TÜRKİYE CUMHURİYET MERKEZ BANKASI

Summary of the Monetary Policy Committee Meeting

28 March 2024, No: 2024-15

Meeting Date: 21 March 2024

Global Economy

1. The global growth outlook remains subdued while labor markets continue to be tight. The global growth index, which is weighted by the export shares of Türkiye's foreign trade partners, remained subdued following the previous Monetary Policy Committee (MPC) meeting period, displaying an annual growth rate of 1.76% for the fourth quarter of 2023. The forecast for the first quarter of 2024 is 1.85%. Accordingly, the global economic slowdown in the third quarter of the previous year continued in the last quarter as well, and global economic activity remained weak. On the other hand, both export weighted growth outlook and PMI figures in January and February indicate a gradual recovery in economic activity relative to last quarter of 2023. Maintaining tight monetary policies to ensure a permanent decline in inflation and geopolitical risks 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 central banks' recent communications and the higher-than-expected US inflation data for January and February, market-implied future policy rates have indicated a more cautious rate-cut path compared to the previous MPC meeting period. Following a slowdown that began in early January, portfolio flows to EMEs have increased again in recent weeks, due to the favorable course of risk appetite.

Monetary and Financial Conditions

3. Total loan growth has accelerated since the previous MPC meeting period. The four-week average growth rate of retail loans has increased since the previous MPC meeting period and stood at 4.12%. The four-week average growth rates of general-purpose loans and personal credit cards materialized at 4.59% and 5.34%, respectively. That of vehicle loans fell by 0.59%, maintaining its weak course since the beginning of the year. On the other hand, Turkish lira-denominated commercial loans and FX commercial loans adjusted for exchange rates recorded four-week average growth rates of 3.34% and 1.28%, respectively, in the same period.
4. Financial conditions were tightened, and monetary policy transmission was reinforced with the measures taken in March. Accordingly, the monthly growth limits for Turkish lira commercial loans and general-purpose loans were reduced to 2%, and, to enhance the effectiveness of this measure, a reserve requirement obligation was introduced in addition to the securities maintenance practice, in case growth rates exceed limits. The maximum interest rates for credit card cash withdrawals and overdraft accounts were raised from 4.42% to 5% in line with the general-purpose loan rates. On the other hand, in order to support Turkish lira deposits, a Turkish lira share growth target for legal entities was set, while the Turkish lira share growth targets for real persons were calibrated according to current trends and the commission rates to be applied in case of failure to

achieve these targets were increased. The remuneration of reserve requirements (reserve requirement reduction for participation banks) was extended to include demand deposits and deposits with maturities up to one month for banks that meet the renewal and transition to Turkish lira targets. The CBRT decided to keep a portion of the required reserve amount for Turkish lira liabilities, maintained as an average of a 14-day period, as blocked.

5. As a result of steps taken towards tightening financial conditions, Turkish lira commercial loan rates and general-purpose loan rates (excluding overdraft accounts) increased by 6.27 percentage points and 15.3 percentage points to 59.6% and 76.0%, respectively, since the previous MPC meeting. Housing loan rates and vehicle loan rates, which posted a limited increase in the same period, stood at 42.7% and 43.1%, respectively, as of 15 March 2024. Credit growth rates are expected to stabilize following the policy rate decision taken in March and the macroprudential measures.

6. Turkish lira deposit rates, which increased by 2.81 percentage points compared to the previous MPC meeting period due to macroprudential measures to support the monetary transmission mechanism, stood at 49.6% as of 15 March. On the other hand, the spread between the interest rates offered for small savings deposits and large deposits persists. The impacts of these developments on the rebalancing process in domestic demand are closely monitored as a risk factor.

7. The gross international reserves of the Central Bank of the Republic of Türkiye (CBRT) declined by USD 6.31 billion compared to the previous MPC meeting period to USD 127.9 billion as of 15 March 2024. Despite the improved global risk appetite, due to short-term domestic uncertainties, Türkiye's five-year credit default swap (CDS) premium increased by 43 basis points to 337 basis points as of 20 March 2024. Similarly, the 1-month and 12-month implied exchange rate volatility of the Turkish lira rose to 8.6% and 19.5%, respectively, as of 20 March 2024. Since June 2023, net portfolio inflows totaled USD 4.57 billion, USD 2.02 billion of which was directed towards government domestic debt securities (GDDS) market and USD 2.55 billion towards the equity market. Meanwhile, the recent increases in the risk premium and exchange rate volatilities have been accompanied by net portfolio outflows.

