Summary of the Monetary Policy Committee Meeting

2 March 2023, No: 2023-11

Meeting Date: 23 February 2023

Inflation Developments

1. In January, consumer prices increased by 6.65% while annual inflation decreased by 6.59 points to 57.68%. Annual inflation rose in the services group against a significant decline in all subgroups, being more pronounced in the energy group. In this period, the month-on-month rise in energy prices remained moderate, while the highest rise was observed in services. The course of services prices was affected by developments in food and minimum wage as well as groups affected by the revaluation rate and groups with time-dependent pricing behavior. Supported by the fall in energy prices, producer prices continued to decrease on an annual basis in January. Against this background, the annual rate of change in the B index decreased while that in the C index increased.

2. Prices in the food and non-alcoholic beverages group increased by 6.62% month-on-month, exceeding its historical January average of recent years. In this group, annual inflation fell by 6.87 points to 71.00%. Annual inflation fell by 4.45 points to 68.80% in unprocessed food and by 8.44 points to 73.56% in processed food. In the unprocessed food group, seasonally adjusted data points to a decline in the prices of fresh fruits and vegetables, more pronounced in the vegetables group. In January, almost three-quarters of the rise in food prices was mainly driven by price developments in bread-cereals, as well as meat, milk and related products.

3. In January, energy prices increased by 1.59%, and annual inflation in this group dropped by 39.40 points to 55.03%. In this period, the rise in municipal water prices continued, while prices of fuels and bottled gas increased due to the rise in the international oil, propane and butane prices. Meanwhile, there has been a decrease in natural gas prices.

4. Services prices increased by 12.70% in January, and the group's annual inflation rose by 6.93 points to 62.42%. Annual inflation decreased in transport services but went up in other subgroups. The most significant rise in monthly price increases in the services group was registered in the other services subgroup with 16.10%. This monthly rise in the other services subgroup was driven by maintenance-repair, health, revaluation-related items and recreation-culture services. In the restaurants-hotels subgroup, prices were up by 12.73%, and annual inflation reached 75.13%. In transport services, prices rose by 10.23% driven by administered services whereas annual inflation receded to 77.97%. Communication services saw a monthly price increase of 8.14% led by mobile phone call charges while annual inflation climbed to 37.42%. The monthly increase in rents was 9.75% in January, and annual inflation in rents reached 57.07%.

5. Annual inflation in core goods declined by 4.14 points to 44.82%. Annual inflation fell across all subgroups, more markedly in other core goods. Prices of durable goods rose by 4.92% in this period triggered by automobiles, furniture and white goods. In other core goods, prices increased by 4.01% in January led by the carry-over effect of medicine prices. Prices in the

clothing and footwear subgroup were down by 1.75%, and annual inflation dropped by 1.69 points to 23.32% due to a stronger seasonal effect than the last year's.

6. Prices in the alcoholic beverages and tobacco products group increased by 11.19% in January, while annual inflation of the group decreased by 14.51 points to 50.60%. The automatic hike in taxes, which is linked to producer price developments in the second half of 2022, was the main factor driving prices in the group upwards.

7. According to the February results of the Survey of Market Participants, inflation expectations remained almost flat as the 12-month ahead inflation expectation edged up by 0.31 points to 30.75%, and the 24-month ahead inflation expectation rose by 0.93 points to 18.11%.

Factors Affecting Inflation and Risks

8. Although recently released data point to a stronger economic activity than anticipated, recession concerns in developed economies as a result of ongoing geopolitical risks and interest rate hikes continue.

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 high level in producer and consumer inflation continues on an international scale. The effects of high global inflation on inflation expectations and international financial markets are closely monitored.

10. The divergence in monetary policy steps and communications of central banks in advanced economies continue to increase 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. Additionally, financial markets have been adjusting their expectations that the central banks would end the rate hike cycles in the near term on the back of the recession risks.

11. Regarding portfolio flows to emerging economies, bond and equity markets saw inflows in February parallel to the improved global risk appetite. On the other hand, 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. In January, international commodity prices recorded a limited increase while energy prices remained relatively flat across subcategories, and non-energy commodity prices edged up. On the back of the grain corridor, agricultural commodity prices remained moderate. A notable decline was seen in natural gas prices in January and February amid mild weather conditions and the significant build-up of gas stocks. International transportation costs fell further in January, while the recent stable course of exchange rates was maintained. Thus, annual producer inflation continued to decline.

13. While level and underlying trend of inflation have been improved with the support of the implemented integrated policy approach, the effect of earthquake driven supply-demand imbalances on inflation is closely monitored.

