Summary of the Monetary Policy Committee Meeting

31 August 2023, No: 2023-33

Meeting Date: 24 August 2023

Global Economy

1. Global inflation has recently been declining, yet it remains above the long-term averages and central bank targets. Consumer inflation in advanced economies decreased from 4.91% to 4.08% over the intermeeting period, whereas consumer inflation in emerging economies increased from 5.41% to 5.84% due to relatively large economies such as Russia, Türkiye and India. In the last ten years, inflation averaged 2.2% in advanced economies and 5.6% in emerging economies. Inflation continues to hover significantly above the average target rate of 2% in advanced economies and 3.5% in emerging economies. The average annual inflation expectation for the last quarter of 2023 for advanced and emerging economies are 3.1% and 6.2%, respectively. Compared to the previous MPC meeting period, core inflation declined from 5.02% to 4.74% in advanced economies, while it remained flat at 6.03% in emerging economies. The average annual inflation expectation for the last quarter of 2023 is 3.1% in the USA and 3.0% in the euro area, while core inflation expectations are 3.6% and 4.1%, respectively.

2. Commodity prices have recently been rising due to energy commodity prices led by oil prices. The current level of the Commodity Price Index is 30.6% above the average of the last ten years. The index fell 26.2% compared to the highest level reached last year. Similarly, the Agricultural Commodity Price Index, which declined by 10.9% compared to the peak it reached last year, is 16.6% above the average of the last ten years. This still has an impact on inflation due to the high share of food in the consumer basket.

3. High levels of core inflation and inflation expectations imply that global inflation will continue to remain above the targets of central banks for a while. As a result, many central banks around the world continue the monetary tightening process. The central banks of 12 advanced countries held a total of 138 meetings in the last 18 months, and policy rates were increased in 97 of these meetings. [1] During the same period, 15 emerging countries' central banks held a total of 205 meetings, and policy rates were increased in 100 of these meetings. The results of the implemented monetary policy have begun affecting financial conditions, and central banks' emphasis on tightening financing and credit conditions has strengthened. On the other hand, the central banks of Brazil and Chile, which initiated their rate hike cycles with early and strong steps and implemented them decisively in a period when inflation started to rise, began to cut rates on the back of the decline in consumer inflation. However,

[1] Advanced Countries: Australia, Canada, Czechia, Denmark, Euro Area, Japan, New Zealand, Norway, South Korea, Sweden, the United Kingdom, the United States of America.
Emerging Countries: Brazil, Chile, China, Colombia, Hungary, India, Indonesia, Mexico, Peru, the Philippines, Poland, Romania, Russia, South Africa, Thailand.

given the high levels of inflation and the central banks' policy communications, it is expected that the tightness of monetary policy will continue in these economies.

4. Despite the flat global growth outlook, relatively strong demand and tight labor markets continue. The global growth index, which is weighted with export shares of Türkiye's foreign trade partners, has posted a very limited increase compared to the previous MPC meeting period. The index is projected to grow by 1.8% in 2023, which is approximately 0.5 points higher than the trough in January. However, when the 3.5% growth of the index in 2022 is considered, a notable slowdown in foreign demand, on an annual basis, in 2023 is evident. Having fallen in June, global PMI declined further in July. In July, the global manufacturing industry PMI remained unchanged at 48.7 over the previous month, while the global services PMI decreased by 1.2 points to 52.7. Thus, the global composite PMI index was down by 1 point to 51.7 in July compared to the previous month. In July, the composite PMI data of both advanced and emerging economies receded. The composite PMI indicator for China remained on the decline in July, falling by 0.7 points to 51.9. The manufacturing PMI dropped by 1.3 points to 49.2, below its threshold value, while the services PMI was relatively flat at 54.1. In the euro area, one of Türkiye's major trading partners, the composite PMI indicator declined further in August, falling by 1.6 points to 47. In August, the manufacturing PMI was up by 1 point to 43.7, only to reach one of the lowest levels since June 2020 when the first wave of the pandemic was experienced. The services PMI, in particular, remained on the decline in August and fell by 2.6 points to 48.3, below its threshold.

5. Portfolio flows to emerging markets continued in June on the back of improving risk sentiment. While there was an inflow of approximately USD 54.2 billion to equity markets in the first half of 2023, there was an outflow of around USD 2.4 billion from bond markets. From the beginning of July until 11 August, the portfolio inflows amounted to USD 3 billion in total, USD 1.3 billion of which were inflows to equity markets.

