Summary of the Monetary Policy Committee Meeting

30 April 2020, No. 2020-26

Meeting Date: 22 April 2020

Inflation Developments

1. In March, consumer prices increased by 0.57% while annual inflation dropped by 0.51 points to 11.86%. Food and energy groups constituted the main drivers of the fall in consumer inflation. Despite the depreciation in the Turkish lira, fuel prices decreased on the back of the fall in international oil prices, and annual energy inflation declined significantly. Meanwhile, the deceleration in food inflation was driven by fresh fruit-vegetable prices. Inflation slightly decreased in services whereas it rose in core goods group due to exchange rate developments. 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 declined by 0.53 points to 10.05% in March. Annual unprocessed food inflation was driven down by fresh fruit-vegetable prices but it rose when this item is excluded. This rise was led by meat prices, followed by increases in prices of pulses. On the other hand, annual inflation in the processed food group increased slightly. While inflation in the bread and cereals group remained elevated, other groups driving processed food inflation up were fats and oils as well as non-alcoholic beverages due to the tax increase in this group.
3. Energy prices fell by 3.12% in March, and annual energy inflation dropped by 5.73 points to 9.81%. This fall was mainly led by fuel prices that decreased in tandem with international oil prices. Leading indicators suggest that the marked decline in annual energy inflation will continue in April.
4. In March, annual core goods inflation rose by 1.13 points to 8.18%. While this rise was observed across all subcategories, it was more pronounced in durable goods inflation. The rise in durable goods prices was predominantly driven by the increases in automobile and furniture prices caused by the depreciation in the Turkish lira, while the seasonal price increase in the clothing and footwear group was somewhat stronger compared to the previous year.
5. Services prices were up by 0.52% in March, and annual services inflation decreased by 0.07 points to 12.42%. In this period, annual inflation slightly rose in transport and restaurants-hotels groups and remained flat in rents and communication, whereas it decelerated in other services group. Among other services, monthly inflation in package tour, maintenance-repair, and recreation and culture services recorded a weak course due to the measures taken against the coronavirus pandemic. Health services prices in this group remained on the rise due to exchange rate developments as well. The pandemic also had an impact on the restaurants-hotels group as inflation in this group was contained by the decrease in

accommodation services prices despite the rise in prices of food and beverage services driven by cost hikes.

6. The improvement in year-end inflation expectations continued in April. However, the inflation forecast uncertainty moderately increased due to uncertainties regarding the course of the pandemic. Accordingly, in 12-month-ahead inflation expectations, probabilities assigned to extreme values in either direction slightly increased.

Factors Affecting Inflation

7. Having displayed a strong upward trend in January and February, thanks to the improvement in financial conditions, economic activity has started to weaken in mid-March due to the effects of the coronavirus pandemic on external trade, tourism and domestic demand. Survey indicators and high-frequency data point that this weakening trend has become pronounced in April, spreading across all sectors. The weakening in services, particularly in tourism-related sectors, has been more accentuated. In the manufacturing industry, orders and capacity utilization rates of main exporting sectors dropped to substantially low levels due to the sharp decline in external demand. Meanwhile, food, paper products, computer and electronic goods, and basic pharmaceutical industries, which periodically record comparatively strong demand, diverge positively in relative terms.

8. Export and tourism revenues are on the decline due to the deterioration in the global growth outlook and travel restrictions. While tourism and related transportation activities have come to a halt, export opportunities are significantly shrinking in motor vehicles, wearing apparel, textile, leather, machinery-equipment, and electrical equipment sectors for which the European region is the main market. On the other hand, import demand is decreasing at a rapid pace in line with the deceleration in economic activity while low levels of commodity prices are restraining the import bill. Against this background, current account balance, which recently recorded significant improvement, is expected to follow a moderate course throughout the year due to the restraining effects of commodity prices and imports.

9. The Committee assesses that the unfavorable effects of the pandemic are temporary and the economy’s recovery, which is expected to be sooner and stronger for domestic demand, will start as of the second half of the year. The pace of the recovery in economic activity will depend on the course of the normalization process in Turkey as well as in the global economy, particularly in our foreign trade partners. Accordingly, to contain negative effects of the 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. In this respect, recent monetary and fiscal measures will contribute to financial stability and post-pandemic recovery by supporting the potential output of the economy.

