Summary of the Monetary Policy Committee Meeting

3 July 2024, No: 2024-36

Meeting Date: 27 June 2024

Global Economy

1. In the first quarter of the year, the global growth outlook displayed a limited improvement while labor markets continued to be tight. The global growth index, which is weighted by the export shares of Türkiye's foreign trade partners, is forecasted to grow by 2.0% in 2024. That is slightly higher than the 1.8% growth recorded in 2023, and global economic activity remains weak. The first quarter growth data for advanced economies is supportive of the moderate recovery in economic activity while leading indicators suggest that this recovery is mostly driven by the services sector. The US economic growth trend continued to diverge positively from other advanced economies. Geopolitical risks and maintaining tight monetary policies to ensure a permanent decline in inflation are regarded as prominent risk factors for the course of global economic activity in 2024.
2. The high levels of core inflation and inflation expectations imply that global inflation will continue to remain above central banks' targets for some time. Despite the sharp decline in inflation in 2023, stickiness in services inflation is particularly evident in many countries. While emerging economies (EMEs) continue to cut interest rates in a way to maintain monetary tightness, the central banks of some advanced economies also started to cut rates. However, due to stickiness in inflation, geopolitical developments, and ongoing risks pertaining to commodity prices, central banks are expected to adopt a cautious approach in rate-cuts. Meanwhile, expectations for growth, inflation outlook, and monetary policies of advanced economies continued to diverge, and risk appetite and portfolio flows towards EMEs have displayed a volatile course due to increased global uncertainty.

Monetary and Financial Conditions

3. Excess liquidity in the market due to residents' and non-residents' preference for Turkish lira assets was mostly replaced by a liquidity deficit after May 24, with the imposed increase in required reserves. However, during this period, liquidity developments and the significant decline in interest rates in accounts switching from FX-Protected Deposit Accounts to Turkish lira deposits had an impact on Turkish lira deposit interests. Turkish lira deposit rates have decreased by 191 basis points since the week ending 24 May and stood at 56.15% as of 21 June. In the same period, Turkish lira commercial loan rates increased by 43 basis points to 63.13%. On the retail loans side, general-purpose loan rates (excluding Overdraft Accounts) declined by 44 basis points to 76.50%, while housing loan rates remained flat at 44.58%. Vehicle loan rates, on the other hand, increased by 21.41 percentage points to 55.31% as of 21 June 2024 due to the recent decline in promotional sales.

4. The effects of monetary tightening on credit conditions and domestic demand are closely monitored. On the back of monetary and quantitative tightening measures, Turkish lira loan growth continued to decelerate while FX loan growth declined. In this context, the average four-week growth rate of retail loans has increased since the week ending 17 May from 1.44% to 2.91% as of 21 June. This increase mainly stemmed from the rise in the growth rates of general-purpose loans from 2.70% to 3.48%, and personal credit cards from 1.12% to 3.36%. As of 21 June, the average four-week growth rates of housing and vehicle loans were 0.41% and 1.18%, respectively. Turkish lira-denominated commercial loans remained on a mild growth path, at an average four-week growth rate of 1.01%. The average four-week growth rate of FX commercial loans adjusted for exchange rates declined from 4.88% to 4.13% due to the restrictions introduced.

5. The simplification steps regarding the macroprudential framework continued with the termination of the practice of maintaining additional required reserves based on leverage ratio on 28 June 2024. Additionally, in order to enhance the functionality of the market mechanism, the maximum fees chargeable by banks upon prepayment of commercial loans were amended. The amendment aims at robust commercial loan price formation, where the early payment fee determination method becomes sensitive to the level of loan interest and the remaining maturity. Thus, the transmission of expectations regarding the disinflation process to long-term commercial loan interest rates is supported.

6. The gross international reserves of the Central Bank of the Republic of Türkiye (CBRT) increased by USD 5.38 billion compared to the previous MPC meeting week to USD 147.6 billion as of 21 June 2024. Türkiye's five-year credit default swap (CDS) premium stood at 279 basis points on 26 June 2024, slightly up from the previous MPC meeting week. The one-month implied exchange rate volatility of the Turkish lira rose to 14.52%, while the 12-month implied exchange rate volatility reached 24.25% as of 26 June 2024. Since the previous MPC meeting week, net portfolio inflows have totaled USD 1.33 billion, accounting for USD 3.03 billion of inflows to the government domestic debt securities (GDDS) market, and USD 1.69 billion of outflows from equity markets.

