TÜRKİYE CUMHURİYET MERKEZ BANKASI

Speech

Central Bank of the Republic of Türkiye

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Briefing on 2023-II Inflation Report

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Ankara

Distinguished Members of the Press, Esteemed Participants,

Welcome to our second Inflation Report Briefing Meeting of 2023. I would like to extend my respect and greetings to you, who joined our meeting today, and all the audience on screen who are following us.

Before starting, I would like to once again commemorate our citizens with mercy who lost their lives in the 6 February Kahramanmaraş earthquakes, the Disaster of the Century. I wish that the spirit of nation-wide cooperation and solidarity we demonstrated after the earthquakes will be fostered further.

In my briefing, I will first share with you our evaluations regarding economic developments in light of the data released since the previous Inflation Report, and our monetary policy implementations. Afterwards, I will announce our medium-term inflation forecasts and present our assessment for the upcoming period.

Rising global inflation and the tightening in financial conditions have led to increased risks to the financial system in advanced economies. Despite the resulting uncertainty in expectations, global economic activity strengthened in the first quarter of 2023 in line with our forecasts. The high-frequency indicators we monitor point to a more favorable outlook for global growth in 2023. Owing to the higher-than-expected resilience of sovereign economies to financial conditions coupled with China's post-pandemic opening, global demand remains robust, while global supply constraints are easing. Accordingly, growth forecasts for our trading partners for 2023 have been revised upwards compared to the previous reporting period.

In 2022, having increased amid soaring commodity prices, mainly energy, inflation trended downwards globally as prices declined. Natural gas prices, a key determinant of global inflation, neared historical averages as concerns over supply eased. Meanwhile, oil prices hover above historical averages and remain volatile due to geopolitical risks, albeit declining compared to their high levels in 2022.

On the other hand, the fall in global core inflation has been slower. The secondary effects of high inflation on pricing behavior accompanied by demand conditions that remain accommodative keep the upside risks to global inflation alive.

Recently, problems driven by the banking sector have aggravated financial risks in advanced economies, causing central banks to prioritize financial stability. Accordingly, the liquidity support provided by major central banks interrupted the downward trend in balance sheet sizes and led to a significant increase in their balance sheets. In addition, the swap lines between central banks of advanced countries have been expanded significantly in order to increase liquidity.

This raises the question of the sustainability of monetary policy implementations that do not take financial fragilities into account. The Turkish banking sector, on the other hand, maintains its robust outlook, thanks also to our holistic strategy. Various criteria such as the return on assets and equity, the ratio of liquid assets to short-term liabilities, capital adequacy, and the ratio of non-performing loans to total loans, which are key banking indicators, also confirm the robustness of the banking sector.

Dear Guests,

Regarding the developments in the Turkish economy, the contribution of our strong policy framework to the resilience of our economy is clearly visible in investments, employment, production, and exports. In addition to the strong growth of our country, I would like to draw your attention to its increasing productivity and the acceleration in high-tech areas within the industrial production.

Sustaining its strong performance of 2021, our GDP posted a growth of 5.6% in 2022. The Turkish economy ranked among the highest growing economies on a global scale during both periods.

According to data released by international organizations, Türkiye ranked among the top G20 and OECD countries in 2022 with its brisk growth performance. Moreover, when compared to other countries, Türkiye also stands out in terms of the increase in value added per employee over recent years. Hence, our country managed to advance its high growth in tandem with productivity increases. Combined with the recently high increases in employment, high productivity gains reflect the extent of our economy's development in productive capacity, innovation, and technology adaptation. Thus, considering the purchasing power parity, which is an appropriate criterion referred to in international welfare comparisons, the Turkish economy strongly converges to advanced countries in terms of per capita income.

Despite the adverse effects of energy and commodity price hikes, continuous improvements in its production capability and capacity through efficient use of its financial resources have enabled our country to attain this economic success.

Regarding industrial production, the effects of the slowdown in external demand had become visible in the second half of 2022, while some recovery was seen in the last months of the year. In January 2023, industrial production grew stronger and the annual rate of increase climbed to 7.1%. Following the disastrous earthquakes that we experienced, industrial production fell by 8.2% in February. Adjusted for seasonal and calendar effects, the January-February average edged down by 0.4% on a quarterly basis.

