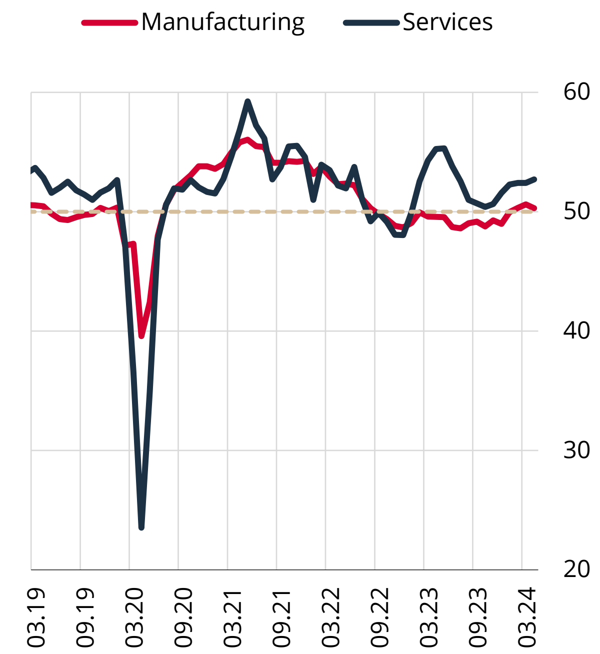
2. Economic Outlook

2.1 Global Economy

While leading indicators pointed to a limited improvement, economic activity nevertheless remained weak in the first quarter of the year. Meanwhile, in terms of the growth outlook, the divergence between the US and other advanced economies became more pronounced. Global PMI data for the manufacturing industry registered a gradual recovery and exceeded the threshold value. However, the index continued to remain below the threshold value in advanced economies for the nineteenth consecutive month. Having lost significant momentum in the second half of 2023, the services sector gained pace again. Accordingly, leading indicators point to a partial improvement in the growth outlook over the previous reporting period, chiefly driven by services (Chart 2.1.1). The growth forecasts were revised upwards in many of Türkiye's trading partners, but the improvement remained limited in countries except the US (Table 2.1.1). Against this backdrop, the global growth index weighted by the export shares of Türkiye's trading partners is estimated to increase by 2.1% in 2024, with an upward revision of 0.1 points compared to the previous reporting period. While the US economy diverges positively from other major economies despite a partial loss of momentum in economic activity in the first quarter of the year, the outlook for the euro area remains weak. As for Chinese economy, the projection for a slowdown in growth in 2024 and 2025 was maintained despite the higher-than-expected first-quarter growth and the slight improvement in forecasts.

Chart 2.1.1: Global PMI Indices (Level)



Source: S&P Global.

Table 2.1.1: Growth Forecasts for Türkiye's Main Trading Partners* (%)

	2023	Forecast for 2024		Forecast for 2025	
		IR 2024-I	IR 2024-II	IR 2024-I	IR 2024-II
Euro Area	0.4	0.5	0.5	1.3	1.4
Germany	-0.3	0.3	0.1	1.2	1.1
USA	2.5	1.4	2.3	1.7	1.7
UK	0.1	0.2	0.3	1.0	1.2
Italy	0.9	0.5	0.7	1.0	1.0
Iraq	-0.6	3.7	2.3	0.5	0.7
Spain	2.5	1.3	1.7	1.8	1.8
France	0.9	0.7	0.7	1.3	1.3
Netherlands	0.1	0.5	0.7	1.6	1.4
Israel	2.0	1.6	1.5	3.4	3.8
Russia	3.6	1.7	2.3	1.1	1.4
UAE	2.9	4.2	4.2	1.5	2.1
Romania	2.1	3.2	2.9	3.7	3.5
Belgium	1.5	1.0	1.1	1.5	1.4
Poland	0.2	2.8	2.9	3.5	3.7
Egypt	3.8	3.5	3.8	4.4	4.8
Bulgaria	1.8	2.2	2.2	2.8	3.0
China	5.2	4.6	4.7	4.3	4.4

Source: Consensus Economics, S&P Global.

* IR stands for Inflation Report. Countries are ranked according to the size of their share in Türkiye's exports in 2021.

The global growth outlook and composition, increased geopolitical risks, financial conditions, and supply-side factors continue to play a determining role in commodity prices. Compared to the previous reporting period, price increases have spread across commodities. There are substantial increases in energy commodity prices. Due to the escalating geopolitical tensions in Russia-Ukraine and the Red Sea as well as the decisions by the OPEC+ member countries to extend production cuts, upward supply-side pressures on oil prices continue. Meanwhile, the global growth outlook, levels of oil stocks, and financial conditions cause fluctuations in oil prices. Brent oil prices per barrel have risen by 4.3% compared to the previous reporting period. Although natural gas prices have increased somewhat in recent months, there has been a significant decline in annual terms due to the weak course of the economic outlook in the euro area as well as the high levels of natural gas stocks thanks to mild climate conditions and increased imports of liquefied natural gas. Industrial commodity prices, which have historically been on a path consistent with the global growth outlook and China's growth in particular, have posted substantial increases compared to the previous reporting period. On the other hand, although agricultural commodity prices exhibit heterogeneity, the headline index for agricultural commodities has gone up by 1.0% compared to the previous reporting period (Table 2.1.2).

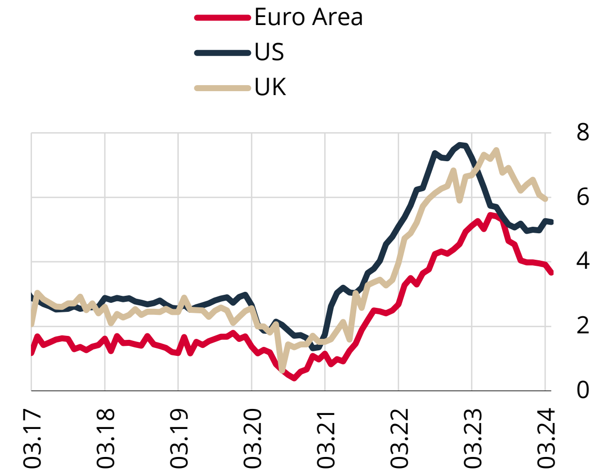
Table 2.1.2: Commodity Prices (%)

	January 2024	February 2024	March 2024	April 2024	Annual	Compared to the Previous Reporting Period*
Headline Commodity Index	0.9	2.1	3.1	3.9	1.9	5.4
Energy	1.8	3.1	3.4	3.7	4.5	3.8
Agricultural Commodities	-3.4	-1.2	0.4	2.5	-14.9	1.0
Industrial Metals	-0.1	-1.1	3.8	9.0	3.4	19.6
Precious Metals	-0.4	-0.5	7.2	8.0	16.0	12.9
Non-Energy	-0.4	0.7	2.8	4.2	-1.7	7.7
Brent Oil	2.5	4.6	2.1	5.1	5.7	4.3
Natural Gas (USA)	7.5	-34.6	-2.2	2.5	-18.1	3.9
Natural Gas (Europe)	-16.9	-14.3	4.4	7.9	-31.1	5.3
Coal	-10.8	-5.9	8.3	-0.7	-32.0	18.0
Aluminum	0.5	-1.1	2.4	11.5	6.6	16.8
Copper	-1.0	-0.5	4.8	9.4	8.9	23.3
Iron	1.1	-6.6	-12.6	-3.8	-9.9	-14.1
Wheat	-1.9	-2.8	-7.1	4.1	-15.4	-0.6
Soy Beans	-6.0	-5.1	0.9	-1.3	-21.8	-4.0
Rice	2.0	5.0	-5.3	2.4	4.7	1.3
Corn	-3.5	-6.5	1.7	1.1	-33.6	1.4
Cotton	3.0	12.7	1.7	-12.1	2.3	-12.5
Sugar	1.5	3.9	-6.7	-5.2	-16.0	-17.8

Source: Bloomberg.
* Denotes the percentage change between 8 February 2024 and 30 April 2024.

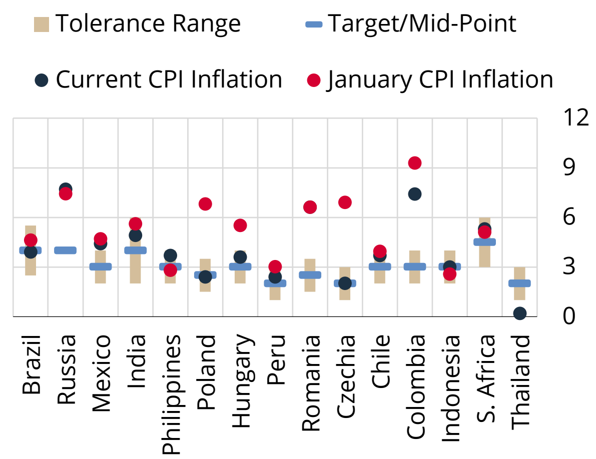
The downtrend in advanced economies' headline inflation has recently been replaced by a rather flat course due to energy price hikes, whereas core inflation has continued to decline. However, inflation is still above the targets, and upside risks to the inflation outlook remain. While tight labor markets and related wage pressures lead to stickiness particularly in services inflation, geopolitical developments also adversely affect the disinflation process through energy prices and global supply conditions. Services inflation in advanced economies is higher compared to the headline inflation that fluctuates within the 3-to-3.5% band (Chart 2.1.2). While this picture is supported by the relatively strong economic activity in the US, inflation rates for the first four months of 2024 have exceeded expectations. On the other hand, recent inflation developments have been more favorable in the UK and the euro area. While inflation rates across emerging economies have continued to converge to the targets in general, the number of countries where the inflation rate has dropped so as to remain within the tolerance range has increased over the previous reporting period (Chart 2.1.3). Thus, the global disinflation process is ongoing, but the importance of sectoral rigidities and risk factors in attaining the targets increases as inflation declines.

Chart 2.1.2: Services Inflation in Advanced Economies (Annual, %)



Source: Bank of England, ECB, St. Louis Fed.

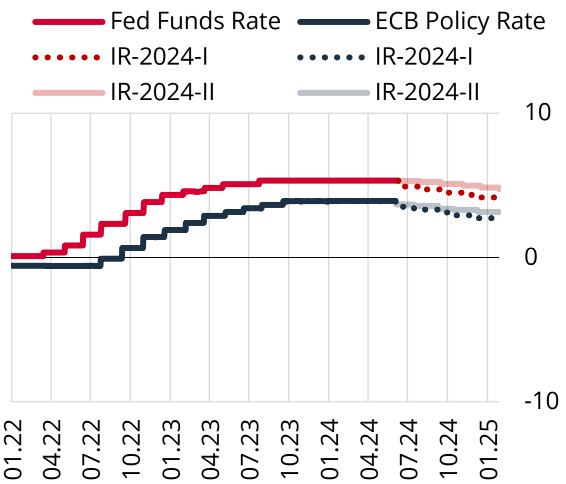
Chart 2.1.3: Consumer Inflation in Emerging Economies
(Target, Tolerance Range, Realizations %)



Source: Bloomberg.

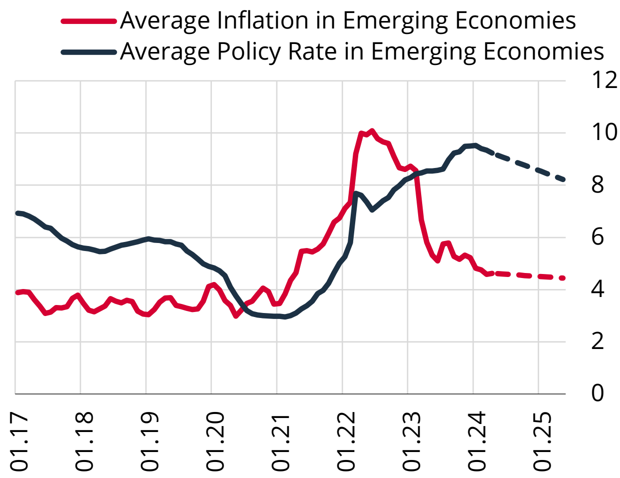
Due to the stickiness in inflation and upside risk factors, expectations for more cautious rate cuts by major central banks have strengthened. As the US economy has diverged from other major economies in terms of growth and inflation outlook, expectations regarding the monetary policy also started to diverge. Compared to the previous reporting period, expected rate cuts by both the Fed and the ECB have been postponed, and a slower pace of rate cuts by both banks has been priced in. However, the market pricing of the ECB policy rate for the year-end has increased by 43 basis points whereas this increase has been more significant for the Fed at 68 basis points (Chart 2.1.4). While the Fed kept the policy rate unchanged at 5.5% in March, the median rate-cut projection of the committee members for 2024 also remained the same at 75 basis points. After its May meeting, the Fed stated that the stickiness in inflation may last longer than anticipated and signaled that it would be patient in reducing rates. Although market pricing at the start of the year was beyond the three rate cuts implied by the Fed in December and March, the upside surprises in inflation rates throughout the reporting period and the Fed's communication led the amount of rate cuts priced by the market to decline even below the 75 basis points that the Fed had implied. Meanwhile, having maintained its policy rate for the fifth consecutive meeting in April, the ECB revised its inflation forecasts downwards and signaled that it may deliver rate cuts in the coming meetings unless there is a new development that will prevent inflation from returning to the target in a sustained manner. In the current reporting period, due to inflation rates climbing above its target, the Bank of Japan took its first policy tightening step in 17 years and raised its policy rate to a positive level while also ending its long-term interest rate targeting policy. On the other hand, interest rate cuts continue in an increasing manner in emerging economies on the back of the ongoing improvement in the inflation outlook. In the current reporting period, Banco Central do Brazil (50 basis points), Banco de México (25 basis points), Central Reserve Bank of Peru (25 basis points), Central Bank of Colombia (100 basis points), Czech National Bank (100 basis points), Central Bank of Chile (75 basis points), and Magyar Nemzeti Bank (225 basis points) cut their policy rates. However, having delivered a more limited monetary tightening in the previous period, Bank Indonesia raised its policy rate by 25 basis points, underlining the increased global uncertainty and the pressure on exchange rates. In the coming period, rate cuts are likely to spread across advanced and emerging economies depending on the fall in inflation. However, considering the level and persistence of inflation, increased uncertainties and risks, rate cuts are expected to be carried out in a way that will maintain sufficient monetary tightness and ensure a sustained decline in inflation. In this respect, futures-implied policy rates suggest that policy rates in emerging economies will continue to be set above the inflation rates (Chart 2.1.5).

Chart 2.1.4: Market-Implied Policy Rate Paths (Effective, %)



Source: Bloomberg.

