Press Release on Summary of the Monetary Policy Committee Meeting

1 October 2020, No: 2020-59

Meeting Date: 24 September 2020

Inflation Developments

1. In August, consumer prices rose by 0.86% and annual inflation remained flat at 11.77%. While annual inflation rose in core goods, energy and food groups, it remained unchanged in the services group. Meanwhile, annual inflation in the alcoholic beverages and tobacco group declined significantly due to the high base from tobacco products. In this period, annual inflation rates and trends of core indicators registered a rise.
2. Annual inflation in food and non-alcoholic beverages increased by 0.78 points to 13.51% in August. The rise in annual unprocessed food inflation by 1.51 points to 15.36% was the main driver of this increase. Seasonally adjusted data indicate that rise in the prices of fresh fruits and vegetables were prominent in the unprocessed food group. Annual inflation in the processed food group increased by 0.22 points to 11.86%. This uptick was led by the bread and cereals group, while annual inflation in the other processed food group remained flat.
3. Energy prices rose by 1.29% in August and the group's annual inflation increased by 1.02 points to 9.59%. In line with the increases in exchange rates and international oil prices, the rise in fuel prices pushed energy inflation up. Municipal water tariffs climbed further in August, another factor that negatively affected the group's inflation. However, the high base driven by the previous year's adjustment to administered natural gas prices limited inflation in this group.
4. Annual core goods inflation increased by 1.44 points to 10.02% in August due to exchange rate developments, as well as stronger demand conditions on the back of the credit impulse. Annual inflation in durable goods, which is characterized by high exchange rate pass-through, climbed by 3.09 points to 13.07%, and leading indicators showed that high price hikes continued across subcategories in September. In August, prices of other core goods posted an uptick, while seasonal discounts in the clothing and footwear group were higher compared to the last year.
5. Services prices rose by 1.14% in August and annual group inflation remained flat at 11.83%. While annual inflation increased in restaurants-hotels and communication services, it declined in other groups. The fall in the annual inflation of transport services was mainly driven by intercity passenger transportation. The restaurants-hotels group posted price hikes both in catering and, more significantly, in accommodation services. While the increase in the prices of exchange-rate-sensitive items in the other services group was notable, the monthly increase in educational services remained limited. Meanwhile, the VAT cut on educational services is expected to have a favorable effect on prices in the upcoming period.

6. Annual inflation in the alcohol-tobacco group dropped by 19.34 points to 2.44% in August. In this period, alcoholic beverage prices rose by 2.58%, while tobacco prices, despite remaining flat, drove the annual inflation in this group significantly down due to the high base. Meanwhile, in response to international prices and exchange rate developments, gold prices registered a monthly increase of 13.72%, thereby contributing to annual consumer inflation by 1.01 points.

7. In September, inflation expectations continued to increase. The year-end inflation expectation rose by 64 basis points to 11.46%, and the 12-month-ahead inflation expectation increased by 45 basis points to 10.15%.

Factors Affecting Inflation

8. Economic activity is recovering markedly in the third quarter owing to gradual steps towards normalization and the strong credit impulse. Adjusted for seasonal and calendar effects, the industrial production index picked up by 8.4% in July month-on-month and converged to the pre-pandemic level. Survey indicators and high-frequency data indicate that economic activity gained strength in August and September. Turnover indices showed that sectoral diffusion of the recovery continues to widen, while economic activity remains relatively weak in some sectors restrained by tourism and export outlook.

9. Recent monetary and fiscal measures that aim to contain negative effects of the pandemic on the Turkish economy contributed to financial stability and economic recovery by supporting the potential output of the economy. Nevertheless, tightening steps through liquidity management have been taken since August in order to contain the adverse effects of the rapid rebound in domestic demand, led by strong credit impulse, on external balance and inflation. Accordingly, the normalization trend recently observed in commercial loans has started in consumer loans as well.

10. Exports continue to recover across regions and sectors, and reached pre-pandemic levels in September in seasonally and calendar adjusted terms. However, imports, which accelerated markedly in August, lost some pace in September and export/import coverage ratio excluding gold remained quite high. The recent upturn in imports, which has resulted from deferred demand as well as pandemic-related liquidity and credit policies, is expected to moderate with the phasing out of these policy measures. Although tourism revenues declined due to the pandemic, easing of travel restrictions has started to contribute to a partial improvement. The recovery in exports of goods, relatively low levels of commodity prices and the level of the real exchange rate will support the current account balance in the upcoming periods. The Committee underscored the importance of the course of the current account balance in terms of a lasting recovery in economic activity and macrofinancial stability. Accordingly, effects of the recent measures on credit growth and composition and external balance are monitored closely.

