Turkish central bank signals end to hiking cycle soon

At the November MPC meeting, the Central Bank of Turkey hiked more than expected, by 500bp, and guided that the pace of tightening will slow down, with the hiking cycle completed in "a short period of time"

The building of Turkey's central bank in Ankara

Following large rate hikes totalling 26.5ppt since June, the CBT announced another 500bp increase, pulling the policy rate up to 40% from 35% ago. The central bank pointed to continuing pricing pressures, driven by the current level of domestic demand, rigidity in services prices and geopolitical risks as factors for the rate adjustment in November. The consensus was for a 250bp hike, with markets expecting a deceleration in the pace of tightening following the significant policy normalisation since the May elections, macro-prudential actions reinforcing rate hikes, and early signals of improvement in inflation.

While hiking decisively in recent months, the CBT has not provided any specific forward guidance for the pace and extent of policy tightening until this meeting. In the latest rate-setting note, the CBT concluded, “the pace of monetary tightening will slow down and the tightening cycle will be completed in a short period of time”. This is based on the assessment that “the current level of monetary tightness is significantly close to the level required to establish the disinflation course”. Continuing its hawkish stance, the bank signalled it would not start cutting earlier and remained committed to keeping a tight stance for longer to "ensure sustained price stability." As an additional note, while reiterating that it will continue to take quantitative tightening decisions that will support the monetary tightening process in addition to interest rate hikes, the CBT did not use the expression "selective credit" decisions this month. This implies that it is likely satisfied with current credit conditions.

Regarding the inflation outlook, there are grounds to proceed with smaller steps:

- The CBT has pledged that its policy rate will be maintained in such a way as to create the monetary and financial conditions necessary to ensure a decline in the underlying trend of inflation. The inflation release in October showed the underlying trend is starting to improve. In fact, the latest data remains in line with the outlook presented in the last Inflation Report of the year, according to the bank.
- Inflation expectations and pricing behaviour show signs of improvement. Indeed, survey-based measures of inflation expectations for 12 months ahead declined in November by 1.3ppt to 43.9% year-on-year. The latest hike would bring the compound policy rate to 49%, above the 12-month inflation expectation in the Market Participants' Survey of the CBT.
- It referred to tight financial conditions. After the MPC meeting last month, the CBT announced a number of regulations easing security maintenance, increasing the target rise in the share of retail TRY deposits and introducing additional reserve requirement hikes. These moves, in turn, led to a significant adjustment in government bond yields. Additionally, commercial lending rates have moved up further to 52% (excluding overdraft & corporate CCs), while consumer lending rates have been relatively flat at around 59%. Tighter credit conditions will likely continue to support the normalisation in domestic demand.
- The recent data indicates that the gap between aggregate demand and supply has slowly narrowed along with gradual policy tightening since the elections. This was also acknowledged by the CBT in the rate-setting note.

While tighter financial conditions than implied by the policy rate increase the challenges for the real economy, the CBT has come up with supportive moves for exports and imports recently. The latest action announced after the MPC meeting was the introduction of an upper limit on the total interest cost of rediscount credits for exports and FX earning services.

> Overall, given the CBT's guidance that the pace of tightening will slow down and the hiking cycle will be completed in a short period, we now expect that the rate increases will be completed at 45.0% with more limited increases of 250 basis points in December and January. Following the end of hikes, the policy rate will likely remain at this level until the third quarter of next year.

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