TÜRKİYE CUMHURİYET MERKEZ BANKASI

Summary of the Monetary Policy Committee Meeting

02 November 2023, No: 2023-42

Meeting Date: 26 October 2023

Global Economy

1. Global inflation has been decreasing recently, but it remains above the long-term averages and central bank targets. In September, consumer inflation was negatively affected by energy prices, while the stickiness in the core inflation trend started to wane in advanced economies. Compared to the previous Monetary Policy Committee (MPC) meeting, consumer inflation decreased from 4.27% to 3.71% in advanced economies and increased from 6.48% to 6.54% in emerging economies[1]. Nevertheless, headline inflation declined in many emerging economies except some large economies such as Brazil, Russia and Turkey. Inflation continues to hover above the average target rate of 2% in advanced economies and 3.5% in emerging economies. Average annual inflation expectations for the last quarter of 2023 for advanced and emerging economies are 3.3% and 6.7%, respectively. Compared to the previous MPC meeting period, core inflation declined from 4.57% to 4.21% in advanced economies, whereas it rose from 6.57% to 7.00% in emerging economies. Average annual inflation expectations for the last quarter of 2023 are 3.3% in the USA and 3.4% in the euro area, while core inflation expectations are 3.5% and 4.1%, respectively.
2. Despite widespread decline in commodity prices recently, geopolitical risks, financial conditions and supply-side factors lead to volatility in oil prices and a rise in natural gas prices. Brent crude oil prices per barrel have fluctuated in the range of 88-99 USD since the previous MPC meeting while the Title Transfer Facility (TTF) price, which serves as a benchmark for European natural gas prices, has increased by 31.9%. The current level of the Commodity Price Index is 30.4% above the average of the last ten years. The index fell by 26.3% compared to the highest level reached last year. Similarly, the Agricultural Commodity Price Index, which has declined by 14.5% compared to the peak it reached last year, is 11.8% above the average of the last ten years. This still has an impact on inflation due to the high share of food in consumer basket.
3. High levels of core inflation and inflation expectations imply that global inflation will continue to remain above the targets of central banks for a while. As a result, many central banks around the world are expected to continue to keep their policy rates at levels that will maintain the tightness of the monetary stance and central banks of advanced economies are generally expected to ease more slowly and at a later pace. The central banks of 12 advanced countries held a total of 153 meetings in the last 20 months, and policy rates were increased

[1] Advanced economies: USA, Czech Republic, Denmark, the Euro Area, South Korea, United Kingdom, Sweden, Japan, Canada, Norway.
Emerging Economies: Brazil, China, Indonesia, Philippines, South Africa, India, Colombia, Hungary, Mexico, Peru, Poland, Romania, Russia, Chile, Thailand, Turkey.

in 102 of these meetings[2]. During the same period, 15 emerging countries' central banks held a total of 225 meetings, and policy rates were increased in 103 of these meetings. The results of the implemented monetary policies have begun affecting financial conditions, and central banks' emphasis on tightening financing and credit conditions has become stronger. The recent rise in uncertainties has had a tightening effect on global financial conditions, and central banks of Thailand and Indonesia raised policy rates in September and October, respectively, emphasizing this development in their decision announcements. Meanwhile, central banks of Brazil, Peru, Poland and Chile continued with policy rate cuts on the back of the decline in consumer inflation. However, given the high levels of inflation and the central banks' policy communications, it is expected that the tightness of monetary policy will continue in these economies.

