

Macro note – MPC Rate Decision

The Central Bank of the Republic of Türkiye (CBRT) lowered its policy interest rate by 150 basis points to 38%, in line with expectations. Despite signs of improvement in inflation expectations and pricing behavior, these remain risk factors for the disinflation process.

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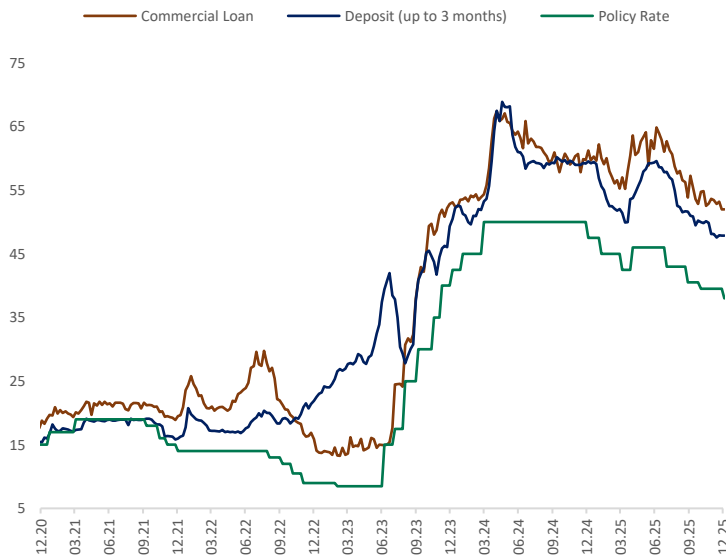
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The Central Bank of Türkiye's Monetary Policy Committee (MPC), at its meeting this month, lowered the policy interest rate by 150 basis points to 38%, in line with market expectations. While the magnitude of the rate cut was in line with expectations, a closer look at the details of the decision statement reveals a strong emphasis on a "prudent monetary policy stance" for the coming period. The decision statement, largely similar to the previous one, included minor changes. Chief among these is the fact that developments in food prices in November brought inflation below expectations. Another important point is the decline in the main inflation trend during October-November. The main trend, which showed an increase in September, experienced a limited decline in October-November. The main inflation trend is an indicator we closely follow because it shows the overall trend rather than just seasonal movements. This month's decision statement placed a significant emphasis on third-quarter growth. We understand that while the effects of inflationary pressures on aggregate demand have largely been brought under control, they continue. The fact that third-quarter growth exceeded forecasts is a reflection of this. The output gap is not in line with the Central Bank's targets, and the spending composition of growth is bringing the output gap closer to positive territory. If this trend continues, the CBRT may maintain its tight monetary policy for a considerable period. This is because the base scenario is based on a negative output gap, the control of demand-driven inflation, and the completion of the disinflation process with improved expectations. Leading indicators for the last quarter show that demand conditions continue to contribute to the disinflation process. The most important point in the text is that long-standing recurring inflation expectations and pricing behaviors continue to be a risk factor. Since backward indexation and inertia affect future price behavior and expectations, this area is critically important for the CBRT's interim targets. Although the effective functioning of the transmission mechanism requires a more significant decline in inflation in the expectations channel, 12–24-month inflation expectations have not retreated to the targeted extent. We believe that structural changes are needed for a market, household, and real sector expectation that is consistent with the CBRT's interim targets. We believe that the effectiveness of the monetary transmission mechanism in the expectations channel is the most fundamental factor in resolving the rigidity in inflation experienced in the 30–35% range. While other channels (consumption/demand, exchange rates, and asset prices) are significantly retreating, the risks in expectations are pushing future inflation outcomes above target levels. The pressure from administered/regulated prices in the new year will show how much fiscal policy will support the disinflation process. This is because the coordination between monetary and fiscal policies has been removed from the text. There are two possibilities here: either the contribution from fiscal policy is fully coordinated and did not need to be emphasized again; or, in the second case, the upward pressure from fiscal policy is mitigated by additional macro-prudential measures. The first possibility is both disinflationary and positive for financial markets, while the second has limited negative implications for risky assets.

The details of the decision text include the justifications for the tight stance and current developments. Accordingly, “Consumer inflation in November was lower than expected due to developments in food prices. The main trend of inflation has slightly declined in October and November after the increase in September. Quarterly growth in the third quarter was higher than expected. Leading indicators for the last quarter suggest that demand conditions continue to support the disinflation process. While inflation expectations and pricing behavior are showing signs of improvement, they remain a risk factor for the disinflation process. The tight monetary policy stance, which will be maintained until price stability is achieved, will strengthen the disinflation process through demand, exchange rate, and expectations channels. The Board will determine the steps to be taken regarding the policy interest rate in a way that will provide the tightness required for disinflation, in line with interim targets, taking into account inflation developments, its main trend, and expectations. The magnitude of the steps is reviewed with a meeting-based and cautious approach focused on the inflation outlook. If the inflation outlook deviates significantly from the interim targets, the monetary policy stance will be tightened. In the event of unexpected developments in the credit and deposit markets, the monetary transmission mechanism will be further tightened.” This will be supported by macroprudential measures. Liquidity conditions will continue to be closely monitored, and liquidity management tools will be used effectively.”

In summary, the Central Bank, in its interest rate decision today, lowered the policy rate by 150 basis points to 38%, in line with expectations. Despite the reduction, a cautious stance prevails throughout the statement. The upward trend in inflation and the risks in expectations and pricing behavior were explicitly highlighted. Furthermore, it was reiterated that meeting-based and inflation-focused decisions will be made, implying that market volatility will not be allowed. Uncertainty in global markets may temporarily hinder the TCMB's disinflation targets. We would like to underline those improvements in this area could lead to larger-than-expected interest rate cuts. The TCMB, effectively utilizing its main policy tool and adjusting liquidity with complementary macroprudential measures, maintains its determined stance in the fight against inflation. In this context, unless there is an additional shock in local and global markets, we expect cautious and gradual interest rate cuts to continue until the end of the year. We would like to emphasize that further 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 (%)



Source: CBRT, ŞEKER Invest

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