

Briefing on 2018-I Inflation Report

January 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

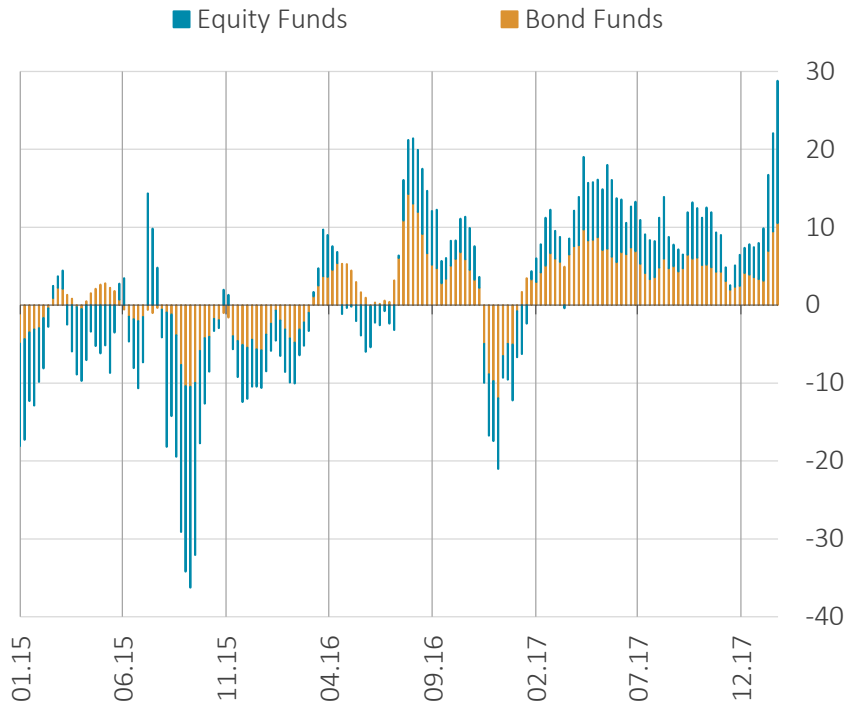
January 2018 Inflation Report: Boxes

- ▶ Potential Effects of the US Tax Reform
- ▶ Analyzing Core Inflation Dynamics
- ▶ Import Dynamics in 2017: The Weak Course of Consumption and Investment Goods
- ▶ The Effectiveness of CBRT on Money Market Rates
- ▶ Latest Developments in Turkish Lira-Settled Forward Foreign Exchange Sale Auctions
- ▶ Distribution of Domestic Borrowing Instruments by Investor Type
- ▶ An Evaluation of End-2017 Inflation Forecasts

Global Developments and Portfolio Flows

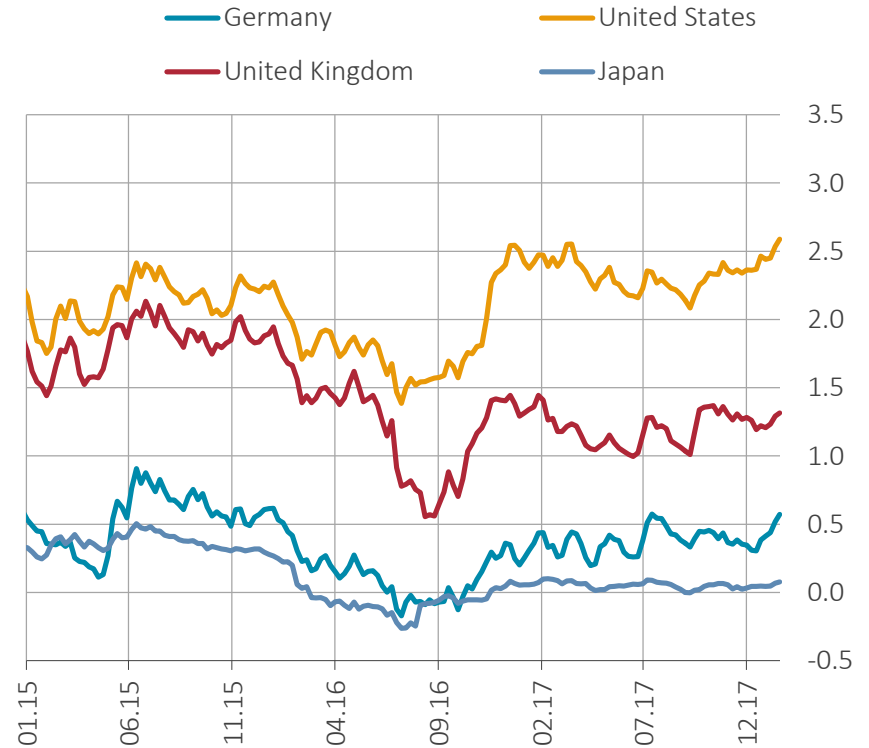
- ▶ Portfolio inflows to emerging economies continue at a steady pace and the rise in long-term bond yields of advanced economies remain limited.

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



Source: EPFR.

10-Year Bond Rates (%)



Source: Bloomberg.

Domestic Economic Outlook

- ▶ Exchange rate volatility and risk premium indicators have improved since November.
- ▶ Banks' lending appetite remained buoyant in the last quarter on the back of the positive outlook in economic activity.
- ▶ The depreciation of the Turkish lira as well as rising import prices, especially oil, elevated the cost push pressures on inflation compared to the previous reporting period.
- ▶ Economic activity proved robust in the last quarter, contributing to the rise in consumer inflation.
- ▶ Despite the improvement in net exports, current account balance partly deteriorated due to the surge in import prices.

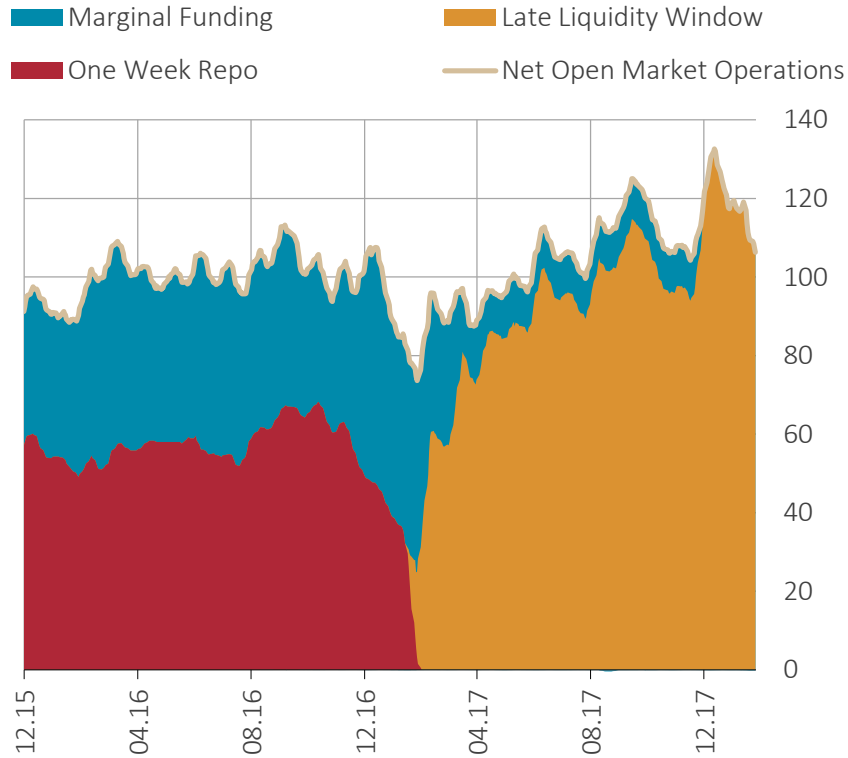
Monetary Policy and Financial Conditions



