

Turkey: Central bank revises up inflation estimates sharply

The Central Bank of Turkey raised its 2018 inflation forecast to 13.4%, reflecting the recent sharp increase in price pressures due to a weaker lira and unprecedented spike in food inflation. The governor reiterated the CBT's commitment to a tight monetary stance for an extended period



Source: Flickr

The governor's messages in a nutshell

In the inflation report and accompanying speech, CBT Governor Murat Cetinkaya announced new inflation forecasts and explained the reasons behind the bank's significant adjustments. He also defended the MPC decision last week and reiterated the Bank's determination to bring inflation down from the current elevated levels and thus to rebuild credibility.

The CBT sees a longer period for inflation to converge to target

According to the report, the CBT now expects CPI inflation of 13.4% this year, up five percentage points from its previous forecast. It also forecasts 9.3% inflation for next year, up by 2.8 percentage points on the back of changing food inflation expectations, higher oil price

assumptions and the impact of recent weakness in the Turkish lira. This is despite a downward adjustment in the output gap estimate, which the Bank now expects to fall into negative territory in the third quarter and remain there in the coming four quarters. For 2020, the CBT now sees 6.7% inflation, up from 5% in the April report. So the CBT expects inflation to stabilise around the 5% target after 2020, in three years time. It previously hoped to bring inflation down to the target level in just two years.

The governor reiterated the same message of the MPC

In the July MPC last week, the CBT ended its tightening cycle in place since April, despite a sharp deterioration in the inflation outlook, ongoing uptrend in forward-looking expectations and external imbalances. The market had been expecting a roughly 100 basis point hike. In today's meeting, the governor repeated the central bank's arguments, citing:

1. Milder demand conditions and the likely disinflationary impact from this.
2. A likely reversal in food inflation (the CBT sees unprocessed food inflation dropping to 12% at the end of this year from 23% in June vs 13% food inflation down from 18.9%).
3. Support from fiscal policy (though it assumes a neutral fiscal stance rather than a pro-growth stance that's been in place since 2016).
4. The lagged impact of tightening since April.

Accordingly, Governor Cetinkaya once again reiterated the CBT's commitment to a tight monetary stance for an extended period. He sounded concerned about the worsening in inflation expectations and the rise in core inflation and he stated that the Bank remains ready to react to inflationary risks (by closely following pricing behaviour, and global risk appetite), signalling the CBT may tighten policy more if inflation and inflation expectations prove sticky.

Next thing to watch is the new Medium Term Programme

In raising inflation forecasts, the CBT has reduced the gap with the market consensus, which is looking for 13.9% inflation. The governor also maintained his cautious tone. Given that the CBT attaches a bigger role to fiscal policy in the disinflation process, the new Medium Term Programme (out likely end-August/early September) will be key for the markets after a series of packages released before the snap elections proved disappointing.

Author

Muhammet Mercan

Chief Economist, Turkey

muhammet.mercan@ingbank.com.tr

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial

instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.