Press Release on Summary of the Monetary Policy Committee Meeting

1 June 2020, No: 2020-31

Meeting Date: 21 May 2020

Inflation Developments

1. In April, consumer prices increased by 0.85% while annual inflation dropped by 0.92 points to 10.94%. The energy group was the main driver of the fall in consumer inflation, whereas the food group hindered a more positive outlook. Energy prices fell further on the back of international oil prices, but food prices increased above seasonal trends. The fall in services inflation spread across subcategories, and annual core goods inflation lost momentum despite the exchange rate developments. Against this background, annual inflation and the trends of B and C indicators posted a decline.
2. Annual inflation in food and non-alcoholic beverages rose by 1.23 points to 11.28% in April. Price increases spread across the unprocessed food group, while red meat as well as pulses with high dependency on foreign trade stood out. The uptrend in processed food prices continued in April. Inflation in the bread and cereals group remained elevated, while fats-oils and non-alcoholic beverages also drove processed food inflation upwards. Prospects for food inflation were shaped by a set of factors such as pandemic-related impacts, the current demand increase as well as tax adjustments and exchange rate developments. Leading indicators suggest that the rise in annual food inflation will continue in May due to unprocessed food prices.
3. Energy prices fell by 4.99% in April, and annual energy inflation declined by 6.51 points to 3.30%. The depreciation in the Turkish lira notwithstanding, falling international oil prices remained as the determining factor. Leading indicators suggest a slight rise in annual energy inflation in May. Meanwhile, due to the raised minimum lump sum special consumption tax, it is projected that cigarette prices will edge up in May, yet annual inflation in this group will decline further due to the base effect.
4. In April, annual core goods inflation dropped by 0.30 points to 7.88%. In this period, annual inflation remained relatively flat in durable goods, and decreased in other subcategories. In the durable goods group, the automobile and furniture items stood out with an upsurge in prices following the depreciation in the Turkish lira, while the seasonal price increase in the clothing and footwear group proved quite limited compared to previous years.
5. Services prices inched up by 0.22% in April, and annual services inflation decreased by 0.66 points to 11.76%. In this period, consequences of the pandemic became quite apparent on services prices. Annual inflation receded in all subcategories, and the most pronounced

decline was seen in the restaurants-hotels and transport services groups, the operations of which were interrupted. In April, communication services recorded falling prices, while increases in rents slowed further. Meanwhile, prices in maintenance-repair services posted a high-rated increase due to exchange rate developments.

6. Inflation expectations improved further in May with a decline across all horizons.

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. The industrial production index posted a month-on-month decline by 7.1% in March in seasonally and calendar-adjusted terms, but remained flat on a quarterly basis. An analysis of sectoral breakdown reveals substantial decreases in production of export-oriented sectors such as manufacture of textiles, wearing apparel, computer-electronic and optical products, motor vehicles and other transport equipment, while the manufacture of food, tobacco, paper, chemical, pharmaceutical, other non-metallic mineral products and basic metal in relative terms diverged positively. Despite the significant weakening in March, due to the robust course in the January-February period, annual growth in national income is expected to realize at a relatively favorable level in the first quarter.

8. The weakening in economic activity became more pronounced in April and spread across all sectors. Activity came to a near standstill in tourism and related sectors while retail trade saw a deepening slowdown, except for food and market purchases. On the manufacturing industry front, new orders and capacity utilization rates fell to record lows across main exporting sectors due to slumping external demand. High-frequency indicators for the first half of May display signs of bottoming-out following the steps taken towards partial normalization. In this context, there have been slight increases in exports, imports and capacity utilization rates.

9. Export and tourism revenues declined due to the deterioration in the global growth outlook and travel restrictions. Export opportunities shrunk significantly 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. As a result, despite the fall in exports and tourism revenues due to the pandemic, current account balance is expected to follow a moderate course throughout the year due to the restraining effects of commodity prices and imports.

10. 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, in order 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.