Monetary Policy

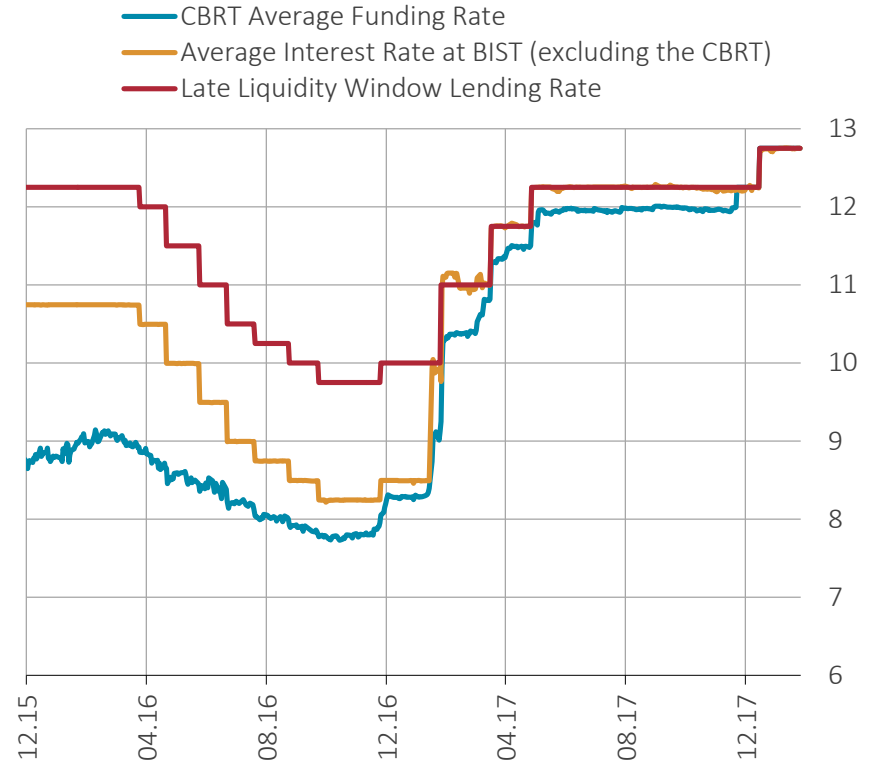
- ▶ The CBRT maintained its tight monetary policy stance to contain the deterioration in the inflation outlook.

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



Source: CBRT.

Short-Term Interest Rates (5-Day Moving Average, %)

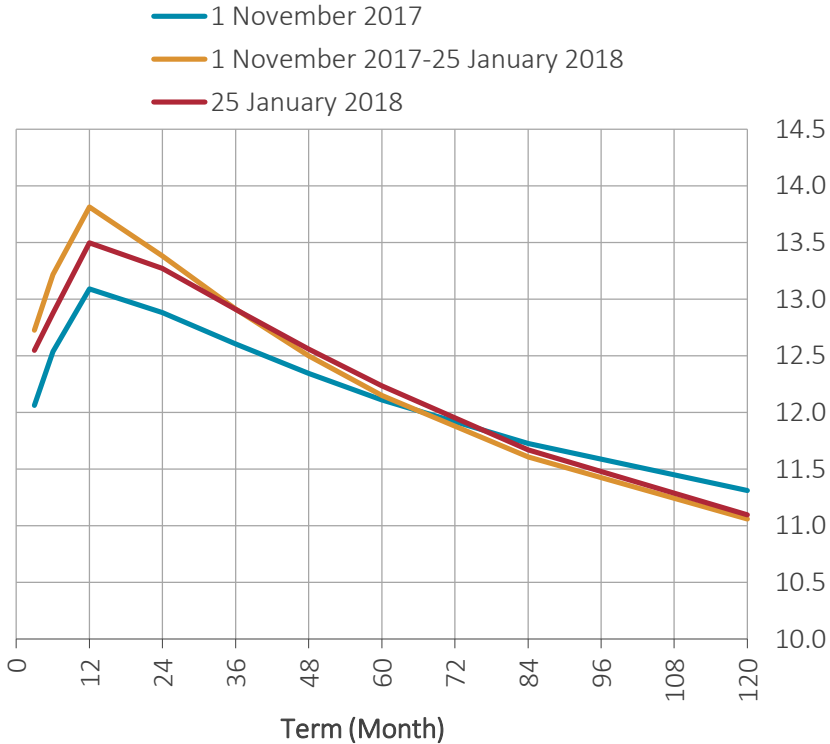


Source: BIST, CBRT.

Monetary Conditions

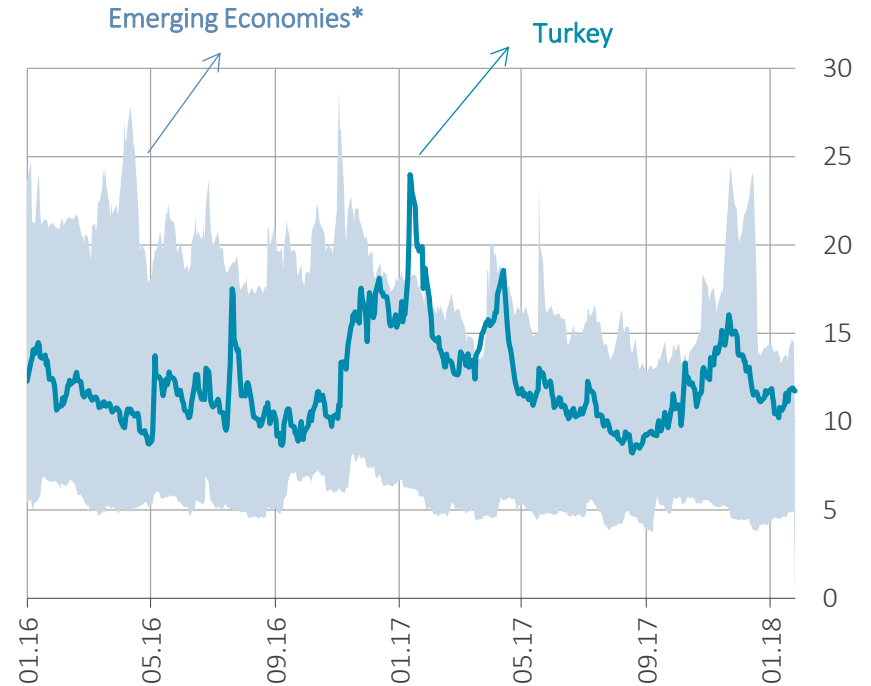
- Compared to the previous reporting period, the short and medium-term currency swap rates increased, while recently the implied volatility of the Turkish lira has recorded a decline similar to the currencies of other emerging economies.

