TÜRKİYE CUMHURİYET MERKEZ BANKASI

Summary of the Monetary Policy Committee Meeting

1 June 2023, No: 2023-21

Meeting Date: 25 May 2023

Inflation Developments

1. Consumer prices rose by 2.39% in April while annual inflation decreased by 6.83 points to 43.68%. Annual inflation declined across all groups, more visibly in energy and food groups. On a monthly basis, prices dropped in the energy group but increased in food and services groups. Supported by the ongoing significant fall in energy prices, the monthly rise in producer prices remained limited and the fall in annual producer inflation continued. Against this background, in seasonally adjusted terms, monthly increases remained on the decline in the B index but edged up in the C index, while annual inflation receded in both indicators.
2. Prices of the food and non-alcoholic beverages group increased by 3.95% in April, while annual inflation in this group fell by 13.97 points to 53.92%. Annual inflation dropped by 13.24 points to 52.70% in unprocessed food and by 13.93 points to 57.75% in processed food. Seasonally adjusted data point that prices of fresh fruits and vegetables rose in April, driven by vegetables. An analysis of unprocessed food price developments excluding fresh fruits and vegetables reveals that the rise in red meat and white meat prices continued. The monthly price increase in the processed food subgroup continued to decelerate, posting a limited rise of 0.97%. Excluding processed meat products, price movements were moderate across the group, while the deceleration of the price increase in bread and cereals was noticeable.
3. Energy prices receded significantly by 3.86% on a monthly basis, while annual inflation in this group dropped by 14.47 points to 21.19%. This was driven by the favorable course of global price movements. While residential electricity tariffs decreased by 15% in this period, fuel (-1.24%) and bottled gas (-4.66%) prices also declined. Meanwhile, municipal water tariffs continued to diverge from the group's outlook with a price increase (1.74%). The fall in energy prices is projected to continue also in May.
4. Prices in the services group rose by 3.89%, while the group's annual inflation decreased by 1.31 points to 58.62%. In this period, annual inflation decreased in the transport and restaurants-hotels subgroups, more visibly in the transport, while it remained flat in other services, and increased in rents and communication. On a monthly basis, prices in transport services, driven by the rise in intercity passenger transportation by road, rose by 3.08%, while annual inflation in the subgroup decreased by 11.68 points to 45.44%. Due to the outlook for food prices, particularly for red meat prices, monthly price increases in the restaurants-hotels group remained high (4.24%), and annual inflation in the subgroup decreased by 4.32 points to 66.41%. The rise in the other services subgroup (2.70%) was mainly driven by package tours, maintenance-repair and education items. Annual inflation in rents increased to 66.76% following the monthly increase of 4.37%. In the communication subgroup, prices rose significantly by 8.02%, mainly due to the increases in mobile phone call and internet charges.

5. Annual inflation in core goods decreased by 2.42 points to 34.16%. Annual inflation fell across subgroups. Prices of durable goods (excluding gold) increased by 3.05% month-on-month, while annual inflation in this subgroup fell by 2.74 points to 37.47%. In April, prices in automobiles and white goods further increased, whereas slowed down in furniture. Prices in other core goods subgroup rose by 1.09%, while annual inflation in this subgroup decreased by 1.15 points to 43.33%. Due to the carryover effects of the revision made in the legal profitability scales of the retail sale of pharmaceuticals in mid- March, medicine prices increased by 5.36% becoming the main driver of the monthly price increases in the subgroup. In the clothing and footwear subgroup, prices increased by 3.80%, while annual inflation fell by 3.49 points to 12.77%. The change in the methodology, which includes the shift of the month of entry of summer products in the clothing and footwear group into the index from April to May, also has the expected effects on the index in these two months.
6. According to the May results of the Survey of Market Participants, the 12-month ahead inflation expectation decreased by 1.18 points to 29.84%. The 24-month ahead inflation expectation and the five-year ahead inflation expectation were measured as 17.74% and 8.22%, respectively.

