

## Turkey's central bank more than doubles inflation forecast for 2023

New Central Bank of Turkey Governor Hafize Gaye Erkan said inflation was expected to reach 58% by the end of 2023, compared with a previous forecast in May of just over 22%



The building of Turkey's central bank in Ankara

In her first public appearance, Central Bank of Turkey (CBT) Governor Hafize Gaye Erkan today held a press conference to introduce the third Inflation report of the year. The CBT has raised its year-end and 2024 inflation forecasts by 35.7pp to 58% and 24.2pp to 33%, respectively. Following these revisions, the CBT's year-end projection moves closer to the market consensus, as economists have started revising year-end forecasts to 60% or above.

According to the CBT, the factors that played an important role in the revision of inflation forecasts for this year and next are food inflation, TRY-denominated import prices, the output gap, administrated prices and unit labour cost, and finally forecast deviation and a change in the forecasting approach. With respect to the latter factor, Erkan, who was appointed in June, said that in the path presented in the previous inflation report, the forecasting approach put a higher emphasis on the intermediate target, while in the latest report, the bank's projections have been aligned with its technical forecasts, in view of the changing macroeconomic outlook.

Recent lira depreciation (around 30% since end-May), large mid-year wage adjustments (a 34%

hike in the minimum wage and 73.5% on average for civil servant salaries) and revenue-raising measures to offset some of the fiscal pressures related to wage hikes and earthquake reconstruction will be inflationary in the period ahead. Acknowledging inflationary pressures and providing a detailed analysis of the drivers, Erkan said there would be a transition heading towards the disinflation and stabilisation period and expected inflation to peak at around 60% in the second quarter of 2024, declining thereafter.

Erkan also used the press conference to:

- Point out recent moves on selective credit tightening and quantitative tightening to support the monetary tightening process in addition to the rate hike. Targeting the most binding constraint in the current micro and macro-prudential policy framework, the CBT eased (FX-protected deposit) conversion requirements that facilitated a decline in deposit rates by around 7ppt in the last three weeks. The bank signalled that it would maintain these efforts to diversify TRY savings and support the deepening of capital markets, while it will closely watch the deposit rates to keep them attractive for savers.
- Mention the recent hike in reserve requirement rates on FX-protected deposits that will lead to the mopping up of around TRY450bn liquidity. The CBT hinted at further quantitative tightening decisions ahead to ensure TRY stability.
- Mention recent selective credit tightening moves. With these moves, including the removal of the first tier in interest rate caps, lending rates are expected to increase in an environment of rapid momentum loss that is evident on both the consumer and commercial side. However, the net impact may not lead to further tightening as banks will likely have more appetite to lend with a less restricted cap on lending rates and hence it seems the CBT has opted to reduce monthly growth limits on some loan categories.
- Try to justify the current gradualist approach in rate hikes, citing the large set of regulations that require slow steps and impact analyses.
- Reiterate the decision to provide banks with FX directly, if there is demand due to maturing FX-protected accounts. In the last few days, according to the CBT's daily balance sheet, there are signs of ceasing reserve accumulation. The Governor stated that the CBT does not utilise the protocol signed with the Treasury to facilitate state banks' activity in the currency market.

All in all, while inflation is likely to change direction and rise markedly in the second half of the year, expectations are also strong for a more rapid shift to conventional economic policymaking. The CBT's signals related to the speed and size of the interest rate hikes hint that restoring price stability will likely remain challenging in the near term.

## Author

### Muhammet Mercan

Chief Economist, Turkey

[muhammet.mercan@ingbank.com.tr](mailto:muhammet.mercan@ingbank.com.tr)

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