TÜRKİYE CUMHURİYET MERKEZ BANKASI

Summary of the Monetary Policy Committee Meeting

19 August 2021, No: 2021-37

Meeting Date: 12 August 2021

Inflation Developments

1. Consumer prices rose by 1.80% in July, and annual inflation increased by 1.42 points to 18.95%. While this development was mainly driven by the rise in food and energy groups, annual inflation increased moderately in services and decreased slightly in core goods. In July, the Turkish lira followed a mild course while international energy prices rose, and non-energy commodity markets continued to register decreases, albeit to a limited extent. Nonetheless, producer inflation remained on the rise due to lagged effects and the ongoing disruptions in supply chains. Against this background, annual inflation increased in the B index but decreased in the C index, while the recent trends of these core indicators remained high.
2. In July, prices of food and non-alcoholic beverages increased by 2.77%, and the group's annual inflation rose by 4.93 points to 24.92%. In addition to the high levels of international agricultural commodity and food prices, cumulative exchange rate effects, and weather conditions, supply constraints for certain products affected food producer inflation adversely, and these increases spilled over into consumer prices with the reopening. Annual inflation rose by 7.03 points to 25.73% in the unprocessed food group, and by 2.93 points to 24.13% in the processed food group. Seasonally adjusted data in the unprocessed food group pointed to a significant monthly increase in the prices of fresh fruits and vegetables, with fruits in the lead. While milk prices rose due to the regulation in raw milk reference prices, there were also increases in prices of some pulses whose domestic production decreased due to weather conditions. In the processed food group, the subcategories that diverged negatively were bread and cereals, cheese and other dairy products, and processed meat products. Another significant subcategory in this period was fats and oils due to external price pressures.
3. Energy prices surged by 6.19% in July while the group's annual inflation rose by 4.23 points to 21.51%. Electricity and natural gas prices increased by 15.01% and 9.84%, respectively, becoming the main drivers of the price dynamics in the energy group. While part of the required price increase in LPG was met through the sliding scale system, part of it was reflected in prices. Bottled gas prices also rose in parallel to the increase in LPG prices.
4. Annual core goods inflation fell by 0.70 points to 21.22% in July. The Turkish lira followed a relatively mild course in this period, which alleviated pressures driven by import prices. Annual inflation decreased in durable consumption goods, but increased in other subcategories. In July, prices of durable goods edged down by 0.11%, while annual inflation thereof registered a decline by 3.68 points to 27.18%. These figures were led mainly by the fall in furniture prices as well as the base effect despite the ongoing monthly increases in electrical and non-electrical appliances, with white goods in the lead. Meanwhile, the clothing and footwear group, which followed a moderate course amid restrictions,

maintained the uptrend stimulated by the reopening, and the group's annual inflation rose by 1.51 points to 8.37%. Reacting more sluggishly to developments in the exchange rate and import prices compared to durable goods, other core goods registered a further increase in annual inflation.

5. In July, services prices increased by 1.32%, while annual group inflation edged up by 0.29 points to 13.75%. Annual inflation rose in restaurants-hotels and transport services, remained flat in rent, and declined in communication and other services. Amid normalization steps, prices increased in the eat-out meals and accommodation services in the restaurants-hotels group in July as well. The negative outlook in catering services is attributable also to the high food inflation. In this period, prices remained relatively flat in transport services, yet annual inflation in this group increased due to the low base. Against this background, prices of services excluding restaurants-hotels recorded a relatively mild course in July.

6. In July, annual inflation in the alcoholic beverages and tobacco group decreased slightly as the increase in the PPI of the last six months was not reflected to lump-sum and minimum lump-sum taxes.

7. The August results of the Survey of Market Participants indicated that the current year-end inflation expectation was revised upwards and the 12-month ahead inflation expectation downwards. Accordingly, while the current year-end inflation expectation rose by 0.66 points to 16.30%, the 12-month ahead inflation expectation fell by 0.14 points to 12.48%. Currently, the 24-month ahead inflation expectation is 10.52%.

Factors Affecting Inflation and Risks

8. Worldwide speeding up of vaccination rollout, especially in developed countries, supports the global economic recovery. Leading indicators suggest that with the normalization steps taken, the services sector, which was affected more by pandemic restrictions, has been accompanying the ongoing recovery in the manufacturing sector. Nonetheless, economies advancing in their vaccination programs exhibit a stronger performance in economic activity by easing the restrictions. On the other hand, some virus variants recently leading to a resurgence of cases keep the downside risks to the global economic activity posed by the uncertainties about the course of the pandemic in place.

