

# Press Release on Summary of the Monetary Policy Committee Meeting

29 July 2020, No: 2020-40

Meeting Date: 23 July 2020

## Inflation Developments

1. In June, consumer prices increased by 1.13% and annual inflation rose by 1.23 points to 12.62%. In this period, annual inflation was down in processed food, but edged further up in unprocessed food, keeping food inflation flat. Despite rising on the back of international crude oil prices, energy inflation continued to restrain consumer inflation. Cumulative exchange rate effects, the pandemic-driven increase in unit costs, and the rising demand for certain sectors amid stronger credit supply drove core goods inflation higher. Meanwhile, services inflation went up due to items affected by normalization process. Consequently, the annual inflation rates and trends of core indicators increased.
2. Annual inflation in food and non-alcoholic beverages rose by 0.06 points to 12.93%. The soaring annual inflation in vegetables pushed annual unprocessed food inflation up by 2.15 points to 12.29%. On the other unprocessed food front, prices of pulses, dried fruits and nuts and rice continued to climb in June, whereas prices of red meat saw a downtick after having soared in recent months. Processed food prices posted a modest monthly increase and annual processed food inflation fell by 2.09 points to 13.41% amid base effects.
3. Energy prices increased by 2.62% in June and annual energy inflation rose by 3.89 points to 9.12%. The ongoing recovery in international oil prices was the main driver of the rise in energy prices. There was also a notable increase in municipal water rates.
4. Annual core goods inflation increased by 2.14 points to 11.39% in June. In this period, annual inflation was up across all subcategories. Prices were driven higher by cumulative exchange rate effects, pandemic-driven unit cost increases and the growing demand for certain subcategories due to favorable credit conditions. Therefore, price hikes were more significant in automobiles, white goods and other electrical and non-electrical appliances. Meanwhile, price increases in clothing and footwear exceeded seasonal averages in June.
5. Prices of services increased by 2.09% in June, and annual services inflation rose by 0.48 points to 11.76%, largely due to sectors facing capacity constraints amid gradual normalization, with transport and restaurants-hotels in the lead. In fact, the largest increase in annual inflation was recorded for transport. Other subcategories with higher annual inflation included catering services, accommodation, and items of other services such as package tours and personal grooming services. In this period, inflation remained low in communication, while annual rent inflation continued to decline.
6. Year-end and 12-month-ahead inflation expectations were up in July while 24-month-ahead expectations remained flat.

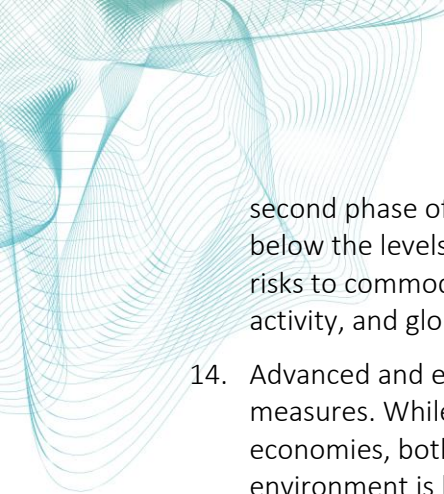


## Factors Affecting Inflation

7. Recent data releases confirmed that economic activity started to bottom out in May. Adjusted for seasonal and calendar effects, the industrial production index was up 17.6% month-on-month. Likewise, turnover indices showed that the decline in non-industrial sectors halted. However, as the March-April contraction was only partially compensated, economic activity seems to have been weak in May.
8. Economic recovery, which started in May following gradual steps towards normalization, is gaining pace. Improving credit conditions support domestic demand. While expenditures by cards for items with high sensitivity to financing conditions and deferred demand have increased briskly, the consumption of electricity has also been increasing steadily. On the other hand, the weak course continues in services groups hardest hit by the pandemic, such as transportation, accommodation, and catering services.
9. High-frequency data indicate that the recovery in the foreign trade volume continues, most visibly in exports. The improvement in exports spreads across all regions and sectors. Although tourism revenues declined due to the pandemic, easing travel restrictions are expected to contribute to a partial improvement. Indeed, credit card spending by foreigners and other high-frequency data carry signals, albeit still weak, for a recovery from trough in tourism activity. The recovery in exports of goods and low levels of commodity prices 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 in terms of macrofinancial stability.
10. In light of currently available data, economic activity is expected to post a significant improvement in the third quarter. Recent monetary and fiscal measures that aim to contain negative effects of the pandemic on the Turkish economy contribute to financial stability and economic recovery by supporting the potential output of the economy.
11. In the April period, employment losses continued to be registered across all sectors, the services sector in particular, and unemployment rates rose. The decline in the labor force participation rate continued to limit the rise in unemployment rates. Leading indicators reveal that new job posts increased and employment opportunities improved partially thanks to the improvement in economic activity. 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.

