TÜRKİYE CUMHURİYET MERKEZ BANKASI

Summary of the Monetary Policy Committee Meeting

25 August 2022, No: 2022-37

Meeting Date: 18 August 2022

Inflation Developments

1. Consumer prices rose by 2.37% in July and annual inflation increased by 0.98 points to 79.60%. In this period, annual consumer inflation decreased in energy whereas it went up in other groups, with core goods and services having a significant impact on the rise in inflation. Annual inflation increased across the core goods group, while in the services group it rose in all subgroups other than restaurants-hotels. In the food group, annual inflation slightly declined in unprocessed food whereas it remained on the rise in processed food. Energy inflation registered a decline on the back of fuel and bottled gas prices that decreased in line with the developments in international energy prices. Despite the decline in prices of refined petroleum products and base metals driven by international commodity prices, producer inflation remained elevated due to other energy items in particular. Against this background, the rise in the annual inflation of core indicators continued.

2. Prices of food and non-alcoholic beverages increased by 3.15% in July, and the group's annual inflation rose by 0.72 points to 94.65%. While annual inflation edged down by 0.65 points to 91.00% in unprocessed food, it increased by 1.98 points to 98.02% in processed food. Seasonally-adjusted prices of fresh fruits and vegetables, which had registered a decline in the last two months, rose in this period. Across unprocessed food items excluding fresh fruits and vegetables, the price increases in rice, eggs, potatoes and pulses were notable. The 3.61% rise in processed food prices was driven by bread-cereals, coffee-tea-cocoa, and non-alcoholic beverages.

3. Energy prices receded by 3.13% in July, and the group’s annual inflation fell by 22.06 points to 129.27%. This was led by the 8.18% decline in fuel prices following the decrease in international crude oil prices, and annual inflation in this subgroup dropped by 37.11 points to 214.87%. In response to positive international developments, bottled gas prices also decreased by 3.98%. On the other hand, municipal water and solid fuel prices continued to increase. The decline in fuel prices is expected to affect energy prices favorably in August as well.

4. Prices of services rose by 3.20% in July, pushing annual services inflation up by 2.76 points to 51.45%. In this period, annual inflation edged down in restaurants-hotels, but increased in other subcategories, more markedly in transport and rent. Prices in transport services increased by 5.01% on the back of intercity passenger transport by rail and road, air transport and urban passenger transport by bus. Thus, annual inflation in transport services rose to 90.71%. Price increases in restaurants-hotels lost pace in July with 2.49%, and annual inflation came in at 79.14% in this subcategory. In this period, internet fees stood out in communication services, while price increases were broad-based across other services. The 4.24% increase signaled an acceleration in monthly rent inflation.

5. Prices of core goods rose by 3.67% in July, pushing annual core goods inflation up by 6.07 points to 70.93%. Prices of durable goods rose by 3.85% due to prices of white goods and automobiles, and annual inflation hit 84.93% in this subcategory. Prices of other core goods rose by 4.47% month-on-month, with medicines, household cleaning supplies and personal care products in the lead. Prices of clothing and footwear increased by 1.74%, contrary to seasonal norms, and annual inflation rose by 5.10 points to 31.45% in this subcategory.

6. Prices of alcoholic beverages and tobacco products increased by 6.85% in July, pushing annual inflation up to 82.66% in this group. This upsurge was attributed to the limited impact of the tax adjustment in cigarette prices as well as the price increments by producer companies.

7. According to the August results of the Survey of Market Participants, current year-end inflation expectations increased by 0.66 points to 70.60%, while 12-month ahead inflation expectations were revised upwards by 1.76 points to 41.99%. 24-month ahead inflation expectations remained almost flat at 24.35%.

Factors Affecting Inflation and Risks

8. The weakening effects of geopolitical risks on global economic activity continue to increase. Global growth forecasts for the upcoming period are being revised downwards and recession is increasingly assessed as an inevitable risk factor.

9. While the negative consequences of supply constraints in some sectors, particularly basic food, have been alleviated by the strategic solutions facilitated by Türkiye, the upward trend in producer and consumer prices continues on an international scale. The effects of high global inflation on inflation expectations and international financial markets are closely monitored. Moreover, central banks in advanced economies emphasize that the rise in inflation may last longer than previously anticipated due to rising energy prices, imbalances between supply and demand, and rigidities in labor markets. The divergence in monetary policy steps and communications of central banks in advanced economies continue due to their diverse economic outlook. It is observed that central banks continue their efforts to develop new supportive measures and tools to cope with the increasing uncertainties in financial markets.

10. Regarding portfolio flows to emerging economies, bond and equity markets have both continued to register outflows in August in line with the global risk appetite. Moreover, 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. In Türkiye, there has been a significant increase in interest from foreign investors in capital markets investment instruments in recent weeks.