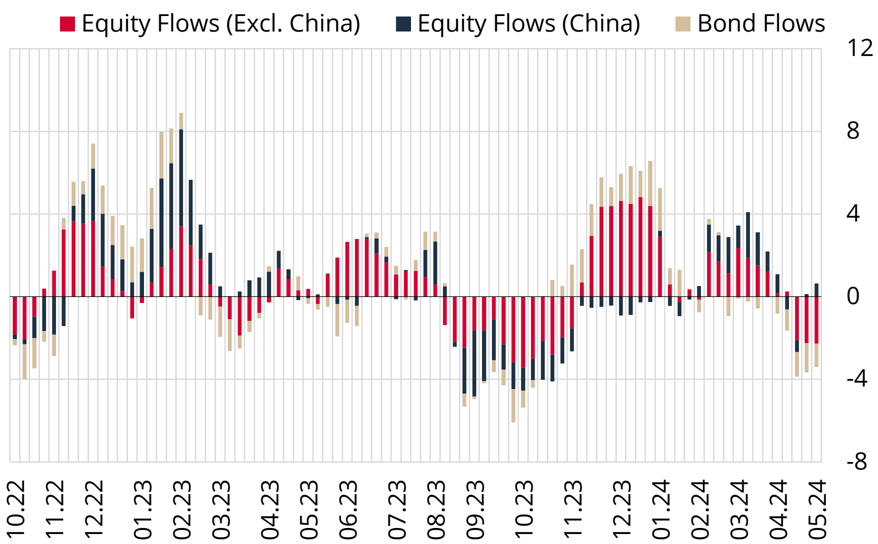
Chart 2.1.5: Futures-Implied Policy Rate and Inflation Expectations* (% Points)



Source: Bloomberg.
* Inflation expectations have been taken from the Bloomberg survey. Emerging economies include Brazil, Chile, Colombia, Czechia, Hungary, India, Indonesia, Mexico, Peru, the Philippines, Poland, Romania, Russia, South Africa and Thailand.

Fluctuations in the global risk appetite and the changes in expectations for rate cut cycles of major central banks, the Fed in particular, lead to a volatile course in portfolio inflows to emerging economies. Between 6 November 2023 and 2 February 2024, corresponding to the previous reporting period when rate cuts by major central banks were strongly priced in, portfolio inflows totaled USD 56.3 billion, USD 17.3 billion of which was to bond markets and USD 39 billion to equity markets excluding China. In the current reporting period, however, there were outflows from bond markets as well as from equity markets excluding China, due to weakened market pricing of rate cuts and increased risk perception. On the back of the financial support program and the facilitation of equity transactions by Chinese citizens and foreign investors from the same market, portfolio inflows (totaling USD 15.9 billion) were registered in China's equity market, which had seen portfolio outflows (totaling USD 30.4 billion between 7 August 2023 and 19 January 2024) for six months in a row (Chart 2.1.6).

Chart 2.1.6: Weekly Portfolio Flows to Emerging Economies
(Four-Week Moving Average, USD Billion)

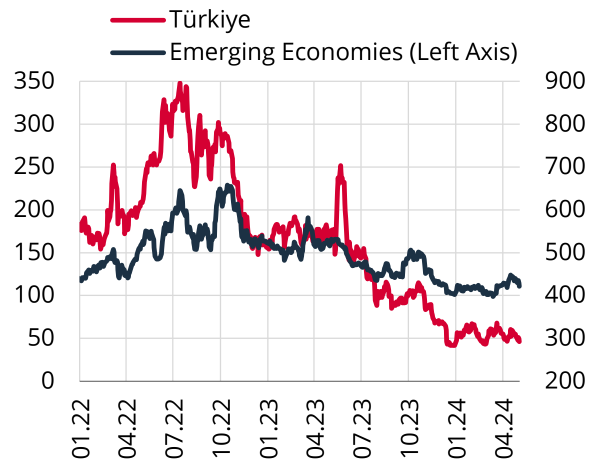


Source: IIF.

2.2 Financial Conditions

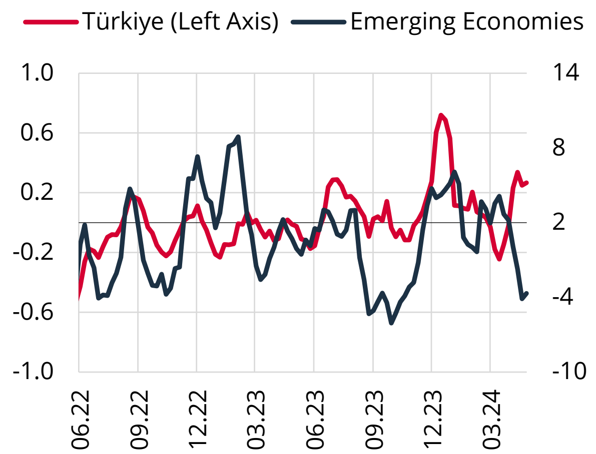
The global risk appetite weakened in the current reporting period, while the CBRT's monetary tightening supported the positive divergence of Türkiye's risk premium from peer countries. As financial conditions became tighter due to heightened geopolitical risks and stronger expectations that emerging economy central banks would be more cautious in rate cuts, the global risk appetite declined, particularly in April. Accordingly, risk sentiment towards emerging market economies deteriorated. Türkiye's risk premium, on the other hand, diverged positively from those of emerging economies in general. Having fluctuated in February and March, Türkiye's five-year CDS premium decreased, particularly after the MPC decision on 21 March, and fell below 300 basis points again (Chart 2.2.1). While international investors sold emerging market assets due to the deterioration in risk appetite, Turkish GDDS and equity markets recorded net inflows of USD 0.56 billion and USD 0.28 billion, respectively (Chart 2.2.2).

Chart 2.2.1: CDS Premium in Türkiye and Emerging Economies* (Five-Year, Basis Points)



Source: Bloomberg.
* Emerging economies include Brazil, Chile, Colombia, Indonesia, Malaysia, Mexico, Philippines and South Africa.

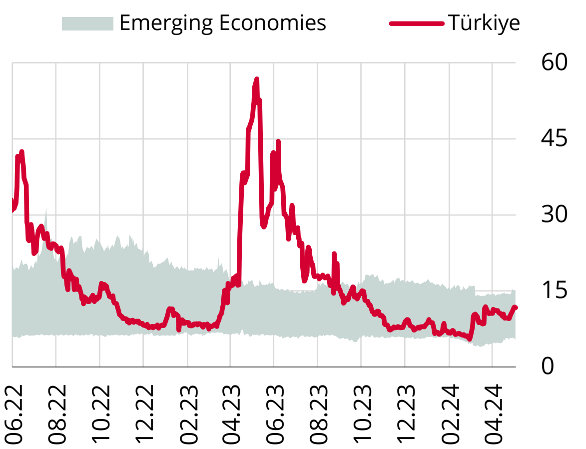
Chart 2.2.2: Portfolio Flows to Türkiye* and Emerging Economies (Four-Week Average, USD Billion)



Source: CBRT, IIF.
* Turkish data includes portfolio flows to equity and GDDS markets. Repo is excluded from the GDDS data.

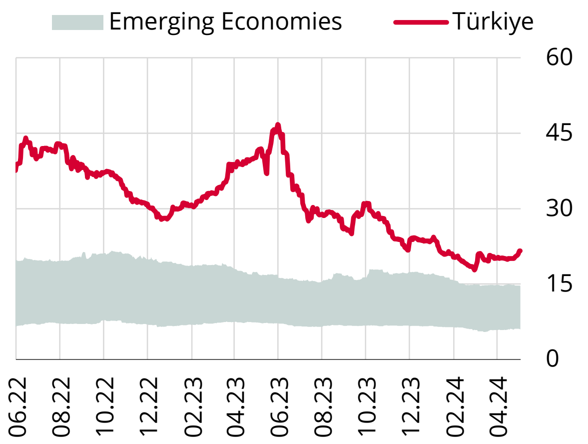
The volatility of the Turkish lira has increased since March. In the current reporting period, emerging market currencies depreciated against the US dollar amid deteriorating global risk appetite, with the Turkish lira depreciating more. Having hovered at very low levels for a long time, the short-term implied volatility of the Turkish lira climbed to middle ranks among emerging market currencies. The increase in long-term FX volatility, on the other hand, was limited. In the current reporting period, the one-month implied volatility of the Turkish lira exceeded 11%, while the 12-month volatility approached 22% (Charts 2.2.3 and 2.2.4). The difference between short and long-term volatilities indicates that policies continue to have an impact on exchange rate stability, but longer-term risks persist.

Chart 2.2.3: Implied Volatility of FX Options* (Against USD, One-Month Maturity, %)



Source: Bloomberg.
* Emerging economies include Brazil, Chile, Colombia, Hungary, Indonesia, Malaysia, Mexico, Philippines, Poland, Romania and South Africa.

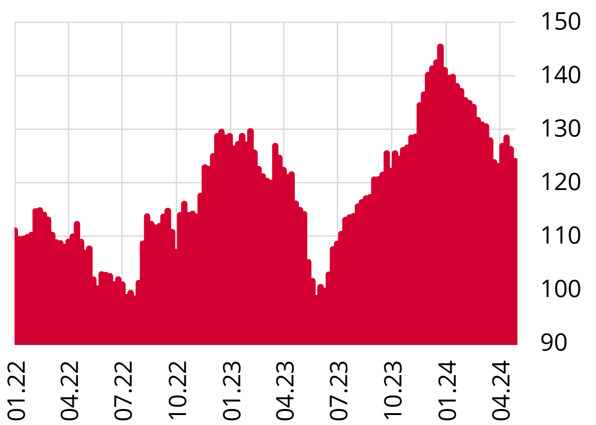
Chart 2.2.4: Implied Volatility of FX Options* (Against USD, 12-Month Maturity, %)



Source: Bloomberg.
* Emerging economies include Brazil, Chile, Colombia, Hungary, Indonesia, Malaysia, Mexico, Philippines, Poland, Romania and South Africa.

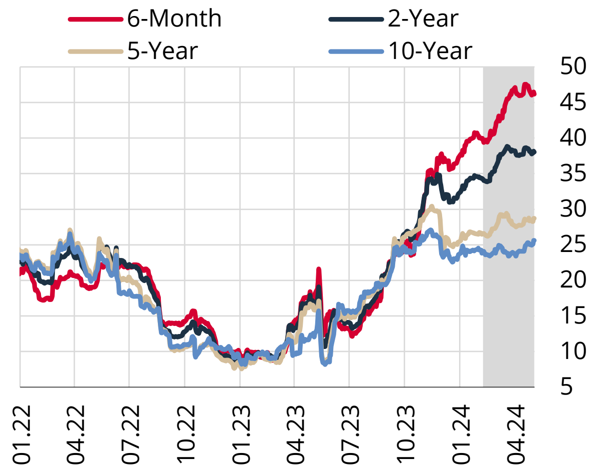
The strong monetary tightening in March reversed the decline in CBRT reserves. The CBRT's gross international reserves had trended down due to increased FX demand from residents and non-residents since January, however they started to recover on the back of the monetary tightening delivered in the March MPC meeting and stood at USD 124.1 billion as of 26 April 2024 (Chart 2.2.5). Meanwhile, the decline in CBRT reserves was mainly driven by the fall in the CBRT's swap transactions, and the share of swaps in the composition of reserves decreased significantly.

Chart 2.2.5: CBRT's Gross International Reserves (Weekly, USD Billion)



Source: CBRT.

Chart 2.2.6: GDDS Yields (%)



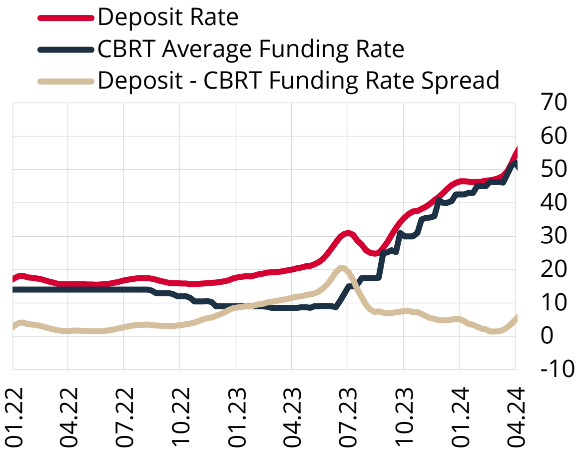
Source: Bloomberg.

Policy rate hikes were largely mirrored in short and medium-term GDDS yields, while the increase in long-term GDDS yields remained subdued (Chart 2.2.6). On the other hand, due to the market sentiment after the MPC decision of 21 March that the peak had been reached in the policy rate, the rise in GDDS yields was replaced by a relatively flat course. The phasing out of the securities maintenance practice in the recent period also supported price formation that is aligned with market conditions. In the period ahead, as the disinflation process continues to strengthen, it is expected that market expectations will be anchored more effectively and bond yields will move in tandem with long-term inflation expectations.

TL commercial and consumer loans continued to increase as a result of rising funding costs and other macroprudential measures. To support the increase in Turkish lira deposits, the CBRT, in addition to the rate hike, has made a number of regulations since the previous reporting period, regarding the Turkish lira share growth target for legal entities, revision of practices related to Turkish lira share growth targets for real persons, and remuneration of required reserves. In response to these regulations, Turkish lira deposit rates continued to increase and reached 60.3% as of 26 April (Chart 2.2.7).Higher interest rates on Turkish lira deposits led to higher preference for these products, while FX deposits and FX-protected accounts continued to decrease (Charts 2.2.9 and 2.2.10). Moreover, there has been an increasing tendency towards alternative Turkish lira assets in addition to Turkish lira deposits (Zoom-In 2.1). Personal loan rates and TL commercial loan rates increased significantly due to higher funding costs, the lowering of monthly loan growth rate limits for personal loans and TL commercial loans to 2% from 3% and 2.5%, respectively, and the replacement of the securities maintenance with the required reserve maintenance in case of exceeding growth limits. In the current reporting period, personal and TL commercial loan rates were up by 20.6 and 13.6 points to 81.3% and 67.1%, respectively, on 26 April. In the same period, housing loan rates remained flat at 44.7% due also to the limited demand, while vehicle loan rates receded on account of car sales campaigns (Chart 2.2.8).

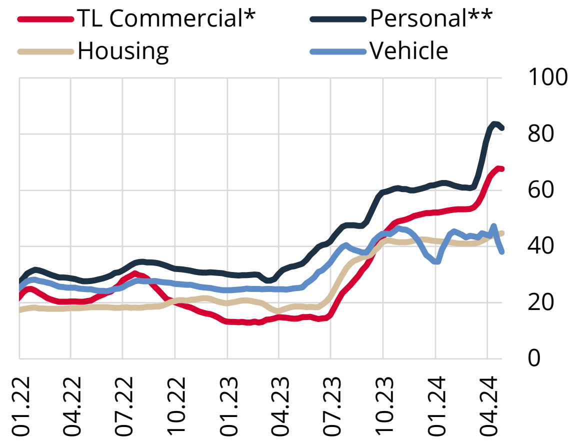
Chart 2.2.7: Turkish Lira Funding Rates

(Four-Week Moving Average, %)



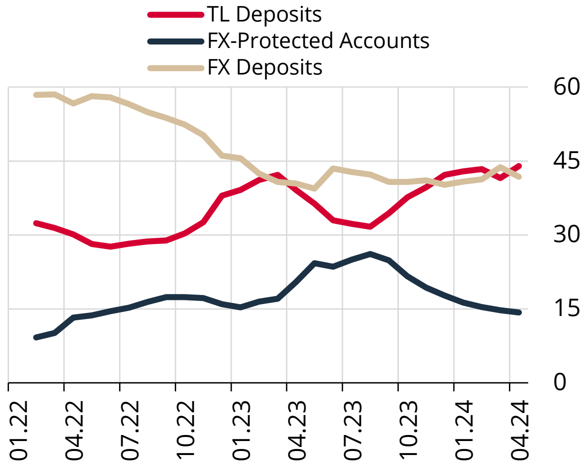
Source: CBRT.

