TÜRKİYE CUMHURİYET MERKEZ BANKASI

Summary of the Monetary Policy Committee Meeting

28 September 2023, No: 2023-37

Meeting Date: 21 September 2023

Global Economy

1. Global inflation has recently been declining, yet it remains above the long-term averages and central bank targets. In August, consumer inflation posted a slight increase in many economies due to energy prices, while core inflation continued to decrease, with some exceptions such as China and Russia. Since the last Monetary Policy Committee (MPC) meeting, consumer inflation has increased from 4.08% to 4.27% in advanced economies and from 5.84% to 6.48% in emerging economies. In the last ten years, inflation averaged 2.2% in advanced economies and 5.6% in emerging economies. Inflation continues to hover significantly above the average target rate of 2% in advanced economies and 3.5% in emerging economies. The average annual inflation expectations for the last quarter of 2023 for advanced and emerging economies are 3.2% and 6.5%, respectively. Compared to the previous MPC meeting period, core inflation declined from 4.74% to 4.57% in advanced economies, whereas it rose from 6.03% to 6.57% in emerging economies. Average annual inflation expectations for the last quarter of 2023 are 3.1% in the USA and 3.3% in the euro area, while core inflation expectations are 3.5% and 4.3%, respectively.
2. Commodity prices continue to increase recently due to energy commodity prices led by oil prices. The current level of the Commodity Price Index is 31.8% above the average of the last ten years. The index fell by 25.5% compared to the highest level reached last year. Similarly, the Agricultural Commodity Price Index, which has declined by 12.3% compared to the peak it reached last year, is 14.8% above the average of the last ten years. This still has an impact on inflation due to the high share of food in the consumer basket.
3. High levels of core inflation and inflation expectations imply that global inflation will continue to remain above the targets of central banks for a while. As a result, many central banks around the world are expected to continue to keep their policy rates at levels that will maintain the tightness of the monetary stance. The central banks of 12 advanced countries held a total of 145 meetings in the last 19 months, and policy rates were increased in 100 of these meetings[1]. During the same period, 15 emerging countries' central banks held a total of 213 meetings, and policy rates were increased in 101 of these meetings. The results of the implemented monetary policy have begun affecting financial conditions, and central banks' emphasis on tightening financing and credit conditions has strengthened. On the other hand, following the central banks of Brazil and Chile, which initiated rate cut cycles earlier on the back of the decline in consumer inflation, the central banks of Poland and Peru also reduced their policy rates in September. However, given the high

[1] Advanced Countries: Australia, Canada, Czechia, Denmark, Euro Area, Japan, New Zealand, Norway, South Korea, Sweden, the United Kingdom, the United States of America.
Emerging Countries: Brazil, Chile, China, Colombia, Hungary, India, Indonesia, Mexico, Peru, the Philippines, Poland, Romania, Russia, South Africa, Thailand.

levels of inflation and the central banks' policy communications, it is expected that the tightness of monetary policy will continue in these economies.

4. Despite the flat global growth outlook, relatively strong demand and tight labor markets persist. The global growth index, which is weighted with export shares of Türkiye's foreign trade partners, remained flat compared to the previous MPC meeting period. The index is projected to grow by 1.7% in 2023, which is approximately 0.4 points higher than the trough in January. However, when the 3.5% growth of the index in 2022 is considered, a notable slowdown in foreign demand, on an annual basis, in 2023 is evident. Having fallen in June and July, global Purchasing Managers' Index (PMI) declined further in August. In August, the global manufacturing industry PMI edged up by 0.4 points to 49 points over the previous month, while the global services PMI decreased by 1.6 points to 51.1. Thus, the global composite PMI index was down by 1 point to 50.6 in August compared to the previous month. With the exeption of Japan, the PMI data for advanced economies continued to deteriorate in August. The composite PMI indicator for the euro area, one of the important trade partners of Türkiye, decreased by 1.9 points to 46.7 in August. Despite an increase of 0.8 points in August, the manufacturing PMI stood at 43.5, recording one of the lowest levels since June 2020. The services PMI, in particular, remained on the decline in August and decreased by 2.9 points to 47.9, which is below its threshold value. This indicates that the slowdown in euro area's economic activity will also continue in the second half of the year. The manufacturing industry PMI of emerging economies rose month-on-month by 1.2 points to 51.4 in August while the services PMI dropped by 1.5 points to 53.1. In the Chinese economy, the composite PMI maintained its downward trend in August and dropped by 0.2 points to 51.7. The manufacturing industry PMI exceeded its threshold value by increasing 1.8 points to 51, while the services PMI fell by 2.4 points to 51.8. These developments suggest that the services sector, which was an important driving force of global economic activity in the first half of the year, has lost strength in recent months.

