



**TÜRKİYE CUMHURİYET
MERKEZ BANKASI**

**Briefing on
January 2017 Inflation Report**

31 January 2017

Ankara

January 2017 Inflation Report: Main Sections

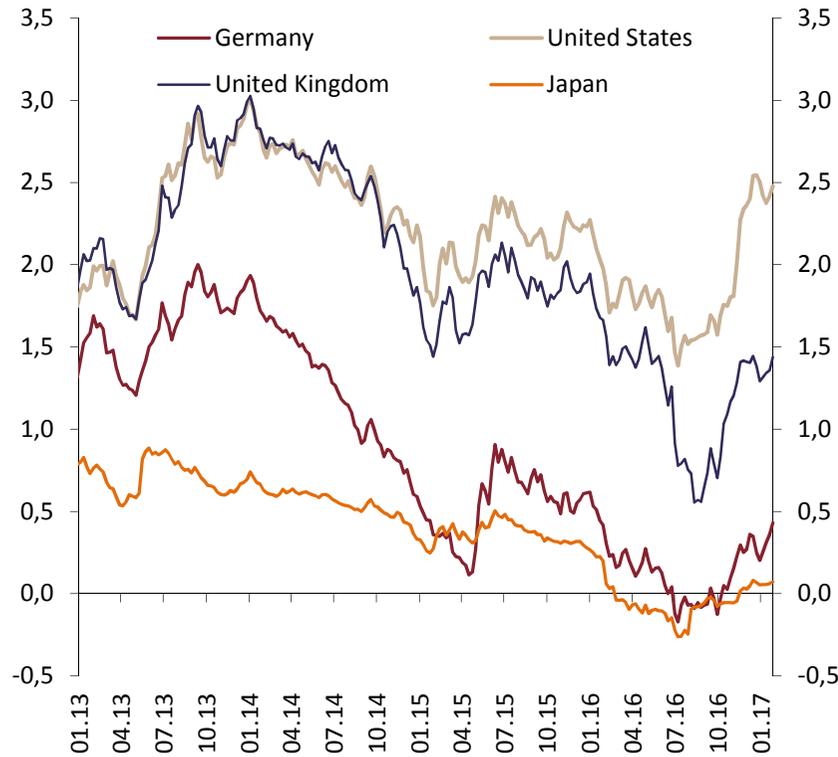
- Overview
- International Economic Developments
- Inflation Developments
- Supply and Demand Developments
- Financial Conditions and Monetary Policy
- Public Finance
- Medium Term Projections

January 2017 Inflation Report: Boxes

- Global Uncertainty and Its Spillovers: Recent Developments
- Import Prices and Exchange Rate Pass-Through to CPI and Subcategories
- An Aggregate Economic Uncertainty Measure For Turkey
- Assessing Output Gap with Alternative Measures
- Credit Growth and Weakening of the Relationship Between Real Trade Deficit and National Income
- The Size of the Open Market Operations Portfolio and Outright Purchase Auctions
- Cyclical Variation of Government Spending Multiplier
- An Evaluation of end-2016 Inflation Forecasts

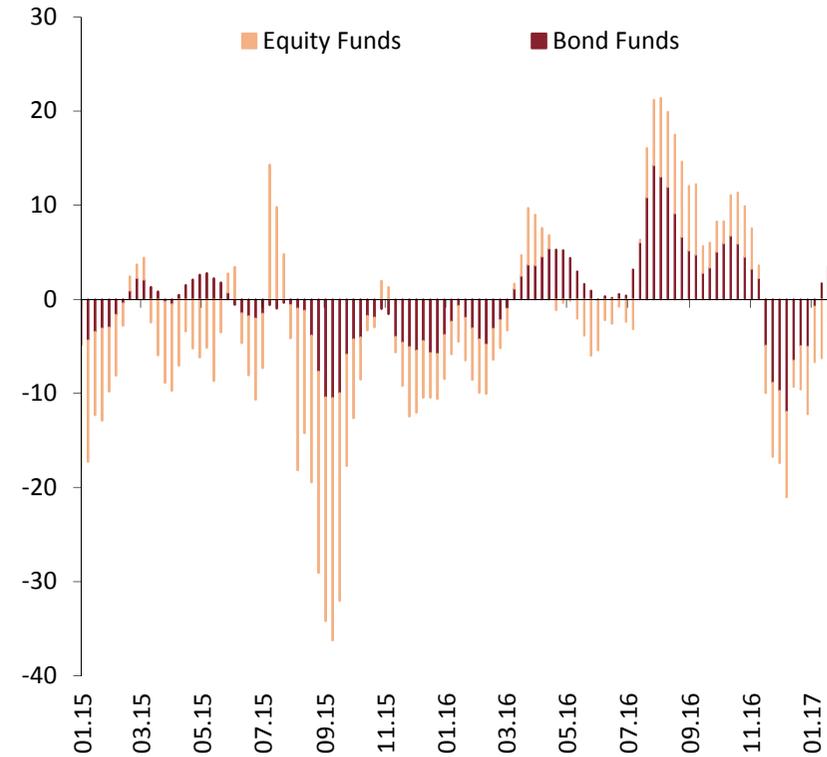
Global Uncertainties and Portfolio Flows

10-Year Bond Rates
(Percent)



Source: Bloomberg.

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



Source: EPFR.

- In the fourth quarter of 2016, interest rates in advanced economies increased, directing capital flows away from emerging markets into advanced economies as of November.