Factors Affecting Inflation and Risks

7. Although recently released data point to a stronger economic activity than anticipated, recession concerns in developed economies as a result of geopolitical risks and interest rate hikes continue, and conditions threatening financial stability, triggered by successive bank failures, have emerged.
8. While the negative consequences of supply constraints in some sectors, particularly basic food, have been alleviated by the strategic solutions facilitated by Türkiye, the high level in producer and consumer inflation continues on an international scale. The effects of high global inflation on inflation expectations and international financial markets are closely monitored.
9. While the divergence in monetary policy steps and communications of central banks in advanced economies continue due to their diverse economic outlook, coordinated steps are taken that prioritize financial stability through swap agreements and new liquidity facilities. Financial markets have been adjusting their expectations that the central banks would end the rate hike cycles in the near term.
10. Regarding portfolio flows to emerging economies, equity markets continued to see inflows in May, while bond markets posted outflows. In the meantime, the volatility in the long-term bond yields in advanced economies and the course of global financial conditions keep the risks to portfolio flows to emerging economies alive.
11. Having increased until mid-April, international commodity prices resumed their downtrend. This decline became broad-based across subgroups, with the energy sub-index falling more noticeably. The retreat in the energy sub-index was not limited to crude oil, but rather spread to products such as propane, butane and natural gas. Indicators for pressures on the global supply chain continued to hover below their historical trend, while international transportation costs remained mild in April. Against this background, producer prices increased slightly by 0.81%, and annual producer inflation decreased by 10.34 points to 52.11%.
12. In addition to international developments, energy consumption supports, natural gas in particular, have been affecting the disinflation process favorably. The decision to provide household natural gas free of charge for full use in May and for use of 25 cubic meters for the following 11 months is likely to have a stronger-than-expected downward effect on prices

in the coming months, due to the significant weight of natural gas in the consumption basket and the country-wide coverage of this support. In the absence of additional supports, this downward effect will gradually become neutralized within the index in the last quarter of the year, as cold weather and consumption of energy for heating purposes come into effect.

13. While level and underlying trend of inflation continue to improve with the support of the implemented integrated policy approach, the effect of earthquake-driven supply-demand imbalances on inflation is closely monitored.

14. Before the disaster of the century, leading indicators were pointing to a stronger domestic demand compared to foreign demand as well as an increase in the growth trend in the first quarter of 2023. The seasonally and calendar adjusted industrial production index fell by 5.9% on a monthly basis in February, but showed a significant recovery in March by 5.5%. Thus, in the first quarter, the industrial production index increased by 0.4% on a quarterly basis despite the impact of the disaster. Meanwhile, having contracted in February, the seasonally and calendar adjusted retail sales volume index increased by 7.3% on a monthly basis in March, exceeding its pre-disaster level. Thus, in the first quarter, the index recorded an increase of 6.5% quarter-on-quarter, thereby confirming the strong course of domestic demand. Other indicators of consumption demand and the survey data suggest that production and consumption, which dropped due to the disaster-related effects in February, have posted a strong recovery trend since March, and that domestic demand has been stronger than foreign demand.

15. Recent data show that economic activity in the earthquake zone has been recovering faster than expected, and it is becoming evident that the earthquake will not have a permanent impact on performance of the Turkish economy in the medium term. Credit card expenditures continued to recover towards pre-disaster levels as of mid-May in the most severely affected provinces, while they are above the pre-disaster levels in other provinces in the disaster zone. Similarly, in seasonally adjusted terms, after a decline in February, exports from the disaster zone as of May are converging further to their pre-disaster level. Detailed information derived from field interviews also confirms that the strong recovery trend in the disaster area continues and there is no medium-term loss in production capacity on a sectoral basis.

