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SUMMARY OF THE MONETARY POLICY COMMITTEE MEETING

Meeting Date: December 18, 2008

Inflation Developments

1. Consumer prices increased by 0.83 percent in November and annual inflation declined to 10.76 percent. Processed food and energy inflation eased on the back of falling commodity prices, while exchange rate pass-through to domestic prices remained limited. In addition, services inflation continued to moderate owing to the weakening in domestic demand.

2. Processed food prices fell in November, whereas unprocessed food prices continued to rise on soaring vegetable prices. Annual inflation in processed food prices registered a cumulative drop of 8.6 points in four months, and is expected to decelerate further in the upcoming period.

3. Owing mainly to the last year's base effect created by the excise tax hikes and the sharp increase in water rates, annual energy price inflation declined by 6.9 points to 24.09 percent in November. Given the reductions in fuel and LPG prices in December, energy prices will continue to support disinflation.

4. Annual inflation in goods excluding energy and food declined by about 1.3 points to 3.83 percent, mainly on account of the moderation in clothing price inflation driven by weak demand conditions. In the durables group (excl. gold), annual inflation rose by about 1 point due to the lagged impact of exchange rate movements. The Monetary Policy Committee (the Committee) noted that the short-term exchange rate pass-through in durable goods has been significantly lower than the levels implied by the historical estimates.

5. The easing in supply shocks and the softening in domestic demand continued to have a favorable impact on services prices in November, bringing its annual inflation down to 10.88 percent. Rent inflation continued to moderate. Annual inflation in catering prices has further declined on slowing food inflation and weakening domestic demand. Moreover, the fall in fuel prices has started to put downward pressure on transport prices. Accordingly, seasonally adjusted core inflation indicators also remained on a downward track.

Factors Affecting Inflation

6. Third quarter GDP developments were largely consistent with the outlook provided in the October Inflation Report. Public spending and net exports were the main drivers of GDP growth. Imports contracted for the first time since the fourth quarter of 2001, and the contribution of net exports turned positive. On the other hand, the contribution of private domestic demand declined considerably, especially owing to the weakening in investments. Thus, annual GDP growth in the third quarter decelerated significantly down to 0.5 percent. Moreover, seasonally adjusted figures suggest that quarterly GDP growth was negative in the second and third quarters of 2008.

7. Indicators on economic activity suggest that the adverse impact of the global economic downturn on both domestic and aggregate demand has intensified in the fourth quarter. Readings on production, capacity utilization, and business confidence point to a marked contraction in economic activity.

8. Ongoing problems in global financial markets have led to a slump in consumer confidence. Following the sharp drop in October, consumer confidence indexes remained at low levels in November. The softening in consumption, the tightening of financial conditions, and the reduction in loan supply has restrained credit growth. Accordingly, consumer loans slowed down considerably in October and November.

9. Other indicators for consumer demand also suggest a weakening in the fourth quarter. Domestic sales of automobiles plummeted in October and November, falling well below the third-quarter average. Moreover, seasonally adjusted consumption indexes point to a contraction in private consumer demand in November. Imports of consumer goods, especially passenger cars and non-durable goods, continued to trend downward.

10. Indicators remain weak for investments. In seasonally adjusted terms, machinery-equipment production fell for the fourth quarter in a row. Imports of capital goods in October were below their third-quarter average. Domestic sales of commercial vehicles displayed a downward trend in October and November, while Business Tendency Survey pointed to a significant deterioration in expected investment spending.

11. Besides the marked reduction in domestic demand, foreign demand has also significantly weakened due to the marked slowdown in global economic activity. Exports fell by 6.5 percent year-on-year in October and posted a steep decline in seasonally adjusted terms. Exports of motor vehicles – a key driver of total exports – fell by 43.9 percent year-on-year in November. The slowdown in imports has also intensified in October, which was down by 15.3 percent in year-on-year terms. Given the fact that imports declined at a faster

pace than exports, net foreign demand is expected to make a positive contribution to growth in the final quarter.

12. Data on labor market confirms the significant slowdown in economic activity. Non-farm employment remained flat in the third quarter, resulting in a marked rise in unemployment rate. The Committee emphasized that the labor market conditions will continue to restrain domestic demand and labor costs.

Monetary Policy and Risks

13. Recent readings indicate that the slowdown in the domestic economic activity has intensified. Ongoing problems in international credit markets and the global economy are expected to continue to restrain both the domestic and external demand for an extended period, putting downward pressure on inflation. The disinflation in core price indices has been so far limited due to the lagged impact of the exchange rate pass-through. Yet, the Committee expects a more significant deceleration in the underlying inflation as the services inflation eases in the forthcoming period.

14. The developments in oil and other commodity prices are having a favorable impact on disinflation. In fact, the contribution of energy and food prices is down by 1.4 percentage points since June. Looking ahead, energy and food prices are expected to continue to contribute to the disinflation process.

15. Although inflation expectations have shown signs of easing recently, they are still above the medium term targets. The Committee judged that inflation expectations will follow a downward trend in the forthcoming period as the deceleration in headline inflation becomes more significant. In this respect, it was stated that the Central Bank should put more emphasis in its own inflation forecasts.

16. In light of these assessments, the Committee judged that inflation would display a rapid fall in the forthcoming period. Accordingly, the Committee has decided to lower short-term interest rates by 125 basis points. The cumulative rate cuts have reached 175 basis points in the last two months.

17. Considering the prevailing tightness in financial conditions and the benign inflation outlook, the Committee indicated that there was room for further monetary accommodation. However, it was stated that, given the existing global uncertainties, it would be appropriate to maintain flexibility regarding future policy decisions. In this respect, the extent and the timing of the next rate cut will depend on the factors affecting inflation outlook.

18. Uncertainties regarding the impact of the problems in financial markets on the real economy remain at high levels. Recently, the forecasts on global economic growth have been continuously revised downwards. Given that factors affecting domestic inflation have been driven largely by global developments, medium term inflation risks are seen mostly on the downside.

19. The Central Bank will continue to take the necessary measures to contain the adverse effects of the global financial turmoil on the domestic economy, provided that they do not conflict with the price stability objective. Prudent monetary policy is necessary but not sufficient to maintain the resilience of the economy against the global financial turmoil. Preserving the fiscal discipline and strengthening the structural reform agenda would also help to mitigate the adverse effects of the ongoing shocks on the domestic economy. In this respect, the European Union accession process and the implementation of structural reforms envisaged in the economic program remain to be of utmost importance. In particular, advances in structural reforms, which would improve the quality of fiscal discipline and enhance productivity gains, are monitored closely by the Central Bank with regard to their implications on macroeconomic and price stability.