TÜRKİYE CUMHURİYET MERKEZ BANKASI

Summary of the Monetary Policy Committee Meeting

24 June 2021, No: 2021-26

Meeting Date: 17 June 2021

Inflation Developments

1. Consumer prices rose by 0.89% in May, while annual inflation decreased by 0.55 points to 16.59%. Annual inflation receded in energy and core goods; remained relatively flat in the food group and increased in services. In this period, lockdown measures led to interruptions in economic activity in certain sectors, which recorded only limited price increases, in turn. Against this background, annual inflation rates and trends of B and C indices registered some decline, maintaining their high levels.

2. In May, prices of food and non-alcoholic beverages increased by 0.29% and the group's annual inflation crept up by 0.06 points to 17.04%. Annual inflation edged down by 0.06 points to 14.61% in the unprocessed food group, but rose by 0.13 points to 19.49% in the processed food group. Annual inflation receded in fresh fruits and vegetables within the unprocessed food group, whereas it increased in the other unprocessed food group due to the hike in red meat prices. Meanwhile, processed food prices registered a monthly increase of 0.87%. Prices in the bread and cereals group rose by 1.00%, while non-alcoholic beverages stood out among other processed food. Moreover, increase in raw milk reference prices became another factor to keep risks to food inflation brisk. The uptrend in international food and agricultural commodity prices accelerated in May, and price hikes spread across all subcategories, with cereals and fats and oils in the lead.

3. Energy prices rose by 1.50% in May, while the group's annual inflation declined by 0.73% to 17.71%. This is attributed to fuel prices that increased by 3.84% due to the uptick in international crude oil prices and exchange rate developments accompanied by adjustments in the sliding-scale system and termination of the price cap practice. It is considered that fuel prices will increase also in June amid the carry-over effects of the SCT rise in May, yet the high base effect will cause annual energy inflation to decline further. It should be emphasized that despite the recent adjustments, the sliding-scale practice continues to limit price increases both directly and indirectly.

4. Prices of core goods rose by 0.86% in May and annual core goods inflation decreased by 2.29% to 20.84%. Annual inflation decreased across all subcategories, particularly in clothing and footwear. The recent trend of upsurge in the clothing and footwear group lost sizeable momentum due to lockdown effects, and annual inflation declined by 5.40 points to 5.56%. In durable goods, prices increased by 0.91%, while annual inflation decreased by 1.76 points, yet remained high at 30.74%. In addition to international commodity prices, exchange rate effects were visible in automobile and furniture items, while the mild course in electrical and non-electrical appliances limited the inflation.

5. In May, services prices increased by 1.18%, and annual services inflation rose by 0.50 points to 13.62%. Annual inflation surged in transport services; rose by a more limited rate in restaurants-hotels, communication and rent; and declined somewhat in other services. The

surge in annual transport services inflation is attributed also to the increases in intercity bus fares due to capacity constraints led by pandemic measures. Price increases in the restaurants-hotels group remained quite moderate due to lockdown, while annual inflation maintained its uptrend owing to the low base.

6. Inflation expectations of market participants increased in June. While the current year-end inflation expectation rose by 0.65 points to 14.46%, the 12-month ahead and 24-month ahead inflation expectations increased by 0.31 points and 0.17 points to 12.12% and 10.16%, respectively.

Factors Affecting Inflation and Risks

7. The worldwide speeding up of vaccination rollout, especially in developed countries, supports the global economic recovery. Accelerated activity in the manufacturing industry and global trade as well as improvements in services bolster this recovery process. Pandemic-led downside risks to the global economic performance are reduced amid ongoing vaccination efforts.

8. The 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, the expectations of policy rate hike have been brought forward in tandem with the median expectations of the FOMC members, while inflation projections have also increased. The normalization process has started in emerging economies, where policy rates remain well below historical averages. This outlook points to increased uncertainties and a slight tightening in global financial conditions compared to the previous MPC Meeting period. 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. Since the last MPC meeting, portfolio inflows to emerging economies have been favorable in both bond markets and equity markets. 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, exchange rate developments and supply constraints, producer prices recorded a high rate of increase also in May, which spread across the sectors. Although non-energy commodity prices displayed a slightly favorable outlook in June, it is considered that cost pressures on consumer prices have remained strong because of the depreciation in the Turkish lira and cumulative effects.

11. Loan growth exhibits a mild course owing to the monetary tightening. However, short-term trends show that retail loan utilization has increased notably owing also to the deferred demand because of pandemic-led restrictions. The Committee assessed that a milder growth in retail loans is critical to curb risks to the inflation outlook and external balance. Accordingly, the course and composition of loans are monitored for macroeconomic stability.

12. Domestic economic activity is strong. Having increased by 7.0% annually and 1.7% quarterly in the first quarter of 2021, GDP confirmed the past evaluations of economic activity being above its potential despite the restraining effects of the pandemic. In this period, final domestic demand slowed down due to private consumption, while total investments and net exports made a positive contribution to the quarterly growth. On the production side,

while the industrial and construction value-added were the main determinant of quarterly growth, the services value-added made a limited contribution to growth due to pandemic-led restrictions.

13. While domestic demand has slightly decelerated in the second quarter due to pandemic restrictions and the tightening in financial conditions, external demand remains strong. The April readings of industrial production, turnover index and retail sales volume index revealed that the measures taken to prevent the spread of the pandemic as of mid-April restricted the economic activity. In April, the industrial production index decreased by 0.9% month-on-month and 0.3% quarter-on-quarter. Industrial turnover indices suggested that the slowdown in this period was driven by domestic demand. Likewise, while the services turnover index declined due to accommodation and catering services, the retail sales volume also went down amid restrictions.

14. High-frequency data indicate that the additional pandemic measures announced for the 29 April-17 May 2021 period continued to slow down economic activity, and that, along with the gradual normalization steps, the rapidly increasing mobility exceeding the levels before the measures, point to a significant recovery in economic activity in the subsequent period. In fact, the weekly credit card expenditures data suggest that services sectors and retail trade items, which were affected more by the restrictions, registered substantial increases starting from the second half of May. For the period ahead, 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.

15. The impact of restrictions on economic activity was also reflected in the labor market. While non-farm employment dropped by 1.1% in April over the previous month, the total unemployment rate rose by 0.9 points to 13.9%. High-frequency data suggest a rapid recovery in job opportunities and labor force participation rates 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.

16. In April, the seasonally-adjusted current account balance started to improve. According to preliminary foreign trade data for May, seasonally-adjusted exports and imports excluding gold increased on a monthly basis. Despite the rise in commodity prices, the strong upward trend in exports, the slowdown in credit growth, the significant fall in gold imports and the strong progress in the vaccination program stimulating tourism activities are expected to accelerate the ongoing improvement in 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

17. 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.

18. In addition to the recent import-price-based cost factors, demand conditions, supply constraints in some sectors, 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 has begun to be 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 Committee has decided to keep the policy rate unchanged at 19%.

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

20. 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.

21. 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.

22. 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. The ongoing improvement in the current account balance is expected to become more evident in the upcoming months due to the developments in foreign trade and tourism. On the other hand, 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.

23. 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.

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