Central Bank of the Republic of Turkey

PRESS CONFERENCE FOR THE PRESENTATION OF THE INFLATION REPORT

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27 July 2010, Ankara

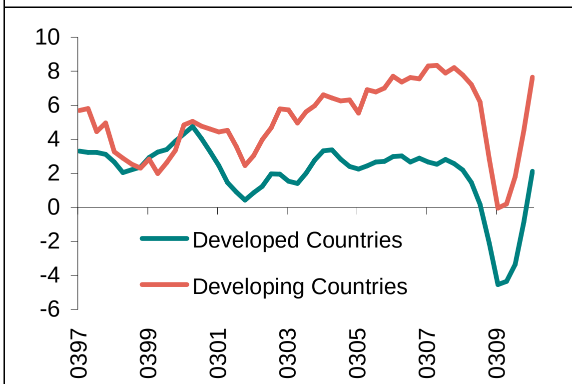
Distinguished Guests and Members of the Press,

Welcome to the press conference held to convey the main messages of the July 2010 Inflation Report.

The report typically summarizes the economic framework addressed in monetary policy decisions, elaborates global and domestic macroeconomic developments and presents the medium-term inflation forecasts, which have been revised in view of previous quarter developments, along with the monetary policy stance.

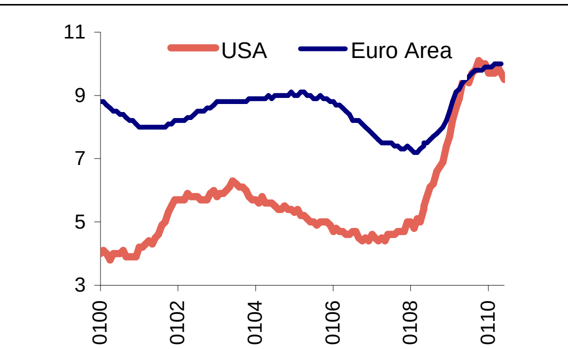
Before moving on to the Central Bank's assessments on the inflation outlook and economic activity, which I will share with you in detail shortly, I would like to summarize the current global conditions. The recovery in global economic activity continued during the second quarter of 2010. However, with the deepening financial distress, the euro area experienced weaker growth than other advanced economies, pushing down the growth rate for advanced economies, whereas, emerging economies continued to grow faster than advanced ones (Figure 1). Furthermore, it is noteworthy that that the modest recovery in growth in advanced economies has not yet been reflected on labor markets (Figure 2). This situation continues to have a detrimental effect on sustainable recovery in these countries.

Figure 1: Aggregated Growth Rates
(Percent)



Source: Bloomberg.

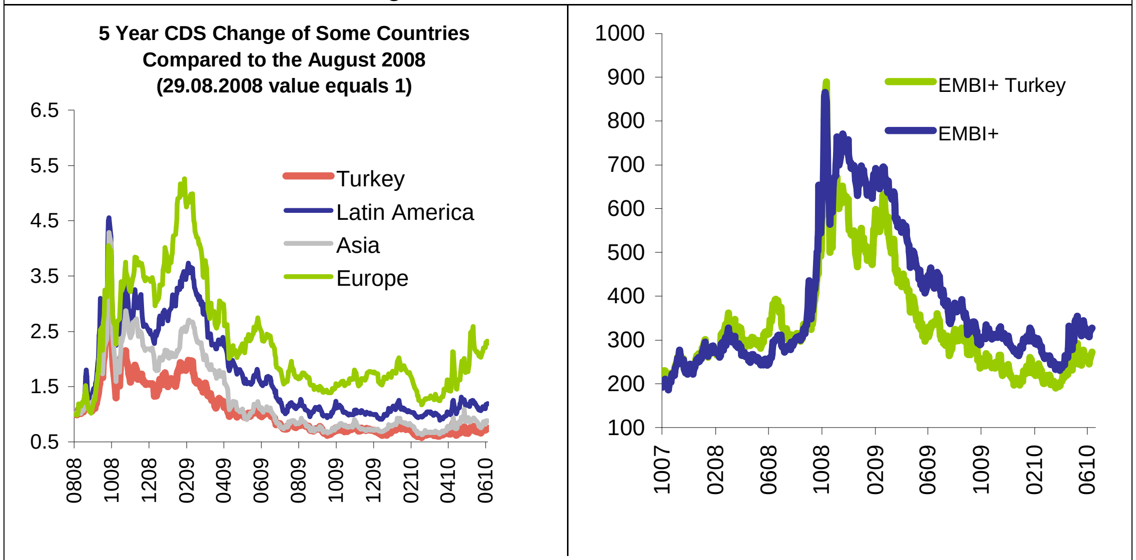
Figure 2: Unemployment Rates in Developed Countries
(Percent)



Source: Bloomberg.

Despite the recovery in global economic activity, recent developments have confirmed that the global economy remains fragile. Rising concerns regarding the debt sustainability of several Southern European countries have caused risk appetites to follow a volatile and downward trajectory, which in turn, have triggered capital outflows from emerging markets and increased risk premiums. While risk premium indicators particularly in some European countries have increased, during this period, increases in emerging market risk premiums—especially in Turkey—have been limited (Figure 3).

Figure 3: Risk Premium Indicators

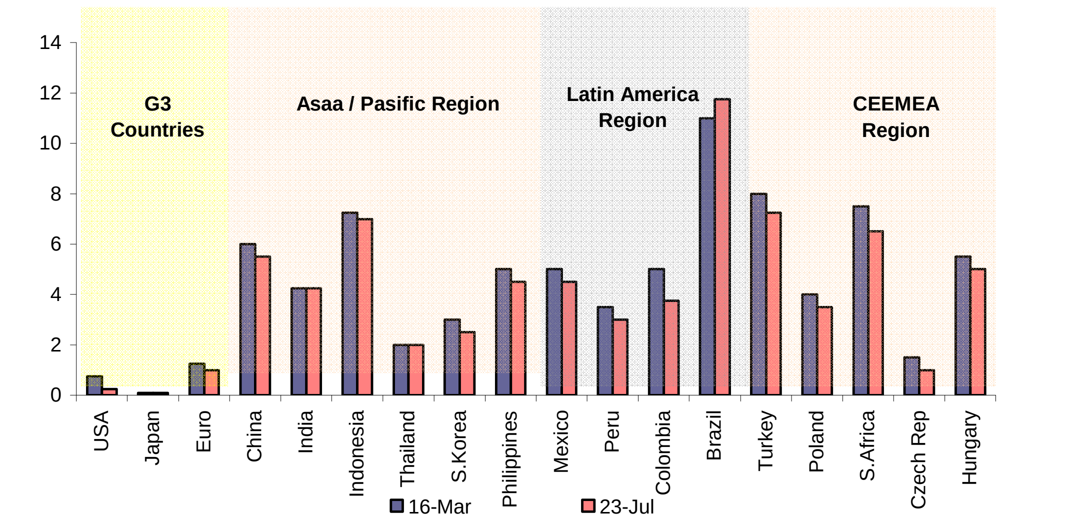


Source: Bloomberg, CBT.

Sovereign debt-related problems in Europe have once again confirmed that downside risks regarding the global economy activity remain. This development led many central banks to adopt a monetary policy stance with an increased emphasis on downside risks, especially in advanced countries. Accordingly, central banks of advanced economies have underscored that the current monetary policy stance would be kept accommodative for a long period, while emerging economies have also adopted similar changes in their rhetoric through policy statements. These developments have postponed the expectations regarding the timing of policy normalization (Figure 4).

