Speech

Central Bank of the Republic of Türkiye

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Briefing on Inflation Report 2024-I

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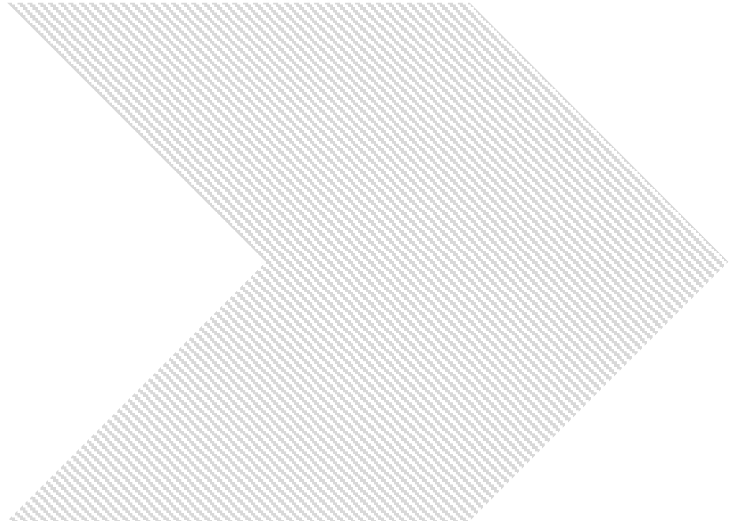

Distinguished Members of the Press, Esteemed Participants,

Welcome to the first Inflation Report Briefing of 2024. I would like to extend my respect and greetings to all our guests.

Once again, I commemorate with mercy our citizens who lost their lives in the earthquakes on February 6 of last year. I would like to offer my condolences to their grieving families. I hope that such a catastrophe never strikes our nation and the entire humanity again.

I would also like to extend my gratitude to Mrs. Hafize Gaye Erkan for her efforts while holding the office of Governor of the Central Bank during my term as Deputy Governor. We will continue our efforts to establish disinflation with determination, together with our strong team at the Central Bank.

The primary objective of the Central Bank is to achieve and maintain price stability. As you know, to this end, we initiated monetary tightening in June 2023.

During this process, we have raised the policy rate from 8.5 percent to 45 percent. We have supported monetary tightening with quantitative tightening and selective credit tightening steps. We have also introduced a simplification process in the macroprudential framework and enhanced the functionality of the market mechanism. We have encouraged the transition to Turkish lira deposits and boosted demand for Turkish lira assets.

As a result of these policies, both real and financial indicators have confirmed that our monetary policy is on the right track since the previous reporting period.

We are determined to maintaining the necessary monetary tightness until inflation falls to levels consistent with our target.

We will be watchful of inflation expectations and pricing behavior. We stand ready to act in case of any deterioration in the inflation outlook.

While our policies are starting to yield results, we will maintain our policy stance until we achieve permanent price stability, lower inflation on the projected path, and bring sustainable price stability to our economy in the medium term.

In my speech, I will first present the developments in the global economy and inflation, our monetary policy strategy, and the impact of our decisions.

Later, I will provide you with our medium-term inflation forecasts and our assessments of how we will achieve our targeted disinflation path.

The dampening effect of tight monetary policies implemented globally and restrictive financial conditions on growth has become more salient since the second half of last year.

Following a gradual decline, global growth weighted by our exports remained flat in the last quarter, compared to the previous reporting period.

Commodity prices continue to be driven by the outlook and composition of global growth, geopolitical risks, financial conditions, and supply-side factors.

Commodity prices excluding energy have continued their limited decline since the previous reporting period.

Over this period, energy commodity prices, in particular natural gas prices, have declined.

While oil prices have declined significantly since the previous reporting period, they remain highly volatile in the short term.

Against this backdrop, the downtrend in global inflation has accelerated in the last quarter of the year owing to energy prices.

Core inflation in many economies has also been falling in recent months.

Meanwhile, inflation hovers above the targets globally.

Although risks are still alive, the fall in inflation is expected to continue over the year.

Under this inflation outlook, the central banks in advanced economies have indicated that the current level of policy rates is adequate to achieve their inflation targets.

The timing and pace of the upcoming rate cuts have become more important.

Amid the improvement in the inflation outlook, interest rate cuts continue in a number of emerging economies.