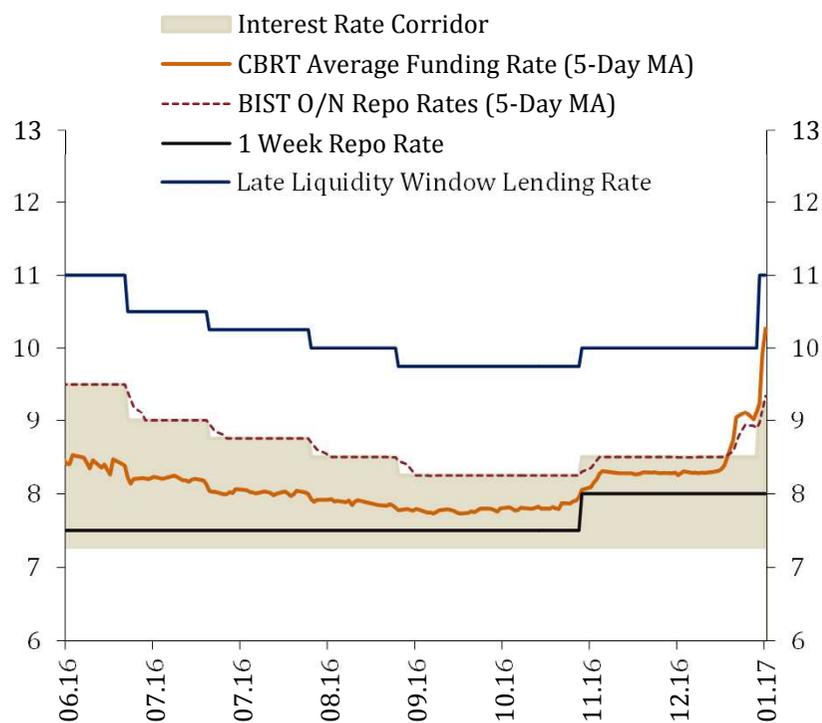
Domestic Economic Outlook

- Domestic financial markets remained volatile over the fourth quarter of 2016.
- Credit use has shown some recovery in recent months thanks to the measures taken.
- Consumer inflation ended 2016 at 8.53 percent amid the TL depreciation, tax adjustments and the partial increase in food prices.
- Economic activity displayed a significant slowdown in the third quarter.
- Thanks to accommodative measures and incentives, economic activity is likely to remain on a moderate upward track.
- Domestic demand remained relatively subdued but the growing EU demand continues to stimulate exports.
- Commodity prices are expected to gradually have less of a positive influence on the current account in the upcoming period however the current account balance will continue to improve with the recovery in the net exports of goods.

Monetary Policy and Financial Stability

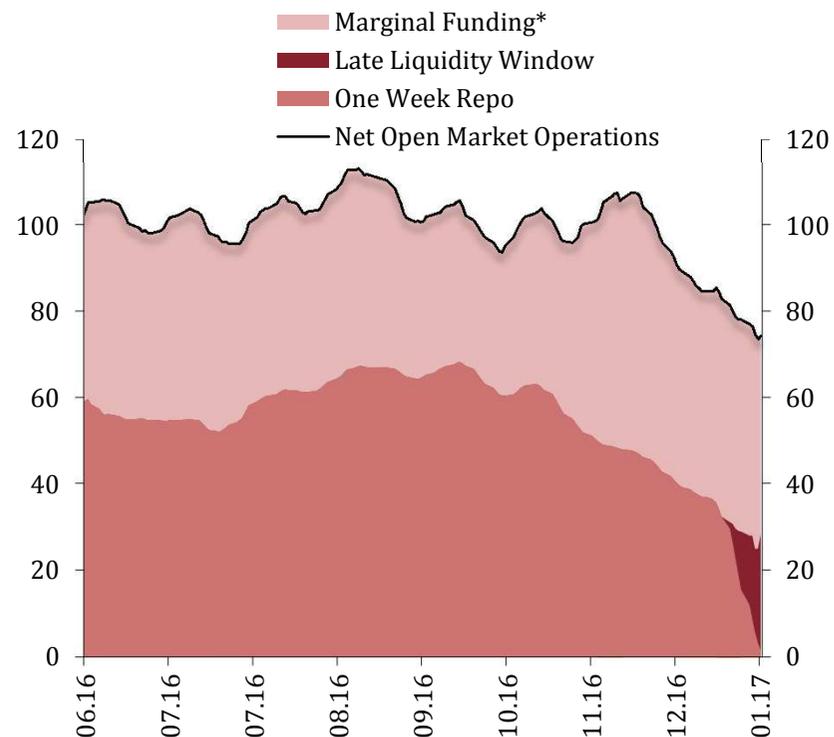
Monetary Policy

CBRT Rates and BIST Interbank O/N Repo Rate
(Percent)



Source: BIST, CBRT.

CBRT Funding
(2-Week MA, Billion TL)



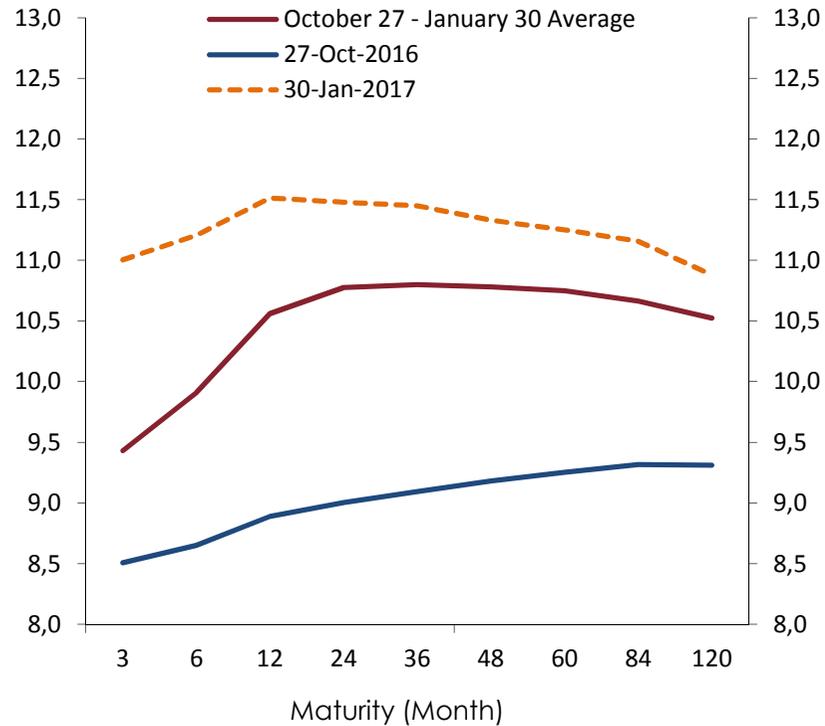
* Marginal funding is overnight funding quoted at the upper band of the interest rate corridor.

