



**TÜRKİYE CUMHURİYET
MERKEZ BANKASI**

Briefing on April 2017 Inflation Report

28 April 2017
İstanbul

April 2017 Inflation Report: Main Sections

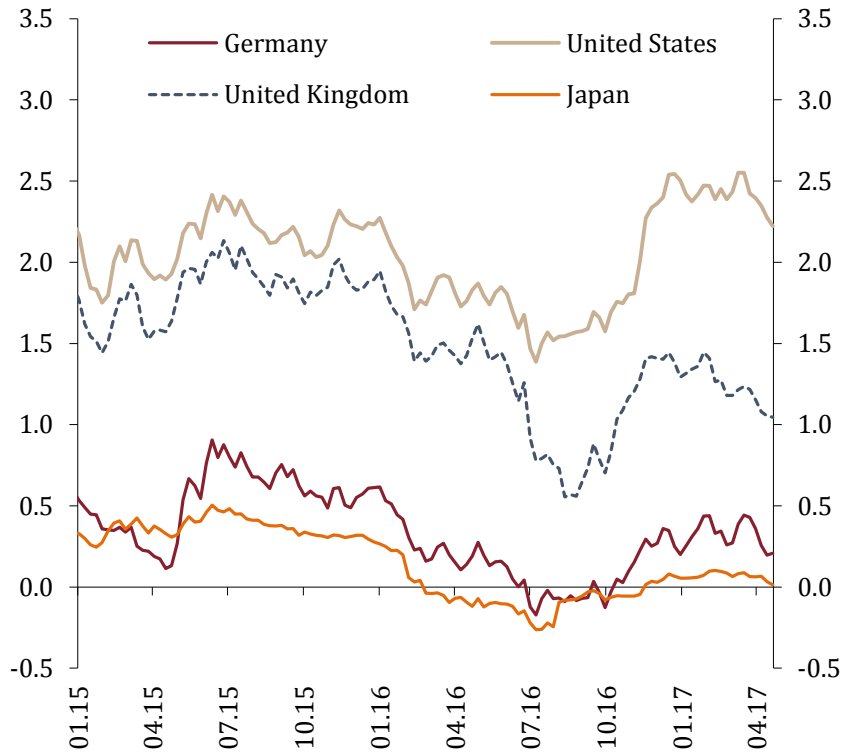
- Overview
- International Economic Developments
- Inflation Developments
- Supply and Demand Developments
- Financial Conditions and Monetary Policy
- Public Finance
- Medium Term Projections

April 2017 Inflation Report: Boxes

- Change in Inflation Dynamics
- The Change in the Weighting Scheme of Clothing and Footwear Price Indices
- Acceleration of Turkey's Automotive Exports and EU Demand
- Foreign Exchange Deposits against Turkish Lira Deposits Auctions
- Cyclical Properties of Tax Revenues in Turkey
- Explaining the Credit Channel via a Structural Macroeconomic Model

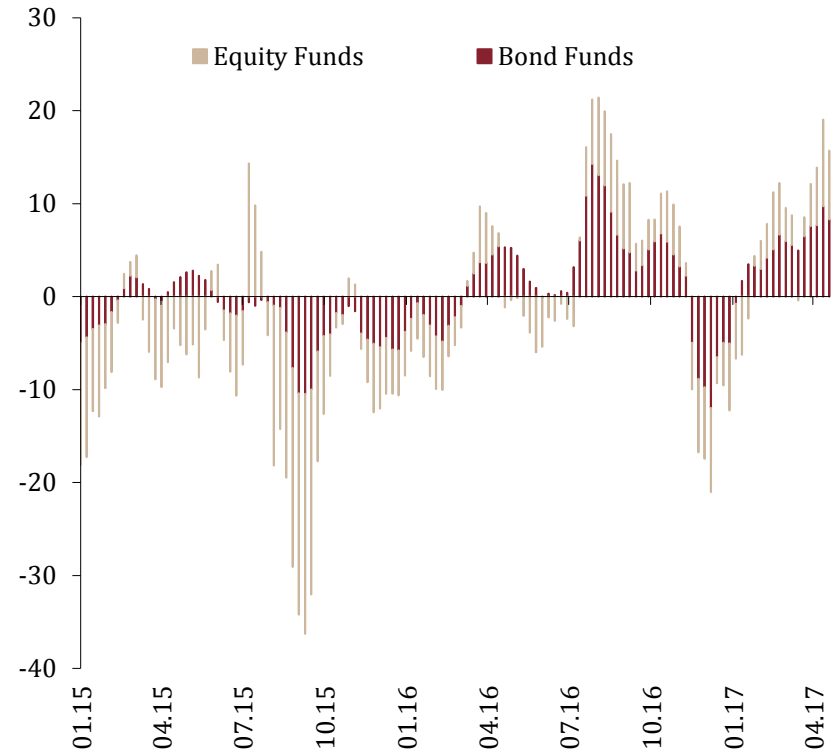
Global Uncertainties and Portfolio Flows

10-Year Bond Rates
(Percent)



Source: Bloomberg.

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



Source: EPFR.

- In the first quarter of 2017, the sharp upward trend in advanced economies' long-term bond yields in the aftermath of the US's November elections came to an end; bond and stock markets in emerging economies received portfolio inflows.

