Press Release on Summary of the Monetary Policy Committee Meeting

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Inflation Developments

1. In September, consumer prices rose by 0.97% and annual inflation remained flat at 11.75%. In this period, annual inflation rose in the core goods and food groups, but declined in services and energy. In the core goods group, durable goods stood out with significant price increases in recent months, while the clothing and footwear group witnessed a weaker course in prices compared to seasonal averages. Seasonally adjusted data pointed to a relatively mild increase in services prices. Against this background, core indicators registered an uptick in annual inflation and maintained their high levels in trends, albeit some weakening.

2. Annual inflation in food and non-alcoholic beverages increased by 1.44 points to 14.95% in September. Annual inflation rose both in the unprocessed and processed food groups by 2.11 points and 0.93 points to 17.47% and to 12.79%, respectively. The pick-up in the unprocessed food inflation was driven by the prices of fresh fruits and vegetables. On the processed food group front, price hikes in the bread and cereals group and fats and oils group were prominent.

3. Energy prices rose by 0.50% in September, but the group's annual inflation fell by 2.82 points to 6.77%. The base effect in natural gas prices was the main driver of this decline in annual energy inflation. International oil prices posted a decline in September, while the depreciation in the exchange rate inhibited a more favorable outlook in group inflation. Electricity prices used by the households, industry and businesses increased starting from October.

4. In September, prices of core goods rose by 2.18% and the group's annual inflation increased by 1.66 points to 11.68%. This was led by the durable goods group, which saw a price hike of 3.70% and an annual inflation reaching 17.38%. In durable goods with high exchange rate passthrough, strong demand conditions on the back of the credit impulse also proved notable in price increases. Other core goods also witnessed a similar course and prices rose by 1.54%. Meanwhile, prices of clothing and footwear diverged from the group, following a flat course. In this period, having displayed a weaker trend compared to seasonal averages, the clothing and footwear group saw a decline in annual inflation to 6.79%.

5. Services prices rose by 0.58% in September and the group's annual inflation fell by 0.99 points to 10.84%. Annual inflation declined in transport services, restaurants-hotels and rent, but increased in communication and other services. Annual inflation in transport services registered a significant decline, which was driven by the base effect as well as the plummeting intercity bus fares. Meanwhile, the depreciating exchange rate continued to

affect the other services group. The VAT arrangement in educational services had a favorable impact on inflation in this group.

6. In October, short and medium-term inflation expectations continued to increase. The year-end inflation expectation rose by 30 basis points to 11.76%, and the 12-month-ahead inflation expectation increased by 38 basis points to 10.53%.

Factors Affecting Inflation

7. The recovery in economic activity continues. The industrial production index picked up by 3.4% in August month-on-month and exceeded the pre-pandemic level. High-frequency data point to a sustained recovery in September and October. While economic activity continues to increase with a wide sectoral diffusion led by sectors sensitive to financing conditions, a relatively weak course persists in tourism and related sectors.

8. Tightening steps through liquidity management have been taken since August in order to contain the adverse effects of the rapid rebound in domestic demand, led by strong credit impulse, on external balance and inflation. Accordingly, following recent policy steps, the normalization trend observed in commercial and consumer loans has become more pronounced. Although domestic demand is expected to slow down in the upcoming period with the stabilization of pandemic-specific supportive policies, the growth outlook for the whole year has improved significantly.

9. Exports continue to recover on the back of the competitiveness gains as well as the rebound in global demand. Meanwhile, the expected moderation in imports has started with the phasing out of pandemic-related supportive policies. The export-to-import coverage ratio excluding gold remains high. The Committee considers that the additional import demand led by the strong credit impulse will lose pace in the period ahead and the balancing effects of the real exchange rate will become more apparent. Accordingly, the strong recovery in exports of goods, relatively low levels of commodity prices and the level of the real exchange rate will support the current account balance in the upcoming periods. The Committee underscored the importance of the course of the current account balance in terms of a lasting recovery in economic activity and macrofinancial stability.

10. The recovery in economic activity has a positive effect on the labor market. In the July period, non-farm employment recorded an increase across sectors. Meanwhile, only half of the employment loss in the second quarter has been compensated for in seasonally adjusted terms. In this period, the labor force participation rate posted an increase on the back of economic recovery, and unemployment rates receded. Leading indicators reveal that new job posts increased and employment opportunities continued to improve.

