Macro: Rate cut up to 150 bps amid low November inflation

The CBRT lowered its policy interest rate by 150 basis points (bps) to 38.0%, in line with rising expectations following the favorable November inflation print. Overnight lending and borrowing rates were also reduced by the same amount, to 41.0% and 36.5% respectively, maintaining the width of the asymmetric interest rate corridor. Prior to the MPC meeting, we had also shared our expectation that the CBRT would implement a 150 bps rate cut based on the November inflation data, provided that the initial signals regarding December price developments were not negative.

Evaluations:

- **There are no changes in forward guidance and in wording regarding the policy stance.** Meeting-by-meeting approach is maintained in decision-making. There is also no change in the communication for macroprudential tools and liquidity tools.

- **The changes concentrated on the assessments regarding inflation and the course of the economic activity.**

    - While CBRT highlighted the role of food prices in the positive trend of inflation in November, it also made a measured assessment of the extent of the improvement in the inflation trend: "***In November, consumer inflation was lower than expected due to a downward surprise in food prices. Following an increase in September, the underlying trend of inflation declined slightly in October and November***". We consider these statements to be a cautious, non-complacent communication.

    - It was stated that growth in Q3 was higher than expected. In our macro note for GDP developments (Macro: "Slowdown narrative" not confirmed by the data), we had stated that the CBRT had predicted a cool down of around 0.3 percentage points in Q3 according to its output gap estimates in its latest inflation report (= growth 0.3 percentage points below the potential quarterly growth), but, just like in Q2, the announced figure did not confirm the predictions for slowdown. Although the MPC stated that demand conditions continue to support the disinflationary process, the fact that it is no longer assessed as being at disinflationary levels indicates an uncertainty in the assessments regarding the level of the output gap.

    - As we shared in our GDP macro note, we assess that the different indicators we prepared by defining the output gap as a combination of the goods/services market, the credit market, and the labor market indicate that the output gap continues to hover at inflationary levels, contrary to the assessments of the CBRT.

- The cautious statement on the inflation trend as well as the statements on stronger-than-expected economic activity, on inflation expectations being a risk factor, and on the tightness of the policy stance, together provide no evidence and rationale to justify the increase in the rate cut from 100 bps to 150 bps. We believe that reserve developments have a significant weight in the policy reaction function. Indeed, the CBRT, which was a net seller of foreign currency in September and October, has once again become a net buyer.

- While there is no significant improvement in the inflation outlook, the fact that the market's expectation of a rate cut has been met signals that the CBRT's implicit inflation target is around market inflation expectations (≈23%)

- Minimum wage and administered price/tax adjustments will be critical in terms of the trajectory of inflation and policy stance in the upcoming period.

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