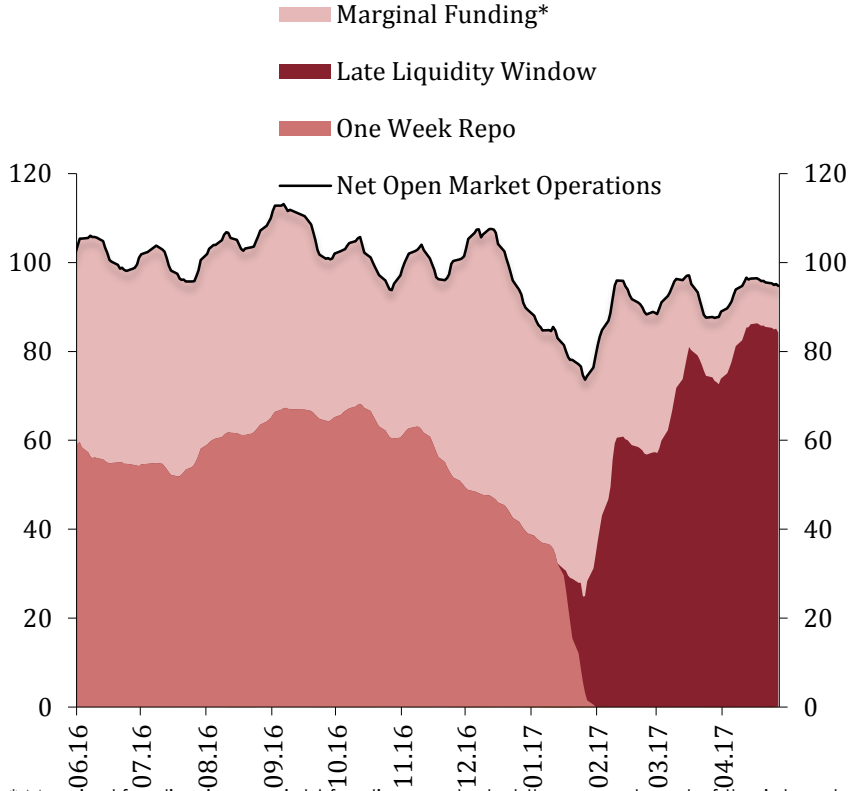
Domestic Economic Outlook

- In the first quarter of 2017 the slope of the yield curve reversed due to monetary tightening.
- The Turkish lira witnessed lower levels and reduced volatility.
- Loan growth is stronger than in previous years owing to macroprudential policies supportive of the financial system.
- The first quarter of 2017 was marked by steeper cost pressures on producer prices and by an increase in core inflation indicators.
- The relative recovery in demand conditions and the high inflation expectations led to price hikes.
- After the temporary third-quarter slowdown, economic activity recorded a moderate growth driven by domestic demand in the fourth quarter of 2016.
- The upsurge in exports of goods as well as the accommodative incentives and measures are likely to help economic recovery strengthen from the second quarter onwards.

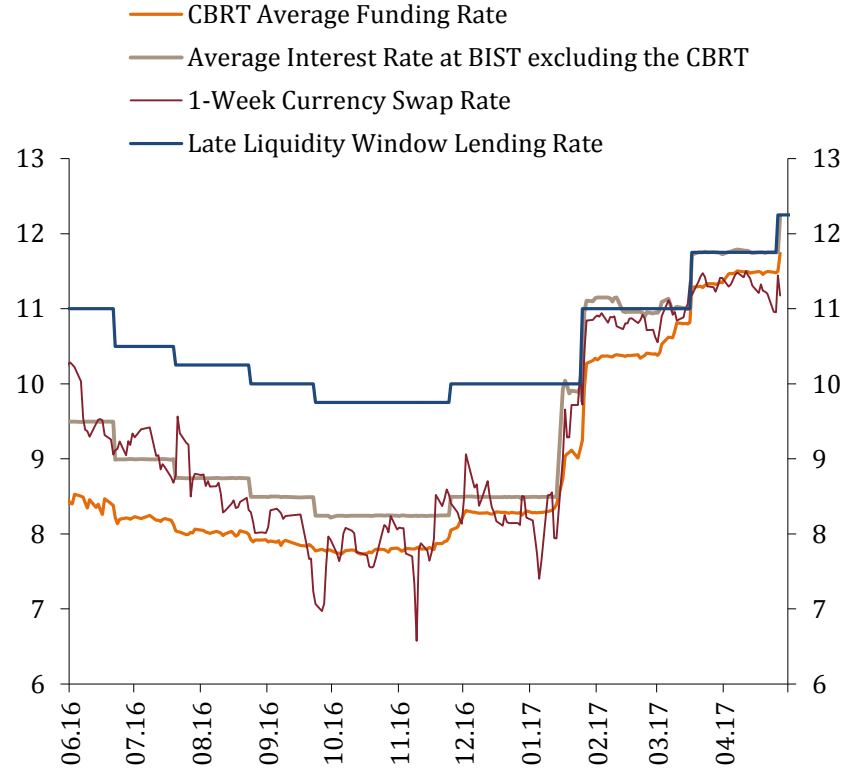
Monetary Policy and Financial Stability

Monetary Policy

CBRT Funding
(2-Week MA, Billion TL)



Bank's Funding Costs at the Money Markets
(5-Day Moving Average, Percent)



* Marginal funding is overnight funding quoted at the upper band of the interest rate corridor.

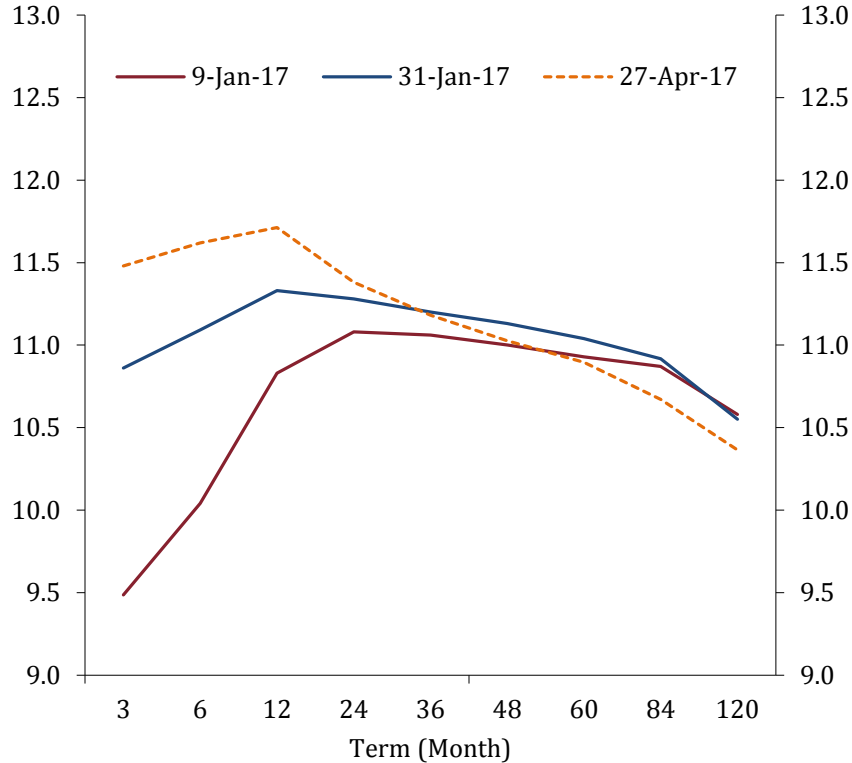
Source: BIST, CBRT.

