

Summary of the Monetary Policy Committee Meeting

25 November 2021, No: 2021-52

Meeting Date: 18 November 2021

Inflation Developments

1. In October, consumer prices surged by 2.39%, and annual inflation rose by 0.31 points to 19.89%, mainly due to price hikes in energy and tobacco. In this period, international energy prices climbed, while domestic energy prices increased sharply coupled with the developments in Turkish lira. Tobacco prices soared due to higher price adjustments by tobacco firms for cigarettes, adding approximately 0.30 points to consumer inflation. Despite a slight drop, annual food inflation remained high. Producer inflation increased across subcategories due to developments in the Turkish lira, surging commodity prices and ongoing supply constraints. Accordingly, annual inflation in B and C indices fell slightly but recent trends remained high despite some deceleration.
2. Food and non-alcoholic beverages prices were up 1.92% in October, while annual inflation dropped by 1.38 points to 27.41% in this subcategory amid a high base from a year earlier. Annual inflation decreased to 29.20% and 25.71% in unprocessed food and processed food, respectively. Prices of fresh fruits and vegetables were the main driver of the decline in annual unprocessed food inflation. Meanwhile, the correction in fresh fruits and vegetables prices that started in September on a seasonally adjusted basis continued into this period on the back of prices of fresh fruits. In other unprocessed food group, price hikes were more notable for pulses, milk and potatoes due to an agricultural drought-driven yield loss, exchange rate developments and input costs. In processed food group, where widespread price increases occurred, bread and cereal prices accelerated further, by 3.16%, under pressure from the negative course of international and domestic wheat prices.
3. Energy prices jumped by 4.58% in October, while annual energy inflation rose by 2.99 points to 25.76%. In this period, international energy prices rose sharply in US dollar terms, while fuel, bottled gas and solid fuel prices recorded large monthly increases coupled with the developments in the Turkish lira.
4. Prices of core goods increased by 2.49% in October, and annual core goods inflation fell by 0.92 points to 18.46%. Annual inflation decreased in durable goods, remained flat in other core goods and increased in clothing and footwear. Prices of durable goods were up 1.23% in October on the back of white goods price increases, while the moderate course in furniture and automobile prices limited the monthly inflation in this subcategory. As a result, annual durable goods inflation decreased by 1.88 points to 20.24%. Rising at a lower rate than the seasonal average in October, clothing and footwear prices recorded higher annual inflation due to a pandemic-led low base from a year earlier.
5. Services prices increased by 1.04% in October, and annual services inflation rose by 0.37 points to 15.43%. While annual inflation decreased in transport and other services, it remained flat in communication services, and increased in rent and restaurants-hotels. Due

to the outlook of food prices and the expiry of the temporary VAT cuts, price hikes in the restaurants-hotels group continued in October and weighed on services inflation. Furthermore, rent inflation remained on an upward track in seasonally adjusted terms.

6. According to the Survey of Market Participants, inflation expectations continued to be revised upward in November. The current year-end inflation expectation rose by 1.68 points to 19.31%, while the 12-month ahead inflation expectation increased by 1.70 points to 15.61%. Currently, the 24-month ahead inflation expectation is 11.76% and the five-year ahead inflation expectation is 7.96%.

Factors Affecting Inflation and Risks

7. Leading indicators show that the robust recovery in the global economy is sustained, albeit with some deceleration in certain regions. Confidence indices in US have recently declined due to the pandemic, while they have recorded a partial improvement in some European countries. Despite the recovery in global economic activity in the first half of the year and the increase in the vaccination rate, new variants keep the downside risks to global economic activity alive.
8. Recovery in global demand, the high course of commodity prices, supply constraints in some sectors and the rise in transportation costs have led to producer and consumer price increases internationally. Unfavorable effects of weather conditions in major agricultural commodity-exporting countries are observed on global food prices. While the effects of high global inflation on inflation expectations and international financial markets are closely monitored, central banks in advanced economies assess that the rise in inflation on the back of rising energy prices and imbalances between supply and demand may last longer than previously anticipated. However, many central banks are of the opinion that the increase in inflation is temporary, depending on the assessment that the increase in inflation is due to transitory factors. Accordingly, central banks in advanced economies continue their supportive monetary stances and asset purchase programs.
9. Emerging market debt securities markets have witnessed fluctuations, while there have been inflows to equity markets since the second half of October. 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. The impact of such risks through portfolio flows channel towards Turkey are judged to prove to be relatively limited, considering the current levels of non-residents' portfolio positions.
10. Producer inflation increased in October due to the outlook of the Turkish lira, the ongoing rise in commodity prices, with energy in the lead, and supply constraints. Price hikes were registered across the index, while the largest price increases took place in energy group, particularly in refined petroleum products, gas production, water and coal. Among intermediate goods, another subcategory with high price increases, mainly metal-related groups, textile-related items, sewing thread and fibers, basic chemicals as well as plastic and paper products stood out.
11. Leading indicators show that domestic economic activity remains strong with the help of robust external demand. Industrial production declined by 1.5% percent month-on-month on account of the items that recorded historical fluctuations and interruption in production led by supply disruptions in September. However, in the third quarter, industrial production rose by 1.6% quarter-on-quarter and remained on an upward trend. Turnover indices indicate that external demand continued to support industrial production in the third quarter. Investment tendencies of manufacturing industry firms for the next twelve months continue to strengthen.

