

Summary of the Monetary Policy Committee Meeting

24 February 2022, No: 2022-16

Meeting Date: 17 February 2022

Inflation Developments

1. In January, consumer prices increased by 11.10%, and annual inflation increased by 12.61 points to 48.69%. While exchange rates were more stable in January, international commodity prices significantly increased led by the energy group. While price increases in the food group spread across the entire group, fresh fruit and vegetable prices, which had been displaying a more moderate course recently, diverged negatively in January. The high course of international commodity prices and the ongoing supply problems led to a significant rise in producer prices. Against this background, the rise in annual inflation and in the recent underlying trends of the B and C indices continued in January.
2. In January, prices of food and non-alcoholic beverages increased by 10.90%, and the group's annual inflation rose by 11.81 points to 55.61%. Due to fresh fruits and vegetables, annual inflation in the unprocessed food subgroup increased by 15.15 points to 54.98%, while annual inflation in processed food increased by 8.63 points to 56.20%. Prices in the fresh fruits and vegetables sub-group, which increased by 20.82% in January, exceeded seasonal averages. In the other unprocessed food subgroup, prices of milk and pulses items displayed remarkable increases while in the processed food group, cereal products, cheese and other dairy products, and fats and oils were the leading items. The VAT rate on basic food items was reduced from 8% to 1% in the middle of the month, thus, the effect of the discount will be reflected on the consumer price index in February and March.
3. While energy prices increased by 27.41% in January, the group's annual inflation increased by 33.45 points to 76.38%. This rise was driven by developments in international energy commodity prices and administered items. As a result of the rise in international crude oil prices and the increase in SCT amounts, fuel prices increased by 23.35%. In January, residential electricity and natural gas tariffs increased by 69.96% and 21.35%, respectively, and municipal water tariffs also increased by 11.87%. Meanwhile, bottled gas prices increased by 11.28%. In this period, secondary effects of the rise in energy costs, particularly electricity, were also observed on consumer prices. While fuel prices continued to increase in February, the change introduced in grading in residential electricity tariffs and reductions in municipal water tariffs will positively affect energy prices in the near future.
4. In January, annual core goods inflation increased by 7.94 points to 48.49%. Annual inflation rose in all subgroups. Prices of durable goods increased by 6.43%, and the group's annual inflation surged by 7.31 points to 56.24%. While white goods and furniture items stood out with high price increases, automobile prices displayed a more limited rise with the contribution of the tax base adjustment. A widespread rise was observed in other core goods prices and annual inflation rose to 51.23%. As seasonal sales in the clothing and footwear subgroups remained quite limited this year, the gradual uptrend in annual inflation continued in this subgroup.

5. Services prices rose by 7.89% in January, and annual services inflation increased by 7.23 points to 29.56%. While the uptick in annual inflation spread across the group, rises were more notable in subcategories excluding rent and communication. Items with administered prices and time-dependent pricing behavior stood out in January. Prices in the restaurants-hotels subcategory rose by 8.45% and annual inflation hit 50.40%. Also standing out in this period, prices in transportation services rose by 16.88%, and annual inflation became 39.31%. Following the recent developments in fuel prices and the high levels of inflation, significant increases were recorded in administered prices of intracity transport and passenger transport by railway as well as in cargo charges and road and air passenger transport fares. Among other services, health services that have a high backward-looking pricing tendency as well as maintenance-repair, recreation and culture, and insurance services were other items that pushed up prices. Seasonally-adjusted data suggest that the uptrend in rent inflation accelerated.
6. Prices of alcoholic beverages and tobacco products increased by 21.90% in January. While the PPI increase pertaining to the second half of 2021 was reflected in specific taxes, producer prices-driven increases were also seen in alcoholic beverages. Against this background, annual inflation in this group reached 45.34%, adding 1.21 points to the increase in annual headline inflation in January.
7. According to the February results of the Survey of Market Participants, the current year-end inflation expectation rose by 4.31 points to 34.06%, while the 12-month ahead inflation expectation dropped by 0.54 points to 24.83%. On the other hand, the upward revisions in the long-term inflation expectations continued in February, and the five-year ahead inflation expectation increased by 0.13 points to 9.05%.

