2. International Economic Developments

Data for the first half of the year suggest that global growth has stabilized and remained strong. Across advanced economies, the US growth was more favorable and stable whereas growth in the euro area, Japan, and the UK decelerated in the first quarter of the year, prompting a downward revision in year-end forecasts. The pressure on emerging market currencies due to increasing yields in the US, rising oil prices, and intensified global protectionism in foreign trade are causing growth prospects in emerging economies to diverge across countries as well. As for the upcoming period, due to geopolitical developments and significantly increasing protectionism in foreign trade, downside risks to the global growth outlook are more evident. The decision of the US in early June to extend the list of countries that will be subject to additional tariffs in imports of iron-steel and aluminum strengthens the probability of a global increase in protectionism in foreign trade. Accordingly, the countries in question raise the possibility of taking counteractions that will contract global trade. The fact that these additional tariffs will also be applicable to European Union countries coupled with political uncertainties keeps the downside risks to economic activity in the euro area, an important driver of global growth, alive.

Despite the rise in commodity and energy prices due to positive global growth, consumer and core inflation rates continue to follow a moderate course. Nevertheless, geopolitical developments and uncertainties about foreign trade policies may pose an upward risk to commodity prices, particularly energy and metal prices. Moreover, the likelihood of an acceleration in wages in advanced economies is also one of the most important risk factors for inflation.

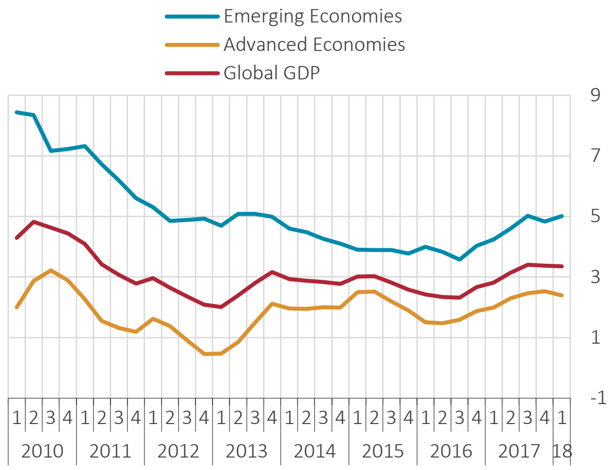
Financial conditions in advanced economies have tightened since the previous Inflation Report period. In particular, the ongoing positive growth performance and the new tax law in the US that can be seen as an expansionary fiscal policy set the ground for the Fed to expedite the monetary policy normalization process. In this respect, the probability of a total of four rate hikes by the Fed in 2018 has significantly increased compared to the previous reporting period, leading to a surge in US bond yields. Due to the appreciating US dollar, global financial markets fluctuated in the recent period, risk perceptions about emerging economies worsened, the depreciation and volatility in exchange rates increased, and portfolio flows weakened in the second quarter of the year. Given the tight financial conditions in advanced economies, lingering geopolitical uncertainties, and possible negative effects of increased protectionism in world trade, portfolio flows to emerging economies are expected to continue deteriorating also in the upcoming period.

Uncertainties regarding the global economic policies, contractionary global foreign trade policies, and geopolitical risks narrow the growth potential of the global economy. Therefore, to reduce vulnerabilities, it is important that macroeconomic policies are implemented effectively and in coordination and also supported by structural reforms and appropriate trade policies.

2.1 Global Growth

The positive growth trend in global economic activity continued from 2017 overall through the first quarter of 2018 when the global economy grew at the same rate as in the previous quarter (Chart 2.1.1). The favorable growth performance in both advanced and emerging economies relative to the previous quarter was influential in this development. In this period, the largest contribution to the growth in advanced economies came from the US whereas the euro area, Japan, and the UK registered a slightly decelerated rate of growth compared to the previous quarter. On the emerging economies front, China and India were the fastest-growing countries whereas the growth rate in Brazil significantly decreased compared to the previous quarter. Analyzing the growth rates of emerging economies by regions, the growth performance in Asia, Latin America, and Eastern Europe was on a far more favorable track in the first quarter of the year than in the previous quarter (Chart 2.1.2).

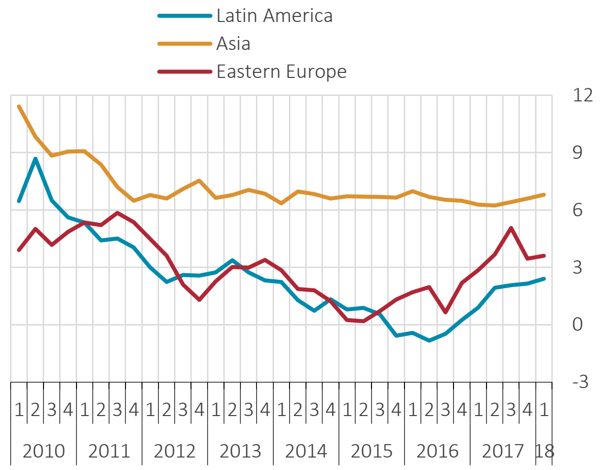
Chart 2.1.1: Global Growth Rates* (Y-o-Y % Change)



Source: Bloomberg, CBRT.

* Weighted by each country's share in global GDP.

