Turkey’s central bank keeps policy rate flat and maintains tight stance

In line with last month's signal to end the tightening cycle, and consistent with the market consensus, the Central Bank of Turkey (CBT) kept its policy rate unchanged at 45% at the February rate-setting meeting

The Central Bank of Turkey in Istanbul

The CBT has maintained its tight stance and hawkish forward guidance given the prudent monetary policy approach that has been in place since the second half of 2023. The February statement showed some tweaks in comparison to the one released a month ago:

- On the inflation side, the bank acknowledged renewed pricing pressures on the back of “month-specific and time-dependent price and wage adjustments” while the increase in the underlying trend was in line with its projections. In terms of the key factors that have been weighing on the outlook, the CBT reiterated inertia in services inflation as well as geopolitical risks and also added food prices to the list this month. In terms of domestic demand, on the other hand, it restated moderation, though made a distinction in February that while “moderation is robust in imports of consumption goods and gold”, “indicators of other consumption expenditures” are moderating slower than envisaged. Currently, there is a consensus that inflation will remain elevated until mid-2024. The second half of this year, on the other hand, will likely see a sharp downtrend although upside risks to the CBT's forecasts are still significant. On the fiscal side, the end-2023 budget recorded a large deficit of close to 5.4% of GDP on the back of earthquake-related spending. In this regard, the gap between the December budget and the cash budget has reached significant levels. If the remaining cash payments are made in early 2024 in a way that increases liquidity in the banking sector, the liquidity surplus that has existed in the system currently will further increase and add to challenges in the disinflation process.

- Additionally, a comparison between the CBT's projections and market participants' expectations still shows a meaningful gap. While the CBT sees inflation at 36% at the end of this year and 14% in 2025, the survey reveals market expectations at 42.96% for 2024 (up from 42% a month ago) and 25.2% for 2025. In this respect, the CBT stated that the alignment of inflation expectations and pricing behaviour with projections and the effects of wage increases on inflation will be closely monitored. Additionally, the bank added to the statement this month that it sees the current stance of monetary policy contributing to the real appreciation of the Turkish lira.

Given the ongoing risks to the inflation outlook, the CBT also strengthened its messages with some changes to the forward guidance:

- The bank stated that the “monetary policy stance will be tightened if a significant and persistent deterioration in the inflation outlook is anticipated” while in January it said, “the Committee will reassess the stance of monetary policy if notable and persistent risks to the inflation outlook emerge”. The new wording implies a more decisive stance towards inflationary risks.
- The current level of policy interest rates will be maintained as long as needed as the bank reiterated two qualifiers to start cutting. Accordingly, the current level of the policy rate will be maintained until there is “a significant and sustained decline in the underlying trend of monthly inflation and until inflation expectations converge to the projected forecast range”. The revised sentence added “sustained” decline as an additional condition to initiate the cutting cycle
- Finally, the CBT reiterated the pledge for further macro prudential moves “in case of unanticipated developments in credit growth and deposit rates” a change from “in case of any potential excess volatility in credit supply and deposit rates”. The CBT also removed the "simplification" emphasis from the current micro and macro-prudential framework. This implies new moves targeting credit expansion, likely credit card growth, and downward pressures in deposit rates.

After reaching the terminal rate of 45%, the bank repeated its pledge to maintain a tight monetary policy stance for longer, and kept the door open to further rate hikes, while it has strengthened its messages with some slight changes in the rate-setting statement. At this stage, we continue to expect a first cut in the last quarter of this year and the policy rate to reach 40% at end-2024 with a risk of delay into early next year.

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