Turkey: Another soft cap on personal need loans

The Central Bank of Turkey (CBT) has announced new regulations that increase security maintenance for banks in order to reduce the spread between commercial loan rates and the policy rate

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Since late 2021, the CBT has been pursuing the policy path of keeping interest rates low, maintaining a selective credit policy and pursuing a ‘Liraisation' strategy. Reserve requirements in the form of long-term TRY-denominated government securities (security maintenance requirements) are one of the major tools to do this, through which the bank controls the size and composition of loans and expands its control over banks' TRY and FX borrowing and lending activities.

On 10 March, the CBT reportedly extended security maintenance for banks in order to reduce personal need loan rates. Banks will have to maintain extra securities for new personal need loans (but not for mortgages and auto loans under consumer loans) that are extended at rates that exceed the CBT's reference rate by 1.8 to 2.0 times, with extra maintenance requirements at 20% and 90% of these loan amounts, respectively. The CBT's reference rate (the compounded annual rate) is currently at 10.31% (for March 2023) based on a formula that is linked to the policy rate.

According to the current reference rate:

- There is no extra security maintenance requirement for personal need loans, having an interest rate of 18.56% or below (in annual compounded terms)
- There is a 20% extra security maintenance requirement for those extended at rates higher than 18.56% and lower than 20.62%
- There is a 90% extra security maintenance requirement for loans with rates higher than 20.62%.

At February's Monetary Policy Committee meeting, while the CBT repeated its emphasis on alternative policy instruments and alignment of all policy instruments with “Liraisation” targets, it said it prioritised the creation of supportive financial conditions in order to minimise the effects of the recent earthquake disaster and support the necessary recovery. This implied that the CBT would continue to use macro-prudential tools and regulations to reduce the secondary effects of the earthquakes on macroeconomic stability. So, the additional security maintenance requirement is a step to ease the costs of additional government borrowing related to the disaster as it implies another boost to banks' demand for long-term fixed-rate TRY securities.

The weekly Banks Association of Turkey data show that consumer loan growth (including credit cards and overdrafts) has increased more rapidly than commercial loan growth in recent weeks, reaching 128% in annualised 13-week moving average terms as of 13 March 2023 compared to 46.4% on 22 October 2022. Since February, we have also seen a jump in overdraft accounts in state banks that are part of personal need loans and are being used as part of a bundle product to encourage FX deposit holders to participate in an FX-protected deposit scheme.

This acceleration is likely because of less volume and rate restrictions on personal need loans. The new regulation is expected to lead to a notable decline in personal need loan rates. The current compounded rate for average personal loans is 28.66% (24.71% including overdraft) as of 3 March. This means that banks should cut the lending rate for these loans (including overdrafts) by at least 6.15pp to avoid the security maintenance requirement.

With this move, the CBT has now extended its control to banks' pricing decisions in personal need loans. In August, the bank first introduced these soft caps on commercial loan rates. However, since then we have seen a significant momentum loss in highly regulated non-SME TRY corporate lending with the growth in annualised 13-week moving average terms only at 32% in private banks (vs annual inflation currently at 55%). Therefore, we can assert that the negative net interest spread on TRY commercial loans has significantly weighed on banks’ lending appetite lately, increasing challenges for corporates in accessing TRY financing. This does not bode well for the CBT's selective lending strategy that aims to support growth in commercial loans, in particular SMEs, so as to support exports, investments, and employment.

> Given this backdrop, despite the expected decline in lending rates, the net impact of this policy decision may not be expansionary. In fact, the net interest spread on consumer loans will likely turn negative and discourage banks from being active in this loan category. There is a verified link between consumer loans and external balances, and a deceleration in consumer loan growth bodes well with current account deficit and inflation.

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