12. The spread of domestic vaccination throughout the society facilitates the recovery in services, tourism and related sectors, which have been adversely affected by the pandemic, and leads to a more balanced composition in economic activity. The retail sales volume and services turnover indices registered a strong increase in the third quarter thanks particularly to tourism-related sectors. The easing of restrictions, together with the strong vaccination momentum, played a role in the significant recovery trend in tourism and related services items. While the demand for durable consumer goods slows down, recovery continues in non-durable consumer goods.
13. The course of employment in the third quarter was in line with the rebalancing in the economic activity underpinned by the recovery in tourism and strong exports. The increase in non-farm employment compared to the previous quarter accelerated and became 2.5% in the third quarter. Meanwhile, services employment increased by 3.0% quarter-on-quarter driven by restaurants-hotels and retail trade sectors and manufacturing and construction sectors also contributed to the increase in employment. Despite the increase in the labor force participation rate, the unemployment rate decreased to 11.5% in September owing to the strong increase in employment. Survey indicators and high-frequency data suggest that the improvement in the employment outlook and the positive course in the labor market continue.
14. Favorable external demand conditions impact the current account balance positively. The current account balance posted a surplus of USD 1.7 billion in September while it decreased by USD 4 billion to USD 18.4 billion in 12-month cumulative terms. Provisional foreign trade data suggest that seasonally adjusted exports and imports excluding gold rose in October, being stronger in exports, and the exports to imports coverage ratio increased. Meanwhile, the recovery trend in tourism revenues became more evident. The improvement in annualized current account is expected to continue in the rest of the year due to the strong upward trend in exports, and the strengthening of this trend is important for the price stability objective.

Monetary Policy

15. The monetary policy stance will be set 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 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, inflation expectations, as well as the temporary factors projected to bear effect on these in the short term, 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.
16. Recent increase in inflation has been driven by supply-side factors such as rise in food and import prices, especially in energy, and supply constraints, increase in administered prices and demand developments. The revision in the monetary policy stance began to affect commercial loans positively. In addition, developments in consumer loans are closely monitored. The Committee evaluated the analyses to decompose the impact of demand factors that monetary policy can have an effect, core inflation developments and supply shocks and decided to reduce the policy rate by 100 basis points to 15 percent. The Committee expects that the transitory effects of supply-side factors and other factors beyond monetary policy's control on price increases will persist through the first half of 2022. The Committee will consider to complete the use of the limited room implied by these factors in December.

17. In order to limit the risks arising from climate-based and other environmental risks, the CBRT decided to establish a new unit called the “Green Economy and Climate Change Division”, within the scope of its decision to support sustainable finance practices as a long-term policy without prejudice to the main objectives of monetary policy. It is aimed that the said unit will carry out studies in order to identify the vulnerabilities and opportunities that climate change may create in the financial system and to reduce related risks.
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. However, a sufficiently tight monetary stance to ensure the return of inflation to its downward trend once temporary effects disappear, will serve as a significant buffer against external and temporary volatilities in the context of inflation expectations, the pricing behavior and financial market developments.
19. 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 percent target is achieved in pursuit of the primary objective of price stability.
20. 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.
21. Demand and cost-side effects are closely monitored for inflation given the developments in the credit market, economic activity, supply-side factors, and import prices. The outlook for monetary policies in advanced economies and the global risk appetite heighten the risks to portfolio flows towards emerging economies. In formulating the monetary policy towards achieving the price stability objective, the Committee will continue to follow an approach that also addresses risks to financial stability. In this context, the effect of macroprudential policies on credit and the CBRT funding’s composition between OMO and swap transactions are closely monitored.
22. The Committee reiterated that in order to achieve price stability, 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.