TÜRKİYE CUMHURİYET
MERKEZ BANKASI

HEAD OFFICE

ANKARA, 5 April 2024

Please refer to:

TCMB: 98422658

Mehmet ŞİMŞEK

MINISTER OF TREASURY AND FINANCE

ANKARA

Pursuant to Article 42 of the Central Bank Law No. 1211, when the inflation target cannot be achieved, the Central Bank of the Republic of Türkiye (CBRT) is mandated to report to the Government and announce to the public the reasons for the deviation from the target and the necessary measures to be taken. In 2023, inflation significantly surpassed the designated uncertainty band around the target. This correspondence serves to elucidate the underlying causes behind this recent deviation from the established inflation target, while also delineating the measures already undertaken and those deemed necessary for reaching the target. Enclosed herewith is the first Inflation Report of 2024, providing in-depth analyses and assessments of the factors affecting inflation in 2023. Additionally, for your information, we submit the document "Monetary Policy for 2024" that offers a comprehensive explanation of the monetary policy to be implemented to achieve the inflation target in the short and medium term.

Annual consumer inflation, which stood at 64.3 percent by the end of 2022, declined in the first half of 2023, attributable to base effects, the fall in import prices denominated in foreign currency, the flat course of exchange rates, and energy subsidies. Thus, annual inflation stood at 38.2 percent in June. On the other hand, surges in loan growth driven by monetary conditions, wage pressures, and the transfers to households exacerbated the impact of demand-side factors on inflation in the first half of the year. These developments led to a widening of the current account deficit through imports of gold and consumption goods, both serving as inflation hedges, and increased the uncertainty in financial markets. Additionally, supply-demand imbalances

TÜRKİYE CUMHURİYET MERKEZ BANKASI A.Ş.
TİCARET SİCİL NUMARASI: 269
SERMAYESİ: 25.000 TL
İDARE MERKEZİ, ANKARA
Hacı Bayram Mah. İstiklal Cad. No:10 PK:06050 Ulus Altındağ - ANKARA
Telefon No: (312) 507 50 00, Faks No: (312) 507 56 40
e-Posta: iletisimbilgi@tcmb.gov.tr, Genel Ağ: http://www.tcmb.gov.tr
Kep Adresi: merkezbankasi@hs02.kep.tr, Ticaret Sicil Numarası: 269, Swift: tcmbtr2a

stemming from the Kahramanmaraş-centered earthquakes in February, most notably in the housing market, but also in goods, services and labor markets compounded the inflationary pressures, also with the short and medium-term repercussions of reconstruction efforts on public finances. These developments facilitated a resurgence in annual inflation in the second half of the year, which had declined in the first half of the year, by adversely affecting pricing behavior.

In June 2023, the Monetary Policy Committee (the Committee) decided to initiate a strong monetary tightening process in order to establish disinflation as soon as possible, anchor inflation expectations, and contain the deterioration in pricing behavior. Accordingly, the policy rate was raised by a total of 34 percentage points from 8.5 percent to 42.5 percent in the June-December period. This monetary tightening was simultaneously accompanied by the simplification of the macroprudential framework with the aim of improving the functioning of the market mechanism and strengthening macro financial stability. Moreover, monetary tightening was supported by selective credit and quantitative tightening measures.

In the third quarter of the year, however, inflation dynamics were shaped by the strong course of domestic demand, tax adjustments, exchange rate developments, wage hikes, the stickiness of services inflation, and the sharp increase in crude oil prices. Moreover, inflation further increased due to the additional deterioration in pricing behavior caused by the concurrence of these developments within a short period of time. Consequently, between June and September, inflation increased by 23.3 percentage points, reaching 61.5 percent. Of this increase, 4.7 percentage points accounted for the changes in fuel prices (including taxes, excluding exchange rate effects), 3.8 percentage points stemmed from the rise in exchange rates, and 2.8 percentage points came from the tax hikes excluding the one on fuel. In the abovementioned period, when the wage increase and demand were still very strong, the additional deterioration in pricing behavior caused by the simultaneous shocks had an upward effect of 10.0 percentage points on inflation. Meanwhile, the total contribution of the remaining factors was limited to 2.0 percentage points.

The initial effects of monetary tightening were primarily evident in financial conditions, gradually filtering through to demand conditions. In the second half of the year, external financing conditions improved significantly, reserves increased steadily, and demand conditions weakened in a way that was reflected in the current account deficit. Furthermore, there was a notable

TÜRKİYE CUMHURİYET MERKEZ BANKASI A.Ş.
TİCARET SİCİL NUMARASI: 269
SERMAYESİ: 25.000 TL
İDARE MERKEZİ, ANKARA
(CENTRAL BANK OF THE REPUBLIC OF TÜRKİYE)
Hacı Bayram Mah. İstiklal Cad. No:10 PK:06050 Ulus Altındağ- ANKARA
Tel: +90 (312) 507 50 00, FaX: +90 (312) 507 56 40
e-mail: iletisimbilgi@tcmb.gov.tr, Web: http://www.tcmb.gov.tr
Swift: tcmbtr2a

increase in the share of Turkish lira deposits, alongside heightened domestic and external demand for Turkish lira assets. All these developments contributed to the effectiveness of monetary policy.