Inflation Developments

6. Although annual inflation in Türkiye has decreased by 37.7 points compared to the peak in October 2022, it started to rise again. Consumer prices rose by 9.49% in July, and annual inflation increased by 9.62 points to 47.83%. Recent indicators point to a continued increase in the underlying trend of inflation. The strong course of domestic demand, cost pressures stemming from wages and exchange rates, stickiness of services inflation and tax regulations have been the main drivers of this development. The increase fuel inflation due to exchange rates and international developments also had an additional effect on the increase in inflation through direct and indirect channels and contributed to its widespread diffusion. In fact, leading indicators suggest that widespread price hikes occurred also in August following the large increases in July.

7. Contributions of subgroups to annual inflation rose from 15.00 points to 17.85 points in the services group (2.86 points of increase), from 10.49 points to 12.95 points in the core goods group (2.46 points of increase), from -2.64 points to -0.39 points in the energy group (2.25 points of increase), from 13.56 points to 15.27 points in the food and non-alcoholic beverages group (1.71 points of increase), and from 1.81 points to 2.15 points in the total of alcohol, tobacco and gold groups (0.34 points of increase).

8. Prices of food and nonalcoholic beverages group increased by 7.71% in July, and annual inflation rose by 6.80 points to 60.72%. Price increases were widespread across the food group. The seasonally adjusted monthly rate of increase in food prices accelerated compared to the previous month, which was again driven by prices of fresh fruits and vegetables. In the

other unprocessed food group, red meat, nuts and potatoes were noteworthy. Processed food prices went up by 6.08% on a monthly basis. While this was mainly driven by bread and cereals, tea prices continued to rise due to fresh tea purchase prices. Having dropped in recent months, prices of milk and dairy products started to rise again in this period.

9. Energy prices rose by 12.73% in July, and the group's annual inflation increased by 13.66 points to -2.86%. Monthly energy inflation was driven by the fuel item, which posted a price hike of 29.04%. Coupled with international crude oil prices and exchange rate developments, the SCT adjustment brought about a significant increase in fuel prices. While fuel prices had surged by 57.35% from early May to the previous MPC meeting, they recorded an additional increase of 14.34% from that period to 23 August. In addition to its direct effect, the increase in fuel prices also has an indirect negative effect on consumer inflation through transportation costs.

10. Services prices rose by 9.81% in July, and the group's annual inflation surged by 10.20 points to 69.65%. Strong price hikes spread across the group, and annual inflation increased in all subgroups. In July, the minimum wage adjustment and the ongoing negative outlook for food prices as well as strong tourism demand led to an 11.92% rise in restaurants-hotels. Due to the minimum wage hike and exchange rate developments, prices in the other services subgroup were up by 10.27%. In other services, the maintenance and repair of personal transport vehicles and health services came to the forefront. Significant increases in fuel prices adversely affected transport services, pushing subgroup prices up by 10.03%. The monthly price increase in the rents subgroup strengthened somewhat in July and was measured at 7.67%. The price increase in communication services was more limited compared to other subgroups with 3.74%.

11. Prices of core goods were up by 9.40% in July, and the group's annual inflation increased by 7.56 points to 44.25%. In July, annual inflation increased across all subgroups, most notably in durable goods. Following the depreciation of the Turkish lira, tax and wage increases as well as buoyant demand conditions, the monthly price increase in durable goods (excluding gold) grew stronger with 12.49% over the previous month, led again by automobiles in July. A similar trend was also observed in other core goods, and the subgroup prices rose by 8.73% due to widespread increases.

12. Prices in the alcoholic beverages and tobacco products group soared by 11.17%, and annual inflation in this group rose by 5.68 points to 46.58%. This was mainly driven by tax adjustments. The VAT increase as well as the reflection of the producer price increase in the first half of the year on specific and minimum specific taxes pushed prices upwards across the group.

13. The underlying trend of inflation increased markedly in July. Seasonally adjusted monthly increases in the B and C indices rose significantly compared to the previous month, which is also confirmed by alternative core inflation indicators. The three-month average increases in the seasonally adjusted B and C indices, which peaked at 8.8% and 8.4%, respectively, in February 2022, stood at 5.1% and 5.7% as of July 2023. In July, the seasonally adjusted rates of increase in the B and C indices were measured at 9.2% and 9.8%, respectively (3.2% and 3.6% in the previous month).

