Turkey: Tighter for (even) longer...

The Central Bank of Turkey kept its 2021 inflation forecast unchanged despite growing pricing pressures and signalled a commitment to reduce inflation with further tightening if needed. The bank also strengthened its forward guidance and suggested it would keep policy tighter for longer

The Turkish Central Bank in Ankara

CBT Governor Naci Ağbal introduced the first inflation report of the year and provided detailed comments about the latest developments and their impact on the current monetary policy stance, with clear forward guidance.

The CBT kept its 2021 and 2022 inflation projections unchanged at 9.4% and 7.0%, respectively, with the Bank expecting a convergence to its 5% inflation target in 2023. The Bank cited the following variables as major determinants in its forecast trajectory for this year:

- Food inflation (+0.2ppt), due to an upward revision in the annual figure to 11.5% from 10.5%, with ongoing pressure in global food prices and the impact from an expected improvement in the tourism sector.
- An increase in real unit labor costs (+1.0ppt).
- TL-denominated import prices (-0.4ppt), likely due to a different exchange rate path projection despite a hike in oil price forecasts to US$54.4 per barrel from US$43.8 per barrel.

- Falling inflation expectations in the CBT's policy framework (-0.5ppt). For the next year, the bank sees support from a tight monetary stance and an improvement in expectations.

In December, annual inflation was again higher than expected, reaching 14.6%, due to food and transportation prices. This was a reflection of continuing cost-push factors, still strong domestic demand and elevated services inflation being highly sticky at current levels.

The outlook has also deteriorated due to a recent significant hike in the minimum wage, by 21%, as well as a rise in oil and commodity prices and the continuing uptrend in food inflation. Given that the CBT's forecasts in the inflation report are actually targets now, and the CBT has not made a change to the 2021 inflation forecast despite growing pricing pressures, it remains committed to its previous target/forecast for this year.

In this regard, the bank has again been vocal on keeping a tight policy stance for a longer period and kept the door open for more hikes if needed. Accordingly, the governor reiterated a continuation of policy tightness "for an extended period" until "strong indicators point to price stability."

The CBT also committed this time to maintain "the level between the actual / expected inflation rate path and the monetary policy interest rate path" until reaching the 5% inflation target, which is projected to be reached in 2023, according to its latest forecasts. This implies that it will continue to keep the real policy rate high enough to pursue "a strong disinflationary balance" and "this balance will be sustained continuously". So, even if we see some downward adjustment in the policy rate depending on an improvement in the inflation outlook, the CBT will allow a higher interest rate level to continue in order to maintain disinflation. This should also be helpful for the reserve accumulation objective by contributing to capital flows and de-dollarisation over time.

The CBT's new target forecast is unchanged compared to its previous report despite growing pricing pressures. It's shown a commitment to reduce inflation by continuing its prudent policy stance, and the bank has provided a clear commitment to remain cautious in the conduct of monetary policy to sustain the disinflationary balance in the medium term.

Author

Muhammet Mercan
Chief Economist, Turkey
muhammet.mercan@ingbank.com.tr