

## Turkey: No change to the central bank's inflation projections

The Central Bank of Turkey has not made any change to its inflation forecasts from the October inflation report and anticipated continued disinflation. Any policy action, likely to be determined by the inflation path, will be cautious going forward



Shoppers in Istanbul

In the first inflation report of the year, CBT Governor Murat Uysal announced new inflation forecasts, commented on the current monetary policy stance and shared views on some key issues for the market.

The CBT has not made any meaningful changes to its inflation projections or to the outlook for this year and next. Accordingly, the bank is maintaining its 2020 estimate of 8.2%, as the impact from higher oil price assumptions, the lower output gap estimate and rise in unit labor costs offsets the downward effects of tax adjustments and an improvement in the underlying inflation trend. The inflation forecast for the end of 2021 remains unchanged as well, at 5.4%. The bank expects the disinflation trend to be more pronounced in the second half of this year, towards its estimate, though we think the outlook is challenging given indexation and a recovery in credit and growth.

The CBT extended its easing cycle further in January with a measured move, despite higher

headline and core inflation at the end of 2019, which pushed the ex-post real policy rate into negative territory- lower than the average of peer countries. However, the governor highlighted the ex-ante real policy rate, which is in positive territory based on 12-month expectations in the CBT's survey and its own forecast for the year. He hinted that the bank would probably remain cautious in the near term on the back of likely flat annual inflation, with a less supportive base in the near term and real rate buffer close to the long-term average. But he also suggested the bank would maintain its easing bias and deliver if the bank sees room to manoeuvre.

Regarding the other issues clarified by the Governor:

1. In the monetary and exchange rate policy paper for 2020, the bank set its securities portfolio for open market operations at a maximum of 5% of its analytical balance sheet total assets. According to the Governor, this translates into TRY32-33 billion at the end of 2020 with a roughly 70% increase from current TRY19 billion levels.
2. The CBT envisages the lending expansion this year to be around 15% in nominal terms, mainly driven by TL lending, while FX loans are expected to remain flat. The credit outlook is seen in line with inflation and growth projections.
3. Residents' FX deposit holdings show an additional US\$3.5 billion in early January, pulling the stock to a new high in nominal terms, despite higher transaction costs and lower returns. However, the bank sees a continued downtrend in dollarisation given that the share of FX deposits in the total has dropped lately to 51% from a recent peak of around 56%, though the current level is still high.

Overall, the CBT has not made any changes to its inflation forecasts compared to the October report and anticipated a continued disinflation trend. Regarding the monetary policy outlook, the CBT has taken advantage of the downtrend in inflation dynamics and recovering inflation expectations, as well as an improving political and geopolitical backdrop. And with deeper than expected cuts in the second half of 2019, the Bank's easing cycle will likely slow down. The current stance does not rule out further cuts but any policy action going forward is likely to be cautious and determined by the inflation path.

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