Summary of the Monetary Policy Committee Meeting

28 July 2022, No: 2022-34

Meeting Date: 21 July 2022

Inflation Developments

1. Consumer prices rose by 4.95% in June and annual inflation increased by 5.12 points to 78.62%. In this period, annual consumer inflation was up across all subcategories, mostly driven by energy (accounting for 3.65 points of the 5.12-point-rise). The rise in energy inflation was determined by fuel, natural gas and electricity items due to the outlook for Turkish lira-denominated international energy prices. Annual inflation was up in all subcategories in the services group. While annual food inflation declined in the unprocessed food group thanks to the ongoing correction in vegetable prices, it continued to increase in the processed food group. Annual inflation in core goods posted a decline across subcategories except for durable goods. The rise in producer prices persisted as a result of the increase in international and domestic energy prices, and ongoing supply chain disruptions. Against this background, while the seasonally-adjusted monthly changes of B and C indices slowed down, their annual inflation increased.

2. Prices of food and nonalcoholic beverages increased by 2.09% in June, and the group's annual inflation rose by 2.30 points to 93.93%. Annual inflation fell by 5.96 points to 91.65% in unprocessed food, but increased by 10.03 points to 96.04% in processed food. In unprocessed food, seasonally-adjusted prices of fresh fruits and vegetables recorded a decline due to the ongoing correction in vegetable prices. Across unprocessed food items excluding fresh fruits and vegetables, prices of rice, potato and dried nuts, in addition to milk, affected by the raw milk reference price adjustment, came to the forefront. Despite the decline in unprocessed food inflation, processed food inflation increased further. The monthly price increase in the processed food group was of 7.53%, mostly driven by cheese and other dairy products, bread and cereals, nonalcoholic beverages, tea, and products related to sugar.

3. Energy prices rose by 16.16% in June, and annual energy inflation increased by 30.12 points to 151.33%. Price increases spread across the group, led by fuel and administered prices. Gaining momentum due to the TL-denominated international oil prices, fuel prices rose by 21.88%, and annual inflation in this subgroup reached 251.98%. Due to the developments in global energy prices, residential natural gas and electricity prices went up in this period by 25.11% and 15.01%, respectively.

4. Prices of services rose by 3.98% in June, and annual services inflation stood at 48.69%. Annual inflation increased in all subcategories. International energy and agricultural commodity prices continued to affect services inflation. In the restaurants-hotels group, prices rose by 5.42%, and annual inflation hit 79.55%. Transport services recorded price increases of 4.57% due to intercity passenger transport tariffs via highway, railway as well as transport by air. Thus, annual inflation in the transport group reached 81.83%. Prices in the other services subcategory rose by 3.14%. Driven by internet and telephone call charges, communication

services prices rose by 3.16%. Rents increased by 3.11% month-on-month, and the seasonally-adjusted data suggested an acceleration in monthly increases.

5. Annual core goods inflation edged down by 0.46 points to 64.86% in June. In this period, annual inflation receded in clothing-footwear and other core goods groups, but rose in durable goods. Driven by furniture and automobile items, the monthly price increase in durable goods became 3.65%, and the group’s annual inflation hit 77.90%. On the other core goods front, annual inflation fell by 0.94 points to 70.64%. Monthly price increases in the clothing and footwear group remained flat, while annual inflation declined by 2.92 points to 26.35%.

6. Alcoholic beverages and tobacco products increased by 2.61% and annual inflation reached 70.99% in June, due also to raised taxes in prices of alcoholic beverages. The contribution of this group to monthly consumer inflation stood at 0.12 points.

7. According to the July results of the Survey of Market Participants, the current year-end inflation expectation rose by 5.35 points to 69.94% and the 12-month-ahead inflation expectation increased by 2.32 points to 40.23%. The 24-month-ahead inflation expectation is 24.27%.

Factors Affecting Inflation and Risks

8. The escalating geopolitical risks have continued to have negative impacts and caused further weakening in the worldwide economic activity. Global growth forecasts for the upcoming period are being revised downwards and the likelihood of a recession has increased.

9. Increasing concern over global food security driven by trade restrictions, high and volatile course of commodity prices, and the persistence of supply constraints in some sectors, particularly in food, have led to producer and consumer price increases internationally. 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 continues due to their diverse economic outlook. It is observed that central banks have increased and diversified their efforts to develop new supportive measures and tools to cope with the increasing uncertainties in financial markets.

10. The strengthening US dollar on a global scale due to rising financial uncertainties exerts pressure on the currencies of other countries. While the currencies of emerging economies depreciated significantly against the US dollar in July, the Turkish lira diverged relatively in a positive manner. 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.

11. Regarding portfolio flows to emerging economies, bond and equity markets have both continued to register outflows in July 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.

12. Increase in inflation is driven by 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. Amid geopolitical tensions, rising international and domestic energy prices and ongoing supply chain disruptions continue to affect producer prices. Across main industrial groupings, annual inflation was up in all sub-groups, with energy inflation in the lead.
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 increased by 0.5% month-on-month and by 13.3% year-on-year in May. Thus, production grew by 0.5% as of May compared to the previous quarter. The quarterly increase in industrial production of sectors with higher export shares was stronger than that of other sectors. Industrial turnover indices also showed that external demand continued to support industrial production. Retail sales volume indices, on the other hand, rose by 4% quarter-on-quarter as of May, pointing to continued recovery in domestic demand.
15. Investment tendencies of manufacturing industry firms for the next twelve months remain high. Firms’ registered domestic and external orders and future order expectations reveal that external demand maintains its supportive course in the second quarter. On the other hand, while continuing to rise throughout the second quarter, card spending indicated a slowdown in domestic demand towards the end of the quarter.
16. Developments in the labor market display a strong outlook in tandem with the outlook of economic activity. Job creation in the post-pandemic recovery period have been more pronounced, especially in industrial and services sectors, compared to peer economies. In fact, seasonally-adjusted total employment grew by 1.2% (approximately by 358 thousand people) month-on-month in May. The 0.4-point increase in labor force participation curbed the decline in seasonally-adjusted unemployment. Thus, unemployment fell by 0.3 points from the previous month to 10.9%. In addition, survey indicators and high-frequency data indicate that the upward trend in employment is maintained, albeit at a slightly slower pace.
17. The recent strong course of energy imports still affects the current account balance. In May 2022, the Current Account Balance (CAB) registered a deficit of USD 6.5 billion, while the annualized current account deficit rose by USD 3.2 billion to USD 29.4 billion. The fact that anticipated exports were brought forward due to the Ramadan Feast in the first week of the month was influential in high current account deficit in May. According to the provisional external trade data, in June, exports remained strong while imports continued to increase despite the partial decline in energy imports. Meanwhile, it is observed that short-term regional losses caused by the conflict are compensated by the increase in exports to other countries thanks to the dynamic capacity and market diversification flexibility of exporting firms. Despite the increase in the foreign trade deficit led by the surge in commodity, mainly energy prices, the ongoing upward trend in services revenues further supports the current account balance. While the share of sustainable components of economic growth increases, the tourism-led improvement in current account balance continues with a solid pace. 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. Despite losing its momentum, credit growth, and allocation of funds for real economic activity purposes are closely monitored. The Committee will continue to implement the strengthened macroprudential policy set decisively and take additional measures when needed.

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. Accordingly, the Committee has decided to keep the policy rate unchanged.

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.