Compared to the previous reporting period, market expectations for the central banks of advanced economies to start cutting interest rates earlier have strengthened.

On the other hand, given inflationary risks, it is assessed that central banks will manage the rate-cutting process gradually and that monetary tightness will be maintained across the board.

In the last quarter of 2023, the global risk appetite rebounded strongly and portfolio inflows to emerging markets increased.

However, since the beginning of this year, portfolio inflows have slowed down as a result of the advanced economy central banks' more cautious forward guidance on interest rate cuts.

Esteemed Guests,

Now, I would like to present our assessments on the inflation developments in Türkiye.

First of all, I will discuss the factors that affected inflation and pricing behavior during the tightening process up until the end of 2023. Next, I will turn my focus to January, which is characterized by a strong time-dependent price-setting tendency, and hence, differs from other months in this regard.

Moreover, I will convey our assessments on the factors that will impact inflation in the upcoming period.

In the last quarter of 2023, inflation remained consistent with the previous Inflation Report forecasts and stood at 64.8 percent at the year-end.

We have stated in all our policy texts, presentations, and Inflation Reports that we expect annual inflation to increase up until the first half of 2024.

Looking back, multiple shocks including oil prices, taxes, exchange rates, fuel prices, minimum wage increases etc. occurred simultaneously in the third quarter. The overlapping of these shocks, which were high in comparison to historical trends, over a short period of time led to an additional deterioration in expectations and pricing behavior. The pass-through of these shocks to inflation was completed to a large extent in the third quarter.

In the last quarter, however, inflation rose at a subdued pace by only 3.3 points amid the improvement in pricing behavior and the underlying trend of inflation on the back of the effects of monetary tightening. The bulk of this increase, 2.4 points, stemmed from exceeding the limit for the free use of natural gas, the first 25 cubic meters.

In this period, the indirect effects of the previous quarter's fuel price hikes on inflation persisted, while demand conditions, along with the monetary tightening, pushed inflation down around 1 point.

Following the decline in commodity prices after 2022, the high and volatile inflation became increasingly demand-driven in 2023.

However, the rebalancing process in demand has started, as a result of our monetary tightening steps.

The retail sales volume growth significantly slowed in the second half of 2023, and turned negative on a quarterly basis as of November.

While our policies have been successful in eliminating excessiveness in demand, we view the current level of retail sales to be still resilient.

We are determined to maintain our monetary stance in order to keep domestic demand driving the disinflation process.

The excessiveness in demand also had an adverse impact on the foreign trade balance through increased imports in the first half of 2023.

Following the rebalancing in domestic demand, import trend has recently weakened.

In fact, gold imports, which increased 8.5 percent in the first half of 2023 compared to the previous half, declined 18.6 percent in the second half of the year.

Similarly, the upward trend in consumer goods imports significantly weakened over the same period. The imports of durable consumer goods excluding jewelry also declined.

In addition, the rise in automobile imports cooled in this period.

Preliminary data for January point to a further improvement in the foreign trade balance, both total and excluding gold and energy.

In the first quarter of 2023, the increase in gold and consumer goods imports pushed the current account deficit to GDP ratio to 5.7 percent.

We forecast the ratio of the current account deficit to have fallen to around 4 percent as of end-2023.

The shaded areas in the chart depict the recent monetary tightening cycles in Türkiye.

These periods marked a recovery in the current account balance as demand weakened and expectations improved.

Similar to the previous periods, the current monetary tightening process has begun to contribute to the current account balance through imports, particularly gold and durable consumer goods.

In 2024, as the lagged effects of monetary transmission kick in, we project a further improvement in the current account balance together with a rebalancing in domestic demand.

The tightening in financial conditions and the rebalancing in domestic demand had a positive impact on pricing behavior in the goods and services groups.

In the durable goods sector that is affected relatively more rapidly by financial conditions, price increases lost pace, particularly in automobiles, white goods, furniture, and household appliances.

According to three-month averages, durable goods inflation decreased from 9 percent in August 2023 to 1.3 percent in December.

Price reductions offered to stimulate demand, particularly in the automotive and white goods sectors, contributed to this decline.

Although the services inflation trend also lost pace in the last quarter, its inertia remains.

Monetary tightening has a stronger effect on goods inflation in the short run.

Services inflation, on the other hand, displays significant inertia due to administered items subject to regulation and items with strong backward-indexation tendency such as education and health services as well as rents. These items cause the impact of shocks on inflation to extend over a long period of time.

