Creating Opportunities

Economic Watch

Türkiye | The CBRT keeps interim inflation targets

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In the first inflation report of the year, the Central Bank (CBRT) maintained their interim inflation targets (36% by end 2024 and 14% by end 2025). Even though the recent minimum wage hike was above their previous assumption, the expected improvement in the underlying inflation trend was the main reason not to revise the current targets. In this regard, the current 45% policy rate will be maintained for a longer period of time and the monetary policy stance will be tightened if necessary. They will monitor the inflation outlook and the rebalancing in demand conditions in February and March. If there is no improvement in the monthly inflation trend as expected they will have to take additional steps towards tightening. We assess the CBRT will primarily use credit policies in addition to ongoing quantitative tightening measures. Hiking the policy rate above 45% will also be likely, in our view. If the policy rate is kept at 45% throughout the year, contrary to our previous downward bias, we evaluate risks are now balanced on our year-end inflation forecast of 45%.

On inflation, the CBRT expects seasonally adjusted monthly trend to reach 3% on average this year with a level declining to 1.5% in 4Q (2-2.5% in our expectations given our expectation of significant energy price hikes for households) from its current level of 6-6.5% in January (its 3-month average corresponding to nearly 4% as used by the CBRT). Parallel to the latest MPC communication, the CBRT assessed the existing monetary tightening level was adequate to establish the targeted disinflation path. Indeed, they acknowledge the potential non-linear impact from above expected minimum wage hike on the inflation trend. However, they feel confident since the deterioration in January inflation was in line with their November projections, and evaluate that this worsening will be temporary given the much faster than expected improvement in inflation trend until December. Additionally, they state the latest required reserves decisions (incentivizing certain KKM conversion thresholds in order to pay remuneration interest) will be as effective as the August measures and they have already started to observe some upward impact on TL deposit rates. It is also positive to hear that “it is very early to talk about the timing a rate cut from today”.

In this respect, February and March inflation figures will be key to check for any improvement as the CBRT expects. If the monthly inflation trend proves to be stickier, they will have to take additional steps towards tightening. Even though we evaluate credit policies and additional quantitative tightening measures will be primarily preferred, we also do not rule out the possibility of hiking the policy rate above 45%.

Our financial conditions index most recently signals somewhat an easing in overall conditions, keeping upside risks on inflation outlook, given still solid domestic demand growing above supply. Second, strong services prices keep inertia high, led by a wage-prices spiral. Third, the latest data shows a robust exchange rate pass-through to inflation at a level around 55% according to our calculations. Last but not the least, inflation expectations are far above the Central Bank’s interim targets with 42% for the end of this year and 24% for end 2025. The likelihood of an acceleration in fiscal impulse will also add challenges on the targeted disinflation path. This is why we eliminate our previous downward bias and evaluate that risks are now balanced on our year-end inflation forecast of 45% in a range of 38-52% with 70% confidence band.

It seems that the CBRT prefers to bet on anchoring inflation expectations by not revising their inflation targets at least limitedly. Since their communication might not have shown the needed hawkishness to do so, we assess converging expectations to the targeted levels now becomes more difficult. It is true that there exist many uncertainties on the required level of adjustment, given the interconnectedness of the current distortions. Nonetheless, the negative ex post real interest rate levels will continue for some time, therefore we think that the signaling impact will remain key and a clearer commitment (an explicit rate hike signal rather than the reassessment on the monetary stance) -if necessary- will enhance the monetary transmission mechanism.