Chart 2.1.2: Regional Growth Rates for Emerging Economies* (Y-o-Y % Change)

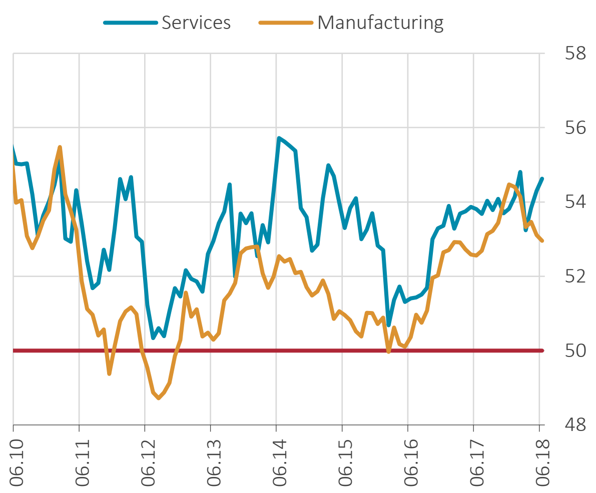


Source: Bloomberg, CBRT.

* Weighted by each country's share in regional GDP.

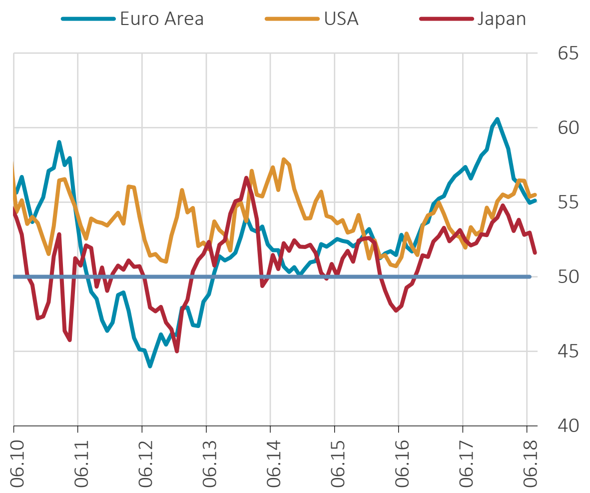
Global PMI data for the second quarter of the year suggest a worse growth performance for the manufacturing industry and a better growth performance for the services sector relative to the first quarter (Chart 2.1.3). In this period, the manufacturing industry PMI in the US rose quarter-on-quarter. The improvement in the PMI indicator and the developments in the labor market both indicate that the positive growth prospect in the US economy continues in the second quarter and raise an expectation that the growth rate will be higher than the previous quarter. Moreover, it can be said that the new tax law enacted on 1 January, which introduced cuts in both income and corporate tax rates, favorably affected domestic demand and accordingly the economic growth in the US. In fact, the historically high levels of consumer confidence indices are a testimony to this judgment. Conversely, data for the manufacturing industry PMI in the euro area and Japan recorded a quarter-on-quarter decrease in the second quarter of the year (Chart 2.1.4). These data demonstrate that the positive growth performance in the euro area slightly weakened and the deceleration in the growth rate of Japan continued in the second quarter. A similar case is also observed in the UK and Canada.

Chart 2.1.3: Global PMI



Source: IHS Markit.

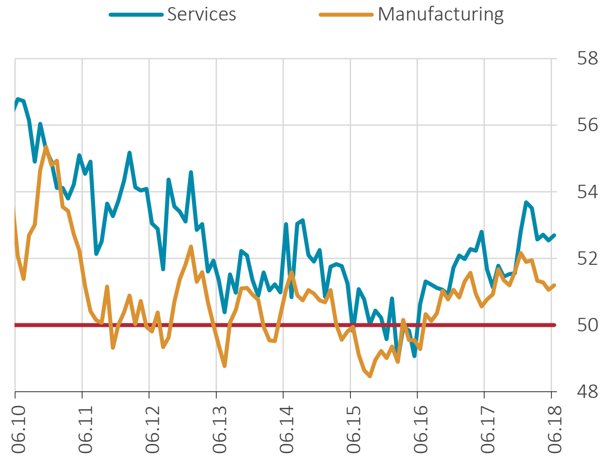
Chart 2.1.4: Manufacturing Industry PMI in Advanced Economies



Source: IHS Markit.

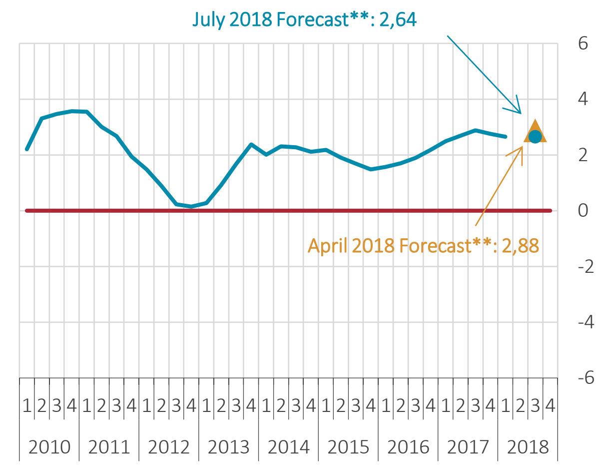
In the second quarter of the year, PMI indicators for emerging economies posted a quarter-on-quarter decrease in the manufacturing industry and the services sector (Chart 2.1.5). This decrease was triggered by the worsening PMI data in Latin American countries, particularly in Brazil. This was also the case in Eastern Europe. However, PMI indicators displayed a favorable outlook in Asia, particularly in India. In light of these data, emerging economies are projected to have a slower growth performance, caused primarily by Latin America, in the second quarter compared to the first quarter, posting a growth rate below that of the first quarter.

Chart 2.1.5: Emerging Markets PMI



Source: IHS Markit.

Chart 2.1.6: Export-Weighted Global Production Index*
(Y-o-Y % Change)



Source: Bloomberg, CBRT.

* Weighted by each country's share in Turkey's exports.

** Average growth forecast for 2018.

In sum, the favorable growth trend in the global economy is estimated to continue in the second quarter of the year but at a decelerated rate compared to the previous quarter. In this period, the main drivers of global growth are expected to be the US on the advanced economies front, and China and India on the emerging economies front.

