



**TÜRKİYE CUMHURİYET  
MERKEZ BANKASI**

## **Briefing on Inflation Report 2014-III**

**Erdem BAŞÇI  
Governor**

**24 July 2014  
Ankara**

# Inflation Report: Main Sections

- Overview
- International Economic Developments
- Inflation Developments
- Supply and Demand Developments
- Financial Markets and Financial Intermediation
- Public Finance
- Medium Term Projections

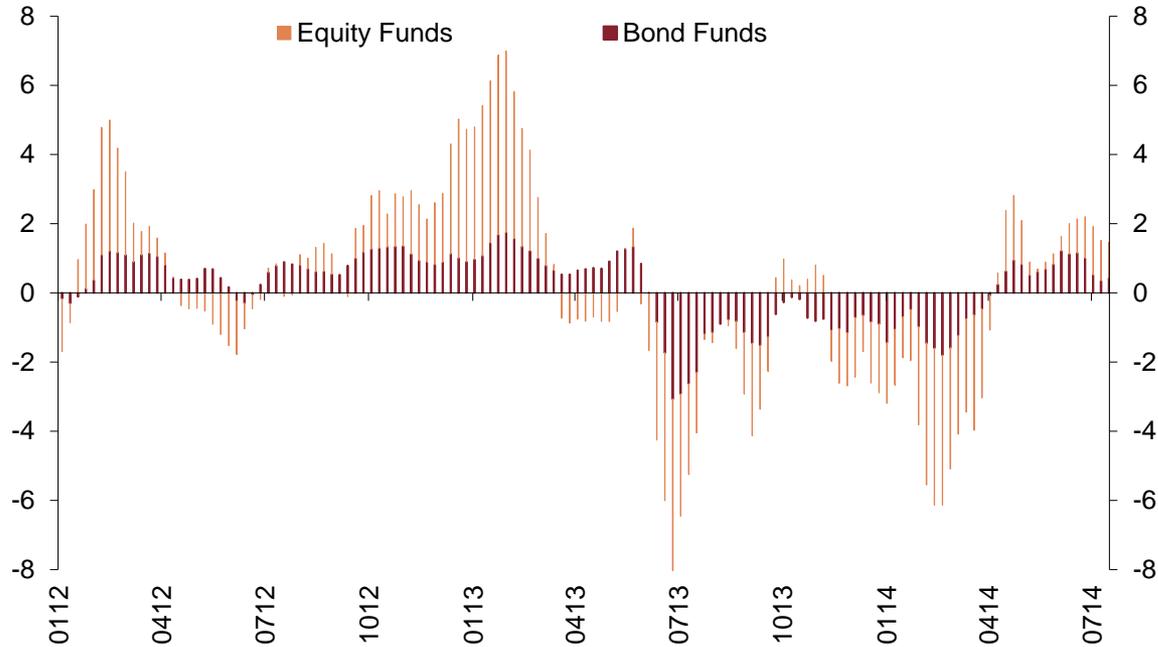
# Inflation Report: Boxes

- Sensitivity of Inflation to Business Cycles in Turkey
- Seasonal Adjustment of Gross Domestic Product Data: Direct and Indirect Approach
- Real and Current Balancing in Turkish Foreign Trade
- Loan Growth and Current Account Balance
- The relationship of Consumer and Commercial Loans with Current Account Deficit in Turkey
- The relationship of Sub-components of Banking System's TL Funding and TL Loans
- Firms' Access to Loans in Turkey: Analysis based on Survey Results

# Portfolio Flows

## Portfolio Flows to Emerging Economies

(4-Week Moving Average, Billion USD)

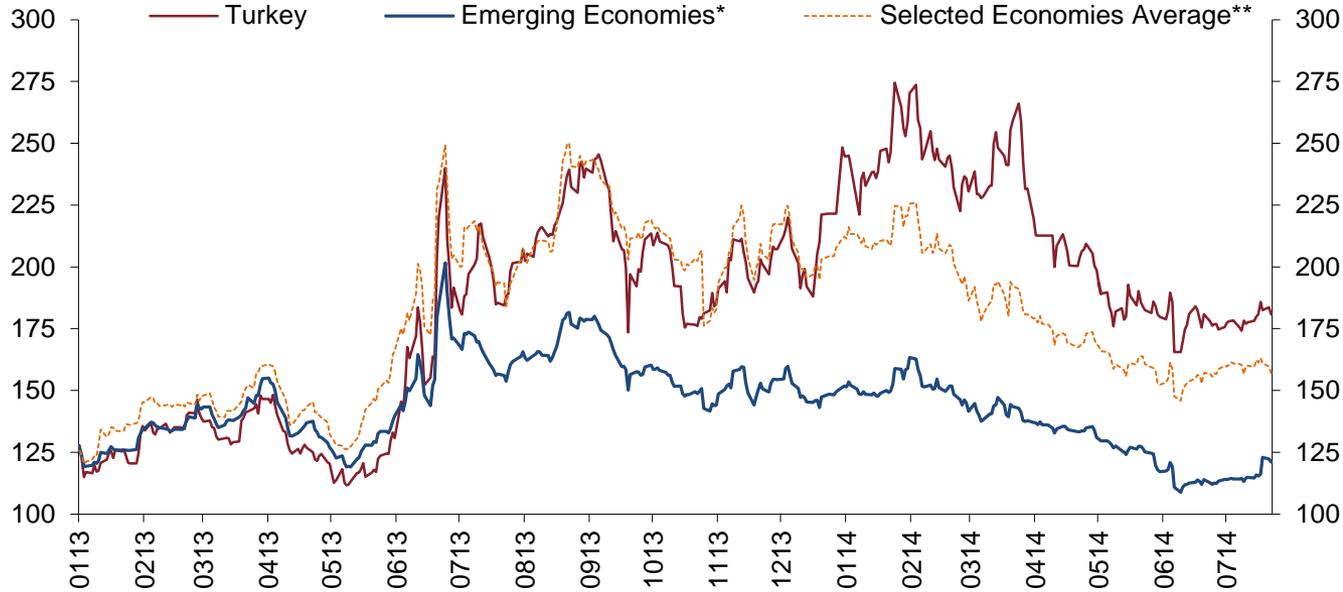


Source: EPFR.

- In the second quarter of 2014, financial volatilities subsided and liquidity conditions improved. Accordingly, portfolio flows to emerging countries picked up.

