Summary of the Monetary Policy Committee Meeting

3 May 2024, No: 2024-25

Meeting Date: 25 April 2024

Global Economy

1. In the first quarter of the year, the global growth outlook displayed a limited improvement while labor markets continued to be tight. The global growth index, which is weighted by the export shares of Türkiye's foreign trade partners, is forecasted to grow by 2.1% in 2024 that is slightly higher than 1.8% recorded in 2023, and global economic activity remains weak. On the other hand, both export weighted growth outlook and PMI figures for the first quarter indicate a gradual recovery in economic activity relative to the last quarter of 2023. Meanwhile the US economic growth trend diverged positively from other advanced economies. Geopolitical risks and maintaining tight monetary policies to ensure a permanent decline in inflation are regarded as prominent risk factors for the course of global economic activity in 2024.

2. The high levels of core inflation and inflation expectations imply that global inflation will continue to remain above central banks' targets for some time. Despite the sharp decline in inflation in 2023, stickiness of services inflation is particularly evident in many countries. While emerging economies continue to cut interest rates in a way to maintain monetary tightness, the central banks of advanced economies are also expected to start rate cuts in 2024. However, due to stickiness in inflation, geopolitical developments and increased risks pertaining to commodity prices, market-implied future policy rates indicate a more cautious rate-cut path compared to the previous MPC meeting period. Meanwhile, expectations for growth, inflation outlook and monetary policies of advanced economies have started to diverge and risk appetite and portfolio flows towards EMEs have displayed a volatile course due to increased global uncertainty.

Monetary and Financial Conditions

3. The monetary policy decisions in March have led to a significant tightening in financial conditions. These steps strengthened the transmission of the policy rate to deposit and loan rates. Turkish lira deposit rates have increased by 1071 basis points since the previous MPC meeting week and reached 60.34% on 19 April 2024. The rise in Turkish lira commercial loan rates and general-purpose loan rates (excluding Overdraft Accounts (ODA)) also exceeded the rise in policy rates, increasing by 871 and 554 basis points to 68.29% and 81.54%, respectively. Housing loan rates increased by 229 basis points to 44.94%, while vehicle loan rates decreased by 1933 basis points to 23.76% as of 19 April 2024 owing to recent campaigns in the sector. Meanwhile, with the increase in the maximum contractual interest rates on credit card transactions from 3.66% to 4.25% on 6 April 2024, credit card expenditures have also started to contribute to the rebalancing process in credit growth. However, it is observed that the spread between interest rates offered for low-amount savings deposits and high-amount saving deposits, the effects of which are closely monitored and which are important for the rebalancing process in domestic demand, continued to widen.

4. The effects of monetary tightening on credit conditions and domestic demand are closely monitored. Total loan growth, which has decelerated notably since the previous MPC meeting

period, is expected to weaken the resilient course of domestic demand with the help of monetary measures and quantitative tightening. The average of four-week growth rate of retail loans has declined from 4.12% to 3.28% since the previous MPC meeting period. This rate fell from 4.59% to 2.49% in general purpose loans and from 5.34% to 5.01% in personal credit cards. Average growth rates of vehicle loans have remained in the negative territory since the previous MPC meeting period and the average four-week growth rate of vehicle loans has become -1.29%. Turkish lira-denominated commercial loans have lost further pace and their four-week average growth rate has dropped from 3.34% to 1.64%, while the same rate in FX commercial loans adjusted for exchange rates has increased from 1.28% to 2.89%.

5. The CBRT continues to simplify macroprudential policies in a way that safeguards macro financial stability. Accordingly, in the press release of 6 April 2024, the securities maintenance ratio applied to liabilities subject to securities maintenance was reduced from 4% to 1%, and the implementation regarding securities maintenance based on loan growth was terminated. In addition, the CBRT shared the plan to terminate the securities maintenance practice in a short while.