Regarding the second half of the year, it is expected that the positive growth trend will continue in the US whereas growth performance in the euro area will somewhat fall. This expectation is reinforced by the fact that compared to the previous reporting period, year-end growth forecasts have been revised upwards for the US and downwards for the euro area according to July Consensus Forecasts bulletins. As for emerging economies, capital outflows are expected to continue from the second quarter through the second half of the year and adversely affect the growth performance of these countries. In fact, 2018 year-end growth forecasts for Latin America have been revised significantly downwards compared to the previous reporting period (Table 2.1.1). In this context, growth rates in emerging economies, Latin American countries in particular, are estimated to continue losing pace in the second half of the year.

The global growth forecast for end-2018 remained the same as in the previous reporting period (Table 2.1.1). However, the annual growth rate of the export-weighted global production index, which was revised by the July growth forecast, moderately decelerated compared to the April Inflation Report (Chart 2.1.6). This deceleration was primarily due to the downward revision in the year-end growth forecast for the euro area. Accordingly, although Turkey's foreign demand outlook for 2018 slightly weakened compared to the previous reporting period particularly due to euro area, it nevertheless remained positive.

Table 2.1.1: Growth Forecasts for 2018 and 2019 (Annual Average % Change)

	April		July	
	2018	2019	2018	2019
Global	3.3	3.2	3.3	3.2
Advanced Economies				
USA	2.8	2.6	2.9	2.6
Euro Area	2.4	1.9	2.2	1.8
Germany	2.4	1.9	2.0	1.7
France	2.1	1.8	1.8	1.8
Italy	1.4	1.2	1.2	1.1
Spain	2.7	2.3	2.8	2.3
Japan	1.4	1.1	1.1	1.1
UK	1.5	1.5	1.3	1.5
Emerging Economies				
Asia Pacific	5.8	5.7	5.9	5.7
China	6.6	6.4	6.6	6.4
India	7.4	7.6	7.4	7.5
Latin America	2.6	2.9	2.0	2.5
Brazil	2.7	3.0	1.7	2.6
Eastern Europe	3.2	2.9	3.2	2.8
Russia	2.0	1.9	1.8	1.8

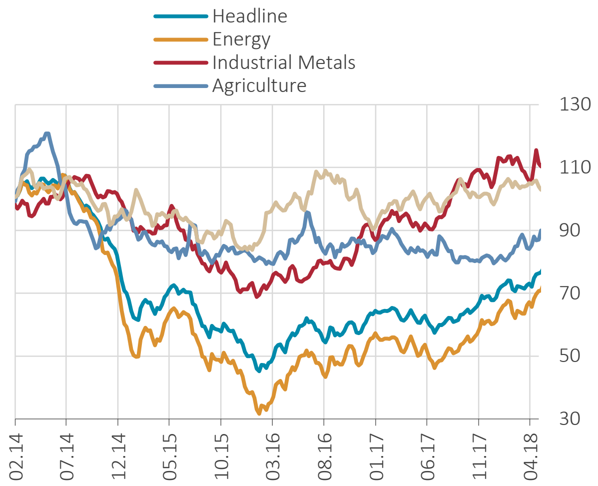
Source: Consensus Forecasts.

2.2 Commodity Prices and Global Inflation

The uptrend in the headline commodity index continued in the second quarter of the year and increased by 25.2 percent on a quarterly basis. In this period, all subcategories recorded an uptick while the increase in energy prices index surpassed the rise in the general price index. Accordingly, energy and industrial metal prices significantly increased by 38.6 percent and 21.4 percent while agricultural and precious metal prices rose by 4.8 percent and 3.1 percent, respectively (Chart 2.2.1).

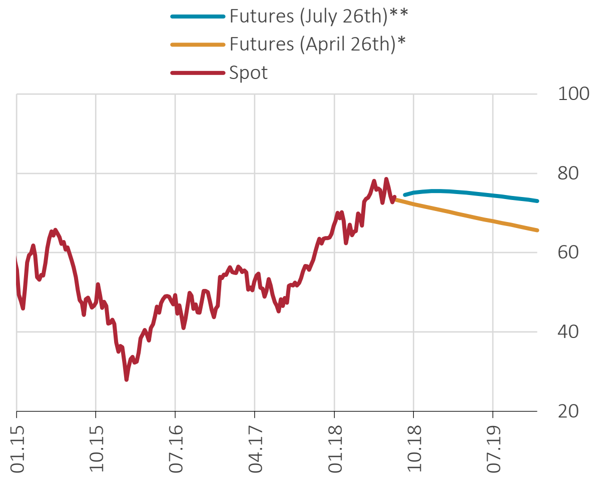
Industrial metal prices, which remained on an uptrend in the first quarter of the year on the back of the positive outlook in global growth, followed a rather flat course in the second quarter due to risks fueled by the increased protectionism in foreign trade policies. In addition, tightened credit conditions and the relatively stagnant course of domestic demand are also believed to have affected these price movements despite China’s ongoing cutback on steel and aluminum production in line with its environmental policies implemented under a three-year program. Moreover, the withdrawal of the US from the nuclear deal with Iran and its announcement to place a new and more aggressive economic embargo on Iran reinforced the uptrend in prices brought about by the positive global growth outlook and the supply-demand balancing in the crude oil market in the first quarter. At the end of June, OPEC members abandoned their previous supply cut decision and announced that they would increase their oil production. However, the potential easing effect of this decision on prices remained limited due to the seasonal increase in demand during the summer months and the persistence of supply cuts in major oil producing countries driven by geopolitical factors. On the other hand, gold prices stuck to their flat course in the second quarter of the year due to the ongoing strong monetary policy normalization by advanced country central banks and the appreciating US dollar.

Chart 2.2.1: S&P Goldman Sachs Commodity Index (January 2014=100)



Source: Bloomberg.

