Briefing on 2020-II Inflation Report

April 30, 2020 | ANKARA
April 2020 Inflation Report: Main Sections

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- Inflation Developments
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- Financial Conditions and Monetary Policy
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April 2020 Inflation Report: Boxes

- Effects of the Pandemic on the Turkish Economy: Transmission Channels and Macro Policy Mix
- Global Economic Prospects and External Demand Outlook
- Global Economic Policies Against the Pandemic
- Possible Effects of the Pandemic on Inflation Outlook
- Possible Impact of the Pandemic through External Demand and Tourism Channels
- Revisions in Balance of Payments Statistics
- Monetary and Macroprudential Measures Against the Pandemic in Turkey
- Fiscal Measures Against the Pandemic in Turkey
Macroeconomic Developments
Global Economic Outlook

- Developments regarding the spread of the coronavirus substantially weaken global growth outlook.
- As the virus spread around the world, emerging economies faced large scale portfolio outflows.

Global PMI Indices (Seasonally Adjusted, Level)

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

Source: IHS Markit

Source: EPFR
Financial Developments

- The decline in global risk appetite led to a rise in country risk premium, a depreciation in domestic currency and an increase in exchange rate volatility.
- While consumer loan growth lost some pace since mid-March, commercial loans continued to accelerate.

**Implied FX Volatility**
(1 month, %)

*Emerging economies include Brazil, Chile, Colombia, Mexico, Poland, The Philippines, Malaysia, S. Africa, Indonesia, Romania and Hungary.*
Economic Activity and Labor Market

- Economic activity remained strong in January and February, with the support of the improvement in financial conditions.
- The effects of pandemic-related developments on economic activity became evident in April.

**Industrial Production Index (Annual % Change)**

- Source: TURKSTAT

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

- Source: TURKSTAT
Current account balance, which recently recorded significant improvement, is expected to follow a moderate course throughout the year due to the restraining effects of commodity prices and imports.

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

Source: CBRT
Consumer inflation was in line with the January Inflation Report forecasts in the first quarter of 2020.

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

- Developments in inflation expectations, domestic demand conditions and producer prices have contributed to a mild trend in core inflation indicators.

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

Source: TURKSTAT

**CPI Diffusion Index, Median Inflation and B Index**

*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: CBRT, TURKSTAT
Compared to previous quarter, inflation expectations remained flat, while forecast uncertainty slightly increased.

**Inflation Expectations (%)**

**Distribution of Inflation Expectations (12-Month-Ahead)**

![Graph showing inflation expectations and distribution over time]

Source: CBRT
Monetary Policy

- One week repo rate was reduced to 8.75 percent based on the inflation outlook.
- The net funding amount provided through open market operations (OMO) increased due to increase in funding need.

**CBRT Rates and Short Term Interest Rates (%)**

**CBRT Open Market Operations (Two-Week Moving Average, Billion TL)**

Source: BIST, CBRT

Source: CBRT
In addition to interest rate cuts, the CBRT has implemented a comprehensive set of measures.

1. Predictability and flexibility in Turkish lira and FX liquidity management are enhanced.

2. Banks are provided with targeted additional liquidity facilities to secure uninterrupted credit flow to corporate sector.

3. Cash flows of exporting firms are supported through changes in rediscount credits.

4. Steps are taken to support the liquidity in the Government Domestic Debt Securities (GDDS) market.
Main Assumptions and Forecasts
Assumptions for External Variables

- Assumptions regarding international crude oil and USD-denominated import prices were revised significantly downwards.

Revisions to Oil Price Assumptions* (USD/Barrel)

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

* Shaded area shows the forecast period.

Source: Bloomberg, CBRT

Source: CBRT, TURKSTAT
## Revisions in Assumptions

<table>
<thead>
<tr>
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<th>January 2020</th>
<th>April 2020</th>
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<tbody>
<tr>
<td><strong>Output Gap</strong></td>
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<tr>
<td>(Percent)</td>
<td>2019 Q4</td>
<td>-2.8</td>
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<tr>
<td></td>
<td>2020 Q1</td>
<td>-2.5</td>
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<tr>
<td></td>
<td></td>
<td>-2.5</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>2020</td>
<td>1.81</td>
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<tr>
<td></td>
<td>2021</td>
<td>-</td>
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<tr>
<td></td>
<td></td>
<td>4.38</td>
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<tr>
<td><strong>Oil Prices</strong></td>
<td>2020</td>
<td>60.0</td>
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<tr>
<td>(Average, USD)</td>
<td>2021</td>
<td>56.7</td>
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<td></td>
<td></td>
<td>36.8</td>
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<tr>
<td><strong>Import Prices</strong></td>
<td>2020</td>
<td>-1.9</td>
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<tr>
<td>(USD, Average Annual Percent Change)</td>
<td>2021</td>
<td>-0.5</td>
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<td></td>
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<td>7.3</td>
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<tr>
<td><strong>Food Prices</strong></td>
<td>2020</td>
<td>11.0</td>
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<tr>
<td>(Year-end Percent Change)</td>
<td>2021</td>
<td>7.0</td>
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Inflation Outlook

Under the current monetary policy stance and strong policy coordination, inflation is projected to converge gradually to the targets.

Inflation is projected to be 7.4% at end-2020 and fall to 5.4% at end-2021, stabilizing around 5% in the medium term.

Accordingly, inflation is expected to be
- between 5.5% and 9.3% (with a mid-point of 7.4%) at end-2020
- between 3.1% and 7.7% (with a mid-point of 5.4%) at end-2021

with 70% probability.

* Shaded region indicates the 70 percent confidence interval for the forecast.
Drivers of the revision in 2020 year-end inflation forecasts relative to previous Report:

- -1.2 points from output gap,
- -0.3 points from food inflation,
- +0.5 points from real unit labor costs,
- +0.2 points from TL denominated import prices.

Accordingly, the inflation forecast for end-2020 was revised downwards by 0.8 percentage points.

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

- Factors that affect 2021 year-end inflation forecasts, relative to previous Report:
  - TL-denominated import prices by +0.3 points
  - Output gap by -0.3 points.
- 2021 year-end inflation forecast remained unchanged, as the downward and upward effects balanced out.

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

- Economic activity has started to weaken in mid-March due to the effects of the coronavirus pandemic on external trade, tourism and domestic demand.

- Developments in inflation expectations, domestic demand conditions and producer prices have contributed to a mild trend in core inflation indicators.

- Despite the recent depreciation in the Turkish lira due to global developments, continued sharp decline in international commodity prices, especially crude oil and metal prices, affects inflation outlook favorably.

- Disinflationary effects of aggregate demand conditions are estimated to have increased as of the second quarter.

- Recent monetary and fiscal measures will contribute to financial stability and post-pandemic recovery by supporting the potential output of the economy.

- Despite the deceleration in exports of goods and services, current account balance is expected to follow a moderate course throughout the year due to the restraining effects of commodity prices and imports.
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