



**TÜRKİYE CUMHURİYET
MERKEZ BANKASI**

**Briefing on
2017-IV Inflation Report**

November 1, 2017

İstanbul

October 2017 Inflation Report: Main Sections

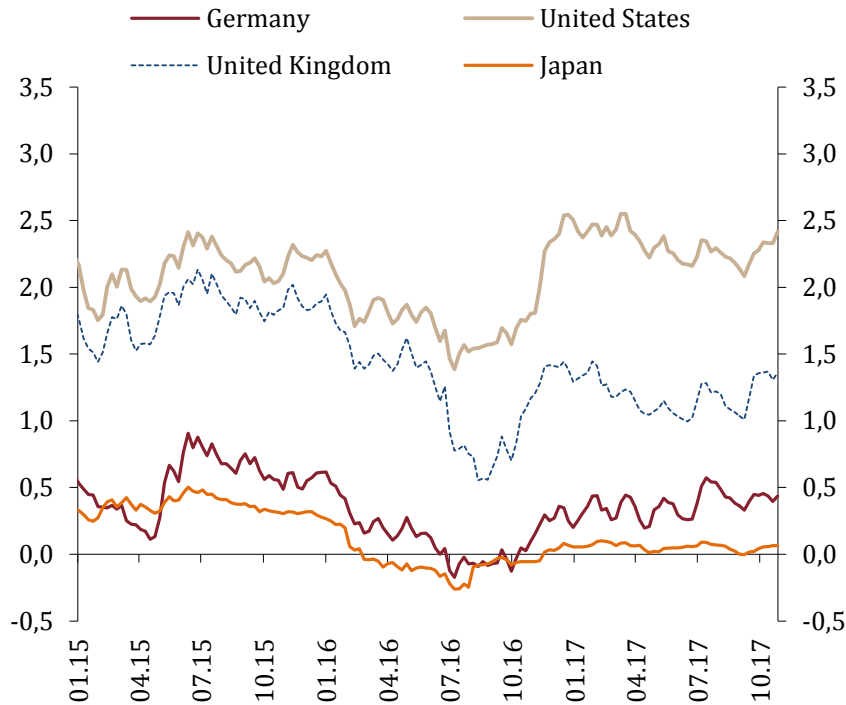
- Overview
- International Economic Developments
- Inflation Developments
- Supply and Demand Developments
- Financial Conditions and Monetary Policy
- Public Finance
- Medium Term Projections

October 2017 Inflation Report: Boxes

- Fed Balance Sheet Reduction and Potential Spillovers
- Pass-Through of Producer Prices to Consumer Prices
- The Improvement in Real Current Account Balance
- Extending the Coverage of Real Effective Exchange Rate Index Based on the Unit Labor Cost
- Capacity Utilization and Implications for Investment in Manufacturing Industry
- The Role of the Credit Channel in Monetary Policy Transmission: A Survey-Based Analysis for Turkey

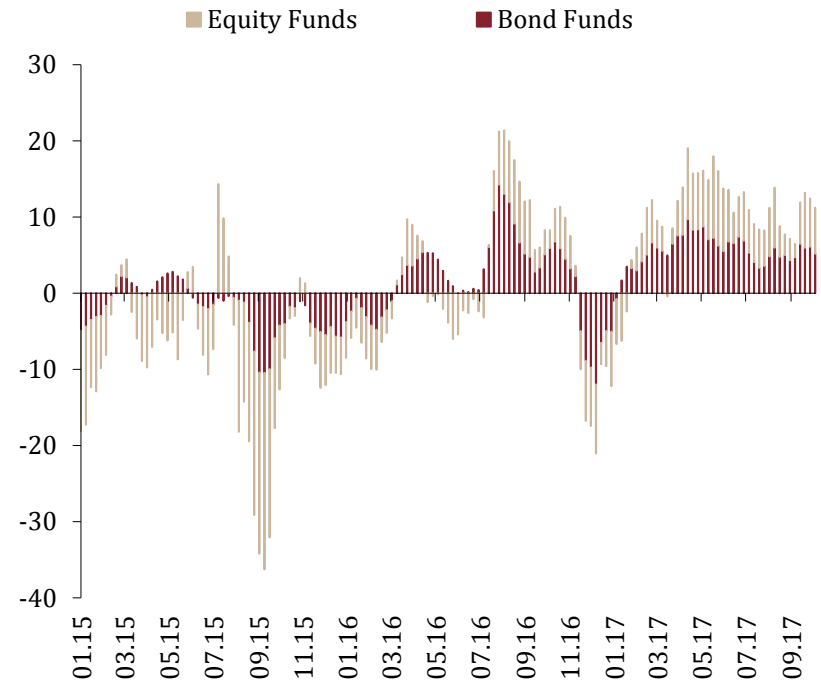
Global Developments and Portfolio Flows

10-Year Bond Rates (Percent)



Source: Bloomberg.

Portfolio Flows to Emerging Economies (4-Week Cumulative, Billion USD)



Source: EPFR.

- In the third quarter, there was a limited rise in the bond yields of advanced economies; bond and stock markets in emerging economies continued to receive strong portfolio inflows.

