Summary of the Monetary Policy Committee Meeting

31 December 2020, No: 2020-77

Meeting Date: 24 December 2020

Inflation Developments

1. In November, consumer prices rose by 2.3% and annual inflation increased by 2.14 points to 14.03%. While the rise in inflation was mainly driven by the core goods and food groups, the services and energy groups displayed limited increases. The increase in food inflation was mostly led by the unprocessed food group, whereas durable goods pushed up the core goods group. Against this background, annual inflation rates and trends of B and C indices increased.

2. Annual inflation in food and non-alcoholic beverages increased by 4.57 points to 21.08% in November. While processed food inflation increased by 1.43 points to 15.92%, unprocessed food inflation rose by 8.24 points to 27.02%. Fresh fruits and vegetables played an important role in the rise in unprocessed food inflation on the back of cumulative exchange rate effects, in addition to seasonality-driven supply-side factors. Meanwhile, in response to international agricultural commodity prices and exchange rate developments, the egg and poultry items that have a significant weight in the other unprocessed food group posted noticeable price increases. These developments also had an adverse effect on the processed food group. The rise in bread and cereals gained pace in November, whereas fats and oils that are highly sensitive to international prices and exchange rates stood out with marked price increases in the other processed food group.

3. In November, energy prices increased by 0.84% and annual energy inflation posted a limited rise to 4.28%. While fuel prices increased by 1.37% on the back of the developments in international oil prices, the 3.44% rise in solid fuel prices was noteworthy in the housing group.

4. Prices of core goods increased by 3.76% and annual core goods inflation rose by 3.23 points to 15.32% in November. The rise in durable goods inflation became more pronounced on the back of strong domestic demand conditions, stemming from the rapid credit expansion and cumulative exchange rate effects, and the annual inflation in durable goods increased by 6.71 points to 26.5%. Automobile prices came to the forefront with a month-on-month increase of 9.7%, while furniture, as well as electric and non-electric appliances continued to post strong price increases. Price hikes in the other core goods group gained momentum, driving the annual inflation up by 2.06 points to 11.46%. Meanwhile, annual inflation in the clothing and footwear group decreased further to 0.76% due to the weak demand conditions.

5. Services prices went up by 0.62% and annual inflation in the group rose by 0.5 points to 11.42% in November. Annual inflation increased in restaurants-hotels, transport and other services, while it remained flat in rents and declined in communication. Exchange rate developments continued to affect the other services group, and the repair and maintenance of personal transportation vehicles, basic hospital care services and dental services stood

out with high price hikes. The monthly price increase in the restaurant-hotel group strengthened in line with the developments in food prices.

6. In December, the rise in inflation expectations continued. The year-end consumer inflation expectation posted a marked increase of 1.71 points to 14.18%. The revision to the medium-term expectations remained relatively more limited, with the 12-month-ahead inflation expectation increasing by 0.07 points to 10.84%, and the 24-month-ahead inflation expectation increasing by 0.04 points to 9.24%.

Factors Affecting Inflation and Risks

7. Global economic activity data indicate that partial recovery since the third quarter continues. However, despite the positive developments regarding the vaccine, uncertainties surrounding the global economic activity prevail due to the recent increase in Covid-19 cases. While the pandemic-related restrictions in European countries create uncertainties over the external demand and export outlook, the upward trend in exports continues. Moreover, uncertainties remain regarding the possible effects of the pandemic and health measures on consumption habits and general spending behavior.

8. Although crude oil prices are still below the pre-pandemic period levels, they have risen significantly since the previous MPC meeting. Besides, the ongoing upward trend in commodity prices excluding energy, specifically industrial metals and agricultural commodities, increases the upward cost pressure on consumer inflation through producer inflation. Developments in international prices as well as the exchange rate have an adverse effect on the trend inflation, particularly in food and core goods groups.

9. Advanced and emerging economies maintain their expansionary monetary and fiscal stances. While long-term interest rates remain at historic lows across advanced economies, both central bank statements and market expectations suggest that the low interest rate environment is likely to continue for a long period. The effectiveness of these policies on financial markets, growth and employment will depend on the course of the pandemic and the available policy room in each country.

