

Turkey: Outright hike instead of changing the rate corridor

Given continuing financial and price stability concerns, the Central Bank of Turkey brought its policy rate into double digits again, despite market expectations of a flat policy rate and wider interest rate corridor



The Turkish Central Bank in Ankara

In a surprise move at the September MPC, the CBT hiked the policy rate (1-week repo rate) by 200 basis points to 10.25%. Accordingly, the entire corridor setup has shifted upwards with the overnight borrowing rate now at 8.25%, the overnight lending rate at 11.75% and the late liquidity window rate at 13.25%. Given the challenging inflation outlook, increasing dollarisation and ongoing deterioration in the external deficit, requiring normalisation in the policies employed since the breakout of pandemic, the CBT showed a decisive response and came out with a formal hike.

Additionally, having been using:

- newly introduced 1-month repo auctions (interest rate being determined by the liquidity conditions and standing above 11.5% in the last two days),
- the upper band of the rate corridor (at 9.75%) and
- the late liquidity window (at 11.25%) to provide liquidity to the banking system since late

July...

the CBT hiked the effective cost of funding by more than 300bp to 10.65% currently, leaving relatively small room for further tightening via liquidity measures. In this regard, the latest MPC decision will provide additional flexibility to further tighten liquidity and to raise its effective funding rate, if needed.

Also, any adjustment to the upper band of the rate corridor (overnight lending rate) and late liquidity window rate would mean a departure from the symmetric and modestly wide corridor setup, determined in mid-2018. The CBT has only been announcing the 1-week repo since then, seeking to reduce unorthodoxy and uncertainty. The latest move indicates that the CBT does not prefer a wide and asymmetrical corridor and will continue with the current corridor framework.

In the statement, the CBT acknowledges that despite earlier expectations of fading pandemic-related pricing pressures after the reopening of the economy and the supportive impact of weak demand outlook, inflation has remained elevated on the back of rapidly improving economic activity amid large credit stimulus and exchange rate developments. This backdrop, requiring the reinforcement of tightening steps in place since early August, is the major driver of the policy rate hike, according to the Bank.

There are also some other minor modifications in the MPC statement:

- the CBT shared its view on the third quarter economic activity, “recovering markedly” thanks to normalisation and strong credit expansion.
- for the credit stimulus, the bank reiterates a loss of momentum in corporate loans, while it also sees the same normalisation trend in consumer loans.

Overall, given continuing financial and price stability concerns, the CBT brought its policy rate into double digits once again. This decision reduces the gap between the policy rate and actual or expected inflation rates in an environment where the outlook for inflation is challenging, portfolio preferences of residents are shifting to foreign currency and capital flows are weak while also providing additional flexibility if the bank opts to tighten with liquidity measures. Exchange rate developments will likely remain one of the key determinants of the CBT's policy in the period ahead, though the hike should support the Turkish lira in the near term.

Author

Muhammet Mercan

Chief Economist, Turkey

muhammet.mercan@ingbank.com.tr

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group*

(being for this purpose ING Group N.V. and its subsidiary and affiliated companies). The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.