Press Release on the Summary of the Monetary Policy Committee Meeting

23 January 2020, No: 2020-04

Meeting Date: 16 January 2020

Inflation Developments

1. In December, consumer prices increased by 0.74% while annual inflation rose by 1.28 points to 11.84%, slightly below the forecast presented in the October Inflation Report. In this period, while annual inflation rose across subgroups, the rise in the services group remained more limited. Energy inflation posted the most noticeable increase in December due to the low base effect from the same period last year. Food inflation remained on the rise driven by both unprocessed and processed food subcategories. Annual inflation in core goods increased due to cost factors as well as the low base effect from the same period last year. Against this background, although annual inflation in core indicators was slightly up, B and C indices maintained their mild trend.
2. Annual inflation in the food and non-alcoholic beverages group rose by 2.00 points to 10.89% in December. This rise was mainly driven by price movements in the processed food group. While price developments in dairy products were noticeable following the increases in purchasing prices of raw milk, the recent uptrend in bread and cereals prices continued. The rise in unprocessed food inflation in December was mainly driven by the other unprocessed food group, while inflation in fresh vegetables and fruits posted a limited increase and remained low at the year-end. Leading indicators signal that despite significant increases in vegetable prices, unprocessed food inflation may slow down in January due to the base effect.
3. Energy prices inched up by 0.16%, while annual energy inflation increased by 3.64 points to 10.98% due to base effects in December. This increase is attributed to the hikes in bottled gas and fuel prices driven by the rise in oil prices and the recent exchange rate developments. The sliding-scale tariff in fuel prices and the decline in municipal water prices limited a more adverse outlook in energy prices. It should be noted that annual inflation in the energy group will also rise significantly in January due to base effects.
4. Annual core goods inflation increased by 0.91 points to 7.48% in December, partly due to the low base effect from the same period last year. In this period, annual inflation increased in clothing and durable goods but slightly decreased in other core goods. The increase in durable goods prices is attributable to depreciation of the Turkish lira. Although clothing and footwear prices posted a more limited decline compared to seasonal averages in December, annual inflation in this group remained significantly low. All in all, the trend of core goods inflation remained almost flat.
5. Services prices increased by 0.37% in December, and annual services inflation rose by 0.14 points to 12.30%. Annual inflation increased slightly in communication and other services,

but declined in transport services and remained almost flat in restaurants-hotels services and rents. The underlying trend of services inflation also inched down. In the upcoming period, the real unit labor costs stemming from minimum wage developments, the tourism demand and the backward-indexation behavior are envisaged to shape the outlook for services prices.

6. The improvement in inflation expectations continues. The downtrend in the medium-term inflation expectations continues to be widespread and the distribution of expectations implies an increased consensus among survey participants, which indicates that uncertainties regarding the medium-term inflation outlook have significantly decreased.

Factors Affecting Inflation

7. Recent data indicate that moderate recovery in economic activity continues. Industrial production posted a month-on-month increase in November and remained on a path of recovery with a rise of 0.7% in the October-November period compared to the previous quarter. Underlying trend in industrial production is stronger after adjusting for temporary fluctuations in sectors with high historical volatility. Survey indicators and foreign trade data indicate that the uptrend in industrial production will continue in December as well.

8. The decline in risk premium and exchange rate volatility as well as the improvement in financial conditions supported domestic demand considerably in the last quarter. Despite the weakness in the labor market, private consumption has been increasing on the back of postponed demand. In addition, public expenditures continued to boost growth through the consumption channel.

9. Sectoral diffusion of economic activity continues to improve. Survey indicators such as the CBRT Business Tendency Survey, PMI and sectoral confidence indices hint at an ongoing increase in the manufacturing industry and services activities. Although investment remains weak, tendencies for investment and employment including that of small and medium-sized firms are recovering. The Committee emphasized the importance of stable growth and demand for a sustainable improvement in investment and employment.

10. While favorable effects of improved competitiveness prevail, weakening global economic outlook tempers external demand. In addition to the EU, signals for a slowdown in MENA countries increased in this period. While flexibility in market diversification and strong course in tourism support exports of goods and services, the recovery in domestic demand stimulates imports. Against this background, in the last quarter of the year, it is expected that the contribution of net exports to economic growth will decline, and the current account balance, which has recently recorded a significant improvement, will maintain a moderate course with the contribution of supportive policy measures.

11. The labor market data for the October period indicate an increase in nonfarm employment including the construction sector as well, and a decline in the unemployment rate. Compared to the previous period, industrial and construction employment posted an upsurge, while the rise in services employment remained limited. Leading indicators signal that the partial improvement in unemployment rates continues, while the weakness in the labor market prevails.

