Turkey's central bank maintains inflation forecasts, emphasises policy caution

The Central Bank of Turkey has maintained its inflation forecasts despite recent market volatility. Governor Fatih Karahan emphasised the bank's commitment to a tight and data-driven policy stance, which aims to support the disinflation process

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Turkish Central Bank (CBT) Governor Fatih Karahan held a meeting to introduce the second inflation report of the year, sharing updated inflation forecasts following the volatility experienced in late March. Despite recent fluctuations, the CBT did not make any significant revisions to its previous projections and maintained its inflation forecasts at 24% for 2025, 12% for 2026, and 8% for 2027. As year-end approaches, the forecast range for 2025 should have naturally narrowed, but the Bank chose to keep it within the 19–29% range, citing "the recent rise in uncertainties".

According to the report, several factors influenced inflation forecasts for 2025:

- The upward revision in expected food inflation (+0.5 percentage points)
- A higher-than-anticipated output gap (+0.3ppt)
- A slightly stronger underlying inflation trend (+0.1ppt)
- Exchange rate developments leading to an increase in Turkish lira-based import prices

(+0.1ppt), even though import price assumptions in US dollar terms were revised downward

- These inflationary pressures were largely offset by downward adjustments in administered prices (-1ppt), primarily driven by the reduction in health examination co-payments in February

Against this backdrop, Governor Karahan emphasised that the CBT's policies have successfully prevented a severe deterioration in inflation expectations. He reaffirmed the bank's commitment to a) maintaining a tight and cautious policy stance, b) setting the policy rate at levels necessary to ensure the projected disinflation path, and c) adjusting interest rates on a meeting-by-meeting basis, relying on data-driven decisions. This approach aims to support the disinflation process through a moderation in domestic demand, the real appreciation of the Turkish lira, and improved inflation expectations

Regarding the other issues discussed in the meeting:

On the inflation side, the CBT's assessment of the underlying trend, based on three-month moving averages, indicates no substantial change. However, preliminary data for May suggests a decline in the underlying inflation compared to April. Moving forward, tighter financial conditions and global economic developments are expected to steer demand more closely toward a disinflationary path starting in the second quarter of the year.

Karahan noted that the recent tightening that occurred during the CBT's cutting cycle will lead to more pronounced effects, and the slowdown in economic growth will therefore be more noticeable. Agricultural frost incidents nationwide pose an upside risk to unprocessed food prices, though current data does not yet reflect an impact on food costs.

Meanwhile, oil prices are expected to help mitigate the effect of TRY-denominated import prices on overall inflation, and inflation expectations and firms' pricing behaviour that show limited deterioration after March volatility will continue to play a key role in shaping the outlook. Overall, the bank doesn't expect to see persistent inflation rigidity, and seasonal factors are expected to bring the seasonally adjusted monthly inflation rate down to slightly above 1% by the end of the year (currently above 2.5%). That said, risks remain tilted to the upside.

Regarding the policy line ahead, Deputy Governor Cevdet Akçay stated that the timing of monetary easing will be determined based on economic data, making it premature to predict whether the pace of rate cuts will be slow or fast. Currently, the CBT also relies on macroprudential measures in addition to the rate tool; it uses policy rate and credit caps with the objective of controlling both the price and quantity of credit.

Akçay highlighted that the bank has multiple options: it can either lower rates if conditions permit while maintaining macroprudential measures, or keep rates high while gradually relaxing volume restrictions. The latter option is being closely considered in response to increasing complaints from the corporate sector about difficulties in accessing bank financing, as we see renewed calls for support from the Credit Guarantee Fund.

Deputy Governor Hatice Karahan commented on the bank's foreign exchange reserves, emphasising that policy rate decisions are not linked to the reserve level. She noted that different indicators provide varying perspectives on reserve adequacy and suggested that reserve accumulation could become a priority depending on market conditions.

Overall, the CBT's latest report signals that the inflation outlook remains largely unchanged and is expected to stay within the bank's target range by the end of the year. Provided there are no additional shocks – major exchange rate fluctuations, sharp wage increases, unexpected hikes in administered prices, or a surge in global commodity prices – we expect inflation to be close to the upper band of the CBT's forecast range by year-end.

Recently, as foreign exchange supply has gradually recovered and the CBT has resumed FX purchases, the Turkish lira liquidity gap has narrowed significantly, and the effective cost of funding has aligned more closely with the policy rate, moving down from the upper band. Despite this, the bank remains cautious, keeping the overnight interbank rate relatively high, though we observed a slight drop from 49% to 48.6%.

When it comes to the timeline of potential rate cuts, CBT officials have avoided providing clear signals. Moving forward, the bank will closely monitor international reserve developments, monthly inflation data, economic activity trends, and residents' portfolio decisions, all of which will influence its monetary policy stance. If global economic growth slows further and oil prices fall at a faster rate than expected, the CBT may accelerate its rate-cutting cycle to reduce the policy rate more aggressively. Currently, the prevailing expectation for a policy rate cut is the July MPC meeting, though given that the effective cost of funding has already returned to the policy rate, we do not rule out an earlier move.

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