Chart 2.2.8: Loan Rates (Flow, Four-Week Moving Average, %)



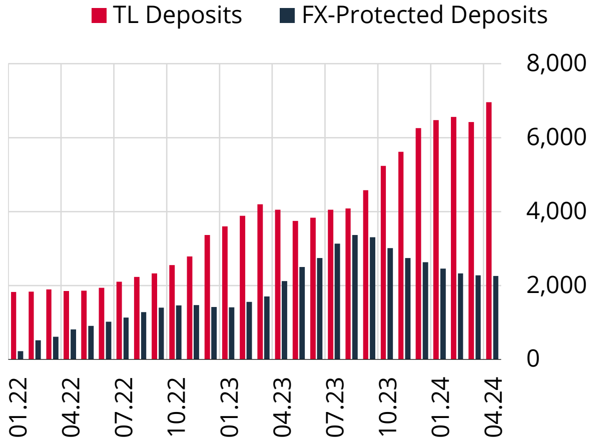
Source: CBRT.
* Excluding overdraft accounts and credit cards.
** Excluding overdraft accounts.

Chart 2.2.9: Deposit Composition (% Share)



Source: CBRT.

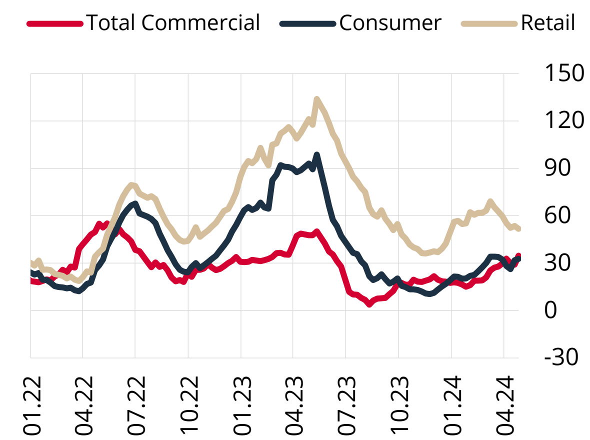
Chart 2.2.10: Turkish Lira Deposit Composition (TRY Billion)



Source: CBRT.

Chart 2.2.11: Loan Growth

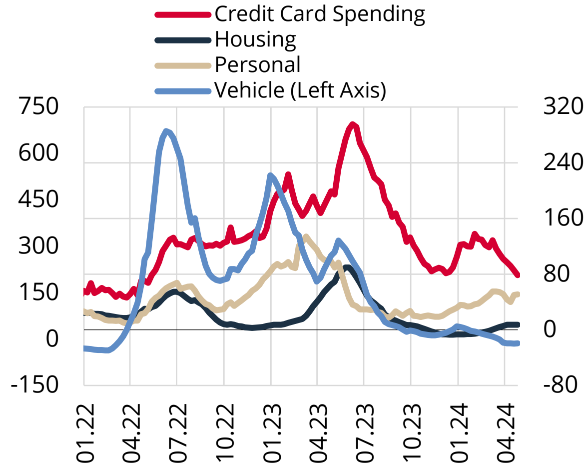
(13-Week Annualized, FX-Adjusted, %)



Source: CBRT.

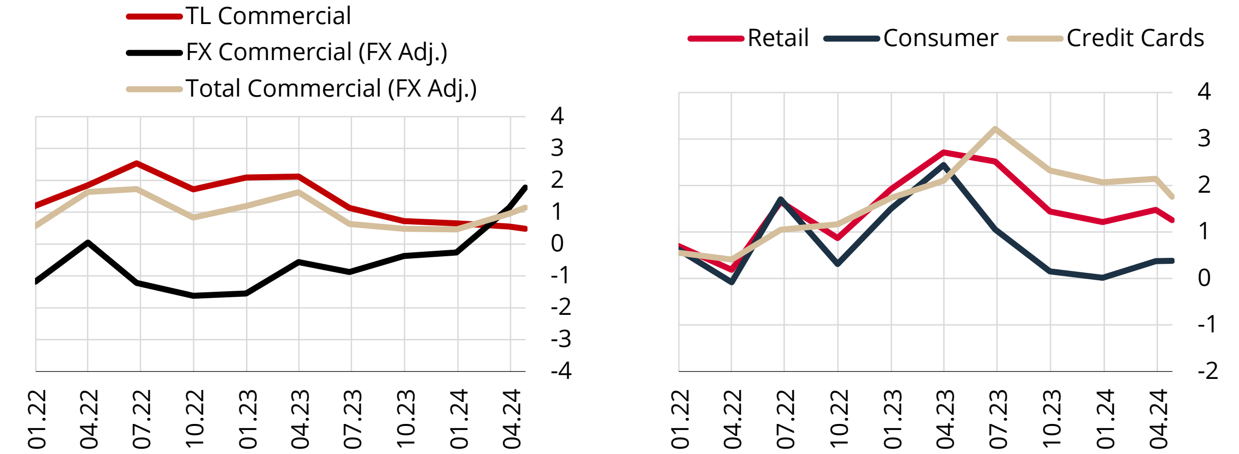
Chart 2.2.12: Retail Loan Growth

(13-Week Annualized, %)



Source: CBRT.

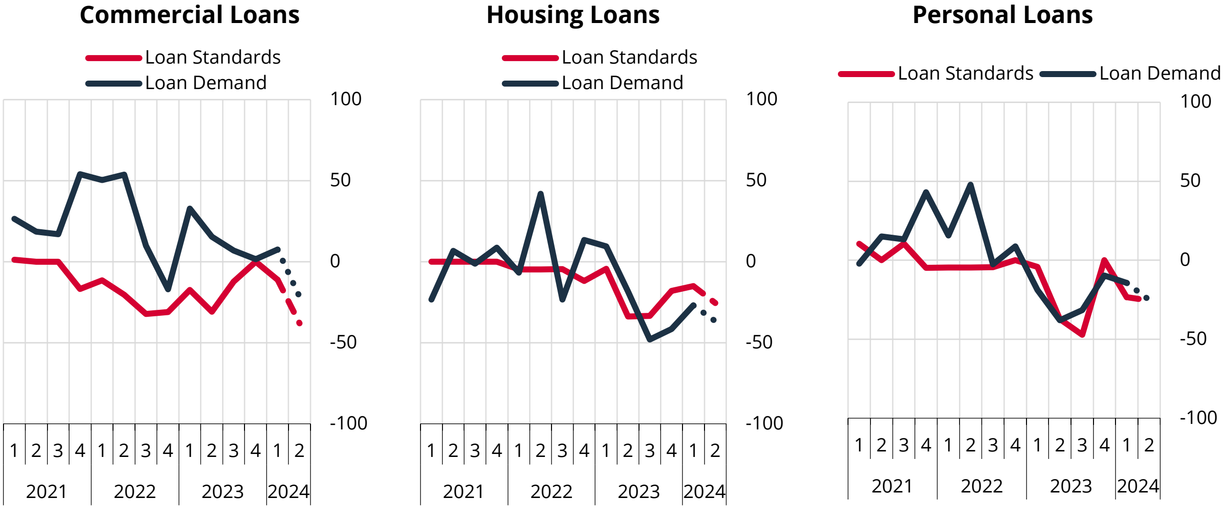
Chart 2.2.13: Credit Change* (Quarterly, Real, Standardized Value)



Source: CBRT.
* Series are deflated by CPI. The mean and standard deviations of the series are calculated based on the 2006-2019 period. The quarterly average is taken after weekly real changes are standardized.

The effect of tight financial conditions on credit growth started to become more pronounced as of the second quarter of 2024. In the current reporting period, the exchange rate-adjusted commercial loan growth rate increased, while retail loan growth declined. As of 26 April, the 13-week annualized growth rates of exchange rate-adjusted total commercial loans and retail loans were 34.7% and 51.7%, respectively (Chart 2.2.11). In retail loans, the 13-week annualized growth rates of housing and personal loans rose to 7.1% and 51%, respectively, as of 26 April (Chart 2.2.12). Due to the increase of interest rates on credit card cash advances and credit card installments, the 13-week annualized growth rate of personal credit card balances fell to 78.6% in the current reporting period. The 13-week annualized growth rate of vehicle loans, which rose slightly with year-end sales campaigns that continued into February, returned to negative territory and stood at -13.9%. To tighten financial conditions, the CBRT lowered the monthly growth rate limits for personal and Turkish lira commercial loans on 6 March, and replaced the securities maintenance practice with maintenance of reserve requirements when growth rate limits were exceeded. After this date, loan rates increased significantly and had an impact on curbing loan demand, resulting in a decline in Turkish lira commercial and personal loan growth. Real changes in credits reveal that in the first quarter of 2024, Turkish lira commercial loans converged to their long-term averages, while FX-adjusted total commercial loans deviated from their long-term averages due to the rise in exchange rate-adjusted FX commercial loans. On the other hand, as the decline in personal credit card balances was offset by personal loans, the change in retail loans remained relatively flat. (Chart 2.2.13). Meanwhile, the Bank Loans Tendency Survey (BLTS) suggests a quarter-on-quarter decrease in the commercial loan demand as well as a continued decline at a stronger pace in housing and personal loan demand for the second quarter of 2024. Banks expect that commercial, personal and housing loan standards will tighten further in the second quarter (Chart 2.2.14).

Chart 2.2.14: Loan Standards and Loan Demand*



Source: CBRT BLTS.

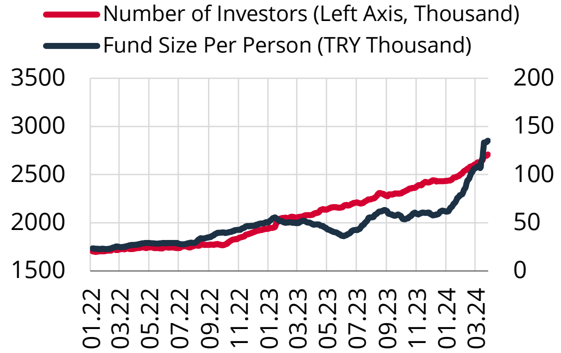
* Denotes banks' expectations. Loan standards and loan demand are calculated as follows: Banks are asked how their loan standards (loan demand) have changed in the past three months. Net trends, which are calculated using percentages, show the direction of change in loan standards (loan demand). An index above zero indicates easing in loan standards (increase in loan demand).

Zoom-In 2.1

Developments in Money Market Funds

Money market funds stand out as an alternative investment instrument to deposits for investors who are willing to invest their savings in short-term and low-risk instruments. In March 2024, the number of people investing in money market funds increased to 2.5 million, and the fund size per person rose to TRY 135,000 (Chart 1). The size of money market funds compared to deposits increased particularly in 2024. In March 2024, the ratio of money market fund size to total deposits and Turkish lira deposits rose to 2.4% and 4.2%, respectively (Chart 2). The exemption of money market fund earnings from withholding tax from 23 December 2020 to 30 April 2024 is also considered to have contributed to the expansion of these funds.

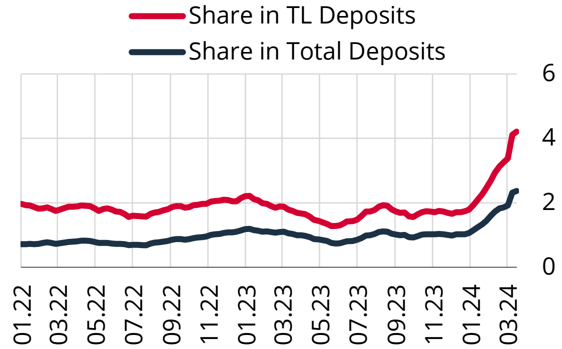
Chart 1: Number of Money Market Fund Investors and Fund Size per Person* (One-Week Moving Average)



Source: TEFAS.

* Shows the number of unique investors per fund. The same person investing in different funds is counted in the number of investors multiple times.

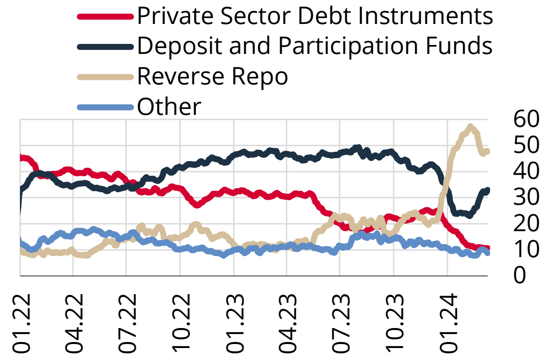
Chart 2: Size of Money Market Funds Compared to Deposits (%)



Source: BRSA, TEFAS.

Money market funds direct investments mainly to low-risk reverse repo, Turkish lira fixed income securities and deposits. The weight of these instruments in investment funds shows variations in line with periodical changes in their returns (Charts 3 and 4). The share of reverse repo transactions, which had remained below 20% until 2024, recorded an increase up to 60% in 2024. This is attributable to the BIST Repo-Reverse Repo Market rates exceeding Turkish lira deposit rates in 2024. Money market fund yields surpassing Turkish lira deposit rates after January 2024 seem to be effective in the increase in the size of money market funds compared to deposits in this period. In 2023, when interest rates in the BIST Repo-Reverse Repo Market and Turkish lira deposit rates diverged, money market fund yields exceeded deposit rates due also to the contribution of returns on private sector debt instruments. However, further depreciation in the Turkish lira and investors' preference for FX-protected deposit accounts in this period are thought to have helped keep the size of money market funds from increasing compared to deposits. Meanwhile, in 2024, the relative stability in exchange rates and stronger investor preference for Turkish lira amid regulations encouraging Turkish lira deposits prompted investors to opt for Turkish lira investment instruments based on their returns.

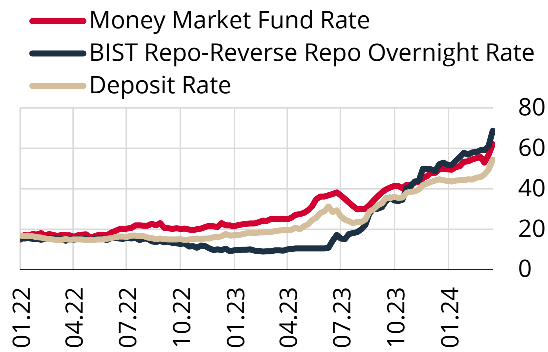
Chart 3: Money Market Funds-Portfolio Breakdown* (One-Week Moving Average, % Share)



Source: TEFAS.

* The chart shows the breakdown weighted by instrument amounts. The other item includes public borrowing instruments and receivables from the Takasbank money market.

Chart 4: Turkish Lira Market Rates* (%)



Source: CBRT, TEFAS.