# Risk Premium

## CDS for Emerging Economies and Turkey (Basis points)



\*Brazil, Czech Rep., Indonesia, S. Africa, Colombia, Hungary, Mexico, Poland, Romania ve Chile.

\*\* Brazil, Indonesia, and S.Africa.

Source: CBRT, Bloomberg

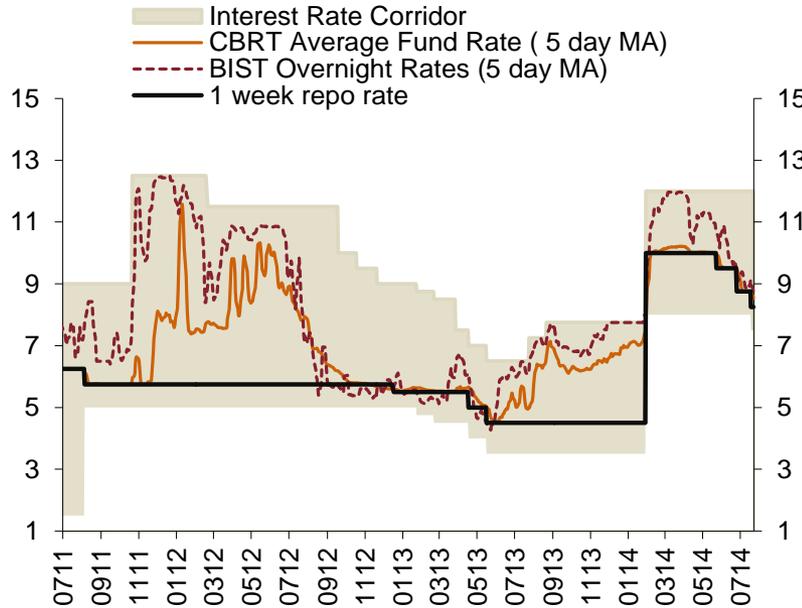
- Turkey's risk premium indicators displayed a notable improvement in the second quarter due to the tight monetary stance coupled with improvement in the domestic and external uncertainties.

# Monetary Policy and Financial Conditions

# Monetary Policy

## CBRT Rates and BIST Interbank O/N Repo Rates

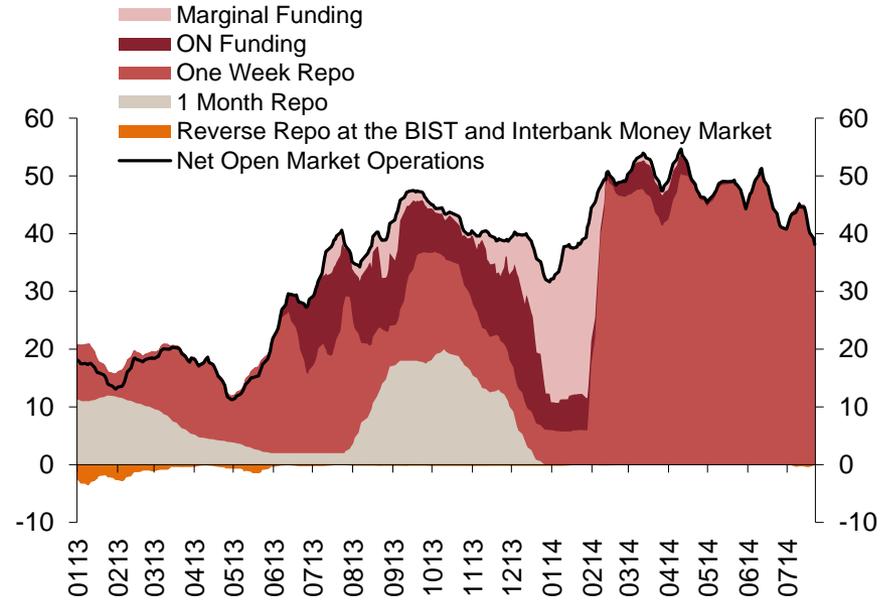
(Percent)



Source: BIST, CBRT.

## CBRT Funding\*

(2-Week Moving Average, Billion TL)



\*Marginal funding is O/N funding quoted at the upper limit of the corridor.

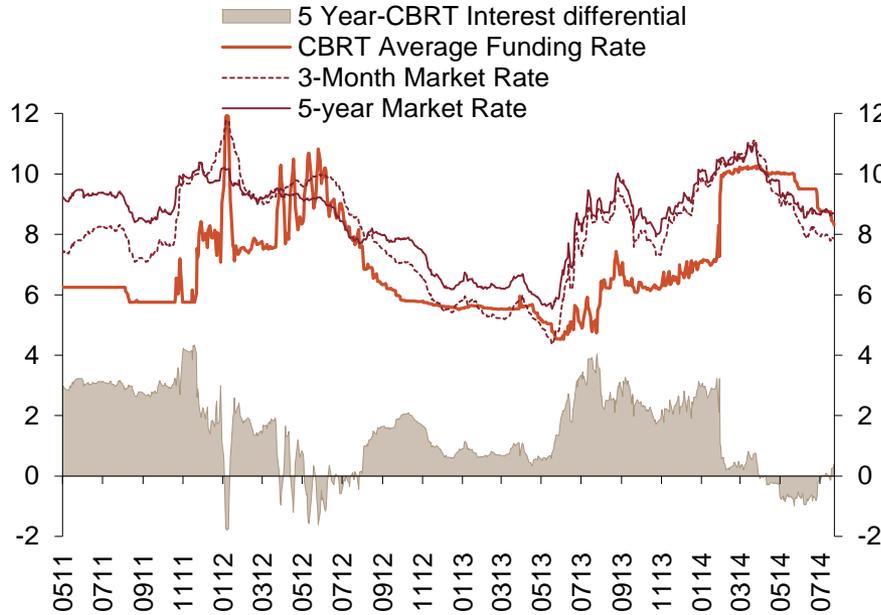
Source: BIST, CBRT.

- Owing to the strong and front-loaded nature of monetary tightening on 28 January, the resulting decrease in risk premiums, the improving global liquidity conditions, the slowing trend of inflation and the waning cumulative effects of exchange rates on inflation; the CBRT decided to deliver measured rate cuts recently.

