Turkey: No surprise at the MPC meeting

A clear hawkish shift from the Federal Reserve had little impact on the Central Bank of Turkey's decision today, with the policy rate flat and policy guidance unchanged

At the June rate setting meeting, the CBT maintained its recent rhetoric and kept the policy rate flat at 19%, in line with market expectations and our call, amid challenging inflation dynamics and a fragile currency outlook. So it seems a clear hawkish Fed shift has not prompted any significant changes at the CBT today.

While the MPC statement saw some minor changes to the assessment of global and domestic developments, policy guidance has remained unchanged, with the current stance expected to continue until headline inflation falls significantly. This is expected to occur at the end of the third quarter or early in the fourth quarter, according to the April inflation report. On the inflation side, the bank is cautious due to the ongoing upside risks driven by a large number of factors including cost effects, demand conditions, supply constraints and inflation expectations despite signs of a moderation in domestic demand. As current low ex-post real rates and risks to the CBT's inflation forecast path leave little room to act, it will likely remain on hold until an improvement in inflation allows the Bank to ease moderately, which is likely in October.

The CBT's assessment of the economic outlook, on the other hand, shows some positive tweaks as it acknowledges the:

- Supportive impact of momentum in vaccinations on the world recovery. However, inflationary forces have gained power, impacting global financial markets.
- Strong economic activity despite a deceleration in domestic demand amid pandemic control measures and a tightening in financial conditions in the second quarter. The bank sees support from increasing vaccinations in Turkey, leading to a recovery in services and tourism.
- Slower credit growth on the back of policy tightening. The CBT has remained on alert regarding the pace and composition of lending.
- Improvement in the current account balance and the Bank expects an acceleration in the pace of narrowing thanks to export strength, weakening credit expansion, lower gold imports and a recovery in tourism revenues.

All in all, given challenging inflation dynamics, fragile capital flows and the exchange rate outlook, the CBT has remained on hold this month, and signals caution in its policy actions near term. The inflation outlook and the Fed's shifting stance which implies earlier tightening are factors that could impact the timing and direction of the CBT's moves in the rest of the year.

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