Turkey: Central bank strikes with a strong rate hike

At the September MPC, the Central Bank of Turkey hiked the policy rate to 24% with a recalibration of monetary policy in a response to weakness in the currency and a further deterioration in the inflation outlook. It also maintained its commitment to take more action, if needed

Source: Shutterstock

625bp

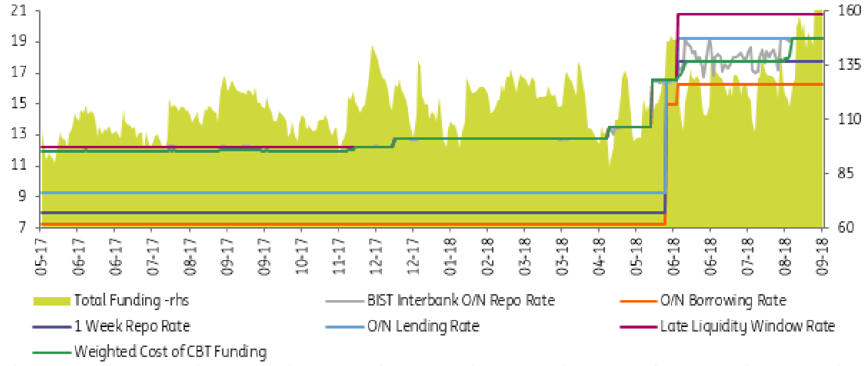
CBT hike

(in 1-week repo rate to 24%)

Higher than expected

At the September rate-setting meeting, the CBT firmly delivered and hiked the policy rate (one-week repo rate) by 625bp to 24%, well above the Bloomberg median consensus and our call at 21%, while also returning to full funding from weekly repo auctions, starting from 14 September (with a one-week transition period). The decision translates into 475 basis points of effective tightening from the current funding cost level of 19.25%. The move also pulled the overnight lending rate and late liquidity window (LLW) rate to 25.5% and 27%, respectively. Markets have reacted positively to the move. Before the decision, the Turkish lira was around 6.4 against the USD. It then plunged to 6.01, currently floating around 6.15.

Key CBT rates (%)

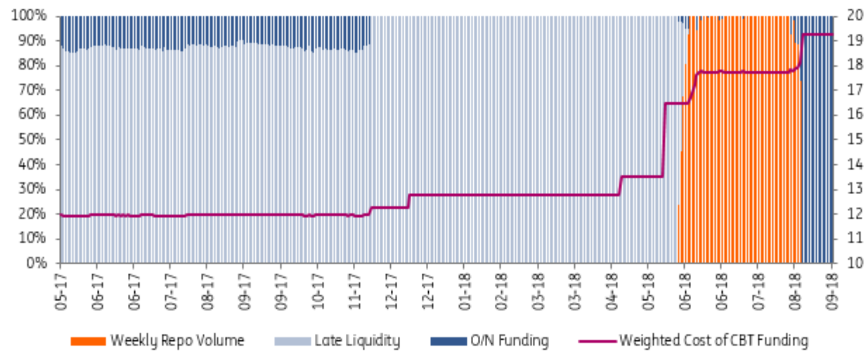


Source: CBT, ING Bank

Prior to the MPC meeting, we discussed the CBT potentially matching the market pricing implied by the swap curve and/or exceeding expectations, though this was not the base case. We also thought the bank could come up with relatively measured actions to pull the ex-post real policy rate towards positive territory. Despite the spike in lending rates and growing concerns about growth prospects in the near time, the bank delivered a strong message to restore confidence.

Funding Comp. & Cost of Funding

(5d-MA, %)



Source: CBT, ING Bank

In the statement, the CBT's growth assessment acknowledged the growing negative signals from early indicators, stating that the "slowdown in domestic demand is accelerating". In the July statement, the Bank said "signs of deceleration in domestic demand (were) becoming more visible".

But, most importantly, the CBT seemed to be vocal about price stability risks given price increases which have shown a "generalized pattern across sub-sectors, reflecting the movements in exchange rates". Recall that despite relatively benign food inflation mostly on the back of unprocessed foods, the latest August data showed a bleak picture, with general upward pressure across various sub-components, exacerbated by a sharp depreciation in the Turkish lira as well as administrative price adjustments. Given that inflation will likely increase towards the 20% handle as FX effects continue to feed through to prices in the coming months, the CBT delivered a stronger hike than expected.

The CBT kept the main policy guidance unchanged while highlighting the determination to tighten further, if needed. The bank will continue to monitor 1) the lagged impact of recent monetary policy decisions and 2) the contribution of fiscal policy to the rebalancing process in addition to 3) inflation expectations, pricing behaviour and other factors affecting inflation. This implies that the CBT is relying on an adjustment in fiscal policy to support disinflation efforts, as frequently mentioned by policymakers in recent months.

All in all, the CBT has sent a strong message with its September decision in response to rising risks around price and financial stability. The bank once again reiterated that its priority is inflation despite the recent worsening in sentiment, which will have a significant impact on domestic demand while volatility in financial markets is likely to make consumers & investors more cautious. The CBT move could contribute to stabilisation in the currency while the release of the Medium-Term Economic Plan detailing the policy reaction of the government to recent volatility, will be key for markets in the near term.

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