Yield Curve on Cross Currency Swaps (%)



Source: Bloomberg.

Implied FX Volatility* (1 Month, %)

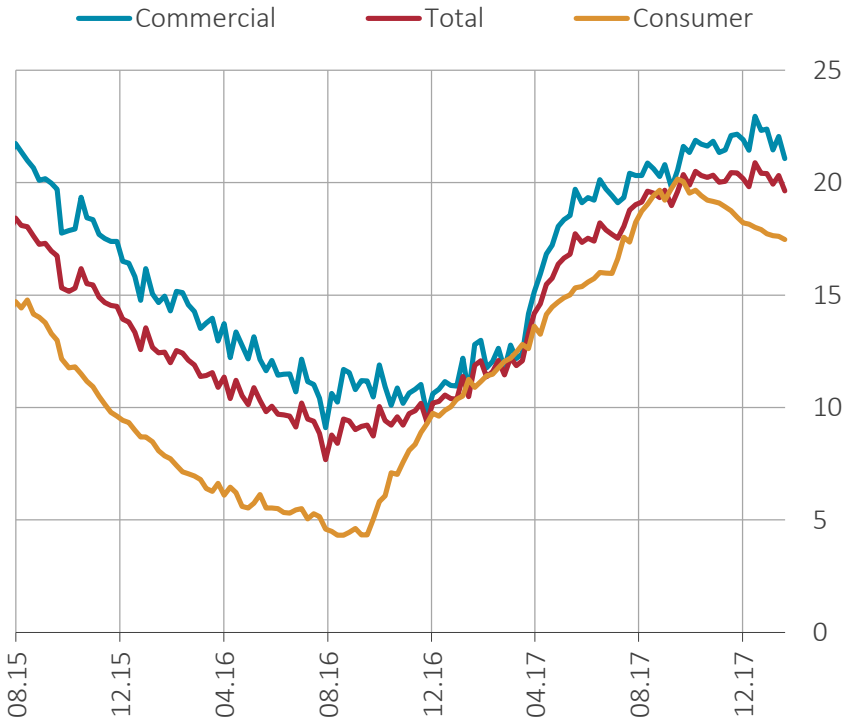


Source: Bloomberg.

Financial Conditions

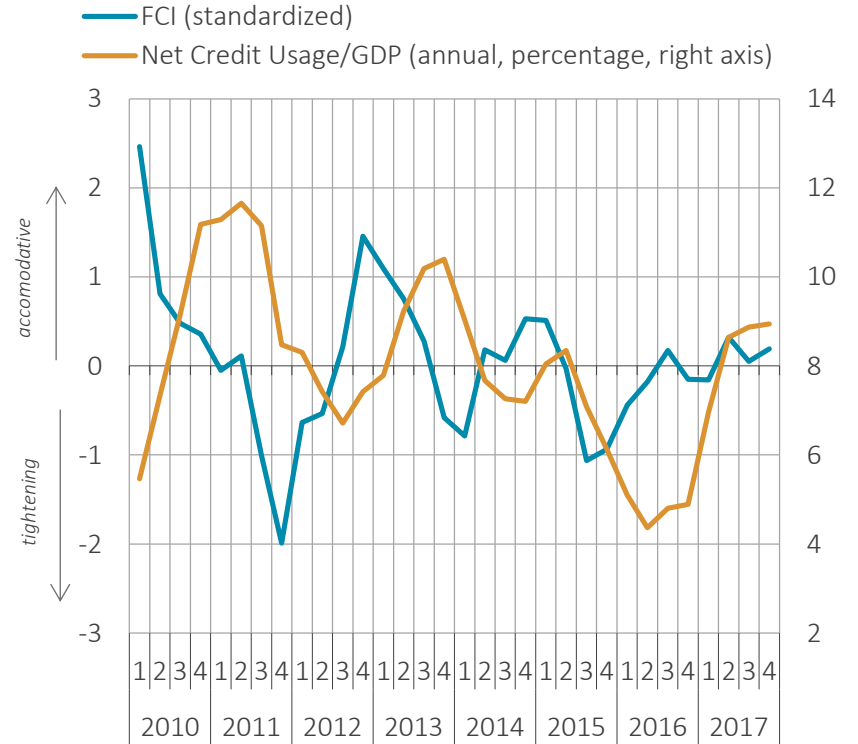
- ▶ In the last quarter, loans continued to stabilize, and the total loan growth remained flat.
- ▶ Aggregate financial conditions have been accommodative throughout 2017.

Annual Credit Growth (Adjusted for Exchange Rate, %)



