

## **PRESS RELEASE**

31 December 2014

### **SUMMARY OF THE MONETARY POLICY COMMITTEE MEETING**

Meeting Date: 24 December 2014

#### ***Inflation Developments***

1. In November, consumer prices rose by 0.18 percent and annual inflation edged up by 0.19 points to 9.15 percent. This rise in annual inflation was mainly driven by food prices. Meanwhile, the energy inflation declined considerably in line with the international oil prices. The underlying core goods inflation increased slightly, while the services inflation lost pace due to the favorable effects of falling energy prices.
2. Annual food inflation rose by 1.81 percentage points to 14.37 percent. This rise was led particularly by fresh fruits and vegetables, the annual inflation of which soared due to the base effect. The seasonally-adjusted data pointed to a partial correction in unprocessed food prices in the last three months. However, the unfavorable outlook that spilled over into processed food prices continued in November and inflation climbed to 13.61 percent in this group. Indicators for December signal a possible decline in the annual food inflation due to the unprocessed food group.
3. Energy prices decreased by 1.44 percent in November, and the group's annual inflation dropped to 2.68 percent. The first-round effects of the decline in oil prices on energy prices, and consumer inflation in turn, appeared in fuel and bottled gas prices. Brent crude oil prices decreased approximately by USD 30 in the July-November period, and the direct effect of this decline through fuel and bottled gas prices on the consumer inflation was around -0.5 points in this period. Indicators for December suggest that in line with the decline in oil prices, the downward course in these two items continued, being more pronounced in fuel prices. Accordingly, the annual energy inflation is foreseen to decrease notably in December.
4. Annual core goods inflation increased approximately by 0.4 points to 9.36 percent in November. Annual inflation increased in durables and clothing, but remained on a downtrend in core goods excluding these items. Prices of services did not record a noticeable month-on-month change and the group's annual inflation receded by 0.36 points to 8.81 percent. The decline in oil prices affected particularly fuel-related

services groups positively, such as transport and package tours. This effect is projected to continue in the upcoming period.

5. The seasonally-adjusted data point to a sustained improvement in the underlying trend of core inflation indicators. The fall in the underlying trend of services inflation triggered by the items closely related to fuel prices contributed to this development.

### ***Factors Affecting Inflation***

6. Data released by TurkStat show that the GDP grew by a mere 1.7 percent year-on-year during the third quarter of 2014. On the production front, the marked yearly decline in the agricultural value-added has been a major factor in the slow GDP growth. On the expenditure front, the final domestic demand made a positive contribution to annual growth after contributing negatively a quarter ago, while net exports have been the main driver of annual growth. Among components of domestic demand, private demand has made a smaller contribution than public demand.
7. Data announced for the final quarter of 2014 point to an improved outlook for economic activity compared to the previous quarter. Even though industrial production decreased by 1.8 percent month-on-month in October, this realization stems largely from the correction of previous months and the effects of shifting holidays on seasonal adjustments. October-November data from the PMI and the Business Tendency Survey are actually signaling an increase in the fourth-quarter economic activity. Survey indicators show that expectations for the domestic market are stronger than those for exports. In this regard, with the support of the recovery in domestic demand, moderate growth in production is expected in the fourth quarter.
8. Leading data on the expenditure side point to a moderate fourth-quarter recovery in private domestic demand. During October-November, automobile sales continued to grow robustly quarter-on-quarter. Loans, on the other hand, remain on a modest growth path. Furthermore, the recovery in expectations for investment during the past three months is notable. Yet, consumer confidence has been weak throughout the last three months, suggesting that the downside risks on consumption still exist.
9. External demand indicators point to no improvement in the rebalancing process based on goods excluding gold, which ground to a halt in the third quarter. Europe's slowing economy and geopolitical tensions have caused exports to lose some pace. However, the favorable developments in the terms of trade and the moderate course of consumer loans are expected to contribute to the improvement in the current account balance.
10. In seasonally adjusted terms, total and nonfarm unemployment rates were higher in September than in the previous period. The rise in unemployment rates was caused by the increase in the ratio of nonfarm labor force to working-age population. All nonfarm subsectors, services in particular, added to employment growth. Total

employment expectations, a Business Tendency Survey indicator, have moved further into positive territory during the final quarter. In this regard, nonfarm employment might see a modest increase in the final quarter.

