

Summary of the Monetary Policy Committee Meeting

21 April 2022, No: 2022-22

Meeting Date: 14 April 2022

Inflation Developments

1. In March, consumer prices increased by 5.46%, and annual inflation surged by 6.70 points to 61.14%. The upward trend in international commodity prices since the beginning of the year has become more evident in this period amid geopolitical developments, with historic monthly rebounds in March, primarily in energy, metal, food and agricultural commodities. These developments had an impact on domestic energy and food prices in particular. In core goods, annual inflation remained flat in clothing and footwear, but rose in other subgroups. In the services group, developments in transport and restaurants-hotels stood out in line with the outlook for energy and food prices. Stronger increases in international commodity prices and supply chain disruptions continued to drive producer prices up. Against this background, annual inflation of B and C indices increased further in March.
2. Food and non-alcoholic beverages increased by 4.73% in March, and the group's annual inflation rose by 5.86 points to 70.33%. In March, the FAO international food price index in US dollars soared by 12.64%, hitting its all-time high. While this upsurge was driven by cereal, vegetable oil and meat prices, the prices of sugar and dairy products also increased substantially. Significant increases in food and agricultural commodity prices due to geopolitical developments exerted pressure on domestic prices, whereas the carry-over effects of the VAT cut in staple food items averted a more negative outlook. In March, annual inflation continued to rise in both unprocessed and processed food groups, more visibly in unprocessed food. In unprocessed food, seasonally-adjusted prices of fresh fruits and vegetables remained relatively flat, whereas in other unprocessed food group, red and white meat prices, which were affected by higher feed prices amid rising external price pressures, diverged negatively along with potato and egg prices. In processed food group, the increase in bread and cereals was mainly determined by wheat prices, while fats and oils, meat products, sugar and non-alcoholic beverages also stood out. Leading indicators suggest that the rise in food inflation persists due to supply constraints and the lagged effects of the increase in international food and agricultural commodity prices.
3. Energy prices increased by 11.01% in March, and the group's annual inflation rose by 19.96 points to 102.94%. Due to accelerating international energy prices amid geopolitical risks, fuels, bottled gas and solid fuels saw significant month-on-month increases. Meanwhile, the decline in residential electricity prices with the increase in the gradual tariff limit and the VAT reduction restrained energy inflation.
4. Prices of core goods rose by 4.56% in March, and annual core goods inflation increased by 4.81 points to 59.19%. Annual inflation remained flat in the clothing and footwear group, standing at 26.54%. In this period, prices of durable goods accelerated somewhat by 5.09%, primarily led by developments in automobile and furniture items. The price increase in the other core goods group remained strong, with a monthly increase of 5.36%. The VAT

reduction on hygiene products from 18% to 8% in April is expected to affect the other core goods inflation positively.

5. Services prices increased by 4.19% in March, and annual services inflation went up by 3.83 points to 36.72%. Annual inflation rose across all subgroups, most notably in transport and restaurants-hotels. Fuel price increases weighed on transport services. The price increases in intercity passenger transport by road as well as in urban passenger transport by bus and railway were notable in this development. The effect of fuel price developments on transport services is expected to persist also in April. Increases in the costs of main inputs had a negative impact on the restaurants-hotels group, and annual inflation in this group reached 60.40%. The increases in international commodity prices, which accelerated significantly due to geopolitical developments, do not only affect tradable goods but also push services inflation up particularly through fuel and food prices. In the subgroups of other services, price increases spread across sub-items, most notably in education services, where backward indexation is common, and insurance. On the other hand, seasonally adjusted data indicate that the monthly increases in rent slowed down.
6. Prices of alcoholic beverages and tobacco products increased by 3.91% in March due to the producer firms driven increases in cigarette prices, and annual inflation rose to 51.43%. This rise will have carry-over effects in April as well.
7. According to the April results of the Survey of Market Participants, the current year-end inflation expectation rose by 5.97 points to 46.44%, while the 12-month-ahead inflation expectation increased by 1.98 points to 28.41%. Currently, the 24-month-ahead and five-year-ahead inflation expectations stand at 17.68% and 9.23%, respectively.