Source: CBRT.

- The CBRT implemented monetary tightening in order to contain the deterioration in inflation outlook due to excessive fluctuations in exchange rates stemming from increased global uncertainty and high volatility.

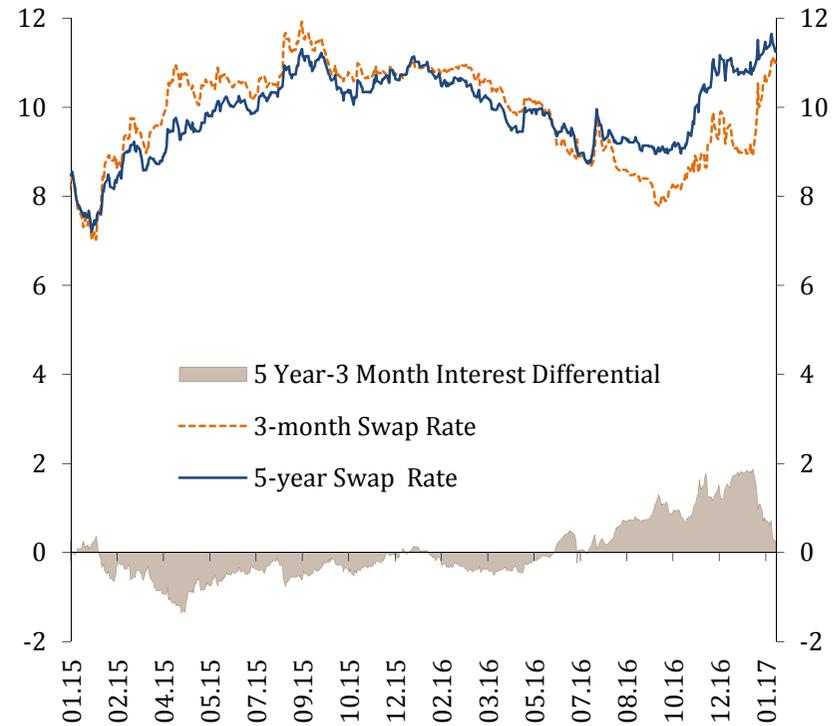
Monetary Conditions

Yield Curve on Cross Currency Swaps
(Percent)



Source: Bloomberg.

Currency Swap Rates
(5-Day Moving Average, Percent)

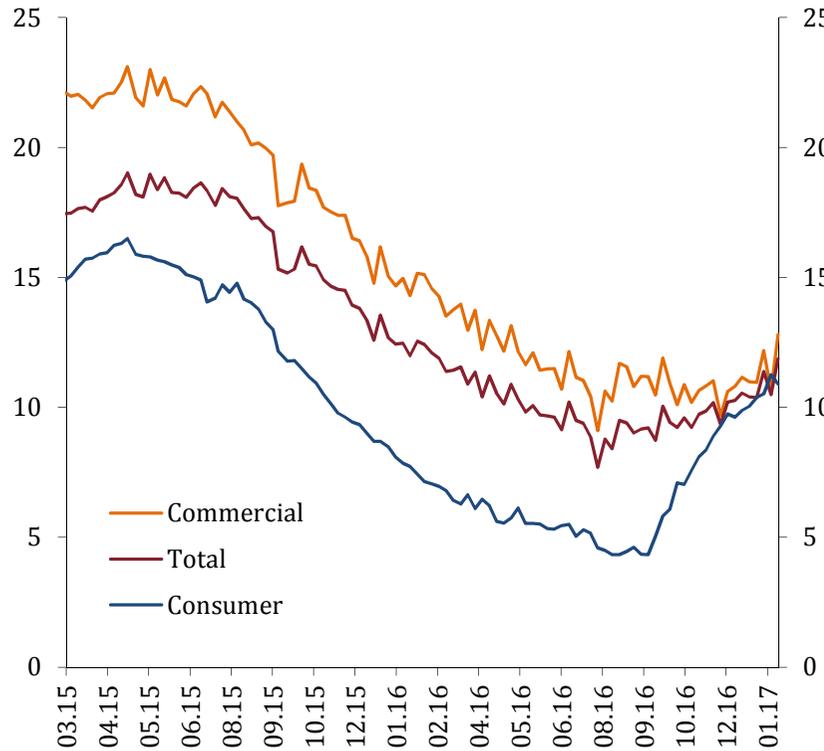


Source: CBRT.

- The yield curve recently became flatter due to monetary tightening.