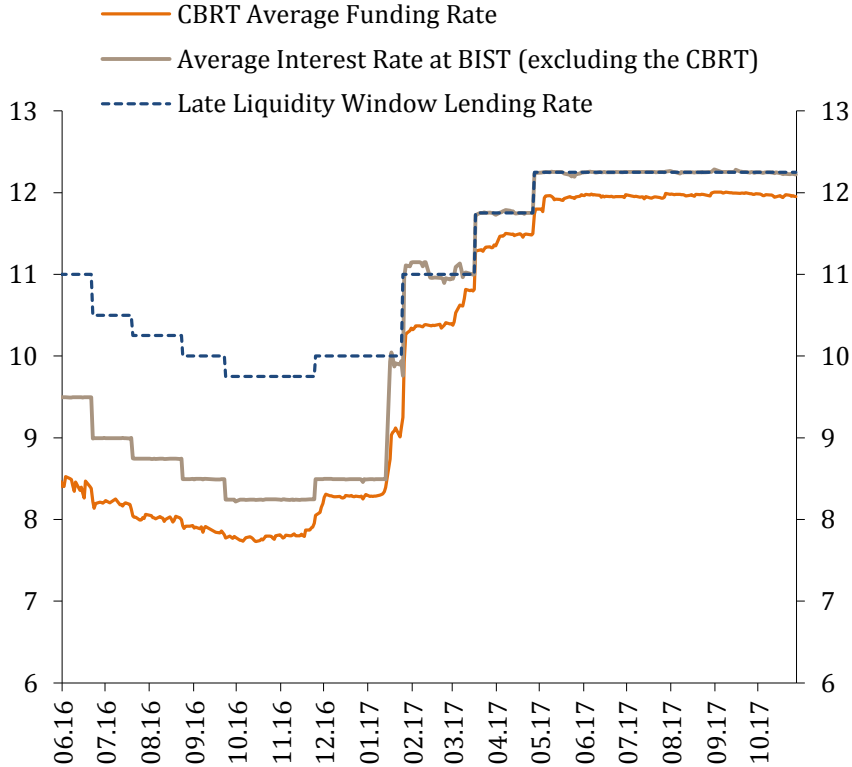
Domestic Economic Outlook

- Exchange rate volatility and risk premium indicators in Turkey performed worse than other emerging market economies relative to end-July.
- The rise in oil prices and the depreciation of the Turkish lira elevated the cost pressures in the third quarter.
- Due to strong economic activity, the disinflationary impact of demand conditions has disappeared.
- Recent data suggest that the economic activity remained robust in the third quarter and the recovery has become more widespread across sectors.
- The contribution of net exports to growth is expected to continue.

Monetary Policy and Financial Conditions

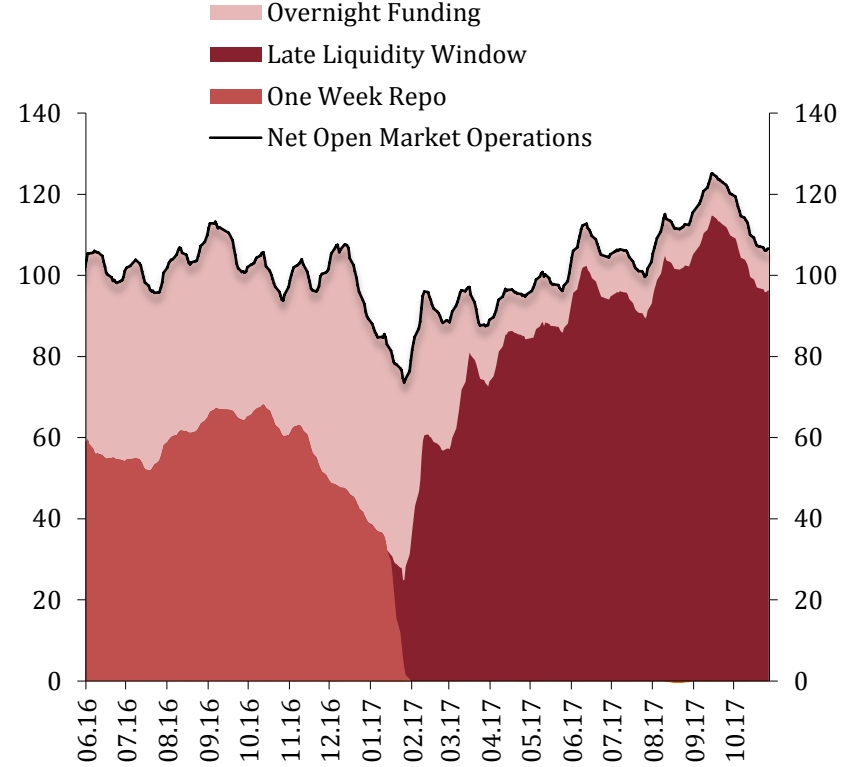
Monetary Policy

Short-Term Interest Rates
(5-Day Moving Average, Percent)



Source: BIST, CBRT.

CBRT Funding
(2-Week Moving Average, Billion TL)

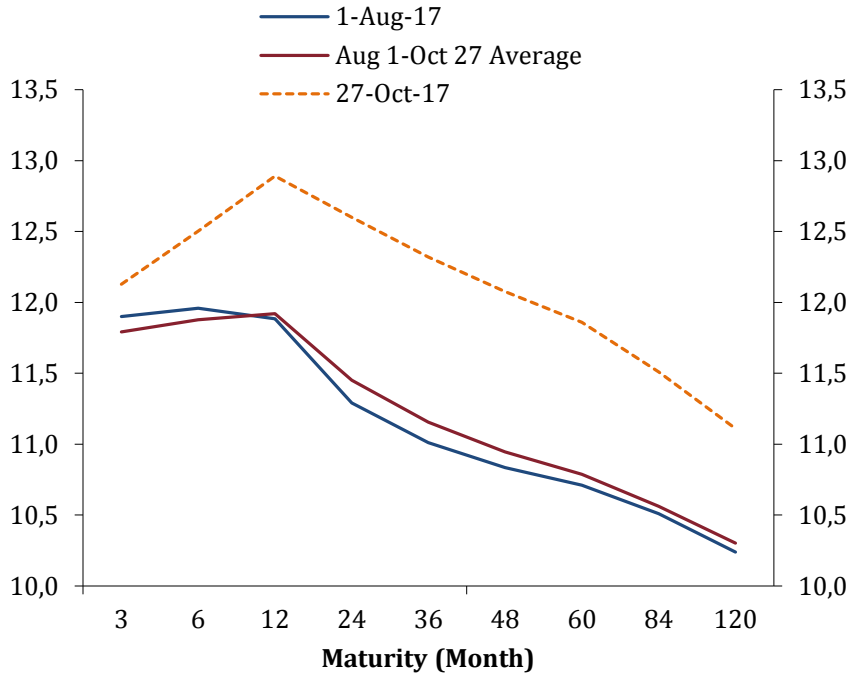


Source: BIST, CBRT.

- CBRT maintained the tight monetary policy stance to contain risks to the pricing behavior.