11. Due to the impact of the policy steps taken within the scope of the liraization strategy, Türkiye's Turkish lira-denominated government bond yields, especially in long maturities, performed more favorably in this period compared to peer economies.

12. Increase in inflation is driven by the lagged and indirect effects of rising energy costs resulting from geopolitical developments, effects of pricing formations that are not supported by economic fundamentals, strong negative supply shocks caused by the rise in global energy, food and agricultural commodity prices.

13. Although the effects of falling international commodity prices have been visible in producer prices through refined petroleum products and base metal items, prices increased further across sub-groups in July, most notably in electricity, natural gas, basic pharmaceutical products and tobacco products.

14. Robust growth in the beginning of the year continued in the second quarter as well, with the support of external demand. Adjusted for seasonal and calendar effects, industrial production grew by 1.3% month-on-month and by 8.4% year-on-year in June. Thus, industrial production increased by 1.1% compared to the previous quarter. In sectors with relatively high export shares, industrial production growth was stronger on monthly and quarterly basis. Although the retail sales volume index decreased by 0.7% month-on-month, it surged by 4.2% in the second quarter compared to the previous one. In this context, in line with the data on card spending, domestic demand implies a recovery in the second quarter.

15. Developments in the labor market display a strong outlook in tandem with the outlook of economic activity in the second quarter. Job creation in the post-pandemic recovery period has been more pronounced, especially in industrial and services sectors compared to peer economies. In fact, seasonally-adjusted total employment grew by 2.5% (approximately by 765 thousand people) in the second quarter. Considering the sectors that contribute to the employment increase, chiefly the industrial sector with a quarterly increase by 3.3%, it is observed that the growth dynamics are supported by structural gains. As a result, unemployment fell by 0.4 points from the previous month to 10.6%. Meanwhile, survey indicators and high-frequency data indicate that the upward trend in employment is maintained, albeit at a slower pace.

16. Leading indicators for the third quarter point to some loss of momentum in economic activity. Survey-based indicators such as the Business Tendency Survey, PMI and sectoral confidence indices as well as other high-frequency data hint at a slowdown in economic activity as of mid-August. Registered domestic and external orders and future order expectations of manufacturing industry firms also point to a weakening in domestic and foreign demand. Firms' investment and employment expectations, although being high, declined as of July. Information obtained from field interviews also gave similar signals regarding the economic activity in this period.

17. The recent strong course of energy imports still affects the current account balance. In June 2022, the Current Account Balance registered a deficit of USD 3.5 billion, while the annualized current account deficit rose by USD 2.3 billion to USD 32.7 billion. The provisional external trade data implies a limited slowdown in exports in July due to the religious holiday and following days-off as well as partial suspension of production in the automotive sector. Meanwhile, thanks to the dynamic capacity and market diversification flexibility of exporting companies, exports remained strong despite geopolitical risks. As for imports, although there has been a partial decline, the high level of energy imports and increasing gold imports limited this decline. Despite the increase in the foreign trade deficit led by the surge in commodity prices, mainly energy prices, the ongoing uptrend in services revenues continue to support the current account balance. While share of sustainable components of economic growth increases, the stronger than expected contribution of tourism revenues to the current account balance continues. On the other hand, high course of energy prices and the likelihood of a recession in main trade partners keep the risks on the 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. In addition, the recent increase in spread between policy rate and the loan interest rate is considered to reduce the effectiveness of monetary transmission. In this context, the Committee decided to further strengthen the macroprudential policy set with tools supporting the effectiveness of the monetary transmission mechanism.

20. The Committee expects disinflation process to start on the back of measures taken and decisively implemented for strengthening sustainable price and financial stability along with the resolution of the ongoing regional conflict. It is important that financial conditions remain supportive to preserve the growth momentum in industrial production and the positive trend in employment in a period of increasing uncertainties regarding global growth as well as escalating geopolitical risk. Accordingly, the Committee has decided to reduce the policy rate by 100 basis points, and has assessed that the updated level of policy rate is adequate under the current outlook.

21. To create an institutional basis for sustainable price stability, the comprehensive review of the policy framework continues with the aim of encouraging permanent and strengthened liraization in all policy tools of the CBRT. 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 OMO funding, to gradually reduce the volume of swaps, and to strengthen foreign exchange reserves.

22. The credit, collateral and liquidity policy actions, of which the review process is finalized, will continue to be implemented to strengthen the effectiveness of the monetary policy transmission mechanism. The rise in the demand for long-term fixed-income and Turkish lira-denominated assets and the course of the yield in tandem with the direction of the efficiency of monetary transmission is 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 within the framework of the liraization strategy 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.