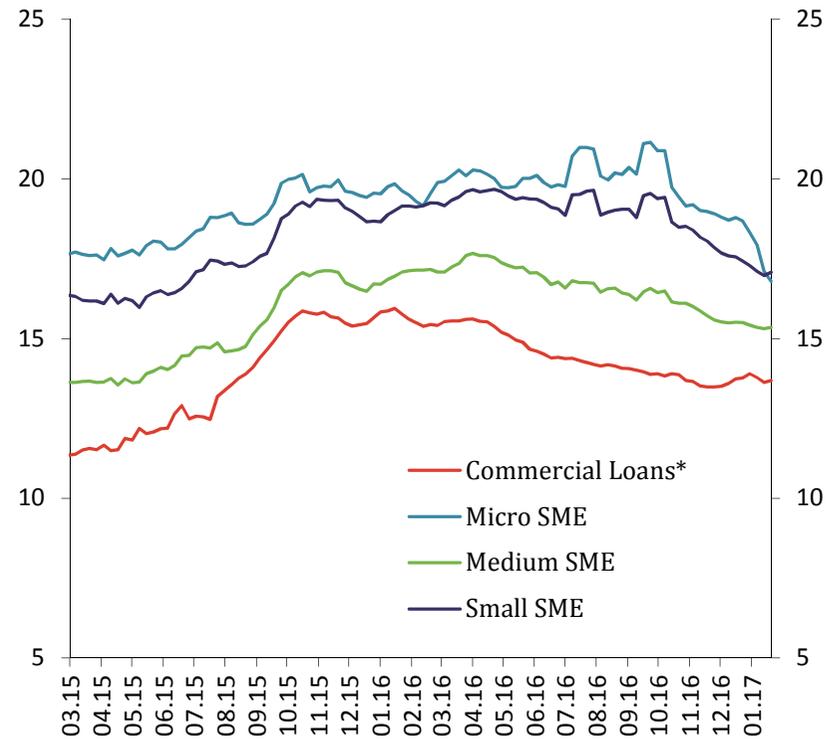
Financial Stability

Annual Credit Growth
(Adjusted for Exchange Rate, Percent)



Source: CBRT.

TL Commercial Loan Rates
(Flow, Annualized, 4-Week MA, Percent)



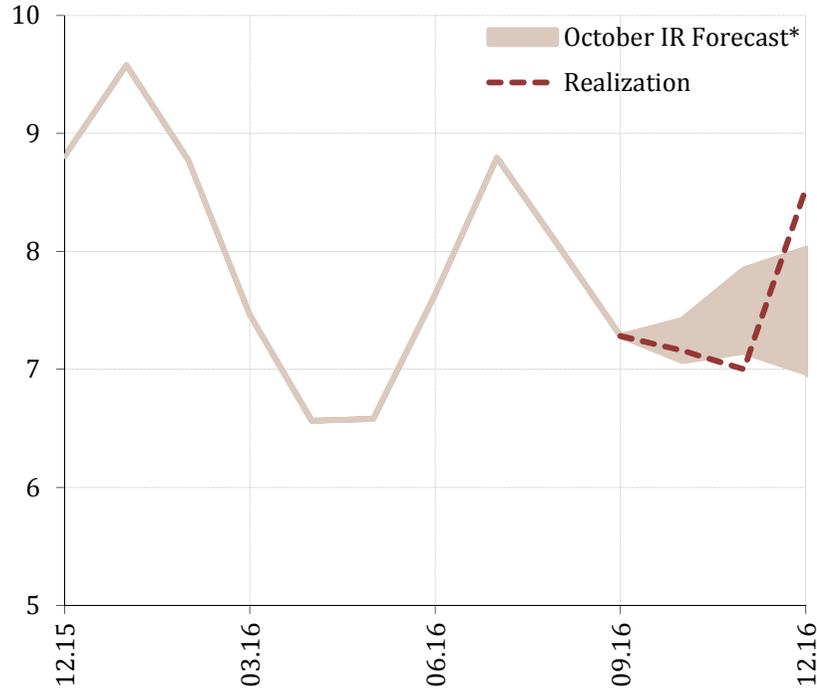
* Excluding overdraft accounts, credit cards and non-zero interest rate loans.
Source: CBRT.

- Loans extended to the non-financial sector displayed a mild recovery in the fourth quarter of 2016, on the back of a strong increase in consumer loans.

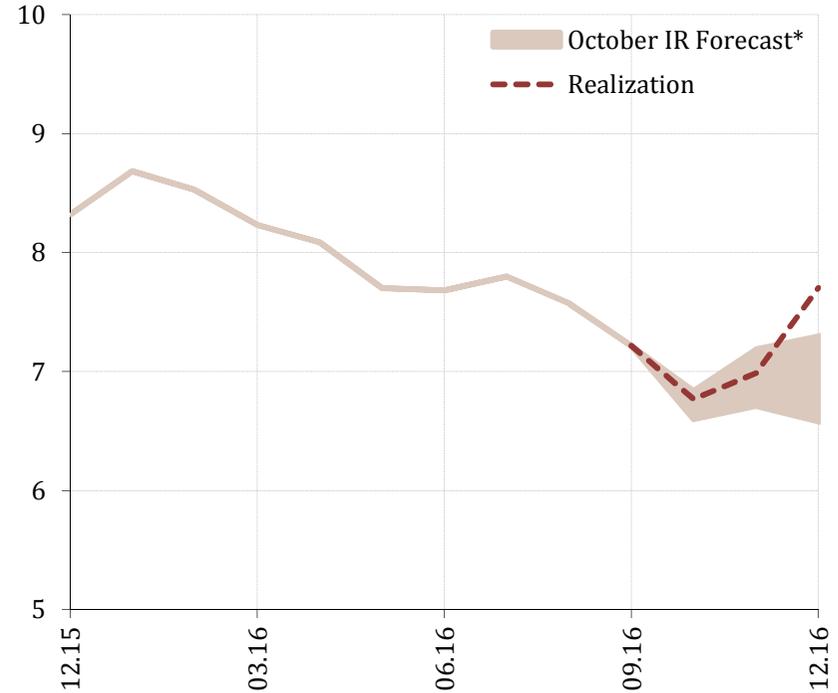
Macroeconomic Developments and Main Assumptions

October 2016 Inflation Report Forecasts and Realizations

Consumer Inflation (Percent)



Inflation Excluding Unprocessed Food and Tobacco (Percent)