Figure 4: Expected Policy Rates at 2010 Year-end

(Percent)

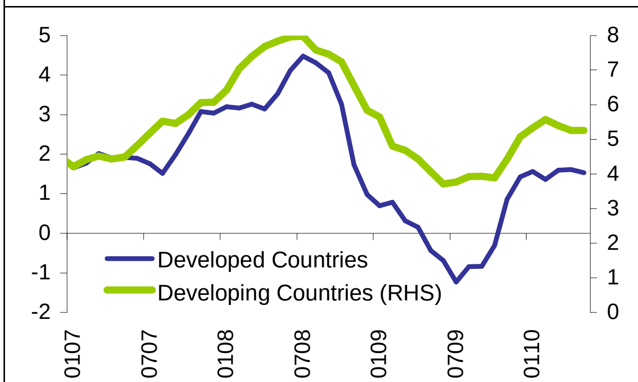


Source: Bloomberg.

According to this outlook, year-on-year inflation in consumer prices was flat in both advanced and emerging economies during the second quarter of 2010 (Figure 5). In the meantime, core inflation continued to diverge between both groups of economies (Figure 6).

Figure 5: CPI Inflation in Advanced and Emerging Economies

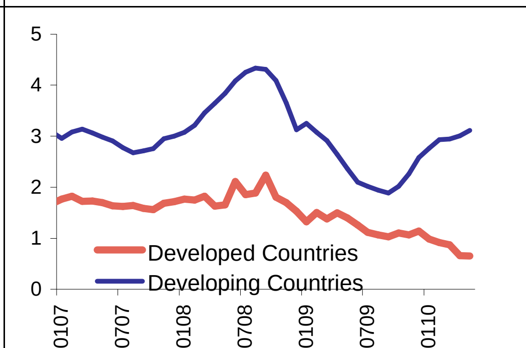
(Annual Percentage Change)



Source: Bloomberg, CBT.

Figure 6: Core CPI Inflation in Advanced and Emerging Economies

(Annual Percentage Change)



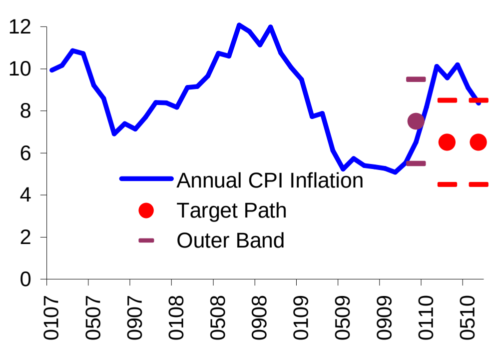
Source: Bloomberg, Datastream, CBT.

1. Inflation Developments

After summarizing current global conditions, I would now like to make an evaluation of the inflation developments in Turkey that took place in the last quarter.

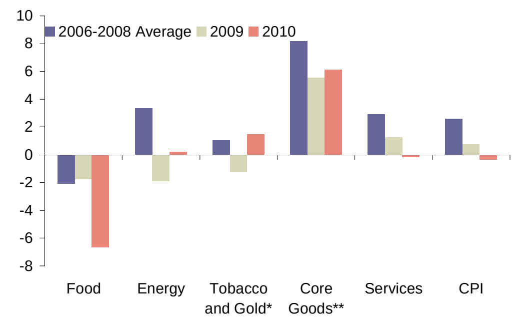
Developments during the second quarter of 2010 confirmed the CBT's assessment that the increase in inflation since the last quarter of 2009 was temporary. The April Inflation Report stated that aggregate demand conditions would support disinflation and that the rise in inflation could be attributed to factors beyond the control of monetary policy such as increases in food, energy and administered prices. In fact, with the reversal of these adverse factors, consumer prices declined by 0.3 percentage points and annual inflation came down to 8.37 (Figure 7). Here I would like to underline that this was the first decline in consumer prices ever in a given quarter (Figure 8).

Figure 7: Annual Inflation and Path Consistent with the Target



Source: TurkStat, CBT.

Figure 8: CPI by Categories
(Second Quarter Percentage Change)

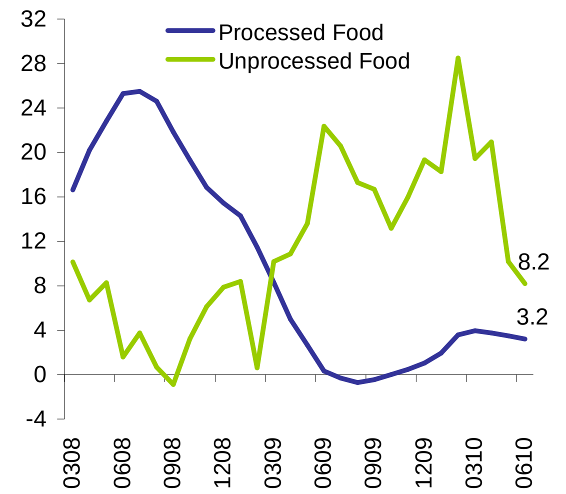


*Core Goods: Goods excluding food, non-alcoholic beverages, energy, alcoholic beverages, tobacco and gold.

Source: TurkStat, CBT.

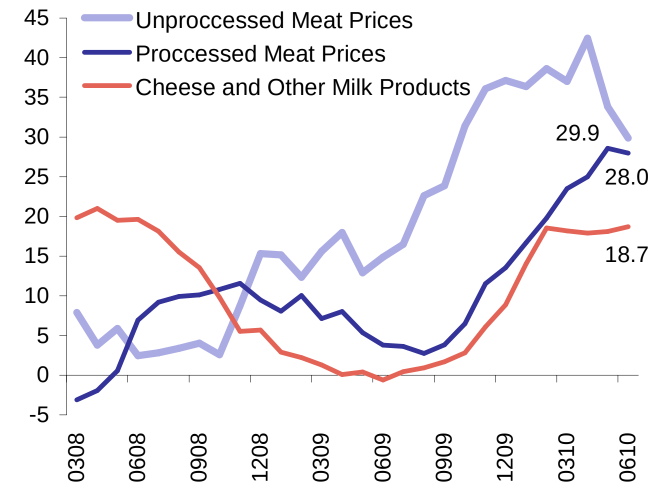
The course of food prices was instrumental in the favorable outlook of inflation in the last quarter. After climbing dramatically in the past two quarters and prompting consumer prices to soar, food prices plunged sharply during the second quarter of 2010 (Figure 8). The fall in food prices was attributable to the significant decline in unprocessed food prices (Figure 9). In addition, the adoption of import regulations for red meat at the end of April was another factor that slowed down unprocessed food prices more than expected (Figure 10). Besides, processed food prices also decreased during the last quarter, pushing food prices down even further (Figure 9).

Figure 9: Food Prices
(Annual Percentage Change)



Source: TurkStat, CBT.

Figure 10: Prices of Animal Products
(Annual Percentage Change)



Source: TurkStat, CBT.

The favorable outlook of inflation was not only limited to food prices; services and core goods prices also saw a significant slowdown in the second quarter of the year (Figure 11). Seasonally adjusted data suggest that prices of services recorded a quarter-on quarter drop for the first time since the inception of the index. While this development was attributable to the sizeable fall in communication services, the rate of increase in other subcategories of services also slowed down (Figure 12). Specifically, annual rental inflation continued to fall steadily to an all-time low during the second quarter, which is a dramatic development (Figure 12).