5. Portfolio flows to emerging markets continued in June and July on the back of improving risk sentiment. While there was an inflow of approximately USD 63.2 billion to equity markets in the first seven months of 2023, bond markets saw an inflow of around USD 1.1 billion. In August (31 July-1 September 2023), driven by the fluctuation in global risk appetite, there was a total outflow of USD 22.1 billion, USD 20.5 billion of which was from equity markets, mainly from China, Taiwan, South Africa and Indonesia.

Inflation Developments

6. Inflation readings were above expectations in July and August. As the strong course of domestic demand and the stickiness of services inflation persist, the increase in oil prices and the ongoing deterioration in inflation expectations pose additional upside risks to inflation. Consumer prices rose by 9.09% in August, and annual inflation increased by 11.11 points to 58.94%. This was due to the carry-over effects of tax and administered price adjustments from July, the lagged effects of the depreciation in the Turkish lira and wage increases, as well as the rise in global energy prices and the stickiness of services prices. The high level of fuel prices due to frequent price revisions had an additional impact on the rise in inflation through direct and indirect channels, and contributed to widespread price hikes.

7. Contributions of subgroups to annual inflation rose from 17.85 points to 20.86 points in the services group (3.00 points of increase), from 15.27 points to 18.13 points in the food and non-alcoholic beverages group (2.86 points of increase), from 12.95 points to 15.54 points in the core goods group (2.60 points of increase), from -0.39 points to 2.11 points in the energy group (2.51 points of increase), and from 2.16 points to 2.30 points in the total of alcohol, tobacco and gold groups (0.14 points of increase).

8. Prices of food and non-alcoholic beverages group increased by 8.48% in August, and annual inflation rose by 12.14 points to 72.86%. Seasonally adjusted data pointed to a significant increase

in prices of fresh fruits and vegetables in this period, with fruit prices in the lead. In the other unprocessed food group, increases in prices of eggs as well as dried fruits and nuts were notable. The monthly price increase in the processed food group grew stronger at 11.17% compared to the previous month. Bread and cereals, bread in particular, as well as milk and dairy products, fats and oils, and non-alcoholic beverages posted noticeable price hikes.

9. Energy prices went up by 14.23% in August, and the group's annual inflation rose by 16.89 points to 14.03%. Monthly energy inflation was driven by the carry-over effect of the tax increase in mid-July as well as soaring international energy prices. Fuel and bottled gas prices surged by 26.11% and 23.93%, respectively. Coupled with international crude oil prices and exchange rate developments, the SCT adjustment brought about a significant increase in fuel prices. In addition to its direct effect, the increase in fuel prices also has an indirect negative effect on consumer inflation through transportation costs. Municipal water prices also posted a sharp increase (7.43%) in August.