14. Leading indicators suggest that the significant monthly price increases coming through the channels of demand, wages, exchange rates, taxes and deteriorating pricing behavior will also continue in August. Accordingly, it is estimated that annual inflation will also increase significantly.

Demand and Production

15. Data for the second quarter of the year confirm that economic activity remained robust, particularly driven by domestic demand. In June, the retail sales volume index maintained its uptrend, increasing by 23.2% year-on-year, while the quarterly rate of increase was 5.2%. The uptrend in card expenditures also continued in July, and seasonally adjusted expenditures by domestic cards posted a strong increase of 12% on a monthly basis. An analysis of manufacturing firms' registered orders in July reveals that orders from the domestic market displayed a significant rise at 8.4 points on an annual basis. Leading indicators suggest that the strong course of domestic market orders is maintained in August. Interviews with firms, on the other hand, point to slight loss of momentum at the sectoral level due to the high rate of price increases.

16. In June, the seasonally and calendar adjusted industrial production index increased by 1.6% month-on-month, while it rose by 2.3% quarter-on quarter, indicating that the earthquake-driven production losses were compensated for. Similarly, the seasonally adjusted manufacturing industry capacity utilization rate increased by 0.3 points month-on-month to 76.9% in July, the highest level in the last ten months. Leading indicators for August also suggest that this outlook for the manufacturing industry continues. Recent data show that economic activity in the earthquake zone continued to recover faster than expected, thereby largely compensating for the disaster-driven contraction.

17. As of June, seasonally adjusted employment increased by 0.5% quarter-on-quarter to 31.5 million, exceeding the average quarterly employment level before the disaster. In this period, the labor force participation rate remained flat at 53.4% while the unemployment rate decreased by 0.3 points to 9.7%, hitting its lowest level since the second quarter of 2014. High-frequency data indicate that demand remains robust in the labor market.

18. In June, in line with the improvement in the foreign trade deficit, the annualized current account deficit decreased by USD 3.3 billion monthly to USD 56.5 billion. This decrease was driven by the strong course of the services balance and the ongoing fall in energy prices over the previous year as well as the notable decline in imports in June. As of June, the annualized balance of payments-defined foreign trade deficit widened by USD 42.5 billion year-on-year to USD 99.3 billion. In the same period, the annualized services surplus rose by USD 9.6 billion to USD 51.9 billion. Gold imports, which have increased due to monetary conditions and expectations, play an important role in the widening of the current account deficit. According to provisional foreign trade data for July, gold imports increased by USD 12.5 billion year-on-year to USD 19.4 billion in the first seven months of the year. Effects of the measures taken to reduce the acceleration in gold imports which is critical for the course of the current account deficit in 2023 are closely monitored. The strong course of domestic demand has an increasing effect on the current account deficit through imports of consumption goods. Provisional foreign trade data for July indicate that exports declined in July due to the bringing forward of deliveries ahead of the religious holiday, while imports of all subgroups of goods, led by consumption goods in particular, recorded increases outpacing the declines in June. On the other hand, high-frequency data for August imply that imports remained relatively flat as against the recovery in exports in seasonally adjusted terms.

19. Tourism revenues, which have been above expectations throughout the year, continue to contribute positively to the current account balance. Travel revenues increased by USD 3.3 billion in the first six months of the year compared to the same period of the previous year, and reached USD 18.9 billion. Similarly, the number of foreign visitors increased by 22.9% year-on-year to 18.8 million in the first half of the year.

Cost Conditions

20. While global commodity prices that have been on the decline since the second half of 2022 have supported the fall in consumer inflation through the input prices channel, price increases in the energy subgroup have been notable recently. These price increases have not been limited to crude oil but have also been observed in propane, butane and coal. Excluding the energy subgroup, international commodity prices remained flat in July, while the general index rose by 4.41%. In this period, exchange rates and rising labor costs stood as the main factors exerting pressure on producer prices.
21. The monthly increase of domestic producer prices at 8.23% was higher compared to the previous month, while annual producer inflation rose by 4.08 points to 44.50%. In this period, capital goods (11.67%), durable consumption goods (10.37%), and intermediate goods (8.93%) were the subgroups that stood out with high monthly price increases.
22. In August, indicators for global supply chain pressures have remained mild while international transportation costs have increased. The Global Supply Chain Pressure Index remained about one standard deviation below its historical average in July as well. While commodity prices excluding energy have declined somewhat in August, increases in the energy subgroup push the general index upwards as in July.
23. Adjustment in the minimum wage in July 2023, accompanied by wage adjustments for civil servants and public sector workers, and wage hikes becoming broad-based are expected to strengthen the upward pressures, particularly cost-driven impacts, on inflation in the second half of the year.
24. The depreciation in the Turkish lira, widespread wage increases and tax adjustments are expected to continue to exert cost-side pressure on inflation in the near term. The pass-through from these factors to consumer prices is particularly strong in times of deteriorating inflation expectations.

