

## Turkey's central bank signals further strengthening of macro-prudential policy set

While the current outlook requires a significantly tighter monetary policy stance, the Central Bank of Turkey has not signalled a shift in the near term, remaining mute again in May and continuing with the same policy line



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As was widely expected, the Central Bank of Turkey (CBT) decided to keep the policy rate on hold (14%) at the May MPC meeting, despite growing pressure on the currency in recent weeks. Messages from the central bank have remained unchanged, but at the meeting there was an emphasis on two key points: further strengthening of the macro-prudential policy set with additional measures, and the implementation of collateral and liquidity policy actions in line with the “liraization strategy”.

Since the first signal at April's MPC meeting to introduce new macro-prudential moves, we have seen a two-pronged approach as a response to a less supportive global backdrop and increasing geopolitical risks that are further weighing on inflation and external balances. Accordingly, the CBT

not only tightened reserve requirements to curb commercial TRY loan growth in late April, but also came up with actions to strengthen its FX reserves. The latest MPC note shows the intention to go further with these moves. Given that the impact of reserve requirements on commercial lending is likely to be seen with a lag, the CBT may come up with additional actions to raise reserves in the near term. On this front, since April's MPC meeting, we have seen higher FX surrender requirements for exporters and the introduction of these requirements for services exporters, and higher FX reserve requirements for banks recording below 10% conversion rates for FX deposits under the FX-protected deposit scheme. So, the bank seems to want to take the same line of action in the near term.

In the MPC statement, the CBT also noted the implementation of collateral and liquidity policy actions in line with the “liraization strategy” that relies on three pillars, including new financial products (i.e the FX-protected deposit scheme), collateral diversification, and liquidity measures. In this regard, the CBT has taken steps to increase the weight of TRY-denominated assets in the collateral system in recent weeks. Accordingly, the bank decided that a minimum 30% of the collateral blockage applied for swap transactions should consist of a basket of government securities (only TRY-denominated government securities or lease certificates issued domestically by the Treasury). The CBT also increased the discount rates for collateral types other than TRY-denominated government securities from 5% to 15%. So, the bank will likely introduce further collateral and liquidity policy actions “of which the review process is finalised”.

The remainder of the rate-setting statement this month was broadly unchanged in comparison to the note released after the April meeting. So, the CBT:

- Maintained its views for the global outlook, focusing on higher downside risks to global economic activity with ongoing geopolitical risks.
- Sees continuing strength in domestic economic activity also supported by external demand.
- Mentioned widening pressures on the current account balance attributable to higher energy prices.

All in all, we see a pronounced TRY weakness in recent weeks and pressure on reserves with a US\$7.4bn decline (in gross reserves) despite continuous FX purchases through the FX-protected deposit scheme and FX surrender requirements. Inflation, on the other hand, maintained a rapid uptrend with risks tilted to the downside given the broad-based deterioration in price dynamics with a largely supportive policy framework and the Russia/Ukraine war pressuring import prices. While the current outlook requires a significantly tighter monetary policy stance, the CBT does not signal a shift in the near term, remaining mute again in May and signalling the continuation of the same policy line.

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