# Turkey’s central bank hikes interest rate to 30% in a bid to control inflation

In line with the consensus, the Central Bank of Turkey continued its hiking cycle with another 500bp hike in the one-week repo rate to 30% and signalled further tightening steps in both rates and macro-prudential instruments


Hafize Gaye Erkan, the Central Bank of Turkey's governor

Turkey's central bank has raised its one-week repo rate by 500 basis points to 30% as it continues to battle sky-high inflation, which is running close to 60%.

This is the fourth time since June that the central bank has raised rates; first by 650bp, then 250bp in July followed by the higher-than-expected surprise in August of 750bp.

In the note explaining its rate decision, the Central Bank of Turkey (CBT) said its focus remained on anchoring inflation expectations and achieving disinflation. While acknowledging the spike in July and August inflation readings, which pulled up the headline reading by 21 percentage points in two months to 59% year-on-year, the bank pointed again to strong domestic demand, stickiness in services prices, the increase in oil prices and the jump in inflation expectations as the factors which pose a risk to the inflation outlook.

Therefore, the bank still sees inflation at the end of the year running close to the upper bound of the forecast range provided in the CBT's Inflation Report at 62% YoY (as also indicated by the forecast in the Medium Term Plan at 65% YoY).

However, on a more positive note, the bank observed that “tax regulations and cost pressures stemming from wages and exchange rates have broadly passed through to prices” and the underlying trend is likely to turn to decline, thus it stands by its forecast for next year, a stance also supported by the ongoing monetary tightening steps.

The CBT stressed again that foreign direct investment inflows and an improvement in the current account would contribute to price stability. This month, the bank, signalling a recovery in the TRY outlook, inserted a new phrase that “increasing domestic and foreign demand for Turkish lira-denominated assets” will also be supportive of the price stability objective.

The forward guidance has remained unchanged as the bank reiterated that:

- It will continue with monetary tightening steps in a "timely and gradual manner" until it achieves a significant improvement in the inflation outlook. While the CBT has kept its focus on disinflation, it has not provided any guidance on the pace of tightening in the coming months.
- It will continue to “simplify and improve the existing micro- and macro-prudential framework” at a gradual pace. Accordingly, to support the monetary policy stance, it pledged the continuation of quantitative and selective credit tightening moves. In this context, the CBT recently hiked the reserve requirements on FX-protected deposits again from 15% to 25% on maturities shorter than six months, to mop up excess liquidity from the banking system. Mehmet Simsek, the Minister of Treasury and Finance, recently signalled that it would introduce new regulations on loans and credit cards to control the growth of these products.

With these actions, in the two weeks following the August MPC, the 1-3 month TRY deposit rate jumped by 10.1pp to 40.9% on the back of the 7.5pp rate hike in August and the CBT’s newly-announced strategy aimed at gradually unwinding the FX-protected deposit scheme. Lending rates are also on the rise, leading to a positive net interest margin in recent weeks.

Overall, following today's decision, the real policy rate based on actual inflation stood at -18.2%, and the figure based on 12M inflation expectations improved to -10.3%. Given the need for rebalancing to control inflation and reduce external imbalances, the CBT’s move and its likely impact on deposit and loan rates will be key for tightening financial conditions and controlling domestic demand.

Additionally, the latest rate action will likely lead to a further increase in expectations for the final policy rate, while the current inflation outlook and trend require an increase in policy rates towards the level of future inflation expectations.

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