As a result of the impact of monetary tightening on financial conditions and domestic demand, annual consumer inflation posted a limited increase of 3.2 percentage points in the last quarter of 2023. Notably, 2.4 percentage points of this modest uptick was driven by the mechanical effect stemming from households exceeding the free usage limit for natural gas consumption. In this period, the underlying trend of inflation also declined. Pricing behavior showed signs of a relatively stronger improvement primarily in core goods, and durable goods group in particular. Despite the stickiness of services inflation, there was a notable deceleration in inflation trends in transportation and catering services, which are typically more sensitive to demand and cost conditions. In the same period, the previously observed excessive increases in housing prices gave way to rises below monthly inflation. Leading indicators also suggested a slowdown in the rate of price increases for new rentals. Across various metrics—including core, statistical, and model-based indicators—evidence indicated a loss of momentum in the underlying trend of inflation throughout the last quarter of the year. Consequently, year-end inflation in 2023 stood at 64.8 percent, closely aligning with the mid-point of the forecast range shared in the last Inflation Report of the year.

Developments in the last quarter revealed a gradual retreat in the factors affecting inflation due to monetary tightening. In this period, external financing conditions, stronger reserves, the improvement in the current account balance, and the demand for Turkish lira assets contributed to exchange rate stability and the effectiveness of monetary policy. As of end-2023, the share of Turkish lira deposits rose to over 42 percent from 32 percent, the low of the year, while the annual consumer loan growth decreased from a peak of 60 percent to below 40 percent, and the annual growth of 12-month cumulative imports of gold and consumption goods declined from a peak of 125 percent to 53 percent.

The Committee raised the policy rate to 45 percent at the January 2024 meeting. In February, the Committee kept the policy rate unchanged at 45 percent, taking into account the lagged effects of monetary tightening and other policy actions supporting the monetary transmission. In March, the underlying trend of monthly inflation was higher than expected, while recent indicators implied that domestic demand remained resilient. In response to the deterioration in the inflation outlook, the Committee raised the policy rate to 50 percent at the March 2024 meeting. The Committee has also decided to adjust the monetary policy operational framework by setting the Central Bank overnight borrowing and lending rates 300 basis points below and above the one-week repo auction rate, respectively. The adjustment in the operational framework is a technical correction considering the high level of interest rates and the one-week repo auction rate will continue to be used as the key policy rate.

The CBRT will maintain its tight monetary stance until there is a significant and permanent decline in the underlying trend of monthly inflation and until inflation expectations converge to the projected forecast range. Monetary policy stance will be tightened in case a significant and persistent deterioration in inflation outlook is anticipated. 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.

The primary objective and foremost priority for the CBRT is to attain price stability. Monetary policy will be formulated in line with this objective. The one-week repo auction rate will remain the policy interest rate, monetary transmission mechanism will continue to be supported in case of unanticipated developments in credit growth and deposit rates.

As indicated in the document “Monetary Policy for 2024”, the key indicators to provide economic agents with guidance on the future course of inflation are the inflation forecasts in the short term and the inflation target in the medium term. Accordingly, the CBRT will continue to shape monetary policy in a way that will create monetary and financial conditions conducive to achieving a downward trajectory in inflation and attaining the 5 percent inflation target over the medium term. By adhering to this monetary stance, inflation is projected to stand at 36 percent by the end of 2024, to decrease to 14 percent by the end of 2025, and further decline to 9 percent by the end of 2026, eventually stabilizing at 5 percent. Stickiness in services inflation, inflation expectations, geopolitical risks, and food prices keep inflation pressures alive.

The coordination of monetary and fiscal policies plays a pivotal role in the disinflation process. Accordingly, this coordination has been embodied by the Medium-Term Program (MTP,

Hacı Bayram Mah. İstiklal Cad. No:10 PK:06050 Ulus Altındağ- ANKARA
Tel: +90 (312) 507 50 00, FaX: +90 (312) 507 56 40
e-mail: iletisimbilgi@tcmb.gov.tr, Web: http://www.tcmb.gov.tr
Swift: tcmbtr2a

2024-2026), which serves to enhance predictability, and the MTP assumptions regarding public policies have also been reflected in the CBRT's inflation forecasts. In this context, revising the minimum wage once a year, setting administered prices, wage and tax adjustments consistent with the MTP's inflation forecasts, and supporting the tight monetary policy stance with prudent fiscal policy are critical to establishing the projected disinflation path.

Additional measures announced in the MTP aimed at bolstering price stability and financial stability are expected to further support the disinflation process. Adhering to the MTP's medium-term objectives in line with the disinflation path will play a critical role in restoring price stability. Meanwhile, the ongoing structural reforms geared towards reducing the stickiness and volatility of inflation, alongside the initiatives supporting technological and digital transformation that will enhance supply capacity will make positive contributions to price stability, and hence social welfare in the medium and long term. Accordingly, the CBRT will continue its efforts to analyze structural issues, formulate relevant policy recommendations, and raise awareness regarding the importance of disinflation among related stakeholders and the public.

Sincerely,

CENTRAL BANK OF THE REPUBLIC OF TÜRKİYE

Head Office

Dr. Yaşar Fatih KARAHAN	**Dr. Osman Cevdet AKÇAY**	**Prof. Hatice KARAHAN**
Governor	**Deputy Governor**	**Deputy Governor**

Annexes: Inflation Report 2024-I, Monetary Policy for 2024