TÜRKİYE CUMHURİYET MERKEZ BANKASI

Summary of the Monetary Policy Committee Meeting

29 February 2024, No: 2024-11

Meeting Date: 22 February 2024

Global Economy

1. The global growth outlook remains flat while labor markets continue to be tight. In the last quarter of the previous year, the global Purchasing Managers' Index (PMI) continued to decline in both advanced and emerging economies (EMEs). Accordingly, the global economic slowdown in the third quarter of the previous year continued in the last quarter as well, the global economic activity remained weak. The global growth index, which is weighted with the export shares of Türkiye's foreign trade partners, remained flat following the previous Monetary Policy Committee (MPC) meeting period, with a forecasted annual growth rate of 1.65% for the third quarter. The forecasts for the fourth quarter were kept close to this level. The PMI data improved slightly in January; however, the manufacturing industry index continued to remain below the threshold level. 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. Nevertheless, as 2023 drew to a close, the central banks of advanced economies, particularly the Federal Reserve (Fed), highlighted the decline in core inflation and revised their medium-term inflation forecasts downwards in their communications. As a result, expectations that rate cuts may start earlier in 2024 have strengthened, while projections for the likely course of policy rates have been revised downwards. However, due to both central banks' caution on overpricing and higher-than-expected US inflation data released in January and February, market implied future policy rates have recently indicated a more cautious rate-cut path. Meanwhile, portfolio flows to EMEs slowed down due to decline in global risk appetite.

Monetary and Financial Conditions

3. Normalization in loan growth and composition continued. The four-week average growth rate of retail loans has decreased since the previous MPC meeting period and stood at 2.98%. The four-week average growth rates of vehicle and general-purpose loans materialized at -1.42% and 1.95%, respectively. Personal credit cards recorded a relatively high rate of 5.38%. On the other hand, Turkish lira-denominated commercial loans and FX commercial loans adjusted for exchange rates recorded four-week average growth rates of 1.39% and 1.49%, respectively, in the same period.
4. With the effects of the monetary and quantitative tightening, and the simplification decisions, the current loan rates are assessed to be in line with the targeted level of financial tightness. Turkish lira commercial loan rates, which had remained flat since the previous MPC meeting, stood at 52.9%. Concurrently, housing loan rates and general-purpose loan rates (excluding overdraft accounts) were flat at 41.0% and 63.4%, respectively, as of 16 February 2024. Meanwhile, vehicle loan rates decreased by 2.6 percentage points to 44.5%.

5. Turkish lira deposit rates, which increased compared to the previous MPC meeting period due to macroprudential measures to support the monetary transmission mechanism, stood at 47.0% as of February 16. On the other hand, the spread between the interest rates offered for small savings deposits and large deposits persisted. The impacts of these developments on the rebalancing process in domestic demand are closely monitored as a risk factor.
6. External financing conditions, the level of foreign exchange reserves, the improvement in current account balance, and demand for Turkish lira denominated assets continue to contribute to exchange rate stability and to the effectiveness of monetary policy. Accordingly, despite declining by 3.88 billion USD compared to the previous MPC meeting period, the gross international reserves of the Central Bank of the Republic of Türkiye (CBRT) stood at 134.2 billion USD as of 16 February 2024 and maintained its high level compared to the previous year.
7. The 1-month and 12-month implied exchange rate volatility of the Turkish lira stood at 6.4% and 18.7%, respectively, as of 21 February 2024. Türkiye's five-year credit default swap (CDS) premium dropped by 23 basis points to 294 basis points amid the improved global risk appetite as of 21 February 2024. The fall in risk premium and in exchange rate volatility were accompanied by net portfolio inflows totaling USD 5.55 billion since June, USD 2.38 billion of which was directed towards government domestic debt securities (GDDS) market and USD 3.17 billion towards the equity market.
8. The determination in tight monetary stance will continue to contribute to the Turkish lira's real appreciation process, which is a key element of disinflation. Tight monetary policy, coupled with macroprudential policies that support the transmission mechanism will not only help the rebalancing of domestic demand, but also keep the demand for Turkish lira assets buoyant, contributing to the improvement in the underlying trend of inflation through real appreciation.

