Snap | 17 March 2022

Central Bank of Turkey keeps rates on hold despite Ukraine war

The Central Bank of Turkey kept the policy rate unchanged at 14%, despite geopolitical risks increasing the challenges for the macro outlook via higher energy and food prices, the likely impact on tourist flows, and the rising risk premium

The Beyoglu district in Istanbul, Turkey

In line with market expectations, the Central Bank of Turkey (CBT) kept its policy rate unchanged at 14% in the March rate-setting meeting. While the CBT acknowledged escalating geopolitical tension and the consequent increasing risks to inflation and external balances, it reiterated the ongoing assessment of the policy framework with a view of "prioritising the liraisation strategy" in all policy tools. So, the bank has maintained its wait-and-see mode, a position it has held since the beginning of this year.

The CBT's assessment note this month showed some tweaks in order to incorporate the likely impact of geopolitical developments. In this regard, the bank sees:

1. Higher downside risks to global economic activity with further uncertainty on the outlook.
2. Widening pressures on the current account balance attributable to higher energy prices.
3. An increase in inflation reflecting not only the drivers that were mentioned in previous

> Monetary Policy Committee statements, including "pricing formations that are not supported by economic fundamentals", supply-side factors and demand developments, but also "rising energy costs resulting from the heightened regional conflict".

Even before the Russia-Ukraine conflict escalated, annual CPI inflation had been rising rapidly since last October and had reached 54.4% – the highest in two decades – while the current account deficit recorded a sharp expansion in January with the worst monthly figure since the end of 2017. So, challenges are growing on both inflation and external balances, while we have already seen a significant deterioration in these two key variables recently.

Despite the acknowledgement of geopolitical risks, the CBT's general assessment for the macro outlook has remained broadly unchanged. For the future course of inflation, the bank continues to be quite optimistic, restating that it sees the start of the disinflation process on the back of measures taken by policymakers, along with supportive base effects and "the resolution of the ongoing regional conflict". For the current account, it dropped the expectation of a surplus this year, although maintained its emphasis on the importance of sustainable current account balance for price stability.

All in all, geopolitical risks increase challenges via higher energy and food prices, the likely impact on tourist flows, and the rising risk premium. However, while acknowledging these challenges driven by recent regional developments, the CBT opted to remain mute again in March and reiterated that it would continue to use all available instruments decisively "within the framework of the liraisation strategy". So, it is likely a signal that the current policy framework will continue, and we can see some adjustments depending on market developments in the recently introduced FX-protected deposit scheme to reduce demand for a switch by TRY deposit holders to FX deposits, and incentivise a conversion of FX deposits into TRY time deposits.

Author

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