# Monetary Conditions

## Money Market and CBRT Funding Rates

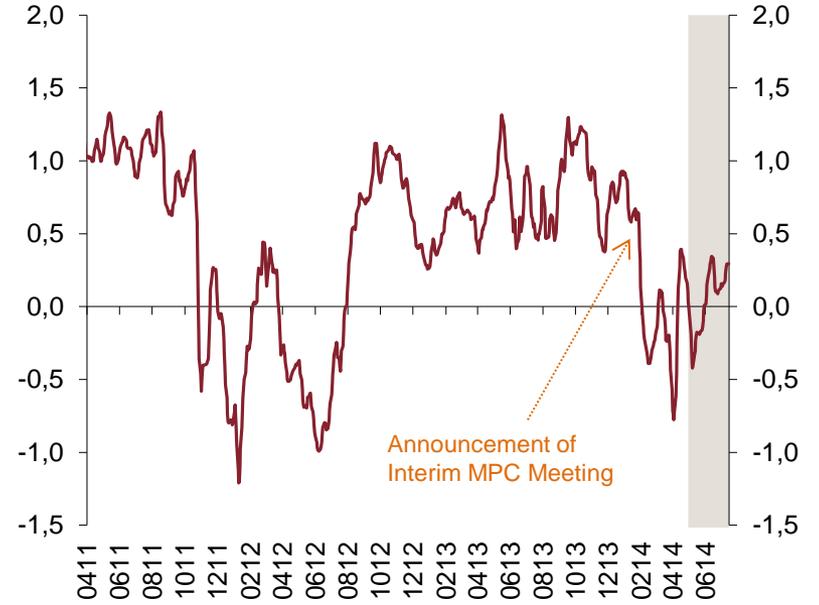
(Percent)



Source: BIST, CBRT.

## Interest Rate Spread\*

(Percent)



\* Spread between 4-year and 6-month yields derived from the ENS yield curve, 5-day moving average. (Last observation : 15 July)

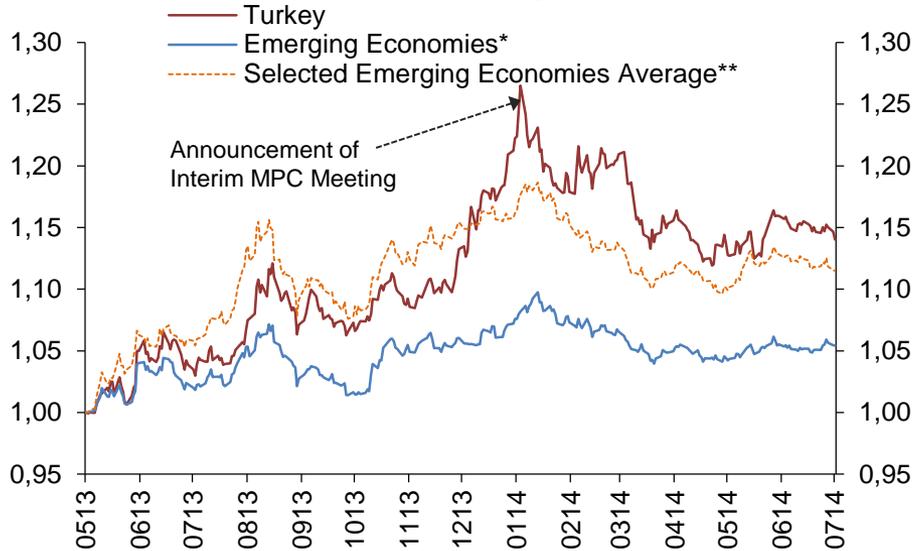
Source: BIST.

- The monetary policy maintains the tight stance by keeping a flat yield curve.

# Exchange Rates

## TL and Emerging Market Currencies vs USD

(22.05.2013=1)

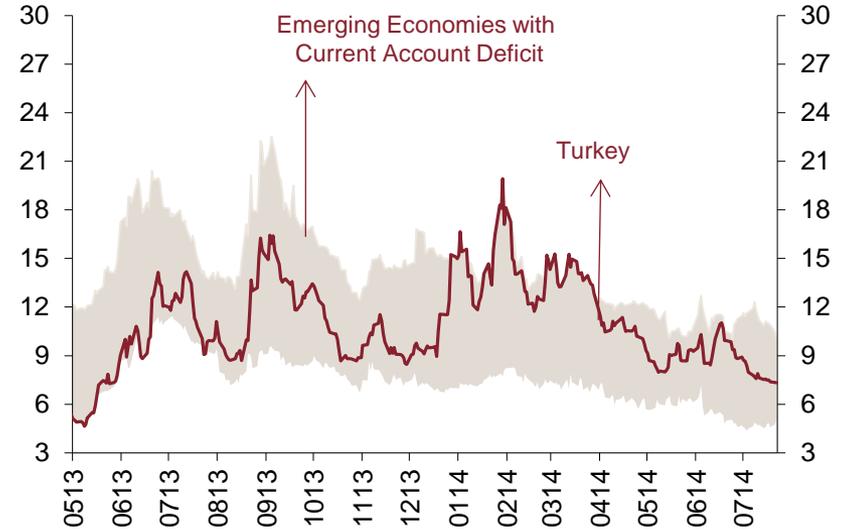


\* Brazil, Chile, Colombia, Czech Republic, Hungary, Mexico, Poland, Romania, Philippines, Malaysia, South Africa, India, Indonesia, and Turkey.

\*\* Brazil, India, Indonesia ve S. Africa Source: CBRT, Bloomberg.

## Implied Volatility of Exchange Rates (1 Month)

(Percent)



\* Emerging economies include Brazil, Chile, Czech Republic, Hungary, Mexico, Poland, South Africa, Indonesia, South Korea and Colombia

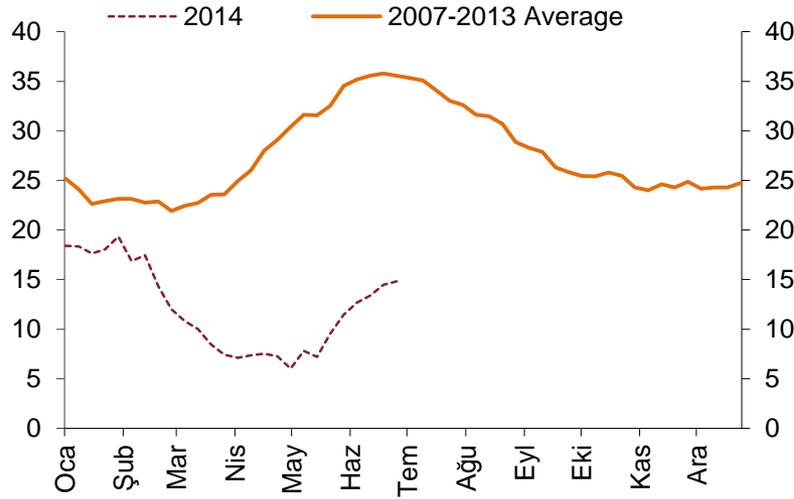
Source: CBRT, Bloomberg.

