



**TÜRKİYE CUMHURİYET
MERKEZ BANKASI**

**Briefing on
July 2017 Inflation Report**

August 1, 2017

Ankara

July 2017 Inflation Report: Main Sections

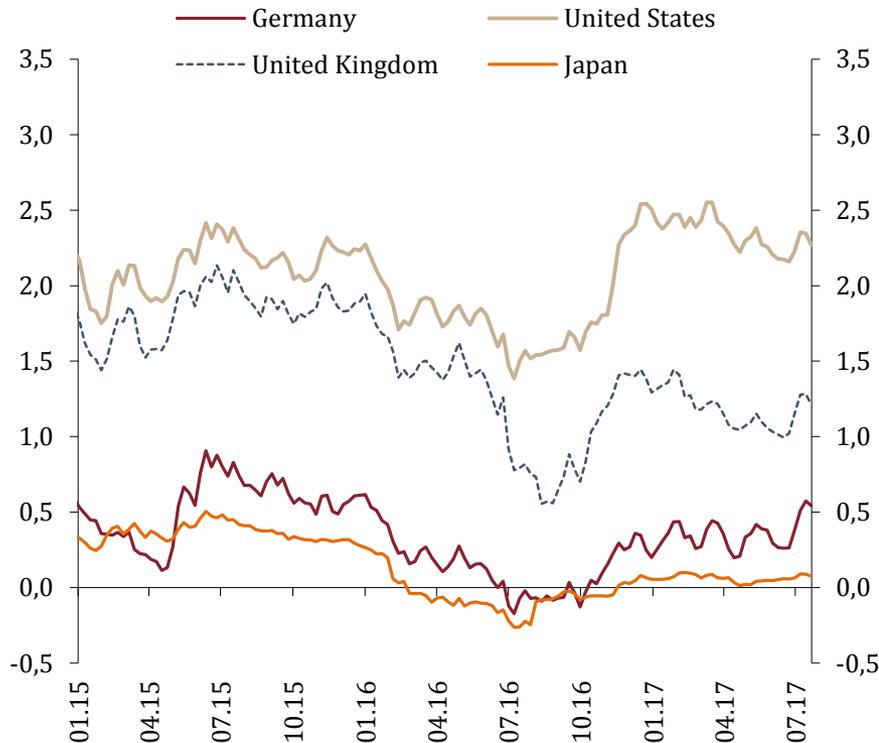
- Overview
- International Economic Developments
- Inflation Developments
- Supply and Demand Developments
- Financial Conditions and Monetary Policy
- Public Finance
- Medium Term Projections

July 2017 Inflation Report: Boxes

- The Expanded Coverage of Export Weighted Global Growth Index
- Recent Developments in Food Prices
- GDP Growth Forecasts: An Application with the New National Income Series
- Resilience of Turkish Exports to External Demand Shocks: The Case of Fresh Fruits and Vegetables
- The Transmission of Monetary Policy on Cross Currency Swap Rates
- Effects of Foreign Holdings on Long-term Borrowing Rate
- Analyzing Macroeconomic Effects of Changes in Credit Supply

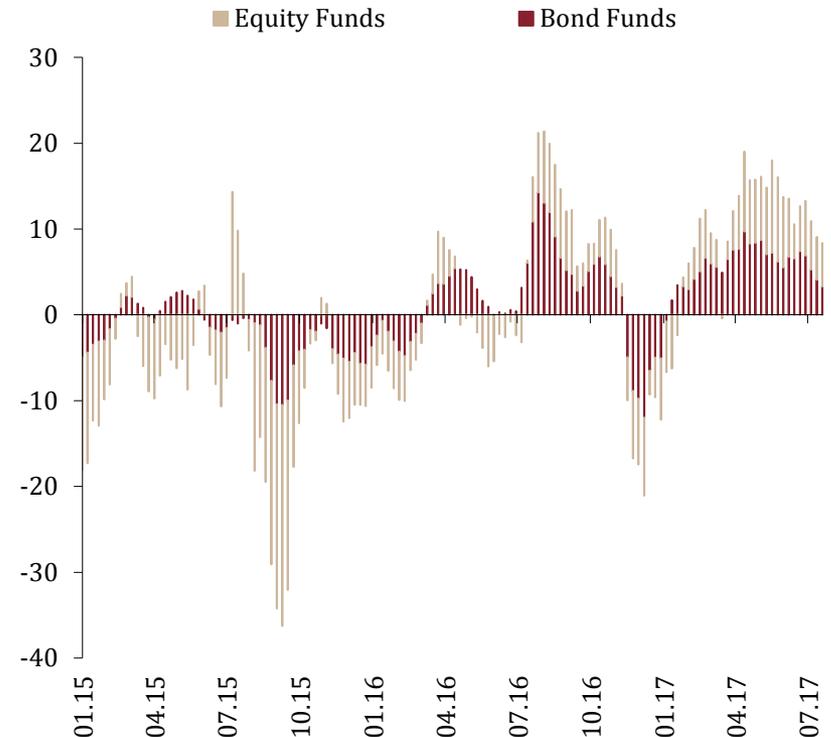
Global Developments and Portfolio Flows

10-Year Bond Rates (Percent)



Source: Bloomberg.

Portfolio Flows to Emerging Economies (4-Week Cumulative, Billion USD)



Source: EPFR.

- In the second quarter, long-term bond yields in advanced economies remained almost flat; bond and stock markets in emerging economies continued to receive strong portfolio inflows.

