TÜRKİYE CUMHURİYET MERKEZ BANKASI

Summary of the Monetary Policy Committee Meeting

19 July 2021, No: 2021-31

Meeting Date: 14 July 2021

Inflation Developments

1. Consumer prices rose by 1.94% in June, and annual inflation increased by 0.94 points to 17.53%. Annual inflation rose in food and core goods, but decreased in energy and services. Amid normalization steps, price increases were recorded in certain sectors that had experienced interruptions in their economic activities. Against this background, annual inflation rates and trends of the B and C indices registered an uptick.
2. In June, prices of food and non-alcoholic beverages increased by 0.88% and the group's annual inflation rose by 2.95 points to 19.99%. Annual inflation soared by 4.09 points to 18.70% in the unprocessed food group, and rose by 1.71 points to 21.20% in the processed food group. Annual inflation remained flat in fresh fruits and vegetables within the unprocessed food group, whereas it increased notably in the other unprocessed food group due to the hikes in red and white meat prices. Meanwhile, processed food prices were mostly driven by the bread and cereals group, processed meat products, fats and oils and non-alcoholic beverages. Moreover, spikes in red meat prices and their spillover effects on the prices of meat products were notable in June.
3. Energy prices rose by 2.24% in June, while the group's annual inflation declined by 0.43% points to 17.28%. With an upsurge of 6.33% due to the carry-over effects of the SCT rise in May, fuel prices pulled energy prices up. Despite the adjustment in May, the sliding-scale system averts possible price increases. On the other hand, electricity and natural gas tariffs were increased in July, and LPG also recorded an uptick in prices.
4. Annual core goods inflation climbed by 1.08 points to 21.92% in June. Annual inflation increased across all subcategories, particularly in other core goods. In durable goods, prices increased by 2.98%, while annual inflation crept up by 0.12 points to 30.86%. These figures were led mainly by the white goods and furniture sectors, while other electrical and non-electrical appliances and automobile items also registered increases. Exchange rate developments, soaring commodity prices and the disruptions in supply chains shaped the prices of durable goods and other core goods. Meanwhile, the clothing and footwear group, which registers decreasing prices in every June due to the arrival of the sale season, saw monthly price increases in this period amid steps towards normalization. Annual inflation in clothing and footwear rose by 1.30 points to 6.86%, yet this level remained low and therefore continued to limit core goods inflation.
5. In June, services prices increased by 1.94%, while annual services inflation edged down by 0.16 points to 13.46%. The course of the group's inflation was affected by the normalization steps taken both last year and this year. Annual inflation rose in restaurants-hotels, other services and rent, but declined in transport and communication services. In the restaurants-

hotels group, prices soared in the eat-out meals and accommodation items, and annual inflation in this group rose by 1.13 points to 18.86%. In other services, amid reopening, annual inflation increased due to recreational and cultural services as well as maintenance and repair. In June, transport services registered price increases due to capacity restrictions in intercity passenger transport by road, but annual inflation receded in this group due to the base effect.

6. Inflation expectations obtained from the Survey of Market Participants are revised upwards in July. While the current year-end inflation expectation rose by 1.18 points to 15.64%, the 12-month ahead and 24-month ahead inflation expectations increased by 0.50 points and 0.27 points to 12.62% and 10.43%, respectively.

Factors Affecting Inflation and Risks

7. The worldwide speeding up of vaccination rollout, especially in developed countries, supports the global economic recovery. With the normalizations steps, the divergence between services and industrial activities started to narrow down. Nonetheless, economies advancing in their vaccination programs exhibit a stronger performance in economic activity by easing the restrictions. On the other hand, some virus variants recently leading to resurgence of cases keep the uncertainties about the course of the pandemic in place.

8. The strong recovery in the global demand, increasing trend of commodity prices, supply constraints in some sectors and the rise in transportation costs have led to producer and consumer price increases internationally. The effects of the rising global inflation and inflation expectations on international financial markets remain significant. Since the previous MPC Meeting, monthly and annual inflation in some developed economies have increased above expectations. The normalization process has started in emerging economies, where policy rates remain well below historical averages, and some central banks have delivered rate hikes. This outlook points to increased uncertainties and a slight tightening in global financial conditions compared to the previous MPC Meeting period. The fluctuating course of global risk appetite and uncertainties regarding the course of long-term bond rates lead to volatility in global financial markets. The Committee maintained its assessment that global inflationary pressures increase data-sensitivity in monetary policies and global financial markets in turn, which may lead to volatilities.

