

Briefing on 2018-IV Inflation Report

October 2018 Inflation Report: Main Sections

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

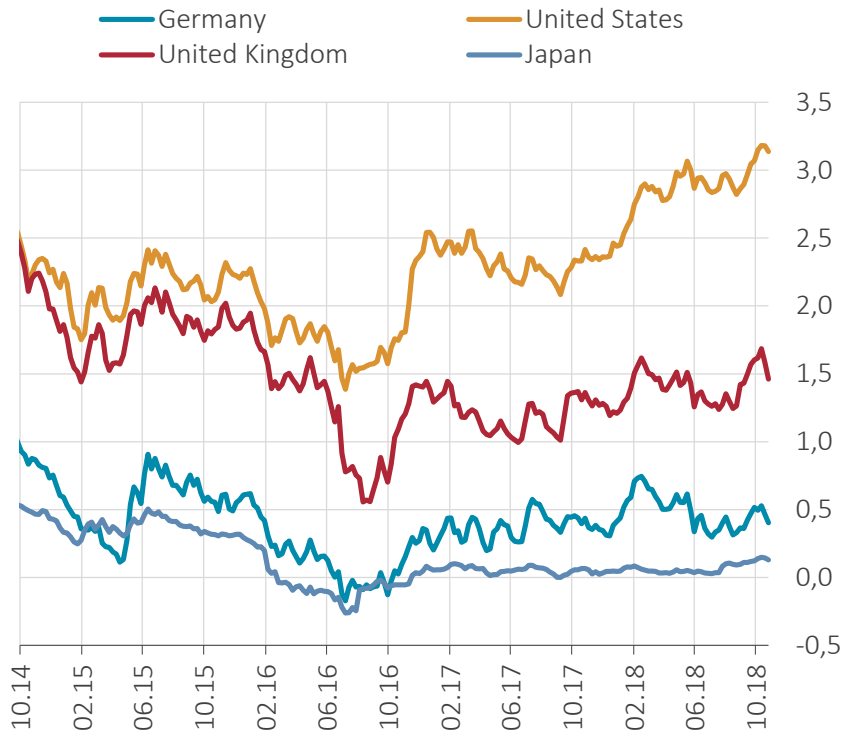
October 2018 Inflation Report: Boxes

- ▶ Changing Behavior of Global Portfolio Investors in Emerging Market Economies
- ▶ A Model-Based Analysis of Recent Inflation Developments
- ▶ A Glance at the Structural Components of Inflation: Demography
- ▶ Understanding Turkey's Wage Dynamics
- ▶ Firm Investment Dynamics in the Manufacturing Sector
- ▶ Manufacturing Industry Firms' Elasticity to Shift into External Markets
- ▶ Monetary Policy Transmission and Banks' Cross-Border Borrowing
- ▶ Fiscal Policy Stance within the Framework of the New Economy Program

Global Developments and Portfolio Flows

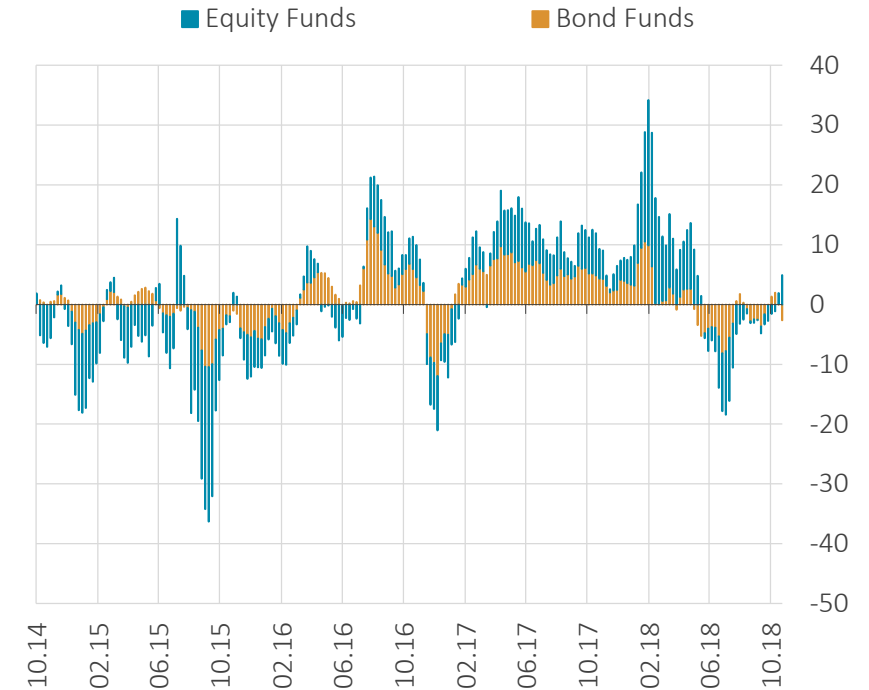
- ▶ The rise in yields in advanced economies and increased protectionist tendencies led to fluctuations in financial markets.
- ▶ While risk premia of emerging economies increased, their currencies depreciated.

10-Year Treasury Bond Yields (%)



Source: Bloomberg.

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



Source: EPFR.

Domestic Economic Outlook

- ▶ Indicators for the third quarter signal that the rebalancing trend in economic activity has become more noticeable.
- ▶ The slowdown in credit growth became more evident in the third quarter.
- ▶ The rise in annual inflation is widespread across all sub-categories and high price increments are observed even in goods with relatively low FX pass-through, indicating significant deterioration in the pricing behavior.

