Press Release on Summary of the Monetary Policy Committee Meeting

26 February 2020, No. 2020-09

Meeting Date: 19 February 2020

Inflation Developments

1. In January, consumer prices rose by 1.35%, while annual inflation increased by 0.31 points to 12.15%. Annual inflation declined across the main groups excluding energy, and the surge in energy inflation stemmed from the low base from the same period of the previous year. In this period, B and C indicators recorded a relatively flat annual inflation, but a slight increase in trends.
2. In January, annual inflation in food and non-alcoholic beverages fell by 1.85 points to 9.04%. Led by fresh fruits and vegetables, unprocessed food prices surged on a seasonal basis, yet the group's annual inflation dropped due to the high base, limiting the food inflation. Meanwhile, processed food prices remained on an upward track in January, driven mainly by the bread-cereals and dairy products.
3. Energy prices rose by 1.11% in January. Annual energy inflation rose by 6.16 points to 17.14% due to the low base effect led by the reduced prices in electricity, natural gas and municipal water in the same period of the previous year. Monthly price increases were shaped by the rise in municipal water tariffs and increased fuel prices due to exchange rate developments notwithstanding the fall in international oil prices. Leading indicators for February signal that the group's annual inflation will decline due to fuel prices. Meanwhile, in February, tobacco prices of the food and non-alcoholic beverages group registered a decline.
4. Annual core goods inflation decreased by 0.13 points to 7.35% in January. In this period, annual inflation dropped in durable goods, rose in clothing and footwear group and remained flat in other core goods. The VAT reduction in furniture products was largely transmitted into prices, pulling down the prices of durable goods in January. All in all, the underlying trend of core goods inflation remained mild.
5. Services prices increased by 2.00% and annual services inflation inched down to 12.20% in January. In this period, annual inflation declined in rents, transport services and communication but crept up in restaurants-hotels and remained relatively flat in other services. According to the monthly price developments, price hikes seen in the other services group items that are inclined to backward-indexation, that reflect the exchange rate effect, and whose prices are set according to the re-valuation rate were noteworthy. The underlying trend of services inflation increased slightly in this period.

Factors Affecting Inflation

6. Recent data indicate that recovery in economic activity continues. Industrial production posted a month-on-month surge in December and rose by 1.5% compared to the previous quarter. Survey indicators signal that the strong course in production will also continue in January.

7. The decline in risk premium, fading uncertainties and the rebound in loans support domestic demand, and the sectoral diffusion of economic activity continues to improve. Despite signs of recovery due to falling loan rates and improving prospects for the overall economy, investment and employment remain weak. The Committee emphasized the importance of growth and demand stability for a sustainable improvement in investment and employment.

8. While favorable effects of improved competitiveness prevail, weakening global economic outlook tempers external demand. The European region's PMI indicators have recently signaled a partial improvement in the growth outlook, with Germany and the UK in the lead. In addition to this improvement in external demand, new market gains also affected exports positively. However, the re-emergence of downside risks to global growth due to the epidemic in China raises the uncertainties over the external demand outlook. Meanwhile, the recovery in domestic demand stimulates imports and the contribution of net exports to economic growth declines. Although the current account balance follows a moderate course, the effect of the developments in the demand composition and the epidemic are monitored closely.

9. The recovery in labor market continues as the economic activity grows stronger. Compared to the previous period, non-agricultural employment increased driven by industrial sector in November period and unemployment rates continued to decrease. The leading indicators signal that the decline in unemployment rates continued in the first quarter of 2020 as well.

10. In sum, as the contribution of net exports to economic growth declines, economic recovery is expected to be sustained with the help of the ongoing disinflation process and improvement in financial conditions.