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- Since early 2017, CBRT has delivered a strong monetary tightening in order to contain the deterioration in the inflation outlook.

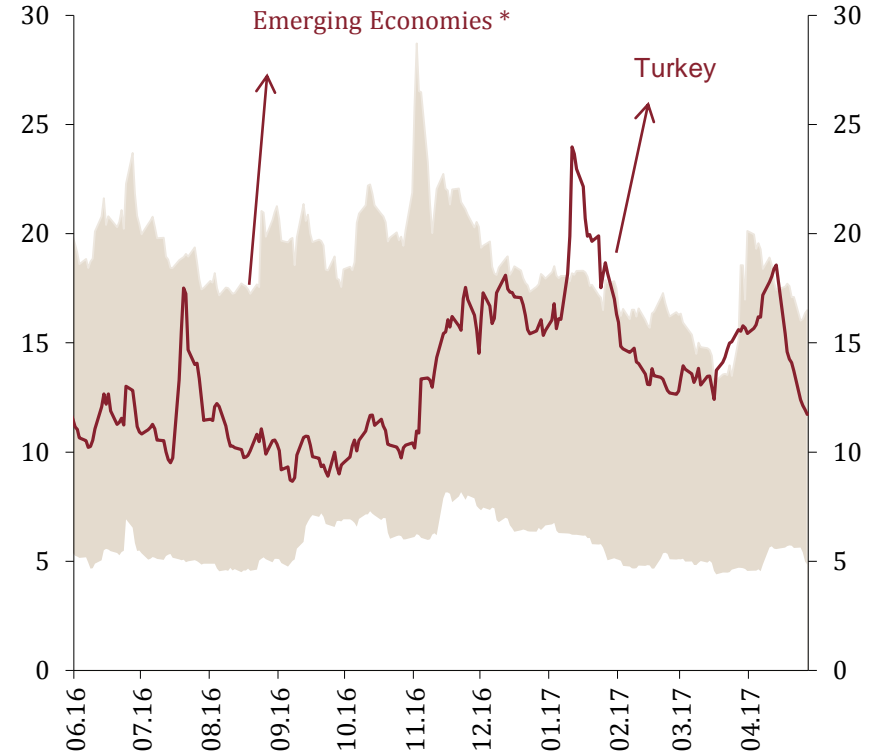
Monetary Conditions

Yield Curve on Cross Currency Swaps
(Percent)



Source: Bloomberg.

Implied FX Volatility
(1 Month, Percent)



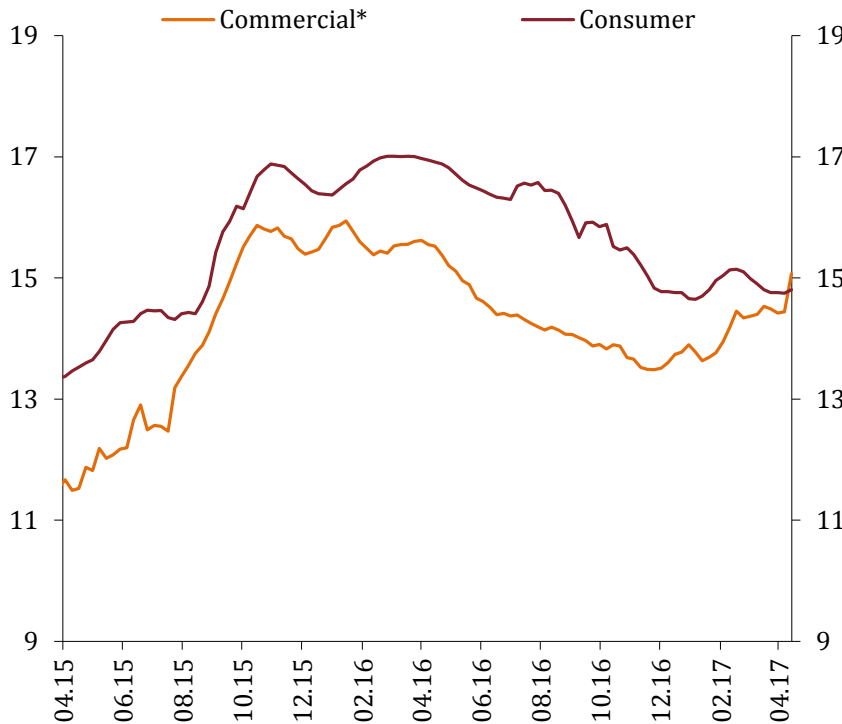
*Emerging economies include Brazil, Chile, Colombia, Mexico, Poland, Philippines, Malaysia, S. Africa, Indonesia, Romania and Hungary.
Source: Bloomberg.

- The slope of the yield curve has been reversing since early 2017, which reflects the tight monetary stance.

