TÜRKİYE CUMHURİYET MERKEZ BANKASI

Summary of the Monetary Policy Committee Meeting

24 March 2022, No: 2022-19

Meeting Date: 17 March 2022

Inflation Developments

1. In February, consumer prices increased by 4.81%, and annual inflation rose by 5.75 points to 54.44%. The exchange rate was more stable in February, while the upward trend in commodity prices became evident following geopolitical developments. The increase in annual food inflation reflected the developments in international markets. Domestic fuel prices were adversely affected by the increase in crude oil prices, and this item became the main driver of energy inflation. In line with the outlook for energy and food, restaurants-hotels and transportation pushed services inflation up. In core goods, price increases slowed down in February but annual inflation continued to rise. Both the developments in international commodity markets and ongoing supply problems caused producer prices to soar. Against this background, annual inflation of indicators B and C increased in February.
2. Food and nonalcoholic beverage prices increased by 8.41% in February, and the group's annual inflation rose by 8.86 points to 64.47%. Annual inflation in unprocessed food increased by 14.95 points to 69.93%, while annual inflation in processed food increased by 3.22 points to 59.42%. Rising at a rate higher than seasonal averages with 32.16%, prices of fresh fruits and vegetables were the key driver of the annual unprocessed food inflation in February. Other unprocessed food items, including red meat, pulses, dried nuts and potatoes increased notably, while fats and oils, sugar and sugar-related products and grain products in the processed food group rose significantly as well. International agricultural commodity prices seem to have a negative impact on these items, directly or indirectly. The VAT reduction of food items from 8% to 1% in mid-February prevented a more negative outlook, while leading indicators point to a more positive outlook for the food group in March, supported by the prolonged effect of the VAT cut.
3. While energy prices rose by 4.00% in February, annual inflation in the energy group increased by 6.60 points to 82.98%. Recent geopolitical developments led to a global upsurge in prices of crude oil, natural gas and solid fuel, aggravating the pressure on domestic prices. Against this background, price hikes were widespread in February, with fuel oil prices soaring notably by 10.10%. On the other hand, the grading in residential electricity tariffs was adjusted, which pulled electricity prices down by 4.84%. In addition, the VAT rate was reduced in early March. Accordingly, electricity prices are expected to decelerate further in March.
4. In February, annual core goods inflation increased by 5.89 points to 54.38%. Annual inflation has been high across all subgroups in this period. Prices of durable goods increased relatively mildly by 3.27% compared to previous months, and the annual inflation in this group rose by 4.70 points to 60.94%. Prices of white goods and furniture items increased markedly, while automobile prices maintained a moderate course. In other core goods, annual inflation reached 61.89% with an increase of 10.66 points. Price hikes in other core goods were widespread, with medicine prices stood out due to backward exchange rate indexing. Prices

of clothing and footwear registered a slight increase by 0.23% in February, contrary to seasonal norms, and annual inflation in this subgroup was calculated as 26.55%.

5. Services prices rose by 3.63% in February, and annual services inflation increased by 3.33 points to 32.89%. Annual inflation increased across all subgroups, but more markedly in transport and hotels-restaurants. Prices in restaurants-hotels increased by 4.54% due to catering services, and annual inflation reached 55.20%, owing to the increases in the costs of main inputs such as food and energy. Fuel price changes also had an adverse impact on transport services led by intercity passenger transport by road and urban passenger transport by bus. Prices in this group went up by 5.73%, and annual transport inflation rose to 46.87%. The subgroup of other services also saw widespread price increases, particularly in health and education services. Seasonally adjusted monthly increases in rent remained high.

6. According to the March results of the Survey of Market Participants, the current year-end inflation expectation rose by 6.41 points to 40.47%, while the 12-month-ahead inflation expectation increased by 1.60 points to 26.43%. On the other hand, long-term inflation expectations lost its upward momentum in March, and the five-year ahead inflation expectation dropped by 0.24 points to 8.81%.

Factors Affecting Inflation and Risks

7. Leading indicators show that the robust recovery in the global economy is sustained, albeit with some deceleration. However, geopolitical risks that evolved into conflict and the variants, keep the downside risks to regional and global economic activity alive and further increases the uncertainty.

8. Recovery in global demand, high course of commodity prices, supply constraints in some sectors that have become more evident particularly in energy, and high transportation costs have led to producer and consumer price increases internationally. The effects of high global inflation on inflation expectations and international financial markets are closely monitored. Moreover, central banks in advanced economies assess that the rise in inflation may last longer than previously anticipated due to rising energy prices and imbalances between supply and demand. Accordingly, while monetary policy communication of central banks in advanced economies varies with their diverse outlook for economic activity, labor market and inflation expectations, they still continue their supportive monetary stances and asset purchase programs at a slower pace.

