# Summary of the Monetary Policy Committee Meeting

**29 September 2022, No: 2022-40**

Meeting Date: 22 September 2022

## Inflation Developments

1. Consumer prices rose by 1.46% in August, and annual inflation edged up by 0.61 points to 80.21%. In this period, annual inflation receded in energy and food, whereas it went up in core goods and services. Annual inflation increased in subgroups of core goods; in services, while dropped in transport, it rose in other subgroups of services. In the food group, driven by prices of fresh fruits and vegetables, annual inflation fell in unprocessed food, but increased further in processed food. Energy inflation registered a decline on the back of fuel prices that fell in tandem with the outlook for international crude oil prices. In line with the fall in international commodity prices, the monthly increase in producer prices lost pace compared to past months, and annual inflation decreased somewhat. Against this background, the rise in the annual inflation of B and C indices continued, while some core indicators such as seasonally-adjusted median inflation posted a limited decline.
2. Prices of food and non-alcoholic beverages increased by 0.85% in August, while the group's annual inflation dropped by 4.40 points to 90.25%. While annual inflation fell by 11.49 points to 79.51% in unprocessed food, it increased by 2.36 points to 100.38% in processed food. Seasonally-adjusted prices of fresh fruits and vegetables recorded a decline in August. In other unprocessed food, price hikes in eggs and rice were notable, while white meat and potatoes registered falling prices. Meanwhile, the rise in processed food prices was driven by bread-cereals accompanied by sugar and related products as well as canned vegetables and non-alcoholic beverages.
3. Energy prices receded by 2.68% in August, and the group's annual inflation fell by 7.54 points to 121.73%. The decline of 7.79% in fuel prices following the fall in international crude oil prices was the main driver of energy prices also in August. On the other hand, municipal water and solid fuel prices continued to increase.
4. Prices of services rose by 3.16% in August, pushing annual services inflation up by 2.85 points to 54.30%. In this period, while annual inflation receded slightly in the transport group due to the developments in fuel prices, it increased in other subgroups, most visibly in other services and rents. Price increases were broad-based in the other services subgroup. Education, due to the raised university tuitions, health, recreation-culture and insurance services driven by car insurance items stood out. The monthly increase in the rents group remained high at 4.40%, and seasonally-adjusted data suggested an acceleration compared to previous months. In the restaurants-hotels group, price increase was higher compared to the previous month, yet remained below those in the first half of the year. In August, annual inflation in this subgroup edged up by 1.81 points and reached 80.95%. In transport services,

increases in urban passenger transport, air passenger transport and cargo fees were notable, while the decline in intercity passenger transport by road kept subgroup’s price increase moderate, and annual inflation edged down by 0.42 points to 90.29%.

5. Annual core goods inflation rose by 5.98% points to 76.91% in August. Price hikes in durable goods were driven by automobiles and white goods, and annual inflation in this group rose by 6.86 points and hit 91.79%. Parallel to July, prices of clothing and footwear registered increases contrary to seasonal norms, and annual inflation rose by 5.93 points to 37.38% in this subgroup. In other core goods, annual inflation increased by 4.41% to 80.12%, with household cleaning supplies, medicines and personal care products in the lead.
6. According to the September results of the Survey of Market Participants, current year-end inflation expectations decreased by 2.87 points to 67.73%, while 12-month ahead inflation expectations were revised downwards by 5.25 points to 36.74%. Meanwhile, 24-month ahead inflation expectations dropped by 3.72 points to 20.63%.

## Factors Affecting Inflation and Risks

7. The weakening effects of geopolitical risks on global economic activity continue to increase. Global growth forecasts for the upcoming period are being revised downwards and recession is increasingly assessed as an inevitable risk factor.
8. While the negative consequences of supply constraints in some sectors, particularly basic food, have been alleviated by the strategic solutions facilitated by Türkiye, the upward trend in producer and consumer prices continues on an international scale. 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, imbalances between supply and demand, and rigidities in labor markets. The divergence in monetary policy steps and communications of central banks in advanced economies continue due to their diverse economic outlook. It is observed that central banks continue their efforts to develop new supportive measures and tools to cope with the increasing uncertainties in financial markets.
9. Regarding portfolio flows to emerging economies, bond and equity markets have both continued to register outflows in September in line with the global risk appetite. Moreover, the volatility in the long-term bond yields in advanced economies and the course of global financial conditions keep the risks to portfolio flows to emerging economies alive.
10. Due to the impact of the policy steps taken within the scope of the liraization strategy, Türkiye's Turkish lira-denominated government bond yields, especially in long maturities, performed more favorably in this period compared to peer economies.
11. Increase in inflation is driven by the lagged and indirect effects of rising energy costs resulting from geopolitical developments, 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. Annual producer inflation decreased in August. It is evaluated that the moderate course of international commodity prices and the declines in transport expenses have alleviated cost pressures to some extent. Having surged due to geopolitical problems, natural gas prices continued to be the main factor deteriorating this outlook in August. Across main industrial groupings, annual inflation declined in the energy group led by petroleum products, but increased in other subgroups in August. While price increases became widespread across subgroups, tobacco products, other mining and quarrying products, basic pharmaceuticals and paper and paper products stood out. Meanwhile, the effect of the positive outlook for

international commodity prices was more pronounced in refined petroleum products and base metals, and prices fell further in these subgroups.

