

Summary of the Monetary Policy Committee Meeting

28 October 2021, No: 2021-47

Meeting Date: 21 October 2021

Inflation Developments

1. In September, consumer prices rose by 1.25%, and annual inflation increased by 0.33 points to 19.58%. The rise was mainly driven by price increases in services and energy groups. Prices of solid fuels such as coal increased due to developments in international markets and energy prices rose on the back of price increments in municipal water. Annual inflation in the food group prices inched down following the acceleration in price increases during summer. Meanwhile, producer inflation remained elevated as problems in supply chains and increases in commodity market and domestic energy prices continued. Against this background, while the annual inflation increased in the B and C indices, the recent trends of these core indicators decreased slightly.
2. In September, prices of food and non-alcoholic beverages increased by 0.50%, and the group's annual inflation decreased by 0.21 points to 28.79%. Annual inflation in the processed food group remained flat at 25.79% while that of unprocessed food posted a limited fall to 32.06%. While prices in the processed food group increased by 1.46%, prices in the bread and cereals sub-group increased by 2.54% parallel to the outlook in the grain market. Unprocessed food prices decreased by 0.53% with the correction in the prices of fresh fruits and vegetables sub-group that had been posting high price increases recently. Indeed, the seasonally adjusted data point to a 4.06% decline in fresh fruits and vegetables prices.
3. Energy prices increased by 2.20% in September, while annual inflation of the group increased by 2.05 points to 22.77%. The rise was mainly driven by increases in the prices of municipal water and in solid fuels such as coal and firewood. As a result of the rise in LPG prices, the SCT on which was nulled, fuel prices increased by 0.60%. The rise in propane and butane prices affected bottled gas prices adversely as well.
4. Core goods prices increased by 1.42% in September, while annual group inflation decreased by 0.90 points to 19.38%. Annual inflation declined in durable goods and clothing-footwear groups, while it remained flat in other core goods. Durable goods prices rose by 1.96% in September due to the increasing prices in the furniture group upon the expiry of special offers. While prices of white goods continued to increase in September, automobile prices registered a mild course. Despite the price hikes in durable goods, annual inflation in this subcategory declined by 2.09 points to 22.12% with the base effect. Meanwhile, the mild course in annual clothing and footwear inflation was maintained in September.
5. Services prices increased by 1.62% in September, and annual services inflation rose by 1.18 points to 15.06%. While annual inflation decreased in communication services, it increased in other subcategories, chiefly in transport services and restaurants-hotels. Services inflation has been affected adversely by the price increases in education-related sectors following the

opening of schools and universities. The interruption of activities last year and the expiry of the temporary VAT cuts in education sector made the price increases in the mentioned items more evident. On the other hand, price increases seen in the restaurants-hotels group due to normalization steps and food prices persisted in September. Rent inflation seems to have gained some pace.

6. According to recent issue of Survey of Market Participants, inflation expectations were revised upward in October. The current year-end inflation expectation rose by 0.89 points to 17.63%, while the 12-month ahead inflation expectation increased by 0.97 points to 13.91%. Currently, the 24-month ahead inflation expectation is 11.27% and the five-year ahead inflation expectation is 7.93%.

Factors Affecting Inflation and Risks

7. Despite the recovery in global economic activity in the first half of the year, recently published confidence indices have started to decline due to the effect of the pandemic. Economies advancing in their vaccination programs exhibit a stronger performance in economic activity by easing the restrictions. Nonetheless, despite the increase in the vaccination rate, new variants keep the downside risks to global economic activity alive.
8. Recovery in global demand, high course of commodity prices, supply constraints in some sectors, and the rise in transportation costs have led to producer and consumer price increases internationally. Unfavorable effects of weather conditions in major agricultural commodity exporting countries are observed on global food prices. While the effects of high global inflation on inflation expectations and international financial markets are closely monitored, central banks in advanced economies assess that the rise in inflation will prove to be mostly temporary with the normalization in demand composition, easing of supply constraints, and waning base effects. Accordingly, central banks in advanced economies continue their supportive monetary stances and asset purchase programs.
9. Emerging market debt securities markets have been witnessing outflows since the second half of September. The volatility in long-term bond rates in advanced economies and the course of global financial conditions keep the risks to portfolio flows to emerging economies alive. The impact of such risks through portfolio flows channel towards Turkey are judged to prove to be relatively limited, considering the current levels of non-residents' portfolio positions.
10. International commodity prices, the lingering problems in supply chains and developments in the domestic energy sector continued to weigh on producer inflation in September. Subcategories that recorded the largest price hikes were transport vehicles, energy, paper, furniture, wood and cork products and fabricated metals. Prices increased at a relatively higher rate across subsectors of energy and sectors that rely heavily on basic metals.
11. Leading indicators show that domestic economic activity remains strong with the help of robust external demand. Industrial production grew by 5.4% percent month-on-month in August, compensating for the fall in July caused by transitory effects. Thus, in the third quarter industrial production rose by 1.2% quarter-on-quarter and remained on an upward trend. Turnover indices and survey-based data indicate that external demand continued to support industrial production in the third quarter. In this period, investment tendencies of manufacturing industry firms for the next twelve months are also getting stronger.
12. The spread of domestic vaccination throughout the society facilitates the recovery in services, tourism and related sectors, which have been adversely affected by the pandemic, and leads to a more balanced composition in economic activity. The retail sales volume index registered a strong increase due to the reopening. The easing of restrictions, together