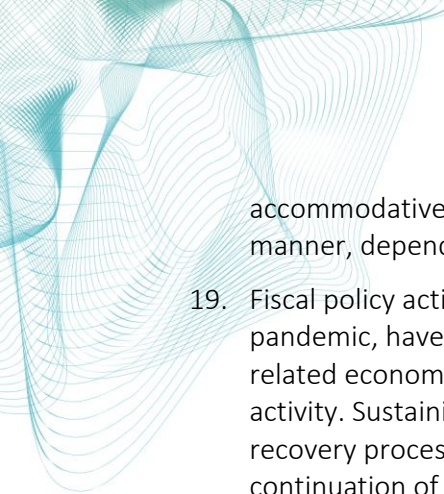
## Monetary Policy and Risks

12. Developments regarding the spread of the coronavirus substantially weakened global growth in the second quarter. 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 likelihood of a second wave. Moreover, uncertainties remain regarding the possible effects of the outbreak and health measures on consumption habits and general spending behavior. If the normalization takes longer or a second wave of the pandemic strikes in the period ahead, the nascent recovery in global economy may be interrupted and there may be fluctuations in the global risk appetite.
13. In the period following the June MPC meeting, crude oil prices mildly increased due to the recovering global activity as well as OPEC+ countries' tapering of supply cuts as part of the



second phase of the agreement they reached in April. Still, 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 take expansionary monetary and fiscal measures. 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. Although accommodative policy measures and steps towards normalization have driven the risk appetite slightly higher recently, portfolio flows to emerging markets remain weak. The ongoing uncertainties over the global economic outlook might lead to fluctuations in the global risk appetite and portfolio flows to emerging economies. The negative effects of global developments have somewhat eased in the recent period but global uncertainties remain high. In this respect, the pandemic disease is closely monitored for its evolving global impact on capital flows, financial conditions, international trade and commodity prices. 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, driven mostly by state-owned banks, make a significant contribution to the uninterrupted flow of credit to the real sector and the economic recovery process. Loan growth, which gained momentum thanks to the guaranteed loans facility and predominantly in line with firms' demand, remains robust due to personal loan packages offered by state-owned banks following the saturation of firms' loan demand as well as due to the realization of consumers' deferred demand. Loan growth and loan composition are closely monitored for their impact on domestic and external balance.
17. Despite the restraining effects of aggregate demand conditions, pandemic-related rise in unit costs have led to an increase in the trends of core inflation indicators. International commodity prices have continued to restrain consumer inflation, while food inflation has risen due to seasonal and pandemic-related effects. As the normalization process continues, supply-side factors, which have prevailed recently due to pandemic-related restrictions, will phase out. Indeed, leading indicators show that monthly price increases have started to slow down in services groups that have been subject to capacity constraints during the normalization process. The Committee maintains the view that demand-driven disinflationary effects will become more prevalent in the second half of the year, but risks to the end-year projection are considered to be on the upside due to recent realizations in inflation. Accordingly, considering all factors affecting the inflation outlook, the Committee decided to keep the policy rate unchanged.
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 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. Accordingly,



accommodative liquidity measures implemented since March may be revised in a gradual manner, depending on how the normalization evolves.

19. 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.
20. It should be emphasized that any new data or information may lead the Committee to revise its stance.