Financial Stability

TL Loan Rates

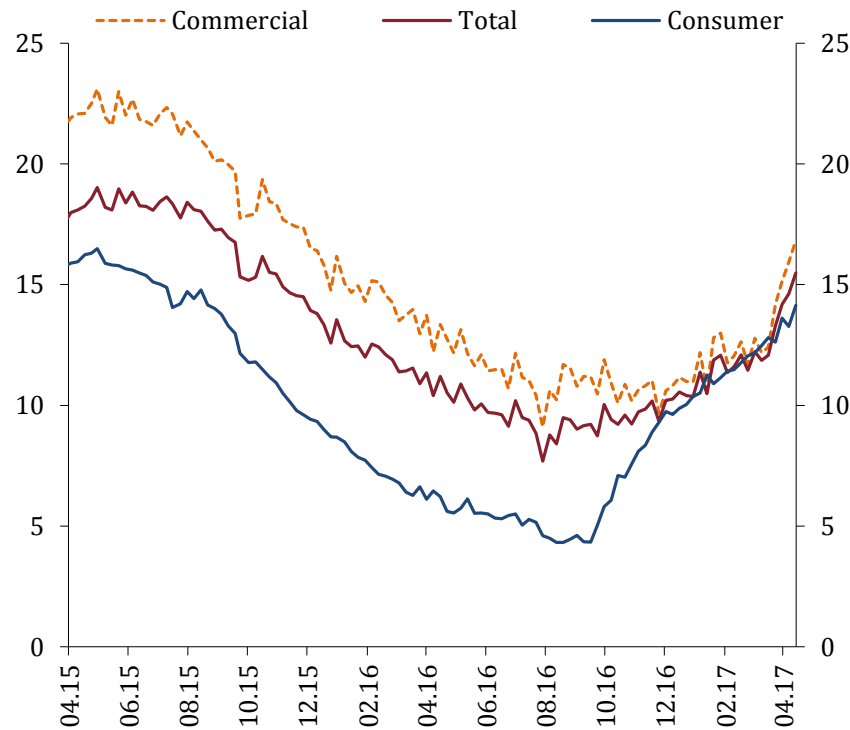
(Flow, Annualized, 4-Week MA, Percent)



* Excluding overdraft accounts, credit cards and non-zero interest rate loans.
Source: CBRT.

Annual Credit Growth

(Adjusted for Exchange Rate, Percent)



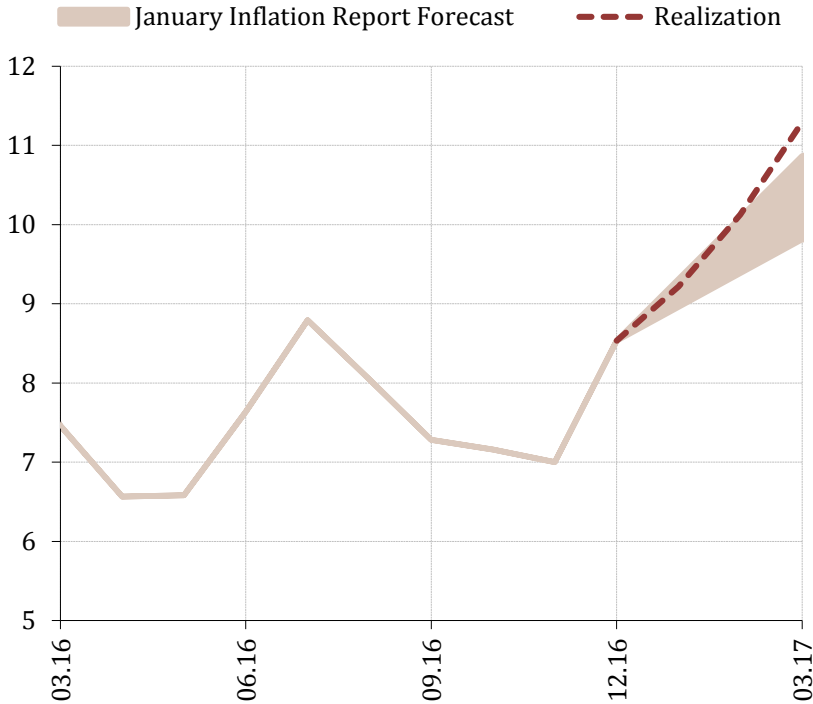
Source: CBRT.

- Credit conditions continued to recover in the first quarter of 2017 thanks to macroprudential policies supportive of the financial system, fiscal incentives and public credit guarantees.

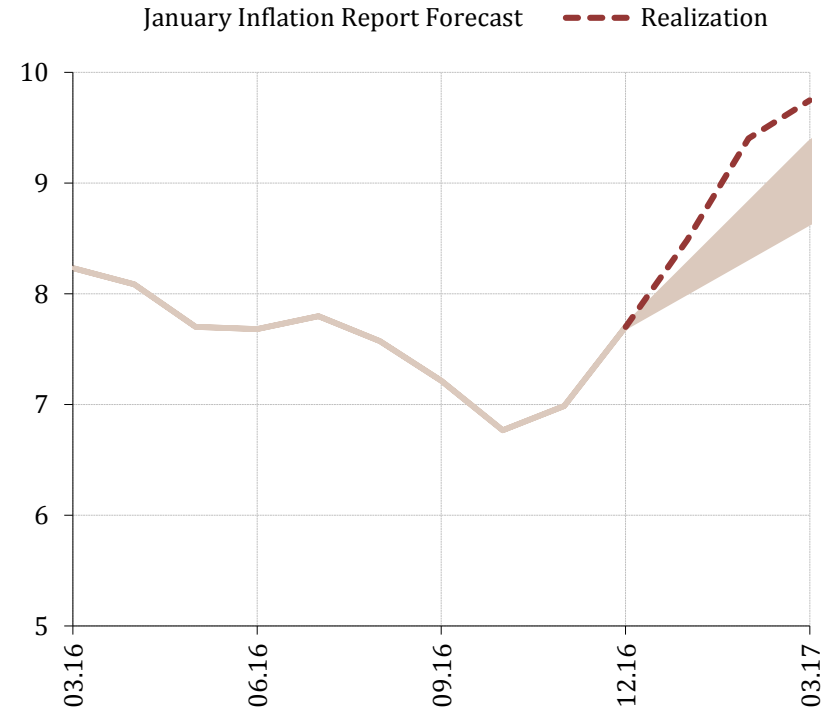
Macroeconomic Developments and Main Assumptions

January 2017 Inflation Report Forecasts and Realizations

Consumer Inflation
(Percent)



Inflation Excluding Unprocessed Food and Tobacco
(Percent)