- Due to decreased domestic and external uncertainty, announcements of extended accommodative monetary policy from central banks in advanced economies and the tight monetary stance, the Turkish lira volatility appears to have recently fallen more, as compared to similar countries.

# Financial Stability

## Consumer Loan Growth

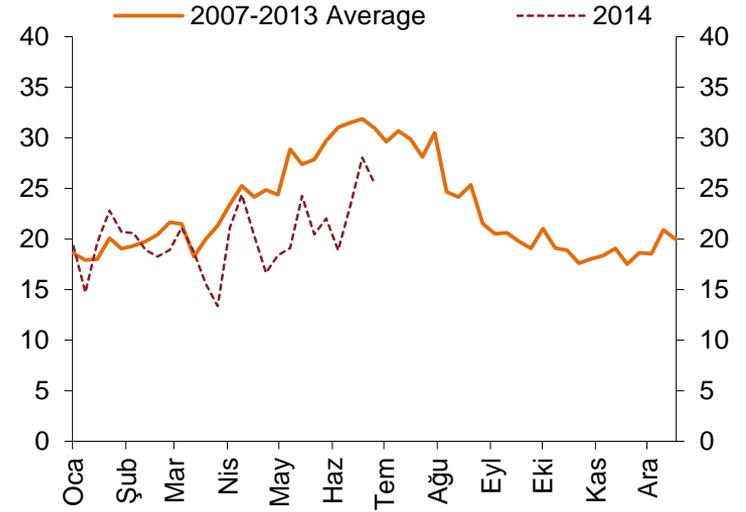
(13-Week Moving Average, Annualized, Percent)



Source: CBRT

## Commercial Loan Growth

(13-Week Moving Average, Adjusted for Exchange Rate, Annualized, Percent)

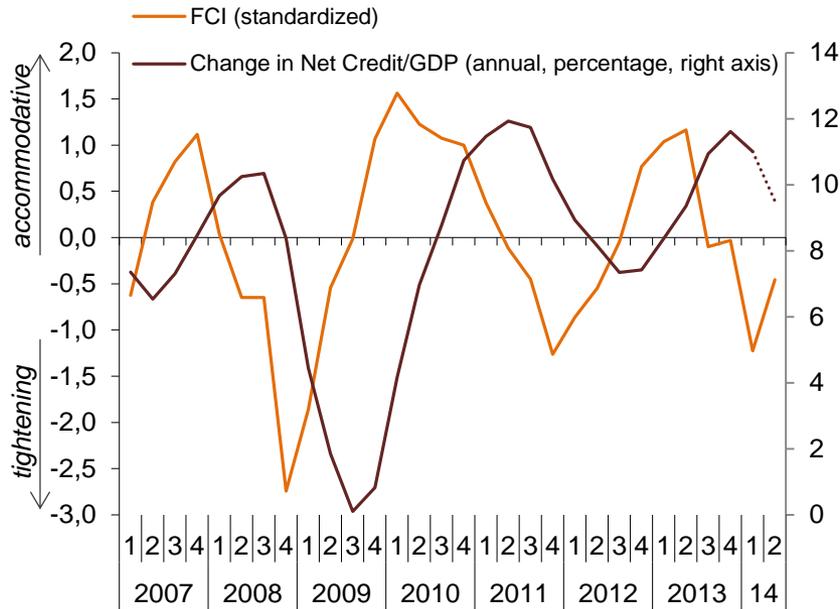


Source: CBRT.

- The growth of commercial loans maintain a robust course, while that of consumer loans recede to more reasonable levels, which support macro financial stability, rebalancing process and disinflation.

# Financial Conditions

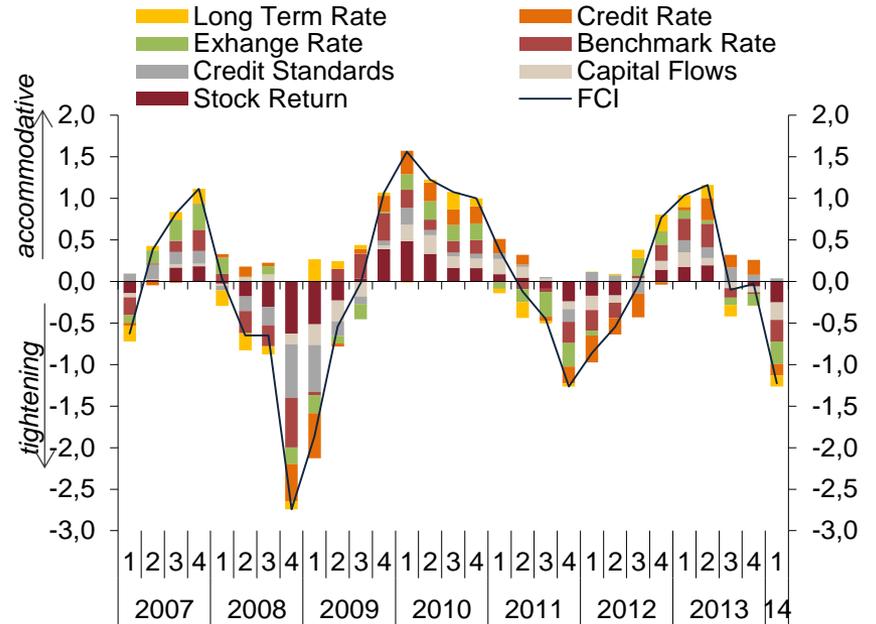
## Financial Conditions Index\*



\*Figures for the second quarter of 2014 are forecasts.

