Turkey's central bank cuts inflation forecast

Turkey's central bank has cut its 2019 inflation forecast to 14.6% and 2020 forecast to 8.2%, along with reiterating its commitment to a tighter monetary stance until there is a convincing decline in inflation

Source: Shutterstock

No signs of complacency

In the first inflation report of this year, Turkey's central bank governor Murat Cetinkaya announced new inflation forecasts and explained reasons behind the downward revisions to the October forecasts. He reiterated his policy stance and vowed to deliver further monetary tightening if needed, in addition to outlining risks to the inflation outlook.

Lower inflation path envisaged in the January report

According to the report, the Bank expects 14.6% CPI inflation this year, down by 0.6ppt on the back of changing assumptions for lira-denominated import prices creating -0.5ppt impact on the headline.

This mainly reflects a significant cut in oil price forecast to USD 63.1 from USD 80 in the previous report, improvement in the underlying inflation trend with -0.4ppt impact, the downward adjustment in output gap estimate as the bank expects it to remain in negative territory beyond 2021, pulling the headline forecast down by -0.3ppt. While assumptions for taxes and administered prices impacted the 2019 inflation estimate by +0.2ppt and +0.4ppt impact from an upward revision in unit labour costs.

> *According to the report, the Bank expects 14.6% CPI inflation this year*

For 2020, the central bank now sees inflation coming in at 8.2%, down from 9.3% in the October report mainly because of the same reasons leading to a downward adjustment to the 2019 forecast. So, the CBT portrays a relatively better outlook as it now sees inflation reaching single digit levels next year and converging to the target in 2020.

Central bank to avoid premature easing

Today's report shows that the central bank will avoid premature easing given the reiterated policy guidance with a promise to further deliver monetary tightening if needed.

The report also signals to maintain a policy that reduces inflation to single digits in the least possible time. The CBT sees the current policy mix has contributed to the stability in recent months and remains determined to keep it until there is a convincing decline in inflation.

This stance shows that despite the recent favourable developments on the inflation front, the bank will focus on credibility building and remain on hold until annual inflation expected downtrend from June onwards with large supportive base effects.

CBT remains wary of the upside risks

Regarding the risks to inflation, the Bank remains cautious given a large list of likely factors that can change the outlook. These include: uncertainty surrounding pricing behaviour and rigidity in formation of expectations, continuing backward indexation, volatility in food prices, capital flow outlook towards emerging markets, further tightness in lending supply, volatility in global energy prices and risks related to coordination between monetary and fiscal policy.

Given the challenges on the inflation front, the risk of the lira coming under pressure again and currently fragile capital flows, the CBT showed no signs of complacency and reiterated the key guidance in place in recent months.

Strong wording and a promise to maintain a policy that reduces inflation to single digits in the shortest possible time has contributed positive sentiment in the currency market as markets have been cautious over the possibility of an earlier rate cut(s) lately.

Author

Muhammet Mercan
Chief Economist, Turkey
muhammet.mercan@ingbank.com.tr

Disclaimer