

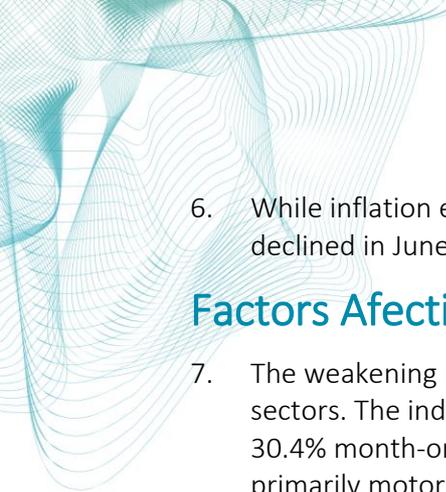
# Press Release on Summary of the Monetary Policy Committee Meeting

2 July 2020, No: 2020-36

Meeting Date: 25 June 2020

## Inflation Developments

1. In May, consumer prices increased by 1.36% and annual inflation rose by 0.45 points to 11.39%. In this period, as underlined in the May MPC meeting summary, food inflation increased due to unprocessed food prices. Although energy inflation increased on the back of international oil prices, it continued to restrain consumer inflation. While the depreciation in the Turkish lira had reflections on the core goods, primarily the durable goods inflation, the slowdown in services inflation continued, led by items that experienced a disruption in activity due to the pandemic. Consequently, the trends of core indicators posted a slight uptick.
2. Annual inflation in food and non-alcoholic beverages rose by 1.59% to 12.87% in May. This rise was mainly driven by the unprocessed food group with an annual inflation that increased by 4.91 points. The fall in the prices of fresh fruits and vegetables that remained relatively limited compared to previous years due to period-specific developments and the price hikes in eggs and pulses that are highly sensitive to the exchange rate were the main factors that had an adverse impact on the unprocessed food inflation. While monthly inflation in the processed food group decelerated slightly, annual inflation declined significantly on the back of the base effect. Meanwhile, leading indicators suggest that annual unprocessed food inflation may also rise in June.
3. Energy prices increased by 2.13% in May and annual energy inflation rose by 1.93 points to 5.23%. The recovery in international oil prices along with the depreciation of the Turkish lira determined the rise in energy prices. Leading indicators suggest that annual energy inflation may rise in June.
4. Annual core goods inflation increased by 1.38 points to 9.26% in May. In this period, both durable consumption goods and clothing and footwear prices posted significant increases. While in the durable goods group increases in the prices of automobiles and white goods driven by the cumulative depreciation of the Turkish lira were noteworthy, the clothing and footwear group saw a price increase above seasonal averages.
5. Services prices increased by 0.73% in May, and annual services inflation edged down by 0.48 points to 11.28%. The limiting effects of the pandemic on services prices started to be felt in this period. As a matter of fact, while the most noticeable decline in annual inflation was seen in restaurants-hotels, the operations of which were interrupted significantly, annual inflation in other services and rents also posted a decline. The capacity limitations in transport services applied as part of gradual normalization steps led to an increase in annual transport inflation through the channel of unit costs.

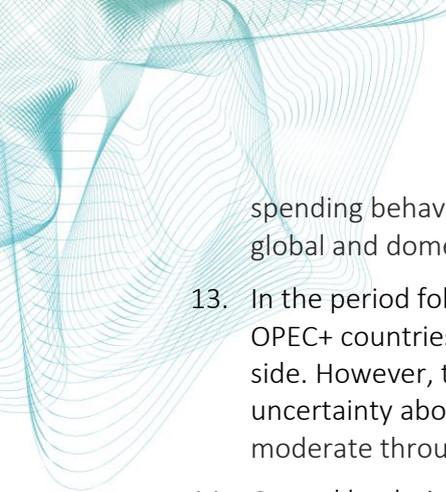
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6. While inflation expectations for the year-end increased slightly, those for the next 12 months declined in June.

## Factors Affecting Inflation

7. The weakening in economic activity became more pronounced in April and spread across sectors. The industrial production, adjusted for seasonal and calendar effects, contracted by 30.4% month-on-month in April. The decline in the production of the main exporting sectors, primarily motor vehicles, wearing apparel and textiles, became more discernible. In the same period, while tourism revenues almost came to a halt due to travel restrictions, services sectors, in particular trade, accommodation-food and transport-storage services, experienced a drastic deceleration due to the measures taken against the pandemic.
8. Economic recovery has started as of May following gradual steps towards normalization. The relief of the restrictions on movement and improving credit conditions support domestic demand. While expenditures by cards for items with high sensitivity to financing conditions and deferred demand have soared, the consumption of electricity has also been increasing steadily. In the meantime, exports show an improvement across foreign trade partners, while the demand for imports has been increasing in line with the domestic demand.
9. Exports and tourism revenues declined on account of the deterioration in the global growth outlook and travel restrictions due to the pandemic. However, the recovery in exports of goods with the ongoing normalization and low levels of commodity prices will support the current account balance in the upcoming periods. The Committee underscored the importance of the course of the current account balance in terms of a lasting recovery in economic activity and in terms of macrofinancial stability.
10. In order to contain negative effects of the pandemic on the Turkish economy, it is of crucial importance to ensure the healthy functioning of financial markets, the credit channel and firms' cash flows. In this respect, the recent monetary and fiscal measures contribute to financial stability and economic recovery by supporting the potential output of the economy. The pace of the recovery in economic activity will depend on the course of the normalization process in Turkey as well as in the global economy.
11. The slowdown in economic activity also had implications on the labor market data. The non-farm employment in March period decreased by 4.3% compared to February period, more apparently in the construction and services sectors. However, the increase in the unemployment rate remained relatively limited on the back of the decline in the labor force participation rate. Leading indicators reveal that new job posts increased and employment opportunities improved partially thanks to the improvement in economic activity. The Committee assessed that subsidies provided through the unemployment insurance fund and current transfers, short-time work allowance in particular, have played a critical role in limiting the income loss of households and maintaining employment.