12. In sum, in the upcoming period, as the contribution of net exports to economic growth declines, economic recovery is expected to be sustained with the help of the ongoing disinflation process and improvement in financial conditions.

Monetary Policy and Risks

13. Global economic activity remains weak in both advanced and emerging market economies. The Phase 1 trade deal between the US and China partially improved the expectations that global trade tensions could ease. Nevertheless, with high tariffs still in place, many issues unresolved and uncertainty over the fulfillment of commitments, trade disputes keep the downside risks to global economic activity alive. The resulting likely effects on domestic growth are monitored closely.

14. Crude oil prices have been more volatile and risen significantly since the previous MPC meeting due to recent geopolitical developments. However, sluggish global economic activity weighs on commodity prices. Thus, after an uptick in the fourth quarter, global headline inflation is expected to remain flat in 2020.

15. Weakness in global economic activity and low levels of global inflation strengthen expectations regarding the continuation of expansionary monetary policies in advanced economies. The expectation that recently adopted accommodative stance of monetary policies in advanced economies, the US in particular, is likely to be maintained over a medium term horizon under current circumstances, and its implications for global financial conditions have paved the way for expansionary policies in emerging market economies as well. Current global financial conditions and the recent partial improvement in expectations regarding global trade support the demand for emerging market assets and the risk appetite. Accordingly, portfolio flows towards emerging economies have presented a more favorable outlook compared to the previous meeting period. Nevertheless, rising protectionism, uncertainty regarding global economic policies and geopolitical developments are closely monitored for their impact on capital flows, international trade and commodity prices.

16. Turkey’s country risk premium continued to decline owing to a cautious monetary policy stance and improved macroeconomic indicators as well as the accommodative monetary policies in advanced economies. However, upside risks regarding global and geopolitical uncertainties on the medium-term inflation outlook through country risk premium and exchange rate volatility channels will continue to be monitored closely.

17. The strong rate cuts since July, lower inflation expectations and improved banking liquidity helped bring loan and deposit rates further down. Thus, TL-denominated loans, consumer loans in particular, remained on the rise thanks to improved financing conditions and recovering domestic demand. This rise can be attributed to supply-side effects caused by expectations for the overall economic outlook as well as postponed loan demand and loan restructuring.

18. The more flexible and effective use of required reserves as a countercyclical macroprudential tool in this period supports credit growth and financial stability. The aim of the reserve requirement practice introduced on 9 December 2019 was to channel credit supply towards production-oriented sectors rather than consumption and encourage the use of long-term commercial loans that have a strong relation with production and investment, and long-term mortgage loans that have a weak relation with imports. In the upcoming period, with the improvement in liquidity and capital adequacy ratios of the banking sector, the fall in interest rates and adjustments in required reserves are expected to further support credit growth. In addition, NPLs and Stage 2 loans are monitored closely for any impact they might have on banks’ loan supply in the short term. Employment and income developments will determine the persistence of recent rate cut-driven rebound in loan demand. The pace, scope and

sustainability of normalization in credit conditions will be important for the outlook for economic activity.

19. Inflation outlook continued to improve and inflation expectations sustained their widespread decline. The improvement in macroeconomic indicators, inflation in particular, supports the fall in country risk premium and helps contain cost pressures. Developments in the exchange rate, domestic demand conditions and producer prices have contributed to a mild trend in core inflation indicators. The course of inflation is considered to be broadly in line with the year-end inflation projection. Accordingly, considering all factors affecting the inflation outlook, the Committee decided to make a measured cut in the policy rate. At this point, the current monetary policy stance remains consistent with the projected disinflation path.

20. The Committee assesses that maintaining a sustained disinflation process is a key for achieving lower sovereign risk, lower long-term interest rates, and stronger economic recovery. Keeping the disinflation process in track with the targeted path requires the continuation of a cautious monetary stance. In this respect, monetary stance will be determined by considering the indicators of the underlying inflation trend to ensure the continuation of the disinflation process. The Central Bank will continue to use all available instruments in pursuit of the price stability and financial stability objectives.

21. The Committee emphasized the importance of sustaining the improvement in the country risk premium for the price and financial stability objectives. In this context, in order to support the effectiveness of the monetary policy and minimize a likely inflation-growth trade-off, it will be crucial that macro-financial policies are determined with a focus on reducing financial volatility and risk premium, and that the predictability of the fiscal policy continues to be reinforced.

22. 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 reduce 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.

23. Collective efforts to turn the recently enhanced coordination between monetary and fiscal policies into a sustained and systematic framework 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.

24. It should be emphasized that any new data or information may lead the Committee to revise its stance.