High rates of increases were observed in services prices in January, which is an important month for wage/price adjustments and contract renewals.

Rents are another important component of the inertia in services inflation. The housing market is critical in this respect, and developments on this front are closely monitored as a leading indicator.

Easing of the pressure on rents and anchoring of inflation expectations will play a significant role in slowing the services inflation.

In the housing market, the growing real estate demand, driven by the impulse to hedge against inflation after 2022, has led to substantial increases in housing prices. This development also affects rents strongly with a lag.

In the period following the monetary tightening, the rate of increase in housing prices significantly decelerated in big cities.

Due to the impact of monetary tightening on financial conditions and expectations, house price inflation decreased on an annual basis.

Continuation of the slowdown in house price increase will contribute to the disinflation process in 2024 through rents and accordingly the services inflation.

Anchoring of expectations will also be critical to reducing the inertia in the services group.

According to the Survey of Market Participants, the 12-month-ahead inflation expectation declined by 6 points after October to 39 percent in January.

As for the distribution of expectations, the agreement around the central tendency is increasing.

Micro data from the survey suggest that inflation expectations of firms and consumers have declined recently, albeit remaining at high levels.

Continuation of this trend in expectations and their convergence to the forecast range is an important criterion for the monetary policy stance.

Consumer inflation fluctuated at levels close to the mid-point of the forecast range throughout the last quarter, and ended the year 2023 at 64.8 percent consistent with the year-end forecast. The course close to the mid-point of the forecast range was also maintained in January.

Nevertheless, in this part of my speech I would like to focus in particular on inflation in January.

We had projected in our previous forecasts that monthly inflation would post an increase in January for reasons specific to this month, and shared this projection with the public.

In fact, due to wage and administered price adjustments as well as the backward-indexation behavior, monthly services inflation rose significantly, and was slightly above our forecast. This development was also influenced by the minimum wage increase, which exceeded our projections.

The improvement in pricing behavior led to a decline in the underlying trend of monthly inflation.

The average of our exclusion-based, statistical, and model-based indicators suggests that the underlying trend of monthly inflation slowed significantly throughout the last quarter.

Three-month averages dropped to approximately 2.9 percent in December but rose to 3.9 percent in January, due to transitory effects.

As shown in the table, indicators suggest an underlying trend that has declined faster than we projected since the previous reporting period. This implies that the monetary tightening has had a stronger-than-expected impact on pricing behavior.

As we emphasized in the last MPC decision statement, we believe that achieving a more significant decline in the underlying trend of inflation consistent with our target path is important for the course of monetary policy.

We assess that the underlying trend of inflation will weaken following the rise in January.

However, there are also some risks to the underlying trend. In particular, we will be closely monitoring the impact of wage adjustments on demand.

Monetary Policy

Esteemed Guests,

In this part of speech, I would like to talk about the monetary policy strategy we are implementing.

As you know, we increased our policy rate from 8.5 percent to 45 percent in line with the monetary tightening process.

With a holistic approach, we introduced regulations to support the monetary tightening process in a gradual manner.

Accordingly, we are sterilizing the excess liquidity in the banking system through quantitative tightening.

Moreover, we implemented selective credit tightening to foster balancing in domestic demand.

Additionally, to restore the efficiency of market mechanism, we simplified the macroprudential policy framework and supported the increase in the share of TL deposits.

We simplified the macroprudential framework by abolishing securities maintenance regulations to encourage transition to FX-protected deposits and restrict lending.

Thus, we fostered the functionality of the bond and credit markets, the normalization of the yield curve, and the strengthening of monetary transmission.

Meanwhile, we continue with regulations to reduce FX-protected deposits and to increase the share of Turkish lira deposits.

In addition to these, to strengthen the monetary transmission mechanism, more than 1 trillion Turkish liras have been sterilized through reserve requirement regulations since July 2023.

Moreover, Turkish lira deposit buying auctions were launched to sterilize the cyclical and temporary excess liquidity. Accordingly, the Turkish lira deposit buying auction balance, which was 290 billion Turkish liras at the end of 2023, rose to 603 billion Turkish liras in January, and fell to 100 billion Turkish liras as of 5 February.

Effects of the Turkish lira liquidity on the secondary market rates will be closely monitored in the upcoming period, and sterilization tools will be further utilized to this end.

