

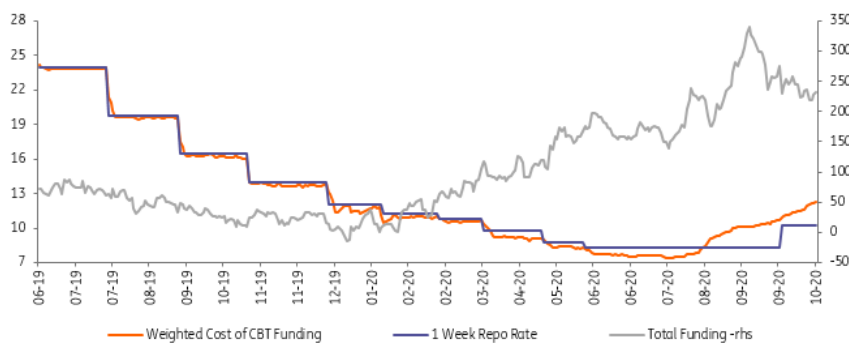
## Turkey: Another rate hike on the cards

Turkey's central bank has maintained tightening measures in October to control inflation and support the currency. At the next meeting, we expect the Bank to hike rates again bringing the policy rate to 11.75% from 10.25%



Source: Shutterstock

### Turkey's central bank funding (Rates in %, Funding in TRY billion)



Source: CBT, ING

Following a surprise policy rate change last month, Turkey's central bank has further raised its effective cost of funding rate to above 12% in a continuation of its previous tightening measures to control inflation and support the currency.

At the next meeting, the Bank is likely to continue tightening the policy rate to 11.75% translating into a 150 basis point hike. An outright hike, as we saw last time will be more effective especially in restoring credibility. In our view, the central bank's recent decision to raise the one-week currency swap rate that generally moves in tandem with the policy rate, by 150bp to 11.75% should also be an early signal.

The pandemic has made the policy mix highly accommodative with unprecedented credit stimulus, jump in base money and a plunge in real rates. Widening external imbalances, weak capital flows, higher dollarisation and worsening inflation dynamics contributed to price and stability concerns - all increasing pressure on policymakers for some normalisation since late-July.

In the framework of policy normalisation, the BRSA i) relaxed asset ratio twice, easing government intervention in banks' portfolio decisions 2) cut macro-prudential limits on offshore swap transactions 3) reduced the general maturity limit for consumer loans 4) loosened limits on TRY transactions with foreign banks.

These moves are targeted to slow down credit formation and support non-residents flows. The impact of these steps has been seen given that FX adjusted lending volume have been broadly unchanged since early September with a significant momentum loss in comparison to March-August period, though further deceleration may be needed to control the deterioration in the external deficit.

In addition, the government cut withholding tax on TRY deposit accounts and FX transactions tax in early October with an objective of supporting TRY deposits in locals' portfolio preferences. Such steps will likely continue to hamper FX demand by local investors and to attract capital inflows.

On the central bank front, the Bank made adjustments in reserve requirement framework and started tightening via an outright hike in the policy rate and changing funding composition. In the current setup, the CBT has been using 1-month repo auctions (interest rate being determined by the liquidity conditions) along with the upper band of the rate corridor (at 11.75%) and late liquidity window (at 13.25%) in providing liquidity to the banking system.

This allows the Bank to push the effective cost of funding up the late liquidity window rate, implying a relatively small room from the current level.

Another rate hike will provide further flexibility to tighten liquidity and raise the effective funding rate if required.

Given that end-year inflation expectations are slightly below 12%, according to the central bank's latest survey and additional room to tighten by 300bp to newly set late liquidity window rate to be at 14.75%, such a move would provide more support to ex-post real interest rates.

## Author

### Muhammet Mercan

Chief Economist, Turkey

[muhammet.mercan@ingbank.com.tr](mailto:muhammet.mercan@ingbank.com.tr)

## Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user’s investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.