9. Strong recovery in global demand, high course of commodity prices, supply constraints in some sectors and 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. The effects of rising global inflation and inflation expectations on international financial markets remain significant. Since the previous MPC Meeting, monthly and annual inflation rates in some developed economies have increased further. The normalization process in emerging economies has continued and some central banks have delivered additional tightening. This outlook points to increased uncertainties and a slight tightening in global financial conditions. The fluctuating course of global risk appetite and 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.

10. In this MPC Meeting period, portfolio outflows from emerging economies have stemmed from equity markets, while bond markets have attracted inflows to a limited extent. 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.

11. Producer inflation continued to rise in July due to the lagged effects of international commodity prices, the lingering problems in supply chains, and the adjustments made to domestic energy prices. In this period, producer prices increased in energy, wood and cork products, the base metal sector, which is one of the sectors providing input to the manufacturing industry, and the construction sector-related non-metallic mineral products. On a global scale, the level hit by producer prices has continued to exert pressure on consumer prices.

12. Commercial loan growth exhibits a mild course. The Committee monitors the adequacy of the implemented macroprudential measures to curb personal loan growth, which recently displayed a rise due to the reopening and deferred demand. The Committee also maintained its assessment that a milder growth in personal loans is critical to curb risks to the inflation outlook and external balance. Accordingly, the course and composition of loans are closely monitored for macroeconomic stability.

13. Domestic economic activity remained strong in the second quarter. In June, the industrial production index increased by 2.3% month-on-month and 23.7% year-on-year. Thus, up 1.6% from the first quarter, production remained strong in the second quarter. Indices for turnover and retail sales volume also recorded a sharp increase in June due to the reopening. However, domestic real turnover in manufacturing and retail sales experienced a quarterly decline in the second quarter.

14. Leading indicators show that domestic economic activity remains strong in the third quarter with the help of robust external demand. High-frequency data show a rapid recovery in the pandemic-stricken subsectors of services amid increased mobility. In fact, the weekly credit card expenditures data suggest that services sectors and retail trade items, which were affected more by the restrictions, registered higher rates of increases. After the reopening, confidence indices registered increases across all sectors in June and July, particularly in services. The acceleration of the 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. In June, total and non-farm unemployment rates were down 2.5 and 2.7 points from May to 10.6% and 12.3%, respectively, thanks to the overall growth of non-farm employment and reduced labor force participation. High-frequency data point to a reopening-induced recovery in the labor market. In this respect, it is assessed that there may be employment increases in the services sector in the upcoming period. However, the rise in labor force participation rates may limit the impact of employment increases on unemployment rates.

16. Favorable external demand conditions and current tight monetary policy impact the current account balance positively. The current account is expected to post a surplus in the rest of the year due to the strong upward trend in exports, and the strong progress in the vaccination program stimulating tourism activities. The improvement in the current account balance is important for the price stability objective. The Committee once again underlined its emphasis on the importance of the course of the current account balance for the sustainability of 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 increases in import prices and administered prices, demand conditions, supply constraints in some sectors, possible volatility in inflation during the summer due to the reopening, and high levels of inflation expectations continue to pose risks to the pricing behavior and inflation outlook. The increase in inflation in July was driven by the rise in food inflation, due to supply-side effects in some products led by climate conditions, the high levels of international agricultural commodity and food prices, as well as the effects of the reopening. On the other hand, the decelerating impact of the monetary tightening on credit and domestic demand is being 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 Inflation Report's forecast path is achieved. Accordingly, the MPC 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 and administered prices in the lead. The impact of possible short-term volatilities in inflation on the underlying trend will be monitored closely for the monetary policy stance. The tight monetary stance will serve as a significant buffer against external and temporary volatilities in the context of inflation expectations, the 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 percent target is reached.

21. 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.

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. While the current tight monetary policy keeps demand-side factors under control by containing loans and domestic demand, it also supports the improvement in the current account balance. Nevertheless, the outlook for monetary policies in advanced economies and the global risk appetite heighten the risks to the portfolio flows towards emerging economies. 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 that in order to achieve price stability, 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.