

Turkey's new Central Bank Governor confident the policy framework is working

The Central Bank of Turkey seems confident about its projected inflation path. It's keeping its forecasts unchanged for this year and next



The Central Bank of Turkey, Governor, Fatih Karahan

Source: CBT

In his first public appearance, Governor Fatih Karahan held a press conference to introduce the first Inflation Report of the year. The CBT kept its year-end and 2025 inflation forecasts, which function as intermediate targets in the disinflation process, unchanged at 36.0% and 14.0%, respectively. This was the prevailing expectation following the bank's assessment after the January inflation numbers (at 6.7%) that the outcome was consistent with the forecast of the last Inflation Report of 2023.

According to the CBT, the change in the underlying trend of inflation and the downward revision in administered prices were offset for this year by upward forecast revisions in the output gap, unit labour costs, TRY-denominated import prices, and food prices. The impact of monetary tightness

on pricing behaviour has been stronger than anticipated. In return, the inflation forecast remained unchanged.

Acknowledging inflationary pressures and providing a detailed analysis of the drivers, the Governor envisages a transition towards the disinflation and stabilisation period. He expects inflation to peak at around 7.3% in the second quarter of 2024 and adopt a declining trend afterwards.

The CBT sees the seasonally adjusted monthly inflation to hover below 4% on average in the first half of this year (around 3% except for January), which will decline to below 2.5% in 3Q and around 1.5% in the last quarter. The path implies a strong disinflation path in the second half.

Given this background, the Governor reiterated the messages provided in the January MPC meeting:

- the monetary tightness required to establish the disinflation course is achieved by including quantitative tightening moves and simplification in the macroprudential framework that also strengthens the monetary transmission
- the current level of policy interest rates will be maintained as long as needed. The CBT will seek a significant improvement in the underlying trend of monthly inflation and convergence of inflation expectations to the projected forecast range to start rate cuts
- monetary tightness will be reassessed if there's a significant deterioration in the inflation outlook, all depending on possible shifts in inflation expectations, price-setting behaviour, public spending, the private consumption outlook and wage adjustments. So, the bank is keeping its tightening bias, though the bar for further hikes seems to be high.

Regarding the other issues discussed in the meeting, the Governor:

- pointed out reserve accumulation as one of the priorities in their decisions. Despite recent pressure in reserves because of an increasing shift to FX from FX-protected deposits lately, the CBT expects the continuation of a positive impact of the monetary tightening process on reserves
- maintained the focus on strong liquidity sterilisation via quantitative tightening steps in a pre-emptive manner. Accordingly, the bank has mopped up more than TRY1 bn through reserve requirement regulations since July 2023, while it's been conducting TRY-deposit buying auctions to sterilise the cyclical and temporary excess liquidity.
- reiterated the pledge for further macro-prudential moves in case of potential excess volatility in credit supply and deposit rates. In this regard, given the recent momentum gain in seasonal credit card spending at the end of the year and the bringing forward of higher consumption due to wage hike expectations, the Governor mentioned a need for a new regulation. Additionally, keeping deposit rates at a level to support the unwinding process of the FX-protected deposit scheme and TRY deposits share has remained among key policy priorities.

The CBT seems confident about the success of the ongoing disinflation policy as the monetary tightening has had a stronger-than-expected impact on pricing behaviour and expects a further improvement in the current account balance together with a rebalancing in domestic demand. In our view, the report and strong messages in the accompanying meeting will likely provide additional assurance for the markets about policy predictability and durability.

We continue expect the first cut in the last quarter of this year, with the policy rate reaching 40%. But don't rule out a possibility of a delay to early 2025.

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