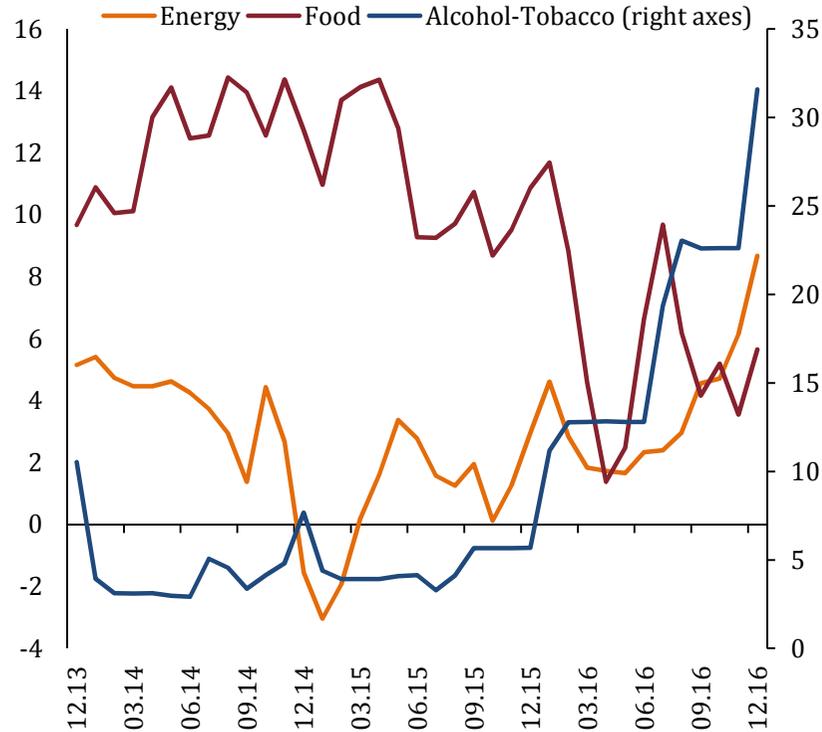


* Shaded region indicates the 70 percent confidence interval for the forecast.
Source: TURKSTAT, CBRT.

- Consumer inflation ended the year at 8.53 percent mainly due to the volatility in unprocessed food prices and adjustments in the prices of tobacco products.
- Inflation excluding unprocessed food and tobacco posted a smaller upturn.

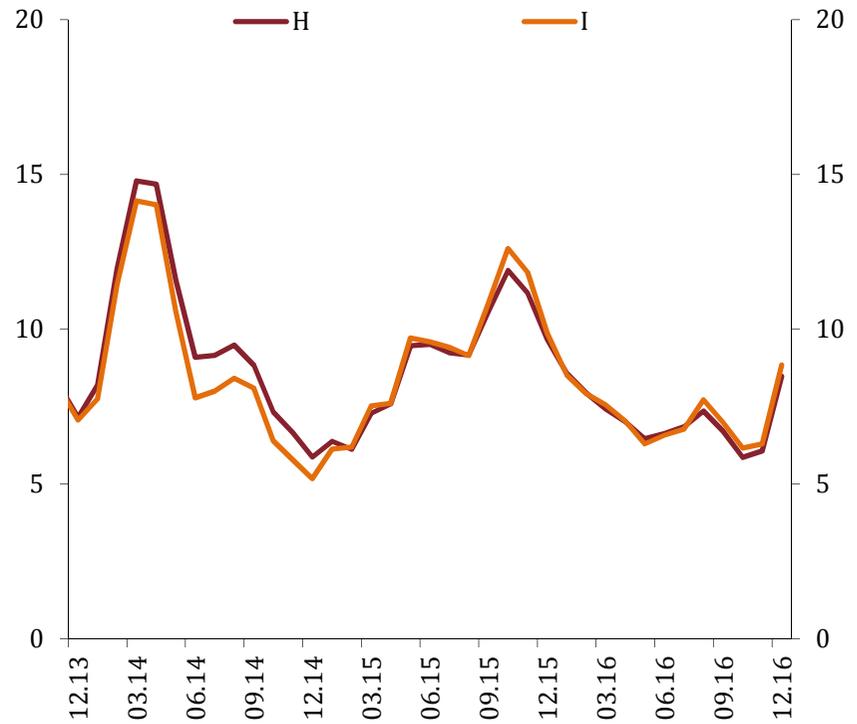
Inflation

**Food, Energy and Alcoholic Beverages-
Tobacco Prices**
(Annual Percent Change)



Source: TURKSTAT, CBRT.

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

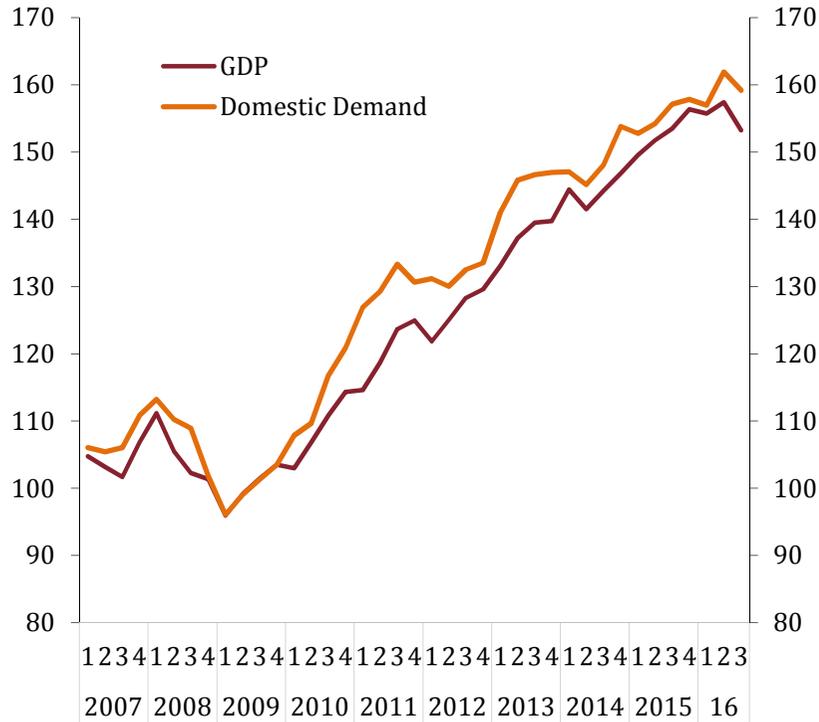


Source: TURKSTAT, CBRT.

