Briefing on 2020-I Inflation Report

January 30, 2020 | ANKARA
January 2020 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 2020 Inflation Report: Boxes

- A Closer Look at Global Trade Interventions
- Main Macro Drivers of the Disinflation in 2019
- An Analysis of Turkish Firms’ Cost Structure
- Nowcasting for Labor Market Data
- Exchange Rate Pass-Through to Export Prices
- The Direct and Indirect Effect of Credit Market Conditions on Investment: Evidence from a Reversal in International Capital Flows
- Effects of Macroeconomic Indicators on Turkey’s Risk Premium
- An Evaluation of End-2019 Inflation Forecasts
Global Economic Outlook

- Current global financial conditions and the recent partial improvement in expectations regarding global trade support the demand for emerging market assets and the risk appetite.
- Possible effects of protectionism, other uncertainties pertaining to global economic policies, and geopolitical developments are closely monitored.

10-Year Bond Rates (%)

- Germany
- United States
- United Kingdom
- Japan

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

- Equity Funds
- Bond Funds

Source: Bloomberg

Source: EPFR
Domestic Economic Outlook

- Turkey’s country risk premium declined significantly due to improvement in macroeconomic indicators and global developments.

- Wide-spread improvement in inflation expectations and increased consensus among individual expectations indicate that uncertainties regarding the medium-term inflation outlook have decreased to a large extent.

- Due to improvement in inflation expectations and decline in the country risk premium, long-term interest rates fall, domestic demand strengthens, investment tendency and labor markets display signs of recovery.

- While favorable effects of improved competitiveness prevail, weakening global economic outlook tempers external demand. The contribution of net exports to economic growth declines with changing demand composition.

- Developments in the exchange rate, domestic demand conditions and producer prices have contributed to a mild underlying trend in inflation indicators.

- Looking forward, on the back of the disinflation process and improvement in financial conditions, recovery in economic activity and the labor market is expected to continue.

- The risks arising from uncertainties regarding the global economy to macroeconomic indicators through capital flows, international trade and commodity prices are closely monitored.
Monetary Policy and Financial Conditions
Monetary Policy

- One week repo rate was reduced to 11.25 percent with a measured cut based on the improvement in the inflation outlook; and the yield curve for government bonds shifted down across all maturities compared to the previous Report.

Short-Term Interest Rates (%)

Yield Curve on Government Bonds (%)
Inflation Expectations

- While improvement in inflation expectations continues, increased consensus among survey participants indicates wide-spread decline in expectations.

Inflation Expectations (%)

Distribution of Inflation Expectations (12 Months)

Source: CBRT
Due to improvement in inflation expectations and decline in the country risk premium, long-term interest rates fell. The volatility of Turkish lira declined.

*Emerging economies include Brazil, Chile, Colombia, Mexico, Poland, Philippines, Malaysia, S. Africa, Indonesia, Romania and Hungary.
Financial Conditions

- While loan rates have decreased significantly, credit growth has accelerated.

**Consumer Loan Rates** (Flow Data, Annual, 4-Week Moving Average, %)

**Annual Credit Growth** (Adjusted for Exchange Rate, %)

Source: CBRT
Macroeconomic Developments and Main Assumptions
Annual inflation was in line with the October Inflation Report forecasts in the last quarter of 2019.

* Shaded region indicates the 70 percent confidence interval for the forecast.
Annual inflation increased owing to base effects. Trends of inflation indicators followed a mild course as a result of developments in the exchange rate, domestic demand conditions and producer prices.

**CPI Sub-Groups (Annual % Change)**

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

*Diffusion Index: Ratio of the number of items with increasing prices minus the number of items with decreasing prices to total number of items within a given month.
Median Inflation: Median monthly inflation of seasonally-adjusted 5-digit sub-indices.
B Index: Seasonally adjusted, annualized, 3-month moving average, percentage change.

Source: TURKSTAT

Source: CBRT, TURKSTAT
Aggregate Demand

- Recovery in economic activity and improvement in its sectoral diffusion continue.

**Contribution to Annual Growth from the Expenditure Side** (% Points)

- Industrial Production Index and Sectoral Confidence Indices**
  (Seasonally Adjusted)

*Includes inventories and statistical discrepancy due to chain linking.