Factors Affecting Inflation and Risks

8. Leading indicators show that the robust recovery in the global economy is sustained, albeit with some deceleration. Despite the recovery in global economic activity and the increase in the vaccination rate, the variants and increasing geopolitical risks keep the downside risks to global economic activity alive and increase the uncertainty.
9. Recovery in global demand, high course of commodity prices, supply constraints in some sectors, 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.
10. The recent recovery in portfolio flows to emerging economies continues. 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 pricing formations that are not supported by economic fundamentals, supply-side factors such as the rise in global energy, food and agricultural commodity prices, supply constraints, and demand developments.

12. Annual producer inflation maintained its upward trend in January. While prices were up across all sectors, the underlying trend of the manufacturing industry excluding oil and base metals rose. Annual inflation increased across all main industrial groups, most notably in energy and intermediate goods. The most dramatic monthly increase was recorded in durable consumption goods. The negative outlook for commodity prices, energy in particular, ongoing supply chain disruptions, and high transportation costs were the factors exerting pressure on producer prices. With especially energy and non-energy commodity (metal and agriculture in particular) prices posting a substantial increase in US dollar terms in January, external price pressures remained strong.
13. Level of capacity utilization and other leading indicators show that domestic economic activity remains strong, with the help of robust external demand. Adjusted for seasonal and calendar effects, the Industrial Production Index (IPI) increased by 1.6% month-on-month and by 4.3% quarter-on-quarter in December, indicating that production continued to grow at an even stronger pace in the fourth quarter of the year. Industrial production grew by 16.4% throughout 2021. Industrial turnover indices suggest that both external and domestic demand were robust in the last quarter. Despite a month-on-month decline in that period, the retail sales volume index remained strong above its trend throughout the quarter.
14. High-frequency data indicate that the natural gas and electricity outages in the last ten days of January had a limited impact on production and foreign trade indicators. Meanwhile, investment tendencies of manufacturing industry firms for the next twelve months were high in January. Despite the recent upsurge in new cases, the spread of vaccination throughout domestic population allows the services, tourism and related sectors, which have been adversely affected by the pandemic, to maintain their strength and leads to a more balanced composition in economic activity. As a matter of fact, the credit card spending in services sectors that are severely hit by the pandemic continued to hover above the trend.
15. The improvement in the labor market continues in line with the economic activity outlook. In December, the seasonally adjusted unemployment rate was 11.2%. Employment grew across all sectors, and the labor force participation rate increased. Survey indicators and high-frequency data suggest that the improvement in the employment outlook and the positive course in the labor market continue.
16. The strong course of energy imports in the recent period has been limiting the improvement in the current account balance. The current account balance ran a deficit of USD 3.8 billion in December, and the current account deficit for 2021 stood at USD 14.9 billion. While exports remained strong thanks to favorable external demand conditions in the last quarter of the year, imports increased due to robust economic activity, the rise in commodity, particularly energy prices and the increase in energy demand. The real balancing in foreign trade excluding price effects continued. Provisional foreign trade data suggest that the energy-driven increase in imports will persist in January. 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, current account balance is expected to post a surplus in 2022. Strengthening of the improving trend in current account balance is important for price stability. The Committee assesses that extending long-term Turkish lira investment credit will play a significant role in achieving this target.

Monetary Policy

17. The monetary policy stance will be set 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. The Committee expects 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. Accordingly, the Committee has decided to keep the policy rate unchanged.
19. While cumulative impact of the recent policy decisions is being monitored, to create a foundation for sustainable price stability, the comprehensive review of the policy framework is being conducted with the aim of encouraging permanent 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 the Turkish lira-denominated assets in the collateral structure of OMO funding, to gradually reduce the volume of swaps and to strengthen foreign exchange reserves. In formulating the monetary policy towards achieving the sustainable price stability objective, the Committee will continue to follow a liraization oriented approach that also addresses risks to financial stability.
20. Accordingly, the effects of the liquidity and distribution developments of 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.
21. 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% target is achieved in pursuit of the primary objective of price stability.
22. 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.
23. The Committee supports building strong policy coordination and a holistic macro policy mix involving all stakeholders in order to achieve price stability.
24. The Committee will continue to take its decisions in a transparent, predictable and data-driven framework.