Macro note – MPC Rate Decision

The CBRT keeps its policy rate unchanged at 37 per cent, in line with expectations. Whilst noting the decline in the underlying trend of inflation, the CBRT emphasizes the upside risks to the domestic inflation outlook posed by energy prices.

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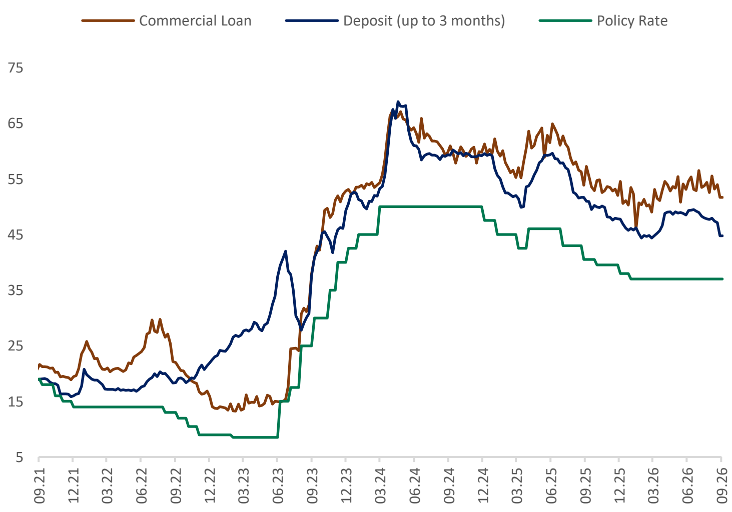
At its meeting this month, the Central Bank of the Republic of Turkey's Monetary Policy Committee (MPC) kept the policy rate steady at 37 per cent, in line with market expectations. Both the market and we had expected rates to remain unchanged. Prior to this decision, a number of measures were taken as part of the normalization process. Due to geopolitical tension, repo auctions were suspended at the beginning of March, and the market had begun to be funded at the upper band of the corridor, 40 per cent. In August, as tensions eased and the underlying trend in inflation moderated, repo auctions resumed and the market began to be funded at the policy rate of 37 per cent. This can, in fact, be regarded as an implicit interest rate cut. Alongside this development—which we might interpret as a fine-tuning of liquidity conditions—a 300 basis point easing took place. The fact that this was reflected in lending and deposit rates has provided the market with some relief. Looking at the details of today's decision, we observe a 'wait-and-see' policy that confirms recent developments. Rather than forward-looking messages of interest rate cuts, we can say that the rationale behind the 300 basis point implicit cut is evident between the lines. The first message is that realized inflation and leading indicators point to a decline in the underlying trend. The second is that the inflationary effects of economic activity and supply shocks have remained limited. When these two factors are assessed together, the CBRT is effectively explaining to the market the developments that took place leading up to the decision and the rationale behind the implicit interest rate cut. To understand why the policy rate was not cut, one needs to look at the upward revision of the forecast level in the latest inflation report and the assumptions regarding oil prices. Whilst the CBRT's assumption regarding oil prices was consistent with actual developments in July–August, it deviated upwards by approximately 10 per cent in September. If energy prices remain at this level, there will be upward pressure of approximately 1–2 percentage points on the CBRT's forecasts. We therefore believe that the CBRT's message to the market was: 'A 300-basis-point implicit cut is sufficient for now; to consider further cuts, we need to see the extent of volatility in the energy market and the new equilibrium levels.' Although core trend indicators, excluding energy prices, have eased, supply shocks may exert an upward influence on headline inflation and expectations. In this environment, where monetary policy is sufficiently tight, the downward impact of lagged effects on the expectations channel will be observed. The positive effects of the central bank's long-standing tight stance have been disrupted by supply-side global shocks. Therefore, maintaining a cautiously tight stance is a sound decision in order to assess the outcomes of the prolonged disinflationary policy. From the policymakers' perspective, the negative consequences of an early interest rate cut may outweigh any short-term positive effects. Should there be sharp fluctuations in oil prices, the most reasonable scenario appears to be maintaining sufficiently tight conditions and awaiting a de-escalation in geopolitical tension, rather than entering a period of uncertainty characterized by tightening followed by cuts, as seen in March.

The details of the decision statement outline the rationale for the tight stance and current developments. Accordingly, “Despite monthly fluctuations, recent inflation outcomes and leading indicators point to a decline in the underlying trend of inflation. Data on economic activity and the limited impact of supply shocks on domestic prices confirm the weak trend in domestic demand. On the other hand, high energy prices resulting from geopolitical developments pose an upside risk to the inflation outlook. The effects of geopolitical developments on the inflation outlook via the cost channel, economic activity and the expectations channel are being closely monitored. The tight monetary policy stance, which will be maintained until price stability is achieved, will reinforce the disinflationary process via the demand, exchange rate and expectations channels. The Monetary Policy Committee will determine the necessary steps regarding the policy rate by considering inflation outcomes, the underlying trend and expectations, in a manner consistent with the intermediate targets and ensuring the degree of tightness required for disinflation. Monetary policy decisions are taken with a focus on the inflation outlook, on a meeting-by-meeting basis and with a prudent approach. Should there be a significant and persistent deterioration in the inflation outlook, the monetary policy stance will be tightened. The Council has emphasized its cautious stance against upside risks to inflation. Should developments in the credit and deposit markets deviate from forecasts, the monetary transmission mechanism will be supported by additional macroprudential measures. Liquidity conditions will remain closely monitored and liquidity management tools will continue to be used effectively”. It has been reaffirmed that interest rate decisions are situation-dependent rather than time-dependent; improvements in expectations, actual outcomes and the underlying trend will lead to interest rate cuts.

In summary, in today’s interest rate decision, the Central Bank kept the policy rate unchanged at 37 per cent, in line with expectations. The effects that geopolitical risks, energy prices and global uncertainties may have on inflation are being closely monitored. Furthermore, it was reiterated that decisions would be made on a meeting-by-meeting basis and with a focus on inflation, and it was emphasized that monetary policy would be tightened should the inflation outlook deteriorate significantly and persistently. The CBRT, which is both making effective use of its primary policy instrument and adjusting liquidity through complementary macroprudential measures, continues to maintain its resolute stance in the fight against inflation. In this context, provided there are no further shocks in domestic or global markets, we anticipate that cautious and gradual interest rate cuts will begin by the end of the year. We would like to emphasize that should any new supply- or demand-side shocks occur, further adjustments to the policy rate stance may be made.

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



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