13. A strong growth was observed in the first half of 2022. The Gross Domestic Product (GDP) data for the second quarter of 2022 indicated that economic activity maintained its strong course in the first quarter. In this period, GDP increased by 7.6% year-on-year, and by 2.1% quarter-on-quarter in seasonal and calendar-adjusted terms. Industrial value added increased by 7.8% on an annual basis thanks to the strong course of exports. The value added of the services sectors increased by 11.9% on the back of the strong tourism activity despite the war. The contribution of net exports to annual growth was 2.7 points. Machinery-equipment investments, one of the subitems of investments, went up by 17.8% on an annual basis, showing an annual increase for eleven quarters in a row.

14. Since the beginning of July, leading indicators have been pointing to a slowdown in growth due to the weakening foreign demand. While industrial production decreased by 6.2% month-on-month in seasonally and calendar adjusted terms, it increased by 3.1% year-on-year in July. After increasing by 1.9% and 0.9% in the first two quarters of the year, industrial production contracted by 5.1% in the third quarter due to the bridge days associated with the religious holidays and partial suspension of production in factories in July. While, the month-on-month decline in industrial production spread across sectors in July, clothing, textiles, basic metals and other transportation sectors posted higher monthly production losses of 8.6%, 10%, 9.3% and 19.4%, respectively. Although the retail sales volume index decreased slightly in July compared to the previous month, credit card spending continued to increase in the July-August period compared to the previous quarter.

15. Leading indicators for the third quarter continue pointing to loss of momentum in economic activity due to the decreasing foreign demand. Survey-based indicators such as Business Tendency Survey, PMI and sectoral confidence indices as well as other high-frequency data point to a quarterly slowdown in economic activity as of mid-September. Registered domestic and external orders and future order expectations of manufacturing industry firms reveals a weakening in total demand, which is more pronounced for external demand. Firms' investment and employment expectations declined compared to the second quarter. Information obtained from field interviews also gave similar signals regarding the economic activity in this period.

16. In July, employment was about 3 million higher than its pre-pandemic level (February 2020). In fact, compared to peer economies, job creation has been stronger. Considering the sectors that contribute to the employment increase, it is observed that the growth dynamics are supported by structural gains. On the other hand, on a monthly basis compared to the previous month, seasonally adjusted employment decreased by 148,000 persons leading 0.5% decrease in July. In this period, seasonally adjusted labor force participation rate decreased from 53.1% in the previous month by 0.5 points to 52.6% and is still 1.7 percentage points above its pre-pandemic level (February 2020). In July, on the unemployment rate, the downward effect of the decline in labor force participation exceeded the upward effect of the decline in employment. Thus, the unemployment rate declined and dropped by 0.3 points from the previous month to 10.1%. Survey indicators and high-frequency data indicate that the upward trend in employment has lost momentum.

17. The recent strong course of energy and gold imports still affects the current account balance. The current account balance posted a deficit of USD 4.0 billion in July 2022, while the annualized current account deficit increased by USD 3.7 billion to USD 36.6 billion. When the provisional foreign trade data for August is evaluated together with the high frequency data for September, it is observed that uptrend in the first half of the year in seasonally adjusted exports is replaced by a limited decline in the third quarter. Imports, on the other hand,

strengthened on the back of high imports of energy and gold. Despite the increase in the foreign trade deficit led by the surge in commodity prices, mainly energy prices, the ongoing uptrend in services revenues continue to support the current account balance. While share of sustainable components of economic growth increases, the stronger than expected contribution of tourism revenues to the current account balance continues thanks to the increase in per capita tourist spending. On the other hand, high course of energy prices and the likelihood of a recession in main trade partners keep the risks on current account balance alive. Sustainable current account balance is important for price stability.

## Monetary Policy

18. 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.

19. In formulating the monetary policy towards achieving the sustainable price stability objective, a liraization-oriented approach will be maintained that also addresses risks to financial stability. The rate of credit growth and allocation of funds for real economic activity purposes are closely monitored. In addition, the spread between policy rate and the loan interest rates driven by the announced macroprudential measures is closely monitored. The Committee will continue to further strengthen the tools supporting the effectiveness of the monetary transmission mechanism.

20. The Committee expects disinflation process to start on the back of measures taken and decisively implemented for strengthening sustainable price and financial stability along with the resolution of the ongoing regional conflict. It is important that financial conditions remain supportive to preserve the growth momentum in industrial production and the positive trend in employment in a period of increasing uncertainties regarding global growth as well as escalating geopolitical risks. Accordingly, the Committee has decided to reduce the policy rate by 100 basis points, and has assessed that the updated level of policy rate is adequate under the current outlook.

21. 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 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.

22. The credit, collateral and liquidity policy actions, of which the review process is finalized, will continue to be implemented to strengthen the effectiveness of the monetary policy transmission mechanism. The rise in the demand for long-term fixed-income and Turkish lira-denominated assets and the course of the yield in tandem with the direction of the efficiency of monetary transmission is closely monitored. Along with credit growth, the Committee will also consider the improvement in financing costs of loans providing efficiency gains in targeted areas so as to maintain the transmission.

23. 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.

24. 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 5 percent target is achieved in pursuit of the primary objective of price stability.

25. 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.

26. The Committee supports building strong policy coordination and a holistic macro policy mix involving all stakeholders in order to achieve price stability.

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