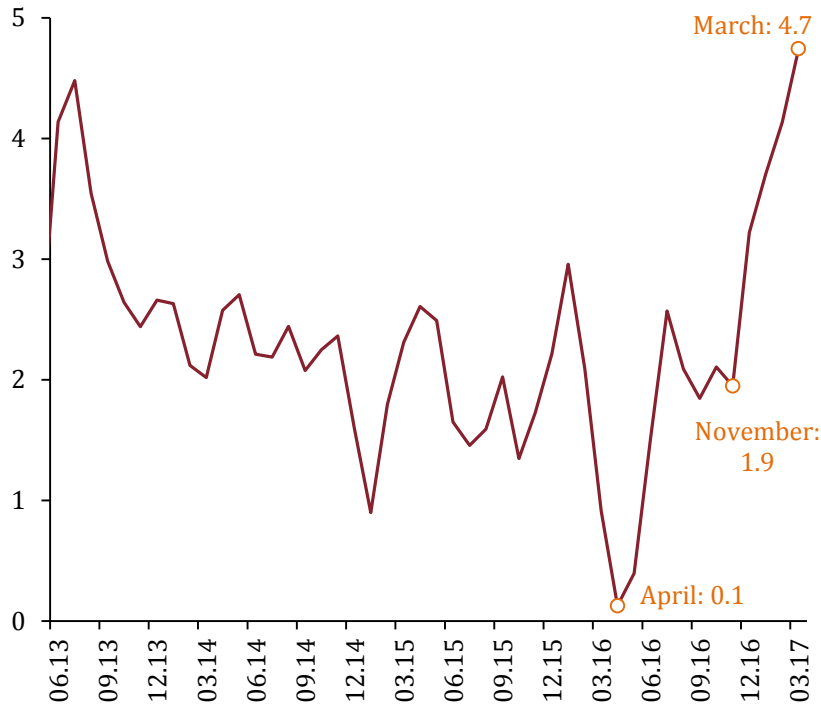


* Shaded region indicates the 70 percent confidence interval for the forecast.
Source: TURKSTAT, CBRT.

- Consumer inflation hit 11.29 percent in March due to the Turkish lira depreciation and higher import prices as well as rising food prices.

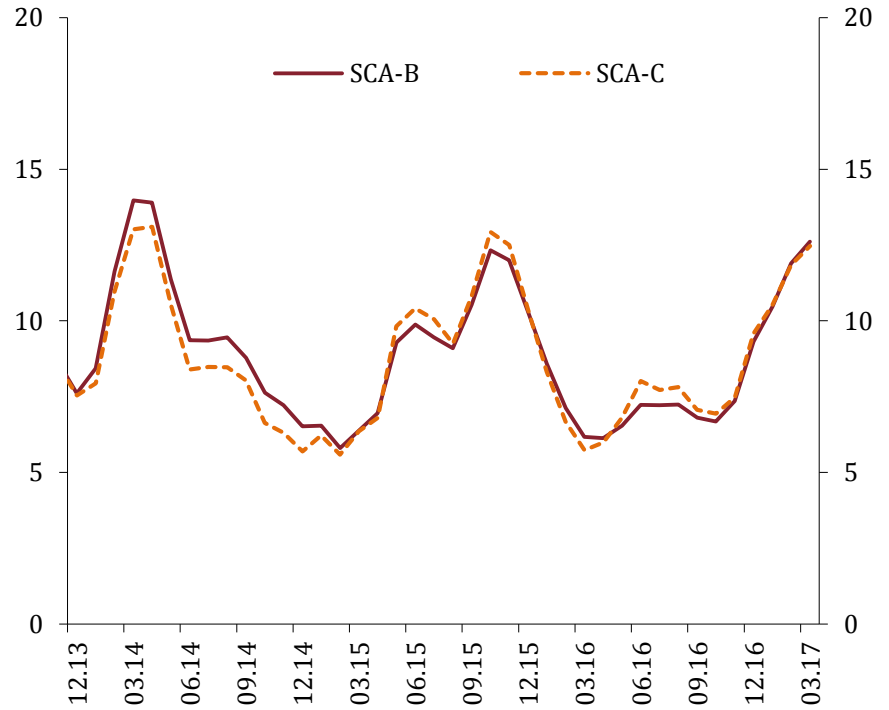
Inflation

Contribution of Unprocessed Food, Energy and Alcohol-Tobacco Products to CPI Inflation
(Percentage Point)



Source: TURKSTAT, CBRT.

Core Inflation Indicators SCA-B and SCA-C
(SA, 3-Month MA, Annualized, Percent)

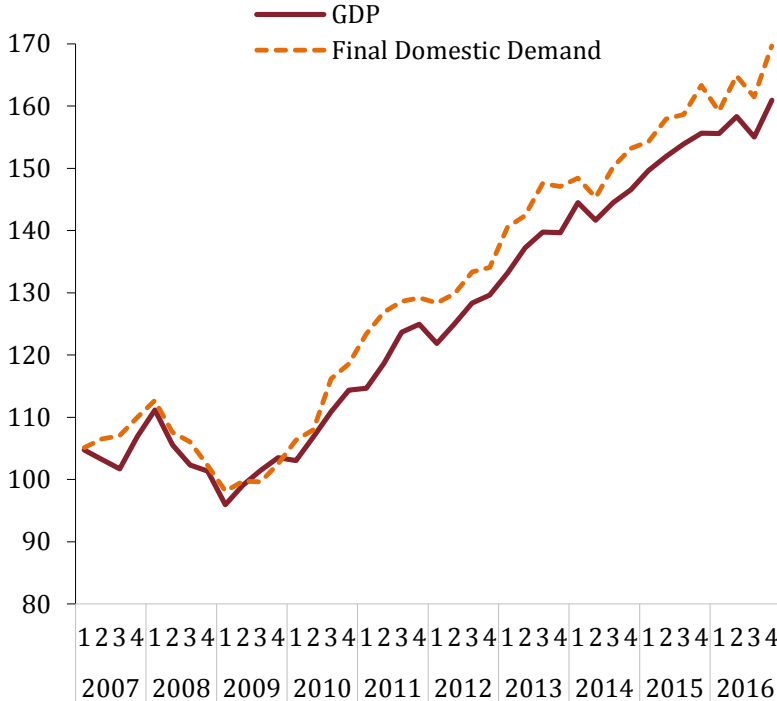


Source: TURKSTAT, CBRT.