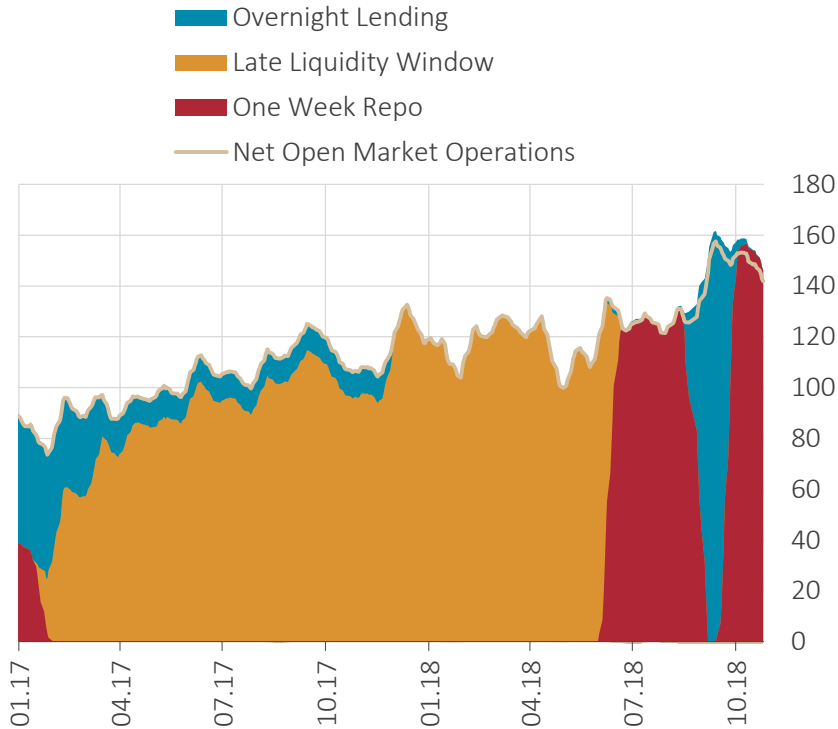
Monetary Policy and Financial Conditions



Monetary Policy

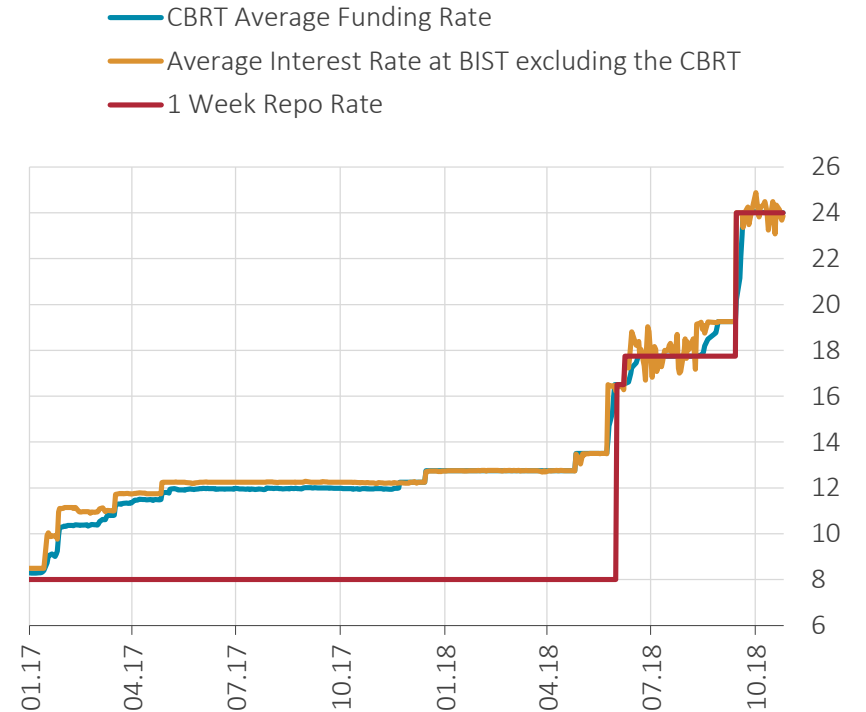
- ▶ A strong monetary tightening was implemented in September to support price stability.

CBRT Funding (2-Week Moving Average, Billion TL)



Source: CBRT.

Short-Term Interest Rates (%)

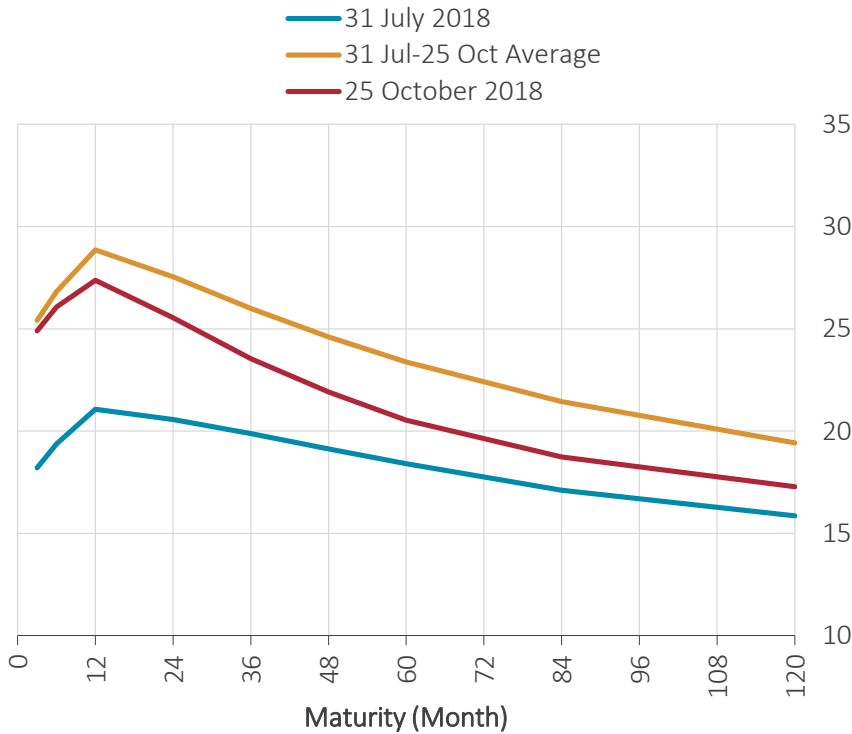


Source: BIST, CBRT.