Chart 2.2.2: Brent Crude Oil Prices (USD/bbl)



Source: Bloomberg.

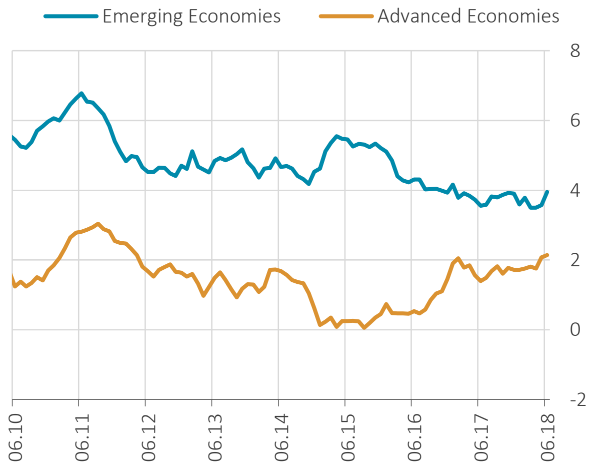
*Denotes the arithmetic average of the prices quoted at futures contracts during 1-26 April 2018.

** Denotes the arithmetic average of the prices quoted at futures contracts during 1-26 July 2018.

The geopolitical turmoil in the Middle East is an upside risk factor for commodity prices. Meanwhile, increased protectionism in global foreign trade stands out as a downside risk factor for commodity prices due to its dampening effect on import demand and potential adverse effect on global growth. It is believed that in the upcoming period, the US shale oil production will be the determining factor in oil prices rather than the production decisions of OPEC. In a period when the crude oil market converged to a more balanced plateau, the moderation in the US shale oil production particularly due to infrastructure problems is also considered an additional upside risk factor in crude oil prices. Accordingly, as signaled by the Brent crude oil futures contracts, crude oil prices are expected to be trading around USD 75 at end-2018 (Chart 2.2.2).

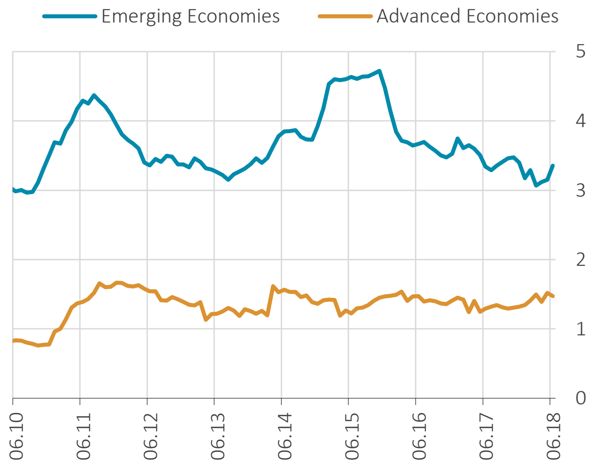
The headline and core inflation rates in advanced and emerging economies have both increased slightly since the previous reporting period in line with rising commodity prices, but they nevertheless remained moderate (Chart 2.2.3 and Chart 2.2.4). Inflation forecasts for 2018 have been revised upwards for some advanced economies in the inter-reporting period (Table 2.2.1).

Chart 2.2.3: CPI Inflation in Advanced and Emerging Economies (Y-o-Y % Change)



Source: Bloomberg, CBRT.

Chart 2.2.4: Core Inflation in Advanced and Emerging Economies (Y-o-Y % Change)



Source: Bloomberg, Datastream, CBRT.

On the advanced economies front, low productivity rates in the US are believed to rein in the inflationary effect of the tight labor market implied by the unemployment rate. Despite survey- and market-based inflation expectations that hover around the 2-percent inflation target, recently rising oil prices have pushed the headline inflation slightly above the core inflation indicators. Inflation forecasts for the euro area based on futures oil prices indicate that consumer inflation is expected to be around 2 percent in 2018. In the medium-term, the ECB's monetary policy steps, declining idle capacity, and accelerated wage increases are believed to moderately elevate core inflation indicators to the 2-percent level in the euro area. In Japan, both the headline and core inflation rates are below 2 percent, and inflation expectations do not display any change. On the other hand, in the UK, the depreciation of the sterling and rising oil prices prompted an upward revision in near-term forecasts for consumer and core inflation rates that hover above the 2-percent target.

Table 2.2.1: Inflation Forecasts for end-2018 and end-2019 (Annual Average % Change)

	April		July	
	2018	2019	2018	2019
Advanced Economies				
USA	2.5	2.1	2.5	2.2
Euro Area	1.5	1.5	1.7	1.6
Germany	1.7	1.8	1.9	1.9
France	1.5	1.5	1.8	1.6
Italy	1.2	1.3	1.2	1.4
Spain	1.4	1.5	1.8	1.7
Greece*	0.7	1.2	0.8	1.1
UK	2.6	2.2	2.5	2.1
Japan	1.0	1.0	1.0	1.1
Emerging Economies				
Asia Pacific (excl. Japan)	2.5	2.6	2.5	2.5
China	2.3	2.3	2.2	2.3
India**	4.8	4.8	4.9	4.8
Latin America	338.6	36.1	1653.7	383.3
Latin America (excl. Venezuela)	5.9	5.2	7.3	6.0
Brazil*	3.5	4.1	4.1	4.2
Eastern Europe	5.0	4.8	5.5	5.3
Russia*	3.7	4.0	3.6	4.1

Source: Consensus Forecasts.
* Annual percentage change.
** Based on fiscal year.