Demand and Production

7. In the first quarter of 2024, economic activity remained robust. Gross Domestic Product (GDP) data suggest that despite a decline, the annual contribution of private consumption to growth remains high. On the other hand, net exports made a positive contribution to annual growth for the first time since the third quarter of 2022. On a quarterly basis, the growth of private consumption decelerated somewhat while the positive contribution of net exports to growth increased over the previous quarter. Accordingly, in the first quarter of the year, domestic demand remained resilient due to wage increases, additional promotions introduced by firms, and the demand brought forward, while the contribution of net exports came out positive in both annual and quarterly terms. Thus, a more balanced demand outlook was observed in terms of growth composition.

8. Recent indicators confirm that domestic demand, albeit still at inflationary levels, continues to slow down. In April, the retail sales volume index fell on a monthly and quarterly basis. During the same period, the trade sales volume index posted a sharper decline. Trade of motor vehicles and wholesale trade, other two main components of the index along with retail trade, also decreased. Services production index, which recorded a moderate increase in the first quarter, fell on a monthly basis in April. As of June, survey data for manufacturing firms indicate that domestic market orders decreased on a quarterly basis. Information on consumption expenditures from interviews with firms also point to a slowdown in domestic demand in the second quarter compared to the first quarter. On the other hand, two religious holidays and the associated bridge days due to administrative leaves in the second

quarter obscured a clear picture regarding the extent of the slowdown in demand. Card spending decreased in April, but when the May-June period is included, it continued to increase on a quarterly basis, albeit at a slower pace. Meanwhile, seasonally adjusted imports of consumption goods fell in May, but still hovered above the average of the previous year and the first quarter of 2024. Accordingly, an overall analysis of consumption indicators along with the more recent data indicate that demand may not be slowing down to the extent envisaged in the Inflation Report.

9. In April, the industrial production index dropped by 4.9% month-on-month when adjusted for seasonal and calendar effects and by 0.7% year-on-year when adjusted for calendar effects. On a quarterly basis, industrial production decreased by 4.2%. Due to the extension of the Eid al-Fitr holiday by an administrative decision in April, the resulting bridge days have also been influential in the monthly decline. Furthermore, the typically highly-volatile sectors experienced compensatory declines in their production which rose sharply in the preceding months, and this also pushed industrial production down on a monthly basis. When these effects are excluded, the underlying trend of industrial production is stronger than the overall index would suggest. In June, the manufacturing industry capacity utilization rate decreased by 0.4 percentage points month-on-month to 76.2%.

10. As of April, seasonally adjusted employment rose by 0.5% on a quarterly basis and stood at 32.6 million people. In this period, the labor force participation rate edged up, while the unemployment rate came down by 0.2 points to 8.5%. Survey indicators, on the other hand, indicate a decline in manufacturing firms' future employment expectations.

11. In April, the current account deficit stood at USD 5.3 billion on a monthly basis and increased slightly to USD 31.5 billion in annualized terms. This was driven by the rise in the foreign trade deficit excluding gold and energy. On the other hand, the energy trade deficit continued to improve, albeit at a slower pace. Meanwhile, the gold trade deficit remained relatively flat compared to the previous month. During this period, the annualized services balance surplus edged down month-on-month.

12. In May, provisional foreign trade data pointed to an increase in exports and a decline in imports, in seasonally adjusted terms. Gold imports remained above the historical averages in May, dropping to around USD 22 billion in annualized terms. The consumption goods imports, which increased in April due to calendar effects resulting from the holiday season, decreased in May. When the provisional foreign trade data for May is considered along with the high frequency data for June, the three-month average trends imply a relatively flat course in exports and a decrease in imports. The trend in imports of consumption goods is closely monitored, in tandem with a number of other indicators, to assess the impact of the monetary tightening on domestic demand.