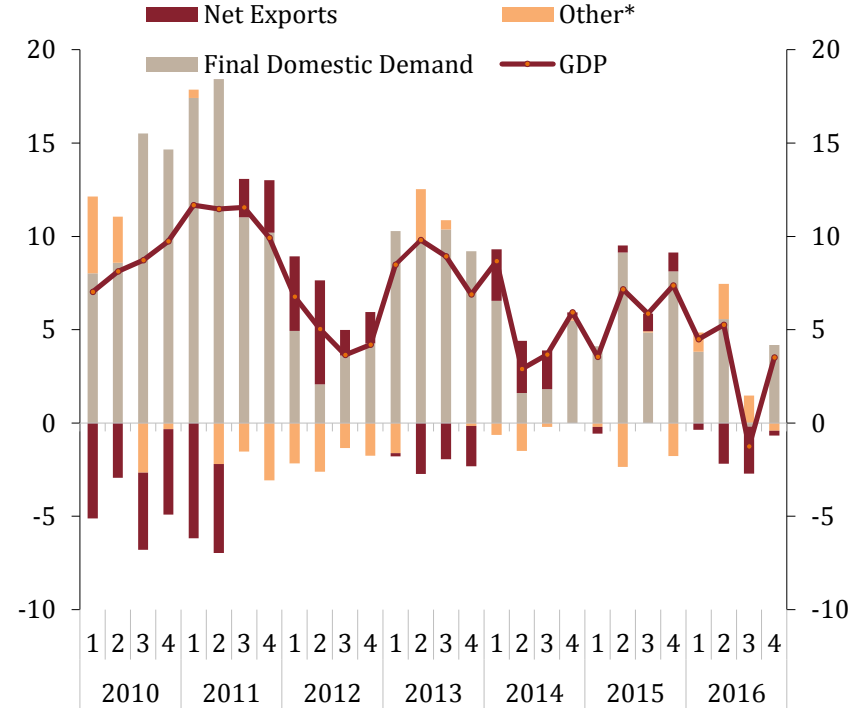
- Core inflation increased in 2017Q1, while non-core items such as unprocessed food, energy and alcohol-tobacco provided a significantly larger contribution to inflation.

Aggregate Demand

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



Contributions from the Expenditure Side
(Percentage Point)



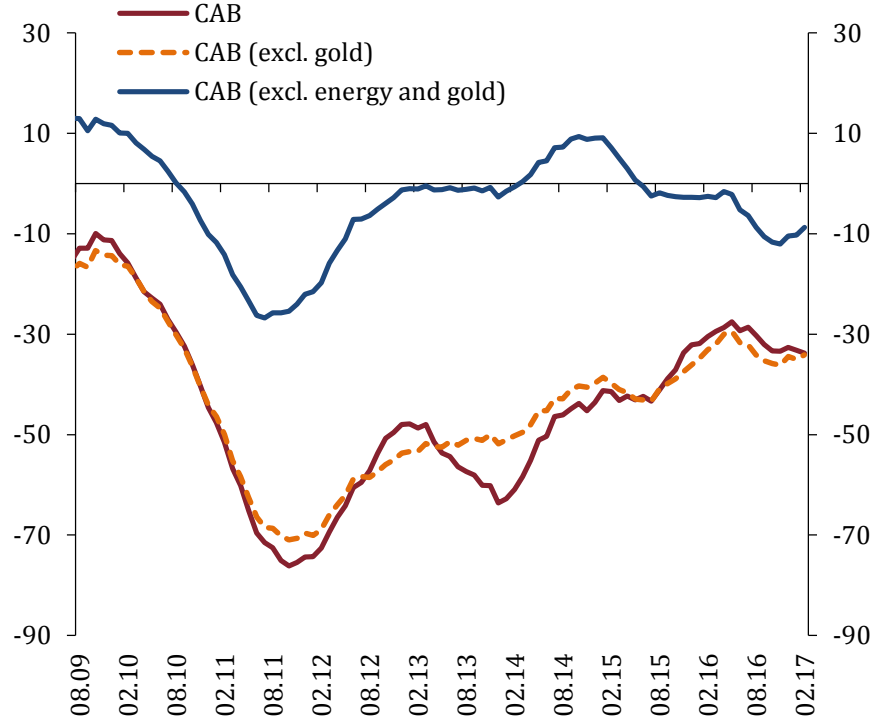
Source: TURKSTAT.

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

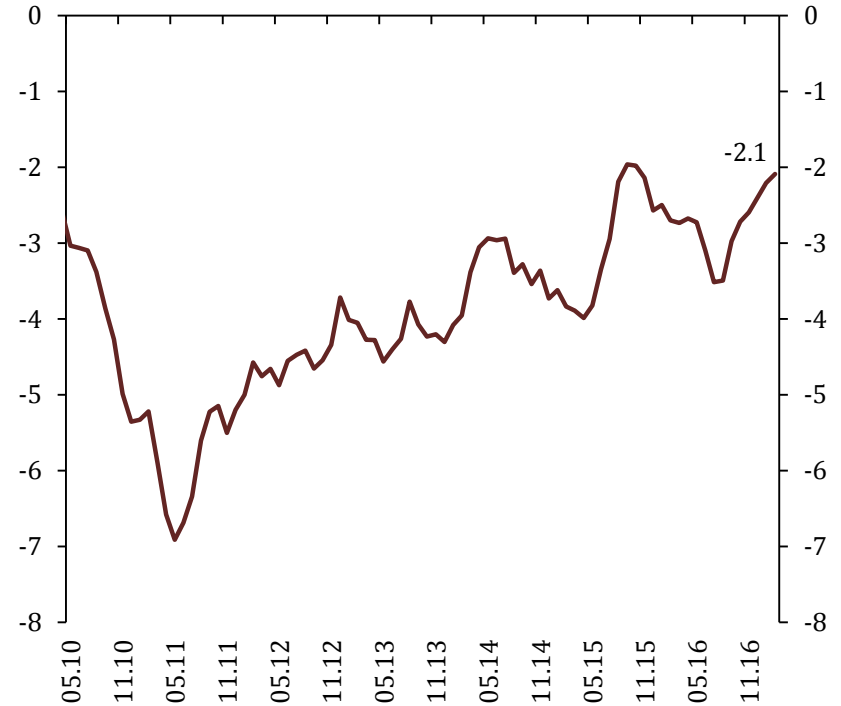
- The fourth quarter of 2016 was marked by a mild growth driven by domestic demand.