Figure 11: Prices of Services
(Annual Percentage Change)

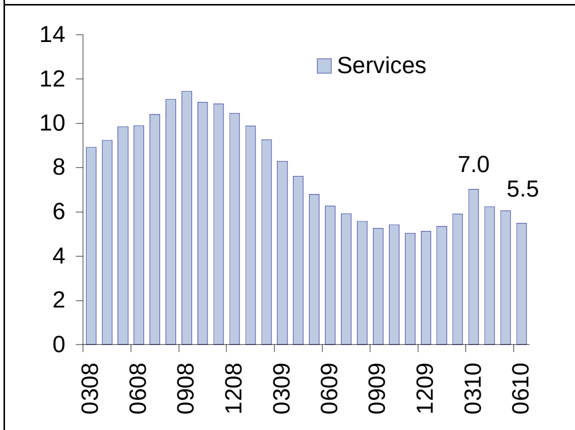
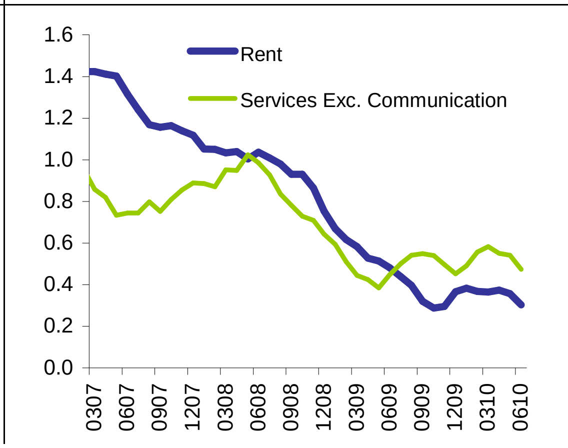


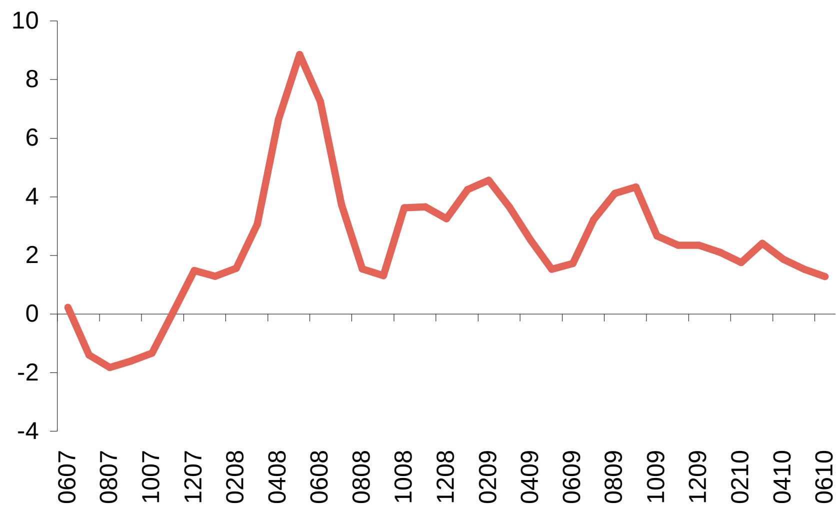
Figure 12: Prices of Services
(Seasonally Adjusted, 3-Month Average Annualized)



Source: TurkStat, CBT.

Prices of core goods excluding food, energy, alcoholic beverages and tobacco and gold, moderated in this quarter owing to euro depreciation as well as easing commodity prices (Figure 13).

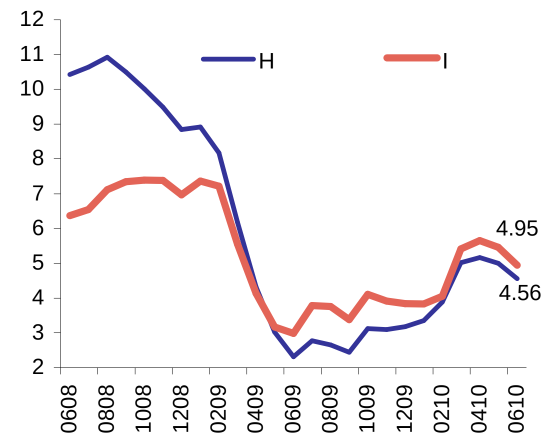
Figure 13: Prices of Core Goods
(Adjusted for Seasonal and Tax Effects, 3-Month Average, Annualized)



Source: TurkStat, CBT.

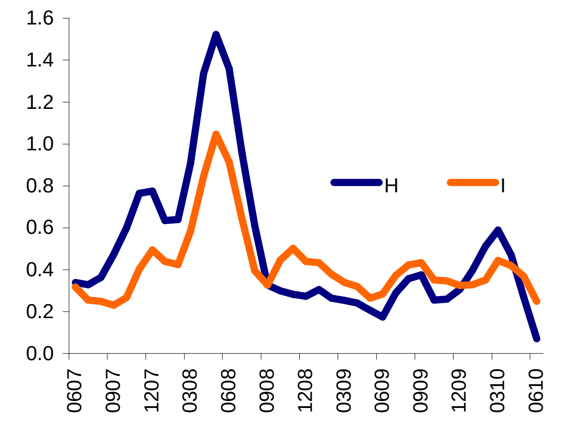
In line with these developments, core inflation indicators also declined in the second quarter (Figure 14). The downward trend in underlying inflation is also apparent in the recent course of seasonally adjusted data (Figure 15). It should be pointed out that the tax incentives in 2009 will put downward pressure on the annual rate of increase in core price indicators during July and October and that we expect core inflation indicators to remain consistent with medium-term targets in the upcoming period.

Figure 14: Core CPI Indices H and I
(Annual Percentage Change)



Source: TurkStat, CBT.

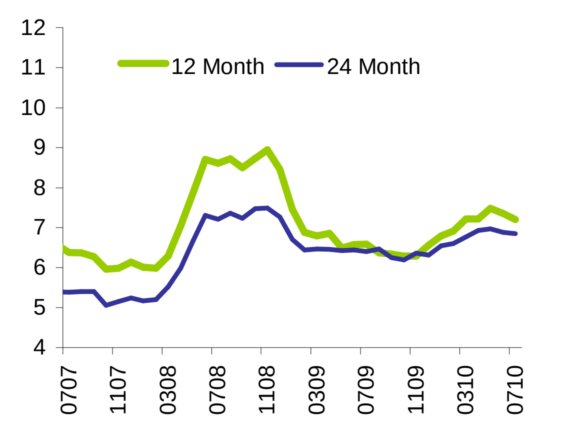
Figure 15: Core CPI Indices H and I Excluding Communication
(Adjusted for Seasonal and Tax Effects, 3-Month Average, Annualized)



Source: TurkStat, CBT.

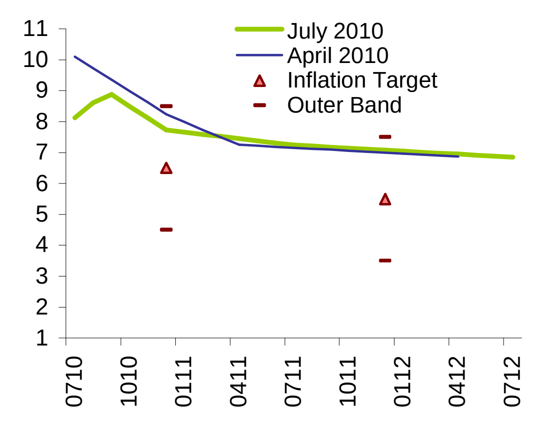
Accordingly, the uptrend in medium-term inflation expectations that started in the final quarter of 2009 slowed during the second quarter of 2010 (Figure 16). In fact, following the better-than-expected price developments during May and June and the return of annual inflation to single digits, near-term inflation expectations were revised down markedly quarter-on-quarter (Figure 17). However, current inflation expectations for 12 and 24- months ahead hover slightly above year-end targets of 5.5 and 5 percent for 2011 and 2012, respectively.

