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.

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