

## PRESS RELEASE

30 June 2015

### SUMMARY OF THE MONETARY POLICY COMMITTEE MEETING

Meeting Date: 23 June 2015

#### *Inflation Developments*

1. In May, consumer prices increased by 0.56 percent and annual inflation edged up by 0.2 points to 8.09 percent. Annual food inflation in this period declined owing to the correction in unprocessed food prices. On the other hand, energy prices maintained the upward trend amid the developments in crude oil prices. Being affected by the exchange rate developments, core goods inflation followed an upward course, while services inflation remained high. Accordingly, the underlying trend of core inflation indicators registered an increase due to core goods.
2. Annual inflation in food and non-alcoholic beverages fell by 1.55 points to 12.81 percent in May. This fall was mainly driven by unprocessed food prices, and partly by the slowdown in bread and cereal products prices. Seasonally-adjusted unprocessed food prices registered a decline due to fresh fruits and vegetables. Early indicators reveal that, amid the increase in product supply, correction in food prices will be more pronounced in June.
3. Energy prices rose by 1.18 percent in May, and the group's annual inflation recorded an uptick by 1.8 points and reached 3.38 percent mainly due to the low base. Domestic energy prices have been following an upward track since February. This rise is led both by the depreciation in the Turkish lira and the recovery in the international oil prices that hit the bottom in January.
4. Prices of services rose by 0.77 percent, and the annual services inflation increased slightly to 8.85 percent in May. This was led by the price developments in restaurants-hotels and transport services, while annual inflation in other sub-groups remained relatively flat. Cumulative increases in food prices and the ongoing uptrend in meat prices pushed the inflation in restaurants-hotels group further upwards. Annual inflation in transport services have been receding since almost six months in line with the outlook in international fuel prices. However, upon the reversal of the downtrend in fuel prices, transport became another service item that

recorded an increase in this period. Against this background, although remaining flat compared in May to the last month, the underlying trend of services stayed high.

5. Annual inflation in core goods rose by 0.83 points to 5.88 percent in May. Among sub-groups, annual inflation in durable consumption goods rose by around 2 points to 4.66 percent in this period. Being led by the recent depreciation of the Turkish lira also against the euro, monthly price increases in durable consumption goods spread across all sub-groups, particularly home appliances and automobiles groups. Annual inflation was up in clothing, but declined in goods excluding clothing and durable goods. All in all, the seasonally-adjusted underlying trend of core goods inflation posted a significant increase mostly due to exchange rate pressures.

### ***Factors Affecting Inflation***

6. According to TURKSTAT's data, Gross Domestic Product (GDP) expanded by 2.3 percent year-on-year in the first quarter of 2015. On the production side, the first quarter saw a yearly growth in the value added from non-construction industries. On the spending side, final domestic demand has increased due to private and public consumption demand. In this period, the ongoing yet slowing increase in domestic demand drove imports higher while net exports continued to make a negative contribution to annual growth amid declining exports caused by weak external demand.
7. After the solid growth in February and March, industrial production remained unchanged month-on-month in April. On a quarterly basis, April's production level is 2.1 percent above the quarter-ago average. Survey indicators suggest that there has recently been a slight recovery in the export orders. Meanwhile, domestic demand is expected to remain on a moderate upward trend. However, the May strikes, particularly those in the automotive industry, will cause output to drop across vehicle and base metal industries in this period. In fact, contrary to survey indicators, May survey data point to a plunge in non-gold exports driven by automotive industry exports. Thus, industrial production is expected to record a monthly fall in May.
8. Data on the expenditure side suggest that private demand continues to rise in the second quarter, albeit more slowly. The production and imports of consumer goods grew faster in April than in the first quarter. Sales of home appliances and automobiles were up in the April-May period from their first-quarter average. Meanwhile, business survey indicators and consumer confidence indices point to a moderate domestic demand for the April-May period. Production and imports data related to non-vehicle investments remained flat in April. Likewise, indicators for the construction industry and companies' expectations for future investments have yet to signal some recovery in investment spending. In sum, indicators on the second-quarter suggest that economic activity grows modestly, driven by private consumer demand.

9. The terms of trade continues to affect the current account balance positively, which however is restrained by the sluggish exports. Leading indicators point to some increase in the seasonally-adjusted current account deficit in May. The improvement in the current account balance is expected to resume starting from June with the moderate course of consumer loans and lower energy prices.
10. In March 2015, unemployment rates were down 0.1 point from the previous period in seasonally-adjusted terms. Amid non-farm employment losses, unemployment rates declined on falling non-farm labor force. In this period, construction employment increased whereas industrial and services employment fell. The drop in services employment mostly reflects a correction of the strong growth in previous months. Since the last quarter of 2014, non-farm employment growth has been driven by the services sector, while the increase in industrial and construction employment have been small. The industrial production tendency and survey indicators suggest that employment might see some recovery in the second quarter. Yet, other leading indicators have been signaling that non-farm employment gains are very limited, thus tempering any expectations of a significant decline in unemployment. The current pace of economic activity and the weakening investment tendency pose downside risks to employment.

#### ***Monetary Policy and Risks***

11. Loans continue to expand at a reasonable pace in response to the tight monetary stance and the macroprudential measures. The recent tightening in the overall financial conditions is expected to further slow down loan growth slightly in the second half of the year. The composition of loans continues to evolve in the desired direction, with commercial loans growing at a faster pace than consumer loans. In addition, consumer loans excluding home loans grow at a more modest pace. This loan outlook not only limits medium-term inflationary pressures but also contributes to the improvement in the current account balance.
12. External demand remains weak while domestic demand contributes to growth moderately. The current course of global demand dampens the improvement in the current account balance. The economic recovery in Europe affects external demand positively but the ongoing geopolitical tensions and the slowing global trade will cause exports to remain weak for some time. The decline in cumulative energy imports is expected to have a further favorable impact on the current account balance, if the current levels of oil prices are maintained. Overall, the favorable developments in the terms of trade and the moderate course of consumer loans contribute to the improvement in the current account balance, while the relatively weaker exports limit this improvement.
13. The Committee stated that the inflation outlook has yet to display the desired improvement. Although a partial correction in food prices is expected to ease inflation in the short term, the recent exchange rate movements have delayed the improvement in core inflation. This, combined with the uncertainty in global

markets and volatility in energy and food prices, makes it necessary to maintain the cautious stance in monetary policy. The Committee has therefore decided to keep the interest rates at current levels.

14. 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.
15. Global markets still pose significant risks. The reduced predictability of global economy and the increased uncertainties amid the divergence among the monetary policies of advanced economies cause global markets to remain highly data-sensitive. Against this background, the volatility in the risk appetite and capital flows continues.
16. The Committee underlined that, besides cyclical policies to stabilize capital flows, structural measures to enhance the resilience of the financial system are important as well. Accordingly, the Committee assessed that the measures implemented to support the FX liquidity, core liabilities, and long-term borrowing have enhanced the resilience of the economy against global shocks. Additional measures along these lines may be adopted if deemed necessary.
17. 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.
18. Sustained fiscal discipline has become a fundamental element in reducing the sensitivity of the Turkish economy against external shocks in recent years. In the current environment of highly uncertain global markets, the value added from maintaining and further advancing these achievements is significant. Any measure that would 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.