Turkey takes steps to add liquidity as lira sinks

Turkey plans to provide $2.2 billion of FX liquidity via a change to its reserve option coefficients

Source: iStock

The Central Bank of Turkey has returned to low-level measures to curb volatility in the Turkish lira. This follows rising tensions between the US and Turkey over the detainment of Pastor Brunson and recent US sanctions. The Bank ended its tightening cycle at the last MPC meeting despite a sharp deterioration in the inflation outlook, ongoing uptrend in forward-looking expectations and external imbalances, leaving the currency vulnerable to shifts in global risk appetite.

Previous CBT actions show that it has responded to TRY weakening via FX liquidity measures rather than via the rate tool. It prefers to use: (1) adjustments in reserve requirement ratios; (2) changes in coefficients of the reserve option mechanism; (3) an increase in the size of swaps; (4) extension of the non-deliverable forward (NDF) programme; and (5) allowing the repayment of rediscount credits available to exporters to be made in TRY at below-market exchange rates temporarily.

Accordingly, the bank today announced adjustments in reserve option coefficients (ROCs), lowering the upper limit for the FX maintenance facility to 40% from 45%. The bank expects around $2.2 billion of liquidity to be provided to the financial system to “support price stability and financial stability".

This step suggests that the CBT is initially hoping to provide FX liquidity to stabilise the Turkish lira, rather than convene an emergency MPC meeting or to shift funding from the one-week repo rate to the overnight lending rate or late liquidity window rate, which it ceased using after the policy simplification announced at the end of May. A monetary policy response would be helpful but not enough to stabilise markets given that the concerns are tied to geopolitical relations.

Author

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

Disclaimer