Macro note – MPC Rate Decision

The Central Bank of the Republic of Türkiye (CBRT) cuts its policy rate by 100 basis points to 39.5%, in line with expectations. The slowdown in disinflation is emphasized, while risks to inflation expectations and pricing behavior are highlighted.

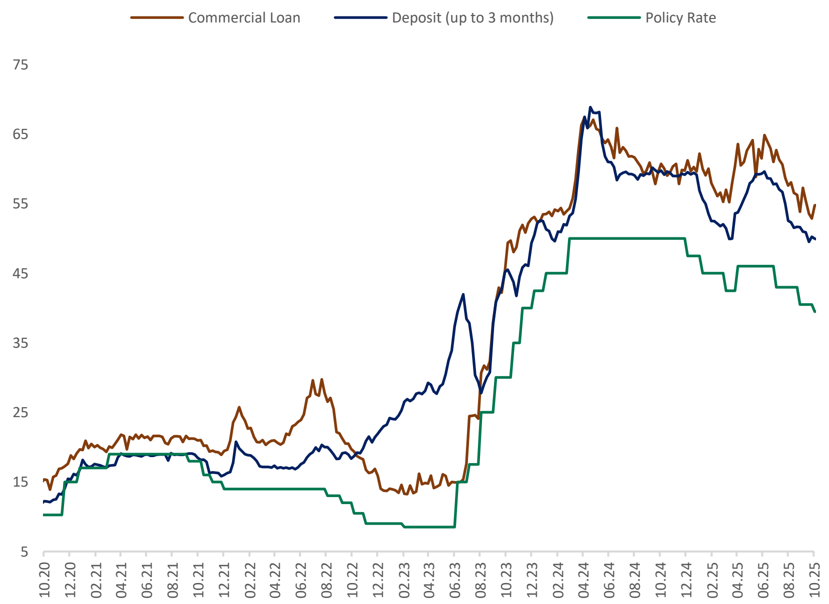
Abdulkadir DOGAN
Chief Economist
adogan@sekeryatirim.com.tr
(+90) 212 334 33 33/313

At its meeting this month, the Central Bank of the Republic of Türkiye (CBRT) Monetary Policy Committee (MPC) cut the policy rate by 100 basis points to 39.5%, in line with market expectations. Despite the interest rate cut, hawkish pronouncements that likely influenced the monetary policy stance suppressed risk appetite. The decision text, which largely resembles the previous text, has been amended slightly. Chief among the factors behind these changes is the underlying inflation trend, which slowed in August, and resumed its uptrend in September. As the disinflation process continued, its momentum slowed, and this slowdown led the CBRT to adopt a more cautious monetary policy stance. Price increases in certain items, particularly food, have highlighted risks to both inflation expectations and pricing behavior. It was stated that demand conditions had contributed to disinflation, but that this contribution has slowed. The emphasis on inflation inertia, global developments, and growth has been removed from the text. While the effective operation of the transmission mechanism requires a more significant inflation decline in the expectations channel, 12-24-month inflation expectations have not been adjusted to the targeted extent. In fact, when recent surveys are evaluated, expectations between the real sector and households have diverged, while upside risks have increased. We believe that the effectiveness of the monetary transmission mechanism's expectations channel is the key factor in addressing the rigidity in inflation at around 30-35%. While other channels (consumption/demand, exchange rate, and asset prices) have significantly retreated, risks to expectations are pushing future inflation figures above target levels. Finally, the coordination contribution from fiscal policy to inflation and monetary policy has also been omitted from the text. It can be inferred that budget pressures will ease, or that their impact on inflation will be limited.

The decision text details the rationale for the tight stance and current developments. Accordingly, "The underlying inflation trend increased in September. Recent data indicates that demand conditions remain at disinflationary levels, but that the disinflation process is slowing. The risks posed to the disinflation process by recent price developments, particularly in food, through inflation expectations and pricing behavior have become evident. The tight monetary policy stance, maintained until price stability is achieved, will strengthen the disinflation process through demand, exchange rate, and expectations channels. The Committee will determine the steps to be taken regarding the policy rate to ensure the tightness required for disinflation, consistent with the intermediate targets, taking into account inflation realizations, its underlying trend, and expectations. The magnitude of these steps is reviewed with a cautious approach, focused on the inflation outlook, on a meeting-by-meeting basis. If the inflation outlook significantly deviates from the intermediate targets, the monetary policy stance will be tightened. In the event of unforeseen developments in the credit and deposit markets, the monetary transmission mechanism will be supported with additional macroprudential measures. Liquidity conditions will remain closely monitored, and liquidity management tools will continue to be used effectively." A cautious stance and hawkish tone are generally adopted throughout the text. The level and frequency of cuts will be determined on a meeting-by-meeting basis and will take into account all macroeconomic variables.

In summary, in today's interest rate decision, the Central Bank lowered the policy rate by 100 basis points to 39.5%, in line with expectations. Despite the reduction, a cautious stance prevails throughout the text. The rise in the underlying inflation trend and the risks to expectations and pricing behavior were clearly emphasized. It was also reiterated that decisions will be made on a meeting-by-meeting basis and focused on inflation, implying that market volatility will not be tolerated. Uncertainty in global markets may temporarily disrupt the CBRT's disinflation targets. We would like to emphasize that improvements in this area could lead to interest rate cuts exceeding expectations. The CBRT maintains its resolute stance in the fight against inflation, both effectively using its primary policy tool and adjusting liquidity with complementary macroprudential measures. In this context, we anticipate that cautious and gradual interest rate cuts will continue until the end of the year, barring any additional shocks in local and global markets. We note that fresh updates to the policy rate stance may be made in the event of new supply or demand-side shocks.

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



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ŞEKER INVEST RESEARCH

Şeker Yatırım Menkul Değerler A.Ş.
Buyukdere Cad. No: 171 Metrocity
A Blok Kat 4-5 34330 SİSLİ /IST
TURKEY

TEL: +90 (212) 334 33 33
Fax: +90 (212) 334 33 34
E-mail: research@sekeryatirim.com
Web: http://www.sekeryatirim.com/english/index.aspx

For additional information, please contact:

Research

Kadir Tezeller	Head	+90 (212) 334 33 81	ktezeller@sekeryatirim.com.tr
Burak Demirbilek	Utilities	+90 (212) 334 33 33-128	bdemirbilek@sekeryatirim.com.tr
Atasav Can Tuglu	Food & Beverages, Automotive, Retail, Aviation	+90 (212) 334 33 33-334	atuglu@sekeryatirim.com.tr
Basak Kamber	Glass, Pharmaceutical, Defense, Telcos, Cons. Dur.	+90 (212) 334 33 33-251	bkamber@sekeryatirim.com.tr
M. Mucahid Yıldırım	Banking	+90 (212) 334 33 33-150	myildirim@sekeryatirim.com.tr
Yusuf Kemal Erdekli	Cement, Conglomerates, Real Estate	+90 (212) 334 33 33-115	yerdekli@sekeryatirim.com.tr
O. Furkan Ozdemir	Iron & Steel, Oil- Gas & Deriv.	+90 (212) 334 33 33-245	oozdemir@sekeryatirim.com.tr

Economy & Politics

Abdulkadir Dogan	Chief Economist	+90 (212) 334 91 04	adogan@sekeryatirim.com.tr

Institutional Sales

Deniz Keskin	Trader	+90 (212) 334 33 36	dkeskin@sekeryatirim.com.tr
Kerim Culum	Trader	+90 (212) 334 33 33-316	kculum@sekeryatirim.com.tr

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