300bp emergency hike from Turkey

The Central Bank of Turkey (CBT) has responded to today's 5% fall in the Lira with an emergency 300bp hike in the Late Liquidity Window rate. Earlier, investors had feared policy paralysis ahead of June 24th elections and that Ankara was in no mood to break the vicious spiral of a weaker Lira and higher inflation. Expect some temporary stability in the Lira.

Source: istock

CBT responds to market pressure.

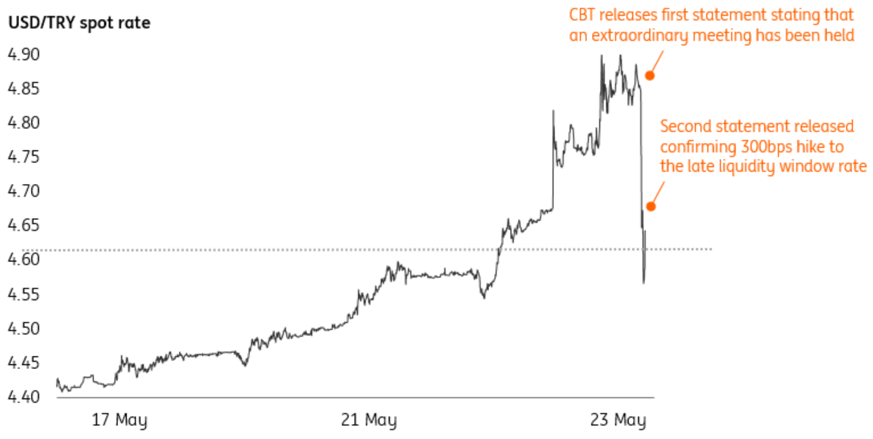
The CBT has surprised the market with an aggressive 300bp hike in the Late Liquidity Window (LLW) taking the LLW rate to 16.50%. Most liquidity is provided through that window currently, such that the effective cost of funding should also rise by around 300bp. In the accompanying statement the CBT said:

'Current elevated levels of inflation and inflation expectations continue to pose risks on the pricing behavior. Accordingly, the Committee decided to implement a strong monetary tightening to support price stability. Tight stance in monetary policy will be maintained decisively until inflation outlook displays a significant improvement.'

In fairness, the market had been expecting this (albeit a smaller) move several weeks ago and the delay has probably caused the CBT to deliver a larger hike. Clearly, external conditions have also deteriorated over recent weeks, with Turkey suffering from: i) the stronger dollar and higher US interest rates impacting the FX borrowing costs of corporates and ii) higher energy costs exposing Turkish energy dependencies.

The timing of today's move comes on the back of the near free-fall in the Lira, initially in Tokyo as Japanese retail traders exited and then through Europe when no policy response was forthcoming.

USD/TRY looking to stabilise around 4.60 level after emergency rate hike



Source: Bloomberg, ING

Is the tightening enough?

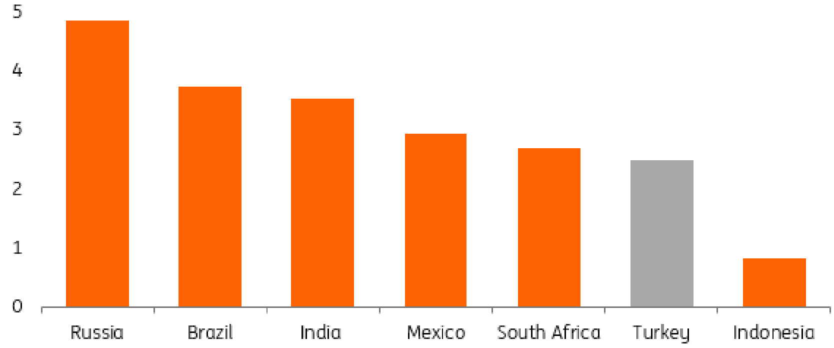
The 300bp rate hike is clearly an effort to break the inflation/FX spiral. Will it be enough to stabilise the TRY? Amongst the EM high yielders, real interest rates are mostly in the 3-4% area. With Turkish CPI potentially moving to 14% this summer, today's emergency hike in the LLW takes Turkey's real policy rate to around 2.5%

Some would argue that's not enough for an economy running a 5% current account deficit and the exposure to FX borrowing and energy as highlighted above. We would say at least this shows policymakers are prepared to act decisively and that there is a limit to CBT tolerance of TRY weakness.

Were the external environment to improve somewhat - e.g. were momentum to build behind a possible OPEC output increase in June - we think today's move should deliver more orderly conditions to the TRY market.

Real policy interest rates amongst EM high yielders

%, real policy interest rate (for Turkey we calculate the real rate based on the average funding cost being at 16.5% and CPI at 14% - the latter likely this summer)



Source: Bloomberg, ING

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