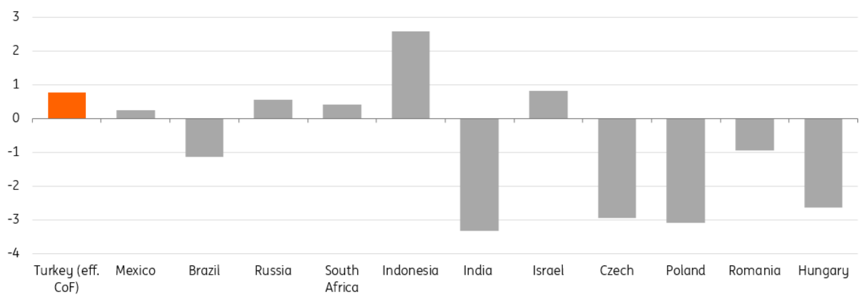
Turkey: Flat policy rate, but change in the rate corridor

In the October rate setting meeting, the central bank did not see the need to make an adjustment in the policy rate, however, it signalled that it will continue with liquidity management tools given ongoing financial and price stability concerns

Ex-post Real Policy Rate (%)

(Ex-post real effective cost of funding for Turkey)



Source: Thomson Reuters, ING

Contrary to rate hike expectations ranging from 100bp-to-300bp, the Central Bank of Turkey kept the policy rate (1-week repo rate) unchanged at 10.25%. However, the bank has lifted the late liquidity window (LLW) rate to 14.75% with a 150bp hike, widening the corridor so as to gain room to manoeuvre in the liquidiy tightening process and signalled it will continue on this path in the near term.

In the current setup, the CBT has been using 1-month repo auctions (interest rate being determined by the liquidity conditions) along with the upper band of the rate corridor (remaining unchanged at 11.75%) and late liquidity window in providing liquidity to the banking system. The latest move will provide additional flexibility to the CBT. Given that the ex-post effective cost of funding is already positive at around 0.8% and broadly aligned with or above of real policy rates of other key EMs (with the exception of Indonesia above 2.5%), any additional tightening via changing the liquidity composition and pulling the effective cost of funding towards the LLW should add to already positive real rates.

The statement seems to be shortened compared with that of September. The CBT reiterated that inflation has remained elevated on the back of rapidly improving economic activity with large credit stimulus and exchange rate developments. This backdrop has required reorientation of monetary policy and liquidity management since early August, leading to significant tightening in financial conditions. The bank still sees the need for a continuation of liquidity measures and makes an adjustment in the corridor structure “to enhance flexibility”.

There are also some other modifications in the MPC statement:

i) the CBT acknowledges the continuation of the recovery in economic activity

ii) for the credit stimulus, the bank now sees momentum loss not in corporate loans, but also in consumer loans. The normalisation trend has turned more evident lately in both categories thanks to the policy moves by the Banking Regulation and Supervision Agency and the CBT as evidenced by broadly unchanged FX adjusted lending volume since early September.

iii) Regarding external balances, the CBT points out the rebalancing in imports and likely improvement in the current account deficit with a strong recovery in exports, supportive commodity prices and competitive currency.

Overall, in the October rate setting meeting, the CBT did not see a need to make an adjustment in the policy rate given signs of momentum loss in activity with a normalisation in credit and rebalancing signals in external balances. However, given continuing financial and price stability concerns, the bank signalled it will continue with liquidity management tools that should provide additional support to the TRY. Exchange rate developments are likely to remain as one of the key determinants of CBT policy in the period ahead given ongoing geopolitical issues and US elections-related sensitivities.

Author

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

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