1.Overview

In the first quarter of 2023, annual consumer inflation decreased by 13.8 points to 50.5% and maintained its downward course in April by declining further to 43.7%. Wages, demand, price adjustments in administered items, and certain unprocessed food products affected by supply problems were among the drivers of price increases during the current reporting period. Additionally, some goods and services were affected by supply-demand mismatches caused by the Kahramanmaraş-centered earthquakes that occurred on 6 February. On the other hand, in this period, the moderate course of commodity prices continued, and the decline in international natural gas prices became more pronounced. Global transportation costs continued to decrease, and global supply chain pressure indicators fell below their historical averages. The ongoing stable course of exchange rates was also maintained. Against this background, price increases decelerated after the high monthly inflation in January. Seasonally adjusted monthly increases in B and C indicators slowed down in the period following the acceleration in January, and the indicators recorded their lowest rates of increase since October 2021.

Inflation is projected to be 22.3% at the end of 2023, to fall to 8.8% at the end of 2024 and sustain the downtrend by receding to 5.0% by the end of 2025.. Regarding the main assumptions underlying the forecasts, the low course of commodity prices has been taken into account. In addition, due to the more balanced-than-expected recovery in global growth, supply conditions and import prices are assumed to normalize faster than in the previous reporting period. It is projected that the current account deficit will be favorably influenced by the fall in commodity prices, tourism revenues, and external demand conditions that are expected to be stronger in the second half of the year. In addition to the favorable course of the current account deficit, stability of the Turkish lira is projected to be maintained by effectively using the Liraization Strategy through targeted loan, liquidity, and diversified reserve management and liraization targets. In this context, expectations, which quickly adapt to the reduction in the inflation rate, are also anticipated to support the decline in inflation.

While making inflation forecasts, the intermediate target nature of the forecasts was taken into account, and the forecasts are based on an outlook in which monetary policy as well as the policy instruments regarding all structural issues related to pricing behavior are used in line with the projected decline in inflation. The forecasts were built upon a monetary outlook in which financial conditions as well as the growth rate, composition and usage areas of loans as a result of the reinforced implementation of the targeted loan policy would be consistent with the projected disinflationary process. A framework was envisaged in which integrated economic policies will be effectively implemented to strengthen this process. Other factors assumed to affect prices were transparency and competition in prices would be enhanced, measures towards ensuring price stability in food markets would be prioritized, the rate of increase in rents would decline, the public fiscal balance would be kept at a level consistent with disinflation, and support in administered prices, particularly in energy prices, would be reflected on prices.

Economic activity posted a quarterly recovery in the last quarter of 2022 on the back of domestic demand. In the last quarter, GDP increased by 3.5% on an annual basis, and by 0.9% in seasonally and calendar-adjusted terms compared to the previous quarter. While the largest contribution to annual growth came from domestic demand in this period, the effects of weak external demand were reflected in the industrial sector's contribution to growth. Growth for the whole year was 5.6% in 2022, and the share of net exports and investments in GDP remained above historical averages throughout the year.

Indicators for the first quarter suggest that the milder external demand compared to the previous reporting period and the buoyant course of domestic demand supported domestic economic activity, despite the earthquake-related effects. While economic activity displayed a strong outlook before the disaster of the century, the production and consumption indicators for February reflected the inevitable effects of the earthquake. The industrial production index contracted in February after having increased in January but was relatively flat in quarterly terms. Despite having decreased on a monthly basis in February following the strong increase in January, the retail sales volume index maintained its robust upward course on a quarterly basis. Survey data and other high-frequency indicators suggest that production and consumption, which declined in February due to the disaster-related effects, displayed a strong recovery trend in March and April, and that domestic demand was more influential than external demand in this development. Leading indicators for the labor market reveal that the upward trend in employment across the country slightly lost momentum after the earthquake disaster but recovered in the following weeks.

Despite stronger support from the services balance and the decline in energy imports, the current account deficit continued to widen as imports of gold and consumption goods increased. The loss of momentum in exports was replaced by a recovery in the first quarter of the year thanks to milder external demand compared to the previous reporting period. The earthquake in February had a limited impact on exports, while export losses were largely compensated for in March and exports approached pre-disaster levels. Total imports, on the other hand, increased in the first quarter on a quarterly basis due to the acceleration in gold imports and particularly the increase in imports of consumption goods, despite the decline in energy imports. The positive impact of energy prices started to be mirrored in energy imports, while imports of intermediate goods excluding gold and energy declined compared to the first quarter of the previous year. Thanks to the high levels of tourism activities and transportation revenues throughout the year, the contribution of the services balance to the current account balance continued to strengthen.

