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Turkey: CBRT keeps rates on hold in line with our expectations

Development

In a widely anticipated move, the Central Bank of Turkey (CBRT) kept its key policy rate – one-week repo rate – unchanged at 17%, in line with our (and consensus) expectations. In the statement complementing the rate decision, the monetary policy committee (MPC) maintained his hawkish rhetoric by emphasising the risks to inflation stemming from robust domestic demand conditions, cost-push pressures and high inflation expectations, in conjunction with increasing non-core volatile food and commodity prices.

Against the backdrop, the CBRT repeated its determination to implement further tightening if needed and maintain a conservative policy stance for an extended period until there are strong signs pointing to a permanent deceleration in inflation towards price stability. Indeed on this point, the only notable change in the statement from last month was the view to maintain a strongly disinflationary balance between the policy rate and expected/realised inflation until permanent price stability and the 5% inflation target are reached.

Key data

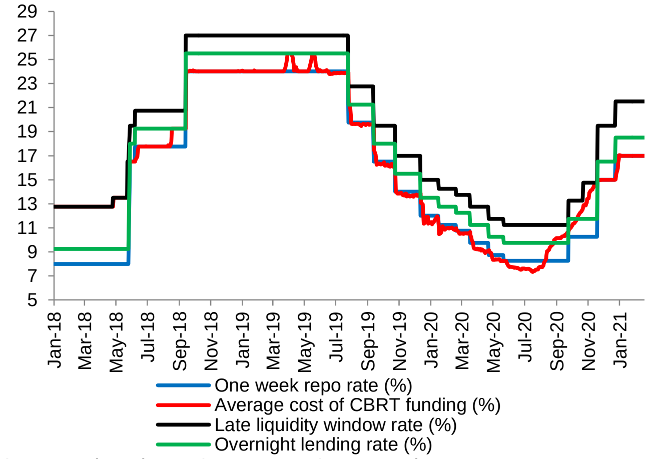
One-week repo rate: no change at 17% (MUFG 17%; consensus 17%)

Macro

Heading into the meeting, we had maintained our view that the CBRT has completed its rate hike cycle for now and that it will conserve rates at the current level

CBRT MAINTAINS MONETARY POLICY PRUDENCE

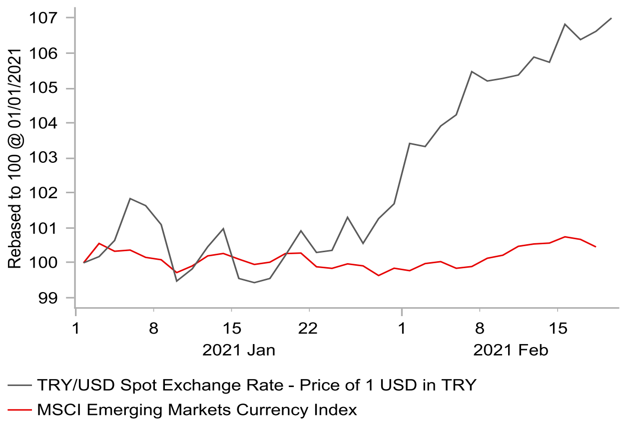
TURKEY BENCHMARK RATES AND EFFECTIVE FUNDING RATE (%)



Source: Bloomberg, CBRT, MUFG Research

TRY HAS BEEN CLEAR OUTPERFORMER

YTD PERFORMANCE OF TRY VS. EM FX



Source: Bloomberg, Macrobond & MUFG Research throughout the first half of 2021 to re-anchor expectations (see here). The 475bps mark-to-market hike in November and the further 200bps hike in December that took the one-week repo rate to 17%, in conjunction with the simplification of the monetary policy framework, has been sufficient enough to secure the measured disinflation the CBRT is calibrating, which has also played a pivotal role in improving investor sentiment.

Looking ahead, we view that sustaining the current positive momentum and restoring macroeconomic stability would also entail a strong commitment to more orthodox policies, including a rule-based fiscal policy. Having said that, we still expect the CBRT could look to start easing in the second half of 2021, though the start of the expected easing cycle will be conditional on evidence of weakening demand pressure, diminishing inflationary expectations, a robust pickup in de-dollarisation and TRY stability. Given Turkey's still elevated risk premium and large external financing requirements, progress in circumnavigating challenges pertaining to (i) inflationary pressures; (ii) requirements to bolster reserves and replenish capital inflows; as well as (iii) pivot residents' portfolio choice in favour of TRY-denominated assets to ensure a durable de-dollarisation strategy, will all require not only an appropriate risk adjusted return but also a sustainable track record. This would, in turn necessitate maintaining a conservative monetary policy stance and to provide robust forward guidance to markets on the CBRT's commitment to undertake additional tightening – which given the challenging inflation outlook, which we envisage peaking in March-April at ~15-16% y/y, and only meaningfully declining by the last quarter of this year when base effects take hold – may be required if there are no further meaningful declines in the risk premium over the near-term. What we believe markets would welcome is the further restoration of macroeconomic stability through a carefully calibrated and credible CBRT strategy to bolster FX reserves.

FX

The TRY continues to be bid up after today's CBRT policy meeting resulting in USD/TRY falling back towards the lows from earlier this week at just below the 6.9000-level. The sharp move higher in US yields in recent days has had limited negative impact on the TRY. It has been by some distance the best performing emerging market currency this year having advanced by around 7.0% against the USD while the second best performing emerging market currency, the ZAR, has advanced by just over 1.0%. The TRY and Turkish assets are continuing to benefit from the CBRT's tighter policy stance which is helping to restore foreign investor confidence. However as highlighted below by our local Treasury branch, it does not yet appear to have had the same positive impact on locals. The largely unchanged CBRT policy statement today is unlikely to materially alter the current bullish trend for the TRY although USD/TRY could soon begin to find more support from the lows from the middle of last year between 6.7000 and 6.9000. If the TRY continues to rise sharply it may start to become more of a policy concern going forwards and undermine efforts to rebalance the economy.

Treasury

According to latest weekly data from BRSA, total FX deposit of local investors surged about USD2.7bn from USD232.9bn to USD235.6bn as of week ending 12th February. As important factor to watch for CBRT, there is still no sign for de-dollarization from Turkish investors whereas recent appreciation of Turkish lira towards 7 mark seemed to attract extra appetite from locals for buying from the dips not seen since last July. Under these circumstances, we expect the main driver for Turkish lira's performance to continue to be foreign investor flows whereas if global risk appetite remains supportive, we may test 6.80 level on the downside as first key target on USDTRY. With expectations for lack of any strong support from local investors on the de-dollarization front, we think CBRT might wait further acceleration of inflows whereas it may start FX purchase auctions gradually if the pair tests below 6.80 .

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