* Money market fund rate is calculated by weighting the daily returns on the funds with their portfolio volumes, and by compounding them under the assumption that they are renewed daily. The BIST Repo-Reverse Repo overnight interest rate has been compounded. Deposit interest rates reported as compound interest have been adjusted assuming a withholding rate of 5%.

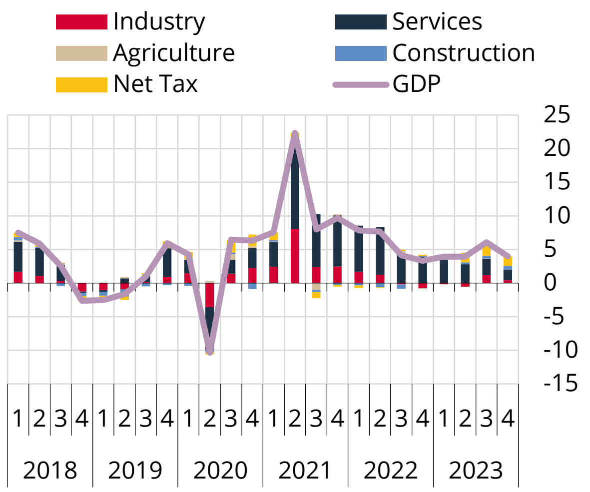
The CBRT's policy rate decisions and liquidity steps affect primarily the interest rates on short-term instruments, and then longer-term interest rates. Therefore, these decisions are first mirrored in interest rates on reverse repo transactions, then in TL deposit rates, and finally in interest rates on private sector debt instruments. Money market funds are considered to support the transmission of monetary policy decisions to market rates by investing in instruments with different maturities and by changing the investment composition periodically. These funds have recently stood out as an alternative instrument that channels low-volume savings, on which lower interest rates are offered (see Box 2.1), towards saving instead of consumption, and for the savings to be invested in short term. The increase in the size of alternative TL investment instruments through financial deepening is expected to support the transmission of the monetary policy to market rates.

2.3 Economic Activity

Supply and Demand Developments

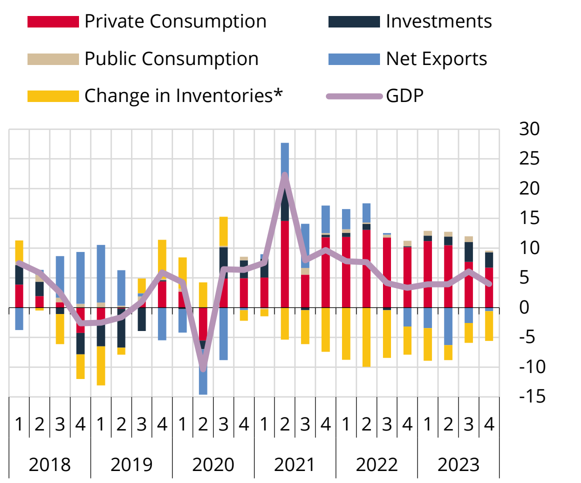
In the last quarter of 2023, economic activity remained robust, indicating that the rebalancing in demand lost pace. In the final quarter, GDP grew by 4% year-on-year and by 1% quarter-on-quarter. Thus, the overall growth rate for 2023 was 4.5%. In the final quarter of 2023, the main driver of annual growth on the production side continued to be the services sector. While the contribution of the industrial sector to annual growth remained limited, that of the construction sector continued (Chart 2.3.1). On the expenditures side, final domestic demand made the largest contribution to annual growth by 9.6 points. Most of this contribution, almost 6.7 points, came from the rise in private consumption (Chart 2.3.2). In this period, while the change in inventories pushed annual growth down by 5 points, the contribution of investments to annual growth was 2.6 points, with machinery-equipment investments making the largest contribution among investment items. On the other hand, the negative contribution of net exports to annual growth, which was 0.6 points, was quite limited compared to the previous quarter. On a quarterly basis, private consumption, which contracted in the third quarter, picked up in the last quarter of 2023, confirming the resilience of household demand. Net exports, meanwhile, made a positive contribution to growth, despite a quarter-on-quarter decline. Accordingly, the demand motive brought forward by sales campaigns and expected wage hikes in the last quarter weakened the rebalancing in demand.

Chart 2.3.1: Annual GDP Growth and Contributions from Production Side
(% Points)



Source: CBRT, TURKSTAT.

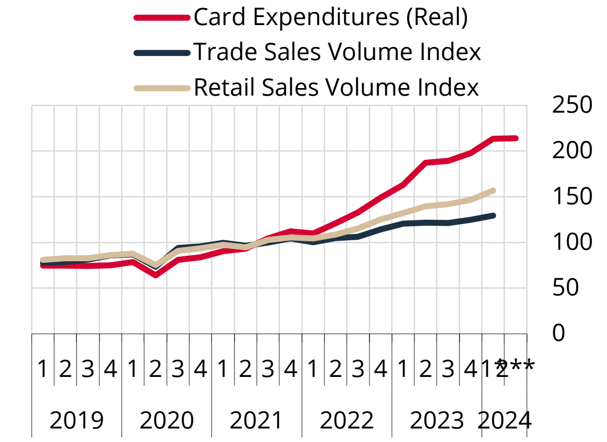
Chart 2.3.2: Annual GDP Growth and Contributions from Expenditures Side
(% Points)



Source: CBRT, TURKSTAT.
* Includes changes in inventories and statistical discrepancy due to chain-linking.

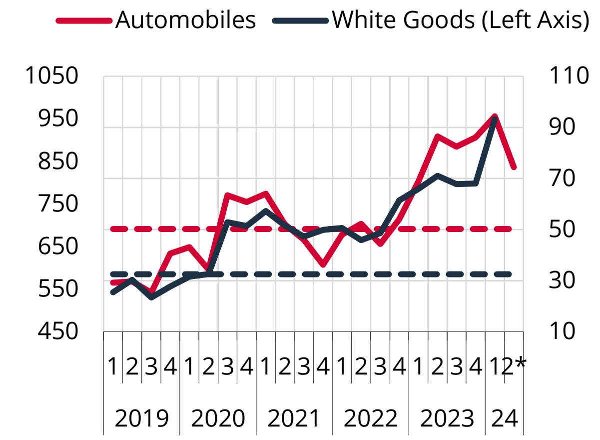
Indicators for the first quarter of 2024 point to a strong course in domestic demand, while leading indicators for April suggest that domestic demand is not as strong as it was in the first quarter. In January 2024, TURKSTAT started to publish *t*he retail sales volume index, an important indicator of household demand, with some changes in the base year and the calculation method. Accordingly, the slowdown in the quarterly growth of retail sales implied by the old index for the second half of 2023 in the previous Inflation Report was replaced by a stronger domestic demand outlook in this period with the new index (Zoom-In 2.2). In the first quarter of 2024, retail sales reaccelerated in both quarterly and annual terms as of February. Meanwhile, the commercial sales volume index, which TURKSTAT started to publish for the first time in January, continued to increase in the same period, although this rise decelerated due to the relatively weaker outlook in the wholesale trade volume index, a sub-item of the index. Credit card expenditures suggest that the rise in consumption demand continued to increase on a quarterly basis in the first quarter (Chart 2.3.3). In this period, sales of white goods posted a significant quarterly acceleration, while automobile sales maintained their upward momentum on the back of campaigns and SCT exemptions. Thus, sales of automobiles and white goods remained above their historical averages (Chart 2.3.4). After declining in the previous quarter, manufacturing industry firms' registered domestic market orders increased again in the first quarter amid wage revisions and continued to rise in the second quarter as of April, albeit at a more subdued pace**.** On the other hand, firms' expectations for domestic market orders over the next three months decreased in this period. Firm interviews revealed that in the first quarter, domestic sales increased on a quarterly basis due to wage hikes, firms' additional campaigns and demand that was brought forward. High-frequency data and field observations for April exhibit some signs of stabilization in domestic demand (Box 2.2). In April, which included the Ramadan holiday, inflation-adjusted credit card spending implies a month-on-month decline and a flat quarterly outlook. Automobile sales, which posted a significant increase in the first quarter, declined by 20.6% year-on-year in April, recording the first such contraction since August 2022. Similarly, firm interviews for April suggest that consumption expenditures are losing momentum due to the demand brought forward in the previous quarter as well as the long holiday break.

Chart 2.3.3: Consumption Indicators
(Seasonally and Calendar Adjusted, Annual % Change, 2015=100)



Source: CBRT, TURKSTAT.
* Average of January-February retail sales and commercial sales volume index.
** As of April.

Chart 2.3.4: Sales of White Goods and Automobiles**
(Thousand, Seasonally and Calendar Adjusted)

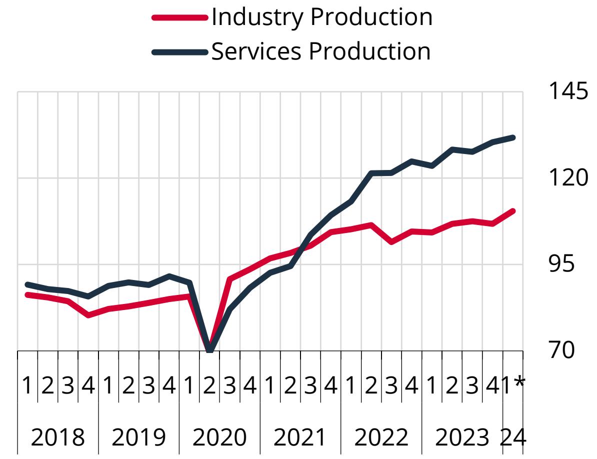


Source: CBRT, ODMD, TURKBESD.
* As of April.
** Dashed lines show the average for the 2011-2019 period.

In the first quarter of 2024, industrial production grew stronger on a quarterly basis, while services production remained relatively flat. As of February, seasonally and calendar-adjusted industrial production increased by 3.4% in the first quarter compared to the previous quarter (Chart 2.3.5). Excluding sectors that are typically highly volatile, such as other transportation, the increase was more limited at 2.1%. In January, TURKSTAT started to publish the services production index that can be linked to both production and demand in the services sector (Box 2.3). Accordingly, services production, which posted a quarterly increase by 2.4% in the last quarter of 2023, posted a quarterly rise of 0.7% in the first quarter of this year as of

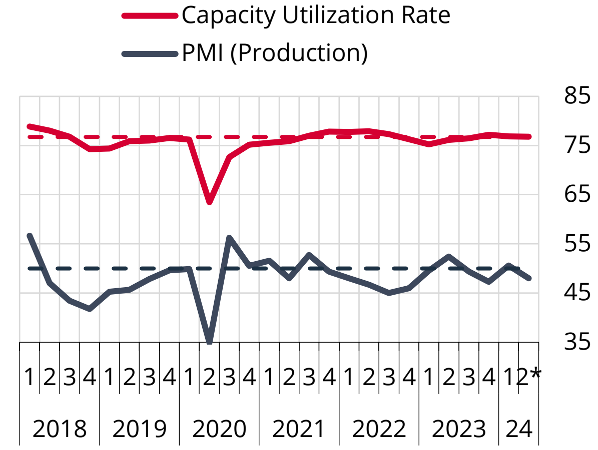
February. Excluding the transportation and storage sector, which has a high weight in the index, services production followed a relatively stronger course. Survey-based indicators suggest that in line with industrial production data, PMI data indicate that production increased in the first quarter, but remained below the threshold in the second quarter as of April, implying a moderate weakening in production (Chart 2.3.6). After a moderate decline in the first quarter, the capacity utilization rate remained almost flat at 77% in the second quarter and continued to hover close to its historical averages.

Chart 2.3.5: Industrial Production and Services Production Indices*
(Seasonally and Calendar Adjusted, 2021=100)



Source: TURKSTAT.
* Average of January- February.

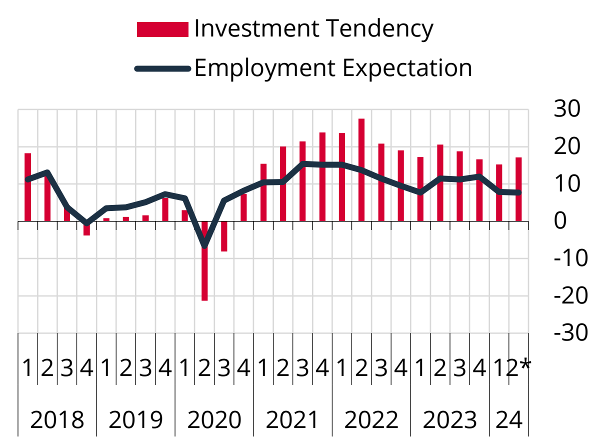
Chart 2.3.6: Capacity Utilization Rate and PMI** (Seasonally and Calendar Adjusted, %)



Source: S&P, TURKSTAT.
* As of April.
**Dashed lines show the average CUR for the 2014-2019 period, Threshold value for PMI is 50.

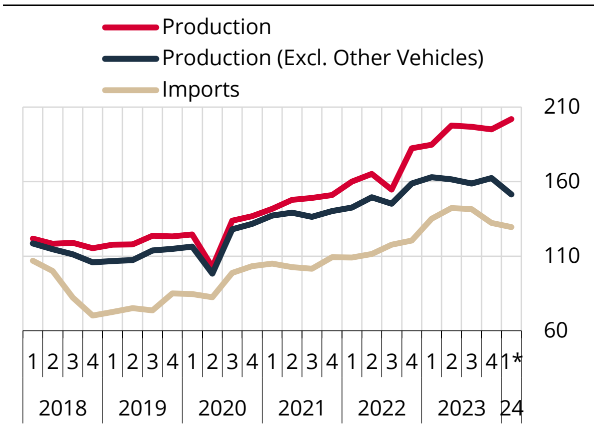
In the first quarter of 2024, investment tendencies of manufacturing industry firms posted a slight decline, while employment expectations remained relatively weak (Chart 2.3.7). Indicators for the production of capital goods and foreign trade confirm the downward outlook for investments. Although the production of capital goods excluding vehicles posted a quarterly increase in February, excluding the other transportation item, which is typically volatile and recorded a sharp increase in February, capital goods production remained relatively weak. Imports of capital goods excluding transport vehicles fell by 7.5% on a quarterly basis in February (Chart 2.3.8).

Chart 2.3.7: BTS Expectations for Fixed Capital Investment Spending and Employment
(Up-Down, Seasonally Adjusted, %)



Source: CBRT.
* As of April.

Chart 2.3.8: Production and Import Quantity Indices of Capital Goods Excluding Vehicles
(Seasonally Adjusted, 2015=100)

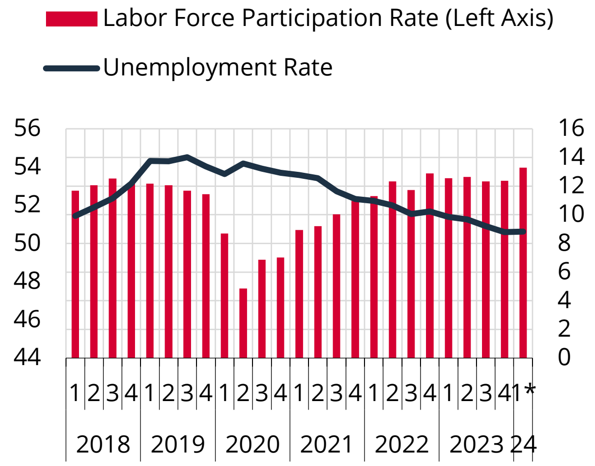


Source: CBRT, TURKSTAT.
* Average of January-February.

