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TURKEY

Turkish central bank resumes rate cuts and signals more to come

The Turkish central bank has cut the policy rate by 100bp to 36%, as expected, amid improving inflation and continued weakness in domestic demand. The bank also indicated that additional rate cuts are likely unless there is a material shift in the conditions underpinning the current rate-cutting cycle



Fatih Karahan, Governor of the Central Bank of Turkey

The Central Bank of Turkey (CBT) has resumed cuts to the policy rate (1-week repo rate) after a nine-month pause, lowering it by 100bp to 36%, while keeping the width of the interest corridor unchanged at 450bp.

The move, which was widely expected, reflects the central bank's assessment of softer economic activity and favourable September inflation data, despite Brent crude oil trading close to US$110 per barrel and lingering geopolitical risks in the Middle East.

In its statement, the CBT said it would continue to monitor the growth and inflation outlook. On inflation, the bank has turned somewhat more confident amid the recently announced inflation figures and leading indicators, which confirm improvement in the underlying inflation trend. Last month, lower-than-expected CPI driven by food, particularly a sharp correction in unprocessed food, contributed to a further decline in annual inflation despite still high energy

prices and unanchored inflation expectations. The underlying trend also improved not only in core goods despite the lira's monthly depreciation accelerating since the start of the war, but also in services, which have been on a steady downward trend since March.

Regarding GDP growth, recent data suggest the economy is following a more moderate growth path in the second half of the year, while the disruption in investment funds is expected to weigh further on domestic demand. As a result, the CBT concluded that domestic demand is weak, providing additional justification for this month's rate cut.

When it comes to forward guidance, the central bank had previously emphasised that monetary policy decisions would be taken with a cautious, meeting-by-meeting approach focused on the inflation outlook. In this month's forward guidance, however, it altered its wording and shifted the emphasis to the magnitude and timing of future policy steps. This change implies that, unless there is a material shift in the conditions that have prompted the easing cycle, the bank is likely to continue its rate-cutting process in December as well.

On the other hand, it kept its messaging around the macroprudential framework and liquidity management unchanged, signalling that a cautious approach in these areas will continue.

Overall, the CBT reiterated its narrative of improving underlying monthly inflation momentum, as higher rates and slower loan growth have weakened domestic demand, containing the indirect effects on inflation.

Against this backdrop, we expect the policy rate to reach 35% by year-end, implying a further 100bp cut in December.

The main risks to this profile stem from the Middle East conflict and the inflation outlook. At the same time, the CBT is likely to continue closely monitoring domestic demand, international reserves and depositor behaviour when determining the pace of future easing. We expect real rates to remain high to contain dollarisation and manage potential reserve pressures in the period ahead.

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