Despite the concerns over the global financial system and the banking sector in advanced economies, steps taken to safeguard financial stability have increased the risk appetite to a limited extent. Despite the recovery in risk appetite, risk premium indicators of emerging market economies increased significantly, while Türkiye was affected to a lesser extent. Having declined significantly since the second half of 2022 across all maturities, the yields on Government Domestic Debt Securities (GDDS) increased slightly after the earthquakes, but still hovered at low levels.

In the first quarter of the year, the increase in loans accelerated, led by retail loans. Having accelerated sharply in the second quarter of 2022, commercial loan growth decelerated in the third quarter due to adopted macroprudential measures and remained moderate in the last quarter of the year. In the current reporting period, FX loans declined further while the TL commercial loan growth continued to strengthen. The strong uptrend in retail loans continued on the back of personal loans and personal credit cards. Commercial loan rates, which converged significantly to the policy rate as a result of the steps taken to support the effectiveness of the monetary transmission mechanism, remained mild. Meanwhile, as a result of the targeted loan policy actions taken to bolster potential growth as well as the current account balance within the context of the Liraization Strategy, the share of investment and export loans as well as Small and Medium-Sized Enterprises (SMEs) loans in total TL commercial loans, which grew noticeably in 2022, remained high.

1.1 Monetary Policy Decisions

Assessing that it became even more important to keep financial conditions supportive to preserve the growth momentum in industrial production and the positive trend in employment after the earthquakes, the CBRT cut the policy rate by 50 basis points in February. At its February meeting, the Monetary Policy Committee (MPC) pointed to uncertainty over the indicators related to economic activity after the earthquakes, and stated that in addition to direct effects, the earthquakes would have indirect effects through reconstruction activities and supportive policies, which would cause various sectoral and regional repercussions that would change over time. The MPC also stated that the impact of the earthquakes on production, consumption, employment and expectations was being extensively evaluated. Against this background, the CBRT decided to reduce the policy rate by 50 basis points in February. In March and April, assessing that the current monetary policy stance was adequate to support the necessary recovery in the aftermath of the earthquakes by maintaining price stability and financial stability, the CBRT kept the policy rate unchanged.

The CBRT implemented policy measures to minimize the effects of the earthquakes of 6 February on the real sector and financial markets. In this context, the CBRT decided to extend the maturities for repayments of rediscount credits and advance loans against investment commitment for companies operating in earthquake-hit provinces. Accordingly, the CBRT granted an interest-free maturity extension up to 180 days for repayments of rediscount credits for export and FX-earning services as well as advance loans against investment commitment with a due date between 6 February 2023 (included) and 30 April 2023 (included), and also introduced an additional export and FX-earning services commitment fulfillment duration of six months for those rediscount credits for export and FX-earning services that had been used before 6 February 2023 (included) to firms operating in the earthquake-hit provinces. Moreover, for loans to be extended to residents of the earthquake zone (including those that are subject to extension or refinancing) and loans to be extended to non-residents of the quake zone i) who have commercial relations with residents of the earthquake zone and can document that they have suffered damage due to the earthquake or ii) who can document that they will engage in activities to meet the shelter needs of those affected by the earthquake or in reconstruction activities of infrastructure and superstructure in the earthquake zone, provided that the loan is proportionate to these damages/activities, the CBRT decided that financing companies shall be exempt from reserve requirement, and banks shall be exempt from maintaining securities according to the loan type and loan growth rate; and these loans shall not be subject to the obligation of submitting documents against spending (except for export and investment loan types) until 31 August 2023. In April, to effectively extend the emergency support funds to be provided by international development and investment banks or the funds to be obtained from abroad to this end to the earthquake zone, it was decided that the transactions carried out in the Turkish Lira Currency Swap Market through the quotation method with one-week maturity can also be realized with longer maturities with the banks that will intermediate the utilization of the funds.

