Central Bank of Turkey keeps rates on hold and rhetoric unchanged

The Central Bank of Turkey kept the policy rate unchanged at 14% again this month. The bank has maintained its wait-and-see approach following the introduction of the foreign exchange deposit scheme in mid-December

The Central Bank of Turkey kept the policy rate at 14% at the second rate-setting meeting of the year

In line with the market consensus, the Central Bank of Turkey (CBT) kept the policy rate at 14% at the second rate-setting meeting of the year. The statement accompanying the rate decision was broadly unchanged, reiterating its ongoing assessment of the policy framework and "prioritising the liraisation strategy" in all policy tools. So the bank has maintained its wait-and-see approach following the introduction of the foreign exchange (FX) deposit scheme to increase household demand for Turkish lira (TRY) savings by reducing their FX risk.

The CBT's assessment note this month was almost a carbon copy of the note shared after the January meeting. The bank's views on the global outlook were unchanged, while it attributed the jump in inflation to "pricing formations that are not supported by economic fundamentals", supply-side factors including an increase in global commodity prices, and demand developments. For the future course of inflation, the bank has remained quite optimistic, restating that it is seeing the start of disinflation on the back of measures taken by policymakers and supportive base effects. In this regard, the CBT's 2022 projection at 23.2% for this year is well below the 35% market consensus, indicating high and unanchored expectations, according to the February release of the Survey of Market Participants.

For the growth outlook, the CBT sees a continuation of strong economic activity while maintaining its call for a current account surplus this year. However, it should be noted that the current account deficit, which narrowed throughout 2021, widened in December. Early indicators for January reveal a continuation of import strength with a surge in energy imports, hinting at further expansion in the near term with a higher foreign trade deficit. The CBT is also keeping a close eye on lending growth with a new focus on "long-term Turkish lira investment credit" which the bank says is playing "a significant role" in the improvement of the current account balance and hence price stability.

Finally, the forward guidance showed a minor change as the CBT restated that it would continue to use all available instruments decisively and added this month that it would do so "within the framework of (its) liraisation strategy". In recent weeks, the CBT has introduced a new policy focusing on the 'liraisation' process with three pillars, including new financial products, collateral diversification and regulations regarding liquidity management practices. Accordingly, the deposit instrument providing currency risk protection is also extended to corporates' FX deposits, while the government also passed a law exempting converted TRY deposits from corporate tax. The final move was to extend the scheme further to Turkish citizens living abroad to repatriate their savings to Turkey. The CBT signalled in its Monetary Policy Committee note that these policies will likely continue.

> The CBT said in its inflation report that it anticipated inflation peaking in April and May at around 50% and remaining close to this level before disinflation kicks in during the fourth quarter. In our view, this backdrop and the current reserve outlook – despite a recent recovery due to the support of new deposit instruments and the UAE's swap deal – will not leave any room for further policy easing in the near term.

Author

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