**As of October and November for industrial production, as of January for confidence indices.
Investment Tendency and Labor Market

- Tendency for investment is recovering, including small and medium-sized firms.
- Unemployment rates start to decline as recovery in economic activity strengthens.

**Fixed Capital Investment Tendency by Firm Scale Based on BTS** (Seasonally Adjusted, Balance, Next 12 Months)

**Unemployment Rates** (Seasonally Adjusted, %)

Source: CBRT

Source: TURKSTAT

* As of October
Current account balance maintains its moderate course.

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

![Diagram showing the current account balance (CAB), CAB (excluding gold), and CAB (excluding energy and gold) over time.](image)

Source: CBRT
Revisions to Oil Price Assumptions* (USD/Barrel)

Revisions to Import Price Assumptions* (Index, 2010=100)

Assumptions regarding international crude oil prices and USD-denominated import prices were revised slightly upwards.

* Shaded area shows the forecast period.

Source: Bloomberg, CBRT
# Revisions in Assumptions

<table>
<thead>
<tr>
<th>Metric</th>
<th>October 2019</th>
<th>January 2020</th>
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</thead>
<tbody>
<tr>
<td><strong>Output Gap</strong> (Percent)</td>
<td></td>
<td></td>
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<tr>
<td>2019 Q3</td>
<td>-3.6</td>
<td>-3.7</td>
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<tr>
<td>2019 Q4</td>
<td>-3.2</td>
<td>-2.8</td>
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<tr>
<td><strong>Export-Weighted Global Production Index</strong></td>
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<tr>
<td>(Average Annual Percent Change)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2019</td>
<td>1.96</td>
<td>1.85</td>
</tr>
<tr>
<td>2020</td>
<td>2.07</td>
<td>1.81</td>
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<tr>
<td><strong>Oil Prices</strong> (Average, USD)</td>
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<td></td>
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<tr>
<td>2019</td>
<td>63.4</td>
<td>64.0</td>
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<tr>
<td>2020</td>
<td>57.7</td>
<td>60.0</td>
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<tr>
<td>2021</td>
<td>56.2</td>
<td>56.6</td>
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<tr>
<td><strong>Import Prices</strong> (USD, Average Annual Percent Change)</td>
<td></td>
<td></td>
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<tr>
<td>2019</td>
<td>-4.0</td>
<td>-4.1</td>
</tr>
<tr>
<td>2020</td>
<td>-2.3</td>
<td>-1.9</td>
</tr>
<tr>
<td>2021</td>
<td>-</td>
<td>-0.4</td>
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<td><strong>Food Prices</strong> (End-year Percent Change)</td>
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<tr>
<td>2019</td>
<td>10.0</td>
<td>10.9</td>
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<tr>
<td>2020</td>
<td>11.0</td>
<td>11.0</td>
</tr>
<tr>
<td>2021</td>
<td>7.0</td>
<td>7.0</td>
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Inflation and Output Gap Forecasts* (%)

- Under a tight monetary policy stance and strong policy coordination focused on bringing inflation down, inflation is projected to converge to the target gradually.
- Inflation is projected to be 8.2% at end-2020, 5.4% at end-2021, and stabilize around 5% in the medium term.
- Accordingly, inflation is expected to be:
  - between 6.2% and 10.2% (with a mid-point of 8.2%) at end-2020
  - between 3.0% and 7.8% (with a mid-point of 5.4%) at end-2021
with 70% probability.

Source: CBRT, TURKSTAT

* Shaded region indicates the 70 percent confidence interval for the forecast.
Inflation and Output Gap Forecasts* (%)

- **Source:** CBRT, TURKSTAT

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

- **Upward effects on the 2020 year-end inflation forecasts:**
  - +0.1 point from upward revision in assumptions for oil prices,
  - +0.1 point from upward revision to output gap,
  - +0.2 points from the rise in unit labor costs.

- **Downward effects on the 2020 year-end inflation forecasts:**
  - -0.2 points from the improvement in the underlying trend of inflation,
  - -0.2 points from tax adjustments.

- **2020 year-end inflation forecast remained unchanged, as the downward and upward effects balanced out.**

- **2021 year-end inflation forecast remained intact as well at 5.4%.**

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Source: CBRT, TURKSTAT
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