Macro note – MPC Rate Decision

The Central Bank of the Republic of Türkiye (CBRT) keeps its policy rate unchanged at 37%, in line with expectations. Whilst emphasizing a cautious stance regarding upside risks to inflation, a hawkish position has been adopted in the communication channel.

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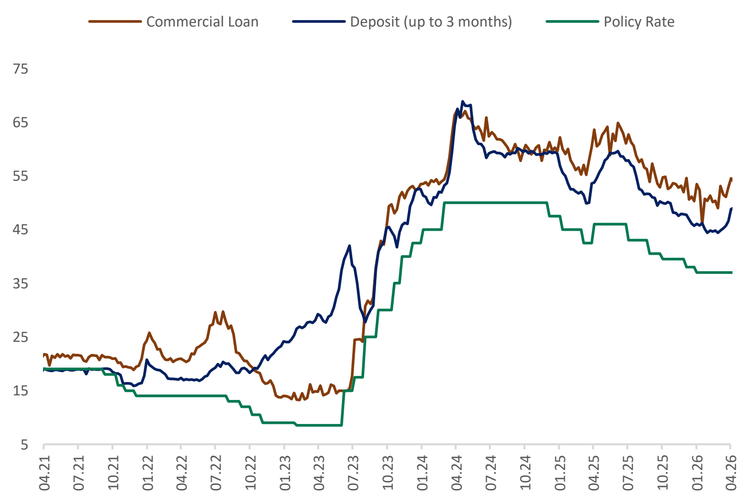
At its meeting this month, the Central Bank of the Republic of Türkiye's Monetary Policy Committee (MPC) kept the policy rate steady at 37%, in line with market expectations. Whilst market expectations were split between a rise and a hold, the balance of opinion favored a hold. Our own expectation was that monetary policy was sufficiently tight and flexible enough to allow for further tightening, and that rates would be kept steady. In this sense, we can say that market expectations have been met. Under current conditions, the fact that market funding is being conducted at the upper band is already being interpreted as a sufficiently tight monetary policy and an implicit interest rate hike. In this context, raising the policy rate to this level and resuming funding via repo operations would not have had a meaningful impact on market interest rates. Therefore, maintaining flexibility and keeping interest rates steady is a sound decision. However, the section added to the final part of the inflation paragraph indicates that the CBRT remains committed to tightening when necessary. We believe that, rather than tightening further by raising interest rates, the preference was to steer expectations through a hawkish tone that limits upside risks and manages expectations. The text briefly summarizes recent developments. It is noted that the underlying trend in inflation rose slightly in April as a result of geopolitical developments. Furthermore, the high trajectory of energy prices will affect inflation through two channels. The inflation outlook, pushed upwards via the cost channel, is expected to ease somewhat due to the weakening of economic activity and the slowdown in growth. We believe the CBRT's wait-and-see policy is appropriate for assessing the direction and magnitude of this net effect. Compared to approximately three weeks ago, the global outlook and uncertainties are currently presenting a relatively more positive picture. Both the war entering a ceasefire phase and moving towards a diplomatic negotiation framework, as well as domestic developments, have strengthened the CBRT's hand regarding its interest rate decision. During the war, there had been a depletion of reserves amounting to approximately 50 billion US dollars. Following this situation, which had strengthened the likelihood of an interest rate hike, the declaration of a ceasefire led to a recovery of approximately 30 billion US dollars in reserves. Furthermore, oil futures are pricing in the expectation that the war will end in the near future. For this reason, an interest rate hike by the CBRT at this meeting might have appeared premature. We could say that both the relative recovery of macroeconomic indicators and the shift in expectations towards a positive outlook have bought decision-makers some time. The most hawkish statement we observed in the decision text is the phrase: "The Council has emphasized its cautious stance against upward risks to inflation." Unlike previous statements, which highlighted improvements in the core inflation trend and a gradual decline, this statement explicitly emphasizes upward risks. We understand from this that the condition of a significant and persistent deterioration in the inflation outlook is being closely monitored. The condition of 'significant' appears to have been met, albeit to a limited extent, but we need time to see how persistent it is.

The details of the decision text outline the rationale for the tight stance and current developments. According to this, “The underlying trend of inflation declined in March. Leading indicators suggest that the underlying trend will rise somewhat in April. Amid geopolitical developments, high energy prices and significant volatility are being observed. The effects of these developments, as well as domestic energy prices, on the inflation outlook via the cost channel and economic activity are being closely monitored. Whilst indicators point to a slowdown in economic activity, the potential secondary effects of recent developments on the inflation outlook will be significant. The tight monetary policy stance, which will be maintained until price stability is achieved, will reinforce the disinflation process through the demand, exchange rate and expectations channels. The Monetary Policy Committee will determine the steps to be taken regarding the policy rate by taking into account inflation outcomes, and the underlying trend and expectations, in a manner consistent with 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 cautious approach. Given recent developments, the monetary policy stance will be tightened should there be a significant and persistent deterioration in the inflation outlook. The Council has emphasized its cautious stance against upside risks to inflation. Should developments in the credit and deposit markets deviate from expectations, the monetary transmission mechanism will be supported by additional macro-prudential measures. Liquidity conditions will remain closely monitored and liquidity management tools will continue to be used effectively.” The core scenario is that exchange rate, expectation and demand channels will support the disinflation process. Consequently, the message being conveyed is that supply-side shocks and exchange rate volatility will be managed effectively.

In summary, the Central Bank kept the policy rate unchanged at 37 per cent in today’s interest rate decision, in line with expectations. Geopolitical risks, energy prices and potential upward pressures on inflation from the supply chain 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. Uncertainty in global markets could temporarily disrupt the CBRT’s disinflation targets. We would like to highlight that improvements in this area could lead to interest rate cuts exceeding expectations. The CBRT, which is effectively utilizing its primary policy instrument whilst adjusting liquidity through complementary macro-prudential measures, maintains its resolute stance in the fight against inflation. In this context, provided there are no further shocks in local or global markets, we anticipate that cautious and gradual interest rate cuts will continue until the end of the year. We would like to emphasize that should new supply- or demand-side shocks occur, further adjustments to the policy rate stance may be necessary.

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



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