Turkey keeps rates on hold

The Central Bank of Turkey keeps all rates unchanged, as expected.

The figures

At the June rate-setting meeting, the CBT kept all rates unchanged, in line with consensus. Accordingly, the late liquidity window (LLW) rate, the main channel for CBT funding (at 90% of the total), was flat at 12.25%, while the O/N borrowing rate, O/N lending rate and 1-week repo rate stood at 7.25%, 9.25% and 8.0%, respectively.

A cautious tone

There's no meaningful change in the Central Bank of Turkey's current policies as it keeps rates on hold and refrained from early easing. This was expected given the current inflation rate and a continued deterioration in inflation expectations.

The statement maintains its cautious tone and reiterates its main policy guidance that a "tight stance in monetary policy will be maintained until the inflation outlook displays a significant improvement" while "inflation expectations, pricing behaviour and other factors affecting inflation will be closely monitored and, if needed, further monetary tightening will be delivered". It should be noted that despite keeping a tightening bias in the statement, markets have started pricing in a 100bp cut at close to a 50% probability until the end of October, and a 100% probability by the end of next March.

Optimistic on growth

Following higher than expected growth in the first quarter and further strength in early indicators for 2Q, the CBT continues to be optimistic on the outlook, citing "ongoing recovery in economic activity". Buoyant domestic demand, to which government measures and incentives have contributed, as well as improving exports not least to the EU, are the major drivers of this performance. The backdrop provides relief for the CBT, removing any imminent need to provide additional support to growth via monetary policy. Regarding inflation, the CBT sees an improvement in cost pressures arising from the currency with stability in the Turkish lira (TRY), though acknowledging that "current elevated levels of inflation pose risks to pricing behaviour".

Our view

We see inflation dropping this month below 10% on supportive base effects and tax cuts, but rising again in August and September. Accordingly, we expect a continuation of the current liquidity conditions and the effective funding rate is likely to remain unchanged at around 12%. The global backdrop is currently supportive for the currency, but bouts of volatility in the global financial markets, as witnessed in recent weeks, are likely to keep the CBT cautious with regards to any early easing. On the flip side, tight TRY liquidity with significant TRY volume expansion in the banking sector and growing FX deposits since the beginning of this year pulled TRY deposit rates to the highest levels since the global crisis. Policymakers have increased efforts to reduce financing costs for the real sector. Should the uptrend in deposit rates continue in the coming weeks, an easing via macro prudential steps may also be on the agenda as Economy Minister Zeybekci has recently stated that reserve requirement cuts, along with other relief in intermediation costs of the banking sector, could be considered.

Author

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