

ahap Kavcolu: Recent economic and financial developments in Turkey

Speech by Mr ahap Kavcolu, Governor of the Central Bank of the Republic of Turkey, at the 91st Ordinary Meeting of the General Assembly, Ankara, 28 March 2023.

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Esteemed Shareholders, Distinguished Guests,

Before I start my speech, I would like to wish Allah Almighty's mercy on our citizens who lost their lives in the devastating earthquakes in February, I extend my condolences to their grieving families, and I wish a speedy recovery to those who are still being treated.

I would like to commemorate again Prof. Yusuf Tuna, our esteemed professor and member of the Monetary Policy Committee, who passed away last year.

Before moving on to the agenda items to be discussed at the General Assembly, I would like to share with you our assessments regarding the macroeconomic outlook and our monetary policy implementations. In the last part of my speech, I will summarize our activities in 2022.

Distinguished Participants,

In 2022, while the negative effects of the pandemic had not yet been fully eliminated, as a result of the Russian-Ukrainian war that took place in Türkiye's immediate region, supply constraints appeared again and particularly energy prices and global commodity and food prices rose rapidly. In addition to the geopolitical uncertainties that emerged due to the war, the supply-demand imbalances that persisted in the aftermath of the pandemic caused inflation to increase rapidly on a global scale, reaching historically high levels. In addition to all these developments, global financial conditions tightened, and 2022 was marked by exceptionally high levels of geopolitical, economic and financial uncertainties.

In 2022, the Turkish economy continued to grow uninterrupted despite global supply shocks and unfavorable geopolitical developments stemming from the Russian-Ukrainian War. Economic activity was particularly strong in the first half of the year and maintained its robust outlook in the second half of the year despite the decrease in external demand. Accordingly, in 2022, the Turkish economy grew by 5.6%, ranking among the top G20 and OECD countries thanks to its growth performance since the last quarter of 2019. In addition, Türkiye ranked ninth in terms of national income calculated according to purchasing power parity and doubled its share in the global economy. In 2022, the Turkish economy reached the highest level of national income in terms of US dollars since 2014.

In the first half of last year, annual consumer inflation increased rapidly due to the sharp rise in global energy, commodity and food prices, disruptions in supply processes, and price formations in FX markets detached from economic fundamentals in the last

quarter of 2021. As the effects of global supply shocks waned and FX markets stabilized, a gradual normalization process started in the underlying trend of inflation as of the second half of 2022.

In the period ahead, the policy mix we implemented under the Liraization Strategy will continue to foster financial stability through healthy credit growth, and potential output through the financing cost channel, and will contribute positively to the supply-demand balance. As a result, an improvement in pricing behavior and inflation expectations and a permanent fall in inflation will be ensured.

Esteemed Guests,

In this part of my speech, I would like to talk about our monetary policy practices in 2022.

In 2022, to reshape price stability within a sustainable context, we conducted a comprehensive policy framework review process that prioritizes the Turkish lira in all policy instruments. Accordingly, we implemented the Liraization Strategy, which we developed with a holistic approach.

With the Liraization Strategy, we tried to eliminate the sensitivity of inflation and pricing behavior to the exchange rate in the short term. In the medium term, we aimed to strengthen the current account balance by supporting production and exports. With the macroprudential tools and FX-protected deposit products we have introduced to this end, we began the liraization process of the banking sector on both the asset and liability side. We adopted a targeted loan approach in terms of creating financial conditions that will ensure permanent improvement in the current account balance by increasing production and exports in our country.

While implementing the Liraization Strategy, we updated our macroprudential policy set according to our targeted loan approach to contain the risks to financial stability and price stability along with interest rate cuts. We based our targeted loan approach on a framework that prioritizes the use of loans in areas of activity that support investment, production and employment. With our macroprudential tools, we also prevented the risks that credit growth may pose to price stability and financial stability.

As another pillar of our targeted loan approach, we have effectively utilized advance loans against investment commitment with a grace period of two years and maturities up to ten years to encourage increased exports and investments in the production of import-substituting goods. Up to now, a total of TRY 111.47 billion in advance loans against investment commitment (YTAK) have been allocated to 740 industrial and tourism investments in 67 provinces.

Moreover, we increased the limits, reduced interest rates and extended the maturities of rediscount credits extended to exporters and firms engaged in FX-earning services and activities, making this convenient financing opportunity more affordable and accessible. In addition, while changing company-based credit limits to Turkish lira in line with the Liraization Strategy, we decided that the rediscount credit limits allocated to banks be also revised to Turkish lira as of 2023.

