Summary of the Monetary Policy Committee Meeting

11 May 2021, No: 2021-22

Meeting Date: 6 May 2021

Inflation Developments

1. Consumer prices were up by 1.68% in April, and annual inflation increased by 0.95 points to 17.14%. While annual inflation rose in energy, core goods, and services groups, it declined in the food group. The uptrend in commodity prices continued in this period, and inflation was affected by the recent exchange rate developments. Against this background, annual inflation rates of B and C indices increased, and their trends remained high despite some improvement.

2. In April, prices of food and non-alcoholic beverages increased by 2.13% but the group's annual inflation dropped by 0.46 points to 16.98%. Annual inflation edged down by 0.31 points to 14.67% in the unprocessed food group, and by 0.51 points to 19.36% in the processed food group. Seasonally-adjusted data for unprocessed food suggest a rise in prices driven by fresh fruits and vegetables. This was mainly led by the strong increase in vegetable prices due to season transition. Although red and white meat items diverged unfavorably, price increases in other unprocessed food were more moderate. The high base in this group was the main factor bringing annual unprocessed food inflation down. While processed food prices rose by 0.97% month-on-month, international prices continued to affect the prices of fats and oils. It is judged that international agricultural commodity prices, which resumed the uptrend in April, will continue to affect food inflation.

3. While energy prices remained almost flat with only a 0.10% increase in April, annual energy inflation surged by 6.01 points to 18.44%. In April, prices of bottled gas and natural gas increased by 1.64% and 1.07%, respectively, whereas fuel prices were down by 0.78%. In this period of relatively flat international crude oil prices, fuel prices dropped on the back of the sliding-scale system and the price cap practice that increased the system's effectiveness. However, annual energy inflation increased significantly in April due to the pandemic-led low base from the previous year.

4. Annual core goods inflation stood at 23.13% in April. Annual inflation decreased in durable goods but rose in clothing-footwear and other core goods. Durable goods registered exchange rate-driven price increases, mainly led by automobile prices, while the decline in furniture prices had a curbing effect. The upward trend in clothing and footwear prices has persisted since the beginning of the year, and annual inflation climbed by 3.63 points to 10.96% in April with the arrival of the new season. Exchange rate effects were visible in the other core goods group, and the group's annual inflation rose by 2.01 points to 18.81%.

5. In April, services prices increased by 0.72%, and annual services inflation rose by 0.56 points to 13.12. While the rise in annual inflation was more pronounced in restaurants-hotels and other services groups, more limited increases were observed in other subgroups. Annual inflation in restaurants-hotels increased significantly due also to the low base stemming from the lockdown of last year, while monthly price hikes proved notable both in catering

and accommodation services. Price increases in other services were triggered by education services as well as by items such as maintenance-repair of personal transport equipment and dental services that are highly sensitive to exchange rate developments. The rise in private primary and secondary school tuition was mainly driven by the backward indexation behavior and the expiration of temporary VAT reductions. The Committee noted that there might be a temporary fluctuation in services inflation due to the lockdown in May and the possible re-opening in the subsequent period.

6. Inflation expectations continued to increase in May. While the current year-end inflation expectation rose by 0.69 points to 13.81%, the 12-month ahead and 24-month ahead inflation expectations increased by 0.55 points and 0.44 points to 11.81% and 9.99%, respectively.

Factors Affecting Inflation and Risks

7. The global economy, having contracted sharply in 2020 due to the pandemic, continues to recover on the back of accommodative policies and positive developments in the vaccination process. This improvement process is determined especially by the acceleration in manufacturing industry activity and global trade. However, despite ongoing vaccination efforts, risks to the global economic activity prevail due to uncertainties pertaining to the course of the pandemic.

8. Commodity prices have increased again in the recent period. Moreover, in tandem with improved growth expectations in advanced economies, the effects of the rising global inflation expectations on international financial markets remain significant. The normalization process has started in emerging economies, where policy rates remain well below historical averages. Long-term bond rates lead to uncertainties about advanced economy monetary policies, and volatility in global financial markets. The Committee noted that global inflationary pressures may lead to a tightening in monetary policies earlier than current projections, and maintained its assessment that a period marked by increased data-sensitivity and related volatilities in global financial markets was entered.

9. Since the last MPC meeting, portfolio flows to emerging economies have continued at a mild pace in both bond markets and equity markets. The volatility in long-term bond rates in advanced economies keeps the risks to portfolio flows to emerging economies alive.

10. Driven by commodity prices and exchange rate developments, producer prices recorded a high rate of increase spread across the sectors in April as well. Moreover, supply constraints arising from disruptions in supply chains continue to have an adverse effect on the producer inflation.

11. In addition to commercial loans, consumer loans exhibit a milder course. The Committee assessed that the demand and cost-side inflationary effects persisted while a slight deceleration was observed in aggregate demand.

12. Despite the constraining effect of the pandemic, domestic economic activity is strong. Manufacturing industry activity exhibits a strong momentum. The seasonally-adjusted capacity utilization rate rose by 0.6 points to 76.2%, hovering close to pre-pandemic levels. While domestic demand has slightly decelerated due to pandemic restrictions, external demand remains strong. PMI data for April point to a sustained rise in export orders and a partial deceleration in domestic orders.

13. The weak course continues in the services sector, which has been adversely affected by the pandemic restrictions. The weekly credit card expenditures data suggest that after posting a recovery in March, the services sector activity weakened in the second half of April due to the re-tightening of pandemic measures. The Committee assessed that the additional

pandemic measures announced for the 29 April-17 May 2021 period would continue to slow down economic activity, however this slowdown would remain more limited compared to the last year's lockdown period. Nevertheless, risks for economic activity exist in either direction depending on the progress of the pandemic and the vaccination process.

14. In February, nonfarm employment remained flat while total and nonfarm unemployment rates rose by 0.7 points to 13.4% and 15.3%, respectively, due to the increase in the participation rate. The high-frequency labor market data suggest that amid tighter restrictions, the improvement trend in the labor market has come to a halt, and job opportunities have remained relatively weak in sectors directly affected by the restrictions and with more limited opportunity for remote work. In the manufacturing sector, the trend of employment remains strong.

15. Despite the rise in commodity prices, the strong upward trend in exports, the significant fall in gold imports and the slowdown in credit amid the tightening of financial conditions support the expected improvement in the current account balance. Preliminary data indicate that in April, exports excluding gold continued to rise on a monthly basis, whereas imports excluding gold declined in spite of the rise in commodity prices. The fall of gold imports significantly below their historical average in April after a gradual slowdown from the second half of January had a positive effect on the foreign trade balance. As the slowing effects of the tightening in financial conditions on the domestic demand and imports become more pronounced in the upcoming period, it is expected that the external balance will continue to improve. The Committee reiterated its assessment that supply problems in certain sectors, the automotive sector in particular, might constitute downside risk factors for the current account balance. 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. Demand and cost factors, supply constraints in some sectors, and high levels of inflation expectations continue to pose risks to the pricing behavior and inflation outlook. The decelerating impact of the monetary tightening on credit and domestic demand has begun to be observed. Taking into account the high levels of inflation and inflation expectations, the current monetary policy stance will be maintained until the significant fall in the April Inflation Report's forecast path is achieved. Accordingly, the Committee has decided to maintain the tight monetary policy stance by keeping the policy rate unchanged at 19%.

18. 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 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. Consumer loans, along with commercial loans, exhibit a milder course, and the durability of this development is monitored for macroeconomic stability. The outlook for domestic demand, international prices and global risk appetite heightens the risks arising from external financing needs to the balance of payments. 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.