13. Regarding the financing of the current account deficit, the banking sector’s annualized long-term debt rollover stood at 125% in April. In the non-bank corporate sector, this ratio was around 97%. Accordingly, external financing opportunities followed a similar pattern as in the previous month.

Inflation Developments

14. Consumer prices rose by 3.37% in May, driving annual inflation up by 5.65 percentage points to 75.45%. Despite the base effect-driven marked increase in annual consumer inflation, annual changes in core indicators B and C followed a milder course compared to the headline index in this period. The expiry of the free use of the 25 cubic meters of natural gas for households pushed the headline inflation up by 0.64 percentage points in May, and when adjusted for this effect, monthly consumer inflation displayed a limited improvement.

15. In May, monthly price increases in the services group remained high, mainly driven by the rents, restaurants-hotels and education items. Monthly inflation in core goods rose in clothing and footwear due to the launch of the new season, but slowed down in durable goods in May. Monthly price increases in the food group weakened on the back of receding prices in the unprocessed food group, with vegetables in the lead. Meanwhile, monthly inflation in the processed food group strengthened due to accumulated cost pressures especially in bread and cereals as well as milk and dairy products, while price hikes in red meat continued to be reflected in processed meat products in this period. Despite the declines in fuel and bottled gas prices following the developments in international energy prices, energy prices soared (by 4.91%) in May due to expiry of the free use of the 25 cubic meters of natural gas.

16. The decline in the underlying trend of monthly inflation registered a temporary pause in May. The seasonally adjusted monthly rates of increase in the B and C indices were realized as 3.2% and 3.4%, respectively, slightly up compared to the previous month. The seasonally adjusted three-month average increases in the B and C indices were measured at 3.2% and 3.4%, respectively, slightly down compared to the previous month, and continued to weaken. Among the components of the B index, price increases in May remained almost flat in core goods and services, but rose in processed food. In this period, the Median, SATRIM, and other underlying trend indicators as well as the diffusion index also posted limited increases.

17. In addition to the high level of and the stickiness in services inflation, inflation expectations, geopolitical risks, and food prices keep inflationary pressures alive.

18. The prevalent price setting behavior in the services sector leads to significant inertia and causes the impact of shocks on inflation to extend over a long time. In May, annual inflation was recorded at 56.5% in core goods, and it was around 40 percentage points higher in services at 95.9%. Moreover, in May, the diffusion index for the services sector hovered around 40% above its historical average, indicating that increases continued to spread across the sector. In this regard, based on the recent realizations of consumer inflation, there is a risk that inflation will remain high in certain services items for an extended period. In May, rents, restaurants-hotels, and education stood out with price increases.

19. Leading indicators tracked through micro data from the Retail Payment System (RPS) imply that the rate of rent increases in new and renewed contracts, despite being below the current annual level in the rent item in the consumer price index, remains relatively high. Moreover, indicators suggest that the monthly rate of rent increases will pick up slightly in June due to the expected rise in the contract renewal rate. On the other hand, the annual increase in house prices continued to decline in real terms, dropping to 48.4% in April, while the seasonally adjusted data point to a significant slowdown in monthly increases in this item in recent months. This development in house prices is expected to have a restraining effect on rent inflation in the coming period. However, the forthcoming repeal of the 25% rent increase cap will also be closely monitored for its impact on rent inflation. Rent inflation is expected to remain high in the short term and will be the main group that will restrain the anticipated slowdown in consumer inflation.

20. The high course of monthly inflation in the restaurants-hotels subgroup continued in May due to restaurant services. Although cost pressures have waned in recent months, the ongoing strong course of catering services has limited the slowdown in consumer inflation. Education was another services item that stood out with price hikes in May due to private school fees. Having a high tendency for backward indexation and being affected by wage developments, the effect of private school fees on consumer inflation may lose strength gradually in the summer depending on the announcement dates. On the other hand, it

should be noted that education services inflation will be affected by price adjustments stemming from private university tuitions in September.