4. Despite the flat global growth outlook, tightness in labor markets persist. The global growth index, which is weighted with export shares of Türkiye's foreign trade partners, remained flat compared to the previous MPC meeting period. The index is projected to grow by 1.7% in 2023, which is approximately 0.4 points higher than the lowest level in January. However, when the 3.5% growth of the index in 2022 is considered, a notable slowdown in Türkiye's foreign demand is observed on an annual basis. Having fallen in June, July and August, global Purchasing Managers' Index (PMI) significantly slowed down in September. In September, the global manufacturing industry PMI edged up by 0.1 points compared to the previous month to 49.1 points, while the global services PMI decreased by 0.3 points to 50.8. Thus, the global composite PMI index was down by 0.1 point to 50.5 in September and remained almost the same as the previous month. In September, driven by the manufacturing industry, the composite PMI for advanced economies increased by 0.2 points month-on-month to 49.7. This development was mainly driven by the slight recovery in the PMI data in September for the euro area, one of Turkey's major trade partners. However, according to the early (flash) PMI data for October, the euro area composite PMI indicator decreased by 0.6 points to 46.5. The manufacturing sector PMI indicator declined by 0.4 points to 43 in October, recording one of the lowest levels since June 2020. The services PMI, in particular, declined once again in October, decreased by 0.8 points to 47.8 and continued to hover below the threshold value. This indicates that the slowdown in euro area's economic activity will also continue in the second half of the year. The manufacturing industry PMI of emerging economies decreased by 0.5 points compared to the previous month to 50.9 in September while the services PMI dropped by 1.2 points to 51.9. In the Chinese economy, the composite PMI maintained its downward trend in August and dropped by 0.8 points to 50.9. The manufacturing industry PMI decreased by 0.4 points to 50.6, while the services PMI fell by 1.6 points to 50.2. These developments suggest that the services sector, which was an important driving force of global economic activity in the first half of the year, has lost strength in recent months and global growth rate has slowed down to a limited extent.

5. Portfolio flows to emerging markets, which improved in the June-July period due to risk sentiment, turned to outflows in the August-October period. The recent portfolio outflows from emerging markets were driven by the expectation that central banks of advanced economies will maintain their tight monetary policy stance for a longer period, fluctuations in the global risk appetite and uncertainties regarding the Chinese economy. In the August-October period (31 July -13 October 2023), there was a total outflow of USD 47.7 billion, USD 43.3 billion of which was from equity markets, mainly from China, Taiwan, South Korea, Brazil, South Africa and Indonesia.

[2] Australia and New Zealand, which are not included in the inflation country set as their data are at quarterly frequency, are included in the policy rate analysis. Turkey, which is included in the inflation set, is excluded from the emerging economies set in the policy rate analysis.

6. Recent developments such as rising geopolitical risks, the course of energy prices, diverging economic growth outlooks across countries, increases in US long-term interest rates and portfolio outflows from emerging markets suggest that uncertainties regarding the global economy are increasing.

Inflation Developments

7. In the third quarter, although inflation readings were above expectations, it displayed a more positive outlook in September. The pass-through from tax regulations and cost pressures stemming from wages and exchange rates, which have been recently impactful, has been largely completed Consumer prices rose by 4.75% in September, and annual inflation increased by 2.59 points to 61.5%.

8. Contributions of subgroups to annual inflation rose from 20.9 points to 22.9 points in the services group (up by 2.09 points); from 2.30 points to 2.81 points in alcohol, tobacco and gold group (up by 0.51 points); from 18.1 points to 18.4 points, the food and non-alcoholic beverages group (up by 0.32 points); from 15.5 points to 15.7 points, in the core goods group (up by 0.21 points), but decreased from 2.11 points to 1.57 points in the energy group (down by 0.54 points).

9. Prices of food and non-alcoholic beverages group increased by 3.32% in September, and annual inflation rose by 2.28 points to 75.1%. Price increases spread across the group, while the deceleration in price increases in bread and cereals as well as fresh fruits and vegetables compared to past months limited the monthly group inflation. Seasonally adjusted data pointed that the slowdown in fresh fruits and vegetables was driven by vegetable prices. Price hikes in eggs, sugar, nuts, milk and dairy products, fats and oils as well as red meat were notable.

10. Energy prices went up by 3.83% in September, and the group's annual inflation fell by 3.78 points to 10.3%. Price hikes in global markets in September, with crude oil in the lead, became the main driver of energy prices. Solid fuels, bottled gas and fuel oil stood out among the group with price increases of 6.11%, 5.93% and 4.62%, respectively. Moreover, municipal water prices remained on an upward track with an increase of 4.42%.

