Summary of the Monetary Policy Committee Meeting

1 December 2022, No: 2022-49

Meeting Date: 24 November 2022

Inflation Developments

1. Consumer prices rose by 3.54% in October and annual inflation increased by 2.06 points to 85.51%. In this period, annual inflation receded in energy and alcoholic beverages, tobacco products and gold groups, but increased in other groups, more markedly in food. While price increases were widespread across the food group, the rise in the prices of fresh fruits and vegetables continued in October, becoming the main driver of the increase in the group's inflation. Annual core goods inflation was up across all subgroups, while the increase in annual inflation in clothing and footwear, which saw the effects of the new season, was more limited compared to other subgroups. In the services group, transportation services came to the forefront in line with the developments fuel prices as well as rents. Despite the hikes in fuel and municipal water prices, annual energy inflation declined. Having decreased somewhat in recent months, global natural gas prices remained still elevated and continued to negatively affect domestic energy prices. As a matter of fact, domestic producer prices rose further in October due to contributions from electricity generation and gas production sectors. Against this background, seasonally-adjusted monthly changes in B and C indices decelerated slightly, while their annual inflation continued to rise.
2. Annual inflation in food and non-alcoholic beverages rose by 6.00 points to 99.05%. While price increases were wide-spread across the group, annual inflation went up by 9.85 points to 92.24% in unprocessed food, and by 2.42 points to 105.32% in processed food. Seasonally-adjusted data indicated that the increase in the prices of fresh fruits and vegetables in the unprocessed food group persisted in October. In addition to fresh fruits and vegetables, the prices of eggs, nuts, rice, milk and red meat had an effect on the increase of prices in the unprocessed food subgroup. In the processed food subgroup, the increasing trend in the prices of bread and cereals persisted, with cheese and other dairy products, sugar-related products and canned vegetables were the other subitems that came to the forefront.
3. Energy prices were up by 2.37% in October, and annual inflation in this group fell by 4.92 points to 128.06%. The October price increase in the energy group was mainly driven by fuel prices, which rose by 3.15% in line with the rise in international crude oil prices. Municipal water, which posted a price hike of 7.17% due to the carry-over effects from the previous month, and solid fuels, whose prices rose by 2.19%, were the other items that stood out. Meanwhile, following the decline in international propane and butane prices, bottled gas prices fell by 1.69% and limited the increase of prices in the group.
4. Services prices were up by 2.63% in October, and the group's annual inflation increased by 2.48 points to 60.24%. In this period, annual inflation increased across all subgroups, most visibly in transport services and rents, as in September. The monthly increase in rents was 4.87%, pushing annual inflation in this subgroup up to 41.24%. Seasonally-adjusted data indicate that the monthly increase in the rent subgroup declined slightly compared to the

previous month, yet remained high. Developments in fuel prices caused transport services prices to increase by 1.97%. Annual inflation in this subgroup rose by 4.22 points to 102.20% driven by urban passenger transport by bus as well as passenger transport by air. Developments in the restaurants-hotels subgroup were led by catering services in line with the food inflation outlook. Prices in other services were shaped mainly by various maintenance-repair, health services, recreation-culture items, and transportation insurance.

5. Annual inflation in core goods rose by 2.16 points to 79.65% in October. Prices of durable goods rose by 2.57% in October, which was driven predominantly by white goods prices. Thus, annual inflation in this subgroup climbed by 2.51 points to 92.47%. With visible effects of the new season, annual inflation in the clothing and footwear group increased by 1.01 points to 40.63%. Price hikes spread across the other core goods group, with personal care products and household-related cleaning materials still in the lead. Prices rose by 2.96% in this subgroup, and annual inflation increased by 2.64 points to 85.38%. Meanwhile, the tax base arrangement introduced to automobiles is expected to pull down the prices of automobiles in a certain segment in December, and affect the group's inflation positively.

6. According to the November results of the Survey of Market Participants, inflation expectations increased to some extent for the short term, but decreased for the long term. 12-month ahead inflation expectations rose slightly by 0.13 points to 37.47%. On the other hand, 24-month ahead and 5-year ahead inflation expectations receded by 0.41 points to 20.76% and 0.17 points to 9.49%, respectively.