Demand and Production

8. Economic activity remained robust in the last quarter of 2023. Gross Domestic Product (GDP) data point to a fall in the contribution of private consumption to annual growth and a decline in the negative contribution of net exports during the same period. However, on a quarterly basis, the GDP data suggest that the contribution of private consumption to growth accelerated in the last quarter of 2023, while the contribution of net exports to growth, albeit being positive, declined compared to the previous quarter. Accordingly, discounts and campaigns in the last quarter of the year and the demand brought forward by expected wage revisions weakened the moderation in demand.

9. While imports of consumption goods and gold slowed down and contributed to the improvement in the current account balance, other recent indicators imply that domestic demand remains resilient. In January, the retail sales volume index, published by TURKSTAT with updated base year and calculations, remained on an upward track on a monthly basis while the growth rate of the index gained momentum in quarterly terms. On the other hand, the trade sales volume index decreased on a monthly basis and remained flat quarter-on-quarter. Similarly, the sectoral turnover and services production indices for January pointed to weaker activity in the services sector. 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. On the other hand, firms' three month-ahead expectations for domestic market orders decreased in this period. Card spending further increased in March as well. Interviews with firms imply that the level of domestic sales increased on a quarterly basis in the first quarter due to wage increases,

additional promotions introduced by firms, and the demand brought forward. Accordingly, the current level of demand continues to be considered as a risk factor on inflation.

10. In January, the seasonally and calendar adjusted industrial production index remained flat month-on-month, while adjusted for calendar effects, it rose by 1.1% year-on-year. On a quarterly basis, industrial production increased by 1.4%. In February, the seasonally adjusted manufacturing industry capacity utilization rate was realized as 77%, hovering slightly above historical averages.
11. As of January, seasonally adjusted employment rose by 1.1% on a quarterly basis and stood at 32.2 million. In this period, labor force participation rate increased. Unemployment rate posted a quarterly increase of 0.2 percentage points and stood at 9.1%. Survey indicators and high-frequency data indicate that labor demand has started to moderate.
12. In January, the annualized current account deficit fell by USD 7.9 billion month-on-month to USD 37.5 billion. While this fall was driven by the rise in exports, the substantial 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. Provisional foreign trade data for February indicate that seasonally adjusted exports remained flat, while imports posted a monthly increase. The three-month average trend, considered along with the high frequency data for March, implies a flat trend in exports and imports.
13. In view of the current data, projections point to a moderate decline in seasonally adjusted imports of consumption goods in the first quarter. Meanwhile, gold imports hover around their historical averages, while the improvement in the gold trade balance continues in annualized terms. On the other hand, as of January, the annualized services balance surplus remained steady at USD 52 billion. Tourism revenues, which have been strong throughout the year, continue to contribute positively to the current account balance.
14. Regarding the financing of the current account deficit, the banking sector's long-term debt rollover ratio exceeded 100% in the last two months of 2023 in annualized terms and stood at 121% in January 2024. In the non-bank corporate sector, this ratio was around 95%. Accordingly, external financing opportunities remain strong.

Inflation Developments

15. In February, monthly headline inflation and the underlying trend decreased, yet remained above the projection of the Inflation Report forecast path. Consumer prices rose by 4.53% in February, and annual inflation went up by 2.21 percentage points to 67.1%. In this period, the contribution of services, food and energy to annual inflation rose, while that of core goods and the alcohol-tobacco-gold group decreased.
16. The increase in consumer inflation for February was mainly driven by services prices affected by the ongoing consequences of wages and backward-indexation behavior, as well as food prices influenced by factors specific to the month of Ramadan. This period saw significant price hikes particularly in red meat and related processed meat products, as well as milk and dairy products, affected by the increase in the reference price of raw milk. 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 was mainly driven by the fuel item, due to the course of the Turkish lira as well as rising oil prices due to geopolitical developments, and the decisions regarding the oil production, and diminishing stock levels, while the mechanical impact of the free use of natural gas on monthly consumer inflation was quite limited at 0.01 percentage points. Monthly core goods inflation weakened in February, with a mild increase in prices within the group, primarily in durable goods. In the first quarter of 2024, the continuing resilient course of domestic demand eased the pass-through of cost increases into prices. Stickiness in services inflation, inflation expectations, geopolitical risks, and food prices keep inflation pressures alive.

