TÜRKİYE CUMHURİYET MERKEZ BANKASI

Summary of the Monetary Policy Committee Meeting

24 March 2020, No. 2020-19

Meeting Date: 17 March 2020

Inflation Developments

1. In February, consumer prices rose by 0.35% and annual inflation increased by 0.22 points to 12.37%. The rise in annual inflation of both unprocessed and processed food groups constituted the main factor that drove up consumer inflation. The fall in international oil prices triggered a decrease in fuel prices, leading to a decline in annual energy inflation. Services inflation slightly increased in February while core goods inflation remained mild. Against this background, annual inflation in B and C indicators rose moderately but they maintained a relatively flat trend.
2. Annual inflation in food and non-alcoholic beverages increased by 1.54 points to 10.58% in February. Led by fresh fruits-vegetables and red meat, unprocessed food prices surged on a seasonal basis. Although annual inflation in this group was driven up by this surge, it remained at historically low levels. The recent strong uptrend in processed food prices somewhat weakened in February, and annual processed food inflation increased to a limited extent. Bread and cereals continued to be the main driver of this increase, followed by fats and oils as well as meat products.
3. Energy prices dropped by 0.63% in February, and annual energy inflation decreased by 1.60 points to 15.54%. This was mainly driven by fuel prices that dropped due to the fall in international oil prices notwithstanding the depreciation in the exchange rate. Leading indicators for March signal that energy prices will decline on a monthly basis, and annual energy inflation will significantly decrease due to base effects as well.
4. In February, annual core goods inflation fell by 0.30 points to 7.05%. In this period, annual inflation remained flat in clothing and footwear group while it slightly decreased in durable goods and other core goods. Durable goods prices declined in February, with continued impact of the VAT reduction in furniture. On the other hand, gold prices rose due to exchange rate effects and international developments, keeping annual inflation in this group elevated.
5. Prices of services rose by 0.84% in February and annual services inflation increased by 0.29 points to 12.49%. In this period, annual inflation was up in transport, rents and other services and flat in restaurants-hotels and communication. Among other services, the increases in maintenance-repair, healthcare services and package tours stand out, all of which are highly sensitive to exchange rate changes, while prices for recreation and culture services also saw a notable increase. Services inflation will likely be determined by real unit labor costs and backward indexation in the upcoming period, whereas, the measures taken to offset the

economic impact of the coronavirus outbreak and weakened demand conditions will put some restraint on services inflation through related sectors.

6. Inflation expectations remained moderate in March, and the distribution of expectations pointed at a strengthened consensus among survey participants.

Factors Affecting Inflation

7. GDP data for the fourth quarter of 2019 suggested that economic activity strengthened on the back of domestic demand thanks to improving financial conditions and accelerating loans. In this period, private consumption spending remained on the rise while public spending continued to be supportive through the consumption channel. Investments remained weak, some recovery notwithstanding. Meanwhile, despite continued increase in exports, net exports made a negative contribution to annual and quarterly growth due to rising imports.

8. Current data suggest that economic activity remains robust for the January-February period, and its sectoral diffusion continues to improve. The acceleration in loans buoyed up domestic demand, while investments and employment showed signs of recovery but nevertheless remained weak.

9. Favorable effects of improved competitiveness and the partial recovery in global growth helped exports remain on the rise through January and February. On the other hand, import demand continued to surge due to the outlook in loans and domestic demand.

10. As of March, the outbreak of the coronavirus pandemic has begun to weigh on economic activity through foreign trade, tourism and domestic demand channels. Contracted global trade volume and restricted travel rights confine exports and transportation activities. Moreover, possible effects of aggravated uncertainties and volatility in the financial markets on the domestic demand are monitored closely. Despite the deceleration in exports and tourism revenues, the sizeable decline in energy prices in the upcoming period is likely to cause the current account balance to follow a mild course.

11. In the December period, the fall in unemployment rates continued with the decline in the participation rate. The partial recovery in construction employment continued compared to the previous period, whereas industrial employment receded, and services employment remained flat. While leading indicators show that unemployment rates will decline further in the first quarter, outlook in the labor market amid the limiting effects of the pandemic on economic activity is closely monitored.