In the first quarter of the year, which was marked by one of the most dramatic disasters in the history of our country, the industrial production remained relatively flat, which is an indication of the resilience and dynamism of our economy. Leading indicators suggest that the losses in industrial production are being recovered strongly and rapidly as the post-disaster recovery takes place.

From a broader perspective, the production-oriented development of our economy is clearly visible. The industrial production index have risen by 23.7% over the last two years.

Despite their accommodative policy implementations after the pandemic, advanced economies were unable to increase their industrial production significantly, and with the tightening in financial conditions, they even lost these limited gains. Meanwhile, emerging economies performed better in this period and achieved a fast recovery.

Our country, on the other hand, displayed an even more successful outlook and increased its industrial production close to three times the average of emerging economies.

In addition to the acceleration in industrial production, there has also been a marked improvement in our industrial structure. Over the last two years, the industrial production index in medium-advanced and high-tech sectors has risen by 33% and 37%, respectively. Thus, our high-tech production records a steady and remarkable development.

The transformation in our production structure is accompanied by an improvement in business dynamism. Patent applications by domestic firms have increased by 10% since the end of 2020. Thus, we have seen a dynamism reflected in the number domestic trademark, domestic utility models and domestic design applications as well as the number of firms established, outpacing many economies.

As of the end of 2022, machinery-equipment investments grew for the thirteenth quarter on an annual basis in a row, and added 1.4 percentage points to growth in 2022. Thus, the share of machinery-equipment investments in GDP rose to 13.1%. Together with net exports, the share of these two significant components in GDP reached its historic high with 17.3% in 2022.

This strong performance was attained despite major negative supply shocks seen in 2022 and the decline in global economic activity in the second half of the year.

In 2023, we project that the improvement in the growth structure will gain more strength as global demand recovers.

Esteemed Participants,

We continue to make a comprehensive evaluation about the effects of the disaster on our economy. In this part of my speech, I will share with you our evaluation about the initial effects of the earthquake on economic activity based on high frequency data.

The post-quake recovery takes place rapidly both in the disaster zone and throughout the country.

Although the leading indicators regarding consumption expenditures in the disaster zone declined after the earthquake, they recently exceeded their pre-earthquake levels. This indicates a quite strong trend of recovery across the earthquake zone.

Survey indicators regarding the strength of post-earthquake recovery also give positive signals. According to Business Tendency Survey, the demand expectations for the next three months have increased. When examined on a provincial basis, it is seen that production and demand expectations of the disaster zone's centers with high economic weight are increasing.

Meanwhile, exports from the earthquake zone fell in the initial weeks following the earthquake. However, as of April, it converged to the same period of the previous year's readings. On the back of strong exports from other provinces, total exports bounced back to their pre-earthquake level.

In the second half of 2022, despite the loss of momentum in economic activity due to external demand, the labor market continued its healthy development in the pre-earthquake period, owing also to the policy rate decisions we have taken with foresight.

Seasonally adjusted employment, which increased by a total of 3.3 million people compared to end-2019, reached 31.5 million people at the end of 2022. In the same period, the labor force participation rate increased by 1.3 points to 53.9%. Despite the rise in labor force participation, the unemployment rate fell by 3.1 percentage points to 10.3% in this period, as a result of high employment gains.

Over the last two years, employment has risen strongly, with total employment increasing cumulatively by 15% and by more than 4 million people. Thus, Türkiye has ranked among the top employment-creating countries over the last two years.

While seasonally adjusted employment increased by 351 thousand people in January, it decreased by 361 thousand people to 31.5 million in February due to the earthquake. The dataflow should be completed to be able to fully assess the effects of the earthquake on the labor market.

Meanwhile, high-frequency data on economic activity as well as job vacancies and job applications suggest that the effects of the earthquake on the labor market will remain limited across the country.

The tourism sector, which strongly supported the services sector growth and employment and also made a significant contribution to the current account balance in 2022, remains strong in 2023 as well. In March, the 12-month cumulative tourism revenues reached 48.6 billion dollars, reaching their highest value ever. Similarly, the total number of visitors exceeded 53 million, marking a historic high. The significant rise in the number of visitors and per visitor spending shows that Türkiye is taking firm steps towards increasing its tourism potential.