Stickiness of Services Inflation

25. Price increases in the services sector, which remained high in the first half of the year, further strengthened as of July. Monthly price increases in the services sector, which displays inertia compared to goods, are high compared to 2022. The average of seasonally-adjusted consumer price increases in the last three months is 5.1% in the B index, while it is 5.7% in services. Additionally, the diffusion index for the services sector is hovering significantly above its historical average, indicating that the increases showed a generalized pattern across the sector.
26. Monthly increases in the restaurants and hotels subgroup, which are significantly affected by food, wage and tourism developments, display a persistent outlook. Given the recent developments in the minimum wage and food prices, the sector is expected to maintain its upward trend in the following months.
27. Certain services items, particularly rents, education, health, recreation and culture exhibit pricing behavior indexed to past consumer inflation, prompting inflationary effects to spread over a long period of time. Given the expected outlook for consumer inflation in the near term, there is a risk that inflation will remain high for an extended period in items in which backward-indexation is prevalent.
28. Fuel prices are capable of having a significant impact on consumer prices, particularly on transport services, through both production inputs and transportation costs. The recent significant increase in fuel prices driven by exchange rates, crude oil prices and tax hikes is likely to continue to exert pressure on transport services prices in the upcoming period.

Tax Adjustments

29. The Committee anticipates that tax regulations will put further pressure on inflation in the short run. However, it is assessed that the impact of tax hikes will be temporary and will be offset to some extent by favorable effects on demand and fiscal discipline.

30. The impact of the VAT rate hike in July on prices is expected to extend into August due to the number of days calculated and in the coming months depending on the frequency of price changes by firms, albeit at a weaker pace.

31. The lump-sum SCT amounts on fuel were increased. The lump-sum SCT increase has a negative impact on consumer inflation both directly and indirectly. As the tax hikes coincided with exchange rate developments and the rise in international crude oil prices, indirect effects, particularly on transportation services and food items, have been realized rapidly. Recently, while price hikes in administered transportation services have become more frequent, it is assessed that the rise in prices of fresh fruits and vegetables contrary to the seasonal averages was also induced by fuel-driven developments.

Inflation Expectations

32. Shocks such as tax and administered price increases, minimum wage regulation and exchange rate developments, which are considered temporary during normal inflation periods, may have longer-lasting negative effects on expectations and inflation inertia than expected in a high inflation environment. In addition to these factors, higher-than-anticipated deterioration in inflation expectations and pricing behavior due to the factors affecting inflation as well as the rise in oil prices in July and beyond keep upside risks to the inflation outlook alive. The headline inflation diffusion index displayed a more unfavorable outlook in July and was about three standard deviations above its historical average.

33. According to the August results of the Survey of Market Participants, the 12-month-ahead inflation expectation increased by 8.80 points from 33.21% to 42.01%, the 24-month-ahead inflation expectation rose by 3.50 points from 19.04% to 22.54%, and the five-year-ahead inflation expectation was revised upwards by 1.56 points from 8.86% to 10.42%.

34. It is anticipated that, at the end of the year, inflation will hover close to the upper bound of the forecast range provided in the Inflation Report (Report) and then, given the monetary tightening stance, disinflation will be established in 2024 in line with the Report.

Monetary and Financial Conditions

35. Credit growth poses a risk to inflation by increasing domestic demand. As of 18 August 2023, the retail loan balance increased by 93.7% in credit cards, 74.6% in vehicle loans, 31.7% in personal loans, and 23.6% in housing loans compared to end-2022, amounting to an increase of 49.3% in total. Meanwhile, since the last MPC meeting period, personal loan growth has lost further momentum, increasing by 0.8% from 14 July. This was driven by the expansion of the scope of the loan growth-based securities maintenance practice. In the same period, although its growth slowed down to 7%, personal credit cards maintained its strong trend, and its annual growth remained flat at 184.2%. For Turkish Lira denominated commercial loans, which grew by 3% compared to the previous MPC period, annual growth stood at 63.5%.

