Summary of the Monetary Policy Committee Meeting

26 January 2023, No: 2023-06

Meeting Date: 19 January 2023

Inflation Developments

1. Consumer prices rose by 1.18%, and annual inflation decreased by 20.12 points to 64.27% in December. Mild price movements pulled annual inflation down across all subgroups, while core goods and food groups became the main contributors of this fall. Annual inflation decreased across all subgroups of core goods, with durable goods in the lead. Prices in the energy group registered a decline due mainly to the fall in fuel prices. Price increases in the food group remained more limited compared to previous months due to the correction in the prices of fresh fruits and vegetables. Producer prices declined due to tumbling prices in petroleum and petroleum products as well as electricity and natural gas, while, sectors excluding energy recorded mild price increases. The fall in headline producer prices led to a sustained decline in annual producer inflation. Against this background, according to the seasonally adjusted data, the slowdown in monthly change in the B index continued, while the C index crept up, and annual inflation of both indices decreased significantly.
2. Annual inflation in food and non-alcoholic beverages fell by 24.68 points to 77.87%. Annual inflation fell by 23.99 points to 73.25% in unprocessed food, and by 25.35 points to 82.00% in processed food, respectively. Seasonally-adjusted data for the unprocessed food group points to a decline in the prices of fresh fruits and vegetables in December, with a more pronounced fall in vegetable prices. In the other unprocessed food subgroup, price hikes in red meat as well as rice and potato stood out. In the unprocessed food group, monthly price increases decelerated to 2.23%. The bread and cereals item recorded further increases in December, while fats and oils as well as canned vegetables in the other processed food group exhibited high price increases.
3. Energy prices decreased by 2.12% in December, and annual inflation in this group dropped by 23.57 points to 94.43%. Despite the hike in municipal water prices, energy prices fell in this period due to tumbling fuel prices in tandem with the decline in international crude oil prices.
4. Services prices rose by 1.85% in December, and the group’s annual inflation decreased by 5.23 points to 55.49%. Annual inflation dropped significantly in restaurants-hotels, transport and other services, while it increased in rents and communication. Seasonally-adjusted data suggest that the monthly increase in the rent subgroup remained almost flat, but annual rent inflation increased further. Prices in the restaurants-hotels subgroup were up by 2.61% in December, driven by catering services due to the recent developments in food prices. Prices in the other services subgroup climbed by 1.65%, due to maintenance and repair, health, and recreational and cultural services. The positive outlook for fuel prices was mirrored in transport services, and prices in this subgroup declined by 0.52%.
5. Annual inflation in core goods dropped by 27.15 points to 48.96%. Annual inflation decreased across subgroups, more markedly in durable goods. In durable goods, the tax base

adjustment led to a decrease in automobile prices, while the ongoing upward trend in white goods and furniture prices pushed the prices in this subgroup up by 1.88%. Medicine prices increased due to the revision of the reference euro exchange rate, and accelerated other core goods inflation (3.56%). Prices of clothing and footwear fell by 1.46%, pulling annual inflation down by 25.01%, and continued to affect annual core goods inflation favorably.

6. The January results of the Survey of Market Participants suggested that inflation expectations decreased further. The 12-month ahead inflation expectation was down by 4.48 points to 30.44%, and the 24-month ahead inflation expectation was down by 3.38 points to 17.18%. Meanwhile, the five-year ahead expectation was revised down by 0.44 points to 8.67%.

Factors Affecting Inflation and Risks

7. 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.

8. 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.

9. 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 started to adjust their expectations that the central banks would end the rate hike cycles in the near term on the back of the increasing recession risks.

10. Regarding portfolio flows to emerging economies, bond and equity markets saw inflows in January 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.