with the strong vaccination momentum since June, played a role in the significant recovery trend in tourism and related services items. While the demand for durable consumer goods slows down, recovery is observed in non-durable consumer goods.

13. In the July-August period, employment posted an increase led by the services sector, due to the reopening and the favorable course in tourism. In this period, non-farm employment and all its subcomponents exceeded pre-pandemic levels. Survey indicators and high-frequency data suggest that the improvement in the employment outlook and the positive course in the labor market continue thanks to the reopening and the course of economic activity.
14. Favorable external demand conditions and current tight monetary policy impact the current account balance positively. The current account balance posted a surplus of USD 0.5 billion in August while it decreased by USD 4.6 billion to USD 23 billion in 12-month cumulative terms. Provisional foreign trade data suggest that seasonally adjusted exports and imports excluding gold registered a partial correction in September, being stronger in imports, and the exports to imports coverage ratio maintained its high levels. Meanwhile, the recovery trend in tourism revenues has become more evident. The improvement in annualized current account is expected to continue in the rest of the year due to the strong upward trend in exports, and the strengthening of this trend is important for the price stability objective.

Monetary Policy

15. The monetary policy stance will be set by taking into account the evaluations on the source and permanence of risks, along with the extent to which they can be contained by monetary policy, and with a focus on bringing inflation down permanently in a cautious manner and achieving the price stability target. Accordingly, the policy stance will continue to be determined by taking into account inflation developments, inflation expectations, as well as the temporary factors projected to bear effect on these in the short term, and at a degree of tightness that will restore the disinflation process as soon as possible and ensure its sustainability until the medium-term targets are achieved.
16. Recent increase in inflation has been driven by supply side factors such as rise in food and import prices, especially in energy, and supply constraints, increase in administered prices and demand developments due to the reopening. It is assessed that these effects are due to transitory factors. On the other hand, the decelerating impact of the monetary tightening on credit and domestic demand is being observed. The tightness in monetary stance has started to have a higher than envisaged contractionary effect on commercial loans. In addition, strengthened macroprudential policy framework has started to curb personal loan growth. The Committee evaluated the analyses to decompose the impact of demand factors that monetary policy can have an effect on, core inflation developments and supply shocks. Accordingly, the Committee decided to reduce the policy rate by 200 basis points to 16 percent. Nevertheless, the Committee assessed that, till the end of the year, supply-side transitory factors leave limited room for the downward adjustment to the policy rate.
17. In order to contain climate-based and other environmental risks, the Committee also decided to support sustainable finance initiatives as a long-term policy without prejudice to the main objectives of monetary policy.
18. Inflation is expected to follow a volatile course in the short term due to various supply and demand side factors, with commodity prices and administered prices in the lead. However, sufficiently tight monetary stance to ensure the return of inflation to its downward trend once temporary effects disappear, will serve as a significant buffer against external and

temporary volatilities in the context of inflation expectations, the pricing behavior and financial market developments.

19. The CBRT will continue to use decisively all available instruments until strong indicators point to a permanent fall in inflation and the medium-term 5 percent target is achieved in pursuit of the primary objective of price stability.
20. Stability in the general price level will foster macroeconomic stability and financial stability through the fall in country risk premium, continuation of the reversal in currency substitution and the upward trend in foreign exchange reserves, and durable decline in financing costs. This would create a viable foundation for investment, production and employment to continue growing in a healthy and sustainable way.
21. Demand and cost-side effects are closely monitored for inflation given the developments in the credit market, economic activity, supply-side factors, and import prices. The outlook for monetary policies in advanced economies and the global risk appetite heighten the risks to the portfolio flows towards emerging economies. In formulating the monetary policy towards the target of price stability, the Committee will continue to follow an approach that also addresses the risks to financial stability.
22. The Committee reiterated that in order to achieve price stability, strong policy coordination and a holistic macro policy mix involving all stakeholders are required.
23. The Committee will continue to take its decisions in a transparent, predictable and data-driven framework.