TÜRKİYE CUMHURİYET MERKEZ BANKASI

No: 2015-22

PRESS RELEASE

24 March 2015

SUMMARY OF THE MONETARY POLICY COMMITTEE MEETING

Meeting Date: 17 March 2015

Inflation Developments

1. In February, consumer prices increased by 0.71 percent and annual inflation rose by 0.31 points to 7.55 percent. This increase was mainly driven by food prices. The decline in the annual inflation of non-food consumer prices has continued. Underlying inflation rose in services but fell in core goods. Overall, core inflation indicators continued to improve.

2. Annual inflation in food and nonalcoholic beverages surged by 2.73 points to 13.70 percent amid developments in unprocessed food prices. This period was marked by escalating vegetable prices caused by adverse weather conditions and supply-related upsurges in meat prices. On the other hand, despite the receding annual inflation in processed food prices, the monthly trend of increase remained elevated in this subcategory. Indicators for March signal that the annual food inflation will remain high.

3. Annual energy inflation remained modest with a growth rate of -1.92 percent despite rising fuel prices and water tariffs. Yet, energy prices are expected to have a less constraining effect on annual consumer inflation due to soaring prices of fuel and bottled gas amid the Turkish lira depreciation in March.

4. Prices of services were up by 0.68 percent in February while annual services inflation fell by 0.10 points to 8.63 percent. In this period, changes in food and oil prices as well as exchange rates exerted cost pressures on prices of services. Accordingly, the monthly rate of increase in catering prices accelerated due to rising food prices. Moreover, having declined since November, prices of transport services picked up slightly amid higher fuel prices while prices of some items sensitive to exchange rates surged notably. As a result, services inflation remained elevated throughout February.

5. Annual core goods inflation decreased by 1.78 points to 6.79 percent in February. Annual inflation was down across all main categories, particularly in durable goods. The decline in annual core goods inflation was largely driven by base effects. Meanwhile, the monthly rate of increase in prices of core goods excluding clothing reflected the pass-through of the Turkish lira depreciation, although the recent weakening of domestic demand conditions has partially balanced off the exchange rate-driven cost pressures. Accordingly, the underlying trend of core goods inflation fell to a modest level in February.

6. To sum up, (core) inflation indicators excluding energy and food continued to decline in February. Yet, the current course of food prices and the exchange rate developments are the key risk factors regarding the inflation outlook.

Factors Affecting Inflation

7. Industrial production recorded a monthly decline of 1.4 percent in January. This was largely attributed to the slowdown in domestic demand growth and the weakening external demand as well as to the setbacks in the supply chain and construction activities caused by January's adverse weather conditions. February's PMI and Business Tendency Survey (BTS) data suggest that the weak course of industrial production has continued lately.

8. Data on the expenditure side suggest that demand conditions do not yet reveal a significant recovery. In January, the production of consumer goods was lower than the previous quarter's average, while the imports of consumer goods were on the rise. In this period, domestic sales of home appliances dropped. Similarly, sales of automobiles were down from the fourth-quarter average during the January-February period. Consumer confidence continued to weaken amid uncertainty over global markets. Among indicators for investments, the production and imports of machinery-equipment fell in January from the previous quarter's average. The BTS investment tendency indicator, which recorded a recovery over the second half of 2014, has not gained a steady footing as of the first quarter of 2015. Among variables related to construction investments, the production of minerals declined whereas the imports of minerals increased. After an upsurge starting in the second half of 2014, construction employment flattened in December. In sum, recent indicators suggest that private domestic demand has contributed moderately to growth albeit at a slower pace in the first quarter of 2015.

9. According to the real measures of external trade indicators, the rebalancing process has not shown a notable improvement in January. During this period, non-gold exports were weaker than their fourth-quarter average, while non-gold imports were flat. The slowdown in exports was mostly due to the weak growth across Turkey's

major trading partners. However, the developments in the terms of trade and the moderate course of consumer loans contribute to the improvement in the current account balance. Thus, the current account balance is expected to improve further throughout 2015.

10. In December 2014, both total and nonfarm unemployment decreased. Although there was no robust employment growth in this period, the flat labor participation rate helped to bring unemployment rates down. Across nonfarm sectors, services employment increased whereas industrial employment recorded a slight fall. The PMI and BTS survey indicators that reflect actual and expected employment figures for firms were down in February 2015. Other indicators for the labor market point to no significant recovery in employment as of the first quarter of 2015.

Monetary Policy and Risks

11. The Monetary Policy Committee (the Committee) stated that economic activity lost some momentum in the first quarter of the year. This slowdown was attributed to the weak external demand, the volatile financial markets and adverse weather conditions. As it is too early at this point to distinguish the negative impact of weather conditions, the Committee suggested monitoring the data closely for a while before making a more definitive assessment regarding the underlying trend of economic activity.

12. The ongoing cautious monetary policy along with prudent fiscal and macroprudential policies are having a favorable impact on inflation, especially inflation excluding energy and food (core inflation indicators). The moderate course of aggregate demand conditions and the continued downtrend in import prices support disinflation as of the first quarter. In the short run, the annual rate of increase in core indicators is likely to decline further thanks to base effects. However, elevated food prices and the recent exchange rate movements will cause inflation to hover above the level indicated in the January Inflation Report for some time.

13. Global markets continue to follow a volatile course. The reduced predictability regarding global economy, the low inflation rates across advanced economies, and the growing uncertainty along with the decoupling of monetary policies cause global markets to remain highly data-sensitive. As a result, the risk appetite and capital flows continue to be volatile. The Committee pointed out that the measures the CBRT has recently taken in terms of foreign exchange liquidity and prudent borrowing are to minimize macro financial risks arising from the uncertainty in global financial markets and global economic activity.

14. In sum, the uncertainty in global markets and elevated food prices necessitates maintaining the cautious stance in monetary policy. Accordingly, the Committee decided to keep the interest rates at current levels.

15. Future monetary policy decisions will be conditional on the improvements in the inflation outlook. Inflation expectations, pricing behavior and other factors that affect inflation will be monitored closely and the cautious monetary policy stance will be maintained, by keeping a flat yield curve, until there is a significant improvement in the inflation outlook.

16. 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.

17. The Committee assessed that the implementation of the announced structural reforms would contribute significantly to potential growth over the medium to long term. Any measure that would strengthen stability and confidence, 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 at low levels.