11. Unemployment remained flat in February, while non-farm employment decreased across all sectors. Job losses were mostly accounted for by unregistered workers, while the falling labor force participation rate prevented the unemployment rate from rising. Leading

indicators suggest that the spillover from the economic slowdown into the labor market was more pronounced in April. 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

12. Developments regarding the spread of the coronavirus substantially weaken global growth outlook. Measures to contain the pandemic not only have affected supply chains and production on the supply side, but also have weakened demand significantly amid heightened uncertainty, tight financial conditions, reduced household income and worsening cash flows of businesses. Growth data available for the first quarter of 2020 confirm a sharp contraction for most economies while April's PMI data and electricity consumption point to an even deeper contraction for the second quarter. As of March, the pandemic has a more limited impact on employment across advanced economies, except for the US, but dismal job prospects suggest that economic slowdown may amplify unemployment in those economies over the upcoming period. Accordingly, global growth forecasts were revised further down and the outlook for external demand, particularly from European economies, deteriorated from the previous month. The effects of these developments on domestic growth, particularly on exports, tourism and related sectors, are being closely monitored.

13. Central banks in advanced and emerging economies continue to take expansionary measures. There have been further rate cuts, albeit more moderate ones, and balance sheet sizes of major central banks remain on the rise. Emerging economies have also taken expansionary monetary policy measures such as bond purchases. The effectiveness of these policies for financial markets, growth and employment will depend on the course of the pandemic in each country and how much policy room each country has.

14. While uncertainties on global economic recovery remain high, normalization steps taken by several countries are being watched. While the impact of normalization steps on economic activity is monitored in those countries, where the outbreak is starting to be brought relatively under control, uncertainties remain regarding the possible effects of the outbreak and health measures on consumption habits and general spending behavior. A prolonged normalization phase could translate into a much weaker global and domestic growth outlook, calling for additional response measures.

15. Crude oil demand has decreased significantly with economic activity ground to a halt across many industries around the globe. Global crude oil inventories are at record-high levels. Although oil prices were slightly up after the steps taken by major oil producing countries to sustain output cuts, there remain downside risks to oil prices, particularly due to the uncertainty about the global economic activity. Amid plunging global demand as well as falling commodity prices, global inflation rates are expected to be moderate throughout 2020.

16. The weakening global risk appetite caused a significant rise in financial market volatility. Global risk appetite and financial market volatility have recently shown signs of improvement. However, stock and bond markets in advanced and emerging economies continue to fluctuate. Emerging markets continue to see massive capital outflows. With somewhat reduced pandemic uncertainty and partially loosened restrictions, and thanks to recent monetary and financial measures, adverse effects of global developments on Turkey's risk premium and exchange rate volatility partially eased. 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.

17. Monetary, financial and fiscal measures introduced to address the pandemic, as well as the expansion of loan supply, mostly by state-owned banks, have mitigated downside risks to loan growth and contributed to the uninterrupted flow of credit to the real sector. After having lost momentum due to macroprudential measures in the first months of 2020, consumer loan growth continues, albeit at a slower pace since mid-March when the first coronavirus case was reported. On the other hand, strong momentum in commercial loans continues. Guaranteed-loans, led by state-owned banks in particular, propped up commercial and personal loan supply and helped bring interest rates further down, thus alleviating the negative effects of the pandemic on income and cash flows of economic units. 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.

18. Developments in inflation expectations and domestic demand conditions have contributed to a mild trend in core inflation indicators. Despite the recent depreciation in the Turkish lira due to global developments, international commodity prices, especially crude oil and metal prices, affect 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. Although consumer inflation might follow a slightly higher course in the short term due to seasonal and pandemic-related effects on food prices, demand-driven disinflationary effects will be more prevalent in the second half of the year. Accordingly, considering all factors affecting the inflation outlook, the Committee decided to make a measured cut in the policy rate. Under the current monetary policy stance, inflation outlook is considered to be in line with the year-end inflation projection.

19. 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.

20. 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 and consider sectoral interactions. Meanwhile, ensuring that policy measures are designed in a targeted and temporary fashion would support policy effectiveness.

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