TÜRKİYE CUMHURİYET MERKEZ BANKASI

Summary of the Monetary Policy Committee Meeting

30 March 2023, No: 2023-14

Meeting Date: 23 March 2023

Inflation Developments

1. In February, consumer prices increased by 3.15%, while annual inflation decreased by 2.50 points to 55.18%. The annual inflation decreased across all groups, being more pronounced in the energy group. On a monthly basis, the rise in food and services groups stood out with price increases. Supported by the significant fall in energy prices, producer prices remained limited and the decline in annual producer inflation continued in February. Against this background, seasonally adjusted data point that the monthly increase in B and C indices slowed down significantly compared to January, while annual inflation decreased in both indices.
2. In February, prices in the food and non-alcoholic beverages group increased by 7.36%, while annual inflation in this group fell by 1.67 points to 69.33%. Annual inflation fell by 2.67 points to 66.13% in unprocessed food and increased by 0.31 points to 73.87% in processed food. Seasonally adjusted data point that prices of fresh fruits and vegetables increased in February, more visibly in the vegetables group. Besides fresh fruits and vegetables prices, the red meat prices stood out with price increases, while prices of processed food items related to these products displayed a similar course. On the other hand, as the fixed price campaigns in the retail sector ended, prices of milk and dairy products increased.
3. In February, energy prices rose by 0.64%, and annual inflation in this group dropped by 5.02 points to 50.01%. The stable course of exchange rates and the favorable outlook in international energy prices led to moderate price movements in this group. Due to developments in international propane and butane prices, bottled gas prices diverged from the general trend.
4. Prices in the services group increased by 3.14% while the group's annual inflation decreased by 0.78 points to 61.64%. While annual inflation rose to a limited extent in the rents subgroup, it remained flat in communication and other services, and declined in transport and restaurants-hotels subgroups. As effects arising from time-dependent price adjustments and the minimum wage adjustment faded, the rise in services group prices weakened in February. Due to the moderate course of fuel prices as well as the fall in passenger transport by air tariffs, the monthly rise in the prices of transport services remained limited, and annual inflation in the subgroup decreased by 7.70 points to 70.27%. The monthly increase in the rents subgroup significantly decelerated compared to January and remained at 2.66%. Prices in the other services subgroup increased by 3.64%, while maintenance and repair of personal transport equipment and education services prices were remarkable. Meanwhile, in the restaurants-hotels subgroup, prices were up by 4.07% while annual inflation in the subgroup displayed a limited fall and came down to 74.34%.
5. Annual inflation in core goods declined by 3.76 points to 41.06% in February. Annual inflation fell across all subgroups, more markedly in other core goods. In February, prices of durable

goods (excluding gold) rose by 2.49%, driven by automobiles and furniture, while prices of white goods remained flat as opposed to previous months. Against this background, annual inflation in the durable goods subgroup decreased by 1.09 points to 44.93%. In other core goods, prices were up by 1.14% in February, showing a significant slowdown compared to previous months, and annual inflation in this subgroup dropped by 8.38 points to 48.48%. Prices in the clothing and footwear subgroup were down by 1.89% on the back of the ongoing seasonal discounts, pulling annual inflation down by 2.61 points to 20.71%.

6. According to the March results of the Survey of Market Participants, the 12-month ahead inflation expectation edged up by 0.88 points to 31.63%, while the 24-month ahead inflation expectation declined by 0.20 points to 17.91%. The five-year ahead inflation expectation, on the other hand, was measured as 9.00%.

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 geopolitical risks and interest rate hikes continue, and conditions threatening financial stability have emerged.

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. While the divergence in monetary policy steps and communications of central banks in advanced economies continue due to their diverse economic outlook, coordinated steps are taken that prioritize financial stability through swap agreements and new liquidity facilities. Financial markets have been adjusting their expectations that the central banks would end the rate hike cycles in the near term.

10. Regarding portfolio flows to emerging economies, bond and equity markets saw outflows in March parallel to the decline in the global risk appetite. In the meantime, 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. International commodity prices went down in February, driven by energy and industrial metal sub-indices, whereas the agriculture sub-index posted a limited increase. The fall in international natural gas prices continued in March amid mild weather conditions and the significant build-up of gas stocks. Accordingly, industrial natural gas tariffs were revised down further in March. International transportation costs remained on a downward trend in February, while the recent stable course of exchange rates was maintained. Against this background, the rise in producer prices decelerated compared to January, and the downward trend in annual producer inflation continued.

12. 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.

13. Gross Domestic Product (GDP) data for the last quarter of 2022 indicate a quarterly recovery in economic activity despite a slight decline in the growth rate in annual terms compared to the third quarter. GDP rose by 3.5% on an annual basis in this period, while it increased quarter-on-quarter by 0.9% in seasonally and calendar adjusted terms. Thus, the overall growth in 2022 stood at 5.6%. Throughout the year, the share of net exports and investments in GDP remained above historical averages. Machinery-equipment investments, one of the sub-items of investments, maintained their upward trend in annual terms for the thirteenth

consecutive quarter. While the largest contribution to growth came from domestic demand in the last quarter of 2022, the impact of weak foreign demand was mirrored in the industrial sector's contribution to growth.

14. Before the disaster of the century, leading indicators have been 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. In January, industrial production rose by 1.9% in seasonally and calendar adjusted terms on a monthly basis and by 7% on an annual basis. Thus, industrial production increased by 2.6% quarterly as of January. Meanwhile, the retail sales volume index increased by 5.4% on a monthly basis in January. The quarterly flat course in registered export orders of manufacturing firms as well as the increase in registered domestic orders confirm that domestic demand was stronger compared to foreign demand.

15. 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. High-frequency foreign trade data for March, on the other hand, suggest that exports from the earthquake-hit zone have shown a recovery trend following the post-disaster decline. Likewise, high-frequency labor market data imply that job posts and applications across the country recovered in the following weeks despite a limited loss of momentum in the aftermath of the earthquake. Card expenditures, on the other hand, are slightly below the pre-earthquake trend in the disaster zone. 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.

16. In January 2023, seasonally adjusted employment increased by 0.8% (264 thousand people) compared to the previous month, while it rose by 1.2% (377 thousand people) on a quarterly basis. The seasonally adjusted labor force participation rate remained unchanged compared to previous month and stood at 54.1%, while the unemployment rate fell by 0.6 points to 9.7% on a monthly basis. Survey indicators and high-frequency data indicate that the upward trend in employment has been maintained, albeit a slight deceleration after the earthquake.

17. 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 remains high, 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

18. 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.

19. 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.

20. 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.

21. 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 after the earthquake. Accordingly, the Committee has decided to keep the policy rate unchanged. The Committee assessed that the current monetary policy stance 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.

22. 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.

23. 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.

24. 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.

25. 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.

26. 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.

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

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