Upside risks to global inflation remain over the upcoming period. In the recent period, the US dollar has appreciated against many emerging market currencies. While the Fed's balance sheet downsizing and rate hike processes continue, the increased borrowing need of the US Treasury due to accommodative fiscal policies dries up the global dollar liquidity. Under these circumstances, the probable persistence of depreciations in emerging market currencies and possible hikes in commodity prices, particularly in oil prices, amid geopolitical tensions in the Middle East may push global inflation up. Also, a US-imposed increase in tariffs on intermediate and consumer goods may accelerate consumer inflation in both the US and the counterparties in the medium term. The duration of this possible inflationary effect will be contingent on the degree of strict implementation of trade restrictions on a country and product basis.

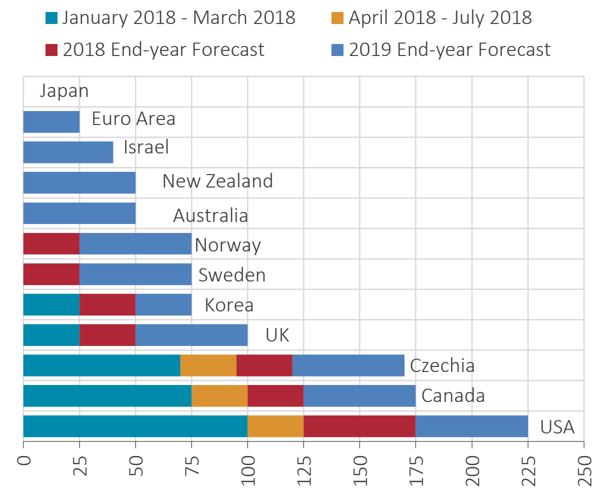
2.3 Global Monetary Policy

Decisions taken at Fed and ECB meetings in June indicate that the monetary policy normalization processes in the respective countries will be somewhat faster than anticipated. Although there was no deviation from the gradual tightening trend in general, the rate of the communicated tightening increased compared to the previous reporting period (Box 2.1). The Bloomberg expectations survey foresees a total of six rate hikes by the Fed in 2018 and 2019, and one rate hike by the ECB in the final quarter of 2019. The tightening in other advanced economies' monetary policies continued in line with the expectations. Accordingly, the central banks of Canada and Czechia further raised their policy rates by 25 basis points (Chart 2.3.1).

At its June meeting, the Fed introduced its second policy rate hike in 2018. In addition, the median of projections was revised to four rate hikes for 2018. In its press release, the Fed reinforced some of its statements on economic activity and the labor market, and signaled that the factors leading to rate hikes had become more evident. The Fed also decided to hold a press conference following each interest rate decision starting from 2019. In the current practice, the Fed holds a press conference for four of its eight interest rate decisions in a year, and although there is no such written rule, as a custom, it changes the interest rates only in months when a press conference takes place. So, through this change, the Fed, which is expected to introduce a maximum of four rate hikes a year, will be able to announce a change in rates after every meeting.

The ECB meeting in June clarified the policy normalization steps to be taken in the near future. At the same meeting, the ECB decided to reduce the monthly pace of the net asset purchases to 15 billion euros from 30 billion euros starting from October and end net purchases at the end of December. Moreover, the account of the meeting included a forward guidance statement that a rate hike was not expected before the summer of 2019. The upward revision in inflation forecasts and the emphasis on cost pressures through rising capacity utilization rates and wages indicate that the ECB has adopted a hawkish stance in the face of the recent sharp increase in inflation. Although these changes in monetary policy are aligned with market expectations, the rising inflation led the ECB to announce these decisions in June instead of suspending them until its August meeting. Yet, the ECB preserves its cautious stance due to the deceleration in growth.

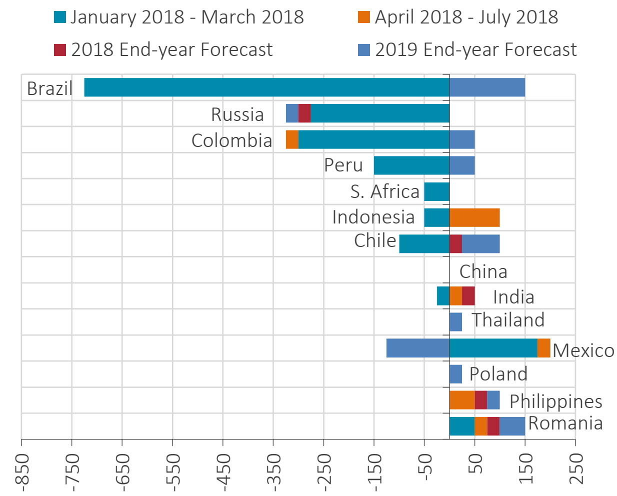
Chart 2.3.1: Policy Rate Changes and Year-End Policy Rate Expectations in Advanced Economies January 2017 – December 2019* (Basis Point)



Source: Bloomberg.

* As of 27 July 2018.

Chart 2.3.2: Policy Rate Changes and Year-End Policy Rate Expectations in Emerging Economies January 2017 – December 2019* (Basis Point)



Source: Bloomberg.

* As of 27 July 2018.

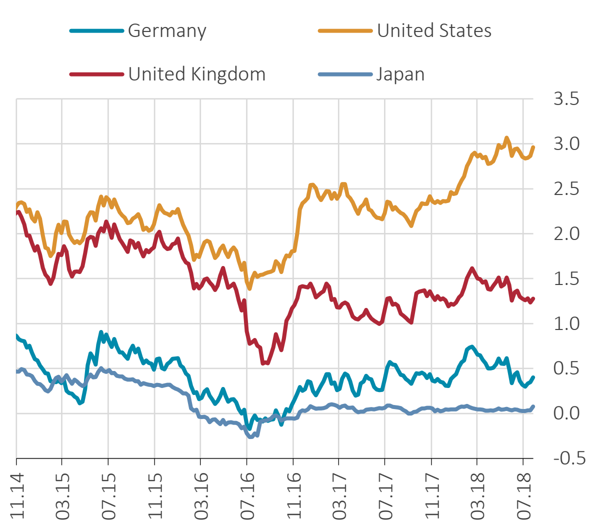
For both the Fed and the ECB, the likely interest rate paths implied by their official statements and surveys significantly diverge from the interest rates priced in financial markets. In other words, these scenarios have not been fully priced on the market. Therefore, if the perception that inflation has definitively hit the medium-term target strengthens and the probability of a total of six rate hikes by the Fed and one rate hike by the ECB in the 2018-2019 period increases, these will probably be effective on financial markets and the risk appetite.