Figure 16: 12 and 24-Month Ahead CPI Expectations*
(Annual Percentage Change)



* CBT Expectations Survey results from the second survey period.
Source: CBT.

Figure 17: Inflation Expectations Curve*
(Annual Percentage Change)



*Calculated using linear interpolation of several maturity yields in the CBT Expectations Survey. Yields are from the second survey period.
Source: CBT.

2. Monetary Policy Response

After commenting briefly on inflation developments, I would now like to cover the policies pursued by the Central Bank during the last quarter.

Anticipating that inflation would decrease sharply following the last quarter of 2008, the Central Bank of Turkey (CBT) focused on alleviating the potentially harsh impact of the global financial crisis on the domestic economy. In this respect, the CBT has delivered sizeable cuts in policy rates, while providing liquidity support to facilitate the smooth operation of credit markets. Accordingly, policy rates have been cut by 1025 basis points since November 2008 (Table 1). Considering the favorable developments in credit markets and the moderate recovery in economic activity, the Monetary Policy Committee (the Committee) ceased policy rate cuts in December 2009. Notwithstanding the rapid increase in inflation during the last quarter of 2009 and the first quarter of 2010, I would like to remind you that the Committee, highlighting the persisting downside risks regarding the global economy and the consistency of core inflation indicators with the medium-term inflation targets, expressed that policy rates would stay at low levels for a long period.

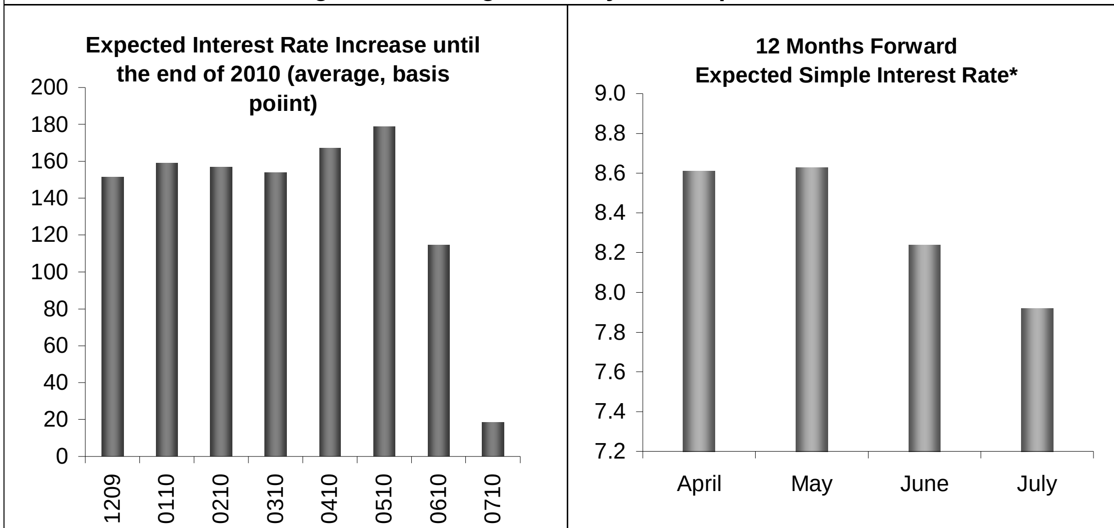
Table 1: Monetary Policy Committee Decisions

Meeting Dates	Interest Rate Decisions (Percentage Points)
19 November 2008	-0.50
18 December 2008	-1.25
15 January 2009	-2.00
19 February 2009	-1.50
19 March 2009	-1.00
16 April 2009	-0.75
14 May 2009	-0.50
16 June 2009	-0.50
16 July 2009	-0.50
18 August 2009	-0.50
17 September 2009	-0.50
15 October 2009	-0.50
19 November 2009	-0.25
December 2009 – July 2010	No change

Source: CBT.

During the second quarter, the fall in inflation and increased downside risks regarding the global economy have vindicated the monetary policy stance of the Committee—that it may be necessary to maintain policy rates at current levels for some time, and to keep them at low levels for a long period. Accordingly, we see that market expectations regarding future policy rates were revised downwards (Figure18).

Figure 18: Change in Policy Rate Expectations

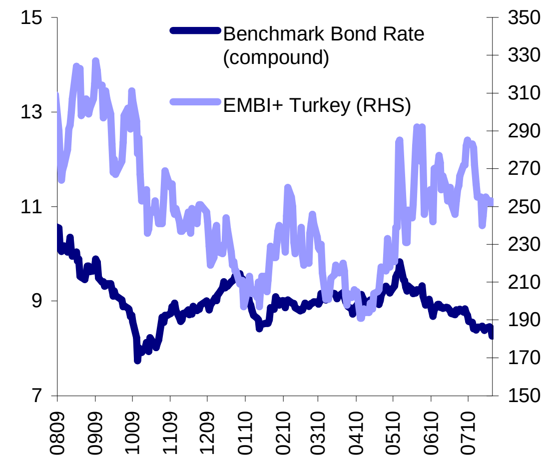


Source: Reuters, CBT.

*CBT Expectations Survey results from the second survey period.

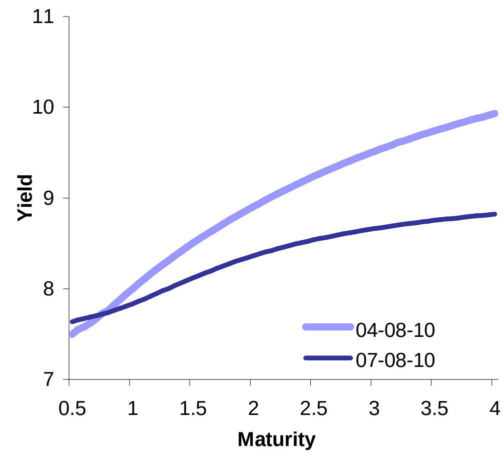
Market rates also reflect growing expectations of delay and moderation in the rate-hike cycle. Accordingly, benchmark bond yields fell during the second quarter and continued to hover around historic lows despite the increased risk aversion (Figure 19). The downturn in market rates was also driven by the improved inflation outlook. The flattening of the yield curve in July compared to April indicates that policy rate-expectations of market players have been revised downwards (Figure 20).

Figure 19: Developments in Interest Rates
(Percent)



Source: ISE, Bloomberg.

Figure 20: Yield Curve*

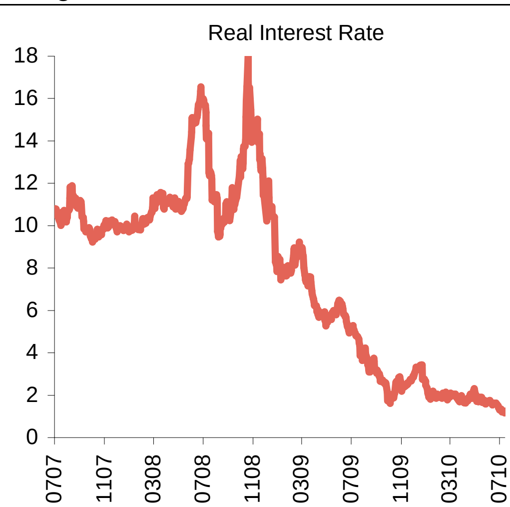


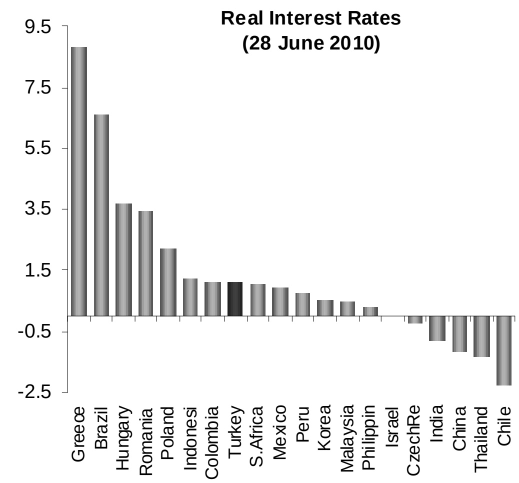
*Calculated from the compound return on bonds from the ISE Bonds and Bills Market using the Extended Nelson-Siegel (ENS) method.