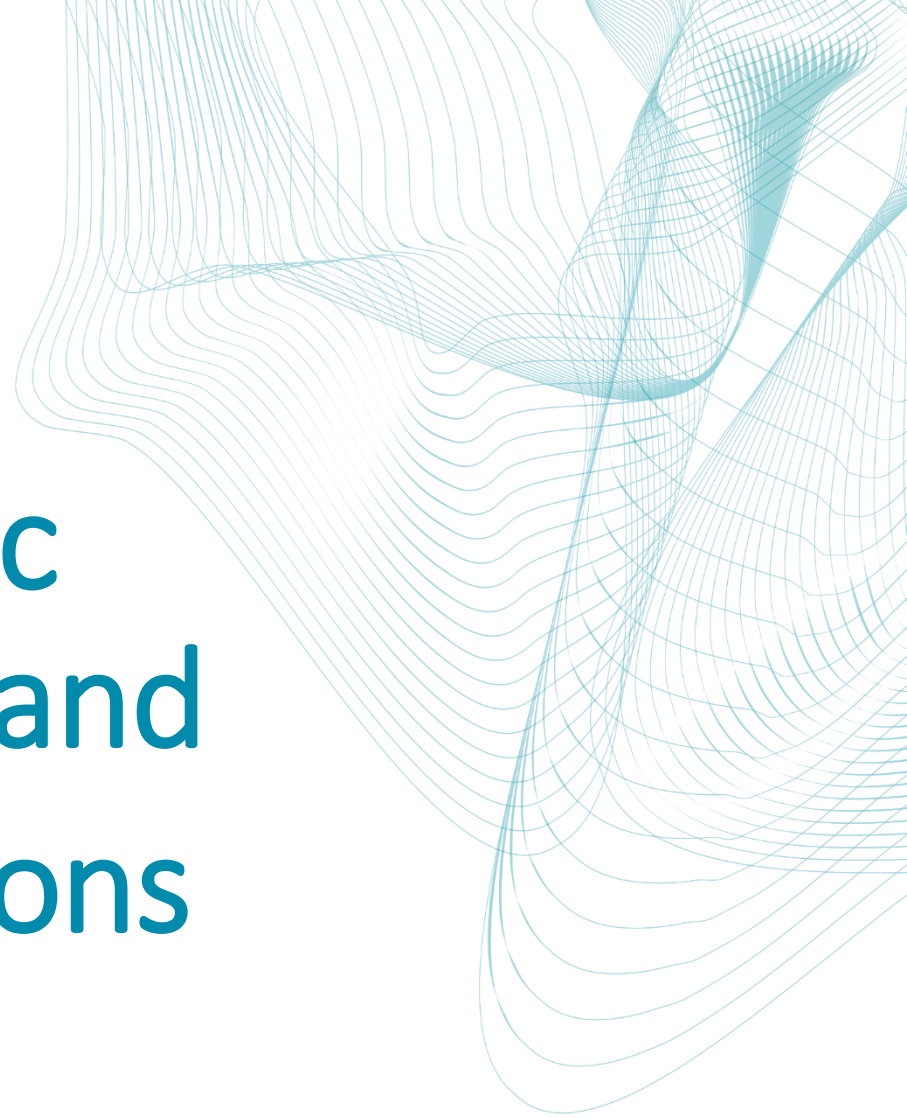
Source: CBRT.

Financial Conditions and Credit Growth*



Source: CBRT.

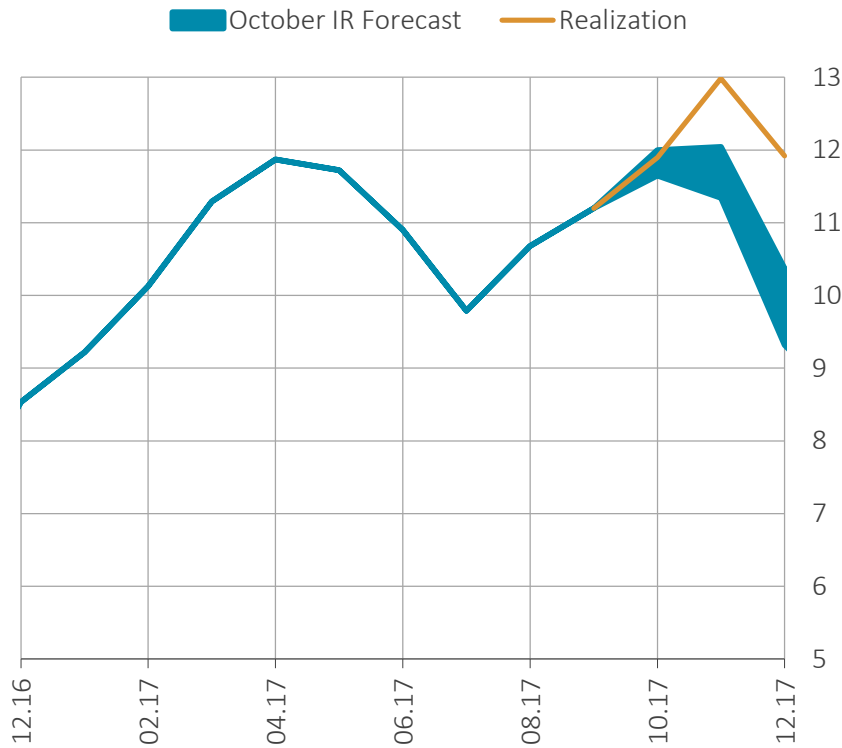
Macroeconomic Developments and Main Assumptions



October 2017 Inflation Report Forecasts and Realizations

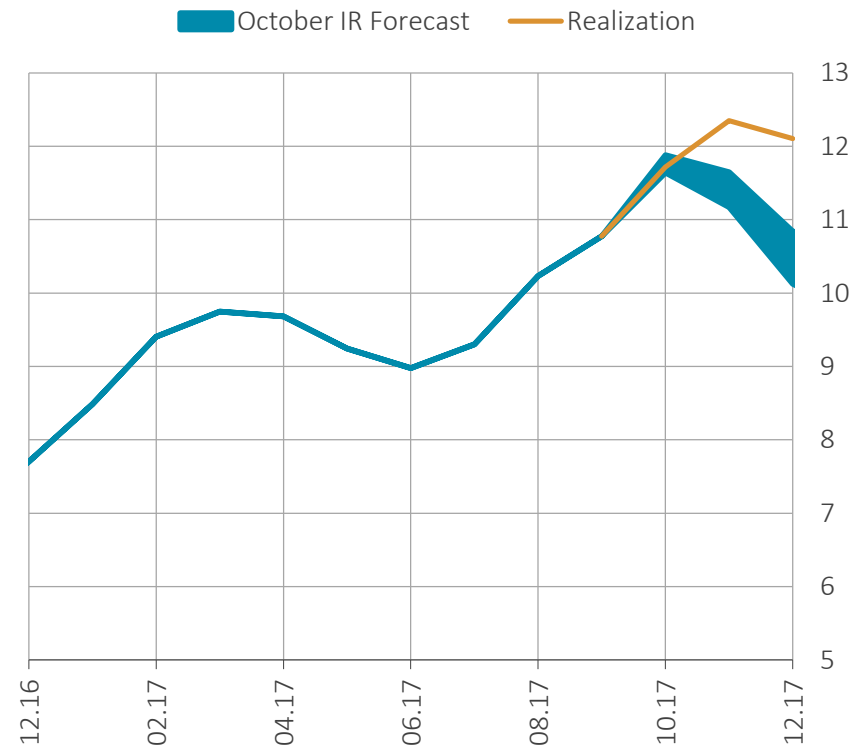
- Consumer inflation and consumer inflation excluding unprocessed food, alcoholic beverages and tobacco remained above the October 2017 Inflation Report forecasts in the last quarter.

Consumer Inflation (%)



Source: CBRT, TURKSTAT.

