Central Bank of Turkey turns more cautious about the pace of disinflation

The CBT's policy rate was kept on hold at 50% in the October MPC meeting as expected, while its statement turned cautious as a result of increasing uncertainty surrounding the pace of inflation improvements

CBT Governor Fatih Karahan

In line with the consensus, the CBT kept rates on hold at 50% at its October rate setting meeting, reiterating key messages related to its attentiveness to inflation risks and forward guidance. The interest rate corridor also remained unchanged, with the upper and lower bounds at 53% and 47% respectively.

Despite a continuing decline in annual inflation due mainly to base effects, the underlying trend has remained elevated over the last month on the back of services. The September print also implied that the 2024 turnout would likely come in above the CBT's forecast range. In its assessment of the inflation outlook, the central bank acknowledged a slight increase in the underlying inflation trend. Given that goods inflation moved down to 40.3% year-on-year and core goods inflation – a better indicator for the trend – inched down to 28.3% YoY (not only thanks to base effects, but also exchange rate-related factors), the CBT added that core goods inflation remained low last month. Services inflation, which is less sensitive to currency movements but more heavily impacted by domestic demand and the minimum wage, stood at 72.9% YoY in September. The CBT has remained optimistic on this front, maintaining its expectation that an improvement will occur in the last quarter. However, the central bank has flagged rising uncertainty related to the pace of the improvement considering recent data releases.

For the second half of this year, there are signals of additional weakness in domestic demand as tightening financial conditions, slowing real wage growth and a likely increase in the unemployment rate point to a further slowdown in economic activity. In this environment, the CBT slightly revised its assessment and noted that domestic demand has approached disinflationary levels, while the previous statement noted a diminishing impact of domestic demand on inflation.

After the change last month where any direct references to policy tightening were dropped, the CBT has maintained its relatively soft tone and continued to point to its reliance on effective use of policy tools in the case of a deterioration in inflation outlook. Additionally, the strong policy guidance in recent MPCs related to the timing of rate cuts has remained unchanged, with a continuing pledge to keep rates higher for longer until a significant and sustained decline in the underlying trend of monthly inflation materialises and inflation expectations converge with the CBT's projected forecast range. 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. Sterilisation efforts are likely to continue in their aim of supporting short-term interest rates remaining 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 the Turkish lira, and c) improvement in inflation expectations. While the statement turned cautious as a result of increasing uncertainty surrounding the pace of inflation improvements, the bank reiterated its expectation that the disinflation process will gain strength with a drop in services inflation in the last quarter. Given this backdrop, we think that there is still room to launch a rate cut cycle in December, depending on the October and November inflation data. The pace of the ongoing slowdown in economic activity will also play an important role in the timing here.

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