As for the monetary policy stance of emerging economies, there has been a relative tightening due to the uptrend in inflation and the tightened global financial conditions. Consequently, interest rate cuts lost pace, and central banks introduced rate hikes in Indonesia, India, and Mexico that were adversely affected by global financial conditions. Expectations signal a more pronounced tightening particularly in 2019 (Chart 2.3.2).

2.4 Global Risk Indicators and Portfolio Flows

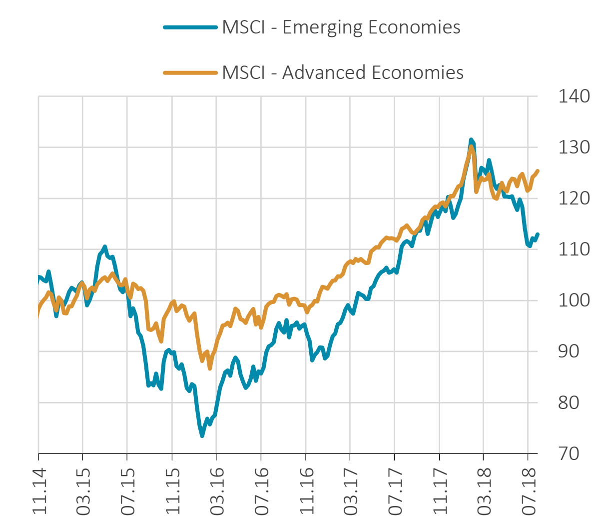
In the second quarter of 2018, increased protectionism in foreign trade affected global bond and stock markets. The possible downward effect of additional tariff steps, particularly by the US but also by China and the European Union, on global growth caused a rise in uncertainties surrounding central bank policies and increased the demand for safe assets, leading to a decline in bond yields (Chart 2.4.1). Moreover, increased expectations for a decrease in global trade volume and in the profitability of firms triggered rapid outflows from stock markets of emerging economies whereas stock markets of advanced economies remained almost flat (Chart 2.4.2).

Chart 2.4.1: 10-Year Bond Yields (%)



Source: Bloomberg.

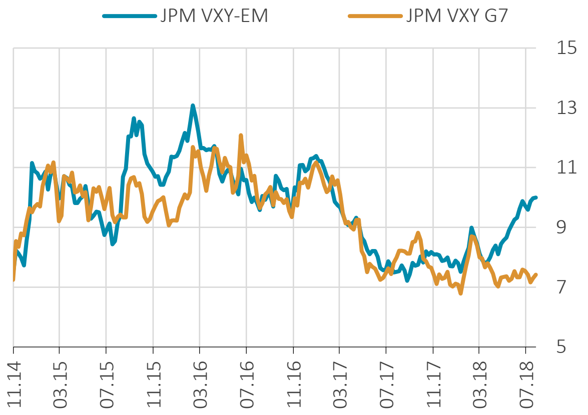
Chart 2.4.2: MSCI Indices (January 2015=100)



Source: Bloomberg.

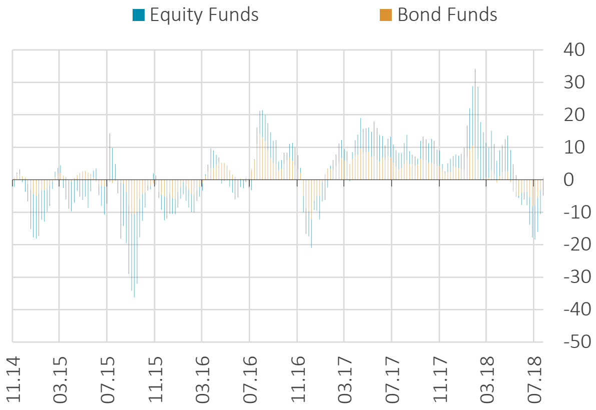
The deterioration in risk perception caused by increased protectionist measures led to outflows from bond and stock markets of emerging economies, which in turn provoked sharp increases in exchange rate volatilities in these countries. However, the volatility in the currencies of advanced economies moderately increased (Chart 2.4.3).

Chart 2.4.3: JP Morgan FX Volatility Indices (Weekly)



Source: Bloomberg.

Chart 2.4.4: Weekly Fund Flows to Emerging Economies (Billion USD, 4-Week Cumulative)



Source: EPFR.

In the first quarter of the year, portfolio inflows to emerging economies continued, albeit less brisk than in early 2018. However, in the second quarter, the strengthening normalization process in monetary policies of advanced economies, consistently increasing protectionism in foreign trade, and the financial worsening in emerging economies with relatively more fragile macroeconomic fundamentals negatively affected portfolio flows to these countries. Accordingly, emerging economies saw portfolio outflows starting from early May (Chart 2.4.4). In this period, emerging economies diverged from each other in terms of portfolio flows, and portfolio movements in countries such as Argentina, Brazil, and South Africa that are relatively more fragile in financial and macroeconomic terms suffered more adverse effects. On the other hand, portfolio inflows to China, which is the foremost target of the protectionist measures of the US, exhibited a more favorable outlook than those in other emerging economies.