Inflation Excluding Unprocessed Food and Tobacco *(%)

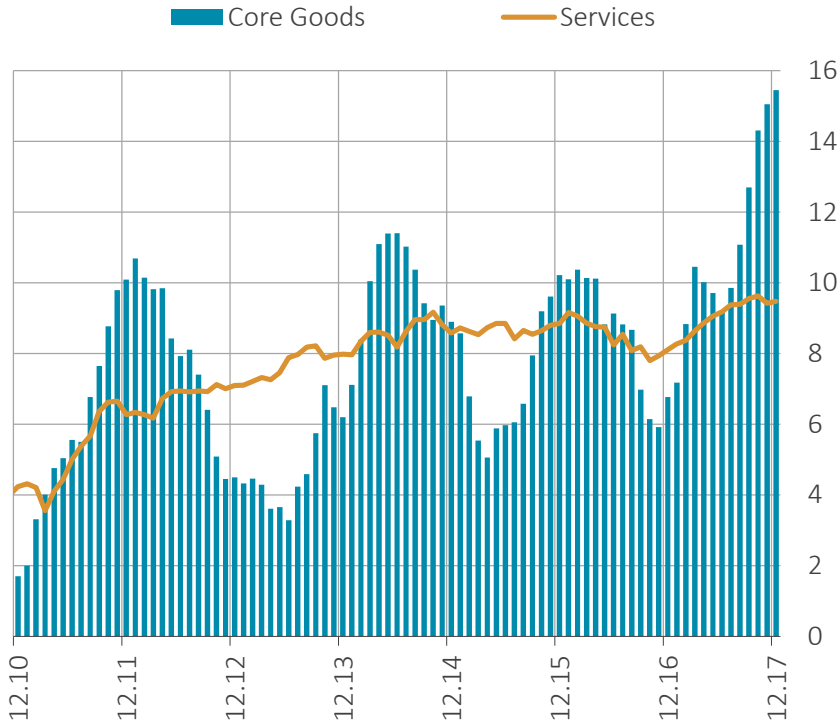


Source: CBRT, TURKSTAT.

Inflation

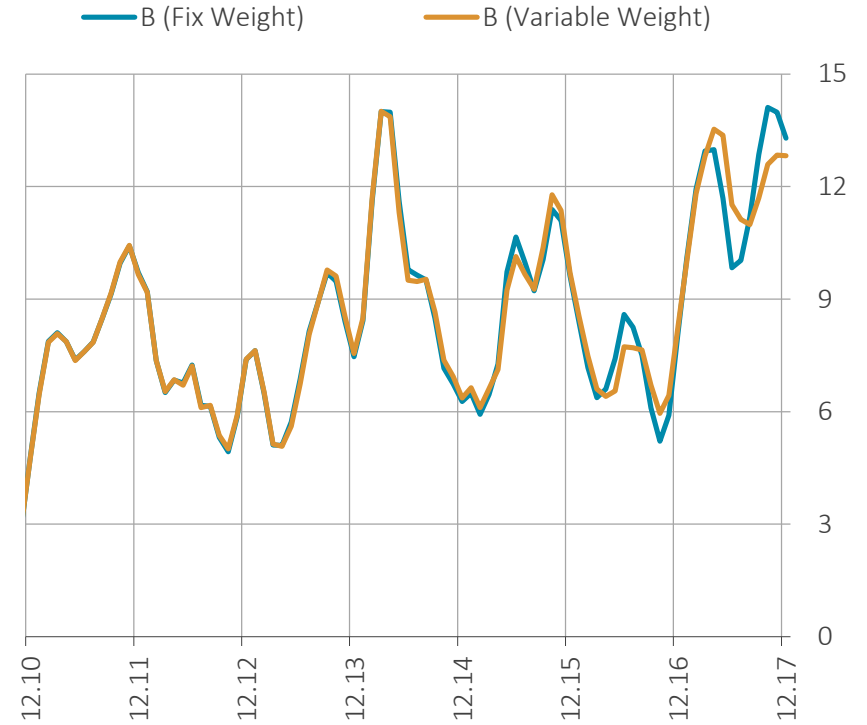
- ▶ Core goods inflation increased notably owing to the effects of the cumulative depreciation in the Turkish lira, while services inflation receded slightly.
- ▶ Core inflation indicators maintained their high levels.

Core Goods and Services Prices (SA, 3-Month MA, Annualized, % Change)



Source: CBRT, TURKSTAT.

Underlying Trend for B Index (SA, 3-Month MA, Annualized, % Change)

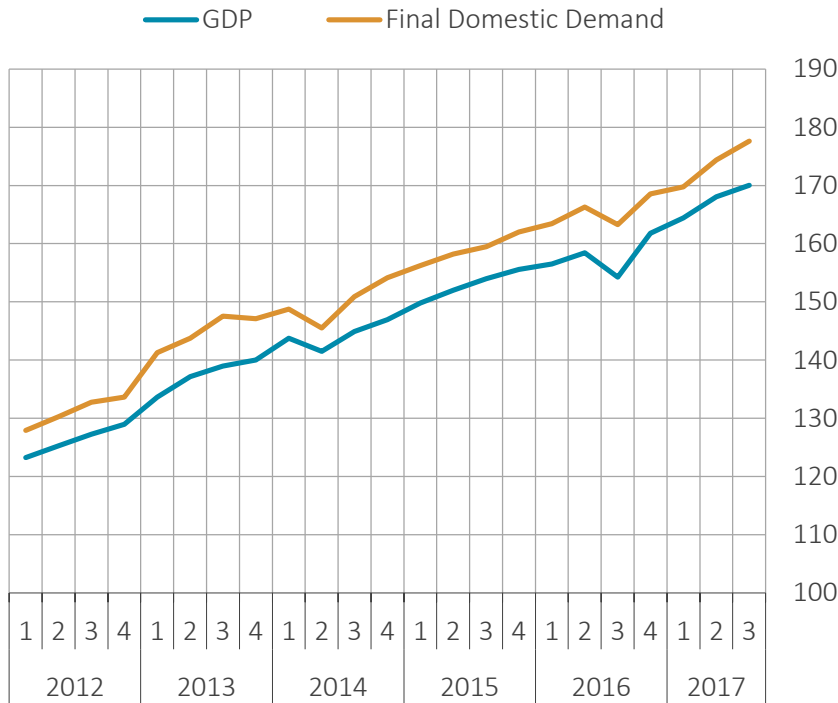


Source: CBRT, TURKSTAT.

