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SUMMARY OF THE MONETARY POLICY COMMITTEE MEETING

Meeting Date: February 16, 2010

Inflation Developments

1. Consumer prices increased by 1.85 percent in January, driving annual inflation up by 1.66 percentage points to 8.19 percent. As emphasized in the January Monetary Policy Committee (Committee) Meeting Summary, the recent rise in annual inflation was primarily due to the administered price and tax adjustments, which added around 1.7 percentage points to CPI inflation in January, and will add another 0.2 percentage points in February. Therefore, the total impact is estimated to reach around 1.9 percentage points. After the tax adjustments are accounted for, underlying inflation continues to hover at low levels.

2. In January, unprocessed food prices picked up at a slower pace than the seasonal norm. Yet, the red meat prices continued to rise, having an indirect impact on processed food and catering prices and leading to higher annual inflation in these subcategories. Moreover, the rise in vegetable prices driven by heavy rainfall and floods may produce a significant but temporary upsurge in the annual unprocessed food inflation in February.

3. Energy prices were up 3.94 percent in January owing to adjustments in Special Consumption Tax and administered prices. Thus, the annual rate of increase in energy prices rose to 8.13 percent. Annual energy inflation is likely to increase further in coming months due to base effects.

4. The annual rate of increase in prices of goods excluding energy and food accelerated in February with the 22 percent increase in tobacco prices; but excluding tobacco, it slowed down from a month earlier.

5. The annual rate of increase in services prices rose moderately, largely owing to changes in costs rather than demand-side factors. In fact, seasonally adjusted data show that the monthly rate of increase in the prices of services, excluding transport and catering, remained modest.

6. The Committee indicated that, due to tax adjustments, unprocessed food price increases and base effects, annual inflation would continue to rise markedly in February and hover above the target for some time. Aggregate demand

slumped with the deepening of the global recession during the first quarter of 2009 causing the rate of change in core price indices to decline to historic lows. Therefore, core inflation indicators would also increase slightly until mid-year owing to base effects, yet remain below the target throughout the year.

Factors Affecting Inflation

7. Recent data releases suggest that a moderate recovery in economic activity is ongoing. Industrial production grew by a robust 25.2 percent year-on-year in December, which seemingly points to a vigorous recovery. However, as noted earlier by the Committee, the rapid growth of production was largely driven by calendar effects and the low December 2009 base. Monthly and quarterly growth rates of seasonally adjusted industrial production figures suggest that the economic activity continues to expand, yet the pace of recovery is moderate. Moreover, the capacity utilization for January 2010 does not point to an acceleration in manufacturing activity.

8. Domestic demand displays a gradual growth trend. Production and imports data indicate that private consumption demand increased quarter-on-quarter during the fourth quarter but remained at low levels. Given the partial recovery in the labor market and expansionary monetary policy, private consumption demand may continue to rise gradually. In fact, the recent increase in total wage compensation and credit utilization supports private consumption demand.

9. Production and imports data for capital goods suggest that the recovery in private investment demand continued into the final quarter. Investments are likely to grow further in the upcoming period, but aggregate demand uncertainty may continue to restrain resource utilization and new investments. Therefore, investment demand is likely to remain below pre-crisis levels for a long period.

10. Uncertainty regarding foreign demand remains. The Committee noted that the pace of recovery in real exports (excluding gold) is far below the pre-crisis level. Leading indicators suggest that the slow pace continued into January. While access to new markets may continue to support exports, the Committee emphasized that the growth outlook for existing export markets, particularly the euro area, remains relatively weaker, and thus the recovery in exports are likely to remain gradual. Taken together, this view regarding aggregate demand seems to imply that it will take a while before capacity utilization rates return to pre-crisis levels.

11. Although there has been a mild improvement in employment conditions, unemployment rates remain at high levels. With the modest rebound in

production, employment grew by 3.5 percent year-on-year in November 2009, while non-farm employment increased by 2 percent. Seasonally adjusted data indicate that the recovery in non-farm employment spread across all industries. Employment continues to grow steadily in construction and services, but still lags behind pre-crisis levels in the industrial sector. Committee members noted that industrial employment is unlikely to improve significantly unless there is a durable recovery in foreign demand.