11. To sum up, fourth-quarter data point to a moderate recovery in economic activity. In this period, external demand remains weak, while the contribution of domestic demand to growth is at moderate levels. Yet, the prevailing signs of global economic slowdown, the uncertainty surrounding global monetary policies and geopolitical tensions put downside pressure on growth. Against this background, demand conditions are expected to support disinflation process.

### ***Monetary Policy and Risks***

12. Loan growth continues at reasonable levels in response to the tight monetary policy stance and the macroprudential measures. The composition of loans also continues to move in the desired direction. While the annual growth rate of consumer loans hovers around low levels, commercial loans remain relatively more robust. This loan outlook not only limits medium-term inflationary pressures but also contributes to the improvement in the current account balance. Additional tightening measures will be taken, should credit growth accelerate in a way that poses upside risks to inflation and aggravates financial risks by distorting the rebalancing process.
13. Languishing external demand due to halting growth in European countries, the largest export market of Turkey, and geopolitical developments in neighboring countries limits the growth of exports. The fall in commodity prices, particularly in oil prices, due to the weak global demand is expected to improve the current account balance by restricting the aggregate spending on imports. Meanwhile, on account of the lingering volatility in financial markets and the sluggish course of confidence indices, private final demand contributes to growth at moderate levels. Therefore, it is expected that the projected recovery in economic activity will be gradual and aggregate demand developments will support the disinflation process. In the case of an additional slowdown in external demand and a sizeable decline in global growth rates, the decrease in commodity prices will pull inflation down. Nevertheless, domestic economic activity may witness notable adverse effects at the same time. Under such circumstances, the Committee will employ policy tools to support the economy.
14. Macroprudential measures taken at the beginning of the year coupled with the tight monetary stance continue to have a favorable effect on the core inflation trend. Accordingly, the adverse impact of cumulative exchange rate developments on annual inflation is also tapering off. Although high food prices delay the improvement in inflation, core inflation trends have displayed a marked decrease compared to the elevated levels in the first quarter. In addition, the fall in commodity prices, especially in oil prices, has shown a favorable impact on inflation. In the event that these new levels of oil prices prove to be largely permanent, this channel will support the projected disinflation process over the upcoming period.

15. Under the current monetary policy stance, the Committee anticipates that inflation will decline in line with the forecast presented in the Inflation Report throughout 2015, at a faster pace in the first half of the year. Along with these positive developments in the inflation outlook, the currently elevated levels of inflation still continue to pose upside risks to medium-term expectations and the pricing behavior. In the forthcoming period, inflation expectations, the pricing behavior and other factors that affect inflation will be closely monitored and the tight monetary policy stance will be maintained, by keeping the yield curve flat, until there is a significant improvement in the inflation outlook.
16. Global financial markets have followed a volatile course recently. It was stated that capital flows to emerging markets may continue to be volatile in 2015. The ongoing uncertainty about the normalization of global monetary policies cause the global risk appetite and capital flows to be data-sensitive. The Committee emphasized that the CBRT has a rich set of policy tools to use against an earlier-than-expected policy rate hike by the Fed.
17. Yet, with the global economic slowdown the normalization of monetary policies might be postponed. In an environment of continued uncertainty over global financial markets and economic activity, it is crucial to support prudential borrowing to limit the accumulation of macrofinancial risks. In this respect, the Committee pointed out the downward trend in long-term interest rates at the global level. It was stated that this trend has been directing banks to use more long-term borrowing under current market circumstances. The Committee members also stated that the implementation of the measures intended for discouraging short-term borrowing by the first quarter of 2015 will offer additional benefits for financial stability.
18. Developments on the fiscal policy and tax adjustments are monitored closely with regard to their effects on the inflation outlook. The baseline monetary policy stance is formulated under the assumption that fiscal discipline will be maintained and there will be no unanticipated hikes on administered prices. A revision of the monetary policy stance may be considered, should the fiscal policy deviate significantly from this framework, and consequently, have an adverse effect on the medium-term inflation outlook.
19. The Committee welcomed the development that the new Medium Term Program incorporates disinflation as one of the main objectives. Moreover, it was indicated that Turkey's growth potential would increase gradually with the implementation of the recently announced structural transformation program. Any measure to ensure the sustainability of the fiscal discipline and reduce the savings deficit will support macroeconomic stability and contribute positively to social welfare by keeping interest rates of long-term government securities at low levels.