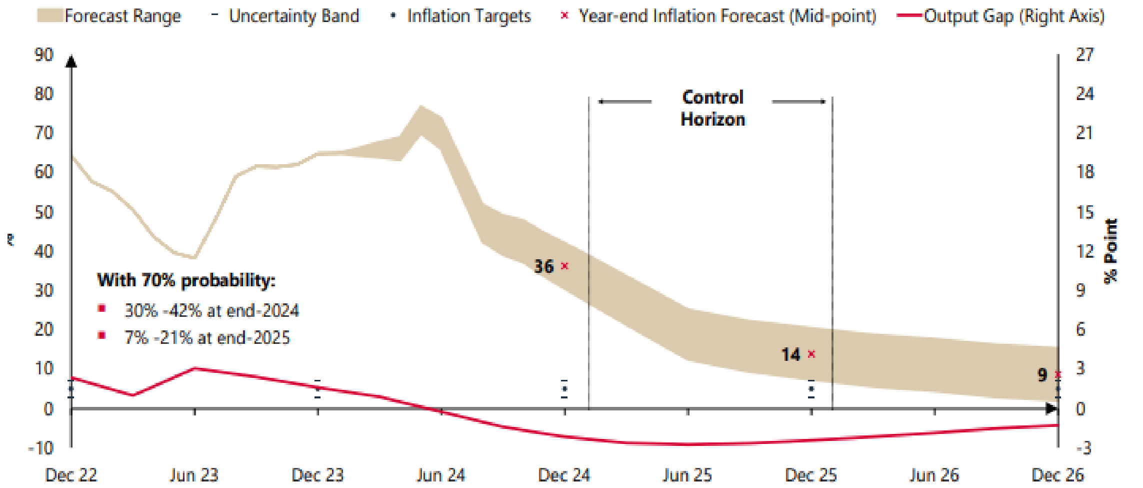
Macro: Inflation forecasts were maintained with the change in the forward guidance on the monetary stance

1. Forecasts

In the 2024-I Inflation Report, CBRT kept its year-end inflation forecasts for 2024 and 2025 at 36% and 14%, respectively, while sharing year-end inflation for 2026 as 9%. (Chart 1).

Chart 1. 2024-I Inflation and Output Gap Forecasts



Sources of forecast revision: According to the accounting presented for the 2024 year-end inflation forecast, the stronger realization of aggregate demand conditions and wage increases than the CBRT's previous forecasts, as well as the upward revision of TL-denominated import price and food price assumptions were the factors that pushed the forecast upwards. In our note evaluating the January MPC decision (Macro: CBRT ended the rate hike cycle), we noted that the additional inflationary impact of cost and demand-side developments on the CBRT's 2023-IV Inflation Report scenario is at least 3 points. In this regard, we stated that it would be difficult to keep the year-end forecast unchanged without changing the monetary stance. As a matter of fact, at the press conference, it was communicated that "the policy rate will be kept at its current level for a longer period compared to the previous report" and the underlying trend of inflation will follow a weaker course. Thus, the year-end inflation forecast remained unchanged (Table 1 and Chart 1).

Table 1. Revisions to Inflation Forecast for 2024

	2024
IR 2023-IV Forecast (%)	36
IR 2024-I Forecast (%)	36
Forecast Revision as Compared to IR 2023-IV Period (% Point)	**0**
Sources of Forecast Revisions (% Point)	
Output Gap	+0.4
Unit Labor Cost	+1.5
Import Prices in Turkish Lira	+0.5
Food Prices	+0.9
Underlying Trend of Inflation	-3.2
Administered Prices	-0.1

2. Assumptions

External demand: The assumption on export-weighted global growth index has not changed. External demand is assumed to grow by 2.0% in 2024. In 2025, external demand conditions are assumed to improve slightly, but expected growth (2.3%) is below the historical average.

Food prices: Food inflation was above the CBRT's forecast in 2023. The assumption for 2024 was revised up by 3.6 percentage points to 34.6%, while the assumption for 2025 was set at 15%. Noting that food inflation has been 8.6 percentage points above the CPI in the last 4 years, we believe that the food inflation assumption for 2024 is a bit optimistic under current demand and cost conditions.

Commodity prices: In the last 3 months, oil prices realized at lower levels compared to the assumptions in the last report. The average oil price assumption was lowered from $88.7 to $83.6 for 2024 and was set as $81.2 for 2025.

Economic activity: Output gap forecasts revised slightly upwards (Chart 1 and Table 1).

- Although demand conditions have started to rebalance, domestic demand conditions are still strong and demand-side risks stemming from the recent minimum wage hike were highlighted. In forecast accounting, aggregate demand conditions are more inflationary compared to the last reporting period.
- We calculate that the illustrated output gap path is consistent with a growth forecast of around 2.0% for 2024. In the previous report, we estimated the implied growth rate for 2024 at around 1.5% (Macro: A plausible disinflation story that compromises growth). For 2025 and 2026, we think the projected growth is 3.0% and 6.0%, respectively.
- When translating output gap forecasts to growth forecasts, the potential growth assumption becomes important. Table 2 presents the growth forecasts implied by the output gap under different quarterly potential growth assumptions:

Table 2. Growth Forecasts Implied by Output Gap Forecasts (%)

	Quarterly Potential Growth (%)		
	0.8	**1.0**	**1.2**
2024	0.6	1.2	2.0
2025	1.4	2.2	3.0
2026	4.3	5.1	6.0

Exchange rate: Although not explicitly shared in the inflation reports, we assess that the inflation forecast continues to be based on the assumption that TL/USD will be depreciation gradually to 36 at the end of 2024.

