Turkey's central bank doesn't rule out further easing

The central bank of Turkey has revised its 2019 inflation forecast downwards but hasn't ruled out further monetary easing

Governor of Central Bank of Turkey Murat Uysal

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According to the last quarterly inflation report of the year, Turkey's central bank Governor Murat Uysal has lowered the CBT's inflation forecast to 12% from 13.9%.

This is attributable to changing food inflation expectations, improvement in the underlying trend, and downward revisions to lira denominated import prices, despite higher than expected price adjustments in tobacco products and an upward revision in the output gap.

For 2020, the central bank kept the forecasts unchanged at 8.2%, even lower than the figure presented in the new economic programme at 8.5% given the supportive impact of improvement in the underlying trend of inflation and the downward revision to assumptions for lira denominated import prices were offset by upward revision in the output gap.

We think inflation is likely to remain in single digits in October *and reverse thereafter because of unsupportive base effects*

The central bank's inflation forecast for 2020 and beyond diverges from the current market consensus on 12-month and 24-month inflation expectations, standing at 11.2% and 9.8%, respectively, as of October. According to the Governor, the disinflation process continues, with base effects, tight monetary policy and domestic demand also contributing to a fall in inflation, while the monetary policy implementation will ensure the forecast is achieved.

In the accompanying meeting, the Governor further clarified the central bank's position in the aftermath of the unexpectedly high 250bp policy rate cut last week following the signal of a more cautious policy stance in September. The Governor acknowledged the bank has used a significant part available for a loose monetary policy, but did not rule out further easing in the near term.

We think inflation is likely to remain in single digits in October and reverse thereafter because of unsupportive base effects, closing the year above the central bank forecast. So, the case for further monetary easing in the last meeting in December should be weak, though the risks are on the upside given the CBT signal, but any move should be at a more gradual pace.

Some other issues under market focus

1. The latest banking sector data shows signs of loan growth recovery, primarily driven by the state banks, though private banks have also signalled to join the trend in consumer lending and improving the appetite for corporate loans in lira. This also reflects positive impact of linking reserve requirements (RRs) and remuneration to credit growth and eight banks in the system have already attained 10-20% growth range in lending to benefit from these incentives. RRs will continue to be actively used by the central bank, while the expectation is a more homogeneous credit growth in the period ahead.
2. The central bank has been employing swaps more often to fund banks, amounting US$12-13bn and that is one of the reasons for declining funding via 1-week repo auctions recently. The governor stated that these transactions are an outcome of structural swap needs in the system and will remain in place in the period ahead, though repo auctions will continue to be the main funding channel.
3. The Governor once again reiterated the difficulty of defining the reasonable rate of real return and pointed out the real interest rate of other peer countries, current level of dollarisation and portfolio preferences of residents, healthy credit growth, keeping inflation on a downward path, among others as the variables to determine the real return.

Overall, the new inflation forecast path is aligned with the one presented in the new economic program. Regarding the monetary policy outlook, the central bank takes the advantage of the downtrend in inflation and recovering inflation expectations along with improving political and geopolitical backdrop with deeper than expected cuts since July and doesn't rule out another move in the near-term.

However, as implied earlier, any policy action to be determined by the inflation path will be at a more gradual pace.

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