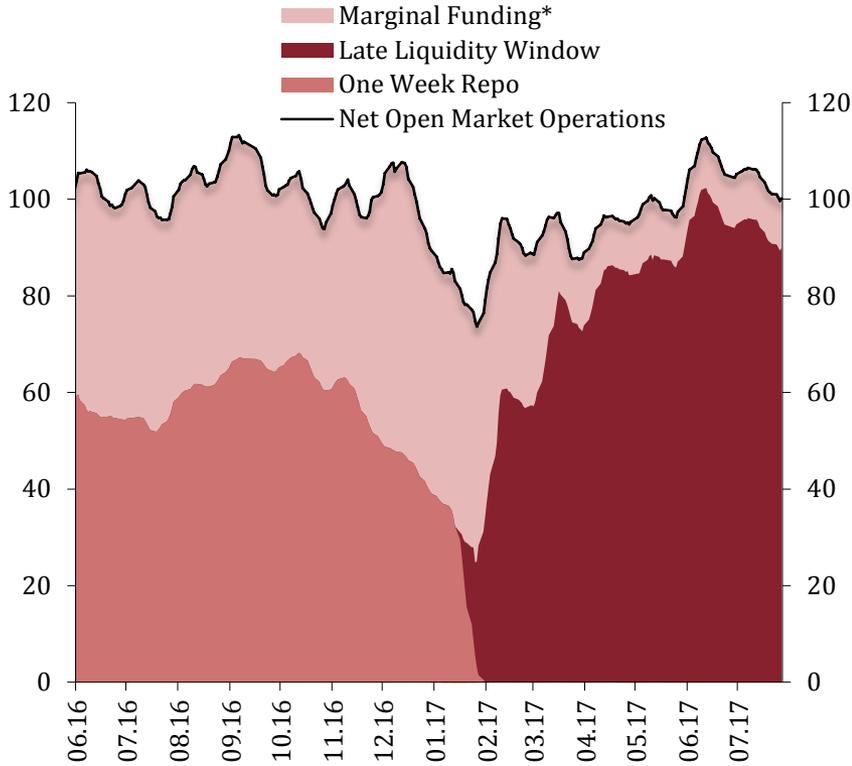
Domestic Economic Outlook

- Since end-January, exchange rate volatility and risk premium indicators in Turkey performed better than other emerging market economies.
- The marked acceleration in loan utilization in the second quarter of the year triggered by the measures introduced assumed a more balanced trend as of the end of the quarter.
- The decline in oil prices and the stable course of exchange rates eased the cost pressures in the second quarter.
- Domestic demand has improved, and the growing EU demand continues to have a positive impact on Turkish exports.
- Economic activity remains strong due to supportive incentives and measures introduced.

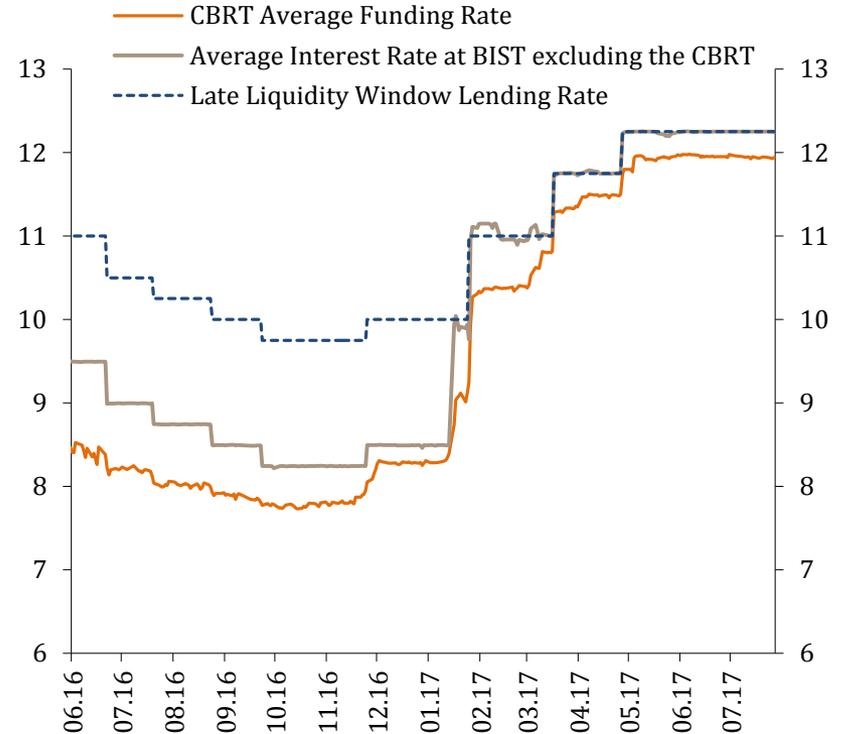
Monetary Policy and Financial Conditions

Monetary Policy

CBRT Funding
(2-Week MA, Billion TL)



Short-term Interest Rates
(5-Day Moving Average, Percent)



* Marginal funding is overnight funding quoted at the upper band of the interest rate corridor.

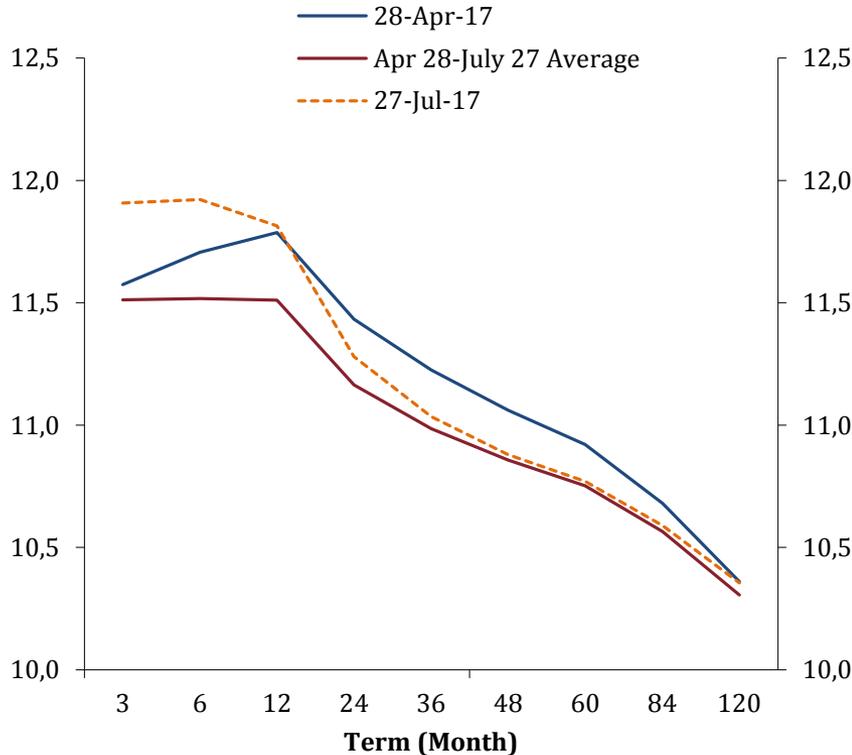
Source: BIST, CBRT.

