TÜRKİYE CUMHURİYET MERKEZ BANKASI

Summary of the Monetary Policy Committee Meeting

27 October 2022, No: 2022-44

Meeting Date: 20 October 2022

Inflation Developments

1. Consumer prices rose by 3.08% in September and annual inflation increased by 3.24 points to 83.45%. In this period, annual inflation decreased somewhat in the alcohol-tobacco-gold group whereas it went up in other groups. The most significant contribution to the rise in inflation came from energy and services groups. While the rise in energy inflation was driven by developments in items with administered prices such as electricity, natural gas, and municipal water as well as in solid fuel prices, fuel and bottled gas prices decreased in tandem with international crude oil prices. In September, annual inflation increased in services and food groups. In the core goods group, annual inflation decreased in durable goods while it rose in other subgroups. As the domestic energy prices were affected by natural gas prices that remained elevated due to geopolitical developments, the rise in producer prices accelerated driven by electricity production and gas manufacturing. Against this background, the seasonally adjusted monthly change in B and C indices decelerated somewhat while their annual inflation continued to increase.
2. Prices of food and non-alcoholic beverages increased by 1.97% in September, and annual inflation rose by 2.80 points to 93.05% in this group. Annual inflation increased by 2.88 and 2.52 points to 82.39% and 102.90% in unprocessed and processed food, respectively. In unprocessed food, seasonally-adjusted data pointed to an upsurge in prices of fresh fruits and vegetables on the back of fresh fruit prices in September. In other unprocessed food, price hikes were notable for rice, eggs and nuts, while potato and red meat prices decreased. The increase in processed food prices was driven by bread and cereals as well as canned vegetables and sugar-related products.
3. Energy prices surged by 7.39% in September and annual inflation in this group rose by 11.25 points to 132.98%. This was mainly driven by natural gas and electricity prices, which soared by 20.98% and 20.00%, respectively as a result of the changes in the residential tariffs. Meanwhile, municipal water and solid fuel prices also posted large increases. On the other hand, fuel oil and bottled gas prices decreased in this period following the decline in international crude oil prices.
4. Services prices were up by 3.90% in September, and the group's annual inflation increased by 3.46 points to 57.76%. In this period, annual inflation increased across all subgroups, most visibly in transport services and rents. The rise in transport prices was mainly led by price hikes in urban passenger transport by bus due to school bus fares as well as in passenger transport by air and railway, despite the decline in the fares of intercity passenger transport by road. Against this backdrop, prices in transport went up by 6.95%, pushing annual inflation up by 7.69 points to 97.98%. Rents posted a monthly increase of 5.45%, and seasonally-adjusted data pointed to a continued acceleration trend. In the other services subgroup, the most significant items were education services due to the ongoing rises in university tuition

fees and insurance services due to compulsory vehicle insurance. In the restaurants-hotels subgroup, prices increased at a more moderate pace compared to previous months, and annual inflation in this subgroup edged up by 0.39 points to 81.34%.

5. In September, annual inflation in core goods rose by 0.58 points to 77.49%. The 0.98% increase in prices of durable goods was led by electric and non-electric appliances, whereas the decline in furniture prices had a positive contribution. Thus, annual inflation in durable goods fell by 1.83 points to 89.96%. Due to the start of the new season, annual inflation in the clothing and footwear group increased by 2.24 points to 39.62%. In the other core goods subgroup, personal care products and household-related cleaning materials stood out, and the annual inflation in this group rose by 2.62 points to 82.74%.

6. According to the October results of the Survey of Market Participants, current year-end inflation expectations remained relatively flat at 67.78%, while 12-month ahead inflation expectations increased slightly by 0.60 points to 37.34%. Meanwhile, 24-month ahead inflation expectations stood at 21.17%.

Factors Affecting Inflation and Risks

7. The weakening effects of geopolitical risks on global economic activity continue to increase. Global growth forecasts for the upcoming period are being revised downwards and recession is increasingly assessed as an inevitable risk factor.

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 upward trend in producer and consumer prices continues on an international scale. The effects of high global inflation on inflation expectations and international financial markets are closely monitored. Moreover, central banks in advanced economies emphasize that the rise in inflation may last longer than previously anticipated due to rising energy prices, imbalances between supply and demand, and rigidities in labor markets. The divergence in monetary policy steps and communications of central banks in advanced economies continue to increase due to their diverse economic outlook. It is observed that central banks continue their efforts to develop new supportive measures and tools to cope with the increasing uncertainties in financial markets.

9. Regarding portfolio flows to emerging economies, bond and equity markets have both continued to register outflows in October in line with the global risk appetite. Moreover, 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.

10. Due to the impact of the policy steps taken within the scope of the liraization strategy, Türkiye's Turkish lira-denominated government bond yields, especially in long maturities, performed more favorably in this period compared to peer economies.

11. Increase in inflation is driven by the lagged and indirect effects of rising energy costs resulting from geopolitical developments, effects of pricing formations that are not supported by economic fundamentals, strong negative supply shocks caused by the rise in global energy, food and agricultural commodity prices.