Monetary Conditions

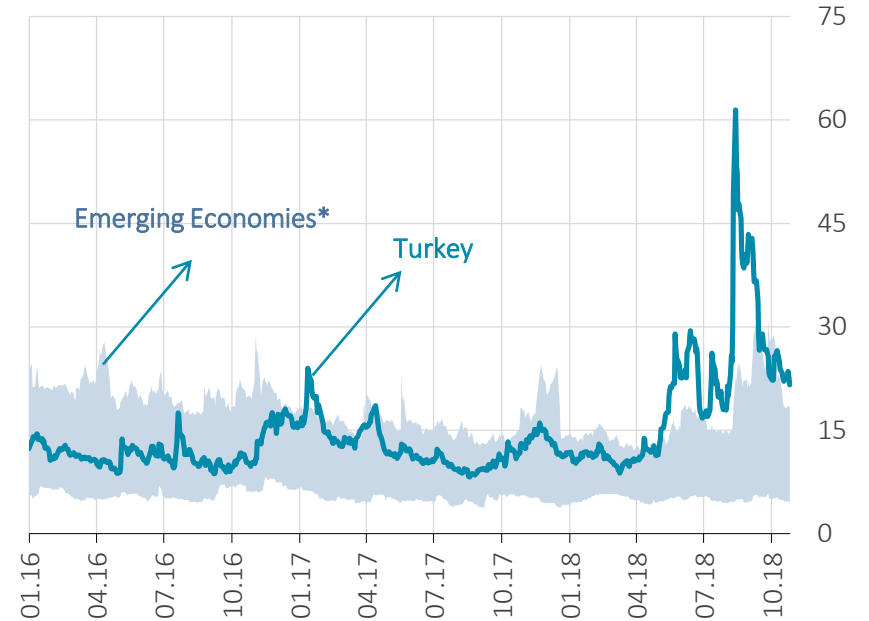
- Thanks to the measures taken and the strong monetary tightening delivered, the implied volatility of the Turkish lira has decreased in the recent period.

Yield Curve on Cross Currency Swaps (%)



Source: Bloomberg.

Implied FX Volatility* (1 Month, %)

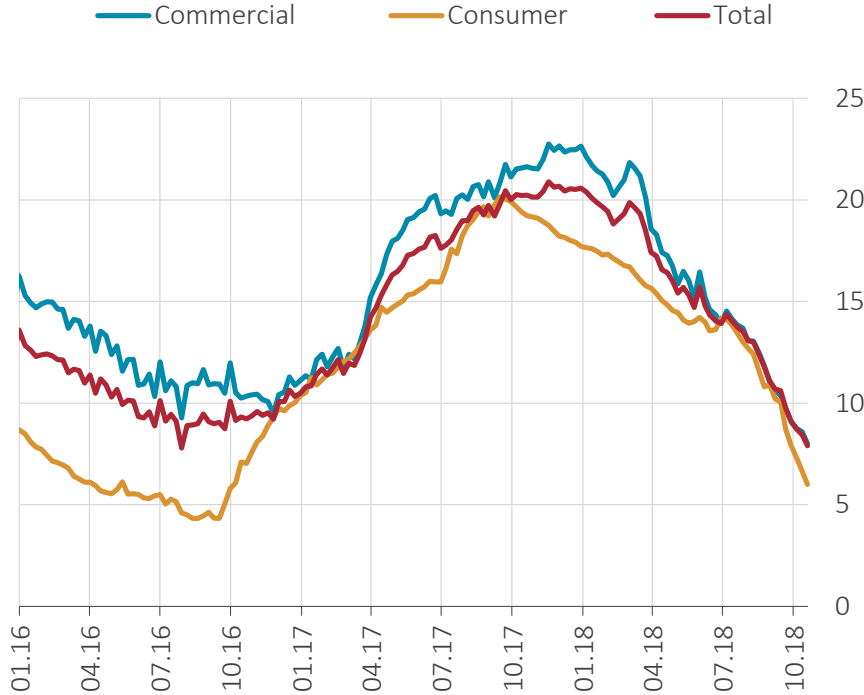


Source: Bloomberg.

Financial Conditions

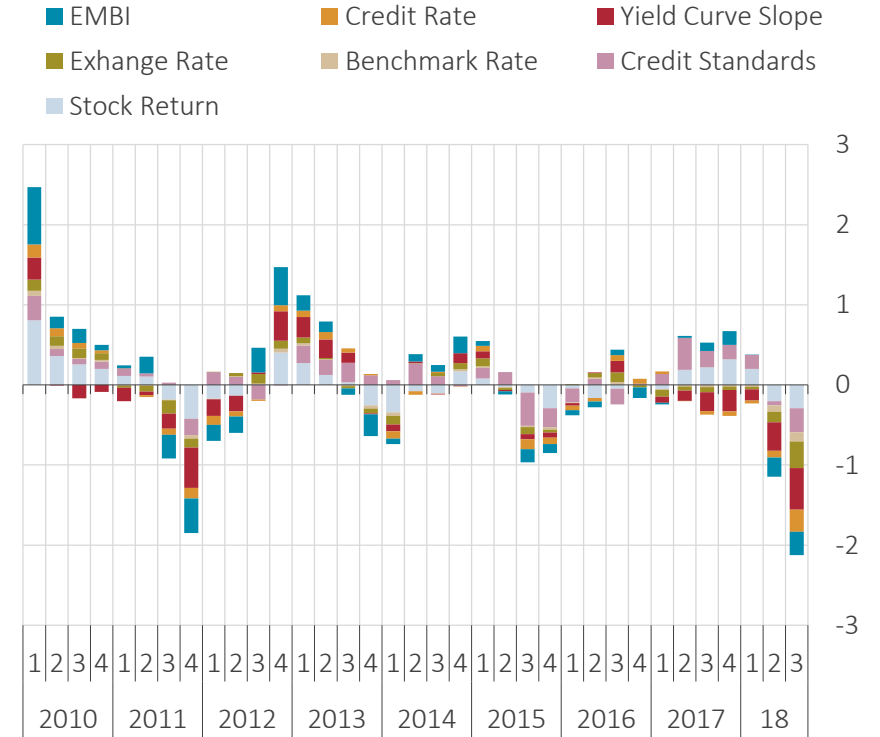
- Tightening in the financial conditions became evident in the third quarter.

Annual Credit Growth (Adjusted for Exchange Rate, %)



