

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.

Author

Muhammet Mercan

Chief Economist, Turkey

muhammet.mercan@ingbank.com.tr

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss

arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.