In 2022, 346 billion Turkish lira worth of rediscount credits were used by our exporters. Facilitated access to rediscount credits led to a huge increase in the share allocated to SMEs compared to previous years. The number of SMEs using rediscount credits surged from approximately 1,900 in 2021 to 5,972 in 2022.

We used our main policy tool, the one-week repo auction rate, and macroprudential policy tools in line with the Liraization Strategy. Accordingly, we kept the policy rate (the one-week repo auction rate) unchanged at 14% in the January-July 2022 period. On the other hand, we acted in a proactive manner in the face of intensifying risks of a global recession driven by geopolitical developments and global financial conditions. To limit the effects of these risks on domestic supply, investment and current account surplus capacity and to sustain the structural gains in industrial production and employment, we initiated a rate-cut cycle in August. As of November, we had delivered a rate cut of 500 basis points in total, bringing the policy rate down to 9%. With these decisions, we enabled investments that will strengthen Türkiye's position to continue at suitable financing costs at a time when the global economy was facing supply chain and financing problems.

In 2022, we also conducted an effective reserve management to reinforce our international reserves. We created a diversity of sources through deposit accounts converted from foreign exchange, YUVAM accounts that we devised for non-resident citizens, FATSI accounts aimed at bringing physical gold into the financial system, and regulations regarding the selling of a portion of export proceeds to the Central Bank.

As a result of all these actions, our international reserves rose by 17% from USD 111 billion at end-2021 to USD 128.8 billion at end-2022. Meanwhile, international reserves of central banks decreased by 6% on a global scale in 2022.

Steps taken as part of the liraization policy, including deposits converted from foreign currency and gold that constitute one of our reserve build-up tools, have not produced a net cost for the Bank's balance sheet. Deposit accounts converted from foreign currency and gold, Turkish lira securities maintained in line with the changes made in the collateral policy, the varying interest cost in Turkish lira reserve requirements, changes in commissions for foreign currency reserve requirements, and the increase in Turkish lira rediscount bills due to the liraization in rediscount credits had a balanced total effect on the balance sheet.

Distinguished Shareholders, Esteemed Guests,

Before concluding my speech, I would also like to mention the major activities we carried out throughout the year to contribute to the financial development of Türkiye.

In line with our vision in the field of information technologies, we maintained our studies to develop the technological solutions and systems needed, as well as to ensure the security and continuity of these systems. Accordingly, we supported our payments infrastructure with innovative business models. We developed and introduced the Security Overlay Service (SIPER), to enhance the security of FAST, our Instant and Continuous Transfer of Funds system that we put into implementation in 2021. To expand the use of TR QR Code, another important application in the field of payments, we continued our work on regulation, infrastructure and promotion. We successfully

completed the FAST TR QR Code studies so that the FAST system would be used as an alternative payment method for shopping. Moreover, we launched open banking services to allow our banks to provide services through the Open Banking Gateway (GEÇT) infrastructure. Thus, we provided technical support to our Liraization Strategy with innovative solutions we developed, which contribute to the execution of payments and money transfers anytime, anywhere in a smooth, rapid and secure way.

In 2022, we also took major steps in the field of financial innovation. Our bank pioneered the establishment of the Digital Turkish Lira Collaboration Platform, building a consensus with related institutions. Additionally, we took steps to further widen the Digital Turkish Lira Collaboration Platform in 2023 to include selected banks and financial technology companies.

In 2022, we continued to keep a tab on climate change developments, one of the top priorities on the global agenda. In line with our country's "2053 Net Zero Emission" and "Green Development" targets, we took a role on national and international platforms to contribute to the combat with climate change in the fields that fall under our Bank's remit. In the period ahead, we will continue to monitor the economic and financial implications of climate change and sustain our cooperation with national and international stakeholders on this matter.

We, at the Central Bank, will be working intensively for permanent achievement and sustainability in all matters related to price stability and financial stability, particularly monetary policies, with the pride and sense of responsibility of celebrating the centenary of our Republic, at the Istanbul Financial Center, the construction of which will be completed this year.

Distinguished Guests,

Concluding my remarks, I would like to thank my esteemed colleagues for their painstaking efforts to support our Bank in its activities, and also would like to pay my respects to you all for your participation.