TÜRKİYE CUMHURİYET MERKEZ BANKASI

Summary of the Monetary Policy Committee Meeting

September 26, 2024, No: 2024-53

Meeting Date: September 19, 2024

Global Economy

1. The limited improvement in the global growth outlook continued in the second quarter of the year while the normalization trend seen in the labor market supply-demand balance was maintained. 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 services sector continued to follow a favorable course while the manufacturing industry remained weak. The US economic growth trend continued to diverge positively from other advanced economies. The cautious pace of interest rate cuts to ensure a permanent decline in inflation and geopolitical risks are seen as prominent risk factors for the course of global economic activity in 2024.
2. Global inflation continues to decline, and the inflation data from the US supports the fact that price rigidity in the services sector has begun to weaken. Meanwhile, it is noteworthy that services inflation has not slowed down to the same extent across advanced economies. While emerging economies (EMEs) continue to cut interest rates in a way to maintain monetary tightness, an additional number of central banks of advanced economies began to cut rates. The US Federal Reserve also cut its policy rate by 50 basis points in September. Even though the ongoing improvement in the inflation outlook and the recent developments regarding services inflation strengthen expectations for rate cuts, central banks of advanced economies are expected to adopt a cautious approach in rate cuts. On the other hand, risk appetite and portfolio flows to EMEs' equity markets have fluctuated due to global uncertainties.

Monetary and Financial Conditions

3. With the overnight interest rates averaging between the policy rate and the upper band of the interest rate corridor during the last MPC meeting period and the effect of the amendments in reserve requirement regulations, Turkish lira deposit rates increased by 67 basis points since the week ending August 23 and stood at 56.14% as of September 13. In the same period, Turkish lira commercial loan rates (excluding overdraft accounts and credit cards) decreased by 40 basis points to 56.59%. On the retail loans side, general-purpose loan rates (excluding overdraft accounts) increased by 43 basis points to 73.65% while housing loan rates decreased by 27 basis points to 43.22%. Vehicle loan rates, which follow a fluctuating course in general, were 43.78% as of September 13.
4. The average four-week growth rate of retail loans has increased since the week ending August 23 from 2.27% to 3.27%. In the same period, Turkish lira commercial loans remained below growth limits, at an average four-week growth rate of 1.51%. The average four-week growth rate of FX commercial loans adjusted for exchange rates declined to 1.43%.
5. In order to support the monetary transmission mechanism, certain macroprudential measures have been taken since the last MPC meeting period. Accordingly, as announced in the press release

dated August 29, 2024, a number of changes were introduced in the reserve requirement practice. The monthly growth target was increased to 0.8 percentage points for banks with real-person TRY deposit shares between 45% and 50%. The monthly growth target was abolished for banks with real-person TRY deposit shares exceeding 60%, and the mere condition of keeping this share above 60% was introduced. Legal-person FX-protected (KKM) accounts were included in the calculation of the total target for KKM accounts' transition to TRY and renewals. The upper limit for the remuneration of required reserves, which should be maintained for TRY deposits, based on the rate of transition to TRY, was increased to 84% of the policy rate. The ratio for maintaining TRY required reserves in blocked accounts was increased by 5 percentage points. As a result of the tight monetary policy stance and macroprudential policies supporting this stance, the share of TRY deposits increased while the balances of KKM accounts and FX deposits declined.

6. The gross international reserves of the CBRT increased by USD 3.14 billion since August 23 to USD 153.55 billion as of September 13, 2024. Türkiye's five-year credit default swap (CDS) premium stood at 261 basis points on September 18, 2024, posting a slight decline since August 19. The one-month implied exchange rate volatility of the Turkish lira rose to 10.78%, and the 12-month implied exchange rate volatility fell to 21.51% as of September 18. Since the previous MPC meeting week, net portfolio inflows have totaled USD 0.11 billion, comprising USD 0.44 billion of inflows to the government domestic debt securities (GDDS) market, and USD 0.32 billion of outflows from equity markets.

Demand and Production

7. Gross Domestic Product (GDP) data pointed to a decline in annual and quarterly growth rates in the second quarter of the year. In this period, the contribution of final domestic demand to annual growth decreased markedly while net exports continued to contribute positively to growth. Thus, on the expenditures side, the composition of growth displayed a more balanced demand outlook. Meanwhile, on the production side, the services sector was the main driver of annual growth in the second quarter whereas the industrial value-added had a downward effect on growth. The weak course of the industrial sector is assessed to have been driven by the two religious holidays and bridge days in the second quarter. GDP data for the first half of the year suggest a moderate slowdown in economic activity, taking into account factors such as the brought-forward demand in the first quarter and the bridge days in the second quarter.

8. Indicators for the third quarter confirm that domestic demand continues to slow down with a diminishing inflationary impact. In July, the retail sales volume index increased on a monthly and quarterly basis while its annual growth lost pace. During the same period, the trade sales volume index dropped both on monthly and quarterly basis in line with the decline in trade of motor vehicles and wholesale trade, the other two main components of the index. The services production index, which had fallen in the second quarter, decreased slightly in July and also continued to decline on a quarterly basis. In August, card spending posted a limited monthly and quarterly increase. Although the mild course in seasonally adjusted imports of consumption goods continued in this period, imports of consumption goods still remain at an elevated level. Survey data for manufacturing firms indicate a quarterly decline in domestic market orders. Information on consumption expenditures from interviews with firms confirm the slowdown in domestic demand. Against this background, consumption indicators as a whole suggest that the slowdown in domestic demand continues at a moderate pace.