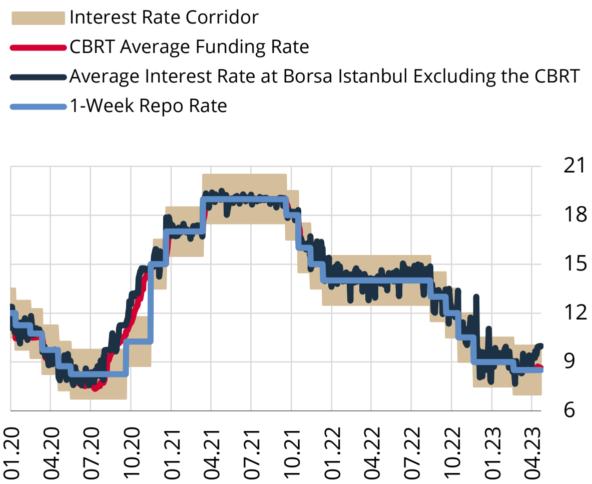
To reshape price stability on a sustainable basis, the CBRT further strengthened its integrated policy framework that prioritizes the Turkish lira in all policy tools. The main elements of the CBRT's integrated policy framework that complement the policy rate have been the increasing of the weight of the Turkish lira in the financial system through liraization steps, diversified reserve management, and targeted loan and liquidity practices.

The CBRT continued to take steps to enhance the effectiveness of the liraization process. In January, as part of its Liraization Strategy, the CBRT took steps to support the conversion of firms' foreign currency obtained from abroad into Turkish lira to promote the liraization in commercial activities. Accordingly, the CBRT introduced a conversion support scheme to encourage firms to sell their foreign currency obtained from abroad to the CBRT. The interest rate cap was cancelled for conversion accounts, to which the CBRT is a party, and it was decided that the interest rate applicable to these accounts could be determined by banks, provided that it is not below the one-week repo auction rate set by the CBRT. In April, additional obligations were introduced for banks whose share of Turkish lira deposits/participation funds in total deposits/participation funds fell below the target of 60%, and banks that reached 70% or above were provided incentives for loans according to the securities regulation. To ensure that liraization is realized through a fall in banks' FX deposit/participation fund balances in addition to the rise in TL balances, the securities maintenance practice based on FX conversion ratios was re-introduced.

The CBRT continued to prioritize TL-denominated assets in securities accepted as collateral against TL funding and strengthened the framework of the securities maintenance to enhance the effectiveness of the monetary transmission mechanism. To increase the share of TL-denominated assets in securities accepted as collateral against TL funding provided by the CBRT, the discount rates for indexed securities and FX-denominated and gold-denominated assets subject to collateral were raised from 70% to 80% as of 10 April 2023. Meanwhile, to enhance the effectiveness of the monetary transmission mechanism, the implementation framework for the policy-loan rate spread on commercial loans was extended to include personal loans in March. The requirement to maintain securities corresponding to 90% was raised to 150% in April for commercial and personal loans with an interest/profit rate higher than 1.8 and 2 times the compound reference rate announced by the CBRT, respectively.

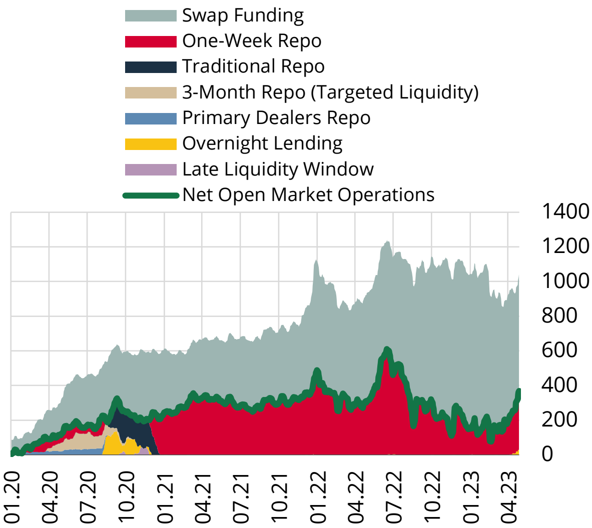
The CBRT provided funding through Open Market Operations (OMO) and currency swaps, and overnight interest rates hovered around the CBRT policy rate. Owing to the CBRT’s predictable liquidity policy, Borsa Istanbul (BIST) overnight repo rates continued to hover around the CBRT policy rate (Chart 1.1.1). The amount of swap transactions, which was TL 900.2 billion as of 19 January 2023, decreased to TL 690.8 billion as of 27 April 2023. In the same period, the net OMO funding rose to TL 345.7 billion (Chart 1.1.2).

Chart 1.1.1: CBRT Rates and Short-Term Interest Rates (%)



Source: BIST, CBRT.

Chart 1.1.2: CBRT OMO and Swap Transactions (One-Week Moving Average, TL Billion)



Source: CBRT.