Demand and Production

9. Recent indicators suggest that domestic demand continues to moderate. This moderation is robust in imports of consumption goods and gold, yet slower than projected in indicators of other consumption expenditures. In December, the retail sales volume index remained on an upward track on a monthly basis and increased slightly in quarterly terms. 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. After a deceleration in January, card spending accelerated again as of mid-February. Interviews with firms imply that the level of domestic sales was sustained in the first quarter due to wage increases and additional promotions introduced by firms. As of February, indicators suggest that moderation which started with the monetary tightening, is progressing gradually and that demand continues to be resilient. Accordingly, the current level of demand continues to be considered as a risk factor on inflation.
10. In December, the seasonally and calendar adjusted industrial production index increased 2.4% month-on-month, and adjusted for calendar effects, it rose by 1.6% year-on-year. On a quarterly basis, industrial production fell by 0.8%. In January, the seasonally adjusted manufacturing industry capacity utilization rate was realized as 76.4% close to historical averages.
11. As of December, seasonally adjusted employment rose by 0.6% on a quarterly basis and stood at 32.1 million. In this period, labor force participation rate followed a flat course. Unemployment rate posted a quarterly decline of 0.4 percentage points and stood at 8.8%. High-frequency data indicate that labor demand has started to moderate.
12. In December, the annualized current account deficit fell by USD 3.9 billion month-on-month to USD 45.2 billion. 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. Moreover, unlike November, the foreign

trade deficit excluding gold and energy registered a decrease. Provisional foreign trade data for January indicate that seasonally adjusted exports and imports posted a monthly decrease. The three-month average trend, considered along with the high frequency data for February, implies a relatively flat trend in exports and a decline in imports.

13. In view of the current data, projections point that the decline in imports of consumption goods, which started in November 2023, continued in February 2024. Meanwhile, gold imports has converged to its historical average, while the improvement in the gold trade balance continues in annualized terms. On the other hand, as of December, the annualized services balance surplus increased by USD 0.2 billion month-on-month to 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 115% in December. In the non-bank corporate sector, this ratio was around 100%. Accordingly, external financing opportunities appear to have improved.

Inflation Developments

15. In January, monthly headline inflation and the underlying trend increased as anticipated in the inflation forecast path. Consumer prices rose 6.70% in January, and annual inflation inched up 0.09 percentage points to 64.9%. In this period, the contribution of energy and services to annual inflation rose, while that of food, core goods and the alcohol-tobacco-gold group decreased.

16. Consumer inflation outlook for January was marked mainly by the significant rise in services inflation due to the wage and administered price adjustments, and backward indexation behavior. The strong increase in unprocessed food prices also pushed headline inflation up. Monthly inflation in the energy group was affected by the automatic lump-sum tax hikes in fuel and bottled gas prices, while the impact of natural gas on monthly consumer inflation came out at 0.23 percentage points, due to increased consumption, in line with projections. In January, monthly core goods inflation increased compared to the previous month due to the developments on exchange rate and labor cost. The current level of domestic demand, stickiness in services inflation, geopolitical risks, and food prices keep inflation pressures brisk.

17. Due to month-specific and time-dependent price and wage adjustments, the underlying trend of monthly inflation rose in January. The seasonally adjusted monthly increases in both the B and C indices accelerated, which was confirmed by higher readings of the diffusion index, Median, SATRIM and other underlying trend indicators monitored. While the rise in the underlying trend was mostly driven by services prices developments, core goods inflation also went up month-on-month, albeit to a relatively limited extent. The seasonally adjusted monthly rates of increase in the B and C indices were 7.0% and 8.2%, respectively, while their three-month average increases were measured at 4.2% and 4.6%.

18. In January, price pressures driven by the services sector were strong, particularly in items such as transportation, rent, restaurants-hotels, health, private education, maintenance-repair, insurance and administered services, which are prone to time-dependent pricing. Indeed, the strong backward-indexation tendency in these groups and rising labor costs led to a high monthly services inflation in January, given the labor-intensive nature of the sector. 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. In this context, the Committee will closely monitor the alignment of inflation expectations and pricing behavior with projections, and the impact of wage increases on inflation in the period ahead.

19. This 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. Annual inflation in the C index, which includes core goods and services groups, was around 70% in January 2024, while annual inflation

in the services sector was about 90%. Moreover, the diffusion index for the services sector hovered around 45% above its historical average in January, indicating that the increases continue to spread across the sector. 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. Accordingly, certain services sectors such as education, health, maintenance-repair, and insurance are expected to continue to stand out in this respect.

