

Snap | 21 December 2023

TURKEY

Turkish central bank likely to end hiking cycle next month

Following its guidance in November and in line with the consensus, the Central Bank of Turkey raised the policy rate by 250bp to 42.5% at the last rate-setting meeting of the year. The communication in December implies an additional 250bp hike in January, pushing the policy rate to 45%, in our view



The Central Bank of Turkey in Istanbul

After large rate hikes totalling 31.5ppt since June, the CBT signalled a slowdown in the pace of hikes, as suggested last month when it said it aimed to complete the tightening cycle in a short period of time. According to the December statement, the wording has now changed a little, with the bank noting that the tightening cycle should be completed as soon as possible. This is based on the bank's assessment that the extent of monetary tightness is close to the required level to achieve disinflation. Recent positive developments have also contributed to this assessment including i) the ongoing improvement in the underlying inflation trend which began in October, ii) recovery in (12M) inflation expectations down from 45.3% to 41.2% in the last two months based on the market participants' survey, and iii) inflation remaining in line with the outlook in the latest inflation report.

However, inflation pressures stemming from domestic demand continue to prevail despite

recent signs of moderation. As such, the bank reiterated that it would not start to cut rates earlier and remained committed to keeping a tight stance for longer to “ensure sustained price stability.” In the December statement, there were two minor additions showing that sentiment has turned more positive since the previous month; the improvement in external financing conditions was deemed “notable” and it also saw an “accelerated” increase in domestic and foreign demand for TRY-denominated assets.

Regarding the micro and macro prudential framework, the bank continued to note that lending rates were at sufficiently tight levels. This implies credit conditions are tight enough and there will not be any move in the near term targeting further tightness. Despite additional reserve requirement hikes introduced in early November, the CBT’s net OMO funding was in negative territory at -TRY 218bn on 20 December. Accordingly, the bank announced that it would hold TRY deposit purchase auctions to strengthen the monetary transmission mechanism and increase the diversity of sterilisation instruments. The bank is also continuing its simplification moves, cutting the security maintenance requirements on FX liabilities to 4% from 5% previously. Finally, the CBT introduced an upper limit (set at 3.11% on a monthly basis, 45.15% compounded) to the reference rate in order to ensure that maximum interest rates on credit cards and maximum commission rates for merchants do not exceed their current levels.

Annual inflation has remained in a 61-62% range in the last three months as the pass-through from the post-election adjustment in FX, wages and taxes has been reflected in prices. The monthly trend of inflation may continue to improve if currency stability is maintained, adjustments in wages and administered prices prioritise inflation concerns, the impact of geopolitical issues on oil prices remains under control, and domestic demand sustains its path of moderation. We expect inflation to remain elevated until mid-2024, with further increases above 70% on seasonal effects in January and unfavourable base effects in May. The second half of next year, on the other hand, will likely see a sharp downtrend – reflecting this year’s high base and the further impact of tighter policy, pulling inflation down to 40-45% at year-end. In this environment, following one more hike in January, we expect the CBT to remain on hold until the third quarter of next year.

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