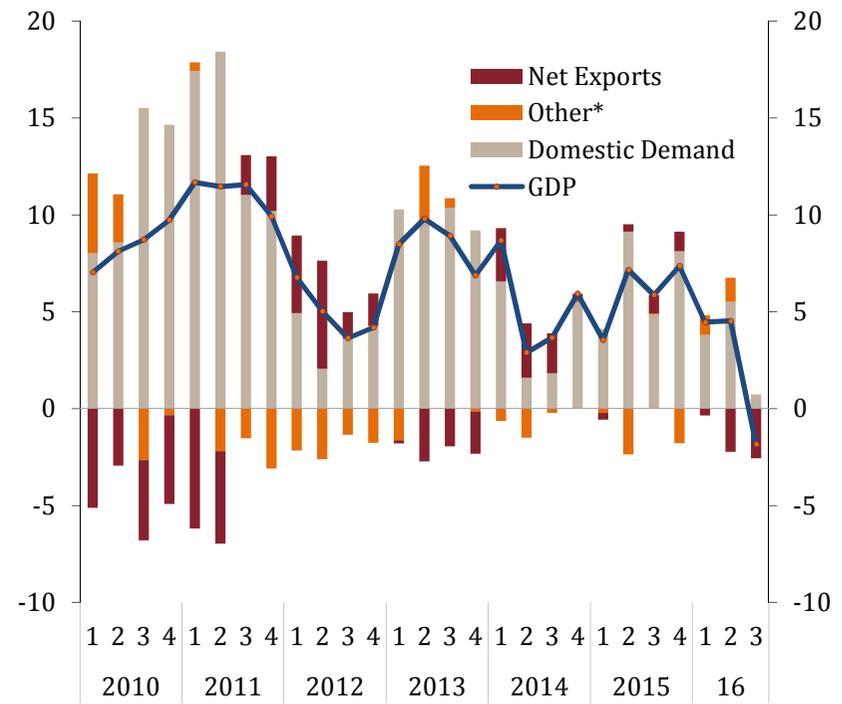
- Despite the downward pressure from economic activity, inflation outlook deteriorated in the fourth quarter due to tax hikes, strong cost pressures and the partial increase in food prices.

Aggregate Demand

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



Contributions from the Expenditure Side
(Percentage Point)



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

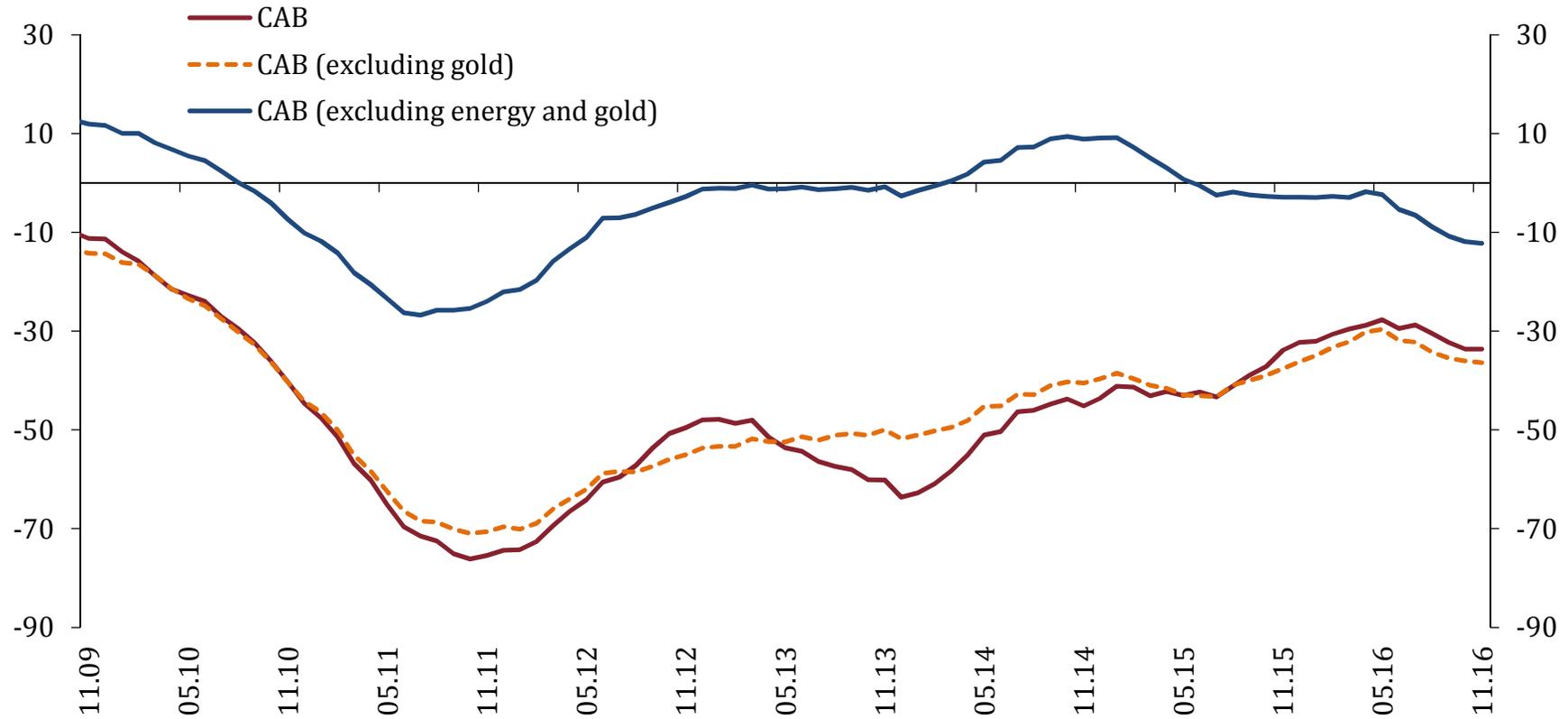
Source: TURKSTAT

Source: TURKSTAT.