Table 2.4.1: Composition and Regional Distribution of Fund Flows to Emerging Economies (Quarterly, Billion USD)

		Total	Portfolio Composition		Regional Composition			
			Bond Funds	Stock Funds	Asia	Europe	Latin America	Middle East and Africa
2015	Q1	-8.6	1.9	-10.5	-8.1	2.2	-2.4	-0.2
	Q2	-8.0	1.4	-9.4	-6.9	0.4	-2.0	0.4
	Q3	-45.3	-16.5	-28.8	-23.8	-6.5	-10.8	-4.1
	Q4	-22.3	-12.7	-9.6	-11.1	-3.0	-6.4	-1.9
2016	Q1	-4.5	-1.2	-1.6	-2.5	-1.4	-0.3	-0.3
	Q2	-1.4	7.3	-8.7	-4.5	0.7	1.9	0.6
	Q3	42.4	26.1	16.3	17.9	7.5	12.4	4.7
	Q4	-17.4	-9.3	-8.1	-12.6	-0.8	-2.7	-1.3
2017	Q1	32.7	19.9	12.8	8.2	7.7	12.4	4.3
	Q2	52.6	24.4	28.2	25.2	7.6	14.5	5.4
	Q3	37.1	17.3	19.8	19.4	4.9	9.2	3.5
	Q4	29.5	11.8	17.6	14.8	3.7	8.3	2.7
2018	Q1	57.9	12.0	46.0	34.1	6.5	12.0	5.3
	Q2	-10.4	-10.4	0.0	-0.7	-4.3	-3.3	-2.1

Source: EPFR.

On a regional basis, all emerging economies registered portfolio outflows from both bond and stock markets in the second quarter of 2018, particularly evident starting from June (Table 2.4.1).

The expansion of the tightening in financial conditions of advanced economies over the near future, lingering geopolitical uncertainties, and possible adverse effects of increased protectionism in global trade signal that the current weak course in portfolio flows to emerging economies will continue in the upcoming period.

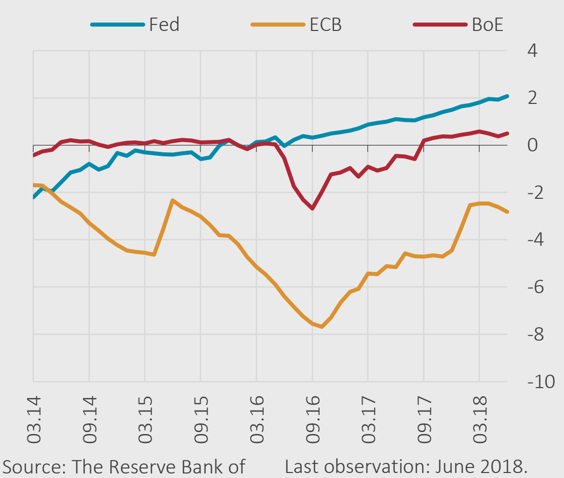
Box 2.1

Monetary Policy Normalization in Advanced Economies: Current Phase and Expectations

The importance of the pace of monetary policy normalization in advanced economies in terms of the global growth outlook and global risk appetite has been underlined many times; and a faster-than-projected tightening was defined as a significant risk factor. Bond purchasing programs with negative or around-zero interest rates have constituted the monetary policy scheme in advanced economies for a long time. However, central banks embarked on gradual monetary policy normalization to expand the room for policy maneuvers and safeguard financial stability. The sustained level of inflation beneath the target challenged normalization at the beginning, yet figures that were more consistent with the targets particularly since the start of 2018 have given a push to normalization. The normalization process has evolved gradually up to now, but its impact on emerging economies (EEs) has recently become more evident.

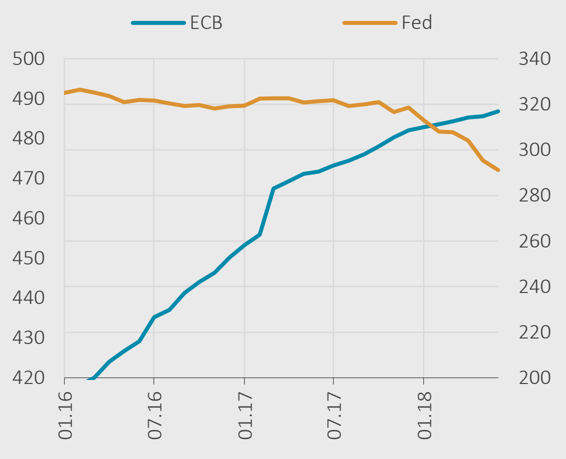
Currently, the Fed, the ECB, the Bank of England, the Bank of Canada and the Czech National Bank continue to progress toward normalization. The Fed ended bond purchases, and embarked on policy-rate increases and balance sheet downsizing. The Bank of England also completed bond purchases and implemented the first policy rate increase. The ECB is cutting down on bond purchases and has announced that the bond purchasing program will be phased out by the end of the year. Not opting for bond purchases, the Bank of Canada and the Czech National Bank also initiated rate increases. In addition to the policy rate, shadow short-term rates that reflect the effects of non-traditional monetary policies are trending upwards (Chart 1). Moreover, the Fed's balance sheet shrank and the growth rate of the ECB's balance sheet lost pace following the reduction of bond purchases (Chart 2).

Chart 1: Shadow Policy Rates (%)



Source: The Reserve Bank of New Zealand. Last observation: June 2018.

Chart 2: Balance Sheet Size (August 2008=100)



Source: Bloomberg. Last observation: June 2018.

June marks an important step for the Fed's and the ECB's decisions on the path to normalization. The ECB in particular conveyed clearer messages for the future. In fact, the rise in inflation trends of both economies invigorated the belief that central banks had attained a target-consistent inflation path permanently, which resulted in a more pronounced communication regarding the normalization process.