Aggregate Demand

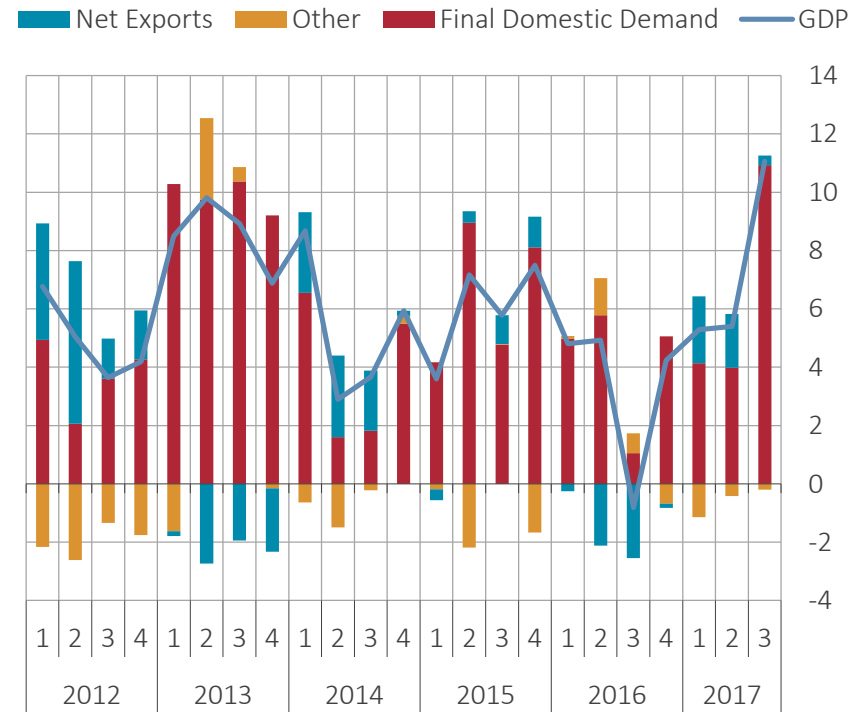
- ▶ Economic activity proved robust in the last quarter on the back of domestic demand as envisaged in the October Inflation Report.

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



Source: CBRT, TURKSTAT.

Contributions from the Expenditure Side* (%)

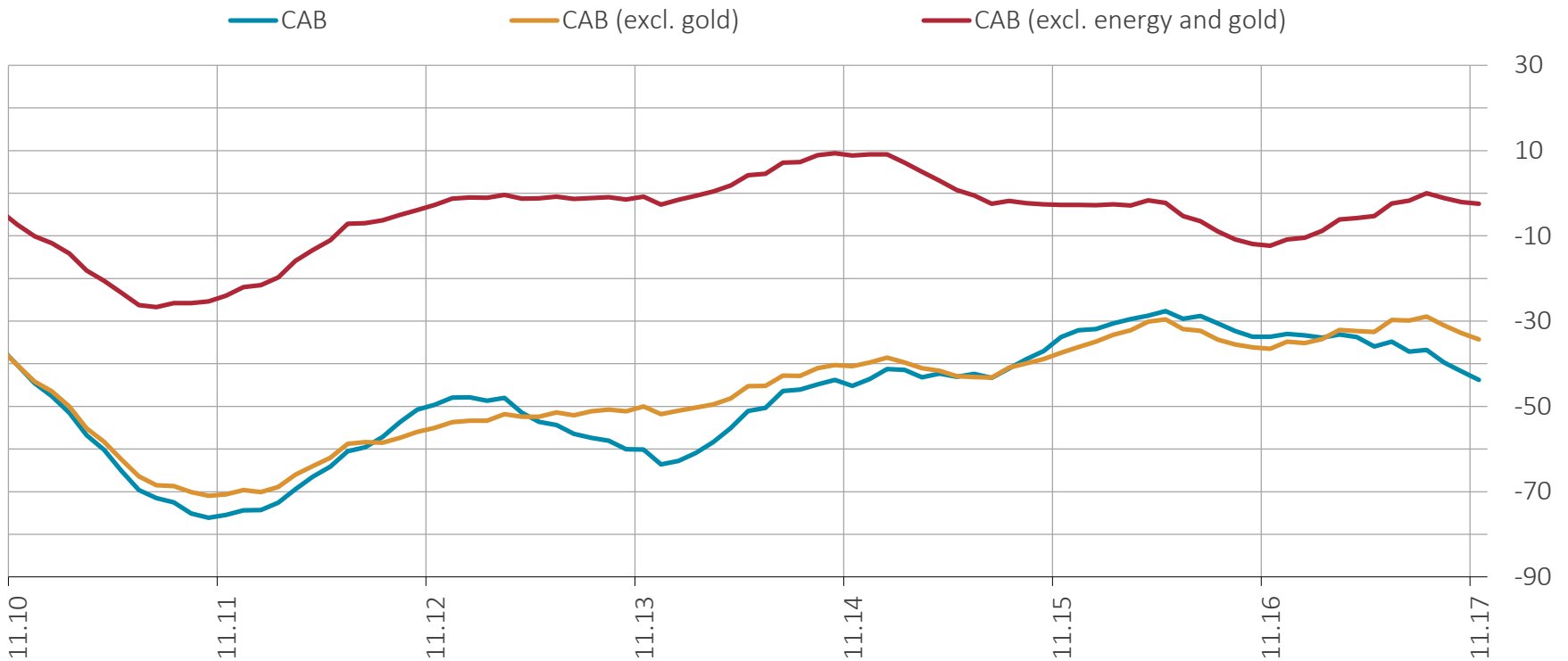


Source: TURKSTAT.

External Balance

- ▶ Despite the improvement in net exports, current account balance partly deteriorated due to the surge in import prices.