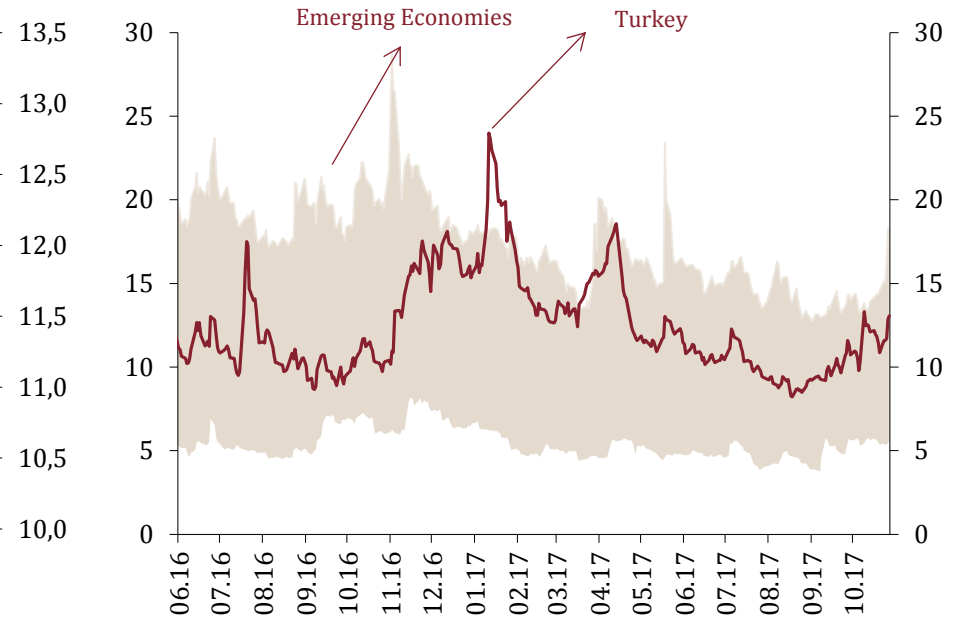
Monetary Conditions

Yield Curve on Cross Currency Swaps
(Percent)



Source: Bloomberg.

Implied FX Volatility*
(1 Month, Percent)



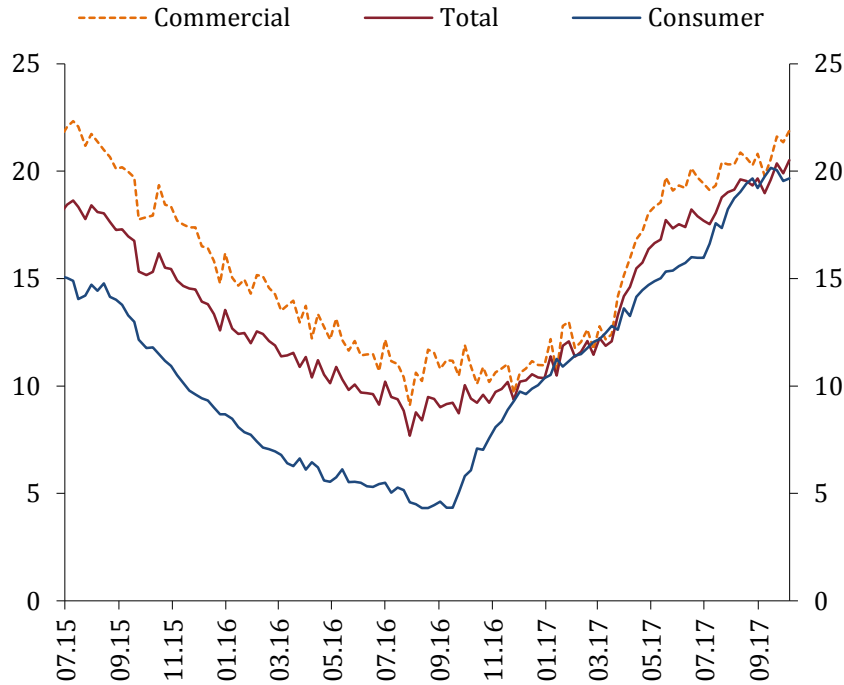
*Emerging economies include Brazil, Chile, Colombia, Mexico, Poland, Philippines, Malaysia, S. Africa, Indonesia, Romania and Hungary.

Source: Bloomberg.

- Since the previous report, currency swap yields have increased, and implied exchange-rate volatility has risen in part due to global and geopolitical developments.

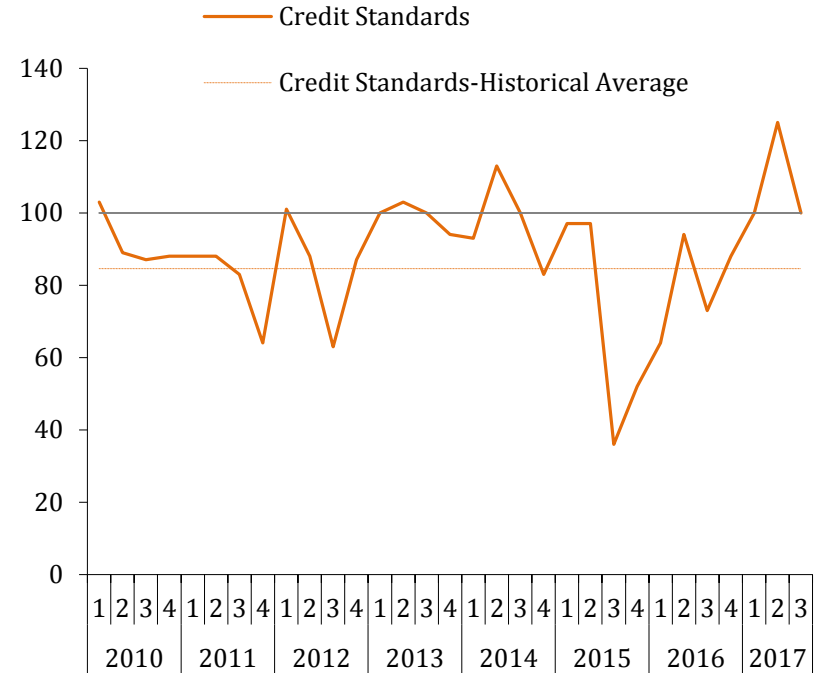
Financial Conditions

Annual Credit Growth
(Adjusted for Exchange Rate, Percent)



Source: CBRT.

Credit Standards for Loans to Enterprises*



*Index values above 100 indicates easing in loan standards.