10. The increase in services prices remained strong at 9.19% in August, and annual services inflation rose by 9.92 points to 79.57%. In this period, price hikes spread across the subgroups, and annual inflation increased in all subgroups. Prices of transport services posted their highest increase in the 2003-based index with a monthly hike of 27.62% due to the drastic rise in fuel prices. Large price increases in transport services also continued in September, albeit with some loss of momentum. The continued significant price increases in the restaurants-hotels subgroup, driven by the ongoing negative outlook for food prices as well as strong tourism demand and the lagged effects of wage hikes, continued in August and prices surged by 7.09%. The monthly price increase in the rents subgroup strengthened somewhat further and was measured at 7.90%. In the other services subgroup, prices increased by 7.19%, led by maintenance-repair of personal transport vehicles, health services and recreation-culture services. The price increase in communication services was higher at 5.14% compared to past months.

11. Prices of core goods were up by 8.57% in August, and the group's annual inflation increased by 7.72 points to 51.97%. For core goods, where the exchange rate pass-through is high, prices increased sharply across subgroups, while annual inflation rose in all subgroups. The monthly price increase in durable goods (excluding gold) remained strong at 7.82%, with significant increases in prices of automobiles, white goods and furniture in August. In the other core goods subgroup, the carry-over effects of tax adjustments and revision of the reference euro exchange rate for medicine prices were felt, and prices posted a widespread increase of 9.92%. In the clothing and footwear group, prices rose (8.25%) contrary to the seasonal averages.

12. Prices in the alcoholic beverages and tobacco group increased by 3.77%, and annual inflation in this group rose by 5.40 points to 51.98%. This development was mainly due to the carry-over effects into August as the price hikes stemming from last month's tax adjustments were reflected in the index on a day-weighted basis. The rise in tobacco prices will continue in September as well due to the price adjustments by producer companies.

13. The underlying trend of inflation remained elevated in August. Seasonally adjusted monthly increases in the B index slightly rose while that in the C index remained flat. This outlook is also confirmed by alternative core inflation indicators. The three-month average increases in the seasonally adjusted B and C indices, which peaked at 8.8% and 8.5%, respectively, in February 2022, stood at 7.0% and 7.2% in August 2023. In August, the seasonally adjusted rates of increase in the B and C indices were measured at 9.8% and 9.2%, respectively.

14. Leading indicators suggest that the high price hikes over the last two months will decelerate. Preliminary data suggest that the rise in food prices has lost pace compared to previous months, while the lagged effects of wages, exchange rates and taxes on inflation have weakened significantly. Meanwhile, services prices remain elevated due to seasonal factors related to the opening of schools, and the impact of rising oil prices on energy items continues.

Demand and Production

15. Gross Domestic Produc (GDP) data for the second quarter of the year suggest that the economic activity remained robust, particularly driven by domestic demand. Recent indicators and high-frequency data point that, in the third quarter, economic activity maintained its strength led by domestic demand, despite a quarterly slowdown in growth momentum. In July, the retail sales volume index displayed a significant rise of 34.8% year-on-year, due to calendar effects. Following the 5.8% rise in the second quarter, the quarterly rate of increase lost some momentum and came down to 3.9%. The upward trend in card expenditures continued in August. In August, manufacturing firms' registered orders from the domestic market increased by 8.6 points on an annual basis, while, in seasonally adjusted terms, they displayed a limited decrease on a quarterly basis. Manufacturing firms' expectations in August for future export orders and domestic market orders declined on a monthly basis, more markedly in expectations for export orders. Meanwhile, interviews with firms point to a loss of momentum at the sectoral level due to the effect of high rates of price increases on the purchasing power.

16. In July, the seasonally and calendar adjusted industrial production index decreased by 0.4% month-on-month, while, adjusted for calendar effects, it increased by 7.4% on an annual basis. The underlying trend in industrial production is stronger when sectors typically exhibiting high volatility, such as computers, other transportation and recorded media, are excluded. Excluding these sectors, industrial production in July is stronger than the general index, with a 0.9% month-on-month increase. On a quarterly basis, industrial production increased by 0.9% in July compared to the second quarter average. In August, the seasonally adjusted capacity utilization rate in the manufacturing industry decreased, led by the vehicles sector due to the annual shutdown in factories for maintenance purposes. Meanwhile, indicators for the third quarter suggest that excluding the vehicles sector, capacity utilization rate remained flat on a quarterly basis.