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

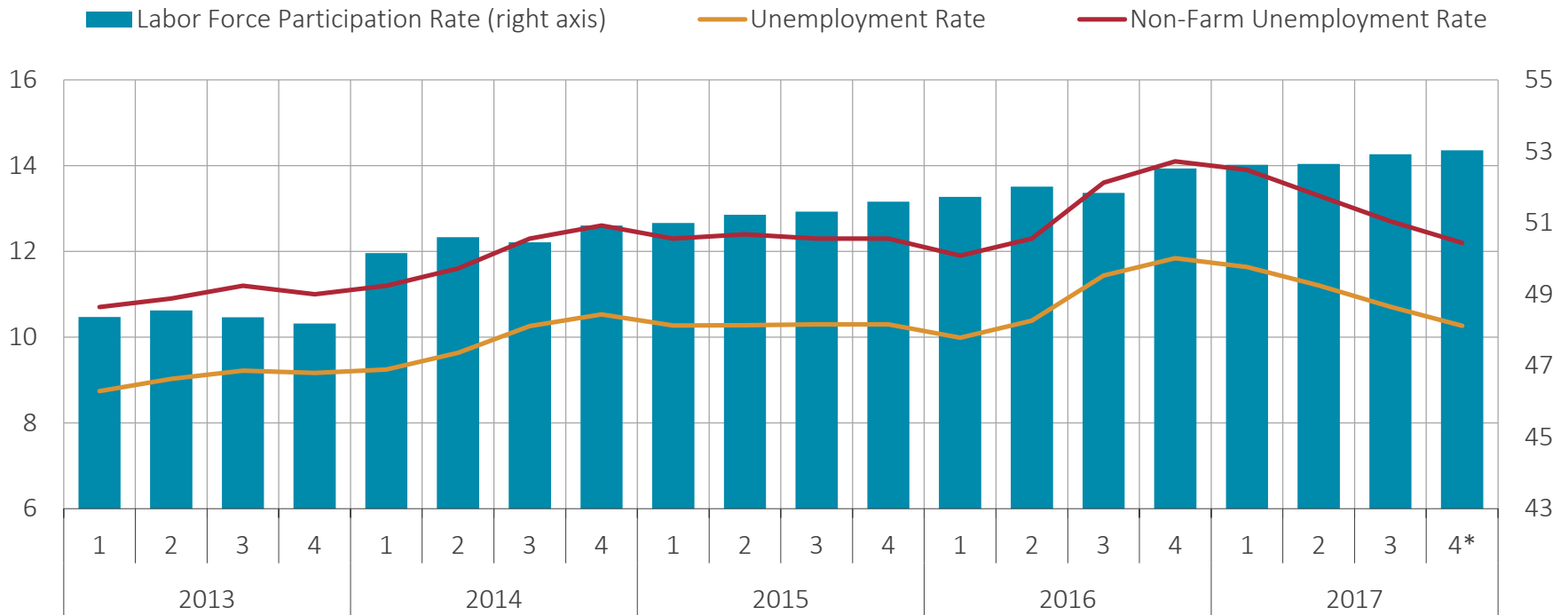


Source: CBRT.

Labor Market

- ▶ As the economic growth spreads wider across sectors, its reflections on the labor market become more visible.

Unemployment Rates (Seasonally Adjusted, %)

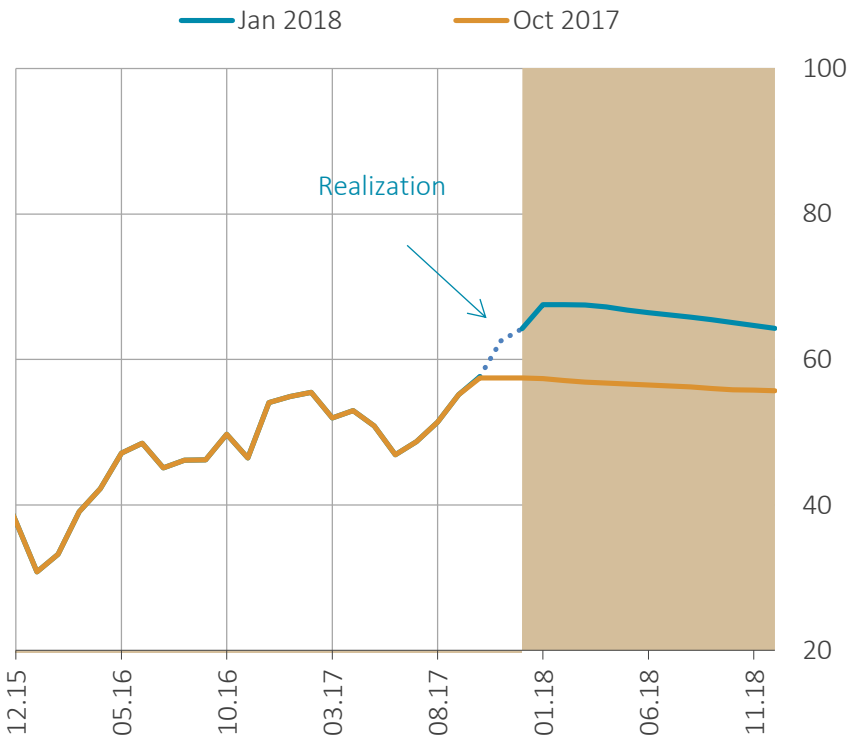


Source: TURKSTAT.

Revisions in Oil and Import Price Assumptions

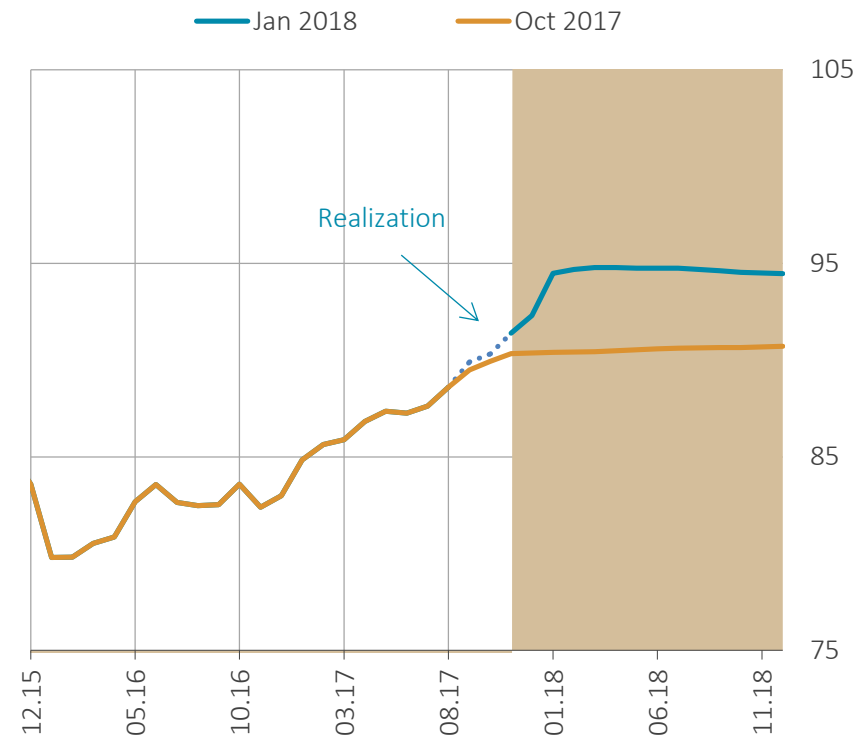
- ▶ In line with the recent developments, assumptions for crude oil prices and USD-denominated import prices were revised upwards for the upcoming period.

Oil Prices* (USD/bbl)



Source: Bloomberg, CBRT.

