Turkey's policy rate and monetary stance unchanged, as expected

The Central Bank of Turkey kept the policy rate flat in June, sticking to the current policy framework which has been in place since last December

In line with expectations, the CBT kept its policy rate on hold (at 14%) at the June MPC meeting, and signalled a continuation of its current policy plans. This includes plans to implement the "strengthened macro-prudential policy set" with additional measures, if needed, and plans to introduce further collateral and liquidity policy actions in line with the "liraization strategy", following a finalisation of the review process.

The CBT's reserve losses accelerated in May despite continuous FX purchases by the CBT through the FX-protected deposit scheme, and FX surrender requirements of exporters and tourism firms. Accordingly, policymakers have reacted with measures to try to replicate some parts of the monetary transmission mechanism. The aim is to:

- Put a break on commercial TRY loan growth in line with the signal to strengthen the macro-prudential policy set (i.e asset-based reserve requirements, risk weight adjustments etc).
- Strengthen FX reserves, reflecting the aim of keeping FX stable (i.e. higher FX surrender requirements).

- Divert local demand away from FX (i.e. new revenue indexed bonds).
- Strengthen demand for local government bonds (ie. collateral requirements for banks against their FX liabilities which are in the form of FX deposits).
- Increase the appeal of TRY assets for foreign investors (i.e the introduction of swap allocations for foreigners & reduced fees for issuance of securities to foreign investors).

The June MPC meeting shows that the CBT will not change its course, and will maintain macro-prudential regulations, as well as collateral and liquidity policies, in line with its "liraization strategy". With these policy actions, the CBT aims to "strengthen the effectiveness of the monetary policy transmission mechanism".

The rate-setting statement this month showed little change in comparison to the note released after the May meeting. The CBT did turn quite negative in its global outlook, noting the "weakening in worldwide economic activity" and downward revisions to global growth forecasts. But it also noted that the robust growth performance has continued in the second quarter thanks to strong external demand. The Bank mentioned that the support provided to the economy from tourism should be sustainable, and it maintained its focus on the "allocation of funds for real economic activity purposes".

After pronounced TRY weakness in recent weeks and pressure on reserves, we see some stabilisation in net reserves (excluding swaps). This is due to a wave of measures from late April onwards, particularly impacted by higher FX selling requirements for goods and services exporters, out of their FX revenues. Given no change in policy direction to prioritise inflation and allow a normalisation in real rates, the risks to the macro outlook will likely remain a key concern depending on exchange rate developments and higher price pressures.

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