

Summary of the Monetary Policy Committee Meeting

27 January 2022, No: 2022-08

Meeting Date: 20 January 2022

Inflation Developments

1. Consumer prices rose by 13.58% in December, and annual inflation increased by 14.77 points to 36.08%. While this development was predominantly driven by the price increases in the core goods and food groups, annual inflation went up across all main groups. The impact of exchange rate developments was observed in the core goods group, in which the exchange rate pass-through is high, led by durable consumption goods, and prices in the food group excluding fresh fruits and vegetables rose substantially. The depreciation of the Turkish lira, the elevated course of commodity prices, and the lingering disruptions in supply chains caused the rise in producer prices to continue at an accelerated pace. Against this background, the annual inflation and the recent underlying trends of the B and C indices increased significantly.
2. In December, prices of food and non-alcoholic beverages increased by 15.99%, and the group's annual inflation surged by 16.69 points to 43.80%. Annual inflation rose to 39.83% in the unprocessed food group, and to 47.57% in the processed food group. In the unprocessed food group, seasonally adjusted data revealed a relatively milder monthly increase in prices of fresh fruits and vegetables whereas they pointed to significant price increases in the other unprocessed food group, particularly in items such as milk, white meat, eggs, potatoes, and red meat. Processed food prices posted a substantial monthly increase of 16.47% in December, with bread and cereals, oils and fats, cheese and other dairy products, and meat products in the lead. These developments were mostly driven by exchange rates, agricultural commodity price developments, and agricultural drought.
3. Energy prices increased by 9.75% in December, and annual energy inflation rose by 10.79 points to 42.93%. Despite a decline in international energy prices in this period, domestic prices rose due to exchange rate developments. Solid fuels, bottled gas, and fuel stood out with the ongoing large price hikes they registered. The rise in energy inflation is expected to continue in a pronounced manner in January. This is due to the rebounding international energy prices as well as the price adjustments made in January in electricity and natural gas used in dwellings.
4. Annual core goods inflation increased substantially by 22.19 points to 40.55%. Led by the durable goods group in which the exchange rate pass-through is high, annual inflation rose significantly across all subcategories due to the developments in the Turkish lira. Durable goods prices surged by 30.33% month-on-month, driven by large price increases in sub-items such as automobiles in particular, white goods, other electric and non-electric appliances, and furniture. The clothing and footwear group, in which seasonal sales began, posted a monthly price increase in this period contrary to the seasonal trend. Meanwhile, price hikes showed a generalized pattern across other core goods as well.

5. Services prices rose by 5.27% in December and annual services inflation increased by 5.45 points to 22.33%. While annual inflation declined in communication, it increased in other subcategories, most visibly in restaurants-hotels. Driven by prices of catering services that increased due also to the negative outlook in food prices, and by prices of accommodation services that further increased in this period, annual inflation in the restaurants-hotels group reached 40.85% and continued to push up the services inflation. The rise in prices of transport services was led by increases in the intercity road transportation and air passenger transportation fares, while insurance charges as well as maintenance and repair prices with high exchange rate sensitivity were the leading drivers of the increase in prices of other services. According to seasonally adjusted data, the upward trend in rent inflation continued in December. The strong backward-indexation mechanism in the services sector keeps the risks for the upcoming period alive.
6. In December, prices of tobacco products posted an increase of approximately TRY 2, driven by producer firms, adding approximately 0.49 points to consumer inflation. As of January, the last six months' PPI increase in the alcoholic beverages and tobacco group was reflected in specific and minimum specific taxes, and cigarette prices rose on average by TRY 4 per pack in line with the tax increase.
7. According to the January results of the Survey of Market Participants, the current year-end inflation expectation stood at 29.75%, while the 12-month ahead inflation expectation increased by 3.98 points to 25.37%. The long-term data reveal that the revision in the five-year ahead inflation expectation remained relatively limited, and the expectation increased by 0.20 points to 8.92%.

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 new 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 and rise in transportation costs have led to producer and consumer price increases internationally. While the effects of high global inflation on inflation expectations and international financial markets are closely monitored, central banks in advanced economies assess that the rise in inflation on the back of rising energy prices and imbalances between supply and demand may last longer than previously anticipated. 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 continue their supportive monetary stances and asset purchase programs.
10. Outflows from emerging market debt securities markets stopped, and equity markets witnessed a surge in inflows. 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 portfolio flows channel towards Turkey are 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 distorted pricing behavior due to unhealthy price formations in the foreign exchange market, supply side factors such as the rise in global food and agricultural commodity prices, supply constraints, and demand developments.

12. Producer prices continued to rise markedly in December, largely due to energy and intermediate goods. Although prices were up across all sectors, their tendency was particularly higher for manufacturing industry excluding oil and base metals. In this period, prices of main inputs such as base metals, energy, textile, paper and chemical products increased significantly. The depreciation of the Turkish lira, higher commodity prices and ongoing supply chains disruptions were the main factors driving producer prices up. It is noteworthy that the indicators monitored for global supply chain pressures reached their highest level in history.
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 3.3% month-on-month in November, indicating that production continued to grow at an even stronger pace in the fourth quarter of the year. While production grew across all main industrial groups, the increases especially in durable and capital goods were stronger than the headline production growth. Industrial turnover indices suggest that both domestic and external demand are robust. As of December, investment tendencies of manufacturing industry firms for the next twelve months remain high.
14. Despite the recent upsurge in new cases, the spread of domestic vaccination throughout the society helps keep services, tourism and related sectors, which have been adversely affected by the pandemic, strong, and leads to a more balanced composition in economic activity. In fact, according to data on credit card spending, the rate of increase is higher for services sectors that are severely hit by the pandemic. The retail sales volume and services turnover indices continue to rise at a stronger pace.
15. The improvement in the labor market continues in line with the economic activity outlook. In November, employment grew across all sectors, and the labor force participation rate increased. Thus, in seasonally adjusted terms, the unemployment rate remained unchanged at 11.2%. Survey indicators and high-frequency data suggest that the improvement in the employment outlook and the positive course in the labor market continue. However, the effects of the large minimum wage hike and the likely increase in other wages to the labor market, especially to registered employment, are closely monitored.
16. Favorable external demand conditions impact the current account balance positively. Current account balance ran a deficit of USD 2.7 billion in November while the current account deficit decreased by USD 0.9 billion to USD 14.3 billion in 12-month cumulative terms. Provisional foreign trade data suggest that exports remained strong in December, but imports continued to increase due to the large increase in energy imports. In addition to strong economic activity, the strong course of energy imports driven by high energy prices and the increased need for heating led to a deterioration in the foreign trade balance in the last quarter, whereas the real balancing in foreign trade excluding price effects continues. 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 improvement trend in current account balance is important for price stability objective, and in that respect, developments in commercial and consumer loans are closely monitored.

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 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. The cumulative impacts of the recent policy decisions are closely monitored and to create a foundation for sustainable price stability, a comprehensive policy framework review is being conducted with the aim of prioritizing Turkish lira 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 price stability objective, the Committee will continue to follow an approach that also addresses risks to financial stability.
20. Accordingly, the effects of Turkish lira liquidity developments on deposits and loan pricing, the lagged effects of exchange rate developments on inflation expectations, and the impact of the developments regarding FX-hedged deposit products on reverse currency substitution, exchange rate stability and price stability are being analyzed and necessary policy measures are being taken.
21. The CBRT will continue to use decisively all available instruments until strong indicators point to a permanent fall in inflation and the medium-term 5 percent 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.