Macro note – MPC Rate Decision

CBRT raises the policy rate by 350 basis points to 46%. Continuing with the asymmetric corridor, the CBRT revises the width of the interest rate corridor to 300 basis points for the lending rate and 150 basis points for the borrowing rate.

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Contrary to market expectations, the CBRT Monetary Policy Committee (MPC) raised the policy rate by 350 basis points to 46% at its meeting this month. Lending and borrowing interest rates were raised by 300 basis points to 49% and 44.5%, respectively. Significant changes were made in both interest rates and the policy statement. First and foremost, core goods inflation is expected to rise slightly due to global developments. As will be recalled, it was stated in previous texts that goods inflation had fallen back to targeted levels. Even if this effect is temporary, we will see inflationary pressure on core goods again. On the other hand, services inflation is expected to remain flat instead of declining. This can be considered as the second negative shock to the disinflation process. While the March MPC decision stated that domestic demand supported disinflation in the first quarter, today's MPC decision stated that “although demand lost momentum, its disinflationary effect weakened.” We understand that the disinflation path is shifting to a gradual outlook. On the global front, it was stated that the impact on the market of protectionist tendencies in trade was closely monitored without specifying the direction of the impact. Finally, it was emphasized that necessary steps were taken regarding liquidity management after the interim decision, and that liquidity tools will continue to be used effectively if necessary.

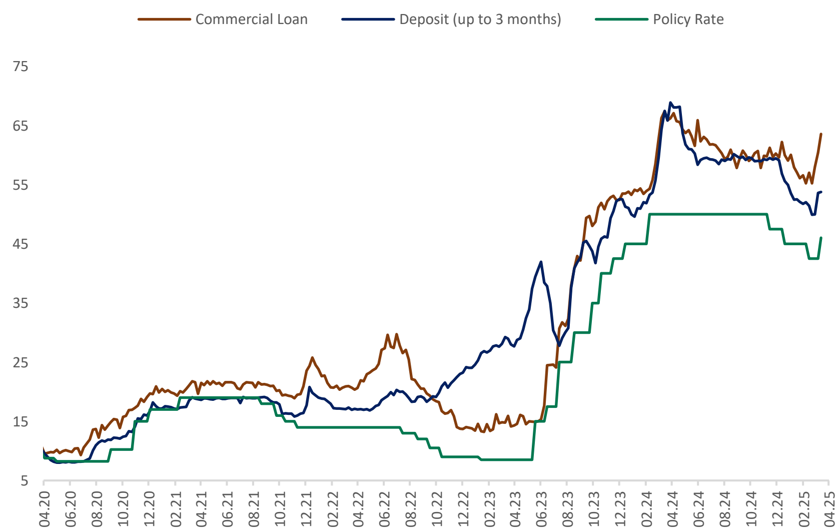
The last time CBRT raised the policy rate to 42.5% and overnight lending to 46%, weekly repo auctions were suspended. In other words, the market was funded from overnight borrowing at 46%. Thereby, the lending rate functioned as the policy rate. In this sense, we find it meaningful to raise the policy rate to 46%. On the other hand, the interest rate corridor, which is normally 300 basis points wide (-/+ 150 basis points around the policy rate), was raised to 500 basis points with the interim decision. Currently, the corridor has been revised to 450 bps, with 300 bps on the lending side and 150 bps on the borrowing side. With the press release following the decision, it was decided to resume one-week repo auctions, which were suspended on March 20, 2025. When all the effects are evaluated together, we see that the CBRT has simplified with the policy rate hike. Actual funding via repo auctions will reduce uncertainty. The asymmetric outlook in the lending rate will allow the CBRT to manage liquidity effectively in case of market volatility.

While the rhetoric on loan and deposit developments was omitted from the text, we note a rather hawkish attitude displayed with the decision. Both the increase in goods inflation in April and the flattening of the decline in services inflation indicate that the decision depends on inflation developments. The weakening effect of domestic demand on disinflation in the first quarter suggests that the disinflation process and its targets may experience some delays. The uncertainty in global developments added to the local outlook has made a rate hike almost mandatory. When all these factors are evaluated together, we understand that the tight stance will be maintained decisively until the inflation targets are achieved.

The decision text details the rationale for the tight stance and current developments. Accordingly, “The underlying trend of inflation declined in March. Monthly core goods inflation is projected to rise slightly in April due to developments in financial markets, while services inflation is expected to remain relatively flat. Leading indicators suggest that domestic demand, despite losing momentum in the first quarter, remained above projections and its disinflationary effect waned. We closely monitor the possible effects of rising protectionist tendencies in global trade on the disinflation process through global economic activity, commodity prices and capital flows. Inflation expectations and pricing behavior continue to pose risks to the disinflation process. The decisive monetary policy stance strengthens the disinflation process through rebalancing domestic demand, real appreciation of the Turkish lira and improvement in inflation expectations. Increased coordination of fiscal policy will also contribute significantly to this process. The tight monetary policy stance will be maintained until inflation falls permanently and price stability is achieved. Accordingly, the policy rate will be set so as to ensure the tightness required by the envisaged disinflation process, taking into account inflation realizations, the underlying trend and expectations. The Committee will determine the steps to be taken regarding the policy rate with an inflation outlook-oriented, prudent and meeting-based approach. In case of a significant and persistent deterioration in inflation, the monetary policy stance will be tightened.”

In summary, the Central Bank raised the policy rate by a surprise 350 basis points to 46% in today's interest rate decision. Continuing with the asymmetric interest rate corridor, the CBRT has revised the width of the band by 300 bps on the lending side and 150 bps on the borrowing side to a total of 450 points. We observe a hawkish stance and a determined rhetoric in the fight against inflation. In addition, it was re-emphasized that meeting-based and inflation-focused decisions would be taken, and it was implied that market volatility would not be allowed. Uncertainty in global markets may hamper the CBRT's disinflation targets for a while. We would like to underline that improvements in this area may bring interest rate cuts exceeding expectations. The CBRT maintains its resolute stance in the fight against inflation, both by effectively using its main policy instrument and by adjusting liquidity through complementary macro-prudential measures. In this context, we expect that the CBRT to continue cutting interest rates in the second half of the year, depending on the course of inflation and global markets in 2025. We underline here that new updates in the policy rate stance may be made in case of fresh supply or demand-side shocks.

Graph 1: Policy, Loan, and Deposit Rates (%)



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