Factors Affecting Inflation and Risks

8. Leading indicators show that the recovery in the global economy is sustained with some deceleration. However, the ongoing geopolitical risks keep the downside risks to regional and global economic activity alive and increase the uncertainty.
9. Concern over global food security, high course of commodity prices, supply constraints in some sectors that have become more evident particularly in energy, and high transportation costs have led to producer and consumer price increases internationally. The effects of high global inflation on inflation expectations and international financial markets are closely monitored. Moreover, central banks in advanced economies assess that the rise in inflation may last longer than previously anticipated due to rising energy prices and imbalances between supply and demand. Accordingly, while monetary policy communication of central banks in advanced economies varies with their diverse outlook for economic activity, labor market and inflation expectations, they still continue their supportive monetary stances and asset purchase programs at a slower pace.
10. Portfolio flows to emerging economies moved in tandem with the risk appetite and decreased until the last week of March before rebounding with equity markets in the lead. However, 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. The impact of such risks through the portfolio flows channel towards Turkey is judged to prove to be relatively limited, considering the current levels of non-residents' portfolio positions.
11. Increase in inflation in the recent period has been driven by rising energy costs resulting from geopolitical developments, temporary 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. Increases in commodity prices that grew stronger amid geopolitical developments accompanied by ongoing supply problems weighed further on producer prices in March. As a result, annual producer inflation rose across all subcategories, especially in energy prices. Adverse impacts of high levels recorded in energy prices became more evident. Across subcategories, monthly price changes were more noticeable in refined petroleum products, construction-related products, metals, production and distribution of electricity and gas, main pharmaceuticals, tobacco and food products.
13. Level of capacity utilization and other leading indicators show that domestic economic activity remains strong, with the help of more robust external demand, even if some regional differences emerge. Adjusted for seasonal and calendar effects, industrial production rose by 4.4% month-on-month in February, indicating that production losses stemming from electricity and natural gas outages in January were compensated. Thus, production rose by 2% quarter-on-quarter as of January and February averages. Monthly increase in production spread across the sectors, while industrial production was stronger in exporting sectors. Industrial turnover indices also reveal that external demand continued to support industrial production. On the other hand, the January-February average of retail sales volume indices decreased compared to the previous quarter, indicating to a loss of momentum in domestic demand.
14. As of March, investment tendencies of manufacturing industry firms for the next twelve months were high. In the first quarter, firms' registered domestic and export orders as well as expectations for future orders reveal that external demand remains strong, while domestic demand lost pace. In fact, credit card spending indicates some recovery in the February-March period, yet fell slightly on a quarterly basis.
15. Developments in the labor market are in tandem with the outlook of economic activity. In February, seasonally-adjusted unemployment rate stood at 10.7%. As of February, employment increased by 0.7% compared to the previous quarter. The participation rate edged down by 0.2 points to 52.2% in February, and seasonally adjusted total unemployment rate in terms of January-February averages has declined by 0.2 points to 10.9% compared to the previous quarter. Survey indicators and high-frequency data indicate that the positive outlook in the labor market is maintained.
16. The recent strong course of energy imports has been affecting the current account balance adversely. The current account balance posted a deficit of USD 5.2 billion in February, while the annualized current account deficit increased by USD 2.7 billion to USD 21.8 billion. Provisional data on foreign trade indicate that exports remained high in March, while imports increased due to high energy and commodity prices. In this context, regional losses occur in exports in the short term due to the heightened military conflict. It is observed that these losses are compensated by the increase in exports to other countries thanks to the dynamic capacity and market diversification flexibility of exporting firms. Despite this outlook in the foreign trade balance, the favorable course in services revenues continues to support the current account balance. While share of sustainable components of economic growth increases, risks on current account balance due to energy prices continue. 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 that also addresses risks to financial stability will continue to be followed. The Committee also assesses that credit growth including long-term investment loans and the targeted usage of accessed funds for real economic activity are important for financial stability. In this context, the Committee decided to strengthen the macroprudential policy set.
19. The Committee expects the disinflation process to start on the back of measures taken and decisively pursued for sustainable price and financial stability along with the decline in inflation owing to the base effect and the resolution of the ongoing regional conflict. Accordingly, the Committee has decided to keep the policy rate unchanged.
20. While cumulative impact of the recent policy decisions is being monitored, 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. Accordingly, the effects of liquidity and distribution developments of the Turkish lira on deposits and loan pricing, the lagged effects of exchange rate developments on inflation expectations, 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.
22. 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 target of 5 percent is achieved in pursuit of the primary objective of price stability.
23. Stability in the general price level will foster macroeconomic stability and financial stability through the fall in country risk premium, the continuation of the reversal in currency substitution and of the upward trend in foreign exchange reserves, and a 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.
24. The Committee supports building strong policy coordination and a holistic macro policy mix involving all stakeholders in order to achieve price stability.
25. The Committee will continue to take its decisions in a transparent, predictable and data-driven framework.