

HEAD OFFICE

ANKARA, 31 January 2023

Please refer to:

TCMB: 98422658 -

Dr. Nureddin NEBATİ

MINISTER OF TREASURY AND FINANCE

ANKARA

Pursuant to Article 42 of the Central Bank Law No. 1211, when the inflation target cannot be achieved, the Central Bank of the Republic of Türkiye (CBRT) is accountable for reporting to the Government and announcing to the public the reasons for the deviation from the inflation target and the necessary measures to be taken. In 2022, inflation remained above the target range. Accordingly, attached we hereby submit to you the first Inflation Report of 2023 explaining the reasons for the deviation of inflation from the target and the Monetary Policy and Liraization Strategy for 2023 summarizing the monetary policy to be implemented to achieve the inflation target, for your information.

In 2022, all policy instruments of the CBRT were subject to a comprehensive review. The CBRT's integrated policy framework, the Liraization Strategy, is formed based on the impact analyses pertaining to the steps to be taken. The implemented strategy has had supportive effects in terms of a structural increase in the weight of the Turkish lira in the financial system and formation of a current account surplus capacity, which are two prerequisites for permanent price stability.

Strengthened by diversified reserve sources, CBRT reserves have increased despite large global reserve losses due to high energy prices and financial volatility. Thanks to the effective use of currency swap agreements, trade in local currency has become more widespread, while important developments have been observed towards a more balanced

structure in the foreign exchange markets in the long run. The effective reserve policy backed by liraization steps led to a strong uptrend in the share of Turkish lira in deposits.

Targeted loan, liquidity, reserve requirement and collateral policies have had significant effects on the growth rate and composition of loans and their allocation for real economic activity purposes. Loan growth, which surged after the Russian-Ukrainian War, was brought under control, and the share of commercial, SME, investment and export credits in the loan composition reached historically high levels. Investment and current account surplus capacity have been supported by favorable financing costs against risks posed by the weakening in global economic activity. Interest rates on commercial loans and bonds, which had risen due to the war, declined significantly on the back of effective measures taken. Thus, monetary transmission has been strengthened. Against this background, excluding the effects of energy prices, the current account surplus capacity was improved in 2022.

Thanks to effective policies implemented, significant gains have been achieved towards elimination of structural problems hindering permanent price stability. Moreover, a gradual slowdown in inflation started in the second half of the year, with the positive results of these policies and the relative stability in global energy prices. The slowdown in monthly inflation rates led to a significant decline in headline and core inflation, inflation diffusion and expectations, as well as in underlying trend indicators.

In 2023, the CBRT will continue to decisively implement and develop the Liraization Strategy with all its elements based on a data-driven approach and impact analyses. It is aimed that the deposit liraization ratio is increased to 60 percent by the first half of the year, and the rise in liraization continues through the rest of the year. Conditions for banks' use of collateral, funding and credit channels will be calibrated in line with the liraization targets. In Turkish lira liquidity management, Open Market Operations will be the main component of the funding channel, and the share of funding via this channel will be increased gradually. It will be ensured that the growth rate and composition of loans are compatible with the projected inflation path in 2023. The targeted loan approach, which envisages use of loans to support activities that will increase investment, employment, production, exports and current account surplus, will be

implemented in a strengthened manner. Reserve sources will be diversified further, and CBRT's reserves will continue to be increased. The policy framework is expected to contribute to the formation of a healthy and stable balance between supply and demand in foreign exchange markets under free market conditions.

The CBRT will continue to decisively implement the Liraization Strategy that it has developed in line with its objective to achieve and maintain permanent price stability. With the support of the high level of coordination established within the framework of the Turkish Economy Model, the annual rate of increase in consumer prices will be reduced to a level consistent with the projections presented in the Inflation Report.

Sincerely,

CENTRAL BANK OF THE REPUBLIC OF TÜRKİYE

Head Office

Prof. Şahap KAVCIOĞLU

Governor

Mustafa DUMAN

Deputy Governor

Annexes: Inflation Report 2023-I