10. Emerging economy portfolio markets continued to attract large volume of inflows since the previous MPC meeting due to improved risk sentiment. Excluding China, inflows to both bond markets and equity markets increased in December. Reinforced perceptions that policy rates will remain low in advanced economies and stimulus packages are likely to improve the positive outlook in portfolio flows to emerging economies in the upcoming period.

11. National income data and indicators for the last quarter point to a strong course in economic activity. In the third quarter of 2020, gross domestic product (GDP) posted a significant recovery with annual and quarterly increases of 6.7% and 15.6%, respectively, exceeding its pre-pandemic level. Domestic demand became the main driver of growth, while net exports had a considerably high negative contribution to growth. Private consumption and total investment expenditures soared in this period. While the rapid rise in the demand for durable goods on the back of a strong credit impulse became the main determinant of the recovery in private consumption, services-related expenditures remained weak due to the pandemic.

12. Recent indicators and high-frequency data indicate that economic activity has followed a strong course throughout the last quarter, although it started to lose momentum as of mid-October. October industrial production, turnover and retail sales volume indices increased rapidly compared to the third quarter averages. High-frequency data for the following months, capacity utilization rates and orders signaled that activity is buoyant in durable

consumption goods sensitive to financing conditions, such as automobiles, white goods and furniture, as well as in construction-related intermediate goods sectors. Field interviews conducted in this period also confirmed the strong course of domestic demand conditions. On the other hand, restrictions introduced due to the increasing number of cases create uncertainties on the short-run outlook of economic activity, particularly on the services sector. The Committee assessed that the inflationary effects of the sectoral divergences that emerged due to pandemic dynamics and the macro policy mix, along with the risks they imply for the period ahead should be monitored.

13. Strengthening domestic demand, due to the cumulative effects of high credit growth during the pandemic, increases the current account deficit. In December, imports excluding gold remain high despite a partial decline, while gold imports decelerate slightly. In spite of tighter pandemic measures in European countries, exports to this region continued to increase, thereby offsetting the slowdown due to Middle East countries and driving the increase in total exports. The Committee underscored once again the importance of the course of the current account balance in terms of a lasting recovery in economic activity and financial stability.

14. Positive reflections of the economic recovery on the labor market have continued. In September, while non-farm employment increased across sectors, unemployment rates declined. Leading indicators suggest that the improvements in the labor market can be hampered due to the services sector on the back of pandemic-related restrictions.

Monetary Policy

15. The Committee re-emphasized that monetary policy decisions will be taken within the framework of inflation targeting regime and with the priority of price stability. The monetary policy stance will be set taking into account the upside risks to the inflation outlook and with a focus on bringing inflation down cautiously and achieving price stability target in the medium term.

16. Breaking the backward-indexation behavior in administered prices and tax adjustments as well as in income policies, maintaining compatibility with inflation targets and enhancing predictability are the key components of the fight against inflation. Endorsement of inflation targets by all stakeholders and commitment to the price stability efforts with a common understanding and public accord, along with determination of macro policies in a coordinated manner in line with the projected disinflation path will strengthen the effectiveness of the monetary policy. In this context, the possible impact of the minimum wage, administered prices and tax adjustments to be determined for 2021 on the inflation outlook through aggregate demand and cost channels were assessed.

17. Domestic demand conditions, cumulative cost effects, in particular the exchange rate effects, increasing international food and other commodity prices and deterioration in inflation expectations continue to affect the pricing behavior and inflation outlook adversely. Accordingly, the Committee, taking into account the end-2021 forecast target, has decided to implement a strong monetary tightening, in order to eliminate risks to the inflation outlook, contain inflation expectations and restore the disinflation process as soon as possible. In this context, the one-week repo auction interest rate, which is the policy rate, is increased from 15% to 17%. In the forthcoming period, tightness of monetary policy stance will be decisively sustained until strong indicators point to a permanent fall in inflation in line with the targets and to price stability.

18. The permanent establishment of a low inflation environment will affect macroeconomic and financial stability positively through the fall in country risk premium, the beginning of

reverse currency substitution, accumulation of foreign exchange reserves and the perpetual decline in financing costs.

19. The Committee reiterated its judgement that in order to achieve price stability, a strong policy coordination and an holistic macro policy mix involving all stakeholders are required.

20. In its decision-making process, the CBRT adopts a framework with a medium term perspective, based on analyzing all factors affecting inflation and the interaction between these factors.

21. It should be emphasized that any new data or information may lead the Committee to revise its stance.