12. In sum, fourth-quarter data suggests that the economic recovery is ongoing. The Committee reiterated that the medium-term trend of aggregate demand would largely depend on the global growth outlook. Based on the assumption that the economy would recover gradually, resource utilization is expected to remain at low levels for some time and continue to support disinflation. In this respect, the Committee emphasized that inflation would display a declining trend once the temporary factors, such as unprocessed food price volatility and tax hikes, taper off.

Monetary Policy and Risks

13. The Committee noted that credit markets have continued to improve due to lagged effects of the monetary easing. The tightness in credit conditions have been moderating since the publication of the July Inflation Report. Easing financial conditions and declining loan rates have been strengthening the expansionary impact of monetary policy. However, lingering problems across the global economy are not resolved completely and there are still uncertainties regarding the strength of the recovery. Accordingly, the Committee has reemphasized that it would be necessary to keep policy rates at low levels for a long period of time.

14. The Committee noted that as predicted in the January Inflation Report, inflation would display sharp increases during the first two months of the year because of tax adjustments and base effects. Moreover, it was emphasized that there would be an additional temporary impact in February coming from a further jump in vegetable prices caused by heavy rainfall and floods. Therefore, inflation is expected to exceed the levels envisaged for February; however, as vegetable prices normalize during March, inflation would revert back to the levels consistent with the January Inflation Report forecast, At the same time, noting that the underlying trend implied by core inflation indicators would remain at levels consistent with medium-term targets, the Committee emphasized that, given the low levels of resource utilization, the precarious state of labor markets, and global economic conditions, general pricing behavior would not be adversely affected by the temporary rise in inflation, and therefore, inflation would display a declining trend once the transitory effects taper off. However, it should be underscored that the Committee will not hesitate to tighten the stance of monetary policy sooner than envisioned

under the baseline scenario of the Inflation Report, should any unforeseen developments lead to a deterioration in general price setting behavior.

15. Both upside and downside risks to global economic activity remain. Rising budget deficits and ongoing problems in credit and real estate markets continue to pose downside risks for global activity, especially for developed economies. Although the probability of a disruption in the recovery of global economic activity has been decreasing, it is still an important source of downside risk on domestic economic activity and inflation. On the other hand, upside risks have also been emerging since the second half of 2009, given the pace of global recovery over this period. The Committee will closely monitor global developments and their impact on domestic inflation, and will take the necessary measures to keep inflation in line with the medium term targets.

16. Increasing budget deficits on a worldwide scale, especially in developed economies, continue to pose risks on inflation expectations and thus on longer-term global interest rates. In fact, recently, long term interest rates in the US economy have been displaying significant increases. Countries with relatively sounder banking systems and prudent fiscal policies would be more resilient against these risks. In this respect, the Committee will continue to monitor fiscal policy developments closely while formulating monetary policy. Should the goals set out in the Medium Term Program be implemented through institutional and structural improvements, rather than tax and administered price hikes, it would be possible to keep policy rates at single digit levels throughout the forecast horizon.

17. The Committee Members continue to view the course of oil and other commodity prices as an important risk factor. Ample liquidity driven by countercyclical policies on a global scale facilitates speculative movements for commodity prices. Fast growth trends in countries like China and India, and the rising share of these economies in global commodity demand, create further pressures on oil and other commodity prices. At this point it is worth noting that weak domestic demand conditions would limit the pass-through stemming from upside cost-push shocks. Therefore, the Committee will not react to the first round effects of short-term volatility in commodity prices, especially when the resource utilization remains at depressed levels. However, if an uptrend in commodity prices reflects a strong and durable rebound in global economic activity that would in turn have adverse effects on inflation expectations, then the monetary policy will be tightened appropriately to keep inflation in line with medium-term inflation targets.

18. Since the last quarter of 2008, the CBT, without prejudice to its primary objective of price stability, has focused on containing the adverse effects of the global crisis on the domestic economy, and this task has been achieved to a

large extent. Monetary policy will continue to focus on price stability in the period ahead. Strengthening the commitment to fiscal discipline and the structural reform agenda would support the improvement of Turkey’s sovereign risk, and thus facilitate macroeconomic and price stability. In this respect, timely implementation of the structural reforms envisaged by the Medium Term Program and the European Union accession process remains to be of utmost importance.