

Turkey: Central bank on hold amid inflation risks

The Central Bank of Turkey has turned more cautious lately, signalling a gradual shift towards policy normalisation



The Turkish Central Bank in Ankara

Following the end of its long rate cutting cycle last month, the CBT remained on hold and kept the policy rate (one-week repo rate) at 8.25% at the July rate setting meeting, in line with expectations. The CBT has adopted a more cautious stance lately, which is likely attributable to the recent deterioration in the inflation outlook, including an increase in core indicators and the fact that the cost of funding is already aligned with the CBT's own inflation forecast of 7.4%. Initial signs of a rebound in economic activity from the bottom in April should also come as a relief, given policy efforts to limit the downside in activity.

The MPC statement has remained broadly unchanged, though the CBT seemed to 1) acknowledge rising risks on the inflation outlook and 2) have a more optimistic view on economic activity.

On the former, the CBT reiterated the deterioration in core indicators, citing the “pandemic-related rise in unit costs” as a key reason, even though demand conditions are keeping a lid on price pressures. Seasonal factors and pandemic-driven effects on food inflation also pushed the headline CPI higher. The bank also maintained its view that demand-driven disinflation will be more evident in the second half of the year, however it is more concerned about upside risks

following stronger-than-expected inflation readings recently.

On the latter, the CBT is more optimistic that the recovery, which started in May with the reopening of the economy, is gaining momentum. Monetary and fiscal measures introduced with the pandemic continue to limit the downside in activity and are contributing not only to the recovery but also to financial stability.

In the remainder of the statement, the CBT commented that it sees a partial global recovery in the third quarter, as several countries emerge from lockdown measures. The bank continued to emphasise a high degree of uncertainty in the global economic outlook and the expansionary measures of global central banks. It also noted that it expects a recovery in exports and benign energy prices, which will be supportive to the current account balance in the period ahead while easing travel restrictions should be supportive for tourism revenues and hence external balances.

Overall, the CBT has turned more cautious with a gradual shift towards policy normalisation, as implied by the recent statement on a hike in the FX reserve requirement. This shifting stance is likely attributable to its focus on financial stability against a backdrop of the widening external deficit, already low real rates and rising money supply, while risks on the inflation outlook are another factor. Signs of a faster economic recovery, on the other hand, should come as a relief.

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 www.ing.com.