

## Turkish Central Bank delivers expected 250bp rate cut

At the year's first MPC meeting, the Central Bank of Turkey (CBT) continued its easing cycle, which began in December, with another 250bp rate cut, bringing the policy rate to 45%, as anticipated. The accompanying statement highlighted a decline in the underlying trend in December but noted a temporary increase in January



Ankara, Turkey

Following higher-than-expected inflation readings between September and November, the underlying trend in both headline and core inflation, which is closely monitored by the CBT, showed significant improvement in December with a downside surprise. Inflation expectations also improved markedly in January, with 12-month and 24-month expectations declining by 1.7pp and 0.8pp to 25.4% and 17.7%, respectively. The end-2025 inflation forecast remained relatively stable at 27.07%, compared to the CBT's upper forecast band of 26%.

Additionally, households' and firms' inflation expectations for the next 12 months have been on a downward trend since the second half of 2024, although they remain well above the CBT's forecast range at 63.1% and 47.6%. This context contributed to the rate cut decision made by the January MPC.

However, the CBT did point out an increase in the underlying inflation trend in January as shown by leading indicators, although the temporary rise in pricing pressures is in line with the bank's projections. We expect January inflation to come in at 4.1% MoM on the back of services inflation given the seasonality in rents and the impact of new year wage adjustments. This implies a continuation of a downtrend in annual inflation to 40.8% from 44.4% a month ago, though a downtrend in the underlying trend will likely cease.

While the CBT is cautious for January to manage inflation expectations, it has revised its guidance by removing the reference that linked rate cuts to the monthly inflation trend. Previously, this reference was changed from exact figures to a reference to the sustained decline in the underlying trend and the convergence of inflation expectations to the CBT's forecast range. Additionally, the CBT stated that "the tight monetary stance will be maintained until price stability is achieved through a sustained decline in inflation." These changes are likely due to an anticipated short-term deterioration in the inflation outlook, in our view.

On the other hand, the CBT reiterated that it would set the policy rate to maintain the necessary tightness for the anticipated disinflation path, taking into account both actual and expected inflation. The bank also conveyed a somewhat hawkish stance, indicating that it would make decisions cautiously on a meeting-by-meeting basis, focusing on the inflation outlook. While suggesting that interest rate cuts may continue in the future, this guidance implies that the cuts will be data-dependent and not aggressive or continuous. Therefore, we anticipate that real rates will remain high during the current rate-cutting cycle.

In the statement, the bank also acknowledged that domestic demand was at levels supportive of disinflation, while additional sterilisation measures would be taken for excess liquidity. Since the beginning of 2025, with reviving foreign inflows and a continuing shift of local investors to TRY assets from FX holdings, the CBT has bought more than US\$15bn, leading to an increase in the banking system's excess TRY liquidity significantly. Accordingly, the bank raised reverse swaps with local banks reaching US\$10.6bn and depo auctions with a stock of TRY1.1 tr. The MPC statement implies additional policy actions to address the TRY liquidity in the system.

Given benign December data and the economic slowdown, the CBT implemented an additional cut in January. While inflationary risks persist in the near term, relatively high real rates and recent tightening in loan growth caps should keep disinflation from continuing. We expect 25.5% inflation and a 27.5% policy rate at the end of 2025 with risks skewed to the upside.

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