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- CBRT maintained the tight monetary policy stance to contain risks to the pricing behavior.

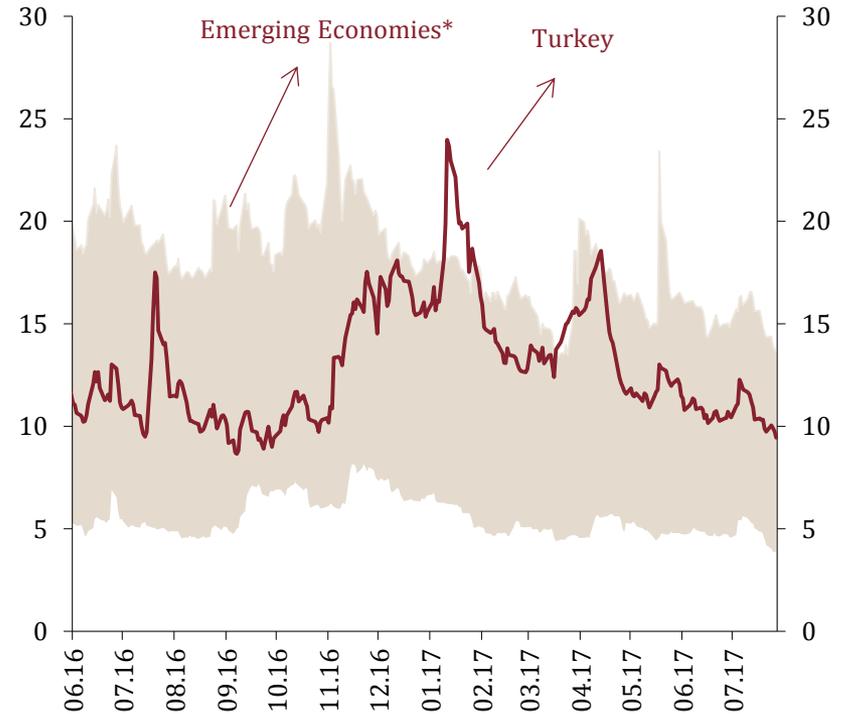
Monetary Conditions

Yield Curve on Cross Currency Swaps
(Percent)



Source: Bloomberg.

Implied FX Volatility
(1 Month, Percent)

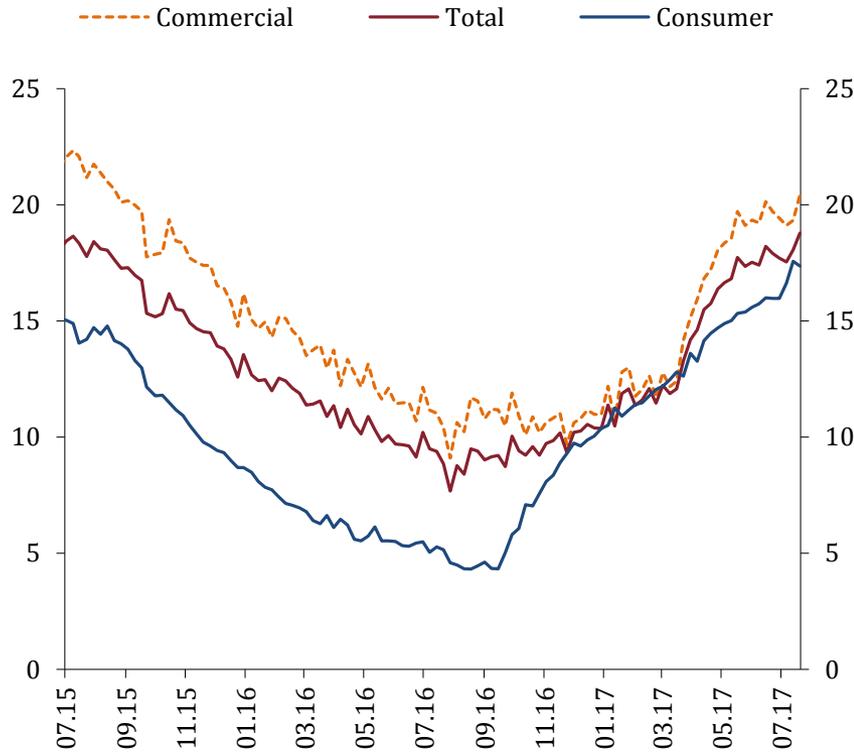


*Emerging economies include Brazil, Chile, Colombia, Mexico, Poland, Philippines, Malaysia, S. Africa, Indonesia, Romania and Hungary.
Source: Bloomberg.

- Since the previous report, medium- and long-term currency swap yields inched down, and implied exchange-rate volatility subdued in part due to the tight monetary policy stance.