11. Adverse conditions in the labor market have started to subside in the June period, and non-farm employment recorded an increase across sectors. Meanwhile, the labor force participation rate, which has recently displayed a significant downward trend, improved on the back of economic recovery, and unemployment rates increased compared to the previous period. Leading indicators reveal that new job posts increased and employment opportunities continued to improve. 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. While global economic activity has shown signs of partial recovery in the third quarter following the normalization steps taken by several countries, uncertainties on global economic recovery remain high due to the continued spread of the pandemic and the possibility of a second wave. Moreover, uncertainties remain regarding the possible effects of the outbreak and health measures on consumption habits and general spending behavior. In case normalization takes a long time or a second wave in the pandemic breaks out in the upcoming period, the nascent recovery in global economy may be interrupted and fluctuations in the global risk appetite may be observed.

13. In the period following the August MPC meeting, crude oil prices receded slightly and downside risks on prices increased. The current level of oil prices is below the levels in the pre-pandemic period. On the other hand, there remain downside risks to commodity prices, particularly due to the uncertainty about the global economic activity, and global inflation rates are expected to be moderate throughout 2020.

14. Advanced and emerging economies continue to maintain expansionary monetary and fiscal stances. While long-term interest rates remain at historic lows across advanced economies, both central bank statements and market expectations suggest that the low-rate environment is likely to continue for a long period. 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.

15. Portfolio inflows to emerging economies have increased since the previous MPC meeting due to improved risk sentiment. Inflows to bond markets observed since June increased significantly in September, while flows to equity markets remained relatively weak and volatile. The Fed's new policy framework and forward guidance reinforced the perception that the policy rate will remain low, which is considered to improve portfolio flows to emerging economies. However, ongoing uncertainties over the global economic outlook might lead to fluctuations in the global risk appetite and portfolio flows to emerging economies. In fact, Turkey's risk premium is fluctuating due to pandemic-driven global uncertainties and country-specific factors. During this period marked with high uncertainties, the pandemic disease is closely monitored for its evolving global impact on capital flows, financial conditions, international trade and commodity prices. Against this background, 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.

16. Monetary, financial and fiscal measures as well as the credit expansion, led by state-owned banks, made a significant contribution to the uninterrupted flow of credit to the real sector and the economic recovery process. Thus, the economy's production potential was supported and economic activity has started to recover significantly since May. The Committee, considering the rebound in the economy and its reflections into macro balances, decided to gradually withdraw the pandemic-specific supportive macro-policy measures since August.

17. Normalization of the measures taken to contain the adverse effects of the pandemic and the tightening steps in liquidity policies have led to an increase in loan and deposit rates, and loan growth has started to decelerate. Amid the policy normalization, the deceleration which had started in commercial loans, started to be observed in retail loans as well during this month. Loan growth and loan composition continue to be monitored closely for their impact on domestic and external balance.

18. The Committee underlined the ongoing high inflation trend and evaluated the factors that interrupted the disinflation process. Pandemic-related supply-side inflationary factors were expected to gradually phase out during the normalization process and demand-driven disinflationary effects were expected to become more prevalent. Pandemic-driven supply-side inflationary effects still persist, as normalization progresses gradually. Aggregate demand conditions continue to curb inflation in certain sectors, while price increases are high for goods that are sensitive to financing conditions. Thus, as a result of fast economic recovery with strong credit momentum and financial market developments, inflation followed a higher-than-envisaged path. The ongoing rise in inflation expectations poses a risk to pricing behavior and medium-term inflation outlook. The Committee assessed that the tightening steps taken since August should be reinforced in order to contain inflation expectations and risks to the inflation outlook. Accordingly, the Committee decided to increase the policy rate by 200 basis points to restore the disinflation process and support price stability.

19. The Committee assesses that maintaining a sustained disinflation 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. Fiscal policy actions, along with other monetary and financial measures taken during the pandemic, have supported the potential output of the economy by limiting the pandemic-related economic risks and significantly contributed to the start of a recovery in economic activity. Sustaining the coordination between monetary and fiscal policies during the recovery process, and determining the macro policy mix in a way that will ensure the continuation of the disinflation process while supporting the current account balance are crucial for maintaining healthy and stable growth. In the upcoming period, temporary and targeted fiscal and quasi-fiscal policy actions will be critical to support the sectors in which the recovery may take longer due to pandemic-related effects.

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