External Balance

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



Current Account Balance
(Excl. Gold, SA, 3-Month MA, Billion USD)

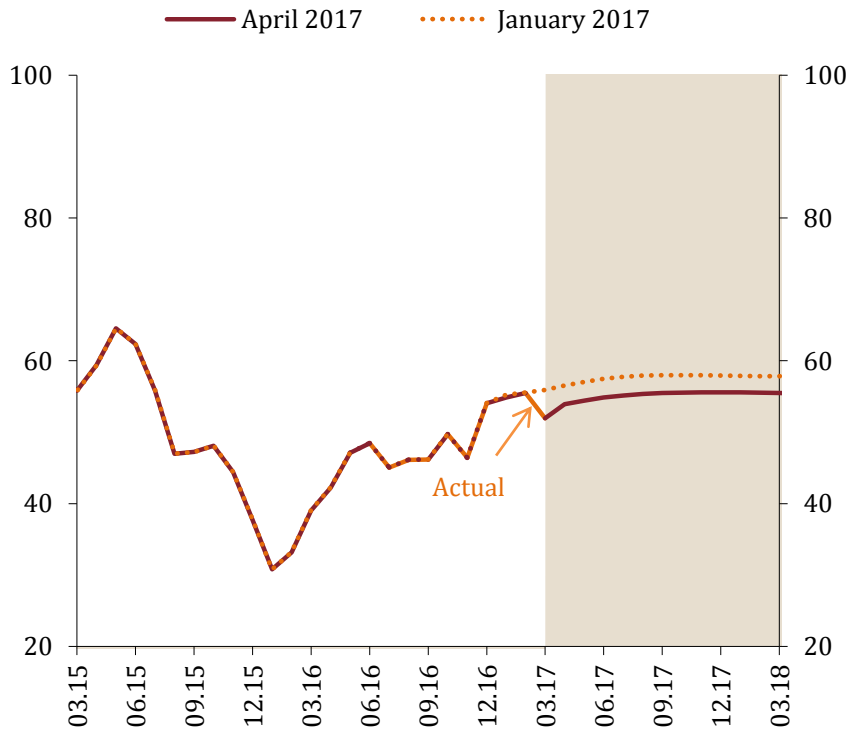


Source: CBRT.

- The recent trend of the current account balance has improved, which is expected to continue across the year especially with the support from goods exports.

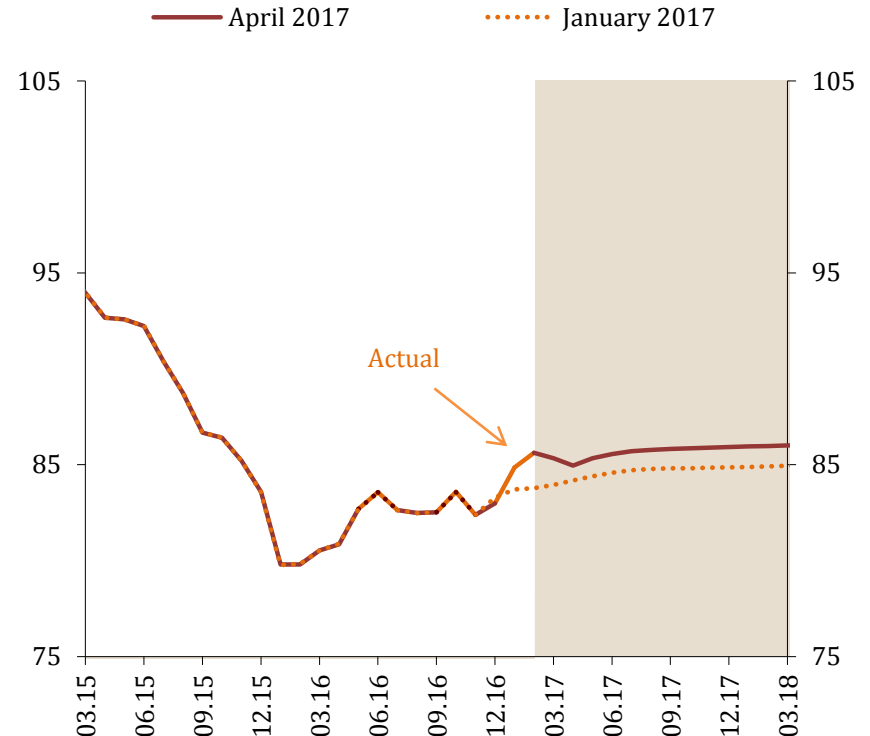
Revisions in Oil and Import Price Assumptions

Oil Prices
(USD/bbl)



Source: Bloomberg, CBRT.

Import Prices
(Index, 2010=100)



Source: CBRT.