17. As of July, seasonally adjusted employment was recorded at 31.7 million. In this period, employment increased by 0.3% quarter-on-quarter, while the labor force participation rate decreased by 0.1 points. In July, unemployment rate decreased by 0.2 points to 9.4% from 9.6% in June. High-frequency data indicate that demand remains robust in the labor market.

18. In July, in line with the significant rise in foreign trade deficit, the annualized current account deficit increased by USD 2 billion month-on-month to USD 58.5 billion. Despite the improvement in the energy balance owing to the ongoing decline in energy prices on an annual basis, this increase was mainly driven by strong increases in imports of gold, investment goods and consumption goods. In this context, the strong course of domestic demand has an increasing effect on the annualized current account deficit through imports of consumption goods. As of July, the annualized balance of payments-defined foreign trade deficit widened by USD 37.7 billion year-on-year to USD 100.6 billion. In the same period, the annualized services surplus rose by USD 7.3 billion to USD 51.7 billion. According to provisional foreign trade data for August, compared to the same period last year, gold imports increased by USD 13.5 billion to USD 22.8 billion in the first eight months of the year. High-frequency data suggest that gold imports, which accelerated in August, are still above historical averages, despite some slowdown in September on the back of the measures taken. Provisional foreign trade data for August and high-frequency data for September imply a decline in both imports and exports in seasonally and calendar adjusted terms in the August-September period.

19. Tourism revenues, which have been strong throughout the year, continue to contribute positively to the current account balance. Travel revenues increased by USD 3.8 billion in the first seven months of the year compared to the same period of the previous year, and reached USD 24.3 billion. Similarly, the number of foreign visitors increased by 19.2% year-on-year to 25.1 million in the first seven months of the year.

Cost Conditions

20. The increase observed in July in energy commodity prices, which had been decreasing since the second half of 2022, continued in August as well. Non-energy commodity prices, which have remained almost flat in recent months, posted a decline in August. As of the first half of September, energy commodity prices continued to rise, while non-energy commodity prices remained relatively flat. Following the decision to continue production cuts, the price of Brent crude oil maintained its upward trend and hovered above USD 90 in the first half of September, marking the highest level since November 2022. In the energy group, international propane and butane as well as coal prices continued to increase in USD terms. Thus, exchange rates and international energy commodity developments as well as the lagged effects of rising labor costs stood as the main factors exerting pressure on producer prices.
21. In August, domestic producer prices rose by 5.89%, pushing annual inflation up by 4.91 points to 49.41%. According to the main industrial groupings, annual inflation increased across all subgroups, while the monthly increase in energy producer prices was significant due to international commodity and exchange rate developments.
22. The Global Supply Chain Pressure Index remained flat in August while international transportation costs maintained their low levels despite a slight increase. Exchange rates, which retreated after the MPC decision in August, remained stable in September.
23. Adjustment in the minimum wage in July 2023, accompanied by wage adjustments for civil servants and public sector workers, and wage hikes becoming broad-based had important impacts on inflation in July and August through the cost channel.

