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First Insights

EMERGING MARKETS

Turkey: TCMB hopes to ride this wave out

The MPC officially confirmed the end of its simplification rhetoric by widening the interest rate corridor northwards and keeping the 1-week repo rate unchanged. In our view, today's decision shows that the TCMB is not ready to deliver decisive, orthodox hikes even so soon after TRY hit all- time lows in a move that seemed on the verge of turning disorderly. Moreover, this decision does not show a willingness to get ahead of the curve in defending the currency. In the absence of a more permanent improvement in risk-reward profile, we think TRY remains exposed to further depreciation pressures. On a side note, we do not yet know when the next MPC meeting will be, which adds to the general sense of uncertainty about Turkish monetary policy.

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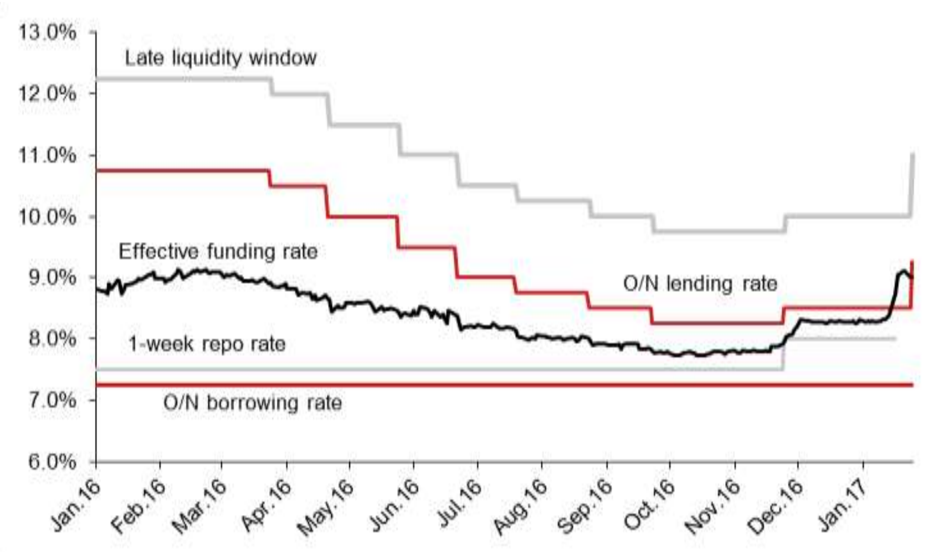
Deeper into unorthodox territory

The TCMB's Monetary Policy Committee (MPC) kept the O/N borrowing and 1-week repo rates unchanged at 7.25% and 8% respectively, while hiking the O/N lending rate by 75bp to 9.25% and the late liquidity window rate by 100bp to 11%. The increases in the latter two rates were in line with market consensus, while the unchanged O/N borrowing and 1-week repo rates were against consensus. Our expectation, meanwhile, was for 50bp hikes in all rates, with the possibility of larger hikes in the top two rates.

Fig. 1: Policy rates and weighted average cost of funding



Source: TCMB

The rate statement was more hawkish as it highlighted the inflationary impact of currency weakness and kept further tightening on the table. But it was also telling that the TCMB said that liquidity measures would be taken in response to "unhealthy pricing behaviour in the FX market". Clearly, the TCMB is satisfied with the impact of recent liquidity measures in stabilising TRY in the current global environment where the dollar is on the back foot against trade partners, and hopes to ride this wave out relying on this policy.

Based on this observation, we have two takeaways from today's decision. First, the TCMB is not ready to hike formally to shift the entire corridor higher – even so soon after TRY hit all-time lows in a move that seemed on the verge of turning disorderly. The first line of defence will remain liquidity measures in an unorthodox policy framework, which

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relies even on the highly unusual lender of last resort facility. This would imply potentially intermittent tightening rather than a more permanent improvement in the risk-reward profile for TRY.

Second, the TCMB will not get ahead of the curve. For instance, the Bank could have formalised the 10% marginal funding rate by pushing the O/N lending rate to that level, which would help avoid using the late liquidity window on a regular basis. But today's decision falls short of even that – hardly a display of forceful, decisive support for the currency.

These two points, we think, will keep TRY exposed in the coming weeks and months, especially if the recent dollar trend reverses. Currently, three-month outright USD/TRY forwards stand at 3.86, while we think the TCMB's current policy framework could push the pair to 4.00 in three months.

On a side note, at the time of writing, we still do not know when the next MPC meeting will be held. This adds to the general sense of uncertainty regarding Turkish monetary policy.

Appendix A-1

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