

Summary of the Monetary Policy Committee Meeting

23 January 2019, No: 2019-04

Meeting Date: 16 January 2019

Inflation Developments

1. In December, consumer prices decreased by 0.40 percent and annual inflation fell by 1.32 points to 20.30 percent. The largest contribution to the decline in inflation came from energy and core goods groups. Oil prices and exchange rate developments favorably affected the energy group, while core goods prices were affected by both exchange rate developments and weaker domestic demand. Services inflation decreased across all subcategories. Against this background, both the annual inflation and the underlying trend in core indicators decelerated. In sum, consumer prices in December reflect the appreciation in the Turkish lira as well as demand-side effects led by weaker economic activity.
2. Annual inflation in food and nonalcoholic beverages maintains its elevated levels with 25.11 percent. As of December, annual food inflation is 27,09 percent in unprocessed food group and 23,22 percent in processed food group.
3. Energy prices were down by 3.12 percent in December and annual inflation in this group fell by 4.53 points to 20.82 percent. This is mainly attributed to the decline in fuel prices driven by the fall in international oil prices as well as the developments in the Turkish lira. Annual inflation in the energy group is projected to decrease significantly in January mostly due to the adjustments in electricity and natural gas prices as well as to the reductions in municipal water prices in some cities.
4. Annual core goods inflation dropped by 2.22 points to 24.67 percent in December. In this period, durable goods prices decreased across all subcategories, most visibly in automobiles. The deceleration in annual clothing and footwear inflation also continued in December due to demand conditions. Although monthly price increases in other core goods significantly lost pace, annual inflation in this group remained high. To sum up, the decline in core goods inflation is attributed to the appreciation in the Turkish lira and the weaker domestic demand.
5. Services inflation decreased by 0.21 points to 14.46 percent. Annual inflation remained flat in the communication group but declined in other subcategories. Cost-side factors led by food and fuel prices continued to have a favorable effect on the catering and transportation services inflation. The Committee noted that the deceleration in monthly inflation in the rents group persisted. It also reiterated that the weakening domestic demand supported the overall slowdown in services inflation.

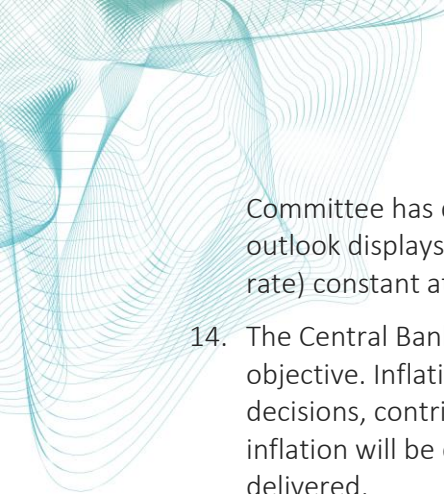


Factors Affecting Inflation

6. Recently released data show that the rebalancing trend in the economy has become more noticeable. Industrial production decreased in the October-November period compared to the third quarter of 2018, and current indicators signal that the weak course in the sector also continued in December. Indicators for services and construction sectors also reveal that the slowdown in economic activity has spread to all sectors. As a result of the domestic demand-led sharp decline in imports coupled with robust exports of goods and strong tourism demand, net exports continued to make a large contribution to quarterly and annual growth in the final quarter of the year and partially prevented the economic activity from weakening further.
7. Slowdown in economic activity continues, partly due to tight financial conditions. Although there has been some improvement in financial indicators recently, loan demand and supply remain subdued. Leading indicators have yet to show signs of recovery in domestic demand. The extended tax cuts for durable goods are likely to spur consumer demand in the first quarter. However, the weak labor market will continue to curb aggregate demand.
8. Despite recent signs of some slowdown in global growth, external demand maintains its strength. Firms' orientation towards external markets amid sluggish domestic demand and their flexibility in market diversification stimulate exports of goods; and the external balance continues to improve rapidly on brisk tourism demand. Thus, the current account balance is expected to maintain its improving trend in the upcoming period.
9. Labor market data confirm that the economy continues to slow down on the back of domestic demand. In the September-November period, construction employment declined further while industrial employment remained flat, and services employment picked up slightly. Business activities with relatively stronger external trade links and the public sector continued to make a positive contribution to employment.

Monetary Policy and Risks

10. Increased protectionist trends in international trade continue to keep the risks to the global growth outlook alive by increasing uncertainties regarding global economic policies. The global economic slowdown has been slightly more pronounced since the previous MPC meeting. Therefore, the outlook for 2019 has been revised down for both advanced and emerging economies.
11. The buoyant labor markets across advanced economies sustain the wages-backed upside risks to global inflation. Nevertheless, given the weaker global growth outlook and the fall in oil prices, the global inflation pressures are judged to be mild in the upcoming period. Still, the Committee will continue to closely monitor the risks to global inflation arising from the high volatility of energy prices and the wage inflation.
12. Expectations on the normalization of monetary policy stances in advanced economies have moderated since the last MPC meeting. However, global financial risks and the uncertainty over global economic policies are rather elevated for the coming months, upholding the downside risks to portfolio flows to emerging economies.
13. While developments in import prices and domestic demand conditions have led to some improvement in the inflation outlook, risks to price stability prevail. Elevated levels of inflation and inflation expectations, and uncertainties over the course of cost factors continue to pose risks to the pricing behavior in the coming period. Accordingly, the



Committee has decided to maintain the tight monetary policy stance until the inflation outlook displays a significant improvement and kept the policy rate (one-week repo auction rate) constant at 24 percent.

14. The Central Bank will continue to use all available instruments in pursuit of the price stability objective. Inflation expectations, pricing behavior, lagged impact of recent monetary policy decisions, contribution of fiscal policy to rebalancing process, and other factors affecting inflation will be closely monitored and, if needed, further monetary tightening will be delivered.
15. 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 reducing 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.
16. Collective efforts to turn the recently enhanced coordination between monetary and fiscal policies into a sustained and systematic structure 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.