Source: CBRT

## Contributions to Financial Conditions Index



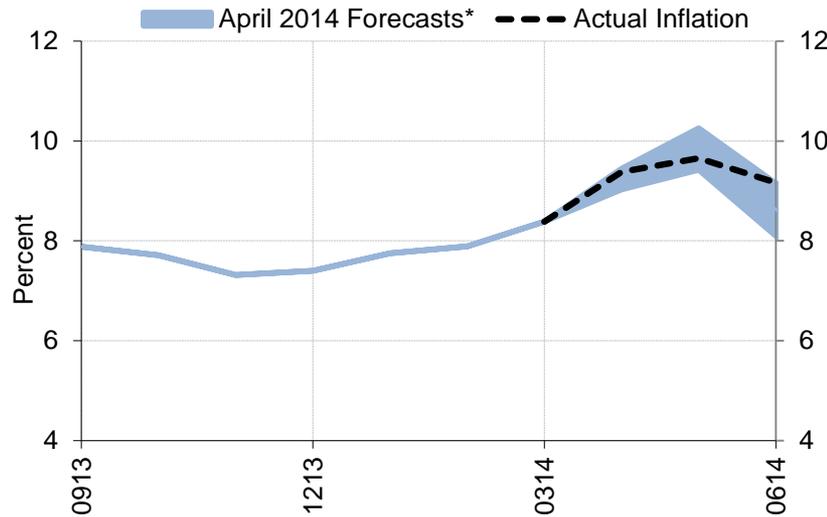
Source: CBRT

- Financial conditions index supported the domestic and external stability in the first half of 2014.

# Macroeconomic Developments and Main Assumptions

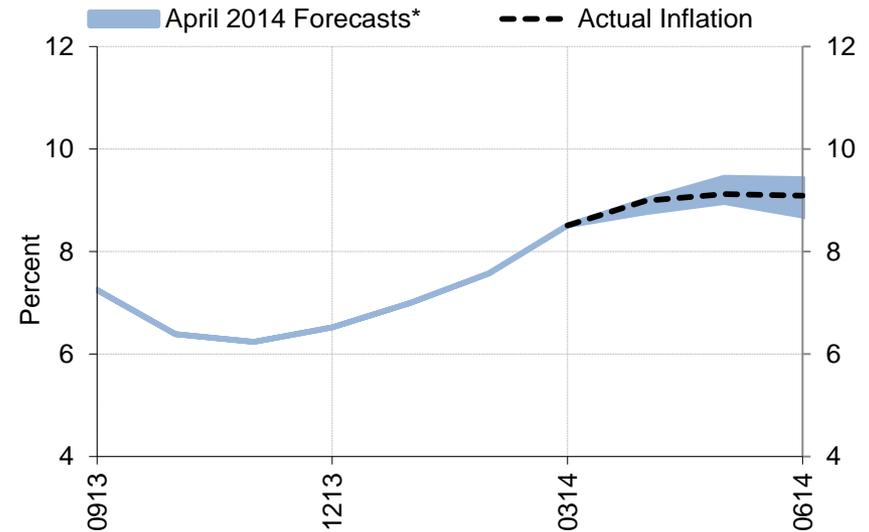
# April Inflation Forecasts and Realizations

April Inflation Forecasts and Realizations  
(Percent)



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

April 2014 Inflation Forecasts and Realizations  
Excluding Unprocessed Food and Tobacco  
(Percent)



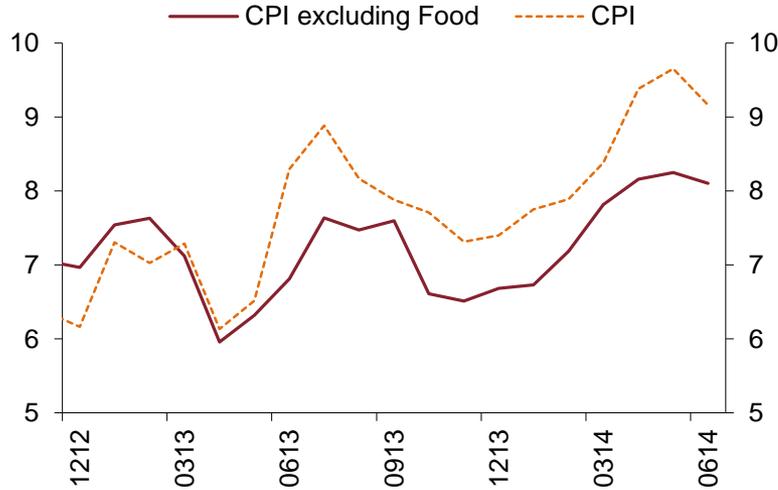
\* Shaded region indicates the 70 percent confidence interval for the forecast.  
Source: TURKSTAT, CBRT.

- In the second quarter of 2014, inflation excluding food proved consistent with the forecasts in the April Inflation Report.

# Inflation

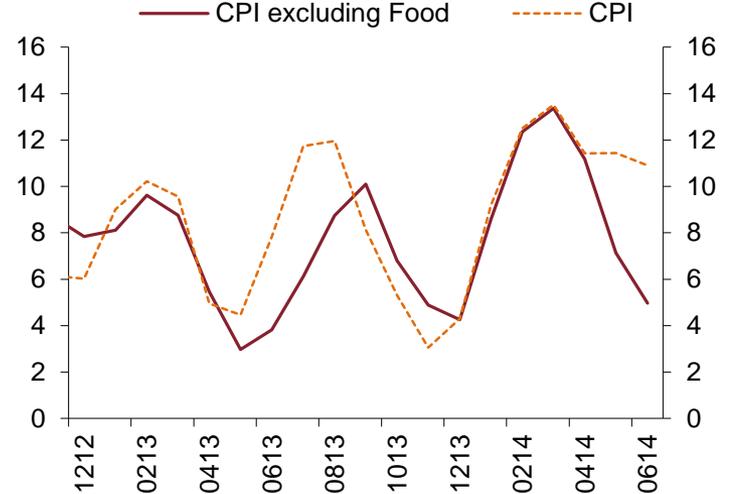
## Food Prices and CPI

(Annual Percentage Change)



## Food Prices and CPI

(Seasonally Adjusted, Annualized 3-Month-Average Change)



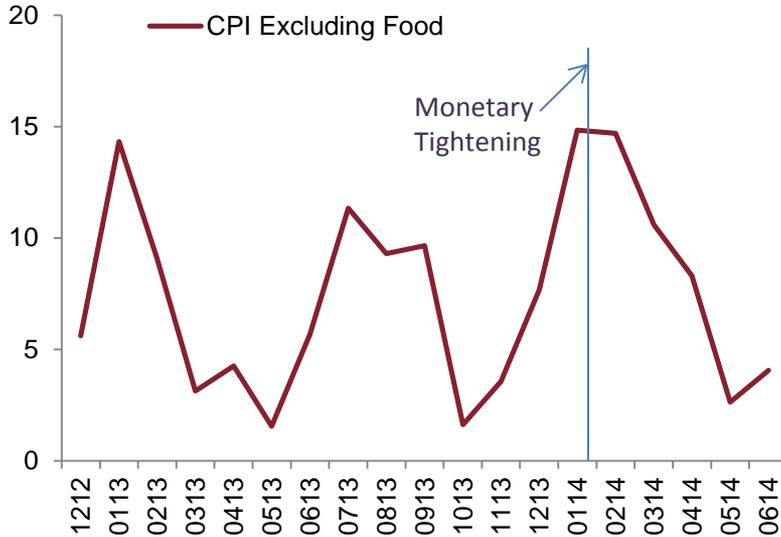
Source: TURKSTAT, CBRT.

