

Snap | 31 July 2019

TURKEY

The Turkish central bank continues to signal further cuts

The CBT has revised its 2019 inflation forecast down to 13.9%. It emphasised the importance of sustaining the disinflation process and its cautious monetary stance, signalling that it will likely come up with measured moves in upcoming MPC meetings.



Source: iStock

In releasing the CBT's inflation report, newly appointed CBT Governor Murat Uysal announced new inflation forecasts and revisions to key assumptions. There was also further clarification on its policy stance.

According to the report, the CBT now expects 13.9% CPI inflation this year (vs 15.0% in the latest CBT survey), revised down from the 14.6% in the April inflation report. This was thanks to lower-than-projected inflation reported and to the ongoing improvement trend. Food inflation assumptions were reduced, despite the upward change in the output gap and the higher impact of administrated prices. Given the improvement trend seen in recent months, inflation expectations will likely move closer to the CBT's forecast in the period ahead.

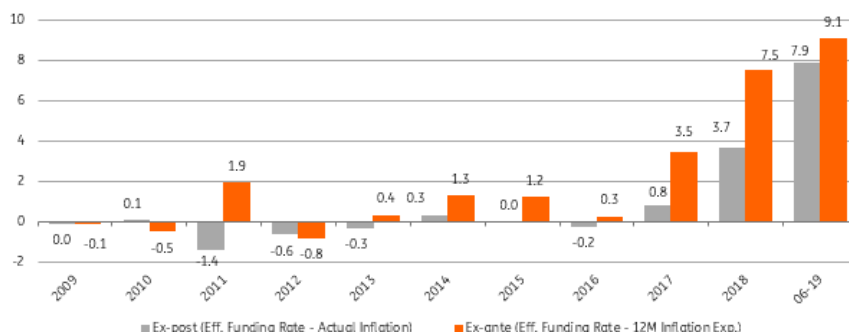
For 2020 the CBT sees inflation at 8.2%, unchanged from the January and April reports. Changing food inflation and TL-denominated import price assumptions were offset by upward

revisions in the output gap. The CBT has the same inflation outlook for the next year as in the previous report, expecting inflation to converge to the target in 2021 and beyond. The CBT's inflation forecast for 2021 diverges from the current market consensus on 12-month and 24-month expectations. These stand at 13.9% and 11%, respectively, as of July although, according to the Governor, monetary policy implementation in line with the inflation outlook will ensure the forecast is achieved.

In the meeting accompanying the inflation report release, the Governor further clarified the CBT position. This followed the unexpectedly high 425bp policy rate cut in the July MPC meeting that led to a range of expectations as to the extent of easing in the period ahead. The Governor noted that the bank would focus on the underlying inflation trend by stripping out temporary changes in headline inflation and in core indicators, including the impact from shifts in administrative prices and base effects. When analysing the underlying trend the CBT would consider seasonally adjusted inflation moves, the diffusion index, services inflation and other micro data along with expectations. By adding “a reasonable rate of real return” to the inflation level implied by the underlying trend, the CBT would determine the extent of “room to manoeuvre”.

Real Policy Rate (%)

(3m BUBOR as a policy rate for Hungary)



Source: CBT, ING

Regarding the level of “a reasonable rate of real return”, the Governor defines this in the context of a neutral interest rate that is quite difficult to determine and varies significantly over time. Accordingly, the CBT will monitor factors including: (1) real interest rates of peer countries (after the July move, the ex-post real policy rate is now close to the highest of Turkey's EM peers), (2) the current level of dollarization and portfolio preferences of residents, (3) healthy credit growth, and (4) keeping inflation dynamics on a downward path.

The CBT took advantage of the downtrend in inflation dynamics and recovering

inflation expectations - along with the improving political and geopolitical backdrop - with a deeper than expected cut in July. In the inflation report release the Governor emphasised maintaining the disinflation process and the cautious monetary stance, signalling that the CBT will likely come up with measured moves in the upcoming MPC meetings. Accordingly, we expect two more cuts in the September and October MPC meetings and see the policy rate at 17.50% at the end of this year. However, risks are to the downside given Governor Uysal's statement that there is significant room to manoeuvre as signalled by current projections.

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