14. Indicators for the last quarter of 2022 show that a slowdown in growth due to the weakening foreign demand is compensated for by the relatively strong course in domestic demand. In December, industrial production rose by 1.6%, adjusted for seasonal and calendar effects, on a monthly basis but it decreased by 1.2% on an annual basis. On a quarterly basis, industrial production increased by 2% in the fourth quarter. Meanwhile, retail sales volume index rose by 4.8% and 7.2% on a monthly and quarterly basis, respectively in December.

15. Before the earthquakes, leading indicators were pointing to a stronger domestic demand compared to foreign demand as well as an increase in the growth trend in the first quarter of

2023. Manufacturing industry firms' registered external and domestic orders increased on a quarterly basis, with a stronger uptick in domestic market orders. The upward trend in card expenditures also continued in the first quarter. Accordingly, indicators, which mostly reflect pre-earthquake data, suggest that domestic demand remained stronger compared to external demand in the first quarter.

16. After the earthquake, uncertainty loomed over the indicators related to economic activity. In addition to direct effects, the earthquake will have indirect effects through reconstruction activities and supportive policies, which will cause various sectoral and regional repercussions changing over time. The impact of the earthquake on production, consumption, employment and expectations is being extensively evaluated. The short-run effects of the earthquake seem to have been partly reflected on production and order expectations of manufacturing industry firms in February. Real sector and sectoral confidence indices also declined on a monthly basis in February. High-frequency foreign trade data for February, on the other hand, suggest that exports from the earthquake-hit zone have shown a recovery trend after the post-disaster decline. Participation in production is expected to gradually pick up in the upcoming weeks on the back of intensive measures taken for employees. In the meantime, detailed information obtained from field interviews indicate that the industrial production infrastructure in the affected region has been largely maintained and production has been sustained. While the earthquake is expected to affect economic activity in the near term, it is anticipated that it will not have a permanent impact on performance of the Turkish economy in the medium term.

17. In December 2022, seasonally adjusted employment remained almost flat compared to the previous month, while increasing by 1.8% on a quarterly basis. The seasonally adjusted labor force participation rate increased by 0.1 points monthly to 54.1%, yet the unemployment rate went up by 0.1 points month-on-month to 10.3%. In the last quarter of 2022, employment posted quarterly growth across all sectors. Survey indicators and high-frequency data indicate that the upward trend in employment is maintained.

18. Despite the increase in the foreign trade deficit led by the acceleration in gold imports, the ongoing upward trend in services revenues continues 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 throughout the year. On the other hand, domestic consumption demand, high level of energy prices and the weak economic activity in main trade partners keep the risks on current account balance alive. Sustainable current account balance is important for price stability.

Monetary Policy

19. 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.

20. 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.

21. The Committee will prioritize the creation of supportive financial conditions in order to minimize the effects of the disaster and support the necessary recovery. Accordingly, in addition to the existing supportive measures, the Committee considered the issue of making

a revision in the tools that support the liquidity conditions, if necessary, as stated in the Monetary Policy and Liraization Strategy for 2023.

22. After the earthquake, it has become even more important to keep financial conditions supportive to preserve the growth momentum in industrial production and the positive trend in employment. Accordingly, the Committee decided to reduce the policy rate by 50 basis points. The Committee assessed that the current monetary policy stance after the measured reduction is adequate to support the necessary recovery in the aftermath of the earthquake by maintaining price stability and financial stability. The effects of the earthquake in the first half of 2023 will be closely monitored.

23. The CBRT will implement Liraization Strategy in order to create an institutional basis for permanent and sustainable price stability. As announced in the 2023 Monetary Policy and Liraization Strategy document, the Committee will continue to decisively use the tools supporting the effectiveness of the monetary transmission mechanism and the entire policy toolset, particularly funding channels, will be aligned with liraization targets. 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 Open Market Operations funding, to reduce the weight of swaps in the composition of funding, and to strengthen foreign exchange reserves.

24. The rise in the demand for long-term, fixed-income and Turkish lira-denominated assets and the course of the yield curve in tandem with the direction of the efficiency of monetary transmission are 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.

25. 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.

26. The CBRT will continue to use all available instruments decisively until strong indicators point to a permanent fall in inflation and the medium-term 5% target is achieved in pursuit of the primary objective of price stability.

27. 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.

28. The Committee supports building strong policy coordination and a holistic macro policy mix involving all stakeholders in order to achieve price stability.

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