Import Prices* (Index, 2010=100)



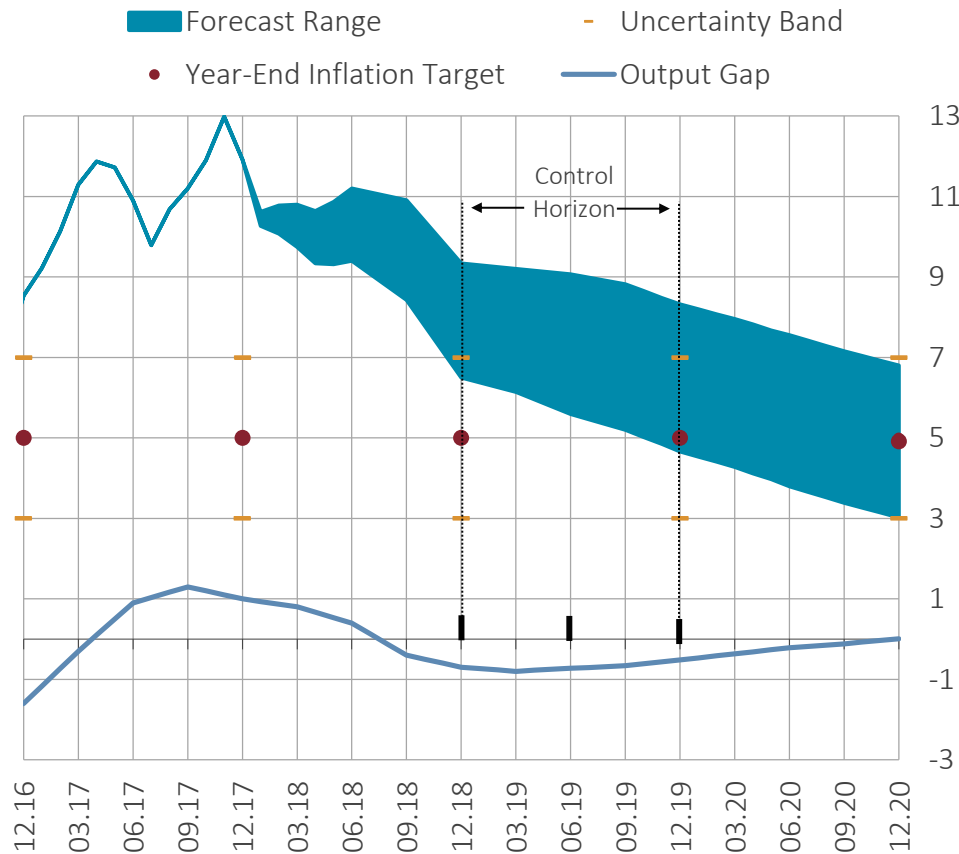
Source: CBRT, TURKSTAT.

Revision in Assumptions

| | | October 2017 | January 2018 |
|--|---------|--------------|--------------|
| Output Gap | 2017 Ç3 | 1.0 | 1.3 |
| | 2017 Ç4 | 0.6 | 1.0 |
| Food Prices (Year-end Percent Change) | 2018 | 7.0 | 7.0 |
| | 2019 | 7.0 | 7.0 |
| Import Prices (Average Annual Percent Change, USD) | 2017 | 7.1 | 7.5 |
| | 2018 | 3.1 | 7.4 |
| | 2019 | - | -0.5 |
| Oil Prices (Average, USD) | 2017 | 53 | 54 |
| | 2018 | 56 | 66 |
| | 2019 | - | 62 |
| Export-Weighted Global Production Index (Average Annual Percent Change) | 2017 | 2.3 | 2.5 |
| | 2018 | 2.3 | 2.7 |
| | 2019 | - | 2.5 |

Inflation Outlook

Inflation and Output Gap Forecasts* (%)

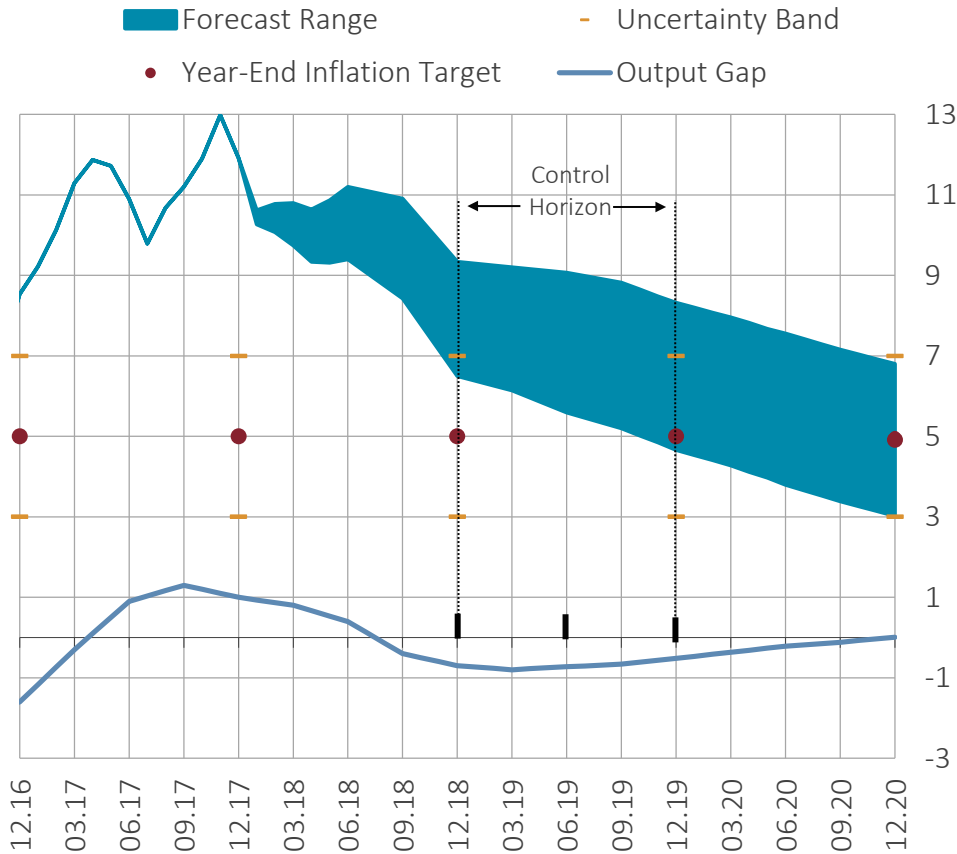


Source: CBRT, TURKSTAT.

- ▶ 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 7.9% at end-2018, and stabilize around 5% in the medium term after falling to 6.5% in 2019.
 - ▶ Accordingly, inflation is expected to
 - be between 6.5% and 9.3% (with a mid-point of 7.9%) at end-2018
 - be between 4.7% and 8.3% (with a mid-point of 6.5%) at end-2019
- with 70 percent probability.

Inflation Outlook

Inflation and Output Gap Forecasts* (%)



Source: CBRT, TURKSTAT.

- ▶ The upward revision in 2018 year-end inflation forecasts by a total of 0.9 points, relative to October Inflation Report, is driven by:
 - Upward revision in assumptions for TL-denominated import prices by +0.7 points,
 - Upward revision in output gap by +0.1 points,
 - Higher-than projected inflation realization at 2017Q4 and the rise in the underlying trend of inflation by +0.1 points.
- ▶ The upward revision in 2019 year-end inflation forecasts by a total of 0.5 points, relative to October Inflation Report, is driven by upward revision in assumptions for TL-denominated import prices.

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