Summary of the Monetary Policy Committee Meeting

29 December 2022, No: 2022-54

Meeting Date: 22 December 2022

Inflation Developments

1. Consumer prices rose by 2.88% in November, and annual inflation decreased by 1.12 points to 84.39%. The fall in annual inflation was driven by energy and core goods groups, and food price developments stood out in monthly inflation. While annual inflation declined across all subgroups of core goods, energy prices were mild and annual energy inflation dropped due to the base effect. Price increases spread across the food group, and the fresh fruits and vegetables item and prices of milk and dairy products were the leading drivers of the rise in annual food inflation. Led by declines in refined petroleum product and base metal industry prices as well as in electricity
and natural gas production prices, the monthly rate of increase in producer prices decelerated significantly. Accordingly, annual producer inflation decreased. Against this background, the slowdown in seasonally-adjusted monthly change in B and C indices continued while their annual inflation went down.
2. Annual inflation in food and non-alcoholic beverages rose by 3.50 points to 102.55%. While price increases spread across the group, annual inflation increased by 5.00 points to 97.24% in unprocessed food, and by 2.03 points to 107.35% in processed food. In unprocessed food, seasonally-adjusted data pointed to an accelerated rise in fresh fruit and vegetable prices in November, which was mainly driven by irregularities in the transition from field to greenhouse and the effect of new products included in the index in fruits. The price hike in the unprocessed food subgroup was led by developments in prices of milk in particular, as well as rice, potatoes and pulses, in addition to prices of fresh fruits and vegetables. The increase in processed food prices was mainly driven by cheese and other dairy products, which were affected by raw milk prices, as well as bread and cereals, fats and oils, non-alcoholic beverages and canned vegetables.
3. Up by 1.28% in November, energy prices were milder compared to recent months, and annual inflation in this group decreased by 10.06 points to 118.00% due to the base effect. The monthly increase is attributable to the 1.19% rise in fuel prices. While municipal water prices went up by 3.33% in this period, bottled gas prices rose by 2.73% following the developments in international propane and butane prices. Leading indicators suggest a fuel prices-led decline in energy prices in December due to the fall in crude oil prices.
4. Prices of services rose by 2.18% in November, and the group's annual inflation increased by 0.48 points to 60.72%. In this period, annual inflation increased in rents and communication services, but decreased in other subgroups. Seasonally-adjusted data indicate that the deceleration in the monthly increase of rents seen in the previous month also continued in November. In the communications subgroup, the 2.96% increase in prices was mainly due to telephone call and internet fees, and annual inflation in this subgroup climbed to 29.17%. Prices in the other services subgroup rose by 1.41% month-on-month, with maintenance-

repair, recreational and sporting services, household services and insurance services in the lead. Driven by catering services, prices in the restaurants-hotels subgroup rose by 3.18%, whereas annual inflation dropped to 80.30% due to the base effect. Prices in transport services remained relatively flat, and annual inflation fell by 1.54 points.

5. Annual inflation in core goods dropped by 3.54 points to 76.11%. In this period, prices of durable goods picked up by 2.46%, which was driven predominantly by white goods, furniture and automobile prices but annual inflation in this subgroup decreased by 2.97 points to 89.50% due to the base effect. Analyses of the course of producer and consumer prices in the durable consumption goods sector indicate that annual producer inflation and consumer inflation in this group are at similar levels as producer price developments have been reflected on consumer prices within a short time. In the other core goods subgroup, prices increased by 2.17% month-on-month, still being led by personal care products and household-related cleaning materials, whereas annual inflation declined by 3.74 points to 81.64%. Contrary to seasonal trends, prices in the clothing and footwear subgroup fell by 1.54% on a monthly basis in November, pulling annual inflation down by 4.41 points to 36.22%.
6. According to the December results of the Survey of Market Participants, inflation expectations decreased. The current year-end inflation expectations dropped by 1.26 points to 66.80%. The 12-month ahead inflation expectations were revised down by 2.55 points to 34.92%. Meanwhile, 24-month ahead and 5-year ahead inflation expectations receded by 0.20 and 0.38 points to 20.56% and 9.11%, respectively.

Factors Affecting Inflation and Risks

7. Leading indicators point to continuation of recession concerns in developed economies as a result of ongoing geopolitical risks and interest rate hikes.
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 high level in producer and consumer inflation continues on an international scale. The effects of high global inflation on inflation expectations and international financial markets are closely monitored.
9. The divergence in monetary policy steps and communications of central banks in advanced economies continue to increase 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. Additionally, financial markets started to adjust their expectations that the central banks would end the rate hike cycles in the near term on the back of the increasing recession risks.
10. Regarding portfolio flows to emerging economies, bond and equity markets saw inflows in December parallel to the improved global risk appetite. On the other hand, 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.
11. 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.
12. Increase in inflation has been 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.

