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SUMMARY OF THE MONETARY POLICY COMMITTEE MEETING

Meeting Date: June 17, 2010

Inflation Developments

1. Consumer prices decreased by 0.36 percent in May and annual inflation declined by 1.09 percentage points to 9.1 percent. The fall in annual inflation was largely due to plunging unprocessed food prices, as noted in the May summary of the Monetary Policy Committee (the Committee) Meeting. Prices in other categories portrayed a favorable outlook as well, while core inflation indicators continued to be consistent with medium-term targets.

2. Changes in unprocessed food prices had a major impact on food prices in May. Prices of fresh vegetables dropped by 34.6 percent with the favorable supply conditions. In addition, the announcement of less restrictive import regulations for red meat brought meat prices down, contributing to the downward pressure on food prices. Accordingly, the direct impact of meat prices on annual CPI inflation was down from 1.9 in April to 1.6 percentage points in May. Early observations suggest that the decline in annual food inflation has continued into June.

3. Despite the recent fall in meat prices, the cumulative increase over the past one year continued to have an adverse impact on catering prices. On the other hand, annual rent inflation continued to trend steadily down, while falling mobile call rates helped lower the annual rate of increase in prices of services. Overall, the average rate of increase in prices of services slowed further in seasonally adjusted terms.

4. Despite rising solid fuel prices, energy prices remained flat for the second consecutive month amid falling international oil prices. However, annual energy inflation continued to rise on the back of the low base effect from 2009. The Committee has noted that this base effect-driven increase would end in June, and expects the annual rate of increase in energy prices to decelerate by the second half of 2010 unless there is a sizable increase in oil prices.

5. The year-on-year increase in core goods (goods excluding food, energy, alcoholic beverages, tobacco and gold) slowed to 4.84 percent. Both the easing of commodity prices and the weakening of the euro contributed to the downtrend of annual core goods inflation, leading to some moderation in core

inflation indicators. It should be noted that the base effects from last year's tax incentives that drove annual core goods inflation higher during March and April would reverse in June, July and October and help improve core inflation indicators.

Factors Affecting Inflation

6. Recent data suggest that the recovery in economic activity is ongoing. Industrial production grew by 0.8 percent month-on-month during April in seasonally adjusted terms, up by 2 percent from the first quarter average. Indicators for May show that the economy continues to recover, albeit more slowly. Yet, the Committee emphasized that production is still below pre-crisis levels.

7. Domestic demand growth is relatively stable. The Committee members noted that production growth is stronger in sectors more sensitive to domestic demand. Production and imports data indicate that private consumption demand continued to recover moderately during the second quarter. Consumer confidence indices and new order data also confirm this outlook. The slow yet steady improvement in the labor market and the favorable credit market developments are supporting the recovery in private consumption demand.

8. Investment demand continues to recover, although investments remain below pre-crisis levels. The production of capital goods excluding vehicles continues to grow, while imports of capital goods remain on the rise. The Committee expects that growing domestic demand and lower commercial loan rates would continue to support the investment recovery. Yet, the Committee noted that new order and confidence indices fell, albeit modestly, during May and June amid mounting problems in the euro area, and indicated that downside risks to the pace of domestic demand growth should not be underestimated.

9. Uncertainty regarding foreign demand has been increasing. The export quantity index excluding gold continued to recover gradually during April in seasonally adjusted terms, whereas recent survey indicators signal slowing export orders. Medium-term growth outlook of the Euro area has recently been revised down amid severe cutbacks in government spending aiming at restoring budget balances in several European countries. Therefore, foreign demand is likely to recover gradually, and it would take a while before industrial capacity utilization rates return to pre-crisis levels.

10. Although employment conditions continue to improve, unemployment rates remain at elevated levels. Seasonally adjusted data indicate that non-farm employment continued to recover in March. Weak foreign demand continued

to restrain industrial employment, while non-farm employment rose further owing to the recovery in construction and services sectors. Nevertheless, the Committee reiterated that the high level of unemployment rates would continue to contain unit labor costs.

Monetary Policy and Risks

11. The Committee noted that the fall in unprocessed food prices and easing commodity prices have led to a more favorable inflation outlook than envisaged in the April Inflation Report, which is also having a positive impact on inflation expectations. Annual unprocessed food inflation is expected to further decline in June. Committee members have stated that the fall in fruit and vegetable prices partly reflect temporary favorable supply conditions due to early harvest of summer products, while the decline in meat prices can be attributed to more durable factors. Besides favorable developments in food prices, oil prices have been lower than envisaged in the April Inflation Report, leading to a downward revision in the short-term inflation forecasts.

12. The Committee members indicated that the favorable outlook in inflation is not only confined to food and energy prices, as core goods and services inflation have been also moderating recently. It was stated that, given the developments in cost and demand factors, core inflation would remain at levels below the year-end target and consistent with the medium-term targets.

13. The Committee indicated that countercyclical monetary and fiscal policies have been continuing to support the recovery in economic activity. Recent data releases suggest that the production in sectors that are sensitive to domestic demand continues to increase. Credit developments indicate a similar outlook. The compression of spreads between business lending rates and demand deposit rates and the ongoing recovery in loans to small- and medium-sized enterprises since the beginning of the year, suggest that the credit conditions have been improving steadily.

14. The Committee indicated that, notwithstanding the relatively stable domestic demand, uncertainties regarding the pace of economic recovery have become more significant. Heightened debt sustainability concerns in Greece and many other European countries have been increasing the downside risks regarding the recovery in Europe—our major trade partner. The significant depreciation of the Euro could adversely affect the competitiveness of exports. Moreover, these developments have the potential to affect domestic demand adversely through the expectations channel. In fact, leading indicators suggest that business and consumer confidence have slightly moderated in June. According to the Committee members, it would be early at this stage to

change the stance of the monetary policy; however, the impacts of the problems regarding global economy on the domestic economic activity should be monitored closely in the forthcoming period.

15. In light of these developments, the Committee reiterated 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.

16. The Committee will continue to monitor fiscal policy developments closely while formulating monetary policy. Should the fiscal rule—which is to be adopted at the beginning of 2011—be implemented decisively as envisaged, it would contribute to the decline in risk premiums, and by decreasing government borrowing costs enhance the effectiveness of monetary policy. Since the second half of 2009, economic activity has been stronger than envisaged in the Medium Term Program (MTP), leading to a better than expected performance in budget revenues. Using this fiscal space resulting from the cyclical factors mostly to reduce the government debt, as implied by the fiscal rule, would facilitate demand management and ease the need for indirect tax hikes, therefore providing more room to conduct countercyclical monetary policy.

17. Monetary policy will continue to focus on price stability in the period ahead. Strengthening the commitment to fiscal discipline and the structural reform agenda in the medium term would support the relative 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.