Labor Market Developments

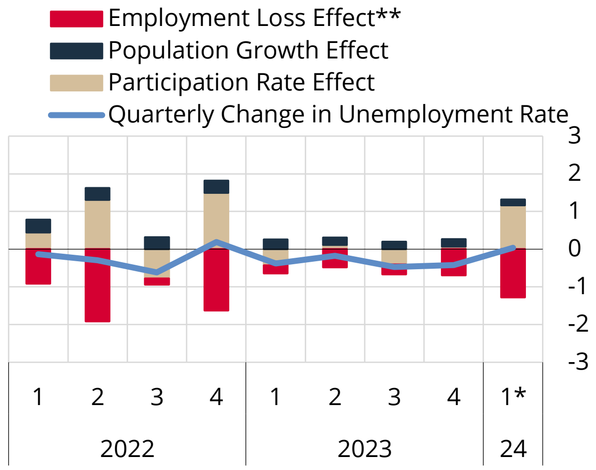
In the first quarter, employment displayed a strong increase in line with the economic activity outlook. As of February, seasonally adjusted employment increased by 1.4% (449 thousand people) quarter-on-quarter. The seasonally adjusted labor force participation rate increased by 0.7 points to 54% (Chart 2.3.9). Meanwhile, the unemployment rate remained flat quarter-on-quarter and stood at 8.8% in the first quarter. In this period, population growth and the increase in the participation rate had an upward effect on the unemployment rate by 0.15 and 1.17 points, respectively, while employment growth had a downward effect by 1.28 points (Charts 2.3.10 and 2.3.11). On the other hand, as of February, the idle labor force, which is the sum of time-dependent underemployment, the potential labor force and the unemployed, increased by 2.6 points in the first quarter of 2024. Meanwhile, the gradual decline in the average weekly working hours continued, dropping by 0.4 hours, which implies that signs of a weakening in the labor market have started to be observed.

Chart 2.3.9: Total Unemployment Rate and Labor Force Participation Rate
(Seasonally Adjusted, %)



Source: TURKSTAT.
* Average of January-February.

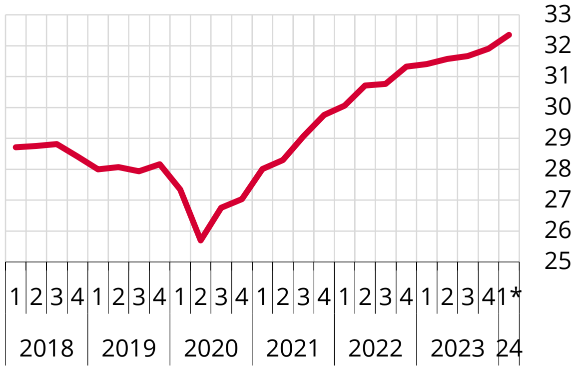
Chart 2.3.10: Contributions to Change in Total Unemployment Rate
(Seasonally Adjusted, % Points)



Source: CBRT, TURKSTAT.
* Average of January-February.
** Negative value of the employment loss effect indicates an increase in employment.

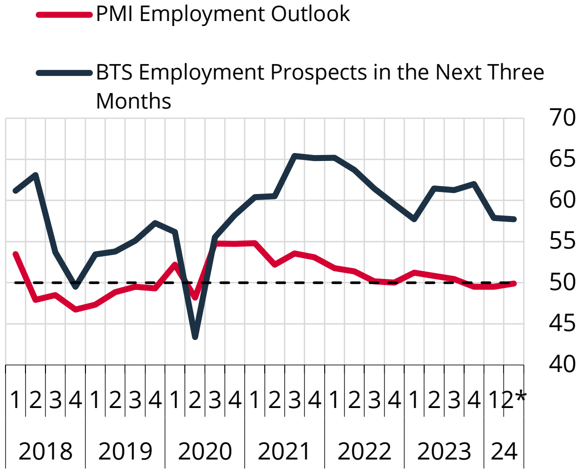
Survey indicators and high-frequency data suggest that demand in the labor market has slightly weakened. As of April, new job listings remain close to last year's levels. Meanwhile, survey data for manufacturing firms suggest that firms' employment outlook deteriorated slightly, while employment expectations for the next three months fell below their historical averages (Chart 2.3.12).

Chart 2.3.11: Total Employment
(Seasonally Adjusted, Million People)



Source: TURKSTAT.
* Average of January-February.

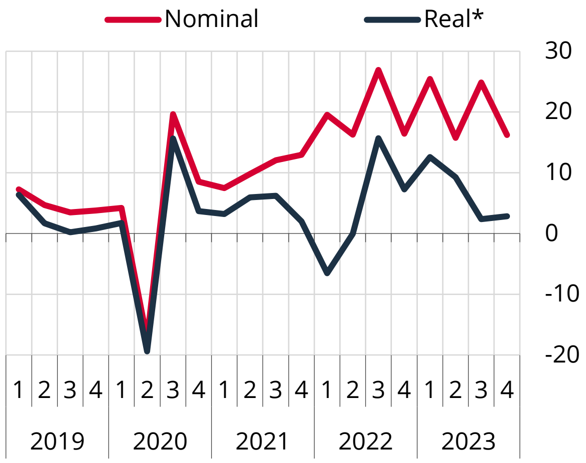
Chart 2.3.12: Employment Outlook and Expectation in the Industrial Sector**
(Seasonally Adjusted, Up-Down)



Source: S&P Global, CBRT.
* As of April.
** BTS indicator is adjusted so that its neutral level will be 50 in line with the PMI.

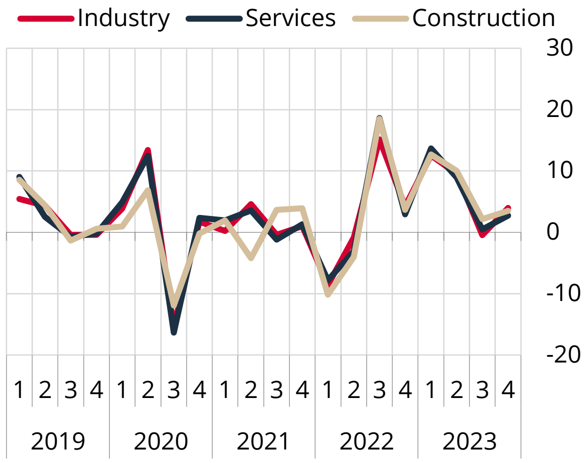
The real increase in the non-farm gross wage and payroll index displayed a moderate trend in the final quarter of 2023 (Chart 2.3.13). Meanwhile, the moderate increase in the seasonally adjusted real earnings index spread across all sectors in the final quarter (Chart 2.3.14). In 2023, the nominal wage increase was higher compared to the previous year, and this mainly stemmed from the biannual minimum wage adjustment and the backward indexation behavior. After the first quarter, when the minimum wage hike supported domestic demand, the projected milder course of economic activity and the absence of additional wage revisions are expected to support the disinflation process through real unit wages.

Chart 2.3.13: Non-Farm Gross Wage and Payroll Index
(Seasonally Adjusted, Quarterly % Change)



Source: CBRT, TURKSTAT.
* Deflated by the CPI.

Chart 2.3.14: Non-Farm Hourly Earnings Index*
(Seasonally Adjusted, Quarterly % Change, Real)

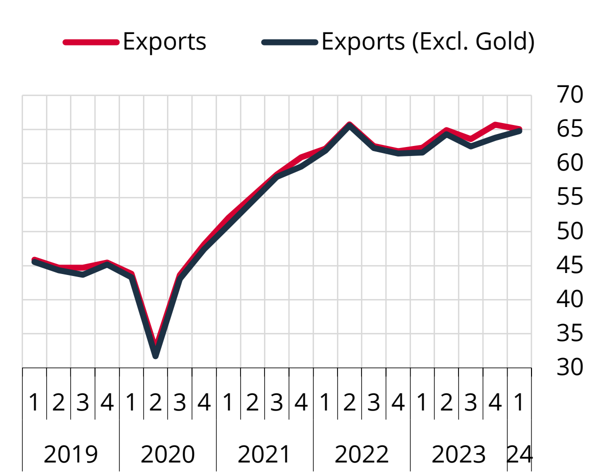


Source: CBRT, TURKSTAT.
* Deflated by the CPI.

Foreign Trade and Balance of Payments Outlook

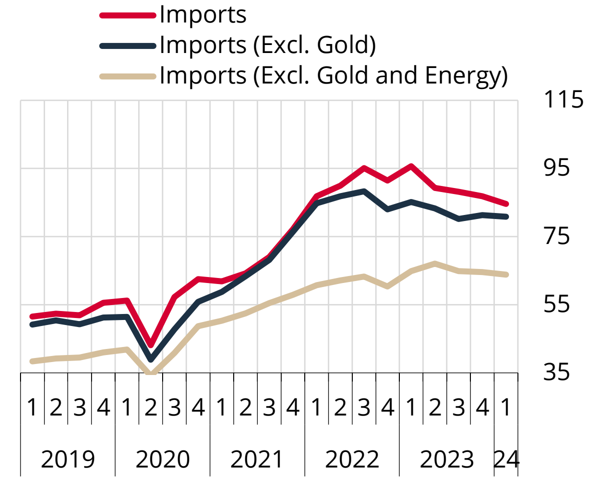
In the first quarter of 2024, exports excluding gold increased, while the downtrend in imports continued. Despite the partial recovery in economic activity in our main trade markets, external demand conditions remained weak in the first quarter, nevertheless, seasonally and calendar-adjusted exports excluding gold continued to increase (Chart 2.3.15). Gold exports, which made a significant contribution to export growth in the last quarter of the previous year, declined significantly in the first quarter of this year due to the rise in domestic demand for gold and played a role in the limited quarterly decline in total exports. In this period, food, chemicals, pharmaceuticals, clothing and textiles sectors made a positive contribution to exports. Exports to the EU recovered, while exports to the Middle East and Africa remained relatively flat. On the imports side, imports excluding gold and energy remained almost flat in seasonally and calendar-adjusted terms as domestic demand remained resilient in the first quarter (Chart 2.3.16). Gold imports declined, while energy imports remained close to the previous quarter's level in seasonally and calendar-adjusted terms. In the first quarter, seasonally and calendar-adjusted imports excluding gold remained the same as the previous quarter, while the downtrend in total imports continued. Accordingly, the seasonally and calendar-adjusted foreign trade deficit continued to narrow in the first quarter, while the gold trade deficit decreased and the energy trade deficit increased slightly. On the other hand, provisional data for foreign trade indicate that the foreign trade deficit in April was above the first quarter's average and imply that unlike signs of slowdown in other domestic market indicators, imports of consumption goods remained strong. Therefore, the course of imports, particularly of consumer goods, will continue to be closely monitored in the rest of the quarter with respect to the rebalancing in demand.

Chart 2.3.15: Exports
(Seasonally and Calendar Adjusted, USD)



Source: CBRT, TURKSTAT.

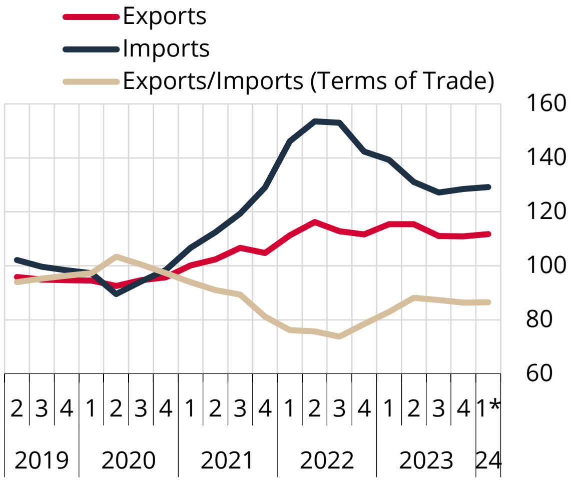
Chart 2.3.16: Imports
(Seasonally and Calendar Adjusted, USD)



Source: CBRT, TURKSTAT.

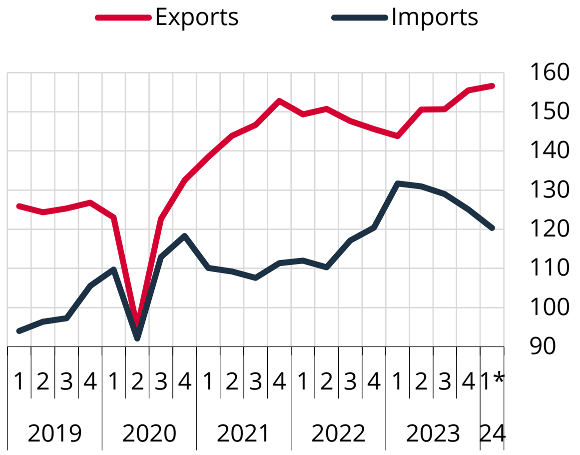
As of February, the flat course of the terms of trade and the real rebalancing in foreign trade supported the improvement in the foreign trade deficit. According to the foreign trade unit value indices for the first quarter calculated based on the January-February average, export and import prices increased slightly quarter-on-quarter (Chart 2.3.17). The terms of trade maintained their relatively high level recorded in the last three quarters, supporting the downtrend in the foreign trade deficit. Meanwhile, according to the foreign trade quantity indices calculated by using the January-February average, seasonally and calendar adjusted exports increased while imports decreased (Chart 2.3.18). Thus, the real rebalancing in foreign trade made a favorable impact on the foreign trade balance. Across goods groups, the downtrend in imports of intermediate goods and investment goods, which started in the previous quarter, was accompanied by the decline in imports of consumption goods that showed a decline in the first quarter for the first time in a long period (Chart 2.3.19).

Chart 2.3.17: Foreign Trade Unit Value Indices
(2015=100)



Source: TURKSTAT.
* Average of January-February.

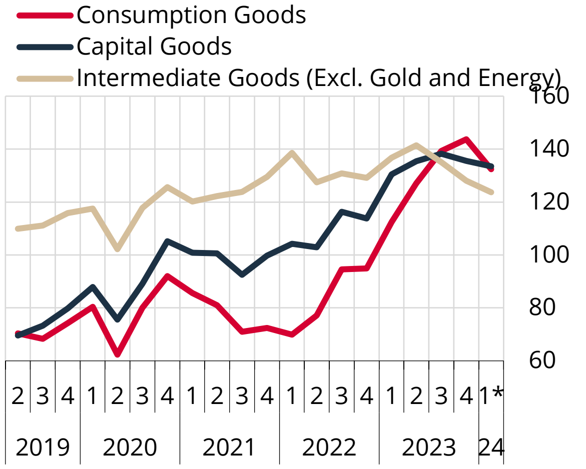
Chart 2.3.18: Foreign Trade Quantity Indices
(Seasonally Adjusted, 2015=100)



Source: CBRT, TURKSTAT.
* Average of January-February.

