The Central Bank of Turkey keeps policy rate on hold

The CBT kept the policy rate unchanged again in July despite significantly high inflationary pressures, while it reiterated that the current policy setting that relies on unorthodox instruments would continue

The Central Bank of Turkey

As widely expected, the CBT kept the policy rate on hold (at 14%) at the July rate setting meeting following the recent policy measures leading to some tightening in credit conditions as loan rates have moved up markedly, while the latest indicators show signals of momentum loss lately.

In the Monetary Policy Committee note, the bank once again reiterated that the current policy setting would continue with i) implementation of the macro-prudential policy set with additional measures, if needed, and ii) introduction of further credit (a newly added word to the statement), collateral and liquidity policy actions, following finalisation of the review process. Thus, the July meeting confirms that the CBT will not change its course and maintain reliance on unorthodox instruments in line with its "liraization strategy". With these actions, the CBT aims to "strengthen the effectiveness of the monetary policy transmission mechanism".

The statement this month showed some minor changes in comparison to the note released after June meeting. Accordingly, the CBT:

- Turned further negative about its views on global outlook, pointing out a higher likelihood of a global recession.
- Mentioned "rigidities in the labour markets" in addition to rising energy prices and imbalances between supply and demands as the factors that lead to a longer-than-expected rise in inflation.
- Stated stronger domestic job creation in comparison to peer economies while reiterating continuation of robust growth performance thanks to strong external demand
- Observed the supportive impact of the tourism sector on the current account, though it was quite concerned about risks from higher energy prices and deteriorating growth outlook in main trade partners.
- Put forward momentum loss in credit expansion with a series of banking sector regulations (including BRSA's latest restriction on commercial TRY loans for firms with excessive FX cash buffers). Indeed, with these policy moves, the average commercial TRY loan rate moved up by 570bp to 27.6% as of 8 July, in comparison to end-April, while the average deposit rate stands at 19.9% (for up to 3-month maturity) translating into around a 290bp increase in the same period.

All in all, we see a stabilisation in net reserves (excluding swaps) in recent weeks thanks to a wave of measures from late April onwards, particularly impacted by higher FX selling requirements for goods and services exporters, out of their FX revenues. However, ongoing widening pressures on the current account and subdued capital flows imply the possibility of a further drawdown in reserves and hence more regulatory steps to support flows to reserves. Given this backdrop, the inflation report release next week (on 28 July) and accompanied press conference should provide further insight on likely CBT moves ahead. The bank is likely to make a notable upward revision to its inflation forecast given the ongoing uptrend with broad-based pricing pressures, pulling market consensus for this year at 70% vs the CBT's latest forecast released in April report release at 42.8%.

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