Monetary Policy and Risks

11. While global economic activity has shown signs of partial recovery in the third quarter following the normalization steps taken by several countries, uncertainties on global economic recovery persist due to the continued spread of the pandemic. The recently elevated pandemic-related restrictions in the European countries keep downside risks to external demand and export outlook in place. Moreover, uncertainties remain regarding the possible effects of the pandemic and health measures on consumption habits and general spending behavior. In case normalization takes a long time or a second wave in the pandemic breaks out in the upcoming period, the nascent recovery in global economy may be interrupted and fluctuations in the global risk appetite may be observed.

12. In tandem with the subsided global economic activity, crude oil prices remained flat since the previous MPC meeting. The current level of oil prices is below the levels of the pre-pandemic period. On the other hand, there remain downside risks to commodity prices, particularly due to the uncertainty about the global economic activity, and global inflation rates are expected to be moderate in the upcoming period.

13. 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-rate environment is likely to continue for a long period. The effectiveness of these policies for financial markets, growth and employment will depend on the course of the pandemic in each country and how much policy room each country has.

14. Portfolio inflows to emerging economies have increased since the previous MPC meeting due to improved risk sentiment. However, excluding China, inflows to bond markets continued with a limited pace, while those to equity markets remained relatively weak. Reinforced perceptions that policy rates will remain low in advanced economies and possible incentive packages are considered to improve portfolio flows to emerging economies. However, ongoing uncertainties over the global economic outlook might lead to fluctuations in the global risk appetite and portfolio flows to emerging economies. In fact, Turkey's risk premium is fluctuating due to pandemic-driven global uncertainties and country-specific factors. During this period marked with high uncertainties, the pandemic disease is closely monitored for its evolving global impact on capital flows, financial conditions, international trade and commodity prices. Against this background, the CBRT will continue to monitor the effects of the pandemic on the Turkish economy and use the tools at its disposal in pursuit of its price stability and financial stability objectives.

15. The recovery stimulated by steps for gradual normalization in economic activity, which started in May, gained strength owing to supportive policies. Rapid credit growth contributed significantly to the economic recovery, and economic activity exceeded the pre-pandemic levels. The Committee, considering the rebound in the economy and its reflections to macro balances, decided to gradually withdraw the pandemic-specific supportive macro-policy measures since August. The gradual increase in the weighted average funding cost achieved by the steps for tightening in the monetary policy and the liquidity management and the balancing in the accomodative stance of state banks had fast and strong repercussions in loan rates. The rise in consumer loan rates proved more noticeable, while the normalization trend in commercial and consumer loans has recently become more pronounced. Presently, curbing risks to the inflation outlook is critical to the maintenance of a healthy and stable growth. Accordingly, the CBRT strengthened its tightening efforts as of August gradually with a view to containing inflation expectations, restoring the disinflation process and supporting price stability.

16. As a result of fast economic recovery with strong credit momentum, and financial market developments, inflation followed a higher-than-envisaged path. A significant tightening in financial conditions has been achieved, following the monetary policy and liquidity management steps taken to contain inflation expectations and risks to the inflation outlook. Accordingly, the Committee has decided to keep the policy rate unchanged, while enhancing flexibility in liquidity management and continuing with liquidity measures until inflation outlook displays a significant improvement. Tightening in financial conditions along with the deceleration in loan growth and the sustained uptrend in the weighted average funding cost in the upcoming period will have a positive effect on the inflation outlook. Effects of the

additional tightening steps on pricing behavior, expectations and the inflation outlook will continue to be closely monitored.

17. The Committee assesses that restoring the disinflation process is a key factor for achieving lower sovereign risk, lower long-term interest rates, and stronger economic recovery. Keeping the disinflation process in track with the targeted path requires the continuation of a cautious monetary stance. In this respect, monetary stance will be determined by considering the indicators of the underlying inflation trend to ensure the continuation of the disinflation process. The Central Bank will continue to use all available instruments in pursuit of the price stability and financial stability objectives.

18. Fiscal policy actions, along with other monetary and financial measures taken during the pandemic, have supported the potential output of the economy by limiting the pandemic-related economic risks and significantly contributed to the onset of a recovery in economic activity. During the stabilization of the economy the determination of the macro policy mix in a way that will ensure the continuation of the disinflation process with a strong coordination among monetary, credit and fiscal policies is crucial for maintaining healthy and stable growth by curbing macrofinancial risks.

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