

Turkey: Long easing cycle comes to an end

Turkey's long interest rate monetary easing cycle, in place since mid-2019, came to an end in June, as Turkey's central bank signalled a wait-and-see approach with no imminent rate changes in the near term



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At the June rate-setting meeting, contrary to market consensus of a 25 basis point cut (and our call of 50bp), Turkey's central bank opted to stay on hold and kept policy rates unchanged at 8.25%.

Before the meeting, the effective cost of funding for the banking sector was at 7.54%, already significantly below the policy rate due to newly introduced channels. This allowed the central bank to fund banks at relatively lower rates. Accordingly, the real funding rate was hardly positive given the bank's inflation forecast for this year at 7.4%.

So, with a gradual recovery in economic activity from the low in April and May, still elevated inflation level with higher than expected realization in May, and cost of funding already aligned with the CBT's own inflation forecast, the bank finalized the rate cut cycle in place in almost a year.

On the inflation outlook, the central bank recognised deterioration in core indicators citing “pandemic-related rise in unit costs” as a key reason, despite limiting impact of demand conditions on pricing pressures. Seasonal factors and pandemic driven effects weighing on food inflation also pushed the headline CPI higher. However, the CBT reiterated the outlook portrayed in the latest inflation report stating that demand-driven disinflation trend to be more evident in the second half of the year. In the statement, the bank dropped the entire sentence that “under the current monetary policy stance, inflation outlook is considered to be in line with the year-end inflation projection”. This can be indicative of a more cautious approach in the near term with recognition of risks on inflation.

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.

In the remainder of the statement, the central bank’s views on other issues are:

- **Current global outlook:** seeing a partial recovery contributed by normalization steps in several countries with the pandemic passing its peak and continuing recoveries. The bank maintained its emphasize on high uncertainties on global economic recovery along with expansionary measures of global central banks
- **Economic activity:** pointing to a more pronounced weakness in April and start of recovery in May with reopening of the economy
- **Current account:** dropping the reference to “a moderate course throughout the year” with more than expected deterioration in the last few months though expecting that recovery in exports and benign energy prices will be supportive in the period ahead.

Overall, the rate cut cycle continuing since mid-2019 with an objective of lowering the cost of funding for banks seems to come to an end as the central bank signals a wait-and-see period with no imminent rate changes in the near term.

This shifting stance is likely attributable to the focus on financial stability in a backdrop of widening external deficit, already low real rates and rising money supply, while risks on the inflation outlook should be another driver. Signs of economic recovery, on the other hand, should be a relief factor for the bank as pointed out in the statement.

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