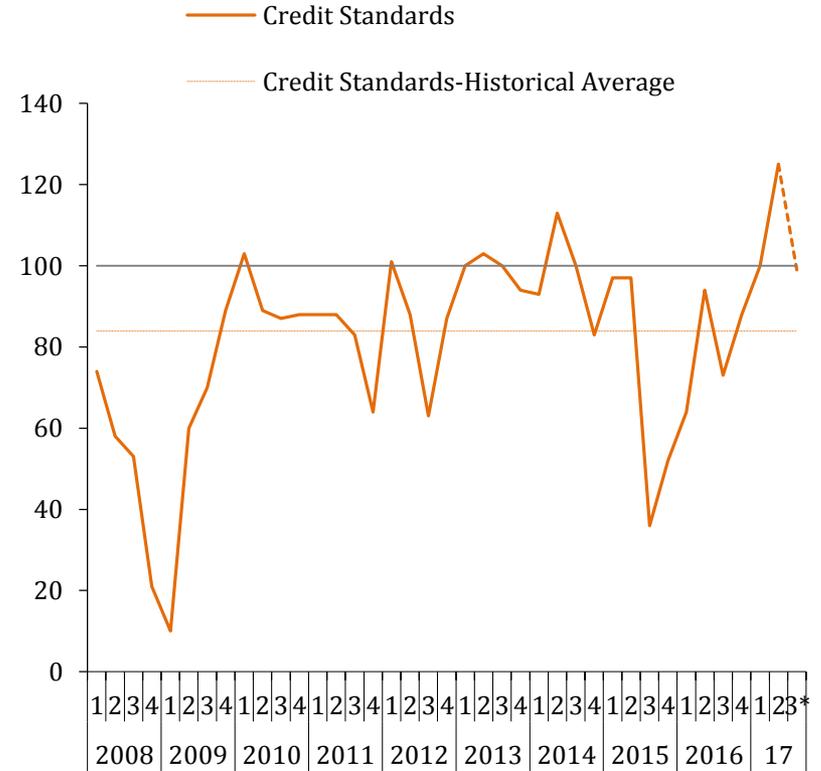
Financial Conditions

Annual Credit Growth
(Adjusted for Exchange Rate, Percent)



Source: CBRT.

Credit Standards for Loans to Enterprises**



*Third quarter data for 2017 is forecast.

**Index values above 100 indicates easing in loan standards.

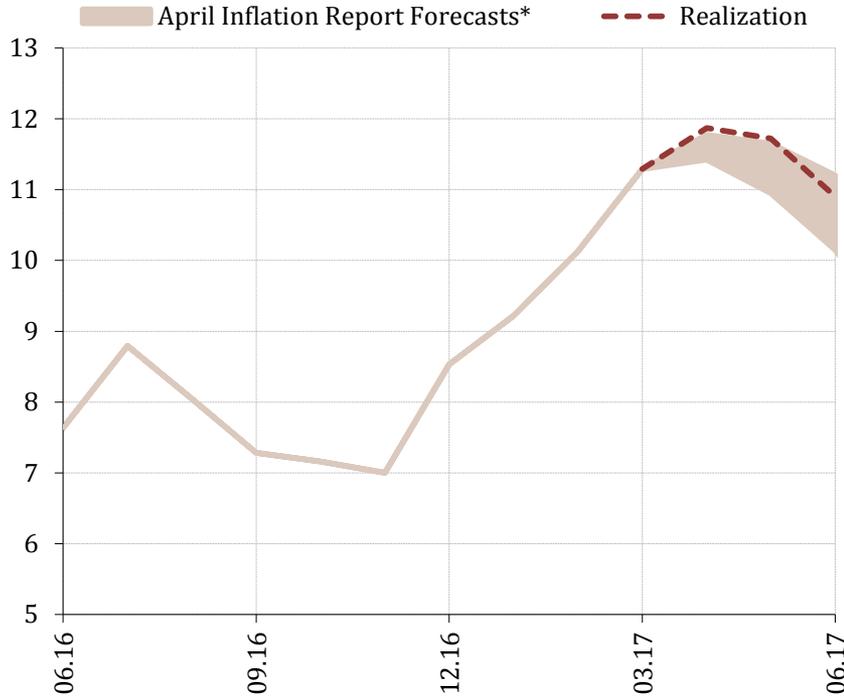
Source: CBRT.

- Bank loans accelerated and lending standards eased in the second quarter due to incentives and measures taken.

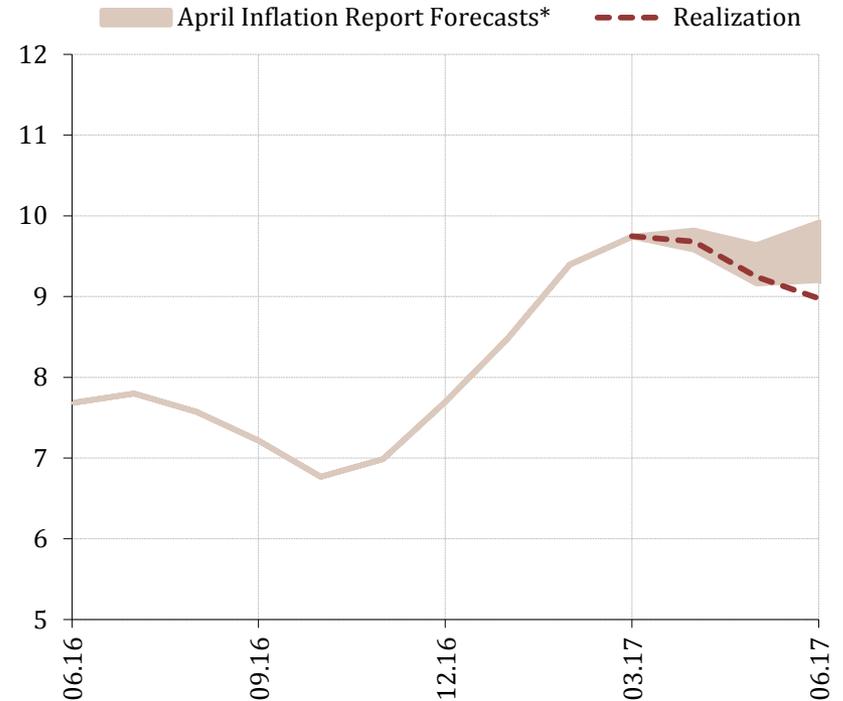
Macroeconomic Developments and Main Assumptions

April 2017 Inflation Report Forecasts and Realizations

Consumer Inflation (Percent)



Inflation Excluding Unprocessed Food and Tobacco (Percent)