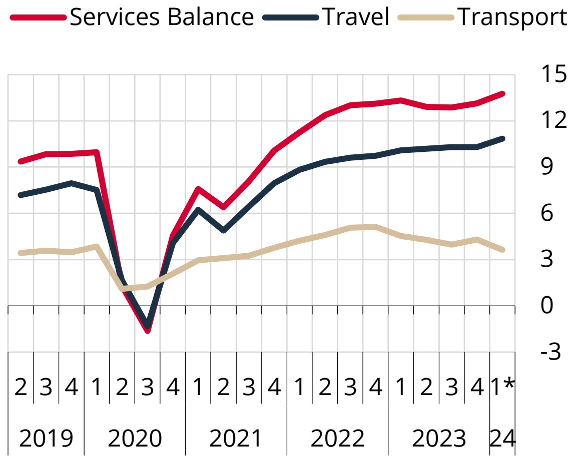
The favorable course in the services balance continues to strengthen on the back of travel revenues. As the rise in seasonally and calendar-adjusted net travel revenues continued in February, the services balance surplus continued to rise in the first quarter, while another important item, transportation revenues posted a slight decline (Chart 2.3.20). Despite the regional geopolitical problems that emerged in the previous two quarters, the uptrend continued in the number of foreign visitors in seasonally and calendar-adjusted terms and became the main driver of the increase in travel revenues. Leading indicators suggest that the number of foreign visitors will remain relatively high in March and net travel revenues will maintain their historically high levels.

Chart 2.3.19: Import Quantity Indices by Good Categories
(Seasonally Adjusted, 2015=100)



Source: CBRT, TURKSTAT.
* Average of January-February.

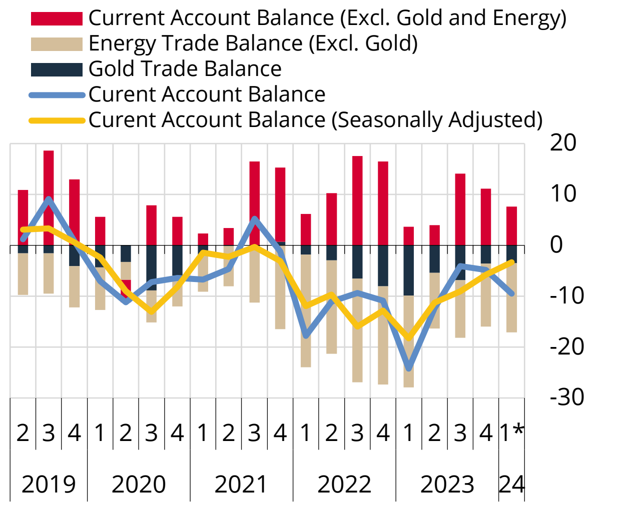
Chart 2.3.20: Services Balance
(Seasonally and Calendar Adjusted, USD Billion)



Source: CBRT.
* Average of January-February.

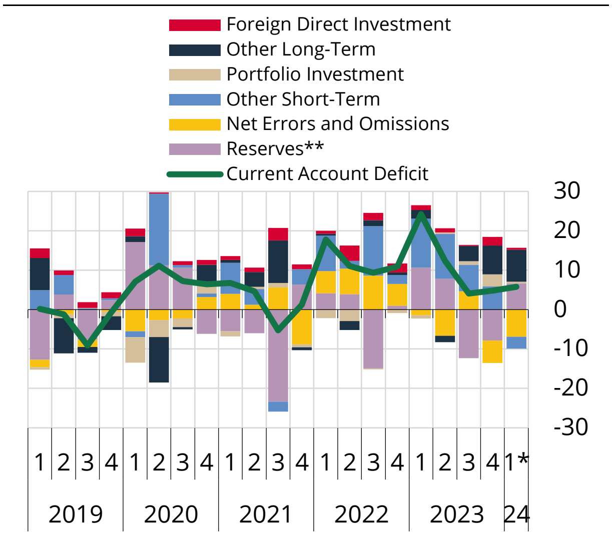
The improvement in the current account balance accelerated in the first quarter due to the decline in the foreign trade deficit and the strong outlook in the services balance. On the back of the ongoing uptrend in the balance of payments-defined goods trade balance and the continued favorable contribution of the services balance to the current account balance, in the first quarter, the seasonally and calendar-adjusted current account deficit narrowed significantly quarter-on-quarter (Chart 2.3.21). The current account surplus excluding gold and energy, which is an underlying trend indicator, increased in seasonally and calendar-adjusted terms. After the first quarter, when domestic demand-driven upward pressures persisted, the impact of the tightening in financial conditions, the normalization in credit growth and the improvement in inflation expectations on domestic demand is likely to become more evident and support the rebalancing process, therefore leading to a further decline in the current account deficit.

Chart 2.3.21: Current Account Balance (Quarterly, USD Billion)



Source: CBRT.
* The values implied by foreign trade data have been used for March.

Chart 2.3.22: Financing of the Current Account Deficit (USD Billion)



Source: CBRT.
* Cumulative as of February.
** Denotes the CBRT reserves plus the cash and deposits at banks abroad. A negative value indicates an increase in reserves.

While the weight of long-term items in financing the current account balance increased, the net errors and omissions item posted outflows and reserves decreased in the first quarter. As of February, non-residents' direct investments decreased in the first quarter due to the quarter-on-quarter decline in capital inflows. Portfolio inflows to equity and debt securities markets and short-term investment items such as non-residents' deposits remained limited compared to the previous quarter. Capital inflows were mainly driven by long-term external bond issues (Chart 2.3.22). Outflows from the net errors and omissions item increased in the first two months of the year, while reserves, which had increased significantly in the previous two quarters following the tightening in monetary policy, decreased in this period. Leading indicators suggest that official reserves increased again in April after having declined in March. In the upcoming period, when the current account deficit will narrow due to seasonal effects, the decrease in the financing need and the improvement in the financing composition in favor of capital inflows will also contribute to reserve accumulation.

Public Finance Developments

In the first quarter of the year, the central government budget ran a deficit of TRY 513.5 billion and a primary deficit of TRY 263.0 billion. The ratio of the annualized budget deficit to national income, which was 5.2% at the end of 2023, is estimated to be 5.6% as of March. In this period, the financing need was met by both domestic and external borrowing, and approximately USD 5.2 billion worth of financing was obtained from international capital markets. It is estimated that the ratio of the central government debt stock to national income was 25.6% in March 2024, while the ratios of domestic and external debt stocks to national income were 12.2% and 13.4%, respectively.

In the first quarter of the year, 19.4% of allocations were used for central government budget expenditures, and the ratio of expenditures to GDP is estimated to have increased by 6.3 points year-on-year to 26.2%. In the first quarter, primary expenditures increased by 101.3% compared to the same period of the previous year. The most significant contribution to the annual growth in primary expenditures came from current transfers and personnel expenditures. In the first quarter of the year, state economic enterprises did not receive any transfer of funds associated with natural gas, while the Electricity Generation Corporation received a total of TRY 55.3 billion for its assignment expenditures. Meanwhile, central government budget revenues increased by 106.0% year-on-year in this period. Annualized budget revenues as a percentage of national income, which were 17.5% in the same period of the previous year, are estimated to have increased to 20.6% as of March. Tax revenues remained strong due to the performance of domestic demand, the course of inflation and the arrangements made in July 2023. In fact, the SCT and VAT items, which are highly sensitive to domestic demand, made the most significant contribution to the annual growth of tax revenues. While the strong performance of tax revenues affected the budget balance positively, the weak course of non-tax revenues limited this effect.

Earthquake expenditures will be one of the main drivers of the budget deficit in 2024. Accordingly, spending from the earthquake allocation of TRY 1.28 trillion in the 2024 budget is closely monitored. In the first quarter of the year, 0.7% of the initial allocations were used from the capital transfers item, which also includes costs related to the construction of earthquake housing.

Zoom-In 2.2

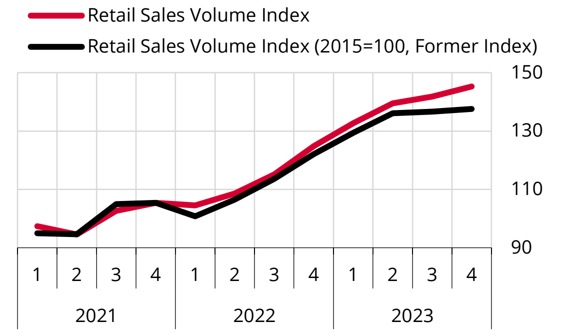
Change of Base Year and Methodology in Retail Sales Volume Index

As part of its regular revisions in the Short-Term Business Statistics, TURKSTAT made some changes in the base year and methodology in the retail sales volume index data. In its press release of 4 March 2024, TURKSTAT announced that it had completed the incorporation of the changes made in the EU Business Statistics regulation into the Short-Term Business Statistics and the production of new indicators. In this context, the retail sales volume index data, previously published taking the base year as 2015=100, started to be published with a base year of 2021=100 in the first release of the Trade Sales Volume Index Bulletin in March.

TURKSTAT determines the product structure of each sector using the results of the "Annual Turnover Survey by Products" and calculates deflators for each sector with appropriate price data. Turnover values are adjusted for price changes using these deflators. Accordingly, the deflation by prices at three-digit, four-digit and special activity levels in previously published indices with a base year of 2015, is now made at the four-digit activity level with the introduction of the new index. Moreover, changes in the data source and main activities of enterprises in 2021 and beyond have also been reflected in the indices. Accordingly, the retail sales volume index has been revised since 2010.

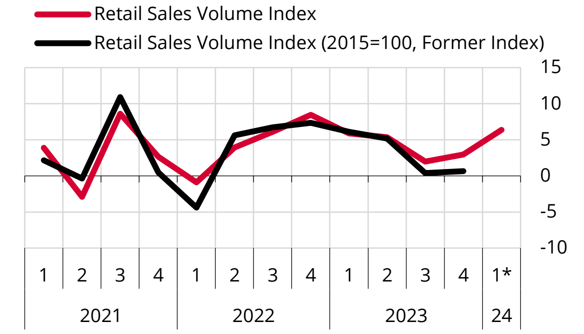
The calculation using the new methodology revised the level of the retail sales volume index upwards. Additionally, since the second half of 2023, quarterly changes in the RSVI have increased significantly in the new series, implying a quarterly acceleration contrary to the outlook presented in the previous reporting period (Charts 1 and 2).

Chart 1: Retail Sales Volume Index*
(2021=100)



Source: TURKSTAT.
* The former index with a base year of 2015=100 is adjusted as 2021=100 to allow for a comparison among levels.

Chart 2: Retail Sales Volume Index
(Quarterly % Change)

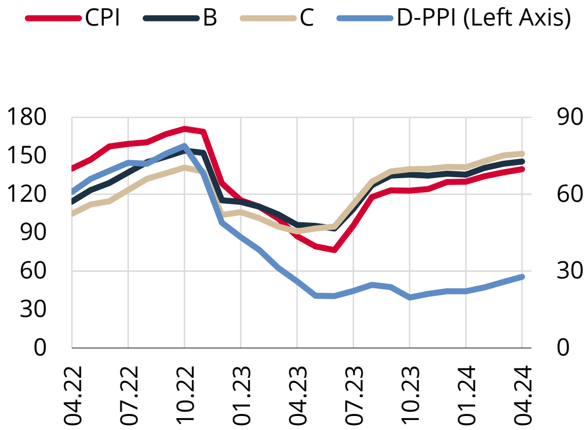


Source: TURKSTAT.
* As of February.

2.4 Inflation

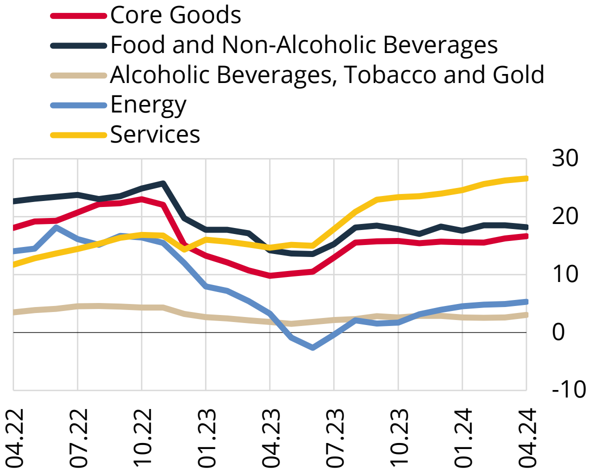
Annual consumer inflation rose by 3.73 points in the first quarter of 2024 to 68.50%, 0.9 points above the forecast range presented in the Inflation Report 2024-I. The uptrend in annual inflation continued in April, rising to 69.80%. USD-based commodity prices increased in the first quarter, which was more evident in the energy group. Freight charges, which rose in January amid geopolitical developments before declining in the following months, remained high. Longer supplier delivery times, which extended in January, partially normalized in the following period. The Global Supply Chain Pressure Index hovered around its historical average in the first quarter. The increase in the exchange rate basket was slightly higher than that in the previous quarter, at 9.8%. In addition to cost-side effects, wage adjustments played a significant role in keeping demand resilient in the first quarter, which eased the pass-through of other non-wage cost increases to prices. Against this background, producer price-driven pressures have strengthened. Medium-term inflation expectations declined, yet remained above medium-term targets and continued to pose an upside risk to the inflation outlook. An analysis of first-quarter developments by sub-items reveals that the services sector made the largest contribution to the rise in annual consumer inflation, followed by the energy group (Chart 2.4.2). Services prices saw a significant increase in this period, driven by items with time-dependent pricing behavior and a strong backward indexation tendency such as administered groups, as well as groups with a high wage sensitivity (Box 2.4). Although the underlying inflation declined following a rise in January, it was higher than projected in the previous Inflation Report, led by services inflation.

Chart 2.4.1: CPI, B Index, C Index and D-PPI*
(Annual % Change)



Source: TURKSTAT.
* B index: CPI excluding unprocessed food, energy, alcoholic beverages, tobacco, and gold. C index: CPI excluding food and non-alcoholic beverages, energy, alcohol-tobacco, and gold.

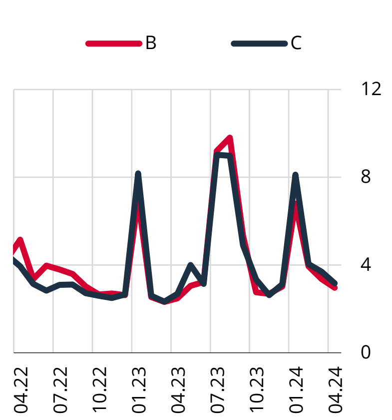
Chart 2.4.2: Contributions to Annual CPI
(% Points)



Source: CBRT, TURKSTAT.

