

PRESS RELEASE

27 January 2015

SUMMARY OF THE MONETARY POLICY COMMITTEE MEETING

Meeting Date: 20 January 2015

Inflation Developments

1. In December, consumer prices edged down by 0.44 percent and annual inflation fell approximately by 1 point to 8.17 percent at the year-end. This fall was mainly driven by energy and food prices, yet inflation lost pace in almost all sub-groups. The decline in energy prices continued at a stronger pace in line with the international oil prices. The decline in the underlying trend in inflation got more apparent in services, but remained relatively limited in core goods.
2. Annual food inflation decreased by 1.64 points to 12.73 percent and stood close to the assumptions made in the October Inflation Report. The seasonally-adjusted data pointed to a partial correction in unprocessed food prices in the last four months, which was led particularly by fruits and vegetables. Similarly, despite the deceleration in the monthly inflation trend in processed food prices in December after a long while, the group's annual inflation remained high with 13.16 percent. Indicators for January signal for a possible decline in the annual food inflation due to the unprocessed food group.
3. Energy prices remained on the decline and fell by 1.86 percent in December. The group's annual inflation plummeted by 4.22 points to -1.54 percent, hitting the lowest level of the index history. The first-round effects of the decline in oil prices on energy prices appeared in fuel and bottled gas prices. Brent crude oil prices decreased approximately by USD 45 in the July-December period, and the direct effect of this decline on the consumer inflation through fuel and bottled gas prices was around -0.76 points in this period. This fall in these two items continued in January.
4. Annual core goods inflation receded approximately by 0.5 points to 8.89 percent. This was led by prices of durables and the high-rated decline in clothing prices. Prices of durable goods edged down by 0.30 percent in December, and the downtrend in the group's annual inflation continued. The sustained mild course of the prices of

durable goods accompanied by the gradual elimination of the cumulative exchange rate effects suggests a notable decline in core goods inflation in the first quarter.

5. Prices of services crept up by 0.18 percent and the group's annual inflation receded by 0.22 points to 8.59 percent in the last month of the year. The rate of increase in the seasonally-adjusted prices of services saw a remarkable improvement in the last two months. Positive effects of the decline in fuel prices on the related groups of services continued with a slower pace in December. In addition, the inflation trend in other services followed a weaker course in the last two months. The notable fall in oil prices is expected to have further positive effects on the prices of services that are closely related to fuel prices.
6. The seasonally-adjusted data point to a sustained improvement in the underlying trend of core inflation indicators. The underlying trend in services inflation displays an evident decline, while the improvement in the trend of core goods inflation remained more limited.

Factors Affecting Inflation

7. Data announced for the final quarter of 2014 point to a moderate recovery for economic activity. Having decreased by a mere 0.1 percent month-on-month in November, industrial production fell by 0.9 percent from the third quarter during October-November. This development stems largely from the weak external demand as well as the volatility caused by shifting holidays and transportation production. On the other hand, the recovery observed in other leading indicators suggests that the information content of the industrial production regarding the underlying trend of the fourth quarter economic activity might be limited. In fact, there have been widespread increases across nonfarm employment recently. Moreover, the import volume index for non-gold intermediate goods grew strongly during October-November, while non-gold exports increased only modestly. Survey indicators also point to a more benign outlook for the fourth quarter compared to the third quarter. The Business Tendency Survey (BTS) and PMI indicators for manufacturing have shown a more robust growth in the fourth quarter than in the third quarter, while the BTS' three-month-ahead expectation for production and question of three-month-ahead total orders continued to improve in the fourth quarter. In this regard, the underlying trend of economic activity is considered to have recovered moderately.
8. Data on the expenditure side point to some increase in private domestic demand for the fourth quarter. During October-November, the production of consumer goods was higher than the previous quarter's average, whereas their imports were lower. An indicator for investments, the production of machinery-equipment remained unchanged quarter-on-quarter, while its imports increased. Domestic sales of automobiles and light commercial vehicles grew robustly in the second half of 2014. Mineral production and construction employment, a proxy for construction

investments, have registered moderate increases. Loans, on the other hand, remain on a modest upward track. Against this background, domestic demand is expected to recover further in the fourth quarter. The improved investment trend contains positive signals for investments over the upcoming period, but the weak consumer confidence poses a downside risk.