- Economic activity displayed a significant slowdown in the third quarter.

External Balance

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

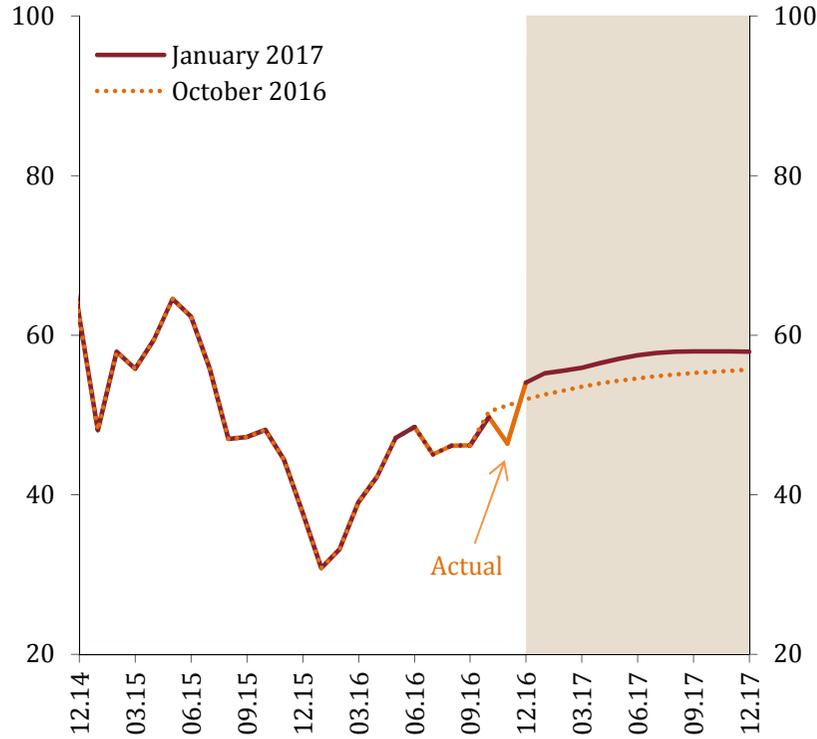


Source: CBRT.

- The improvement in the current account balance is expected to continue.

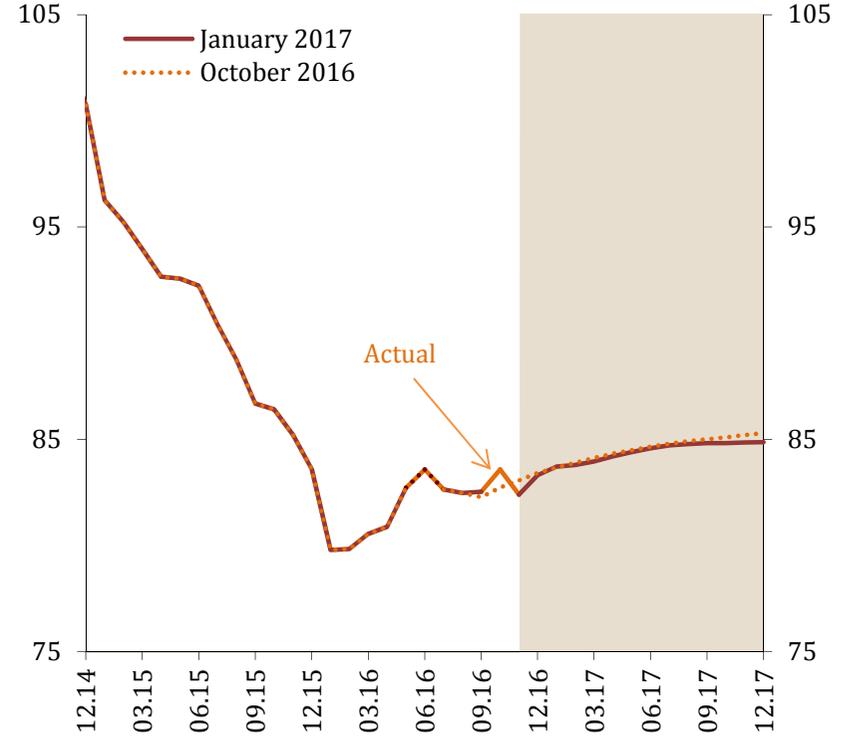
Revisions in Oil and Import Price Assumptions

Oil Prices
(USD/bbl)



Source: Bloomberg, CBRT.

Import Prices
(Index, 2010=100)



Source: CBRT.

