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SUMMARY OF THE MONETARY POLICY COMMITTEE MEETING

Meeting Date: February 19, 2009

Inflation Developments

1. Consumer prices increased by 0.29 percent in January, and inflation dropped to 9.50 percent year-on-year. Exchange rate pass-through remained low owing to the marked slowdown in economic activity, while easing oil and other commodity prices continued to help bring inflation down.

2. Unprocessed food prices continued to rise whereas processed food inflation remained on the decline. Unprocessed food price inflation is expected to ease in the short run due to favorable weather conditions and weak foreign demand. On the processed food prices front, annual inflation is expected to remain on a downward path in the first half of 2009. Accordingly, food prices will continue to contribute to disinflation in the coming months.

3. Annual energy price inflation dropped by a cumulative 16 points to 15.02 percent in the last three months on falling oil and other commodity prices. Energy price inflation will continue to fall with the reduction in natural gas rates in February, which will have around 0.3 percentage points downward contribution to inflation.

4. Annual inflation in goods excluding energy and food increased by 1 point to 4.74 percent in January. After displaying a sharp drop in December due to early seasonal discounts, clothing prices decreased at a less marked pace in January than in previous year, pushing the group's annual inflation up in January. Meanwhile, the ongoing weakening in economic activity continued to mitigate the exchange rate pass-through on prices of durable goods. Accordingly durable goods inflation increased only slightly to an annual rate of 3.46 percent in January.

5. Inflation in services declined to 9.89 percent in January. The significant slowdown in annual services inflation suggests a downward course in the underlying inflation trend. Plunging world oil prices have brought transport inflation down, while weaker domestic demand and lower food prices have had a favorable impact on catering prices. Rent inflation eased further in January. Given the continued softening in domestic demand, annual inflation in services is expected to moderate further.

6. Overall, the Monetary Policy Committee (the Committee) expects inflation to decelerate at a faster pace in the coming months, thanks to the fall in underlying inflation and the favorable base effect.

Factors Affecting Inflation

7. Recent readings suggest that economic activity continues to weaken. Industrial production, which has been on the fall in seasonally adjusted terms since July, displayed a sharp contraction in the final quarter. Readings on capacity utilization and other key indicators point to a further decline in industrial production in January.

8. Readings on the labor market confirm the sharp weakening of economic activity. In the fourth quarter of 2008, non-farm employment fell quarterly on a seasonally adjusted basis, and non-farm unemployment surged rapidly. The fall in non-farm employment can be attributed not only to the slowdown in overall economic activity but also to the sectoral shock driven by the sharp decline in exports. The number of people receiving unemployment benefits increased markedly in January, suggesting that the rise in unemployment accelerated in early 2009. In light of these assessments, the Committee noted that non-farm unemployment might display a historic high in the first quarter.

9. Recent readings indicate that although consumer sentiment has shown signs of recovery, it has remained low by historical standards. Automobiles sales displayed a contraction in annual terms since June, whereas they increased in December and January in seasonally adjusted terms. Consumption indices followed a similar pattern, showing a slight recovery in January. The deterioration in consumer confidence stopped in December-January period, while housing and personal loans have displayed signs of recovery recently. However, the Committee noted that it would be too early to make a conclusive statement whether these indicators point to a long lasting recovery.

10. Indicators for investment demand continued to display a weak course. Production and imports of capital goods dropped dramatically in the final quarter of 2008, both in annual and quarterly terms. The Committee indicated that the recovery in investment spending would take time, given the historically low capacity utilization rates.

11. Industrial production indexes in advanced economies registered a sizable drop in December and foreign demand remained weak on slower global growth. Accordingly, the export quantity index continued to fall in December, posting a steep quarterly drop in the fourth quarter of 2008. Nominal export figures on January and February suggests that the weakening of foreign demand continued into the first quarter.

Monetary Policy and Risks

12. Problems in international credit markets and the global economy persist, while new information lead to further downward revisions in the forecasts for global economic outlook. Uncertainties regarding the impact of the problems in financial markets on the real economy remain high. In this context, domestic and foreign demand are expected to stay weak in the near term, and thus it will take some time for the economic activity to recover. Therefore, downward pressures on inflation are expected to prevail.

13. The Committee indicated that the recovery in credit would be slow, reflecting tight financial conditions both in domestic and external terms. Besides, disposal income growth is expected to remain subdued, given the moderating employment growth and weakening labor market conditions. Therefore, the recovery in domestic demand is expected to be gradual and slow, which is also supported by the recent readings on domestic economic activity.

14. The fall in oil and other commodity prices are having a favorable impact on inflation, and thus contributing to the decline in inflation expectations. Recently, survey based medium term inflation expectations have been lower than the inflation targets. The Committee expects a rapid deceleration in inflation in the short term with more significant contribution of easing energy and food inflation. This should also bring down inflation expectations further.

15. Looking ahead, it is anticipated that developments in both the aggregate demand conditions and the real marginal costs will drive down inflation significantly in the forthcoming period, bringing inflation to the target levels sooner than envisaged. Judging that inflation is likely to undershoot the target significantly at the end of the year, the Committee decided to lower short-term interest rates by 150 basis points. In line with the baseline scenario at the January Inflation Report, the Committee stated that the amount of the next rate cut would likely be less than the current one and reiterated that the extent and the timing of a possible future rate cut would depend on the factors affecting the inflation outlook.

16. Business loan rates have responded less to the policy rate cuts compared to the consumer loan rates. Accordingly, the spread between business loan rates and the policy rates have remained at significantly high levels. In this respect, the Committee indicated that the tightness in financial conditions still persist to some degree, notwithstanding the recent policy rate cuts. Credit supply remains tight and a significant part of the credit demand by firms can be attributed to debt restructuring. Therefore, the role of the credit channel in facilitating economic activity remains limited. Developments in credit markets are closely monitored as a coincident indicator for economic activity and also in terms of their importance for the transmission of monetary policy.

17. It is worth to mention that a critical assumption underlying the inflation and monetary policy outlook outlined above is that government fiscal stance will remain neutral in cyclically adjusted terms. In other words, the baseline scenario envisages that government expenditures will evolve in line with the official projections, while tax revenues will moderate as implied by the cyclical downturn. Any significant deviation from this framework may lead to a revision in the outlook for inflation and monetary policy.

18. 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. In this context, the Committee underscored the importance of maintaining the smooth functioning of the financial system and the efficient operation of credit markets, and reached a consensus on implementing additional measures regarding the foreign exchange liquidity.

19. Prudent monetary policy is necessary but not sufficient to maintain the resilience of the economy against the global crisis, especially under current conditions. The Committee noted that the rise in the public sector borrowing requirement throughout the year 2009 could undermine the effectiveness of monetary policy by weakening the impact of policy decisions over the longer end of the yield curve. Strengthening the commitment to fiscal discipline and structural reform agenda is critical for facilitating expectations management and also for enhancing the simulative impact of the monetary accommodation. In this respect, commitment to the European Union accession process, and timely implementation and revision of the structural reforms envisaged in the Medium Term Program remain to be of utmost importance.