Turkish Central Bank keeps rates on hold

In line with its forward guidance that the current policy rate is adequate to support the country's recovery from the earthquakes, the Central Bank of Turkey (CBT) left the policy rate flat at 8.5%

The Turkish Central Bank has kept its policy rate on hold

The CBT remained on hold, as expected, keeping the policy rate at 8.5% in the last rate-setting meeting ahead of the May 14 double elections. Accordingly, the market reaction to the decision was muted as the USD/TRY parity has been flat. The CBT reiterated the implementation of its "Liraisation" strategy and its conclusion that the current stance was adequate in terms of supporting the necessary recovery after the earthquakes and maintaining price and financial stability.

The CBT's assessment note this month was almost a carbon copy of the note shared after the March meeting.

1. The bank once again mentioned "conditions threatening financial stability". This environment, according to the CBT, led to "coordinated steps" by global central banks, and hence, financial markets are also shifting their expectations related to the end of tightening cycles in the near term.
2. The CBT also 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".

3. Finally, while the bank restated the need to keep financial conditions supportive in response to the earthquake, it also repeated its emphasis on alternative policy instruments and alignment of all policy instruments with "Liraisation" targets.

The key challenge for the CBT currently is to maintain the stability of the exchange rate in the near term, ahead of the elections. Recently, it has asked banks to limit the number of dollar purchases they make in the interbank market to ease pressure on the Lira. Following the CBT move, banks began widening spreads between their bid and ask prices for foreign currencies, while volatility in the currency market has increased to some extent.

The latest indicators point to a need to rebalance the economy:

1. While the current account deficit remained on its expansionary path in February, the latest indicators hint at further widening in March with a continuing increase in the foreign trade deficit driven by gold trade and core imports. Total flows have also remained weak in the absence of strong unidentified inflows, leading to pressure on international reserves so far this year.
2. The extra fiscal burden of reconstruction costs and the CBT's supportive stance will likely create further pressure on the already elevated headline inflation.
3. In the first quarter of this year, we expect major fiscal expansion will pull the budget deficit to 2.5% of GDP from 0.9% at the end of last year on the back of weakening tax collection performance and earthquake recovery-related expenditures. Given this backdrop, the consensus view sees a normalisation in the conduct of monetary policy in the period ahead.

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