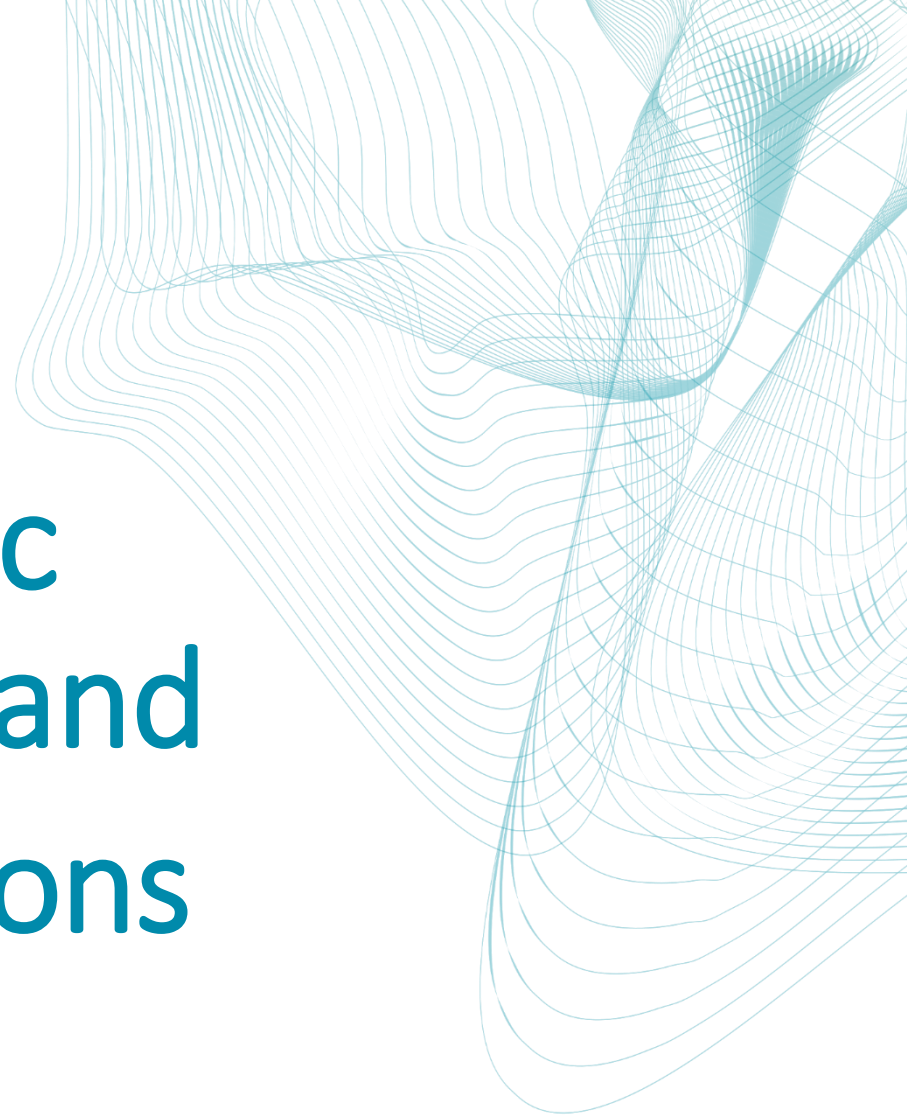
Source: CBRT.

Contributions to the Financial Conditions Index



Source: CBRT.

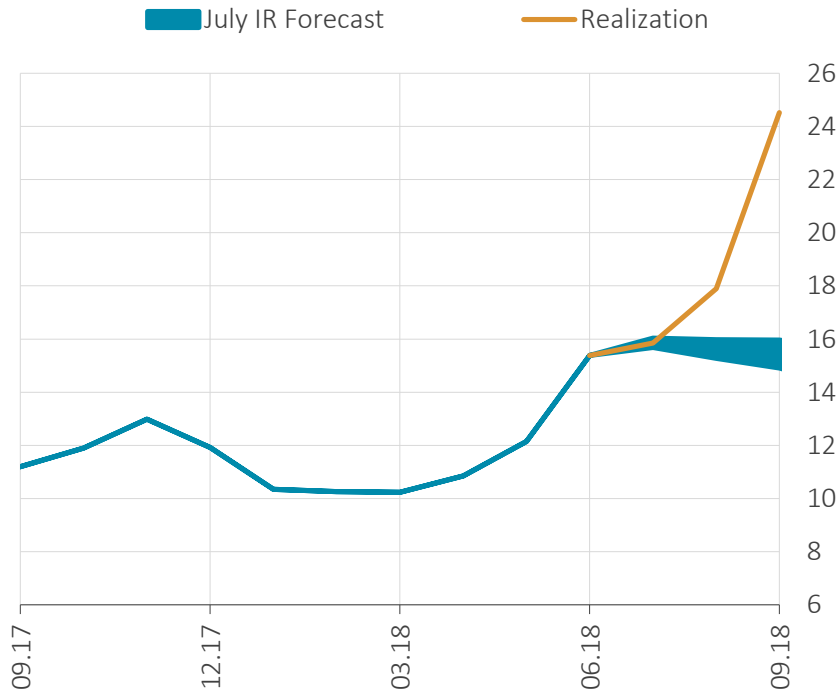
Macroeconomic Developments and Main Assumptions



July 2018 Inflation Report Forecasts and Realizations

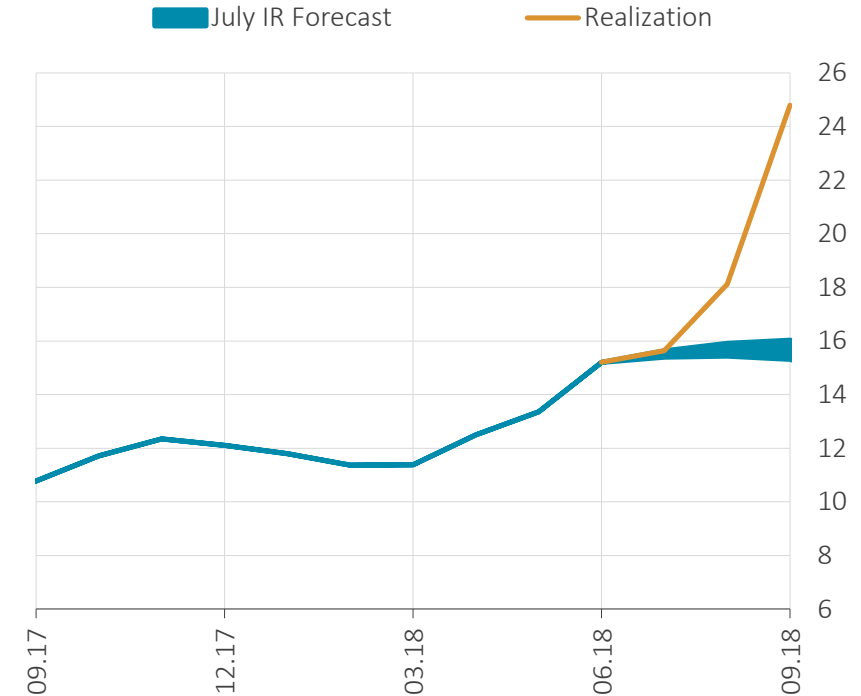
- ▶ Consumer inflation and inflation excluding unprocessed food and tobacco were significantly higher than July Inflation Report forecasts in the third quarter of the year.

