Macro note – MPC Rate Decision

CBRT cuts policy rate by 250 basis points to 47.5%, above expectations. Borrowing-lending interest rate corridor is reduced to 150 basis points around the policy rate and the decision text clearly emphasizes that the tight stance will be maintained despite the rate cut...

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At its meeting this month, the CBRT Monetary Policy Committee (MPC) cut the policy rate by 250 bps to 47.5%, exceeding expectations. The CBRT also changed the operational framework and decided to set the overnight borrowing and lending rates with a margin of -/+ 150 bps compared to the one-week repo auction rate (previously -/+ 300 bps). Given recent developments, the emphasis on upside risks to inflation was removed from the text. The importance of fiscal policy coordination was reiterated, and the contribution of fiscal discipline to price stability was underlined. It was stated that the policy rate will be adjusted so as to ensure that inflation realizations and expectations support disinflation. In addition, it was stated that the Committee's decisions would be taken on an inflation-focused, prudent, and meeting-based basis. The CBRT reiterated that it would support monetary transmission through macroprudential measures in case of unexpected developments in the credit and deposit markets. It was stated that liquidity conditions were closely monitored and sterilization tools would continue to be used effectively. Although inflation expectations have improved, they remain a risk factor. In case of a deterioration in the inflation outlook, it was re-emphasized that monetary policy tools would be used effectively instead of monetary tightening. We observe that a hawkish tone was preferred throughout the decision text. Despite the interest rate cut, the tight stance will be maintained, as evident from the tone adopted throughout the text. The narrowing of the interest rate corridor prevented downward pressure in the borrowing market and showed that the correlation between the loan/deposit market and the funding rate would be closely monitored. The verbal guidance mechanism was actively transformed into a monetary policy tool, and it was stated that the policy rate would be adjusted to the extent required by disinflation. Moreover, it was stated that decisions would be taken on a meeting-by-meeting basis, and it was emphasized that price pressures caused by unexpected developments would be evaluated at each meeting. From all these messages, we understand that the tight stance will be maintained, and the interest rate cut will not continue under all circumstances.

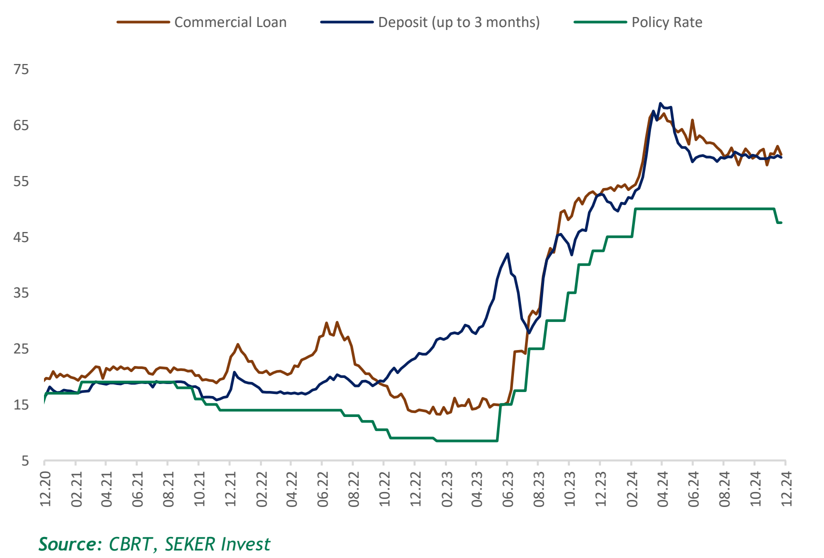
In the details of the decision text, the reasons for the tight stance and current developments are given. Accordingly, "The underlying trend of inflation remained almost flat in November. Leading indicators point to a decline in the underlying trend in December. Indicators for the last quarter suggest that domestic demand continues to slow down and remains supportive of disinflation. Core goods inflation remains low, while the improvement in services inflation is becoming more evident. Unprocessed food inflation appears to have moderated in December after a high course in the previous two months. Inflation expectations and the pricing behavior display an improving trend, yet remain a risk factor for the disinflation process." The fact that inflation, which was almost flat in November, remained moderate in December is one of the key reasons behind the rate cut. Domestic demand has reached disinflation levels, and we can say that demand inflation is at the desired level. The fact that services inflation has also become more evident indicates that goods and services inflation will converge to the desired level in the near future. When this chapter is evaluated as a whole, we note that there have been positive developments in the fight against inflation.

The section on the rationale for the interest rate decision is summarized as follows. "The decisive stance in monetary policy, stabilization in domestic demand, real appreciation in the Turkish lira, and improvement in inflation expectations have been reducing the underlying trend of monthly inflation and strengthening the disinflation process. Increased coordination of fiscal policy will also contribute significantly to this process. The tight monetary policy stance will be maintained until the underlying trend of monthly inflation declines significantly and permanently and inflation expectations converge to the projected forecast range. Accordingly, the level of the policy rate will be set to provide the tightness required by the envisaged disinflation process, taking into account inflation realizations and expectations. The Committee will make its decisions with a prudent and meeting-based approach focusing on the inflation outlook. In case of a significant and persistent deterioration in inflation, monetary policy tools will be used effectively." Emphasis on fiscal policy was reiterated and it was stated that pressures from administered prices should be alleviated. Therefore, if the public sector does not create inflation, the path to disinflation will become more effective. It was re-emphasized that the tight stance will continue until the underlying trend of inflation declines on a monthly basis. The fact that the policy rate is discussed on an inflation-focused and meeting basis suggests that interest rate cuts may not be permanent.

The paragraph on macro-financial stability was amended as follows. "In case of unanticipated developments in credit and deposit markets, the monetary transmission mechanism will be supported by additional macroprudential steps. Liquidity conditions are closely monitored in view of possible developments. Sterilization tools will continue to be used effectively." It was re-emphasized that deterioration in the credit and deposit spreads will not be allowed. The TL surplus arising from FX outflows and capital inflows will continue to be sterilized through appropriate instruments, and the tight stance will be maintained.

In summary, in today's interest rate decision, the Central Bank cut the policy rate by 250 basis points to 47.5%, above expectations. Along with the first-rate cut, the operational framework was also changed, and the interest rate corridor was narrowed by 150 basis points. In this way, downward interest rate pressures in the market were eliminated, and the tight stance was maintained. Moreover, it was emphasized that decisions would be taken on a meeting-based and inflation-focused basis and that caution should be exercised regarding interest rate cuts. The apparent improvement in services inflation indicates that both goods and services inflation has reached the desired levels. 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 macroprudential measures. In this context, we expect that gradual rate cuts will continue at a total of eight meetings in 2025, depending on the course of inflation. We underline here that new updates in the policy rate stance may be made in case of new supply or demand-side shocks.

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



Source: CBRT, SEKER Invest

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