11. Prices of services rose further strongly by 7.88%, and annual services inflation increased by 6.89 points to 86.5%. In September, price increases spread across the group, pushing annual inflation up across all subgroups. In this period, price hikes in associated services items were notable following the opening of schools. Prices of transport services continued to rise strongly due to the substantial rise in fuel prices, which was driven mainly by the increase of 65.4% in school bus fares in September. Monthly increases in rents strengthened further and reached 9.52%. Prices in other services increased by 8.46%, with education services being the leading item following the hike in university tuition fees of 127.7%. Monthly inflation in the restaurants-hotels subgroup was limited compared to previous months with 4.15%, led by catering services due to the slowdown in food prices, while accommodation item posted high-rated increases driven by dormitory fees.

12. Prices of core goods were up by 2.59% in September, and the group's annual inflation increased by 1.26 points to 53.2%. Price increases weakened across subgroups, while annual inflation receded in other core goods and rose in durable goods (excluding gold) and clothing and footwear. The monthly price increase in durable goods (excluding gold) slowed to 2.58% month-on-month, yet divergences were seen within the subgroup. In September, automobile prices remained almost flat, while price increases in white goods and furniture maintained the robust course. Price increases in other core goods were more moderate, and monthly inflation stood at 2.66%. In the clothing and footwear subgroup, prices rose by 2.51%, bringing annual inflation up to 31.4%.

13. Prices in the alcoholic beverages and tobacco group increased by 10%, and annual inflation in this group rose by 15.2 points to 67.2%, which stem from was a company-led price hike of 11.1% in tobacco prices.

14. Indicators of the underlying trend of inflation weakened in September[3]. Seasonally adjusted monthly increases receded both in the B and C indices in September. This outlook is also confirmed by the declining figures in Median and SATRIM indicators. The three-month average increases in the seasonally adjusted B and C indices, which peaked at 8.78% and 8.49% respectively in February 2022, stood at 7.89% and 7.88 % respectively in September 2023. In September, the seasonally adjusted rates of increase in the B and C indices were measured at 4.87% and 5.50%, respectively.

15. Leading indicators suggest that the fall in the underlying trend of inflation, which started in September, strengthened further in October as cost shocks have been largely reflected in prices. According to preliminary data, price increases lost momentum across groups, while the positive course is notable in the prices of durable goods, while the services group exhibit higher price increases compared to other groups.

16. The strong course of domestic demand, the stickiness of services inflation, and the deterioration in inflation expectations continue to put upward pressure on inflation. In addition, global energy prices, which started to recede from the levels they hit towards the end of September, pose a risk with a re-increase amid geopolitical problems. On the other hand, while domestic demand lost some momentum, the increase in inflation expectations slowed down.

Demand and Production

17. Following the increase in demand for Turkish lira savings instruments due to monetary tightening, some effects of monetary transmission on demand are gradually appearing. Domestic demand indicators, price reductions in sectors such as durable goods as well as plans thereof, and orders and related expectations provide leading signals of a rebalancing in demand. Accordingly, imports have fallen and the foreign trade balance has displayed a relatively favorable outlook.

18. Recent indicators and high-frequency data point to a quarterly slowdown in growth momentum in the third quarter. In August, adjusted for seasonal and calendar effects, the retail sales volume index decreased by 4.7% on a monthly basis. The annual growth of the retail sales volume index fell by 14.4 points to 17.2%. Following the 5.4% rise in the second quarter, the quarterly rate of increase slowed down to 1.6%. The upward trend in card expenditures continued in September. On the other hand, in realized terms, the rise in card expenditures decelerated on a quarterly basis. In October, manufacturing firms’ registered orders from the domestic market increased by 7.5 points on an annual basis, while, in seasonally adjusted terms, they displayed a quarter-on-quarter decline in the last quarter. An analysis of the broad economic categories reveals that the decline was more pronounced in the durable goods group. In this period, manufacturing firms' expectations for future export and domestic market orders increased slightly on a quarterly basis. Interviews with firms point to a loss of momentum at the sectoral level due to the slowdown in demand for consumption goods, particularly durable goods.

[3] In determining the underlying trend of inflation, in addition to approaches based on the "methods of exclusion" such as the B and C indices, "statistical methods" such as Median and SATRIM inflation are also used. In order to determine the developments in the underlying trend, the seasonally adjusted monthly changes and 3-month moving average changes of these core indicators are closely monitored.