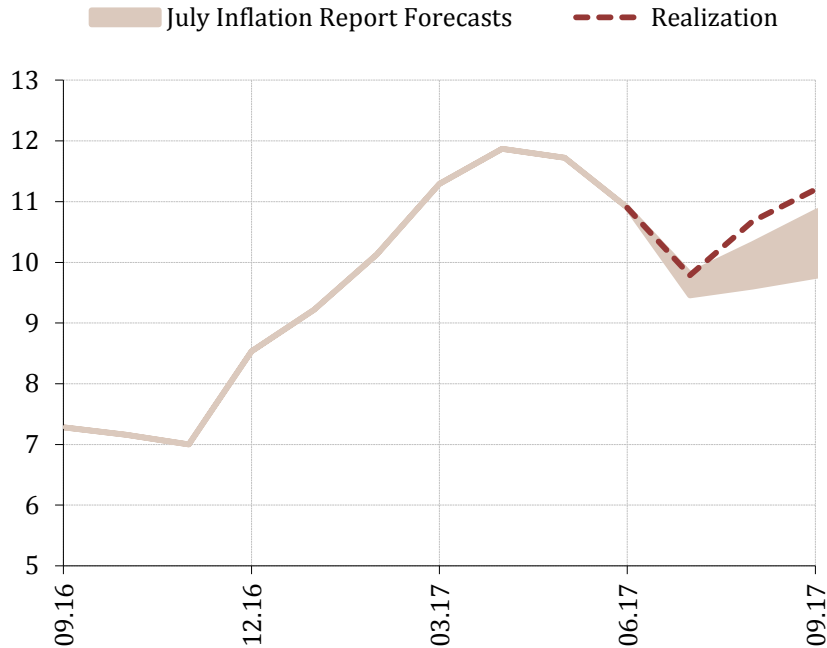
Source: CBRT.

- Credit Guarantee Fund facility neared the pre-determined limits in the third quarter, leading to deceleration in commercial loans; but credit standards continued to support economic activity.

Macroeconomic Developments and Main Assumptions

Inflation

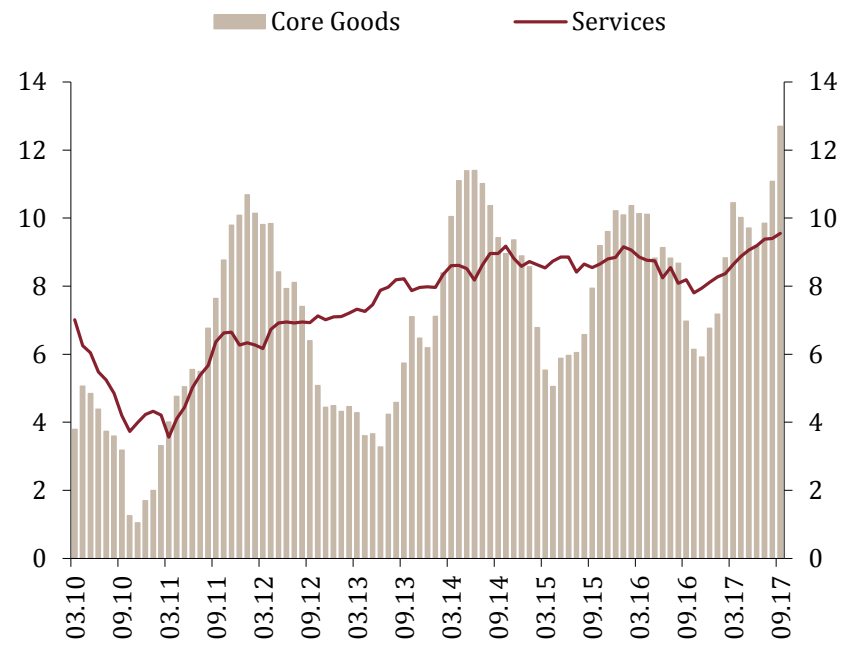
Consumer Inflation*
(Percent)



* Shaded region indicates the 70 percent confidence interval for the forecast.

Source: CBRT, TURKSTAT.

Core Goods and Services Prices
(SA, 3-Month MA, Annualized, Percent Change)



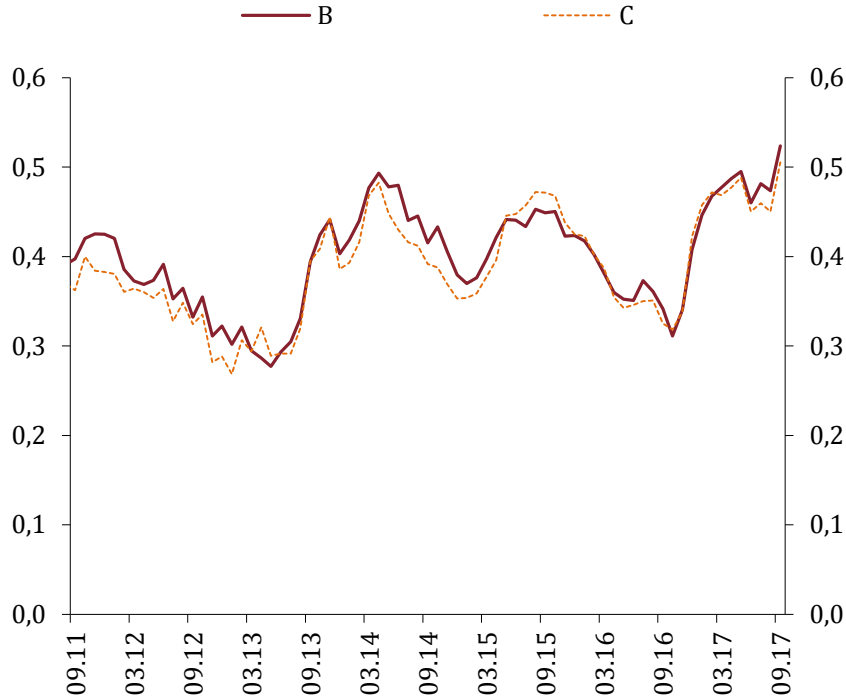
Source: CBRT, TURKSTAT.

- Annual core goods inflation increased due to the Turkish lira's depreciation against the euro, annual services inflation remained on an upward track.
- Consumer inflation remained above the July Inflation Report forecasts in the third quarter.