9. Portfolio flows to emerging economies suggest that inflows to equity markets have recently continued albeit at a slower pace and bond markets have posted outflows. The volatility in long-term bond rates in advanced economies and the course of global financial conditions keep the risks to portfolio flows to emerging economies alive. The impact of such risks through the portfolio flows channel towards Turkey is judged to prove to be relatively limited, considering the current levels of non-residents' portfolio positions.

10. Increase in inflation in the recent period has been driven by rising energy costs resulting from the heightened regional conflict, temporary effects of pricing formations that are not supported by economic fundamentals, supply side factors such as the rise in global energy, food and agricultural commodity prices, supply constraints, and demand developments.

11. Despite the mild course in exchange rates, the commodity price increases that became more evident due to lingering supply-side problems and the geopolitical unrest affected producer prices negatively in February. While annual inflation increased across all subgroups, the energy group diverged negatively in line with international developments. Across subgroups,

monthly changes were remarkable in electricity-gas production and distribution, crude oil-natural gas, main pharmaceutical, wood and construction related products.

12. Economic activity remained strong in the final quarter of 2021, with the help of both domestic and external demand. In this period, Gross Domestic Product (GDP) rose by 9.1% on an annual basis while it increased by 1.5% quarter-on-quarter in seasonally and calendar-adjusted terms. Accordingly, overall 2021 growth became 11%. On the production side, industrial and services sectors were the main drivers of annual and quarterly growth in the final quarter whereas the construction sector limited growth. On the expenditures side, the main driver of quarterly growth was final domestic demand led by private consumption while net exports contributed to quarterly growth by 0.9 points.

13. Level of capacity utilization and other leading indicators show that domestic economic activity remains strong, with the help of robust external demand even some regional differences emerge. Adjusted for seasonal and calendar effects, industrial production declined by 2.4% month-on-month in January. However, it is assessed that electricity and natural gas outages in industrial plants in the last ten days of the month were effective in this decline and the production remains strong when these effects were excluded. In terms of export intensity, industrial production is stronger than implied by the general index in exporting sectors excluding other transportation. Industrial turnover indices also reveal that external demand continued to support industrial production in January. On the other hand, retail sales volume indices declined also in January, indicating a loss of momentum in domestic demand.

14. High-frequency data suggest that production and foreign trade indicators posted some recovery in February after registering declines due to natural gas and electricity outages in January. As of February, investment tendencies of manufacturing industry firms for the next twelve months were high. Firms' existing domestic and external orders as well as expectations for future orders reveal that external demand remains strong while domestic demand is expected to increase although it has declined slightly. On the other hand, the credit card spending increased substantially on a monthly basis in February.

15. Developments in the labor market are in tandem with the outlook of economic activity. In January, employment decreased by a mere 0.1% compared to the previous month. With the effect of the decrease in the participation rate, seasonally adjusted total unemployment rate remained unchanged month-on-month and was recorded at 11.4%. Survey indicators and high-frequency data indicate that the positive outlook in the labor market is maintained.

16. The recent strong course of energy imports has been affecting the current account balance adversely. While the current account deficit was USD 7.1 billion in January, the annualized current account deficit increased by USD 5.3 billion to USD 20.2 billion. Provisional foreign trade data indicated that, the strong course of exports in February continued recently despite regional differences, while imports increased due to high energy and commodity prices. In this context, regional losses occur in exports in the short term due to the heightened military conflict. It is observed that, short-term loses are largely compensated by the increase in exports to other countries thanks to the dynamic capacity and market diversification flexibility of the exporting firms. Despite this outlook in the foreign trade balance, the favorable course in services revenues continues to support the current account balance. While share of sustainable components of economic growth increases, risks on current account balance due to energy prices are closely monitored. Sustainable current account balance is important for price stability.

Monetary Policy

17. 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.
18. In formulating the monetary policy towards achieving the sustainable price stability objective, a liraization- oriented approach that also addresses risks to financial stability will continue to be followed. The Committee also assesses that credit growth including long-term investment loans and the targeted use of accessed funds for real economic activity is important for financial stability.
19. The Committee expects disinflation process to start on the back of measures taken and decisively pursued for achieving sustainable price and financial stability once global peace is restored and base effects are ceased. Accordingly, the Committee has decided to keep the policy rate unchanged.
20. While cumulative impact of the recent policy decisions is being monitored, 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 the Turkish lira-denominated assets in the collateral structure of OMO funding, to gradually reduce the volume of swaps and to strengthen foreign exchange reserves.
21. Accordingly, the effects of the liquidity and distribution developments of Turkish lira on deposits and loan pricing, the lagged effects of exchange rate developments on inflation expectations, 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.
22. 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.
23. 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.
24. The Committee supports building strong policy coordination and a holistic macro policy mix involving all stakeholders in order to achieve price stability.
25. The Committee will continue to take its decisions in a transparent, predictable and data-driven framework.