Central Bank of Turkey surprises with steeper rate cut

At the September MPC meeting, the Central Bank of Turkey continued to cut rates, this time by 250bp to 40.5% vs the market consensus of 41%. The Bank also updated its main message with an emphasis on intermediate targets

The Central Bank of Turkey in Istanbul

At its September Monetary Policy Committee meeting, while keeping the asymmetrical interest rate corridor unchanged, the Central Bank of Turkey cut rates by 250bp following a 300bp cut in July, pulling the policy rate to 40.5%. Although not explicitly mentioned in the statement, domestic uncertainty ahead of the 15 September hearing likely influenced the CBT's decision to scale back the pace of rate cuts. The bank cited a slowdown in underlying inflation in August, weak final domestic demand in 2Q GDP, and disinflationary demand conditions based on the latest data.

Last month, the Bank introduced its year-end interim targets, along with its inflation report. Governor Fatih Karahan emphasised that these interim targets (which represent specific inflation levels that the CBT is committed to achieving in the short term as part of its broader disinflation strategy) will act as benchmarks for shaping the monetary policy trajectory. This adjustment to the framework reflects a stronger commitment by the CBT to respond decisively to developments that could cause inflation to diverge from its targets. In line with this change in strategy, it

repeated its pledge to maintain a tight monetary stance to support disinflation but added that it would do this “in line with interim targets” and will tighten “in case of a significant deviation in the inflation outlook from the interim targets”. This marks a hawkish shift from the previous statement, which had committed to deploying all monetary policy tools effectively.

The MPC expects tight monetary policy to contribute to the disinflation process via three main channels, demand, the exchange rate and expectations. In July, this was framed more specifically as 'domestic demand, real appreciation of the Turkish lira, and improved inflation expectations. We think, despite a slight revision in the wording, the substance has remained unchanged as the bank considers the real appreciation of the Turkish lira to be a natural outcome of its tight monetary stance which increases demand for the lira. While we may not observe consistent appreciation in the short-term i.e. on a month-to-month or quarterly basis, it is highly likely that the lira will experience cumulative real appreciation over a longer period, according to the Bank.

The CBT also considers that “(t)he macroeconomic framework outlined in the Medium-Term Programme will contribute (..)” to the disinflation process. The growth trajectory presented in the MTP remains below Turkey’s long-term average, signalling that policymakers are prioritising disinflation over rapid expansion. While the government has signalled fiscal discipline by keeping the deficit (excluding earthquake-related spending) near the Maastricht threshold of 3.0%, a notable increase in primary spending and interest payments is expected next year. This rise, however, is projected to be offset by stronger revenue generation. Policymakers have emphasised that fiscal policy will support disinflation, suggesting a reduced reliance on inflationary measures such as administered price hikes and tax increases. Accordingly, the CBT views the new MTP as signalling a macro policy mix that is conducive to disinflation.

Overall, the CBT sees recent data as supportive of continued easing. This view is based on three factors: (i) a slowdown in underlying inflation despite upward pressure from food and services prices, (ii) weak final domestic demand in 2Q despite stronger-than-expected GDP growth, and (iii) demand conditions that remain disinflationary. The CBT signals no changes to the macroprudential framework and intends to continue rate cuts, with the pace depending on the inflation outlook, dollarisation trends, and reserve dynamics - especially given potential market volatility around upcoming court hearings. If the Bank maintains the pace of cuts at 250bp, the policy rate would fall to 35.5% by year-end, while reducing the pace to 200bp would result in a rate of 36.5%.

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