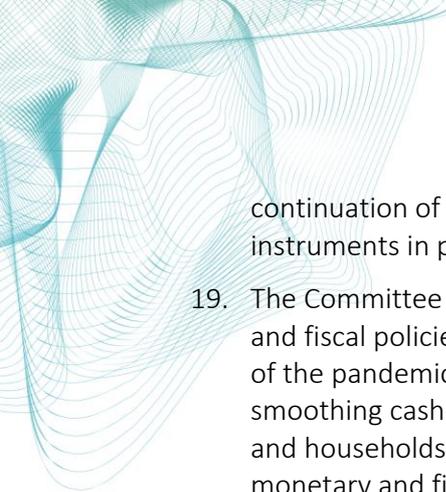
## Monetary Policy and Risks

12. As developments regarding the spread of the coronavirus substantially weakened global growth in the second quarter, normalization steps taken by several countries have contributed to a partial recovery. Nevertheless, due to the continued spread of the pandemic primarily in the southern hemisphere and the likelihood of a second wave, uncertainties on global economic recovery remain high. Uncertainties remain regarding the possible effects of the outbreak and health measures on consumption habits and general



spending behavior. A prolonged normalization phase could translate into a much weaker global and domestic growth outlook, calling for additional response measures.

13. In the period following the MPC meeting, oil prices posted a recovery over the agreement of OPEC+ countries on supply cut and the expectations that the worst is over on the demand side. However, there remain downside risks to commodity prices, particularly due to the uncertainty about the global economic activity, and global inflation rates are expected to be moderate throughout 2020.
14. Central banks in advanced and emerging economies continue to take expansionary measures. Long-term interest rates fell to historic lows across advanced economies, and both central bank statements and market expectations suggest that the low-rate environment is likely to continue for a long period. The effectiveness of these policies for financial markets, growth and employment will depend on the course of the pandemic in each country and how much policy room each country has.
15. Accommodative policy measures and steps towards normalization have driven the risk appetite slightly higher, slowing down portfolio outflows from emerging markets. Following the normalization steps, and also thanks to recent monetary and financial measures, the adverse effects of global developments on Turkey's risk premium and exchange rate volatility somewhat eased. However, the ongoing uncertainties over the global economic outlook and effectiveness of policy measures might lead to fluctuations in the global risk appetite and portfolio flows to emerging economies. As uncertainty still reigns, the pandemic disease is closely monitored for its evolving global impact on capital flows, financial conditions, international trade and commodity prices. Thus, the CBRT will continue to monitor the effects of the pandemic on the Turkish economy and use the tools at its disposal in pursuit of its price stability and financial stability objectives.
16. Monetary, financial and fiscal measures introduced to address the pandemic, as well as the expansion of loan supply, mostly by state-owned banks, have mitigated downside risks to loan growth and contributed to the uninterrupted flow of credit to the real sector. The momentum of loan growth remains robust thanks to guaranteed loans facility, as well as supporting packages for construction, tourism and domestic manufacturing sectors. Guaranteed loans, led by state-owned banks in particular, propped up commercial and personal loan supply and helped bring interest rates further down, thus alleviating the negative effects of the pandemic on income and cash flows of economic units. Recently announced personal loan packages also helped boost the demand for housing loans.
17. Despite the restraining effects of aggregate demand conditions, the pandemic-related rise in unit costs have led to some increase in the trends of core inflation indicators. International commodity prices have continued to restrain consumer inflation, while food inflation has risen due to seasonal and pandemic-related effects. As the normalization process continues, supply-side factors, which have prevailed recently due to pandemic-related restrictions, will phase out and demand-driven disinflationary effects will become more prevalent in the second half of the year. Accordingly, considering all factors affecting the inflation outlook, the Committee decided to keep the policy rate unchanged.
18. The Committee assesses that maintaining a sustained disinflation process is a key factor for achieving lower sovereign risk, lower long-term interest rates, and stronger economic recovery. Keeping the disinflation process in track with the targeted path requires the continuation of a cautious monetary stance. In this respect, the monetary stance will be determined by considering the indicators of the underlying inflation trend to ensure the



continuation of the disinflation process. The Central Bank will continue to use all available instruments in pursuit of the price stability and financial stability objectives.

19. The Committee assessed that it is essential to sustain the coordination between monetary and fiscal policies to minimize the pandemic-related economic risks. The multifaceted effects of the pandemic on the economy call for coordinated policy actions aiming particularly at smoothing cash flows and stabilizing employment in order to minimize the impact on firms and households. Therefore, it is considered to be of critical importance that macro-scale monetary and fiscal policies be complemented with policy measures that target the most-affected economic units and consider sectoral interactions. Meanwhile, ensuring that policy measures are designed in a targeted and temporary fashion would support policy effectiveness.
20. It should be emphasized that any new data or information may lead the Committee to revise its stance.