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SUMMARY OF THE MONETARY POLICY COMMITTEE MEETING

Meeting Date: 24 June 2014

Inflation Developments

1. In May, consumer prices edged up by 0.40 percent month-on-month, and annual inflation reached 9.66 percent. This uptick in annual inflation was driven by the course of food and core goods prices. In this period, cumulative effects of the depreciation in the Turkish lira waned and the annual rate of increase in core inflation indicators followed a relatively flat course.

2. Annual food group inflation climbed by 1 percentage points to 14.11 percent amid soaring prices of unprocessed food group, the annual inflation of which reached 17.1 percent. On the processed food front, prices of bread and cereals continued with an upsurge, while the uptrend in other processed food products lost pace. As of May, the contribution of food prices to annual consumer inflation reached 3.4 percentage points. On the other hand, energy prices continued with a relatively favorable path with an annual increase of 4.62 percent.

3. Prices of services rose by 0.67 percent month-on-month, and the group's annual inflation edged down to 8.52 percent in May. Annual inflation in restaurants-hotels and rents recorded an increase contrary to the decline in other sub-items of services. The seasonally adjusted data point to a downward trend, yet persisting high levels in the underlying trend of services inflation.

4. Annual core goods inflation crept up by 0.29 percentage points to 11.39 percent in May. Following the appreciation in the April-May period, prices of durable consumer goods registered a month-on-month decline for the first time since the start of the year. Meanwhile, annual inflation in core goods, excluding durable goods remained on the rise, witnessing the effects of the exchange rate with a further lag. The seasonally-adjusted data indicated a slight improvement in the underlying trend of the core goods inflation.

Factors Affecting Inflation

5. Gross Domestic Product (GDP) data for the first quarter of 2014 proved broadly consistent with the outlook presented in the April Inflation Report. The public sector compensated for the fall in private sector demand, leading the final domestic demand to follow a flat course. Exports of goods and services continued to expand at a robust pace, while imports registered a quarterly decline. Thus, net exports appeared as the main driver of quarterly growth in the first quarter, and the rebalancing process among demand components continued as projected.

6. Data for the first quarter of 2014 point to a moderate increase in economic activity. On the production side, the industrial production index posted a month-on-month increase by 1.0 percent following a slight fall in the preceding two months. Thus, production maintained a steady trend of quarterly increase by exceeding the average of the previous quarter in the April. The upcoming period is expected to witness an ongoing modest rise in production with the support of exports and a rebound in the private domestic demand.

7. Data on the expenditure side exhibit a modest course in final private domestic demand in the second quarter. Among the indicators of consumption demand, the production and exports of non-durable goods rose, whereas the imports thereof declined quarter-on-quarter in April. Production and imports of durable goods recorded higher figures on a quarterly basis in April. Among indicators of consumption of durable goods, sales of automobiles displayed a flat course following a plunge in the first quarter, while the sales of white goods recorded an increase in the April-May period following an interval of two quarters. Thus, it is considered that the uptrend in the demand for non-durable goods continued in the second quarter, and that the fall in demand for durable goods may have halted. Indicators of machinery-equipment investments point to a flat course in the second quarter. Moreover, the data regarding construction investments show that the construction investments continued with a decelerating pace.

8. Owing to reduced perceptions of uncertainty, recovered confidence indices and improved financial conditions, consumption demand is projected to post better figures and final private domestic demand is expected to settle on a track of gradual increase starting from second quarter.

9. Recent data show that exports continued to grow in the second quarter of 2014 and contributed positively to growth owing also to the recovery in foreign demand. Having increased month-on-month in April, the export volume index excluding gold went above the average of the previous quarter. Due to the recent global recovery pointed by survey indicators and the improvement in world trade, exports are envisaged to support growth further in the upcoming period. However, the geopolitical developments in Iraq pose downside risks regarding the contribution of exports to growth in the second quarter.

10. The ongoing upsurge in employment since November 2013 lost pace in March and seasonally-adjusted unemployment rates followed a flat course. Industrial and construction employment paused in this period, while non-farm employment rose on the back of the services sector. Leading indicators on the second quarter point to a mild increase in employment.

Monetary Policy and Risks

11. Loan growth continues at reasonable levels in response to the tight monetary policy stance and macroprudential measures. Consumer loans grew well below the historical averages in the first half of the year, while the deceleration in the growth of commercial loans remained relatively limited. The Committee stated that by limiting excessive consumption, the current growth composition of loans not only curbed inflation but also supported rebalancing.

12. In line with these developments, recent data indicate a modest course in private final domestic demand. Meanwhile, with the help of the recovery in foreign demand, exports contribute positively to economic growth. The Committee expects that such a demand composition will support disinflation and will lead to a significant improvement in the current account balance in 2014.

13. The adverse impact of exchange rate developments since mid-2013 on annual inflation will taper off. In fact, amid alleviated inflationary pressures stemming from the exchange rate, the underlying trend of core inflation indicators trended downwards particularly in durable goods for the first time after a long time in May. With the contribution of base effects, inflation is expected to decline markedly starting from this month. The Committee stated that the cumulative impact of food inflation and the exchange rate pass-through to annual headline inflation reached around 6.5 percentage points, which constitutes a considerable room for disinflation in the medium term. Meanwhile, the Committee added that the effects of the ongoing high inflation rates on the pricing behavior needed to be closely monitored.

14. The meeting also involved a discussion on the probable impact of the recent geopolitical developments on the current account balance and inflation. It was assessed that should uncertainties persist in Iraq, exports and oil prices channels may lead to a slowdown in the rebalancing process. Similarly, it was mentioned that if higher energy prices persist, it may lead to a limited impact on inflation. The Committee stated that providing a monetary policy reaction to the geopolitical uncertainties at this stage would not be appropriate; yet these developments should be closely monitored.

15. In the light of these assessments and the recent improvement in global liquidity conditions, the Committee decided to deliver a measured cut in the one-week repo rate. Inflation expectations, pricing behavior and other factors that affect inflation will be closely monitored and the tight monetary policy stance will be maintained by keeping a flat yield curve until there is a significant improvement in the inflation outlook.

16. The Committee closely monitors developments on fiscal policy and tax adjustments with regard to their effects on the inflation outlook. The baseline monetary stance is formulated under the assumption that fiscal discipline will be maintained and there will be no unanticipated hikes on administered prices in the forthcoming period. A revision of the monetary policy stance may be considered, should the fiscal stance deviate significantly from this framework, and consequently, have an adverse effect on the medium-term inflation outlook.

17. Strengthening structural reforms that will ensure the sustainability of the fiscal discipline and reduce the savings deficit will support macroeconomic stability in the medium term. Steps taken in this regard will also provide more room for maneuvering the monetary policy and improving social welfare by keeping interest rates of long-term government securities at low levels. In this respect, implementing the structural reforms required by the Medium Term Program remains to be of utmost importance.