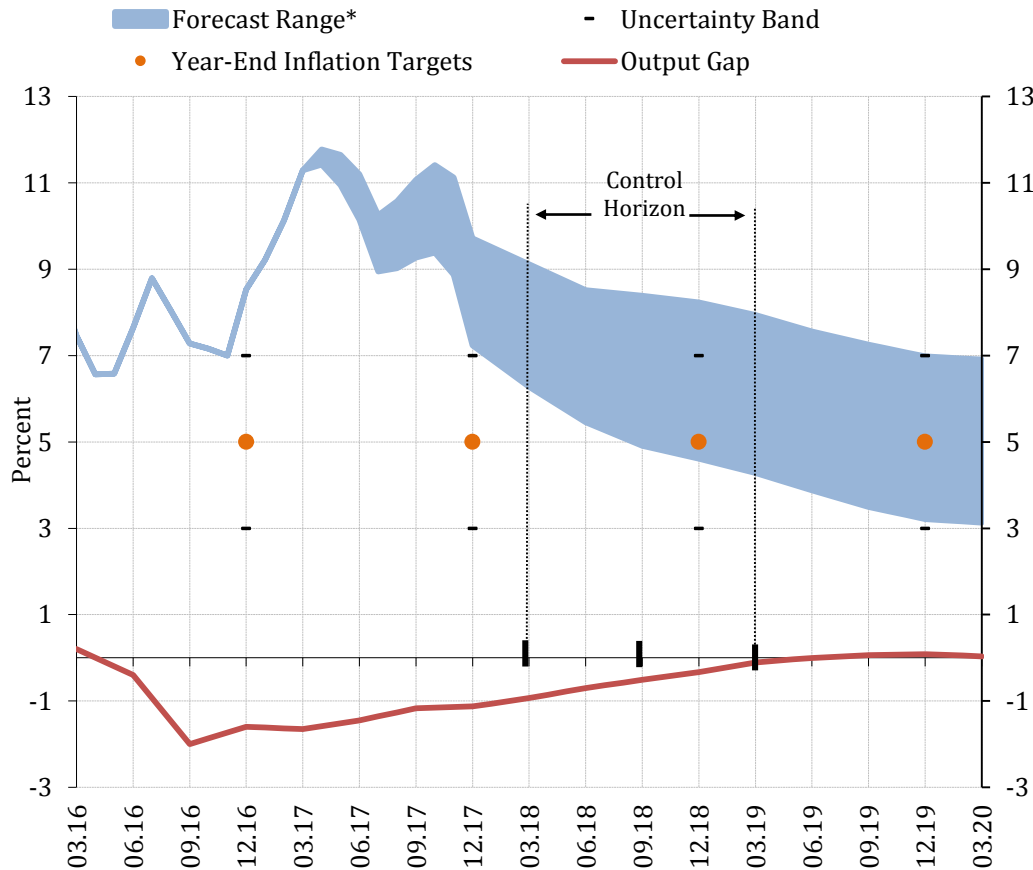
- Due to recent developments, assumptions for crude oil prices were revised downwards while assumptions for USD-denominated import prices were revised considerably upwards for 2017.

Revisions in Assumptions

		January 2017	April 2017
Output Gap	2016 Q4	-2.0	-1.6
	2017 Q1	-2.2	-1.7
Food Prices (Year-end Percent Change)	2017	9.0	9.0
	2018	7.0	7.0
Import Prices (Average Annual Percent Change, USD)	2017	3.0	4.4
	2018	0.7	0.5
Oil Prices (Average, USD)	2017	57	55
	2018	58	55
Export-Weighted Global Production Index (Average Annual Percent Change)	2017	1.9	1.8
	2018	1.9	2.0

Inflation Outlook

Inflation and Output Gap Forecasts (Percent)

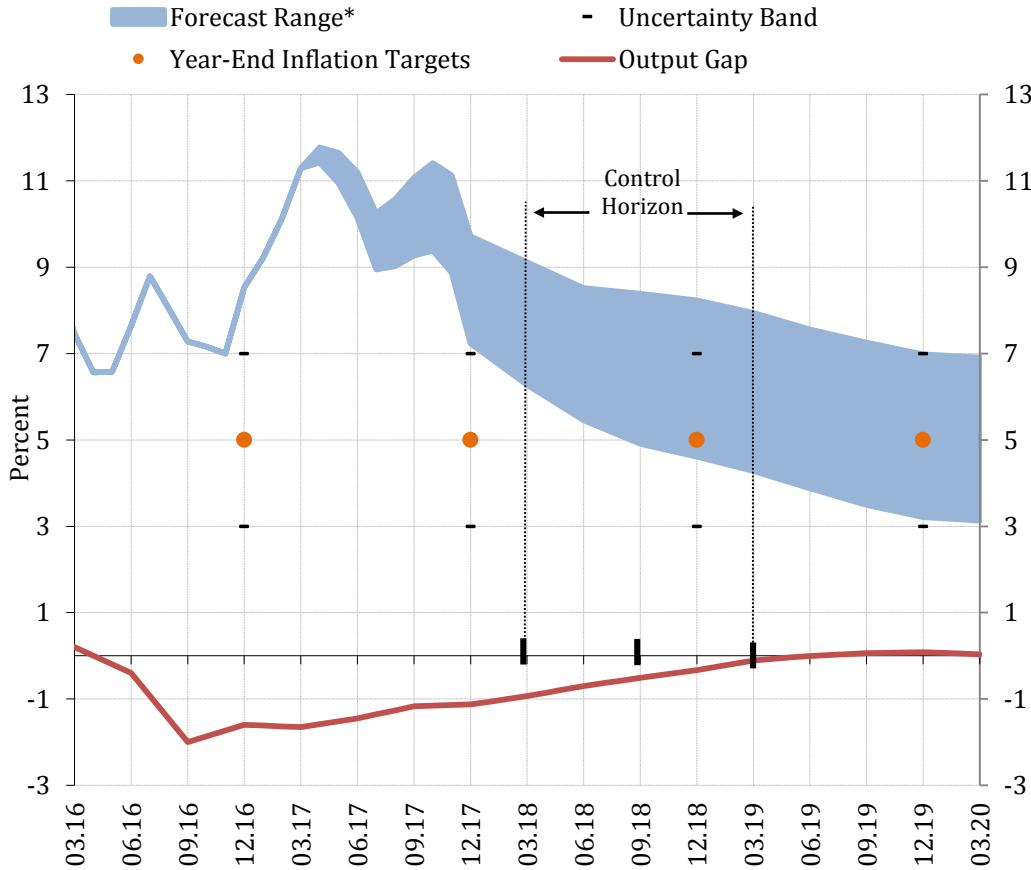


*Shaded region indicates the 70 percent confidence interval for the forecast.

- 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 8.5% at end-2017, and stabilize around 5% in the medium term after falling to 6.4% in 2018.
 - Accordingly, inflation is expected to
 - be between 7.3% and 9.7% (with a mid-point of 8.5%) at end-2017
 - be between 4.6% and 8.2% (with a mid-point of 6.4%) at end-2018
- with 70 percent probability.

Inflation Outlook

Inflation and Output Gap Forecasts (Percent)



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

The upward revision in 2017 year-end inflation forecasts by a total of 0.5 points, relative to January Inflation Report, is driven by:

- Upward revision on assumptions for TL-denominated import prices (0.1 points).
- Upward revision on output gap forecasts (0.2 points).
- Higher-than projected inflation at 2017 Q1 compared to previous forecasts and the increase in the underlying trend of inflation (0.2 points).



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