9. In July, the industrial production index increased by 0.4% month-on-month when adjusted for seasonal and calendar effects, but declined by 3.9% year-on-year when adjusted for calendar effects. On a quarterly basis, industrial production fell by 0.6%. The sector-wide monthly rise in July is attributed to the mechanical effect that compensated for the loss of production stemming from the three-day-long bridge days in June associated with the administrative extension of the religious holiday. Excluding the bridge days and highly volatile sectors, the underlying trend of

industrial production in July is estimated to have been relatively weak. Meanwhile, the manufacturing industry capacity utilization rate posted a quarterly decline in the third quarter.

10. As of July, seasonally adjusted employment rose by 0.3% on a quarterly basis and stood at 32.7 million people. In this period, the labor force participation rate went up slightly while the unemployment rate remained flat at 8.8%. Survey indicators suggest a decline in manufacturing firms' future employment expectations.
11. In July, the current account balance ran a monthly surplus of USD 566 million, whereas the annualized current account deficit decreased by USD 5.9 billion to USD 19.1 billion. This decrease was mostly driven by the fall in the foreign trade deficit excluding gold and energy. On the other hand, the energy trade deficit remained relatively flat, and the gold trade deficit narrowed significantly compared to the previous month. During this period, the annualized services balance surplus recorded a month-on-month increase.
12. In August, provisional foreign trade data pointed to growth in both imports and exports, in seasonally adjusted terms, and a bit more pronounced one in exports. Accordingly, on an annualized basis, the improvement in the current account balance is projected to continue also in August, bolstered by travel revenues. Gold imports were close to their historical averages in August, but dropped to around USD 17.5 billion in annualized terms. Having decreased in the previous three months, imports of consumption goods posted a limited rise in August, and remained elevated in seasonally adjusted terms. When the provisional foreign trade data for August is considered along with the high frequency data for September, the three-month average trends imply a sustained strength in exports, and a mild course in imports, similar to the previous month. These trends point to a limited increase in consumption goods imports in September. 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 ratio stood at around 147% in July. In the non-bank corporate sector, this ratio was around 93%. Accordingly, for the banking sector, external financing opportunities appear to have improved over the previous month.

Inflation Developments and Expectations

14. In August, consumer prices were up by 2.47%, while annual inflation fell by 9.81 percentage points to 51.97% due also to the high base effect. Annual inflation in the B and C indices declined by 9.44 and 8.67 percentage points to 50.87% and 51.56%, respectively. In August, the contribution to inflation dropped across all groups. Adjusted for seasonal effects, monthly consumer inflation slowed slightly. Administered prices once again had a significant impact on headline inflation in August (by 1.2 percentage points), although there was a month-on-month decline in their contribution.
15. In August, monthly price increases in the services group maintained their strong course. The standout items with price hikes in the services group were transport services, due to the adjustments in administered prices, and education services driven by university tuition fees, as well as rents. Despite a slight increase, monthly core goods inflation remained low in seasonally-adjusted terms. This was mainly due to the rise in automobile prices caused by general safety regulations and the course of the euro exchange rate. The prices in the food group decreased in August, led by the unprocessed food subgroup. The main driver of the decline in unprocessed food prices was fresh fruits and vegetables, whose prices saw a sharper drop than their seasonal averages. In this period, both red meat and white meat prices decreased. Price increases in the processed food subgroup weakened in August while the slowdown in the monthly inflation in bread and cereals was noteworthy. Monthly energy inflation, which followed a strong course in the previous month due to the electricity and fuel led developments, remained high due to the

adjustments in natural gas tariffs for households. On the other hand, the decline in fuel prices in line with global developments curbed the monthly energy inflation.

16. When all indicators pertinent to monthly inflation are jointly analyzed, its underlying trend is assessed to have displayed no discernible change in August. The seasonally adjusted three-month average increases in the B and C indices were relatively flat at 2.7% and 2.5%, respectively. In August, processed food, which is among the groups making up the B index, recorded a slight deceleration, whereas other groups posted increases. The impact of certain items with strong time-dependent price setting tendencies, such as education, on indicators based on methods of exclusion, such as B and C indices, was notable. Contrary to this outlook, other underlying trend indicators that are based on the distribution of monthly price changes of subgroups, such as the Median, SATRIM, and the dynamic factor model, as well as the diffusion index weakened month-on-month.

17. Services inflation still exhibits strong backward-indexation. This 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 August, annual inflation was recorded at 28.91% in core goods, and it was around 49 percentage points higher in services at 77.83%. Moreover, the diffusion index for the services sector indicated that price increases continued to spread across the sector.