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 high level of 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 continues 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 saw inflows in November parallel to the improved global risk appetite. On the other hand, 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. In October, international commodity prices displayed a limited increase. Recently, the pressure on commodity markets has eased due to the weakening trend in global demand conditions that has become more manifest. Excluding energy, commodity prices slightly decreased in October. In crude oil markets, where a volatile course prevails, prices have increased as a result of supply-side decisions. Thanks to favorable stock developments, price movements in international natural gas prices have been more moderate. In addition to these developments, the decreasing trend in international transportation costs continues. On the other hand, despite the recent easing, the lagged effects of the cumulative cost increase in energy prices continue to affect domestic prices. As a matter of fact, the lagged effects of the rise in natural gas prices were reflected on domestic industrial energy tariffs in October, and rising energy costs had widespread effects on producer prices. An analysis of developments in producer prices by sectors reveals that following the price adjustments in electricity and natural gas prices, prices in the electricity-gas-steam and air conditioning and crude oil-natural gas sectors increased significantly and prices of clothing, refined petroleum products, non-metallic mineral products related to construction and beverages sectors displayed a noteworthy increase. Despite the energy-related developments, the seasonally-adjusted underlying trend indicators of producer prices pointed out that the cost-based pressures continued, 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. In September, industrial production adjusted for seasonal and calendar effects decreased by 1.6% quarter-on-quarter against a 0.4% rise on an annual basis. Thus, having increased by 1.8% and 0.8% on a quarterly basis in the first two quarters, industrial production decreased by 4.1% in the third quarter. In this period, the quarterly decline in industrial production spread across all manufacturing sectors except vehicles. While the retail sales volume index and credit card spending continued to increase in the third quarter, their growth momentum decelerated on a quarterly basis.
14. Pressures on the manufacturing industry due to foreign demand and their currently limited impact on domestic demand and supply capacity have been more pronounced. In addition to industrial production realizations, survey-based indicators such as Business Tendency Survey, PMI and sectoral confidence indices as well as other high-frequency data point that the slowdown in economic activity continues. 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. In the third quarter, firms' investment expectations remained flat while employment expectations decreased compared to the previous quarter. Information obtained from field interviews conducted in this quarter also confirm this outlook for the economic activity.
15. In the third quarter, quarterly employment growth slowed down in line with the deceleration in economic activity. In the same period, seasonally adjusted labor participation rate decreased by 0.4 points. On a monthly basis, the unemployment rate increased by 0.3 points in September compared to the previous month and was realized as 10.1%. Survey indicators and high-frequency data indicate that, although losing momentum, the upward trend in employment is maintained. On the other hand, employment gains are more positive compared to peer economies when the post-pandemic period is examined. When the sectors that contribute to the increase in employment are considered, it is seen that the growth dynamics are supported by structural gains.
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 billion in September, the annualized current account deficit increased by USD 5.7 billion to USD 39.2 billion. The

provisional foreign trade data for October suggest that the deceleration in exports continues. Having posted a slowdown 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 continues to support the current account balance. While share of sustainable components of economic growth increases, the stronger than expected contribution of tourism revenues to the current account balance continues. On the other hand, the 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 the policy rate and loan interest rates driven by the announced macroprudential measures is closely monitored.
19. The Committee will continue to decisively use the tools supporting the effectiveness of the monetary transmission mechanism and implement additional measures. In this framework, targets encouraging conversion to Turkish lira deposits under the Liraization Strategy have been fulfilled, and starting from the end of the year, commission rates applicable to required reserves for banks' foreign currency deposits will be varied according to targets regarding Turkish lira deposit shares only.
20. The Committee expects the 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 for the sustainability of structural gains in supply and investment capacity by preserving 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.
21. The Committee assessed that the financing costs of companies' production-oriented activities should be set at reasonable levels in order to minimize the probable effects of aforementioned global uncertainties and risks on investment and production capacity via a proactive approach, thereby maintaining the supply continuity and the current surplus capacity. Accordingly, the Committee has decided to reduce the policy rate by 150 basis points. Considering the increasing risks regarding global demand, the Committee evaluated that the current policy rate is adequate and decided to end the rate cut cycle that started in August.
22. 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.

23. The credit, collateral and liquidity policy actions, of which the review process has been 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 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 comprehensive set of policies to be implemented to boost the effectiveness of the monetary transmission mechanism will be published in the 2023 Monetary and Exchange Rate Policy document in December.

26. The CBRT will continue to use all available instruments decisively within the framework of 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.

27. 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.

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

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