Inflation

Diffusion Indices for B and C

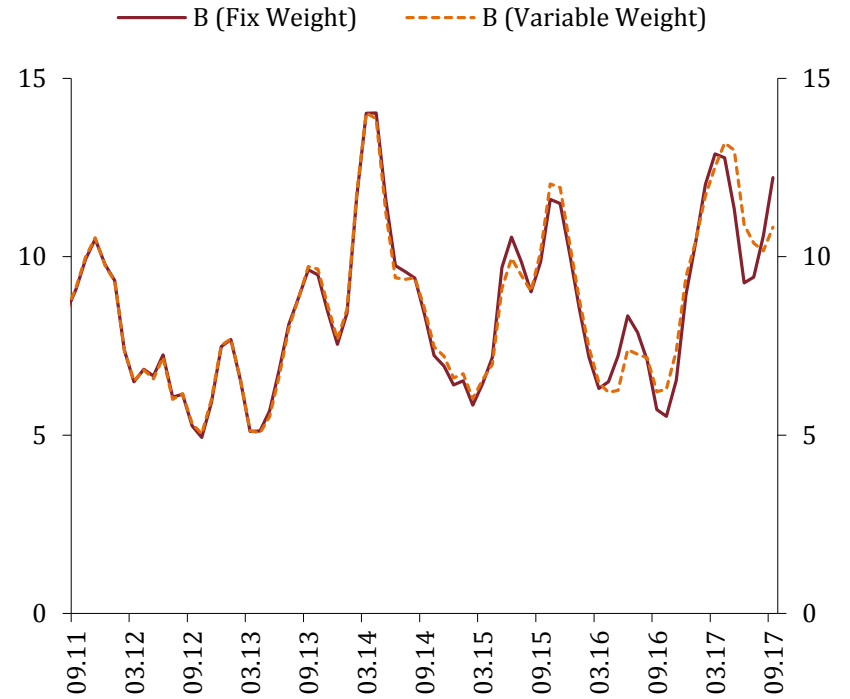
(Seasonally Adjusted, 3-Month Moving Average)



Source: TURKSTAT.

Underlying Trend for B Index

(SA, 3-Month MA, Annualized, Percent Change)

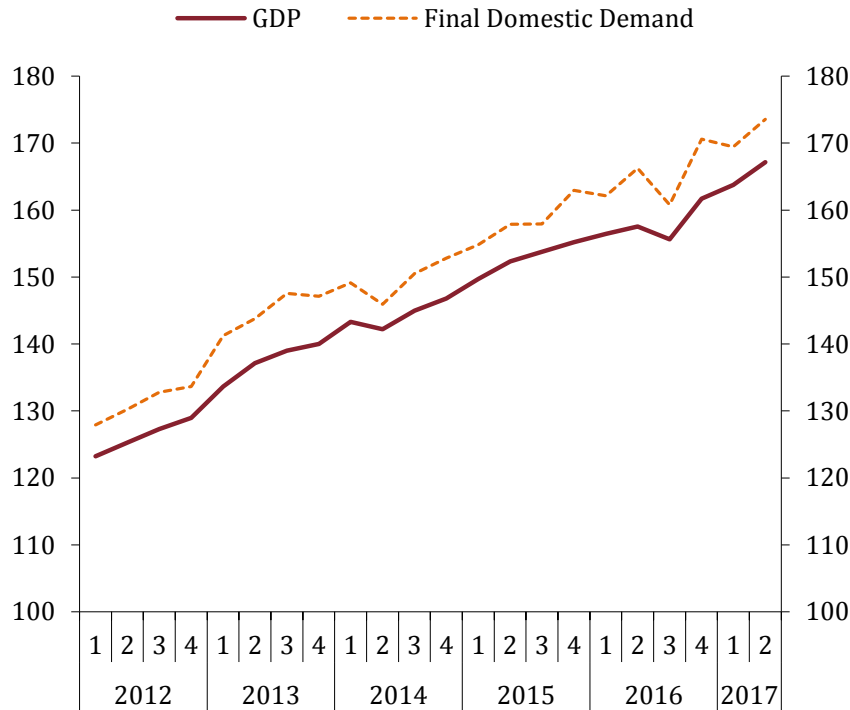


Source: CBRT , TURKSTAT.

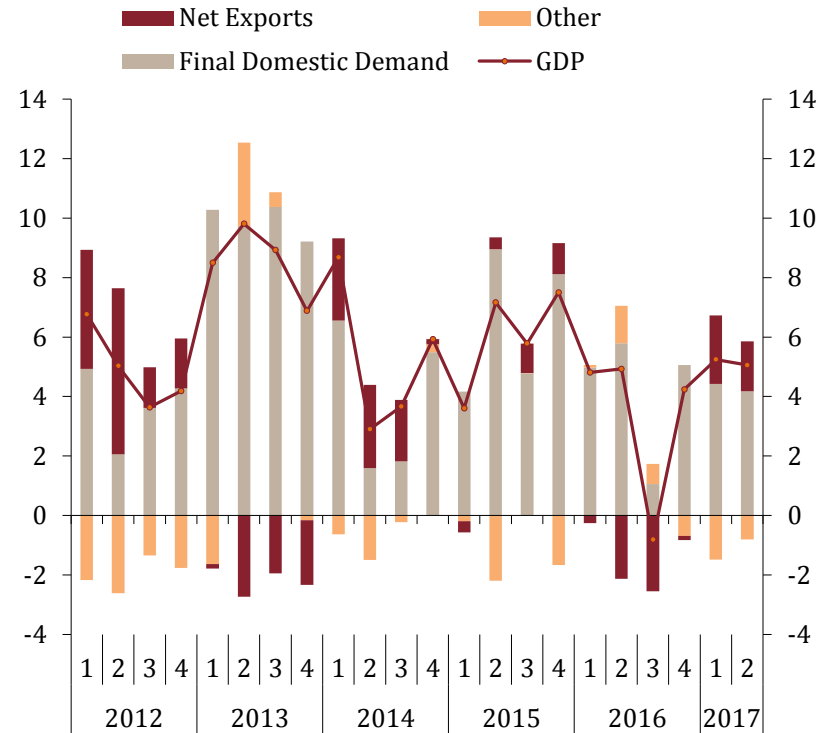
- Diffusion indices suggest a stronger tendency of price increases.
- Adjusted for the methodological change in clothing prices, the core inflation trend receded in July and August, and increased again in September.

Aggregate Demand

GDP and Final Domestic Demand
(Real, Seasonally Adjusted, 2009=100)



Contributions from the Expenditure Side*
(Percentage Point)



* Other item comprises change in stocks and statistical discrepancy due to the use of chain linked index.