20. In January, domestic producer prices rose by 4.14%, while annual inflation remained flat at 44.2%. According to main industrial groupings, energy prices receded in January but price increases gained strength in other subgroups. Meanwhile, annual inflation declined across all subgroups, excluding intermediate goods.

21. Global commodity prices, having declined since October 2023, posted a moderate increase in January. In a breakdown by subgroups, global energy prices rose in January while non-energy commodity prices maintained their almost flat course of recent months. As of the first three weeks of February, prices have recorded a limited increase in both energy and non-energy commodities, being more pronounced in energy.

22. The Global Supply Chain Pressure Index was close to its historical trend in January, while international transportation costs increased due to the geopolitical developments concerning the Red Sea. Following the significant rise in January, global freight rates remained high in February, albeit with some decline. Although this development has not yet had a significant impact on domestic pricing, it is considered to be a risk factor given the extension of suppliers' delivery times since January. The evolution of transportation costs in the following months and their possible impact on inflation are other factors to be monitored closely.

23. While the rate of increase in housing prices continued to decelerate, rent increases grew stronger on account of the number of renewed contracts in January amid seasonal effects. Leading indicators tracked through micro data from the Retail Payment System (RPS) suggest that the rate of increase in rents will lose pace in February following the rise in January. According to leading indicators, this slowdown is attributable to the fall in contract renewal rate as well as the weakened rate of increase in renewed rents.

24. The decline in medium-term inflation expectations continues. According to the February results of the Survey of Market Participants, the 12-month-ahead inflation expectation decreased 1.31 percentage points from 39.1% to 37.8%; while annual inflation expectation for the end of the next year decreased 0.24 percentage points from 25.4% to 25.2%; the 24-month-ahead inflation expectation decreased 0.64 percentage points from 23.7% to 23.1%. Meanwhile, the current year-end inflation expectation rose by 0.92 percentage points to 43.0%. The five-year-ahead inflation expectation was revised upwards by 0.32 percentage points from 12.0% to 12.3%. The distribution of 12-month-ahead inflation expectations suggests that consensus over the central tendency has increased, while indicators related to the dispersion of expectations, such as the standard deviation and the coefficient of variation, remained at a similar course to the previous month.

25. Leading indicators point to a slowdown in the underlying trend of inflation in February compared to January. According to the preliminary data, price increases in the food group were stronger compared to the previous month, but slowed down in other groups, particularly in the services group. Indicators suggest that food prices display a higher-than-anticipated course also due to Ramadan, and the repercussions of these developments are further observed in dining out services in the restaurants-hotels group. The rapid increase in the volatility of oil prices triggered by geopolitical developments remains as a potential risk factor for inflation, particularly via the fuel prices channel. In fact, leading indicators suggest that the rise in fuel prices remained relatively high in February as well and this outlook continued to be reflected on transport services. While natural gas prices are not expected to have a significant impact on monthly headline inflation in February, monthly inflation in core goods is projected to weaken slightly.

Monetary Policy

26. The Committee has decided to keep the policy rate (the one-week repo auction rate) constant at 45 percent. Taking into account the lagged effects of monetary tightening, the Committee will determine 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.

27. The Committee has assessed that the current level of the policy rate will be maintained until there is a significant and sustained decline in the underlying trend of monthly inflation and until inflation expectations converge to the projected forecast range. The lagged effects of the monetary tightness on financial and economic conditions will be closely monitored in the upcoming period. Monetary policy stance will be tightened in case a significant and persistent deterioration in inflation outlook is anticipated.

28. The Committee will continue to implement macroprudential policies in a way to preserve the functionality of the market mechanism and macro financial stability. Accordingly, monetary transmission mechanism will be supported in case of unanticipated developments in credit growth and deposit rates. 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. It is assessed that significant progress has been made in the simplification process.

29. In the recent period, temporary excess liquidity emerged in the market due to the impact of public expenditures and monetary base developments. Against such circumstances, in order to support the monetary tightness, developments in market liquidity will be closely monitored and sterilization tools will be effectively used whenever needed.

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 continue to make its decisions in a predictable, data-driven, and transparent framework.