

Summary of the Monetary Policy Committee Meeting

13 March 2019, No: 2019-11

Meeting Date: 6 March 2019

Inflation Developments

1. In February, consumer prices increased by 0.16% and annual inflation fell by 0.68 points to 19.67%. Annual inflation receded in subgroups other than energy. This rise in energy inflation was driven by oil prices, while the core goods inflation was affected by the mild course of the exchange rate as well as the subdued domestic demand. Services inflation offered a limited contribution to disinflation, yet remained high. Against this background, core inflation indicators recorded a slowed annual inflation. Meanwhile, the underlying trend of core indicators rose slightly, yet remained low. In sum, the recent moderation in the Turkish lira as well as the weak domestic demand support the fall in consumer inflation, whereas cumulative cost pressures put a limit on better prospects.
2. Annual inflation in food and nonalcoholic beverages declined by 1.72 points in February to 29.95%, contributed both by the processed and unprocessed food groups. Annual inflation in these groups stood at 20.18% and 39.07%, respectively. The fall in the unprocessed food group was led by fresh fruits and vegetables, while the annual inflation in this group remained high with 59.75%.
3. Energy prices were up by 0.75% in February and annual energy inflation rose by 1.51 points to 14.57%. This is mainly attributed to the rising fuel and bottled gas prices in tandem with the outlook for international energy prices.
4. Annual core goods inflation fell by 1.53 points to 21.22% in February. In this period, annual inflation lost further pace across all subcategories. Prices of durable goods maintained the downtrend, while the clothing and footwear group witnessed a slower decline in annual inflation led by the weak domestic demand. Monthly price increases remained subdued also in other core goods. To sum up, the recent modest course of core goods inflation is attributed to the course of the Turkish lira and the slow progress of domestic demand.
5. Following an upsurge in January, services inflation posted a relatively mild increase in February by 0.58%. Thus, annual services inflation declined by 0.26 points to 15.14%. Annual inflation remained flat in rents, but decreased in other subgroups. Annual price increases in the restaurants-hotel group recorded an increase in tandem with the food inflation. Led also by demand conditions, annual inflation in transportation services posted a decline due chiefly to highway and airway transport fees. Despite the slow course of domestic demand, services inflation remained elevated due to the cost factors as well as the backward-indexation behavior.

Factors Affecting Inflation

6. Recently released data show that the rebalancing trend in the economy has become more noticeable. Industrial production posted a quarter-on-quarter fall in the fourth quarter of 2018, and the economic slowdown has spread across all sectors as suggested by indicators for services and construction. It has been assessed that, despite the slowdown in domestic demand and imports, net exports, coupled with robust exports of goods and tourism demand have continued to boost quarterly and annual growth in the last quarter.
7. Economic activity displays a slow pace, partly due to tight financial conditions. Increasing public expenditure, extended tax cuts for durable goods and the partial rebound in loan growth appear to have spurred domestic demand in the first quarter.
8. Despite recent signs of a global economic slowdown, particularly for the EU, external demand maintains its relative strength. Firms' orientation towards external markets amid sluggish domestic demand and their flexibility in market diversification stimulate exports of goods; lagged exchange rate effects, loans and economic slowdown dampen import demand, 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. In the October-December period, nonfarm employment was down quarter-on-quarter across all sectors, construction in particular; while unemployment remained on the rise.

Monetary Policy and Risks

10. The global economy continued to lose momentum since the previous MPC meeting, with the EU posting a more noticeable downturn. Therefore, global growth forecasts for 2019 have been revised down. Protectionist trends in international trade keep the downside risks to the global growth outlook alive by increasing uncertainties regarding global economic policies.
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 course of energy prices, global inflation pressures are expected to be mild in the upcoming period.
12. As the deceleration in global growth became more pronounced, the outlook regarding the monetary policy stance of advanced economies further eased compared to the previous MPC meeting period. This outlook implies more favorable conditions in terms of portfolio flows to emerging economies, however elevated levels of uncertainty over global economic policies and global financial risks keep the downside risks to portfolio flows alive.
13. While developments in import prices and domestic demand conditions have led to some improvement in inflation indicators, risks to price stability continue to prevail. Elevated levels of inflation and inflation expectations, and uncertainties over the course of cost factors and pricing behavior continue to pose risks to the inflation outlook 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%.
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 the 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.