Briefing on 2019-IV Inflation Report
October 2019 Inflation Report: Main Sections

- Overview
- International Economic Developments
- Inflation Developments
- Supply and Demand Developments
- Financial Conditions and Monetary Policy
- Public Finance
- Medium Term Projections
October 2019 Inflation Report: Boxes

- Foreign Investor Position Index for Bond Markets in Emerging Economies
- An Evaluation of the Impact of Output Gap on Inflation
- Effect of Bridge Days on Economic Activity
- Cyclically Adjusted Current Account Balance
- Average Travel Expenditures per Visitor: Developments in Nominal and Real Terms
- Determinants of Turkey’s External Borrowing Rate
- Fiscal Stance in the New Economic Program
Global Developments and Portfolio Flows

- Global monetary policies have been more expansionary as weakening global economic activity and downside risks to inflation became more evident, and market rates have been declining.
- Possible effects of rising protectionism and uncertainty regarding global economic policies are closely monitored.

Manufacturing PMI Indices of Developed Countries

10-Year Bond Rates (%)

Source: Bloomberg
Domestic Economic Outlook

- Moderate recovery in economic activity continues, however investment demand remains weak.
- While favorable effects of improved competitiveness prevail, weakening global economic outlook tempers external demand.
- Looking forward, the gradual recovery in domestic demand is likely to continue with the help of the disinflation trend and improvement in financial conditions.
- Current account balance, which has recently recorded significant improvement due to the composition of growth, is expected to maintain a moderate course.
- Underlying trend indicators, supply side factors, and import prices lead to an improvement in the inflation outlook.
Monetary Policy and Financial Conditions
Monetary Policy

- One-week repo rate was reduced to 14 percent based on the improvement in the inflation outlook.

CBRT Rates and Short-Term Interest Rates (%)

Source: BIST, CBRT

Bond Yields (%) and Inflation Compensation (5-Day Moving Average, %)

Source: Bloomberg
Monetary Conditions

- Currency swap rates shifted down at short maturities owing to monetary policy easing, and at medium to long maturities owing to the decline in the inflation expectations.
- Implied volatility of Turkish lira remained flat during the third quarter.

Yield Curve on Cross Currency Swaps (%)

- Currency swap rates shifted down at short maturities owing to monetary policy easing, and at medium to long maturities owing to the decline in the inflation expectations.
- Implied volatility of Turkish lira remained flat during the third quarter.

Emerging Economies include Brazil, Chile, Colombia, Mexico, Poland, Philippines, Malaysia, S. Africa, Indonesia, Romania and Hungary.
In addition to the fall in the policy rate, decline in inflation expectations and improvement in the banking sector liquidity resulted in significant decreases in loan and deposit rates, thus boosting credit growth.

**TL Consumer Loan, Commercial Loan and Deposit Rates** (Flow Data, Annual Interest Rates, 4-Week Moving Averages)

- TL Consumer Loan Rate*
- TL Deposit Rate
- TL Commercial Loan Rate**

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

* TL consumer loan rate series is the average of personal, vehicle and housing loan rates.
** TL commercial loan rate series excludes overdraft accounts, credit cards and zero-rate loans.
Macroeconomic Developments and Main Assumptions
In the third quarter, inflation materialized close to the lower bound of the forecast interval given in the July Inflation Report.

**Consumer Inflation**

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

- With the contribution of strong base effects, the decline in annual inflation spread across all sub-groups.
- In the third quarter, indicators of pricing behavior suggest a notable improvement in the underlying inflation trend.

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.
Aggregate Demand

- While moderate recovery in economic activity and improvement in its sectoral diffusion continue, investment demand remains weak.

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

**BTS Fixed Capital Investment Tendency by Sectors** **(Seasonally Adjusted, Balance, Next 12 Months, %)**

*As of August for industrial production, as of October for confidence indices

**As of October. Exporters are manufacturers of wearing apparel, computer, electronic and optical products, electronical equipment, machinery and equipment not elsewhere classified, motor vehicles, and other transport equipment.
Current account balance has recently recorded significant improvement due to competitiveness gains and buoyant tourism demand.

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

Source: CBRT
Labor Market

- Labor market outlook remains weak.

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

[Graph showing labor force participation rate, unemployment rate, and non-farm unemployment rate from 2014 to 2019.]

Source: TURKSTAT

*As of July.
## Revisions in Assumptions

<table>
<thead>
<tr>
<th>Category</th>
<th>Quarter</th>
<th>July 2019</th>
<th>October 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Output Gap (Percent)</td>
<td>2019Q2</td>
<td>-4.5</td>
<td>-3.6</td>
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<tr>
<td></td>
<td>2019Q3</td>
<td>-4.2</td>
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<td>Export-Weighted Global Production Index</td>
<td>2019</td>
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<td>(Average Annual Percent Change)</td>
<td>2020</td>
<td>2.14</td>
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<td>Oil Prices (Average, USD)</td>
<td>2019</td>
<td>65.0</td>
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<td>2020</td>
<td>62.6</td>
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<td>Import Prices (USD, Average Annual Percent Change)</td>
<td>2019</td>
<td>-3.1</td>
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<td></td>
<td>2020</td>
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<td>Food Prices (End-year Percent Change)</td>
<td>2019</td>
<td>15.0</td>
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<tr>
<td></td>
<td>2020</td>
<td>11.0</td>
<td>11.0</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 12.0% at end-2019, 8.2% at end-2020, and stabilize around 5% in the medium term.
- Accordingly, inflation is expected to be
  - between 11.2% and 12.8% (with a mid-point of 12.0%) at end-2019
  - between 5.3% and 11.1% (with a mid-point of 8.2%) at end-2020

with 70% probability.

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

- Forecast Range
- Inflation Targets
- Year-end Inflation Forecast (Mid-point)
- Uncertainty Band
- Output Gap

Source: CBRT, TURKSTAT

Relative to July Inflation Report, the downward revision in 2019 year-end inflation forecast by a total of 1.9 points is driven by:

- Downward revision in assumptions for food inflation by -1.2 points,
- Improvement in the underlying trend of inflation by -1.1 points,
- Downward revision to assumptions for TL-denominated import prices by -0.3 points,
- Upward revision in output gap by +0.1 points,
- Higher-than-expected hike in tobacco prices by +0.6 points.

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

- **Downward effects on the 2020 year-end inflation forecast:**
  - -0.2 points from downward revision to assumptions for TL-denominated import prices,
  - -0.3 points from the improvement in the underlying trend of inflation,

- **Upward effects on the 2020 year-end inflation forecast:**
  - +0.5 points from upward revision in output gap.

- Inflation forecast for 2020 year-end remained unchanged compared to the previous Report, as the downward and upward effects balance out.

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

Source: CBRT, TURKSTAT
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