Stickiness of Services Inflation

24. Price increases in the services sector became stronger as of July. Monthly price increases in the services sector, which displays inertia compared to goods, are higher compared to 2022. Annual inflation in the C index, which includes the core goods and services groups, is around 65%, while annual inflation in the services sector is around 80%. Additionally, the diffusion index for the services sector is hovering approximately 60% above its historical average, indicating that the increases showed a generalized pattern across the sector.
25. Monthly increases in the restaurants and hotels subgroup, which are significantly affected by food, wage and tourism developments, display a persistent outlook. Given the weakening in lagged effects of the minimum wage and the recent deceleration in food price increases, the uptrend in prices in the sector is expected to lose some momentum in the following months.
26. Fuel prices are capable of having a significant impact on consumer prices, particularly on transport services, through both production inputs and transportation costs. In fact, the recent significant increases in fuel prices driven by exchange rates, crude oil prices and tax hikes have rapidly passed through to transport services prices. The outlook for international oil prices is likely to continue to exert pressure on transport services prices in the upcoming period.
27. In addition to rising house prices and backward-indexation behavior, imbalances between supply and demand in the real estate market are pushing rent increases upwards and adversely affectting consumer inflation.
28. Certain services items, particularly rents, education, health, recreation and culture exhibit pricing behavior indexed to past consumer inflation, prompting inflationary effects to spread over a long period of time. Given the expected outlook for consumer inflation in the near term, there is a risk that inflation will remain high for an extended period in items in which backward-indexation is prevalent.

29. Seasonal effects will be apparent on services prices due to the opening of schools in September. This period sees high price hikes as service items such as university tuition fees, student accomodation fees and school bus fares are priced at certain times of the year (time-dependent pricing).

Tax Adjustments

30. The short-run effects of the recent tax adjustments on consumer inflation were observed in July and August, along with the carry-over effects arising from the number of days calculated.

31. The direct effects of the tax hikes have largely played out. In the coming months, the indirect effects of the tax hikes are expected to continue, albeit at a weaker pace, depending on the frequency of price changes by firms.

Inflation Expectations

32. The current course of inflation expectations and the deterioration in pricing behavior keep upside risks to the inflation outlook alive. The consumer inflation diffusion index continued to rise in August, remaining three standard deviations above its historical average.

33. According to the September results of the Survey of Market Participants, the 12-month-ahead inflation expectation increased by 2.93 points from 42.01% to 44.94%, the 24-month-ahead inflation expectation rose by 1.33 points from 22.54% to 23.87%, and the five-year-ahead inflation expectation was revised downwards by 0.39 points from 10.42% to 10.03%.

34. These factors imply a year-end inflation close to the upper bound of the forecast range provided in the Inflation Report (Report). The Committee evaluated that tax regulations and cost pressures stemming from wages and exchange rates, which have been pushing up inflation, have broadly passed through to prices, and that the underlying trend in monthly inflation is on course to decline. Given the monetary tightening stance, the Committee is determined to establish the disinflation course in 2024 in line with the Report.

Monetary and Financial Conditions

35. Credit growth poses a risk to inflation by increasing domestic demand. As of 8 September 2023, the retail loan balance increased by 107.7% in credit cards, 75.8% in vehicle loans, 34.0% in personal loans, and 24.2% in housing loans compared to end-2022, amounting to an increase of 54.4% in total. Meanwhile, personal loan growth, which lost momentum due to the expansion of the scope of the loan growth-based securities maintenance practice, increased by 1.8% since 18 August. In the same period, although their growth slowed down to 6.9%, personal credit cards maintained their strong trend, with an annual growth rate remaining flat at 181.6%. For Turkish lira-denominated commercial loans, which grew by 1.3% compared to the previous MPC meeting period, annual growth stood at 61.3%.

36. Average personal loan rates (excluding overdraft accounts), which, due to the policy rate hike, have posted a significant increase of 1,260 basis points since the previous MPC meeting period, became 59.7% as of 8 September 2023. In the same period, vehicle loan rates rose from 38.1% to 46.5%, and housing loan rates rose from 36.4% to 38.9%. Meanwhile, Turkish lira commercial loan rates increased by 931 basis points to 40.6%.

37. As of June, the measures taken to ensure the sound functioning of the banking system within the scope of the simplification process have primarily restored the flow of Turkish lira commercial loans. Turkish lira commercial loans, which increased by 0.3% across the sector in June, grew 2.4% in July and 2% in August. Turkish lira deposit rates stood at 24.9% in the week ending 18 August and at 31.6% in the week ending 8 September. Owing to the policy rate hike and the recent steps taken as part of the simplification of the macroprudential framework, it is evaluated that there was

a growth in the demand for Turkish lira investments. Simultaneously, loan and deposit rates also rose in tandem, resulting in the strengthening of the monetary transmission mechanism.

