

Third Inflation Report

The CBRT announced the third Inflation Report of the year today and raised its year-end inflation forecast for 2022 from 42.8% to 60.4%. It stated, that increases in global commodity prices, especially energy and food, supply constraints caused by ongoing disruptions in the global supply chain, and exchange rate developments are the main determinants of the increase in consumer prices and continued to put pressure on them in the second quarter. In the third version of 2022 inflation report, import prices increased by 7.4 points, food prices climbed by 3.0 points, unit labor cost rose by 2.4 points and price adjustments increased by 0.4 points. Inflation rose 4.1 points due to deviation from the inflation forecast/revision of the underlying trend. The output gap has been updated to +0.3.

The key topics to highlight and summarize are:

- **Data for the second quarter of the year indicate that economic activity has remained strong although losing some momentum compared to 2021.** The solid course of economic activity was also reflected in the labor market, reducing the unemployment rate and increasing employment. The course of the industrial production index and import quantity indices in the second quarter of the year suggests that the upward trend in investments is continuing.
- **Investment expenditures increased in the first quarter of the year.** Machinery-equipment investments, one of the sub-items of investments, grew by 10.5% on an annual basis and continued their yoy positive trend for the 10th consecutive quarter as well. It was emphasized that the consistent growth in machinery-equipment investments would boost the supply capacity of the economy and contribute to long-term price stability. While capacity utilization rates in manufacturing industry are increasing across the board, they are above historical averages in some sub-sectors. In line with the investment trend developments, the seasonally adjusted capacity utilization rate also remained strong. The CBRT further remarked that this indicates the need for additional capacity and supports investment demand. At this point, capacity increases have become more visible in sectors where companies with a high investment. Moreover, survey data show that investment expenditures of firms tend to increase in the upcoming periods as of July.
- According to the CBRT, the manufacturing and export-oriented production structure is on a solid footing: It is observed that the regional export losses due to the Russia-Ukraine war are compensated by the increase in exports to other countries thanks to the market diversification flexibility of the exporters. It was stated that there was an increasing trend in exports to Russia and Ukraine, especially in May, compared to the previous months.
- The CBRT states that export-oriented firms continue to play a leading role in economic activity.
- **CBRT underlined that the share of machinery-equipment investments and net exports in national income, which are supportive components of the economy's strong and sustainable growth performance focused on increasing production, exports and employment, grew continuously.** The CBRT emphasizes that it is critical for long-term price stability to increase the current account balance and increase its capacity through regulations that support the positive contribution of export- and investment-oriented targeted loans to the current account balance. Therefore, on the one hand, export and current account balance, investment and employment environment are supported by targeted loans, while on the other hand, matching the growth rate and composition of loans with economic activity in line with its purpose is followed.

- The CBRT also assessed that, despite geopolitical circumstances, the number of foreign visitors increased in April and May, and that if this upward trend continues throughout the summer months, travel revenues throughout the year may exceed pre-pandemic levels. Existing data show that the favorable trend in the tourism sector has remained uninterrupted during the first half of the year.
- According to the CBRT, increasing the percentage of sustainable components in the production structure, such as investment and exports, has a positive impact on employment. While the labor-force participation rate improved, the number of unemployed people continued to fall. As a consequence, the overall number of people employed hit a new high of 30.8 million in May in seasonal and calendar adjusted terms. The CBRT, on the other hand, assesses the unemployment rate of %10.9 is still at high levels.
- In the May-July period, the CBRT conducted the credit, collateral and liquidity policy actions, the evaluation processes of which were completed within the framework of the liraization strategy, and strengthened its macro prudential policy set. In this context, monetary policy measures continue to be taken in line with the liraization strategy to support sustainable price stability and financial stability. The CBRT monitors the compatibility of the development of commercial loans with economic activity in terms of financial stability: The use of loans in targeted areas that will enable them to be transformed into investments that expand capacity and boost exports maintains its importance.
- The CBRT highlights that, together with its interest rate policy, it effectively employs the policy component relating to the liquidity management, collateral, required reserves and international reserves. He also stated that they used and will continue to use their tools effectively in the previous quarter within the scope of the integrated policy framework and the liraization strategy.
- The CBRT expects inflation to decline to levels in line with the forecasts, with the macro prudential measures taken and the normalization of financial conditions, as well as the achievement of sustainable levels of the current account and fiscal balance, and the establishment of a strong financial architecture on the axis of liraization in this process.

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