

Turkey: Another strong rate action

Turkey's central bank (CBT) hiked the one-week policy rate by 125bp to 17.75%. The increase was more than markets expected and another strong step to support the currency and safeguard price stability



Source: istock

125bp

Higher than expected

Hike by the CBT

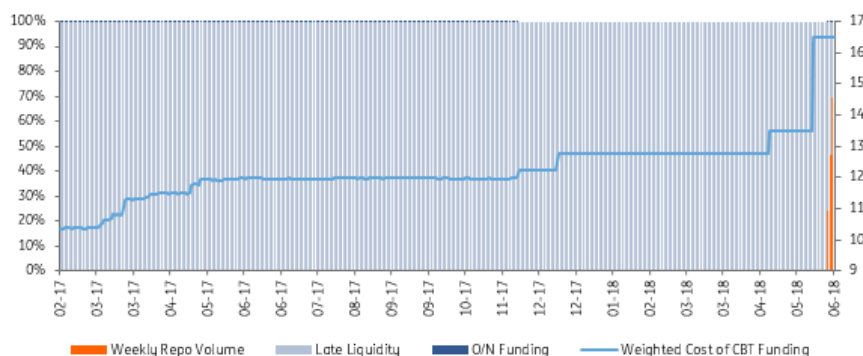
(in the one-week repo rate)

At the June rate-setting meeting, the CBT hiked its one-week repo rate- the bank's main rate after it simplified policy at the end of May- by 125bp to 17.75%.

- Under the new operational framework, the CBT's rate communication will be based solely on the one-week repo rate, with other rates tied to this benchmark. As a result, the bank only announced the repo rate in its June statement. The move lifted the overnight lending rate and late liquidity window lending rate to 19.25% and 20.75%, respectively.

- Ahead of the meeting, markets were not pricing in a hike. According to a Reuters survey, expectations were quite diverse, with almost half of the participants expecting no hike and the rest predicting an increase in the range of 25 to 100bp. The CBT tightened more than expected in an effort to cement its improving credibility and show independence.
- In a technical note after the bank simplified policy, the CBT promised to keep market overnight rates close to the policy rate, signalling that it would likely fund the banking system mainly from one-week repo auctions, rather than use the late liquidity window. With the shift from the late liquidity window to one-week repo funding, we will be watching to see if the CBT opts for liquidity tightening in the coming period. However, we do not expect such a move given the guidance provided by the bank and today's strong rate action.
- In the statement, the CBT once again acknowledged the deterioration in the inflation outlook, stating that "*cost factors have been the main driver of the recent upsurge in inflation*". It also said that "*price increases have shown a generalised pattern across sub-sectors*". There was no meaningful change in the interest rate announcement regarding its policy guidance. The bank has maintained its tightening bias, reiterating that "*inflation expectations, pricing behaviour and other factors affecting inflation will be closely monitored and, if needed, further monetary tightening will be delivered*".

Funding Comp. & Cost of Funding (%)



Source: CBT, ING Bank

The CBT has continued its strategy- in place since early April- to safeguard price stability with a larger-than-expected hike. In the near term, markets will be looking to the election outcome, the new government's economic management and the post-election economic policy mix. But for now, the CBT has made an additional strong step to support the currency, following its emergency hike and policy simplification at the end of May. This move has already had an impact on the Turkish lira with USD/TRY dropping to 4.46s from close to 4.60.

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