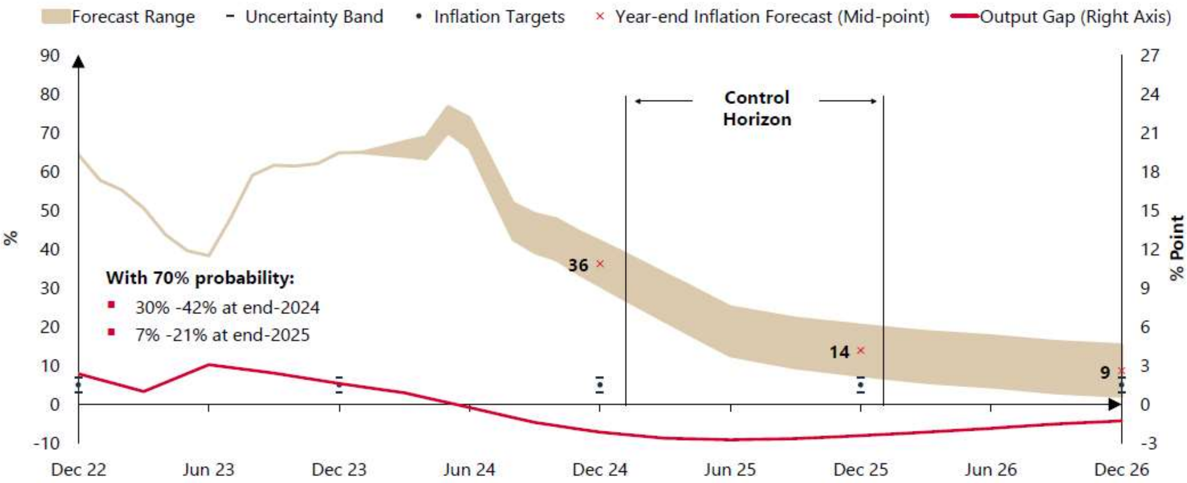
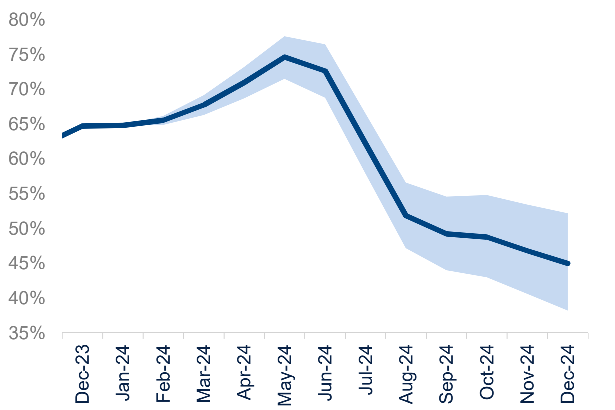


Chart 1. **Revisions on CBRT CPI Projections**

	2024
Nov23 Inflation Report Forecast	36%
Jan24 Inflation Report Forecast	36%
Total Revision	**0**
Factors behind the revision (pp)	
Unit labor cost	1.5
Import prices (TL)	0.5
Output gap	0.4
Food prices	0.9
Administrative prices	-0.1
Decline in monthly inf trend	-3.2
Total Revision	**0**

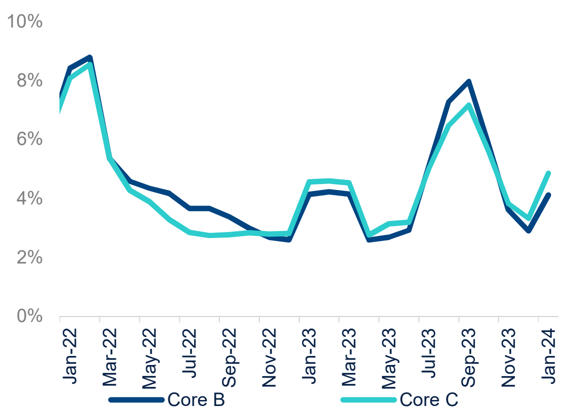
Source: CBRT

Chart 2. **Garanti BBVA CPI Forecasts (YoY, %, 70% confidence band)**



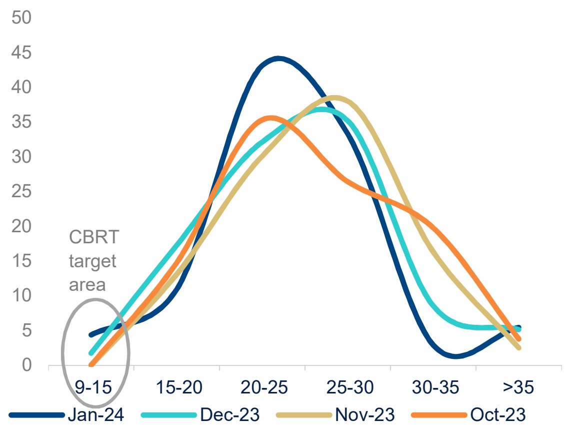
Source: Garanti BBVA Research, CBRT

Chart 3. **Trend CPI Indicators (SA, MoM, 3M avg)**



Source: Garanti BBVA Research, TURKSTAT

Chart 4. **CBRT Market Participants Survey Inflation Expectations (24M ahead, probability distribution)**



Source: Garanti BBVA Research, CBRT

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