36. Average personal loan rates (excluding ODA), which had been trending flat since the previous MPC period, became 47.1% as of 18 August 2023. In the same period, housing loan rates increased from 32.6% to 36.4% and vehicle loan rates decreased from 41.3% to 38.1%.

Meanwhile, Turkish lira commercial loan rates increased by 632 basis points to 31.3% as the first tier for TL commercial loan was removed and the policy rate was increased.

37. As of June, the measures taken to ensure the sound functioning of the banking system within the scope of the simplification process have primarily restored the flow of Turkish lira commercial loans. Turkish lira commercial loans, which increased by 0.3% across the sector in June, grew 2.4% in July. Turkish lira deposit rates, which started to decline in this period, stood at 24.9% in the week ending August 18. Owing to the policy rate hike and the recent steps taken as part of the simplification of the macroprudential framework, it is expected that the demand for Turkish lira instruments will increase, loan rates and deposit rates will rise concurrently and the monetary transmission mechanism will be strengthened.

38. Foreign direct investments, improvement in external financing conditions, continued increase in foreign exchange reserves, and the positive impact of tourism revenues on current account balance will contribute significantly to price stability.

39. With the recently-signed agreements, foreign direct investments that will focus on improving technology investments and production capacity will support external financing in the upcoming period.

40. Türkiye's 5-year CDS premium, which peaked this year with 703 basis points on 22 May 2023 amid domestic uncertainties, declined to 457 basis points in the previous MPC meeting period and to 412 basis points on 23 August 2023. Similarly, 1-month and 12-month exchange rate volatilities of the Turkish lira, which were 23.6 and 30.3 points in the previous MPC meeting period declined to 15.2 and 28.5 points, respectively. Falling figures in the risk premium and exchange rate volatilities were accompanied by net portfolio inflows totaling USD 2.23 billion since June, USD 0.48 billion of which went to the GDDS market and USD 1.75 billion to the equity market.

41. International reserves of the CBRT have assumed a strong upward trend since June. Having declined from USD 128.8 billion at the end of 2022 to USD 98.5 billion at the end of May, gross international reserves of the CBRT rose to USD 117.1 billion as of 18 August 2023.

Monetary Policy

42. The policy rate will be determined in a way that will create monetary and financial conditions necessary to ensure a decline in the underlying trend of inflation and to reach the 5 percent inflation target in the medium term. The Committee assessed that because of the inflation outlook and the upside risks, the capacity of the monetary policy framework to achieve the 5% inflation target should be enhanced. The Committee drew attention to the risks that a deterioration in price stability may pose to macroeconomic stability and especially to financial stability. Monetary tightening will be further strengthened as much as needed in a timely and gradual manner until a significant improvement in the inflation outlook is achieved.

43. The Committee decided to continue the monetary tightening process in order to establish the disinflation course as soon as possible, to anchor inflation expectations, and to control the deterioration in pricing behavior. Therefore, the Committee has decided to raise the policy rate (the one-week repo auction rate) from 17.5% to 25%.

44. To increase the functionality of market mechanisms and strengthen macro financial stability, the Committee will continue to simplify and improve the existing micro- and macroprudential framework. A gradual simplification policy will continue to be implemented, and the pace and sequence of the transition will continue to be determined through impact analyses. Impact analyses of the CBRT's regulations are conducted for all components of the framework by assessing their impact on inflation, interest rates, exchange rates, reserves, expectations, securities and financial stability.

45. In this context, recent regulations targeting a rising share of Turkish lira deposits will strengthen the monetary transmission mechanism. In addition to the increase in the policy rate, the Committee will continue to make decisions on quantitative tightening and selective credit tightening to support the monetary policy stance. While policy rates, the main policy instrument, affect monetary and financial conditions and expectations, these decisions aim to stabilize excess Turkish lira liquidity and consumption demand and increase the effectiveness of monetary policy.

46. With the acceleration in retail loans, it is assessed that domestic demand is deteriorating price stability both directly and through the current account balance. Selective credit tightening decisions are expected to support the rebalancing process in domestic demand.

47. The Turkish lira liquidity inflows to the financial system stemming from the foreign exchange difference payments of FX-protected deposit accounts due to the exchange rate developments are closely monitored. Due actions will be taken based on the impact analyses in view of the current market conditions and liquidity projections for the upcoming period.

48. Indicators of inflation and underlying trend of inflation will be closely monitored and the Committee will continue to decisively use all the tools at its disposal in line with its main objective of price stability.

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