

Summary of the Monetary Policy Committee Meeting

2 June 2022, No: 2022-27

Meeting Date: 26 May 2022

Inflation Developments

1. In April, consumer prices increased by 7.25%, and annual inflation surged by 8.83 points to 69.97%. The rise in annual consumer inflation spread across sub-categories, which were driven mostly by the food group, followed by energy and services. Food inflation remained on an upward track due to international price developments, rising input costs and unfavorable supply conditions. Energy inflation was shaped by the developments in administered items, while annual inflation in services recorded increases across sub-categories, with transport and restaurants-hotels in the lead. In core goods, annual inflation increased in durable goods, but declined in other sub-groups. The VAT reduction introduced to the main hygiene products curbed inflation in other core goods. The persisting high course in international commodity prices, increases in domestic energy prices and ongoing disruptions in supply chains continued to drive producer prices up. Against this background, annual inflation of B and C indices continued to increase.
2. Prices of food and non-alcoholic beverages increased by 13.38% in April, and became the main driver of consumer inflation. Accordingly, annual inflation in this group went up by 18.77 points to 89.10%. High levels in international agricultural commodity prices, elevated input costs and supply conditions led to overall price increases in April, and annual inflation reached 100.67% in the unprocessed food group and 78.09% in the processed food group. On the unprocessed food front, rises in seasonally adjusted prices of fresh fruits and vegetables were noticeable. Meanwhile, in the other unprocessed food subcategory, red and white meat, which were affected adversely by feed prices, as well as potatoes and rice stood out with surging prices. Milk prices increased amid the adjustment in raw milk reference price. Negative effects of price increases in unprocessed food items were reflected on the related processed food items. While annual inflation in bread and cereals reached 85.81%, price increases in cheese and other dairy products, sugar and related products, fats and oils, non-alcoholic beverages and meat products were notable.
3. Energy prices increased by 7.62% in April, and the group's annual inflation rose by 15.26 points to 118.20%. This rise was driven mainly by natural gas and tap water prices among administered items, while fuel, solid fuel and bottled gas saw further price increases. Even though international energy prices excluding natural gas had posted a slight fall in April, this was only temporary and energy prices rebounded in May due to geopolitical developments.
4. In April, prices of services increased by 4.74%, and annual inflation went up by 5.46 points to 42.18% in this group. Annual inflation rose across all subgroups, most notably in transport and restaurants-hotels. Annual inflation in the intercity and urban passenger transport group increased to 78.00% while that in restaurants-hotels group reached 69.26%. Price increases

spread across items in other services. Meanwhile, seasonally adjusted data indicate that the monthly rise in rents remained flat in April.

5. The annual core goods inflation increased by 2.39 points to 61.58%. Annual inflation increased in durable goods, while it decreased in other sub-groups. In April, prices of durable goods rose by 5.11%, mainly driven by the rise in furniture prices, followed by automobiles and white goods prices. In other core goods group, the rise in prices of housing maintenance and repair, recreation and culture, and household products was remarkable, while the VAT reduction in basic hygiene products mostly reflected on prices, thereby preventing a more negative outlook. In the clothing and footwear group, the monthly price increments for the new season remained lower than those in the previous year, thus annual inflation in this group decreased by 0.79 points to 25.75%.
6. In April, prices of alcoholic beverages and tobacco products increased by 4.02%, and annual inflation of the group rose to 56.38%. The rise was affected by lingering effects of price increases in cigarette prices in March implemented by producer firms. The uptrend is expected to continue due to the increase in cigarette prices imposed by producer firms in May.
7. The May results of the Survey of Market Participants suggest that inflation expectations have increased for all maturities, being more evident in shorter maturities. The current year-end inflation expectation rose by 11.48 points to 57.92%, while the 12-month-ahead inflation expectation increased by 4.87 points to 33.28%. Currently, the 24-month-ahead and five-year-ahead inflation expectations stand at 19.54% and 9.96%, respectively.

Factors Affecting Inflation and Risks

8. Leading indicators show that the recovery in the global economy is sustained with some deceleration. However, the escalation of ongoing geopolitical risks keeps the downside risks to regional and global economic activity alive and increase the uncertainty.
9. Increasing concern over global food security driven by trade restrictions, high course of commodity prices, supply constraints in some sectors that have become more evident particularly in energy and food, 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 emphasize 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 steps of central banks in advanced economies vary with their diverse outlook for economic activity, labor market and inflation expectations, they still continue their supportive monetary stances.
10. Regarding portfolio flows to emerging economies, bond and equity markets both registered outflows in May in tandem with the global risk appetite. 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 Türkiye is judged to prove to be relatively limited, considering the current levels of non-residents' portfolio positions.
11. Increase in inflation is 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. Elevated levels of commodity prices, disruptions in supply chains, and increases in domestic energy costs continued to affect producer prices. According to main industrial groupings,

annual inflation remained almost flat in intermediate goods, but increased in all other subcategories.

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 some regional differences emerge. Despite having fallen by 1.8% month-on-month in March, seasonal and calendar adjusted industrial production remained strong. Thus, production grew by 2% quarter-on-quarter in the first quarter. While production posted a quarterly growth across all sectors, industrial production was stronger in exporting sectors. Industrial turnover indices also reveal that external demand continued to support industrial production. On the other hand, retail sales volume indices were down in the first quarter compared to the previous quarter, indicating a loss of momentum in domestic demand.
14. As of May, investment tendencies of manufacturing industry firms for the next twelve months were high. Firms' registered domestic and external orders and future order expectations reveal that external demand remains strong in the second quarter. On the other hand, card spending data point to a recovery in domestic demand for the April-May period.
15. Developments in the labor market are in tandem with the outlook of economic activity. Although in the first quarter employment increased by 0.7% compared to the previous quarter, the seasonally adjusted total unemployment rate rose by 0.1 percentage points to 11.4% due to the increase in the participation rate. In this period, industrial employment grew on the back of external demand, while services employment increased amid stronger tourism. Non-farm employment rose despite the decline in construction employment. 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. The Current Account Balance (CAB) registered a deficit of USD 5.6 billion in March 2022, while the annualized current account deficit surged by USD 2.2 billion to USD 24.2 billion. According to provisional external trade data, exports remained strong in April, while imports remained high due to energy and commodity prices. On the other hand, it is observed that short-term regional losses caused by the conflict 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 the credit growth including the long-term investment loans and targeted usage of accessed funds for real economic activity is important for financial stability. In this context, the Committee will decisively continue to implement the strengthened macroprudential policy set by taking additional measures.
19. The Committee expects disinflation process to start on the back of strengthened measures 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. 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 collateral and liquidity policy actions, of which the review process is finalized, will be implemented. 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 effects of exchange rate developments on inflation, 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.