Source: ISE, CBT.

The downslide was more significant in market rates than in inflation expectations during the second quarter, pushing medium-term real rates down to historic lows (Figure 21). Yet I would like to underline that real market rates in Turkey did not decouple substantially from other emerging economies (Figure 21).

Figure 21: Medium-Term Real Interest Rates from the Yield on Government Securities *





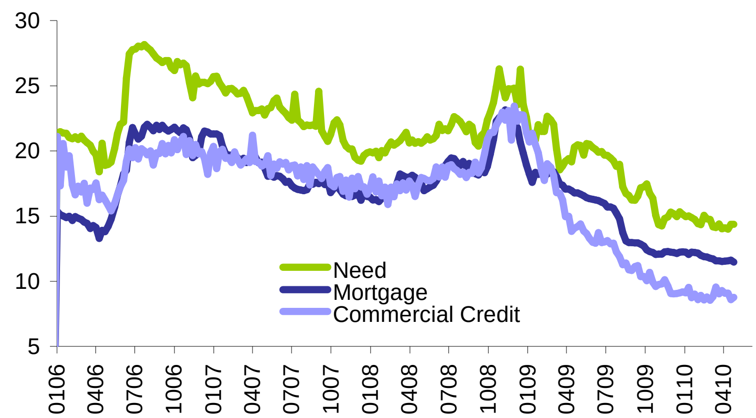
* 2-year real interest rates, calculated using 2-year nominal interest rates from the yield curve and inflation expectations from the CBT's Expectations Survey.

Source: ISE, Bloomberg, CBT.

The ongoing downward trend both in market rates and the tightness in credit conditions contributed to the maintenance of low levels in loan rates. No remarkable change is observed in loan rates in the second quarter despite the continuing improvement in credit markets (Figure 22).

Figure 22: Loan Rates*

(Percent)



* Consumer and commercial loans' rates are calculated on an annual basis.

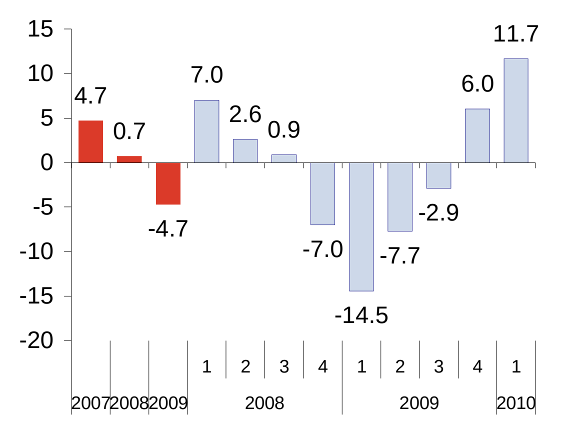
Source: CBT.

3. Inflation and Monetary Policy Outlook

Having summarized the Central Bank's monetary policy stance as well as the effects of this stance on the markets, I would like to share with you the economic outlook underlying our revised forecasts.

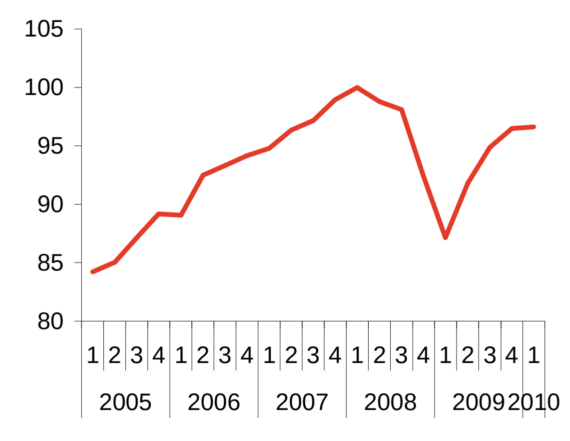
The first-quarter data on the GDP were largely consistent with the outlook presented in the April Inflation Report. Accordingly, the GDP expanded by 11.7 percent year-on-year during the first quarter of 2010 (Figure 23). This increase was driven by the low level in the same quarter of 2009. Meanwhile, in seasonally adjusted terms, the GDP followed a nearly-horizontal course by growing by 0.1 percent quarter-on-quarter (Figure 24).

Figure 23: GDP Annual Growth Rate by Periods
(Percent)



Source: TurkStat.

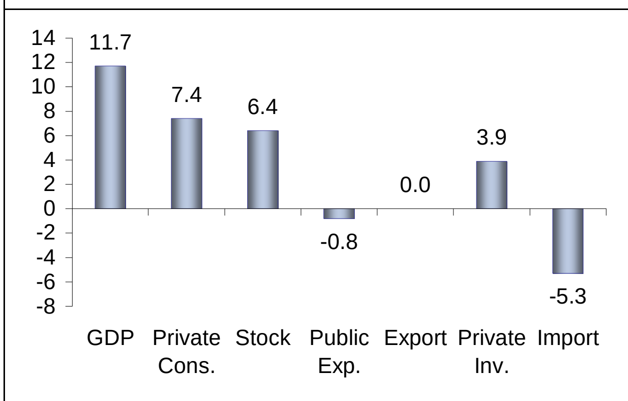
Figure 24: GDP
(Seasonally Adjusted, 2008 Q1=100)



Source: TurkStat, CBT.

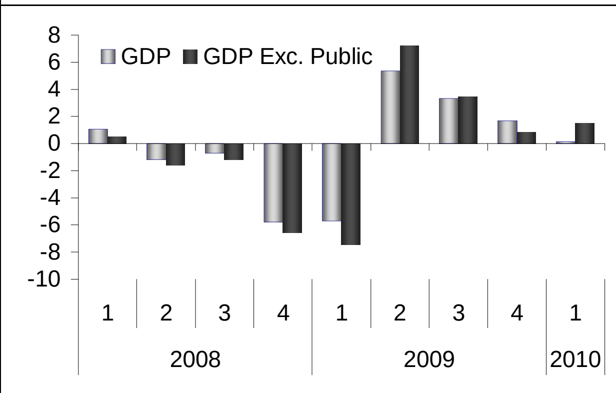
The weak global economy continued to weigh on economic activity and employment in external demand-oriented sectors. The recovery in the private sector gained stability in line with our forecasts. In this respect, the largest contributors to growth in the first quarter became private consumption expenditures and the change in stocks. This was also affected by the low base in the same quarter of 2009 (Figure 25). Meanwhile, public expenditures contributed to growth by –0.8 points (Figure 26).

Figure 25: Contribution to Annual Growth from Spending
(Percentage Points)



Source: TurkStat.

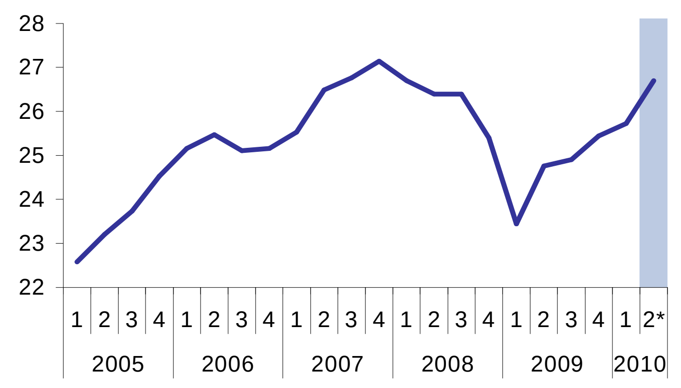
Figure 26: GDP and GDP excluding the Public Sector
(Seasonally Adjusted, Quarterly Percentage Change)



Source: TurkStat, CBT.