Monetary Policy and Risks

12. The fast spread of the pandemic on a global scale aggravates uncertainties and deteriorates global growth prospects. Global monetary policies grew more supportive of economic activity within the scope of emergency measures to minimize the financial and economic impacts of the pandemic. While central banks in advanced and emerging economies have taken coordinated expansionary measures, comprehensive sets of fiscal policy measures have been introduced in many countries to support households and firms. Meanwhile, persisting financial volatilities and measures to slowdown the spread of the disease weigh on aggregate demand conditions on a global scale. Impacts of these factors on domestic growth, especially through exports, tourism and related sectors are monitored closely. Monetary policy instruments could be readjusted depending on the size and persistence of the effects of

measures, such as travel restrictions and uncertainties, on economic activity and labor market through the domestic demand channel.

13. Along with the downturn in global economic activity that limits the demand for commodities, increased volatility in financial markets led to plummeting prices in commodities, with crude oil and metals in the lead. Moreover, supply-side effects driven by disagreements among oil exporters regarding the amount of oil production keep crude oil prices subsided. Against this background, and also with the weakening global growth outlook, global inflation rates are expected to be lower in 2020.

14. Meanwhile, heightened uncertainties regarding the recent coronavirus outbreak and the liquidity crunch caused a sharp downturn in global equity and bond yields as well as a decline in risk appetite and the demand for emerging market financial assets. The evolving global impact of the pandemic disease on capital flows, financial conditions, international trade and commodity prices as well as policy actions taken towards limiting this impact are closely monitored.

15. In the period preceding the coronavirus outbreak, Turkey's macroeconomic indicators improved significantly. A sustained fall in inflation and a sizable adjustment in the current account were achieved. The recovery of economic activity became stronger along with the improvement in financial conditions. In this period, foreign currency indebtedness of nonfinancial firms decreased; liquidity and capital buffers of the banking sector strengthened. The achievements of the rebalancing process have increased the resilience of the Turkish economy against unfavorable shocks. Nevertheless, the increase in financial volatility and expected slowdown in aggregate demand are closely monitored for their impact on firms' cash flows and balance sheets. Accordingly, necessary measures will continue to be taken in coordination with other policies.

16. In order to contain negative effects of the coronavirus pandemic on the Turkish economy, it is of crucial importance to ensure the healthy functioning of financial markets, the credit channel and firms' cash flows. Accordingly, with an aim to support financial stability, the Central Bank implemented a comprehensive set of measures. With the objective of containing possible adverse effects of the global uncertainty led by the coronavirus pandemic on the Turkish economy, the CBRT has announced a series of measures aiming at (i) enhancing predictability by providing banks with flexibility in Turkish lira and foreign exchange liquidity management, (ii) offering targeted additional liquidity facilities to banks to secure uninterrupted credit flow to the corporate sector, (iii) boosting cash flow of exporting firms through arrangements on rediscount credits.

17. Additionally, considering that downside risks to the year-end inflation projection increased, the Committee decided to cut the policy rate by 100 basis points. Developments in inflation expectations, domestic demand conditions and producer prices have contributed to a mild trend in core inflation indicators. Despite the recent depreciation in the Turkish lira due to global developments, the sharp fall in international commodity prices, especially crude oil and metal prices, affects inflation outlook favorably. Furthermore, due to the weakening in global trade and measures such as travel restrictions, the disinflationary effect of aggregate demand conditions has increased to some extent. The policy rate cut, along with other measures taken, is expected to contribute to ensuring healthy functioning of financial markets and supporting the cash flow of the corporate sector. The Central Bank will continue to use all available instruments in pursuit of the price stability and financial stability objectives.

18. The Committee assesses that maintaining a sustained disinflation process is a key factor 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.

19. The Committee assessed that it is essential to sustain the coordination between monetary and fiscal policies to minimize the pandemic disease-related economic risks. The multifaceted effects of the pandemic on the economy call for coordinated policy actions aiming particularly at smoothing cash flows and stabilizing employment in order to minimize the impact on firms and households. Therefore, it is considered to be of critical importance that macro-scale monetary and fiscal policies are complemented with policy measures that target the most-affected economic units also by considering sectoral interactions. Meanwhile, ensuring that policy measures are designed in a targeted and temporary fashion would support policy effectiveness.

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