18. In tandem with the higher rate of contract renewals in August, rent inflation increased somewhat and remained strong. Leading indicators tracked through micro data from the Retail Payment System (RPS) imply that rent increases will remain high due to the noteworthy level of renewed contracts in September. On the other hand, rates of rent increases in new and renewed contracts obtained from RPS micro data, and those monitored through residential property valuation reports are below the current annual inflation in the rent item of the consumer price index (CPI). In fact, it is noteworthy that rates of rent increases in new and renewed contracts show a decline in the RPS data for September. Monthly rent inflation is expected to decelerate in the last quarter of the year as contract renewal rates will fall compared to the third quarter, and the rate of rent increases in new and renewed contracts will continue to decline.

19. The increase in prices in transport services became more discernible in August in line with developments in energy prices. This is mainly attributed to urban passenger transport by road and air passenger transport fees. Contrary to the previous year, the increase in university tuition fees started to take place in August as enrollments began at an earlier date this year. Following the high rate of increases announced, education services became another item whose inflation stood out. Meanwhile, the slowdown in monthly inflation of the restaurants-hotels subgroup was noteworthy, accompanied by moderate price increases in items such as package tours and communication. As the adjustments in private school and university tuition fees have been completed, price increases in education services will weaken considerably in the last quarter of the year.

20. Domestic producer prices rose by 1.68% in August, and annual inflation dropped by 5.62 percentage points to 38.75% due also to the high base effect. According to the main industrial groupings, energy prices remained on the forefront with a monthly increase of 3.04% while price increases in other groups, particularly in non-durable consumption and intermediate goods, were more moderate.

21. Having started in late April, the fall in international commodity prices continued in August as well. Across subgroups, declines were widespread except for gold, and this decline was driven by the energy group led by crude oil. As of the first three weeks of September, the decline in energy prices continued. The decline was driven by Brent crude oil prices dropping to USD 74.1 approximately in the first three weeks of September after hovering around USD 80.9 in August. Meanwhile, non-energy commodity prices have been increasing slightly due to agricultural products.

22. The Global Supply Chain Pressure Index edged up in August, hovering slightly above its historical average. Container indices for the globe and China, which had posted an increase after April, started to decrease in August while dry cargo transport indices have been on a relatively mild track. After mildly strengthening in August, the rise in the basket exchange rate weakened again in September and exchange rate-driven pressures proved temporary. Meanwhile, in August, the seasonally-adjusted manufacturing industry PMI data point that input prices remained flat and final product prices increased slightly.
23. According to the results of the Survey of Market Participants in September, inflation expectations declined across all horizons. The 12-month-ahead inflation expectation was down by 1.2 percentage points from 28.7% to 27.5% while the 24-month-ahead inflation expectation was down by 0.9 percentage points from 19.3% to 18.4%. Moreover, inflation expectations for the end of current year and the next year decreased by 0.2 and 0.3 percentage points to 43.1% and 25.3%, respectively. Meanwhile, the five-year-ahead inflation expectation was measured at 11.2%. Although inflation expectations have declined across all horizons, the current levels continue to pose an upside risk to the inflation outlook. According to the expectations of the real sector, the 12-month-ahead inflation expectations of firms declined from 55.0% in June to 53.8% in August, showing a limited improvement. On the other hand, in the same period, the 12-month-ahead inflation expectations of households increased slightly from 72.0% to 73.1%. The Committee noted that inflation expectations and pricing behavior continue to pose risks to the disinflation process.
24. Leading indicators suggest that seasonally adjusted monthly consumer inflation will slow down in September compared to the previous month. Average monthly inflation in B and C indicators is expected to follow a relatively flat course in seasonally adjusted terms. In September, the core goods group has registered a somewhat stronger price increase. Meanwhile, monthly services inflation has remained elevated. Services inflation has been marked by the start of the new education year in September. The carry-over effects of university tuition fees pushed education services upwards while school bus fares spurred prices of transport services. Moreover, the increase in dormitory fees added to the inflation in the restaurants-hotels subgroup. Price developments in items other than school bus fares have been moderate in transport services. After a decline in August, food prices are expected to edge up in September but remain on a favorable track. Processed food inflation recorded a month-on-month deceleration and price increases appear to be mild across the group. In the energy group, tariff revisions in administered items ended in August while fuel prices receded in line with global developments. Having surged due to administered prices in the last couple of months, energy prices are assessed to remain relatively flat in this period.
25. While core goods inflation remains low despite a slight uptick, the improvement in services inflation is expected to occur in the last quarter. As the relative price adjustments have been completed to a large extent in items exhibiting strong time-dependent price setting as well as backward-indexation behaviours, services inflation is expected to follow a milder course in the last quarter with rent inflation displaying some improvement as well.

Monetary Policy

26. The Committee decided to keep the policy rate unchanged, but reiterated that it remains highly attentive to inflation risks.
27. 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, the disinflation process will gain strength. 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 tools will be used effectively in case a significant and persistent deterioration in inflation is foreseen.

28. In case of unanticipated developments in credit and deposit markets, monetary transmission mechanism will be supported via additional macroprudential measures. Liquidity conditions are assessed with respect to prospective developments and closely monitored. Sterilization tools will continue to be implemented effectively.

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.