

Turkey: Central bank revises up inflation forecast, as expected

While the Central Bank of Turkey sees the inflation rate peaking in April, the trajectory is relatively optimistic compared to current market expectations



In his first inflation report and accompanying meeting, CBT Governor Şahap Kavcıoğlu announced new inflation forecasts, commented on the current monetary policy stance and shared views on some key issues for the market.

In line with the signal given in April when the MPC eliminated a reference to the end-2021 interim target, the CBT revised up its inflation target for this year to 12.2% from 9.4%. However, the new figure is still relatively optimistic given the market consensus is at 13.1% in the bank's April survey and that this is likely to increase further this month. The 2022 inflation projection was also pulled up to 7.5% from 7.0% in the previous report, while the CBT continues to expect convergence to the 5% inflation target in 2023.

The bank cites the following variables as the major determinants of the forecast trajectory for this year: (i) food inflation (+0.4ppt), due to the upward revision in the annual figure to 13.0% from 11.5%, given pressure in global food prices; (ii) TL-denominated import prices (+1.8ppt) reflecting both TRY weakness and higher US\$ denominated price assumptions at 13.3% on a year-on-

year basis, from 6.5% YoY in the previous report, while the oil price forecast was also revised up to US\$64.4 per barrel from US\$54.4 per barrel; (iii) a narrower output gap assumption (+0.4ppt), (iv) the impact from administered prices (+0.1ppt) and (v) the rise in the underlying trend (+0.1ppt). For next year, the bank sees adverse effects from TL-denominated prices, higher food inflation and the rising underlying trend despite some support from a wider output gap than expected earlier.

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

- reiterated the policy guidance that the “policy rate would continue to be determined at a level above realized and expected inflation” while clarifying that the bank would consider not only the ex-ante real policy rate, but also the ex-post real rate, he did not provide any insight as to the magnitude of the real interest rate to be provided in the period ahead.
- pointed out that the tight monetary stance would be maintained with “great determination and patience” until a sustainable improvement in the inflation outlook. Given changing expectations about the likely future course of monetary policy after the April MPC meeting with a possibility of earlier easing, this wording should aim to manage expectations on the likely CBT actions ahead.
- sees that inflation will peak at over 17% in April (the upper bound of the forecast range is slightly above 18% for the coming few months), and the improvement will be more evident in the second half of the year with a convergence to the CBT’s forecast. However, risks to the inflation outlook in the short term are quite significant, and the expected improvement could be slower than what the CBT envisaged, according to current market expectations.
- mentioned the possibility of some macroprudential moves to curb the ongoing momentum in retail lending which has been accelerating since early this year.

All in all, while the CBT revised its inflation forecasts as expected, the trajectory is relatively optimistic compared with the current market consensus, despite strong favourable base effects in the second half of the year. The policy stance, on the other hand, has remained in line with what was laid out at the last MPC meeting, focusing on the positive real policy rate. The CBT will likely focus on the right time for a first rate cut, with challenging inflation dynamics, fragile capital flows and the exchange rate outlook keeping the bank cautious going forward.

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