# Turkish central bank keeps rates unchanged at 50%

While the Monetary Policy Committee has voted to keep the policy rate on hold at 50%, the forward guidance also remains unchanged as the central bank continues to focus on disinflation

Turkey's central bank governor Fatih Karahan

The Central Bank of Turkey (CBT) kept the policy rate flat at 50% at the August rate-setting meeting, in line with the consensus and our call, while the interest rate corridor was also unchanged with the upper and lower at 53% and 47%, respectively.

There was a reiteration of the strong policy guidance from recent committee meetings and in the press conference that was arranged to coincide with the release of the latest inflation, such as:

- Continuing tightening bias to manage expectations for future rates and inflation.
- Pledging to keep rates higher for longer until a significant and sustained decline in the underlying trend of monthly inflation and convergence of inflation expectations to the CBT's projected forecast range.

According to the bank, "the alignment of inflation expectations and pricing behaviour with projections has gained relative importance for the disinflation process". This implies that it remains sensitive to the credibility gap. While market participants' expectations for this year and end-2025 have been sticky in recent months, standing at 43.3% (34-42% forecast band of the CBT) and 25.6% (14-21% forecast band), respectively, HHs and corporates see inflation at around 72% and 55%, respectively over the next 12 months.

Given this backdrop, as well as risks related to the inflation outlook and foreigners' and locals' portfolio preferences, the CBT has maintained its cautious approach as recently signalled by CBT officials with a preference to "err on the side of caution".

For the inflation outlook, according to the CBT, the underlying trend rose slightly in July but remained below its second-quarter average. It continued to see that inflationary risks are attributable to a high level of services inflation and its stickiness, inflation expectations, and geopolitical developments, while it removed food prices from the risk list this month.

The bank also acknowledged a slowdown in economic activity, stating that third-quarter indicators suggest continuing moderation in domestic demand with "a diminishing inflationary impact". Indeed, when we look at the July tendency surveys and sectoral confidence indices, they provide additional signals about the slowdown in the economy:

- Manufacturing industry capacity utilisation dropped by 0.3 points to 75.9% in seasonally adjusted terms.
- A deterioration in manufacturing and sectoral PMIs driven by declining orders.
- A drop in real sector confidence (seasonally adjusted) to below 100 for the first time since the pandemic.
- Signs of a slowdown in services with a plunge in PMI into contractionary territory. Based on the July data, GDP growth will likely lose further momentum in the third quarter at an accelerating pace given the extent of tightness in financial conditions.

Since mid-July, downward pressure on the interbank rate has continued, although the surge in global market volatility in early August that in return triggered net FX sales by the CBT led to the temporary withdrawal of the excess TRY liquidity from the market with an upward push in the interbank rate. With the resumption of reserve accumulation, TRY liquidity has increased, and the interbank rate has come down below 50% again in recent days. Accordingly, sterilisation remains one of the CBT's priorities as it reiterated that "sterilisation tools will continue to be implemented effectively".

Overall, the CBT remains cautious with a continuing focus on the inflation outlook. It expects that the tight monetary stance will lead to a decline in the underlying trend of monthly inflation by moderating domestic demand, a real appreciation in TRY, and an improvement in inflation expectations.

According to the Governor's recent comments, the CBT can maintain a tight monetary stance while cutting the policy rate. This implies that the CBT will remain cautious, and the timing of cuts will depend on data and be gradual. Given that the relatively stable currency and normalisation in domestic demand should support a decline in the underlying inflation trend over the remainder of this year, we see room to cut in November or December, depending on the data.

## Author

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

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