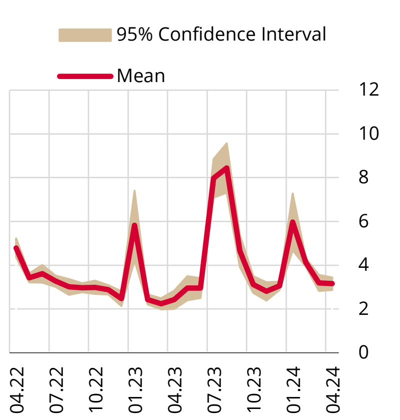
The monthly rate of increase in core indicators slowed down following the high levels seen in January, falling back to December levels, but remained above the projections. Annual inflation rates rose compared to the previous quarter. The seasonally adjusted B and C indices, which declined more than projected in the last quarter of 2023, posted significant monthly increases in January. This was mainly due to wage adjustments as well as services items with a high time-dependent price-setting behavior and backward-indexation tendency. The monthly increases of indices remained above forecasts, albeit rising at a slower pace in the following months (Chart 2.4.3). The seasonally adjusted average monthly increases in the B and C indices were 4.7% and 5.3%, respectively, in the first quarter (2.8% and 3.0%, respectively, in the last quarter of 2023). Alternative indicators such as median inflation, SATRIM and dynamic factor also displayed a similar trend and confirmed this outlook. As of April, the seasonally adjusted monthly increases in core indicators have continued to ease and were close to December 2023 levels (Chart 2.4.4). An analysis of the subgroups of the B index reveals that price increases picked up across all subgroups quarter-on-quarter in the first three months of the year, and the main driver of the strong increase in inflation was the services sector (Chart 2.4.5). Services prices increased notably across all subgroups compared to the previous quarter. The highest quarterly price increase was in the rent subgroup. The rise in the restaurants-hotels group was driven by catering services, which are highly sensitive to food prices, particularly red meat, and minimum wage developments (Table 2.4.1). Education, health, and insurance services, in which indexation behavior is widespread, as well as maintenance-repair services, which encompass labor expenditures, stood out in the other services subgroup, another notable subgroup in this period. Price increases remained strong in communication services with contractual price rigidities, on the back of internet and phone call charges. Transportation services prices with a high time-dependent pricing tendency were driven by fuel prices as well as minimum wage developments. Accordingly, the contribution of services to annual consumer inflation increased by 2.24 points quarter-on-quarter to 26.23 points, thus becoming the most significant contributor to consumer inflation (Chart 2.4.2). Price increases in core goods followed a relatively milder path compared to other B index subgroups (Chart 2.4.5). Durable goods price hikes were volatile, and the strong domestic demand conditions eased the pass-through of cost increases to durable goods prices. Electrical and non-electrical household appliances as well as the labor-intensive furniture sector were the main drivers of price increases in this group. In the first quarter, automobile prices rose at a relatively milder pace. The prices of processed foods, another subgroup of the B index, displayed a strong course in January and February, but remained moderate in March. In line with the outlook for red meat, processed meat products, milk and dairy products, oils and fats, and bread and cereals had a significant impact on the group prices. Processed food prices maintained their relatively mild pace in April. In seasonally adjusted terms, core goods prices converged to December 2023 levels in April, while services prices remained strong, albeit at a slower pace.

Chart 2.4.3: B and C Indices (Seasonally Adjusted, Monthly % Change)



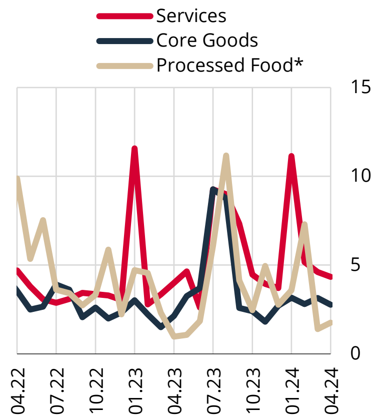
Source: CBRT, TURKSTAT.

Chart 2.4.4: Seven Different Indicators of Underlying Inflation* (Seasonally Adjusted, Monthly % Change)



Source: CBRT, TURKSTAT.
* Monthly average of seasonally adjusted B and C indices, SATRIM, Median, the index excluding most volatile items, indicators produced by principal components, and dynamic factor models. Shaded area shows 95% confidence interval.

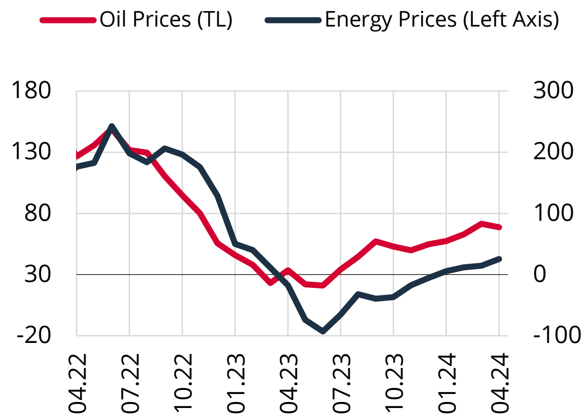
Chart 2.4.5: Subgroups of B Index (Seasonally Adjusted, Monthly % Change)



Source: CBRT, TURKSTAT.
* Processed food is not adjusted for seasonality due to absence of statistically significant seasonal effects.

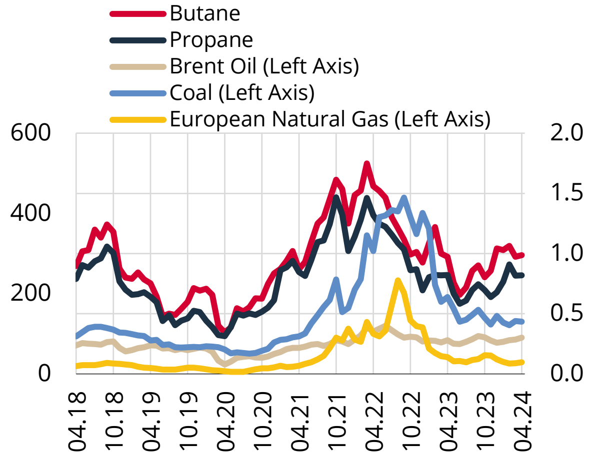
In the first quarter, fuel prices came to the fore in the course of energy prices, in parallel with the outlook for natural gas and oil prices, and annual energy inflation continued to rise. Despite the flat course of energy prices in April, annual energy inflation increased due to base effects (Chart 2.4.6). Domestic energy prices were up 10.80% in the first quarter of the year (Table 2.4.1). The international Brent crude oil price, which was USD 78 on average in December, ended March at around USD 85 on average. The USD exchange rate also increased by approximately 10% during this period. The producer inflation in the second half of 2023 was passed through to the lump sum SCT on fuel and bottled gas in January, and the tax hike had a significant impact on energy inflation that month. Natural gas, the first 25 m^3 of which are provided free of charge, had a significant impact on annual consumer inflation in January due to consumption-driven developments. However, this mechanical effect was rather subdued in February and March. Thus, the effect of natural gas on annual consumer inflation in the first quarter was 0.38 points in total. The downward trend seen in energy commodity prices in the last quarter ended in January on the back of the oil price outlook, and prices increased in the first quarter. Meanwhile, propane prices rose, whereas butane, coal, and natural gas prices declined, diverging from this outlook (Chart 2.4.7). In line with global energy prices, solid fuel prices slowed down, and the uptrend in municipal water prices weakened in the first quarter. Against this background, the contribution of the energy group to annual consumer inflation increased by 1.01 points quarter-on-quarter to 4.91 points (Charts 2.4.6 and 2.4.2). Despite the fuel price hikes in line with global developments in April, energy prices remained flat, by being balanced by the consumption-driven downward mechanical effect on natural gas prices. Annual energy inflation rose to 42.83% in April due to the base effects but still lags considerably behind the other main groups.

Chart 2.4.6: Energy Prices (Annual % Change)



Source: Bloomberg, CBRT, TURKSTAT.

Chart 2.4.7: Energy Commodity Prices* (USD, EUR)



Source: Bloomberg.
* Brent oil prices are per barrel, coal prices are per ton, butane and propane prices are per gallon. European natural gas prices are in euro and per MWh.

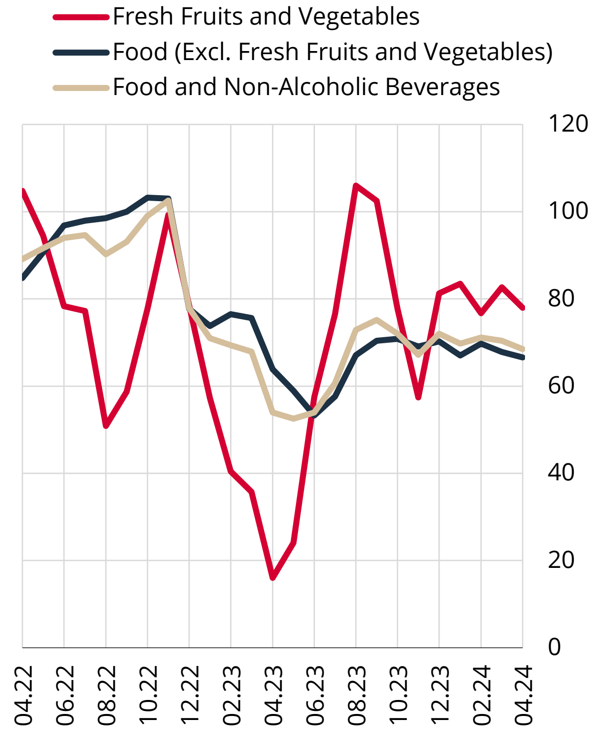
Table 2.4.1: Consumer Prices

	Quarterly % Change (Seasonally Adjusted)				Annual % Change			
	2023			2024	2023			2024
	II	III	IV	I	II	III	IV	I
CPI	**6.01**	**26.49**	**10.32**	**13.78**	**38.21**	**61.53**	**64.77**	**68.50**
B	**8.83**	**26.26**	**8.83**	**14.99**	**46.63**	**67.22**	**68.02**	**71.89**
C	**9.99**	**24.55**	**9.47**	**16.92**	**47.33**	**68.93**	**70.64**	**75.21**
1. Goods	5.40	24.86	9.12	10.01	30.92	52.39	55.46	58.17
Energy*	**-20.84**	**33.71**	**17.08**	**10.80**	**-16.52**	**10.25**	**27.19**	**37.32**
Food and Non-Alcoholic Beverages	**12.63**	**22.36**	**10.49**	**11.89**	**53.92**	**75.14**	**72.01**	**70.41**
Unprocessed Food	21.69	23.74	8.93	12.27	68.44	96.17	91.23	84.14
Fresh Fruits and Vegetables	29.32	35.32	-1.69	6.15	57.49	102.46	81.29	82.67
Processed Food*	3.96	22.81	10.50	12.68	43.36	59.95	58.05	58.97
Core Goods	**9.15**	**21.98**	**7.22**	**9.55**	**36.69**	**53.23**	**52.81**	**56.46**
Clothing and Footwear	6.95	16.33	9.04	9.15	20.04	31.36	39.74	49.12
Durable Goods (Excl. Gold)	12.55	23.61	5.55	9.80	43.30	65.61	60.70	61.11
Furniture	4.14	21.99	7.84	16.72	37.52	62.08	55.21	60.00
Automobile	17.16	29.15	3.88	5.09	46.61	72.91	72.24	66.93
Electrical and Non-Electrical Appliances*	7.56	22.01	6.56	10.79	42.53	57.63	47.89	54.94
Other Durable Goods*	6.51	23.07	9.30	13.75	36.33	53.37	55.64	62.98
Other Core Goods*	4.13	22.69	9.17	11.31	37.75	50.10	50.42	55.25
Alcoholic Beverages, Tobacco Products, and Gold*	**12.25**	**26.24**	**9.45**	**6.58**	**40.14**	**67.19**	**71.18**	**65.30**
2. Services	**11.50**	**27.80**	**12.71**	**22.44**	**59.45**	**86.46**	**90.66**	**96.48**
Rent	17.50	24.52	19.47	28.05	75.91	95.03	108.58	123.95
Restaurants and Hotels	13.95	24.31	12.38	22.64	67.22	92.48	93.24	94.97
Transport	3.20	59.37	5.34	12.35	36.25	95.97	92.44	94.41
Communication	14.48	14.16	13.21	16.09	43.84	55.04	63.92	71.99
Other Services	9.88	27.83	12.44	20.45	57.42	81.64	85.20	90.41

Source: CBRT, TURKSTAT.
* No seasonality detected.

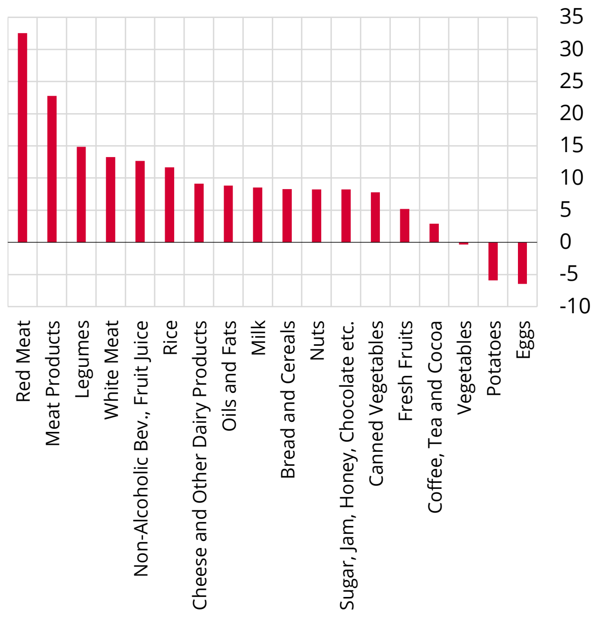
Inflation in food hovered above headline inflation on an annual basis in the first quarter but was slightly below headline inflation in April. Annual inflation in food and non-alcoholic beverages was on an upward trend in the second half of 2023, reaching 75.14% in September. In the following six months, it followed a resilient course fluctuating around 70% (Chart 2.4.8). Seasonally adjusted data pointed to a quarter-on-quarter pickup in food inflation (Table 2.4.1). After falling in the previous quarter, prices of fresh fruits and vegetables rose by 6.15% in the first quarter. Meanwhile, vegetable prices increased at a rate close to their historical average, while fruit prices rose at a rate above their trend. The main driver of the outlook in food prices in the first quarter was red meat prices (Chart 2.4.9). Red meat prices had a negative impact on substitute white meat prices and pushed prices of processed meat products significantly upwards. Food prices excluding fresh fruits and vegetables strengthened on a quarterly basis, driven mainly by meat prices as well as price developments in pulses, non-alcoholic beverages, rice, milk and dairy products, and oils. Rice prices were affected by external prices as well, while the impact of the raw milk reference price hike in January (17.4%) on prices of milk and dairy products was visible in the first quarter. Olive oil prices, which have been on the rise since the second half of the year due to foreign demand and falling yields, and for which export measures have been taken, resumed their upward trend in the first quarter. In the first quarter of the year, potato and egg price increases were below historical averages (Chart 2.4.9). Food price increases slowed in April, and the unprocessed food subgroup's prices were the main driver of the monthly increase. The prices of red and white meat continued to rise.

Chart 2.4.8: Food Prices (Annual % Change)



Source: CBRT, TURKSTAT.