As global tourism demand reaches pre-pandemic levels, we predict that, supported by our competitive structure in this industry, the rise in tourism revenues and their contribution to the current account balance will continue in the coming period, spreading across all months of the year.

Having remained strong in 2022 amid the war and the decrease in global demand, our exports continue to prove their resilience owing to their diversified dynamic structure at the product and country level, despite the ongoing weakness in demand conditions and the earthquake disaster in 2023.

While energy prices were the main driver of our rising foreign trade deficit in 2022, as in the rest of the world, the positive effects of the decline in energy prices started to be reflected on our imports, which is still somewhat high. On the other hand, imports of gold and consumption goods remained high. Provisional data for foreign trade in April indicate that gold imports retreated to approximately a quarter of the peak value recorded in January 2023.

The rest of 2023 will be a period in which the current account rebalancing will be stronger. In addition to the normalization in energy prices and gold imports, further recovery in global demand is expected to improve the foreign trade balance on an annual basis, through its effects on exports. On the back of the strong course of tourism revenues, we expect the current account balance to be maintained in the second half of the year. Moreover, according to our current assessments, return of our investments towards increasing capacities of high technology, energy, underground reserves and tourism is estimated to make a cumulative contribution of approximately 289 billion dollars to the current account balance by 2030.

Distinguished Participants,

In this part of my speech, I would like to talk briefly about the inflation outlook.

Inflation, which reached a peak level of 85.5% in October, decreased by around 42 points to 43.7% in April.

The disinflationary process is driven by the exchange rate stability that was achieved as a result of our effective policies, the improvement in expectations, and the slowdown in global commodity prices.

The disinflation process was slightly slower than the path that we announced in the previous Inflation Report. This deviation mainly stemmed from meat and dairy products due to problems in the unprocessed food market. Moreover, the simultaneous increase in wages, pension adjustments and acceleration in credit growth leading to stronger consumption demand, and the supply-demand mismatches particularly in the housing market due to the earthquake, also played a role in this development.

Our indicators for the underlying trend of inflation confirm the marked slowdown in price increases. Core and median inflation indicators maintain their steady downtrend except for the increase due to time-dependent price and wage adjustments in January. Recently, core indicators have recorded the lowest monthly rate of increase since October 2021. Indicators of not only the underlying trend of inflation, but also its diffusion is declining. The diffusion index, which provides insight as to the ratio of items with increasing prices to items with decreasing prices, verifies the loss of momentum in inflation particularly as of the third quarter.

The deceleration in inflation has also been reflected in expectations. As of April, the 12-month-ahead and 24-month-ahead inflation expectations have declined by 11.0 and 6.8 points, respectively, since September. The Consumer Confidence Index and Business Tendency Survey data also indicate an improvement in household expectations and corporate costs.

Having risen since the last quarter of 2021 and accelerated amid geopolitical developments, the Turkish lira-denominated import unit value index has recently posted a decline on an annual basis. The ongoing normalization in international prices and the steady course of exchange rates were instrumental in this development. Thus, cost pressures on inflation have largely disappeared in the recent period.

Having recovered throughout 2022, domestic suppliers’ delivery times have improved noticeably since September. In particular, they reached a historically good level in October and performed even better in December, thereby strengthening their positive outlook. Although there was a limited decline in domestic delivery times due to the earthquake in February, this decline was temporary and delivery times started to recover rapidly.

Price hikes in the manufacturing industry excluding petroleum and base metals have been on a gradual decline since September. Accordingly, the annual rate of increase in the prices of these products decreased by 72 points to 55.1% in April, from its peak of 127.1% in September.

Monetary Policy

Dear Guests,

After our evaluations regarding inflation, I would like to talk about our monetary policy implementations.

As you know, we summarize our monetary policy, which we have been implementing with a holistic perspective over the past year, under the name “Liraization Strategy”. Within the framework of the Liraization Strategy, we aim to make available affordable financing opportunities for real sector activities that will boost our investment, employment, production and export capacity. Accordingly, in the second half of 2022, assessing that financial conditions should be supportive against heightening uncertainties surrounding global growth, we cut the policy rate by 500 basis points with a proactive approach. In the aftermath of the earthquake, we lowered the policy rate by another 50 basis points to 8.5% in order to minimize the effects of the disaster and support the recovery process.