- Recently, elevated food prices have been the main factor limiting the pace of decline in inflation.
- The underlying trend of inflation excluding food has been on a marked downward path in recent months, while food inflation remains elevated due to negative supply-side factors.

# Inflation

## CPI Excluding Food

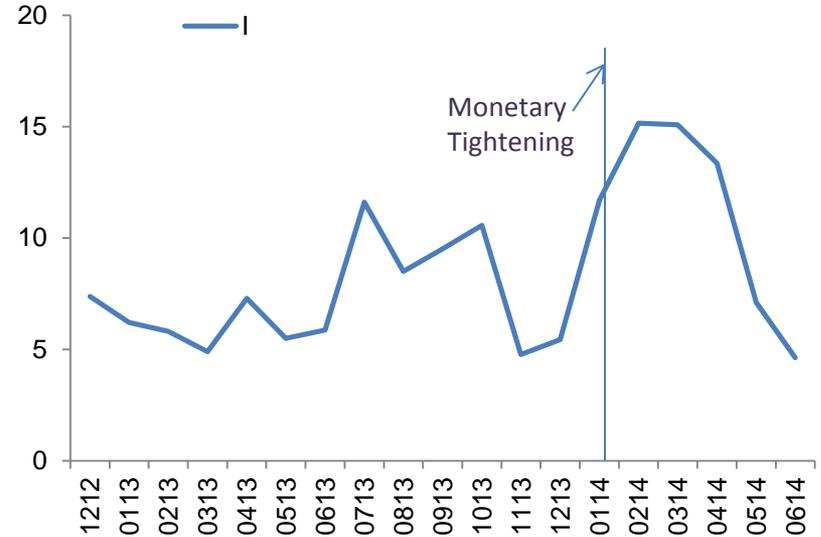
(Seasonally Adjusted Monthly Change, Annualized)



Source: TURKSTAT, CBRT.

## I Index

(Seasonally Adjusted Monthly Change, Annualized)



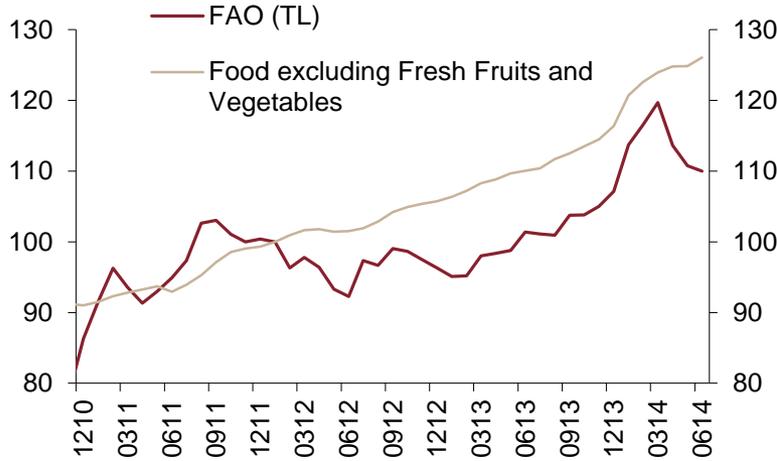
Source: TURKSTAT, CBRT.

- The recent trends indicate that core inflation is under control.
- Seasonally adjusted trends of both CPI excluding food and core I inflation are below 5 percent in annualized terms.

# Domestic and International Food Prices

## Domestic and International Food Prices

(Index, January 2012=100)

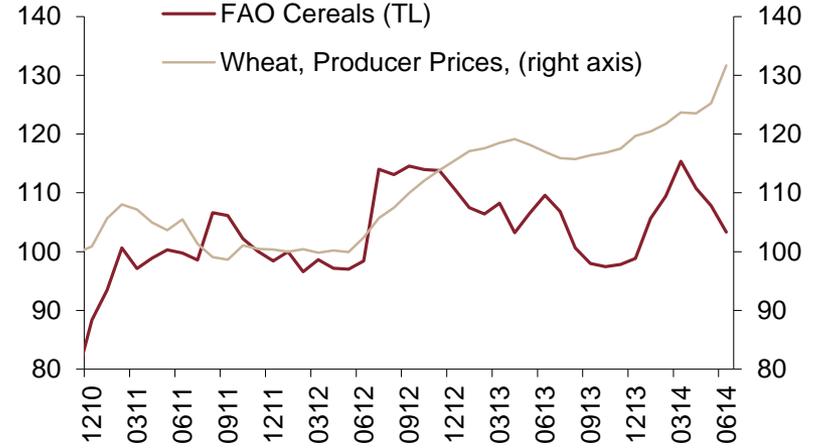


FAO prices are calculated in TL.

Source: FAO, TURKSTAT, CBRT.

## Domestic and International Wheat Prices

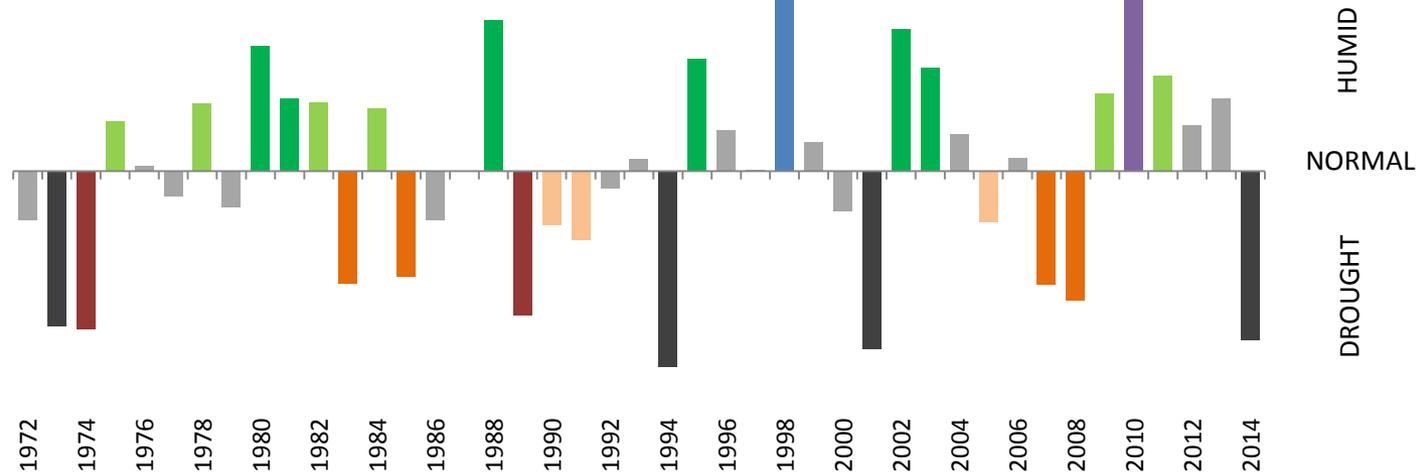
(Index, January 2012=100)



