Turkey's central bank opts to continue on at the same pace

At its October MPC meeting, the Central Bank of Turkey (CBT) raised the one-week repo rate from 30.0% to 35.0%, in line with both the consensus forecast and our own expectations

The building of Turkey's central bank in Ankara

By opting for another 500bp hike at its October rate-setting meeting, the Central Bank of Turkey (CBT) has pulled the policy rate to 35% and repeated its signal for further tightening steps in rates and macro-prudential instruments to achieve disinflation. According to the bank, the persistence of upward pressures and risks on the inflation outlook and the alignment of the disinflation course with the forecast path in 2024 were the major driving factors.

In a note explaining the rate decision, the bank reiterated that it will continue with monetary tightening steps in a "timely and gradual manner" until it achieves a significant improvement in the inflation outlook. In this regard, the CBT acknowledged that the pass-through from the post-election adjustment in FX, wages and taxes has been "largely completed". It pointed again to strong domestic demand, stickiness in services prices and a jump in inflation expectations as the key factors putting upward pressure on the inflation outlook, while also mentioning the upside risk to oil prices due to geopolitical developments.

The MPC statement once again noted a determination to set the monetary policy stance in a way that achieves the projected disinflation path for 2024, which was set at 33% in the July inflation report (the next report will be released on 2 November) and the Medium-Term Plan. This stance is in line with Treasury and Finance Minister Mehmet Simsek's recent communication stating an aim to i) steer inflation expectations towards target levels and ii) move towards a positive ex-ante real policy rate. This is the case with the latest move, based on the CBT's forecast.

However, survey-based inflation expectations currently stand at 45.2% for the next 12 months, implying a higher trajectory in comparison to the central bank's target disinflation path. While the CBT expects underlying inflation trend “on course to decline”, it also pledges that the policy rate will be determined in a way that will create the monetary and financial conditions necessary for ensuring a decline in the underlying trend of inflation. This guidance and current expectations both signal that the Turkish central bank's rate hike cycle is coming to the end, with the pace set decline in the months ahead.

The CBT stresses again the importance of FDI inflows, recovery in FX reserves, “stable” (changed from “improving” last month) external financing conditions, an improvement in the current account, as well as higher demand for TRY assets to contribute to price stability. Regarding domestic demand conditions, the CBT points to “rebalancing” this month, attributable to tightening financial conditions with a supportive impact on the inflation outlook.

Finally, to support the monetary policy stance, it pledged the continuation of quantitative and selective credit tightening moving at a gradual pace. Given the return of excess liquidity in the banking system prior to this decision, we should not rule out the possibility that the CBT may come up with a new quantitative tightening decision. Given the need for rebalancing to control inflation and reduce external imbalances, the central bank's move and its impact on deposit and loan rates will be key for tightening financial conditions and controlling domestic demand. Deposit rates (in up to three months and up to six months tenors) that moderated recently according to the latest data will be under close watch in order to prevent an early easing in financial conditions.

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