Sterilization of excess Turkish lira liquidity through reserve requirements and the subsequent rise in the funding cost resulting from reserve requirements put downward pressure on Turkish lira deposit rates.

In this context, it was decided to remunerate Turkish lira reserve requirements in line with the targets of conversion of FX-protected deposits to Turkish lira deposits.

This decision aims to strengthen monetary transmission by increasing the share of Turkish lira deposits and by supporting the transition from FX-protected deposits to Turkish lira deposits.

With the help of the level that the policy rate reached in January and the steps we are taking to strengthen the monetary transmission, we assess that the monetary tightness required to establish the disinflation course is achieved.

Here, I would like to underline that the current level of the policy rate **will be maintained as long as needed.**

We will pursue the two main conditions to this end:

The first one is a **significant decline in the monthly underlying trend of inflation**. Accordingly, we will monitor indicators regarding the underlying trend, domestic demand, imports and financial conditions.

The second one is the **convergence of inflation expectations to the projected forecast range**. In this context, broad inflation expectation indicators will be monitored.

On the other hand, monetary tightness will be reassessed in case of a significant deterioration in the inflation. If we consider that factors such as

Inflation expectations,

Price-setting behavior,

Public spending and the tax policy,

Wages,

Private consumption,

may lead to a higher deviation in the inflation outlook from our forecasts, the monetary policy stance will be tightened.

Distinguished Guests,

Our monetary tightening steps have immediate and strong effects on financial markets. In this part of my speech, I will talk about the impacts of our policies on financial conditions.

During the monetary tightening process, loan and deposit rates were raised, and financial conditions were tightened.

The wide negative spread between commercial loan rates and deposit rates was eliminated and normalized.

During this period, loan rates rose sharply, while deposit rates recorded a rather gradual increase.

In January, we saw a slight retreat in Turkish lira deposit rates. On the other hand, preliminary data suggest the beginning of a re-increase in Turkish lira deposit rates following our latest regulation.

Retail loans exhibit evident consequences of monetary tightening. In fact, the retail loan growth, which was quite strong in the first half of 2023, weakened in the subsequent period of tightening.

Meanwhile, an acceleration, mostly in personal credit card balances, was seen in December. This was led by the seasonal discounts and expected wage increases that brought consumption forward.

Ensuring normalization of consumer loans at a pace that will restore the rebalancing in domestic demand is critical to our monetary transmission. With this in mind, we will not allow any excess volatility in credit growth.

There is a balanced progress in commercial loans in line with the desired level of tightness.

The corporate sector is provided with a healthy credit flow at sustainable rates, and we see that private banks now have a more active role regarding commercial loans in line with their total asset size.

On the deposits side, there has been a strong shift to Turkish lira time deposits since end-August amid monetary tightening.

In the last five months:

Turkish lira deposits increased by 2.4 trillion Turkish liras,

FX-protected deposits fell by 910 billion Turkish liras,

FX deposits declined by 1.3 billion dollars, and in parity-and-price adjusted terms, by 3.6 billion dollars.

Thus, the share of Turkish lira deposits rose from 30 percent to 43 percent, while the share of FX-protected deposits fell to 16 percent.

However, in January, the increase in the share of Turkish lira deposits decelerated. We anticipate that our recent regulation will support the increase in the share of Turkish lira deposits.

Deposit rates and Turkish lira deposit share will remain essential components of our policy framework.

Our monetary tightening and simplification steps also reflected positively on the bond market, and aligned the yield curve with the monetary stance.

Accordingly, the yield curve exhibits normalization.

It is also noteworthy that the negative slope has become more pronounced amid this process.

The increase in our international reserves on the back of our monetary tightening steps has brought about a significant improvement in market-based risk indicators, despite escalating geopolitical risks in our region.

Having exceeded 700 basis points in May, the five-year CDS premium, fell below 300 basis points, and is trading around 325 basis points as of this week despite the recent volatility in emerging markets.

Against this background, capital inflows posted a strong increase.

The January-May 2023 period saw an average monthly capital outflow of 800 million dollars against a total inflow of 12.6 billion dollars in the second half of the year.

Between June and October, the monthly average inflows rose to 600 million dollars.

In November and December, inflows accelerated to over 4.5 billion dollars on average.

In January, capital flows lost momentum, but remained in positive territory.