38. Foreign direct investment, improvement in external financing conditions, continued increase in foreign exchange reserves, the positive impact of tourism revenues on current account balance, and increasing domestic and foreign demand for Turkish lira denominated assets will contribute significantly to price stability.

39. With the recently-signed agreements, foreign direct investments that will focus on improving technology investments and production capacity will support external financing in the upcoming period.

40. Türkiye's five-year CDS premium, which peaked this year with 703 basis points on 22 May 2023 amid domestic uncertainties, declined to 412 basis points in the previous MPC meeting period and to 385 basis points on 20 September 2023. Similarly, one-month and 12-month exchange rate volatilities of the Turkish lira, which declined noticeably in the same period remained flat in this MPC meeting period at 15.7 and 28.9 points, respectively. Falling figures in the risk premium and exchange rate volatilities were accompanied by net portfolio inflows totaling USD 2.47 billion since June, USD 0.81 billion of which went to the government domestic debt securities (GDDS) market and USD 1.66 billion to the equity market.

41. International reserves of the Central Bank of the Republic of Turkey (CBRT) maintain the strong upward trend they assumed in June. Having declined from USD 128.8 billion at the end of 2022 to USD 98.5 billion at the end of May, gross international reserves of the CBRT rose to USD 120.6 billion as of 8 September 2023.

Monetary Policy

42. The policy rate will be determined in a way that will create monetary and financial conditions necessary to ensure a decline in the underlying trend of inflation and to reach the 5% inflation target in the medium term. The Committee assessed that because of the inflation outlook and the upside risks, the capacity of the monetary policy framework to achieve the 5% inflation target should be enhanced. The Committee drew attention to the risks that a deterioration in price stability may pose to macroeconomic stability and especially to financial stability. Monetary tightening will be further strengthened as much as needed in a timely and gradual manner until a significant improvement in the inflation outlook is achieved.

43. The Committee decided to continue the monetary tightening process in order to establish the disinflation course as soon as possible, to anchor inflation expectations, and to control the deterioration in pricing behavior. Accordingly, the Committee raised the policy rate (the one-week repo auction rate) from 25% to 30%.

44. To increase the functionality of market mechanisms and strengthen macro financial stability, the Committee continues to simplify and improve the existing micro- and macroprudential framework. A gradual simplification policy will continue to be implemented, and the pace and sequence of the transition will continue to be determined through impact analyses. Impact analyses of the CBRT's regulations are conducted for all components of the framework by assessing their impact on inflation, interest rates, exchange rates, reserves, expectations, securities and financial stability.

45. In this context, recent regulations targeting a rising share of Turkish lira deposits strengthen the monetary transmission mechanism. In addition to the increase in the policy rate, the Committee will continue to make decisions on quantitative tightening and selective credit tightening to support the monetary policy stance. While policy rates, the main policy instrument, affect monetary and financial conditions and expectations, these decisions aim to stabilize excess Turkish lira liquidity and consumption demand and increase the effectiveness of monetary policy.

46. With the acceleration in retail loans, it is assessed that domestic demand is deteriorating price stability both directly and through the current account balance. Selective credit tightening decisions are expected to support the rebalancing process in domestic demand. The Committee assesses that the rebalancing in domestic demand resulting from credit tightening decisions and the the improvement in the distribution of financing sources will have a positive impact on factor productivity.

47. The Turkish lira liquidity inflows to the financial system stemming from the foreign exchange difference payments of FX-protected deposit accounts due to the exchange rate developments are closely monitored. Due actions will be taken based on the impact analyses in view of the current market conditions and liquidity projections for the upcoming period.

48. Indicators of inflation and underlying trend of inflation will be closely monitored and the Committee will continue to decisively use all the tools at its disposal in line with its main objective of price stability.

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