13. International commodity prices dropped in November. As for sub-groups, industrial metal prices increased and diverged from other sub-groups. International crude oil prices slightly decreased in November, and the decrease became more evident in December. The retreat in natural gas prices continued in November as well. International transportation costs maintained their downward trend in November. Moreover, exchange rates have followed a moderate course over the last few months. On the back of these developments, the monthly rate of increase in producer prices slowed down significantly led by the decline in electricity and natural gas production, refined petroleum products and basic metal industry prices, and annual producer inflation decreased. An analysis of annual inflation by main industry groups reveals that annual inflation decreased in all sub-groups, particularly in energy. When analyzed by sectors, prices of electricity, natural gas manufacturing, refined petroleum products and base metal industry decreased, while prices of other mining and quarrying, leather, paper and non-metallic mineral products related to construction increased. The seasonally-adjusted underlying trend indicators of producer prices point that the weakening trend in cost pressures continues.

14. A strong growth was observed in the first three quarters of 2022. In the third quarter of 2022, the Gross Domestic Product (GDP) increased by 3.9% on an annual basis, while growth in the first three quarters of the year was 6.2% compared to the same period of the previous year. While the main driver of annual growth in the third quarter was the services sector, the contribution of the industrial sector to growth remained limited due to the weakening foreign demand. While the share of sustainable components in economic growth increases, the share of the contributions of machinery-equipment investments and net exports accounted for approximately 62% of the average annual growth in the first three quarters of the year.

15. Leading indicators for the last quarter of the year continue pointing to a slowdown in growth due to the weakening foreign demand. In October, industrial production increased by 2.4%, adjusted for seasonal and calendar effects, on a monthly basis and it increased by 3.1% on an annual basis. However, when production developments are analyzed at the sectoral level, it is observed that the production of computers, electronics, optical products and other transportation vehicles sectors, which have a relatively high export intensity and typically exhibit high volatility, increased significantly (27.5% and 53.2%, respectively) on a monthly basis; when these two sectors are excluded, the monthly increase in industrial production was 0.7%. On a quarterly basis, the rise in industrial production in the fourth quarter as of October was 2.1%, while the increase in industrial production remained limited at 0.6% when typically volatile sectors were excluded.

16. The effects of foreign demand-based pressures observed in the manufacturing industry on domestic demand and supply capacity currently remain limited. Survey-based indicators such as the Business Tendency Survey and PMI as well as other high-frequency data indicate that the deceleration in economic activity continues. Manufacturing industry firms' registered domestic and external orders and future order expectations reveal that the decrease in export order expectations continued in the last quarter, albeit at a slower pace, while domestic market order expectations remained flat. In this context, despite the weakening in external demand, domestic demand has followed a relatively mild course. As a matter of fact, while the retail sales volume index increased by 1.4% on a monthly basis in October, as of November, the uptrend in credit card expenditures continued in the last quarter. Meanwhile, firms' investment and employment expectations for the future decreased slightly in the last quarter.

17. In October, seasonally-adjusted employment grew by 0.7% monthly, and by 1.0% quarterly. In the same period, seasonally-adjusted labor participation rate increased by 0.4 points to 53.5%. Despite the rise in employment, seasonally-adjusted total unemployment rate

increased by 0.1 points in October compared to the previous month and reached as 10.2% due to the increase in the labor participation rate. Survey indicators and high-frequency data indicate that, although losing momentum, the upward trend in employment is maintained. On the other hand, compared to peer economies, job creation has been stronger when the post-pandemic period is examined. Considering the sectors that contribute to the employment increase, it is observed that the growth dynamics are supported by structural gains.

18. The strong course of energy and gold imports still affects the current account balance negatively. While the current account balance posted a deficit of USD 0.4 billion in October, the annualized current account deficit increased by USD 4.5 billion to USD 43.5 billion. The provisional foreign trade data for November suggest that seasonally-adjusted exports and imports increased on a monthly basis, partially offsetting the deceleration in the previous month. Foreign trade deficit stood at USD 8.8 billion in November due to energy and gold imports, which maintained their relatively high levels. Despite the increase in the foreign trade deficit led by the surge in commodity prices, mainly energy prices, coupled with the acceleration in gold imports, the ongoing uptrend in services revenues continues to support the current account balance. The stronger-than-expected contribution of tourism revenues to the current account balance continues. On the other hand, high level 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

19. 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.

20. 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.

21. The Committee will continue to decisively use the tools supporting the effectiveness of the monetary transmission mechanism and the entire policy toolset, particularly funding channels, will be aligned with liraization targets. The comprehensive set of policies to be implemented will be published in the 2023 Monetary and Exchange Rate document in December.

22. 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. The effects of slowing foreign demand on aggregate demand conditions and production are closely monitored.

23. It is critically important that financial conditions remain supportive for the sustainability of structural gains in supply and investment capacity by preserving the growth momentum in industrial production and the positive trend in employment in a period of increasing uncertainties regarding global growth as well as further escalation of geopolitical risks. Accordingly, the Committee has decided to keep the policy rate unchanged. Considering the increasing risks regarding global demand, the Committee evaluated that the current policy rate is adequate.

24. 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.

25. The credit, collateral and liquidity policy actions, of which the review process has been 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 curve in tandem with the direction of the efficiency of monetary transmission are 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.

26. 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.

27. The CBRT will continue to use all available instruments decisively within the framework of 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.

28. 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.

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

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