10. In the January period, the fall in unemployment rates continued while non-farm employment slightly declined led by the industrial sector. Leading indicators suggest that the slowdown in economic activity started to have its impact on the labor market as of mid-March. The Committee assessed that subsidies provided through the unemployment insurance fund and current transfers, short-time work allowance in particular, have played a critical role in limiting the income loss of households and maintaining employment.

Monetary Policy and Risks

11. The coronavirus-led global economic downturn is deepening. Measures to contain the contagion first affected supply chains and production, but demand has also weakened significantly amid heightened uncertainty, tight financial conditions, reduced household

income and worsening cash flows of businesses as the outbreak evolved into a global pandemic. Substantial economic measures are introduced to avoid any permanent damage to employment, supply chains and output capacity. Central banks in advanced and emerging economies continue adopting expansionary policies, and rate cuts, asset purchases, liquidity measures and credit support programs are among the foremost monetary responses to the pandemic. On the fiscal front, spending, tax and credit-related measures have been in place to support the hardest hit sectors and lay out the foundation for a post-pandemic recovery. The effectiveness of these policies for financial markets, growth and employment will depend on how fast the pandemic is contained in each country and how much policy room they have.

12. There remain uncertainties regarding the global and domestic pace of the virus' spread and the normalization process. In this regard, it is still unclear how long the measures taken to prevent the spread of the virus such as travel restrictions, lockdowns and social isolation will last, timing of these measures and how much they will affect consumer behavior and buying habits. A prolonged normalization phase could translate into a much weaker global and domestic growth outlook, calling for additional response measures.

13. Crude oil demand has decreased significantly as economic activity is grinding to a halt across many industries around the globe. While global crude oil inventories are at record-high levels, oil output reductions may still fall short of the decline in demand. Thus, there remain demand-led downside risks to crude oil prices. Amid plunging global demand as well as falling commodity prices, global inflation rates are expected to be moderate throughout 2020.

14. The weakening global risk appetite caused significant rise in financial market volatility. Stock and bond markets in advanced and emerging economies have recently seen major volatility. As substantial capital outflows were observed in emerging economies, Turkey's country risk premium increased, Turkish lira depreciated, and exchange rate volatility rose in line with the overall trend. Once uncertainty about the pandemic declines, the negative impact of global developments on country risk premium and exchange rate volatility will likely fade, also with the help of monetary and fiscal policy measures. As uncertainty still reigns, the pandemic disease is closely monitored for its evolving global impact on capital flows, financial conditions, international trade and commodity prices. Thus, the CBRT will continue to monitor the effects of the pandemic on the Turkish economy and use the tools at its disposal in pursuit of its price stability and financial stability objectives.

15. Before the outbreak, financial conditions have improved considerably thanks to falling inflation and rate cuts, and loan growth has accelerated since the third quarter of 2019. Having lost momentum due to macroprudential measures in the first months of 2020, consumer loan growth has slowed further since mid-March when the first coronavirus case was reported. On the other hand, commercial loans remained on the rise in the first quarter. Monetary, financial and fiscal measures introduced to address the pandemic as well as the expansion of loan supply, mostly by state-owned banks, seem to have mitigated downside risks to loan growth and contributed to the uninterrupted flow of credit to the real sector. In this regard, the Bank will continue to monitor the credit market closely and implement necessary measures to ensure that the credit channel functions smoothly.

16. 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, continued sharp decline in international commodity prices, especially crude oil and metal prices, affects the inflation outlook

favorably. While the rise in unit costs resulting from declining production and sales is closely monitored, the disinflationary effects of aggregate demand conditions are estimated to have increased. In this respect, it is considered that risks to the year-end inflation projection presented in the January Inflation Report are on the downside. Accordingly, the Committee decided to make a 100 basis point cut in the policy rate.

17. 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. The Central Bank will continue to use all available instruments in pursuit of the price stability and financial stability objectives.

18. The Committee assessed that it is essential to sustain the coordination between monetary and fiscal policies to minimize the pandemic-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 be 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.

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