6. On the other hand, in the press release of 25 April 2024, in order to strengthen the monetary transmission mechanism, increase the share of Turkish lira deposits, and support the transition from FX-protected deposits (KKM) to Turkish lira deposits, remuneration of the reserve requirements of eligible banks maintained for their Turkish lira deposit and KKM accounts was regulated and renumeration rate was related with policy rate. Accordingly, the upper limit of the remuneration rate applied to the amount of required reserves that should be maintained for Turkish lira deposits based on the Turkish lira conversion rate was set at 80% of the policy rate, and was raised from 36% to 40%. Moreover, the upper limit of the remuneration rate applied to the amount of required reserves that should be maintained for KKM accounts based on the renewal and Turkish lira conversion rate was set at 60% of the policy rate, and was raised from 25% to 30%. Thus, by lowering the cost of Turkish lira deposits borne by the financial sector, formation of deposit rates at a higher level is targeted, which will lead to an increase in Turkish lira savings as well as the demand for Turkish lira assets of economic agents. Specifying such rates to be applied to reserve requirements as a ratio to the policy rate is considered to enable the adjustments to become automated in tandem with the policy rate.

7. The gross international reserves of the Central Bank of the Republic of Türkiye (CBRT) increased by USD 2.44 billion compared to the previous MPC meeting period to USD 126.3 billion as of 19 April 2024. Despite the weakened global risk appetite, Türkiye's five-year credit default swap (CDS) premium diverged significantly from similar emerging market CDS premiums following the MPC decision in March and declined to 310 basis points as of 24 April 2024. The one-month implied exchange rate volatility of the Turkish lira fell to 9.6%, while the 12-month implied exchange rate volatility remained flat at 20.1% as of 24 April. Since June 2023, net portfolio inflows have totaled USD 5.89 billion, USD 2.27 billion of which was directed towards the government domestic debt securities (GDDS) market and USD 3.62 billion towards the equity market.

Demand and Production

8. While imports of consumption goods and gold contribute to the improvement in the current account balance, other recent indicators imply that domestic demand remains resilient. In February, the retail sales volume index remained on an upward track on a monthly basis, while the growth rate of the index gained momentum in quarterly terms. The trade sales volume index increased on a monthly basis, while its growth rate declined slightly quarter-on-quarter. The sectoral turnover and services production indices for February pointed to a moderate quarterly increase in services sector activity. Following a decline in the previous quarter, manufacturing firms' registered orders from the domestic market increased again in the first quarter of the year amid wage adjustments. Meanwhile, card spending further increased in the first quarter.

Accordingly, the current level of demand continues to be considered as a risk factor on inflation. Although the interruption in data flow for April due to the religious holiday obscured a clear picture, high-frequency data and information from regional business contacts for this period point to some signs of moderation in the domestic demand. In this respect, card spending in realized terms in the first half of April indicates a monthly decline. Similarly, interviews with firms for April imply that consumption spending is losing momentum due to the demand brought forward in the previous quarter and the extended holiday. However, the uncertainty led by calendar effects on the related indicators is taken into consideration, and demand indicators are monitored at high frequency.

9. In February, the industrial production index posted a strong increase of 3.2% month-on-month when adjusted for seasonal and calendar effects, and 11.5% year-on-year when adjusted for calendar effects. The high annual increase in industrial production is also attributable to the base effects stemming from the earthquake in February last year. The high monthly increase was due to the 11.3% rise in the manufacture of capital goods, driven by the manufacture of other transport equipment, which typically exhibits high volatility. On a quarterly basis, industrial production increased by 3.4% as of February. In April, the seasonally adjusted manufacturing industry capacity utilization rate was realized as 77%, implying a flat course on a quarterly basis.

10. As of February, seasonally adjusted employment rose by 1.4% on a quarterly basis and stood at 32.4 million people. In this period, the labor force participation rate increased quarter-on-quarter, while the unemployment rate remained unchanged at 8.8%. Survey indicators, on the other hand, indicate a decline in manufacturing firms' future employment expectations.

11. In February, the annualized current account deficit fell by USD 5.8 billion month-on-month to USD 31.8 billion. While this fall was driven by the rise in exports, the decline in the gold trade deficit, and the ongoing annual decline in energy prices, the foreign trade deficit excluding gold and energy continued to decrease. In this period, the annualized services balance surplus increased by USD 0.2 billion month-on-month to USD 52.2 billion, on the back of tourism revenues, which have been strong throughout the year.

12. Provisional foreign trade data pointed to a flat trend in seasonally adjusted imports of consumption goods in the first quarter. Gold imports exceeded the historical averages in March, while, in annualized terms, remained stationary at around USD 23 billion. The three-month average trend, considered along with the provisional foreign trade data for March and high frequency data for April, implies a flat trend in exports and an increase in imports.

