Central Bank of Turkey surprises with a 100bp rate cut

The Central Bank of Turkey (CBT) has today cut its policy rate by 100bp to 13% – a move all the more surprising given inflation is near 80%. The CBT cited slowing leading indicators of growth as its reason to ease. The prioritisation of growth over disinflation remains very much in place, as does investor concern over the path of policy

First rate move since December

Unlike virtually all other central banks around the world, Turkish authorities have addressed inflationary pressures through a complex set of measures this year – largely targeting credit growth. The policy rate – the one-week repo rate – had been left untouched at 14% until today.

Why now? In its statement, the CBT cited the slowing of leading indicators and what they meant for growth in the third quarter. It emphasised the need to maintain supportive financial conditions for industrial production and employment growth. An insight into today's rate cut could have been found in some of the recent volume momentum in the banking sector that has remained elevated despite efforts to curb credit growth, though it has retreated a bit in recent weeks.

In its statement, the CBT also signalled further macroprudential policy moves with the objective of supporting the effectiveness of the monetary transmission mechanism. This means we may well see additional measures to maintain selective credit growth policies, support FX reserve growth, increase demand for TRY assets, and divert FX demand in the period ahead.

A further key reason for today's rate cut may have been the recent recovery in FX reserves as tourism continues to help, along with Russian FX transfers, boost liquid FX reserves. Prospects of capital flow from Saudi Arabia and other gulf countries could also have been providing confidence to Turkish authorities in delivering a cut – a move that has seen the Turkish lira come under further pressure.

Still, there is no major underlying improvement in the FX reserve position and pressure will likely remain on reserves as a result of a large FX financing gap.

Looking ahead

Today's move will do little to address Turkey's inflationary challenges. The CBT sees inflation peaking in September-October. Given that the current policy setting does not prioritise disinflation, inflation will likely remain elevated despite a recent moderation in international food and energy prices.

But the risks of unconventional policy are clear. And local financial markets could once again come under pressure once the tourism season passes. So far today, the rate cut has seen the Turkish 5-year sovereign Credit Default Swaps widen by 35bp to 781bp, reversing the narrowing in sovereign risk premia seen over recent weeks.

Authors

Muhammet Mercan
Chief Economist, Turkey
muhammet.mercan@ingbank.com.tr

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com