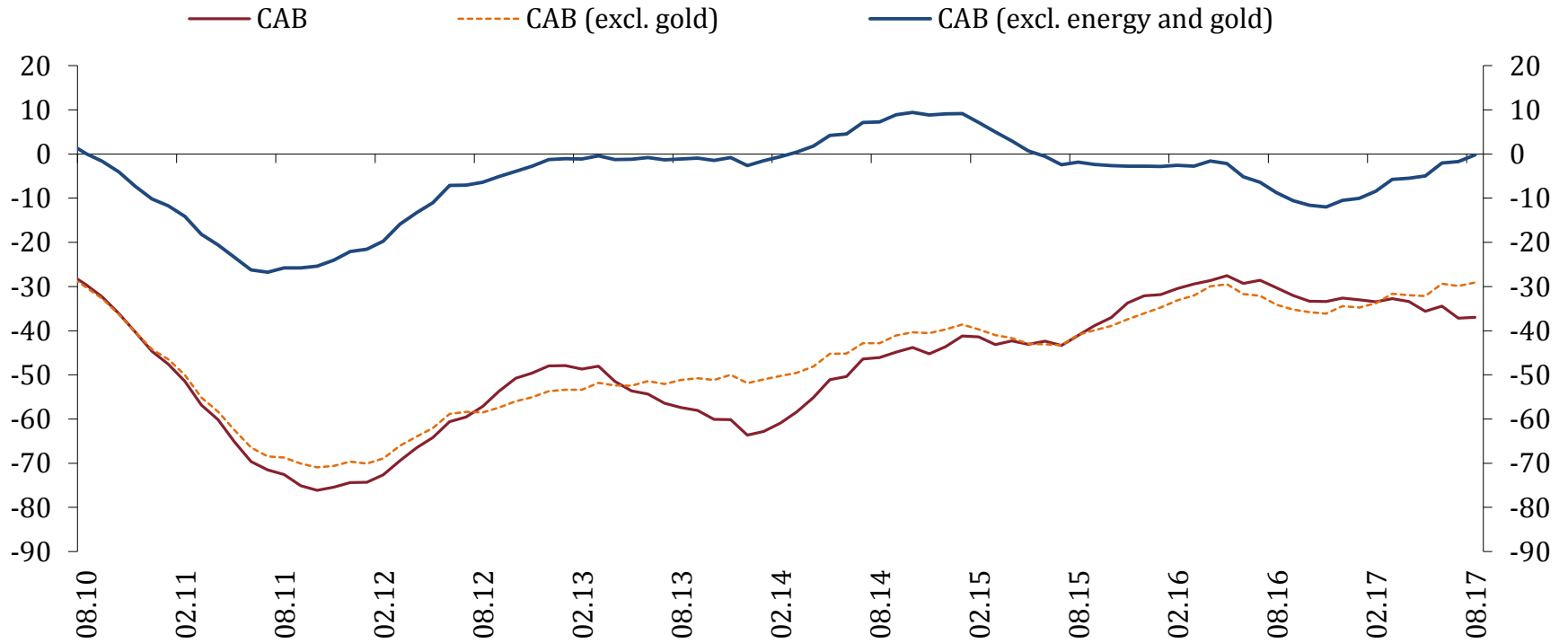
Source: TURKSTAT.

Source: CBRT, TURKSTAT.

- Economic activity in the second quarter proved to be stronger compared to the outlook envisaged in the July Inflation Report.

External Balance

Current Account Balance (CAB) (12-Month Cumulative, Billion USD)

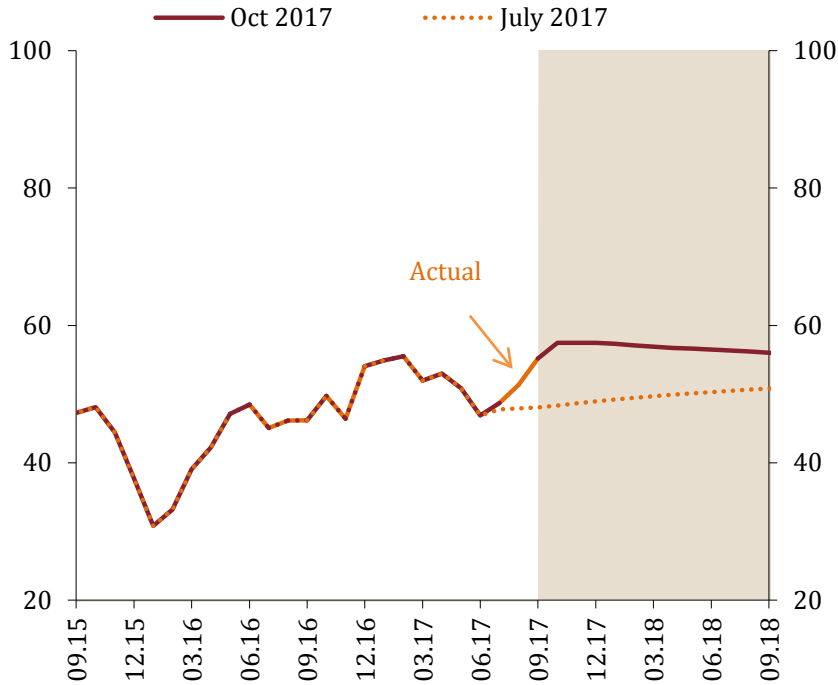


Source: CBRT.

- Current account excluding gold displays a stable course.