Consumer Inflation* (%)



Source: CBRT, TURKSTAT.

Inflation Excluding Unprocessed Food and Tobacco * (%)

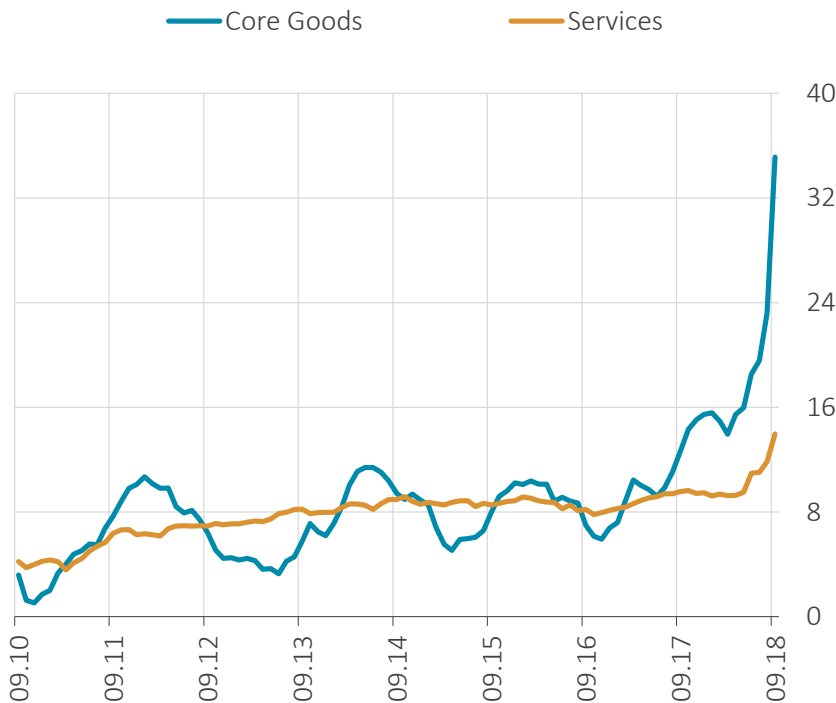


Source: CBRT, TURKSTAT.

Inflation

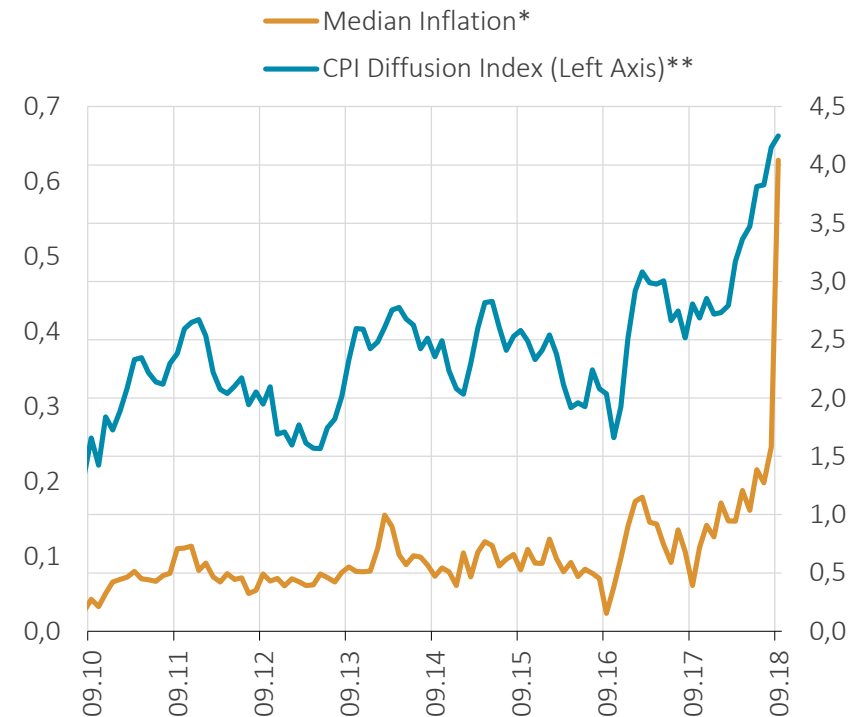
- Indicators regarding inflation and pricing behavior suggest a notable deterioration in the underlying trend of inflation.

Core Goods and Services Prices (Annual % Change)



Source: TURKSTAT.

CPI Diffusion Index and Median Inflation (Seasonally-Adjusted, 3-Month Average)

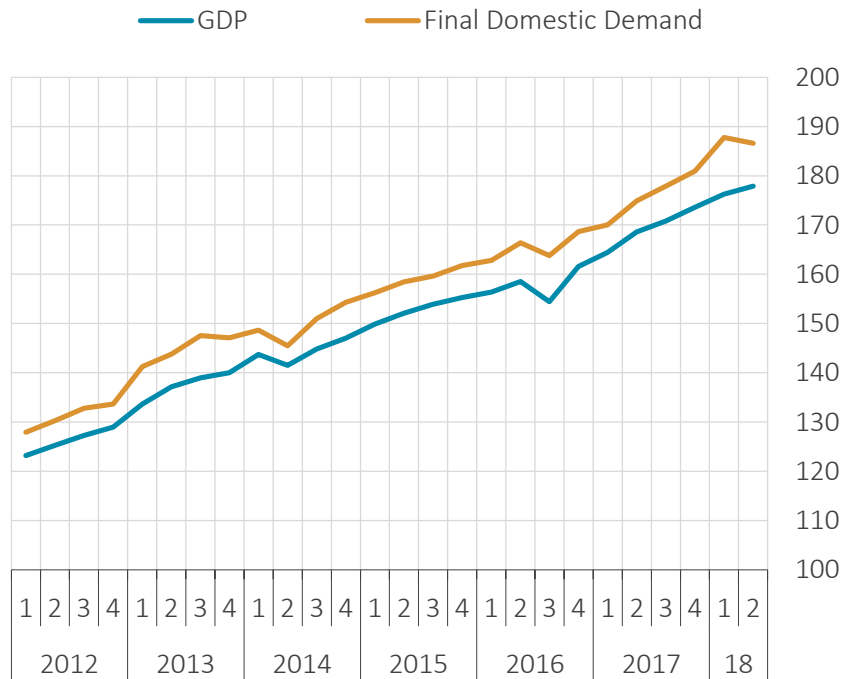


Source: CBRT, TURKSTAT.