13. Regarding the financing of the current account deficit, the banking sector’s annualized long-term debt rollover ratio that has been hovering above 100% since November 2023 stood at 118% in February 2024. In the non-bank corporate sector, this ratio was around 93%. Accordingly, external financing opportunities remain similar to the previous month.

Inflation Developments

14. In March, monthly headline inflation and the underlying trend decreased, yet remained above the path projected in the Inflation Report. Consumer prices rose by 3.16% in March, and annual inflation went up by 1.43 percentage points to 68.5%. In this period, the contribution of core goods, services, and energy to annual inflation rose, while that of food and the alcohol-tobacco-gold groups remained flat.

15. In March, services was the group which recorded the highest price increase. Monthly inflation in this group decelerated but the consequences of wages and backward-indexation tendency continued, and price increases were seen across the group excluding transport services. Monthly core goods inflation strengthened on account of exchange rate developments and pass-through from costs, which is eased by resilient domestic demand conditions. The red meat item stood out in the food group. Ongoing price increases in this item also affected the prices of substitute white

meat products, and pushed up the prices of processed meat products for which they constitute an input. In March, the deceleration of monthly processed food inflation was noteworthy. In addition to its direct effects, the food group continued to have a negative impact on headline inflation indirectly through catering services. Monthly inflation in the energy group decelerated in line with fuel prices. In March, the mechanical impact of the free use of natural gas on monthly consumer inflation was quite limited at 0.02 percentage points.

16. In March, despite an ongoing decline, the underlying trend of monthly inflation was higher than expected. The seasonally adjusted monthly rates of increase in the B and C indices were realized as 3.5% and 3.9%, respectively, remaining high in spite of a slight weakening compared to the previous month. The seasonally adjusted three-month average increases in the B and C indices were measured at 4.8% and 5.4%. In March, among the components of the B index, price increases strengthened in core goods with respect to the previous month, but decelerated in services and particularly in processed food. In this period, the Median, SATRIM, and other underlying trend indicators declined, while the fall in the diffusion index was more restrained.

17. The high level of and the stickiness in services inflation, inflation expectations, geopolitical risks, and food prices keep inflationary pressures alive. While the cost-side effect of wage hikes is reflected in prices of both goods and services relatively more rapidly, the demand-side effect extends over time and harbors relatively more uncertainties.

18. The prevalent price setting behavior in the services sector leads to significant inertia and causes the impact of shocks on inflation to extend over a long time. While annual inflation was 56.5% in the core goods group in March, it was 40 percentage points higher at 96.5% in the services sector. In addition, the diffusion index for the services sector hovered around 32% above its historical average in March, indicating that the increases continue to spread across the sector, albeit at a somewhat weaker pace. In this regard, based on the recent realizations of consumer inflation, there is a risk that inflation will remain high in certain services items for an extended period. Certain services sectors such as rents, education, and communication are expected to stand out in this respect.

19. While annual rent inflation remains elevated, leading indicators tracked through micro data from the Retail Payment System (RPS) imply that the slowdown in the rate of increase in rents that started in February will also continue in April. On the other hand, the annual increase in house prices dropped to 58.3% in February, falling below the increase in annual consumer inflation, while the seasonally adjusted data point to a significant slowdown in the monthly increases in this item in recent months. This development in house prices is expected to have a restraining effect on rent inflation in the coming period. However, the forthcoming repeal of the 25% rent increase cap will be closely monitored for its impact on rent inflation. In education services, high rates of increases are observed due to private school fees. This item, which is also affected by wage developments and highly prone to the backward-indexation tendency, will be reflected in the Consumer Price Index gradually until July, albeit to a lesser extent, depending on price announcement dates, there is a risk that services inflation will be unfavorably affected in the near future. Communication services, led by mobile call and interest fees, posted sharp month-on-month price increases. It is noteworthy that annual communication inflation, which has historically been on a mild course, reached 72% in March, surpassing consumer inflation. In addition, given the ongoing surge in red meat prices, the upside risks to catering services prices remain alive. While developments in insurance services were driven by transportation insurance, led by compulsory traffic insurance item, related price increases have been slowing down stemming from the transition into the new system.