Chart 2.4.9: Food Prices by Sub-Items* (2024Q1 % Deviation of Change from Historical Average, Sorted)



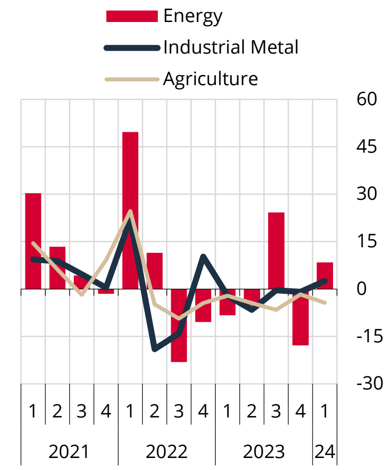
Source: CBRT, TURKSTAT.
* Denotes the difference between the 2024Q1 quarterly percentage change and the historical average (first quarter average of the 2012-2021 period).

Prices of alcoholic beverages and tobacco products rose by 5.42% in the first quarter of the year, while price increases in tobacco products due to producer firms pushed the monthly increase in April to 9.56%. The tax reform on tobacco products led to a limited price increase in January. Alcoholic beverage prices rose by 30.39% in the first quarter due also to the tax hike, while prices of tobacco products increased at a low rate of 3.49%. Thus, annual inflation in the alcoholic beverages and tobacco group decreased by 8.28 points quarter-on-quarter to 62.98%, and the contribution of the alcohol-tobacco group to annual inflation fell by 0.33 points. In April, prices of alcoholic beverages and tobacco rose by 9.56% amid the price hikes driven by producer firms, pushing annual inflation up by 15.56 points to 78.53%.

Drivers of Inflation

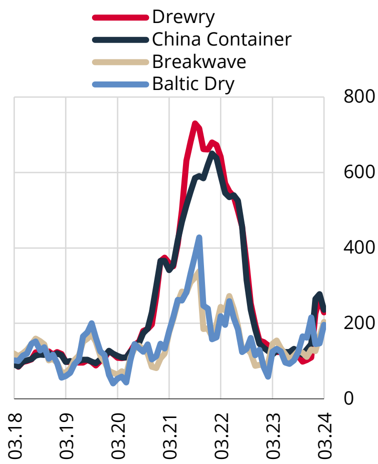
Global commodity prices posted increases in the first quarter of the year, led by the energy group. Global crude oil prices went up due to production cuts along with geopolitical developments and were the main driver of higher energy commodity prices. Domestic fuel prices soared dramatically in the first three months of the year, adversely affected by tax and exchange rate hikes in addition to global developments. The rise in fuel prices pushed consumer inflation up indirectly through production costs and transportation, together with its direct effects. Meanwhile, global natural gas prices declined in the first quarter, curbing the rise in energy commodity prices. After having displayed moderate price movements in 2023, industrial metal prices edged up in the first quarter of the year, while prices in the agriculture group remained on a downward track (Chart 2.4.10). Following these developments in the first quarter of the year, commodity prices increased across the board in April, with industrial metal and energy prices posting stronger increases. Escalating geopolitical tensions had a negative impact on international transportation costs. The preference for alternate routes led to prolonged delivery times and increased freight charges. Tracked indicators suggest that the rise in freight charges was moderate compared to the 2021 and 2022 realizations (Chart 2.4.11). Meanwhile, as of February, the import unit value index remained close to its value in the last quarter of 2023, as the limited increase in the intermediate goods sub-index was offset by the declines in the investment and consumption goods sub-indices (Chart 2.4.12).

Chart 2.4.10: Commodity Price Indices (Quarterly % Change)



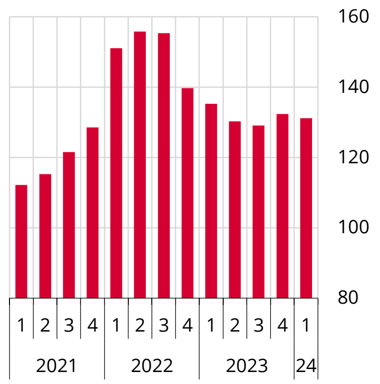
Source: Goldman Sachs.

Chart 2.4.11: Global Freight Charges (2016-2019 Average =100)



Source: Bloomberg.

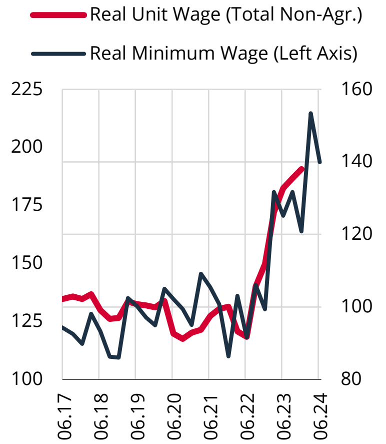
Chart 2.4.12: Import Unit Value Index* (2019Q4=100, USD)



Source: TURKSTAT.
* Quarterly data denote the last month of the respective period. As of February for 2024Q1.

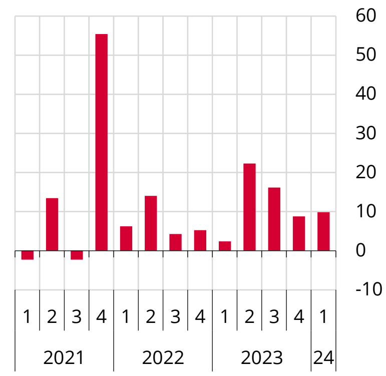
The underlying producer inflation regained strength following the minimum wage increase. As the minimum wage was revised twice and at high rates in 2023, the rise in nominal wages across the economy took on a sustained pattern, pushing the real unit wage upwards. Accordingly, the real unit wage increased significantly in the third quarter due to the minimum wage increase in mid-2023 and continued to rise in the following quarter, albeit at a slower pace. Likewise, the real unit wage is expected to have increased significantly in the first quarter of the year following the minimum wage revision at the beginning of 2024, but this increase is projected to lose pace in the second quarter (Chart 2.4.13). After having increased by 8.8% in the last quarter of 2023, the currency basket increased by 9.8% in the first quarter of this year (Chart 2.4.14). The depreciation of the Turkish lira remained below the current inflation rate, leading to a slight appreciation in the real exchange rate. The depreciation of the Turkish lira at close to the rate in the previous quarter led to a more limited inflationary pressure driven by items with high import intensity at a time when global prices of certain commodity products, particularly energy prices, and freight charges rose due to geopolitical tensions. While risks stemming from geopolitical developments have recently gained in importance, the impact of global developments on domestic costs has been more pronounced in the energy group but limited in the non-energy groups. Domestic developments, especially wage realizations as well as rising food prices, were the other main drivers of the increase in the underlying producer inflation (Chart 2.4.15).

Chart 2.4.13: Real Unit Wage per Hour Worked* (Value Added, 2015=100, Seasonally Adjusted) **and Real Minimum Wage**** (2015=100)



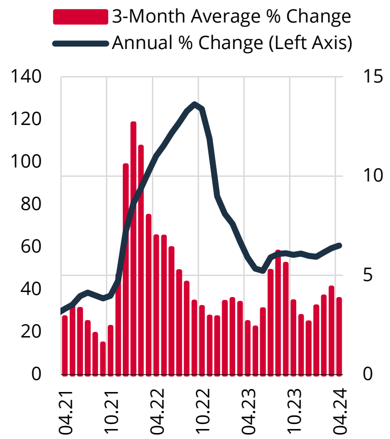
Source: CBRT, TURKSTAT.
* Deflated by the CPI. Real wage per hour worked/productivity.
** Deflated by the seasonally adjusted CPI. Forecast is used for the 2024Q2 inflation data.

Chart 2.4.14: Currency Basket* (Quarterly % Change)



Source: CBRT.
* USD and euro have equal weights. Calculations are based on the average exchange rate in the last month of the relevant quarter.

Chart 2.4.15: Manufacturing Prices Excluding Petroleum and Base Metals

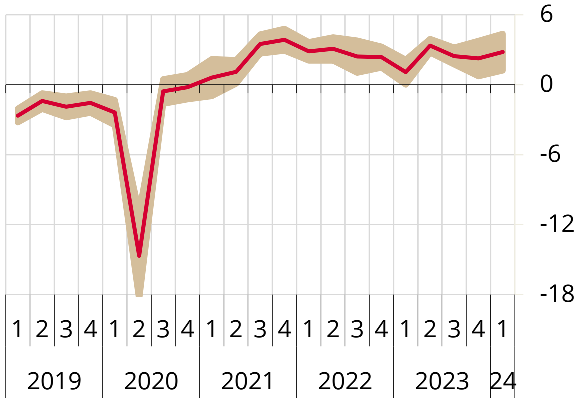


Source: CBRT, TURKSTAT.

Demand conditions remained strong in the first quarter of the year. In the last quarter of 2023, GDP growth accelerated on the back of domestic demand following the expected wage increase and campaigns and materialized at a figure close to potential. Consistent with this development, the main output gap indicator followed an almost flat course. Leading indicators suggest that growth strengthened somewhat, and the output gap expanded in the first quarter of 2024. Meanwhile, the uncertainty band derived from the output gap series monitored by the CBRT widened slightly in the first quarter (Chart 2.4.16). Survey-based indicators moved upwards, while indicators based on statistical filtering moved downwards, thereby widening the band.[1] Wage adjustments have an impact through the demand channel as well as the cost channel and are among the main drivers of inertia in inflation. Wage increases stood as a key factor driving domestic demand in the first quarter, and total credit change hovered above its historical average. Credit change strengthened despite the monetary tightening measures (Chart 2.4.17). In the first quarter of the year, both corporate and consumer loans, mainly credit cards, grew, yet retail loans in particular saw a slowdown in April (Chart 2.2.13). It is projected that loan growth will be more constrained starting in the second quarter of the year as the lagged effects of monetary policy become more evident and that the output gap will start to narrow as wage increases slow down, thereby bolstering the disinflationary path.

[1] For further information, see Box 3.1 of the Inflation Report 2024-I.

Chart 2.4.16: Output Gap* (%)



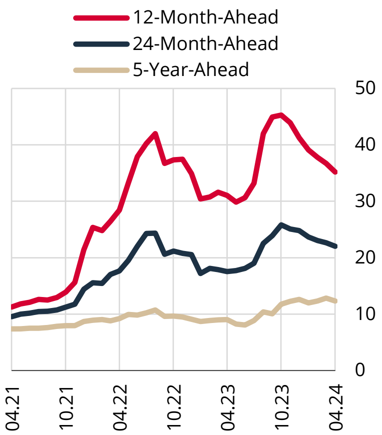
Source: CBRT.
* Displayed with 95% confidence interval, which is computed based on eight output gap indicators calculated with different methods.

Chart 2.4.17: Total Credit Change*
(13-Week Average, Real, Standard Value)

Source: CBRT.
* Weekly credit changes adjusted for exchange rates are deflated by the CPI. The 13-week average is taken after weekly real changes are standardized. The mean and standard deviations of the series are calculated based on the 2006-2019 period.

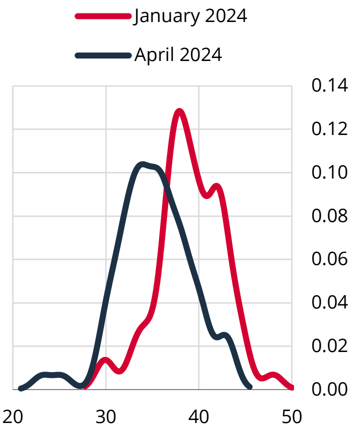
Inflation expectations continued to decline, albeit remaining above the projections in the previous Inflation Report. The results of the Survey of Market Participants in April reveal that the 12-month-ahead inflation expectation decreased by 3.92 points over the previous reporting period to 35.17%, while the 24-month-ahead inflation expectation receded by 1.64 points to 22.05%. Meanwhile, the 5-year-ahead inflation expectation edged up by 0.31 points to 12.32% (Chart 2.4.18). Despite the favorable changes in expectations, inflation expectations for end-2024 stood at 44.16%, above the forecast presented in the previous Inflation Report. Data from the Business Tendency Survey and the Consumer Tendency Survey indicate that the real sector and consumers have higher and more rigid inflation expectations. While the distribution of responses to the Survey of Market Participants' 12-month-ahead CPI inflation expectation shifted to the left, indicators reflecting the dispersion of expectations, such as the coefficient of variation, decreased slightly (Chart 2.4.19). The diffusion index for consumer prices picked up again amid the minimum wage and administered price adjustments but remained almost flat in the following months (Chart 2.4.20). It is projected that the services sector will continue to spread the impact of shocks over time in the upcoming period, and hence the diffusion index for the sector will register high values. The diffusion index for the core goods sector, on the other hand, will start to decline.

Chart 2.4.18: Consumer Inflation Expectations* (%)



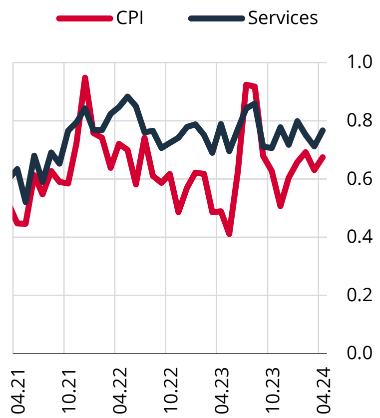
Source: CBRT.
* Results of the CBRT Survey of Market Participants that polls real and financial sector representatives as well as professionals.

Chart 2.4.19: Distribution of Survey of Market Participants
(12-Month-Ahead CPI Expectations)



Source: CBRT.

Chart 2.4.20: Diffusion Indices of CPI and Services Sector*
(Seasonally Adjusted, Monthly)



Source: CBRT, TURKSTAT.
* Calculated as the ratio of the difference between the number of items with increasing prices and the number of items with decreasing prices to the total number of items.

Despite the revisions made at the beginning of the year, the impact of taxes and administered items waned in the first quarter due to natural gas-related developments. Administered items posted significant price increases in January. While certain taxes and charges were raised at the revaluation rate, fuel and bottled gas prices increased due to the hike in the lump sum SCT. As a result of the minimum wage adjustment and the rise in fuel prices, the fees of certain transportation services soared in January and February. Revisions to the tariffs of the Turkish Medical Association and the Turkish Dental Association led to sharp price increases in health care services, particularly in January. In education services, where fees are indexed to past inflation as required by regulations, prices rose significantly in February and March, mainly for preschool as well as primary and secondary education. Increases in municipal water tariffs were high in January but weakened significantly in the following months. In February, milk and dairy products recorded price hikes due to the increase in the raw milk reference price effective from the last week of January. To be applicable as of early May, the raw milk reference price was raised again, albeit to a lesser extent than in January. Prices of tobacco products, which had seen tax-induced increases in January, rose again in April, driven by producer firms. Taxes and administered prices pushed headline inflation upwards in the first four months of the year, while their overall effect weakened compared to the previous quarter due to natural gas. In fact, in the last quarter of 2023, the natural gas item drove headline inflation significantly upwards as the free-of-charge consumption limit was exceeded due to rising consumption. Prices in the index maintained their upward course in January, albeit at a slower pace, and remained almost flat in the two subsequent months. On the other hand, natural gas prices, which declined in April on the back of falling consumption, are projected to rise significantly in May due to the termination of free-of-charge consumption.