9. Portfolio inflows to emerging economies continued in this MPC Meeting period on the back of bonds, albeit at a decelerated pace. Nonetheless, the volatility in long-term bond rates in advanced economies and the course of global financial conditions keep the risks to portfolio flows to emerging economies alive.

10. Driven by international commodity prices, disruptions in supply chains, as well as exchange rate developments, producer prices increased also in June. The rise in producer prices and the pressure it exerts on consumer prices have become more pronounced on a global scale, including advanced economies. On the other hand, the upward trend in non-energy commodity prices has reversed since June, albeit to a limited extent.

11. Commercial loan growth exhibits a mild course. The effects of the implemented macroprudential measures will be monitored on personal loans, which recently displayed a rise due to the reopening and deferred demand. The Committee maintained its assessment that a milder growth in personal loans is critical to curb risks to the inflation outlook and external balance. Accordingly, the course and composition of loans are closely monitored for macroeconomic stability.

12. Domestic economic activity is strong. While domestic demand has slightly decelerated in the second quarter due to pandemic restrictions and the tightening in financial conditions,

external demand remains strong. In April-May period, industrial production increased by 0.4% over the previous quarter. Industrial turnover indices suggest that this deceleration was driven by domestic demand due also to pandemic restrictions, while external demand was supportive of industrial production. In this period, the retail sales volume also went down amid restrictions.

13. High-frequency data indicate that economic activity regained strength with the rapidly increasing mobility exceeding the levels before the measures due to the speeding up of vaccination and easing of pandemic restrictions. In fact, the weekly credit card expenditures data suggest that services sectors and retail trade items, which were affected more by the restrictions, registered higher rates of increases. The acceleration of domestic vaccination rollout facilitates the recovery in services and tourism sectors, which have been adversely affected by the pandemic, and leads to a more balanced composition in economic activity.

14. The impact of restrictions on economic activity was also reflected in the labor market. As of May, total and non-farm unemployment rates increased quarter-on-quarter by 0.5 points and 0.7 points to 13.5% and 15.6%, respectively. High-frequency data suggest a rapid recovery in job opportunities following the easing of restrictions. In this respect, it is assessed that there may be employment increases in the services sector in the upcoming period. However, the rise in the labor force participation rates may limit the impact of employment increases on unemployment rates.

15. Favorable external demand conditions and the current tight monetary policy impact the current account balance positively. The current account balance ran a deficit of USD 3.1 billion in May, while the annual deficit decreased by USD 0.9 billion to USD 31.9 billion compared to the previous month. According to preliminary foreign trade data for June, seasonally-adjusted exports and imports excluding gold increased on a monthly basis. Despite the rise in commodity prices, the current account is expected to post a surplus in the rest of the year due to the strong upward trend in exports, and the strong progress in the vaccination program stimulating tourism activities. The Committee maintained its emphasis on 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. In addition to the recent increases in import prices and administered prices, demand conditions, supply constraints in some sectors, possible volatility in inflation during the summer due to the reopening, and high levels of inflation expectations continue to pose risks to the pricing behavior and inflation outlook. On the other hand, the decelerating impact of the monetary tightening on credit and domestic demand is being observed. Taking into account the high levels of inflation and inflation expectations, the current tight monetary policy stance will be maintained decisively until the significant fall in the April Inflation Report's forecast path is achieved. Accordingly, the MPC has decided to keep the policy rate unchanged at 19%.

18. Inflation is expected to follow a volatile course in the short term due to various supply and demand side factors, with commodity prices and administered prices in the lead. The impact

of possible short-term volatilities in inflation on the underlying trend will be monitored closely for the monetary policy stance. 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 positively 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. While the current tight monetary policy keeps demand-side factors under control by containing loans and domestic demand, it also supports the improvement in the current account balance. Nevertheless, the outlook for monetary policies in advanced economies and global risk appetite heighten the risks to the portfolio flows towards emerging economies. 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.