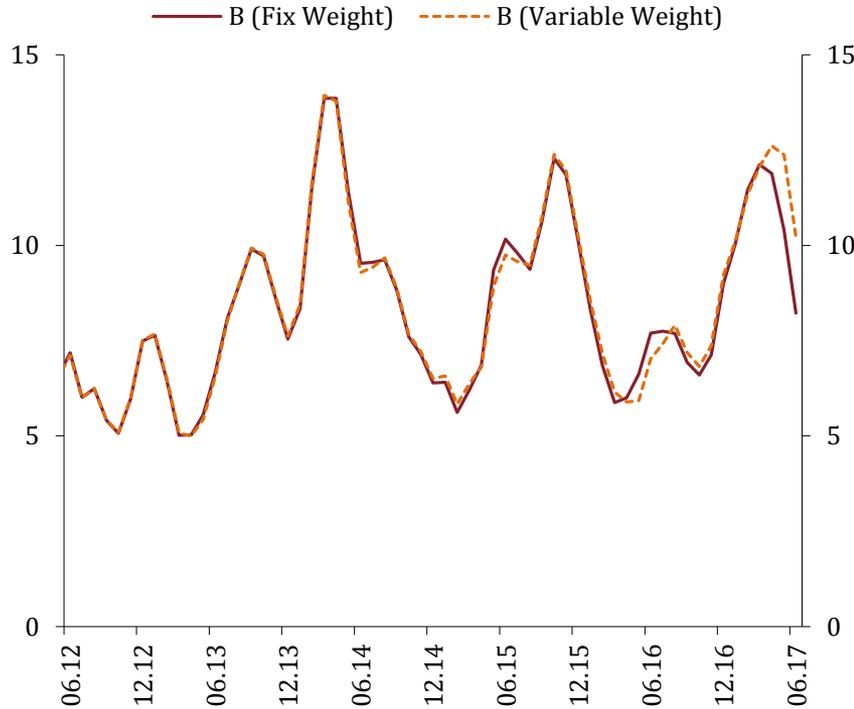


* Shaded region indicates the 70 percent confidence interval for the forecast.
Source: TURKSTAT, CBRT.

- Consumer inflation was in line with the April Inflation Report forecast, whereas consumer inflation excluding unprocessed food, alcoholic beverages and tobacco was slightly below the previous forecast.

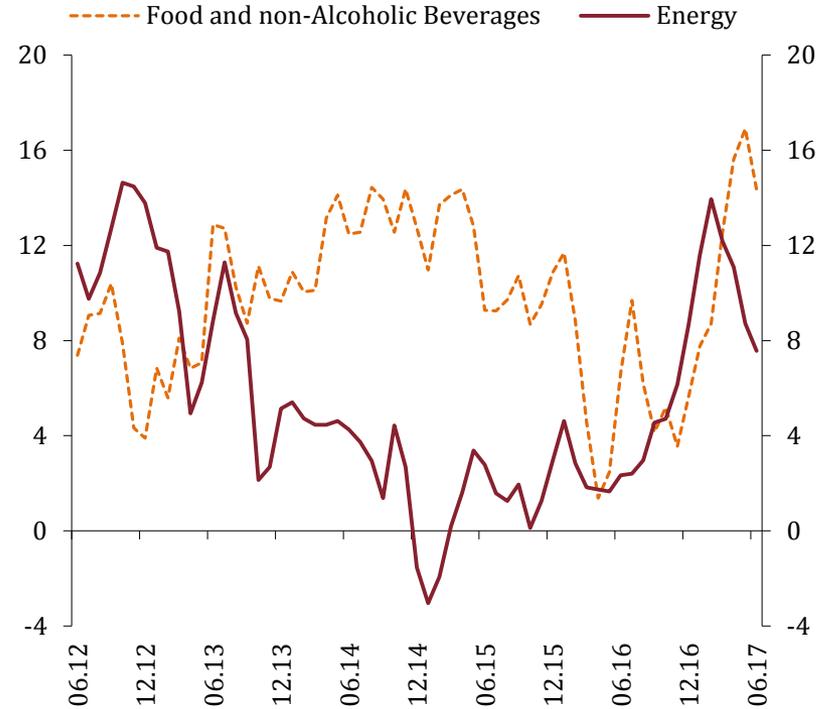
Inflation

Core Inflation Indicators
(SA, 3-Month MA, Annualized, Percent)



Source: TURKSTAT. CBRT.

Food and Energy Prices
(Annual Percent Change)

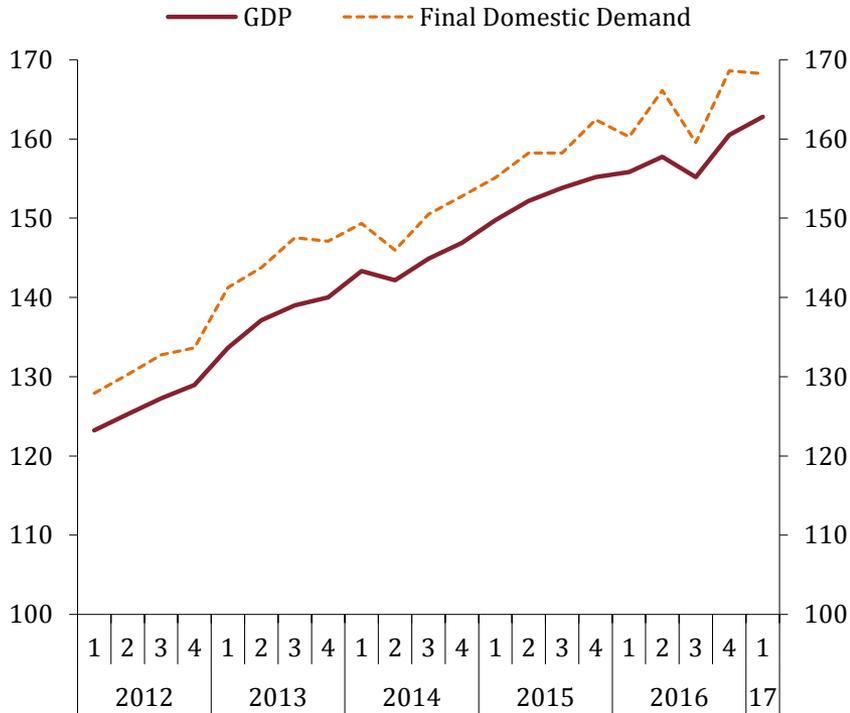


Source: TURKSTAT. CBRT.