As expected, the Fed raised the policy rate by another 25 basis points, and median expectations for the policy rate rose by 25 basis points both for 2018 and 2019[1]. The Fed announced press meetings to be held following every FOMC meeting within the year as of January 2019 and also signaled for more than four possible rate increases. Hinting at a tighter monetary policy, an attempt was made to soften these decisions through Chairman Powell's statement that they would not react to an inflation shock which is not likely to be persistent as well as the emphasis on the risks of a faster-than-needed tightening.

The ECB kept its policy rate unchanged, but announced a decision for the future of the bond purchasing program following September. Accordingly, the ECB will reduce bond purchases by half in the October-December period to 15 billion euro and terminate bond purchasing at end-2018. Statements of forward guidance were kept intact as the principal payments from maturing securities purchased will be reinvested for an extended period after the end of net asset purchases (i.e. the balance sheet would not be downsized) and accommodative monetary policy would continue as long as it is needed. Meanwhile, the forward guidance for rate hikes was rendered clearer and it was stated that the policy rate was not projected to change until the summer of 2019. The table below summarizes "hawkish" and "dovish" elements in the announcements of both central banks.

Table 1: Decisions Taken in June Meetings of the Fed and the ECB

	Hawkish	Dovish
Fed	Policy-rate increase by 25 basis points Increase in expected median policy rates by 25 basis points each for 2018 and 2019 Press meetings to be held following all meetings as of 2019 Strengthening of some expressions in announcements on economic activity, special consumption and the labor market Omission of the expression from the announcement that the policy rate will remain below the long-term equilibrium for a while	Chairman Powell's press announcement of no reaction to an inflation shock that is unlikely to be persistent and emphasis on the risks to a fast tightening Preserving the expression that the monetary policy remains "accommodative" in the announcement (the minutes of the last meeting include debates over the omission or preservation of this sentence)
ECB	The announcement on tapering bond purchases following September and termination by the year-end Rendering the policy-rate projection clearer and announcement of no expected change in rates until the summer of 2019 Raising inflation forecasts and emphasizing cost pressures ,capacity utilization ratios and wages	Keeping the policy rate unchanged Maintaining expressions such as there is no ruling on balance sheet downsizing

[1] In fact, this points out an additional rate increase in total for 2018 and 2019. The median expectation, which was 3+3 previously, became 4+3. Moreover, it should be noted that these projections are median values. Median values went up due to a change in 1-2 members' forecasts. Nevertheless, it will be more accurate to conclude that the FOMC members slightly tightened the monetary policy stance-.

Given the decisions and projections of both central banks, together with the Bloomberg survey of expectations, two base scenarios appear. Possible scenarios can be summarized as four rate increases in total in 2018 (two more hikes in the rest of the year) and three hikes in 2019 by the Fed; and one rate hike in the last quarter of 2019 by the ECB. Meanwhile, rates implied by options point that these scenarios have not yet been completely priced by the market (Charts 3, 4 and 5).

Rates implied by options are below FOMC median value for the Fed, and projections of the Bloomberg survey for the ECB. In other words, a development such as an increase in the inflation trend to cause the above-mentioned scenarios to stand out or render these scenarios more likely has the potential to exert pressure on the emerging economies' exchange rate and policy rates. On the other hand, if the expectation for a looser rate path compared to these scenarios comes to the fore, the outcome will be the exact opposite. The aim here is to emphasize that the market does not completely priced possible scenarios. For example, if the expectation for the Fed to implement a fourth rate hike in this year grows stronger, this may exert pressure on the exchange rate and interest rates. Against this background, the normalization process is believed to remain influential in emerging economies.

Chart 3: End-2018 Fed Funds Rate Mid-point (%)

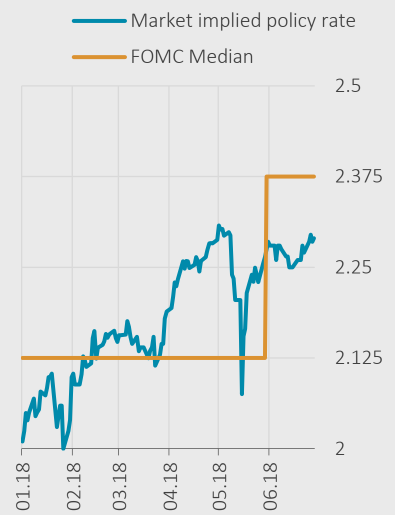


Chart 4: End-2019 Fed Funds Rate Mid-point (%)

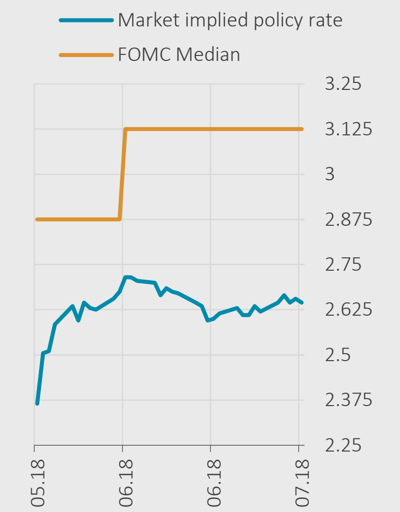
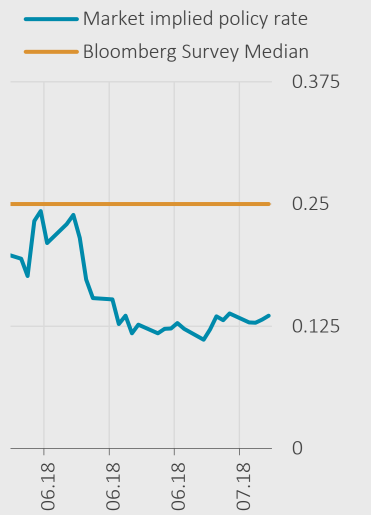


Chart 5: End-2019 ECB Main Refinancing Rate (%)



Source: Bloomberg.

Last Observation: June 2018.