11. The favorable outlook in international commodity prices prevailing in the second half of 2022 continued into December, and price decreases were registered in subgroups excluding industrial metal. Although crude oil prices assumed an upward trend as of mid-December due to the easing of lockdown measures in China, their January average remains close to the December average. The fall in natural gas prices observed in December became more evident in January on the back of mild winter conditions. The deceleration in global demand conditions also triggered a decline in international transportation costs. The mild course in exchange rates was maintained in December. Against this background, producer prices decreased by 0.24% in December, led by energy items. Following the monthly decline in producer prices, annual producer inflation dropped by 38.30 points to 97.72%. Across main industrial groupings, annual inflation decreased in all subgroups, most notably in energy. An analysis of monthly price developments by sectors indicates that prices of refined petroleum products as well as electricity and natural gas production declined whereas price increases continued in sectors other than energy.

12. The level and underlying trend of inflation have been improved with the support of the integrated policy approach implemented to strengthen sustainable price stability and financial stability. The effects of slowing foreign demand on aggregate demand conditions and production are closely monitored.

13. A strong growth was observed in the first three quarters of 2022. Indicators for the last quarter of the year show that a slowdown in growth due to the weakening foreign demand is compensated for by the relatively strong course in domestic demand. In November, industrial production declined by 1.1%, adjusted for seasonal and calendar effects, on a monthly basis and it decreased by 1.2% on an annual basis. However, when sectors typically exhibiting high volatility such as other transport that posted a strong increase in the previous month are excluded, the monthly decline in manufacturing industry production was more limited at 0.9%. An analysis of production developments with respect to export share suggests that the fall in industrial production in November was stronger in sectors with high export intensity. On a quarterly basis, the rise in industrial production in the fourth quarter was 1.9% as of November, while it remained limited at 0.5% when typically volatile sectors were excluded.

14. The effects of foreign demand-based pressures observed in the manufacturing industry on domestic demand and supply capacity currently remain limited. Manufacturing industry firms' registered domestic and external orders and future order expectations reveal that the weak course in export order expectations continued in the last quarter, while domestic market order expectations increased. In this context, despite the continued weakening in external demand, domestic demand followed a relatively stronger course. As a matter of fact, while the retail sales volume index increased by 1.5% on a monthly basis in November, the increase on a quarterly basis reached 4.5%. The uptrend in credit card expenditures also continued in the last quarter. Meanwhile, firms' investment and employment expectations for the future decreased slightly in the last quarter.

15. In November, seasonally-adjusted employment increased by 0.9% on a monthly basis and by 1.6% on a quarterly basis. The seasonally adjusted labor force participation rate increased by 0.4 points monthly to 54.1%. In this period, despite the rise in employment, the seasonally-adjusted total unemployment rate remained unchanged compared to the previous month and stayed at 10.2% due to the increase in labor force participation. Survey indicators and high-frequency data indicate that the upward trend in employment is maintained. Compared to peer economies, job creation has been stronger when the post-pandemic period is examined. Considering the sectors that contribute to the employment increase, it is observed that the growth dynamics are supported by structural gains.

16. The strong course of energy and gold imports still affects the current account balance negatively. While the current account balance posted a deficit of 3.7 billion dollars in November, the annualized current account deficit increased by 1.6 billion dollars to 45 billion dollars. The provisional foreign trade data for December suggest that seasonally adjusted exports and imports increased on a monthly basis. In 2022, exports and imports reached 254.2 billion dollars and 364.4 billion dollars, respectively, while foreign trade deficit realized 110.2 billion dollars, mainly due to the annual increase in gold and energy imports. Despite the increase in the foreign trade deficit led by the surge in commodity prices, mainly energy prices, coupled with the acceleration in gold imports, the ongoing upward trend in services revenues continues to support the current account balance. While the 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 likelihood of a recession in main trade partners keep the risks on current account balance alive. Sustainable current account balance is important for price stability.

Monetary Policy

17. 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.

18. 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.

19. 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.

20. It is critically important that financial conditions remain supportive for the sustainability of structural gains in supply and investment capacity by preserving the growth momentum in industrial production and the positive trend in employment in a period of increasing uncertainties regarding global growth as well as further escalation of geopolitical risks. Accordingly, the Committee has decided to keep the policy rate unchanged.

21. The CBRT will implement the Liraization Strategy in order to create an institutional basis for permanent and sustainable price stability. 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 gradually reduce the volume of swaps, and to strengthen foreign exchange reserves.

22. 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.

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 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.

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.