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SUMMARY OF THE MONETARY POLICY COMMITTEE MEETING

Meeting Date: February 21, 2012

Inflation Developments

1. In January, consumer prices were up 0.56 percent and annual inflation reached 10.61 percent. While the lagged effects of the exchange rate pass-through continued through the prices of core goods, services prices followed a moderate course in this period.

2. Annual inflation in food and alcoholic beverages group went down to 11.67 percent. Seasonally adjusted unprocessed food prices slowed down in January following a notable increase in the last quarter of 2011. Although processed food prices went up by 1.06 percent in the same period, annual inflation in this group recorded a decline after a long period. Leading indicators suggest that food inflation will continue to decrease in February.

3. Among subcategories, energy prices stood out recording the highest increase in January. Owing to the increases in all subcategories, primarily in water tariffs and fuel prices, energy prices went up by 2.19 percent in this period. International oil prices posted an upward trend in the first two months of the year, posing upside risks on consumer prices.

4. Annual services inflation increased modestly up to 6.33 percent. Although annual inflation edged up in transport services, the favorable outlook continued in other services prices. Despite the high course of consumer inflation, rent increases remained at low levels. Meanwhile, seasonally adjusted prices of services and diffusion index suggest that the underlying trend of service inflation has sustained its benign outlook.

5. Annual inflation in core goods climbed to 10.70 percent in January. Lagged effects of the depreciation in the Turkish lira on core goods continued especially through durable goods in this period. Nevertheless, the prices of core goods are expected to follow a milder path amid the recent moderation in cost pressures. Accordingly, the Monetary Policy Committee (the Committee) expects core inflation indicators to follow a downward trend starting from February.

Factors Affecting Inflation

6. Data releases on the final quarter of 2011 suggest that economic activity has remained robust. Seasonally adjusted industrial production posted a sizeable increase in December, and remained well above the average of the previous period on a quarterly basis. Although construction sector displayed a slowdown, employment in the services sector maintained a stable upward trend.

7. Following the robust course in the last quarter of 2011, economic activity lost momentum owing to domestic demand. Domestic sales of automobiles and commercial vehicles posted a decline in January. In the meanwhile, expectations on domestic new orders in the manufacturing industry moderated. Consumer confidence remained weak in February; and seasonally adjusted consumer loans recorded a mild growth.

8. Final domestic demand is decelerating while the contribution of net exports to growth is increasing. The recovery in global PMI indices in January suggests that there is no further deterioration in global outlook compared to the last quarter of 2011, and supports the gradual improvement in exports. Despite the recent policy actions towards a more expansionary monetary stance at a global scale slightly alleviate the downside risks on global growth, the outlook for 2012 still signals for a slowdown in almost all economies. Highlighting that global uncertainties still remain significant, the Committee has noted that global problems will continue to restrain foreign demand, notwithstanding the improved market diversification and enhanced competitiveness provided by exchange rate movements.

9. The Committee also stated that restrictive effects of the ongoing slowdown in domestic demand and the cumulative depreciation in the Turkish lira on imports have become more evident. Accordingly, the rebalancing process and the improvement in the current account deficit will continue in the forthcoming period.

10. Labor market data confirm that there is no significant and widespread deceleration in overall economic activity. As opposed to the decline in employment in the industrial and construction sectors in the last quarter of 2011, non-farm employment remained robust thanks to the strong course of the services sector. Although leading indicators for the first quarter of 2012 do not indicate any deterioration in employment conditions, the Committee has noted that the impact of global uncertainties on the domestic economy may continue to restrain employment growth in the period ahead.

Risks and Monetary Policy

11. Recent data releases confirm that the rebalancing between the domestic and external demand continues as envisaged. The measures undertaken in 2011

have not only led the credit growth rate to decline to more reasonable levels but also removed the excessive appreciation pressure on the exchange rate; and both of these factors contribute the economy to attain a more stable growth composition.

12. The Committee has indicated that although there is a noticeable slowdown in the economic activity due to weaker domestic demand in early 2012, this slowdown largely reflects temporary and seasonal factors. The Committee members stated that domestic demand may recover in the forthcoming period with the improved risk appetite and increasing capital inflows. In fact, both the production of investment goods and new investment plans of manufacturing firms remain robust, suggesting that there is no significant deterioration in demand expectations.

13. Starting from February, core inflation indicators are expected to follow a downward path due to favorable cost factors. The pass-through impact of the exchange rate developments in 2011 to annual core goods inflation is expected to ease in February. In the meanwhile, services prices are expected to follow a benign path in parallel to the moderation in domestic demand.

14. Developments since the Committee meeting in January have eased the adverse impact of the Euro area-related problems on global markets, leading to a significant increase in risk appetite. This, in turn, has lowered the likelihood of a sudden capital outflow in the short-term due to a possible sharp swing in global risk perceptions. Therefore, also considering the recent expansionary monetary policy decisions at a global scale, the Committee has decided to cut the upper limit of the interest rate corridor. However, given the prevailing uncertainties regarding the global economy, it would be appropriate to preserve the flexibility of the monetary policy. Therefore, the impact of the measures undertaken on credit, domestic demand, and inflation expectations will be monitored closely and the amount of Turkish lira funding via one-week repo auctions will be adjusted in either direction, as needed.

15. Although the Committee members expect inflation to follow a downward trend in the forthcoming period, they have also noted that inflation will hover above the target for some time. Inflation expectations are under control and there is no significant deterioration in the pricing behavior. Both of these factors are seen as favorable developments for medium term inflation outlook. However, recent supply-side increases in energy prices pose risks to inflation. In light of these assessments, the Committee has indicated that the cautious monetary policy stance should be maintained for a while in order to keep inflation outlook consistent with the medium term targets.

16. Monetary policy will continue to focus on price stability while preserving financial stability as a supplementary objective. To this end, the impact of the

macroprudential measures taken by the Central Bank and other institutions on the inflation outlook will be assessed carefully. Strengthening the structural reform agenda to ensure the sustainability of the fiscal discipline and reduce the saving deficit will support the relative improvement of Turkey's sovereign risk, and thus facilitate price stability and financial stability in the medium term. This will also provide more flexibility for monetary policy and contribute to social welfare by keeping interest rates of long-term government securities at low levels. In this respect, steps towards the implementation of the structural reforms envisaged by the Medium Term Program remain to be of utmost importance.