

## The Central Bank of Turkey's June meeting brings no surprises

While the policy rate was kept on hold at 50% in its June MPC meeting, the Central Bank of Turkey retained its tightening bias and continued to monitor liquidity conditions



The Central Bank of Turkey in Istanbul

The Central Bank of Turkey (CBT) has kept its policy rate unchanged at 50%, in line with both the consensus and our call. The upper band and lower bands of the interest corridor (53% and 47%, respectively) have also remained flat.

In its statement, the CBT once again cited the lagged effects of monetary tightening for its rationale, while maintaining forward guidance by keeping its tightening bias, still leaving the door open for further hikes if required by the inflation outlook. The central bank restated that the MPC remains highly attentive to inflation risks, pledging to keep rates higher for longer, until a significant and sustained decline is seen in the underlying inflation trend and convergence of inflation expectations to its forecast range.

According to the CBT, the transmission of changes in the policy rate to financial conditions is strengthened if the following two conditions are met: 1) strengthening the transmission from the policy rate to TL deposit rates 2) stabilisation of credit growth. In this regard, the CBT announced several actions last month, including a hike in reserve requirement ratios, an adjustment in

remuneration of required reserves, the introduction of 2% growth limit on FX lending, and fine-tuning of deposit conversion targets. While liquidity management remained under focus in its June meeting, the CBT did not come up with additional actions.

A couple of areas we'd take note of in June:

Firstly, despite a temporary shift to negative levels, OMO funding has turned positive after the Bayram holiday. Meanwhile, the ON interbank rate – which was quite volatile in June and moved below the policy rate – has risen back to above 50% lately. The CBT also reduced its TRY funding via FX swaps (to US\$5bn as of 26 June) from above US\$20bn levels at the end of May. We'd also note the CBT's high interest rate and tight liquidity policy support deposit rates and de-dollarisation. Following the central bank's actions last month, deposit rates seem to stabilise, with the one to three-month maturity bracket at around 60-61% in June so far. Finally, on the lending side, the rate of lending growth has been slowing down significantly, while pickup in the week of 14 June (due to credit cards) is likely to be temporary due to Bayram spending. This backdrop seems to reduce the need for further action.

Finally, regarding the assessment of macro-outlook:

The CBT continues to see that inflationary risks are attributable to a high level of services inflation and its stickiness, inflation expectations, geopolitical developments and food prices. The improvement in the underlying trend of monthly inflation, on the other hand, temporarily paused in May. A slowdown in domestic demand was noted, though still at inflationary levels, according to the CBT assessment. With moderation in domestic demand, real appreciation in the lira and improvement in inflation expectations will support disinflation in the second half of this year.

Overall, the CBT has remained cautious with a continuing focus on its inflation outlook. There are also signals of fiscal consolidation lately, with increasing efforts to cut spending and for revenue raising actions without exerting pressure on prices. While adjustments on the fiscal side should be supportive for the disinflation process, monetary policy will remain key in the near term.

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