17. In February, led by services inflation, 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 4.3% and 4.2% respectively, weakened yet remained high compared to previous month. The seasonally adjusted three-month average increases in the B and C indices were measured at 4.8% and 5.2%. Compared to January, among the components of B index, price increases strengthened in processed food, but decelerated in core goods and services. In this period, the diffusion index increased slightly over the previous month, while the Median, SATRIM and other underlying trend indicators declined.
18. In February, the services item, which remained higher than expected, although slowed down on monthly basis, posted the largest price increase across subgroups, after the food item. Price increases spread across the services group due to the ongoing effects of the backward-indexation behavior and wage adjustments. While the cost-side effect of wage hikes is reflected to prices of both goods and services relatively more rapidly, the demand-side effect extends over time and harbors more uncertainties than cost-side effects. The Committee closely monitors the alignment of inflation expectations and pricing behavior with projections, and the impact of wage increases on inflation.
19. The prevalent pricing 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 54% in the core goods group in February, it was 40 percentage points higher at approximately 94% in the services sector. The diffusion index for the services sector hovered around 40% above its historical average in February, 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 insurance are expected to stand out in this respect.
20. Annual rent inflation remains elevated. Although 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 March, the current levels are higher than projected in the Inflation Report. In education services, high rates of increases are observed due to private school fees. Considering that private school fees, which are highly prone to the backward-indexation tendency and are also affected by wage developments, will be reflected to the Consumer Price Index gradually until July depending on price announcement dates, there is a risk that services inflation will be unfavorably affected by this channel in the near future. Developments in insurance services were driven by transportation insurance, in which the rise in compulsory traffic insurance prices over the last two months was noticeable.
21. In February, domestic producer prices rose by 3.74%, while annual inflation went up by 3.09 percentage points to 47.3%. According to main industrial groupings, energy prices remained flat in February but prices of the durable and non-durable consumption goods groups increased significantly. Annual inflation was relatively flat in the capital goods item, whereas it rose in other subgroups.
22. Having declined since October 2023, global commodity prices assumed an upward course in January that also continued into February. In a breakdown by subgroups, global energy prices remained on the rise in February, while non-energy commodity prices partly maintained their almost flat course of recent months. As of the first three weeks of March, prices were increasing in both energy and non-energy commodities.
23. The Global Supply Chain Pressure Index was close to its historical trend in February. Global freight rates, which posted some decline in February, maintain their downward course in March but still remain high. Having been extended in January, suppliers' delivery times did not record any

significant change in February. The evolution of transportation costs in the following months and their possible impact on inflation are the factors to be monitored closely.

24. While the decline in medium term inflation expectations continues, year-end inflation expectations for 2024 and 2025 have increased. According to the March results of the Survey of Market Participants, the 12-month-ahead inflation expectation decreased by1.08 percentage points from 37.8% to 36.7%, while the 24-month-ahead inflation expectation declined by 0.38 percentage points from 23.1% to 22.7%. Meanwhile, the current year-end inflation expectation rose by 1.23 percentage points to 44.2%. Inflation expectation for the end of the next year also increased by 1.09 percentage points from 25.2% to 26.3%. The five-year-ahead inflation expectation was revised upwards by 0.51 percentage points from 12.3% to 12.8%. The current course of inflation expectations poses an upside risk to the inflation outlook.

25. Leading indicators point to a slowdown in the underlying trend of inflation in March. On the other hand, despite this slowdown, the underlying trend is considered to be slightly above the level projected in the Inflation Report. According to the preliminary data, in March, price increases in the core goods group have been slightly stronger compared to the previous month, but have slowed down in other groups, particularly in the energy group. Food prices, which rose significantly in the previous month also due to the Ramadan, posted a more moderate increase in this period owing to vegetable prices. Monthly price increases in services are also expected to remain high, but weaken compared to February. On the other hand, leading indicators point to a month-on-month increase in prices of durable goods that have high and fast exchange rate pass-through. Thus, the March inflation outlook is affected by developments in exchange rates and commodity prices, resilient course of domestic demand, and the effects of Ramadan-specific factors (especially on red meat) carried over from the previous month, while the backward-indexation tendency continues to have repercussions and price increases continue particularly in education services.

Monetary Policy

26. The Committee has decided to raise the policy rate (the one-week repo auction rate) from 45 percent to 50 percent. 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.

27. In response to the deterioration in the inflation outlook, the Committee decided to raise the policy rate. 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.

28. The Committee continues to implement macroprudential policies in a way to preserve the functionality of the market mechanism and macro financial stability. 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.

29. Taking into account the lagged effects of monetary tightening, the Committee will make its policy decisions 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 percent inflation target in the medium term.

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