

Summary of the Monetary Policy Committee Meeting

30 May 2018, No: 2018-22


Meeting Date: 23 May 2018

Global Developments

1. In consideration of recent developments, the Monetary Policy Committee (the Committee) reviewed the risk scenarios discussed in the meeting on 25 April 2018 as well as the Inflation Report.
2. Financial conditions have recently tightened in advanced economies. The probability of an accelerated inflation due to brisk demand conditions and rising commodity prices constitutes a risk of triggering a faster-than-projected tightening in monetary policies of these countries. The Federal Reserve (the Fed) is more likely to implement three more policy rate hikes in the remainder of 2018, and the US bond returns have increased. Led also by the appreciation trend in the USD, global financial markets have witnessed fluctuations, the risk sentiment for emerging economies have deteriorated, exchange rates saw depreciation and increased volatility and portfolio flows lost momentum.
3. Fluctuating global financial markets have a tightening effect on domestic financial conditions. Due to geopolitical developments accompanied by prospects for macro indicators such as inflation and the current account deficit, Turkey grew more sensitive against global fluctuations. Due to higher risk premium and lower portfolio flows, the depreciation and volatility in the Turkish lira was higher compared to the currencies of other emerging economies. The depreciation trend in the Turkish lira has gained pace since the third week of May and signaled for unhealthy price formations inconsistent with economic fundamentals.
4. Accordingly, considering the effects of unhealthy price formations and excessive volatilities in the markets on the inflation outlook, the Central Bank has introduced some adjustments for the foreign exchange market since the meeting on 25 April. These adjustments aim at controlled and efficient provision of the liquidity required by the market in times of excessive volatility.

Market Measures

5. It was announced on 7 May 2018 that the upper limit for the foreign exchange maintenance facility within the reserve options mechanism was lowered from 55 percent to 45 percent, and tranches were re-adjusted. Through this revision, banks were provided with foreign exchange liquidity and Turkish lira liquidity conditions were tightened.
6. With an announcement on 9 May 2018, the daily amount of Foreign Exchange Deposits against Turkish Lira Deposits auctions was raised from 1.25 billion USD to 1.5 billion USD. Accordingly, the maximum total outstanding deposit amount in the auctions of 6.25 billion USD was enabled to amount to 7.5 billion USD. Through the same announcement, the



calendar for Turkish lira-settled forward foreign exchange sale auctions to be held in the second quarter of 2018 was updated. Accordingly, the amount of forward foreign exchange sale position was increased to 7.1 billion USD.

Macroeconomic Outlook and the Policy Rate

7. In the previous meeting, the Committee viewed the case in which cost-push inflationary pressures on the Turkish economy are accompanied by portfolio outflows as a risk scenario, and stated that the extent of the pass-through from rising exchange rates to consumer prices and the potential impact on overall financial stability will shape the monetary policy response.
8. Consumer prices rose by 1.87 percent in April, and annual inflation increased by 0.62 points to 10.85 percent. The rise in inflation was mostly due to oil prices and exchange rate-driven increases in prices of energy and core goods. Annual inflation rates and underlying trends of core indicators went up due to developments in core goods. Annual food inflation declined on the back of unprocessed food prices whereas annual inflation in indices B and C increased by 0.59 and 0.80 points to 12.54 and 12.24 percent, respectively. Producer-driven cost pressures were stronger than in the previous month while demand conditions caused cost shocks to have a more significant effect on inflation.
9. High inflation and rising inflation expectations keep risks to pricing behavior alive. According to diffusion indices, economic agents are much more inclined to raise prices. The inertia in the indicators for underlying inflation trends and the high levels of core inflation continue to pose risks to pricing behavior. In addition, the recent increases in import prices, particularly for oil, add to these risks.
10. After a robust first quarter, economic activity has begun to converge to its underlying trend as of the second quarter of 2018. Although aggregate demand conditions are likely to have a steadily waning effect on inflation, the cost pressures from the recent Turkish lira depreciation and their potential second-round effects weigh on the inflation outlook.
11. In sum, the recent unhealthy price formations in the markets and the ongoing increase in inflation expectations continue to pose risks to pricing behavior. Against this background, the Committee decided to implement a strong monetary tightening to support price stability. Accordingly, the Late Liquidity Window lending rate was raised from 13.5 to 16.5 percent.
12. At the meeting, the Committee also agreed to simplify the operational framework shortly in order to enhance the predictability of monetary policy and strengthen the transmission mechanism.
13. The CBRT will continue to use all available instruments in pursuit of the price stability objective. The tight stance in monetary policy will be maintained decisively until the inflation outlook displays a significant improvement and becomes consistent with the targets. Inflation expectations, pricing behavior and other factors affecting inflation will be closely monitored, and, if needed, further monetary tightening will be delivered.