

## Turkey: Liquidity measures to continue

The Central Bank of Turkey left the policy rate, and all other rates in the current corridor framework, unchanged and vowed to continue with liquidity measures



The Turkish Central Bank in Ankara

In line with the prevailing expectations of no change in the one week repo rate, at 8.25%, the CBT kept the policy rate flat. By channelling liquidity via a variety of its instruments, the CBT has been increasing the effective cost of funding to local banks from 7.5% in July to above 9.37% as of yesterday. In the meeting, despite some expectations of a widening in the policy corridor from its current 6.75% (lower band)-9.75% (upper band) range, the CBT also left all other rates (including the 11.25% late liquidity window rate) unchanged and instead vowed to continue with liquidity measures.

The decision implies that the bank will likely pull the effective cost of funding higher in the current corridor setup. Given newly introduced 1-month repo auctions in an 11.0-11.3% range so far (close to the TRY OIS rate at the same tenor), the CBT is using this new tool and upper band of the rate corridor (at 9.75%) currently, while lending from the late liquidity window (at 11.25%) is also a possibility in the period ahead. So, the current framework can allow the CBT to hike the effective cost of funding to above 11% in the near term.

There are some modifications in the MPC statement:

- Regarding the inflation outlook, the CBT has become less comfortable recently and raised its year-end inflation forecast to 8.9% from 7.4%, while also increasing its 2021 projection to 6.2% from 5.4%. In the August statement, the bank cites pandemic-related supply side constraints, accelerating lending and currency weakness as the major drivers of higher core indicators. As in previous statements, it expects supply side factors to ease with the removal of pandemic restrictions, while it sees a normalisation in “pandemic-specific financial measures” and ongoing liquidity tightening to be supportive for financial stability. Finally, the bank is less optimistic about the inflation path as it does not mention “more prevalent demand-driven disinflationary effects in the second half of the year”.
- For credit stimulus, the bank acknowledges a loss of momentum in corporate loans, despite continuing strength in consumer lending. It expects a moderation in imports with a normalisation in “pandemic-related liquidity and credit policies” as we have already seen a revision in the asset ratio to ease the pace of lending expansion.
- The CBT also sees some improvement in external balances given the recovery in exports, benign energy prices and as a new addition to this month’s statement, the level of the real exchange rate, in addition to the expected rebalancing in imports and easing travel restrictions, which have already started to support tourism revenues.

The forward guidance part of the statement was unchanged. The CBT reiterated that a cautious stance is required to keep the disinflation process on track and that the monetary stance will be determined based on indicators of underlying inflation.

Overall, the CBT has maintained a gradual shift in its policy stance as we have seen i) the end of a long rate cutting cycle in June ii) a hike in FX RRRs by 300 basis points last month iii) a tightening in the effective cost of funding by changing the funding composition and finally iv) a hike in TRY and FX reserve requirement ratios (RRR) today for banks fulfilling real credit growth conditions, another move to curb lending expansion. As a result of this decision, the CBT envisages it will withdraw approximately TRY17 billion and USD8.5 billion of FX and gold liquidity from the market. Adding the impact of the July decision, the total withdrawal will match the amount injected in March with RRR cuts following the breakout of the pandemic. These decisions and the pace of tightening show that the CBT will continue to make use of a step-by-step approach rather than an abrupt change. Exchange rate developments will likely determine the extent and pace of adjustment in the period ahead.

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