Monetary Policy and Risks

11. Weakness in global economic activity continues both in advanced and emerging economies. Global economic activity presents a favorable outlook on the back of the favorable developments towards settlement of trade tensions between the US and China, dissipating Brexit-related uncertainties and the ongoing accommodative stance in global monetary policies. Nevertheless, aggravated geopolitical tensions in January, social unrest in some emerging markets, drought in the southern hemisphere and concerns over the epidemic that broke out in China keep downside risks to global economic activity in place. The likely impact of the listed factors on domestic growth are closely monitored.

12. Weak global economic activity coupled with more apparent downside risks repress commodity prices and lead to a mild course in oil prices despite supply-side problems stemming from geopolitical developments. In this respect, global inflation is expected to remain flat in 2020.

13. Weakness in global economic activity and low levels of global inflation strengthen expectations regarding the continuation of expansionary monetary policies in advanced economies. On the other hand, recently elevated uncertainties regarding global economic outlook lead to volatility in the demand for emerging market assets and the risk appetite.

Rising protectionism, uncertainty regarding global economic policies, geopolitical developments and the recent outbreak of an epidemic disease are closely monitored for their impact on capital flows, international trade and commodity prices.

14. The cautious monetary policy stance, the improvement in macroeconomic indicators, and accommodative monetary policies in advanced economies have positively affected Turkey's country risk premium. However, upside risks to the medium-term inflation outlook that may be triggered by global and geopolitical uncertainties through the country risk premium and exchange rate volatility channels will continue to be monitored closely.

15. The strong rate cuts since July, lower inflation expectations and improved banking liquidity helped bring loan and deposit rates further down. Thus, TL-denominated loans, consumer loans in particular, remained on the rise thanks to improved financing conditions and recovering domestic demand. This rise can be attributed to supply-side effects caused by expectations for the overall economic outlook as well as postponed loan demand and loan restructuring. Nevertheless, developments in credit growth and its composition are closely monitored for their impact on external balance and inflation. Going forward, sustaining a moderate course in the current account balance, which has recently recorded significant improvement, is considered as a crucial element of the macroeconomic policy mix. Accordingly, the Committee assessed that macroprudential measures addressing credit growth and its composition might be reviewed to safeguard the achievements in the current account balance for price stability and financial stability objectives.

16. In the upcoming period, with the improvement in liquidity and capital adequacy ratios of the banking sector, the fall in interest rates and adjustments in required reserves are expected to further support credit growth. In addition, non-performing loans and Stage 2 loans are monitored closely for any impact they might have on banks' loan supply in the short term. Employment and income developments will determine the persistence of recent rate cut-driven rebound in loan demand. The pace, scope and sustainability of normalization in credit conditions will be important for the outlook for economic activity.

17. Inflation expectations remain favorable. Developments in inflation expectations, domestic demand conditions and producer prices have contributed to a mild trend in core inflation indicators. The improvement in macroeconomic indicators, inflation in particular, supports the fall in country risk premium and helps contain cost pressures. The course of inflation is considered to be broadly in line with the year-end inflation projection. Accordingly, considering all factors affecting the inflation outlook, the Committee decided to make a more measured cut in the policy rate. At this point, the current monetary policy stance remains consistent with the projected disinflation path.

18. 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 on 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. In order to support the effectiveness of monetary policy and minimize a likely inflation-growth trade-off, it will be crucial that macro-financial policies are determined with a focus on reducing financial volatility and risk premium, and that the predictability of fiscal policy continues to be reinforced.

19. The fiscal policy outlook that the monetary policy is based on incorporates a policy stance that focuses on price stability and macroeconomic rebalancing and that is coordinated with the monetary policy. Accordingly, the monetary policy stance assumes that administered price and tax adjustments are formulated in a way that will help reduce the backward-indexation behavior. If the fiscal policy significantly deviates from this framework leading to an adverse impact on the medium-term inflation outlook, the monetary policy stance may be revised.

20. Collective efforts to turn the recently enhanced coordination between monetary and fiscal policies into a sustained and systematic framework are expected to support the achievement of price stability. Moreover, continued structural steps focusing on reducing rigidity and volatility in inflation will contribute to price stability and therefore social welfare.

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