Turkey's central bank revises its inflation forecast upwards

The Central Bank of Turkey has revised its 2024 inflation forecast by 2ppt to 38% on the back of some upward surprises we've already seen this year. It continues to see a strong disinflationary path in the second half, and it's leaving the door open for further hikes if required

Turkey's Central Bank governor, Fatih Karahan

CBT Governor Fatih Karahan introduced the latest inflation report today and shared forecasts that serve as intermediate targets in the disinflation process. The inflation forecast for this year has been raised from 36% to 38%. The targets for the following years, of 14% and 9%, are unchanged.

Mr Karahan said the revision for 2024 was down to upward surprises in the first four months of the year, amounting to some 4%. He believes fully compensating for this unexpected rise seems challenging, even with additional tightening. On the flip side, a strong increase in the policy rate and additional tightening in monetary conditions delivered in March helped the bank to come up with a lower revision than the deviation in the underlying inflation trend.

The forecast range narrowed to 34-42%, leaving the upper band unchanged. The Deputy Governor, Cevdet Akcay, added that he was comfortable with the width of the range of inflation expectations, and there was no possibility of ending the year above 42%. This implies an improvement from the current level of 44.2% in the April market participants' survey.

According to the report, the change in inflation's underlying trend, higher food inflation and the output gap were major determinants of the upward revision in the 2024 inflation forecast, while downward revisions in administered prices and TL import prices reduced the extent of the hike. The assumptions reveal that:

1. there will not likely be a significant correction in electricity and natural gas prices until inflation is on a notable downward trend
2. TRY will likely follow a stronger path as implied by a positive contribution from TL import prices (-0.2ppt impact on the inflation forecast revision) despite an upward revision in USD import prices (by 0.8% in comparison to the first inflation report)

Acknowledging inflationary pressures and providing a detailed analysis about the drivers, the Governor envisaged inflation to peak at around 75-76% in May and adopt a declining trend after that. The CBT sees a decline in seasonally adjusted monthly inflation to around 2.5% on average in the third quarter, and slightly below 1.5% in the last quarter of the year. Remaining broadly unchanged in comparison to the previous report, the path continues to imply a strong disinflation path in the second half.

Given this background, the Governor reiterated the messages provided in the April MPC meeting with a strong tightening bias and left the door open for further hikes if required by the inflation outlook. Regarding the other issues discussed in the meeting:

- He pointed out reserve accumulation as one of the priorities in their decisions. As the perception that tight policies would continue after the local elections strengthened, the CBT's reserve position started to improve in recent weeks, especially due to residents' FX sales and partly due to foreign portfolio inflows. Accordingly, net reserve positions (excluding swaps) improved by a significant US$17.0bn (between March 29-April 26). The Governor stated that the up-to-date data shows a US$34bn increase in the recent period.
- He maintained the focus on strong liquidity sterilisation via quantitative tightening steps in a pre-emptive manner. Accordingly, the bank has mopped up more than TRY 1 bn through reserve requirement regulations since July 2023, while it has been conducting TRY deposit buying auctions to sterilise cyclical and temporary excess liquidity.
- Mr Karahan shared the observation that commercial loan growth slowed down after the rate hike, while consumer loan growth and credit card lending have been weakening lately. The Governor does not see a need for raising credit card interest rates at this stage.

All in all, the CBT moves since March including an unexpected and strong rate hike, a large set of macro-prudential measures and liquidity tightening have eased concerns about the disinflation priority and contributed to support both local and foreign investors' confidence in TRY assets. Accordingly, while the CBT sees monetary tightening steps as having immediate and strong effects on financial markets, it firmly signals it will do more to avoid any lasting deterioration in inflation. A disinflation in line with the CBT projection will increase the chance of a rate-cutting cycle towards the end of 2024. We continue to expect 250bp cut towards the year-end.

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