Summary of the Monetary Policy Committee Meeting

30 April 2019, No: 2019-18

Meeting Date: 25 April 2019

Inflation Developments

1. In March, consumer prices were up by 1.03% and annual inflation rose by 0.04 points to 19.71%. In this period, annual inflation increased in food and energy groups while it decreased in the core goods group. The rise in annual food inflation was driven by the significant hike in prices of fresh fruits and vegetables. Energy prices rose mainly due to international oil prices and exchange rate developments. While services inflation followed an almost flat course, the slowdown in core goods inflation continued across all subgroups. Against this background, core inflation indicators suggested a continued deceleration in annual inflation, and the underlying trend of core indicators remained low.

2. Annual inflation in food and non-alcoholic beverages rose by 0.52 points in March to 29.77%. Unprocessed food prices, led by fresh fruit and vegetable prices, had a decisive role in this development. The processed food group posted moderate price increases while annual inflation in this group declined.

3. Energy prices were up by 1.94% and annual energy inflation rose by 1.84 points to 16.41%. This rise is mainly attributed to the rising fuel and bottled gas prices in tandem with exchange rates and the outlook for international oil prices.

4. In March, annual core goods inflation dropped by 1.30 points to 19.92%. In this period, annual inflation decreased across all subgroups. The decline in durable goods prices was mainly driven by the fall in automobile prices while the new season price hikes in the clothing group remained below those of the previous year. Annual inflation in other core goods lost pace but still remained high. To sum up, the moderate course of core goods inflation is attributed to weak domestic demand.

5. Services inflation rose month-on-month by 0.07 points to 15.21%. Annual inflation slightly decreased in restaurants-hotels, rents, and transportation services whereas it increased in the other services subgroup. The decline in annual inflation in transportations services was led by local passenger transportation. Meanwhile, the increase in prices of maintenance-repair services as well as in prices of education services driven by private school fees constituted the most significant factor affecting other services inflation. Despite the slow course of domestic demand, services inflation remained elevated due to the cost factors as well as the backward-indexation behavior.

Factors Affecting Inflation

6. In the final quarter of 2018, GDP decreased by 3.0% on an annual basis and by 2.4% on a quarterly basis. Thus, growth in 2018 was 2.6%. While the contraction in economic activity in the final quarter of 2018 was driven by domestic demand conditions, net exports continued to underpin growth and the rebalancing trend in the Turkish economy became more apparent.

7. Recently released data show that the rebalancing trend in the economy continues. Economic activity displays a slow pace due to tight financial conditions. The rise in public expenditures, extended tax cuts on durable goods and the partial rebound in loan volume underpinned a moderate recovery in domestic demand in the first quarter. Accordingly, while a partial recovery is observed in economic activity compared to the previous quarter, the contribution of aggregate demand conditions to disinflation continues. The recent rise in financial volatility and risk premium indicators increases the downside risks to the domestic demand outlook.

8. Despite recent signs of a global slowdown, particularly for the EU, external demand remains relatively strong. Firms' orientation towards external markets amid sluggish domestic demand and their flexibility in market diversification stimulate exports of goods; lagged exchange rate effects, subdued loans and economic activity dampen import demand; and external balance continues to improve rapidly on brisk tourism demand. Thus, the current account balance is expected to maintain its improving trend in the upcoming period.

9. Labor market data confirm the slowdown in economic activity. The data for January 2019 suggest that nonfarm employment was down across all sectors compared to the previous period, construction in particular; while unemployment remained on the rise.

Monetary Policy and Risks

10. Economic activity has lost further momentum across the world, particularly in the EU, since the previous MPC meeting. The ongoing political uncertainty surrounding the EU, the current trade conflict between the US and China and geopolitical tensions have led to higher uncertainty over global economic policies and persistently fragile financial markets, which feeds into the downside risks to global economic activity.

11. Supply-side effects may pose upside risks to prices for international crude oil and other commodities in the upcoming period. If such risks materialize, the monetary policy response will ensure to keep the possible deterioration in inflation expectations and the pricing behavior under control.

12. The improvement in the risk appetite due to the postponed normalization of monetary policy across advanced economies has provided a partial boost for portfolio flows to emerging economies.

13. Developments in domestic demand conditions have led to some improvement in inflation indicators. However, higher food and import prices and the elevated course of inflation expectations point to continued risks to price stability. Accordingly, the Committee has decided to maintain the tight monetary policy stance until the inflation outlook displays a significant improvement, and kept the one-week repo auction rate, i.e. the policy rate, unchanged at 24%.

14. The Committee, at its meeting, evaluated the medium-term projections that are envisaged to be included in the April Inflation Report. Projections are based on an outlook in which the

country risk premium that has increased in recent weeks due to geopolitical factors and uncertainties would recover in response to a partial normalization of those factors as well as to a tight monetary policy stance and the inflation-focused macro-policy mix. In the event that the recovery of the risk premium and financial volatility indicators are delayed, inflation and exchange rate expectations may hamper the disinflation process.

15. The Central Bank will continue to use all available instruments in pursuit of the price stability objective. Factors affecting inflation will be closely monitored and monetary stance will be determined to keep inflation in line with the targeted path.

16. The fiscal policy outlook that the monetary policy is based on incorporates a policy stance that focuses on price stability and macroeconomic rebalancing and that is coordinated with the monetary policy. Accordingly, the monetary policy stance assumes that administered price and tax adjustments are formulated in a way that will help reducing the backward indexation behavior. If the fiscal policy significantly deviates from this framework leading to an adverse impact on the medium-term inflation outlook, the monetary policy stance may be revised.

17. Collective efforts to turn the recently enhanced coordination between monetary and fiscal policies into a sustained and systematic structure are expected to support the achievement of price stability. Moreover, continued structural steps focusing on reducing rigidity and volatility in inflation will contribute to price stability and therefore social welfare.