Recent domestic demand indicators show that private consumption demand continues to grow and it will run above pre-crisis levels in the second quarter. Meanwhile, despite the rebound in the first quarter, investments remain below pre-crisis levels. These developments indicate that the total final domestic demand continued to grow in the second quarter (Figure 27).

Figure 27: Final Domestic Demand
(Seasonally Adjusted,
deflated by 1998 Constant Prices, Billion TL)

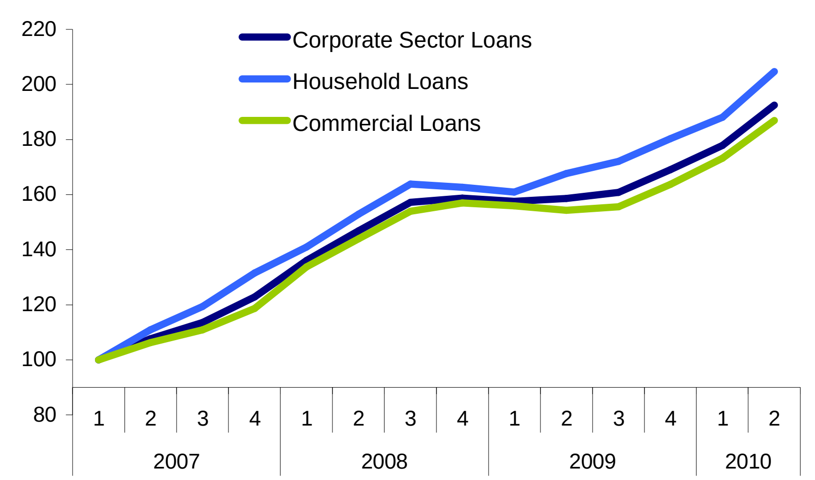


*Forecasts.

Source: TurkStat, CBT.

Parallel to the recovery in domestic demand, credit markets continued to rebound robustly in the second quarter, leading to rapid loan growth in the real sector (Figure 28). The ongoing recovery both in commercial and consumer loans indicates that credit conditions support the rebound in economic activity. Accordingly, as in the previous quarter, our revised forecasts are based on an outlook that envisages the gradual removal of financial tightness.

Figure 28: Corporate Sector Loans *
(2007=100)



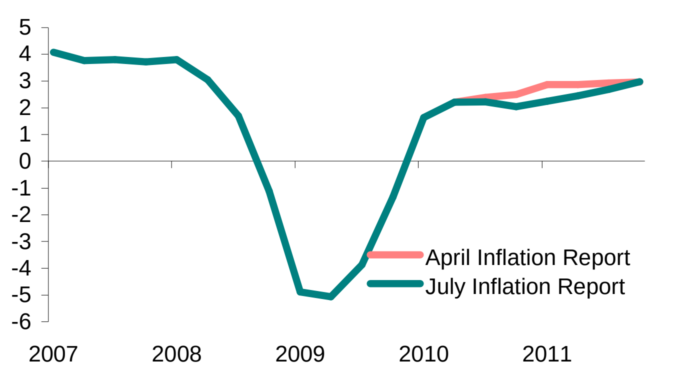
*Corporate sector loans are composed of household loans and commercial loans.

Source: CBT.

Developments in global economic activity have been of major concern for our forecasts through external channels ever since the global financial crisis erupted. In this respect, I would like to express our views on the effects of global developments on aggregate demand and the inflation outlook in the second quarter of the year.

The uncertainty caused by fiscal problems in the euro area in May, and the consequent sharp depreciation of the euro led to a weaker external demand in the second quarter than envisaged in the April Inflation Report. Global growth forecasts remain basically unchanged compared to the April Inflation Report. However, euro area growth forecasts have been revised slightly downwards, reflecting the change in the outlook owing to the problems in Greece, Portugal, and Spain spreading throughout the financial systems of the euro area—our largest export destination. In this respect, the export-weighted global economic activity index constructed by the CBT implies weaker external demand than that envisaged in April (Figure 29).

Figure 29: Export-weighted Global Economic Activity *
(Annual Percentage Change)



* For method, see: Inflation Report 2010-II, Box 2.1 “Foreign Demand Index for Turkey”.

Source: CBT, Bloomberg, Consensus Forecasts April and July 2010 Bulletins.

When assessing the external demand outlook, it is important to consider our trading partner’s headline growth forecasts as well as the composition of growth. In this respect, it is noteworthy that the latest Consensus Forecasts release indicates a noticeable change in the composition of the euro area 2011 growth forecasts. More specifically, along with the depreciation of the euro owing to financial distress and the weaker growth outlook, euro area private consumption and investment forecasts have been revised downwards, thereby emerging as a potential factor to affect our external demand prospects adversely (Table 2). In other words, despite the absence of a major revision in euro area growth forecasts, the change in the composition of GDP growth indicates a weaker external demand outlook for Turkey compared to the previous Report.

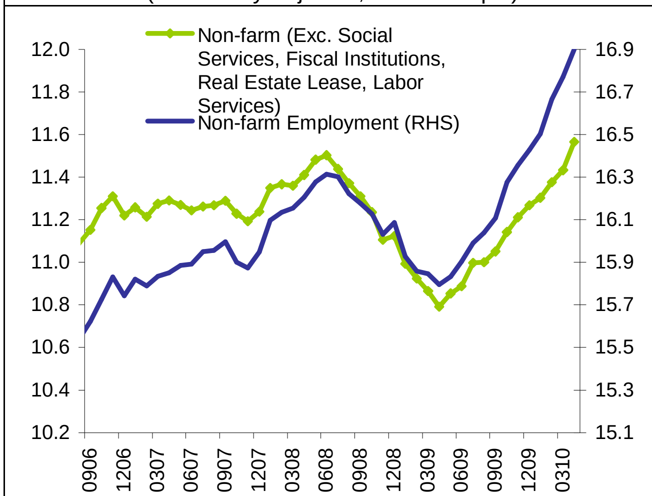
Table 2: 2011 Revised Growth Forecasts for the Euro Area (Percent)

Survey Period	Growth	Private Consumption	Public Consumption	Investment	Exports	Imports
April 2010	1,5	1,0	1,1	2,6	4,9	4,8
July 2010	1,4	0,7	0,5	2,1	5,3	4,4

Source: Consensus Forecasts April 2010 and July 2010 Bulletins (annual average growth).

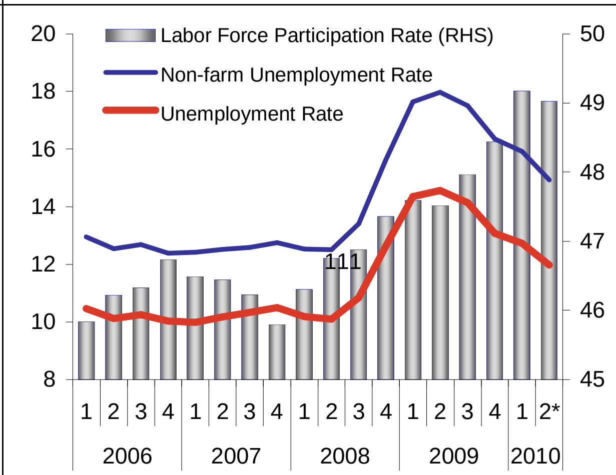
Although weak external demand restrained recovery in industrial employment, the steady recovery in the labor market continued in the last period and non-farm employment posted a significant rise in the last one-year period fuelled by the steady increase in employment in construction and services sectors (Figure 30). The continued rise in labor force participation rates in the first quarter of 2010 curbed further decline in unemployment rates. Unemployment rates fell markedly in April amid increased employment and reduced labor force participation (Figure 31). Leading indicators imply that the recovery in non-farm employment will continue, albeit slower. Unemployment is expected to remain well above pre-crisis levels for a long while, and therefore to exert no significant pressure on unit labor costs in the upcoming period.

