

Turkey's central bank maintains forecasts amid cautious optimism on inflation

The Central Bank of Turkey has kept its inflation forecasts unchanged in its latest inflation report, adding that the tightening of financial conditions would further support the ongoing normalisation of demand



The Central Bank of Turkey's Governor, Fatih Karahan

CBT Governor Fatih Karahan held a meeting to introduce the third inflation report of the year and shared forecasts that function as intermediate targets in the disinflation process. The central bank maintained its inflation forecasts at 38%, 14% and 9% for this year, 2025, and 2026 respectively. According to the report, this year the impact of a slightly higher underlying inflation trend (+0.2ppt) and marginal upward revision in output gap (+0.2ppt) was offset by downward revisions in administered prices (-0.3ppt) and TL import prices (-0.1ppt).

Approaching year-end, the forecast range corresponding to 2024 should have automatically narrowed but the bank kept it between 34% and 42%, citing "the mounting uncertainties amid recent geopolitical developments and global financial volatility." Both Governor Karahan and Deputy Governor Cevdet Akcay also stressed that the forecast range of the bank should be taken

into consideration, rather than focusing only on the point forecast in the assessment of the performance (current market participants' survey points to 43%, slightly higher than the upper band of the forecast range at 42%). The band for next year – between 7% and 21% – also remained unchanged.

Given this background, the bank's governor reiterated the strong policy guidance seen in recent MPC meetings, including a) continuing its tightening bias, i.e., leaving the door open for further hikes if required by the inflation outlook, and b) pledging to keep rates higher for longer until a significant and sustained decline in the underlying trend of monthly inflation and convergence of inflation expectations to the CBT's projected forecast range. Regarding the other issues discussed in the meeting:

- The CBT recently started publishing household and firms' inflation expectations. These have declined in recent months but remain markedly higher than those of market participants. The bank tracks broad measures rather than focusing on only market participants' expectations as firms form their strategies in line with their inflation expectations, while consumer expectations play an important role in consumption, saving, and portfolio decisions. Akcay pointed out that relatively higher real sector expectations are attributable to the impact of inflation developments in the past and would likely improve in the period ahead. The extent and pace of improvement rather than levels in comparison to the CBT's forecast range would likely impact the central bank's decisions going forward.
- The CBT sees a slowdown in domestic demand in the second quarter, though it's likely to remain at an inflationary level and narrow the output gap. This trend will continue in the third quarter as implied by several early indicators. The rebalancing of domestic demand will remain in place thanks to a tight policy framework. The output gap will slide into negative territory in the second half of this year and contribute to the disinflation process. Prioritising inflation over GDP growth, the governor reiterated the bank's price stability mandate and implied that it could tolerate further weakness in economic activity.
- According to the governor, the CBT can maintain a tight monetary stance while cutting the policy rate. This implies that the central bank will remain cautious and that the timing of cuts will be gradual and will also depend on data. Given that the relatively stable currency and normalisation in domestic demand should support a decline in the underlying inflation trend for the remainder of this year, we see room to cut in November or December, depending on the data.
- Regarding the underlying trend, the CBT reiterated its expectation of a decline in seasonally adjusted monthly inflation to around 2.5% on average in the third quarter, slightly below 1.5% in the last quarter of the year. Both TurkStat and the CBT currently work together to generate seasonally adjusted figures tracked by the bank. When questioned, the governor expressed confidence in TurkStat and added that inflation data is broadly in line with what the monthly prices collected by the bank imply.
- Finally, the governor added that the recent 38% electricity and natural gas price hikes (in line with the CBT's inflation forecast) illustrate the coordination of monetary and fiscal policies which will continue to contribute to this disinflation process.

All in all, the CBT kept its inflation forecasts and policy guidance unchanged and seemed cautiously optimistic about the inflation outlook. It expects that a decisive monetary policy stance will support the downtrend in monthly underlying inflation with a) the rebalancing in domestic demand, b) the real currency appreciation, and c) a continued improvement in inflation

expectations.

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