Press Release on Summary of the Monetary Policy Committee Meeting

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Inflation Developments

1. In September, consumer prices rose by 0.99%, while annual inflation decreased by 5.75 points to 9.26%. In September, with the contribution of strong base effects, consumer inflation displayed a significant fall particularly in core goods and food inflation. In addition to the stable course of the Turkish lira, improvement in inflation expectations and mild domestic demand conditions supported the disinflation in core indicators. Against this background, core indicators B and C maintained their mild course.
2. In the food and non-alcoholic beverages group, annual inflation fell by 7.70 points to 9.52% in September. This fall was led by the favorable courses of unprocessed and processed food prices as well as the strong base effect. The decline in inflation in fresh fruits and vegetables shaped the course of the unprocessed food inflation. Meanwhile, processed food prices, on the other hand, displayed a moderate increase across the subcategories, excluding tea prices.
3. In September, energy prices rose by 3.17%, while annual energy inflation declined to 4.86% due to the base effect. In this period, the impact of the adjustments in natural gas prices proved evident, and fuel prices also increased in tandem with the developments in the exchange rate and oil prices. Meanwhile, the sliding scale system contained a worse outlook in fuel prices. The course of energy prices in October will be shaped by the adjustment in electricity prices.
4. In September, annual core goods inflation decreased by 10.04 points to 2.98%, mainly due to the base effect. Annual inflation declined in all subgroups, with durables and other core goods in the lead. Despite price increases in white goods, prices of durable goods registered a slight month-on-month decline due to automobile prices. Prices of other core goods recorded an increase after the decline in August. Besides the strong base effect, the outlook of the Turkish lira and the mild course of domestic demand were influential in the course of core goods inflation in this period.
5. Services prices rose by 1.47% in September, while annual services inflation went down by 1.65 points to 12.54%. Annual inflation increased in the transport group, but declined in the restaurants-hotels and other services groups due to the base effect and remained almost unchanged in the communication group and rent. In transport services, price hikes particularly in urban transport fares (municipality bus, taxi, train etc.) were influential. The downward impact of domestic demand conditions on services inflation have recently been restrained by real unit labor costs, cumulative cost increases in some items and the backward indexation behavior.

Factors Affecting Inflation

6. Recently obtained data indicate that moderate recovery in economic activity continues. While industrial production has been highly volatile due to working day effects associated with official holidays in recent months, its underlying trend has maintained a moderate pace of growth. In August, the industrial production adjusted for seasonal and calendar effects decreased by 2.8% month-on-month. Working day losses due to the bridging of the Feast of Sacrifice holiday with the weekend and the correction made in other transportation vehicles sector that is volatile in general limited the industrial production significantly in August. In light of a technical recovery to be enabled by the removal of those effects peculiar to August and the favorable outlook in leading indicators, the September industrial production is expected to resume its monthly growth.

7. Leading indicators point to continuing improvement in the sectoral diffusion of economic activity. While the weak labor market outlook and the expiry of tax cuts limited private consumption, the continued improvement in public expenditures and financial conditions underpinned the domestic demand. Indicators such as the CBRT Business Tendency Survey, PMI and sectoral confidence indices hint at an ongoing improvement in the manufacturing industry and services activities. Information obtained during the interviews conducted with firms in this period also gave similar signals regarding the economic activity. Investments, on the other hand, remain weak despite showing signs of a slight recovery starting from the third quarter.

8. The recent slowdown in the global growth outlook, particularly in the EU, became more apparent. While favorable effects of improved competitiveness prevail, weakening global economic outlook tempers external demand. In the third quarter, the exports of goods and services contributed further to growth on the back of market diversity and the strong course in tourism, while the recovery in the domestic demand had implications on imports. Looking forward, net exports are expected to contribute to economic growth, although to a lesser extent, and the gradual recovery of the economy is likely to continue with the help of the disinflation trend and improvement in financial conditions. In this context, the current account balance, which has recently recorded significant improvement due to the composition of growth, is expected to maintain a moderate course.

9. Labor market data is relatively weak. According to July 2019 data, nonfarm employment declined while nonfarm unemployment rate continued to rise compared to June figures. Across sectors, industrial and services employment remained almost flat, while employment in the construction sector continued to fall compared to the previous period.

Monetary Policy and Risks

10. The weakening in global economic activity became more pronounced. Protectionist trade policies and heightened geopolitical uncertainties have noticeably increased the uncertainty regarding global economic policies. These developments keep downside risks to global economic activity alive and should be monitored closely in terms of their impacts on domestic growth via both capital flows and international trade channels.

11. The weak global economic activity depresses commodity prices and leads to a mild course in crude oil prices despite supply-side hurdles arising from geopolitical developments. Accordingly, global inflation rates remain flat.

12. Recently, advanced economy central banks have been pursuing more expansionary policies as weakening global economic activity and downside risks to inflation became more evident.

These developments reflect a more favorable outlook for global financial conditions and support the demand for emerging market assets and the risk appetite. On the other hand, rising protectionism and the uncertainty regarding global economic policies restrain capital flows to emerging markets and add to downside risks for the upcoming period.

13. Although Turkey's risk premium dropped in September owing to a cautious monetary policy stance and improved macroeconomic indicators as well as major central banks' move to expansionary policy stance, it has been up and volatile afterwards due to geopolitical tensions. The elevated levels of the country risk premium and the exchange rate volatility amid global and geopolitical uncertainties keep upside risks to the medium-term inflation outlook alive.

14. The strong rate cuts in July and September and expectations of further rate cuts thereafter helped bring loan and deposit rates further down. Thus, TL-denominated commercial and consumer loan rates dropped significantly while improved financing conditions and growing domestic demand helped total loans, consumer loans in particular, gain momentum. Consumer loans have seen an upswing since early August while commercial loans have been on a more modest rise. This upturn can be attributed to supply-side effects caused by expectations for the overall economic outlook as well as delayed loan demand. Moreover, as part of the scheme in which required reserves are being more flexibly and effectively used to support financial stability, the decision to decrease TL required reserve ratios and to raise the remuneration rate for TL required reserves for those banks having TL credit growth rates between 10-20 percent also contributed to the recovery in credit. Improved liquidity and capital adequacy ratios of the banking sector and lower interest rates are likely to provide a boost to loan growth in the upcoming period. In addition, NPLs 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 if the recent rate cut-driven rebound in loan demand will persist. The pace, scope and sustainability of the normalization in credit conditions will be important for the outlook for economic activity.

15. Despite the restrictive impact of domestic demand conditions on inflation, the current levels of inflation expectations continue to pose an upside risk to the medium-term inflation outlook. Anchoring inflation expectations is crucial for a more effective monetary policy and a reduced inflation-growth trade-off.

16. The inflation outlook continued to improve. Domestic demand conditions and the level of policy tightness continue to support disinflation. Underlying trend indicators, supply side factors, and import prices lead to an improvement in the inflation outlook. In light of these developments, recent forecast revisions suggest that inflation is likely to materialize significantly below the projections of the July Inflation Report by the end of the year. Accordingly, considering all the factors affecting the inflation outlook, the Committee decided to reduce the policy rate by 250 basis points. At this point, the current monetary policy stance, to a large extent, is considered to be consistent with the projected disinflation path.

17. The Committee assesses that maintaining a sustained disinflation process is the key 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 policy stance. In this respect, the extent of the monetary tightness 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.

18. The Committee emphasized the importance of sustaining the improvement in the country risk premium for the price and financial stability objectives. In this context, in order to support the effectiveness of the 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 the 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.