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The real message of central banks is hidden in the gap between rates and inflation



One of the most common mistakes in judging central banks is to look only at the headline policy rate. A high nominal interest rate may look hawkish at first glance, but it tells us very little unless it is compared with inflation.

What matters for a simple cross-country comparison is not only the policy rate itself, but also the gap between the policy rate and inflation.

There is, however, an important technical distinction. The real interest rate is usually calculated by comparing today's policy rate with expected inflation over the next 12 months. In other words, it is a forward-looking concept.

But when we want to compare how hawkish or dovish central banks look at a given moment, a simpler and more immediate measure can be used: subtracting the latest announced inflation rate from the current nominal policy rate. This does not give us the technical real interest rate, but it gives us a practical "hawkishness gap."

This gap is best read as the difference, in points, between the policy rate and the latest inflation rate. It tells us whether a central bank is standing above inflation, close to inflation, or below inflation. It is not perfect, but it is useful for comparing monetary policy stances across countries.

The balancing act

Türkiye, for example, has a policy rate of 37 per cent and inflation of 32.61 per cent. The difference between the two is 4.39 points.

At first glance, 37 per cent looks like an extremely high policy rate. But once we remember that inflation is still above 32 per cent, the picture becomes more balanced.

Türkiye's monetary policy is tight, but not as aggressively tight as the headline interest rate alone would suggest.

The Central Bank of the Republic of Türkiye is operating with a positive gap between the policy rate and inflation

This is why Türkiye should not be judged only by the level of its policy rate. The Central Bank of the Republic of Türkiye is operating with a positive gap between the policy rate and inflation, but the gap is not extraordinarily wide.

The policy stance seems designed not only to fight inflation, but also to stabilise the exchange rate, anchor expectations, and keep foreign capital interested in Turkish assets. In Türkiye's case, monetary policy is tight, but it is also defensive.

The global contrast

Brazil stands out as the clearest hawk in this comparison. Brazil's policy rate is 14.75 per cent, while inflation is 4.72 per cent. The gap is 10.03 points. This is a much stronger signal than Türkiye's.

Although Brazil's nominal policy rate is far lower than Türkiye's, the distance between the policy rate and inflation is much wider. That means Brazil is sending a much firmer message to markets: inflation will not be tolerated easily.

This comparison is important because it shows that central banking is not about appearances. Türkiye looks tougher from the outside because its policy rate is 37 per cent. Brazil looks softer because its policy rate is below 15 per cent.

But when we compare both rates with inflation, Brazil is clearly more restrictive. In central banking, the headline rate is the shop window; the rate-inflation gap is closer to the kitchen.

The **United Kingdom** offers a more moderate example. The Bank of England's policy rate is

3.75 per cent, while inflation is 2.80 per cent. The gap is 0.95 points. This is not aggressive tightening, but it is still a cautious anti-inflation stance.

The Bank of England appears to be saying that inflation is closer to control, but it is still too early to declare victory. In that sense, the UK is not sharply hawkish, but it is not careless either.

Chile is even closer to neutral. Its policy rate is 4.50 per cent, and inflation is around 4 per cent, giving a gap of 0.50 points. This suggests a mildly restrictive stance.

Chile's central bank seems to be trying to keep inflation under control without putting excessive pressure on the economy. It is a balanced position, not an aggressive one.

The ECB cannot fight inflation by ignoring the weakness of the real economy

The **United States** looks different. Using the midpoint of the Federal Reserve's policy range, the policy rate is around 3.625 per cent, while inflation is 4.20 per cent. This means the policy rate is 0.575 points below inflation.

In simple terms, the Fed is not strongly above inflation. But the United States enjoys a privilege that other countries do not: the dollar is the world's reserve currency. This gives the Fed more room to move slowly.

Still, the gap tells us that the Fed is not as hawkish as its language may sometimes sound.

The **European Central Bank** is also below inflation. The ECB's policy rate is 2.25 per cent, while inflation is around 3.20 per cent. That means the policy rate is 0.95 points below inflation.

This reflects Europe's **difficult position**. The euro area is not only fighting inflation; it is also dealing with weak growth, industrial fatigue, energy costs, and competitiveness problems, especially in Germany.

For that reason, the ECB has to be careful. It cannot fight inflation by ignoring the weakness of the real economy.

Argentina is the most striking case on the dovish side. Its policy rate is 29 per cent, while inflation is 33.60 per cent. That puts the policy rate 4.60 points below inflation.

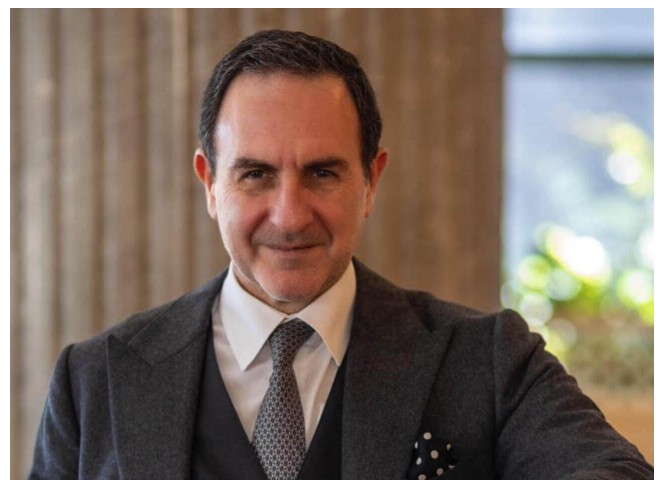
Nominally, 29 per cent looks high. But compared with the latest inflation rate, it is not tight.

Argentina is, of course, a very special case because of its long history of inflation, dollarisation, weak credibility and repeated crises. Still, the lesson remains clear: a high nominal interest rate does not automatically mean tight monetary policy.

The ultimate takeaway

The key lesson for Türkiye is simple. A 37 per cent policy rate may look very high, but the relevant question is how far it stands above the latest announced inflation rate. At the moment, that gap is 4.39 points.

This is meaningful, especially when compared with Türkiye's previous years of deeply negative rate-inflation gaps. But it is not enough, by itself, to prove that monetary policy is overwhelmingly restrictive.



The policy rate is the headline, the latest-inflation gap shows the central bank's visible hawkishness, and expected inflation determines the true real-rate story - Emre Alkin

Türkiye's real challenge is credibility. Inflation expectations, exchange-rate policy, fiscal policy, tax adjustments, administered prices and confidence in official data all affect how markets interpret the central bank's stance.

If markets believe that inflation over the next 12 months will remain higher than the official path suggests, then the forward-looking real interest rate may be much less comfortable than the simple hawkishness gap implies.

This is why the Turkish central bank's job is not simply to keep interest rates high. It must make its policy believable.

A high policy rate without credibility works only partially. A moderate policy rate with strong credibility can sometimes be more effective. In monetary policy, trust is the multiplier.

The broader comparison tells us that Brazil is the clearest hawk. Türkiye is restrictive but still fighting a credibility battle. The UK is cautiously tight. Chile is mildly restrictive. The Fed and the ECB are more dovish when measured against the latest inflation rate. Argentina remains loose despite its high nominal policy rate.

In the end, central banking is not about the number written on the policy-rate board. It is about how that number stands against inflation, how markets perceive it, and whether people believe the central bank will stay the course.

Some central banks look tough because their nominal rates are high. Others are actually tougher because their rates sit much further above inflation.

That is the real lesson: the policy rate is the headline, the latest-inflation gap shows the central bank's visible hawkishness, and expected inflation determines the true real-rate story.