Revisions in Oil and Import Price Assumptions

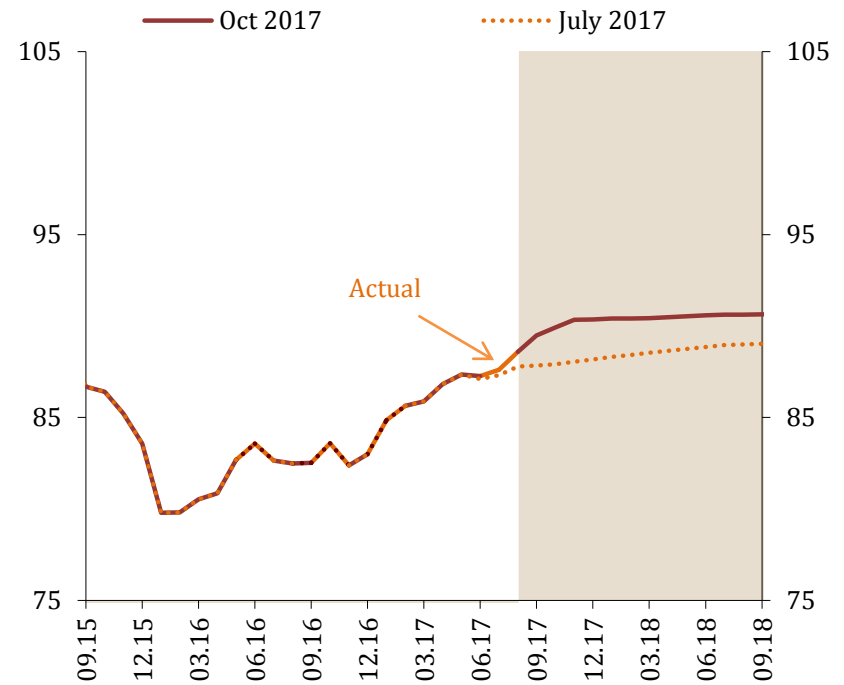
Oil Prices*
(USD/bbl)



*Shaded region indicates the forecast period.

Source: Bloomberg, CBRT.

Import Prices*
(Index, 2010=100)



Source: CBRT, TURKSTAT.

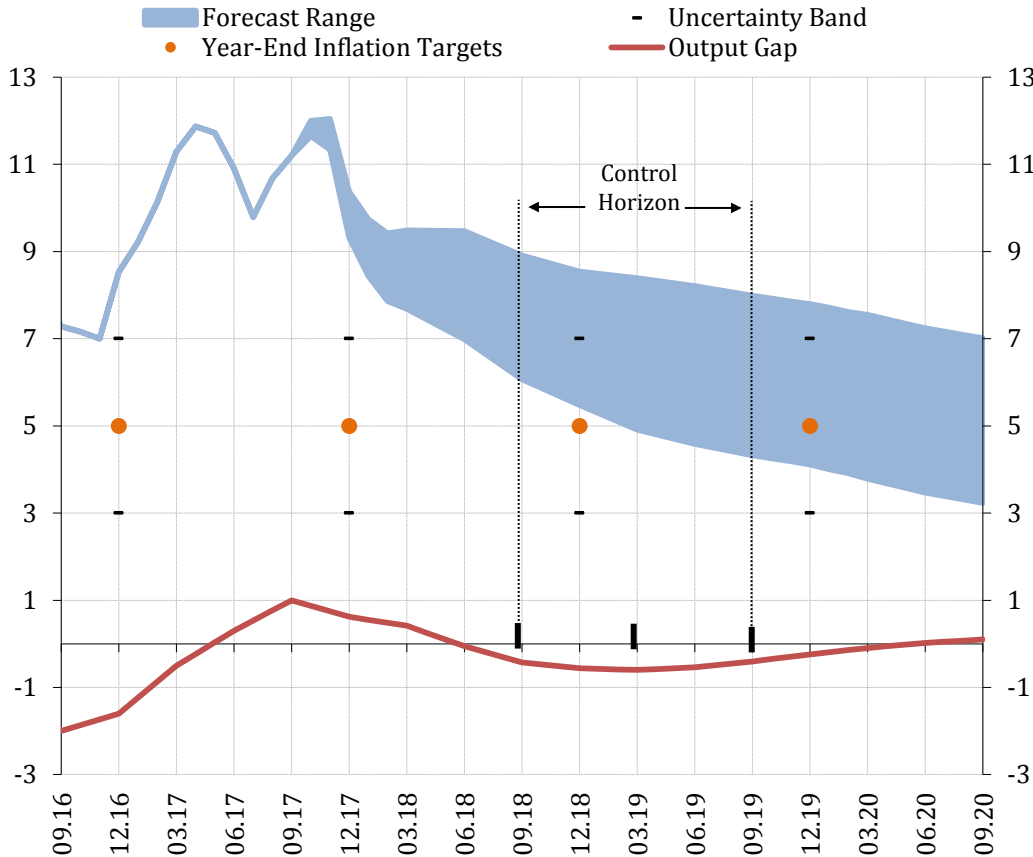
- Assumptions for crude oil prices and USD-denominated import prices were revised upwards for 2017 and 2018.

Revision in Assumptions

		July 2017	October 2017
Output Gap	2017 Q2	-0.6	0.3
	2017 Q3	-0.3	1.0
Food Prices (Year-end Percent Change)	2017	10.0	10.0
	2018	7.0	7.0
Import Prices (Average Annual Percent Change, USD)	2017	6.2	7.1
	2018	2.0	3.1
Oil Prices (Average, USD)	2017	50	53
	2018	50	56
Export-Weighted Global Production Index (Average Annual Percent Change)	2017	2.1	2.3
	2018	2.2	2.3

Inflation Outlook

Inflation and Output Gap Forecasts* (Percent)



*Shaded region indicates the 70 percent confidence interval for the forecast.

