rule out the possibility of one more cut in the December rate-setting meeting and then declaring the finalisation of the easing cycle in the near term. The CBT's increased focus on the current account balance should also be supportive for such a policy perspective.

All in all, despite already elevated price and financial stability risks, rate cuts continued as widely expected in November, likely attributable to an objective of providing support to the real economy. In this environment, further TRY weakness can't be ruled out - we've already seen close to a 30% increase in USD/TRY parity in recent weeks - creating additional cost-led pressures. Accordingly, the ex-post real policy rate is now deeply negative and is set to remain so next year. This environment will likely further deteriorate expectations and add to already high inflationary pressures.

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