Turkey’s central bank pushes inflation forecasts up for 2025

The Central Bank of Turkey has markedly revised its inflation forecasts for next year to above 20%. We think the new set of projections is now more attainable, but the projected delay in the disinflation process will likely attract some attention

CBT Governor, Fatih Karahan

Turkish Central Bank Governor Fatih Karahan held a meeting to introduce the last inflation report of the year, and to share the central bank's latest inflation forecasts. With a significant revision to those presented in the previous report, the CBT raised its inflation forecast to 44% (from 38%), 21% (from 14%) and 12% (from 9%) for this year, 2025 and 2026 respectively.

On the one hand, the governor pointed out factors relatively beyond the domain of monetary policy as major drivers of the large forecast revisions. He focused on the recent upsurge in prices of fresh fruits and vegetables, but also on rents, which have a structural dimension and need to be handled separately due to factors such as earthquakes, urban renewal and the removal of limitations on rent increases that paved the way for a significant readjustment from July. The central bank infers that the decline in the reference rates in contract renewals suggests monthly rent inflation should slow in the last quarter.

On the other hand, Karahan downplayed missing forecasts presented in the previous report. Given that the new set of forecasts aim to achieve the previous upper band for the end of this year (which was 42%) in January and its previous year-end forecast in March, the governor suggested that spending a few months behind in a disinflation programme spanning several years is not a big deviation. In this regard, he concluded that the upward revision in forecasts did not indicate a change in monetary policy.

According to the report, the sources of forecast revisions are:

- Underlying inflation trend and inertia: 3.9 percentage points for 2024 and 3.5ppt for 2025.
- Food prices: 1.6ppt for 2024 and 1.9ppt for 2025.
- Turkish lira import prices: 0.2ppt for 2024 and 0.5ppt for 2025.
- Upward revision in output gap: 0.3ppt for 2024 and 0.2ppt for 2025.
- Administered prices with an assumption of no impact for the rest of 2024, and pulling the headline up by 0.9ppt in 2025.

Given this background, the governor reiterated the following policy guidance:

- Pledging to keep rates higher for longer until a significant and sustained decline in the underlying trend of monthly inflation materialises. Regarding recent price developments – while acknowledging slower-than-expected disinflation so far – he added that underlying inflation continued to decelerate in October, driven by lower core goods inflation as well as a more pronounced deceleration in services (excluding rent).
- The convergence of inflation expectations to the CBT's projected forecast range. Approaching year-end, the forecast range corresponding to 2024 narrowed mechanically to 42-46%, while the band for next year was 16-26%. Accordingly, market participants' end-2025 inflation expectation of 25.6% in the latest survey is now in the CBT's forecast range.

For the inflation outlook in the period ahead, the central bank reiterated its assessment that domestic demand has continued to lose pace and came close to levels supportive of disinflation. Meanwhile the output gap, which should fall to negative levels in the upcoming period, will be an important component of the disinflation process.

Inflation expectations also continued to gradually improve, and in the industrial sector, pricing behaviour among firms shows a clear improvement. Regarding the minimum wage adjustment for 2025, Deputy Governor Cevdet Akcay commented that the pass-through of the minimum wage increase is lower when economic activity is relatively weak, while the current environment is likely to allow wage setting based on inflation expectations.

The governor sees this dropping below 1.5% month-on-month in seasonally adjusted terms in the third quarter of next year (implying a significant delay, as this level was the call for the last quarter of 2024 previously). This should decline further to slightly above 1% MoM in the fourth quarter of 2025. However, according to Karahan, there may be temporary pressures in the first quarter of next year. This will liekly be due to the impact of automatic revisions in special consumption tax (SCT) on certain products in January, as well as uncertainty surrounding minimum wage hikes.

All in all, the shared forecasts that function as intermediate targets have been substantially revised upwards, implying a significant delay in Turkey's disinflation process –

although they are now more realistic and are closer to market expectations. While addressing structural challenges related to food and rent inflation, the CBT's relatively positive assessment of the October data and projected inflation path suggests that a rate cut in December should not be fully ruled out if we see more benign data releases in November. That said, economic activity may be headed for a further slowdown given the significantly tight financial conditions, and a deeper-than-expected impact could also be a key factor in the timing of the cutting cycle.

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