12. Despite moderate international commodity prices and transportation costs, natural gas prices that remained elevated due to geopolitical developments, affected domestic energy prices, leading to an increase in annual producer inflation driven by electricity production and gas manufacturing. According to the main industrial groupings, annual inflation increased across subcategories, more markedly in energy and non-durable consumption goods. Across sectors, in addition to electricity production and gas manufacturing, which recorded significant price increases amid high international natural gas prices, water treatment and

distribution, clothing, coal-lignite, beverages and construction-related products also saw notable price hikes. Meanwhile, seasonally-adjusted underlying trend indicators for producer prices pointed that cost-based price pressures persisted, albeit at a weaker rate.

13. A strong growth was observed in the first half of 2022. Leading indicators for the second half of the year continue pointing to a slowdown in growth due to the weakening foreign demand. While industrial production increased by 2.4 percent in August, adjusted for seasonal and calendar effects, compared to the previous month, it increased by 4.1 percent on an annual basis. Thus, the monthly production loss in the previous month due to bridge days was partially compensated. After growing by 1.9% and 0.9% in the first two quarters of the year, respectively, industrial production dropped by 3.9% in the third quarter as of August. In this period, the quarterly decline in industrial production spread across all manufacturing sectors except vehicles. The retail sales volume index increased quarter-on-quarter in August, but the quarterly growth rate slowed. Similarly, the quarterly increase in credit card spending lost momentum in the third quarter.

14. Pressures on the manufacturing industry due to foreign demand and their currently limited impact on domestic demand and supply capacity are being monitored closely. Survey-based indicators such as Business Tendency Survey, PMI and sectoral confidence indices as well as other high-frequency data point to a continued slowdown in economic activity. Registered domestic and external orders and future order expectations of manufacturing industry firms reveals an ongoing weakening in total demand, which is more pronounced for external demand. Firms' investment and employment expectations declined as of September compared to the second quarter. Information obtained from field interviews also confirm this outlook for the economic activity in this period.

15. As of August, the quarterly employment growth slowed down in the third quarter in tandem with the decelerating economic activity. The seasonally-adjusted employment as per the averages of July and August increased by 0.4% (116 thousand people) compared to the previous quarter, and stood approximately 3.4 million people above its pre-pandemic level (February 2020). Nevertheless, this rate of increase remained below the quarterly employment growth in the first two quarters of 2022 (0.7% and 2.5%, respectively). Meanwhile, compared to peer economies, job creation has been stronger. Considering the sectors that contribute to the employment increase, it is observed that the growth dynamics are supported by structural gains. The seasonally adjusted labor force participation rate on a quarterly basis, which fell by 0.4 points to 52.8% as of August, is approximately 2 points above its pre-pandemic level. An evaluation on a monthly basis indicates that the downward effect of the August employment growth exceeded the upward effect of the increase in labor force participation on the unemployment rate. Thus, the unemployment rate declined by 0.4 points compared to previous month and realized as 9.6%. Survey indicators and high-frequency data indicate that the upward trend in employment remains in place, albeit with a loss of momentum.

16. The strong course of energy and gold imports still affects the current account balance negatively. While the current account balance posted a deficit of USD 3.1 billion in August 2022, the annualized current account deficit increased by USD 4.2 billion to USD 40.9 billion. The provisional foreign trade data for September and the high frequency data for October suggest that the deceleration in exports continues. Having posted a limited deceleration excluding energy and gold, imports, on the other hand, have maintained their strength due to the high level of energy and gold imports. Despite the increase in the foreign trade deficit led by the surge in commodity prices, mainly energy prices, the ongoing uptrend in services revenues continue to support the current account balance. While share of sustainable components of economic growth increases, thanks to the increase in per capita tourist

spending, the stronger than expected contribution of tourism revenues to the current account balance continues. On the other hand, high course of energy prices and the likelihood of a recession in main trade partners keep the risks on current account balance alive. Sustainable current account balance is important for price stability.

Monetary Policy

17. 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.

18. 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. In addition, the spread between policy rate and the loan interest rates driven by the announced macroprudential measures is closely monitored. The Committee will continue to further strengthen the tools supporting the effectiveness of the monetary transmission mechanism.

19. The Committee expects disinflation process to start on the back of measures taken and decisively implemented for strengthening sustainable price and financial stability along with the resolution of the ongoing regional conflict. The effects of slowing foreign demand on aggregate demand conditions and production are closely monitored. It is critically important that financial conditions remain supportive to preserve the growth momentum in industrial production and the positive trend in employment in a period of increasing uncertainties regarding global growth as well as further escalation of geopolitical risks. Accordingly, the Committee has decided to reduce the policy rate by 150 basis points. The Committee evaluated taking a similar step in the following meeting and ending the rate cut cycle.

20. To create an institutional basis for sustainable price stability, the comprehensive review of the policy framework continues with the aim of encouraging permanent and strengthened liraization in all policy tools of the CBRT. 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 OMO funding, to gradually reduce the volume of swaps, and to strengthen foreign exchange reserves.

21. The credit, collateral and liquidity policy actions, of which the review process is finalized, will continue to be implemented to strengthen the effectiveness of the monetary policy transmission mechanism. The rise in the demand for long-term fixed-income and Turkish lira-denominated assets and the course of the yield in tandem with the direction of the efficiency of monetary transmission is 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.

22. 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.

23. The CBRT will continue to use all available instruments decisively within the framework of the liraization strategy 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.

24. 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.

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

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