16. After a decline in February, seasonally adjusted employment remained flat in March. Thus, employment increased by 195 thousand people in the first quarter and rose by 0.6% on a quarterly basis. In March, the seasonally adjusted labor force participation rate remained almost unchanged, while the unemployment rate remained intact at 10% due to the limited rise in employment. On a quarterly basis, the labor force participation rate stood at 53.7% in the first quarter, while the unemployment rate fell by 0.3 points to 9.9%. The impact of the earthquake on the labor market in the disaster zone will be evaluated more clearly in the coming months. Along with the flow of data on employment, survey indicators and high-frequency data are also closely monitored. Data on employment expectations, job vacancies and job applications suggest that despite a limited deceleration in the aftermath of the disaster, the upward trend in employment has been maintained across the country owing to the strong recovery that followed the deceleration.

17. While the share of sustainable components of economic growth remains high, the stronger-than-expected contribution of tourism revenues to the current account balance continues throughout the year. On the other hand, the ongoing increase in domestic consumption demand, high level of energy prices and the weak economic activity in main trade partners keep the risks on current account balance alive. Sustainable current account balance is important for price stability.

Monetary Policy

18. The monetary policy stance will be determined by taking into account the evaluations on the source and permanence of risks, along with the extent to which they can be contained by monetary policy, and with a focus on achieving the sustainable price stability target, in a cautious manner.
19. In formulating the monetary policy towards achieving the sustainable price stability objective, a liraization-oriented approach will be maintained that also addresses risks to financial stability. The rate of credit growth and allocation of funds for real economic activity purposes are closely monitored.
20. The Committee will prioritize the creation of supportive financial conditions in order to minimize the effects of the disaster and support the necessary recovery. It has become even more important to keep financial conditions supportive to preserve the growth momentum in industrial production and the positive trend in employment after the earthquake. Accordingly, the Committee has decided to keep the policy rate unchanged. The Committee assessed that the current monetary policy stance is adequate to support the necessary recovery in the aftermath of the earthquake by maintaining price stability and financial stability. The effects of the earthquake in the first half of 2023 are closely monitored.
21. The CBRT will implement Liraization Strategy in order to create an institutional basis for permanent and sustainable price stability. As announced in the 2023 Monetary Policy and Liraization Strategy document, the Committee will continue to decisively use the tools supporting the effectiveness of the monetary transmission mechanism and the entire policy toolset, particularly funding channels, will be aligned with liraization targets. The focus of this process will be on developing policy instruments to support the improvement of Turkish lira deposits, to increase Turkish lira-denominated assets in the collateral structure of Open Market Operations funding, to reduce the weight of swaps in the composition of funding, and to strengthen foreign exchange reserves.
22. The rise in the demand for long-term, fixed-income and Turkish lira-denominated assets and the course of the yield curve in tandem with the direction of the efficiency of monetary transmission are closely monitored. Along with credit growth, the Committee will also consider the improvement in financing costs of loans providing efficiency gains in targeted areas so as to maintain the transmission.
23. Accordingly, the effects of liquidity and distribution developments of the Turkish lira on deposits and loan pricing, the effects of exchange rate developments on inflation, and the impact of the developments regarding FX-protected deposit products on reverse currency substitution, the depth and stability of the foreign exchange market, and price stability are being analyzed, and necessary policy measures are being taken.
24. The CBRT will continue to use all available instruments decisively until strong indicators point to a permanent fall in inflation and the medium-term 5 percent target is achieved in pursuit of the primary objective of price stability.
25. Stability in the general price level will foster macroeconomic stability and financial stability through the fall in country risk premium, continuation of the reversal in currency substitution and the upward trend in foreign exchange reserves, and durable decline in financing costs. This would create a viable foundation for investment, production and employment to continue growing in a healthy and sustainable way.
26. The Committee supports building strong policy coordination and a holistic macro policy mix involving all stakeholders in order to achieve price stability.

27. The Committee will continue to take its decisions in a transparent, predictable and data-driven framework.