Turkey's central bank remains on hold with no change in guidance

The Turkish central bank kept rates on hold and maintained its cautious stance. While the bank still signals to move in late 2021, ongoing risks could make the central bank wait for longer

Source: Shutterstock

19%

Policy Rate

(1-week repo rate)

As expected

Turkey's central bank kept its policy rate unchanged at 19%, as expected by the market consensus, and remains determined to maintain the current monetary policy stance until inflation slows down.

The latest inflation release with broad-based deterioration in price dynamics, recent administrative price adjustments that will further increase the headline figure in July and persistent increases in

PPI inflation are the reasons for the Bank's decision and its cautious tone.

The rate-setting statement was broadly unchanged compared to last month, while the central bank continued to rely on the main policy guidance. Accordingly, the Bank reiterated that the current stance would be maintained until there is a significant fall in inflation, expected in late 3Q or early 4Q. The difference between the CBT projection (12.2%) and the market consensus (15.6%) for 2021 inflation is increasing. It is set to revise its forecast when it publishes the quarterly inflation report at the end of July. While the base effects kicking in last quarter will likely lead to a drop, headline inflation will remain elevated given the current uncertain outlook with higher risks in the near term, narrowing the room for the bank to ease.

> *We see the policy rate at 18% this year with a 100bp cut in November, though upside inflation surprises can further delay the first cut to early 2022.*

Key takeaways related to the CBT's assessment of economic outlook are:

- Global recovery gains momentum with accelerating vaccinations while improving demand, supply constraints and commodity prices uptrend feed into inflation, impacting global financial markets.
- Despite a deceleration in domestic demand with pandemic control measures and tightening financial conditions in the second quarter, the CBT sees strengthening economic activity with support from increasing vaccinations in Turkey, leading to a recovery in services and tourism.
- The bank reiterates improvement in current account balance and now projects a surplus in the remainder of 2021. The current account in the first five months posted a US$12.7 bn deficit, narrowing over the same period of 2020, driven by a smaller deficit in the gold balance and a stronger core balance (excluding gold and energy). If the CBT forecast holds, the 2021 deficit will even be lower than the figure in the first five months, implying a significant adjustment in comparison to the latest market consensus at US$-24.7 bn.

The central bank kept rates on hold and maintained its cautious stance on the back of challenging inflation dynamics, fragile capital flows and exchange rate outlook as well as vulnerability to a stronger USD and rising US real yields. While the bank still signals to move in late 2021, we think these risks factors could encourage the Bank to remain put for longer.

Author

Muhammet Mercan
Chief Economist, Turkey
muhammet.mercan@ingbank.com.tr

Disclaimer