- Recent realizations on domestic food prices diverge markedly from those on international food prices.
- Domestic prices rose on par with international prices in the first quarter, but continued to climb in the second quarter even if international prices were markedly down.

# Negative Supply Conditions in Agriculture

## 1972-2014 Drought Analysis\* (12-month)



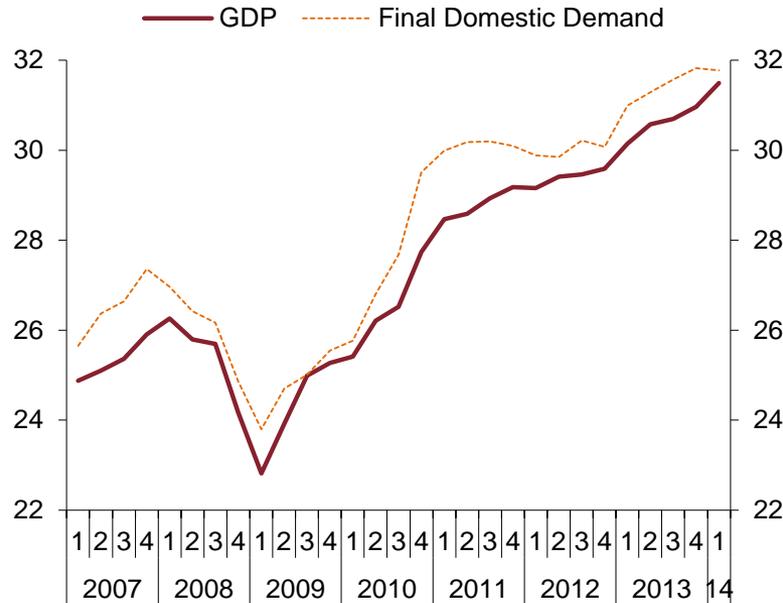
Source: Department of Meteorology. \* Shows the deviation from the average for last 12 months as of June.

- Drought had negative effects on domestic food prices.
- An active foreign trade policy to be imposed on certain agricultural products can be effective in curbing the upside risks on food prices.

# Demand Developments

## GDP and Final Domestic Demand

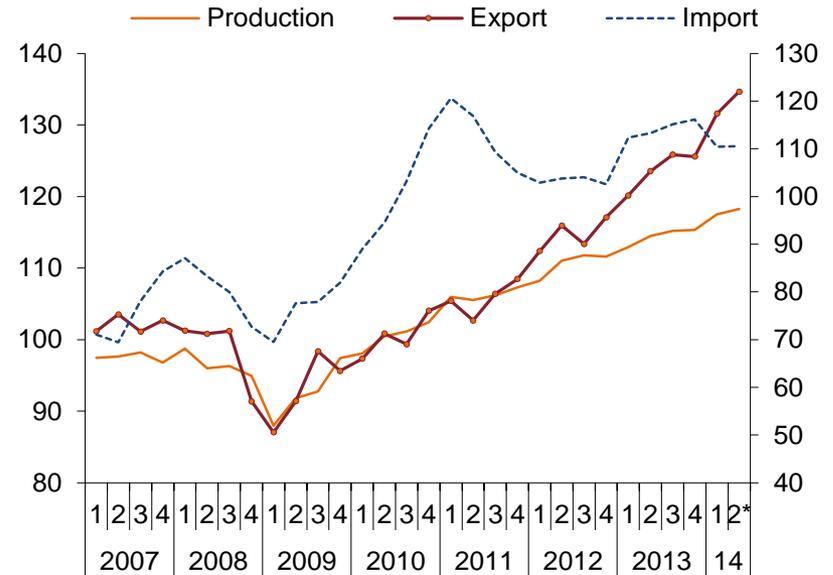
(Seasonally Adjusted, Billion TL, 1998 Prices)



Source: TURKSTAT, CBRT.

## Production and Trade of Consumption Goods

(2010=100)



- National income maintains its moderate course and net exports contribute positively to growth.

# Financial Stability

## Export and Import Volume Indices

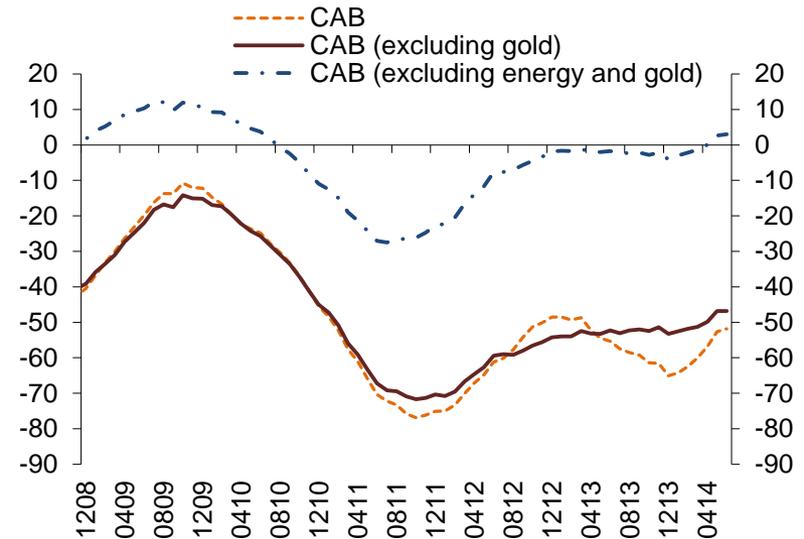
(Seasonally Adjusted, 2010=100)



\* Second quarter data reflects April, May realizations and June forecasts.  
Source: TurkStat, CBRT.