Figure 30: Non-Farm Employment
(Seasonally Adjusted, Million People)



Source: TurkStat, CBT.

Figure 31: Unemployment Rates
(Seasonally Adjusted, Percent)



*As of April.

Source: TurkStat, CBT.

Against this background, we now envisage weaker external demand conditions compared to the previous Report, while domestic demand continues to recover as anticipated. Therefore, the revised forecasts envisage that the resource utilization would stay at low levels and the contribution of aggregate demand conditions to disinflation would increase slightly.

Regarding fiscal policy, in line with the MTP projections, we envisioned that the fiscal stance would remain supportive throughout 2010, albeit less strongly than in 2009, and that fiscal consolidation would gradually ensue starting from 2011 as guided by the fiscal rule set out in the MTP. In this respect, we assumed that the fiscal space created by the stronger-than-expected economic activity leading to better-than-expected performance in budget revenues, would be used mostly to reduce the government debt stock and hence, fiscal adjustment in 2011 and onwards would be implemented through institutional and structural improvements. In other words, we assumed that tax adjustments would be consistent with inflation targets and automatic pricing mechanisms throughout the forecast horizon.

Consequently, we envisaged that the rising debt-to-GDP ratios would reverse course gradually starting in 2011, while the risk premium would not display any significant changes throughout the forecast horizon.

There have been some important developments since the April Inflation Report that necessitated a downward revision of the 2010 inflation forecast. I strongly believe that a better understanding of the rationale behind the changes in our forecasts is very important for communicating our policy as well as for the viability of the principles of transparency and accountability; therefore, I would like to explain these factors in detail.

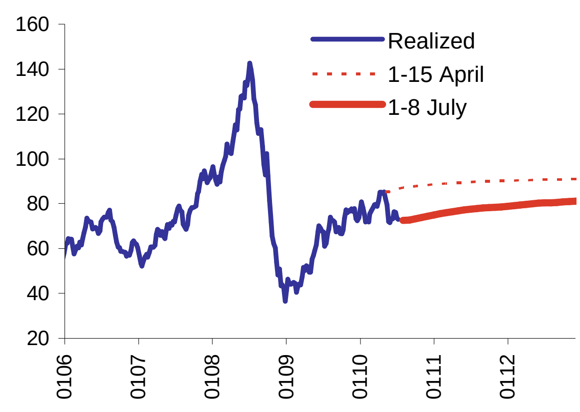
Better-than-expected outcomes regarding unprocessed food prices urged us to revise our assumption for food inflation downwards. Accordingly, while we decreased our food inflation assumption for end-2010 from 9 percent to 7.5 percent, we maintained our assumptions for food inflation for 2011 and 2012 at 7 percent (Table 3). The change in question had a 0.4 percentage point downside impact on end-2010 inflation.

Table 3: Sources of Revisions to Inflation Forecasts								
	April 2010 IR				**July 2010 IR**			
Food Prices	2010: 9% 2011: 7% 2012: 7%				2010: 7.5% 2011: 7% 2012: 7%			
Oil Prices	2010: 85 USD/bbl 2011: 90 USD/bbl 2012: 90 USD/bbl				2010: 80 USD/bbl 2011: 85 USD/bbl 2012: 90 USD/bbl			
Output Gap	2009 Q4: -6.0 2010 Q1: -4.7 2010 Q2: -3.1				2009 Q4: -6.0 2010 Q1: -4.7 2010 Q2: -3.4			
Euro Area Growth Forecasts[1]	2010		2011		2010		2011	
	CF	*WEO*	*CF*	*WEO*	*CF*	*WEO*	*CF*	*WEO*
	1.2	1	1.5	1.5	1.1	1	1.4	1.3

[1] Consensus Forecasts (CF) April 2010 and July 2010 Bulletins (average annual growth, percent); World Economic Outlook (WEO), April 2010 and July 2010 Bulletins (average annual growth, percent).

With the increased downside risks regarding global economic activity, oil prices in the second quarter were below the levels assumed in the April Inflation Report (Figure 32). In this context, while we revised our assumptions for crude oil prices for 2010 and 2011 downwards, oil price assumptions for 2012 were maintained at USD 90 (Table 3). This revision shifted the 2010 inflation forecast down by 0.2 percentage points.

Figure 32: Crude Oil (Brent) Prices
(US dollar/Bbl)



Source: Bloomberg.

Core goods and services inflation, which we believe to reflect the main trend of inflation, declined more than we had anticipated. This decline led to a 0.2 percentage point fall in our year-end inflation forecast.

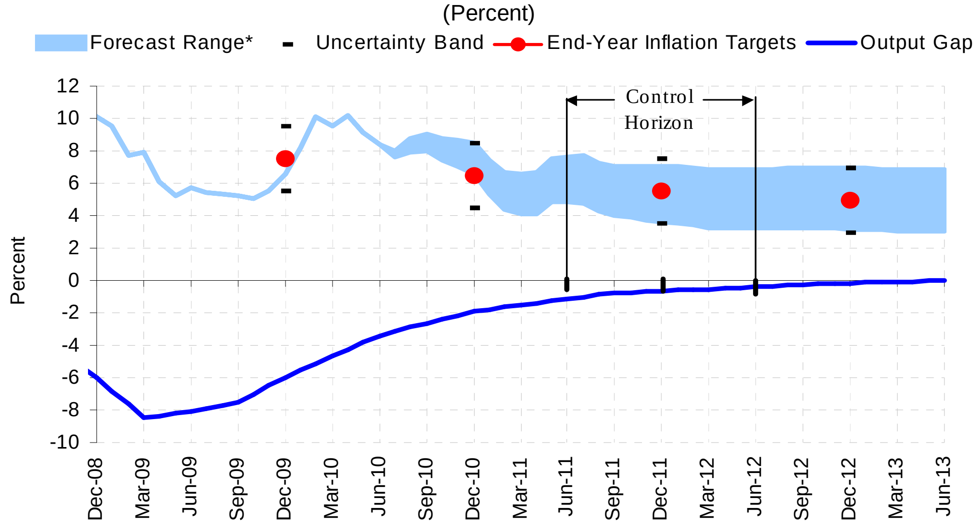
The contribution of aggregate demand conditions to disinflation in the revised forecast is slightly higher than envisaged in the previous Report due to the weaker external demand Outlook. Therefore, we made a downward revision in output gap forecasts that constitutes the basis for our medium-term forecast (Table 3). This change yielded 0.1 percentage point downward revision in the end-2010 inflation forecast.

Overall, the mid-point of the end-2010 inflation forecast has been revised down by 0.9 percentage points, owing to the downward revisions in food and energy prices assumptions and the recent slowdown in core inflation indicators.