Aggregate Demand

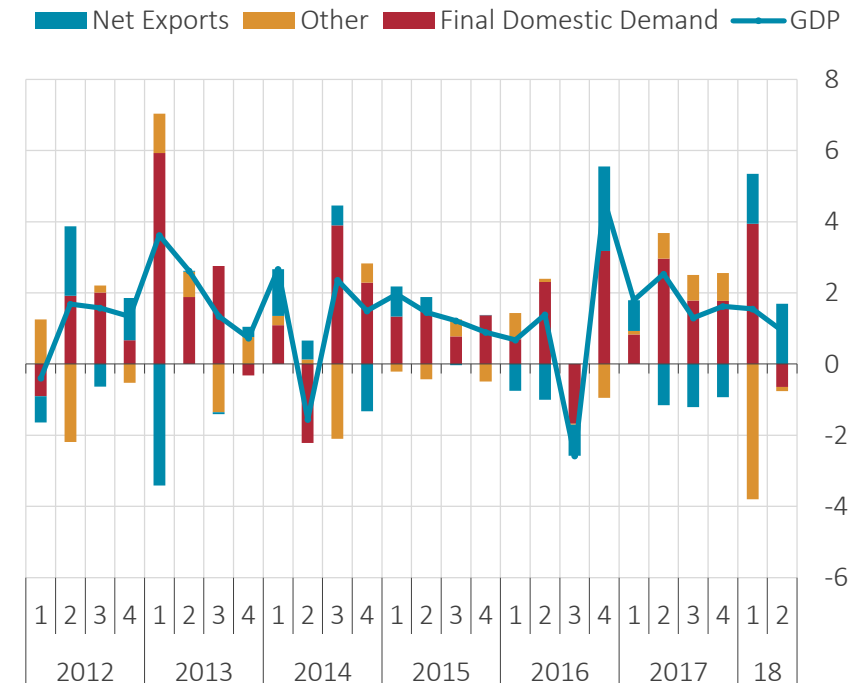
- ▶ Recently released data show that the rebalancing trend in economic activity has become more noticeable.

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



Source: CBRT, TURKSTAT.

Contributions from the Expenditure Side* (%)

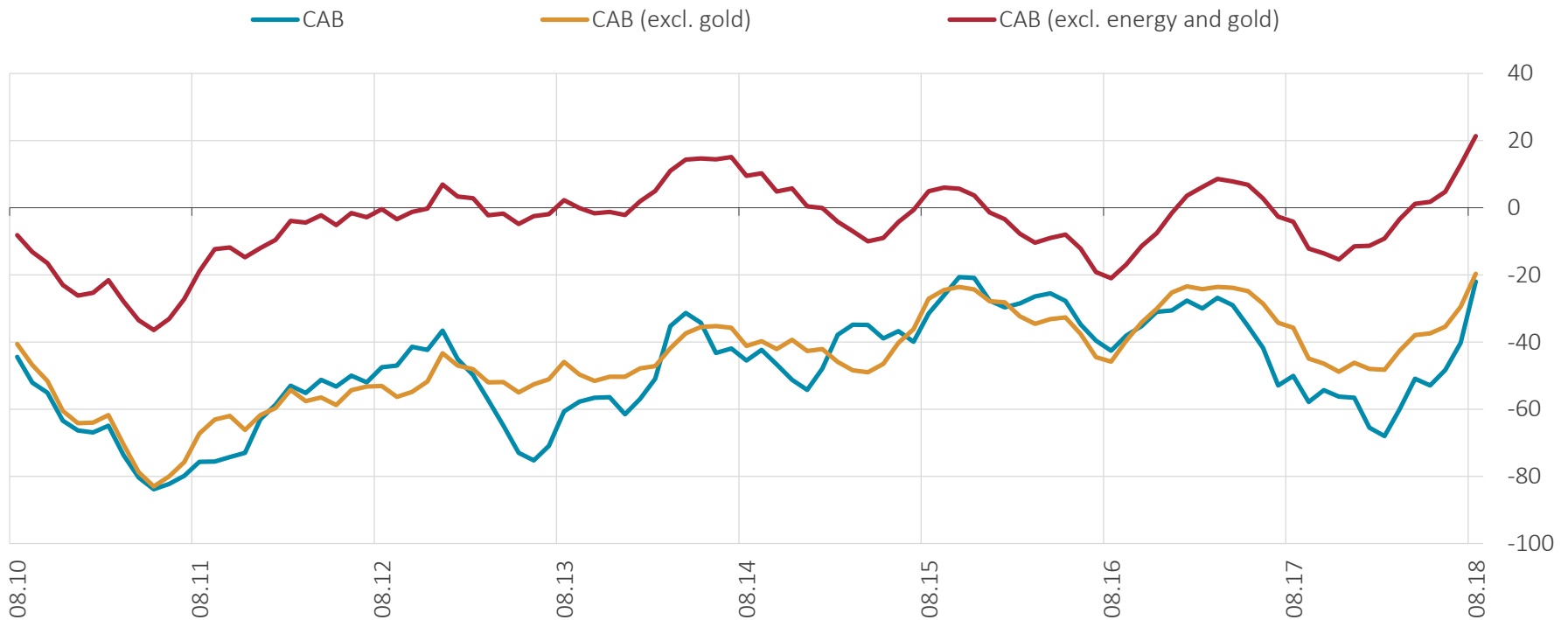


Source: CBRT, TURKSTAT.

External Balance

- ▶ The improvement in the current account balance has become evident as a result of the slowdown in economic activity and the real depreciation in the Turkish lira.

