TÜRKİYE CUMHURİYET MERKEZ BANKASI

Summary of the Monetary Policy Committee Meeting

19 June 2019, No: 2019-25

Meeting Date: 12 June 2019

Inflation Developments

1. In May, consumer prices were up by 0.95% and inflation decreased by 0.79 points to 18.71%. In this period, annual inflation remained flat in the services group while it decreased in food, energy and core goods groups. Annual food inflation declined, led by fresh fruit and vegetable prices. While energy group inflation posted a mild monthly increase, it recorded an annual decline due to the base effect. The slowdown in core goods inflation continued across subgroups. Despite the ongoing deceleration in annual inflation of core inflation indicators, the underlying trend recorded a moderate increase.
2. In the food and non-alcoholic beverages group, annual unprocessed food inflation declined to 35.33% from 45.69% due to fresh fruit and vegetable prices. Processed food prices, on the other hand, posted a significant month-on-month increase in response to the effect of cumulative cost increases on prices.
3. In May, while energy prices increased by 0.25%, the decline in the municipal water tariff contained a further rise in prices. The effect of the recent depreciation in the Turkish lira on fuel prices remained limited due to the implementation of the sliding scale tariff.
4. In May, annual core goods inflation decreased by 0.86 points to 16.59%, underpinned by declines across all subgroups. The clothing group price hikes, which had remained below seasonal averages in April, displayed a slightly similar trend in May. Despite the inflationary impacts of the recent increase in exchange rates, the weak course of domestic demand is assessed to contribute to the deceleration in core goods inflation.
5. Annual services inflation remained flat at 15.15% in May while the underlying trend of services inflation increased. The downward impact of the weak domestic demand on services inflation is believed to be restrained by the backward indexation behavior and elevated levels of inflation expectations as well as the accumulated cost increase in some items.

Factors Affecting Inflation

6. In the first quarter of 2019, the gross domestic product dropped by 2.6% in annual terms whereas it increased by 1.3% in quarterly terms. The recovery in the first quarter was driven by domestic demand, led by the accommodative stance of the public sector. Net exports did not contribute to quarterly growth but their strong contribution to annual growth continued.
7. Recently released data show that the rebalancing trend in the economy has continued. Economic activity displays a slow pace due to tight financial conditions. A weaker public expenditure support and slower loan growth than in the first quarter as well as rising

financial volatility and risk premiums all weigh on domestic demand. Accordingly, developments in domestic demand conditions support disinflation.

8. Despite recent signs of a global 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, subdued loans and economic activity dampen import demand; and external balance continues to improve rapidly on brisk tourism demand. Thus, net exports are likely to provide a strong boost to annual growth and the current account balance is expected to maintain its improving trend.

9. Labor market data confirm the slowdown in economic activity. The data for February 2019 suggest that services employment was up from the previous period whereas industrial and construction employment remained on the decline and unemployment continued to rise.

Monetary Policy and Risks

10. Global economic activity has lost further momentum due to more pronounced slowdown in the growth rates of both advanced and emerging economies. The trade tension between the US and China, the more-than-expected deceleration in growth rates of advanced economies and fluctuations in financial markets of some emerging economies have led to higher uncertainty in global economic policies, which feed into the downside risks to global economic activity.

11. Supported also by the flat course of crude oil prices in a vast part of the April-May period, global inflation rates remained mild. Although crude oil prices receded to a great extent amid global trade tensions and concerns over growth following the third week of May, it is considered that crude oil prices are likely to exhibit high fluctuation in the period ahead due to demand prospects and geopolitical risks.

12. Monetary policy outlook in advanced economies has eased since the previous MPC meeting. However, the high uncertainty over global economic outlook and high volatility in financial markets may lead to a more volatile course in portfolio inflows to emerging economies. In addition, ongoing geopolitical problems and country-specific fragilities are considered to be influential in portfolio flows to emerging economies.

13. Developments in domestic demand conditions and the tight monetary policy support disinflation. In order to contain the risks to the pricing behavior and to reinforce the disinflation process, the Committee has decided to maintain the tight monetary policy stance and keep the policy rate (one-week repo auction rate) constant at 24%.

14. The Committee keeps its evaluation that, if uncertainties stemming from geopolitical factors are eased, in response to the tight monetary policy stance and the inflation-focused macro-policy mix, the country risk premium would continue to decline, which would support the recovery of the economy.

15. The Central Bank will continue to use all available instruments in pursuit of the price stability objective. Factors affecting inflation will be closely monitored and, monetary stance will be determined to keep inflation in line with the targeted path.

16. 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.

17. 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.