21. Domestic producer prices rose by 1.96% in May, and annual inflation increased by 2.02 percentage points to 57.68%. Following the mild course of the Turkish lira, monthly increase in producer prices weakened significantly, while annual producer inflation grew higher also due to the low base. According to the main industrial groupings, energy prices stood out with a surge of 3.32% driven mainly by natural gas and municipal water producer prices, while monthly price increases were more moderate in the remaining groups, with intermediate goods and capital goods in the lead.

22. The upward course that started in international commodity prices in January posted a slight decline in May after the level recorded in April. Global energy prices receded, while non-energy commodity prices went up in May. As of the first three weeks of June, commodity prices dropped further due mostly to non-energy commodities. Having strengthened in the first four months, pressures led by external prices weakened to a limited extent in the last two months.

23. Global Supply Chain Pressure Index hovered close to its historical averages in May. Global freight indices have recently displayed a diverging outlook. Container indices for the globe and China posted an increase after April, while dry cargo transport indices have been on a relatively mild track. In May, lead times of domestic suppliers grew slightly longer compared to the previous month. The manufacturing industry PMI data decelerated both in input and final product price indices, implying alleviated inflationary pressures.

24. According to the results of the Survey of Market Participants in June, inflation expectations have declined across all horizons. The 12-month-ahead inflation expectation was revised down by 1.4 percentage points from 33.2% to 31.8%, while the 24-month-ahead inflation expectation was revised down by 1.0 percentage point from 21.3% to 20.3%. Inflation expectations for the current year-end and the end of the next year edged down by 0.1 percentage points to 43.5% and 25.5%, respectively. Meanwhile, the five-year-ahead inflation expectation decreased from 11.8% to 11.6%. Although inflation expectations have declined across all horizons, the current levels continue to pose an upside risk to the inflation outlook. The Committee closely monitors the alignment of inflation expectations and pricing behavior with projections.

25. Leading indicators point to a slowdown in the underlying trend of inflation in June, consistent with the projections in the May Inflation Report. Across the groups making up the B index, monthly price increases are expected to lose pace in the services and more evidently in the core goods groups compared to the previous month. Price increases in the food group are envisaged to decelerate somewhat in June. In the processed food subgroup, the bread and cereals item stand out with its price hike. In unprocessed food, the ongoing rise in red meat prices has been replaced by a decline. Preliminary data suggest that prices of durable goods have remained mild in June, driven by the fall in prices in the automobile sector. Price increases continue in other durables. Services inflation also remains elevated. In this group, it is notable that prices in the rents and restaurants-hotels subgroups have maintained their upward course, while price increases have also become pronounced in transport services in this period due to the religious holiday. Meanwhile, the price increase in the energy group has weakened compared to the previous month. Municipal water tariffs have risen in this period, whereas fuel prices that have declined following the fall in international crude oil prices limit the rise in the energy group.

Monetary Policy

26. Considering the lagged effects of the monetary tightening, the Committee decided to keep the policy rate unchanged, but reiterated that it remains highly attentive to inflation risks.
27. The tight monetary stance will be maintained until a significant and sustained decline in the underlying trend of monthly inflation is observed, and inflation expectations converge to the projected forecast range. Monetary policy stance will be tightened in case a significant and persistent deterioration in inflation is foreseen. The decisiveness regarding tight monetary stance will bring down the underlying trend of monthly inflation through moderation in domestic demand, real appreciation in Turkish lira, and improvement in inflation expectations. Consequently, disinflation will be established in the second half of the year.
28. In case of unanticipated developments in credit and deposit markets, monetary transmission mechanism will be supported via additional macroprudential measures. Liquidity conditions are closely monitored. Sterilization will be implemented effectively by also enriching the toolset whenever needed.
29. Taking into account the lagged effects of monetary tightening, the Committee will make its policy decisions so as to create the monetary and financial conditions necessary to ensure a decline in the underlying trend of inflation and to reach the 5 percent inflation target in the medium term.
30. Indicators of inflation and underlying trend of inflation will be closely monitored, and the Committee will decisively use all the tools at its disposal in line with its main objective of price stability.
31. The Committee will make its decisions in a predictable, data-driven and transparent framework.