Current Account Balance (CAB) (3-Month MA, Annualized, Billion USD)

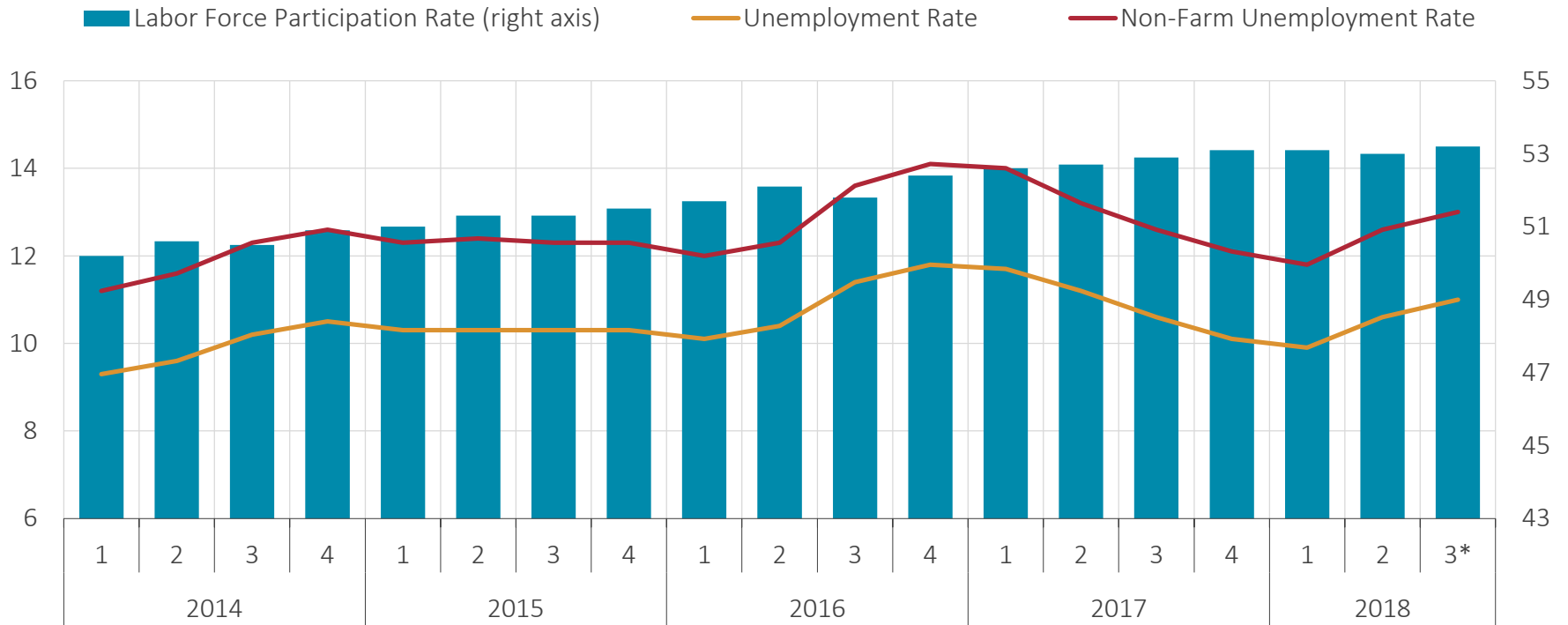


Source: CBRT.

Labor Market

- ▶ The unemployment rate, which regressed throughout 2017, started to rise as of the second quarter of 2018.

Unemployment Rates (Seasonally Adjusted, %)



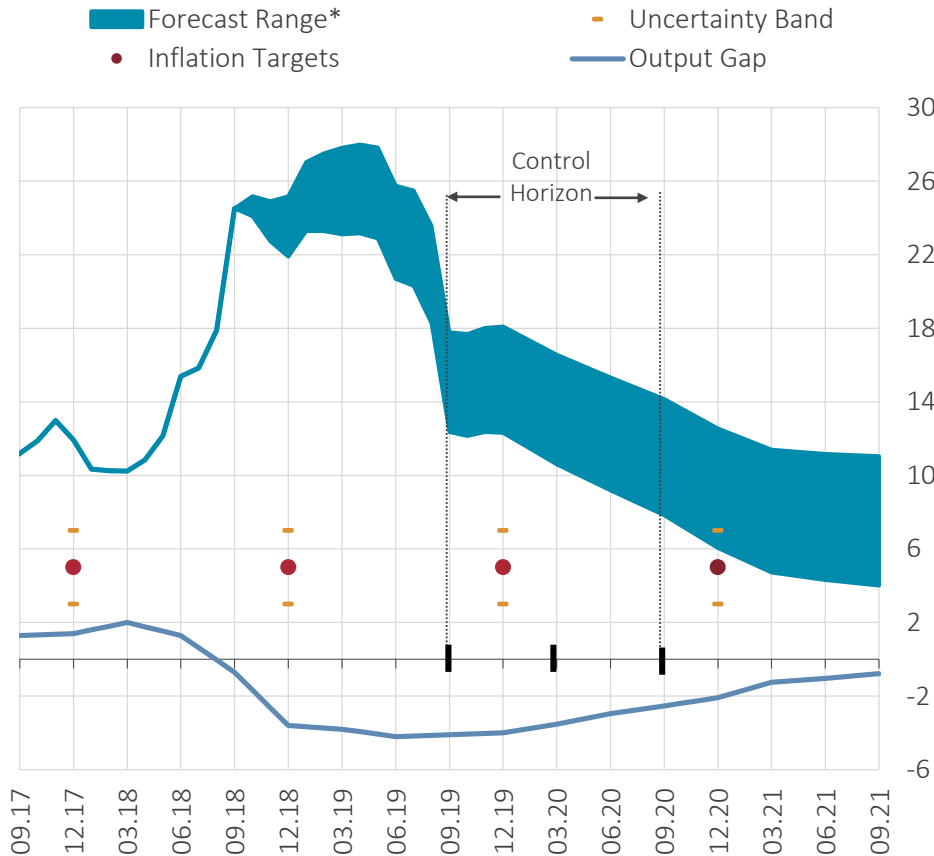
Source: TURKSTAT.

Revision in Assumptions

		July 2018	October 2018
Output Gap	2018 Q2	0.4	1.3
	2018 Q3	-0.5	-0.7
Export-Weighted Global Production Index (Average Annual Percent Change)	2018	2.6	2.5
	2019	2.7	2.6
Oil Prices (Average, USD)	2018	73	75
	2019	73	80
Import Prices (USD, Average Annual Percent Change)	2018	6.3	6.0
	2019	0.5	1.3
Food Prices (Year-end Percent Change)	2018	13.0	29.5
	2019	10.0	13.0

Inflation Outlook

Inflation and Output Gap Forecasts* (%)



