TÜRKİYE CUMHURİYET MERKEZ BANKASI

Summary of the Monetary Policy Committee Meeting

22 April 2021, No: 2021-18

Meeting Date: 15 April 2021

Inflation Developments

1. Consumer prices rose by 1.08% in March, and annual inflation increased by 0.58 points to 16.19%. Annual inflation increased in energy, services and core goods groups, but declined in the food group. Against this background, annual inflation rates of B and C indices increased, and their trends remained high despite some decline.
2. Prices of food and non-alcoholic beverages increased by 1.13% in March, and the group's annual inflation fell by 0.96 points to 17.44%. While this was largely due to annual unprocessed food inflation declining to 14.98%, annual processed food inflation rose slightly to 19.87%. The decline in annual unprocessed food inflation was led by the recently mild course of fresh fruit and vegetable prices. Seasonally adjusted data indicate that fruit and vegetable prices fell in March, while the increase in other unprocessed food prices slowed. After upswings in January and February, processed food prices continued to rise in March, albeit at a slower rate. International oil prices continued to rise, and domestic prices of fats and oils continued to climb, although at a slowing pace. Prices of international agricultural commodities, which have been on the rise for a long time, have recently displayed a more moderate outlook. Leading indicators suggest that annual food inflation continued to fall in the first half of April.
3. Rising by only 0.09%, energy prices remained largely unchanged in March, but the group's annual inflation rose by 3.61 points to 12.43% due to the base effect. Bottled gas and natural gas prices increased by 2.81% and 0.93%, respectively, in March, while fuel prices fell by 0.69%. Despite the rise in international crude oil prices and exchange rate developments, their impact on fuel prices was prevented by the sliding scale system and the price cap practice that helps this system to be more effective. Currently, the sliding scale system eliminates an important inflationary effect given the direct and indirect effects of fuel prices. The upward trend in annual energy inflation is expected to continue in April due to the base effect.
4. Core goods prices rose by 1.39% in March, and the group's annual inflation rose by 0.44 points to 22.14%. Annual inflation increased in clothing and footwear and other core goods, but declined slightly in durable goods. Across other core goods, prices were notably higher in household repair-maintenance and personal care products with high exchange rate pass-through in addition to the lingering effect of adjustments to prices of medicine. Durable goods prices had a limited increase in March due to supply constraints and rising international industrial metal prices. Furniture and automobile prices rose in this period, while prices of electrical and non-electrical appliances decreased, easing the rise in the group’s prices.
5. Prices of services increased by 1.26% in March, and the group's annual inflation rose by 0.82 points to 12.56%. Annual inflation increased in restaurants-hotels, communication and other

services, but followed a flat course in rents and transport services. With the easing of pandemic measures, restaurants-hotels prices increased significantly in March. Cost increases during the period when activities were interrupted passed through to prices, while the increasing demand, triggered by capacity constraints, was another factor that put pressure on prices. Prices of communication services rose amid the lingering effects of the increases in the special communication tax. Among items grouped within other services, education and recreation services diverged negatively due to sharp price increases. The increase in prices of recreation services was driven by the easing of pandemic measures. On the other hand, prices of education services increased on the back of the backward indexation in private school tuitions as well as the expiration of temporary VAT reductions.

6. According to the results of the CBRT Survey of Expectations, participants' inflation expectations have increased in April. While the current year-end inflation expectation increased by 1.58 points to 13.12% in April, the 12-month ahead and 24-month ahead inflation expectations rose by 0.79 points and 0.37 points to 11.26% and 9.55%, respectively.

Factors Affecting Inflation and Risks

7. The global economy, having contracted sharply in 2020 due to the pandemic, continues to recover on the back of accommodative policies and positive developments in the vaccination process. This improvement process is determined especially by the acceleration in manufacturing industry activity and global trade. However, despite ongoing vaccination efforts, risks to the global economic activity prevail due to uncertainties pertaining to the course of the pandemic. In this period, the upward trend in commodity prices has decelerated.

8. In tandem with the recovery in expectations of growth in advanced economies, the effects of the rising global inflation expectations on international financial markets remain significant. Long-term bond rates lead to uncertainties about advanced economy monetary policies, and volatility in global financial markets. Nevertheless, the Committee maintained its assessment that global inflationary pressures might cause an earlier-than-projected tightening in monetary policies, and maintained its assessment that a period marked by increased data-sensitivity and related volatilities in global financial markets was entered.

