Turkish central bank cuts again, despite September inflation surprise

At its October MPC meeting, the Central Bank of Turkey cut the policy rate by 100bp to 39.5%, signalling a slower pace of easing amid mounting inflation concerns

Fatih Karahan, governor of the Central Bank of Turkey

At its October rate-setting meeting, the Central Bank of Turkey kept the asymmetrical interest rate corridor unchanged but slowed the pace of easing, cutting rates by 100bp to 39.5%, down from 250bp in September and 300bp in July.

The decision came a day before the court hearing about the main opposition party's 2023 congress that resulted in a leadership change. Estimates were ranging from 38% to 40.5%, while the prevailing expectation was a slowdown in rate cuts to either 100bp or 150bp rather than a pause.

A surprise inflation spike last month complicated Turkey's path to further rate cuts ahead of the October meeting. Annual inflation, which had been on a continuous downtrend, rose for the first time since May 2024, given a significant increase in food prices and elevated services inflation. In the latest market participants' survey, year-end Consumer Price Index (CPI) forecasts for 2025 and 2026 rose by 1.9ppt and 1.4ppt respectively, from the previous month, reaching 31.8% and 22.1%. 12M and 24M inflation expectations also increased to 23.3% and 17.4%, respectively.

Regarding reserves, higher gold prices have contributed to the increase in recent weeks, though the CBT balance sheet implies a less favourable picture in terms of FX purchases since the beginning of September. In fact, with the termination of the FX-protected deposit scheme, FX deposits rose by US$5.8bn between the end of August and 10 October, after adjusting for gold and parity effects, while FX investments in mutual funds grew by $4.6bn during the same period after elimination of the gold price impact.

With the CBT's hawkish forward guidance – pledging to tighten policy if the inflation outlook strays from interim targets – the key question was whether the bank would pause or simply slow the pace of rate cuts in response to recent data.

Based on the MPC statement, it is clear that the CBT has turned more cautious. It acknowledged an increased underlying trend in September, referring to demand conditions that point to a slowdown in the disinflation process, and citing more pronounced risks posed by recent price developments on the disinflation process. This implies that the CBT has responded to the deterioration in the inflation outlook by slowing down the rate cuts.

Overall, the CBT signals no changes to the macroprudential framework and a continuation of rate cuts, with the pace of easing to be guided by the inflation outlook, dollarisation trends, and reserves. The bank repeated its pledge to maintain a tight monetary stance to support disinflation and added that it would do this "in line with interim targets" and would tighten "in case of a significant deviation in inflation outlook from the interim targets".

Given this backdrop, the policy rate will stay at 38.5% at the end of this year if the bank maintains 100bp cuts, while the decision will be shaped by the October and November CPI releases. The last inflation report of the year, to be released on 7 November, and accompanied by inflation forecasts, will also provide further insights about the CBT's behaviour in the period ahead.

Author

Muhammet Mercan
Chief Economist, Turkey
muhammet.mercan@ingbank.com.tr