20. In March, domestic producer prices rose by 3.29%, while annual inflation went up by 4.18 percentage points to 51.5%. According to main industrial groupings, prices saw a monthly increase across all groups in March, with a more limited one in the energy group. Annual inflation was

relatively flat in the non-durable consumption goods group, whereas it went upwards in other groups.

21. Having declined since October 2023, global commodity prices assumed an upward course in January that strengthened somewhat in March. In a breakdown by subgroups, global energy prices maintained their upward course in March, while non-energy commodity prices, which had been almost flat in recent months, recorded a rise led by the industrial metals subgroup. As of the first three weeks of April, price increases became more pronounced in both groups. In this period, industrial metals continued to stand out among non-energy commodities with the rise in their prices. Additionally, following March, international gold prices also posted a strong increase in April.

22. The Global Supply Chain Pressure Index was close to its historical trend in March. Global freight rates, which posted some decline in March, maintain their downward course in April but still remain relatively high. Suppliers' delivery times, which had not recorded any significant change in February, improved slightly in March. The evolution of transportation costs in the following months and their possible impact on inflation are the factors to be monitored closely.

23. While the decline in medium term inflation expectations continues, year-end inflation expectations for 2024 and 2025 have remained stable above the Inflation Report projections. According to the April results of the Survey of Market Participants, the 12-month-ahead inflation expectation decreased to 35.2% from 36.7%, while the 24-month-ahead inflation expectation declined to 22.1% from 22.7%. Meanwhile, inflation expectations for the current year-end and the end of the next year remained unchanged at 44.2% and 26.3%, respectively. The five-year-ahead inflation expectation was revised downwards by 0.52 percentage points from 12.8% to 12.3%. The current course of inflation expectations poses an upside risk to the inflation outlook. The Committee closely monitors the alignment of inflation expectations and pricing behavior with projections.

24. Leading indicators point to a continued slowdown in the underlying trend of inflation in April. On the other hand, despite this slowdown, the underlying trend is slightly above the level projected in the Inflation Report. According to the preliminary data, in April, seasonally adjusted price increases have lost pace in the core goods group compared to the previous month but remained high in the services group despite a deceleration. An examination of sub-groups shows that price increases in durable goods that have high and fast exchange rate pass-through continue in this period although weakening. In the services group, in addition to the prominent items of previous months, transportation prices have also posted a strong increase due to the religious holiday effect. In the energy group, the rise in fuel prices is expected to be counterbalanced by the fall in natural gas prices reflected in the index following the seasonal decline in natural gas consumption. The preliminary data suggest that the positive outlook in processed food is maintained in the food group, but large price increases in unprocessed food continue, albeit at a slower pace. In April, prices of fresh fruits and vegetables have recorded a relatively mild increase led by vegetables, whereas strong hikes continue in red meat and accordingly white meat. Meanwhile, alcohol-tobacco prices are on the rise due to the developments in tobacco products. Thus, the April inflation outlook is shaped by the developments in commodity prices and the lagged effects of exchange rates as well as the effects of red meat price developments along with the resilient course of domestic demand, while the backward-indexation tendency continues to have repercussions and price increases in the services group continue in a broad-based manner.

Monetary Policy

25. Considering the lagged effects of the monetary tightening, the Committee decided to keep the policy rate unchanged, but reiterated that it remains highly attentive to inflation risks.

26. The tight monetary stance will be maintained until a significant and sustained decline in the underlying trend of monthly inflation is observed, and inflation expectations converge to the projected forecast range. Monetary policy stance will be tightened in case a significant and

persistent deterioration in inflation is foreseen. The decisiveness regarding tight monetary stance will bring down the underlying trend of monthly inflation through moderation in domestic demand, real appreciation in Turkish lira, and improvement in inflation expectations. Consequently, disinflation will be established in the second half of 2024.

27. The Committee continues to implement macroprudential policies in a way to preserve the functionality of the market mechanism and macro financial stability. In this context, monetary transmission mechanism will continue to be supported in case of unanticipated developments in credit growth and deposit rates. Market liquidity will be closely monitored and sterilization tools will continue to be effectively used whenever needed. 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, and on financial stability with a holistic approach.

28. Taking into account the lagged effects of monetary tightening, the Committee will make its policy decisions in a way that will create the monetary and financial conditions necessary to ensure a decline in the underlying trend of inflation and to reach the 5 percent inflation target in the medium term.

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

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