

Chapter 1

AN EVALUATION OF INFLATION

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INTRODUCTION

World inflation has dropped significantly from 8,9 percent to 2,2 percent over the last decade (IMF, 2017). After experiencing deflation in 2014 and 2015, the European Union and The United States both had inflation rates climbing back to around 1.5 percent in 2018. Although the target inflation rate for both is 2.0 percent, they are stucked well under 2.0. The numbers for Turkey's are substantially higher. Following a sharp decline from double digits to single digit in 2013, Turkey inflation rate has climbed back to double digits, 25.2 percent in October 2018, which is the highest rate in the past one and a half decades. Over the last two years, Turkey is also leading all OECD countries in CPI (OECD, 2019).

Many commentaries made by economists on high inflation in Turkey have indicated the sharp incline in goods, food, energy and import prices due to exchange rate shocks. According to the European Central Bank (ECB), global factors tend to have a stronger impact on non-energy industrial goods price inflation than on services price inflation (ECB, 2014). Services inflation was more related to internal policies, hence increasing exchange rate shocks have created increasing substantial differences between goods and services. The incline in services inflation was around four times less than goods inflation in 2018. Therefore, goods was a better determinant of the total inflation index than services when exchange rate inclined. Inflation bias, including intervention in response to global factors, seems to be one of the important determinants of high inflation. In addition to high inflation and economic instability, institutional factors also played an important role in the evolution of dollarisation in Turkey (Bahmani-Oskooee & Domac, 2003). Dollarization keeps dollar/TL pressure and hence, high inflation pressure upward. However, there are more determinants of inflation that are not spelled out much

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