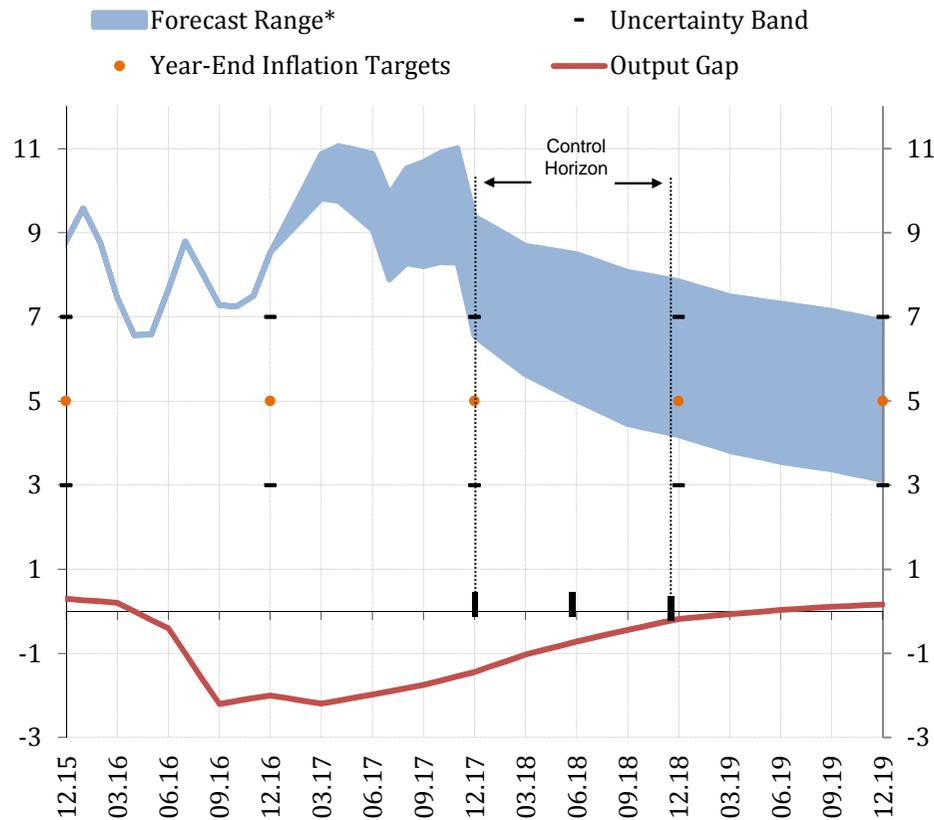
- Due to recent developments, assumptions for crude oil prices were revised upwards to USD 57 while assumptions for USD-denominated import prices saw a limited downward revision for 2017.

Revisions in Assumptions

		October 2016	January 2017
Output Gap	2016 Q3	-1,5	-2,2
	2016 Q4	-1,2	-2,0
Food Prices (Year-end Percent Change)	2017	7,0	9,0
	2018	7,0	7,0
Import Prices (Average Annual Percent Change, USD)	2016	-9,2	-9,2
	2017	3,2	3,0
	2018	-	0,7
Oil Prices (Average, USD)	2016	44	44
	2017	54	57
	2018	-	58
Export-Weighted Global Production Index (Average Annual Percent Change)	2016	1,7	1,8
	2017	1,8	1,9
	2018	-	1,9

Inflation Outlook

Inflation and Output Gap Forecasts (Percent)

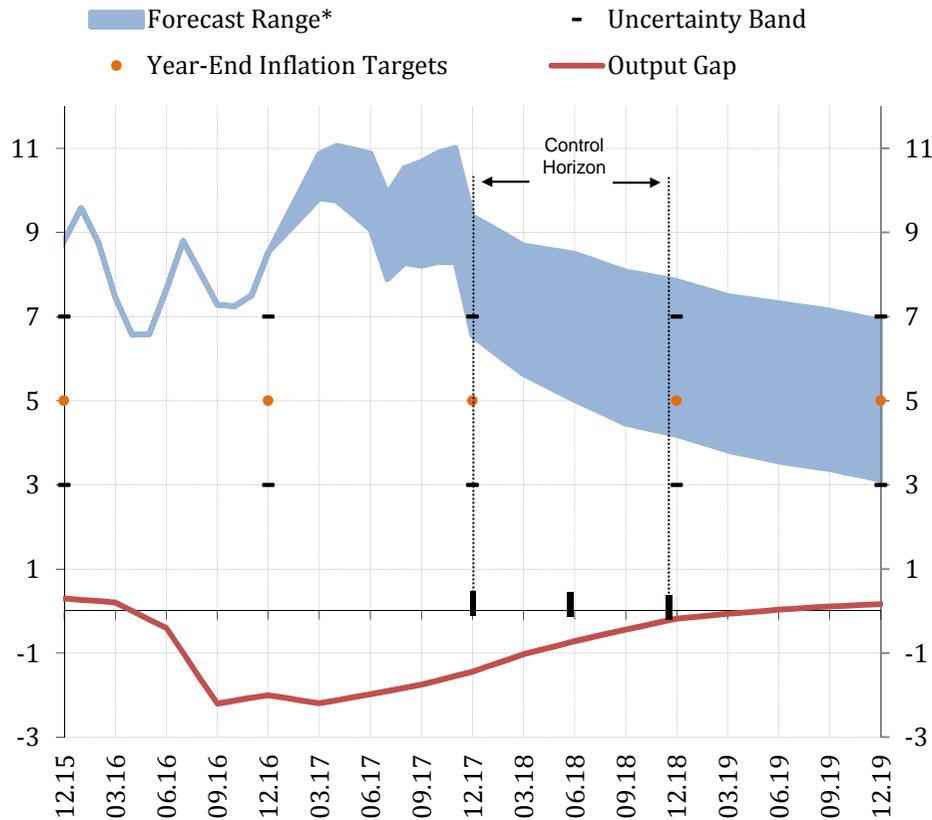


*Shaded region indicates the 70 percent confidence interval for the forecast.

- 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% in 2017, and stabilize around 5% in 2019 after falling to 6% in 2018.
 - Accordingly, inflation is expected to
 - be between 6.6% and 9.4% (with a mid-point of 8%) at end-2017
 - be between 4.2% and 7.8% (with a mid-point of 6%) at end-2018
- with 70 percent probability.

Inflation Outlook

Inflation and Output Gap Forecasts (Percent)



The upward revision in 2017 year-end inflation forecasts by a total of 1.5 points, relative to October Inflation Report, is driven by;

- upward revision on assumptions for TL-denominated import prices (1.3 points),
- downward revision on output gap forecasts (-0.4 points),
- upward revision on 2017 food inflation forecasts (0.4 points),
- higher-than projected inflation at end-2016 compared to previous forecasts and the rise in core inflation indicators (0.2 points).

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



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