3. Our Evaluations

Forecasts are close to our forecasts for the first half of the year. The inflation trend seems to improve rapidly in the second half, with a more pronounced improvement in the last quarter.

- CBRT expects inflation to enter a downward trend after peaking at around 73% in May.
- Regarding the disinflation path, monthly average inflation is assumed to be around 3.0% in February-June, 2.5% in July-September and 1.5% in October-December.
- Based on the visualization in the report, we calculate a seasonally adjusted average monthly inflation rate of 1.0% (annualized 12.7%) for the October-December period.

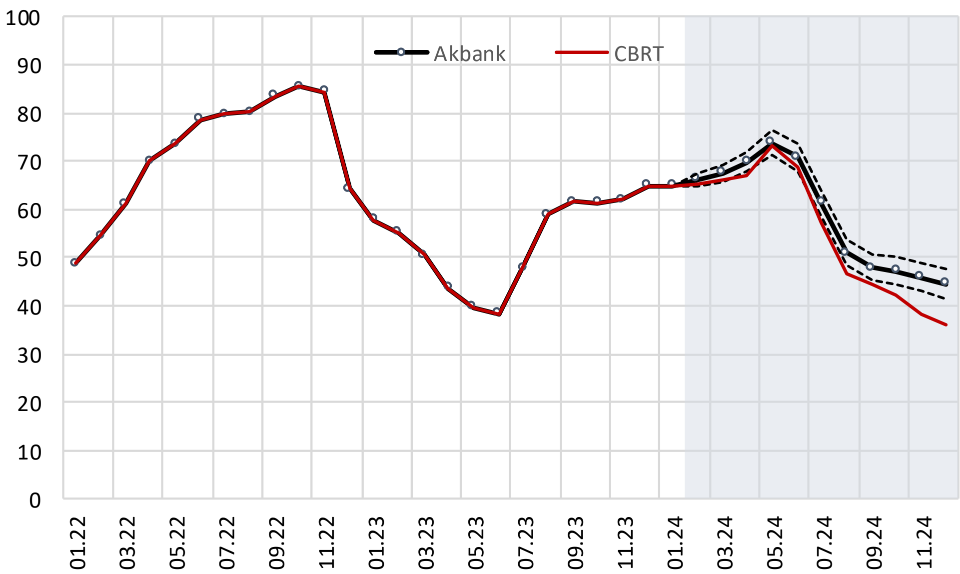
As long as inflation remains within the forecast band, no further rate hikes are likely, in line with past communication.

- The messages in the January MPC decision were strongly repeated. As a novelty, the message that "**we will maintain the current interest rate level for a longer period of time compared to the previous report**" aims to prevent the expectation of an early interest rate cut.
- The current monetary stance is considered to be **tight enough in absolute** terms. A possible additional rate hike is subject to a somewhat imprecise condition: "The monetary stance will be tightened in case inflation deviates from the projected path in a significant and persistent manner", does not clarify what the real target is. For instance, the question of whether the monetary stance will be revised if inflation hovers close to the upper bound of the forecast band for a while remains unanswered.
- In the event that the desired decline in the inflation trend is not recorded in the second half of the year and the conditions for additional tightening are met, we consider the timing of a possible rate hike important, as the policy response will concern inflation in 2025 rather than the end of 2024.

Under the current monetary and fiscal stance, we believe that inflation is unlikely to remain within the forecast band at the year-end.

- We think that current cost and demand conditions present a more inflationary outlook compared to the CBRT's baseline scenario.

Chart 2. Annual Inflation Forecasts



Source: CBRT, Akbank.
Note: CBRT forecast path is derived from the Chart in the Inflation Report by ourselves.

- Under the assumptions that (i) the policy rate will be kept unchanged at 45% until the end of the year, (ii) fiscal policy will adopt a supportive stance with a primary budget deficit similar to last year, (iii) the controlled depreciation of the exchange rate will continue throughout the year, (iv) Brent oil price will hover around $80 on average (v) due to cumulative cost pressures, household electricity and natural gas prices will be raised substantially after the elections, (vi) there will be no further adjustment to the minimum wage in the middle of the year, and (vii) growth will slow down more moderately throughout the year compared to the inflation report projections, the average of our models points to a year-end inflation forecast close to 45% (between 41.4% and 47.6%) (Chart 2).

- We may revise our forecast downwards in case of a tighter macro policy stance compared to these assumptions. Despite the assumption in the report that "minimum wage will not be revised in the second half of the year", we consider the possibility that the energy price adjustments we anticipate for the post-election period may lead to the need for an additional adjustment in wages as a significant upside risk factor on our baseline forecast.

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