Now I would like to share with you our inflation and output gap forecasts produced in line with the framework that I have outlined so far. While producing our forecasts, we assumed that the measures outlined in our exit strategy would be completed to a large extent during the rest of the year, and that policy rates would be kept constant at current levels for some time to be followed by limited increases in 2011, with policy rates staying in single digits throughout the 3-year forecast horizon. Within this framework, medium-term forecasts suggest that, with 70 percent probability, inflation will be between 6.5 and 8.5 percent with a mid-point of 7.5 percent at end-2010, and between 3.6 and 7.0 percent with a mid-point of 5.3 percent by the end of 2011. Furthermore, inflation is expected to decline to 5.0 percent by the end of 2012 (Figure 33).

Figure 33: Inflation and Output Gap Forecasts*

(Percent)



* The shaded region indicates the 70 percent confidence interval for the forecast.

I would like to underline that our revised forecast indicates that the monetary tightening required to keep inflation in line with medium-term targets would start later and would be more limited than implied by the previous forecast.

Although inflation trend is expected to remain consistent with the medium-term targets and follows a stable path, the exact course of headline inflation until mid-2011 would depend on the base effects driven by the volatile unprocessed food prices in the past year and the tax hikes implemented at the beginning of 2010 (Figure 33). Therefore, in order to help economic agents to better interpret developments in headline inflation, which would increase the effectiveness of expectations management, I would like to provide you with some more information about this issue.

Owing to the base effects resulting from the tax hike on tobacco in 2009 and the tax cuts on durable goods in March and April 2009, which began to cease in June 2009, inflation is likely to fall markedly in July 2010. Inflation is expected to rise in August due to the sharp drop a year ago, and decline substantially in the final quarter with the reversal of base effects from food prices.

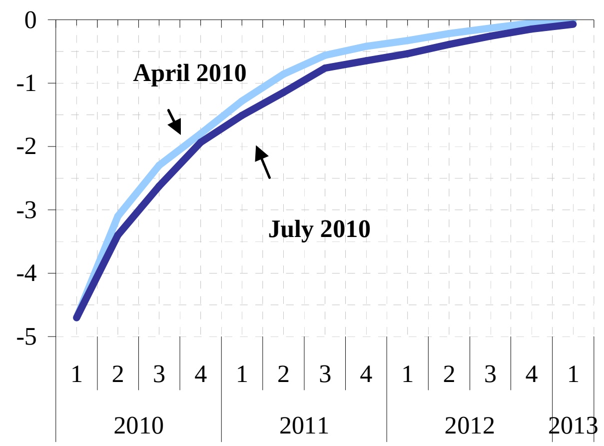
The contribution of tax hikes introduced in early 2010 will have largely disappeared and this will be the primary factor influencing the inflation trend in the first two months of 2011. Although annual inflation may rise during the second quarter of 2011 amid very low base effects from food inflation, inflation is expected to fall gradually in subsequent periods to stabilize at around 5 percent by early 2012.

I think analyzing the forecasts by comparing the latest data with the previous Report period would help to better understand the changes in forecasts. As I have mentioned earlier, we revised our output gap estimates slightly downwards compared to the April Inflation Report, owing to the anticipated impacts of the problems in the euro area on aggregate demand (Figure 34). However, there is no significant revision in the pace of the recovery, as the downward revision in the monetary policy stance is expected to partially compensate for the adverse impact of weaker external demand. In this respect, we based our assumptions on an outlook, in which there would not be a remarkable change in the pace of the recovery in economic activity.

Accordingly, there has been no significant revision in the inflation forecasts for 2011 and onwards (Figure 34).

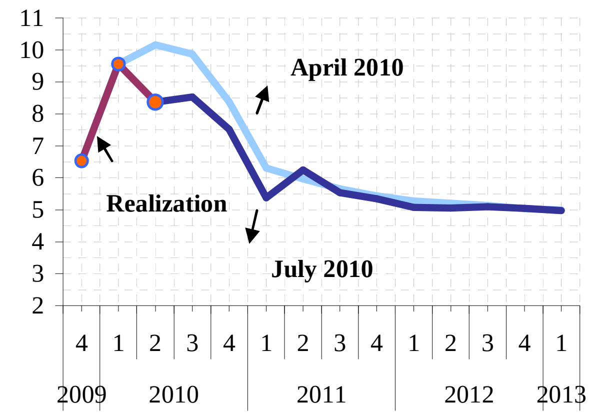
Figure 34: Comparison of April and July 2010 Inflation Report Forecasts

Output Gap Forecasts



Source: CBT.

Inflation Forecasts



Source: TurkStat, CBT.

Any new data or information regarding the inflation outlook may lead to a change in the monetary policy stance. Therefore, I would like to underline once more that the assumptions regarding the future policy rates underlying the inflation forecast should not be perceived as a commitment on behalf of the CBT.

4. Risks

In the last part of my speech, I would like to provide some information on the risks regarding the inflation outlook in the upcoming period and the prospective monetary policy strategies to be implemented should these risks materialize.

By influencing commodity prices and external demand conditions, global economic activity would continue to be the main factor driving inflation dynamics and the monetary policy outlook. In this respect, the timing and the extent of monetary tightening to be implemented during 2011 under the baseline scenario may change depending on the course of economic activity.

Recently, rising concerns regarding debt sustainability in several euro area countries and the spillover effects to the financial system have led to renewed turmoil across financial markets, underscoring the downside risks to global economic recovery. Furthermore, ongoing problems in credit, real estate and labor markets in advanced economies, with little policy options left in case of further disruption in global economic activity, suggest that downside risks regarding the pace of global growth are likely to persist for some time. Should the global economy face a longer-than-anticipated period of anemic growth, which would consequently delay domestic recovery significantly, the monetary tightening envisaged in 2011 under the baseline scenario may be postponed towards the end of 2011. Moreover, an outcome whereby global economic problems intensify and contribute to a contraction of domestic economic activity may trigger a new easing cycle. By contrast, monetary tightening may be implemented in an earlier period during 2011, should the recovery in economic activity materialize faster than expected.

Despite the increased downside risks pertaining to external demand, domestic demand remains strong. Although problems regarding the global economy have the potential to restrain domestic demand through confidence and financing channels, countercyclical monetary policy and the ongoing improvement in employment conditions are likely to support the recovery in domestic demand. On the other hand, given the relative improvement in the creditworthiness of Turkey during the post-crisis period, a possible strengthening in capital inflows in the forthcoming period stands out as another factor that may lead to a faster recovery in domestic demand in contrast to external demand. Should the divergence in growth rates between domestic and external demand continue in the forthcoming period, it would be necessary to utilize other policy instruments such as reserve requirement ratios and liquidity management facilities more effectively. Accordingly, if the composition of strong domestic demand and weak external demand continue as envisaged, and if this pattern of growth co-exists with rapid credit expansion and a deterioration in the current account balance, consequently leading to financial stability concerns, then the CBT may bring forward measures outlined in the exit strategy expected to be implemented until the end of 2010.

Distinguished guests,

The Central Bank of Turkey will continue to monitor fiscal policy developments closely while formulating monetary policy. Since the second half of 2009, economic activity has been stronger than envisaged in the MTP, leading to better-than expected performance in budget revenues. Using this fiscal space mostly to reduce government debt would facilitate demand management and reduce any need for indirect tax hikes, therefore providing more flexibility regarding the conduct of countercyclical monetary policy. In this respect, should fiscal discipline be implemented through institutional and structural improvements, such as enacting and establishing the fiscal rule, it would be possible to keep policy rates at single-digit levels over the medium term.

Since the last quarter of 2008, the CBT has focused on containing the adverse effects of the global crisis on the domestic economy without conflicting with its primary objective of maintaining price stability and this has to a large extent been achieved. 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. Before concluding my speech, I would like to reiterate that timely implementation of the structural reforms envisaged by the Medium Term Program and the EU accession process remains to be of utmost importance. Thank you very much for your attention.