Turkish Central Bank raises policy rate and keeps options open for further tightening

At the April Monetary Policy Committee meeting, the Central Bank of Turkey (CBT) hiked its policy rate by 350bp to 46% and preserved its flexibility by maintaining the asymmetry in the rate corridor

CBT Governor Fatih Karahan

At its April rate-setting meeting, the CBT delivered a hawkish surprise by increasing the policy rate (1-week repo rate) by 350bp to 46%, bringing it to the current effective funding rate of 46%. The bank maintained an asymmetrical interest rate corridor, with the overnight lending rate at 49% and the overnight borrowing rate at 44.5%, although the corridor has narrowed to 450bp from the previous 500bp. Ongoing reserve losses since late March appear to have influenced the central bank's decision.

Ahead of the MPC meeting, the consensus was that the bank would keep the policy rate flat at 42.5% and maintain tight liquidity via providing TRY funding via the upper band of the corridor, which was raised to 46% (+200bp) at an interim meeting on 21 March. However, since this meeting, despite an upward adjustment in deposit rates (from 50% to 53.75% on a compounded basis in 1-3 month maturity bracket), locals' FX demand continued with a 6.2% (US$11.1bn) rise between 18 March and 4 April, while adjusted growth (after elimination parity and gold price impact) was $8.8bn (with $3.5bn attributable to households and $5.3bn to corporates).

This period was marked by foreign outflows amid domestic and global uncertainties. As a result of these outflows and local demand, the CBT's net reserve position (excluding swaps) decreased by $34.5bn. The decline persisted, with significant daily reserve losses recently approaching $43bn.

Given this backdrop, the CBT implemented a rate hike to stabilise reserves despite heightened global recession risks, which are potentially disinflationary due to the decline in oil prices and pose increasing downside risks to the domestic growth outlook. By raising the policy rate to match the current effective funding rate, the CBT can continue providing liquidity via the 1-week repo rate without easing the monetary stance. In fact, the bank has announced the start of 1-week repo auctions, ie providing liquidity via the policy rate. An adjustment in the upper band to 49%, on the other hand, will allow the bank to push the interbank rate higher towards this level in case of further volatility.

The forward guidance remains largely unchanged, indicating that policy tightness will be determined by considering both realised and expected inflation, as well as the underlying trend. The bank also reiterated its meeting-by-meeting decision approach. However, the tone became more hawkish as we see signals of direct tightening in case of a "significant and persistent deterioration in the inflation outlook," while the previous message emphasised the effective use of monetary policy tools.

Additionally, the bank dropped its previous message about implementing additional macroprudential tightening measures in response to unexpected developments in credit and deposit markets, such as accelerated loan growth or increased local demand for foreign exchange. In its latest note, the bank highlighted policy moves introduced to counter recent volatility and support the monetary transmission mechanism. Finally, the bank maintained its usual guidance for closely monitoring liquidity conditions and effectively using sterilisation tools.

In the rate-setting statement, the CBT acknowledged the improvement in the underlying inflation trend in March and warned against a slight increase in monthly core goods inflation and relatively flat services inflation in April. It also noted that leading indicators point to domestic demand being above projections despite momentum loss in the first quarter. Finally, the bank set a cautious tone about recent external developments and remains in a wait-and-see mode.

All in all, the CBT delivered a 350bp rate hike in its April meeting and adjusted the rate corridor, though keeping asymmetry as an insurance in case of a further need for tightening. Its message was more hawkish than its previous one.

On the inflation side, following recent exchange rate developments and the 25% electricity hike, we expect annual inflation in April to slightly increase in comparison to a month ago.

Until the June meeting, the CBT will likely monitor demand for TRY assets and reserve changes and determine the timing for the resumption of rate cuts to normalise high ex-post real rates, given increasing risks to the growth outlook due to both domestic and external factors.

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