With our targeted policies geared towards setting commercial loan rates and long-term interest rates in a way that will strengthen the monetary transmission, financing costs have been lowered significantly. TL commercial loan rates have dropped by around 18 points since July 2022, in line with our policy rate. The interest rates on 10-year TL securities have also declined since March 2022, receding by around 15 points.

In the context of our policy framework, it is essential that financing costs are lowered, as well as loans are utilized in productive areas to boost our production and current account surplus capacity. In this respect, thanks to the effectiveness of our targeted loan policy, the SME loan share, which accounted for less than 40% of TL commercial loan disbursements in the first quarter of 2021, increased to 43% in the first quarter of 2022, and to 62% in 2023.

In the meantime, despite the recent decline in FX-denominated commercial loans, the total loan growth has increased due to the significant acceleration in consumer loans. For the success of our targeted credit policy, we will continue to decisively implement all policy tools regarding the growth rate, composition and intended use of loans in line with our objectives.

With the effective policies we implemented as part of the Liraization Strategy, we achieved a significant rate of liraization in the banking sector's deposit structure. Accordingly, the ratio of Turkish lira deposits increased to the current level of 59.7% from the January 2022 level of 35.6%. At the same time, the share of fixed-income TL-denominated securities in the collateral structure and the share of the Turkish lira in the funding of the system increased. In tandem with the banking sector, the share of the Turkish lira in the assets and liabilities of firms and households continues to increase. We will continue to head towards our target of permanent liraization of the financial system on a permanent basis with firm steps and with the same determination, taking also into account financial stability.

Medium-Term Projections

Esteemed Guests,

After summarizing the economic outlook, the starting point for our forecasts, let me now share with you our medium-term projections.

Regarding the main assumptions underlying our forecasts, we have taken into account the downward course of commodity prices.

Our downward expectation for import prices in 2023 has strengthened. Compared to the previous reporting period, we observe a more balanced and faster regional recovery in global growth, and a stronger-than-expected improvement in supply constraints and supply conditions. Accordingly, we assume that energy and commodity prices will be more favorable than we expected in the previous report.

We have included in our forecasts that, compared to the beginning of the year, more affordable energy prices will show up for consumers thanks to the support of global conditions and increased domestic supply.

Global food prices saw quite a significant decline. Meanwhile, concerns about drought early in the year were largely dissipated by the rains seen in the last two months. Domestic food inflation turned out to be higher than what we expected due to domestic market problems, driven by meat prices in particular. Our forecasts reflect that domestic food prices will remain more consistent with international food prices as all measures focusing on price stability and supply will be taken in the food market in the rest of the year.

Global growth figures have outperformed forecasts, and recession concerns have eased. Accordingly, we have revised our global growth forecasts slightly upwards compared to the previous reporting period. On the other hand, we assess that the current tightness in global financial conditions will continue through credits.

We expect our policy mix to strengthen monetary stability in the forecast period. Accordingly, we have assumed an outlook in which the Liraization Strategy will be implemented with all its elements and financial conditions will be compatible with the disinflation process we have projected.

Our forecasts have been produced based on an outlook in which necessary measures will be taken in all structural matters concerning pricing behavior, and a holistic approach focusing on price stability will be implemented decisively.

Distinguished Participants,

Now, I would like to share with you our inflation forecasts that we have produced in line with this framework. The mid-points of our inflation forecast range correspond to 22.3% at the end of 2023 and 8.8% at the end of 2024.

Although inflation continues to decrease, it has remained above the forecast range presented in the previous Inflation Report. This has been significantly driven by the increases in unprocessed food prices that exceeded projections. On the other hand, as we also stated in the 2023 Monetary Policy and Liraization Strategy text, we consider our inflation forecasts as an interim target. We will continue to use all the tools of our Liraization Strategy to support an inflation path consistent with our forecasts. Thus, we have not changed our forecasts, and have kept the year-end inflation forecast constant at 22.3% for 2023 and 8.8% for 2024.

When we look at the revisions, Turkish lira-denominated import prices had a downward effect of 2.3 points on our forecasts due to the continued stable course of the Turkish lira.

