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SUMMARY OF THE MONETARY POLICY COMMITTEE MEETING

Meeting Date: 14 June 2007

Inflation Developments

1. Consumer prices rose by 0.50% in May. Annual inflation fell to 9.23% by 1.5 percentage points, mainly owing to the lagged effects of monetary tightening, the partial correction in unprocessed food prices and the base effect.

2. Annual inflation of unprocessed food prices declined to 11.09%. This downfall was, as noted by the Monetary Policy Committee (MPC) last month, due to warmer weather conditions resulting in the early marketing of certain summer crops. This development mainly drove down the vegetable prices, whereas fruit prices continued to rise dramatically. The considerable decline in vegetable prices in May had a favorable impact on May inflation but brought along the possibility that price declines may remain more limited during the summer months. Rising support prices for grains, possible drops in crop yields of certain products caused by unusually warm weather conditions and low rainfall, and the new Wholesale Market Regulation on fresh fruit-vegetable trade are among other factors posing uncertainties over food prices. On the other hand, recent Value Added Tax cuts in a number of food items may have a slightly favorable effect on food prices in June.

3. The recent downfall in services inflation became quite discernible in May. Annual services inflation fell by 0.91 percentage points to 10.85% down from April. Cumulative rise in services prices for the first five months is 3.39%–the lowest figure since the 2003 based CPI index was introduced. Especially inflation in transportation services and restaurants-hotels indicate a notable improvement compared to the previous years. Prices of most items under services tend to decelerate owing to the monetary tightening, yet rents maintain an elevated course.

4. Energy prices are much affected by soaring global oil prices. Fuel prices rose by 8.45% within the last three months. Utility prices, on the other hand, display a benign outlook with quite moderate rises. The Committee, however, carefully evaluates the possible impact of oil prices on utilities.

5. The Committee predicts that inflation will further slow down in the coming months. The fading out of the exchange rate pass-through effect driven by last year's volatility, and the lagged effects of monetary tightening especially on prices

of services and durable goods are expected to add to the decline in annual inflation. Special CPI aggregates also suggest a similar outlook.

Factors Affecting Inflation

6. The Committee assesses that recent data on economic activity is broadly consistent with the outlook presented in the April Inflation Report.

7. The slowdown in private demand becomes more pronounced. Available data suggest that domestic demand continued to moderate in the second quarter. Housing and personal expenditure loans expanded at a modest pace in annual terms, whereas the demand for automobile loans continued to decline. Seasonally adjusted white good sales and imports of consumer goods fell in April and the automobile sales plunged in April and May—indicating an ongoing retrenchment in consumer demand.

8. Private investment demand for machinery and equipment continues to slow down. While the seasonally adjusted data for the electrical machinery and electronics production and capital goods imports in April are higher than the March figures, the reduced machinery-equipment production and the continued decline in commercial vehicle sales indicate that investment growth remains at a subdued level. Production and import data on non-metallic minerals, on the other hand, signal a modest growth in construction.

9. External demand remains strong. Exports continued to grow more than imports in real terms in April. The leading indicators reveal a similar pattern for May and June. These developments suggest that net external demand has continued to support growth during the first half of 2007.

10. Weakening course in domestic demand led to a slowdown in industrial production, despite robust external demand. April industrial production figure was lower than that of March in seasonally adjusted terms. Also considering the strong second-quarter figures of the last year, annual growth in industrial production is expected to decelerate significantly in the second quarter of 2007.

11. Moreover, the moderating growth in services employment in the last three quarters is in line with the slowdown in economic activity.

12. The marked decline in annual inflation in May had a favorable impact on inflation expectations. Accordingly, short and medium term expectations displayed a slight improvement. However, ongoing perceptions of uncertainty limit the downward trend in inflation expectations. The improvement in medium-term expectations should continue as the headline inflation keeps decelerating towards the 4 per cent target in the upcoming period.

13. In sum, economic developments over the last 12 months are highly consistent with the Committee's predictions. Demand for consumption and investment continue to ease, while strong external demand moderates the slowdown in overall economic activity. Aggregate demand conditions increasingly support disinflation. Against this background, inflation is expected to maintain its downward course.

Monetary Policy and Risks

14. Parallel to the favorable outlook in medium-term inflation expectations, interest rates on government securities continue to decline. The fall in interest rates and the ongoing capital inflows expand the supply of loanable funds and add to the downward pressure on bank lending rates, as recently observed in housing loan rates. However, considering the cautious stance of monetary policy, the downward trend in lending rates is expected to be limited in the short term. Current levels of the bank lending rates are still high enough to curb expenditures. Moreover, the rise in risk perceptions and the resulting precautionary savings further limit the demand for credit.

15. Monetary indicators also confirm the tight stance of monetary policy and the slowdown in economic activity. Real volume of currency in circulation that displayed a slowdown since mid-2006 declined in annual terms in 2007. Nevertheless, changes in portfolio preferences and innovations in the financial system should also be taken into account while evaluating the monetary indicators.

16. The lagged effects of monetary tightening exercised since June 2006 are quite noticeable. Against this background, inflation is expected to maintain its downward trend. However, there are some remaining risks to the inflation outlook.

17. Inertia in inflation expectations and the backward looking pricing behavior poses a significant risk for the inflation outlook. The elevated course of medium-term inflation expectations continue to stand as a risk factor, particularly through its potential impact on the wage and price setting behavior. The Committee perceives the recent decline in services inflation as a favorable development, but also notes the risk that services inflation may remain high for a prolonged period. In order to eliminate the gap between medium-term expectations and targets, the prudent monetary policy needs to be reinforced by sustained fiscal discipline.

18. Although the monetary tightening exercised since June 2006 is affecting domestic demand as expected, uncertainties over the lagged effects of monetary policy on inflation still remain. Moreover, rising non-interest government expenditures has the potential to limit the effectiveness of monetary tightening. Non-interest budget expenditures of the central government during the first five months of 2007 surpassed the already generous budgetary projections—a

development that requires close monitoring. In this respect, the Committee carefully evaluates the potential impacts of the developments in incomes policy and public sector non-interest expenditures on inflation and inflation expectations.

19. Recent developments suggest that international liquidity conditions and global risk appetite remain to be risks against the inflation outlook. Currently, the uncertainty related to main economic indicators in developed economies is perceived as a risk factor. As a matter of fact, recently, stronger-than-expected data on the US economic activity has deferred rate cut expectations, which in turn led to fluctuations in the global financial markets. Moreover, ongoing uncertainties over the global imbalances stand out as another risk factor that might lead to abrupt changes in global risk appetite and liquidity conditions.

20. The elevated crude oil prices continue to exert inflationary pressures and slow down the pace of disinflation. The Committee judges that the risks against energy prices continue to be of concern, and closely monitors the movements in crude oil prices with regard to the inflation outlook.

21. To sum up, the Committee decided to keep the policy rates unchanged against the risks such as the gap between inflation expectations and targets, the backward looking pricing behavior, the remaining uncertainties—notwithstanding recent favorable developments—over services price inflation, rising oil prices, and prevailing uncertainties. The Committee assesses that meeting the medium term inflation targets requires the maintenance of the tight policy stance.

22. Prudent monetary policy is necessary but not sufficient for achieving price stability. The role of fiscal policy and structural reforms are also critical in this process. Developments in structural reforms that would enhance the quality of fiscal discipline are closely monitored in terms of both macroeconomic and price stability. The European Union accession process and the implementation of the structural reforms envisaged in the economic program also remain to be of concern. Continued determination in implementing the decisive steps taken in these areas in recent years will strengthen the resilience of the economy against sudden changes in global sentiment.