Turkey: Downward revision to 2020 inflation forecast

The Central Bank of Turkey markedly reduced its 2020 inflation projection and anticipates that the disinflation trend will continue. The current stance does not rule out further cuts, in our view, while currency developments will be closely watched

Governor of Central Bank of Turkey Murat Uysal

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CBT Governor Murat Uysal provided detailed comments about the April inflation report and the impact it will have on the current monetary policy stance.

The Bank revised its 2020 inflation projection down to 7.4% from 8.2% in the January report. The Bank cited the following variables as major determinants of the forecast trajectory: (i) the output gap (-1.2pp); (ii) food inflation (-0.3pp), due to the downward revision in the annual figure to 9.5% from 11% and due to the impact from weak tourism; (iii) real unit labour costs (+0.5pp) (iv) TL denominated import prices (+0.2pp), which are relatively lower due to the change in the oil price forecast to US$32.6 per barrel from US$60 per barrel, despite the recent depreciation in the Turkish lira.

The 2021 year-end inflation forecast remains flat at 5.4%, as the supportive impact from a widening output gap is offset by the upward pressure from TL-denominated import prices.

According to the CBT's inflation forecast trajectory, the Bank sees the downtrend this year accelerating from July onwards, towards 8% in September. It's expected to maintain its downtrend thereafter, reaching 7.4% by the end of 2020. As a cautionary note, forward-looking expectations remain ahead of consensus estimates, with 12-month and 24-month forecasts at 9.70% and 8.62%, respectively, while a high exchange rate pass-through points to another challenging year, in our view.

The CBT extended its easing cycle further, with two 100 basis point rate cuts in March and April despite elevated headline and core inflation as of March, pushing ex-post real policy rates to markedly negative territory. Given the bank's revised inflation forecast, the Governor, once again, highlighted the ex-ante real policy rate, which is positive territory, and currently low real interest rates at the global level. So, the bank likely sees room to act further, though depreciation pressures due to locals' portfolio preferences and the external debt payment schedule should act as a constraint.

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

- The CBT will remain focused not only on price stability but also financial stability, with a great deal of attention on the question of swap operations and the bank's FX reserves.
- The maximum limit for the ratio of the CBT's securities portfolio to its total assets, set at 5% for 2020 in the Monetary and Exchange Rate Policy for 2020 text, has been revised to 10% and there is no need for another limit change currently. Accordingly, the ceiling for the portfolio should be around TRY70 billion based on the current size of the CBT's balance sheet (though the limit excludes government securities that primary dealers have bought from the Unemployment Insurance Fund and sold to the CBT, according to the Governor's remarks in the meeting).
- The CBT expects the current pressure on reserves to ease. This is due to the relatively healthy debt rollovers of around 80% in the currently challenging environment and an improvement in the portfolio flow outlook. The balance of payment conditions is also benign because while there is pressure on export growth and tourism revenues, imports are weaker due to faltering domestic demand and low oil prices.

The CBT has swiftly responded to Covid-19 related developments with a series of measures aimed at providing liquidity to banks, supporting exporting firms via arrangements on the rediscount credits, securing credit flows to the corporate sector and boosting the liquidity of government debt securities while continuing to cut rates. The current stance does not rule out further cuts, in our view, while currency developments that put prices and financial stability at risk will be closely watched.

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