19. In August, the seasonally and calendar adjusted industrial production index decreased by 0.8% month-on-month, while, adjusted for calendar effects, it increased by 3.1% on an annual basis. On a quarterly basis, industrial production increased by 0.5% in August compared to the second quarter average. Excluding the sectors with high monthly volatility, industrial production was higher in August with a quarterly increase of 0.9%. In October, the seasonally adjusted capacity utilization rate in the manufacturing industry remained flat at 76.8% with a decline of 0.1 points.

20. As of August, seasonally adjusted employment was recorded at 31.7 million. In this period, seasonally adjusted employment increased by 0.3% quarter-on-quarter, while the labor force participation rate decreased by 0.1 points. In August, unemployment rate decreased by 0.2 points to 9.2% from 9.4% in July. High-frequency data indicate that demand remains robust in the labor market.

21. In August, in line with the decrease in foreign trade deficit, the annualized current account deficit fell by USD 2.1 billion month-on-month to USD 57 billion. This fall was driven by the improvement in the energy balance due to the ongoing annual decline in energy prices, despite the rise in the cumulative gold trade deficit. Provisional foreign trade data for September indicate, in seasonally adjusted terms, a moderate monthly increase in exports as against a decrease on the imports side across all subgroups of goods. The three-month average trend, considered along with the high frequency data for October, implies a limited improvement in exports and a flat course in imports as well as an annual decline. Although gold imports decreased in the September-October period, they are still above historical averages.

22. As of August, the annual services balance surplus increased by USD 5.1 billion compared to the same period of the previous year, reaching USD 51.2 billion. Tourism revenues, which have been strong throughout the year, continue to contribute positively to the current account balance. Travel revenues increased by USD 4.1 billion in the first eight months of the year compared to the same period of the previous year, and reached USD 30.5 billion. Similarly, the number of foreign visitors increased by 15.7% year-on-year to 32.5 million in the first eight months of the year.

Cost Conditions

23. The increase that started in July in energy commodity prices, which had been decreasing since the second half of 2022, continued in September as well. Non-energy commodity prices, which have remained almost flat in recent months, did not exhibit a significant change in September. In the first three weeks of October, commodity prices, including energy prices, were on the decline. However, Brent crude oil prices, which fell until the first week of October, are on the rise again in a highly volatile state due to the geopolitical problems. In addition to these global developments, industrial electricity and natural gas tariffs and electricity producers' natural gas tariffs were raised by 20% in early October. Thus, the lagged effects of exchange rate and rising labor costs on producer prices weakened, while energy costs increased. The recent period has seen heightened risks to global energy prices due to geopolitical developments.

24. In September, domestic producer prices rose by 3.40%, pulling annual inflation down by 1.97 points to 47.4%. According to the main industrial groupings, the energy group stood out with a high monthly price hike of 6.12% on the back of global energy commodity prices. Annual inflation decreased in the energy group due to the base effect, while it displayed a more limited change in other main groups.

25. The Global Supply Chain Pressure Index remained mild in September. Having remained almost flat after the MPC decision in September, exchange rates increased moderately in October.

26. Adjustment in the minimum wage in July 2023, accompanied by wage adjustments for civil servants and public sector workers, and wage hikes becoming broad-based had important impacts on inflation in the third quarter of the year, especially through the cost channel.

Stickiness of Services Inflation

27. The services sector has posted strong price increases as of July. Monthly price increases in the services sector, which displays significant inertia, are higher compared to 2022. Annual inflation in the C index, which includes the core goods and services groups, is around 69%, while annual inflation in the services sector is around 86%. Additionally, the diffusion index for the services sector is hovering approximately 33% above its historical average, indicating that the increases continue to spread across the sector.

28. Seasonal effects were apparent on services prices due to the opening of schools in September. This period saw high price hikes, as services items such as university tuition fees, student accommodation fees and school bus fares are priced at a certain time of the year. The September figures are an example of the sector's ability to spread the effects of shocks over time.