9. External demand indicators point to no improvement for the fourth quarter of 2014 in the rebalancing process based on goods excluding gold, which ground to a halt in the third quarter. Europe's slowing economy and geopolitical tensions have caused exports to lose some pace. Thus, during October-November, exports excluding gold increased only slightly from the previous quarter, whereas imports excluding gold picked up at a relatively faster pace. However, the favorable developments in the terms of trade and the moderate course of consumer loans will support the improvement in the current account balance.
10. Having weakened after the first quarter of 2014, nonfarm employment posted notable gains during August-October period. Yet, this nonfarm employment growth has been balanced off by the growing nonfarm labor force participation recently, causing unemployment to remain steady. Employment growth was evident across all nonfarm sectors. Specifically, industrial and construction sectors are still experiencing growth in employment, which started in August. The services sector also has contributed further to nonfarm employment growth. As of October, actual data and leading indicators signal some recovery in employment for the fourth quarter, but considering the increase in labor force participation, unemployment rates are not expected to decrease.

Monetary Policy and Risks

11. Loan growth is at reasonable levels in response to the tight monetary policy stance and the macroprudential measures. The composition of loans also continues to evolve in the desired direction. While the annual growth rate of consumer loans hovers around low levels, commercial loans remain relatively more robust. This loan composition not only limits medium-term inflationary pressures but also contributes to the improvement in the current account balance.
12. The Monetary Policy Committee (the Committee) expects the growth composition to change in favor of domestic demand in the upcoming period. Ongoing weakness in growth across European countries, the largest export market of Turkey, and geopolitical developments in neighboring countries limits the growth of exports. Yet, with improved financial conditions and income effect of falling oil prices, domestic demand may see some recovery. In sum, external demand remains weak whereas domestic demand contributes moderately to growth. This change in the growth composition might lead to a widening in the non-energy current account deficit to some extent but the overall current account deficit is expected to narrow further down thanks to the improvement in the energy trade balance.

13. Downside risks regarding economic activity continue to be important for the upcoming period. The lingering volatility across global financial markets and the sluggish course of confidence indices may cause private final demand to provide limited support to growth. In the case of an additional slowdown in external demand and a sizeable decline in global growth rates, the decrease in commodity prices will pull inflation down but at the same time lead to notable adverse effects on economic activity. Under such circumstances, the Committee will employ the policy tools to support the economic activity.
14. There are many factors that might have a favorable effect on the inflation outlook for 2015. The recovery of economic activity is likely to be a gradual one and aggregate demand developments are expected to support disinflation. The tight monetary policy stance and the macroprudential measures continue to have a favorable impact on inflation, especially on inflation excluding energy and food (core inflation) indicators. The adverse impact of cumulative exchange rate developments on annual inflation is also tapering off. Moreover, falling commodity prices, in particular oil prices, contribute to disinflation. In fact, there has been a notable decline in medium-term inflation expectations recently. In light of these positive developments, the Committee has decided on a measured cut in the one week repo rate.
15. Global financial markets have followed a volatile course recently. It was stated that capital flows to emerging markets may continue to be volatile in 2015. The ongoing uncertainty about the normalization of global monetary policies cause the global risk appetite and capital flows to be data-sensitive. The Committee stated that, against heightened global volatility, it would be helpful to pursue a flexible monetary policy in the short term and assessed that it would be appropriate to keep the overnight rates unchanged at this stage.
16. The Committee stated that using a flexible interest rate corridor would cushion the economy against the volatility in global markets. In this regard, inflation expectations, the pricing behavior and other factors that affect inflation will be further closely monitored and the tight monetary policy stance will be maintained by keeping the yield curve flat until there is a significant improvement in the inflation outlook.
17. The meeting also included a discussion of the projections to be published in the Inflation Report. Under the current monetary policy stance, the Committee anticipates that inflation will decline to levels close to the target by mid-2015. Yet, a more persistent reduction in inflation necessitates a cautious approach in monetary policy. The Committee sees that a major opportunity has emerged to bring inflation down permanently in an environment where cost and demand factors are supportive of disinflation. Keeping inflation permanently at low levels might contribute to investments and potential growth. In this context, the Bank will continue to act decisively to bring down inflation and make future monetary policy decisions conditional on the pace of improvement in the inflation outlook.
18. Developments on the fiscal policy and tax adjustments are monitored closely with regard to their effects on the inflation outlook. The baseline monetary policy stance

is formulated under the assumption that fiscal discipline will be maintained and there will be no unanticipated hikes on administered prices. A revision of the monetary policy stance may be considered, should the fiscal policy deviate significantly from this framework, and consequently, have an adverse effect on the medium-term inflation outlook.

19. The Committee welcomed the development that the Medium Term Program incorporates disinflation as one of the main objectives. Moreover, it was indicated that the implementation of the announced structural reforms would contribute to the potential growth significantly. Any measure to ensure the sustainability of the fiscal discipline and reduce the savings deficit will support macroeconomic stability and contribute positively to social welfare by keeping interest rates of long-term government securities at low levels.