## Current Account Balance

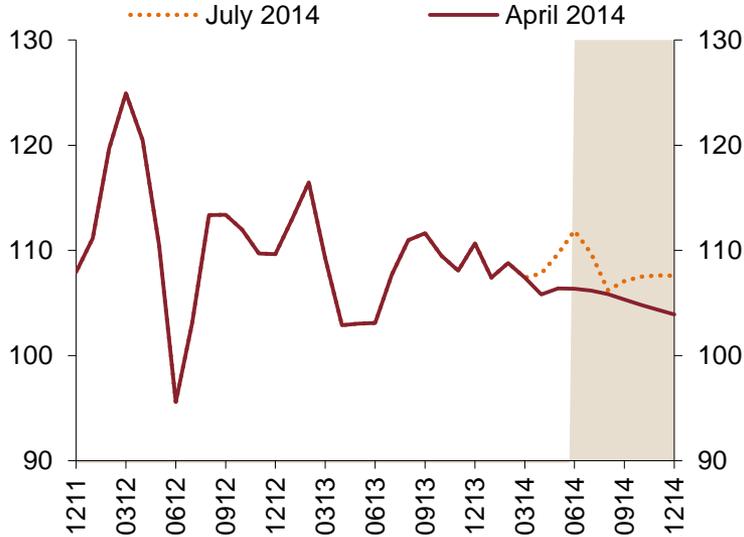
(12-Month Cumulative, Billion USD)



- Non-gold exports remain on the rise, while non-gold imports continue to fall.
- Accordingly, a significant improvement in the current account balance in 2014 is expected.

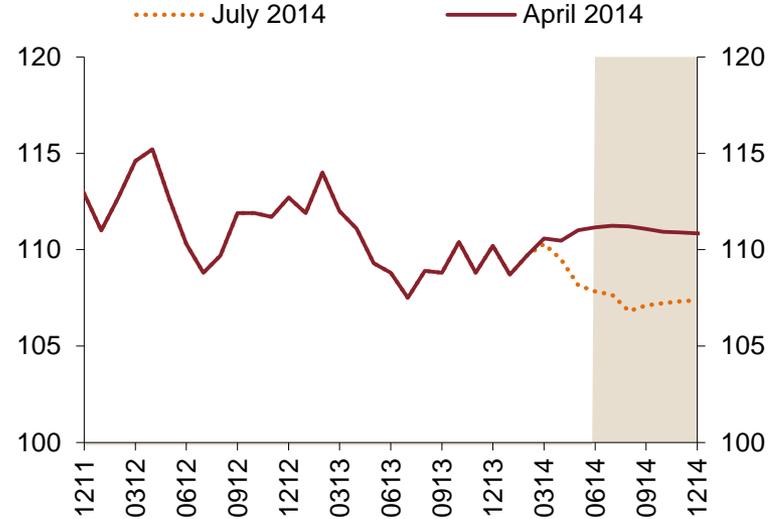
# Commodity and Import Prices

**Oil Prices\***  
(USD/barrel)



\* Shaded area indicates the forecast horizon.  
Source: Bloomberg, CBRT.

**Import Prices\***  
(USD, 2010=100)



\* Shaded area indicates the forecast horizon.  
Source: Bloomberg, CBRT.

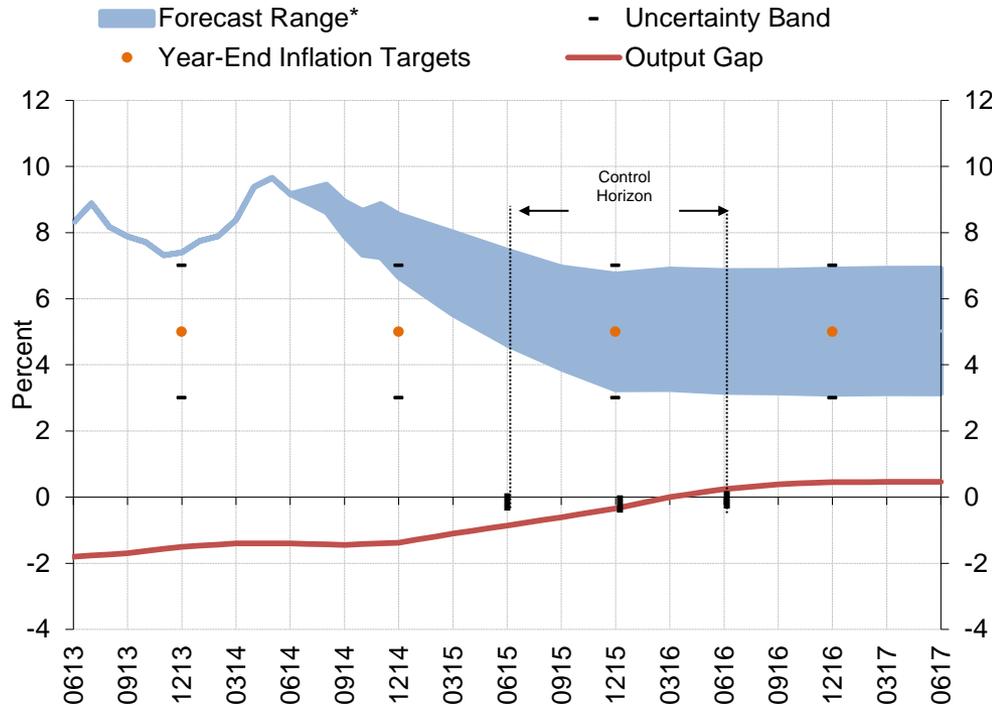
- Oil prices remained a little above the April forecast in the second quarter, whereas import prices lagged below projections .
- Given the current outlook, the developments in oil and import prices by and large balances each other off for inflation outlook.

# Monetary Policy Stance

- Medium-term forecasts are based on the assumption that the tight monetary policy stance will be maintained by keeping a flat yield curve and the improvement in global liquidity conditions will be sustained.
- It is assumed that the annual loan growth rate will stabilize around 15 percent towards the end of 2014 on the back of the macro prudential measures taken.

# Inflation Outlook

## Inflation and Output Gap Forecasts



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

Thus, inflation is expected to

- be between 6.7% and 8.5% at end-2014 (midpoint 7.6%),
- be between 3.3% and 6.7% at end-2015 (midpoint 5.0%),
- and stabilize at 5% in the medium term

with 70% probability,



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