

Central Bank of Turkey keeps policy rate on hold

In line with its forward guidance introduced last month that the current policy rate is adequate to support the recovery from the earthquakes, the Central Bank of Turkey has left the policy rate (1-week repo rate) unchanged at 8.5%



The Central Bank of Turkey in Istanbul

As expected by the markets, and us, the Central Bank of Turkey (CBT) kept rates on hold today, despite some calls to cut by 50bp, in order to maintain favourable financial conditions with the objective of minimising the effects of the earthquakes.

The rate-setting statement did not reveal any major surprises but there were some tweaks made relating to the bank's assessment of the global outlook. The bank acknowledged that are "conditions threatening financial stability". This environment, according to the CBT, has led to "coordinated steps" by global central banks to "prioritise financial stability through swap agreements and new liquidity facilities". It therefore observed the shifting expectations in financial markets related to the end of tightening cycles in the near term.

In the Monetary Policy Committee note, the CBT kept the forward guidance unchanged, concluding that "the current monetary policy is adequate to support the necessary recovery in the aftermath

of the earthquake”, while pointing out that “the effects of the earthquake in the first half of 2023 will be closely monitored”. This line of thinking implies, in our view, that it will not make any rate move and remain in a wait-and-see mode in the near term.

At the same time, while the bank reiterated the need to keep financial conditions supportive in response to the earthquakes, it also repeated its emphasis on alternative policy instruments and alignment of all policy instruments with “Liraisation” targets. Following on from that last month, the CBT extended security maintenance for banks to reduce personal need loan rates in early March. The new regulation is expected to lead to a notable decline in personal need loan rates, even if the net impact of the policy decision may not be expansionary with a tightening in the supply of consumer loans. The reliance on the same guidance implies that we can see further moves like this in the near term.

However, FX reserves continue to decline despite the CBT’s FX purchases related to increased inflows to FX-protected deposits. While the latest weekly data as of 17 March hints at a recovery in reserves, with the additional support of a deposit deal between Turkey and Saudi Arabia, the gross reserves will likely remain under pressure in the near term given continuing external imbalances and weakness in capital flows. The current account deficit remained on its expansionary path in January, and almost all of the monthly was financed through official reserves with sluggish capital flows because of locals’ asset acquisitions and declining net errors and omissions. This backdrop does not provide a space for accommodative financial conditions, in our view.

Finally, on inflation, the bank seems unconcerned but cautious, stating that “the effect of earthquake-driven supply-demand imbalances on inflation is closely monitored”. However, the extra fiscal burden of reconstruction costs and the CBT’s supportive stance will likely create further pressure on the already elevated headline inflation. We have seen a sharp widening in the February budget deficit, rising to 2.8% of GDP on a 12-month cumulative basis vs 0.9% at the end of last year.

Overall, the CBT has hinted that it will maintain a wait-and-see mode, while we can expect further macro-prudential measures to maintain favourable financial conditions with the objective of minimising the effects of the earthquakes. Given this backdrop, the CBT remains on the policy path of keeping interest rates low, maintaining a selective credit policy and pursuing a ‘Liraisation’ strategy.

Author

Muhammet Mercan

Chief Economist, Turkey

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>.