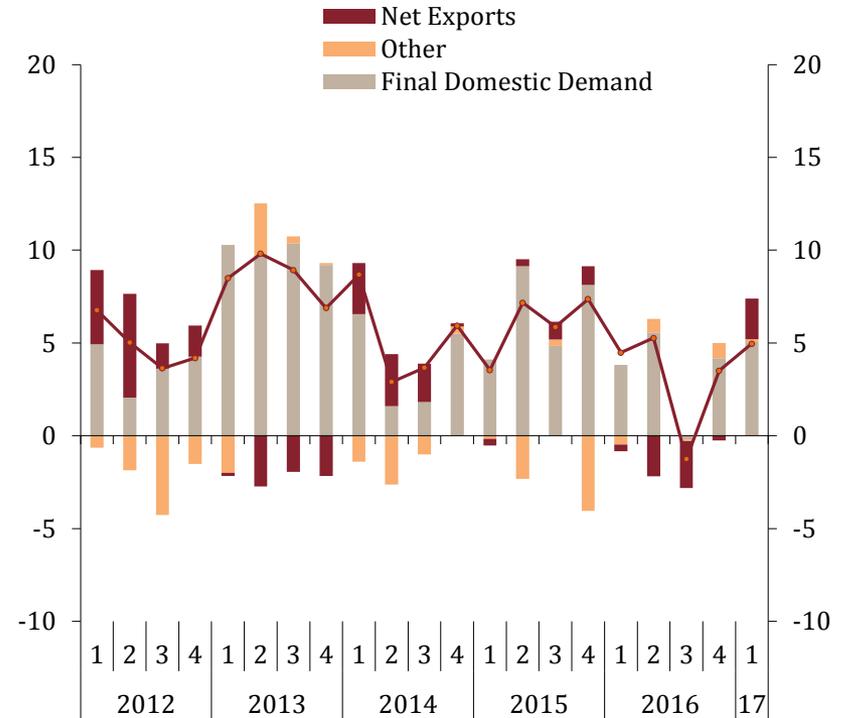
- Despite the recent slowdown, underlying inflation remained elevated.
- Food inflation surged in the second quarter, whereas the fall in energy prices contained consumer inflation.

Aggregate Demand

GDP and Final Domestic Demand
(Real, Seasonally Adjusted, 2009=100)



Contributions from the Expenditure Side
(Percentage Point)



Source: CBRT, TURKSTAT.

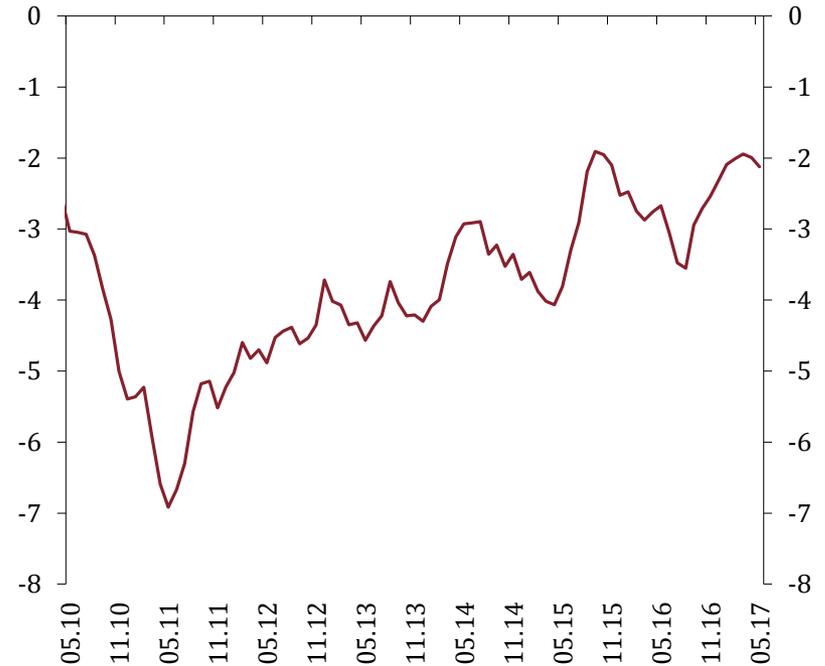
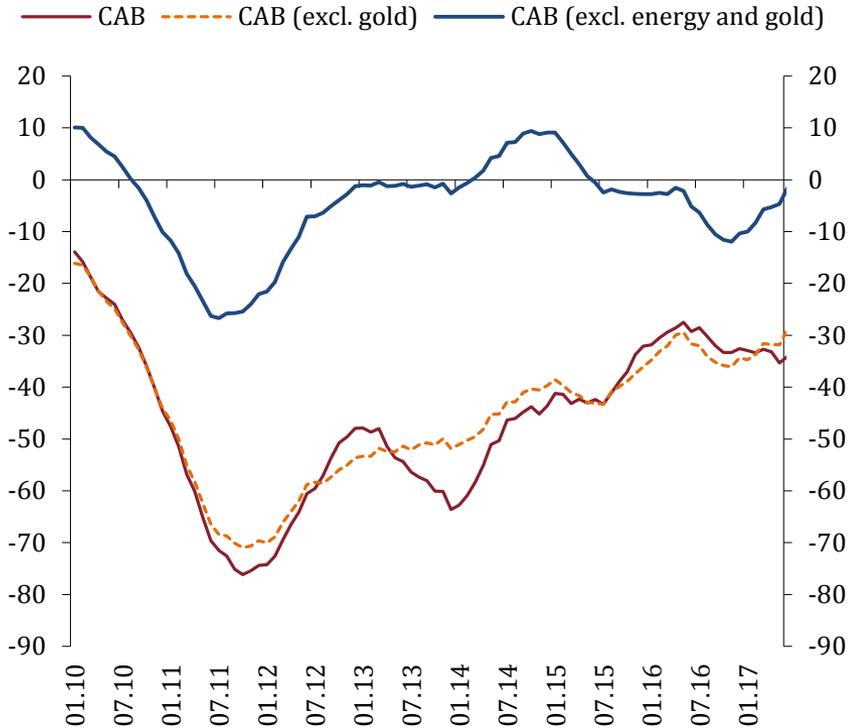
* Other item comprises change in stocks and statistical discrepancy due to the use of chain linked index.
Source: TURKSTAT.

- Economic activity in the first quarter proved to be stronger compared to the outlook envisaged in April Inflation Report.