Our international reserves showed a significant improvement on the back of the favorable trend in capital movements.

Having dropped to 98 billion dollars in May 2023, reserves increased by more than 40 billion dollars to 140 billion dollars by the end of the year, and declined slightly in January 2024.

In the same period, net reserves also recorded a strong increase of approximately 35 billion dollars.

We will be watchful of market conditions and continue to strengthen our reserves.

Medium-Term Projections

Esteemed Participants,

Against the backdrop of the economic outlook I have summarized so far, I will share with you our medium-term forecasts.

Medium-term forecasts are based on an outlook in which the tight monetary policy stance will be maintained until a significant improvement is achieved in the inflation outlook, in a way that reflects our commitment to intermediate targets.

Accordingly, the year-end inflation forecasts for 2024, 2025 and 2026 have been preserved as in the previous report. The year-end forecasts are 36 percent for 2024 and 14 percent for 2025.

The lower and upper ends of the forecast ranges correspond to 30 percent and 42 percent for 2024, and 7 percent and 21 percent for 2025.

Inflation is projected to fall to single-digit levels and end 2026 at 9 percent, before stabilizing at the 5 percent target in the medium term.

An array of counterbalancing factors came into play in maintaining our forecasts for 2024.

Compared to the previous Report, we expect the output gap to be higher in the first quarter of 2024, due to wage adjustments and public spending.

We also believe that the rebalancing process in domestic demand will continue with the contribution of tight monetary policy and fiscal policy coordination.

Against this background, our revision to the output gap forecast increased our inflation forecast for 2024 by 0.4 points.

In addition, unit labor costs, which increased due to higher-than-expected wage increases, pushed our forecast up by 1.5 points.

The total impact of the revisions in food prices and TL-denominated import prices is 1.4 points.

Despite these upside effects, the improvement in the underlying trend of inflation had a downward impact on forecasts.

Firstly, the impact of monetary tightness on pricing behavior has been stronger than we had anticipated.

Moreover, our policy stance towards our intermediate target, which will be maintained for a longer period than envisaged in the previous report, will also have a favorable impact on the underlying trend.

The impact of these factors lowered our forecasts by 3.2 points.

I would like to conclude my speech with our assessment of inflation and monetary policy.

In the first half of the year, we expect seasonally adjusted monthly inflation to hover below 4 percent on average, and around 3 percent except for January. Until the end of May, when inflation will peak, some temporary effects will be observed, similar to what we saw in January.

After May, we will enter a disinflation period in which we will see a rapid decline in annual headline inflation. In this period, both the favorable base effects and, more importantly, the continued decline in the underlying trend of inflation will be effective. In this process, the continued rebalancing in domestic demand, completed wage revisions and further improvement in expectations driven by the fall in headline inflation will play an important role.

Thus, firstly, we expect seasonally adjusted monthly inflation rate to fall below 2.5 percent, and then around 1.5 percent in the last quarter of the year.

As inertia in services prices will be resolved in this process and the monetary stance will continue to be managed in line with the targets, the downtrend in the underlying trend of inflation towards historical averages will continue throughout 2025.

Our mandate and objective is to bring inflation down on the targeted path. We consider the rebalancing process in domestic demand, the normalization in credits, the transition to the Turkish lira and the improvement in pricing behavior as a whole within the monetary transmission mechanism.

Thanks to our strong monetary tightening, the underlying trend of inflation, credit growth, and growth in imports of gold and consumption goods have significantly decreased in line with our projections since the previous Inflation Report.

The transition to Turkish lira deposits is also taking place as we had projected.

We believe that the current level of tightness and the tools at our disposal are strong enough to ensure that all these processes continue as anticipated.

Accordingly, we will maintain the current level of the policy rate until there is a significant decline in the underlying trend of inflation and until inflation expectations converge to the projected forecast range.

As for deposit rates and credit supply, we will not tolerate any volatility that may undermine monetary transmission. In this framework, we will continue with strong liquidity sterilization in a preemptive manner.

The monetary tightness will be reassessed if a significant deterioration in the inflation outlook is foreseen.

Before concluding my remarks, I would like to thank once again all my colleagues who contributed to the writing of the Report and the making of this press conference, primarily the members of the Monetary Policy Committee and the staff of the Research and Monetary Policy Department.

We can now move onto the Question and Answer session and our Deputy Governors will also be happy to answer your questions.