29. Fuel prices are capable of having a significant impact on consumer prices, particularly on transport services, through both production inputs and transportation costs. In fact, the recent significant increases in fuel prices driven by exchange rates, crude oil prices and tax hikes have rapidly passed through to transport services prices. Transport services recorded a strong price increase in September, led by school bus item. The unstable outlook for international crude oil prices remains a risk factor for transport services prices in the upcoming period.

30. Rising house prices, backward-indexation behavior, and imbalances between supply and demand in the real estate market are pushing rent increases upwards and adversely affecting consumer inflation. On the other hand, data monitored on online platforms indicate that rents in big cities have tended to slow down recently.

31. In the restaurants and hotels subgroup that is significantly affected by food, wage and tourism developments, monthly price increases display a persistent outlook. While the weakening in lagged effects of the minimum wage remains in place, and the relative importance of food prices in the outlook for restaurant and hotel prices is increasing.

32. Certain services items, particularly rents, education, health, recreation and culture exhibit pricing behavior indexed to past consumer inflation, prompting inflationary effects to spread over a long period of time. Given the expected outlook for consumer inflation in the near term, there is a risk that inflation will remain high for an extended period in items in which backward-indexation is prevalent.

Inflation Expectations

33. The current course of inflation expectations and the deterioration in pricing behavior keep upside risks to the inflation outlook alive. The consumer inflation diffusion index remained elevated in September and stood at two standard deviations above its historical average.

34. The month-on-month increase in inflation expectations is slowing down. According to the October results of the Survey of Market Participants, the current year-end inflation expectation rose by 0.79 points from 67.22% to 68.01%, the 12-month-ahead inflation

expectation increased by 0.34 points from 44.94 % to 45.28 %, the 24-month-ahead inflation expectation rose by 1.95 points from 23.87% to 25.82%, and the five-year-ahead inflation expectation was revised upwards by 1.73 points from 10.03% to 11.76%.

35. In this framework, while the year-end inflation is projected to be close to the upper bound of the forecast range provided in the Inflation Report (Report), it is evaluated that the underlying trend in monthly inflation is on course to decline. On the other hand, geopolitical developments pose risks to the inflation outlook due to oil prices. Through the monetary tightening process, the Committee is determined to establish the disinflation course in 2024 in line with the Report.

Monetary and Financial Conditions

36. It is assessed that the initial impact of monetary tightening on financial indicators has started to be observed. While market interest rates have moved in tandem with the policy rate, retail loan growth has assumed a downtrend. Turkish lira deposits increased whereas FX-denominated and FX-protected deposits started to decrease.

37. The normalization in loan growth and composition continued. As of 13 October 2023, the retail loan balance increased by 118.9% in credit cards, 77.2% in vehicle loans, 36.6% in general-purpose loans, and 23.5% in housing loans compared to end-2022, amounting to an increase of 58.9% in total. The average 4 week growth rate of retail loans, which continued to lose momentum due to monetary tightening and other steps taken, stood at 2.37% as of 13 October 2023. In the same period, average 4 week growth rates of vehicle and general-purpose loans materialized at 0,63% and 1,41%, respectively. Although personal credit cards maintained their strong trend with an average 4 week growth rate of 4,82%, it continued to slow down. On the other hand, Turkish lira-denominated commercial loans experienced an average 4 week growth rate of 2,18 in the same period.

38. Average personal loan rates (excluding overdraft accounts), which have increased by 165 basis points since the previous MPC meeting period parallel to the rise in banks' funding costs, became 60.5% as of 13 October 2023. Having remained flat during the same period, vehicle and housing loan rates materialized at 46.7% and 41.5%, respectively as of 13 October 2023. Meanwhile, Turkish lira commercial loan rates increased by 608 basis points to 49.3%.