External Balance

Current Account Balance (CAB)
(12-Month Cumulative, Billion USD)

Current Account Balance
(Excl. Gold, SA, 3-Month MA, Billion USD)



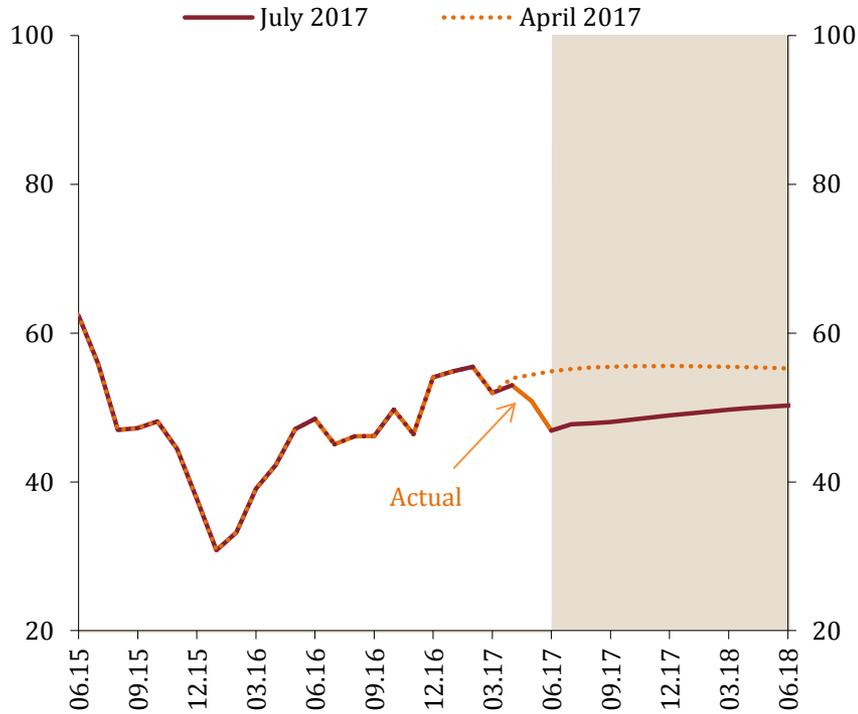
Source: CBRT.

Source: CBRT.

- The strong performance in exports of goods will continue to have a favorable impact on the current account.

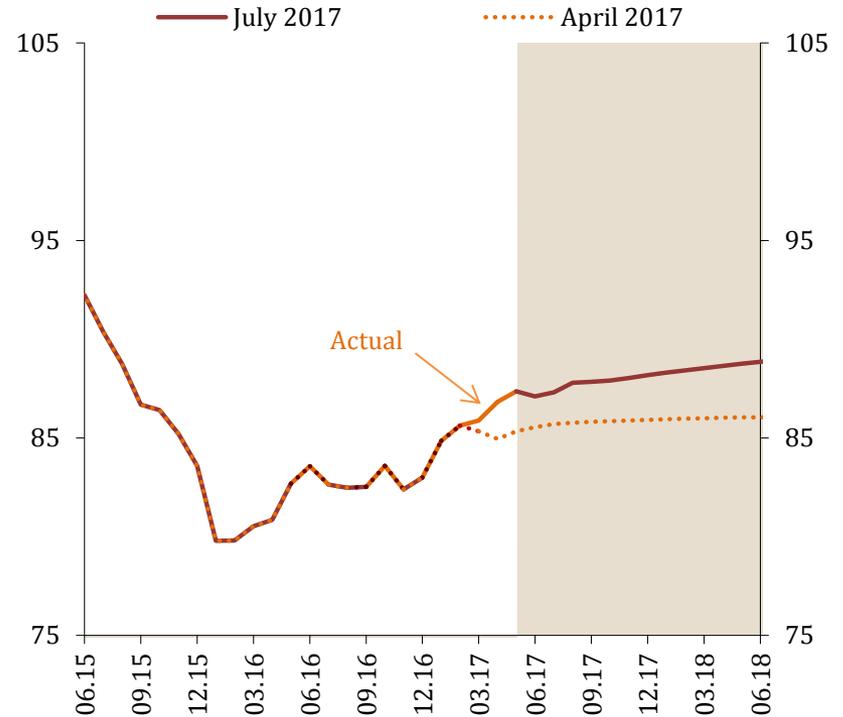
Revisions in Oil and Import Price Assumptions

Oil Prices
(USD/bbl)



Source: Bloomberg, CBRT.

Import Prices
(Index, 2010=100)



Source: CBRT, TURKSTAT.

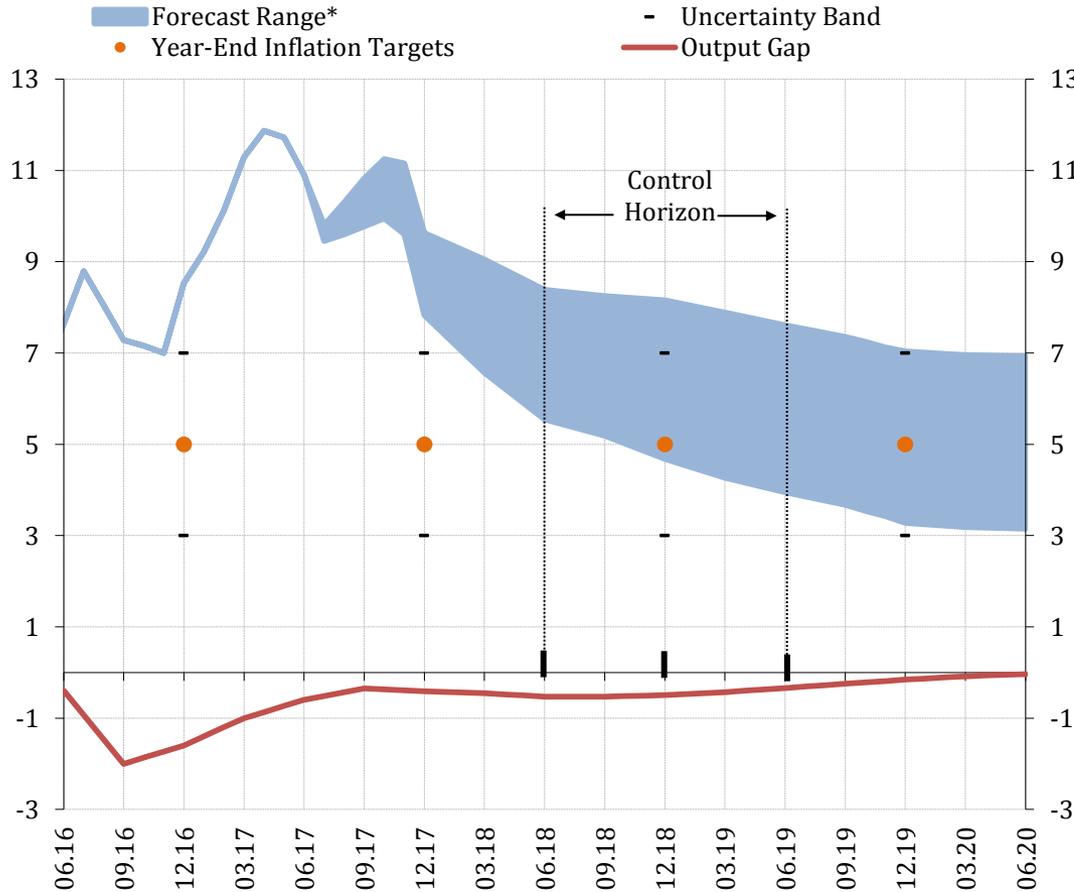
- Assumptions for crude oil prices were revised downwards, while USD-denominated import prices were revised upwards for 2017.