9. Since the last MPC meeting, portfolio flows to emerging economies have continued at an accelerated rate in bond markets and at a milder pace in equity markets. The volatility in long-term bond rates in advanced economies keeps the risks to portfolio flows to emerging economies alive.

10. Driven also by the exchange rate developments, producer prices posted a strong widespread increase in March. Commodity prices have registered some deceleration in the recent period. However, inflationary effects arising from disruptions in supply chains persist.

11. While commercial loans exhibit a moderate course, an upward trend is observed in consumer loan growth despite tightening financial conditions. Noting that demand and cost-side inflationary effects persisted, the Committee maintained its assessment that the risks to the year-end forecast target announced in the January Inflation Report were on the upside.

12. Despite the constraining effect of the pandemic, domestic economic activity is strong, led by domestic and external demand. In January-February period, industrial production rose by 2.3% compared to the previous quarter, and continued to hover above its long-term trend despite the constraining effect of the pandemic in this period. The strong momentum in manufacturing industry activity has widely spread across sectors, being particularly significant in intermediate and durable consumer goods. On the other hand, the weak

course continues in the services sector, which has been adversely affected by the pandemic restrictions.

13. In February, nonfarm employment remained flat while total and nonfarm unemployment rates rose by 0.7 points to 13.4% and 15.3%, respectively, due to the increase in the participation rate. During this period, employment increased in the services and construction sectors, but decreased in the industry sector.

14. Regarding the cyclical state of the economy, the data released for the first quarter indicate that economic activity remains above the potential and aggregate demand conditions continue to be at inflationary levels. While high-frequency data indicate that economic activity remains strong amid credit developments and controlled normalization, risks for economic activity exist in either direction depending on the progress of the pandemic and the vaccination process in the period ahead.

15. Notwithstanding the rise in exports and the fall in gold imports, strong domestic demand and commodity prices continue to adversely affect the current account balance. Provisional data suggest that imports increased in real terms along with price increases in March. Gold imports, which started decelerating in the second half of January, have declined even below their historical averages in the recent period. This trend in gold imports limits the adverse effect of the terms of trade on the current account balance. Meanwhile, exports to both European and non-European countries are on the rise. Current trends indicate that the annualized current account balance will start to improve in the second quarter of this year. The Committee noted that tightened pandemic restrictions in some trading partners and supply problems in certain sectors, the automotive sector in particular, may constitute downside risk factors for the current account balance. The Committee underscored once again the importance of the course of the current account balance in terms of a lasting recovery in economic activity and financial stability.

Monetary Policy

16. The monetary policy stance will be set taking into account the upside risks to the inflation outlook and with a focus on bringing inflation down permanently in a cautious manner and achieving the price stability target. Accordingly, the policy stance will continue to be determined by taking into account inflation developments and inflation expectations, and at a degree of tightness that will restore the disinflation process as soon as possible and ensure its sustainability until the medium-term targets are achieved.

17. Demand and cost factors, supply constraints in some sectors, and high levels of inflation expectations continue to pose risks to the pricing behavior and inflation outlook. The decelerating impact of the current monetary stance on credit and domestic demand is envisaged to become more significant in the upcoming period. Accordingly, the Committee has decided to maintain the tight monetary policy stance by keeping the policy rate unchanged at 19%.

18. The tight monetary stance will serve as a significant buffer against external and temporary volatilities in the context of inflation expectations, pricing behavior and financial market developments.

19. The CBRT will continue to use decisively all available instruments in pursuit of the primary objective of price stability. The policy rate will continue to be determined at a level above inflation to maintain a strong disinflationary effect until strong indicators point to a permanent fall in inflation and the medium-term 5% target is reached.

20. The stability in the general price level will foster macroeconomic stability and financial stability through the fall in country risk premium, reversal in currency substitution,

accumulation of foreign exchange reserves and perpetual decline in financing costs. This would create a viable foundation for investment, production and employment to continue growing in a healthy and sustainable way.

21. Demand and cost-side effects remain significant for inflation given credit market and economic activity indicators, as well as exchange rate volatility and developments in import prices. The outlook for domestic demand, international prices and global risk appetite heightens the risks arising from external financing needs to the balance of payments. In formulating the monetary policy towards the target of price stability, the Committee will continue to follow an approach that also addresses the risks to financial stability.
22. The Committee reiterated its judgement that in order to achieve price stability, a strong policy coordination and a holistic macro policy mix involving all stakeholders are required.
23. The Committee will continue to take its decisions in a transparent, predictable and data-driven framework.