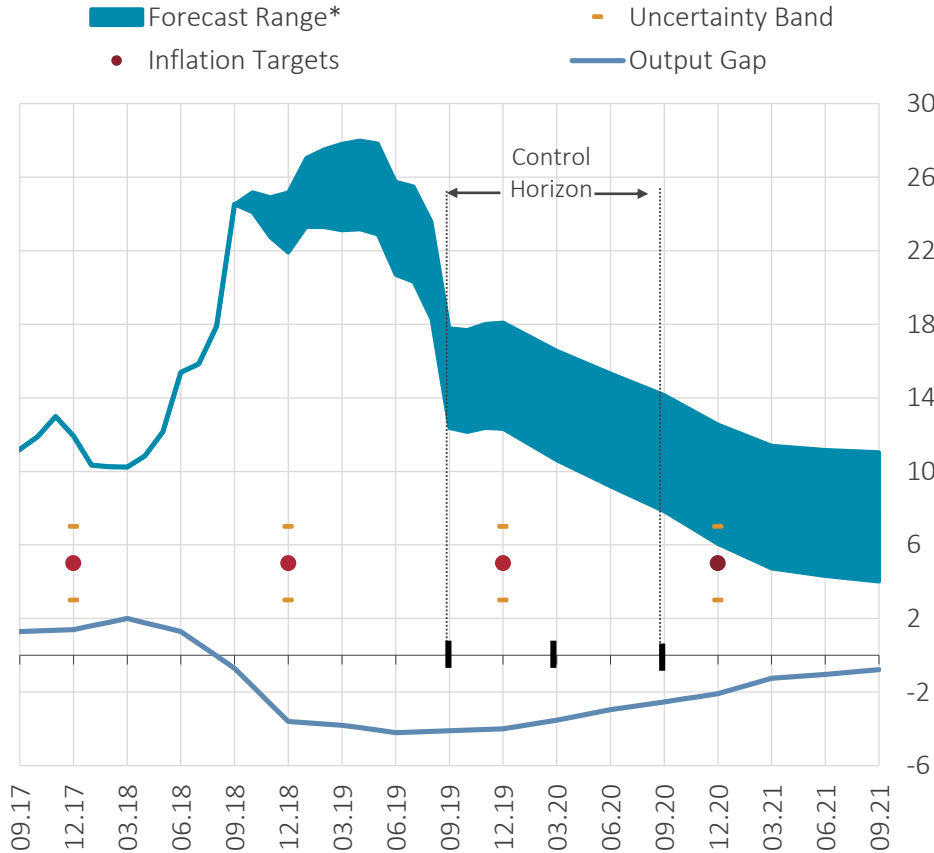
Source: CBRT, TURKSTAT.

- ▶ Under the assumption of a tight monetary policy stance and enhanced policy coordination focused on bringing inflation down, inflation is projected to converge gradually to the target.
- ▶ Inflation is likely to be 23.5% at end-2018, 15.2% at end-2019, 9.3% at end-2020, and stabilize around 5% in the medium term.
- ▶ Accordingly, inflation is expected to
 - be between 21.9% and 25.1% (with a mid-point of 23.5%) at end-2018
 - be between 12.3% and 18.1% (with a mid-point of 15.2%) at end-2019
 - be between 6.0% and 12.6% (with a mid-point of 9.3%) at end-2020

with 70 percent probability.

Inflation Outlook

Inflation and Output Gap Forecasts* (%)



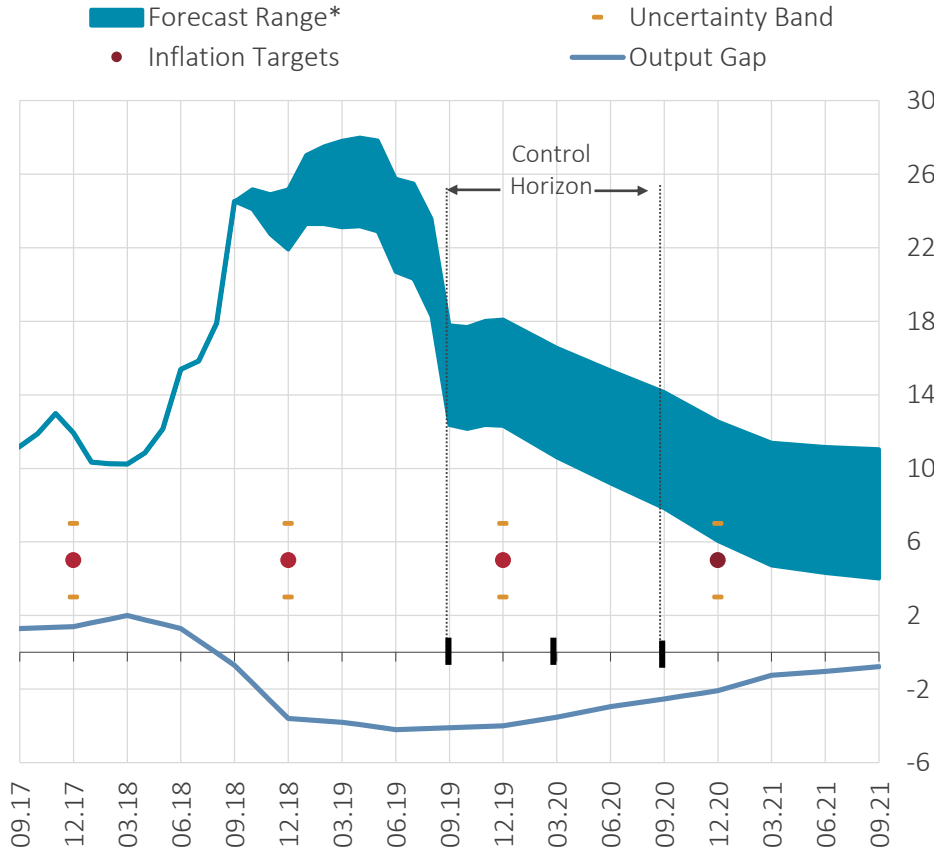
Source: CBRT, TURKSTAT.

► The upward revision in 2018 year-end inflation forecasts by 10.1 points, relative to July Inflation Report, is driven by:

- Upward revision in assumptions for TL-denominated import prices by +4.1 points,
- Upward revision in assumptions for food inflation by +3.8 points,
- Higher-than projected inflation at 2018Q3 and deterioration in the underlying trend by +2.5 points,
- Downward revision in output gap by -0.3 points.

Inflation Outlook

Inflation and Output Gap Forecasts* (%)



Source: CBRT, TURKSTAT.

- The upward revision in 2019 year-end inflation forecasts by 5.9 points, relative to July Inflation Report, is driven by:
 - Upward revision in assumptions for oil and TL-denominated import prices by +3.0 points,
 - Upward revision in assumptions for food inflation by +0.7 points,
 - Higher-than projected inflation and deterioration in the underlying trend by +3.6 points,
 - Downward revision in output gap by -1.4 points.

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