Revisions in Assumptions

		April 2017	July 2017
Output Gap	2017 Q1	-1.7	-1.0
	2017 Q2	-1.5	-0.6
Food Prices (Year-end Percent Change)	2017	9.0	10.0
	2018	7.0	7.0
Import Prices (Average Annual Percent Change, USD)	2017	4.4	6.2
	2018	0.5	2.0
Oil Prices (Average, USD)	2017	55	50
	2018	55	50
Export-Weighted Global Production Index (Average Annual Percent Change)	2017	1.8	2.1
	2018	2.0	2.2

Inflation Outlook

Inflation and Output Gap Forecasts (Percent)

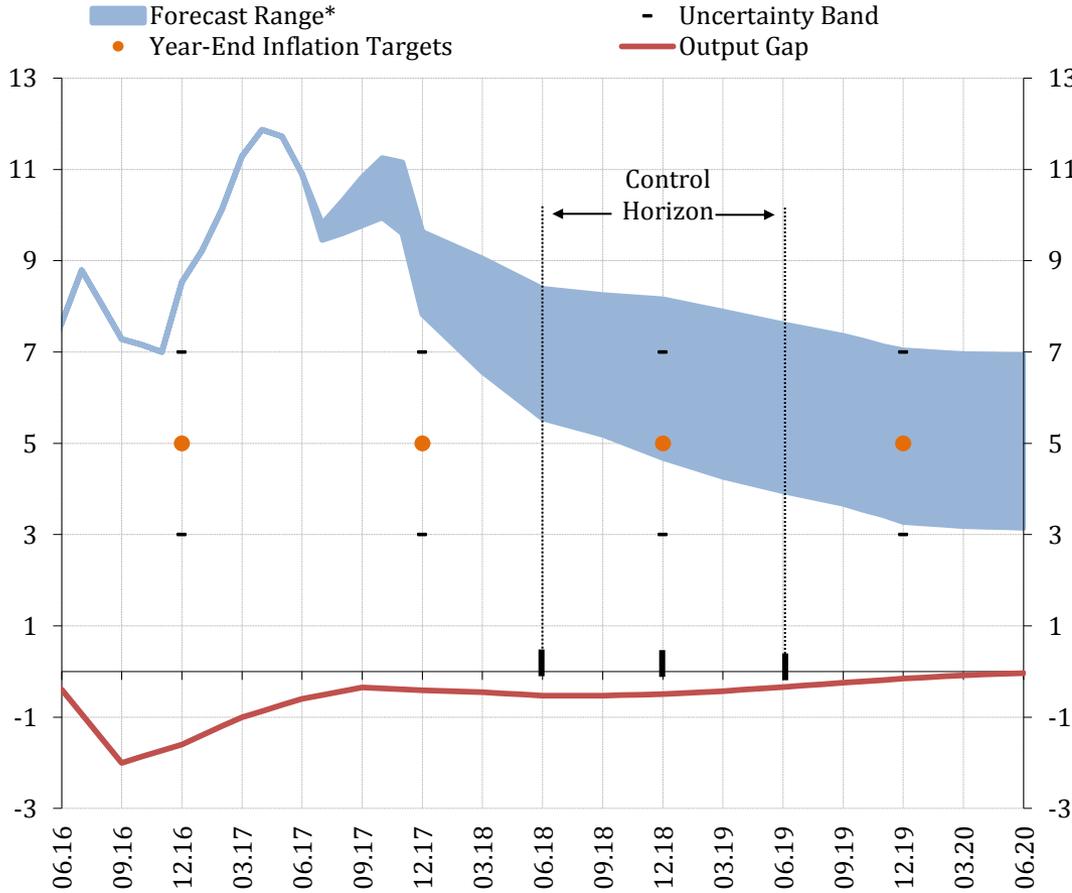


*Shaded region indicates the 70 percent confidence interval for the forecast.

- Given a tight policy stance that focuses on bringing inflation down, inflation is estimated to converge gradually to the 5% target.
- Inflation is likely to be 8.7% at end-2017, and stabilize around 5% in the medium term after falling to 6.4% in 2018.
- Accordingly, inflation is expected to
 - be between 7.8% and 9.6% (with a mid-point of 8.7%) at end-2017
 - be between 4.7% and 8.1% (with a mid-point of 6.4%) at end-2018
 with 70 percent probability.

Inflation Outlook

Inflation and Output Gap Forecasts (Percent)



*Shaded region indicates the 70 percent confidence interval for the forecast.

The upward revision in 2017 year-end inflation forecasts by a total of 0.2 points, relative to April Inflation Report, is driven by:

- Upward revision in output gap by +0.2 points,
- Upward revision in assumptions for food inflation by +0.2 points,
- Downward revision in assumptions for TL-denominated import prices by -0.1 points,
- Suspension of automatic tax hikes on tobacco products by -0.1 points.



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