39. As of June, the measures taken to ensure the sound functioning of the banking system within the scope of the simplification process have primarily restored the flow of Turkish lira commercial loans. Turkish lira commercial loans, which increased by 0.34% across the sector in June, grew 2.38% in July, 2.26 % in August, and 2.52 % in September. Meanwhile, Turkish lira deposit rates stood at 24.9% in the week ending 18 August, at 33.5% in the week ending 15 September, and at 37.9% in the week ending 13 October. In parallel, Turkish lira deposits have started increasing while FX-protected and FX-denominated deposits have both declined. Owing to the policy rate hike and the recent steps taken as part of the simplification of the macroprudential framework, it is evaluated that there was a growth in the demand for Turkish lira denominated assest. Simultaneously, loan and deposit rates also rose in tandem, resulting in the strengthening of the monetary transmission mechanism. It is assessed that the monetary transmission mechanism has been strengthening due to the recent steps taken within the scope of the simplification process in the macroprudential framework and the increase in the demand for Turkish lira instruments with the increase in the policy rate, and the rise in loan and deposit rates together.

40. Foreign direct investment, stable course of external financing conditions, continued increase in foreign exchange reserves, the positive impact of rebalancing in demand on current

account balance, and the increase in domestic and foreign demand for Turkish lira denominated assets will significantly contribute to price stability.

41. With the recently-signed agreements, foreign direct investments that will focus on improving technology investments and production capacity will support external financing in the upcoming period.

42. Türkiye's five-year CDS premium, which peaked this year with 703 basis points on 22 May 2023 amid domestic uncertainties, declined to 385 basis points in the previous MPC meeting period but rose to 417 basis points as of 25 October 2023 parallel to other emerging economies due to the recently escalating geopolitical risks. 1 month and 12-month exchange rate volatilities of the Turkish lira declined by 4.8 and 1.0 points, respectively in this MPC meeting period to 11.0% and 27.9% as of 25 October 2023. Falling figures in the risk premium and exchange rate volatilities were accompanied by net portfolio inflows totaling USD 1.69 billion since June, USD 0.50 billion of which went to the government domestic debt securities (GDDS) market and USD 1.19 billion to the equity market.

43. International reserves of the Central Bank of the Republic of Türkiye (CBRT) maintain the strong upward trend they assumed in June. Having declined from USD 128.8 billion at the end of 2022 to USD 98.5 billion at the end of May, gross international reserves of the CBRT rose to USD 126.1billion as of 20 October 2023.

Monetary Policy

44. The policy rate will be determined in a way that will create monetary and financial conditions necessary to ensure a decline in the underlying trend of inflation and to reach the 5% inflation target in the medium term. Given the inflation outlook and the upside risks, the Committee evaluated strengthening the monetary policy framework in line with the price stability objective. The Committee drew attention to the risks that high inflation may pose to macroeconomic stability and especially financial stability. Monetary tightening will be further strengthened as much as needed in a timely and gradual manner until a significant improvement in the inflation outlook is achieved.

45. The Committee decided to continue the monetary tightening process in order to establish the disinflation course as soon as possible, to anchor inflation expectations, and to control the deterioration in pricing behavior. Accordingly, the Committee raised the policy rate (the one-week repo auction rate) from 30% to 35%.

46. To increase the functionality of market mechanisms and strengthen macro financial stability, the Committee continues to simplify and improve the existing micro- and macroprudential framework. Guided by impact analyses, the simplification process is advancing gradually. Impact analyses of the CBRT's regulations are conducted for all components of the framework by assessing their impact on inflation, interest rates, exchange rates, reserves, expectations, securities and financial stability with a holistic approach.

47. In this context, monetary transmission mechanism will be further strengthened by taking additional steps to increase the share of Turkish lira deposits. In addition to the increase in the policy rate, the Committee will continue to make decisions on quantitative tightening and selective credit tightening to support the monetary policy stance. While the policy rate, the main policy instrument, affect monetary and financial conditions and expectations, these decisions aim to stabilize excess Turkish lira liquidity and consumption demand and increase the effectiveness of monetary policy.

48. The Turkish lira liquidity inflows to the financial system stemming from the foreign exchange difference payments of FX-protected deposit accounts due to the exchange rate

developments are closely monitored. Due actions will be taken based on the impact analyses in view of the current market conditions and liquidity projections for the upcoming period.

49. Indicators of inflation and underlying trend of inflation will be closely monitored and the Committee will continue to decisively use all the tools at its disposal in line with its main objective of price stability.

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