In addition to the positive effects I have mentioned above, food prices pushed our forecasts up by 1.5 points due to the realization effect. Due to a stronger-than-expected course, domestic demand, on the other hand, had a contribution of 0.2 points.

We will decisively pursue our disinflation strategy in which holistic policies focusing on price stability will be implemented by all stakeholders in the most effective way. We project that credit conditions compatible with the disinflation process and the stable exchange rates within our current policy framework will ensure a stronger improvement in the underlying trend of inflation than we estimated in the previous Report. Accordingly, the food and earthquake-driven forecast deviation has been largely counterbalanced by the correction in the underlying inflation trend, and had an upward effect of 0.6 points on the forecasts for 2023.

Esteemed Participants,

Before concluding my speech, I would like to present our overview of the upcoming period in the framework of our monetary policy implementation.

Despite the periodic crises in the global economy, the era in which inflation and interest rates remained low for decades, and public deficits as well as the central bank balance sheets expanded rapidly, came to an end with the inflationary effects of supply shocks driven by the pandemic and the war. While the initial effects of the supply shocks have faded, we are now in a transition period in which core inflation indicators are high, financial conditions have tightened, borrowing costs have increased, and uncertainties surrounding the financial system remain elevated. In this conjuncture, the Liraization Strategy, our monetary policy framework which we have built with complementary tools and a sustainability perspective, increases the Turkish economy's resilience and capability to realize its potential.

Over the past two years, while the effects of the pandemic have not yet completely disappeared, the robust structure of the policy framework that we implemented has enabled our economy to continue to strengthen successfully in the face of multiple negative shocks caused by the war in our immediate region and high global inflation.

Despite the challenging effects of geopolitical and global financial conditions, the Turkish economy outperformed all expectations in 2022, and proved its resilience by increasing its national income by 5.6%, machinery-equipment investments by 11.7%, exports by 12.9%, and employment by 6.8%.

The effective policies that we implement also contribute to rapid healing of the wounds in our fight against the massive earthquake disaster that we have experienced.

In the upcoming period, we will continue to decisively implement the Liraization Strategy developed with a sustainable and permanent price stability perspective. While we will determine our policy rates at a level that will ensure the development of the production capacity by analyzing the balance of the economy in detail, we will also ensure that the monetary transmission we aim to achieve will function properly with our targeted loan policy and liquidity tools.

We will further develop our framework to improve investments, employment, production and exports, while minimizing the demand-side effects of financial sources that hinder these objectives. By creating the financial conditions that will increase the supply capacity, we will furnish our current account balance with a structure compatible with permanent price stability.

As a result of our liraization steps and diversified reserve management, we have significantly increased the resilience of our reserves. We will maintain our strong reserve structure, which also serves as an important anchor in reducing the volatility in the foreign exchange markets.

Distinguished Guests,

I would also like to strongly emphasize that the policies we implement have the power to reduce inflation. Despite the geography we live in where global shocks are more severely felt, the fact that our inflation is falling simultaneously with a high economic performance is the biggest indicator of this power. We constantly monitor the developments in the Turkish and the world economy through our up-to-date and extensive data set, and we rigorously evaluate these developments also in light of information that we instantly obtain from the field regarding the real and financial sectors. Thus, we are all witnessing the Turkish economy's dynamism and resilience as well as the strength of real and banking sector indicators. In this way, we also quickly heal the wounds caused by the earthquake disaster.

For the period ahead, we anticipate that the disinflation process will continue while at the same time our production and current account surplus capacity will improve, financial sources will be used in the most efficient way, and the revival activities for the disaster zone will continue successfully. With the tools offered by the policies that we have developed, we will continue to eliminate the factors that could hinder the realization of this projection as well as to decisively maintain the disinflation process.

As I conclude my remarks, I would like to thank all my colleagues once again who took part in the preparations of the entire Report and the press conference, primarily the members of the Monetary Policy Committee and the staff of the Research and Monetary Policy Department.

As you know, we have reached the final stage in the construction of our building in the Istanbul Financial Center. I would like to say that we would be very pleased to hold our future meetings in our new building and to welcome you there in the coming period.

We can now move on to the question and answer session.