Macro note – 2024/IV Inflation Report

In the last inflation report of the year, CBRT rises its year-end inflation forecast for 2024 by 6 percentage points to 44%. Pressures from food prices and inflation inertia increase the upside risks to inflation...

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In its latest inflation report for 2024, the Central Bank shared the outlook for the local and global economies, developments in the real sector and financial markets, and medium-term forecasts. According to the August Inflation Report, CBRT raised its year-end inflation forecasts for 2024-2025-2026 to 44%, 21% and 12%, respectively (previously 38%, 14% and 9%, respectively). The end-2024 inflation forecast was revised up by 1.6 points for food prices, 0.2 points for TL-denominated import prices, 0.3 points for the output gap and 3.9 points for the inflation trend/inertia. Some revisions were also made to assumptions compared to the previous reporting period. In this context, the export-weighted growth index remained unchanged, oil prices were revised down by 3.1 USD to 81.1 USD, import prices were revised up by 0.1 point to 0.8% and food inflation was revised up by 6.3 points to 41.8%. Despite the tight monetary policy, underlying inflation and inertia remain high and deviate upwards from CBRT forecasts. The recent significant increases in unprocessed food prices compared to the previous inflation report also led to an update in the year-end inflation forecast. With the current outlook, we think that the possibility of a rate cut will be postponed by at least one quarter to the first months of 2025, and in case of unforeseen shocks, this period may be further delayed.

The highlights of the overall assessment of the inflation report are as follows: "Compared to the previous reporting period, inflation on a global scale displayed an outlook more in line with the targets. Labor markets continued to normalize, while inflation rigidities in the services sector continued to weaken. The global risk appetite, which deteriorated rapidly in early August due to geopolitical developments, recession concerns and the surprise interest rate hike by the Bank of Japan, improved in the following period, yet the recovery remained limited due to geopolitical risks and uncertainties stemming from the US election process. While financial conditions remain tight, the share of TL in deposit composition continues to increase. Both annual and quarterly growth rates declined in the second quarter. Indicators for the third quarter suggest that domestic demand has continued to slow down, approaching levels supportive of disinflation. Seasonally adjusted employment growth continued in the third quarter, diverging from other demand and production indicators. The improvement in the current account balance gained momentum in the third quarter on the back of the significant decline in the foreign trade deficit and the continued strength in the services balance. Medium-term forecasts are based on an outlook in which the tight monetary policy stance will be maintained and the coordination between economic policies will be strengthened until a significant and lasting improvement is achieved in the inflation outlook". The retreat in economic indicators in line with inflation is the main sign of the cooling in the economy. However, despite the pullback in demand, shocks from outside the control of monetary policy (unprocessed food, etc.) limit the significant decline in inflation.

In the section on the revisions in forecasts and their sources, the following explanations are given "End-year inflation forecasts for 2024, 2025 and 2026 have been revised to 44 percent, 21 percent and 12 percent, respectively. With 70 percent probability, inflation is projected to be between 42 percent and 46 percent with a mid-point of 44 percent at the end of 2024; between 16 percent and 26 percent with a mid-point of 21 percent at the end of 2025; and between 6 percent and 18 percent with a mid-point of 12 percent at the end of 2026. Inflation is projected to stabilize around the inflation target of 5 percent in the medium term. Forecasts are based on an outlook in which the tight monetary policy stance will be maintained and the coordination between economic policies will be strengthened until the inflation outlook displays a significant and lasting improvement."

In sum, the Central Bank raised its year-end inflation forecasts for 2024-2025-2026 to 44%, 21% and 12%, respectively, in its final inflation report for 2024. Pressures from food prices and inflation inertia in particular limit downward movements in price dynamics. The year-end forecast, which converged to market expectations, showed that the fight against inflation may take more time than envisaged. Increased uncertainty over the duration and maturity of disinflation increases volatility and pressures in financial markets. Postponed expectations for the rate cut cycle exacerbate selling pressure or increase the demand for risk-free assets. The CBRT, which effectively utilizes both the monetary transmission mechanism and macroprudential measures, has once again stated that it is determined to use all instruments to bring current inflation closer to the forecast path. We would like to state that we find the revisions made by the CBRT more realistic than the forecasts in the previous report period. If the global economy does not deteriorate and the CBRT maintains its decisive stance, we expect that the targeted levels can be achieved in the medium term.

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