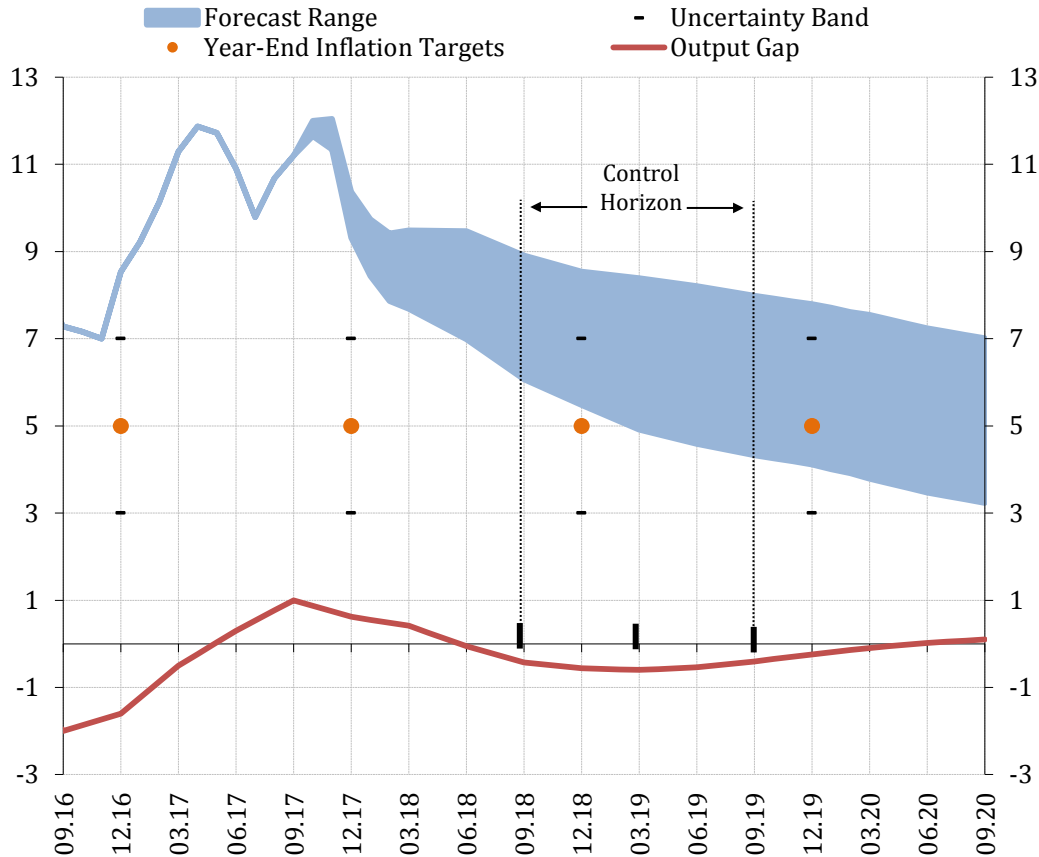
Source: CBRT, TURKSTAT.

- Given a tight policy stance that focuses on bringing inflation down, inflation is estimated to converge gradually to the 5% target.
- Inflation is likely to be 9.8% at end-2017, and stabilize around 5% in the medium term after falling to 7% in 2018 and 6% in 2019.
- Accordingly, inflation is expected to
 - be between 9.3% and 10.3% (with a mid-point of 9.8%) at end-2017
 - be between 5.5% and 8.5% (with a mid-point of 7%) at end-2018

with 70 percent probability.

Inflation Outlook

Inflation and Output Gap Forecasts* (Percent)



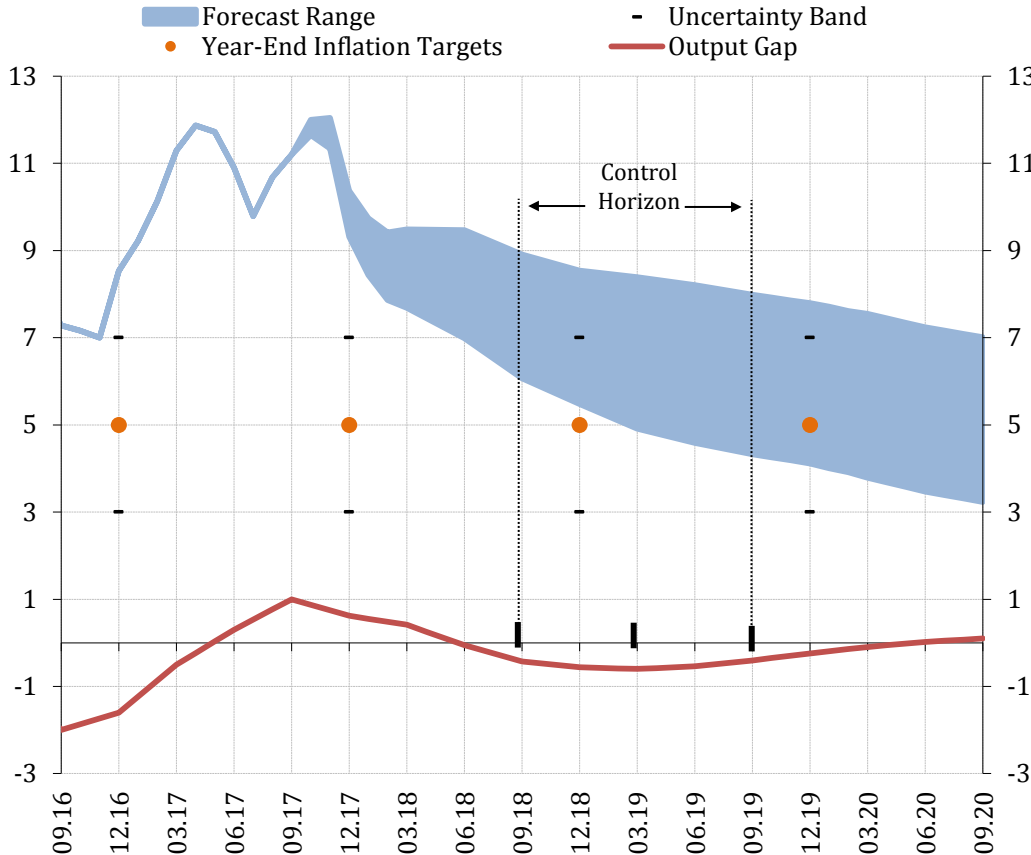
The upward revision in 2017 year-end inflation forecasts by a total of 1.1 points, relative to July Inflation Report, is driven by:

- Upward revision in assumptions for TL-denominated import prices by +0.5 points,
- Upward revision in output gap by +0.4 points,
- Higher-than projected inflation realization at 2017Q3 and the rise in the underlying trend of inflation by +0.2 points.

*Shaded region indicates the 70 percent confidence interval for the forecast.
Source: CBRT, TURKSTAT.

Inflation Outlook

Inflation and Output Gap Forecasts* (Percent)



The upward revision in 2018 year-end inflation forecasts by a total of 0.6 points, relative to July Inflation Report, is driven by:

- Upward revision in assumptions for TL-denominated import prices by +0.4 points
- Upward revision in output gap by +0.1 points,
- The raise in the year-end inflation forecast for 2017 and the increase in the underlying trend of inflation by +0.1 points.

*Shaded region indicates the 70 percent confidence interval for the forecast.
Source: CBRT, TURKSTAT.

Monetary Policy Outlook

- The Central Bank will continue to use all available instruments in pursuit of the price stability objective.
- The Central Bank aims to bring inflation down to 7 percent by the end of 2018, and gradually to 5 percent afterwards.
- Tight stance in monetary policy will be maintained decisively until inflation outlook displays a significant improvement and becomes consistent with the targets.



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